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Economic Indicator — September 1, 2022

Construction Spending Dips in July

Nonresidential Rise Not Enough to Offset Residential Decline

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Summary

Total Spending Dragged Down by the Residential Sector

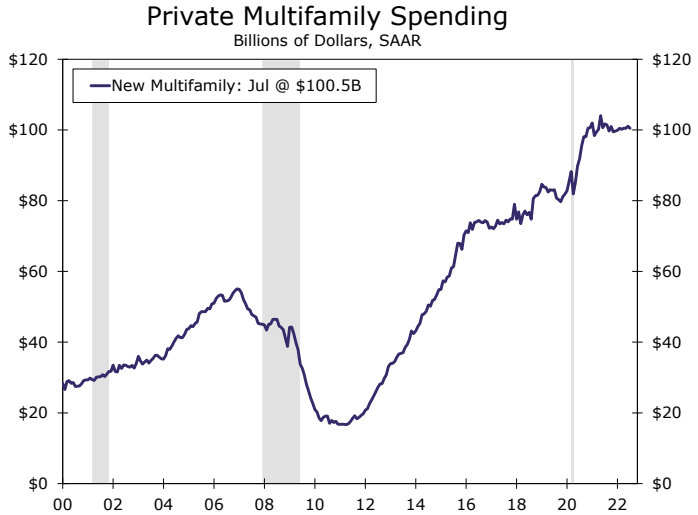
- Total construction spending declined 0.4% during July, the second straight monthly drop.
- Upward revisions to overall spending in June takes some sting out of July's larger than expected drop. Total spending fell 0.5% in June, slightly better than the 1.1% decline published in the first estimate.
- Residential spending fell 1.5% during the month, with single-family (-4.0%) and multifamily (-0.6%) outlays declining in July. Home improvement spending rose 1.5%. Total residential spending is still up 14.0% over the year, however the drop-off in home buying brought on by higher mortgage rates is weighing heavily on the residential sector.
- Overall nonresidential spending advanced 0.8%, the second consecutive monthly gain. Private nonresidential improved 0.4%, while public nonresidential increased 1.5%.
- Most major total nonresidential subcategories rose during July, notably commercial (0.7%), office (0.5%) educational (0.1%), power (0.1%) and manufacturing (0.6%).
- Healthcare (-1.3%), water supply (-0.5%) and sewage & waste disposal (-0.3%) registered monthly declines.
- Public works expenditures rose 1.5% in July, with both the residential (0.8%) and nonresidential (1.5%) subcategories advancing during the month.
- Rising building material and labor costs have likely boosted overall spending, which is not adjusted for price changes. The Producer Price Index for inputs into construction rose 12.6% year-over-year in July.
- The Architecture Billings Index slipped to 51.0 in July from 53.2 in June. While still in expansion territory, the index has dropped for four straight months and now sits at the lowest point since January.

Higher Interest Rates Weigh on Spending

This year's sharp increase in interest rates is starting to weigh on the construction industry. Total construction spending declined 0.4% during July, the second straight monthly drop. Upward revisions to overall spending in June takes some sting out of July's larger than expected drop.

Still, the drop in overall spending was largely the result of a 1.5% decline in residential outlays. Single-family spending fell 4.0% in July, which was the largest monthly downturn since April 2020. The pull-back in spending has occurred against a backdrop of sharply higher mortgage rates which has worsened affordability and pushed prospective home buyers to the sidelines. New home sales and home builder sentiment have moved markedly lower in recent months, and builders are now starting to scale back production alongside lower demand.

Multifamily spending declined 0.6% in July, which translates to a 1.2% yearly drop. Despite the decline, multifamily spending still ran at a strong $100.4 billion dollar pace during the month, which is not far off the record pace hit in July 2021. Declining single-family affordability and low apartment vacancy rates are driving the lofty pace of multifamily development. Another bright spot in the residential category is home improvement spending, which expanded 1.5% in July. Record levels of homeowner equity and relatively few single-family trade up-options have led to a robust rate of spending on additions and renovations. That noted, higher financing costs are likely to lead to a more moderate pace moving forward.



