

market monitor

**Focus on construction sector
performance and outlook**





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In this issue...

Introduction	More challenges than opportunities 4
Full reports	
Belgium	Downside risks have increased 5
France	Slowdown expected across all subsectors in 2020 7
Italy	Several insolvencies of major players in 2019 9
Poland	Slower economic growth will have its impact 11
The Netherlands	Environmental issues pose a major challenge 13
United Kingdom	A mixed performance outlook with major uncertainties 15
Market performance at a glance	
	Australia 17
	Singapore 18
	Spain 19
	Sweden 20
Overview chart	Industry performance per economy/market 22
Industry performance	Changes since December 2019 24

On the following pages we indicate the general outlook for each sector featured using these symbols:



Excellent

The credit risk situation in the sector is strong / business performance in the sector is strong compared to its long-term trend



Poor

The credit risk in the sector is relatively high / business performance in the sector is below its long-term trend



Good

The credit risk situation in the sector is benign / business performance in the sector is above its long-term trend



Bleak

The credit risk in the sector is poor / business performance in the sector is weak compared to its long-term trend



Fair

The credit risk situation in the sector is average / business performance in the sector is stable

More challenges than opportunities

There are certain issues and patterns that construction industries have in common in any country, regardless of their performance in individual markets: a high level of competition, low profit margins, the fact that public buyers generally pay late and that there is a higher than average proportion of business failures. Long payment duration and cash flow problems/weak financials of smaller construction companies are issues in almost every market.

Construction remains a cyclical industry, i.e. the performance of building companies is closely linked to a country's economic growth, investor sentiment and business and consumer confidence. Therefore, current downside risks to the global economic outlook (such as an escalation of trade disputes and growing political uncertainty) that could adversely impact investments and confidence across markets, would also affect construction performance in many countries.

Belgium

- Downside risks have increased
- Insolvencies expected to increase again in 2020
- Bank financing remains an issue



Overview

Financing conditions		Business conditions		Credit risk assessment	
Dependence on bank finance	high	Profit margins: general trend over the last 12 months		Trend in non-payments over the last 6 months	
Overall indebtedness of the sector	high	General demand situation (sales)		Development of non-payments over the coming 6 months	
Willingness of banks to provide credit to this sector	low			Trend in insolvencies over the last 6 months	
				Development of insolvencies over the coming 6 months	



Source: Atradius

Despite low confidence and modest 1.4% GDP growth in 2019, the construction sector performed quite well in terms of volume, and value added increased more than 2%. Persistent low interest rates were the main driver of growth, stimulating investors to place money in residential and commercial real estate (mainly offices and logistics buildings). Prices increased in almost all real estate segments.

However, downside risks for construction performance in 2020 and beyond have increased. Belgium's economic outlook remains subdued, with annual growth rates of 1.1% expected in 2020 and 2021 (the construction sector usually follows economic cycles with some delay). Additionally, in some regions there is a potential risk of the market overheating due to an oversupply of new (overpriced) buildings.

A more difficult year ahead

After the May 2019 general elections forming a new government has proved to be difficult, and the country is still governed by a caretaker administration. For the time being, the investment policies of the incumbent or any new government (affecting public construction and infrastructure) remain uncertain. This also applies to future fiscal and tax policies (potential incentives for residential and commercial construction). The increased public construction activity starting ahead of the May 2019 federal and regional elections has meanwhile abated.

Residential construction activity is sustained by low interest rates and high demand for energy efficient buildings. However, there is some uncertainty over the impact of the phase out of the "woonbonus" (a tax reduction for mortgage loans that stimulated households to buy their own homes) in the region of Flanders since January 2020. Much depends on how interest rates will evolve. Commercial construction is impacted by the sluggish performance of the Belgian economy, hampering larger business investment.

Despite elevated working volumes seen in 2019, margins of construction businesses remained very low due to high competition, especially in the public tendering business, and the margin situation does not seem to be improving in 2020. The bargaining power of (smaller) subcontractors and suppliers has decreased. High labour costs remain an issue, and the lack of skilled staff often limits construction companies' ability to provide higher volumes.

At the same time, delays in the start-up of projects remain common. This reduces the time to prepare work since contractors need to respond swiftly once an order has been placed. In the private sector customers tend to split building projects into parts, which increases tendering costs. The final settlement of projects can take a very long time as well.

**Belgium: Construction**

	2018	2019	2020f
GDP growth (%)	1.5	1.4	1.1
Sector value added growth (%)	1.2	2.2	1.0

Average sector growth over the past 3 years (%)	2.1
Average sector growth over the past 5 years (%)	2.5
Degree of export orientation	low
Degree of competition	high

Sources: Macrobond, Oxford Economics, Atradius

Ongoing market consolidation and new working activities

The Belgian construction sector remains highly fragmented; however, consolidation in the market is ongoing. We expect that in the coming two years one in four general contractors will adapt different/new working activities to improve efficiency and productivity. Such businesses increasingly try to turn to more project development/coordination and renovation activities. Additionally the focus is increasingly on energy efficiency, sustainability, new techniques, circular construction and Building Information Modeling (BIM).

Such a shift in business activity requires sufficient financial resources, but in many cases we notice that banks are reluctant to finance those projects. This drives construction companies to

look for alternative ways of financing. Smaller companies unable to finance and/or to cope with the shift to new fields of activity/new technologies will probably lose their competitive edge (especially against larger players) and experience more troubles in the future.

