RIBA Quarterly Economics Report

The Architectural Market

Spring | 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.

The central view is still that the UK economy will perform weakly in 2023, however, there is a growing consensus that a recession will be avoided.

The months leading up to this report have seen the UK's historically high inflation rate begin to peak, and political and economic uncertainty recede. Economic indicators are starting to improve. The outlook from practice and the wider construction industry is becoming more optimistic. 2023 will not be a year of rapid growth and will be difficult for many. But it will perhaps be less challenging than feared.

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

+5

The UK Economy

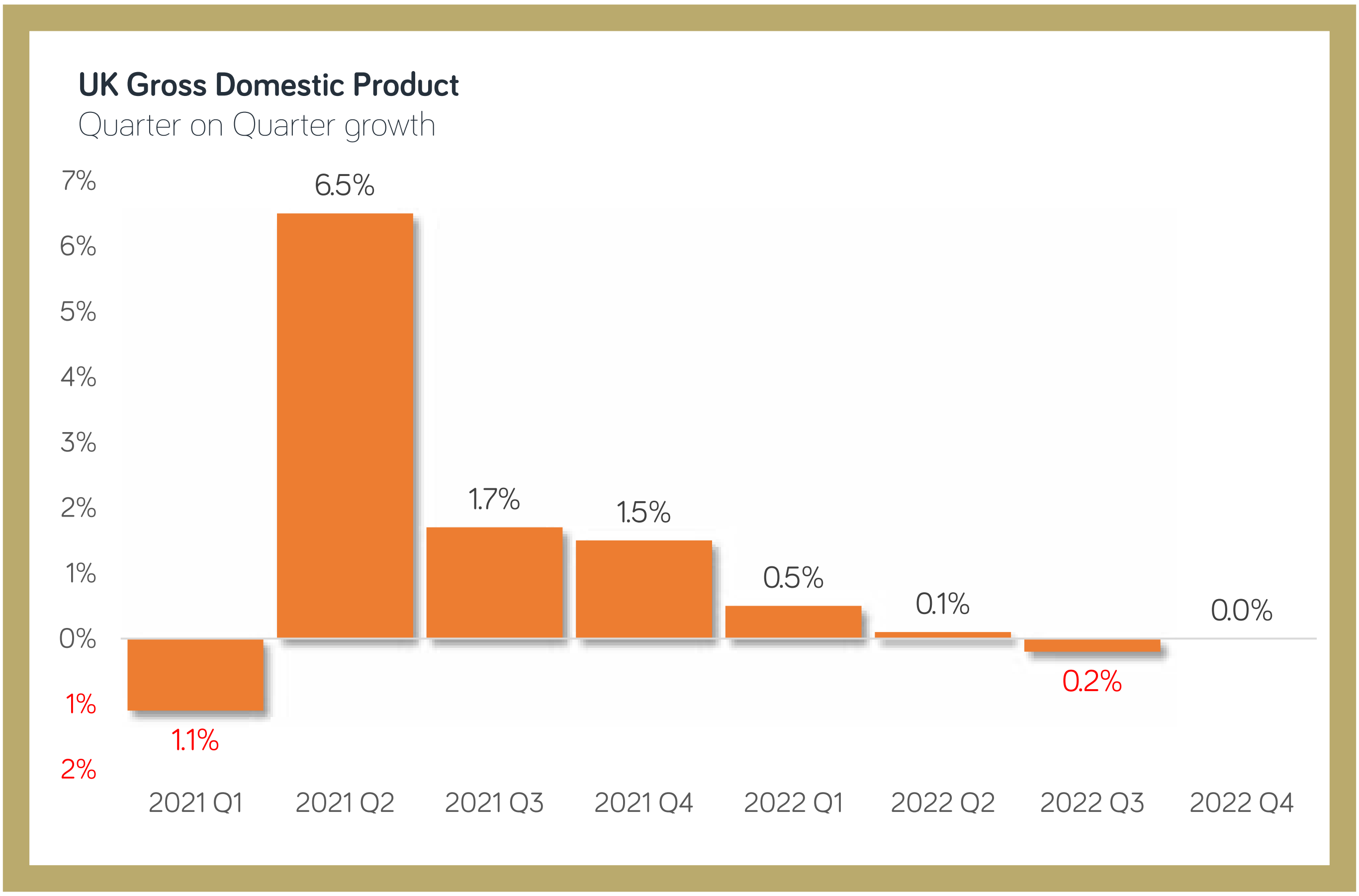
UK Gross Domestic Product

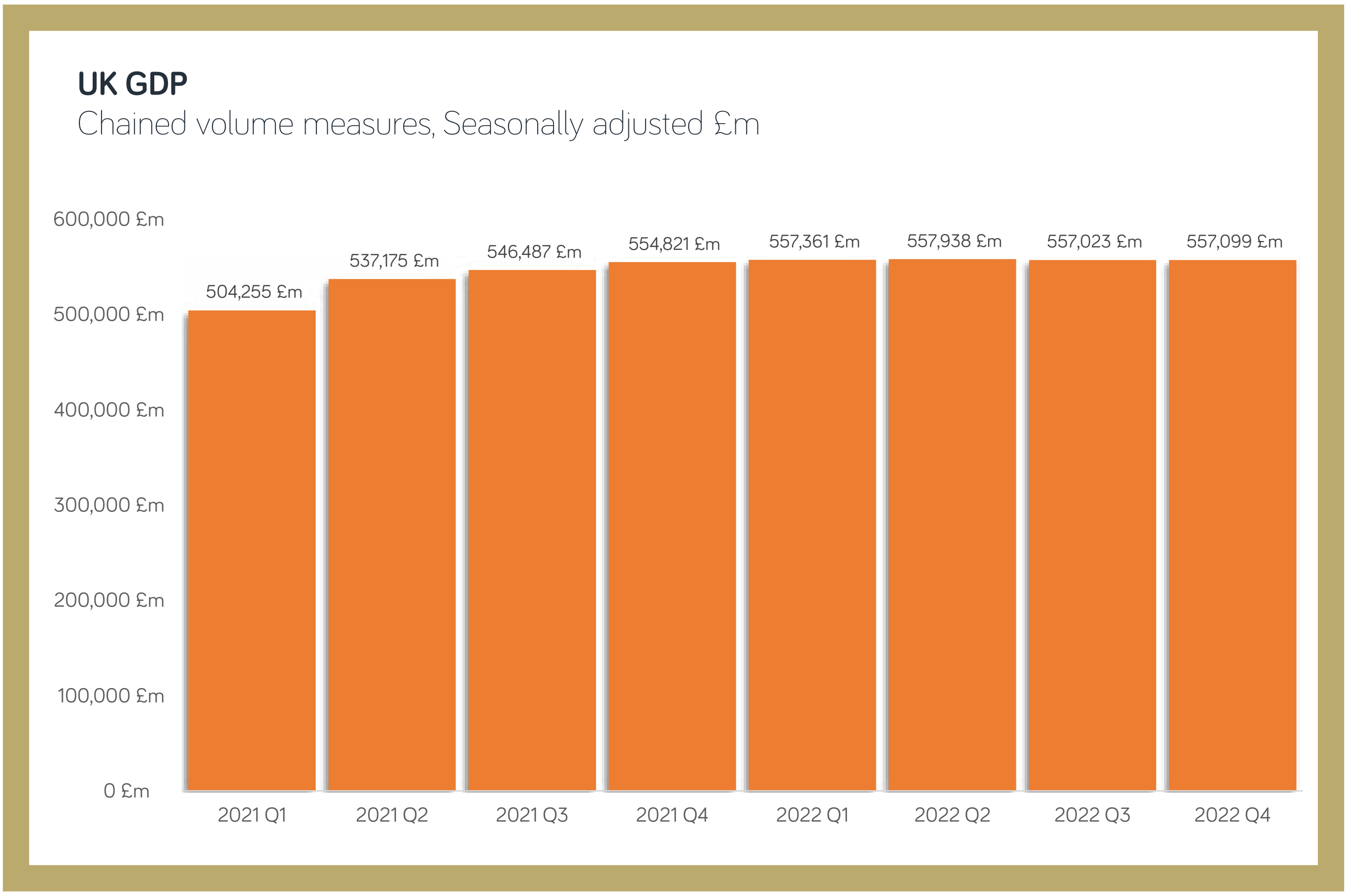
Since our last report, the UK economy has avoided falling into recession, with Q4 2022 showing no, rather than negative, growth. Economic indicators have generally been less bad than anticipated and are improving. The period of high economic uncertainty that accompanied the Truss premiership has passed and a greater degree of stability has returned.

Nevertheless, with three successive quarters of economic stagnation, the UK economy is performing comparatively poorly. Both the IMF and the Bank of England (BoE) anticipate the UK's economy contracting slightly in 2023, with a shallow recession remaining possible.

Inflation remains exceptionally high and continues to be driven by the cost of energy. The Consumer Prices Index (CPI) stood at 10.4% in February, an unexpected increase from January's figure. Construction output prices are rising too, with a 9.7% increase in the 12 months to December.

The Bank of England continues to deploy successive interest rate increases to limit and reduce inflation. The current BoE base interest rate is 4.25%, the highest its been since 2008. Higher interest rates will put a break on consumer and business spending, so dampening inflation and economic output.





UK Quarterly GDP Value, Source ONS

In their last full forecast (in February), the Bank of England (BoE) forecast that a recession would start in early 2023 and the economy would continue to contract until the latter half of 2024.

