CONSTRUCTION OUTLOOK: what happens when high cost inflation meets low demand?

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THE PANEL

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AGENDA

What happens when high cost inflation meets low demand?

- Forecasts of future demand levels
- Inflationary pressures
- Industry views
- Conclusions
- Questions

SETTING THE SCENE

- Conditions in the UK construction sector worsened in 2Q2026
- Geopolitical tensions disrupted energy markets, increasing input costs and adding to inflationary pressures across the supply chain
    - Although, reduced demand continues to counter some of this upward pressure for the time being
- However, inflation is expected to rise and the potential for a hike in the base rate is possible in the next round leaving the cost of borrowing elevated, this will likely stall investment in fixed capital
    - In other words, the construction sector will see reduced investment in new projects
- Although the situation in the Middle East currently appears stable, ongoing domestic political uncertainty is creating instability

BACKDROP TO THE CURRENT UK CONSTRUCTION MARKET

Construction output	Construction insolvencies	Construction workforce	Construction vacancies
-1%	3,803	-14%	-35%
12 months to Apr 26	12 months to May 26	From 1Q 2006 to 1Q 2026	Apr-Jun 2022 to Mar-May 2026

Bank Rate	BCIS GBCI	BCIS All-in TPI	CPI
3.75%	4%	3.2%	2.8%
June 2026	12 months to 2Q 2026 (forecast)	12 months to 2Q 2026 (provisional)	12 months to May 26

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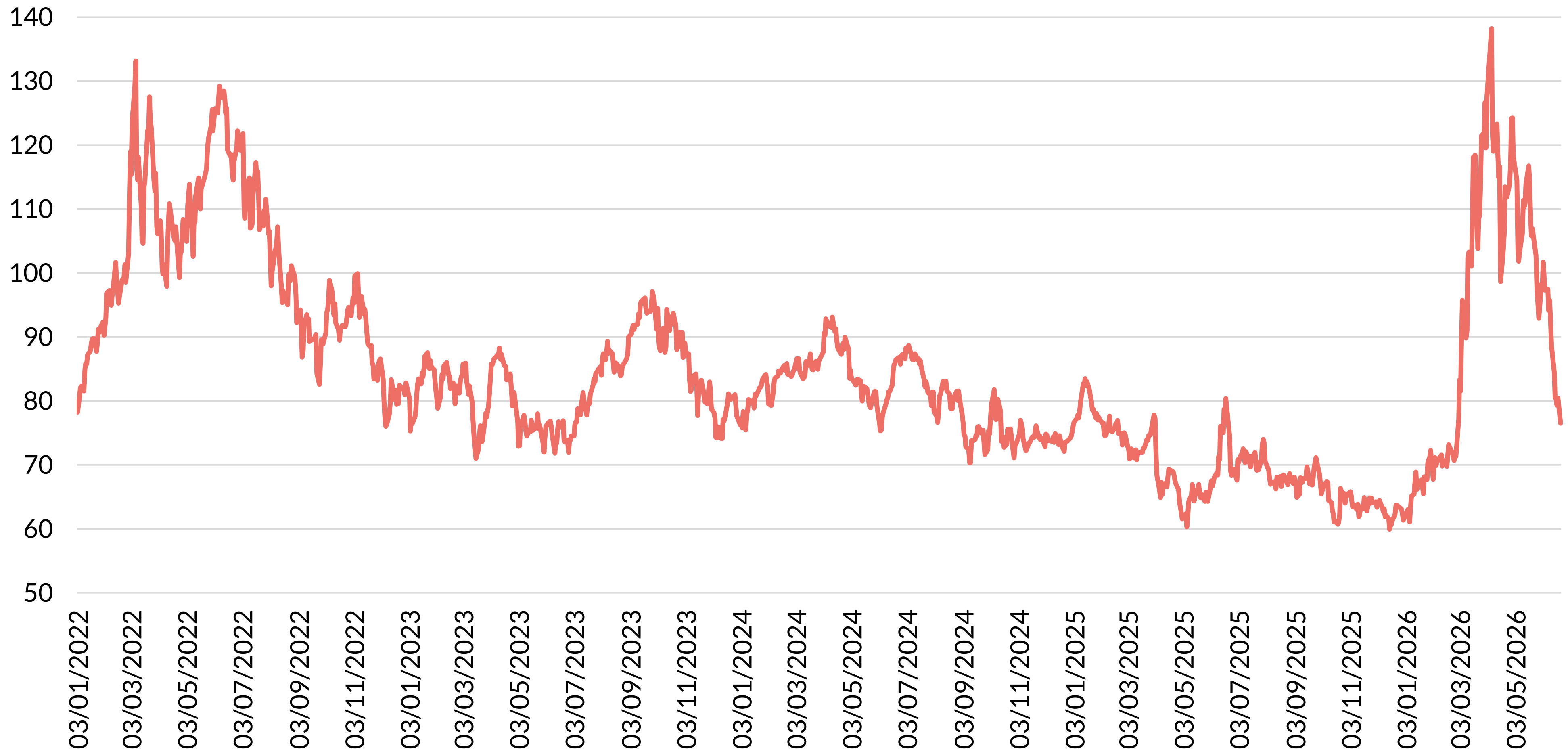
EUROPEAN BRENT CRUDE SPOT PRICE ($/BARREL)



