

UK MARKET VIEW

**Spending Review to support growth
but geopolitical concerns a major risk**



Q2 2025

Introduction

The UK construction market is showing signs of resilience in 2025, with new orders rebounding and infrastructure investment gaining momentum following the Spending Review.

While stabilising material prices offer some relief, rising labour costs and ongoing skills shortages continue to challenge delivery. The sector is also navigating geopolitical uncertainty, from tariffs to global commodity shifts, which risks impacting future inflation.

Encouragingly, government reforms and funding commitments are beginning to unlock opportunities, albeit slowly, particularly in transport and energy. However, the industry must remain agile, as capacity constraints and planning delays could limit progress as new orders begins to ramp up.

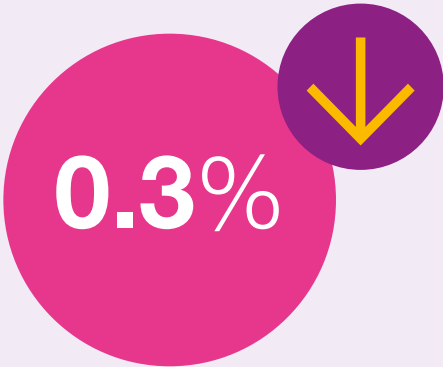
As we look ahead, collaboration across the supply chain and a focus on productivity will be essential to sustaining growth.



Oliver North

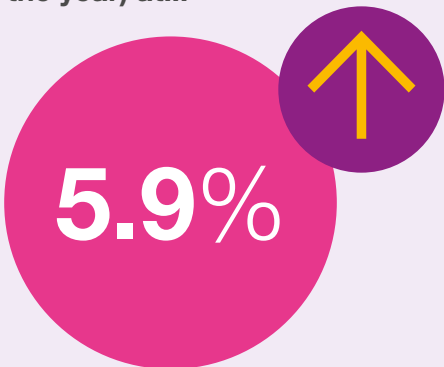
UK & Europe Director of Cost and Commercial
Management, Consultancy

After growing 0.7% in the first quarter, GDP had a month-on-month fall of...



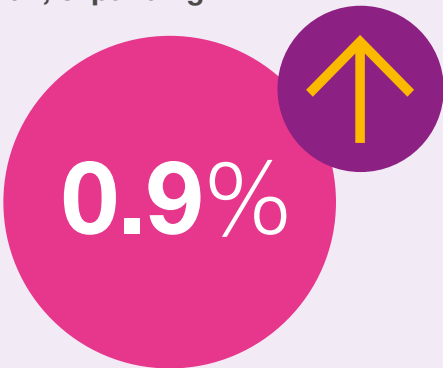
in April, in part due to a considerable drop in exports to the US.

Regular pay is still growing rapidly (albeit at a slightly slower rate than earlier in the year) at...



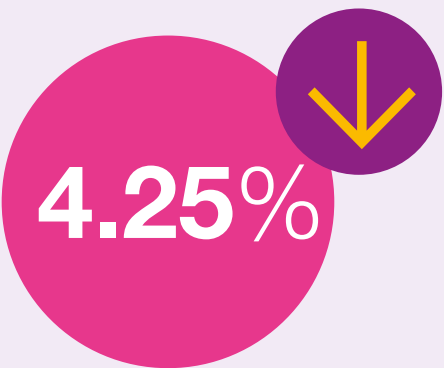
for construction and 5.2% across the whole economy.

All new work continued its recent good run, expanding...



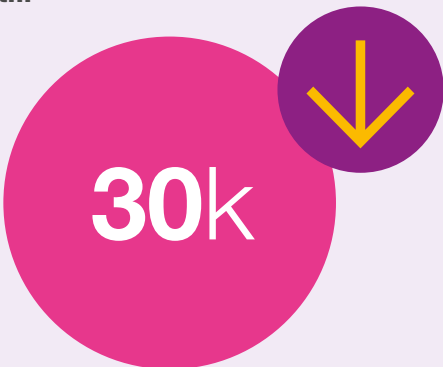
in Q1, leaving this 1.7% larger than in Q1 2024.

Interest rates continue to come down steadily, now at...



but the Bank of England will be nervously watching inflation, which stands at 3.4%.

There was a worrying drop of almost...



in the number of payrolled employees in April and May, a two-month drop off larger than at any point in the pandemic, likely caused by the increase in National Insurance contributions.

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

Much of the economic news over the past quarter has focused on US President Donald Trump's tariffs. Fortunately, tariffs on UK exports were set at the lowest rate of 10% and, so far, with the 90-day pause on reciprocal tariffs and a lack of retaliation from most countries, the macroeconomic effects on the UK look to be limited. On average, GDP growth forecasts for this year are the same as they were in March, although economists have nudged down expectations for 2026.

With regards to the latest numbers, the tariffs caused UK exports to the US to slump in April in part resulting in a poor month for GDP. However, we shouldn't read too much into one month of data and, importantly for tender prices, declines in a variety of commodity prices, supported by the pound's appreciation against the dollar, should be deflationary. The escalating conflict in the Middle East caused a spike in the price of oil, but even here, Brent is currently lower than where it started the year. Meanwhile, there is growing evidence that the labour market is loosening. For construction, as well as a substantial drop in vacancies, that there were almost 30,000 fewer payrolled employees in May than March points to the change in National Insurance contributions having a substantial impact on the industry. If this does reflect weakening demand for labour, exacerbated by slower than anticipated start on site new projects, we would expect construction pay growth - which has eased to 5.9% - to slow rapidly. More generally, unemployment has risen to 4.6% although pay growth for the whole economy has slowed, at 5.2% this is still too high for many members of the Monetary Policy Committee. While the rise in CPI to 3.4% in April was anticipated, the Bank of England remains cautious given the 2% inflation target, suggesting that any further interest rate cuts are likely to be gradual.

