ARCADIS

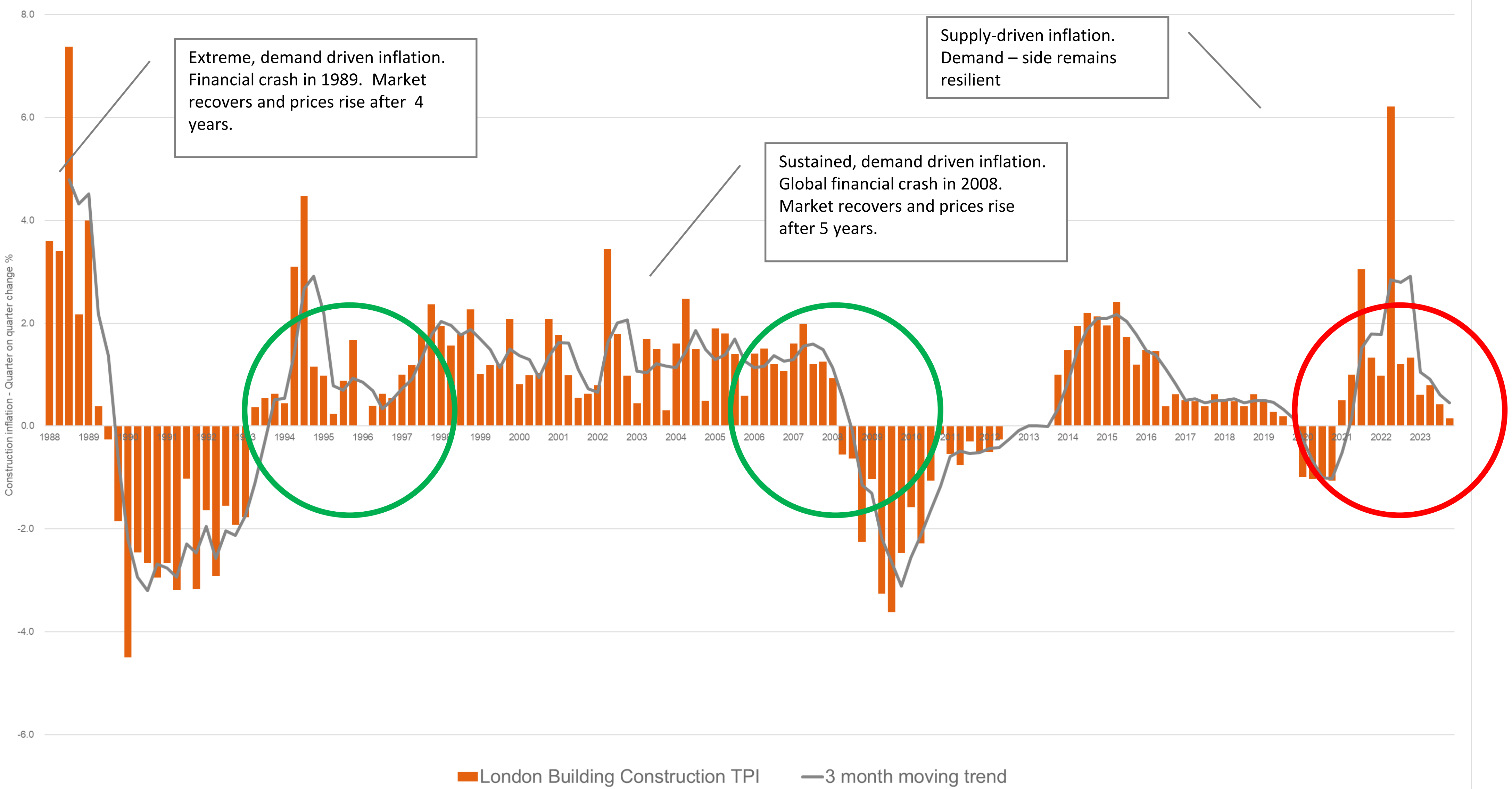
Construction Productivity Conference – Economic update and Market Forecast

Simon Rawlinson

January 2025

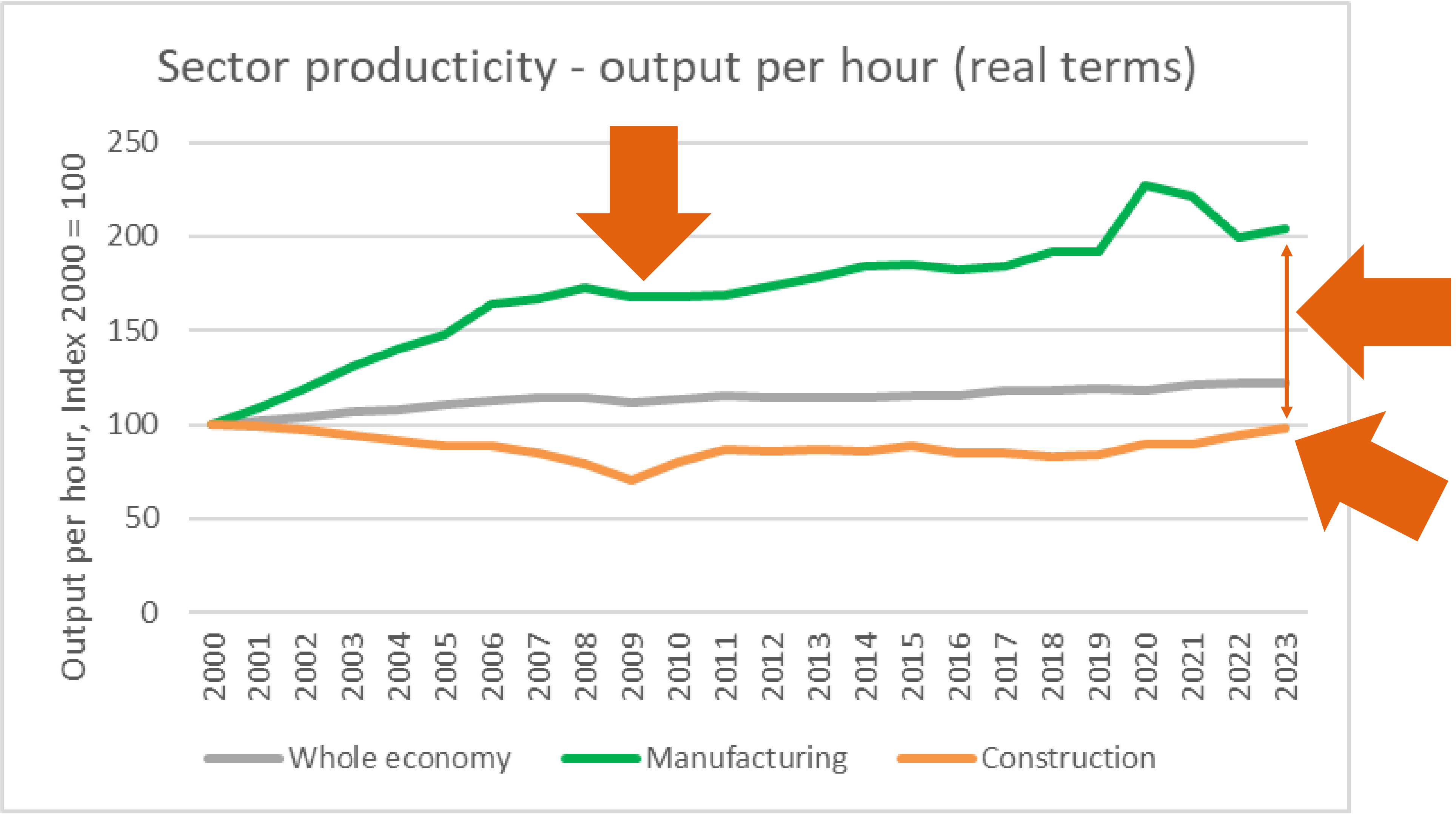
CONSTRUCTION PRODUCTIVITY CONFERENCE

What's going to happen to inflation and why?



