There has been little cause for celebration on the economic front in 2014, but 2015 should see improved growth, reported William Strauss, senior economist and economic advisor for the Federal Reserve Bank of Chicago, in his remarks at MSCI’s Forecast 2015 conference last month in suburban Chicago.

The year got off to a poor start as extreme winter weather conditions in the first quarter slowed the recovery’s progress. GDP is forecast to finish this year up around 1.9 percent, following on the heels of 3.1 percent growth in 2013. Next year will see an improved growth rate around 2.9 percent, he said.

Home prices continue to improve, but remain well below their peak after a 40 percent drop during the recession. The consensus forecast calls for a very gradual recovery in homebuilding with 1.0 million housing starts this year and 1.2 million in 2015. “That’s still below the normal rate. We need the labor market to improve first,” Strauss said.

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As of May, the U.S. finally had more people working than before the recession. But that’s not necessarily the good news it appears. The population grows at an annual rate of about 1 percent, so the economy needs to create about 3 million more jobs each year just to keep up with the expanding labor force.

The labor force participation rate remains 3 percent below the level of 2008 at about 63 percent. Half of that 3 percent is due to demographics and the larger number of retirees in the aging population. The other half represents a greater number of individuals who have given up looking for work.

Three out of 10 of the unemployed have been out of work for more than six months. Five percent of the total workforce, or four million people, are working part-time because they cannot find full-time employment. The 6.5 percent unemployment figure, while improved, masks the plight of the underemployed and discouraged. “We are still two years away from the point we can talk about the labor market being in balance,” Strauss said.

On a positive note, inflation remains moderate, forecast to rise 2.3 percent this year and 2.1 percent next year. To keep stimulating the economy, the Federal Funds Rate is expected to remain near zero until next year, and then rise by only about 1 percent. “Government policy can remain aggressive, even to the point of enduring a little inflation, to give the labor market more time to recover,” Strauss said.

Pointing to specific markets, Strauss noted that the industrial sector continues to do very well. Industrial production is forecast to grow above trend at 4.1 percent this year and 3.5 percent in 2015. Motor vehicles, primary metals and machinery are leading the rebound. In the auto sector, light vehicle sales are forecast to hit a healthy 16.3 million units this year and 16.7 million in 2015. Steel production has increased at a moderate pace with capacity utilization around 80 percent—pretty good considering the weakness in nonresidential construction, one of steel’s biggest markets. Aluminum production growth has been relatively flat, but excess capacity in the sector should be absorbed by the growing use of aluminum sheet in automotive body panels.

“As of May 2014, we are now producing more than ever before—24 percent of world manufacturing output,”

“We are still two years away from the point we can talk about the labor market being in balance.”

William Strauss, Federal Reserve Bank of Chicago

Through the first three quarters, 2014 fell short of expectations with an economy that can’t seem to shake its labor woes. But the experts are predicting better times in 2015, led by energy and long-awaited gains in nonresidential construction.
Strauss said. Yet only about one-third of the U.S. manufacturing jobs lost during the recession have been recovered. How’s that possible? More automation and greater productivity, he said.

Putting the labor situation in perspective, he noted that in the late 1800s nearly half of all Americans were involved in farming. Today, only 1-2 percent of jobs are in agriculture. “Productivity gains are good in the long term,” he said.

**Anticipation Builds for Construction Upturn**

The construction sector is the largest consumer of steel, so for the steel industry to have done so well with mediocre support from its top market is a testament to the hidden strength of the economy’s recovery. How much better will steelmakers and distributors fare when construction finally takes off? They may soon find out.

Speaking at MSCI’s annual forecast conference, Kermit Baker, chief economist for the American Institute of Architects, presented a fairly optimistic outlook for the steel-intensive nonresidential construction market. “It has been slow to respond to the broader recovery, but it looks like we’ve finally turned the corner,” he said.

Construction spending, both residential and nonresidential, represented 8.5 percent of the U.S. economy in 2006. That share bottomed at 5.1 percent in 2011 and has only inched back up to around 5.3 percent to date. The nonresidential spending portion has seen limited improvement over the past three years, from $337 billion in 2011 to a projected $368 billion this year. Spending in the first half of 2014 grew by a modest 3.6 percent, according to Census Bureau data.

But pointing to various market factors, Baker is convinced the construction market is poised to surge. AIA’s Architecture Billings Index, which uses current design projects to predict construction activity 8-12 months in the future, recently hit its highest mark since before the recession. Its July reading of 55.8 reflects stronger gains in architectural billings than any period since mid-2007. The index indicates that business conditions have improved for firms in all regions of the country and in all the major construction sectors: residential, commercial/industrial and institutional, Baker said.

