GARDINER &THEOBALD

MARKET UPDATE

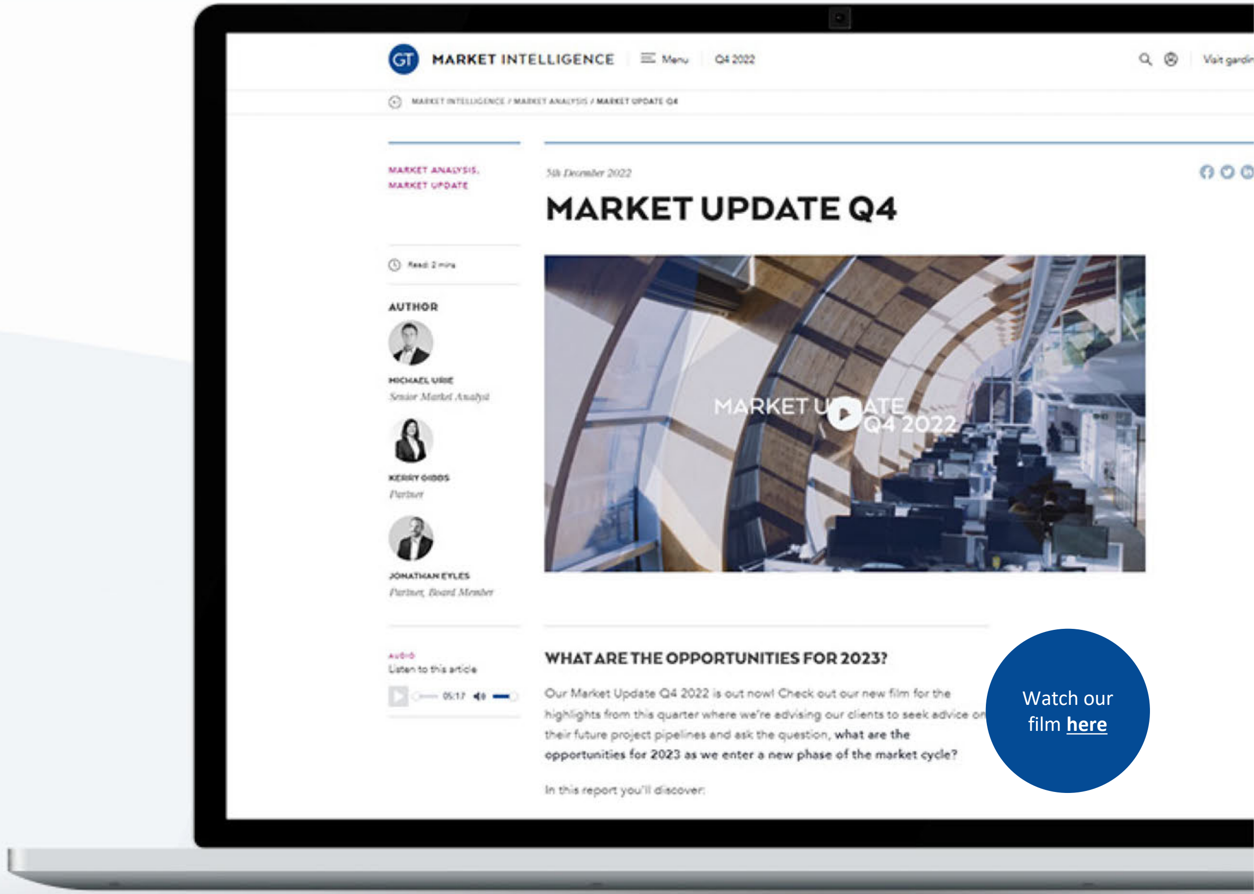
What are the opportunities for 2023?

December 2022

*In G&T's final market update of the year we're advising our clients to seek advice on their future project pipelines and ask the question, **what are the opportunities for 2023 as we enter a new phase of the market cycle?***

Key topics in this report…

- UK Economic Overview
- The Construction Market
- An Update on Energy, Trades and Transport
- M&E Focus
- TPI & Key Recommendations



Watch our film **here**

01 / MACRO ECONOMICS & CONSTRUCTION OUTPUT

***UK consumer confidence fell in October** to its lowest level since April 2020*

UK Growth Downgraded

Britain's economy is already in recession and set to shrink by **1.4%** next year after OBR slashes growth forecast due to rampant inflation

CPI 11.1% *(Oct 2022)*

Annual inflation hits 41-year high due to steep rises in consumer essentials

UK Construction PMI 52.2 *(Oct 2022)*

After a summer dip, construction activity expanded due to delayed work, but firms remain pessimistic about 2023 growth expectations

3% Base Interest Rate

Base rate raised to tackle increasing inflation, with more rate rises expected

3.6% Unemployment Rate *(Jul – Sep 22)*

Labour market remains tight as unemployment stays at near multi-decade lows

Source: *ONS, IMF, Bank of England, S&P Global*

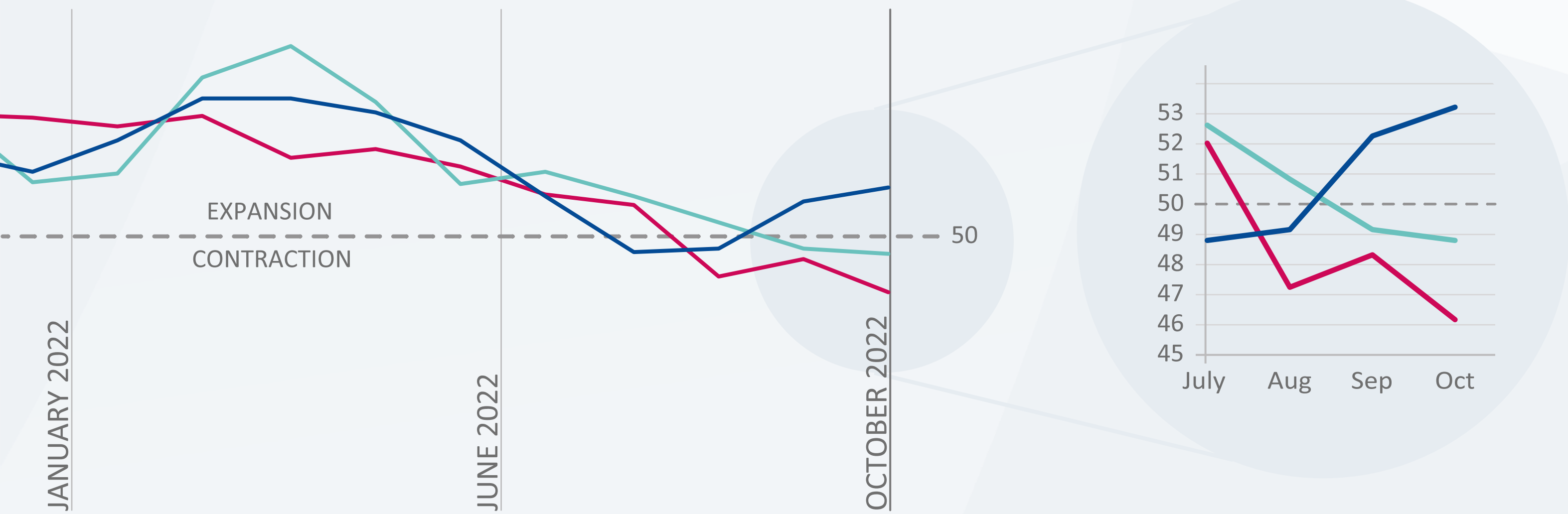
***UK Construction PMI beat market expectations in October,** signalling the sharpest expansion in the sector since May…*

