UK MARKET VIEW

Pick-up in tender prices despite weak growth

Q1 2025

Introduction

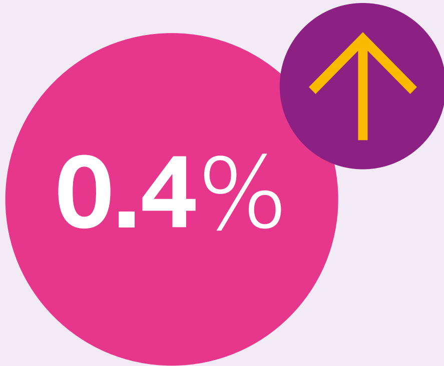
The UK construction market faced significant challenges in 2024, with a mere 0.4% growth in construction output and a 5.3% reduction in all new work. As we turn to 2025, stabilising material prices look set to be outweighed by rising labour and energy costs coupled with looming inflationary pressures.

The Bank of England's interest rate cuts and the government's infrastructure and planning reforms are positive steps to stimulate growth, but they are not enough on their own, with productivity issues and labour shortages remaining critical hurdles for the industry.

As the industry navigates these uncertain times, with many pieces of the puzzle yet to fall into place, including the upcoming spending review, it must remain agile and ready to adapt to the evolving landscape.

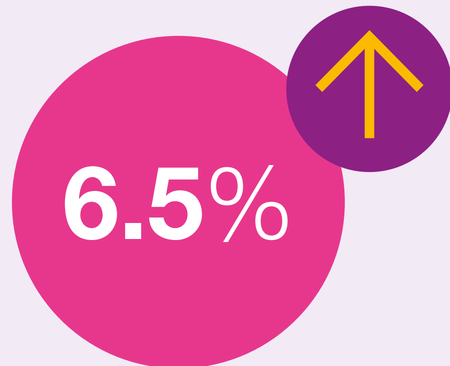
Oliver North
UK & Europe Director of Cost and Commercial Management, Consultancy

Overall, construction output grew just...



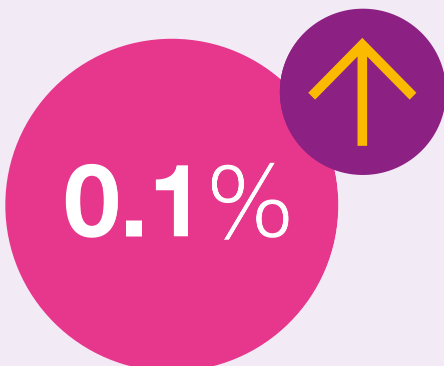
last year, with a reduction in all new work offset by greater repair and maintenance output.

Regular construction earnings saw a considerable acceleration last year, and at...



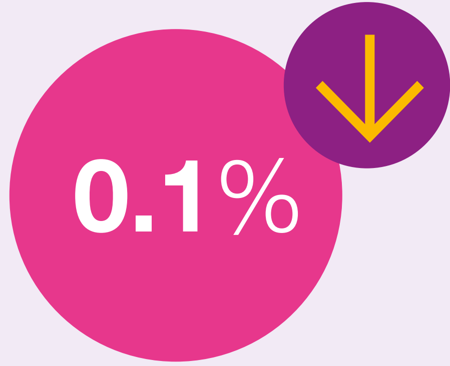
higher than at the end of 2023, they are increasing at close to their fastest pace since the pandemic.

The economy continues to stutter as GDP increased by...



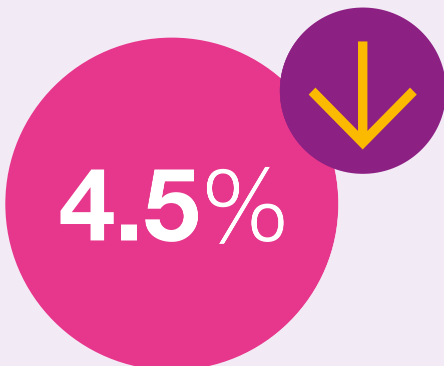
in the last quarter of 2024, up 0.9% for the year as a whole.

Pressure from material prices are low, and prices were...



lower in December 2024 than a year earlier.

The Bank of England have cut interest rates to...



in February, but despite weak growth, rising inflation creates uncertainty about how far they will fall this year.

Tender prices

	2024	2025	2026	2027	2028
National	3.0%	4.0%	3.5%	3.5%	4.0%
London	2.5%	3.5%	3.0%	3.5%	4.0%

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

Setting the scene

The UK economy's struggles continued in the final quarter of 2024. Growth of 0.1% followed no change in Q3 and, despite the more promising first half of the year, GDP only increased by 0.9% last year. Conditions in construction were even weaker as the industry mustered growth of only 0.4% in 2024. With all new work shrinking by 5.3%, many contractors likely found a shortage of work and opportunities. In spite of this unfavourable backdrop, we have decided to slightly increase our tender price forecasts both for 2024 and 2025.

The reasoning behind deciding to increase our 2024 figure for tender price inflation by 0.5% is straightforward. Labour costs have continued to increase, rising another 1.6% in Q4. With even larger jumps in the second and third quarter, regular construction earnings stand 6.5% higher than in the final quarter of 2023. Poor construction output growth hasn't prevented pay rises and the earnings growth rate has rebounded considerably since earlier in the year, meaning we must adjust our forecast accordingly. The pressure facing contractors last year would have been even greater if material prices had not remained essentially unchanged. However, we must remember that these forecasts are an average, and there will have been very different moves across packages as well as sub-contractors.

Higher pay is another reason we are adjusting our forecast for 2025. Earnings growth should ease, but vacancies jumping to their highest level in 18 months suggest the slowdown may be gradual. One reason that the average price of construction materials didn't budge last year was because of lower energy prices, but conditions have now reversed. In January, natural gas prices were higher than at any point in 2024, leading to another increase in the Ofgem energy price cap. As such, businesses will be facing even bigger spikes. That the Bank of England recently revised its forecasts for CPI inflation and now expects it to peak at 3.7% in Q3 demonstrates how inflationary problems are mounting. Worryingly, the eye-catching start of Donald Trump's presidency suggests logistical challenges will be at the forefront of procurement teams' thoughts.

