



# market monitor

Focus on construction performance and outlook

February 2012

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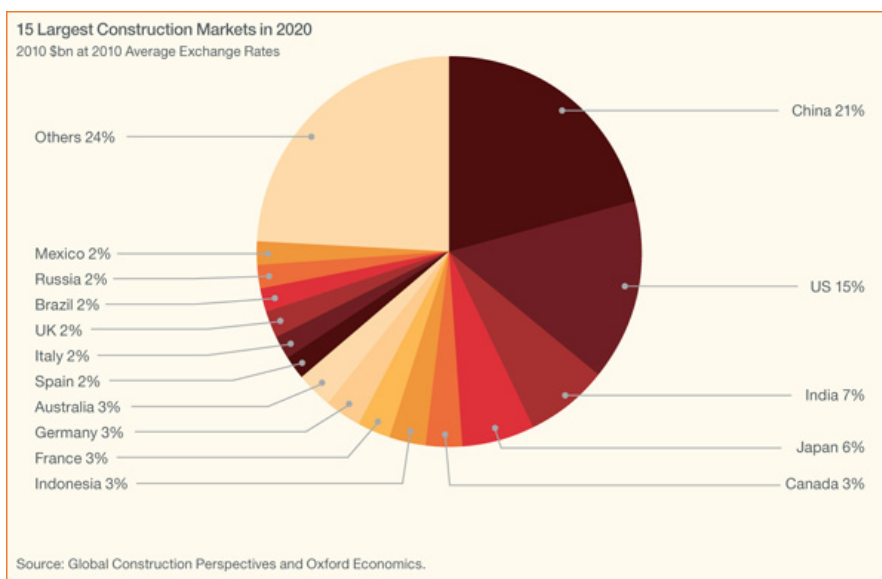
On the following pages we indicate the general outlook for each sector featured using these symbols:



# Building a better future?

Despite the muted outlook for the construction industry in many countries, the long term forecast is cause for some optimism, according to a recent report entitled Global Construction 2020.<sup>1</sup> The report forecasts that global construction output will outpace the world's GDP over the next decade, driven mainly by rapid urbanisation and economic growth in emerging markets like China, India and Brazil. The US too will contribute in no small measure to this growth, with an upturn in both residential and non-residential construction.

But, of course, for the construction businesses currently caught up in the Eurozone crisis and its ramifications, that optimism must have a hollow echo. According to Euroconstruct's November 2011 estimates, European construction output will decrease 0.3% in 2012 after already contracting 0.6% last year, with those dependent on publicly funded projects the worst affected because of the austerity packages initiated by many European governments.



Those estimates are borne out by many of the reports in this month's Market Monitor, with insolvencies in the construction sector in many markets due to rise this year, and an overall picture of both pressure on margins and cash flow problems. Of the European markets featured this month, only Germany seems to be bucking the trend, as their housing market is seen as a safe bet by investors.

This graph forecasts the relative sizes of construction markets across the globe by 2020. With a subdued outlook for construction in many Western markets, those in the sector who can diversify their sales into other countries may be well served by doing so.

<sup>1</sup> Global Construction 2020 is a major study about the global construction industry to 2020, produced by Global Perspectives and Oxford Economics

# Belgium

## Subdued expectations in 2012

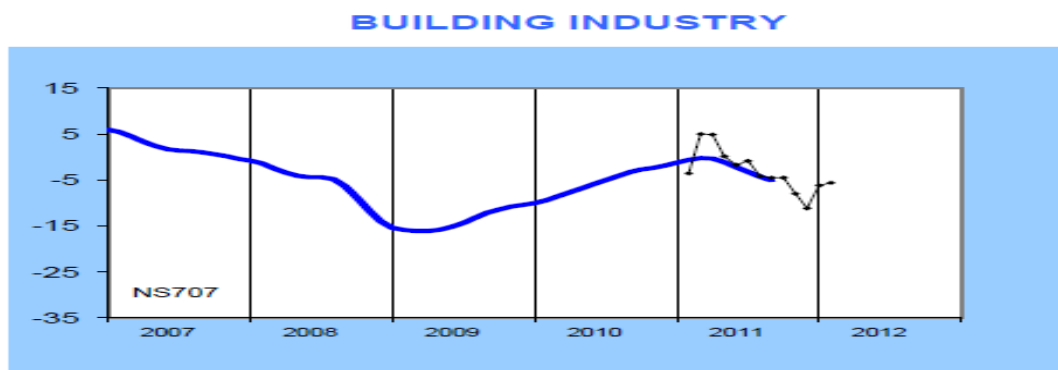


The Belgian construction industry experienced a strong first half of 2011, but the pace of growth did not persist into the second half of the year. For the whole of 2011, growth of 2.5% is expected, according to the Belgian construction Federation. In the first 7 months of 2011, 32% fewer permits for new houses were granted than in the same period of 2010, due in part to the extraordinarily high level in 2010: the result of government stimulus measures. Permits are however also 11% lower than in 2009. This drop had been expected, but is now intensified by the economic uncertainty triggered by the Eurozone crisis, increasing interest rates and reduced tax deductions.

