Atradius

February 2023

Industry Trends Construction

Credit risk outlook clouded by high levels of uncertainty

In this issue ...

Disclaimer

Construction industry performance per market

February 2023

Austria	
Belgium	
Czech Rep.	
Denmark	
France	
Germany	
Hungary	
Ireland	
Italy	
The Netherlands	
Poland	
Portugal	

Slovakia	
Spain	
Sweden	
Switzerland	
Turkey	
United Kingdom	

Brazil	
Canada	
Mexico	
USA	

Australia	
China	
Hong Kong	
India	
Indonesia	
Japan	
New Zealand	
Singapore	
South Korea	
Taiwan	
Thailand	
United Arab Emirates	

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

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

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

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

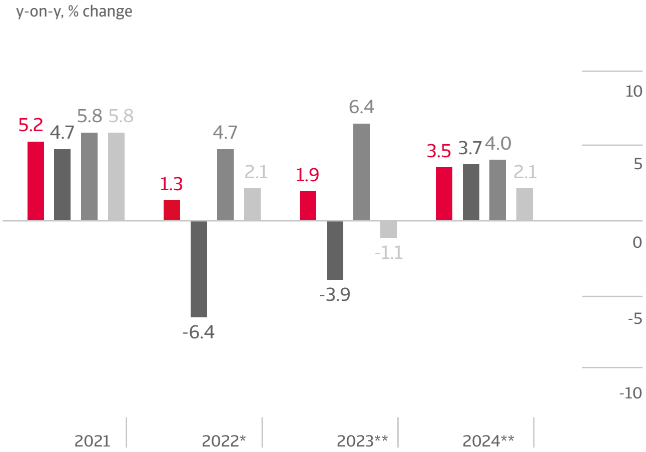
Poor
The credit risk in the sector is relatively high / business performance in the sector is below its long-term trend

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

Global construction – performance at a glance

Construction output: global and per region

Emerging economies in Asia are driving global construction growth, while aggregated activity in developed markets is contracting



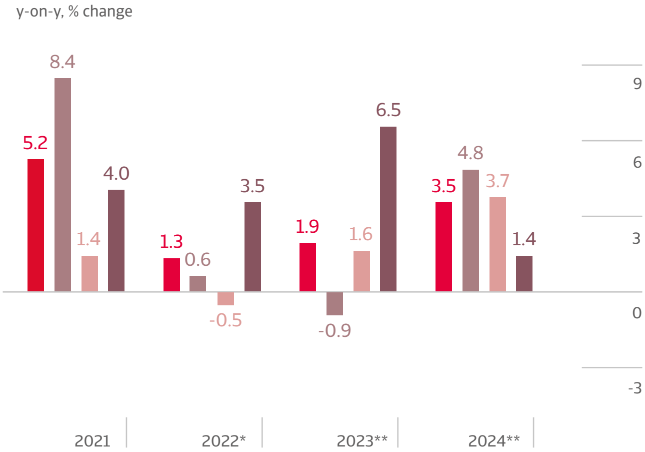
*estimate **forecast

Source: Oxford Economics

World
Americas
Asia-Pacific
Europe

Global construction – subsectors output

Civil engineering sustains the sector´s growth in 2023, driven by public infrastructure building projects



*estimate **forecast

Source: Oxford Economics

Construction overall
Residential building
Non-residential building
Civil engineering

Global construction

Global market developments

- The short-term outlook for the global construction industry is clouded by high levels of uncertainty. With a looming economic recession in major markets due to soaring energy prices and high interest rates, prospects for growth will be muted in 2023.
- Tighter monetary policy and lower household purchasing power will weigh on demand for new buildings. Aggressive policy tightening by central banks in 2022 has lifted borrowing rates and thereby reduced the demand for building construction work. However, a large backlog of work will help to mitigate somewhat the impact on construction work done during 2023.
- Infrastructure investment will drive growth in construction activity. Governments worldwide continue to champion major infrastructure projects to boost their economy's productive potential and drive the post-Covid economic recovery. This will see civil engineering be the fastest-growing sector in the construction market.
- Construction materials supply-side constraints will ease but not dissipate in 2023.
- In advanced markets, labour shortage has become a serious issue. Tight labour markets and lack of a skilled workforce increase wage costs for builders in many advanced markets. In Europe this could become a structural problem in the mid-term future.
- Construction costs will rebase at a higher level. A correction in the mismatch between supply and demand will ease the pressures driving construction cost growth. However, we do not expect construction costs to fall back to pre-Covid levels.
- Work towards a more sustainable future will remain steady. The global push towards a less carbon-intensive future will continue in 2023 and beyond, with further investment in renewable energy generation and other green infrastructure.

Global construction

Construction and sustainability – challenges and benefits

The construction industry is a major user of natural resources. From energy usage to emissions, it has a huge impact on the environment. According to the International Energy Agency (IEA), the buildings and construction sector accounts for a whopping 36% of worldwide energy use and 40% of CO_2 emissions globally. Heavy plants used in construction still lean heavily on fossil fuels. Fabrication and shipping of construction materials have a massive impact on carbon emissions. Global cement manufacturing currently accounts for 8% of CO_2 emissions annually, for example, with a rising rates due to ongoing urbanisation around the world.

