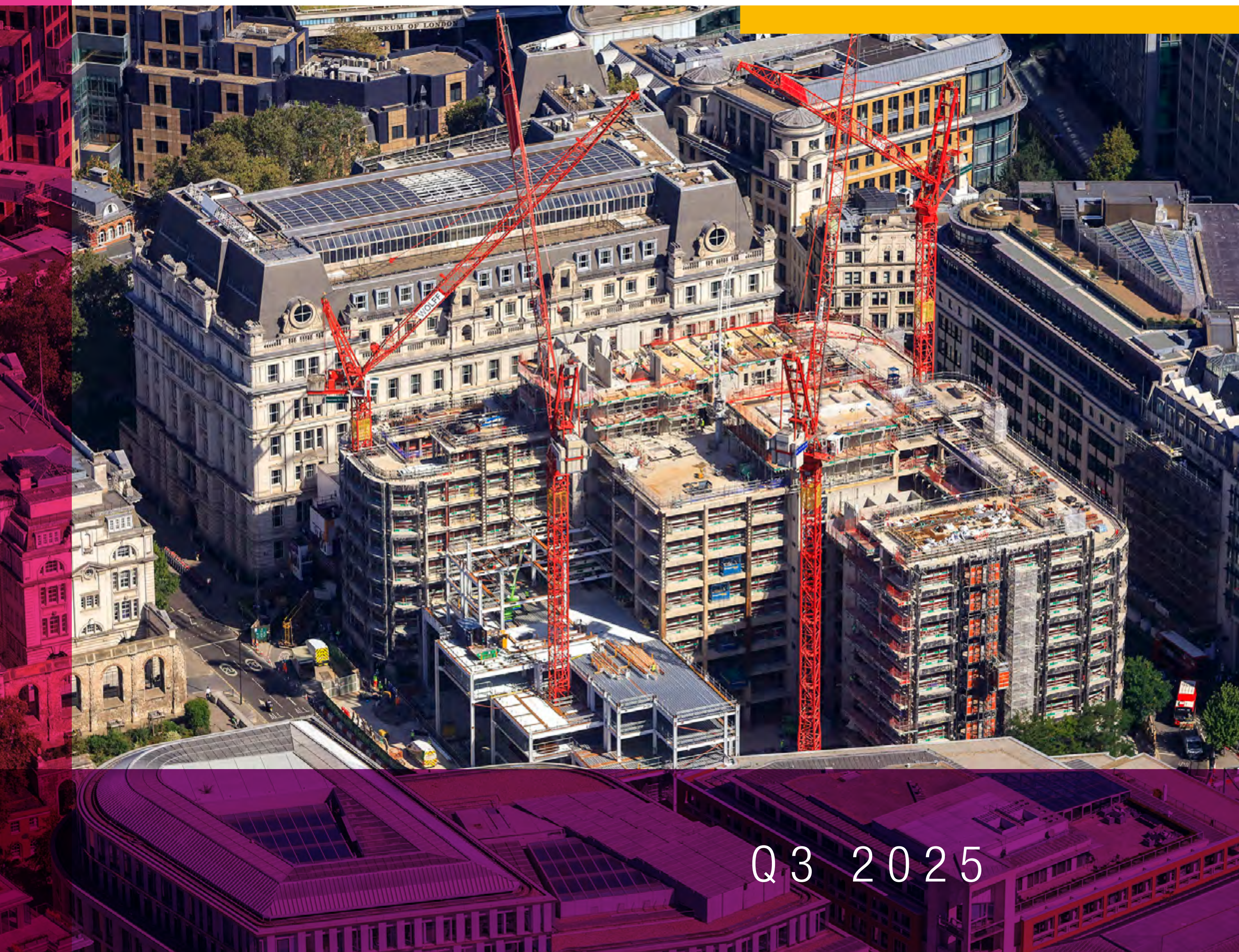
UK MARKET VIEW

Construction output rises but industry remains nervous



Q3 2025

Introduction

Construction output rose by 1.2% in Q2, its strongest performance since 2022, driven by infrastructure growth despite economic, policy and programme maturity headwinds.

Beneath the surface, the pipeline is showing signs of fragility. Skills and capability shortages persist, and the market is unlikely to meet rising demand without strategic intervention.

Supply chain partners are growing cautious, reassessing commitments amid uncertainty around future supply. Clients may need to look further afield to strengthen delivery capacity, while European suppliers view the UK's pipeline as a potential opportunity.

Policy constraints and complex public-private partnerships continue to add risk. With inflation at 3.8% and slower interest rate cuts, fiscal uncertainty looms ahead of the Autumn Budget. Smarter project positioning and early market engagement will be essential to attract the right delivery partners and restore confidence, particularly as proposed amendments to the Planning and Infrastructure Bill seek to streamline the call-in system, reform judicial review processes, and reclassify key assets, like reservoirs, as nationally significant infrastructure.

Oliver North
UK & Europe Director of Cost and Commercial Management, Mace Consult

Construction output rose...

1.2% ↑

in the second quarter, its best since the end of 2022.

Over the past three months, regular construction pay rose just...

0.1% ↑

and the annual rate of growth has slowed to 3.9%.

GDP increased...

0.3% ↑

in Q2 as the economy continues to manage only modest growth.

Small setback in new orders but even after the...

8.3% ↓

drop, the sector was still much larger than in the second half of 2024.

The Bank of England is concerned about inflation which stands at 3.8%. While it lowered interest rates to...

4.0% ↓

in August, further rate cuts are likely to be less frequent.

