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Allianz Research

Breaking or laying bricks? How policymakers will shape the construction recovery

Executive summary



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- **Despite major headwinds, the residential construction segment has remained resilient and lower interest rates could revive prices and activity in 2025.** Housing starts and residential building permits have been going down in most countries over 2024. However, real estate prices have probably bottomed-out after the significant correction in most markets. We expect prices to increase by +1% in France, Italy and Spain in 2025, while they should grow by +2% in Germany and the Netherlands. In line with this trend, affordability has improved in most countries as wages have increased. In Europe, Germany remains the weakest market, with building permits down by -22% y/y as of Q2 2024 and the sharpest correction in prices. In the US, new house builds declined by -8% y/y in the first half of the year but prices were slightly up. The renovation market managed to grow as energy-efficiency improvements demand was solid. However, going forward, the segment should slow down as it was supported by subsidies and government schemes that will be downsized in 2025. Decreasing interest rates could provide a tailwind in 2025: We estimate that a 1pp drop in mortgage rates increases residential building permits by +3pps over the next quarter in Italy, +5pps in France, +6pps in Spain, +8pps in Germany and as much as +19pps in the US. Furthermore, the transmission of lower policy rates to mortgages is rather fast – a matter of months in most countries. But some have even seen rates start to decrease even before the central bank rate cuts as banks attempt to attract and lock in clients early. Over the full loosening cycle which would leave rates 2pps lower by fall 2025, this would mean a significant boost to residential construction.
- **But the non-residential segment is navigating structural changes.** In the first half of 2024, office construction saw double-digit decreases in the US, France and Germany while transportation, logistics and data centers experienced sharp increases and hotels recovered, especially in Southern Europe. Overall, non-residential construction was sluggish. These developments reflected the continued preference for hybrid work models, the restructuring of supply chains amid geopolitical tensions and the boom in travel. In this context, Commercial Real Estate (CRE) investments are still decelerating but we see sign of stabilizations going forward, especially as demand for CRE loans is picking up and should continue to do so as rates decrease. Overall, the non-residential segment has been following trends such as the rise of remote

work, e-commerce and artificial intelligence but there are signs of reversals that could prove costly over the longer term.

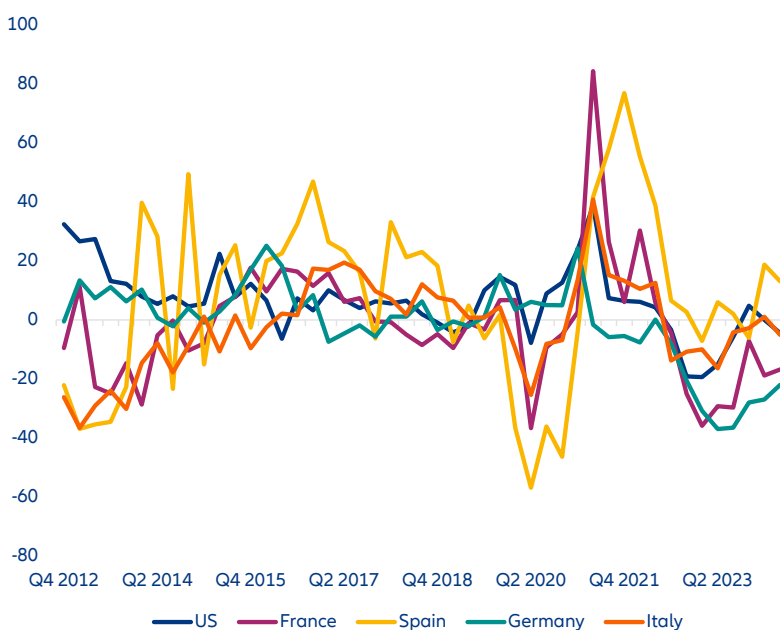
- **Infrastructure should recover but is facing fiscal squeezes.** The US has been leading the way in terms of infrastructure projects and investments, with the Bipartisan Infrastructure Law (BIL) and the Inflation Reduction Act (IRA) boosting the segment massively. In Europe, the civil engineering and infrastructure output has been resilient mostly thanks to Next Generation EU funds. However, recent figures show a dip in output and the incoming fiscal austerity in many countries will only reinforce this trend, though a more favorable rate environment should help the sector recover. Fundraising in Q3 2024 was 28% higher than in 2023 and (non-renewable) energy projects represented over a third of fundraising up to Q3 2024, highlighting the rush-for-power narrative. Returns of infrastructure assets are also improving progressively, which should bolster demand and support the sector further.
- **China's construction sector is still facing a significant slowdown due to the persistent real estate crisis, with no strong rebound in sight.** Construction project initiations and total investments declined by around -40% y/y so far in 2024. The real estate downturn that started in 2021, provoked by fast debt accumulation, excessive investments and regulatory tightening, has caused sharp declines in housing starts, sales and prices. We estimate that government support in 2024 adds up to nearly 4% of GDP as authorities aim to break the doom loop between the real estate sector and local government finances. Even if they are successful, we doubt that the real estate sector will return to its former glory in the long run, given deteriorating demographics, smaller room for further urbanization and debt deleveraging. In contrast, infrastructure investment, particularly in renewable energy and electricity, provided some stability to construction overall, growing by +7.9% in August 2024. Electricity investment reached a record RMB1.6trn in 2023 as part of China's strategy to shift toward sustainable, high-quality development.
- **Ultimately, lower interest rates are a relief but not a booster for companies in the global construction sector.** The slowdown in input prices, from cement to lumber, is benefiting companies that had been squeezed by inflation in the last couple of years. Nevertheless, ongoing labor shortages are pressuring profitability and increasing opportunity costs. In the US, construction wages increased by +3% y/y in Q2 2024; in Germany and Italy, which report the most labor shortages in Europe, wages grew by +5% and +3% respectively. Lower interest rates will improve interest coverage and access to credit but are unlikely to offset the trend of higher insolvencies in the sector that accounts for 20-25% of corporate failures. Insolvencies have risen by +20% y/y in Germany, +31% y/y in France, +35% in Italy and Sweden and +21% in Belgium – with a prolonged high number of major cases globally, particularly in Western Europe and Asia.

Residential: tailwinds from lower interest rates and better affordability

Construction output remained resilient in 2024 despite major headwinds. New housing starts decreased in the US, particularly in Q1 and Q2 2024, driven by persistently high mortgage rates at the start of the year. New projects declined by almost -8% compared to 2023. However, the renovation market saw an uptick, with spending on home improvements rising by +5% over the same period, driven by consumer demand for more energy-efficient homes. As inflation started to moderate and interest rates began easing in Q2, new projects started to pick up in anticipation of an improving backdrop. The two largest Eurozone economies saw a similar pattern. In France, new housing starts declined by -10% y/y in Q2 2024, while Germany faced a sharper contraction of around -12%. Both countries saw a modest uptick in renovations, driven by sustainability concerns and the need to upgrade older housing stock to meet increasingly stringent energy-

efficiency standards. Likewise, Italy's construction market slowed due to the phasing out of the "Superbonus" scheme. In contrast, Spain's residential construction market remained more robust. The Spanish government's continued investment in housing projects helped buffer some of the slowdown, though renovation projects were also on the rise as homeowners sought to take advantage of government-backed energy efficiency subsidies. In the UK, new housebuilding starts were down by close to -30% y/y in Q1 2024. However, renovation activities gained momentum, bolstered by ongoing initiatives to improve the housing stock. This included a rise in demand for retrofitting older homes with modern insulation and energy-efficient heating systems. Residential building permits bottomed out in Q2 2023 and are progressively recovering in most countries (see Figure 1).