Our report for the first time separates real estate from infrastructure to reflect the differing market impact on these sectors. It will now provide forecasts for UK real estate, UK infrastructure and an all-in number for London. Differences in demand for materials, contractor capacity and labour shortages will all help explain the variation in tender prices. In general, the two prices should move closely together especially over the medium-term, however there can be substantial short-run differences.

Demand and sentiment, always key considerations when preparing our tender price forecasts, have

diverged noticeably over recent years between infrastructure and real estate. In particular, housing and private commercial, by far the two largest real estate sectors, have had a torrid time. By contrast, infrastructure output is almost 20% larger than pre-Covid and the Spending Review providing more funding for transport and energy as well as over £14bn for Sizewell will only strengthen it further. New orders for infrastructure in Q1 were also almost 130% higher than in Q4 2024 and we expect tender price inflation to be noticeably higher for the next two years. Beyond that point, a recovery in the housing market, potentially supported by the £39bn Affordable Homes Programme, should lead to a convergence in tender price inflation across sectors.

Government departments have been waiting for the Spending Review for some time. Keen to know their budgets up to 2030, some will have delayed projects in the meantime. The Infrastructure Strategy highlighted many of the schemes mentioned in the Spending Review and, alongside the £725bn of government funding, explained how fixing issues around planning regulations and encouraging private investment should drive growth. Although it is dependent on the industry to deliver, there are no easy solutions to skills shortages, and an expanding pipeline will only increase client concerns around delivery. There will need to be help on the issue around protracted PCSAs delaying contractors from starting work, leaving the supply chain underutilised and creating pent-up demand. Additionally, the scale of some of the programmes announced in the Spending Review has the potential to occupy some firms for years, but in doing so, it will only cause inflationary pressures elsewhere in the system. Options such as working with a wider supply chain, including potentially greater use of international contractors alongside modern methods of construction will be essential for government success. The changes in planning should also help, however, with day-to-day spending seeing slower growth than capital expenditure, departmental capacity will remain constrained. There are also questions about what happens in the next Budget, and whether tax rises will be necessary. A recent report from the OBR highlighted the long-term vulnerable nature of the public finances, while in the immediate term, the current budget deficit was £5bn (12.7%) above forecast. If this does prove the case, it will likely slow growth and dampen tender price inflation.

All new construction output continues to recover

Although construction output was flat in Q1, it marked the sector’s weakest quarterly growth performance in a year. However, there were further signs of promise from some parts of the industry. In the latest quarter, as in Q4 2024, all new work grew, while the repair and maintenance sector declined. For all new work, it was the third quarter in a row where all new work expanded which, after six successive quarterly falls, marks a much-improved environment. All new work output is now 1.7% larger than in the first quarter of 2024, giving it its best annual change in two years.

Within all new work, there was a widespread difference in the performance of the sectors. Public non-housing and private industrial had outstanding quarters, growing 11.9% and 8.7% respectively. In the case of public non-

housing, output is over 20% higher than in the same quarter a year ago, as government expenditure has accelerated rapidly since Labour’s election last summer. Meanwhile, private housing and infrastructure have seen more modest changes, of 1.4% and 1.8%.

Also standing out, albeit for the wrong reasons, was the drop in private commercial. Output has declined in all three months this year, and over the quarter it sunk 7.1%. Disappointingly, it is now over 30% smaller than in Q4 2019, and the only quarter since the end of 2019 where output has been lower was Q2 2020 (at the start of the pandemic). The entertainment and shops subsectors are the biggest culprits, but new offices, which is the largest subsector, has also faced challenges.

