

TENDER PRICE FORECAST

for 1st Quarter 2023 is...

2.75%

Annual UK Average

▼ compared to 5.5% Annual UK Avg. in Q4 2022

2022 provided the industry with a solid pipeline of workload and a good foundation to buffer against an economic slowdown. As we are likely to enter recession, some key sources of construction cost inflation are set to ease or fall back in the coming months. Economic headwinds and anticipated reductions in workloads may act to partly offset some prevailing inflationary pressures, as we forecast a reduced rate of inflationary increase. With certain sectors and project types being more exposed to recessionary conditions than others, a two-speed inflationary picture may evolve as we move through the year.

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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.

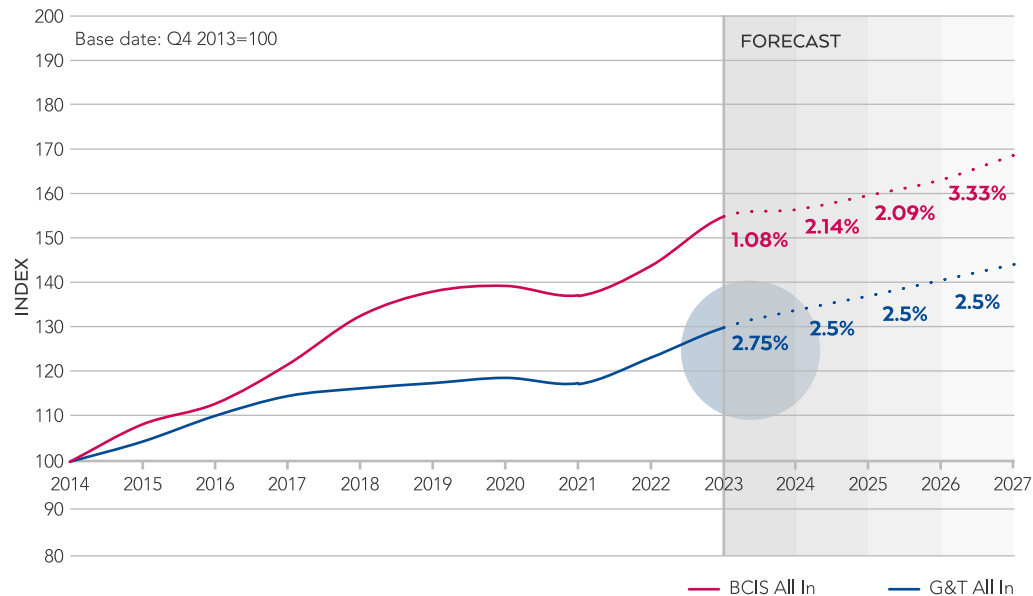
TENDER PRICE ANNUAL PERCENTAGE CHANGE Q1 2023

%	2023		2024		2025		2026	
Regional forecasts	Now	Last*	Now	Last*	Now	Last*	Now	Last*
Greater London	2.75	3.00	2.25	2.50	2.50	2.50	2.50	N/A
South East	2.75	3.00	2.25	2.50	2.50	2.50	2.50	N/A
South West	3.75	4.00	3.50	3.50	3.00	2.50	2.50	N/A
East	2.75	3.00	2.50	2.50	2.50	2.50	2.50	N/A
Midlands	3.00	2.50	2.50	2.50	3.00	2.50	2.50	N/A
Wales	2.50	2.00	2.50	2.50	2.00	2.00	2.50	N/A
Yorks & Humber	3.00	4.00	2.50	3.00	2.50	2.50	2.50	N/A
North West	2.00	2.50	2.00	2.00	2.00	2.00	2.00	N/A
North East	2.50	3.00	2.00	2.00	2.50	2.00	2.00	N/A
Scotland	2.25	2.50	2.00	2.00	2.00	2.00	2.00	N/A
Northern Ireland	3.00	3.00	2.50	2.50	2.00	2.00	2.50	N/A
UK Average	2.75	3.00	2.50	2.50	2.50	2.25	2.50	N/A

Last* 4Q22

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

TENDER PRICE TREND 'ALL UK TPI'



HOW DO WE REACH OUR TENDER PRICE FORECAST?

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

INPUT COSTS

- ▲ 4.8% BCIS Labour Cost Index Nov 2021 - Nov 2022
- ▲ 33.2% BCIS Plant Cost Index Nov 2021 - Nov 2022
- ▲ 5.9% BCIS M&E Cost Index Nov 2021 - Nov 2022
- ▲ 6.1% Fabricated Structural Steel Oct 2021 - Oct 2022
- ▲ 21.1% Concrete Reinforcing Bars (Steel) Oct 2021 - Oct 2022
- ▼ -19.9% Imported Sawn or Planed Wood Oct 2021 - Oct 2022
- ▲ 18.5% Ready Mixed Concrete Oct 2021 - Oct 2022
- ▼ -3.7% Oil Prices Brent Crude Jan 2022 - Jan 2023

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

- ▲ 2.4% UK GDP Annual Growth Rate Q3 2021 - Q3 2022
- ▲ 10.7% CPI Nov 2022 12-month rate
- ▲ 14.0% RPI Nov 2022 12-month rate
- ▲ 3.5% UK Base Interest Rate Dec 2022
- ▲ 3.7% UK Unemployment Rate Aug 2022 - Oct 2022
- ▲ 6.1% UK Wage Growth Average Weekly Earnings (Total Pay) Y-on-Y three-month average to Oct 2022

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 2023 and beyond.

OUR FORECASTS

The construction sector bucked the broader economic trend in the latter half of 2022, expanding when other core sectors of the economy contracted. As the stand out sector, strong output growth in 2022 provided the industry with a buffer of workload and laid a solid foundation for the industry to enter an economic slowdown.

Reassuringly, some key sources of construction cost inflation are set to ease or fall back in the coming months. This is welcome news as we enter what is expected to be the second global recession in less than three years. Economic headwinds and projected reductions in workloads will act to partly offset some prevailing inflationary pressures, but this easing of inflationary pressure will likely be accompanied by a greater degree of caution for some as they navigate an increasingly challenging market. However, with certain sectors and project types being more exposed to recessionary conditions than others, a two-speed, forward inflationary picture may evolve as we move through the year.

There are compelling signs that headline inflation has finally peaked and, as with the broader or macro inflationary trend, 2022 could prove to be the high-water mark for construction tender price inflation. Still, little downward construction cost movement is expected in 2023. Instead, the consensus across much of the supply chain is for a 'levelling off' in the rate of tender price inflation rather than any overall downward movements this year.

The rapid tightening of interest rates by central banks globally has, as intended, led to an economic slowdown and played a role in cooling inflation. With further rate rises expected however, banks are unlikely to end their rate-tightening cycle just yet. It is far from certain that underlying inflationary pressures will be stamped out this year and concerns linger that inflation may take too long to fall back to the central bank's 2% target. These concerns, particularly across Europe, are linked to the time it will take for the 2022 energy shock to fully work its way through the economy. Furthermore, tight labour markets in which wages are rising at rates that are incompatible with 2% inflation targets will be a further source of domestic inflation.