In comparison, non-residential construction fared better. Permits for new buildings were at their highest level in a long time in Q2 of 2011, but again the uncertain economic climate raises questions about the future of this segment.

The civil engineering sector currently benefits from the increased level of activity in the run-up to the municipal elections. However, contractors in this segment fear that public budgets and spending will decrease due to Dexia liabilities (after Dexia's severe difficulties, on 10 October 2011 it was announced that the Belgian banking arm is to be purchased for EUR 4 billion by the Belgian government. The government will also fund guarantees for a 'bad bank' which is taking over troubled assets from Dexia).

2012 is expected to be a difficult year for the construction industry, with contractors' confidence remaining shaky (see chart below). Output is forecast to decrease up to 5% year-on-year in 2012.



Source: National Bank of Belgium

In general, construction companies' profit margins and equity remain weak. With fierce competition in the industry, the many small and medium sized companies that dominate the market are struggling for turnover as they vie for the few projects on offer. There is some consolidation by bigger groups to achieve vertical integration, but they then have the problem of filling their production capacity efficiently as well as competing with large foreign groups entering the Belgian market.

## Another turnaround in public bodies' payment behaviour

On average, payments in the construction industry take 60 days, and we have seen increasing payment delays in the last couple of months: a trend that will probably continue. While, until recently, government bodies have made every effort to pay on time, we are receiving more and more reports that now these special efforts to improve payment behaviour are drying up. According to Statistics Belgium, business insolvencies increased 5.8% year-on-year from January to the end of October 2011 - to 8,485 cases - of which 1,416 were in the construction sector: a year-on-year increase of 10.5%. We expect this trend to continue due to the overall shaky economic climate and lower orders, turnover and margins in the construction sector.

Due to these subdued prospects, we maintain a cautious underwriting policy towards the construction industry. In terms of subsectors we performed special reviews for:

- manufacturing metal structures/parts,
- demolition and wrecking of buildings
- civil engineering
- installation electrical wiring/fittings
- joinery installation
- floor and wall covering
- wholesale wood/construction materials

In general, we focus on the following criteria for underwriting construction:

- type of business, to predict level of activity and competition
- dependence on one type of business or diversification
- concentration of risk towards a single customer
- most important ongoing projects and most important projects in the order portfolio
- issues with projects (delays, technical problems, etc)
- market position, networking qualities, skills/reputation/experience
- financial standing: liquidity, solvency, rotations, cash flow, etc
- Sufficient working capital to cope with slow payments from government, disputes, etc.
- financial policy: profit reservation

### Belgian construction sector

STRENGTHS	WEAKNESSES
Demographic evolution	Fierce competition
Energy saving investments	Tight market
Niche sectors development	Weak financial structures
	Difficulty to keep/find good workers

# France

## Challenged by fierce competition, austerity measures and expiring incentives

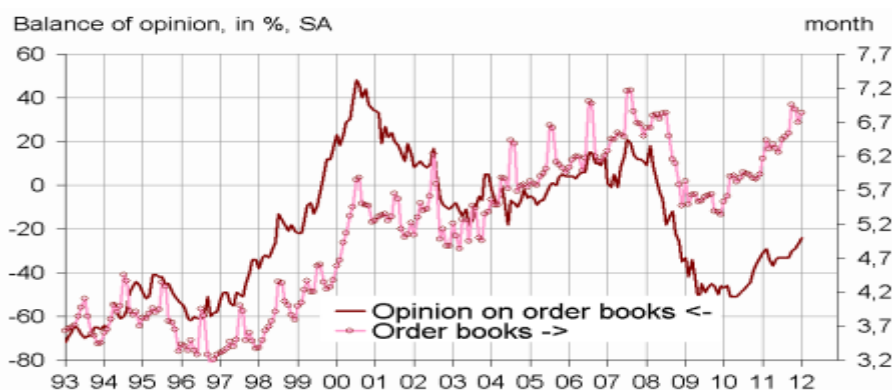


After three consecutive years of decrease (3.2% in 2008, 8.3% in 2009 and 3.8% in 2010) the volume of activity in the French building industry finally increased again - by 1.2% - in 2011, according to the French construction association FFB). This positive development was due to a recovery in new housing market activity (+ 3%), driven by low interest rates and a tax incentive: the so-called 'Loi Scellier', an income tax incentive for individuals investing in new ecological housing. However, margins in the housing subsector decreased in 2011 because of the pressure from rising construction material costs and tougher competition.

In contrast, the non-residential construction market remained sluggish, with a 2.5% decrease in output. Overall turnover amounted to EUR 19.6 billion in 2011 (down from EUR 20.1 billion in 2010) and is expected to level off at EUR 19.5 billion in 2012, according to FFB. Public works construction revenues increased slightly in 2011, to EUR 40.8 billion. However, this positive trend is insufficient in view of the large production capacities which have triggered fierce competition, leading to price wars and subsequently significant pressure on margins. In light of necessary austerity measures, the outlook for this subsector is quite pessimistic.

