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TENDER PRICE **FORECAST**

for 3rd Quarter 2022 is...

5%

UK Average

compared to 5.0% Q2 UK Avg.

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 sharp reductions in commodities from their Q2 peak.

Some inflationary pressures on material prices, may begin to ease in 2023, but we anticipate production costs will remain elevated and supply constrained. The current labour dynamics will also ensure upward pressure unless cooled by a significant drop off in demand.

There are several risks that could push construction costs and tender inflation higher than forecasted, but these have to be considered against the deteriorating macroeconomic conditions and negative impact on demand for construction.

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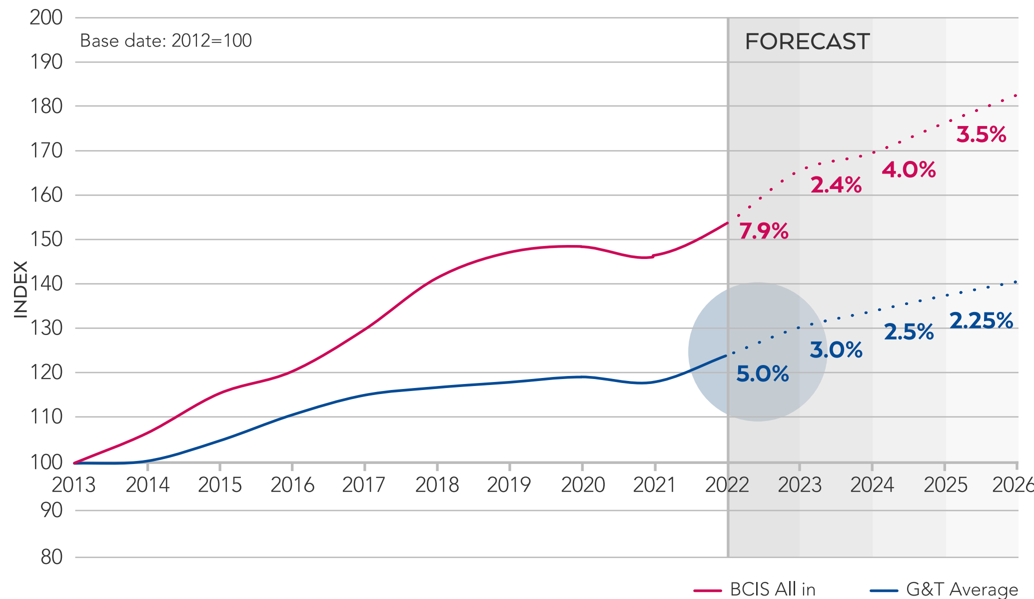
TENDER PRICE ANNUAL PERCENTAGE CHANGE Q3 2022

%	2022		2023		2024		2025	
Regional forecasts	**Now**	**Last***	**Now**	**Last***	**Now**	**Last***	**Now**	**Last***
Greater London	5.50	5.50	3.50	3.50	2.50	2.50	2.25	2.25
South East	5.50	5.50	3.50	3.50	2.25	2.50	2.25	2.25
South West	4.50	4.50	3.00	3.00	2.50	2.50	2.25	2.25
East	4.50	4.50	3.00	3.00	2.50	2.50	2.00	2.00
Midlands	5.00	4.50	3.00	3.00	2.50	2.50	2.00	2.25
Wales	4.50	4.50	2.00	2.00	2.00	2.00	2.00	2.00
Yorks & Humber	4.00	4.00	2.50	3.00	2.00	2.00	2.00	1.75
North West	5.00	4.00	3.50	3.00	2.50	2.50	2.50	2.25
North East	4.00	4.00	2.00	3.00	2.50	2.50	2.00	2.00
Scotland	5.50	5.50	3.00	3.00	2.50	2.50	2.00	2.00
Northern Ireland	5.00	5.00	3.00	3.00	2.50	2.50	2.00	2.00
UK Average (weighted)	**5.00**	**5.00**	**3.00**	**3.00**	**2.50**	**2.50**	**2.25**	**2.25**

Last* 2Q22

Our forward forecasts show annual tender price inflation (Jan-Dec) with a base date of 1st May 2022

TENDER PRICE TREND 'ALL UK TPI'



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.

HOW DO WE REACH OUR TENDER PRICE FORECAST?

We conduct a detailed industry survey and consider factors including...

INPUT COSTS

- ▲ 3.1% — BCIS Labour Cost Index, May 2021 - May 2022
- ▲ 35.3% — BCIS Plant Cost Index, May 2021 - May 2022
- ▲ 9.2% — BCIS M&E Cost Index, May 2021 - May 2022
- ▲ 52.7% — Fabricated Structural Steel, May 2021 – May 2022
- ▲ 64.9% — Concrete Reinforcing Bars (Steel), May 2021 – May 2022
- ▲ 28.8% — Imported Sawn or Planed Wood, May 2021 – May 2022
- ▲ 15.2% — Ready Mixed Concrete, May 2021 – May 2022
- ▲ 37.3% — Oil Prices Brent Crude, July 2021 - July 2022

KEY

Input to tender price movement of a typical project has a range of contributory impacts from:

High Cost Driver · *Medium Cost Driver* · *Low Cost Driver*

MACRO ECONOMICS

Unless otherwise indicated, figures show percentage change over 12 months

- ▲ 8.7% — UK GDP Annual Growth Rate, Q1 2021 - Q1 2022
- ▲ 9.1% — CPI May 2022, 12-month rate
- ▲ 11.7% — RPI May 2022, 12-month rate
- ▲ 1.25% — UK Base Interest Rate, June 2022
- ▲ 3.8% — UK Unemployment Rate, February 2022 - April 2022
- ▲ 6.8% — UK Wage Growth, Average Weekly Earnings (Total Pay), Y-on-Y three-month average to April 2022

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Our Tender Price Inflation report looks at the movement of prices in tenders for construction contracts in the UK. The report examines a number of contributing factors and is further informed by our market survey responses and contractor consultations. This forward forecast illustrates our view of annual tender price inflation from January to December 2022.

OUR FORECASTS

We are now four months into the Russia/ Ukraine conflict and the world has a far better understanding of the disruptive impacts and costs that have stemmed from the war.

Global supply chains have become far more resilient and proficient at adapting to supply chain disruptions in recent years, but models are not equipped for continued uncertainty. There are still unknowns regarding the length and severity of disruptions and reinventing supply chains to accommodate for this is no easy task. Historically, Europe has been dependent on a number of Ukrainian and Russian-made materials and products and so the disruptive impact of the conflict has forced companies to seek alternative sources of supply. Trade sanctions and embargos applied against Russia has resulted in a global loss of supply for several key commodities, putting a strain on production capacity elsewhere and resulting in additional costs.

Elevated inflation across the globe has impacted every sector and UK construction is no exception. The post-pandemic rebound that was building prior to the conflict has come to a halt following broad-based inflationary pressures and the risk of stagflation or recession. Elevated costs are a threat to the forward pipeline but for the time being, the UK construction sector has strong positive momentum that has carried over into this year from 2021. Construction activity is still in growth territory, but some early indicators suggest a loss of confidence in recent months as pressure on input costs build.