None of this helps the prospects for construction output this year. While growth in 2025 should comfortably beat last year's muted return, uncertainties are still prevalent. Some of these challenges should become clearer as the year progresses, but for the time being, decision-making remains slow. The Planning and Infrastructure Bill, published in March, sets out ways in which the government hopes to encourage investment and speed-up delivery of homes and infrastructure. However, the initiatives won't be effective immediately and the industry will also be awaiting the spending review due in June. March's Spending Review was not intended to be a fiscal event, and there was little for construction to get its teeth into. Like the BoE, the Office for Budget Responsibility became less positive about how the economy will perform this year. Of more interest was their view that the UK would be building over 300,000 new homes a year by the end of the decade, with planning reform contributing greatly to this. That the decision to raise capital spending by £2bn a year compared to October, was the only real giveaway once again shows how important they view investment is to drive growth. Meanwhile, devolution plans will create opportunities, albeit in the short-term, the plans come with risks to new projects.

Alongside these uncertainties, momentum on new projects going into 2025 was also poor. After declining by over 20% in Q3, a further small reduction in the volume of new orders shows that clients are still incredibly cautious and pipelines aren't recovering. New orders in all sectors were down in the second half of the year, with private industrial, public non-housing and both housing sectors over 20% lower. With government finances and updated policies likely to constrain public-sector spending, housing is also suffering from changing regulations. Additional funding for the Building Safety Regulator (BSR) will help, but new housing starts in England had only recovered to 30,000 in Q3 2024, far below the levels seen in 2021 and 2022.

Being a long way short of where the government desires, there is significant potential but also many questions about whether its targets are achievable. With the Bank of England cutting growth forecasts for this year because of poor productivity, it looks like it could be another year of sluggish economic performance.

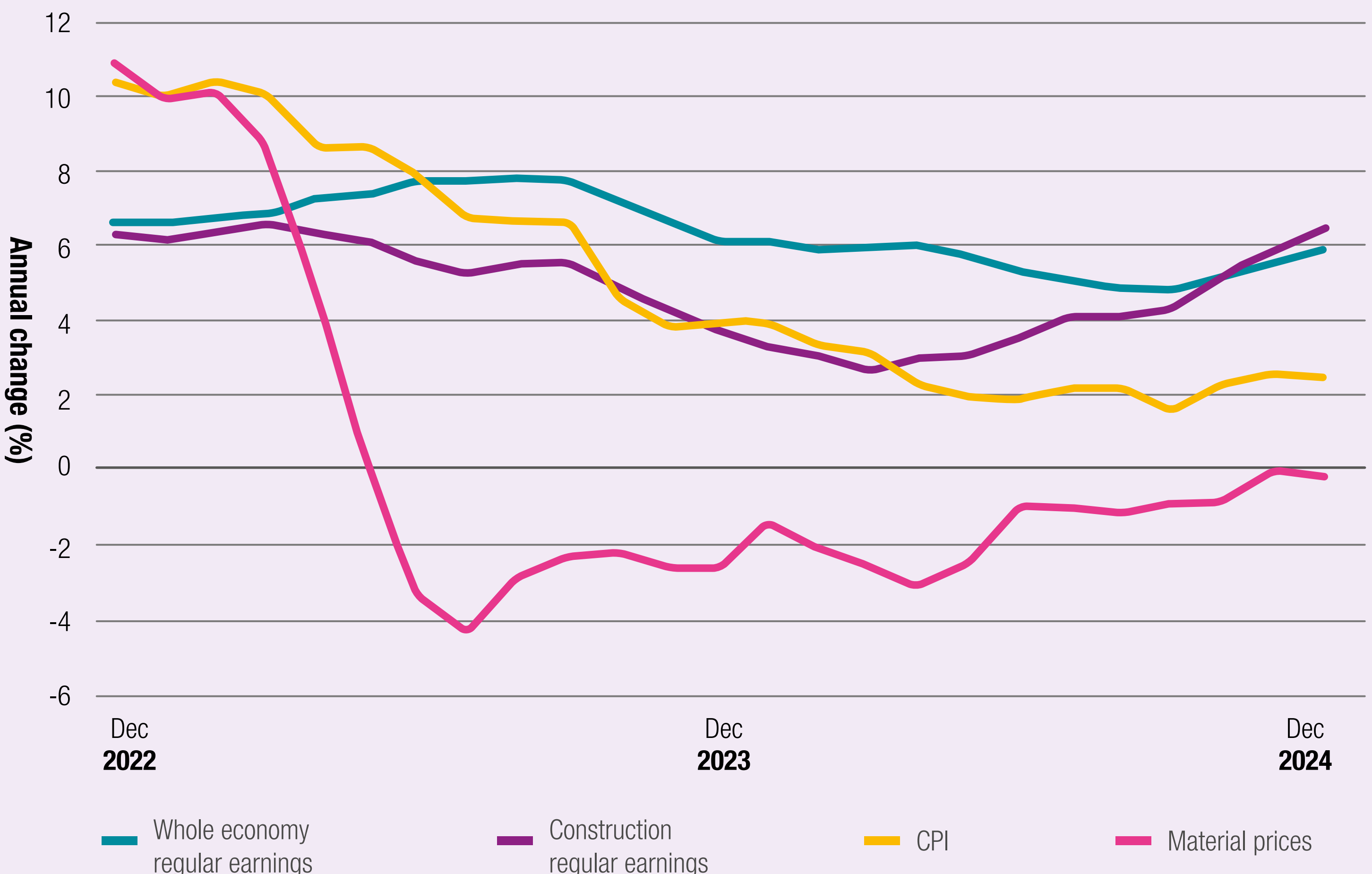
The past:
Labour cost pressures climb further

One positive for contractors in 2024 was the lack of movement in material prices. Between the final quarter of 2023 and Q4 2024, the 'all work construction material price index' decreased 0.3%. With prices falling consistently in the second half of last year, the lack of upwards pressure will have been a relief. Furthermore, the index in December was at its lowest since April 2022 just after the start of the Ukraine war. This highlights the importance of levels as well as growth but, purely from a change perspective, last year doesn't appear to have been a troublesome one. For the year ahead, it seems unlikely material prices will continue easing, with recent rises in energy prices alongside the upcoming increases in National Insurance Contributions and the National Living Wage adding to costs. Nonetheless, contractors should be capable of managing this type of moderate inflationary pressure.

