INVESTMENT SOLUTIONS & PRODUCTS
Swiss Economics

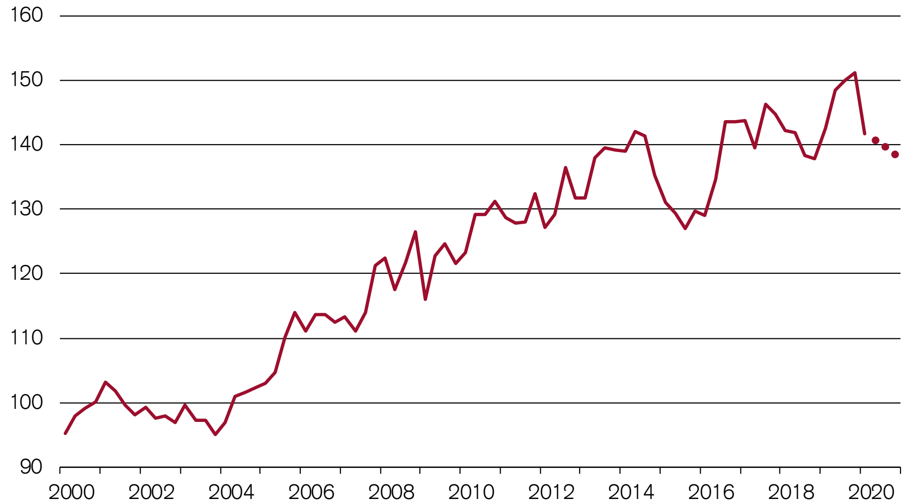
Swiss Construction Index

Index as of Q1 2020: 142 points
Change on previous quarter: –6.3% ↘
Change on same quarter in previous year: –0.7% →

Q1 2020

Swiss Construction Index: The state of the construction industry at a glance

Q1 1996 = 100, seasonally adjusted, nominal, points = trend outlook



The Swiss Construction Index is published jointly by Credit Suisse and the Swiss Contractors' Association (SCA) each quarter. It serves as a leading indicator for the state of Switzerland's construction sector by forecasting the turnover in the main construction trade in the current quarter as well as the trend for the next few quarters. The indicator, which is computed by Credit Suisse, is based primarily on the quarterly survey conducted by the SCA among its members. Additional data are sourced from the Swiss Federal Statistical Office and the Baublatt. Whereas the construction index provides an outlook for the first quarter 2020, the SCA quarterly survey provides detailed information on the fourth quarter of 2019.

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The Construction Index appears on a quarterly basis. Free subscriptions are available from Credit Suisse. To subscribe, please send your email address to: realestate.swisseconomics@credit-suisse.com.

Detailed results of the SCA quarterly survey, which is published at the same time as the construction index, together with further facts and figures on the main construction trade, can be found at http://www.baumeister.ch/de/politik-wirtschaft/wirtschaftsdaten

