

New foundations for the construction sector?

Ludovic Subran,
Chief Economist & Research Manager

Yann Lacroix,
Sector Research Manager

Didier Moizo,
Sector Analyst



Press
conference
Paris,
21 June 2012

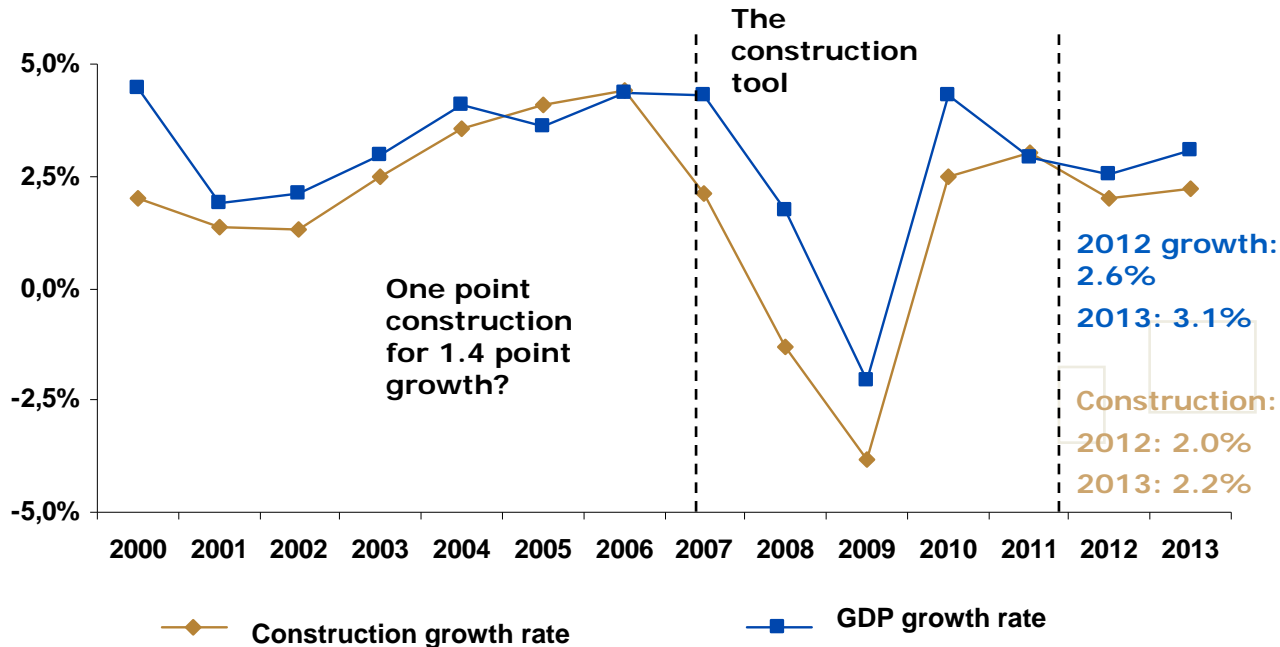
Contents

- 1. Can construction growth revive?**
- 2. Without growth, what is left for the construction sector?**
- 3. Erosion of profitability for sector companies**
- 4. Conclusion**

Can construction growth revive?



Evolution of GDP and construction at global level



Sources: GlobalInsight, IMF, Euler Hermes

- Existence of a structural link between the construction sector and economic growth: myth or reality?

- If so, how?

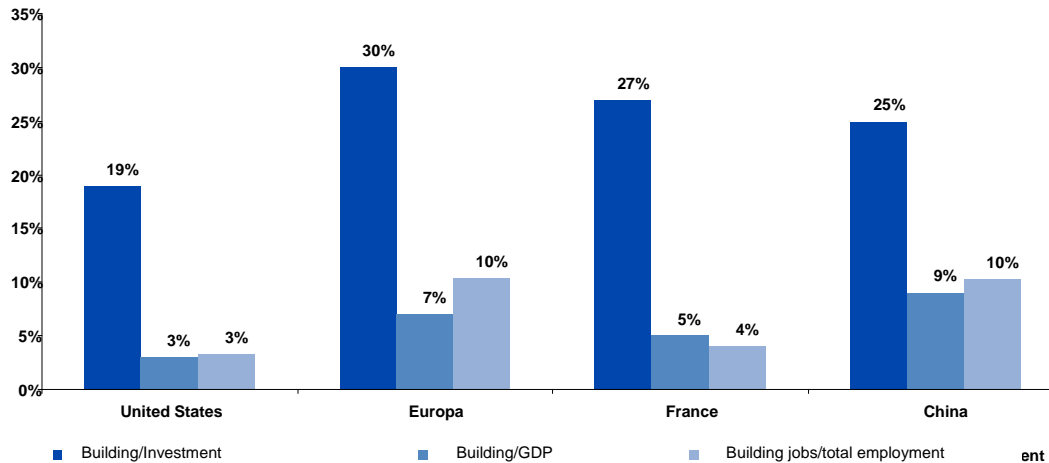
- No direct answer, but an intuition?

