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Private Work Remains Abundant while Public Work Stagnates

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U.S. Economic Recovery Enters its Ninth Year

If one were casting for the movie "The Tortoise and the Hare," the U.S. economy would be a favorite to play the tortoise. For the most part, economic growth remains slow, but persistent.

Perhaps comparing the U.S. economy to a turtle is a bit harsh. Based on recently revised data characterizing gross domestic product, by expanding 2.9 percent in 2015, the U.S. economy came close to the magical 3 percent threshold; a threshold it has failed to cross since 2005. In 2014, the U.S. economy expanded 2.6 percent.

However, last year, the U.S. economy expanded just 1.5 percent. It then began the new year by expanding 1.2 percent during 2017's initial quarter on an annualized basis. In other words, for more than a year, the U.S. economy has been consistently growing at less than 2 percent.

That changed, at least temporarily, during the second quarter of 2017. Based on initial estimates from the Bureau of Economic Analysis, the U.S. economy expanded 2.6 percent on an annualized basis during the April-June quarter. As has been the case for several years, much of the growth was driven by consumer outlays. Government spending, by contrast, continues to contribute little if anything to the current pace of economic expansion.

While output growth has generally remained soft, the nation has continued to add jobs at a healthy clip. After adding 233,000 jobs in June, the nation added another 209,000 in July. These numbers are important for what they tell us about the demand for human capital, but they are perhaps even more important for what they reveal about the supply of labor.

With the nation's unemployment rate now well below 5 percent (4.3 percent in July 2017), economists and others have generally concluded that the nation is close to full employment. As available human capital continues to be siphoned off through monthly job growth, the pace of job creation will presumably soften and wage growth will accelerate. Many economists had expected by now that the nation would suffer increasing difficulty exceeding 200,000 net new jobs created per month and would be experiencing accelerating wage growth.

That hasn't happened. Labor force growth has been fast enough to support solid job growth, and wage growth has remained stable. Over the past year, average hourly earnings are up 2.5 percent on a year-over-year basis. That general pace hasn't moved much over the past few quarters and falls short of the hourly earnings growth that typifies a solidly performing economy. During the months preceding the most recent recession, wage growth was consistently over 3 percent. Since 2009, when the economy began its recovery, wage growth has only expanded at a rate of 2.2 percent a year. This is less than wage growth seen in the 1980s (3.3 percent), 1990s, (3.2 percent), and the 2000s (3.0 percent).

The fact that wage growth has failed to accelerate represents one of the great economic mysteries of our time. With construction firm owners, trucking companies, manufacturers, and others complaining bitterly about the dearth of skilled and trainable talent, why are wages not rising more rapidly in an environment characterized by immense labor scarcity?

There is no shortage of potential explanations. These include globalization, a decrease in the influence of unions, and overall slower productivity growth. All these explanations are likely valid to some extent, but a more likely explanation lies in demographics.

I hope all of our readers have enjoyed a productive and profitable summer and, as we enter its dog days, have their eyes towards the coming quarters and the work ahead. So what's in store for us? Well, if you read our experts and their research, the answer is…. it depends. For those of us building or supporting the construction of office buildings, laboratories, fulfillment centers, and other commercial projects, the trend is good. Low interest rates and, consequently, higher risk appetites have driven more and more investment into the commercial construction space, as you'll see in this quarter's Marcum index. Conversely, in the public sector, the infrastructure boom we have been waiting for has not arrived yet. In fact, in June, the only two construction contractor subsectors with double-digit improvement were Commercial and Office and, of all 16 subsectors we measure, 11 showed negative growth year-over-year, including all of the public segments (public safety, highway and street, water supply, sewage and waste disposal, and conservation and development).

The good news? Business attitudes and the business environment and confidence remain high for now. Backlogs (in the private sector) are healthy. Investment is robust. It's my hope that we can turn some of this momentum towards infrastructure, sooner rather than later.

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With roughly 10,000 Baby Boomers turning 65 each day, the number of retirees continues to grow. Increasingly, as younger workers replace older ones, labor costs subsequently fall. Additionally, this helps explain the surprisingly strong corporate profitability, even as the nation's economy only expands at a rate of 2 percent and while the global economic growth remains well below 4 percent.

