UK MARKET VIEW

Subdued activity leaves construction exposed to rising costs

Q2 2026

Introduction

The second half of 2026 presents an important opportunity for clients to take a proactive and informed approach to cost and commercial strategy.

While the market continues to adjust to softer new work, changing demand and targeted cost pressures, there are also encouraging signs. Repair and maintenance activity remails resilient, recent public investment should support future infrastructure and public sector pipelines, and the easing in oil prices could help reduce fuel, transport and energy-related pressures if sustained.

This creates scope for more balanced tender price inflation, improved market confidence and better informed procurement decisions.

In this environment, the greatest value will come from early engagement, careful market testing, transparent supply chain dialogue and robust commercial controls, helping clients turn volatility into better planning, stronger risk management and more resilient project outcomes.

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Mace Consult

In Q1, GDP increased...

0.6%

but contracted 0.1% in April and may soften further as the year progresses.

The construction labour market is going through a tough time, and regular earnings are...

0.7%

lower than a year ago.

Material prices are rising at their fastest rate in three years, and at…

3.2%

are sitting above CPI inflation.

New orders fell in the first quarter as confidence waned, declining…

10.5%

over the quarter.

Repair and maintenance is propping up the construction sector, and all new work declined…

1.9%

in Q1.

Tender prices

	2026	2027	2028	2029	2030
National Real Estate	3.5%	3.5%	4.0%	3.5%	3.5%
National Infrastructure	4.5%	4.5%	4.5%	4.0%	4.0%
London	3.5%	3.5%	4.0%	3.5%	3.5%

This table gives our current tender price inflation forecast. The figures should be treated as averages and there will be variations due to procurement methods, project type and local factors.

Setting the scene

It has been another quarter of significant change in the UK government. Following Keir Starmer's resignation, Andy Burnham will become the seventh prime minister in the last decade. Construction will hope that last year's boost to capital budgets remains, while the delivery of Burnham's ambitions for council housing will present a significant challenge. Importantly, he has promised to stick to the existing fiscal rules. It may take time before we see detailed policy announcements, however, his main goal of rebalancing the UK economy will require strong support from construction to build the infrastructure that will support such growth.

A deal between the USA and Iran had caused oil prices to recede. However, this is becoming increasingly precarious. Prices had eased below US$80/b following the agreement, close to their pre-conflict levels, but fresh clashes have pushed them back up. With fuel and energy costs remaining elevated, inflation will stay as a concern and construction material prices will continue trending upwards.

The fall in oil prices helped the Bank of England keep interest rates on hold at 3.75% at its June meeting. However, there are still tensions around whether it will need to raise rates later in the year. While raising interest rates will do little to dent inflation due to higher energy costs, the Monetary Policy Committee would make such a move to prevent second-round effects and to try to avoid wages following prices higher, which in turn would drive inflation up. The last time this scenario played out was following Covid, when the labour market was in a much stronger position. Unemployment is almost 5% and wage growth has been slowing for most of the past three years. Economy-wide regular earnings growth was 3.4% in March, this is noticeably stronger than in the construction sector. Here, pay is 0.7% lower than a year ago, pointing to an incredibly difficult market for workers in the industry. Meanwhile, output in the industry has stuttered in the first few months of the year, with all new work struggling.

This means that, once again, the construction industry has to battle the twin challenges of rising inflation and depressed activity which comes with worrying implications. Weaker output and greater competition for work may encourage some firms to aggressively price tenders. Yet, in an inflationary environment there is greater risk of costs spiralling above winning bids and putting schemes under pressure. Clients need to be aware of these risks and be cautious of artificially low tenders. As well as causing problems for individual projects, contractors and subcontractors who overextend themselves may eventually become insolvent. Although the number of insolvencies in the industry has eased from their peak in 2023, they are still significantly higher than their pre-pandemic levels. The concern now is that current market conditions will lead to numbers climbing again in the future. Recently, Ardmore Construction – a business with £350m turnover – became the latest big-name firm to go into administration. Rules brought in by the Building Safety Act with regard to Building Liability Orders and parent companies' exposure to liabilities appear to have contributed to its collapse. In addition, the High Court ruling, which relates to a project completed in 2009, creates new risks for contractors and highlights the importance of due diligence during the tender process.

One problem with insolvencies is the impact felt along the supply chain. Main contractors hold on to retentions for subcontractors, and if they fall into administration, the retentions are typically lost. The government has introduced a Bill in Parliament which should eventually see retentions banned. In this report, we discuss this topic as well as a second new government policy under which it has changed the rules about imported steel. Reducing quotas and increasing tariffs has already caused prices to rise. While the aim of the Bill is to protect UK steel by pushing up prices, it has the potential to damage the construction industry. This would seem to conflict with the government's aim of increasing housebuilding and supporting the infrastructure sector. Estimates that it will add up to £4,000 extra on each residential unit will add to tender price inflation, which we have chosen to leave unchanged this quarter. Whereas in our last report we said risks to tender price inflation skewed to the upside, this time they are more balanced. Alongside the reduced risk of oil prices spiking, declining construction pay growth means there are some offsetting downwards pressures. Much is likely to depend on whether output, which we had hoped would grow strongly this year, rebounds, or if a lack of confidence means it stays subdued.