Amid widespread concern about climate change and the need to cut down emissions, there is increasing pressure on construction firms to reduce their environmental impact. Planning, building materials and construction processes must all change comprehensively. Supply chains have to be rethought, and an understanding of the materials required for a life-cycle approach will become crucial.

Revisions to building regulations are already changing the boundaries for the minimum requirements expected in construction today. This can be challenging, as the example of the Netherlands shows, where construction has been impacted by the need for nitrogen reduction and tighter rules introduced regarding per- and polyfluoroalkyl substances (PFAS) in the soil. This has resulted in building project delays and postponement of building permits during the past few years.

Some benefits already visible

Public construction is currently a strong driver towards more sustainability. National Highways in the UK, for instance, has committed itself to reduce construction-related emissions by 50% until 2030. As this report shows, public initiatives in advanced markets related to sustainability help to sustain the industry during a rather subdued market environment. There are many examples of this trend. The civil engineering segment in Belgium is supported by public investment in clean energy projects, while the Inflation Reduction Act boosts spending in energy-efficient and sustainable building activities in the United States. The Next Generation EU fund supports large investments in projects with a sustainability aspect, benefiting the Italian and Spanish construction sectors in particular. A widespread phenomenon is increasing demand for renovation/upgrades to improve energy efficiency, and to comply with tighter environmental standards. The residential renovation work segment focused on energetic renovation (heating, ventilation, isolation and renewable energy) benefits from fiscal support/tax deductions e.g. in Belgium, France and Italy.

Australia

Labour and material shortages remain a major issue

In 2023, Australian construction output is expected to slow somewhat, to about 3%. Residential building is impacted by elevated inflation and increasing interest rates, which have led to a deterioration of property prices, while construction costs have surged.

Margins of builders and subcontractors were severely impacted in the Financial Year 2022 (1 July 2021-30 June 2022) due to sharply increased costs for construction materials, coupled with fixed price contracting. Since 2022, most new contracts contain escalation clauses, which enable construction businesses to pass on a large part of increased input prices.

That said, all construction subsectors still suffer from ongoing labour and material shortages. This is extending build times and costs, threatening the viability of future projects. Supply shortages lead to inefficiencies and problems with scheduling. As a result, construction businesses are facing cash flow issues. Skilled labour shortage in Australian is one of the key challenges for the sector, leading to soaring labour costs, which puts pressure on margins.

Payments in the Australian construction industry take about 60-90 days on average, and the number of payment delays is high. However, the majority of these are of small amount, and are finally settled.

Construction insolvencies increased sharply in 2022, as builders struggled with high prices for key materials, while many had taken on too many projects that were no longer profitable, causing them to go bust. However, this increase was from a very low level, because during the pandemic several forms of government support led to sharp decreases in 2020 and 2021. We expect further rising construction business failures in 2023 because cash flow issues persist for many construction companies and market conditions remain volatile. Therefore, we still assess the credit risk situation of the industry as “Poor”.

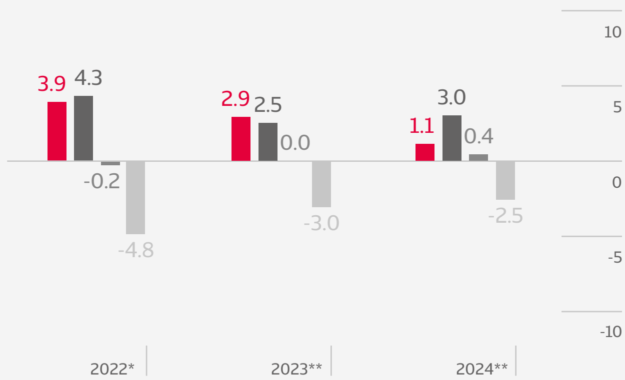
Performance forecast along subsectors

Residential building	Non-residential building	Civil engineering

Source: Atradius

Australia construction output

y-on-y, % change



*estimate **forecast

Source: Oxford Economics

Construction overall | Residential building | Non-residential building | Civil engineering

Australia construction sector - credit risk assessment

Poor

Business conditions		Financing conditions		Default assessment	
+	Demand situation (sales)	Overall indebtedness of the sector	high	-	Non-payments over the last 12 months
-	Profit margins: trend over the last 12 months	Dependence on bank finance	high		Non-payments over the next 12 months
		Willingness of banks to provide credit	high	-	Insolvencies over the last 12 months
				-	Insolvencies over the next 12 months

big increase | increase | stable | decrease | big decrease

Source: Atradius

Belgium

Energetic renovation keeps up activity

In 2023, we expect Belgian construction output to contract 1.3% after a 0.8% decrease in 2022, mainly due to lower activity in the residential and industrial construction segments. Both suffer from high inflation and increased financing costs for building activities. Only civil engineering output is expected to grow this year (by about 3%), supported by public investment in clean energy and infrastructure projects. The renovation work segment focused on energetic renovation (heating, ventilation, isolation and renewable energy) remains resilient, because it benefits from government support (VAT decrease).