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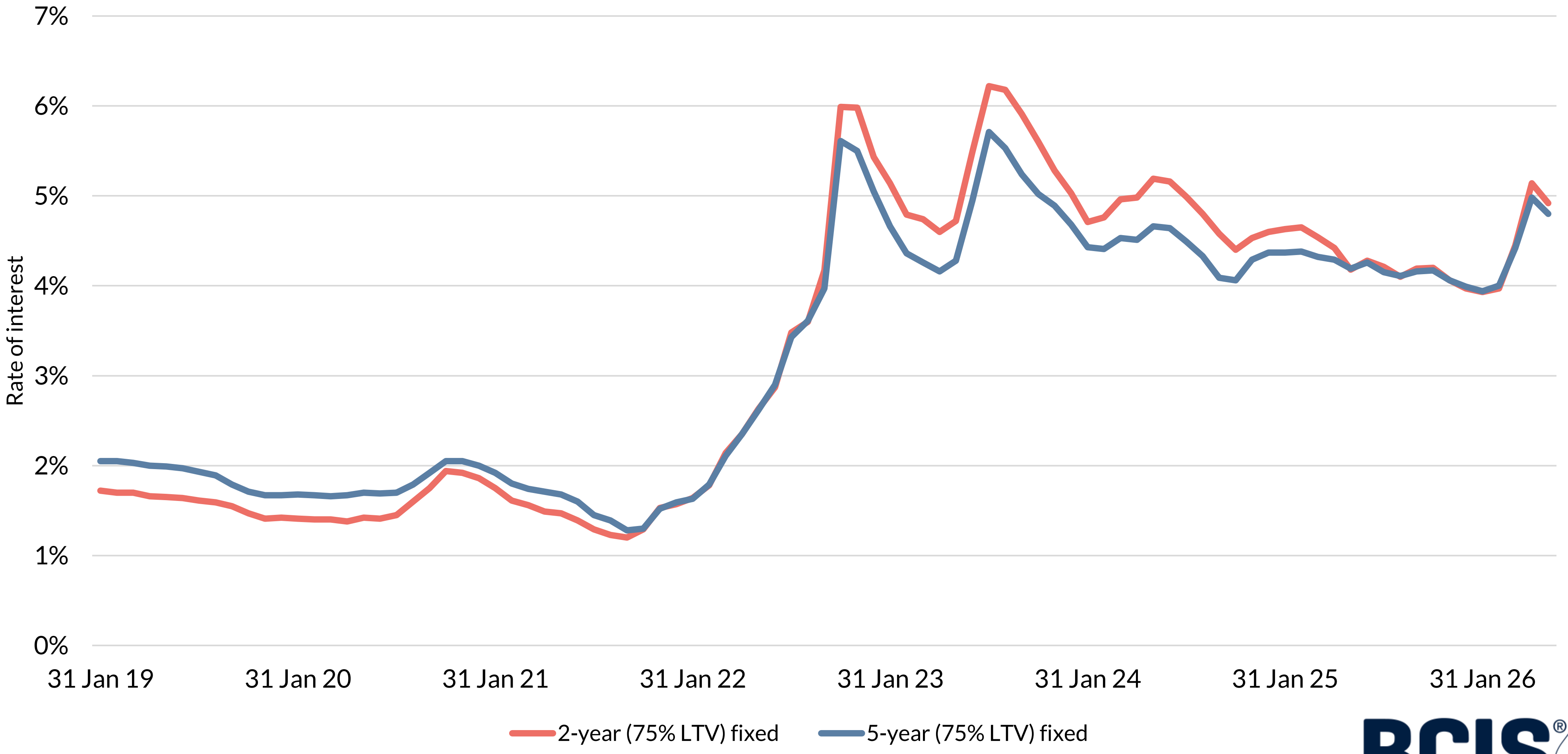
MORTGAGE RATES REMAIN A PRIMARY HEADWIND ON DEMAND

Average monthly interest rate on UK fixed-rate mortgages (75% loan to value, i.e. 25% deposit), not seasonally adjusted



Source: Bank of England

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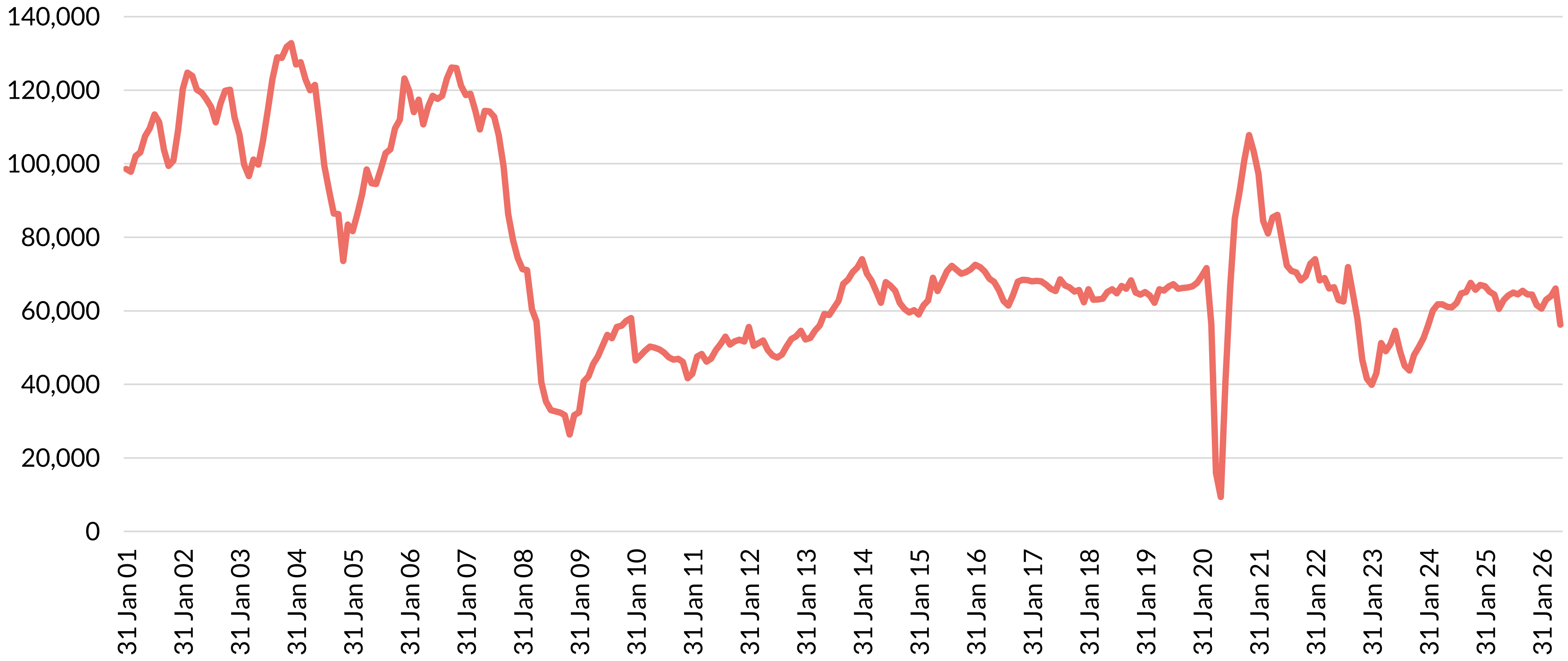
MORTGAGE APPROVALS IN MAY 2026 AT LOWEST LEVEL SINCE DECEMBER 2023

Monthly number of total sterling approvals for house purchase to individuals, seasonally adjusted



