

Quarterly Economic Bulletin

Spring 2009

The international picture

The global economy has deteriorated further over the last three months. The real economy is now broadly being crunched with deep synchronised slowdowns in trade, consumer spending and demand. Economies with excessive debt levels are attempting to repair balance sheets whilst export-led countries are also struggling. Recovery is dependent on restoring aggregate confidence.

The latest OECD figures forecast the US economy to contract by around 4% this year, Japan by 6.6% and Germany by 5.3%. However, monetary policy activism in America should help draw a line under troubled mortgages. Europe and Asia – including China and India – still face challenges and the data is still pointing south. The output of the recent G20 summit could provide a much needed bounce through shoring up the international financial infrastructure.

UK snapshot

GDP in Q4 2008 shrank by a revised 1.6% which is an annualised contraction of 2%. On current trends, GDP is forecast to contract by around 4% for 2009 and remain stagnant through 2010. The labour market is also under pressure; unemployment rose to 2 million in January and is likely to peak at over 2.5 million by mid 2010. Forthcoming data for this quarter is likely to be similarly weak. Gross fixed capital formation (total investment levels) also decreased by 8% year on year and is predicted to contract by 10% in 2009.

However, some indicators point to the UK economy stabilising since the last bulletin. These include improvements to debt repayments, mortgage lending and the trade deficit. Systemic risk in the banking sector has been reduced and losses seem contained. The slowdown could be slowing down. Aggressive monetary policy by the Bank of England combined with falling price pressures are supporting this stabilisation and should feed through into the real economy over the next six months. However, the bottom is not yet visible. Falling tax revenue and an expanding public sector net cash requirement are key downside risks. The economy is still path dependant and the recovery may not necessarily be linear. Weak activity is forecast for the next two quarters but could start to pick up by the end of 2009.

Inflation, interest rates and sterling

Continuing the deflationary theme of the last bulletin the RPI measure of inflation fell to 0%. This negative trend is likely to accelerate throughout 2009 due to the build up of spare capacity in the economy. RPI could fall below -2% by the end of the year. CPI inflation actually increased by 0.1% to 3.2% in February as ►



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Chief Executive, ACE

This bulletin helps convey that perhaps we are starting to see light at the end of the tunnel.

There is still demand for engineering services. Coming out of this recession it is clear that future UK economic growth needs to be built on exports, investment and world class infrastructure systems. Engineers and consultants have a critical role to play in these goals and in designing a new low-carbon economy to enhance competitive and productivity gains. It seems that, finally, all levels of government are beginning to realise this. ACE and our member firms will continue to work with the highest levels of decision makers.

-1.6%
UK Q4 GDP growth

-10%
Q4 construction output y/y

-28%
Q4 new construction orders y/y

Fourth 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] | -27.1% | -10.2% | +20.7% | +1.1% | -10.1% | -25.3% | -10% |
| Output [q/q] | -13% | -14.1% | +2.4% | -15.3% | -11.2% | -6.5% | -9.6% |
| New orders [y/y] | -58% | -26% | +28% | +15% | -41% | -36% | -28% |
| New orders [q/q] | -5% | -22% | -5% | +21% | -22% | -16% | -9% |

the rising cost of consumer imports, driven by the weak sterling, passed through. However, the downward pressure on prices and fees is likely to resume in the coming months. Growth in average earnings has also fallen. This will impact on sector fees. As the CPI is expected to remain positive this could be the optimal basis for fee adjustment in the short term. Whilst a brief, narrowly-focused phase of falling prices could have a positive impact, a protracted period could become structural. Conversely, there is also a risk of quantitative easing leading to future inflationary pressures.

In line with the last bulletin's forecast the UK base rate has fallen to 0.5%, down from 5% in October. The Bank of England is now likely to try alternative monetary means such as further expanding its £75 billion bond purchases in order to bring the cost of borrowing down. Meanwhile, although the past three months have been difficult for sterling as the market reacted to the UK economy and the 'printing money' paradigm, it has stabilised somewhat. Looking forward, sterling should make up some ground against the dollar and euro but is likely to remain at a depreciated value as the economy attempts to re-balance in favour of export-driven growth.

The construction industry

Construction activity in the last quarter of 2008 contracted by an annualised average of 20%. Industrial and residential work experienced the largest contractions. Construction output growth is predicted to average around 0.5% from 2009-2013. Employment growth over the same period is expected to be just 2.9% or 74,000 (source: Construction Skills). The construction purchasing managers index stabilised somewhat in March to around 28.0, but is still some way away from the 50.0+ that denotes growth. The consultancy and engineering sector, however, should be more robust, especially civil engineering. Activity will not decline across all sectors; waste and transport remain strong and other opportunities exist. Total consultancy fee income increased to £10.3 billion in 2008, a 20% hike from the year before. However, things are changing quickly. Forward order books, new project starts and workforce levels should continue to weaken through 2009, albeit at a slower rate. The Midlands, East England and the devolved markets especially are narrowing. There is still work out there but uncertainty – even on seemingly secured workload – is still present.

The government has also safeguarded around £13 billion of public investment, although the majority of projects will not begin being closed until 2010. The situation then is perhaps better than expected six months ago. Nonetheless, private finance remains constrained as severe funding issues in the LSC's college building program highlighted. Maintaining project portfolios, fee and competition pressures and cash flow are likely to remain key issues for consultants in 2009. ■



Check out the latest European construction outlook with ACE/Experian's quarterly bulletin. Available at acenet.co.uk

ACE Business Insight

For further information about ACE's market intelligence and the bespoke research services we can provide please contact Adam Patterson, ACE Economic Analyst on apatterson@acenet.co.uk or 020 7227 1882

Aggregate forecasts

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