Tender prices

	2025	2026	2027	2028	2029
National Real Estate	3.5%	3.0%	3.5%	4.0%	3.5%
National Infrastructure	4.0%	4.0%	4.5%	4.5%	4.0%
London	3.5%	3.0%	3.5%	4.0%	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

With plenty to discuss in the year's first two Market Views, following Donald Trump's tariffs and the UK government's Spending Review, conditions have settled over the summer. Promisingly, construction output has continued to grow, with a 1.2% increase in Q2 marking the sector's best since Q4 2022. This included another robust rise in infrastructure output. Despite a setback in new orders, the sector remained stronger than the previous quarter. New orders fell 8.3%, which was disappointing, but only two quarters in the past two years saw higher volumes. Following a strong Q1, orders held up relatively well. Overall, the first half of the year marked a clear improvement on the second half of 2024, and output is expected to strengthen further in 2026.

While output and new orders are encouraging, other indicators are more fragile, particularly the jobs market. Regular pay grew just 0.1% in Q2, and annual growth eased to 3.9%, its slowest in a year. Survey data points to a more challenging environment than official figures suggest. The S&P Global UK Construction PMI has now reported eight months of declining activity, with the index hitting a five-year low in July. Falling subcontractor usage and a lack of optimism about the next 12 months indicate greater caution than official data reflects.

One factor the government hopes will stimulate the sector is the Planning and Infrastructure Bill. Now in the House of Lords, it includes reforms to speed up housing delivery and infrastructure approvals. The industry awaits the final legislation, hopeful it, alongside Spending Review promises, will drive growth. Infrastructure and public spending are becoming more important as the Bank of England may cut interest rates more slowly in response to higher inflation, potentially affecting sectors like housing.

Adding to nervousness is uncertainty around pipelines and when projects will reach site. This is causing the supply chain to reassess and seek new opportunities, doing little to de-risk projects. Collaboration between clients and the supply chain to manage risk is especially important for larger schemes under the government's £725bn Infrastructure Strategy. Clients are finding contractors unwilling to accept all the risks they'd like to pass on, and a shortage of UK contractors with the capacity to deliver such schemes is encouraging new entrants. Infrastructure, healthcare and technology are presenting the most opportunity. Early market engagement and using a wider range of suppliers will help clients achieve their goals.

Nervousness also surrounds the next major government announcement, the Autumn Budget, due 26 November. The UK's fiscal position is weaker than previously forecast, making tax rises or spending cuts likely. Construction will hope any cuts don't affect the large projects announced earlier this year. Currently, there are no signs the Treasury will walk back on June's Spending Review. This means tax rises are necessary to stay within fiscal rules. As seen with the increase in employer national insurance contributions earlier this year, such moves have consequences. The government faces the difficult task of avoiding tax increases that could trigger economic challenges, while keeping the deficit in check to prevent further rises in bond yields and borrowing costs.

Expectations that the Office for Budget Responsibility (OBR) will revise productivity assumptions will add to fiscal pressures. Lower productivity forecasts reduce GDP, hit revenues and increase deficits. While the OBR focuses on the whole economy, construction is known for struggling with productivity. Recent data on output per hour worked showed improvements in specialised construction activities, likely due to data centres and high-value electrical installation work. Without productivity gains in building and civil engineering, the sector will struggle to deliver future workloads while keeping costs under control.

Based on this, we've decided to leave our tender price forecasts unchanged. While the slowdown in pay could have justified a downward revision for this year, contractors' risk aversion and selective bidding mean we still anticipate healthy tender price increases. We expect inflation to be strongest later in the forecast period, when government policies will have a marked impact. Higher workloads, skills shortages and a limited number of contractors able to deliver the largest schemes are all likely to drive inflationary pressures.

Strongest quarter for construction sector in two-and-a-half years

Construction output rose 1.2% in Q2. After declining 0.6% in each of the previous two quarters, repair and maintenance rebounded, rising 1.4%. Combined with another healthy jump for all new work, which grew 1.1% in Q2 and is now 3.8% larger than a year ago, the industry had its best quarter since Q4 2022.