Many businesses are highly indebted, and a combination of high prices for energy, building materials and increased wage expenses is putting high pressure on margins. Belgian construction companies operate in a very competitive environment, in particular in the public tendering business. Passing on higher input costs is very difficult, because prices have usually been fixed for a longer period of time.

According to the latest Atradius Payment Practices Barometer, Days Sales Outstanding (DSO) in the Belgian construction industry averaged more than 60 days during the past 12 months. This clearly points to the issue of late payments and consequent pressure on business cash flow. As an immediate measure to avoid liquidity shortage, businesses are delaying payments to their own suppliers, with the resulting danger of a domino effect through the industry supply chain.

Due to the sluggish economic performance outlook for this year, rising high input prices and the expiry of (pandemic-related) government support measures we expect that both payment delays and insolvencies will increase further in 2023, with construction business failures expected to rise by more than 20% this year.

We assess the credit risk situation as "Poor" for the residential and non-residential subsectors and as "Fair" for civil engineering and construction materials. Even though demand should pick up again in 2024 and inflationary pressures abate, skilled labour shortage will remain a serious challenge. There is a lack across all levels, from engineers to calculators, site managers, yard supervisors, to all types of construction and installation workers. This will have a negative impact on the completion of construction projects and will increase wage costs for builders in the future.

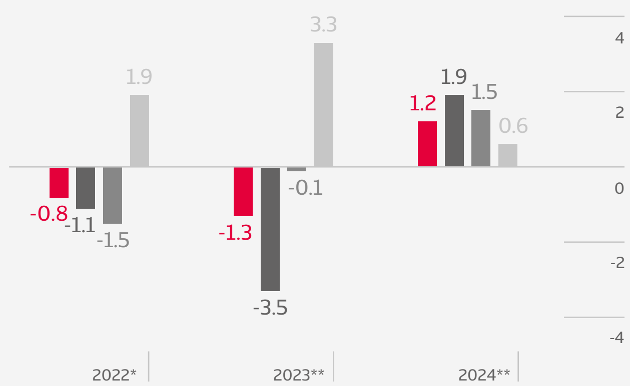
Performance forecast along subsectors

Residential building	Non-residential building	Civil engineering

Source: Atradius

Belgium construction output

y-on-y, % change



*estimate **forecast

Source: Oxford Economics

Construction overall
Residential building
Non-residential building
Civil engineering

Belgium construction sector - credit risk assessment

Poor

Business conditions	Financing conditions		Default assessment
Demand situation (sales)	Overall indebtedness of the sector?	high	Non-payments over the last 12 months
Profit margins: trend over the last 12 months	Dependence on bank finance	very high	Non-payments over the next 12 months
	Willingness of banks to provide credit	average	Insolvencies over the last 12 months
			Insolvencies over the next 12 months

big increase | increase | stable | decrease | big decrease

Source: Atradius

France

A substantial increase in business failures in 2023

The 2023 outlook for construction activity is subdued, due to low economic growth of 0.1%, elevated inflation and higher interest rates. Increased expenses for construction materials and wages, together with tighter environmental standards, weigh on building costs. Additionally, supply chain issues for some materials still cause construction delays.

In the residential construction segment, inflationary pressures and tighter credit conditions severely weigh on building activity. The non-residential market suffers from lower investment in offices and retail spaces, and has not yet recovered to pre-Covid levels. Civil engineering order books for public projects are low, and authorities are slow in adjusting their budgets to higher inflation.

Given the difficult market conditions, it comes as no surprise that operating margins started to deteriorate, and this will continue in 2023. High input costs for materials and energy strongly affect builders holding contracts without escalation clauses. These are frequent among public construction builders, but uncommon in the residential construction market, and most real estate developers cannot pass on cost increases to customers. Construction businesses are currently more highly indebted than in the past. Many have started to draw on their short-term credit lines to cope with increased working capital requirements (WCR), but banks are generally reluctant to support their financing needs.

Payments in the construction sector take 64 days on average, compared to 44 days for all other industries. In particular, public bodies and larger construction companies tend to extend payment terms. Due to government support measures, construction insolvencies remained low in 2020 and in 2021. However, payment delays and insolvencies started to increase in H2 of 2022, back to pre-Covid levels. The main reasons are sharply increased input cost and cash issues due to difficulties in WCR-funding. We expect this deterioration to accelerate in 2023, with construction business failures rising by more than 40% year-on-year, mainly affecting smaller companies. Therefore, we assess the credit risk situation as "Poor" across all main subsectors. Only the renovation work segment focused on energetic renovation remains resilient, because it benefits from government subsidies.

