

2022

CONSTRUCTION
SUPPLY CHAIN
Q3 UPDATE



Funded by
Building Research Levy

THE CURRENT SITUATION:

Supply issues impacting the market look to be stabilising.

A year on from our first construction supply chain report it's clear that while circumstances are improving slowly supply-wise, we are still facing continued cost increases. As an example, structural products now have a lead time of eight weeks, down from eleven weeks in January. We still have the same constraints, however, they have been mitigated through an increase in domestic warehousing, more efficient port operations and domestic freight efficiencies.

Over the last year, sell prices of building products have increased by an average of between 28% – 33% (category dependant) with structural products showing the largest increases. This latest update shows that there are more cost increases to come. These increases have made it tough going for the industry, and suppliers are certainly feeling the pinch. The full cost increases experienced by suppliers haven't been passed through to the market, and suppliers are running on low margins at a time when they're holding far more stock in order to meet market demand.

In July last year we asked suppliers how we should be responding to supply chain issues as an industry. The number one answer was more planning ahead on the part of architects and builders. We know that planning has become more embedded in how industry works, but there is still room to improve given that we're still seeing delays onsite due to lack of stock or the need to substitute products.

From here, we know that demand is likely to slow in reaction to inflationary pressures, but we will continue to see price increases and the need for thorough forward planning on projects.

THE SURVEY

The data for this Q3 update was gathered in July 2022, with responses from managers of 154 leading product suppliers across all main product categories.

CATEGORY:

Structure n=27

Enclosure n=49

Interior n=42

Finish n=30

External & Other n=54

REVENUE:

Under \$10m n=27

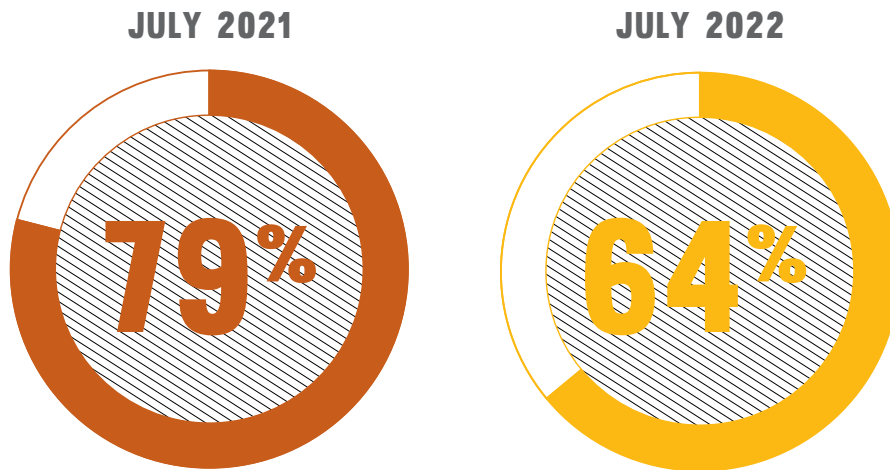
\$10m - \$49.9m n=48

\$50m + n=17

Not provided n=62

THE CURRENT SUPPLY SITUATION

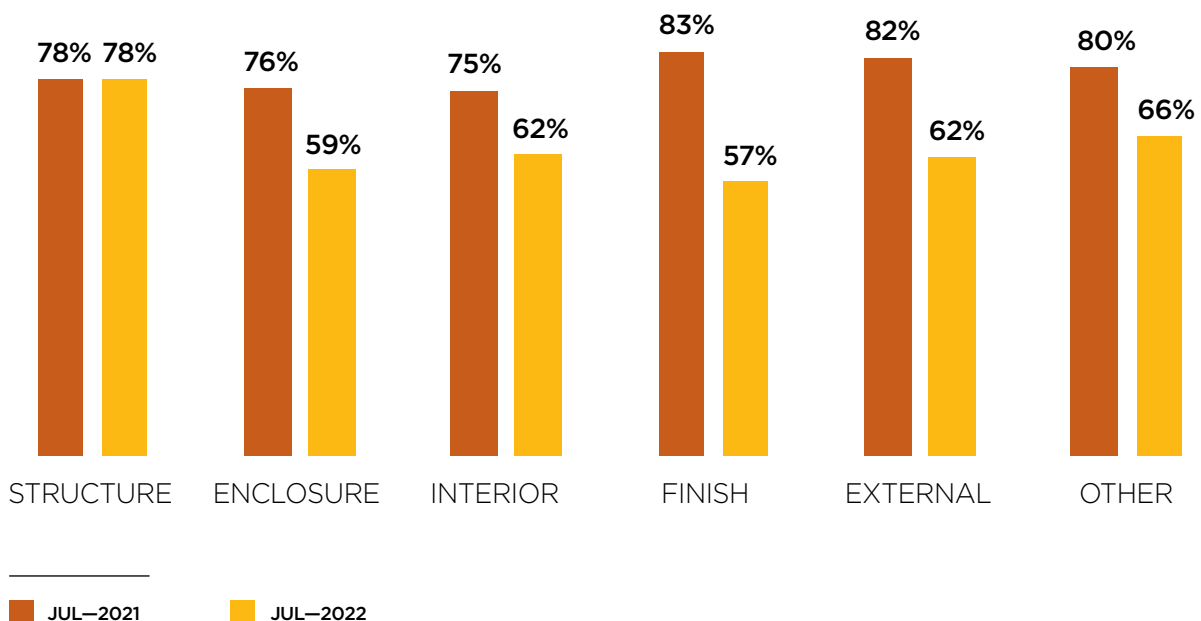
SUPPLIERS EXPERIENCING DISRUPTIONS TO SUPPLY CHAIN REDUCED NEARLY 20% IN THE LAST YEAR



In July 2022, one year on from our first report, we are starting to see some improvement in the ability to supply the market. Where four in five product suppliers were finding it difficult to supply the market in July 2021, this has dropped to 64% in July 2022.

