INTERNATIONAL INSURANCE MARKET COST REPORT

CONSTRUCTION MARKET INTELLIGENCE

THIRD QUARTER (Q3/22)

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This report reviews global trends, split into three regions:

1. *AMER* North, Central and South America
2. *EMEA* Europe, Middle East and Africa
3. *APAC* Asia Pacific

In each, we consider several factors:

i. Inflation
ii. Interest Rates
iii. Construction Activity
iv. Material Prices
v. Labour Costs
vi. Supply Chains
vii. Insurance Trends & A Look Ahead

Q3 - Continuing Market challenges and volatility, but some areas easing

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As we approach the end of 2022 the world economy is experiencing challenges with significant long term implications for the construction sector. In Q3, global economic growth slowed sharply; the IMF predicts a reduced global annual growth rates of:

- 3.0% in 2022; and
- 2.9% in 2023.

Inflation rates continue to rise with global inflation predicted to reach 8.7% in 2022 and then fall to 5.3% in 2023. The global construction market continues to experience volatility stemming from inflation, geopolitical tensions, and gas prices. Central banks appear to be prioritising controlling inflation (rather than economic growth) leading to rising interest rates; consequently, most economists now predict recession across advanced global economies, meaning GDP growth will contract while inflation is expected to remain high.

In Q3 some underlying causes of volatility have eased. For example, some commodities prices have stabilised (*Chart 1). S*hipping rates fell an average *29% to $4,056/FEU in* September, and are 61% lower than a year ago; although we note this is still 170% higher than the pre-pandemic norm. According to the Federal Reserve Bank of New York, *Global Supply Chain Pressures Index* (GSCPI) *(Chart 2)* supply pressures have eased in Q3, with the expectation that they fall towards historical averages.

Chart 1: World Bank 'Pink Sheet—October 2022'

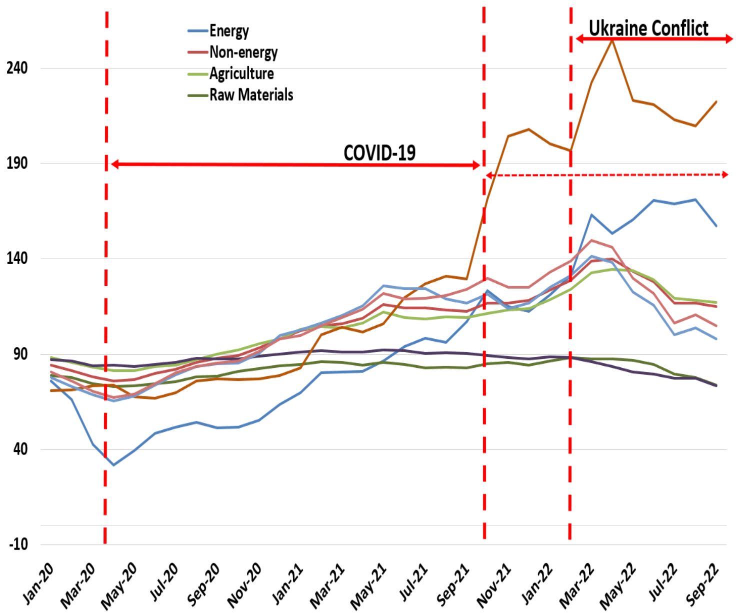
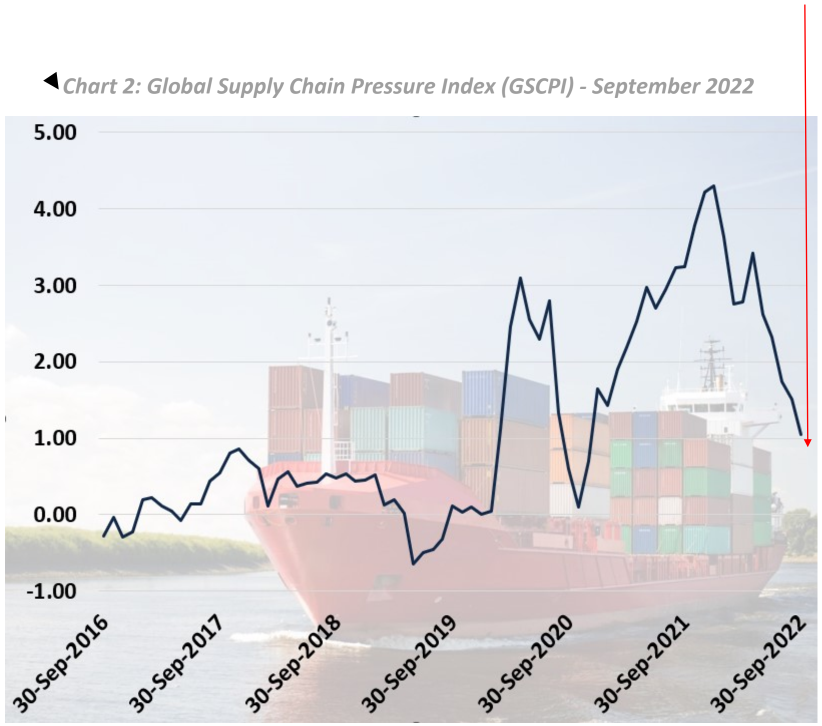


Chart 2: Global Supply Chain Pressure Index (GSCPI) - September 2022



GLOBAL MARKET KPI SNAPSHOTS

USA

- CPI (Sept '22) 7.7%
- Interest Rate 3.75%
- Producer Price Index (y-on-y) 4.1%
- Construction Inflation 8.8% - 9.2%

CANADA

- CPI (Sept '22) 6.9%
- Producer Price Index (y-on-y) 4.6%
- Interest Rate 3.15%
- Construction Inflation 7.7% - 8.2%

MEXICO

- CPI (Sept '22) 6.3%
- Interest Rate 4.5%
- Producer Price Index (y-on-y) 14.84%
- Construction Inflation 8.7% - 9.2%

EUROPE

- Average Euro area CPI 9.9%
- ECB Interest Rate 1.5%
- Construction Inflation Average 9.6%

UNITED KINDGOM

- CPI (Sept '22) 10.1%
- UK Interest Rate 3%
- Construction Inflation average 10.3%

GLOBAL

- OPEC to cut production by 100Mbbl/d
- Global Inflation 2022 8.7%
- Ukraine – Russia Conflict
- Geo-political factors
- Global Energy Crisis
- Skilled Labour Shortages

SAUDI ARABIA

- CPI (Sept '22) 3.1%
- Interest Rate 3.75%
- Producer Price Index (y-on-y) 4.1%

UAE

- CPI (Sept '22) 5.41%
- Interest Rate 3.15%
- Producer Price Index (y-on-y) 4.6%

QATAR

- CPI (Sept '22) 6.3%
- Interest Rate 4.5%
- Producer Price Index (y-on-y) 14.84%

AUSTRALIA

- Construction Output rose Q2-Q3 **0.2%**
- Construction Cost Index (Y-on-Y) **11%**
- Construction Inflation forecast for Q4 **5.8% - 6.8%**
- Residential Construction Costs in Q3 rose **4.7%**
- Interest rate (Cash rate Sept) **2.35%**
- CPI Inflation **6.1%**

NEW ZEALAND

- Construction Output **0.2%**
- Construction Cost Index (Y-on-Y) **11%**
- Construction Inflation forecast for Q4 **5.3% - 5.9%**
- Construction Costs in Q3 rose **4.7%**
- Interest Rate (Cash rate) **3.5%**
- CPI Inflation **7.3%**

Definitions

CPI - Consumer Price Index

PPI - Producer Price Index

GDP - Gross Domestic Product

EXECUTIVE SUMMARY | KPI's | NORTH AMERICA | SOUTH & CENTRAL AMERICA | UNITED KINGDOM | EUROPE | MIDDLE EAST | AFRICA | AUSTRALIA & NEW ZEALAND | ASIA | SUMMARY | REFERENCES | CONTACT

NORTH AMERICA

Highlights

1. In Q3, the region experienced ongoing inflationary pressures, despite several interest rate rises. Inflation for the US and Canada was 8.2% and 7.7% respectively.

2. Availability of skilled labour is a major concern; 91% of surveyed North American construction firms report struggling to fill skilled labour openings.

3. Hurricane Ian caused widespread damage across Florida and South Carolina. Total losses are estimated to reach up to USD 70 billion, USD 48 billion of which is associated with insured losses in Florida. This makes it the costliest Florida storm since 1992.[1]

4. USD 391 billion investment into Energy and Climate Change ventures due to the Inflation Reduction Act of 2022.

5. Construction costs in North America continue to increase.

Interest Rates & Inflation

To counter inflation, both the US Federal Reserve and the Central Bank of Canada have raised interest rates multiple times in 2022. In Q3, interest rates in the US and Canada were raised by 1.5%[2] and 1.75% respectively.[2]

Inflation and interest rate data are summarised in *Table 1* below.

	Q3 Inflation	Q3 Interest Rates
US	8.2%	3.25%
Canada	7.7%	3.25%

Table 1 - AMER Inflation and Interest Rate Summary

Core Inflation, a measure of inflation that excludes certain volatile and seasonal prices, is still on the rise, despite interest rate rises. The International Monetary Fund (IMF) suggests that inflationary pressures are becoming increasingly embedded into the economy and are not being driven by short-term inflationary shocks (i.e. shocks caused by short term commodity price volatility).[4]

Construction Activity

Investment and Confidence

Construction-related investment has continued to rise in Q3; by 1.6%[5] and 1%[6] for the US and Canada respectively. However, this might change heading in 2023 since, according to the Construction Industry Confidence Index, US construction confidence fell 2.8% from Q2 to Q3. According to Engineering News-Record, which produces the index, this fall in confidence is related to a weakening economic outlook and fears of recession.[7]

In Q3, President Joe Biden signed the Inflation Reduction Act of 2022 (IRA) into law. Whilst broad in scope, it is intended to curb inflation by reducing the budget deficit. One of the Act's more notable provisions is a USD 391 billion commitment for investment into Energy and Climate Change initiatives.[8]

Construction Costs

In the US, both Residential and Non-Residential construction costs have continued to increase, per *Table 2* below.[9]

	Residential		Non - Residential	
Time Period	Q2 – Q3	2021-2022	Q2 – Q3	2021-2022
US	2%	5.7%	2.18%	8.6%
Canada	2.5%	18.7%	2.1%	12.5%

Table 2 – Construction Cost % index increase for US and Canada.[10 &11]

Material Prices

Throughout 2022 construction materials prices have increased. This trend continued through Q3, as highlighted by *Figure 1* and *Figure 2*, which show that inflationary pressures are affecting a wide range of construction materials.

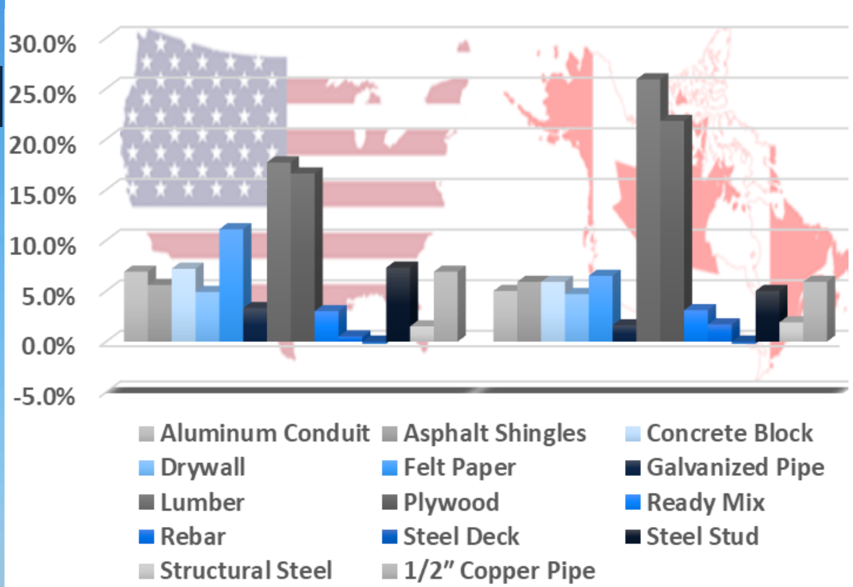


Figure 1: US & Canada % Changes in Residential Construction Materials, Q2-3 2022 [12]

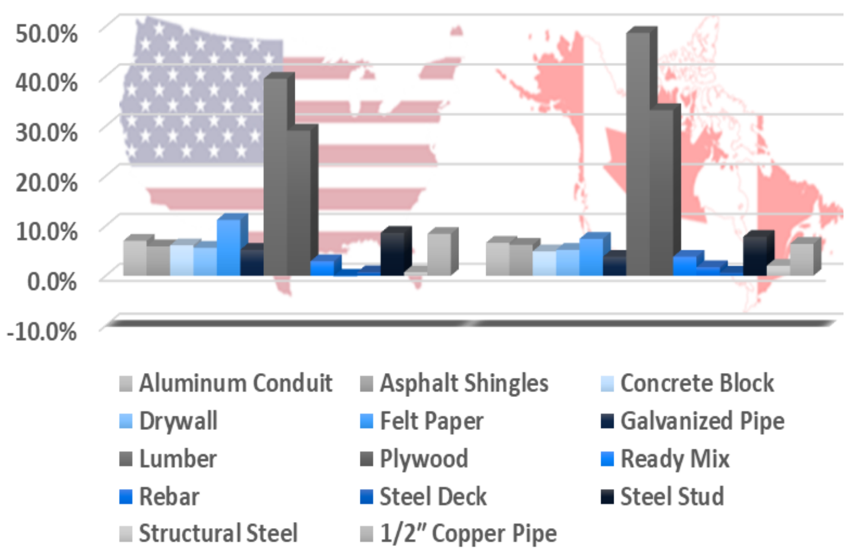


Figure 2. US & Canada % change in Commercial Materials Q2 - Q3 [13]

