

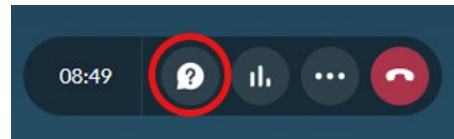


Outlook for Construction

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Please ask questions



<https://www.linkedin.com/company/bcisonline/>

Agenda

Inflation remains stubbornly high. Price increases are likely to be sticky as businesses maintain price levels to recover losses suffered as a result of the pandemic and the war in Ukraine. We therefore ask the question - Construction inflation: is the worst really over?

To address that question, we'll examine current inflationary pressures in construction, looking at:

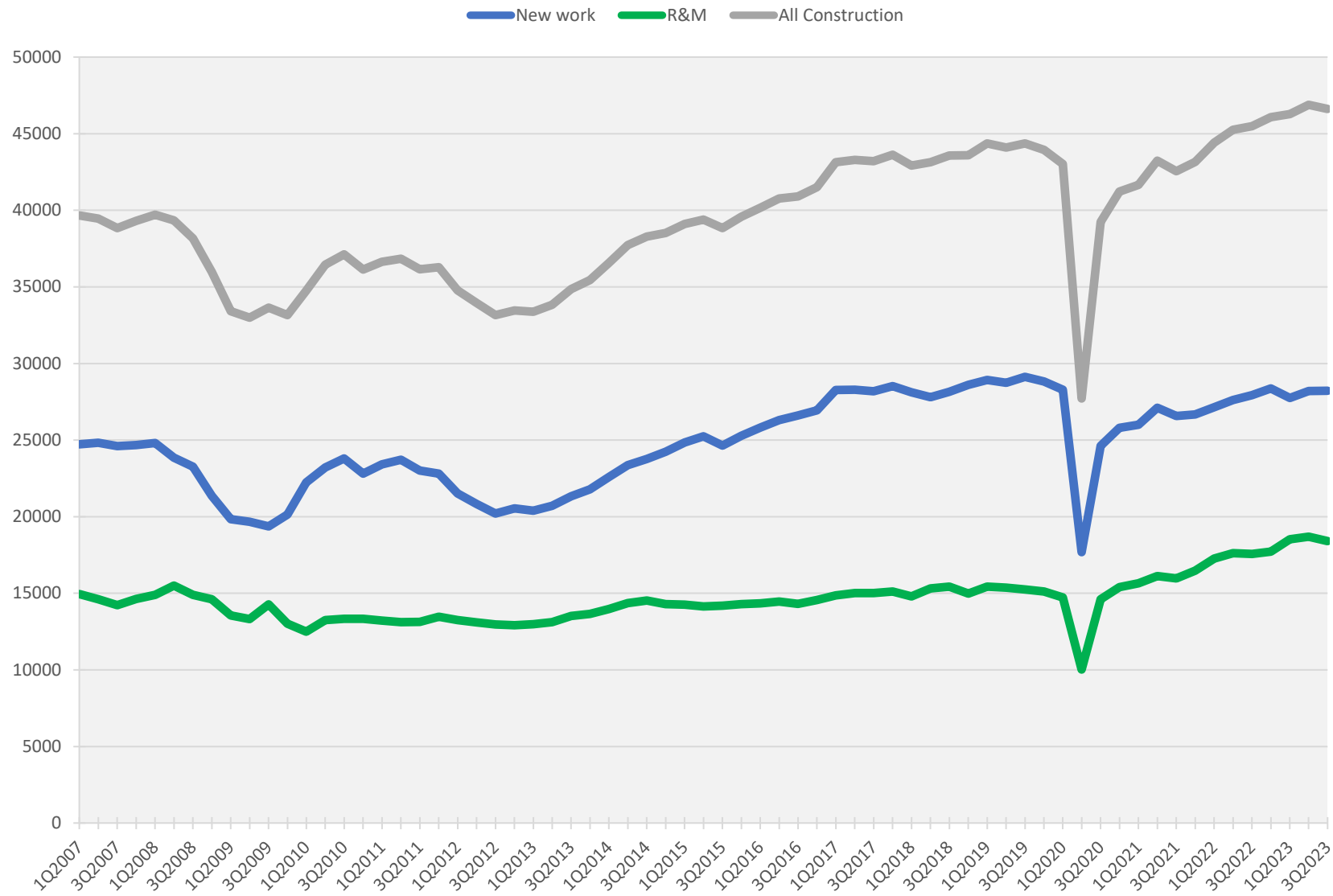
- ▶ Forecasts of future demand levels
- ▶ Cost and price movement in construction, including wages
- ▶ Draw some conclusions
- ▶ Questions

Setting the scene

- ▶ Typically, higher commodity prices and labour costs squeeze corporate profit margins, especially if the economy is stagnating. However, this doesn't appear to be the case this time, with margins being maintained or even improved in some cases
- ▶ Therefore, our suspicion is that any reduction in the cost of production is not likely to be passed on to consumers via price cuts
- ▶ This brings us to the concept of Greedflation = exploiting inflation to make excessive profits. Firms appear to be keeping prices high, despite falling costs. This is likely to contribute to persistent inflation as wage demands increase to offset price rises leading to a wage/price spiral
- ▶ Question: does anyone have any recent evidence of construction prices actually falling back to their previous pre-crisis levels?