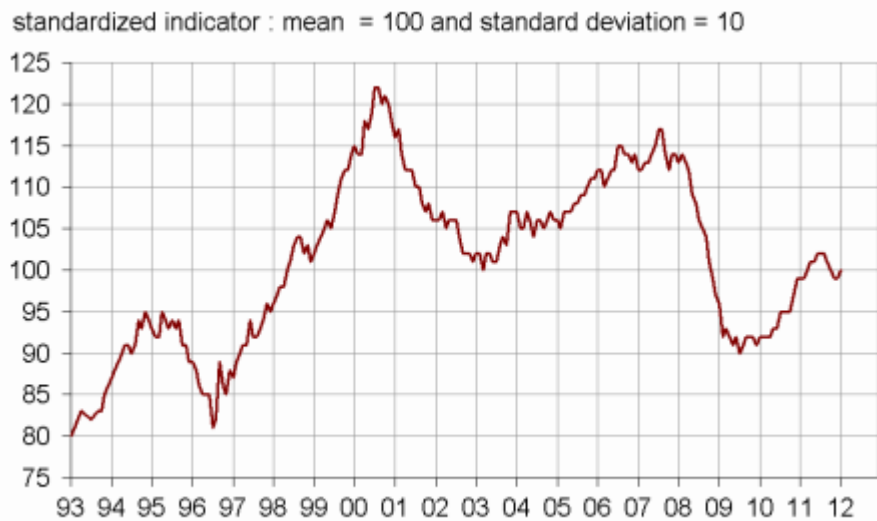
The performance of the building materials subsector follows the trend of global construction markets. Wholesale construction materials performed the best, recording a 6% year-on-year increase in activity in 2011. The renovation and remodelling markets grew 1.3% in 2011, albeit with a decreasing trend throughout the course of the year. The better performers were those linked to roofing, plumbing and heating. Sales prices increased by around 2% year-on-year, with a positive impact on margins, but the outlook for 2012 is still rather negative.

According to the French Statistics Office INSEE, construction order books stood at 6.8 months in January 2012 (see chart below): slightly below the average level of 7 months recorded from 2007 to 2010.



Source: INSEE

The business climate indicator was stable in January 2012 (see chart below).



Source: INSEE

However, we expect the French building sector to face some serious troubles ahead. As already mentioned, 2012 output and activity forecasts show a downward trend for some subsectors. The economic outlook remains weak, with French GDP to record growth of only 0.2% according to January's IMF forecast, leading to decreasing private and public investments. Based on 2011's good order levels, construction activity should remain reasonably healthy in the first half of 2012. However, we expect a difficult second half of the year: with the expected economic slowdown, construction activity could decrease around 2% for the whole of 2012, and also negatively affect the construction materials sector.

This outlook is accompanied by key issues such as decreasing sales prices, driven down by fiercer competition, and deteriorated funding conditions (increasing interest rates, reduction of banks' loan capacities). The increase in the VAT rate from 5.5% to 7% (one of the measures to reduce the public deficit) will add to the financial pressure on many construction businesses. Moreover, the expiry of the 'Loi Scellier' will be a major setback for the residential construction subsector, while the termination of fiscal incentives for photovoltaic facilities will lead to turnover losses.

The French construction sector is highly dependent on public spending. Long-term projects initiated during the 2008 credit crisis have helped a number of large and regional medium-sized companies operating in the civil engineering sector to keep their business activity levels elevated. However, while sales remained quite stable in 2011, the order book for public works has substantially decreased since then due to a contraction in investments by local authorities. Maintaining unchanged production capacities often leads to businesses accepting contracts with poor margins. The forthcoming presidential and general elections, the need for austerity to combat the public debt level, and increased financing costs for public buyers are expected to have a very negative impact on public spending, which should lead to major challenges for construction in 2012.

Around 98% of French companies involved in construction are small and medium-sized enterprises with a low equity ratio (an average 10% of balance sheet). Their profits will continue to decrease, impacted mainly by rising price

