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Construction National Outlook – March 2014

Much of the economic data that has been reported by government or private research since the first of the year has been explained through the prism of the unusually bad weather. Harsh winters put a dent in construction of course, but the bigger concerns about the weather are in the effect on consumers.

For the most part the American consumer has maintained a more optimistic outlook while spending with slightly less optimism. Data reported during the first week of March showed an increase in consumer spending in January but when all of the increase for higher heating bills was backed out, consumer spending actually declined. Moreover, the spending figure for December was revised downward to one percent.

Bad weather is an inconvenient economic event for car dealers, homebuilders, appliance centers and the like. Demand from consumers will be deferred until the weather breaks but the decision to spend for these kinds of items will still take place. For seasonal retailers, restaurateurs or entertainment venues, however, the missed opportunities won't come back when the temperatures climb. Some of the business damaged as a result of the cold winter cannot be recovered. By mid-year, however, how businesses are doing will depend more on the direction of the overall economy.

Much of the data has been showing less optimistic short-term results (consumer spending, contracting volume, housing sales, etc), while the macroeconomic trends still point to a more robust economy for 2014-2015. The job creation numbers for the past three months have been erratic but have washed out after February's upbeat surprise to be following a trend towards more hiring. The share of home sales that were short sales or bank REO properties fell to roughly 17 percent at year's end, about half the share at the trough of the recession. Similarly, American households have significantly de-leveraged since the height of the credit bubble. Household debt service has fallen to 10 percent of annual income, a level that is lowest since before 1990; and the ratio of total liabilities-to-income has fallen from 1.4 to 1.1 times income. At the same time, consumer credit has begun climbing again. Taken together, the data suggests that Americans are borrowing more but paying more back as well. That typically bodes well for consumer demand.

One of the significant reasons for the decline in household leverage is unfortunately, that fewer households have been formed and home ownership has declined. Residential mortgages represent the largest category of debt. All things being equal, the consumer should be ready to buy or move up again after a half-decade of pent up demand. With very limited inventory of new homes and little overhang left from the crisis, the conditions are ripe for a robust housing construction market. New regulations affecting qualified mortgages will dampen demand that exists for the foreseeable future, however, so the prospects are for more new homes but a total that will still be several hundred thousand units short of historical normal.

There are some other important economic influences that have moved to being positive factors in early 2014. Federal and state governments have not reversed course on many fiscal problems but revenues have returned at the state level and the accords on the budget and debt ceiling have eliminated the threat of federal government shutdown or default. Federal tax hikes that impacted consumers and businesses at the start of 2013 have been digested. Employee productivity has leveled off after climbing post-recession, meaning that new business will necessitate new hiring.

These macroeconomic factors are drivers of hiring and spending that are often overlooked by news media – as they were certainly overlooked when negative in 2007. The suggest growth is coming but confidence at the consumer and business level is still needed to move from potential to construction.

As could be expected, construction numbers from the recent months are underwhelming.

Census Bureau reports on construction put in place showed $943 billion in January, 9.3 percent higher than in January 2013 and the fastest rate of growth for total construction spending since May 2006. Private residential construction increased by 15 percent year-over-year., while private nonresidential spending rose 9.7 percent. Public construction spending increased 2.5 percent from January 2013.

As part of his analysis of the Census data, Ken Simonson, the chief economist of the AGC, noted that the government utilizes models as much as field reports to estimate its monthly numbers. While this methodology generally leads to revisions of less than one percent on a regular basis, there is a high likelihood that the impact of the weather will appear as actual data on starts in factored in over the next couple months.

The reports of the two national private construction reporting services, McGraw Hill Construction and Reed Construction Data, validate Simonson's point.

McGraw-Hill reported on February 21 that the value of total new construction starts dropped 13 percent, seasonally adjusted, in January 2014 from December 2013. McGraw-Hill reported a decline of five percent, not seasonally adjusted, from January 2013. It saw declines that were in line with the overall market in the nonresidential building and housing segments and noted a sharp increase in public works construction, in spite of the weather.