Source: Bank of England

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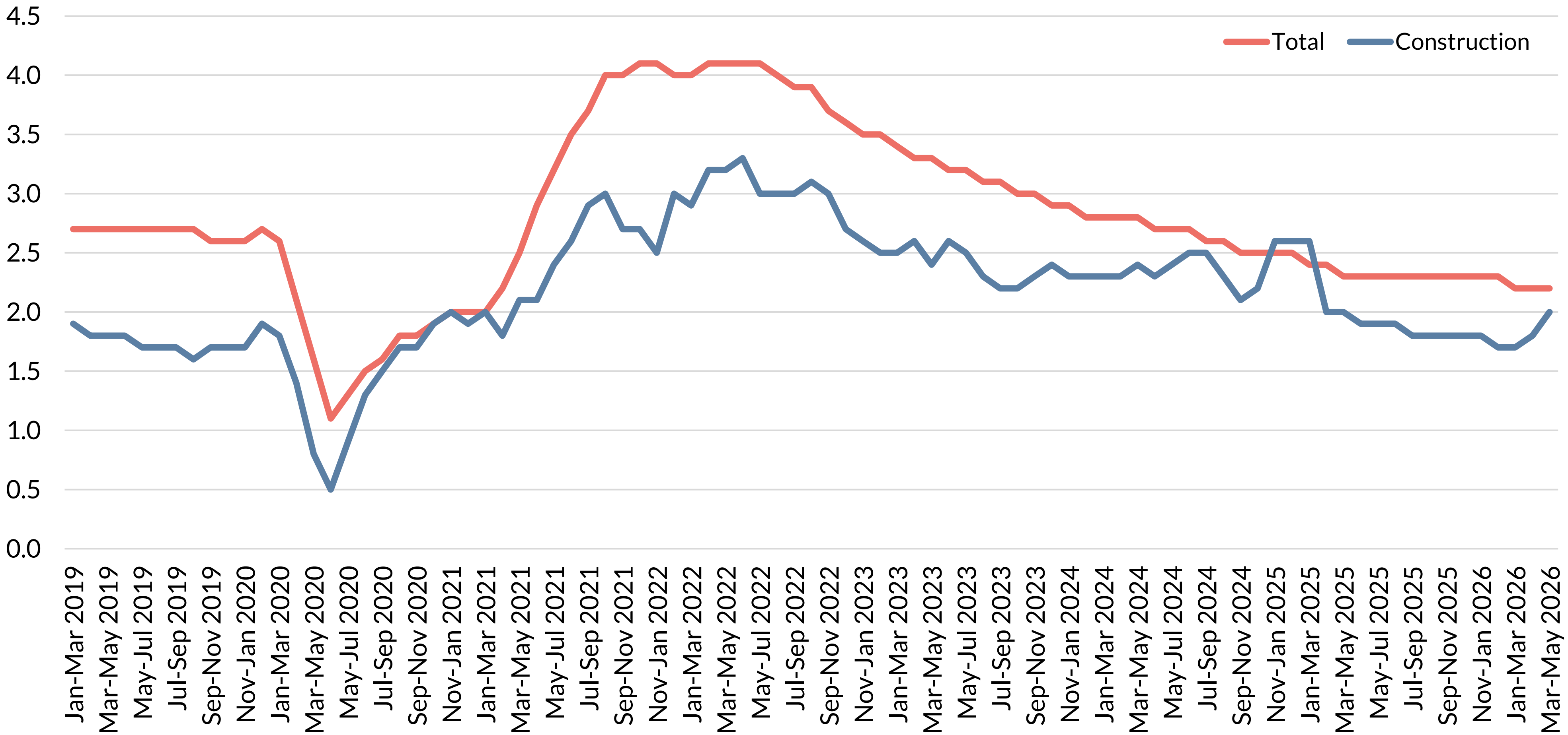
VACANCY RATES ARE FAR BELOW THEIR PEAK SEEN IN 2022 (%)

Vacancies per 100 employee jobs



Source: ONS

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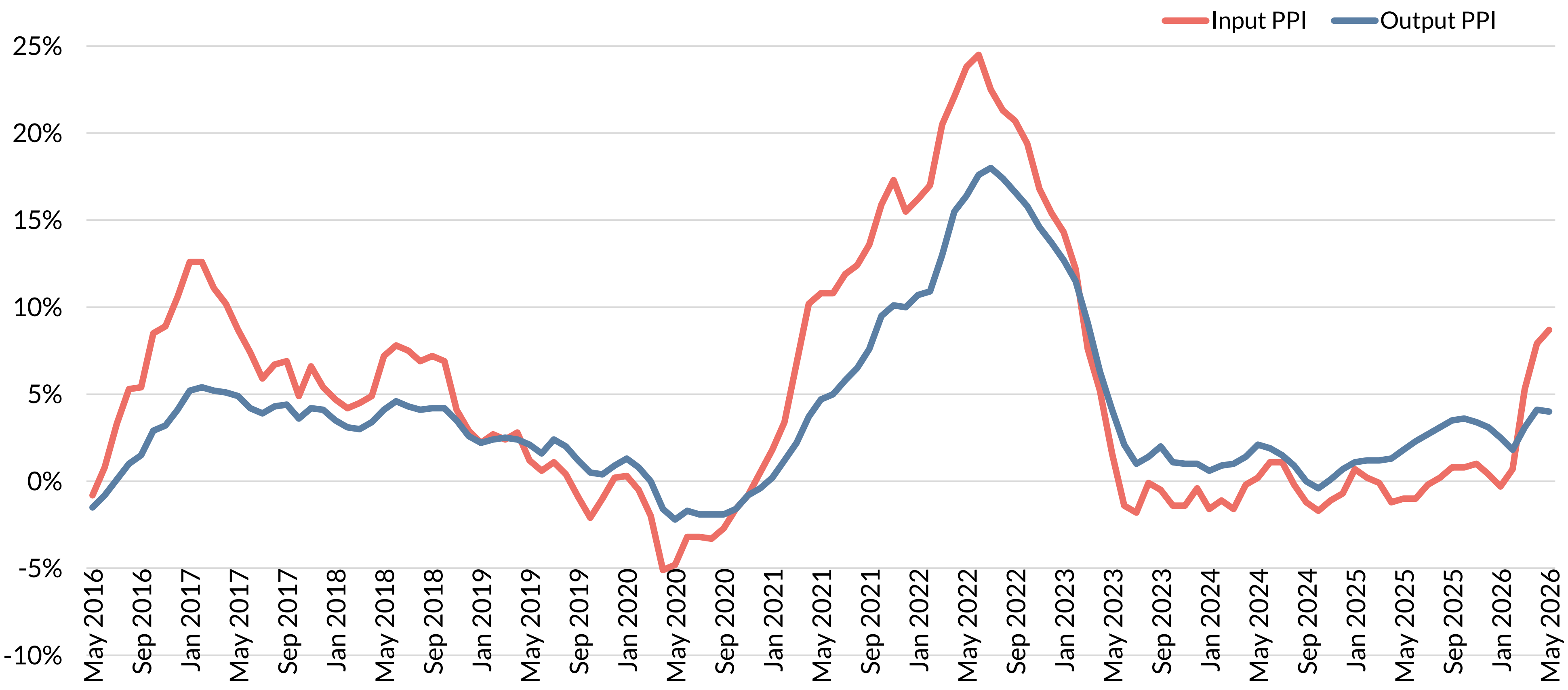
PRODUCER INPUT PRICES INCREASED AT A GREATER RATE THAN PRODUCER OUTPUT PRICES IN MAY

