CONSTRUCTION MARKET BRIEFING

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Construction industry growth forecasts downgraded to 1.7% per year for next five years.

Infrastructure expected to represent 45% of construction growth.

Regional new orders up whilst London new orders fall.

Tender inflation for 2017 set to be zero percent.

SPRING 2017

With material cost hikes starting to bite and a potential deepening of the skills shortage, the UK construction industry faces challenging headwinds. The Government's increased commitment to infrastructure spending is a positive, but it remains to be seen whether this can offset the detrimental impact of Brexit.

Infrastructure is the foundation for growth

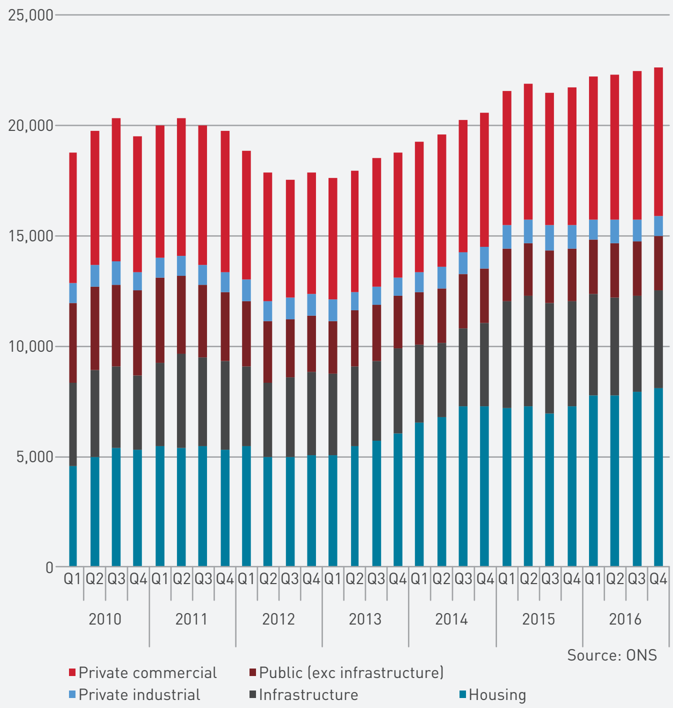
The Construction Industry Training Board (CITB) has recently lowered its five year growth forecasts for the construction industry down to 1.7% per year up to 2021. However, the latest Markit/CIPS UK Construction PMI predicts a modest rise in construction output in February, with infrastructure replacing the residential housing sector as the main driver of growth in the industry.

This growth is forecast to come from large infrastructure projects such as HS2, Hinkley Point and Wylfa Newdd nuclear power plants. According to the CITB, the infrastructure sector is forecast to grow significantly over the coming years and, if all three of these projects proceed, the sector will represent 45% of all construction growth in the period.

The latest figures from the Office for National Statistics (ONS) reveal that Great Britain's construction output for all new work stagnated in January 2017, with month-on-month growth of only 0.1%. However, this followed 2.1% growth over the previous three months and 3.5% growth during 2016.

The ONS data also confirms the strong performance of infrastructure over private housing, with infrastructure growing by 4% over the preceding three month period and private housing at 3%. Private commercial, which is also a significant contributor in terms of output value, saw only marginal growth of 0.5%, with private industrial seeing the largest fall of 7.3%.

Construction output (£m)