Material prices rising but weakness in construction pay

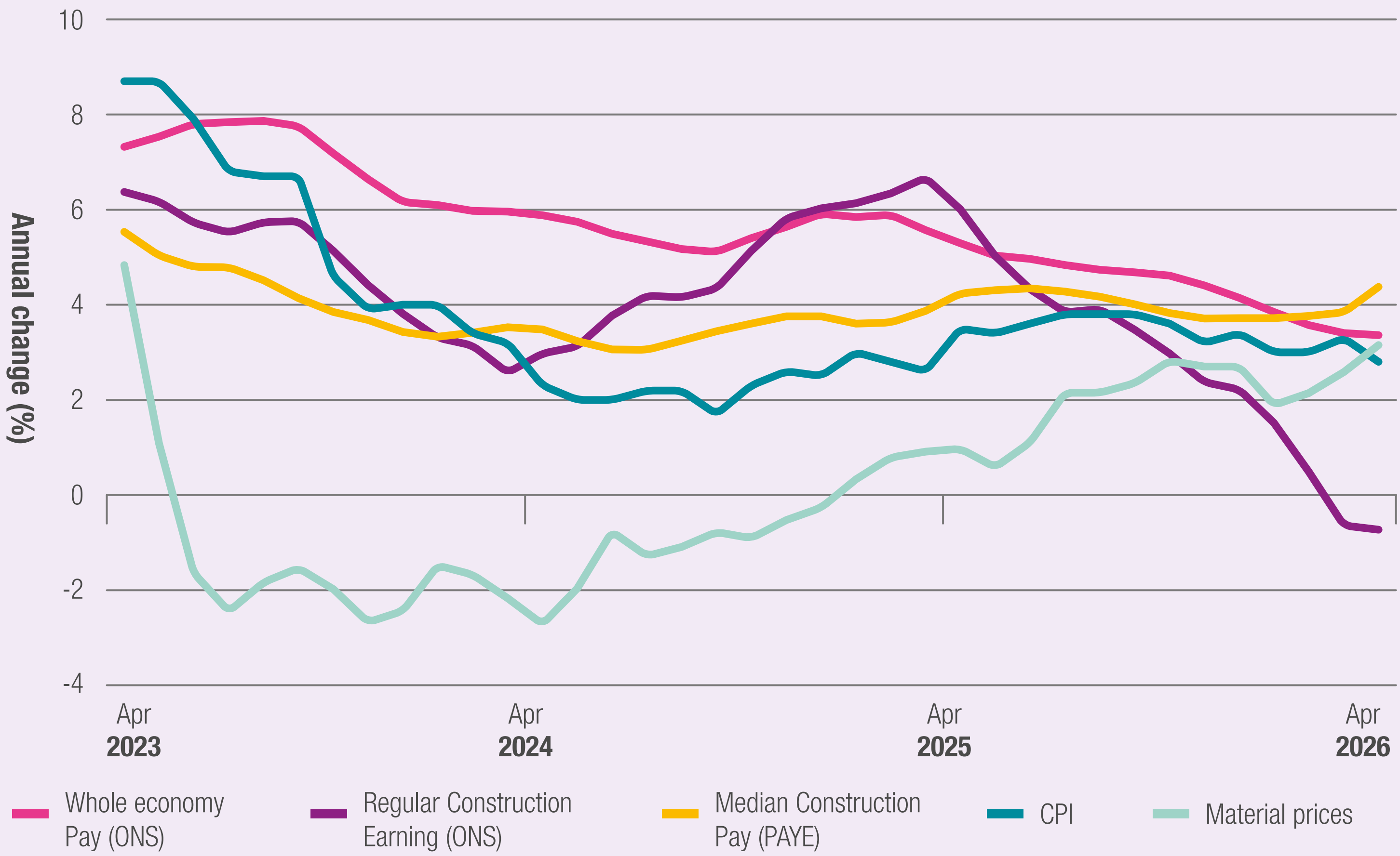
Material prices

As expected, the conflict in the Middle East is causing material prices to rise. In March, the monthly increase in the 'all work construction material price index' was 0.9%, and the index rose a further 1.1% in April. These increases have driven the annual rate of material price inflation up to 3.2%, the highest it has been since April 2023. It is the first time that material price inflation has been higher than consumer price inflation in over three years. What is also noticeable is the number of products that saw their prices rise in April. Of the 27 construction materials the Department for Business and Trade provides information on, prices were higher for 21 of them. Usually around half of this list experiences a monthly price rise, and the much larger proportion of products whose prices went up in April shows how widespread the impact of the conflict on inflation currently is. Over the past year, fabricated structural steel is the product that has seen the largest increase in price. However, its annual increase of 8.5% has all come in the past three months. The index is 10.4% higher than it was in January. This is, in large part, due to panic buying in the lead-up to a new tariff and quota system coming into effect at the start of July.