EXCEPTIONAL GROWTH FROM THE PUBLIC SECTOR

Source: ONS



New orders

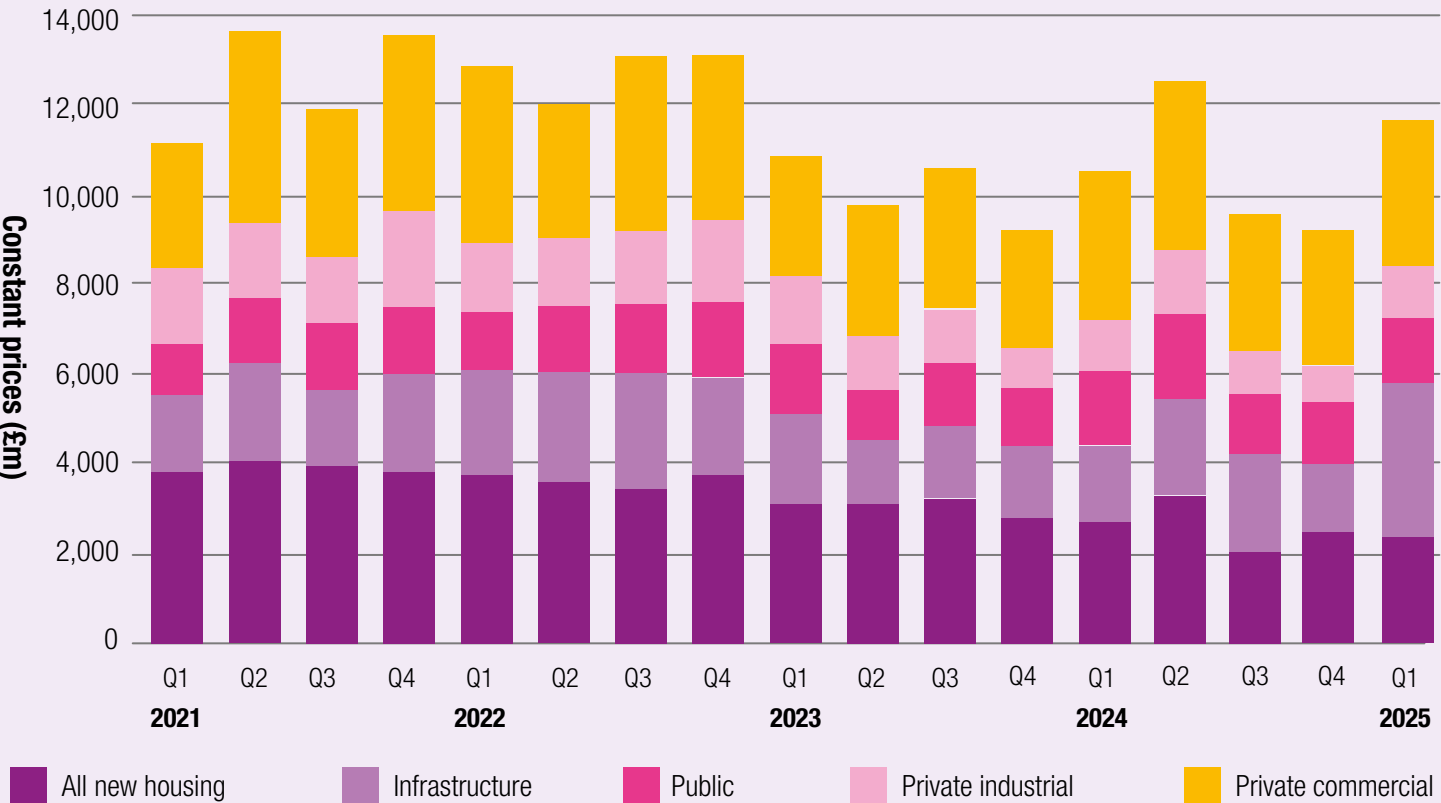
Hopes of a further pick-up in output stemmed from the latest new orders numbers, where there was a 26.6% increase compared to Q4 2024. The Spending Review is also likely to provide opportunities going forward. Nonetheless, it is necessary to weigh this against an especially poor second half of last year. The infrastructure sector was the primary driver of the quarterly increase, with new orders more than doubling compared to the previous quarter. The rail sector led the way, and there were also sizeable improvements for roads and electricity. Overall, this helped infrastructure have its best four-quarter period of growth since the end of 2022, and despite two very weak periods in Q3 and Q4 of last year, total new orders posted its best rolling four-quarter figure in a year-and-a-half.

Private industrial (up 38.5%), private commercial (up 8.5%) and non-housing public (up 5.6%) also enjoyed healthy starts to the year. Nonetheless, each sector's latest four-quarter number is below where it finished 2024, with new orders for Q1 2025 also down on Q1 2024. One quarter can't reverse the impact of several poor ones and, going forward, Donald Trump's tariffs are likely to particularly affect the two private sectors, causing uncertainty about future prospects for corporate decision makers.

The one sector where new orders declined in Q1 was private housing. Dropping by 6.8%, the total of the past four quarters were weaker than during the pandemic and the lowest since 2012. While new housing starts are more positive and showed a steady increase throughout 2024, there is one trend consistent in both datasets. London has struggled far more than elsewhere. With the capital far more reliant on the sort of high-rise flats that need approval from the Building Safety Regulator, the challenges with the Gateway 2 process are almost certainly the main driver behind the recent slump. It is still too early to say what impact the planning changes are having, but by next year this should be boosting the numbers.