Source: Arcadis

What’s going to happen to productivity and why?



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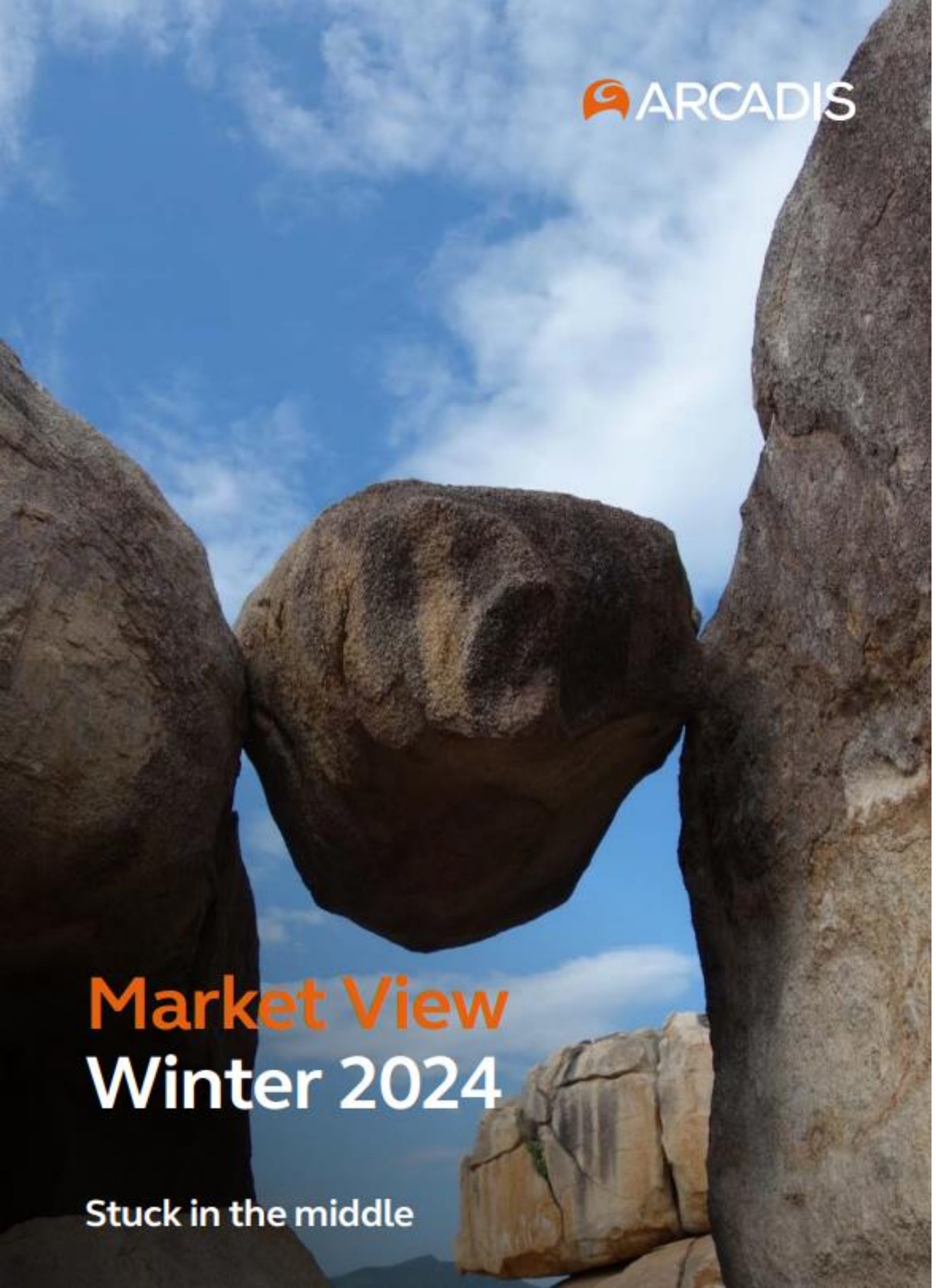

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Our latest UK Market View:

Evidence:

- Reduced business confidence and slow growth in Q324 point to a slower recovery than previously forecast.
- Increased 10-year bond yields cancel out gains from November's base rate cut – viability still under pressure
- New orders growth trend reversed, high density residential and commercial pipelines deteriorating
- Increased employer's NICs are likely to be inflationary
- Gateway 2 processes having a material impact on high-density housing pipeline

Consequence:

- Workload-led recovery pushed back into 2026
- Resource constraints and delayed procurements will lead to inflationary recovery
- Signs of labour capacity issues impacting delivery

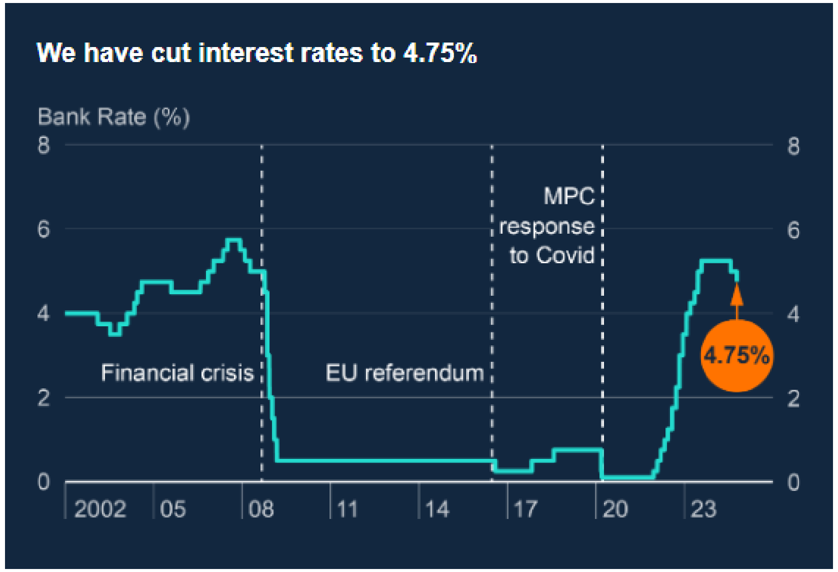
GDP and Inflation latest…

Inflation on the rise…

Latest data…..

- CPI fell to 2.5% in Dec 2024 – down from 2.6% in Nov
- Services inflation fell sharply to 4.4% (5%)
- Core inflation at 3.2% - down from the 3.2% reading in Nov

- CPI likely to return to above target levels – c.2.5% in 2025
- Eurozone inflation flat at 2.3% in Nov (2.3%) while in US it was up to 2.7% (2.6%).