ONS input and output Producer Price Indices annual inflation rates, UK



Source: ONS

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OUTPUT & ORDERS

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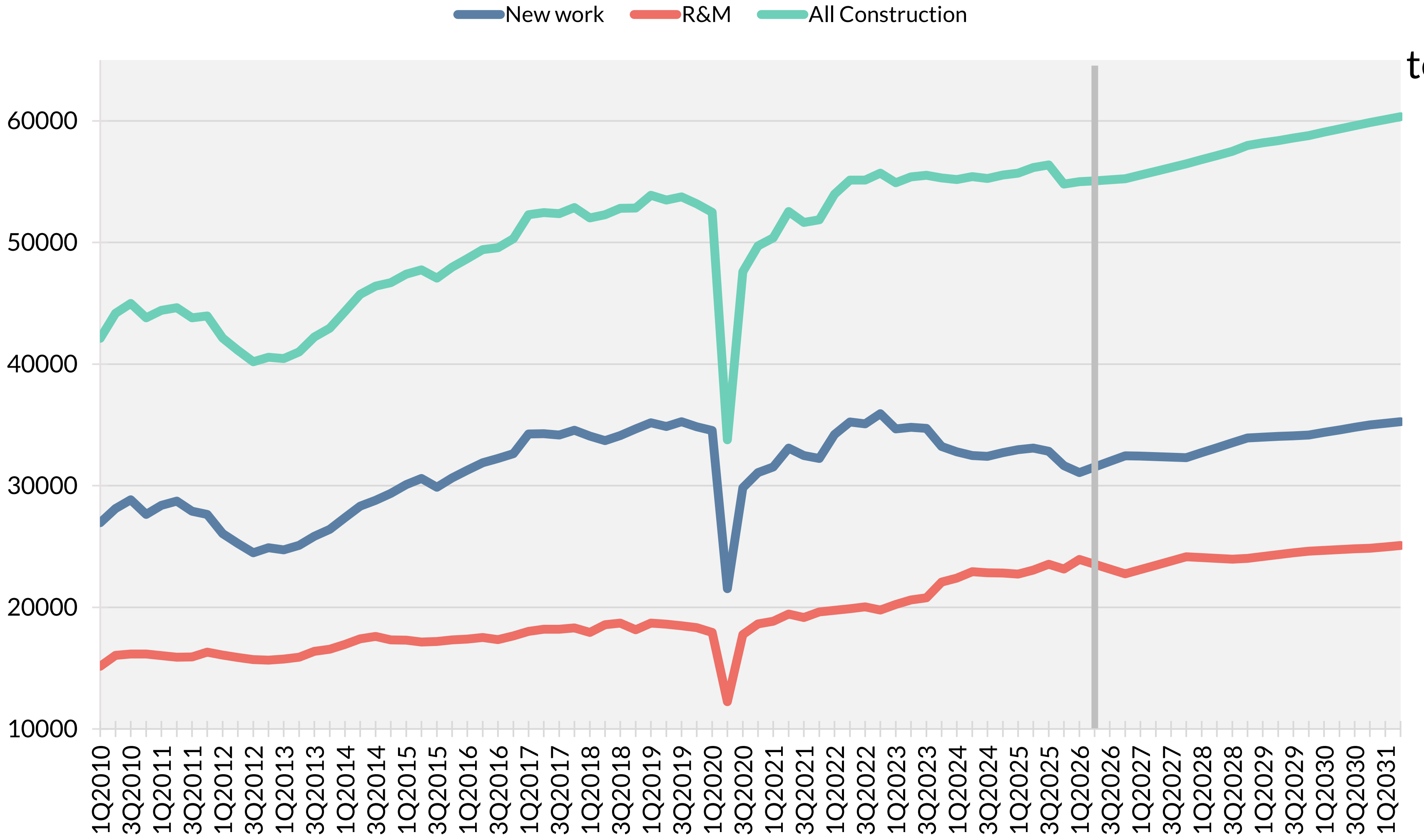
CONSTRUCTION OUTPUT FORECAST (ONS/BCIS, 2026 £M)



After recent falls, total output forecast to flatline this year, before subdued recovery driven by new work growth

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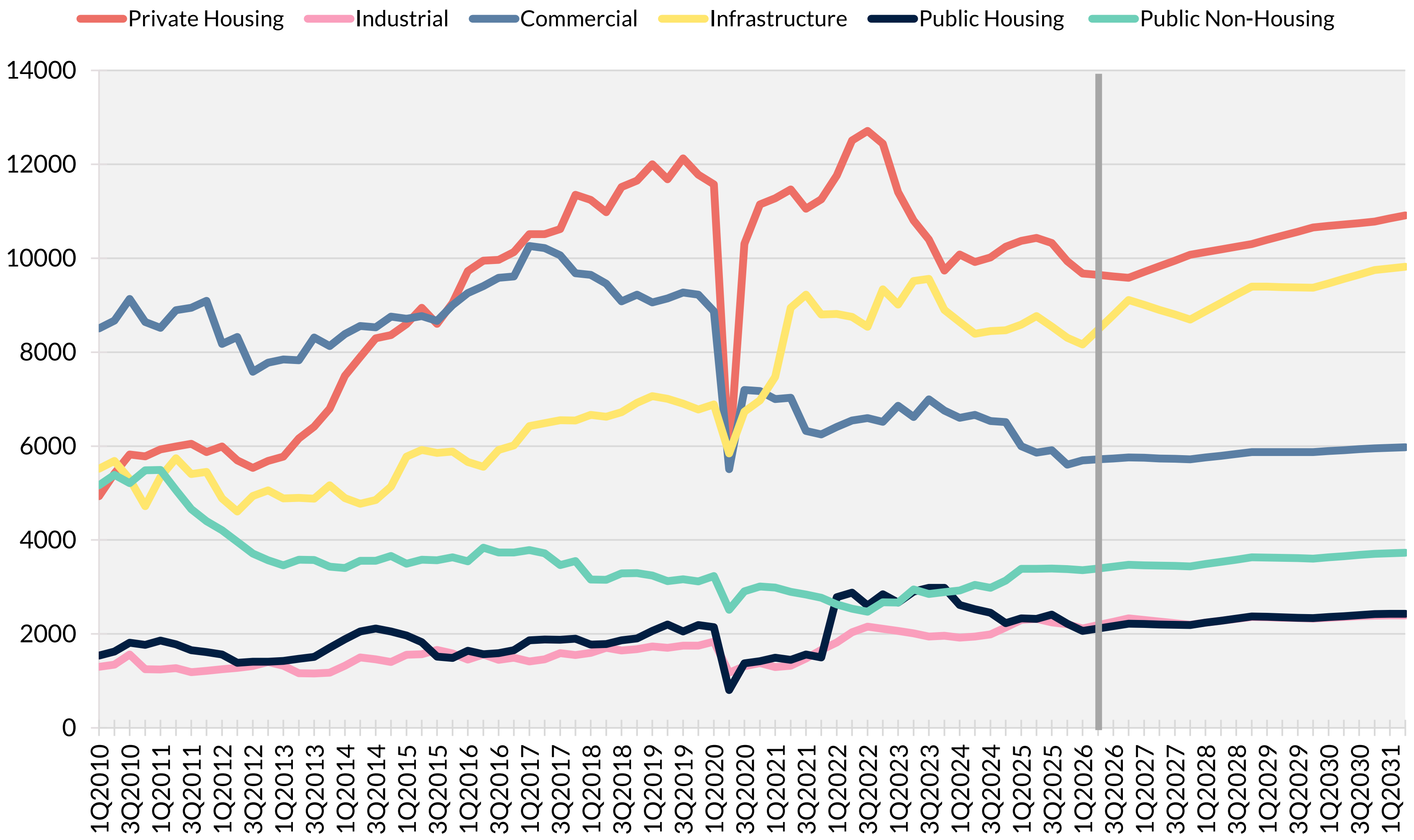
NEW WORK OUTPUT FORECAST BY SECTOR (ONS/BCIS, 2026 £M)



