

Economic Indicator — December 1, 2023

# Construction Spending Picks Up in October

## Residential Rises Solidly While Nonresidential Ekes Out Small Gain

### Summary

#### Residential Boosts Overall Outlays as Nonresidential Slows

Total construction spending advanced solidly during October. The 0.6% gain in overall outlays was driven by a 1.2% rise in residential spending. Despite higher mortgage rates, lean resale inventory and incentives such as rate buy-downs and price discounts have boosted sales and encouraged builders to move forward with new single-family projects. Spending on multifamily development, which dipped modestly in October, is being supported by the substantial amount of apartment and condo construction underway. A sharp pullback in new multifamily starts alongside deteriorating apartment market fundamentals and reduced credit access should bring a weaker pace of multifamily outlays in the months ahead.

Meanwhile, nonresidential spending inched up 0.1% during the month. On balance, nonresidential spending appears to be shifting into a lower gear, notably for commercial construction. In addition to knock-on effects of the pandemic, elevated financing costs, more restrictive lending and heightened economic uncertainty look to be weighing on office, retail and warehouse construction. By contrast, spending on manufacturing, education and infrastructure projects continues to strengthen alongside supply chain relocation, demographic shifts and the implementation of government spending programs.

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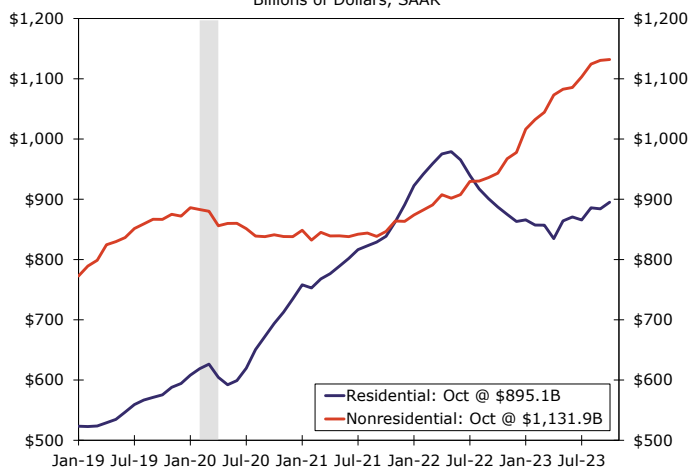
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### Residential & Nonresidential Construction

