Stace Outlook Index: Q2 2025

Fragile and Uncertain

The UK economy ended 2024 in a precarious position, narrowly avoiding a technical recession but offering little sign of meaningful or sustained growth. GDP stagnated in the second half of the year, with weak business investment and subdued consumer spending weighing on performance. Although inflation eased from its 2022 peak, it remained above the Bank of England’s 2% target, limiting the scope for interest rate cuts. High borrowing costs continued to constrain both businesses and households, while government fiscal tightening added further pressure. The Bank’s decision in May to lower interest rates from 4.5% to 4.25% signals growing concern over the fragility of the economy amid rising global uncertainty but also suggests cautious optimism that monetary easing could support recovery if underlying conditions improve. However, the move alone is unlikely to materially lift sentiment in the short term given persistently weak indicators.

Recent GDP figures showed 0.7% growth in the first quarter of 2025, above analysts’ expectations. In addition, the UK has signed several trade deals with the US, India, and the EU. While these developments offer some reassurance about the economy’s short-term resilience, they have also complicated the outlook for interest rates. The unexpected strength of Q1 growth may give the Bank of England reason to be more cautious about cutting rates too quickly, particularly as it risks prolonging inflationary pressures The Bank has acknowledged that the robust Q1 performance is likely to be temporary, but markets remain alert to the possibility of a slower pace of monetary easing.

Amid sluggish growth and geopolitical instability, construction output showed resilience in late 2024, outperforming the wider economy. However, a downturn in activity and project commitments during the second half of the year pointed to growing headwinds. Although both output and new orders picked up in Q1 2025, this likely reflects existing pipeline momentum rather than a sustained recovery in demand. The bounce came from a low base – new orders having dropped to their lowest level since Q1 2020 – while business sentiment and consumer confidence remained subdued into early 2025, adding to the sense of fragility.

The Construction PMI, which peaked in September 2024, fell to a 17-month low by February 2025, with the new orders component also declining sharply. April’s PMI readings for Services, Manufacturing, and Construction all dropped below the neutral 50 mark, signalling broader contraction and reinforcing concerns over weakening demand and persistent uncertainty. This reversal suggests that any view of Q1 results as evidence of a corner turned may be premature, as firms continue adjusting to tighter financial conditions and falling demand.

Residential construction has experienced its steepest fall since 2009 (excluding the pandemic), with higher mortgage rates and affordability constraints continuing to suppress activity. Nevertheless, underlying demand, particularly in the Build to Rent sector, remains relatively robust. However, viability is now the key barrier to development. Building Safety Regulator (BSR) processes, particularly delays at Gateway 2, are slowing approvals and increasing costs. Meanwhile, high borrowing costs and land values that have not sufficiently adjusted downward are compounding these challenges and holding back new starts.

Elsewhere, despite the new government’s housing targets and positive rhetoric on infrastructure, civil engineering activity remains mixed: new orders have risen, albeit from a low base, while output is broadly flat and sentiment subdued. Commercial construction is also being constrained by fragile consumer confidence and corporate caution. While wage growth has recently outpaced inflation, it's expected to ease this year, and with unemployment also on the rise, overall sentiment could be eroded further.

The General Election in July 2024 brought a change of government, but confidence has yet to rebound, and businesses and households arguably still lack a clear sense of whether Labour’s economic agenda will deliver. With limited fiscal headroom and persistent global uncertainty, the outlook remains clouded. The prolonged Russia–Ukraine war, rising trade tensions following the US presidential election, and ongoing supply chain disruptions risk exposing the UK economy to renewed inflationary pressures. While US-imposed tariffs may exert some disinflationary effects by dampening global trade volumes, the net impact is more likely to be inflationary, especially for globally traded construction materials like steel and timber, where supply constraints are already driving up costs. In contrast, weaker global demand may continue to exert downward pressure on oil prices, helping to moderate fuel costs in the UK in the short-term. Overall, tariffs are expected to dampen global growth, with forecasts suggesting a potential GDP reduction of up to 0.6% according to World Trade Organization (WTO) estimates. The Office for Budget Responsibility has already downgraded its 2025 UK growth forecast from 1.9% to 1.0%, and further revisions are a possibility.

For construction, while tariffs may have limited direct impact on exports, they are expected to suppress client investment due to increased input costs. Rising material prices could threaten the viability of projects—especially low-margin schemes and larger developments. These pressures increase the risk of a contraction in construction output in 2025. At the same time, employment costs are rising, driven by higher employer National Insurance Contributions (NICs) and the National Minimum Wage (NMW), further dampening demand and squeezing contractors already facing elevated insolvency risks.

