Market Update
October
2020

@gt_llp
gardiner.com
marketintel.gardiner.com

G&T's Market Update for October 2020 provides an overview of the London construction market. In light of the disruption caused by the coronavirus (COVID-19) pandemic and its impacts on the construction industry, the report highlights changes to key macro-economic indicators over the reporting period, as well as significant construction-specific metrics such as the UK Purchasing Managers' Index, construction output, commercial and residential new orders, key material costs, trade package inflation and tender price trends and forecasts.

In this update we:

- Provide an overview of some of the key takeaways from Deloitte's Summer 2020 London Office Crane Survey
- Analyse the ONS' Business Impact of COVID-19 Survey (BCIS) Results in order to gain an insight into the impact of the pandemic on turnover and operating costs, as well as furloughing trends and construction vacancies
- Summarise some of the impacts that a no-deal Brexit could have on construction

Please note – whilst our Market Update uses the most recently published data at the time of writing, release schedules between data sets differ. This inevitably means that not all datasets will cover identical periods.

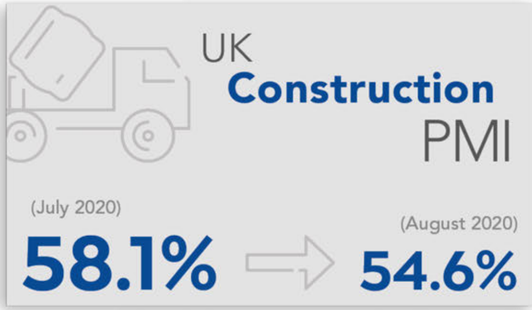
Following a ***2.5%*** fall in Q1, the UK economy contracted by ***19.8%*** in Q2 2020 as coronavirus-induced lockdowns hammered activity.

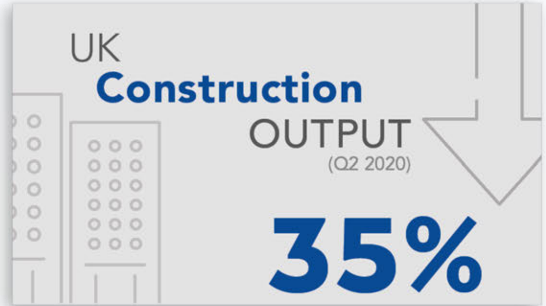
The second quarter plunge was the worst on record, with all sub-sectors (services, construction and production) seeing record quarterly falls, particularly in the sectors most exposed to Government restrictions.

However, economists expect a sharp rebound in Q3, fuelled by strong consumer spending. This has been reaffirmed by the most recent monthly GDP data which show three consecutive monthly increases to GDP (***2.4%*** in May, ***8.7%*** in June and ***6.6%*** in July 2020). Growth is expected to have continued in August, putting an end to current technical recession.

Although on the path to recovery, the UK economy still has to make up nearly half of the GDP lost since the start of the pandemic. The threat of a second wave of COVID-19 cases, no-deal Brexit and an anticipated sharp rise in unemployment could derail the recovery.

- In its Summer Forecast, the EY Item Club downgraded its outlook for the UK economy. The Club anticipates a ***11.5%*** contraction in GDP in 2020 - a substantially deeper drop than the ***8%*** fall that was anticipated in its early June Interim Forecast.
- However, the Club upgraded its expectations for 2021, anticipating that GDP will expand by ***6.5%.***
- Although some Government support schemes in their current form are coming to an end, the Government is considering new packages and measures to support jobs and growth.
- The Bank of England's Monetary Policy Committee announced that the £745bn asset purchase programme will run to the end of the year and could potentially increase if the recovery lags.
- A trade deal between the UK and EU has yet to materialise which could mean an extended transition period or trade taking place between the UK and EU under World Trade Organisation (**WTO**) rules.





The UK Construction ***PMI fell to 54.6 in August 2020*** from a reading of ***58.1*** in the previous month. A reading above 50 indicates a month-on-month expansion in construction activity.

Although the speed of recovery lost some momentum in August the surveys gauge of business optimism rose to a six-month high. However, hopes of a boost from increased major infrastructure work over the next 12 months were weighed against slowing new order growth, some ongoing supply chain disruption and a decline in staffing numbers.

The civil engineering sector fell back into contraction in August and growth in both the commercial and housebuilding sectors slowed with construction companies saying that “economic uncertainty and a wait-and-see approach among clients” had limited opportunities to secure new contracts.

According to the latest ONS data:

- UK construction output (All Work) fell by ***35%*** in Q2 2020 – the largest drop since quarterly records began
- However, month-on-month, UK construction output rose by ***17.6%*** in July 2020, with all sub-sectors experiencing output growth
- UK Construction new orders fell by ***51%*** in Q2 2020 compared to the previous quarter, representing another record quarterly decline. The decrease in new orders came mainly came from weakness in April and May when activity on many sites was paused
- London new orders followed a similar trend with residential and commercial new orders falling by 53% and 71% respectively

Material Price Index
(All Work)
-1.3%
(May 2020 - July 2020)

Structural Steel experienced the **highest rate** of **inflation**
3.8%
(May 2020 - July 2020)

Significant deflationary pressures affecting ***input costs*** and ***tender pricing*** into 2021

The closure of manufacturers and builders merchants in Q2 2020 initially pushed construction material prices up. The ONS' material price index for ***'All Work'*** rose by a substantial ***2.1%*** between April and May but prices have since softened, with the index dropping by ***1.3%*** between May and July, coinciding with the reopening of the economy and the lifting of restrictions.

- Although most materials are now readily available, some remain difficult to obtain as a result of supplier stock shortages (eg certain MEP products, timber and drylining).

- Fabricated structural steel has been one of the few key construction materials to rise in price in the three months to July 2020 (***3.8%***). The rise has partly been fuelled by a Chinese construction boom as well as higher iron ore prices. However, steel prices were still ***3.3%*** lower in July 2020 than they were one year ago.

- Although construction material prices have trended upwards so far in 2020 (with the ***'All Work'*** index up ***1.8%*** in the year to July), the rises are unlikely to have a significant impact on tender prices. With prices so volatile, contractors are likely to view the rise as temporary and will therefore be unlikely to significantly alter bids.

- In May, nearly ***20%*** of surveyed constructions firms stated that they had not been able to get the materials/goods they needed. This figure dropped to ***6.1%*** in mid-August, indicating that material shortages are expected to be less of a problem as the year goes on, especially in light of lower anticipated demand.

- We anticipate that significant deflationary pressures will affect input costs and tender pricing into 2021. This, combined with fewer new tender opportunities, is likely to create a tighter market with greater discounting to win work and secure pipeline.

- Construction activity is also likely to be tempered by an uncertain trading relationship with the EU, lower business and consumer confidence, the risk of rising unemployment and hesitant business investment.

0.2%
Consumer spending rose 0.2% year-on-year in August

-10.1%
OECD forecast a 10.1% contraction in GDP for 2020

Pent-up demand released for residential housing
Demand Released

Oil US$43
Prices up from 17-year low in April 2020 ($19)

Construction
PMI 54.6 (August)
Down from 58.1 in July
(Above 50 indicates monthly expansion in activity)

CPI
0.2% (August)
(down from 1% in July) Expected to hover close to zero in H2 2020

0.1%
Base Interest Rate held

£745bn
Quantitative easing programme target by Bank of England

£35.4bn
Paid through Coronavirus Job Retention Scheme since April

Unemployment Rate
4.1%
(May - July 2020)
Rate edged higher in latest three-month period. BoE expects rate to rise to 7.5% by end of 2020

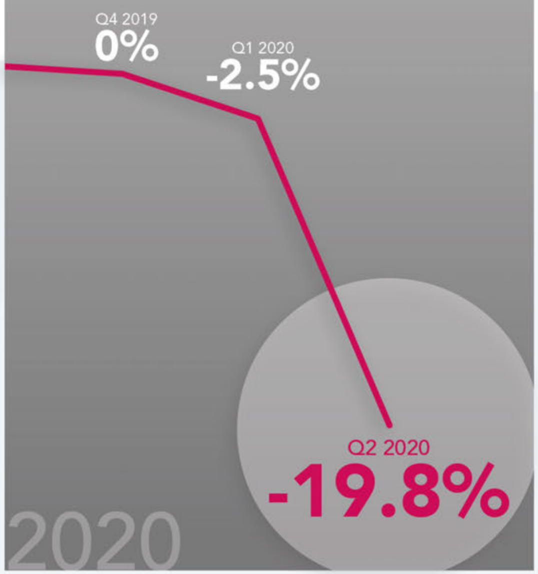
-1.4%
Average weekly earnings fell between Jan – Jul 2020

