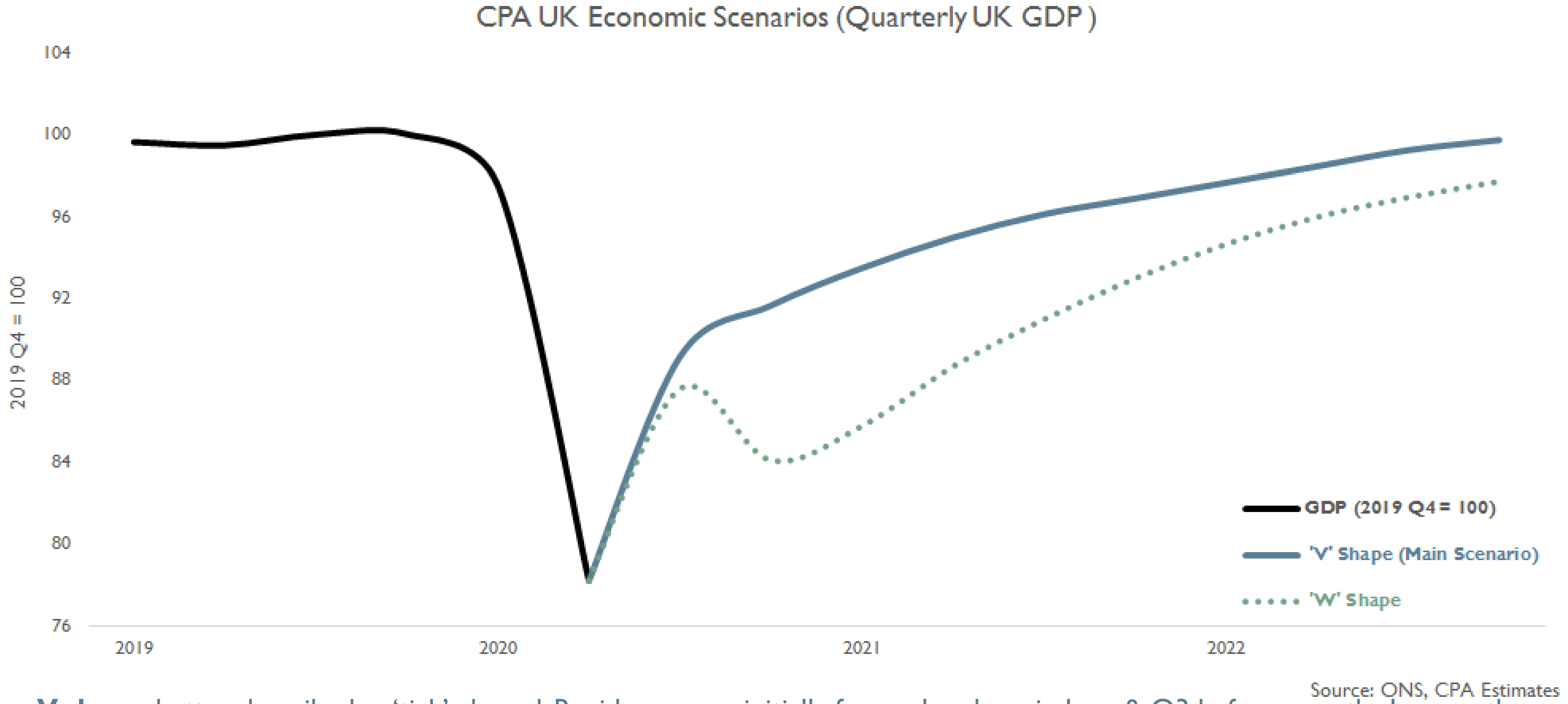
CPA Scenarios for TTF – 24th November 2020

