



Focus on

Short term prospects for the construction sector

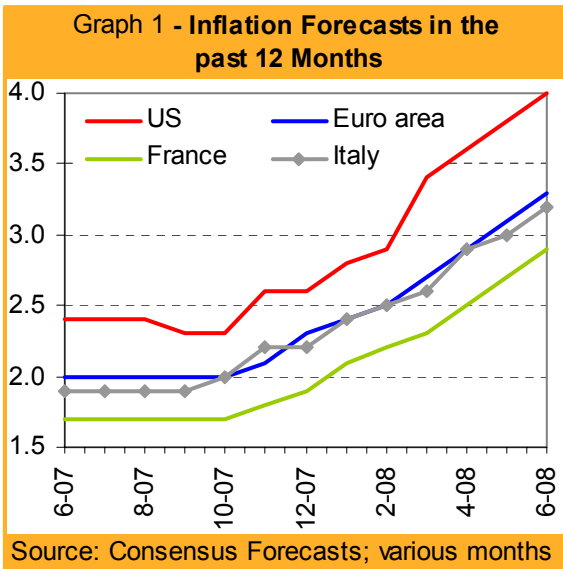
June, 26th 2008

Highlights

- ⇒ Oil price spikes of unprecedented size and the ongoing financial turmoil have combined, yielding the worst mix for the global economy experienced in the last few years.
- ⇒ Although speculation and the weak dollar have played an important role, the oil price boom is mainly prompted by fundamental supply-demand disequilibria. As such, hopes of a sharp correction of the ongoing trend may be misplaced unless a dramatic downturn of economic activity occurs at the world level.
- ⇒ In the financial markets uncertainty remains high. Some signs of improvement have been observed of late; however, overall losses suffered in the financial system have not yet been fully detected and banks' stocks, particularly in the US, are again under pressure.
- ⇒ On balance, Q1 08 outcomes have been slightly better than expected on both Atlantic sides. However, the global setting is increasingly volatile and – looking at confidence indicators – economic activity is set to weaken markedly in the months ahead.
- ⇒ Driven by oil and food prices, inflation has strongly accelerated worldwide. It is thus at peaks not seen over the last 12-13 years in the mature area while it has reached double digit levels in some important emerging countries. In addition, the pass-through from primary commodities to the overall price system seems far from ended, which means that further rises are in the pipeline.
- ⇒ As an effect of the above, monetary authorities are confronted with a tricky dilemma. Both the ECB and the Fed have signalled a tightening bias. Room to manoeuvre is in any case limited and a more neutral stance may again be adopted later this year.
- ⇒ The construction sector is exposed both directly to the credit crisis and indirectly to the deteriorating macroeconomic conditions. In our April R1, outcomes expected for 2008 have been revised downwards for some mature countries, but further revision may be needed. According to available forecasts the downturn could continue well into 2009. The emerging area keeps growing at a satisfactory pace but a worsening macroeconomic environment could, with some delay, impact negatively also on construction.

1. Macroeconomic conditions

Signals coming from the international economy are mixed. On the one hand, in the industrial area (as well as in many important emerging countries) output growth has performed better than expected in Q1 08, which, in turn, has been enough to persuade many analysts that the worst of the crisis has passed and that the major



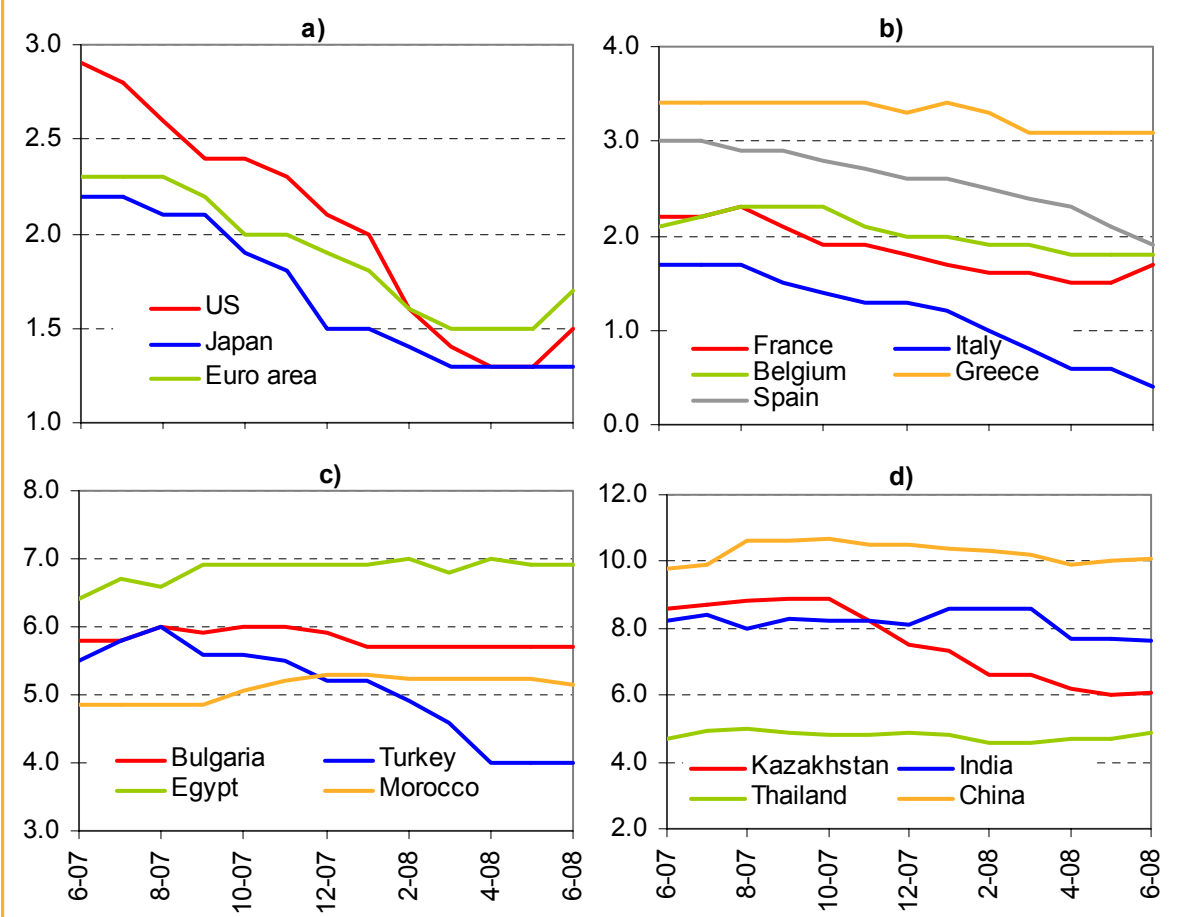
economies have been able to cope fairly well with the ongoing real and financial turmoil. On the other hand, turbulences in financial and energy markets appear far from over while room to manoeuvre in the hands of monetary and fiscal authorities is shrinking as inflation has become more and more worrying. As a matter of fact, inflation is surprising on the upside on both Atlantic sides; consequently, expectations have been substantially raised. As it can be seen from graph 1, forecasts figures for 2008 inflation have increased dramatically since last October and further revisions are likely; however, the current bout of inflation is still assessed as being of a

transitory nature.