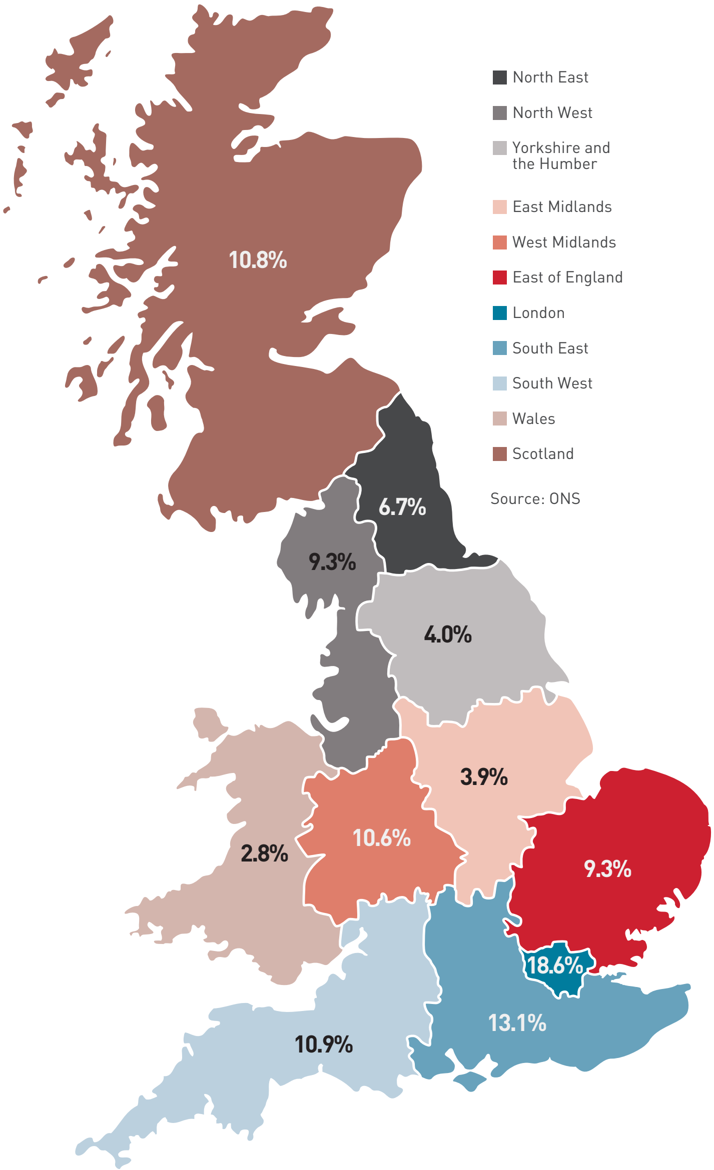


Regional value of new orders

The value of new orders for construction over the last quarter saw London maintain its prominence, taking 18.6% of Great Britain's total. The South East was second at 13.1%, and the South West was third at 10.9%. However, London and the South East both saw a reduction on the previous quarter, down 7% and 6% respectively, perhaps indicating that new orders are starting to move out from London and into the regions.

Indeed, the North East saw the largest percentage increase quarter-on-quarter, recording a 178% jump in the value of new construction orders and driven by strong growth in infrastructure. The South West also saw a 59% increase over the same period, principally due to an increase in orders for the public (excluding infrastructure) sector.

Regional new order values Q4 2016



	Value £m		% change	
	Q3 2016	Q4 2016	Q3 2016	Q4 2016
TOTAL ALL NEW WORK	13,066	12,704	-3%	-3%
PUBLIC HOUSING	449	371	-1%	-17%
PRIVATE HOUSING	3,506	3,440	0%	-2%
INFRASTRUCTURE	3,012	2,894	25%	-4%
PUBLIC (EX INFRASTRUCTURE)	1,505	1,898	-26%	26%
PRIVATE INDUSTRIAL	1,002	890	4%	-11%
PRIVATE COMMERCIAL	3,592	3,210	-11%	-11%

Source: ONS

Referendum uncertainty impacts upon new orders

In spite of the huge level of uncertainty engendered by last year's referendum result, 2016 as a whole was the strongest year for new orders since 2008. Performance for all new work was up 3% on 2015, while all sectors witnessed growth year-on-year except for private industrial, which fell 11%.

That said, new orders were impacted in the wake of the referendum outcome. The quarterly figures recorded negative growth of 3% in both Q3 and Q4 2016, reinforcing the view that many projects were initially put on hold following the EU referendum due to investment uncertainty. Private industrial and commercial both fell by 11% over the last quarter, albeit this was partly offset by public (excluding infrastructure), which saw a notable 26% increase in new orders.

Rising costs and labour shortages pose major challenges

While the impact of the EU referendum result has already been felt, this is arguably just the start of a long period of uncertainty, with up to two years of Brexit negotiations ahead of the UK Government. The pound has fallen circa 10% against the euro, the effects of which can be felt in many different areas of the economy, not least in the construction industry.

Eastern European labour is a vital component of the UK construction sector. These workers are highly skilled and make up the lion's share of the 12% of foreign workers in the UK construction industry. However, they are acutely aware of the effects of the falling pound, as many repatriate their wages to support their families. Add to this the potential of stricter immigration controls flowing from a 'hard' Brexit, there is a risk that this key part of the workforce will leave the UK in search of more lucrative work elsewhere in the EU, heaping further pressure on an industry already in short supply of skilled workers.

The fall in the pound is also driving up prices for imported materials. The Markit/CIPS UK Construction PMI reported that January saw the steepest rise in costs in over eight years. Another effect of the EU Brexit negotiations could result in tariffs on the importing and exporting of construction products, increasing the possibility of a further hike in the cost of imported materials.

The Government has done its research on these pressing matters for the industry. Unsurprisingly, its formulated response concludes that the construction sector is a low priority in the Brexit negotiation strategy. However, they also have some ambitious plans for both housing and the infrastructure sectors.

Unless the current and foreseeable skills shortages and rising cost of imported materials are addressed, they will severely hinder achieving the Government's own targets. Ultimately this will restrict both supply and demand for construction and could have an adverse effect on wider economic growth.