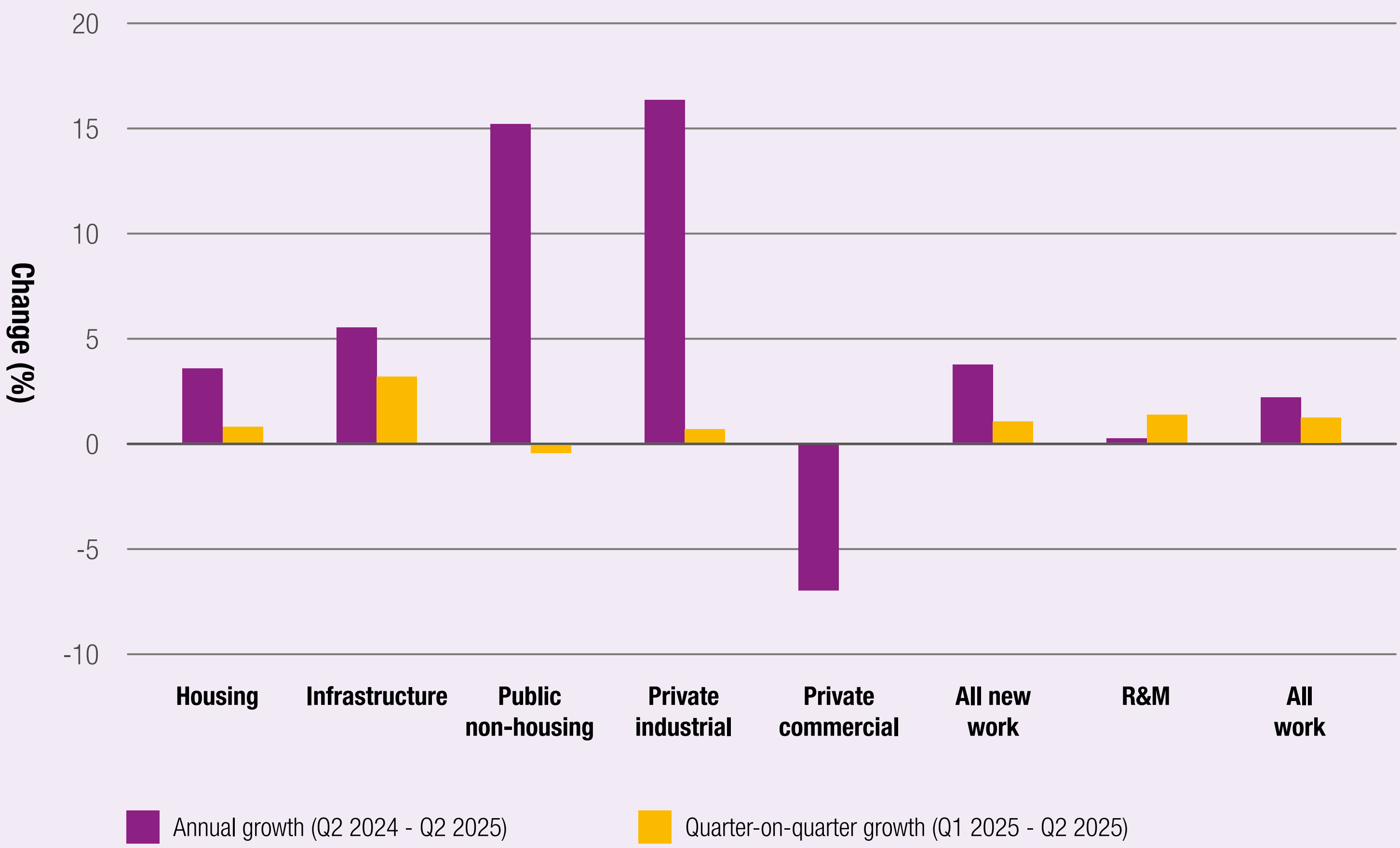
Within all new work, infrastructure was the fastest growing sector. Following on from a 2.2% increase in Q1, it expanded 3.2% in Q2 and is now 5.5% larger than in Q2 2024. Even more impressive than infrastructure's robust growth were the gains seen in the public non-housing and private industrial sectors. Public non-housing has risen 15.2% over the past year and, despite a small decrease of 0.5% in Q2, both recent new orders and government policy announcements indicate good prospects for further growth. Having an even better 12 months, private industrial is up 16.4%.

However, here the pace of growth slowed dramatically in the second quarter, collapsing from 8.3% in Q1 to 0.7% in Q2. In addition, a lack of recent new orders points to future weakness. Demand for data centres remains strong, albeit they face delivery challenges, problems in the wider manufacturing sector and ongoing uncertainty around exports to the US are also likely to hinder future short-term prospects.

The second quarter was another bad one for public housing, the third one in a row where the sector has shrunk considerably. Down 4.5% in Q2, it is now 11.3% lower than a year ago and 21.9% below where it stood in Q4 2023 when it was at its post-pandemic peak. By contrast, private housing continues to grow, and in rising 1.4% over the past three months, and 5.7% over the past year, it has more than offset the downturn in public housing. In doing so, it has also ensured the overall housing sector has continued to grow steadily.

HEALTHY GROWTH FROM INFRASTRUCTURE HELPS ALL NEW WORK RECORD FOURTH SUCCESSIVE INCREASE

Source: ONS



New orders

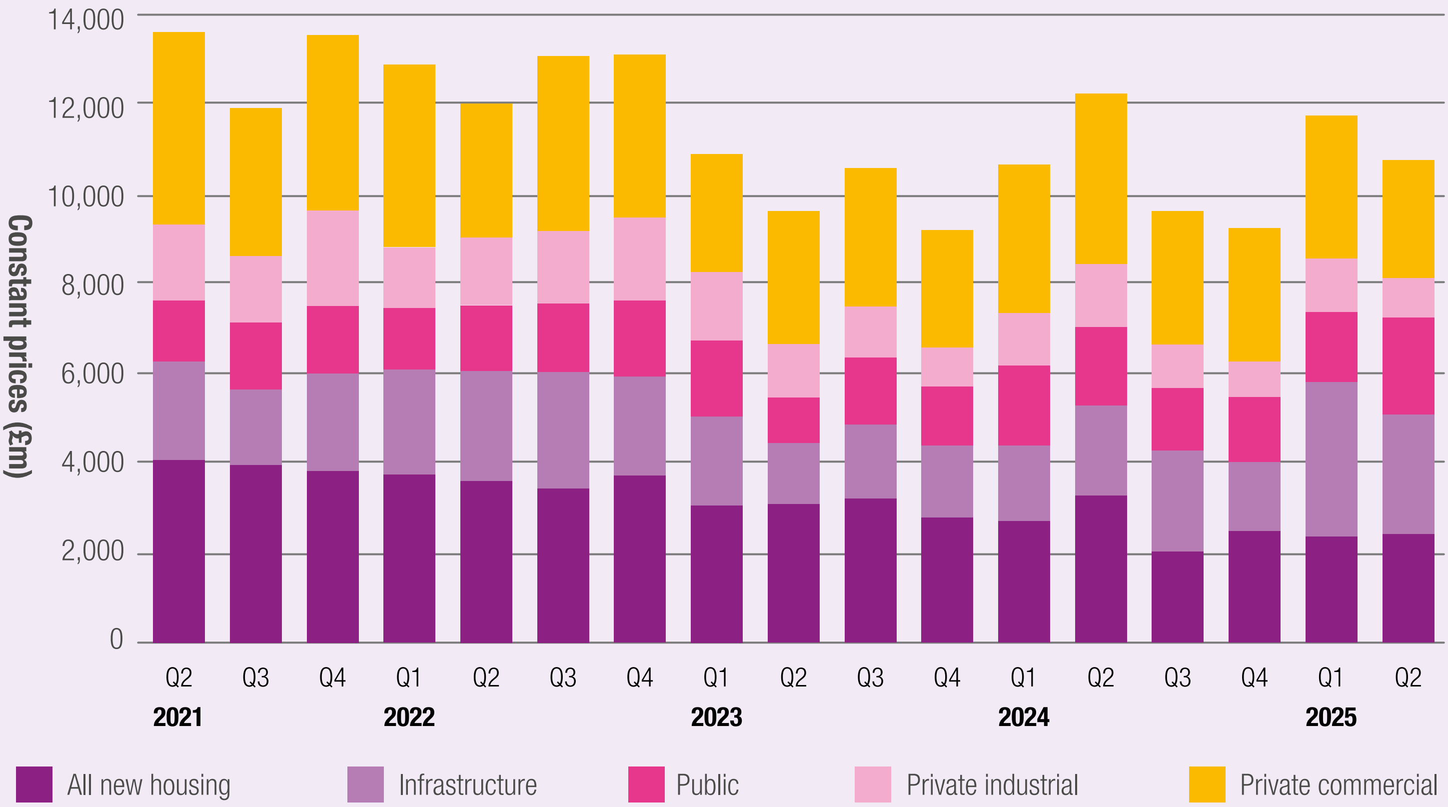
New orders, which had grown substantially in Q1, slipped back in Q2, falling by 8.3%. Despite this decline, volumes remain considerably higher than in Q3 and Q4 2024. The latest weakness reflects the lumpy nature of contracts, challenges in maintaining momentum, and ongoing headwinds in certain sectors. Larger schemes are particularly affected, with clients struggling to get projects to contract stage. Risk profiles are proving particularly problematic - a challenge also highlighted in the Future of Major Programme Delivery report, which examines barriers to successful delivery of major programmes - and contractors are often unwilling or unable to take on all the risks clients would like to pass on. Similarly, due to limited supply chain capacity, and with only a handful of Tier 1 contractors capable of delivering the most complex and costly projects, clients may not have as much leverage as when managing more standard construction work. In addition, projects taking longer to get to site is causing contractors and subcontractors to reassess and reprioritise their pipeline, and if necessary, look for new opportunities.