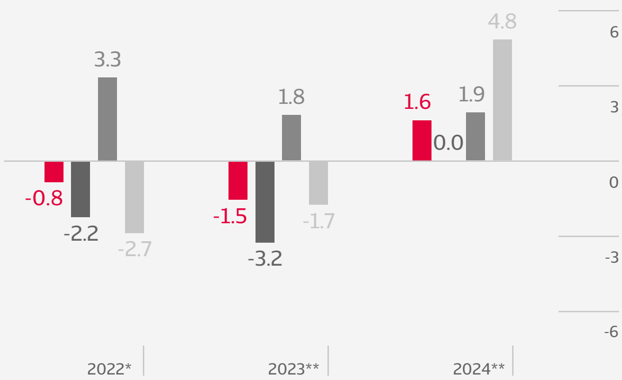
Performance forecast along subsectors

Residential building	Non-residential building	Civil engineering

Source: Atradius

France construction output

y-on-y, % change



*estimate **forecast

Source: Oxford Economics

Construction overall
Residential building
Non-residential building
Civil engineering

France construction sector - credit risk assessment

Poor

Business conditions	Financing conditions		Default assessment
Demand situation (sales)	Overall indebtedness of the sector?	high	Non-payments over the last 12 months
Profit margins: trend over the last 12 months	Dependence on bank finance	high	Non-payments over the next 12 months
	Willingness of banks to provide credit	low	Insolvencies over the last 12 months
			Insolvencies over the next 12 months

big increase | increase | stable | decrease | big decrease

Source: Atradius

Germany

A marked decline in residential construction activity

After performing relatively well in 2021, the German construction industry has faced severe headwinds since early 2022. Output contracted across all main subsectors in 2022, and this deterioration continues in 2023. Ongoing supply chain issues, high prices for energy and raw materials and increased interest rates weigh on the industry. Lack of skilled labour force is an issue, and higher wage costs additionally weigh on builders´ financials.

Increased costs of financing construction projects has led to postponements of projects or cancellation of orders. While the Federal Government has set itself the goal of constructing 400,000 new dwellings every year, this target has been missed by a long way in 2022, and the same is expected this year. Higher interest rates and inflation make property purchases by households harder. We expect residential construction output to contract by 3.5% in 2023. Builders find it difficult to pass on price increases to customers unless escalation clauses are part of the contracts, which is often not the case (meanwhile builders try to negotiate price clauses for new projects).

Due to all the issues, profit margins of construction businesses have started to deteriorate, and this negative trend will continue in the coming months. Payments in the industry take 30-60 days on average, and the payment behaviour was good in 2021 and early 2022. However, since then both payment delays and insolvencies have started to increase. According to the German statistics office, construction business failures increased 10% year-on-year in the period January-October 2022, compared to a 2% increase across all industries. We expect the deterioration to continue in 2023, with construction insolvencies increasing by 25%-30% year-on-year in 2023. Small and medium-sized businesses are most at risk (in the German construction sectors 85% of companies have only 20 employees or less).

Due to the deteriorating credit risk situation and business performance of the industry, we have downgraded our sector assessment from "Fair" to "Poor" by the end of 2022. We expect the sector to rebound in 2024, growing by more than 3.5%. Shortage in housing facilities and a big necessity for infrastructure investment should support construction activity in the years to come.

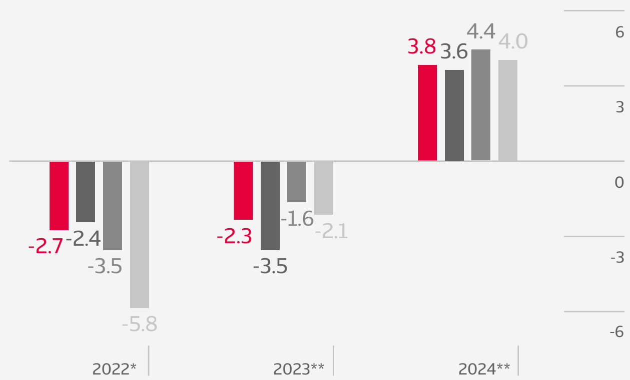
Performance forecast along subsectors

Residential building	Non-residential building	Civil engineering

Source: Atradius

Germany construction output

y-on-y, % change



*estimate **forecast

Source: Oxford Economics

Construction overall · Residential building · Non-residential building · Civil engineering

Germany construction sector - credit risk assessment

Poor

Business conditions	Financing conditions		Default assessment
- Demand situation (sales)	Overall indebtedness of the sector?	low	Non-payments over the last 12 months
- Profit margins: trend over the last 12 months	Dependence on bank finance	average	- Non-payments over the next 12 months
	Willingness of banks to provide credit	average	Insolvencies over the last 12 months
			- Insolvencies over the next 12 months

big increase · increase · stable · decrease · big decrease

Source: Atradius

Italy

Structural weaknesses continue to impact credit risk

After a whopping 12% growth in 2022, Italian construction output is forecast to stagnate in 2023. This is mainly due to a contraction in the residential building segment, triggered by high inflation and deteriorated household purchasing power. A “superbonus” government scheme drove energy-saving home improvements in 2022 (it provided homeowners with a tax deduction of 110%, allowing them to renovate at no cost). However, since the beginning of 2023 the tax reduction was reduced to 90%, and due to the surge in energetic renovation, prices for solar plants, boilers and window frames have sharply increased.