By contrast, the main driver behind build cost inflation last year was construction's labour costs. 6.5% higher than at the end of 2023, the only category seeing regular earnings rise faster was wholesaling, retailing, hotels and restaurants. Having started the year in relatively modest fashion, construction pay has ramped up and the growth rate is now at its second highest since coming out of the pandemic. Whereas pay growth across the whole economy spent most of last year between 5% and 6%, construction pay growth more than doubled from March to the year end. As a result of this escalation, we have pushed up our forecast for tender price growth in 2024. With vacancies also making a surprise jump in the three months to January, returning to 40,000 and the highest it has been since the middle of 2023, pay pressures look set to persist in 2025.

CONSTRUCTION PAY NOW RISING FASTER THAN IN MOST OTHER SECTORS

Source: ONS, DBT



As with the wider economy, 2024 was a year to forget for the construction sector. Growth of just 0.4% was lacklustre and included a 5.3% reduction in size of all new work. Holding up the sector was repair and maintenance, where output rose 8.5%. In particular, there was a 14.2% increase in public housing R&M as remediation drove growth. Although private housing R&M rose 7% for the year, output did drop in Q2, Q3 and Q4, with households cutting back. However, following first the post-pandemic jump as households made home improvements, and the more recent surge in remediation spending, private housing R&M is still almost 40% higher than in Q4 2019.

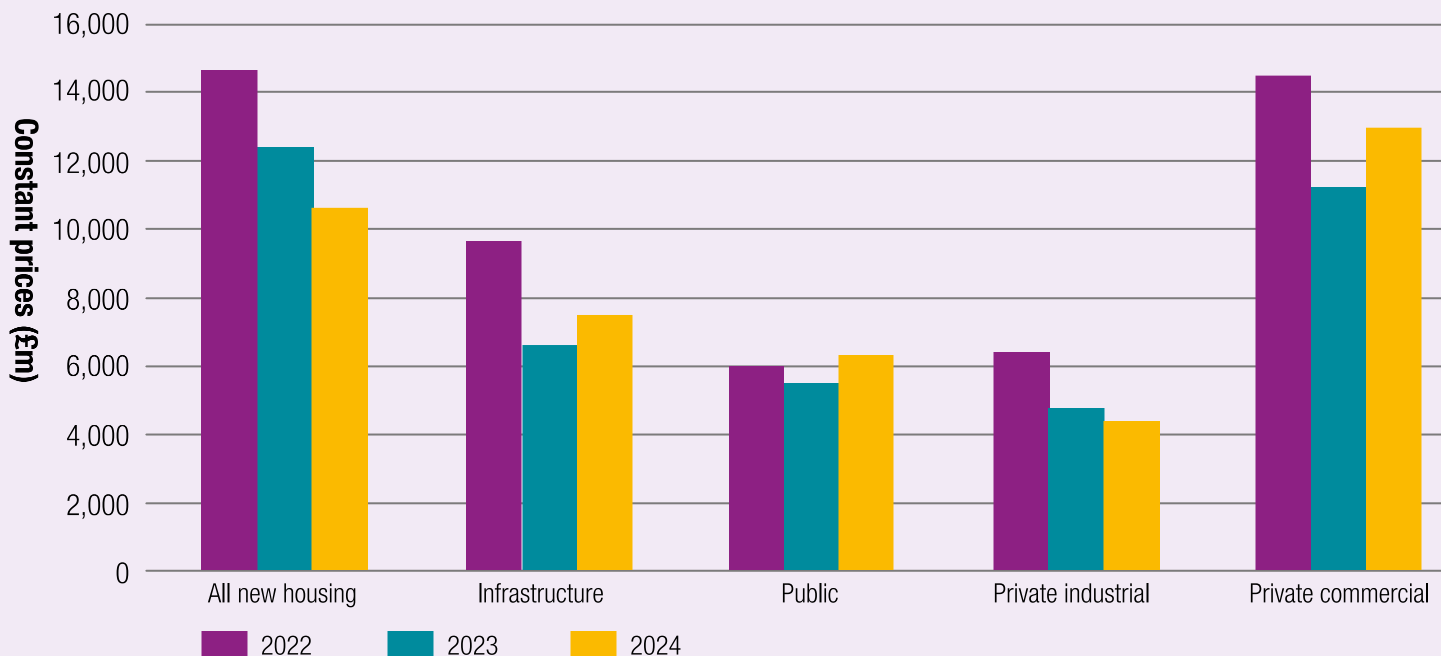
Unfortunately, most sectors within all new work saw a reduction in output last year. The only sector where growth took place was public non-housing, albeit still marginally below Q4 2019. Housing output fell again in 2024 as, amongst other reasons, high interest rates and construction costs caused developers to scale back further. Having an even worse year was infrastructure, where output dropped 9.3%. Poor new orders in 2023 had indicated the pipeline going into 2024 was lacking so the drop wasn't a complete surprise. As with housing, money seems to be going towards R&M, with the strong growth in non-housing R&M pointing to a larger proportion now aimed at fixing potholes as opposed to for new roads.