A key knock-on effect of recent aggressive rate tightening to the construction sector has been the increased risk profile for securing project funding. This, in conjunction with elevated construction input costs, has had an impact on tendering activity with some projects ultimately pausing or being shelved. While a reduced supply of new projects to tender may help with the recent contractor capacity issues and encourage more competitive tendering, certain stubborn underlying inflationary pressures will ensure a positive inflation figure overall for construction costs in 2023.

With various material price increases scheduled for January, G&T forecasts the profile of tender price inflation in 2023 will accordingly start off high, but subsequently reduce as recessionary pressures bite harder as we move through the year. Overall, our weighted 2023 tender price inflation forecast for the UK is 2.75% - slightly higher than our long-term average which is reflective of ongoing energy-driven pressures on some materials categories, as well as pressures from the cost-of-living crisis and a shrinking pool of resource on labour costs. Acting against these pressures and holding even higher rates of potential inflation in check will be a forecast contraction in new work orders and output and in certain sub-sectors. Accordingly, inflation trends will see some divergence depending on the specific sector, with those affected most by recession likely to see some discounting by main contractors on controllable on-costs in order

to secure long-term pipeline. More protected sectors (such as infrastructure, industrial and even London commercial office fit-out, where demand is expected to remain relatively strong) will likely see significantly higher rates of tender price inflation in 2023.

Beyond 2023, assuming no unknown seismic economic shock, we envision a return to more typical inflation rises in line with the long-term average rate of tender price increases. From 2024, our weighted average TPI forecasts then drop further to 2.5% each year until 2026 on the expectation that energy prices won't continue to rise so quickly, any remaining global production difficulties for products and materials end and that demand conditions normalise. Of course, if the past few years have taught us anything, it's that the future is largely unpredictable and that making specific long-term forecasts and predictions can be a futile exercise. As such, our forecasts continue to be subject to a high degree of market uncertainty and will continue to be reviewed on a regular basis.

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

There is a very strong correlation between GDP growth in the wider economy and construction output/activity. However, economic growth tends to lead construction activity. With a protracted but shallow recession being widely forecast in the UK for much of 2023, many expect a lagged impact on construction output/activity growth. One silver lining is that tender price indices (which reflect the price of construction materials, labour, and plant) also tend to fall in times of economic recession. After years of rampant input cost inflation, recession may be the force that douses the stubborn inflationary flames that have engulfed the sector.

Although a synchronised global slowdown is on the cards, leading economists forecast the

UK will experience a worse recession in 2023 than most other advanced economies. Unwise short-term actions, the impact of Brexit and poor investment growth are expected to affect the UK's longer-term economic performance. Although the peak to trough contraction of GDP is likely to be shallow (c.1-2%), a number of economic forecasters anticipate five-six quarters of recession (starting in 3Q 2022) as household consumption falls. Consumer confidence is already at or close to historic lows, and that is before unemployment has started to rise. However, as recession bites headline inflation is expected to fall so long as there is no repeat of the recent supply-side shocks.

The UK's 10.7% annual CPI figure in November is a consequence of several factors – but primarily the knock-on effect of the war in Ukraine on commodity, food and energy prices, as well as global supply chain bottlenecks (both pandemic and war-related). Without the Government's Energy Price Guarantee package or 'EPG' (which caps the unit price of energy) the OBR estimates that inflation would have peaked at 13.6% in early 2023 (2.5% higher than forecast with the EPG). However, both the OBR and the Bank of England (BoE) expect annual inflation to ease in 2023 as the steep rises in energy prices seen in 2022 fall out of the annual comparison (ie the mathematics of 'base effects'). The OBR expects inflation to slow to 3.8% by Q4 2023, while the BoE forecasts a rate of 5.2% for the same period, partly due to the expectation that domestic inflationary pressures will "remain strong".

Additional base interest rate rises to quell inflation (and to safeguard the credibility of monetary policy in the face of question marks over fiscal policy) have been pencilled in by markets, further squeezing household and business budgets in 2023. Despite BoE Governor Andrew Bailey claiming in December's Monetary Policy Committee meeting that inflation has "reached its peak", Bailey suggested a tight labour market and inflationary pressures in domestic prices and wages could indicate greater persistence that justifies a "further forceful monetary response" in order to see a sustainable return of inflation to its 2% target. Whether this means rates will have to rise as high as financial

markets expect, which at present are forecast to peak just above **4.5%** by mid-2023, remains to be seen but more hawkish voices on the MPC noted the need to combat an “inflation psychology” that was embedding itself in wage settlements and inflation expectations. With private sector wage growth at more than **6%**, companies may be forced to keep increasing prices for goods and services sold at rates well above the BoE’s target.

Regardless of how quickly inflation returns to target, businesses should find some relief from falling goods price inflation in 2023. While the first order of business may be to bring inflation down, inflation isn’t the only issue affecting the UK economy: skill shortages, high non-employment (ie those not in work and not seeking work) creating a tight labour market, longstanding relatively poor productivity performance and weak business investment are all fundamental problems that risk becoming structural rather than cyclical without policymaker intervention or a plan to boost long-term growth.

CONSTRUCTION OUTPUT AND NEW ORDERS

Construction output defied the economic slump in Q3 (the latest full quarter we have data for). Output rose by **0.6%** in a quarterly basis to reach a new record high. Q3 2022 marked the fourth consecutive quarter of output growth for the sector, making it the odd one out of the UK’s major sectors which all stagnated in Q3. More recent monthly data also revealed a continuation of the Q3 growth trend with total output in October growing by **0.8%** month-on-month.

As ‘Repair and Maintenance’ output growth slowed in Q3 (-**2.2%**), total ‘New Work’ output picked up the slack and grew by **+2.4%** - reversing the trend seen in earlier in the year of Repair and Maintenance being the main growth driver. Although the most recent PMI survey reports and forecasts from the Construction Products Association suggest output growth will see a dip in 2023 (-**3.9%** according to the CPA’s latest Autumn 2022 industry forecast), 2022 has provided the industry with a solid cushion of workload and a good foundation for the industry to enter an economic slowdown.

This year’s forecast dip in total output does not mean activity in all sub-sectors will contract – some are set to buck the overall negative trend. Below we summarise growth expectations for some of the key UK sectors and incorporate the CPA’s latest output forecasts:

1. Industrial:

Industrial is currently the fastest-growing construction sector and there is a strong pipeline of new projects, but growth rates are set to cool in 2023 as demand for warehousing peaks

Rising construction costs and lower end consumer demand are set to dampen growth. Regardless, output is expected to rise by 3.1% in 2023 before falling by **1.5%** in 2025.