While it is true that the Dow Jones Industrial Average and other financial indicators have rocketed to all-time highs in 2017, overall economic performance is hardly altered from what it has been for years. Through July, national job growth is averaging 184,000 per month, not far removed from the 196,000 average that characterized a comparable period in 2016.

Exhibit 1. *Nonresidential Spending, June 2017, Millions of dollars, Seasonally Adjusted Annual Rate*

Subsector	June 2017	1-month % Change	12-month % Change	36-month % Change
Nonresidential	**$696,993**	**-2.0%**	**-3.1%**	**18.4%**
Commercial	$84,980	-1.2%	13.0%	56.6%
Office	$72,974	1.9%	11.0%	64.1%
Communication	$22,365	2.8%	4.9%	43.5%
Health care	$39,516	-0.2%	2.8%	1.4%
Lodging	$27,923	-0.1%	-0.2%	80.7%
Amusement & recreation	$23,436	-1.2%	-0.7%	40.3%
Public safety	$7,624	-6.5%	-4.0%	-17.9%
Educational	$86,767	-4.3%	-6.1%	14.7%
Manufacturing	$68,554	-1.8%	-7.3%	36.0%
Highway & street	$82,727	-6.4%	-8.1%	9.8%
Religious	$3,360	-1.7%	-8.1%	-11.1%
Transportation	$41,342	-2.1%	-8.7%	2.0%
Power	$99,090	-1.2%	-9.9%	-4.5%
Water supply	$11,321	-3.7%	-16.4%	-11.3%
Sewage & waste disposal	$18,487	-2.4%	-16.8%	-15.9%
Conservation & development	$6,529	-7.3%	-20.6%	-19.8%

Source: United States Census Bureau

Construction firm operators and many other businesspeople are likely disappointed that the broad trajectory of the economy hasn't fundamentally changed. Coming into the year, conventional wisdom suggested that the new administration in Washington, buoyed by a favorably inclined Congress, could put forth and begin to implement a highly pro-business agenda that, among other things, included much-needed corporate tax reform and an infrastructure-led stimulus package driven primarily by public-private partnerships.

Based on survey data, despite difficulty implementing that pro-business agenda, business confidence remains high. That confidence, combined with plentiful liquidity and low interest rates, has helped to spur another round of private development, often taking the form of fulfillment centers, data centers, office buildings, and hotels.

Though overall nonresidential construction spending was actually 3.1 percent lower in June 2017 relative to June 2016, commercial construction, which encompasses much of the e-commerce boom, was up 13 percent year-over-year and office construction was up 11 percent. Hotel construction, which had been a leading driver of private construction spending growth, appears to have cooled of late, but is up 81 percent over the past three years. According to the American Institute of Architects, architectural firms continued to "report strong business conditions to start the summer… firms continue to report robust backlogs… and indicate a steady supply of work in the pipeline."

The implication is that a number of private construction segments are poised for continued growth over the near- and mid-terms. This is especially true in the nation's most rapidly expanding regions, including metropolitan areas like Denver, Nashville, and Charlotte.

Exhibit 2. *Construction Employment Growth, Twenty Largest U.S. Metropolitan Areas June 2016 v. June 2017, Not Seasonally Adjusted*

Rank	MSA	Percent Change	Rank	MSA	Percent Change
1	Riverside-San Bernardino-Ontario, CA	19.7%	11	Phoenix-Mesa-Scottsdale, AZ	3.9%
2	Tampa-St. Petersburg-Clearwater, FL	11.7%	12	Philadelphia-Camden-Wilmington, PA-NJ-DE-MD*	3.5%
3	Detroit-Warren-Dearborn, MI*	11.6%	13	New York-Newark-Jersey City, NY-NJ-PA*	1.5%
4	San Francisco-Oakland-Hayward, CA	8.1%	14	Baltimore-Columbia Towson, MD*	1.1%
5	San Diego-Carlsbad, CA	7.6%	15	Dallas-Fort Worth-Arlington, TX*	1.0%
6	Los Angeles-Long Beach-Anaheim, CA	6.4%	16	Chicago-Naperville-Elgin, IL-IN-WI	0.9%
7	Atlanta-Sandy Springs-Roswell, GA	5.2%	17	Boston-Cambridge-Nashua, MA-NH*	0.7%
8	Miami-Fort Lauderdale-West Palm Beach, FL	5.0%	18	Washington-Arlington-Alexandria, DC-VA-MD-WV*	0.0%
9	Minneapolis-St. Paul-Bloomington, MN-WI*	4.9%	19	Houston-The Woodlands-Sugar Land, TX	-2.4%
10	Seattle-Tacoma-Bellevue, WA	4.4%	20	St. Louis, MO-IL*	-3.8%