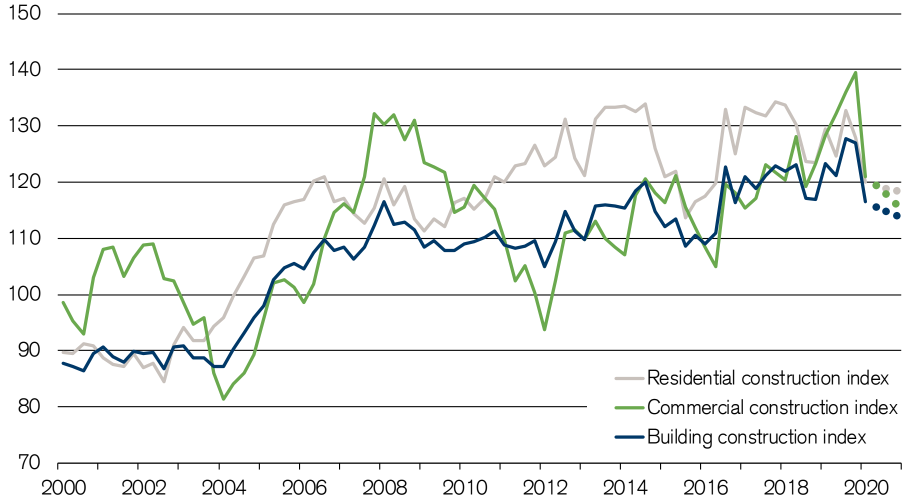
Temporary correction

In the first quarter of 2020, the construction index has been unable to maintain the high level of the previous quarter and is set to decline by 6.3%. We are also expecting a slight decline of 0.7% compared to the first quarter of 2019. We are expecting sales to weaken in both civil engineering (–4.4%) and building construction (–8.2%). After a successful 2019, the main construction trade is therefore likely to have got off to a modest start to the new year. The correction, which has hit commercial and residential construction most of all, was ultimately only a matter of time, as it had long been foreshadowed by the negative development of building permits (approved construction volume in 2019: –9.4%). Many real estate investors had been anticipating an imminent reversal in the interest rate trend until well into 2018. At the same time, concerns grew over the increasing vacancy rate in the rental apartment market. On top of this came an economic slowdown as well. All in all, these developments resulted in a scaling-down of new project planning – which can now be expected to feed through into the sales of developers, subject to the usual timelag. However, the direction of monetary policy has now changed course once again, with any end to the negative interest policy pushed back far into the future. For investors, there is still no getting away from real estate as a source of yield, and financing conditions remain attractive. As a consequence, the expected decline in sales should be viewed as a temporary correction, and the building economy is likely to stabilize once again as the year progresses.

Year:	2018				2019				**2020**	**Forecast turnover growth compared to**	
Quarter:	I	II	III	IV	I	II	III	IV	**I**	**4th Q 2019**	**1st Q 2019**
Construction index	142	142	138	138	143	148	150	151	**142**	**-6.3%** ↘	**-0.7%** →
Building construction index	122	123	117	117	123	121	128	127	**117**	**-8.2%** ↘	**-5.5%** ↘
Residential construction	134	130	124	124	129	125	133	128	**120**	**-6.2%** ↘	**-7.3%** ↘
Commercial construction	120	128	119	123	128	132	136	140	**121**	**-13.3%** ↘	**-5.7%** ↘
Civil engineering index	171	169	169	168	171	188	182	186	**178**	**-4.4%** ↘	**+4.4%** ↗

Development of the sub-indicators

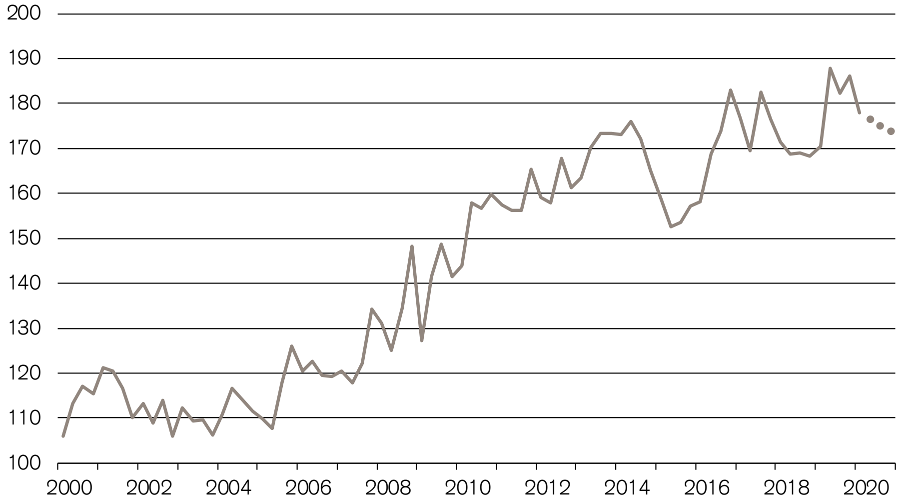
Building construction index Q1 1996 = 100, seasonally adjusted, nominal, points = trend outlook



Peak passed for now

At the start of the year, the civil engineering index is set to record an 8.2% decline compared to the previous quarter. At 5.5%, the smallest decline is evident in public sector construction, whereas residential construction should decline by 6.2% and commercial construction by as much as 13.3%. The correction in the commercial construction segment was to be expected sooner or later. Planning applications for office space have been in decline for three years now, and demand for retail space is being squeezed by digitalization. That sales development should only now be showing the first signs of a correction is likely to be attributable to two factors in particular. Firstly, sales have been supported by various major projects such as "The Circle" at Zurich airport and the Roche Tower 2 in Basel. Secondly, a number of major projects have also been implemented in the manufacturing sector, such as Biogen in Luterbach just outside Solothurn (investment volume: CHF 1.5 bn) and CSL Behring in Lengnau (between Biel and Solothurn, CHF 1 bn). A significant proportion of these projects is now relatively close to completion. At the same time, the slowdown of the economy is reining in corporate investment appetite.