While it should not come as a surprise that material prices are going up, recent moves in labour costs are harder to explain. According to the ONS, regular construction earnings were 0.7% lower in April 2026 than a year ago. Over the past three months, pay in the sector has fallen 0.8%. Despite weakness in parts of the industry, output is at its highest level in seven months. Similarly, vacancies have weakened, but not enough to suggest firms have completely stopped hiring. Regular pay growth across the economy at 3.4% also makes the construction sector an outlier and shows there is not a widespread downturn in

CONSTRUCTION PAY GROWTH HAS COLLAPSED OVER THE PAST YEAR

Source: ONS, DBT, HMRC



pay. As well as the fundamentals not warranting such decreases in pay, inflation rising means on average real pay is falling rapidly. This could mean that the sector is in more trouble than output figures are showing. If workers start looking for roles in other sectors, it could have negative long-term implications.

A further conundrum related to construction pay is just how much PAYE data from HMRC differs from the ONS figures. In contrast to the declining pay the ONS' Monthly Wages & Salaries Survey is reporting, median construction pay is 4.7% higher than a year ago based on PAYE data, putting the sector in a much better place. In this dataset, construction pay growth is also faster than the 4.5% employee pay growth across the whole economy. The ONS data includes self-employed workers, but it would seem highly unlikely that pay for these workers is falling fast enough to explain the difference between the two datasets.

Output

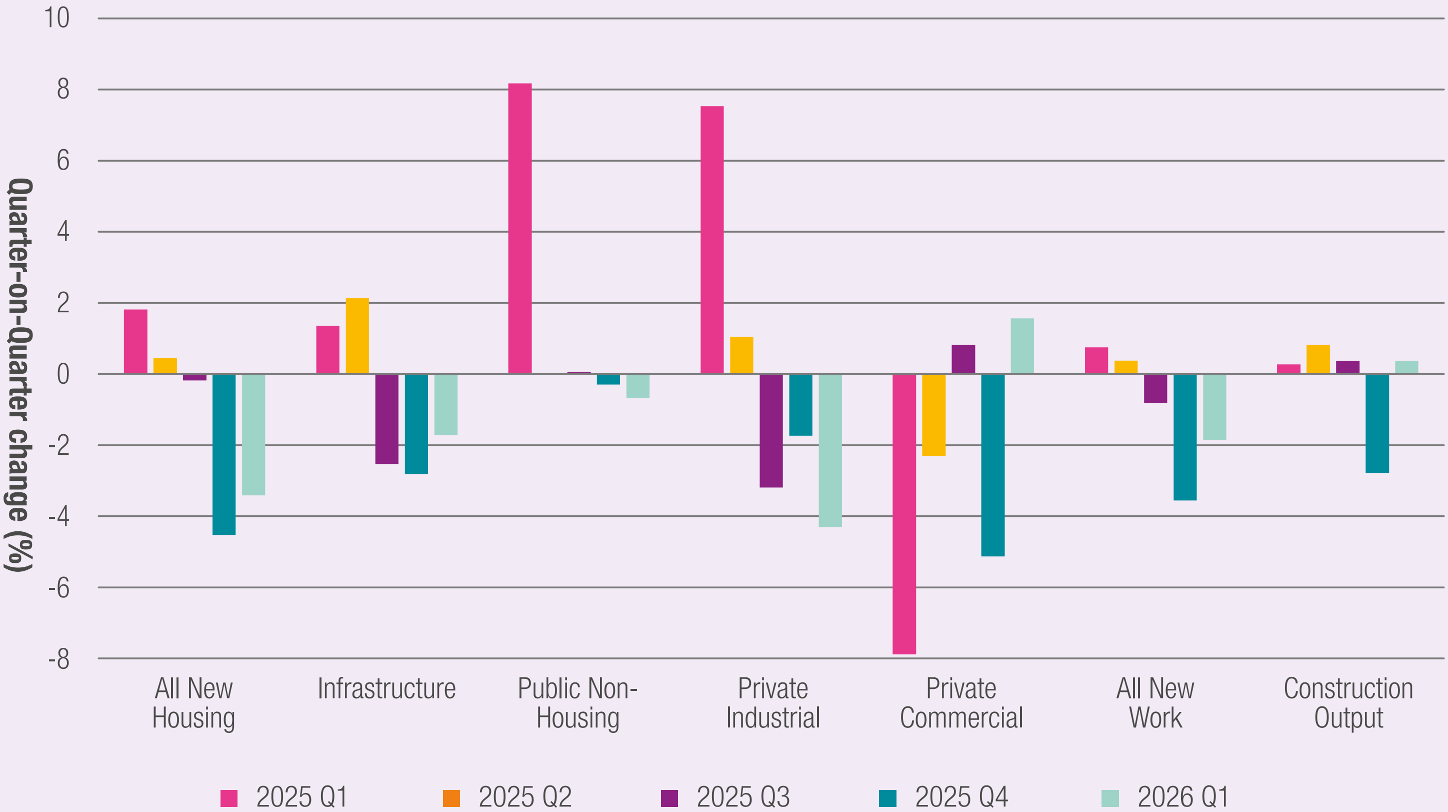
Construction output rose 0.4% in the first quarter. However, this was due to repair and maintenance having its strongest quarter in over two years. While repair and maintenance grew 3.4%, all new work output shrank 1.9%, and within that category, private commercial was the only sector that increased. After the considerable weakness in the second half of last year, a further quarterly decline left all new work 5.8% smaller than it was in Q1 2025. Not only is this significant reduction a concern, but the fact that output in all six components constituting all new work is lower than it was 12 months ago shows there are few bright spots for a clearly struggling industry. Furthermore, the conflict in the Middle East adds to the problems facing the sector, which were underscored by April's 0.3% reduction in all new work, largely driven by a 3.3% drop in private housing.

