

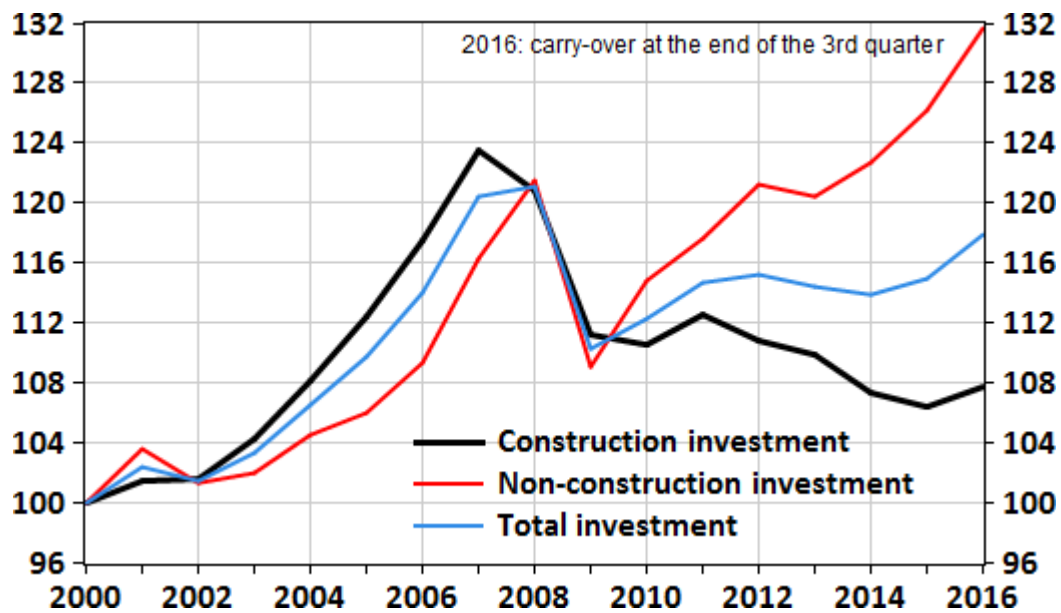
What are the consequences of the construction crisis?

By [Eric Monnet](#) and Camille Thubin

Unlike other forms of investment, construction investment in France has still not returned to the levels seen before the 2008 crisis. The drop in construction activity had a significant negative impact on French employment and GDP growth up until 2016. In the case of housing construction in particular, despite a recent upturn, unfavourable demographic factors could again place a drag on investment growth going beyond 2017.



French gross domestic product (GDP) returned to its pre-crisis levels in the first quarter of 2011. Since then, annual GDP growth has remained positive, albeit fairly weak. One component of GDP stands out as an exception, however: construction investment has remained mired in a near-permanent recession, and has still not returned to where it was immediately before the crisis. Indeed, in 2016 it only just reached the level seen in 2004. Construction investment comprises housing investment (by households and social housing companies), investment in non-residential property by the government and by businesses (premises, offices and warehouses), and investment in public works. It accounts for more than half of total investment, but differs from investment in machinery and equipment, transport equipment, and R&D in that it does not contribute directly to a firm's production.