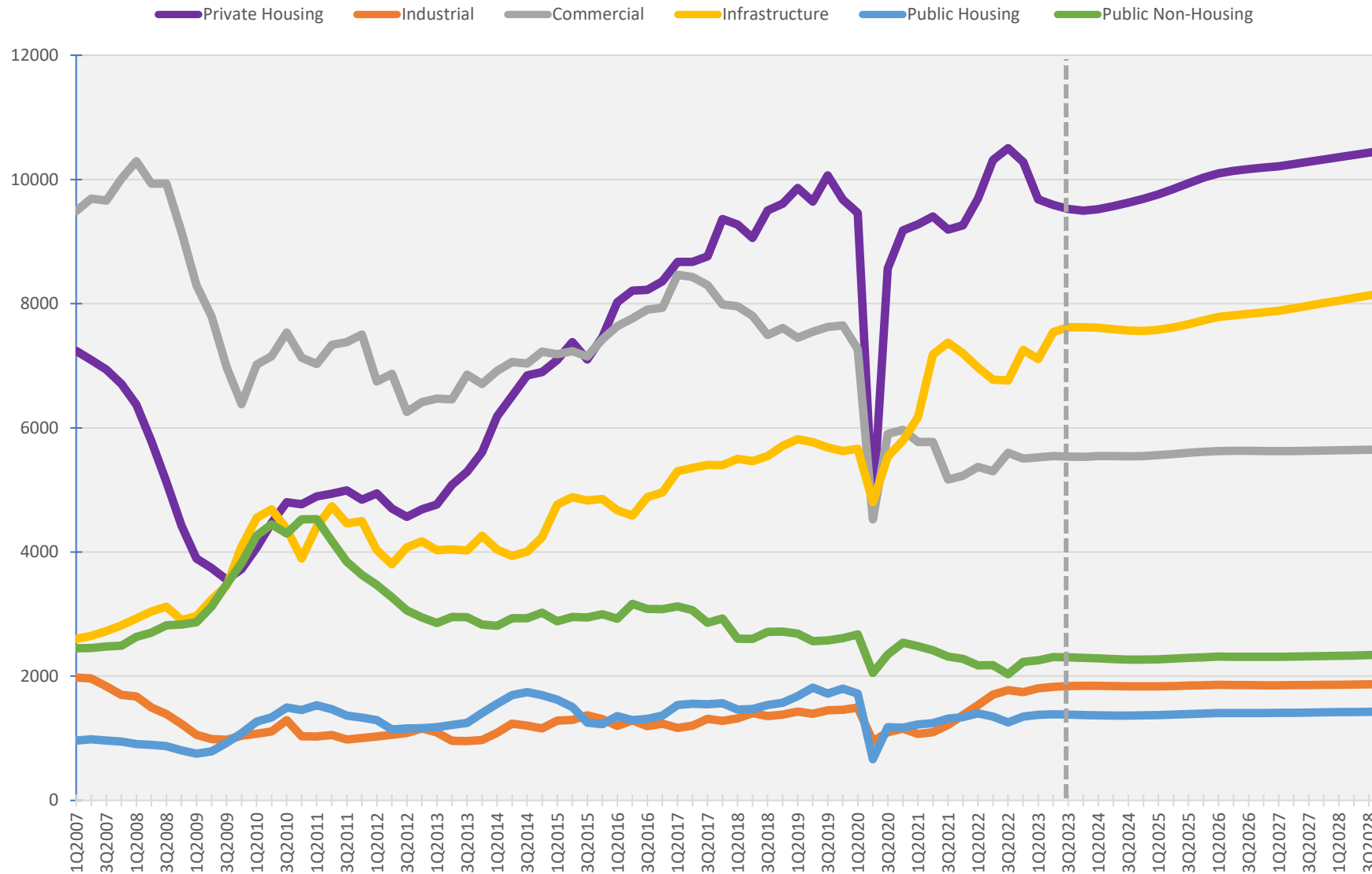
Inflationary drivers

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



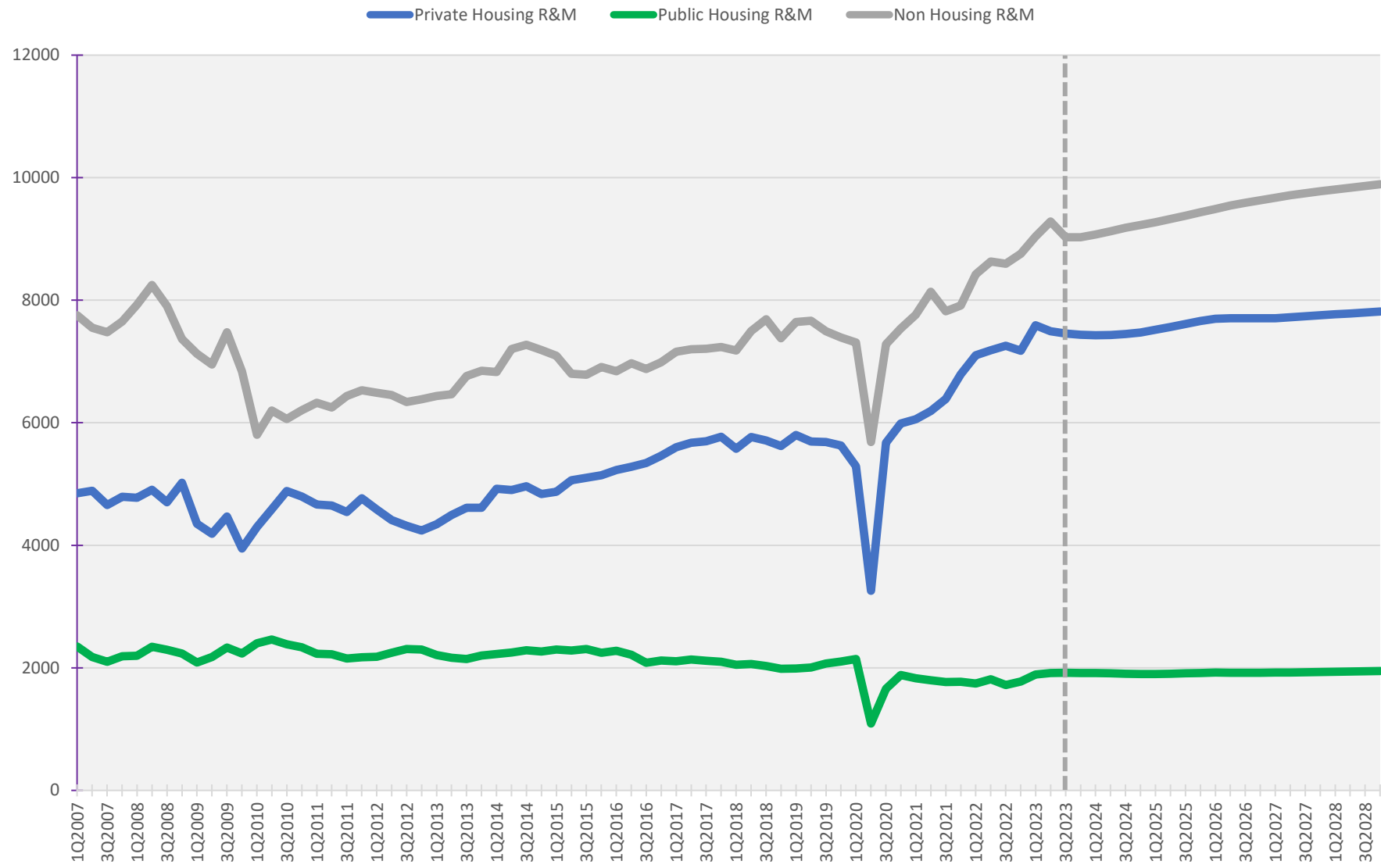
Total output remains just above pre-crisis levels, but is stagnating. New work growth was flat in the latest quarter. Following sustained growth, repair & maintenance sector is starting to turn down

Forecast for NEW construction output by sector (ONS/BCIS, 2023 £m)



