



2022 Q4

THE LOOK AHEAD

Market Overview

The Federal Reserve’s rate hikes began to temper inflation in 2022’s fourth quarter, but the economy continues to put up strong numbers due to tightness in the labor market. Discipline is the key word heading into 2023—discipline to hold rising interest rates to assure inflation is halted. In this issue, we dive into the national strategy our mission critical team is employing to deal with resource challenges across the country. We also examine how consumer spending, the housing market, and the steep increase in grocery prices are impacting the economy, particularly construction.

THE SAVANNAH MARKET

The Savannah construction market remains strong as we close out the year, marked by steady workflow for trade partners and substantial backlog through at least the first quarter of 2023 for most. General contractors are gently navigating the contrast between owner budget expectations and the actual cost of construction, resulting in heavy value engineering efforts early in the design process on multiple projects.

In addition, private owners are experiencing difficulty securing financing, which has resulted in delayed project start dates. Labor shortages are subsiding, as the unemployment rate has decreased over the past year (approximately 2.5% locally). However, finding quality, skilled labor remains a challenge for some construction trades in our market. Because the labor market in the country is relatively strong, this could mean more rate hikes are needed to tame inflation.

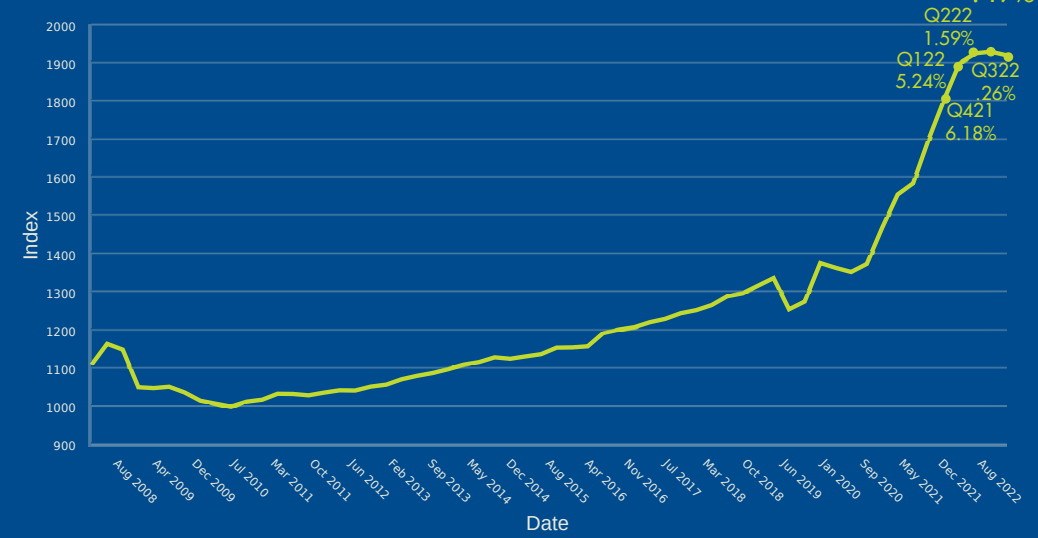


Ryan Price
OFFICE LEAD
912.335.4008
ryan.price@jedunn.com



David Newland
PRECONSTRUCTION LEAD
912.228.3952
david.newland@jedunn.com

Savannah Area Escalation Q4.2022



In general, material prices are decreasing or leveling off for most trade industries. Longer lead times still prevail, and general contractors are negotiating early release bid packages to mitigate potential delays during construction.

Overall, supply chain disruptions have eased and prices for many goods and commodities have fallen from their mid-year highs. Metals prices have risen slightly as the United States Dollar (USD) weakened but are still below highs earlier in 2022. West Coast ports have experienced work stoppage and reduced productivity due to strikes and the union still not having reached a contract agreement. This has pushed most importers to look to the East Coast. While delays have persisted at East Coast ports, the declining volumes have eased backlogs significantly. Savannah’s anchorage to berth average is still very high. However, overall congestion is moderate as we move into 2023.