While private industrial output has jumped over the past year, new orders have been trending downward since late 2021. This is partly due to higher interest rates and weaker demand for logistics centres post-pandemic. Another factor affecting this sector is the difficulty around power and planning for new data centres. Although the relationship between new orders and output isn't always direct, the 17.7% decline in industrial new orders over the past four quarters compared to the same period to Q2 2024 suggests output may struggle to maintain its upward trajectory. Private commercial new orders also offer little optimism for a near-term turnaround. Orders fell 17% in Q2 and are 7.2% lower on a rolling four-quarter basis compared to a year ago. Offices were the main contributor to the decline, but there was also a significant drop in the schools and universities sector, making it an exceptionally weak quarter for this part of the market.

The most positive news came from the non-housing public sector, which saw new orders surge by 35.7%. However, much of this growth appears to stem from one-off projects. In contrast, public infrastructure continues to struggle, with roads and railways both underperforming. This suggests that the work outlined in the Spending Review has yet to fully materialise. Further concern comes from the National Infrastructure and Service Transformation Authority's (NISTA) annual report. Of the 61 construction projects rated, 11 are in the red (unachievable), and 40 in amber (significant

SETBACK FOR NEW ORDERS BUT THEY REMAIN HIGHER THAN IN H2 2024

Source: ONS



problems). Only 10 are rated green, indicating they should be delivered on time and on budget. With more red-rated projects than last year, this adds to supply chain nervousness around public sector schemes.

To encourage private investment, the government is also working to improve market conditions. The private part of infrastructure had a strong quarter, driven by electricity, while the smaller water sector grew by over 600%. Although infrastructure overall fell 23% compared to Q1, its past four quarters have been the strongest since the pandemic. It should continue to offer a robust pipeline for the industry in the years ahead.