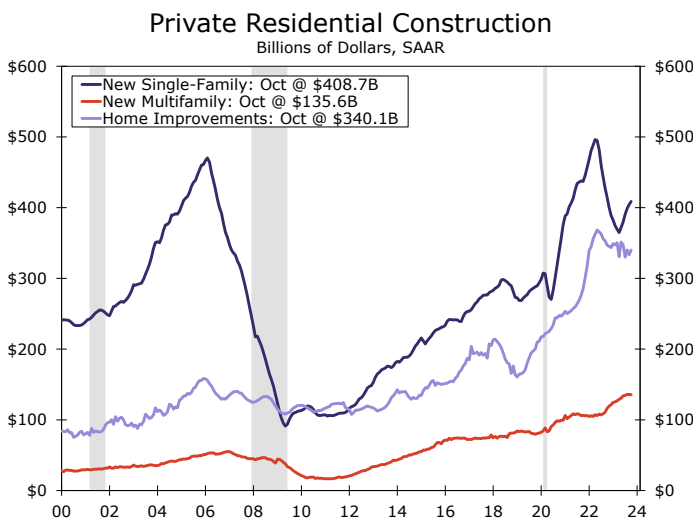
Billions of Dollars, SAAR



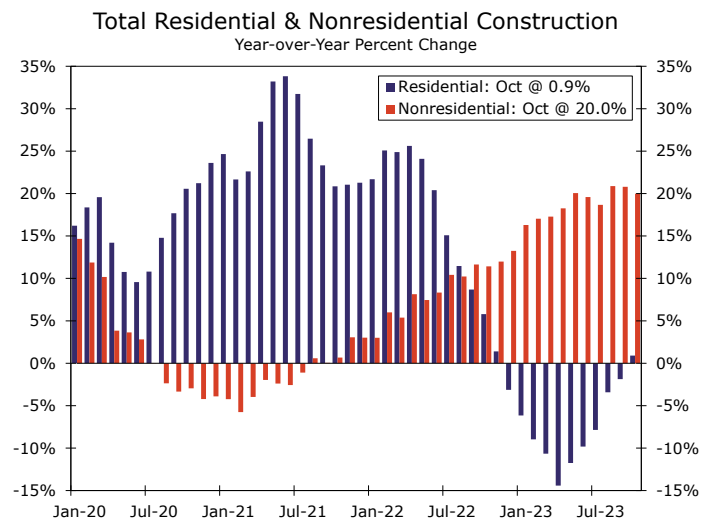
Source: U.S. Department of Commerce and Wells Fargo Economics

## Single-Family Construction Fuels Overall Increase

- A rebound in residential outlays helps explain the bulk of October's increase in construction spending. Overall residential spending rose 1.2% over the month, resulting in the first year-over-year improvement since November 2022.
- A trend improvement in single-family building continues to propel residential construction. Private single-family construction spending posted its sixth consecutive increase in October, climbing 1.1% over the month.
- Alternatively, multifamily outlays dipped for the second consecutive month as an abundance of incoming supply prompts builders to pull back on new starts. Despite October's drop, multifamily outlays remained 16.7% higher than in October 2022.
- Home improvement spending bounced back from September's drop and rose 2.0% in October. Improvement outlays tend to be quite volatile. Broadly speaking, however, households appear to be pulling back on home improvement projects amid elevated material prices, tight credit conditions and high financing costs.



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

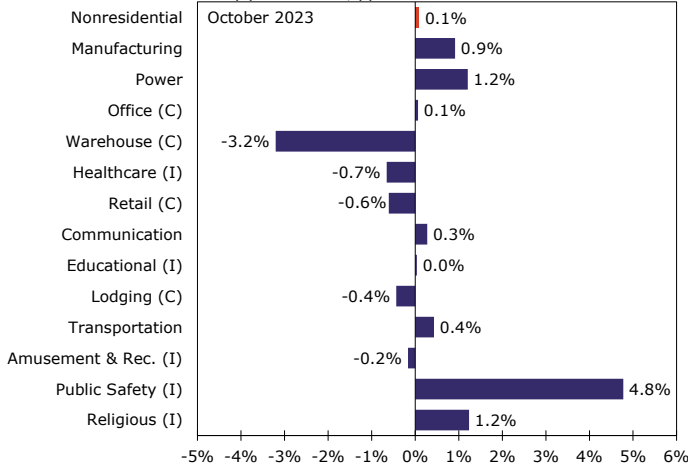


Source: U.S. Department of Commerce and Wells Fargo Economics

## Nonresidential Showing Signs of Fading

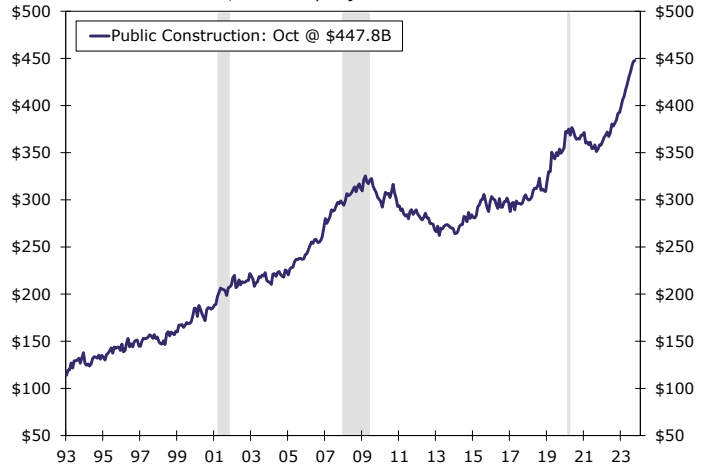
- Total nonresidential spending rose 0.1% in October. On balance, nonresidential spending appears to be shifting into a lower gear. Although spending is up 20% over the past year, October's slight improvement was the smallest gain so far this year.
- Commercial construction remained relatively sluggish in October as the reverberations of the pandemic endure, macroeconomic headwinds intensify and lending for new development remains restrictive. Lodging, retail and warehouse outlays contracted during the month, while spending on office projects remained weak.
- By contrast, spending on manufacturing construction continues to strengthen. The over-71% increase in spending over the past year has been largely driven by semiconductor fabrication plants and the build out of electric vehicle supply chains.
- Education projects have been another growth area, with spending up 0.4% in October and 18.3% over the past year. The recent rise, which has been concentrated within K-12 schools, looks to be propelled by demographic shifts, delayed maintenance projects and energy efficiency retrofits.
- Nonresidential public construction rose just 0.1% during October. Expenditures, however, are still up 16.4% over the year. Over that period, power, highway & street, transportation and educational expenditures have risen notably with the help of fiscal measures such as the Infrastructure and Jobs Act and Inflation Reduction Act.