A bad payment experience over the past two years

In 2019, many construction companies were still confronted with defaulting payers (high DSO), and few Belgian companies are paid in advance. In general, payment terms tend to be long in the sector, i.e. "60 days end of month" is very common.

Payment experience has been bad over the past two years, and the number of non-payment notifications in the sector was high in 2019, with no major improvement expected in 2020. Construction insolvencies increased more than 8% year-on-year between January and November 2019, higher than the average growth rate of businesses failures overall during this period. In 2020, construction insolvencies are expected to increase further, although at a lower level (up 2%-3%).

Our current underwriting stance is neutral for the residential construction segment, but rather restrictive for commercial and public construction. In order to sustain our risk appetite, it is necessary to identify the most affected companies/subsectors and to contact buyers for up-to-date financial information and performance outlooks. We examine the flexibility of companies (fixed cost structure), and whether they are able to build a buffer against potential economic downturns.

Belgian construction sector

Strengths

Demographic evolution and robust spending power of households

Aged real estate stock, high demand for energy efficient buildings

Currently low interest rates



Weaknesses

A very fragmented market – high competition – low margins

Cyclical trend in public spending and long time between tender and actual execution of public works

Temporary disruptions due to fiscal stimulus changes

High labour costs and lack of skilled workers

Source: Atradius

Performance forecast along subsectors

Residential construction



Commercial construction



Public construction



Source: Atradius

France

- Slowdown across all subsectors expected in 2020
- Deterioration of profit margins expected
- Payments take 65 days on average



Overview

Financing conditions		Business conditions		Credit risk assessment	
Dependence on bank finance	high	Profit margins: general trend over the last 12 months		Trend in non-payments over the last 6 months	
Overall indebtedness of the sector	average	General demand situation (sales)		Development of non-payments over the coming 6 months	
Willingness of banks to provide credit to this sector	low			Trend in insolvencies over the last 6 months	
				Development of insolvencies over the coming 6 months	



Source: Atradius

Growth of French GDP is expected to slow down further in 2020, and the outlook for the construction sector is rather subdued across all major segments. The French Builders Association FFB (Fédération Française du Bâtiment) estimates construction output growth at 1.2% in 2019 (after growing 2.3% in 2018 and 5% in 2017). The modest increase was sustained by non-residential works, while residential construction performed poorly (up 0.8% only).

In 2020 residential construction output is forecast to contract 1%. New housing permits are expected to decrease by about 1.5%, affecting both single-family and multi-family housing. The decline is mainly due to lower public spending. Since 2018, the scope of beneficiaries for tax exemptions (both first-time buyers and investors) has been significantly reduced, and investment in social housing has declined. Businesses active in residential construction often suffer from tight margins and working capital requirement issues.

Commercial and public construction losing steam

Non-housing construction output increased 5.1% in 2019, driven by robust demand for industrial and logistics buildings, and, on a smaller scale, office buildings (mainly in the Paris area). However, production growth is expected to slow down to 2.8% in 2020 due to decreasing demand from the retail sector, while industrial investments are hampered by modest economic growth.

The public construction segment is losing steam after two dynamic years helped by the electoral cycle. Order books are decreasing since September 2019, and output is expected to slow down in H2 of 2020. The Grand Paris project will continue to sustain the segment in the coming years. However, businesses active in this subsector already suffer from fierce competition and slim margins. The cancellation of tax breaks in 2020 will have a negative effect on companies' financials.

Construction materials value added is expected to contract 0.3% in 2020 after decreasing 0.4% in 2019. The market remains sluggish with tight margins for businesses.

While construction businesses face higher prices for commodities and energy as well as increased labour costs, they struggle to pass on those price increases due to fierce competition. Larger contractors keep putting pressure on their subcontractors. Operating margins remained tight in 2019, whereas a significant amount of cash was needed to fund order books. Cash management remains a major issue for many (mainly smaller) construction businesses, while banks are rather unwilling to provide loans to the industry. The cancellation of tax breaks (for non-road diesel fuel and social charges of construction workers) will contribute to a decrease in profit margins in 2020.

**France: Construction**

	2018	2019	2020f
GDP growth (%)	1.7	1.2	0.9
Sector value added growth (%)	0.1	1.4	1.5
Average sector growth over the past 3 years (%)			0.8
Average sector growth over the past 5 years (%)			-0.2
Degree of export orientation			low
Degree of competition			high

Sources: Macrobond, Oxford Economics, Atradius

Payment delays have significantly increased

Payments in the construction industry take about 65 days on average. The payment experience over the past two years has been rather bad, and non-payment notifications have significantly increased since H2 of 2018, reflecting difficulties in the structural works and single-housing construction segments.

According to the Banque de France, construction insolvencies decreased 6.2% year-on-year in January-November 2019. Among those that failed, companies with more than ten employees were mainly affected. Bucking the overall trend, the single-family homes segment showed a high deterioration (up 19%). While business failures decreased, payment delays increased at the same time. This reflects a situation where many construction businesses encountered only temporary cash problems in financing increased working capital requirements. In 2020 construction insolvencies are expected to level off or to increase slightly by about 2%.

French construction sector

Strengths

Structural lack of housing due to demographic developments (growing population)

Low interest rates



Weaknesses

Slowdown of economic growth

Lack of skilled workforce

Costs rising faster than prices

Downturn in the new residential market

Source: Atradius

Due to the subdued performance outlook our underwriting stance remains restrictive across all subsectors. However, we continue to provide cover to our customers whenever it is reasonable and prudent to do so.