Civil engineering activity in 2023 and beyond is driven by investments in infrastructure, energy security and power grids funded by the EU´s Recovery and Resilience Facility (RRF). While there have been project delays in 2022, it is expected the rollout will gain momentum this year.

The high price increases for energy and raw materials have a major negative impact on the profit margins of construction companies. While the government has provided support in 2022 to dampen those effects, applications are overly complex, with the result that about 70% of companies have not been able yet to cash in the funds. Some measures to adjust the cost of works to market prices leave out the private sector and only affect public works.

Payments in the Italian construction industry take 200- 250 days on average. SMEs in particular suffer from the bad payment behaviour of public bodies. We expect that both payment delays and insolvencies will increase in 2023, with businesses dependent on the residential construction segment most affected. Business failures could increase at double-digit levels, although from low levels seen in 2021 and 2022.

Structural weaknesses continue to affect the credit risk outlook of the sector. These include tight margins and high gearing of businesses, combined with tight lending conditions. Banks are generally unwilling to provide loans to construction businesses due to a history of high levels of default. The willingness of banks to grant loans to construction companies has steadily decreased, from EUR 52 billion in 2007 to EUR 15 billion in 2022.

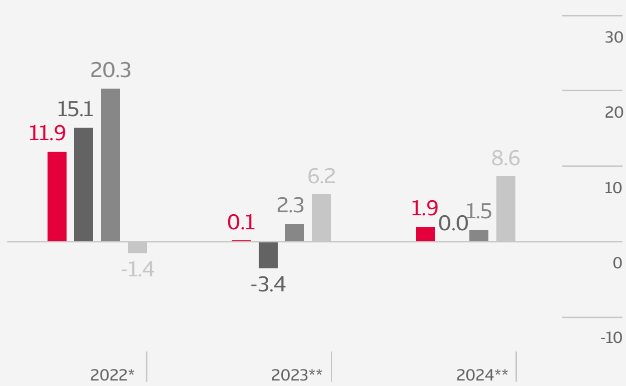
Performance forecast along subsectors

Residential building	Non-residential building	Civil engineering

Source: Atradius

Italy construction output

y-on-y, % change



*estimate **forecast

Source: Oxford Economics

- Construction overall
- Residential building
- Non-residential building
- Civil engineering

Italy construction sector - credit risk assessment

Poor

Business conditions	Financing conditions		Default assessment
Demand situation (sales)	Overall indebtedness of the sector?	high	Non-payments over the last 12 months
Profit margins: trend over the last 12 months	Dependence on bank finance	high	- Non-payments over the next 12 months
	Willingness of banks to provide credit	low	+ Insolvencies over the last 12 months
			- Insolvencies over the next 12 months

big increase | increase | stable | decrease | big decrease

Source: Atradius

The Netherlands

Increase in insolvencies, but from a historically low level

In 2023, Dutch construction output is expected to contract by 0.7%, due to a slowdown in residential construction growth, as well as contractions in the non-residential and civil engineering subsectors. At least the renovation work segment focused on energy-efficient appliances (e.g. solar panels, heating pumps) is still growing.

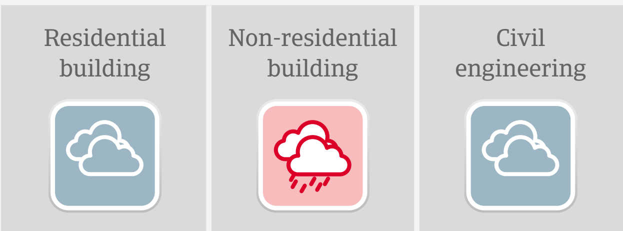
High inflation is reducing real incomes, while monetary tightening has led to higher mortgage rates and made building financing more expensive. Therefore, households and businesses are reluctant to invest. At the same time, energy and building material costs have substantially increased. Passing on price increases to customers is difficult, because most current contracts lack escalation clauses (although builders aim to include price escalation clauses in new contracts).

Payments in the industry generally take about 45-60 days. Payment experience has been good during the past two years, as the sector remained relatively stable during the pandemic. However, lower demand, inflation, monetary tightening, higher input prices and the expiry of fiscal stimulus have begun to trigger more payment delays and insolvencies. Construction business failures rose 8% in 2022, although from a historically low level. In 2023, we expect insolvencies to increase by about 15%.

Despite the mounting difficulties, our sector assessment remains "Fair" for the time being. The industry has benefited from increasing demand and productivity during the last couple of years, which had a positive impact on profitability and liquidity. Housing demand will remain high in the coming years, while infrastructure needs to be maintained and upgraded.

