RIBA Quarterly Economics Report

The Architectural Market

Summer | 2023

RIBA

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Contents

Introduction

This economic report brings together information from a range of primary sources. It aims to help practices place their work within a broader economic context.

While the widely forecast recession has not appeared, the central view is that the UK economy will perform weakly in 2023.

The architects' market, the construction sector, and the wider economy are all coming under increased pressure from stubbornly high inflation and subsequent rises in interest rates, rate rises that make project financing more difficult for both domestic and commercial clients.

Forecasts for the construction industry suggest contraction this year, but a return to growth in 2024.

The RIBA is always here to offer help and advice where it can. The RIBA Business Resilience Roadmap and regular Professional Features provide helpful information on navigating challenging times.

RIBA Future Trends Index now stands at

+2

The UK Economy

UK Gross Domestic Product

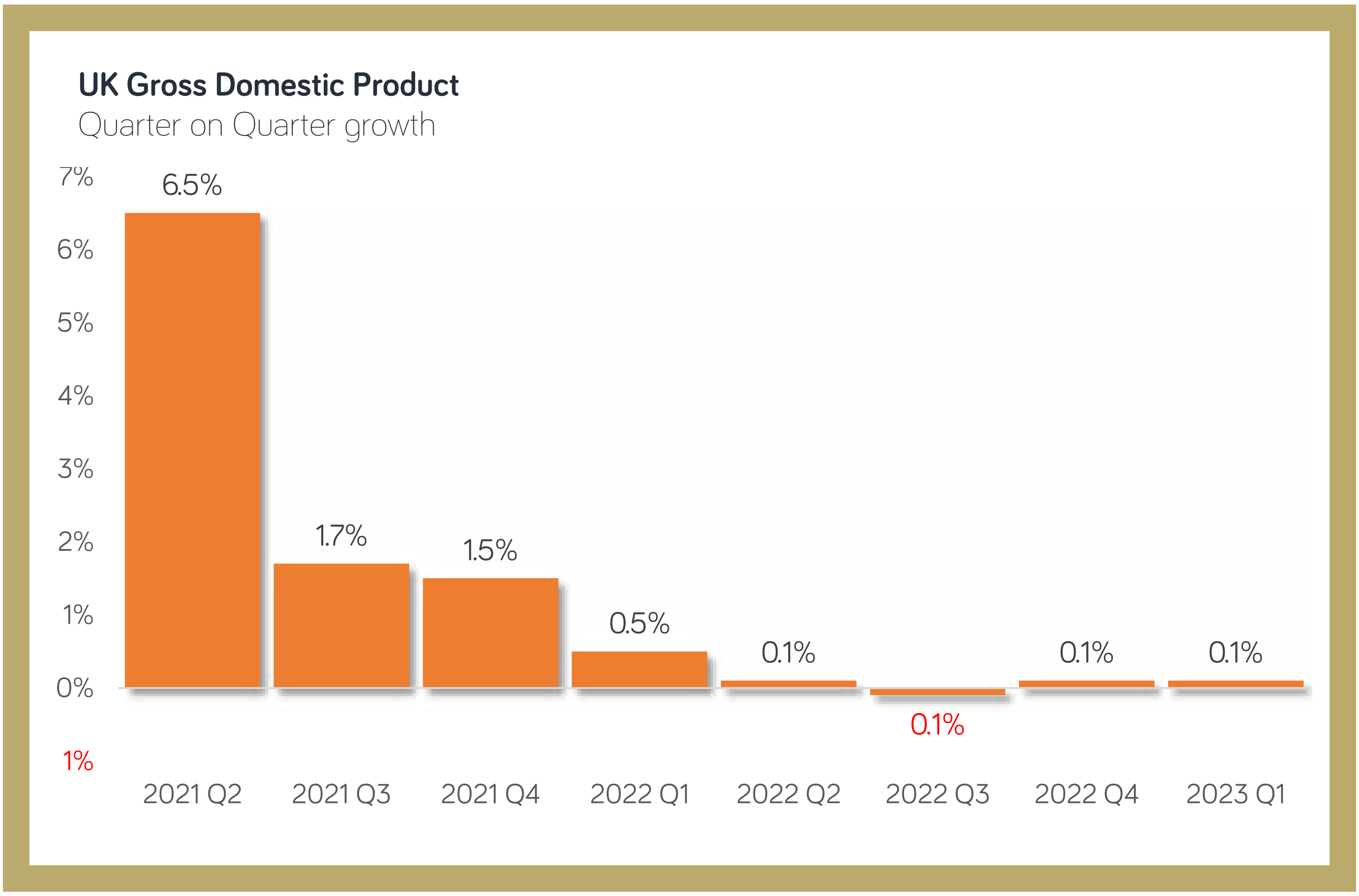
The UK economy continues to perform poorly and inflation remains stubbornly high. Increases in interest rates are eroding household incomes for many, and making project financing more difficult.

