Quarterly Economic Bulletin

consultancy engineering business environment

Winter 2009

The international picture

The international outlook has deteriorated considerably since the last economic bulletin with industrial output, trade and confidence levels severely weakening. Three months is certainly a long time in economics, as the global bank bailouts, coordinated interest rate cuts and the 'bankruptcy' of Iceland demonstrated. The financial crisis has developed into a global economic recession.

2009 is likely to be a challenging year for growth. The US, the Eurozone and Japan are now firmly in recession and unemployment is rising. However, China, India, and Brazil continue to exhibit strong albeit slowing growth. Overall, the world economy is predicted to grow at 2.2% this year. Market volatility remains as the financial market corrects, a sustained equilibrium is some way off. Despite this, signs of normalisation may begin later this year following further liquidity injections and improved fiscal policies.

UK Snapshot

The UK economy continues to struggle as consumer spending, trade and manufacturing face renewed pressures. Credit for business is still restricted as lenders adopt a more risk-averse approach.

Since the last ACE bulletin the prospect of a more prolonged downturn and flatter recovery has increased. At the same time unemployment is predicted to rise above 2.5 million in 2010. Furthermore, UK Gross Fixed Capital Formation, which provides a measure of investment in fixed assets by business, government and households, has also fallen 5.3% on the year which is indicative of a constrained future climate. However, there is a differential outlook in the regions, with Northern Ireland and Wales looking particularly vulnerable. The upside is that at both the regional and national levels authorities have committed to abide by their public spending commitments. Historically, significant post war recessions have lasted for around five quarters although the credit issue complicates this model somewhat. Current conditions could take longer to unwind. Analysts are currently forecasting a 2.0% to 2.5% contraction in GDP for 2009. UK activity in Q3 2008 decreased by 0.6% with annual growth now predicted to be at 0.3%.

Inflation, interest rates and Sterling

Since the last bulletin, economic focus has shifted from inflationary to deflationary risks, at least in the short term. CPI inflation reduced to 3.1% in December. Evaporating price pressures from commodities, falling demand and rising unemployment mean that deflation is a real possibility. Whilst low inflation is good for businesses as wages and ▶

Nelson Ogunshakin
Chief Executive, ACE

"ACE welcomes the latest measures from the government to promote lending but the politicians' words must be turned into action by the banks. The prime minister's comments that "Good businesses must have access to credit, jobs should not be lost needlessly," underlines the seriousness of the current situation. It is vital to both the construction sector and the economy as a whole that lending is increased, and in some cases restarted, by the banks to ensure that quality companies are able to trade their way through the current crisis thereby safeguarding jobs and resources."

-0.6%
UK Q3 GDP growth

-1.2%
Q3 construction output y/y

-17.6%
Q3 new construction orders y/y

Third Quarter 2008 - Output and new orders in the construction industry:

Source: ONS

	Private housing	Public housing	Public non-residential	Infrastructure	Commercial	Industrial	Total new work
Output [y/y]	-23.3%	-8%	+26.3%	+19.2%	+2.1%	-20.7%	-1.2%
Output [q/q]	-6.7%	-6.8%	+10.7%	+6.2%	+3.4%	-3.4%	+1.8%
New orders [y/y]	-53.7%	+4%	+41.3%	+19%	-32.4%	-15.5%	-17.6%
New orders [q/q]	-34.1%	+1.4%	+8.2%	-9.3%	-13.9%	+14.3%	-9.6%

costs are kept in check, deflation would mean a sustained fall in asset and project values. According to the Bank of England, inflation could fall to as low as 1% in 2009 (the RPI could drop even further), although it is expected to rise steadily from 2010.

UK interest rates have fallen from 5.0% in September 2008 to 1.5% in January 2009. The markets are pricing in a rate as low as 0.5% over the coming months. When rates are approaching zero, the Bank may start to consider more unconventional strategies such as quantitative easing (printing money). However the Bank of England's asset purchase facility which formed part of the latest bank bailout may initially increase the supply of money to businesses without an expansion of the monetary base. The sterling exchange rate has fallen by an average 30% over the last 18 months. Looking forward, the pound is likely to continue to weaken through a negative market perception rather than the interest rate differentials of other countries. It should only begin to appreciate when the broader economy begins to recover. For consultancy firms operating abroad on existing projects it could mean an increase in absolute earnings as well as generally making UK exports more competitive.

The construction industry

Construction output and new orders contracted in Q3 compared to the same period a year ago. The outlook for the industry has weakened in line with the wider economy. A tough trading environment is likely until 2010 at the earliest. Alongside financial services, construction has created the majority of jobs over recent years and this increases the potential of future structural adjustments. Maintaining the theme of the last bulletin; residential, commercial and industrial output continue to be affected. Average planning applications have fallen considerably. Industry tender prices are expected to deflate further. At the international level the market in infrastructure development has started to stall. Although extensive infrastructure investment is forecast over the longer term, high oil prices and restrictions in funding will impact upon the sector in the short term.

However, some construction sectors such as public non-residential and infrastructure remain buoyant. In contrast to many contractors, there are still opportunities for consultancy firms. Infrastructure and public non-residential output expanded in Q3. Rail construction work, for instance, is predicted to grow by almost 200% over a five year period (source: CPA). A lot depends on the delivery of government capital expenditure programmes as private sector investment contracts and projects are postponed. Significant downside risks to the construction industry remain. Delays to the implementation of the government's fiscal stimulus package will exacerbate the gap between public and private funding.

Nonetheless, the UK consultancy and engineering sector is vital in building the infrastructure on which our long term competitiveness and productivity will be built. ACE is confident that when the industry emerges from this current recession it will be much stronger. ■

European Construction [Q3 2009]
Annual variation

Source: EUROSTAT

	Construction output [%]	Building [%]	Civil Engineering [%]
Eurozone	-3.2	-3.2	-3.4
EU27	-1.6	-1.9	-0.2
Eastern Europe*	12.5	/	/

*Poland; Romania; Hungary; Bulgaria; Slovenia and Slovakia

For futher information please contact:
Adam Patterson Economic Analyst
Tel: +44 (0)20 7227 1882 Email: apatterson@acenet.co.uk

Aggregate forecasts

See below for a consensus of independent forecasts for construction output [annual percentage change]