

Supply Chain Sentiment

Q3 2022 report





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In our quarterly market sentiment series, we take an in-depth look at the confidence and attitude of the social housing supply chain and what this means for PfH members.

Every three months, we speak to a range of manufacturers, merchants and contractors from across the country to understand the challenges they face now and how they feel about the future.

We hope that by reading the mood of where the market is heading, social landlords can better prepare, particularly in such volatile times.

Although the war in Ukraine is driving up energy prices and overall inflation, shipping, demand and supply shortages are all stabilising, creating some guarded optimism in the supply chain.

Key findings

73%
of supply chain predict a rise in costs (down 16%)

Manufacturers are more positive, only **58%** expect climbing costs

47% of all respondents forecasting supply shortages (down 13%)

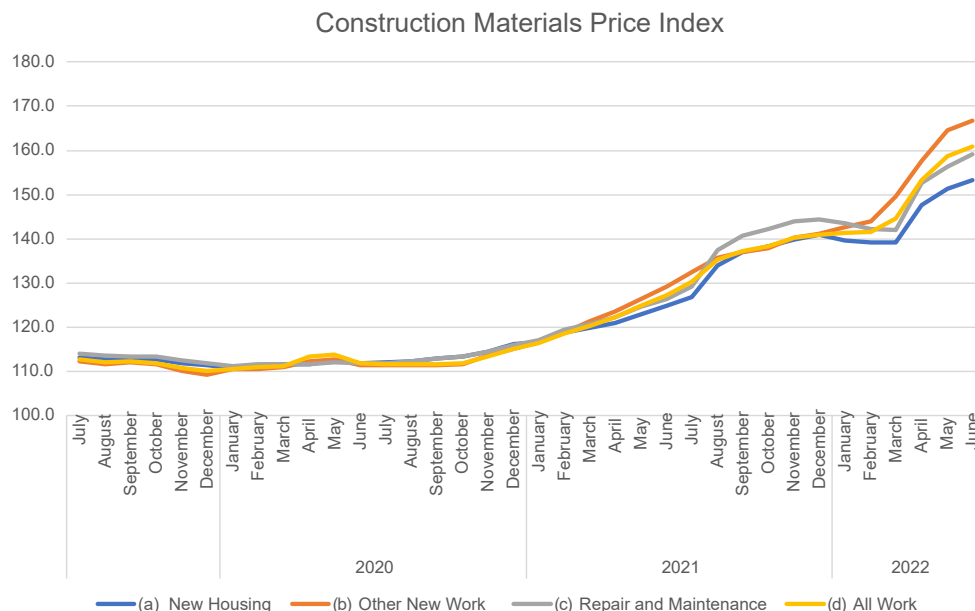
Demand is also steadier, with **70%** predicting increases (down 9%)

However, inflation is still a main factor behind supplier price rises and energy crunch particularly

Prices

We are now seeing the true impact of Russia's invasion of Ukraine on social housing supply chains.

Early in 2022, our sentiment briefing reported a tail off in materials price rises. Indeed, Q3 and Q4 results from last year's Construction Materials Price Index (CMPI) showed that costs had begun to flatten. By and large, supply chains were beginning to stabilise, with the exception of microchips and components.



But the war in Ukraine changed everything. The latest CMPI figures indicate that prices in the first half of 2022 have shot up again. And when we speak to manufacturers, merchants and contractors, they all say that price volatility - caused by the war - will continue until the end of this year. Nearly three quarters of respondents told us that costs would climb in the next six months.

What's interesting is that when you break this figure down, 100% of merchants and 83% of contractors predicted these price surges but only 58% of manufacturers thought the same. In fact, 42% of manufacturers said they were anticipating a dip in prices.

"Prices seem to have reached a static period, difficult period to predict but we do not have any planned increases that are imminent." - manufacturer

"Fuel cost increases. Commodity increases. Raw material cost increases. Salary cost increases. Ukraine war." - merchant

"War in Ukraine [is behind price rises]." - contractor

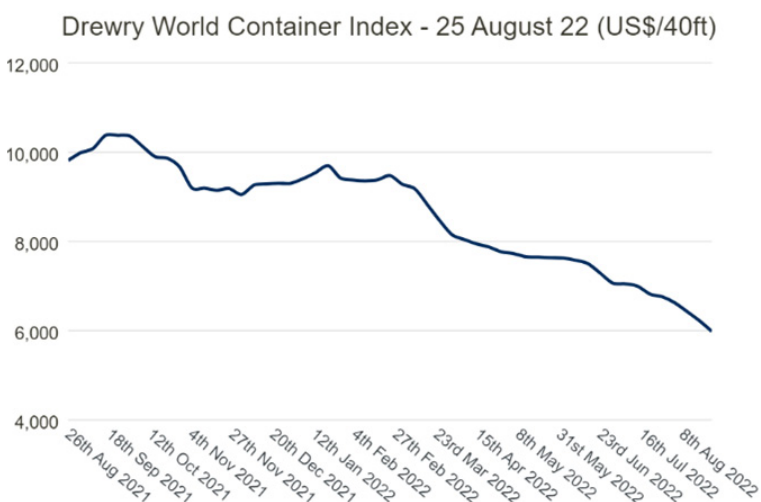
What's behind this disparity in the supply chain? One reason is that many global supply issues have been resolved for manufacturers, apart from those making boilers or pumps with microchips.

