Economic Indicator — December 1, 2021

Construction Spending Rises in October

Summary

Economist(s)

Mark Vitner
Senior Economist | Wells Fargo Securities, LLC
Mark.Vitner@wellsfargo.com | 704-410-3277

Charlie Dougherty
Economist | Wells Fargo Securities, LLC
Charles.Dougherty@wellsfargo.com | 704-410-6542

Nonresidential Strengthens as Residential Continues to Cool

Total construction spending rose 0.2% during October. Overall construction outlays are now up 8.6% over the past year. One of the major themes over the past year and a half has been the divergence in residential and nonresidential activity owed largely to the aftershocks of the pandemic. Now, with vaccines and an expanding toolbox of therapeutics, the post-pandemic economic picture is coming into clearer view and the gap appears to be narrowing. Residential spending, which slipped 0.5% during the month, has moderated recently. Despite strong buyer demand and dwindling inventories of existing homes, persistent shortage of materials and labor as well as substantially higher input costs have forced builders to tap the breaks on new development.

On the other side of the ledger, nonresidential outlays rose 0.9% in October, the fourth straight month spending has either been flat or improved. The nonresidential sectors suffering the most acute impacts from the pandemic are still struggling to get back on track, notably for new office, hotel, education and healthcare projects. That said, the knock-on effects of the pandemic continue to be a boon for new warehouse development. Demand for retail space has also improved, as consumers have more time to shop given more flexible work schedules. Manufacturing outlays have also firmed, as many producers are looking to boost capacity. Public construction, which climbed 1.8% during the month, has also improved in recent months. State and local governments are now flush with cash from unexpectedly strong tax receipts and federal aid, and much of this money appears to be flowing into a myriad of public works projects.

Widespread supply-side constraints, however, continue to weigh on the entire construction industry. Shortages of key building materials have pulled prices sharply higher for a wide array of items ranging from steel and copper to appliances and pick-up trucks. In addition, labor shortages have added to the rising cost environment and thrown meticulously choreographed project schedules into disarray, leading to delays and uncertain completion timelines.

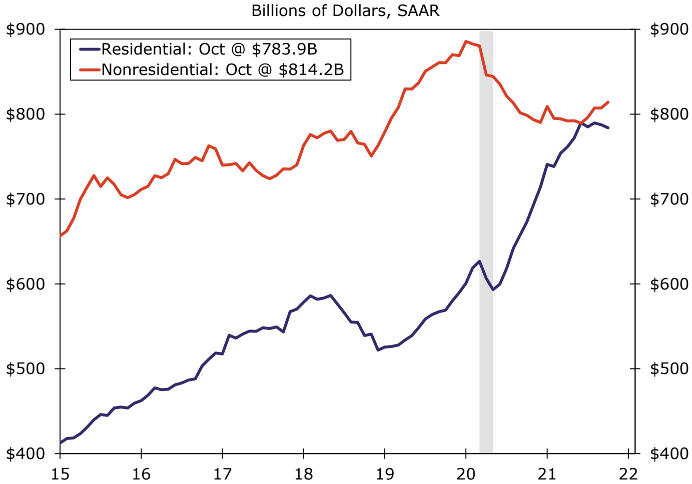
Despite these headwinds, builders and developers appear to be pressing ahead. While total housing starts have moderated somewhat recently, overall permitting activity has strengthened with both single-family and multifamily permits rising during October. Nonresidential activity looks poised for further improvement. According to Dodge Data & Analytics, total nonresidential building starts shot up 29% in October and starts are up 11% on a year-to-date basis. What's more, the forward-looking Architecture Billings Index has been solidly in expansion territory for nine straight months. The recently enacted Infrastructure Investment & Jobs Act, which provides $550 billion of new spending for roads, bridges, mass transit, water and numerous other infrastructure projects, stands to boost public sector construction further, but the bulk of that spending will not materialize for a year or more.

Residential Spending Cooling Down

- Residential spending fell 0.5% during October. Despite the drop, outlays remain 16.4% above their year ago level. Spending has moderated in recent months amid worsening building material and labor shortages.
- Single-family spending dipped 0.8% during the month, although outlays are up 23.1% over the year. Buyer demand remains strong, as evidenced by a 7.5% jump in pending home sales during October and a similarly strong gain in mortgage applications for purchase during November (both reported separately). However, builders appear to be tapping the breaks as supply-side challenges wreak havoc on project timelines. There is a growing pipeline of single-family homes currently under construction, many of which are awaiting key components in order to be completed.
- Multifamily outlays back-tracked 0.1%. However, the lofty level of multifamily permitting recently suggests developers are encouraged by the broad-based resurgence in demand for apartments and are planning to push through the supply headwinds. A large proportion of apartment development is in mid-rise and high-rise projects.
- Home improvement outlays fell 0.2%, the second straight decline. Home improvement spending is highly volatile on a monthly basis, but the recent weakness indicates that repair and remodel projects have not been immune to rising material costs and unavailable labor.