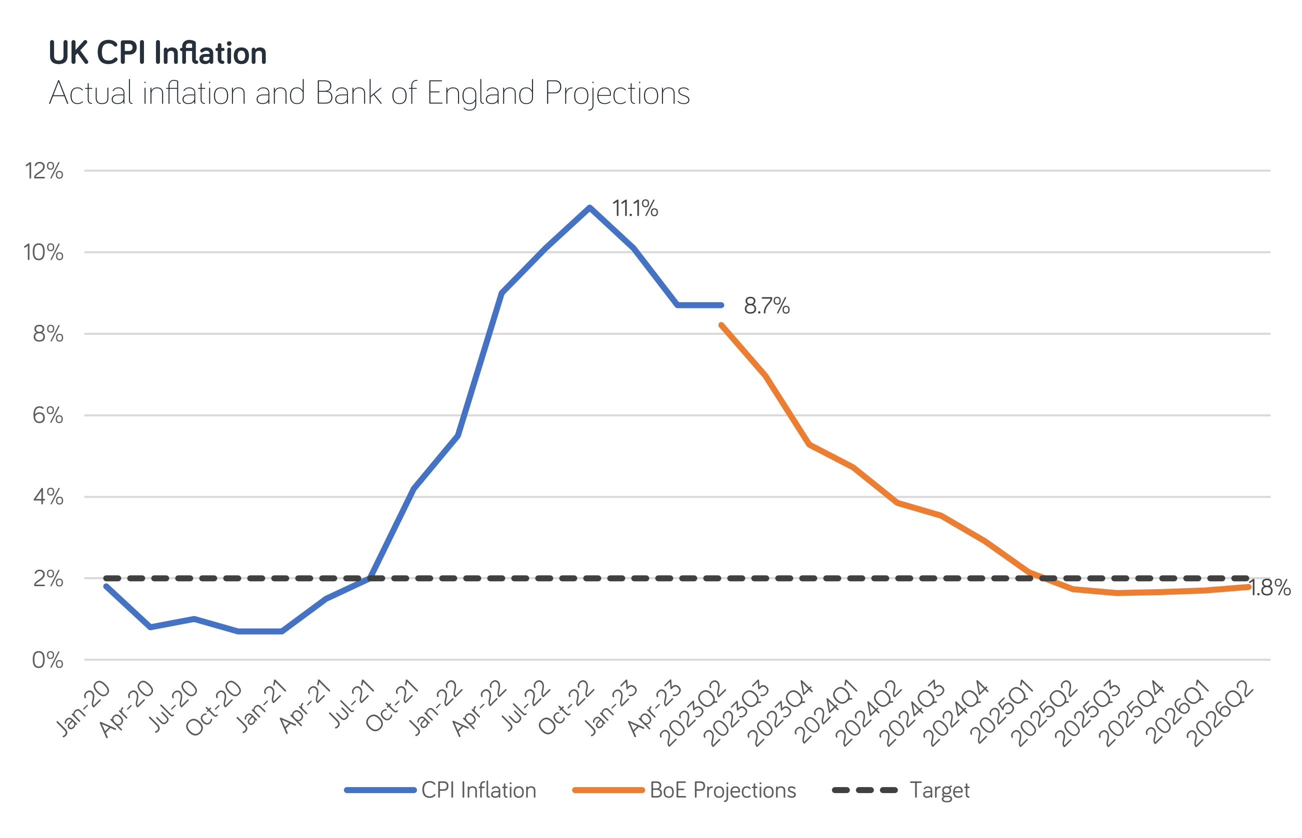
In the last four quarters (to Q1 2023) UK GDP has, on average, grown by just 0.05% per quarter. Monthly GDP growth has picked up slightly, however, with a 0.2% increase in April, following a 0.3% fall in March.

Inflation remains the stand-out economic challenge. The twelve-month CPI inflation peaked at 10.1% in March, fell to 8.7% in April and remained unchanged in May. Whilst falling, UK inflation is falling less quickly than forecast by both the Bank of England (BoE) and the Office for Budget Responsibility and is the highest among the G7 economies.

Construction output inflation continues to be high, with an 8.5% increase in output costs in the 12 months to March, although this is down from the peak of over 10% in mid-2022. Indications suggest it is on a downward trajectory.

With CPI inflation at 6.7% above the BoE's 2% target rate, the Bank has been responding with successive interest rate rises. The base rate now stands at 5% with the next review to come in August. Increased interest rates mean that mortgages are becoming less affordable, financing capital projects is increasingly expensive, and the wider economy is suppressed.





UK Quarterly CPI: Source ONS and Bank of England

In their last full forecast (in May), the Bank of England (BoE) noted that the economy performed better than had been anticipated, meaning that the previously forecast recession has been avoided. While growth in the first half of 2023 is set to be negligible, it will accelerate somewhat, remaining positive throughout the Bank's projection, to Q2 2026. Nevertheless, UK growth remains set to be subdued by historical standards, and among the weakest of the developed nations.

