

Today's Construction Economy

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Introduction

Today's Construction Economy captures key insight directly from leaders in the construction industry. The newsletter pulls from these observations to determine the market's message.

This quarter's edition highlights the persistently high inflation and its continued impact on construction pricing. An old Wall Street maxim states that the best cure for inflation is high prices, and that is bearing out in some corners of the construction economy as owners are beginning to balk. Materials prices are easing, but labor availability and wages are prevailing issues and have become the biggest concern among contractors.

Fourth Quarter 2022

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The U.S. Economy

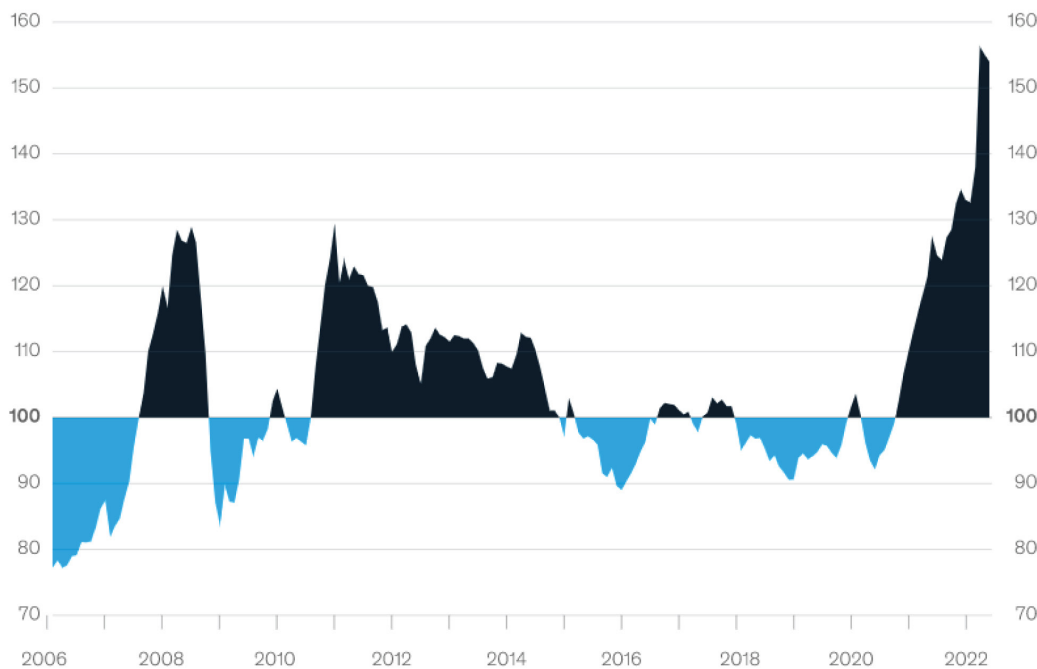
After declining for several months, the labor force participation rate — a measure of people working or looking for work — rose meaningfully, according to (Associated Building Contractors’ chief economist Anirban) Basu, from 62.1% to 62.4%. With wages expanding 5.2% in all industries over the last year, and 5.3% in construction, it’s an indication that a combination of inflation and rising pay rates have induced workers back to their jobs, after the exodus of the Great Resignation.¹ ↑

Americans as a whole have experienced two years in a row of flat or declining household income, new government data showed Tuesday (Sep 13), reflecting the pandemic’s lingering economic pain as inflation is also taking the largest bite out of pocketbooks in four decades.² ↑

The federal government ran a deficit of \$220 billion in August, a shortfall that widened compared with the year before, as spending grew faster than revenue collection last year.³ ↑

(U.S.) Commerce Department figures show prices for goods sold by manufacturers, wholesalers and retailers were 15.2% higher in the second quarter than a year earlier, whereas the (U.S.) Labor Department reported that private-sector compensation costs were up 5.5% over the same period.⁴ ↑