Infrastructure output to lead growth, with renewed growth in private housing predicted from next year

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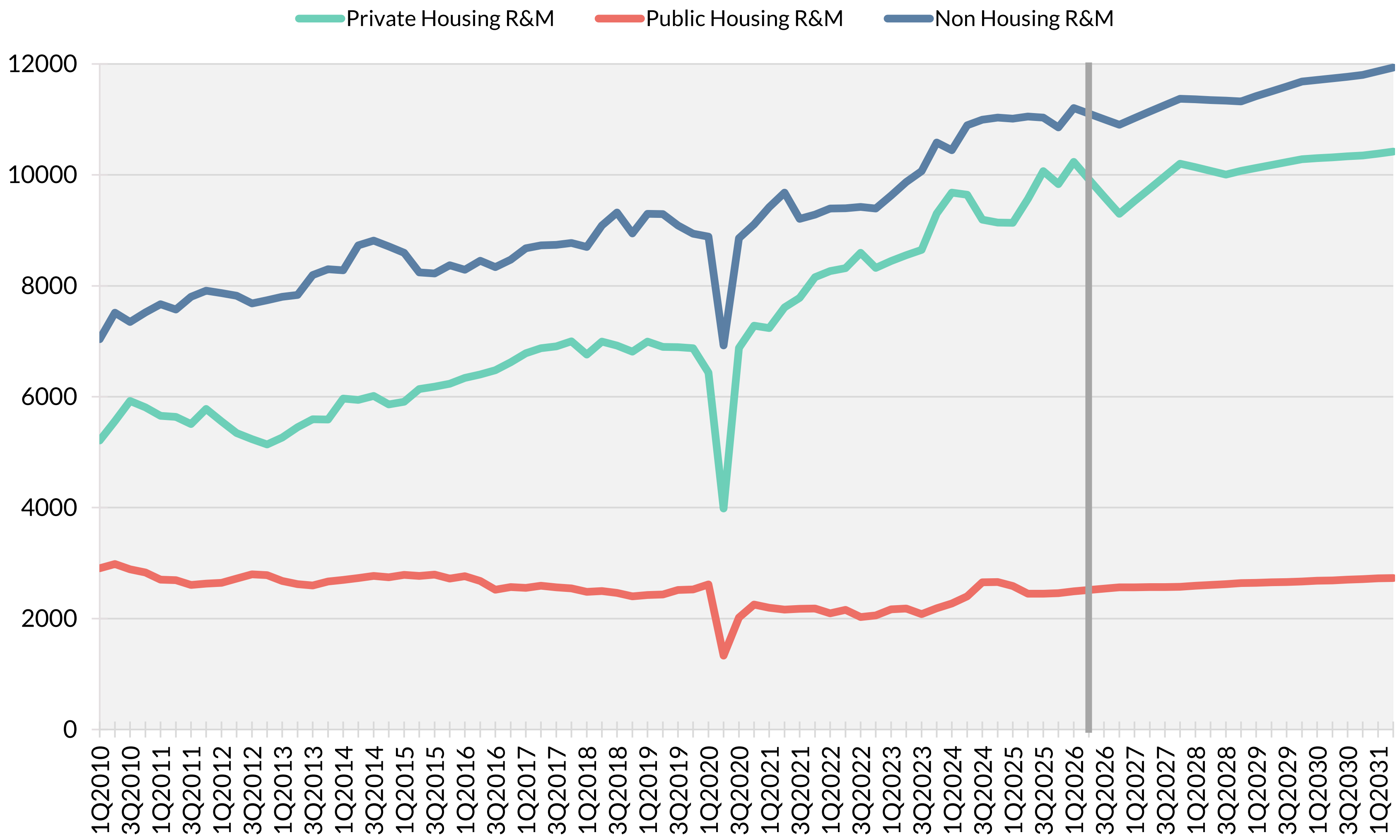
R&M OUTPUT FORECAST BY SECTOR (ONS/BCIS, 2026 £M)



R&M output forecast to decline, before recovery through 2027. Driven by growth in private housing R&M and non-housing R&M

