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## National Outlook: What a Difference Six Months Makes to Some National Forecasters

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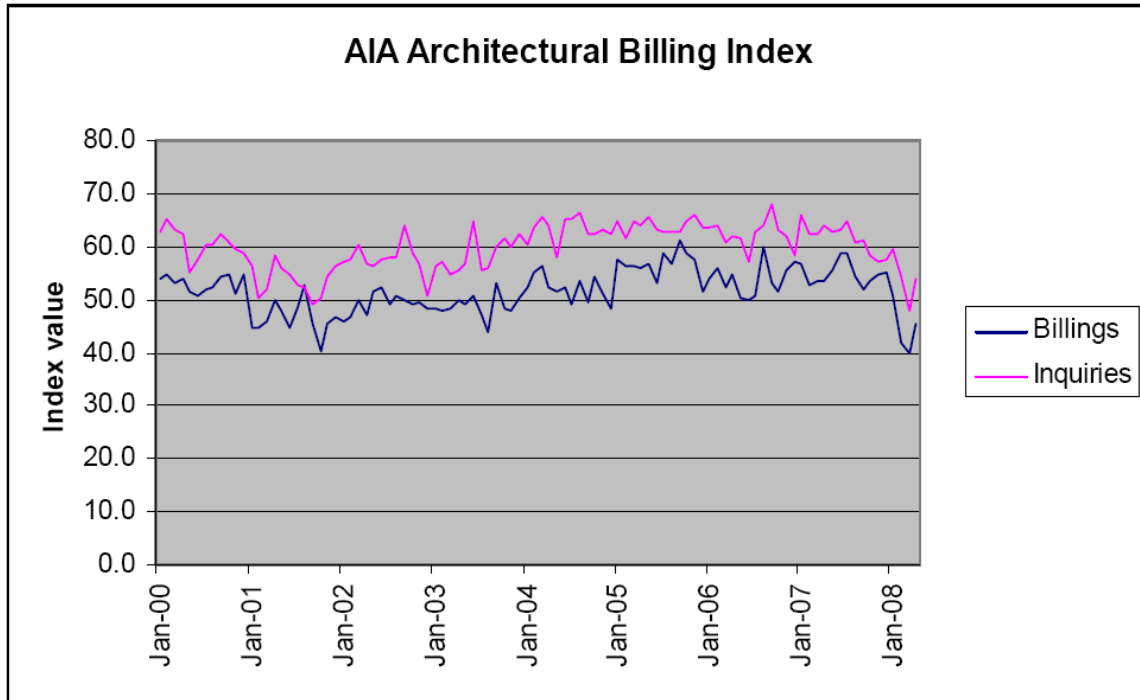
Professional economists (ones that are paid to forecast rather than profess) are faced with putting their reputations on the line each year by foretelling the future. Forecasting is a matter of assessing what you know, and don't know about the economy, and then taking a flyer at what you don't know that you don't know.

For construction economists, the end of 2007 was pretty straightforward. They knew the housing market was bad and not getting better. They knew non-residential construction was probably going to keep its head above water for another year. And they knew the price of construction materials and inputs was going to rise faster in 2008 than in 2007. What they couldn't know that they didn't know was that the market still had more downside than they thought, and that the increase in costs could go so high, so fast.

"Unquestionably the biggest surprise for me was that fuel and steel prices have increased much faster than I imagined," says Associated General Contractors of America's Chief Economist, Ken Simonson. "I'm not alone. No one I know thought rebar and structural shapes would keep going up, or that #2 diesel would be \$4.70/gallon."

For American Institute of Architects Economist Kermit Baker, not much has changed since January, but then, a lot changed in January. "The market for architects was pretty strong right through the end of 2007," Baker observed. "The Architectural Billing Index (ABI) collapsed more sharply in January than I would have expected. The surprise was that the decline was as steep and as steady"

The AIA's Billing Index is a simple percentage of the number of firms who report gains versus declines. While it can be argued as an oversimplified view of the market, the history of the ABI suggests it's a good lead indicator. "The last time there was a decline like this there was a four year downturn, so I went back and looked closer at the index," says Baker. "The ABI was strong through 2000, and then dropped 10 points in early 2001. I don't think conditions are nearly as bad as they were then, but you only have to get a whiff of the housing market to get an idea of how bad things could get."



