Building Resilience: Navigating Economic Shifts

U.S. Market View
Winter 2025

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Introduction

Welcome to the Winter 2025 U.S. Market View entitled, "Building Resilience: Navigating Economic Shifts." The inauguration of President Donald Trump has triggered a positive market reaction focused on technology companies and crypto-currency. The blizzard of executive orders that have followed the ceremonies on January 20th point to a highly consequential and highly unpredictable presidency.

The real-world economy of construction is likely to benefit from improved investor sentiment in the medium term, but the impact will be delayed, particularly while the cost of finance presents headwinds to the all-important housing and commercial sectors.

The decision of the U.S. Fed to hold interest rates in its January 2025 meeting highlights that the U.S. appears to have achieved its soft-landing objective. With strong job growth, a 2% GDP growth forecast for 2025 and overall inflation at 2.2% (CBO data), the Fed's view is that further monetary stimulus is currently not needed.

The Fed chose not to comment on President Trump's policy platforms including trade and migration, which potentially bring new inflationary risks associated with tariffs and labor shortages. We briefly examine the implications of tariffs on materials pricing for the construction sector.

In the meantime, the volume of construction grew by 3.8% in real terms in the U.S. in the 12 months to November 2024, with the public sectors in particular seeing strongest growth at 5.5% year-over-year. However, activity slowed in the autumn, with an early indication of contraction in the private and residential sectors.

Only weeks into the new presidential term, it is too early to assess what the direct implications will be for the construction sector – whether consumer confidence takes off, or whether tariffs and inflation outweigh any benefits secured from cheaper energy, deregulation, and other policy priorities. What can be certain is that construction's health in 2025 will be more reliant on the performance of the private sector than in the past 2 years, during which federal programs have underpinned growth.

Construction Market Overview

Although construction grew briskly in 2024, up by nearly 4% in the year to November 2024, latest data points to a roller coaster year for different sectors. The public and non-residential sectors continued to see steady growth in inflation-adjusted output throughout the year, while the private and residential markets faded after a bounce-back that started in Q3 2023 ran out of steam, even as the Fed started its rate-cutting cycle.

The private sector, including residential, accounts for 75% of the market and the overall growth rate slowed to 0.25% quarter-on-quarter up to November 2024. By contrast, the public sector's growth rate was over 2%.

	QoQ	YoY
Total construction	0.3%	3.8%
Non-Residential	1.3%	3.7%
Residential	-1.2%	4.1%
Private	-0.3%	3.4%
Public	2.2%	5.5%

Table 1: Construction Growth (Real terms - % change) | *Source: Bureau of Labor Statistics*

Construction Output in Constant Prices

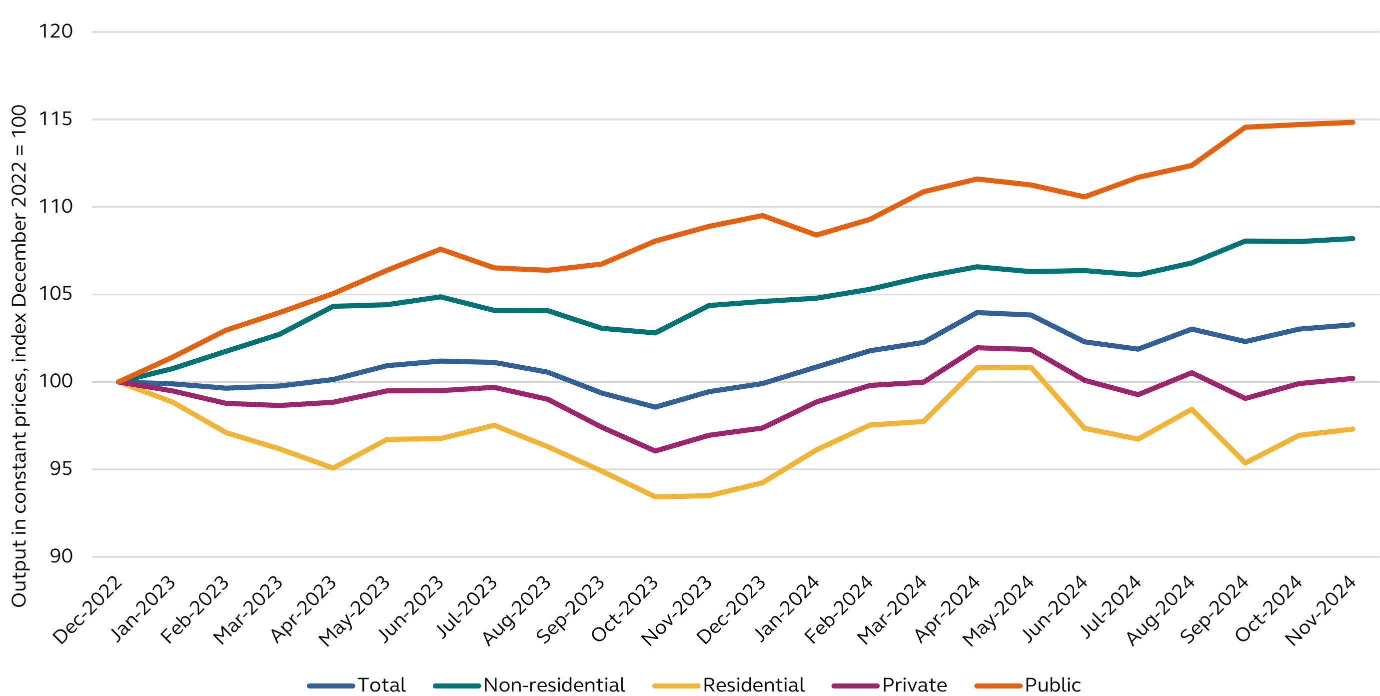


Figure 1: Construction output trends, 2023 to 2024 (real terms) | *Source: Bureau of Labor Statistics, Arcadis*

