Blog | 10 Jan 2024

Weakness in construction and its related sectors show the impact of interest rate hikes

Share

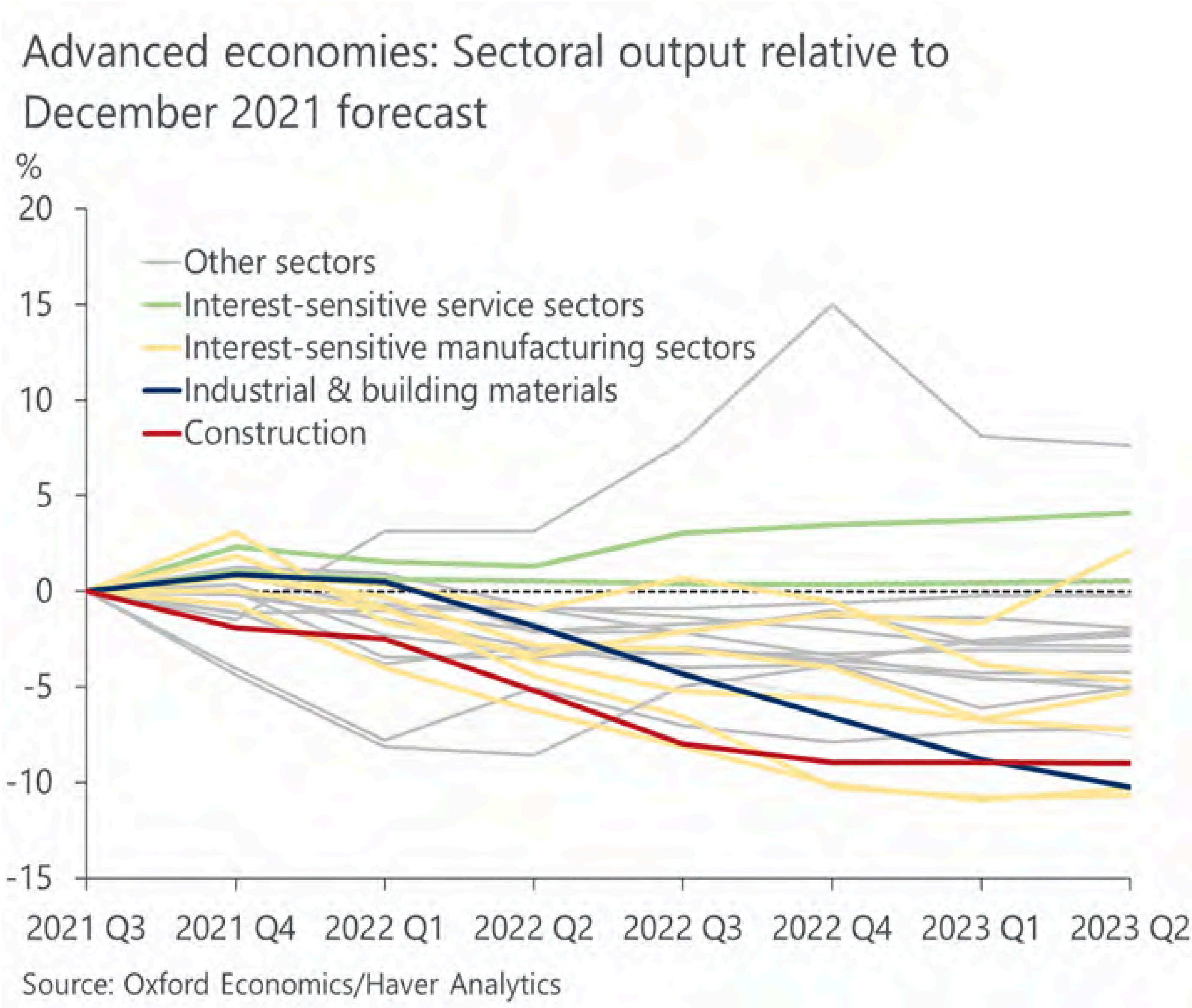
Nico Palesch
Senior Economist

Share

Ever since the onset of advanced economies' campaign of interest rate hikes in December 2021 there has been a lively debate about the impact and efficacy of tighter monetary policy in terms of reducing inflation and slowing growth. While inflation has indeed fallen across the world, the relative economic resilience in the United States in particular, which has raised interest rates significantly more than the eurozone, has raised questions about if and how much interest rates are actually depressing activity.