Figure 1: Residential building permits (y/y%)



Sources: LSEG Datastream, Allianz Trade

The worst is likely behind us for residential real estate prices as we expect the sector to bottom out in 2025, driven by a compelling mix of economic and policy factors. After two turbulent years marked by record-high interest rates, reduced transaction volumes and housing price corrections, the ECB’s latest Bank Lending Survey signals a gradual recovery in housing loan demand and a loosening of credit standards across Europe as the easing cycle unfolds. With interest rates on the decline, the 10-year mortgage rate in the Eurozone has steadily fallen from its peak of 3.7% in November 2023 (Figure 2). This downward trend, alongside more relaxed credit standards reported by banks, has created a more favorable financing environment. As a result, net demand for housing loans rose for the first time since early 2022,

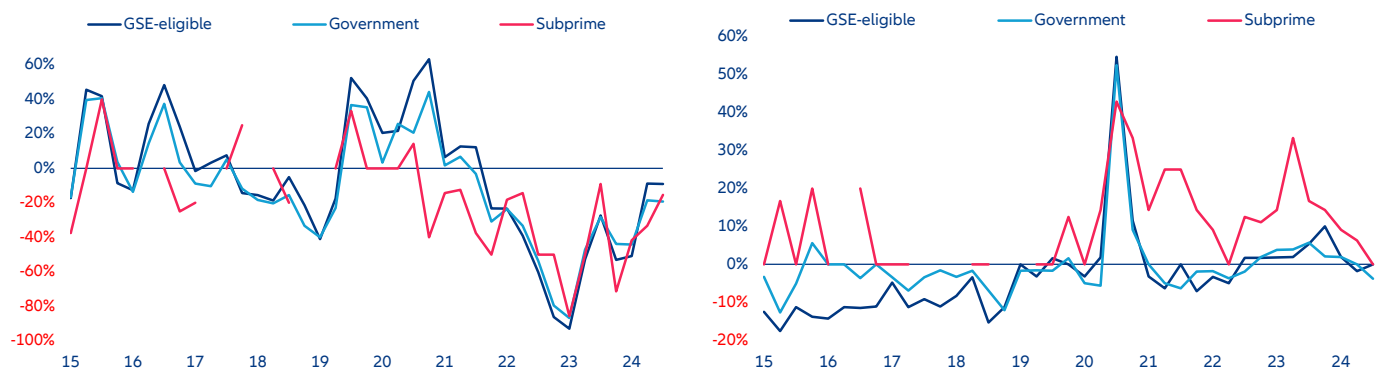
with a strong rebound in Q3 2024 (+39%) – the highest since Q2 2025 (Figure 3), particularly in France (+67% y/y), Italy (+45% y/y) and Germany (+44% y/y). Positive signs on the demand side are also becoming evident in the US. After experiencing a steady decline in net demand for housing loans since late 2021, the market is on track to return to positive growth (Figure 3). This shift is largely driven by a gradual loosening of credit standards and declining interest rates. Banks are reporting a net easing of lending conditions, which is providing much-needed support to prospective buyers and stimulating demand for new mortgages. This recovery in loan demand is expected to gain further momentum in Q4 2024, supported by rising consumer confidence and continued rate declines.

Figure 2: ECB Bank Lending Survey (left) and loans to households for house purchase in the Eurozone (right)



Sources: LSEG Datastream, Allianz Research

Figure 3: Net percentage of US banks reporting stronger credit demand (left) and tightening credit standards (right) according to Senior Loan Officer Opinion Survey on Bank Lending Practices



Sources: LSEG Datastream, Allianz Research

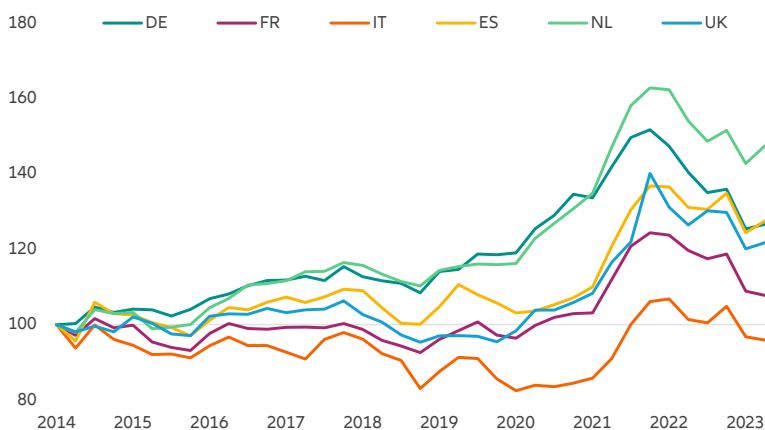
Improving housing affordability will provide some further support for the demand recovery. Corrections in housing prices across major European countries, combined with falling inflation and a return to growth in real wages, have led to a marked improvement in affordability (Figure 4). This improvement is driving renewed demand for new mortgages and a rebound in investment activity. Real estate investment volumes in Europe grew by +16% y/y in Q2 2024, driving a +10% y/y increase in investment volumes in H1 2024. Although still below the long-term average, rising transaction volumes suggest improving sentiment in the investment market. Countries such as Denmark, the Netherlands and, more recently, Germany have already returned to positive price-change territory (Figure 4), with other nations like Sweden expected to follow suit as further rate cuts and rising real wages are anticipated throughout 2024.

As economic growth returns to the region, demand for housing stabilizes and the easing of monetary policy lowers borrowing costs, real property values should increase. We expect France's recovery to take the longest, with prices expected to bottom out only at the end of

2024, resulting in a decline of -4.5% for the year. This will be followed by modest price growth of around +1% and +2% in 2025 and 2026, respectively. Southern Europe markets, including Italy and Spain which have shown more resilience, are likely to struggle to maintain momentum, with nominal price increases of around +1% in 2025 and +1.5% in 2026. Conversely, Germany and the Netherlands, having already experienced significant adjustments, are expected to see a quicker turnaround, with prices already forecasted to grow by above +2% annually in 2025 and 2026. The UK is projected to be the fastest-growing market in the coming years, with nominal price growth exceeding +2.5% during the same period, reflecting a more robust recovery.

Lower interest rates should support the recovery in residential construction – but only in 2025. With central banks in the US, Eurozone and UK easing monetary policies, financing costs and mortgage rates have been declining since the second half of the year. This should continue to have a positive impact on home-buyer sentiment and demand. However, the full effects of lower interest rates on housing markets are expected to

Figure 4: Home-affordability index for selected European countries



Sources LSEG Datastream, Allianz Research. Note: Affordability calculated vs income, using OECD house price-to-income indicators. It refers to the affordability of buying a home in the moment of buying, assuming a LTV (loan-to-value) of 75%, fixed mortgage rates and 20Y mortgage term.

materialize only in 2025. Our historical analysis reveals that a 1pp drop in mortgage rates increases residential building permits over the next quarter by +3pps in Italy, +5pps in France, +6pps in Spain, +8pps in Germany and as much as +19pps in the US. Furthermore, the transmission of lower policy rates to mortgages is rather fast – a matter of months in most countries. There are even some where rates started to decrease even before the central bank’s rate cuts as banks attempted to attract and lock in clients early.

budget, which could slow the pace of upgrades to older properties and hurt the renovation segment. In Italy, the “Superbonus” scheme, which incentivized energy-efficient renovations with significant tax rebates, ended in 2023. This is expected to lead to a sharp decline in renovation projects in 2024 and beyond, particularly among middle-income homeowners. However, Spain’s renovation market is expected to remain supported by EU green subsidies through 2025.

