

Government Announcements Abound but to What Effect?

The last few weeks have seen government announcements aplenty and consequent media headlines regarding 'boosts' for construction, in turn intended to provide a stimulus for the economy. The stimuli were in housing, education and infrastructure. Yet sitting behind the big headlines are the figures within the documents, which suggest that it is not likely to be the great boost, at least near term, that the industry, and the economy, is likely to need given that forecasts for both have been revised down.

November's housing strategy was more a list of policies than a strategy but does include two key policy elements to help private housing; mortgage indemnity insurance and 'Get Britain Building'. With the estimates of new households created more than double the number of homes currently built each year, there is a clear latent demand for housing and although transactions at the higher end of the housing market have recovered considerably since the nadir in early 2009, the housing market has remained stalled at the first and second time buyer level where a considerable deposit is required.

The mortgage indemnity insurance announced in the housing strategy, which applies new build, should ensure that there is a considerable increase in the number of 95% mortgages that are made available and boost private housing from April 2012. However, it is critical that lenders don't merely lend the same amount and switch mortgage availability to the 95% mortgages so that they are underwritten to reduce their exposure to risk. The £400 million 'Get Britain Building' funding is expected to kickstart stalled private housing projects and should also provide a boost.

However, it is possible that the effect of these policies may merely be to offset the effects of worsening economic prospects. Standard Chartered, who have been the most accurate macroeconomic forecasters over the past two years, anticipated the UK economy contracting 1.3%, a startling difference to the 2.5% growth that the official government forecasts were showing for 2012 just six months ago.

In the Autumn Statement, the Chancellor announced a £5 billion capital boost for construction across housing, education and infrastructure with an additional £20 billion private sector finance to be drawn in from pension funds and investment funds. Yet, behind the headlines, the figures are not as positive for the industry.

Firstly, despite the 'boost', capital investment is still falling from £62 billion in 2010/11 down to £45 billion in 2013/14. Secondly, the £5 billion includes the previously announced initiatives highlighted in the housing strategy. Thirdly, 85% of this capital boost only occurs from 2013/14 and, as a consequence, it will not be providing a 'boost' anytime soon despite the fact that construction output is expected to fall 4%. If anything, it will be providing the boost from mid-2013, when economic recovery and private sector growth is expected to provide rising workloads for construction anyway. A cynic would suggest that the effects of this boost will be just in time for the next election, expected in 2015.

Regarding the drawing in of private sector investment, financial institutions are currently cash-rich at the moment and there is a great potential for this finance and there is a precedent for this model in Canada, where it works well in making use of pension funds and investment funds for infrastructure investment. However, this works well in Canada after operating since 1995 and while it won't take 16 years for it to work well here, it also won't occur quickly because pension funds, who tend to be risk-averse, will need convincing that this is the way forward.

In terms of what this likely to mean for the industry going forward, and the construction industry forecasts in particular, it is still a boost compared to the spending outlined six months ago in the Budget so it is likely to provide some growth during 2013 and accelerate growth for the industry during 2014 and 2015. However, it is unlikely to have a significant impact in the next 12 months when public sector spending will still be falling sharply and economic concerns will still be likely to hinder private investment in construction.