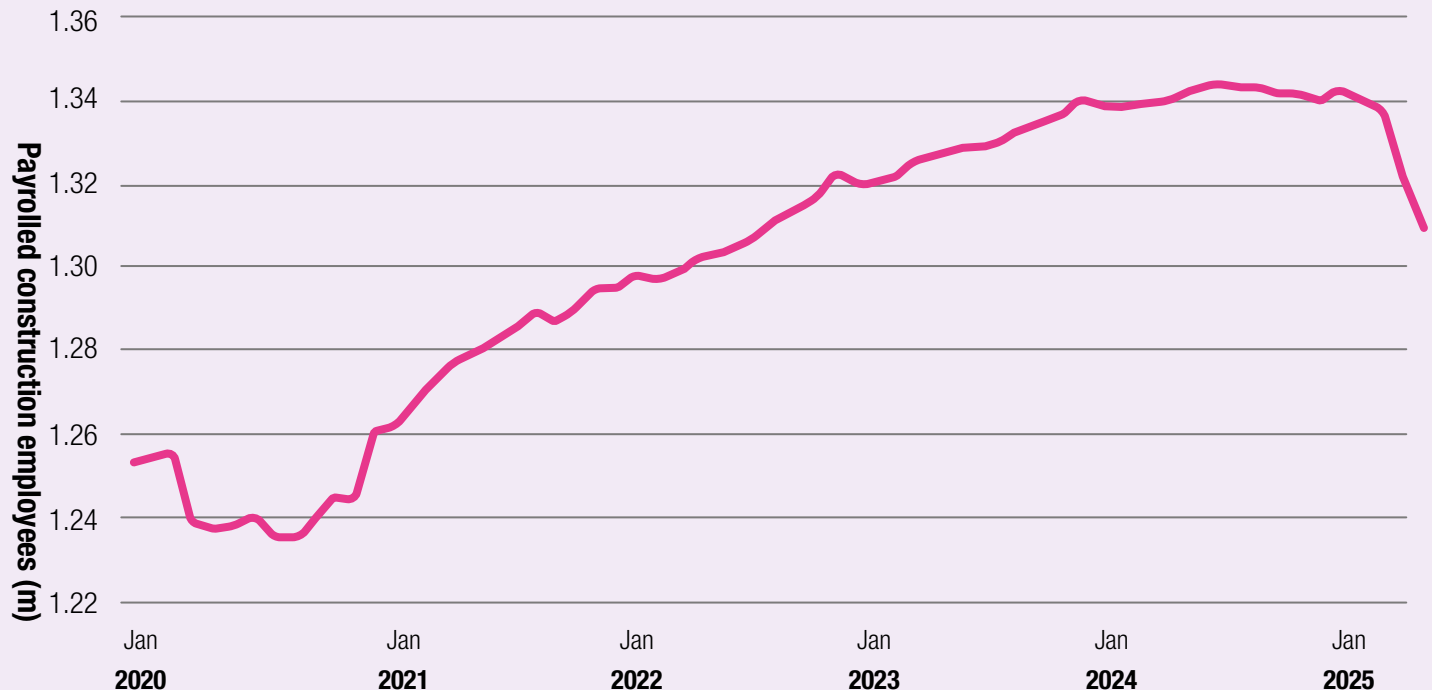
INFRASTRUCTURE NEW ORDERS
MORE THAN DOUBLE

Source: ONS



RISE IN NATIONAL INSURANCE CONTRIBUTIONS LOOKS TO HAVE TRIGGERED CONSIDERABLE REDUCTION IN CONSTRUCTION EMPLOYEES

Source: HMRC



Labour costs

As in other sectors, there are some signs that pay growth in the construction labour market is starting to slow. According to the ONS, regular construction pay growth eased to 5.9% in April, down from 6.4% in March, and is the weakest it has been in six months. Weekly earnings in April were also slightly lower than in February and March. Additionally, when looking at how pay may change in the near term, there has been a large drop in the number of construction vacancies. In the three months to May, these had slipped from 43,000 to 34,000. Close to one of the lowest number of vacancies since coming out of the pandemic, a weakening in demand for workers would justify slower pay growth.

HMRC data, looking at PAYE employees, offers an even more worrying perspective on demand for workers. Despite reporting a slight acceleration in the growth rate of mean and median construction incomes, this appears to have come at the expense of lower paid workers losing their jobs rather than widespread pay rises. With data from April and May showing a substantial reduction in the number of payrolled employees, if those made redundant are in lower pay brackets, it can drive up the averages. Furthermore, the number of employees declined 2.4% compared to a year ago, with the reduction over the

past two months steeper than during April and May 2020. As well as showing how successful the furlough scheme was, it also points to a fairly damaging impact from the rise in National Insurance contributions. Between March and May, admittedly a small timeframe, construction's 2.1% decline in employees was sharper than any other sector and much larger than the 0.5% drop across the whole economy. With overall unemployment also rising, this is a worrying sign of the labour market starting to loosen.

Only around 60% of construction jobs are payrolled employees and the large proportion who are self-employed won't face the same issues around National Insurance changes. Although the link between reduced employee numbers and pay is less direct due to the lower share of payrolled workers, downward pressure on wages is still expected. Nonetheless, overall pay growth at its current level of almost 6% is still very high and, given well-known skills shortages, alongside a government that is wanting to see much more building, a pronounced slowdown would likely be temporary.

Material price data goes missing at worst possible time

At this stage in our report, we would usually discuss construction material price inflation based on government statistics. Accounting for upwards of 40% of a project's build cost, this data release is fundamental to much of our tender price analysis. However, since April, the Department for Business and Trade which publishes the data, has been unable to provide an update. Coming as a result of the Office for National Statistics (ONS) pausing their production of the producer price indices (PPI), this is not the first dataset they have had to revamp. Our own data and internal analysis tells us that, in light of some of the broader economic and geopolitical factors, material prices on the whole are flat. This can be attributed in part to the industry resilience in supply chain planning due to previous challenges around Brexit and Covid.

