2 The economic situation and construction-sector developments in the UNECE region, 2011-2012

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Highlights

- The economic recovery in the UNECE region has been sluggish, national income in one half of the economies has yet to return to 2008 levels, and unemployment remains high.
- There are numerous downside risks to even attaining moderate growth in 2013, a deepening eurozone crisis being the most likely.
- If the eurozone crisis should further deteriorate, it will have significant implications not only for the EU but also for the global economy.
- The modest recovery of the US economy is not strong enough to re-employ the people who lost their jobs during the crisis.
- As a result, the US housing market is still weak, with new housing starts and sales at their lowest levels since modern records began to be kept in 1963.
- The Canadian housing market is in a better state than that of the US, although housing starts are below 2008 levels; and some people are concerned about a housing bubble in Canada.
- The European housing construction market is still sluggish, as the sovereign debt and lingering financial crisis continue to affect many countries. Norway and Switzerland are the notable exceptions to the ongoing housing malaise.
- After four years, the correction in the housing market is far more advanced in the US than in Europe.
- Economic conditions, such as unemployment, tightened loan requirements and consumer sentiment, are still hindering a robust recovery in new home starts in the UNECE region.
- In the EU, there is no immediate sign of any housing recovery.

2.1 Current economic developments

The global economy has entered its fourth year of recovery since the Great Recession of 2008-2009, the largest peacetime economic downturn since the Great Depression of the 1930s. Although the national economic recoveries in the developing world have been reasonably strong, they have been weak in the UNECE region where one half of the economies have real gross domestic product (GDP) levels that are below those of 2008 (see table 2.1.1).

In the EU and south-east Europe, real GDP is still below the pre-crisis levels. In North America it is 3% higher, and in the CIS 6% higher; this lack of income growth has also translated into high rates of unemployment. Both in North America and in the CIS, unemployment remains high, although it is slowly falling. In Europe, it continues to rise, and in a few European countries has reached worrisome levels.

Throughout the region, youth unemployment is particularly high. The crisis and slow recovery created large budget deficits and rising debt levels. This has further resulted in several serious sovereign-debt crises in the eurozone.

During the past year, the eurozone has been moving from one crisis to another, and there are some who believe that its very existence is now threatened. Such a breakup would have serious ramifications for Europe and could well trigger another global financial crisis. Even in a reasonable best-case scenario, Europe is facing another one or two difficult years with very low growth, high unemployment and financial instability.

In the US, excessive housing stock remains a big drag on the economy and, until the housing market stabilizes, growth will remain sluggish.

Growth in the economies of the non-UNECE region, which account for about half of the world's output, was only moderately affected by the crisis, and in recent years these economies have even seen relatively robust growth.

World growth in 2012 is forecast to be 3.5%, a slight decline from 2011, but a minor increase is expected in 2013. This subdued outlook for growth may, however, prove optimistic. Numerous downside risks could derail the global economy in 2012-2013 – including the further withdrawal of fiscal stimulus in the advanced economies, an unexpected slowdown in China, or a eurozone crisis. The global forecast is more uncertain than usual as critical policy choices that will be made in mid-2012, especially in the eurozone, will have significant implications for the global economy.

The Great Recession and sluggish recovery have had a greater impact on the UNECE region than on the other regions of the world. Quantifying the extent of this difference is complicated because the crisis began in each region at different times and, already, regions had been growing at different rates. One possible approach is to ask how much lower current GDP is compared with what it might have been had the pre-crisis growth trends continued.

For the UNECE region as a whole, GDP is now about 14% lower than what might have been expected. This is more than double the figure of 6% for all the non-UNECE economies. Within the region, there is also considerable variation: North America is 11% below the longer-term trend, while the eurozone is 13% lower, south-east Europe 14%, the UK 17%, and the CIS 35% lower. A few economies such as in the Baltics, Armenia and Ukraine have GDP incomes that are only about one half of what would be expected had the pre-crisis trends continued.

Several western European economies that have seen a debt or banking crisis, such as Greece, Iceland and Ireland, have incomes about one third below trend expectations. Even Poland, which was the only EU economy that avoided recession in 2009, has a GDP of 10% below its trend rate. There is some uncertainty about how much of this decrease represents a permanent decline and how much of it could be made up once a strong recovery begins.

Any crisis and subsequent slow recovery affects the long-term potential of economies, as public and private investments are not made. Training, education and research are not undertaken, labour skills depreciate as people stay unemployed, workers retire early or take disability leave, population health deteriorates, and sectoral shifts (such as the decline of the financial sector) destroy human capital.

In some cases it may be possible to recover these losses, especially in countries where unemployment is high and there is a reasonable expectation that currently unused resources can be redeployed. How much of this lost growth might be recovered? The best estimates for the US suggest that about half of its GDP decline from trend or about 5% of GDP represents a permanent loss that will never be made up.

The slow recoveries in the advanced economies were generally expected. The Great Recession was not a typical recession, it was a financial crisis. Historically, economies recover more slowly from financial crises than from a recession. In this recovery, there has been sluggish growth in all the components of aggregate demand.[3] Due to high unemployment and falling equity and house

[3] Aggregate demand is the sum of consumption, investment, government spending and net exports, or more famously, Y=C+I+G+(X-M).

prices, households find themselves excessively in debt and needing to cut back on spending so as to restore their financial position[4].

The financial system is not lending because it remains impaired by exposure to questionable loans (sovereign debt and mortgages) and also needs to pay off debt to meet recently proposed higher capital requirements. And although the monetary authorities have lowered interest rates to almost zero to encourage investment, with low inflation the real interest rate (nominal interest rate minus inflation) is not low enough to stimulate investment.

Housing has been a leading sector during earlier recoveries, a house purchase being a discretionary expenditure and sensitive to interest rates. Lower interest rates are usually effective in stimulating demand for new houses. When people buy new houses they also tend to buy new furniture and other objects for their house. In this instance, the financial crisis was preceded in the US and some European economies by a boom, with excessive housing construction, leaving large stocks of houses unsold, coupled with falling house prices. This has meant that the housing sector has been unable to play its traditional role during this particular recovery.