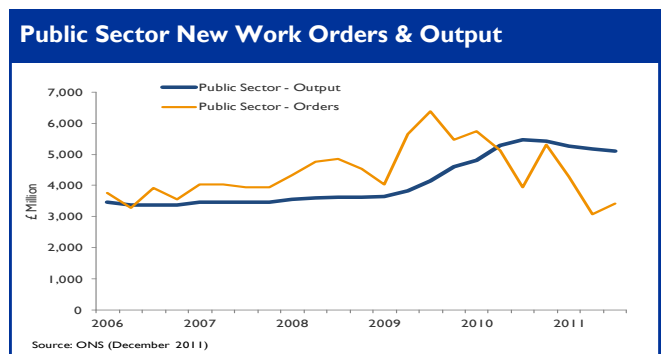
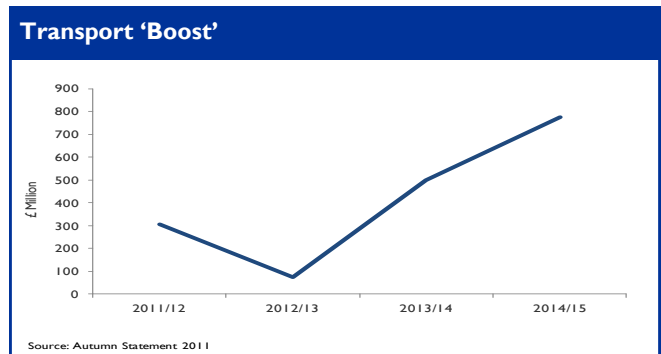
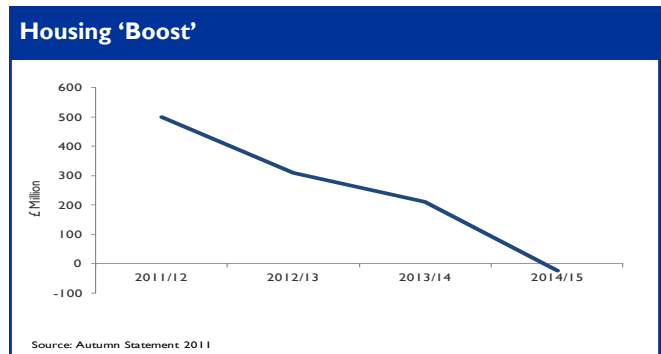
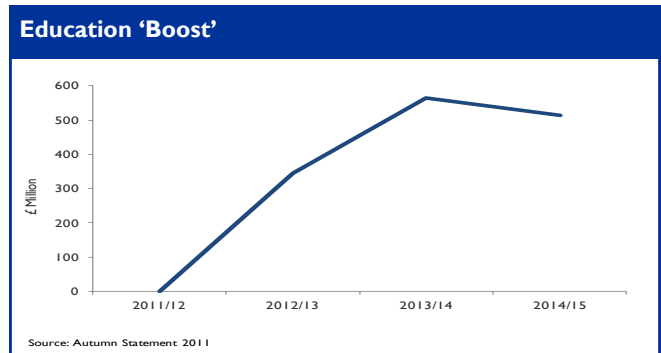
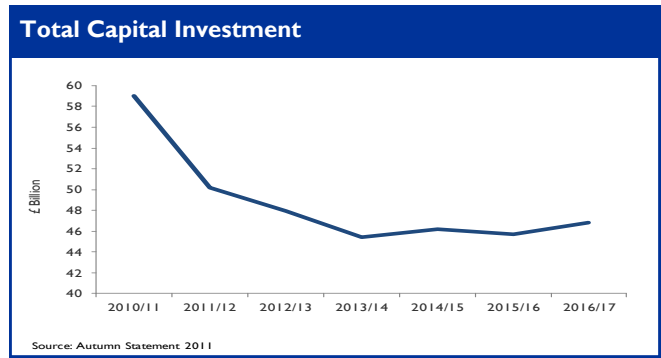
Despite government talk of a £5 billion 'boost', capital investment is falling sharply so it will merely lessen the fall. Capital investment in 2010/11 was £59 billion, albeit buoyed by fiscal stimulus in response to 2009's recession. Yet, even with the 'boost', capital investment is set to fall to £45 billion during 2013/14, a 30% fall in just three years and capital investment is expected to remain between £45 billion and £47 billion until 2016/17. As a result, public sector construction will still fall sharply in the next couple of years without significant growth after.

The boost to education covers £1.2 billion to provide 100 new Free Schools and also ensure extra funding for school places. This should ensure that education construction does not fall as much as anticipated in previous Association forecasts in the medium term. Yet, 76% of this 'boost' only occurs from 2013/14. As a consequence, it is unlikely that it will affect the Association's forecasts near term and we will still be expecting to see double-digit falls in education construction in 2012 and 2013.

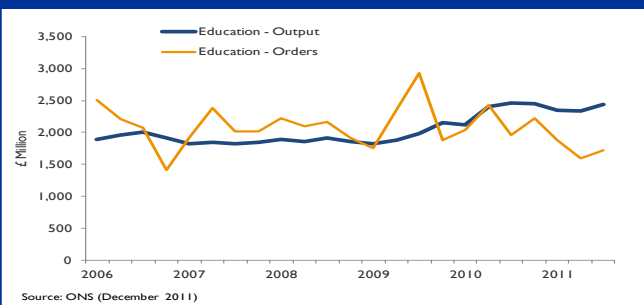
The boost to housing could be the most significant part of the many announcements relevant to construction. The capital 'boost' is relatively early with 81% in this financial year and 2012/13 but the mortgage indemnity insurance could enable up to 100,000 people to purchase new build homes. The overriding concern currently must be that consumer confidence is low and deteriorating, with ONS reporting in December that unemployment rose to 2.64 million, which may offset any potential growth this boost would normally provide.

