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TENDER PRICE **FORECAST**

for 4th Quarter 2022 is...

5.5%

UK Average

▲ compared to 5.0% Q3 UK Avg.

Energy-driven material price increases continue to be a key driver of cost inflation, but 2022 is shaping up to be a tale of two halves. Input cost inflation has largely been front-loaded in the first half of the year with easing pressure on supply chains and opening of capacity in the second half.

With an economic slowdown on the horizon, there are signs the market has peaked and the post-pandemic recovery cycle is entering a new phase – a phase with reduced demand in a weaker economy and subsiding inflationary pressures in the medium term.

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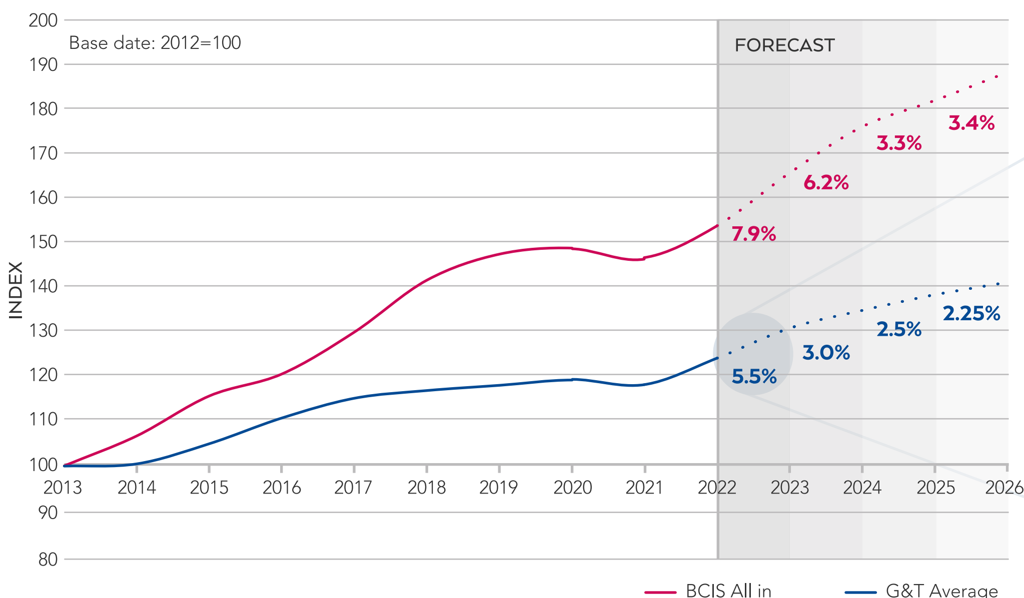
TENDER PRICE ANNUAL PERCENTAGE CHANGE Q4 2022

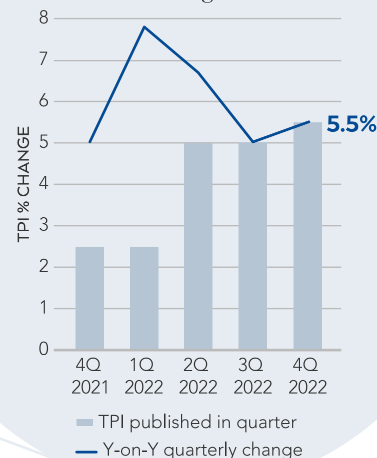
%	2022		2023		2024		2025	
Regional Forecasts	**Now**	**Last***	**Now**	**Last***	**Now**	**Last***	**Now**	**Last***
Greater London	6.00	5.50	3.00	3.50	2.50	2.50	2.50	2.25
South East	6.00	5.50	3.00	3.50	2.50	2.25	2.50	2.25
South West	4.50	4.50	4.00	3.00	3.50	2.50	2.50	2.25
East	4.50	4.50	3.00	3.00	2.50	2.50	2.50	2.00
Midlands	5.00	5.00	2.50	3.00	2.50	2.50	2.50	2.00
Wales	4.50	4.50	2.00	2.00	2.00	2.00	2.00	2.00
Yorks & Humber	6.00	4.00	4.00	2.50	3.00	2.00	2.50	2.00
North West	6.00	5.00	2.50	3.50	2.00	2.50	2.00	2.50
North East	5.00	4.00	3.00	2.00	2.00	2.50	2.00	2.00
Scotland	5.50	5.50	2.50	3.00	2.00	2.50	2.00	2.00
Northern Ireland	6.00	5.00	3.00	3.00	2.50	2.50	2.00	2.00
UK Average (weighted)	**5.50**	**5.00**	**3.00**	**3.00**	**2.50**	**2.50**	**2.25**	**2.25**

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

Last* 3Q22

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

- ▲ 5.4% — BCIS Labour Cost Index, Sep 2021 - Sep 2022 (High)
- ▲ 34.5% — BCIS Plant Cost Index, Sep 2021 - Sep 2022 (Low)
- ▲ 7.2% — BCIS M&E Cost Index, Sep 2021 - Sep 2022 (Medium)
- ▲ 16.2% — Fabricated Structural Steel, Aug 2021 – Aug 2022 (Medium)
- ▲ 28.5% — Concrete Reinforcing Bars (Steel), Aug 2021 – Aug 2022 (Medium)
- ▼ -15.6% — Imported Sawn or Planed Wood, Aug 2021 – Aug 2022 (Low)
- ▲ 15.2% — Ready Mixed Concrete, Aug 2021 – Aug 2022 (Low)
- ▲ 15.0% — Oil Prices Brent Crude, Oct 2021 - Oct 2022 (Low)

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

- ▲ 4.4% — UK GDP Annual Growth Rate, Q2 2021 - Q2 2022
- ▲ 9.9% — CPI Aug 2022, 12-month rate
- ▲ 12.3% — RPI Aug 2022, 12-month rate
- ▲ 2.25% — UK Base Interest Rate, Oct 2022
- ▼ 3.5% — UK Unemployment Rate, Jun 2022 - Aug 2022
- ▲ 6.0% — UK Wage Growth, Average Weekly Earnings (Total Pay), Y-on-Y three-month average to Aug 2022

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.

GT

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

Forecasting is an inherently difficult task, even at the best of times, but a constantly shifting economic landscape and enhanced market volatility in recent weeks has made predicting where the market will be next week, let alone in the years to come, a complex and problematic undertaking.

