Outlook for Construction

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Agenda

Is a period of stagflation - characterised by high inflation and low economic growth - inevitable for the UK?

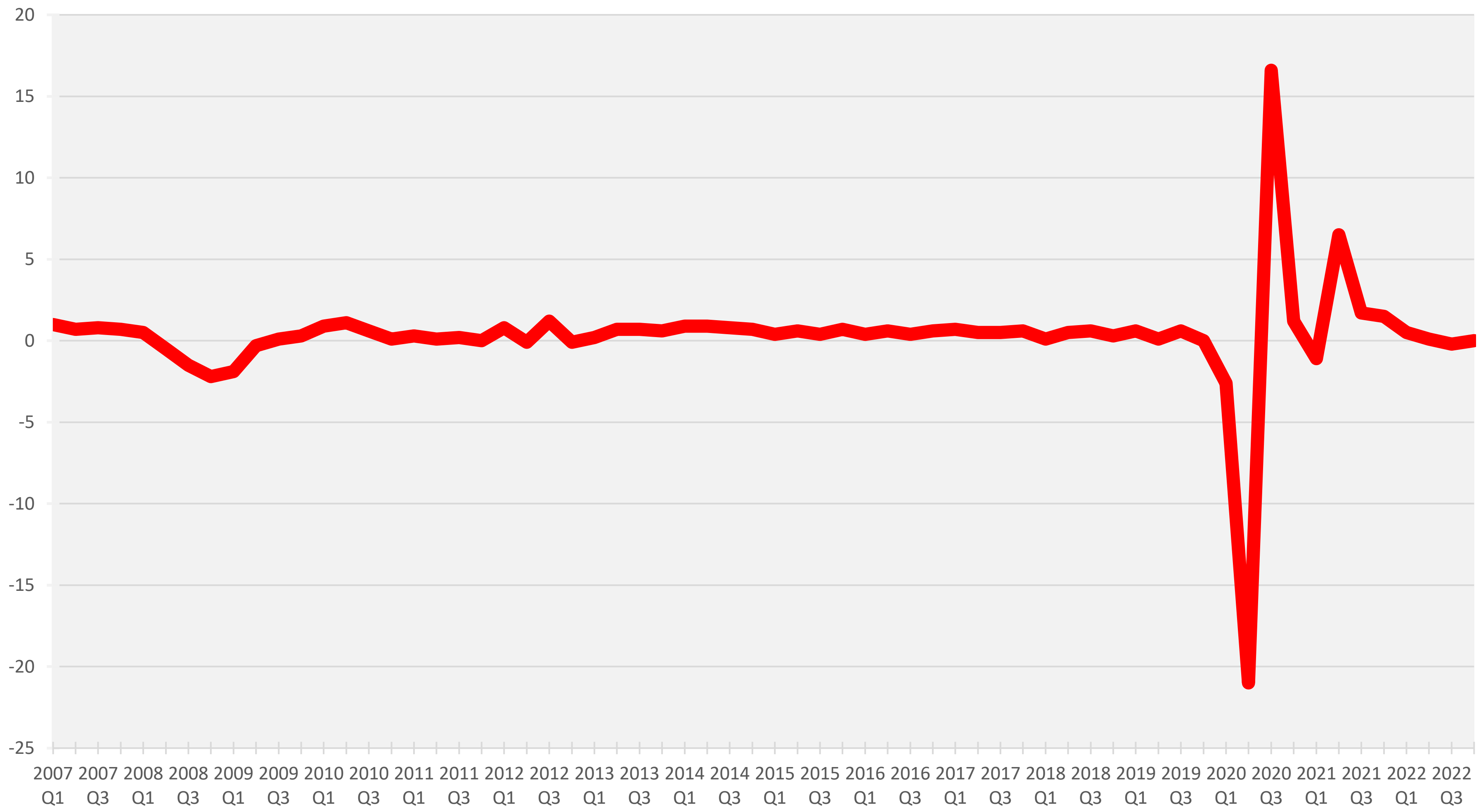
To address this question, we will examine:

- Overview of the wider economy
- Analysis of the fundamentals of the construction sector
- Summary outlook for construction
- Questions