**Construction, Mining, and Logging are included in one industry; Source: Bureau of Labor Statistics*

Weakness in construction spending continues to be concentrated in public segments. For instance, construction spending in the conservation and development category, a segment that includes efforts at flood control, is down 20 percent over the past three years. Declines in public construction spending are also apparent in categories like sewage and waste disposal, water supply, transportation, highway and street, education, and public safety.

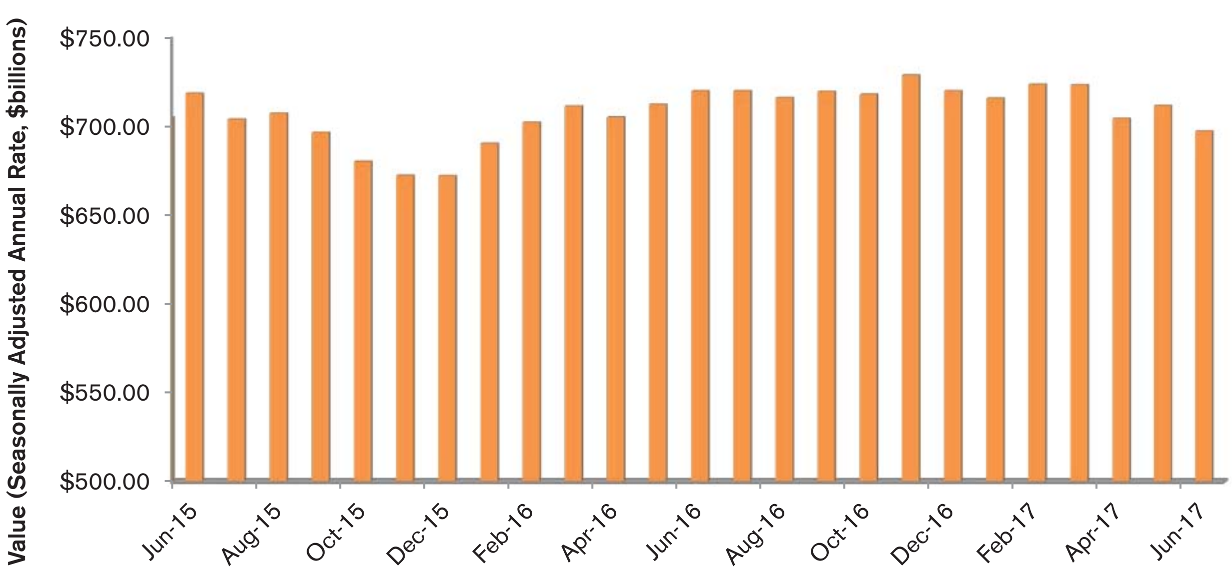
Private Construction Outlook Remains Benign

The key to the economic outlook is... inflation. The lack of inflation over the past several quarters has allowed the Federal Reserve to alter its pro-growth monetary policies only gradually. With interest rates remaining near rock-bottom levels, investors have been chased up the risk spectrum, including into commercial real estate. That has helped to raise property values and to prompt new construction. These dynamics have also helped lift industry backlog and supported reasonably solid profit margins. According to Associated Builders and Contractors' widely followed Construction Backlog Indicator, average industry backlog rose to 9 months earlier this year, with all major industry segments exhibiting rising average backlog.

Low inflation has also helped support equity and bond prices in the U.S., which in turn has triggered positive wealth effects. This, in turn, has supported consumer spending along with job growth. For now, America's consumer-led recovery remains firmly in place.

Whether America can get back to 3 percent growth will have much to do with Washington, D.C. For now, the pro-business agenda remains largely theoretical. Ongoing political intrigue could continue to jeopardize that agenda, leaving the economy increasingly vulnerable in 2018, 2019 and/or 2020.