Like the AGC's Simonson, Reed Business Information's Jim Haughey has also been caught short by the magnitude of the rise in prices. "We forecasted an overall increase in prices of 4% more than 2007, but costs are up 6.5% through April, and are continuing to accelerate," admitted Haughey. "A lot of the energy frenzy has spilled over into other commodities, primarily in metals, where producers continue to ask more, and are getting a lot of it."

As June closes out there are a couple of trends in the market worth noting. The housing market remains in its slump, with starts holding at an annualized rate of 700,000 units of single-family housing, and 300,000 multi-family units. May's starts were 674,000 single-family and 301,000 multi-family units. Without any further improvement, total housing starts would end up just over 1 million units, or roughly 20% lower than 2007, and half of the record highs of 2005. For those who predicted a bottom and the beginnings of recovery by late 2008, there are almost no signs pointing to that happening.

House inventories for sale remain high, foreclosures continue to add supply to already high backlogs of houses, and housing prices have dropped further. While there are some indications that the slide in prices has started to entice buyers off the sidelines, any renewed interest is not expected to ease the declining values. Henry Kaufman, president of financial consulting firm Henry Kaufman & Company Inc. said U.S. home prices have slumped 12 to 17 percent from their peak in the summer of 2006 "and it wouldn't surprise me to see a further decline, to 25 percent nationally in housing prices."

	Monthly Figures (1)		Actual			Forecast	
	8-Mar	8-Apr	2005	2006	2007	2008	2009
	Northeast	97	117	189	171	143	127
Midwest	121	144	357	284	206	151	198
South	498	516	1,001	912	675	543	658
West	227	269	551	444	317	225	274
Total	954	1,032	2,073	1,811	1,341	1047	1274
Total Single-family	704	692	1719	1,474	1,034	724	928
Total Multi-family	250	340	354	338	307	323	346

The value of new construction starts in April climbed 9% to a seasonally adjusted annual rate of \$553.5 billion, according to McGraw-Hill Construction, a division of The McGraw-Hill Companies. Excluding residential building, new construction starts in the first four months of 2008 rose 3%.

April's data produced a reading of 117 for the Dodge Index (2000=100), up from a revised 108 for March, and equal to the average for January and February. "While housing is still in the process of reaching bottom, and tighter lending standards are raising concern about the prospects for commercial building, publicly-financed construction is expected to hold up relatively well during 2008," stated Robert A. Murray, vice president of economic affairs for McGraw-Hill Construction.

Reed's Jim Haughey also feels that non-residential construction should be OK for the remainder of the year. "The market, excluding housing, should be plus or minus a couple of points compared to last year on a square foot basis," he says. "I'm seeing easing in the financial constraints that were in place from September through March; it's not problem #1 anymore. If I build it will anyone rent it is now problem #1."

Ken Simonson sees 2008 on slightly thinner ice. "The number of projects started should be positive compared to last year, but profitability is getting out of whack," he notes. Simonson's concern is that higher costs will soon erode developer confidence. "The prospects for the future are darker. The government revenues will be lower, money supply will be tighter, and higher budgets won't pencil out with the developer's expectations for rent."

One sector where the financial markets are having an impact is in hospital construction, which was one of the bright spots of the market. For the first half of the year the combined healthcare categories were up 5% over 2007, compared to growth rates of 14-20% in previous years. Simonson is concerned that problems with February auction rate securities may foretell future problems financing hospital capital plans. "The hospitals try to moderate the changes in interest rates by rolling out new bonds monthly," explains Simonson. "Suddenly the banks that bought these bonds in past weren't interested." A lack of financing could halt hospital capital plans temporarily, while the bond markets

sort themselves out, even though the demographics and demand support more healthcare facilities.

Kermit Baker sees the increase in ABI's May inquiries and billings as a relief, even if it's temporary. Still he's cautious about the end of 2008. "The implications of a (billing) slowdown like we had are that things should be healthy through the third quarter," he says. "But after that there could be a quick slowdown."