



CONFIDENTIAL

2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

My ref:

Your ref:

The Rt Hon Norman Lamont MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1

MBM
RACG
2/10

2 October 1989

Dear Chief Secretary

Thank you for your letter of 15 September.

and request is required

I am afraid the figures for construction prices which I gave you in my letter of 8 September were a year wrong. Construction industry prices were rising 6%-7% faster than the RPI in the last financial year 1988/89, not the present year. The best estimate for 1989/90 is that price inflation is moderating and is now between 2% and 7% faster than general inflation, and coming down. In 1990/91 construction prices are likely to slow to the general rate of inflation. I attach a summary page from the full paper circulated in parallel with my previous letter at official level, which set out these dates correctly.

The conclusion I would draw from these figures is that the industry has coped reasonably with a limited period of sharp growth of output, without excessive inflation (particularly bearing in mind the softening of prices and tenders earlier in the decade). The current reduction of pressure seems likely to leave some margin of spare capacity by 1990/91. But pressure has not been evenly spread between different sub-sectors of construction; so the available margin in different sub-sectors for the next year may vary.

So far as my own capital bids for housing and other services are concerned I see no reason to think that the additional investment implied would have a significant effect on our forecast for construction prices. I believe the housing industry in particular would now be well able to take up the modest increase in output which I have proposed. Obviously, I cannot comment in detail on the capacity of the relevant sub-sections of the industry to

CONFIDENTIAL

absorb the capital bids made by other colleagues. But in view of the general reduction in the pace of construction price inflation it would seem that most of the industry should be able to accommodate a reasonable level of capital bids without causing construction prices to accelerate ahead of general inflation again. I realise that, at this time of year in particular, there will be several different views on what is and is not reasonable.

/ Copies go to the Prime Minister and Cabinet colleagues.

Yours sincerely,

RB

CHRIS PATTEN

PP (approved by the Secretary of State and signed in his absence).

CONSTRUCTION INDUSTRY: PRICES AND DEMAND PRESSURES

Summary

1. There is no good estimate of the capacity of the construction industry. Nonetheless, it appears that the industry has been fairly fully if not uniformly stretched throughout 1988 and into 1989. The degree of stretch is now becoming less. By 1990/91 output should have ceased to rise, and might even fall very marginally.
2. The Secretary of State's letter to the Chief Secretary of 31 August 1988 looked forward to construction price rises 5-10% above general inflation in 1988/89. That forecast has been borne out. The August 1988 letter also spoke of this excess over general inflation tailing off into 1989/90 and later years. The current best guess is that construction prices this year will rise 2-7% more than general inflation, and that in 1990/91 there might be a range from a little below general inflation to a small percentage above it.
3. Private housing work has tailed off. Commercial construction is very vigorous, notably in the South-East. There are no particularly sharp sectoral or regional constraints on the industry. Amongst technical specialisms, the previous signs of shortage of mechanical and electrical work capacity in the South-East have faded. In civil engineering some specialisms may still give cause for concern.
4. Expected growth in road, railway, water, sewage and other infrastructure work over the rest of the century, coupled with continued long-term strength of housing demand, points to a need to continue the expansion of the construction industry. Our current guess is that the critical constraint may be in recruiting suitably qualified managers and technical staff.

Note: The dates above should be used in place of those in the letter of 8 September 1989.

