As the U.S. economy struggled to recover from the financial crisis at the beginning of the decade, there were three consecutive years that appeared to be carbon copies of each other. The years 2010-2012 had slow growth that was held back by extraordinary events that derailed recovery as it was beginning to build momentum. The flash crash, European sovereign defaults, the S & P downgrading of U.S. debt and the government shutdown and sequester all blunted economic momentum.

As May’s data began to trickle in, it appears the economy is in another “groundhog day” scenario and that may not be a bad thing.

Much like what happened in 2014, the unusually cold and snowy winter of 2015 put a damper on consumption and mobility that slowed gross domestic product (GDP) and output. After the second revision of first-quarter GDP growth on May 29, data showed the economy contracted 0.7 percent from January to March. This was after an initial estimate of 0.2 percent growth during the first three months. As much as the bad weather, continued strengthening of the U.S. dollar contributed significantly to the slowdown, as unfavorable exchange rates made American-made products more expensive than previously. The significant drop in oil and gas investment was another major contributing factor to the slowdown in output.

The main influence on the slowdown in activity was the U.S. consumer. Bad weather in the major population centers kept consumers out of malls and restaurants in January and February. Consumer spending rebounded in March, growing by 0.5 percent that month, but that was not enough to boost the quarter’s economic activity.

On June 1, the Commerce Department reported that spending in April was flat compared to March. Moreover, data showed that consumer spending growth over the preceding 12 months had slowed. But in the data were also indications that consumers were beginning to see real increases in wages – which would be consistent with the tightening labor force – and were using those additional wages to pay down more debt and boost the savings level to 5.7 percent. That pattern of behavior doesn’t help the economy at the cash register but is more positive than not for the long-term health of the economy.

May’s data on wage increase showed another slight creep in the overall wage increase to 2.3 percent year-over-year but showed a significant jump in the measure of private sector employees. The Employment Cost Index (ECI) is done quarterly and is a better measure of workforce pressures on wages since it measures wages for a sector with fewer increases fixed by contract. The ECI is more likely to reflect inflationary moves than the overall increase rate, since the overall measure includes public employees whose wages are driven less by supply and demand.
Most of the measures of economic activity thus far in 2015 have mimicked those of a year before. First quarter 2014 GDP declined by 2.1 percent, three times the slowdown indicated by the second estimate of 2015. The Bureau of Economic Analysis’ second estimate of GDP generally steepens the first estimate – whether positive or negative – because it takes a deeper look at consumer spending. The final estimate of GDP, which looks more closely at business investment, tends to moderate the second revision. This was true in 2014 and is likely to be the case when the final estimate is announced at the end of June.

The Economic Advisory Committee of the American Bankers Association (ABA) – a group of 16 bank economists, which includes PNC’s Stuart Hoffman – sees the first quarter activity as a “soft patch” and forecasts real GDP growth of 2.8 percent for the balance of the year. The ABA economists are bullish on consumer activity due to the steadily improving job market and the impact of the significantly lower gas prices, the benefits of which the ABA feels haven’t been realized as yet. The Economic Advisory Committee also predicts that the current job creation pace of 200,000 per month will continue through 2016, bringing the nation to full employment by mid-2016. As a result the group forecasts consumer spending to increase 2.7 percent in 2015.

If U.S. consumers are taking a break from increased spending by strengthening balance sheets and stocking away more dry powder, the results for the long-term health could be very positive, particularly for the housing market and durable goods. Sales figures for automobiles and homes – including new housing starts – will be good indicators of whether or not consumers are pausing to replenish or building war chests in reserve for future slowdowns.

The first of those indicators – new car and light truck sales – was surprisingly strong. May’s volume of 17.79 million vehicles was up significantly from April’s 16.5 million and represented the highest rate since July 2005.

Given the trend in the labor market, it seems less likely that consumers are hoarding cash in anticipation of tougher times. Year-over-year wage growth was only 2.2 percent in April but the recent months’ growth rate has been higher. And the spread between wage growth and the 1.2 percent inflation rate leaves room for comfort. Jobless claims are at a 15-year low. The unemployment rate is 5.4 percent. Labor participation rates remain low but in the face of multiple months of stronger hiring, it may be time to credit the lower participation to increased retirement rates, or at least voluntarily reduced working hours.

The takeaway from the first quarter thus far seems to be that consumers and businesses are catching their breath following brisk growth in the mid and latter parts of 2014. Economists still expect to see GDP growth for the full year that is 2.5 percent or better, meaning that the balance of 2015 should see robust activity.

Construction activity is also uneven through five months, although the overall trend is steadily higher in non-residential and significantly higher in residential.

