



# market monitor

Focus on construction performance and  
outlook



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



Excellent



Good



Fair



Poor



Bleak



# More solid foundations

After the major shake-up of the global construction industry caused by the 2008 financial crisis, a return to economic normalcy has become visible, albeit at varying degrees across regions and countries.

Developed markets are set for a more positive near-term outlook than in previous years, as the fallout from the global financial crisis recedes, household incomes recover, and public finances improve. It seems that in countries like France, Italy the Netherlands and Spain the construction recession has started to bottom out, while the US and Germany already record persistent growth.

At the same time, the current economic slowdown in China has consequences on construction performance in other countries, as it triggered decreasing commodity demand and prices. Mining construction in Australia is an example showing how the building industry and major commodity exporters are negatively affected by China's slowdown. The sharp decline in oil prices impacts

construction in a positive and negative way: while it seriously hampers building activities in oil-producing countries like the United Arab Emirates and has hit the energy-related construction segment in the US hard, it could help construction activity in other markets indirectly, by relieving public budget burdens (e.g. in India it leaves more room for infrastructure spending) and by increasing disposable household incomes. Additionally, oil-related construction materials have become cheaper.

However, while construction businesses in most countries covered by this Market Monitor benefit from lower commodity prices, the positive effect on their financials is mostly offset by high competition and pressure on prices, which continue to strain profit margins. Late payments and cash flow problems of smaller players remain an issue for the industry. While construction insolvencies are expected to level off or even to decrease in many countries, the proportion of business failures in this sector is still higher than in most other industries.

# France

- Construction activity decreased 3% in 2015
- Still a high level of payment delays
- A modest rebound expected in 2016



## Overview

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

Source: Atradius

Construction accounts for 4.9% of French GDP, with 540,000 companies employing about 1.5 million people. The sector consists mainly of small businesses (about 95% of construction businesses have 1-10 employees), with just about 200 companies employing more than 200 people, and some larger, internationally active players like Bouygues, Vinci and Eiffage.

According to the French builders association FFB (Federation Française du Bâtiment), in 2015 French construction activity continued to deteriorate (down 3% in volume), the seventh year of decrease since the major recession of 2008. The sector was negatively impacted by still sluggish economic growth (0.2% in 2014 and 1.1% in 2015), low household purchasing power (due to persisting high unemployment and unfavourable fiscal measures) and public budget spending constraints – all hampering construction investment.

According to FFB, new residential construction output decreased 3.9% in volume in 2015, with the number of housing starts remaining low. In the non-residential subsector public construction decreased 18%, while the private segment recorded a 6.6% decline. The level of activity, employment, backlog and production capacity remained very low compared to the long-term average.

Given the poor construction performance and low demand in previous years, it comes as no surprise that French construction businesses face many difficulties. Revenues and investments are low, competition is fierce, and prices and profitability are both being squeezed. Major players keep putting pressure on their subcontractors, and banks remain very selective with their loans, making access to short-term credit difficult. Additionally, the financial situation of construction businesses is often impacted by the 'scissor effect' of low margins and long payment delays.

### France: construction sector

	2014	2015f	2016f
GDP growth (%)	0.2	1.1	1.3
Sector value added growth (%)	-0.7	-0.6	1.6
Sector share in the national economy (%)	4.9		
Average sector growth over the past 3 years (%)	-1.0		
Average sector growth over the past 5 years (%)	-1.7		
Degree of export orientation	very low		
Degree of competition	high		

Sources: IHS, Atradius

The adverse market conditions with strong competition and feeble demand prevent companies from price increases, while high personal costs weigh on businesses' budgets. Due to continued difficult access to short-term credit facilities, cash management remains a major issue. In 2015 both non-payment notifications and insolvencies increased further.

In 2016, construction output is expected to rebound 2.5%, with residential construction activity expected to grow 5.5%, helped by government support for new buildings and modernisation (e.g. tax exemptions and reductions for real estate investors and first-time buyers and VAT reduction for finishing) and increasing loans for real estate acquisitions by private households. That said, non-residential construction activity is expected to remain subdued, especially in the public construction segment. Public works will likely continue to suffer from poor investments: The

government has reduced funds allocated to local authorities by nearly EUR 12 billion from 2015 to 2017 (approx. EUR 4 billion per year) as part of an overall cost cutting program of EUR 50 billion over three years to tackle the public deficit. Maintenance, renovation and repair are expected to increase 0.4%. While both non-payment notifications and insolvencies are not expected to increase further in H1 of 2016, their level will remain high.

Despite the expected rebound, we must remain cautious in our underwriting stance, but we still provide cover to our customers whenever it is reasonable and prudent to do so. We closely monitor and review buyers to anticipate potential high risks to our customers. 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.