Activity driven by **backlogs of unfinished work**

New orders declined for first time in 28 months

Concerns over **high input prices** and **borrowing costs**

Growth expectations for year ahead remain **subdued**

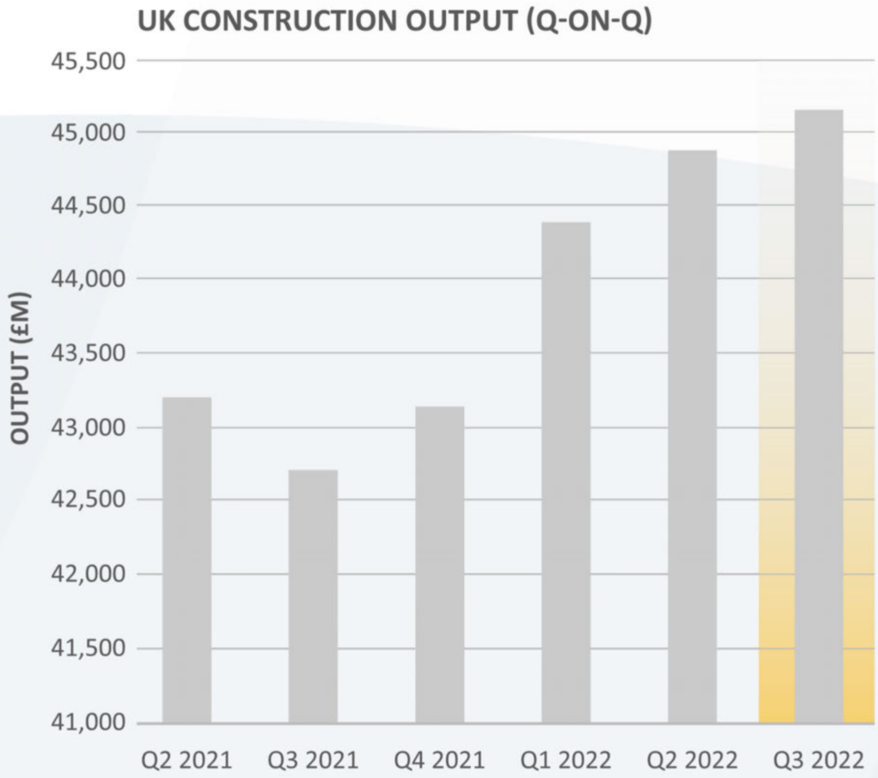


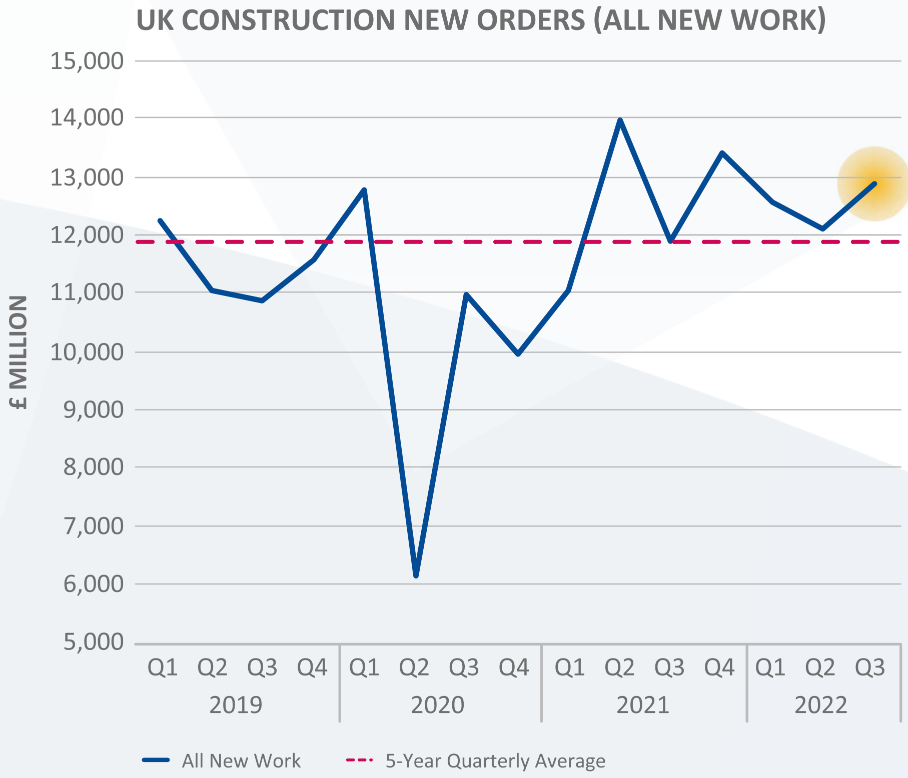
*Construction **53.2***
*Manufacturing **48.8***
*Services **46.2***

Source: S&P Global

UK construction output growth rose by 0.6% *in Q3 2022 with a record quarterly output of* ***£45,157 million***

UK construction new orders rose by 6.4% *Q3 2022 with values remaining above the five-year quarterly average*





Source: ONS

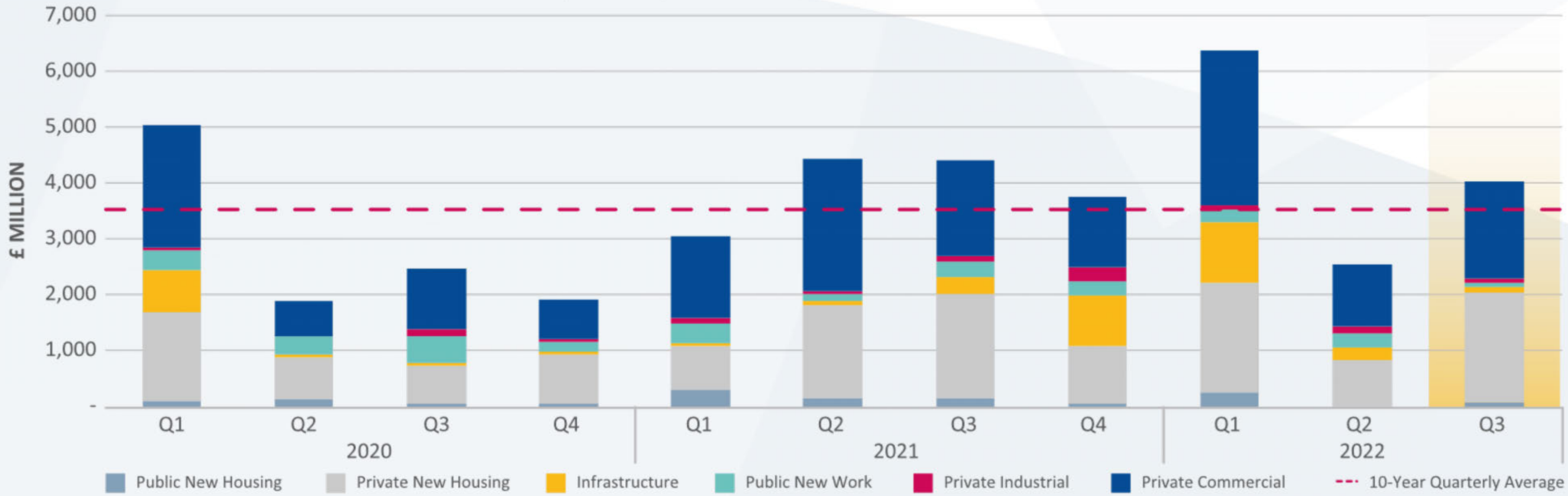
New orders in Q3 were £4bn – 14.4% above the ten-year average of £3.5bn

