Intelligently procuring value

Supply Chain Sentiment

Q1 2024 report

Version-1

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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 Inprova 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.

There's a slight uplift in supplier confidence with price predictions falling, rising expectations on demand, and Red Sea resilience. Despite this, high salaries amid static output could pose big risks.

Key findings

- Optimism is rising: now 9.03% (up by 0.23%)
- Price rise fears are falling: now 63% (down 16%)
- 80% of supply chain are forecasting rising demand (up 9%)
- 29.4% of contractors expect demand to exceed capacity in next six months (up 16.4%)
- 88.2% of contractors are seeing cost increases for labour
- Worries over Red Sea crisis disrupting supply chain stand at 5.5

Economic outlook

Our first sentiment report for 2024 begins with a brand new feature. We've asked Inprova's award-winning Chief Financial Officer, Richard Godsland to share his economic analysis for 2024.

2023 was a tough year and economic confidence dipped. High interest and inflation rates added to the post-COVID cost-of-living squeeze. However, in the first few months of 2024, there have been some promising green shoots with interest rates steadying and inflation beginning to drop.

Short recession

A larger than expected decline in gross domestic product (GDP) meant that in February 2024 we heard the UK had slipped into 'technical' recession. This is when there are two consecutive quarters of contracting GDP, and although recession is a taboo term, making it official can often be a positive first step in looking to the future and re-building confidence.

There is cautious optimism within the markets that this will be a short 'technical' recession and that growth will slowly return towards the end of 2024.

Flat consumer price index

Positively, the consumer price index (CPI) measure of inflation is now stabilising. January 2024 figures put it at 4% - unchanged from December 2023. This represents a significant drop from its most recent peak of 11.1% in October 2022.

Lower inflation

Inflation in 2024 is expected to continue a downtrend trend due to fading energy pressures and weaker labour markets. Market leading financial service providers **predict that it will average 2.8% over the year.** By the end of Q4 2024, inflation in developed markets is expected to be close to the 2% target set by the Bank of England.

Interest rates steadying

We're definitely seeing stabilisation in this area. The Bank of England hasn't moved interest rates since August 2023 (when they were set at 5.25%) and there's a general consensus that we'll start to see rates being cut in Q3 this year.

Now we're officially in recession there is more pressure on the Bank of England to take action. And as interest rates come down, we're likely to see confidence rising in the markets, with lower borrowing costs and increased spending power a real positive for social housing providers.

Prices

There are some positive signs around price stability. This quarter we've seen fewer suppliers predicting increases (63% compared to 79% in December 2023).

> "In the current stagnant market, we are not anticipating our current consultancy cost to significantly increase"
>
> "Things are settling down and starting to stabilise"

Interestingly, there is a stark contrast in opinion between manufacturers, merchants and contractors on the direction of prices over the next six months. 87.5% of manufacturers expect the picture to remain static, whereas 80% of merchants foresee rises, possibly because they feel more exposed to the crisis in the Red Sea and the controversial Clean Heat Market Mechanism (more details of that below). 82% of contractors believe prices will rise, but 6% of them predict prices will fall by the summer.

Inflation is still the main reason manufacturers, merchants and contractors give for price hikes.

If we examine suppliers' price increase expectations, there are some stark differences. Merchants are forecasting rises of anywhere between 0 – 13%, and contractors are anticipating 0 – 10% hikes, with some outliers expecting increases of up to 20%. Manufacturers, however, are much more conservative.

Graph 1

The broad range of these figures shows that price sentiment depends very much on the type of business a construction supplier operates and the risks they are exposed to.

Clean Heath Market Mechanism

This quarter's figures are further skewed by a government scheme due to be introduced in April 2024, with the goal of 'incentivising the UK's heating industry to invest in making heat pumps an increasingly attractive and affordable choice for families and businesses.'

The Clean Heat Market Mechanism has been branded the 'boiler tax' because of the quotas it proposed for heat pump sales and the fact it would land manufacturers of boilers and heat pumps with fines for each heat pump they didn't sell. Many manufacturers increased their boiler prices to cover future fines – and this will have impacted price increase prediction data this quarter.