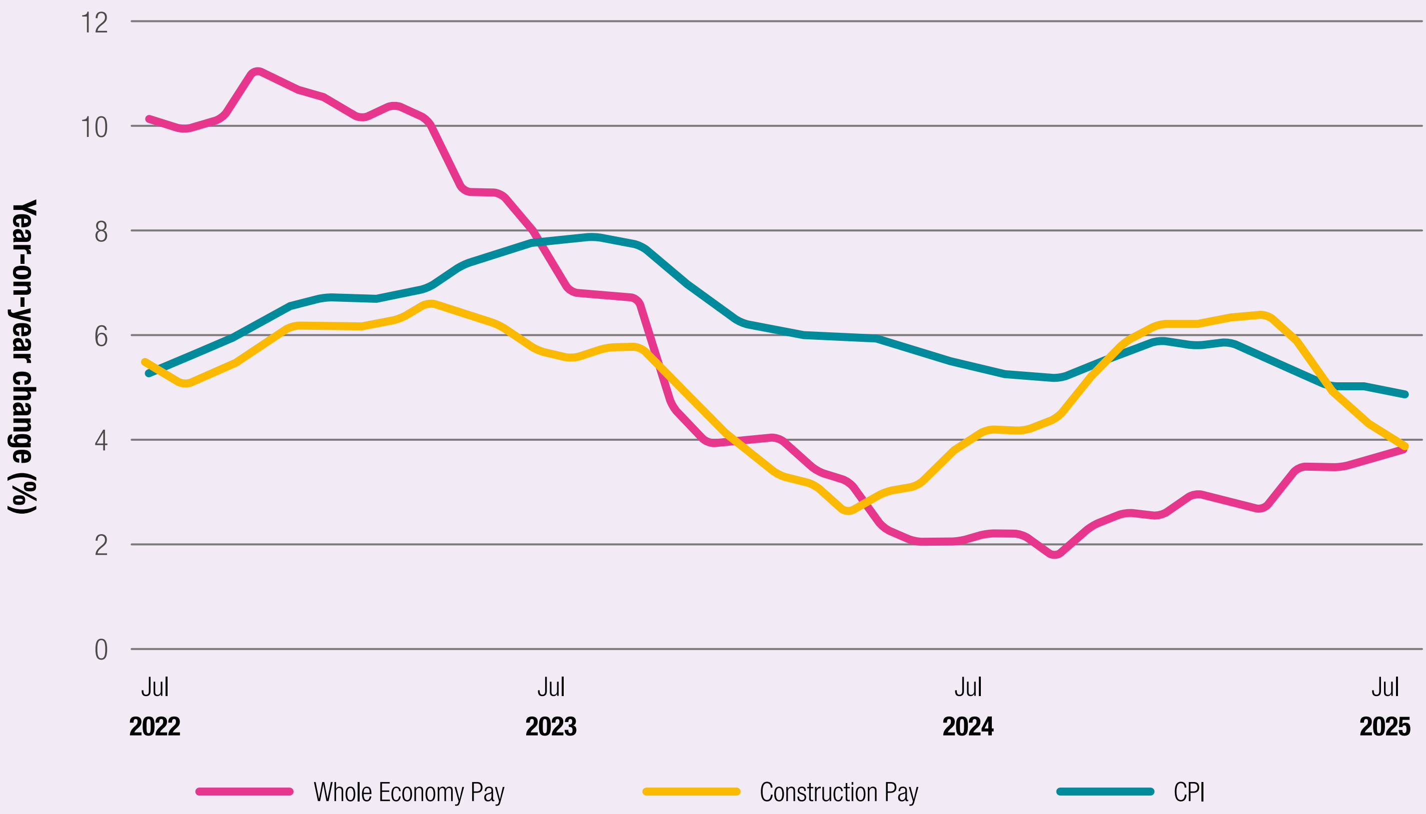
Whereas construction output is steadily growing, regular construction pay has barely moved over the past few months. In the three months to July, pay was just 0.1% higher than it was in the three months to April. As a result, annual regular pay growth has slowed to 3.9%, its weakest rate in a year. Leaving it close to inflation, this is notably lower than average pay growth across the whole economy, which is 4.8%, with only finance and business services, at 3.0%, below it.

In our previous report, we mentioned how HMRC data on construction employees showed the number of employees in construction had fallen by almost 30,000 between March and May. Despite having revised this data, and no longer reporting quite as steep a drop, the number of construction employees is still over 22,000 lower than it was in January. Furthermore, according to the latest ONS data, there was also a decline in construction workforce jobs. Dropping from 2.25m in March to 2.10m in June, this series has been relatively stable since Covid.

While the wider economy is also showing the labour market loosening, that the drop-off is larger in construction helps explain why the sector's deceleration in pay has been faster. Easing vacancies add to the impression that firms are scaling back, and in construction these have now slumped to a post-pandemic low. Nonetheless, with the outlook for output in 2026 brighter than it has been, further depressed labour demand seems unlikely to persist for too long into next year.

CONSTRUCTION PAY WEAKENS TO ALMOST THE SAME LEVEL AS INFLATION

Source: ONS



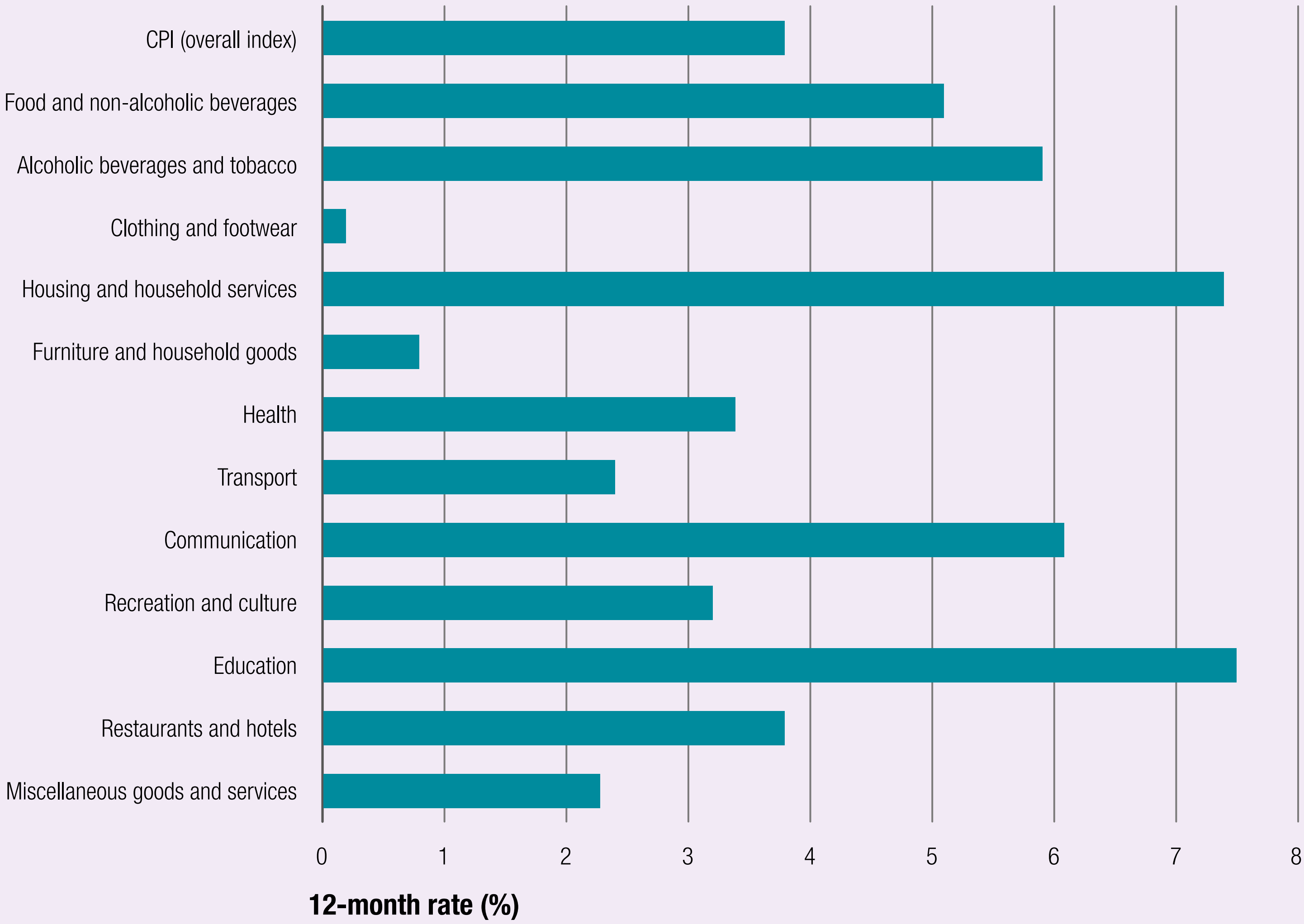
Are higher consumer prices also an issue for construction?

