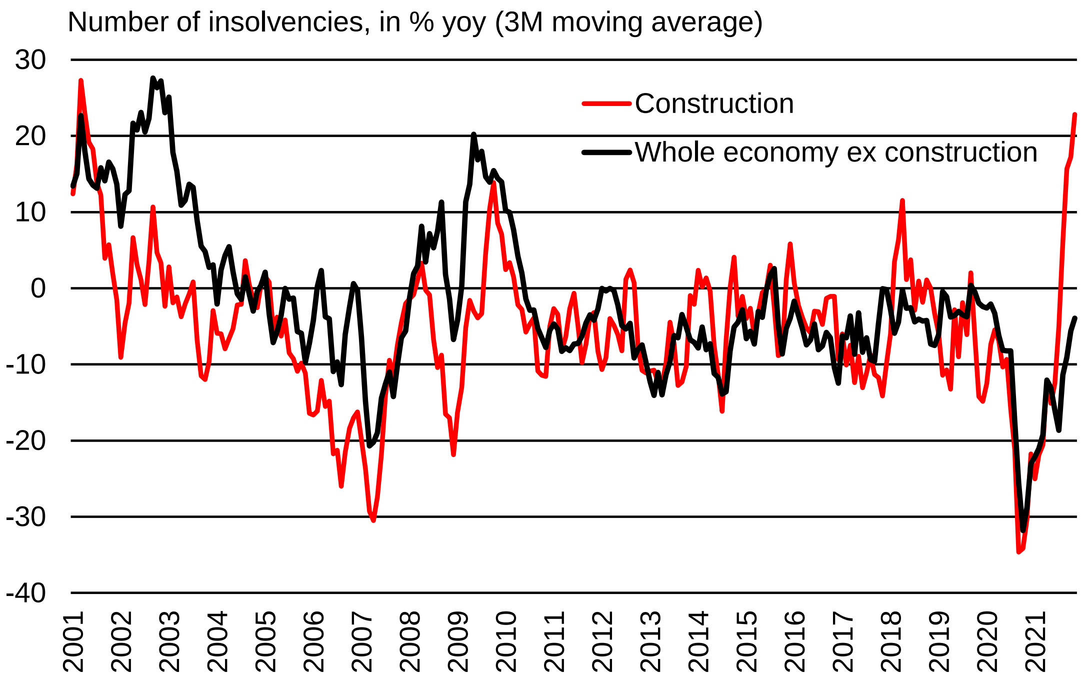
Surging insolvencies in the German construction sector



Source: destatis, UniCredit Research

- The German construction sector has been well known for its long streak of success, especially in the booming residential property market. Paradoxically, a new pattern has recently emerged in the forming of surging business failures. In November 2021 (latest available figure), insolvencies in the construction industry rose by more than 20% yoy, their strongest increase in the last 20 years.

- The paradox seemingly becomes even bigger when comparing construction to the rest of the economy. The "tsunami" of business failures triggered by companies in the services sector, which was predicted by some doomsayers after the outbreak of COVID-19, has not materialized. While the phasing-out of insolvency rules finally ended in May 2021, the number of business failures outside construction kept shrinking, albeit less markedly. Tellingly, insolvencies in the hospitality industry, which is usually regarded as one of the most exposed sectors in the COVID-19 crisis, still even declined by more than 20% yoy in November.

- The probably most important reason for the surging business failures in the construction sector has been the unprecedented supply shortages which have led to skyrocketing input prices. As some of the builders had made contracts with their clients at much lower prices beforehand, profits collapsed. The traditionally low equity ratios which are, with less than 20%, significantly below those in other sectors (more than 30% on average) added to the pressure. This is especially true for smaller companies in the ancillary construction trades which were increasingly founded during the boom years. Another reason could also be the still lackluster activity in the non-residential construction sector such as commercial real estate.

- The good news is that the supply shortages in the construction industry peaked in the summer of last year and have eased since then according to business surveys. The bad news is that they still have remained at elevated levels by historical standards. Hence, as the number of insolvencies processed by local courts are a classic lagging indicator, it may still take some time before the number of business failures in the construction industry will decline. For the overall economy, we continue to expect no "tsunami" but a further normalization after the phasing-out of insolvency rules which are likely to result in moderate rises of business failures due to the aftermath effects of the pandemic.

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MR 22/1

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