UK Economy

Overview	Latest	Forecast Q3/20	Q4/20	Q1/21	Q2/21	Q3/21	Units
GDP Growth Rate	-19.8	14.0	4.8	1.0	0.8	0.7	%
Unemployment Rate	4.1	4.9	6.8	6.5	6.3	6.0	%
Inflation Rate (CPI)	0.2	0.2	0.9	1.9	1.8	2.0	%
Interest Rate	0.1	0.1	0.1	0.1	0.1	0.3	%
GDP from Construction	28,694	28,657	27,926	28,034	33,715	28,820	GBP Million
Government Debt to GDP (the ratio between a country's government debt (cumulative amount) and its GDP)	80.7	100	100	100	96	96	%

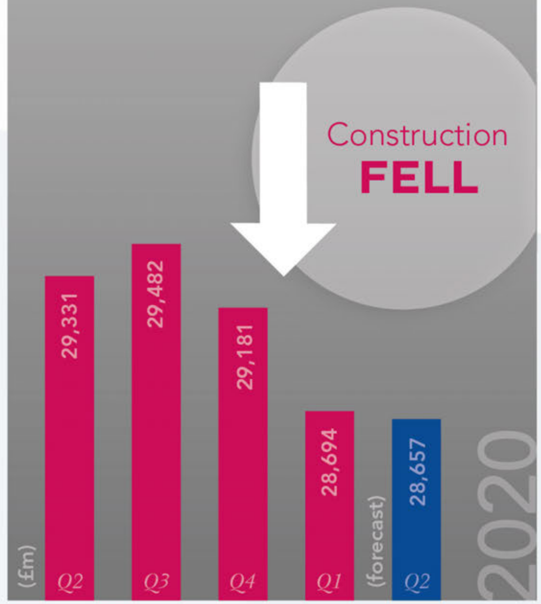
Source: *Trading Economics and ONS*

UK GDP growth fell by **19.8%** in Q2 2020, marking the second consecutive quarterly decline after it fell by **2.5%** in Q1. All three major drivers of growth – services, manufacturing and construction – saw record quarterly falls.



GDP: Quarter on Quarter Growth: Chained Volume Measure Seasonally Adjusted *

GDP from Construction in the United Kingdom decreased to **£28,694m** in Q1 2020 from **£29,181m** in the fourth quarter of 2019.



UK GDP From Construction

Construction productivity fell by **2.2%** in Q1 2020 as many UK contractors closed sites or paused work on-site at the end of March. Productivity levels are expected to fall even further in Q2.

Construction Productivity Index: Output per job (Q1 1990=100), SA, UK

**** Please note** – Chained Volume Measure (CVM) means that data from successive years have been put in real (inflation-adjusted) terms by computing the production volume for each year in the prices of the preceding year, and then 'chain linking' the data together to obtain a time-series of production figures from which the effects of price changes (ie monetary inflation or deflation) have been removed. **Source:** [Trading Economics](#) and [ONS](#)*

Europe

Eurozone economy contracted by ***11.8%*** in Q2 2020 – a record, broad-based decline largely caused by COVID-19 restrictions.

Household consumption and investment plunged ***12.4%*** and ***17%*** respectively, whilst the bloc's imports and exports also fell.

ECB kept monetary policy unchanged in September but noted that its €1.35bn quantitative easing programme will continue until the end of June 2021.

Economic recovery in Q3 partially undermined by signs of rising virus cases.

ECB expects GDP to shrink ***8%*** in 2020, before rebounding ***5%*** in 2021 and ***3.2%*** in 2022. Real GDP not expected to return to pre-crisis levels until 2022.

US

US GDP fell at an annual rate of ***31.7%*** in Q2 2020 pushing the economy into a recession.

Unprecedented economic crisis has simultaneously created demand, supply and financial shocks.

In the absence of new stimulus, economic recovery slowed in September but the Federal Reserve said it will continue to support the recovery and stimulate growth though low interest rates and bond-buying.

The FED projects the US economy will shrink ***3.7%*** in the fourth quarter of 2020 from the same period a year before, revised up from a ***6.5%*** contraction estimated in June.

China

China's economy reportedly grew by ***3.1%*** in Q2 2020 from a year ago, beating analysts' expectations and rebounding from the first quarter's ***6.8%*** contraction.

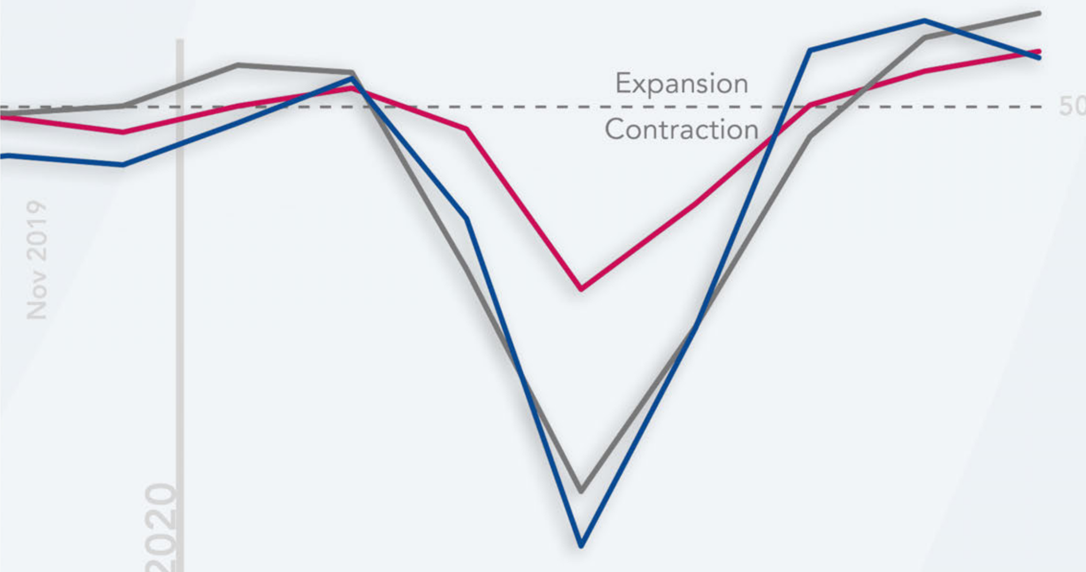
Fiscal spending and cuts to lending rates helped to boost the economy. Strong domestic demand has helped offset weaker international demand.

Factory production and capital spending continued to grow in August and Government infrastructure spending is expected to accelerate in the coming months.

The OECD forecasts that China will be the only G20 country to see positive economic growth in 2020 (***1.8%***).

August's construction PMI survey revealed...

- Speed of recovery lost momentum
- Lack of new work replacing completed contracts in August, acting as a brake on speed of expansion
- New order growth slowed and some supply chain disruption persisted
- Input cost inflation increased due to stock shortages and an imbalance of supply and demand
- Further drop in staffing numbers but rate of job shedding has eased slightly since July
- Civil engineering sector fell back into contraction and growth in the commercial and housebuilding sectors slowed
- Business expectations improved amid hopes of a boost from major infrastructure projects and resilient public sector construction spending

