AUSTRALIAN CONSTRUCTION MARKET CONDITIONS REPORT

May 2024

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ABOUT THE AUTHOR

Damon Roast is WT Australia's Construction Economist. He brings a wealth of experience from economic analysis and output communication across the in-house and consulting worlds for more than 20 years. His career began as a classical economist before the changing landscape increased the demand for his services in the construction universe, initially in infrastructure and mining before broadening across the sector, most notably for a Tier 1 contractor, before joining WT in 2022.

INTRODUCTION

ESCALATION REMAINS ELEVATED, WITH NO IMMEDIATE PROSPECT OF COST PRESSURES EASING. HOW SOON MAY THIS CHANGE, AND HOW MIGHT THE OUTLOOK VARY ACROSS MARKETS?

It will be no surprise to any interested observer that elevated construction cost conditions are persisting. What continues to baffle many, however, is exactly how this situation came to be. For the most part, the distortions and disruptions of 2020 to 2022 are now out of the system, yet we remain in a world that is still far unlike our pre-pandemic reality.

In this edition of WT's Australian Construction Market Conditions Report, our analysis digs deep into data from the construction sector to provide novel insights on escalation from a broad market perspective as well as by inputs. We explore how we got into the current situation, how we might be able to get out, what is required, and how it long it might take. We'll also investigate how different markets and sectors are impacted and how they might respond.

Chifley South, Sydney, NSW.

COST ESCALATION BUILDING

WT'S VIEW ON AUSTRALIA'S COST ESCALATION BY KEY MARKET – BUILDING

	2022	2023	2024	2025	2026
SYDNEY	6.5%	5.2%	5.0%	4.6%	5.0%
MELBOURNE	9.5%	9.0%	5.5%	4.8%	4.5%
BRISBANE	8.5%	8.0%	7.5%	6.5%	5.3%
ADELAIDE	6.0%	5.0%	4.5%	4.5%	5.0%
PERTH	11.0%	4.5%	5.0%	5.5%	5.2%
HOBART	10.5%	6.0%	5.5%	6.0%	6.0%
CANBERRA	10.0%	6.0%	4.0%	3.5%	4.0%

CONTRIBUTION TO COST ESCALATION BY INPUT – BUILDING

	2024	2025
LABOUR (DIRECT)	Makes escalation much worse	Makes escalation somewhat worse
MATERIALS	Has no real impact on escalation	Makes escalation somewhat worse
PLANT AND EQUIPMENT	Makes escalation much worse	Makes escalation much worse
ENERGY	Has no real impact on escalation	Improves escalation somewhat
FREIGHT	Improves escalation significantly	Has no real impact on escalation
EXCHANGE RATES	Has no real impact on escalation	Makes escalation somewhat worse
INDIRECT COSTS	Makes escalation much worse	Makes escalation much worse
TOTAL	Makes escalation much worse	Makes escalation much worse

VS. LONG-TERM ESCALATION AVERAGES

- Improves escalation significantly
- Improves escalation somewhat
- Has no real impact on escalation
- Makes escalation somewhat worse
- Makes escalation much worse

Both tables refer to general, market-wide figures.

COST ESCALATION INFRASTRUCTURE

WT'S VIEW ON AUSTRALIA'S COST ESCALATION BY KEY MARKET – INFRASTRUCTURE

	2022	2023	2024	2025	2026
SYDNEY	9.0%	7.0%	4.8%	5.0%	5.3%
MELBOURNE	8.0%	5.5%	5.0%	5.0%	4.5%
BRISBANE	8.5%	5.3%	5.5%	7.5%	6.3%
ADELAIDE	9.3%	7.0%	4.5%	9.0%	6.5%
PERTH	8.6%	4.7%	4.0%	4.8%	5.5%
HOBART	8.3%	8.5%	4.8%	7.0%	4.0%
CANBERRA	8.8%	6.0%	6.0%	5.0%	4.8%

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KEY POINTS TO ESCALATION OUTLOOK BY MARKET

CONSTRUCTION ACTIVITY BAROMETER BY BROAD SECTOR

	STARTS 2023 (INFLATION-ADJUSTED)	VS. STARTS 2013–22 (AVERAGE ANNUAL)	LEAD INDICATORS ($B, INFLATION-ADJUSTED, 2023)
BUILDING			**APPROVALS**
COMMERCIAL	$21b	36% higher	$21b
APARTMENTS	$27b	11% lower	$25b
INDUSTRIAL	$13b	103% higher	$14b
SOCIAL	$25b	22% higher	$30b
INFRASTRUCTURE			**WORK YET TO BE DONE**
TRANSPORT	$32b	25% higher	$49b
UTILITIES	$35b	24% higher	$44b
MINING	$27b	2% lower	$30b

Source: Australian Bureau of Statistics (ABS), WT

- 2023 activity more than 20% above annual average of the prior decade
- 2023 activity between 10 and 20% above annual average of prior decade
- 2023 activity between +10 and −10% vs annual average of prior decade
- 2023 activity between 10 and 20% below annual average of prior decade
- 2023 activity more than 20% below annual average of prior decade

Sydney

Escalation to remain stubborn, with increased unionisation of trades, the ongoing impact of recent regulation, and concerns about loss of skills to Brisbane and South East Queensland. The **infrastructure** pipeline is still significant but there is potential for further cuts in the next state budget.

Melbourne

Some escalation softness in coming years sits in contrast to the strength of fundamental drivers, which should reassert themselves by 2026 and push escalation higher. Increasing concerns of debt profile could see public cuts ahead, which could see escalation soften further.

Brisbane

Continued market tightness, a strong pipeline, and shortages of key trades drive the outlook (and that of other major states). The upcoming state election is likely to play a key role in policy direction (BPIC) and in obviating current uncertainty around Olympics-related construction.

Adelaide

A solid pipeline of (mostly public) major projects to keep escalation elevated in the **building** sector. However, the potentially very strong **infrastructure** outlook (across major **transport**, **utilities** and **renewables**) could lift cost pressures state (and industry) wide.

Perth

The potential for markedly higher escalation in Perth appears set to be realised. This could come both from fundamental drivers and impacted industry capability, as well as the trend of greater unionisation and a lack of depth in the Tier 1 contractor market.

Hobart

With key **building** and **infrastructure** projects increasingly likely to proceed, already-elevated building activity could lead to significant escalation. Some uncertainty around the magnitude of **renewables** investments may see the escalation outlook soften.

Canberra

There are increasing concerns regarding the pipeline in the **commercial** sector, which could weigh on the escalation outlook in **building**, although activity in the **social** sector is still expected to pick up some slack. **Infrastructure** is likely to remain elevated led by a pipeline of major/complex projects (requiring a higher percentage of FIFO trades).

KEY POINTS TO ESCALATION OUTLOOK BY YEAR

2024

- Broadly robust market conditions and pre-existing market imperfections (driving ongoing cost pressures in labour markets, plant and equipment, and indirect costs) appear set to persist for some time yet. This should see elevated escalation persist through 2024.
- **Building** escalation should be 4–5.5% for most cities – with Brisbane the exception at 7.5%. For **infrastructure**, escalation of 4–5.5% is also likely, with Canberra to stand out at 6%.

