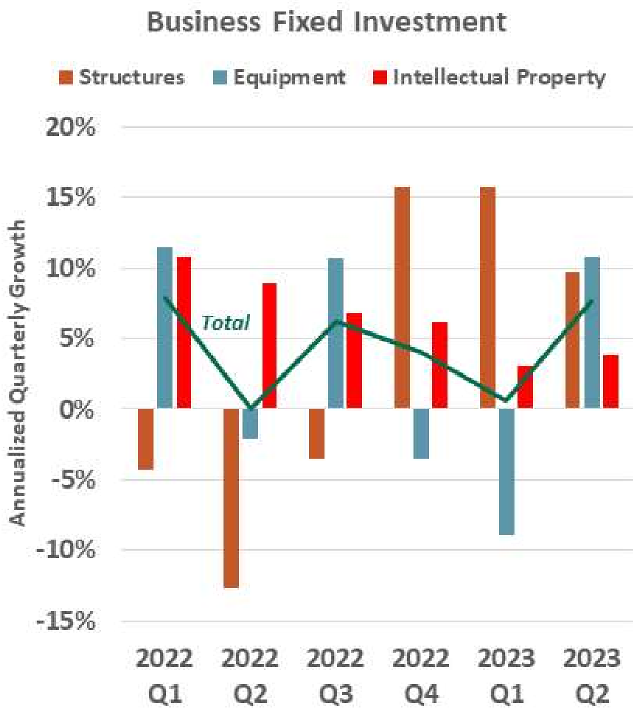
AUGUST 4, 2023

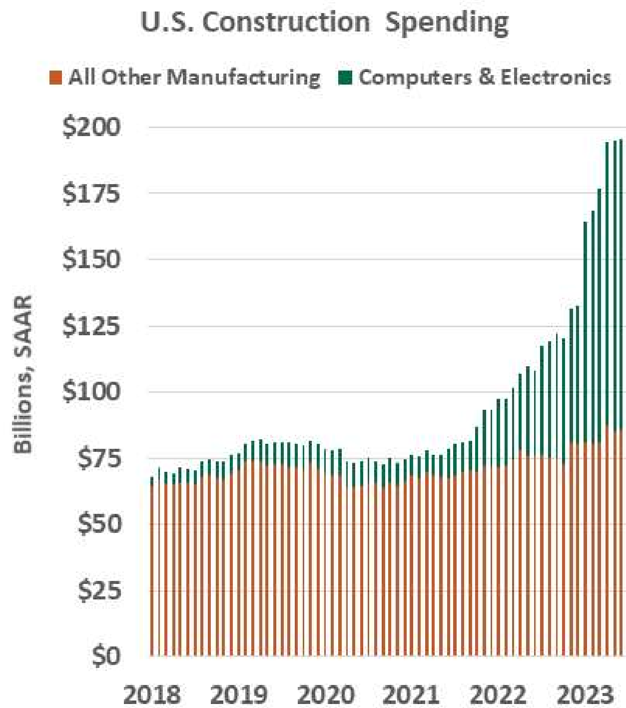
Construction Taking Off

Public and private projects are fueling a new building boom.

My time growing up in Chicago helped me appreciate the power of building. The city as we know it today exists because of massive civil undertakings: reversing a river to gain clean drinking water, elevating the whole terrain to stop flooding, and rebuilding the city after most of it was destroyed by fire. Railroads define the city and are still key to the local economy. A strong public plan motivated more private investment, shaping the city as we know it today. Construction projects are often expensive, slow and difficult, but the imprint they make can last for generations.

That spirit of building and rebuilding lives on today, and it’s helping the economy grow. Business investment was the most cheerful component in the reading of second quarter U.S. gross domestic product (GDP) last week. The report showed that non-residential investment grew at an annualized rate of 7.7%, up from nearly zero the prior quarter. The upswing is encouraging for several reasons. In terms of the broad mix of economic activity, this cycle has been dominated by strong consumer spending. However, as pent-up savings are depleted, consumption cannot continue to grow indefinitely. The boom in investment produced an upward surprise for overall growth, even as consumption moderated.





Sources: BEA, Census Bureau, Haver Analytics

Additionally, business investment is often a leading indicator of both booms and busts. Managers conserve their resources when the outlook is slow, and wait to make capital expenditures until prospects are brighter. A broad rise in investment, even in the face of rising borrowing costs, is a positive omen for the years ahead.