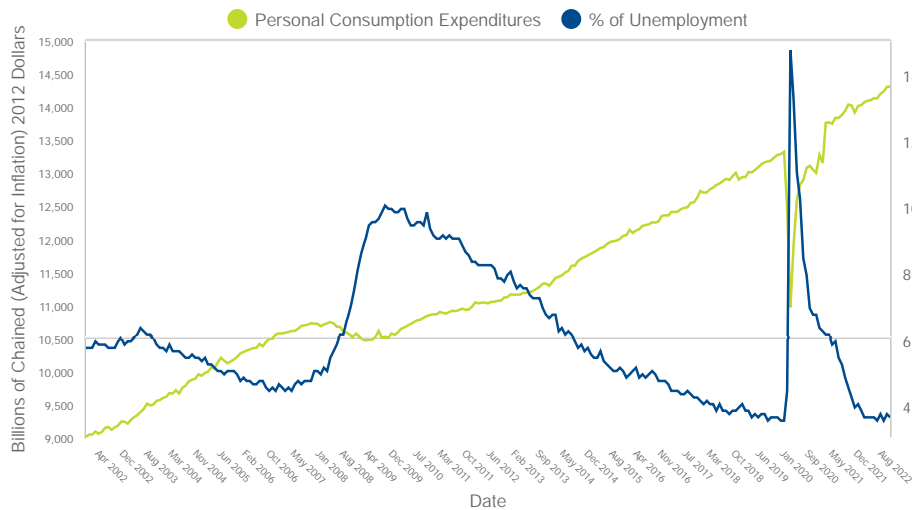
LABOR & MATERIAL TRENDS THIS QUARTER			
Labor Wage Change		Material Price Change	
Carpenter	0.00%	Fabricated Steel	-5.38%
Laborer	-8.00%	Fabricated Copper	5.65%
Sheet Metal Worker	0.00%	Fabricated Aluminum	5.00%
Plumber/Fitter	0.00%	#2 Diesel Fuel	-7.81%
Electrician	0.00%	4,000 psi Concrete Ready Mix	3.26%
Bricklayer	0.00%	Lumber, FOB Jobsite	-7.24%
Iron Worker	0.00%	Glass	3.70%
Glazier	0.00%	Sheet Metal	-0.91%
Roofer	0.00%	Gypsum	11.46%
Operator	6.40%	Other Materials	1.21%

Other Materials consists of brick, block, precast insulation, floor covering, ceilings, and Miscellaneous materials

CONSUMER SPENDING

In previous issues of The Look Ahead, we took an in-depth look at how The Federal Reserve uses interest rates to control inflation and the cause and effect between the labor shortage and extended periods of inflation. In construction, the supply chain and escalation are still the primary issues affecting project success.

To understand the current juxtaposition of price inflation in the midst of slowing, but positive, GDP growth and historically low unemployment numbers,



it helps to understand where these discrepancies originated and how our everyday personal expenses impact the overall economy.

PERSONAL CONSUMPTION

Consumer spending or Personal Consumption Expenditures (PCE) make up 70% of our economy, so what Americans are spending their money on is extremely important to the direction of the economy.

This consumption includes all purchases made by consumers, such as food, housing, energy, clothing, health, leisure, education, communication, transportation, travel, and dining out. It is estimated that the national average amount spent is somewhere around \$60k/year or just over \$5k each month. The vast majority of that gets spent on five things: housing, transportation, food, utilities and taxes.

RELATIONSHIP TO UNEMPLOYMENT

Traditionally, unemployment moves inversely with PCE as shown in the chart below.

In 2023, we should see reigned-in spending as unemployment rises due to measures aimed at reducing inflation.

But why is spending still so high when inflation is so high? Right now, consumers have approximately \$930 billion in excess savings; that is the amount saved above the normal, pre-pandemic savings rate. This savings was accumulated during the pandemic through stimulus money and sheltering in place. As of October 2022, consumers had spent only 25% of these excess savings.¹

TIME FRAME

This balance-sheet excess has enabled consumers to spend at an elevated rate even as the Federal Reserve tries to squeeze demand out of the economy—exacerbating the need for a more severe and longer-lasting rate hiking cycle. However, inflation continues to take a bite out of purchasing power, shrinking the effect of all those extra dollars in peoples’ wallets. Consumers have a cushion, but that cushion won’t last forever. Estimates show that this excess savings will last until roughly the second half of 2023. As these excess savings run out, inflation will subside not only in the personal consumption retail market, but also across commodities heavily utilized in the construction industry.