2025

- While we continue to expect the Australian economy to enter a period of slowdown from late 2024 into 2025, this is now not anticipated to be as significant as was previously expected, due to a robust corporate sector and stronger prospects in key overseas markets (e.g. United States (US)).
- Given healthy prospects in many sectors – healthier than may be expected at this time in the cycle – a shallower-than-expected downturn should aid construction activity further.
- With that said, some of these activity forecasts may be reined in to some extent by the increasing concern that state governments may pull back on new investment spending.
- For **building**, escalation is forecast to be around 3.5–5% across most cities. Brisbane, with its booming pipeline of work and concerns regarding its ability to deliver, is at 6.5% in 2025.
- For **infrastructure**, the national average should jump to almost 6%, largely in line with a bounce-back in activity in a number of key sectors.

2026 and beyond

- Our analysis notes the extent to which construction has been stretched in recent years (and how new, capability-building investment has not come through as needed over many years). These sector features are unlikely to be remedied by 2026, continuing to contribute to an elevated escalation environment, perhaps towards 2030.
- The economy emerging from its downturn, ongoing robust levels of construction in many sectors, plus a backlog of activity based on the strength of key drivers (e.g. population growth) point to the need for stronger activity from 2026 in **building** and **infrastructure**.
- Our analysis points to the persisting likelihood of shortages of key trades. There may be some differences as to the likelihood and magnitude of shortages by trade; analysis of the pipeline of supply of key trades will be a crucial part of our ongoing analysis.
- Escalation is forecast at 4–6.5% in most markets across **building** and **infrastructure**.

Key risks

- Geopolitical volatility and uncertainty (and associated supply chain and energy impacts)
- **Residential** construction activity returning to more normal levels (let alone those proposed in prominent medium-term targets)
- A more significant economic slowdown should inflation remain stubborn and/or minimal interest rate cuts or even possible rate increases driven by the robust US economy
- Potential for prolonged economic weakness in China to drive cost pressures for many materials and plant and equipment to potentially very low levels in coming years.

BROAD SECTOR DRIVERS WITH IMPLICATIONS FOR ESCALATION

ECONOMY (LOCAL AND INTERNATIONAL)

While the economic outlook always provides an important backdrop to developments in construction and cost escalation, it becomes more crucial amidst elevated economic uncertainty.

That appears to be the case in early 2024. A combination of weakening economic growth (which is increasingly likely to impact labour markets), governments more reticent to stick with significant investment plans, and reduced prospects of interest rate relief (according to the market, at least) may ultimately flow through to construction sector prospects.

However, all is not lost. It is always important to remember that construction famously operates with a lag of several years (at least), more so outside of the **detached housing sector** (i.e. in **attached residential** (mostly **apartments**), **non-residential** and **infrastructure** sectors). So, the construction sector today more or less reflects market conditions several years ago.

Furthermore, the economic outlook appears to have improved compared to our November report. This was reflected by the International Monetary Fund (IMF) upgrading the growth outlook to 2026 (slightly) in its recent World Economic Outlook update.

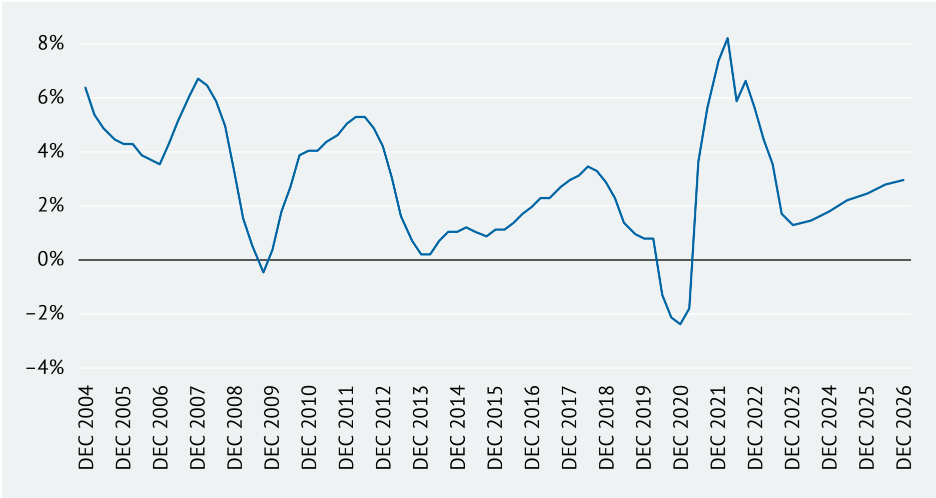
Of most importance is the ongoing robust health of corporates, as reflected by solid profit and sentiment indicators, but also stronger capital expenditure plans (over the 2024/25 financial year). This health is despite elevated interest rates; for many, action to lock rates in 2020 and 2021 for extended periods was prudent and will last longer than similar actions taken by households. An economic slowdown remains likely (encompassing further 'per capita' negative growth, i.e. where population growth is greater than Gross Domestic Product (GDP) growth) but the chances of a shallower slowdown (rather than a significant recession) have increased compared with last November.

GROSS NATIONAL EXPENDITURE (GNE)

Annual % change

(2024 to 2026 forecast)

Source: Australian Bureau of Statistics (ABS), International Monetary Fund (IMF), WT



In addition, the outlook for major international economies has improved since November, most notably that of the US. As per the IMF's update, economic growth for the US was somewhat stronger than expected in 2023 before a marked increase in growth forecast for 2024. Expectations of an economic slowdown, previously the base case for many, are now a fringe view.

This has seen the outlook for interest rates in the US transition away from multiple (perhaps a handful of) cuts to possibly zero cuts in 2024. Due to the US's influence on global markets, this appears to be a key driver of a similar outlook for Australian interest rate cuts. This may yet have a distinct local impact, but a stronger world economy supports the Australian outlook.

While it remains to be seen if construction activity can avoid a period of softness during 2025 and 2026 related to market conditions during 2023 and 2024, there should be guarded optimism that the worst can be avoided, for several key reasons:

1. The strength of population growth, and its importance in adding support to the pipeline
2. The IMF's update highlighted that Australia is among the countries where households feel the pain of higher interest rates more than most. If/when this becomes apparent, the Reserve Bank of Australia (RBA) will be able to provide solid economic support via lower interest rates
3. The contribution to activity from newer drivers, including digital disruption, resilience and the clean energy transition
4. Government investment plans (especially of state governments) should play a key role (although these may yet be diminished by cost-cutting).

CONSTRUCTION-WIDE ANALYSIS

Analysis of the broader construction sector provides wider context and a greater understanding of the current state of play, specifically why the easing of most supply chain pressures has not led to escalation falling back to or near the 3% per annum mark.