After a **60%** drop in Q2, London new order values partially recovered in Q3

Infrastructure **(-53%)**, public **(-64%)**, and private industrial work **(-42%)** all suppressed growth

While housing **(+142%)** and private commercial **(+55%)** performed strongly

LONDON CONSTRUCTION NEW ORDERS (Q-ON-Q) SECTOR



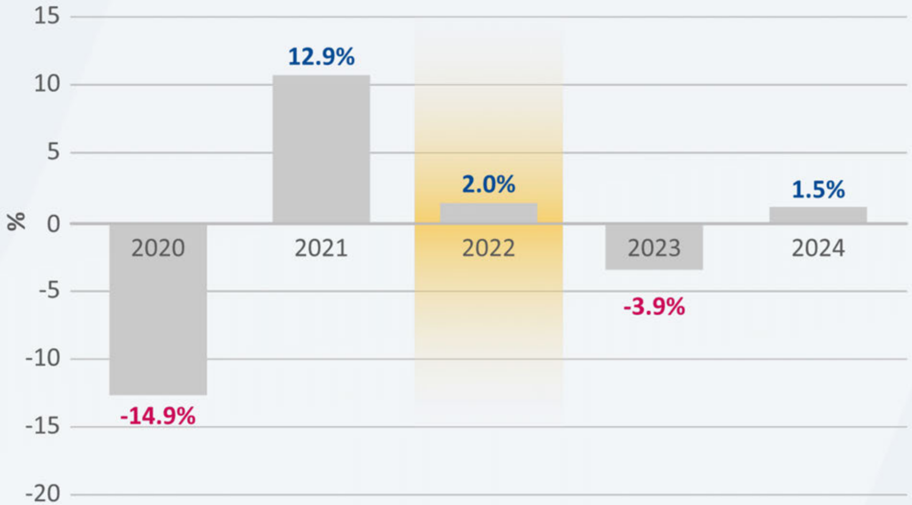
Source: ONS

Activity in the industry remains at a historically high level, but it will not be immune to the continuing market pressures.

Output volume growth forecasts revised down due to:

- Economic outlook/political uncertainty
- Rising interest rates resulting in lower disposable income and consumer spending
- Falling demand for new housing
- Construction cost inflation causing project viability concerns

CONSTRUCTION OUTPUT (% GROWTH)



Source: CPA

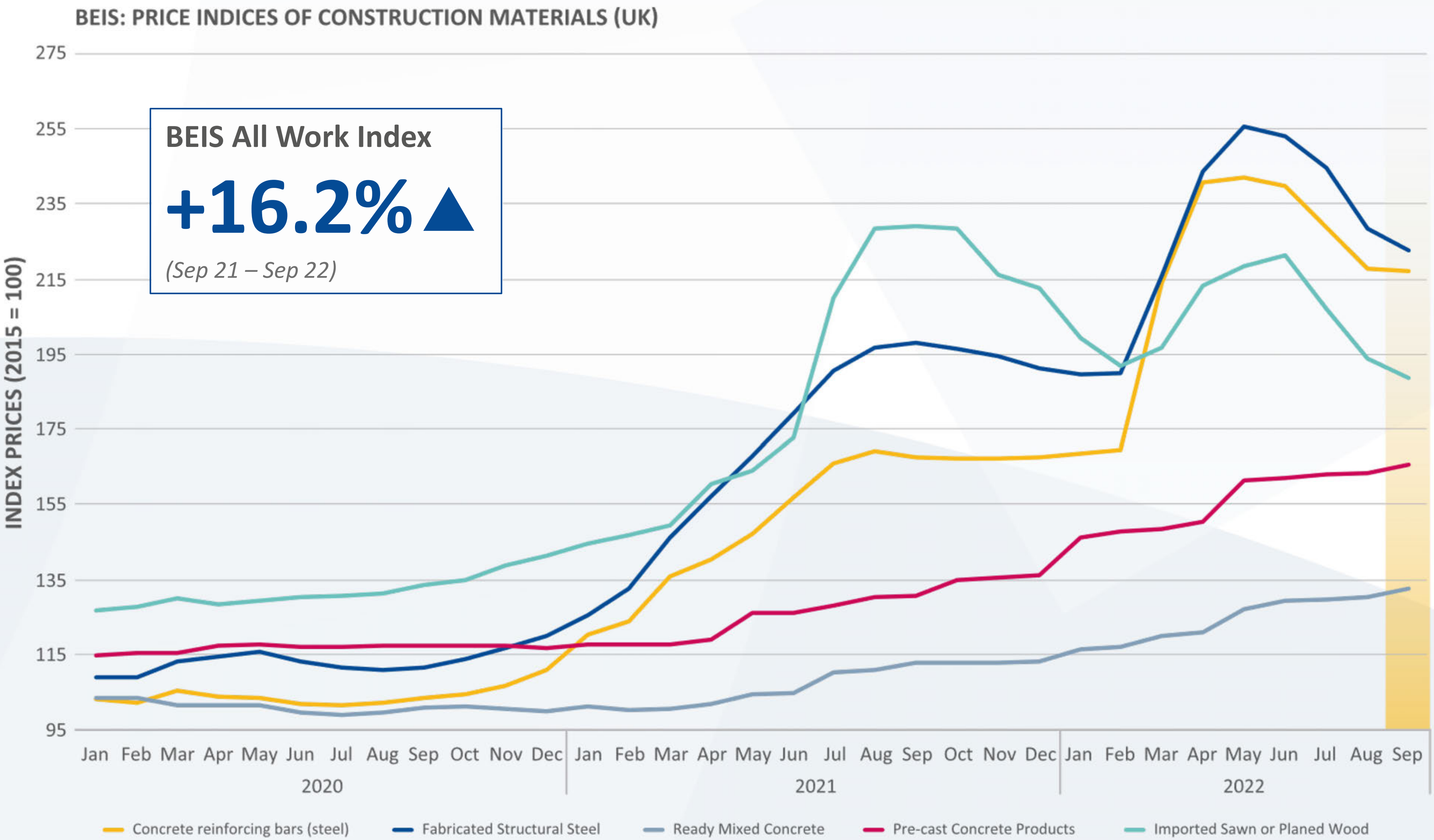
Industrial
Output remains strong but there are concerns warehouse investment has peaked.

Infrastructure
Growth due to increased activity in major projects but sustained cost inflation will hit budgets.

Residential
Falling incomes and rising interest rates to adversely affect demand for private housing.