Real food price index, index (100 = 2014–16 average) (as of Apr 4, 2022) ⁵ ↑



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- Lahart, Justin, “The Earnings Crunch Is Only Just Getting Going,” WSJ, Sep 28, 2022, p. B14.
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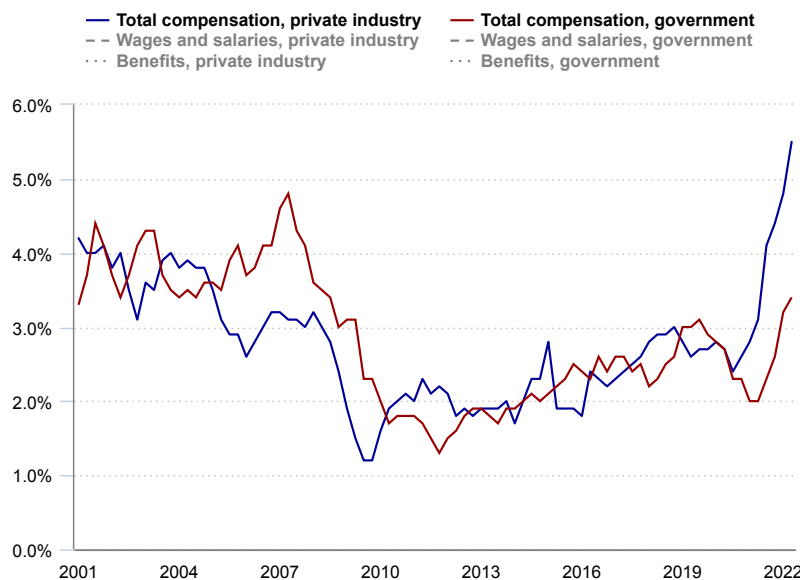
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The U.S. Economy (continued)

Recessions are bad for most people, but they tend to hit the poor and working class hardest....The Covid-19 crisis was different. First, several rounds of government relief buoyed household finances....Second, as the economy struggled to hire, wages for lower-income people started rising at a faster clip than for people with higher incomes – a marked contrast from the years following the 2008 financial crisis, when wage growth at lower income levels was moribund.⁶ ↑

Record tax collections “are allowing states to return some surplus revenues back to citizens, contemplate further tax cuts, and...providing additional funding to transportation projects as most recently seen in Florida and North Carolina,” investment research firm Thompson Research Group posted on September 7.⁷ ↑

12-month percent change in total compensation, wages and salaries, and benefits costs, in private industry and state and local government, March 2001–June 2022¹⁰ ↑



U.S. suppliers cut prices for a second straight month in August, underscoring the turbulent inflation backdrop that is leaving investors and policy makers uncertain about whether price pressures are losing steam or getting worse.⁸ ↓

Rents and other shelter costs are emerging as a major driver of overall consumer inflation, keeping it high at a time when many other sources are starting to ease.⁹ ↻

THE MARKET'S MESSAGE

One single feature of the U.S. economy is both a cause and an effect – inflation. No one is immune – record demand spurred by easing COVID restrictions and coupled with immense government spending has driven prices up for food, shelter, and most everything else. There are signs, though, that this will not last forever. The nation will not tolerate these levels – inflation will ease late in 2023.

SOURCES

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⁷ Data Digest, Vol. 22, No. 32, Sep 13-19, 2022.

⁸ Rubin, Gabriel T., “Supplier Inflation Remains Elevated,” Sep 15, 2022, p. A2.

⁹ Harrison, David, “Rising Housing Costs Drive Up Inflation,” WSJ, Sep 21, 2022, p. A2.