Overall construction activity by sector

Looking across the construction sector (**residential, non-residential** and **infrastructure**), the chart on page 9 shows that activity was at a sustained decade-plus high during 2022 and 2023. While media attention can focus too much on beleaguered sectors (parts of **commercial** and **residential** sectors) at times, strength elsewhere across the sector means the overall view has been at long-term highs.

However, this doesn't provide convincing proof as to why escalation remains elevated (despite easing of most supply chain pressures) without analysis of the amount of work still in the system.

Canberra Light Rail Stage 2A, ACT.

Amount of work still in the system

While trends in new project starts have been generally moving higher over time, other trends mean the amount of work in the system has only just come off record highs (over 30% higher than peaks of the late 2010s). These trends include larger and more complex projects, requirements for more specialist trades and equipment, and some lingering supply chain issues (which are magnified due to trends in projects and project resources).

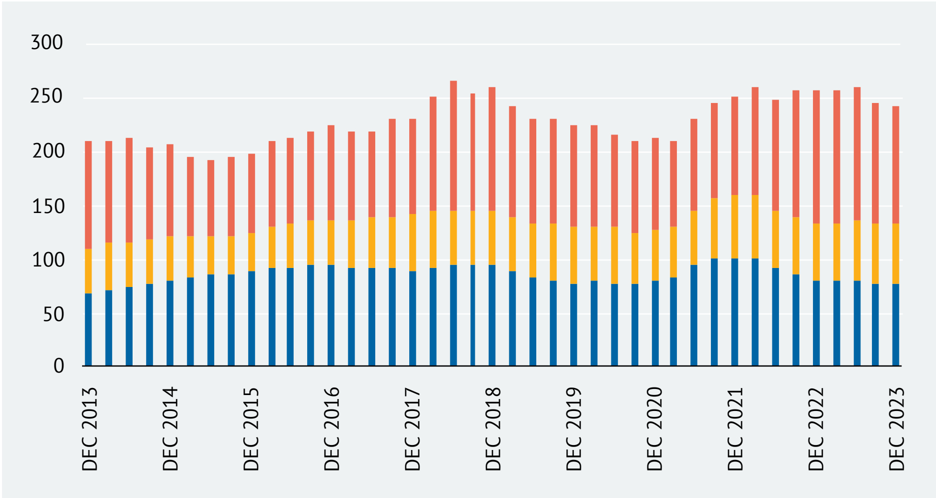
One last aspect of broad sector analysis paints the complete picture of why escalation remains elevated: trends in investment (or lack thereof) in sector capacity and capability.

CONSTRUCTION ACTIVITY BY BROAD SECTOR

$b
Commencements basis, moving annual total, inflation-adjusted

- Residential
- Non-residential
- Infrastructure

Source: ABS, WT

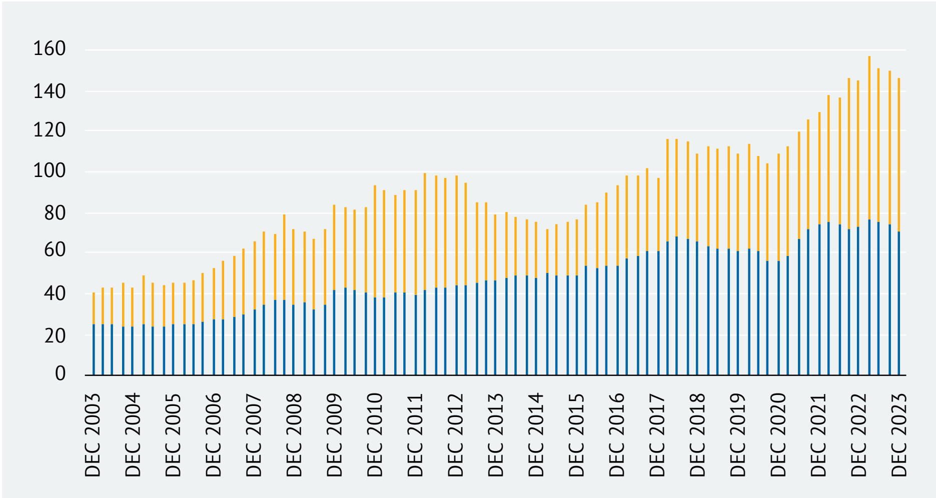


WORK YET TO BE DONE BY BROAD SECTOR

$b
Inflation-adjusted

- Building (non-res, apartments)
- Infrastructure (ex-mining)

Source: ABS, WT



Investment in sector capacity/capability

New investment in a sector's productive capacity (and hence capability) reflects confidence in the sector's medium to long-term growth prospects, as well as the periodic need to update and replace aging infrastructure.

Despite the construction sector's strong recent activity, record levels of work still in the system, and the healthy standing of some important demand drivers, new investment has seen only modest growth since 2010. For the manufacture of some building materials (e.g. glass, concrete, plasterboard), investment has been sub-par since the global financial crisis.

This combination of elevated levels of new projects, record levels of work still in the system, longer and more complicated projects (requiring more specific trades and equipment), some lingering supply chain issues (which exacerbates the aforementioned trends) and insufficient levels of new investment in sector capacity/capability all lead to an environment of sustained higher escalation.

This situation has been years in the making and there are few, if any, quick fixes. Without measures or incentives to encourage new sector investment, the risk is that the current situation becomes entrenched and a vicious circle begins: brief periods of respite in activity/escalation give way to longer and more frequent episodes of elevated cost pressures which weigh on construction activity and new investment and sow the seeds of recurring escalation spikes.

Of course, sector profitability is important here too. Construction sector margins have been poor for many years and sector insolvencies have hit record highs of late. The longer the status quo persists, the more important a government-led solution becomes (or, at least, legislation to support the sector and encourage new investment or, ideally, some combination of the two).

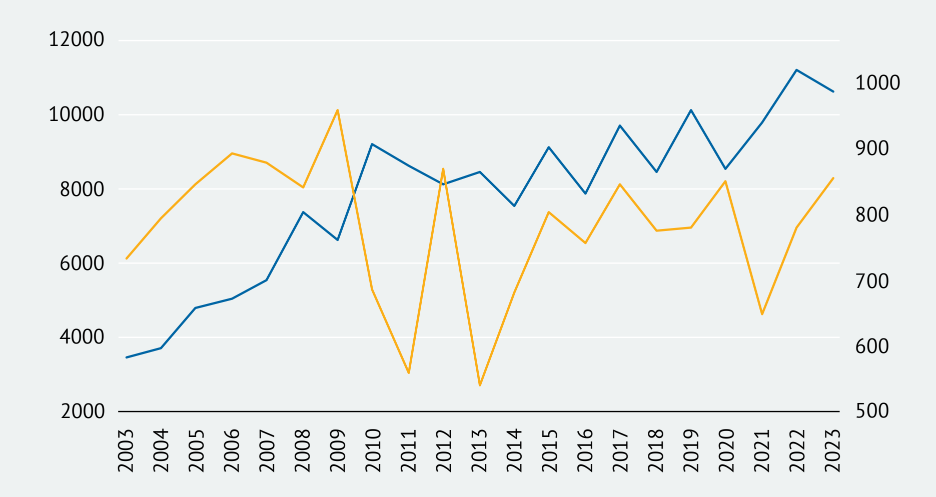
More immediately, however, the sector requires state governments to stay strong amid increasing debt concerns and stay the course with major plans across **building** and **infrastructure**.