▶ The structural link between construction and GDP

Can construction growth revive?



Construction to support growth



Source: Comptes de la Nation, Euler Hermes

- **Construction is a source of investments**
- **Construction creates wealth and jobs**

Recovery plans:

France: 1.8 billion Euros

China: 12 billion Euros

United Kingdom: 2.1 billion Euros

Investment plans:

Brazil 2001/2014: 660 billion Euros (road network, energy production)

India: 100 billion Euros over 5 years (rail network, bridges)

Measures to support the residential sector:

Tax allowances, low-interest loans (France: zero-interest loan).

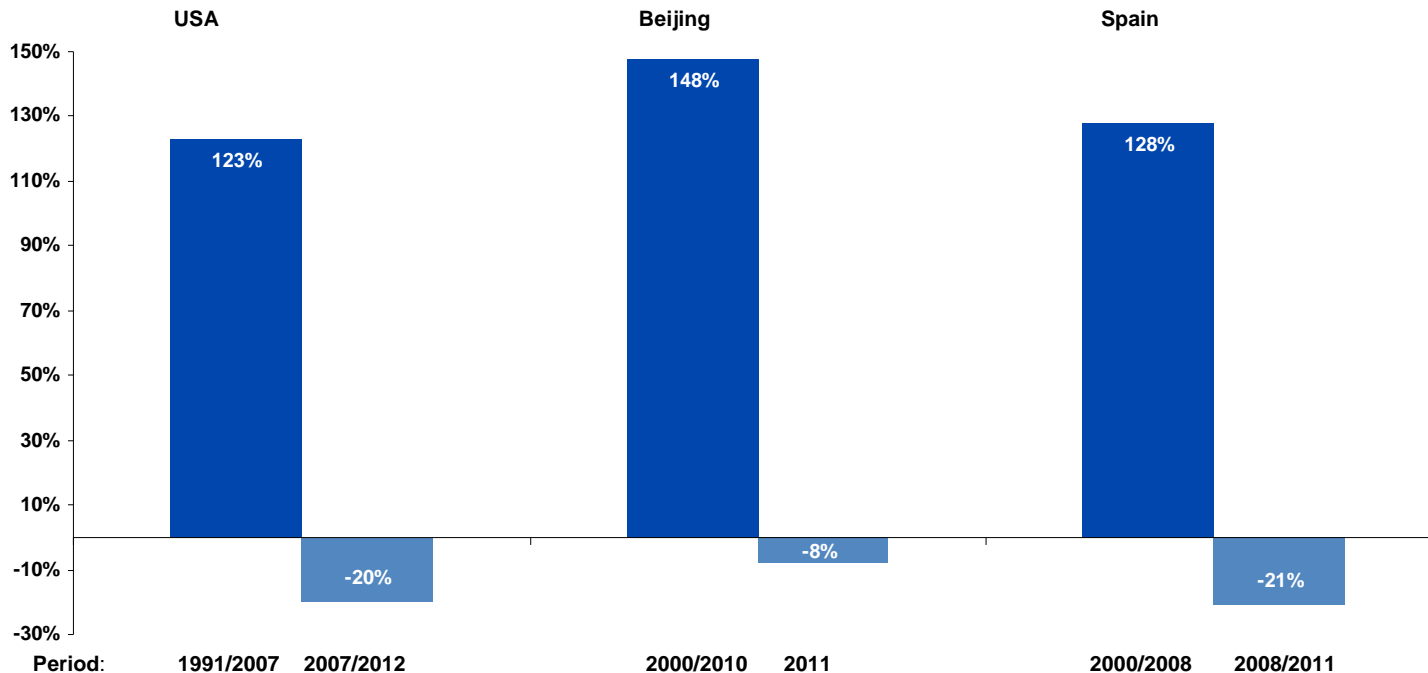
Extending credit periods (USA: 30 years, Spain and Portugal: 40 to 50 years)

Construction represents key element of the economy

Can construction growth revive?



