

Overview

After strong growth over the last three years the construction industry now faces a more uncertain global economic outlook, weaker private sector demand and the turbulence of rising energy and raw material costs. Overall the construction industry is forecast to avoid recession, but with output rising less than 1% per annum in 2005 and 2006, continued growth will be critically dependent upon the delivery of promised government investment.

Higher government investment and strong consumer confidence have been the principal drivers for construction growth over the last three years, enabling the industry to outpace growth in the wider economy.

However, slower growth in disposable incomes, higher mortgage payments and a cooling housing market are now tempering related construction areas such as housing, retail and leisure premises. Slower UK economic growth and an uncertain global economy are also forecast to constrain UK corporate profitability and investment intentions, especially in manufacturing. Overall private sector construction activity is expected to slip back this year and next.

Accordingly, government investment (including PFI projects) will be the primary source of industry growth over the forecast period. Public sector investment has already risen sharply over the last three years, although actual spending has still fallen short of Government plans. Public sector activity grew 6% last year as sharp increases in Government funding lifted work on-site in a number of key areas, including school buildings, health facilities and social housing. Transport investment, however, has been a particular area of disappointment, with double digit declines in rail and road investment initiating a 12% fall in infrastructure output in 2004.

Key points include:

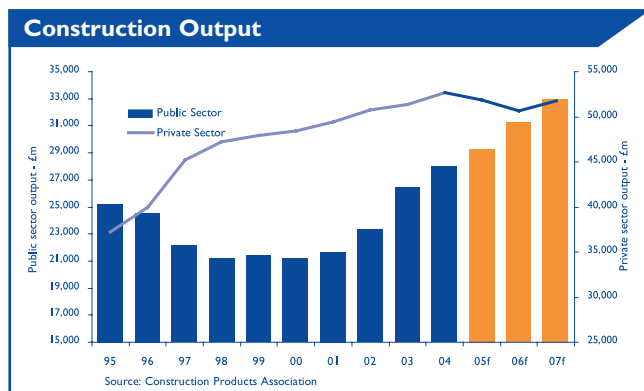
- Higher Government investment drives growth
- Cooler housing market tempers consumer & housing related activity
- Uncertain economic outlook constrains corporate profitability and investment
- Overall recorded construction output slows to under 1% this year and next
- Firmer output growth forecast for 2007

While further rises are predicted in public sector investment over the forecast period, the pace of growth is expected to moderate during 2005 before recovering in the subsequent two years. Growth is forecast to remain centred upon the Government's priority areas of health, education and social housing, with only a modest recovery anticipated in road and water investment. Any additional construction activity generated by a successful outcome in July to London's Olympic bid is expected to fall outside the forecast period.

Over the last three years the private new housing sector has benefited directly from the strength of general housing market activity, while burgeoning mortgage equity withdrawal has boosted home improvement work. However, with house prices and consumer indebtedness at historic highs against income levels, firmer interest rates and slower real earnings growth, housing market activity has cooled and house price inflation has stalled. Against this more subdued economic backdrop, housing-related construction is also expected to moderate over the next two years.

Whilst anticipating a soft landing for the wider housing market, there is a significant risk of a sharper correction in house prices which could initiate a contraction in consumer confidence and housing related construction. The other principal downside risk to the forecast is the slower than anticipated delivery of the Government's investment plans. These factors could push the industry into recession with output falling 3.1% this year.

Conversely a more positive economic environment and better progress implementing planned Government investment could secure average growth of around 3.6% per annum over the next three years. *These risks are explored in more depth in the full forecast report.*



	2002	2003	2004	2005	2006	2007
	Actual	Actual	Actual	Forecast	Forecast	Forecast
Public Sector inc. PFI	7.7%	13.4%	5.7%	4.6%	6.8%	5.5%
Private Sector	2.7%	1.3%	2.5%	-1.4%	-2.4%	2.2%

New Housing

Substantial increases in Government funding for social housing have begun to lift the number of new homes being built. Public sector starts grew by 17% last year to over 19,000 dwellings. This positive trend is expected to continue over the forecast period with starts climbing steadily to 22,000 during the current year and to 25,000 by 2007.