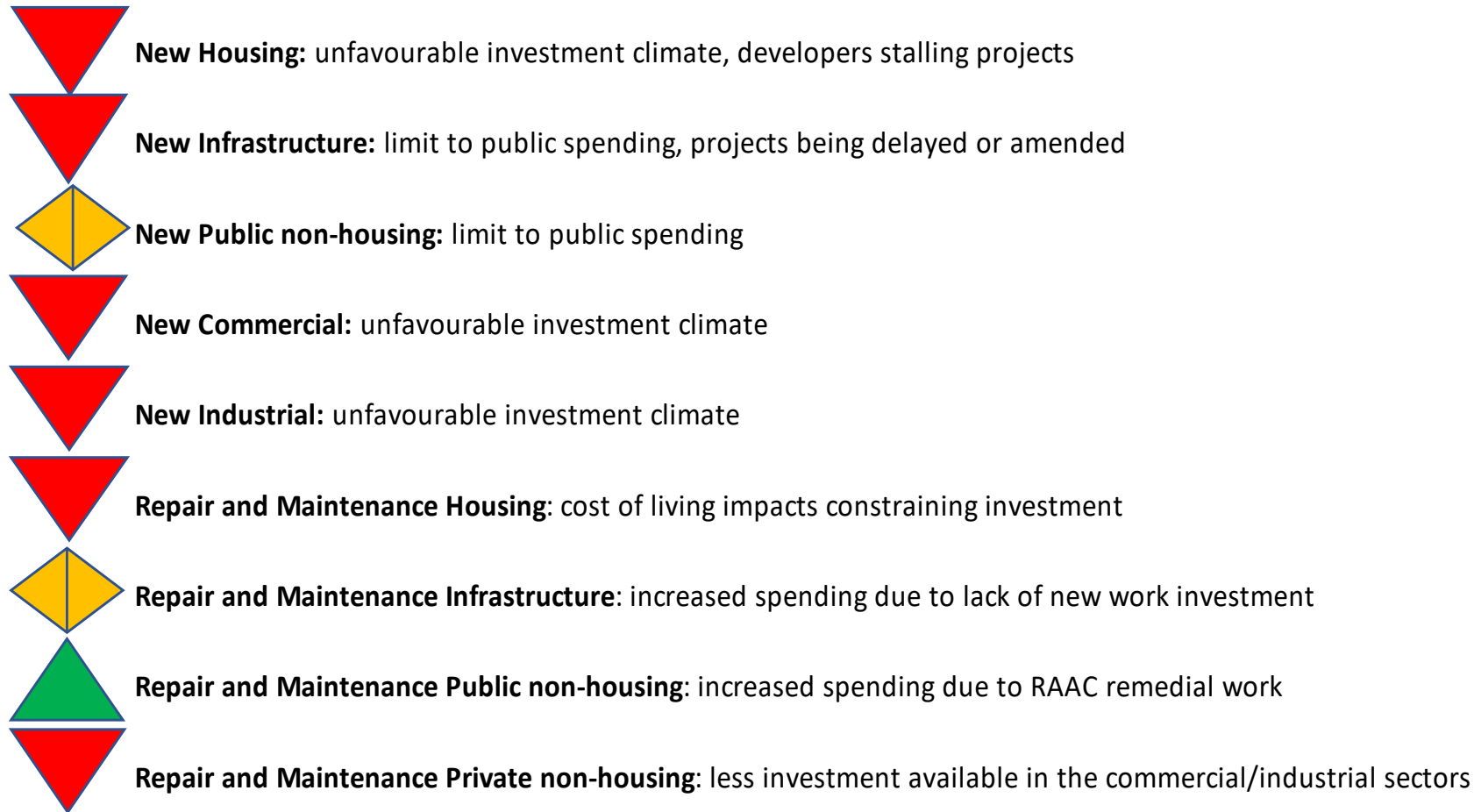
New work output is expected to fall in 2023, primarily from declining output in the housing sector. Subdued growth is likely the infrastructure sector, while all other sectors exhibit no growth

Forecast for Repair & Maintenance construction output by sector (ONS/BCIS, 2023 £m)