2. Infrastructure:

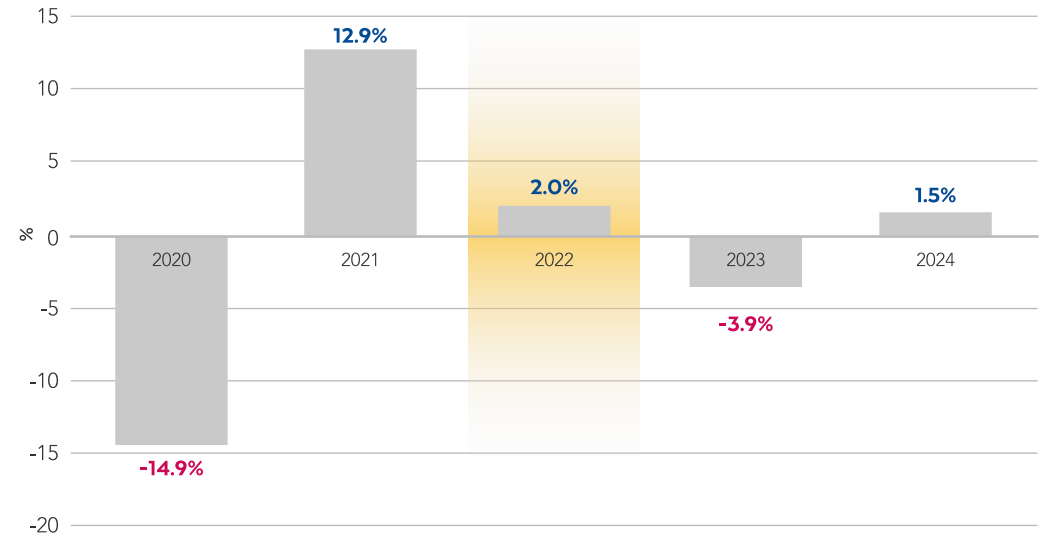
Infrastructure is also expected to remain in growth territory next year due to increased activity on major projects. However, sustained cost inflation will hit fixed budgets and lead to a variety of adverse issues for central government, private firms in regulated sectors and local authorities. With the current economic challenges, the Government is likely to be focusing on cost cutting rather than increasing budgets, so infrastructure spend for 2023 may be lower than previously expected

Overall, infrastructure output is forecast to rise by **1.6%** in 2023 and **2.6%** in 2024 as the Government focuses on larger projects already on the ground. In the longer-term, however, the sector will likely see the value of construction spending previously anticipated but not the volume due to substantial cost inflation since the IPA’s Spending Review in November 2021

3. Residential:

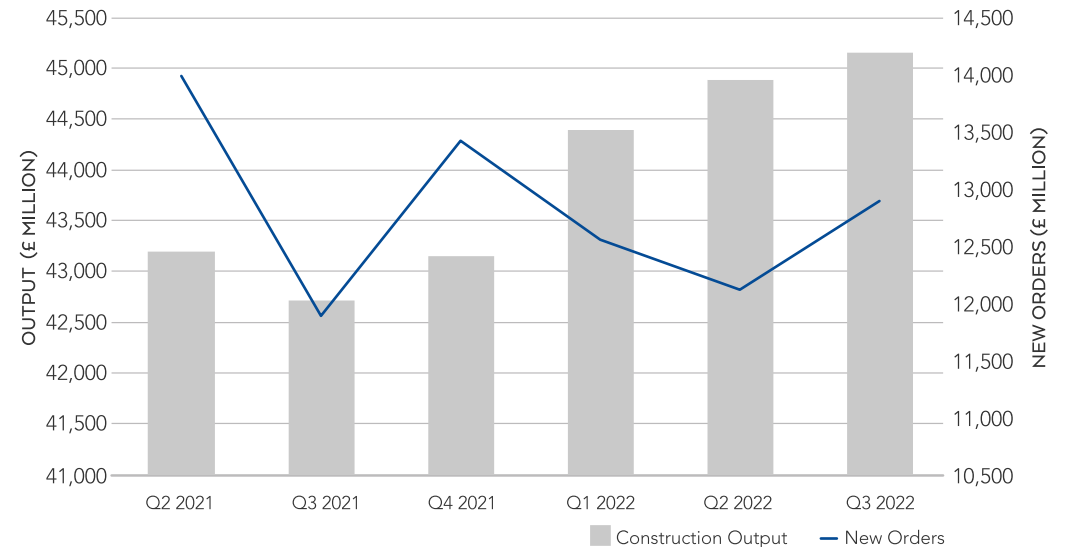
Whilst the housing market and housebuilding sector currently remain robust, falls in demand are expected to hit both in 2023. Starts are anticipated to fall by **10%** in 2023 whilst completions fall by **8%**. However, the risks are heavily weighted to the downside and considerably greater falls may occur if interest rates rise more than expected and if the housing market hits a tipping point

CPA: CONSTRUCTION OUTPUT FORECAST (% GROWTH)



Source: [CPA](#)

UK CONSTRUCTION: NEW ORDERS (ALL NEW WORK) V OUTPUT (ALL WORK)



Source: [ONS](#)

4. Commercial:

Forecasts for the commercial sector have been downgraded sharply since the Summer to reflect a broader economic slowdown and recession in 2023. Output is expected to contract by **5.1%** in 2023 as confidence for consumer-focused sub-sectors such as retail and entertainment that are already contending with the rising cost of living worsens. The CPA suggests this could lead to delays for larger office tower projects that were expected to start in 2023 and 2024.

Turning to new work, like output Q3 new order data from the ONS was also positive suggesting that order books remained strong. New order growth rose by **6.4%** in Q3, remaining some **8.5%** above the five-year quarterly average new order figure. Not all sub-sectors fared well in Q3, however. New order growth contracted in the new housing sectors (**-5.8%**) while orders for public new work also dipped in the quarter (**-1.1%**). However, a **28%** increase in new commercial work and a **6.5%** quarterly rise in infrastructure new orders more than made up for the weaker residential sector. Again, recent PMI data from construction companies suggests the third quarter spike in new orders won't mark the start of a sustained upward trend. Weakening demand is starting to squeeze the pipeline of new construction work. Waning sentiment in the wider economy, rising interest rates and high construction costs have dampened demand and lead to greater degree of hesitancy/caution before committing to new work.

Despite the reduced medium-term prospects for new work growth, data from Glenigan suggests there is a strong development pipeline. The value of detailed planning approvals increased **6%** during the three months to November to stand **3%** higher than the same period one year ago. This has been driven by key sectors such as industrial, civil engineering and health. However, strong planning approval growth won't necessarily translate into new starts in 2023. Tough economic conditions, high interest rates and heightened materials prices will likely put some of these approved projects on ice, preventing them from moving to site until better market conditions materialise. In fact, Glenigan's report points to a

50% increase in the time taken for a project to move from planning approval to start on site in light of these economic conditions and market pressures.

Other forward-looking gauges of activity and workload growth suggest expectations for 2023 are subdued. December's S&P Global/CIPS UK Constriction PMI report pointed to the fastest contraction in construction sector output since August 2022 while new orders and purchasing activity declined the most for over two-and-a-half years, driven by weak client demand. Furthermore, business sentiment dipped into negative territory for the first time since the initial COVID-19 wave and for only the sixth time on record. The latest RIBA Future Trends Workload Index (which monitors business and employment trends affecting the architects' profession) returned a balance of **-21** in November, suggesting architects on the whole remain pessimistic about workloads across all monitored work sectors (but particularly about private housing).

G&T TPI SURVEY FEEDBACK

Workload

While the rate of new project enquiries may be slowing from that seen in the first half of 2022, existing workloads and expectations for future order books remain strong.

A number of G&T project teams elaborated, explaining that 2023 workloads would likely centre around masterplan works, public sector schemes and opportunities for expansions of current projects. There are also a handful of sectors (for example, senior living, high-end residential, commercial office fit-out and warehousing & logistics) where demand is outstripping supply and where developers have aggressive planning programmes for multiple schemes. These sectors are likely to provide a solid base of workload in 2023 and beyond.