Noble Francis – Economics Director

UK Economy

CPA Economic Scenarios

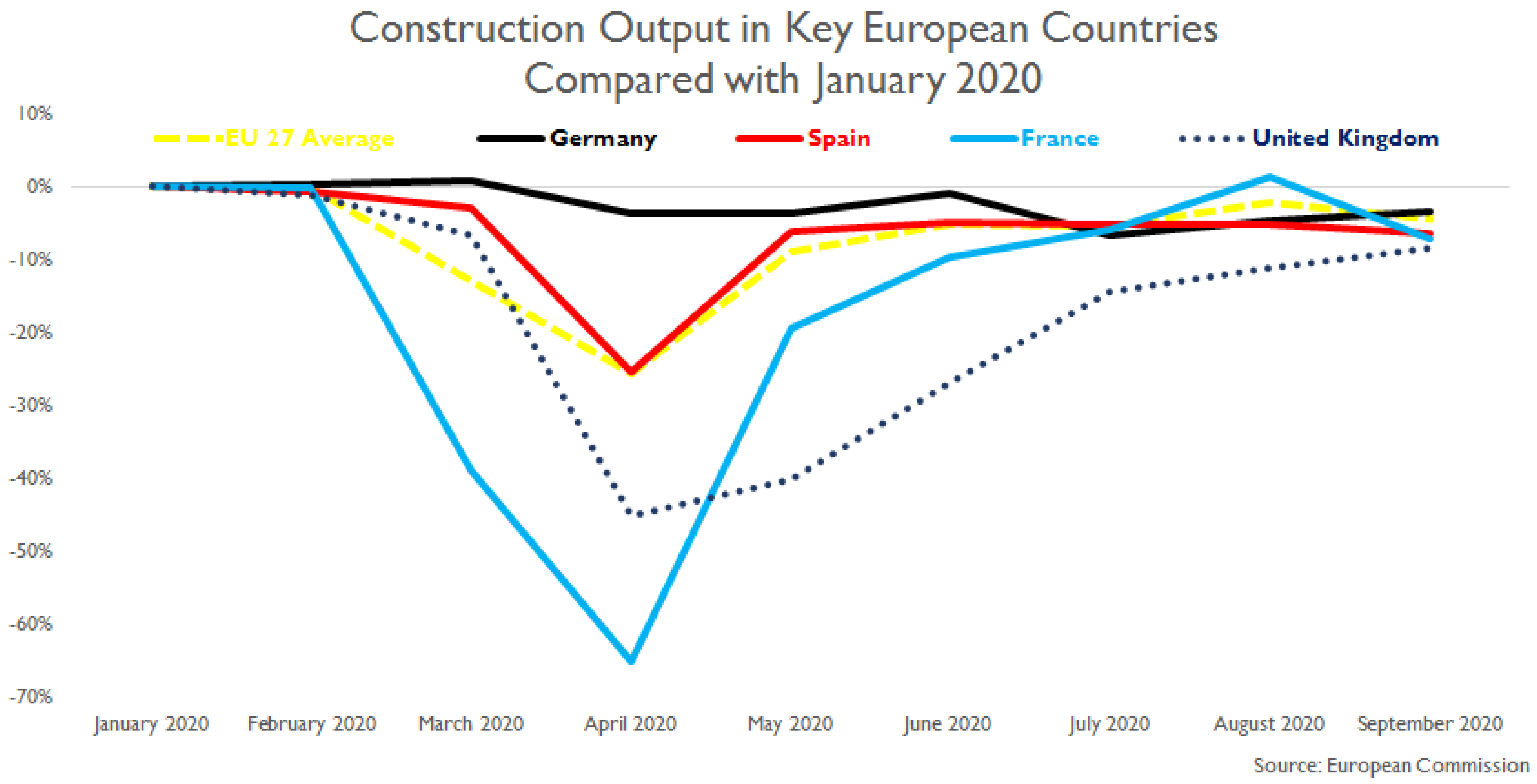


V-shape; better described as 'tick'-shaped. Rapid recovery initially from a low base in June & Q3 before growth slows as the furlough scheme ends, unemployment rises and hinders recovery in demand. Local/regional lockdowns occur but primarily focus on restricting social interactions between households although parts of the hospitality sector would still be affected

W-shape; recovery in June & Q3 before second wave, with colder weather, in the same strain before a vaccine or in a different strain leading to a nationwide lockdown. There is assumed to be a higher degree of business continuity due to learning from the experience of the initial lockdown and consequently the second dip is not as harsh.