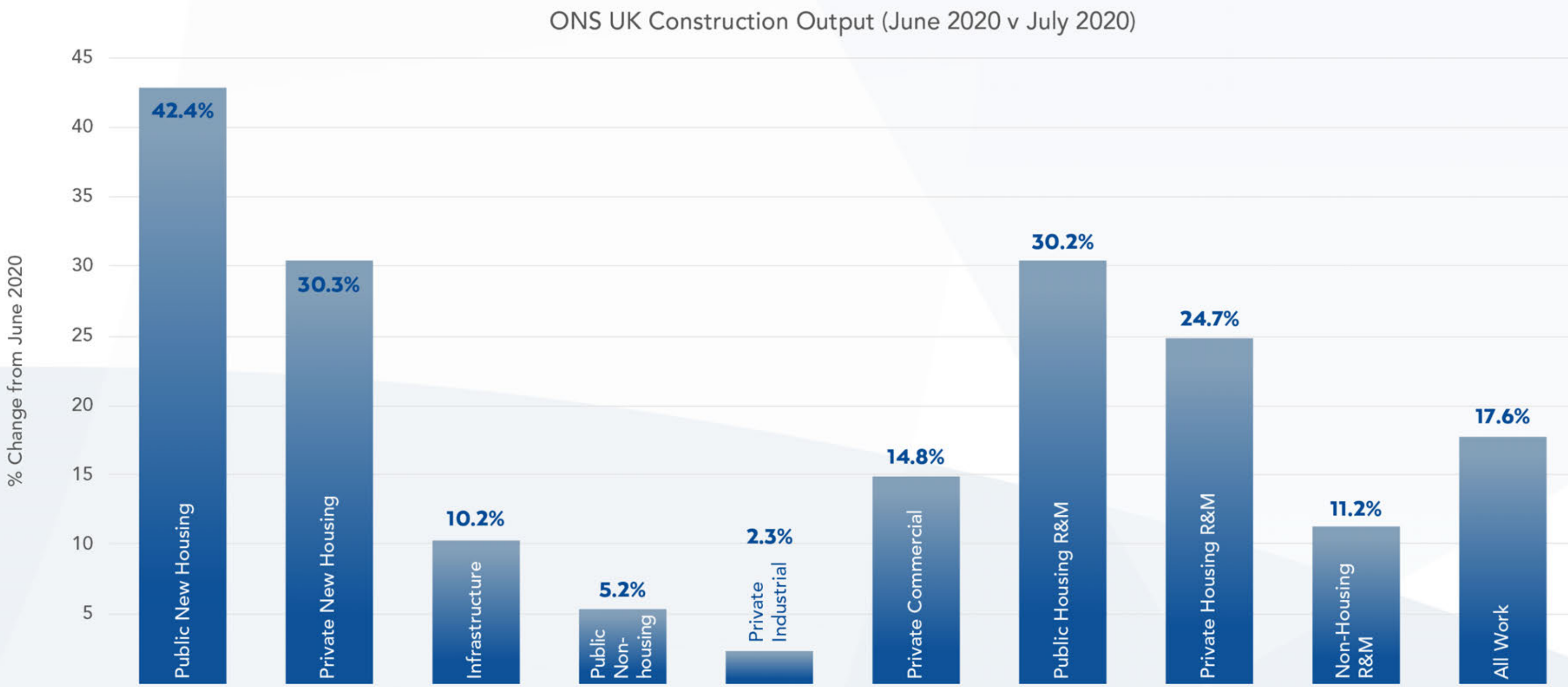


Services **58.8**

Manufacturing **55.2**

Construction **54.6**

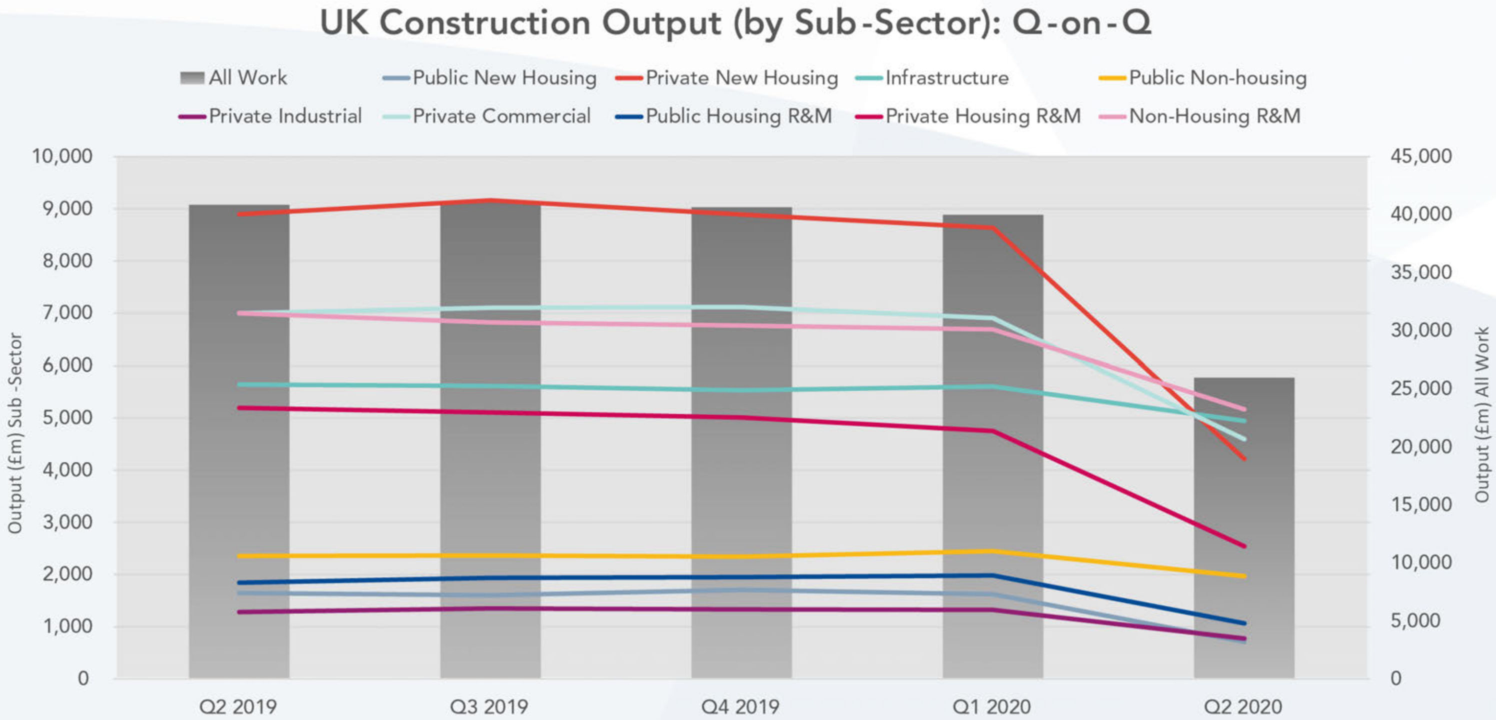
Source: IHS Markit/CIPS



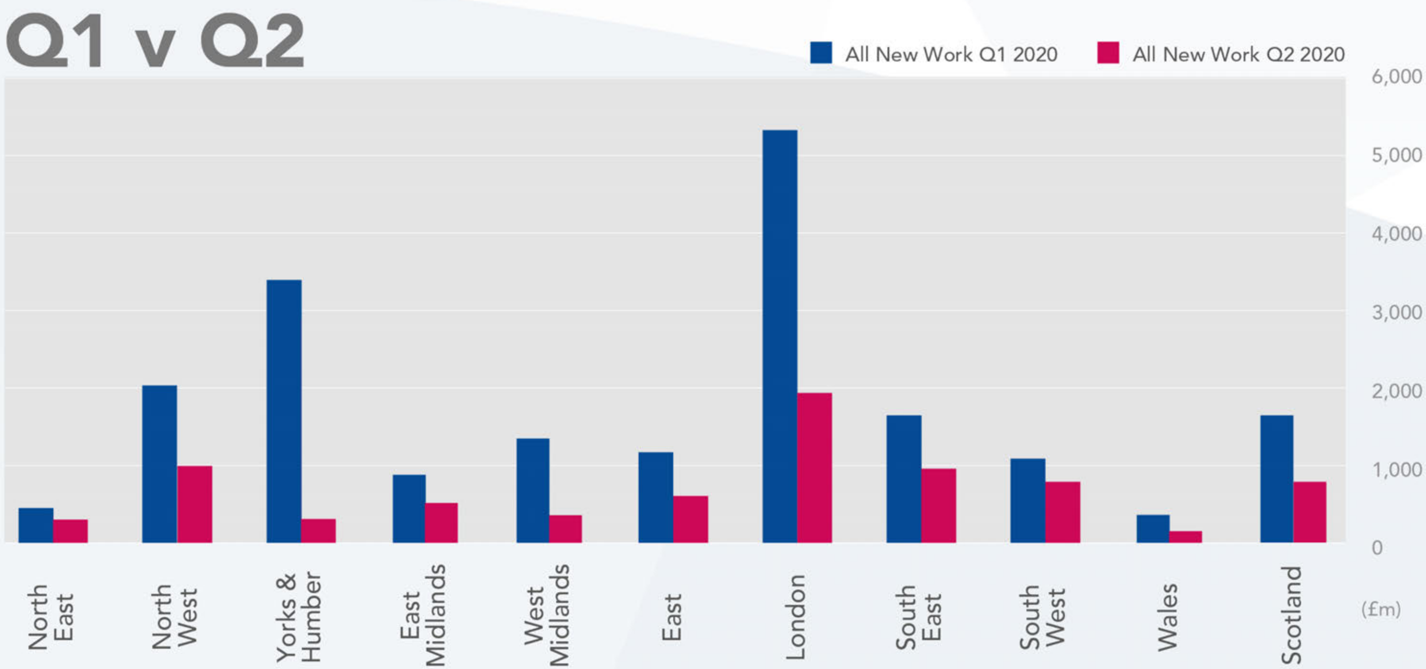
- Construction output rose by **17.6%** in July 2020 compared to the previous month, with all sub-sectors experiencing output growth
- However, 'All Work' Output in July was down **12.8%** compared to the same month in 2019. Infrastructure was the only sub-sector to exceed July 2019 output values
- April marked the nadir (low-point) for monthly output in 2020 (**£7.6bn**), but since then output has steadily increased month-on-month as sites reopened and social distancing restrictions eased
- Public non-housing has been the least affected sub-sector, primarily due to work on hospitals and schools. Infrastructure has also been less affected as social distancing is easier to maintain on large sites