Sources: 1) [federalreserve.gov](https://www.federalreserve.gov)

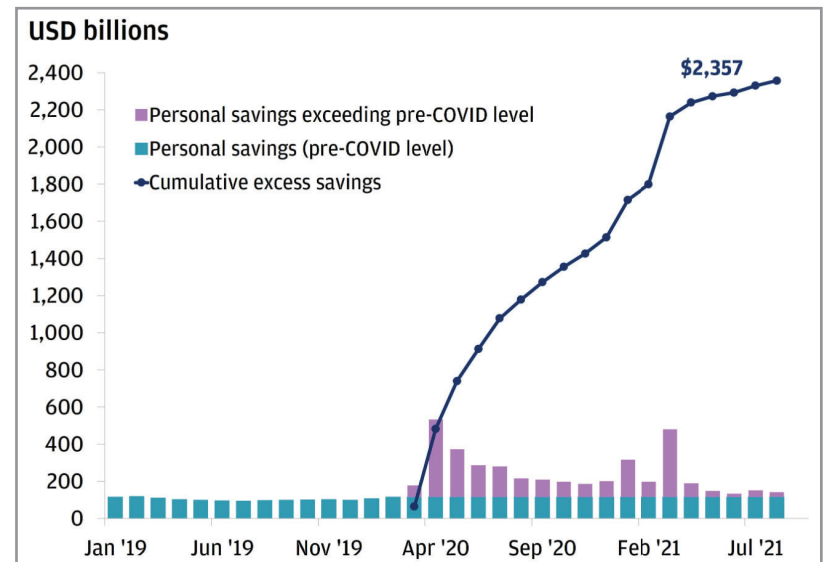
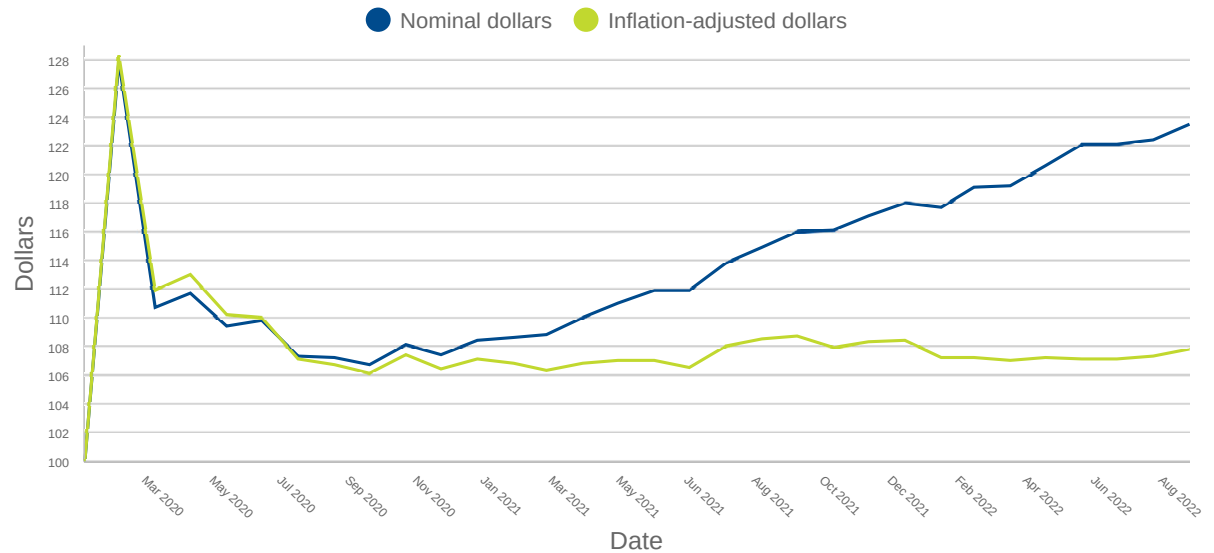


Chart Courtesy of Chase.com



U.S. Consumer Spending on Groceries, Changes Since Feb 2020 (Source: FRED)

GROCERIES

According to the Bureau of Labor Statistics, one of the items seeing an above average rate of inflation is food. People are spending more dollars on groceries today than they were pre-pandemic, but they are buying fewer groceries. In real terms (dollars minus inflation), they are spending a great deal less and being fiscally conservative. Consumers are also saving by substituting, buying the store brand over the national brand, but even with that change, the practical effect is still less-full pantries overall.