When consumers and businesses cannot maintain spending at the level necessary to maintain full employment, the government may step in, but to do so it must issue debt. If the recession and recovery is short, the additional debt may not be so significant or present a problem. However, if the recovery lasts longer, as it is currently doing, debt begins to mount up to such an extent that a government may find its ability to keep issuing debt heavily constrained.

This is what has happened in some UNECE economies, especially in those that were heavily indebted before the crisis. In these circumstances, several governments began cutting back expenditures and increasing taxes to try to contain their growing indebtedness – even when this may be the opposite of what is required to stimulate recovery.

Although expanding net trade (exports minus imports) could provide a source of stimulus, this can only happen if countries improve their competitiveness. In the short and medium term, the only way to achieve this is by depreciating the currency. However, the exchange rates of the major economies of the region are determined in foreign-exchange markets. If governments implemented policies such as exchange-market intervention to lower rates, this would risk setting off a series of competitive devaluations, as happened during the Great Depression of the 1930s, and which proved destructive[5].

In the final analysis, "net exports" is a zero-sum game: the gains for one come at a loss for others. Thus, governments are reluctant to attempt overtly to improve competitiveness through market intervention[6]. Also, a number of economies experiencing especially low demand form part of the eurozone and, consequently, do not have the option of changing their exchange rates.

As a result, aggregate demand is too low to fully employ the region's labour supply. Unfortunately, there is no reason to think that there will be any great increase in the components of aggregate demand any time soon. If anything, there is a concern that the government spending component will decline further in 2012-2013.

In Europe, a number of legislated austerity programmes have yet to be fully implemented. In the US, several important temporary tax cuts and spending increases are due to expire at the end of 2012.

In its 2012 *World Economic Situation and Prospects* publication, using its Global Policy Model, the United Nations has modelled an ideal approach. This consists of a well-designed and regionally coordinated further fiscal expansion, combined with legislation that would ensure that budget deficits would be reduced significantly once robust growth was attained. In the Global Policy Model this policy package not only achieves higher growth and lower unemployment but also has better debt dynamics in the medium and longer term. However, the combination of a short-term policy with a long-term policy must be credible to assure financial markets that any increase in deficits would be temporary.

There has been much political opposition to such a programme by those who feel that the public sector is already too large. For them it makes little sense to increase government spending in the short term when it needs to be reduced in the long term, nor to cut taxes now when in the long term they will need to be raised.

As a result, a number of countries have put in place austerity programmes. Unfortunately, these programmes have yet to prove effective in improving the debt and economic dynamics of the affected countries. Under more normal conditions, reducing government borrowing results in lower interest rates that stimulate investment

[4] For example, the median wealth of American families declined by 39% from 2007 to 2010 and is now back to the level in 1992.

[5] Another non-cooperative option to increase net exports is trade protectionism, but just like a competitive depreciation, it is likely to result in a cycle of retaliations that ends poorly.

[6] This has of course not stopped China and as a result there has been considerable criticism of their behaviour. The Swiss have also intervened but have largely avoided condemnation due to the feeling that they are not attempting to depreciate below the equilibrium rate but are simply trying to stop an appreciation that is significantly over the equilibrium rate.

while also increasing exports as exchange rates decline. Lower government purchases are thus compensated for by increases in investment and exports. As a result, national income and employment may not be greatly affected and with the government spending cuts, the deficits decline.

Since 2009, however, the advanced economies have been in a liquidity trap, with interest rates near zero. In this environment, austerity programmes have not led to lower interest rates, and investment and exports have not increased. Therefore, as net government expenditure has gone down, national income has had a tendency to decline, together with tax revenues. In some cases, the loss of revenue was as much as the original spending cuts and thus deficits have not yet fallen significantly.

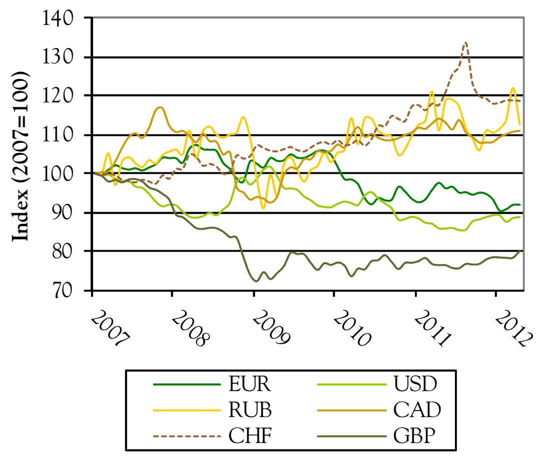
One positive piece of economic news for the region is that inflation has been moderate and generally close to central bank targets. In Europe and North America the target has been in a range around 2%, while in the CIS the range has been higher but still well within single digits. This price stability has been largely due to high unemployment, which has kept wage costs under control despite significant price increases in many global commodity markets, although recently commodity prices appear also to have stabilized. This low inflation combined with subdued economic growth and high unemployment has allowed the monetary authorities to continue their accommodating monetary policy with interest rates in some economies, such as the US and UK, at historically low levels. In addition, the central banks in the US, eurozone and UK vastly expanded their balance sheets over the last few years to provide sufficient liquidity to still-impaired capital markets. There are, however, concerns about the potential longer-run inflationary impact of these operations.

Exchange-rate volatility has been moderate since the beginning of the financial crisis (graph 2.1.1). Since the start of 2007, real exchange rates (nominal rates adjusted for inflation) of the major UNECE advanced economies (dollar, euro and pound) have depreciated, due principally to their very low interest rates. The US dollar appreciated during the height of the crisis because of its safe-haven status but then declined; the British pound, in particular, has declined over this period.

The natural resource exporters, Canada and the Russian Federation, however, have experienced currency appreciations due to firm commodity prices, although both suffered short-lived large depreciations at the height of the crisis, when commodity prices collapsed.[7] The Swiss franc, which was already overvalued, has kept rising. Over the past 12 months (mid-2011 to mid-2012), the US dollar strengthened against most currencies; the Canadian dollar fell against the dollar but gained against the euro; and the euro and Russian rouble declined against most major world currencies.

GRAPH 2.1.1

Real exchange indices of selected currencies, 2007-2012



Notes: EUR = euro, USD = United States dollar, RUB = Russian rouble, CAD = Canadian dollar, CHF = Swiss franc, GBP = British pound.