Having contended with an overheating market, rampant inflation and strong construction activity growth for much of 2022, the market may be on the verge of a turn. There are signs that the market has peaked and the post-pandemic recovery cycle is entering a new phase – a phase with slowing output and new order growth and a certain degree of demand-destruction.

The IMF predicts that one-third of the global economy will be in recession next year. Even more will feel like they are in a recession. This is in large part due to a combination of the ongoing cost-of-living crisis, Russia's invasion of Ukraine and the slowdown of growth in China. In Europe, a severe energy crisis has hampered economic activity and fuelled levels of inflation not seen since the early 1980s. Governments have reacted to tame inflation but the risk of monetary, fiscal or financial policy mis-calibration has risen sharply at a time when the world economy remains historically fragile and financial markets are showing signs of stress.

The UK looks set to narrowly avoid recession, growing by ***0.3%*** in 2023 according to the IMF, but it wouldn't take much to swing the pendulum in the other direction. Most other key European economies look likely to fall into recession over the next two-three quarters. Any recessions experienced are likely to be relatively shallow. Banks are in better shape, governments are unlikely to implement austerity and household finances are also in a better position than they were in 2008/09, so recession won't be as deep this time round. Weakening inflation, easing supply-chain pressures and supportive policy stimulus by governments should also ensure that any recessions will be relatively mild and short.

Any slowdown, however severe, will have second round effects that will impact UK construction activity, but the taming of inflation due to lower demand is likely to be one of the positive benefits that stem from lower growth.

Against this backdrop, we have raised our UK and London TPI forecasts from last quarter's (Q3 2022) TPI report by 50 basis points, to ***5.5%*** and ***6%*** respectively for 2022. These figures, as always, represent an average inflationary increase across all project types, values and sub-sectors of the built environment. Some sectors, such as industrial warehousing and logistics, will have experienced levels of inflation significantly higher than this in 2022 while others, such as office fit-out, may have seen less construction cost inflation. With a slowdown on the horizon and an easing of certain price pressures expected in the coming months, the rate of inflation is likely to subside in 2023. G&T's current expectation is that tender prices will rise by ***3%*** in 2022 (UK average and London) as manufacturers feed through higher energy costs into their pricing strategies and increased labour costs as the tightening labour market plays catch-up with headline inflation amid cost-of-living pressures.

If current macro-economic forecasts play out as expected and UK growth slows to a crawl in 2023, competition to secure pipeline and win reduced volumes of new work coming to the market may encourage more competition with contractor margins. However, many contractors will be unwilling to surrender their higher post-pandemic margins and remain selective and risk averse in their bidding for as long as possible.

Longer-term inflationary movements are even more difficult to assess. For now, we have reverted towards our long-term inflationary average of ***c.2.5%*** for 2024 and ***2.25%*** for 2025. The Bank of England currently expects headline inflation (or CPI) to fall back to its ***2%*** target in around two years' time. Construction tender price inflation is closely correlated with wider economic outlook, so as the BoE forecasts a return to more normal growth market across the whole economy by 2024, we would expect tender price inflation to ultimately follow suit (albeit with some potential lag effects).

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

UK GDP grew by just ***0.2%*** in the second quarter of this year, suggesting that Britain is not quite in recession...yet. However, the marginal rise in quarterly GDP means the UK is the only G7 country with an economy smaller than in early 2020, prior to the pandemic.

The UK's Q2 GDP figure does not reflect the latest upsurge in inflation and leap in borrowing costs, which are expected to contribute towards the ***0.1%*** contraction of GDP being factored in by the Bank of England in Q3. Unless growth can be spurred in Q4, there is a likelihood the UK will enter a recession (ie two consecutive quarters of economic contraction) by the end of the year.

Economists don't hold much hope for an improvement next year either. Data from Consensus Economics – which provides an average of leading forecasts – point to an economic contraction of ***0.3%*** in 2023. Despite annual headline inflation (or CPI) easing back from its recent peak of ***10.1%***, households face the prospect of stubbornly high inflation running at or near double digits over the winter period before starting to come down. This is likely to quash consumer confidence and lead to falling spending and demand in the coming quarters.

The complete and indefinite halting of Russian pipeline gas supplies to Europe, combined with the UK's recent mini-Budget, were just two of the key inflationary events in Q3. The inflationary impact of these events will be somewhat blunted by the deployment of fiscal support measures that place an upper limit on typical household energy bills (a key driver of headline inflation). However, the mini-Budget was inflationary in other ways – not least of which was the subsequent plunging of the pound, driving up the cost of imported goods and energy while domestic price pressures remain elevated. This has made the prospect of stagflation and recession almost inevitable.

The Bank of England will likely respond to these additional inflationary pressures by raising interest rates to further cool the economy and attempt to rein in sky-high inflation. However, doing so may mean sacrificing a portion of the UK's potential GDP growth over the next few years, producing tougher financing conditions when these higher rates feed through to the real economy. The markets believe that UK base interest rates of ***5-6%*** by mid-2023 are a realistic prospect, but others argue this is excessive given the relatively small size of the packages announced in the mini-Budget.

After the pound's strong sell-off in late September, sterling became significantly undervalued. The reason for the sell-off was simple. After the mini-Budget, international investors panicked that the sweeping tax cuts would need to be paid for with higher Government borrowing. Households would then spend the additional money as a result of the tax cuts, increasing demand for goods and services and driving inflation even higher. A later policy reversal regarding the ***45%*** rate tax cut provided some relief to investors and saw the pound rally but bouts of volatility in the currency in the coming weeks are inevitable until a credible medium-term fiscal strategy is published to help restore the markets confidence. On the positive side, a weaker pound tends to increase net investment from abroad which acts as a shock absorber, providing a cushioning effect from the impact of a weaker pound.

Another lever the Government could pull to instil confidence in the markets is austerity and spending cuts. After announcing that the departmental spending envelope will remain the same in nominal terms (despite much higher-than-expected inflation), there are signs the Government might rein in some of its spending. Deep spending cuts, however, may not be politically viable given that the Conservative Party has an election to fight in around two years' time and many public services are currently experiencing significant post-pandemic backlogs under existing spending allocations.

Meanwhile, the Bank of England is likely to use all levers at their disposal to tackle some of the current economic pressures. It's not inconceivable the Bank of England will push interest rates higher than 75-basis points in November in order to head off any concerns the markets might have about any loosening of fiscal policy through tax cuts. Its ***£65bn*** intervention programme in the debt markets has already helped avoid a fire sale of gilts (ie UK Government bonds/debt). Without this intervention, pension funds would have been forced to quickly sell ***£50bn*** worth of long-term Government debt, but the Bank of England's emergency bond-buying scheme helped stave off a financial meltdown and the risk of entering into a self-reinforcing spiral in the funding markets.