The Bank of England's central forecast is for growth from 2022 to 2025 is:

0.0% in the year to Q2 2023

0.9% in the year to Q2 2024

0.7% in the year to Q2 2025

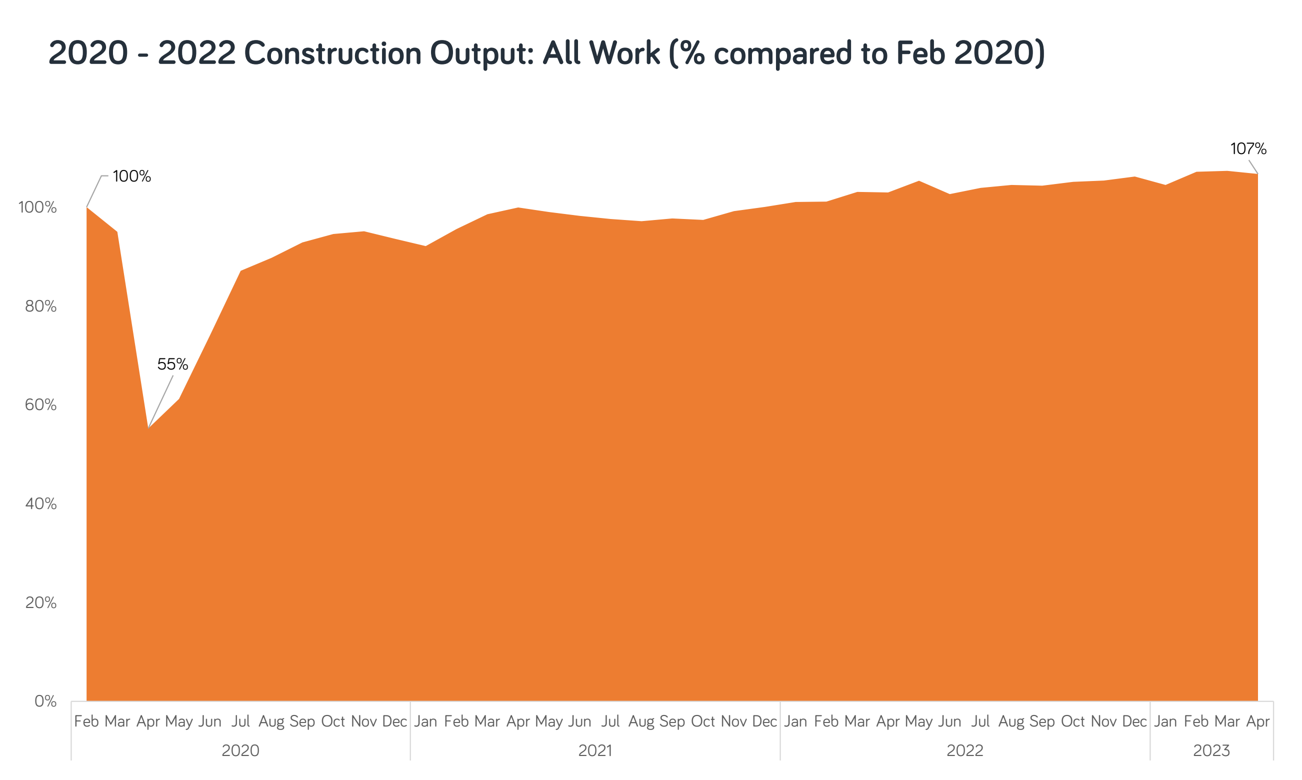
1.1% in the year to Q2 2026

Inflation has proven more persistent than previously projected, although the Bank suggests that it will begin to fall quickly this year and reach the 2% target by the first half of 2025. Early signs are that inflation is falling, but less quickly than the Bank has projected.

Significant falls in Energy Prices are feeding through to this fall in inflation. Food price inflation is projected to fall further in the coming months. However, inflation in services is expected to remain high throughout this year. Annual growth in private sector Average Weekly Earnings remains high but below CPI inflation, at 7.6%.

As in the previous report, these economic models and forecasts remain highly uncertain. It is clear, however, that UK growth will be weak and inflation will fall, although less quickly than needed and previously projected.

Construction Output



Percentage Change in Construction Output, source ONS

The latest data from the ONS suggests the construction industry continues to come under pressure from a weak general economy and the effects of rising interest rates. The ONS note anecdotal evidence of a continued slow-down in the private housing sector especially, as customers become hesitant to commission work, partly because of rising interest rates and economic uncertainty.

In the latest month for which data is available, April 2023, monthly ONS estimates construction output to have decreased by 0.6%, following two months of consecutive growth. Taken together, the three months to April 2023 saw a 1.6% increase in output.