Civil engineering index Q1 1996 = 100, seasonally adjusted, nominal, points = trend outlook

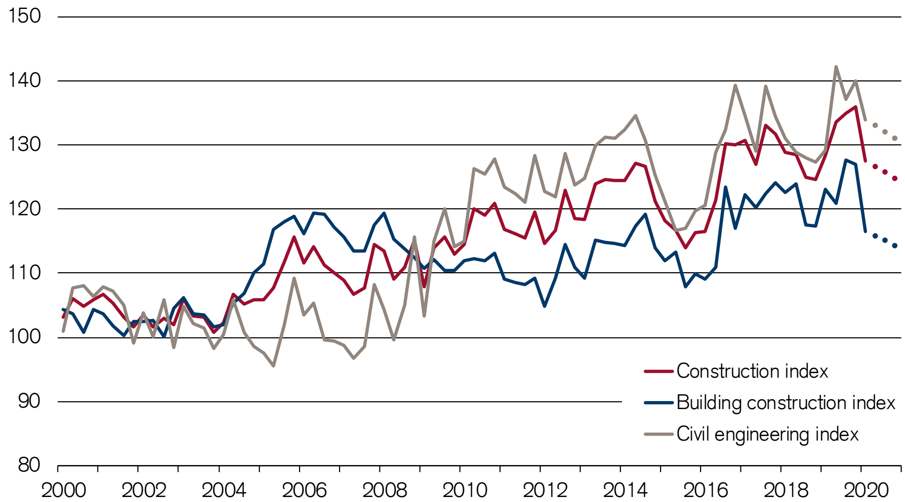


Private civil engineering likely to slow

Seasonally-adjusted civil engineering sales are likely to record a decline in the first quarter of 2020 (–4.4%) compared to the previous quarter. The short-term development of the civil engineering economy remains highly volatile and influenced by a small number of large projects. Construction delays, e.g. as a result of objections or extended political decision-making processes, reduce the predictability of turnover development going forward. However, we are not anticipating any lasting trend reversal here. There is a high order backlog in public civil engineering, which is likely to develop in a comparatively robust way despite the weakening of the economy. By contrast, private civil engineering can be expected to feel the pinch from the rather lower demand coming from the commercial and residential construction side over the next few quarters.

