TENDER PRICE INDICATOR

GARDINER & THEOBALD

Market Focus: Brexit's impact on UK labour market

2nd Quarter 2018

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ONE SPINNINGFIELDS

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Allied London

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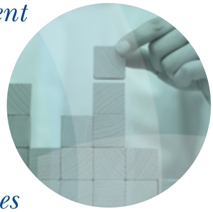
Our Tender Price Inflation report looks at the movement of prices in tenders for building contracts in the UK. The report examines a number of contributing factors including GDP, sterling, oil price, employment levels, input costs and construction output. This is further informed by our market survey responses and contractor consultations.



As UK economic growth slows, the construction industry appears less resilient with reduced levels of growth.

Faced with lack of clarity on Brexit and upward pressure on pricing, forecast demand for construction continues but at a slower rate than 2017. Against this back-drop we have left our UK average tender price forecast for the next three years unchanged from our last review.

London remains flat at 1% for 2018 and 0.5% for 2019, with reductions to 1.0% and 1.5% for 2020 and 2021. In the UK regions our forecasts for the majority remain unchanged, but the North, Scotland and Yorkshire are all down.

The North West bucks the trend with forecast increases to 2.5% in 2018 and 2.0% in 2019 on the back of increased demand.

Into 2022 we forecast a return to a normal growth market and have adopted our long-term average tender inflation rate. However our forward order survey is illustrating a reduction in demand and limited orders compared to our last quarter survey.

Our forecasts take account of all sectors and all project sizes as a statistical average indicating an overall trend in pricing levels. It should be remembered that individual projects may experience tender pricing above or below the average rate, reflecting the project specific components and conditions.

MACRO ECONOMICS

GDP OUTPUT ANNUAL CHANGE

▼ *1.2%* ▼

CPI APRIL 2018

▼ *2.4%* ▼

RPI APRIL 2018

▲ *3.4%* ▲

INTEREST RATE

◀ *0.5%* ▶

UNEMPLOYMENT

▼ *4.2%* ▼

ECONOMY

▲ *Weekly earnings 2.9%* ▲

Figures are cumulative annual. ▼▲ denotes movement trend.

UK economic growth slowed in the first quarter of 2018, with GDP down to 1.2%, both services and construction reducing output affecting headline figures. This was weaker than expected and has led to a reduction in overall forecast output to 1.4% from 1.8% in 2018.

The Consumer Price Index (CPI) measure of inflation reduced to 2.4% in April down from 2.5% in March. There is still upward pressure on inflation as the pass through of higher fuel oils has not yet registered.

The Retail Price Index (RPI) measure of inflation conversely rose marginly to 3.4%.

Interest rates remained on hold at 0.5% in May with the mooted rate rise scuppered by the lacklustre growth data for the first quarter. Interest rates are now not expected to rise until the end of the year.

CONSTRUCTION OUTPUT AND REGIONAL DIFFERENCES

The Construction Products Association (CPA) latest forecast is anticipating zero growth in 2018. A rise in private housing and infrastructure activity is likely to be offset by a slowdown in work across commercial, industrial and health sectors.

Private housing is forecast to grow 2% per annum to 2019 and infrastructure by 6.4% in 2018 and 13.1% in 2019. In contrast commercial offices are predicted to fall 20% this year and 10% in 2019.

Over 2017 we found the following changes in output:

- Construction market outputs in the North West rose 19%, the South West up 17%, North East up 16% and East Midlands up 13%.
- Growth was also strong in Yorkshire and Humber up 10%, West Midlands up 8%, South East up 8%, East of England and Wales both up 6%.
- In contrast, construction output in London fell by 6% and by 3% in Scotland.

In London, the decline was due to a drop in commercial office work, although the residential and infrastructure sectors remain more upbeat.

Our regional tender price forecasts reflect these differences.

INPUT COSTS - YEAR ON YEAR

M&E COMPONENTS

▼ *3.2%* ▼

STRUCTURAL STEEL

▲ *4.0%* ▲

REINFORCEMENT

▼ *3.5%* ▼

CONCRETE

▲ *2%* ▲

OIL PRICES

▲ *US$75 bbl* ▲

CONSTRUCTION INDUSTRY

▼ *Weekly earnings 2.9%* ▼

MARGINS

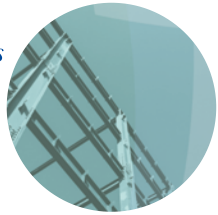
◀ *Flat* ▶

MANUFACTURING OUTPUT

▼ *2.9%* ▼

Figures are cumulative annual. ▼▲ denotes movement trend.