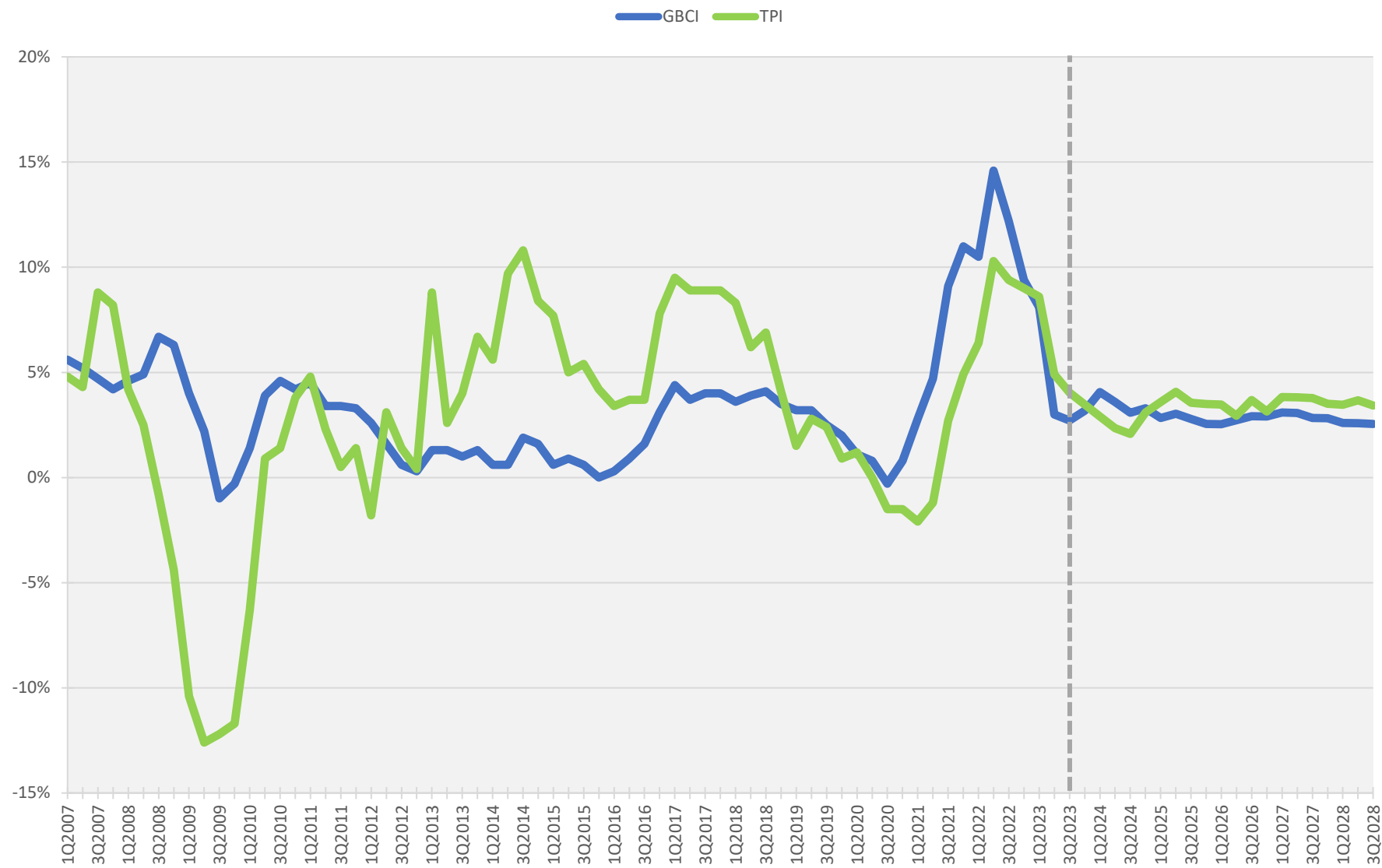


Some drop off in repair and maintenance (R&M) output is forecast, before recovery driven by growth in non-housing R&M

Summary of growth predictions by sector following latest data

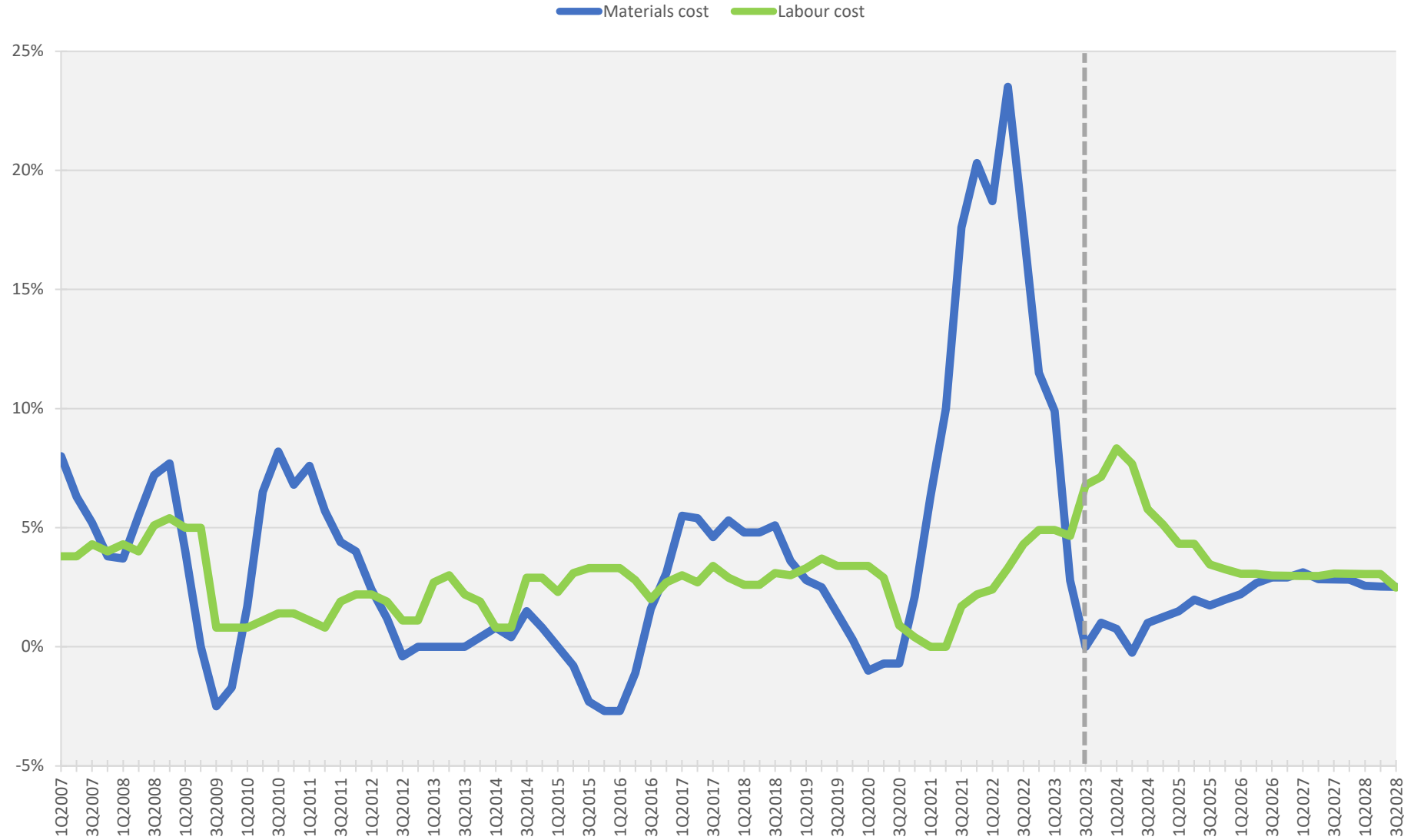


Growth in BCIS General Building Cost Index & Tender Price Index (BCIS 2023)