We focus on the cash situation and loan facilities available to buyers, especially smaller and mid-sized companies. Several key financial indicators must be analysed: the level of activity, margins and ability to fund working capital requirements. High financial costs are a key indicator of potential pressure on cash. We also try to assess the ability of construction businesses to manage bigger projects than usual, as we often notice that smaller enterprises cannot cope with financial distress due to insufficient pricing and allocation of resources.

Performance forecast along subsectors

Residential construction



Commercial construction



Public construction



Source: Atradius

Italy

- Several insolvencies of major players in 2019
- The 2020 outlook remains uncertain
- Payments take more than 200 days on average



Overview

Financing conditions		Business conditions		Credit risk assessment	
Dependence on bank finance	very high	Profit margins: general trend over the last 12 months		Trend in non-payments over the last 6 months	
Overall indebtedness of the sector	very high	General demand situation (sales)		Development of non-payments over the coming 6 months	
Willingness of banks to provide credit to this sector	very low			Trend in insolvencies over the last 6 months	
				Development of insolvencies over the coming 6 months	



Source: Atradius

According to the national association of construction companies (ANCE), in 2019 construction investment increased 1.7% year-on-year, to about EUR 130 billion. However, the industry has been severely affected by insolvencies of some major players and is facing one of the most challenging periods since the 2008/2009 economic crisis. The 2020 outlook remains uncertain due to continued subdued economic growth (forecast is a modest 0.3% in 2020) and persisting political uncertainty.

Residential building investment increased 5.4% in 2019 and renovation rose 0.7, supported by fiscal incentives. However, in Q4 of 2019 the number of permissions for new houses decreased 0.9%, which indicates slower growth in 2020. The average selling price for houses decreased by more than 15% year-on-year in 2019.

Commercial construction investment increased 2.5% in 2019, but will be impacted by lower business investment in the currently feeble economic environment.

Public construction investment increased 2.9% in 2019 after annual decreases since 2016. However, this rebound was not sufficient to balance the large 51% investment decline in the period between 2007 and 2019. Uncertainty about state investment, political support for future projects as well as frequent delays in public spending cast a doubt on growth expectations in 2020.

It was announced that public tenders will rise 39% year-on-year to EUR 40 billion in 2020, mainly driven by building projects of municipalities. However, it could take years until works start,

mainly due to complicated legal compliance and delays in financial spending by the main state-owned assignors ANAS (roads, bridges, tunnels) and RFI (railway infrastructures).

Major financial difficulties for many businesses

Tight lending conditions set by banks remain a major issue for the industry, exacerbating the fact that many Italian construction businesses are highly geared. In Q3 of 2019 loans for non-residential builders decreased 30% year-on-year. By the end of September 2019 the construction sector had accumulated non-performing loans (NPL) worth EUR 16 billion, out of a total of EUR 55 billion corporate NPLs in Italy.

Financial difficulties are affecting the top-players as well as small- and medium-sized companies along the value chain. The slow or non-implementation of larger projects is a big issue. The average payment duration in the industry amounts to 200-240 days, mainly due to slow payments from public clients. Payment experience in the construction sector has been very bad over the past two years, and non-payment notifications were again at a very high level in 2019.

In 2019 five major players that were mainly involved in domestic public work went bankrupt. The main reasons were the length of the execution of public works, liquidity issues of public assignors, limited access to credit and the need to finance cash requirements through expensive instruments (such as bonds), as well as delays in works abroad (mainly in Venezuela and Algeria).



Italy: Construction

	2018	2019	2020f
GDP growth (%)	0.7	0.2	0.0
Sector value added growth (%)	1.9	3.8	1.5

Average sector growth over the past 3 years (%)	1.1
Average sector growth over the past 5 years (%)	-1.5
Degree of export orientation	very low
Degree of competition	very high

Sources: Macrobond, Oxford Economics, Atradius

The business failures of those larger players have caused trouble for many subcontractors. Outstanding receivables, stop-and-go in public works and lack of credit led to many insolvencies of small- and medium-sized businesses. We expect that in 2020 both the number of non-payment notifications and insolvencies will remain high, with larger players continuing to struggle with liquidity issues.

A very restrictive underwriting stance

The Italian government has meanwhile intervened and is trying to establish a major construction player, headed by Salini-Impregilo and involving other larger businesses. The aim is to establish a construction conglomerate, large and strong enough to better handle major public projects, and more competitive in foreign markets. However, this so-called 'Progetto Italia' project has not yet materialised.

Italian construction sector



Strengths

Rebound in the number of investments in 2019 and 2020

'Progetto Italia' could create a major player able to manage large domestic bids and to compete abroad



Weaknesses

Subdued GDP growth and unclear political strategy for future investments

Credit crunch and restrictive bank lending

Expected more insolvencies and liquidity issues for the largest players

Delay in public spending by the main public assignors, lack of large projects (above EUR 500 million)

Source: Atradius

Due to the adverse insolvency development, subdued demand, uncertainty about the future spending capacity of public bodies and their persistent bad payment behaviour our underwriting stance remains very restrictive for all the main subsectors, but especially for public construction. We are also restrictive on construction materials; however, in this segment we are seeing stable performance by high quality ceramics and tiles producers, with ongoing export opportunities.