The boost to transport could be of benefit to roads construction, which is where the transport 'boost' is focused as rail funding is fixed to 2014 through the regulator. Roads is where it is most needed as capital expenditure from Highways Agency will be falling 44% and local authorities are also expected to be highly constrained in finance going forward. Yet, as with education, 77% of this finance will occur only from 2013/14. As a consequence, it is unlikely to significantly affect the roads and rail near term.

Public sector new work orders rose strongly in 2009 and, consequently, new work output rose strongly during 2010 and, at peak in 2010 Q3, was 62% higher than it had been just four years earlier as a result of the public sector fiscal stimulus in response to the effects of the recession during 2009. Public sector funding has already started to fall away and, likewise, orders in 2011 Q3, were 13% lower than one year earlier. Output in the third quarter of 2011 was 7% lower and the orders imply that public sector output will only fall further near term.

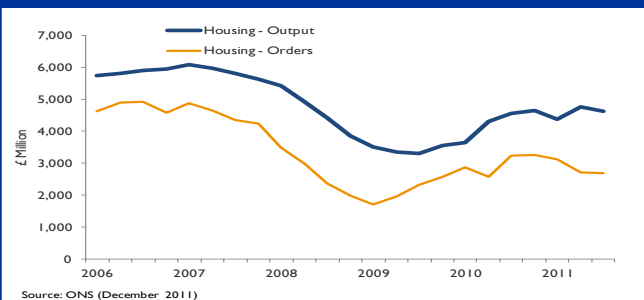


Education inc. PFI Output & Output



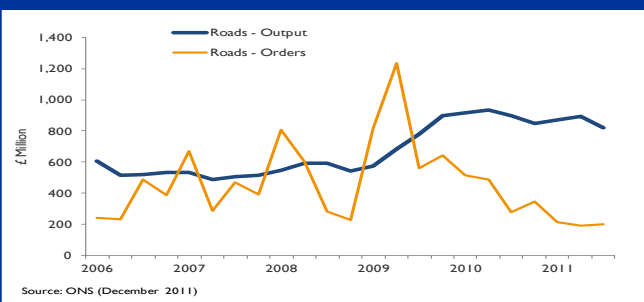
Despite the cut in funding from government and cancellation of programmes such as BSF around 18 months ago, output remained relatively high in Q3, rising 4% compared to the previous quarter and were only 1.2% lower than a year ago. As a consequence, it appears likely that output will remain broadly flat in 2011 due to the extent of work on framework contracts signed up to prior to summer 2010. Yet, orders fell 13% in the third quarter and this will feed through into output during the final quarter of 2011 and in 2012.

Housing Output & Orders



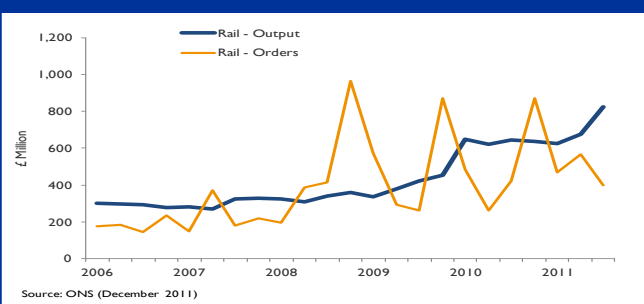
Housing output in Q3 was 1.2% higher than a year ago due to the slowly recovering private housing market. Yet the sharp fall in the relatively small public housing area is starting to be felt overall and Q3 output was 3% lower than in Q2. Furthermore, new orders within housing fell 1% compared to the previous quarter and 17% compared to one year ago and although this fall has not fed through into output as yet, the relatively short lead time in housing means that it is likely to feed through during the final quarter of 2011 and the first quarter of 2012.