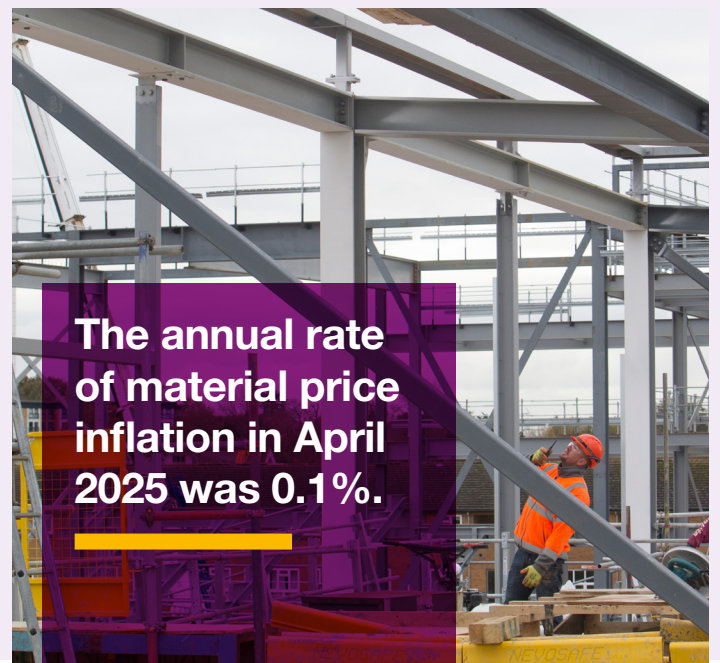
The Labour Force Survey, which the ONS uses to calculate the unemployment rate, has faced significant challenges and uncertainty about its accuracy for a while now. In the wake of lower response rates, the ONS paused its publication in 2023, and while this was temporary, issues with sufficient responses remain. The importance of reliable unemployment figures, alongside the relative lack of progress made in fixing the problem, led to the Bank of England's Chief Economist writing a letter of complaint to the ONS over a year ago. Despite the need for accurate unemployment figures, it may not be until 2027 until the proposed resolution becomes fully operational. While there is a more technical reason than lack of responses as to the suspension of the PPI dataset, alongside other issues, including with trade data, unfortunately for policymakers, as well as economists, there are now a variety of doubts about the ONS' credibility.

The ONS anticipates being able to restart publication of PPI data during the summer. At the earliest it will be several more months before we get new government material price data. While we have our own data, context of the broader industry comes from BCIS, which is currently estimating construction material price indices using its own PPI estimates. BCIS supports the production of the DBT material price index but typically use the ONS PPI data for this.

Regardless of the concerns and the likelihood the ONS will revise historical PPI data, according to BCIS, the annual rate of material price inflation in April 2025 was 0.1%. This follows three successive months where

material prices have risen, and with prices having trended downward for several years, we may have reached the end of such falls. Higher labour costs, including National Insurance contributions, are also likely to be pushing up material prices. However, for the time being, an annual rate of 0.1% remains very low by historical standards, as well as compared to the current CPI rate. The level of stability should continue to provide support to contractors and do little to inflate tender prices.

Commodity prices and a weaker dollar have also played a role in keeping material costs in check. The timing of the pause in the material price index is particularly unfortunate given the uncertainty caused by Donald Trump's tariffs and the need for understanding their impact. By fuelling concerns over global growth, the tariffs have helped push down commodity prices. This includes aluminium, iron and copper, with UK buyers benefiting from the pound's appreciation against the dollar. Before the escalation of conflict in the Middle East, oil prices had also fallen substantially. In turn, petrol prices were their lowest for four years, and while some sort of rebound is inevitable, the scale of the conflict will determine whether construction products continue to enjoy lower haulage costs. Meanwhile energy prices may be pushing up the cost of concrete production, however, offsetting this is a huge drop off in demand. Along with a weak commercial sector, increased carbon consciousness may be contributing to this. Total ready mixed concrete deliveries were down 5.9% in the first half of 2025 compared to H1 2024, and 23.4% lower than in H1 2023.



The annual rate of material price inflation in April 2025 was 0.1%.

Tariffs shock markets but end of 90-day pause will determine economic cost

On 2nd April, Donald Trump caused upheaval in financial markets announcing his 'Liberation Day' tariffs. Initially setting a rate of 10% for UK exports to the US, many other countries, most notably China, faced reciprocal tariffs and much higher rates. Fairly soon after, partly due to the turmoil in the financial markets, Donald Trump suspended the reciprocal tariffs for 90 days, allowing time for negotiations on trade deals while continuing to treat China, as well as steel and aluminium products, as exceptions. For the construction sector, most of what has happened appears to be noise and unlikely to have much of a bearing on projects. However, there are some areas, where if not necessarily of immediate concern, are worth covering. Overall, and recognising much could change, a lack of retaliation means growth won't slow as much as feared. Meanwhile lower commodity prices and a weaker dollar, should help cool inflation.

Firstly, sectors which export to the US will face a direct hit. UK carmakers, which exported £9.0bn to the US last year, making it the largest export sector to the US, were set to face a higher rate of 27.5% and be particularly hardly hit. Fortunately, a small trade agreement between the two countries, bringing the tariff down to 10% will help avoid the worst of it, but the uncertainty is still likely to hurt investment. Executives will struggle to approve expensive projects if they believe conditions will change and car manufacturers, along with pharmaceutical firms who are the second largest exporter to the US, are most at risk of such shifting sentiment.

Exports of goods to the US account for 16.2% of total goods exports but at £59.3bn this is only around 2%

of GDP. As a result, for most firms, the direct impact should be minimal. However, uncertainty will always damage investment plans and there are expectations of weaker global growth. The OECD recently cut their forecasts for global growth from 3.1% to 2.9%, primarily because they revised down US growth from 2.2% to 1.6%. For the UK, the Treasury's collection of forecasts, published monthly, saw GDP growth for this year cut in April but this view was short-lived, with forecasts reverting back in May, and at 1% they are no different to before the tariffs announcement.