Factories have also absorbed the higher cost of energy and are beginning to see the first signs that shipping is steadier, with container prices coming down.

Shipping stabilisation

As a reminder, pre-pandemic, a container from China to the UK was around £3,000. Over the past year, that price tripled, reaching a peak of nearly £9,000. But in the last six months shipping costs have been on a [downward trajectory](#).

Drewry's composite World Container Index, which tracks the cost of shipping around the world, reports that prices are 35% less than they were in August 2021, having decreased for 25 weeks in a row. If container costs continue to fall then this should impact manufacturer prices fairly quickly.



"Freight costs are still a challenge for manufacturers The market has definitely improved since the start of 2022, however there are still challenges ahead from my conversations with our key suppliers."

It's worth considering whether steadier supply and transport costs will offset potential energy price hikes for manufacturers.

Manufacturer confidence

Because of the change in perspective from manufacturers, there's a feeling that pricing may actually start to level out towards the end of the year. Last quarter, 89% of all respondents predicted cost increases over the next six months but that figure dropped to 73% in this survey.



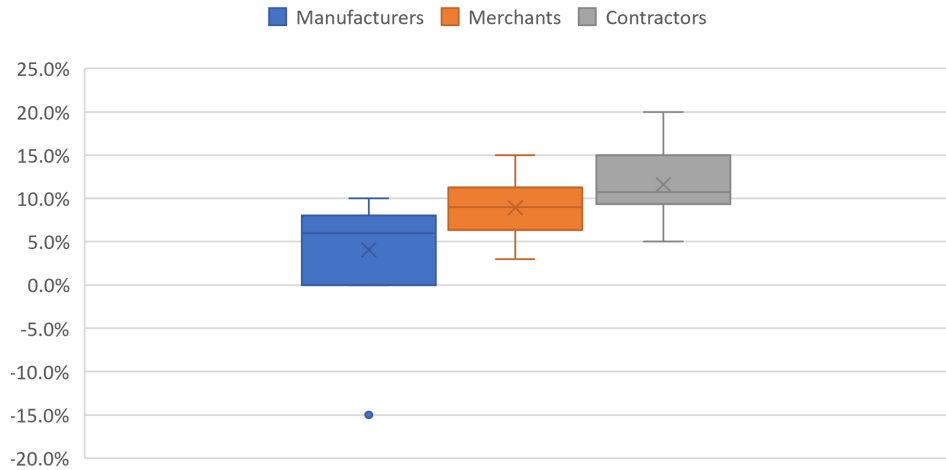
However, this glint of positivity is largely down to the manufacturer base, and it will take time – at least six months - for confidence to flush through to merchants and contractors.

It's important to take this sentiment with a pinch of salt. As we know, current turbulence means that things change quickly, specifically the global supply of energy which is having a massive impact on businesses.

When we asked suppliers for price rise estimates, manufacturers said 0 – 8%, merchants 6 – 12% and contractors 8 – 15%. This range demonstrates the varying perspectives in the supply chain. Next quarter we'll see if a growing confidence amongst manufacturers is beginning to impact merchants and contractors.

"The current situation is ever changing and unpredictable. We have a very agile procurement team that is dealing with a difficult situation excellently."

Price Increase Expectations



Contributing factors

When we asked suppliers about their price rise predictions, Brexit didn't feature highly. Only 14% of all respondents mentioned it as a contributing factor, compared to 40% last quarter. Covid, too, is no longer pushing prices up as it once did, particularly for contractors. This quarter, half of contractors cited the pandemic as a reason, down from 62% in July.

Manufacturers, merchants and contractors told us that demand and capacity is no longer affecting prices as much, with figures down by 20% from last quarter.

It's becoming clear that inflation is the key driver of price rise predictions, with 62% of all respondents citing it as a factor, although this figure is down by 19% from last quarter.

"Controlling the effects of inflations within the business [is a challenge]."

"Stock issues and the rising cost of inflation across all aspects of the business."

"Product availability and inflation cost increases."