However, those who supply products in the Structure category are still feeling the pain of supply chain issues, with no change 12 months on.

Supply issues for products in the Finish category have eased the most over the last year, though even in that category more than half still find it difficult to supply the market.

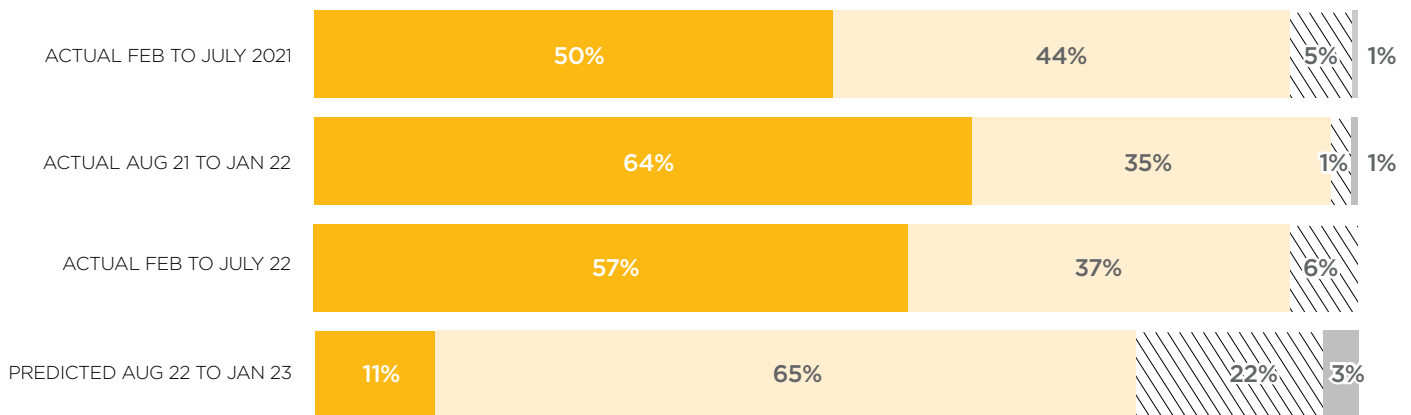


PERSISTING PRICE PRESSURE IN THE LAST SIX MONTHS

GLOBAL ISSUES LEAD COST OF MATERIALS INCREASE

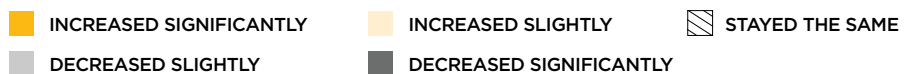
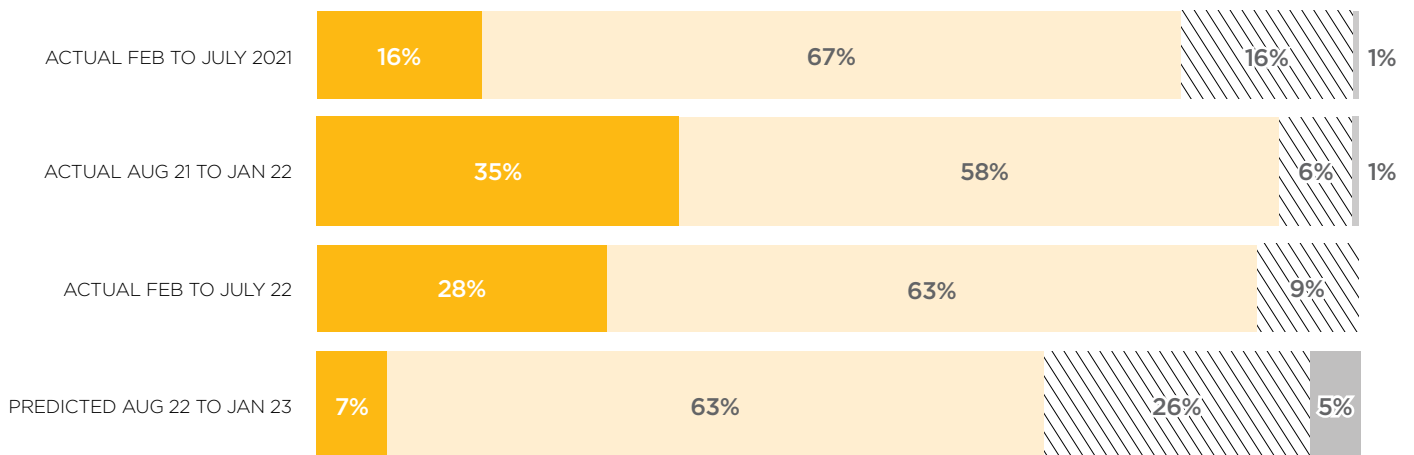
Price pressure remains, with 94% saying the cost they buy at has increased over the last 12 months, and 76% expecting buy-in costs to further increase in the next six months.

COST YOU BUY IN AT



It appears that suppliers have not been able to pass on the full extent of the cost increases from their suppliers.