While this particular crisis may have been averted for the time being, 2022 has experienced one unforeseen supply shock after another. Higher borrowing costs in the short-medium term will impact all corners of the UK economy. Construction, like all sectors, is exposed to the second-round effects of higher intertest rates. The housing market has been used to mortgage interest rates of around ***0-2%*** over the past decade and taking away this prop by potentially increasing rates to ***4-6%*** or more could put considerable downward pressure on housing demand.

With inflation hovering around double digits, the risk of an imminent recession and rising interest rates, the economy is predicted to perform weakly in 2023. Despite the darkening economic outlook, construction continues to surprise. Positive activity growth indicators (in the form of recent Construction PMI readings) and strong momentum from the past year provide hope that the sector can weather any storms in 2023.

CONSTRUCTION OUTPUT AND NEW ORDERS

July saw another month of declining construction output – the second consecutive decrease following seven months of growth. July's ***0.8%*** fall was ironically blamed on the weather being too good. Amber and red weather warnings across the country meant several working days were lost to extreme weather conditions and record-breaking temperatures.

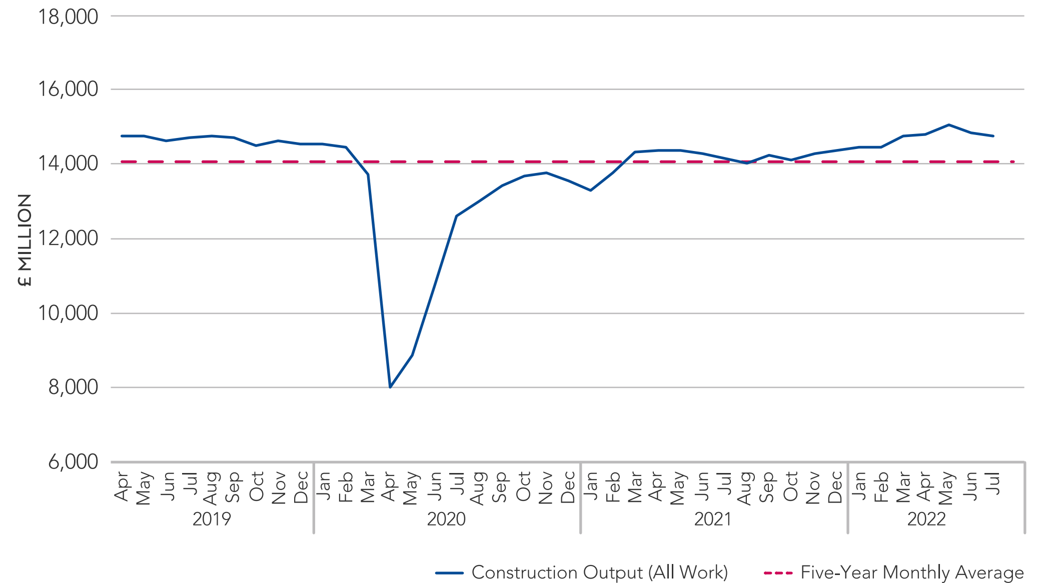
Repair & maintenance was the driver behind the drop in output (***-2.6%***) while total new work saw a slight increase (***0.3%***) in the month. However, repair & maintenance output values remained nearly ***10%*** higher than their pre-pandemic levels, and with financially constrained councils looking to switch resource away from new projects to basic repair and maintenance jobs, further declines in repair & maintenance output could be stemmed. Of all the sub-sectors the biggest decline was reserved for public new housing (***-13.1%***), but all sectors other than private new housing and private commercial experienced modest monthly declines in output values.

Of course, the weather isn't solely to blame for July's dip in output. The cumulative effect of falling demand in light of rising costs and uncertainty over the UK's economic policy and growth prospects are weighing in on investor and developer confidence. Supply bottlenecks also continue to impact the sector (albeit to a lesser extent than a few months ago). Some of those that are contemplating major new projects are holding off on committing investment or progressing projects from design while they see how the current pressures and economic situation evolve.

Somewhat reassuringly, the level of construction output remained some ***2.1%*** above the February 2020 pre-pandemic level, but an interesting trend has emerged in recent months. Price rises in the construction industry have seen the gap widen between the value and volume of construction

CONSTRUCTION OUTPUT: ALL WORK

Seasonally adjusted



Source: ONS

NEW ORDERS INDEX

50.1

sa, >50 = growth since previous month

Sep'22

Source: S&P Global

output, suggesting higher project values are making up for less overall construction activity.

With respect to new order growth, ONS data for Q2 2022 revealed a drop in new work below the five-year quarterly average. New orders have been on a downward trend for several quarters now and more recent indicators suggest this continued into Q3.

October's S&P Global/CIPS UK Constriction PMI report pointed to the weakest trend for new orders since the sector's recovery began in June 2020. A scarcity of incoming new orders has been pinned on slowing decision making among clients and greater risk aversion due to inflation concerns. Squeezed budgets and worries about the economic outlook are also reasons why the PMI new orders index has slipped in recent months.

Increasingly fragile business confidence and rising interest rates doesn't bode well for a pick up in new order growth anytime soon. As contractors complete their delayed projects that have spilled over into Q3 and look to bolster their longer-term pipeline, we may see more competitive tendering conditions arise. Furthermore, if a sustained, global drop in demand for new construction work materialised, purchasing activity would likely put greater downward pressure on key construction material prices. Combined, both factors could bring about a drop in cost burdens in 2023.

The PMI survey's forward-looking indicators weakened in September while output growth expectations for the year ahead were the lowest since July 2020. Although optimism is evidently subdued and growth projections have weakened, firms continue to comment on "forthcoming" projects, suggesting many clients are just waiting for an improvement in conditions before greenlighting planned projects.

In terms of the underlying value of UK construction work starting on site on site, Q3 figures from construction data provider Glenigan show a ***27%*** decline compared to the previous month (and a ***23%*** decline on the same quarter in 2021). Thanks to utilities work starting on site, civil engineering project starts provided one of the few bright spots (*+1%* Q-on-Q) while residential starts fell by a third against the preceding three months. Most non-residential building sectors also saw sharp declines in the third quarter of 2022.