Roads Output & Orders



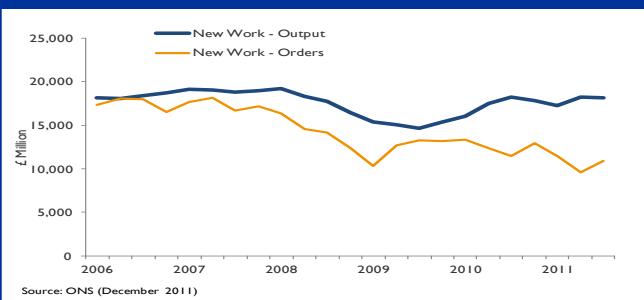
Output in the roads sub-sector almost doubled between 2007 Q2 and 2010 Q2, rising 91%. Yet, since then, output has been falling away gradually and in Q3 output was 8% lower than in Q2 and 9% lower than one year earlier. During Q3, roads new orders were 29% lower than 2010 Q3, a 4Q moving average of orders shows orders to be 50% lower than the same period one year earlier. This will clearly feed through into output in the next couple of years but hopefully this will be partially offset by measures announced by the Chancellor.

Rail Output & Orders



Rail output has been increasing since 2007 despite recession and government spending cuts as Network Rail funding is fixed for five year periods, the latest of which continues to 2014. Output accelerated further in the third quarter, rising by 22% compared to the previous quarter and 28% higher than a year earlier to a level two and a half times the level seen just three years earlier. On a four quarter moving average, orders rose 13% in Q3 and this would be expected to feed through over the next year as the sub-sector sees further growth.

New Work Output & Orders



Overall, the picture is mixed for new work. Output was broadly flat in Q3, falling 0.1% compared to Q2 and 0.3% compared to the third quarter of 2010. New orders for all work rose by 13% in the third quarter, yet this was from the lowest orders on record experienced during Q2. The four quarter moving average shows orders to be 11% lower than over the same period one year earlier. As a consequence, orders in Q3 were 6% lower than one year earlier and this will, inevitably, feed through into output over the next 18-24 months.