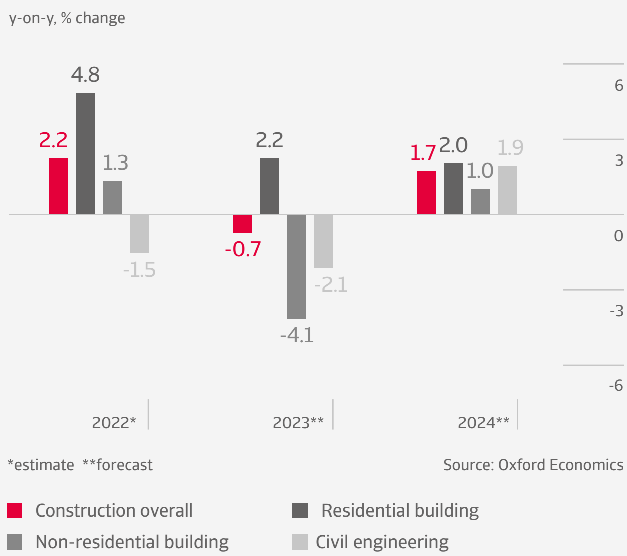
However, there are also challenges ahead. The market remains fiercely competitive, with persistent pressure on margins. To keep profitability at sufficient levels, construction companies have to focus on first time and innovative building (e.g., more modular construction). Construction activity remains impacted by environmental issues such as nitrogen reduction and tighter rules regarding per- and polyfluoroalkyl substances (PFAS) in the soil. They have resulted in building project delays and postponement of building permits during the past years. Additionally, there is the structural problem of not enough land available for building new houses.

Performance forecast along subsectors



Source: Atradius

Netherlands construction output



*estimate **forecast

Source: Oxford Economics

The Netherlands construction sector - credit risk assessment

Fair

Business conditions		Financing conditions		Default assessment
-	Demand situation (sales)	Overall indebtedness of the sector?	average	Non-payments over the last 12 months
	Profit margins: trend over the last 12 months	Dependence on bank finance	average	- Non-payments over the next 12 months
		Willingness of banks to provide credit	high	- Insolvencies over the last 12 months
				- Insolvencies over the next 12 months

big increase | increase | stable | decrease | big decrease

Source: Atradius

Poland

Freeze of EU funds severely affects civil engineering

After growing 6.7% last year, Polish construction output is forecast to contract by more than 3% in 2023. Due to double-digit inflation rates the central bank has sharply increased interest rates, to 6.75% since September 2022. This had a negative impact on financing existing and new building projects. It also led to a major decline in mortgage loans, hitting residential construction in particular. Many infrastructure projects are dependent on EU funding. However, the ongoing freeze of EUR 36 billion from the Next Generation EU fund (due to a dispute between the EU and Poland about rule-of-law issues) severely affects civil engineering activity. Commercial construction is affected by higher loan costs and the economic slowdown. That said, last year we saw a robust increase in industrial and warehouse construction.

Alongside lower demand, the construction sector suffers from high energy costs. After a sharp increase in 2021, prices for building materials have started to decrease in H2 of 2022, but remain elevated. Passing on higher input prices to customers is very difficult in a market characterised by fierce competition and a marked activity slowdown. Profit margins of construction businesses increased in 2020 and H1 of 2021, but have decreased since then, and we expect this downturn to continue in 2023.

Payments in the Polish construction industry take 83 days on average. The sector is prone to payment delays, as there are many disputes related to quality and scope of work. Overdue payments of up to 30 days are common. Payment delays suffered by a company are usually passed on to peers along the value chain. Since H2 of 2022, we have observed a significant increase in non-payment notifications, and we expect this adverse trend to continue in 2023. Insolvencies are following the same trend, and we expect construction business failures to increase by more than 30% in 2023, due to the strained liquidity situation of many companies, coupled with decreasing demand. Most vulnerable are companies that have a low level of diversification in their work portfolio, and that are focused on infrastructure and/or residential construction. Given the deteriorated credit risk situation and subdued business performance outlook for this year, our sector assessment remains "Poor" for the time being.

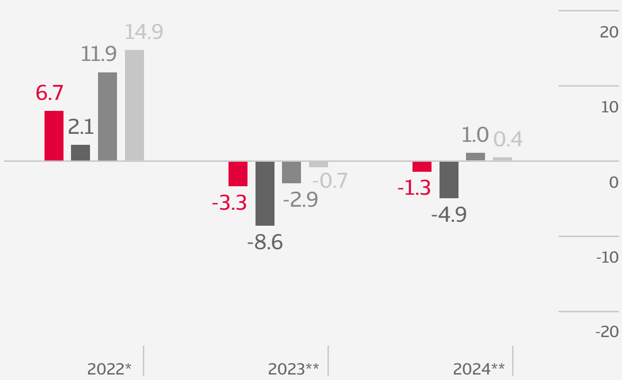
Performance forecast along subsectors

Residential building	Non-residential building	Civil engineering

Source: Atradius

Poland construction output

y-on-y, % change



*estimate **forecast

Source: Oxford Economics

Construction overall · Residential building · Non-residential building · Civil engineering

Poland construction sector - credit risk assessment

Poor

Business conditions	Financing conditions		Default assessment
Demand situation (sales)	Overall indebtedness of the sector?	low	Non-payments over the last 12 months
Profit margins: trend over the last 12 months	Dependence on bank finance	low	Non-payments over the next 12 months
	Willingness of banks to provide credit	low	Insolvencies over the last 12 months
			Insolvencies over the next 12 months

big increase · increase · stable · decrease · big decrease

Source: Atradius

Spain

Woes predominantly in the residential construction segment

Construction output in Spain is forecast to grow by just 1.8% in 2023, as interest rate increases hamper building projects across all subsectors. The residential construction segment will contract as a combination of higher interest rates and lower disposable household incomes negatively affect access to affordable mortgages. While the Next Generation EU fund will support large investments in projects with a sustainability aspect, its implementation has been slower than expected so far.

