Euler Hermes Economic Research

Economic Insight

Construction: The end of the Polish exception

15 May 2013

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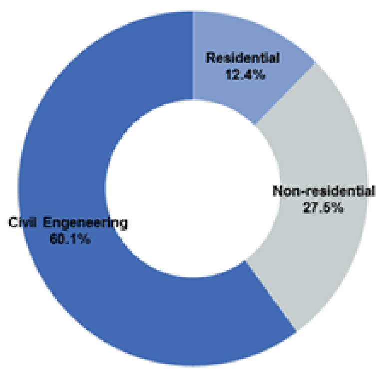
In summary:

- The construction sector was boosted from 2004 by investments in infrastructure and housing partially financed by European Union funds and public spending.
- Poland's economic catch-up with its European neighbors then ran into the economic downturn, a drying up of loans and a fiscal deficit that forced a change of economic policy.
- The contraction in international demand, budgetary restrictions and the shrinking of European Union funds caused the financial situation of construction companies to deteriorate, resulting in a surge in insolvencies.

An active policy of investment in the construction sector provided the means for infrastructure development and new housing in Poland

As a basis for its economic development, Poland invested heavily in infrastructure, which led to an unusual breakdown of its construction market. In late 2011, civil engineering spending represented 60% of the construction sector. The project to upgrade the road network around Gdansk between 2007 and 2013 is symbolic of these major public works. In addition, PLN 250 million (EUR 60 million) was borrowed to build stadiums for the Euro 2012 soccer tournament.

Graph 1 : Construction market structure



Source : PMR Publications

Public spending boosted investment in construction in particular and funding was earmarked notably to build housing. For example, an additional 85,000 residential homes were built over and above the long-term trend between 2007 and 2009 inclusive. Nevertheless, this drive failed to meet needs estimated at 700,000 homes in 2007. Moreover, 40% of existing homes require renovation work.

Poland thus managed to converge toward the other European countries and to get through the 2009 crisis without too many problems. All in all, revenue in the construction sector has grown markedly since 2004. This leap forward, however, started to slow significantly in 2012: +17% average annual growth between 2004 and 2011, but +6% in 2012 and probably +5% in 2013.

The mechanisms that funded growth in the construction sector proved to be fragile

To finance this growth, Poland turned to the European Union structural funds, from which it was the largest beneficiary during the 2007-2013 period, receiving 19% of sums allocated. The granting of these funds, however, has become more restrictive and more beneficial to international companies.

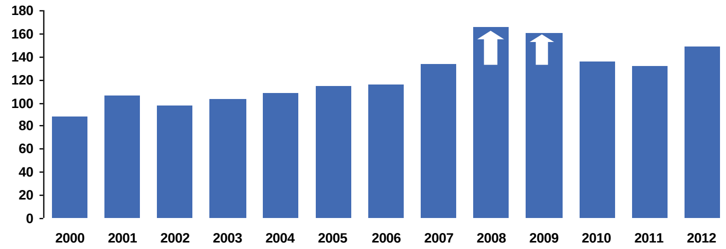
Poland's fiscal deficit, which reached EUR 27 billion in 2010, had to be reduced to around EUR 13 billion at the end of 2012. Faced with a spiraling public debt (56% of GDP at end 2011) and the necessary convergence with European deficit reduction rules, the country was forced to undertake measures to reduce its fiscal deficit. Activity has suffered as a result of this policy, notably in the construction sector.

Exacerbated by the European slowdown, the downturn in activity put an end to the exception of the Polish construction sector in Europe

In early 2012, the production index in industry started to dip and the construction production index also fell drastically, affecting all segments in the sector. While public works were the first to decline in mid-2011 and then in early 2012, the other segments in the construction sector slowed before beginning to fall in 2012. Heightened competition often exacerbated by foreign competitors ended up hurting Polish companies.

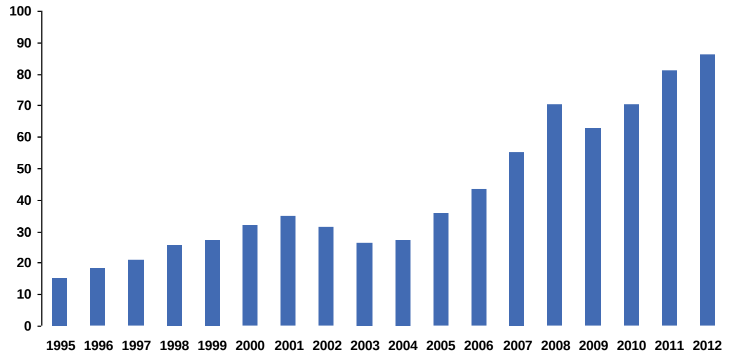
In response to this slowdown, a national stimulu package of EUR 52 billion over three years (8% GDP) was voted in late 2012, favoring especial road and rail infrastructure. These measures may n be enough, however, given that the focus of th 2014-2020 EU structural funds program is c increased regulations and savings measures.