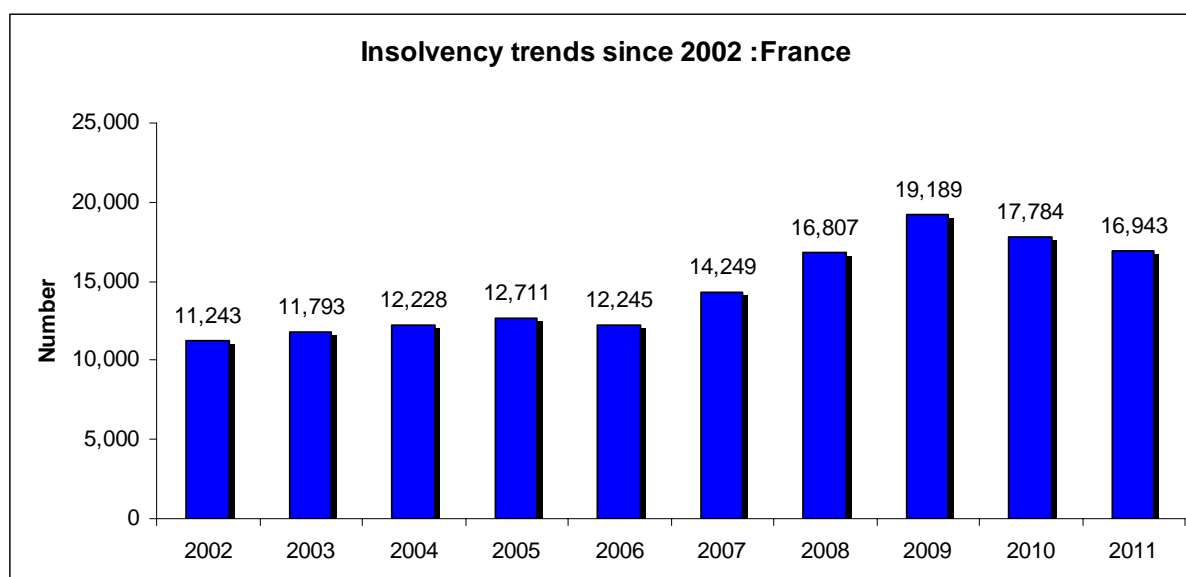
competition. Long operating cycles and long-term contracts demand high working capital requirements, while the cash situation of these companies has generally deteriorated.

## Payment delays and insolvencies will increase again

On average, payments in the French construction industry take 60 days. Payments have improved in the construction sector since the new law of economy modernisation (LME) was introduced in 2008. Payment terms are now fixed at 45 days end of month compared to 50 days end of month in 2011 and 60 days end of month in 2010. However, we have seen that public buyers seldom respect those terms and their average payment delays have even increased in 2011: a tendency that we expect to grow in 2012 due to public sector budget constraints. More payment delays will also result from the deteriorating trend in construction businesses' cash levels.

We saw an increase in credit insurance claims in the construction industry in the second half of 2011. On average, the construction sector's insolvency rate is significantly worse than other French industries, mainly because of the high number of small enterprises with low capital levels and high risk profiles.

In 2011, insolvencies in the construction sector decreased by 4.7% year-on-year: to 16,943 cases, according to Altares. However, this figure is still high compared to 2007 pre-crisis levels. Insolvencies decreased in the masonry subsector (-12%) and residential construction (-7%) while the electricity sector saw an increase (+7%), as did heating equipment (+12%). Insolvency levels in the electrical, insulation and plastering works subsectors are especially high due to the high number of small and under-capitalised businesses. Steel price volatility, marked by a significant increase in the first half of 2011 followed by a price decrease in the second half, and shrinking order books in the non-residential building sector, have led to increased insolvencies in the metallic construction frame subsector.



Source: Altares

In light of the weak GDP forecast for France and key problems in the construction sector, we expect an 8%-10% insolvency increase for this industry in 2012. What is even more worrying is the age of failing companies: in 2008, 59% of insolvent companies were less than 5 years old while, in 2011, this percentage fell to 29%. The expected increase in insolvencies will be accompanied by higher levels of debt (accounts payable and bank debt) which will have to be borne by the bankrupt companies.

In view of the negative outlook for construction, our underwriting stance remains very cautious, especially in the case of businesses which show weak net worth, decreasing operating margins, low cash flow generation, high dependency on bank credit facilities, and/or thin order books. While taking into account every company's individual performances, we have already, since early 2011, intensified our monitoring of some sensitive sectors such as photovoltaic, installation of electrical wiring and fittings, plumbing, and joinery installation.

Overall, we are increasing our regular contacts with buyers, to gain insight into their cash planning and order books, and we continue to focus on the very latest financial information from buyers.

#### French construction sector

STRENGTHS	WEAKNESSES
Backlog recorded last year	Weak GDP growth
Still low level of interest rates	Access to bank funding
Demographic evolution	Government measures to reduce sovereign debt
	Decrease of sales prices and margins

# Germany



## Residential construction profits from Eurozone crisis

The German construction industry remains cautiously optimistic, despite the current overall economic uncertainties. According to the German builders association (Hauptverband der Deutschen Bauindustrie), total construction turnover will grow by a nominal 2.5% (real growth of 1%) year-on-year in 2012, after a nominal 9.5% increase (real growth rate 6.5%) in 2011 - due mainly to the revival from the 2009 economic crisis. Residential construction recorded the strongest growth - a nominal 14% - and for 2012 an above-average growth rate of a nominal 6% is expected. Ironically, this subsector is profiting from the current Eurozone crisis, as investors (including some from Southern Europe) perceive the German housing market as a safe haven. New orders and construction permissions increased by around 20% year-on-year in the first 10 months of 2011, and in some metropolitan areas by as much as 70%.