¹⁰ <https://www.bls.gov/opub/ted/2022/compensation-costs-for-private-industry-workers-up-5-5-percent-from-june-2021-to-june-2022.htm>



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Construction Labor Shortages and Wages

Construction firms are struggling to find workers to such a degree that it's threatening the success of federal investment in infrastructure and manufacturing projects, the Associated General Contractors of America (AGC) said Wednesday (Aug 31).¹ ↑

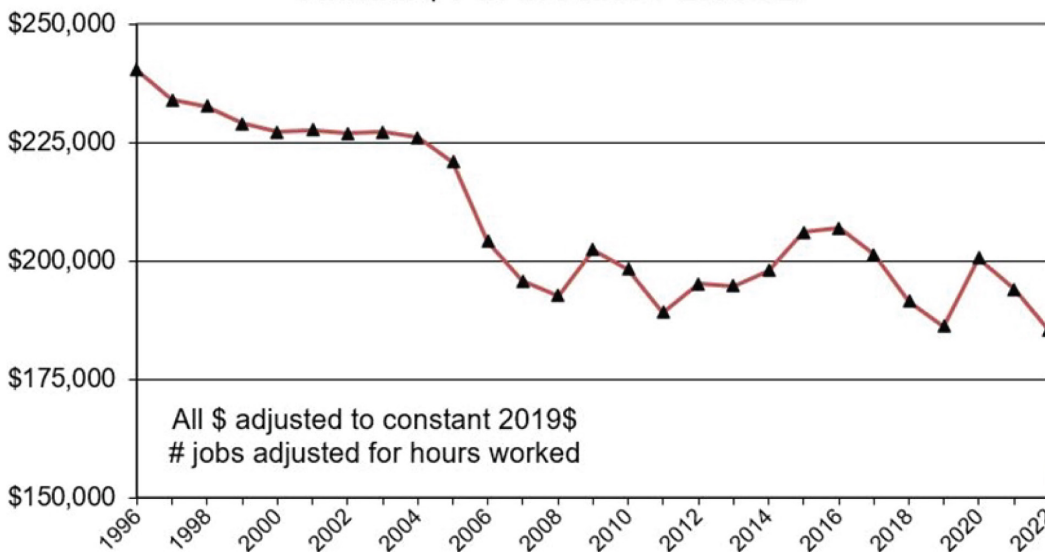
Citing July's construction unemployment rate of 3.5%, which was lower than that of the overall economy, (AGC chief economist Ken) Simonson said, "That essentially means there's almost nobody out there with construction experience looking for a new job in construction."² ↑

A full 77% of respondents to the (AGC annual construction workforce) survey said their biggest challenge in finding workers is that available applicants simply don't have the construction skills to do the job.³ ↑

In the Billd (2022 National Subcontractor Market) Survey, 40% of respondents ranked availability of skilled construction workers as their biggest business risk in 2022, with materials prices and volatility placing second, with 30%.⁴ ↑

Construction productivity is at historic lows – one job delivers the smallest amount of construction Put-in-Place in 25 years.⁵ ↑

**Total All Construction
Annual \$ Put-in-Place PER JOB** ⁶ ↑



edzarenski.com

SOURCES

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² Ibid.

³ Ibid.

⁴ https://www.enr.com/articles/54680-specialty-contractors-in-high-demand-amid-supply-constraints?oly_enc_id=0128A9634190J6E

⁵ <https://edzarenski.com/>

⁶ Ibid.



Construction Labor Shortages and Wages (continued)

The number of seasonally adjusted employed construction workers in Florida reached 593,800 in August, according to the Bureau of Labor Statistics (BLS). That was an increase of 3.3% from August 2021....Nevertheless, unemployment for job-seekers with construction experience was nearly 4% in August nationwide, close to an all-time low for the month, and close to the all-industry rate. Florida's low, industry-wide rate of unemployment was 2.7%, an all-time low since 2006.⁷ ↑

"I believe we're in a prolonged period of 5% wage increases or even more for craftworkers," Simonson said.⁸ ↑

Total compensation for construction industry employees (salaried and hourly) averaged \$43.56 per hour in the second quarter of 2022, the BLS reported on Wednesday (Sep 21) in the latest Employer Costs for Employee Compensation release. That was 12% more than the average of \$38.91 for all private sector employees.⁹ ↑