Evolution of real estate prices in the USA, China and Spain



- No continent has been spared the real estate bubble
- Absorbing the housing inventory available for sale will take several years

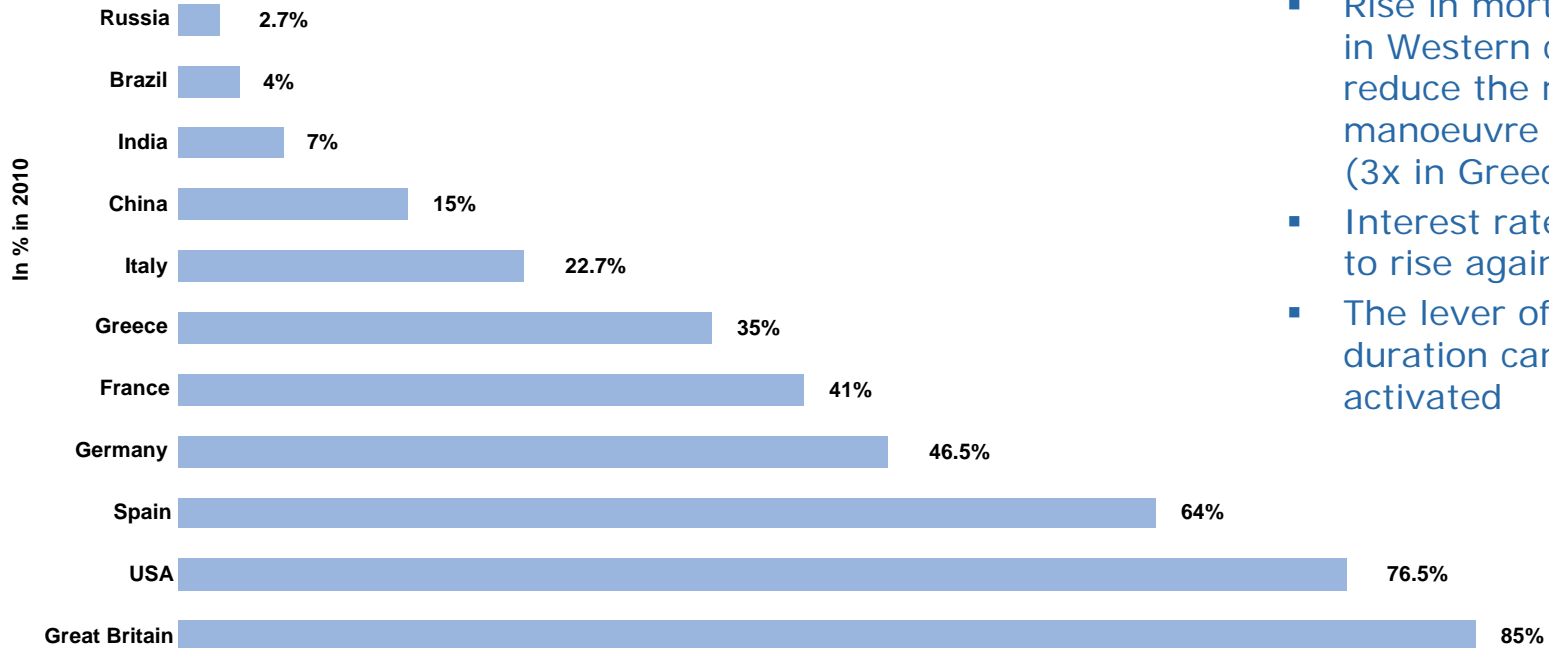
Source: Euler Hermes

▶ Real estate bubbles have followed successively on all continents

Can construction growth revive?



Household mortgage debt/GDP



- Rise in mortgage debt ratio in Western countries will reduce the room to manoeuvre for several years (3x in Greece in 10 years)
- Interest rates have started to rise again.
- The lever of extending loan duration can no longer be activated

