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## What's It Cost?

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One of the few benefits of a construction market that is stuck going sideways is the short-term impact on construction inflation. After a few price increases occurred for some basic items early in 2010, sluggish demand has drawn most prices back to last year's levels, with the prospect of further price deflation likely as the year winds down.

July's report on inflation showed that the Consumer Price Index was flat from June to July and up only 1.2% for the past 12 months. Producer Price Index (PPI) showed slightly higher rates of inflation, at 0.3% for the month and 4.4% for the previous year, but the PPI growth has continued to decline since the beginning of the year. PPI for products and materials that are used for construction actually declined from June to July by two-tenths of a percent. Like the overall PPI, the inflation for construction inputs continues to fall, slipping to an annual rate of 4.5%.

For contractors, and especially specialty contractors the declines have not occurred soon enough or steeply enough to offset the deflation from competitive pressures for their installed work. Of the major specialty trades measured by the Bureau of Labor Statistics only plumbing construction has risen more than one percent, and that trade's 2.7% increase is owed entirely to the disproportionate inflation in copper and steel prices over the past 12 months. With each of those materials rising more than 25%, the slight increase in installed plumbing masks the decline in what plumbing subcontractors are able to charge for skilled labor, overhead and profit. Among the other trades, roofing has seen a 2.9% decrease; electrical has risen 0.3% and concrete 0.1%.

The diverging trends have put unusual pressure on subcontractors nationally. The recipe of 25% to 40% fewer projects, combined with pricing deflation in the face of even low inflation for materials has created a very tenuous landscape for the specialty contractors. Many industry observers – the surety companies in particular – are anticipating record high levels of business failure among the specialty trades in 2011.

Over the past two decades the share of work being self-performed by general contractors has fallen significantly, so that the health of the specialty contractor should be of major concern to the industry's developers and institutional owners. Should the worst case scenarios come true – the worst skeptics predict one in four subs will fail – the impact on construction in progress will be dramatic. During the course of the next 12 months the likely trend for building materials and products is for continued soft pricing, perhaps falling to an annualized PPI increase in line with the CPI's one to two percent rise. This forecast seems essential to cushioning specialty contractors in the transition from their current difficulties to a recovery, assuming recovery is in the works.

PERCENTAGE CHANGES IN COSTS	July 2010 compared to		
	1 mo.	3 mo.	1 yr.
<b>Consumer, Producer &amp; Construction Prices</b>			
Consumer price index (CPI-U)	0.0	0.0	1.2
Producer price index (PPI) for finished goods	0.3	0.1	4.2
PPI for construction	-0.2	-0.5	4.5
<b>Costs by Construction Types/Subcontractors</b>			
Highway and street construction	-0.2	3.1	6.8
Residential buildings	-0.2	-0.2	3.7
New industrial building construction	0.1	0.4	0.0
New warehouse construction	0.2	0.2	-0.6
New school construction	0.1	-0.2	0.6
New office construction	0.3	0.4	-0.6
Concrete contractors, nonresidential	0.6	0.3	0.1
Roofing contractors, nonresidential	-1.5	-1.5	-2.9
Electrical contractors, nonresidential	-0.1	0.0	0.3
Plumbing contractors, nonresidential	-0.4	0.1	2.7
<b>Costs for Specific Construction Inputs</b>			
#2 diesel fuel	-1.5	-9.0	26.4
Asphalt paving mixtures and blocks	0.0	0.0	6.6
Concrete products	0.0	-0.1	-1.9
Brick and structural clay tile	-0.3	0.6	0.2
Plastic construction products	-0.5	-0.7	2.7
Gypsum products	-2.2	2.6	0.2
Lumber and plywood	-1.4	-3.3	12.1
Architectural coatings	0.0	0.1	-3.2
Steel mill products	-1.4	0.7	26.1
Copper and brass mill shapes	-0.1	-13.0	16.1
Aluminum mill shapes	-0.6	-4.7	9.0
Fabricated structural metal	0.4	-1.5	-2.8
Prefabricated metal buildings	1.6	7.0	9.2
Crude petroleum (domestic production)	-0.1	-11.3	29.0
Asphalt (at refinery)	-2.1	-0.4	23.2
Cement	-0.7	-2.7	-6.9
Iron and steel scrap	-6.7	-16.5	45.6
Copper base scrap	1.4	-15.1	27.1

Source Bureau of Labor Statistics, Updated August 17, 2010  
Compiled by Ken Simonson, AGC Chief Economist

Within the major categories of products and materials there are few changes in price during the past two months but significant changes since the start of the second quarter. Most materials have seen noticeable declines since April but are flat or up over the past twelve months, suggesting that the trend is still downward.

Copper, lumber, drywall, aluminum, concrete and steel scrap have all declined in the range of 4% to 7% over the past 60 days, but are all still higher than last July. Some other basic commodities have experienced even greater divergence.

Structural steel has been one of the more volatile components but the volatility has been within a very narrow range. For example, the nation's largest domestic mill, Nucor announced a \$20 per ton decrease on July 13. By August 15 the steel mills had put in place a \$25 per ton increase for rebar and structural

shapes. Steel executives surveyed in July expressed doubt that any supply and demand changes were in the offing to give a boost to prices, expressing the opinion that prices were likely to bounce around within a few percentage points from a bottom during the second half of 2010. Even with the lower outlook the price of structural steel remains more than 26% higher than last year.

The price of #2 diesel, like that of crude oil, remains higher than supply and demand support would suggest, although the commodity has fallen around 20 cents per gallon from the May high of \$3.22. Since last July the price of #2 diesel is also up over 26%. Refining capacity continues to lag demand, even at these lower levels, but the main support for #2 diesel pricing seems to be the elevated price of crude oil. That commodity has declined somewhat since April, but the price of crude oil – which closed at \$74 per barrel on August 20 – is essentially flat compared to August of 2009, even though optimism about the prospect of global recovery has fallen dramatically.

Similar pricing action has occurred in asphalt materials, a byproduct of diesel refining, and plastics, which have natural gas as their source commodity. Both have seen declines in recent months but have a 12-month trend that shows double-digit increases.

With the exception of stainless steel and iron ore, prices for construction products and materials are showing similar and stable pricing patterns as the third quarter winds down. Barring an unexpected acceleration of the economy, those trends will be with the industry into 2011.