20th Weekly Crisis-era Message to Contractors from: Dr Tom Schleifer

US Economic and Construction Market update

Here we are 20 weeks after the mid-March economic crisis began with the V-shaped recovery off the table and a resurgence of the virus a continuing threat. There are still some positive thinkers out there with one saying last week, “What about the improvement in consumer spending?”. I agree it was nice to see, but with consumer spending having been so seriously diminished, the only thing you can say about the improvement is that consumer spending is still seriously diminished. Improvement is not “recovered”. The US economy is in recovery, but it has a long way to go before it stimulates the construction market which is still declining. It is possible that the word “recovery” is being confused by some to be the goal when it simply means the time needed for recovering.

The construction market lags and will continue to lag the US economy by 12 to 18 months. The critical point to recognize is that the construction market does not begin its recovery until the US economy “recovers”. They are not parallel, but sequential. My current preoccupation with the US economy is an attempt to project when it will recover. Because that is when the construction market will “begin” recovery, starting the clock on the 12 to 18-month lag. It was my intention to list current US economic data, but decided against it because you read and watch the news and while you may not keep a written list, you know the information is not positive enough to indicate very much recovery progress. The construction market continues to decline and will get worse before it gets better. The next milestone I am trying to project is when the construction market decline will bottom out.

Knowing the US economy is improving is of limited value to plan with unless it includes how far along it is or a projection of when it might recover. It is too early to project the length of the recovery beyond a range which for now is too broad to be of use. What can be said is that the timing of the US economic rebound is more than the six-month benchmark presented in the 15th weekly message and combined with the 12 to 18 month lag, the construction market rebound is 18 months out. I am inclined to use a range of 12 to 24 months and refine it periodically as new data becomes available.

I use a series of “what if” scenarios to assist in developing adjustments to the projected range:

- Significant resurgence of the spread of virus and/or improvements in testing, tracing, and treating it
- Development of an effective vaccine distributed across the US
- Distribution of the vaccine throughout the developed nations of the world
- Political uncertainty in the US and the results of the congressional and presidential elections in November
- More stimulus funding from congress, or less
- Worsening of geopolitical tensions with China
- Delayed development or ineffective vaccine, or (the unthinkable) no development of a vaccine. Time is critical as business failures and strain on the economy could reach a tipping point into depression
- To a lesser extent than above but positive for the economy-the potential for liability protection for businesses against COVID related lawsuits

A refresher on why and how the construction market lags the US economy may be in order. When the US economy enters a disruption (on average every 10 years), the construction market continues to prosper because the projects in process and most of the backlog are designed, funded and contracted for which, because of the average lengths of projects, provides 12 to 18 months of continuing work. This work, priced during the healthy economy prior to the decline, is profitable. While the work is being completed the amount of work being designed and funded declines. As a seller's market causes aggressive competition for the less available work it drives pricing down and profits suffer. Construction enterprises are then subjected to both diminished sales and diminished profit while their cost of doing business, being difficult to reduce, continues. When the economy recovers it takes 12 to 18 months to design, fund and contract for new work.

I am regularly accused of being a pessimist in the interpretation of economic information which is not the case because this is the interpretation of years of research into every construction market downturn since WWII. The dynamics of each downturn were similar and, in most cases, the same. The model developed prior to the last downcycle was live tested in the 2009-2012 recession and accurately predicted each stage of that declining construction market. Resistance to reacting sooner continues today, particularly because the unique cause of the rapid deterioration of the economy makes this appear different to some. However, the model is in lockstep projecting this market.

The reason I am chronicling this weekly is in hopes that by the next downturn cycle the industry will use it to prosper during the decline, recovery, and following growth market. We do not have to lose money in a market downturn.