



Risks and uncertainties impeding the growth of the European construction market

The continuation of the war in Ukraine, the severe energy crisis, and the sudden changes in monetary policy were initially pointing towards a recessionary outlook for the European economy. However, it has performed better than expected in recent months due to lower energy prices, reduced supply constraints, improved business confidence, and a strong labour market. In 2022, for the European construction sector, a growth of 3% is confirmed, within an overall expansionary economic environment.

In contrast, the new forecast for the European construction sector has been revised downward, with a shift from the previous assumption of stagnation in 2023 to an anticipated reduction in volumes. The factors that explain the gradual slowdown in growth, leading to a contraction in construction spending levels in 2023, have been developing and solidifying over time, such as weaker momentum of the global economy, inflation, change in monetary policy direction, and the consequent rise in interest rates. The latest forecast now projects a decline of 1.1% this year, followed by a further contraction of 0.7% in the subsequent year, highlighting the challenging outlook for the construction industry, whose expectations of recovery have been postponed to 2025.

The sharp rise in inflation in 2022, caused, among others, by the energy crisis, forced central banks to raise interest rates sharply and, as a result, worsened the ability to finance housing investment. Mortgage interest rates have doubled in most European countries in 2022 and tripled in Finland, Slovakia, Switzerland, and the UK in 2022. According to the current forecast, total housing production in 2023 in the EUROCONSTRUCT countries will be EUR 996.1 billion, which is -3.6% or EUR 37.1 billion lower than in 2022, when it increased by 4.6% compared to 2021. Residential construction output in the EC-4 countries will decline by -8.4% in 2023, more than twice as much as in the EC-15 countries (-3.6% decline). The downward trend will continue in 2024, in which a deeper decline of -3.2% is forecast to take place in the EC-15 countries, while in the EC-4 countries it will only be -1.7%. The decline in residential construction output is projected to halt and even increase slightly by 0.7% for the EC-19 countries in 2025.

The clear slowdown of economic growth will undermine non-residential construction in the next few years. The output of total non-residential construction amounted to EUR 609 billion in 2022 (at 2022 prices), which marks a 2.2% increase compared to the 2021 level. In 2022, total non-residential construction accounted for 29.2% of total construction output across the Euroconstruct network. The growth projections for output in the field have remained the same as in the previous report. A slight growth of 0.7% is forecast for this year. Growth will pick up marginally in the remaining period and stand at 1.1% in 2024 and 1.7% in 2025. Production output will only exceed the 2019 pre-pandemic level in 2025.

The impact of the business cycle is smaller for civil engineering due to many long-term projects and a high share of activities financed by the public sector. Multinational funds in the EU have generally been a stabilising factor. Additionally, in economic downturns, the government often decided to implement economic stimulus packages for the construction sector which contained maintenance and improvements of existing infrastructures as well as new infrastructure projects. The growth rates of civil engineering work outperform the development in the building sectors and show continuous growth from 2021 until the end of our forecast period. The annual growth rates for 2023-2025 are rather moderate (2.3%, 2.5%, and 2.3%).

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The postponement of new investments in infrastructure and the delaying of ongoing public infrastructure improvement programmes kept Portugal as one of the worst performers concerning the contribution of public investment to GDP, which stands below 3%, together with Spain and Belgium. Notwithstanding, the construction industry has been increasing its contribution to the country's Gross Fixed Capital Formation, and kept its growth in 2022, though at a more moderate rate. The value added by the construction industry reached about EUR 23.8 billion in 2022, with an increase of 3.5% (y-o-y) and is expected to expand by more than 2% this year. The construction production index published by INE recorded a growth rate of 4.1% (y-o-y) last March and a chain increase of 1%, its expansion being mostly driven by the civil engineering segment.

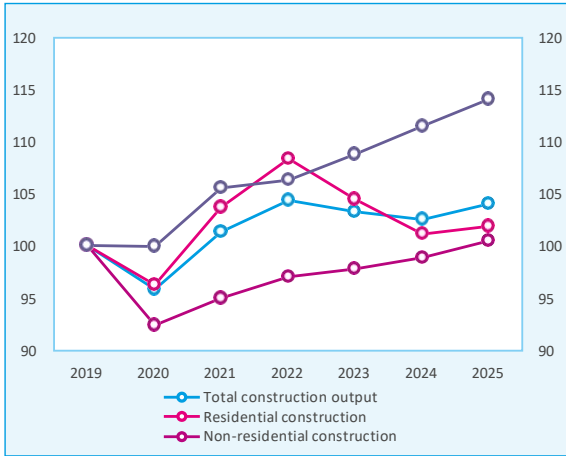
According to sector sources, the real estate market achieved about EUR 34 billion in transactions last year, an increase of 14% over 2021. About 90% of this amount concerns sales of single and multi-family homes, involving about 170 thousand dwellings. Eleven thousand (6.5%) of these were sold to foreigners, amounting to about 11.8% of the total value of dwelling transactions. Currently, the real estate business is facing two major challenges: (1) the announcement by the government of a radical package of measures aiming at alleviating the current shortage of affordable housing by coercing the lease of vacant flats, tightening the licensing of short-term holiday rentals, and introducing an "extraordinary" tax on their business; (2) the disclosure by the government that the golden visa programme will be terminated soon.

In the housing sector, about 19.7 thousand dwellings were completed in 2022, placing the construction of residences at a 3.7% growth rate. The number of dwellings to be completed this year is expected to follow a slower pattern (2%). The renovated housing segment that has seen a considerable increase in the last decade, notably in the historic centres of Lisbon and Porto, is currently under a declining drift. The growth of housing prices is showing acceleration, placing Portugal above the European average with an increase of 64% since 2013, 22 percentage points over the +44% European average. The exceptional increase in housing prices in PT is mostly due to an insufficient supply of housing in the country, which results from the combined effect of poor housing policies by the government and wrong incentives to housing promoters offered by the tax system, particularly in the rental housing market.

