

Economic Indicator — September 1, 2021

Construction Spending Rises Modestly in July

Summary

Construction spending rose 0.3% in July, which was in line with expectations. Data from the past two months were revised higher, so building activity is somewhat more robust than previously thought. Most of the strength continues to be in the residential sector, where construction outlays rose 0.5%. Nonresidential construction spending rose 0.1%, with all the gain coming in public projects. Private nonresidential construction fell 0.2%, with most of the drop coming from transportation and utility projects. Office construction fell 0.1% and has been more or less unchanged since March.

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Home Building Remains Strong

Private residential outlays rose 0.5% in July, with all the gain coming from single-family construction. Home builders have been racing to catch up with demand but have been bogged down by shortages of key raw materials and labor. The strength in single-family spending and some upward revisions to all three residential construction categories suggest that residential investment did not fall as much as previously thought and might lead to a small upward revision to Q2 real GDP growth.

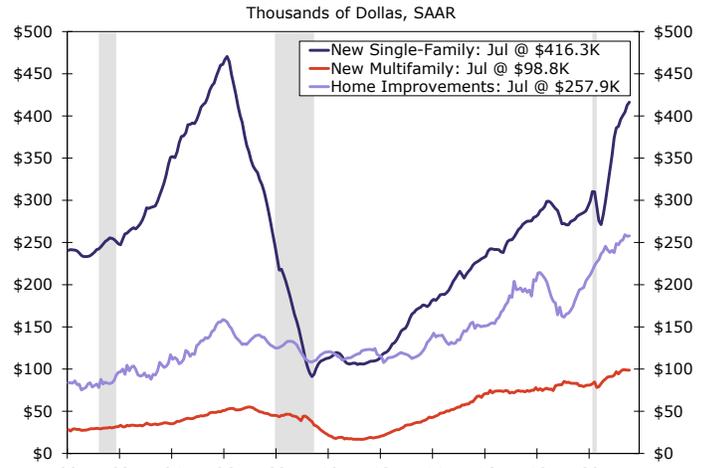
Spending for home improvements edged lower in July but remains close to its all-time high reached in May. Spending for home improvements continues to be driven by the need to accommodate more work and entertainment from home. The lack of new homes available for sale and push of new development to the exurbs is also making renovating homes closer to urban centers more attractive.

Apartment construction is also holding up well, although multifamily outlays fell nominally in July (less than 0.1%). Demand for apartments has been surprisingly strong, with rents surging in rapidly growing parts of the South and Southwest. Rents have risen faster than income, leading to a shortage of affordable apartments for workers earning the median income in many areas.

Nonresidential activity remains bogged down by the knock-on effects of the pandemic. Total nonresidential construction modestly rose 0.1%, marking only the second monthly gain over the past six months. In July, the entire gain came from the public sector (+0.6%), as spending in the private sector fell 0.2%. Public outlays on highway & street projects rose 1.9%, while power (+2.3%), commercial (+1.7%) and conservation & development projects (+1.6%) saw sturdy gains as well. Many state and local governments are relatively flush from their share of federal stimulus programs. The strong gains seen in public infrastructure-related outlays likely reflects spending of these funds, which should continue to support public spending throughout the year.

In the private sector, most nonresidential categories remain sluggish. A further delay of the return to the office has added to the uncertainty about the future of the office market. Lodging development has also weakened considerably over the year, reflecting the weaker operating fundamentals for much of the market. Although leisure travel has strengthened, business travel will not likely return in a major way until at least early next year. One notable standout is warehouse spending, which is up 13.8% year-over-year. Growth in online retailing and the desire by more businesses to hold more inventory are helping drive demand for space.

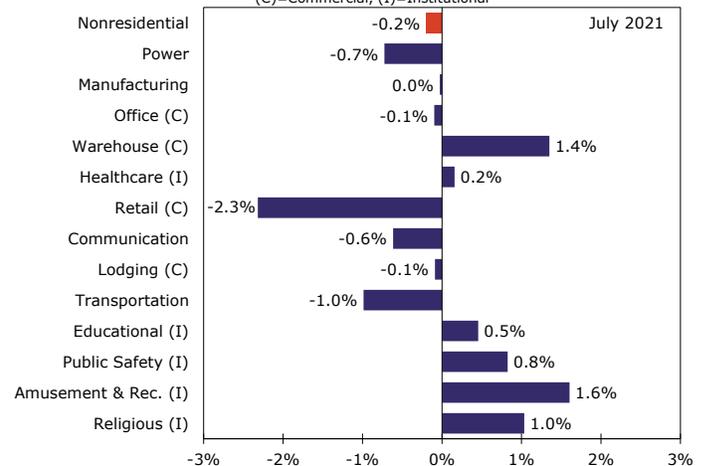
Private Residential Construction



Source: U.S. Department of Commerce and Wells Fargo Securities

Private Nonresidential Construction Put-in-Place

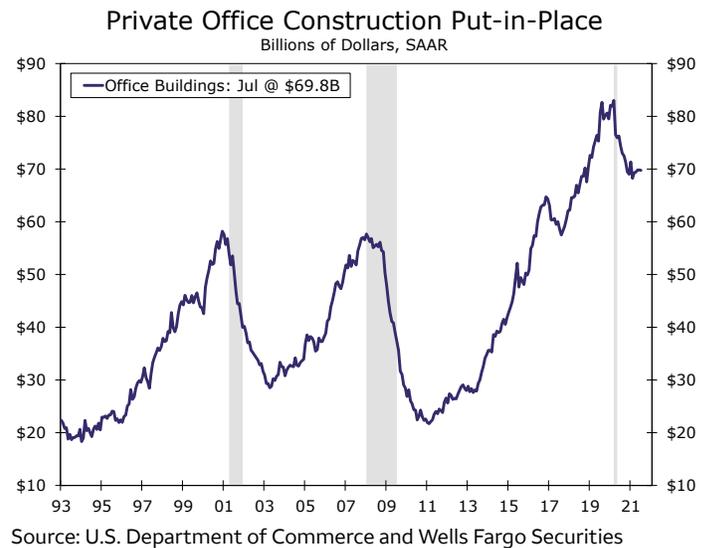
Month-over-Month Percent Change, SA, Ranked by Level of Spending
(C)=Commercial, (I)=Institutional



Source: U.S. Department of Commerce and Wells Fargo Securities

Private healthcare (+0.2%) and educational (+0.5%) spending also saw modest increases, while religious (+1.0%) and amusement & recreation (+1.6%) projects posted sturdy gains. The broadening reopening of restaurants, bars and hotels over the summer likely boosted recreational project spending. That said, mobility moderated in August due to the rise in COVID cases, presenting some headwinds for spending in this sector in the months ahead.

Overall, private nonresidential construction is currently 12% below its pre-pandemic level. We expect private nonresidential construction to improve during the coming year, as supply shortages ease and the outlook for the office, retail and lodging markets becomes more certain. Demand for suburban office space has strengthened since the pandemic began. The market was oversupplied prior to pandemic, however, which has resulted in mostly remodeling projects as of late, which provide much less of a boost to construction spending. There are plenty of new suburban office projects in the pipeline, but many developers are having a tough time sourcing materials, securing labor and estimating project costs.



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