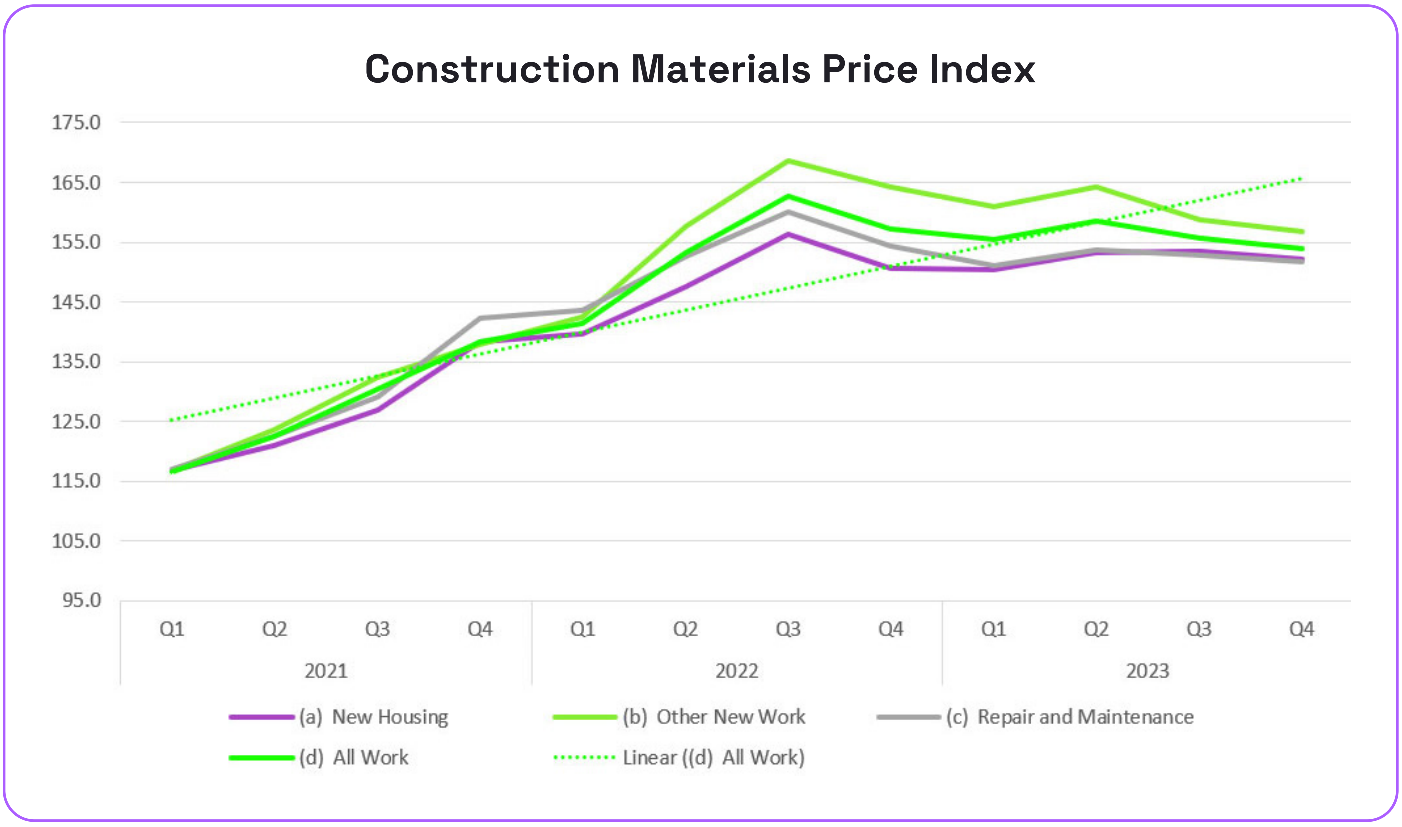
> "CHMM - £95 per boiler [more]"
>
> "... the government's Clean Heat Market Mechanism has seen prices for boilers start to increase in anticipation of the launch - however now reports are suggesting the government may do a U-turn on this. Uncertainty over polices across a duration several months, inevitably leads to price increases, clients changing procurement priorities at tender stages (a focus on price over quality) which is damaging for our sector"

Interestingly, it's been reported that the energy secretary may now shelve the Clean Heath Market Mechanism to protect consumers from boiler price hikes. We will update you on developments around this scheme in next quarter's sentiment report.

Materials prices

Over the past 12 months we've seen a slow drift down on the Construction Materials Price Index and it's likely that the picture here remains fairly stable in 2024, dependent on what happens in the Middle East (more below on this).