This ongoing concern around inflation is in line with wider economic predictions. In August, one of the world's biggest banks, Citi said [it expected inflation in the UK to reach 18% in early 2023](#), mainly due to the worsening energy crisis.

Feedback from suppliers this quarter confirmed that energy and fuel rises are a big issue for them:

"Energy (Gas/Electric) & Fuel increases."

"Fuel Surcharges and Energy Cost increases."

"Rising energy and fuel costs."

"Continuous increase in pricing of energy & fuel supply."

The question for social housing providers is how inflation translates to supplier pricing. Are price rises based on genuine inflationary pressures or actually a risk management policy launched by manufacturers, merchants and contractors to future-proof their business?

See our checklist on page 8 on how to manage cost inflation in the supply chain.

Supply

Supply is beginning to stabilise. Last quarter, 60% of all respondents were anticipating shortages and this has now decreased to 47%.

"Market has settled slightly currently."

"The market has definitely improved since the start of 2022, however there are still challenges ahead from my conversations with our key suppliers."

In spite of this, the global shortage of microchips and semiconductors is still having an impact.

"Our sector is experiencing a shortage of semi-conductors on varied numbers of components. We are managing this very closely..."

"Products that require Microchips. Boiler supply highly constrained. Not clear at this stage when the situation will improve."

"It is a moving target. Whilst we are coping generally, it is still very fragile in terms of component supply."

"Boilers, ASHP and Pumps. Anything [with] a microchip."

"Boiler Parts, Boilers, Cable, Extractor Fans (certain brands)."

Boiler manufacturers have been hit hard by this lack of availability and the situation won't resolve anytime soon. We're hearing predictions that it will be quarter 2 of 2023 when supply finally catches up with demand.

This is impacting decision making from a customer perspective. Housing associations and local authorities don't want to swap boiler manufacturer once they have committed as this impacts future service delivery and costs.

Renewables have also been affected. Air source heat pumps use microchips, so the solution is not as easy as fast forwarding your net zero programme to replace all gas boilers.

Demand

The demand surge seen in previous months is tailing off. Last quarter, 79% of respondents forecast an increase in demand but this has now dropped to 70%. Just over one quarter said it would remain static and 3% predicted a decrease.

“Increase in costs but static demand.”

It’s clear that economic uncertainty is impacting market confidence and for the social housing sector, that might be a positive.

Over the last 6 - 12 months we’ve been operating in a supplier-led market with companies free to increase prices significantly as demand outstripped supply. But with a downturn on the horizon, we may see more suppliers transition from working mainly in the private sector to projects in the public sector, in order to sure up their order books. This could lead to increased bargaining power for councils and housing associations.

We’re also seeing demand for greater competition within the social housing sector. With costs rising sharply, boards are calling for more competitive tender exercises. Value for money is more prevalent in decision making than it has been for some time.

Although demand is plateauing, we don’t expect it to drop suddenly and what remains to be seen is whether the new prime minister will use construction as the traditional lever to mitigate the economic downturn and depth of the forthcoming recession. Could this mean more money for social housing to meeting the Net Zero agenda?



Labour demand

If demand does continue to flatten then construction labour shortages may become less of an issue. However, it’s crucial that housing providers and suppliers remain proactive in addressing the skills gap.

With an [estimated 240,000 workers](#) leaving the building industry between the first quarters of 2019 and 2022 due to Brexit, Covid, retirement and a lack of employee status, this isn’t the time to rest on your laurels.

“Labour Shortages are still an issue.”

“Skilled workers [are a challenge].”

“Material costs and keeping good staff [are challenges].”

[Recent reports](#) indicate that the number of apprenticeship starts fell by 22% between 2018/19 and 2020/21, mainly because of a lack of appetite from employers. Historically, building firms recruit from agencies, not colleges and this systemic practice makes it difficult to find work for apprentices on a large scale. Economic uncertainty hasn’t helped either with firms reluctant to take on trainees or commit extra budget to skill people up over a number of years.

People

This quarter, respondents told us they aren’t as worried about future labour shortages. When we asked manufacturers, merchants and contractors how concerned they are on a scale of 1-10 (10 being most concerned) they responded as 3.32, 3.83 and 5.5 respectively. These figures are down from those in July.

Feedback from survey respondents shows they are reasonably confident that they have skills planning in place:

“We are confident we have made adequate provision for training and developing new starters and enhancing the skills of our existing teams.”

“We continue to employ apprentices and graduates year on year, in the hope we can train and nurture our own staff to the desired skill level.”

“Through weekly vacancy lists our vacancies are advertised internally before going external. Long-term planning by our management teams ensures we undertaking recruitment drives early, Meet the Buyer events to recruit local businesses to support in the short term. We currently employ apprentices and work placements supported by university studies.”