Exhibit 3. *Nonresidential Construction Spending, June 2015 through June 2017*



Sources: U.S. Census Bureau

Second Quarter 2017 Performance		Values		% Change from	
Gross Domestic Product	**2017Q2[1]**	**2017Q1**	**2016Q4**		
Overall Real GDP	2.6%	1.2%	1.8%	NA	NA
Nonresidential Fixed Investment in Structures	4.9%	14.8%	-2.2%	NA	NA
Construction Spending, Seasonally Adjusted (in $millions)	**June-17**	**May-17**	**June-16**	**May-17**	**June-16**
Total Construction	$1,205,788	$1,221,609	$1,186,402	-1.3%	1.6%
Residential	$508,795	$510,232	$466,870	-0.3%	9.0%
Nonresidential	$696,993	$711,377	$719,533	-2.0%	-3.1%
Lodging	$27,923	$27,962	$27,966	-0.1%	-0.2%
Office	$72,974	$71,584	$65,765	1.9%	11.0%
Commercial	$84,980	$86,046	$75,188	-1.2%	13.0%
Health care	$39,516	$39,592	$38,422	-0.2%	2.8%
Educational	$86,767	$90,693	$92,420	-4.3%	-6.1%
Religious	$3,360	$3,419	$3,657	-1.7%	-8.1%
Public safety	$7,624	$8,157	$7,941	-6.5%	-4.0%
Amusement and recreation	$23,436	$23,713	$23,603	-1.2%	-0.7%
Transportation	$41,342	$42,235	$45,261	-2.1%	-8.7%
Communication	$22,365	$21,753	$21,314	2.8%	4.9%
Power	$99,090	$100,262	$110,021	-1.2%	-9.9%
Highway and street	$82,727	$88,425	$90,009	-6.4%	-8.1%
Sewage and waste disposal	$18,487	$18,950	$22,228	-2.4%	-16.8%
Water supply	$11,321	$11,755	$13,547	-3.7%	-16.4%
Conservation and development	$6,529	$7,043	$8,219	-7.3%	-20.6%
Manufacturing	$68,554	$69,789	$73,973	-1.8%	-7.3%
Employment, Seasonally Adjusted (in thousands)	**July-17**	**June-17**	**July-16**	**June-17**	**July-16**
National Total Nonfarm	146,404	146,182	144,166	0.1%	2.8%
Construction	6899.0	6893.0	6708.0	0.7%	4.9%
Residential building	767.2	762.1	731.2	0.1%	0.3%
Nonresidential building	762.1	761.7	759.7	-0.1%	2.9%
Heavy and civil engineering construction	973.4	974.6	945.8	0.1%	4.4%
Residential specialty trade contractors	1932.4	1930.3	1850.1	0.0%	1.7%
Nonresidential specialty trade contractors	2463.4	2464.3	2421.1	0.1%	2.8%
Producer Price Index[2]	**June-17**	**May-17**	**June-16**	**May-17**	**June-16**
Finished Goods (seasonally adjusted)	*196.8*	*196.4*	*192.5*	*0.20%*	*2.23%*
Inputs to Construction Industries	*215.5*	*215.1*	*210.0*	*0.19%*	*2.62%*
Nonresidential general contractors	104.9	104.9	103.2	0.00%	1.65%
New nonresidential building construction, National	105.4	105.3	104.2	0.09%	1.15%
New nonresidential building construction, Northeast	105.2	105.1	104.6	0.10%	0.57%
New nonresidential building construction, South	106.1	105.8	104.6	0.28%	1.43%
New nonresidential building construction, Midwest	103.6	103.5	102.6	0.10%	0.97%
New nonresidential building construction, West	106.1	106.0	104.6	0.09%	1.43%

Source: U.S. Bureau of Economic Analysis; U.S. Census Bureau; U.S. Bureau of Labor Statistics

[1] *Advance (1st) Estimate.*

[2] *The Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services. All figures are indexed from a base year, that base year being different for each individual index.*

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- Marital Dissolution

Joseph Natarelli

Joseph Natarelli is the national leader of Marcum's Construction Industry Practice and partner-in-charge of the Firm's New Haven office. For more than a decade, he has served as a technical reviewer for the AICPA's Audit Risk Alert for Construction Contractors and the AICPA Accounting Guide – Construction Contractors. Joe has also chaired the annual AICPA National Construction Industry Conference.

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