Performance forecast along subsectors

Residential construction



Commercial construction



Public construction



Source: Atradius

The Netherlands

- Environmental issues pose a major challenge
- Payments take 60-90 days on average
- More insolvencies cannot be ruled out in 2020



Overview

Financing conditions		Business conditions		Credit risk assessment	
Dependence on bank finance	high	Profit margins: general trend over the last 12 months		Trend in non-payments over the last 6 months	
Overall indebtedness of the sector	high	General demand situation (sales)		Development of non-payments over the coming 6 months	
Willingness of banks to provide credit to this sector	average			Trend in insolvencies over the last 6 months	
				Development of insolvencies over the coming 6 months	



Source: Atradius

Dutch construction contributes approximately EUR 70 billion to, and accounts for 4.5% of GDP. The number of construction and construction-related companies grew 8% in 2019, to 216,000. Out of them about 160,000 were one-man businesses or employing just a single employee, while only 70 companies employ more than 250 people.

Construction output grew about 5% in 2019. However, the exceptionally high increase of more than 10% seen in Q1 of 2019 could not be matched during the rest of the year. In 2020, construction output is expected to increase only 0.5%.

18,000 building projects delayed by environmental issues

The main reasons for lower growth are a general slowdown of the Dutch economy, capacity problems (staff and building permission bottlenecks), and environmental issues: in May 2019, the country's highest court ruled that regulations dealing with nitrogen emissions imposed by the Dutch government in 2015 were in breach of EU laws. Therefore, 18,000 building projects worth approximately EUR 14 billion have been delayed. Additionally, new rules regarding per- and polyfluoroalkyl substances (PFAS) in the soil have led to a stop of about 70% of building projects involving soil removal.

While 2019 was a reasonably good year for residential construction, order portfolios for 2020 have shrunk, mainly due to fewer permits (down 33% year-on-year in October 2019). Housing corporations are building less, while projects are postponed due to environmental issues. Shortage of new construction sites is also a problem, mainly in the Randstad.

Demand for commercial and office buildings increased in 2019, but by the end of 2019 order backlog decreased from 10.7 to 9.4 months. Public infrastructure building is the segment most severely affected by the PFAS and Nitrogen issue. In 2020, output in this subsector is expected to shrink 3.5%.

Profit margins of construction businesses have been stable over the past 12 months, but due to the above mentioned challenges, deterioration is expected in 2020. That said, payment behaviour in the industry is still at an acceptable level, with no major increase in payment delays expected in 2020. The average payment duration in the industry is 60-90 days. Construction insolvencies (excluding one-man businesses) decreased slightly, from 306 cases in 2018 to 291 cases in 2019.



The Netherlands: Construction

	2018	2019	2020f
GDP growth (%)	2.5	1.7	1.1
Sector value added growth (%)	7.5	5.0	0.5
Average sector growth over the past 3 years (%)			8.0
Average sector growth over the past 5 years (%)			6.8
Degree of export orientation			very low
Degree of competition			very high

Sources: Macrobond, Oxford Economics, Atradius

The mid-term outlook remains moderately optimistic

Although construction activity will be much lower in 2020 than in previous years, the mid-term outlook is still moderately benign, as the current decline is not the result of low structural demand. We expect that growth will pick up again as soon as capacity issues and the nitrogen and PFAS problems are solved. In the medium- and long-term, more housing is required, and infrastructure needs to be maintained and upgraded.

Dutch construction sector



Strengths

Demographic development

Bank financing generally not an issue

Many businesses have benefited from robust growth over the past couple of years



Weaknesses

Fast solution of the environmental problems is not certain

Infrastructure building has lost steam

Overcapacity and pressure on margins remain issues

Source: Atradius

Our underwriting stance remains positive to neutral for the time being. We especially try to identify and monitor individual construction businesses that could suffer from the current decline caused by the nitrogen and PFAS issues. While we do not expect a substantial increase in construction business failures in 2020, smaller businesses, especially sole proprietorships, could find surviving a temporary backlash too difficult.

Performance forecast along subsectors

Residential construction



Commercial construction



Public construction



Source: Atradius

Poland

- Slower economic growth will have its impact
- Payments take 75 days on average
- Rising payment delays and insolvencies



Overview

Financing conditions		Business conditions		Credit risk assessment	
Dependence on bank finance	low	Profit margins: general trend over the last 12 months	➡	Trend in non-payments over the last 6 months	➡
Overall indebtedness of the sector	average	General demand situation (sales)	➡	Development of non-payments over the coming 6 months	⬅
Willingness of banks to provide credit to this sector	low			Trend in insolvencies over the last 6 months	➡
				Development of insolvencies over the coming 6 months	⬅



Source: Atradius

According to Statistics Poland, output of construction and assembly works increased 2.6% in 2019. Main contributors were ongoing road and railway infrastructure projects, residential housing, office and warehouse construction. However, as construction activity is highly correlated with the economic cycle, growth in this sector will slow down in line with lower Polish GDP growth in 2020 and 2021.

According to Statistics Poland, the number of residential buildings delivered increased more than 11% year-on-year between January and November 2019, together with a 4.5% increase in construction permits. Low interest and unemployment rates as well as quickly rising wages continue to contribute to high demand. There is currently a need for 2-2.5 million dwellings in Poland. However, due to a shrinking population the gap will narrow in the coming ten years. Despite the current robust demand, residential construction businesses have problems finding and keeping employees and with high labour and material/commodity costs.