Tender price inflation forecasting during Brexit

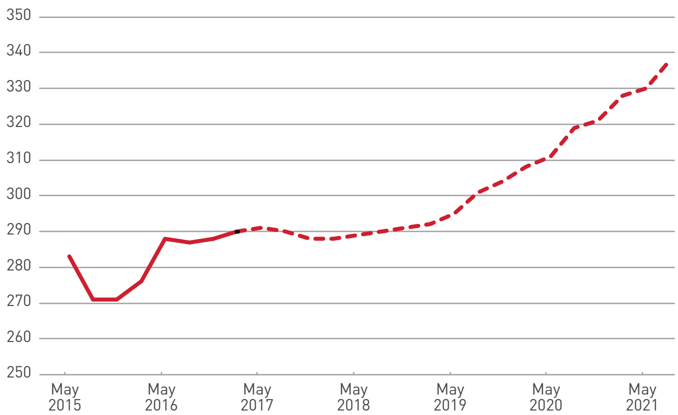
With so much uncertainty in the economic outlook, no one really knows what a post-Brexit Britain will look like. Inflation forecasting has therefore become difficult to predict. Currently the BCIS is running three scenarios:-

1. An 'upside' scenario based on the assumption that we will remain in the European free trade area, but there would be some restrictions on the movement of labour.
2. A 'downside' scenario based on the assumption that we do not have favourable access to the European Union market and there would be restrictions on the movement of labour.
3. A 'central' scenario based on some restrictions to trade and there are restrictions on the movement of labour.

BCIS's All-in Tender Price Index assumes a 'central' scenario, with growth slowing in the short term particularly around the private non-housing sector. Tender prices are expected to stabilise in the second half of 2017 and into 2018 due to the ongoing uncertainty and the need for contractors to maintain competitiveness in the market place.

The effect on tender price inflation can be seen from the latest BCIS All-in Tender Price Index:-

BCIS All-in Tender Price Index (1985=100)



Source: BCIS

Tender prices are set to stagnate for the next two years. BCIS is forecasting flat growth of 0.0% in 2017 followed by 1.0% growth in 2018 before rising by 4.4% in 2019.

UK tender price index forecast

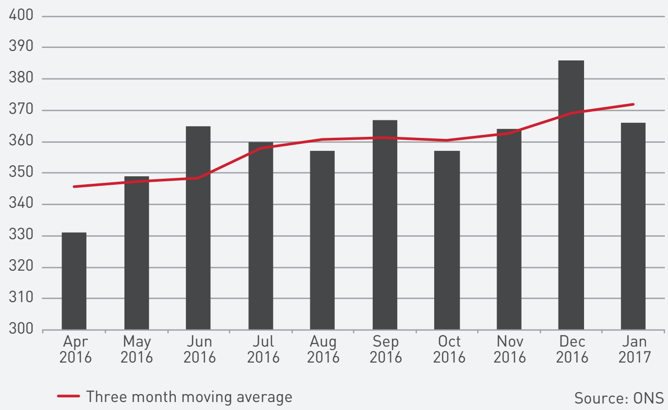
	2016	2017	2018	2019
Q1	1.8%	0.7%	0.0%	0.3%
Q2	4.3%	0.3%	0.3%	1.0%
Q3	-0.3%	-0.3%	0.3%	2.0%
Q4	0.3%	-0.7%	0.3%	1.0%
TOTAL	**6.2%**	**0.0%**	**1.0%**	**4.4%**

Source: BCIS

Construction output (all new work)

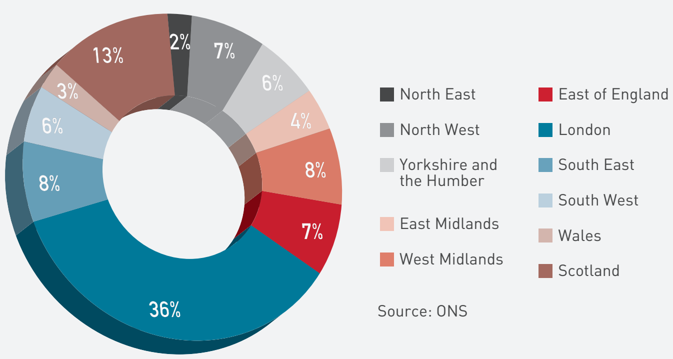
PUBLIC HOUSING

Output value (£m)



Source: ONS

Output by region (%)



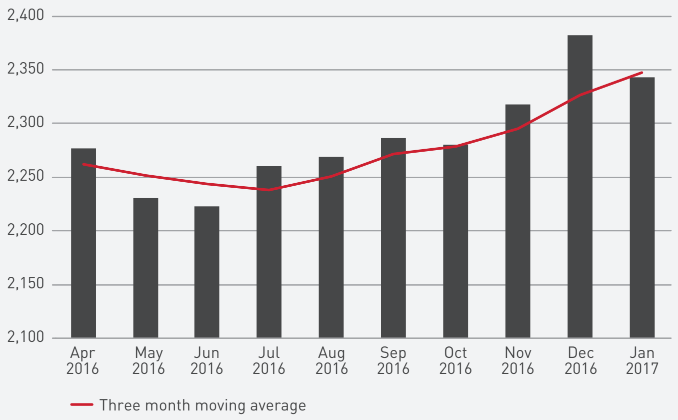
Source: ONS

Construction output for the public housing market dipped in January, down 5% month-on-month. However, output over the last three months (November to January) has seen a 3.2% increase on the previous three months. This is supported by the positive direction of the three month moving average. Performance over the last 12 months has however dropped 5.1%