Government support is likely to be downsized, hurting renovation in particular. Several government schemes that supported housing markets are being rolled back or reduced, which will have implications for both new construction and renovation activities. In the UK, for instance, changes to the stamp duty in April 2025 are expected to deter buyers as they will then apply to properties above GBP125k (vs 250k GBP currently) or GBP300k for first-time buyers (vs GBP425k today), which could be a blow to demand in an already sluggish market. In France, renovation subsidies (i.e. Ma Prime Renov) are being reduced as the government refocuses its

Figure 5: Renovation indicators (y/y%)



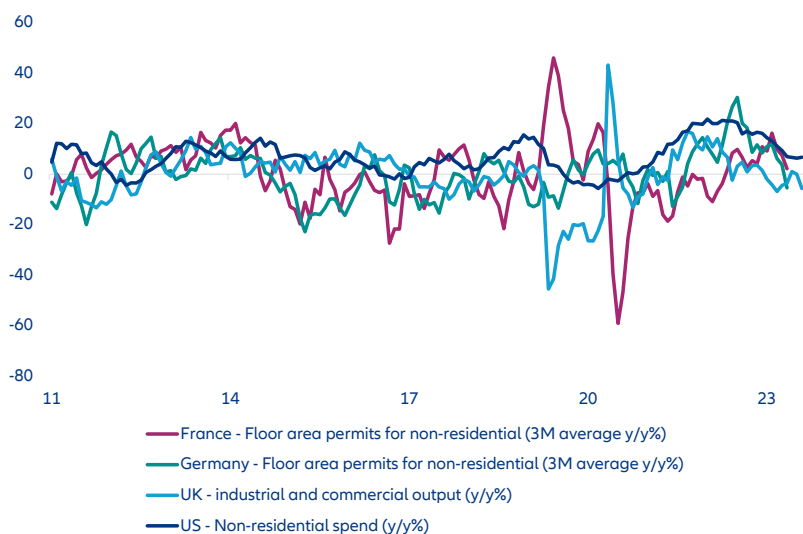
Sources: Refinitiv, CERC, Allianz Research

Non-residential: can you tell a structural change when you see one?

2024 has been a mixed bag for non-residential construction. New office construction dropped in the US (-19% y/y as of Q2 2024), reflecting the post-Covid shift to remote work models, with most companies reassessing their office space needs, leading to oversupply in many markets. Retail construction remained mostly stable in the US while the industrial and logistics segments benefited from strong demand related to e-commerce and nearshoring as companies restructured supply chains amid geopolitical risks. The +4% y/y rise in new starts in the segment reflects this trend. Data centers experienced a significant boost (+15% y/y), thanks mostly to the boost from AI adoption. Hotel construction remained steady, with most activity focused on renovation in urban centers to meet the evolving needs of business and leisure travelers. In France and Germany, office construction saw a sharp decline (about -10% y/y for both). Retail construction showed resilience while the logistics and industrial segments were the standout performers across Europe. In Spain, for example, the surge in e-commerce

and the drive to nearshore production boosted new logistics projects by +6% y/y. The hotel segment saw robust renovation activity in Italy and Spain, where the post-pandemic tourism recovery spurred investments in upgrading existing infrastructure. Like in the US, data-center construction across Europe grew substantially. In the UK, office construction activity remained sluggish, with central London seeing a -26% drop in investment volumes compared to 2023. The retail sector showed resilience and industrial and logistics construction remained robust, driven by ongoing e-commerce demand, with logistics take-up rising by +18% y/y in the first half of the year. The hotel sector in the UK remained stable, focusing more on renovations as urban markets benefited from recovering tourism. Data centers in the UK also experienced the same strong momentum as in the other countries in our panel.

Figure 6: Non-residential indicators



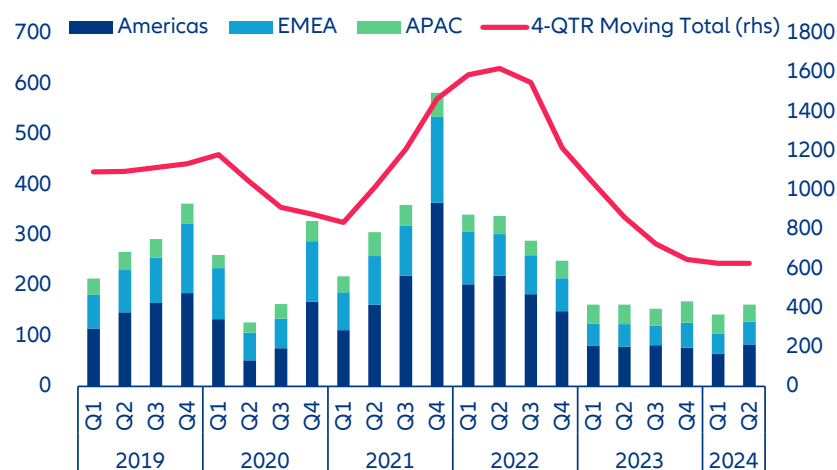
Sources: LSEG Datastream, Allianz Trade

Office vacancy remains high. The oversupply of office space in the US pushed vacancy rates to close to 20% in Q2 2024. This rather high rate reveals the slow recovery in demand as companies are still committed to hybrid work environments. Unsurprisingly, prices for office space fell slightly. In Europe, office vacancy rates in France and Germany hovered around 8-9%, with a widening gap between prime locations and secondary assets. Retail has remained broadly stable. In Europe, prime retail spaces had low vacancy rates (3%), and rents were stable. However, secondary retail properties, especially non-essential and fashion retail, faced higher vacancy rates and falling rents. In the US, non-essential retail faced greater challenges, with vacancy rates nearing 10%, still suffering from the effects of the pandemic and the growth of e-commerce. The industrial and logistics sectors continued to benefit from high demand, with vacancy rates around 6% in the U.S. and 4% in Europe. This low vacancy rate, driven by robust demand from e-commerce, logistics providers and the nearshoring trend, resulted in rents rising by +6% in key markets like London, Paris and major US cities. Meanwhile, logistics hubs near ports and major transportation corridors saw particularly strong demand and hotels saw a strong recovery in occupancy rates, particularly in Italy and Spain, where city hotels achieved occupancy rates of around 70%, fueled by pent-up demand for international travel.

Global commercial real estate investment remained muted in the first half of 2024, but the pace of the decline decelerated compared to 2023, signaling early signs of stabilization. Global transactions continued to drop by -17% in Q1, followed by a more moderate -1%

decline in Q2 (Figure 7) as financing costs began to fall and prices started to stabilize and recover. While activity remains subdued, the gap between buyers' and sellers' price expectations is narrowing, which could support a recovery in investment volumes. The living sector has been leading the recovery in deal volume, driven by sustained rental growth and demand for housing. In Europe, the hotel sector has been a bright spot, bolstered by a strong rebound in tourism demand. However, the industrial sector, which had been a robust performer in recent years, is now seeing some softening in demand as supply chains stabilize and the urgency for logistics space diminishes. Meanwhile, the office sector continues to be a significant drag on the overall market, still grappling with the structural shifts brought on by the rise of remote and hybrid work models. The prolonged uncertainty in the segment is likely to persist, with businesses continuing to reassess their long-term space requirements. Despite the challenging environment over the past two years, as pricing dynamics improve and the broader economic outlook stabilizes, we expect the commercial real estate market to gradually recover extending into 2025, although the pace of recovery will vary across different sectors.