As for output growth (graph 2), expected figures for the major industrial areas have stopped worsening (and have rebounded a bit of late, leveraging on better-than-expected Q1 08 outcomes). In the euro area this changing mood is centred on the reviving German economy while Spain and Italy keep worsening. However, confidence levels are trending downwards almost everywhere, which signals that weakening economic conditions may be looming in the horizon. Among the Group's major emerging countries prospects remain relatively favourable but in the case of Turkey and Kazakhstan that are undergoing a serious deterioration for specific reasons (political turmoil in Turkey, financial fragility in Kazakhstan).

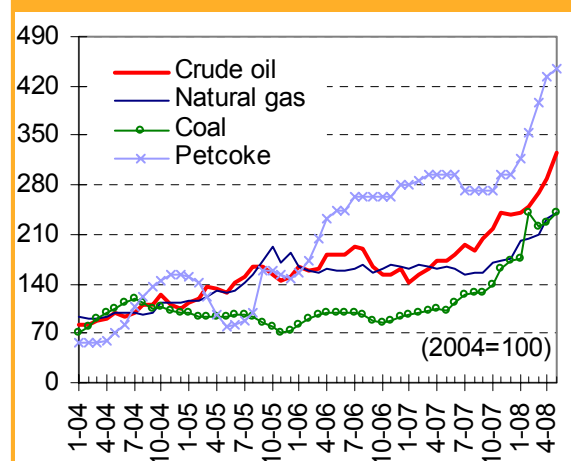
Unfortunately, the two powerful engines are still at play that have triggered the international crisis – namely, the oil price spike and the turbulence caused in the credit markets by the US sub-prime crisis. Oil price is hovering in the range of 130-140\$/b and hopes that more "normal" prices could be re-established soon do not seem well founded as vigorous forces are shaping current trends, driving the prices of the whole chain of energy products upside (graph 3; on this issue see also the box at the end of this paragraph). In any case, uncertainty concerning short term developments (i.e., up to 12 months) is at record highs, as it may be seen from graph 4.

Graph 2 - GDP Growth Forecasts in the past 12 Months



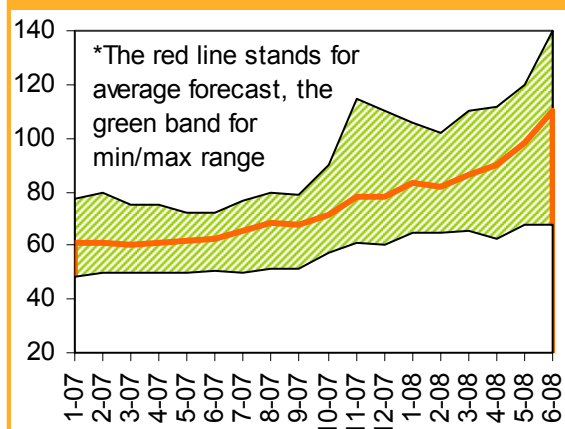
Sources: EIU, Global Insight, Consensus Forecasts; various months

Graph 3 - Energy Price Indices



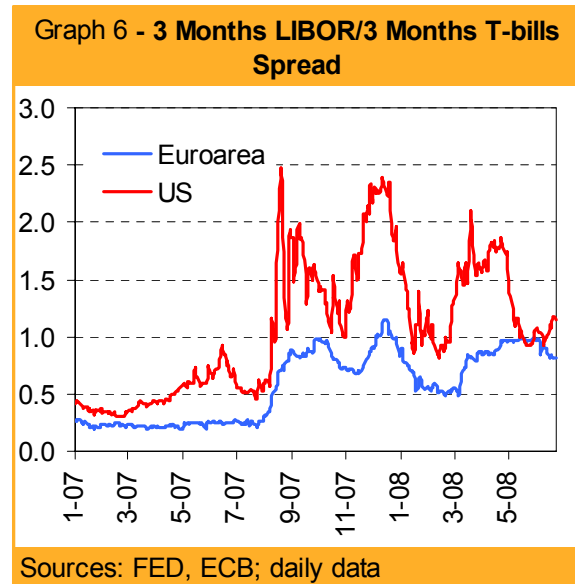
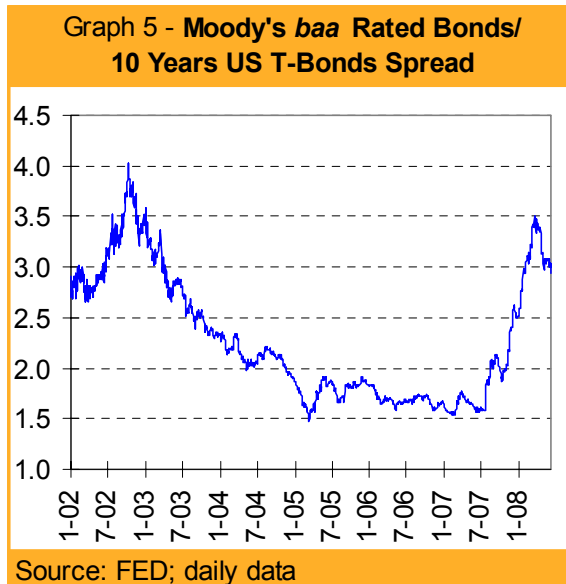
Sources: IMF and PACE Global Energy Services; monthly data

Graph 4 - Oil Prices: 12-months Forecasts* (WTI, US\$ per barrel)

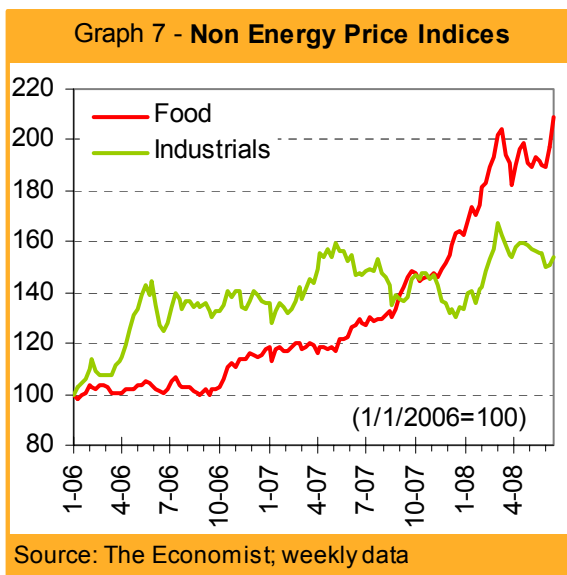


Source: Consensus Forecasts; various months. Forecasts by 70 international institutions

In the credit markets, conditions are much more uneven. Spreads on riskier assets have moderated somewhat as well as spreads between risk-free short term assets (T-bills) and the Eurodollar (graphs 5 and 6). At the same time, the actual size of the losses suffered from financial institutions has not yet been definitely quantified and most stock markets remain weak. In other words, the worst seems over but negative consequences may be felt for long before ordinary levels of confidence and credit conditions prevail.



The inflation rebound is limiting the possibility to carry out aggressive monetary and fiscal initiatives. Particularly as far as the monetary stance is concerned, the phase of strong rate cuts may be over in the US while the ECB has already announced that it will rise its policy rates soon (by 25bp). On the fiscal front, there is no further room to exploit due to ongoing cyclical worsening of deficits.