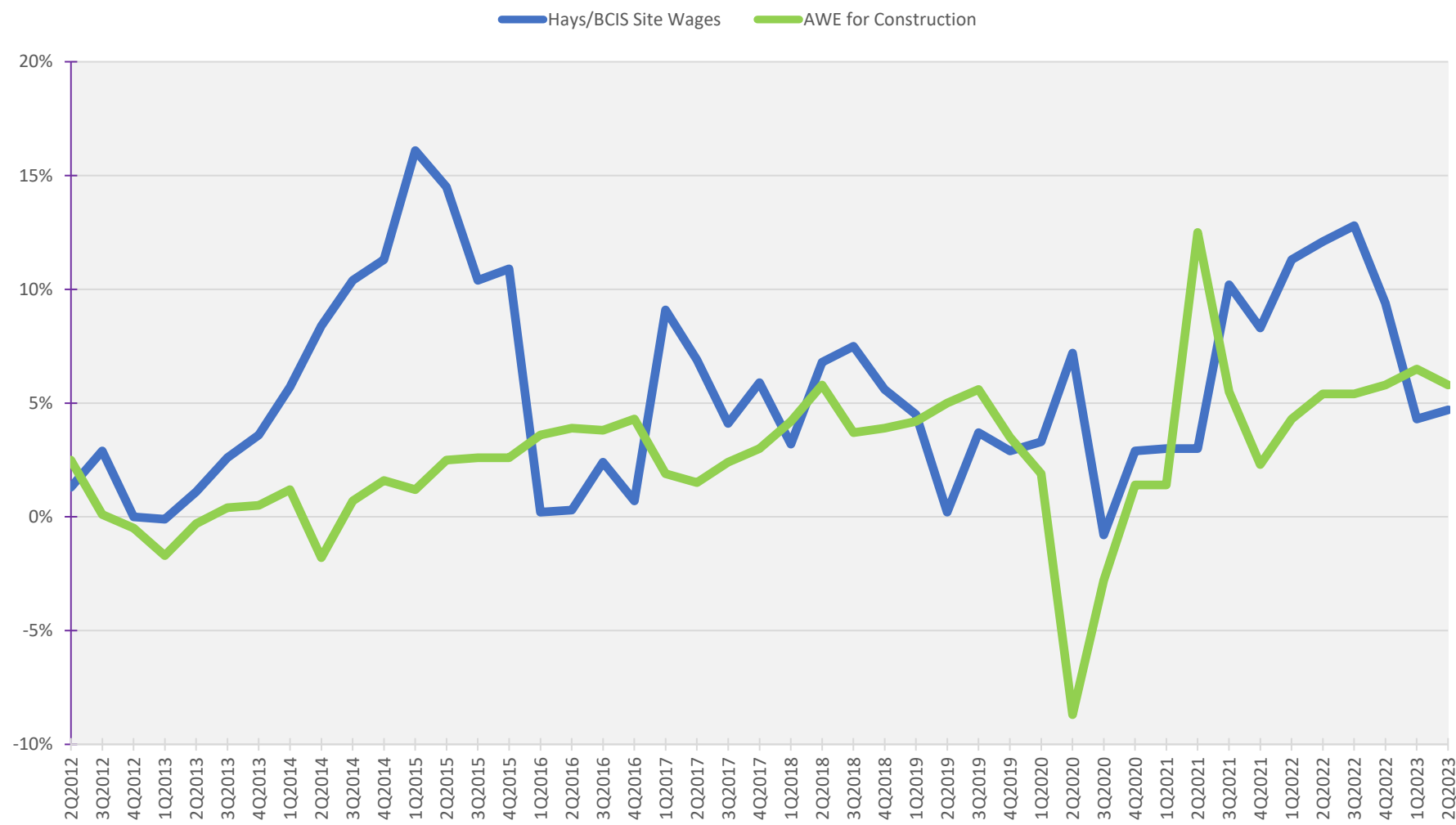
Forecasts relatively benign compared to the recent past. Some evidence of a minor uptick in the GBCI next year, while the TPI remains subdued given demand conditions