CUTTING BACK

According to research from *Forbes*, over half of respondents—51%—say they are buying fewer non-essential groceries, and 39% are buying fewer groceries altogether. Some 46% of respondents are using leftovers more often in an attempt to reduce food waste. Meanwhile, 49% are cooking more meals at home instead of ordering takeout, and 62% say they are dining out less frequently.

Even with these measures consumers still must spend on essentials, and we chose to highlight groceries because some of those items are getting hit with higher inflation than what is being measured by the overall level. For instance, a grocery cart of chicken, soda, toilet paper, bread, milk, coffee, cereal, rice, pasta, butter, apples, and bananas costs 14% more in October 2022 compared to a year earlier, whereas the overall inflation number is less than 8% year over year.

TAMING OVERALL INFLATION

Many economic principles show direct relationships. When one factor increases, another decreases, and so on. The cost of food is one area where a negative impact on individual consumers may actually have a positive impact on the overall economy.

As consumers deplete their excess post-pandemic savings resources, they will be forced to spend less in the overall economy, thus driving down consumer spending and helping tame inflation.

This is a prime example of real world daily purchasing habits that have direct impact on U.S. inflationary values that extend both to general retail and our construction industry.



HOUSING

Housing, or shelter, is a large part of what makes up the Consumer Price Index (CPI), accounting for 30% of the total value.

Measuring it properly can be very tricky. Because the CPI focuses on consumption, it considers housing as a service that people use, as opposed to an investment good, and only incorporates the price of that service into the index. Unfortunately, the price of shelter services for homeowners is hard to measure because the price cannot simply be read off a price tag. The price must be estimated, and there is no single best way. The current measure uses market rents, which assumes renters and owners face similar price dynamics. In addition, rents often change on an annual schedule, which can result in the well-documented lag between the CPI measure and price indexes for houses and rental units.

IMPACT ON MONTHLY BUDGET

Despite these challenges, the CPI can still be useful for getting a sense of how prices have changed for housing. The cost of shelter has increased 7% year over year. While that isn't the biggest percentage change that we'll look at, it is being applied to the largest expenditure that consumers face—roughly 21% of the total monthly budget on average. As a result, we recently saw a contraction in residential investment.

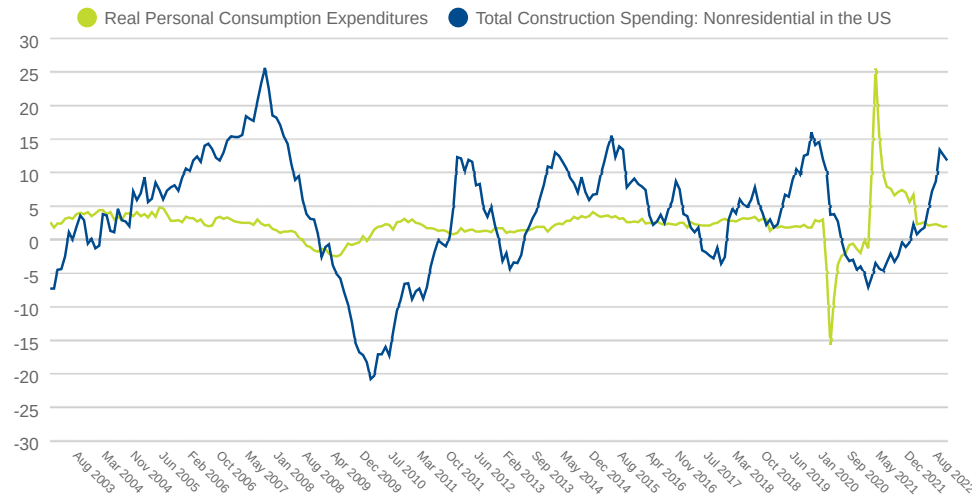
RELATIONSHIP TO CONSTRUCTION

What do these consumer indicators mean for commercial construction? While not directly tied, there is some degree of correlation between construction spending and consumer spending. As previously mentioned, consumer spending makes up a very large part of our economy and as spending goes up—increasing GDP—we often see a rise in construction spending. In fact, when the quarterly gain in spending is greater than 2% year over year, typically

construction spending often sees percentage gains more than double consumer spending gains.