Higher prices for energy and construction materials additionally weigh on activity and margins of businesses. Mainly affected are builders involved in new residential construction, because they struggle to pass on higher input prices to end-customers. The situation seems better for builders with public contracts because the Spanish government wants to mitigate the consequences of raw material price increases for businesses.

The Spanish construction sector is characterised by long payment terms, mainly from large groups and companies, at the expense of smaller businesses in the value chain. The average duration amounts to about 100-120 days. The number of protracted payments is generally elevated due to public clients with long payment periods, and frequent disputes about materials, installations, etc. Payment delays increased in 2022, and we expect this negative trend to continue in 2023. Higher financing costs, as well as increased raw materials and energy prices, continue to constrain the liquidity of businesses, making it more difficult for them to meet payment obligations on time. Construction insolvencies increased 30% year-on-year in the period of January-November 2022, in part because a pandemic-related bankruptcy moratorium expired at the end of June 2022. We expect further rising construction business failures this year, with smaller businesses active in residential construction facing the highest risk.

Due to the subdued credit risk situation, cost pressure and weaker demand for residential construction we assess the sector as "Poor". Shortage of skilled workforce will remain an issue in the mid-term, with the National Confederation of Construction estimating that Spain requires about 700,000 construction workers during the next couple of years.

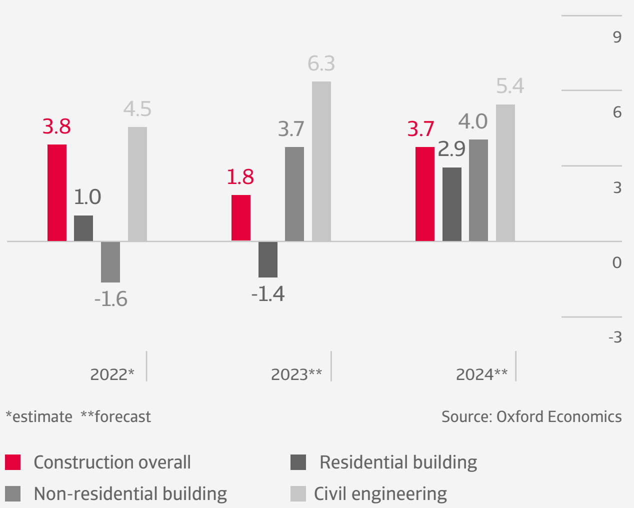
Performance forecast along subsectors

Residential building	Non-residential building	Civil engineering

Source: Atradius

Spain construction output

y-on-y, % change



Spain construction sector - credit risk assessment

Poor

Business conditions	Financing conditions		Default assessment
Demand situation (sales)	Overall indebtedness of the sector?	high	Non-payments over the last 12 months
Profit margins: trend over the last 12 months	Dependence on bank finance	average	Non-payments over the next 12 months
	Willingness of banks to provide credit	average	Insolvencies over the last 12 months
			Insolvencies over the next 12 months

big increase | increase | stable | decrease | big decrease

Source: Atradius

United Kingdom

Labour availability and wage costs have turned into serious issues

After growing by more than 5% in 2022, we expect British construction output to level off this year, with a 1.5% contraction in the residential construction subsector. Demand in this segment suffers from falling real disposable incomes, rising interest rates leading to higher mortgage interest rates, and the economic contraction in 2023 (forecast -0.7% year-on-year). We expect house prices to decline by more than 10% in 2023 and 2024. However, there are major infrastructure projects still going ahead (HS2, Hinkley Point and the Thames Tideway project), which support the sector´s performance. Additionally, ongoing Renovation Maintenance Improvement (RMI) work sustains the construction materials industry.

All major building segments have been hit by increased energy and construction material costs, which raises the question of how far builders are able to pass on higher input prices to their customers. Since the pandemic, all contracts have been generally negotiated with price escalation clauses. However, the issue of legacy contracts still exists for many businesses.

Payments in the construction industry take between 75-90 days on average. The number of overdue payments, payment plans, and insolvencies has increased at double digit-rates in H2 of 2022, although from a very low level. Companies´ liquidity is squeezed by increased input charges, with inflation and particularly wage increases putting pressure on their cashflow. Another issue is the expiry of pandemic-related government support for businesses (during the lockdowns many companies have preserved cash, supported by several government schemes). Now, this financial support has to be repaid to HM Revenue and Customs.