High inflation has impacted union craft pay rates more than two other recent factors – the craft labor shortage and COVID-19. CLRC (the Construction Labor Research Council) projects future new settlements to average approximately 4.2% by 2024.¹⁰ ↑

Average hourly earnings for production and nonsupervisory employees in construction (craft and office) rose 6.7% y/y (year over year) to \$32.83 per hour. That was the steepest y/y increase in 40 years and exceeded the 5.8% increase for all such private sector employees....The industry's unemployment rate, not seasonally adjusted, declined from 4.5% to 3.4%, the second-lowest rate in the 23-year history of the series.¹¹ ↑

There were 437,000 job openings in construction, not seasonally adjusted, at the end of August, a rise of 47,000 (12%) from August 2021, BLS reported on Tuesday (Oct 4). That was the largest August total in the 22-year history of the series and the 18th consecutive month of rising y/y openings.¹² ↑

THE MARKET'S MESSAGE

Despite extremely high wage rate increases, there continues to be a serious construction labor shortage. This problem will most likely keep prices high if the country enters a recession. While jobs are being filled at record pace, the industry cannot stay ahead of labor demand. The well for experienced construction workers has almost run dry. And, while available workers are added to construction jobs increasing sales, worker productivity continues to erode. At some point this will drag down new starts and impact sales if more labor cannot be enticed to enter the construction industry.

SOURCES

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⁸ Buckley, Bruce, "Wage Rates Spike For Both Union and Open Shop Craftworkers," ENR Third Quarter Cost Report, p. 53.

⁹ Data Digest, Vol. 22, No. 33, Sep 20-23, 2022.

¹⁰ Data Digest, Vol. 22, No. 36, Oct 10-18, 2022.

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Materials Pricing and Supply Chains

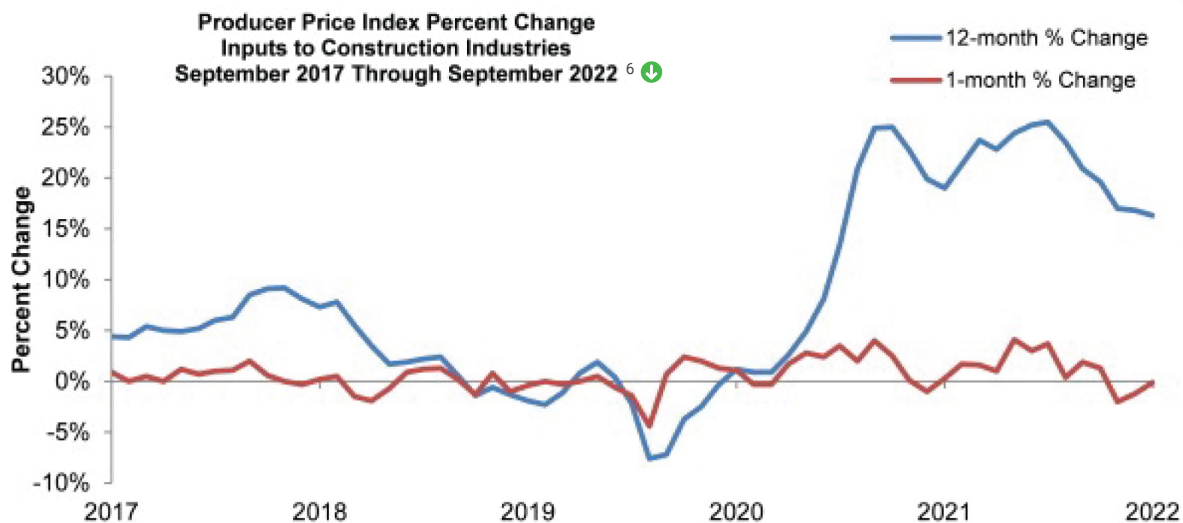
Even if materials are available, subcontractor bids are becoming increasingly short-lived. Adam Carrouth, chief operations officer of SPC Mechanical, Wendell, N.C., says some quotes his firm has submitted to general contractors had a shelf life of less than a week....“That makes it tough for them to submit a bid to an owner because the approval process might take several weeks,” he says. “That’s not easy to manage.”¹ ↑