Setting the scene

- Have we gone back in time to the 1970s? Then as now the UK experienced widespread industrial action, spiralling energy costs and rampant inflation, add in a war in mainland Europe and stagflation in the UK is becoming a real possibility
- Inflation is still rising and tends to be sticky, it is remaining stubbornly high at over 10% (five times higher than the BoE's 2% target)
- While we may have avoided a technical recession so far, quarterly GDP growth is hovering around zero and coupled with high inflation we have the ideal conditions for a stagnating economy
- We're going to look at the outlook for construction....but first we need to examine the context of the wider economy

GDP Q on Q growth % (ONS, 2023)

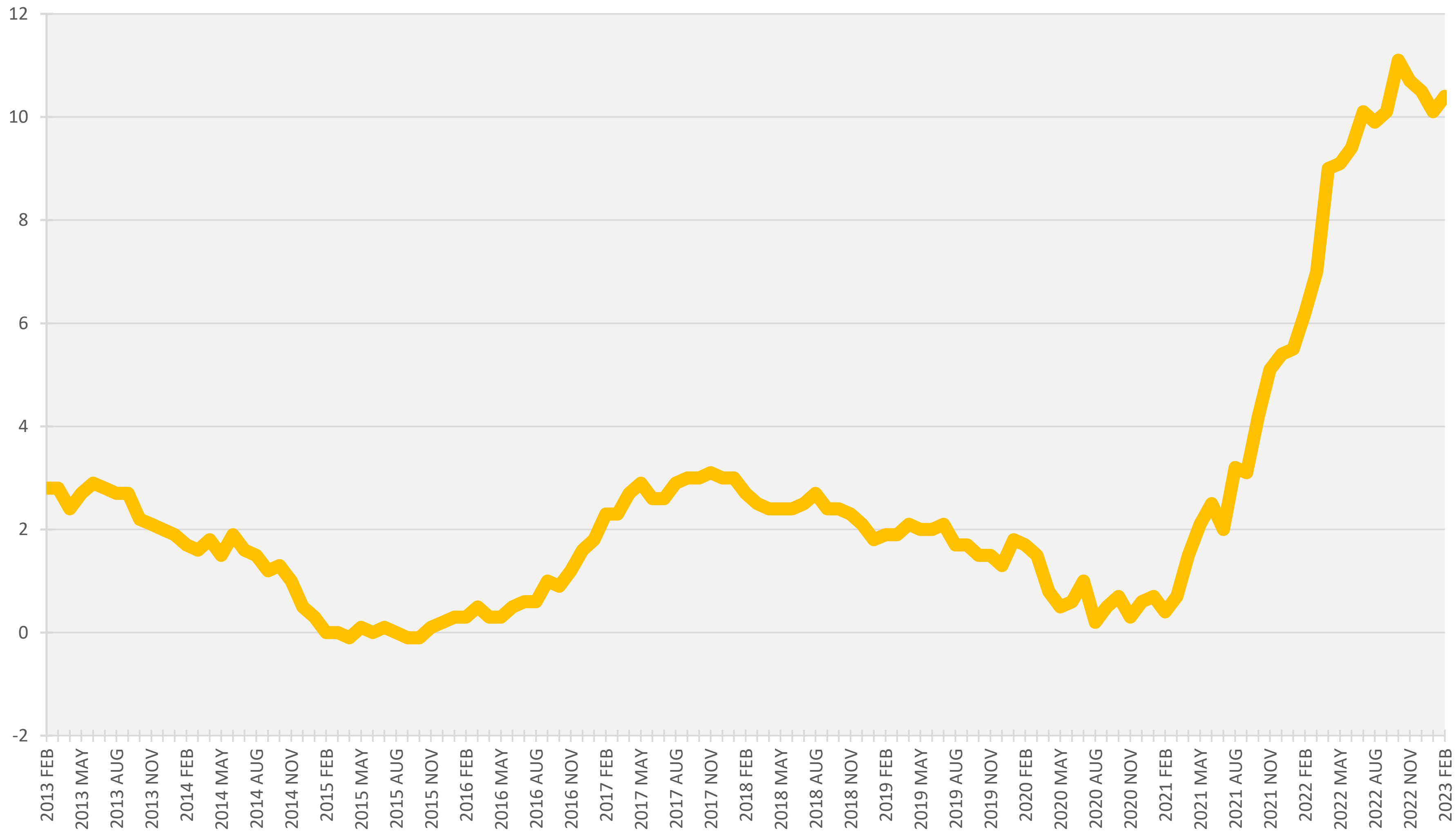


OBR forecasts 1-year of negative growth:

- 2023 = -0.2%
- 2024 = 1.8%
- 2025 = 2.5%

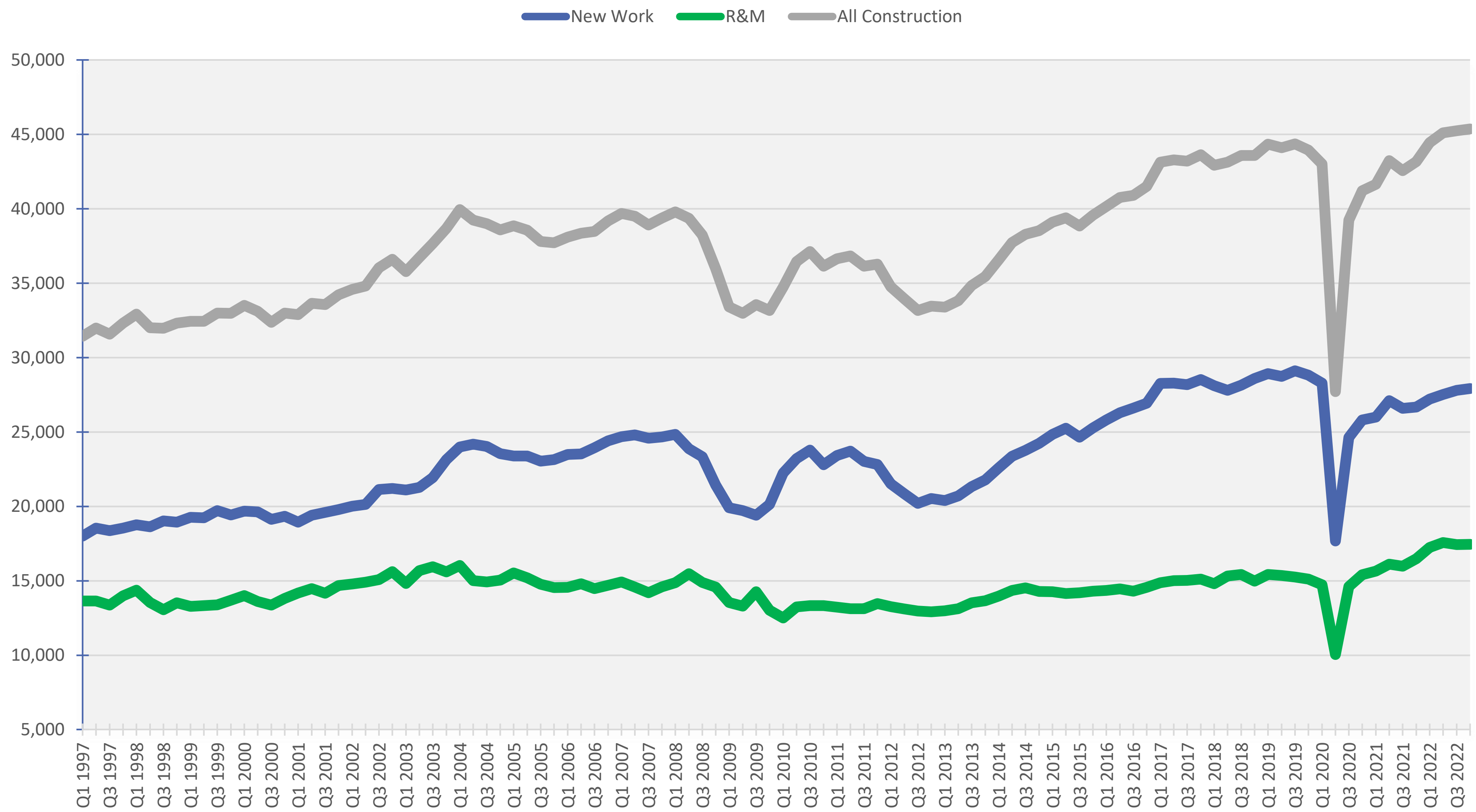
Not sure the fundamentals support this upbeat prediction