Even sectors that are perhaps more exposed to recessionary conditions, such as the new commercial office market, are still seeing some projects being green lit to commence pre-planning activities and procurement in the second

half of the year. Some clients, particularly those with larger schemes are also likely to press on with opportunities regardless of the economic climate given the longer time horizons involved.

Although very few live projects are being paused, those in RIBA stages 2-4 are stalling more frequently amid ongoing upward cost pressures. Survey respondents noted there is a strong sense among most clients of wishing to progress projects but that they were being held back by funders and the high cost of borrowing at present. In the current climate there are also a considerable number of feasibility studies being undertaken. As a result, some schemes will not progress beyond feasibility while others may be scaled back given the dampening effects of recession and high input cost pressures.

Anticipated delays to projects will also have an impact on workloads in 2023. A number of TPI survey respondents observed that some projects requiring Government decisions and sign-off are either not being made or further information is being requested, preventing the project from moving forward. Although the November 2022 Autumn Statement reiterated there would be no cuts to infrastructure project spending and that investment would be maintained in line with the National Infrastructure Strategy, capital budgets were frozen in cash terms until 2027-28 instead of increasing in line with inflation, which effectively means a cut. With rising construction costs and headline inflation in the double digits, these projects will have to do more with less which could potentially cause delays and impact workload. Cost, and how this can be best managed by cost teams, is currently a real sticking point for workload growth.

In summary, while some projects are dropping off there is still a strong amount of bidding opportunities, particularly from stalled 2022 projects, project extensions and additional service requests. Although projects are taking longer to progress to site, a healthy level of requests for proposals (RFPs) from clients suggests the pipeline of new work opportunities is relatively robust.

MARKET CONDITIONS

Our latest TPI survey shows a slight shift in terms of perceived market conditions over the next six months compared to our Q4 2022 TPI survey. This suggests that those surveyed anticipate slightly lower levels of construction market activity and bidding opportunities, which should ultimately bring about more competitive tendering conditions.

The broad sentiment across the construction market (as well as among those surveyed) is that the rapid rate of input cost inflation has peaked and that material price spikes of late are indeed subsiding. However, some further cost push inflation is expected to come in the form of high energy prices and rising labour costs in 2023. The real driver of market activity in 2023, however, is likely to be the wider macro pressures and a slowing economy.

Widespread forecasts of a protracted recession have put a dampener on demand/appetite for certain projects, impacting client investment plans. Some will be questioning their next steps as they deliberate how to secure funding at the right price in the debt markets. Cheap debt-funded schemes may have become a thing of the past which will inevitably have an impact on tendering activity this year and into 2024.

If, as expected, new order growth does decelerate as we move through the year, contractors will closely review their turnover which may lead to sharper/keener pricing in the market. This may act to soften tender price inflation from various upward pressures as contractors and supply chains take more of a commercial view on elements such as margin and risk allowances. Furthermore, it may prompt some contractors to pivot into different sectors in order to maintain turnover. G&T has seen evidence of main contractors switching focus away from sectors where workloads are drying up or where projects are becoming commercially unviable, to sectors where projects are fully funded with operators that are ready to go (eg senior living projects).

While there are still numerous pockets of strong activity in the tendering market, G&T has noticed

a small number of contractors are enquiring about business opportunities more frequently – an indication that appetite to fill order books is starting to increase among some contractors. One of the deflationary pressures identified in our previous TPI report was that project deferrals (and recently completed schemes) would create workload gaps that contractors would increasingly seek to fill through greater competitiveness with regards to on costs. However, with most contractors reporting relatively strong pipelines and levels of tendering activity, this is unlikely to materialise in the immediate future.

In fact, it was noted that several responses to expressions of interest for civils and logistics projects are returning with rejections due to heavy contractor workloads and capacity constraints. As such, there is a prevailing element of contractors being able to “pick and choose” work that suits them best in these more active sectors. While not a recurring theme across all sub-sectors, stretched lead times and work from delayed projects spilling over into 2023 will help prop up construction activity levels overall in the first half of 2023.

INPUT COSTS

Key inflationary and deflationary pressures

The latest independently produced raw input cost inflation metrics from the BCIS, show inputs of materials and plant have been biggest drivers of inflation in 2022.

Higher fuel and energy costs led to the BCIS’ Plant Cost Index rising by nearly **32%** in 2022 while supply pressures and rising manufacturing costs saw the BCIS’ Material Cost Index rise by **12%** overall in the period. However, with materials accounting for **c.57%** on a typical commercial office project, this has been the real driver of 2022 construction cost inflation in weighted terms.

At an estimated **4.8%** for the year, the labour inflation index has lagged both the BCIS’ materials and plant inflationary indices but is forecast to see a significant step change in the second half of 2023 as earnings growth attempts to partly catch up with broader inflationary trends and higher costs of living. Construction’s skill shortage issues and tight labour market will likely

mean less downward pressures on wages in 2023 compared to previous economic downturns.

Construction cost inflation for the first half of 2023 is in stark contrast to that of 2022. The BCIS Materials Cost index is set to continue its downward trend that started in mid-2022, dropping a further **2.2%** in six months to June 2023 (on top of a **2.1%** fall in the second half of 2022). This compares to a **14.2%** increase to the materials index in the first six months of 2022. Meanwhile, BCIS’ Labour Cost Index is forecast to increase by just **0.3%** in the six months to June 2023 (compared to a **1.4%** increase over the same period in 2022).

As we likely enter recession, some key sources of construction cost inflation are set to ease or fall back in the coming months. 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 this year. Several factors from our previous TPI report continue to impact tender pricing, but economic headwinds and anticipated reductions in workload may act to partly offset these prevailing inflationary pressures.

Material Costs

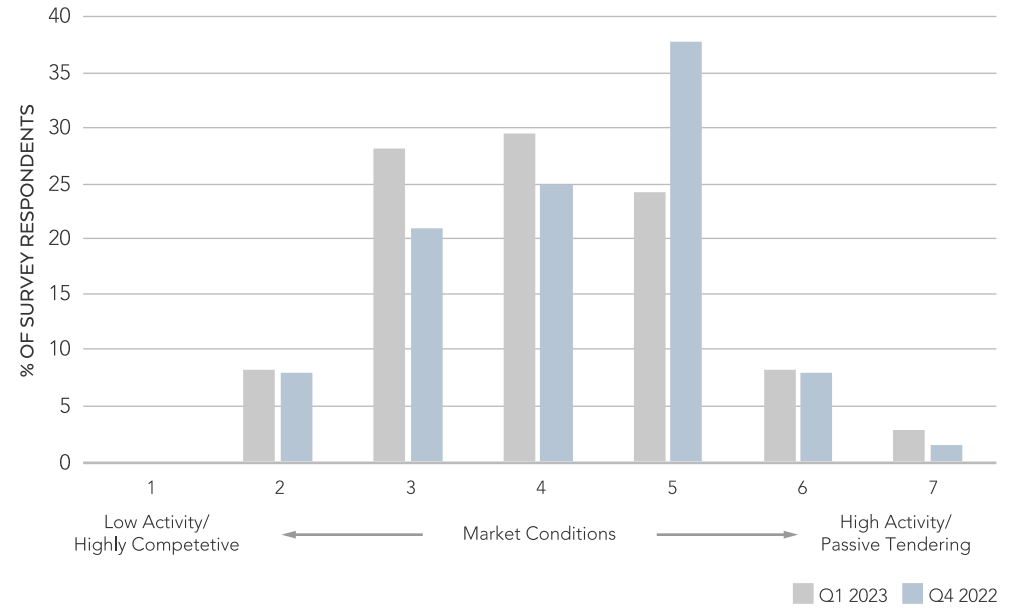
Key to our lower inflationary expectations for 2023 is peaking materials prices. Since the summer, several key materials (such as structural steel and rebar) have fallen in price while other items (such as insulating materials) have risen due to high demand.