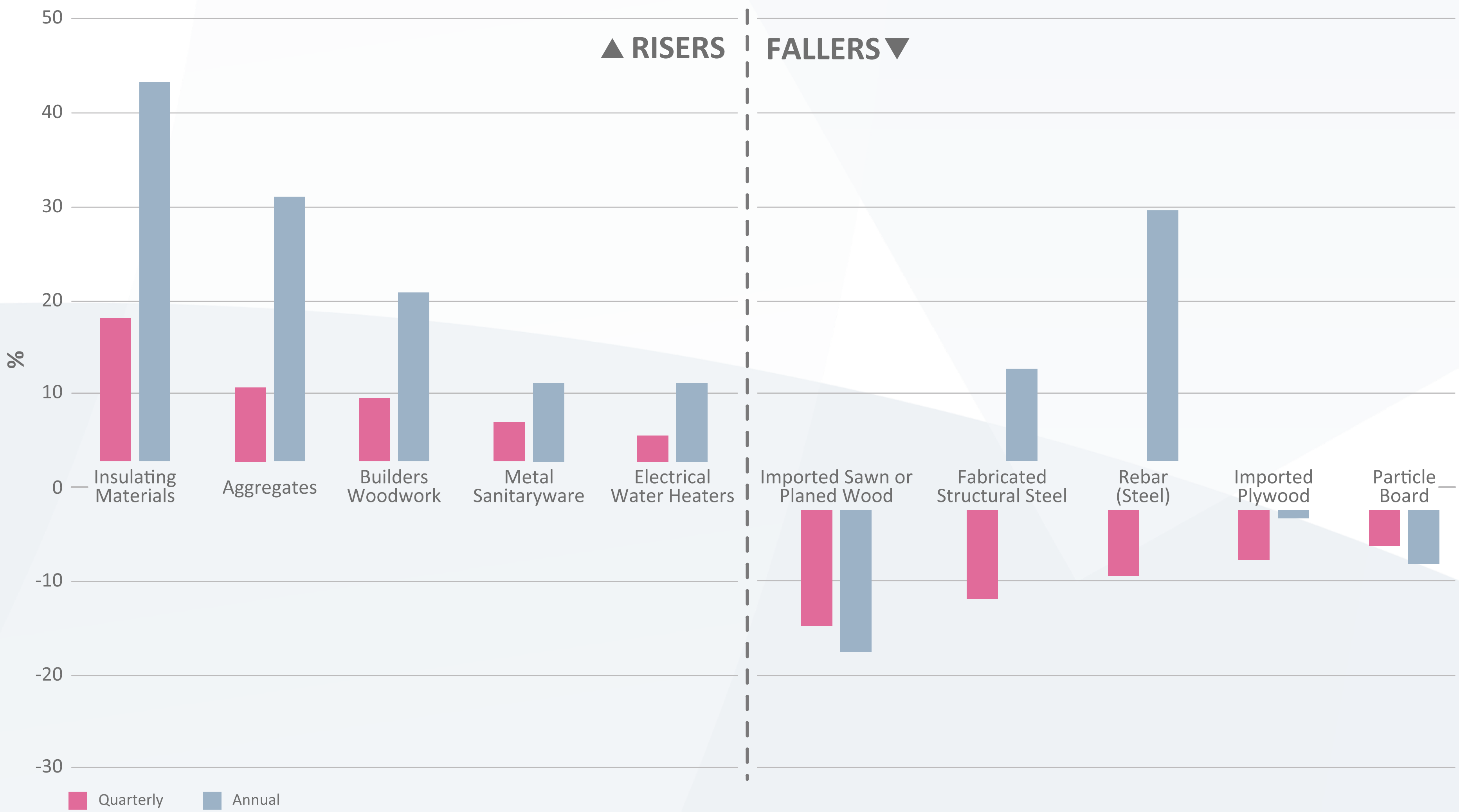
Commercial
Continued strong fit-out activity to be offset by delays to new tower projects in the pipeline paused for repricing.

02 / CONSTRUCTION MARKET TRENDS – MATERIALS & LABOUR


BEIS: PRICE INDICES OF CONSTRUCTION MATERIALS (UK)
INDEX PRICES (2015 = 100)
275
255
235
215
195
175
155
135
115
95
BEIS All Work Index
+16.2%
(Sep 21 – Sep 22)
Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec
2020
Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec
2021
Jan Feb Mar Apr May Jun Jul Aug Sep
2022
Concrete reinforcing bars (steel)
Fabricated Structural Steel
Ready Mixed Concrete
Pre-cast Concrete Products
Imported Sawn or Planed Wood

Source: BEIS

BEIS MATERIALS RISERS AND FALLERS: QUARTERLY V ANNUALLY



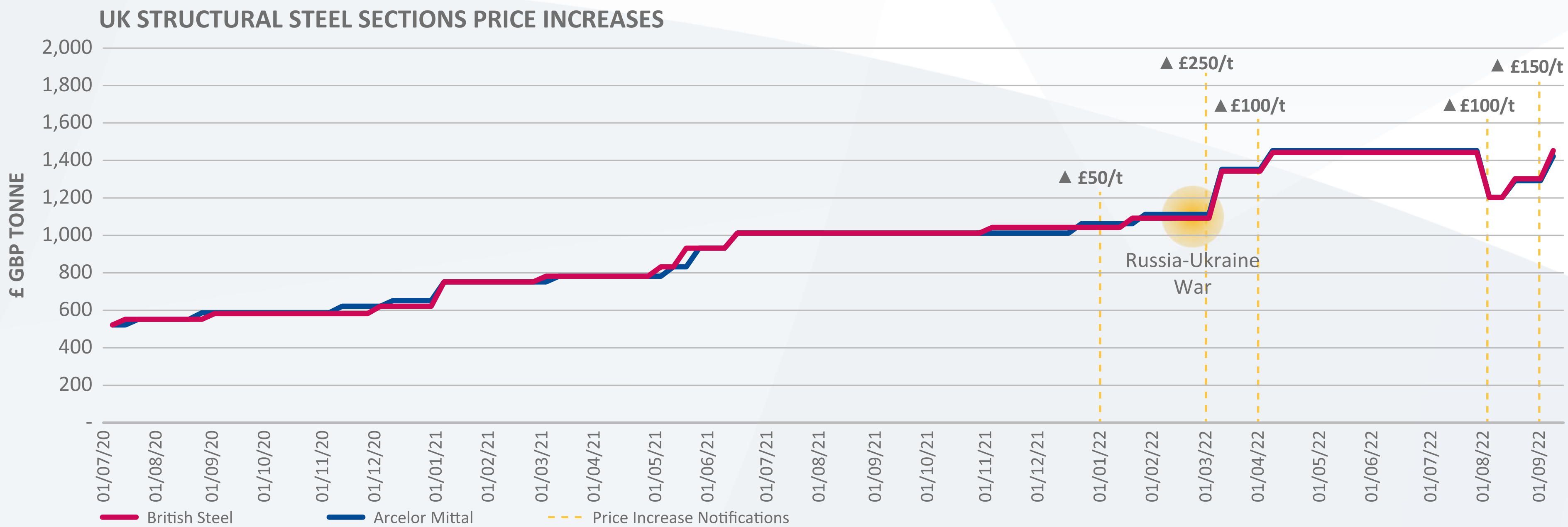
Structural steel prices up by almost 33% to £1,425/tonne