However, following better-than-expected global economic performance and the extended fiscal support announced in the Spring Budget, the BoE now expect a recession to be avoided. After an expected flat Q1 2023, the BoE anticipate modest growth in Q2 2023.

BoE modelling suggests CPI inflation is now at or near its peak, and will fall quite rapidly through this year, and return to around the target 2% rate in 2024. Wholesale gas futures and oil prices are falling.

However, if inflation remains stubborn, the BoE has indicated its willingness to increase interest rates further.

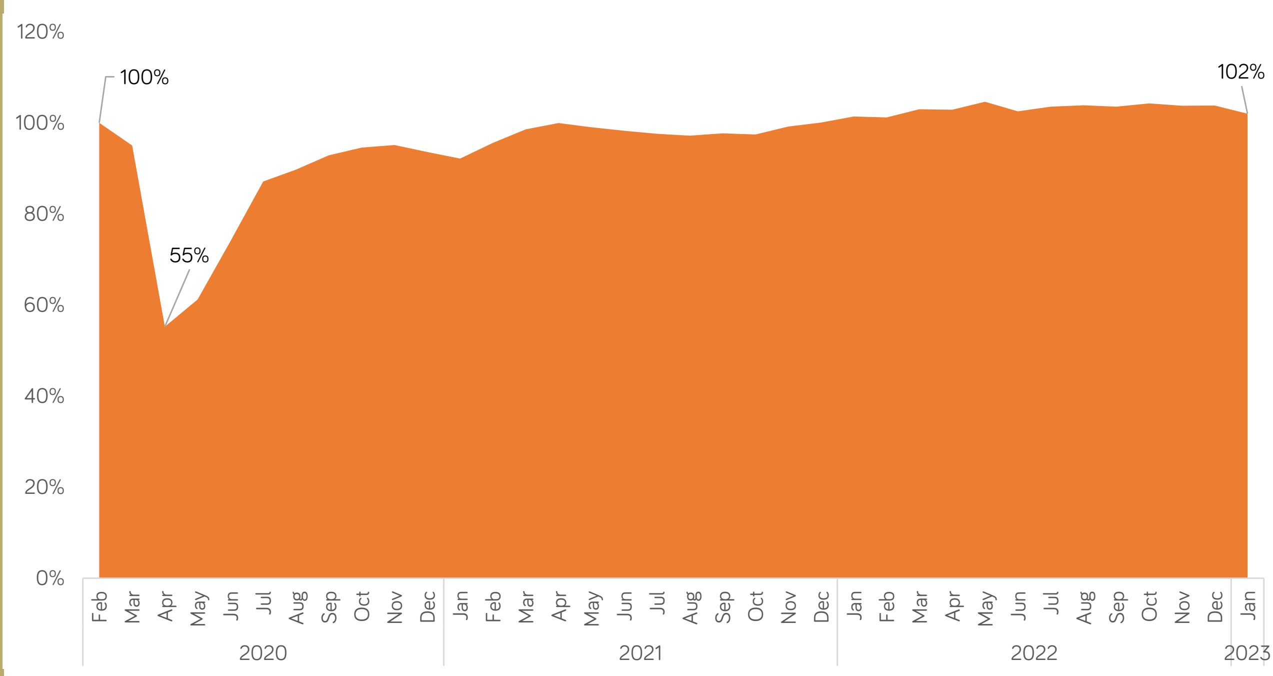
The Office for Budgetary Responsibility (OBR) gives a relatively upbeat assessment of the UK economy's medium-term prospects, with a milder contraction in 2023 (-0.2% growth) followed by 1.8% growth in 2024, 2.5% in 2025 and 2.1% in 2026. Like the revised outlook from the BoE, the OBR's outlook suggests a technical recession of two successive quarters of contraction will be avoided.

These economic models and forecasts remain highly uncertain. In the previous quarter, the trend was for economic indicators to be deteriorating. However, in this quarter they are improving. Indicators of business sentiment are on the up, and these are often early indicators of an improving economy. Whether the UK will avoid a recession is uncertain, but is looking increasingly likely. However, the UK's economy still looks set to grow only weakly in the coming months and perhaps years. It is performing less well than other major economies.

Global banking fragility is a growing concern.

Construction Output

2020 - 2022 Construction Output: All Work (% compared to Feb 2020)



Percentage Change in Construction Output, source ONS

The latest data from the ONS suggests the construction industry is coming under increased pressure, in part due to rising interest rates and economic uncertainty.

Early construction output estimates for January 2023 (£14,841 million) suggest that construction output decreased by 1.7%, the weakest monthly growth since June 2022 and the lowest monthly output value since February 2022 (£14,719 million).

As well as a monthly fall in construction output, the three months to January 2023 saw an overall decrease of 0.7%. This follows four three-month periods of growth.