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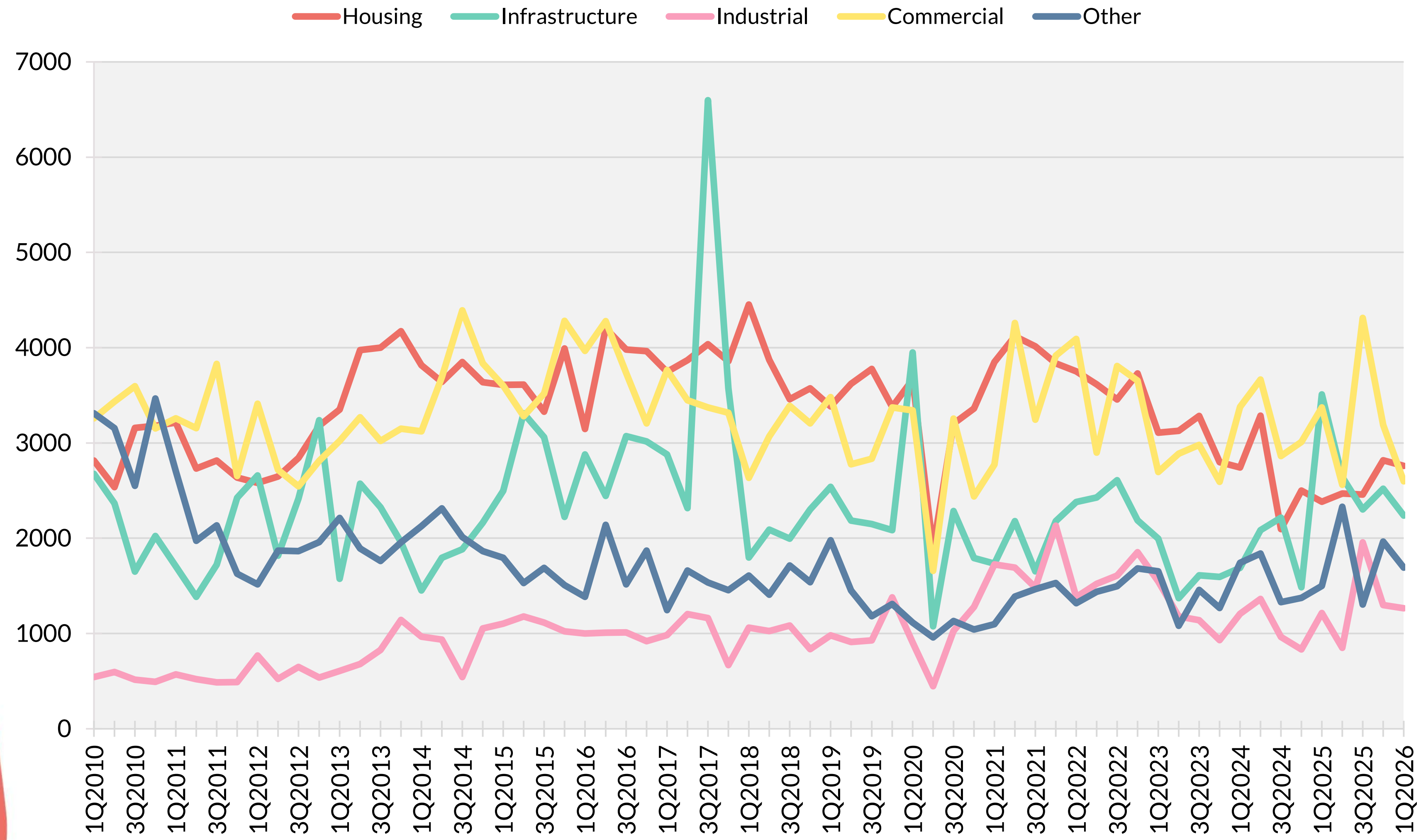
CONSTRUCTION NEW ORDERS (ONS 2026: QUARTERLY VOLUME £M)



Latest new orders data show a fall in total orders. All sectors show declines, with the most marked in commercial orders

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SUMMARY OF GROWTH PREDICTIONS BY SUB-SECTOR

New Housing: growth flatlining, recovery from a relatively low base postponed until next year

New Infrastructure: robust growth in output likely although conditional on availability of private finance

New Public non-housing: recovery expected as spending plans unwind

New Commercial: growth stalling as speculative investment climate weakens

New Industrial: growth flatlining as investment climate weakens

Repair and Maintenance Housing: output stalling as cost of living impacts persist

Repair and Maintenance Infrastructure: growth in output evident although conditional on spending plans

Repair and Maintenance Public non-housing: growth in output evident although conditional on spending plans

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

Positive signs of growth in new work infrastructure and public non-housing sectors. Most other sectors remain subdued

COSTS & PRICES

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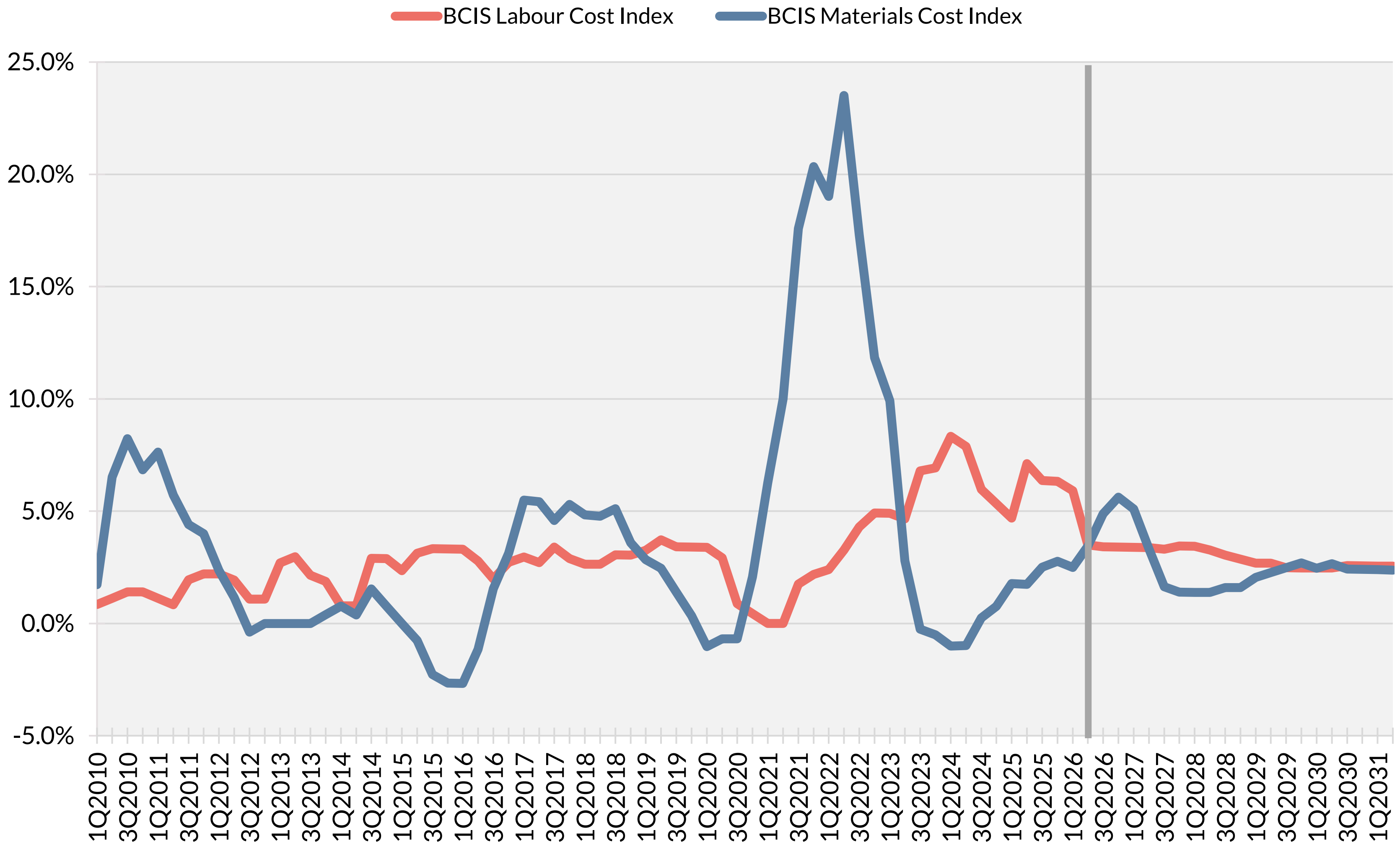
GROWTH IN INPUT COSTS (BCIS, 2026)