Sources: International Monetary Fund and UNECE, 2012.

As concerns developed about its health and even its future, traders and central banks began to sell the euro, which led to its depreciation – especially against safe-haven currencies such as the US dollar and the Swiss franc. In Switzerland, capital inflows and speculation were so large that the central bank (SNB) had to abandon its generally flexible exchange rate and fix it (on the upside) to the euro.

After suffering a major collapse in 2009, world trade rebounded in 2010, although its growth has decelerated significantly due to the weak recovery. In Europe, import growth may be close to zero in 2012, and this will transmit Europe's economic weakness to much of the rest of the world. The weakened economic recovery and slowing growth of trade flows have moderated global commodity price increases.

The world's second largest economy, China, has continued its strong growth and through its demand for imported components has kept growth high in most of Asia and in the natural-resource-exporting countries of Africa and Latin America. In mid-2012, its economy began to slow down but the authorities responded quickly and aggressively, as they had done in 2009, with counter-cyclical macroeconomic stimulus in the form of lower interest rates and increased government investment. The latest expectation is that these policy actions should keep growth

[7] When inflation occurs, trends in the real and nominal exchange rates can vary significantly. For instance, the Russian ruble has depreciated versus the dollar in nominal terms but appreciated in real terms.

in China and much of the developing world on a reasonable growth trajectory in 2013, unless there is a serious decline in economic output in either the US or Europe.

2.1.1 Europe

The eurozone is going through a severe economic and political crisis. Real GDP is lower than five years ago and industrial production is 12% below its mid-2008 peak. Unemployment is at 11% and rising. By the end of 2012 in Greece and Spain unemployment could reach 25% and youth (i.e. under 25) unemployment is close to 50%. Five governments have already turned to the EU or IMF for financial assistance and one or two more may follow.

The financial system has been impaired by numerous bank bailouts, and more seem imminent. A double-dip recession seems to be under way and any recovery in 2013 and 2014 is likely to be weak. Long-term growth is also being jeopardized by falling investments in education and infrastructure.

A more coordinated European solution could help, especially if it were able to address a number of key issues in the eurozone that have contributed to this crisis. The three most important of these being:

1. **No lender of last resort**. This has made eurozone members susceptible to currency/sovereign debt crises.
2. **No adjustment mechanism for current-account imbalances**. Eurozone members have neither fiscal transfers nor significant labour mobility as in a typical monetary union such as the US or Canada and must rely on recession and wage deflation to restore competiveness. This was also the adjustment mechanism used under the gold standard and was ultimately the major cause of its collapse and it does not appear to be working today in the eurozone.
3. **No central financial regulator or common system of deposit insurance.** This would help avoid bank runs and support financial stability. For example, as the crisis has evolved, so too have concerns about the solvency of some countries' banking systems; and as a result, customers have been transferring their money to other countries. Between the beginning of 2010 and mid-2012, Greek residents withdrew one third of their deposits from Greek banks and either moved those accounts to another country or "tucked the euros in their mattresses".

The solution to the eurozone crisis will probably require finding solutions to these aspects of the eurozone: an enhanced lender of last resort, a more symmetric and growth-oriented adjustment mechanism, and a stronger regional banking authority.

Germany is one of the few advanced economies that has lower unemployment now than before the crisis; although unemployment was 6.8% in the first quarter of 2012, which is not so low. Germany also has been well positioned to take advantage of the more robust growth in the developing economies as it is a major exporter of capital equipment to these regions.

Outside the eurozone, the United Kingdom also introduced an austerity programme, and is, likewise, seeing an economic downturn and rising unemployment. Unlike the situation in the eurozone, where there were numerous institutional constraints and significant market pressure on a few economies, the motivation in the UK was to decrease the size of government more broadly as well as slow down the country's increasing debt levels. However, as in the eurozone, austerity has proved to be only marginally successful in improving the country's debt dynamics.

2.1.2 Transition economies

In the transition economies, GDP fell during the 2008-2009 crisis. The CIS economies generally bounced back reasonably well so that, for most, GDP levels in 2012 are above pre-crisis levels. In southeast Europe, however, national recoveries have been slow and most of these countries still have not regained their pre-crisis GDP levels. Current incomes in the CIS are also much lower than might have been expected, based on earlier trends. This is due to their much higher trend growth rates before the crisis.

Foreign direct investment (FDI) throughout the transition economies fell significantly during the crisis and remains depressed today. This decline in investment is an important factor in explaining their current and expected lower future growth. A systemic problem for the region appears to be capital flight, especially when financial market conditions weaken as they might with a deeper eurozone crisis. In many countries, this is probably due to a history of hyperinflation and bank defaults, combined with weak rule of law.

Growth in Azerbaijan, the Russian Federation and Central Asia has been moderate since 2010 but remains much below the rates in the five years leading up to the crisis. The growth has been driven by continued high commodity prices, especially of oil and gas. Large crop harvests, following the drought in 2010, have also contributed to growth and have helped keep food prices and inflation under control.

Remittances from the Russian Federation to the Central Asian economies, which fell considerably in 2009 and 2010, rebounded in 2011 and 2012 but in many cases still constitute a smaller share of GDP than before the crisis. Post-crisis growth in the European CIS (Belarus, Republic of Moldova and Ukraine) has been weaker than elsewhere in the CIS.

Unemployment varies considerably throughout the CIS, with the officially reported statistics provided by some countries generally underestimating unemployment, as defined by the International Labour Organization. It remains moderate (single figures), with a downward trend in the Russian Federation, Ukraine and much of Central Asia; but particularly high in Armenia and Georgia. Despite a currency crisis in Belarus in 2011, growth is expected to be about 3% in 2012 with low official unemployment. Inflation, however, has escalated due to its currency depreciation and is likely to continue at over 50% in 2012. The Ukrainian-EU free trade agreement and association agreement, which have largely been negotiated and agreed upon, have not yet been signed.