A consequence of rising material prices is increased 'Reconstruction Costs'. *Figure 3* shows the rise in construction costs through Q3 within the Residential, Commercial and Agricultural sectors.[14]

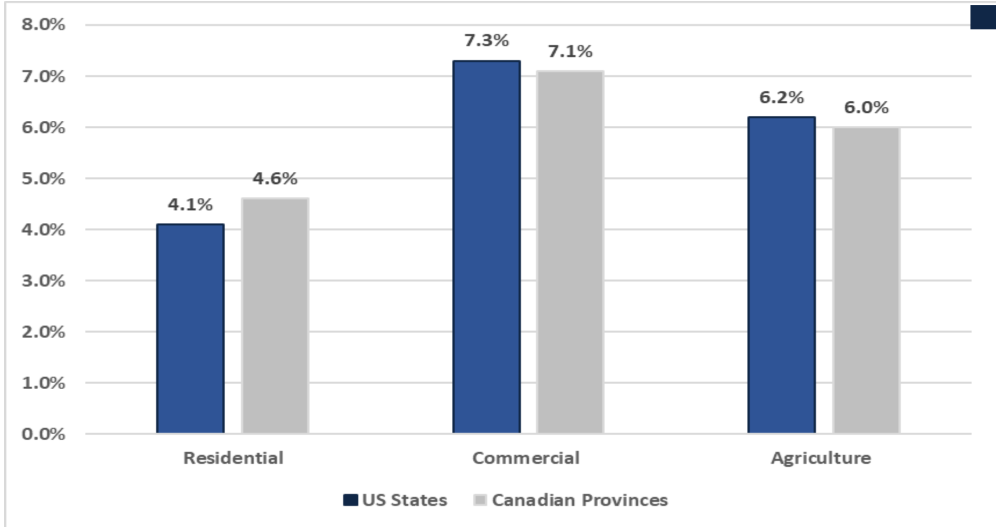


Figure 3 - Residential, Commercial and Agricultural Reconstruction Cost % Increase Q2 - Q3 2022

Labour

USA

In September, US construction-related employment grew to 7,719,000. Throughout Q3, the construction industry added 49,000 jobs according to the US Bureau of Labour Statistics.[15]

This leads to concerns around the availability of skilled labour across the US: companies are having to pay more to recruit and retain skilled labour. For example, the US Bureau of Labour Statistics show average hourly earnings increased 13% over the last 12 months. According to the Association of General Contractors (AGC), these wage pressures and shortages are likely to undermine the industry's ability to complete projects on budget and to schedule.[16]

Our Q2 report showed the Federal Infrastructure Bill, with USD 550 billion in approved spending, may add to the sector's demands: construction activity associated with this Bill will require an estimated 3.2 million new workers. The Blue Green Alliance estimates that the recent IRA Bill could create an additional 9 million jobs over the next decade, averaging 1 million jobs each year. Whilst these are positive developments, they could add significant pressure to an already tight labour market. [17]

More generally, unemployment rates fell throughout Q3, to:

- 3.5% for all industries, and
- 3.4% for the construction industry.[18]

Canada

Labour shortage for businesses increased from 42% in Q2 to 46% in Q3.[19] In addition, average construction wages in Canada also increased 7.5% in the last 12 months according to Statistics Canada, which we expect will add to wage inflationary pressures, similar to that of the US.[20]

Supply Chain

The Federal Bank of New York's Global Supply Chain Pressures Index (GSCPI) reported a decrease in September (Fig*ure 4*), a fifth consecutive monthly reduction. Global supply chain pressures appear to be gradually reverting back to historical levels.[21]

Shipping delays at the US' largest seaports, and backlogs of domestic freight operations, continued to ease through Q3 compared to the up-ward trend seen in H1. Notably, in September, railroad unions and em-ployers reached a tentative settlement to avoid a potential US rail strike. This is particularly important as rail transit represents almost 40% of US long-distance trade. Any service disruption would cause significant ship-ping delays.[22]

Freight backlogs continued to decline through Q3. By August the average had dropped to 5.86 days; by the end of Q3, it fell to 5.81 days. This is below 2021 levels *(Figure 5)* but still significantly above historical averages.[23]

According to a recent ABC (Associated Builders and Contractors) survey, the Construction Backlog Indicator (CBI) increased to 9 months in September, 1.4 months higher than in September 2021. The CBI is a forward-looking national economic indicator that reflects the amount of work to be performed by commercial and industrial contractors in the months ahead. The backlog specifically related to Heavy Industry also increased (to 8.5 months in September from 7.4 months in August).[24]

This increased backlog appears to be related to a 21.5% year-on-year in-crease in manufacturing-related construction spending. By the end of Q3, we expect a more positive outlook for the construction industry, despite continued challenges surrounding skilled labour shortages, equipment deliveries and increases in material prices.[25]

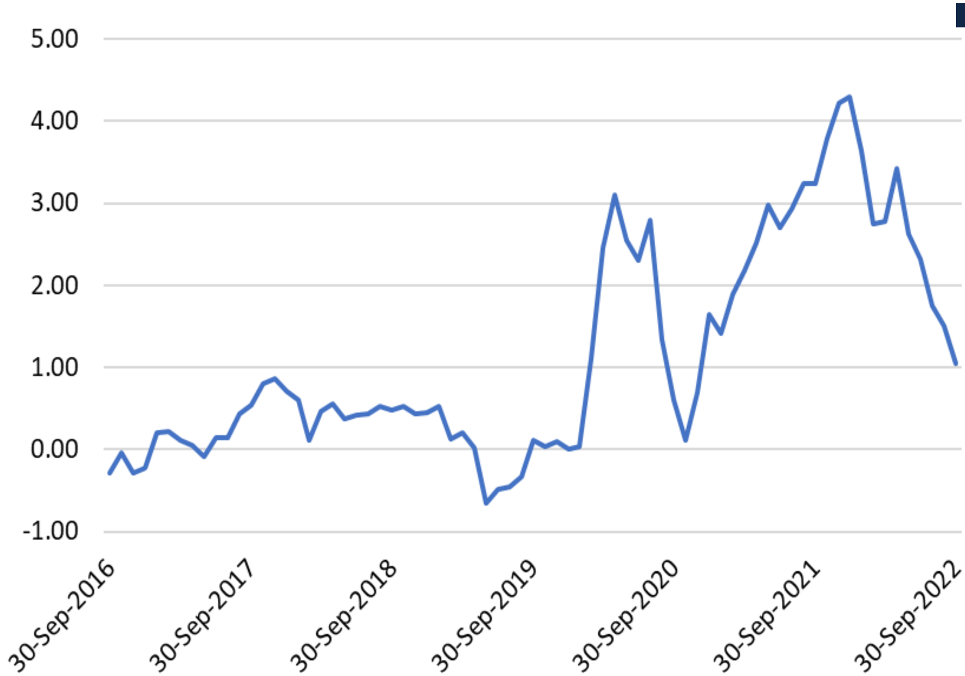


Figure 4 Federal Bank of New York's Global Supply Chain Pressures Index (GSCPI)

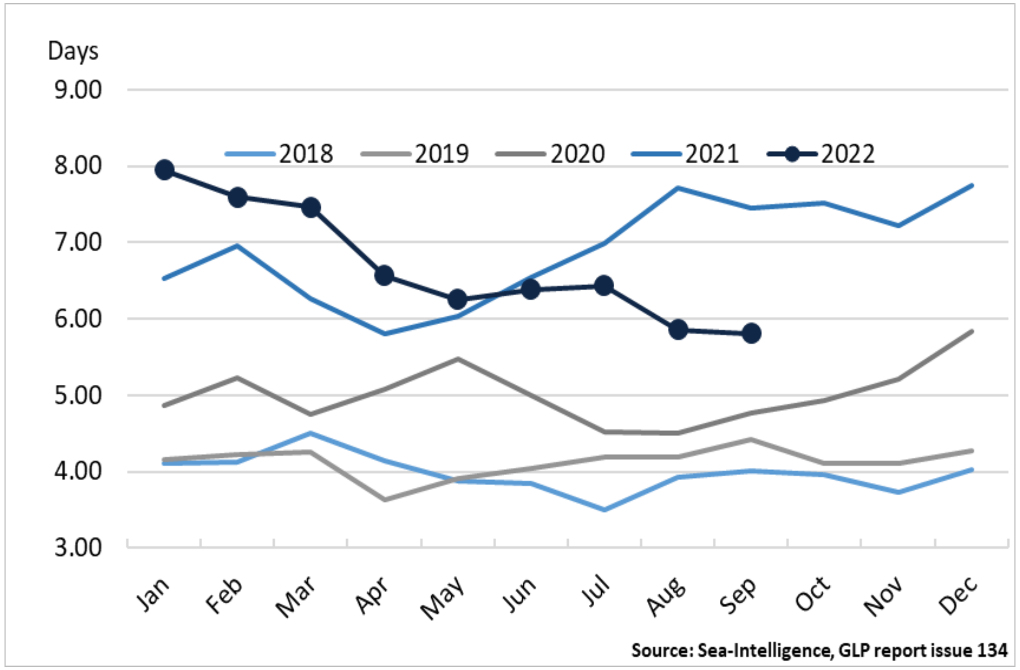


Figure 5. Sea Intelligence Report 134, Global Average Delays for Late Vessel Arrivals - Sept '22

Insurance Perspective/Trends

The impact of inflation on Insurers will vary by business lines and region, but Property and Construction are likely to come under pressure, with concerns that insured assets may be under insured if values at risk are not accurately assessed. A McKinsey report estimates that rising prices contributed to USD 30 billion in global P&C (Property & Casualty) losses in 2021.[26]

Property values and construction costs are focus areas. In the US, coverage -limiting endorsements such as margin clauses and co-insurance have come into play.

Fitch reportedly expects North American life and non-life insurers to be adversely affected by inflationary pressures and recession; they consider the combined effect of these factors will outweigh the benefits of rising interest rates on investment performance.[27]

The Fitch report went on to state that inflation is a greater risk for non-life insurers. Long-term higher inflation affects claims drivers, such as property repairs, medical care and litigation costs. This creates challenges in pricing risk and accurate reserve setting. Strong statutory capitalization, position the industry to navigate near-term volatility tied to inflation.[28]

A Look Ahead

Positive trends include falling commodity prices and easing supply chain backlogs. Notwithstanding this, several challenges facing the US and Canadian economies and construction sectors include:

- Ongoing Ukraine conflict, likely to increase construction material costs into Q4.
- Negative economic outlook, with JPMorgan forecasting a US recession in 2023.[29]
- High inflation is expected to continue into Q4, although the Federal Reserve forecasts that it may fall in 2023.[30]
- With large infrastructure investment planned, the lack of spare capacity in the labour market leads us to anticipate wage inflation in 2023.

SOUTH AND CENTRAL AMERICA

Highlights

1. Central and South American countries continue to experience inflation. Overall, interest rate rises in the region have been faster and more pronounced compared to other regions.
2. There is a mixed picture with inflation. Some economies are comparable to the Eurozone and US, with rates at around 8-9%.
3. Rising material cost is a major factor affecting Latin American construction activity.

Interest Rates and Inflation

Inflation in Latin America is growing at its fastest pace in over 20 years. Across the 12 South American countries, inflation-related energy, oil and goods costs continue to affect economic and construction growth.[31]

Inflation in the region can be classified into 3 groups: [32]

High inflation

Venezuela (inflation of 117%)

Argentina and Suriname (inflation between 50 -50%)

Haiti and Cuba (inflation of ~25%)

Inflation between 8% and 14%

Countries with inflation levels of around 8-9% (comparable to Europe and the US) include Mexico, Guatemala, Peru, Uruguay and Brazil.

Countries with inflation of around 10-14% include: Colombia, Nicaragua, Costa Rica, and Chile.

Low inflation (below 5%)

Countries such as Ecuador, Panama and Bolivia are reporting lower levels of inflation of less than 5%.

Mexico

In Mexico, interest rates increased by 0.75% in both July and September. September was 2022’s sixth consecutive increase, with current annual inflation of 8.7%.[33]

South America

In September, Brazil's central bank opted not to change the benchmark Selic interest rate of 13.75% after 12 consecutive increases (up from 7.75% in Q4 2021). The Bank released a statement that the interest rate level would be maintained for as long as it takes to control inflation. This underlines that inflationary pressures are still very much a concern in the region but are starting to show signs of easing. [34]

Construction Activity

Mexico

The S&P Global Mexico Construction PMI, which tracks construction output, reports that output fell by 3.83% between September 2021 and September 2022. It has been suggested that the reason behind this fall in output is a combination of inflationary pressures, cashflow problems and material shortages.[35]

Industrial production continued to grow throughout 2022 and into Q3, with a Q3 annual rate of 3.5%, up from 3.3% in Q2 2022.[36]

Material Prices

Mexico

The National Producer Price Index (NPPI) measures changes in producers’ prices, which have increased by 13.17% over the last 20 months.[37]

From June to July, the price of construction materials rose by 14.3%. However, in Q3, price increases slowed, and the construction materials index fell 0.97% in September.[38]

South America

At the end of Q2 and into the start of Q3, rising costs of raw materials were still a major factor affecting civil construction.