Still, subcontractors appear to be bracing for supply chain issues to be a part of life well into next year, with the addition of projects funded by the Infrastructure Investment and Jobs Act potentially complicating an already difficult environment.² ↻

Nonresidential construction input prices dipped for a second consecutive month in August, providing more evidence that construction material costs peaked in June and supporting newfound optimism in the sector.³ ↓

Prices for steel mill products, crude petroleum and softwood lumber were down 5.7%, 5.3% and 3.1%, respectively, for the month (August), while cost for all nonresidential supplies moderated 1.4%, according to an Associated Builders and Contractors analysis of Bureau of Labor Statistics producer price index data.⁴ ↓

Lumber prices have fallen to their lowest level in more than two years, bringing two-by-fours back to what they cost before the pandemic building boom and pointing to a sharp slowdown in construction.⁵ ↓



Source: U.S. Bureau of Labor Statistics

SOURCES

¹ https://www.enr.com/articles/54680-specialty-contractors-in-high-demand-amid-supply-constraints?oly_enc_id=0128A9634190J6E

² Ibid.

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⁵ Dezimmer, Ryan, “Lumber Declines to Price Levels Before Pandemic,” WSJ, Sep 28, 2022, p. B1.

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Materials Pricing and Supply Chains (continued)

Pricing and availability for some steel, lumber, and plastic construction products have stabilized or improved in recent weeks....“Rebar has remained flat through August and thus far through September,” New South News reported on Thursday(Sep 29)....The lumber market continues to bump along the bottom.⁷

(The) Supply chain remains challenging – All we can say is it’s not much better. Sure, lead times for certain categories of equipment have improved. But on whole, managing supply chain has become an exercise of being pretty happy with ‘less bad’.⁸

Producer Price Index, September 2022 ⁹

	1-Month % Change	12-Month % Change	% Change Since Feb 2020
Inputs to Construction	-0.1%	16.3%	40.5%
Inputs to Nonresidential Construction	-0.1%	15.9%	40.8%
Plumbing Fixtures and Fittings	1.1%	11.6%	16.3%
Fabricated Structural Metal Products	-0.2%	14.0%	54.2%
Iron and Steel	-5.4%	-12.8%	69.2%
Steel Mill Products	-6.7%	-14.3%	91.3%
Nonferrous Wire and Cable	-0.4%	4.6%	41.7%
Softwood Lumber	-4.6%	14.5%	36.5%
Concrete Products	1.0%	14.3%	23.1%
Prepared Asphalt, Tar Roofing & Siding Products	0.8%	15.3%	36.2%
Crude Petroleum	-3.4%	29.1%	84.3%
Natural Gas	3.1%	106.5%	497.6%
Unprocessed Energy Materials	0.5%	66.6%	193.3%

THE MARKET’S MESSAGE

After a rapid runup in construction materials prices early last year, key materials prices are now falling. The supply chain issues that have hampered construction materials availability are not completely solved yet, but they are getting better.

SOURCES

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⁸ Data Digest, Vol. 22, No. 35, Oct 4-7, 2022.