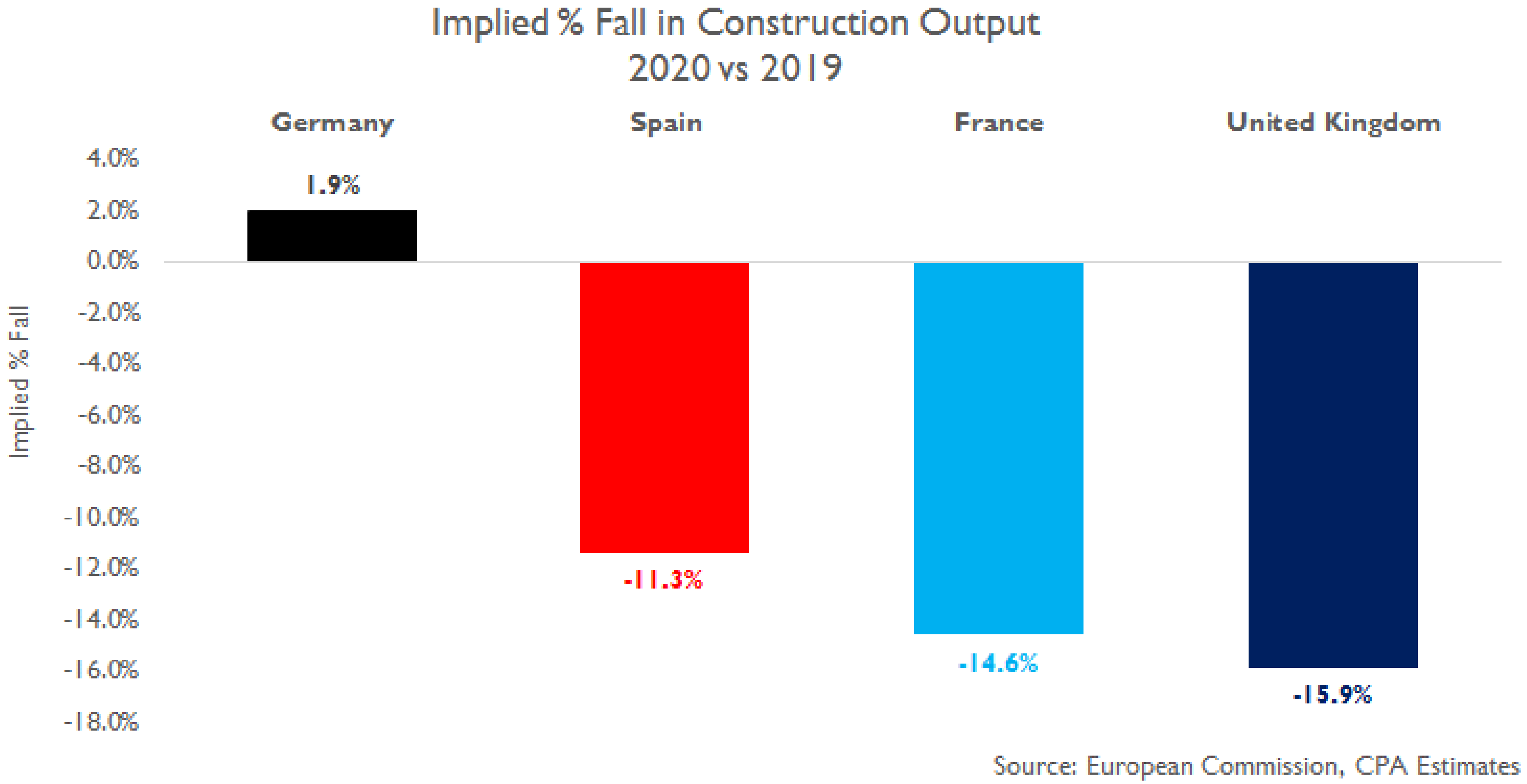
Construction

EU Construction Output



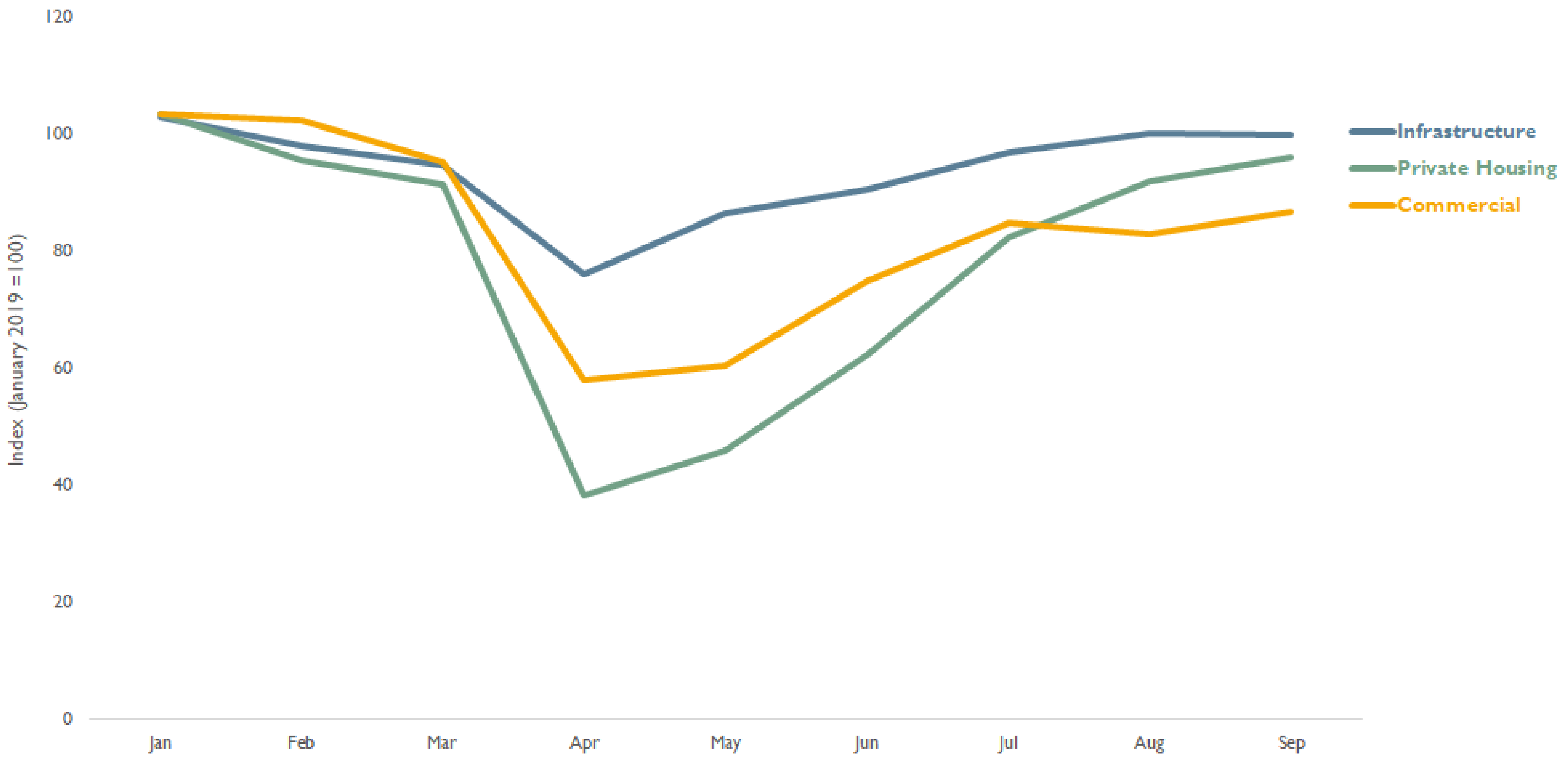
Construction output in France had the sharpest hit during lockdown in March and April but by August activity had recovered to pre-Covid-19 levels whilst UK construction output fell faster than in Spain and Germany. Although output in the UK did not fall as fast as in France during March and April, it was considerably slower to recover and in August remained 9% lower than in January 2020, pre-Covid-19.

Implication for the Year Overall



If UK construction activity remains at August 2020's level for the rest of the year, UK construction output in 2020 would be 16% lower than in 2019, a worse fall than in Germany (in which output only fell by 5% during lockdown), Spain and France.