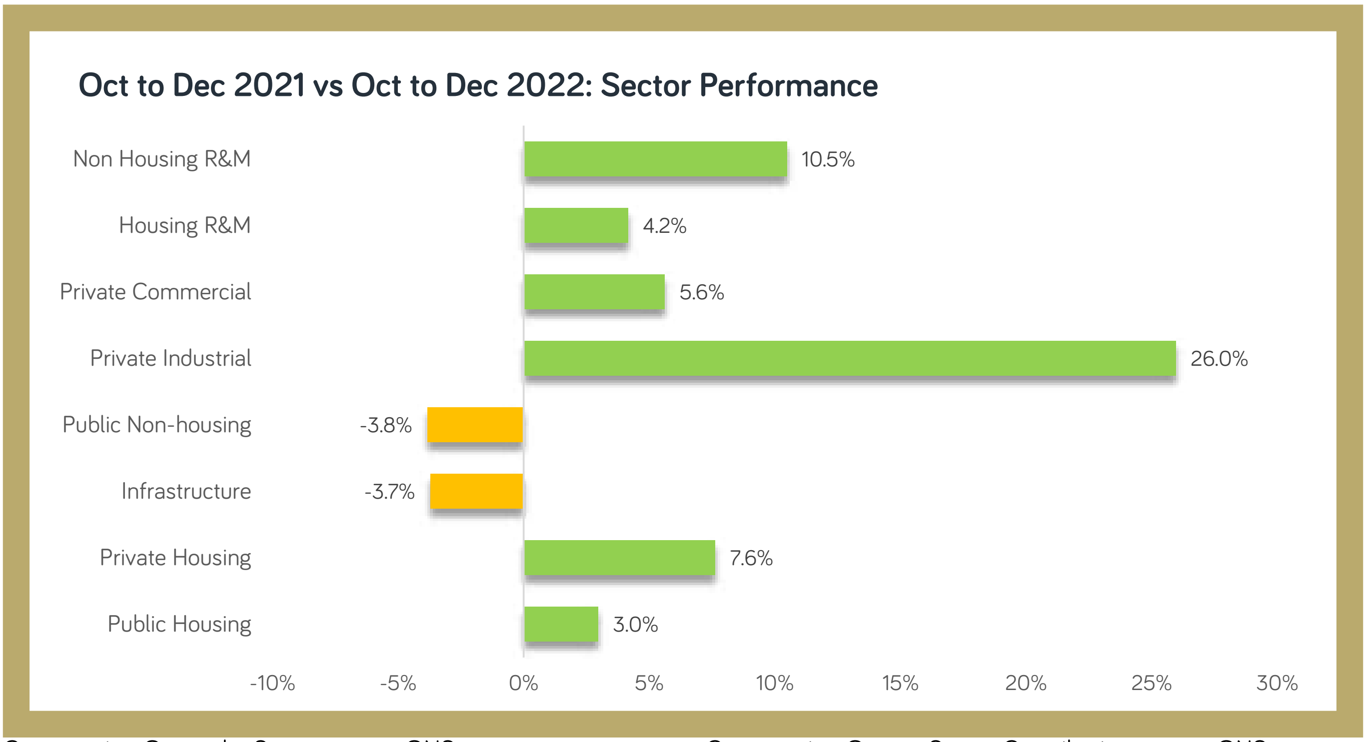
Total construction output in January 2023 is just 2% higher than the pre-pandemic level of February 2020.

New Orders for construction fell by -4.3% in the period from October to December 2022.

Total construction output in Jan 2023

2.0%

higher than in Feb 2020



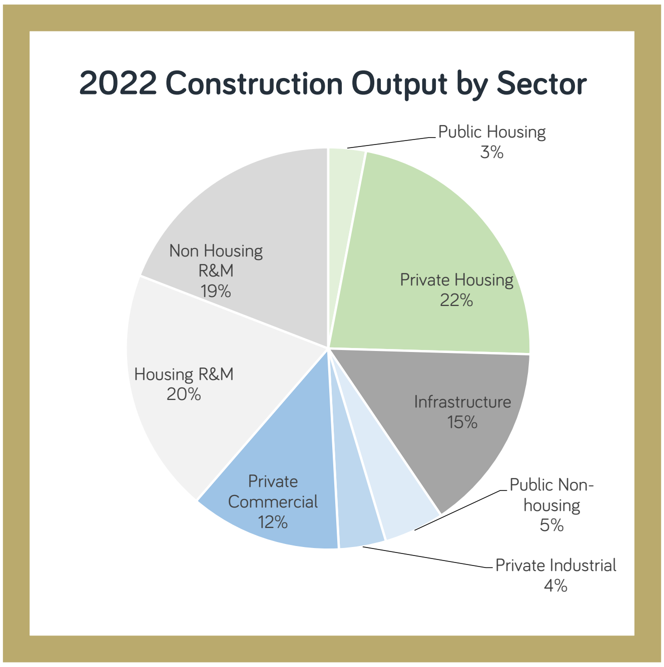
Construction Output by Sector, source ONS