Employment is another positive indicator. Department of Labor data shows the construction sector has been adding jobs at a healthy pace of about 24,000 per month this year. Market data, such as property values, vacancy rates and rents, have reached a level that should encourage new construction investment.

Overall, AIA’s Consensus Construction Forecast Panel expects 4.4 percent growth in total nonresidential construction this year, followed by a much stronger 8.1 percent gain in 2015. Double-digit increases in commercial construction, including hotels, offices and retail, will lead the way. Even institutional projects such as schools and health care facilities, which have been flat this year, will grow by nearly 6 percent nonresidential construction is expected to increase a modest 4.4 percent this year, but enjoy more robust growth next year. (Source: American Institute of Architects)
percent next year, the panel of experts predicts.

“The fundamentals, by and large, are improving in every category. We are encouraged to begin seeing improved numbers on the institutional side,” Baker said.

Longer term, demographics trends will dictate much of what gets built. The U.S. population is projected to add 24.5 million people by 2020, then another 24.6 million from 2020-2030. Nearly 60 percent of them will be “seniors” in the 65-84 age range, which assures enormous demand for construction of hospitals, elder care facilities, and the like. The second-largest group, about 25 percent of the total, will be made up of “millennials,” those in the 25-44 age range, who will need a place to work, live and shop for their young families. Thus office, residential and retail construction is on the industry’s radar.

In the near term, Baker said, nonresidential construction has been slow to materialize. But given the market’s strong fundamentals, construction activity should respond quickly, beginning in 2015.

Panel: Government Regulation is a Drag on the Economy

Government regulation, especially of the energy industry, brings enormous cost and uncertainty to the marketplace and may well be preventing the economy from reaching its full potential, asserted energy market panelists at MSCI’s Forecast 2015 conference last month in Chicago.

By some estimates, compliance with government regulation costs American industry nearly $2 trillion a year or the equivalent of 10 percent of total GDP. It is difficult to measure the full effect of regulations and how they may alter investment, said panelist Susan Dudley, professor of public policy and director of the Regulatory Studies Center at George Washington University. “And the churning of the regulations only adds to the uncertainty.”

Government regulation puts the markets on a completely different trajectory, said panelist Toby Mack, president and CEO of the Energy Equipment & Infrastructure Alliance. “What could markets become in the regulations’ absence?” he asked. “What would the benefit to society otherwise have been?”

Regulations that increase energy costs affect all parts of the economy to one degree or another, the panelists noted. Subsidies for alternative energy sources, such as wind and solar, may inhibit investment in other areas, such as nuclear. “A sensible energy policy is essential to the future, but government should not be in the business of picking winners and losers,” Mack said. “Let the market and its investors determine which energy sources are best.”

New EPA regulations focused on reducing harmful emissions from coal-fired power plants could be especially costly, critics claim. “You can’t just get rid of coal and expect the lights to stay on,” said panelist Christopher Guith, senior vice president for policy at the U.S. Chamber of Commerce Institute for 21st Century Energy.

The promise of cheap oil and gas from North America’s abundant shale deposits, and the economic boom it will fuel, is almost indescribable, Guith said, “but we could still screw this up. We have a vocal minority who hate fossil fuels.”

The rapid advancement of the new hydraulic fracturing drilling technique or “fracking” has had a big effect on the economy in all 50 states, not just those with energy-rich shale deposits. Regulations that restrict this new economic engine stand to hurt everyone, the panelists said.

Mack asserted that there is no scientific evidence fracking is harmful to the environment or the water supply. But fear mongering by those who are misinformed, no matter how well-intentioned, is putting a drag on progress. Hundreds of actions have been taken by various agencies at the federal, state and local levels to restrain fracking, at least temporarily. “Hydraulic fracturing won’t be banned, but regulations will add incremental costs,” Guith said.

The Obama administration’s prolonged inaction on the Keystone XL pipeline, designed to transport oil from Canada to refineries on the Gulf of Mexico, may well be intentional, Guith said. The cross-border project cannot proceed without the president’s approval. The goal of the administration may be to run out the clock while the Canadians find other ways to get their oil and gas to market. “Though it is far more efficient and economical, Keystone may eventually become moot,” Guith said.

Dudley urged the service center and mill executives in the audience to be vocal on proposed rule changes and appeal for reasonableness to their elected officials. Energy companies have a presumed agenda; a steel company has credibility, she said.