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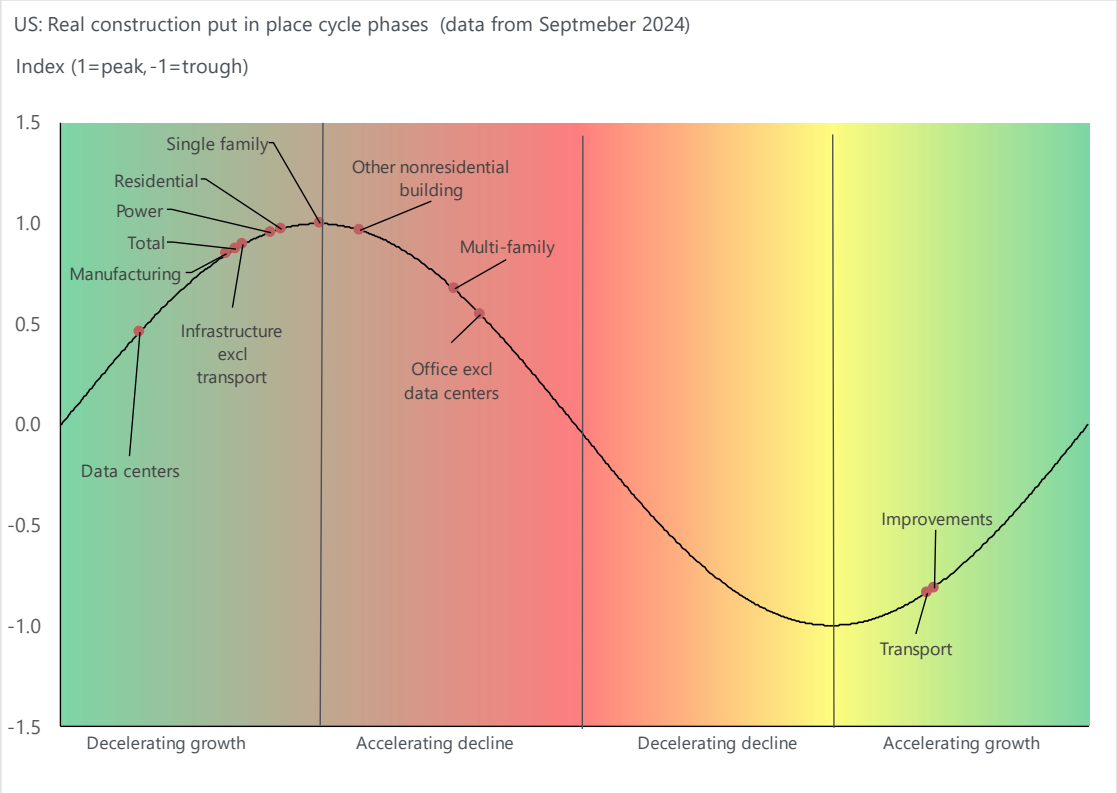
Research Briefing | United States

Construction spending growth nearing end of the line

- **Oxford Economics' new proprietary business cycle indicator shows that real US construction spending is firmly in a decelerating growth phase. Strategically important sectors have had mass investment in recent years, but that phase is reaching a natural peak, and the impact of interest rate cuts will not be felt immediately.**
- **Manufacturing and infrastructure projects have seen large investments and are still growing solidly. Funding from the Inflation Reduction Act and CHIPS packages means there is still room to run and projects are breaking ground, however, the pace of new construction is unlikely to be maintained indefinitely.**
- **Receding inflationary pressures and further rate cuts will begin to support single family residential construction, but mortgage rates remain elevated and interest rates will need to fall further before private investment returns.**
- **Multi-family residential construction has struggled through 2024 due to concerns about over-supply and developers being overly exposed to interest rate risks. Material costs may be lower than the peak in early 2022 but declines have been slow, and the impact of interest rate cuts are still waiting to be felt.**

Applying our proprietary business cycle indicator to real US construction put in place spending reveals a granular view of US construction performance across sectors at the end of Q3. The business cycle indicator tracks the acceleration or deceleration of economic activity across key sectors, identifying those in an upswing and those facing a downturn. By standardizing each sector's position in the cycle, it identifies which sectors are approaching a peak, at risk of contraction, or nearing a trough and poised for growth.

