QUEENSLAND MAJOR CONTRACTORS ASSOCIATION

BIS Shrapnel
BUSINESS RESEARCH AND FORECASTING

A joint initiative of the Queensland Major Contractors Association and Construction Skills Queensland

2013 Major Projects Report Update



1. Overview – key messages

Welcome to the *2013 Major Projects Report Update (Update).* The aim of this Update is to provide a mid-term snapshot on the outlook for major engineering construction projects (>$100 million in value) and activity in Queensland.

Since the *2013 Major Projects Report* was released in February, there have been significant changes in global and Australian economic conditions.

The Australian dollar has depreciated over 10 % and, politically, the Federal arena continues to create instability on a number of fronts.

Some, but not all, of these changes were anticipated in the *2013 Major Projects Report.*

In aggregate, the outlook remains very similar to before, with major project activity declining by half over the next four years. However, the composition and key drivers of growth have shifted slightly since February.

Weaker commodities prices coupled with a high cost base has seen further project deferrals in the mining sector.

*Consequently, major project work is now forecast to be **weaker** over the next two years compared to the February report.*

Offsetting these forces somewhat is an improvement in the outlook for non-mining projects, particularly transport projects, predicated on a collaborative approach to major infrastructure project delivery and, Federally, a new tax loss incentive for major infrastructure projects. In part, this has seen the inclusion of two new transport projects (although still unfunded) which has **bolstered** the outlook for activity from 2015/16.

2. Economic Update

Since the publication of the *2013 Major Projects Report* in February, economic conditions have worsened more than anticipated, both at the global and Australian level.

Global economic growth for calendar 2013 is now anticipated to be closer to 3 % (down from the 3.5 % forecast in February) with weaker growth in China key to this outcome.

China's economy is now forecast to grow 7.5% in calendar 2013. This will limit growth in demand for metals, minerals and commodity prices, and in turn, continue to slow the pace of resources investment in Australia.

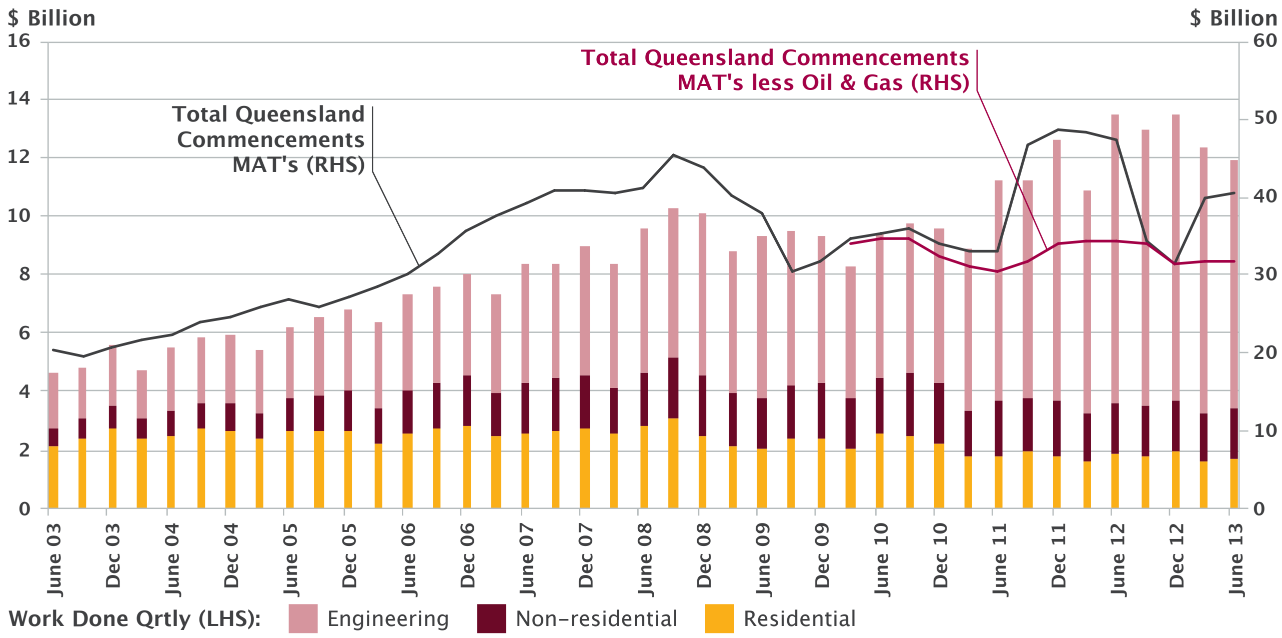
Meanwhile, the Australian economy is also likely to be weaker than previously forecast in 2013/14 and 2014/15 given a weaker contribution from public and private (particularly resources) investment.