PRICE YOU SELL TO MARKET AT

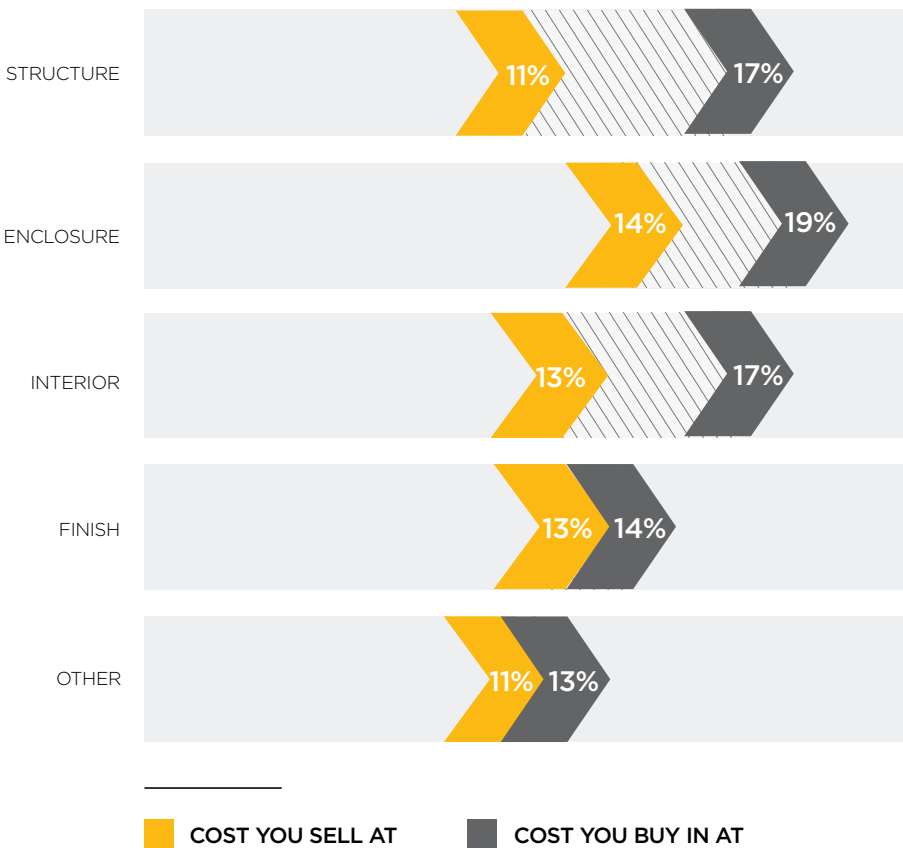


“Having just returned from a European trade show and visiting suppliers, the outlook is not good. Already there have been two price increases this year of 5.5 & 7.5% whereas the norm is one at 2.5%. Raw material and energy is a big issue in Europe.”

“We are ordering above sales volumes to allow for longer lead times, effectively increasing our stock in transit be it that transit times have almost doubled. We are also having to lift prices constantly to meet the ever-increasing costs of global shipping.”

COST AND PRICE INCREASES STRETCH

ACTUAL JAN TO JUL 22



Although a 12% increase in sell price to customers is less than the 19% increase seen in the previous 6 months (August 21 – January 22), there is a cumulative impact of multiple increases and the margin-on-margin increases from merchants/resellers. Material buy-in costs from international suppliers increased 16% over the last six months, again down from 19% over the previous quarter, from international suppliers.

For Structure, Enclosure and Interior products the gap between increases to costs and increases to selling price has started to open again as global price increases hit against a local economy that is starting to slow or delay projects due to cost increases.

“We are trying to hold pricing but it has gotten difficult so we’ve had small increases to keep us competitive in the market. We cannot increase at the same rate as import costs so we have reduced the GP margin.”

OVER THE LAST SIX MONTHS

16%

IS THE AVERAGE INCREASE TO THE COST OF MATERIALS TO SUPPLIERS (SUPPLIER BUY-IN COST)