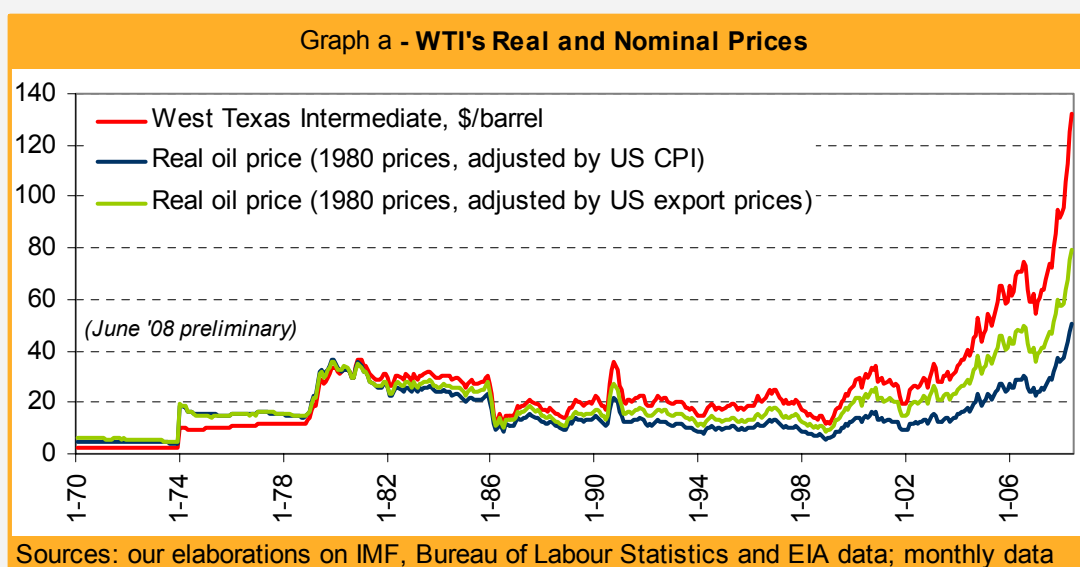


Inflation is becoming a much more worrying issue in most emerging countries for a number of reasons. First, oil intensity per unit of output in countries such as China is higher than in the industrial area; second, the rise in food and agricultural prices (70% higher compared to a year ago, see graph 7) hits hard countries where consumption of foodstuff absorbs a higher share of available income. Third, in a large number of the emerging economies fuel prices are strongly subsidised. When such policies become unsustainable in terms of fiscal burden, the resulting inflationary backlash may prove particularly serious.

To sum up, the two crises that have been unfolding since last summer have hit the world economy in depth. Prospects for both growth and inflation – particularly the latter – have further deteriorated and the risk that also next year the world economy will remain sluggish is far from negligible. The emerging region has so far coped fairly well with the ongoing turbulences. However, in perspective the weakening industrial area's demand and severe inflationary pressures are set to affect negatively output growth even in the most dynamic emerging countries.

BOX: The determinants of the current oil price shock

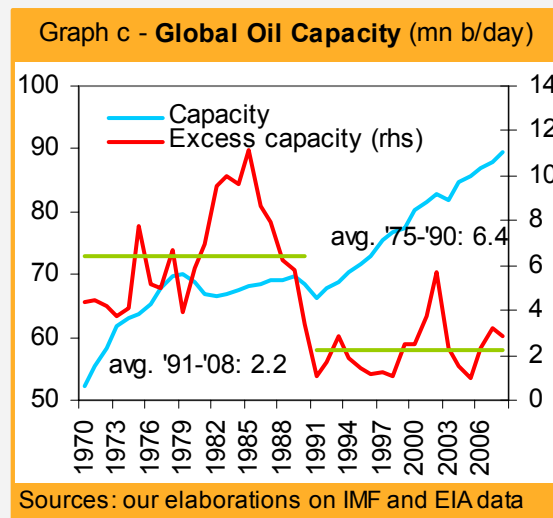
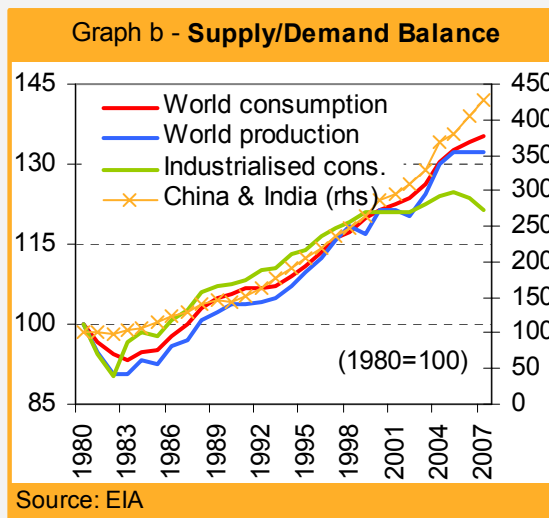
Oil prices have reached unprecedented highs both in nominal and in real prices (see graph a) and remain above 130\$/b despite recent news that Saudi Arabia will increase production by 200k b/d. The price for West Texas Intermediate in the year up to these days has already averaged almost 110\$/b. In nominal terms, the oil price is more than eleven times what it was at the end of 1998, the lowest level in the last decade, and two and a half the level of just a year and a half ago.



These ratios translate in real terms as follows: nine times since December 1998 and twice since January 2007. Never in modern history has an oil shock been as sharp: in 1973 real prices went up by a factor of three and a half, while in 1979 the factor was around two and a half. Given its size, it is surprising how well the world economy is withstanding the shock. In this box we try to describe what the forces behind the ongoing oil price rally are and leave aside the issues related to its consequences.

Three main factors are at the roots of these developments: supply/demand fundamentals, US\$, financial speculation. According to data published by the US based Energy Information Agency (EIA), global oil demand has outpaced production in the past two years as consumption growth accelerated while production levels stagnated. Graph b shows how most of the additional oil consumption has come from China and India in the past four years while demand in industrialised economies as a whole has stagnated. From the supply side, new

production has not kept pace and skepticism is increasing about the global supply landscape. For example, production from North Sea fields peaked in 2001 and has since declined, production in Mexico peaked in 2004 and there is mounting evidence that production in Russia has also peaked. All this is happening without any major new discovery. In addition, global spare capacity has decreased (graph c) and the real picture may be worse than officially depicted. Spare capacity represents the buffer in world oil production that could offset temporary supply shocks. The growing supply/demand imbalance coupled with the thinning spare capacity thus are the most powerful engines which have pushed up prices in the past two years.



But that is not all: the depreciation of the dollar has also played an important role. Because international oil trading is done in dollars, a weaker dollar implies that a higher oil price is needed in order to keep the purchasing power of the oil rent unchanged. The greenback has lost around 13% of its value against the major currencies in nominal terms since the beginning of 2006 and according to some analysts approximately \$20 of the current oil price is being caused by the dollar weakening.