Chart 1: Real construction spending firmly in decelerating growth territory



Source: Oxford Economics

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Investment will continue to flow into strategic sectors

Industrial policy has moved towards the top of policymakers' agenda in recent years and has had a large impact on the allocation of construction spending. Reshoring manufacturing capabilities has been a key focus for the current administration, and looks set to continue under the new administration, with projects focused in strategic sectors, ranging from semiconductor fabs to EV battery plants and data centers. Both the manufacturing and data centers subsectors have been experiencing large scale growth since 2022, with data centers now representing 32% of all office spending, up from 5% in 2014.

Our business cycle indicator has both subsectors in the deceleration growth phase as the initial influx of spending has already occurred, but this does not mean our view of the sectors are dimming. Both are looking at strong spending moving forward, if not at quite the same pace, as the AI boom and government strategies will continue to boost investments across key non-residential building categories. These trends are borne out in our tech spend forecasts. Growth in these categories implies that the level of construction activity is higher than in the previous year—such heady rates of growth are unlikely to continue indefinitely, hence its placement near the peak of the cycle.

Uncertainty around government policy a constraint for Infrastructure spending.

Infrastructure spending has been in the decelerating growth phase for much of 2024 as similar forces to manufacturing have played out in the sector. The past year has seen strong growth, in large part due to government spending ramping up with the Infrastructure Investment and the Jobs Act providing large scale funding for many programs. However, this funding is highly targeted, so there is some deviation across subsectors with transport displaying accelerating growth.

Decaying infrastructure across large parts of America has continued to drive the need for replacement investment and the regulatory backdrop has been positive for developers. While there is bipartisan recognition for ongoing infrastructure spending, budgetary constraints and bureaucratic dispersal of funds could lead to slower construction growth going forward.

Non-residential building is declining outside of key sectors

Outside of the data centers and manufacturing, we see non-residential construction spending in the accelerating decline phase of the business cycle. From a growth perspective, the sector is looking at stagnation and decline; some of this can be attributed to the extraordinary growth in sectors such as education and commercial activity having recently peaked.

Levels of spending will remain high, but the sector's wider performance is sensitive to the broader economic situation. Material costs have been falling from the post-Covid-19 spike but have remained elevated, with little change since the end of 2023. In addition, government focus on only a few subsectors has come at the expense of other non-residential building sectors. Subsectors such as health, education, and commercial have seen growth slow as interest rate rises have hurt private investment, and government funds—as well as material and labor inputs—have been diverted to more strategic sectors.

Residential construction holding out for further rate cuts to re-energize spending

On the residential side, the sector has spent four consecutive months in the decelerating growth phase following an improved performance from its trough in April 2023, but the sector still faces headwinds. Interest rate cuts are expected to be gradual, and their impact on construction will be felt with a lag. Single family construction is being constrained by household budgets and stretched affordability, but lower mortgage rates should boost affordability for households currently locked into a lower rate.

Multi-family building has been very exposed to higher interest rates, exacerbated by issues around over-supply caused by a surge in building in 2021–22. Multi-family construction is firmly in the accelerating decline phase of the business cycle. Both single-family and improvements are in a growth phase, with improvement showing accelerating growth and single family showing decelerating growth. These two segments are larger than multi-family homebuilding, so it is no surprise to see the aggregate residential sector exhibiting decelerating growth.

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Appendix

Chart 2: Construction spending performance in real terms

Sectors	Y/Y growth in 12 month moving average
Total	7.7
Residential	5.2
Infrastructure excl transport	11.8
Office excl data centers	-9.9
Data centers	59.3
Manufacturing	27.0
Other nonresidential building	2.8
Transport	4.0
Single family	9.1
Multi-family	-2.2
Improvements	3.4
Power	12.7

Source: Oxford Economics

Methodological Note

Our proprietary indicator places the total construction spending, as well as seven individual building categories, into a stylized business cycle based on two types of momentum in the monthly construction put in place spending: the sequential rate of change; and whether that rate of change is accelerating or decelerating.

To abstract from the inevitable noise in monthly data that can obscure the underlying trend and potentially give false readings, we calculate these rates of change based on a smoothed 12-month moving average of US construction put in place spending in real terms, deflated by the construction PPI. Furthermore, we calculate sequential momentum as the monthly change in a three-month moving average of the smoothed industrial production index. The sequential change, combined with whether that change is accelerating or decelerating, places the economy in one of the four phases of the cycle in Chart 1.

It is also important to note that because downturns are often shorter than expansions, economies can move through the downcycle relatively quickly (though it is not always the case). For the same reason, an industry may remain in the accelerating growth or decelerating growth phase for quite some time—being close to the top of the cycle does not necessarily mean that a downturn is imminent.

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