



IRELAND MARKET VIEW

February 2023
Mace Consult



Foreword

Despite some of the obvious challenges, 2023 looks set to be an exciting year. Construction material price inflation has been rampant over the past 12 months and, while it is starting to ease, is still putting the viability of many projects under pressure. In trying to control for higher costs, as well as the ever growing importance of sustainability, clients and contractors need to become more familiar with emerging innovations and digital tools, such as offsite construction and the latest BIM developments, all of which can help deliver more for less. As ever, it is necessary that investors not only think about the short-term, but also focus on the full project life cycle. With retrofitting of existing property set to be a flourishing construction sector in the coming years, it highlights the risks of failing to do so.

Rising interest rates and falling real incomes are likely to hit the housing market and, even with no let-up to supply shortages, the new build sector will face considerable headwinds this year. By contrast, one sector which should power ahead is infrastructure. The Irish government has ambitious plans, particularly around energy, utilities and transport. Such investment is vital in order to reach carbon neutral targets. However, to successfully complete all of these schemes, the government will require an intelligent approach to skills shortages.

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Overview of the economy

Last year was a relatively good one for the Irish economy. The strength of its pharmaceutical and ICT sectors helped provide protection against rising energy prices and it continued to recover from the pandemic.

In most countries, GDP is the usual measure to see an economy’s size and whether it is performing well or not. However, due to a few large multinationals distorting this metric in Ireland, it is preferable to use alternative indicators, such as modified domestic demand. Showing how different the figures can be, GDP was 2.3% higher in Q3 2022 than Q2 2022 and had risen by over 10% relative to a year earlier. By contrast, modified final domestic demand had fallen 1.1% in the latest quarter, albeit growth of 6.2% over the previous 12 months was still very strong.

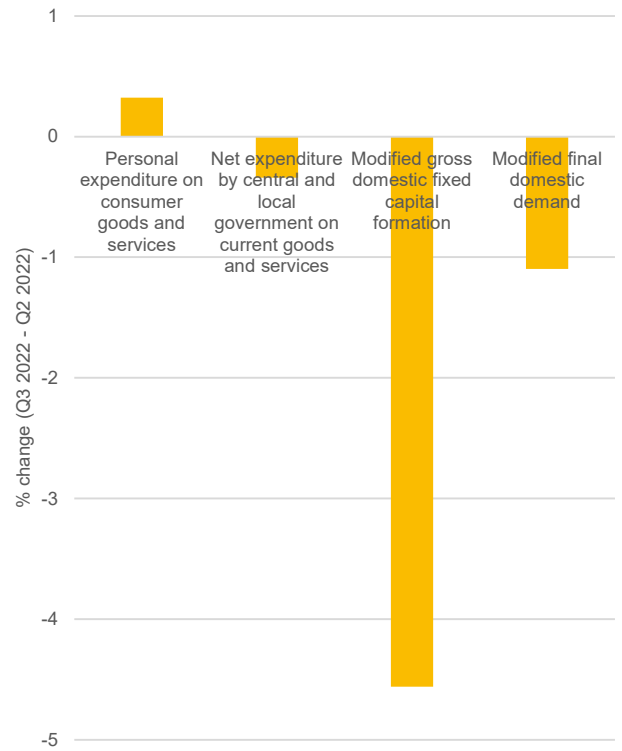
Given construction is much more dependent on the domestic economy than how global tech giants perform, the fall in Q3 is important. This is doubly so because it primarily came from a reduction in fixed capital formation, an item which includes investment in buildings and construction. Fortunately, from a construction perspective, the majority of the drop came from lower spending on machinery and equipment, suggesting there may be some problems in the manufacturing sector. Furthermore, both building and construction, as well as machinery and equipment, are well up on Q3 2021, with 2022 overall being a good one for investment.

The fastest growing sector in Q3 was personal consumption, but this is likely to come under pressure in 2023 as real incomes fall.