Figure 1 highlights how sector growth rates have diverged over the past two years.

Public sector spending boosted by federal programs grew in real terms by 15% over the period, reversing a brief contraction that took place in H1 2024.

By contrast the private sector, which includes the rampant manufacturing sector, has effectively flatlined with a particularly weak performance in investment-led sectors including commercial and office. Residential staged a strong recovery in 6-months to May 2024 but has since lost momentum and remains the softest major industry segment over the past two years.

Sales of previously occupied homes slumped to a 30-year low, falling by 0.7% during 2024. Paradoxically, one of the reasons for weak sales, on top of high finance costs and sales costs, is the lack of inventory, to which the slowdown in the housing construction market will have contributed.

The outlook for 2025 is much less certain, particularly for public sector construction. An early Executive Order halting further disbursements of federal grants under the IIJA and IRA worth $294 billion has the potential to delay a wider range of projects including wind and solar power, EV charging stations and passenger rail, as States and Cities scramble to confirm the scope of the measure.

This could affect elements of the power sector, for example, which grew by 5.7% in 2024, as well as highway and street works. Given the contribution of the public sector to growth in 2024, short-term disruption to publicly funded programs could prove to be a drag anchor on construction activity in Spring 2025.

A deep dive into industry sectors highlights the public programs that have benefited from short-term growth focused on large-scale public/utility spend. The top six sectors including education, highways, water, and waste management are all dominated by public sector investment.

Construction Growth in Constant Prices - Major Sectors

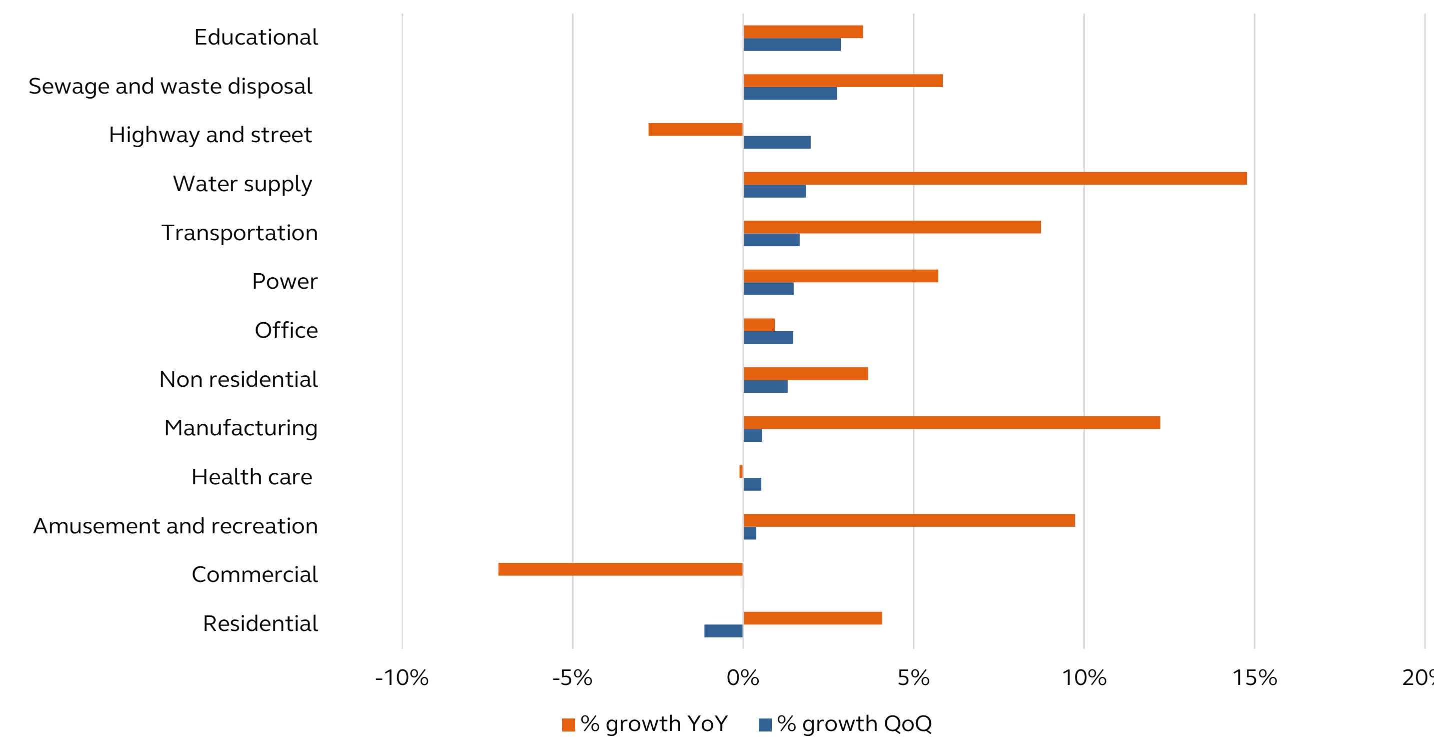


Figure 2: Construction sector growth rates (real terms) | *Source. Bureau of Labor Statistics, Arcadis*