In the commercial construction sector new office buildings increased by about 15% in 2019. Low vacancy rates encourage new investments, especially in larger cities. The number of retail-related buildings delivered increased 6% year-on-year between January and September 2019. However, market saturation of shopping centers is already high, leading to lower growth in 2020. Demand of warehouses (up 8% in 2019) is driven by logistics operators (mainly due to increasing e-commerce retail), with steady growth expected in 2020.

Infrastructure builders severely impacted by price increases

Infrastructure development is ongoing, especially railway and road construction. Planned expenditures for road construction in 2020 amount to 23.5 billion Polish zloty (EUR 5.5 billion). However, the prices companies offered for 2015 and 2016 infrastructure tenders were often far below budgets. Therefore, those long-term contracts had a negative impact on the results of general contractors in 2018 and 2019. The main reasons were significant increases in prices for construction materials (mainly asphalt and concrete), labour and subcontractors (adjusting their prices to changing conditions). Investors terminated many contracts due to slow work progress. In 2020, the profitability of public construction businesses will remain low due to still elevated input costs (material, labour, energy).

The profits of construction businesses increased in 2019 compared to 2018, but are still far from a satisfying level. The increase did not compensate for the decrease in 2018, when profits were severely impacted by substantial increases in construction material prices and expenses for wages and subcontractors. Many construction businesses suffered significant losses due to those costs, having signed project contracts with fixed prices beforehand. While the share of such unprofitable contracts decreased in 2019, price pressure remained high due to still rising labour costs (lack of qualified staff). Competition is fierce, with foreign businesses participating in tenders with low price offerings.

**Poland: Construction**

	2018	2019	2020f
GDP growth (%)	5.1	4.2	3.1
Sector value added growth (%)	17.2	4.5	3.3

Average sector growth over the past 3 years (%)	5.2
Average sector growth over the past 5 years (%)	5.9
Degree of export orientation	very low
Degree of competition	very high

Sources: Macrobond, Oxford Economics, Atradius

Suppliers, not banks, mainly finance construction businesses as the latter massively reduced their engagement in the industry during and after the last major construction crisis in relation to the UEFA Euro 2012 championship. Turnover of trade receivables and trade payables in the construction sector is longer than in other sectors. While total indebtedness of businesses is often quite high, net gearing is at an acceptable level.

High overdue payments remain common

Payments in the construction industry take 75 days on average. The payment experience over the past two years has been bad, with overdues of up to 30 days being quite common. The number of non-payment notifications is high and expected to increase by about 10% in 2020, due to lower output growth and higher input prices. Construction insolvencies are expected to increase in line with the ongoing slowdown of Polish economic growth (Polish business insolvencies are forecast to increase 3% year-on-year in 2020).

Polish construction sector

Strengths

Ongoing demand for infrastructure development

Low interest rates



Weaknesses

Slowdown of economic growth

Lack of skilled workforce

Costs rising faster than prices

Source: Atradius

Our underwriting stance for the construction industry remains generally neutral to restrictive due to the major issues ahead (GDP slowdown in the coming years, issues in road infrastructure subsector, lack of qualified staff and increase in minimal wages), and the still elevated level of credit insurance claims.

Performance forecast along subsectors

Residential construction



Commercial construction



Public construction



Source: Atradius

United Kingdom

- A mixed performance outlook with major uncertainties
- A high level of payment delays
- Insolvencies are expected to increase further in 2020



Overview

Financing conditions		Business conditions		Credit risk assessment	
Dependence on bank finance	very high	Profit margins: general trend over the last 12 months		Trend in non-payments over the last 6 months	
Overall indebtedness of the sector	high	General demand situation (sales)		Development of non-payments over the coming 6 months	
Willingness of banks to provide credit to this sector	low			Trend in insolvencies over the last 6 months	
				Development of insolvencies over the coming 6 months	



Source: Atradius

Construction activity decreased towards the end of 2019 against the backdrop of weaker economic growth and political issues (shifting Brexit deadlines and a snap general election in December). Private investors adopted a 'wait and see' approach, delaying new projects for the time being, while the commissioning of government-funded projects was also postponed.

The construction outlook for 2020 remains mixed. After the December 2019 election, the political situation is stable. On 31 January the UK left the EU with a structured withdrawal agreement. While uncertainties over the future trading relationship with the EU remain, the fact that Brexit is finally executed should support investor and, in particular, consumer confidence. Renewed consumer confidence would lift housing market activity and in turn private housing starts over the coming months. There is a shortage of housing in the UK and demand is outweighing supply. Therefore, activity in the residential construction subsector should remain reasonably buoyant in the short- to medium-term.

In the commercial construction sector, the London area remains the main driver. The value of new office project starts in the capital increased 16% in 2019 and is expected to continue rising in 2020. However, there could be more uncertainty over further business construction investment in other regions where local industries could be negatively affected by the Brexit outcome.

The public construction segment should benefit from renewed progress of public projects that were delayed ahead of the December 2019 snap election. The government has proposed in-

vestment in several major infrastructure projects (e.g. Northern Powerhouse Rail and the Midlands Rail Hub, new hospitals). The upcoming budget proposal in March 2020 should reveal more about the government's capital expenditure plans.