The economies in southeast Europe have performed poorly since the economic crisis and are forecast to have weak growth in 2012 as the eurozone crisis has had an impact on their economies due to the extensive trade and financial ties. Over 85% of southeast European exports (and over half of Turkey's) go to some other European economy. Growth is likely to be near zero in 2012 and remain weak in 2013. In all of these countries, unemployment is above 10% and expected to stay high for several years. Unlike the high unemployment in much of the rest of the UNECE region, which is largely cyclical, the unemployment in this subregion is mostly structural. Reductions in unit labour costs, reforms in labour market policy, improved education and training facilities and more incentives for investment are needed to address this problem.

The transition economies were the worst affected region of the world during the 2008-2009 crisis, in large measure due to their over-reliance on commodity exports and on external capital to finance their development. If the eurozone crisis deteriorates into a full-blown financial crisis, where global credit markets seize up as they did in 2008-09, the region would once again be seriously exposed through trade and financial channels. Although the Central Asian economies have less intensive ties with Europe and would be less directly affected, they have strong ties with the Russian Federation, which would be significantly affected.

The transition economies have made progress in reducing their vulnerability to external events by reducing their reliance on capital inflows, but their policy space to address any downturn is less today than in 2008 because of already high unemployment rates, weakened financial systems, and rising sovereign debt levels (although not in the Russian Federation). A eurozone crisis would be expected to lead to a large fall in oil prices, a depreciation of the currencies of the region, and higher inflation and unemployment. Some countries, such as Ukraine, that remain severely depressed would be particularly hard hit.

2.1.3 *North America*

The moderate economic recovery in North America has not been strong enough to re-employ the many millions who lost their jobs early in the crisis and the approximately one million new entrants in the job market each year. As a result, while US unemployment has fallen from its peak of about 10% during the crisis to 9% in 2011 and 8% in 2012, it may still be three or four more years before it falls to its longer-term non-inflationary equilibrium rate of about 5.5%. Currently 40% of the unemployed, a large percentage by historical comparison, are long-term unemployed who have been without paid employment for at least six months.

Given the modest growth rate, the decline in unemployment over the last year has been much faster than what was expected due to the departure of an unusually large number of people from the labour force. Although the lower unemployment rate presents an optimistic picture, the lower labour force has negative long-term implications since there will be fewer people to pay off the debt and support the retiring baby-boomer generation.

The speed of the recovery in the US could be enhanced by any initiative that would stabilize the housing market. US policies to help distressed mortgage holders have, so far, had a limited impact on the overall market, although changes by the Federal Finance Housing Agency in its "Home Affordable Refinancing Programme" (HARP), raising the loan-to-value ratio, have resulted in a significant increase in refinancing by those with little equity in their houses. These borrowers have therefore been able to take advantage of the lower interest rates and lower their monthly payments. Overall, the enactment of any policies that could spur the economy has been made very difficult by the political gridlock that has developed, in part due to 2012 being an election year. The expectation is that the economy will continue to limp along with moderate growth and sustained high unemployment.

Since 2006, the Canadian economy has performed slightly better than that of the US but given the high level of trade and financial integration, these two economies tend not to diverge significantly over lengthy periods. In 2011, growth in Canada at 2.5% was much above the US's 1.7% and it should at least match the US rate in 2012. Canada's unemployment rate of 7.2% in the spring of 2012 was slightly below that of the US. Canada has enjoyed relatively good economic performance thanks to its housing market and financial sector having escaped much of the devastation in the US because of better regulation and corporate management. In addition, as a major exporter of natural resource products, Canada has benefited from firm global commodity prices due to robust growth in Asia. Growth has been stronger in the western provinces, which export commodities, and slower in the eastern provinces, which export manufactured goods – as these have been affected by a relatively strong exchange rate. Although the generally slower growth since the crisis has resulted in fiscal deficits, the overall debt level of the country (34% of GDP) is the lowest of any of the G7 countries.

TABLE 2.1.1

UNECE region real GDP growth rates (%), 2011-2012

Country/region	*2011*	*2012f*	*Change % 2008 to 2012*	*Country/region*	*2011*	*2012f*	*Change % 2008 to 2012*
Albania	3.1	1.5	12.3	Slovakia	3.3	2.1	4.5
Bosnia and Herzegovina	1.7	0.3	-0.3	Slovenia	-0.2	-0.9	-7.7
Croatia	0.0	-0.8	-7.9	Spain	0.7	-1.5	-4.6
Montenegro	2.5	0.2	-0.8	Eurozone	1.5	-0.4	-1.5
Serbia	1.6	0.5	-0.5				
TfYR of Macedonia	3.0	2.0	7.2	Bulgaria	1.7	0.8	-2.7
Turkey	8.5	2.3	15.1	Czech Republic	1.7	-0.3	-0.8
South-east Europe (non-EU)	7.1	1.9	11.7	Denmark	1.1	0.5	-3.1
				Hungary	1.6	-0.6	-4.7
Armenia	4.7	3.7	-4.7	Latvia	5.5	2.5	-11.4
Azerbaijan	0.1	2.9	18.2	Lithuania	5.9	2.5	-6.3
Belarus	5.3	2.5	16.5	Poland	4.3	2.8	13.2
Georgia	7.0	5.0	14.8	Romania	2.5	1.2	-4.7
Kazakhstan	7.5	5.8	23.4	Sweden	4.0	0.9	5.6
Kyrgyzstan	5.7	5.0	13.6	United Kingdom	0.7	0.2	-1.5
Republic of Moldova	6.4	3.1	10.4	EU 27	1.6	0.0	-0.8
Russian Federation	4.3	4.0	4.3				
Tajikistan	7.4	6.0	26.0	Iceland	3.1	2.4	-5.6
Turkmenistan	14.7	7.4	42.7	Norway	1.7	1.8	2.5
Ukraine	5.2	2.7	-4.2	Switzerland	1.9	0.8	3.5
Uzbekistan	8.3	7.1	36.0	Israel	4.7	2.7	13.7
CIS	4.8	4.0	6.5	Europe 31	1.6	0.1	-0.5
Austria	3.1	0.9	2.4	Canada	2.5	2.1	4.9
Belgium	1.9	0.0	1.2	United States	1.7	2.0	3.2
Cyprus	0.5	-1.0	-1.2	North America	1.8	2.1	3.3
Estonia	7.6	2.1	-3.6	UNECE 52*	2.2	1.3	2.2
Finland	2.9	0.6	-1.6				
France	1.7	0.3	0.7	Memorandum items			
Germany	3.1	1.0	2.3	SEE-6 (Except Turkey)	1.3	0.3	-1.2
Greece	-6.9	-4.7	-17.2	CIS (less Russian Federation)	6.0	4.1	12.2
Ireland	0.7	0.5	-6.3	EU-pre 2004 -15	1.4	-0.2	-1.3
Italy	0.4	-1.9	-5.2	EU NMS-12	3.1	1.4	2.9
Luxembourg	1.0	-0.2	-2.0	UNECE emerging economies**	5.4	3.4	7.9
Malta	2.1	1.2	2.8				
Netherlands	1.3	-0.5	-1.2	World	3.9	3.5	12.5
Portugal	-1.5	-3.3	-6.2	Non-UNECE economies	5.5	5.7	23.5