Building cost indicators recorded further increases in the first quarter of 2018, through a combination of new year price rises and pass through of sterling depreciation on restocking.



General building costs rose at a slower rate than those of mechanical and electrical components, but both recorded 1.5% and 2.9% respectively higher costs than the first quarter a year ago.

In April aluminium prices rose to their highest level in three years due to impending sanctions from the US government on Russia, which produces a significant portion of the world's aluminium. Sanctions are still being clarified and volatility is to be expected in market pricing which could impact component costs, however costs have returned to pre sanction levels for now.

Fuel oils rose further in the quarter to over US$75bbl recorded in April, as sanctions are imposed on Tehran following the US nuclear deal fallout.

LABOUR RATES

Average weekly earnings increased at a rate of 2.9%, the first time in more than a year that the rate of increase was higher than headline inflation at 2.5%.

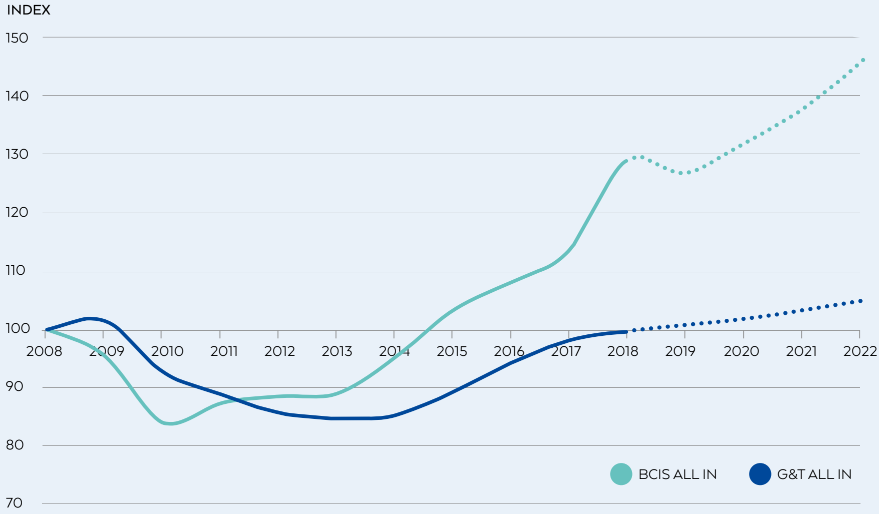
This growth in real wages will benefit consumer demand, but will take a more sustained period of increase to ensure more resilience to compound overall demand, which could be difficult given the public sector 1% cap.

Construction rates of pay have fallen back in the period and are now at parity with average weekly earnings at 2.9% annualised.

UNEMPLOYMENT

The UK unemployment rate fell in the three months to March to 4.2%, the lowest level since 1975. The number of people recorded in work increased by 197,000 to 32.3 million, with 75.6% of people aged from 16 to 64 now in work.

TENDER PRICE TREND "ALL UK TPI" 1Q 2018



TENDER PRICE TREND "LONDON TPI" 1Q 2018

Note: BCIS do not publish regional forecasts only records of prices received

TENDER PRICE ANNUAL PERCENTAGE CHANGE 1Q 2018

%	2018		2019		2020		2021		2022	
Regional forecasts	Now	Last	Now	Last	Now	Last	Now	Last	Now	Last
Greater London	1.00	1.00	0.50	0.50	1.00	1.50	1.50	2.00	2.00	2.50
South East	0.50	0.50	0.50	0.50	1.00	1.50	1.50	2.00	2.00	2.50
South West	0.50	0.50	0.50	0.50	1.00	1.25	1.50	2.00	2.00	2.50
East Anglia	1.00	1.00	1.00	1.00	1.50	1.50	2.00	2.50	2.00	2.50
Midlands	1.00	1.00	1.50	1.50	1.50	1.50	2.00	2.50	2.00	2.50
Wales	0.50	0.50	0.50	0.50	1.50	1.50	2.00	2.00	2.00	2.00
Yorks & Humber	1.00	1.00	1.00	1.25	1.00	1.50	1.50	1.50	1.50	2.50
North West	2.50	2.00	2.00	1.50	1.50	1.00	1.75	2.50	1.75	2.50
North	1.00	1.00	1.00	1.00	1.50	1.50	1.50	2.00	2.00	2.00
Scotland	1.00	1.00	1.00	1.50	1.50	1.50	1.50	2.00	2.00	2.50
Northern Ireland	1.00	1.00	1.00	1.00	1.50	2.00	1.50	2.00	2.00	2.00
UK Average	**1.00**	**1.00**	**1.00**	**1.00**	**1.50**	**1.50**	**1.50**	**2.00**	**2.00**	**2.50**