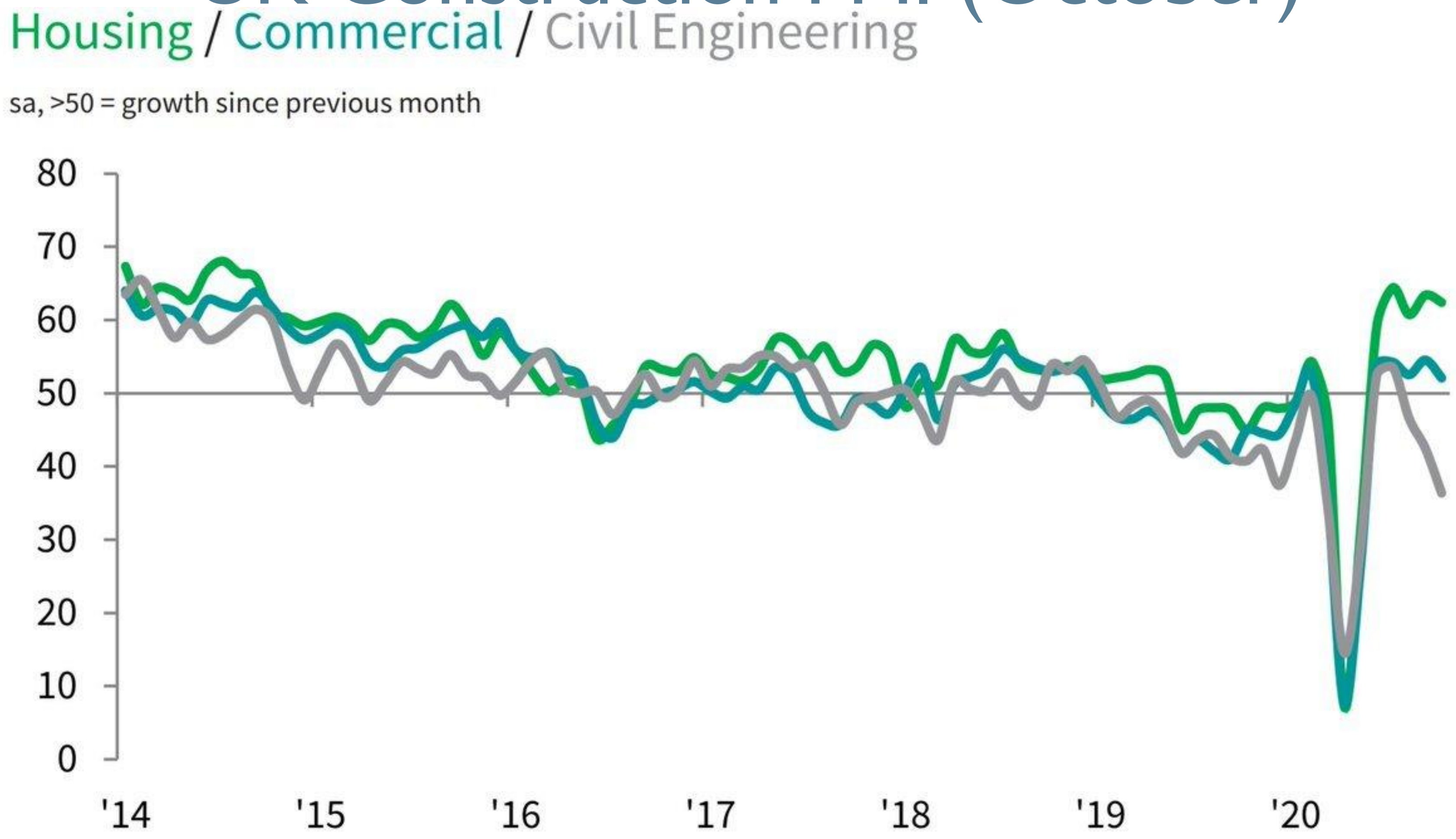
Construction Output So Far This Year



Source: ONS

Construction output has recovered sharply since the initial lockdown eased in the Summer and recovered further in Autumn. The indications from house builders and contractors are that demand will be strong in housing new build and refurb for the next 4-5 months whilst infrastructure demand should be strong long-term

UK Construction PMI (October)



Activity grew but there was a slight dip in the rate of growth after September's acceleration in activity. Growth was once again primarily driven by housing with a slowdown in commercial. The PMI reported that civil engineering activity fell for a 3rd consecutive month but that is not in line with civils contractors that we have spoken to, which say civils work is strong in all areas except airports and local authority maintenance.

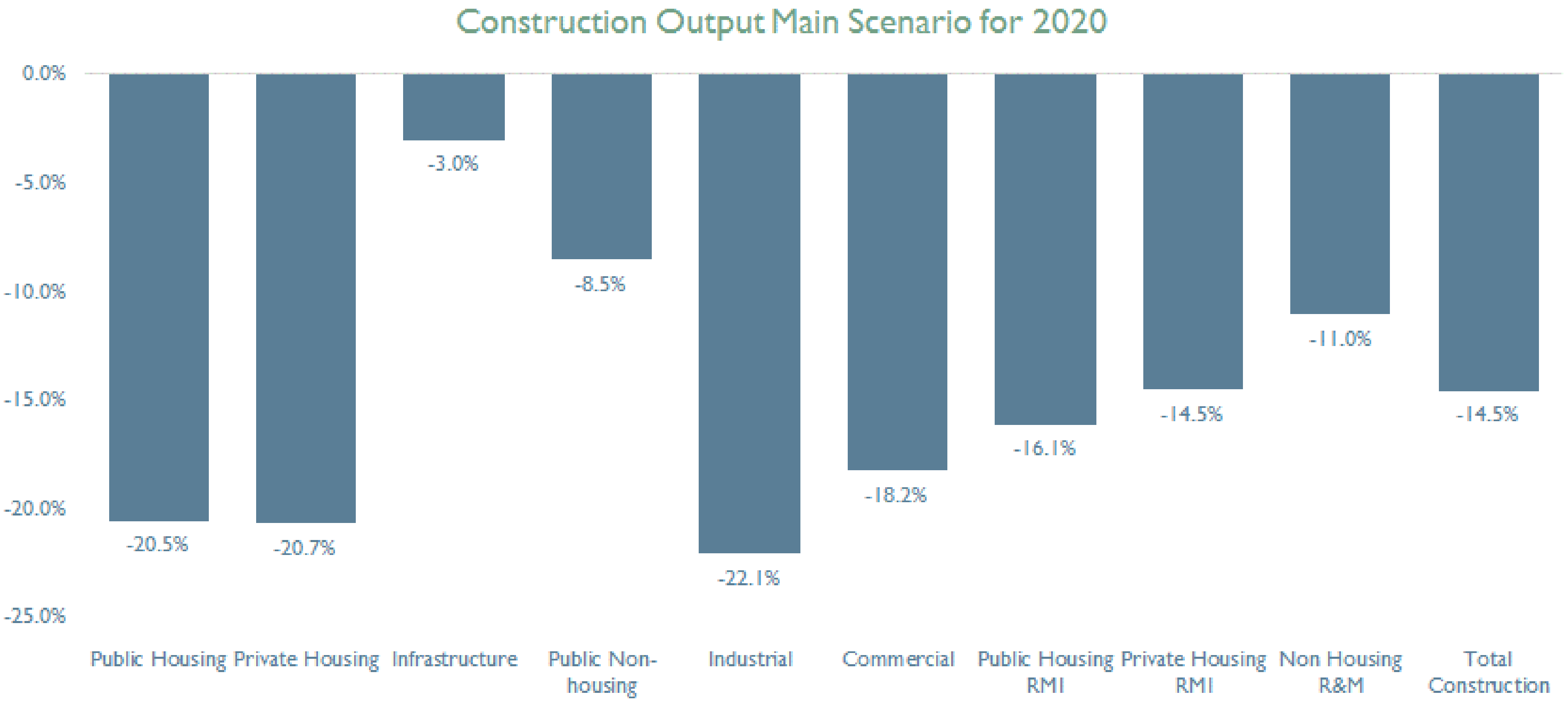
Recovery – Positives

- Activity got back on site quicker than anticipated & social distancing guidance on site isn't as strong as it was in April-May
- 2nd Lockdown hasn't hindered construction activity
- The furlough scheme delayed sharp increases in unemployment so demand remains strong
- The Stamp Duty holiday and Help to Buy are sustaining housing & house building demand
- Infrastructure – Clients with certain finance, a pipeline of major projects & frameworks
- Infrastructure, housing new build and refurb (and especially DIY) remain strong
- House builders & SMEs report demand is likely to remain strong for the next 4-5 months at least although little visibility after that
- Government policy – £1 billion for decarbonisation of public sector buildings & £2 billion for energy-efficient retrofit of the existing housing stock… but will it happen?