Graph 2: Number of dwellings completed in Poland (thousand)



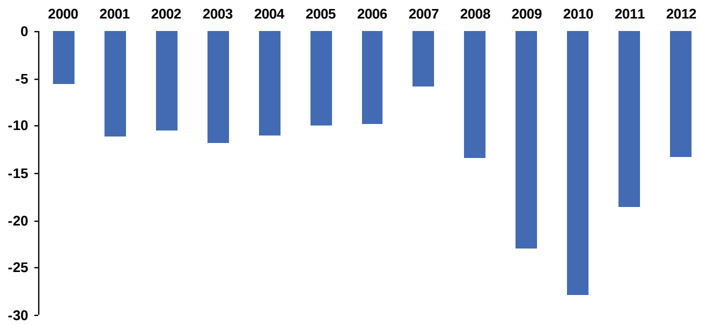
Sources : GUS, Central Statistical Office

Graph 3: Poland construction sector turn over (billion euros)



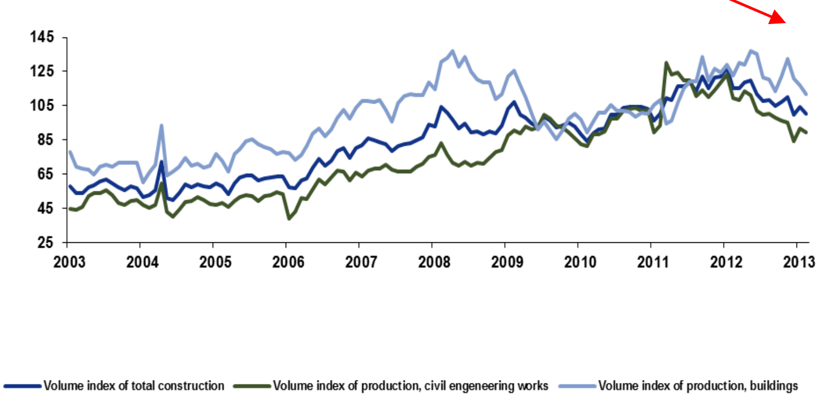
Sources : IHS Global Insight, Euler Hermes

Graph 4: Poland, General Government deficit (billion euros)



Sources: Eurostat, Euler Hermes

Graph 5: Volume Index of production in construction (basis 100 in 2010)



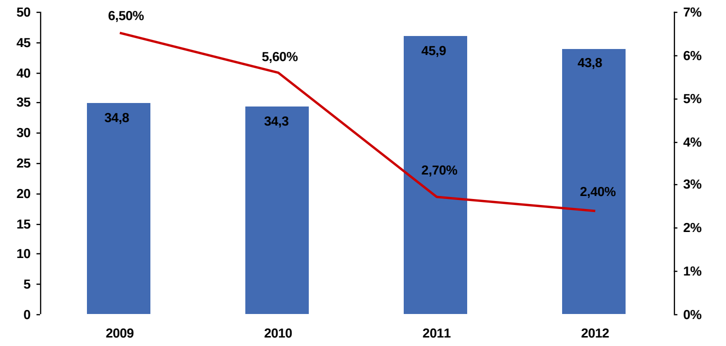
Source: OCDE

An analysis of the accounts of Polish construction companies confirms the weakening of this sector in Poland

Average revenue grew strongly in 2011 (+34% for our sample), comfortably making up for the turbulence in late 2008 and mid-2010. By contrast, revenue fell in 2012 (-4.5%). At the same time, profit margins at these companies contracted sharply under the effect of the greater competition: from 6.5% in 2009, margins fell to 2.4% in 2012.

Consequently, corporate profits, which had been bolstered by improving results and the reopening of the Warsaw Stock Exchange in 1991, have gradually been eroded by deteriorating results and payment delays equivalent to 12 days of revenue for our sample.

Graph 6: Average turn over (billion zlotys) and profitability rate (post tax profit / turn over)



Sample: 500 companies of the construction sector (excluding real estate activities)

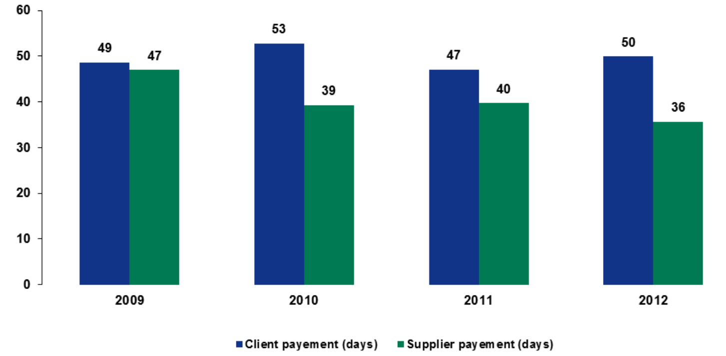
Source : Euler Hermes

In the end, companies have weakened, which has translated into an increase in corporate insolvencies

After enjoying a period of economic growth, the number of insolvencies in the construction sector surged. In 2012 they doubled in this sector and now account for 27% of total insolvencies.

For example, PBG, the sector's third-largest company and which had played a role in the construction of three of the four large stadiums built for the European soccer championship, filed for bankruptcy in June 2012. This fresh outbreak of insolvencies in the construction sector is exacerbated by the structure of the industrial fabric, made up of many small firms sensitive to jolts in activity.

Graph 7: Payment duration (days)

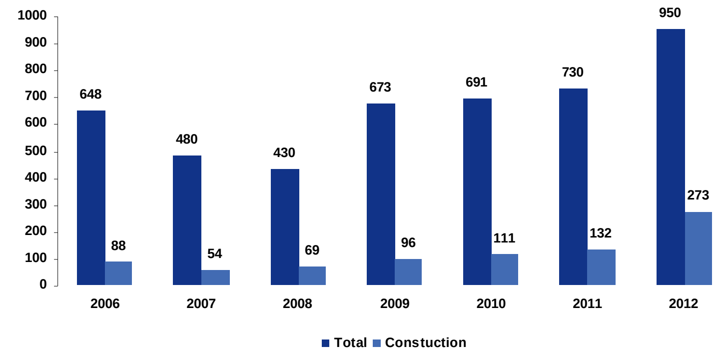


Source : Euler Hermes

Six largest construction companies in Poland:

Strabag Polska
Budimex (Ferrovial)
Polimex Mostosal
Skanska Poland
Mostotal Warszawa (Acciona)
Trakcja Polska

Graph 8: Insolvencies (number of cases of liquidation)



Source: Euler Hermes

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