Key Statistics on the UK Economy and Construction Industry

		Annual % change unless otherwise stated								
Next Issue	Economy	2010	09Q4	10Q1	10Q2	10Q3	10Q4	11Q1	11Q2	11Q3
22-Dec	GDP	1.8	-0.8	0.9	2.2	2.6	1.3	1.6	0.6	0.5
	Fixed Investment	2.6	-9.8	0.7	3.6	3.5	2.7	-4.3	-0.6	-1.8
	Consumer Expenditure	1.0	-0.4	0.6	1.8	1.3	0.2	-0.4	-1.7	-1.5
	Real Disposable Income	-0.8	1.2	3.9	-1.5	-0.7	-1.3	-3.4	-1.2	-
	Government Consumption	1.5	-0.3	1.4	2.3	1.5	0.9	1.1	1.9	2.9
	Unemployment Rate	8.0	7.8	8.0	7.8	7.7	7.9	7.7	7.9	8.3
		2010	Apr'11	May'11	Jun'11	Jul'11	Aug'11	Sep'11	Oct'11	Nov'11
13-Jan	Inflation - Consumer Price Index	3.3	4.5	4.5	4.2	4.5	4.5	5.2	5.0	4.8
13-Jan	Inflation - Retail Price Index	4.6	5.2	5.2	5.0	5.0	5.2	5.6	5.4	5.2
		2010	Apr'11	May'11	Jun'11	Jul'11	Aug'11	Sep'11	Oct'11	Nov'11
13-Jan	Manufacturers' Output Prices	4.2	5.6	5.4	5.8	6.1	6.0	6.3	5.7	5.4
		2010	Apr'11	May'11	Jun'11	Jul'11	Aug'11	Sep'11	Oct'11	Nov'11
	House Price Inflation (Nationwide Index)	5.7	-1.3	-1.2	-1.1	-0.4	-0.4	-0.3	0.8	1.6
	House Price Inflation (Halifax Index)	2.9	-4.9	-3.7	-1.4	-2.2	-3.8	-0.6	-0.7	-1.5
	Property Transactions HMRC (000s)	879	71	69	71	72	70	68	73	-
	Property Transactions HMRC (% change)	3.8	-1.4	-8.0	-5.3	-4.0	-5.4	-9.3	0.0	-
29-Dec	Number of Mortgage Approvals	2.5	-9.1	-6.8	0.4	2.8	11.9	8.5	12.6	-
		2010	May'11	Jun'11	Jul'11	Aug'11	Sep'11	Oct'11	Nov'11	Dec'11
12-Jan	Interest rates (End of month)	-22.0	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
	£ - € Exchange Rate (End of month)	1.17	1.14	1.13	1.13	1.14	1.15	1.1	1.2	-
	US\$-£ Exchange Rate (End of month)	1.55	1.63	1.62	1.61	1.63	1.58	1.58	1.6	-
	Brent Crude Oil (Monthly average)	28.7	114.5	113.8	116.5	110.1	110.8	109.5	110.5	-
		2010	09Q4	10Q1	10Q2	10Q3	10Q4	11Q1	11Q2	11Q3
02-Mar	Construction									
	Total New Orders	1.6	6.7	29.9	-2.2	-13.3	-1.9	-14.5	-22.3	-5.5
		2010	09Q4	10Q1	10Q2	10Q3	10Q4	11Q1	11Q2	11Q3
	New Output									
	Housing	25.2	4.4	28.8	37.7	30.7	19.6	10.4	1.2	-7.6
	Infrastructure	26.0	41.7	46.2	39.9	26.6	0.3	4.1	10.9	13.6
	Other public sector	31.6	34.7	36.7	42.7	33.5	16.9	9.5	-5.7	-7.6
	Industrial	11.8	-15.0	-0.1	14.8	36.2	-1.1	-2.8	-4.2	-22.5
	Commercial	-1.7	-30.1	-19.1	-8.2	10.0	16.2	2.5	2.8	-0.3
	Repair and maintenance	-3.4	-10.3	-9.0	-0.9	-5.6	2.1	8.7	1.0	1.3
	Total work	8.2	-7.9	-0.7	10.0	12.7	10.9	8.1	3.1	0.2
		2010	09Q4	10Q1	10Q2	10Q3	10Q4	11Q1	11Q2	11Q3
16-Feb	Housing (000's of dwellings) <i>England</i>									
	Private Housing Starts (000s)	78.8	18.6	18.9	21.6	19.9	18.4	19.3	18.5	19.2
	<i>percentage change</i>	29.7	44.8	76.7	57.1	11.9	-0.7	2.3	-14.5	-3.4
	Social Housing Starts (000s)	23.3	5.6	5.7	7.1	6.0	4.6	6.4	5.1	4.2
	<i>percentage change</i>	25.6	23.2	49.1	73.7	16.5	-17.2	13.5	-27.3	-30.4
	Private Housing Completions (000s)	81.3	22.4	20.5	20.8	22.1	17.9	21.5	20.6	20.4
	<i>percentage change</i>	-12.9	-10.3	-16.6	-12.0	-2.6	-20.2	5.0	-1.1	-7.7
	Social Housing Completions (000s)	22.3	5.9	5.8	5.8	5.0	5.8	7.3	6.7	5.8
	<i>percentage change</i>	-14.7	-16.6	-6.6	-11.0	-33.8	-2.9	26.4	16.5	15.5
		2010	09Q4	10Q1	10Q2	10Q3	10Q4	11Q1	11Q2	11Q3
	Material Deliveries									
	Ready-Mix Concrete	-0.2	-23.0	-7.1	5.0	5.6	-5.0	15.0	2.3	2.0
	Concrete Roof Tiles	9.8	2.6	6.8	25.1	8.5	-1.4	16.4	-10.7	1.6
		2010	Apr'11	May'11	Jun'11	Jul'11	Aug'11	Sep'11	Oct'11	Nov'11
	Builders Merchants Sales	-4.0	-4.9	-2.3	-5.3	-6.7	-6.5	-5.4	-5.6	-
	Bricks	6.8	-6.4	1.5	10.7	2.5	13.4	12.7	-0.4	-
	Concrete Blocks	2.2	-12.9	-1.6	-2.5	-8.0	1.3	1.4	6.1	-
	Steel Output	-1.6	-7.2	-5.5	4.6	7.9	-3.8	-4.0	-0.5	-9.7

N.B. Monthly interest rate figures are bank base rates at the end of the month.

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