Construction material price data from the Department for Business and Trade is currently unavailable, and this now looks set to last until towards the end of 2025. Our own data and internal analysis are showing that overall material prices have remained consistent over the past year. Although there is much variation across products, the industry has learnt lessons from Covid with better management of the supply chain, helping keep shocks in check. By contrast, the consumer price index has increased over the past few months. Having risen to 3.8% in August, and with the Bank of England expecting it to peak at 4% in September, even though there is little overlap with construction products, it will still affect the industry.

There are a multitude of factors pushing up consumer prices and, fortunately, most of these are not considerations for construction. The clearest example of this is education and, of the CPI divisions, it saw the largest increase over the past year. Because of school fees now being subject to VAT, the index is 7.5% higher than a year ago. Carrying a much larger weight in the index, housing and household services has risen 7.4%. Including a jump of over 26% in the water category, electricity and gas prices have also increased sharply. As well as these issues, a more general reason for the rise in inflation is pay growth and the increase in employers' national insurance contributions. In particular adding to services inflation, it also suggests the market is strong enough for firms to be able to pass on higher costs.

LARGE PRICE RISES ACROSS MANY DIVISIONS

Source: ONS



Many of the factors behind the current price pressures are unique to the UK, and unlike in previous bouts of inflation, this time there seems to be a much clearer divergence of trend compared to elsewhere. Latest figures have consumer price inflation as below 1% in France, and around 2% in Germany, as well as the euro area as a whole. Even in the US, where tariffs on imports are causing price increases, inflation is only 2.9%. That policymakers can't use global forces to explain away inflation adds to the predicament they are in. Furthermore, higher inflation is coming from across the board. Of the 12 CPI divisions, only one of them is higher in the eurozone than the UK. That the largest differences are in housing and household services and communication highlights how issues around inflation-linked contracts and the need for investment in the water sector are pushing up bills for UK consumers in a way not seen in other parts of Europe.

Despite the rise in consumer prices coming from factors not relevant for construction, there are two primary ways in which this is a concern. The first is through interest rates while the second is the impact it may have on pay in the industry. Interest rates, which the Monetary Policy Committee (MPC) has been cutting 25 basis points a quarter, are currently at 4%. However, in their August meeting, when they last cut them, there were a number of signals that their recent approach of cutting and then holding may be ending. Similarly, as discussed at September's meeting, there is a worry about upside risks to medium-term inflationary pressure.

This matters for construction, as much private investment is dependent on borrowing costs. The housing market, by far construction's largest sector, is particularly sensitive to interest rate cuts, and how easily households can obtain mortgages. Rates staying higher for longer are likely to delay investments, and while indicators such as housing output, new orders and starts have all recovered from their lows, they are still weaker than they were. Given one of Labour's priorities is building more homes, as well as the wider fiscal implications of higher interest rates, it will also cause specific challenges to one of their manifesto promises.

The Bank of England is also worried about what high levels of inflation mean for pay. Coming out of the pandemic, and with supply chain bottlenecks and the war in Ukraine causing prices to spike, pay rises followed suit. When facing higher prices, workers expect more pay, and the nervousness for the MPC is that even without a wage-price spiral to the same extent as previously, a smaller one might still occur. Because of this, higher inflation expectations can pose a significant problem to central banks. Minutes from

the latest MPC meeting had several mentions about inflation expectations, and it is clearly something they are worried about. As a result, in trying to combat this and bring expectations back down, they may hold off from interest rate cuts.

For the moment, construction pay is just above inflation, but it has been easing, while inflation has been rising. This suggests that for the time being employers are able to resist demands for higher pay, the longer inflation stays high, the harder it will be for them to continue to do so. With the Bank of England upping its inflation forecasts for next year, as well as construction growth set to rise at a much healthier pace than it has done recently, employers may find that not only are workers expecting higher pay increases, but that they have little choice but to acquiesce to them.

The impact of higher consumer price inflation on construction is therefore not straightforward. If it delays interest rate cuts it will lead to weaker new orders, and in turn more competitive tenders. At the same time, it will cause construction workers to push for higher pay, resulting in tender price increases. How these two counteracting forces play out will depend on just how much it hurts new orders and how easily firms can push back on such pay demands. Given expected growth in infrastructure and public spending, as well as the support from changes in planning rules, higher interest rates may be less problematic than they have been. Unlike housing or commercial, these types of spending are less beholden to interest rates so project delays due to monetary policy are less of a risk. Similarly, despite pay currently decelerating, the risk for tender prices is that skills shortages limit firms' ability to control pay and wages ramp up. Accordingly, the housing sector should worry as it may face problems in getting cheap financing for new projects as well as workers looking for higher pay and moving into other construction sectors if their expectations are not met.