The price of construction-related bulk materials and equipment (e.g. copper wiring, structural steel, rebar, piping, etc.) has continued to rise through Q3, with these rises attributed to material shortages and increases in freight/ shipping costs. [39]

Labour

Mexico

In Mexico, the unemployment rate decreased to 3.3% in September 2022 from 4.2% in September 2021.[40]

South America

South & Central America construction industry experienced a 16.6% fall in hiring activity in October 2022, according to Global Data's Job Analytics dashboard. [41]

Supply Chain

The Ukraine conflict has caused inflationary pressures. Sanctions on Russia and Belarus have reduced fertilizer availability. Latin America is the second most dependent region in terms of fertilizer imports; 80% of fertilizers must be imported.[42]

UNITED KINGDOM

Highlights

1. Record inflation and subsequent interest rates rises.
2. Increased material prices.
3. Political and economic instability, leading to the depreciation of GBP.
4. 4,000 construction firms have become insolvent in the 12 months ending Q3 2022. 59% of these were ‘Specialist Contractors’.
5. Extensive Public Sector strike action.
6. Skilled labour shortages.
7. Material supply: 49% of contractors are reporting that they are seeing ‘some’ stability in the supply chain returning.

Interest Rates and Inflation

At the end of Q3, the Consumer Price Index (CPI) was 10.1%, the highest recorded annual inflation rate in the National Statistic Series, which began in January 2006. *Figure 6* shows the rate of increase over the last 12 months.[43]

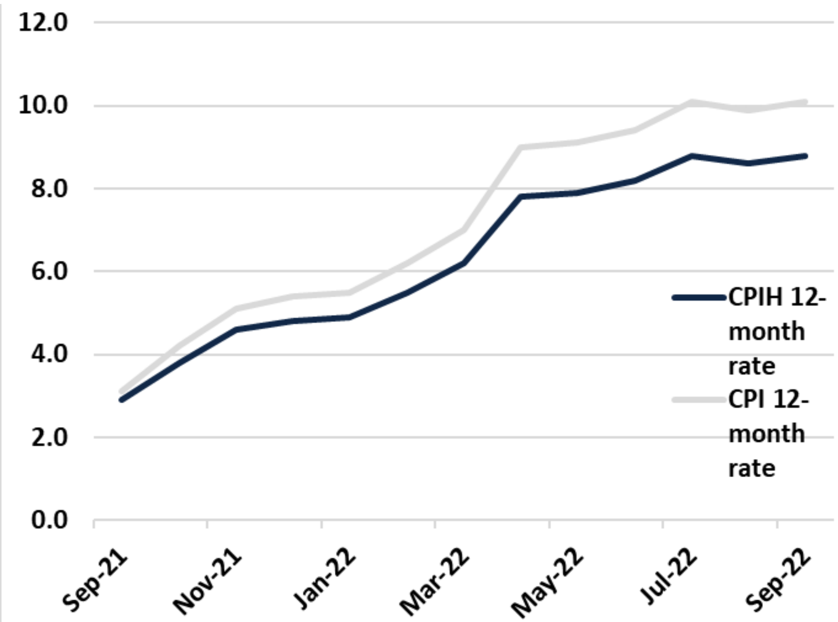


Figure 6. CPIH (Consumer Price Index with Housing) and CPI Index 12 months Sept'22

Political instability throughout Q3 led to a significant depreciation in GBP, leading to further increases in imported construction material prices.[44]

In September, the UK government announced an estimated GBP 150 billion support package for businesses and households struggling with record-high energy costs. Confirmation of the six-month business support scheme is due in November.[45]

Industry / Construction Activity

The RICS UK Construction and Infrastructure Monitor suggests that, in Q3, construction activity increased, albeit with slowing momentum. New business enquiries rose more modestly compared with Q2 and workload expectations for the next twelve months suggest a further softening in the growth trend. Significantly, there is now concern regarding macroeconomic factors such as credit constraints.[46]

The Business Confidence Monitor (BCM) Index *(Figure 7)* suggests that during 2021, confidence climbed to near-record highs, as companies experienced an upturn following the pandemic. However, this has declined consistently throughout 2022. In Q3 2022 it fell into negative territory for the first time since the peak of the pandemic.[47]

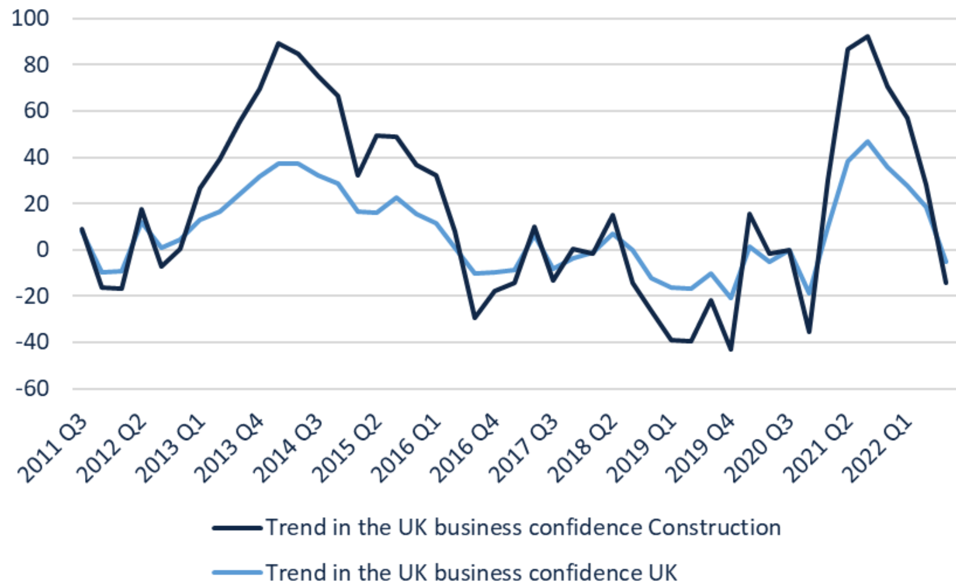


Figure 7. ICAEW - UK Business Confidence Monitor Q3 2022

In Q3, quarterly construction output saw an increase of 0.6%; this is the weakest quarterly growth since Q3 2021, which also suggests the pace of growth is slowing.[48]

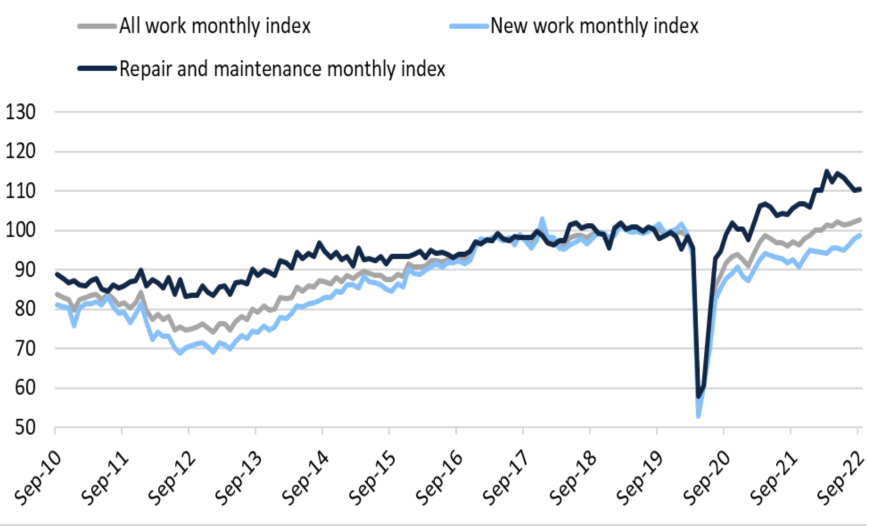


Figure 8. Office for National Statistics 'All Work Index'

Total new construction orders increased 6.4% in Q3 (from GBP 728 million to GBP 774 million).[49]

Projects progressing through Q3 were often based on prices agreed before the recent increases. According to the BICS (Business Insights and Conditions Survey) data *(Figure 9),* 29%, of construction firms reported that they had to absorb recent cost rises.[50]

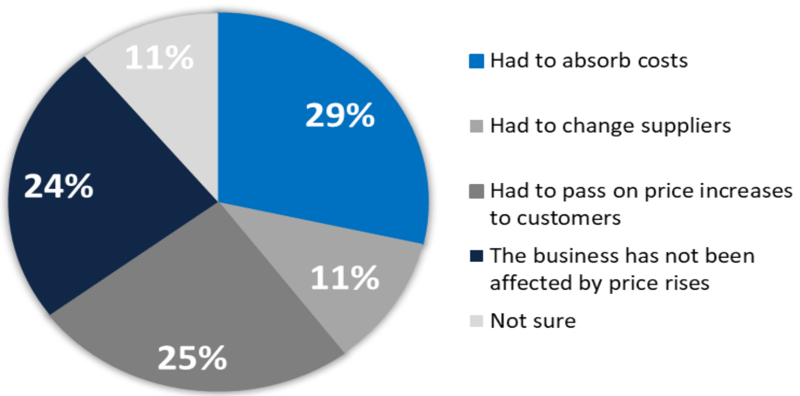


Figure 9 . Impact of price rises, construction businesses not permanently stopped

Materials

Throughout Q3, rising fuel and energy prices have impacted imported European goods prices. In July, construction material prices were:

- 24% higher than a year earlier; and
- 44.7% higher than before the COVID-19 pandemic.[51]

High energy costs have continued to impact UK manufacturers, making goods more expensive to produce. This has been compounded by a significant drop in the value of the pound; this increases the relative cost of imported construction and manufacturing goods. According to BEIS (Business, Energy and Industrial Strategy)' latest 'Monthly Statistics of Building Materials and Components, the material price index for 'All Work' increased by 10.1% from September 2021 to September 2022. [52]

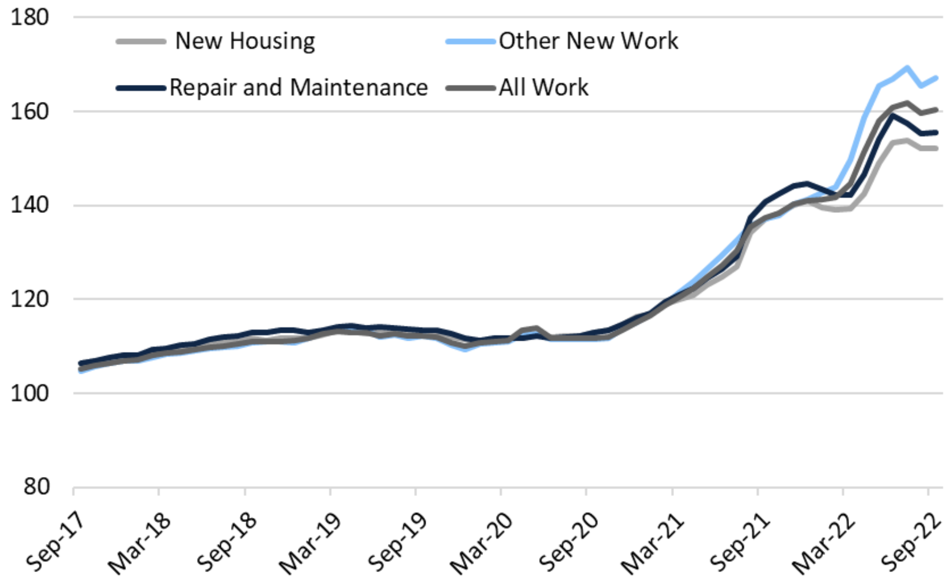


Figure 10. ONS Construction Material Price Index, UK 2015=100

The most significant material price increases are found in energy-intensive and high-demand materials such as aggregates, insulation, steel rebar, pre-cast concrete and doors & windows. *Figure 11* shows those energy-intensive materials with the fastest material annual price inflation in Q3.[53]

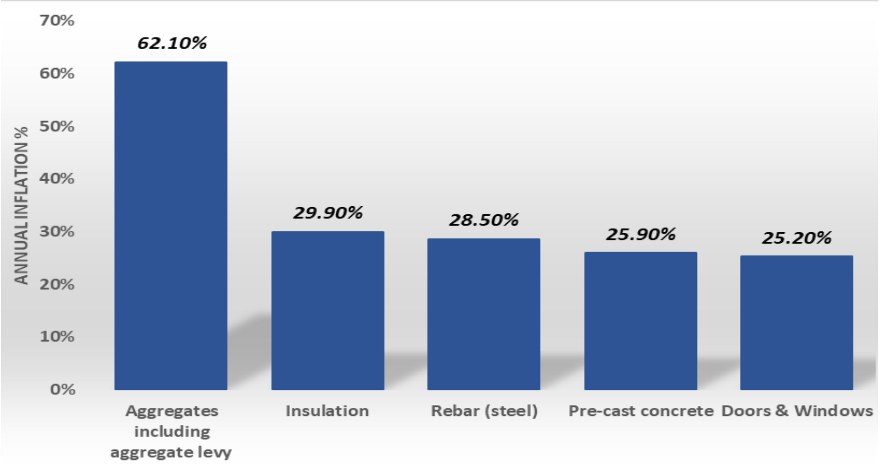


Figure 11. Extracted ONS Material Price Index - Fastest material inflation

We previously reported that In Q2, British Steel (BS) increased the price of its steel by GBP 250 per tonne (structural sections). This trend has continued into Q3, as they twice increased prices by a cumulative GBP 250 per tonne. BS report that these price increases reflect increased energy costs and supply disruption stemming from the Russia-Ukraine conflict.[54]

The International Steel Statistics Bureau (ISSB) suggests that long steel costs, produced via electric arc furnaces in the UK, increased by 49%, to GBP 790 per tonne. It forecasts a further 19% increase to GBP 970 per tonne, by Q1 2023. [55]

A Mineral Products Association[56] (MPA) survey suggests a Q3 decline in demand for aggregates, asphalt, and ready-mixed concrete for the second successive quarter. The importance of these materials means that it acts as useful Key Performance Indicator (KPI) to monitor the health of the Construction Sector. The apparent decline in demand may suggest an upcoming decline in construction activity. In the past year, both asphalt and crushed rock sales have declined by 5%. A summary of the % change in sales volumes for various aggregates is shown in *Table 3.*

	Q3 Inflation	Q3 Interest Rates
Asphalt	-5.9%	-0.6%
Ready Mixed Concrete	-7.2%	-4.05%
Crushed Rock	-9.4%	0.8%
Sand & Gravel	-4.7%	-4.7%
Mortar	-3.0%	4.2%

Table 3. % Change in Sales Volumes for Aggregates

Tender Prices

Rising interest rates will affect tenders, due to higher financing costs and their impact on project viability assessments and subsequent approval decisions. This may force firms to find ways to be more competitive with their bids.