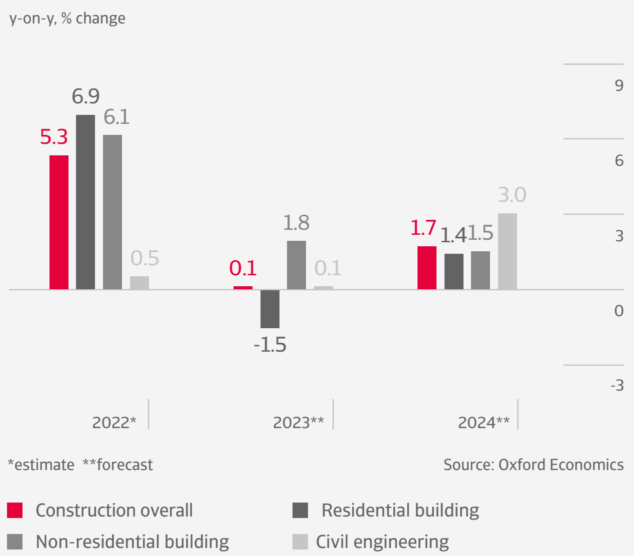
Due to all these factors putting high pressure on the cash situation of businesses, we expect further rising payment delays this year and business failures to increase by about 10%. Given the deteriorated credit management situation of the construction industry, our sector outlook remains "Poor". In particular, labour availability and wage costs have become serious problems for construction companies, and both Brexit and the pandemic have aggravated this issue. There is a shortage in all specialised building skills, which leads to higher labour expenses, adding to cost pressure for builders in the short and medium-term.

Performance forecast along subsectors

Residential building	Non-residential building	Civil engineering

Source: Atradius

United Kingdom construction output



United Kingdom construction sector - credit risk assessment

Poor

Business conditions	Financing conditions		Default assessment
Demand situation (sales)	Overall indebtedness of the sector?	high	Non-payments over the last 12 months
Profit margins: trend over the last 12 months	Dependence on bank finance	high	Non-payments over the next 12 months
	Willingness of banks to provide credit	average	Insolvencies over the last 12 months
			Insolvencies over the next 12 months

big increase | increase | stable | decrease | big decrease

Source: Atradius

United States

Government support sustains non-residential building activities

US construction output is forecast to contract by 5% in 2023, mainly due to a slump in residential construction. Rising interest rates lead to higher costs of project financing, while inflation has increased construction material costs. Supply of skilled workers and supply chain disruptions have led to longer lead times with project delays. The lack of skilled labour and an ageing workforce could curtail potential construction output in the future.

We expect the residential building segment to see the largest contraction, because aggressive monetary tightening is feeding into higher mortgage rate, and high inflation weighs on the affordability of homeownership. However, non-residential construction remains more resilient due to government stimulus. The Infrastructure Investment and Jobs Act will provide stimulus for construction this year, aiming at comprehensive investments in ageing infrastructure (including roads, highways, bridges, rail, and broadband development). Additionally, the Inflation Reduction Act encourages spending on energy-efficient and sustainable building activities.

During the past twelve months profit margins of businesses have improved because businesses have been able to pass along higher input costs to their customers. However, we expect that construction companies will need to work through bloated inventory levels and deal with higher operating and financing costs, which should diminish margins going forward. Higher working capital requirements brought on by supply chain issues have caused cash flows to turn negative in some parts of the industry.

Payments in the construction industry take about 60 days on average. Given the length of projects, protracted payments are fairly common in the industry, with payments made as the stages of projects are achieved. Due to the economic slowdown, subdued demand in residential construction and rising pressure on margins we expect both payment delays and insolvencies to increase in 2023. With high interest rates and a slowdown in activity, businesses with limited liquidity and/or elevated debt levels will face difficulties in servicing their obligations. Given the more subdued credit management situation and business performance of the construction industry, we have recently downgraded our sector outlook from "Good" to "Fair".

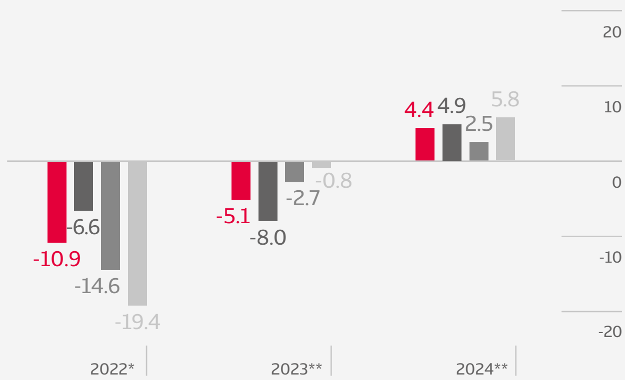
Performance forecast along subsectors

Residential building	Non-residential building	Civil engineering

Source: Atradius

United States construction output

y-on-y, % change



*estimate **forecast

Source: Oxford Economics

Construction overall · Residential building · Non-residential building · Civil engineering

United States construction sector - credit risk assessment

Fair

Business conditions		Financing conditions		Default assessment	
- Demand situation (sales)		Overall indebtedness of the sector?	high	- Non-payments over the last 12 months	
+ Profit margins: trend over the last 12 months		Dependence on bank finance	high	- Non-payments over the next 12 months	
		Willingness of banks to provide credit	high	Insolvencies over the last 12 months	
				- Insolvencies over the next 12 months	

big increase · increase · stable · decrease · big decrease

Source: Atradius

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