As in the final quarter of 2025, public housing was the worst performing sector in Q1, declining 6.8%. With private housing also down 2.6%, the housing sector started the year in a similarly troubled fashion as it ended 2025. Major housebuilders are talking about scaling back, and with interest rates potentially rising, once again there are likely to be significant headwinds affecting the largest part of the construction industry. Private industrial also performed poorly in Q1. Slumping 4.3% over the quarter, output is 8.0% lower than it was in the first quarter of last year.

As with total housing and private industrial, infrastructure recorded its third successive quarterly decline. Output dropped 1.7% in Q1 and is now 4.9% lower than it was in Q1 2025. However, taking a slightly longer view gives a better impression, and infrastructure output is over 20% larger than before

ALL NEW WORK SHRINKS FOR THIRD SUCCESSIVE QUARTER

Source: ONS



the pandemic. This recent weakness will hopefully prove temporary, with the sizeable jump in new orders last year likely to boost output in 2026. Helped by increased government capital expenditure, this should also support public non-housing output. While output here has declined in the past two quarters, falls of 0.3% followed by 0.7% represent only marginal declines.

New orders

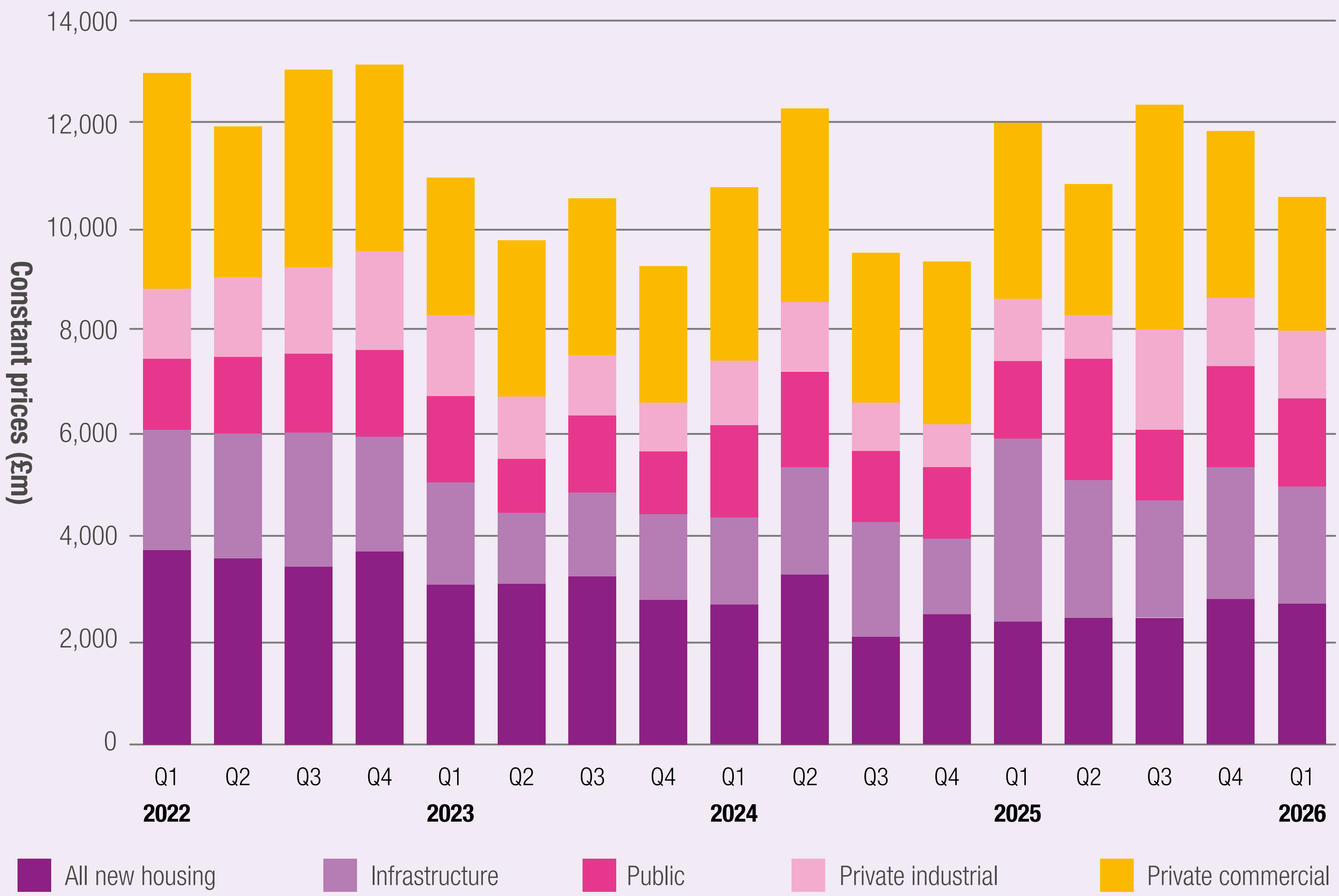
Due to the quarterly nature of the data, it's hard to say whether disappointing figures in Q1 were the result of a major downtown associated with the conflict in the Middle East in March, or a steady slowdown across the three months. Either way, new orders declined 10.5% in Q1 and were at their lowest level since the end of 2024. Looking ahead, the considerable economic and political uncertainty will deter firms from giving new projects the green light, and it seems likely that new orders will remain under pressure until there is greater clarity.