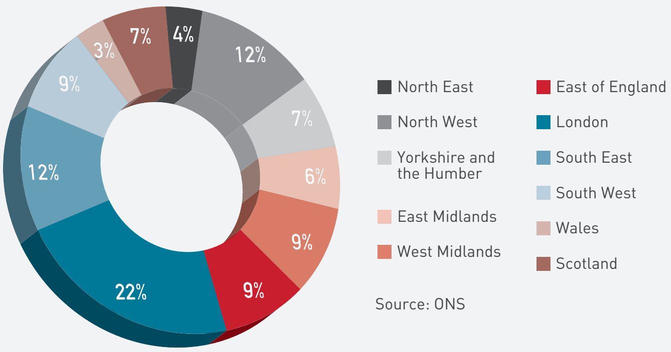
London dominates output for public housing, with 36% of the national total and maintaining its top position in the previous quarter. Scotland also maintains its position in second place, with a 13% share of the total output.

PRIVATE HOUSING

Output value (£m)



Output by region (%)

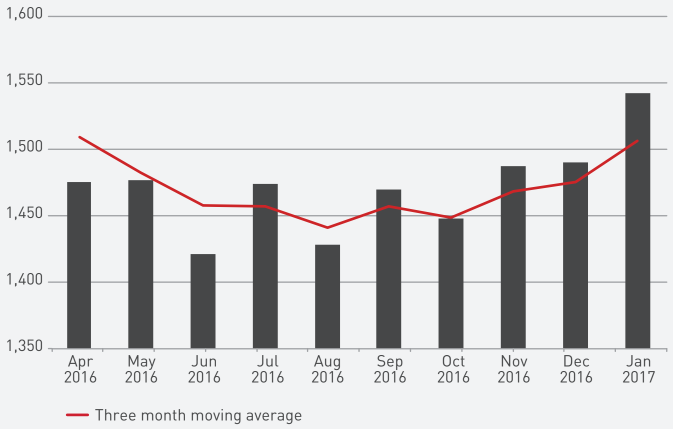


The sector saw a nominal fall in January 2017 of 1.6% on the previous month. However, it continues to perform well overall with a 3% increase on the previous three months, and a 13% increase on the previous 12 months. This shows that the private housing market continues to put forward a strong performance which is demonstrated by the positive three month moving average.

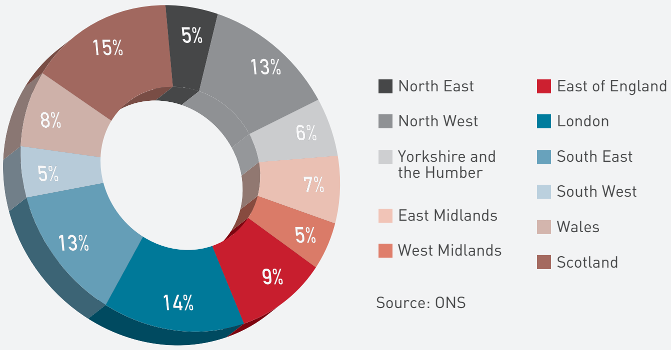
The private housing sector is also dominated by London with 22% of the construction output in Q4 2016. The North West and South East both share second place with 12%. However, the largest mover was the West Midlands, with an increase of 11% on the previous quarter.

INFRASTRUCTURE

Output value (£m)



Output by region (%)

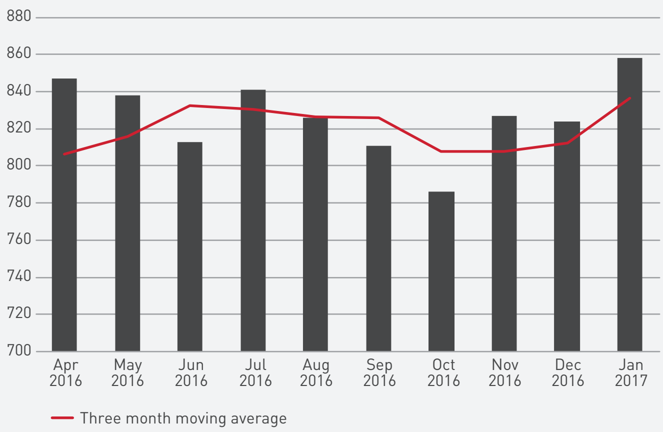


The data below indicates that construction output in infrastructure continues to strengthen with a positive increase of 3.5% in January 2017. The sector has also put in a positive performance with a 4% increase in output over the last three months. However, output is down by 9% on the previous 12 month period.