Notes: f = forecast. NMS = new Member States. *This total excludes four countries within the UNECE region: Andorra, Liechtenstein, Monaco and San Marino which do not report GDP. **This total includes CIS and South-east Europe.

Source: UNECE secretariat, 2012.

2.2 Construction-sector developments

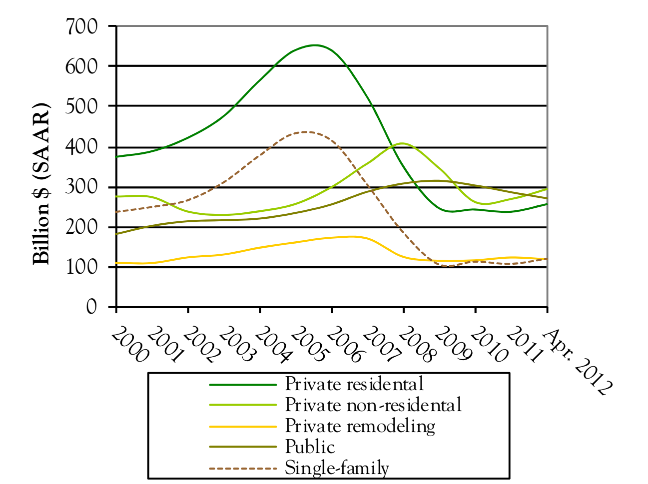
2.2.1 *United States construction market review*

The US housing market continues to struggle from overbuilding, the housing crash, and the Great Recession. It is still in a correction that began in 2008, with new housing starts and sales at their lowest levels since modern records began being kept in 1963 (graph 2.2.1). Spending on housing construction is at record lows; however, the remodelling and multi-family subsectors' expenditures are increasing slightly. Most estimates for a moderate to robust housing recovery are still several years in the future.

In April 2012, new US house sales increased to a seasonally adjusted annual rate (SAAR) of 343,000; a decrease of 73% from the housing peak in July 2005 or about 50% of average annual sales dating back from 1963 (graph 2.2.2). New home construction comprised 6.7% of the 2011 residential sales market, a decline of 15% from the past decades housing boom. New home sales are depressed and the quantity of new homes on the market is the lowest in 47 years (US Department of Commerce-Construction (DOC), 2012b).

GRAPH 2.2.1

US construction spending data, 2006-2014



Notes: Single-family expenditures are also included in private residental spending. Single-family data was included here to illustrate the housing crash and "Great Recessions" effect on single-family expenditures.

SAAR = Seasonally Annualized Adjusted Rate.

Source: US Census 2012a and US Department of Commerce-Construction (DOC) 2012a.

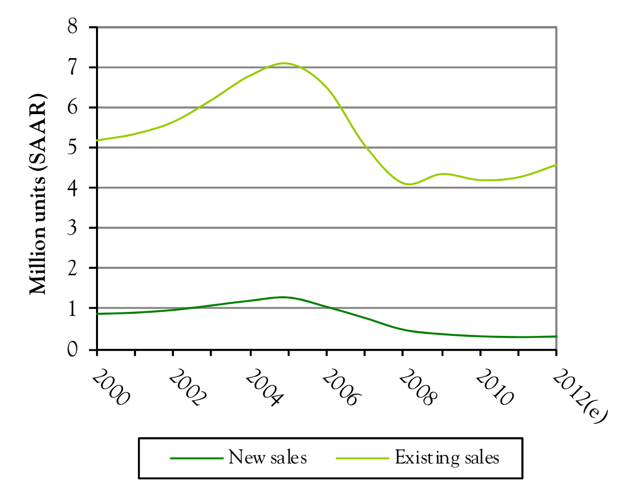
Existing home sales in May 2012 were 4.55 million (SAAR) (National Association of Realtors (NAR), 2012) – a decrease of 69% from the housing peak in 2005 (graph 2.2.2). The median existing house sales price in May 2012 was $177,400; 9.6% greater than in May 2011 (NAR, 2012). Also in May 2012, the median new home sales price was $235,700, nearly 5% greater than in April 2011 and the largest percentage increase since January 2006 (US DOC, 2012b). Standard & Poor's (S&P)/Case-Shiller Home Price Indices, show a declining trend in US home prices since the peak in late 2006 and now the price indices stand at early 2003 levels. There has been also short term increase in these price indices since 2006, but the overall trend has been declining(S&P, 2102a).

The US housing market continues to be troubled. In the first quarter of 2012, the original property loan values of more than 31% of borrowers – equivalent to about 16 million homeowners – exceeded the current market value of their properties. In total, the value of the so-called "negative equity" is $1,200 billion, with homeowners owing on average of $75,644 more than the value of their individual property (Zillow, 2012).

At March 2012, about 2.57 million property loans were at least 90 days behind in their repayments. In addition, almost 1.5 million properties were faced with repossession: more than two-thirds of the owners of these properties had made no loan repayments in over a year; with the remaining one third having made no repayments in two years (Lender Processing Services, 2012). By the end of March 2012, the stock of repossessed houses stood at 1.4 million, about 3.4% of all mortgaged properties.

GRAPH 2.2.2

New and existing US housing sales, 2000-2012



Notes: e = estimate. SAAR = Seasonally Annualized Adjusted Rate.

Sources: US Census (2011b) and National Association of Realtors 2012.