Independent growth forecasts across the western world have been cut due to the anticipated effects of inflation on demand. A combination of factors, including higher interest rates, higher taxes, reduced trade and more expensive energy, have hit the UK. Many of these factors are a result of global pressures which are difficult to fully insulate against, but as we explore in this report, domestic or home-grown pressures have also been building, becoming more embedded in pricing decisions.

There is still a steady stream of tendering opportunities coming through as post-COVID projects obtain planning permission, but a slight drop-off in tendering activity is being reported by the supply chain. This could create gaps in contractors' workloads and order books further down the line, but for now, with positive growth dynamics from unleashed pent-up, post-pandemic demand, one of the key challenges is to keep projects on track in terms of lead times and cost. With high inflation, contractors are finding it increasingly difficult to agree terms and are understandably nervous about committing to long-term fixed prices. Input costs are unlikely to fall significantly in the immediate future, therefore the affordability and viability of projects are being closely appraised by clients which is leading to some delays on contractor appointment and project starts.

So, what does this mean for our tender price inflation forecasts? For now, our forecasts remain largely unchanged from our previous (Q2 2022) TPI report with our UK weighted average staying at 5% for 2022. We acknowledge that there are a number of risk factors that could push construction costs and tender price inflation even higher, for now these are largely potential risks and have to be considered against the deteriorating macroeconomic conditions and any negative impact these might have on demand for construction. Because inflation has a project, region and sector-specific element which a single index cannot account for, a number of projects will experience inflationary uplifts greater than our weighted UK average forecast of 5% this year.

We envision that some inflationary pressures will start to ease back in the second quarter of 2023, but this is partly contingent on any further escalation of the Russia-Ukraine conflict and whether Russia continues to squeeze or shut off pipeline gas supply to Europe. Once the rate of inflation plateaus, we do not expect a large correction or reduction in construction costs. External factors and pressures acting on material prices may ease but we anticipate production costs will remain elevated and supply constrained for several key construction materials. The current labour market dynamics, with widespread shortages of skilled labour supply and near-record vacancy levels, will ensure upward pressures on labour rates for some time to come unless cooled by a significant drop off in demand.

A hard landing scenario would likely dent confidence and development would consequently slow, but this in turn could increase tendering competition as contractors become more competitive with preliminaries costs and overheads and profits. In short, while the immediate trend for inflation is up it is increasingly difficult to predict into 2023 and beyond. A levelling off in tender price inflation is on the horizon, but to what extent inflationary forces subside has become a progressively more difficult question to answer due to the uncertain economic outlook and a range of underlying risk factors.

Because of the level of uncertainty, we continue to use our TPI fan chart that was first published in our report on the impact of the Russia-Ukraine conflict on construction. This chart shows the potential range of inflationary increases to tender pricing depending on how the conflict (and subsequent macro-economic conditions) might develop and evolve from this point.

All forecasts in this report take account of all sectors and 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 published average rate, reflecting the project specific components and conditions.

THE ECONOMY

After contractions in both March and April, UK economic activity returned to growth in May. To the surprise of economists GDP output grew by 0.5% between April and May. A flat performance had been expected as surging prices hit household spending and business activity, but all main sectors of the economy grew, likely due to the recovery in supply chain disruptions enabling manufacturers to fulfil a backlog of orders, as well as greater spending on travel. Consumer-facing services performed less well, with the cost-of-living crisis taking a toll on consumer spending. Household disposable income is set to come under even greater strain in the Autumn as the energy price cap increases, adding to the risk of recession.

Inflation is undesirably high and is expected to stay this way for some time to come. Inflationary metrics show pressures are broadening and intensifying leaving the Bank of England (**BoE**) with a difficult balancing act of reversing nearly a decade of ultra-loose monetary policy to tackle inflation while avoiding significant falls in spending and output growth.

According to BoE Governor Andrew Bailey, 80% of price rises come from abroad (ie 'imported inflation') and the UK central bank has little control over these pressures. However recent incoming data shows there is a growing element of domestic inflation being embedded in companies' domestic pricing decisions, supported by excessive domestic demand.

With domestic inflationary pressures building and compounding the pressure of imported inflation on the economy, more robust policy moves could be needed. Ending this period of unanticipated and entrenched inflation is likely to require further interest rate hikes, with money markets pricing in a year end interest rate of 3%. While the BoE could adopt a more gradual and limited uplift in interest rates, rises to date have already started to negatively impact output growth.

The UK economy slowed to a crawl according to the latest set of PMI surveys, with forward looking indicators hinting that worse is to come. Headwinds of soaring prices, supply delays and labour shortages have pared back growth prospects, prompting some forecasting bodies, such as the OECD, to project looming stagnation next year. The economic authority says the UK is poised for the weakest growth in the developed

world due to global pressures and the UK's current fiscal stance (ie the combined impact of all Government decisions on taxing and spending).

According to KPMG – which is forecasting a significant risk of mild recession next year – recently said that likely policy actions to combat inflation, if combined with further fallouts from geopolitical tensions, could see annual GDP growth shrink to just 0.7% in 2023. KPMG also notes three developments which could push the UK into recession:

- A potential US recession arising from a significant monetary tightening by the US Fed
- A potential Eurozone recession due to interruptions of gas supplies from Russia, as well as a significant additional shock to global wholesale gas and oil prices
- An ongoing and worsening squeeze on UK household incomes leading to a sharp decline in household consumption

The overall economic outlook is contingent on any further deterioration in Russian energy supply and further lockdowns in China as a result of its zero COVID policy. These supply issues could significantly worsen the outlook.

On the positive side, the rate of inflation could soon peak. While a lot hinges on energy price cap announcements and whether increased labour earnings rise enough to create a wage-price spiral, there is broad consensus among economists and forecasting bodies that the headline rate of inflation (CPI) has either peaked or will do so soon. Supply issues are expected to gradually ease during the course of this year and certain goods categories begin to contribute less and less to the overall rate of inflation. However, the tight UK labour market may put some pressure on pay in the short-term, which will likely be passed onto consumers through higher prices. Even so, a number of economists expect that from Q2 2023 onwards, the headline rate of inflation will fall as quickly and dramatically as it rose with the BoE forecasting CPI to be close to 2% in around two years.

Regardless of the timeline, as with all inflationary bursts, the rate of inflation will eventually cool. Rising interest rates and the growing cost-of-living crisis will help see to that. The questions is what type of landing we have during any inflationary descent - 'Hard' (ie a sudden, sharp economic slowdown) or 'soft' (a cyclical or gradual slowdown that avoids recession, with interest rates raised just enough to stop an economy from overheating without causing a severe downturn). While the jury is still out on this, many suspect that a soft landing is becoming a distant dream, but something in between – a 'bumpy landing' – is still very possible.