"The year 2014 began slowly, due to behavior specific to each of the three main construction sectors," McGraw-Hill vice president Robert Murray said in a prepared release. "Nonresidential building in 2013 advanced 7 percent, but the progress was occasionally hesitant, including sluggish activity at the end of last year that carried over into January. At the same time, the prospects for continued growth for nonresidential building during 2014 are generally positive, helped by receding vacancies for commercial properties and some improvement in the fiscal health of state governments

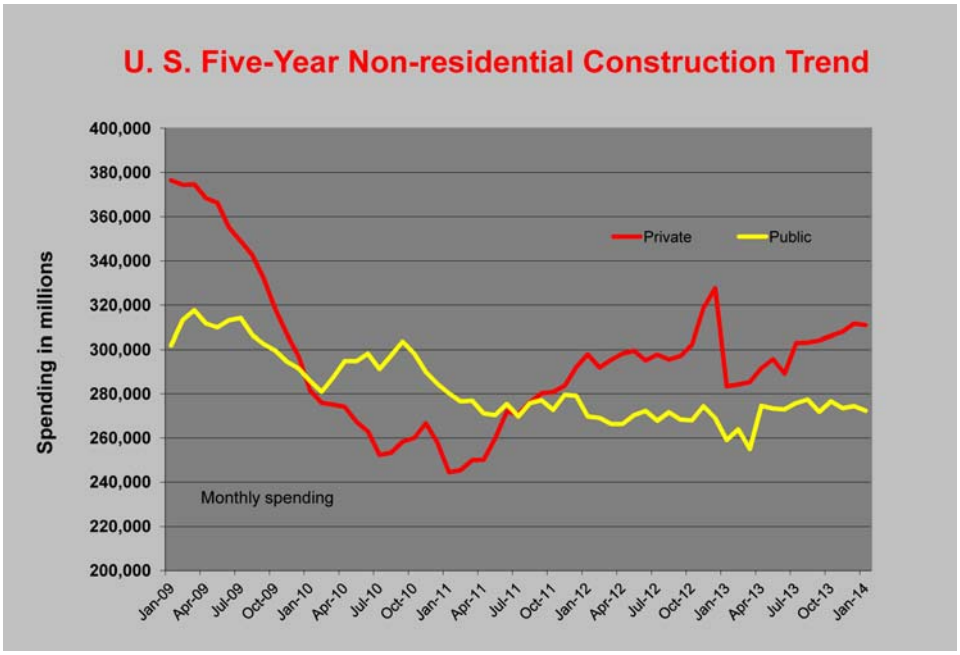
The value of nonresidential construction starts fell 6.4 percent, not seasonally adjusted, from January 2013 to January 2014, according to Reed Construction Data.

Nonresidential building construction starts slumped 12 percent. Reed saw declines in all three major nonresidential categories it tracks. Commercial construction declined 17 percent; institutional fell 4.0 percent; and industrial plunged 42 percent. Steep declines in individual categories can often be attributable to timing of reporting, especially of large projects. Reed's public works category, heavy engineering, also showed an increase climbing 4.3 percent.

The surprising activity level in public construction of infrastructure is unusual given the more unfriendly conditions for heavy construction in 2014 versus 2013. Observers do not necessarily see it as the beginning of a trend upward. Deferred maintenance and poor weather create demand for more road and sewer work. State and municipal coffers are fuller. Without a commitment from the federal government for funding past the point that the federal highway trust fund runs out of money – forecasted to be in summer 2014 – infrastructure construction will drop sharply.

Local government revenues are continuing to recover. States saw general fund tax revenues climb 7.7 percent in the first half of fiscal year 2014 and more than 21 percent over the recession lows in 2010. Fuel tax collections were also up, growing by 3.6 percent in the first half of 2014 and 7.2 percent from the 2010 lows.

American Institute of Architecture reported that its most recent survey of member firms showed a rebound in January. The Architecture Billings Index (ABI) hit 50.4 after two months below the breakeven level of 50. The ABI is a binary survey that tracks whether billings are increasing or declining. Advancing for most of the past 18 months, the ABI fell just below 50 in November and December of 2013.



The gap between private grew as private spending continued a year-long upward trend in January while public construction declined.