Figure 7: Global commercial real estate investment volume by region (USD bn)



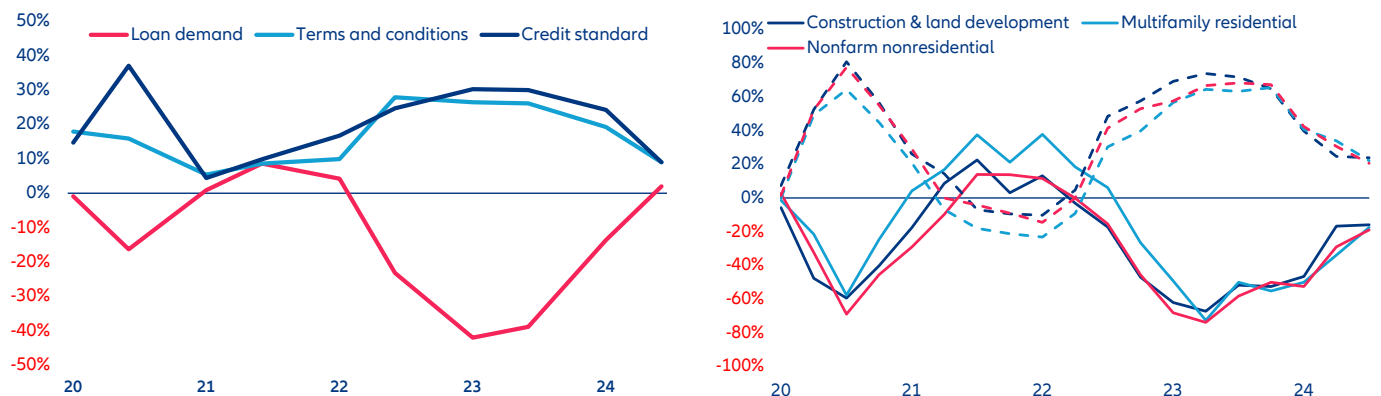
Sources: CBRE, Allianz Research

Bank lending surveys point to loosening credit standards and strengthening loan demand for commercial real estate on both sides of the Atlantic, suggesting a further recovery in investment activity as financing conditions improve. In the Eurozone, the net tightening of credit standards reported by banks has significantly declined, dropping from 30% in H1 2023 to just 9% in H2 2024 (Figure 8). This easing of lending conditions has helped fuel a recovery in loan demand, with net demand growth returning to positive territory after two years of sharp declines. In Q3 and Q4 2024, 2% more banks reported an increase in demand relative to a decrease for commercial real estate loans in Europe, signaling renewed confidence in the sector. A similar trend can be observed in the US, where although net demand for commercial real estate loans is still declining, the pace of decline has slowed significantly. Lending standards in the US have been loosening since mid-2023, when approximately 70% more banks reported tightening relative to loosening (Figure 8). By H2 2024, that figure has dropped to less than a quarter, signaling more favorable conditions for borrowers and supporting a further recovery in demand. While part of the current loan demand is driven by refinancing needs, as large investments made in 2021 are coming due, the improving credit conditions are also expected to support new investment activities in the sector.

Structural changes have been driving the segment.

Since the pandemic and the rise of remote work, the office segment has taken a serious blow and is unlikely to fully recover over the next couple of years. However, more and more corporates are reconsidering the benefits of remote work and backpedaling. Should this trend continue or amplify further, the office segment could be poised for a comeback. Retail is another segment that was heavily impacted by the pandemic and the sharp rise of e-commerce. Nevertheless, some segments such as experiential retail and grocery remain rather untouched by the digitalization of purchasing habits as shoppers still come to stores for a “unique” experience or to see and touch products. The industrial and logistics sectors are expected to thrive in the coming years, supported by trends in e-commerce but also by the reorganization of global trade (i.e. nearshoring, friendshoring etc.) and supply-chain diversification. Again, in this case, it is yet to be confirmed whether this trend will last or could be reversed in the medium to long term. Lastly, we expect data centers to continue to grow strongly, driven by the fast adoption of AI and cloud computing, and the rise of 5G.

Figure 8: Net percentage of banks reporting tightening credit standards and stronger loan demand for commercial real estate in the Eurozone (left) and in the US (right)s



Sources: ECB, Board of Governors of the Federal Reserve System, Allianz Research

Notes: The dashed lines in the graph on the right-hand side refer to credit standards and the solid lines refer to loan demand.

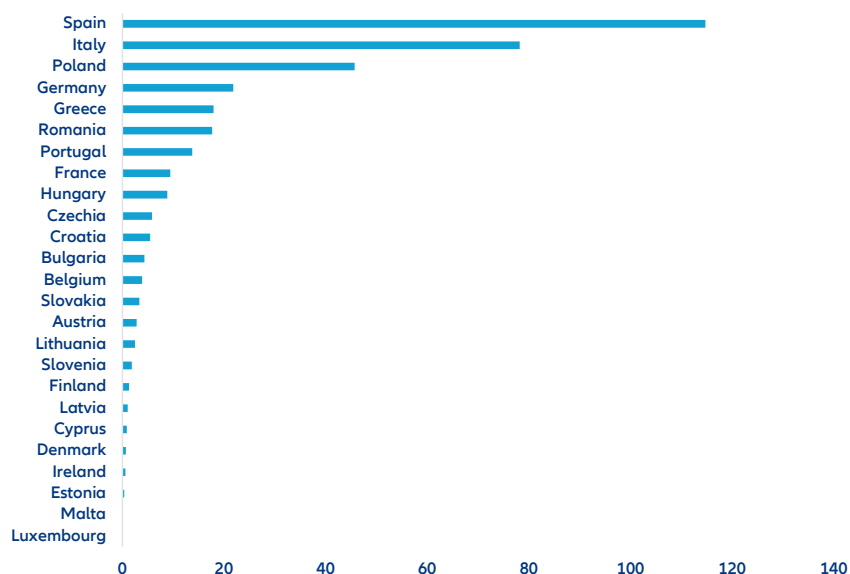
Rising tides, tightening belts: infrastructure recovery amid fiscal squeezes

The US is still surfing on the infrastructure boom, while Europe is trailing behind. The infrastructure sector in the US saw substantial growth in 2024, primarily driven by the Bipartisan Infrastructure Law (BIL) and the Inflation Reduction Act (IRA). Major projects in transportation, such as highway and bridge repairs, received over USD110bn in funding under the BIL. The IRA continued to fuel investment in clean-energy infrastructure, with significant expansions in power grids and renewable energy. Digital infrastructure also grew, with USD65bn allocated to improve broadband access across rural and remote areas. Nevertheless, we should note that healthcare and education infrastructure saw much slower growth despite some modernization efforts in various states, particularly for aging hospitals and schools. In Europe, spending remained resilient mostly thanks to the EU's Next Generation EU recovery fund but did not get the same boost as in the US. In the UK, 2024 saw moderate decline in infrastructure output despite some flagship projects such as the High-Speed 2 (HS2) rail project, which continues to progress despite many hurdles. In Europe, countries such as Spain or Poland have only used close

to 20% of their allocated amounts, while Portugal or Romania still have over 60% of their budget to spend. Italy, the largest recipient, received about half of the allocated amount so far and still has about EUR90bn to receive/spend (see Figure 9). With over 40% of the recovery and resilience fund allocated to green projects, this will be a welcome boost for the segment.