Every region in England saw declines in project starts in Q3 2022 (NI and Wales bucked the trend), and with further headwinds ahead new starts on site look to remain sluggish for the short-term.

G&T TPI SURVEY FEEDBACK

Workload

From an internal perspective, workloads remain consistent to high across most sectors, but inflation, recessionary risk and rising interest rates pose a threat to output growth which could affect workstreams in 2023.

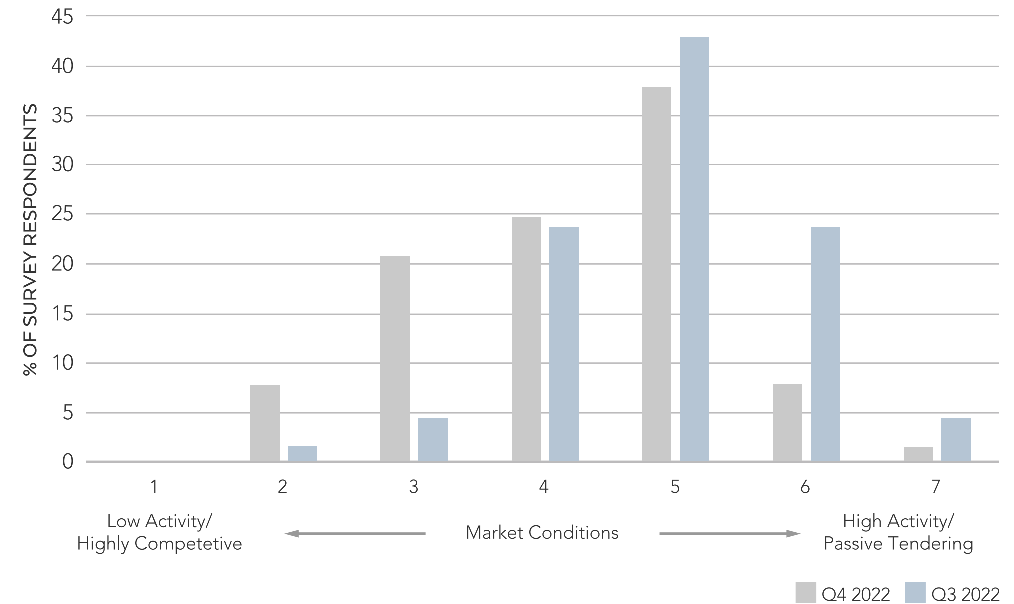
Some TPI survey respondents noted that current workloads and new opportunities even appear "gravity defying" in light of high cost inflation and against the development appraisals clients are running. While there is little sign of pausing, stopping or let up among many clients, others expect that as their pipeline of work completes over the next year, it is difficult to see workloads being replaced given higher interest rates and ongoing inflationary pressures.

Concerns around viability and rising costs continue to prevent a limited number of projects in the early design stages from progressing. In these few instances, delays stem from prolonged decision making, hesitations around project funding, conversion of contracts and difficulties in gaining relevant planning approvals.
Even then, many of these clients are keen to push ahead with early-stage design and are assembling large design teams which shows a good level of commitment. However, the same clients also acknowledge that projects can get switched off quickly if necessary.

The volume of incoming enquiries into the business for short, medium and longer-term projects received over the past few months suggests that for most, workloads will remain high. However, some sectors, such as private residential, are expected to feel the pinch as demand slackens with rising interest rates.

PERCEPTION OF MARKET CONDITIONS OVER THE NEXT SIX MONTHS

London



Respondents noted strong activity in the Higher Education sector, with clients' long-term development plans attracting significant capital investment and producing in a continuous flow of work. There is also positive momentum in the commercial office fit-out market. This is being driven by the expectation that the office working will continue to recover towards pre-COVID levels. Meanwhile there are some early signs of slowing activity in the red-hot industrial warehousing and logistics sector. Rents have not increased at the same pace as land prices and the impact of recent inflation has put a negative pressure on appraisals.

Market Conditions

Our previous TPI survey in June 2022 pointed to an expectation of higher levels of activity and passive tendering over the following six months. While still showing this to an extent, our latest September 2022 survey saw a clear left-shift, reflecting expectations of reduced market activity and more competitive market and tendering conditions.

Persistent and further anticipated inflation, along with growing economic uncertainty, is expected to have a cooling effect on the highly active tendering market that has been seen over the past 12-18 months.

Global supply chains continue to adjust and adapt following the war in Ukraine while the backlog of orders that built up during the pandemic is starting to clear. Both trends should add downward inflationary pressure in 2023 and beyond. G&T is beginning to see more active engagement from the supply chain which implies contractors are beginning to look for new work. Demolition contractors, for example, are hungrier for work which is a potential sign the market is turning. More capacity in the market in 2023 would encourage more competitive bidding.

In an uncertain market contractors will seek to secure turnover, but a strong short-medium term project pipeline will likely create a slight lag effect that will support above-average tender price inflation in 2023. For now, the risk of a potential

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Inflationary Pressures

- De-globalisation/protectionist government policies, as well as aggressive fiscal policy (eg tax and spending)
- European energy scarcity (and elevated energy prices) could shut down some manufacturing plants and reduce supply of materials
- Lag effect between falling wholesale energy prices and manufacturers' longer-term supply contracts
- Removal of red diesel rebate has significantly increased operational costs of running plant/ machinery on site
- Tight labour market with upward pressure on wages
- Substantive annual rise in contractor insolvencies reducing supply chain capacity and tendering competition
- Global events forcing some to seek alternative sources of supply at greater cost
- Weaker pound increasing cost of importing materials (due to reduced purchasing power)
- Foreign investors could use a weak pound as an opportunity, attracting foreign capital
- Strong short-term order books easing immediate pressure to win new work by reducing margins

Deflationary Pressures

- Uncertainty and elevated input costs leading to deferrals/delayed starts. Contractors could seek to fill gaps in workload by reducing risk allowances and on-costs
- Risk of stagflation/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
- NIC reversal for employers
- Falling commodity prices improving scheme viability
- Falling transport and shipping costs
- UK energy price per unit cap (EPG) and falling wholesale gas prices
- Higher interest rates may reduce willingness/ ability to borrow and fund projects
- Projects put on hold due to viability issues

slowdown isn't being reflected in the pricing strategies of many contractors and key trades, nor is it likely to do so while contractors have a base level of tendering opportunities to bid on. This is enabling contractors to be selective, picking and choosing projects with the lowest risk profiles and even making it difficult to get contractors to agree to tender on some projects.