Finally, also financial factors are at play. Demand for oil by non-commercial traders, including speculators, has considerably increased which is indirectly revealed by both increasing levels of inventories in OECD countries and the higher volatility of crude oil prices, which have become extremely sensitive to every bit of news bearing on future conditions. As a matter of fact, data from the Commodity Futures Trading Commission show that speculative activity, as reflected in net long non-commercial contracts, is at all-time highs. On top of all the above, risk premia have increased as crude oil sellers are requiring a larger price because of the uncertainties surrounding global crude supplies. The risks of geopolitical shocks (see Iran, Venezuela, Nigeria) have also contributed to expand risk premia.

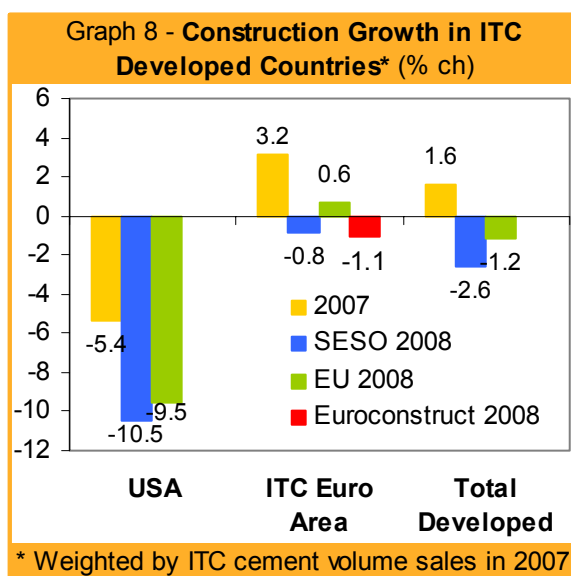
All the above suggests that the era of cheap oil may be over for ever, although the recent peaks could be seen as such, hence hope for a relative retrenchment of the crude price towards more sustainable levels.

2. Construction outlook in the Group's countries

2.1 Overall view

Worsening macroeconomic conditions are negatively affecting the construction outlook as, although to a different extent, a gloomier economic environment impacts on all construction segments.

The weakening housing cycle is concerning in particular the mature economies where it is expected to turn negative in most of the Group's euro countries and worsen further in the US. In addition, anecdotal evidence shows that at least in

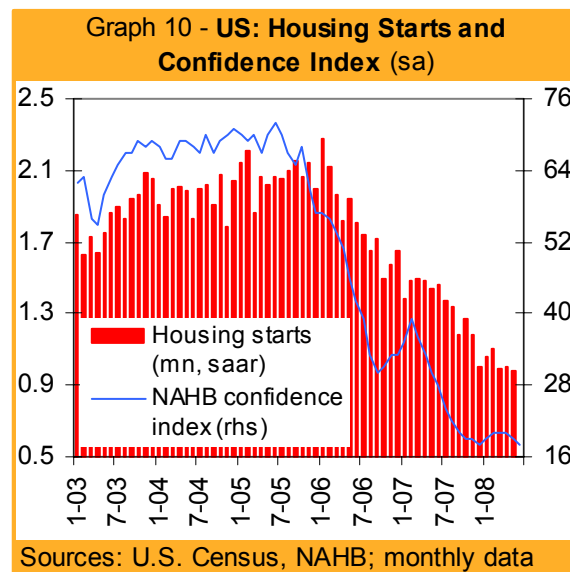
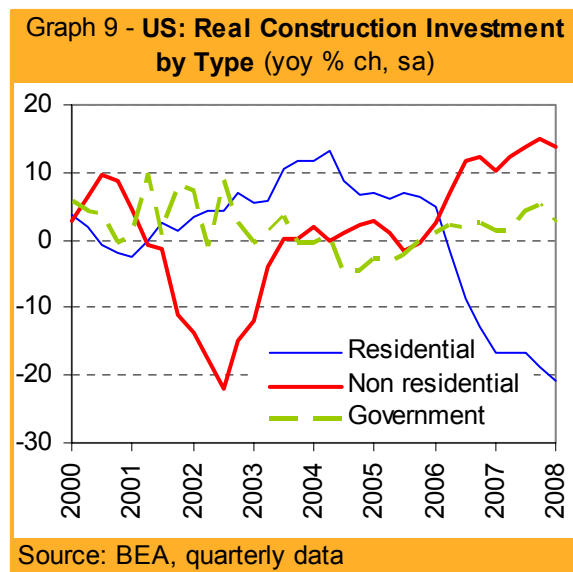


some countries (e.g. Italy and Spain) construction outcomes may be even worse than projected in our April R1. In any case, cyclical positions within the euro countries are furtherly diverging, after an expansionary phase that has seen for long the Group's euro major countries moving all together on the upside. In this regard, it is also worth noting that most recent forecasts are now pointing to a slightly wider decline than envisaged in R1 (Euroconstruct, June 2008, graph 8). As for 2009, according to available forecasts at the overall mature Group countries level, construction is set to perform still negatively.

2.2 North America

According to national accounts data, construction investment continued to drop in Q1 08 due to the further worsening of the housing sector (graph 9). Most housing indicators are still pointing downward. Housing starts are now hovering around the 1mn threshold (at annual rate, graph 10), permits issued continue to decline at rates well above 30% yoy, and the inventory of unsold homes remains near record levels. The severe supply-demand imbalance is putting strong downward pressure on house prices (-14.1% yoy in Q1). Furthermore, all major metros show declines, a sign of the geographic spread of the contraction. However, the rapid fall in house prices, which is helping to improve affordability, is expected to be offset by weaker labour market conditions and rigid lending standards.

The Consensus forecasts for 2008 (table 1) have been deteriorating markedly over the last few months and some relief from harsh conditions is not expected until late 2009.



The non residential segment weakened in Q1 08 and it is set to subside further this year, due to the economic slowdown and to stricter lending standards. A significant deceleration is also forecast for public works. In this regard, the expected shortfall in state/local revenues is darkening the picture considering that more than 90% of public construction is performed at the state/local level. As a matter of fact, the combination of lower revenues and higher spending on other items suggests that public construction activity will remain subdued.

Table 1 - US Residential Investments: Forecasts 2008-09*
(Housing units and real private residential investment, % change)

CONSENSUS	2008		2009	
	Housing starts	Residential investment	Housing starts	Residential investment
May-June	-30.0	-21.6	7.6	-2.4
March-April	-27.8	-20.8	13.6	0.6
January-February	-22.7	-19.2	11.9	2.2
November-December	-17.7	-15.9	10.2	1.5

* The two indicators may differ for the following reasons: time lags between the two series; the *number* vs the *value* of homes; the inclusion of maintenance outlays in the residential investment figure

2.3 Euro area

ITALY. Italy's economy remains weak, even though a boost from net trade in Q1 08 enabled GDP to recover from the contraction in Q4 07. However, the external sector is expected to deteriorate this year as exporters will be faced by a downturn in external demand and a strong euro during the remainder of 2008. With leading business and consumer confidence indicators being depressed in the final months of 2007 and in early 2008, it appears that the current weakness of the economy will be more prolonged than previously forecasted.