> *In this Update, it is now expected that the Australian economy will grow by only 2.2 % in 2013/14 (against a forecast of 2.5 % previously), with strong growth in exports offsetting very weak growth in domestic demand (Gross National Expenditure, or GNE).*

The Queensland construction market is at the forefront of both of these negative forces, with the State and Federal Governments both cutting expenditure to bring their budgets back to surplus, and major mining developments being deferred.

As **Chart 1** below highlights, Queensland construction activity plateaued in 2012 and has already started to weaken. To sustain construction activity at $12 billion a quarter or higher, annual commencements need to be nearer to $50 billion, not the $40 billion currently. Without further sizeable new projects coming on stream, the pace of the decline in the Queensland engineering and civil construction industry will accelerate.

Chart 1 – Value of Construction Work Done and Commencements, Queensland, 2010/11 Prices



3. Queensland Major Projects Update

In aggregate, the revised mid-year forecasts for Major Project work follows the path set out in the initial report.

> *Following a peak of $17.9 billion in 2012/13, Major Project work done is anticipated to decline each year, with work done falling to $8.5 billion by 2016/17. This represents a 53 % decline from the 2012/13 peak.*

As **Chart 2** highlights, major project prospects have been revised down compared to the February report, with the Shell/Arrow LNG project now considered a more marginal project. This view is based on:

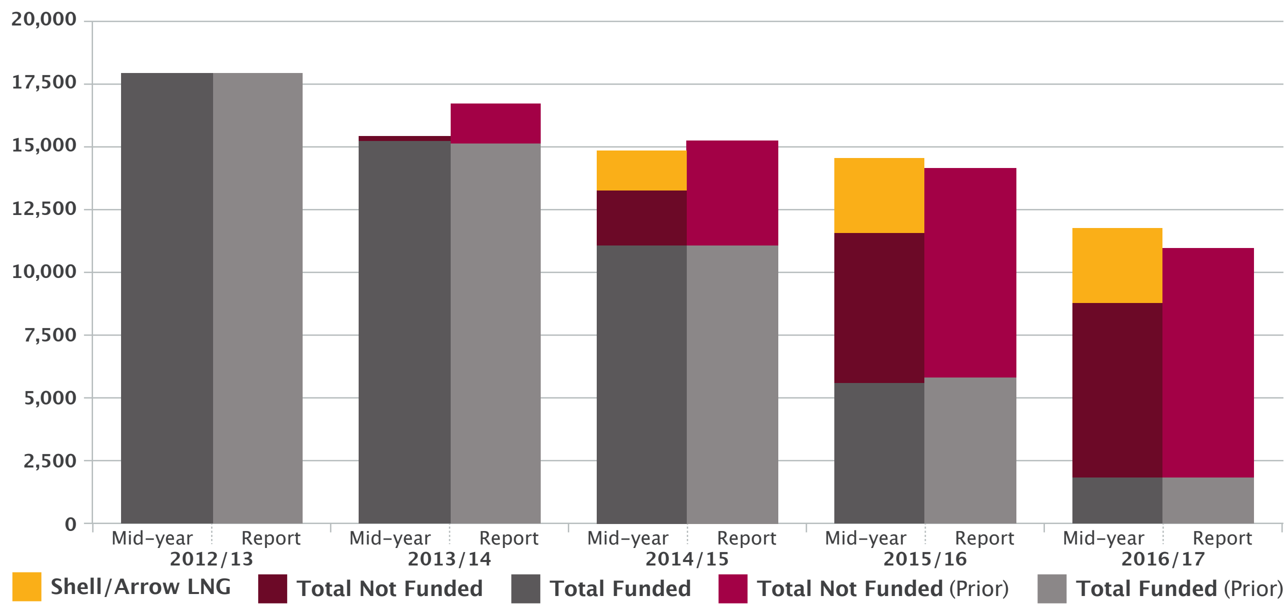
- The deferral of a number of near term coal projects in the Bowen Basin due to further cuts in coal prices and a generally weaker outlook for prices (which has offset the benefits of a lower Australian dollar). Combined with Australia's high cost base, unfunded projects in the mining and heavy industry sector have been revised down between 2014/15 and 2015/16. Recent deferrals include Aquila's Eagle Downs Underground Coking development and Peabody's Millennium mine expansion. These projects (and others) have been pushed back two to three years from the original report start date.