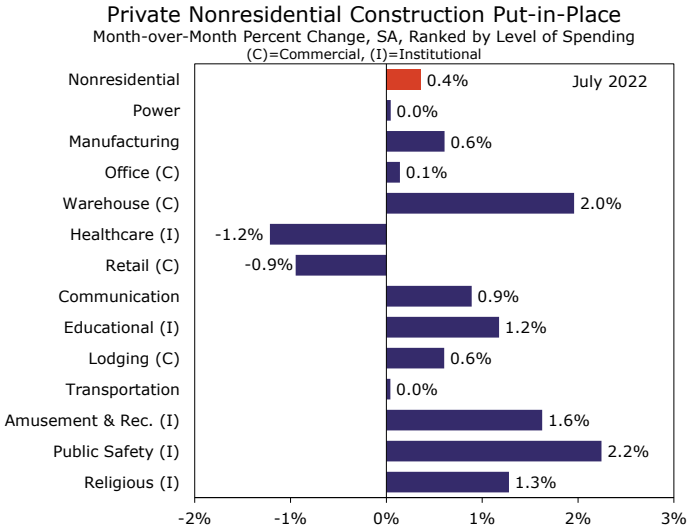
Source: U.S. Department of Commerce and Wells Fargo Economics

Nonresidential Boosted by Higher Material Prices

Overall nonresidential spending advanced 0.8%, the second consecutive monthly gain. The recent string of improvements is encouraging sign that projects are moving ahead despite increased economic uncertainty, however spending has likely been inflated by higher building material prices. Building material price growth appears to be slowing, notably for steel, copper and diesel fuel. Still, the Producer Price Index for inputs into construction was up 12.6% in July.

Within the total nonresidential category, private spending improved 0.4%, while public expenditures increased 1.5%. Most major total nonresidential subcategories rose during July, notably commercial (0.7%), office (0.5%) educational (0.1%), power (0.1%) and manufacturing (0.6%). Manufacturing spending, which is up 19.3% over the year, continues to stand out. The global shortage of semiconductors and shift to electric vehicle production has spurred a dramatic rise in manufacturing projects across the country.

Not every nonresidential sector rose. Health care project spending declined -1.3% during the month. Water supply and sewage & waste disposal dropped 0.5% and 0.3% respectively. In terms of public works projects, total public expenditures rose 1.5% in July, with both the residential (0.8%) and nonresidential (1.5%) subcategories advancing during the month.



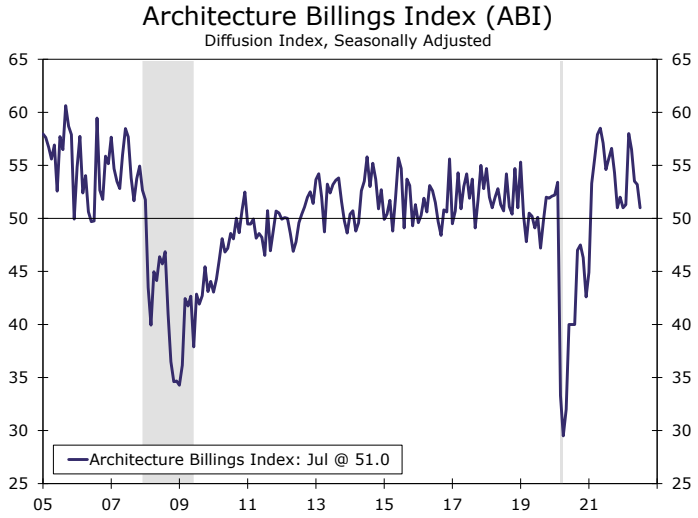
Source: U.S. Department of Commerce and Wells Fargo Economics

Modest Drop in the ABI Points to Slower Growth Ahead

The Architecture Billings Index (ABI) fell 2.2 points to 51.0 in July. The index has been in positive territory for 18 straight months, however July's drop brings the index closer to the 50-threshold below which would indicate a contraction in billings. Respondents to the survey reported that the backlog of construction projects is still growing, albeit at a slower pace. A greater share of firms believe rising material prices may lead to stalled projects. The share of firms which rated the issue of stalled, delayed or canceled projects at least “somewhat serious” clocked in at 42%.

Inflation remained as a top concern for construction firms, with 66% citing issues with rising material prices, 64% citing contractor bids being too high or construction schedules that are too long and 61% citing budget shortfalls for projects. Twenty four percent of firms cited insufficient construction budgets as their greatest single issue with high bids and long schedules coming in second at 22%. Despite recent interest rate increases, only one percent of firms reported higher financing costs as the most important reason for delays, interruptions or cancellations.

On a regional level, billings grew at a much slower pace in the West, falling to 51.7 from 57.8. The index moderated in the Midwest, falling to 52.2 from 54.8. The South saw growth accelerate slightly in July, ticking up to 53.6 from 51.5 the month prior. The Northeast, which fell into contraction territory in June, declined ever-so-slightly to 48.4 from 48.7. Concerns over construction delays and cancellations are reportedly higher among firms located in the Midwest and West



Source: American Institute of Architects and Wells Fargo Economics

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