Shadows over future construction investments

Despite potential for further growth in the short-term major uncertainties remain. UK economic growth is forecast to slow to 1% in 2020, and the clarity over Brexit and its implications remains limited. Uncertainty remains over the shape of future trading arrangements, and many British companies will have no choice but to make key decisions without real insight into labour and material availability at the end of the transition period with the EU on 31 December 2020. At the same time public construction initiatives, including new housing and the major HS 2 project, could be impacted by delays in delivery and pressure on costs. All this casts a shadow over future construction investments.

Once the UK leaves the Single Market it is likely that the current issue of skill shortage will worsen for the construction industry, especially if there are no follow-up agreements with the EU on the free movement of people. This could result in even higher pressure on wages, causing construction firms to face considerably higher project costs.



United Kingdom: Construction

	2018	2019	2020f
GDP growth (%)	1.3	1.4	1.0
Sector value added growth (%)	-0.4	1.7	0.2
Average sector growth over the past 3 years (%)			3.3
Average sector growth over the past 5 years (%)			4.7
Degree of export orientation			low
Degree of competition			very high

Sources: Macrobond, Oxford Economics, Atradius

As more than 60% of building materials are imported from the EU, any increase in tariffs or limits on quantities imported after leaving the EU could lead to higher costs for British construction businesses and a shortage of building materials

A 5%-7% increase in insolvencies expected in 2020

The construction industry is characterised by fierce competition, especially at the lower end of the value chain (due to low barriers to entry). Liquidity remains an issue, with access to bank finance still being difficult as financial institutions want to reduce their exposure to construction and related sectors.

The average payment duration in the British construction industry is 90 days, and the level of protracted payments and payment delays remains high. After increasing in 2019, the level of non-payment notifications is expected to increase further in H1 of 2020.

British construction sector



Strengths

Supply of new housebuilding is not matching demand

Larger projects Crossrail, Thameslink, HS2 and Hinckley Point help to sustain output

Increased spending in the regeneration of major cities such as Birmingham and Manchester



Weaknesses

Continued uncertainty due to Brexit

High level of payment delays

Skills shortages across the industry

Source: Atradius

Construction insolvencies were at a high level in 2019, increasing by more than 6% year-on-year, to almost 3,200 cases. Legacy contracts were again the cause of many business failures (in the past, many businesses pursued an aggressive accounting strategy by sealing risky contracts, which proved unprofitable). Financially overstretched contractors will remain an issue in 2020, together with persistent late payments, lack of supplier support, contract overruns, higher costs and retention payment issues. Therefore, it is expected that construction insolvencies will increase another 5%-7% in 2020, across all subsectors. The increase could even be higher if a serious deterioration in economic growth and investment materialises.

We continue to underwrite cautiously, with risks considered on a case-by-case basis. Even more than in the past the requirement for up to date regular financial information supported by visits, meetings and conference calls is essential to be able to provide the most informed underwriting decision we can. We look closely at whether companies have taken into account possible project overruns and cost increases and have the necessary safeguards in place should these things happen.

Performance forecast along subsectors

Residential construction



Commercial construction



Public construction



Source: Atradius

Market performance at a glance

Australia

- Construction is a significant contributor to the Australian economy, accounting for 8.1% of GDP. It is the largest non-service related industry employing more than 1.1 million people.
- 2019 was a difficult year for the industry with lower building activity and decreasing value added (down 5.7%). Residential construction output continued to decline due to more restrictive lending practices and falling property prices. Growth in the non-residential subsector could not outweigh this decline. Fierce competition has lowered profit margins of residential construction businesses.
- The residential construction slump is expected to bottom out in early 2020. In the course of the year performance is expected to rebound, together with renovation activities, due to interest rate cuts, population growth, a rising national dwelling stock deficiency and housing stimulus.
- At the same time, commercial construction is forecast to remain robust in the medium-term, while in the public construction segment high levels of infrastructure activity underpinned by public investment are expected to continue. Demand for construction materials remains high, and value added in this segment is expected to increase almost 2% in 2020.
- Payments in the construction sector take 30-60 days on average. The portfolio payment experience has been bad over the past two years, and the number of non-payment notifications and value of credit insurance claims was high in 2019. This is expected to continue in 2020.
- Construction business failures account for about 20%-25% of total Australian business insolvencies. Underperforming projects and rising costs led to more high profile business failures in 2019. Despite signs of a performance rebound on the horizon, we expect further insolvency increases in 2020.
- Due to ongoing high levels of payment delays and increasing insolvencies our underwriting approach remains cautious, especially for small businesses active in the residential segment. Construction sector performance needs to be closely monitored given its volatility.



Australia: Construction

	2018	2019	2020f
GDP growth (%)	2.7	1.8	1.9
Sector value added growth (%)	1.5	-5.7	-4.4
Average sector growth over the past 3 years (%)	0.2		
Average sector growth over the past 5 years (%)	0.1		
Degree of export orientation	low		
Degree of competition	high		