A look under the sectoral hood however shows that while interest rate hikes may not yet have had a large impact on consumer spending, output has been substantially underperforming in interest-sensitive sectors. Most prominently, the construction and industrial & building materials sectors are two of the worst-performing sectors in advanced economies relative to our December 2021 forecast, which represents our view before the onset of the interest-rate shock (see Fig. 1). Output in both sectors is around 10% below the pre-rate hike forecast level in Q2 2023, and both have undergone significant output contractions in recent quarters. This is substantially worse than the performance of GDP, services, and manufacturing output in that same time horizon, which are -1.5%, +0.2%, and -3.7% relative to the pre-interest rate hike baseline.

Fig. 1. Construction and industrial & building materials underperform



A large part of this can be traced back to falling residential construction. Higher interest rates affect demand for housing on both the demand and supply side, by making mortgages more expensive for consumers and credit more expensive for builders. We have already seen significant weakness in residential construction activity in economies where interest rates have gone up significantly. Japan, which has not seen monetary tightening anywhere on the scale of the US, UK, or eurozone, is a notable exception, seeing growth in the first half of the year relative to the first half of 2022, unlike in the US and much of western Europe.

Other construction, including private non-residential investment in structures and civil engineering projects, has helped bolster activity in recent quarters. This includes the boom in US factory construction, spurred on in large part by subsidies embedded in the Inflation Reduction and CHIPS Acts, and in Europe various public investment projects in

Share

the wake of Covid-19. However, these growth impulses are likely to moderate next year, which, combined with low levels of residential investment, will extend construction weakness into next year. This outlook is reinforced by data showing low levels of building starts and housing permits in the US, UK, and Europe. Again, Japan stands out as the exception, with steady building starts and construction orders.

Nonetheless, the prospect the prospect of recovery in construction and its related sectors is not hopeless. We expect that growth will pick up in the second half of 2024 as the peak of the negative impacts of interest rate hikes pass, sentiment picks up, and the prospect of interest rate cuts begins to take centre stage.

Find out more about how interest-sensitive sectors are faring in the current environment and download the full research briefing here.

Share

DOWNLOAD RESEARCH BRIEFING

Authors

Nico Palesch

Senior Economist

+44 203 910 8000

Email | Linkedin | Profile

Tags: **Construction** **Construction and Engineering** **Construction Sector**

Construction input prices jump again, continue 2024’s upward climb

constructiondive.com/news/construction-input-prices-april-2024/716119

Sebastian Obando

Dive Brief // Economic Reports

A new ABC report points to yet another sign that inflation is accelerating and that interest rates are set to stay higher for longer.

A sign is posted near a bulldozer parked at the planned Brightline West Las Vegas station during a groundbreaking ceremony on April 22, 2024 in Las Vegas, Nevada. Ethan Miller/Getty Images via Getty Images

Dive Brief:

- Construction input prices increased 0.5% in April due to inflation and energy costs, according to a new Associated Builders and Contractors’ analysis of U.S. Bureau of Labor Statistics Producer Price Index data released Tuesday.
- The jump in April marks an increase in input prices for every month of 2024 so far. Both overall and nonresidential construction costs remain 2.3% and 2.2% higher, respectively, than a year ago, according to the report.

- “Construction input prices jumped half a percentage point higher in April and have increased 3.5% over the first four months of the year,” said Anirban Basu, ABC chief economist. “This is yet another sign that inflation is accelerating and suggests that interest rates are set to stay higher for longer.”

Dive Insight:

Ken Simonson, chief economist at the Associated General Contractors of America, echoed Basu’s concerns about rising input costs and its impact on contractors’ bids and project expenses.

“Prices for construction inputs have risen faster than contractors’ bids every month so far in 2024,” said Simonson. “In addition, persistently long lead times for electrical equipment are adding to the cost of many building and infrastructure projects.”