Development in real terms: seasonally and price-adjusted construction index

Q1 1999 = 100, points = trend outlook

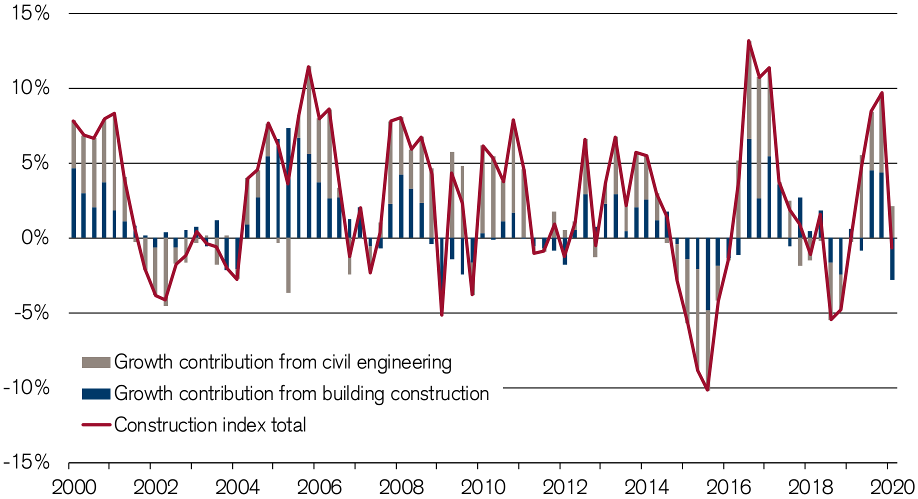


Prices edging up in building construction and civil engineering

Adjusting the construction index to take account of inflation in construction prices recorded since 1999 (Swiss Federal Statistical Office) neutralizes trends attributable to price-related turnover increases. Construction prices are extending their mild uptrend with an expected +0.5% year-on-year increase. Civil engineering companies have been able to raise prices rather more strongly (+0.7%). Overall, the deviation between real and nominal index movements remains manageable. The Swiss franc, which has appreciated sharply against the euro once again over the last few months, and the slight slowdown in the construction economy should mean only minimal price growth over the next few quarters.

Construction index year-on-year

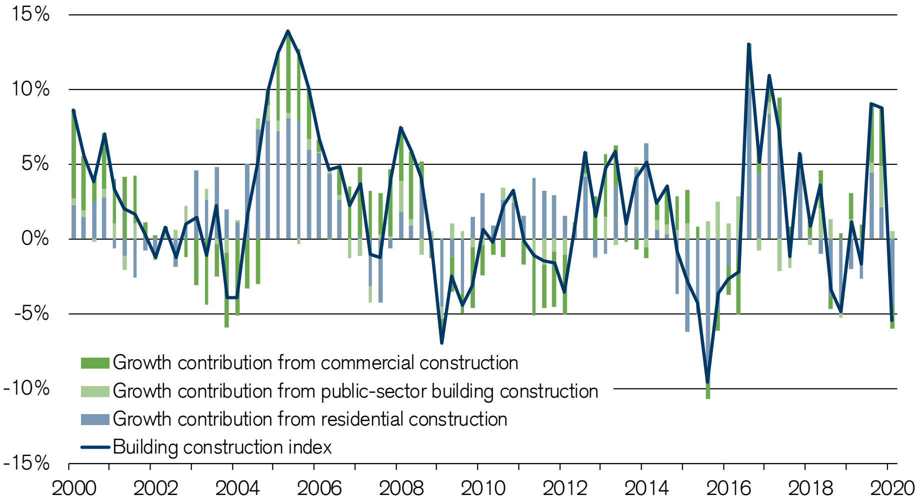
Construction index, seasonally adjusted, growth rates versus same quarter in previous year



Sluggish start to 2020

The construction index is set to fall sharply in the first quarter of 2020, taking it back toward the level of the prior-year quarter (–0.7%). While the civil engineering index remains 4.4% above the prior-year equivalent, building construction turnover is unlikely to maintain the high level of 2019 (–5.5%). This has long been presaged by the volume of construction projects gaining approval, which recorded a year-on-year decline of 9.4% in 2019. Together with the recent weakening of the economy, this can be expected to hold back construction sales over the next few quarters. At the same time, in the absence of any negative economic surprises, persistently low interest rates should prevent any lasting downturn of the construction economy. The first positive signals can already be discerned on the building applications front. For example, the total volume of submitted planning applications from construction projects declined by just 1% in 2019 (previous year: –6.2%) and in the second half of 2019 more rental apartments were approved than in the equivalent period of the previous year.

Building construction index, seasonally adjusted, growth rates versus same quarter in previous year