CONSTRUCTION OUTPUT AND NEW ORDERS

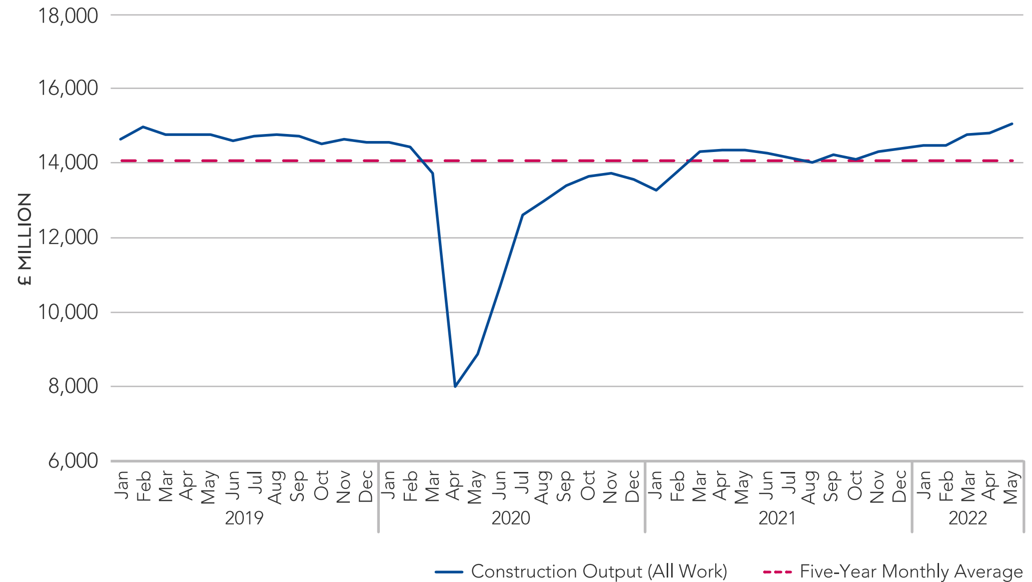
ONS data shows UK construction output defied expectations and grew by 1.5% in May 2022. May marked the seventh consecutive month of growth, culminating in a record-high quarterly output figure of £15.05bn.

May's increase came solely from a strong (2.8%) rise in new work while repair and maintenance output growth contracted by 0.4%, month-on-month. Output in the month was nearly 7% higher than the five-year monthly average and more than 4.1% higher than its pre-coronavirus level.

At the sector level, the main contributors to the May increase were private commercial new work and private new housing, which jumped by 12.1% and 7.2% respectively. Since the falls at the start of the pandemic, the recovery to date has been mixed at the sector level. The private industrial and infrastructure sectors have been the stand-out performers for new work output growth, having grown by 18.1% and 19% respectively compared to their February 2020 levels. Monthly output in the commercial sector, however, is more than 21% lower than it was just before the pandemic.

These recent output figures are reassuring given the amount of supply chain disruption, demonstrating the robustness of the sector to weather volatile and uncertain market conditions. The industry faces a turbulent period of rising input costs but effective scenario planning and building in flexibility to project specifications

CONSTRUCTION OUTPUT: ALL WORK
Seasonally adjusted



Source: *ONS*

NEW ORDERS INDEX **53.5**
sa, >50 = growth since previous month *Jun '22*

Source: ***S&P Global***

has helped to maintain its strong momentum in recent months. A continuation of this momentum, however, is far from certain. Despite seeing strong growth in May, private commercial output remained well below pre-pandemic levels – a sign of subdued confidence amongst some developers. With the likelihood of further interest rate rises and uncertainty over the direction the new Prime Minister will take over policy in areas such as housing and infrastructure, this may potentially translate into a pause on investment before committing to longer-term projects.

Turning to new orders, the latest S&P Global/CIPS UK Construction PMI surveys give us the most up-to-date snapshot of new work growth. New orders expanded again in June, increasing for the 25th successive month in the construction sector. However, the rate of growth eased further from March's recent peak, hitting its lowest level since October 2021. The survey's New Orders Index adding to signs that heightened economic uncertainty and inflation concerns is starting to impact client spending and leading to greater hesitancy among clients.

Concerns about the business outlook were signalled by a fall in construction sector growth projections to the lowest for more than one-and-a-half years in May. Around 19% of construction firms predict an outright decline in business activity during the year ahead, up from just 5% at the start of 2022. While this does not bode well for new order growth, subsiding supplier delays and an easing of the rate of inflation to a three-month low in May according to purchasing managers, will hopefully mean that any curbing in appetite as a result of these specific concerns will be relatively short-lived.

Higher borrowing costs, economic uncertainty and the war in Ukraine were all cited as reasons for an expected slowing of overall construction activity in the short-term. That said, the publication's Future Activity Index was still well above the neutral threshold, and purchasing managers indicated that extra recruitment was linked to rising workloads and the anticipation of new project starts.

Furthermore, recent figures from construction data provider Glenigan show a 9% increase in the number of sub-£100m UK project starts in the three months to May 2022 compared to the previous three months – a promising sign of recovery following the fallout from the Russia-Ukraine war. This comes on the back of a strong development pipeline of detailed planning approvals and contract awards, which rose by 1% and 13% respectively compared to the previous three months. However, while underlying project starts were up, the overall value of work commencing fell 5% to £6.54bn compared to the previous quarter, with major project starts (ie those costing more than £100m) falling by 32% over the same period. This is an indication that project sizes are growing smaller.

While activity still remains buoyant overall, forecasters are downgrading their growth forecasts. The Construction Products Association (CPA) is predicting a 2.8% growth in construction output for 2022 – a figure that would typically be viewed as very healthy – but this represents a sharp revision from the 4.3% growth in output that was forecast three months earlier. With an even lower (2.2%) growth in output forecast for 2023, there has been a net loss of c.£3bn from the pipeline for this year and the next.

The CPA noted some sectors such as private housing repair and maintenance are particularly exposed to the combination of price inflation, falls in consumer confidence and pressures on household spending. More generally, high near-term inflation will make it increasingly difficult to reach acceptable terms and will lead to a number of projects being delayed. Over time, these delays will lower demand and feed into slower output growth until a more normal, competitive tendering market can be established.

G&T TPI SURVEY FEEDBACK

Workload

Responses to our Q3 TPI survey indicated an overall expectation that workloads will remain buoyant for the next six months, but there are growing concerns that some projects could pause and order books shrink as suppliers struggle to provide cost and programme certainty to clients.

Most reported a steady flow of projects were coming online and that there were opportunities on the horizon for work across most sectors. Strong enquiry levels and requests for proposals (RFPs) are boosting potential workload growth.

However, positive momentum from 2021 has not carried through to 2022 for all sectors. While survey respondents pinpointed the commercial, life sciences, senior living and industrial sectors as being particularly 'hot' with high activity levels, they highlighted only a limited number of new opportunities in the hospitality sector (both in terms of new development and refurbishment projects). Some sectors, such as the private residential sector, are very exposed to the cost-of-living crisis and slowing economic growth and a number of respondents expected subdued workload growth in these sectors over the short-medium term.

Respondents also noted that while very few clients are slowing on live committed projects, they are increasingly cautious about 2023 due to the risk of potential recession. Clients are taking longer to determine and assess affordability following tender reports and contractors are increasingly having to chase up on previous quotes/tenders that have been provided. So, while site activity is currently high, decision-making and progress on potential pipeline projects is slowing.