While the BEIS All-Work Index (a basket of goods that tracks price movements for construction materials) shows material prices in October 2022 were **14.7%** higher than they were one year ago (and **44%** higher than they were pre-pandemic), materials prices appear to have turned a corner. August and October saw two monthly contractions to the Index – the first time prices have contracted in over two years. The recent easing in general material price inflation reflects a stabilization of energy and commodity price inflation.

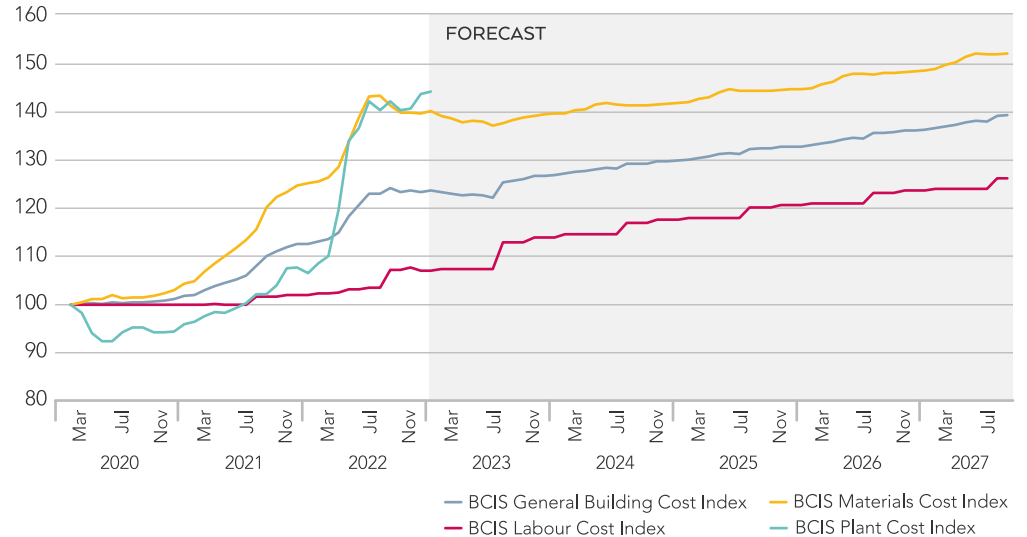
The risk of a global recession has had a part to play in easing demand (and hence, price)

PERCEPTION OF MARKET CONDITIONS OVER THE NEXT SIX MONTHS

London



BCIS INPUT COSTS



Source: **BCIS**

Inflationary Pressures

- Tight labour market (due to reduction in supply) to put upward pressure on wages
- Risk of geopolitical tensions escalating, disrupting supply chains further
- Strong domestic inflationary pressures as businesses raise selling prices
- Ending of the Energy Bill Relief Scheme (ie discounted energy bills for businesses) in late March
- Risk of further energy supply disruptions may lead to energy price volatility
- De-globalisation/protectionist government policies
- Substantive rise in contractor insolvencies could reduce supply chain capacity and tendering competition
- Strong workload levels and short-term order books easing immediate pressure to win new work by reducing on-costs/margins
- No immediate cuts to planned infrastructure project spending and investment to support workload

Deflationary Pressures

- Falling fuel and wholesale energy prices to ease energy crisis
- Monetary tightening (aggressive interest rate rises increasing borrowing costs and deterring investment)
- Recession to impact demand, client investment plans and spending decisions
- Viability concerns putting projects on hold and reducing construction activity
- Greater competitiveness by contractors with on-costs and risk allowances to win work/secure turnover
- China ending zero-COVID policy to ease supply chain pressures further and improve global trading bottlenecks
- Risk of rising unemployment to ease upward pressure on labour costs
- Raw commodity prices retreating due to slowing global demand
- Global inventories/stock levels of finished goods and materials are starting to build
- Shipping costs returning to pre-pandemic levels weighed by weaker demand for vessels

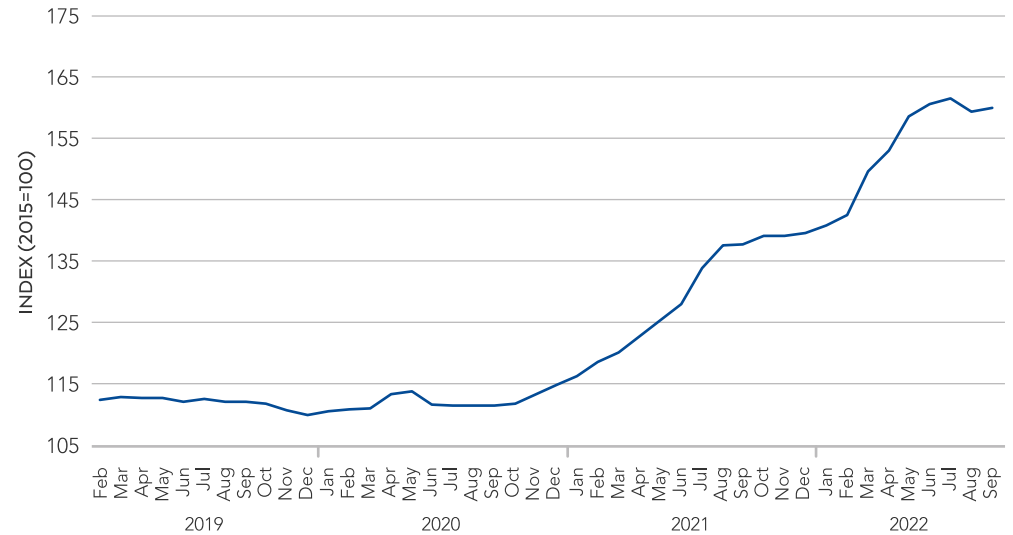
for many construction materials, but with manufacturers of several key materials such as bricks and plasterboard set to increase prices again in January, we're unlikely to see an unbroken downward trend when it comes to materials costs.

Wholesale energy prices will remain a significant upside risk in 2023 for materials manufacturing costs. Recent falls in gas and oil prices are reassuring but prices remain historically elevated and the underlying/fundamental causes of these higher fuel and energy remain stubbornly in place. According to the Dutch TTF (a Europe-wide natural gas price benchmark), European natural gas prices fell back to pre-Ukraine war levels of **€70/MWh** in mid-January 2023. Milder European temperatures this winter reduced consumption, while record LNG imports, a rise in renewable capacity and high gas storage levels across Europe all helped bring wholesale energy prices down from their 2022 peaks. Regardless, the energy market will remain volatile through 2023 and beyond – especially now that gas demand from China and other Asian countries could increase competition in the LNG market.