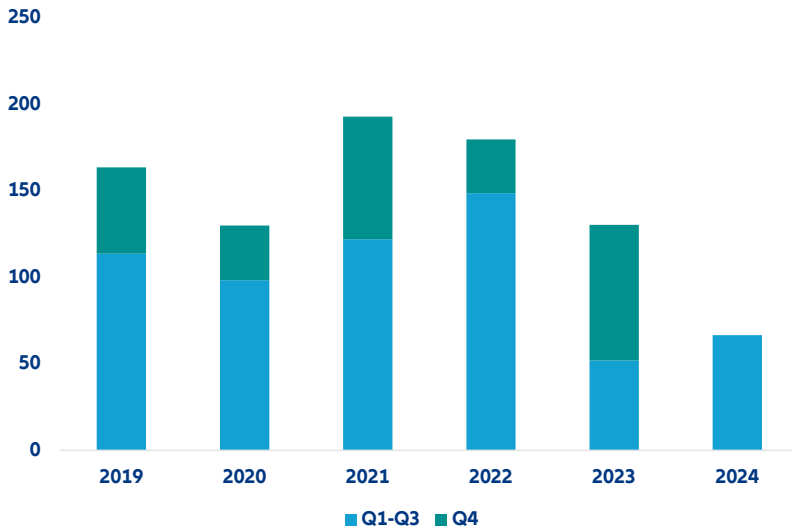
Fundraising remains difficult, but returns are improving. Infrastructure fundraising in 2024 is recovering somewhat from the significant decline experienced in 2023. Over the first three quarters, fundraising in 2024 was 28% higher than in 2023 (see Figure 10). In the US, infrastructure assets continued to be attractive to investors, with energy and transportation infrastructure leading in deal volume. Energy assets, in general have been important in fundraising even beyond those related to decarbonization and renewable energy (see Figure 11). As Europe continues to grapple with an energy crisis, and as many segments in the renewable space have been through major challenges over the last couple of years, this does not come as a surprise.

Figure 9: Allocated NGEU funds that are yet to be paid (EUR bn)



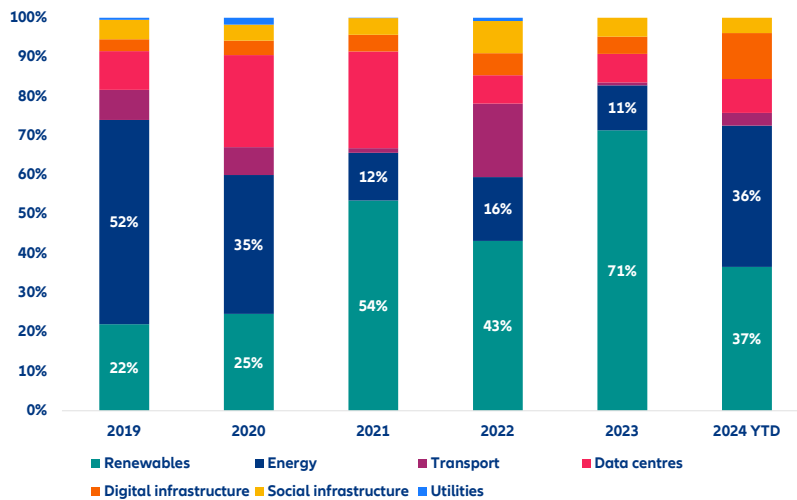
Sources: European Commission, Allianz Research

Figure 10: Infrastructure fundraising (USD bn)



Sources: Infrastructure Investor, Allianz Research

Figure 11: Infrastructure fundraising breakdown (% of total)



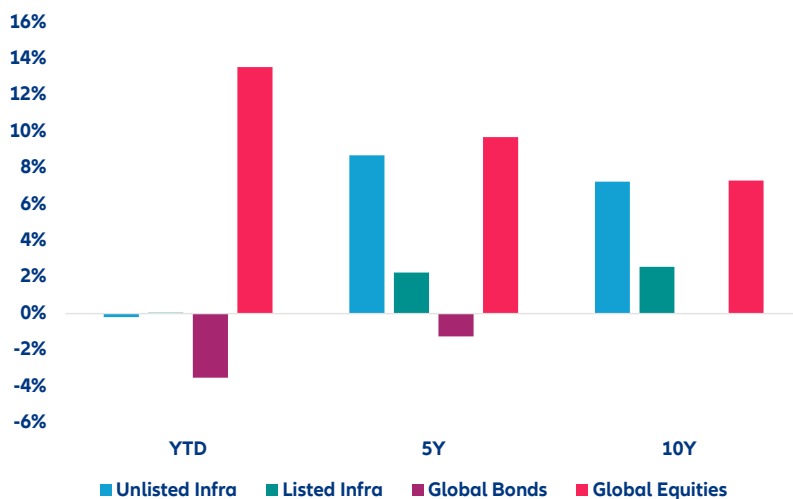
Sources: Infrastructure Investor, Allianz Research

However, global infrastructure returns were weighed down by high interest rates. Listed infrastructure in particular was hit by a combination of higher rates and negative sentiment following turmoil in renewables and especially in wind. In the context of the ongoing energy crisis, power projects outperformed traditional infrastructure sectors. Unlisted infrastructure assets posted better returns, with solid performances of transport and utilities assets. Lower energy prices and lower inflation also meant that assets in energy and those with contracted prices linked to CPI have seen returns normalize.

should also increase in the coming years. The expansion of electric vehicle (EV) charging networks and grid modernization projects will also become more attractive with better financing conditions. Lastly, the development of AI is increasing demands for power supply but also for digital/communications infrastructure. However, the overall optimism may be tempered by fiscal austerity in many parts of the world. Indeed, beyond the already voted and secured funding, we do not expect a boost for infrastructure projects in 2025.

The monetary easing cycle is expected to significantly boost demand for infrastructure projects, but fiscal austerity will be a drag. Capital-intensive sectors such as transportation and energy will benefit from lower interest rates. Large-scale infrastructure investments should pick up as the global economy is still desperately in need of power, and clean power especially. Moreover, as geopolitics becomes more complex and leads to supply-chain fragmentation, projects related to transportation

Figure 12: Returns of listed, unlisted infrastructure compared to other assets as of Q2 2024(%)