The first quarter saw new orders decline for both infrastructure (-11.1%) and public non-housing (-13.9%). However, this follows a healthy 2025, and on a rolling four-quarter basis, both are in a much stronger position than a year ago. Notably, schools and colleges have strengthened, supporting the non-housing public sector. Meanwhile, in infrastructure, Q1 was another robust quarter for electricity. In nominal terms, electricity new orders over the past four quarters were 50% higher than in the four quarters leading up to Q1 2025. The ongoing push for electrification means this part of the industry should remain active going forward. Rail new orders were weak in the latest quarter, but East-West Rail and the Transpennine Route Upgrade, as well as HS2, will continue to support output into the 2030s.

Following an exceptionally strong Q2 2025, private commercial declined again. On a rolling four-quarter basis, the sector is at a similar level to a year ago, but offices continue to face challenges and it is hard to see a sustained recovery for commercial output in the near term. Output is 5.1% lower than in Q1 2025, with the small increase in the first quarter of 2026 following a much larger decline at the end of last year.

NEW ORDERS SLIP BUT LAST YEAR'S STRENGTH SHOULD STILL HELP OUTPUT

Source: ONS



Are we going to see another year marked by political uncertainty?

Keir Starmer resigned as prime minister in June, less than two years after securing a landslide general election victory in 2024. Labour's poor performance in the May local elections, in which it lost almost 1,500 council seats, proved the final straw for discontented Labour MPs and set the wheels in motion for Andy Burnham to become the UK's seventh Prime Minister in a decade.

For now, the construction industry will need to wait for detailed policy announcements before understanding what it can expect from the new administration. Although Rachel Reeves announced a significant increase in capital expenditure last year, which should support the sector for years to come, the arrival of a new Prime Minister will also bring a new Chancellor.