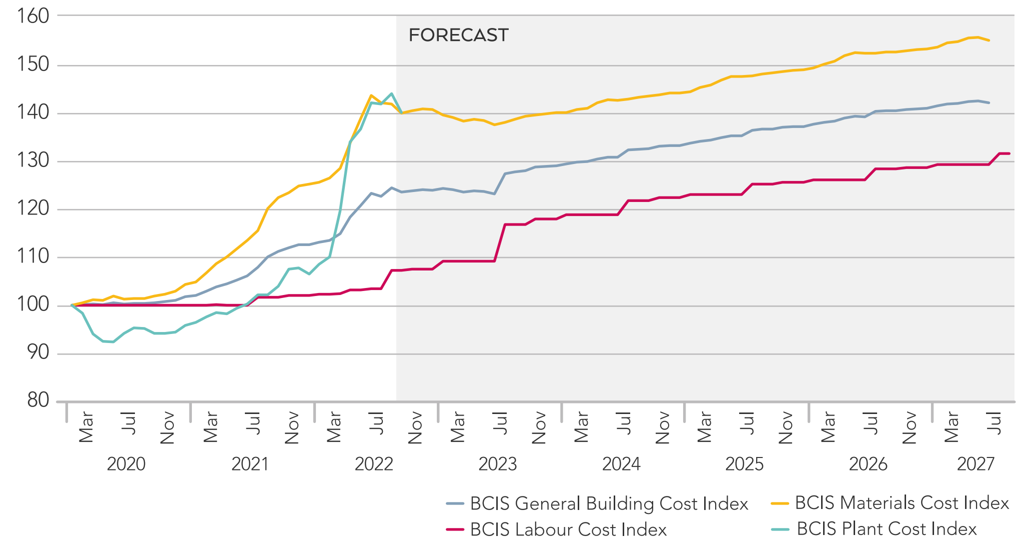
The risk of recession, or at least economic stagnation, will affect construction output growth and have a cooling effect on market demand in 2023/24. This will likely bring about a slight shift in contractors' attitude towards risk, but contractors will still be sensitive towards taking on riskier projects if a protracted downturn should materialise while price volatility persists.

Successive interest rate rises, which at this point appear inevitable, will further tighten the debt market. A reduced willingness to lend and increased borrowing costs would also impact the industry's growth activity and may make it more difficult for some projects to get funded and past the planning stage. Given this backdrop, a gradual easing in the rate of tender price inflation is expected in 2023 as the contracting supply chain shows a greater appetite to secure work.

With so many moving parts, considering future market conditions has become increasingly difficult – especially as a UK recession is not a foregone conclusion at this stage. A deep and protracted decline in economic growth would likely see businesses cut back on resource and overheads, dampening demand for construction activity. A downturn or shallow contraction (of which there is a greater degree of certainty to happen) would still bring about a squeeze on household and businesses finances, but to a lesser extent.

Over the next six months, market conditions are likely to turn more competitive as projects are potentially put on hold and some projects wrestle with viability concerns. Contractors meanwhile will be partially and temporarily buffered from competitive tendering pressures given their relatively heathy pipelines, but as we move through 2023 contractor workloads may begin to drop off and chasing work could become more commonplace.

BCIS INPUT COSTS



Source: BCIS

INPUT COSTS

Key inflationary and deflationary pressures

Looking at independently produced raw input cost inflation metrics from the BCIS, it is clear that materials and plant have been biggest drivers of inflation throughout 2022.

Driven by the red diesel ban and higher fuel costs, the BCIS Plant Cost Index has risen by more than ***31%*** in the first three quarters of 2022 alone. Fortunately, plant typically accounts for less than ***3%*** of the total construction cost on a commercial project so the total weighted impact has been less significant than materials, for example. The BCIS Materials Cost Index is expected to rise by ***c.12%*** in the 2022 calendar year (Jan-Dec 2022) and with materials accounting for ***c.57%*** on a typical commercial office project, this has been the real driver of input cost inflation in 2022.

At an estimated ***5.3%*** for the year, labour inflation has lagged both the BCIS' materials and plant inflationary indices but is forecast to see a significant step change from late 2023 as wages catch up with broader inflationary trends and higher costs of living.

With the exception of labour, all BCIS input cost indices show that inflation in the construction sector was heavily sacked or front-loaded in the first half of 2022. In fact, the vast majority of all input inflation in 2022 occurred in a single quarter (Q2) following the disruption that ensued from Russia's war with Ukraine. With the initial supply shock now over and supply chains having had time to adapt and adjust, inflation is set to drop across all three key BCIS input cost indices in Q4.

Depending on how these raw input costs are weighted (in terms of their elemental contribution to total construction cost) across sectors, building, and project types, certain schemes will have experienced inflation well in excess or even below our UK average TPI forecast of ***5.5%***. It is therefore important to bear in mind that G&T's figure is an indicative average across all sectors and project types. However, with G&T's diverse project mix, the latest set of TPI forecasts for 2022 are reflective of the broader construction cost inflation movements.

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, but recent macro-economic developments may act to partly offset these prevailing inflationary pressures.

Material Costs

Material prices have undoubtedly been the main driver of construction cost inflation so far in 2022, as manufacturers successfully passed on rising production costs and commodity price increases down the supply chain.

However, material prices appear to have turned a corner, as evidenced by the BEIS's 'All Work' material price index falling by a notable ***1.42%*** in August. This was the first monthly fall in material price inflation since July 2020 – the point at which demand started to come back online within the UK construction sector and material price inflation began its rapid ascent, fuelled by global supply-demand imbalances.

Will this mark the beginning of a much-anticipated cooling of material price inflation? A lot depends on energy price movements. Russia's decision to shut off gas supply to the European Market via the Nord Stream 1 pipeline in September stoked a further energy price spike, but EU gas prices (as reflected in the Dutch TTF Gas benchmark) have since dropped to three-month lows (of ***c.€150*** per megawatt-hour) due to an improving supply outlook.

LNG flows to northwest Europe are at their highest seasonal levels since 2016, as shipments continue to arrive from US and Qatar. Gas Infrastructure Europe says gas stocks have reached 98% in France, ***94%*** in Germany and ***92%*** in Italy – enough to get through the winter. Temperatures also remain higher than forecast which has seen declining demand from both industry and households.