“Training Academy’s, work placements/ experience etc and job fairs targeted at young people”

“Working with local schools and colleges to create interest in our sector and already providing apprentice and work placement opportunities - over 10% workforce apprentices.”

“Increasing the number of apprentices and using local back to work schemes we are involved in. Open days at local schools and colleges.”

So, what does all of this mean for social landlords?

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“It’s becoming clear that the driving force behind inflation is..... inflation. We’re bombarded with financial warnings at the moment – rapidly rising energy bills, petrol and diesel prices, raw materials costs and the cost-of-living crisis. There’s an argument that some suppliers could be inflating prices because everyone else is. The challenge for housing providers is to work out which price rises are genuine and which ones come from a risk management policy.”

“The wider economic headwinds are all pervading – they impact decision making right across procurement. You can’t pigeon hole them in to just one area such as demand, cost, supply or labour. Things are also so volatile and uncertain at the moment that there are a number of different scenarios that could play out.”

“On one hand, we’ve got rampant inflation and a predicted recession. That could tip government into turning the taps on in construction which could be a positive for housing, although it may also increase construction demand again, which would be a negative.”

“And on the other hand, for the first time in around seven months, we are seeing demand plateauing. This, too, could be a positive for housing – we’ve had a supply challenge for a while now, particularly with contractors, and that’s pushed prices up. A potential contraction in construction may help social landlords because those contractors that transitioned to the private sector are now coming back and increased competition means better prices and supply.”

“It’s ‘watch this space’ on both these scenarios and also on the labour situation. Finding workers has been a real problem for many months but as demand is stabilising and contractors move from post-pandemic growth to a slightly calmer period of consolidation, the skills gap is less of an issue. Housing providers must still keep this challenge at the front of their mind though – working with suppliers to ensure the existing gap doesn’t widen further.”

Supply chain optimism score

Merchants: 9.67%



Contractors: 9.75%



Manufacturers: 8.79%



Back in July, we had an overall confidence score of 9.23. This quarter that figure has risen to 9.4. So overall, optimism has gone up, but strangely, we’re only seeing that in the scores of merchants and contractors. This is anomalous given the more positive manufacturer mood we reported on earlier in this briefing.

However, when you dig deeper, there may be an explanation. Although shortages and shipping are beginning to stabilise, manufacturers are more susceptible to price changes, above all around power. Factories are hugely energy-intensive whereas merchants and contractors are less so. Also, if there are shortages of products, component or materials in coming months, merchants and contractors can source alternatives but it’s harder for manufacturers to do the same. They are more exposed, hence their gloomier outlook.

Checklist for PfH Members

What actions should social landlords consider in response to this market intelligence?

Consider price rise alternatives

If a supplier says their costs have gone up and they need to pass this on then think through your options. Are they overregging their price rise request now because they are worried about inflation over the next 12 months?

For example, if they ask for an extra 15%, get to the bottom of what is driving this. You might find out that the direct impact on their cost base is only 10% and they are adding a 5% future inflation risk 'mitigator'. If that's the case, can you defer this extra 5% for six months to see if this risk materialises?

Rather than entering full negotiation again in six months' time, you could suggest agreeing now the parameters and application (or not) of that secondary price increase. This might be an approach to take with your main, strategic suppliers.

Understand a supplier's cost base

It's worth getting to know your strategic suppliers' primary costs. Being aware of these driving forces, how much relates to energy, shipping or labour will empower you when negotiating. You can agree what those costs look like now and use them as a base line for future discussions.

Reintroduce competitive tension

If you are still in a position where a supplier insists there is no way around their 15% price hike then it might be worth considering more competitive procurement activity. For instance, if your organisation traditionally awards contracts without competition then look again at the reasons why. Is it because this type of procurement is easy, because you are confident it will achieve the best value for money or maybe because you lack the resource to reprocure? Understand your driving forces and make an informed decision.

If it's skill set then there are providers that can support. If it's value for money then a live market test will reconfirm whether you really are achieving best value.

If it's just because direct awards are easy then this needs to be discussed within your business. There might be a push to increase competitive tension across different category areas because your organisation wants to manage costs more effectively. If so, extra resource will be needed to conduct more complex procurement exercises.

Contact

PfH's procurement team reviews prices on behalf of Members. For more information on how PfH can support your organisation today, get in touch:

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 www.pfhscotland.co.uk

Or alternatively you can request a call back from a member of our team [here](#).

Remember that PfH publishes this Sentiment Report every three months and we also distribute an annual Building Materials Pricing Summary. Visit [here](#) for more information.

Report contributors

Thank you to the following organisations for their continued support in contributing to knowledge pool across the Social Housing landscape.