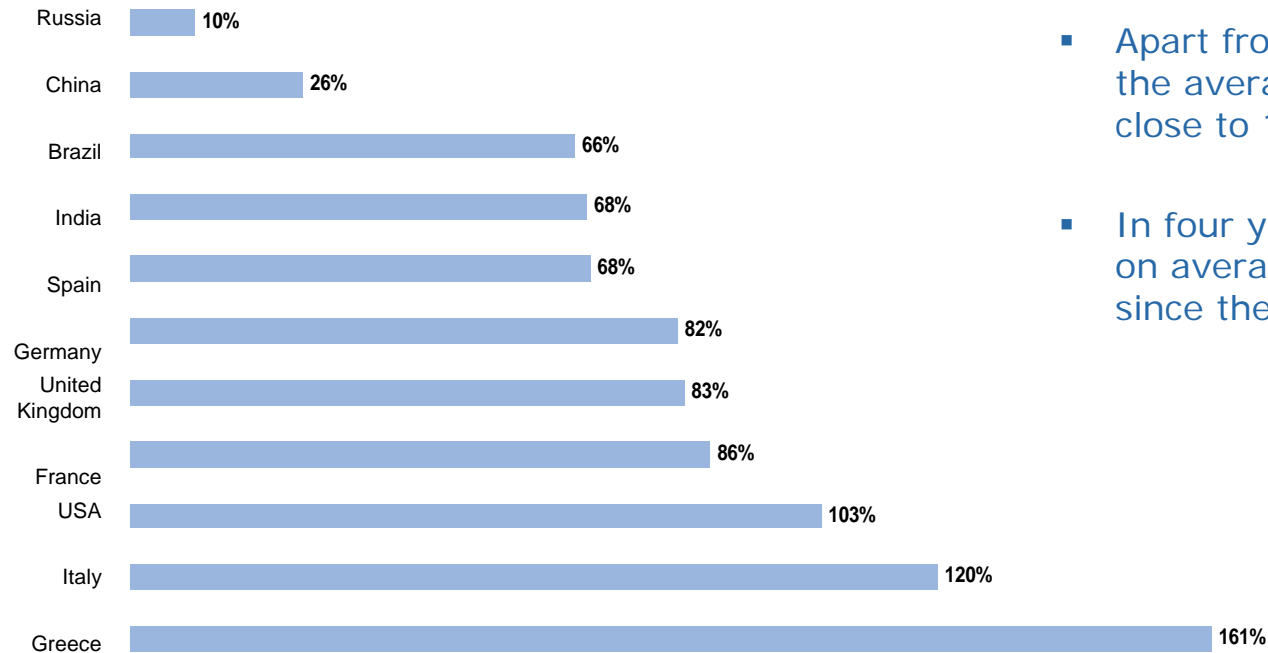
Sources: European Mortgage Federation, Eurostat, Euler Hermes

▶ Household debt has eroded their financial position

Can construction growth revive?



National debt as a % of GDP



- Apart from emerging countries, the average national debt ratio is close to 100%
- In four years, it has risen by 35% on average, after being stable since the beginning of the decade