The strong inflationary environment has seen the viability of some projects negatively affected, resulting in the revisitation of appraisals by clients. It is inevitable that some projects will not be viable amid rising construction costs and there is a risk that this could cool the market as clients once again adopt a 'wait and see' approach. However, questions over affordability and the inflationary environment are not the only headwinds the construction sector is facing. Respondents noted a number of schemes were being held up due to planning constraints and sustainable design factor which is slowing down project progress.

For the time being at least, there is still a good number of tendering opportunities, but if market conditions were to stabilise, even more projects would likely to proceed from feasibility into design.

Market Conditions

While the future growth prospects of the construction sector may have reduced in recent months, the sector has strong momentum behind it which means activity will remain relatively high throughout the rest of 2022. Demand is expected to remain positive into the second half of the year but with worsening economic prospects there is a greater risk of a slowdown in activity and project starts. Any lull in activity could create gaps in contractor order books and promote more competitive tendering as contractors seek to fill these.

While there are some early indicators that construction's positive growth dynamics are beginning to subside (eg a slowing rate of new order growth, increased client hesitancy and difficulty getting into contract etc), this does not mean prices will fall in the near future. Fewer bidding opportunities may encourage more competition with on-costs and risk allowances (as well as greater flexibility on preferred procurement routes), but contractors are unlikely to absorb the ongoing inflationary increases we are seeing in relation to material/commodity prices and labour costs.

There is a clear mix of views in the market currently, with some expecting a temporary lull or inflationary-driven pause in tendering activity while clients ensure their projects are sufficiently engineered, designed, resourced and funded before procurement. Those that sit in this camp are sceptical whether inflationary pressures will continue and suggest price rises are beginning to plateau. Others expect, and indeed are seeing, clients push ahead out of fear that matters will not improve and inflation will only escalate further as a heated market keeps prices high and supply low.

For now, the market remains busy, and demand is relatively high. Post-pandemic investment (particularly in office projects) is sustaining contractors' workload. According to our latest Main Contractors Survey, most contractors have secured more than 90% of their workloads for this year and many have secured in excess of 70% of their 2023 workload capacity. While contractors are still willing to tender for projects, some are declining due to high workloads and adopting more selective

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Inflationary Pressures

- Interrupted global supply chains and bottlenecks in wake of Ukraine conflict, forcing some to seek alternative sources of supply at greater cost
- Elevated fuel and energy prices increasing material production and transport/logistics costs
- Upward pressure and supply risk on materials and commodities for which Russia/Ukraine account for large proportion of total global supply (eg certain metals, asphalt, and wood products)
- Removal of red diesel rebate in construction increasing operational cost of running plant/ machinery on site
- High vacancy levels, an ageing workforce and skills shortages are increasing labour rates and the cost of employee retention
- Rising number of contractor insolvencies reducing supply chain capacity and tendering competition
- Strong and stable public sector spending/ investment pipeline, leading to increased construction activity and competition for resources
- Increase in NIC rates being passed on
- Strong short-term order books easing immediate pressure to win new work. Greater ability to be selective
- Contractors targeting higher margins and increasing risk allowances/premiums
- Widespread awareness of global inflationary pressures generally allowing for potential profiteering and artificial inflationary uplifts
- Retreat from globalisation and return to protectionism (eg decoupling accompanied by reshoring/near-shoring of manufacturing and production to higher-cost regions)

Deflationary Pressures

- High input costs leading to project deferrals/ delayed starts. Contractors could seek to fill gaps in workload by reducing risk allowances and on-costs
- Stagflationary conditions and risk of UK recession to impact demand, client investment plans and spending decisions
- New global supply coming online with factory activity expanding in China after recent lockdown-related declines
- Supply chains adapting to interrupted trade flows and establishing new trading partners and routes
- Increasing investment in new technologies/AI to improve site productivity

attitudes towards risk. This is creating some issues on new projects being put out to tender as they are not receiving adequate responses, resulting in delays on contractor appointments.

INPUT COSTS

Key inflationary and deflationary pressures

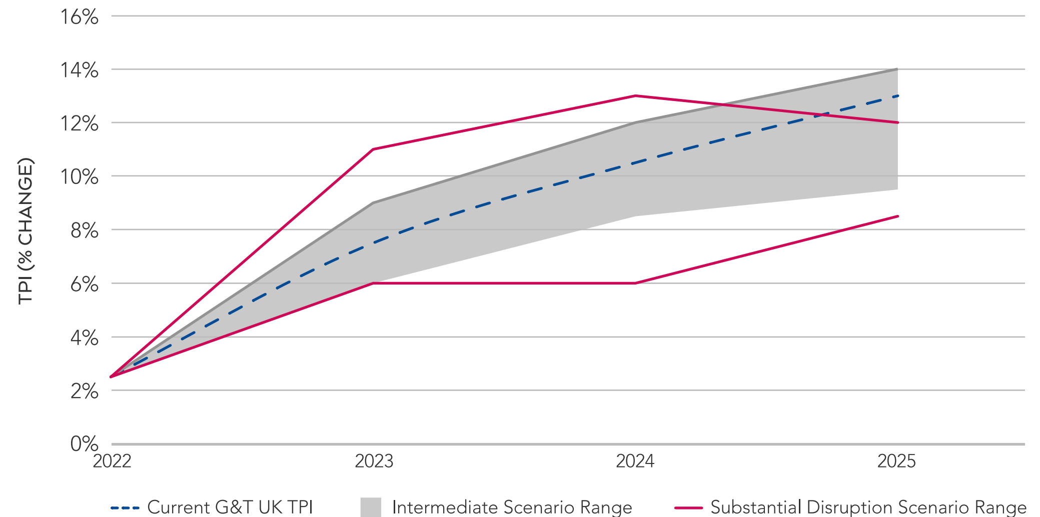
Based on our observations of the market in tender returns, survey feedback and our extensive discussions with the supply chain, we have established that a number of inflationary and deflationary pressures are likely to impact tender pricing. Many of the pressures from our previous TPI report continue to impact tender pricing due to the ongoing disruption from the Russia-Ukraine war and the potential for this to escalate further as Russia considers cutting off pipeline gas supply to Europe. Consequently, the number and severity of inflationary pressures continue to far outweigh any current or potential deflationary pressures.

In G&T's Russia-Ukraine Conflict Report, we explored to what extent the UK is exposed to the impacts of the Ukraine crisis and how it might impact construction costs. In it, we included a scenario-based fan chart outlining how three possible scenarios could potentially impact tender price inflation. In each scenario various supply, demand and macro-economic conditions and qualifying criteria were outlined.

Since publishing the original report the conflict has evolved, increasing in duration and severity and moving beyond the scope and conditions laid out in our 'Limited Disruption Scenario'. The requisite demand, supply and macro conditions outlined in our 'Intermediate scenario' have now been met and so we have updated our fan chart to show what are now the two most relevant scenarios – the 'Intermediate' and the 'Substantial' disruption scenarios.

The chart below shows G&T's latest weighted UK average TPI forecast, which now sits roughly in between the upper and lower inflationary ranges of the Intermediate scenario. Also displayed are the upper and lower ranges of the Substantial disruption scenario. Descriptions of each scenario, and the relevant qualifying conditions for each, are provided in our Russia-Ukraine Conflict Report.