High inflation

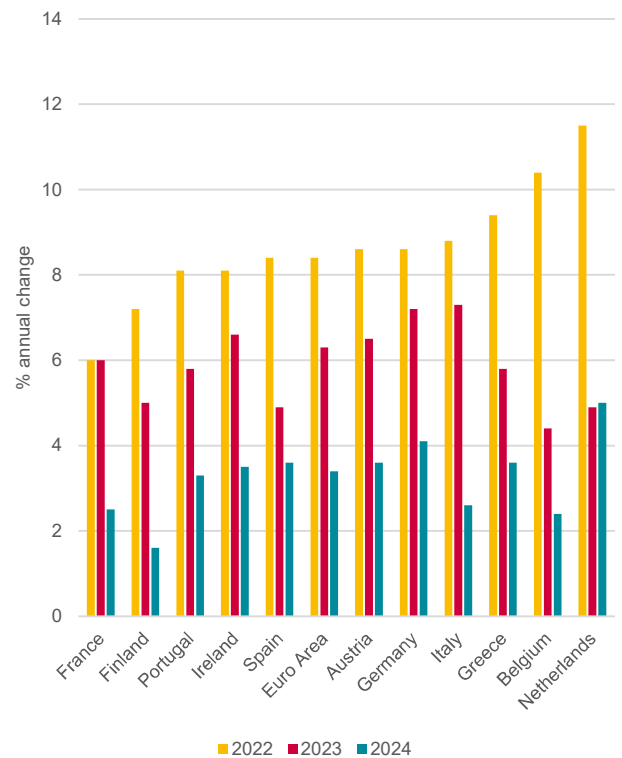
In 2022, Ireland had one of the lower inflation rates in Europe, but the European Central Bank (ECB) still expects the annual change to have been over 8%. Gas and electricity prices have surged, rising 62.7% and 86.4% respectively in the past year. However, many other items, including food, transport and education have risen by noticeably less than in other European countries. Overall, inflation is both much higher than wage growth and will

Figure 1: Domestic demand



Source: Central Statistics Office

Figure 2: CPI inflation forecast



Source: European Central Bank

remain considerable this year. Real pay is falling rapidly and, along with the ECB starting to raise rates in the middle of 2022, this will put households under pressure this year.

Strong labour market

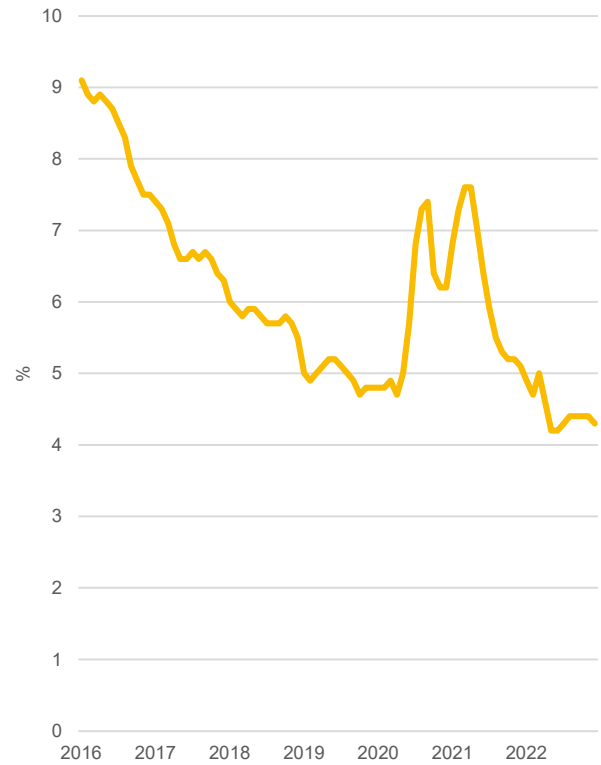
Even with falling real wages, low levels of unemployment are still able to provide some support to consumption. Standing at 4.3%, this is marginally higher than June's 4.2%, at which point it was at its lowest in over 20 years. However, while low unemployment suggests the economy is holding off against some of the inflationary headwinds, it also creates problems for employers. Notably, since coming out of the worst of the pandemic, vacancies have been surging. This is true both in the wider economy, and in construction, which is the worst affected sector. Vacancies in this sector are up five-fold since before the pandemic, with transportation and storage the next worst, having seen a quadrupling of figures.

Tight labour markets are helping to drive inflation in other countries, such as the UK and US but, in Ireland, labour costs are not yet accelerating to the same extent. Regular weekly earnings were 3.5% higher in Q3 2022 than a year earlier and, as such, they have picked-up from Q2 when the pace of growth was 2.5%. With unemployment so low, and vacancies high, pressure to increase pay may mount in the coming months.