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Foretelling Trends

Despite those higher costs, the report (2022 National Subcontractor Market Report: How Labor Shortages & Market Volatility are Impacting Subcontractors) adds, contractors were apparently hesitant to increase their bids in 2021's highly competitive environment, with more than half of the Billd survey respondents reporting decreased profitability for the year.¹ 🔄

"There's plenty of work, and subcontractors can pick and choose projects," (American Subcontractors Association chief operating officer Richard) Bright says, "but some may get to the point of having to decide whether they're worth it."² ↑

"There was also evidence that compensation growth is slowing, which is relief to contractors who have become increasingly pessimistic about their profit margins," Basu said.³ 🔄

Principal challenges in the sector relate to supply-side issues like worker shortages, equipment delivery delays and elevated materials prices, as opposed to demand for their services, the typical hallmark of a weaker environment in the sector.⁴ ↑

"Many contractors expect to pass along their cost increases to project owners during the months ahead," said Basu. "Some contractors may be in for a rude surprise. With borrowing costs rising and risk of recession elevated, it is perfectly conceivable that project owners will become increasingly resistant to elevated charges for the delivery of construction services."⁵ ↓

Specifically, the producer price index (PPI) for material and service inputs to new nonresidential construction slid 1.1% for the month (August), while the PPI for new nonresidential building construction — a measure of the price that contractors say they would bid to build a fixed set of buildings — rose 0.3%.⁶ 🔄

(Apartment) "vacancy rates remain low but have risen for three straight quarters alongside an elevated pace of new completions and moderating net absorption," Wells Fargo Economics posted on September 26. The marked rise in rents and other inflation pressures are leading to renter consolidation and slower demand.⁷ ↓

SOURCES

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⁵ https://www.constructiondive.com/news/construction-input-prices-fall-ppi-second-straight-month/631895/?utm_source=Sailthru&utm_medium=email&utm_campaign=Issue:%202022-09-16%20Construction%20Dive%20Newsletter%20%5Bissue:44588%5D&utm_term=Construction%20Dive

⁶ Data Digest, Vol. 22, No. 32, Sep 13-19, 2022.

⁷ Data Digest, Vol. 22, No. 34, Sep 26-Oct 3, 2022.



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Foretelling Trends (continued)

“We want to go after work when there’s a high degree of confidence that it’s going to get built,” he says. “Some of the more speculative projects that are really sensitive on interest rates – those are the ones we’re doing a bit more due diligence [on]...before we put too much time and effort in going after that kind of work.”⁸ ↑

Compared to a year ago, however, the (Dodge Momentum) index was still significantly positive, up 14% from August 2021....“This indicates continued confidence from owners and developers that nonresidential building projects will be realized in the coming year,” said Sarah Martin, senior economist at Dodge Data & Analytics.⁹ ↻



“The labor shortage did not have a big effect on union wages,” (Construction Labor Research Council’s executive director Larry) Peters says. “COVID-19 had a much more substantial impact on the size of increases.”¹⁰ ↑

A persistent economic puzzle is why labor is still so tight amid slowing growth, high inflation and growing fears of recession.¹¹ ↑

Trans-Pacific shipping rates have plummeted roughly 75% from year-ago levels. The transportation industry is grappling with weaker demand as big retailers cancel orders with vendors and step up efforts to cut inventories.¹² ↓

THE MARKET’S MESSAGE

While inflation continues to rage, there are forces pushing back. Demand is loosening up in various sectors of the construction economy, discouraged by high prices, worker shortages, and a pending recession. Both owners and contractors are becoming more selective.

SOURCES

- ⁸ https://www.enr.com/articles/54680-specialty-contractors-in-high-demand-amid-supply-constraints?oly_enc_id=0128A9634190J6E.
- ⁹ https://www.constructiondive.com/news/dodge-construction-index-dips-in-august/631471/?utm_source=Salithru&utm_medium=email&utm_campaign=Issue:%202022-09-09%20Construction%20Dive%20Newsletter%20%5Bissue:44427%5D&utm_term=Construction%20Dive.
- ¹⁰ Buckley, Bruce, “Wage Rates Spike For Both Union and Open Shop Craftworkers,” ENR Third Quarter Cost Report, p. 53.
- ¹¹ Cambon, Sarah, “Companies Keep Hiring Despite Slowing Economy,” WSJ, Sep 30, 2022, p. A1.
- ¹² Paris, Costas, “Cargo Shipowners Cancel Sailings,” WSJ, Oct 3, 2022, p. B1.
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Confidence and Forecasts