Producer Price Index, April 2024

	1-Month % Change	12-Month % Change	Change Since Feb 2020
Inputs To Industries			
Inputs to construction	0.5%	2.3%	42.1%
Inputs to multifamily construction	0.6%	3.3%	41.5%
Inputs to nonresidential construction	0.6%	2.2%	42.8%
Inputs to commercial construction	0.7%	1.8%	42.5%
Inputs to healthcare construction	0.7%	2.1%	42.3%
Inputs to industrial construction	0.7%	2.9%	38.7%
Inputs to other nonresidential construction	0.6%	2.2%	42.7%
Inputs to maintenance and repair construction	0.4%	1.9%	40.2%
Commodities			
Adhesives and sealants	0.1%	-0.1%	34.1%
Brick and structural clay tile	0.4%	4.3%	30.1%
Concrete products	-0.2%	6.7%	38.5%
Construction machinery and equipment	0.4%	4.1%	30.2%
Construction sand, gravel, and crushed stone	0.7%	7.2%	35.0%
Copper wire and cable	5.2%	2.8%	40.3%
Crude petroleum	10.6%	7.6%	75.0%
Fabricated structural metal products	0.0%	1.1%	54.5%
Gypsum products	-0.4%	0.8%	45.6%
Hot rolled steel bars, plates, and structural shapes	-2.4%	-4.4%	49.7%
Insulation materials	0.0%	3.8%	42.5%
Iron and steel	-1.7%	-9.6%	50.3%
Lumber and wood products	0.6%	-1.3%	25.8%
Natural gas	-0.9%	-25.5%	-15.1%
Plumbing fixtures and fittings	0.2%	1.8%	18.5%
Prepared asphalt, tar roofing and siding products	-2.1%	2.3%	39.4%
Softwood lumber	1.4%	-4.3%	12.9%
Steel mill products	-2.7%	-9.8%	58.7%
Switchgear, switchboard, industrial controls equipment	0.1%	6.6%	43.7%
Unprocessed energy materials	8.2%	1.6%	69.2%

Source: U.S. Bureau of Labor Statistics

While iron, steel, asphalt and gypsum product prices fell in April, oil and copper prices surged, driving the overall monthly increase, said Basu.

For example, prices increased in two of the three energy subcategories in April. Crude petroleum prices jumped 10.6%, while unprocessed energy materials prices increased 8.2%. Natural gas costs decreased slightly by 0.9% in April.

Basu added rising input costs will put pressure on profits at a time when nearly one in four contractors expect their margins to contract over the next two quarters.

STORYLINE // Economic Reports

May 16, 2023
Backlog rebounds from 7-month low

Jun 01, 2023
Higher material prices here to stay

Jun 01, 2023
‘What recession?’ Nearly all sectors see strong construction spending

Jun 08, 2023
Weak office, hotel sectors continue to drag on construction planning

Jun 15, 2023
Infrastructure projects hold backlog steady

Jun 15, 2023
Construction prices fall for third straight month, but inflation persists

Jun 21, 2023
Public projects surge, private starts falter

Jul 05, 2023
Nonresidential construction spending shrinks for first time in 11 months

Jul 12, 2023
Construction backlog holds steady on infrastructure tailwinds

Jul 12, 2023
Construction planning falls for fourth straight month

Jul 14, 2023

NAHB > **Blog** (https://www.nahb.org/blog) > **Soaring Prices for Building Materials Impact Housing**

How Soaring Prices for Building Materials Impact Housing

Material Costs

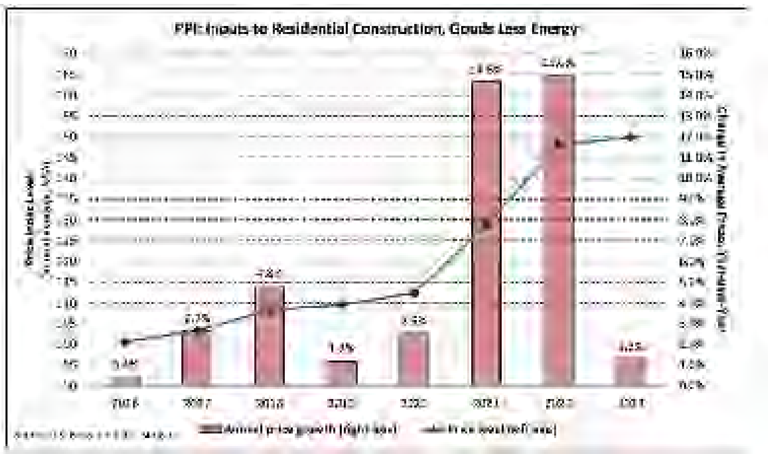
Published

Jul 26, 2024

Prices of materials used in residential construction have been flat or even declined in some cases, providing welcome relief to home builders. But overall, prices of building materials are still far above their pre-pandemic levels, and the impact of those elevated prices can be seen in unexpected places.

