TRUMP WILL BE GOOD FOR CONSTRUCTION IN THE NEAR TERM; LONGER TERM IS LESS CLEAR

The near-term implications of a Trump presidency for nonresidential construction activity appear to be a net positive.

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The construction spending outlook for 2017 has improved with the election. Economists, pundits, and most of the United States have been puzzling over what the election results from this past November will mean for the country, both in terms of public policy and economic performance. President Donald Trump has indicated that he plans to slash corporate and personal income taxes, renegotiate trade deals with U.S. partners, end commitments to follow certain environmental rules, follow through with his promises on immigration reform, partially deregulate banking, and make it easier to tap into U.S. oil and natural gas reserves. He's also promised an infrastructure-led stimulus package and significant reforms to U.S. health insurance setup.

Trump and his coterie of advisors believe these moves will supercharge the sluggish U.S. economy, which has failed to expand at more than a 3 percent pace or better since the middle of the last decade. Whether these policies will ramp up the national debt, initiate trade wars, and/or accelerate inflation, only time will tell. In the near term, the U.S. economy is expected to enjoy added stimulus even as the country already approaches full employment. The stimulus the president promises will likely push prospective economic weakness back toward the end of the current decade, possibly beyond. When the next recession does arrive, however, it may be much deeper than it otherwise would have been.

For now, equity markets are ebullient. Some of the rise in stock prices was perfectly predictable. After all, if corporate taxes are reduced, corporate after-tax

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profits will also rise, all things being equal. That translates into healthier balance sheets and perhaps larger dividends, which renders holding U.S. equities more valuable.

But there's something more at work. Economists have a tough time accounting for the impact of the so-called animal spirits, but they know that psychology plays a critical role. CEO sentiment has improved markedly since the November 8 election.[1] The notion among many is that the period of stagnant growth in the United States is coming to an end. The next few years will be associated with faster economic growth and more inflation, which jointly create better opportunities for companies to boost corporate earnings. That altered expectation may translate into more business investment today as corporations seek to position themselves to take full advantage of the faster growth to come.

Those who were following the polls and coverage in the leadup to the election saw that general consensus had Clinton winning handily, as well as the Democrats winning enough seats to retake the Senate. With Republicans holding onto the House, divided government was to remain in Congress. With Trump's victory as well as Republicans holding onto the Senate, one party controls both the executive and legislative branches of government.

The night of the election, as a Trump presidency became more and more likely, the Dow Futures slumped, dropping 5 percent (roughly 800 points) overnight. Many other global markets had similar reactions, such as the Nikkei stock exchange, which closed down 5.4 percent, and the Financial Times Stock Exchange, which dropped 2 percent when it opened on Wednesday, although it did recover by the end of the day.[2]

Financial markets rebounded the next day, and the Dow Jones closed 256 points higher for the day, nearing an all-time high in the process. In fact, the 1.1 percent increase in the Dow marked the first time since 2004 the market did not drop the day following the presidential election.[3]

Construction spending growth set to accelerate

In terms of construction, Donald Trump, first as a candidate and again as president-elect, has made it clear that revamping the nation's infrastructure is high on his list of priorities. He has proposed a $1 trillion stimulus plan (spread over 10 years) and endeavors to support more public–private partnerships (P3s) to help finance infrastructure projects.[4] Part of this private capital would come back to the United States from abroad, thanks to a proposed foreign profits tax holiday.

Donald Trump has also proposed to supply $137 billion in federal tax credits to private investors who back transportation projects.[5] He has indicated that he wants to streamline construction projects by eliminating the "mountain of red tape" investors routinely face.[6]

Much of this is likely to represent a source of optimism for those who manage construction firms. However, economists can always find ways to defend a glass half empty posture. First of all, it is not clear when an infrastructure package will be submitted for congressional approval, how large it will be, or whether it will actually pass at all. Many in Congress are likely to express concerns regarding the impact of such a package on the federal budget deficit and the national debt. Some are also likely to point out that the American Recovery and Reinvestment Act, the stimulus package passed in February of 2009, ended up generating underwhelming impact on economic growth.

There are also concerns regarding the related specters of higher inflation and interest rates. The economy is now in its eighth year of recovery. Unemployment is neatly less than 5 percent.[7] Wage pressures are building, partly due to a wave of minimum wage increases being passed in communities across the nation. Healthcare costs have also been rising in recent months, as have energy prices. Tax cuts and more federal spending would place additional strain on available productive resources, including human capital. The result could be meaningful

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increases in borrowing costs, which would ultimately suppress both private and public construction activity. At the time of this writing, the yield on the 10-year Treasury had surged to around 2.5 percent, while the average rate on a 30-year fixed rate mortgage is now easily above 4 percent.[8]

Construction firm operators have also expressed concerns regarding the new president's positions on immigration and trade.[9] Construction would stand to be among the three most impacted industries in the wake of a crackdown on illegal immigration, along with hospitality and agriculture.

Many construction firms use foreign workers who have been granted temporary work visas. Stiffer restrictions on the movement of workers would presumably translate into faster increases in construction worker compensation without there necessarily being an offsetting increase in productivity. Construction executives have already been expressing concerns regarding the stagnant construction workforce for years, and the pace of craft worker retirement will be elevated over the next several years.

CONSTRUCTION EXECUTIVES HAVE ALREADY BEEN EXPRESSING CONCERNS REGARDING THE STAGNANT CONSTRUCTION WORKFORCE FOR YEARS, AND THE PACE OF CRAFT WORKER RETIREMENT WILL BE ELEVATED OVER THE NEXT SEVERAL YEARS.

There are other worrisome considerations. Slapping tariffs on foreign products could also negatively impact construction firms by increasing the price of building materials and other inputs. The result could be more slender profit margins even in the presence of higher levels of construction activity.

Conclusion

The near-term implications of a Trump presidency for nonresidential construction activity appear to be a net positive. The recovery in the United States from the Great Recession has been genuine but slow. One of the reasons for this has been a general lack of private and public investment growth. The recovery has largely been dependent upon growth in consumer outlays, which in turn has been heavily reliant upon low interest rates.

U.S. economic recovery appears set to broaden. Although export growth could stumble in the wake of a much stronger U.S. dollar, business and public investment is set to rise. That will translate into ongoing growth in nonresidential construction spending even in the context of rising interest rates.

However, beyond the initial period of positivity, there are concerns. No one can know for sure what the impact of financial deregulation would be, although many businesspeople are delighted by the idea presently. Moreover, tax cuts without matching cuts in spending will cause the budget deficit to grow in the absence of a rapid acceleration in economic growth. There are many economists who believe that proposed tax cuts will not produce enough increases in economic activity to offset the effect of lower corporate and personal income tax rates. Ultimately, that may translate into a reversal of the tax cuts presently being proposed. Alternatively, there could be reductions in government outlays, which could easily translate into diminished infrastructure investment over the longer term.

The nation's energy sector represents another source of uncertainty. Partial deregulation will reduce compliance costs, which would boost production, all things being equal. Greater oil and natural gas output could cause prices to fall, which in turn would result in a flattening of both production and investment.

Bottom line — the majority of construction firm operators should look forward to a robust 2017. However, these same business leaders need to carefully monitor wage growth, energy prices, overall inflation, interest rates, monetary policy, budget deficits, bank financial performance, and fiscal policy to help determine whether risks to the construction spending cycle are beginning to emerge. ■

NOTES

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