NEW INVESTMENT IN SECTOR CAPACITY/ CAPABILITY

$m, financial years
Inflation-adjusted

Construction
Non-metallic mineral products manufacture (right axis)

Source: ABS, WT



IMPORTANCE OF STATE GOVERNMENTS

It has become tradition in Australia to follow developments on Federal Budget night each May. While the federal government's role in the economic process has changed considerably over the years, its annual Budget is consumed – by the business media at least – in much the same way it was in the pre-Internet era: with significant attention paid to every policy announcement.

In contrast, state governments – and their annual budgets – receive far less attention from corporate cognoscenti. This is unfortunate, because their combined impact on economic investment (which encompasses construction but also other investment spending) is several times greater than that of the federal government. The importance of state spending has also increased markedly over the last decade.

More importantly, while the federal government has made efforts to rein in its investment and, by extension, construction spending, the states – certainly the larger ones – have carried on regardless.

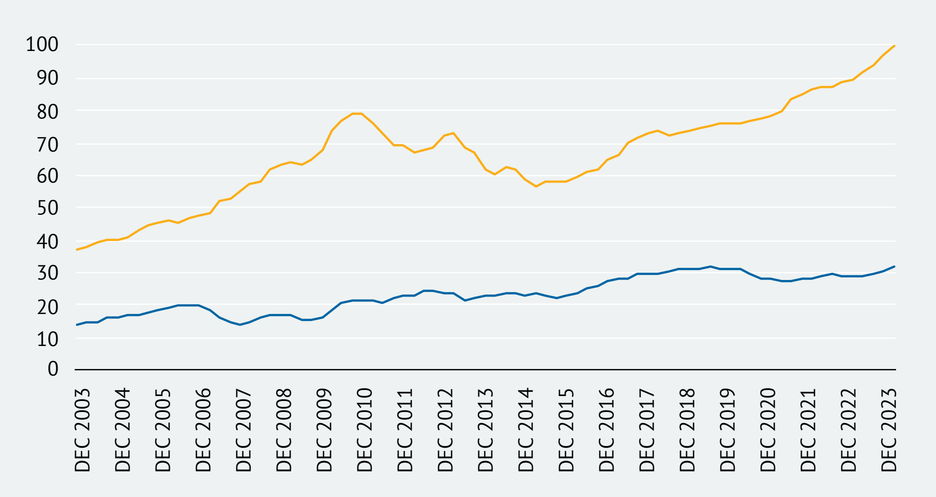
What the states have done is unequivocally a good thing from the perspective of the construction sector, the certainty of the pipeline, and, by extension, a solid basis from which the sector can confidently make major investments in capacity and capability. However, from the perspective of state treasury departments – especially in Sydney, Melbourne, and Brisbane – it is not so good and risks becoming worse, especially with higher interest rates and debt profiles.

NEW INVESTMENT (CONSTRUCTION + OTHER): FEDERAL VS STATE GOVERNMENTS

$b
Inflation-adjusted, annual totals shown quarterly

Federal
States

Source: ABS, WT



The chart below shows the shape of the debt profiles of the four largest Australian states as per their mid-financial-year budgets. While there is no 'magic number' of debt to total state output that triggers a credit rating cut (i.e. increases state borrowing costs) or any other significant consequence, for Victoria and NSW it is clear that their debt profiles have moved into unchartered waters (at least in the era since the early 1990s recession). There are concerns that upcoming budgets in May and June respectively in these states may see some notable projects with at least slower spending profiles.

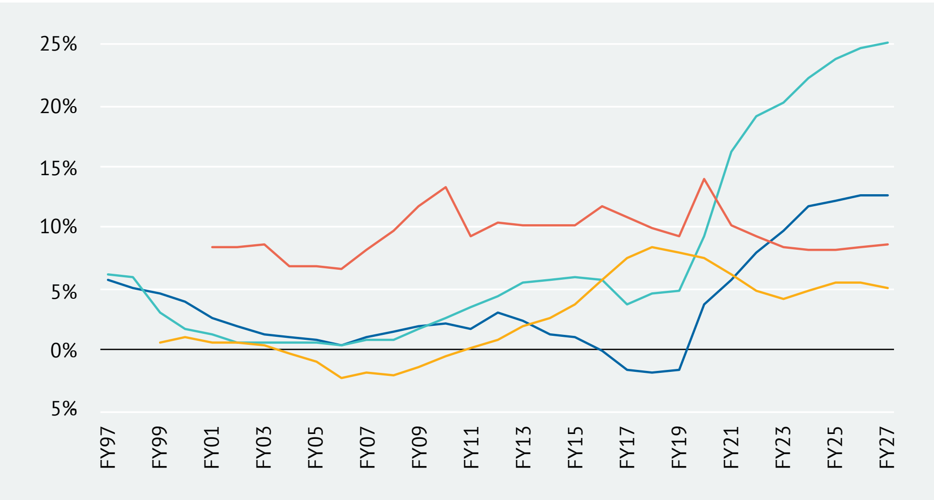
For Queensland, however, while the outlook based on the mid-year budget is relatively sanguine, there have been suggestions that further spending commitments since then (and some weakness on the revenue side, notably with coal royalties) mean that the debt profile will show a sharp increase in the June budget. This is not the best news, given the significant pipeline ahead in Queensland across the **health, infrastructure** and Olympics-related spheres.

NET GOVERNMENT DEBT

% of Gross State Product

- NSW
- WA
- QLD
- VIC

Source: state government budget papers, WT



IMPLICATIONS FOR CONSTRUCTION AND COST ESCALATION

We have previously made the point that while the travails of the economy and construction (especially in **building**) are often closely linked, these can be dislocated for prolonged periods and that the approach to the mid-2020s was set to be a period in which dislocation could be significant.

We continue to hold this view, albeit that the risks have increased that construction activity comes in somewhat softer than previously expected. While more positive economic outlooks for local and (especially) key international markets should provide some support for construction activity, this could be more than offset by the negative impact to activity from elevated escalation and some reprofiling (or project postponements) by state governments.

Near-term prospects by broad construction sector

Commercial is, on balance, holding up rather well in the face of ongoing disruption. Rumours of the **office** sector's demise have been greatly exaggerated. While office demand drivers have run into notable headwinds, the flight to quality and stronger competition to retain and win tenants has seen activity levels remain somewhat elevated, similar to what has been seen in **retail** over a number of years. In addition, a greater push to satisfy ESG mandates is adding complexity and costs to new projects, further supporting the activity outlook.

Similarly, sentiment relating to prospects for **attached residential** construction (largely **apartments**) has been increasingly negative – in contrast to robust market data. With that said, pandemic-led disruption to apartments demand was far less than seen in the office sector, with the sharp rebound in population growth playing a key role. Despite the negative sector sentiment, and legitimate concerns from developers that project profitability is difficult in current market conditions, construction activity has held up at fairly elevated levels.