Year on year, the sectors that have seen strongest consistent growth in volumes of activity include water supply, manufacturing, and transportation. Manufacturing continues to be the standout sector with respect to sustained growth, having doubled in size since December 2021 and having grown by a further 12% in the year.

Future growth prospects are also subject to dynamic forces unleashed by the federal government. Trade and tax policies will encourage U.S. firms to direct future investment in production towards home markets. By contrast, reduced support for energy transition will directly affect progress on factories manufacturing products as diverse as batteries, transmission cables and wind turbines.

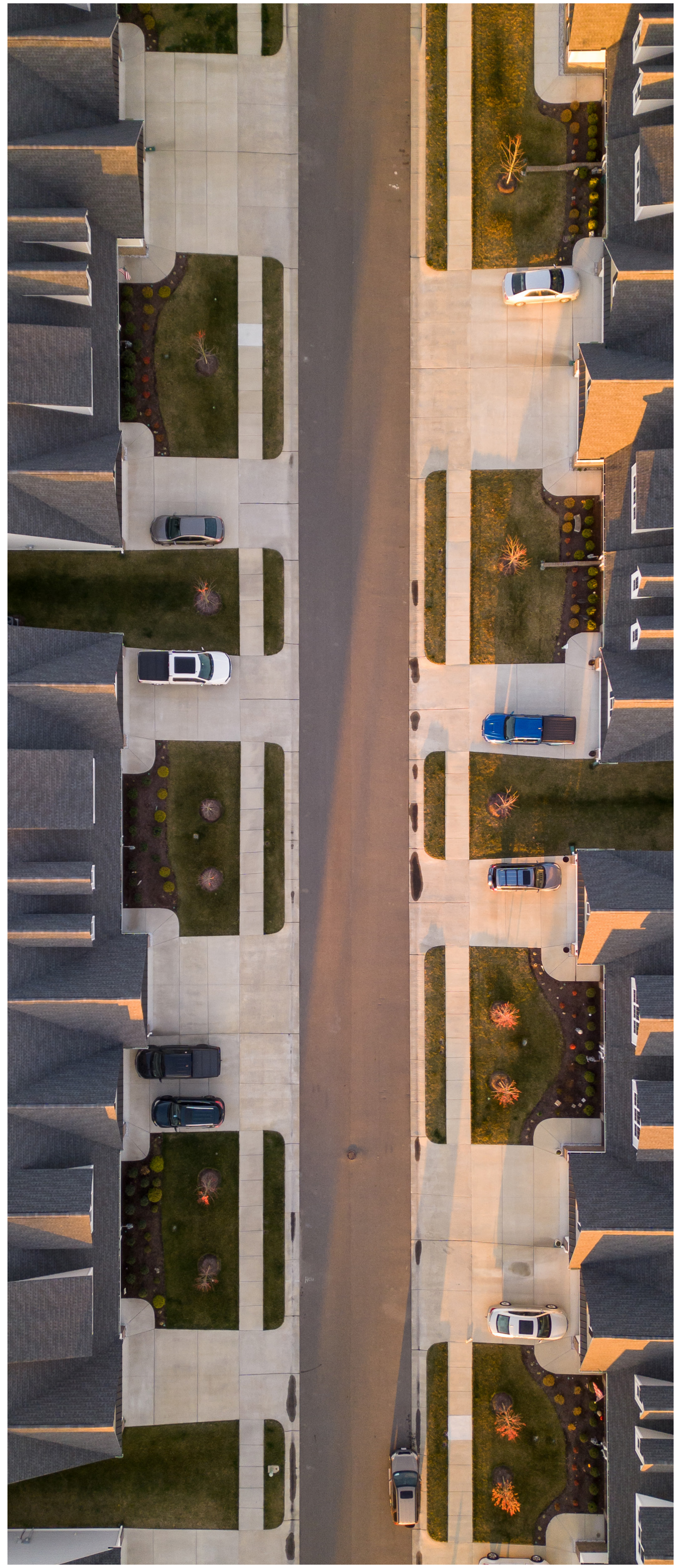
Residential output slowed towards the end of the year after a strong start to 2024. However, immediate prospects are much stronger, following an increase in housing starts in December reported by the National Association of Home Builders (NAHB). Growth of 16% to an annualized rate of 1.5 million is the highest level since February 2024. 30-year mortgage rates are down from their peak but have increased by eighty-five basis points to 6.95% in January 2025. The consensus is that rates will stabilize at 6% in 2025, giving little relief to hard-pressed buyers.