Gas prices still remain exceptionally high compared to a year ago (***€38*** per megawatt-hour in October 2021) and this has meant that parts of the European industrial sector have been forced to cut production hours due to the energy crisis.

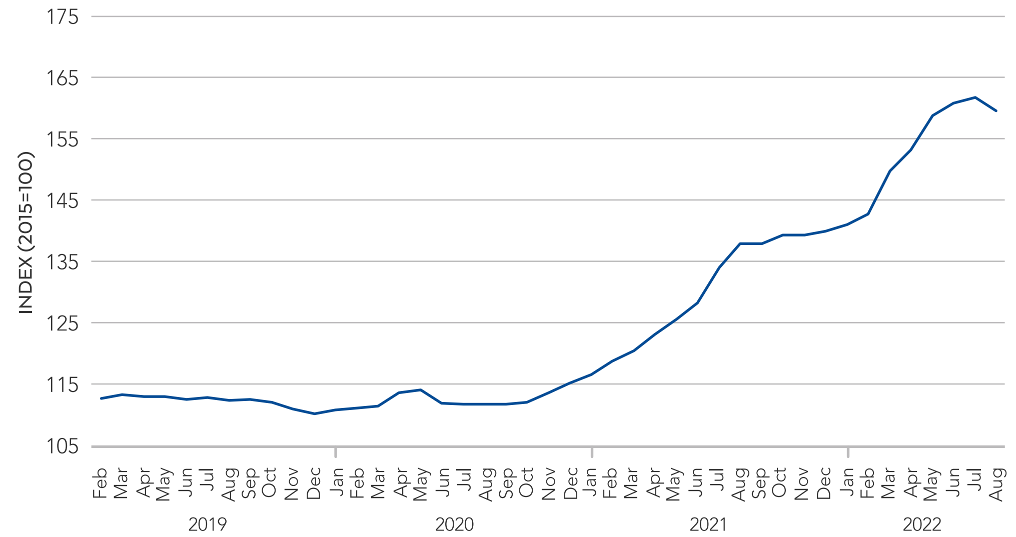
However, the short-term outlook at least is now far more positive. The likes of Goldman Sachs has forecast gas prices to drop even further to below ***€100*** per megawatt hour by the end of Q1 2023 due to "gas demand destruction" and high gas inventory levels, which bodes well for energy-intensive materials in 2023.

Falling energy prices will particularly help sectors that have a higher level of exposure to heavy-side, energy-intensive construction products and materials (eg infrastructure and industrial warehousing), but because manufacturers buy energy in advance via fixed-price energy contracts over set periods, falling wholesale energy prices will take time to trickle down through to product pricing strategies. Furthermore, the fall in the value of pound will inhibit any trickle-down effect of lower wholesale energy prices as oil and natural are traded in the strong US dollar on the global energy markets.

Some key construction materials have surpassed the decline experienced by the broader BEIS 'All Work' material price index. After peaking in June, structural steel, rebar and imported wood have all fallen by more than ***12%***. However, September will likely experience a further upward spike in steel prices following the knee-jerk reaction in the energy markets to Russia's cut off of Nord Stream 1 pipeline gas supply. Indeed, both British Steel and ArcelorMittal put out two separate price increase notifications for structural steel sections shortly after energy prices shot up in August, citing cost pressures in the production of and transportation of steel. This reflected a total increase of ***£250*** within the space of a month.

Through eight months of activity (Jan-Aug 2022) and with ***1.25*** billion metric tons produced, global steel output for 2022 is down by ***5%*** year-over-year compared to 2021. The fall in production reflects weakening industrial demand globally, rising energy costs, as well as complicating factors such as the Russian invasion of Ukraine. The global economy is cooling in light of what are widely acknowledged to be the toughest conditions outside of pandemic lockdowns and since the global financial crisis. Goods-producing industries, including construction, are starting to see falls in real-terms spending amid increased global

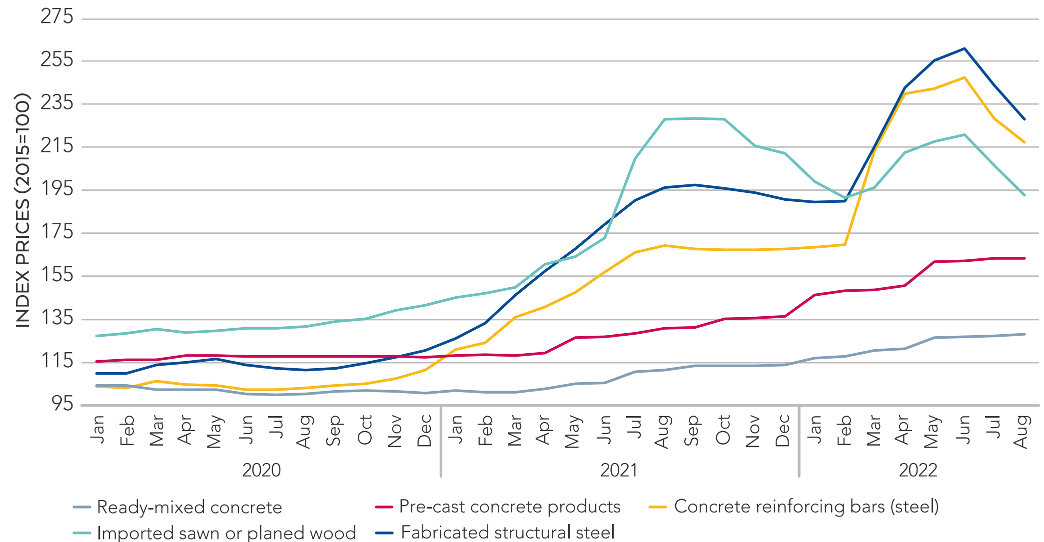
BEIS: 'ALL WORK' CONSTRUCTION MATERIAL PRICES INDEX, UK



Source: BEIS

KEY MATERIAL PRICES

Index 2015 = 100



Source: BEIS

economic uncertainty. Inventory reduction polices and destocking are even becoming more common in many countries.

Changes in demand conditions typically bring about price corrections. Global output contracted for the second straight month in September – a trend being mirrored in the domestic UK construction market. Future output expectations have also diminished according to the CPA. In tandem, cost pressures are moderating. While material price inflation is clearly still an issue, early data (through PMI surveys and public data sets) and a sense among the construction supply chain points to a near peaking of material price inflation.

Labour

Construction continues to try and boost capacity by increasing staffing levels amid greater workloads and ongoing efforts and reduce backlogs. However, firms continue to cite a shortage of candidates to fill vacancies, creating a strong upward pressure on wages.

