

Happy New Year?

The construction market outlook for 1990 has both good news and bad. Here's a rundown by region and by type of construction.

After the roller coaster ride experienced by the construction industry for most of this decade, the current stage of the construction cycle seems like pure tranquility. Nonresidential construction spending has been flat over the past year; through July, construction levels were up a mere 0.8 percent in inflation-adjusted dollars compared to year-ago levels.

Unfortunately, this does not mean the entire construction industry is enjoying stable activity levels. The region diversity that has been with us for several years now continues, only with a slightly different twist.

As the Frostbelt begins to cool off and the Sunbelt revives, less regional diversity is being seen. However, the construction sectors within a region used to move in roughly the same direction. Now, more diversity by type of construction is being seen within a region.

The Frostbelt regions are facing flat levels of commercial construction, declining levels of institutional construction, and rapidly increasing levels of industrial activity. The Sunbelt is experiencing declining commercial, flat industrial, and growing institutional construction levels.

While overall economic growth levels are evening nationally, some disparate trends continue to affect individual construction sectors. Institutional construction levels are driven primarily by demographic trends and population growth in the Sunbelt continues to be much stronger.

The traditional manufacturing base of the Frostbelt (particularly the Midwest) has benefitted from the surge

	Actual		Forecast		Annual % Change			
	1988	1989	1990	1991	'88/'87	'89/'88	'90/'89	'91/'90
Total	350.5	353.0	377.7	405.5	+2.2	+0.7	+7.0	+7.4
Res.	138.9	139.7	158.1	175.6	-0.7	+0.5	+13.2	+11.1
Nonres.	124.3	127.1	128.3	134.0	+6.1	+2.0	+1.0	+4.4
Nonbldg.	87.0	86.2	91.3	96.0	+1.3	-1.2	+5.9	+5.1

*Construction figures exclude improvements to existing buildings.
Source: U.S. Commerce Department; Forecast: Cahners Economics.*

in exports. Moreover, the growth in manufacturing construction has been strongest in areas where the manufacturing base is the most concentrated.

Finally, the regional levels of commercial construction are residuals of economic growth over the past few years. The growth temporarily favors the Frostbelt, but will reverse in the near future.

Growth temporarily favors the Frostbelt, but will reverse.

	Northeast	Midwest	South	West
Total Nonres.	2.6	-3.6	-5.1	-4.3
Commercial	0.7	2.8	-10.2	-4.3
Institutional*	-9.0	-24.2	20.8	10.2
Industrial	16.5	30.8	4.3	-5.2

**includes hospital, health care, and educational facilities.
Source: U.S. Commerce Department.*

Economic Outlook
(Annual % Change)

	Forecast				
	Q1/89	Q2/89	1989	1990	1991
Gross National Product	+3.7	+2.7	+2.3	+2.4	+3.0
Personal Consumption Expenditures	+2.0	+2.2	+1.9	+1.8	+3.1
Durables	-1.1	+5.5	+2.2	+3.0	+3.4
Nondurables	+1.3	-2.2	+0.5	+1.8	+3.0
Business Fixed Investment	+6.9	+8.2	+2.3	+1.3	+3.1
Equipment	+9.6	+14.3	+4.0	+1.6	+3.4
Structures	-1.0	-8.9	-3.0	+0.7	+2.3
Residential Investment	-5.0	-12.6	-1.2	+4.7	+4.5
Government Purchases	-3.3	+6.3	+2.5	+1.0	+1.7
Exports	+14.0	+11.3	+8.9	+5.6	+7.9
Imports	-0.4	+8.7	+4.8	+4.0	+5.3

All calculations % change in 1982 \$; Quarterly figures seasonally-adjusted annual rates. Source: U.S. Commerce Dept.; Forecast: Cahners Economics.

General Economy Strong

According to the preliminary report on the Gross National Product, the economy grew at a 2.7 percent rate during the second quarter of 1989—compared to 3.7 percent for the first quarter.

A slowing inventory build-up was primarily responsible for the slower growth in the overall economy. After adjusting for differential inventory growth levels, the economy grew at almost the same rate during the second quarter as during the first.

Improvements in trade and producers durable equipment continue to provide the main strength in the economy, as they have for two years now. Yet the composition of economics has changed. For one thing, consumer expenditures for durable goods—such as cars, furniture, and appliances—have revived.

Spending increases accounted for more than 20 percent of the growth in the economy during the second quarter, largely as a result of declines in interest rates. Spending for consumer durables declined in real terms when interest rates were rising.

Thirty-year fixed-rate mortgages (FRMs) hit a low of 9.7 percent in early August 1989, according to the Freddie Mac national mortgage survey. Meanwhile, one-year adjustable-rate mortgages (ARMS) fell to 8.6 percent at about the same time. Since then, both types of mortgages have risen slightly.

This turnaround has resulted from indications of strength in the economy. After almost universal weakness in economic indicators between March and mid-July 1989, signals became mixed. The July trade figure was unexpectedly strong, while housing starts for June and July showed solid rebounds.