### French construction sector



Strengths

Structural lack of housing due to the demographic development (growing population)

Still low interest rates



Weaknesses

Feeble economic growth and measures to curb the high public deficit

High unemployment

Costs rising faster than prices

Source: Atradius

# Germany

- Growth expected to accelerate in 2016
- Poor payment behaviour of public buyers remains an issue
- Decrease in insolvencies slowing down



## Overview

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

Source: Atradius

The German construction sector accounts for 3.3% of German GDP. Within the industry, 90% are small businesses (less than 20 employees) accounting for 45% of total construction turnover. 35% of sector turnover is realised by companies with 20 to 100 employees, and the remaining 20% turnover share is generated by large companies with more than 100 employees. Small companies are mainly focused on residential construction (about 70% of operations), while large building companies generate most of their turnover abroad.

The performance of the German construction sector continued to be positive in 2015, although turnover growth slowed down to 1% after a 4.1% increase in 2014. According to the German Builders Association, turnover growth will increase 3% in 2016, to EUR 103 billion. Residential construction is expected to increase 5%, driven by a high employment rate, low interest rates and the need to provide new housing for the high number of refugees

and asylum seekers. Public construction is expected to increase 4% due to higher infrastructure investment, while commercial building output is forecast to level off this year.

On average, payments in the German construction sector take around 45-50 days. Instances of payment default decreased again in 2015, and this positive trend is expected to continue in H1 of 2016. Construction businesses' dependence on bank finance is not overly high, given that payments in advance or instalment payments by investors are a major source of financing.

However, the poor payment behaviour of public buyers still remains an issue, as it puts a strain on suppliers' liquidity. With demand increasing and profit margins stable, construction insolvencies have decreased in recent years and are expected to decline further in 2016, in line with the overall trend in Germany (business insolvencies in Germany are expected to decrease 2%

**Germany: construction sector**

	2014	2015f	2016f
GDP growth (%)	1.6	1.7	2.0
Sector value added growth (%)	2.7	2.5	4.1
Sector share in the national economy (%)	3.3		
Average sector growth over the past 3 years (%)	1.3		
Average sector growth over the past 5 years (%)	3.2		
Degree of export orientation	low		
Degree of competition	high		

Sources: IHS, Atradius

in 2016 after a 5% decline in 2015). However, the proportion of insolvencies in the construction sector is still higher than in other industries. According to Creditreform, in H1 of 2015 there were 95 insolvencies per 10,000 firms in the construction industry, compared to 43 per 10,000 in the manufacturing sector.

Due to the good performance of the German construction and construction materials sector in the last couple of years and the promising business outlook for 2016, our underwriting stance for the industry remains quite relaxed. In general, when assessing buyer risk we take into account operating results, equity, liquidity and financing (e.g. the ratio of work in progress/advanced payments) and orders in hand.

Despite our broadly open stance, we still consider the construction sector to be a riskier than other industries. Many construction companies – especially smaller ones – traditionally have weak equity ratios (the proportion of equity used to finance a company's assets) and limited financial scope. With less back-

ground information to work with, we are naturally very cautious when assessing the creditworthiness of construction/construction materials businesses that have operated for less than one year, unless they are part of, or a spin off from, a larger group. Where we identify poor creditworthiness and negative operational results, our underwriting stance is naturally very restrictive.

Businesses that are mainly active for public customers (road and railway and other infrastructure construction) often face delayed payments by their clients, which could put a strain on their liquidity. Therefore, our underwriting approach towards this segment is more cautious, and we hold additional reviews.

**German construction sector**

Strengths

**Solid performance since 2010 helped by a robust German economy**

**Significant amount of specialisation, mainly in construction services**

**Strong in technical innovations especially in the area of energy-efficiency**



Weaknesses

**Very high number of small companies active in this sector**

**Limited access to international capital markets**

Source: Atradius



# Italy

- The recession is expected to have bottomed out
- Smaller players still face more troubles
- Banks remain reluctant to lend



## Overview

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

Source: Atradius

The Italian construction sector accounts for 4.8% of the country's GDP. The industry was severely affected by the economic downturn in recent years, with yearly GDP contractions between 2012-2014. Since the global credit crisis in 2008, Italian construction lost nearly 50% of production value and 69,000 employees due to the economic slump, decreased public spending, declined private investment and a profound credit crunch.