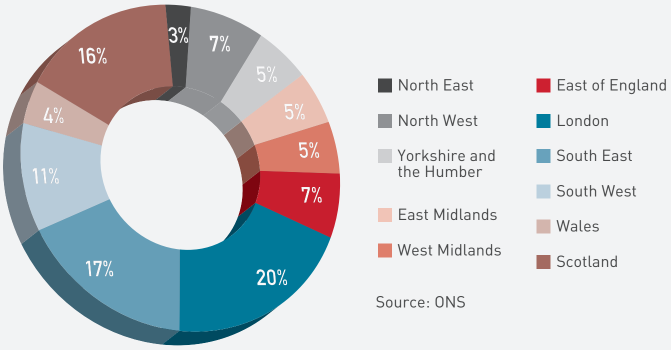
Scotland has topped the table with the highest proportion of construction output within the infrastructure sector, maintaining its position from the previous quarter. London comes in marginally lower at 14%. The regions showing the largest movement in the quarter is shared by the North East and the West Midlands, both with an 18% increase on the previous quarter.

PUBLIC (EXCLUDING INFRASTRUCTURE)

Output value (£m)



Output by region (%)

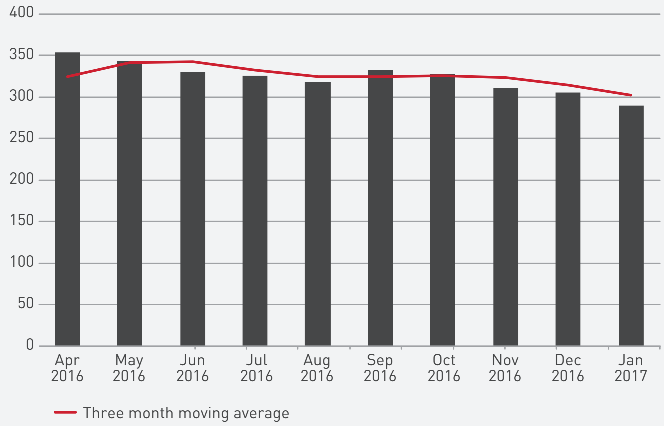


Recent data shows that the sector increased output in January by 4.1%. A further 3.5% has been achieved over the last three months when compared to the previous three months. Output over the proceeding 12 month period is also up by 2.8%.

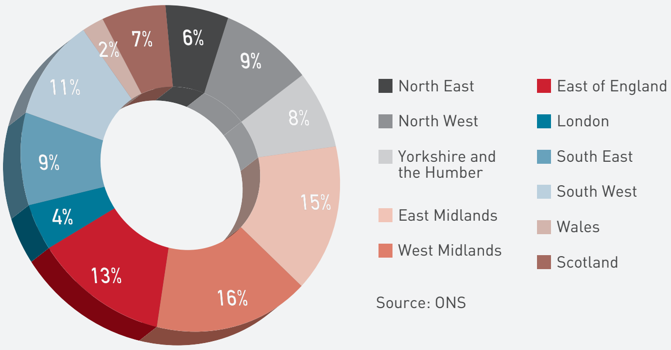
The last quarter of 2016 saw every region put in a negative performance in terms of construction output with the exception of the South West, which had a 40% increase in output when compared to the previous quarter.

PRIVATE INDUSTRIAL

Output value (£m)



Output by region (%)

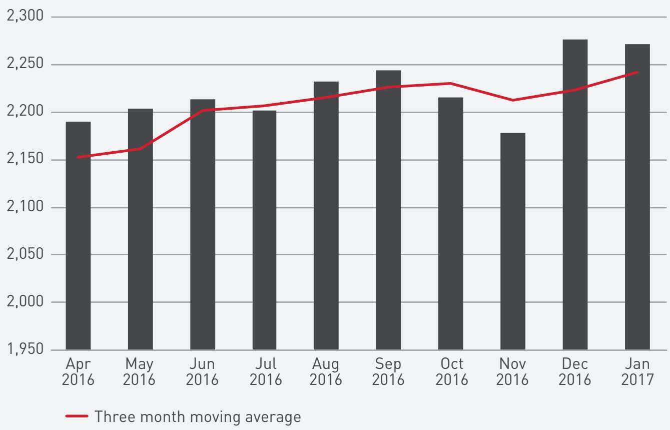


Private industrial has been in decline since May 2016. The last three months has seen a negative growth in output of 7.3%. Over the last 12 months growth has also fallen by 10% due to the reduction in warehouse output. Growth figures for factories has however been maintained when compared to the previous year.