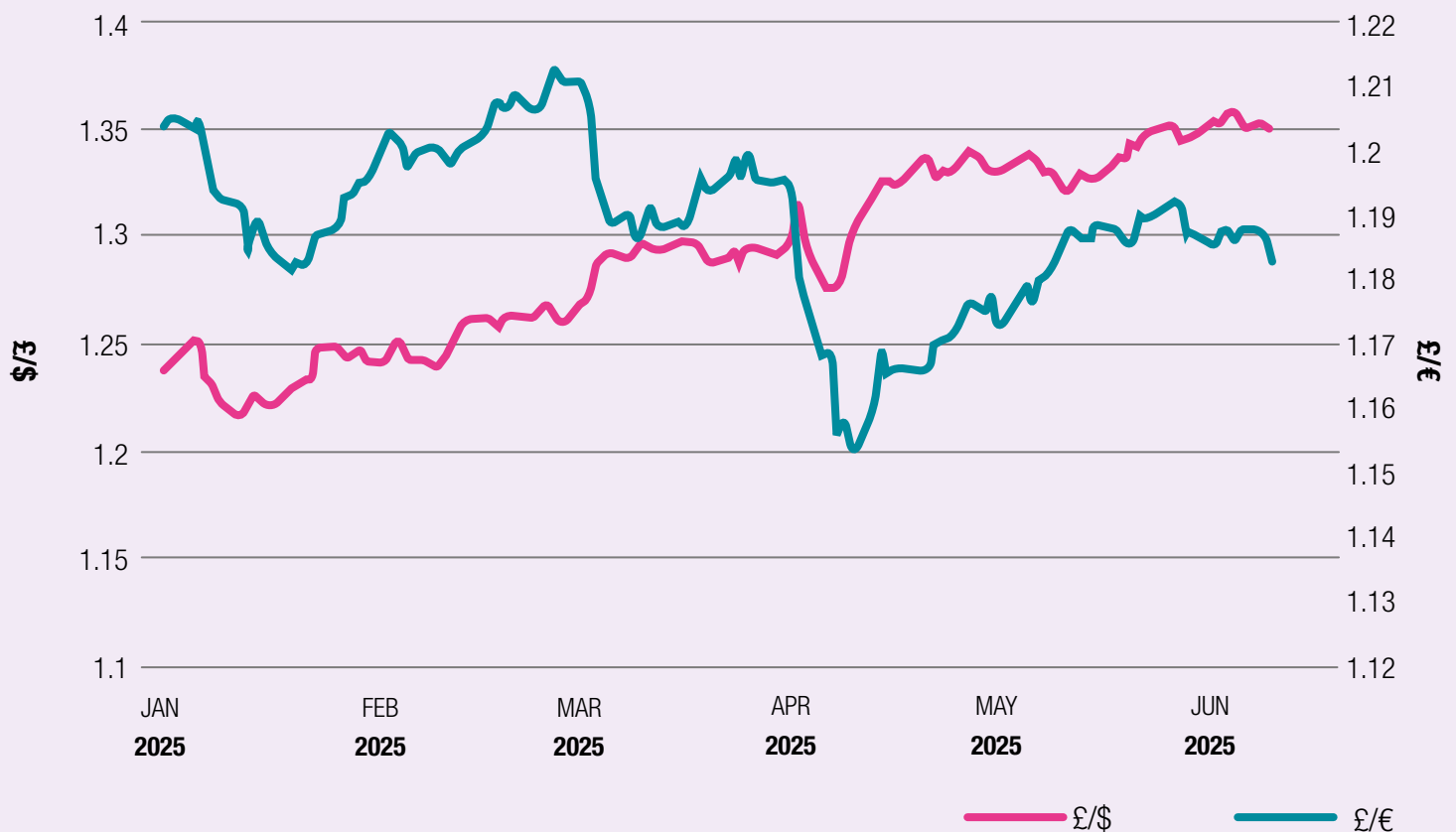
Whereas some of the tariff impact, such as a slowdown to global growth, was easy to predict, the behaviour of exchange rates was less so. The Bank of England's February Monetary Report chose to sit on the fence saying the pound might appreciate or depreciate. Were the pound to appreciate, it would make imports cheaper. By contrast, a depreciation, as happened after the Brexit referendum, would see higher import prices and push up inflation. Immediately after 2nd April, the pound depreciated against the dollar, as investors' initial reaction was to move towards their usual safe haven. Yet a few days later, having digested the news, the pound started appreciating, eventually passing US\$1.35, suggesting the Bank was correct in not wanting to offer a direction of travel on exchange rates. Movements against other currencies only amplified the complexity. Against the euro, which is more important for construction products, the pound's initial depreciation was much steeper, but it has since recovered most of this. Overall, other than for a handful of global commodities, the recent exchange rate movements shouldn't have a noticeable impact on material prices.



Exports of goods to the US account for 16.2% of total goods exports but at £59.3bn this is only around 2% of GDP.

WEAKENING DOLLAR WILL SUPPORT UK COMMODITY BUYERS

Source: Bank of England



Adding to the selloff in the dollar is a second Donald Trump policy, his 'big, beautiful bill'. Forecast to add trillions to US debt, bond markets have reacted with the price of US Treasuries dropping and yields rising. Other government bonds, including gilts, have also seen yields rise and there are several ways nervousness about bonds and borrowing could hit UK construction, both in the public and private sector. Higher government borrowing costs may put the promises from the Spending Review at risk. The announcement didn't include a new assessment from the Office for Budget Responsibility, however, if yields haven't come down when they deliver an updated forecast later in the year, fiscal pressures will come to the fore, potentially requiring tax rises or spending cuts. For the private sector, when government yields rise, it typically pushes up the cost of borrowing for corporates and the discount rates they use in their viability assessments. These viability assessments then become less attractive, potentially deterring investment. While developers don't tend to react to every market move, if higher bond yields persist, it could affect the number of projects getting approval in the medium term.

