

Construction inflation: is this the new normal?

On 18th January 2024, BCIS held a webinar entitled ‘Construction inflation: is this the new normal?’. During the webinar, attendees had the opportunity to submit questions, but the webinar team were unable to answer all questions due to time constraints.

Below is a selection of the questions that were submitted, with answers from BCIS.

Q: Do you think the ongoing situation in the Red Sea will cause further inflation over the coming months towards construction materials?

A: If the situation escalates then there is likely to be an inflationary impact on imported materials and oil and gas that come via the Suez canal. At the moment, the trade impacts are relatively minor but if the situation persists for any length of time then potential shortages may arise which, along with increased shipping costs, will likely feed through to some cost inflation.

Q: Isn't construction inflation also the 'old' normal?

A: As with the wider economy, we've been used to a period of prolonged relatively low inflation in the construction sector pre-pandemic, but I also remember periods of very high inflation in the 1970s, so I guess it depends on length of experience.

Q: Since last March, the professional services index has increased by 0.6% thus far, to November 2023 – given wage increase will be in the region of 5-6% will this index reflect this and we do not see starting salary reducing to negate this salary rise?

A: We would expect so, although the data we present is largely trade/site-based and not professional services, which tend to move differently.

Q: Why are we seeing wage costs it is purely due to inflation?

A: Wage costs are rising largely as a result of inflation, although in construction they have generally been below the headline rate. As demand softens, we expect wage growth to return to a long-term trend of 2.5% per annum.

Q: What does it mean if prices rise faster than costs?

A: It means that tender prices are rising faster than input costs, which should result in higher prices paid by clients and higher margins for contractors – all things being equal.

Q: What is the main reason causing the continuous increase of M&E cost?

A: There are a number of factors. Capacity in the sector has fallen, so there are fewer firms, which tends to push up prices. Much of the plant is specialised and tends to be imported, and there is residual high inflation for those components.

Q: How has administration in the supply chain affected cost inflation?

A: Currently not dramatically as the relatively high number of insolvencies has coincided with a fall in demand, but if demand picks up then there could be shortages of firms willing to tender.

Q: Are there likely to be cost pressures due to Insurance markets increasing premiums due to changing risk profiles?

A: Probably not in the short-term but, as demand picks up, there could be implications.

Q: How will major infrastructure projects impact stats discussed today?

A: Infrastructure delivery tends to be used by governments as an investment vehicle to stimulate demand in the wider economy, via the multiplier approach, so it would be helpful to see the government confirm what's in the pipeline for future demand planning.

Q: Does the favourable market condition index suggest that the industry will become more profitable?

A: Perhaps. With prices rising faster than costs, contractors might be able to secure higher margins when compared to the recent past.

Q: Will the impact of Performance Bonds and Insolvency Cover being more difficult to obtain impact thoughts on growth and activity?

A: Potentially it could remove capacity from the industry, which, when demand recovers, will likely push up prices.

Q: Do you see net zero design targets impacting construction costs at this stage? Appreciate BCIS analyses are backward looking rather than forward so its hard to judge if this is being factored in already to cost data

A: Yes, more than likely at some stage.

Q: Do you see the Building Safety Act resulting in a slow down in more markets over and above residential?

A: There may be some impacts as actors get up to speed with the legislation, but we don't expect them to be major impacts as the act is predominantly focused on high-rise buildings.

Q: Could the increase in package costs namely M&E be also attributed to the introduction of the Building Safety Act as well as other areas such as changes to building regs?

A: Changes in regulation will change specification and quantum, and so affect the overall cost of a project. Changes to ways of working will affect the cost of doing the work and therefore feed into construction inflation.

Q: What are the major reasons for the labour cost increases? Is government policy on immigration a major reason?

A: Labour cost increases are largely the result of increased wage demands, due to the relatively high inflation that we've experienced over the last two years. Immigration may actually put downward pressure on wage growth if labour supply increases significantly as a result.

Q: Is the forecast in the infrastructure spending assuming there will be a labour government with plans for public spending?

A: Not at this stage. We have not factored any change of government into our current forecasts.

Q: You predict material cost to reduce this year however we are still witnessing increases such as PIR insulation which is going up as much as 10% next month.

A: Overall that is our prediction, though there will still be some materials subject to cost increases – in particular those that are energy-intensive in their production process.

Q: Given that material prices have fallen, and because we were continuously told that a lot of the cost increases recently were linked to the Ukraine war – what do you think about the current inflationary effect of the Ukraine war? Has it diminished or not?

A: Yes, it has diminished somewhat given that alternative sources have been found for energy, in particular, with the reduction of reliance on Russian oil and gas. However, recent cost inflation was not just about the war in Ukraine but also the post-pandemic recovery, whose impacts have also diminished somewhat.

Q: Is the RAAC issue will be resolved in this year?

A: RAAC remedial work is predicted to last for some time, at least the next two years.

Q: You have mentioned the housing section is stalled, is it due to lack of govnt investmnet?

A: No, this is more about wider economic conditions impacting private sector property developers. The cost of borrowing is making mortgage finance expensive for buyers who are putting off purchasing decisions. Therefore, developers are reining in the amount of property that they bring to the market, which impacts output levels. Developers are able to control the supply of property coming to market in an attempt to maintain price levels.

Q: Is your assessment of labour costs not falling on the basis that unemployment will increase? It seems building, in particular house building is slowing.

A: Demand is softening and the effects of inflation are diminishing. Therefore, labour cost increases are expected to tail-off mid-2024.

Q: Has there been any indications of changes within the performance bond market to ease the current challenges in obtaining bonds?

A: Not currently, although the likelihood is that once demand conditions improve, and some stability returns, the picture will change.

Q: How is the public sector faring? is insolvency impacting more or less

A: Generally, growth in public work output is fairly stagnant given the current limits on public spending. Insolvencies are therefore not expected to have a dramatic impact, although that might change when demand recovers.