Outlook

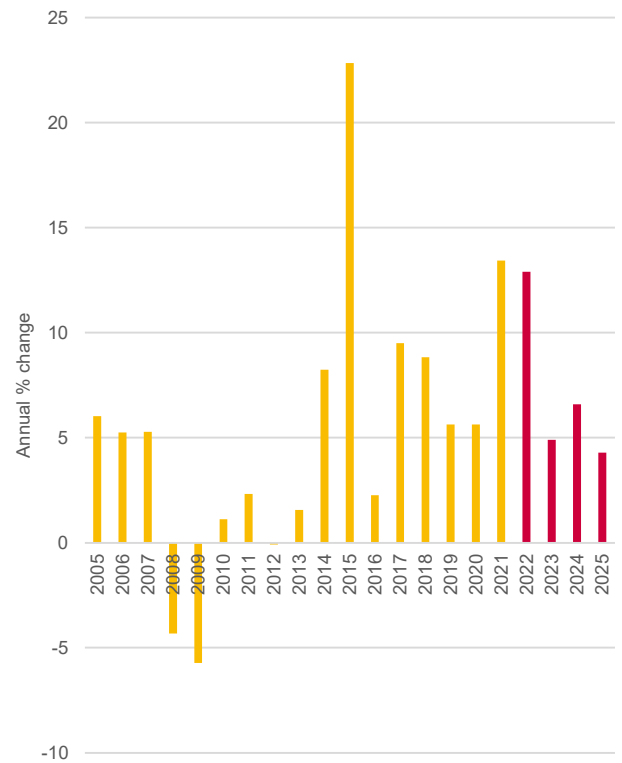
Looking to the year ahead, it seems almost certain that the economy will slow in 2023. As mentioned, there are complications with calculating Irish GDP, and while the ECB expects it to outstrip other European countries in the coming years, as elsewhere, growth will slow significantly. Ireland's economy, like across the eurozone, will suffer from higher inflation and the pressure this will put on consumers. Given the uncertainty around energy prices, ongoing issues such as rising interest rates, and new ones, including the reopening of China, 2023 promises to be another demanding year for business.

Figure 3: Unemployment rate



Source: Central Statistics Office

Figure 4: GDP forecasts



Source: OECD, ECB forecasts

Construction Sector

Data up to the third quarter of 2022 points to the construction industry having a challenging year, with production falling in each of the first three quarters. As a result, the sector is now 8% smaller than at the end of 2021 and almost 15% down on where it was in the final quarter of 2019, just before the pandemic.

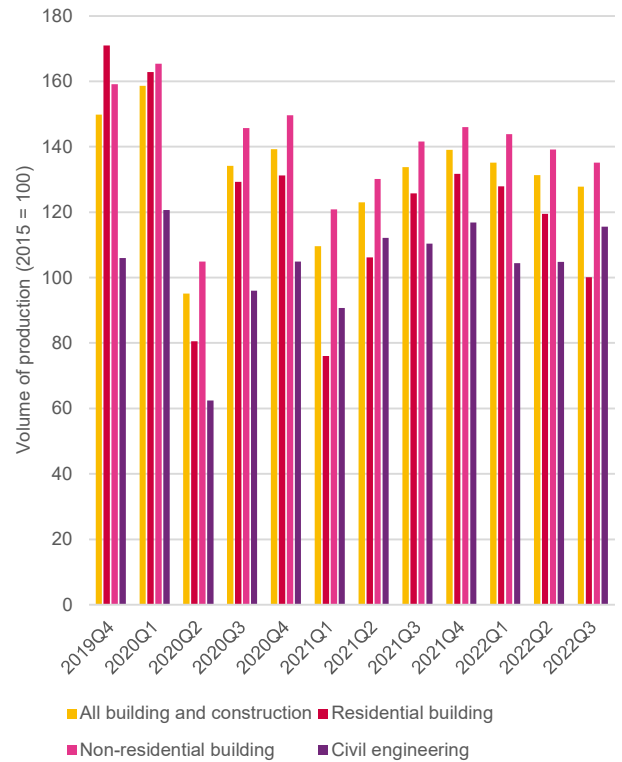
Based on this data, the residential sector appears to be the one facing the biggest difficulties, with production declining 16.2% in the third quarter. This is somewhat surprising given other statistics show that 2022 was a stellar year for home completions. That said, completions peaking in Q2 and slipping in the third and fourth quarter indicates developers may be taking a step back. Demand may remain high, but housebuilders that are nervous about rising costs and interest rates could be starting to pull back.