Base rate prospects

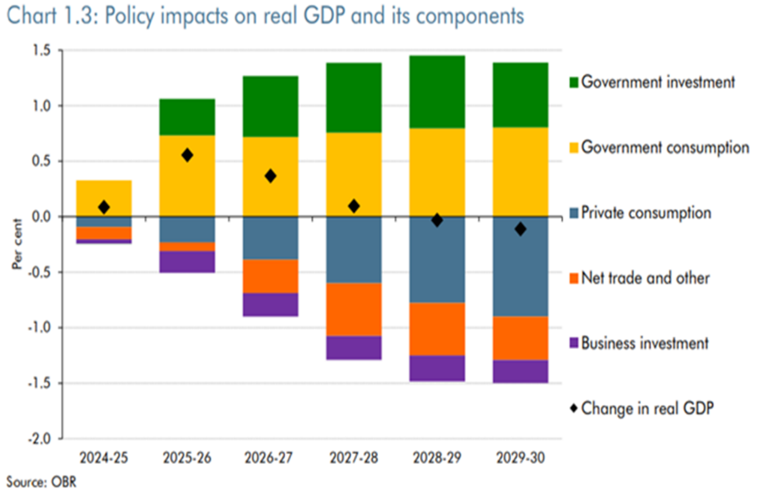
- Dec 24 – interest rates held at 4.75%. Followed 2nd interest rate cut in the cycle in Nov.
- 3-4 rate cuts expected in 2025 but a very uncertain outlook.
- Future pathway complicated by public spending
- Bond rates up by over 100 points since September 2024 to 4.65%
- ECB and US Fed likely to have greater scope to cut as inflation falls
- ECB cut rates to 3% in Dec – fourth cut of 2024

Sluggish growth in economy

- Slow growth compared to historical norms with short term boost in 2025 and 2026

	2024	2025	2026
BoE	1.0	1.5	1.25
OBR	1.1	2.0	1.8
OECD	0.9	1.7	1.3

GDP growth projections based on market interest rate expectations



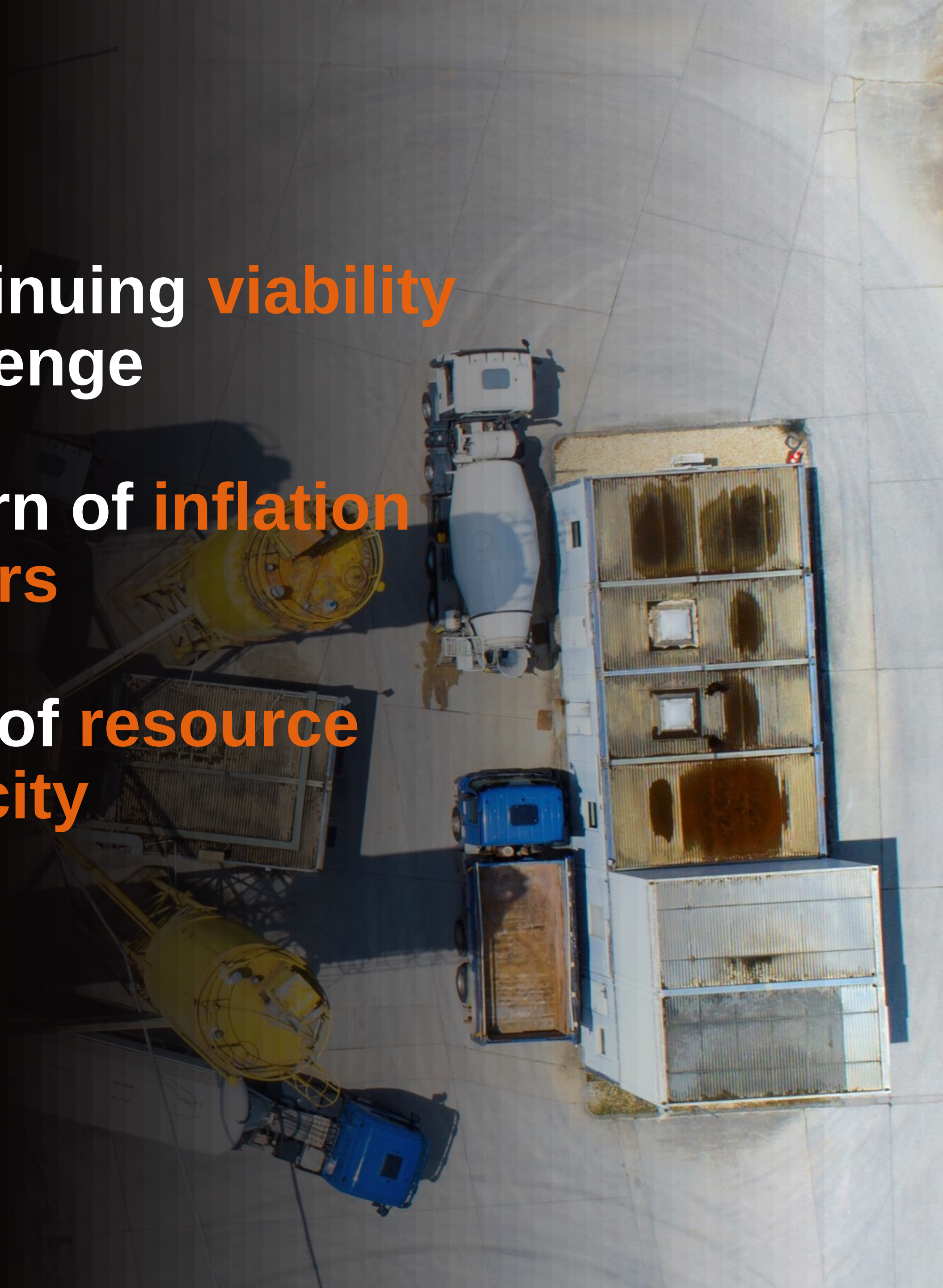
Arcadis Winter 2024 Construction Price Forecast

Inflationary drivers	Deflationary drivers
• Potential recovery of NICs from April 2025	• Slowing order book replacement across most sectors.
• Elevated levels of workload in network infrastructure.	• Soft material prices in 2024
• Loss of capacity for large project delivery in buildings	
• Supply chain consolidation	
• Attitude to risk transfer	
• Materials inflation from mid-2025	

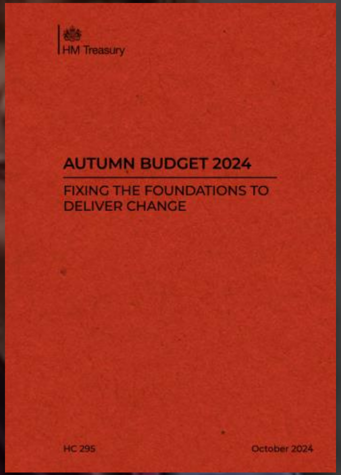
	Regional Building Construction TPI	London Building Construction TPI	National Infrastructure Construction TPI
2023	2% (2%)	2% (3%)	5-7% (5-7%)
2024	1-2% (1-2%)	1-2% (1-2%)	3-6% (3-6%)
2025	2.5-4.5% (3-4%)	2.5-4.5% (3-4%)	4-7% (3-7%)
2026	4-5% (5-6%)	4-5% (5-6%)	4-6% (4-7%)
2027	5-6% (5-6%)	5-6% (5-6%)	3-7% (3-7%)
2028	5-6% (5-6%)	5-6% (5-6%)	3-8% (3-8%)
Total	**19.5-25.5%**	**19.5-25.5%**	**23-22%**

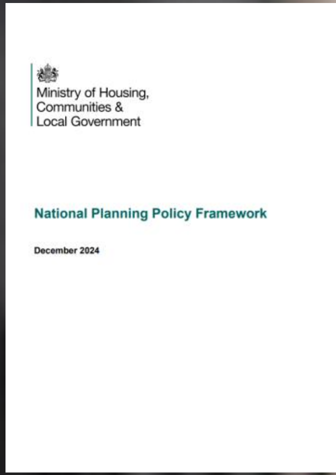
Key market drivers

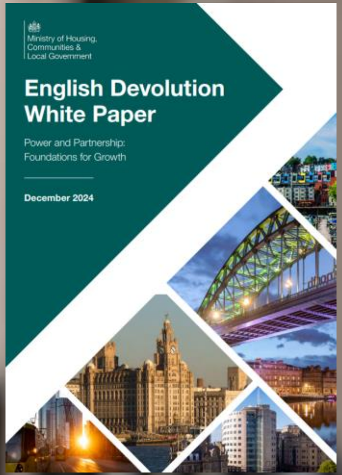
- Bottom of development cycle
- Slow recovery of investment demand
- Change in infrastructure investment priorities
- Continuing viability challenge
- Return of inflation drivers
- Risk of resource scarcity



Impact of the growth agenda?