Source: *ONS*
Note: In a letter from the UK Statistics Authority dated 7th March 2019, the ONS stated that sub-national and sub-sectoral estimates of construction output no longer carry National Statistics status

- Construction output in Q2 2020 was down a record **35%** from the previous quarter - the largest drop since quarterly records began in Q1 1997 and nearly five times larger than the previous record quarterly fall in Q1 2009
- Based on the current monthly trend of output growth, Q3 2020 output figures are likely to improve significantly from their low Q2 base as the economy begins to recover and productivity levels are ramped up
- However, reduced order pipelines, workloads and productivity levels over the next few months are likely to keep output growth subdued, below pre-Covid-19 levels
- The CPA forecasts a **20.6%** fall in output in 2020 with the worst affected sectors being private housing (**-33%**) and commercial (**-29%**). Output is expected to rebound in 2021, rising by **18%**, but output will still be **6.4%** lower than pre-coronavirus levels. The delivery of major infrastructure projects will be crucial to growth in 2021.

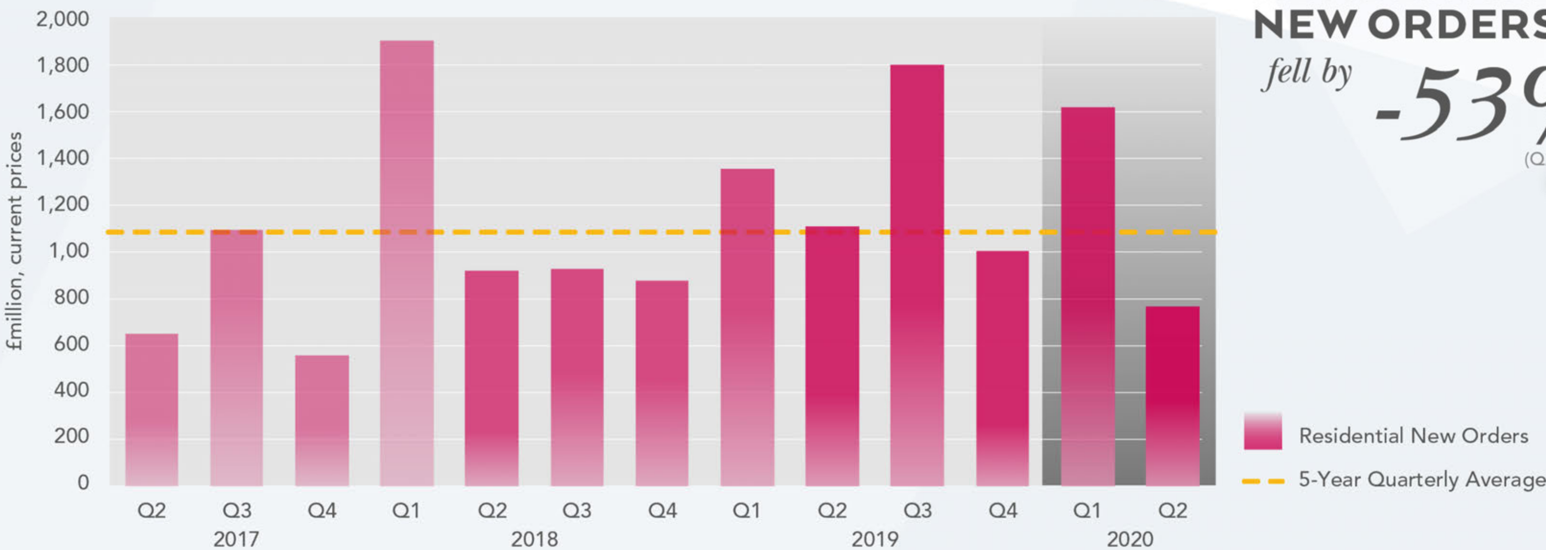


- Construction new orders fell by **51%** in Q2 2020 compared to the previous quarter - the lowest level of new orders since quarterly records began in 1964
- There were record quarterly falls in new work across all sectors other than infrastructure, public new housing and public other new work
- The decrease in new orders in Q2 mainly came from weakness in April and May, with new orders increasing in June as activity gradually restarted
- New orders dropped sharply in all 11 regions in Q2. Yorkshire & Humber saw the sharpest Q-on-Q decline (**-91%**), exacerbated by record new order values in Q1 from several large infrastructure projects
- August's PMI data pointed to an increase in new work for a third month running but noted that the rate of expansion remains modest with respondents saying that new business intake remains subdued
- New order values are likely to remain subdued in Q3 2020. Many firms anticipate a reduced pipeline of work in the short-term as developers/investors defer projects and adopt a wait-and-see approach



Source: ONS

- London Residential new orders fell sharply by ***53%*** to ***£751m*** in Q2 2020 compared to the previous quarter – well below the five-year quarterly average of ***£1.07bn.***
- ***21,092*** housing completions were recorded in the year to Q2 2020 – an annual fall of ***10.5%*** and well below the ***66,000*** homes per annum outlined in the draft London Plan.
- In Q2 alone, just over ***3,000*** housing completions were recorded due to the pause in construction activity (the lowest quarterly number of completions since Q3 2014) as housebuilders downed tools due to COVID-19 restrictions.
- Despite the short-term impact of COVID-19 on housing delivery, there remains a significant pipeline of over ***61,000*** private units under construction (on sites with more than 20 private homes) in London which will translate into increased housing delivery in the medium term.
- Residential construction costs are expected to rise significantly, fuelled by regulation changes, labour shortages and potential supply disruption. According BCIS' latest upside forecast, build costs are forecast to rise by **17%** over the next five years.