Sources: IMF, Eurostat, Euler Hermes

▶ The cost of reviving construction is very high

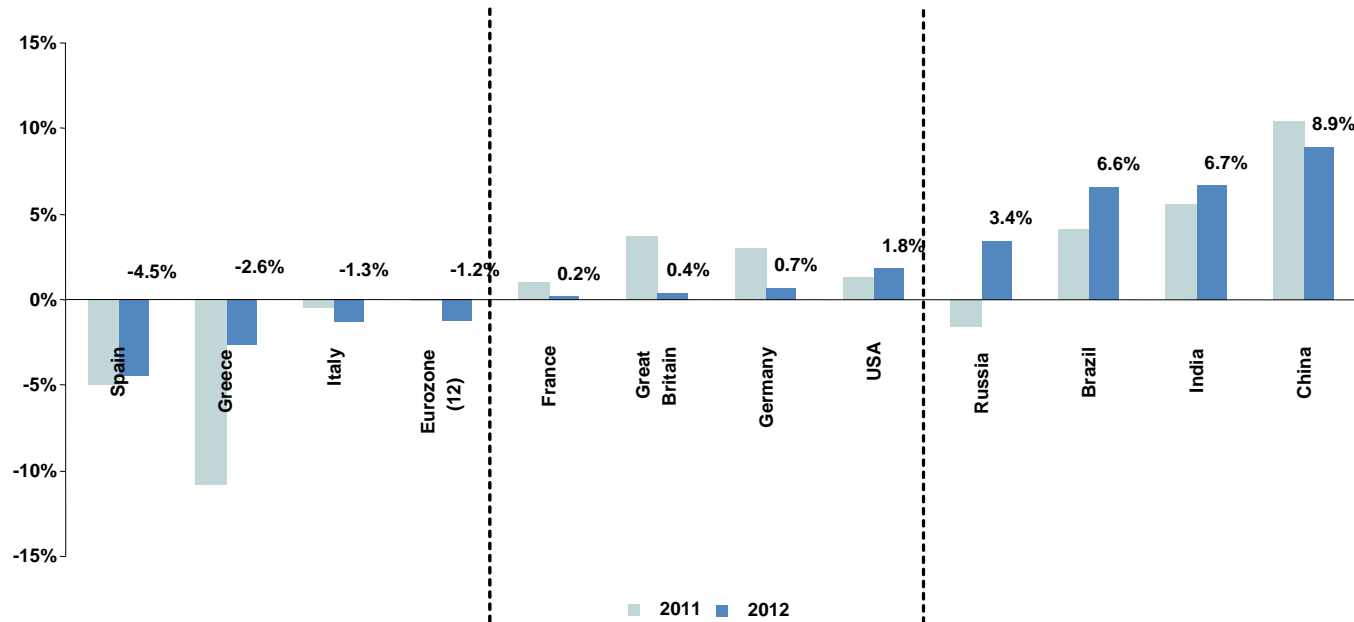
Contents



1. Can construction growth revive?
2. Without growth, what is left for the construction sector?
3. Erosion of profitability for sector companies
4. Conclusion

What is left for construction?

Evolution of construction activity indices in volume



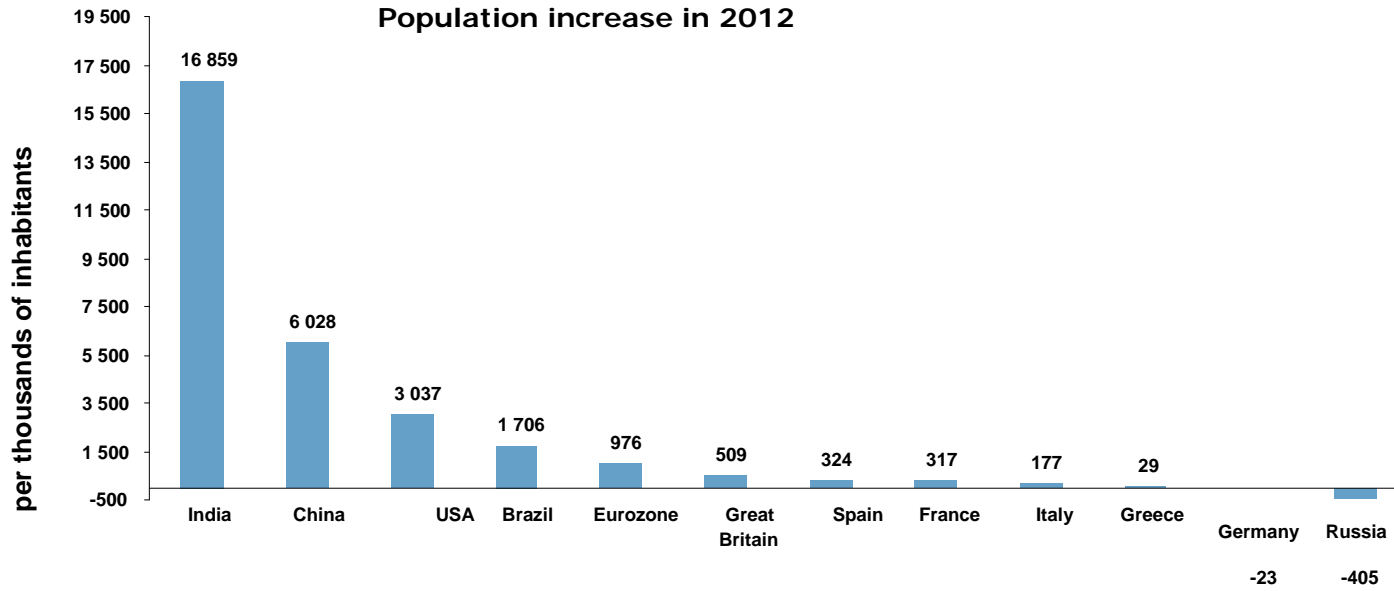
- USA: a gradual exit from crisis for the first country to enter it
- Spain: continuing impact from the collapse of the real estate bubble
- Eurozone hampered by the Mediterranean countries

Sources: GlobalInsight, IMF, Euler Hermes

▶ The activity (+2.0% in 2012) is driven by the emerging countries

What is left for construction?