Perversely, regulatory impediments are playing a part here too; while the trend in approvals is soft, the delayed impact of stronger approvals in prior years is helping put a floor under activity and may do so for some time to come.

Retail is, of course, much further into its post-disruption universe than the **office** sector. It is unlikely to revisit previous peak levels of activity anytime soon, but the sector's major players have become increasingly innovative in making new centres and upgrades more responsive to the ever-changing needs of consumers. This has helped to strengthen centre demand and, in turn, sector activity, and should continue to do so in coming years.

It appeared as though **short-term accommodation** might face significant disruption, catalysed by the pandemic. However, traveller numbers, notably for tourists but increasingly so for business, have returned to (or are near) pre-COVID highs. This should soon translate to elevated activity on the next round of projects, but for now much of the pipeline is focused on **student housing**.

Of course, **data centres** are a major beneficiary of digital (and pandemic-led) disruption. This sector has seen a sharp increase in activity. While the outlook is not necessarily expected to see continued or consistent growth in activity, sector fundamentals remain extremely positive. Perhaps similar to the **warehouses** sector, it may only be availability of sites or some other supply-related aspect which ultimately determines the path of activity in coming years, as demand should remain strong.

Elsewhere in the **industrial** sector, **factories** should continue to see periodic spikes in areas such as building materials, life sciences, defence, and food and beverage. There is potential for greater Australian involvement and investment in **renewable energy** and **critical minerals processing**, but prospects here remain unlikely, despite government hopes.

Education has long been the largest **social** sector but is increasingly leveraged to the private sector via the tertiary education system and its evolution away from the public purse. **University** construction will remain a key plank of activity in the sector, even if the surge in overseas students begins to moderate. While the universities remain in adequate financial health, the fight for market share means they will continue to build. Competition for students is also a driver of construction in private **schools,** while for their public counterparts, demographic issues and insufficient school numbers in inner-urban areas (previous closures) and outer-urban areas (urban sprawl) over recent decades will continue to support construction – albeit there can be long lead times, especially in inner-urban areas.

For the next largest **social** sector – **health** – significant project pipelines, especially in the eastern states should, at worst, see activity remain at current elevated levels. With that said, major **hospital** projects are becoming more complex, which is increasing lead times and decreasing the pool of contractors able to bid on these projects. This may make a plateau of activity the most likely outlook, despite the strength of state government investment plans (less likely to be hit by cost-cutting).

While traditionally classed in the **commercial** space, the **transport** sector of **building** construction is increasingly led by state governments, with station components of major rail investment dominating sector activity. Given the very long timelines of major rail investment across the largest capital cities, **transport** construction is expected to remain at very strong levels for years to come, with government-led stations to continue to be crucial.

Health, education and **transport** – both the **building** and (much larger) **infrastructure** components – form the basis of the aforementioned major state government investment plans. Depending upon the extent of the looming/expected economic slowdown, these state government plans could be crucial in supporting overall activity should private-led work come under increasing pressure (due, perhaps, to interest rate relief not coming until 2025 or later).

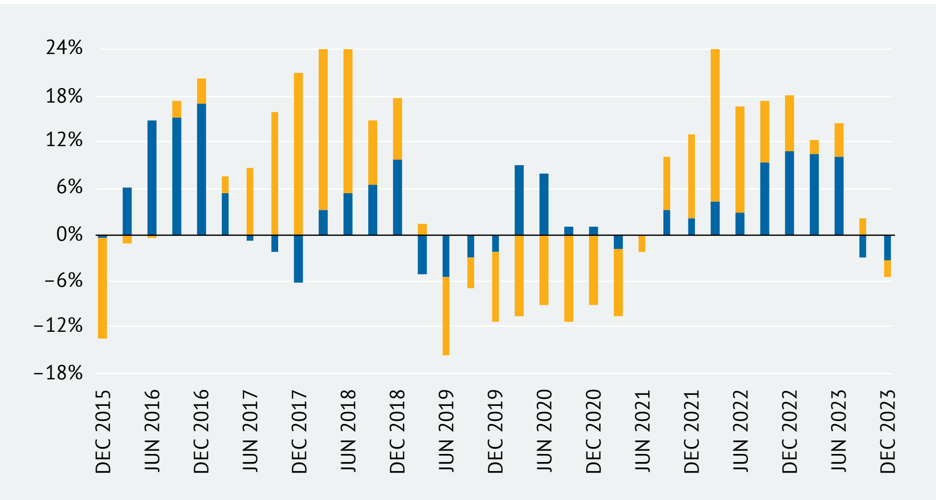
Of course, any reprofiling or cost-cutting among major **rail** spend could impact transport construction. However, we expect improved prospects over the outlook years for other sub-sectors of transport construction, notably **airport** upgrades (delayed, in many cases, by the impact of the pandemic on traveller numbers).

NON-RESIDENTIAL BUILDING AND INFRASTRUCTURE

Growth by source

Public
Private

Source: ABS, WT



Entertainment and recreation, much like short-term accommodation, is a function of tourist numbers (for museums, casinos, convention centres) but is also reliant on the pipeline of major **stadium** projects. However, stadia and other types of projects in this sector share the common driver of 'keeping up with the Joneses'; states may only have a strong desire for a project if a similar project has been seen elsewhere. New or substantial upgrades for stadia appear to have reduced in popularity among voters (perhaps other than potential Olympics-related projects in Brisbane, where prospects appear uncertain), which could weigh on overall sector prospects.

Elsewhere in **social building**, fundamental drivers for **defence** construction remain robust, with federal government funding available for phases of upgrades in coming years to support broad geopolitical goals.

Justice construction (e.g. prisons, courts) remains weak after a very strong period during the 2010s, but this should begin to show signs of cyclical recovery through the late 2020s.

Lastly, **aged care**, a beleaguered sector but one with promising longer-term fundamentals, should see an overdue cyclical uplift commence in coming years.

Near-term prospects in infrastructure

After a number of years of moving in unison, **transport** leviathans **roads** and **rail** are set to diverge. Except for the massive River Torrens to Darlington upgrades in Adelaide, there is not much in the pipeline of major roads projects not already underway. In contrast, there is another major phase of rail projects in the pipeline, including Suburban Rail Loop, Sunshine Coast Rail, Gold Coast Light Rail (Stage 4), Canberra Light Rail (2A and 2B) and possibly several others.

The outlook for **utilities** – which includes **energy, water/sewerage** and **telecommunications** – may well be better than **transport**. This is a function of weaker activity across much of the utilities sector in recent years but also the increasingly strong demand drivers of resilience (in the face of climate change and increasingly frequent and intense natural disasters) and of the clean energy transition.

With the boom in activity in the late 2000s now in the rearview mirror, the next round of major **water** and **sewerage** projects are now beginning to impact activity. Capex plans and demand drivers point to much more ahead in this space, although most likely not back to late-2000s levels – but should the Northern Water project in South Australia proceed, it would be the largest project in the sector since the late 2000s without doubt.