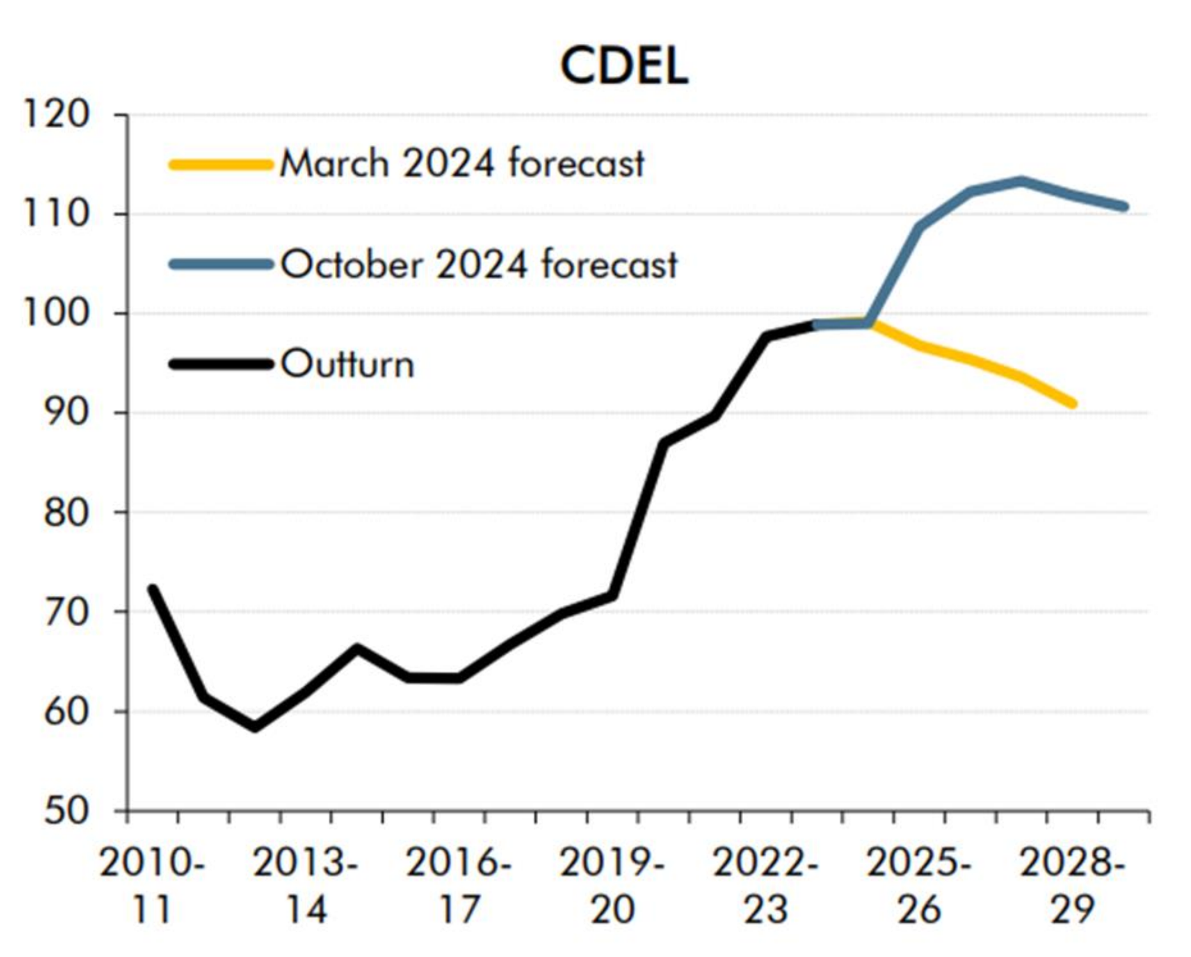






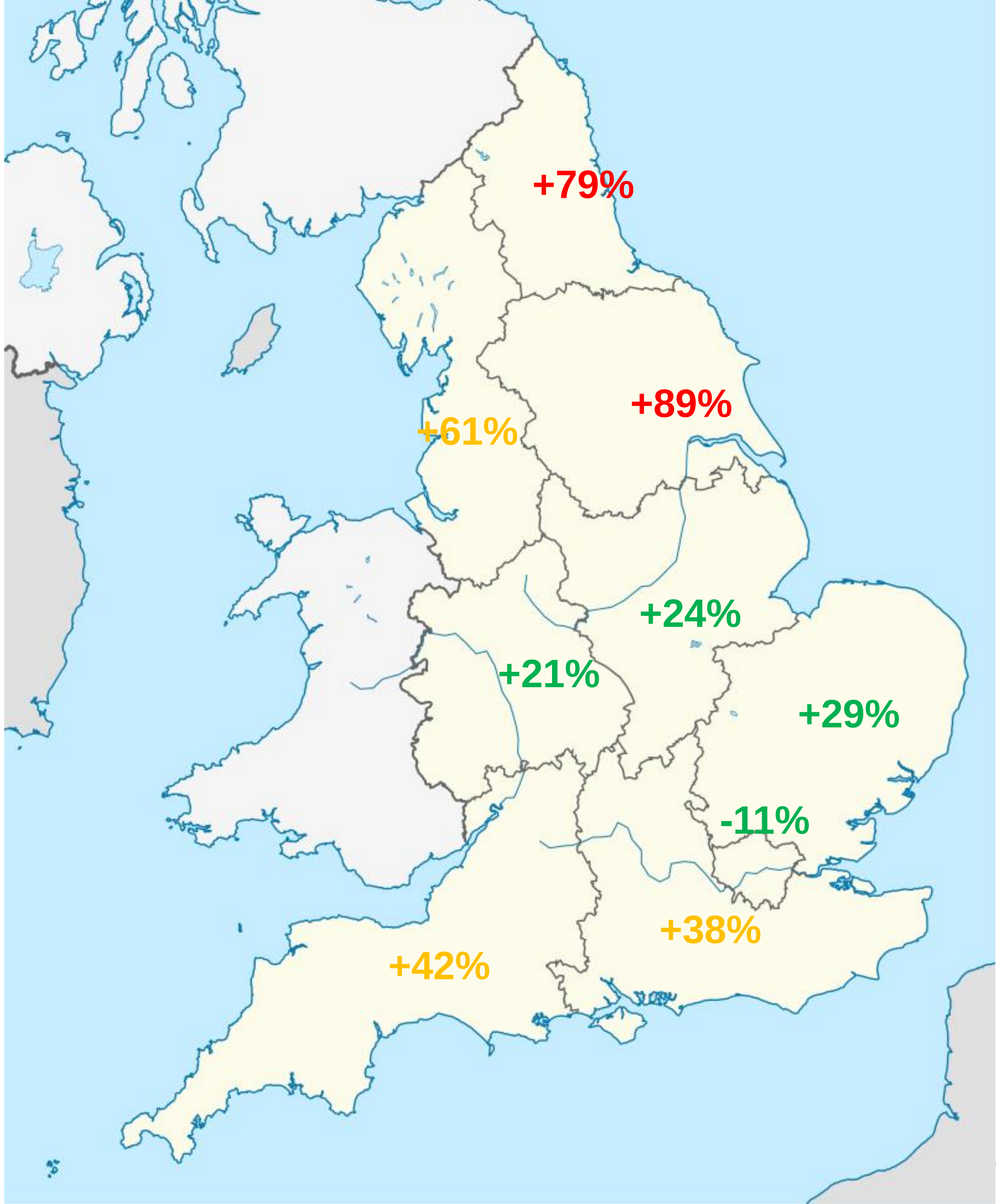
Impact of increased investment

- Refocus on social infrastructure
- Hunt’s Capex cliff-edge averted
- Implausible front loaded spend profile
- Shovel-ready pipeline not in place
- Net positive to capex focused businesses