Viewing the all new work data in a more positive light, conditions did improve in the second half of the year. After six successive quarterly falls, all new work grew 0.5% in Q3 and 1.2% in Q4. The final quarter saw large increases in private industrial (6.4%) and public non-housing (4.3%) output, with private commercial (1.5%) and private housing (1.3%) also experiencing healthy growth. While the worst for all new work looks like it is now over, and the recovery should continue in 2025, unconvincing new orders and ongoing uncertainties suggest it will be a steady rather than stellar year.

CONSTRUCTION OUTPUT BARELY GREW IN 2024

Source: ONS

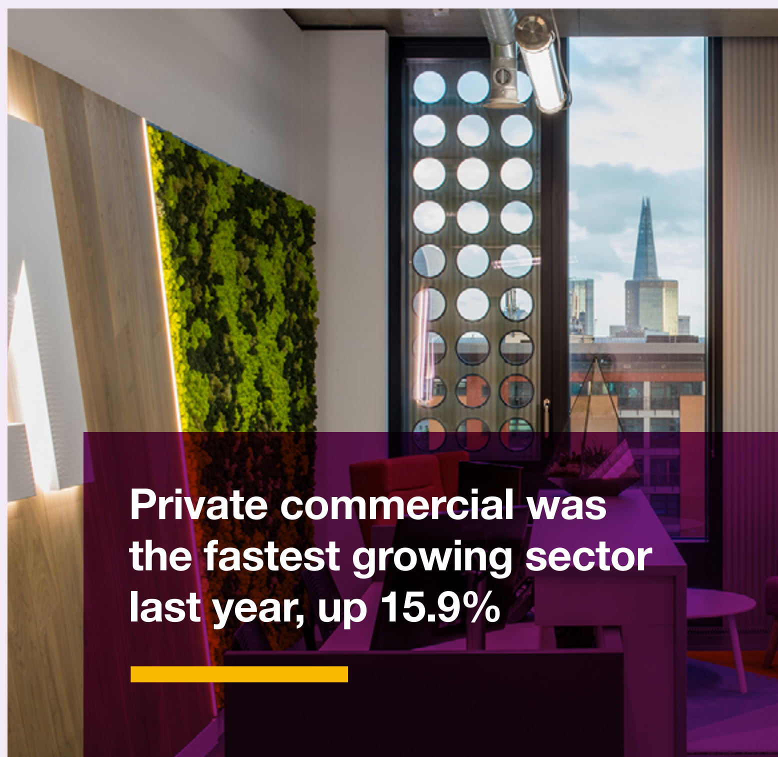
ANOTHER WEAK YEAR FOR NEW ORDERS



It was a disappointing final quarter for new orders. Having declined by almost 25% in the third quarter, the additional decline of 2.4% in Q4 suggested an industry still flagging. New orders had a promising first half of the year but took a noticeable turn for the worse in the second half and overall was just 3.5% higher than in 2023. With 2023 being almost as bad a year as 2020, when Covid created huge amounts of uncertainty, the lack of any sort of noticeable recovery last year continued to hurt the sector. Getting projects onto sites also remains problematic and, even once contracts are signed, it takes time before work gets going.

Private commercial was the fastest growing sector last year, up 15.9%. Private health, offices and, in particular, private schools and universities, all contributed to this. With many universities under substantial financial pressures, it seems likely that private schools have been the driver here. This is potentially due to Labour's VAT change making it possible for schools to use the Capital Goods Scheme. This allows them to reclaim VAT on construction projects and means such expenditure is now more attractive. For offices, 2024 was a noticeable improvement on 2023 but, after adjusting for inflation, was still below 2021 and 2022. Within the commercial sector, retail remains in crisis. New orders for shops fell again in 2024, with its share of the sector slumping to 6%, the lowest it has been on record. By comparison, in 2007, the year Amazon Prime started in the UK, shops' share of commercial was over 20%.

Both infrastructure and public non-housing enjoyed a better year than 2023 but, compared to average levels in the 2010s, were noticeably lower. In part, this shows the depth of the malaise in 2023, but it also indicates that the increase likely still leaves many contractors' pipelines below their desired levels. Of the two largest infrastructure categories, electricity, rebounded after 2023 and in nominal terms was almost equal to where it was in 2022. While roads new orders also grew, it was to a much lesser extent and, following a terrible 2023, the sector remains far weaker than in previous years. Frustratingly in both cases, Q4 was a poor one, dragging infrastructure down over 20%. For the public sector, its two largest components, schools and health, both weakened, with growth coming from other, smaller categories.



Private commercial was the fastest growing sector last year, up 15.9%

The present: Is this going to be another wait-and-see year?

With poor new orders numbers pointing to weak pipelines, developers and contractors face several challenges before conditions improve. Despite expectations of easing uncertainties as the year progresses, the first half of 2025 will be tough.