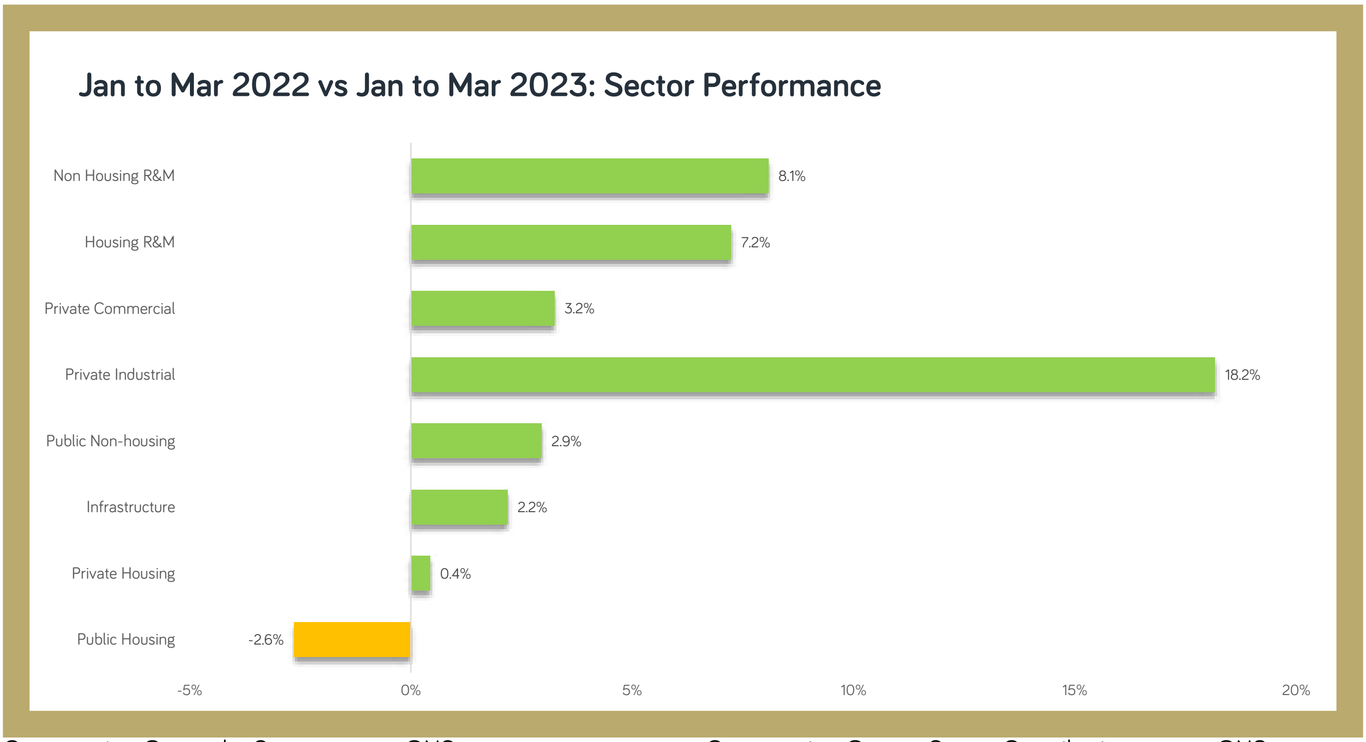
The sectors to make the biggest contribution to the monthly fall were private housing repair and maintenance, and private housing new work. They decreased 5.7% (£149 million) and 3.0% (£99 million), respectively.

Taking a longer view, construction output was 5.7% higher in the 12 months to April 2023 than in the 12 months to April 2022. Output in April 2023 is 7% higher than in pre-pandemic Feb 2020.

Total construction output in April 2023

7%

higher than in Feb 2020



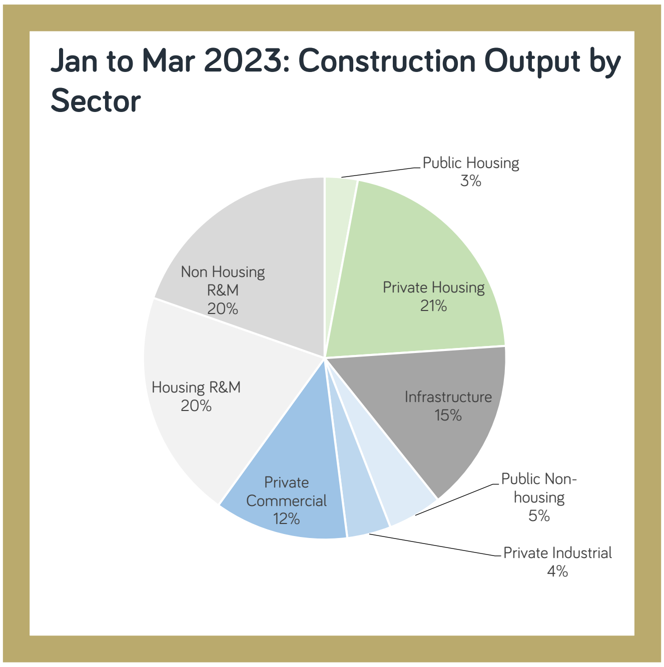
Construction Output by Sector, source ONS