Since September 2008, mortgage lenders have repossessed 3.5 million properties, with 1.4 million foreclosed in 2011 alone. This has led to the existence of a "shadow inventory" of housing stock, which consists of repossessed properties that have still to be listed for sale. Estimates of this shadow inventory range from 1.13 million (S&P, 2102b) to 1.5 million housing units, and its existence undoubtedly affects consumer sentiment and property prices (CoreLogic, 2012).

Factors hindering any significant housing recovery include a continuing high level of foreclosures (repossessions); shadow inventory; low consumer confidence (important since consumer spending is about 73% of the US economy); high unemployment and underemployment; sizeable and increasing student debts; a lethargic economy; and strategic defaults. A strategic default occurs when homeowners, who may be financially able to make loan repayments, voluntarily choose to stop making payments and, in many instances, simply to walk away from their homes in order to escape from negative equity.

Source: C. Giordano, 2012.

2.2.2 US construction outlook

Historically, housing has been the key market driver for sawn softwood and structural panels and their prices normally track housing starts. There are several estimates of new housing starts from May 2012.

(1) 708,000 units, including new single-family starts of 516,000 units (SAAR) (US DOC, 2012c).

(2) 706,000 units (consisting of 499,000 single-family and 207,000 multi-family) (National Association of Homebuilders, 2012).

(3) Other estimates for projected total starts in the range of 700,000 to 740,000 units (Alderman and Buehlmann, 2012).

In April 2012, total residential construction was \$256.1 billion; single-family was \$119.4 billion; multi-family was \$18.0 billion; and home improvement was \$128.6 billion (all SAAR) (US DOC, 2012a). The Leading Indicator of Remodelling Activity (LIRA) (2012) estimated that spending on remodelling should increase by nearly 5.9%, or \$122.6 billion, by the end of 2012. Authorized building permits for residential remodels in April were 2,729,000 (SAAR), 12% above the April 2011 estimate (BuildFax, 2012). Since 2009, expenditures for private remodelling have exceeded or been equivalent to new single-family spending (US DOC, 2012a).

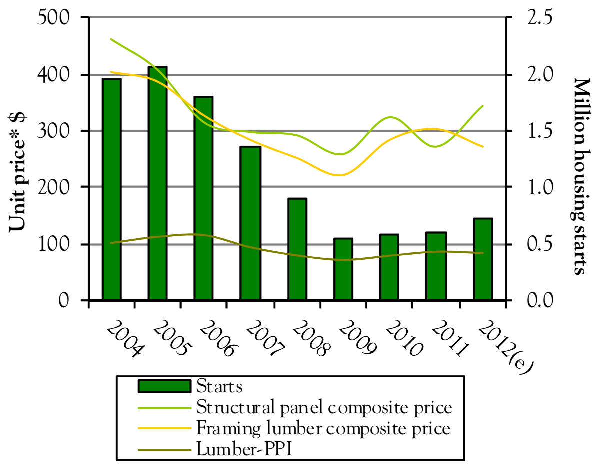
2.2.3 US building material markets

Sawn softwood and panel prices historically tend to correlate with housing starts. The recent increase in demand and material prices appears to be driven by improvement, albeit small, in the North American housing market, and hope for a turnaround in the housing market (graph 2.2.3). While total housing starts have increased above the levels of the past three years, a primary component for these starts has been multi-family housing, a subsector that traditionally does not consume large quantities of hardwood products, though softwood products may benefit.

North American homes historically have been the primary market for sawn softwood and structural panels – in the past some estimates indicated that 65% of wood building materials are directed to this market. This may be changing, as reported last year, as industrial markets consume more sawnwood than new housing, about 35% while new housing construction is nearly 22% (Random Lengths, 2011).

GRAPH 2.2.3

US sawnwood and panel prices versus US housing starts, 2004-2012



Notes: e = estimate, *structural panel composite price unit = 1 000 square feet, framing lumber composite price unit = 1 000 board feet, lumber PPI index (2004=100).

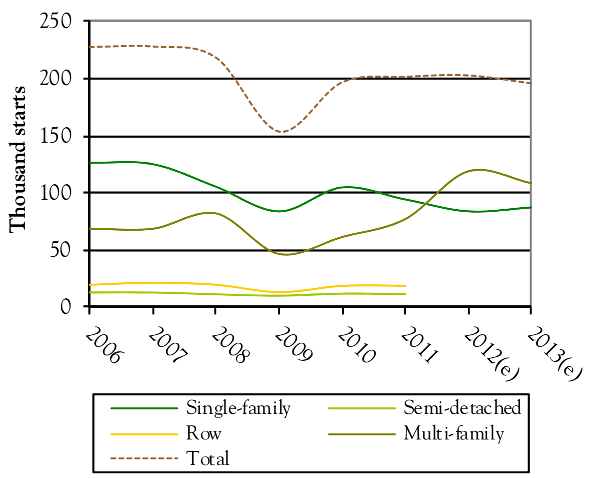
Sources: US Census, 2011c, US Bureau of Labor Statistics – PPI lumber prices, and Random Lengths© – sawnwood and panel prices, June 2012b.

2.2.4 *Canadian housing market*

The Canadian housing market has recovered better that the US market from the effects of the economic crisis. Housing starts increased from 189,930 units in 2010 to 193,950 in 2011 but are still well below the 2002-2008 levels. Like in the US, multi-family housing is projected to be a primary component of housing in the future; generally multi-family housing consumes less sawnwood than single-family units. And sawn wood is vulnerable to substitute products such as steel, aluminium, and concrete. Single-family starts are estimated to be 86,800 and multi-family starts are 118,900, for an estimated 202,700 starts for 2012. Starts are projected to decrease to 196,750 in 2013 (graph 2.2.4). Mortgage rates are expected to range from 3.1% to 3.6% in 2012 and increasing to up to 5.0% - 5.4% in 5 years. Additionally, the unemployment rate is projected to decrease from 7.4% in 2011, to 7.3% in 2012, and to 7.1% by 2013 (Canada Housing and Mortgage Corporation, 2012). The Bank of Canada has reported that housing shows signs of being overvalued and is vulnerable to the European debt crisis. The report highlighted that the risk associated with high household debt levels and a possible correction in the housing market had not diminished (Palmer, 2012).