Recovery – Negatives

- Demand is slowing in commercial, industrial & public housing rm&i (outside of cladding remediation)
- Productivity on site is 10-15% lower so projects cost more and take longer but who will pay?
- We are hearing that main contractors and major house builders are asking specialists & sub-contractors to cut rates & cash flow is a big issues for many SMEs
- What about the impact of rising unemployment on private construction demand after the furlough eventually scheme ends?
- Long-term impacts on structurally changing work/spending patterns (where is the demand for new, additional commercial offices, retail & leisure space?) and households/firms may need to build in additional risk into spending/investment plans?

CPA Main Scenario for 2020 (Autumn)

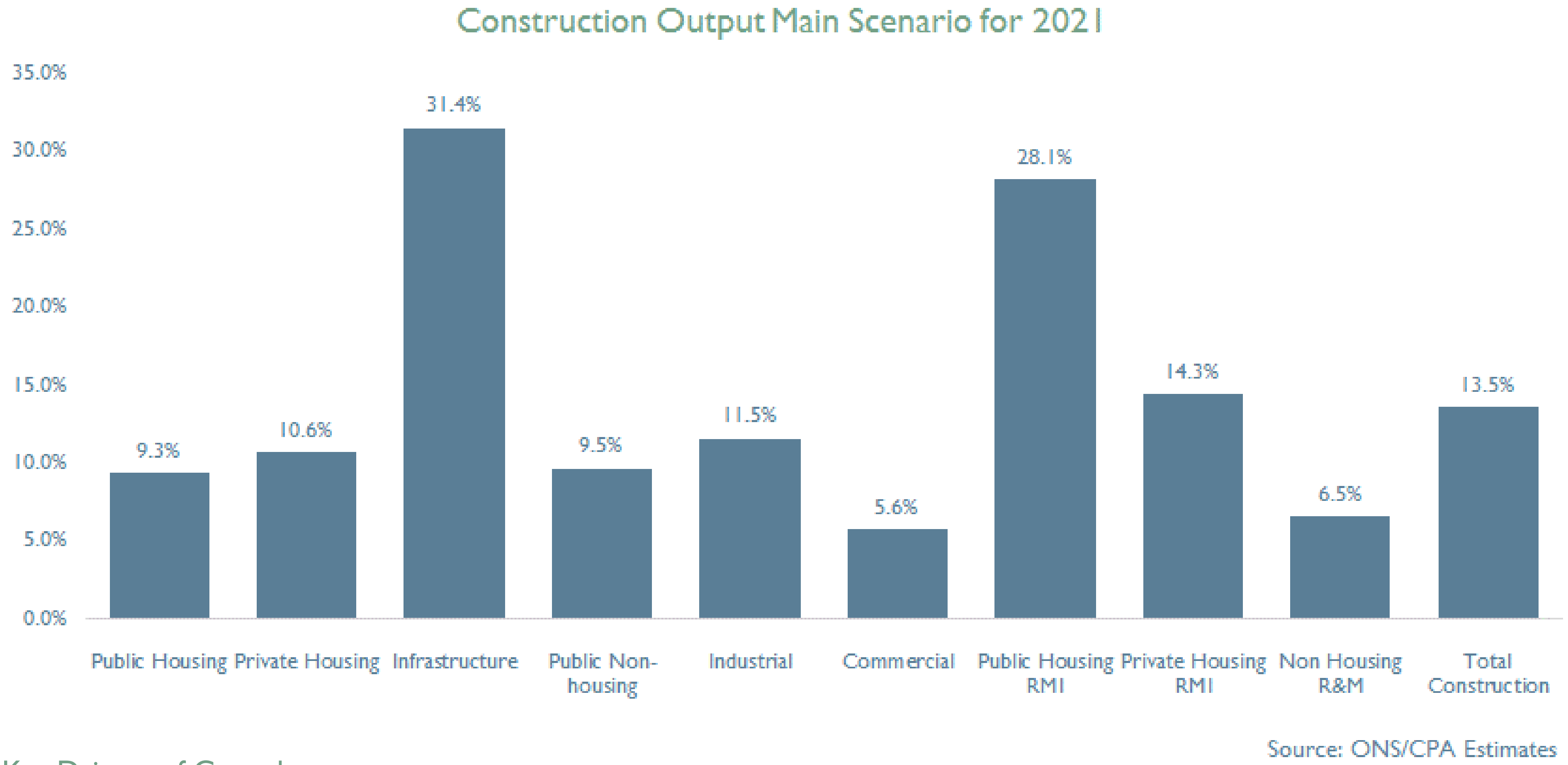


Source: ONS/CPA Estimates

Key drivers of Recovery in Second half of the year

Private housing: the indications are that activity should continue into the new year before any significant slowdown).
Private housing rm&i: activity remains high but could be impacted by local lockdowns).
Infrastructure: activity continues to be strong due to government pipeline of activity

CPA Main Scenario for 2021 (Autumn)



Key Drivers of Growth

Infrastructure: boosted by activity on HS2 and other large projects plus frameworks activity.

Public housing rm&i: remediation activity that needs to take place.