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



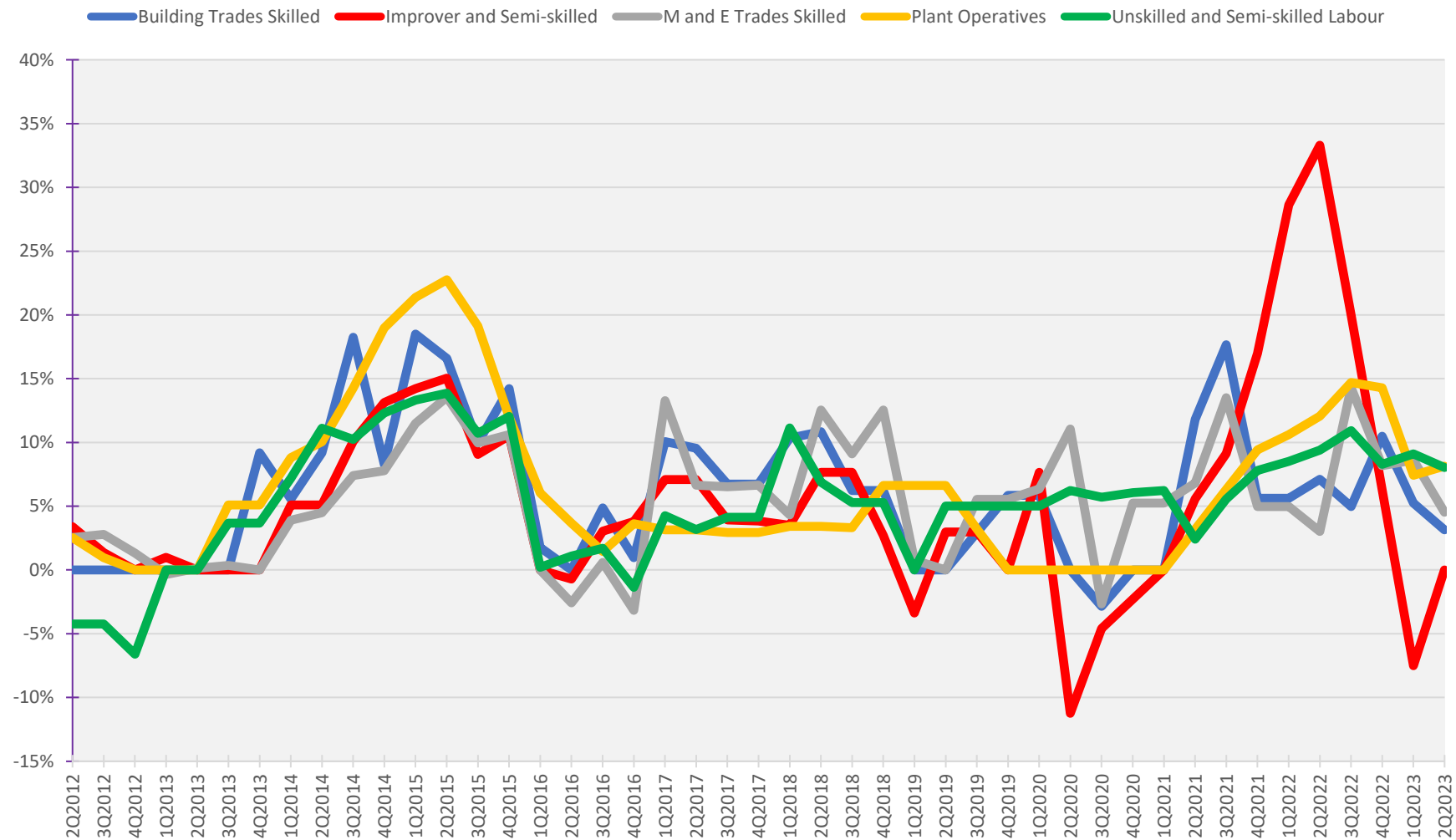
Labour costs have taken over from materials costs as the key cost driver. Although growth will be much more subdued, peaking at 8.3% 1Q2024

Growth in construction earnings (BCIS/ONS, 2023)



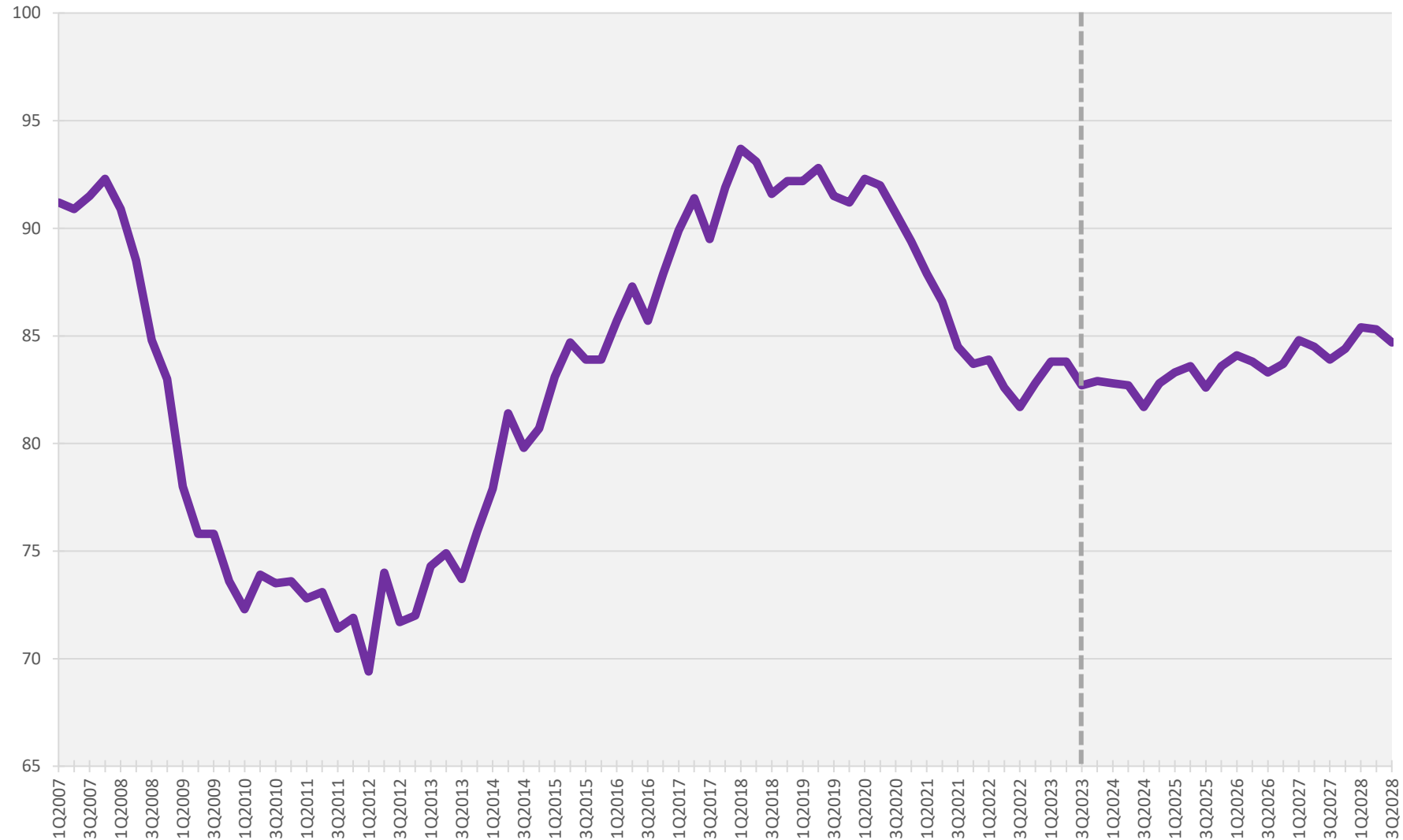
Given wider inflation levels, these rates don't appear excessive