The nominal turnover of commercial/industrial construction increased 11% in 2011 and optimistic market participants expect 3% growth this year. However, the outlook for public construction is subdued, with a 2.5% contraction in 2012 after 4% growth in 2011, due to the necessary consolidation of public finances and the subsequent expiry of stimulus packages.

Overall, the German construction sector has compensated for the losses it suffered in 2009 and 2010 as a result of the global economic crisis. Profit margins have increased, and the equity base of many German construction companies improved in 2011, from very low levels during the past years, to an average 10%, according to the German builders association. However, many construction businesses - especially smaller ones - still have weak equity ratios and limited financial scope. Payment delays, especially from public buyers, and payment losses still put a strain on the liquidity of many smaller companies. But, at least in the last couple of months, payment delays have not increased, and we do not expect any change in the first half of 2012. On average, payments in the German construction industry take around 45-50 days.

A 5.3% decrease in construction insolvencies was recorded in 2010, and we expect a lower number for 2011. However, reduced growth expectations for 2012 will have a slightly negative impact on this development, i.e. insolvencies will level off in 2012 or even increase, albeit slightly.

## Construction materials are generally performing well

In the case of construction materials, we have seen some disparate developments, with those subsectors engaged in reconstruction and modernisation activities performing better than those active only in the new building sector. The sanitary, heating and building equipment subsectors have recovered well from the 2009/2010 crisis. Thanks to the higher number of building permissions, building material merchants have achieved good profitability levels in 2011. The construction electronics subsector has also performed well and the outlook for the sanitary and the heating subsectors remains satisfactory. As in 2011, both will profit from favourable basic conditions and from the willingness

of private homeowners to invest in new building and refurbishment. The heating subsector additionally profits from the turnaround in Germany's energy policy (the phasing out of atomic power/increasing share of renewable energies).

However, we have seen some problems in the construction timber subsector, especially the sawmill industry, as higher commodity prices and increased imports of sawn timber (due to different price levels in Europe) have eaten into the profits of German businesses in this sector. Even some larger businesses suffered liquidity problems in the second half of 2011, and we expect that, as sales prices for sawn wood could fall further due to seasonality, profitability will also deteriorate.

## Relaxed underwriting stance – with some strings attached

With the apparent improvements in the German construction and construction materials sectors, our current underwriting approach is quite relaxed. However, we still consider construction as a sector with higher than average risk. Therefore, we are closely monitoring developments because of the current economic uncertainties in the Eurozone, which could negatively affect the sectors' performance if the situation worsens.

We are generally very cautious about construction/construction materials businesses that have operated for less than one year, unless they are part of larger groups or spin-offs. While we normally hold annual reviews, in more problematic subsectors (e.g. businesses that are focused solely on public clients) we hold additional reviews. In general, we scrutinise operating results, equity, liquidity and financing (e.g. ratio of work in progress/advanced payments) and orders in hand. We recommend the use of retention of title agreements, especially when trading with weaker performing companies. In cases of negative creditworthiness and negative operational results, our underwriting stance is very restrictive. Due to the problems referred to, our underwriting for the timber/sawmill sector is also quite restrictive.

### German construction sector

STRENGTHS	WEAKNESSES
Strong in technical innovations esp. in the area of energy-efficiency	Huge number of small companies active in this sector
Partially high grade of specialisation, especially in construction services	Limited access to international capital markets
	Partially high dependency on public works (e.g. road and railroad construction)

# The Netherlands

## Hard times continue for the Dutch construction industry

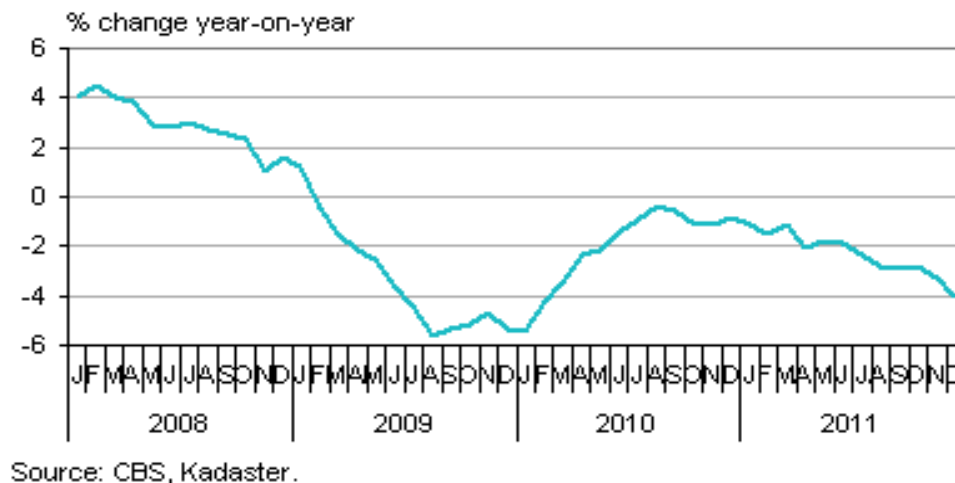


The Dutch construction industry continues to face hard times. Despite a slight recovery in the Dutch economy as a whole (1.5% GDP growth expected in 2011), because of its late-cyclical character the construction sector will show a decrease over 2011. Earlier predictions from a year ago - of a slight (1%) increase in production and further recovery during 2012 and 2013 - will not now materialize, as the Dutch economy is expected to contract between 0.3% and 1.0% in 2012.