Additionally, there is a risk that prices paid for gas and electricity will rise once the UK Government's energy support packages end on 31st March. Support from April is likely to be less generous so energy prices for businesses in the short-medium term will rise, even if wholesale energy prices continue to fall. The lag effect from energy hedging will also feed into elevated energy prices, with lower wholesale prices not passed on to consumers/end-users immediately.

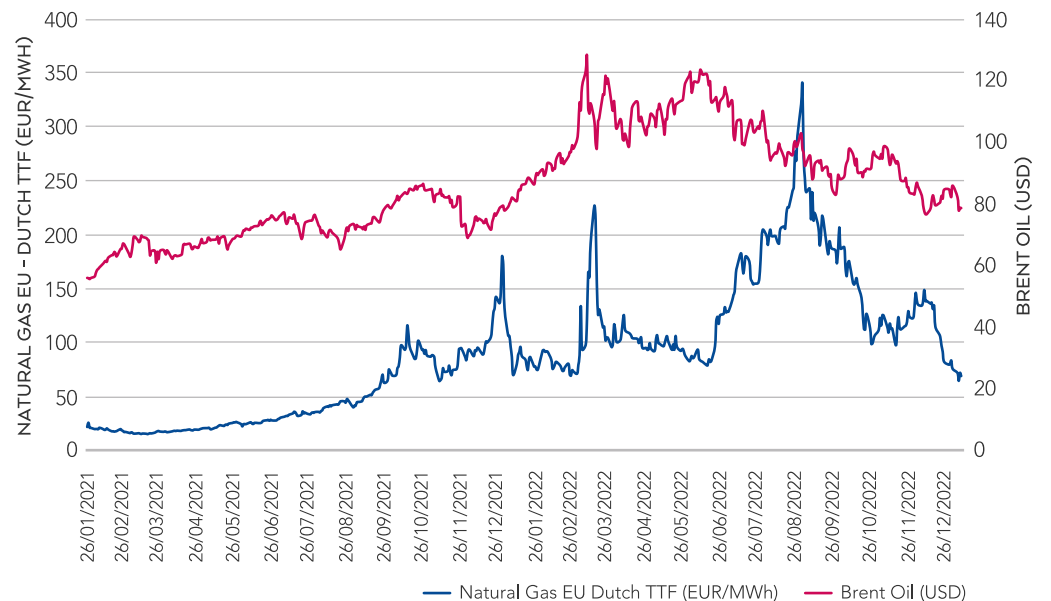
Lower Brent crude oil prices also bode well for plant and machinery operational costs. At less than **\$80/bbl**, oil prices in early January 2023 were on par with January 2022 levels. Prices have been slashed due to concerns over the impact a global economic slowdown will have on short-term crude demand. However, the recent UK/EU ban on Russian oil (which will add to demand), China's COVID policy change and chronic underinvestment in upstream capacity mean the outlook for oil is bullish and prices may once again increase.

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



Source: **BEIS**

NATURAL GAS EU DUTCH TTF V BRENT OIL: JAN 2021 - JAN 2023



Source: **Investing.com**

So, with energy-led materials price increases confirmed for January, prices for a number of key construction items will invariably increase. Fortunately, several materials that saw rapid price increases have subsided resulting in a net stabilisation of prices overall. While natural resources from Ukraine and Russia (eg neon, copper, aluminium, nickel, platinum etc) will remain in short supply and maintain higher pricing levels and longer lead times, most material resources have become more available as supply chain issues have eased and global demand subsided. Falling raw commodity prices have helped apply downward pressure on materials-related input costs of late, with basket of goods indices such as the 'S&P GCSI' showing broad downward trends since June of last year.

Amid a clouded global backdrop of slowing economic growth and monetary policy tightening by central banks worldwide, physical as well as speculative demand for commodities began to decline in the second half of 2022. Supply chain issues also began to ease significantly, alleviating stock shortages, while the cost of shipping freight (which exploded in 2021) is now roughly one-tenth of the levels reached in August 2021. These big declines in commodity prices began to feed through to the price of finished construction material prices, as evidenced by the BCIS' price indices of key construction materials.

BEIS data shows that in October 2022 (the latest figures available at the time of writing), fabricated structural steel prices were just 6.1% higher than they were one year ago. Rebar prices have been more stubborn and are still 21% higher on an annual basis but a handful of materials cost less in October than they did one year ago (eg imported timber which dropped nearly 20% year-on-year).

Interestingly, both aggregates and insulating materials have outstripped until what were recently the most inflated materials in 2022 – structural steel and rebar. Insulating materials were more than 51% higher in October 2022 than they were one year ago, while some aggregates were nearly 57% higher. Both materials have been affected by a combination of ongoing shortages, strong demand and higher energy costs. These have forced manufacturers to add significant surcharges and make multiple unscheduled price increases.

The elevated costs of fuel and energy will continue to impact manufacturers in 2023 due to the lag effects noted previously. Builders merchant chain Jewson warned that the price of bricks and drainage pipes would rise 20% in January 2022 while block paving will increase by up to 19.5%. Aerated blocks, plaster and roofing materials are all increasing by up to 18%, and plasterboard and specialist board by up to 17% in January. There are also double-digit price increases for aggregates, PIR insulation and for heating and plumbing materials. Evidently, material price movements will continue to play a significant role in terms of input cost inflation in 2023, but the situation has improved significantly compared to 2022. Falling commodity prices are playing a part, applying some much-needed downward pressure on construction costs, but higher prices are likely here to stay for at least the short to medium-term.

Labour

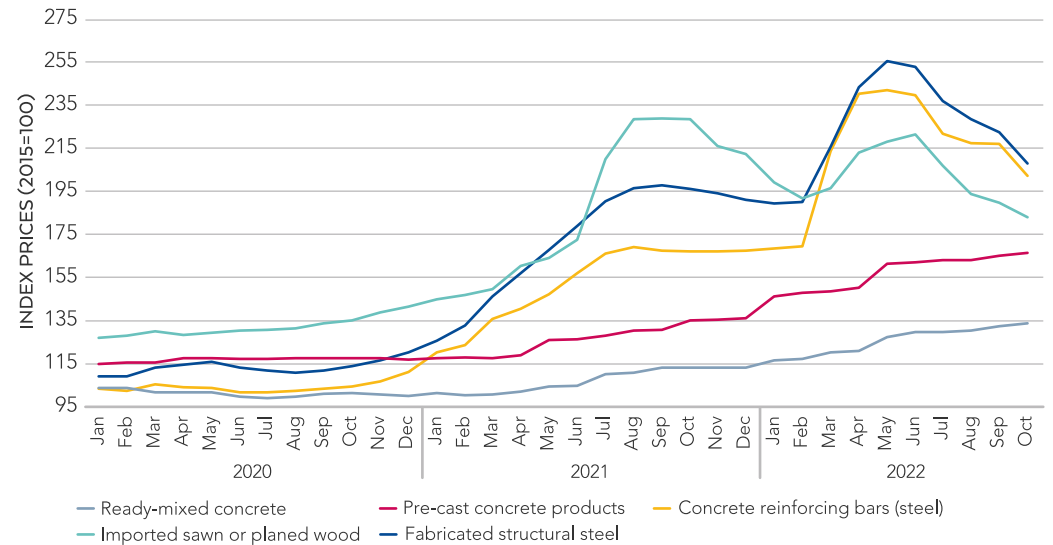
The construction labour market remains tight. Structural supply issues with skilled labour and cost-of-living pressures helped push average weekly earnings (AWE) across the industry up by 6.1% (on a year-on-year, three-month average basis) in October 2022. It's difficult to see the construction employment market being anything other than constrained in the near term. As such, pressure on wages will remain until either the pool of skilled labour expands or falling construction output starts to reduce workloads and demand for workers.