GRAPH 2.2.4

Canadian housing starts, 2006-2013



Note: e = estimate.

Source: Canada Housing and Mortgage Corporation 2012.

2.2.5 *European construction market*

2.2.5.1 *Review and outlook*

The global economy is teetering on the edge of a double-dip recession and the eurozone has sovereign debt problems and banking woes. These problems are reflected in the overall volume and value of the Euroconstruct region (ER)[8] western European housing market. Residential construction is the largest single activity, accounting for 45% of total construction in 2011. Renovation and maintenance work comprises 60% of this subsector and typically is a source of stable activity – in contrast to new residential construction, which fluctuates due to economic conditions.

Throughout Europe, home construction is still sluggish with the exceptions of Finland, France, Norway and Switzerland. Conversely, Ireland and Spain's housing prospects appear grim. From 2007 to 2010, there was a 22% decline in housing production in the Western European Euroconstruct region. Taking into account potential economic threats, a thin housing recovery is forecast for 2012 (1.4% gain); 2.4% for 2013; and 2.7% for 2014. The most promising construction areas, from an increasing percentage basis, are the eastern ER countries, which include the Czech Republic, Hungary, Poland and Slovakia. In absolute terms, 2012 new residential construction is estimated to be €235.64 billion in the ER region, nearly 25% less than in 2008 (Euroconstruct, 2011).

Reviewing housing valuations, the correction in the US is still far more advanced than in the United Kingdom and Spain. Spain will likely see further price adjustments as current valuations pose a threat to the banking sector and economic growth. However, for many ER countries, price changes were relatively modest. Several indices indicate that ER house prices are generally stable or declining (Ball, 2012).

2.2.5.2 *European construction trends*

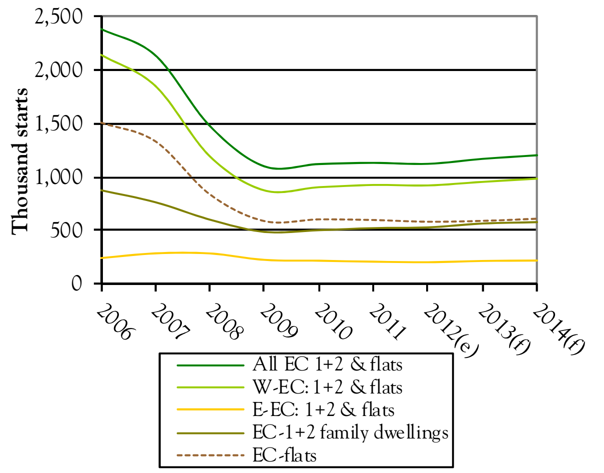
A recovery in new home starts is being delayed by economic conditions that include a weak European economy, high sovereign debt; bank solvency issues; high unemployment; consumer uncertainty, and a housing crash in some countries. At its peak in 2006, a record 2.38 million homes were completed (1.55 million multi-family (flats) and 837,000 1+2 family houses). By contrast, in 2012, only about 1.1 million units are being forecast to be built (597,800 multi-family units and 521,600 1+2 family dwellings) (graph 2.2.5). In 2014, new residential construction values are predicted to increase by 9.3%

[8] Euroconstruct is the main network providing forecasts about construction, finance and business. The Euroconstruct region comprises 19 countries. The western region includes EU-17 member States (Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, Netherlands, Poland, Portugal, Slovakia, Spain, Sweden, and United Kingdom), jointly with Norway and Switzerland. Euroconstruct's western European countries are not the EU-27, but the first 17 countries listed above. Euroconstruct's analysis of eastern European construction also is based on the Czech Republic, Hungary, Slovakia and Poland.

($321.7/€253.1 billion from $264.3/€231.5 billion in 2011) (Euroconstruct, 2011).

GRAPH 2.2.5

Euroconstruct region housing starts, 2006-2014



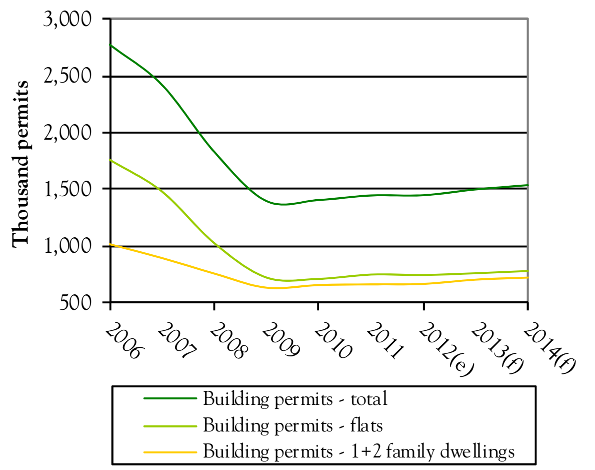
Notes: e = estimate, f = forecast.

Source: Euroconstruct 2011.

The deteriorating economic outlook has negatively affected building permits and new starts. An earlier projected housing recovery in 2012 now seems unrealistic. Any recovery in 2013 in new residential construction is likely to be marginal and it seems highly unlikely that activity will increase significantly, even when looking ahead to 2014 (graph 2.2.6) (Euroconstruct, 2011).

GRAPH 2.2.6

Euroconstruct region building permits, 2006-2014



Notes: e = estimate, f = forecast.

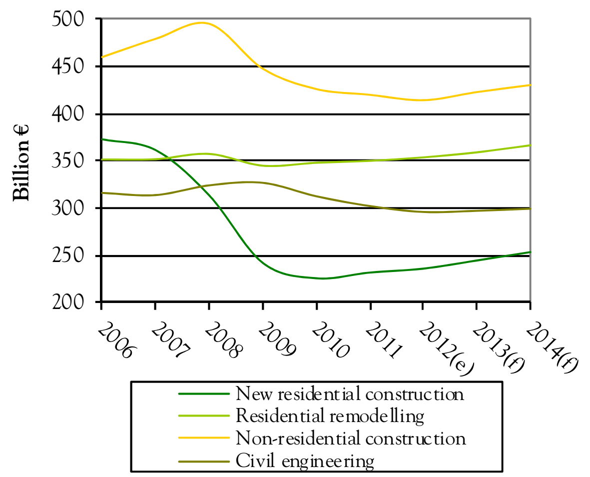
Source: Euroconstruct 2011.

