MATERIALS PRICES ON THE RISE:

After years of fretting about shortages of skilled craftspeople, construction industry leaders have a new source of concern — materials prices and distortionary public policies.

RECENT INCREASES MAY REPRESENT TIP OF THE ICEBERG

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Given an improving global economy, rising construction backlog, a weaker U.S. dollar, ongoing efforts by the Organization of the Petroleum Exporting Countries to artificially limit oil production, and a growing number of trade disputes involving the United States, it perhaps comes as little surprise that construction input prices are on the rise. This represents a far cry from 2015 and 2016.

Beginning in mid-2014, global commodity prices began to slump, in part because of the end of a construction bonanza that had taken place in China, the world's second largest economy. The result was slumping global demand for fuel, steel, copper, and a variety of other commodities.

With Chinese production of steel and aluminum contending with diminished demand from Chinese customers, Chinese output began flooding global markets, leading to shrinking commodity prices. The combination of weak demand and rising production capacity in the United States and elsewhere also impacted international energy markets and prices. The price of oil, which easily exceeded $100/barrel during the early summer of 2014, fell to dollar values in the mid-20s by early 2016.

This period coincided with a period of declining construction materials prices. Between September 2014 and September 2015, the inputs to construction producer price index slid by more than 5 percent.

However, after that period, materials prices began to stabilize. By early 2016, oil prices were marching higher. The price of natural gas stabilized and then began to ascend. The same was true of

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steel, copper, and other key inputs to construction.

According to the most recently available data, construction input prices have increased nearly 5 percent over the past year. Certain input prices have increased sharply. For instance, according to January 2018 producer price index data, crude petroleum prices have increased by more than 30 percent, softwood lumber by nearly 15 percent, nonferrous wire and cable by more than 8 percent, and iron/steel by more than 6 percent.

Softwood lumber prices have been driven higher in part due to an ongoing trade dispute between the United States and Canada. Last summer, the U.S. government announced that it would impose additional punitive tariffs on imports of Canadian softwood lumber of as much as 7.7 percent. That move followed the government's decision in April 2017 to slap tariffs of up to 24.1 percent on shipments from Canadian companies, including West Fraser Timber Company and Canfor Corporation.[1]

While such moves may uplift the spirits of U.S. producers of lumber, users of that lumber have been significantly less enthusiastic. Earlier this year, the National Association of Homebuilders published results of a survey regarding the biggest challenges builders expect to encounter in 2018. Topping the list is the cost/availability of qualified workers and materials prices, with 84 percent of builders listing each as a potential problem.[2] To put that into context, back in 2011, when the nation's unemployment rate was 8.9 percent and the U.S. economy remained stuck in 2 percent growth mode, only 13 percent of builders identified building materials prices as an issue. However, between 2016 and 2017, the percentage of builders viewing materials prices with concern surged from 48 percent to 77 percent.[3]

ACCORDING TO THE MOST RECENTLY AVAILABLE DATA, CONSTRUCTION INPUT PRICES HAVE INCREASED NEARLY 5 PERCENT OVER THE PAST YEAR.

In January 2018, U.S. construction firms added a net 36,000 workers to their payrolls. The implication is clear: Construction work abounds, leading to expanding staffing levels. Still, this implies that demand for materials will also be on the rise. With construction wages growing more rapidly, and with materials prices ramping higher, estimators will need to be especially thoughtful and farsighted in 2018.

Moreover, this is not simply about economics. The direction of economic activity is difficult to predict, but shifts in policymaking are perhaps even more so. Rising materials prices come with additional concern regarding burgeoning trade disputes.