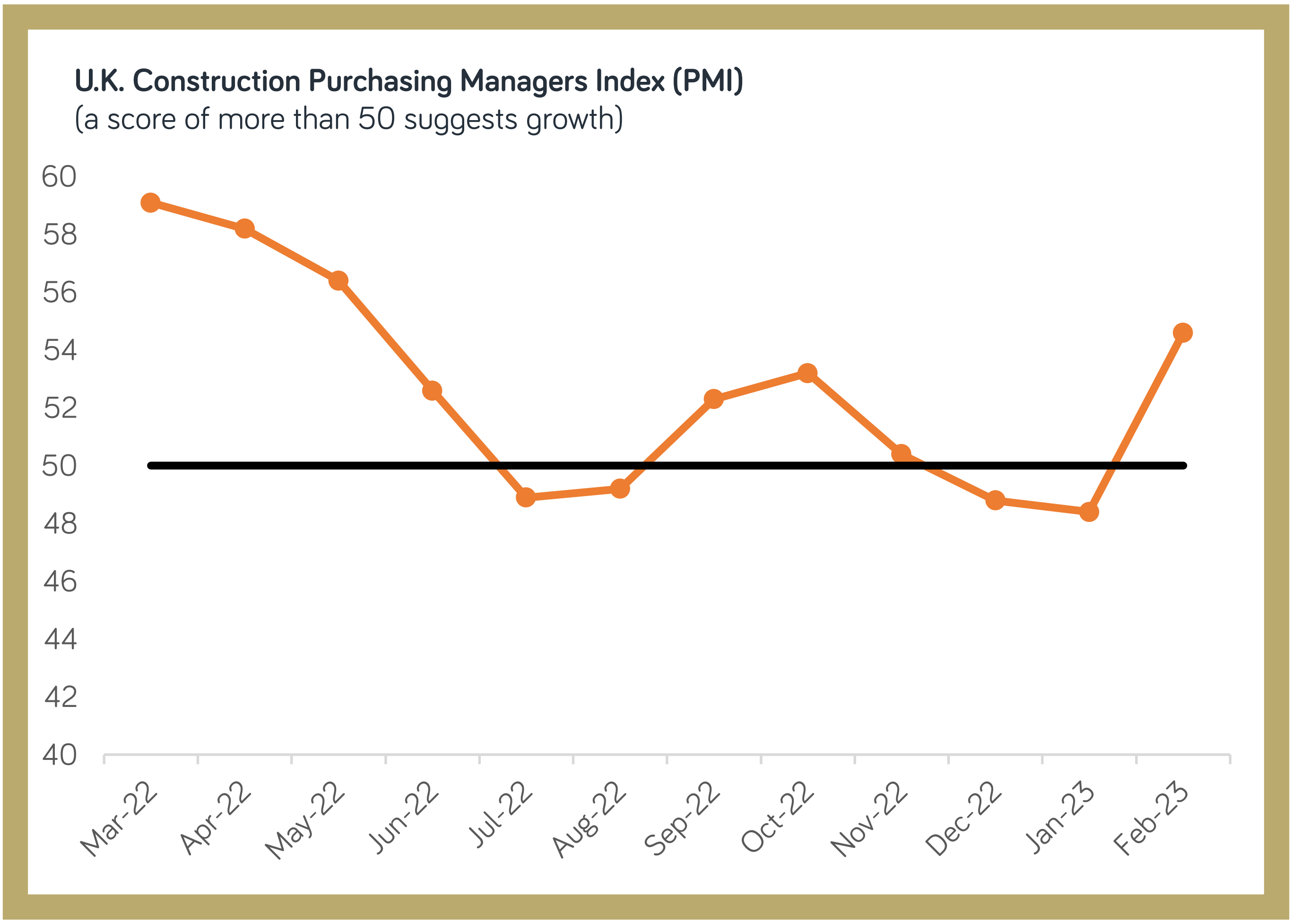
Comparing October to December 2021 with the same period in 2022, Private Industrial has been the best-performing sector. Private Housing, Private Commercial and the Repair and Maintenance (R&M) sectors have also seen growth. Public non-housing and Infrastructure have contracted.

The sectors to perform least well at the start of the year were private new housing and private infrastructure.

Looking at sectoral performance since the onset of the pandemic, private housing R&M has been a stand-out sector, with a 24% increase in the period from February 2020 to January 2023. In contrast, new public-sector construction output (excluding public housing) has fallen by 22% and new private commercial new work by 24%.

Construction Output, Sector Contribution, source ONS





Construction PMI, source IHS Markit

Confidence in the Construction Industry

IHS-Markit 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.