In a particularly interesting development, the lagging multi-family segment, which contracted in volume terms by over 8% YoY, saw the strongest growth in starts – up by 62% on an annualized basis. Given that multi-family development accesses the general contractor supply chain, if this development does convert into substantial growth in H1 2025, then competition for contractors is likely to increase in the coming months.

Another factor focused mainly on the residential market is the consequence of natural disasters. The U.S. has been repeatedly hit during the past 6 months by events including Hurricane Helene, which caused damage valued at over $80 billion, and the recent Los Angeles wildfires, estimated to cost $250-275 billion in rebuild alone. Recovery will require significant reconstruction works, albeit that the timing and scale could be very variable. Given the size of the U.S. housing sector, reconstruction works are unlikely to affect national markets but will no doubt impact labor and materials markets at the local level.

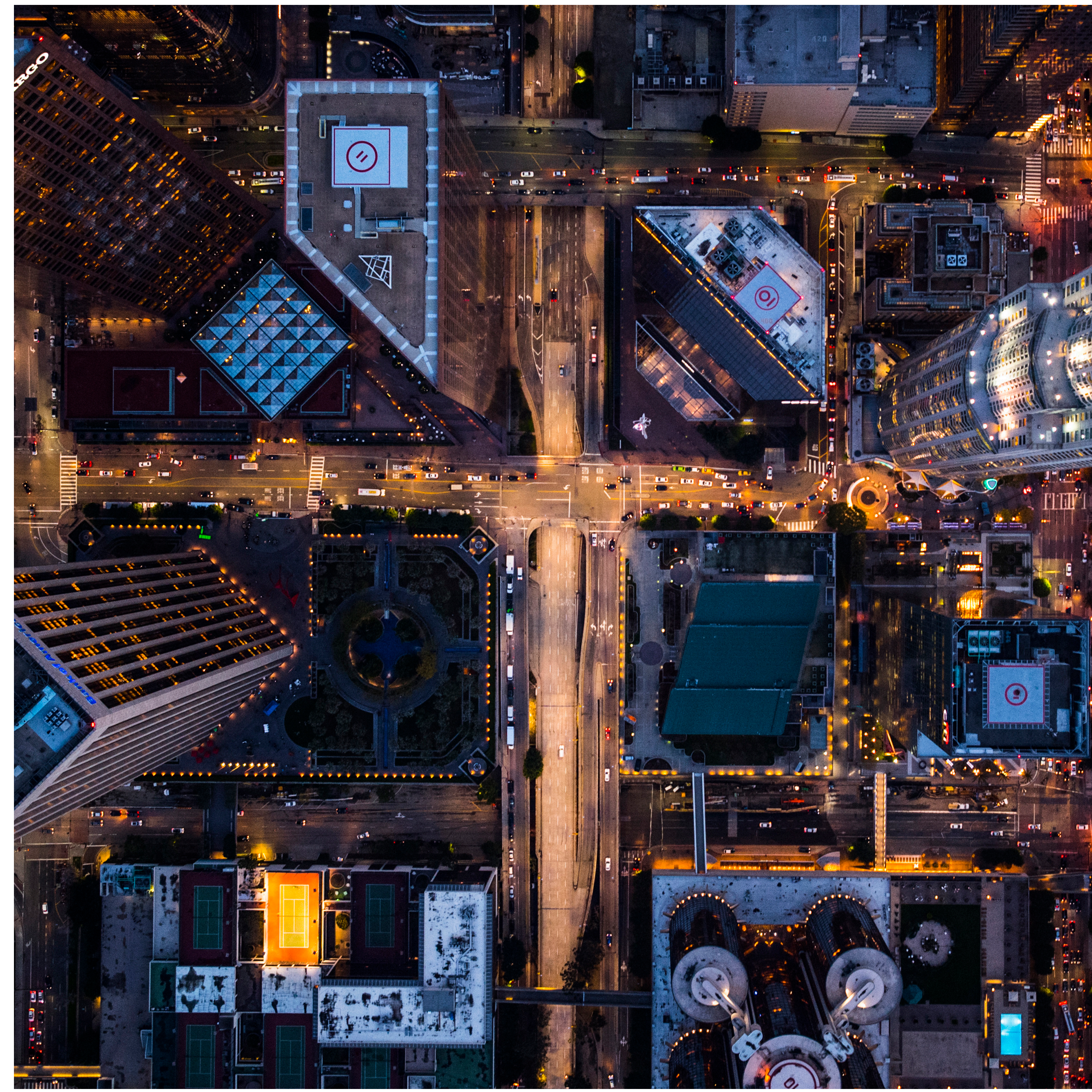
Looking further ahead, some of the structural drivers for housing demand may be changing. A recent Harvard University paper projects a lower rate of household growth at 860,000 per year. Reduced immigration will also hold back household formation. Due to the housing shortage and increased demand from older households, lower growth rates may not directly convert into reduced construction demand, but it does point to further headwinds for this crucial sector.

Future growth prospects are also subject to dynamic forces unleashed by the federal government.