Last year marked the top of the current housing market cycle. A weakening in the wider housing market and modest house price falls near term are expected to dampen new housing activity over the forecast period. Private new housing and RM&I activity are expected to weaken during 2005 and 2006.

Public Non-Housing

Sharply increased Government funding has fuelled a strong rise in education and health related work, securing four years of double digit growth in public non-housing output. Whilst health and education new orders remained strong during 2004, sector growth is forecast to moderate over the forecast period as an increasing proportion of the additional investment in new premises is delivered through the PFI.

Infrastructure

Infrastructure output has fallen back over the last two years in response to sharp declines in road and railway activity. Road activity is forecast to gradually recover during 2005 in response to a strengthened Highways Agency investment programme with further growth anticipated for 2006 and 2007. The sharp decline recorded in rail output over the last two years is forecast to moderate during 2005 and 2006. The commencement of work on the East London Line extension is expected to help offset the impact of the completion of the CTRL and major improvements to the West Coast Main Line during the forecast period. The sector will also benefit from a gradual revival in water & sewerage output over the forecast period as the water industry implements capital expenditure programmes agreed with Ofwat under the latest periodic review.

Industrial

Trading conditions remain difficult for UK manufacturers. Industrial sector orders fell 5% last year while any recovery in manufacturers' prospects is expected to be gradual and will be insufficient to generate increased investment in capacity or factory premises. Whilst the sector should benefit near term from increased investment in distribution warehousing facilities, overall industrial activity is predicted to be broadly flat over the forecast period.

Commercial

The recent stabilisation in the supply of vacant property in the key central London market is expected to help support a modest recovery in office construction activity during the current year with growth gathering momentum during 2006 and 2007. However retail construction sector growth is forecast to slow during 2005 before turning down next year as weaker consumer spending growth deters investors and depresses new orders for retail projects. Weaker consumer spending growth is also forecast to dampen entertainment related output. Whilst work on the new Wembley and Arsenal stadia is expected to maintain growth during the current year, output is forecast to fall back in 2006 as these major projects are completed. In contrast the flow of new PFI education and health projects is expected to strengthen over the next three years.

Repair & Maintenance

Housing RM&I is set to benefit from increased government investment in improving the social housing stock over the next three years, counter-balancing a poorer outlook for private housing RM&I work as the housing market slows. Recorded non-residential R&M work will be depressed by the exclusion of rail maintenance work from the official statistics and the Chancellor's decision to relax ring-fencing controls of councils' maintenance expenditure.

Construction Industry Forecast - Summer 2005

Construction Output	2003	2004	2005	2006	2007
£million 2000 constant prices	Actual	Estimated	Forecast	Forecast	Forecast
percentage changes year on year					
New Housing	11,205	12,783	13,000	12,645	12,870
	12.8%	14.1%	1.7%	-2.7%	1.8%
Public Non-Housing	7,273	8,374	8,585	9,060	9,455
	20.8%	15.1%	2.5%	5.5%	4.4%
Infrastructure	6,734	5,906	5,775	5,965	6,315
	-9.5%	-12.3%	-2.3%	3.3%	5.9%
Industrial	3,064	3,373	3,405	3,375	3,405
	7.0%	10.1%	1.0%	-1.0%	1.0%
Commercial	12,096	12,756	13,380	13,590	14,245
	-4.7%	5.5%	4.9%	1.6%	4.8%
Total RM&I	37,480	37,440	37,010	37,265	38,450
	6.6%	-0.1%	-1.2%	0.7%	3.2%
Total All Work	77,852	80,632	81,155	81,900	84,740
	5.1%	3.6%	0.6%	0.9%	3.5%

Full copies of the Construction Industry Forecasts are available from the Association at a cost of £200. For further information on the content and availability please contact:

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