

# [Impact of brexit on the construction industry](https://assignbuster.com/impact-of-brexit-on-the-construction-industry/)

Task

Critically analyse the potential effects of the United Kingdom leaving the EU on a specific sector of the construction industry.

Choosing just one sector of the construction industry, critically analyse the potential impacts on that sector of the UK’s exit from the EU. Use economic theories and current economic data to explain and illustrate your arguments.

Maximum 1000 words, excluding references.

Presentation of Preliminaries

Marking scheme

|  |  |
| --- | --- |
| Introduction | 10% |
| Outline and presentation of the data | 15% |
| Analysis of the data | 30% |
| Synergising of data with relevant economic theory | 30% |
| Supported conclusions | 10% |
| Presentation, referencing | 5% |

Construction Economics Summative Assignment 1

By Aivaras Symanas

Introduction

United Kingdom (UK) decision to withdrawn the membership of the European Union (EU) will shape the future of the country’s relationship with its largest trade partner – the EU. This assignment will examine various positives and negatives effects that Brexit might have on residential construction sector in relation to economic theories, it will also review latest data, statistics and key arguments from various construction bodies and journals as well as other sources.

Uncertainty

Uncertainty resulting from Britain’s vote to leave EU will potentially have an impact on house price growth and housing transactions with implications for existing and aspiring homeowners. It will take some time for the extent of those impacts to become clear and much depends on how economic uncertainty affect sentiment, particularly in the short term. Within days of the referendum, the share prices of housebuilders and leading estate agencies reportedly fell down. London estate agent Foxtons issued a profits warning and some high-profile developments were put into question. (Garrett, 2016).

In a world of uncertainty, prospect theory aims to explain how people make choices between different options or prospects, it focuses to describe, explain, and predict the choices that the typical person make. Prospect theory tells us that as long as prospects are in the positive domain, the certainty effect leads to a risk-averse preference for a sure gain, rather than one which may be larger but be merely probable. However, once prospects are in the negative domain, people exhibit risk-loving preferences for larger losses which are probable, rather than smaller certain ones. (Kahneman & Tversky, 1979)

In a Brexit scenario it is not surprising that consumer confidence was knocked by the continued uncertainty, especially with regard to trade. As a result, activity on the market fell drastically quickly just within a days after referendum. According to Morgan Stanley Capital International (MSCI) index, UK real estate investment trust shares fell by an average of 23 per cent, but have since regained half of that loss. (Evans, 2016). On the other hand, there are investors who will be likely to take these risks in order to gain more profit. ‘ Financial Times’ reports that more than 80 investment deals have been agreed on central London buildings since the referendum, and 80 per cent of transactions were made by the buyers from overseas. (Evans, 2016).

Housing Shortage

National Statistics suggest that the number of households in England will rise to at least to 28 million by 2039 – an increase of between 210’000 new households each year (Hawkins, 2014). Brexit could have both positive and negative effects on housing shortage in UK depending on changes in laws, exports and imports deals, immigration levels and most importantly on the activity in the market. Construction industry is a complicated process due to longevity, cost, and investment nature of the products and it has been a great challenge for the industry to provide the supply which is needed.

Adam’s Smith classical theory of economics involves minimizing the role of government intervention and taxation in the free markets, and brings the idea that an ‘ invisible hand’ guides supply and demand (Wolf & Resnick, 2012). Adam’s supply and demand principle explains the tendency of free markets to regulate themselves by means of competition and self-interest.   
The UK construction sector has a robust reputation for construction services such as architecture and development of advanced technologies used in construction such as Building Information Modelling (BIM) which enables businesses to make more intelligent use of data and hence minimise waste from construction processes. (BIS, 2013) This is just one of the examples how demand and supply chain can achieve equilibrium based merely on means of competition and self-interest.

Labour

In 2013, Department for Business, Innovation & Skills published ‘ Construction 2025’ which revealed government strategy and goals for the upcoming years in the industry. Government are expecting to lower construction costs, increase delivery speed, improve in exports and sustainability in construction, in order achieve these objectives industry will require major labour force. The construction industry is already struggling with a labour and skills shortage caused mainly by lasting effect from recession and ageing workforce. (HM Government, 2013)

According to Royal Institute of British Architects (RIBA), as a result of the skills shortage 66% of firms reported having turned down work due to a lack of staff. As a sector which relies greatly on foreign skilled and non-skilled workers, it is unsurprising that one of the main concerns within the construction industry is the potential shutdown of the free movement of persons following Brexit. (RICS, 2016)