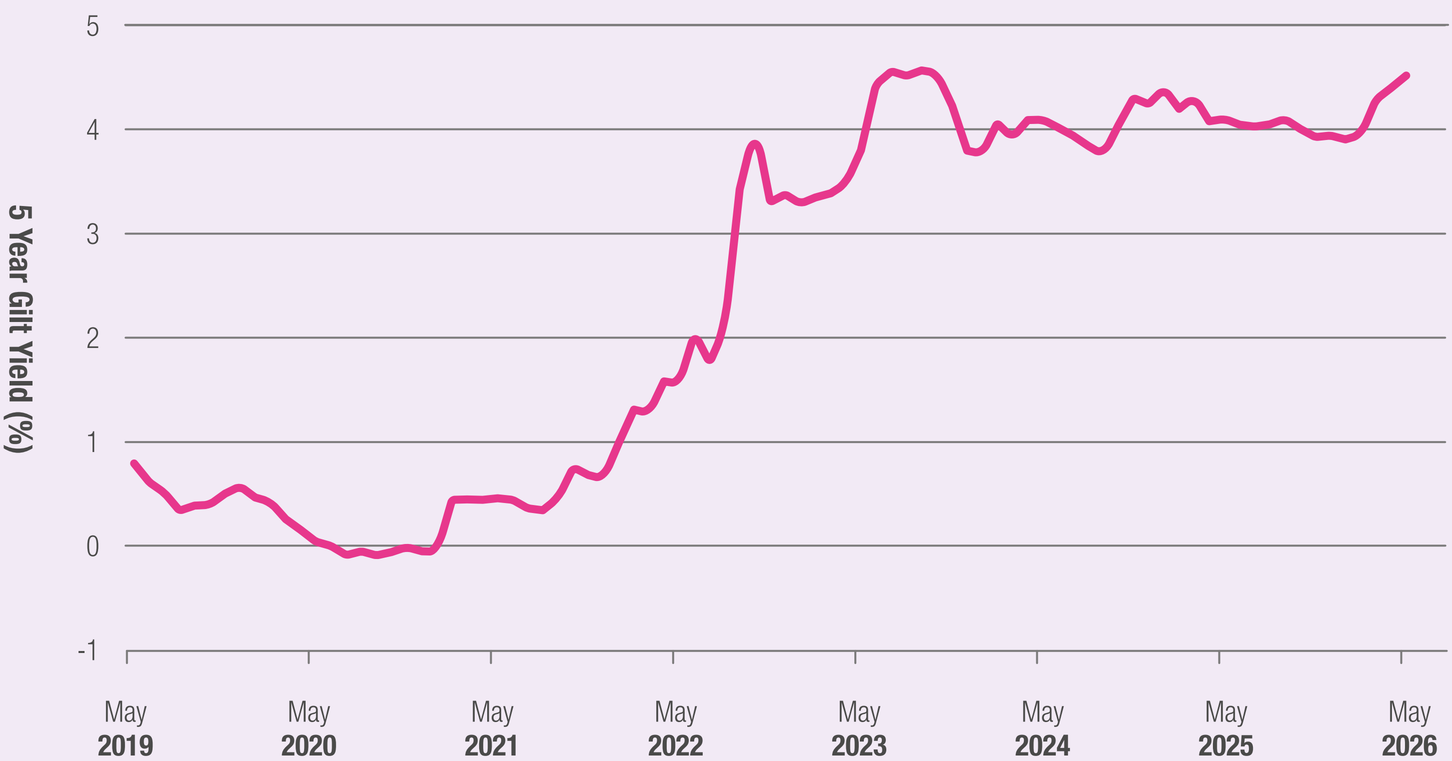
Whether Burnham chooses to maintain existing spending plans, particularly the commitments attached to individual projects, remains unclear. He has said that he will stick to the fiscal rules introduced by Reeves, but he may have different priorities and choose to focus on other areas. The key question is whether planned infrastructure and public sector projects will remain intact under the new government.

In the medium term, Burnham's support for greater public control of key services could result in increased investment in sectors such as water and energy. However, in the short term, uncertainty around potential changes in ownership structures may cause businesses operating in these sectors to delay investment decisions. Providing confidence to investors and supply chains at an early stage will therefore be vital to maintaining spending momentum. The impact of uncertainty should not be underestimated. Ahead of last year's Autumn Budget, both businesses and households delayed spending decisions while waiting for greater clarity. A similar pattern could emerge again unless the government moves quickly to establish its priorities and delivery plans.

A renewed focus on skills could be one of the more positive developments for the construction industry. Burnham has highlighted the high number of young people not currently in education, employment or

HIGHER BORROWING COSTS MAY LIMIT A NEW PRIME MINISTER'S FREEDOM

Source: Debt Management Office



training, and the associated social and economic costs. His ambition to expand work placements and apprenticeships complements last year's £600m commitment to train up to 60,000 additional construction workers. As we regularly highlight in these reports, one considerable risk to the UK's pipeline of projects is skills shortages. Unfortunately, training takes time, and inflationary pressures caused by skills shortages are likely to persist in the near term.

One of the dominant themes emerging from Burnham's early speeches is the importance of devolution and shifting decision-making away from central government. For many years, local authority funding increases failed to keep pace with rising demand for statutory services such as adult and children's social care. This has reduced the funding available for areas closely linked to construction, including education, highways and planning services. The resulting strain has contributed to weaker housebuilding activity and created additional barriers to delivery.

If Burnham is serious about increasing social housing provision, reversing this trend will be essential. Meanwhile, Reform faces its own challenge. Its ability to manage local government responsibilities effectively will be critical if it hopes to maintain momentum and position itself as a credible contender at the next general election.

A huge challenge for Starmer and Reeves was the UK's constrained fiscal position, and the new Prime Minister and Chancellor will face the same problem. Tight public finances have left bond markets increasingly sensitive to developments in UK fiscal policy. As gilt prices influence the government's borrowing costs, market sentiment has an effect on future spending. Compared with other major economies, yields, which move inversely to prices, have seen a larger increase in the UK than elsewhere. Higher inflation and potential increases in interest rates have caused yields to rise everywhere, but the shift has been larger in the UK due to its greater exposure to imported energy prices. On top of this, political uncertainty and speculation about Starmer's position added to the volatility in early May. Concerns about whether a more left-leaning candidate would change fiscal policy and increase spending pushed yields even higher. Burnham's commitment to maintaining existing fiscal rules helped reassure investors, but the underlying challenge remains. Financial markets may have limited appetite to fund significantly higher levels of public spending. Recent movements in gilt yields are likely to place additional pressure on project viability while exacerbating affordability challenges within the housing market. Strong leadership and a clear fiscal strategy will therefore be essential if the government is to prevent these pressures from intensifying.