Until 2010, the subsector most affected by the downturn was new building (both housing and utility) but now civil engineering has also been badly hit, especially by the government's cost-saving measures that will increase further in the light of the ongoing euro crisis. Moreover, several temporary fiscal measures that have proved beneficial to the building industry will expire during 2012 and are unlikely to be renewed.

Housing corporations - in the past regarded as solid - have had to cope with severe financial demands and write-offs of their assets and projects. A number of real estate and investment companies - and even municipalities - are also experiencing dramatically heightened financial problems. Residential property prices have continued to decrease since late 2010: down 4% year-on-year in December 2011 (see chart below).

Prices of existing own homes



Additionally the current political debate on mortgage interest deductibles indicates that this fiscal advantage will shrink in the near future and, in the longer term, even be scrapped. This will have consequences for the housing industry, especially for first-time buyers: even though interest and inflation are both low and demand is high, the loss of this additional benefit will put house prices beyond their reach. To illustrate this, the number of newly constructed houses is now expected to decrease to below 60,000 a year, whereas some 80,000 are required.

The construction materials sector has also had to cope with decreasing volumes, especially raw materials such as concrete and cement, with some of the top 10 building companies having to announce drastic cuts in their activities. Brick manufacturers are also suffering, as are those in related sectors, such as architects, civil engineering companies and suppliers of steel and wood. Initiatives in the areas of public-private partnerships (PPP) – which looked promising some years ago - have not yet resulted in the expected boost to the sector.

Employment in the construction sector stabilised during 2011. However, this is largely due to self-employed professionals ('zzp-ers') who are mostly contractors in small-scale house renovation and maintenance and who have benefited from tax relief. This is the only subsector that has shown robust stabilisation.

## **Insolvencies will increase again in 2012**

In the light of the ongoing slump, many construction companies have experienced decreases in volume and turnover - and especially in order portfolios. While these firms' financial reserves are diminishing, the banks are still reluctant to provide loans to either businesses in the sector or to private individuals seeking to buy a house. While the short-term growth expectations for the construction sector as a whole remain pessimistic, over-capacity continues to put pressure on margins. Lower consumer confidence and increasing unemployment (up to 5.8% in November 2011) are not helping either. All these negative factors will continue to dampen sector performance in 2012 and, with the deteriorating financial strength of building companies, acquisitions by foreign competitors can be expected. Payment periods in the construction industry have generally improved slightly in the last couple of months, mainly because companies have improved their credit management, e.g. with earlier dunning. In 2011, the number of insolvencies in this sector decreased 3% year-on-year, helped by favorable weather conditions in early 2011. However, construction insolvencies were still 9% higher than in 2009: the first year of crisis for the sector. We have noted an increase in credit insurance claims in the last six months, and expect that, apart from maintenance and renovation, all construction subsectors will suffer from increased insolvencies in 2012.

## **The construction sector remains highly important to Atradius**

The industry's risk profile has been above average for some years now, with a rebound not expected during 2012-2013. We have had to tighten our underwriting stance, but the construction and construction materials sector remain highly important for Atradius in the Netherlands.

We continue to actively monitor the financial performance of individual construction companies, through close direct contact with buyers and umbrella-organisations and by gathering the most recent information on financials, order portfolios, financing strength and outlook. Payment patterns are closely monitored, and the information that our clients have given us over recent years has helped us to analyze and anticipate risk early.

This approach means we can maintain a similar acceptance rate in the construction sector to that in other sectors. Despite the difficult conditions in the construction sector, we cover a significant level of the credit amounts requested by our customers. However, a serious deterioration in payment behaviour, combined with an increase in collection cases or claims, would be a signal for us to reassess our overall stance toward the sector.

### Dutch construction sector

STRENGTHS	WEAKNESSES
Flexible work force (cost structure)	Pressure on margins/restrictive bank lending
Enhanced working capital management	Cost cutting measures of government/ future of mortgage interest deductibles unclear
Larger companies: order portfolio is still reasonably well filled / diversified activities	Decreasing number of houses sold/ declining house prices
SMEs: maintenance and renovation activities	Increasing interest from foreign competitors

# Snapshots

Market performance at a glance



## Italy

Further signs of deterioration



Since our last Market Monitor analysis in August 2011, the signs of further deterioration in 2012 have increased. According to the Italian construction association Federcostruzioni, residential construction will decline 18.6% in the period 2008-2012, while non-residential construction will decrease by as much as 29.5%. Public sector spending on building work has dropped by 48% in value compared to its 2008 pre-crisis level, leading to fierce competition among builders for the remaining bids.