Impact of the new NPPF

New model vs. old model

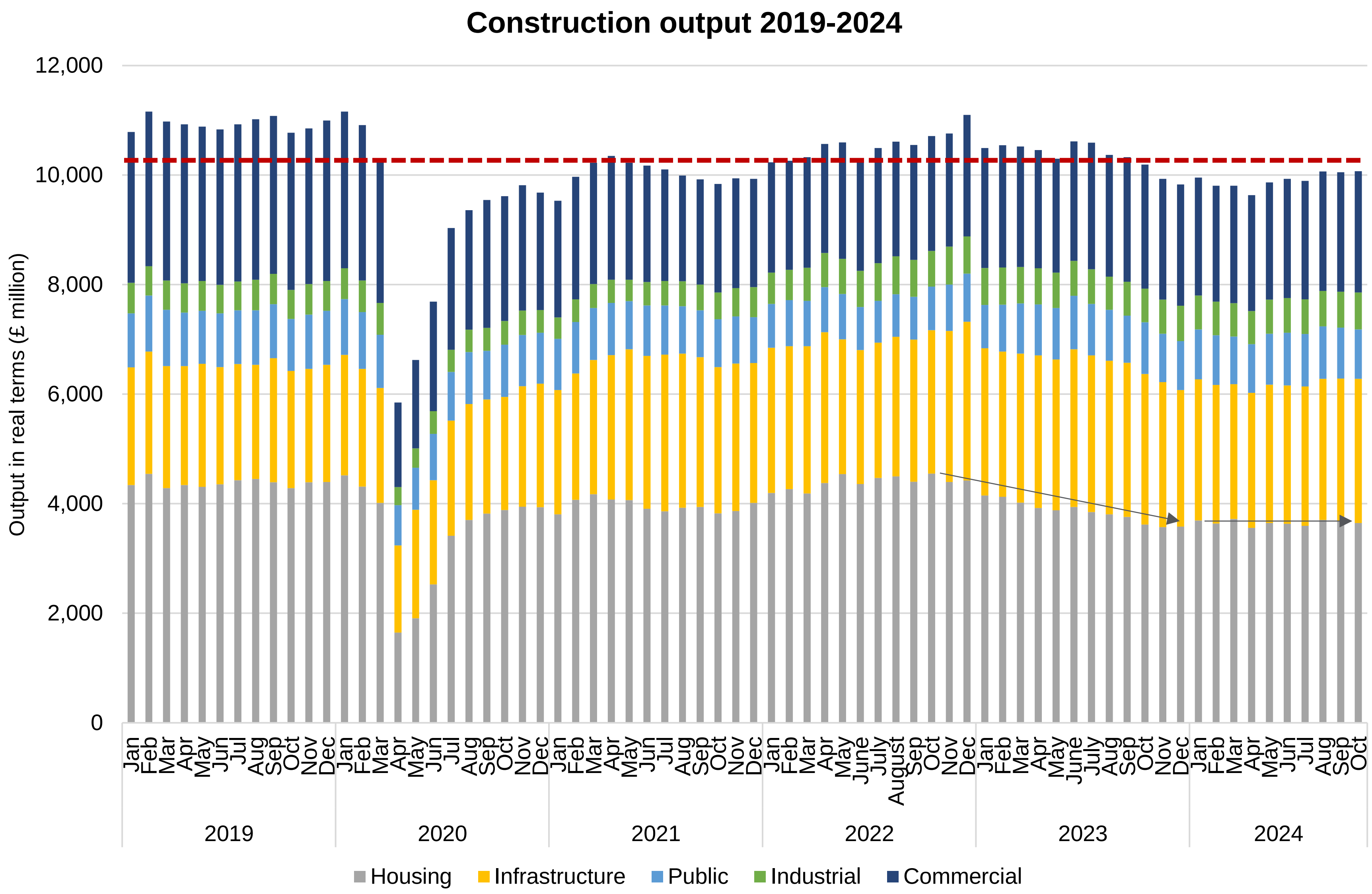


Source: ONS, Arcadis

UK Construction Market

Construction activity: UK-wide

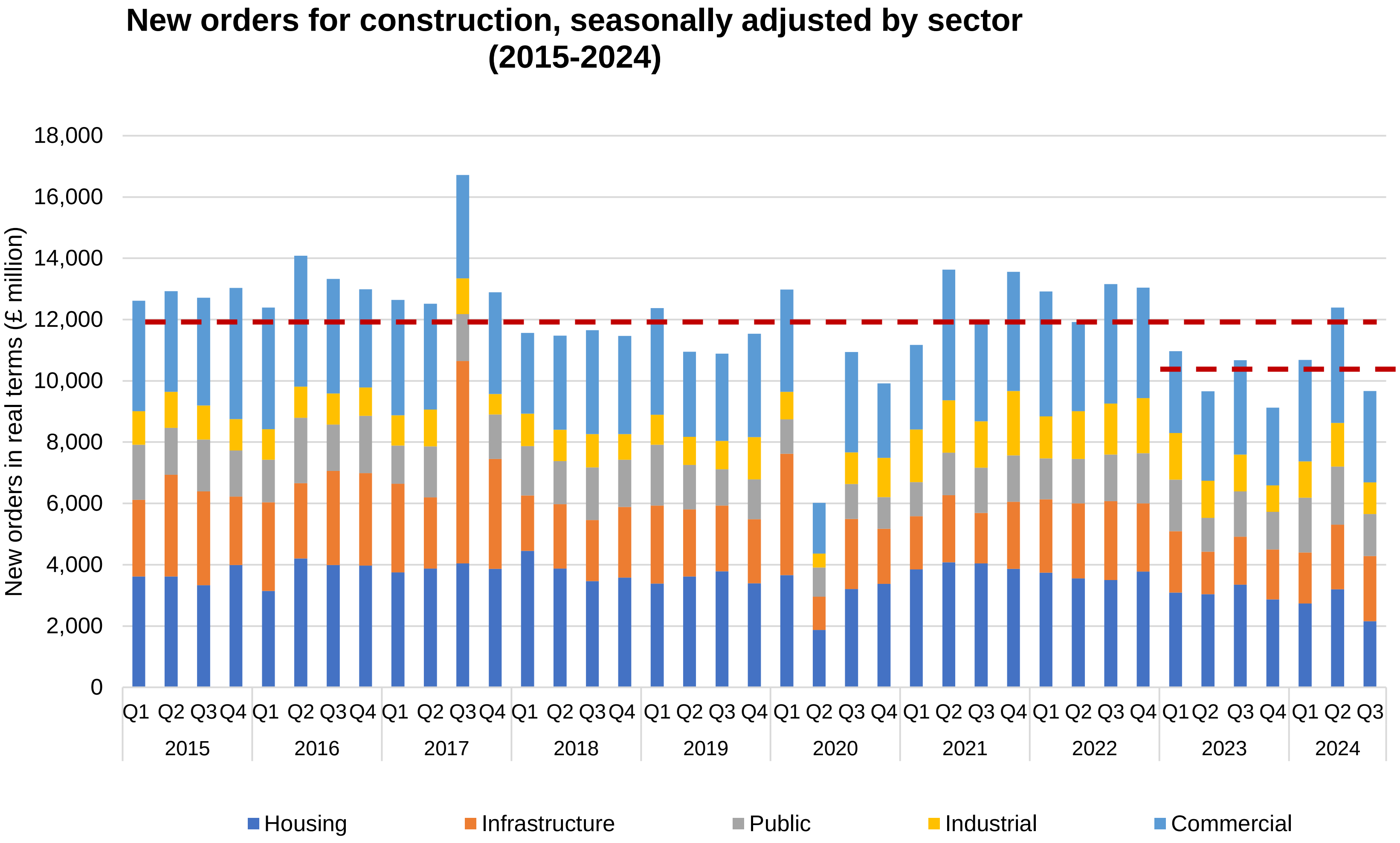
- Overall new build volumes over 4% down compared to Q3 2023
- Slight recovery in Q3 – 0.8% growth.
- Housing output has largely stabilised – up 1% in Q3, but 11% down year-on-year
- Short-term fluctuations month on month – but no sign yet of a pick-up
- Output expected to recover from 2025 onwards