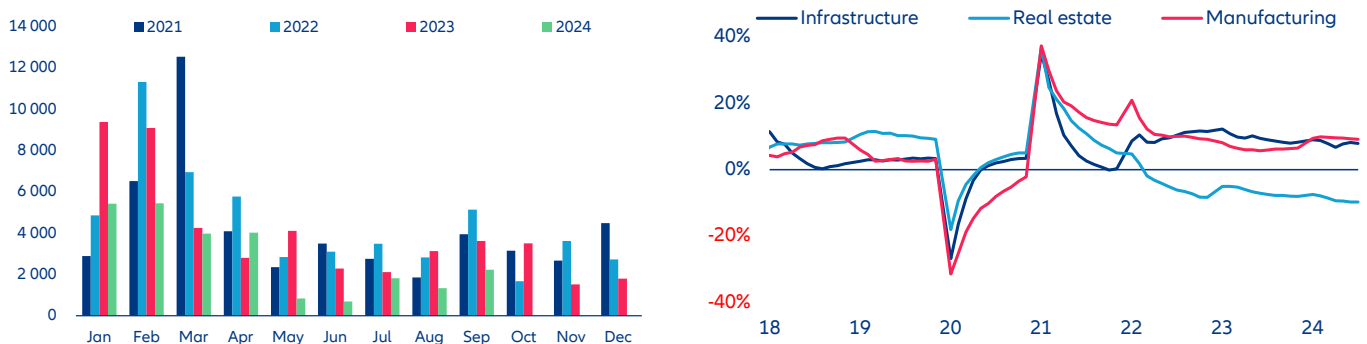
Sources: EDHECinfra, LSEG Datastream, Allianz Research

China: real estate crumbles but energy infrastructure powers ahead

Construction activities in China have slowed significantly in 2024, weighed down by a deepening downturn in the real estate sector. In the first three quarters of 2024, a total of 47,490 construction projects were initiated, marking a sharp -36.8% y/y decline (Figure 13). Correspondingly, the total investment in these projects dropped to RMB40.8trn, compared to RMB75.2trn in the same period in 2023. One of the major drivers of this slowdown has been the persist property crisis, which has placed severe strain on real estate investment. By August 2024, real estate investment had contracted by -9.8% (Figure 13), deepening the sector’s decline as property developers grapple with tighter credit conditions, sluggish demand and unfinished projects. However, infrastructure investment has provided some stability to the overall construction landscape. Infrastructure spending grew by +7.9% in August as the government continued to push for public works projects, including transportation, energy and urban infrastructure, as part of its efforts to stabilize the economy. While infrastructure investment growth has helped offset some of the decline in real estate, it has not been enough to fully compensate for the downturn in the broader construction sector.

The crisis in the Chinese real estate sector is not over yet. The ongoing real estate crisis in China was precipitated by a combination of fast debt accumulation, excessive investments and regulatory tightening. Between 2010 and 2019, household credit (mostly mortgages) rose from 26% of GDP to 56%. While authorities had focused on deleveraging the economy between 2016-2019, the pandemic led to renewed stimulus that focused on the real estate sector. Non-financial corporates’ credit rose from 90% of GDP in 2008 to 155% in Q1 2016, before declining to 128% in Q4 2019 and bouncing back to 140% two quarters later. In reaction, regulatory guidelines were introduced to help rein in real estate developer’s debt (the “three red lines”) and limit bank financing to the housing sector (the “two red lines”). Such conditions precipitated liquidity crises and defaults among the most overleveraged developers (including very large ones), halting construction projects, shaking household confidence and causing a decline in housing prices. As of Q3 2024, housing starts are -69% below their Q4 2020 peak, housing sales are -56% below their peak and

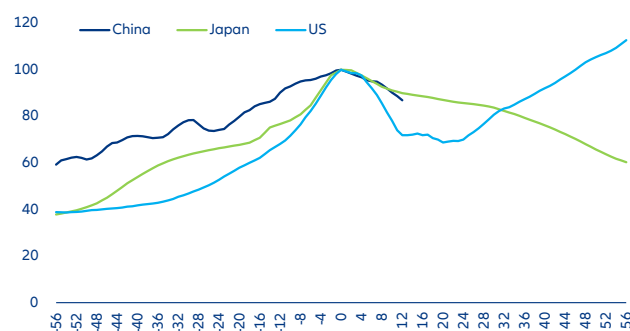
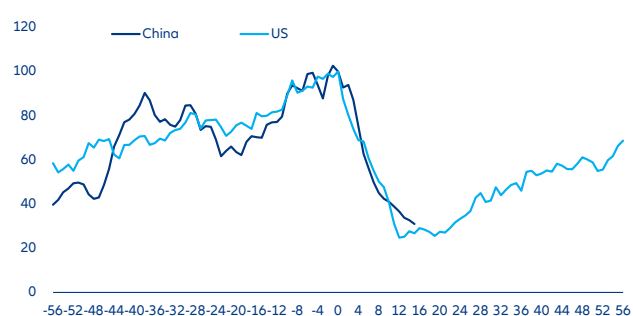
Figure 13: Total investment of construction projects starting in the month (RMB bn, left) and cumulative fixed asset investment growth (y/y, right) in China



Sources: Mysteel, National Statistics, Allianz Research

housing prices are -13% below their peak (reached in Q3 2021) – see Figure 14. Despite individual specificities, past crises in other countries would suggest that the correction is not over yet: in the US, the peak-to-trough decline during the Great Financial Crisis reached -75% for housing starts, -77% for housing sales and -31% for housing prices. While the former two measures would suggest that China is not too far from the trough, the correction in housing prices seems to have been much milder. This is probably due to several reasons: (i) China’s measure focuses on new home sales rather than repeat sales, (ii) the national gauge of housing prices is not representative enough and masks large divergence across cities and (iii) authorities have put in place a host of measures to try and contain the decline in prices.

Figure 14: Housing starts, peak = 100 – Q4 2020 for China and Q1 2006 for the US (left) and Nominal property prices, peak = 100 – Q3 2021 for China, Q1 2006 for the US and Q1 1991 for Japan (right)



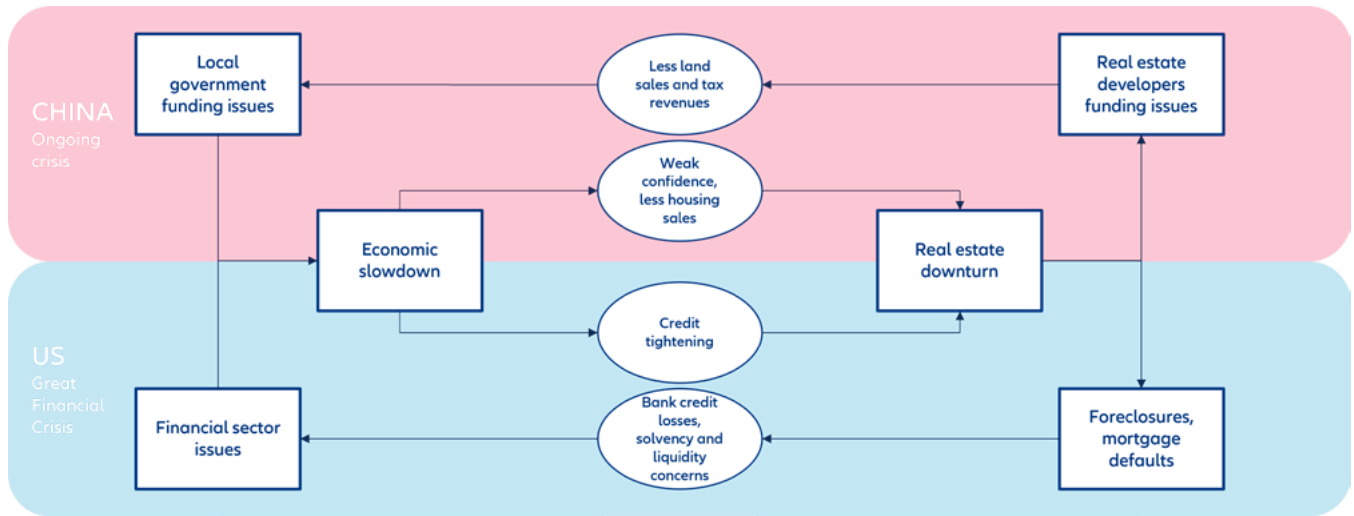
Sources: National Statistics, LSEG Datastream, Allianz Research