DISRUPTION SCENARIO RANGES COMPARED TO G&T TPI (CUMULATIVE INFLATION) FORECAST



Source: *G&T*

With the growing risk that Russia will cut off European pipeline supply of natural gas in the months ahead, many European leaders (including the UK Government) are preparing to ration or scale back energy use. This would constrain manufacturers and producers in energy-intensive industries such as steelmaking and reduce production output. While the UK only relies on Russia for 4% of its gas needs, it would find itself in competition with European buyers for gas if the continent suffered supply shortages. The UK (like most countries) is exposed to global markets – so any supply shocks on mainland Europe would be felt here too. With a reduced global supply of gas, further pressure on energy prices would feed through to commodities and the manufacture of construction materials which manufacturers would seek to pass on through higher pricing strategies.

Russian gas supplies have already been cut to several European countries and significantly lowered to others – a situation which has forced Europe to look further afield for gas supplies, driving up prices across the globe. Any further tightening of Russian gas supply to Europe would likely see manufacturers across Europe increasingly cut production and international trade, severely affecting the supply of European manufactured materials to UK construction sites and impacting project progress. Furthermore, with curtailed manufacturing output and strong inflationary pressures, European economies would face an almost certain recessionary period.

Material Costs

So far this year, material prices have been the biggest contributor to construction input cost inflation. Key indices such as the BEIS 'All Work' material price index have risen by 12.6% between January and May 2022 and the same index was 26.5% higher than it was one year ago in May 2021.

While all materials have experienced some degree of inflation in 2022, it has been metals and other energy-intensive products that have been disproportionately affected by high energy costs. A summary of the main pressures and trends affecting key construction materials is provided below:

Steel:

- BEIS data shows a sharp rise in structural steel/ rebar prices between February and May 2022, but in June the supply chain reported greater price stability
- With Russia and Ukraine out of the global supply chain, steel plate shortages pushed prices higher initially
- Global steel shortages have since been met by an oversupplied Chinese steel market and a drop in demand in the international markets following concerns of a slowdown in global construction activity
- Iron ore prices have also been on a downward trajectory since April, surrendering their 2022 gains as investors became fearful about waning Chinese demand and weak construction starts in the country
- In Europe, weakening manufacturing demand (due to slowing European economies) and replenished inventories following Russia's invasion of Ukraine have seen steel prices fall
- While steel prices are still at historically high levels, an oversupplied Chinese steel market and falling iron ore prices are helping to lessen the impact of high energy costs in the steelmaking process
- The UK is set to extend a package of quotas and tariffs on 15 categories of foreign steel imports by two years in an effort to protect domestic producers and prevent a flood of cheap steel into the UK

Timber:

- Prices have stabilised from last summer with supply chain issues easing as sawmill outputs increased
- Timber futures have dropped 55% since March 2022 due to lower global demand for the commodity, suggesting a gradual return to pre-pandemic price levels
- Easing demand and strong stocks of structural timber in the UK has helped to make supplies readily available for contractors/merchants
- Firm-strong pricing of timber in US and Europe means UK imports of structural timber are falling, according to the CLC
- Some structural panel products (eg Birch Plywood and its substitutes) have seen little or no availability due to Russian sanctions, putting upward price pressure on these particular products

Concrete/Cement:

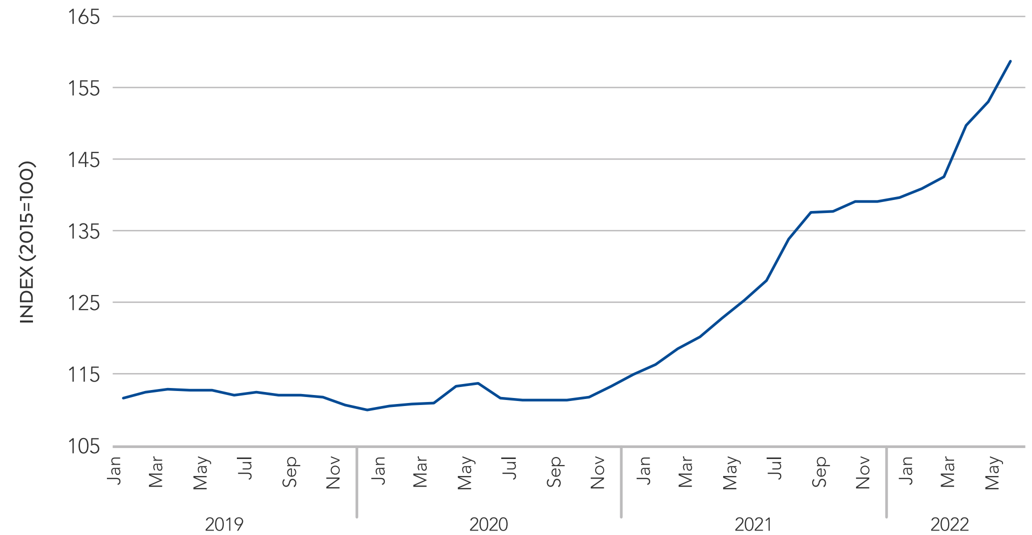
- Energy-intensive nature of the concrete/cement production process will likely result in sustained upward cost pressure and volatile pricing
- Concrete prices are currently sitting around £152/t according to G&T's latest Main Contractor Survey (up from c£100/t in October 2021) and has seen some of the biggest price hikes in decades over the past year
- Price rises will hit most projects but particularly major/key Government infrastructure projects
- Contractors are experimenting with techniques that involve less cement (eg use of graphene-enhanced concrete and 3D printing) to reduce costs

Façade:

- Strong façade supplier pricing has been driven by aluminium billet premium surcharges and European aluminium systems houses reaching capacity (which the UK has a strong reliance on)
- Rising energy costs have had a significant impact on the curtain walling market in terms of glass, aluminium and shipping costs
- Also factoring into high costs is the current exchange rate, the fact that there is only a small pool of Tier One cladding contractors, rising demand from Europe (France and Germany in particular) and a scarcity of labour to fit curtain walling
- Aluminium prices hit their lowest in nearly six months in June 2022 as weaker economic growth prospects hit metals demand. However, lower demand and high energy prices will likely lead to production cuts which will provide some support to prices

Owing to rising energy prices and manufacturing input costs, further price rises for most of these energy-intensive products are expected in the second half of the year – some of which have already been notified to customers.