Graph 2



Supply

Crisis in the Middle East

This quarter we asked suppliers to what extent (1 being not at all, 10 being major global disruption) they believe construction supply chains are impacted by the growing crisis in the Middle East and more specifically the Red Sea.

"Red Sea Transportation Issues [are affecting prices]

"We have very little requirement for products or raw materials from the far east"

"Red Sea shipping issues [are impacting] due to an increase in container and shipping costs"

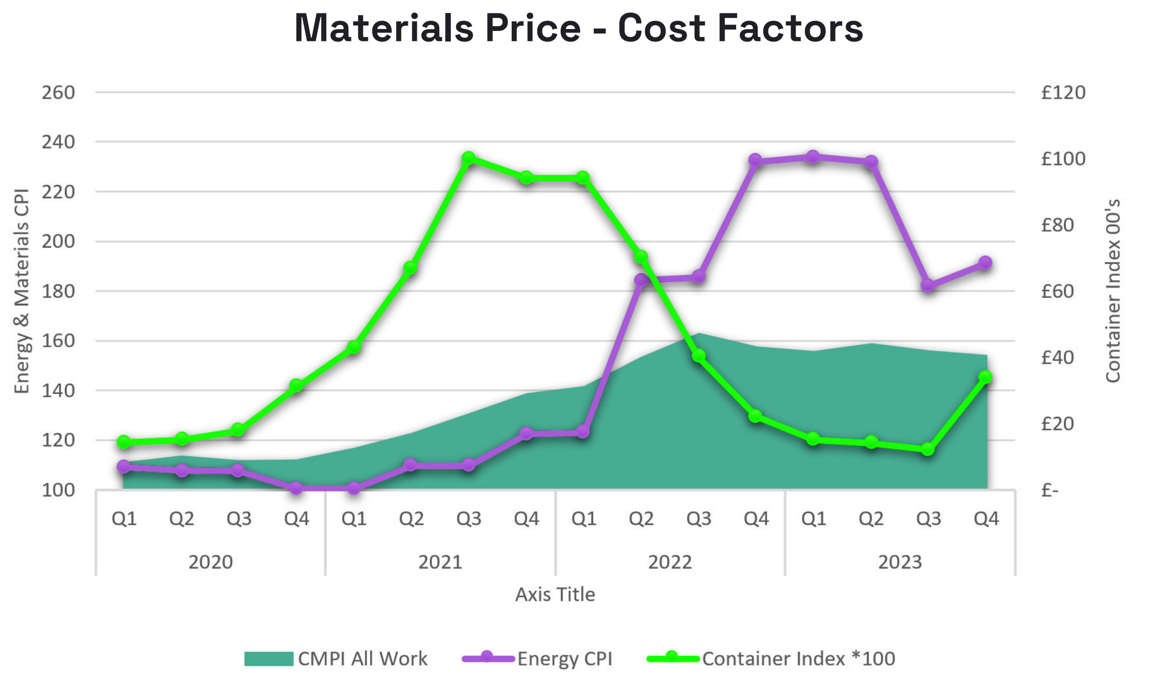
"Not anticipating being impacted as we do not supply goods, only services"

"The vast majority of our suppliers are European with less reliance on components from the Middle East"

"We have various suppliers & do not expect an impact. We will be monitoring the situation closely"

An even spread of risk was raised by manufacturers, merchants and contractors, with an average score of 5.5. Suppliers are reporting an uptick in the cost of containers, with some ships having to divert and take longer routes.

Graph 3



Despite this, it appears that manufacturers, merchants and contractors are managing this disruption well through a range of measures.

"[We] multi source product from various places across the globe, not just the far east. For those products sourced in the far east, we have already increased our UK stock holding and [we are] allowing increased lead time"

"Whilst I believe the middle east crisis will be disruptive to global supply chains, I feel we have mitigated any risk by our commitment to large volume forward stocks of small components sourced from areas affected by the supply route"

"We are carrying extensive stocks which mitigates any concern to our ability to supply. Red Sea is currently causing a delay of around 2 weeks which will not cause us a problem"

"We have identified alternate shipping routes for materials that have been affected by delays in the red sea. This ultimately can put a 3-week delay on any orders being delivered. We have increased core stock of raw material to factor in any delays. Although short term the farmers strike / protests are holding up certain supply out of France"

"[We] are closely monitoring the growing crisis in the Middle East and the recent attacks on commercial vessels in the Red Sea...These risks include rising energy prices and the erosion of excess inventory in supply chain, driving up costs. To mitigate this, [we] fix prices with our suppliers through a procurement exercise for large contractors and common parts and periodically test the market to ensure we are getting the most competitive price"

"More forward planning, we usually place orders 12 weeks out but are now placing orders originating from China to 20 weeks"

If disruption in the Red Sea becomes a longer-term issue, then the rising cost of shipping containers will begin to impact materials prices.