Sources: Macrobond, Oxford Economics, Atradius

Performance forecast along subsectors

Residential construction	Commercial construction	Public construction

Source: Atradius



Singapore



- Lower global trade, ongoing trade policy uncertainty, less demand from China and the ICT downcycle have an immediate impact on Singapore's export-driven economy. Subdued GDP growth in 2019 and 2020 is impacting private construction activity in the city state.
- In the medium-term the construction sector is facing a protracted slowdown in growth. Output growth, in real terms, is expected to decrease to 2.7% in 2020 and 0.5% in 2021. Mainly affected are the residential and commercial construction subsectors. There is a slowdown in private projects, while businesses face fierce competition, tighter margins and slow payments.
- That said, the outlook for the public construction sector segment remains benign. Government investment in infrastructure and civil engineering works remains high. Annually, it is expected to be between SGD 27 billion and SGD 34 billion in 2020 and 2021. This will mainly benefit multinational building companies. Several megaprojects are currently underway or in the pipeline, including the Thomson-East Coast MRT Line, the new Tuas Mega Port and Changi Airport Terminal 5. Public sector projects are expected to account for 60% of overall construction demand in 2020.
- The profitability of many construction businesses remains low and profit margins are expected to deteriorate further in 2020. Small and medium-sized contractors in particular continue to suffer from tight cash flow and deteriorating margins. This is due to a lack of projects, increasing competition, and higher labour and rental costs.
- Singapore's construction businesses are heavily reliant on banks for loans and project funding. Government measures to cool down the property market include tighter lending criteria (such as higher deposit requirements, lower loan-to-value limits, additional stamp duty and higher interest rates) for both private consumers and developers.
- On average payment duration in the industry is 60-120 days. Payment behaviour has slowly deteriorated since 2017. Slow payments in the construction industry increased to 49% in Q4 of 2019 from 47% in Q3 of 2019, mainly due to payment delays by special trade contractors. Payment delays are expected to rise further in 2020, especially in the residential and commercial construction segments. Overall, the protracted default rate in the industry remains high.
- Construction insolvencies increased by about 5% in 2019 year-on-year, and another 5% increase is expected in 2020. Construction businesses can now choose adjudication under the recently updated Building and Construction Industry Security Payment Act (with an emphasis on debtor protection and corporate rescue), rather than resorting to litigation or arbitration. While this offers valuable breathing space and a chance of survival for struggling SMEs, slow payments continue to trouble businesses.

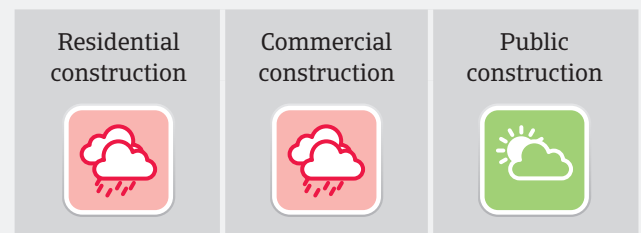
Singapore: Construction

	2018	2019	2020f
GDP growth (%)	3.1	0.7	1.0
Sector value added growth (%)	-3.7	2.8	2.9

Average sector growth over the past 3 years (%)	-5.5
Average sector growth over the past 5 years (%)	-0.6
Degree of export orientation	high
Degree of competition	high

Sources: Macrobond, Oxford Economics, Atradius

Performance forecast along subsectors



Source: Atradius

- Due to sluggish demand, tough competition, tight margins, slow payments and increased insolvencies our underwriting stance remains restrictive for the residential construction, commercial construction and construction materials segments, especially for smaller contractors. That said, we remain generally open for businesses active in the public construction segment.

Spain

- Over the past years construction investment and valued added grew at a faster rate than GDP, benefitting from robust economic growth in Spain (higher than EU average), increased foreign investment and low interest rates. However, it must be said that the construction rebound came from a very low level, following years of severe recession.
- In 2020, construction value added growth is expected to slow down, in line with lower economic expansion, and this deceleration is expected to continue in 2021. Building activity is reaching a more mature phase, with mortgage grants, sales prices and housing construction losing momentum.
- The overall situation of the residential construction market remains weak. Profit margins remain very tight despite a modest rebound in 2019 (in 2018 margins were affected by higher labour costs). Input costs remain elevated and the level of competition is high. Uncertainties in the housing market related to sales prices and lower demand remain.
- Non-residential building is not affected by rising input cost as much as residential construction is, but more modest profit returns will have a dampening effect on investments made by real estate investment trusts, funds, etc. This will lead to more moderate growth.
- It is expected that the new government will moderately increase public construction and civil engineering investment. However, uncertainties remain over political stability and budget issues (necessary deficit reduction measures)
- In the construction material subsector profit margins remain affected by increased energy costs and raw material prices. Moreover, the high average payment period of customers (mainly larger constructor companies) affects the working capital management of many small companies. Overseas markets are impacted by more uncertainty due to tariff disputes and Brexit.
- Across all subsectors many Spanish construction businesses are highly leveraged and depend on external financing, while financing demand continues to grow due to higher labour and commodity costs. Smaller companies often have limited capacity to access to new financing.
- The average payment duration in the construction industry is quite high at 100 days. Compared to other industries the level of protacted payments and insolvencies remains high. Both non-payment notifications and insolvencies increased in H2 of 2019, but are expected to level off in 2020.
- Our underwriting stance for the residential construction segment continues to be restrictive, while remaining neutral for the commercial construction, public construction and construction materials subsectors. It is necessary to contact buyers for updated financial information. Performance outlooks as well as potential changes in the current financing conditions are closely monitored.