However, not all businesses have been equally affected by the downturn. Most large construction companies have proved to be resilient due to their portfolio diversification of infrastructure works and export orientation. For example, in 2014 construction turnover generated by exports increased 9.7%, partly compensating for the slowdown of domestic turnover (down 6%). While this mainly benefited larger players, construction cooperatives and consortiums focused on the domestic market and dependent on public works have been severely hit by deteriorating de-

mand and decreasing bank loans. Another major issue are late payments from public bodies, with an average payment duration of 177 days and unpaid bills amounting to EUR 8 billion in 2015. Small and medium-sized businesses focused on residential construction was the business segment most severely affected by the decline, due to decreased investment in private housing and restricted bank loans. The only exception was renovation works supported by government incentives.

Since the end of 2014 deterioration in the Italian construction sector started to slow, as the economy rebounded modestly (GDP grew 0.7% in 2015). According to the Italian Statistics Institute ISTAT, contraction in construction production slowed down to 2.6% year-on-year in January-October 2015, after a 6.9% decline in January-October 2014. However, market indicators remain negative for investments in public housing and public infrastructure spending.

**Italy: construction sector**

	2014	2015f	2016f
GDP growth (%)	-0.4	0.7	1.0
Sector value added growth (%)	-6.9	-1.3	1.8
Sector share in the national economy (%)			4.8
Average sector growth over the past 3 years (%)			-6.2
Average sector growth over the past 5 years (%)			-5.2
Degree of export orientation			very low
Degree of competition			high

Sources: IHS, Atradius

In 2016 the Italian economy is forecast to grow 1%, and construction production is expected to decrease only 0.5%. Investments are expected to increase 3.2%, driven by public investments and by investments for extraordinary maintenance of existing buildings (up 1.5%), while investments in new housing is expected to decrease again (down 3%).

Construction insolvencies still increased in 2015, among them three established building consortiums. Business failures are not expected to decrease substantially in 2016 and to remain on a historically high level – in contrast to the forecast for all Italian business insolvencies, which are expected to decrease 4% in 2016. Cooperatives and SMEs focused on domestic residential construction remain highly exposed to the risk of business failure. Trade payables and receivables days are expected to remain long, with no remarkable improvement in liquidity and in the payment performance of the industry.

Banks are still very restrictive when it comes to providing loans to construction businesses, while loans for private housing projects also remain subdued – although the European Central Bank's Quantitative Easing programme is addressed to inject liquidity and encourage investments. Many businesses in the sector remain highly geared.

Therefore, our underwriting stance remains restrictive. It seems that the recession has bottomed out, but a profound recovery is not yet on the horizon. However, underwriting is more open for construction players who are export-oriented and less dependent on the domestic public sector.

When underwriting construction businesses, we pay special attention to the quality of the credit portfolio, the order situation and the coverage with prepayments, the amount and maturity of debt, and the ability of cash flow to cover investments and service debt. Financial leverage has to be coherent with available liquidity and equity consistency. With more sensitive and large cases, there are meetings with buyers to get a better insight into their business and financial strategies.

**Italian construction sector**

Strengths

**Larger players benefit from export demand**

Weaknesses

**Still weak domestic demand****Restrictive bank lending****Smaller businesses lack financial resilience**

Source: Atradius

# The Netherlands

- A one-sided recovery
- Margins remain under pressure
- Consolidation has yet to take place



## Overview

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

Source: Atradius

Following two years of contraction, the Dutch construction sector finally rebounded in 2014, with turnover growing 1.5%. This recovery continued in 2015, in line with the pick-up of economic growth in the Netherlands (GDP up 2.1%). It is estimated that construction production volumes increased 3% in 2015, and further growth is expected in 2016. Home prices have recovered, and the sentiment of many construction companies has turned to be more positive, with businesses expecting revenue increases.

That said, the recovery has started from a very low basis, as in 2014 construction volumes were still more than 20% lower than in 2008. The number of finished residential buildings decreased by about 60% between 2009 and 2014. At the same time, the recovery in the Dutch construction market remains one-sided, driven mainly by growth in the residential construction segment, while the non-residential subsector, especially the infrastructure and utility construction segments, still face modest demand.

Residential construction output is expected to have grown 6% in 2015, and a growth rate of more than 3% is forecast in 2016. In the coming years the demand for newly built homes is expected to be structurally higher than during the crisis.

The infrastructure segment has also partly benefited from improving market conditions, but strongly depends on the government as its main client and could be therefore negatively affected by any measures to trim the public budget. Competition between businesses in the infrastructure construction segment remains very fierce. At the same time, the utility construction sector still suffers from an imbalance between supply and demand.

Many businesses active in this segment still show decreasing revenues with strong pressure on their margins. A positive exception is the increase in newly built logistics centres and an increase in the number of renovation and transformation projects.

