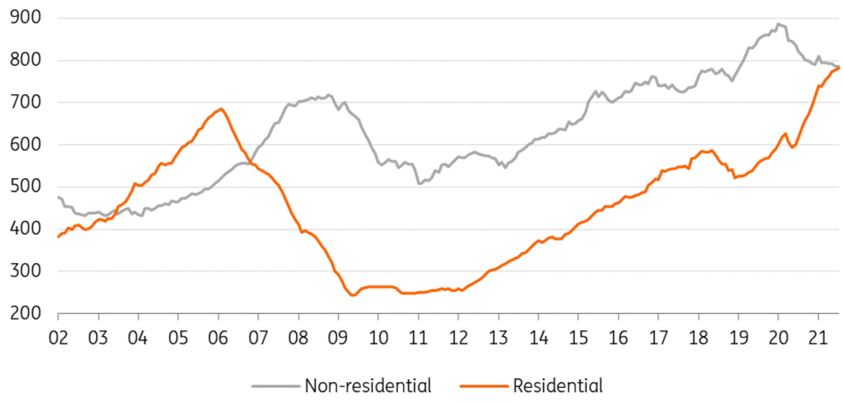
US Construction: Biden's billions to boost non-residential spending in 2022

While residential construction was the post pandemic winner through 2020 and 2021, non-residential construction will lead the charge in 2022 as a reopened economy and fiscal infrastructure spending splurge will support the outlook

Non-residential's torrid 2020

Non-residential construction has had a very different pandemic to residential construction. With workers staying away from offices, towns and cities emptied. Footfall in commercial districts dropped sharply and commuting stopped. Hotel demand collapsed, schools were deserted and recreation activities were scaled back. Given uncertainty over how long this situation would last, plans for repair, renovation and new construction were delayed or cancelled and as legacy building work ceased it wasn't replaced with new projects.

Total construction spending (USD bn)



Source: Macrobond, ING

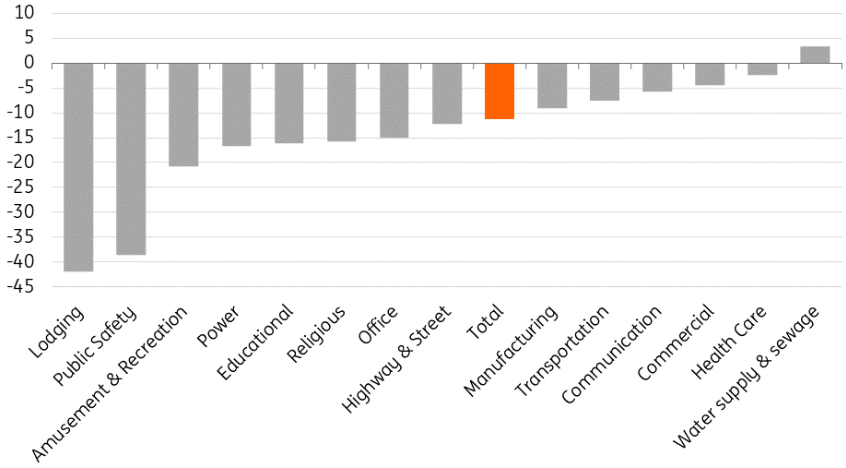
2022 looking better already

While non-residential construction is up 25% on its pre-pandemic highs, non-residential construction is down 11.1% from its January 2020 peak. Lodging (hotels), public safety and recreation are the hardest hit sub-sectors. Only water supply and sewage spending has increased since the start of the pandemic.

However, we are hopeful that 2022 will be a much better year. Already there are tentative signs of stabilisation in non-residential construction activity and as more people return to the office, cities are likely to get busier again, with bars, restaurants and hotels also seeing increased demand. With tourism and leisure returning - US borders are yet to reopen to European, Chinese, Indian and Brazilian tourists and business people, which will give another substantial uplift - non-residential construction should see a significant acceleration.

Given the scale of the rebound in demand in the US economy, with GDP levels now above pre-pandemic levels and the economy expected to expand by around 6% this year and 4% next, there is going to be a major backlog of repair work and deferred projects will be reinstated. The prospect of major government infrastructure investment will further fuel growth.

Non-residential construction spending change versus peak (% change)



Source: Macrobond, ING

Covid resurgence dents office return

Many companies started ordering staff back to their offices earlier this year and people movement in major US cities has certainly picked up. JLL reported that in the second quarter "gross leasing activity rose by 28.7% over the quarter to 34.7 million square feet in Q2, the first time that it has surpassed 30 million square feet since the onset of COVID-19. Despite this increase, this is still 41.6% below the pre-pandemic quarterly average, underscoring the road to recovery for office leasing fundamentals".

Unfortunately, the resurgence of Covid through the Delta variant has put this movement on hold and makes it increasingly likely that we will see an ongoing drift lower in non-residential construction, particularly for new offices, in the months ahead until there is clarity on the way forward.