For **renewables**, it may well be only the beginning of a super-cycle of investment across the portfolio of generation/storage options (e.g. wind, solar, batteries) and transmission lines. However, despite the urgency with which this investment is needed and the persistent cost reductions across the renewable energy spectrum, a combination of increasingly slow approvals and community opposition to projects is extending lead times and dampening construction activity growth.

Lastly, **mining** and **heavy industry** construction may see a boost due to buoyant demand across a range of base and critical minerals. However, near- and medium-term prospects for new or upgraded mines for critical minerals have a much lower construction impact than similarly important projects across the major contributors during the 2000s and 2010s: iron ore, liquefied natural gas (LNG), coal and gold. Apart from gold, hopes for major new investment here are remote.

For iron ore and (metallurgical) coal, the combination of progress towards 'green' steel, major new (low-cost) iron ore mines in West Africa, and materially lower Chinese steel demand suggests that the likelihood of any major new investment is slim. The situation is similar for LNG, where continued potential as a 'transition' fuel is being negated by Qatar aggressively bringing on new supply from lower-cost LNG prospects.

An escalation perspective

From an escalation perspective, while we see a slightly greater risk of construction activity coming in softer than expected (as compared to our view in our November Report), this will not be enough to overcome key sector shortcomings that have been many years in the making and will see escalation remain elevated.

In fact, the logic as it relates to escalation is flipped on its head: the prospects for more moderate escalation would be aided by sustained strength in construction activity. This would help to attract resources to the sector and, more importantly, help to incentivise new sector investment in capacity and capability. The combination of strong state government investment plans plus indicative numbers based on the strength of fundamentals and demand drivers suggests that sustained strength in construction may eventuate through the late 2020s, but this is far from guaranteed.

A more likely outlook is one where elevated escalation, some spend reprofiling by the states, and/or stubbornly high interest rates keep a lid on construction and make major new sector investment unlikely. This doesn't mean escalation can't soften but any improvement is unlikely to be sustained. The next recovery in construction would only expose prior issues, with escalation higher as a result.

Our detailed analysis of escalation by key component, as well as several deeper dives, follows.

Western Sydney International Airport, NSW.

ESCALATION ANALYSIS
KEY COMPONENTS – DEEP DIVES

wtpartnership.com

LABOUR (DIRECT)

Recent trends: Overall annual construction wage escalation has continued to rise, reaching its highest level since mid-2012 in December 2023.

The genesis of this upswing initially – a jump in demand (construction activity) during a period of weak supply (closed borders and some loss of workforce due to COVID or early retirement) – was not a surprise, but what was less expected is that the upswing has persisted amidst activity moderating or showing signs of moderating. However, our previous analysis that showed exactly how stretched the sector has been in recent years is compatible with an outcome of more elevated wage escalation.

Looking forward: Signs of slowing sector activity – more so in **building** – have increased in recent months. Given persistent sector tightness, we don't expect these slowing signs to flow through to more moderate wage escalation until late 2024. Furthermore, we expect only a minor moderation and for wage escalation to remain quite elevated at least through 2025.

We noted previously that the view across the construction wages landscape can encapsulate a wide range of outcomes. This is certainly possible in coming years, with the potential for divergent outcomes for construction wage escalation between trades, between states and between wage determination mechanisms.

AUSTRALIA – CONSTRUCTION WAGES

Annual % change

(calendar years 2024 and 2025 forecast)

Source: ABS, WT

Deeper dive – wage determination mechanisms: enterprise bargaining agreements vs other

Typically, any discussion of wages in construction turns quickly to trends in enterprise bargaining agreements (EBAs). This is understandable, given that many who are regularly engaged on projects led by Tier 1 contractors are on EBAs, and EBA trends can filter through the remainder of the sector.

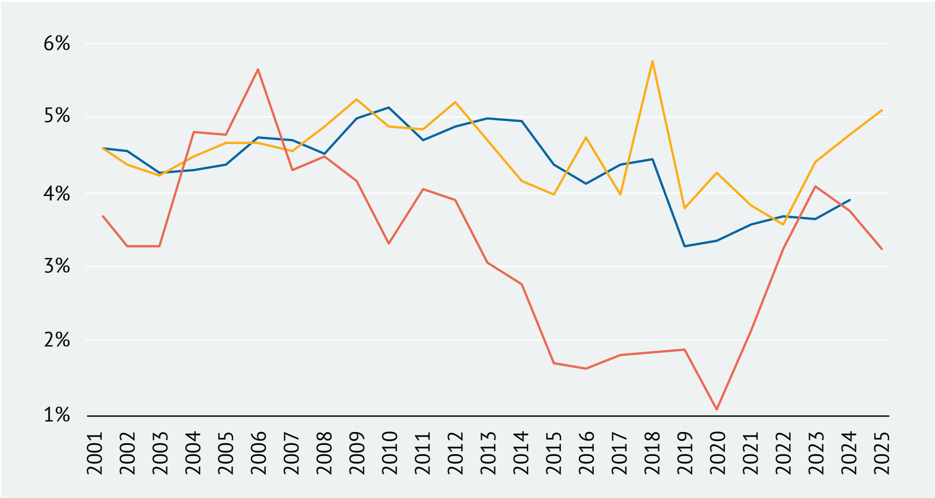
However, it is important to note that the vast majority of construction sector workers are not on EBAs. Quarterly data from the Department of Employment and Workplace Relations (DEWR) and the Australian Bureau of Statistics (ABS) reveals that the percentage of construction workers on EBAs typically varies between 7% and 10%.

Nevertheless, trends in the current round of EBA outcomes are certainly significant. These could see escalation for those on EBAs move higher towards and over 5% – while our view of overall market escalation is set to moderate towards 3%. This would see a similar market divergence to that of the mid-to-late 2010s.

ANNUAL CONSTRUCTION WAGES GROWTH BY WAGE DETERMINATION MECHANISM

(calendar years 2024 and 2025 forecast)

- EBAs (total)
- EBAs (recently approved)
- Total construction wages



Source: ABS, Department of Employment and Workplace Relations (DEWR), WT

Deeper dive – specific trades (labour capability, implication)

The potential for divergent wage escalation outcomes by trade is common. Different trades may have different demographic compositions, different demand drivers, and are featured at different stages of construction.

Our analysis suggests that some of these factors could be in play but also that the presence of other factors could lead to wider divergence of wage escalation outcomes than normally expected.

While there are common elements pointing to tightness and elevated demand across the trades considered in our analysis, each trade is positioned differently with respect to the recent past and the likely outlook.

For carpenters/joiners, the numbers coming through the pipeline (starting apprenticeships or traineeships) have remained in line with the increasingly inadequate numbers seen over the last 5 years. Should reports continue that an increasing percentage of the workforce within this trade is moving into retirement, it would suggest greater tightness ahead and upward pressure on escalation to persist.