Source: ONS, Molior

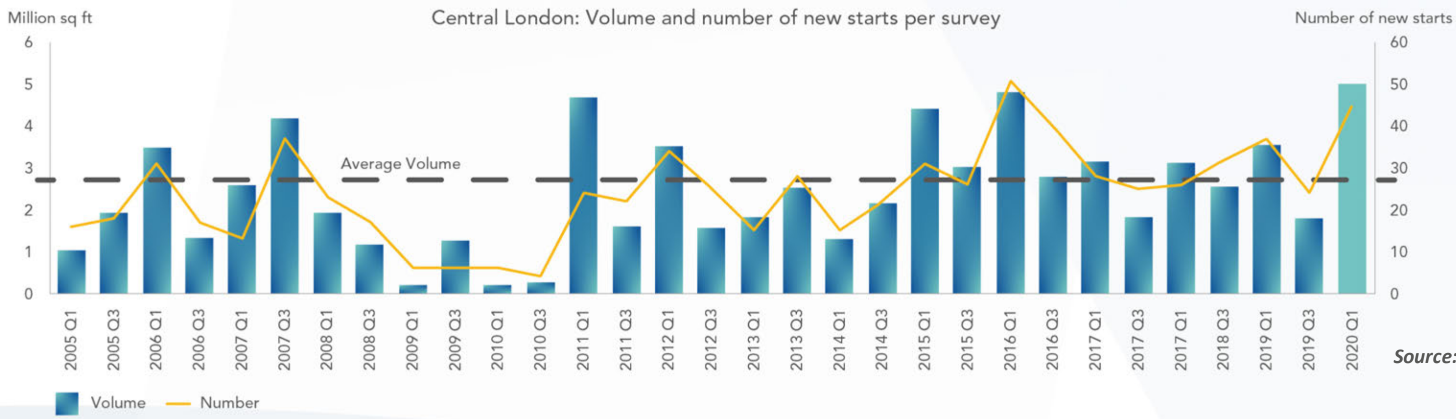
- London Commercial new orders in Q2 2020 fell by ***71%*** compared to the previous quarter, from ***£2.2bn*** to ***£628m*** – well below the five-year quarterly average of ***£1.4bn.***

- However, there is still a strong central London office pipeline with the amount of new office space under construction hitting an all-time high (15.3m sq ft across 112 schemes in Q1 2020). This represented an ***29%*** uplift compared to the previous six month period and was ***41%*** higher than the long-term average (Deloitte).

- Construction started on more than 5m sq ft of new office space in the six months to 21 March 2020, with 45 schemes breaking ground – almost double the long-term average.

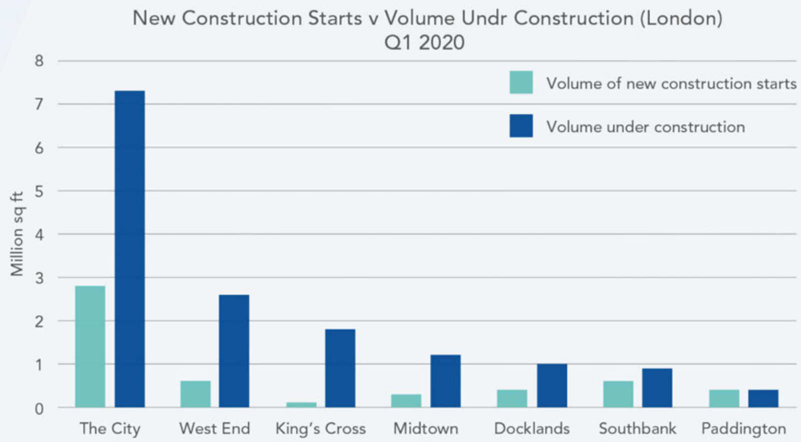
- Sentiment has shifted with Covid-19, decreasing construction activity and temporarily reducing demand for commercial space. In the short term, we're more likely to see price drops, delayed decisions, extended feasibility review of schemes and perhaps more phased starts with limited commitment.

Source: *ONS*



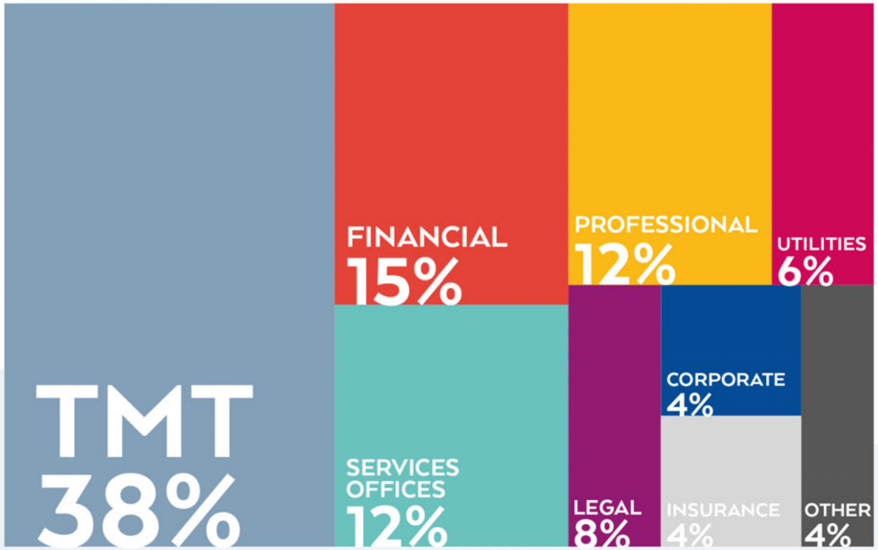
Source: [Deloitte Real Estate]

- 5m sq ft of new London office projects started in the six months to March 2020.
- Highest volume of new starts on record.
- 40 Leadenhall and 8 Bishopsgate broke ground in the period. Both developments together account for ***33%*** of all new construction volume.



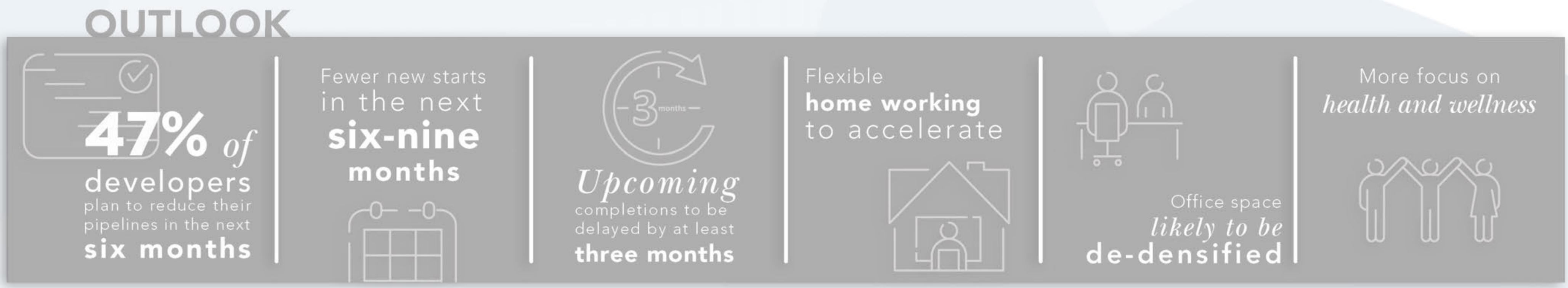
- 15.3m sq ft currently under construction across 112 schemes.
- Construction volumes in the City grew by ***38%*** to a total of 7.3m sq ft. The City also currently represents ***48%*** of all space under construction in Central London.
- The West End experienced steady rise in construction activity. With 2.6m sq ft underway, the submarket accounts for nearly ***20%*** of all Central London office space currently under construction.

Percentage of pre-completion space let by sector



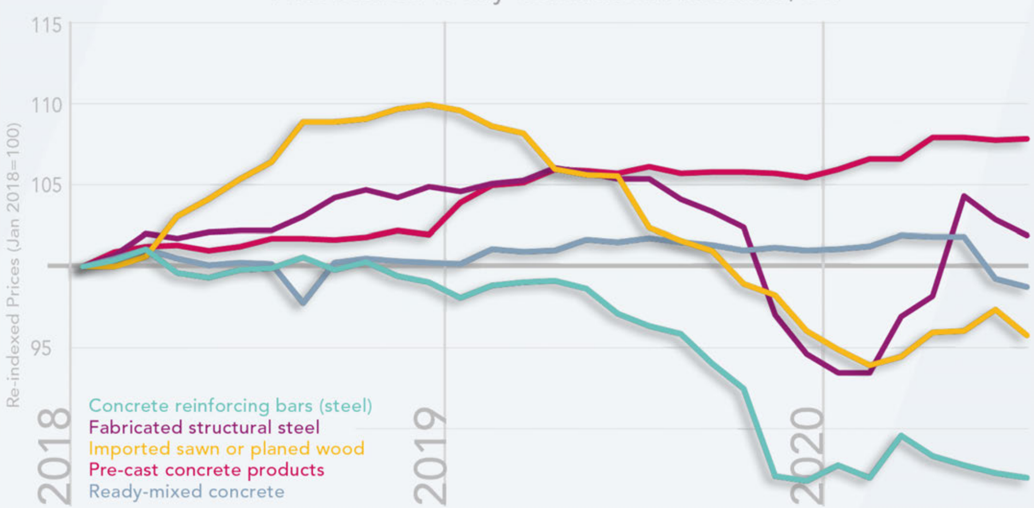
Source: *Deloitte, Summer 2020 London Office Crane Survey*

- ***44%*** of the 15.3m sq ft of space currently under construction is pre-let.
- Strong pre-letting market driven by limited 'ready to occupy' Grade A space, especially for larger requirements.
- TMT sector continues to drive office demand taking up ***38%*** of all pre-let space under construction.
- Serviced office providers likely to reduce their office footprint in coming months in response to weaker tenant demand for short-term space.
- Deloitte anticipates that given the disruption caused by the pandemic, businesses will take a three-six month break before committing to new office space.