The Building Construction Information Service (BCIS) All-in, Tender Price Index (TPI) shows a Q3 1.4%[57] increase and an 8% year-on-year increase. The BCIS Tender panel *(Table 4)* also reported an increased appetite to tender in the quarter.[58]

	1	2	3	4	5
Appetite to tender on a scale 1-5	Cannot get anyone to tender		Desired number of suitable tenderers found		Contractors are very eager to tender
Q3 2021	0%	15%	62%	23%	0%
Q4 2021	0%	17%	42%	33%	8%
Q1 2022	0%	17%	58%	17%	8%
Q2 2022	0%	39%	46%	15%	0%
Q3 2022	0%	8%	67%	25%	0%

Table 4. BCIS Tender Panel - Appetite to Tender Q3 2022

According to the BCIS, Civil Engineering tender prices rose by 4.6% from Q2; and 9.6% from 2021.[59] The Middle Market Business Index suggests tender prices are forecasted to rise by 20% by 2027.[60] To mitigate material price volatility, we are seeing an increased use of indexed linked provisional sums and fluctuations clauses in contracts, a measure employed by contractors to protect their margins.

Labour

ONS (Office for National Statistics) data reveals that whilst construction labour shortages eased slightly towards the end of Q3, they remained at historically high levels, as shown by *Figure 8.*[61] In Q3 there were 2.16 million workers in construction. However, according to the ONS that is:

- 2.3% lower than in Q2; and
- 11.1% lower than Q1, 2021.

This means there were 269,678 fewer workers in UK construction (compared with Q1, 2021) at a time when demand is increasing.[62]

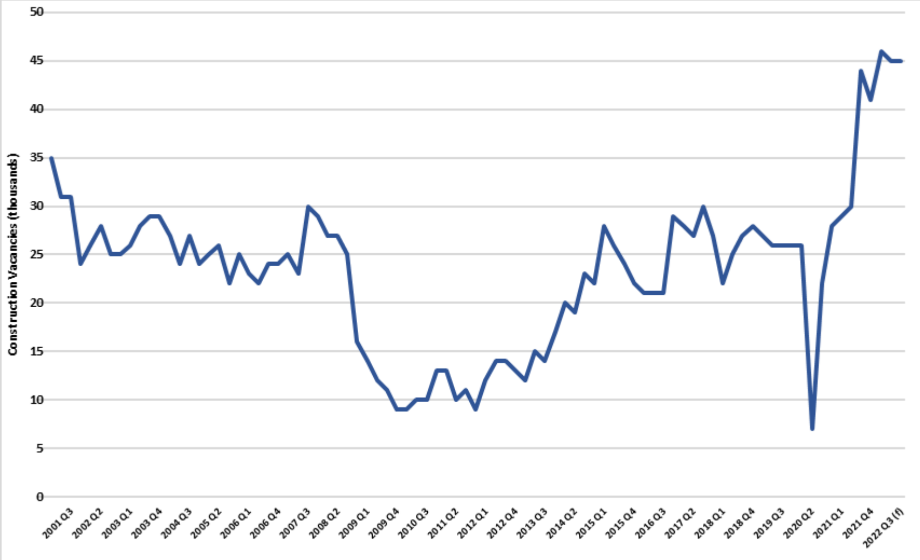


Figure 12. ONS Construction Vacancies 2001 - Q3 2022

In Q3 we saw extensive strike action across many industries. These appear to have influenced labour rates; a recent RICS industry survey and supported contractor survey showed that 76% of the companies surveyed reported increases in labour rates in Q3.[63]

Figure 13 shows that the construction industry is still being challenged by skilled labour shortages and financial constraints. According to the RICS UK Construction monitor the key areas of labour shortages include Bricklayers, Carpenters and Quantity Surveyors.[64]

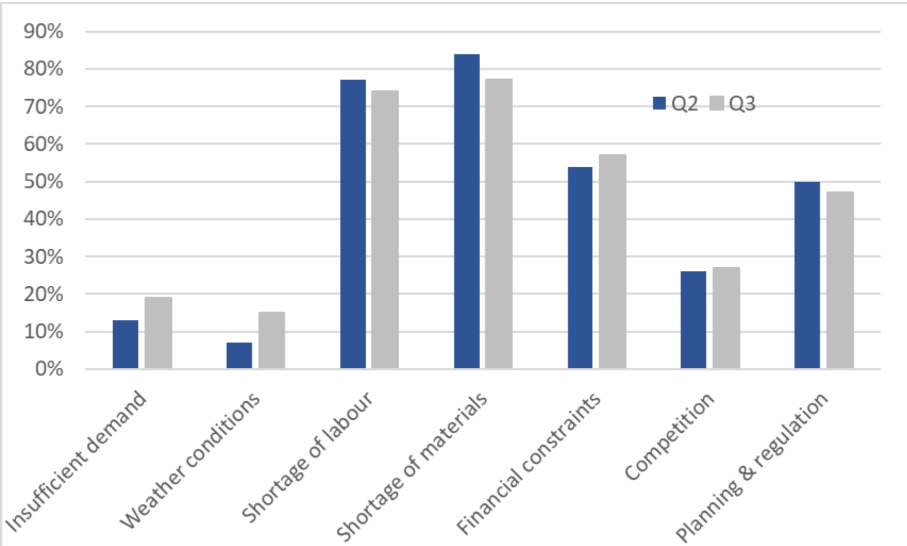


Figure 13. RICS Q3 2022 UK Construction and Infrastructure Survey

The UK construction sector has historically been reliant on foreign workers, particularly those from the EU.[65] Therefore, Brexit-related restrictions on the movement of foreign workers is affecting the sector.

Supply Chain

In Q3, supply shortages and delivery delays eased. In Q2, 20% of businesses reported that they experienced disruption across their global supply chains. In Q3 that reduced to 18% according to the ONS Business Insights and impact on the economy Q3 report.[66]

According to the Builders Merchants Federation, Q3 saw easing pressure on material volumes. However, it also showed a slow down in volume sales of 6.8% compared to Q3 2019 (pre-pandemic), while prices were up 32.4%. [67]

The Insolvency Service reports insolvencies increased by 7%, with almost 4,000 construction firms becoming insolvent over the last 12 months. This is the highest rate of insolvencies seen in the UK since the 2008 Financial Crisis. 59% of these were 'Specialist Contractors. [68]

Extensive strike action in Q3 caused significant supply chain disruption. An example is rail strikes, which disrupted the transit of aggregate and concrete to major infrastructure projects. We expect continued industrial action in Q4 and 2023.

Construction material availability is improving, with 49% of contractors reporting an improvement in the availability of materials across the supply chain. There are exceptions, which include bricks, air-crete blocks, roof tiles, chipboard flooring, gas boilers and products requiring semi-conductors within sub-components – all of which, according to Construction Products Association, will be subject to longer lead times going into Q4 and 2023. [69]

Impact on Insurers - Insurance Perspective

For insurers with UK exposures, volatility of inflation, costs, lead times, and material and labour shortages, pose significant challenges in pricing risk and estimating loss exposure. In such a volatile environment, what was true and accurate last quarter, may not be now. Keeping abreast of market rates is imperative when assessing risk and claims exposures. The above challenges also create additional risks of underinsurance, which is something that needs to be carefully considered going forward.

EUROPE[70]

Highlights

1. Inflationary risks are still high across the Eurozone, due to rising energy prices.
2. Rising energy costs are increasing production costs across energy-dependent industries.
3. Supply chain pressures due to heatwaves affecting waterways.
4. Contraction of the construction industry and recession fears.

Interest Rates and Inflation

Inflationary pressures remain high across Europe, in part due to energy prices. Those that are more reliant on Russian gas, such as Germany, Italy and Spain, are most exposed.

In Q3 inflation for the Eurozone and European Union is currently reported as 9.9% and 10.9% respectively. This represents a 1.3% inflationary increase across the region from Q2 to Q3.[71]

Figure 14 is the European Central Bank's visualisation of forecast inflation rates across the region for the remainder of 2022. As a result, we expect the Region will see further interest rate rises.[72]

In Q3 energy costs continued to be the largest contributor to inflation. Nord Stream 1, the main pipeline supplying Russian gas to Europe, was closed for unscheduled maintenance in Q2. It came back onstream temporarily before shutting again in Q3. This puts further pressure on European power plants, with concerns over potential energy shortages this winter.[73]

The Euro is down 13% for 2022 against the US Dollar. The likely impact is the increased cost of imported goods and materials, which further feeds inflation.[74]

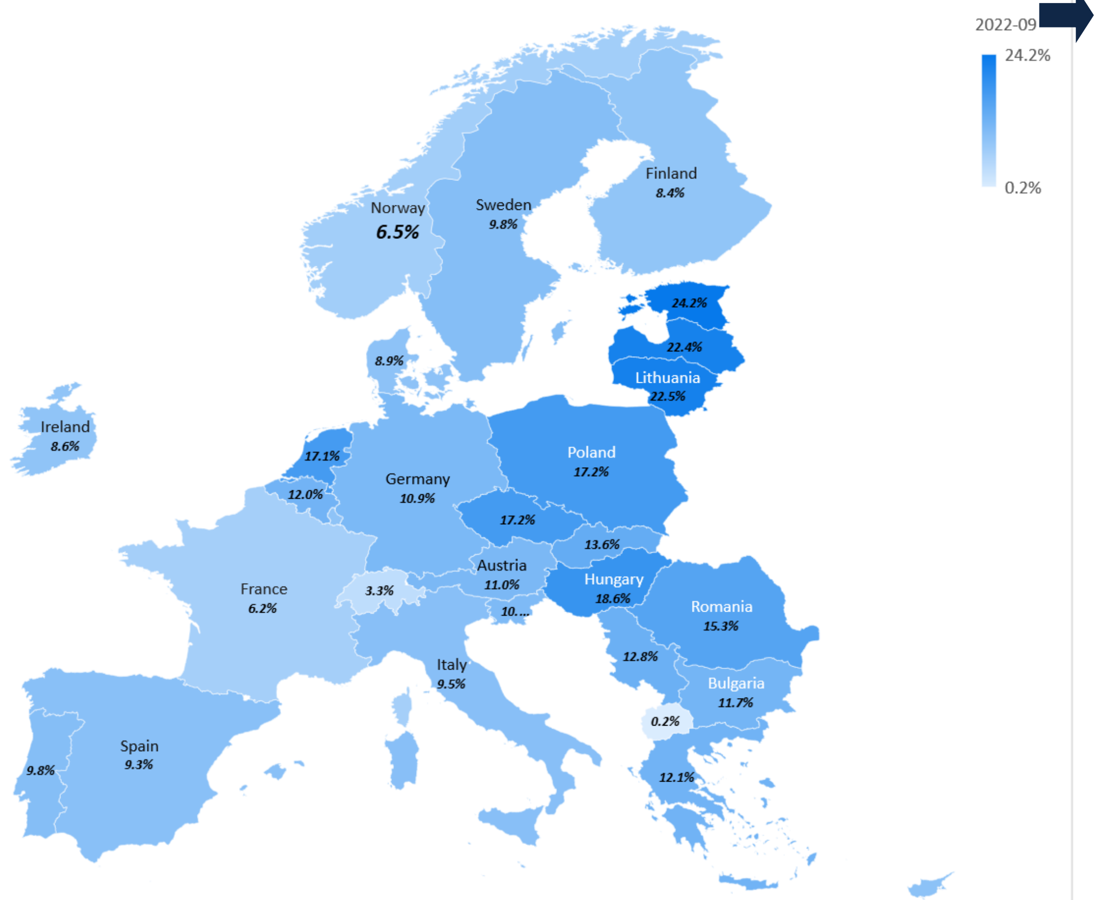


Figure 14: Eurostat European Inflation Rates, chart by GRS

Industry / Construction Output

The S&P Global Final Composite Purchasing Managers' Index (PMI), a measure of economic health, fell to an 18-month low during Q3. A PMI of less than 50 indicates economic contraction. In Q3, the PMI has been below 50 for 3 consecutive months. It can therefore be concluded that the region is entering a recession, perhaps earlier than forecast.[75]