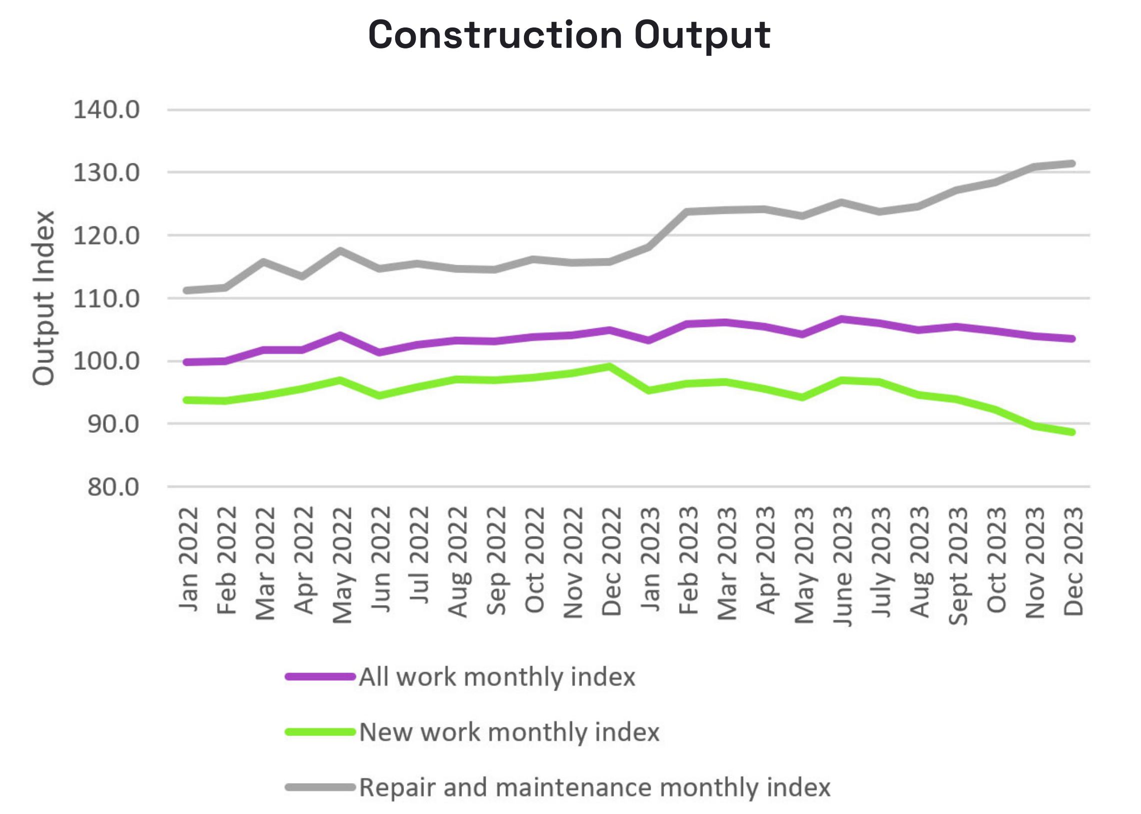
Tellingly, when we asked suppliers last quarter whether they are forecasting supply shortages for their products and services, they all said no. Although the supply picture still remains relatively settled this quarter, there has been a slight shift. 17% of the suppliers we have just surveyed said they are now anticipating supply shortages, with contractors the most worried.

People

Overall, construction output was static throughout most of 2023, with a decline towards the end of Q4. When you break this down, new build work has reduced considerably, yet repairs and maintenance - prompted by mounting pressures around damp and mould – has grown.

