The Brexit Paradox

It was supposed to be a meltdown, but...
Sentiment has picked up since the EU referendum vote

Purchasing Managers Index
(Composite, Construction, Manufacturing, Services)

Source: Markit
UK equities have shrugged off Brexit and Trump

Source: Bloomberg
Though performance is a function of external exposure

Performance of KPMG indices since Brexit vote

Source: KPMG analysis, Bloomberg, Capital IQ and Thomson Reuters Datastream
And removing the exchange rate effect changes the picture.

Performance of KPMG indices since vote, in dollars

Source: KPMG analysis, Bloomberg, Capital IQ and Thomson Reuters Datastream
Retail spend has proved remarkably resilient

Retail Sales
(Retail Sales: All Retailing including Automotive Fuel (SA,2013=100))

Source: ONS
Fuelled by low interest rates

UK Bond Yields and BoE rate

Source: Bank of England
Exports are benefiting from the 18% fall in sterling in 2016

Sterling exchange rate
(effective exchange rate index, 2005=100)

Source: Bank of England
But nearly half of UK exports go to Europe
& trade deficit suggests the fall is likely to prove permanent

Source: ONS, The Pink Book
So it will all be ok then?

Well, not really...
Raw materials cost has risen 12% as sterling has weakened

Manufacturing input prices

Source: ONS
Leading to a 2% increase in output prices

Manufacturing output prices

Source: ONS
Driving increases in inflation and reducing real wages

CPI - Inflation
Consumer Price Indexes (2015=100)

Source: ONS, KPMG projections
Real retail sales have outpaced real wages since 2010

Source: ONS
Funded by a fall in savings

Household savings ratio
(savings as a percentage of household disposable income)

Source: ONS
Acknowledged by Government in lower growth forecasts

Table 1.1: Overview of the economy forecast

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Output at constant market prices</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross domestic product (GDP)</td>
<td>2.2</td>
<td>2.1</td>
<td>1.4</td>
<td>1.7</td>
<td>2.1</td>
<td>2.1</td>
<td>2.0</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>1.4</td>
<td>1.3</td>
<td>0.7</td>
<td>1.0</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>GDP levels (2015=100)</td>
<td>100.0</td>
<td>102.1</td>
<td>103.5</td>
<td>105.2</td>
<td>107.4</td>
<td>109.7</td>
<td>111.9</td>
</tr>
<tr>
<td>Output gap</td>
<td>-0.3</td>
<td>-0.2</td>
<td>-0.6</td>
<td>-0.6</td>
<td>-0.3</td>
<td>-0.1</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Expenditure components of real GDP</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Household consumption</td>
<td>2.5</td>
<td>2.8</td>
<td>1.2</td>
<td>1.1</td>
<td>2.1</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>General government consumption</td>
<td>1.5</td>
<td>1.0</td>
<td>0.6</td>
<td>0.5</td>
<td>0.3</td>
<td>0.6</td>
<td>0.8</td>
</tr>
<tr>
<td>Business investment</td>
<td>5.1</td>
<td>-2.2</td>
<td>-0.3</td>
<td>4.1</td>
<td>5.3</td>
<td>4.1</td>
<td>3.6</td>
</tr>
<tr>
<td>General government investment</td>
<td>-2.0</td>
<td>2.3</td>
<td>3.3</td>
<td>2.1</td>
<td>1.9</td>
<td>8.8</td>
<td>3.3</td>
</tr>
<tr>
<td>Net trade¹</td>
<td>-0.4</td>
<td>-0.2</td>
<td>0.3</td>
<td>0.3</td>
<td>-0.1</td>
<td>-0.1</td>
<td>-0.1</td>
</tr>
<tr>
<td><strong>Inflation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CPI</td>
<td>0.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Labour market</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employment (millions)</td>
<td>31.3</td>
<td>31.7</td>
<td>31.8</td>
<td>31.9</td>
<td>32.0</td>
<td>32.2</td>
<td>32.3</td>
</tr>
<tr>
<td>Average earnings</td>
<td>1.8</td>
<td>2.2</td>
<td>2.4</td>
<td>2.8</td>
<td>3.3</td>
<td>3.6</td>
<td>3.7</td>
</tr>
</tbody>
</table>

Source: OBR Economic and Fiscal Outlook, November 2016
Impact on construction

Divides the industry into winners and losers
Construction output reflects GDP & Government policy

Source: ONS, Economist Intelligence Unit and Mintel
Commercial

Is likely to suffer under all scenarios
Commercial is already the weakest construction segment

Source: IHS Markit / CIPS
And private investment is being stalled by uncertainty

Source: KPMG Forecast
Infrastructure

Will keep the lights on
Government infrastructure spend is forecast to rise

Source: HMT “Investing in Britain’s Future”, June 2013; Office of Budget Responsibility
But spend is concentrated on road and rail

Source: HMT “Investing in Britain’s Future”, June 2013
Energy dominates the overall infrastructure pipeline

Source: National Infrastructure Pipeline
Housebuilding

Depends on Government policy
House price valuations continue to diverge by region

Regional house price to income ratios for all buyers
(Halifax House Price Earnings Ratio)

Source: Halifax, Haver
But interest rates are low, so mortgages remain affordable

Mortgage interest payments relative to income
(per cent)

Source: Council of Mortgage Lenders
Supply side gap remains the fundamental constraint

House building since 1946

Source: Shelter / KPMG “Building the Homes We Need” 2014
Employment & Skills

Is the major risk (and opportunity)
Unemployment levels are at an historic low

Unemployment and Wages
(Unemployment rate and average weekly earnings)

Source: Haver
So construction labour shortages will persist

London and South East construction labour estimates 2014 - 2017
(Blue = pipeline; orange = estimated)

- **At least 20% more labour required than available**
- **51% deficit in training provision**
- **70% of Nine Elms workforce is non-UK nationals**

**Source:** LCCI – KPMG Skills to Build 2014 Construction Skills Index, November 2014
Economic growth has come from rising employment.

Source: ONS
And productivity remains a major issue

Productivity performance, 2010-2014 average (current prices, UK=100)

Source: ONS
Especially in construction

UK productivity (1997 Q1 = 100)

Source: ONS
Key issues and challenges
Key Strategic Issues for the construction industry

1. Industry skills need and gap
2. Technology opportunity
3. Leadership, voice and Industrial Strategy
4. Industry structure and initiatives to drive reform
5. Potential for consolidation