Population increase (in thousands) and urban development rates (in %)



Urban development rates by country in 2011 (in % of the population)

30.9%	49.2%	82.1%	84.2%	73.0%	79.5%	77.3%	85.2%	68.2%	61.2%	73.8%	73.7%
-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------

Sources: OECD, United Nations, Euler Hermes

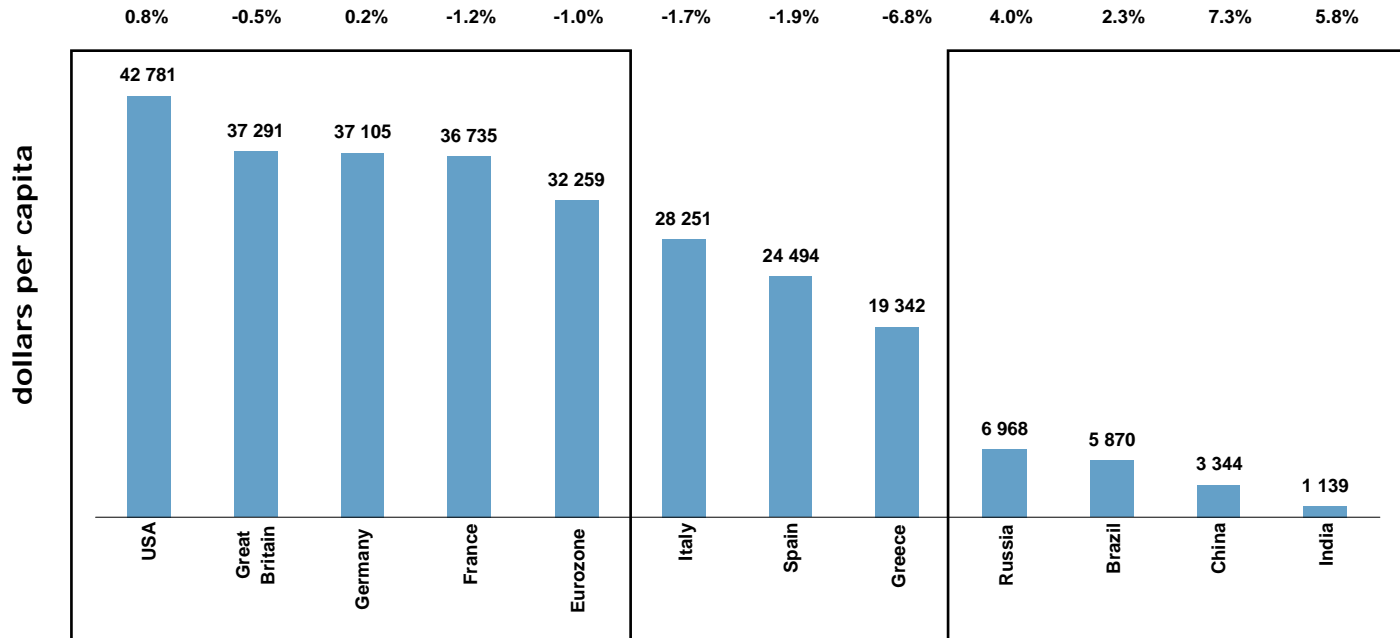
- Dual demographic effect in India
- High urban development potential
- Brazil to rebuild urban housing
- Housing shortage:
France: 500 000
Brazil: 10 million
India: 24 million

The dual effect of the demographic variable

What is left for construction?

Per capita GDP change in 2012 (in \$ and in %)