The civil engineering sector is marginally smaller than at the end of 2021, but had a very strong third quarter. Production rose by more than 10% and, based on the government’s plans, potential for growth is good. Released last year, Prospects 2022 – Ireland’s major infrastructure pipeline – showcased a number of significant forthcoming projects and programmes, with many due to start this year.

Material costs outpacing consumer inflation

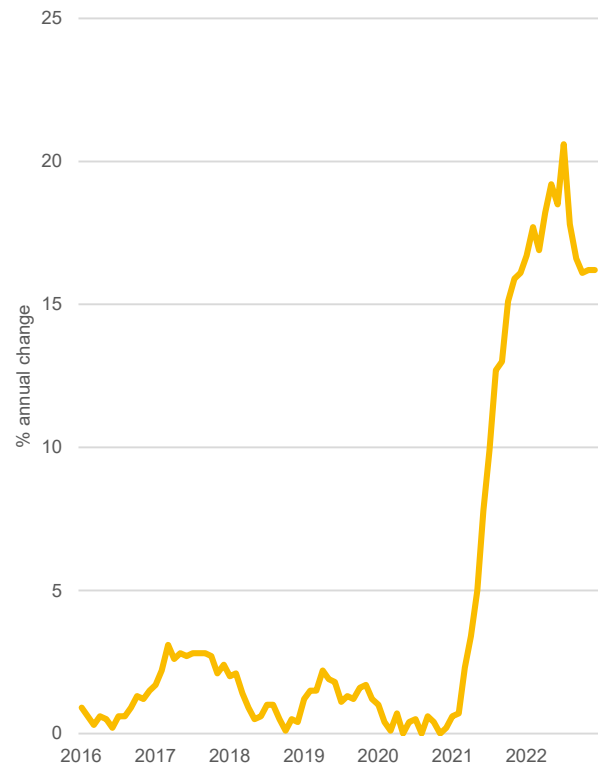
2022 was a tricky one for contractors trying to deal with rising material prices. Data shows that, following on from rising 16.1% in 2021, the wholesale price of building and construction materials rose a further 16.2%. Since December 2020, material prices have risen 35% - a huge amount and far higher than the general rate of inflation. By the end of last year, there were signs that inflation was starting to ease but, even in the final quarter, prices had risen almost 2%. Base effects mean that, as we move through spring and the immediate impact of the Ukraine crisis falls out of the data, the rate of inflation should cool sharply. However, weaker inflation need not mean falling prices, and construction projects will continue to face significant challenges in proving their viability.

Figure 5: Construction production



Source: Central Statistics Office

Figure 6: Wholesale price index for building and construction materials



Source: Central Statistics Office

Last year, the price of steel rocketed. This was due to global factors, albeit prices had started to come down by the end of the year. Structural steel was not the only product seeing exceptional rises, with many other materials also seeing double-digit increases. With the price of energy soaring in the face of the war in Ukraine, it is unsurprising that construction products, many of which are energy intensive, had such large increases. Even where some material prices fell, such as with softwood, this was in large part due to previous rises. While softwood may be noticeably cheaper than at the end of 2021, prices are still around 50% greater than they were in December 2020.