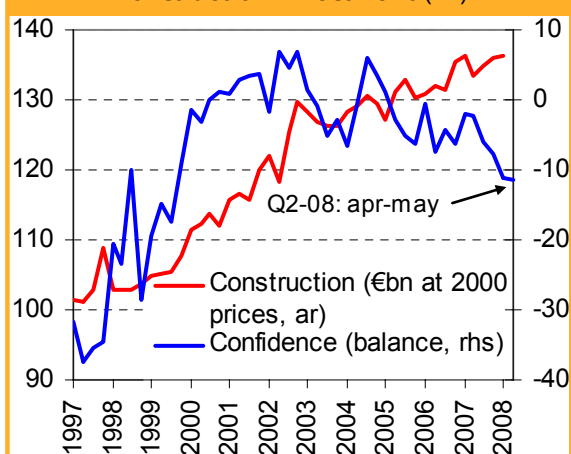
Table 2 - GDP and Construction Investment: 2008-2009 Forecasts*
(% change in real terms)

	GDP**		Construction**	
	2008	2009	2008	2009
EU (Apr 08)	0.5 (1.4)	0.8 (1.6)	0.4 (2.2)	0.4 (2.1)
Prometeia (Apr 08)	0.5 (0.8)	1.0 (1.4)	1.2 (0.8)	0.7 (1.0)
REF (Apr 08)	0.6 (0.9)	1.1 (1.4)	-1.1 (-1.0)	-1.0 (-0.5)
IMF (Apr 08)	0.3 (1.3)	0.3 (--)	--	--
Ance (May 08)	--	--	0.6 (-0.1)	--
ASI (May 08)	--	--	1.4 (1.8)	1.2 (1.3)
OECD (Jun 08)	0.5 (1.3)	0.9 (1.3)	0.7 (1.0)	-0.1 (1.2)
Euroconstruct (Jun 08)	0.5 (1.5)	0.9 (2.0)	-2.1 (-0.2)	-1.9 (-0.2)
Consensus	0.5 (1.2)	0.8 (1.5)	0.2 (0.6)	-0.1 (0.6)

* Month of forecast publication in brackets;

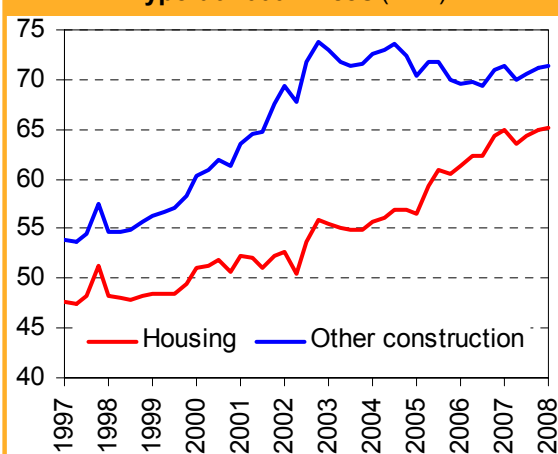
** Previous forecast by same institution in brackets

Graph 11 - Italy: Confidence Index and Construction Investment (sa)



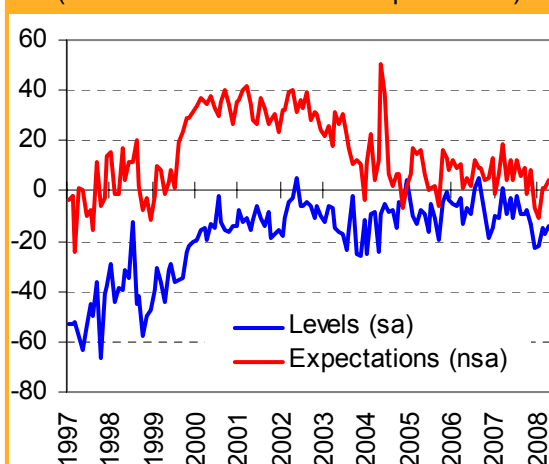
Sources: EU, ISTAT; quarterly data

Graph 12 - Italy: Construction Investment by Type at 2000 Prices (saar)



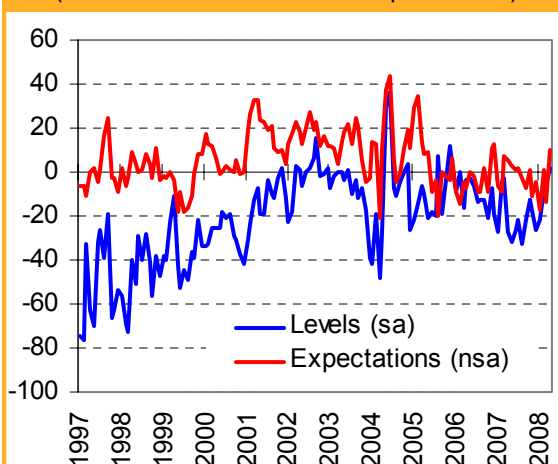
Source: ISTAT; quarterly data

Graph 13 - Italy: Building Book of Orders (assessment of levels and expectations)



Source: ISAE; monthly data

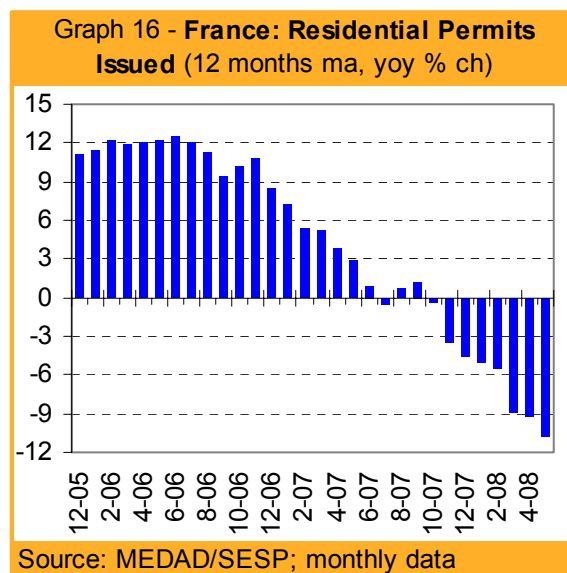
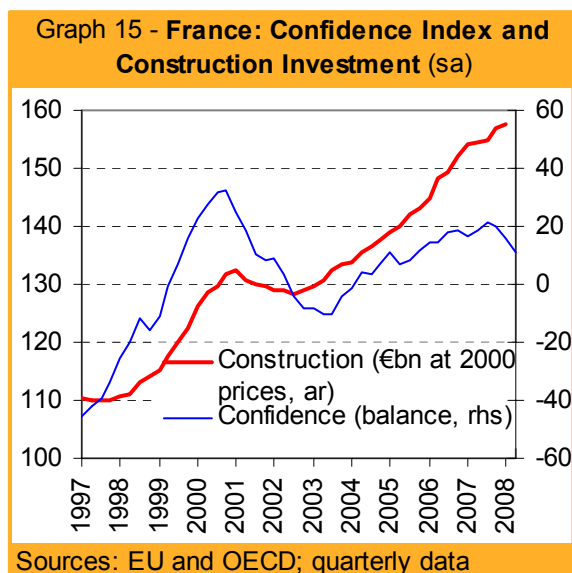
Graph 14 - Italy: Civil Works Book of Orders (assessment of levels and expectations)



Source: ISAE; monthly data

Although Italian banks seem to have had little or no direct exposure to the sub-prime loan crisis, credit conditions have since deteriorated, with interest rates on loans to households already higher than they were during most of last year. This, together with higher food and energy prices, which are affecting household purchasing power, will have a negative impact on residential investment. In addition, housing prices are slowing down, the time span needed to sell an apartment is widening, the number of sales is shrinking, while the amount of new mortgages have already slowed down dramatically. As a consequence, the demand-supply balance of the housing market can be found only at lower activity levels. However, the hypothesis of a strong turnaround of residential investment looks unlikely for most of forecasters (which point to a strong slowdown for the current year and a slight contraction in 2009, table 2), as there is no sign of a credit crunch. As a matter of fact, household indebtedness is much lower than in many countries where the housing boom has been stronger and where sub-prime loans have financed a larger share of the expansion. The non residential component is expected to subside in 2008 due to the weakening international and domestic context and to stricter financing conditions. As for public works, the new government has already announced it will reset most of the projects scheduled by Mr Prodi's cabinet, changing again programs and priorities with the risk of causing an "air pocket" in the next few months. In addition, there are still lots of uncertainties about how and how many resources will be made available by the government for the implementation of the new infrastructure's agenda.

