



Situation of the construction industry in the financial and economic crises

FIEC input to the ITRE Committee of the European Parliament

FIEC is the European Construction Industry Federation, representing via its 33 national Member Federations in 28 countries (26 EU & EFTA, Croatia and Turkey) construction enterprises of all sizes, i.e. small and medium-sized enterprises as well as "global players", performing all sorts of building and civil engineering activities.

CAVEAT: Due to the rapidly changing situation both at national and European level, these facts should be treated with some caution. They however reflect the current general trend.

1. General situation and its developments in Europe and the world

Key figures 2007 of the construction industry in Europe:

| | |
|-------------------------|--|
| €1,304 Bn. output | = 10.7% of GDP (EU27) = 51.5% of Gross fixed Capital Formation (EU27) |
| 2.9 million enterprises | Of which 95% SMEs with fewer than 20 workers |
| 16.4 million workers | = 7.2% of total employment (EU27) = 30.4% of industrial employment (EU27) |

Source: FIEC "Key figures 2007" (edition 2008)

The construction sector usually reacts to economic changes with some delay, as current activity is based on orders made months/years earlier. Although the true extent of the downturn will not become apparent before mid 2009, the global recession caused by the financial crisis is naturally having an impact on the real economy and signs of this are already visible in our sector, mainly in the form of postponed investments or contracts yet to be started being cancelled.

According to initial estimates¹, European construction industry output decreased for the first time in many years in 2008 (-3%), on the back of the sharp decline in housing activity. The latter was successively affected by a fundamental trend reversal in some countries (those where overvaluation of house prices came to an abrupt end), the financial and economic crises and the looming recession.

In comparison, the path followed by the US market in 2008 shows some similarities with Europe, but the housing market crisis started earlier and has gone much deeper so far. Figures² for 2008 show a further major collapse of the housing sector (-39% of new construction starts), bringing down the overall results (-15% of new construction starts).

¹ Source: Euroconstruct, 2008, 66th Euroconstruct conference, Summary Report.

² Source: McGraw-Hill Construction, 2009, Forecasts & Trends.



Although the situation varies significantly from one EU country to the other and from one sub-sector to the other, the following general trends can now be observed, which are not, in all countries, only related to the current financial crisis (e.g. in Spain, the UK or Ireland):

- Financing difficulties and in some extreme cases, even bankruptcies: the sector is mainly composed of SMEs which are heavily reliant on bank lending and are most exposed to late payments by clients (which tends to be increasing);
- Tightening of credit conditions, downgrading of credit insurance and consequently problems to obtain credit insurance;
- Initially, a certain decrease of civil engineering works, which is expected to be compensated by the various national recovery programmes;
- Strong decrease in housebuilding: many (private) clients prefer a “wait and see” approach and are therefore postponing their investments, although the decrease in mortgage rates and the effects of the various recovery plans should have a positive effect in the near future;
- Non-residential: according to some forecasts, sharp decline expected in Western Europe whereas certain Eastern Europe markets could still see an upward trend (e.g. Czech Republic, Poland);
- Better prospects for rehabilitation and maintenance works: following the financial crisis and current trend towards environmental considerations, investors may tend to favour investments in the real economy and particularly in renovation and retrofitting of housing (and namely due to the fiscal incentives which exist in many EU countries for energy efficient investments, further promoted by the various recovery plans);
- Evidently, all these developments will have an impact on temporary and permanent jobs in the construction industry.

In general, according to December 2008 Euroconstruct forecasts, the volume of construction output in the EU19 (EU15 + Czech Republic, Hungary, Poland, Slovak Republic) should evolve as follows in 2009 (forecast, % change in real terms):

| | |
|---------------------|-----|
| - Residential | -7% |
| - Non-residential | -4% |
| - Civil engineering | +0% |
| - Total | -4% |

These preliminary forecasts are however likely to be revised downward.

In this context, both the EU and most Member States have realised the immediate, medium- and long-term advantages of investment in infrastructure and energy efficiency measures (for which the need pre-existed the financial crisis) for achieving real progress with their recovery plans.

This is the recognition that construction is part of the solution and not the problem. The construction sector is not asking for subsidies but for the maintenance of investment necessary for satisfying the objectively existing needs for infrastructure and energy efficiency measures, in particular for the renovation of buildings. The recovery plans both at EU and Member State level promote this approach.