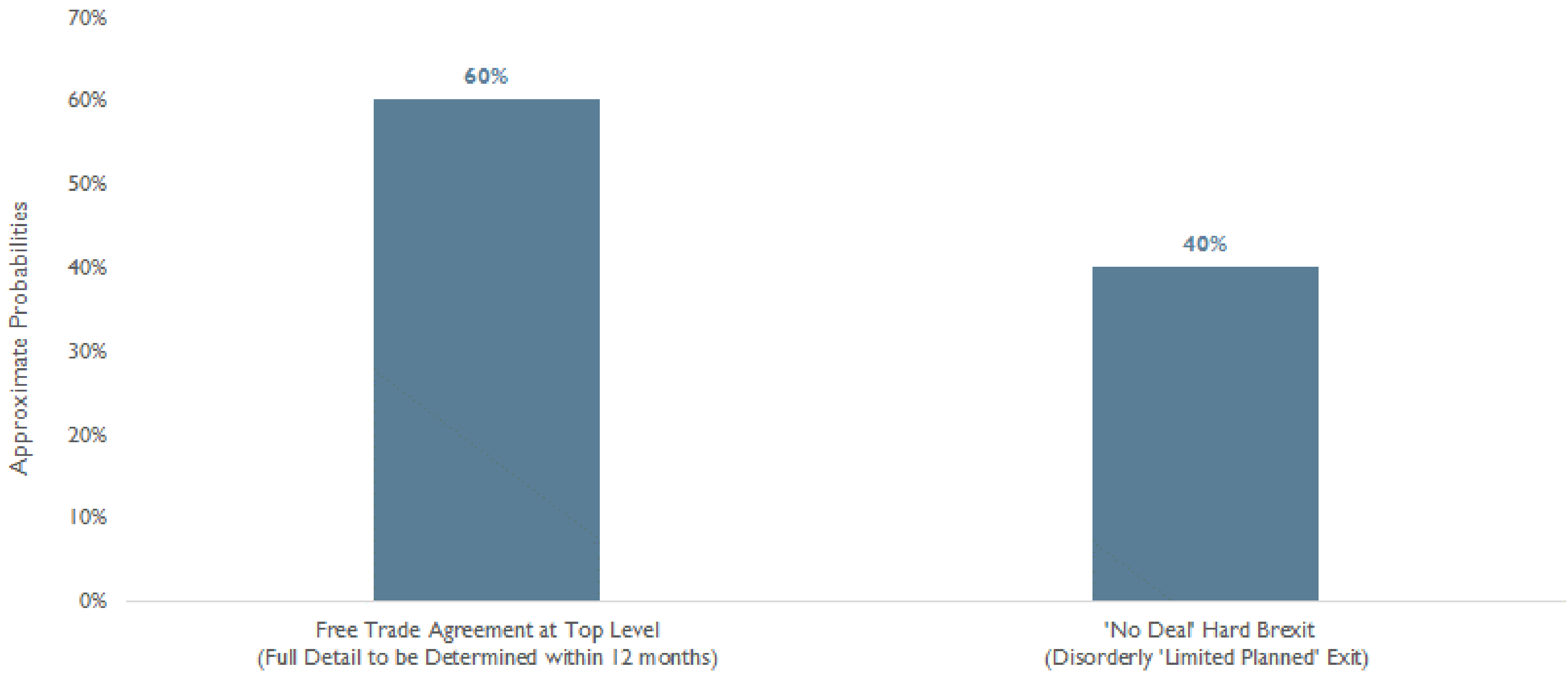
Private housing rm&i: activity boosted by work after the recovery in property transactions

Recovery – Key Issues & Risks

- 2nd National Lockdown
- Government Policy Reliance
- Margins
- Productivity
- Brexit

Brexit

CPA Brexit Probabilities



Source: CPA Estimates

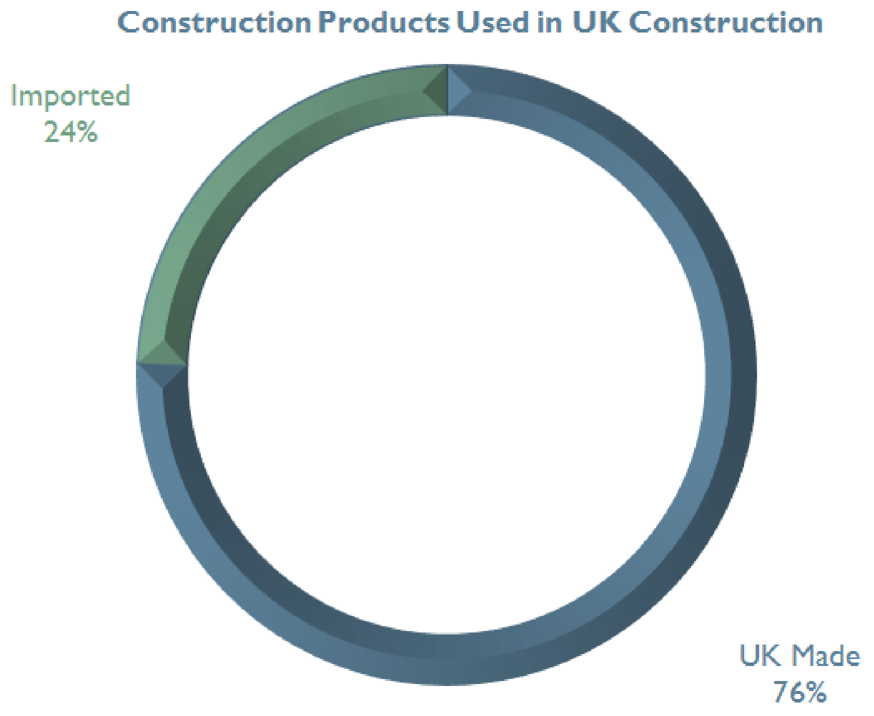
The CPA estimate that a Free Trade Agreement at the top level is still the most likely option despite the rhetoric and lack of time and this is still the default assumption in the CPA main scenario but there is still an approximate 40% chance of a 'No Deal' Hard Brexit