Consumer price inflation monthly growth % (ONS, 2023)



Inflation on the rise again? Price rises tend to be sticky and the target for halving CPI by the end of the year looks very optimistic based on this data

Construction output (ONS: Quarterly volume, seasonally adjusted £m)



Total output has finally exceeded pre-crisis levels largely driven by growth in R&M, new work remains below 2017 levels

Near-term growth predictions by sector following Spring budget

New Housing: unfavourable investment climate, supply currently exceeds demand

New Infrastructure: limit to public spending, projects being delayed or amended

New Public non-housing: limit to public spending

New Commercial: unfavourable investment climate

New Industrial: unfavourable investment climate

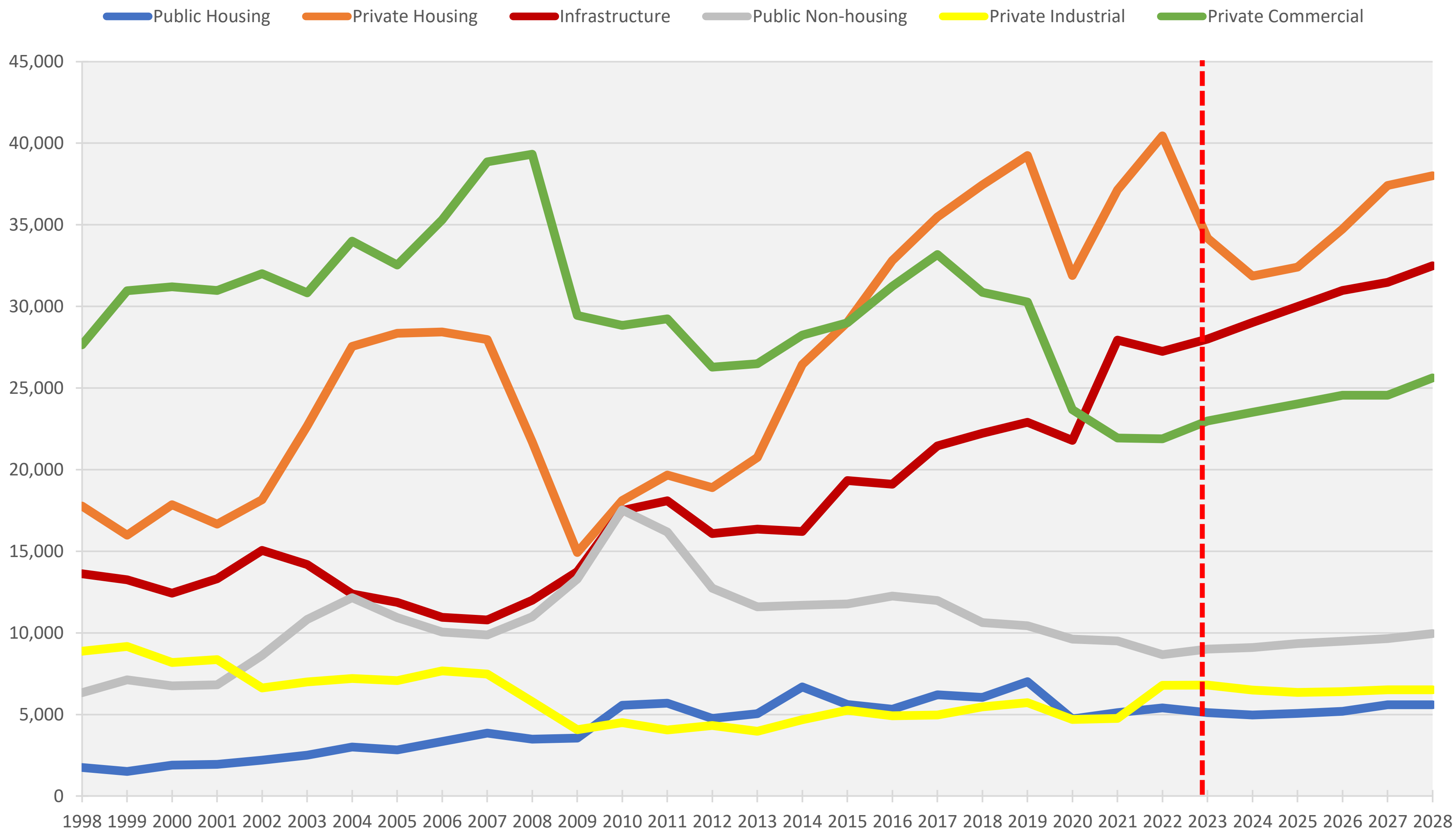
Repair and Maintenance Housing: cost of living impacts constraining investment