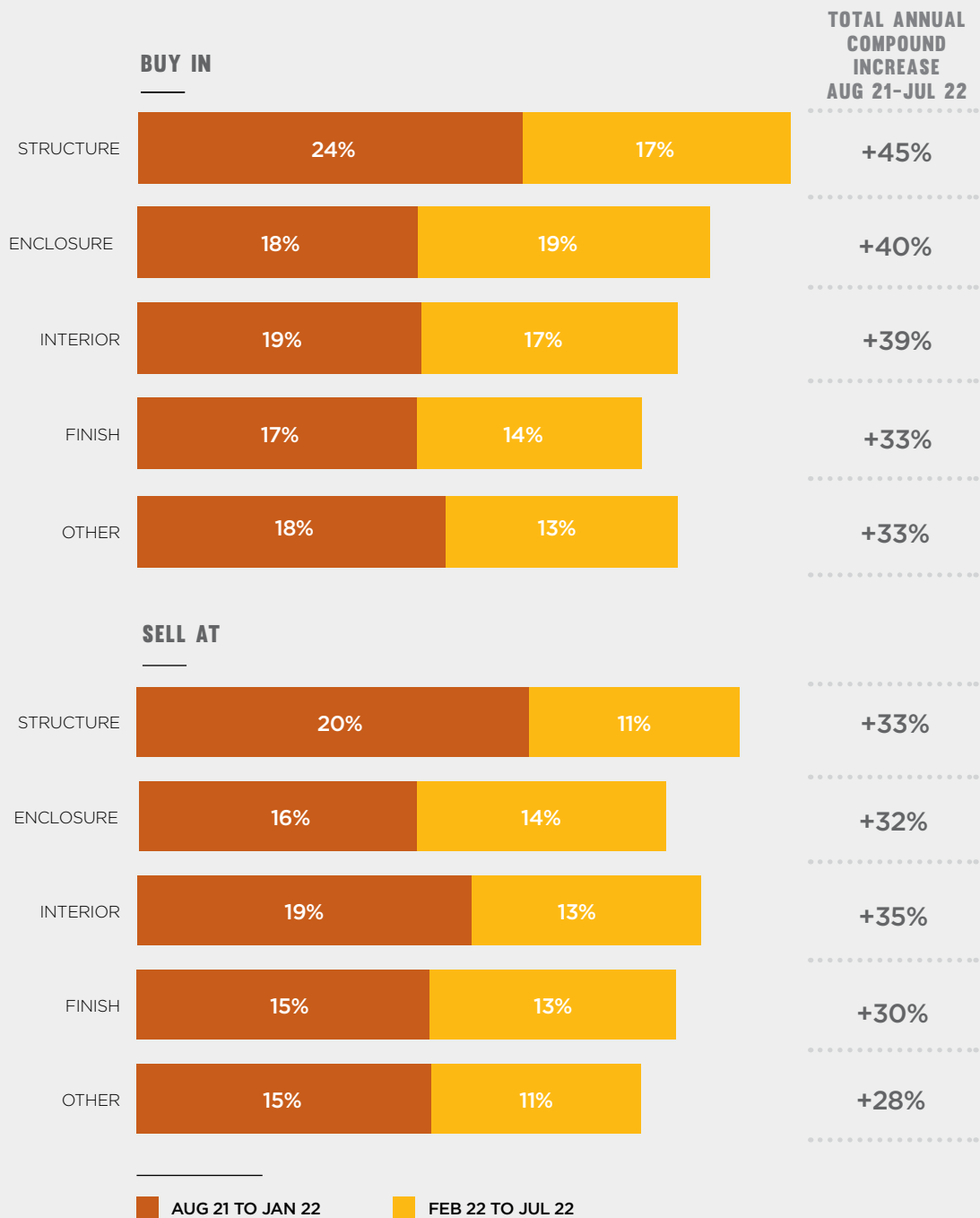
12%

IS THE AVERAGE INCREASE TO CUSTOMERS (SUPPLIER SELL PRICE)

THE LAST YEAR — PRODUCTS AVERAGED A 32% INCREASE IN SELL PRICE

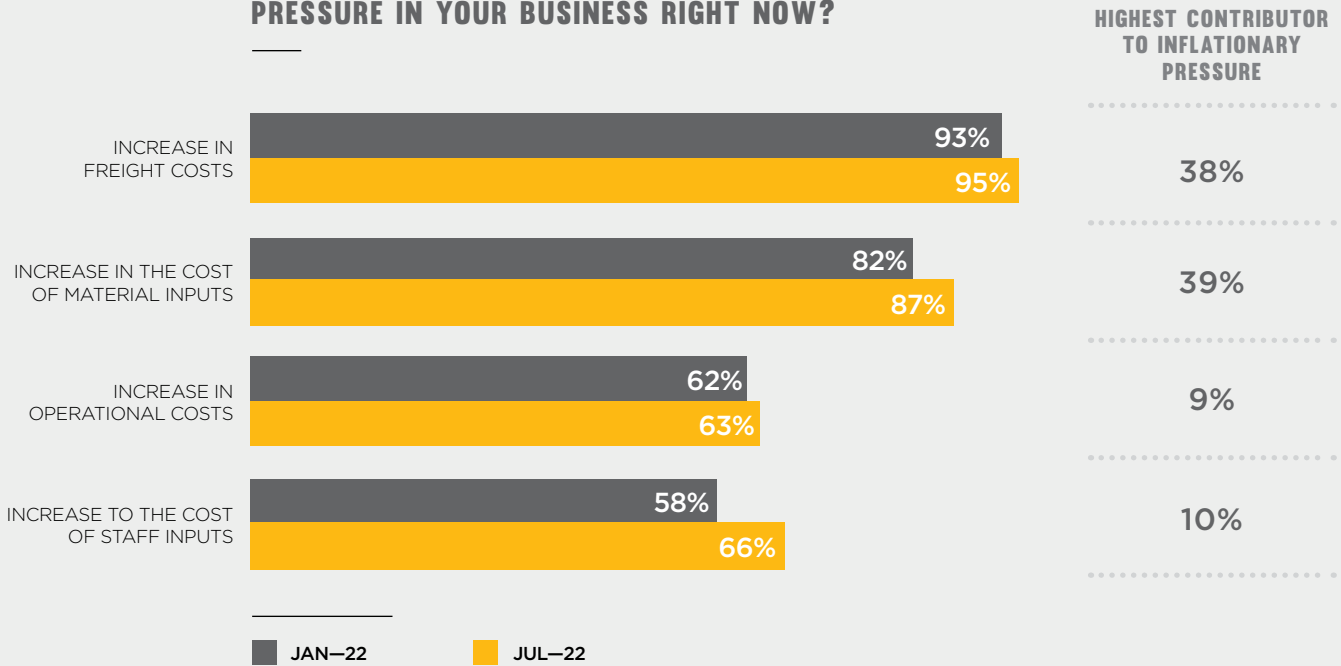
SUPPLIER MARGINS CONTINUE TO SHRINK

Over the last 12 months, on average the buy-in cost of structural materials has increased the most at 45%, and yet only two thirds of this has been passed on to customers. Suppliers who supply products in the Interior and Finish categories are doing better at passing through cost increases, though still not all have been passed on.



CUMULATIVE IMPACT OF INFLATIONARY PRESSURES

WHICH OF THE FOLLOWING ARE CREATING INFLATIONARY PRESSURE IN YOUR BUSINESS RIGHT NOW?



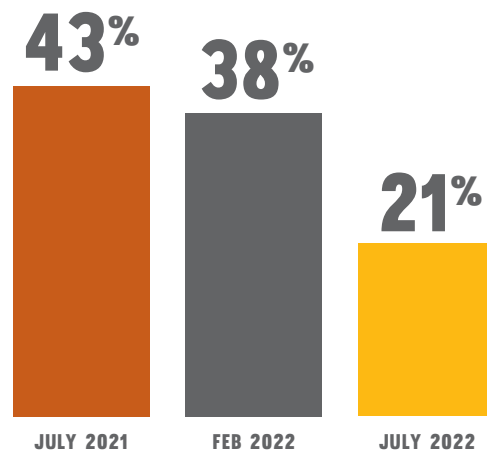
Staffing costs have had the largest annual increase, however, the combination of delays, cost of freight, and unplanned congestion charges still represents a significant impact. With sea freight capacity not forecast to dramatically increase until Q2 2023, we should expect freight costs to continue at current rates for the rest of the year.

DOMESTIC DEMAND — SUPPLY IS QUICKLY CATCHING UP WITH REDUCING LOCAL DEMAND

In June 2021, suppliers were overwhelmed with the level of domestic demand, with two in five saying it was impacting their ability to supply the industry. This continued at much the same rate at the beginning of 2022. However, in the last six months, this has halved, with only one in five saying domestic demand is impacting their ability to supply.

“Demand has dropped off a cliff and supply from overseas has swamped the market.”

