Activity in the construction sector has been contracting for almost one year. The slowdown started in mid-2007 and by the end of 2008 activity was declining at an annual rate of 3.5%. According to the available indicators, in the first few months of 2009 the decline seems to have gathered momentum. The purpose of this box is to assess the recent weakness in construction from a longer-term perspective, reviewing some of the features of its cyclical behaviour and its importance to the wider euro area economy.

The construction industry in the euro area experienced rapid growth from 2004, which peaked in early 2007. This can be seen clearly in the evolution of investment, value added and production in construction, as shown in Chart A. In terms of individual countries, the largest contributions to the expansion of overall euro area construction activity during the period 2004-2007 were made by Italy, France and, in particular, Spain, compensating for a contraction in the German construction industry. In terms of types of construction production, as shown in Chart B, the strength of the

**Box 6**

**THE CONSTRUCTION INDUSTRY IN THE DOWNTURN**

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**Chart A Investment, value added and the construction production index**

(annual percentage changes; quarterly data)

- investment in construction
- value added in construction
- construction production index

**Chart B Production indices for building, civil engineering works and total construction**

(annual percentage changes; quarterly data)

- total construction
- building
- civil engineering works

Source: Eurostat.
industry during this period was mainly due to fast growth in building construction, including both
dwellings and non-residential buildings. The other segment of the industry – civil engineering
works – for which the main customer is the public sector, recorded subdued growth prior to 2007.

The construction industry and in particular the building sub-sector makes relatively intensive
use of labour. According to Eurostat, the share of personnel costs in total expenditure is high
in the construction sector as a whole (23.3%) and in particular in the building completion
activities sub-sector (30.8%), well above the average for non-financial business (16.4%).
As a consequence, employment creation in this industry was relatively strong in the period
2004-2007, being equivalent to 17% of total net employment growth in the euro area over this
period – significantly above the 6% share of the sector in terms of value added. The indirect
effects in other industries are also likely to have been substantial (for instance affecting metal
products, cement, wood products, real estate services, etc.) and as a consequence this sector
merits close attention when assessing cyclical movements in the euro area economy.

One of the features of the construction industry is the long length of its production period, which
makes it very dependent on external financing requirements. The ECB started recently to estimate
euro area aggregate data on loans to non-financial corporations by branch of activity according
to the NACE classification. This allows the magnitude of the industry’s financing requirements
to be assessed for the first time. Some caution is needed in this analysis, given that the data are
based on non-harmonised national statistics which differ in a variety of ways. According to these
new data, by the end of 2008 over 9% of loans to non-financial companies were for financing
construction activities, which is above the 6% share of value added in construction in 2008.
There are important differences across countries, with Ireland and Spain being among those in
which loans funding the construction industry as a proportion of total loans were relatively high
in 2008.3

The slowdown started in 2007 and construction output declined during most of 2008

By mid-2007 output growth in the construction industry had slowed considerably, and since
spring 2008 value added has contracted. By the end of 2008 value added in construction was
down by 3.5% compared with the fourth quarter of 2007. According to data on construction
production, the downturn differed in intensity across sub-sectors and countries. The decline
was sharpest in the residential and commercial property component (included under the
building heading in Chart B), while the civil engineering works component was generally more
resilient. Focusing on the most recent data on construction production, it is notable that while
all countries have recorded a decline in construction production, among the larger countries,
the fall has been sharpest in Spain and Germany. In the former the annual growth rate of the
three-month moving average up to February fell by 16%, while in the latter it fell by 11.3%,
although this figure is potentially distorted by the effects of unusually cold weather in central
Europe in the early months of 2009. The contraction in the industry was mirrored in the
shrinking share of the construction companies in the total volume of loans to non-financial
corporations (NFCs); the stock of outstanding loans to the construction industry peaked in
mid-2007 when it amounted to 9.6% of the total volume of loans to NFCs, and has gradually

2 See Box 9 of the March 2008 issue of the Monthly Bulletin entitled “Employment developments in the euro area construction sector”.
3 According to data from the Central Bank and Financial Services Authority of Ireland for December 2008 and Banco de España
economic indicators.
Output, demand and the labour market

Output, demand and the labour market declined since, reaching 9.2% by the end of 2008. This evolution is also visible in Chart C which shows the rapid decline in the growth of loans to construction companies in 2008.

The available information for the first few months of 2009 points to a further decline in construction activities. As seen in Chart A, the construction production index, which follows euro area value added data quite closely, points to a further contraction in the first quarter of 2009, which was more pronounced in the building component of this indicator, while moderating in the civil engineering works component (see Chart B). The impact on employment trends is already visible in a number of countries. Looking ahead, while the Purchasing Managers’ Index (PMI) statistics show a modest rebound in February, they remain well below the level of 50 which is considered to be consistent with stable production and recent data also show that confidence in construction remains weak, with no sign of a turnaround for the time being (see Chart D).