Economic Outlook – July 2022

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The questions I have been getting lately are that with negative GDP in the first quarter, the stock market having its worst 6 month run in recent history, inflation, rising interest rates, inventory shortages, etc. why am I not forecasting an imminent recession? The reason is that despite all those negatives the three main indicators for the construction industry will all be positive at the same time during 2022. Housing permits and starts, nonresidential construction, and highway-infrastructure are all forecast to be positive during 2022 and currently also for 2023. The risks are that the consumer will stop spending and too many people will be priced out of the housing market. So far neither one of those things is happening. There are some obstacles in the way of continued economic growth but none that should alter the outlook significantly. Economists are split on the likelihood of a recession and those who disagree with my analysis are easy to find if you follow the news. The following bullet points address the positives and negatives of the outlook.

- A recent article in the *Wall ST Journal* stated that the full impact of spending from the infrastructure package will not be realized until 2024. When you look at the time it is taking to set up the bureaucracy to distribute the funds to the states, the labor and equipment shortage it is hard to argue with that assessment. When you look at the current level of government spending on infrastructure, the addition will be significant whenever it starts to arrive. A positive in the near term is that contrary to expectations, most states did not have significant reductions in tax revenue during 2020 or 2021, and have not made significant reductions in infrastructure spending. The one negative here is that with rising inflation, we will be able to fund fewer projects.

- The employment side of the economy continues to improve; however, employment gains have slowed. As of May, total employment has now exceeded pre-pandemic levels (149,359,000 in 2019 and 151,773,000 for 2022) but still showing 11 million jobs available, specifically in the service sector. The jobs report showed 1.5 million hires in January and another 678 thousand in February, well above expectations but coincidental with declines in the individual savings rate and the end of government stimulus. The June jobs report just came in showing another 372 thousand new jobs outpacing the estimates, another indicator that a recession is not imminent. On the construction side of the employment picture, we still have six states that have negative job growth from May of 2021. We have added 50,600 jobs in residential building and 283,000 for total construction across the U.S. and the direction is positive. Back to pre-pandemic levels but showing little growth since 2019.

- **Inflation.** The consumer price index increased by 7.5% during 2021 and the producer price index by 9.7% and continues to increase into 2022. As a result, the Federal Reserve has now changed direction and anticipates interest rate increases at every meeting during 2022. The first was a quarter point in March and then a three-quarter point in May. Many categories important to construction ended 2021 with significant year over year increases, some are listed below.

  Asphalt +69.5%, Steel bars, plates, & structural steel + 58.9%, aluminum +29.8%
  Copper wire & cable +20.7%, Gasoline +67.4%, Diesel fuel +54.9%

- We are starting to see the trend in housing changing as the impact of inflation and mortgage rates start to have an impact. Many markets are still overpriced but we are starting to see price reductions and some small growth in the inventory of unsold homes. If this continues it is the start of a move from a sellers' market to a neutral market. It will still probably be 2023 before we get to a 6-month inventory of unsold homes returning the market to a normal buyer-seller relationship. Current and anticipated increases in 30-year mortgage rates (now about 5.5%) have slowed the growth in permits but the level is still high at over 1 million per year. Lumber prices are trending downward but are still about 100% higher year over year. The risks to the housing market are continued material price increases and/or mortgage inflation. We are seeing some of both now.

- Oil ended 2021 at $91 per barrel and as of today 6-28-2022, is $110 per barrel for WTI crude and gasoline is around $4.90 average. It is difficult to see significant declines in inflation with the current administrations energy policy. Energy is a constant in the inflation calculations as everything that must be transported will increase in price. Inflation in the 8% to 9% range is not sustainable for the long term.

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- The trend in housing is impacting the nonresidential sector as well. I expect declines in sectors like lodging, brick & mortar retail, and office space. However, as more people move to the suburbs more infrastructure will be needed, water, sewer, power, and communications. It will also bring the normal building of grocery, medical, educational, etc. that follows population growth or migration. Nonresidential construction will return to positive growth during 2022 for the first time since 2019 and continue through 2023 with the housing trend contributing to some of the increase. I have forecast an increase in total nonresidential construction forecast for 2022 but not back to the levels of 2019.

- There seems to be little change with supply issues. From chips to steel many of the things we consume in the construction industry are in short supply. As a result, availability of equipment will continue to be an issue for construction equipment dealerships. We are faced with a situation where the economy will support more equipment purchases than the manufacturers can provide. As of May there were still close to 100 container ships waiting to dock at the Los Angeles and Long Beach ports, about the same as year-end 2021. We can expect continued long lead times and prices to increase as we go forward as the average time it takes to get product from Asia to the U.S. has increased by 43% and the price of containers has increased 500% year over year. This situation does however raise the value of existing inventory and equipment fleets allowing for higher margins. This applies to parts departments as well. Another shortage in the construction industry is labor. Whether it is qualified technicians or manual laborers for our contractors they are in short supply and labor rate inflation is averaging 15% to 20% in construction.

- The rental side of the industry is a mix of high demand and low supply. With a number of manufacturers selling only to retail, dealerships are having to keep machines in fleet longer than normal because they cannot be replaced. This results in the rental fleet needing more maintenance and the costs to maintain the fleet increase faster than we can increase rates. When additional equipment is available dealerships will restock and replace their fleets extending the demand for equipment.

- With all three primary construction indicators positive I expect 2022 to be a year of growth in construction and machinery and that that will continue into 2023. The pandemic is not behind us yet, but economic activity is no longer being hampered by the shutdowns that had such a major impact during 2020. As always there are challenges to overcome but the outlook is still positive.