A view of the UK economy and construction industry in the post EU referendum world

There is little doubt that the vote in favour of leaving the European Union will have a significant impact on the UK's economic and political landscape in the ensuing years.

Economic growth is likely to be slower than would otherwise have been the case, with the possibility of a mild recession in the second half of this year.

Slower economic growth will inevitably affect construction activity, particularly on the private side, with declines in total output now projected for this year and next.

Empirical evidence to support post-referendum forecasts remains thin on the ground and will do so for some months to come.

The UK economy actually performed reasonably well in the first half of this year despite the uncertainty surrounding the European Union (EU) referendum, with GDP posting growth of 0.4 per cent quarter-on-quarter in the first quarter and 0.6 per cent in the second.

Household expenditure growth was robust in the first half of the year, averaging 0.8 per cent a quarter, employment continued to expand with the unemployment rate falling to 4.9 per cent by end June and inflation remained low, although on an upward trend.

However, some of the underlying data paints a weakening picture. Investment growth has generally been weaker since the second half of 2014 and the increase was marginal in the second quarter of this year. There was a distinct slowdown in workforce jobs growth, to just 0.1 per cent in the second quarter of 2016, and the lack of productivity gains remains a significantly issue for the UK economy – it has been running at just 0.1 per cent a quarter since the end of 2013.

Concerns have also been raised around our current account deficit, which has been running at between 6 per cent and 7 per cent of GDP for the past three quarters. Unless capital inflows can take the strain there is likely to be further pressure on sterling which could force the Bank of England to raise interest rates before the wider economy is ready and able to deal with this.

The information available post the EU referendum is sending out some very mixed messages about future prospects and the suspicion is that there was a certain amount of knee-jerk reaction in the immediate aftermath of the vote. Perhaps the two indicators most at odds with each other at the moment are GfK's Consumer Confidence index and the Office for National Statistics' (ONS) retail sales figures. The July edition of the former shows the index slumping from -1 to -12 between June and July, an even worse result than the 'Brexit Special' index produced in the immediate aftermath of the referendum. This was the sharpest monthly fall since March 1990 and would have been expected to affect consumer spending patterns. However, retail sales volumes rose by 1.4 per cent month-on-month in July according to the ONS, which was the best result for some time.

The evidence base for the impact of the referendum vote remains sketchy and will do so for some time to come, thus there is a high level of uncertainty around forecasts produced at this time. However, the consensus of opinion is definitely on the negative side, especially for 2017. HM Treasury's monthly comparison of independent forecasts shows the median GDP growth prediction for this year falling from 1.8 per cent in June to 1.6 per cent in August and that for 2017 dropping from 2.1 per cent to 0.6 per cent over the same period.

Experian's current GDP forecast for this year and next is a little below consensus at 1.4 per cent this year and 0.4 per cent in 2017, with consumer spending growth weakening significantly next year and investment heading into negative territory.

This weaker economic outlook has obvious implications for the construction industry, particularly for the private sectors. Construction activity had already stagnated in the first half of the year and the quarter-on-quarter outturn for the second quarter was slightly negative.

Our Dublin forecasts, based on the premise of no change in the UK's relationship with the EU, assumed a better second half of 2016 than the first once EU referendum uncertainties were out of the way. However, we now expect a worse second half of 2016 with the industry experiencing a mild recession over the next two years. Some of this downgrade is related to the referendum and some is due to the weakness of some sectors in the first half of this year.

Interestingly in the new house building sectors, public housing output is faring worse than expected while private housing output is holding up. Given the particularly poor second quarter, when public housing output barely stayed above £1bn in 2013 prices, a double digit decline is almost inevitable for the year as a whole. The current political environment remains unconducive for any pick up in the sector over the forecast period, although there have been increasing calls, even from some on the government back benches, for more funding for genuinely affordable housing.

Our prognosis for private housing has not changed substantively from that put forward in the summer, despite the initial post-referendum panic from investors. We have halved the growth rate for next year on the basis of weaker economic performance but the underlying driver of the sector, lack of supply compared with latent demand, has not changed, thus the projection is still for growth over the forecast period.

Infrastructure output is likely to contract more sharply this year than anticipated and this is believed to be due to a hiatus in road building and a weak performance in the electricity sub-sector for the first time in many years. While there could be some slippage in timing for some of the major projects in the pipeline we do not foresee any significant cancellations over the forecast period. In fact, the government may boost capital spending to mitigate the impact of the referendum vote. Hopefully, the position will become clearer with the Autumn Statement in late November.

The sector we believe is most vulnerable to the impact of the referendum vote is the private commercial one, with its heavy reliance on overseas investors in the London market. The capital's office development cycle had probably already peaked, thus the referendum result is likely to sharpen the downturn. However, the regional markets are somewhat more insulated from this effect and given a shortage of Grade A space in many, the prospects for new build remain good.

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CONSTRUCTION OUTPUT FORECASTS

annual percentage change

		Forecasts		
	2015	2016	2017	2018
New Housing	+3.2	+2.6	+1.3	+0.9
New Infrastructure (civil engineering)	+30.3	-6	+1	nc
New Non-residential Building	+1.7	-0.9	-1.3	+1.5
Housing R&M	+1.5	-0.9	-1.6	-0.2
Non-residential R&M	-2.6	+0.7	nc	+1.7
Infrastructure R&M (civil engineering)	-4.8	-6	nc	+1
ALL WORK	**+3.8**	**-0.8**	**-0.3**	**+0.9**

Sources: ONS and Experian.