For electricians, strong demand and strong recent escalation, buoyed by the tailwinds in this sector due to the boom in renewable energy construction, are set to be mitigated somewhat by robust levels of apprenticeship or traineeship commencements.

WAGE ESCALATION DRIVERS/METRICS BY TRADE

	CARPENTERS/ JOINERS	PLASTERERS/ RENDERERS	ELECTRICIANS
JOB VACANCIES (AS % OF EMPLOYED)			
COMMENCEMENTS (OF APPRENTICESHIP)			
ESTIMATED (ATO) WAGE ESCALATION			

NOTE: Shading reflects % change between recent performance vs medium/long-term average.
NOTE: ATO data is only available to FY20/21; FY22/24 is based on WT estimates.

Source: ABS, ATO, Jobs and Skills Australia, National Centre for Vocational Education Research

VS. LONG-TERM ESCALATION AVERAGES

- Improves escalation significantly
- Improves escalation somewhat
- Has no real impact on escalation
- Makes escalation somewhat worse
- Makes escalation much worse

For plasterboard trades, however, the recent trend of significantly increased unionisation is notable (carpenters/joiners, electricians and other trades much more commonly seen on site were largely unionised many years ago). This has led to wage escalation increasing more sharply than for other trades, but the fundamentals here suggest a strong jump in escalation was already underway (via drivers such as sub-par levels of workers coming through the pipeline).

Hence, this deeper dive analysis on wage escalation by trade reaffirms that factors keeping broad sector escalation elevated (in this case, a lack of investment in the pipeline of new workers) are also at play in labour. This points to a scenario we have highlighted in the past: that labour market conditions are set to remain somewhat tight for many years to come and that skills shortages could recur for much of the 2020s. While there are some signs of hope, such as we see in the pipeline of electricians, much more is required, either in terms of sustained growth in numbers in the pipeline across more trades or another solution that would provide an ongoing boost to labour numbers and reduce the risk of recurring skills shortages.

It is worth noting that short-term workers on visas are typically only a very small proportion of the workforce for each trade (well below the numbers coming through the apprenticeship/traineeship pipeline). Much greater numbers of working visas would put downward pressure on escalation and help lower the recurring skills shortage threat, but this may not be realistically or politically achievable.

Metro Tunnel Project, Melbourne, VIC.

MATERIALS

Recent trends: As expected, materials prices generally have continued to retrace towards long-term norms. For those materials priced and traded internationally, more moderate demand and incremental supply increases have further reduced prices. While supply chains and logistics have been impacted by recent volatility in the Middle East, this does not appear to have had much impact on prices of materials.

Downward pressure on energy costs (via federal government legislation) has helped to moderate prices of locally produced materials and should continue to do so once producers cease efforts to catch-up on pandemic-era cost pressures they were unable to pass through in prior years.

Looking forward: While our view remains for materials escalation to bottom out by late 2024, this is now expected to be at a somewhat higher level of escalation (just over 2%). In large part, this will be due to stronger global demand, boosting prices for globally traded materials, as well as our view that the likely domestic economic slowdown is set to be softer than previously expected (with materials price relief perhaps not coming until signs of weaker activity are more apparent).

However, similar to the outlook expected for labour, there is an increasing risk that a blended (overall) market outlook will obscure the diverging trends between 'standard' and 'green' (higher-cost) materials. Projects based on the latter, more common in the era of ESG mandates and emphasis on sustainability, could see much greater materials escalation (despite increased take-up of these materials in recent years, leading to increased likelihood of economies of scale and hence some downward pressure on prices).

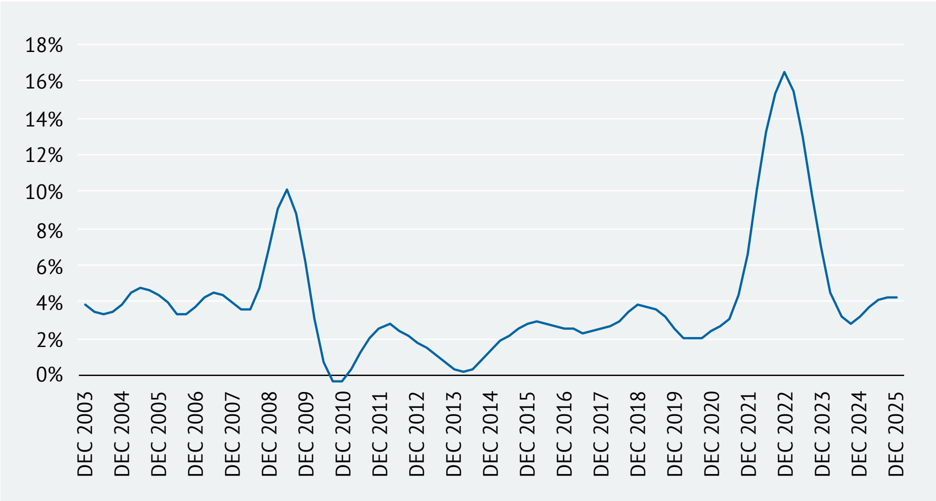
Elsewhere, the seemingly ongoing risk of international conflict will likely remain a driver for higher materials escalation for years to come. Sustained or significant conflict could see supply chains and commodity markets impacted, leading to higher freight and energy costs, which would further increase materials escalation.

AUSTRALIA BUILDING MATERIALS COST INDEX

Annual % change

(calendar years 2024 and 2025 – forecast)

Source: ABS, WT



INDIRECT COSTS (INCLUDING PRELIMINARIES, DESIGN, OVERHEADS)

Recent trends: While most other escalation components have seen some moderation since our last report, the same cannot be said for the increasingly important and prominent indirect costs:

- Professional services wage growth (both overall and for construction-specific sectors) continued to move higher, now at a 10.5-year and (ex-COVID) 12-year high respectively.
- Sector insolvencies remain highly elevated – March quarter 2024 (732) was the second highest on record (i.e. since September 2013), only trailing the 785 of September 2023. For the last 12 months, however, insolvencies have been at a record in the post-2013 era of 2757, most likely a two-decade-plus high, and possibly a high since the early 1990s recession.
- Insurance costs continue to surge, with annual growth in insurance costs nationally (via the Consumer Price Index (CPI)) now above 15%.
- Continued strength in construction activity outside of the 5 largest capital cities, with the prospect of this persisting for many years to come (led by very strong renewable energy construction), has led to additional costs to attract workers away from major capital cities – such as an increased Living Away From Home Allowance and other labour costs – becoming more widespread or even permanent.

These costs have strengthened and become more entrenched, while increased signs of market weakness have emerged in some sectors and states (as represented by more projects being put on hold after the tender stage, most notably in **commercial** sectors). Together, these factors have seen the following impacts continue in recent months, with follow-on impacts to indirect costs:

- Impact of insolvencies spread across overheads or new projects
- Lower subcontractor competition, more so among Tier 2 players
- Risk contingencies have reportedly increased.

Looking forward: The prospect of a looming (albeit slightly weaker than previously expected) economic slowdown may see softening of some cost pressures outlined above.