The outlook for housing markets in the eurozone countries is especially bleak; and even in countries outside the eurozone, housing markets are likely to be affected by economic difficulties (Ball, 2012). In the EU 27 countries, building permits have decreased by 44% and price changes vary from a 33% decline in the UK to a 5% increase in Sweden since 2007 (Ball, 2012). Building permits give an indication of future construction activity. For 2012, permit activity is estimated to be only marginally higher than 2011. Even looking ahead to 2014, permits are expected to increase to just over 1.5 million units, or roughly 6% higher than in 2011 (Euroconstruct, 2011).

Demand for most construction services weakened as a result of the financial crisis and the current economy; future work orders are projected to increase slightly in all sectors. By the end of 2011, construction output had been declining for five years and was 16% less than the 2007 peak. In 2011, more than 60% of the construction market was in the five big countries (France, Germany, Italy, Spain, United Kingdom). A mere two years ago, this same construction market was greater than 70% due to the very large Spanish market. The actual composition of the market is expected to remain substantially unchanged up to 2014, with the exception being some further reduction in the Spanish market. Many countries have introduced austerity measures to attempt to control increasing levels of public debt and these measures are likely to dampen construction in all sectors (graph 2.2.7), particularly in education and health (Euroconstruct, 2011).

GRAPH 2.2.7

Euroconstruct region construction spending, 2006-2014



Notes: e = estimate, f = forecast.

Source: Euroconstruct 2011.

Non-residential construction is predicted to increase by 2.4% to €430.2 billion in 2014 from €419.9 billion in 2011. In 2012, this sector is predicted to decrease to €414.2 billion but with an increase that begins in 2013 and 2014 (Euroconstruct, 2011).

Construction growth will not approach pre-crisis levels, as the expected cumulative growth of ±4% (by volume) between 2012 to 2014 will be minimal in contrast to the aggregate decline of around 17% between 2008 and 2012. By the end of 2014, total output is projected to come close to the level of the early 2000s (2010 price basis).

In the overall construction market, the residential sector dominates, accounting for 45% of all spending on construction in 2011. Within the residential sector, renovation (termed "remodelling" in North America) and maintenance account for 60% of spending: typically, this is a fairly stable market that is less affected by the kind of abrupt adjustments that may occur after periods of "overheating" in the market.

Spending in the non-residential sector is projected to increase minimally. In 2011, it was 32% of all construction, with renovation and maintenance accounting for 47% of this. Civil engineering, at 23% of the European construction market in 2011, can vary greatly from one country to another but has generally proved to be fairly stable over time. In recent years, it has tended to be the main driver of activity in the construction market. Since 2011, however, it has been the weakest of the three main construction sectors.

Civil engineering was less affected during the economic crisis due to public-sector funding as part of planned stimulus measures. Forecasts of spending in the civil engineering and non-residential (public) building sectors have since been revised strongly downwards to reflect the fact that these sectors are particularly vulnerable to the austerity measures being implemented by countries most exposed to the debt crisis. Renovation, in both residential and non-residential sectors, has been consuming an increasing share of overall construction spending, rising from 23% in 2006 to more than 27% in 2011. Current projections are for little, if any, growth in 2013 and 2014 (Euroconstruct, 2011).

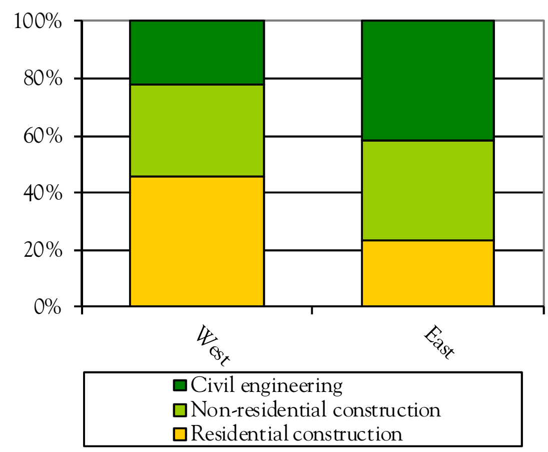
2.2.5.3 Construction-sector shares and growth: contrasting western and eastern Europe

New residential construction projections for the western ER countries indicate incremental increases in the near term, from €218.3 billion in 2011 to €238.8 billion in 2014. In contrast, the four eastern ER countries are projected to increase slightly from €13.2 billion to €14.3 billion. It is estimated that the residential construction share, of all construction investments, will be 46% in western Europe and 5% in eastern Europe by the end of 2012 (Euroconstruct 2011).

Since 2008, the construction sector's share in spending has changed in western Europe. New residential construction has declined sharply, civil engineering and non-residential have fallen slightly and only residential renovation has shown any sign of improvement (Euroconstruct, 2011). Three factors are at play here: a) the financial crisis and housing crash; b) austerity (both public and private); and c) people focusing on improving their homes (graph 2.2.8).

GRAPH 2.2.8

Euroconstruct region construction sector shares, 2011



Source: Euroconstruct 2011.

2.2.5.4 House construction in the Russian Federation

According to the Russian Federal State Statistics Service (2012), in 2009 some 217,253 residential houses were constructed; 201,758 houses were built in 2010; and 210,757 were constructed in 2011. Total dwelling floor space increased from 3,229 million m^2 in 2010 to 3,272 m^2 in 2011.

The country has begun implementation of the 2011-2015 Housing Programme, which projects a 50% increase in annual construction levels and aims to reach 90 million m^2 per year of residential construction by 2015. By 2016, residential construction is projected to reach 100 million m^2 and by 2020 is expected to increase to 140 million m^2. Russian housing officials state that 67 million m^2 of housing will be built in 2012, almost 3 million m^2 more than the record level reached in 2008. In the first quarter of 2012, some 111,800 new housing units with a floor space of 9.8 million m^2 were built, a 5.7% increase over the first quarter of 2010 (Obetkon, 2012). Further information about Russian housing markets can be found in the sawn softwood chapter, section 5.3.2.

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