

## INFLATION: JUST HOW BAD CAN IT GET?

### December 2022

On 9<sup>th</sup> December 2022 BCIS held a webinar entitled 'Construction Inflation: Just how bad can it get?'. During the webinar a Q&A session took place, but due to the sheer number of questions submitted, time ran out for BCIS to answer several of them.

Below is a selection of questions that were submitted and the answers of the BCIS panel.

**With residential values falling by a predicted 20%, interest rates rising, and construction costs having increased by c15% what do developers do for the next 2 years? Can costs help save the day?**

BoE expect house prices to fall 9%. This will affect the viability of some developments. In previous downturns some developers shut up shop and many sites were mothballed. There is no evidence of that happening at the moment.

**Presumably new work includes new extensions of existing buildings?**

Generally speaking, not. In both the Average prices section and the Analyses sections of the service there are separate options for new build, horizontal extensions, and vertical extensions. When we allocate projects for inclusion in the Tender Price Index then horizontal and vertical extensions will be grouped with new build.

**How does this correlate with supplier price rises that are being forecast for early 2023?**

With the cost of raw materials continuing at higher levels, at least in the short term, and pressure on labour costs there will inevitably be some further price increase from manufacturers. However, some commodity prices are beginning to fall and the anticipated slow-down in the economy will make it harder for price increases to stick.

**Based on the charts it looks like the projection is prices increases are going to slow but not expecting a decline in tendering prices, so it looks like these will remain at elevated levels. Is this the correct interpretation?**

Yes we are predicting that the rate of increase in costs and prices will get lower - so both are still increasing just at a lower rate.

**Source of tender price data - is there an attempt to expand sources in future? I believe that public sector works might outweigh private sector (e.g. in housing) which maybe doesn't give an industry wide picture.**

We aim to capture and analyse a wide variety of projects from the public and private sector. Currently, we will be capturing more public sector projects and are very keen to receive data from as many sources as possible.

**When will carbon data information commence?**

BCIS already contains carbon data in our component life cycle database (this plots LCC and carbon data together for some common building components). We are planning to put carbon data against other BCIS data increasingly over the next 12 months. This will be the subject of a future BCIS webinar.

### **What role will productivity play going forward?**

Productivity is notoriously difficult to measure in construction, but a continued move towards the offsite manufacture of components will help. There was some anecdotal evidence that the COVID site operating procedures improved productivity. Personal opinion biggest improvements would be allowing sufficient time and a right first-time culture.

**I am interested to know what sort of sample size indices of TPI and PUBSEC are based on. Do contractors and/or consultants report the cost of projects as frequently as it used to be? I'd be very grateful for an idea of the sample size of All in TPI for past 5 years or so.**

Since the pandemic hit in 2020 the BCIS All-in TPI has been based on the TPI Panel consensus. We are still indexing projects received and are exploring how to re-integrate the project results with the TPI Panel consensus and the modelling approach that we had introduced in 2019. Prior to this the number of projects included in the TPI was as follows: 2019: 40, 2018: 66, 2017: 94, 2016: 101. We receive projects up to 2 years after the quarter so the samples for 2019 and 2018 would have been affected by the pandemic. There has been a decline in the number of projects available for indexing which is why the model smoothing methodology was introduced. Because this approach makes use of projects over several quarters the effective sample size increased significantly. PUBSEC is now a smoothed version of the BCIS All-in TPI so the number of projects included is the same.

**Why do they use CPI as the official inflation measure and not RPI? What is the difference in the measure of RPI, CPI and CPIH? Do they want to eventually replace CPI with CPIH as it is lower?**

There are several differences between CPI and RPI and RPI will be effectively discontinued as a separate index in 2030. CPI was introduced as a macro-economic measure of inflation that is internationally comparable and it is an appropriate measure for purposes such as the Bank of England's target. RPI is a much older measure and was originally intended to measure inflation experienced by households. The biggest difference between the measures is a technical difference in the formulae used which means CPI will always be lower than RPI. The formulae used within RPI are generally agreed to be flawed and over-estimate inflation. On the other hand, there are arguments that suggest the formulae used in CPI must underestimate inflation. There are other differences between CPI and RPI, involving the weighting of items, that can make a difference. CPI weights are based on all expenditure by individuals in the UK (including foreign tourists) while RPI is based on UK residents only, excluding the richest and the poorest and those living in institutions. CPI weights are based on total expenditure while RPI weights give equal emphasis to expenditure patterns from all households which means CPI gives greater weight to luxury items. CPIH is CPI with a housing component added but the method of calculating owner occupied housing costs is controversial and even its supporters would not claim it represents costs actually experienced by homeowners. ONS are working on a whole new series of indices called Household Cost Indices which will provide a much better measure of inflation as experienced by households.

**The TPI chart shows a sharp decrease and bottoms out about 3Q2023. Does this mean we have greater chance for a better tender price (cheaper?) by waiting say 6 months before going out to tender?**

We are predicting that the rate of increase in costs and prices will get lower - we are not forecasting a fall in costs or prices.

**Are you seeing a shortage of skilled labour in the industry?**

Yes, there will very likely be a shortage of certain trades in certain locations across the UK.

Borrowing costs for developers have doubled from 2020 Q1 to date, sales values being down valued by valuers on purchases. This will lead to a significant stall in work. Surely this will cause an increase in availability of labour and materials. I can't see anything but a fall in tender prices in 2023 rather than just a decline in inflation. Is there another agreement to this view from the panel?

The Office for Budget Responsibility (OBR) forecasts a 9% drop in housing prices challenging the viability of new house developments. As a result, private housing completions are expected to fall from 174,000 in 2022 to a low of 132,500 in 2025. This will lead to the release of labour, but we believe that wages will continue to reflect rises in the cost of living in the short term.

**Is there a risk that over forecasting for risk contingencies associated with inflation is creating a situation where pipeline projects are getting pulled and further impacting growth?**

Yes - we are already witnessing this with larger programmes of work that are predicting that the scope of what can be delivered needs to reduce to compensate for the cost and price increases.

**Do your forecasts consider political impact?**

Forecasts are only based on the information that we know now - not different scenarios and policy changes that may or may not happen.

**Do the panel think constraints on the supply of labour following the impact of Brexit will continue?**

That seems likely at least until after politicians adopt a policy and stick to it.



For the past 60 years, we have been collecting, collating, analysing, modelling and interpreting cost information.

The Building Cost Information Service (BCIS), makes that information easily accessible through our online applications, data licensing and publications. We also provide consultancy and research support to clients from both the public and private sector.

**t:** +44 0330 341 1000  
**e:** [contactbcis@bcis.co.uk](mailto:contactbcis@bcis.co.uk)

**[bcis.co.uk](http://bcis.co.uk)**

©BCIS2022