Government support aims to pick up the pieces but cannot avoid a multi-year structural adjustment. With around 70% to 80% of Chinese household wealth in real estate, stabilizing housing prices is of the utmost importance for policymakers. Indeed, declining housing prices would tend to weaken private sector confidence, leading to less spending and housing sales. This in turn adds to real estate developers’ funding strains, leading to less land sales and tax revenues for local governments, and public finances issues create less room for fiscal spending and support to the overall economy. Chinese authorities have been doubling down on efforts to break this doom loop this year (see Figure 15). RMB500bn of Pledged Supplementary Lending for affordable housing was allocated and a RMB300bn relending loan facility was created to fund the purchase of unsold apartments by state-owned enterprises¹. Additionally, local governments are now allowed to use funds derived from special bond issuance to purchase unused lands and

unsold property from developers. Funding for “white list” housing projects will rise to RMB4trn by the end of the year (from RMB2.23trn in mid-October and RMB1.4trn in mid-August). All these measures add up to nearly 4% of GDP this year. This compares with roughly 5% of GDP over two years under the US Troubled Asset Relief Program in 2008-2010, which was a government response during the Great Financial Crisis focused on recapitalizing banks, purchasing troubled assets and refinancing mortgages (see Figure 15). Even if Chinese authorities manage to break the ongoing real estate doom loop, we doubt that the sector will return to its former glory in the long run, given deteriorating demographics, smaller room for further urbanization and debt deleveraging. The Chinese economy has embarked on a multi-year restructuring of its growth model.

1. We estimate that absorbing excess housing inventories could cost around RMB4tn (see [here](#) for more details).

Figure 15: Real estate doom loops in China and the US, and government attempts to break them



* Expected. We do not take into account the potential multi-year local government debt swap program that could also be announced.

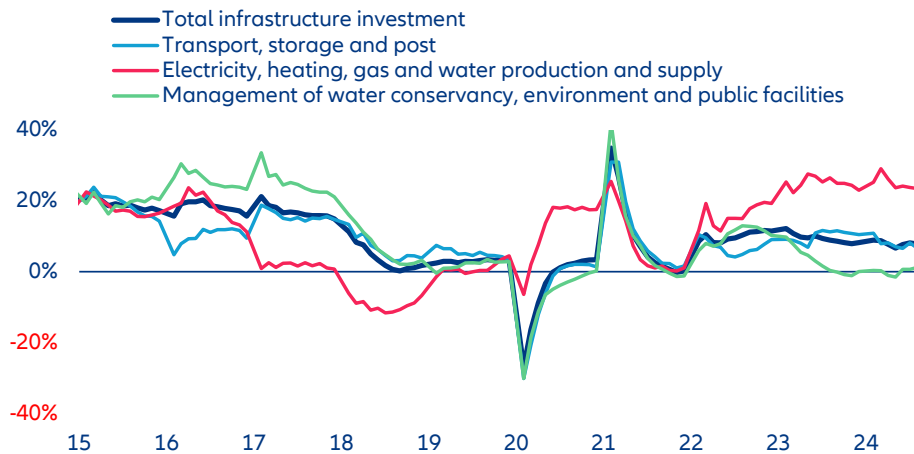
Note: TARP = Troubled Asset Relief Program, amounting to USD700bn (later reduced to USD475bn). This was a government response to recapitalize banks and systemic financial institutions, purchase troubled assets, modify and refinance mortgages.

Sources: National sources, Allianz research

Within the infrastructure sector, investment in electricity, heating, gas and water production and supply has clearly outpaced other categories as the government targets renewable energy development as part of its broader strategy to transform the economic model into one centered on high-quality development. The monthly investment in this category has consistently grown above +20% y/y since 2023 (Figure 16). Notably, electricity investment alone reached RMB1.6trn in 2023, marking a historical high with a +24.7% y/y increase. This surge is part of China’s broader effort to expand its energy infrastructure, support renewable energy projects and upgrade the aging grid to meet rising demand for clean

energy. Although the pace of growth has moderated slightly in 2024, the subsector remains on track to set another record in investment. The government’s continued focus on expanding renewable energy capacity — such as wind, solar, and hydropower — along with the need for a more resilient and efficient energy grid are expected to drive sustained investment growth and construction demand.

Figure 16: China’s infrastructure investment growth (y/y)



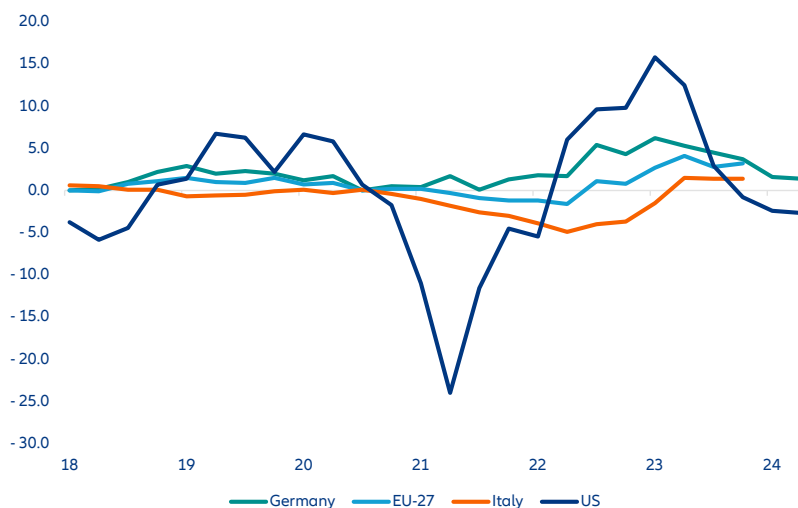
Sources: National Statistics, Allianz research

Lower rates are a relief but not a booster for corporates in the construction sector

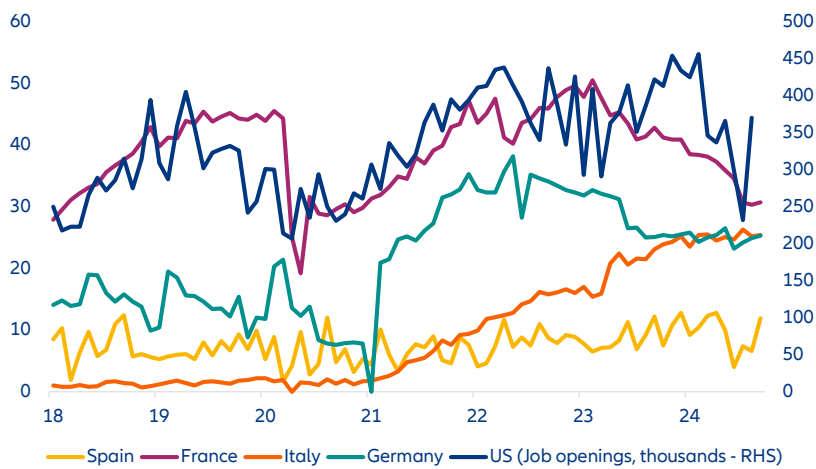
Profitability in the construction sector has been recovering somewhat since 2023, with raw material and construction materials costs showing moderate increases after the post-pandemic peaks. Key inputs like steel, cement and lumber have seen their prices ease. For instance, cement prices measured by producer prices grew by +1% y/y in the UK in Q1 2024, +2.3% in the Eurozone and +6.6% in the US, far from the double-digit increases seen in 2022-2023. This slowdown in costs is benefiting companies that had been squeezed by inflation in the last couple of years (see Figure 17). However, the ongoing labor shortage remains a significant challenge, especially in countries like the US,

Germany, Italy and the UK, driving up construction wages. For instance, US construction wages increased by +3% y/y in Q2 2024, weighing on smaller firms that find it harder to compete for skilled labor. In Europe, the labor shortage has been exacerbated by demographic challenges and lower labor mobility, which has kept wages high for many construction firms. Companies in Italy and Germany are reporting the most difficulties to hire while pressures seem to be easing in France (see Figure 18).

