CONSTRUCTION
INTELLIGENCE CENTER

‘BREXIT’ AND THE IMPACT ON CONSTRUCTION IN THE UK

timetric

Short-term pain and little or no gain

There is still a great deal of uncertainty as to what the full implications of 'Brexit' are for the UK's construction industry, but the view from Timetric's Construction Intelligence Center (CIC) is that there are major downside risks to growth, with little or no upside.

Following the victory in the June 23rd referendum for the campaign for the UK to leave the EU and the subsequent decision by the prime minister, David Cameron, to announce his resignation, the CIC has made an initial revision to its forecast for growth in the construction industry in 2016. The CIC now expects growth of 2.8%; this is down from the previous projection of 3.4%, which was based on the assumption that the result of the referendum would be in favour of remaining in the EU.

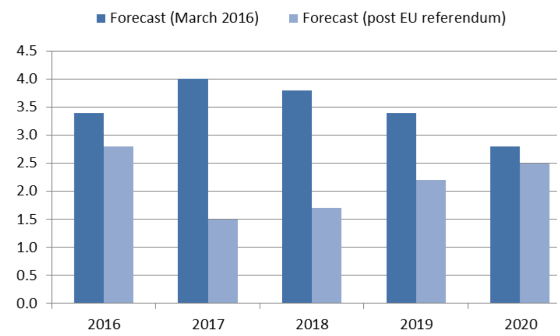
A sharp downturn in growth in 2016-2017

The pace of growth in the UK's construction industry will then slow to 1.5% in 2017 (down from 4% previously), reflecting a sharp downturn in investment as the UK government embarks on the two-year process of negotiating its exit from the single market. The timing of the government's decision to invoke Article 50 is crucial in terms of determining exactly when the UK will be formally outside of the EU, but the negative impact on investor confidence stemming from the uncertainty over how the UK economy will perform outside of the single market will weigh heavily on the construction industry during this period.

Investors will also take steps ahead of the formal exit to ensure that they are protected from any negative fall-out, and this is likely to mean a drop-off in new projects and the potential for existing projects in the pipeline to be put on hold or cancelled.

Assuming that the UK will formally be out of the EU by 2019 and a clear picture emerges on the post-EU trading environment, investment will likely pick up again as new opportunities become apparent. However, there is little prospect of a surge in new activity at this time, as the UK is not expected to be in a position of strength to strike a deal that is favourable with respect to the EU.

Figure 1: UK Construction Output (real % change), 2016-2020



Source: Timetric

Potentially higher costs for labour and materials

The UK's construction industry is currently reliant on foreign labour from within the EU owing to insufficient numbers of new and existing skilled domestic workers. Ahead of the referendum, the Chartered Institute of

Building warned that tight regulation of migration would damage construction activity in the UK. Reduced access to skilled workers from the EU could exacerbate the skills shortage, potentially delaying projects and increasing labour costs.

The industry is also reliant on the import of construction materials and equipment from EU countries, in particular Germany, Sweden and Italy, and in the post-EU trading environment, the construction industry could face higher costs for key inputs in construction. There is still the potential for the UK to negotiate trade deals outside of the EU, but there is no guarantee as to whether these deals will be more favourable with respect to the goods and services required by the construction industry.

Pessimism among housebuilders

Housebuilders were among the worst affected in terms of the sharp decline in their share prices in the hours after the referendum result was announced. This reflects the dire prediction for the real estate market. Prior to the referendum, the UK Treasury suggested that house prices could fall by up to 17% due to Brexit, and a group of 17 of the UK's biggest housebuilders reported that Brexit would inevitably reduce the amount of housing being built, owing to labour shortages and increased import prices, together with reduced demand for property from overseas investors.

Infrastructure to lose key source of funding

There will also be direct consequences in terms of the loss of future funding from EU sources for major projects in the UK. The European Investment Bank (EIB), which is the EU's bank and operates in the interests of EU member states, increased its lending to UK infrastructure projects to EUR5.5 billion in 2015. The UK has also received funds from the EU's European Fund for Strategic Investment (EFSI), which is aiming to provide EUR315 billion in infrastructure investment across the continent. According to the UK's Infrastructure and Projects Authority, the UK has been the second-largest recipient of funds under the EFSI, which has supported projects including smart meters and offshore wind projects.

The heightened political instability following the referendum, not least in terms of who will be the next prime minister, also means that some major infrastructure projects could be put on hold. For example, David Cameron was a major supporter of the large-scale expansion plans at Heathrow, while Boris Johnson, a leading member of the campaign for the UK's exit from the EU, is a vocal opponent of the plans. Other major projects, including the GBP55 billion High-Speed 2 railway project could also be subject to further delays, impacting negatively on investor confidence.