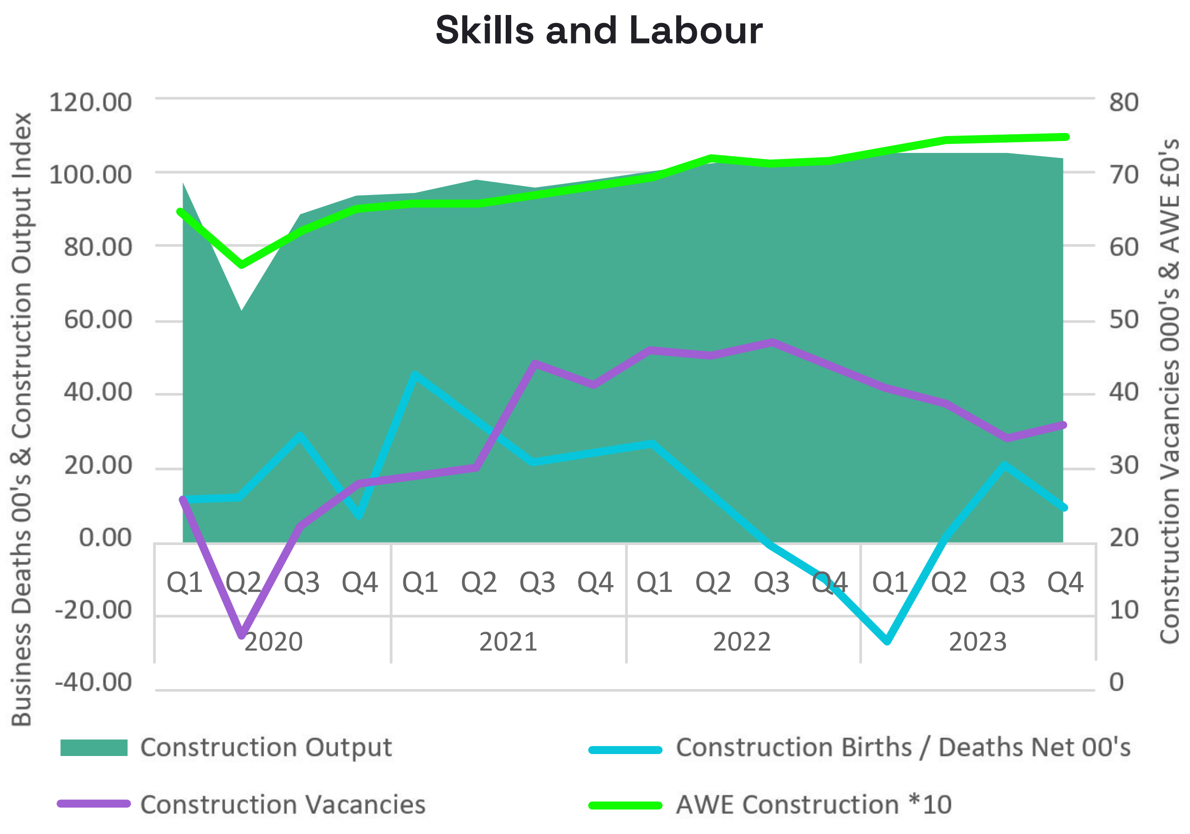
> "Increased focus on Resident health and wellbeing and property safety"

Graph 4



Construction vacancies, as you would expect in a landscape of stagnant output, have been on a downward trend, too. Despite all of this, average weekly earnings in construction are on the rise.

Graph 5



The Office for National Statistics (ONS) reports an annual growth rate of 4.9% in construction sector average weekly earnings for 2023. Although this is down from 2022 (when it stood at 5.36%), a 4.9% rise whilst output and vacancies are low, raises alarm bells.

"We have a direct workforce and anticipate a 5% pay increase"

"….labour demanding more money, skill sets dropping"

"Costs for external survey staff are starting to increase as demand grows and supply weakens"

"We are currently seeking new young design talent, for the benefit of internal training in advance of the anticipated forthcoming changes to affordable housing procurement"

"Working hard to secure additional labour, subcontractors and suitably qualified staff to ensure we can deliver"

"Seeking to recruit additional full time staff into the team to build capacity, expand expertise and widen service offering to clients"

If wages are climbing whilst output has slowed and there are less vacancies, what will happen when this picture changes? Once growth in construction output returns, and vacancies rise, it's likely the sector will see significant inflation in average weekly construction earnings.

And there are signs this uptick is on its way.