Moreover, while construction activity is suffering from strained liquidity along the whole value chain, banks have continued to tighten up on their loan criteria - and it seems that these criteria will be even tougher than in 2008. More than 60% of businesses currently complain about difficulties with their banks – double the number in 2008. In the first half of 2011, credit lines for residential housing activity reduced 25%, and by 30% for non-residential construction. Therefore it is very likely that, as in 2008-2009, we will see payment delays and proposals for rescheduling from many companies.

At the same time, we have seen a constant and progressive increase in payment delays cascading through the entire market, caused mainly by public buyers: between May and September 2011 alone payment delays increased 40%, with peaks of up to 24 months. We expect further deterioration in the coming months, as austerity will dent public buyers' spending capacity.

Against this backdrop, we expect a further increase in insolvencies in 2012. There is a higher risk for small and medium-sized buyers/subcontractors (i.e. those with turnover of less than EUR 10 million) with weak financial profiles, many of which face long payment periods from their clients. Therefore, our underwriting stance towards this sector remains very restrictive, as we expect even more businesses to face such problems in the coming months. With payment behaviour deteriorating, we are also closely monitoring less late payment cases and applying appropriate measures to manage our clients' risks.

# Poland

## Growing pressure on operating margins



The relatively mild winter provided the opportunity for most construction work to progress, and therefore Q1 of 2012 will not be as tough for the sector as Q1 of 2011. The Polish construction sector's short-term economic outlook for the next 18 months is indeed quite positive, with many companies now able to strengthen their balance sheets. Most large investments will end by mid-2013 (with the expiry of EU related funds) and until then we don't expect any major changes in the market.

However, there is growing pressure on operating margins, which could negatively impact SMEs in particular. This is due mainly to strong competition from both domestic and foreign companies and a shortage of workers leading to rapidly rising wages. Additionally, general investors have pressed for longer payment terms and there are frequent payment delays. On average, payments in the construction industry take 60 days.

In the road construction subsector we have seen some general contractors paying their subcontractors late (for instance, in mid-2011, the Chinese consortium Covec was barred from carrying out further highway construction work, because it failed to meet schedules or to pay its subcontractors). This may cause some further payment problems along the value chain. Insolvencies increased sharply last year (up more than 40% year-on-year), mainly affecting smaller businesses battered by fierce competition and cash flow problems due to payment delays and long payment terms.

Therefore our underwriting stance in this sector remains cautious. We very closely monitor developers in the residential building subsector, where the turnover of stock is slow: the sale of new apartments can take around 2-4 months from building completion because of high prices. Some developers will no doubt have to reduce the price of apartments, and consequently their margins.

	2008	2009	2010	1-10 2011
<b>Sales in the construction sector*</b>	10.9%	3.7%	3.5%	17.2%
<b>Buildings*</b>	8.6	- 1.1	2.8	2.6
<b>Civil engineering work *</b>	13.7	16.9	1.8	29.4
<b>Number of dwellings completed (thousands)</b>	165.2	160.1	135.7	100.9
<b>Prices*</b>	4.8%	0.2%	-0.1%	0.9%
<b>Wages*</b>	13.0%	2.8%	2.2%	5.2%
<b>Profitability</b>	5.7	5.5	4.2	2.2

\*Year-on-year change

Source: Polish statistics office

# Spain

## Further contraction expected



In 2011 the construction sector's contribution to the Spanish economy continued to shrink, both in terms of overall investments and net output. Tighter access to credit and stricter loan conditions have further worsened the situation. In Q3 of 2011, investments decreased 10.4% in the non-residential subsector and 4.1% in the residential subsector. In the construction materials sector, cement, construction steel, installations (facilities), furniture, carpentry and sanitary equipment also continued to suffer. A striking example is that of cement consumption, which has declined 50% since Q2 of 2007. For 2011 we expect a 15% year-on-year decline.

Our 2012 forecast is for a year-on-year contraction of 9% in construction output, while a (fragile) stabilisation will probably materialise in 2013. In 2012, the residential construction subsector will stagnate or increase only slightly, while the non-residential subsector will contract 10%. Civil engineering production dropped 35% last year, as this subsector is directly affected by the government's austerity measures, and 2012 forecasts point towards another major contraction in those civil works promoted by the central government and regional administrations.

The overall level of extension of maturities and delays in payments will continue to be unfavourable throughout 2012. Much will depend on the further development of the banking sector and financing conditions in particular. Insolvencies in the construction sector increased 12% year-on-year in 2011 - to 1,584 cases - while overall Spanish business insolvencies rose 14% - to 6,486 cases. This below-average increase indicates that the painful major adjustments in this sector have already taken place. However, construction and related sectors will continue to account for the bulk of insolvencies (one in four), followed by the services sector.

Therefore, we will continue to treat the construction sector and all closely related industries with special care in our underwriting. In view of the restricted liquidity combined with very modest levels of market demand, we are closely monitoring the parameters that determine the payment behaviour of construction businesses. Because it is essential that buyers generate sufficient cash to meet their short-term financial obligations, we seek details of the bank financing that those buyers need to fund their operations. Additionally, up-to-date financial information (i.e. for the fiscal year 2011) gives us a better insight into whether companies can maintain their liquidity and generate cash. We arrange frequent buyer meetings with higher volume buyers to ensure that our information is kept current.