ONS data suggests that average weekly earnings in the construction sector rose by ***4.4%*** in the year to August 2022 – significantly higher than the long-term annual average growth rate of ***3%***. While labour has been the least inflated construction input cost in 2022, G&T and other independent forecasters anticipate a step change 2023 that will see labour take over as the biggest driver of tender price inflation and lead the charge.

With no immediate solution to the tight construction labour market and a cost-of-living crisis sustaining upward pressure on wages, labour looks set to continue its role as a long-term inflationary driver.

The latest Construction Skills Network (CSN) report points to an additional ***266,000*** construction workers being required by 2026 in order to meet demand (the equivalent of ***53,200*** workers per year, and up from a 2021 figure of ***43,000***). The process of recruiting and developing a highly skilled workforce was recently described by the Tim Balcon, CEO of the CITB as, "…by far the construction industry's biggest challenges over the next five years."

The largest increases in annual demand will be for occupations such as carpenters/joiners and construction managers, along with a range of technical roles. These include electronics technicians, civil engineering technicians, estimators and valuers, as well as office-based support staff. All nine English regions, as well as Scotland, Wales and Northern Ireland, are expected to experience growth resulting in increased demand for workers over the 2022-2026 period. Strong demand in the private housing, infrastructure and repair & maintenance sectors are expected to be the main drivers of recruitment activity over the period.

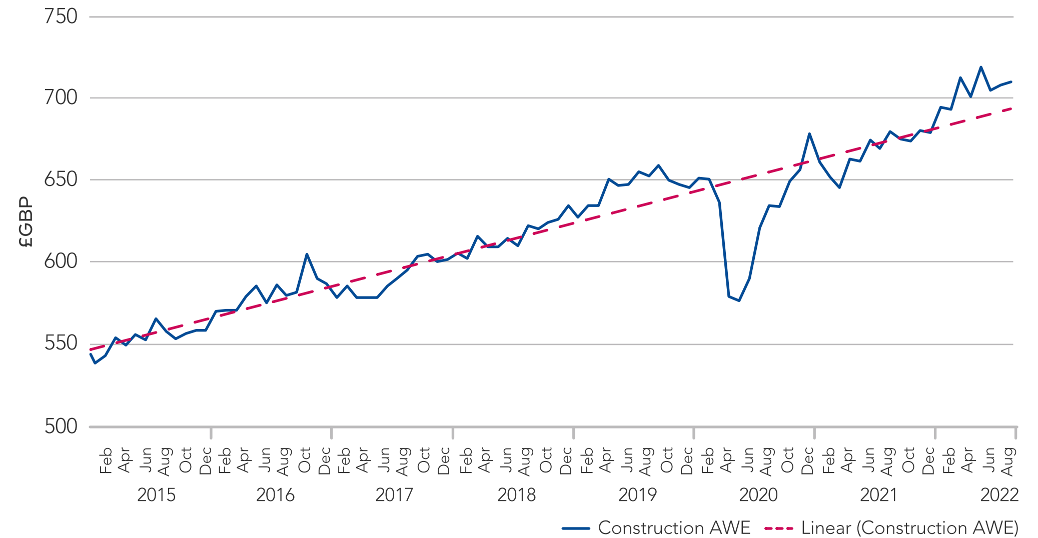
Depending on the severity and extent of any economic slowdown over the next year, future growth projections for the industry may be temporarily reined in. However, this is unlikely to impact the CSN's recruitment requirements significantly over the longer-term and will be difficult to meet without introducing greater flexibility into the UK's current worker immigration policy or substantial investment into training and skills development. Despite signs of an imminent economic cooling, construction vacancies remain at a near all-time high.

Job vacancies in the sector edged higher in the Jul-Sep period, reaching ***45,000***. This figure is some ***94%*** higher than the 20-year, long-term average of ***23,200*** vacancies. Construction industry vacancies also bucked the national trend, which saw vacancies in the Jul-Sep period actually fall by ***1%***.

September's UK PMI readings published by S&P Global suggest that the construction sector was the only key sector to see an overall growth in activity in the month. According to September's report, the construction employment growth accelerated from August's 17-month low, pointing to a strong rate of job creation. Strong, positive momentum in the sector is supporting employment growth for the time being but recessionary concerns could see a slowdown in the rate of job creation and vacancies.

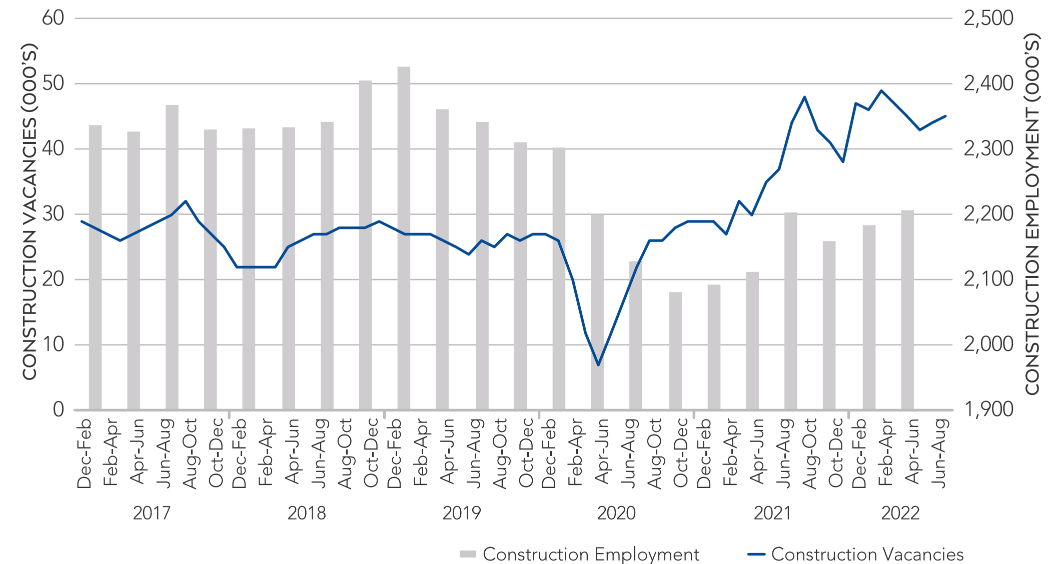
Our TPI survey revealed that whilst projects on site are not generally experiencing labour shortages, some trade contractors have noted