- Although volatile, construction material price inflation saw general upward trend in H1 2020. Prices for most of the key materials in the graph below rose in Q1 and into early Q2, but subsequently eased back towards the end of Q2 as the economy reopened and materials became more readily available.
- Upward price pressure from reduced manufacturing capacity, supply disruptions of imported materials and a scarcity of certain products were accompanied by a unprecedented drop in demand for construction materials as sites temporarily closed.
- In the year to July 2020, the material price index for ‘All Work’ rose by ***0.1%.*** Although material prices (on the whole) have reversed their 2019 downward trend, some key materials (eg rebar, fabricated structural steel and imported sawn or planed wood) are still lower than they were one year ago.

Price Indices of Key Construction Materials, UK



Source: gov.uk

Construction Material Price Indices

	Month on Month June 20 - July 20	Year on Year July 19 - July 20
New Housing	0.2%	-1.0%
Other New Work	-0.2%	0.0%
Repair & Maintenance	0.1%	-1.5%
All Work	-0.6%	0.1%

Key Trade Analysis

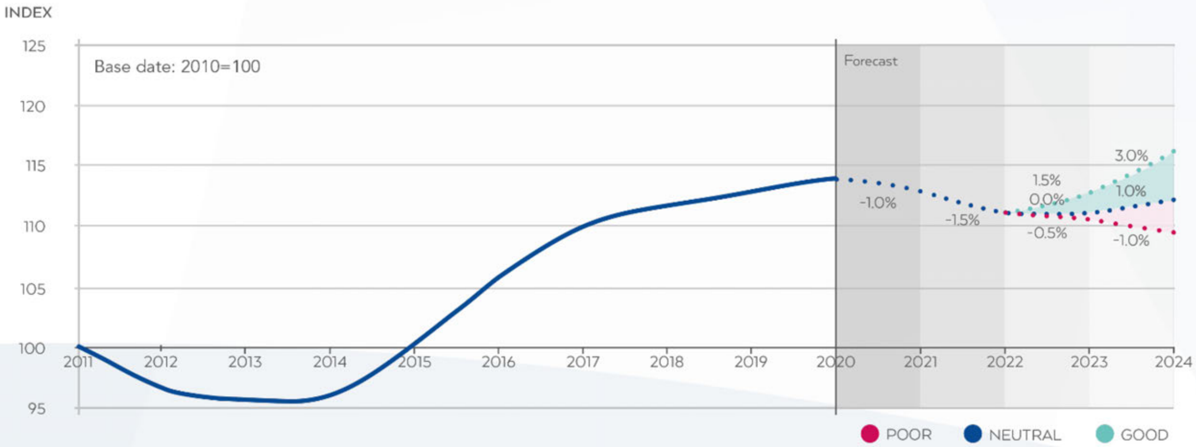
Likely 12-month inflationary range for key trade packages based on our Q3 2020 TPI Survey results

Key Trade Packages	Summary	Likely Inflation Range (Next 12 months)
Demolition	Although demolition is less exposed to the cost impacts of social distancing, early trades are often the most sensitive to a reduction in workload. We anticipate highly competitive tendering for demolition packages.	**-7% to -5%**
Groundworks	Productivity levels remain strong but fewer new projects coming through will mean increased competition for tendering groundworks packages.	**-3% to -1%**
Concrete	Lower demand for concrete will mean that suppliers will be keen to secure workload resulting in more competitive package pricing. Lead times have risen slightly in the last six months and although new enquiries are up, workload is down compared to six months ago. Ready-mixed concrete prices have fallen by 3% in the year to July 2020 primarily due to lower energy costs (eg natural gas prices), reducing input cost inflation.	**-3% to -1%**
Steel	Fabricated structural steel prices fell significantly towards the end of 2019/early 2020 but have seen a revival since March, helped, in part, by a Chinese construction boom and higher iron ore prices. However, the recent rise in prices is the result of a supply squeeze rather than a demand surge. ArcelorMittal (the world's biggest steel producer) has cut global production in alignment with reduced demand and expects overall steel consumption to be lower in 2020 than in 2019. Despite this, steel prices are set to keep rising in the coming months as economies recover and demand picks up. On site, steelwork erection continues to work significantly below normal productivity levels.	**-2% to 0%**
Facades	Supply pressure and increased cost of design, installation and materials following the Hackitt report. Façade packages are significantly more expensive due to limited supply options and the weak pound to Euro exchange rate. Cladding firms reporting steady workloads but lead times are expected to increase due to the closure of manufacturing facilities and suppliers increasing procurement periods.	**-1.5% to 0.5%**
Brick	After suspending/scaling back production in the spring, brick manufacturers have resumed production. Demand has been strong over the summer and manufacturers have said that trading has retuned to a stable state with no impact on capacity under the new operating conditions. Brick deliveries (a useful lead indicator or residential construction volumes) reached a 2020 high point in July and were close to the 2018/19 average monthly figures. Lead times, workload and enquiries remain steady but labour availability continues to be a concern.	**-1.5% to 0.5%**

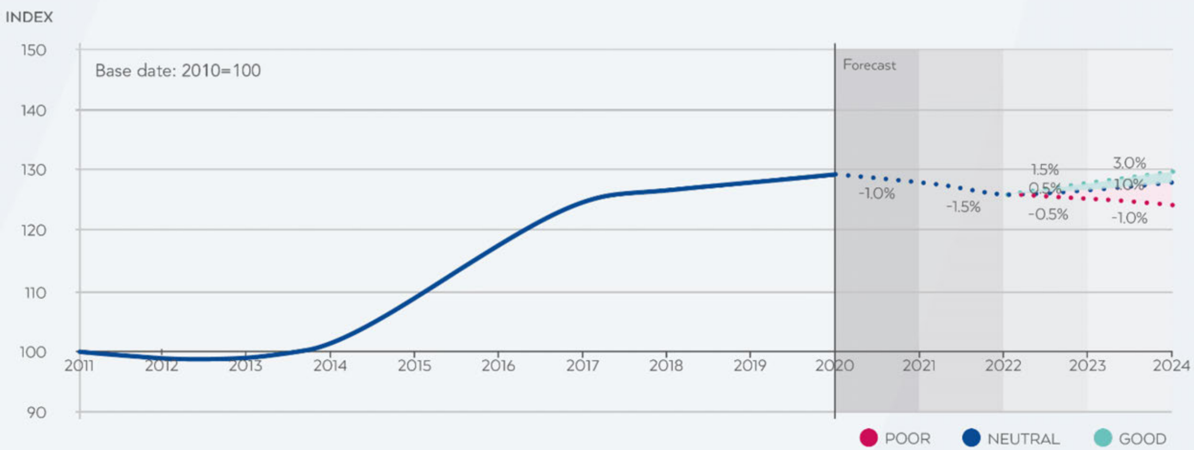
Key Trade Packages	Summary	Likely Inflation Range (Next 12 months)
Dry lining	Shortages of skilled labour are supporting prices, particularly in residential. Costs are being pushed up by supplier stock shortages of plasterboard and insulation materials. Drylining lead times have ben stretched with little-to-no manufacture of UK plasterboard but have since recovered.	**-1.5% to 1%**
Carpentry	Demand for carpentry from the residential sector has returned and continues to stretch capacity. Imported sawn or planed wood prices have gradually risen since March 2020 as a result of tighter supply and surging demand from renovation projects. Lumber prices have soared this year but sawmill supply is improving and demand is levelling off which will lead to a softening in prices.	**-1.5% to 0.5%**
Joinery	Workloads are down but there is no evidence of weaker pricing. Material availability and labour are not seen as issues and no rise in lead times is anticipated.	**-1.5% to 0.5%**
Finishes	Social distancing measures impacting productivity but enquiries and workload remain stable. Rates are high due to demand working through rather than any shortage of skilled labour.	**-1.5% to 0.5%**
M&E	A large proportion of M&E components and materials are imported from Europe and have therefore been impacted by sterling weakness and exchange rate volatility. Additionally, issues have been reported concerning availability of sprinklers, pumps and lighting from overseas (eg LED lights from China) contributing to increased lead times. Copper prices rose to a two-year high in September (supported by Chinese demand) but are expected to remain steady for the remainder of 2020. Active pursuit of workload by MEP contractors may result in more competitive tenders.	**-1% to 1%**
Roof	Shortages in roofing supplies and restrictions on labour have pushed lead times higher but there are signs of improvement with contractors anticipating that lead times will fall. Costs continue to be pushed up by a shortage of contractors and labour, as well as a volatile insulation market. Oil prices expected to remain relatively subdued in 2020, lowering the price of asphalt shingles and reducing overhead cost pressure on roofing contractors.	**-1.5% to 0.5%**
Preliminaries	COVID-19 measures on site creating upward pressure on preliminaries costs but likely to be counteracted by a more competitive market/ desire to secure work. Although contractors will be more competitive with their direct costs, we anticipate that preliminaries will rise marginally in 2020 - averaging around 16%.	**0 to 1.5%**
OH&P	Main contractor OH&P levels expected to fall in order to secure turnover. Tier 1 MCs working on larger schemes appear to be holding their pricing levels but lower tier contractors are tightening their bidding and reducing OH&P to secure order books. Overall, we expect OH&P to fall from a pre-pandemic average of 5-6% to around 3-5%.	**-10% to -5%**