“The buoyancy of the nation’s nonresidential construction marketplace is really quite remarkable,” said Anirban Basu, ABC chief economist, in a release. “Rising interest rates have already driven the single-family homebuilding market into recession, but brisk nonresidential activity continues.”¹ ↑

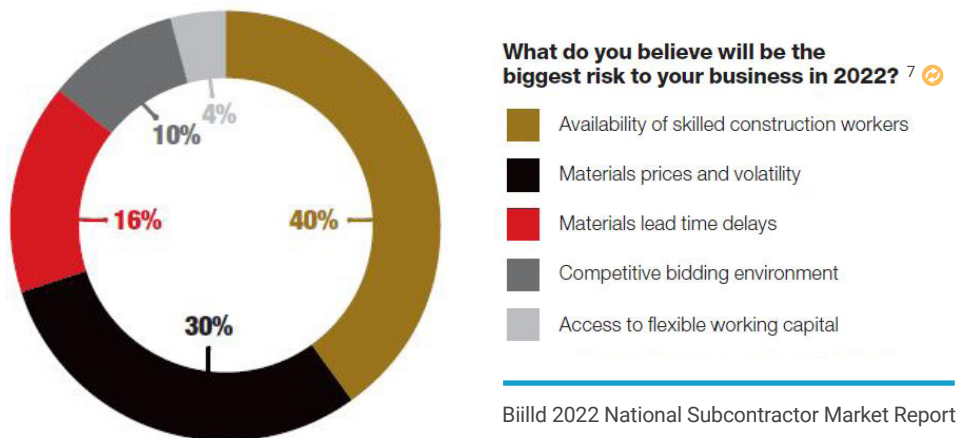
The increasingly optimistic outlook among commercial construction contractors was reported on the same day August’s inflation report came in hotter than expected, tanking financial markets on Wall Street. The consumer price index unexpectedly rose 0.1% in August, and was up 8.3% for the year, despite a recent fall in fuel prices.² ↑

The ABC’s Construction Backlog Indicator, which measures the months of work contractors have won but haven’t yet started, held at 8.7 months in August, the same level as July and a full month higher than August 2021.³ ↻

“According to ABC’s Construction Confidence Index and (the) Backlog Indicator, many contractors remain in expansion mode and expect to experience rising sales and profit margins going forward. Many also expect their employment levels to be higher in six months....But the nonresidential construction data indicate that consistent spending growth remains elusive,” said Basu. “Given the rising costs of project financing and delivering construction services, that is not surprising. Arguably, it is contractor confidence that is counterintuitive.”⁴ ↑

Backlog reached its highest level since May 2022 and is once again above the level observed at the start of the pandemic (8.9 months in February 2020). Backlog in heavy industrial increased sizably in September, spurred by a 21.5% year-over-year increase in manufacturing-related construction spending.⁵ ↑

Shares of transportation companies are falling twice as fast as the hard-hit U.S. stock market, reflecting investors’ expectations that a recession is ahead.⁶ ↓



SOURCES

¹ https://www.constructiondive.com/news/steady-backlogs-nonresidential-construction-pros-shrug-off-recession/631763/?utm_source=Sailthru&utm_medium=email&utm_campaign=Issue:%202022-09-14%20Construction%20Dive%20Newsletter%20%5Bissue:44512%5D&utm_term=Construction%20Dive

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³ Ibid.

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⁵ <https://www.abc.org/News-Media/News-Releases/entryid/19644/abcs-construction-backlog-indicator-jumps-in-september-contractor-confidence-remains-steady>

⁶ Singh, Haridka, “Transportation Stocks Flash Alert,” WSJ, Sep 26, 2022, p. B1.