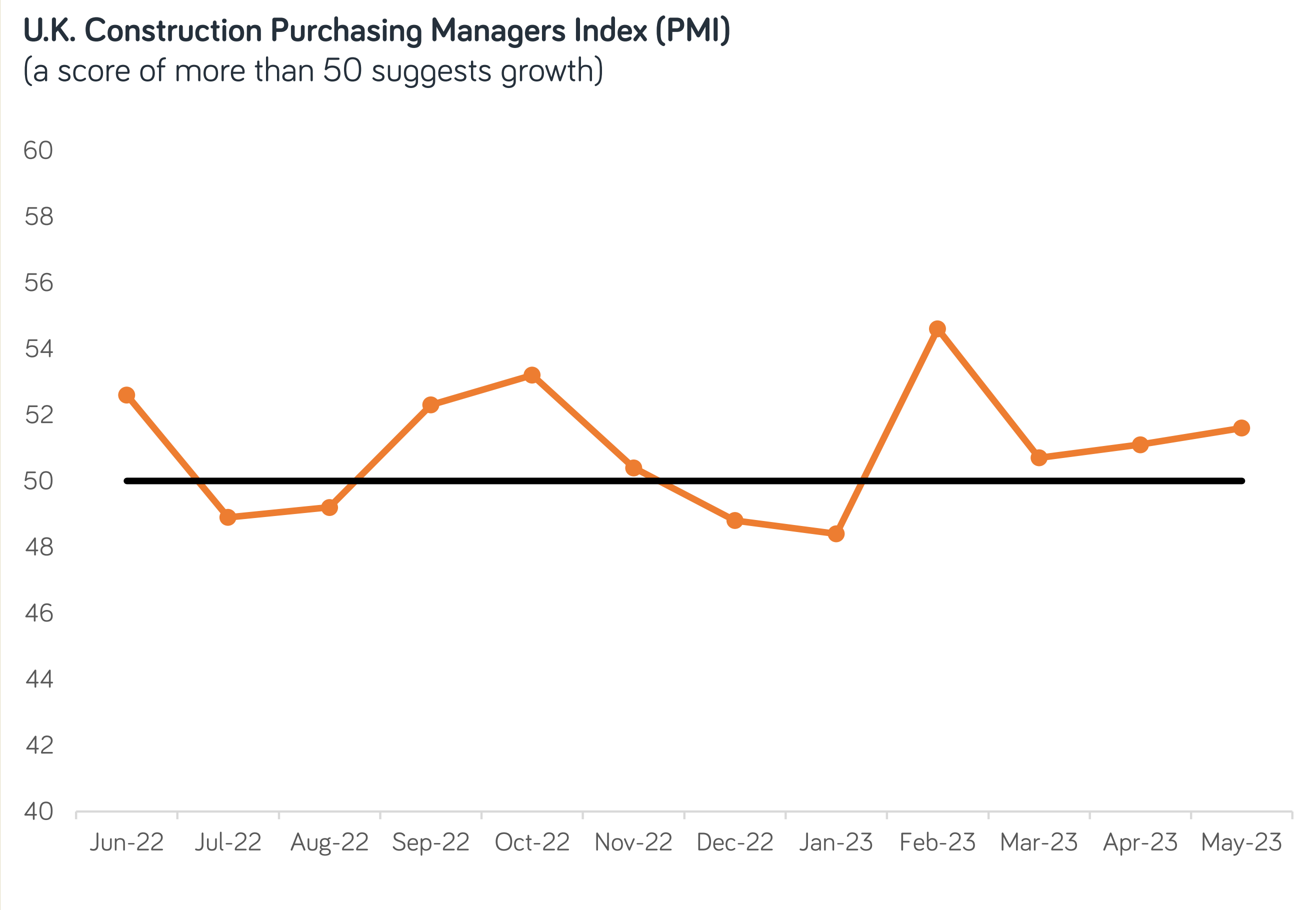
Comparing January to March 2022 with the same period in 2023, Private Industrial has again been the best-performing sector. In part, this has been driven by rising demand for warehouses as retail shifts from high street to online. The Repair and Maintenance (R&M) sectors have also seen growth. There has also been quarter-to-quarter comparative growth in the Commercial, Public Non-Housing (including schools and hospitals) and infrastructure.

Amid an ongoing housing crisis, the two sectors to perform the least well are public and private housing, with the former showing just 0.4% comparative growth and the latter contracting by 2.6%.

Looking at the overall mix of the construction sector (with a total output value of around £180Bn in 2022), Private Housing makes up around a fifth of the total value, as do both housing and non-housing R&M. Infrastructure (15%) and Private Commercial (12%) are the other two large sectors. Together, Public Housing, Private Industrial, and Public non-housing account for 12% of the industry's output by value.

Construction Output, Sector Contribution, source ONS





Construction PMI, source S&P Global / CIPS

Confidence in the Construction Industry

S&P Global / CIPS monitors activity in the UK construction sector through its monthly Purchase Manager's Index (PMI). A PMI score of over 50 indicates growth since the previous month, and a score below 50 indicates comparative contraction.

The May 2023 PMI Index was above the 50.0 no-change mark, for the fourth successive month, with a balance score of 51.6 in May, up from 51.1 in April.

On balance, construction firms are seeing a slight upturn in overall UK construction output, driven by increases in commercial building and civil engineering activity.