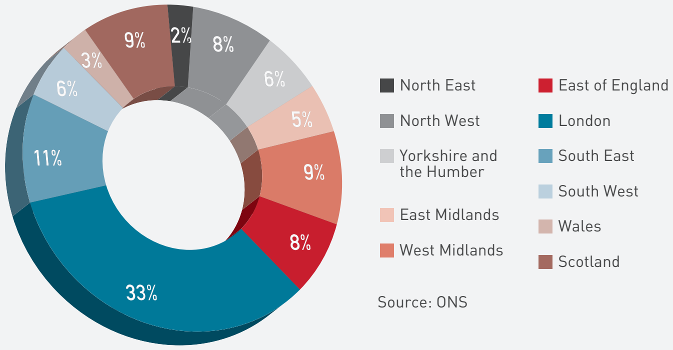
The West and East Midlands are performing well with a 16% and 15% share of ouput respectively, however, both are down on the previous quarter. London saw the largest fall of 27%. Scotland was one of the few regions to put in a positive performance with a gain of 11% on the previous quarter.

PRIVATE COMMERCIAL

Output value (£m)



Output by region (%)



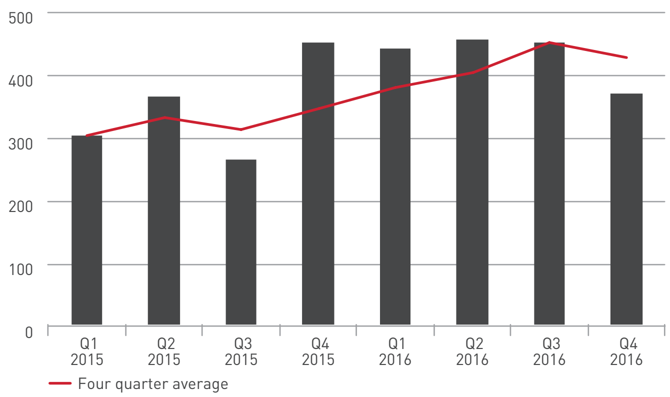
Commercial output dipped slightly in January 2017 by 0.2%. However, it is up 0.5% on the previous three months and up 8.4% on the previous 12 months. Schools, universities, offices and entertainment all showed positive growth during 2016 with the exception of retail shops which had a 5% fall in growth over the year. The three month moving average is showing a gradual positive growth pattern.

London secured a third of all private commercial construction output during Q4 2016 with 33% of the share. However, this was down 7% on the previous quarter. The South East was second with 11%, maintaining its previous position. The West Midlands saw the greatest gain of 10% on the previous quarter.

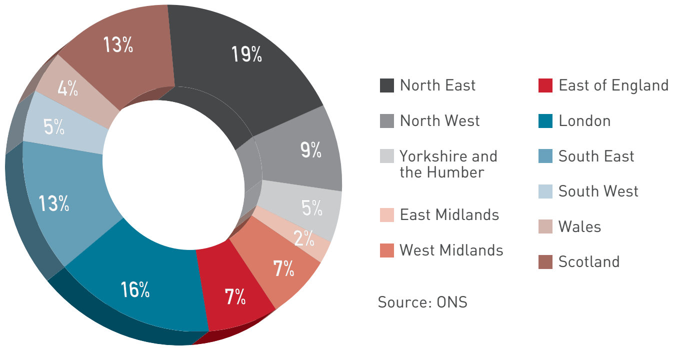
New orders

PUBLIC HOUSING

New contract values (£m)



New orders by region (%)

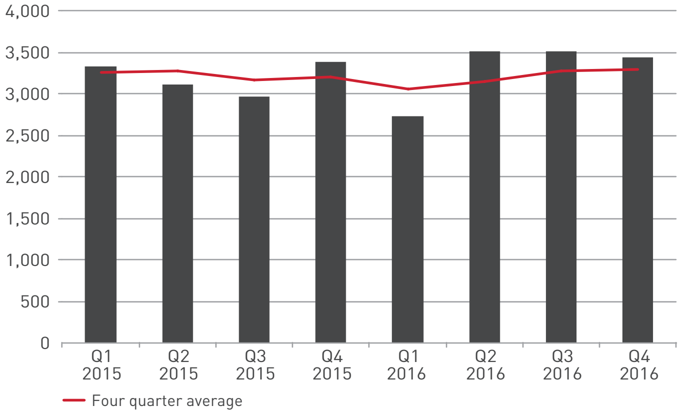


The value of public housing contracts awarded during Q4 2016 dropped by 17% against the preceding quarter. However, the sector finished 24% higher than the previous year up £332 million.

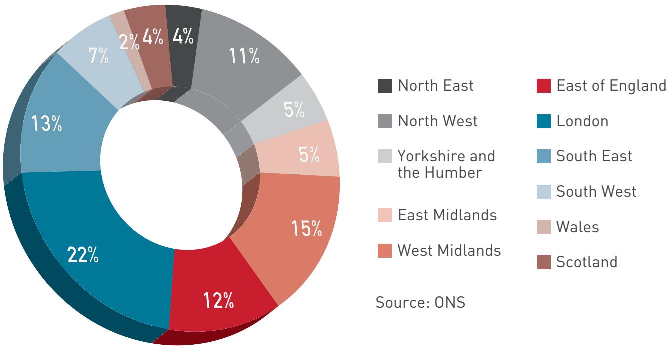
The North East saw the largest value of new contracts awarded during Q4 2016 at 19%, closely followed by London at 16%. The North East also received the largest increase in new contract values up 800% from Q3 2016 levels, with London and the East Midlands receiving the largest falls of 61% each.