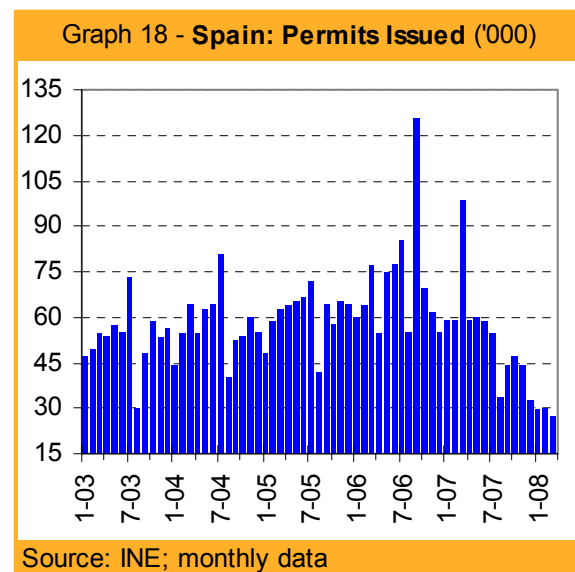
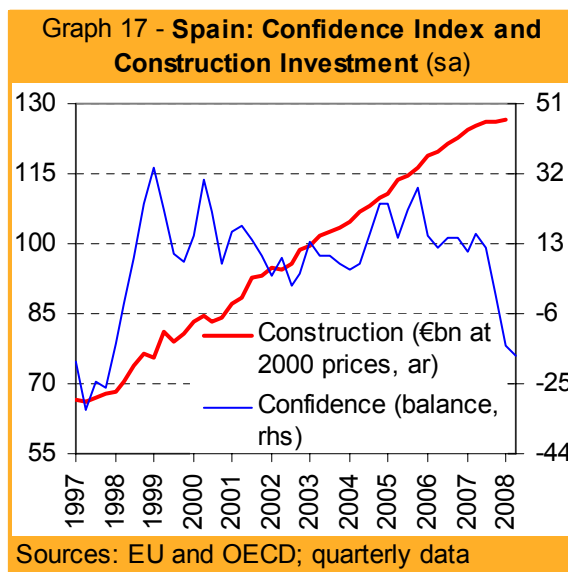
FRANCE. Leading indicators have been of late showing that the residential sector is set to run out of steam. As a matter of fact, both building permits issued (graph 16) and housing starts decreased by over 14% yoy between January and April 2008. The slowdown in mortgage lending continues which is reflected in a deceleration in the rate of increase of outstanding loans.



However, the tightening of mortgage lending conditions remains more moderate in France than in the other euro countries, for a variety of reasons: French banks tap the international capital markets less than banks in Anglo-Saxon countries when it

comes to loan refinancing; competition is fierce among banks, and mortgages are used as a way of retaining customers; banks have been already selective and careful about borrower creditworthiness, especially as far as mortgages are concerned. House prices are now very high and mortgage rates have been rising since early 2006¹. Buyers are therefore increasingly stumbling on solvency restrictions, becoming more cautious and more selective. This has led to a slight decline in sales, an increase in the housing stock and longer sale lead-times which, altogether, should lead to a slight decline in transaction volumes and property prices in 2008. A slowdown is expected also for public works and for the non residential sub-sector. As for the latter, leading indicators exhibited a turnaround in the first four months of 2008 with permits issued and building starts declining by 22.5% and 17.6% yoy respectively.

SPAIN. Most recent data from the construction sector point to an intensification of the correction process. Overall investment contracted in Q1 08 for the first time since Q2 02, but on yoy comparison it remained positive, although growing at the lowest pace since Q3 97 (+1.5%). The high level of household indebtedness and the rises in interest rates have led to a deterioration in housing affordability. This has had an impact on real estate transactions, which declined by a total of 14% in 2007. The effect can also be seen in new loans for home buying, which dropped by 15% in 2007. Supply began to show clear signs of weakness in mid-2007, and is falling faster than demand. In February 08, building permits fell by 48.7% yoy.



In this context, property price inflation has continued to slow down following 16 quarters of gradual deceleration, from the yoy peak of 18.5% in Q4 03 to 3.8% in Q1 08. In 2008, we expect the current trends to continue, with supply contracting until it reaches volumes more in line with potential market growth. However, there are several factors which could prevent a severe US-style recession from unfolding: there is sustained household formation by residents and non-residents,

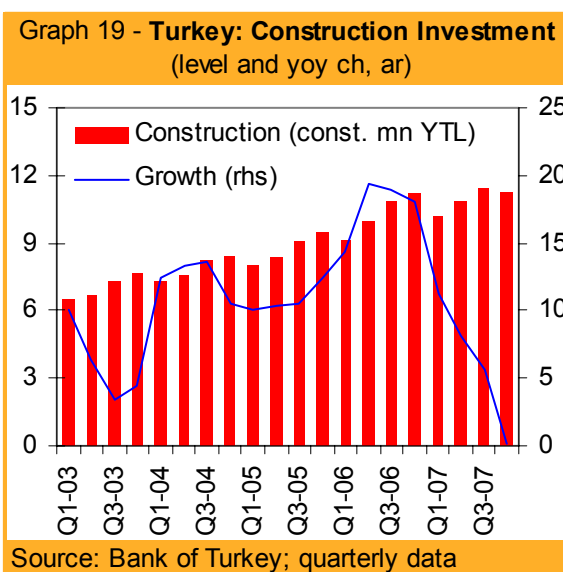
¹ The average annual percentage rate for a fixed-rate mortgage rose from 4.29% at end-2005 to 5.44% in Q1 2008

the financial system is solvent and well-provisioned, and the fiscal position is sound enough to afford anti-cyclical policies.

GREECE. According to unofficial estimates, growth in residential investment registered a decline of 6.8% in 2007, following a 21.5% surge in 2006. Residential construction activity - as measured by the volume (m³) of building permits - registered negative growth of 2.6% yoy in Jan-Feb 2008, compared with the +7.6% in the same period a year earlier. Nevertheless, demand for new housing remains supported by strong mortgage lending, though this is set to decelerate in 2008, following the recent surge in the cost of borrowing as a result of the international financial crisis.