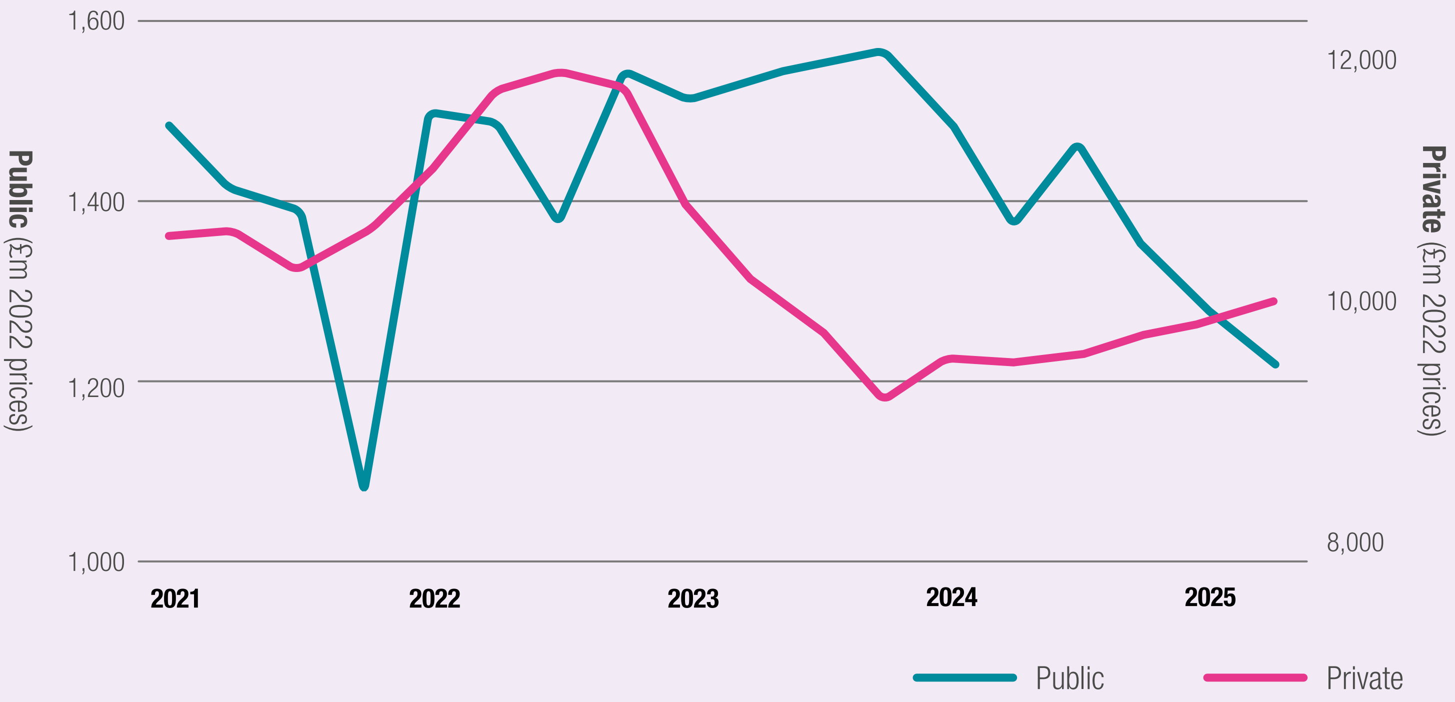
Parts of the housing sector starting to recover

One of the most noticeable movements in construction output in the last year has been the drop in public new housing. Down 11.3% between Q2 2024 and Q2 2025, the sector has now fallen dramatically over the past two years. Meanwhile, private housing output has grown 5.7%, and despite being a long way from the level the government needs if it is to hit its targets, this part of the industry is at least moving in the right direction. However, only over the past eighteen months has it started to recover, and it is facing many of the same problems as the public sector. Whereas, between public housing's recent peak in Q4 2023 and current trough output is down 21.9%, between private housing's peak in Q3 2022 and its trough in Q4 2023, output fell a similar 23.3%. Since then, private housing has improved but, despite growing 9.4% over the last year-and-a-half, it is still much lower than it was.

Based on leading indicators, such a fall in output comes as no surprise. As well as a slump in new orders, housing starts had also declined substantially from 2023 onwards. Digging slightly deeper into the data reveals where one of the biggest headwinds is coming from. In particular, it is London experiencing more than its fair share of the downturn and dragging things down. In the fiscal year 2024-25, housing starts fell to 112k, having stood at 135k in the previous year and 176k in the fiscal year ending in 2023. For London, there were only 4k new starts in the latest fiscal year, and its share of housing starts in England has dropped from 12.3% to 3.6%. Furthermore, housing associations and local authorities have seen a much larger proportional fall than private starts, although the private sector is far bigger. Overall, in the last fiscal year there was a 17.4% drop in total new starts. However, in London, the total reduction was 67.3% with an 80.3% fall in housing association starts and a 95.6% decline in local authority starts. A similar trend can be seen with new orders where public housing in the capital saw a much larger drop-off in 2024 than private housing. While over the past two quarters, conditions have improved, there is usually a lag between new orders, starts, and output. That we are also still a long way from previous levels means output seems unlikely to surpass its 2022 peak for some time.