AWE growth in UK construction (again, on a year-on-year, three-month average basis) is typically 3% according to the ONS, but the construction sector is not alone in seeing such high levels of wage growth. The average weekly earnings figure for the economy as a whole (at 6%) is also nearly double the typical annual growth rate. Despite this doubling of typically annual wage growth, labour was the least inflated construction input cost in 2022.

However, many forecasters anticipate that labour will take over as the biggest driver of tender price inflation in 2023, pushing up installation costs on site and adding upward pressure to preliminaries. The UK unemployment rate recently reached its

BEIS: PRICE INDICES OF CONSTRUCTION MATERIALS (UK)

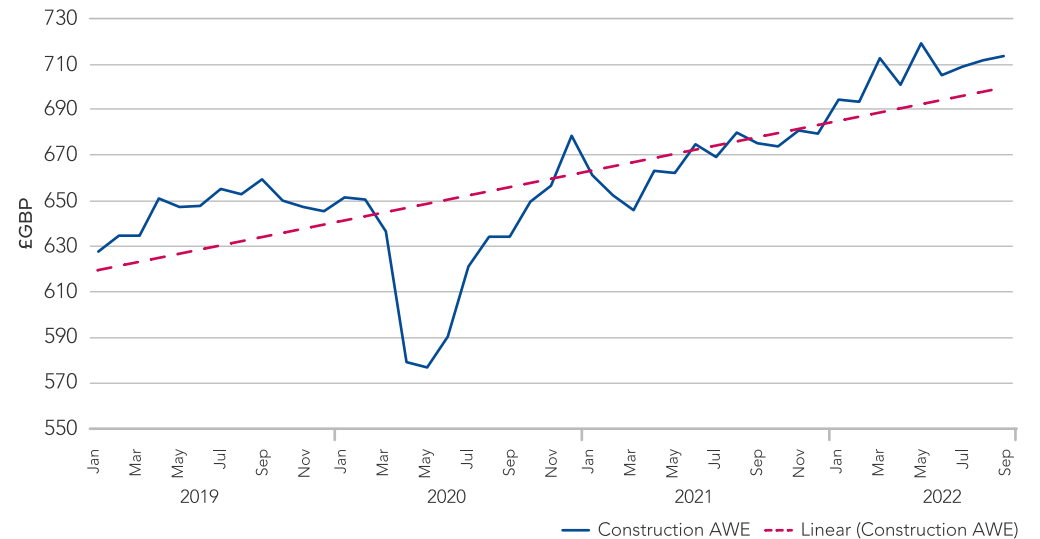
Index 2015 = 100



Source: BEIS

AVERAGE WEEKLY EARNINGS:

UK CONSTRUCTION V WHOLE ECONOMY *Seasonally adjusted*



Source: ONS

lowest level since the mid-1970s and many firms continue to struggle with recruitment difficulties. Difficulties in recruiting continue to support underlying wage growth. In fact, vacancy rates in construction reached an historical high of **c.50,000** in the Aug-Oct period last year given the strong levels of demand for labour. However, high vacancy rates have also been associated with high hiring rates – with the labour market exhibiting significant ‘churn’ as many workers decided to move jobs in 2022. This may partly be a reflection of the inflexibility to move from one job to another during parts of the pandemic when many were initially furloughed.

Another key factor behind the current tightness in the labour market is a fall in participation rates among the working age population. The reasons behind the decline are varied but the Bank of England suggests that the impact of the pandemic on early retirement and long-term health, as well as underlying demographic developments, all seem to have played a role in reducing participating rates of those in the 50-65 age group. These rising levels of inactivity among the working age population contributed to an adverse labour supply shock and have played a role in preventing total construction employment numbers from returning to pre-pandemic levels. Following the winding down of the furlough scheme, policy makers expected that releasing furloughed workers back into the labour market would ease some of the recent tightness, however this did not materialise owing to the adverse developments in participation rates.

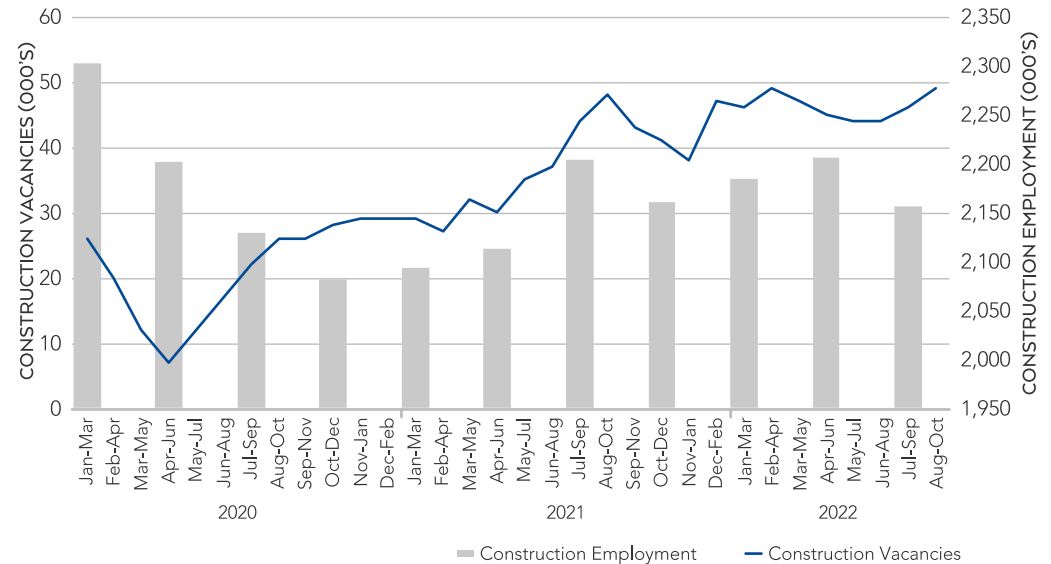
Brexit has undoubtedly been another factor that has weighed on labour supply. Although aggregate levels of immigration into the UK remain elevated (1.1 million in the year ended June 2022 – up **435,000** compared to YE June 2021), the loss of flexibility associated with the end to free movement of EU workers into the UK has not helped address labour market mismatches and is now more costly for employers. However, with the economy now slowing, ongoing resource pressures may partly be offset as current projects reach completion and demand for new construction projects recedes, releasing labour back into the market.