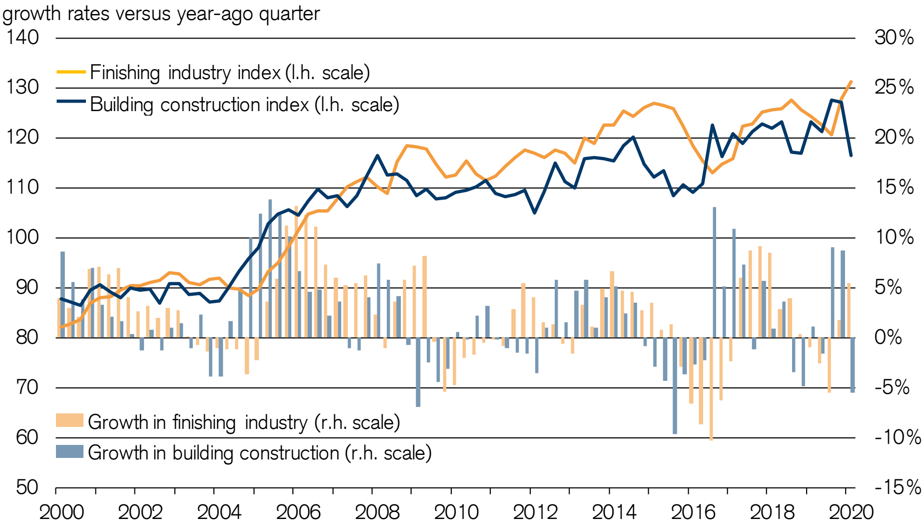


Public sector construction a source of support

In a year-on-year comparison, the building construction segment is set to record negative growth of 5.5% in the first quarter of 2020. Sales of the prior-year quarter are unlikely to be reached in either residential construction (–7.3%) or commercial construction (–5.7%). On the other hand, public sector construction is expected to buck this trend (+4.6%). Indeed, the public sector should account for some 13% of construction sales in the first quarter of 2020, a level not seen for more than 20 years. The largest construction projects at the moment include hospital projects such as the University Children's Hospital Zurich (planned investment volume: CHF 625 mn), the cantonal hospitals of St. Gallen and Aarau (CHF 600 mn each) and additional infrastructure projects such as the Zurich Police and Judiciary Center (CHF 570 mn).

Situation in the finishing industry

Finishing industry and building construction index: Q1 1996 = 100, seasonally adjusted, nominal; growth rates versus year-ago quarter

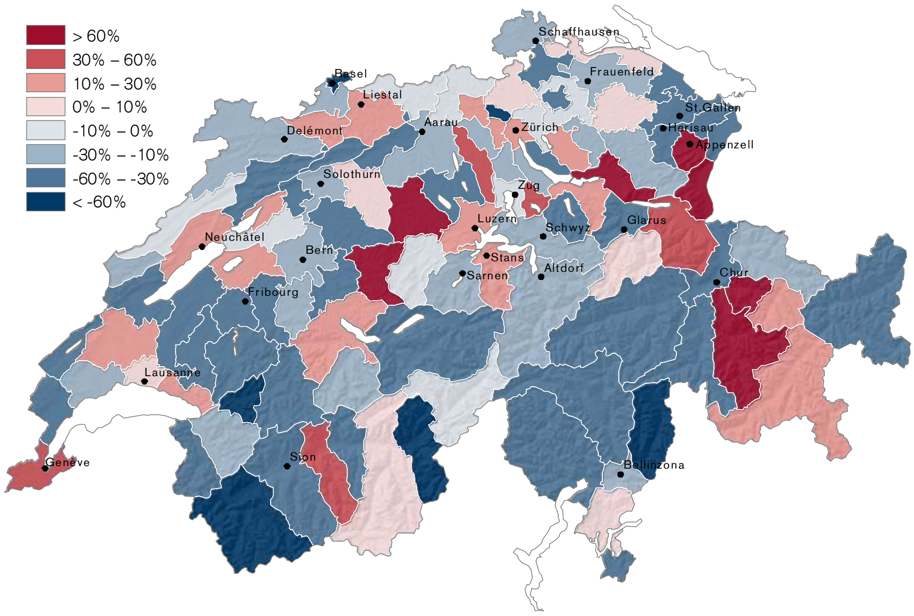


Robust sales development

The finishing index estimates turnover in the finishing industry in the current quarter and lags the building construction index by two to four quarters. In the first quarter of 2020, the finishing industry index is 2.6% above the prior-quarter level and 5.5% higher than the prior-year level. In other words, the finishing industry continues to benefit from the strong construction economy of the previous year. The recent slowdown is not expected to reach the finishing industry until the second half of the year at the earliest. As the themes of energy-related improvements and greater density of urban living are a rising political priority, longer-term growth potential exists above all in the areas of improving the energy footprint of buildings and finishing/additional floors/replacement newbuilds.