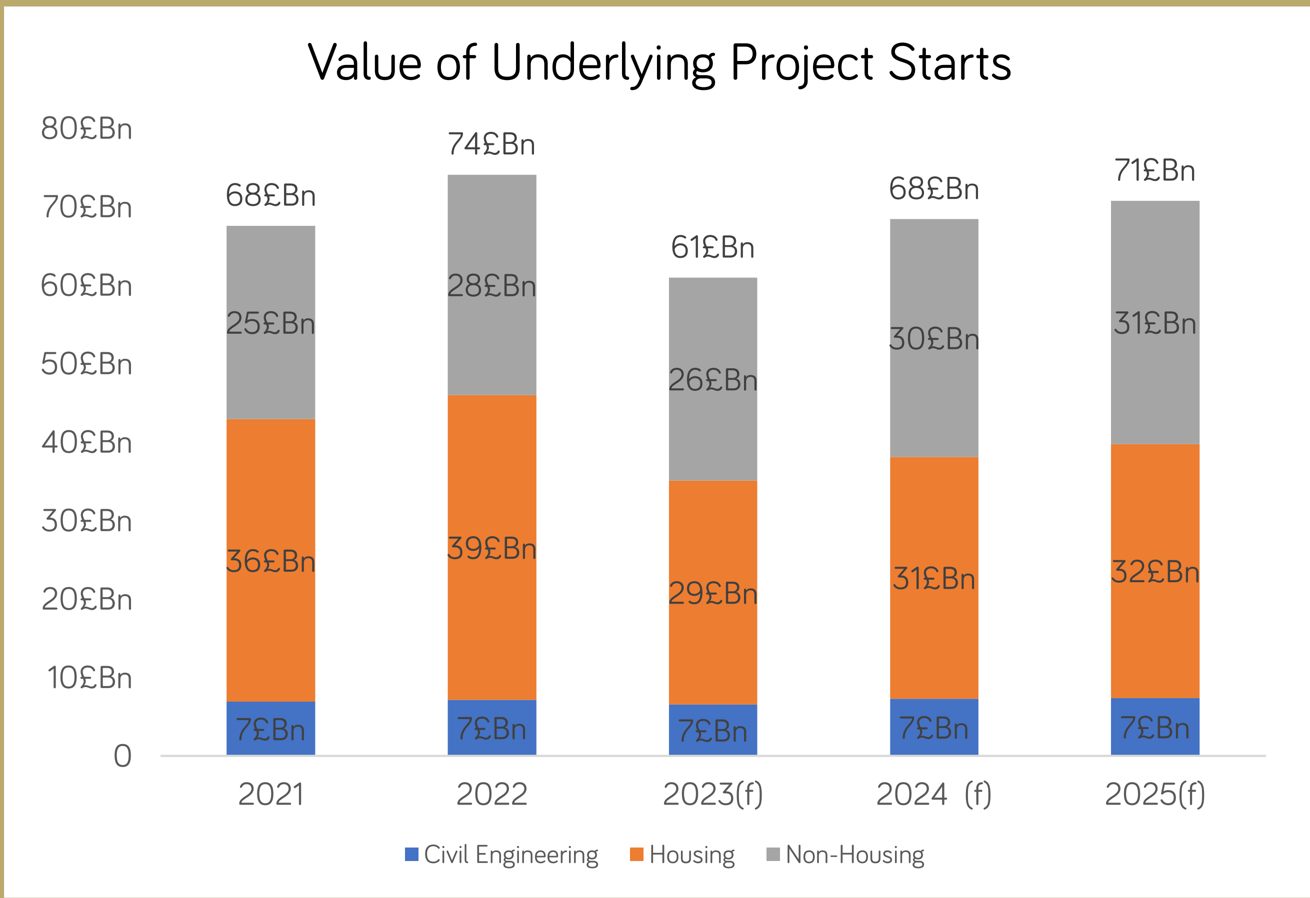
However, concerns about the effects of rising interest rates and weak economic conditions continue to subdue the housing market, with the PMI indicating that work on residential building projects decreased for the sixth month, and is declining at the steepest pace for three years.

After an extended period of rapid cost increases and supply constraints for construction products, conditions are improving. May saw PMI highlight the greatest improvement in vendor lead times since August 2009. In turn, this has reduced cost pressures, with the overall rate of input price inflation easing to its weakest for two and a half years.

S&P Global / CIPS continues to note an industry that is optimistic, but whose optimism is waning.

"Around 45% of the survey panel expect an increase in output levels, while only 14% predict a decline. That said, the degree of positive sentiment slipped to a four-month low in May. Survey respondents suggested that concerns about the UK economic outlook and the impact of rising interest rates were the main factors holding back growth projections in May."

Construction Output: Future Projections



Construction Output: source Glenigan

The Glenigan Construction Industry Forecast 2023-2025 provides a view of the performance of the industry based on the value of project starts (rather than output value) and excludes projects with a value greater than £100m.