Growth in site wages (BCIS/Hays, 2023)



Highest growth in site wages for plant operatives & unskilled labour

Market conditions index (BCIS 2023)



MCI is currently falling,
costs are still rising
faster than prices

BCIS Industry panel (View on the ground)

Procurement route

- ▶ Contractors are being more selective on the tender routes they are willing to work, preferably two-stage, adding inflation pressure on prices. No appetite for single-stage tender
- ▶ Fixed price contracts still attracting a premium

Sectors

- ▶ Residential pricing heading lower due to a lack of new starts reducing demand
- ▶ Reduced residential activity impacting that sector, some contractors looking to alternative sectors for work

BCIS Industry panel (View on the ground)

Pinch points

- ▶ Mechanical & electrical (M&E) work is facing higher rates of inflation than general building
- ▶ Projects experiencing high M&E tender returns

Inflation

- ▶ Certain materials that require a lot of energy during production are still experiencing inflation, such as ready-mixed and pre-cast concrete. Additionally, materials used for sustainable retrofits, such as insulating materials and electric water heaters, are also seeing price increases
- ▶ Steel pricing has become less volatile, but pressure has moved to installation. Materials price increases are generally not being accepted by the market. Demolition prices which were offered a while ago are seeing large increases due to changes in the price of scrap, red diesel and personnel changes

BCIS Industry panel (View on the ground)

General comments

- ▶ Materials prices remain elevated, surpassing levels seen prior to the pandemic and the conflict in Ukraine. Furthermore, inflationary pressures from the labour sector are becoming more pronounced. Despite nominal wage increases, these have failed to match the rate of consumer price inflation, intensifying pressures as the demand for higher wages extends across the industry
- ▶ The impact of insolvencies is being felt in the market, with specific sectors experiencing more pronounced effects than others. The prolonged duration of challenging financial conditions, coupled with economic uncertainties, disruptions in supply chains, and labour shortages, has led contractors to be more risk-averse, particularly on bigger projects
- ▶ In contrast, decreasing demand has triggered a certain level of capacity within the market. However, contractors are keener to bid for simpler projects. This strategic shift is driven by the aim to mitigate cash flow exposure and distribute risks in collaboration with clients

Summary

Is the worst really over?...Possibly

- ▶ What does the data tell us?
- ▶ Total output is stagnating, and future demand is forecast to soften and likely remain subdued over the next five years
- ▶ Materials cost increases have stabilised, although there is no evidence of costs falling
- ▶ Labour costs are increasing, but within the bounds of expectations given wider inflationary pressures
- ▶ It seems, from the data, that there is no evidence of a wage/price spiral in construction. Although wages have increased, prices are relatively stable
- ▶ Market conditions have intervened, slowing demand has impacted firms' ability to raise prices

Conclusion

- ▶ Returning to our original question: Is the worst really over?
- ▶ The very worst might be...but:
- ▶ Input cost rises may be slowing, although we don't expect levels to fall from their elevated heights any time soon, this is the new normal
- ▶ Oil prices are on the rise again
 - ▶ This could feed through to increased price levels in materials that are energy intensive in their production
 - ▶ With winter just around the corner this could be a problem
- ▶ The cost of borrowing has increased significantly, thus project realisation will be conditioned by investors ability to afford the financing costs
- ▶ Overall, a rather gloomy picture...

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