Spain: Construction

	2018	2019	2020f
GDP growth (%)	2.4	2.0	1.6
Sector value added growth (%)	5.7	4.0	2.1
Average sector growth over the past 3 years (%)	4.8		
Average sector growth over the past 5 years (%)	3.7		
Degree of export orientation	medium		
Degree of competition	high		

Sources: Macrobond, Oxford Economics, Atradius

Performance forecast along subsectors

Residential construction	Commercial construction	Public construction

Source: Atradius



Sweden

- Total investment in domestic construction decreased 4% in 2019. Demand and margins of businesses remained stable in some segments like office buildings and civil engineering. However, the market for building new malls and hotels is increasingly mature.
- While renovation works showed a modest decline, investment in new residential buildings sharply decreased by 14%. Restrictions for consumer credits imposed on banks by the state have curbed loans to households for house buying, and some oversupply has led to falling prices. Many residential construction businesses recorded deteriorating margins in 2019.
- The 2020 domestic construction performance outlook remains subdued, as Sweden's economic growth remains modest at about 1%. Investment in the residential construction subsector is set to decline further, however the decrease will be lower than in 2019 as house prices stabilise. On the other hand, investment in public construction (mainly infrastructure) is expected to increase.
- Value added in the Swedish construction material segment is forecast to decrease slightly in 2020 (down 0.1%) after declining 0.7% in 2019. Consolidation in the market is ongoing, with financially stronger groups buying financially weaker businesses. In the mid-term construction materials should benefit from high renovation requirements in the housing segment.
- Construction businesses are often highly indebted, especially those active in the real estate and housing construction segment. Banks are reluctant to lend to this subsector, but are more willing to provide loans to companies active in other segments.
- Payment duration in the industry is 30-45 days on average. The level of protracted payments and the number of insolvencies is high compared to other industries. Both payment delays and insolvencies are expected to level off in 2020 after increasing in 2019 (construction insolvencies increased 2% year-on-year in 2019).
- Our underwriting stance remains restrictive for businesses active in residential construction and for relevant subcontractors. The subsector is impacted by tighter access to bank financing and is expected to face another decrease in demand in 2020.



Sweden: Construction

	2018	2019	2020f
GDP growth (%)	2.3	1.2	1.0
Sector value added growth (%)	3.6	1.2	-0.2

Average sector growth over the past 3 years (%)	3.4
Average sector growth over the past 5 years (%)	4.0
Degree of export orientation	average
Degree of competition	high

Sources: Macrobond, Oxford Economics, Atradius

Performance forecast along subsectors

Residential construction	Commercial construction	Public construction

Source: Atradius

- At the same time we are less restrictive on commercial construction. While this subsector is also facing decreasing demand, businesses and end-customers are generally financially healthier and have easier access to loans. That said, commercial real estate businesses that rent out to retailers could be negatively affected by decreasing brick-and-mortar retail sales.
- We are generally neutral for the construction material segment and open for businesses active in public construction, where businesses are financially stronger than in other segments.



Industries performance forecast per economy/market

March 2020

TABLE OF CONTENTS

FULL REPORTS

MARKET PERFORMANCE AT A GLANCE

OVERVIEW CHART

INDUSTRY PERFORMANCE

	Agriculture	Automotive/ Transport	Chemicals/ Pharma	Construction Const.Mtrls	Consumer Durables	Electronics/ ICT	Financial Services	F
Austria								
Belgium								
Czech Rep.								
Denmark								
France								
Germany								
Hungary								
Ireland								
Italy								
The Netherlands								
Poland								
Portugal								
Russia								
Slovakia								
Spain								
Sweden								
Switzerland								
Turkey								
UK								
Brazil								
Canada								
Mexico								
USA								
Australia								
China								
Hong Kong								
India								
Indonesia								
Japan								
New Zealand								
Singapore								
South Korea								
Taiwan								
Thailand								
United Arab Emirates								

Food	Machines/ Engineering	Metals	Paper	Services	Steel	Textiles

Excellent

Good

Fair

Poor

Bleak

TABLE OF CONTENTS

FULL REPORTS

MARKET PERFORMANCE
AT A GLANCE

OVERVIEW CHART

INDUSTRY PERFORMANCE



Industry performance

Changes since December 2019

Europe

Czech Republic

Automotive/Transport

Down from Fair to Poor

The sector is very susceptible to the business cycle, and therefore affected by the current economic slowdown. Additionally the number of payment defaults is increasing.

Metals

Down from Fair to Poor

The sector is affected by slowing demand from manufacturing, low sales prices in combination with rising costs, and high financing needs.

Poland

Electronics/ICT

Up from Poor to Fair

There remain challenges, like pressure on margins and market consolidation, but the number of VAT tax fraud legal proceedings has decreased, while private consumption and business digitalization are driving sector growth.

Slovakia

Automotive/Transport

Down from Fair to Poor

The sector is very susceptible to the business cycle, and therefore affected by the current economic slowdown. Additionally the number of payment defaults is increasing.

Metals

Down from Fair to Poor

The sector is affected by slowing demand from manufacturing, low sales prices in combination with rising costs, and high financing needs.

Turkey

Agriculture

Down from Good to Fair

The sector is highly exposed to currency volatility, and we observe a deterioration in payment behaviour, especially in the poultry and feeding stuff segments.

Americas

Brazil

Chemicals/Pharmaceuticals



Up from Fair to Good

Services



Up from Fair to Good

In both sectors the credit insurance claims situation has improved, and they will benefit from the economic rebound expected in 2020.

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Atradius N.V.
David Ricardostraat 1 · 1066 JS Amsterdam
Postbus 8982 · 1006 JD Amsterdam
The Netherlands
Phone: +31 20 553 9111

info@atradius.com
www.atradius.com