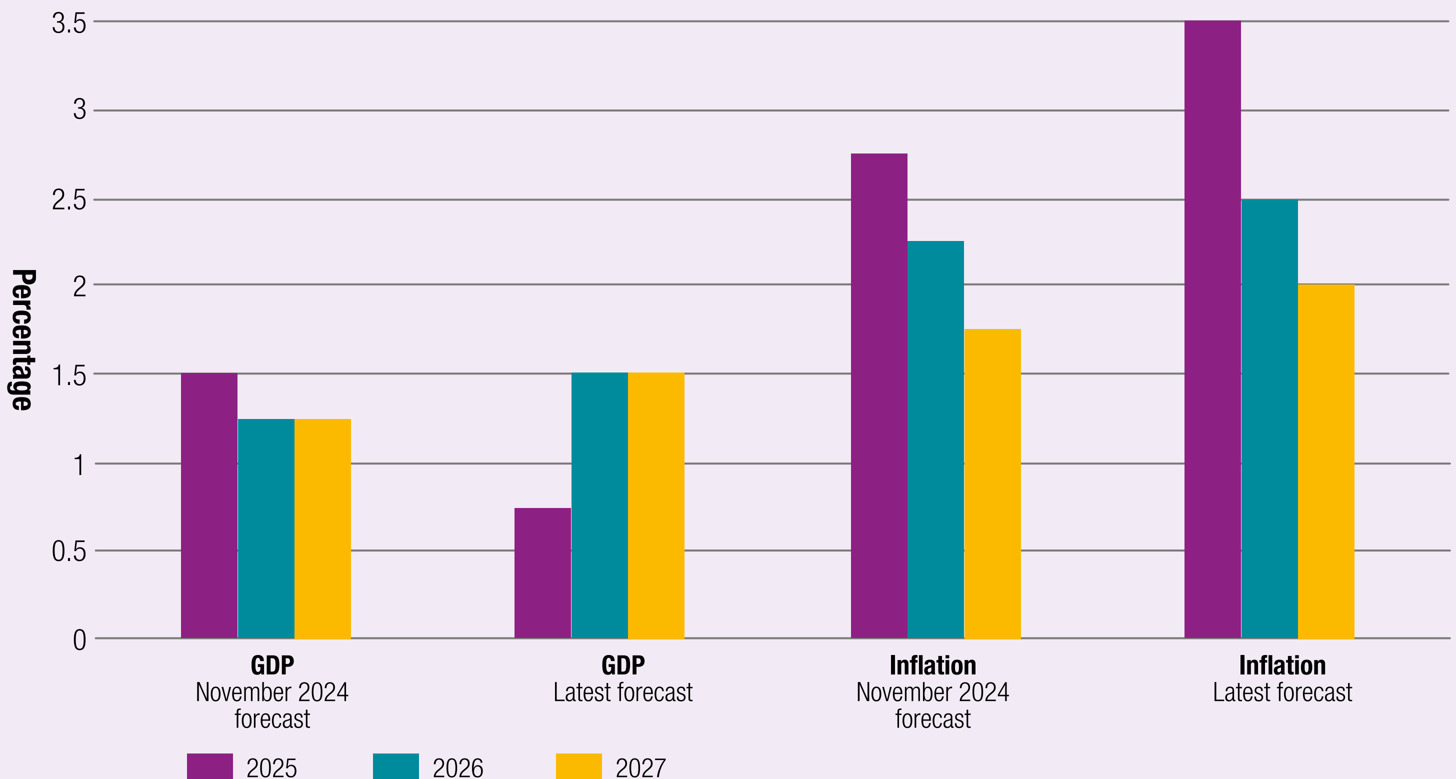
One hope last year was that the Bank of England cutting interest rates would stimulate the economy and construction sector. However, there are few signs of the desired boost so far. Higher inflation creates uncertainty about how far the Bank can cut rates this year. This dichotomy of high inflation and low growth, known as stagflation, is evident in the latest forecasts from the Bank. Released alongside the decision to cut rates from 4.75% to 4.5%, the Bank reduced its GDP forecast from 1.5% to 0.75%. Other forecasters, including the Office for Budget Responsibility, have also cut their growth expectations due to poor data releases and reassessment of productivity and inflation. Instead of peaking at 2.8%, the Bank now anticipates inflation will reach 3.7% in Q3. These forecasts underscore the challenges facing the Bank. In a low growth environment, the MPC might try to bring forward rate cuts to stimulate the economy. However, with inflation potentially rising to almost twice its target rate, aggressive rate cuts are unlikely.

Two or three further rate cuts are still likely this year, but risks have increased. This poses problems for construction. Developers and housebuilders may find borrowing more expensive, making appraisals harder and delaying new projects. Similarly, contractors have struggled to get credit in recent years, and higher interest rates will prolong this issue.

For housing, the sector most affected by the base rate, prospects have also been hampered due to challenges around the implementation of building safety regulations for High Risk Buildings. Delays to securing Gateway Two approvals for projects are in turn preventing project progressing on to site. The industry, Government and the regulator are now working closely together to find collaborative solutions for the delays, supported by additional resourcing for the Building Safety Regulator and new guidance for industry on the Gateway Two application process. However, as elsewhere, these solutions will take time to implement and output is unlikely to improve overnight.

WORSE FORECASTS FOR THE YEAR AHEAD

Source: Bank of England



Alongside economic uncertainty there remains much political uncertainty, and here the fog should lift in the second half of the year. The government will publish its spending review in June. Local authorities and public sector clients are delaying work until they have more certainty from these plans. Unfortunately, although not surprisingly, it seems that a number of local authorities and other public sector clients are delaying work until they have more certainty from these plans. Without a guarantee on future budgets, there is an unwillingness to press ahead with new projects. Furthermore, two recent events have made the outcome of the review even more challenging.

Firstly, in January, there was a large shift in the gilts market. Highlighting the precariousness of the government's fiscal position, when yields peaked, they virtually eliminated the £10bn headroom the Chancellor had without breaking their fiscal rules. While yields have since settled back down, it points to sizeable risks on future capital expenditure, and in March's Spring Statement, welfare reforms and day-to-day spending both saw large cuts. A second and perhaps more worrying event is the increased uncertainty caused by Donald Trump and implications for Ukraine and European security. This means the UK has increased its defence spending, leaving less for other departments' budgets including overseas aid. Despite the Ministry of Defence having one of the largest capital expenditure budgets, around half of this goes towards Single Use Military Equipment. By contrast, and as an example, the capital expenditure budget for education primarily goes towards maintenance, rebuilding and expansion, all of which link to construction. The shift towards defence spending on equipment could have knock-on effects for the construction industry. That said, in our response to the Defence Industrial Strategy Statement of Intent, we made clear our view that appropriate investment in the defence estate can feed into the government's wider vision for economic growth and should not be overlooked.