Materials cost increases are ramping-up and are likely to remain elevated through 2026

Labour cost growth is falling to trend levels

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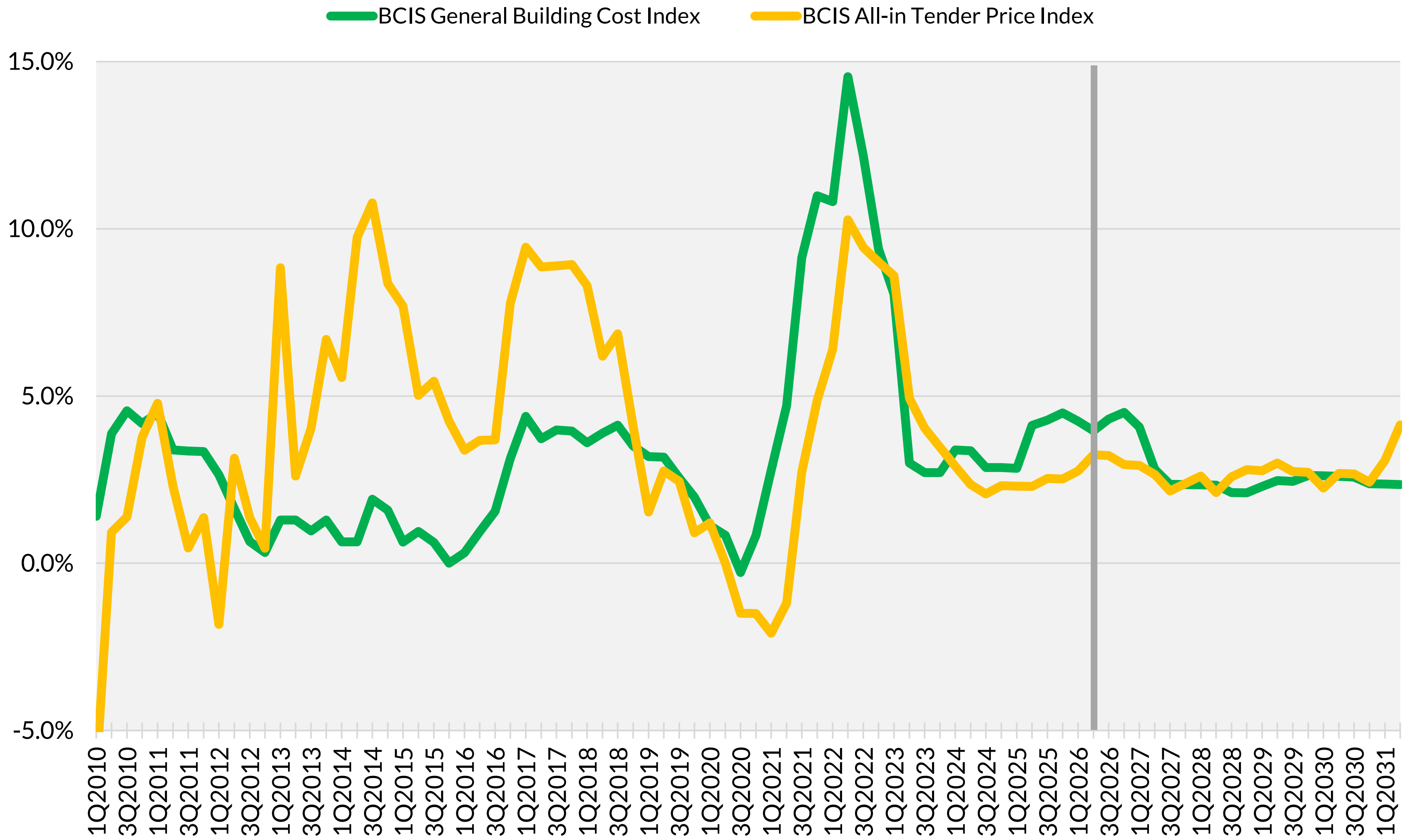
GROWTH IN BUILDING COSTS & TENDER PRICES (BCIS, 2026)