Residential & Nonresidential Construction

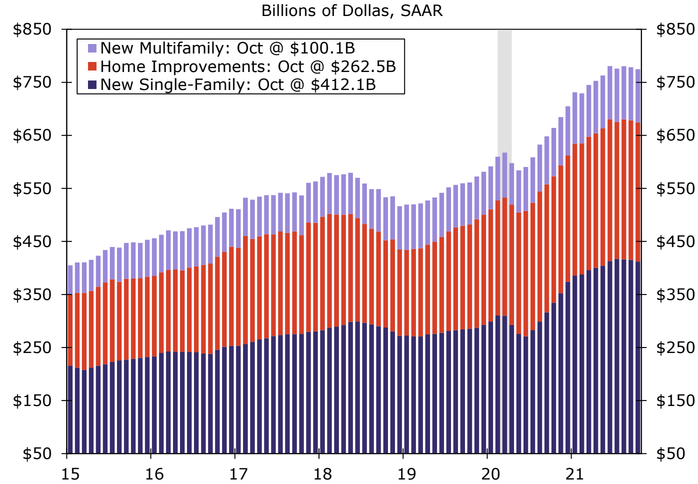
Billions of Dollars, SAAR



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

Private Residential Construction

Billions of Dollas, SAAR

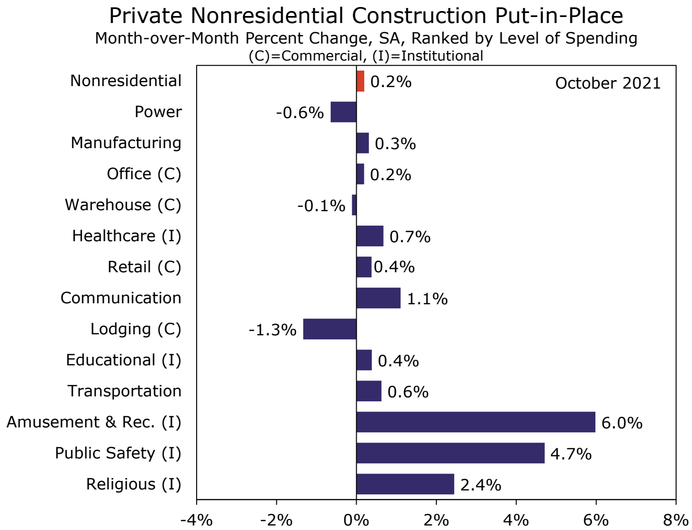


Source: U.S. Department of Commerce and Wells Fargo Securities

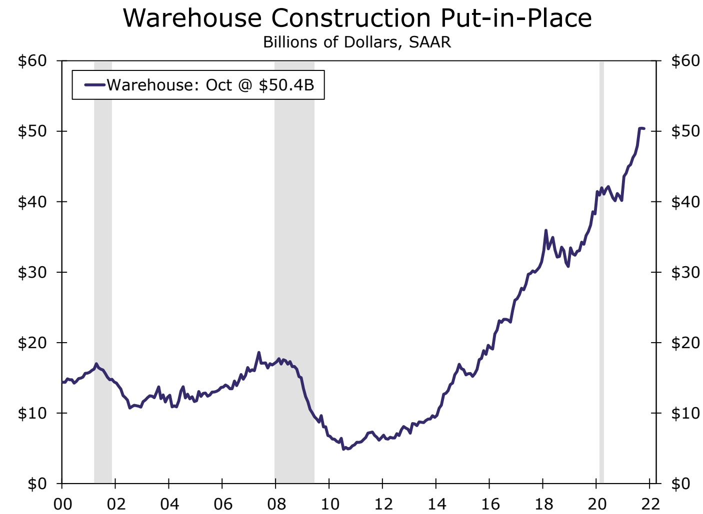
Nonresidential Activity Is Finally Picking Up

- Overall nonresidential spending rose 0.9% during October, marking the fourth straight month spending has either been flat or improved.
- Most major nonresidential categories advanced during the month. Office spending increased 0.5% and is now up 1.2% over the year. Much of the recent strength appears to be renovation and remodel spending as employers prepare for the return to the office. Part of the pickup may also be owed to a rise in data center construction, which is included in this category, although specific details are not provided by the Census Bureau.
- Spending on retail projects, which rose 0.4% during the month, has strengthened for much of the past year, as retailers follow residential development spurred by the population shift to the suburbs.
- Warehouse construction continues to boom, although spending inched 0.1% lower in October. As we have recently written, the rise of e-commerce and congested supply chains continues to drive demand for warehouses, distribution centers and logistics facilities. Warehouse spending is now up 22.4% over the year.
- Manufacturing has been another bright spot recently. Manufacturing outlays rose 0.4% in October and are up 13.4% over the year. In addition to the pickup in manufacturing activity brought on by robust consumer goods spending, some global manufacturing capacity is being re-shored as firms seek shorter and more resilient supply chains. Higher commodity prices also appear to be allowing some LNG and petrochemical manufacturing projects to get back underway, notably in the Western Gulf states.

- Lodging construction remains weak. While domestic travel has picked up considerably this year, uncertainty surrounding the full return of business and international travel continues to weigh heavily on new development. Spending on hotels and motels fell 1.8% in October and is down 33.9% over the past 12 months.



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



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

Public Sector Poised for Growth

- Public construction has improved in recent months. Total public expenditures climbed 1.8% during October. Highway and street spending increased 2.4%, while transportation outlays rose 1.7%.
- Federal spending surged 14.6% during the month, while state and local outlays rose 0.9%.
- State and local governments are now flush with cash from unexpectedly strong tax receipts and federal aid, and new funding now appears to be flowing to public works projects.
- The recently enacted Infrastructure Investment & Jobs Act, which provides $550 billion of new spending for roads, bridges, mass transit, water and numerous other infrastructure projects, stands to boost public sector construction, but the bulk of that impact will not become apparent for a year or more.

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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Mark Vitner	Senior Economist	704-410-3277	Mark.Vitner@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Charlie Dougherty	Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Shannon Seery	Economist	332-204-0693	Shannon.Seery@wellsfargo.com
Nicole Cervi	Economic Analyst	704-410-3059	Nicole.Cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	704-410-1437	Sara.Cotsakis@wellsfargo.com
Jessica Guo	Economic Analyst	704-410-4405	Jessica.Guo@wellsfargo.com
Karl Vesely	Economic Analyst	704-410-2911	Karl.Vesely@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

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