Construction activity throughout the region has continued to decline through Q3, as shown by the S&P Global Eurozone Construction Total Activity Index.[76] This index shows 5 consecutive months of decline. This trend is also confirmed by the RICS Q3 Global Construction Monitor which suggests that high energy prices and falling consumer confidence are influencing factors.[77]

EUROPE

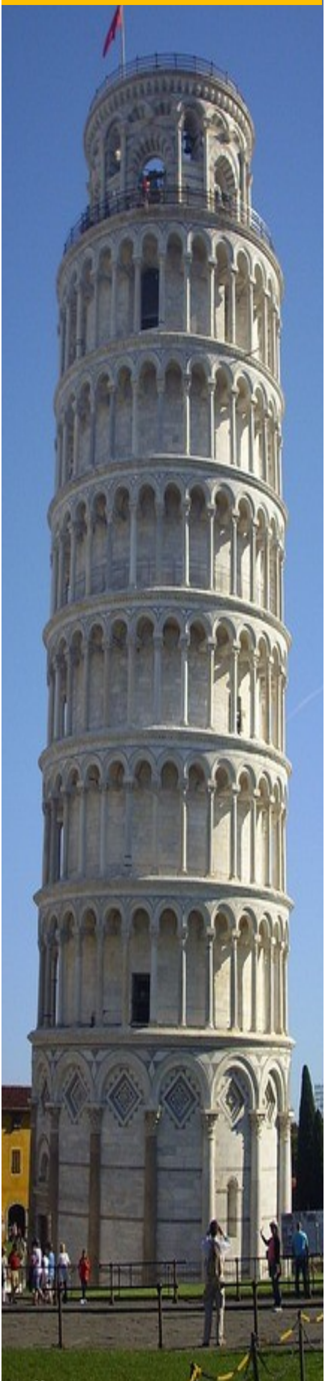


Figure 15 shows the increase in construction costs in new European residential buildings according to Eurostat, on a quarter-to-quarter basis from Q2 2020 to Q3 2022 (including Q3 provisional forecast figures). From this, we can see that COVID-19 and the Ukraine conflict significantly influenced residential construction costs, specifically with the ongoing energy crisis maintaining the rising trend through Q3.[78]

In Q3, Industrial Production costs continued to rise (*Figure 16*). From September 2021 through to September 2022, costs rose across the Euro Zone and the EU by 4.9% and 5.7%, respectively.[79]

Materials

Across the region, rising material costs (*Figure 17*) and availability are affecting construction activity.

Construction companies across the EU are reporting problems with materials shortages. Whilst there appears to have been a recent reduction in the number of companies reporting problems, these reported figures remain historically high. [80]

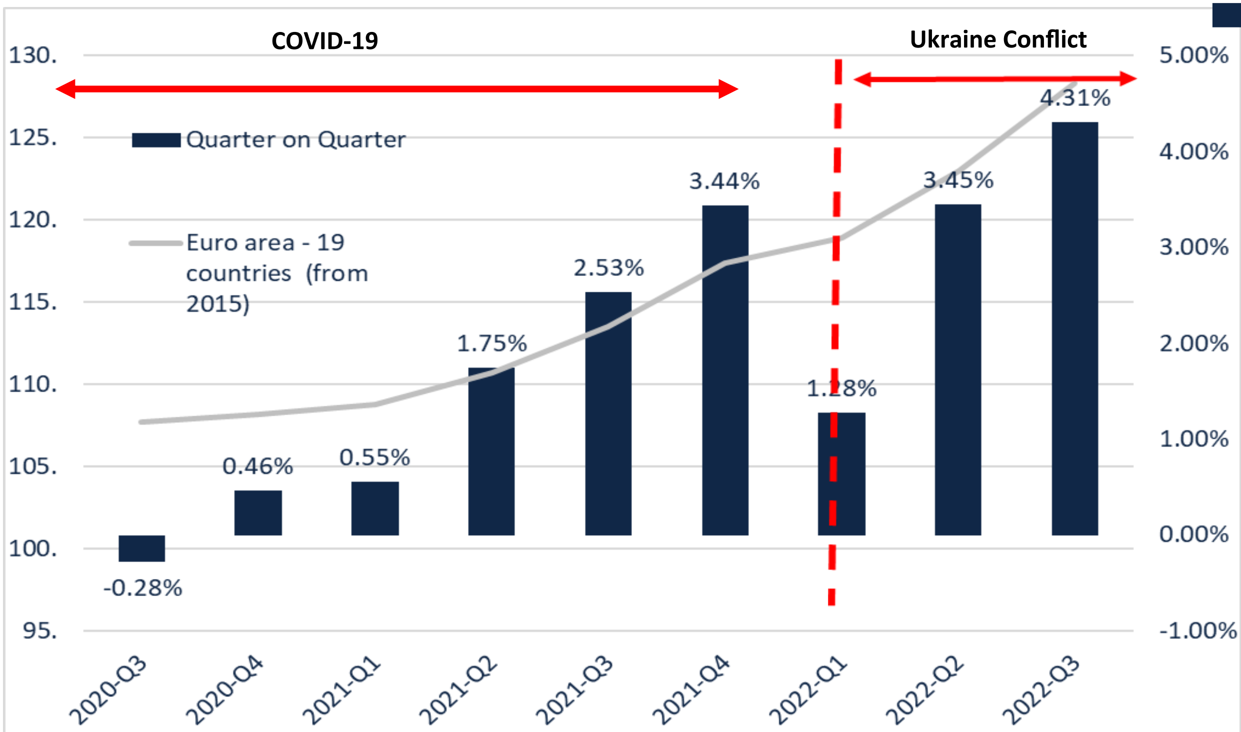


Figure 15. Residential Construction cost Q2 - Q3

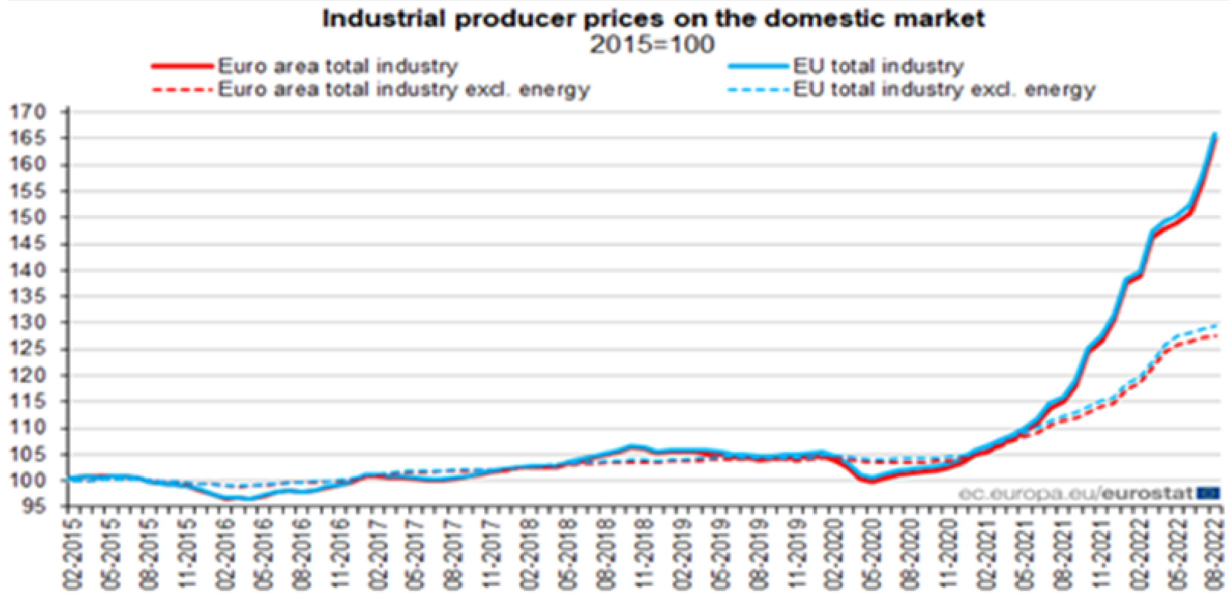
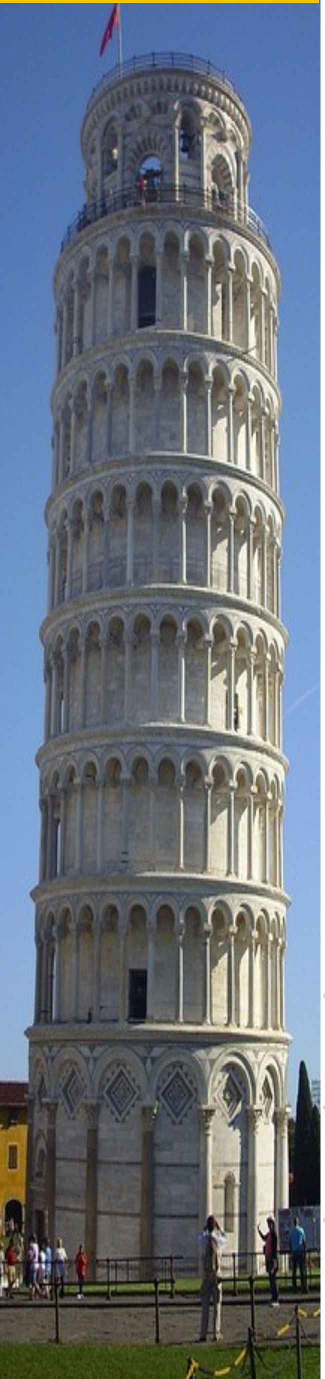


Figure 16: Eurostat Industrial producer price index



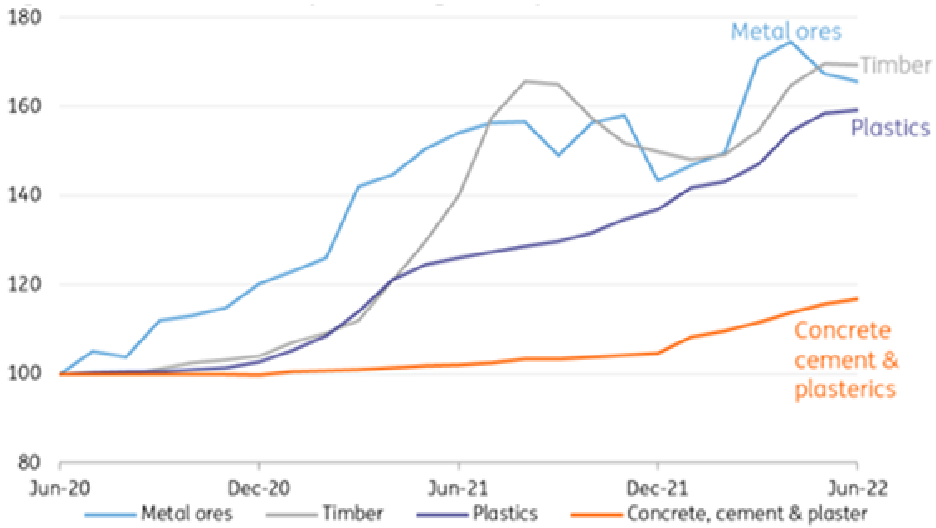


Figure 17: Eurostat and ING - Development Building material Prices

The *'Construction Confidence Indicator,* a measure of industry confidence, is shown in *Figure 18*. From this, we can see that confidence in the Construction Sector is declining, but still positive. However, confidence within the Building Materials Sector has declined into negative territory. It is worth noting that the Building Materials Sector can be more vulnerable to economic shocks than the Construction Sector.[81]

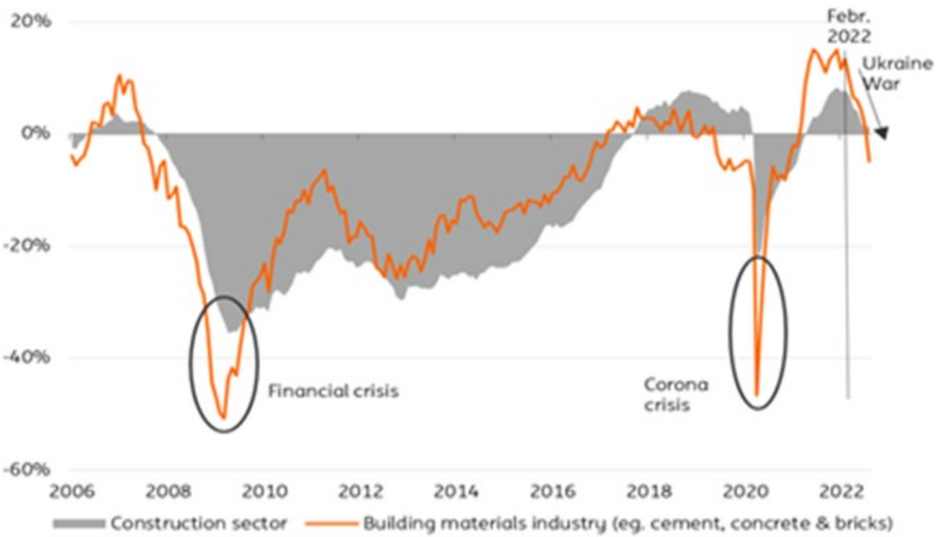


Figure 18: Eurostat and ING Construction Confidence Indicator

Labour

Total employment across the Euro Zone and the EU increased by 0.2% in Q3.[82] The Construction Sector is the leading industrial employer within Europe representing 7.5% of total European employment and 28.1% of industrial employment.[83]