**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 Economics

**Public Construction Spending**  
 Billions, Seasonally Adjusted Annualized Rate

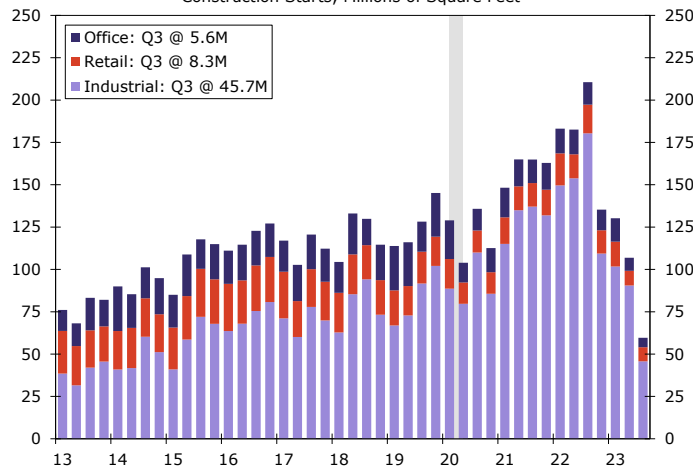


Source: U.S. Department of Commerce and Wells Fargo Economics

**Commercial Construction Pipeline Narrowing**

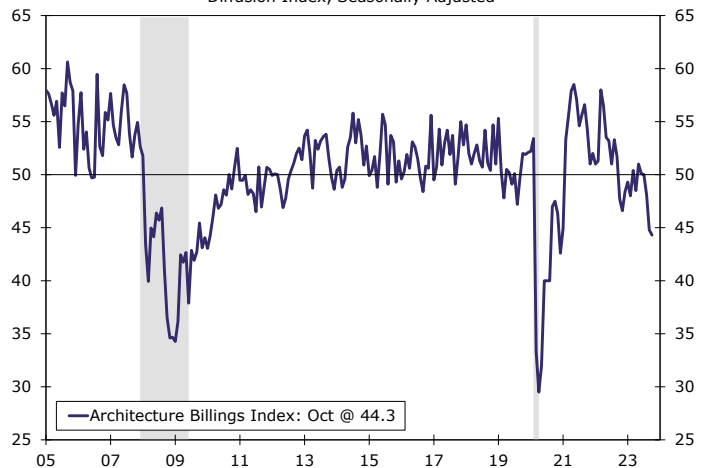
- Commercial construction looks poised to slow further in the months ahead. According to Costar, retail, industrial and office starts have all pulled back considerably this year. On the multifamily-side, new apartment starts amounted to just 77.7K units in Q3, their lowest level in 10 years.
- Business conditions at architecture firms softened further in October, pointing to a softer pace of nonresidential construction ahead. The AIA/Deltek Architecture Billings Index inched down to 44.3 as billings fell at a majority of firms.
- The pipeline of future projects also looks to be narrowing. A majority of firms reported a decline in inquiries for the first time since July 2020 as the value of new contracts fell for the third straight month. The pullback in inquiries tracks with the general downshift in commercial projects as higher financing costs weigh on development.

**Commercial Construction Downshifting**  
 Construction Starts, Millions of Square Feet



Source: CoStar Inc. and Wells Fargo Economics

**Architecture Billings Index (ABI)**  
 Diffusion Index, Seasonally Adjusted



Source: American Institute of Architects and Wells Fargo Economics

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