**The Netherlands: construction sector**

	2014	2015f	2016f
GDP growth (%)	1.0	2.1	1.7
Sector value added growth (%)	3.6	4.3	2.6
Sector share in the national economy (%)			4.5
Average sector growth over the past 3 years (%)			-2.9
Average sector growth over the past 5 years (%)			-2.9
Degree of export orientation			very low
Degree of competition			very high

Sources: IHS, Atradius

The Dutch construction sector is expected to show an average growth rate of about 2% in the coming years, given that economic growth remains robust.

Due to the construction recovery, a decrease in non-payment notifications and credit insurance claims was recorded in 2015, and it is expected that non-payments and insolvencies will further decrease in H1 of 2016. However, the on-going strong competition in the market indicates that many Dutch construction businesses remain affected by price wars, leading to on-going pressure on margins. In the past years of downturn, the liquidity of many companies has weakened due to losses and impairments, straining both solvency and liquidity. At the same time, loan policies of banks towards construction companies continue to remain rather restrictive for the time being. As a result, businesses' focus is still on cash flow and working capital - and on tighter credit management. Despite the fact that many Dutch construction businesses went bankrupt in the last couple of years, there is still overcapacity in the market, and a consolidation has yet to take place.

While having slightly increased our risk appetite for Dutch construction businesses in 2015, we still maintain a cautious underwriting stance due to the still difficult market conditions. This approach is underlined by the fact that major insolvencies are still an issue despite the overall decreasing trend, such as the recent bankruptcy of the large technical service provider Royal Imtech N.V.

When assessing a buyer's creditworthiness, we require up-to-date financial information, and details of the 2015 order book and payment experience. Additionally, we seek details on a company's financing (covenants/securities) and the maturity dates of bank loans. Our aim is still to maximise the insurance cover we can give our customers, and in this respect third party securities, if available, can help.

**Dutch construction sector**

Strengths

Economic rebound underway

Flexible work force (cost structure)

Demographic development



Weaknesses

Overcapacity and pressure on margins

Restrictive bank lending

Non-residential segment still faces difficulties

Source: Atradius

# United States

- The robust performance is expected to continue in 2016
- Payments take between 30-60 days on average
- Still many foreclosures in some states



## Overview

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

Source: Atradius

In 2015 the US construction sector continued its rebound that started in 2012, with increases in both employment and reported billings, and there is a sense of optimism among construction industry executives that growth will continue for the foreseeable future. The Wells Fargo Equipment Finance's Construction Optimism Quotient among US contractors and equipment distributors reached new highs in three of the last four years, culminating in a record high for 2015.

Residential construction is estimated to have grown 8% in 2015 and is expected to remain robust through 2019. Foreclosures have decreased 19% over the past 12 months, with foreclosure filings in August 2015 on just 1 in 1,205 houses. Non-residential construction had its second best year since 2002, with reported spending increased by more than 8% year-on-year. The US construction equipment market saw improvements in 2014 and 2015, and expectations remain strong for equipment rental. Construction industry unemployment rates further declined,

narrowing the gap between it and the national unemployment rate. According to the US Bureau of Labor Statistics, the unemployment rate in the construction sector declined from 8.3% in December 2014 to 7.3% in December 2015. Unemployment rates in the construction industry are at the lowest levels since 2007.

In 2016 construction production is expected to grow further, as US economic growth is forecast to increase 2.9%, driven by robust private consumption expansion and rising investment. Construction output is expected to grow around 5% in 2016 and 2017 respectively. Accelerating job growth and decreasing unemployment, increasing new-home construction, and lower construction input prices have all increased the likelihood of construction projects advancing. Banks are principally willing to lend to the construction industry, but only for viable and promising projects. As the commercial and residential development markets strengthen, the construction sector's financing climate is improving.

**United States: construction sector**

	2014	2015f	2016f
GDP growth (%)	2.4	2.4	2.9
Sector value added growth (%)	0.7	3.0	8.0
Sector share in the national economy (%)	3.3		
Average sector growth over the past 3 years (%)	1.7		
Average sector growth over the past 5 years (%)	0.1		
Degree of export orientation	average		
Degree of competition	high		

Sources: IHS, Atradius

Payments in the US construction industry still take 30-60 days on average, while 90 day terms are not uncommon. The overall number and the value of late payment notifications we received in 2015 has decreased, as did insolvencies. Given the positive growth prospects for the industry, we expect notifications of late payments to decrease further in H1 of 2016. In line with the overall trend in the US, construction insolvencies are also expected to decline further, but at a slower pace than in 2015. Small businesses in the industry are generally still paying later and have higher bankruptcy rates and delinquent debt than other industries. At the same time increasing salaries, healthcare costs for staff and miscellaneous expenses continue to affect margins. While foreclosure rates have decreased in general, states such as Maryland, Florida, New Jersey, and Nevada still record high delinquency rates. At the same time, building segments dependent on the energy sector continue to suffer from sharply decreased investments.