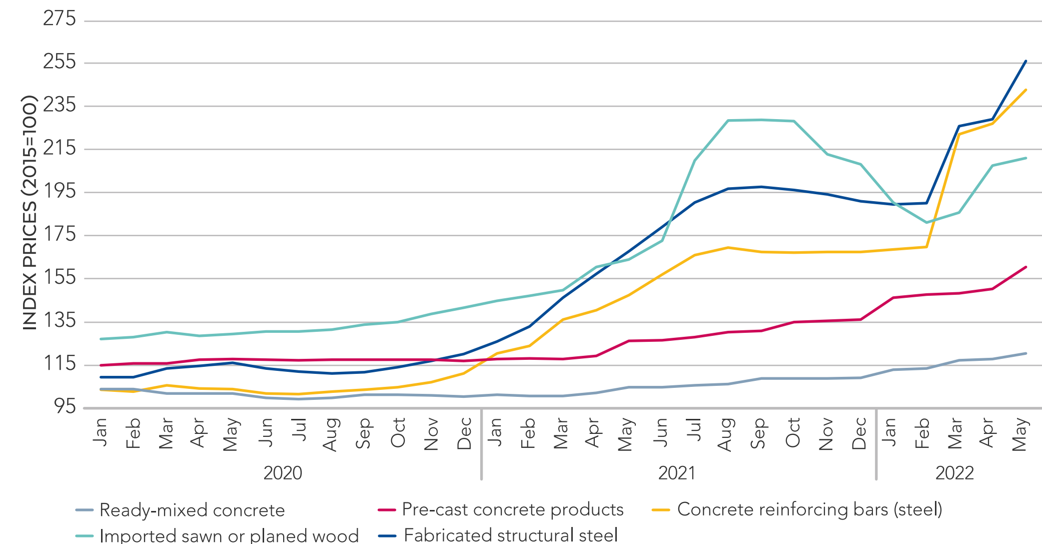
BEIS: 'ALL WORK' CONSTRUCTION MATERIAL PRICES INDEX, UK



Source: *BEIS*

KEY MATERIAL PRICES

Index 2015 = 100



Source: *BEIS*

Raw material prices were already being pushed higher by a post-pandemic bounceback and a lack of investment in new energy, but Russia's invasion of Ukraine has had a compounding affect, triggering sharp rallies in the commodity markets in March. These commodity price rises rippled through to construction products and materials, leading to multiple, unscheduled price increases in recent months from key material suppliers.

It is Russia's outsized role as a global exporter of energy (such as oil and gas) that has been the real driver of broader material price inflation. Reduced global energy supply has pushed manufacturing costs for nearly all construction materials higher in the wake of the conflict. However, the impacts of rising energy costs since Russia's invasion of Ukraine have not fully fed through due to most manufacturers working on forward energy contracts (typically lasting six months), which creates a lag between wholesale cost rises and the impact on production costs. These rolling hedging policies will mean higher energy costs for manufacturers in the longer-term, putting upward pressure on materials prices for many months to come, particularly if Russia decides to increasingly curtail or sever gas exports to Europe.

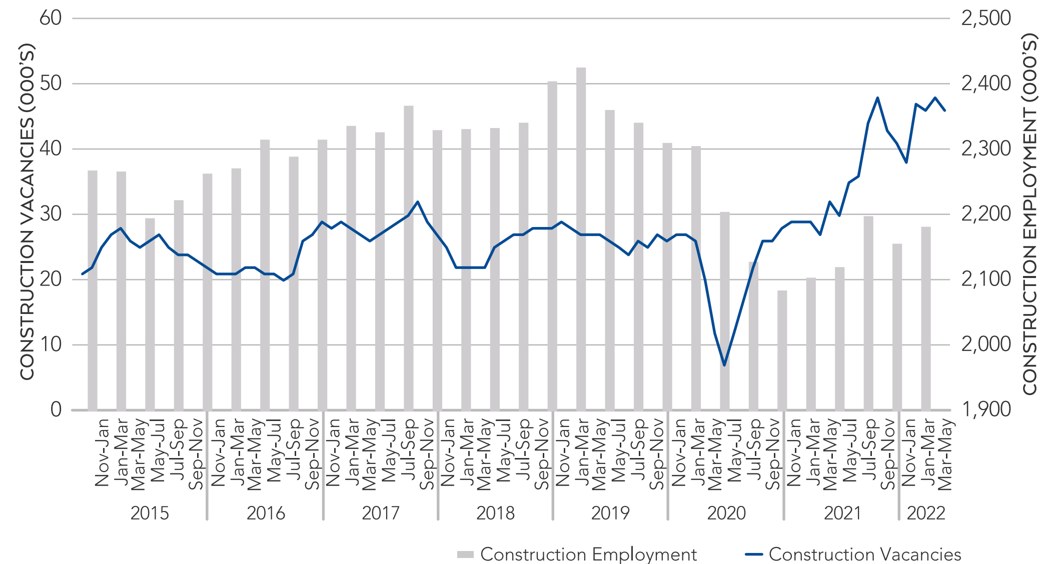
If Russian pipeline supplies were cut, key European manufacturing countries such as Germany may have to scale back or ration energy use in the short-term, hitting manufacturing and production in energy-intensive industries such as steelmaking. Another potential result of this scenario could be that energy prices become so high that it makes production uneconomic. Any consequent scaling back of manufacturing output would have significant implications for the construction sector and its ability to source materials to site. Even if Russian gas supplies to Europe are not completely severed, energy prices will remain high until European and domestic energy markets reduce their dependence on Russia through diversification of supply.

Construction purchasing managers continue to report strong demand for construction products and materials. Rapid cost inflation persisted in June with most purchasing managers (71%) reporting a rise in purchasing prices due to higher fuel, energy, and raw material costs. Upward pressure on input prices was also applied through greater logistics costs and supply shortages for some materials. In terms of purchasing activity, there was a sharp fall in June, with input buying increasing to the least marked extent since January 2021. Softer demand for construction products and materials was primarily a result of less new work replacing completed projects due to economic uncertainty and inflationary concerns. There was also less pre-purchasing activity/safety stock building of materials in June which contributed to the sharp drop in purchasing activity.

While there are still global supply chain issues and competition for certain raw materials is heightened, the Construction Leadership Council (CLC) paints an increasingly positive picture on product availability. Some products including bricks, concrete blocks, some roof tiles and semi-conductors (used in building services products and gas boilers) remain on allocation or subject to longer lead times, but manufacturers are mostly keeping up with demand and managing supply with planned delivery times. Any softening of demand as a result of economic uncertainty or inflationary concerns will likely further improve the availability of materials as stocks are allowed to re-build. Even though the availability of materials is improving, supplier delivery times continue to lengthen with longer wait times pinned on staff shortages and a lack of transport availability.

Also likely to alleviate concerns of manufacturers is the UK Government's recent announcement regarding the transition from CE marking to UK marking. Recognition of CE marking – which indicates a product has been assessed by the manufacturer and deemed to meet EU safety, health, and environmental protection requirements – will end on 31st December 2022. However, the Government has said that manufacturers with existing CE tests from EU notified bodies (under AVCP System 3) can affix the UK mark to their products and continue to supply them to the UK market without the need to be retested, providing the product has been tested by 31st December 2022. This effectively means that manufacturers will still be able to place their products on the UK market next year.

VACANCIES IN UK CONSTRUCTIONS (SA) V CONSTRUCTION EMPLOYMENT (NON SA)



Source: *ONS*

Labour

While most main contractors recently surveyed by G&T indicated that staff and project labour resource was available, good quality labour is becoming more difficult to employ and retain. Availability of site workers is particularly constrained and the shallow pool of skilled labour now prefers being more localised rather than travelling great distances.

Strong forward order books are likely to keep labour resource requirements high in the short-term at least, allowing workers to demand higher rates. There is a near record-high number of unfilled construction vacancies in the UK currently, and with retiring site workers and a loss of European migrant labour, these dynamics point to a further tightening in the supply of skilled workers.