As previously highlighted, commercial and residential development represent the pivot sectors that could trigger a significant growth in activity levels when markets turn. Despite a significant uptick in data center (DC) work, a deep fall in levels of investment in other commercial categories including retail and office has continued into 2024, and volumes are down by over 5% YoY. Given the explosive growth in DC investment unleashed by AI, once investment in traditional real estate recovers, the sector should bounce back quickly. There are also tentative signs of a recovery in the commercial market with BlackRock reputedly close to acquiring a major Midtown New York asset at a bargain price. The return of institutional money into the property market will accelerate price discovery, land value resets and developer interest.

One source of potential uncertainty follows the launch of the DeepSeek Large Language Model (LLM), which is likely to unleash new competition focused on reduced computing costs. Continuing high volumes of data center development are not necessarily guaranteed as a result. Major data centers (DCs) investors including Blackstone have so far indicated that development plans are unchanged, but it is possible that reduced computing requirements will over time result in changed functional requirements for new DCs.



Future Outlook

2025 has opened with the U.S. economy in robust health. Annualized GDP growth at 4th quarter 2024 has been confirmed at 2.3% and the latest forecast for growth for 2025 has been set at 1.9% by the Congressional Budget Office. However, sustainable growth rates may not be enough for President Trump who has urged the Federal Reserve to cut the base rate to provide further stimulus.

Inflation has been on an upward trend since August 2024, complicating monetary policy. Based on robust non-farm payroll data for December, up by 256,000 and with Core CPI falling fractionally to 3.2%, the Fed called a temporary halt to base rate cuts in January 2025. The stage is set for an early test of Central Bank independence in the second Trump term, potentially increasing economic risk.

Forward indicators for the economy point to expansion, but for the construction sector are more mixed. Purchasing Managers' Indices published by S&P Global Ratings for December 2024 were borderline positive indicating continuing growth. The Services PMI has fallen back slightly since the summer, whereas Manufacturing has moved into growth mode. Housing starts and sales data published in December highlighted a significant uptick, even though residential construction fell in the 4th quarter.

Immediate construction indicators are positive, with DCs playing an outsize role in the robust performance of the Dodge Momentum Index. At 212 in December, the index is barely changed from September 2024 but is up 19% compared to December 2023. According to Dodge, 14% of this increase can be explained by new DC projects. ConstructConnect forecasts project starts to grow by 8.5% in 2025 after a steady year in 2024. However, their forecast is based on assumptions of continuing elevated levels of government spending and falling interest rates, and as a result may prove optimistic.

Recently published AGC surveys also reflect modest expectations that the dollar value of workload will increase in 2025, with DCs, water and power and manufacturing being seen as the sectors with the greatest promise.

Reflecting this uncertain outlook and looking towards future workload, Architecture Billings Index published by the AIA continues to highlight that a growing proportion of firms are exposed to a declining income and new work pipeline. Project inquiries remain steady at 52, indicating a fractional increase in opportunities.

Forward Indicators for the U.S. Economy

Forward Indicator	Values
GDP (Q4 2024, annualized)	2.3%
S&P Manufacturing PMI (Jan 2025)	51.2
S&P Services PMI (Jan 2025)	52.9
NAHB Housing Market Index (Jan 2025)	47.0
Housing Starts (December 2024, yoy)	+15.8%
House Sales (November 2024, yoy)	+4.9%
ABI Billings Index (December 2024)	44.1
ABI Design Contracts Index (December 2024)	45.5

***Table 2: Selected economic indicators** | Sources: Bureau of Economic Analysis, S&P, NAHB, National Association of Realtors, AIA*

Construction continued to outperform the wider economy in Q4, finishing the year on a positive note. However, headwinds remain. In particular, the cost of finance is expected to remain elevated as the Fed pauses rate cuts and as long-term bond yields well above 3%. In addition to the continuing drag on commercial development, cuts to public sector programs could follow a review of federal spending programs, albeit that these are likely to affect the booming energy sector, taking away some inflationary pressure.

The new administration is also likely to reprioritize its capital spending priorities which will delay approvals, even if programs are retained. With the commercial real estate market still to reach the bottom, the non-residential general contractor sector is likely to be most exposed to the risk of slowdown in 2025.

Forecast

Prospects for construction in 2025 have been complicated by the continuing resilience of the U.S. Economy and the breakneck pace of the presidential transition.

Steady growth and job creation have reduced the prospects for rate cuts, delaying the point at which the key cyclical sectors of commercial and residential will return to growth.

President Trump's overhaul and reprioritization of federal funding will delay decisions and, in some cases, will lead to project cancellations. As a result the public sector's outsize contribution to growing construction output is set to diminish in 2025.

Some sectors are robust enough to be able to withstand the headwinds. As a result, activity within existing 'hot' sectors including manufacturing and tech-related investment should be maintained at current levels.

We anticipate that growth rates will fall to around 2% before the housing market and other sectors show signs of recovery. Our view is that this will be delayed until H2 2025 at the earliest.