Due to the positive development, we have steadily increased our risk appetite for the industry over the past few years. But given the problems mentioned above caution is still advised, especially with smaller construction businesses. When available, financial statements are to be reviewed annually with supplemental soft

credit information reviewed more frequently. Trading experience will be used to gain a better comfort level in gauging the relationship between our customers and their buyers. Reduction or withdrawal of cover is considered if the buyer shows significantly worsening results, including losses, heavy debt levels, problems with working capital, cash flow or liquidity or deteriorating payment trends. We look for signs of progressive and profitable operations, positive working capital and cash flow, and satisfactory debt to net worth leverage. We also take into account less measurable aspects such as goodwill, health/pension liabilities, and litigation issues.

**US construction sector**

Strengths

Construction input prices, especially in non-residential construction, have decreased

Construction benefits from accelerating job growth and decreasing unemployment

Builders are expected to increase the pace of new-home construction in 2016



Weaknesses

Downward pressure on revenues has continued

Many prospective workers lack the necessary skills to fill various openings creating skill mismatches

Rising home prices and tight lending standards create a prohibitive environment for first-time home buyers

Source: Atradius

# Market performance snapshots

## Belgium

- Growth expected to remain subdued in 2016
- Low public construction investment
- Level of payment delays and insolvencies remains high



The rebound of the Belgian construction sector remains slow, as the industry is still underperforming compared to the rest of the economy. Since the end of 2011, 20,000 construction jobs have been lost, down to about 200,000 by the end of 2015. Belgian construction businesses suffer from high labour costs, especially when compared to construction businesses from Eastern Europe active in Belgium. Public initiatives to restrict unfair competition from foreign businesses and to reduce domestic labour costs in order to increase competitiveness had no real success so far. Construction output is expected to grow by just about 1% in 2016, and pressure remains on businesses' profit margins.

Perspectives in the new residential construction segment remain subdued, with the number of permits for residential buildings recording a year-on-year decline in 2015. However, 2014 had been an exceptionally positive year, with the number of building permits up in the first half of 2014 as many households had filed requests before the end of 2013 in order to avoid stricter energy regulations. Most construction companies in this segment expect a decrease in the construction and completion of new buildings in 2016. Prospects for renovation businesses are more positive, with orders showing an increasing trend due to the aged real estate stock in Belgium.

In the non-residential construction sector, we have noticed a year-on-year decrease in the number of permits in 2015. Government investment remains low (1.7% of GDP) compared to the European average (3% of GDP). Infrastructure building is still facing decreasing order books and prices. The public tendering business seems to be most affected in Wallonia.

Payment terms of "60 days end of month" remain very common in the sector. However, some construction contractors (mainly large businesses) are trying to solve their liquidity issues by extending their payment terms even longer when paying their subcontractors. Payment behaviour of public bodies remains bad, and it is still quite common that businesses ask suppliers for longer payment terms if they themselves are waiting for overdue payments from public bodies.

Overall, we observed an increase in payment delays in 2015. Given the difficult market conditions, the number and amount of notifications of non-payments is expected to remain high.

In 2015, 1,868 construction companies went insolvent: an 8% year-on-year decrease. Construction accounted for 18% of all Belgian business insolvencies. We expect business failures to decrease further in 2016, although at a slower pace. Despite the decreases, the overall level of construction insolvencies remains high, given the steady increases seen in the years 2008-2013. We noticed that construction businesses increasingly apply for protection against suppliers according to the Wet Continuïteit Ondernemingen (WCO) regulation, the Belgian equivalent of the Chapter 11 procedure under US law.

That said, our prudent underwriting stance should allow us to maintain our current level of engagement. 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 have conducted review actions in particular for subsectors (infrastructure works and metal manufacturing/metal construction) due to rising credit insurance claims.



## Spain

- Finally a rebound is underway
- Still very long payment terms
- Current political uncertainty has a dampening effect



The Spanish construction sector's contraction bottomed out in 2015, with a 0.3% contribution to GDP growth. In 2016 a robust output growth of about 4% is expected, followed by 5.5% in 2017. This upswing is due to Spain's economic recovery, more foreign investments and a return of business confidence. Lower commodity prices have also had a positive impact on the current rebound. However, it must be said that the current construction recovery comes from a very low level following years of severe recession.