Repair and Maintenance Infrastructure: increased spending due to lack of new work investment

Repair and Maintenance Public non-housing: limit to public spending

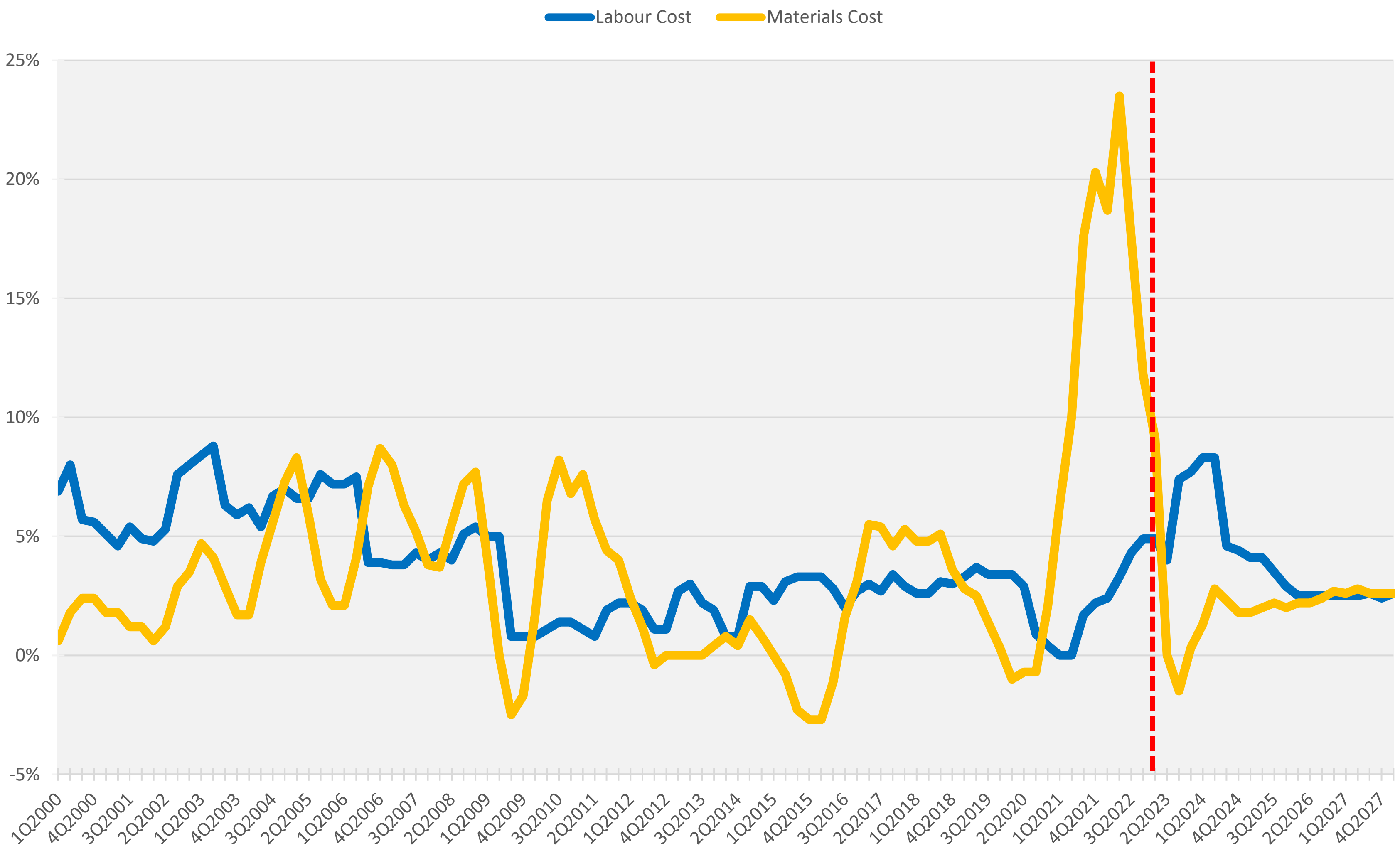
Repair and Maintenance Private non-housing: less investment available in the commercial/industrial sectors