Another reason this year is likely to see weaker growth than future ones is that the new Labour government is still working through changes to planning and updating various pieces of legislation. One such plan that's in the works is a 10-year Infrastructure Strategy which will be published in June, at the same time as the spending review. By linking it to the spending review and its five-year budget, the aim is to coordinate the government's approach across economic infrastructure including transport, water and energy as well as housing and social infrastructure such as hospitals, schools and prisons. For the construction sector, arguably the most important principle it presents is the focus on providing long-term confidence. Ensuring a secure pipeline will provide the certainty the industry needs to invest. In building this pipeline, the Strategy will look at ideas such as an investment programme with priority projects. Allowing the construction supply chain to plan for the future and invest should lead to more innovative and productive solutions, in turn reducing outturn costs. Through the Infrastructure Strategy's three objectives of enabling resilient growth, delivering clean energy and ensuring social infrastructure can support public services, the government hopes it will drive infrastructure spending in a deliverable and affordable fashion. Yet, while the plan is much needed, it will still take time before it can shift the dial.

An interlinked policy is the Planning and Infrastructure Bill, which was introduced in March. One part of the Bill was focused on Nationally Significant Infrastructure Projects (NSIPs) and how to speed up delivery. Its aim is to get at least 150 such projects through during the Parliament, almost three times as many as in the previous one. To achieve this, they intend to make National Policy Statements clearer, stronger and more frequently updated, while also wanting the NSIP system to be less burdensome. A second part of the Bill relates to planning committees, with a focus on improving housing delivery. Aiming to create a standardised approach to decisions, one change is delegating most decisions to planning officers and only having contentious or proposals far removed from local development plans going to committees. Likely to simplify how things work, one risk is how planning teams, already saturated and suffering from a lack of resources, manage. In both papers the fundamental aim is to provide confidence for developers and ultimately to secure delivery of critical housing and infrastructure. As well as providing them with a consistent approach to their applications, the intention is that decision making will happen much faster than is currently the case.

Alongside these two key areas, the wide-ranging Bill also had sections on development corporations, intending on making it easier to build large communities or new towns, reforming Compulsory Purchase Orders and a more strategic approach to environmental responsibilities. The government is pinning a lot of hope on these changes, and rightly so. The RICS UK Construction Monitor has consistently shown Planning and Regulation as one of the biggest impediments to building activity. In Q4 2024 over half of respondents said it was an issue, making it the second biggest problem behind financial constraints. As with many policies, it will take time for this one to bear fruit, another reason why this year may well be a modest one. Nonetheless, if it is successful then we should start to see more projects getting the green light as we progress through this Parliament.

The future:
Can the proposals be delivered?

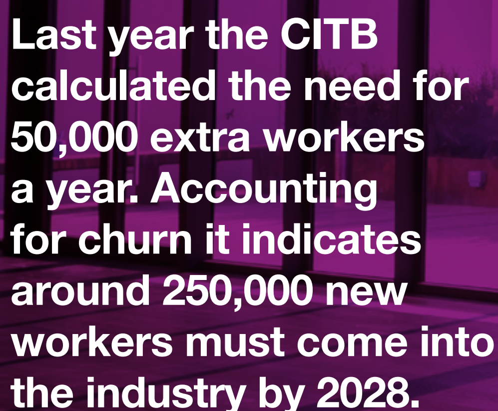
The CLC has been working closely with DfE and Government to address the skills challenges, this culminated in a £600m investment to help train up to 60,000 more construction workers over the course of Parliament. A common talking point in our Market View, the start of the year saw a flurry of articles in the mainstream press, including The Financial Times, The Economist and The Guardian, highlighting the issue. With the government wanting to be builders not blockers, the focus on how feasible its ambitions are should come as no surprise.

To give an idea of the scale of the task at hand, the government would like to build 1.5 million homes in this Parliament, while also approving 150 Nationally Significant Infrastructure Projects. Net additional dwellings, the government's most generous figure on homebuilding, had a peak of a little bit below 250k in 2019, therefore requiring a 20% increase to reach 300k. Similarly, there were only 57 NSIPs in the last Parliament meaning that once all these projects get onto site there would be a substantial jump in construction.

Last year, the Construction Industry Training Board (CITB) calculated the need for 50,000 extra workers a year. Accounting for churn, it indicates around 250,000 new workers must come into the industry by 2028.

Yet these figures were based on more modest growth construction forecasts than one would expect to see if the government are to meet their goals. Even hitting these numbers seems highly unlikely. ONS data shows the number of construction workforce jobs is lower than it was before the pandemic. Problems with ONS data mean we might want to look elsewhere and data from HMRC is more promising. However, in showing the number of PAYE construction workers has been increasing, it suggests that construction workers are moving away from being self-employed. Additionally, even here, the change of less than 100,000 employees over five years seems a long way short of requirements.