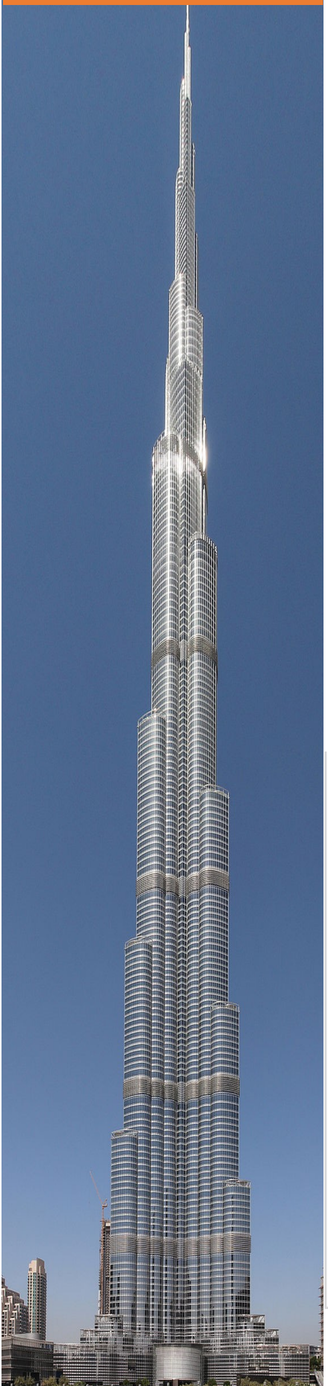
The availability of skilled labour continues to be an issue across Europe. For example, ING report that in Italy, there is a lack of bricklayers. In Spain, tenders and projects are being affected by a lack of qualified construction companies with trained technical personnel.[84]

Supply Chain

In Q3, pressure on supply chains have eased. However, the intense heat waves experienced throughout Europe over the course of this quarter gave rise to low water levels.[85] In Europe, waterways are the main mode of transport for raw building materials. Therefore, on many rivers, barges could not be loaded at full capacity. With barges only able to sail partially full, there was an increased reliance on road exports. This situation led to a general increase in transit duration and cost. [86]

A Look Ahead… The next 12 months

Supply chain disruption and energy price volatility remain the key risks for the region. Countries such as Germany, Spain and Italy, with greater reliance on energy imports, are particularly exposed to energy prices in Q4 and early 2023.



MIDDLE EAST

MIDDLE EAST

Highlights

1. Rising inflation and interest rates remain key challenges across the region.
2. Saudi Arabia continued its strong economic growth due to high energy prices and major infrastructure projects.
3. Material costs, availability and financial constraints continue to affect activity in the Middle East region.
4. Significant large-scale investment proposed across the region.

Interest Rates and Inflation

Rising interest rates and inflation remain key challenges across the region. Central Banks have typically been responding by raising interest rates. The exception was Egypt which, in September, decided to keep interest rates on hold at 11.25%.[87] *(Figure 19).*

Across the region, inflation varied between 3 – 11%, apart from Lebanon, which currently has inflation of 182%.[88]

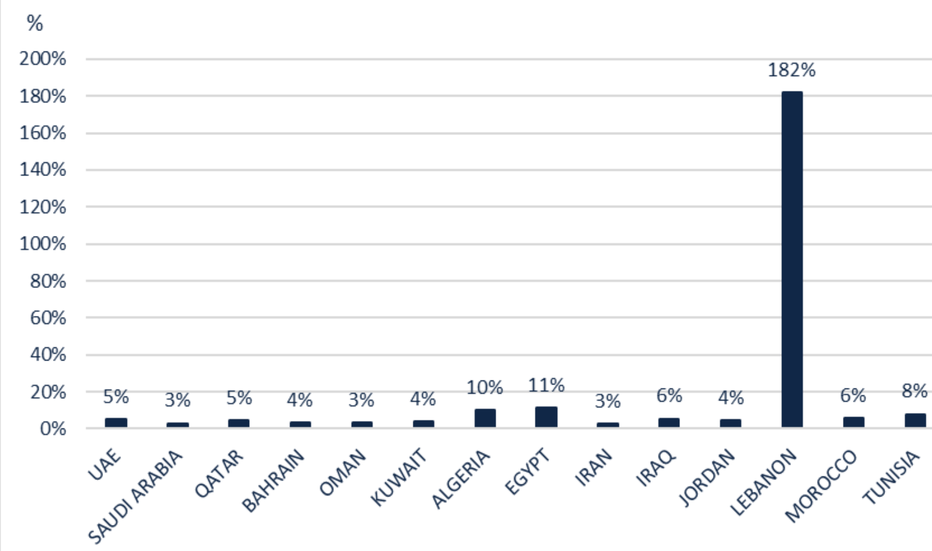


Figure 19. RICS Global Construction Monitor MENA

Industry / Construction Activity

The Middle East construction sector is more positive than in many other parts of the world. Construction activity across the Middle East increased throughout 2022. This is forecast to continue.

There are continued challenges but overall, the region is likely to see growth in Q4 and 2023. In part, this is due to significant government spending.

According to Meed Project's regional project tracker, more than USD 121 billion worth of social projects are planned or underway in the GCC (Gulf Cooperation Council). The region's spending is shown in *Table 5,* (which is positively affecting growth. This trend may cause inflationary pressures, due to the impact on the availability of skilled labour, plant and material.[89]

	Bahrain	$71bn
	Kuwait	$33bn
	Oman	$5.7bn
	Qatar	$4.7bn
	Saudi Arabia	$3.7bn
	United Arab Emir-	$3.1bn

Table 5. Meed Projects key construction

The RICS (Royal Institute of Chartered Surveyors) Global Construction Monitor *(Figure 20)* summarises construction activity across the Middle East: Saudi Arabia is continuing to show the strongest regional activity.[90]

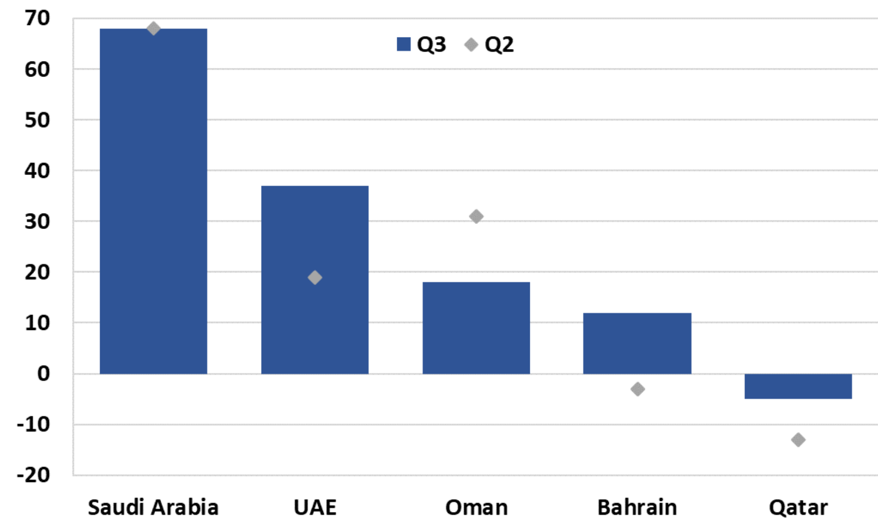
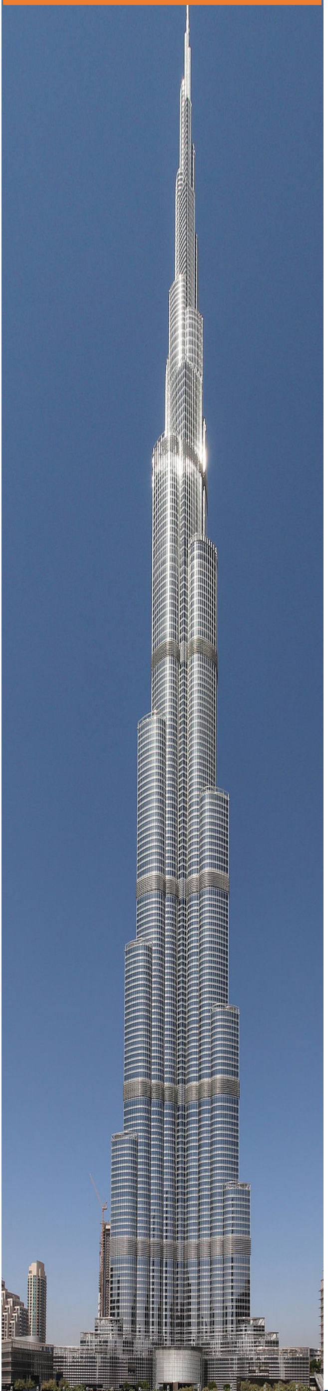


Figure 20. RICS Global Construction Monitor MENA



The region is also progressing hydrogen investment. There are at least 24 'Green Hydrogen' projects planned across North Africa and the Middle East, representing almost USD 92 Bn of investment in clean energy. The largest projects are located within the Gulf. [91] According to the latest RICS Global Construction Monitor, in Q3 there are several factors affecting construction activity across the region (*Figure 21*). The three most significant factors are: [92]

1. Material Costs
2. Financial Constraints
3. Material Shortages

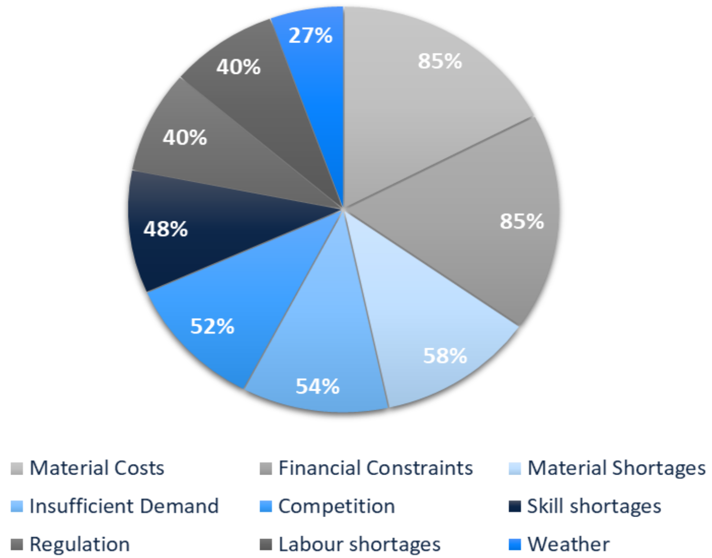


Figure 21: RICS Construction Monitor, Q3

Saudi Arabia

The Saudi Arabian Construction Sector is active, with three million workers engaged in the industry. According to the Saudi Contractors Authority, the next five years will see more than USD 5.3 trillion in projects, which will increase demand for skilled labour. [93]

United Arab Emirates (UAE)

In the UAE, non-oil trade was up 17% during the first half of 2022. Abu Dhabi launched a USD 2.7 billion drive to expand its manufacturing sector, as part of a strategy built around the "circular economy" concept. Etihad Rail marked a new milestone, with the connection of Khalifa Port and the national rail network on mainland Abu Dhabi via the country's first marine rail bridge. [94]

Kuwait

The construction sector is recovering strongly. A recent industry report estimates that total contract values will reach USD 9.2 billion by 2028. The '2035 Vision' is expected to stimulate construction industry growth of 6% over the next three years, during which the sector is being urged to adopt state-of-the-art technology. [95]

UAE

The country recently approved its federal budget for 2023 - 2026 with a total expenditure of AED 252.3 billion (~ USD 69 billion). [96] The UAE also increased its green energy focus with 20% of its energy mix being accounted for through clean energy. [97]

Materials

UAE

The Dubai Construction Material Price Index (CMPI) *Figure 22* shows a range of price changes from Q2 to Q3, with some materials experiencing sharp increases, and others decreases. [98]