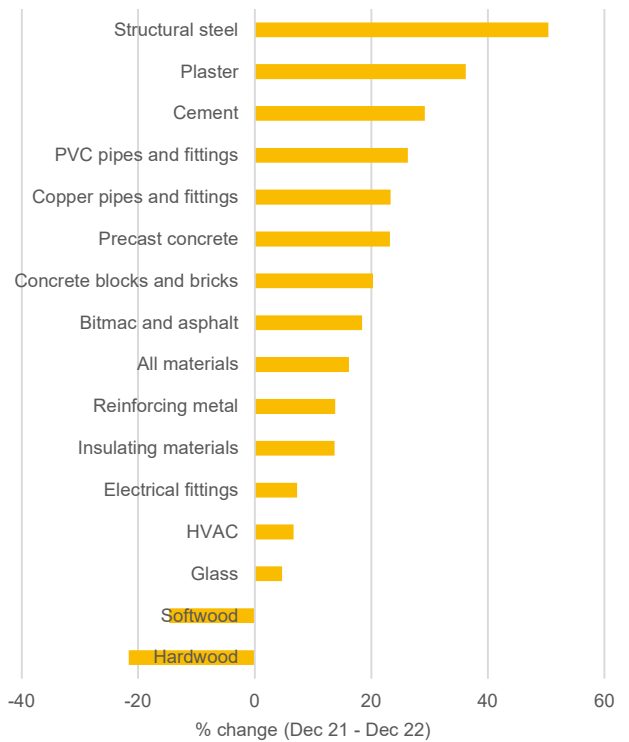
Slowing pay growth

Regular weekly earnings in construction, having risen steeply since the pandemic, dropped in the third quarter, bringing the annual rate of growth down from 10.4% to 5.1%. This is likely to be another sign of the challenges facing the industry. Despite the substantial increase in vacancies, with production falling, workers may find it harder to get large pay increases. Firms, seeing less work, may be less concerned about staff shortages, as well as less able to raise pay. However, the large infrastructure pipeline is likely to limit their ability to keep a lid on wage growth.

Outlook

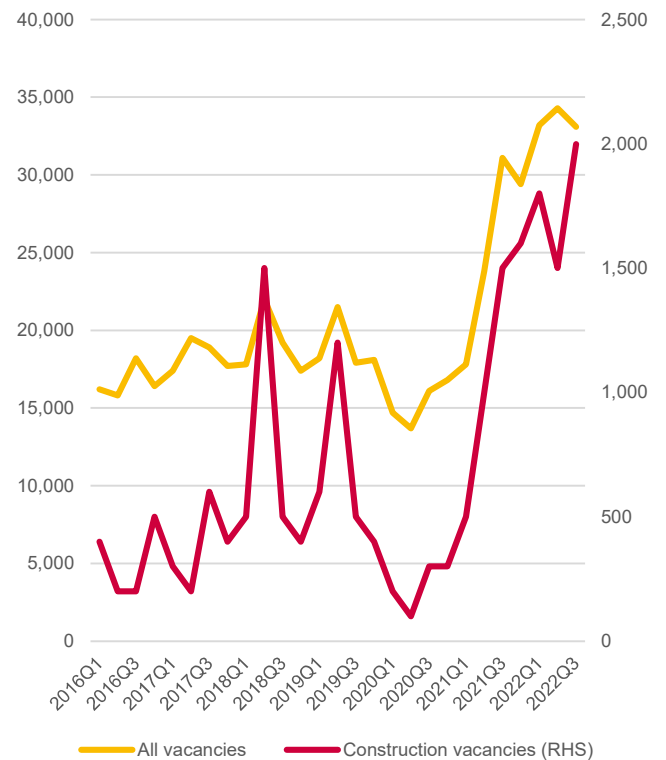
The December survey from the European Commission found Irish respondents at their most confident since March 2022. In particular, order books are rising and, while over half still expect prices to increase in the coming quarter, this is the lowest share since early 2021. Furthermore, material shortages are evidently less of a problem than they were earlier in the year, with December also being the best month for construction activity since April. Overall, the survey gives the impression of the industry moving into the new year in positive fashion.

Figure 7: Material price inflation



Source: Central Statistics Office

Figure 8: Number of vacancies



Source: Central Statistics Office

Opportunities

There are a number of opportunities and considerations for clients in the near future. We summarise a couple of these as well as explaining how Mace can help clients make the most of them.

Sustainability and decarbonisation

It should come as no surprise that this will be a driver behind much of construction over the next decade. Environmental considerations will come to the fore in many different ways, with one being the need to improve a building's energy efficiency through retrofitting. The embodied carbon of an existing building means demolishing it and replacing it with a new one can be incredibly costly from an emissions perspective. Increasingly clients are asking whether a cut and carve approach to the building is appropriate. By maintaining the existing structure, considerable carbon savings can be made. At the same time, this still allows for a much more energy efficient building, while also often allowing for additional floors and improvement to the high-grade office space.