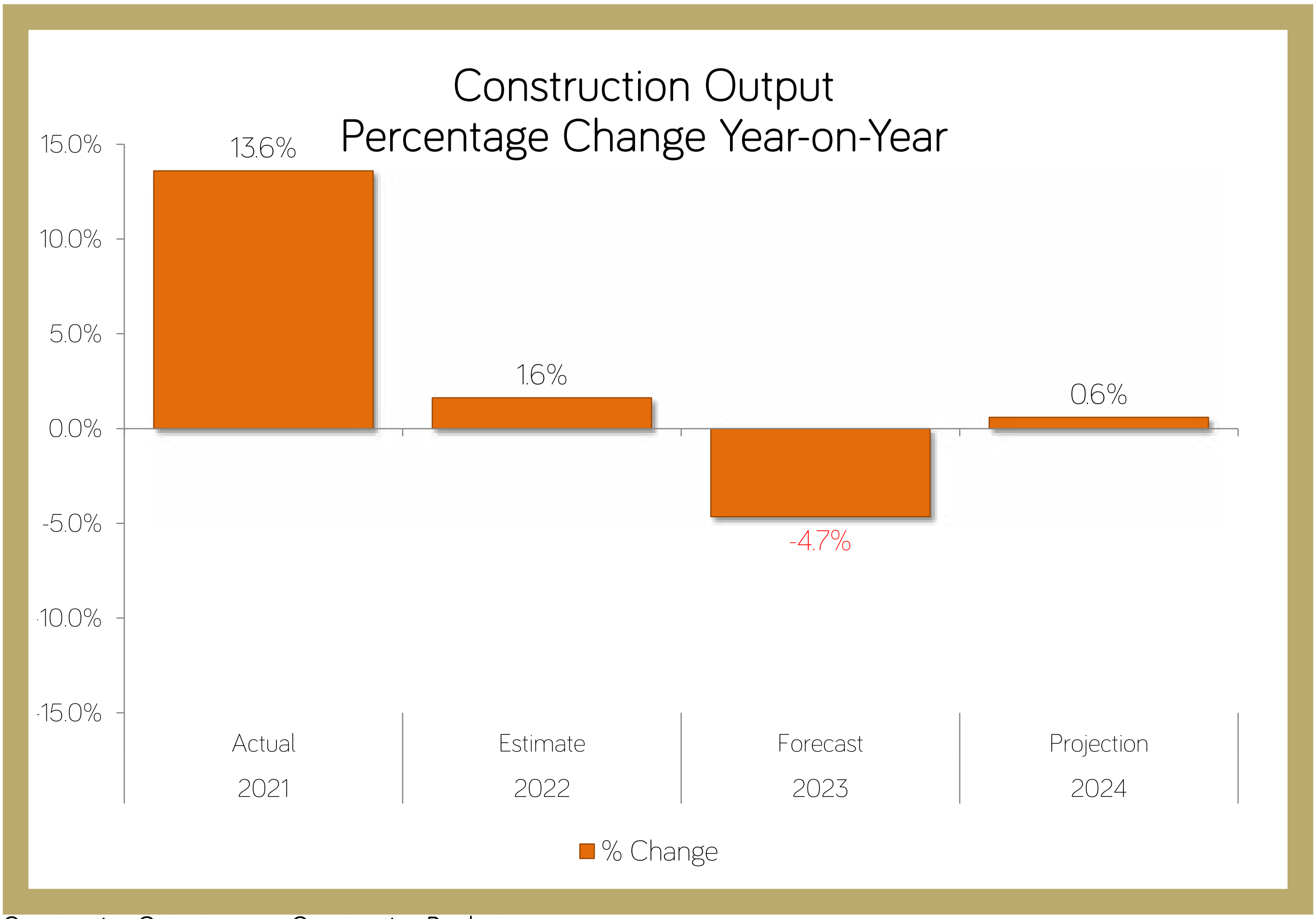
On balance, construction firms are noting early signs of a recovery in client demand, despite increased interest rates and the continued risk of a recession.

The February 2023 PMI Index was above the 50.0 no-change mark, with a balance score of 54.6, up from 48.4 in January, reflecting increased sector confidence. The Index figure was the highest since May 2022, driven by a rebound in commercial work. Housing activity, however, decreased for the third month in a row.

Looking at the wider context, respondents to the PMI survey reported the least widespread supplier delays since January 2020 and a slowdown in input cost inflation. The overall rate of purchase price inflation was the lowest for 27 months in February as construction supply begins to align with demand.

IHS-Markit notes an optimistic prognosis, describing "Business expectations for the year ahead improved further from the 31-month low seen in December 2022. Around 46% of the survey panel anticipate a rise in construction activity over the year ahead, while only 13% predict a decline."

Construction Output: Future Projections



Construction Output: source Construction Products Association

The Construction Products Association (CPA) provide quarterly forecasts of construction output, broken down by sector. Their latest forecast suggests that after two strong years, construction output will fall by 4.7% in 2023 before recovering slowly in 2024 with growth of just 0.6%.