Source: ONS

Construction pipeline

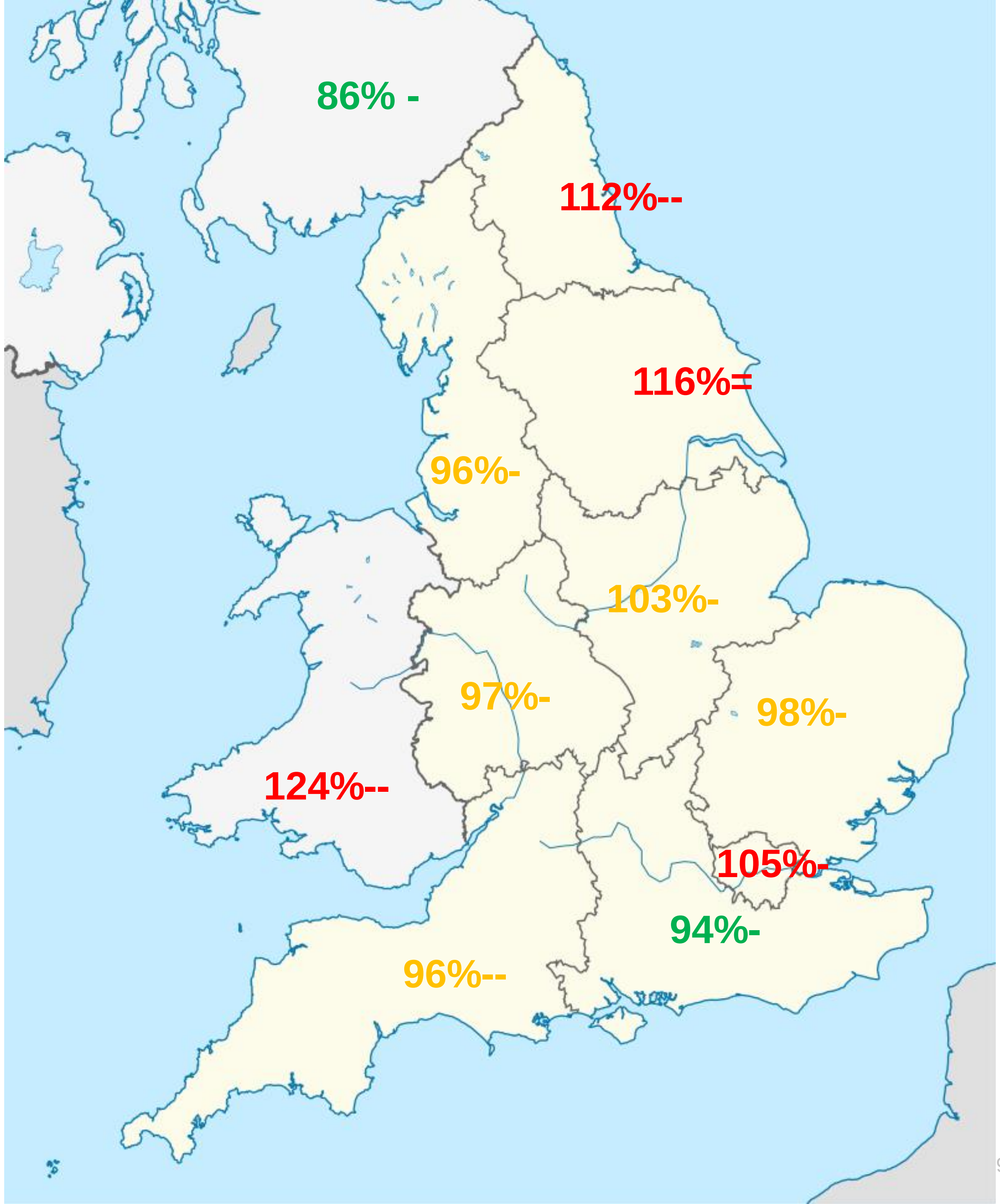
- Q3 2024 new orders down by 22% compared with Q2 2024.
- 9.4% below same period last year and 19% below long-term average.
- Driven mainly by quarterly decreases in private new housing and private commercial work, which fell 31.3% and 20.8% respectively.
- Infrastructure only sector to see a rise, up c.0.8% QoQ and 36% on same period on 2023.



Source: ONS

Regional Hot Spots - workload

As at Q3 2024.



Source: ONS, Arcadis

Key:

- % figure is trend rate for last 24 months v LTA from 2015
- +/- = short term movement of full Y-o-Y change
- --/++ >10%
- -/+ < 10%

Regional Hot Spots - pipeline

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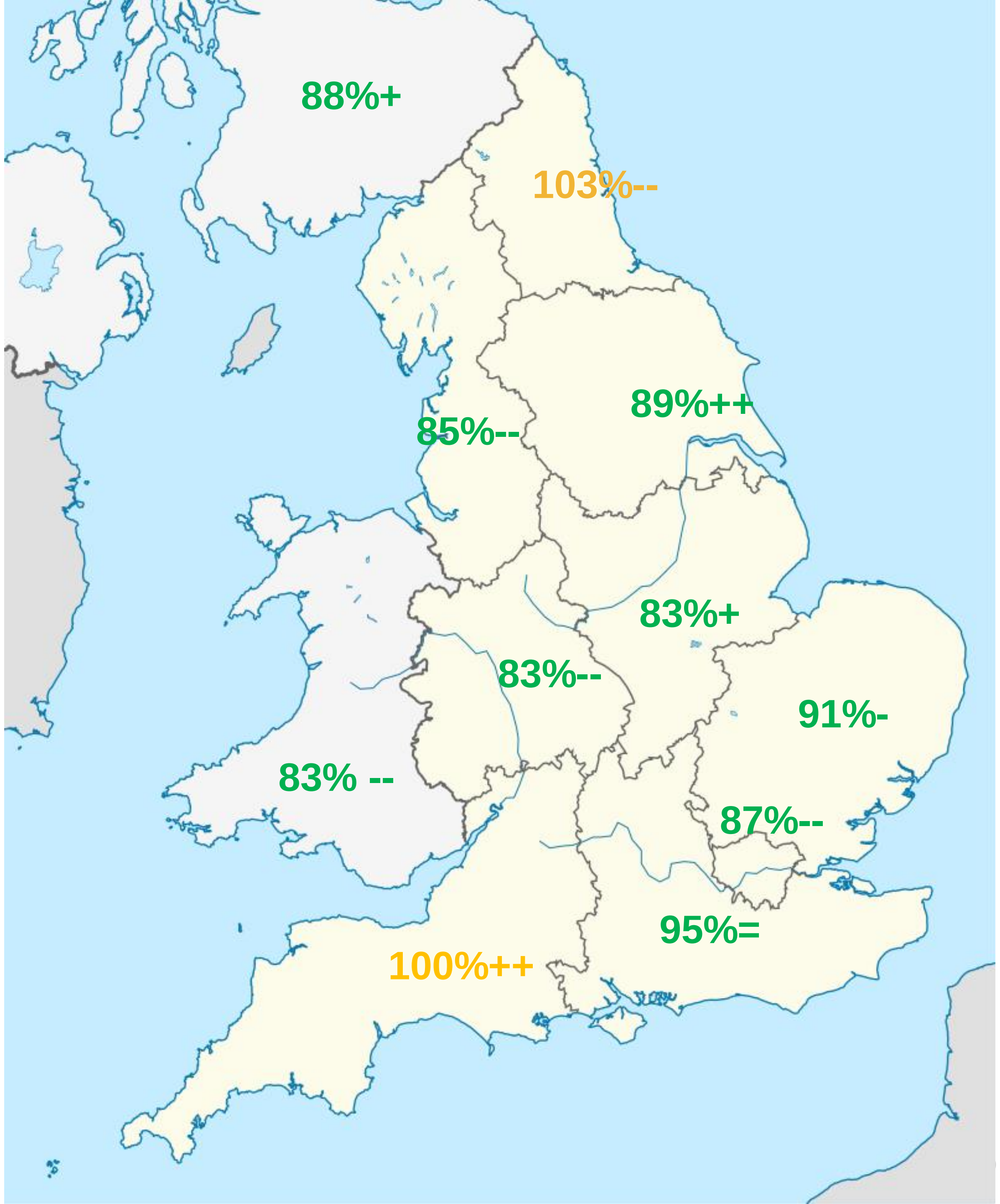