Residential construction is expected to grow by more than 4% in 2016 and 2017 due to increasing demand in big cities such as Madrid and Barcelona, where the economic recovery is well ahead of the rest of the country. However, a volatile job market could weigh on demand.

After contracting in 2015, commercial construction is expected to grow 2.5% in 2016. The key to a real improvement in this segment will be the recovery of enough demand from the commercial sector (shops and offices) to justify the launch of new projects.

Public construction has experienced a revival in 2015 as a result of the general elections in December, with growth estimated at 6%. However, a continuation of the current political uncertainty with a hung parliament could affect investments. At the same time, there is still a great deal of uncertainty about any new government's infrastructure development plans for the future.

Competition in the industry has ceased, as a large number of players have left the market since 2008. In 2015 construction businesses' profit margins improved slightly, and this positive

trend is expected to continue. Spanish residential, non-residential construction and civil engineering are highly dependent on bank funding. In this respect, conditions for external financing have improved in 2015 due to lower country risk and better growth prospects for the Spanish economy.

Payments still take more than 100 days on average, as construction has always shown longer payment periods compared to other sectors. However, in the last two years we have seen a slight reduction in payment duration, and no increase in payment delays was recorded in 2015.

Construction insolvencies continued to decrease by 25% in January-September 2015. Due to lower leverage of businesses and the positive growth outlook we expect business failures to decrease further in 2016, by about 10%-15%.

Due to the rebound, our underwriting stance for the construction sector has become less restrictive than in previous years. However, we are still prudent as the market has not yet fully consolidated and lending conditions have not yet fully eased. Due to the still high indebtedness of many businesses active in residential and commercial construction, we are still cautious with those sub-sectors, and the same accounts for real-estate developers. Public construction could be negatively affected by lower government investment in case of on-going political uncertainty.



# United Kingdom

- Many insolvencies in 2015
- Still very long payment terms
- Solar sector-related segment under threat



The UK construction sector accounts for more than 6% of British GDP, and employed 2.1 million people in 2015. The industry suffered heavily after the 2008 credit crisis, but rebounded in 2013 and 2014. However, this recovery lost some steam in 2015, with construction output decreasing 2.2% in Q3 of 2015, and activity increasing again towards the end of the year. Skill shortages often lead to the postponement of construction projects.

Despite the overall rebound in output, construction is still affected by trailing effects of the past recession. This became evident in H1 of 2015, when construction insolvencies increased steeply. Some larger business failures had a knock-on effect causing their suppliers and subcontractors to go bust due to large sums of monies owed.

The on-going problems are particularly noticeable in the tendering process, as during the downturn, construction companies took on contracts at conditions that were no longer sustainable in 2014 and 2015, mainly due to raw material price increases and higher labour costs. As many construction businesses are still working on such low margin legacy contracts, losses on contracts are still relatively frequent despite improving forward order books. Late payments remained a major issue in the industry, especially from Tier 1 contractors, who have issues with legacy contracts themselves. Non-payment notifications showed an increasing trend in 2015, and are expected to remain high in 2016.

At the same time, access to bank finance remains difficult for many smaller businesses or businesses subject to unattractive terms. This lack of funding affects SMEs that may need to resume investment, particularly in capital expenditure to cope with a growing market.

Due to the upward trend in construction output since 2013/2014, builders are now able to be more selective in choosing which contracts to tender, and therefore have more influence on payment terms. However, this is somehow counteracted by increased labour and material costs, which have a negative effect on businesses' margins. Construction insolvencies are expected to level off in 2016 after the increasing trend in 2015.

After increasing our risk appetite in 2014, we have turned to be more restrictive again in our underwriting stance since early 2015, when construction business failures started to increase again. We will maintain a cautious stance on the industry in the coming months, with risks considered on a case-by-case basis. The speed of deterioration seen with some of the recently failed construction businesses highlights the need to receive the most updated management accounts from buyers. Regular provision of management accounts enables us to make a more informed decision on credit limit applications and ensures that decisions are as current as possible.

We are currently especially cautious with construction businesses highly dependent on the UK solar sector, which is threatened by a major downturn after the government decided to cut the Feed-In Tariff by more than 80%. Insolvencies have already increased in this segment since the end of 2015.