So what's driving this relationship? In this case, it is likely that a rising tide lifts all boats; when consumer spending increases, it signals an aggregate increase in demand across other sectors, even nonresidential construction. When consumer spending decreases, we often see a pullback in demand across those sectors as well. If businesses are a main driver for construction starts and the overall level of demand for businesses is determined by consumers, that means when consumers aren't demanding as much, the business won't need the new office building or infrastructure or factory, etc.

Increases in consumer spending are almost always a boon for the construction industry. However, just like an overgrown forest can benefit from occasional fires clearing out the underbrush and debris, the construction industry can benefit in the long-term from a cooled-off labor market and price resetting, improving their ability to hire and retain workers and ultimately offer a better product.



Nonresidential construction activity is moderately correlated with consumer spending. Though construction activity is much more volatile, a tendency exists for consumer spending to slightly lead nonresidential construction activity. This is evident as businesses tend to need more factories, offices, capacity etc. when people are buying more of their things or using more of their services.

2023 OUTLOOK

Since we launched The Look Ahead in 1Q2022, we have received valuable feedback and a lot of questions about the future of our economy. As our internal teams keep close tabs on economic fluctuations, material pricing, and the national supply chain, we wanted to offer some thoughts on the direction we think our economy could go in 2023.

RATES

We believe the Federal Reserve will raise the Federal Funds rate .25% in February and at least another .25% at the end of March. Members of the FOMC have indicated that the terminal Federal Funds rate will still not have been reached with those two hikes. If that proves to be the case, then the economy won't reach a sufficiently suppressive state to drive inflation down fast enough, and up to another .50% in hikes will be required. This would leave the rest of 2023 between 5.25% and 5.50%.

GROSS DOMESTIC PRODUCT

Given those operations, we see real Gross Domestic Product (GDP) growth staying in positive territory for 4Q22 but falling into negative growth for the first half of 2023. It may cross back into the positive by the second half of the year.

CONSUMER SPENDING

Consumer spending will likely stay elevated for the first part of 2023 and will be what keeps inflation from coming down at the pace we need. With heightened spending, the labor market stays tighter for longer, sustaining inflation. Once the lag from Fed hikes finally works through the system, and consumers run out of cash, spending will fall and wage growth will slow—especially on the services side. The labor market would likely then loosen, and unemployment could rise somewhere in excess of 5%, though not likely above 6%. This will cause inflation to subside and come within sight of the Fed's target rate of 2%. We don't think reaching 2% this year is possible, but we should get below 4%, which would be a welcome change.

CONSTRUCTION

For construction, we see the effects of the slowdown as planned jobs reduce due to higher interest rates and lower spending in general. We expect costs to moderate as well but not enough to fully prop demand back up. Most of the effects on construction should come in the back half of the year. Overall, we anticipate the impact will be milder than the last two recessions (Pandemic & Great Recession), and the industry will likely enter back into the expansionary portion of the cycle sometime in late 2024.

MARKET-BY-MARKET

Additionally, here are some predictions for specific construction markets. Demand for new retail will be negatively impacted by a decline in spending. New housing supply (single and multi-family) will see some relief with the pandemic backlog and will impact rent and vacancy by driving down rates as more units become available. While bringing workers back into the office boosts that demand, loosening the labor market will mean less workers on payroll and fewer cubicles needed. Chip manufacturing is seeing some cooling for the most cutting-edge products, but older tech is still in high demand. We foresee some of that demand waning by the end of 2023 thanks to a pullback in consumer spending. Hospitals and schools are typically not directly impacted by retail spending and will therefore be more resilient to the effects of a cooling economy.