Indeed, a number of labour market indicators are starting to turn. Vacancies appear to have stabilised, according to the latest ONS data. In fact, in December’s UK Construction PMI survey purchasing managers noted that pessimistic expectations over the near-term economic outlook and construction activity in the year ahead were reflected in the first round of job shedding since January 2021. The PMI employment index fell below the no-change level (indicating a contraction in staffing levels at construction firms), ending a 22-month sequence of jobs growth. Further anecdotal evidence suggests some firms were also not replacing leavers due to weaker levels of new work.

Furthermore, several economic forecasters (including the OBR and the Bank of England’s Monetary Policy Committee) suggest unemployment rates have likely bottomed out and will start to rise as the economic downturn impacts trade and investment. Should economic slack emerge and unemployment rises as expected, this will weigh on domestic inflationary pressure and ease the threat of inflation persistence and the prospect of wage-price spirals. While these emerging pressures haven’t had much impact on wage inflation yet, they are likely to place increasing constraint on potential earnings growth.

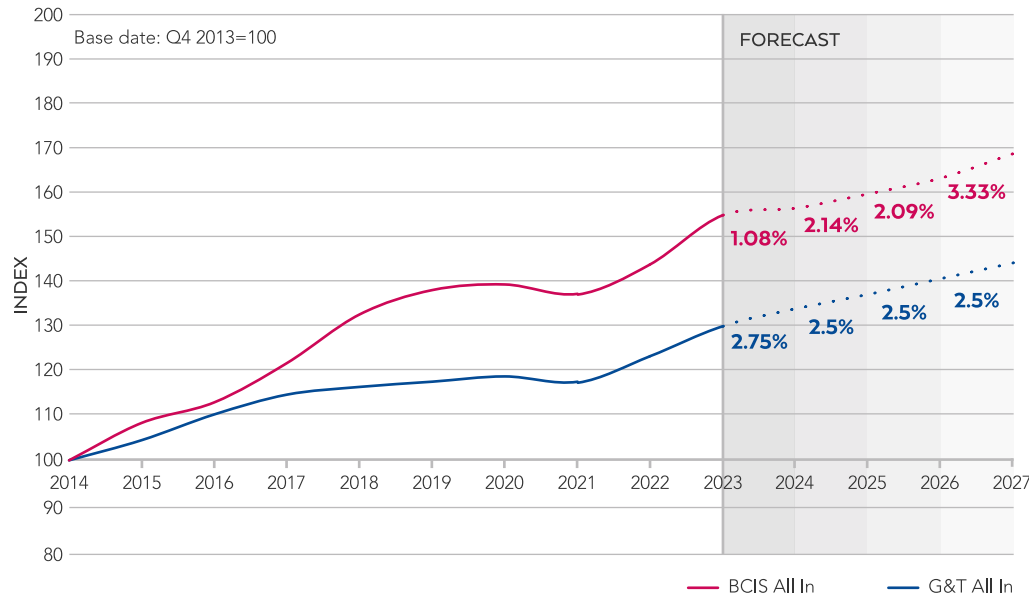
For now, though, the current scarcity of available staff and labour resource across several trades (eg plumbers, joiners, painters and bricklayers) and dampened candidate availability due to increased caution in seeking new roles in the current economic climate continues to drive construction labour costs higher.

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



Source: [ONS](#)

TENDER PRICE TREND 'ALL UK TPI'

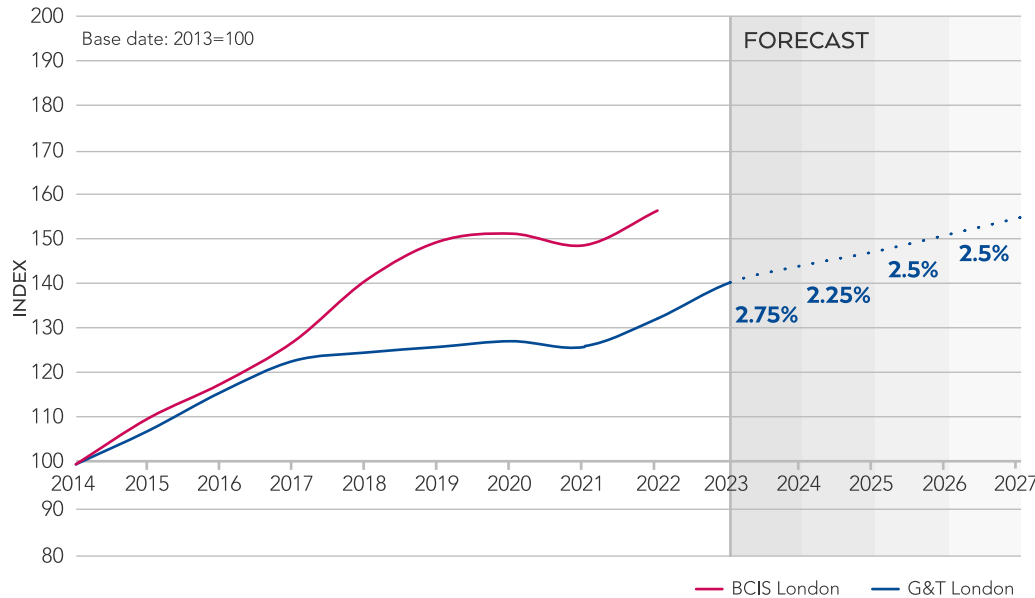


TENDER PRICE ANNUAL PERCENTAGE CHANGE Q1 2023

% Regional forecasts	2022		2023		2024		2025	
	Now	Last*	Now	Last*	Now	Last*	Now	Last*
Greater London	2.75	3.00	2.25	2.50	2.50	2.50	2.50	N/A
South East	2.75	3.00	2.25	2.50	2.50	2.50	2.50	N/A
South West	3.75	4.00	3.50	3.50	3.00	2.50	2.50	N/A
East	2.75	3.00	2.50	2.50	2.50	2.50	2.50	N/A
Midlands	3.00	2.50	2.50	2.50	3.00	2.50	2.50	N/A
Wales	2.50	2.00	2.50	2.50	2.00	2.00	2.50	N/A
Yorks & Humber	3.00	4.00	2.50	3.00	2.50	2.50	2.50	N/A
North West	2.00	2.50	2.00	2.00	2.00	2.00	2.00	N/A
North East	2.50	3.00	2.00	2.00	2.50	2.00	2.00	N/A
Scotland	2.25	2.50	2.00	2.00	2.00	2.00	2.00	N/A
Northern Ireland	3.00	3.00	2.50	2.50	2.00	2.00	2.50	N/A
UK Average (weighted)	2.75	3.00	2.50	2.50	2.50	2.25	2.50	N/A

Last* 4Q22

TENDER PRICE TREND 'LONDON TPI'



COMPARISON OF PUBLISHED FORECASTS FOR TENDER PRICE CHANGE

	G&T UK AVER.	BCIS UK AVER.	G&T LONDON	AECOM UK	ARCADIS LONDON
	Q1 2023	Jan 2022	Q1 2023	Q1 2023	December 2022
% CHANGE					
2023	2.75	1.08	2.75	5.00	2.00
2024	2.50	2.14	2.25	3.50	3.00
2025	2.50	2.09	2.50	N/A	3.00
2026	2.50	2.33	2.50	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.