In order to achieve sustainability objectives in general, and carbon neutral objectives in particular, they need to be central to the objectives of the project and the design solution from the outset. If they are part of the framework for the project's development from the start, then it avoids the problem of them arriving too late. Issues when thinking about ideas and solutions to reduce embodied and operational carbon later on in the project lifecycle include the need to re-think and redesign the project. These inevitably come with costs and can be difficult to implement if time pressures are too severe.

Infrastructure

Included in the 50 projects identified in Prospects 2022 is the €1 billion+ due to be spent on Metrolink, potentially over €3 billion on the DART+ programme and another €1 billion+ on a new road between Cork and Limerick. As well as numerous transport schemes, Prospects 2022 also reported on

many new water projects. These projects will help provide long-term, sustainable water supply and aid economic growth. Furthermore, Ireland has significant onshore and offshore wind capabilities which will also see sizeable investments in the next few years. Building a stronger utilities system is an essential part of Ireland's carbon neutral ambitions. What all these schemes will have in common is they are likely to be complex, taking many years to complete and involving coordination with a wide variety of different stakeholders. Delivering a successful project on budget and on time will involve knowledgeable well-resourced teams who can work collaboratively.

Particular problems with large infrastructure projects include scope creep and price creep. The last two years have highlighted the risks of price creep beyond the desired cost plan. In this case, the true impacts of market conditions only appear through direct supply chain engagement and market testing. With these projects, which can last for many years, effective use of data becomes particularly important. Successful use of data and evaluation techniques will help to improve the overall solution and better meet a project's objectives. When costs are rising during the construction phase, having greater confidence that the solution is the right one, optimised in terms of what drives value and minimises waste, is vital. Wherever possible, solutions to reduce the whole life cost of an asset will provide financial benefits in future years.

Challenges

With this report having already outlined the economic challenges facing the country, let's look at the mitigations.

Rising costs

Both material price inflation and labour cost growth may be on the way down from their peak, but they remain at elevated levels. Similarly, the fact they are starting to ease does not mean that they are falling, and the pressure on many new schemes' viability will still be acute. In such an inflationary environment, providing cost certainty is almost impossible, but construction is changing and there are many ways to support a client in helping reduce some of these risks.

To facilitate current industry best practice and realise the associated productivity and efficiency benefits, procurement practices need to consider how best to make the most of modern-day technologies. An objective from the procurement process should enable the right capabilities, experience and organisations to influence the solution to best meet the overarching objectives of the project or programme. With the right environment, there can be no doubt as to the cost saved through efficiency of both process and delivery. In turn this maximises value of the scheme, and provides increased certainty and better management of risk; all of which are welcome propositions to any stakeholder in a volatile market. Earlier involvement in driving ideas, solutions and value with a positive lens to right first-time design, manufacture and delivery must be a more attractive proposition in the market. Evidence from projects such as the rising factory at East Village shows that early strategic engagement and amalgamation of specialists in their field, alongside the design team, can drive the most effective and efficient solutions through Design for Manufacture and Assembly (DfMA).

Lack of sizeable contractors

With all the projects mentioned in the opportunities section, and many more outlined in Prosects 2022, as well as labour shortages,

there are questions about the feasibility of delivering them all. Ireland is a fairly small market, and there are not many contractors large enough for what some of the schemes will require. As with managing rising costs, leveraging new ways of thinking could provide better outcomes.

Firstly, adopting an integrated approach, working closely with a collaborative supply chain should help the number of contractors who can tender. Considering modern methods of construction is also likely to be beneficial, especially given the challenges around the labour market. Using a kit of parts or construction to production may help lower costs and risks. It is only possibly to truly realise a shift from construction to production if there is the support of the contractor and the supply chain. However, once again, the best time to consider construction to production is early on in the project life cycle. As with meeting sustainability objectives, if the original design does not take it into account, then it is likely to involve a re-engineer and re-design at a later stage. Along with adding to the cost, this delayed approach may fail to achieve all the wide-ranging benefits that construction to production offers. Too often the desire to embrace construction to production comes too late in the process and fails to include the right experience and parties early enough to positively influence the solution.

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