The aggregated useful floor area of licensed buildings in the non-residential market kept declining from 2019 to 2021. However, in the last year, the licensed area rebounded by 14% followed by a more modest increase of 6% in the completed floor area in the same period. Thus, the forecast for the current and next years is kept unchanged. The medium-term growth of storage, office, and commercial buildings (including hotels and resorts) is deemed to be more dynamic, and the health sector will keep its long-term expansion trend. Industrial buildings are expected to recover a little later and educational buildings may undergo a recovery due to the availability of financing by RRF, the European Union funded "Recovery and Resilience Facility" programme.

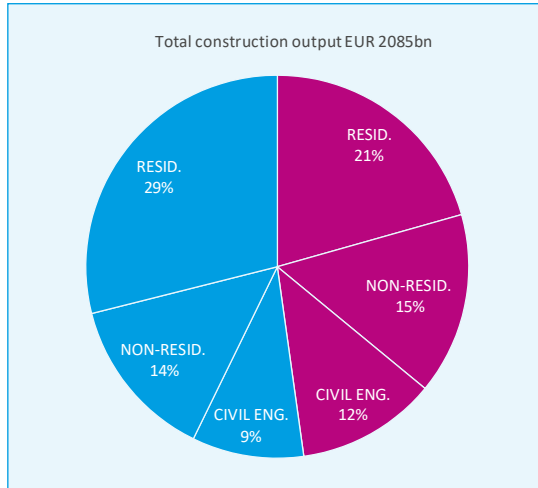
Previous estimates and forecasts for the civil engineering market for the 2021/2022 period were not confirmed by newly published data and updated estimates for the 2nd half of 2022. Thus, growth rates for the period were reviewed, placing the segment on positive grounds. The government's allocation of about 20% of the available RRF funds to transport infrastructure is generating some optimism, particularly in the rail segment. However, the execution of the investment programmes will be restrained by the scarcity of government funding, increasing construction costs due to inflation, and persistent disruptions of some supply channels. Thus, the forecast for the overall outlook of the segment is conservative, to the tune of 2%, with the railway subsegment undergoing a more robust trend.

Construction output by sector (EC-19)
index at constant price,



Source: EUROCONSTRUCT, June 2023

Construction market by subsectors (EC-19, 2022)
share in %, 2022.



Source: EUROCONSTRUCT, June 2023

| TOTAL CONSTRUCTION OUTPUT | | | | | | | | (% change in real terms) |
|---------------------------------|------|-------|------|------|-----------|------|---------|--------------------------|
| Country/Year | | | | | Forecasts | | Outlook | |
| | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | |
| Austria | 3,6 | -3,4 | 5,8 | -0,8 | -1,2 | -1,8 | 0,7 | |
| Belgium | 1,1 | -5,0 | 6,2 | 1,5 | -0,3 | 3,0 | 1,6 | |
| Denmark | 1,6 | 8,8 | 6,6 | 5,5 | -1,1 | 0,1 | 1,8 | |
| Finland | -2,5 | -1,2 | 1,2 | 0,8 | -5,9 | 0,9 | 0,3 | |
| France | 2,3 | -10,4 | 8,2 | 2,8 | 0,3 | 0,7 | 1,2 | |
| Germany | 1,5 | 2,3 | 0,1 | -1,5 | -2,2 | -1,6 | -0,8 | |
| Ireland | 5,8 | -9,1 | -3,2 | 10,3 | 2,1 | 5,9 | 4,9 | |
| Italy | 3,5 | -4,6 | 18,0 | 12,4 | -0,5 | -6,0 | 1,5 | |
| Netherlands | 5,3 | 0,2 | 2,3 | 3,3 | -1,9 | -2,1 | 1,2 | |
| Norway | 1,0 | -1,0 | 0,4 | -1,9 | -0,3 | 0,2 | 4,1 | |
| Portugal | 8,4 | 3,4 | 15,3 | 0,5 | 1,2 | 1,5 | 1,5 | |
| Spain | 4,6 | -9,3 | 6,7 | 3,6 | 3,2 | 2,5 | 1,5 | |
| Sweden | 0,3 | -0,4 | 5,0 | 1,4 | -8,2 | -2,9 | 4,7 | |
| Switzerland | -0,2 | -0,6 | -3,0 | -3,7 | -0,9 | 0,9 | 1,7 | |
| United Kingdom | 2,2 | -13,9 | 11,7 | 5,6 | -1,5 | 1,1 | 2,7 | |
| Western Europe (EC-15) | 2,4 | -4,2 | 5,9 | 3,0 | -1,0 | -0,8 | 1,2 | |
| Czechia | 3,5 | -3,3 | 1,7 | 2,9 | -3,5 | 1,1 | 3,1 | |
| Hungary | 16,8 | -6,6 | 4,4 | 2,5 | -7,6 | -3,1 | 3,3 | |
| Poland | 5,0 | -1,7 | 3,8 | 5,1 | 0,9 | 2,5 | 4,0 | |
| Slovakia | -4,7 | -12,7 | -3,7 | 0,1 | 1,1 | 3,1 | 2,1 | |
| Eastern Europe (EC-4) | 5,9 | -3,6 | 3,0 | 3,8 | -1,7 | 1,3 | 3,5 | |
| Euroconstruct Countries (EC-19) | 2,6 | -4,2 | 5,8 | 3,0 | -1,1 | -0,7 | 1,4 | |

Source: EUROCONSTRUCT, June 2023