Longer-term forecast for new construction output by sector (ONS/BCIS, 2023 £m)



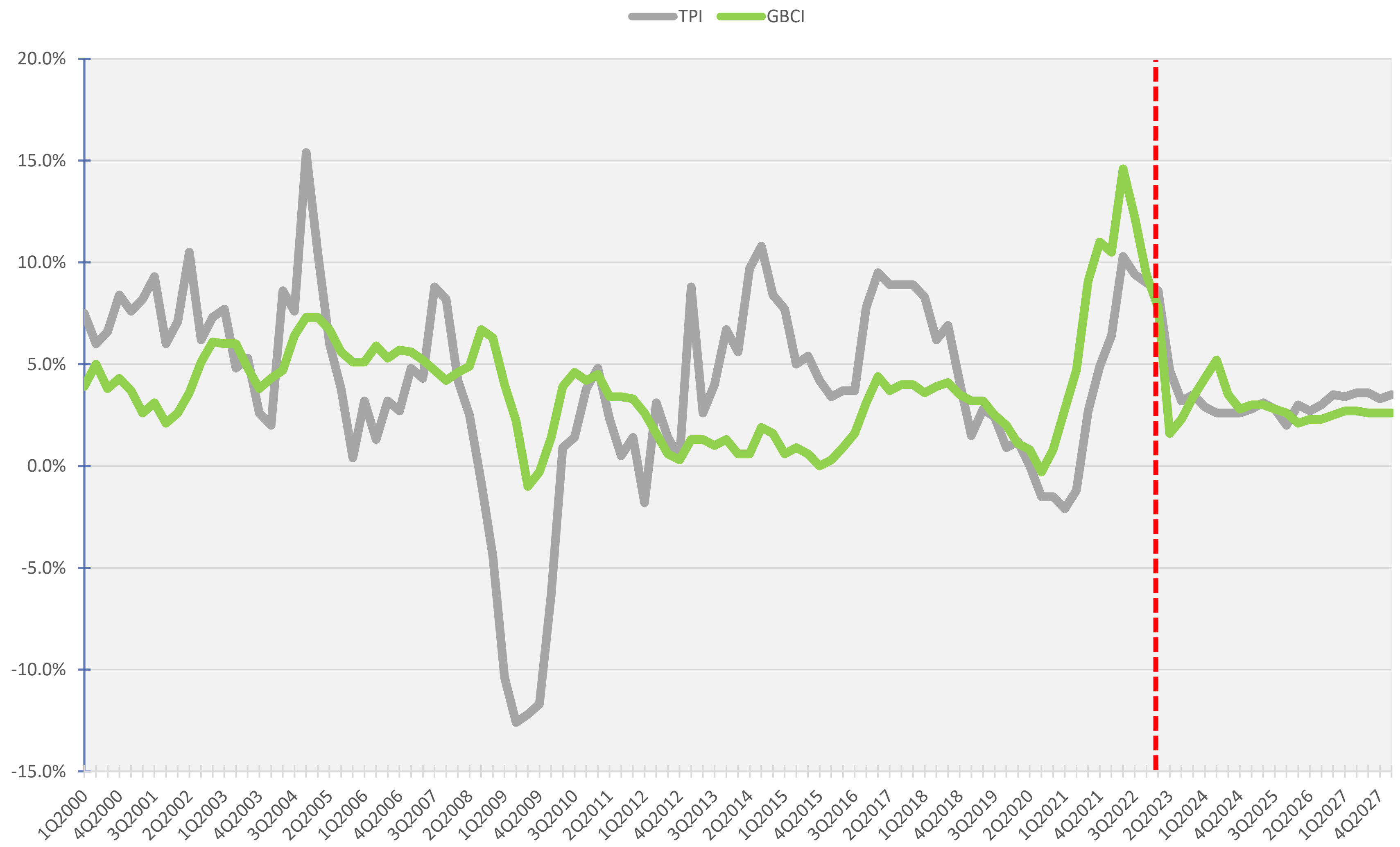
Infrastructure is the only sector forecast to remain above pre-crisis levels and exhibit consistent growth. Growth in all other sectors remains subdued