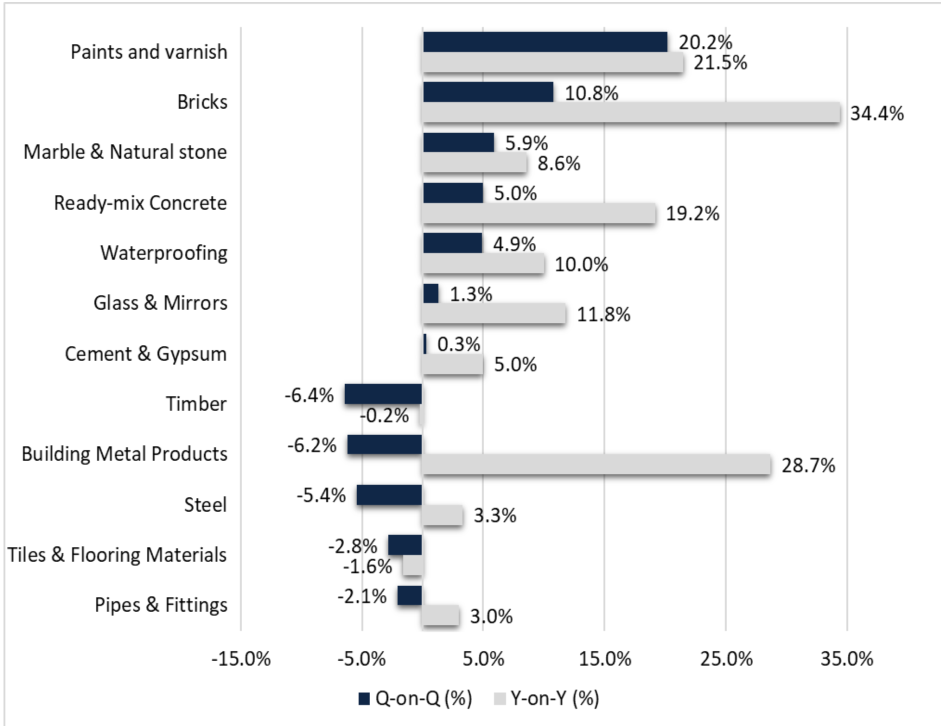
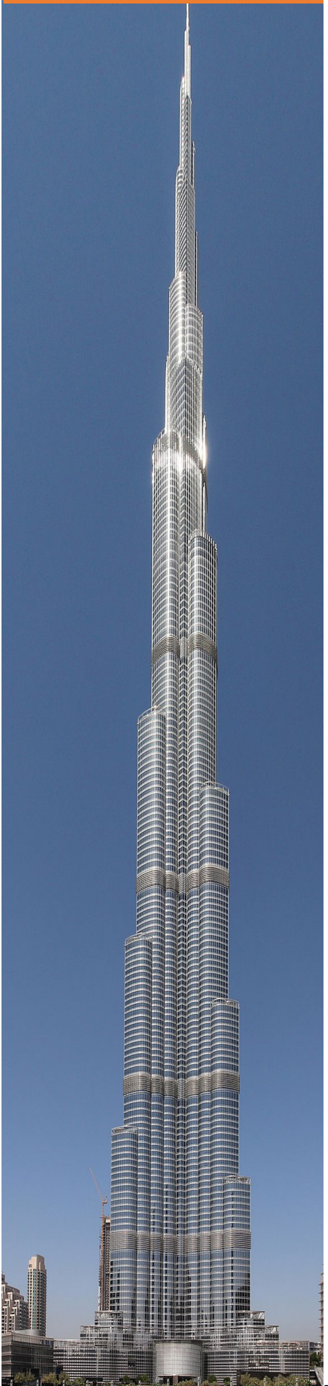


Figure 22: Dubai CMPI Material Increases



Saudi Arabia

Inflationary pressures within the industry are apparent; materials such as rebar and industrial metals have increased in price. However, others such as concrete, blockwork, gypsum and steel show more modest price rises, remaining within the inflation rate of 2.7% reported by the Saudi Arabian Monetary Authority (SAMA).[99]

Labour

Labour shortages across the Middle East remain less of a concern compared with the Asia Pacific, European and the US (United States).

The region continues to employ high volumes of expatriate construction workers. In Q2 we reported that the lingering impacts of COVID-19 were still affecting the labour market. Through Q3, this effect has eased. However, with pressures on skilled labour continuing globally, this could still pose a risk, especially with the ongoing and upcoming major project investment. More specifically, access to skilled labour continues to be a challenge, with the region experiencing skilled labour competition, particularly from Saudi Arabia, who has been attracting labour via attractive wage packages.

Supply Chain

Equipment lead-in times have increased dramatically over the course of 2022. Suppliers have seen the knock-on effect of material shortages, delays and price hikes throughout the supply chain, which has caused longer lead times and reduced order commitments for new projects and/or orders.

Construction projects can be considered to have three key drivers: time, cost, and quality. In our view, ‘time’ is the most significant of these drivers for construction projects across the Middle East. Consequently, regional projects are likely to be more adversely affected by supply chain disruptions. Whilst these disruptions are starting to ease, they are still well above historical norms and these are pressures which we expect to continue into Q4.[100]

Insurance Insight - By GRS’ Dubai Manager, David Russell

The challenges remain as they were in Q2: increased materials and labour costs, result in potentially inadequate Sums Insured.

Larger loss exposure for Insurers were evident, as longer lead times and delayed raw material deliveries to the site extended remedial works. This will create a longer indemnity period for business interruption losses.

With so many variables and volatility affecting insurers' reserving and reinstatement exposures, a proactive and expert-led approach to claims assessment is vital.

David Russell
BA (Hons), ACILA
Manager - Dubai,
GRS International

A Look Ahead… The next 12 months

Regional material price fluctuations are likely to continue to cause uncertainty. The Ukraine situation, and associated sanctions, may add to this. Inflation is likely to continue to increase in Q4, which is therefore likely to lead to upward pressures on insurance claims values and adequacy of sums insured.

According to the RICS Global Construction Monitor, the sentiment in the region still reflects concern about prolonged logistic delay, competition in the labour market - particularly from Saudi Arabia, and ongoing recessionary fears. However, we believe the Middle East region appears to have a bright outlook with expected growth due to the large-scale investment schemes and high oil prices.[101]

QATAR – Country in Focus

Highlights

1. Inflation has continued to rise into Q3 and is currently reported as 6.03%.
2. Whilst material prices are still high, by historic levels, there is some evidence that prices have started to ease going in to Q3,
3. Reliance on foreign labour throughout the region. Spending on wages and salaries has increased ~12% this year.
4. Supply shortages and rising costs of materials throughout Europe, may force regional contractors to find alternative suppliers.
5. 2022 World Cup will keep business activity strong. However, pipeline of new work may continue to soften into 2023.

Interest Rates and Inflation

According to Emirates NBD, Qatar's GDP grew 4.3% in H1 2022. This was principally due to construction associated with the 2022 FIFA World Cup.[102]

According to the State of Qatar Planning and Statistic Authority, in Q3, inflation rose to 6.03%, from 5.4% in Q2. In response, the Qatar Central Bank (QCB) raised interest rates to 4.5% in September, up from 3.75% in Q2. [103]

Industry / Construction Activity

Qatar Energy is expanding production of the world's largest natural gas field, attracting Italian investment into the USD 28 billion North Field East Project. This is a project which began in response to the uncertainty facing Russian gas supplies since the invasion of Ukraine. [104]

Building and construction is the largest non-oil sector in Qatar, accounting for 13% of GDP. The wholesale and retail trade sector reported double-digit growth in Q2 while manufacturing output grew 6.2% year-on-year. However, financial and insurance services contracted 5.1% year-on-year in Q2 and -3.7% year-on-year in H1.[105]

Smaller sectors such as transport and storage, real estate activities and business services posted strong annual growth, contributing to the 9.7% year-on-year growth in non-oil GDP. Oil and gas GDP was much more modest at 1.2% year-on-year.[106]

A recent RICS Economics Report highlights several factors affecting construction activity. In Doha, factors include:[107]

- Temporary stoppages of construction activities due to the World Cup
- Decline in work following World Cup
- Shortage of skilled labour
- High material costs
- Slow client payments

Materials

While material prices are still high, by historic levels, there is some evidence that prices have started to ease in Q3, in line with other areas of the Middle East. For example, 8mm rebar costs have reduced by ~6% since Q2, after rising between Q1 and Q2.[108]

Labour

According to Fitch Solutions, weaknesses in the domestic labour market are offset by hiring foreign labour for both low and higher-skilled positions.[109] NBD Research report that current spending on wages and salaries has increased 11-12% year-on -year in H1 2022. [110]

Supply Chain

Contractors in Qatar are particularly reliant on suppliers and manufacturers in Europe for mechanical, electrical, and plumbing products. The supply shortage from Europe may require contractors to find alternative suppliers. This is compounded by rising costs being experienced throughout Europe as a result of the European energy crisis.[111] In Q3, Hamad, Ruwais and Doha Ports registered strong growth.[112]

A Look Ahead… The next 12 months

In Q4 the World Cup will keep business activity strong but the pipeline of new work may continue to soften as borrowing costs rise and fewer new projects are launched. Some commentators suggest this may be offset with the restart of projects that may have been deprioritised in the run-up to the World Cup.

AFRICA

Highlights

1. Rising inflation continues to present a significant regional challenge.
2. The region has severely been impacted by Ukraine conflict, especially with wheat imports
3. Material price increases show as a common trend across region affecting industry.

Interest Rates and Inflation

Compass International suggests that rising inflation is affecting food, energy and commodity prices. This remains a significant challenge to the continent, and we consider it likely to hinder construction in Q4 and 2023.[113]

Industry and Construction

In South Africa, the construction sector outlook remains weak, with previous strike action at Transnet, the state-owned transport and logistics company, continuing to disrupt supply chains throughout 2022 and into 2023, according to the SAAFF (South African Association of Freight Forwarders).[114] Africa was a big importer of wheat and barley from Ukraine and Russia and, we speculate, may face challenges in sourcing alternatives in Q4.

Materials

We note a trend of material price rises across Africa. In South Africa, construction materials have increased 8-10% over the last year.[115] In Nigeria, these rises are closer to 20%. Kenya has experienced 40% increases in fuel and steel prices over the last 12 months alone. [116]

In Egypt, we have observed a more mixed picture. For example, the price of steel reinforcement appears to have decreased by 5% from Q2 to Q3, whilst ready-mix concrete, gypsum ceiling board and internal wall paints increased by 15%, 3% and 5% respectively. [117]

Prices of other standard construction materials appear to have remained stable in Q3 and into Q4.

Supply Chain

In Egypt, infrastructure supply bottlenecks continue to add pressure to supply chains. This is due to restrictions in the frequency of freight trains between Alexandria Port, the ‘6th of October Dry Port’ (DP6), and destinations in the Greater Cairo Area (GCA). To address this, Egypt has embarked on an ambitious infrastructure investment programme.[118]

A Look ahead

The Ukraine conflict seems likely to continue to severely impact African economies and their construction sectors. Furthermore, we are likely to see a continuation of construction cost increases across the region, and less CAPEX investment in the near-term future.

AUSTRALIA AND NEW ZEALAND

Highlights

1. Australia has seen record quarterly construction costs increases reaching 11% over the last 12 months.
2. Residential sector has suffered sharp decline in activity across the region.
3. Common trend of skilled labour shortages and wage growth affecting the construction industry.
4. Imported goods have affected prices due to 40% increase in shipping costs over the last 12 months.

Interest Rates and Inflation

High inflation, skills shortages and rising costs of construction are impacting construction activity.

Inflation rose 1.8% and 2.2% for Australia and New Zealand, respectively, from Q2 to Q3. Annual inflation is now 7.3% and 7.2% for Australia and New Zealand.[119] Consequently, the Reserve Banks of Australia and New Zealand have raised interest rates by 0.5% to 2.35% and 3.5% respectively. This was the eighth successive rate increase in 12 months for New Zealand.[120]

Industry / Construction Output

According to the recent Australia and New Zealand (ANZ) Business Confidence Outlook Survey (ANZBO), overall confidence is improving. However, there has been a sharp fall in activity indicators for the residential construction sector.[121]

Australia

Construction Output rose 0.2% from Q2 to Q3 with a 4.2% change year-on-year. However, rising interest rates and economic uncertainty, are challenging consumer facing construction sectors.[122]

The Australian Industry Group and HIA Australian Performance of Construction Index (Australian PCI®) fell by 46.5 points in September, declining for the fourth consecutive month.[123] This shows a contraction in activity across the construction sector.

From Q2 to Q3 construction volumes declined across residential, non-residential and commercial construction as shown in *Figure 23*.[124]

According to builder Webuild, infrastructure construction contracts signed before the pandemic have become widely unworkable because of increasing labour and materials costs, supply-chain blockages and difficulties in securing labour. The firm is struggling with a 2019 agreement with the Australian government to build the country's largest hydroelectric power station for AUD 5.1 billion.[125]

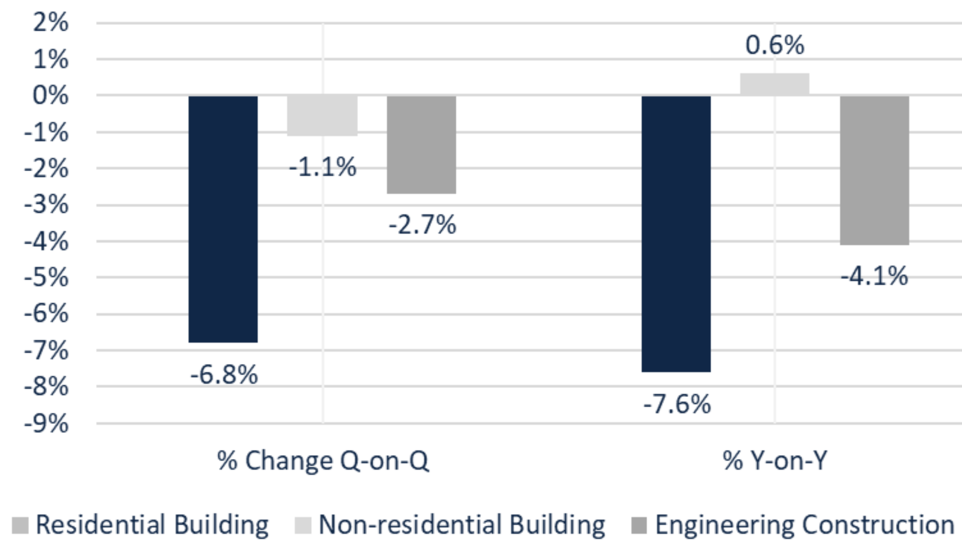


Figure 23. Construction volumes across residential, non-residential and commercial Q-on-Q and Y-on-Y.

