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“We have reached ‘tipping point’ as downturn in construction arrives”

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The UK’s construction market has reached a ‘tipping point’ as the widely expected downturn arrives, according to analysis from Arcadis in their Winter 2022 Market report.

The report highlights that while construction has continued to avoid the gloom engulfing the wider economy so far, with output and new orders increasing in the third quarter of 2022, all signals point to the slowdown having arrived.

However significant uncertainty remains around the size and scale of the downturn and the different challenges it will present to the building and infrastructure markets.

The quarterly analysis of the UK construction market from Arcadis looks across sectors and regions to deliver a tender price forecast to inform clients about what is going on in UK construction, helping financial decision making for projects and programmes.

The story of 2022 has been the consistent ability of UK construction markets to overperform, with continued growth as the wider economy has started to contract. This has continued throughout Q3, with total new orders up by 6.4% (£774m). Although markets cannot defy gravity forever, the strong order book represents a solid cushion of workload ahead of the slowdown, providing strong foundations for the eventual rebound.

However, Arcadis maintains that there is still a significant degree of uncertainty surrounding the coming 12 months. With infrastructure workload somewhat protected by continuing Government investment, it is increasingly likely that price trends in commercial building and public infrastructure markets will diverge, with much higher inflation affecting infrastructure schemes.

As a result:

- The final 2022 forecast has been confirmed at 10% for buildings and 12% for infrastructure
- For infrastructure construction, the forecast for 2023 has been increased to 6-7% from 5%, reflecting high volumes of investment that will continue to be delivered and the use of procurement practice such as Early Contractor Involvement (ECI) that reduces competitive pressure during the later stages of bidding.
- For 2024 and 2025, infrastructure inflation is anticipated to fall to 4%, in part reflecting the much lower levels of inflation expected in wider markets.
- We reduce our buildings forecast in both London and Regional markets to 2% for 2023.
- Our forecast for buildings inflation for 2024 and 2025 remains low at 3% for buildings in all UK markets.

Simon Rawlinson, Head of Strategic Research & Insight at Arcadis, said: “With the Chancellor shielding the public sector capital programme from market effects in the short term, our forecast is subject to even higher levels of uncertainty than usual.

“Many sectors, including infrastructure, industrial and even non-housing repair and maintenance are entering the downturn from a position of record workload, and there is a chance that not all sectors will fall into recession.

“We expect input costs to continue to rise in 2023, but these won’t all be passed to clients. Competitive pressures in finance-driven sectors like housebuilding and commercial property will result in low tender price inflation.”

The tension between cost and price in the construction industry Arcadis has also considered the tension between cost and price within the industry, looking in particular at how inflationary pressure absorbed within the supply chain over the last 18 months has led to an increasing divergence in the way in which inflationary risks are managed by contractors and their suppliers.

With construction prices discounted during 2022, not all sectors have been equally affected. For example, housebuilders have up until recently been able to readily absorb construction cost inflation because house prices were moving even faster. By contrast, main contractors in the buildings sector, focused mostly on commercial, industrial and public-sector schemes, have seen most pressure exerted even though the bidding environment has been less competitive over the past 18-months.

Ross Baylis, Head of Cost and Commercial Management, said: “Compared to the previous downturn in 2007 and 2008, today construction markets are increasingly varied, meaning that commercial pressures are applied in very different ways.

Regardless of the model adopted, from JVs to vertical integration, inflation always needs to be absorbed somewhere in the chain, from self-employed labour to the client in a JV. As markets get tighter in 2023 and beyond, the level of absorption will increase and alongside that, so could the commercial stress.

“With energy and labour costs still likely to be significant cost drivers in 2023, such variation in practice and procurement means that clients and their advisors will need to think even more carefully about how their bid strategy will share the cost and price tension across the wider project team.”

The full UK Winter Market View is available to download here.