There were 46,000 UK construction vacancies in the three months to May 2022, according to the ONS – down from recent peaks but still at historically high levels. The slight (4.2%) drop in vacancies compared to the previous three-month period (Feb-Apr 2022) will do little to ease the tight UK construction labour market. Although June's UK Construction PMI survey saw a slowing in the rate of job creation due to concerns over future new order growth and business activity, job creation has now been recorded in each month since February 2021. Additional recruitment has been linked to endeavours to boost business capacity in line with rising workloads and the anticipation of new project starts. However, filling these vacancies has been challenging. Construction companies cited severe and ongoing difficulties in finding suitable candidates in June's survey, despite rising wages and new recruitment initiatives.

The total number of workers employed in the UK construction sector is still significantly below pre-pandemic levels. In Q1 2022, the total number of UK construction workers was 2.18 million – 10% (or 244,000) fewer than there were in the recent peak before the pandemic in Q1 2019. The sector

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desperately needs an injection of new skills in the workforce to replace outgoing workers that retire or migrate. According to the CITB skills body, 25,000 migrant workers left construction in the post-Brexit and pandemic upheavals, and more and more are taking early retirement or moving to other industries. Nearly half of the 244,000 workers that have left the industry over the past two years came from the skilled 45-55 age group – a key age profile. While it is not clear if these workforce changes are permanent, the ageing workforce demographic is a systematic problem – one that has been accelerated by the pandemic and will only deepen in the future without intervention.

There is an urgent need to get attract a new generation of homegrown construction workers or find ways for employers to better engage with the new point-based immigrant system licence scheme that enables them to hire non-UK born workers. Although labour from South America is now becoming more commonplace and helping to fill the void left by European counterparts, some skilled trades are not accessible through the skilled worker visa route (eg dryliners and insulators) and this is preventing some contractors, particularly smaller ones, to take on jobs. Unless greater flexibility is introduced which allows the new points-based immigration system to respond rapidly to changing pressures, workload capacity and output growth in the future will likely be curtailed. Another issue is that with contractors struggling to deliver their current workloads, this is hampering their ability to free up time to invest in the necessary training just as its needed most.

London and the South East, which have historically had higher levels of migrant labour and higher wages, are pulling resource from the rest of the country, exacerbating the skills difficulties nationwide. G&T's latest Main Contractor survey found that London in particular is seeing volatility around the movement of labour resource caused by high levels of construction activity. This is putting pressure on rates and staff costs. According to G&T's survey, around 60% of main contractors expect directly employed staff cost movements to 'increase' or 'significantly increase' over the next 12 months in light of the cost-of-living crisis and current construction employment market dynamics. An even greater proportion (73%) expect subcontract labour cost movements to increase over the period, as strong activity increases competition between contractor to secure labour.

ONS data shows UK construction average weekly earnings (**AWE**) were 7.6% higher in the three-month period to April 2022 in comparison to the same period one year earlier. This is a greater annual growth rate the UK economy as a while, which saw AWE rise by 6.1% over the same period. The general shortage of quality workmanship across all trades is putting pressure on labour costs and many in our TPI survey suggested that labour could potentially become the bigger issue over the next year and beyond. Slowdowns tend to follow sharp spikes – something which many expect to see in relation to material prices – but underlying pressure on labour from skills shortages is a potentially longer-term issue that will support high pricing beyond any cooling off in material price inflation.

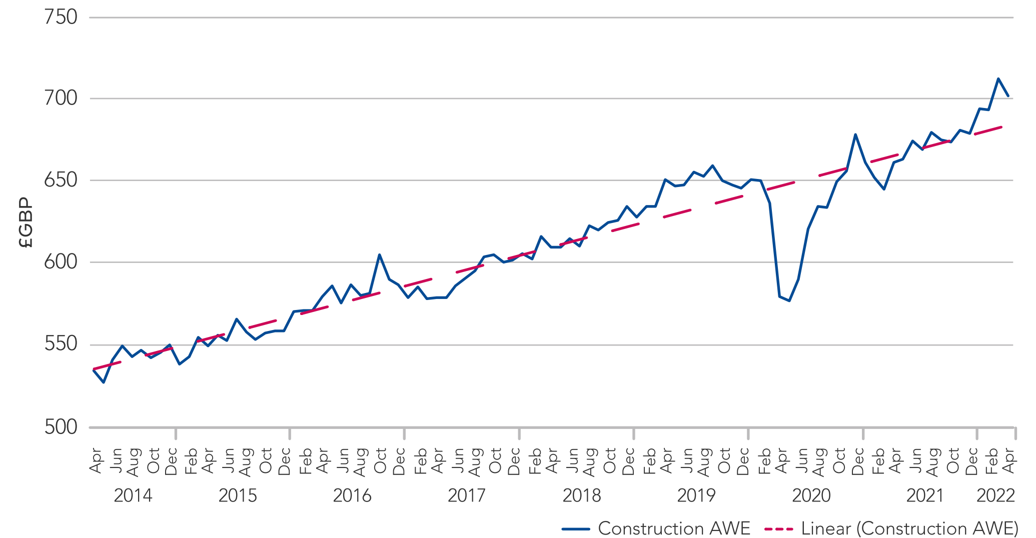
Labour shortages for demolition workers, roofers, and finishing trades (eg drylining) are creating sustained upward pressure on rates. Data from Hudson Contract, which shows self-employed labour rates for several key trades, found that rates for many trades have exceeded the cost-of-living inflationary rises (ie annual CPI inflation of 9.1%):

Hudson contract data shows across all trades and UK regions, labour rates grew by 2.8% compared to the previous month with self-employed subcontractors taking home an average weekly pay of £918 in May.

Earnings rose in all regions in England and Wales in May other than the North-East, with plasterers seeing the biggest month-on-month rise (+12.2%). Wage growth for roofers, demolition workers, scaffolding and lifting workers and plumbers also kept ahead of the UK's official inflation rate over the same period. However, not all trades with notable labour shortages have seen wage growth keep place with headline inflation. MEP and brick/blockwork for example are all grappling with significant skilled labour shortages but wage growth in these trades failed to keep pace with headline inflation. However, it is important to note that wage growth trends for self-employed workers may differ from directly employed labour, who are reliant on negotiated annual pay deals (often with unions involved). Self-employed workers also have the option to take on more or less work to increase their income which creates differences between direct and self-employed pay.

While very few in the sector are struggling to win work in the current growth market, labour wage inflation could ease if, as some anticipate, demand takes a hit and fewer tenders come through the door. A sustained period of subdued new work growth may take some of the heat out of the labour market and cool rate rises, but even if tendering opportunities do drop off from current levels, the near-record level of job vacancies and widespread skills shortages will maintain pressure on rates and contractors' prices.