- Partially offsetting these factors is an improvement in the medium term outlook for the transport sector with the forecasts including two new projects. The first is the $1.6 billion Toowoomba Second Range Crossing, beginning 2014/15, which will boost major project work through to 2016/17. The second project is Townsville Eastern Access Rail Corridor beginning 2016/17. Together, these projects add roughly $500 million to the unfunded component of major project work in the latter years of the outlook.

*The net effect in activity is still a pronounced **weakening** over the next four years. However, activity could end up **higher than previously forecast** for 2015/16 and 2016/17 if the Shell/Arrow LNG project were to proceed alongside the new transport projects and delayed coal projects.*

The timing of these coal projects, however, remains highly uncertain and so presents further risks to the outlook.

Chart 2 – Major Projects Work Done Forecasts (Mid-Year Updated Forecasts vs. Report Forecasts)



4. Risks

Given the dominance of major international companies and exposure to international supply and demand forces, Queensland's engineering and civil construction industry will remain highly volatile and subject to risks.

Key risks to our base case include:

- **Uncertainty surrounding the timing of LNG projects.** Australia's relatively high cost structure coupled with increasing competition from global sources is placing new greenfield LNG developments at risk. Furthermore, recent approval of Shell's Prelude Floating LNG project casts further doubt over the timing of Shell/Arrows $20 plus billion development in Gladstone, (which was timed to commence in 2014/15).
- **Similarly, Queensland's status as a premier investment location for coal projects is threatened by a high cost base and current low prices.** A number of major projects in this sector remain at risk of being delayed beyond our current timing. This is particularly true for those projects that are tied to the 27mt Wiggins Island Coal Terminal development which is due for completion in late 2014/15, as well as projects in the Galilee Basin (which are also still assumed to proceed in this *Update).*

Opportunities on the upside have also developed since our initial report, including:

- **The revised scope of Brisbane's now $5 billion plus Cross River Rail project and the inclusion of this project as a 'ready to proceed' priority in Infrastructure Australia's project list.** While this project has not been added to the outlook for this *Update,* it may appear in future Major Project Reports (albeit at the possible expense of other transport projects).

- **The possibility of an earlier boost to public investment to boost economic activity.** In particular, a number of roads projects may be beneficiaries of further funding given a weakening resources sector and more generally a slowing economy. However, this is all subject to funding constraints and political uncertainty.
- **The real wild card remains the Australian dollar.** Further sustained depreciation of the Australian dollar will boost US dollar profitability of Australian energy and resource projects. This could see an earlier upswing for a number of major energy and resources projects.

More generally risks to contractors have also emerged, including:

Project owners are reported to be seeking cost reductions on existing projects (and contracts), particularly in relation to LNG packages of work, which were negotiated at the height of the resources boom. This is placing contractors under further pressure over the next one to two years.

Implications

While it may be too late to arrest the forecast halving in major project work, actions should be taken now to tackle challenges facing the industry – particularly, high costs and low competitiveness – so that Queensland can be better placed to attract investment and meet the demands of future cycles in Major Project work.

Whilst a lower Australian dollar will help, this outcome is uncertain and industry participants will need to focus on what it can control and achieve to reduce inefficiency and costs. This may involve further efforts to reduce unnecessary industry regulations, streamlining unproductive workplace practices, re-considering inefficient contracting arrangements and ensuring the industry has the right mix of skills and competencies to meet future demand.

Regional differences

One interesting feature of this *Update* is that differences amongst sectors and regions are expected to be more prominent than previously presented. As Chart 3 highlights, as the LNG driven boom moves towards completion, coal projects are delayed, and publicly funded transport projects pick up, a greater share of Major Project work will be focused in South East Queensland (SEQ) at the expense of Gladstone.

Chart 3 – Major Projects Work Done – All Segments by Region (Share LHS, $Billions by column in constant 2009/10 prices)