## United Kingdom

### Cash flow is a major issue



The construction sector remains extremely competitive as public spending cuts, deferred private sector capital expenditures and a lack of bank financing have all contributed to a reduction in new projects. New orders decreased at double-digit rates in 2011 and, according to the Office for National Statistics (ONS), output decreased 1.6% year-on-year in November. The public sector, excluding infrastructure, saw the largest year-on-year decline - down 16% to £1 billion - while infrastructure grew 18.8%. Commercial construction output grew 1%.

UK house sales fell just 1% last year to 869,000, one of the lowest totals on record, as reported by HM Revenue & Customs. It means that the property market has been in a three-year slump, with sales roughly half those recorded in the run-up to the banking crisis in 2007. Sales have been depressed by a combination of mortgage rationing by lenders and rising unemployment.

Due to these massive problems, cash flow is now a real concern, with only 2% of specialist contractors having received payment within 30 days in Q3 of 2011. Average payment terms have lengthened, with the majority of contractors now having to wait more than 60 days for payment. Withholding of payment of retentions is also increasing as the credit squeeze continues. Construction insolvencies rose 6.4% year-on-year in 2011 - to 2,688 cases - while in Q4 the year-on-year figure even reached 16%.

We apply a cautious underwriting stance across all construction subsectors. In more extreme cases, we will seek to ensure that we have information less than 3 months old on which to base our underwriting decision. This approach has allowed us to build an extensive library of information as well as a network of buyer contacts, enabling us to evaluate the strengths and weaknesses of businesses and assess the key drivers relevant to the subsectors in which they operate.

Despite the difficulties that the industry faces, we are acutely aware that there are many businesses - new and old - that are more than capable of adapting to the challenges they face. With this in mind, as well as requesting information we will continue to meet and speak to companies to achieve an up-to-date appreciation of their business and ensure that we underwrite each company on a case by case basis.

# United States

## Further improvement depends on the trend in employment



The US construction industry is slowly recovering from its lowest level of production in over 50 years. According to the U.S. Commerce Department, overall housing construction was pegged at 606,900 units in December 2011: 3.4% better, overall, than in 2010. While nationwide construction of new single-family homes rose 4.4% - to a seasonally adjusted annual rate of 470,000 units - the multi-family side experienced a 20.4% dip. Looking ahead, the National Association of Home Builders is forecasting an increase of approximately 17% in both single and multi-family housing construction in 2012. The inventory level of new homes for sale fell 1.3% to 158,000 units in November, which was a record low and represented six months' supply at the current sales pace.

Real GDP is expected to remain positive in 2012 (forecast 1.8% by the IMF) but, with growth in consumer spending expected to stay close to the current low rate, the projected improvement in housing starts will still be less than half of the historical average. Paramount to sustained momentum in the construction industry will be job growth, as evidenced in December 2011, which saw an additional 200,000 jobs and a decline in the unemployment rate to 8.5%: down 0.6% since August 2011. In addition, the sector-specific hiring rate for construction was at the relatively high level of 5.8% in October 2011.

While our prudence about agreeing cover in this sector continues, we are cautiously optimistic due to the (slight) improvements that have materialised since our last Market Monitor analysis in September 2011. Nevertheless, our stringent buyer review process remains in place: we conduct annual or biannual reviews and continue to require detailed financial disclosure when reviewing and maintaining sizeable credit limits: i.e. those exceeding US\$ 250,000.

# Mexico

## A healthy outlook that could be hit by a global downturn



In the first ten months of 2011, the public sector's share of overall construction activity was 51.8%, while the private sector contributed 48.2%. The construction of buildings (including housing, schools, hospitals, manufacturing and services sector premises) contributed 45.7% of total construction, with 27.5% coming from infrastructure and 26.8% from the energy industry (oil and electricity) and water projects. Employment in the construction industry increased 2.6% year-on-year. Construction directly affects more than 35 subsectors in the Mexican economy, such as cement, wood, steel, electric equipment, metal structures, non-ferrous metals, other mining and chemical products, and glass products.

Overall construction output is expected to increase 5% year-on-year in 2011, followed by another 3.8% in 2012, as the forthcoming presidential elections to be held on July 1, 2012 will boost public investments in infrastructure and house building. Another factor that will support the positive expectations for the industry is a new law permitting an increased share of private investment in infrastructure construction. In 2012, the growth rate in construction will outpace GDP growth (expected to be 3.5% by the IMF)

On average, payments in the construction industry take between 45 and 120 days. It is common for payment times in this sector to be slow, especially of those dependent on public works. However, we have seen payment delays decrease in the second half of 2011, as did the number of credit insurance claims received. We expect the situation to remain stable in 2012, although our underwriting approach remains cautious for the time being, as any deterioration in the global economy would directly impact Mexico and have immediate consequences for construction.



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