% SAYING INCREASED DOMESTIC DEMAND IS IMPACTING THEIR BUSINESS AND ABILITY TO SUPPLY RIGHT NOW



ISSUES IMPACTING SUPPLIER BUSINESSES

There is a confluence of factors impacting supplier businesses including delays in prior supply, deferment of projects, and the increased working capital to grow capacity and hold additional stock, alongside being unable to pass through full cost increases.

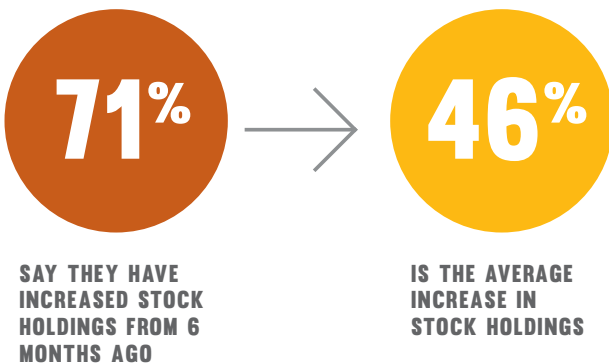
“With all the construction site delays we are close to being unable to import future stock requirements.”

An emerging issue in this survey is the flow-on impact of supply material delays occurring earlier in the build project. Delays in structure, enclosure, or even lining products mean projects are slowed or delayed, impacting the viability of suppliers later in the build programme.

“Shortages of plasterboard are creating a halt in projects therefore a delay for the need of our products.”

THE INCREASE IN STOCK HOLDINGS PLACES OUR SUPPLIERS IN A PRECARIOUS POSITION

CHANGES TO STOCK HOLDINGS



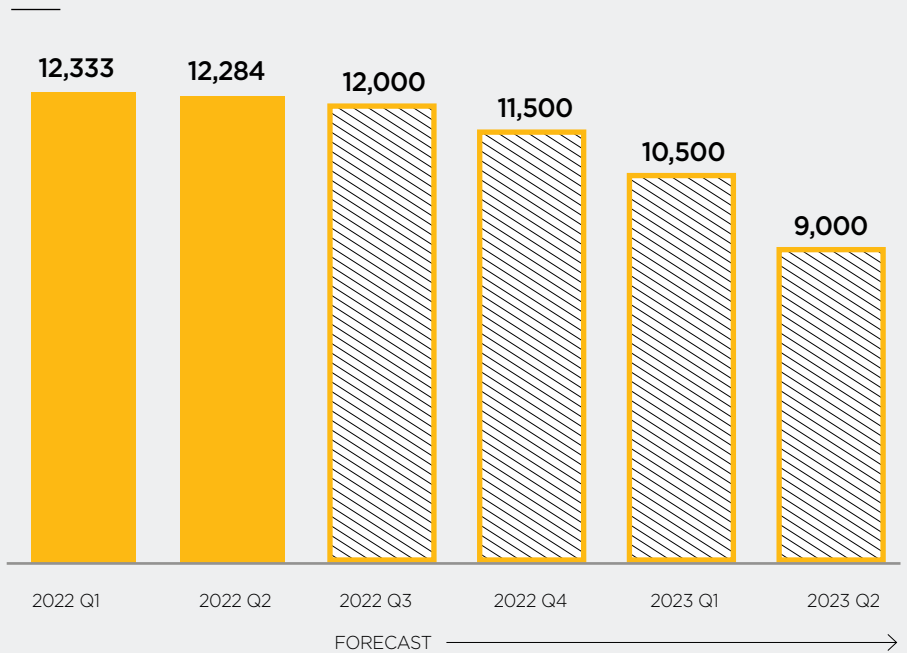
“High costs of securing material with extended lead times have required us to hold high stock levels and increase loans. This has put everything at a highly risky situation should customer demand reduce due to financial constraints.”

LOCAL DEMAND FOR PRODUCTS FORECAST TO DECREASE BY 26%

Alongside supply lead times improving, a decrease in demand will also reduce the issues flowing on from recent delivery delays.

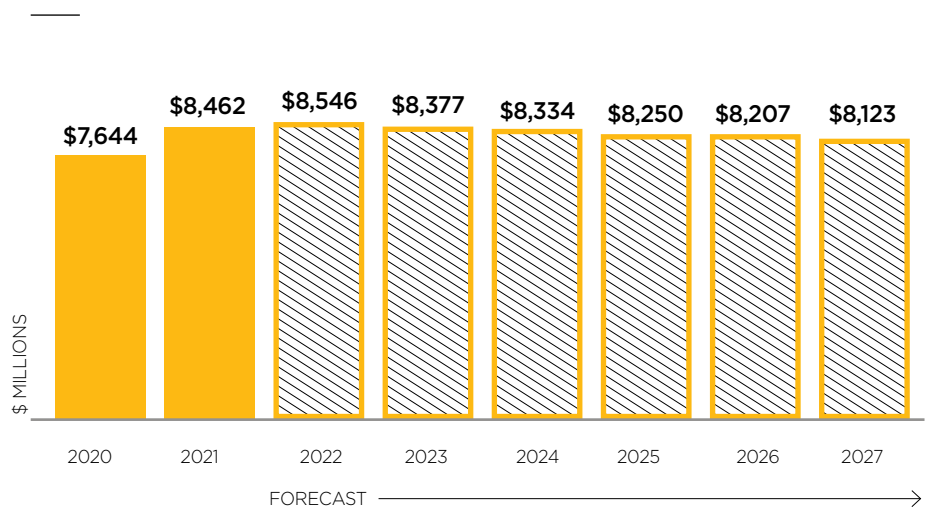
A recent BRANZ forecast shows residential consents for new builds falling over the next few quarters from recent record levels. Q3 in 2023 is forecast to be 26.7% lower than the same quarter this year.

BRANZ QUARTERLY RESIDENTIAL DWELLING CONSENTS FORECAST



BRANZ forecasts commercial consents to stay at record levels for the next two years with a slight increase in 2023 from 2022 which should provide a degree of insulation from the fall in residential construction.