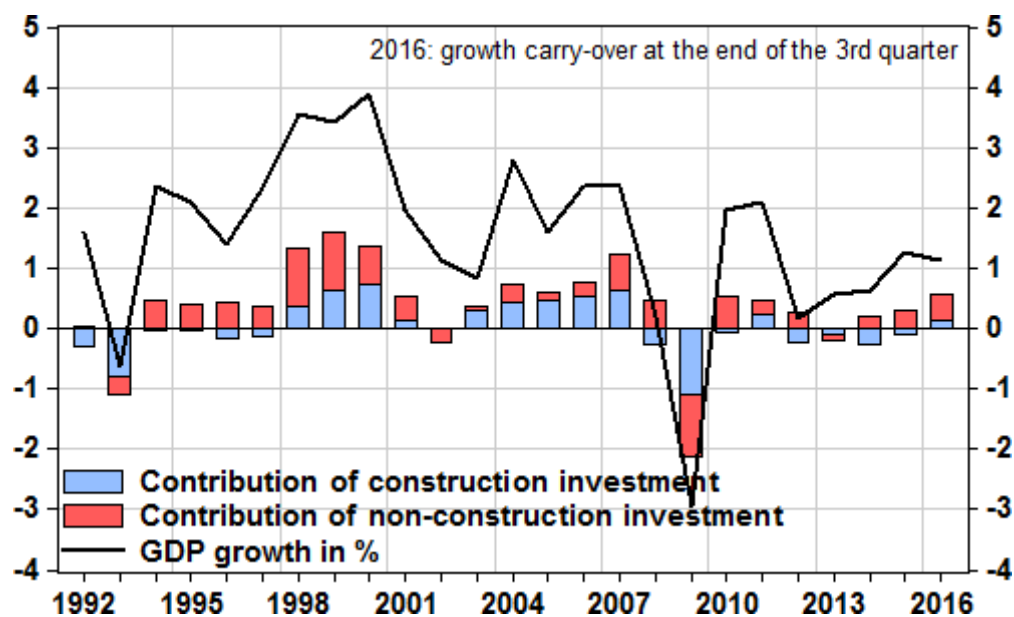
Chart 1: Divergence of French construction investment since the crisis*(real investment, 100=2000)**Source: Eurostat, investment by asset.*[\[1\]](#)

Disconnect between construction and non-construction investment

Trends in non-construction and construction investment have diverged massively since the crisis (see Chart 1). In real terms, the latter has plummeted by more than 10% since 2008, with both the residential and non-residential segments feeling the effects of the downturn. By contrast, non-construction investment has risen by 8% over the period; it returned to pre-crisis levels as early as 2012 and has since continued to trend upwards, growing by an average of 2% per year from 2012 to 2015. The fact that total investment remains below its pre-crisis levels is therefore essentially due to construction.

After rebounding slightly in 2010-2011, construction investment made a negative contribution to French GDP growth from 2012 to 2015, while all other forms of investment helped to support economic expansion (see Chart 2).

Chart 2: Negative contribution of construction to growth



Aside from a slight respite in 2010, construction has been almost permanently in recession since the start of the 2008 economic and financial crisis, in sharp contrast with the dynamism seen at the start of the 2000s. Construction investment in fact only stopped declining very recently, in 2016. As a share of GDP, construction investment (including housing investment) has fallen to its lowest level in three decades, at 11%, whereas non-construction investment has reached an all-time high of 10%.

The construction cycle and the growth differential between France and Germany

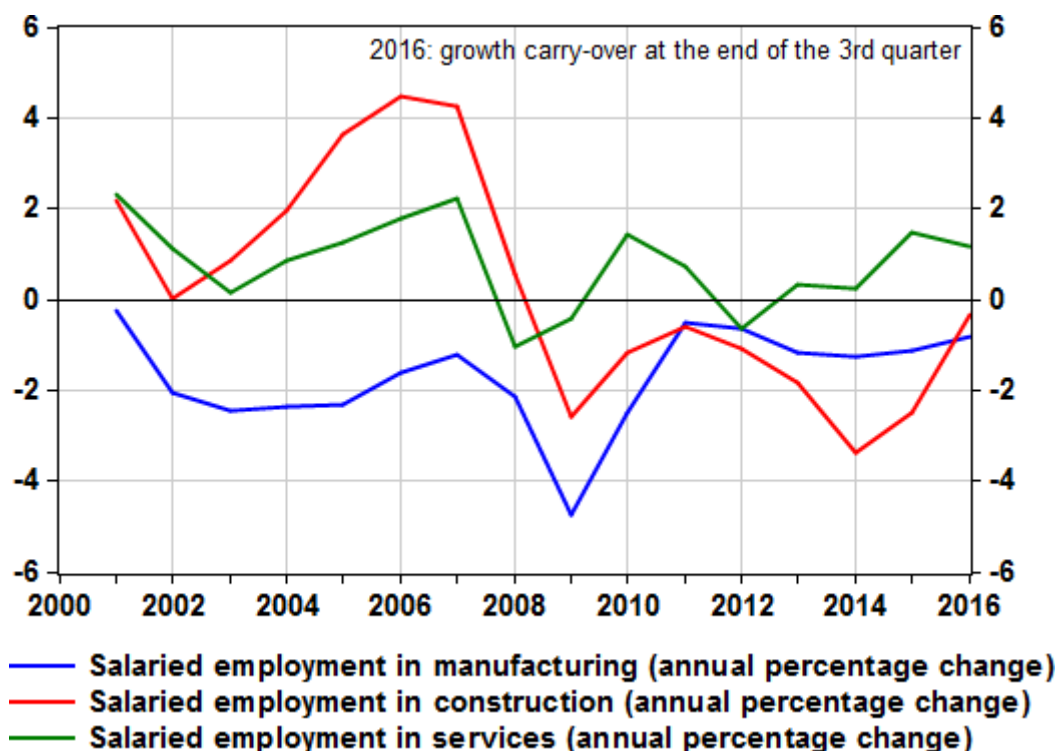
The construction cycle is an important factor in understanding the specific pattern of French growth since 2011, especially when compared to that of Germany where there has been no comparable construction crisis in recent years. Between 2011 and 2015, more than 40% of the growth gap between France and Germany can be attributed to differences in the