The Glenigan forecast suggests that the value of project starts will fall by 18% in 2023 when compared to 2022, but will recover by 12% and 3% respectively in 2024 and 2025. The value of project-starts in 2025 (£71Bn) will be less than that of 2022 (£74Bn).

The Private Housing sector will be the worst affected, with a fall in the value of project starts of 33%, as the market is affected by weak household earnings and higher mortgage rates.

Other sectors will have a difficult 2023 with falls for Retail (-25%), Offices (-11%), Hotel and Leisure (-9%), and Health (-17%). All sectors are anticipated to return to growth in 2024. Only Education is expected to grow in both 2023 and 2024: 22% and 12% respectively.

Value of Project Starts 2023:

-18%

Glenigan

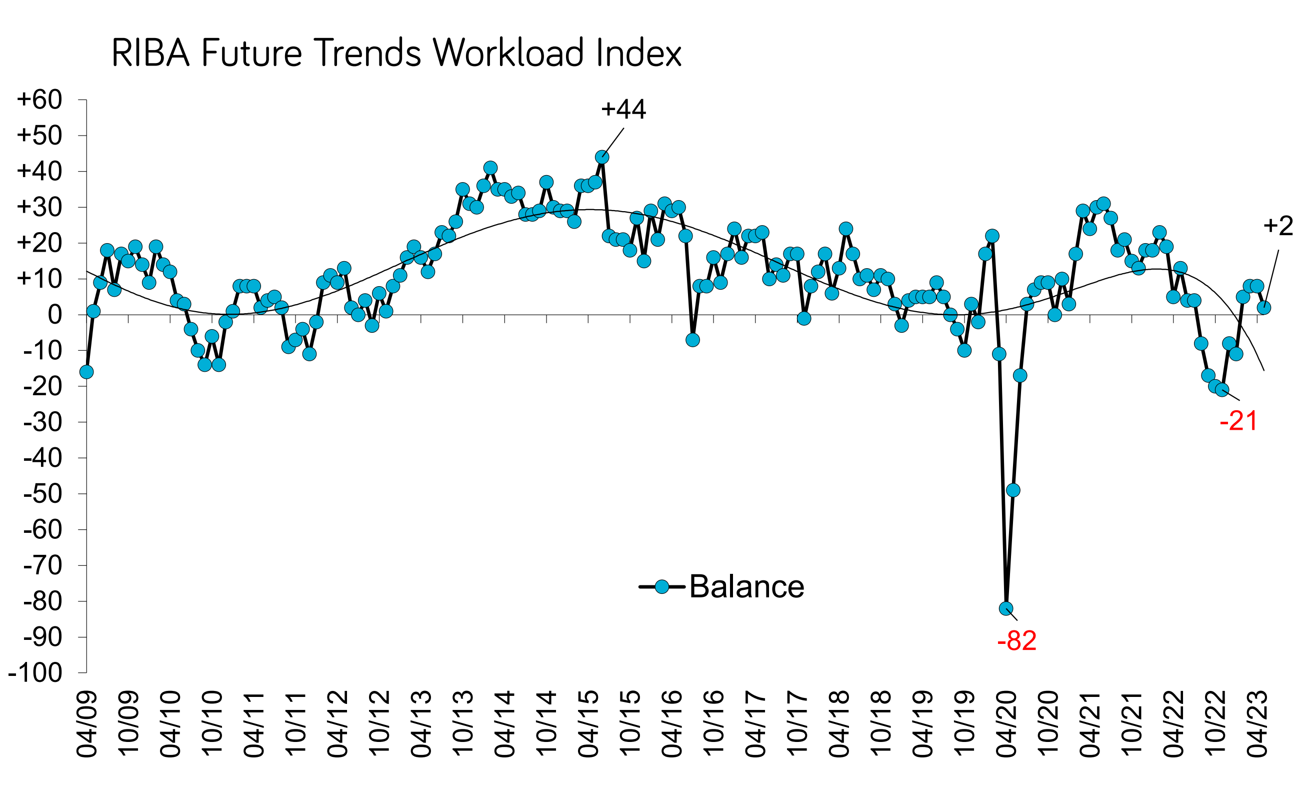
Architectural Workload

RIBA Future Workload Index*

The second quarter of 2023 has seen architects remain optimistic about future workloads, but that confidence has shown early signs of waning. After six months of a negative outlook in the second half of 2022, the RIBA Workload Index returned to a positive figure in February 2023 (+5). It has now been positive for four months, reaching a peak of +8 in March and April. May saw confidence dissipate somewhat, as the Index fell by 6 points in May, to +2.