## Market performance at a glance

### Australia



- Construction performance in Australia remains subdued, mainly due to the massive decrease in mining-related heavy industrial, rail and port infrastructure construction activities after the end of the commodity boom.
- Business construction has contracted in 2015, but an upturn is expected in the medium-term, driven by higher investment and increased economic growth. Residential building spending is expected to increase further in 2016, fuelled by low interest rates, pent-up domestic demand and foreign investment.
- Payments in the construction sector take between 90-120 days on average. Notifications of non-payments have increased and the current level is high.
- Construction insolvencies are expected to level off in 2016, but the overall level remains high. Debt levels have increased and margins have decreased, especially for smaller businesses with little ability to differentiate themselves, and which therefore rely on price competition in order to acquire orders.
- Our underwriting approach remains cautious, especially for small businesses and the mining-related segment.
- Besides focusing on the type of construction subsector it is also important to take into account regional differences, e.g. while engineering construction in Queensland and Western Australia remains subdued, it is expected that in New South Wales it will benefit from infrastructure investments (roads, telecommunications).

### India



- The Indian construction sector has been facing challenging times in recent years due to slow reforms, weak investment cycles, subdued business confidence, and delays in land acquisition/clearance processes.
- The outlook for 2016 has improved due to a better business environment and large infrastructure projects launched by the new government.
- On-the-ground, recovery is expected to be a gradual process as the sector still deals with structural constraints.
- Construction companies remain highly leveraged, and obtaining financial support for projects remains a challenge. However, banks have increased loans to the sector.
- Payments in the construction sector take between 90-120 days on average.
- We continue to maintain a cautious approach in underwriting this sector.
- Besides financial information, we assess trading experience with buyers and monitor any changes in payment behaviour. We also assess the strength of the customer-buyer relationship.
- We would generally not encourage customers to lengthen their normal terms of payment.

## Japan



- The short-term outlook for the Japanese construction sector remains positive, as the industry will benefit from increasing demand, triggered by a rebound in residential construction and projects related to the 2020 Tokyo Olympics. There are also some other major long-term projects such as the Maglev railway, upgrades to highway networks, and a new rail link to Haneda Airport in Tokyo.
- Profit margins of businesses have improved, as labour costs have not risen so far and material costs have remained stable. It is expected that the margins improve further in 2016.
- The general willingness of banks to lend to this sector means that there is additional financing easily available for companies that are not heavily indebted.
- Payment duration in the industry is 90-120 days on average. Payment experience has been good over the past two years.
- Construction insolvencies remained stable year-on-year in 2015 and are expected not to increase in 2016 due to increased building demand and the stabilisation of input prices.
- Our underwriting stance on construction is generally open. However, smaller businesses with weak financials could face some difficulties in 2016 due to the overwhelming dominance of four major construction firms and the potential increase in low-priced tenders.
- More caution is advised for construction materials exporters dependent on the Chinese market.
- A planned consumption tax hike to 10% in April 2017 could derail the positive outlook earlier than expected. Smaller players would also be less able to cope with a potential rise in labour costs due to a lack of workforce.

## Mexico



- Mexican construction output grew 3% in 2015, with both residential and non-residential construction recording increases. Growth was mainly driven by private investment. Housing construction has rebounded due to the low interest rates on mortgage loans, increased funding for housing companies and increased subsidies.
- In 2016, construction output is expected to grow at the same rate as in 2015. The energy sector reform and a national infrastructure plan should boost the construction of pipelines, power plants and airports. The 500 most important projects planned for 2016 would amount to Mexican pesos 446 billion (EUR 24 billion).
- However, a further decline in oil prices, slower US growth, uncertainty about interest rates and currency volatility could derail the performance of the sector in 2016.
- On average, payments in the construction industry take 45-120 days. It is common for buyers in this sector to pay slowly, especially in the public infrastructure segment. In 2015 payment delays by public bodies and state-owned enterprises increased.
- Considering the potential impact of the still uncertain domestic and international environment on the construction industry, we maintain our 2016 performance outlook of 'poor' for the time being.

## Turkey



- Turkish construction growth slowed to 1% in 2015, as investments and purchasing activities were negatively affected by political uncertainty around the two general elections held in June and November 2015. Another negative factor was the sharp depreciation of the Turkish lira.
- In 2016 the sector is forecast to grow 2.5%, as the risk situation in public construction has eased somewhat, while residential construction still struggles with overhead supply.
- Profit margins have deteriorated in 2015 due to increasing labour and raw material costs and exchange rate volatility. Additionally, with too many players in the market, a serious supply-demand imbalance was observed in 2015, causing severe price wars.
- Bank loans to construction businesses have sharply increased since 2010, and account for more than 10% of total bank loans. Due to the high indebtedness in the construction sector, businesses have to provide significant collateral when lending.
- Payment duration in the industry is 120-180 days on average. Payment experience has been bad over the past year, and non-payment notifications and insolvencies increased in 2015 due to the high indebtedness of businesses. Non-performing loans in the construction sector amounted to EUR 1.3 billion in November 2015 (3.% of all loans in this sector).
- It is expected that non-payments and insolvencies will level off in 2016.
- Our underwriting stance on construction companies remains restrictive, with the exception of businesses related to strong groups and companies without liquidity problems.
- Caution is also advised for companies doing business in Russia and Iraq.
- In the medium- and long-term, the sector should benefit from population growth and urban development.