Energy markets react to Russian gas supply concerns

Oversupply to cool prices

Recent spike due to production and **transportation cost pressures**

Iron ore prices moderating to pre-pandemic levels



Source: *Bourne Steel*

The S&P GSCI Commodity Price Index has fallen c.16% since peaking in mid-June

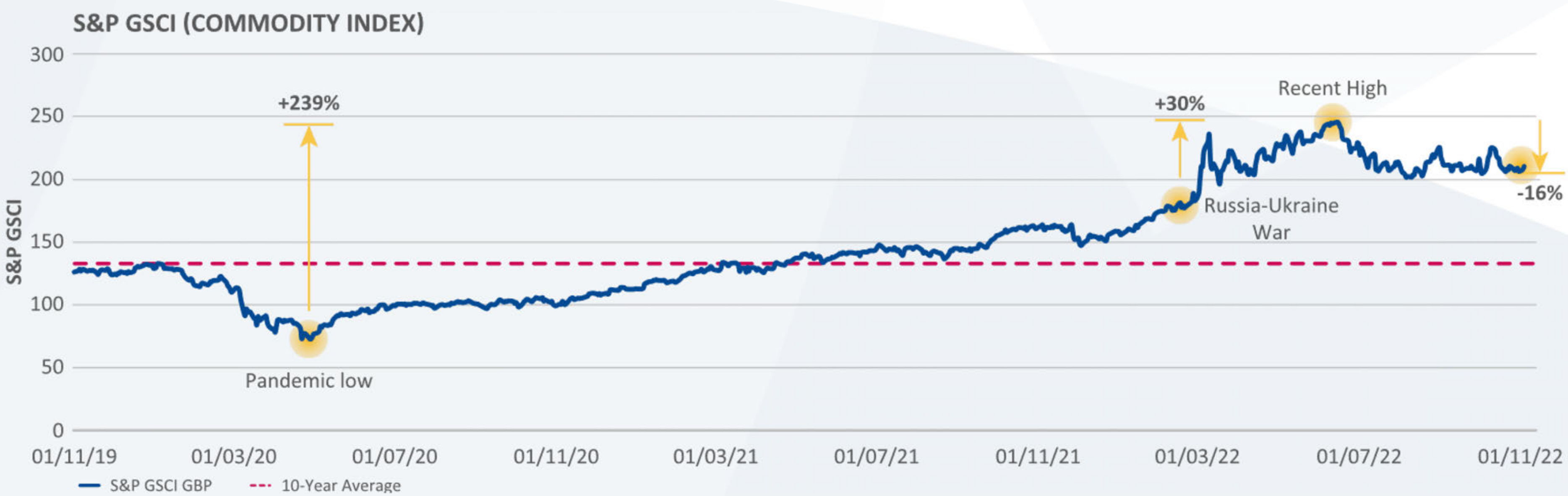
Post-pandemic bounce back in demand and recent supply challenges **triggered broad inflation**

Recession fears dampen commodities rally

Lower global building activity to **soften metals pricing**

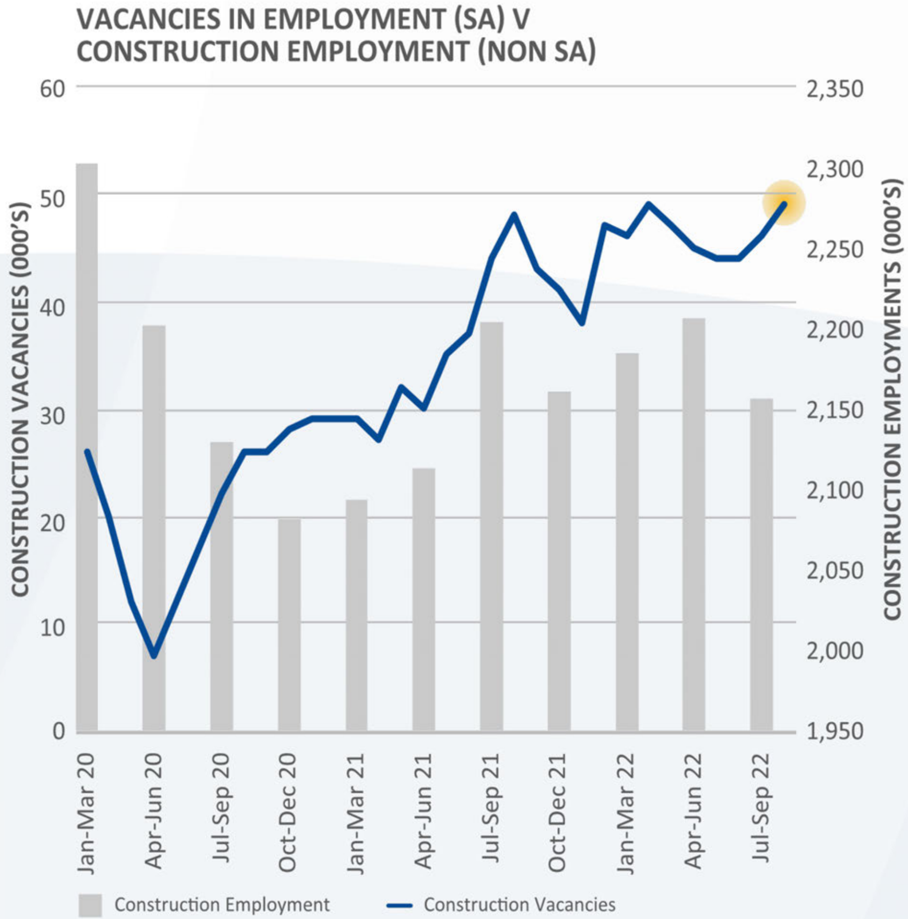
Risk of further **price volatility** due to ongoing geopolitical uncertainty

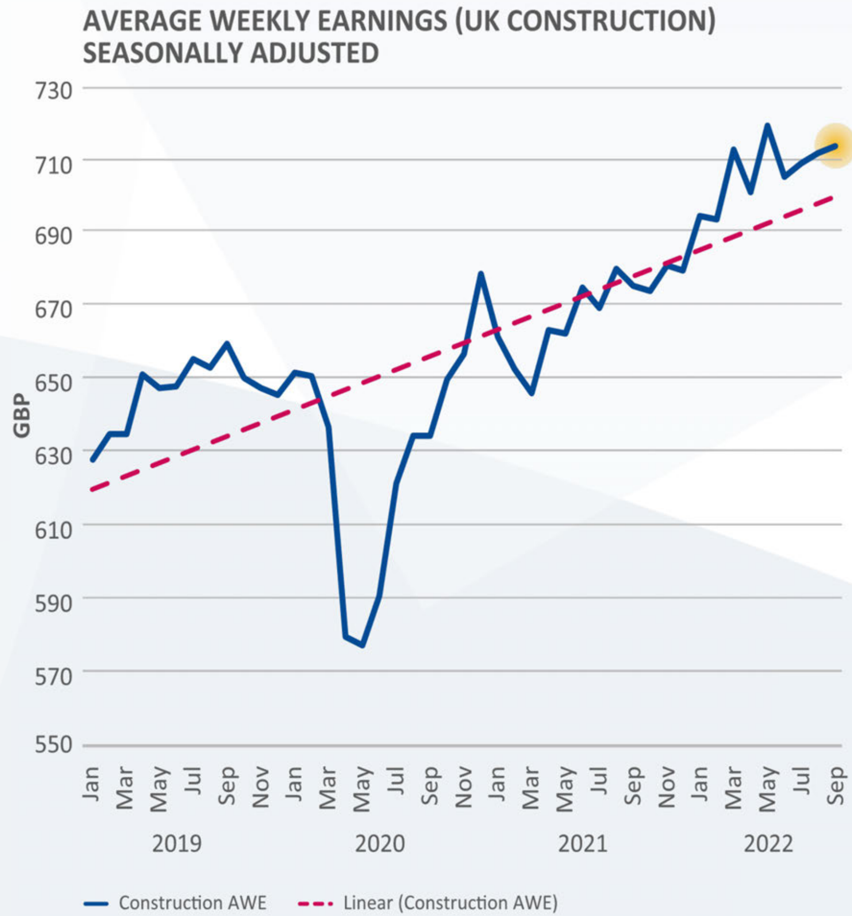
Commodity prices to remain structurally higher for some time due to supply challenges and threats



Source: *S&P Global*

Construction vacancies return to record-high levels. Average Weekly Earnings in September 2022 rose by 5.3% (on a year-on-year three-month average basis).