BULGARIA. Economic growth strengthened further in Q1 08, largely propelled by the increase in exports of goods and services. However, slowing global growth is likely to affect economic expansion in the second half of 2008, while also domestic demand looks set to be moderating somewhat compared to 2007. As for the construction sector, booming growth of the real estate continued, and prospects remain bright for the rest of the year. Average residential prices increased by 33.7% between the Q4 06 and Q4 07. Most analysts expect robust growth in house prices to continue in 2008, although at significantly lower rates (13-14%). Developers are showing most interest in shopping centres, with many new projects being announced or already under construction. 14 construction projects are planned for Sofia, as well as many more in other major Bulgarian cities. Developers have complained about stricter lending requirements from banks and higher interest rates in recent months, but there is still no shortage of funds in the sector. There is instead growing concern that the sharp decreases in property prices in the UK and Ireland could affect British and Irish developers' investment also in Bulgaria, and efforts are being made to attract more investment from other countries such as Russia and Scandinavia.

2.4 Emerging countries



TURKEY. The year 2007 ended with a sharp deceleration in construction activity (graph 19). On a yearly basis construction investment grew by 6% (down from 17.8% in 2006) but the quarterly profile looks particularly worrying with the latest yoy figure plunging to 0.2%. The biggest drag was the public component which fell by over 6% in Q4 07. The construction sector is suffering from the deteriorating macroeconomic setting which in turn is also being hit by growing political instability (related to the uncertain future of the ruling Justice and Development party). Prospects for the sector are

uncertain but mainly tilted downwards as the economic slowdown adds to the political turmoil. Mounting inflationary pressures have prompted a turnaround in monetary policy in mid-May; following a second interest rate hike in mid-June, further intervention may be in the pipeline in the coming months. In addition, a recent ruling by the Constitutional Court - banning the sale of all forms of real estate to non-Turkish nationals - has sent the holiday property market, a backbone of Turkey's real estate sector, into chaos although the finance minister has promised a new property law as soon as possible. All the above, coupled with the ending of the IMF support, may in the end dent investors' confidence, hence reduce foreign direct investment and hurt not only the whole economy but also the construction sector.

EGYPT. The Egyptian economy has continued to expand strongly in 2007 on the back of robust export growth, healthy revenue flows from tourism and the Suez Canal, and higher investment. According to preliminary estimates GDP grew by 7.5% yoy in Q1 08 while the construction sector kept running at almost 15% after closing the year 2007 with a robust 16.2%. Foreign direct investment has continued to flow in and is estimated to reach 8.4% of GDP in the fiscal year ending June 2008. However, some clouds are looming in the horizon as inflation is accelerating rapidly, pushed up by rising food and energy prices and by the subsequent need of the government to reduce energy subsidies in order to pursue fiscal sustainability. Some further monetary tightening is also in the cards following the previous two rate hikes of earlier this year (March and May). Prospects for the construction sector remain so far relatively optimistic although some slowdown may be expected. As said in previous notes of ours, the booming tourist sector is attracting huge capital inflows (particularly from the Gulf) while the government's efforts at overhauling the infrastructure of the country (from road development to port and airport construction to social housing programmes) are strongly sustaining construction activity. Among the most recent construction announcements, albeit still in a very preliminary phase, there are a new terminal building of the Hurgada International Airport, housing projects by the Arab Real Estate Development Company on 34mn sqm of land in Egypt starting from Cairo, and a number of new upmarket hotels.

MOROCCO. A sharp contraction in cereal production last year resulted in overall real GDP growth of 2.7%. This notwithstanding, the construction sector kept running at a robust pace (+9.7%) posting its highest result in a decade and the outlook remains positive. The government is tenaciously pursuing social housing programmes both directly and via fiscal incentives. In 2007 the government also incorporated seven social housing institutions into the state owned Al Omrane holding group in an effort to boost efficiency. It is also trying to develop public-private partnerships (PPP) to provide affordable housing. The Dar Lakbira (Hospitable House) initiative is one recent example of PPP announced in 2007. The other backbone of Moroccan construction is the tourist sector which continues to be its driving engine with investment projects including the government initiated Plan Azur beach resort (worth about US\$6bn), the Gulf Finance House beach resorts (US\$1.4bn), the high-end Qatari Diar residential and tourist complex in Tangier (US\$660mn) plus other luxury, residential tourist and leisure facilities

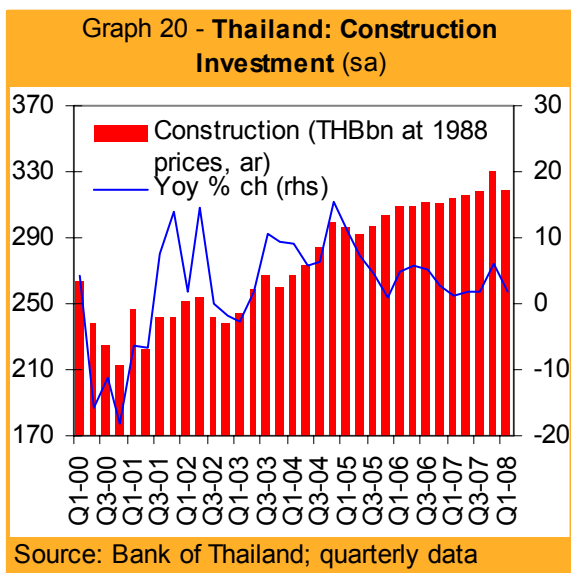
complexes in Tangier and Rabat. Activity is also buoyant in the infrastructure sub-sector. The Tangier-Med Special Agency has just launched a tender for the construction contract to expand the Tangier-Med port (worth about €850mn), while a major dam construction project (consisting of five dams) is to be launched this year. Finally, both the investment programmes for the construction of highways (over 2006-10) and rural roads (2005-15) are underway.

INDIA. The Indian economy continues to power ahead (+9.4% in 2007 for GDP) although a slight slowdown is in the cards given the global economy weakening and the impact of higher domestic inflation. The latter has recently prompted a monetary tightening which will likely intensify in the coming months. Value added in the construction sector expanded by 10.6% in 2007, down from 13.3 % in 2006, and figures for Q1 08 show that the momentum is continuing (+12.6% yoy). Construction activity is boosted by the government commitment to overhaul the country's infrastructure. In its latest budget, approved end-February, despite a greater concern on rural poverty alleviation, the government pledged an increase of 25% in an urban infrastructure programme. Last May an agreement with France was signed aimed at upgrading the railway, aviation and freight transport infrastructures, which are in dire need of upgrades and expansion. The real estate is booming in all its segments (residential, offices, hotels, etc.) and prospects remain very favourable: according to a government-sponsored study, urban India had a huge housing shortage of 24.7m units in 2007. The sector is emerging as a hot attraction for foreign investors after the liberalisation of policy in 2005. Foreign direct investment has started to pour into the country's real estate exhibiting a spectacular growth: from zero in 2004, to Rs21.2bn in 2006 and further to Rs60.6bn in 2007 (about US\$1.5), ranking second only to India's computer software industry in attracting FDI. Property prices appear to have softened since mid-2007 in many locations, which indeed was largely anticipated. Overall, construction activity should remain buoyant in the forecast horizon even discounting a slight weakening given the ongoing monetary tightening.