Although construction vacancies have been falling since 2022, the last few months of 2023 saw them pick up. This could be the early signs of an uptick in output, something also supported by suppliers' burgeoning confidence about demand. This quarter, 80% of suppliers are forecasting an increase in demand over the next six months (up 9% from December 2023).

Interestingly, when we asked contractors if they are experiencing demand that exceeds capacity, nearly 30% said not currently but they are expecting to within the next six months. This figure has shot up from just 13% last quarter.

And this quarter, when we asked contractors whether they are seeing an increase in their cost base around labour, a resounding 88.2% said yes. This is reflective of the skills shortage which is really starting to bite, particularly for contractors.

Optimism Score

Manufacturers: 8.88%

Merchants: 9.4%

Contractors: 8.82%

Although most suppliers are still in a holding pattern (like last quarter), when we spoke to manufacturers, merchants and contractors for this survey there was a slight uplift in confidence. Optimism scores have drifted up to 9.03% (compared to 8.8% in December 2023) and this is despite the more challenging Q4 that many suppliers experienced.

Some merchants, for example, went through a restructure process at the end of last year, resulting in redundancies. However, they have now come though this, having re-shaped their business to ensure its viability during the current period of stagnation.

Analysis

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

> "Yes, we are in a technical recession, but it won't be deep or long, and we predict 2024 will be a fairly stable year, economically. In terms of the deals market, there is definitely an uptick in that space with valuations of businesses holding up. There is more confidence starting to come through."
>
> "Suppliers are telling us that housing associations and local authorities are wanting more for less due to stretched budgets and significant priorities around RAAC, damp, mould and fire safety. What we're seeing in construction output is an overall downward trend with budgets being moved from new build, major CapEx and planned investment programmes into repairs and maintenance."
>
> "The growing crisis in the Middle East has the potential to disrupt global supply chain resilience across supply chains. Suppliers can currently deal with the six-week delay of container ships – we're seeing some robust resilience plans being put in place. But everyone is alive to the possibility that issues in the Red Sea could become a structural macro-economic problem and this will have severe consequences for construction prices."

Checklist

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

Focus on operational efficiency

Try not to fall into the trap of stripping costs today at the expense of tomorrow. A short-term approach on prices will store up trouble for next year. My advice is 'do it once and do it well'. Focus on life-cycle costing not just line-level pricing.

For example, the cost of repairs and maintenance isn't in the product, it is always in the labour. Have a look at how you can operate your responsive repairs more efficiently, with greater control. Yes, you might be able to save 2% on certain products but if that is at the expense of an operative efficiently delivering a job, then work out the real cost. It is probably far greater, especially if you are paying your staff more due to the current skills shortage.

Break the 'tragedy of the horizon'

Under the new procurement regulations, there will be a transition from 'most economically advantageous tender' (MEAT) to 'most advantageous tender' (MAT). This new language will change the focus from best price to best value. In theory, this should guard against what former Bank of England Governor, Mark Carney termed 'the tragedy of the horizon', where organisations adopt a short term perspective, looking at in-year fiscal performance at the expense of a longer term, more strategic outlook.

However, the proof will be in the pudding when it comes to whether social housing procurement professionals are able to think beyond short-term economic savings and translate the policy of the Procurement Act into practice.

Culture change and communication

Instilling a culture within your procurement team is key to achieving a more strategic approach – where long term value is celebrated over quick cost wins. But the wider business must also recognise and reward this long term view. Communicate MEAT Vs MAT changes in the Procurement Act across your organisation, so colleagues understand that price won't play such a key part in tender criteria going forward.

Managing board expectation is crucial here. Have meaningful conversations with different board members and your finance director, using the intelligence you've gathered from suppliers, operatives and your own research to evidence current conditions. Convince board members to focus on a long-term value approach to procurement rather than speedy savings.

Be alive to the changing geo-political environment

It may sound obvious, but we all know from the past few years that economic and political developments can happen fast. Make sure your business is primed and ready. Whether that's an escalation in the Middle East, the impact of impending policy changes or a new government closer to home, make sure you have the time and headspace to anticipate and plan for possible changes.

Report contributors

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

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- HUWS GRAY
- SCOTEC LIFTS LTD
- dfp SERVICES
- arc GROUP LONDON
- paularosa | manhattan
- MCP
- MP GROUP UK
- Oakray
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Get in touch to discuss your challenges or to find out more about how we can add value to your organisation.

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