Inflation Drivers

Commodity Price Trends

Commodity prices have been relatively stable. The uptick in the price of iron ore in Q4 2024 was a price recovery rather than a hike. The notable increase is natural gas, returning to price levels not seen since early 2023. Triggers for the rise include increased export volumes and an accelerating switch to gas-fired power generation. Lumber prices are at their highest level since summer 2022, but only 50% of prices seen during Spring 2022. The driver for lumber inflation is loss of capacity rather than demand. Localized lumber prices in disaster areas are likely to see significant price fluctuation.

	Price, Dec 2024	Quarterly change %	Annual change %
Crude Oil – West Texas Intermediate	$69.79/bbl.	0.3	-3.2
Natural gas – Henry Hub	$3.02/MMBtu	34.3	19.6
Iron ore	$102/dmtu	10.1	-25.4
Copper	$8,916/tonne	-3.5	6.1
Aluminium	$2,541/tonne	3.7	16.4
Lumber	$570/tbf	11.3	5.1
Plywood	$3.54/sheet	-7.0	-6.5

***Table 3: Commodity prices** | Source: World Bank, Macrotrends*

Construction Market Trends

Annual inflation in the basket of twenty-three materials tracked by Arcadis totalled 1.0%, lower than the ENR's MCI which increased by 2.4% in the year to January 2025. Figure 3 highlights that low inflation is the product of a balance, with materials associated with house building exposed to the greatest hikes on a quarterly and annual basis. Steel and steel pipe had seen the deepest price reductions – favoring logistics and manufacturing development, but these relatively small-scale price cuts could easily be upset by tariffs and the potential for a shortage of home-produced steel.

Construction Materials Price Trends

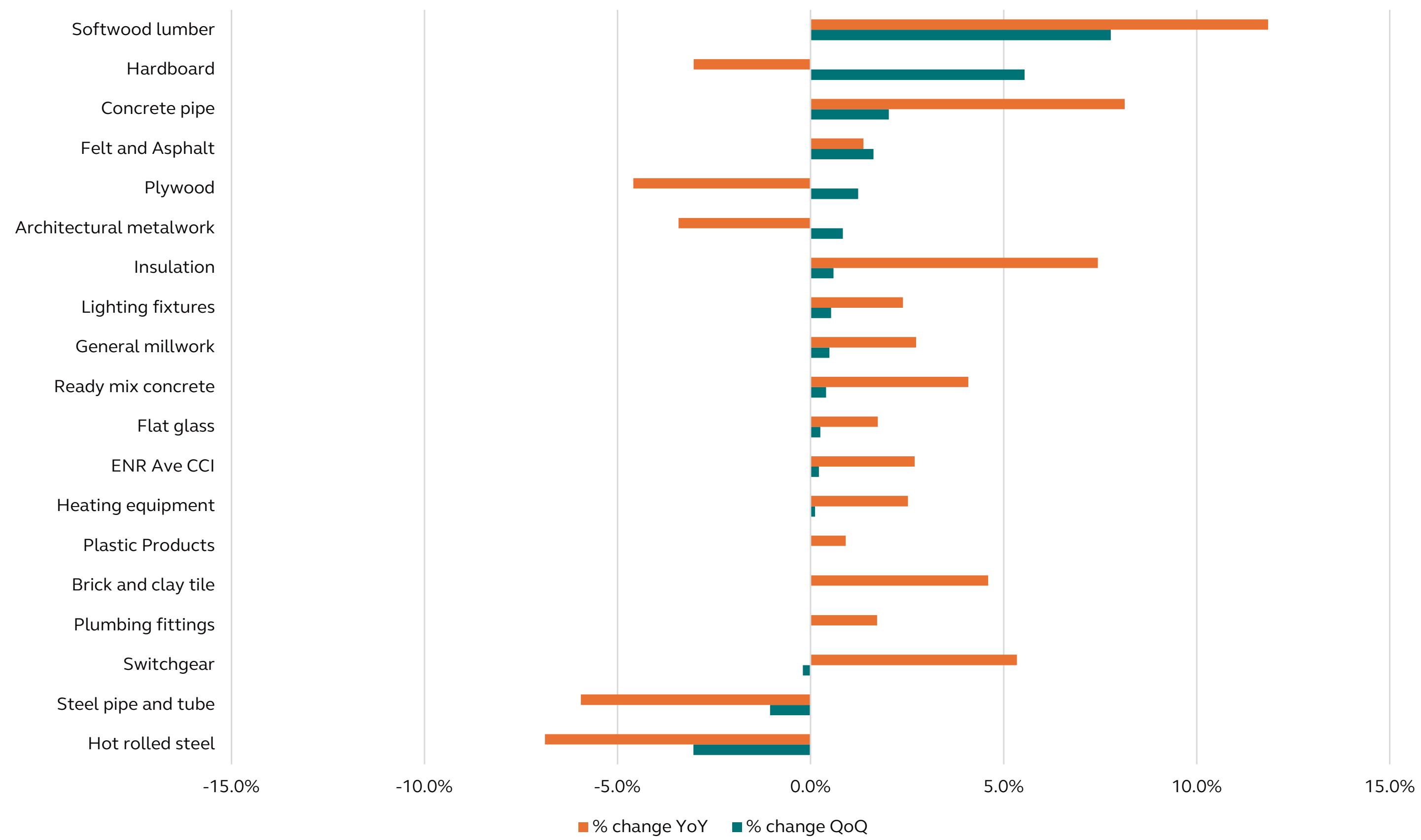
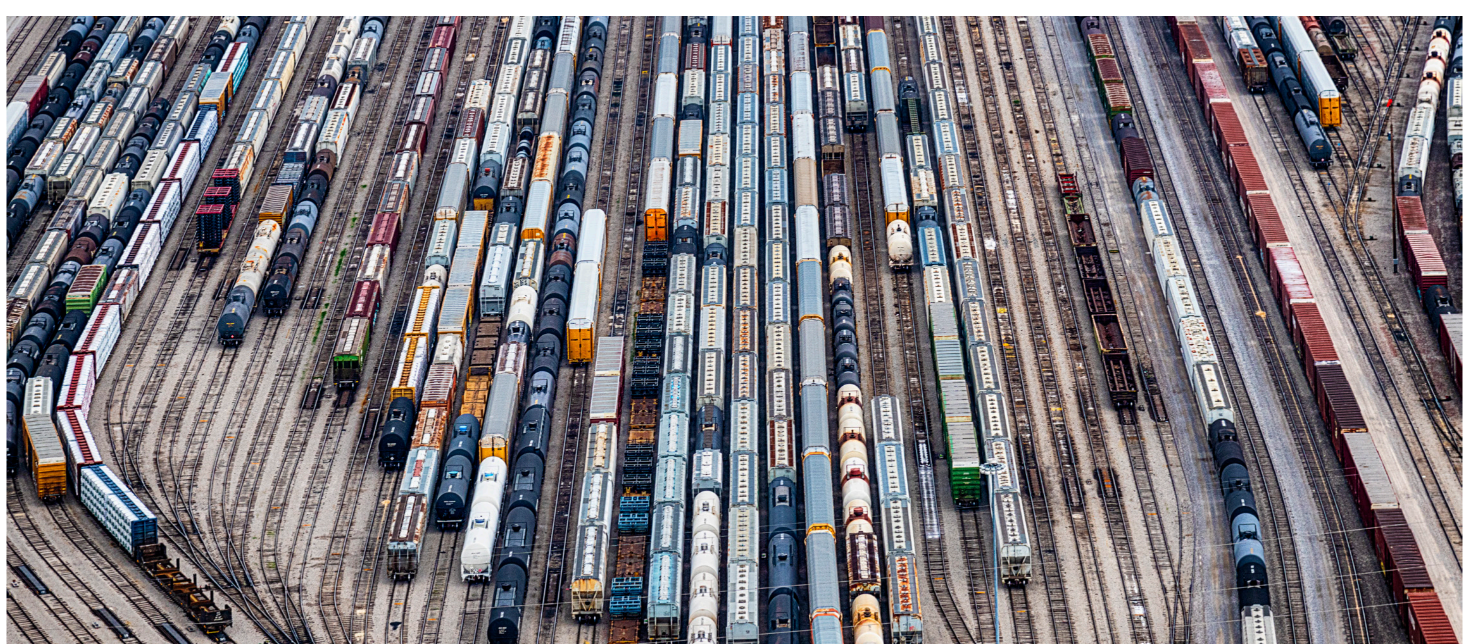