One piece of government policy which will have a major impact on construction relates to retentions. The Commercial Payments Bill, which was introduced in Parliament in May, sets out plans to end the practice of retentions. Alongside setting a maximum payment period of 60 days before incurring late payment fees, the aim of the Bill is to support SMEs. Late payments cost the economy almost £11bn a year and cause 38 businesses to close every day. By bringing forward the Bill, the government hopes to reduce the harmful effects of unreliable cashflows, the mistreatment of firms further down the supply chain, and the downstream impacts of contractor insolvencies.

Retentions have been a controversial topic for years. The Conservatives ran a consultation in 2017/18 but, despite Build UK the Construction Leadership Council and the Civil Engineering Contractors Association supporting the abolition of retentions, there were no changes to legislation. However, following a consultation run last year where 87% of respondents favoured reform of retentions, Labour are now acting. Although the consultation found no consensus on whether an outright ban or the protection of retention sums was preferable, Labour has decided that ending them is the way forward. Proponents of retentions argue that they are necessary to ensure contractors return to site to fix defects after practical completion. Retentions provide some protection to clients in the case of insolvency and act as a form of financial assurance linked to delivery performance. Additionally, alternatives such as bonds, insurance or project bank accounts are more costly and complex.

Now that the Bill has entered Parliament, it is likely to take about a year to receive Royal Assent. After this, following a lead-in period and then a two-year transition period, retentions will be banned. It is therefore likely to be over three years before the changes come into effect. This should hopefully give clients and consultants enough time to figure out how best to manage defects effectively and think through the impact of changes to contracts, risk allocations and how to deal with practical completion. Without this, there is a risk that banning retentions will lead to a more adversarial and litigious approach to disputes about work, practical completion and defects, resulting in higher tender prices.

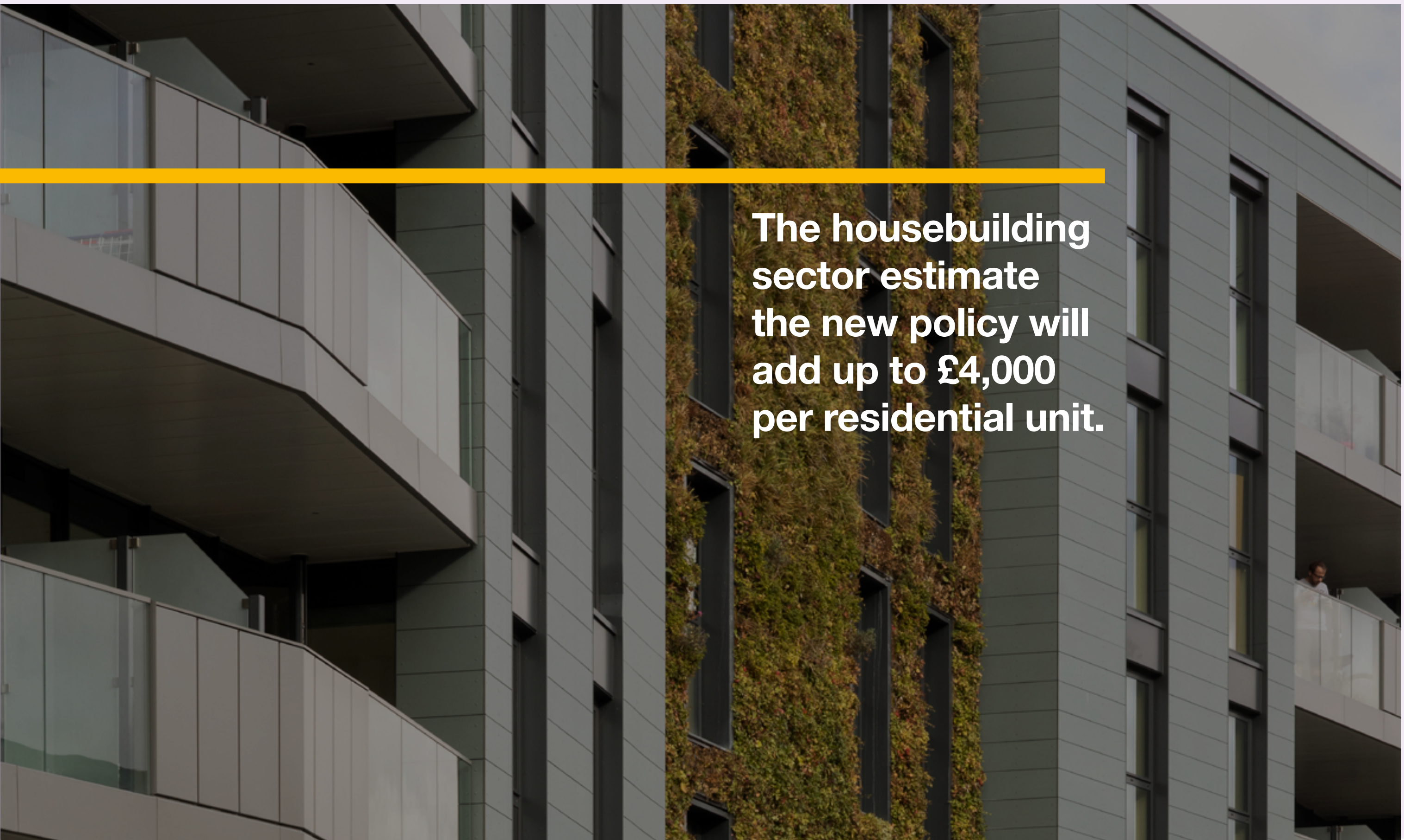
A new steel tariff and quota system will be unhelpful for construction