The CPA see a UK economic slowdown affecting construction output and new commissions.

Private Housing repair, maintenance and improvement is a crucial sector for smaller practices. It is likely to come under downward pressure, due to falling real wages, faltering consumer confidence and high construction cost inflation. The commercial sector is set for contraction too. Only the industrial and infrastructure sectors are set for growth in 2023.

As part of our series of Economic Panel events, you can view a detailed discussion between architects, the CPA and the RIBA about what's ahead for the profession and the construction industry: here.

Construction Output 2023:

-4.7%

Construction Products Association

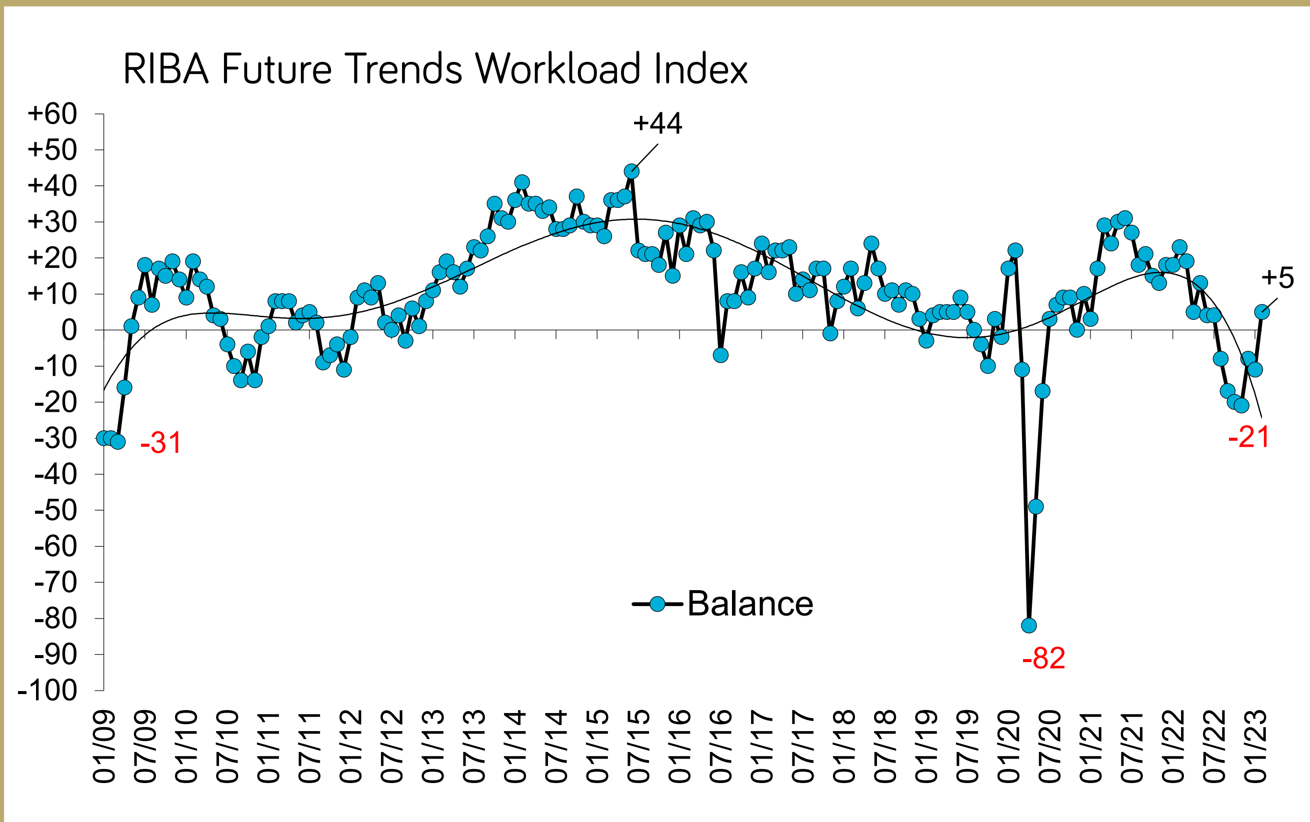
Architectural Workload

RIBA Future Workload Index*

The first quarter of 2023 has seen an uptick in architects' confidence about future workload. After six months of a negative outlook in the second half of 2022, the RIBA Workload Index returned to a positive figure of +5 in February 2023. A positive figure indicates more practices expect workloads to increase rather than contract in the coming three months. Since a post-lockdown low of -21 on November 2022, the Index has risen 26 points.