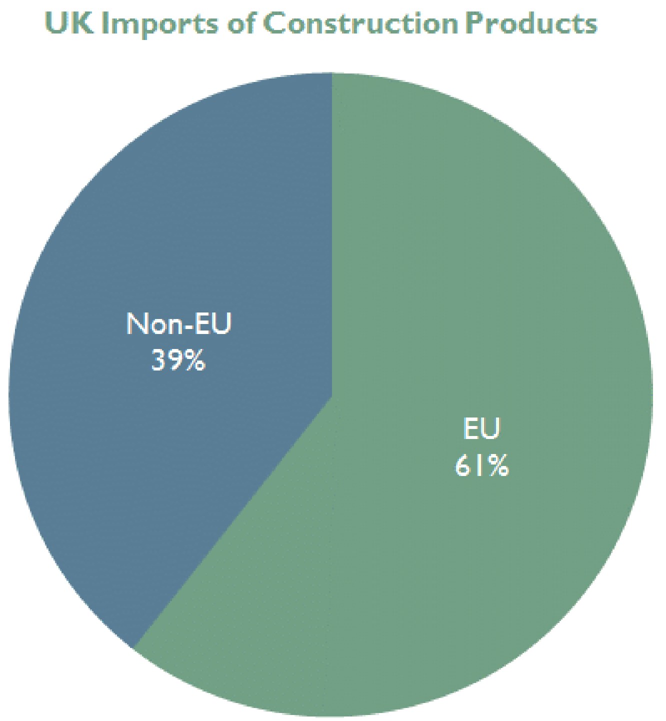
Key Issues

- Businesses are still not clear exactly what admin/certification delays they must prepare for
- Many firms have not had the chance to build up stocks due to a sharp recovery in demand since social distancing restrictions eased or cannot justify the expense yet again
- Any potential new restrictions resulting from localised COVID-19 outbreaks also pose a risk of unpredictable and repeated disruptions to supply over the coming months
- In the absence of a Free Trade Agreement, tariffs would impose additional financial and administrative burden on businesses trading between GB and the EU, requiring firms to be ready to calculate and pay tariffs on their goods. Given the economic environment it is unlikely that these costs will be easily passed on to customers
- A 'No Deal' would also be associated with sharp falls in Sterling against the Euro and US Dollar (to £/€ 1:1 and £/$ 1:1.12 by December 2020), which could lead to double-digit increases in the cost of some imported products, materials, fuel/energy & component costs

Product Issues

- 24% of products used in UK construction are imported (61% of which come from the EU)
- However, it is not just about products: imported input materials or machinery components may be needed for products manufactured in the UK
- Key products potentially affected with 'No Deal': timber, roofing products & white goods (imported products where demand already exceeds supply & little opportunity to stockpile)
- Key issues also revolve around UK REACH and CE/UKCA/UKNI marking