Hopes that Spending Review is the starting gun for numerous new opportunities

Last year's Autumn Budget included large commitments to increase capital expenditure. In changing fiscal rules on investment, it was possible to make £100bn of additional money available, a number which has since increased by a further £13bn. However, having made promises for the total budget, the details on where the funding would go for the fiscal years from 2026-27 were missing. Facing a lack of clarity, departments may have pushed back decisions for some projects. Making the Spending Review a highly anticipated event, one of the main hopes is that in providing greater confidence around money, it will allow such projects to get the green light.

Much of Chancellor Rachel Reeves' speech involved listing funding plans for several largescale programmes and projects. These included £14bn for Sizewell C, extra money for the TransPennine Route upgrade and East-West rail, £4.7bn per year for fixing and rebuilding schools and £39bn for a new Affordable Homes Programme. All sounding incredibly positive, once we dig into the numbers, growth won't be quite as stark as the impression given from the speech, and there is little capital expenditure growth beyond 2027. This is one reason why we don't expect tender price growth in 2029 to be as fast as 2028. From this fiscal year onwards, real average annual growth of capital expenditure will be 1.8%. Having got into office in June 2024, the new Labour government has already pushed through large increases in departmental budgets. It will, therefore, be keen to point to the larger average annual growth rate of 3.6% from the fiscal year ending in 2024. This rise in capital spending is already feeding through into the construction sector and public non-housing output was 12% higher in Q1 than Q4 2024 as well as being over 20% up on the first quarter of last year. The Spending Review should help boost output further even if the current pace of growth is not sustainable.

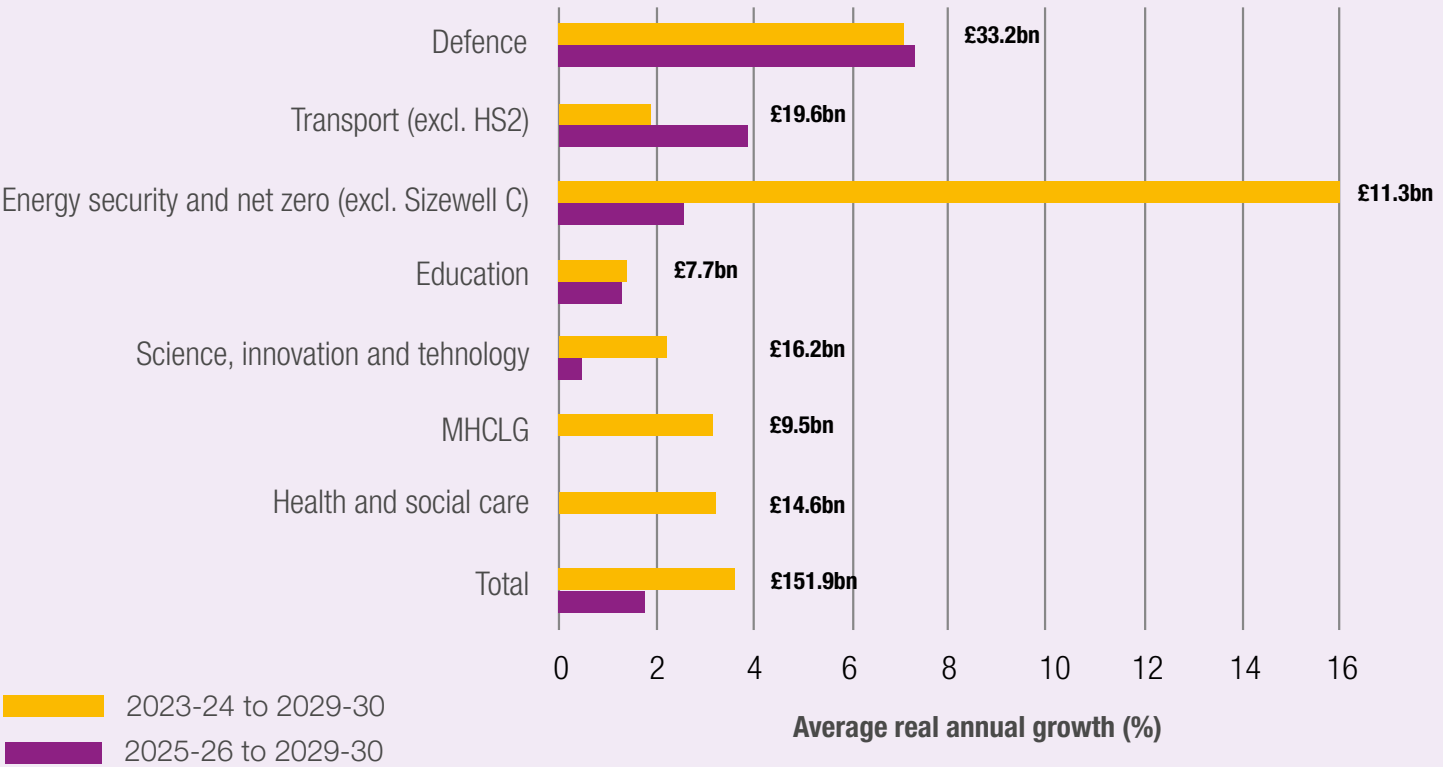
The war in Ukraine and pressure from Nato to raise spending meant defence was always likely to be a big priority. This has proved the case and, with growth of 7.3% from 2025-26 to 2029-30, it is the department enjoying the largest increase. While much of the new defence spending will go on equipment, spending for construction projects will come from the £4.5bn for munitions factories and £7bn for military accommodation.