BRANZ COMMERCIAL CONSENTS FORECAST*



*forecast value of consents in constant December 2021 dollars

GLOBAL DEMAND IS STABILISING QUICKLY

While there is a shift in domestic demand, global construction is still forecast to grow. Inflationary pressures and the tightening of monetary policies are contributing to a slower overall growth outlook, however, globally the construction industry continues to build strong workloads across many of the larger markets. Construction is expected to achieve 3.7% growth in 2022 according to the Construction Intelligence Center.

The Q2 2022 RICS Global Construction Monitor (GCM) results suggest momentum is softening in many parts of the world as a more challenging macro environment is starting to take its toll on activity.

When disaggregated at the regional level, the most pronounced moderation came in Europe and APAC. The latest readings across both regions are now indicative of growth largely stalling during Q2 2022.

Several European markets saw a noticeable easing in momentum, with previously positive feedback across nations such as France and Germany turning flat over the Q2 period.

CONSTRUCTION OUTLOOK* (NEXT 12 MONTHS BY COUNTRY)**

STRONG OUTLOOK

SAUDI ARABIA

INDIA

USA

UK

ITALY

LOW GROWTH

AUSTRALIA

NEW ZEALAND

FLAT

GERMANY

SPAIN

FRANCE

NEGATIVE OUTLOOK

CHINA

MALAYSIA

*Includes residential, commercial and infrastructure construction

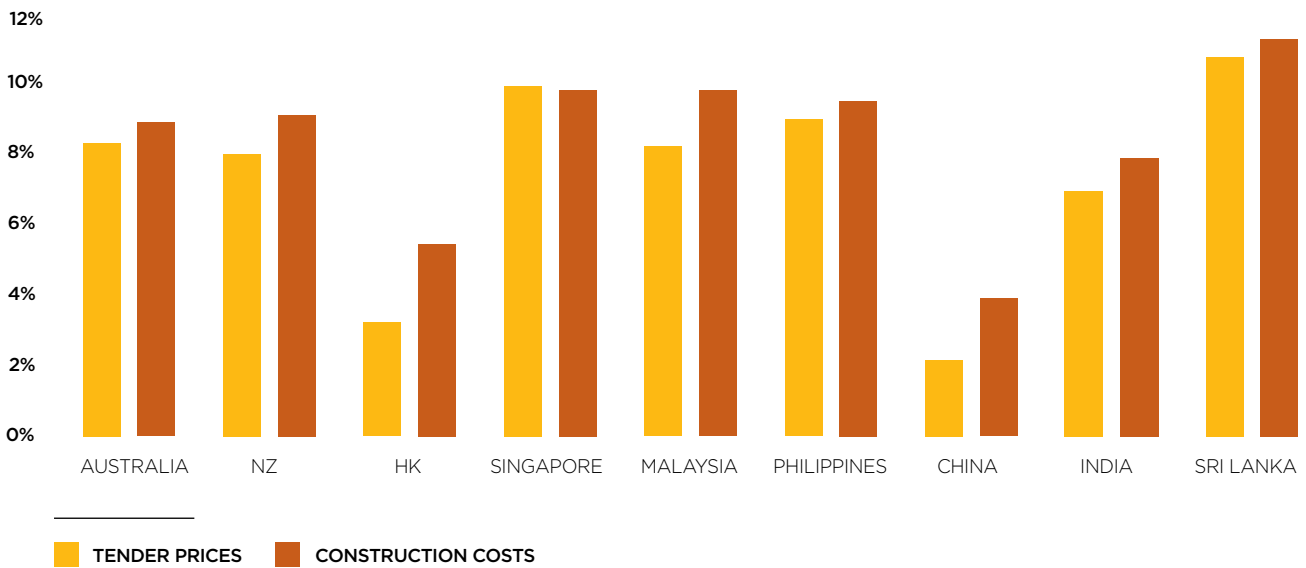
**SOURCE: RICS Economics Q2 2022 Global Construction Monitor

<https://www.rics.org/globalassets/rics-website/media/knowledge/research/market-surveys/construction-monitor/q2-2022-global-construction-monitor---headline-report.pdf>

The rising cost of materials is cited across all regions as a major obstacle to construction activity. Looking ahead, projections for material cost inflation remain elevated globally, forecasting a further increase of 8% over the next twelve months.

Across Asia Pacific rising cost pressures persist, reflecting ongoing challenges around the availability of building materials and labour shortages. Australia, Malaysia and the Philippines all are forecast to experience similar material cost increases to New Zealand.

12 MONTH TENDER PRICE AND CONSTRUCTION COSTS EXPECTATIONS



**SOURCE: RICS Economics Q2 2022 Global Construction Monitor
<https://www.rics.org/globalassets/rics-website/media/knowledge/research/market-surveys/construction-monitor/q2-2022-global-construction-monitor---headline-report.pdf>

THE EXCHANGE RATE IS PLAYING A BIG PART

One of the growing contributors to the cost of materials, referenced in supplier feedback, is the impact of the NZD/USD exchange rate. Below, XE Director of Sales Doug Warren provides a high level forecast for the next six months:

In the first half of 2022, the state of the New Zealand economy has largely been influenced by two factors. Firstly, on our shores, economists have been watching the housing market closely to see how it will be effected as interest rates are raised to combat our high level of inflation. In late 2021 we saw a significant rise in mortgage rates and a subsequent drop in house sales. As interest rates continue to increase, we can expect to see a moderate decline in house sale prices from H2 2022 to 2023.

The Russia-Ukraine War has also impacted our local economy. While direct exposure to New Zealand is low with Russia taking just 0.4% of our exports, the conflict has pushed commodity currencies (such as the New Zealand dollar) higher, increasing inflation locally.

In May, the RBNZ raised its outlook for the OCR to 3.9% by September 2023 as inflation is likely to remain above its target range (1-3%) for most of 2023. Commentary now suggests a more aggressive approach than initially expected, with more forecast rises bringing the OCR to a peak of 4.1%, and returning to the target range by early to mid-2024 instead of the end of 2023.