In addition to these direct impacts, the future of the UK construction industry also greatly depends on how the UK economy holds up in the coming years. Although Timetric is not currently forecasting that the UK economy falls into recession, a slowdown in household spending and business investment, including the potential for an outflow of foreign capital, could result in a sharp deceleration in economic growth, curtailing activity in residential, commercial and industrial construction projects.

A downgrading in the Construction Risk Index

Reflecting this heightened risk, the UK has been downgraded in the latest update of Timetric's Construction Risk Index. The UK has fallen six places to be ranked 15th out of the 50 countries in the index, and has been downgraded to B1. This reflects the upturn in political and market risk and also in operating risk given the uncertainty over how the regulatory environment will change.

The international ratings agencies have also downgraded the UK's sovereign credit ratings. Standad & Poor's, for example, cut the UK's rating from AAA to AA (down two notches), and it also warned that further downgrades could be forthcoming reflecting the likelihood of a weaker and less effective policymaking environment in the UK and the negative impact this will have on the economy and fiscal and external balances.

Figure 2: Construction Risk Index, updated June 27th 2016

Rank	Change	Country	Score	Change	Rating
1	0	Sweden	16.85	1.50	A1
2	2	Singapore	20.06	0.56	A2
3	-1	Switzerland	20.56	1.50	A2
4	-1	US	20.98	1.54	A2
5	0	Hong Kong	21.56	-0.94	A2
6	0	Australia	23.04	-0.52	A2
7	0	Denmark	23.71	-0.19	A2
8	0	Canada	24.94	-0.75	A2
9	1	Austria	26.00	-3.00	A2
10	5	Finland	29.31	-1.09	A2
11	3	South Korea	29.63	0.00	A2
12	0	Chile	29.66	0.38	A2
13	-2	Germany	29.98	0.75	A2
14	-1	Qatar	30.14	0.60	B1
15	-6	UK	30.31	1.99	B1
16	0	Belgium	30.75	-0.37	B1
17	0	Japan	31.74	0.19	B1
18	1	Netherlands	33.19	-2.25	B1
19	2	Ireland	33.19	-2.81	B1
20	-2	Malaysia	34.56	0.19	B1
21	1	Poland	35.83	-0.22	B1
22	1	France	35.94	-0.19	B1
23	-3	UAE	36.38	0.88	B1
24	0	Czech Republic	38.44	1.88	B1
25	0	Saudi Arabia	38.84	1.33	B1

Source: Timetric

Table 1: Ratings, Scores and Definitions

Rating	Score	Risk Level	Definition
A1	<20	Very Low	The construction industry in countries assigned an A-rating is considered to be in a robust state, owing to few, if any, financing, operating or market difficulties and general political and economic stability. Project operators are therefore not expected to face any major disruption at the country level that could result in project failure.
A2	20-30	Low	
B1	30-40	Low to Moderate	The construction industry in countries assigned a B-rating is deemed to be in a relatively healthy state, but facing some headwinds from country-level issues, such as economic weakness, political instability, or minor financing, operating or market difficulties. Although not expected to face major disruption at the country-level, operators need to be prepared for the potential for disruption.
B2	40-50	Moderate	
C1	50-60	Moderate to High	The construction industry in countries assigned a C-rating is deemed to be in a troubled state, facing severe headwinds owing to political unrest, serious economic weakness, or major problems in financing, operating or market conditions. Project operators therefore face a high risk of disruption owing to conditions at the country level.
C2	60-70	High	
D	>70	Very High	The construction industry in countries assigned a D-rating is deemed to be in a dire state and exposed to major political or economic instability, or crisis conditions in terms of financing. Project operators therefore face a very high risk of project disruptions or failures.

Unrivaled Construction Market Insight

The Construction Intelligence Center is the most comprehensive source of data and analysis on the global construction industry. Our unique construction projects database tracks projects over US$25 million in all sectors across the globe and can be contextualized with our forecasts of future project activity, rich market data and analysis as well as competitive intelligence and company activity. We provide more data, insight, analysis and commentary than any other information provider in this industry. Our intelligence is designed to ensure our clients can better understand and exploit commercial pressures and market trends.

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Construction Intelligence Center's intuitive, cutting edge delivery platform means that you can find, understand, download and manipulate the data and analysis you want easily and quickly - assisting you to make better decisions, faster.

About Timetric

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