Growth in BCIS material & labour cost indices (BCIS 2023)



Materials cost increases have been dramatic but are predicted to slow. Labour will replace materials as the main cost driver in the near term given ingrained shortages which are likely to push up wages

Growth in BCIS GBCI & TPI (BCIS 2023)



Some stability returning to costs and prices, building costs are predicted to lead tender prices in the near term as demand softens before prices marginally lead costs by 2028

BCIS Industry panel (View on the ground)

"Material costs may have stabilised but the level of uncertainty hasn't really changed"

Cost/price increases

- Materials costs starting to settle but NOT reducing. Labour is the next big problem
- Steel price falls have levelled off. Steel mills are looking to increase prices due to significant energy price uplift, however demand is quite low across all market sectors and price rises are not sticking
- Pressure has abated somewhat on commodity-based goods but has increased on energy-intensive goods and products
- Plasterboard has seen large cost increases. Insulation and bricks have both gone up. Heating and power costs are still an issue which means products such as specialist cladding and metal products are expensive
- Staff and labour availability issues are going to grow
- Labour availability is becoming an increasing issue, but our conversations with contractors suggest that grassroots support for future skills is there, but that doesn't avoid the current shortage

BCIS Industry panel (View on the ground)

Logistics challenges

- Logistics challenges softened but still some long lead in items impacting on programme
- Extended lead in periods for European sourced materials and components
- Logistics are not so much of a problem anymore. Most projects are proposing products that could be substituted for an equal or approved product if necessary
- Lead in times for materials now back to pre-Covid levels

