Construction Spending Declines in 2005

Associated Press, Publication date: 2005-08-01

Builders, showing some restraint, trimmed spending on construction projects around the country in June, marking the fourth consecutive monthly cutback.

The latest snapshot of construction activity released by the Commerce Department on Monday showed that builders have been paring spending each month after the value of all construction projects surged to an all-time high of $1.13 trillion, on an annualized basis, in February.

Spending on all construction projects dipped by 0.3 percent in June from the previous month. Even with the decline, though, the value of all projects was still at a healthy level of $1.1 trillion, at a seasonally adjusted annualized rate.
The drop took analysts by surprise. Before the release of the report, they were predicting construction spending would rise by 0.5 percent.

"The biggest worry is material costs, plus widespread tight supplies of cement," said Ken Simonson, chief economist for Associated General Contractors of America. "Although recent numbers have been a bit sluggish, there are plenty of indicators that activity will gain momentum in the second half of 2005 and beyond."

In June, spending cutbacks were mixed. Spending by private builders on residential projects declined in June as did their spending on factories, hotels and motels and power plants. But spending by private builders on office buildings and transportation facilities increased.

The government also trimmed overall spending on construction in June. Cuts in spending on power plants, highways and streets, schools and health-care facilities swamped spending increases on offices, transportation projects and public safety facilities.

Even with the moderation in overall construction activity over the last three months, the economy grew by an energetic 3.4 percent in the April-to-June quarter, the government reported last week. Analysts believe the economy will perform even better in the current quarter if businesses rebuild inventories of supplies.

With economic growth solid, Federal Reserve policy-makers are focusing on making sure inflation doesn't become a problem to the recovery. The Fed is widely expected to boost interest rates by another quarter-point when it meets next week. That would mark the 10th interest increase of that size since the Fed began to tighten credit in June 2004.

Although builders are keeping a watchful eye on the supply of new residential projects, sales of both new and previously owned homes soared to record highs in June - suggesting demand remains buoyant.

"Private residential construction is likely to shrink gradually over the next year. But there isn't likely to be a crash," Simonson said. "Long-term interest rates are still remarkably low and builders remain optimistic, with large backlogs of unused permits."

Greenspan, meanwhile, has expressed concern about "speculative fervor" in the booming housing market, which in some local market may have propelled house prices to "unsustainable levels." If prices were to drop or if interest rates were to suddenly shoot up, some home buyers and lenders could find themselves in a bad financial situation, the Fed chief has warned.