Note: Inflationary ranges were produced prior to the COVID-19 outbreak. The pandemic is likely to impact trade package inflation in the short-medium term.

TENDER PRICE TREND **"UK AVERAGE FORECAST SCENARIO"** Q3 2020



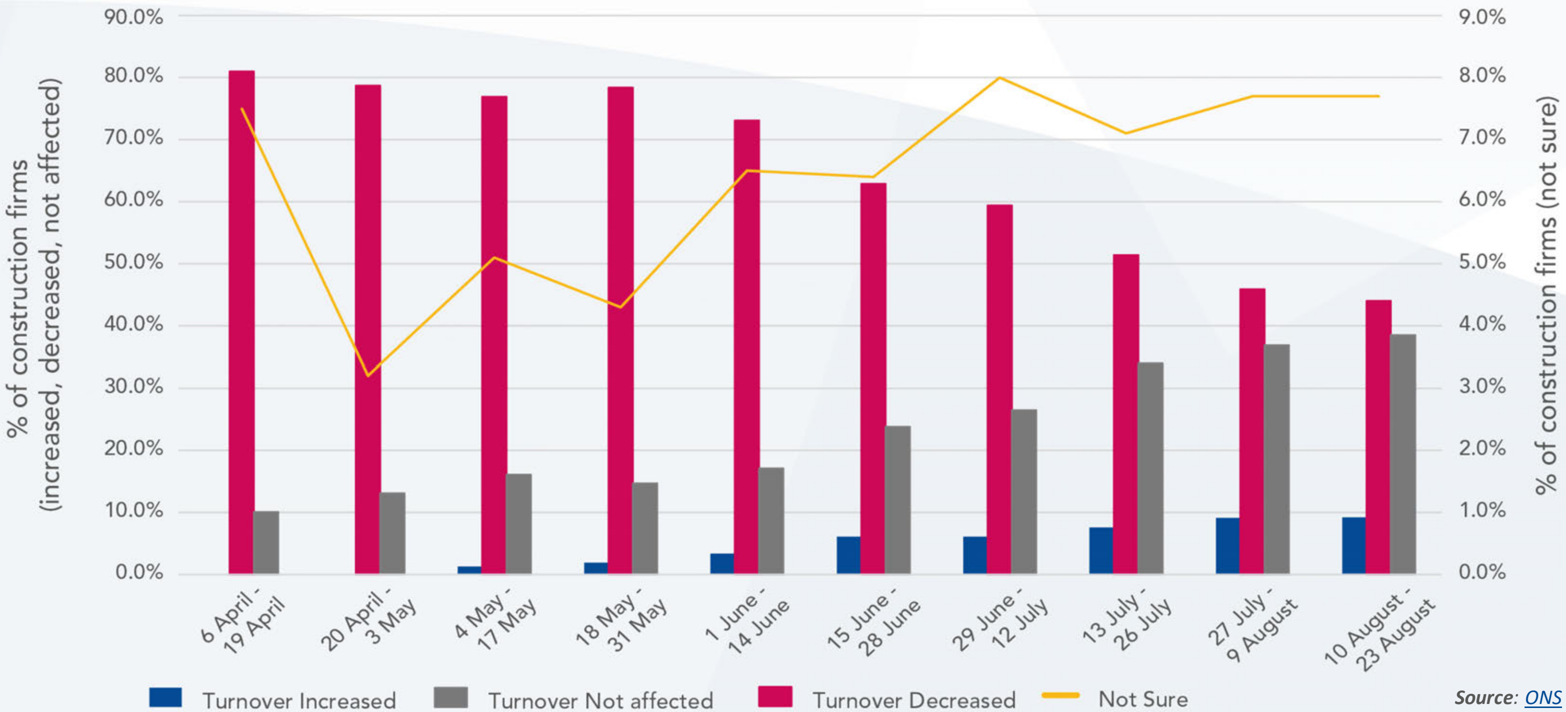
TENDER PRICE TREND **"LONDON FORECAST SCENARIO"** Q3 2020



- Substantial deflationary pressures affecting input costs and tender pricing into 2021.
- Some pent-up demand released in Q3 but activity likely to be tempered by an uncertain trading relationship with the EU, lower business and consumer confidence, the risk of rising unemployment and hesitant business investment.
- Most sites are now fully functional and are operating at around 80-90% of pre Covid-19 productivity levels, but fewer operatives on site will limit potential output.
- Firms moving out of 'survival mode' are now focusing on winning reduced levels of new work in order to maintain cashflow and increase market share in a tighter/more competitive tendering environment.
- Upward cost pressures from rising preliminaries and programme delays, but with fewer tender opportunities we anticipate some price discounting to win work and secure pipeline.
- Supply chain currently resizing to cater for anticipated lower levels of demand for projects and schemes in the short-term.

- According to the ONS' ongoing fortnightly Business Impact of COVID-19 Survey (BCIS) Results, the number of construction firms reporting that their turnover was lower in the period compared to that was normally expected for this time of year has steadily decreased since 18th May 2020.
- The number of firms reporting that turnover has not been affected or has increased compared to the same period last year has also steadily risen since 18th May 2020.
- Although a high number of firms (***44%*** of those surveyed) continue to operate at a reduced turnover, only ***10.2%*** said their business was at a moderate risk of insolvency.

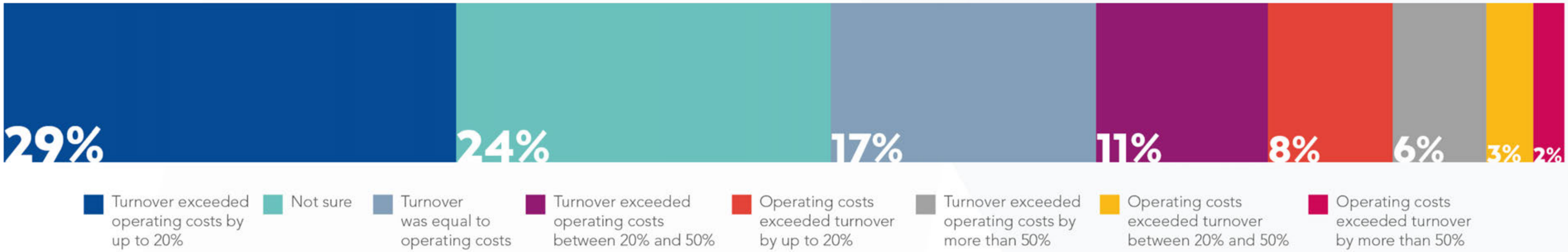
In the last two weeks, how has the coronavirus (COVID-19) pandemic affected your business's turnover, compared to what is normally expected for this time of year?