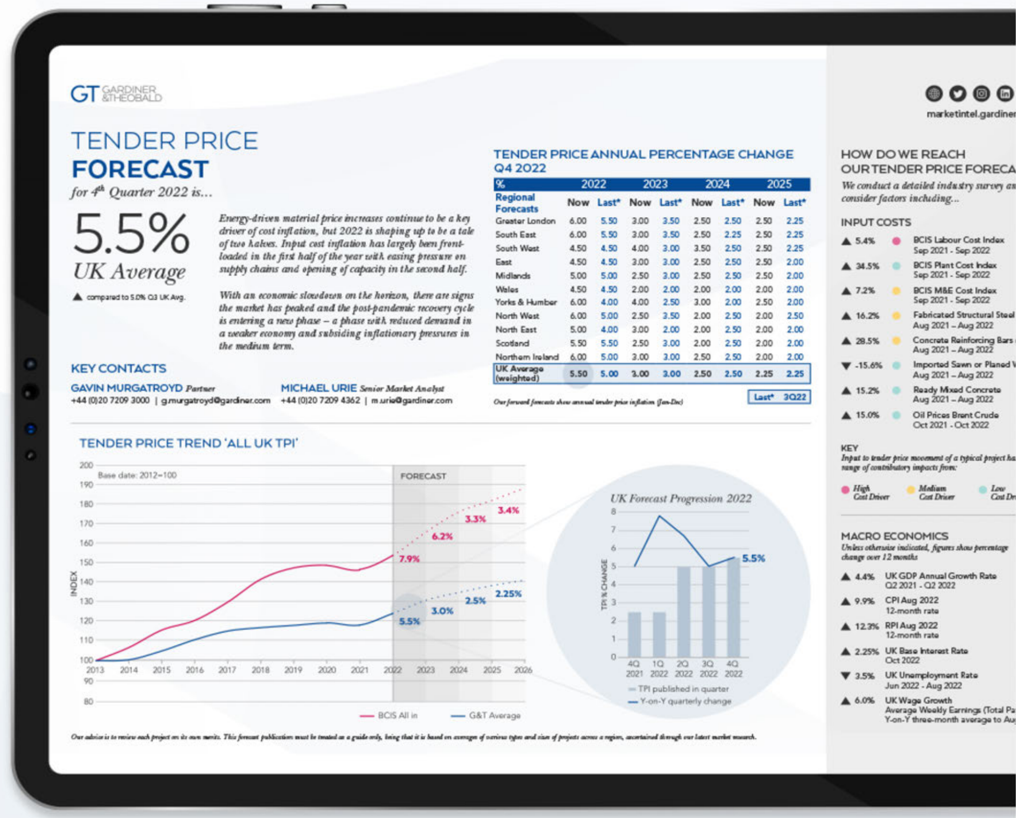


Source: ONS, Hudson Contract

03 / TRENDS IN ENERGY, TRADES AND TRANSPORT

*In our latest TPI, we noted the following market conditions in the **UK construction sector**:*

- **Some increased competition** to secure future pipelines
- Greater contractor capacity anticipated in 2023
- Contractors continue to be **selective**
- Higher **interest rates** to act on growth/activity with **deflationary pressures** mounting
- Recessionary conditions to **squeeze businesses' finances**
- Risk of **contractor insolvency** as borrowing costs continue to rise



Note: see ***G&T's Q4 2022 TPI report*** *for a more detailed analysis and insights into how market conditions are driving tender price inflation.*

*Russia started cutting gas pipeline flows to Europe before the war in Ukraine started, but **Europe now faces an indefinite halt to Nord Stream 1 supplies…***

The cut in supply:

- Initially caused a big spike in gas prices
- Inhibited economic growth in Europe
- Drove headline inflation higher
- Stoked concerns for future European gas shortages

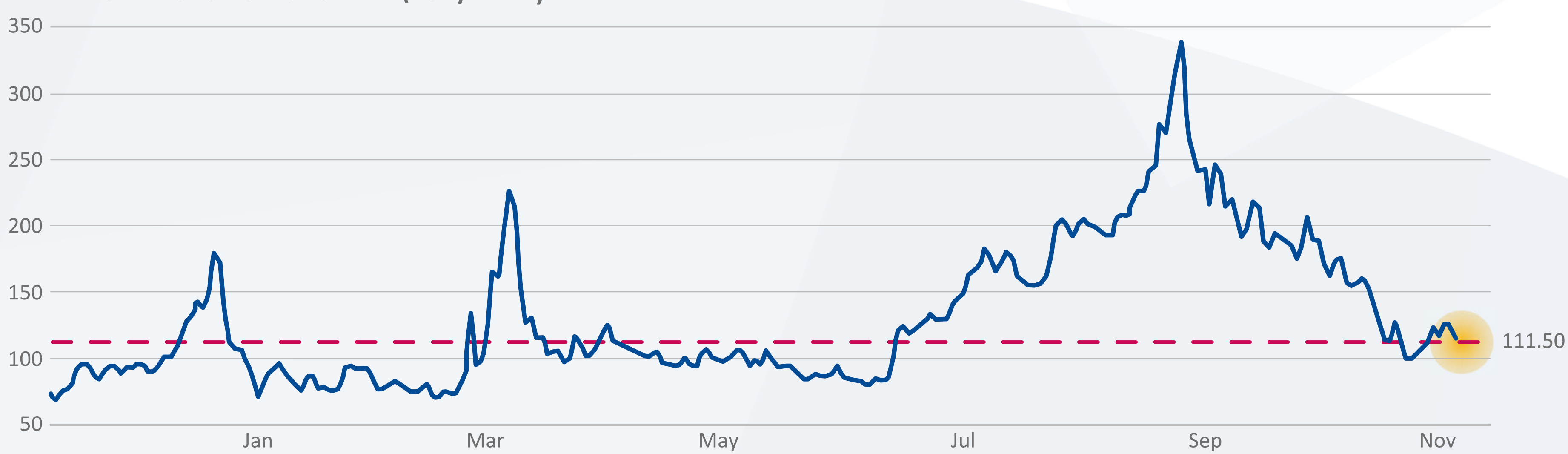
Why have wholesale gas prices fallen since September?

Improving supply outlook

Full/near full European gas inventories

Milder weather resulting in gas "demand destruction"

Lag effect from falling wholesale prices



Source: *Trading Economics, IMF*

Key Trade Analysis

Remains competitive

Demolition

OH&P

Moderately competitive

Substructure

Finishes

Frame

M&E

Drylining

Preliminaries

Joinery

Higher inflation to come

Façades

After spiking in September, the TEG Road Transport Price Index fell in October 2022...