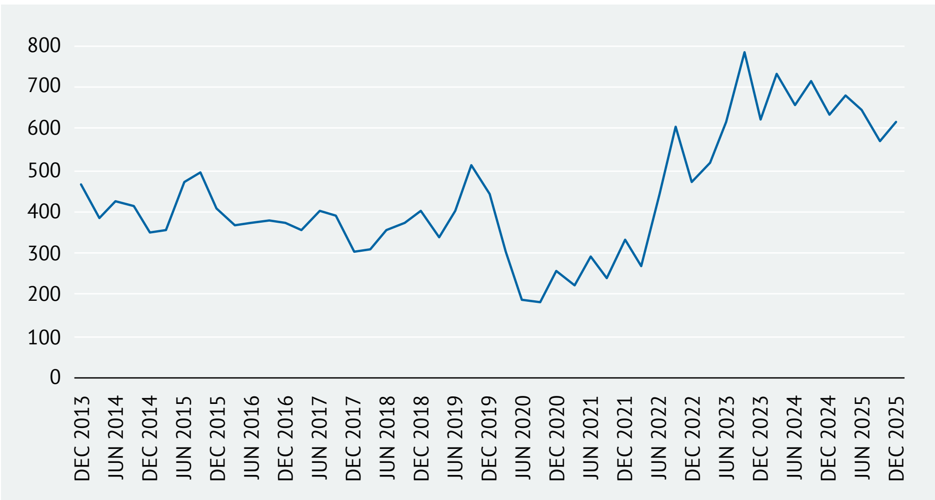
However, most of the cost pressures associated with strong indirect costs escalation are not related to the volume of work in the market. Instead, they reflect market imperfections or issues that have accumulated over many years and relate to insufficient investment in sector capacity or capability. Hence, they are unlikely to see much improvement in the near term.

AUSTRALIA CONSTRUCTION INSOLVENCIES

Quarterly

(June quarter 2024 onwards forecast)

Source: Australian Securities and Investments Commission (ASIC), WT



IN SUMMARY

An environment of sustained higher escalation has been years in the making and there are few, if any, quick fixes. Key factors driving escalation have been a combination of elevated levels of new projects, record levels of work still in the system, longer and more complicated projects, some lingering supply chain issues and insufficient levels of new investment in sector capacity/capability.

Escalation appears set to persist for some time yet, in an environment of broadly robust market conditions and pre-existing market imperfections (driving ongoing cost pressures in labour markets, plant and equipment, and indirect costs).

A combination of weakening economic growth, governments more reticent to stick with significant investment plans, and reduced prospects of interest rate relief may ultimately flow through to construction sector prospects.

This should see elevated escalation persist through 2024 to 2026, perhaps towards 2030.

- In 2024 we expect **building** escalation to be 4–5.5% for most cities – with Brisbane the exception at 7.5%. For **infrastructure**, escalation of 4–5.5% is also likely, with Canberra to stand out at 6%.
- For 2025, we expect **building** escalation of around 3.5–5% across most cities, except Brisbane at 6.5% in 2025. For **infrastructure**, the national average should jump to almost 6%, largely in line with a bounce-back in activity in a number of key sectors.
- For 2026 and beyond, escalation is forecast at 4–6.5% in most markets across **building** and **infrastructure**.

Elevated escalation, some spend reprofiling by the states, and/or stubbornly high interest rates may keep a lid on construction and make major new sector investment unlikely. This doesn't mean escalation can't soften but any improvement is unlikely to be sustained. The next recovery in construction would only expose prior issues, with escalation higher as a result.

However, there should be guarded optimism that the worst can be avoided due to:

- strength of population growth
- potential for reduction in interest rates
- contribution to activity from drivers including digital disruption, resilience and the clean energy transition
- strong state government investment plans.

The sector needs state governments to stay strong amid increasing debt concerns and stay the course with their major building and infrastructure plans.

DISCLAIMER AND METHODOLOGY

This report and the market data it represents are general market information only. WTP Australia Pty Ltd (WT) does not make or imply any specific advice or applicability of this information to any individual recipient. WT has taken care to ensure accuracy and that all data and details are correct to the best of our knowledge but does not warrant completeness or infallibility of the information presented. WT and its staff do not accept any liability for any loss or damage whatsoever arising from the use or dissemination of any part of this report (via any medium).

While our view is based on a variety of sources (not the least of which is our own market insight), the general approach in this report is based on escalation from the input cost perspective. This aligns with the traditional QS approach to escalation but also allows rationalisation of bottom-up (i.e. input-level) and top-down (i.e. sector or economy level) escalation perspectives.

There is no single market-level data series that conceptually matches this. However, data available by key inputs provides checks and balances on the overall WT view for key markets.

Points to note:

- All escalation shown is on a calendar year basis and is the % change between the full-year average vs the previous year's full-year average.
- Escalation contribution by input is on a general, Australia-wide basis, while state-by-state figures are general across sub-sectors, project types and values (i.e. contractor tiers).
- In addition, escalation contribution by input assumes no other major drivers of escalation (e.g. large productivity increases, significant regulation changes for approvals).

For more information on escalation relative to your project or sub-sector, please discuss with your usual WT contact or call your local WT office.

Kardinia Park (GMHBA Stadium), Geelong, VIC.

ABOUT US

WT empowers clients to grow, inspiring confidence through independent cost management and advisory services. Our expertise spans the building, construction, infrastructure and defence sectors.

Operating for nearly 75 years, WT supports clients with an award-winning team of specialists in cost management, quantity surveying, digital solutions, sustainability, asset and buildings, portfolio and program advisory, PMO, PPP and facilities management.

CONTACT US

ADELAIDE
Sam Paddick, National Director
spaddick@wtpartnership.com.au

BRISBANE
Jack Shelley, State Director
jshelley@wtpartnership.com.au

Paul Noonan, State Director
pnoonan@wtpartnership.com.au

CAIRNS
Julie McClelland, Associate
jmcclelland@wtpartnership.com.au

CANBERRA
James Osenton, National Director
josenton@wtpartnership.com.au

GOLD COAST
Shaun Muddock, Associate Director
smuddock@wtpartnership.com.au

GEELONG
Stewart Lyons, Associate Director
slyons@wtpartnership.com.au

HOBART
Chris Hawkins, State Director
chawkins@wtpartnership.com.au

MELBOURNE
Nicole Trumbull, National Director
ntrumbull@wtpartnership.com.au

James Ford, National Director
jford@wtpartnership.com.au

NEWCASTLE
Kyle Hutchinson, Associate Director
khutchinson@wtpartnership.com.au

PERTH
John O'Gorman, National Director
jogorman@wtpartnership.com.au

SYDNEY
Ian Menzies, National Director
imenzies@wtpartnership.com.au

Toby Brown, National Director
tbrown@wtpartnership.com.au

WESTERN SYDNEY
Simon Hensley, National Director
shensley@wtpartnership.com.au

WTPARTNERSHIP.COM.AU