Housing starts overall have stepped up to a higher pace, seemingly leaving the one million-unit mark behind for this business cycle. May’s 1,036,000 housing starts were somewhat lower than April’s level but starts in April jumped over 20 percent
from March; moreover, housing activity in May was some 5.1 percent higher than May of 2014. Building permits in May showed a dramatic increase, jumping to 1,275,000 units, a year-over-year rise of 25.4 percent. It’s worth noting that apartment construction remains robust, if no longer booming, even though investor and financing appetite may finally be cooling off. Lifestyle preferences of the Millennial cohort appear to be driving demand enough to offset the demand that was coming from those who wanted to buy but could not get financing during the post-recession period.

New home construction is getting a boost from the low inventory of homes for sale relative to the demand from buyers. Recent data shows new home sales firmly above the five million mark, but that level of activity is still below what would be expected of an economic recovery in its second or third year. Current home sales more closely match the volumes during the 2000-2001 recession. Conditions suggest that there is more upside to a housing construction recovery.

Non-residential construction volumes have been maintaining the expected six-to-eight percent growth rate for 2015, although the activity within individual sectors has been spotty.

Commercial construction is the most interesting sector to analyze. Because of the improved labor market and troubled public sector, commercial construction volume has tracked much closer to institutional construction since mid-2013. But commercial starts still remain below the mid-2008 high of the last business cycle. Given the fact that a lot of construction was driven by financing demand during the 2006-2008 period, the current volume may seem reasonable but a comparison of construction to existing supply shows that all the major commercial segments are lagging the historical norms.

Newmark Grubb Knight Frank (NGKF) looked at the share of space under construction relative to inventory and found that new office, industrial and retail space in the pipeline made up a much lower share than in previous boom cycles. Office buildings under construction, for example, totaled only 1.7 percent of the inventory, compared to 2.7 percent in 2007, 4.6 percent in 2000 and 13.6 percent in 1986. Similar ratios exist in the industrial and retail markets.

NGKF suggests that the regulatory fallout from the financial crisis is still holding back financing for office and other commercial categories and that a more conservative attitude prevails in 2015 than in previous cycles. According to real estate company CBRE, demand for space has also been changed from previous cycles by shifts in office usage that have reduced the amount of square feet needed per worker significantly. Retail demand for space has similarly been influenced downward by a shift in consumer appetite for big box stores and the increase in online shopping.

Comparison of CMD’s reporting on commercial construction shows that the category as a whole has been lifted by the gains in the job market over the past three years but that the sub-segments of commercial real estate have been impacted differently. Retail space in particular has been constrained by changing consumer habits, even as consumer spending has recovered fully. The value of retail construction was roughly 50 percent higher than the value of office construction during the last
business cycle, but construction spending on both types of space has been essentially equal since the beginning of the recovery in the third quarter of 2009.

Construction spending in April totaled $1.006 trillion, up 2.2 percent from the upwardly revised rate in March, up 4.8 percent from April 2014, and the highest rate since November 2008, the Census Bureau reported on June 3. Compared to the same four months one year ago, total spending increased 4.1 percent from the same months of 2014, private nonresidential spending increased 8.7 percent, public construction spending gained 3.1 percent and private residential construction rose 27 percent for multifamily and 10 percent for single-family. Within the market segments, manufacturing construction increased 43 percent; warehouse construction rose 42 percent and office construction was up 22 percent.

Dodge Data & Analytics (formerly McGraw Hill Construction) reported that new construction value was up 10 percent from March to April. During the first four months of 2015, total construction starts were up 24 percent, although Dodge’s data was somewhat skewed by the inclusion of several unusually large industrial projects.

"The presence of unusually large projects in early 2015, particularly several liquefied natural gas [terminals and] petrochemical plants, has elevated the level of activity shown by total construction starts beyond the underlying trend," stated Robert Murray, Dodge’s chief economist. "It's also increased the volatility on a month-to-month basis...Despite these wide swings on a monthly basis, it's still possible to identify several aspects of how the construction expansion is proceeding in 2015. For nonresidential building, the upturn is broadening in scope, with its institutional segment continuing the upward movement established in 2014. For residential building, single-family housing has shown some improvement yet remains hesitant, while multifamily housing is generally proceeding at a healthy clip. For non-building construction, the electric power and gas plant segment has provided a substantial near-term boost that will soon recede, while public works is beginning to face constraints after surprisingly resilient activity in early 2015."

*Commercial have recovered significantly since the recessionary trough while institutional projects remain depressed by funding problems.*
Improving employment has lifted construction of private office buildings without driving retail projects back to pre-recession levels.

Source: National Association of Realtors