Weaker pound pushed haulage prices higher in September

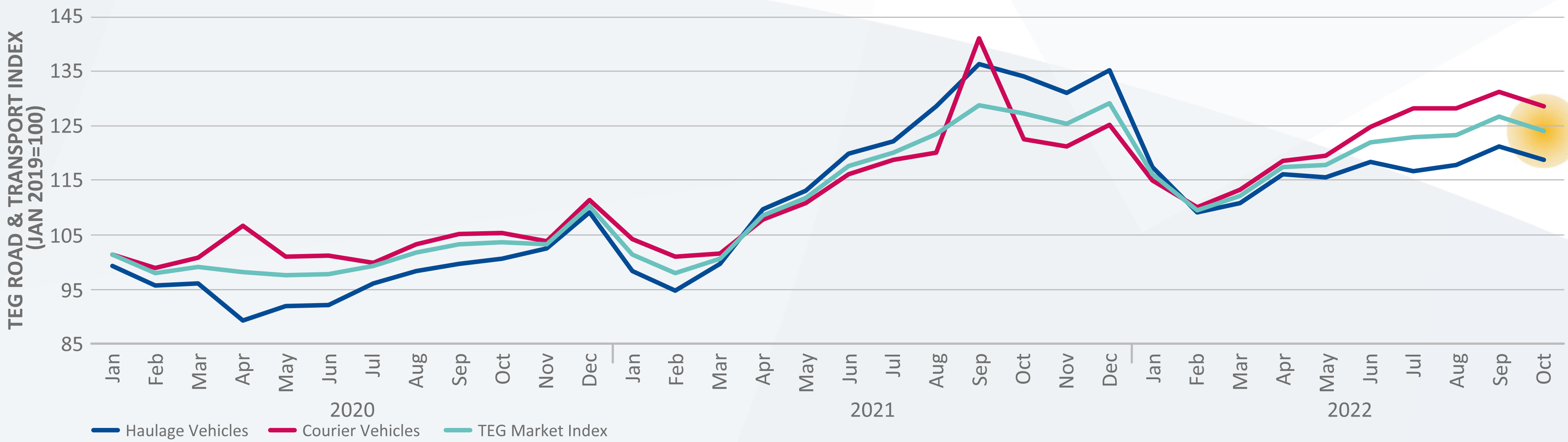
Lower spending/reduced demand prompted latest drop

Prospect of **recession to interfere** with traditional peak transport period

Higher driver numbers and **greener fleets** adding some downward pressure on costs

What does this mean for your project?

TEG ROAD TRANSPORT INDEX



***TEG Road Transport Price Index** charts the price per mile (ppm) for UK haulage and courier vehicles each month against a base of January 2019.*

Source: *Transport Exchange Group*

BDI has fallen c.75% from its peak in October 2021 and is now below the five-year index average…

Shipping **disruption abated**

Supply chain shocks/ bottlenecks eased

Lower shipping costs a relief to logistics budgets

Cooling demand to reduce freight volume growth

BALTIC DRY INDEX (BDI): SHIPPING COSTS

*The Baltic Dry Index (**BDI**) – an index of average prices paid for the transport of dry bulk materials (eg coal and steel) across 23 routes*

Source: *Investing.com*

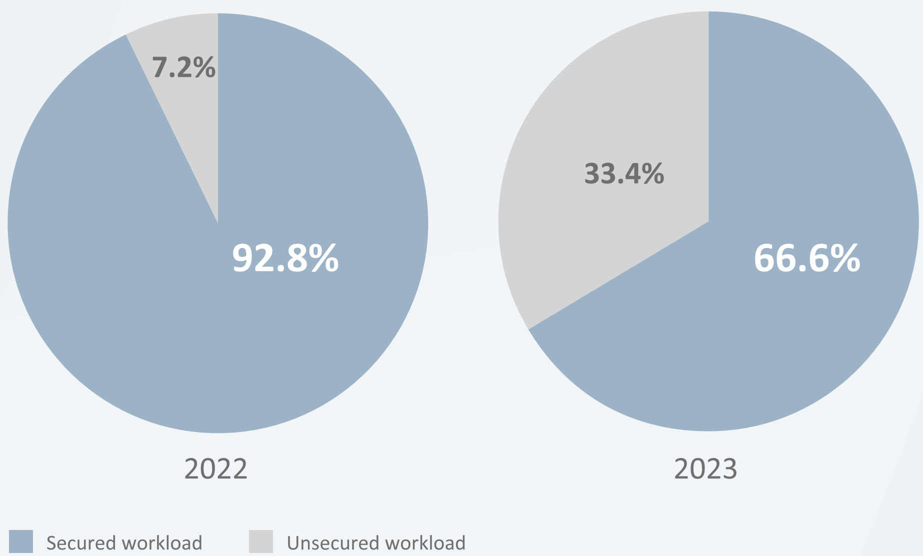
04 / M&E SPOTLIGHT – WHAT IS THE LATEST FROM THE SUPPLY CHAIN?

On average, contractors have 93% of 2022 workloads secured

One-third of 2023 workload capacity yet to be secured

More competitive tendering due to anticipated market downturn

AVERAGE SECURED WORKLOAD (2022 V 2023)

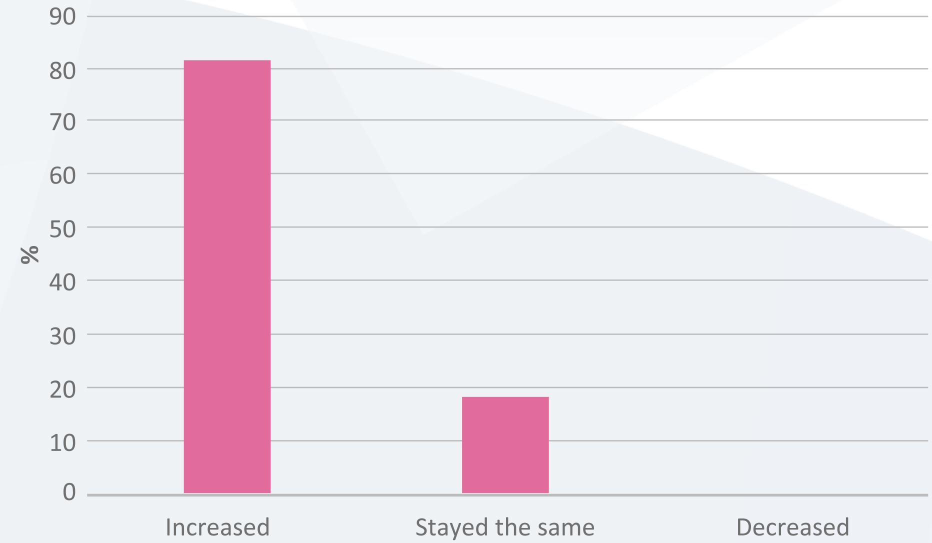


*Combined effects of Brexit, the pandemic and war in Ukraine pushing **lead times higher***

High demand for **chillers, generators, switchgear** and **air source heat pumps**

Global supply chain issues **causing delayed orders, extended delivery times and part shortages**