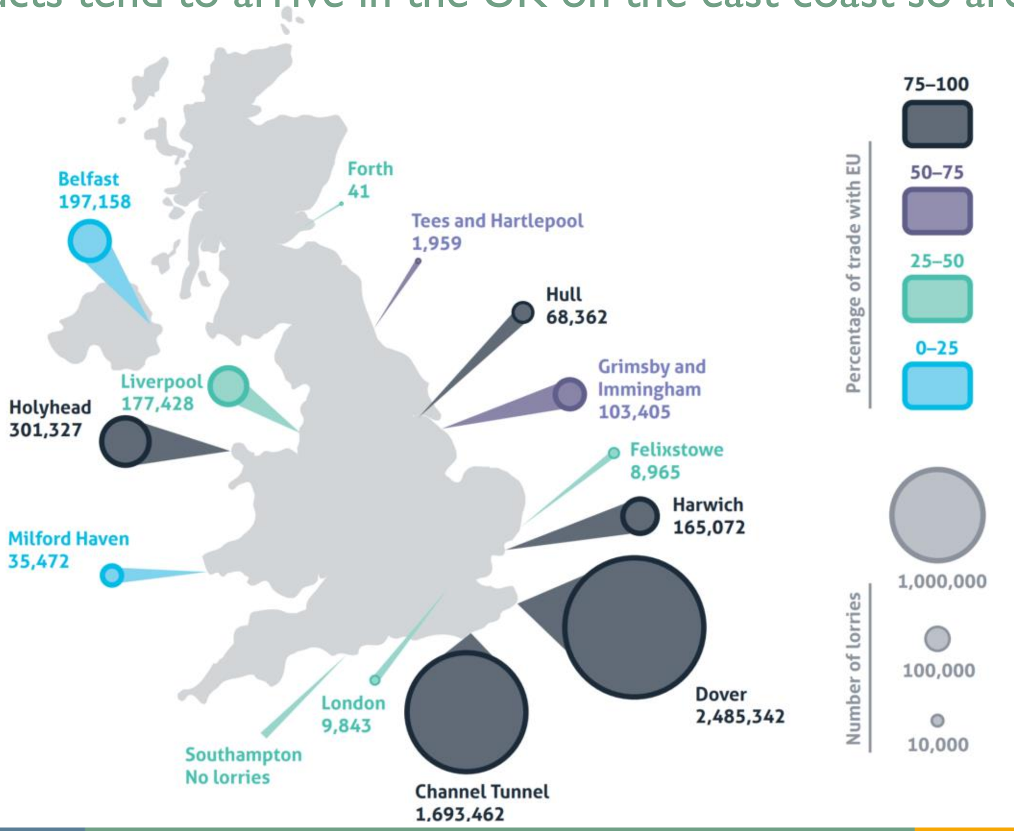




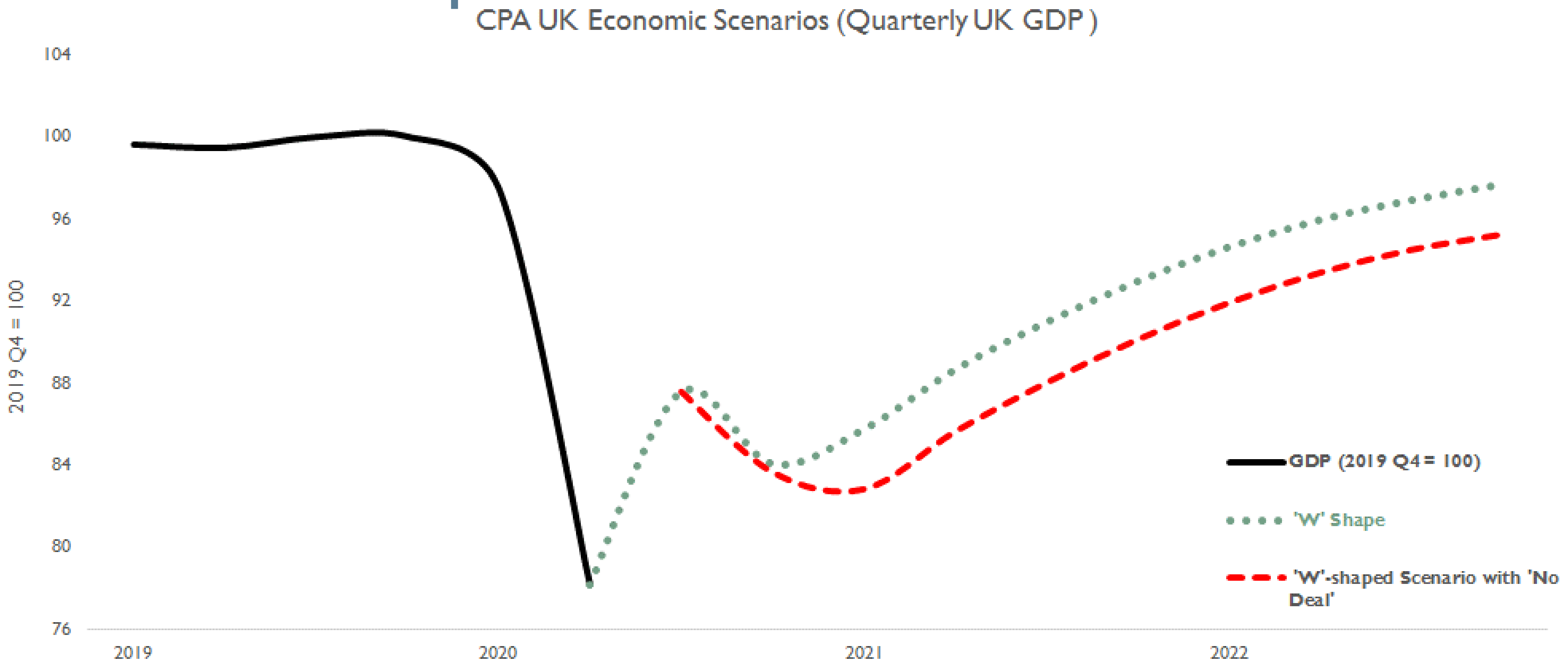
Source: BEIS

EU – UK Trade Issues

- UK-EU trade from 2021 will require firms to comply with sanitary and phytosanitary (SPS), safety and security checks as well as admin such as (up to 215 million) certifications
- There will need to be (up to 50,000) more customs agents and greater ports capacity. Issues are likely to be greatest where most lorry traffic is with the EU (i.e. Dover)
- Construction products tend to arrive in the UK on the east coast so are likely to be less affected



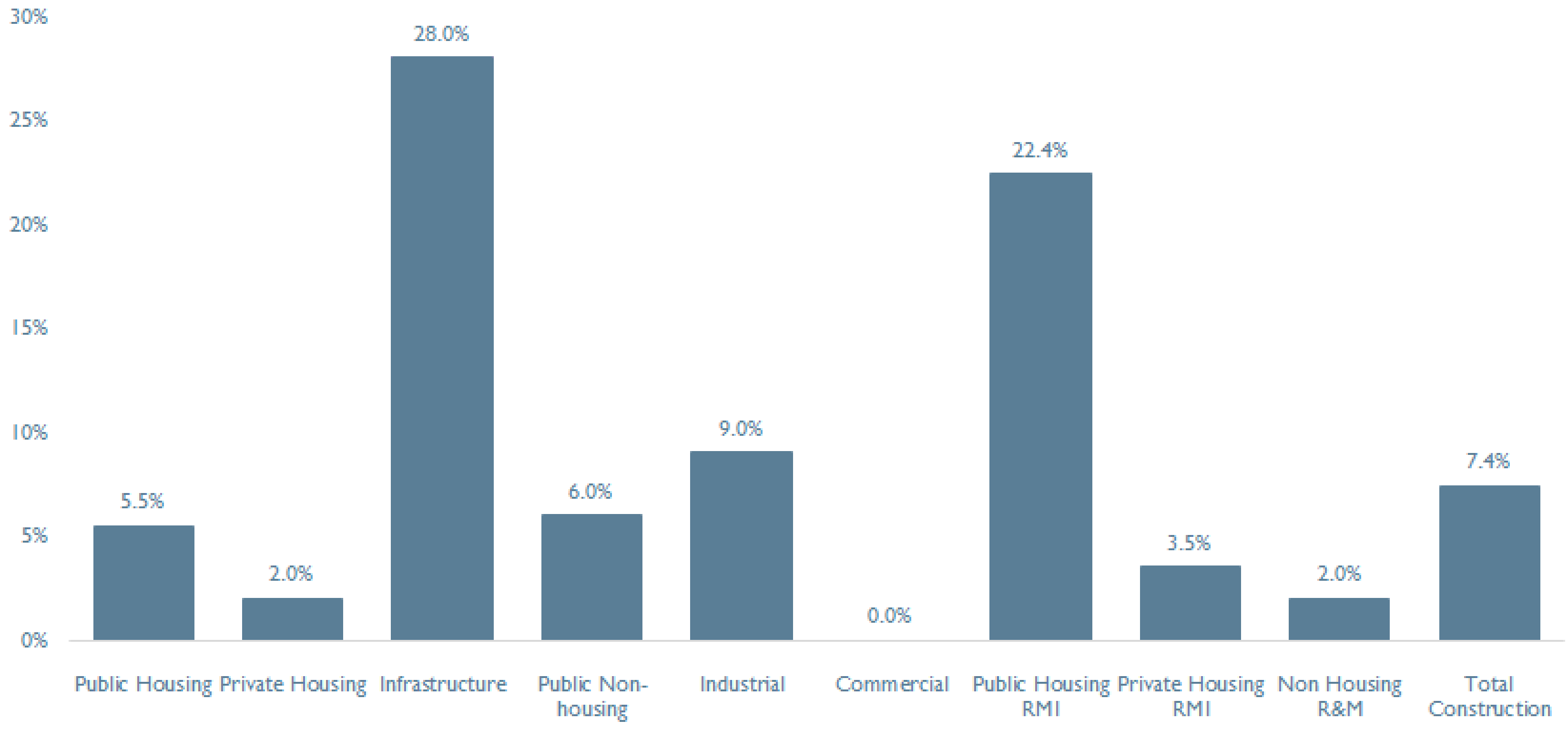
CPA 'W' Shape & 'No Deal' UK GDP Scenarios



Source: ONS, CPA Estimates

With a 'W'-shaped recession and recovery combined with a 'No Deal' Scenario, UK GDP falls in Q4 due to the lockdown and then falls further in Q1 due to the disruption and rise in costs from January alongside rises in imported costs due to tariffs and depreciations in Sterling , which means GDP in 2021 Q1 may be 3% lower than in the 'W'-shaped scenario

CPA 'No Deal' Construction Scenario 2021



Source: ONS, CPA Estimates

Output in the 'No Deal' scenario still rises 7.4% in 2021 compared with Covid-19 hit 2020 due to recovery in H2 but the output level in 2021 is 6.0% lower than in the main scenario due to negative impacts in particular on speculative development sectors (commercial, private housing) and sectors dependent on consumer spending (private housing rm&i)

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