Procurement routes

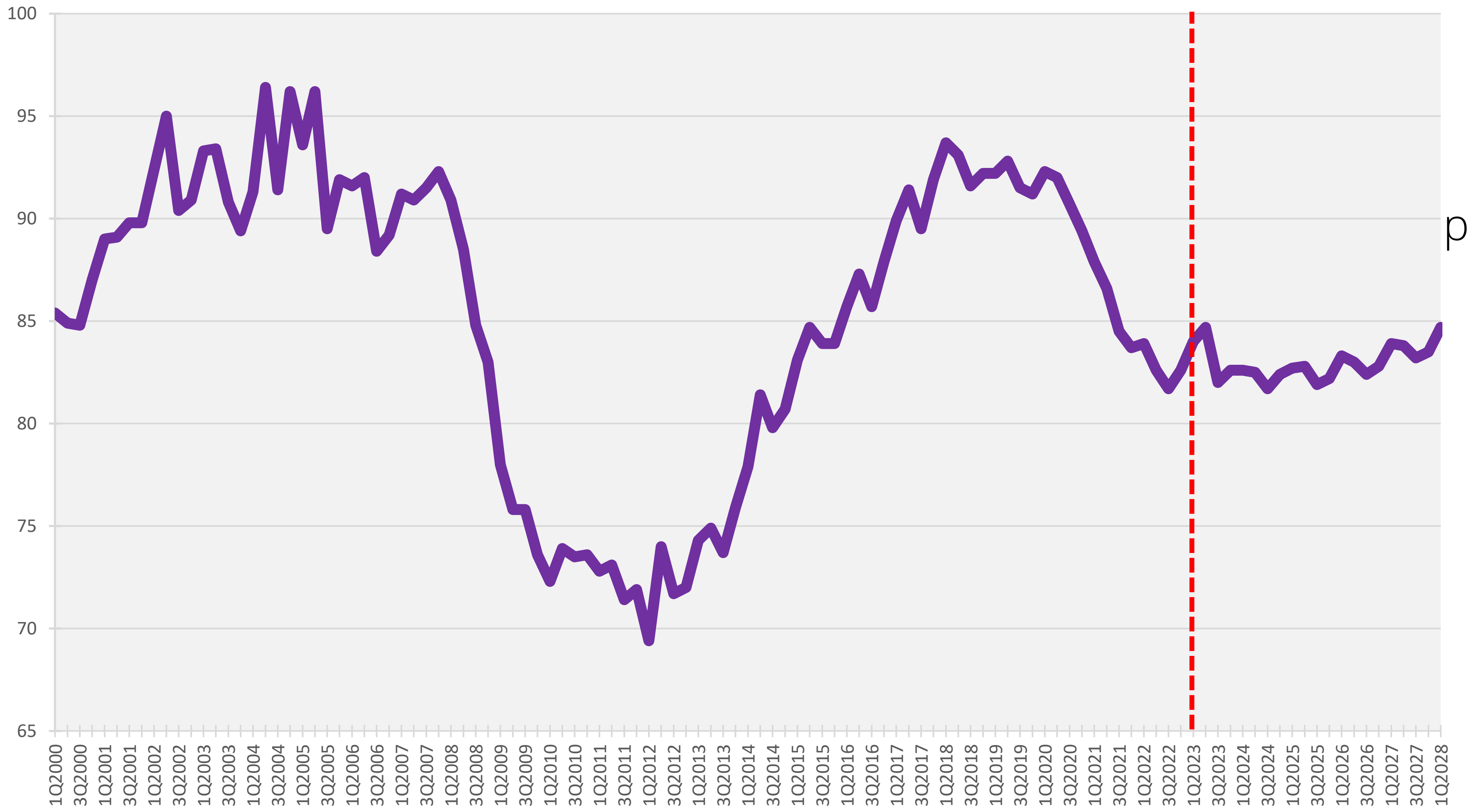
- Finding fixed prices on large projects is still a problem, because the level of uncertainty hasn't really changed
- Contractors will include a premium for price volatility in a fixed-price contract

BCIS Industry panel (View on the ground)

Inflation risk sharing

- 2-stage pricing. Cost indexation on specific trade packages
- Some use of PAFI and even CPI, as well as own in-house indexation
- Use of provisional rates
- JCT terms. Prime cost of price sensitive materials e.g., plasterboard
- There is a lot of early ordering and storing of materials off site to offset having to use fluctuations clauses. Fluctuations clauses based on indices and for certain material supply only
- Open book, adjustment of provisional allowances

Market conditions index (BCIS MCF 2023)



Compared to the recent past market conditions are predicted to be relatively benign out to 2028

Outlook – fairly bleak

- While the wider economy seems unlikely to fall into a deep recession, a sustained period of stagnation is perhaps the best that can be expected
- Stagflation seems very likely with little or no growth coupled with persistently high inflation, a very challenging environment for construction investment
- Indeed, new work output is still below the pre-crisis levels recorded in 2017
    - Levels of investment are likely to remain constrained in the immediate future
    - Forecasts suggest that new work output won't return to the pre-crisis levels recorded in 2017 until the end of 2027, that's ten years of no real growth in the sector – a lost decade
- On the ground, materials supply constraints are easing leading to costs stabilising
- However, labour will replace materials as the main cost driver going forward
- Output in the largest sub-sector housing is expected to decline sharply this year, infrastructure is the only sector showing any sustained growth over the next five-years despite recent tinkering
- Although, this assumes that the Infrastructure & Construction Pipeline isn't drastically cut back