MEP PRODUCTS/MATERIALS LEAD TIMES: PAST SIX MONTHS



Market pressures currently driving M&E prices…

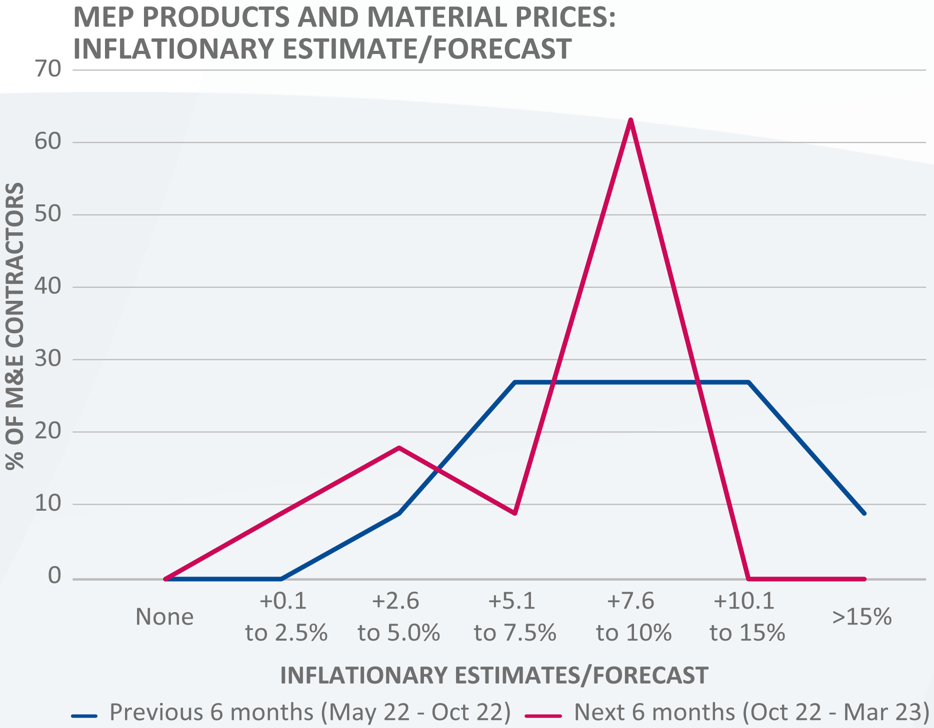
- Energy costs/fuel prices
- Material and labour availability
- Weaker pound and fixed price requests
- Financial pressure on suppliers/sub-contractors

Market risks for 2023…

- Further inflationary rises (fuel/energy-driven)
- Shortages of materials and long lead times
- Labour shortfall
- Exchange rate volatility
- Political/economic uncertainty slowing demand

Inflationary estimates for MEP products and materials are dropping compared to six months ago

While most respondents still expect inflation to be high (within a +7.6 to 10% range) over the next six months, fewer expect inflationary rises of 10% or more while nearly one-third expect inflation to fall within an even lower +0.1 to 5% range.



Upward pressure levelling off, but further cost pressures anticipated

Large variance in materials makes it difficult to provide a broad forecast

Ductwork prices steadied but insulation products seen big increases

M&E FOCUS: MARKET TRENDS & CHANGING BUSINESS MODELS

MEP Market Trends

Net zero carbon, social value and sustainability

Data information gathering for the use within smart buildings

MMC/DfMA being seen on more projects

Rapid advancement of new technologies

Strategic/business model **changes planned…**

- Looking at opportunities **from all angles** with more care/consideration
- **Strategic tendering** introduced
- Greater **focus on programme** and risk profile of projects
- **Pivoting** to develop capability in ‘recession-resilient’ sectors
- **Focus on sub-sectors** where “added value” can be provided

05 / TPI Q4 2022 & KEY RECOMMENDATIONS

Energy-driven material price increases continue to be a key driver of cost inflation, but 2022 is shaping up to be a year of two halves

UK Average Tender Price Forecast (2022)...

5.5%

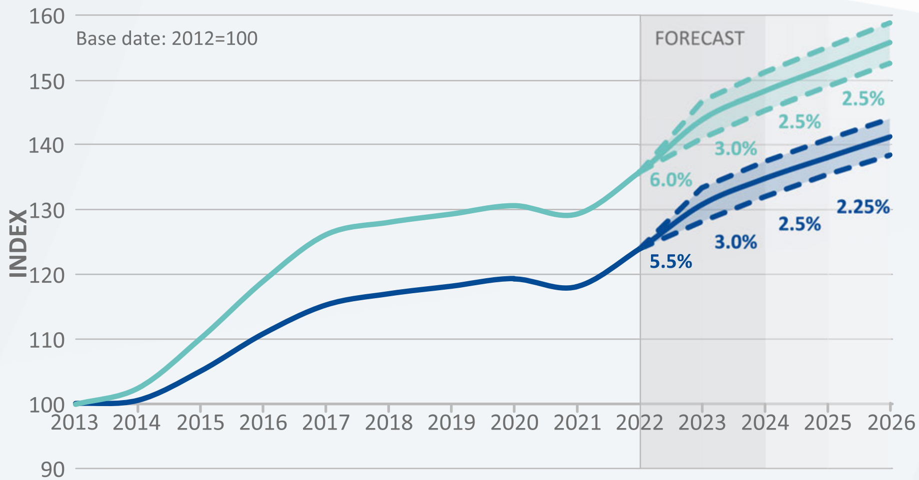
London Tender Price Forecast (2022)...

6%

Elevated inflation across the globe continues to impact every sector in the UK. Rising input costs are a threat to forward pipelines, but for the time being construction is benefitting from strong forward momentum.

Some inflationary pressures are set to ease in 2023, but we anticipate material production costs will remain elevated and the labour market tight.

G&T TENDER PRICE INFLATION FORECAST: UK AND LONDON



Graph shows indicative sensitivity on forecast TPI dependant on developing scenarios and evolution of inflationary pressures

TENDER PRICE ANNUAL PERCENTAGE CHANGE Q3 2022

%	2022		2023		2024		2025	
Regional forecasts	Now	**Last***	Now	**Last***	Now	**Last***	Now	**Last***
Greater London	6.00	**5.50**	3.00	**3.50**	2.50	**2.50**	2.50	**2.25**
South East	6.00	**5.50**	3.00	**3.50**	2.50	**2.25**	2.50	**2.25**
South West	4.50	**4.50**	4.00	**3.00**	3.50	**2.50**	2.50	**2.25**
East	4.50	**4.50**	3.00	**3.00**	2.50	**2.50**	2.50	**2.00**
Midlands	5.00	**5.00**	2.50	**3.00**	2.50	**2.50**	2.50	**2.00**
Wales	4.50	**4.50**	2.00	**2.00**	2.00	**2.00**	2.00	**2.00**
Yorks & Humber	6.00	**4.00**	4.00	**2.50**	3.00	**2.00**	2.50	**2.00**
North West	6.00	**5.00**	2.50	**3.50**	2.00	**2.50**	2.00	**2.50**
North East	5.00	**4.00**	3.00	**2.00**	2.00	**2.50**	2.00	**2.00**
Scotland	5.50	**5.50**	2.50	**3.00**	2.00	**2.50**	2.00	**2.00**
Northern Ireland	6.00	**5.00**	3.00	**3.00**	2.50	**2.50**	2.00	**2.00**
UK Average (weighted)	5.50	**5.00**	3.00	**3.00**	2.50	**2.50**	2.25	**2.25**

Last* 3Q22

Our forward forecasts show annual tender price inflation (Jan-Dec)

SUPPLY CHAIN

EARLY ENGAGEMENT WITH THE SUPPLY CHAIN

RISK RESPONSE

SET UP “BESPOKE” PROJECT RISK RESPONSE PLANS

STRATEGIES

FLEXIBLE PROCUREMENT STRATEGIES

CONTRACTORS

UTILISE OUR STRONG CONTRACTOR AND TRADE RELATIONSHIPS

PROCUREMENT

REVIEW OF BENEFITS FOR ALTERNATIVE PROCUREMENT ROUTES

CAPACITY

MATCH YOUR PROJECTS TO THE RIGHT CONTRACTOR AND THEIR CAPACITY

More opportunities in certain sectors for 2023

Settling market: less volatility but continued price growth

Contractor competition to fill emerging pipeline gaps

FIND OUT HOW WE CAN HELP...

https://marketintel.gardiner.com/

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Find out how we can help

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