



What's it cost?

The recent run in precious commodities in response to the drop in the dollar and better signs of global recovery has missed most of the products and inputs that factor into construction costs. And according to AGC's chief economist the calm in construction pricing should remain in to early 2011.

"I still think PPI for construction will be flat year-over-year when all is said and done," offers Ken Simonson. "My bet for 2010 is that it will end looking like December 2009. The recent spikes in diesel, copper and steel will calm down and the declines in gypsum board and lumber will continue through the end of the year."

It appears that weak supply and demand dynamics are trumping any dollar denominated inflation run, except for the three commodities Simonson names above. The mid-October inflation reports from the Bureau of Labor Statistics confirmed that the producer price index would remain below inflationary concern levels for the year. In September, the PPI rose just 0.3% from August and the moving twelve-month PPI increase was 4%. The weighted average of products and materials used in construction was even tamer, with inputs for construction down 0.1% for the month and up only 3.8% for the previous twelve months.

Of the three commodities showing significant gains, copper has been the most volatile. Copper for December delivery ended October 27 at \$3.77 per pound up from \$3.46 on September 15. The action in copper was most likely the result of investors seeking safer returns as the dollar weakened and other metals gained in favor. The October 27 close was only 50 cents lower than the \$4.27 record high of May 5, 2008, a time when copper demand globally was much higher. A more optimistic explanation for copper's recent run is its reputation as a harbinger of economic activity. The metal gained 1.5% in August and 12% in July as well.

Copper tends to run up in price ahead of demand because it is used broadly in construction, manufacturing and electronics, and its supply inventories are somewhat erratic, leading to shortages with even modest increases in demand. The current copper market isn't showing spikes in demand but exchange inventories for the metal run only about five quarters. Speculators in copper are seeing signs of global demand improvement and betting ahead on recovery leading to spikes in price.

The prices of steel and diesel, although somewhat higher than in 2009, are trading within a fairly narrow range since the beginning of 2010. Nothing extraordinary is in the offing to create a spike in demand for either, and seasonal slowdowns in usage should pressure pricing back to levels that were seen in January 2010.

Of the materials that showed unusual changes earlier in the year the most interesting was the jump in gypsum board. Price increases 20% were put in place in

May by National Gypsum and U. S. Gypsum to reverse a trend of losses by the nation's drywall manufacturers. With only four main producers in the market, and two that dominate the share, the price increases were fairly arbitrary and the manufacturers had to take great care that the increases weren't seen as being collusive. All the manufacturers had been losing money for more than two years so the increases could be justified, but with the end use markets for drywall in such bad conditions the increases looked like they would be difficult to hold. After a couple of months of stubborn resistance, competitive pressures worked to erode the pricing during the slow summer and the trend is for the erosion to wipe out the increases by year's end.

Global conditions haven't produced growth just yet but the perceived improvement in conditions has allowed for prices to drift slightly upward on selected materials and products.

The National Association of Business Economist's mid-year survey found slightly more firms reported rising materials costs than in the second quarter (33% vs. 30%), while only 2% reported falling costs, down from 10% in the previous survey. In contrast, more firms lowered selling prices (17%) than raised them (14%). These pricing dynamics reflect continued competitive conditions that would ease if a recovery begins, and allow producers to begin passing higher material costs on to their customers.

Because Ken Simonson anticipates slightly higher levels of residential and non-residential construction in 2011, he anticipates that manufacturers will be able to push price increases through, although his forecast anticipates a range of price inflation – between 3% and 8% - that is fairly broad.

Before drawing the curtain on 2010, one interesting exercise is to compare pricing on commodities to the year end of 2003, a year that had a similar feel in terms of the recovery from the last recession. Consumer price index inflation has been a cumulative 18.5% over that time, a low rate historically for consumer inflation. The producer price index during that time rose 24.7%, with the PPI for construction up 38%. Inflation for almost all construction inputs rose more or less in the range of the PPI, between 25% and 40%. A look at the outliers, however, provides insight as to why construction costs are up so stubbornly in a bad economy.

The biggest spikes were in energy and oil-related commodities, and steel. The latter rose the most modestly of this group, up 71% since December 2003, but that increase is roughly double the overall PPI. Prices for oil, refined products and copper rose at twice the rate of steel or higher. A few notable items among this group are diesel (up 132%), asphalt (up 195.4%), copper (up 155.1%) and copper scrap (up 265.7%).

PERCENTAGE CHANGES IN COSTS	Sept 2010 compared to			
	1 mo.	3 mo.	1 yr.	Dec. '03
Consumer, Producer & Construction Prices				
Consumer price index (CPI-U)	0.1	0.2	1.1	18.5
Producer price index (PPI) for finished goods	0.3	0.6	4.0	24.7
PPI for construction	-0.1	-0.1	3.8	38.0
Costs by Construction Types/Subcontractors				
Residential buildings	-0.1	-0.2	3.2	31.1
New industrial building construction	0.0	0.1	0.4	N/A
New warehouse construction	0.0	0.2	-0.3	N/A
New school construction	-0.1	-0.2	1.0	N/A
New office construction	-0.2	0.1	-0.4	N/A
Concrete contractors, nonresidential	-0.4	0.7	0.1	N/A
Roofing contractors, nonresidential	0.0	-1.6	-2.7	N/A
Electrical contractors, nonresidential	-0.2	-0.2	0.1	N/A
Plumbing contractors, nonresidential	0.0	-0.4	2.8	N/A
Costs for Specific Construction Inputs				
#2 diesel fuel	-1.5	2.6	17.8	132.0
Asphalt paving mixtures and blocks	-0.3	-0.6	5.1	98.3
Concrete products	0.0	0.2	-0.8	36.0
Brick and structural clay tile	-0.3	-0.7	-0.1	18.5
Plastic construction products	-0.2	-1.0	1.6	36.7
Gypsum products	-2.6	-4.9	-2.3	16.4
Lumber and plywood	-1.3	-5.0	6.5	-9.3
Architectural coatings	0.0	0.0	-3.2	43.0
Steel mill products	1.2	-4.1	13.8	71.3
Copper and brass mill shapes	5.1	11.8	5.9	155.1
Aluminum mill shapes	2.0	3.2	7.9	19.9
Fabricated structural metal	0.1	0.9	-0.7	37.1
Prefabricated metal buildings	-0.4	0.9	10.4	73.6
Crude petroleum (domestic production)	-2.2	-0.5	9.6	147.7
Asphalt (at refinery)	-8.0	-12.9	12.6	195.4
Cement	-0.6	-0.8	-6.1	27.3
Iron and steel scrap	5.1	2.2	33.9	136.2
Copper base scrap	2.3	13.6	23.8	265.7
<i>Source Bureau of Labor Statistics, Updated October 15, 2010</i>				
<i>Compiled by Ken Simonson, AGC Chief Economist</i>				

The disparity between these commodities and those closer to core inflation and producer prices can be explained away as anomalous for a few reasons, but there is also a case to be made for the higher rates of inflation in these items as indicators of future inflation in all commodities. Virtually all of these runaway commodities and especially those with the highest inflation are subject to speculation, which could suggest that the allowance for coming demand increases is being built into the pricing now. Demand for all construction materials and products will have to grow significantly for a longer period of time to test that theory, but if predictions of growth in 2011 are correct, we should see some validation tested early next year.