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Supply chain considerations

Materials

Labour

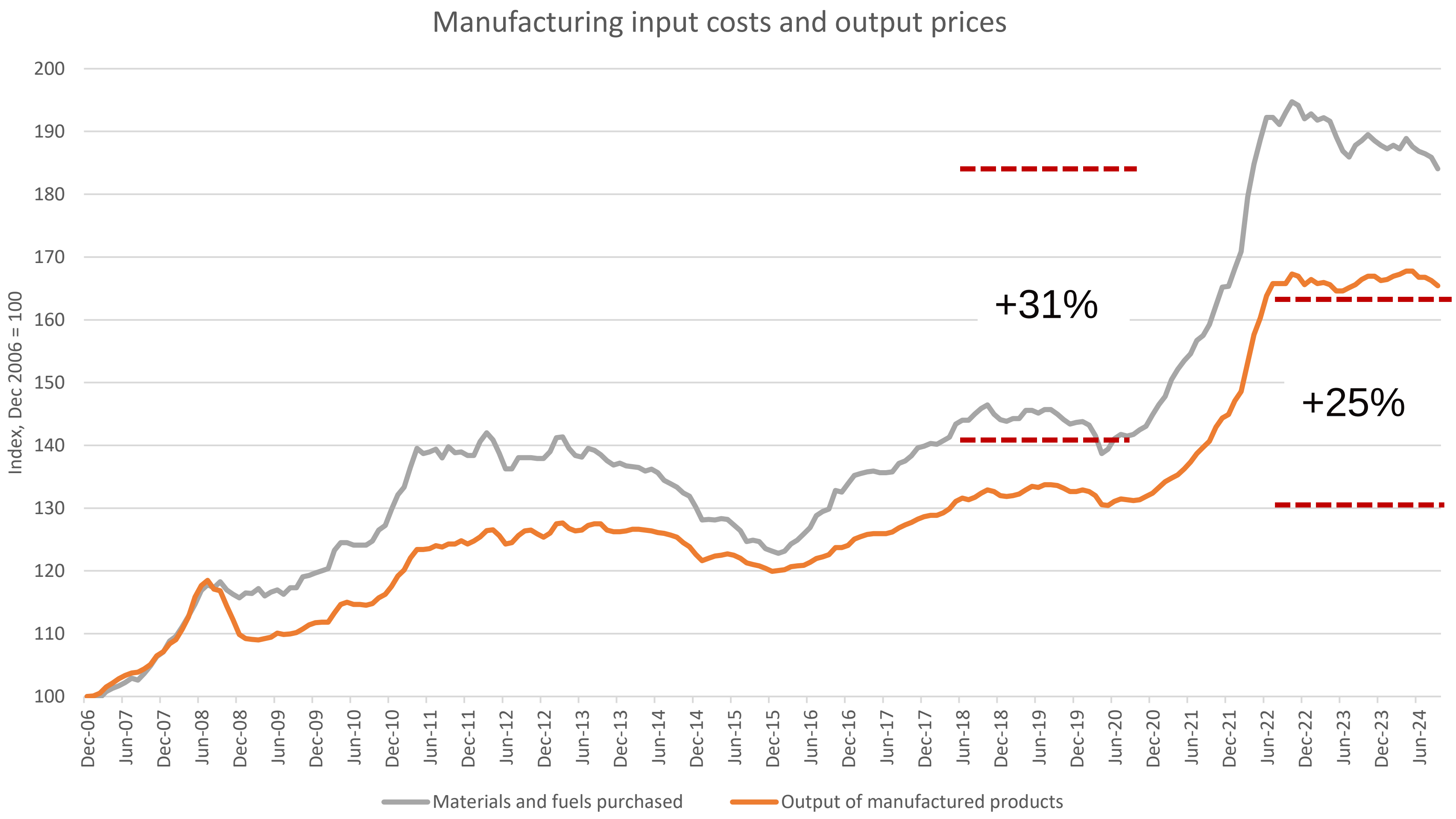
Contractor capacity

Input cost headlines

- Energy costs – Wholesale gas and electricity have risen to Dec 2023 levels – gas up 50% year on year, electricity up 25%
- Material costs – inflation returning in early 2025
- Material availability – back to pre-covid levels, but worries about availability post-recovery
- Labour costs – wage awards for 2024 around 5% but weekly earnings growing at 6%+
- Labour costs - Oct Budget - potential for 0.75% to 1%+ inflation from 2025 onwards related to higher employers' NICs.
- Insolvency – high levels of failure continuing into 1H2025

Material price inflation

- Permanent reset of manufacturing costs
- Year on year materials inflation by end 2024
- Manufacturers absorbed costs during 2021 and 2022
- Falling input costs have not been passed to consumers
- Potential for price hikes in 2025 as demand returns