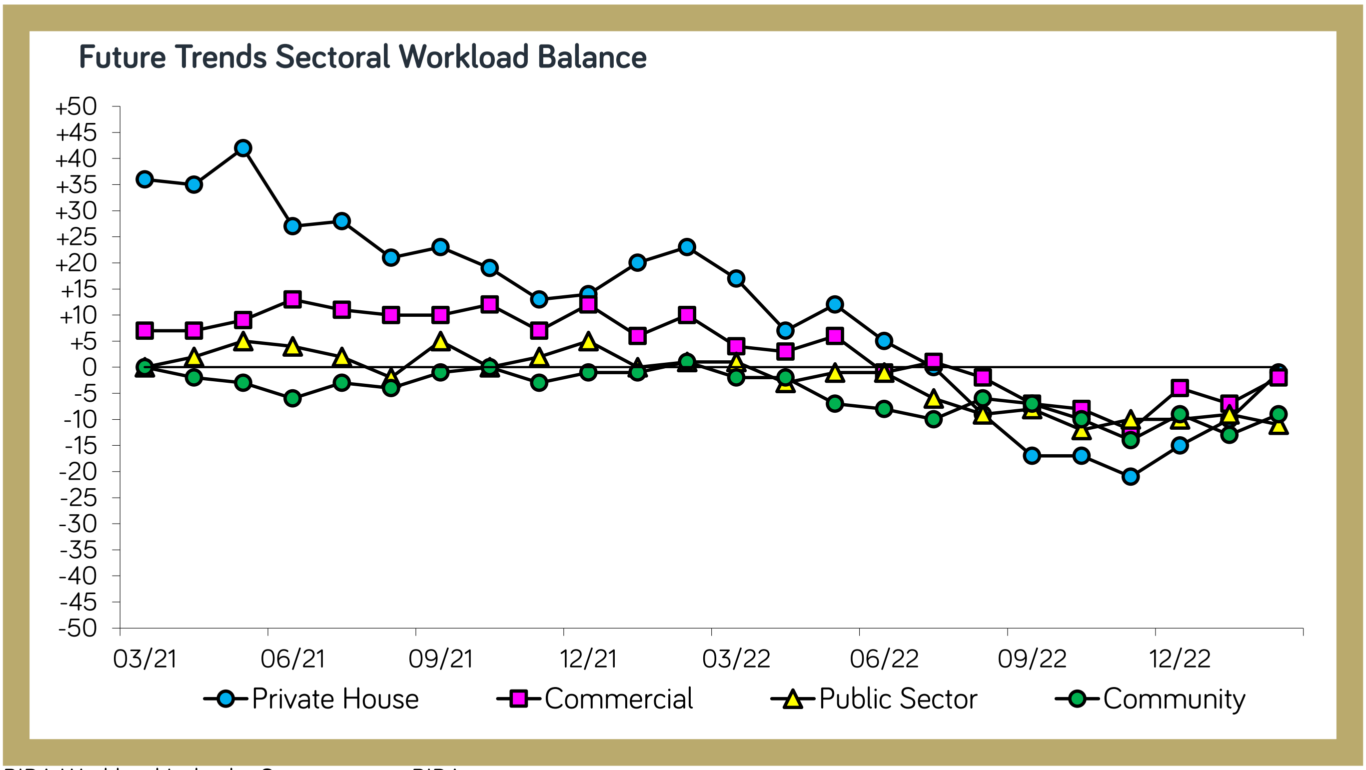
All regions are becoming less pessimistic when compared to last quarter. The most positive outlooks for future work is outside London and the South.

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

Despite remaining in negative territory, in early 2023, all four work sectors monitored through RIBA Future Trends have strengthened. Whilst the negative index scores indicate sectoral workload contraction, the rising index suggests the expectation is that the anticipated contraction in each sector will be less widespread than envisaged in Q4 2022.

The Private Housing Sector has been the most volatile sector in respect of attitudes to future workloads. The sector hit an all-time high with a workload Index score of +42 in May 2021 but fell to a post-lockdown low of -21 in November 2022, marking the end of the pandemic-induced "race-for-space" and "rush-for-refurb". However, the outlook for the sector has rallied to -1, a strong upward trajectory where now overall workload stability is expected. Challenges remain, however. The government is unlikely to meet its manifesto commitment of 300,000 new homes each year. Interest rate rises and a weak general economy are making home improvements less affordable for many.

While investment in public sector buildings is clearly needed, particularly in schools and hospitals, workload predictions for the Public Sector remain weak. The Public sector workload index has remained negative for 11 months and now stands at -11, the lowest of all sectors.

Like the private housing sector, the Commercial Sector has rallied strongly in the first quarter of 2023. It includes the retail, office and entertainment sub-sectors. The sector's balance score now stands at -2, having risen 10 points from -12 in Q4 2022. An encouraging upward trajectory. The office sector seems to have stabilised with the widespread adoption of hybrid work. With minimum EPC requirements coming into force and office quality used to attract staff, office refurbishment is likely to be a growing subsector. However, with real incomes falling, pressures continue to weigh down on the consumer-facing sub-sectors, entertainment and retail sectors.

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.