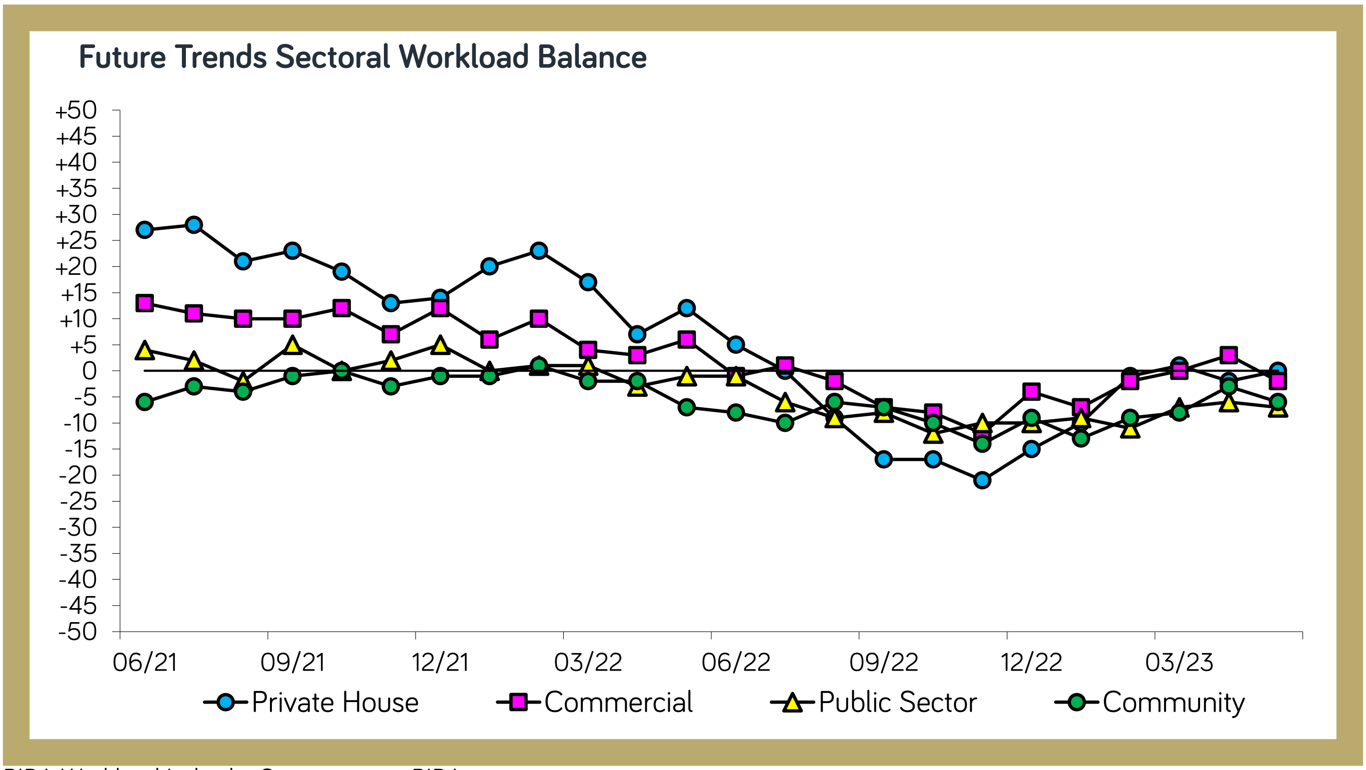
The most positive outlook for future work is among Medium and Large-sized practices, with smaller practices tending to be more pessimistic.

The 2023 Future Trends reports can be seen here.



*The RIBA Future Workload Index figure is the difference between those expecting more work and those expecting less.

Architectural Workload Index* by Sector



RIBA Workload Index by Sector, source RIBA

All four work sectors monitored through RIBA Future Trends have weakened slightly this quarter, after a brief rally in the first quarter of 2023.

The **Private Housing Sector**, having been the stand-out sector through and beyond the pandemic, has been weak for the last year. The housing Index slipped from positive territory in July 2022 and has returned a zero or negative Index for all but one month since then.

With low household disposable income, increased mortgage rates, reduced mortgage availability, and a likely fall in house prices, the sector is likely to underperform for the remainder of the year. However, anecdotal evidence from architects suggests that the high-end residential sector, whether new-build or refurbishment, is largely unaffected by the current economic turbulence.

Workload predictions for the **Public Sector** remain weak, with the sector Index being negative for over a year. Nevertheless, there is a significant unmet need for spending in the public sector, notably in the Health and Education sectors. The Department of Education is expected to support investment in schools, many of which are in urgent need of refurbishment or rebuilding. For Health, the coming years should see increased capital investment, although the immediate focus may be on current spending, to stabilise or reduce waiting times.

Architects' assessment for future work in the **Commercial Sector** sector remains weak, with the sector Index being negative or zero for 9 of the last 10 months, currently standing at -2.

Within the Commercial sector, the Office sector faces weak near-term prospects, in the context of high interest rates and low economic growth. However, the office refurbishment sector may remain healthy as offices continue to adapt to hybrid working and seek to reduce carbon emissions.

The Retail, Hospitality, Culture and Entertainment sectors are all likely to face a challenging few months as consumer spending falls, staff remain difficult to recruit, and people turn to online media for shopping and entertainment.

The **Community Sector** includes work for not-for-profit organisations; work with churches, charities and trusts, for example. With ongoing financial pressure within the sector, the workload index figure remains low and currently stands at -9. On balance, practices have been expecting a falling workload in the sector for 12 months.