Figure 17: Difference between output price y/y growth and input price growth (pp)



Sources: LSEG Datastream, Allianz Research

Figure 18: European firms reporting labor as a hurdle for production (%) and job openings in construction in the US

Sources: European Commission, BLS, Allianz Research

Interest coverage should improve as interest rates fall...

As high interest rates have been inflating interest expenses, the interest coverage of construction firms deteriorated in most countries. Italy was one of the notable exceptions that saw interest coverage improve but this stems from the bumper effect of the “Superbonus” rather than a specific debt-management strategy among Italian firms. Coverage deteriorated in countries where leverage was already high, such as France, Sweden, Denmark and the US, which show net gearing (i.e. the ratio of total debt to equity) above 80% in 2023 (see Figure 19). At the opposite end of the spectrum, countries like Germany, Italy and Norway have seen some deleveraging.

...along with liquidity positions. SMEs in particular have struggled with rising debt-service costs amid slower project pipelines so the reduction in borrowing costs should alleviate some of the pressure on leverage metrics. However, this recovery will be gradual as we estimate that it takes a couple of months for lower rates to be passed on to firms, and many smaller firms are likely to continue to face difficulties in accessing credit. The ongoing challenge for firms will be managing debt repayments in an environment where project backlogs are shrinking and public funding for large-scale projects is being reduced due to fiscal austerity.

Insolvencies continue to pick up in the construction sector.

Corporate failures have been on the rise across many economies and this trend is expected to continue through 2024 and peak in 2025. The construction sector has been no exception since it is mostly composed of SMEs and tends to account for 20-25% of total insolvencies (Figure 20) in most countries as a result. The most recent figures show a +20% y/y increase in Germany, +31% y/y in France, +35% in Italy and Sweden, +21% in Belgium and +4% in the Netherlands while they were broadly stable in the UK and decreased by -11% in Denmark. However, large companies are not immune. Bankruptcies of companies with a turnover of more than EUR50mn remain significant, with over 30 cases globally in the first half of the year, primarily in Western Europe and Asia. Construction is the third most affected sector when it comes to major bankruptcies, following trade and services. Looking ahead, any delay in project financing or revenue realization could push even more highly leveraged companies toward insolvency.

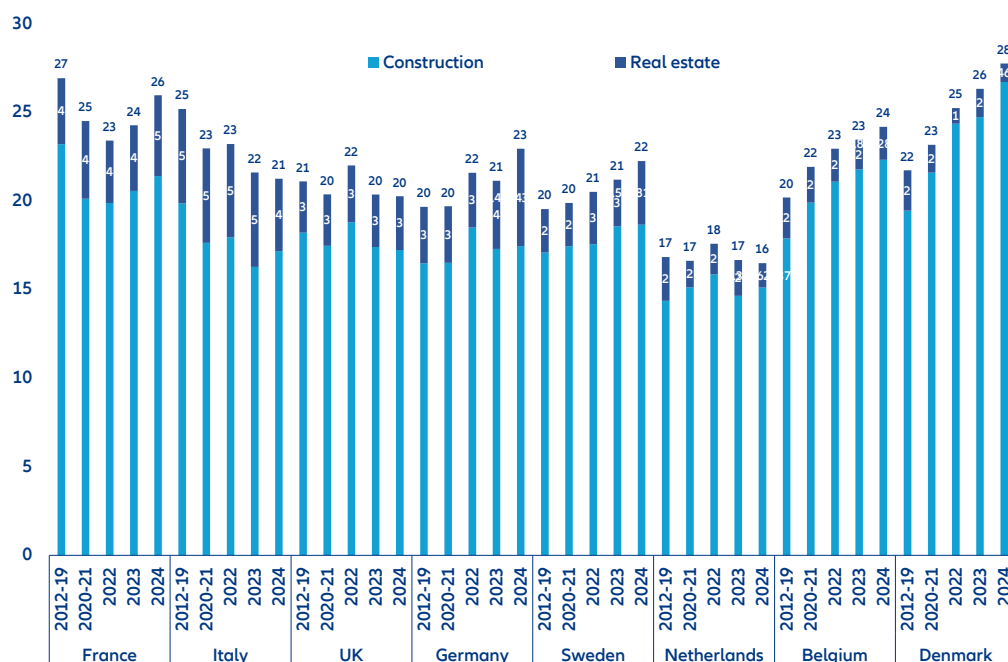
Figure 19: Construction firms leverage and liquidity metrics 2022-2023

	Net gearing	Net gearing change	OCF	OCF change	Interest coverage	Interest coverage change
France	91%	27.5	9.2	4.7	3.9	-2.3
Canada	90%	16.1	11.7	4.5	2.7	0.2
Sweden	90%	7.6	6.9	0.1	2.4	-1.0
Switzerland	86%	1.9	13.2	4.0	5.1	-3.2
Denmark	84%	34.6	6.6	2.3	2.7	-9.2
US	80%	5.9	6.3	0.4	3.8	-0.4
Netherlands	70%	28.9	4.1	2.0	4.5	-1.7
Belgium	67%	0.0	6.5	0.0	3.4	-2.3
Global	48%	12.7	3.5	1.4	3.9	-0.9
Australia	44%	20.1	0.0	-1.2	2.1	-2.0
Norway	43%	-32.4	3.0	-4.6	2.5	-0.2
Finland	39%	-27.5	5.9	5.3	3.5	-4.4
Singapore	38%	-13.0	3.9	1.1	3.1	0.2
Brazil	37%	7.6	0.1	0.8	2.4	0.7
Spain	34%	-6.5	5.2	-0.1	3.0	-0.1
Hong Kong	34%	18.2	12.0	11.3	2.7	-0.5
United Kingdom	31%	6.0	3.5	1.1	6.4	1.8
Korea	29%	-6.5	1.3	0.1	3.4	-2.4
Saudi Arabia	22%	-1.3	2.7	0.6	9.8	-3.4
Germany	22%	-36.3	4.2	-0.1	4.3	-0.4
Italy	19%	-18.3	0.9	-1.7	11.1	3.9
Japan	6%	-0.6	2.1	0.9	25.3	1.6
Poland	1%	-11.4	0.5	0.0	9.1	4.4
Turkey	-1%	-6.6	0.3	0.2	1.6	-3.0

Net gearing (2023 level + 2023/2022 change), operating cashflow coefficient (2023 level + 2023/2022 change), interest expense coverage (2023 level + 2023/2022 change). Median figures for sectors with 5+ listed firms.

Sources: LSEG Workspace, Allianz Research

Figure 20: Share of construction in insolvencies (% of total)



Sources: national sources, Allianz Research



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