The NZD/USD exchange rate is tied closely to the outlook for the USD — including the contributing factors of inflation in the US, US interest rates and the global economy. The US Federal Reserve is likely to continue raising interest rates until inflation comes down. Under the current economic outlook, the central scenario could see the NZD/USD falling below 0.6000. However, a mild US recession could see NZD/USD lift back above 0.6500 and if the US and global economy go into a deep recession then the NZD/USD could depreciate to 0.5700.

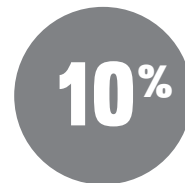
SIX MONTH COST/PRICE FORECASTS PREDICT FURTHER INCREASES

Builders and quantity surveyors still need to factor in further increases to materials for the next 6 months. On average prices will increase 9%, with the cost of materials (supplier buy cost) averaging an increase of 10%.

A new theme emerged from the comments in this survey, with several mentioning currency changes as having potential future impacts. See supporting summaries on page 11 discussing global forecasts for building products and short term factors influencing exchange rates

“The lower NZD has added around 10% to the cost of imported goods since December – currency forecasts vary but the NZD could go lower which would add to cost increases. The 10% increase in our sell price we have forecast includes the impact from a lower NZD as forward cover rolls off.”

PREDICTED AUG 22 TO JAN 23



10% IS THE AVERAGE INCREASE TO THE COST OF MATERIALS TO SUPPLIERS (SUPPLIER BUY-IN COST)



9% IS THE AVERAGE INCREASE TO CUSTOMERS (SUPPLIER SELL PRICE)

However, we know from each edition of this survey that suppliers tend to underestimate the cost increases each time, by around a half to a third.

SUPPLY CHAIN FORECAST

LEAD TIMES HAVE EASED AS STOCK HOLDINGS INCREASE AND DEMAND EASES

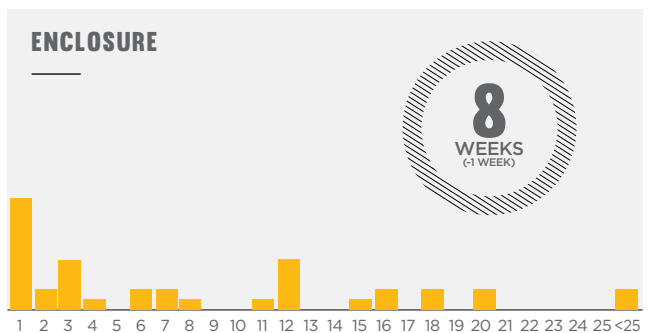
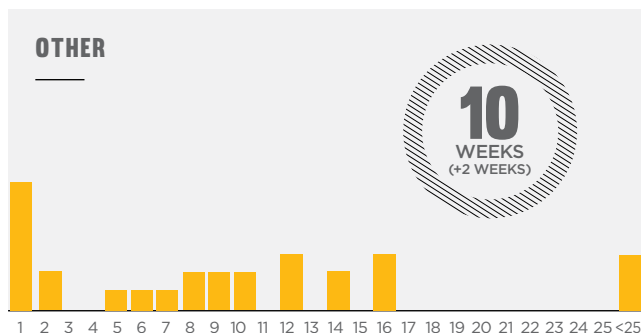
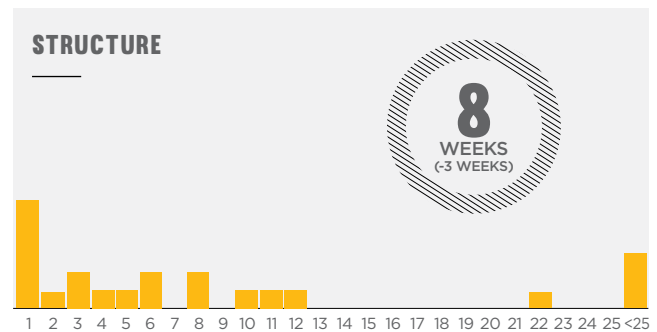
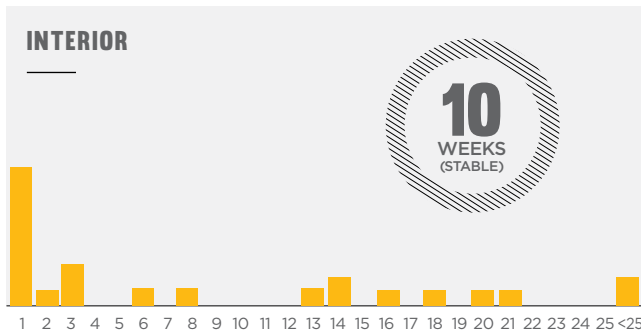
Putting the unique situation relating to the supply of plasterboard aside, lead times have eased this quarter, with products in the Structure category now down to eight weeks from 11 weeks six months ago.

Most notably, the distribution of lead times has changed, with the bulk of suppliers able to provide materials within one or two weeks across each category. Particular suppliers in

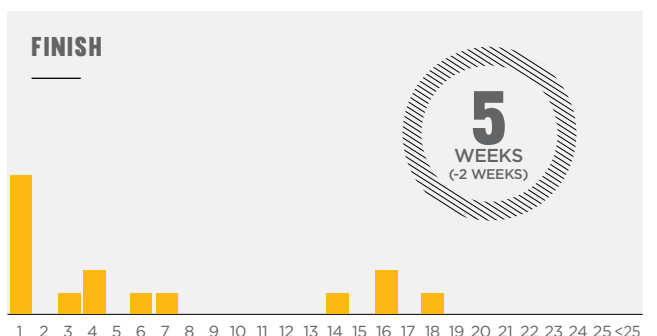
certain micro-categories have longer lead times that increase the average.