On 1 July, rules relating to steel imports changed. The changes involved a 51% reduction in quota levels, which was lowered from 60%, while anything above those levels will now face a 50% tariff. These changes are in response to other countries' own protectionist strategies, with the UK government deciding it needs to intervene to prevent surplus global steel production from undercutting UK production.

Underscoring the challenges facing the industry, the government have nationalised British Steel. They will now be even more keen on making a success of the policy, which aims to boost domestic steel production by 30% and have 50% of steel used in the UK made in the UK. However, as in the US with Donald Trump's wide-ranging tariffs, the impact of protectionist policy is that it increases costs for the end user alongside several other downsides.

While there is no data for the UK, globally, construction accounts for over 50% of steel consumption. In Europe, due to its significant automotive sector, this figure is a little over a third. The UK is likely to be similar, and as the largest consumer of steel, the construction sector is particularly at risk from the new policy. In response, the Construction Leadership Council has been working closely with the government and setting out the industry's concerns. The most obvious problem is that it will cause the price of steel to rise. A lower quota means less steel can be imported tariff-free, while the tariff rate above the reduced quota has doubled, from 25% to 50%. Once the threshold is met, importers will have no choice but to pass on higher costs. In turn domestic producers may respond to a drop in supply in the market by increasing their own prices, leading to wider cost increases.

Alongside the direct cost implications, with the housebuilding sector estimating it will add up to £4,000 extra per residential unit, the CLC discusses increased uncertainty and how this will affect projects in various ways. Not only are steel prices rising, but as the market adjusts, they are likely to be more unpredictable and volatile. Adding to commercial risks for lump-sum contracts, client teams will need to carefully assess the most appropriate procurement routes. Lead times may also rise, both in the short term due to panic buying and in the medium term if UK manufacturers cannot meet demand or do not produce the necessary type of steel.



A final word of warning from the CLC applies to fabricated structural steel. As the quota only applies to raw products, fabricated structural steel does not fall under it. Suppliers will therefore be incentivised to import fabricated structural steel rather than buying from domestic suppliers. This could potentially cause job losses of up to 30,000 over the next 5-7 years, which accounts for around half of the total jobs in the fabricated steel sector and would mean a significant loss in domestic capability.

Even before the change in policy, it is thought that the new rules have caused panic buying and had an impact on prices. Steel prices surged following the end of Covid and then spiked further due to the Ukraine war. Rebar hit a peak in May 2022, over 40% higher than three months earlier and 138% higher than the low point reached during the pandemic. From this high, steel prices steadily eased for several years, and rebar had dropped 45% by December 2025. Yet since September last year, fabricated structural steel prices have been rising, with rebar following suit since the turn of the year. Fabricated structural steel prices have risen 16.2% over the past six months, initially driven by geopolitical trade issues and then by the conflict in the Middle East, which has exacerbated trade disruptions and increased energy costs, alongside rising demand as buyers build up stocks ahead of the policy change.

With the new system potentially making projects unviable and working against the government's desire for more housebuilding and infrastructure expenditure, March's Steel Strategy looks likely to come with unintended consequences. Yet alongside the challenges, the government report also addressed another issue that the construction sector will need to manage. The adoption of green steel in the industry will require a significant increase in its usage to meet net zero targets. Last year, green steel made up around 13% of total steel consumption in the industry. This needs to more than double to 29% by 2030, rising to 87% by 2040 with a target of accounting for virtually all steel used in construction by 2050. Recognising that meeting such targets requires lower electricity prices, the report emphasises some of the government's other policies, such as its Clean Energy Superpower Mission. Recent news about delays to the Port Talbot steelworks project because of electrical connectivity problems also highlights how the relationship between steel and construction is not one-directional. The £1.25bn scheme was one of the largest projects in last year's new orders numbers, so delays to the project will hurt output. More importantly, it shows that a thriving construction sector, which can support the electrification of the economy, is essential for the steel industry's future requirements.

RISING STEEL PRICES

Source: Department for Business and Trade

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