More recent releases for the government's index of leading indicators and employment figures have both confirmed there is more strength than expected in the economy. The Federal Reserve has responded by moving to stabilize interest rates until the economy shows further evidence of weakening. With this scenario, interest rates should continue to fall well into 1990.

Residential Construction

The outlook for residential construction has improved dramatically in recent months. With the Federal Reserve Board continuing its less-restrictive monetary policy, plus small but

measurable gains in overall economic activity, residential construction should gain momentum in the months ahead.

Residential starts should total 1.46 million by the end of 1989, a modest 2 percent decline from the 1988 level. Construction of single-family homes should about equal the 1988 figure, though some decline is expected in the over-built multifamily sector.

For 1990, residential starts should increase 3.7 percent from the 1989 level. Multifamily starts should start plateauing at about 380,000 units, with single-family construction reaching a level of more than 1.13 million homes.

Affordability continues to be a problem for median-income households, especially in the Northeast. While the median-priced new home in the United States sold for \$119,000 during the first half of 1989, the median value of a new house in the Northeast was 56 percent higher at \$186,200. Not surprisingly, then, Northeast housing starts for the period were 23.8 percent below year-ago levels—while the value of new residential construction permits was down 17.6 percent.

While 81 percent of new homes in the Northeast sold for more than the national median price, 70 percent in the South sold for less. In that region, during 1989's first half, housing starts were down only 1.2 percent below year-ago levels, while the value of construction permits rose 2.1 percent. For the same period, the West and Midwest saw housing starts increase 1.7 percent and 6.5 percent, respectively, as permit values went up by zero and by 12.9 percent.

High housing costs have meant an ever-increasing share of construction

Housing Starts
(Thousands of Units)

	Actual		Forecast		Annual % Change			
	1988	1989	1990	1991	'88/'87	'89/'88	'90/'89	'91/'90
Total	1488	1459	1513	1520	-8.1	-2.0	+3.7	+0.5
Single-Family	1081	1083	1134	1139	-5.7	+0.2	+4.6	+0.5
Multi-Unit	407	375	380	380	-14.2	-7.7	+1.2	+0.2

Source: U.S. Commerce Department; Forecast: Cahners Economics.

dollars are going to remodeling, repairing, and maintaining existing residential structures. Although higher interest rates caused a slowdown in spending on these projects during 1989, high rates of growth should resume throughout the 1990s.

Lower financing costs, continued growth in household income, and improved sales of existing homes, will combine to raise 1990 remodeling spending to a level of \$114.4 billion—9.3 percent above the total expected for 1989.

Nonresidential Construction

After a surprisingly strong showing in 1988, the gain in non-residential construction for 1989 should be about half as large. The weakness should continue into 1990, before momentum picks up in 1991. (However, after adjusting for inflation, spending on new nonresidential buildings is unlikely to show any growth during the next two years.)

Here is a detailed market outlook:

Office. Although development will remain strong in some parts of the nation—most notably Washington, D.C., and southern California—the generally over-built office building construction market will limit growth over the next two years. Spending in 1989 should show little or no increase overall, with a decline likely in 1990. But in 1991, office construction spending should again approach the level recorded in 1988.

Retail. Recent spending trends for this sector make evident the relationship between new residential construction and the development of new retail shopping centers. Total retail construction will decline about 1 percent for 1989, but marginal growth is anticipated through 1990 and 1991.

Hotel and Motel. The Northeast remained weak in 1989, but healthy gains were recorded in both the South and the West. Slow improvements should continue in 1990 and 1991, with spending gains average between 2 percent and 4 percent nationally.

Industrial. Spending on industrial space grew faster in 1989 than for any

	Actual		Forecast		Annual % Change			
	1988	1989	1990	1991	'88/'87	'89/'88	'90/'89	'91/'90
Total Nonres.	124.3	127.1	128.3	134.0	+6.1	+2.0	+1.0	+4.4
Commercial	64.9	64.8	63.3	65.5	+3.3	-0.2	-2.3	+3.6
Office	28.0	28.1	26.1	27.2	+6.1	+0.2	-7.2	+4.3
Retail	30.1	29.8	30.1	31.0	+3.6	-0.9	+1.1	+2.9
Hotel & Motel	6.8	6.9	7.0	7.3	-8.0	+1.2	+2.5	+4.3
Industrial	14.9	15.6	15.8	16.5	+8.9	+4.7	+1.1	+4.2
Institutional	44.5	46.7	49.2	52.0	+9.5	+4.3	+5.5	+5.6

Source: U.S. Commerce Department; Forecast: Cahners Economics.

other nonresidential construction sector. However, demand for new industrial space will moderate in the next few years, bringing spending growth more in line with other nonresidential building sectors.

Institutional. Spending on hospitals, schools, and other institutional buildings has been strong in recent

years. However, the expected growth rate for 1989 is half the previous years', while gains of about 5.5 percent annually should continue in 1990-91.



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