Residential demand will be influenced by:

- The perceived “permanent” available income of household, negatively affected by unemployment which is expected to rise from 7% to 8.7% in 2009;
- The currently very low interest rates;
- The more restrictive credit conditions;
- The state of the market (declining house prices and increase of unsold stock in some countries);
- The possible rise in precautionary savings.

Residential renovation could reach a higher level of activity if the announced stimulus measures in favour of energy efficiency succeed.

Non-residential construction is mainly influenced by the business climate, which is experiencing low investment levels. Public building investment (e.g. in health and education sectors) is expected to increase but not in every Member State.

Civil engineering shows mixed prospects. For the whole region, a status quo is expected, but actually this belies a balance between decline in some Member States, and expansion in others. The national and European recovery plans will hopefully provide a temporary boost in public works. On the other hand, local authorities may cut back their spending due to reduced fiscal revenues.

Consequently, the most affected area of the construction sector in 2009 and 2010 is likely to be "new building".

The more optimistic forecast for the renovation sector has to be seen, in many countries, in the context of a real estate crisis which has had a negative impact on both new **and** existing housing, with a strong decline in orders.

Some of this had however commenced **before** the financial crisis of September 2008 (e.g. in Spain, the UK and Ireland).

2. **Impact on investments and access to financing**

As mentioned in item 1, investment in construction represents significant amounts of money both for public and private clients, who have adopted a “wait and see” approach (except for those projects already started, which should continue and help maintain a certain level of activity), and is therefore being postponed or cancelled.

Although mortgage rates are at low levels, access to lending is becoming increasingly difficult. The situation differs from one country to another and SMEs seem to be more affected by financing problems than larger enterprises. Such a situation, combined with late or non-payments by clients (against which, moreover, credit insurance is getting more

difficult or impossible to obtain), may be particularly difficult for SMEs, which represent the largest number of enterprises in the sector.

3. Predicted impact of the crisis on employment

As the construction sector always reacts with some delay to economic changes, the exact impact on employment is extremely difficult to forecast. However, despite such uncertainties, unemployment is already beginning to rise particularly in Western Europe.

The UK and Spain experienced the loss of thousands of jobs in the construction sector in 2008. France expects to lose around 25.000 and 30.000 jobs in the building sector alone in 2009. The majority of EU countries expect a loss of jobs in 2009 and 2010. Germany has already lost about half of its construction workforce over the recent decade of recession.

In the past, such situations have led to greater mobility towards markets less affected by the crisis and we expect similar movements during this downturn.

4. Specific situations in individual Member States

Construction activity remains mainly a local activity and therefore each country has its own specificities. The current financial and economic crisis is having a very different impact on the construction sector from one country to the other.

In general, it seems that the Eastern European countries are the ones which will be the least impacted by the crisis. Poland (+6%), Romania (+10 to 12%), the Czech Republic (+5%?) forecast good construction activity growth rates for 2009. Against this backdrop, Hungary is the only exception but its economic difficulties had started already before the crisis. Bulgaria also faces difficulties but to a smaller extent. This has been namely worsened by the recent suspension by the European Commission of €560 million from the PHARE programme (EU pre-accession aid) and by the cancellation of big infrastructure projects.

Eastern European countries are however likely to be affected by the credit constraint as these countries rely greatly on credit from Western European banks priced in euro.

Otherwise, the current crisis should probably impact construction activity less in those Member States which will benefit from significant national recovery plans and EU funding for public investment, but this will also depend on the capacity of each country to efficiently "absorb" these available funds.

The construction markets of Western European countries seem, in general, to be more sensitive to the consequences of the financial crisis and the general economic downturn.

It is however to be noted that the difficulties experienced now by some countries are not systematically due to the financial and economic crisis. It is, in particular, the case for the UK,



Ireland and Spain where the real estate market has already experienced a major crisis since 2007. In France for example, the current electoral cycle is not in favour of local public investment (end of electoral cycle, decrease of public share in investment).

In Germany which remains the more stable country from this group, a strong slowdown is expected in the construction sector from mid-2009 and in particular in 2010. For now, no major impact has been noticed as construction companies still have orders to carry out until then (mid-2009).

One after the other, Member States are launching their own recovery plans, and in principle in coordination with the EU recovery plan adopted by the Council in December 2008.

However, it is to be noted that there is generally little real new money in these plans. The already available recovery plans present investments and infrastructure operations with money which would have been spent in any case, budget which were already planned for the coming years.