Excluding Sizewell C, the capital budget for the Department for Energy Security and Net Zero is more than double for the current fiscal year than the last one. Yet even though growth slows in the coming years, the energy sector will still outstrip many sectors. Whereas some of this budget will go towards repair and maintenance projects through the Warm Homes Plan, as well as large engineering projects such as Small Modular Reactors and carbon capture, usage and storage, there will still be plenty of money funnelled towards construction. Adding Sizewell C to the mix, and the £14bn of funds for the next five years, swells the potential. Here, a Final Investment Decision is due later in the summer, and with private funding not covered by the Spending Review, the project will be one of the biggest for many years to come. As we've seen from Hinkley Point C, the benefits to the local community are sizeable. However, in pushing up wages, it may present challenges, not only to other local schemes, but also further afield including London.

News on HS2, the other project presented as a line item in the capital expenditure tables is arguably less good. Between 2025-26 and 2029-30, spending in real terms will decline by almost 9%. That it will now not become operational until much later into the 2030s appears to be due to plans for a longer testing period, and with much of the construction having already taken place, it seems reasonable to expect some form of contraction in expenditure. Having said that, questions about Euston and the suitability of a London terminal at Old Oak Common remain unanswered and more funding may therefore be necessary. More widely, transport will see an acceleration of growth with an aim to prioritise funding in the North and Midlands. As well as the TransPennine upgrade, the Infrastructure Strategy promised an update on Northern Powerhouse Rail soon. Additionally, there will be £15.6bn for Transport for City Regions, including £2.1bn for West Yorkshire's Mass Transit System. Similarly, changes to the Green Book are also aimed at supporting projects outside London and the South East.

CAPITAL BUDGET GROWTH TO SLOW

Source: HM Treasury
Values are Capital Departmental
Expenditure Limits in 2029-30



Housing is not only one of the government’s biggest priorities, but also one of the clearest examples of how they have provided large increases in money from the off. The Ministry of Housing, Communities and Local Government’s (MHCLG) capital budget jumped 20% from 2023-24 to 2024-25 and, with another substantial increase due next year, that real growth will be flat in later years is not a huge concern. In total, the government has promised £39bn of funding for a new Affordable Homes Programme. Typically coming in the form of grants for social housing, this increase in funding should improve the viability of mixed-tenure schemes. Furthermore, the hope is that almost £5bn of money for financial transactions, such as for loans and guarantees, will also drive private investment. Housing associations will also be in a better position to deliver new homes following a 10-year social housing rent agreement at CPI + 1% that gives them much needed certainty. New rules on planning are also aimed at spurring developments, although the pressure facing Local Authority finances, as well as a real terms cut in day-to-day spending for MHCLG over the next few years present risks around delivery. Unfortunately, irrespective of future growth, the lack of new housing starts over the past year leaves Labour’s aim of 1.5 million new homes over this Parliament a very long way away.

On 19th June, a week after the Spending Review , the government launched its 10-year infrastructure strategy. The Strategy, which focuses on both types of infrastructure, social (e.g. schools and hospitals) and economic (e.g. transport and energy), as well as housing, sets out a number of new approaches which the government hopes will help improve productivity and enhance growth. While the Spending Review and associated £725 billion in government funding show some of the sectors the government are prioritising, the Strategy goes much further, recognising efficient delivery requires more than money.

The first two chapters will be key to ensuring delivery. Chapter 1 builds on already announced changes such as the creation of the National Infrastructure and Service Transformation Authority (NISTA) and the Planning and Infrastructure Bill. Aimed at giving greater confidence, particularly around long-term plans, it includes a new Infrastructure Pipeline, due out in July. Tracking investment status and anticipated spend should prove useful for other projects, worried about localised bottlenecks. In Chapter 2, the Strategy discusses how it will crowd in private investment. For some sectors, such as housing, water and energy, it is clear why private capital is necessary. Yet in providing greater certainty, as well as by using more

sophisticated financing methods such as a regulated asset base, as used in Thames Tideway, and making greater use of public-private partnerships, it will make infrastructure a more attractive investment.

The final four chapters look at different sectors, offering details on how each of these can grow and succeed. Key takeaways from these include the importance of regional growth, which will hopefully be unlocked by investments in new towns, transport, digital connectivity and housing. Meanwhile, new budgets will be made available for maintenance of health, education and justice facilities. Finally, the Strategy focuses on net zero and sustainability, both from its goals around decarbonisation and electricity distribution, alongside protecting the environment and improving regulation of it. Overall, the two recent government announcements are very positive, however, and in particular when thinking about tender prices, market capacity challenges may act as a break on parts.

Mace

155 Moorgate
London EC2M 6XB
+44 (0)20 3522 3000

Contacts

Oliver North oliver.north@macegroup.com
James Donald james.donald@macegroup.com

macegroup.com