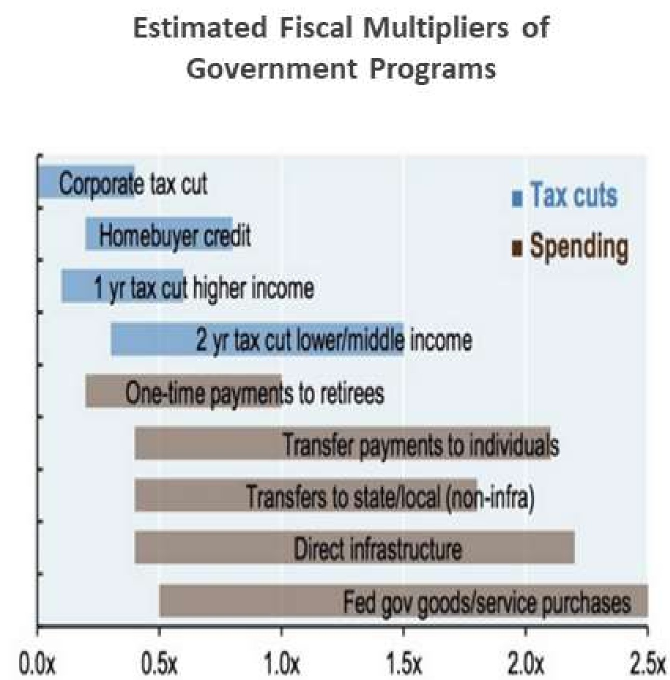
Business investment is reported in three major categories: structures, equipment and intellectual property. All three showed growth in the second quarter, the first time that has happened in over two years. This is a positive signal for employment. Projects launched today are putting people to work, creating the buildings, machines and systems that will keep people occupied and productive.

The upturn in construction is evident across the data sources we track. Construction of manufacturing structures has roughly tripled over the past two years. Nearly all that gain has come from projects in the computing sector; the move to re-shore production of electronic components is underway. And within labor reports, the number of workers employed in non-residential construction has reached several all-time highs this year.

Some of this run-up is surely attributable to fiscal policy. One of the hallmarks of the Biden administration has been a push into industrial policy, in three acts: the **Bipartisan Infrastructure Law (BIL)**, the **CHIPS Act**, and the **Inflation Reduction Act**. All of these allocated substantial funding for major public infrastructure and private capital investments, most of which require years of planning before breaking ground. Two years later, those projects are taking shape, supporting investment and employment.

The BIL was the first to pass and has the most progress to report. Over **36,000 projects** have been funded, ranging from minor local public works to billion-dollar allocations for power plants and large bridges. Most of it remains in the pipeline. The headline cost of the BIL was $1.2 trillion, of which $550 billion was new spending; to date, only $116 billion has been allocated. Important investments in the nation's electrical, broadband and rail networks are still in the planning phase.

The case for infrastructure investment is strong. Aside from near-term stimulus, reliable infrastructure is needed to facilitate commerce and ensure resiliency. The multiplier effect, or the follow-on activity it generates, is among the highest of any form of government spending. Infrastructure projects carry costs, and the nation's fiscal state should not be ignored. However, infrastructure is so fundamental to growth that it should be among the last programs to cut.



Sources: Build.gov (announced funding as of July 7, 2023), CBO

The current push for public investment also comes at a challenging time in the business cycle. Amid high inflation and a shortage of labor, spending on public works will add to pressures on costs of wages and raw materials, just as the private sector is trying to undertake its own construction projects. In theory, government spending can be an effective countercyclical measure to offset private downturns, but that's easier said than done. In practice, these projects are not easy to stop and start, and they often prove complementary to private undertakings.

Unallocated funding will support the outlook for economic activity. Engineers, contractors and laborers in civil developments can look forward to favorable prospects for some time to come, and the rest of the economy will benefit from the final outcomes of the projects.

Architect Daniel Burnham created a comprehensive Plan of Chicago in 1909, laying out a vision for the young city that has endured to this day. Burnham is best remembered for his call to action: “Make no little plans. They have no magic to stir men's blood and probably will not themselves be realized.” A trillion dollars of funding for infrastructure and construction was by no means a little plan, and it is beginning to bear fruit. A commitment to public spending helped to spur private investments. The projects may take some time, but their impact will last for generations.

Ryan James Boyle

Senior Vice President, Senior Economist

Ryan James Boyle is a Senior Vice President and Senior Economist within the Global Risk Management division of Northern Trust. In this role, Ryan is responsible for briefing clients and partners on the economy and business conditions, supporting internal stress testing and capital allocation processes, and publishing economic commentaries.

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