December 02, 2014

Economics Group

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Construction Spending Makes a Comeback in October

Following a negative reading in September, construction spending rose a better-than-expected 1.1 percent in October. On net, revisions to the two previous months of data were positive. Private and public outlays rose.

Construction Spending is Back on Track

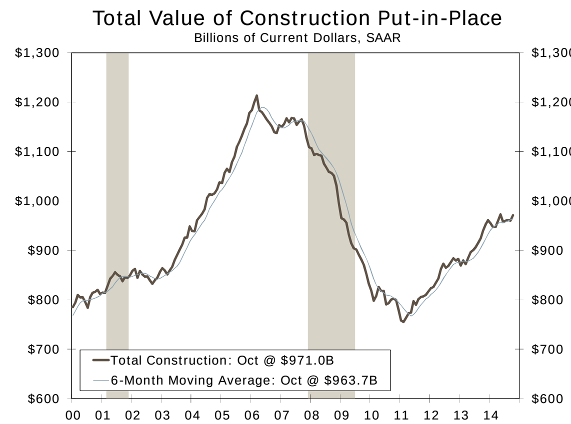
Starting the fourth quarter off on a solid note, total construction spending rose 1.1 percent in October at a seasonally adjusted annual rate of $971.0 billion. Private residential construction spending rose for the second consecutive month and is now up 1.9 percent over the past year. The gains in residential were broadly based. Even home improvements, which have seen a string of negative readings since the beginning of the year, rose in October. Last year, home improvements reached their highest level since 2007, but the pace of home remodeling has slowed along with the moderation in home prices. It is too early to tell if October will mark a shift in remodeling activity. Relative to the same period last year, home improvements are down 19.2 percent in October.

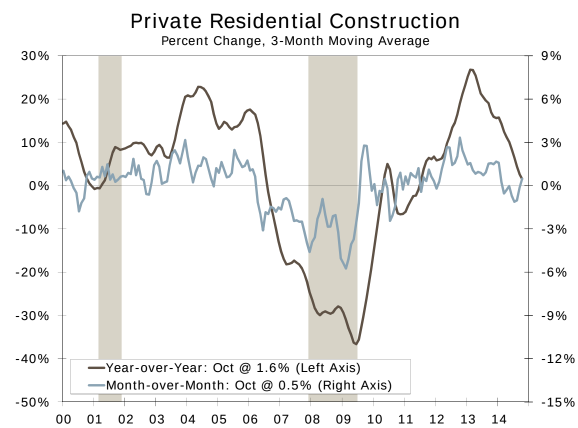
The volatile multifamily component continued to make strides in October, increasing 1.0 percent. Multifamily construction spending reached its highest level since mid-2008 and is up 27.2 percent year-over-year. Apartment fundamentals remain strong. According to REIS, net absorption, which is the change in occupied stock, is expected to end the year at its highest level in four years. However, solid demand has given builders reason to increase supply. Completions surpassed net absorption for the second-straight quarter, and by the end of the year deliveries will reach their highest level since 1999. That said, we expect that apartment demand and completions are nearing their peak levels. Following four years of compression, the apartment vacancy rate rose in the third quarter.

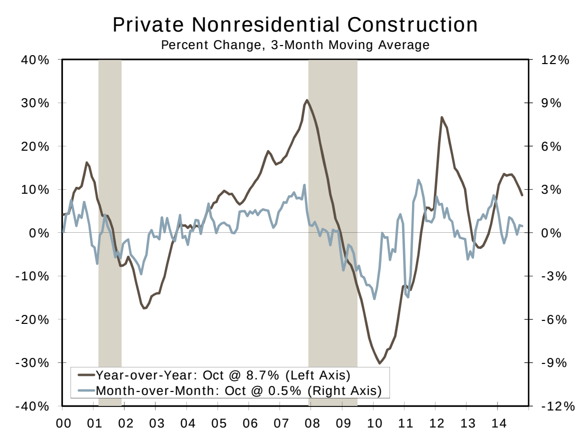
Although private residential construction spending strengthened on the month, nonresidential outlays fell 0.1 percent. Weakness in this component was due to declines in power, commercial, healthcare, communication and religious construction spending. Power construction, which makes up a sizable portion of private nonresidential construction spending, is not expected to make a meaningful contribution to the headline for some time. On the other hand, manufacturing, lodging and office outlays improved during the month.

Structure Investment—No Change

According to the U.S. Bureau of Economic Analysis (BEA), structure investment rose at a 1.1 percent annualized pace in the third quarter. The improvement made only a modest contribution to headline real GDP growth, but marked the sixth straight quarterly gain. Despite the upward revisions, the BEA's assumptions were in line with the actual reading in September, which suggests the contribution to real GDP growth in the third quarter will remain unchanged. For residential investment, we could see a modest increase to headline real GDP growth in the third quarter, all things equal. Despite the monthly volatility, we continue to expect construction to improve in the coming quarters.







Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

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