Strong wage growth fuelled by persistent skills shortages continues to drive costs higher, even as the labour market shows further signs of cooling. This highlights a broader challenge facing labour-intensive sectors like construction: even in a slower growth environment, structural supply–demand mismatches in the workforce are likely to maintain upward pressure on wages.

Government commitments to infrastructure and housing targets may offer some medium-term stability. Labour’s ambition to build 1.5 million homes, alongside increased focus on energy and transport infrastructure, has the potential to support growth in key sectors. However, without meaningful reforms to planning, procurement, and workforce development, delivery at scale remains uncertain. Slower economic growth will limit fiscal flexibility, making project delays or scaling back more likely than outright cancellations. The latest PMI data and the Bank’s measured rate cut underscore persistent fragility in the outlook and may further test the government’s ability to deliver on infrastructure and housing goals.

There are, however, a few potential bright spots. Increased defence spending, driven by geopolitical tensions, is expected to support investment in infrastructure and manufacturing, benefitting construction as an enabling sector. Trade relations with the EU also appear to be improving, raising hopes of more stable supply chains and improved export prospects, particularly for industries still recovering from Brexit. If managed effectively, closer EU cooperation could help rebuild resilience across key sectors, including construction.

Tender prices continued to rise in early 2025, albeit more moderately than in recent years. Labour remains the dominant cost driver although material prices remain elevated. However, the BCIS has downgraded its All-In Tender Price Index estimate for 2025 to 2.3% (from 3.8%) and for 2026 to 2.7% (from 4.1%) since Q4 2024.

Looking ahead, mounting economic uncertainty, viability challenges, cautious client sentiment, and a slowing project pipeline are expected to constrain tender price inflation. Input costs are likely to rise due to higher NICs, the increased NMW, and the potential resurgence in material price pressures resulting from tariffs and supply chain disruption. However, competitive pricing is expected to remain a feature of the market, as contractors compete for limited opportunities. Forecasts indicate tender price inflation of 2.3% to 3.75% in 2025, rising slightly to between 2.7% and 4.6% in 2026, although some of the higher forecasts may be revised downward in response to ongoing economic headwinds. Stace's current analysis of the data has been maintained, setting the Stace LLP TPI all-in average forecast for 2025 at 2.5% and 3.0% for 2026.

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Tender Price Forecast

	BCIS	Stace Forecast	
	Annual	Annual	Av. per quarter
2025	2.8%	2.5%	0.625%
2026	2.7%	3%	0.75%
2027	3.1%	3%	0.75%

2.5%
2025 UK TPI All-in

2.5%
2025 London TPI All-in

Industry Headlines

Construction output showed no growth (0.0%) in Q1 2025, as gains in new work were offset by declines in repair and maintenance. New work rose by 0.9%, driven primarily by an 11.9% increase in public other new work. However, overall output was dragged down by a 1.2% fall in repair and maintenance, with private housing repair and maintenance contributing most to the decline, down 1.9%. New build housing recorded marginal growth of 0.6%, while commercial output contracted by 7.1%. (ONS)

Total construction new orders rose by 26.6% in Q1 2025 compared with Q4 2024, which had marked the lowest level since Q2 2020. On an annual basis, new orders were up 10.5%. The increase was driven primarily by infrastructure new work, which surged by 127.8% to its highest level since Q1 2020, alongside a 38.5% rise in private industrial new work. In contrast, private housing new orders fell by 6.8%. (ONS)

Construction materials prices for All Work fell by 0.9% in the 12 months to January 2025, but there is an indication of resurgent price pressures and BCIS expects material prices to increase by 15% to Q1 2030 reversing the brief decline observed in 2023-2024. (DBT and BCIS)

Labour remains the main driver of input costs, although annual growth in the BCIS Labour Cost Index is expected to have slowed in Q1 2025, the index is forecast to increase by 18% between up to Q1 2020. (BCIS)

Construction vacancies decreased 26.7% in the latest quarter (February to April 2025) and down 16.3% on the year to April 2025, although continue to trend above the long-term average. (ONS)

The UK Economy

0.7%
GDP Growth January-March 2025 ↑

3.5%
CPI to April 2025 ↑

6.4%
HPI to March 2025 ↑

4.25%
Bank Rate May 2025 ↓

5.6%
UK Regular Wage Growth March 2025 ↓

4.5%
Unemployment Rate March 2025 ↑

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