Regional demand focus in building construction

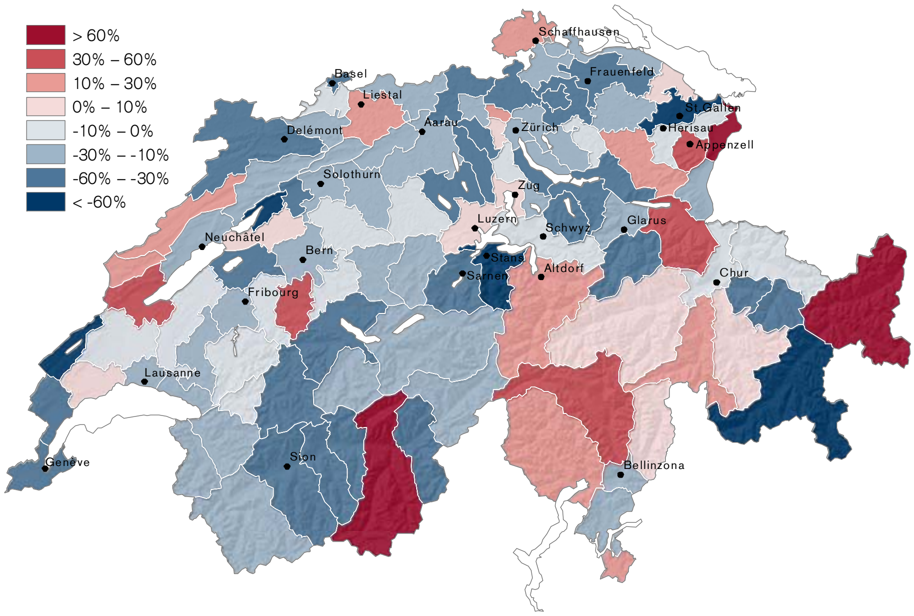
Applications for new-build projects: deviation in the volume of planning applications submitted in last 6 months from 10-year average, by economic region*



Focus of new-build projects

The investment volume of building permit applications indicates regional demand for construction services. In the economic regions marked in red, plans for new-build projects exceed the average for the last ten years; in the regions marked in blue, planning is below this average. With a volume of CHF 17.0 bn, projected activity across Switzerland over the last six months has declined, and is now 7.6% below the 10-year average. 14% of the planned volume relates to just two out of the total 110 economic regions: Zurich city and Geneva, where a number of large-scale projects are scheduled to be realized over the coming years. Below-average projected activity is apparent in 73 of the 110 economic regions. These include large parts of the Alpine region and north-eastern Switzerland, as well as the Bern-Aarau axis and the Jura arc. A slowdown in the medium term also looks likely in a number of regions currently exhibiting high construction activity, such as Ticino and Canton Fribourg.

Applications for refurbishment projects: deviation in the volume of planning applications submitted in last 6 months from 10-year average, by economic region*



Focus of refurbishment work

The volume of submitted refurbishment applications amounted to CHF 4.8 bn in the second half of 2019, which is 19.2% below the 10-year average. Above-average momentum is still evident in 27 more rural regions – predominantly in the cantons of Ticino, Graubünden, St. Gallen, and Neuchâtel. However, projected refurbishment volumes, which reached a record high in 2018, have fallen sharply in the majority of Switzerland's economic regions. Measures to encourage energy-based renovations as part of the Confederation's Energy Strategy 2050 are likely to remain a source of support. Ever since January 1, 2020, property owners who are planning an energy-related renovation can benefit from changes to direct federal tax. The deductions for such measures can now be spread over up to three tax years, even if the corresponding work is only undertaken and billed in a single year. This has the effect of reducing the tax burden more than previously due to the progressive tax bands. It is therefore conceivable that a number of property owners will have postponed their planned renovations in order to benefit from this additional tax relief. By contrast, renovation work is under threat of becoming more expensive due to the considerable restriction of deductions set to be implemented as part of the abolition of imputed value taxation. That said, this kind of system change is highly unlikely to be implemented before 2023, and the prospects of the reform's success remain unclear.

*Credit Suisse has defined these economic regions on the basis of the Mobilité Spatiale regions used by the Swiss Federal Statistical Office. Political borders play less of a role in the definitions than economic phenomena, geographical and demographic features, and mobility patterns. Consequently, some of these economic regions straddle cantonal borders.

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