Growth rate of per capita GDP 2012/2011



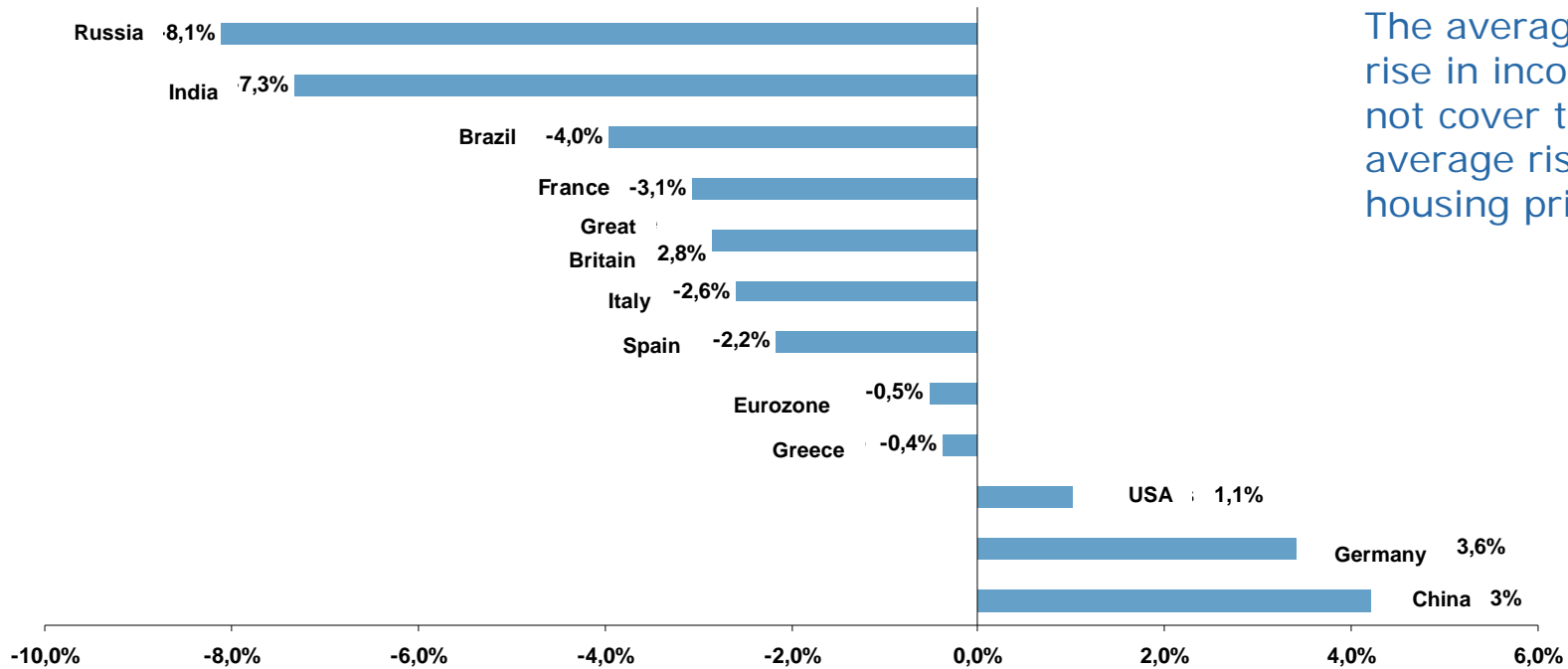
Sources: GlobalInsight, World Bank, Euler Hermes

- High levels of wealth in Western countries
- Faster growth in the emerging countries, despite persistent inequalities
- Tense situation in less wealthy Western countries that are experiencing the crisis

▶ Two worlds with two measurements of wealth

What is left for construction?

Differential between the growth rate of income and housing prices since 2000



The average annual rise in income does not cover the annual average rise in housing prices

Sources: World Bank, National statistics offices, Euler Hermes

▶ But the disparity between prices and income is general

What is left for construction?

New growth opportunities

Environmental standards for energy savings and lower CO2 emissions: 550 billion dollars

Additional cost of an HEQ and BBC building: 10% to 15% more

Prospects for the renovation sector: 80% of buildings do not meet environmental standards

75% of existing buildings in Russia and 40% in Poland

**Commercial and office investment:
office real estate is driving corporate investment in Western Europe:
+7% in the first quarter 2012**

**External events:
2014: World Cup in Brazil
2016: Olympic Games in Brazil
2014: Winter Olympic Games in Russia**

Source: Euler Hermes

► **Some potential for growth exists in the world**

Contents

1. Can construction growth revive?
2. Without growth, what is left for the construction sector?
3. Erosion of profitability for sector companies
4. Conclusion

Erosion of company profitability

Profitability of large global groups

Net income/Turnover	2010	2011	2012
China	1.9%	2.1%	2.2%
Europe	5.0%	3.7%	3.6%
USA	4.3%	4.9%	4.8%

Sources: Companies, Euler Hermes

- Low profitability of Asian groups, despite a very gradual improvement
- European and American groups lead, despite eroding profits

▶ Large European groups caught by the crisis: -1.4 point in two years

Erosion of company profitability

French companies' profitability

France	2010	2011	2012
Turnover trend	0.8%	1%	0.5%
Net income trend	-9%	+0.5%	-3%
Net income/turnover	3.6%	3.6%	3.4%