contributions of construction investment. In Germany, GDP growth averaged 1.6% a year between 2011 and 2015, while construction investment contributed an average 0.2 percentage point to this rise; in France, meanwhile, growth averaged 0.9% a year over the period, and construction investment contributed an average of -0.1 percentage point. Thus, if we exclude the contributions of construction investment to GDP growth, the average growth differential observed between France and Germany from 2011 to 2015 is halved. Similarly, between 2000 and 2005, when France outpaced Germany in terms of growth, more than 70% of the difference was attributable to the contribution of construction investment, which at the time was growing at a stronger pace in France.

Consequences for employment

The drop in construction investment has been a major feature of the French business cycle over the past few years, and has resulted in a dramatic decline in value added and employment in the sector. Value added in construction (excluding construction-related services) has fallen by 19% since the crisis, while annual employment growth has remained consistently negative over the period, contrasting with the positive trend seen at the start of the 2000s (see Chart 3).

In services, on the other hand, employment started rising again as early as in 2010, and in some years has even matched the pace of growth seen in the 2000s. In manufacturing, employment growth remains negative, but job numbers were already declining prior to the crisis; since 2011, however, employment growth in manufacturing has moved closer to zero. It is thus in the construction sector that pre- and post-crisis employment trends have differed the most.

Chart 3: Marked decline in employment in construction

Potential causes of the recession in construction investment

Economists remain divided as to the main factors behind the recession in construction investment. However, a number of possible causes have been identified: demographic factors in the case of residential investment (see *Conjoncture in France*, Insee, June 2015; *Banque de France Working Paper*, April 2016); a drop in government investment (see report by the Cour des comptes, June 2016); overregulation; financial factors (see *Rue de la Banque*, June 2016); the bursting of a property bubble that supposedly built up before the crisis; continuing high prices (see report by the CAE or economic analysis council, February 2013); multiplier effects stemming from the fall in household incomes and corporate margins, etc.

Whatever the reasons, the findings outlined here illustrate just how important the construction cycle is in explaining the French business cycle and how it differs from that of Germany, and in understanding the evolution of French employment. The Banque de France has taken these findings on board and has notably constructed a new forecasting model that incorporates the specific features of the construction cycle (PRISME model), both in the housing and public works segments.

Outlook for the coming quarters

Construction investment started rising again in 2016 and employment levels in the sector finally stabilised. That said, it is still important to keep an eye on how the sector evolves in order to better understand the recovery, its duration and its impact on the unemployment rate. According to the Banque de France's three-year macroeconomic projections, household investment, which consists essentially of housing investment, should continue to be supported by various government incentives in 2017 (easing of the qualifying conditions for zero-interest loans, Pinel incentive for buy-to-let investment), as well as by low borrowing rates, and should grow at a faster pace than in 2016.[2] Beyond 2017, however, unfavourable demographic factors (fall in the share of 30-59 year-olds in the population) could once again dampen growth in housing investment. Government investment, meanwhile, which consists primarily of construction investment (public works) will make a positive contribution to GDP growth over the coming years, after rebounding in 2016.

[1] The breakdown by asset differs from the breakdown by product in the quarterly accounts. The item "construction assets" is notably broader than "construction products" as it also includes construction-related services.

[2] Banque de France, *Macroeconomic projections – France*, Summary, December 2016.