Figure 3: Selected inflation trends for construction materials | Source: Federal Reserve Economic Data



The Impact of Tariffs

Imported steel and aluminium have been an early target of tariff proposals under the Trump Administration. The speed and scale of the application of tariffs has surprised many commentators. They clearly are intended to be an opening round of a wider trade negotiation but are a clear sign that the U.S. plans to disrupt global trade.

Construction markets are typically less dependent on imported materials than other sectors due to the low value and bulk of many construction products. The total value of the construction sector is $2.5 trillion, and the value of materials is likely to be in the range of $800 billion to $1 trillion.

The construction sector accounts for 44% of U.S. steel consumption, based on data from 2021. Imports account for about 20%, focused on rolled steel products. Clearly the imposition of a 25% tariff on imported steel could have a significant impact on the economics of storage sheds and other steel framed buildings as well as MEP systems if followed through. Looking at data from 2018, when 25% tariffs were last imposed, costs of steel sections and steel pipes increased by 20% year on year, and for added-value architectural metalwork by 10%.

Looking at risks associated with generalized tariffs, the NABH published an early assessment of the exposure of the housing market to imports and tariffs in December 2024, calculating that 7% of goods by value were imported. The greatest import penetration affected computers, electronic components, and household appliances, highlighting that higher technology construction including DCs and power will be more exposed to the impact of tariffs. By contrast, economic infrastructure that is dominated by heavy-side materials such as road construction is less exposed.

Notwithstanding the impact of tariffs, which could be very disruptive if implemented, the prospect is for a continuing trend of easing materials inflation. Competition between suppliers and contractors in sectors that have lagged, including residential, may mean that the full cost of general tariffs is not passed on. Steel tariffs are a different matter. Taking into account the large on-costs associated with the fabrication of structural steel, frame costs are likely to increase by 7-10% - a significant hike for sectors sensitive to demand and increased costs of funding.