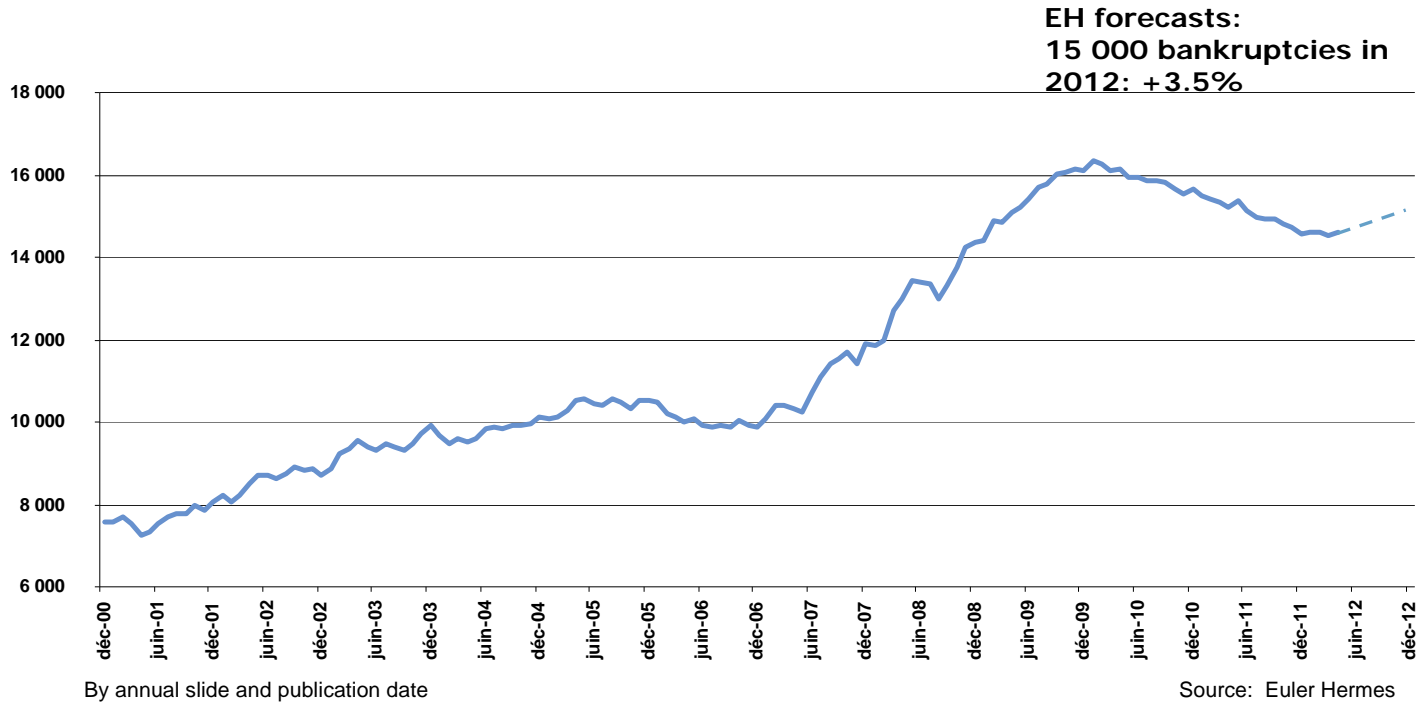
- Business stagnation
- Pressure on prices
- Scissor effect on raw materials:
 - Steel:**
August 09/April 12: +22%
 - Cement:**
+3% per year since 2010
- Deterioration of profitability

Source: Sample of 125 000 companies, Euler Hermes

▶ 3% profitability drop expected in 2012

Erosion of company profitability

Bankruptcies in Building & Public Works in France



Building & Public Works in France: 25% of bankruptcies in France

Bankruptcy rate: 3.2% in 2011 (vs. 1.7% on average in France)

2012 outlook: High level of bankruptcies, and a further 3.5% increase

Fragility of French small business network

Contents

1. Can construction growth revive?
2. Without growth, what is left for the construction sector?
3. Erosion of profitability for sector companies
4. Conclusion

Conclusion

- **The historically established correlation between construction and growth encourages recovery policies that focus on construction to exit the crises.**
- **These policies are hard to implement given the levels of private and public debt. They can prove costly in the short and medium term, despite the visible effect on employment.**
- **Given debt and costs factors, and a lack of economic growth, construction must go back to basics, or seek new growth areas.**
- **Against this backdrop, the sector will continue to face serious difficulties in 2012 and 2013, and company profitability will continue to decline.**



Thank you.

www.eulerhermes.com