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Confidence and Forecasts (continued)

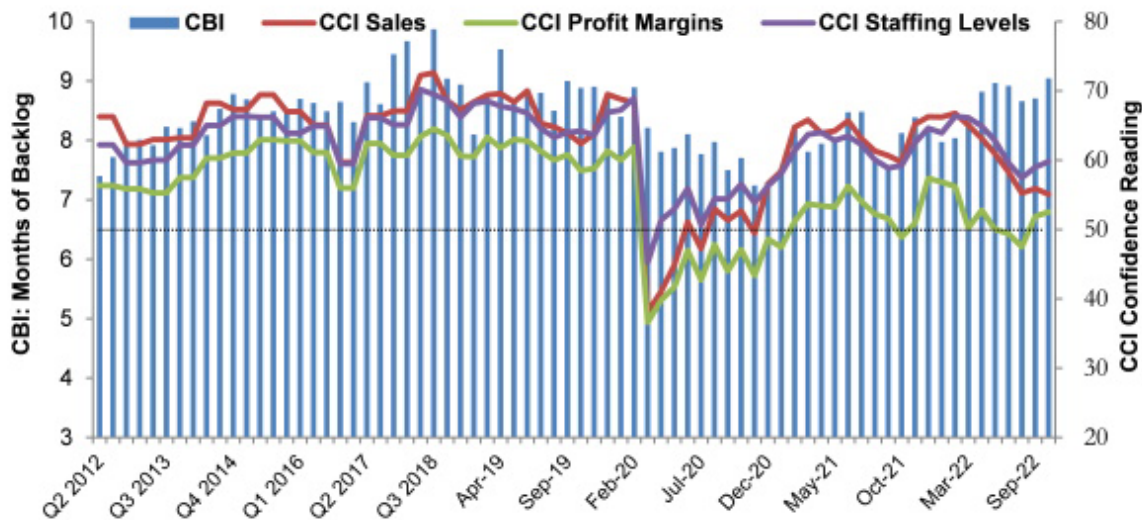
Consumers' moods about the economy improved in September while a jump in new-home sales and a decline in orders for long-lasting goods offered a mixed picture of demand at the end of the summer.⁷

Branch continues to predict no recession for 2023, but says the risk is rising. Should one occur, non-residential starts could decline by 16%, according to the (Dodge Data and Analytics) forecast.⁸

The Dodge Momentum Index rose 5.7% in September from August and 26% y/y, Dodge Construction Network reported today (Oct 7). The index "is a monthly measure of the initial report for nonresidential building projects in planning, which have been shown to lead construction spending for nonresidential buildings by a full year."⁹



ABC Construction Backlog Indicator & Construction Confidence Index, 2012-Sep. 2022¹⁰



© Associated Builders and Contractors, Construction Backlog Indicator, Construction Confidence Index

THE MARKET'S MESSAGE

A healthy backlog and continually rising sales and profits are adding to contractor confidence. They are ignoring mounting evidence of an impending recession next year. In the meantime, inflation is raging, interest rates are rising, and prices for some inputs to construction are levelling off or falling.

SOURCES

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⁸ Zevin, Elisa, "Material Prices Slide Amid Unsteady Market," ENR Third Quarter Cost Report, p. 46.

⁹ Data Digest, Vol. 22, No. 35, Oct 4-7, 2022.

¹⁰ <https://www.constructiondive.com/news/tougher-times-ahead-construction-july-backlogs-fall/629203/?%3A+2022-08-10+Construction+Dive+Newsletter+%5Bissue%3A43721%5D=>

Final Thoughts

While inflation continues to fill the headlines, some trends are emerging. Wages are losing purchasing power and federal deficits are rising, but labor force participation and state budget surpluses are rising, too. Construction labor issues are beginning to have a real impact on new project starts – while jobs are being filled at a record pace, new jobs are popping up even faster. Contractors continue to navigate the challenges to profitability – high input costs and apprehensive owners. Intolerably high Inflation is here for another year, though.

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