Source: ONS

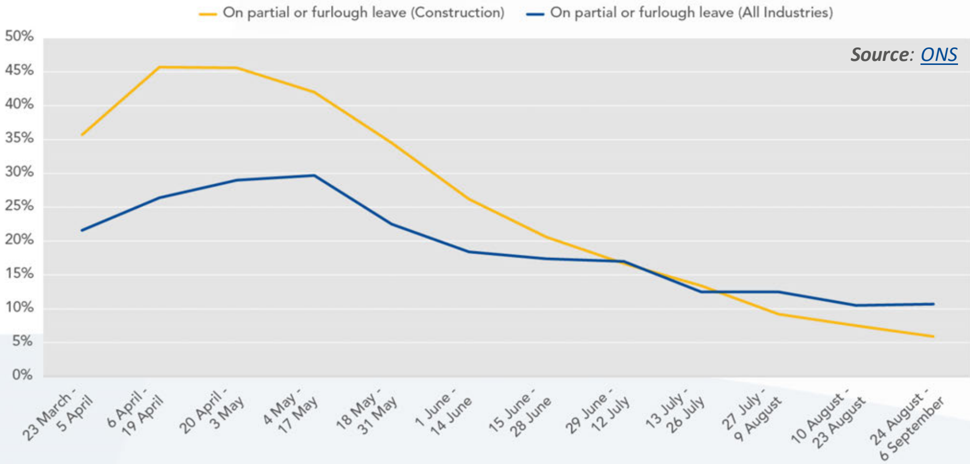
In the last two weeks, how did you business's turnover compare to its operating costs?

Source: ONS



- Between 10th-23rd August, ***13.1%*** of surveyed construction firms said that they were effectively operating with operating costs exceeding turnover, whilst ***17.1%*** of firms noted that turnover in the period was equal to operating costs.
- Additionally, a significant proportion of firms (***38.3%***) stated that their enterprises cash reserves would last less than three months.
- With new orders at an all-time low, a number of firms are likely to feel increased financial pressure in the coming months. Indeed, a recent payment times report indicated that more than half (***55%***) of all construction related business were taking longer to pay their suppliers since the COVID-19 lockdown. Increased payment times will inevitably cascade down the supply chain and risks pushing some contractors and subcontractors to insolvency.

In the last two weeks, roughly what proportion of your enterprise's workforce was furloughed?



- According to the ONS' fortnightly Business Impact Survey, surveyed construction firms reported that, on average, the proportion of their workforce that were on furlough (or partial furlough) leave had fallen from a high of ***45.7%*** during 6-19 April to just ***7.5%*** during 10th-23rd August.
- Since the end of July, UK construction firms reported that a lower proportion of their workforce were on furlough leave compared to the 'All Industries' sector classification.
- Construction has gone from being one of the industries with the highest proportion of furloughed workers to one of the least. Indeed, a number of the UK's larger contractors have stated that an extension to the furlough scheme is now no longer necessary.

Vacancies in UK Construction, Seasonally Adjusted

- The number of vacancies in UK construction between June-August 2020 were ***32%*** higher than in the last three-month period. However, vacancies between June and August 2020 were still ***29.8%*** lower than they were during the same period one year ago.
- The partial recovery in vacancies is in line with construction activity levels, which have also risen sharply from a low base in the last three months but remain considerably lower than they were one year ago.
- Construction vacancies have experienced a sharper initial recovery compared to the 2008/9 recession. Hiring demand in the sector has also recovered far more quickly than it has in other sectors of the UK economy.

Materials

76%
of construction products are ***made in the UK***

15%
of imported construction products are ***from the EU***

9%
of imported construction products are ***from non-EU***

Approximately 15% of construction products used in UK construction would be exposed to tariff increases in a no-deal

Labour

- 7% of all workers in the UK construction industry are EU27 nationals. In London, 28% of the construction workers are EU27 nationals.
- **RICS**: construction sector could lose up to 200,000 (8%) of its total workforce in a no-deal Brexit.
- Overall we perceive the potential impacts of labour shortages are likely to be greater than the impact of additional tariffs applied to EU imports.

Tariffs

- Average import tariff for the most imported building materials/components from the EU would, under the new UK Global Tariff (**UKGT**) regime, be **3.3%.**
- A **3.3%** cost increase on construction products imported from the EU (which account for **15%** of all construction products used in the UK) amounts to a **0.5%** cost increase overall to materials and products.
- MEP products and materials: New average tariff under the UKGT is **2.53%.**

Currency

- Anticipated **10-15%** fall in the Pound making imported construction materials and equipment more expensive.
- Import inflation could put upward pressure on domestic inflation as UK manufacturers raise prices in response to higher domestic demand.
- Exchange rate fluctuations increase procurement and contract risk for the supply chain, making it difficult to achieve cost certainty.

	Cost Impact on Total Project Value	Cost Impact on Trade Package Value
5% Fall in Sterling	1.75%	2.10%
10% Fall in Sterling	3.50%	4.20%
15% Fall in Sterling	5.25%	6.30%

G&T has estimated that approximately 35% of the Total Project Value of a typical mixed-use development is exposed to exchange rate fluctuations

> *Generally speaking, a 'no- deal' Brexit could potentially increase construction costs, delay project completion or even make some projects unviable in the short-term*

Non-Tariff Barriers

Non-Tariff Barriers (**NTB**s) can be more restrictive for trade than actual tariff barriers. NTBs may cause:

Border delays

Supply chain disruption

Increased costs for businesses

Reduced capacity to trade

CBI estimates that in a no-deal NTBs are expected to be an equivalent to an additional tariff of **6.5%**

Construction Materials: Bottom Line

3.3%

The average import tariff (base rate of duty) for the top 17 most imported building materials/components from the EU in 2018 would, under the UKGT regime, be 3.3%

0.5%

Under a no-deal, a 3.3% cost increase on construction products imported from the EU (which account for 15% of all construction products used in the UK) amounts to a 0.5% cost increase overall to materials and products (ie 3.3% of 15%)

However, a portion of the additional tariff costs could potentially be absorbed by suppliers who still want to trade with the UK and desire to retain market share

Notes:
1. This presumes that the project/scheme cannot source a greater proportion of products and materials from UK-based manufacturers or from countries with which the UK secures a FTA with
2. This only takes an average tariff of the top 17 (BEIS-published) building materials and components imported into the UK from the EU (by value) in a single year (2018)
3. This does not take into account the specific materials required for a given project

The ‘No-Deal’ Brexit Scenario: Conclusion

Whilst there are significant negative ramifications associated with a no-deal Brexit in the short-term, the full extent of the impact that a no-deal would have on UK construction is difficult to quantify.

- A ‘no deal’ Brexit could potentially increase construction costs, delay project completion or even make some projects unviable in the short-term.

- The impact of new tariffs applied to the 15% of construction materials currently derived from the EU and used in the UK is likely to be minimal, particularly if a portion of the additional tariff costs are absorbed by suppliers’ margins. Some materials that are currently imported from the EU could be replaced by domestically produced alternatives. However, UK manufacturers are unlikely to be able to meet domestic demand for materials such as structural steel, electrical wiring and sawn wood.

- Non-tariff barriers may be more significant for the industry. NTBs could increase administrative and transport costs as well as causing delays to the ‘Just-In-Time’ delivery model, which would impact programme planning and delivery. Although the EU and UK would initially have regulatory convergence of their construction products under the Europe-wide CE-Mark product certification system, this will not eliminate the need for goods to be checked for appropriate paperwork at the border, increasing the risk of border delays.

- The anticipated devaluation of Sterling and the impact a no-deal would have on the supply of construction labour are arguably the biggest risks. A third of European construction workers already in the UK have reportedly considered leaving due to Brexit[1]. The removal of free-movement of EU labour and a further devaluation of the Pound could add to this figure as EU workers seek lucrative work outside the UK.

[1] https://www.theguardian.com/business/2019/jun/24/construction-pay-rises-as-eu-workers-weigh-up-leaving-uk-survey-brexit

Market Update
October
2020

@gt_llp
gardiner.com
marketintel.gardiner.com