Where are Building Material Prices Now?

Earlier this year, NAHB reported that building material price growth slowed dramatically in 2023, in line with slowing inflation in the broader economy. Prices still grew, though, and were still elevated from post-pandemic surges.



“The only major building material to see **[price recovery is lumber](https://www.nahb.org/news-and-economics/housing-economics/national-statistics/framing-lumber-prices)** (https://www.nahb.org/news-and-economics/housing-economics/national-statistics/framing-lumber-prices),” said Jesse Wade, NAHB director of tax and trade policy analysis. “At the end of 2023, lumber was trading about 20% higher than in 2019, but with further price declines in 2024, the price is roughly back to normal. This is after surges in 2020-21 that saw lumber prices rise more than 300%.”

For other build materials categories, prices are still far above their pre-pandemic levels.

> **Gypsum (drywall):** Prices decreased 2% over 2023, after increasing 44.6% over the two years ending December 2022.
>
> **Ready-mix concrete:** The average price of concrete increased 11.2% in 2023 and 10.3% in 2022, combining for the second-largest two-year increase since 2000.
>
> **Steel mill products:** Steel mill products annual average prices declined 16.1% in 2023 after increasing 8.7% in 2022 and the historic 90.3% increase of 2021. Prices are 31.2% lower than their 2021 peak but remain 65.1% higher than they were in January 2020.

Why Did Building Material Prices Rise So High?

It's easy to blame the pandemic for all our woes, and it certainly didn't help building material prices. But material prices were pointed higher long before the first mention of COVID.

Beginning in late 2017 and continuing for most of 2018, building material prices grew more than 5%, mostly driven by trade disputes for materials sourced overseas.

"In the spring of 2020, supply and demand forces took over the lumber market," said Wade, who continually tracks and analyzes short- and long-term trends in commodities pricing. "Home builders got back to work very quickly, and people stuck at home decided to invest in home repairs, renovations and upgrades. So lumber prices soared. But it wasn't until early 2021 that other material prices began to rise."

What Causes the Rise in Material Prices?

Supply and demand: Although lumber was the most sensitive material to demand, other materials quickly followed, and for good reason. There were more homes started in 2020 than in 2019, even with all the lockdowns. The number of homes started in 2021 was a 15-year high. In short, there was high demand for materials in 2020 and 2021.

Broader inflation: When the general cost of goods and services rises across the economy, it inevitably impacts the price of construction materials.

Global factors: Factors such as geopolitical tensions, trade disputes and changes in international trade policies can disrupt supply chains and lead to price instability.

Sustainability initiatives: There's a growing demand for eco-friendly, sustainable building materials and **green practices** (https://www.nahb.org/advocacy/industry-issues/sustainability-and-green-building) in the construction industry. Although this is a positive trend for the environment, it can put pressure on costs as these specialty materials often come with a higher price tag.

How Do High Material Costs Impact Housing?

Aside from simply making it more expensive to build — and thus, buy — a home, **rising material prices** (https://www.nahb.org/advocacy/top-priorities/material-costs) can have insidious effects on the housing market.

Home insurance premiums have soared over the past year. One of the primary drivers of the rate increases is the cost of building materials used to repair homes after claims. Although building material prices have been growing for years, we are just starting to see the impact on the insurance market.

Material cost fluctuations also make it more difficult for **appraisals to reflect the true value** (https://www.nahb.org/advocacy/industry-issues/appraisals) of the home, because costs are rising too rapidly and builders are having to compensate on the front end of construction by decreasing amenities available in the home. Inaccurate valuations can cause major issues in financing for home buyers.

At a time when **mortgage rates** (https://www.nahb.org/news-and-economics/housing-economics/national-statistics/weekly-mortgage-rates-15-and-30-year) and home prices are at multi-decade highs, the rising insurance premiums and uneven valuation environment makes housing attainability much harder.

()