CHINA. In the past two years the real estate sector has enjoyed a spectacular rise, with average prices doubling in some cities. As a consequence, in late 2007 the State Council has rolled out a series of regulations - from credit ceilings to a 40% down-payment requirement for second mortgages - in order to combat property speculation. With China continuing to struggle with high inflation, the central bank is likely to keep tight reins on monetary policy. The housing market in China has indeed shown some initial signs of slowdown, with housing transactions in many major Chinese cities plummeting and home price increases decelerating. Slowing sales are putting developers everywhere in difficulty. Many have aggressively bid for land to develop through the first quarter of this year. However, they now find that banks are reluctant to provide easy financing for construction. Nevertheless, the extent of market correction will vary among China's regions, with activity in certain regions - such as Beijing and Shanghai - expected to remain robust due to the high value of the ongoing investment projects and the sheer concentration of economic activities there. As for public works, perspectives are positive in the medium term as the impressive 11th Five-year plan (2005-2010) is ongoing and the central government has recently announced that infrastructure

restoration was a priority in reconstruction after the May 12th earthquake in the Province of Sichuan. Deutsche Bank estimates the effort will require US\$78bn over the next three years.

THAILAND. Political instability has weakened significantly domestic demand in 2007, but a strong external contribution helped to prop up the economy. A newly



elected government took office in January but the political arena is far from having regained stability particularly given the return of Mr. Thaksin - the former Prime Minister ousted by the 2006 coup - from his self-imposed exile, a development which bodes ill for the near future. Tension is very high between Thaksin supporters (including the governing party PPP) and the opposition. While the global economic slowdown will somewhat drag the external contribution to growth, domestic demand may be posed to suffer again from the political debacle following what it could turn out to have been a "false start", i.e. a particularly

brilliant Q1 08 boosted by the new political setting. In addition, as in most emerging countries, inflation has sharply accelerated in recent months which may soon prompt a reversal in the monetary policy stance following aggressive loosening in early 2007. Construction investment is also suffering from this uncertain environment: it grew by only 2.7% in 2007 (down from 4.5% in 2006) and only thanks to the public sector component as the private one fell by 2.1%. Q1 08 figures are still relatively weak (+1.8% yoy) reflecting a rebound in the private residential and a contraction in the public component. Given the uncertainties looming in, prospects for the current year are rather blurred and mostly rely on the announced government expansionary manoeuvres. In fact, the government has reprioritised the large infrastructure investment programme. Tenders for three new train routes in Bangkok will be called this year as part of a US\$22.2bn plan to develop the nine lines mass transit rail network for the city. To help fund the rail projects the government has announced it will draw US\$15bn from its 2008-2013 budget. As for the real estate market, last year sluggishness will hardly be reversed although it stands to benefit from the government's recent stimulus programmes for the economy which include tax incentives for the real estate industry.

KAZAKHSTAN. The Kazakh economy is finally cooling down after years of economic expansion topping 9% annually. GDP grew only by 6% in Q1 08. The slowing construction is the main culprit while stellar oil prices keep sustaining the oil related GDP. The construction sector, which so far has experienced an outright boom, has been financed mainly through massive bank credits but a serious credit crunch is now biting as a consequence of the global financial turmoil. According to

some analysts, local banks are highly exposed to the property market, with some 70% of loans reported to be directly or indirectly connected to real estate, compared to about 25% in Russia. The Kazakh banking sector has borrowed aggressively from abroad in recent years; the international credit crunch has limited the banks' access to foreign financial markets and thus led to higher refinancing costs. Hence, the tighter liquidity conditions have impaired construction most significantly, particularly the residential sector - and the bubble has finally burst (unofficial estimates put the house price decline in Almaty, where sales have practically dried up, at 30-40% in just 6 months). In addition, inflation has been running at rates close to 20% since December 2007 posing a serious challenge to policymakers as inflation fighting would call for monetary tightening while easing the banking sector's liquidity crisis would rather require the opposite. To avoid the collapse in the real estate market - and an ensuing recession - the government allocated US\$4bn as a rescue package: US\$1bn was used in 2007 and the rest is to be taken up this year. Prospects for construction are quite gloomy in the forecast horizon as, despite strong government intervention, the banking crisis will take some time to resolve. On the positive side, strong oil prices will grant positive growth albeit at much lower rates than in the past decade while the still huge unsatisfied real estate demand should ensure vibrant construction activity in the medium term.

Table 3 - ITC Group Countries: Construction Investment Forecasts
(% change in real terms)

	ITC SESO		EU		OECD		Euro construct ⁽²⁾		Other sources	
	(Apr '08)		(Apr '08)		(June '08)		(June '08)			
	2007*	2008	2008	2009	2008	2009	2008	2009	2008	2009
Canada	3.6	1.0	--	--	1.8	0.7 ⁽³⁾	--	--	-0.3	1.6 ^(4,5)
US	-5.4	-10.5	-9.5	-3.7	-23.6	-8.5 ⁽³⁾	--	--	-9.1	4.7 ^(4,6)
France	3.8	0.6	1.1	0.6	0.6	0.3 ⁽³⁾	1.5	1.0	0.9	-0.9 ^(3,7)
Belgium	3.9⁽²⁾	0.5	1.3	1.1	3.9	3.5 ⁽¹⁾	2.7	1.2	0.9	1.1 ^(3,8)
Spain	4.1	-3.0	-0.7	-4.8	0.0	-2.8 ⁽¹⁾	-5.9	-3.7	-2.2	-3.8 ⁽⁹⁾
Italy	2.0	-1.5	0.4	0.4	0.7	-0.1	-2.1	-1.9	1.4	1.2 ⁽¹⁰⁾
Greece	4.0	1.0	4.0	4.1	5.8	6.1 ⁽¹⁾	--	--	9.2	-- ⁽¹¹⁾
Turkey	6.0	6.0	9.9	9.1	2.0	4.7 ⁽¹⁾	--	--	4.8	6.5 ^(1,12)
Bulgaria⁽¹⁾	23.3	12.0	14.0	11.0	--	--	--	--	16.0	12.5 ⁽¹²⁾
Morocco⁽²⁾	9.7	9.0	--	--	--	--	--	--	6.0	6.5 ^(1,13)
Thailand	2.7	5.0	--	--	--	--	--	--	6.4	8.5 ^(1,12)
India⁽²⁾	10.6	8.5	--	--	--	--	--	--	12.4	13.3 ^(1,12,fy)
China⁽¹⁾	11.1	11.0	--	--	--	--	--	--	10.8	9.8 ⁽¹³⁾
Egypt⁽²⁾	16.2	9.0	--	--	--	--	--	--	26.0	19.5 ^(1,13)
Kazakhstan⁽¹⁾	8.2	5.0	--	--	--	--	--	--	13.5	17.0 ⁽¹³⁾

* Preliminary actual data in italics

(1) Gross fixed capital formation, for India "fy": fiscal year data beginning April 1st; (2) Value added; (3) Private residential investment; (4) Private construction investment; (5) Toronto Dominion, June 2008; (6) Economy.com, June 2008; (7) Société Générale, April 2008; (8) Bureau Fédéral du Plan, May 2008; (9) BBVA, April 2008; (10) Prometeia-Intesa Sanpaolo, May 2008; (11) Alpha Bank, May 2008; (12) Consensus Forecast, June 2008; (13) Economist Intelligence Unit, May-June 2008