John Maynard Keynes suggested that the state as the institution in modern society should have the power and obligation to manage economical cycles. (Wolf & Resnick, 2012). Keynesian economists would propose deficit spending on labor-intensive infrastructure projects to encourage employment and stabilize wages during economic downturns. They would raise taxes to detain the economy and prevent inflation when there is abundant demand-side growth. Monetary policy could also be used to stimulate the economy-for example, by reducing interest rates to encourage investment. (Jahan, et al., 2014)

Interest Rates

According to RICS Residential Market Survey in May, new buyer enquiries have declined significantly across the UK in June, with 36% more chartered surveyors nationally reporting a fall in interest – this is the lowest reading since mid-2008. (Rubinsohn, 2016). The Bank of England has already taken steps to facilitate the market and lowered mortgage base- interest rates at a record low of 0. 25 % hoping that it may stabilise activity in the market. (Allen & Elliott, 2016)

Austrian economist, Friedrich August Hayek would argue with Keynes that lowering the interest rates would only help in the short- term, while in a long run the artificial lowering of interest rates would mislead investors (buyers) and they are led to engage in ventures that would not otherwise have appeared profitable, even more, further efforts to stimulate the economy would only make things worse – especially if they meant more borrowing by government.

As an example, lower base- interest on mortgage would most definitely mean lower housing prices and lower borrowing for business which increases activity in the market, although in a long term, it eventually creates the economical bust, which was witnessed in USA in 2008, which followed by the credit crunch.

Conclusion

We could conclude that residential sector in the UK had already seen the impact of the Brexit, most noticeably in numbers of new buyers in the market, although with a help of the government, the sector have restored it confidence by at least some margin. With so little known about the agreement that the UK will eventually negotiate with the EU, it is too early to tell exactly what impact Brexit will have on the industry in the long term.

## References

Allen, K. & Elliott, L., 2016. The Guardian. [Online]   
Available at: https://www. theguardian. com/business/2016/aug/04/bank-of-england-cuts-uk-interest-rates   
[Accessed 02 11 2016].

BIS, 2013. An economic analysis of the sector, London: Department for Bussiness Innovation & Skils .

BPF, 216. British Property Federation. [Online]   
Available at: http://www. bpf. org. uk/sites/default/files/resources/Investing%20in%20residential%20property%20%E2%80%93%20a%20BPF%20guide%20for%20asset%20allocators. pdf   
[Accessed 02 11 2016].

Cook, L., 2016. Savills. [Online]   
Available at: http://www. savills. co. uk/research\_articles/205507/205389-0   
[Accessed 26 10 2016].

Emmett, S., 2016. Savills. [Online]   
Available at: http://www. savills. co. uk/research\_articles/205507/205965-0   
[Accessed 26 10 2016].

Evans, J., 2016. Financial Times. [Online]   
Available at: https://www. ft. com/content/a400b0b0-7b2d-11e6-b837-eb4b4333ee43   
[Accessed 10 11 2016].

Garrett, A., 2016. Money Observer. [Online]   
Available at: . http://www. moneyobserver. com/our-analysis/what-are-prospects-uk-residential-property-market-after-brexit   
[Accessed 15 11 2016].

Giles, C., 2016. Financial Times. [Online]   
Available at: https://www. ft. com/content/c15cd060-0550-11e6-96e5-f85cb08b0730   
[Accessed 05 11 2016].

Hawkins, A., 2014. 2014 Based Household Projections; England 2014-2039, London: Housing Statistical Release.

HM Government, 2013. Industrial Strategy: government and industry in partnership Construction 2025, London: HM Government.

Jahan, S., Mahmud, A. & Papageorgiou, C., 2014. What Is Keynesian Economics?. FINANCE & DEVELOPMENT, 51(3), pp. 1-2.

Kahneman, D. & Tversky, A., 1979. Prospect Theory: An Analysis of Decision under Risk. Econometrica, 47(2), pp. 263-292.

RICS, 2016. RICS. [Online]   
Available at: http://www. rics. org/uk/knowledge/market-analysis/rics-uk-construction-market-survey/   
[Accessed 25 10 2016].

Rubinsohn, S., 2016. RICS. [Online]   
Available at: http://www. rics. org/uk/news/news-insight/press-releases/brexit-uncertainty-hits-activity/   
[Accessed 30 10 2016].

Wolf, R. & Resnick, S., 2012. Contending Economic Theories: Neoclassical, Keynesian and Marxian. London: Massachusetts Institute of Technology.