AVERAGE WEEKLY EARNINGS: UK CONSTRUCTION V WHOLE ECONOMY *Seasonally adjusted*



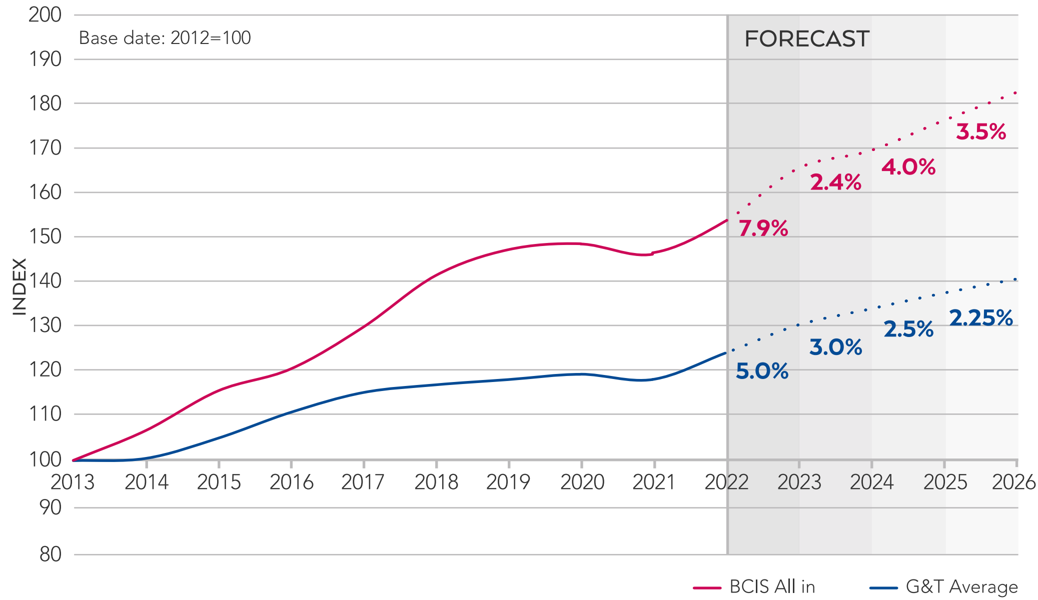
Source: *ONS*

SELF EMPLOYED TRADES: WEEKLY PAY RATES

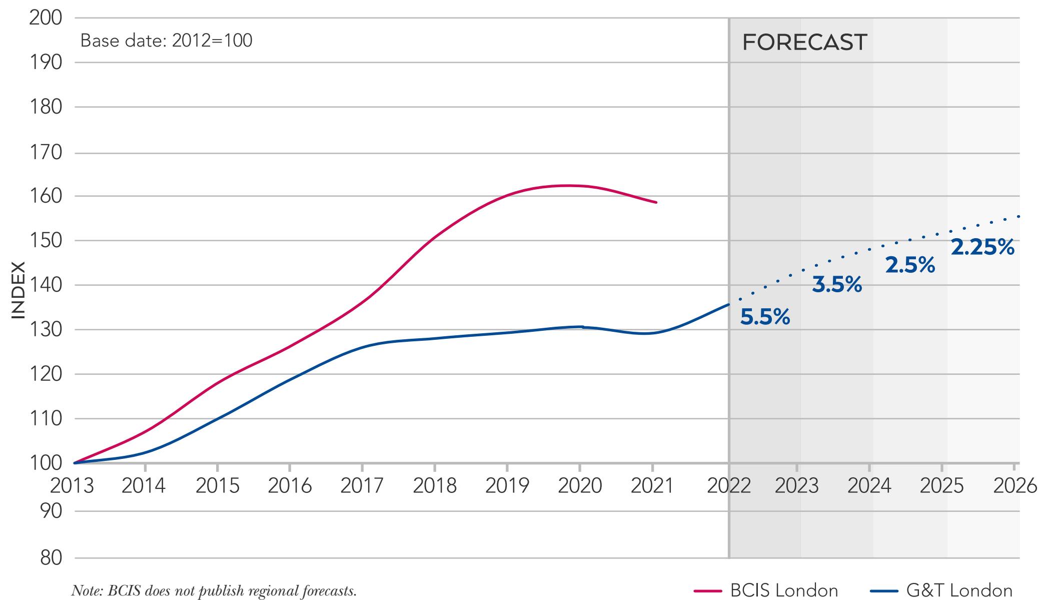
Trade	May 2021	May 2022	% Change
Plastering	£741	£831	12.2%
Roofing	£698	£781	11.9%
Demolition & Wrecking	£777	£864	11.1%
Scaffolding & Lifting	£725	£800	10.3%
Plumbing	£967	£1,065	10.1%
General Construction	£889	£948	6.6%
Equipment & Operator Hire	£891	£935	4.9%
Civil Engineering	£828	£864	4.3%
Shop Fitting	£1,060	£1,105	4.3%
Insulation	£889	£918	2.1%
Specialist Trades	£824	£841	2.0%
Joinery	£1,011	£1,029	1.8%
Electrical	£1,063	£1,071	0.7%
Surfacing Contractors	£818	£809	-1.1%
Bricklaying	£897	£859	-4.2%
Steel & Timber Frame Erection	£882	£842	-4.6%
Mechanical & Engineering	£1,068	£1,011	-5.3%

Source: *Hudson Contract*

TENDER PRICE TREND 'ALL UK TPI'



TENDER PRICE TREND 'LONDON TPI'



Note: BCIS does not publish regional forecasts.

TENDER PRICE ANNUAL PERCENTAGE CHANGE Q3 2022

%	2022		2023		2024		2025	
Regional forecasts	**Now**	**Last***	**Now**	**Last***	**Now**	**Last***	**Now**	**Last***
Greater London	5.50	5.50	3.50	3.50	2.50	2.50	2.25	2.25
South East	5.50	5.50	3.50	3.50	2.25	2.50	2.25	2.25
South West	4.50	4.50	3.00	3.00	2.50	2.50	2.25	2.25
East	4.50	4.50	3.00	3.00	2.50	2.50	2.00	2.00
Midlands	5.00	4.50	3.00	3.00	2.50	2.50	2.00	2.25
Wales	4.50	4.50	2.00	2.00	2.00	2.00	2.00	2.00
Yorks & Humber	4.00	4.00	2.50	3.00	2.00	2.00	2.00	1.75
North West	5.00	4.00	3.50	3.00	2.50	2.50	2.50	2.25
North East	4.00	4.00	2.00	3.00	2.50	2.50	2.00	2.00
Scotland	5.50	5.50	3.00	3.00	2.50	2.50	2.00	2.00
Northern Ireland	5.00	5.00	3.00	3.00	2.50	2.50	2.00	2.00
UK Average (weighted)	**5.00**	**5.00**	**3.00**	**3.00**	**2.50**	**2.50**	**2.25**	**2.25**

Last*	2Q22

COMPARISON OF PUBLISHED FORECASTS FOR TENDER PRICE CHANGE

	G&T UK AVER. Q3 2022	**BCIS** UK AVER. June 2022	**G&T** LONDON Q3 2022	**AECOM** UK June 2022	**ARCADIS** LONDON June 2022
	% CHANGE				
2022	5.00	7.85	5.50	7.60	8.00 - 10.00
2023	3.00	2.43	3.50	5.30	2.00 - 3.00
2024	2.50	3.95	2.50	N/A	4.00
2025	2.25	3.54	2.25	N/A	5.00

Note: Arcadis' TPI figures are for its 'London Building Construction TPI' series

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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