## United Arab Emirates



- The sharp decrease in oil prices has a negative impact on construction activities in the UAE. The government as the largest sponsor of construction (especially infrastructure) is facing a deterioration of its fiscal position due to decreasing oil revenues. Commercial and residential construction are facing headwind due to reduced demand and a cooling down of the real estate market.
- Decreasing demand, payment delays and strong competition have led to an erosion of businesses' profitability - both in terms of reduced margins as well as increased provisions towards bad debts.
- Construction businesses are largely dependent on banks to fund their working capital requirements. However, banks have become very restrictive on lending due to the low demand situation and the fact that many construction businesses are already highly geared.
- Payments in the construction sector now take between 90-180 days on average (after 90-120 days in early 2015). Due to the current liquidity squeeze, many players are delaying payments. This has a knock-on effect on the trade cycle, with many smaller players struggling to meet their payment commitments. Non-payments are expected to increase by more than 30% in the coming six months, and business closures are also on the rise.
- Due to the current challenging business environment, we have decreased our risk appetite in all construction subsectors. We are especially cautious on large buyers with sizeable exposure to government projects, buyers operating in the infrastructure segment, and businesses operating in oil field support services.



# Industries performance forecast per country

February 2016

	Agriculture	Automotive/ Transport	Chemicals/ Pharma	Construction Const.Mtrl	Consumer Durables	Electronics/ ICT	Financial Services
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	N/A						
India							
Indonesia							
Japan							
New Zealand							
Singapore							
Taiwan	N/A						
Thailand							
United Arab Emirates							

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Food	Machines/ Engineering	Metals	Paper	Services	Steel	Textiles

Excellent

Good

Fair

Poor

Bleak

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# Industry performance

## Changes since December 2015

### Europe

#### Denmark

##### Construction/Construction Materials



Up From Poor to Fair

Both residential and non-residential construction have rebounded in 2015, and insolvencies have decreased. We have increased our risk appetite for this industry.

#### Germany

##### Agriculture



Down from Good to Fair

Sales have sharply decreased in the dairy and meat segments, while prices for cereals and animal feed declined. The sector is affected by the on-going Russian import ban and decreasing demand from China.

#### Portugal

##### Food



Up from Fair to Good

The industry has shown a robust performance in 2015, and the number of businesses active in the food sector has increased.

##### Services



Up from Fair to Good

The tourism segment has grown in the past few years, and is expected to continue growing in 2016. An easing of the austerity policy would probably help to increase private consumption, which would benefit the services sector.

#### Spain

##### Automotive



Up from Fair to Good

Car production is expected to increase in 2016 and 2017, with robust investments made by major carmakers and rising exports. At the same time domestic demand is expected to increase 10% in 2016, due to the economic rebound and low oil prices.

#### Switzerland

##### Construction



Down from Good to Fair

Higher risk of increasing business insolvencies in this sector in 2016.



## Asia/Oceania

### Indonesia

#### Agriculture



Down from Good to Fair

Non-payments in this industry have increased to a high level.

### Singapore

#### Construction/Construction materials



Down from Fair to Poor

#### Machines/Engineering



Down from Good to Fair

Both sectors are affected by lower economic growth in Singapore and in the region, as well as by decreased investments. Private construction activity is expected to slow down in 2016 due to an increased supply of already completed private housing projects and offices.

### United Arab Emirates

#### Agriculture



Down from Excellent to Good

#### Paper



Down from Good to Fair

Both sectors are negatively affected by the current economic downturn.

#### Chemicals



Down from Good to Fair

Low oil prices have an immediate negative impact on chemicals, especially the petrochemicals segment.

#### Construction



Down from Fair to Poor

#### Consumer durables



Down from Fair to Poor

#### Electronics/ICT



Down from Fair to Poor

The 2016 performance outlook for the construction, consumer durables and electronics/ICT industries is subdued, and credit insurance claims have sharply increased.

#### Food



Down from Good to Poor

Non-payments have sharply increased and the number of insolvencies is high.

#### Metals



Down from Fair to Poor

#### Steel



Down from Fair to Poor

Both sectors are negatively affected by the deterioration in the construction sector.

#### Textiles



Down from Fair to Poor

There have been several insolvency cases in the industry, and the 2016 performance outlook is subdued.

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