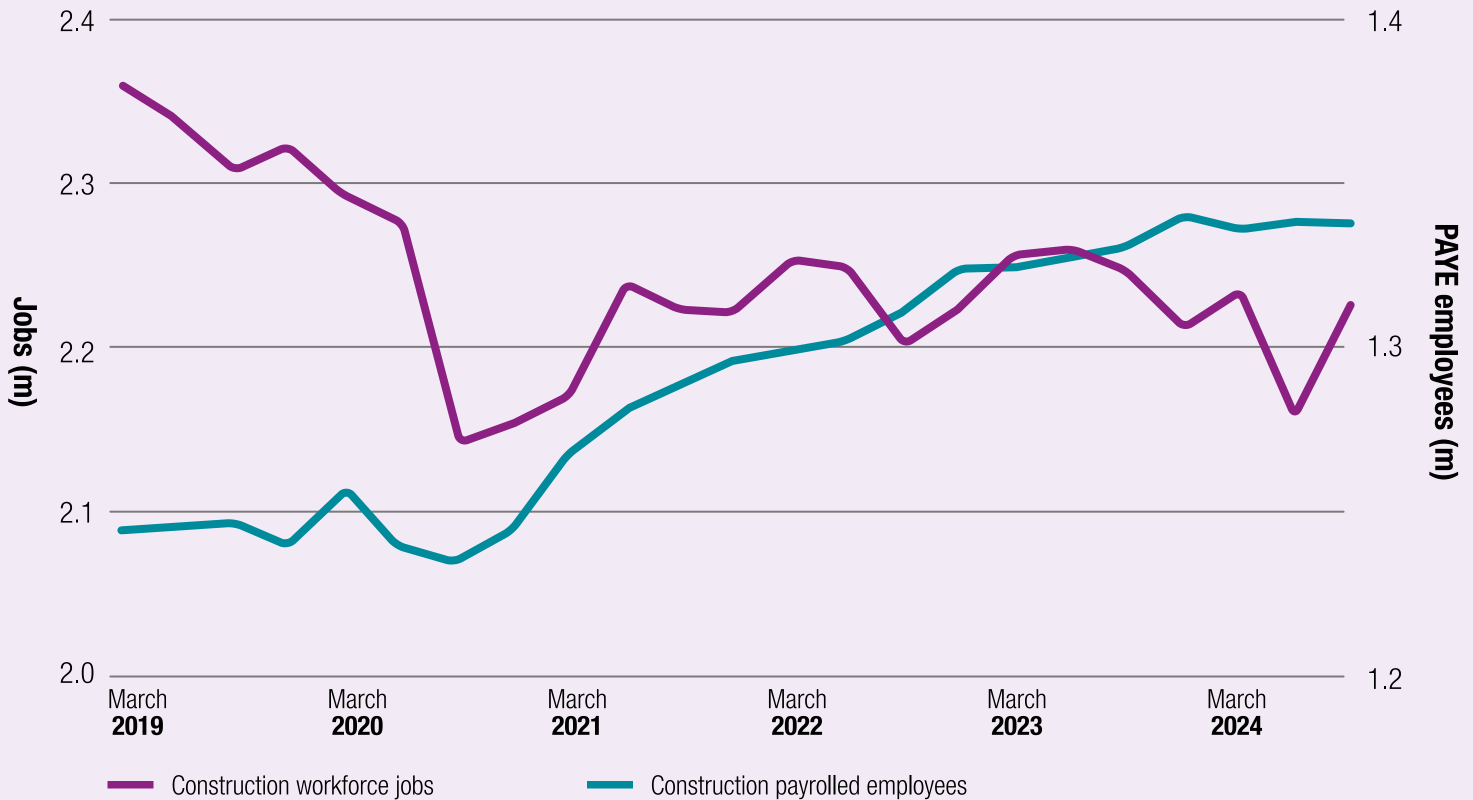
Recognising this problem, the government has just announced £600m of funding to help train up to 60,000 more construction workers over the course of Parliament. Measures include £100m for 10 new Technical Colleges and £165m of additional funding for existing colleges to provide more construction courses. Employers will benefit, with £2,000 on offer for every foundation apprentice they take on and a further £80m of funding on offer for bespoke training requirements. The government will also provide £100m of funding for Skills Bootcamps and £100m for 40,000 industry placements and there will be a new Construction Skills Mission Board co-chaired by Mace Executive Chairman Mark Reynolds.



Last year the CITB calculated the need for 50,000 extra workers a year. Accounting for churn it indicates around 250,000 new workers must come into the industry by 2028.