PRIVATE HOUSING

New contract values (£m)



New orders by region (%)

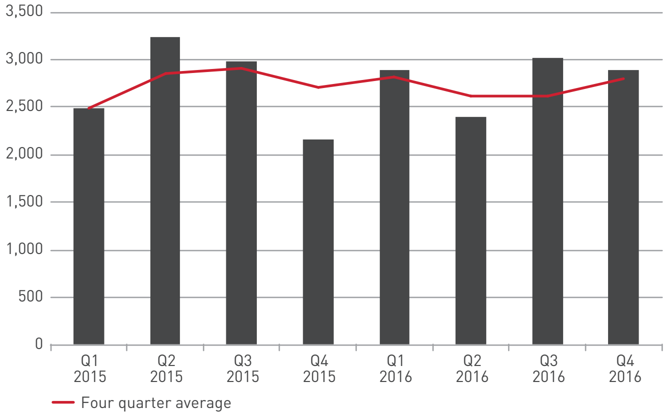


Private housing contract values were down during Q4 2016 by 2%. However, there was positive movement over the year, up 3% equating to £386m. The moving average is also showing positive movement in the year, but overall a flat line pattern is emerging.

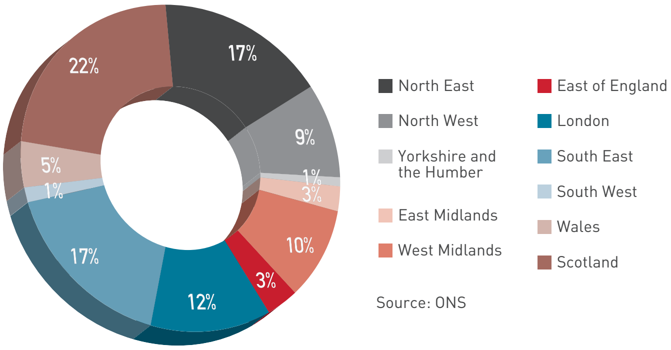
Unsurprisingly, London has recorded the highest value of contracts awarded during Q4 2016 at 22%. However, the data from the ONS indicates that there was a marked reduction in new contract values awarded in London in Q4 2016, down 29% on the preceding month. The West Midlands saw a significant leap of 121% compared with the preceding quarter.

INFRASTRUCTURE

New contract values (£m)



New orders by region (%)

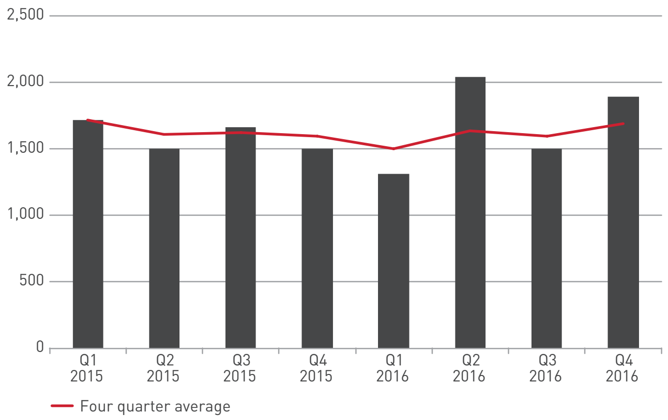


Whilst new contract values for infrastructure have been inconsistent over the last two years and have in fact dipped 4% on the previous quarter, the moving average is indicating that values have broadly been maintained, in fact they are up 3% on the previous year. There is also a 34% increase when comparing Q4 2016 with a year earlier and should show signs of further improvement once the government spending plans kick in.

Scotland leads the way with 22% of the new orders placed during Q4 2016. The South East and North East are both at 17%, however the North East has seen a significant investment allowing it to jump to joint second position.

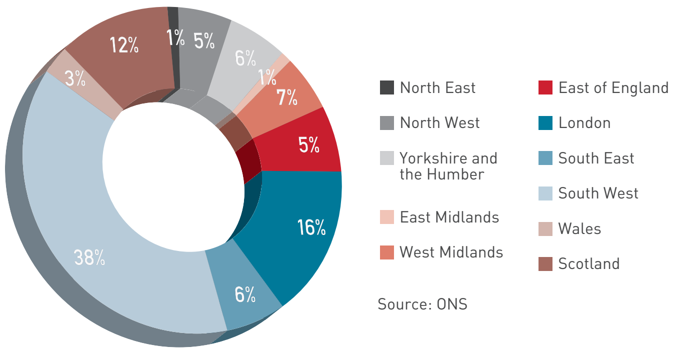
PUBLIC (EXCLUDING INFRASTRUCTURE)

New contract values (£m)



New contract awards in both universities and agriculture has seen this sector increase by 26% on the previous quarter. New orders are also up 6% on the previous year. The moving average is also indicating an upward trend for the sector.