New Zealand

New Zealand's infrastructure construction activity also remained high. However, higher fuel and commodity prices, and financial market volatility, have affected construction costs by limiting material availability and increasing costs.[126]

Materials

Australia

According to the Cordell Construction Cost Index (CCCI), residential construction costs increased at a record rate since 2001.[127]

The Q3 figure rose 4.7% from Q2 and 11% over the 12 months to September, surpassing the record 10% annual rise recorded over the 12 months to the end of Q2. In Q3, construction costs experienced record increases.[128] As shown in Figure 24, construction costs have increased across the region; almost all have show record quarterly rises.[129]

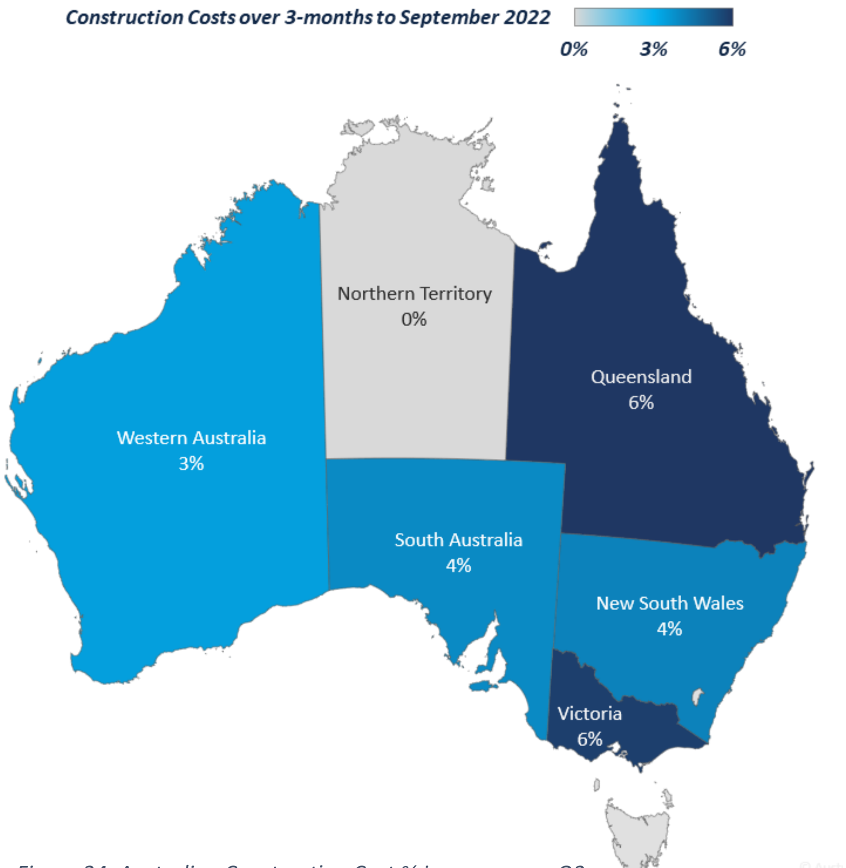


Figure 24: Australian Construction Cost % increase over Q3.

Labour

Australia

In Q2 labour shortages and more expensive overheads continued to affect the residential construction industry. The Australian Bureau of Statistics report that more businesses were able to find staff in Q3, suggesting that labour shortages might continue to ease into Q4. [130]

New Zealand:

According to the RICS Global, Construction Monitor report for Q3 cost escalation and labour resources are the two biggest issues facing the industry.[131] *Figure 25* shows wage growth continuing to increase over the course of 2022.[132]

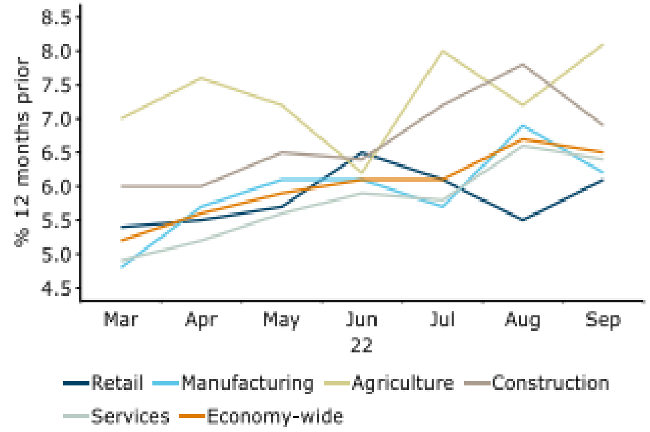


Figure 25. RICS Construction Moni-

A recent ANZ Banking Group (ANZ) survey[133] suggests the biggest factors affecting construction in Q3 were (*Figure 26*):

- Availability of skilled labour
- Regulatory and administrative difficulties
- High rates of pay

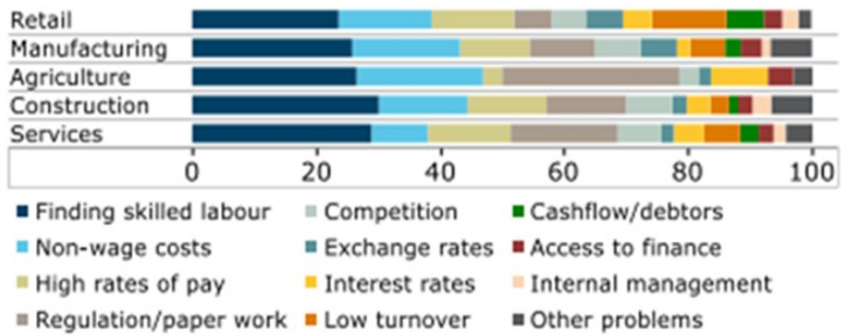


Figure 26: ANZ's Macro Bond Factors Affecting Industry

Supply Chain

China's continued COVID-19 measures may disrupt supply chains over the coming months. Data from the S&P Global Composite PM shows contractors experiencing material shortages, and significantly increased delivery times. Overseas Ocean freight costs have increased by more than 40% in 2022, which will affect imported materials into both Australia and New Zealand. [134]

Impact of Inflation on Insurers

For Insurers, inflation, high construction costs, material shortages and longer lead times makes assessing the Values at Risk and potential loss exposures particularly challenging. Assessments conducted last quarter, may no longer be true or accurate.

With the ongoing issues with material cost increases, supply chain disruption and increasing major weather events Insurers are exposed to this volatility.

A Look Ahead... The next 12 months

High inflation is likely to continue to affect the region. Furthermore, it is likely that we will still see ongoing shortages of both materials and skilled labour.

Near term future construction activity looks positive, driven by a backlog of construction work approved during the COVID-19 pandemic, as well as mounting rebuild and repair work following past and forecasted major weather events.

ASIA

Highlights

1. China's construction activity slows below other areas in the region for the first time in 25 years.
2. Japan's construction activity growth continues.
3. Rising costs of materials still proving to be the biggest factor affecting the industry in the region.

Industry / Construction Output

Figure 27 below summarises the RICS Construction Activity Index data. We can see that construction activity has increased in India, Singapore and the Philippines. However, this is contrasted by declines in construction activity in China and Sri Lanka.[135]

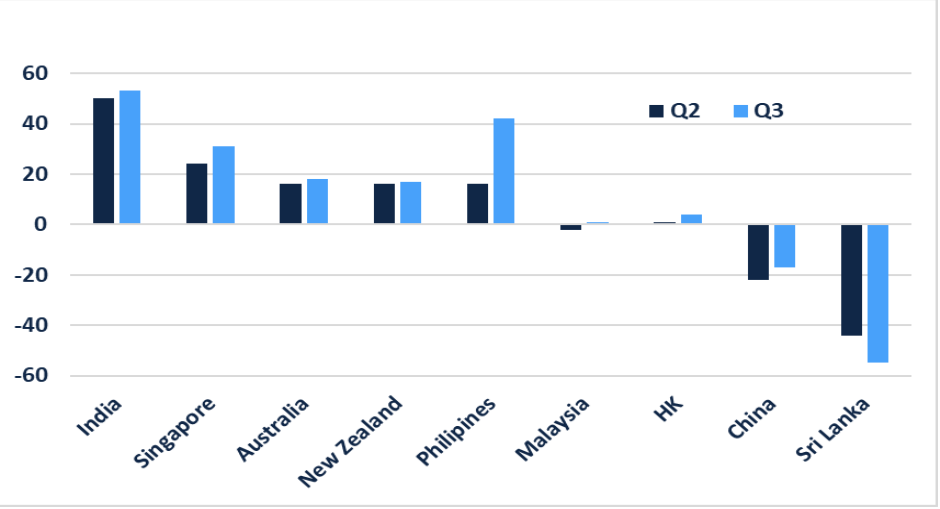


Figure 27. RICS Construction Activity APAC Q2 - Q3 2022

According to the National Bureau of Statistics China, China's GDP growth rate for Q4 is forecast at 3.3% - 3.6%. This is down considerably from 12 months ago. The significance of this statistic is that China's economy is now growing at a slower rate than many of its Asian neighbours, for the first time in over 25 years.[136]

ASIA

China's zero-COVID lockdown course of action is one of the main reasons for this slowdown (many factories have been partially or fully closed for 6 months or more).[137]

The construction industry in Japan continues to experience slow or minimal growth for the sixth consecutive year, across civil/infrastructure, home building, commercial, institutional and industrial sectors.

Materials

India

According to the Q3 Gleeds India Market Report, material costs have increased by 3-4% over the last two quarters. This is primarily due to cement and steel price increases. This has a significant influence on project costs, particularly for high-rise building projects, where concrete, shuttering and reinforcement can form a significant element of the total construction costs. [138]

Copper prices in India remain heavily influenced by international prices. Prices have trended downwards since the second quarter of 2022, dropping 16% between Q2 and Q3.[139]

China

According to the RICS Global Construction Monitor, the main factors holding back activity across the region are the Cost of Materials, Financial Constraints and Competition. However, in China, there are also concerns about insufficient demand.[140]

Singapore

According to the Q3 2022 Linesight Commodity Report – Singapore, material costs across Q3 eased. The exceptions to this trend were steel flat and lumber, which this quarter increased by 3.3% and 5.4% respectively.[141]

Japan

According to the Q3 2022 Linesight Commodity Report – Japan, material prices continued to increase. This included a 17.5% increase in Asphalt this quarter. However, copper prices were reported to be down 13%, over the same period.[142]

South Korea:

According to the Q3 2022 Linesight Commodity Report – South Korea, copper, steel rebar and welded mesh prices dropped this quarter by 12.3%, 3.5% and 3.5% respectively. However, lumber was up 4% from Q2 to Q3.[143]

Labour

According to the RICS Global Construction Monitor Q3 2022 – APAC, skilled labour shortages remain a key factor in the region.[144]

China is experiencing challenges as a consequence of more than 40 cities and/or regions under some form of partial or complete COVID-19 lockdown. Consequently, construction activity in these regions has slowed down considerably, as the protocols are restricting many construction workers from working.

Supply Chain

We understand that instrumentation devices and process control equipment remain in short supply. As a result, prices for these items have continued to increase.

We also note that the cost of construction related bulk materials, including copper cable/pipe, structural steel, rebar, piping, lumber, plywood, etc., has continued to rise. This will have a knock-on effect to future construction costs throughout the region.

A Look Ahead… 12 Months

Asia inflationary pressures and material shortages have led to a slowdown across the construction markets. In addition, labour shortages and supply chain disruption has led to issues across infrastructure and real estate sectors. These factors are likely to continue in the short to medium term.

However, we speculate that longer term, 'Emerging Asia', which includes the economies of China, India, Indonesia, Thailand the Philippines and Vietnam, will continue to be one of the fastest-growing regions globally for construction.

SUMMARY

The global outlook for Q4 and further into 2023 is likely to remain volatile, driven by several factors.

Existing issues, including the Ukraine Conflict and the European Energy Crisis will continue to pose significant challenges.

Global inflationary pressures are not declining; in many nations core inflation rose in Q3. According to Euromonitor's Global Inflation tracker report for Q3, 2022, the baseline scenario for global inflation is forecast to reach 8.7% in 2022 and then fall to 5.3% in 2023.[145] In response to inflation, central banks are raising interest rates, with the consequence of recessionary concerns for Q4 and into 2023.

Reduced volatility in commodities prices and lower fuel costs are the main factors that will help to cap the inflation surge. However, inflation currently remains at a high and will continue to erode consumer purchasing power. Supply chain disruptions and potential energy price shocks also stay among the key risks and could accelerate price growth in Q4 2022, with potential energy price shocks the main risk to price stability.

Energy supply measures from Russia and lagging global production output of oil and gas remain among the key risks for an inflation surge in 2022-2023. Energy-intensive industries, such as road transport, plastic products, chemical products and the electricity sector, would be the most affected by any increase in energy prices.

In addition, the ongoing impact of climate change is likely to be a significant factor, particularly to insurers with the volatility increasing. Pressures to 'build back better' may also drive increasing insurers' reinstatement costs.

Q4 and into 2023 look set to show a continued trend of volatility, with recession and prolonged economic weakness resulting from the energy crisis affecting overall demand for insurance and drive up claims costs.

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