“Other” is the only category with an increase in average lead times. “Other” includes items like lighting, front of wall plumbing, hardware, landscaping, ventilation, fireplaces, and some electrical products.

AVERAGE LEAD TIME



“We have been paying substantially more to secure slots on ships. Overstocking to ensure we do not exhaust the supply. Purchasing from non-preferred suppliers.”



FREIGHT ISSUES ARE STILL WIDELY FELT

Freight issues are still being experienced by four in five suppliers, though the nature of these has shifted. Delays at NZ ports are far less of an issue now, and it is the high cost of freight that stands out as the main issue. Suppliers talk about trying to negotiate better pricing for freight, though not all are able to.

Of note, this update highlights that the heightened level of domestic demand seen previously is far less of an issue than it was a year or even six months ago. Again, comments from suppliers suggest that a drop in demand might place them in a precarious position with cash flow concerns, given the high stock holdings many have built up in anticipation of further supply chain issues.

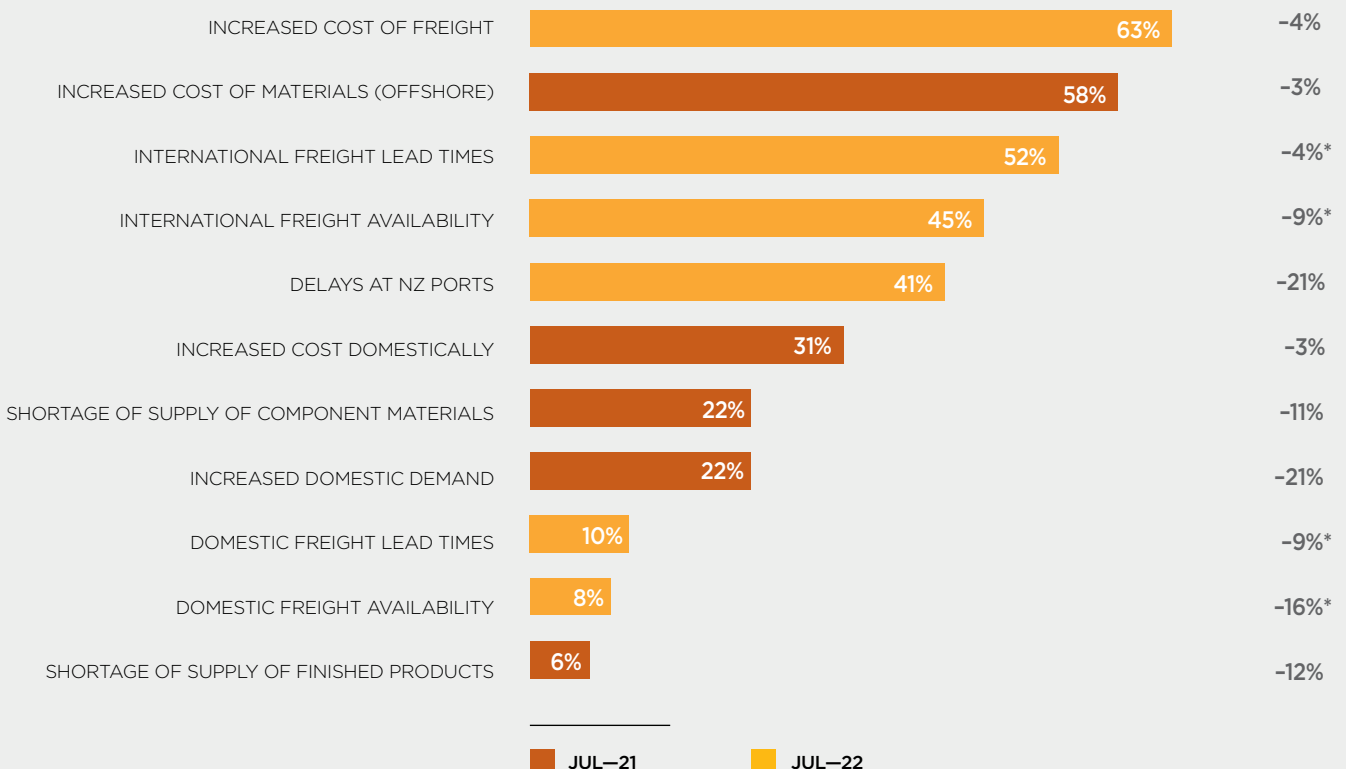
EXPERIENCING FREIGHT ISSUES



WHICH FACTORS ARE IMPACTING YOUR BUSINESS AND ABILITY TO SUPPLY RIGHT NOW?

COMPARED TO JULY 2021

* not asked in July 21, results compared to Jan 22 data



APPENDIX

The categories are described as:

Structure: Aluminium, Composite Panels for Floors and Walls, Concrete, Fasteners and Connectors, Masonry, Plastics, Site Safety and Roof Access Equipment, Stainless Steel, Steel, Structural Systems, Structural Timber

Enclosure: Awnings and Canopies, Enclosure Adhesives, Sealants and Fasteners, Enclosure Balustrades and Stairs, Exterior Decorative Items, Flashings and Expansion Joints, Glazing, Insulation, Roofing and Decking, Tanking and Pre-Cladding, Wall Cladding, Windows, and Doors

Interior: Ceiling Systems, Floors, Furniture, Hardware, Joinery Fixtures and Appliances, Partitions and Interior Doors, Signs and Features, Wall, and Ceiling Linings

Finish: Applied Coatings, Carpeting, Flooring Ancillaries, Flooring Underlays, Overlay Flooring and Wall Panels, Painting, Decoration and Coating, Resilient Surfacing, Tiling

External: Engineering Works, External Heating, Landscaping, Roads and Paving, Stretched Fabric Systems

Other: Services, Central Vacuum Systems, Communications and Controls, Fire Safety, Heating and Cooling, Lighting and Electrical, Plumbing and Drainage, Sanitaryware, Tapware, Transport, Ventilation and Air Conditioning

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Note: The ratings in some of the stacked bar charts may not add to 100%. This is due to rounding.