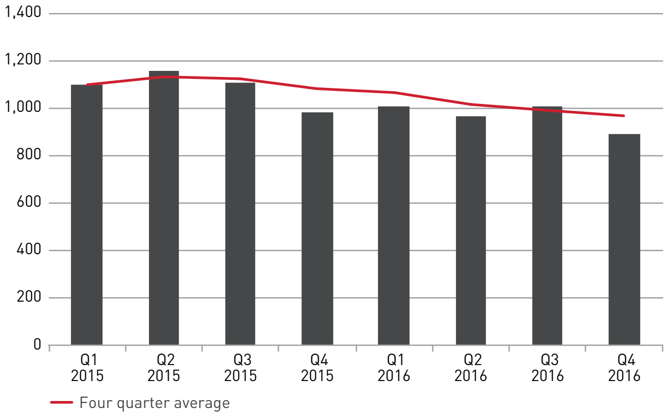
New orders by region (%)



The South West has dominated the sector over the last quarter with a 38% share of total output, moving up from 10% on the previous quarter. London achieved 16% which is marginally down on the previous quarter of 19%.

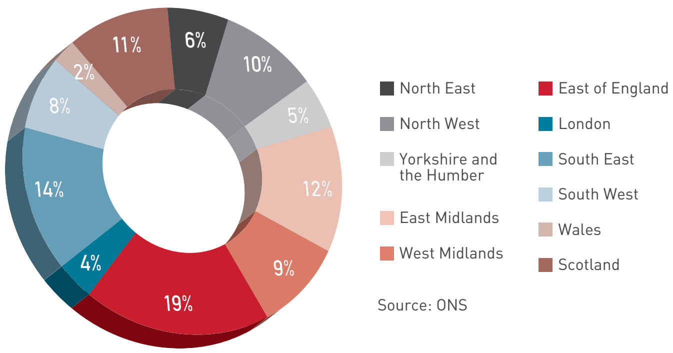
PRIVATE INDUSTRIAL

New contract values (£m)



The private industrial sector continues its decline on new orders following a disappointing drop of 11% in the quarter. The moving average line also demonstrates a gradual decline in the sector. Activity for the year has also seen a 11% fall in new orders when compared to 2015.

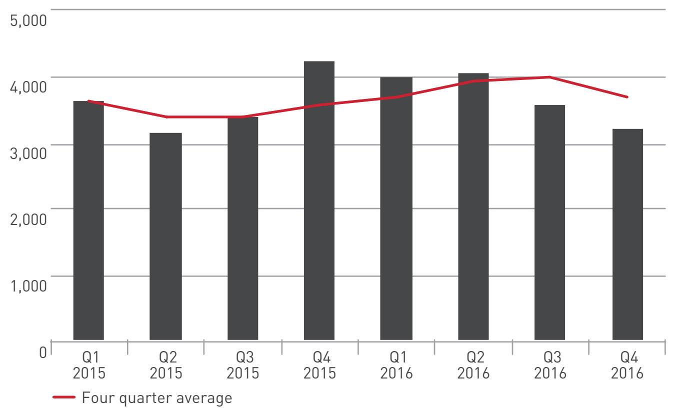
New orders by region (%)



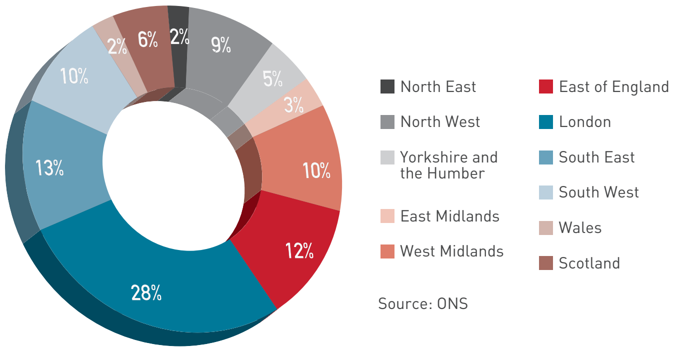
The East of England won 19% of the value of new contracts awarded during Q4 2016, with the South East and East Midlands taking second and third place respectively. The South East has seen a significant increase in the value of new orders over the quarter jumping from ninth to second position.

PRIVATE COMMERCIAL

New contract values (£m)



New orders by region (%)



Source: ONS

New order values for commercial premises have fallen once again in Q4 2016 with a drop of 10.6%. However, the value of new orders are up on the previous year with a 3% increase over 2015. The value of new orders on commercial offices, although down on the previous highs at the beginning of the year, are actually up by 2% on the previous quarter. Health however has seen a large fall of 53% when compared against Q3 2016.

London dominates the sector with a 28% share of the new contract values, and is marginally down by 5% when compared against the previous quarter. However, the South East, South West and East of England have all shown positive growth in the period.

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