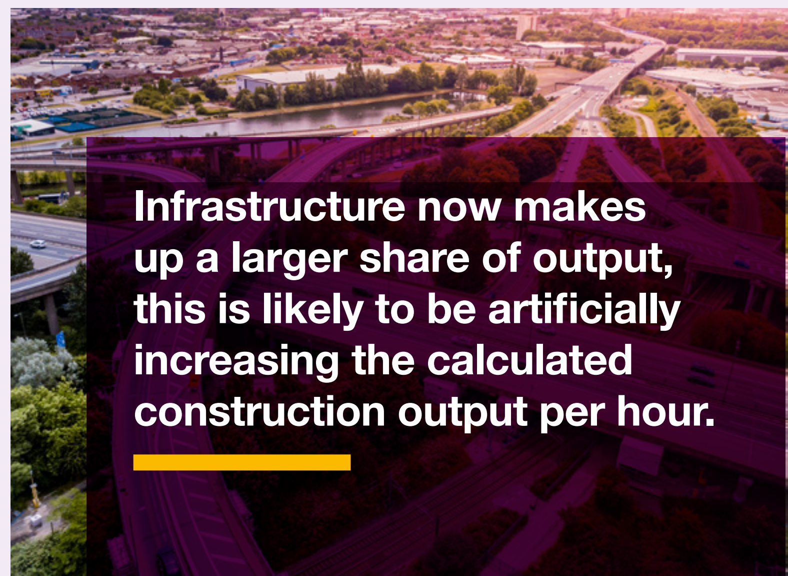
THE CONSTRUCTION WORKFORCE WILL NEED TO INCREASE TO MEET GOVERNMENT TARGETS

Source: ONS, HMRC



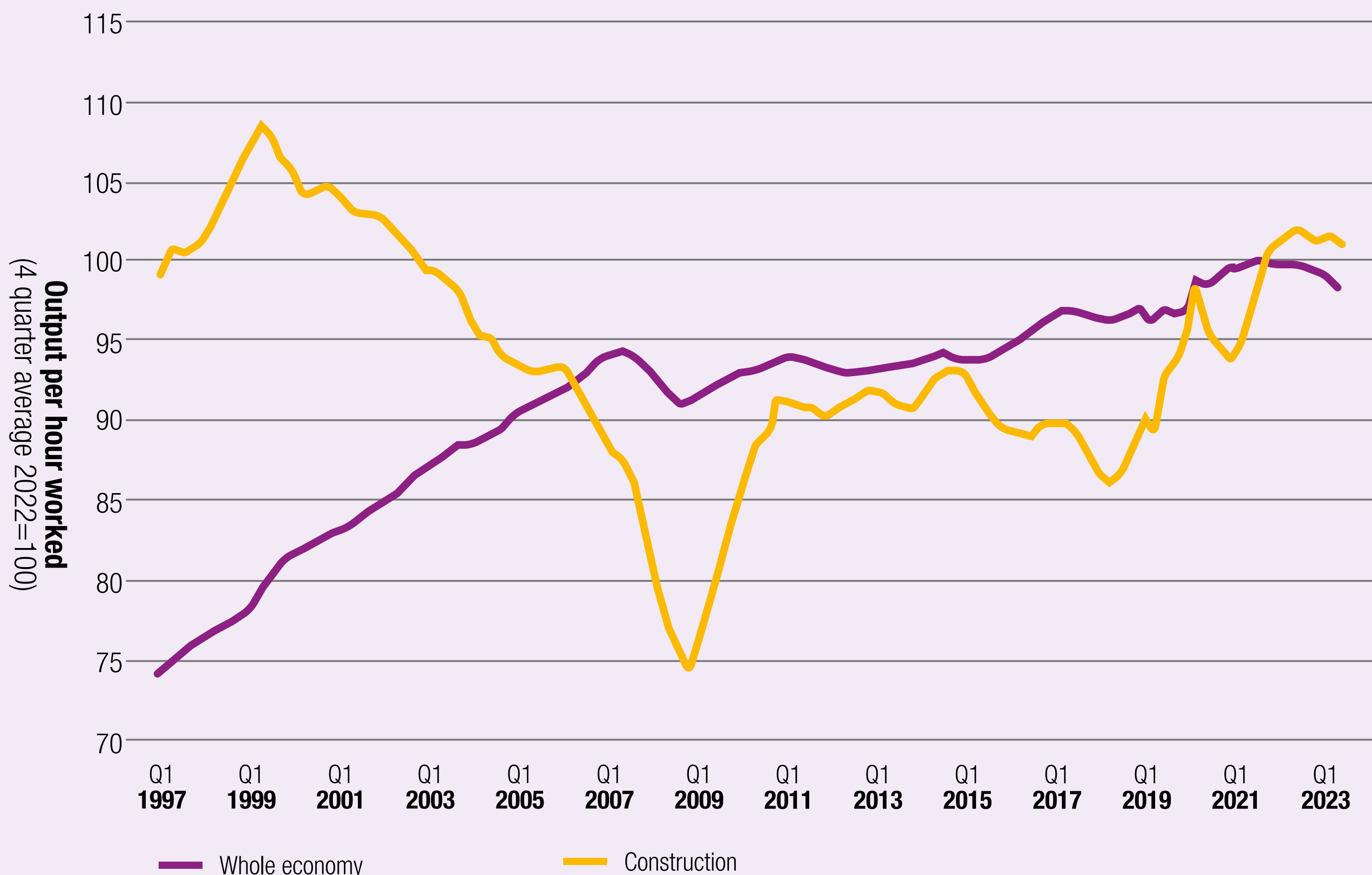
Training and immigration are two obvious ways to increase employment, but are unlikely to be enough. Additionally, there are many other countries pushing ambitious construction agendas, and keeping hold of employees is often a challenge. Given the difficulty in raising employment by such numbers, one alternative to having more workers is getting higher output from existing ones. Unfortunately, this also presents problems. Poor productivity, calculated as output per hour worked, is a major issue not only for construction but also for the wider economy. Notably, the Bank of England is very concerned about it. As covered by the Governor of the Bank of England, Andrew Bailey, at a press conference, there has been an increase in labour supply without an increase in GDP. This means "mathematically that productivity has got much worse" and, while they expect it to recover, it won't be immediate, and this is one key reason they have revised down their growth forecast for 2025.

While productivity has fallen since 2023, it has been an issue ever since the global financial crisis. That productivity growth has been so poor over the last 15 years, explains much of the economy's struggles. Similarly, much of the purpose behind the changes to planning and higher infrastructure spending is to improve long-term productivity. This will take time and to deliver the projects at pace construction productivity must improve. Following a collapse in construction productivity in the early 2000s, it struggled in the 2010s. Unfortunately, the fact that it finally looks as though it has improved is potentially misleading. As well as all the usual caveats we have to apply to any ONS data looking at the labour market, the change in composition of construction output is also a factor. Infrastructure and civil engineering projects typically have a higher output per hour than occurs for property. Given infrastructure now makes up a noticeably larger share of output this is likely to be artificially increasing the calculated construction output per hour.



Source: ONS

LOW PRODUCTIVITY IS ONE OF THE MAIN REASONS FOR WEAK GROWTH



While improving productivity is one way to get around labour shortages, it won't be any easier to achieve. The industry is well aware it has productivity problems and there are many explanations for why as well as suggestions on how to improve it. These explanations include a lack of investment in R&D and technology. In 2023, the CLC published a report looking into productivity, with suggestions for both government and industry. Importantly, some of the actions for government, such as giving confidence in pipeline and reforming town planning, look likely to happen. Providing certainty should lead to higher investment and the potential for a more programmatic approach to delivery. However, other factors such as the fragmentation of the industry and its low margins which reduce investment, as well as attitudes to risk are likely to be much harder to fix.

Assuming the government can fix the planning system, the capacity of the labour market, which goes hand-in-hand with productivity, is only one part of the challenge in terms of future delivery. Other constraining factors include material supply and financing, but the labour market is likely to be the biggest one. Higher wages, and them increasing more rapidly than general pay, is a market solution and seems almost inevitable. Clearly, this will drive up tender prices and create upside risks to our forecasts. One thing is clear though, the industry will need more than higher pay to solve its labour problems and the recent history is worrying.

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