In February, the U.S. Department of Commerce recommended the imposition of heavy tariffs and/or quotas on steel and aluminum imported into the United States. Recommendations advocated for either (1) a tariff of 24 percent on all imported steel; (2) a targeted 53 percent tariff on 12 countries including China and Brazil; or (3) a quota on all imported steel. U.S. Secretary of Commerce Wilbur Ross also recommended a 7.7 percent tariff on aluminum imports, with targeted tariffs on the likes of China, Hong Kong, Russia, Venezuela, and Vietnam.[4]

Some implications are obvious, but others are less so. The most apparent outcome of such policymaking would be sharply higher steel and aluminum prices. This would impact private and public construction alike given that structural steel is used in both infrastructure and building construction.

The effects of such policymaking would probably not end there. Higher prices would contribute to expanding inflationary pressures in the broader economy, which in turn would produce more rapid increases in interest rates. Higher borrowing costs, including for both government agencies and private developers, would eventually translate into less demand for construction services, all things being equal.

There would also likely be retaliation by the trading partners of the United States. That would soften export growth, which in turn would slow current economic momentum. The U.S. auto sector, a major source of demand for contractors, would be doubly impacted. Domestic producers would be hampered by higher steel and aluminum prices even as their exports likely slumped. None of this would benefit the average U.S. construction firm.

By early March, the Trump administration was turning the Commerce Department's recommendations into action, announcing that the U.S. will impose tariffs on steel and aluminum almost immediately. There will be a 10 percent tariff on aluminum and a 25 percent tariff for steel. The Dow Jones Industrial Average responded by giving back 420 points on March 1, 2018.

The Department of Commerce's recommendations regarding steel and aluminum continue a pattern of anti-trade sentiment emerging from Washington, D.C. Some characterize these positions as being in the interests of "fair trade." Naturally, no one would oppose the concept of fair trade. There is no reason that U.S. producers should be treated unfairly. If the U.S. marketplace is open to a particular nation, that nation should open its markets to U.S. exporters.

However, pursuit of fair trade does not seem to explain the totality of policy emerging from the nation's capital. For instance, the White House announced that it was pulling out of Trans-Pacific Partnership (TPP) negotiations early last year. One might have thought that a better fair trade strategy would have been to aggressively participate in negotiations with nations like Australia, Japan, Canada, Vietnam, Mexico, and Singapore. By pulling out of negotiations, it is quite possible that a TPP deal will be reached by the remaining nations, and this may result in a negative outcome for U.S. producers and consumers. The United States, after all, is no longer at the negotiating table to defend its interests. Put simply, by pulling out of negotiations, the chances of unfair trade go up, not down, from the perspective of the United States. This ultimately could translate into both shrunken export markets and higher prices paid for imports, including construction materials.

Meanwhile, current trade deals (like the North American Free Trade Agreement and a free trade deal with South Korea) are under intense scrutiny. The elimination of trade agreements with these nations and others can result in higher prices for both raw materials and engineered construction components, thus raising the cost of delivering construction services in the process.

In sum, after years of fretting about shortages of skilled craftspeople, construction industry leaders have a new source of concern — materials prices and distortionary public policies. These dynamics represent another reason to believe that the economic environment for contractors will become more challenging over the next two to three years. ■

NOTES

[1] Skeritt, J., "U.S. duties on softwood lumber brings price surge, profit to Canada," TheStar.com (Sept 20, 2017). Available at: https://www.thestar.com/business/2017/09/20/us-duties-on-softwood-lumber-brings-price-surge-profit-to-canada.html.

[2] Chaluvadi, A., "Building materials prices and labor access top challenges for 2018," National Association of Home Builders (Jan 16, 2018). Available at: http://eyeonhousing.org/2018/01/building-materials-prices-and-labor-access-top-challenges-for-2018/?_ga=2.230183772.1953659907.1519423242-629179351.1519423242.

[3] *Ibid.*

[4] Tausche, K., "Commerce Department calls for Trump to impose steep tariffs or quotas on foreign steel and aluminum," CNBC.com (Feb 16, 2018). Available at: https://www.cnbc.com/2018/02/16/commerce-department-suggests-trump-impose-steep-tariffs-or-quotas-on-foreign-steel-and-aluminum—sources.html.