But signs of stabilisation elsewhere

The latest Federal Reserve's Beige Book suggested that regions around the US are experiencing slightly different rates of performance. For example, the environment in Manhattan was described as "moribund" but the Cleveland Federal Reserve bank said that in its region "activity within the industrial sector remained strong and demand for office spaces experienced notable increases in activity". Both the Richmond and St. Louis Federal Reserve regions are experiencing strong industrial real estate activity, while in the Texas region it was described as "exceptionally strong". The San Francisco region noted "demand for industrial, warehouse, and distribution spaces remained robust".

Moreover, assuming the efficacy of vaccinations holds and the latest Covid wave subsides swiftly (Covid rates seemingly peaking out in some of the key hotspots, such as Missouri, Arkansas, Florida and Texas) we are upbeat on the prospects for non-residential construction.

Office construction to underperform

Compositionally, office construction is likely to remain subdued, but this accounts for only 10% of US non-residential construction spending. Working from home has undoubtedly been a success with technology certainly meeting and, in most cases, beating expectations. We are unlikely to go back to the way things were with everyone in the office at all times. Instead, some form of hybrid model is most likely. This will limit the need for additional office space with firms more likely seeking to sub-let unutilised floors. Emergency back-up sites will also no longer be required with working from home available.

This could also hamper any recovery in the commercial sector, particularly in major cities. While footfall in office areas will increase, it won't return to pre-Covid levels quickly so neither will demand for food outlets, bars, restaurant and business hotels. Indeed, business travel in general is unlikely to make a full recovery with video conferencing a much cheaper option, compounding the issue for major commercial centres.

That said, given the effective mothballing of numerous entertainment venues, hotels, bars and restaurants over the past 18 months, there is clearly scope for significant refurbishment work, which will benefit the construction sector.

Moreover, with online shopping set to hold onto much of the gains made as a proportion of total spending, demand for logistics centres and warehousing looks set to continue growing. There is also likely to be more demand for recreational areas outside of the major cities given households will likely spend less time commuting to work and more time in their local areas. We would also imagine a strong pipeline of work required for educational buildings as students return.

Financing looks supportive

Financing conditions do not seem to be a barrier to growth. The Federal Reserve's Senior Loan Officer Survey shows that commercial banks have relaxed lending standards to levels not seen for six years while demand for new loans has rebounded sharply, suggesting appetite for investment has returned.

Federal Reserve's Senior loans Officer Survey points to a positive lending outlook

Source: Macrobond, ING

Biden's billions boost the outlook

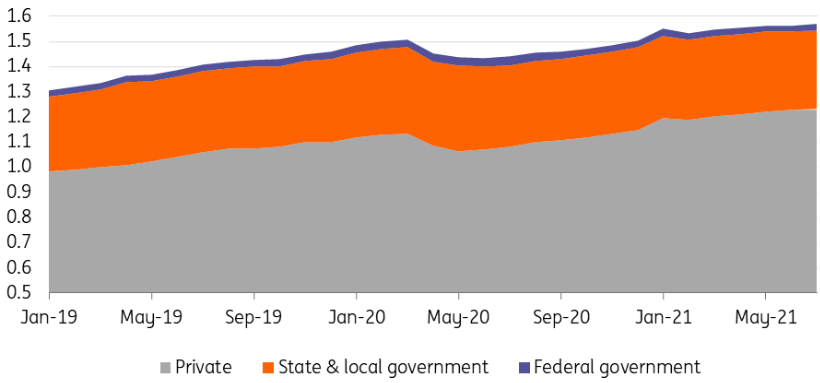
Then we have to acknowledge the anticipated support from the bi-partisan Infrastructure Investment and Jobs Act, which provides for an extra $550bn of infrastructure spending for the next five years over and above the $450bn already approved by Congress. This will also require additional workers, with President Biden stating that the intention of this plan is also to "create good-paying, union jobs".

This is not guaranteed at this point with only the Senate having voted in favour. The legislation still needs to be approved by the Democrat-controlled House of Representatives, which is looking to delay a vote. Progressives within the Democrat party have threatened to vote down the bill unless it is linked to a separate $3.5tn social security bill that will increase taxes on the wealthy and corporates to help fund spending increases and an expansion of healthcare and social benefits.

The social spending bill will also need to be approved by the Senate, which is unlikely to get the 60 votes required given the Democrats wafer thin majority in the upper house and Republicans hostility to such an increase in government spending and taxes. This means the Democrats are likely going to have to go down the route of using the budget reconciliations process to get the plan approved by a simple majority, but even this is not necessarily guaranteed to work given differing positions of individual Democrat Senators.

While we strongly suspect both bills will eventually be approved, it means it could take a few more months for it to be finalised, meaning the money for the infrastructure spending won't come before 2022.

Construction spending by sector



Source: Macrobond, ING

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