Growth in building costs starting to rise and the risks remain on the upside

Tender price growth remains subdued until the end of the forecast period

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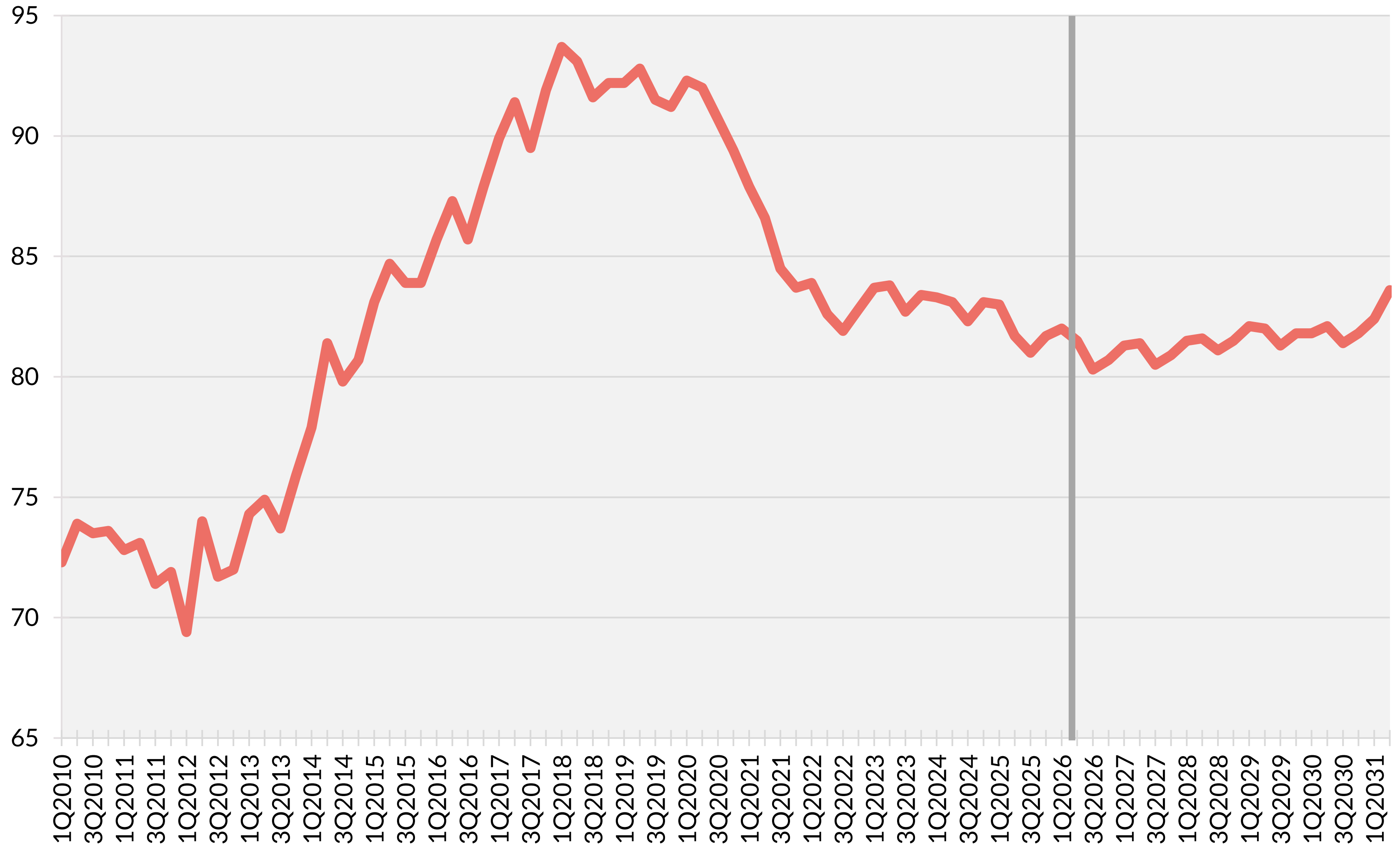
MARKET CONDITIONS INDEX (BCIS, 2026)



MCI currently falling = costs rising faster than prices

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INDUSTRY VIEWS

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BCIS INDUSTRY PANEL (VIEW ON THE GROUND)

Sectors

- Significant gaps are opening up in tender prices by sectors
  - Those with constrained client pipelines are seeing absorption of input cost increases as replenishing work becomes a concern (residential, commercial)
  - Those projects where pipelines are robust, or spanning multi-year are typically seeing input cost increases passed through, and even some risk pricing on top (infrastructure, data centres)
- We are seeing very competitive prices on residential projects currently, with first stage bids coming in at or near cost plan
  - This reflects the use of T2/T3 contractors to meet very testing price points for viability
- Sectors supported by public and institutional investment, such as infrastructure, energy, and defence, are maintaining volume levels

BCIS INDUSTRY PANEL (VIEW ON THE GROUND)

Materials

- Copper prices continue to have an impact, and shipping / transport costs playing into costs more significantly
- Expecting the impact of the Middle East conflict to drive processed components for M&E goods even higher
- Any energy intensive product seeing elevated costs. Steel, glass, cement, brick, plus aluminium. Bitumen and derived products including PVC, surfacing and waterproofing, insulation
- There have been material price increases across the board in the past quarter
  - Suppliers generally advising increases in the order of 5-10%
- Introduction of steel tariffs in July and CBAM from the start of 2027 bringing new considerations and cost planning uncertainties

BCIS INDUSTRY PANEL (VIEW ON THE GROUND)

Market

- While a lot of focus has been on energy prices and the resultant material price increases, we have seen evidence of the supply chain cutting margins to avoid passing on all of the increases
- Contractors are showing an increased appetite to tender schemes in order to fill their order books. This increased competitive tension is helping to offset some of the material price increases resulting from the middle east conflict
- Appetite for new work remains strong although we note that contractors are being selective with the opportunities they are pursuing.
  - Government funded/part funded projects via Frameworks are attracting significant contractor interest
- There has been an uptick in contractors keen to secure order books, with many absorbing cost increases due to their desire for work.
- There has been a marked increase in appetite for single stage bids, possibly associated with T2/T3 contractors now being approached

SUMMARY

WHAT'S THE OUTLOOK FOR CONSTRUCTION?

- Substantial downgrade to our previous output forecast
    - Particularly for repair and maintenance
- Orders declining, which could negatively impact future output levels
- Materials cost increases rising, and risk is on the upside
    - Particularly for materials with energy intensive production processes
- Labour cost increases slowing
- Building cost growth being driven by increasing materials costs
- Tender price growth stagnant, and expected to remain subdued until the end of the forecast period

CONCLUSION

Returning to our original question: what happens when high-cost inflation meets low demand?

- Rising energy and materials costs are creating renewed inflationary pressure across the construction supply chain
  - But weak demand remains the dominant force in the market
- Contractors continue to face competitive conditions, limiting the extent to which higher costs can be passed on in tender prices
- Although activity is expected to recover over the forecast period
  - The recovery is likely to be gradual, with significant uncertainty remaining around both costs and demand

QUESTIONS

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QUESTIONS

If demand remains weak, at what point do contractors stop absorbing inflationary pressures and begin passing them through into tender prices?

WHEN DO YOU EXPECT THE CURRENT CONFLICT IN THE MIDDLE EAST TO START IMPACTING UK CONSTRUCTION TENDER PRICES?

	March 26	April 26	June 26
Already impacting prices	28%	43%	54%
Within the next 3 months	50%	33%	27%
Within 3 to 6 months	21%	21%	15%
Later than 6 months	1%	2%	2%
No impact expected	1%	0%	1%

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QUESTIONS

Historically, inflation and demand tend to move in the same direction. What makes the current environment different, and how long can the industry sustain a situation where costs continue to rise while demand remains subdued?

QUESTIONS

With infrastructure projects set to miss out on funding to increase defence spending, what does this mean for the wider construction pipeline and how should cost professionals be planning ahead?

QUESTIONS

Andy Burnham's trying to distance himself from the current government's record while remaining committed to the same manifesto. What would genuinely different look like for construction?

QUESTIONS

In a high-inflation, low-demand market, are we likely to see a rise in contractor insolvencies driven by increasingly aggressive pricing and margin compression?

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