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



Source: ONS

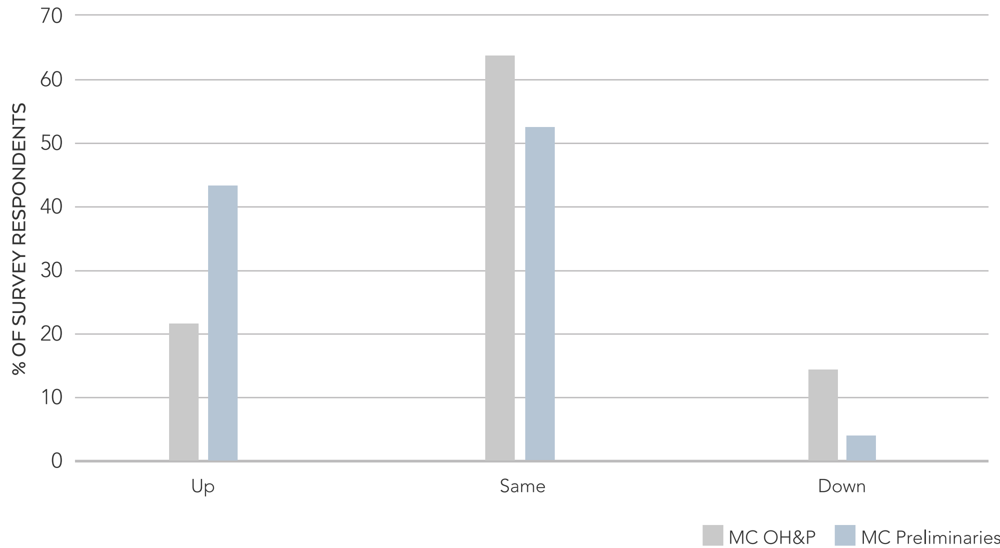
VACANCIES IN UK CONSTRUCTIONS (SA) V CONSTRUCTION EMPLOYMENT (NON SA)



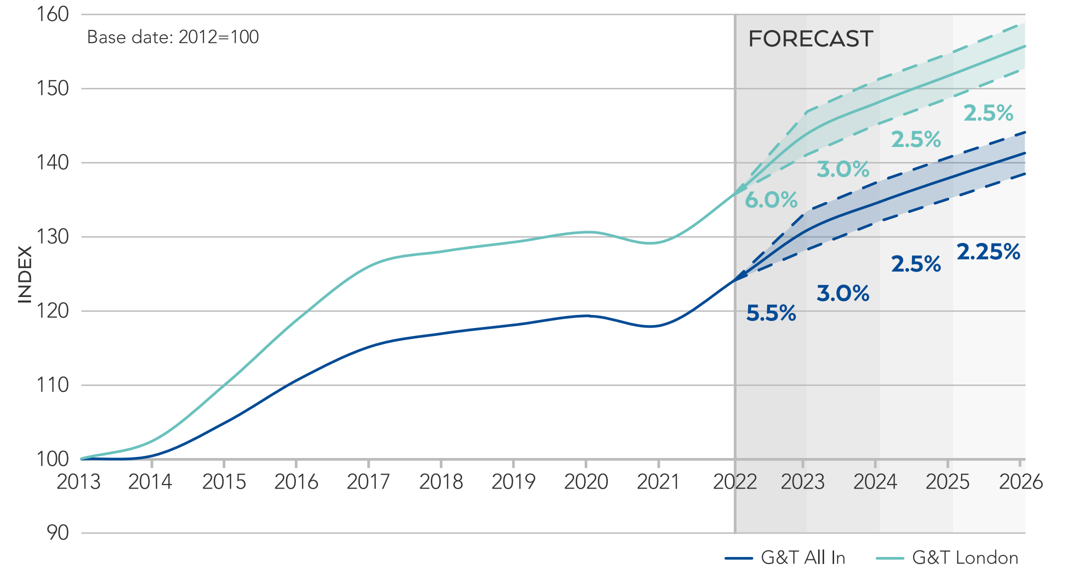
Source: ONS

GT

INFLATIONARY PREDICTION FOR MAIN CONTRACTOR OH&P AND PRELIMINARIES OVER THE NEXT 12 MONTHS



G&T TENDER PRICE INFLATION FORECAST: UK AND LONDON



Graph shows indicative sensitivity on forecast TPI dependant on developing scenarios and evolution of inflationary pressures

increased difficulty in securing labour. This has limited some subcontractors' ability to submit tenders due to the risk of not having access to sufficient labour to fulfil the contract. Even with a weakening in demand and a reduction in forecast output growth, the tight labour market is unlikely to ease significantly. It will continue to be a major task for contractors to find fully skilled workers simply because these workers are currently available - they have either left the industry through retirement, emigration or choice.

On Costs

On the whole, main contractor overheads and profit (OH&P) levels were unchanged over the past three months. OH&P levels for most incoming tender returns were within the usual/expected range and given that order books are full, most contractors will likely maintain their OH&P at current levels in percentage terms (albeit on projects that are of a higher value).

Just over ***20%*** of our TPI survey respondents thought that OH&P would rise over the next 12-month period. Very few are expecting to see any downward trend in terms of OH&P levels, despite the prospect of sluggish economic growth. Beyond this though, as gaps in pipelines emerge and contractors become keener for work in the open market, OH&P levels may come off slightly.

More upward pressure is expected to be seen with regards to preliminaries costs. Labour costs are increasing as finding the right calibre of staff becomes increasingly difficult, while high energy prices will continue to impact the cost of operating plant on site. Rising insurance premiums will also be a contributing factor in pushing preliminaries higher.

Acting against some of these upward pressures on preliminaries costs will be the Government's reversal of the National Insurance increase. This may provide contractor employers with a buffer that could be used to partially offset or absorb some of the other inflationary factors acting on preliminaries costs to win work in a more competitive tendering market.

COMPARISON OF PUBLISHED FORECASTS FOR TENDER PRICE CHANGE

	G&T UK AVER. Q4 2022	BCIS UK AVER. Sep 2022	G&T LONDON Q4 2022	AECOM UK Oct 2022	ARCADIS LONDON Autumn 2022
	% CHANGE				
2022	5.50	7.85	6.00	9.00	10.00
2023	3.00	6.20	3.00	4.00	2.50
2024	2.50	3.30	2.50	N/a	3.00
2025	2.25	3.44	2.50	N/a	3.00

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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