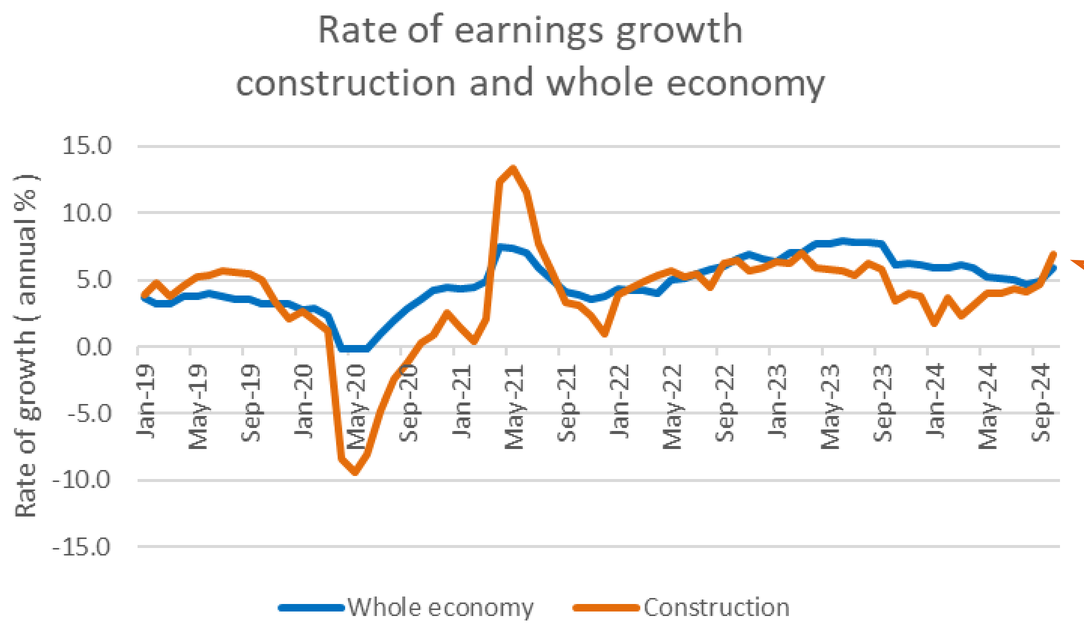


Source: ONS, Arcadis

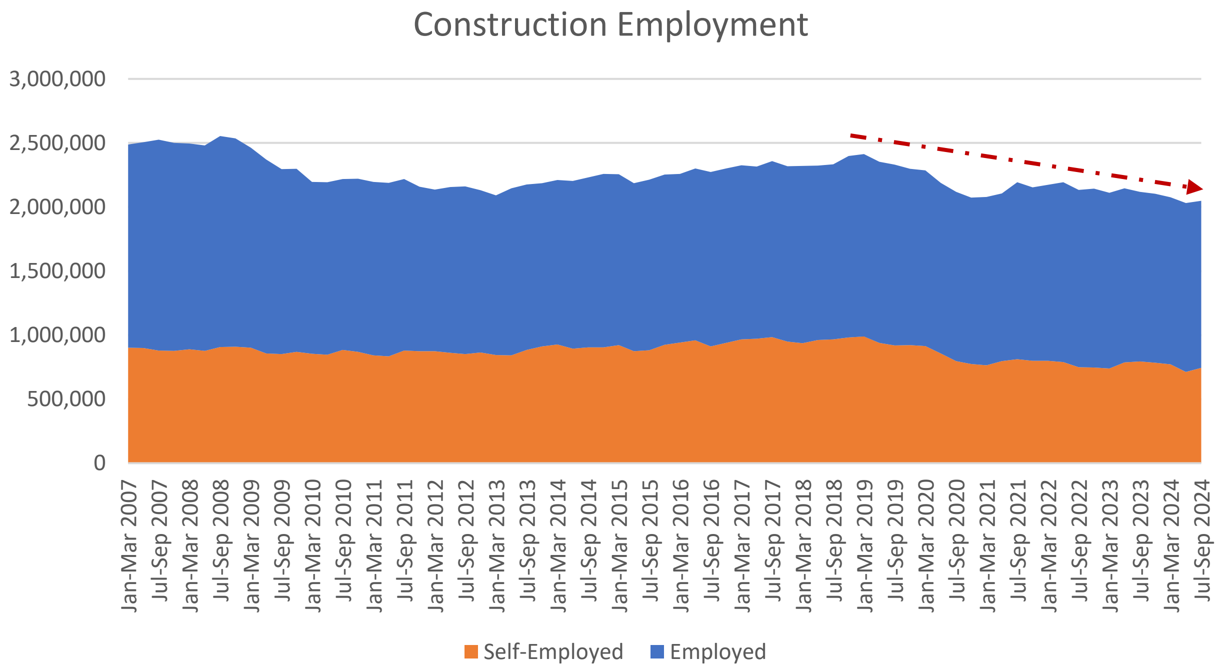
Construction labour market dynamics

- Average sector earnings up 6.9% yoy in October
- Strong rebound during 2024 from 1.8% low point in January

- Implications of growth in sectors where labour shortages already exist
- Limitations on training capacity
- Constrained access to migrant labour



Sector wage growth exceeding the national average for first time since 2022

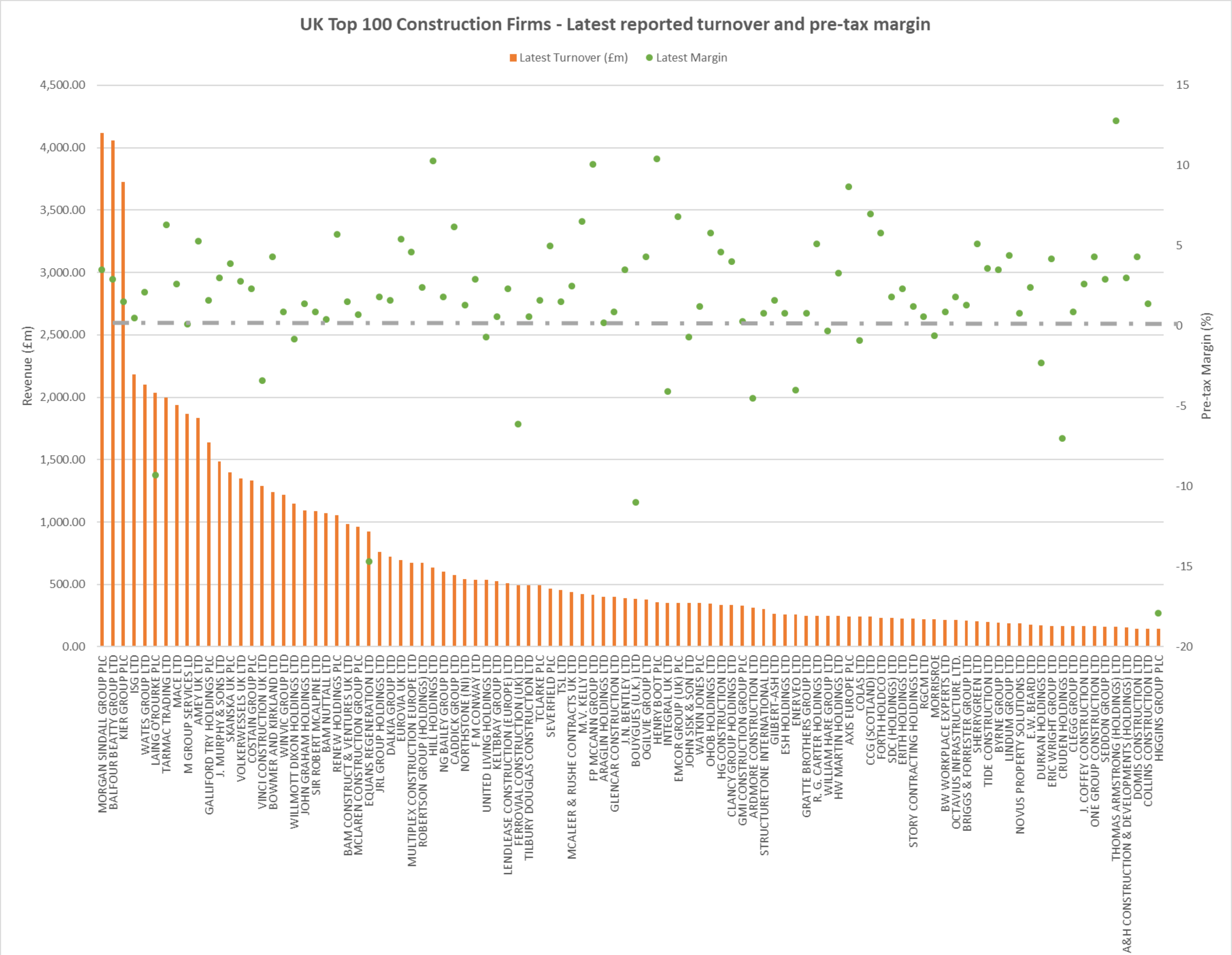


Workforce contracting since 2019 and at lowest point in 20 years

Source: ONS, Arcadis

No signs of improvement in contractor financial performance

- Review of CN100 data for 2024 (e.g. accounts for years ending 2022 and 2023)
- Total aggregate turnover = £70 billion (-7%)
- Total aggregate profit = £1.2 billion
- Average margin = 1.7% (previously 2.7%)



Watch outs - Winter 2024

- Plenty of opportunity – but taking longer to convert

- Labour costs likely to be the key inflationary metric with NICs adding to the pressure

- Forward pipeline starting to look weak again - market recovery delayed until late 2025

- Fall-out from ISG collapse reiterates importance of supply chain due diligence

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