Germany announced on 13/1/2009 its second recovery plan: between €17 and €18 billion out of €50 billion will be spent on the modernisation of federal, regional and local infrastructure (roads, rails, schools, universities). Some national experts have calculated that this expenditure programme should achieve GDP growth of 0.5 to 0.7 points in 2009 and the creation/maintenance of 200,000 jobs. The first recovery plan presented in November 2008 (€31 billion) also partly targeted the construction sector but was considered insufficient.

In France, following the measures foreseen in the national recovery plan (namely towards public procurement, infrastructure, building and housing), a less strong slowdown of the activity has been forecast (decrease of the activity of “only” 4% instead of 6%).

In Spain, amongst other measures, €8 billion will be distributed to local authorities to help them launch new public works projects. The objective is to create 200,000 jobs in a sector which has seen thousands of job losses since last year.

The UK, Ireland, Belgium, Italy (and the majority of EU countries) have also opted to invest in public infrastructure to boost the national economy in their respective recovery plans.

5. Actions expected from public authorities in support of industry

- Speed up political decisions and actions, including the obtention of the necessary permits: speed is the key for recovery in the real economy; quick decisions and fast actions for projects which can be commenced without further delay are highly necessary;
- Invest in sectors which can quickly create a lot of jobs (e.g in particular renovation and retrofitting of buildings);
- Maintain and possibly extend the application of reduced VAT to the whole housebuilding sector;



- Complete projects which are already in the pipeline;
- Invest in infrastructure, amongst others by facilitating the participation of private capital (ex. PPPs) as public money won't be sufficient, and accelerate procedures;
- Prioritise infrastructure projects (give the priority to those already funded and ready to start);
- Promote private investments in renovation and retrofitting of buildings (through specific incentives);
- Accelerate public procurement procedures, in particular the time necessary for obtaining decisions, permits, certificates etc. from public authorities, in order to speed up the commencement of large-scale public projects: This is already proposed in the EU and in some national recovery plans for 2009 and 2010, and provided for by the public procurement Directives, although the principle that the deadlines have to be such as to allow the submission of good quality tenders must not be jeopardised under the pretext of urgency;
- Facilitate access to financing (in particular for SMEs);
- Ensure swift payment of public contracts;
- Ensure that the banks actually use the state guarantees and funds they receive for lending to enterprises and citizens;
- Ensure that central banks rate cuts are passed on to mortgage and business lenders.

On this last point, some governments have propped up the financial system under strict conditions and have already set up mechanisms to ensure that, in turn, the banks use this support to aid the real economy.

In France for instance, a mechanism of "credit mediation" has been put in place in order to help enterprises deal with financing problems with their banks. Within two and a half months of the mechanism being set up, it seems that the results are positive.

As regards the completion of ongoing infrastructure projects, this is more specifically justified by the fact that these projects are necessary to national, regional and local economic development; a lot of these projects are ready to start very quickly and they can exercise a positive effect on related sectors can act as a lever for the whole economy.

6. Element of the single market acquis that might be brought into question: the threat of Member States protectionist's reaction to the crisis

Considering the depth of the crisis and the interconnection of economies, solutions restricted to Member State economies alone are bound to fail. As no single country is strong enough to solve the crisis alone, Member States should ensure that their national recovery plans are coordinated with each other (and coordinated with the EU Recovery Plan), although set up with a certain flexibility depending on their national situation.

Conclusion:

Despite the varying national situations across Europe, EU Member States are likely to experience a slowdown of construction activity in 2009 and obviously an even stronger one in 2010. Considering the measures taken by both the EU and Member States to boost large-scale public infrastructure projects (in particular transport infrastructure) and to promote the energy efficiency of buildings as a solution to the crisis, the most affected construction area is likely to be the construction of new buildings where the demand has collapsed in most EU countries. SMEs will also be particularly exposed to economic setbacks, due to lack of liquidity, late payments of clients and the decrease/cancellation of orders. Civil engineering companies, on the contrary, are expected to benefit from public investments foreseen for (large) infrastructure projects in most of the national recovery plans.

Whatever positive outlook may be generated by the various recovery plans, it will become reality only if public authorities ensure prompt implementation of these plans. Amongst other measures, awarding authorities have to succeed in accelerating the procedures concerned – in a way that safeguards fair and transparent competition – to enable the works to commence as soon as possible. The construction industry is qualified and ready for this.