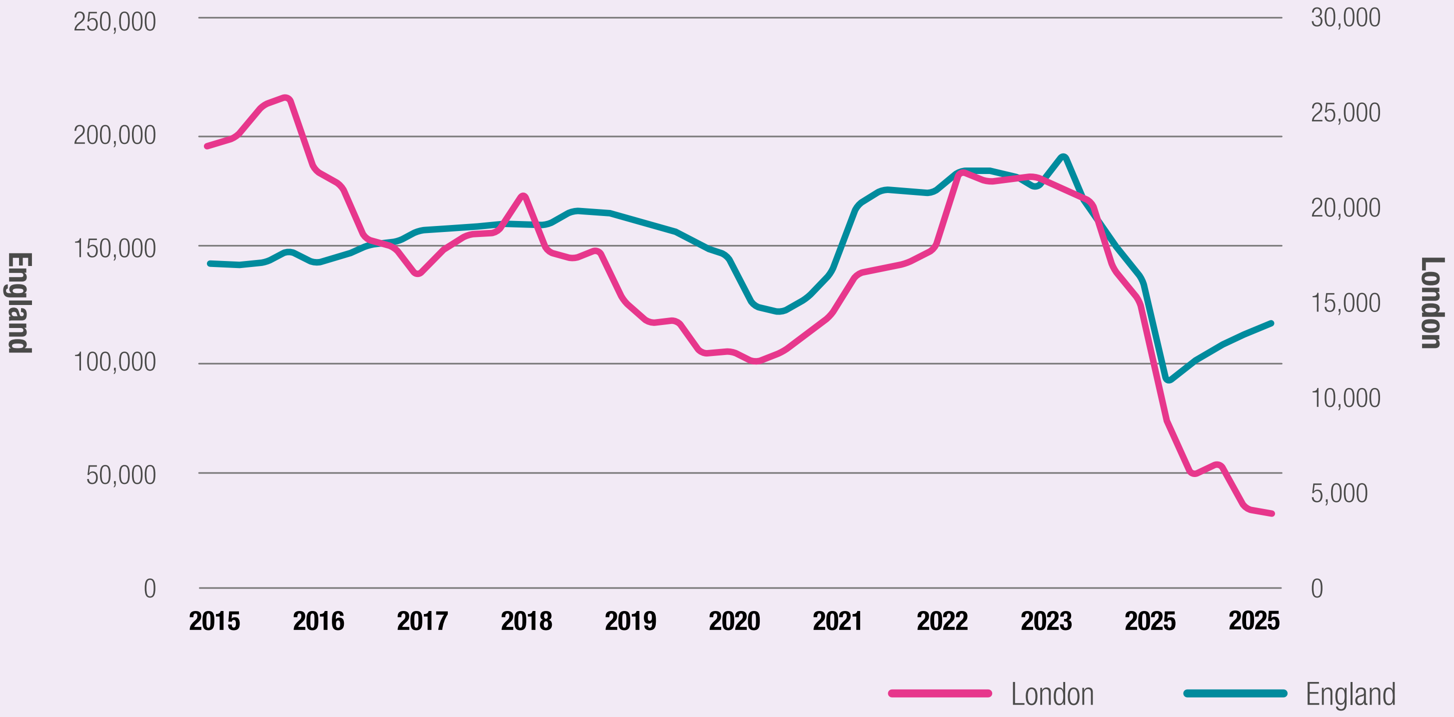
OUTPUT IN PRIVATE HOUSING SLOWLY IMPROVING WHILE PUBLIC HOUSING TUMBLES

Source: ONS



HOUSING STARTS HAVE FALLEN FAR FASTER IN LONDON

Source: Ministry of Housing, Communities and Local Government



Delays with Gateway 2 help explain why London is facing greater challenges than other regions, particularly among housing associations and local authorities, which have seen the steepest declines. Latest data from the Ministry of Housing, Communities and Local Government shows that, in England, 83% of completed dwellings were houses with the remainder flats. By comparison, 97% of completed dwellings in London were flats. While they don't provide information on local authorities, housing associations, which operate in a closer way to them than private enterprises, also have a larger share of flats. With flats more likely to be found in higher-risk buildings, it is unsurprising that London, where flats are much more likely to be built, is facing the most difficulties. More detailed analysis by Architects Journal following a Freedom of Information request found over half of projects delayed more than the target time of 12 weeks were in London. In total, these delays account for almost 18,500 homes, explaining a substantial proportion of the drop off in housing starts over the last two years. Some developers will also be choosing not to progress with schemes which will have to go through Gateway 2, so this is likely to be an underestimate of the true impact it has had on delivery. This behaviour means that it will take time for the sector to fully get over them. Developers will be pleased that the Building Safety Regulator and the Construction Leadership Council has been working closely together to smooth some of the obstacles. Similarly, news of relaxing rules on the share of affordable homes and planning rules in London should help, however, with the drop in starts so considerable, we cannot expect an immediate recovery.

Other reasons for the drop include viability problems, from the income as well as expenditure side. Since the end of 2022, average sales price has increased 0.9% for England but declined 2.3% in London. Rising interest rates dampened house prices, and the reason for these going up was due to surging inflation. Weak or falling prices, higher borrowing costs as well as higher build costs all meant developers were likely to see lower profits and so they cut back on new projects.

All of this matters because housing is the largest part of the construction industry. When new housing struggles, so does all new work. In only two quarters since 2010 has housing output shrank, but all new work expanded. Therefore, housing has a considerable bearing on tender prices. Resolving the blockages will support the sector, however, faster growth is likely to come with inflationary pressures. As the sector picks up, it is necessary for clients to anticipate the implications for project viability and budgeting. Increased demand may lead to capacity constraints, giving contractors and suppliers greater choice. Similarly, clients with a strong pipeline of work are well-positioned to secure better terms by leveraging long-term relationships, exploring framework agreements and engaging the supply chain early to ensure alignment on cost, programme and delivery.

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