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## Construction: Growth opportunities exist for construction amid a global economic slowdown

Analysis by credit insurer Euler Hermes

- **Emerging countries are driving sector activity**
- **Growth opportunities: renovation, compliance with environmental standards, office construction**
- **Constraints: Government debt, deteriorating consumer finance**
- **Company profitability eroded by a combination of high raw material prices and stagnating housing starts, especially in Southern Europe**

Political and financial leaders have often counted on the [construction sector](#) to revive growth. But these stimulus policies are not without repercussions, as demonstrated by the property bubble seen in many countries over the period 2000-2010.

“These economic policies often come at a high cost. Today, it is becoming difficult to implement them because of government debt and consumer financing conditions,” says [Ludovic Subran, chief economist at Euler Hermes](#). “The sudden withdrawal of stimulus policies is being felt in all developed countries and is especially acute in southern European countries. These trends facilitate a shift in the centre of gravity of the construction sector towards emerging countries, where growth prospects are far brighter. French companies that have no access to these markets will remain highly vulnerable in 2012 and 2013.”

### A host of difficult conditions

Government debt and unfavourable [economic growth forecasts](#) in developed countries are compounded by:

- Rising household mortgage debt ratios (85% of GDP in the UK and 76.5% in the US this year, for example)
- Loan terms that cannot be extended much further, up to 50 years in Spain
- The average term is 17 years in France, but 16% of current mortgages are for periods of between 25 and 30 years
- Slower growth in incomes than in property prices in most countries since 2000.

In this difficult economic context, construction sector companies are also facing a decline in profitability. While the margins of the leading European and US groups remain higher than those of Asian groups, they are being steadily eroded year after year. European groups have seen margins fall by 1.4 points in two years. Those of French companies are expected to decrease to 3.4% of sales in 2012.

“The fabric of the French construction sector, which consists primarily of small companies, is fragile. Some companies are not financially solid enough to withstand stagnating activity, price strains and high raw material costs. As a result, company insolvencies, already very high in 2011, will continue rising in 2012. We forecast 15,000 company insolvencies in the sector this year in France,” concludes Didier Moizo, sector advisor at Euler Hermes.

## Slight improvement in 2012

However, despite an unfavourable backdrop, the construction sector activity index (in volume) is forecast to increase by 2% at the global level in 2012 due to the dynamism of emerging countries (China +8.9%, India +6.7%, Brazil +6.6%). In the euro zone, in contrast, the index is expected to fall (-1.2%), impacted in large part by Mediterranean countries (-2.6% in Greece and -4.5% in Spain), where the bursting of the property bubble has left lasting traces. Other European countries are still expected to see improvements, albeit modest ones: France +0.2%, UK +0.4% and Germany +0.7%.

The US is set to confirm its gradual recovery from the crisis with a projected increase in its index of 1.8% in 2012.

## The driver: Emerging countries

The ramp-up of emerging countries, which have substantial infrastructure, equipment and housing needs, appears to be the construction sector's principal growth driver. For example, the deficit of homes is estimated at 24 million in India, and 10 million in Brazil where a large portion of urban areas need rebuilding.

"Much less indebted than developed countries, governments in these countries have the means to finance large infrastructure projects. They can also provide extensive support for the construction of new homes, which has become indispensable because of accelerating urbanisation," explains Ludovic Subran. "These countries can count on solid growth in the years ahead, but their per capita GDP remains low. Moreover, home prices are tending to increase more rapidly than household incomes. Access to credit and income growth are thus crucial for growth in the housing construction market."

## Growth opportunities for the sector

In addition to the momentum of emerging countries, there are other significant growth opportunities for the construction sector.

- The application of environmental standards aimed at reducing CO<sub>2</sub> emissions and improving the energy efficiency of buildings. This market is potentially worth \$550 billion, considering a LEED building is 15% more costly.
- Renovating existing buildings. Some 80% of buildings do not comply with environmental standards, and the existing base in some countries is in a very poor state (75% of existing buildings in Russia and 40% in Poland).
- Construction of commercial and administrative offices is picking up again in Western Europe: +7% in the first quarter of 2012.
- External events can help stimulate construction, such as the football World Cup in 2014 and the Olympic Games in 2016 in Brazil, and the 2014 Winter Olympics in Russia.

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