Note: 2022 is long term average market forecast

COMPARISON OF PUBLISHED FORECASTS FOR TENDER PRICE CHANGE

	G&T UK AVER.	BCIS UK AVER.	G&T LONDON	AECOM LONDON	ARCADIS LONDON
	2Q TO 2Q	MAY 18	2Q TO 2Q	1Q18	SPRING 18
	% CHANGE				
2018	1.00	1.60	1.00	1.80	2.00
2019	1.00	1.90	0.50	2.00	3.00
2020	1.50	4.30	1.00	2.50	4.00
2021	1.50	4.50	1.50	N/A	4.00
2022	2.00	6.00	2.00	N/A	4.00

Note: All figures relate to year on year quarterly changes

There continues to be a great deal of concern about the effect of Brexit on the UK labour market, and the impact on the construction industry in particular given its reliance on a European sourced workforce.

Recent research has highlighted shifting dynamics of the UK labour market:

- A rise in the number of UK workers planning to emigrate to the EU
- Increased employee anxiety on the ability to recruit lower-skilled EU workers into the UK
- Regional draining of workers to London from other parts of the country
- The border in Northern Ireland

With Brexit under a year away, the percentage of British-based workers planning to emigrate to the EU has returned to the same levels seen in the immediate days following the UK's vote to leave the EU. The world's largest job platform, Indeed, has released data showing that the share of UK jobseekers looking for EU-based roles has risen to 15.2% above pre-referendum levels.

A study of HR professionals has shown that nearly half think that the UK is less attractive to EU candidates due to Brexit and most conclude that leaving the EU will have "long-term" impact on the UK's supply of labour. According to a poll of recruiters, the sectors which are likely to feel the biggest impact on hiring as a result of Brexit are healthcare (13%), manufacturing (11%), construction (11%), education (11%), banking and finance (11%) and retail (10%).

Lower skilled employees will potentially be impacted by proposed tighter restrictions in the Immigration White Paper expected by the end of this year, which is considering caps on the number of lower earners. This provision was recently highlighted by an NHS study which suggests that such policies are draining the supply of unskilled labour and lead to labour shortages.

The Office for National Statistics most recent figures show a drop in EU net migration to 90,000 over 12 months, less than half pre-referendum levels. The number of EU nationals working in the UK has dropped by 28,000 to 2.29 million, the first fall since 2010. There is evidence to suggest that UK employers are now starting to recruit outside of the EU to fill those gaps.

A survey from the Scottish Building Federation (SBF) showed growing concerns among construction companies that Brexit will increase labour costs. The SBF also highlighted the negative impacts on the local construction sector, as labour would potentially move to London as companies in the UK capital provided better opportunities for a smaller pool of labour due to Brexit.

Pure economics dictates that a constrained labour supply with continued demand will cause higher labour costs for construction. The question is whether the Brexit effect will be balanced against the impact of slowing demand for output. Again pure economics would dictate that lack of demand will alleviate price increases as it is better to work for lower pay than to have no work.

Are we at a tipping point for labour price change?

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Our advice is to review each project on its own merits. This forecast publication must be treated as a guide only, being that it is based on averages of various types and sizes of projects across a region, ascertained through our latest market research. The quality, both of design and desired end product, procurement route (particularly ownership and transfer risk), delivery timescales, complexity of design and desire of contractors to tender should be carefully considered in project specific estimates and their outturn cost.

Suitable allowances should be made for project specific designs, site conditions and local market conditions, which should be reviewed regularly with your Gardiner & Theobald team to determine the appropriate base cost.

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