> The imposition of a 25% tariff on imported steel could have a significant impact on the economics of storage sheds and other steel-framed buildings as well as MEP systems if followed through.

Increasing gas costs are also a long-term concern. This trend could be offset by policy measures designed to increase production volumes, although increased import capacity may encourage U.S. firms to serve overseas markets with higher prices such as Northern Europe. Energy prices are likely to remain uncertain even as the administration seeks to drive them down.

In summary, market conditions should lead to reduced materials inflation. However, due to the potential impact of tariffs, we have broadened the range of our forecast to 2-4%.

Construction Labor

The construction workforce grew faster than the wider economy during 2024. Overall, the workforce grew by 2.4% to 8.32 million people according to data from the Federal Reserve Economics Department, compared to 1.4% for the wider economy. However, the rate of growth slowed in the 4th quarter to 0.2% (seasonally adjusted). For example, the construction payroll grew by 8,000 in December, well down on the rapid growth seen earlier in the summer. Unemployment has also increased during 4th quarter. This is a typical, seasonal pattern but the rate jumped to 5.2% in December 2024, higher than normal. Unemployment tends to increase until March due to weather conditions.

National earnings growth up to December 2024 was 4%, with 1% growth in the quarter. This is in line with the national trend. Contractors continue to highlight difficult hiring conditions, even as the workforce expands. For example, 70 to 80% of respondents to a recent AGC contractor survey stated an intention to increase their workforce in 2025. Responses highlighted labor costs, labor supply and operative quality as the three most cited risks for 2025.

However, the picture is not consistent. Official job openings data for construction for example, points to reduction in job opportunities, with the 2024 average being the lowest since 2020 and the Covid-19 pandemic. Figure 4 highlights the rapid fall in job openings during late 2024, even as workforce numbers remained steady. The reduction in new opportunities does not necessarily point to the risk of labor shortages in the event of a recovery. Arcadis analysis highlights that the construction workforce has been growing faster than the rate of output growth since early 2021 and that productivity growth has flatlined since mid-2022. Should a faster recovery materialize, then we anticipate that construction firms will be able to increase productivity in addition to creating new job openings.

Employment Trends - U.S. Construction

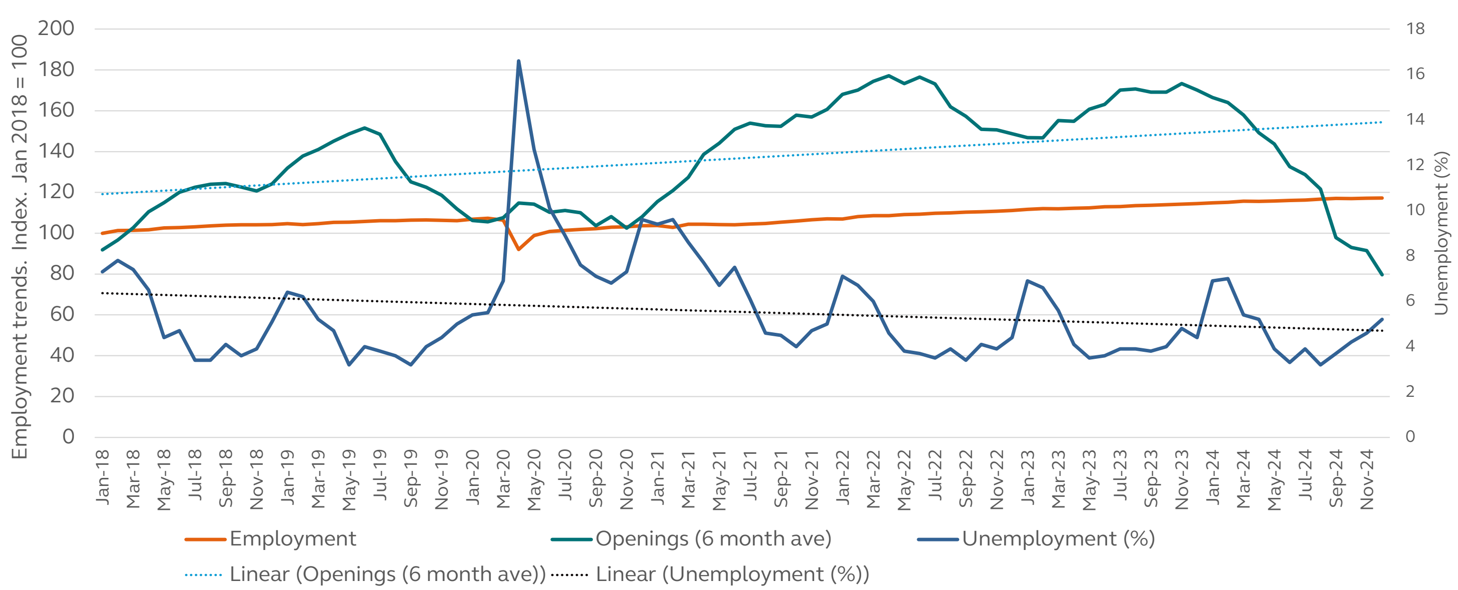


Figure 4: Employment trends in U.S. Construction | *Source: Bureau of Labor Statistics*

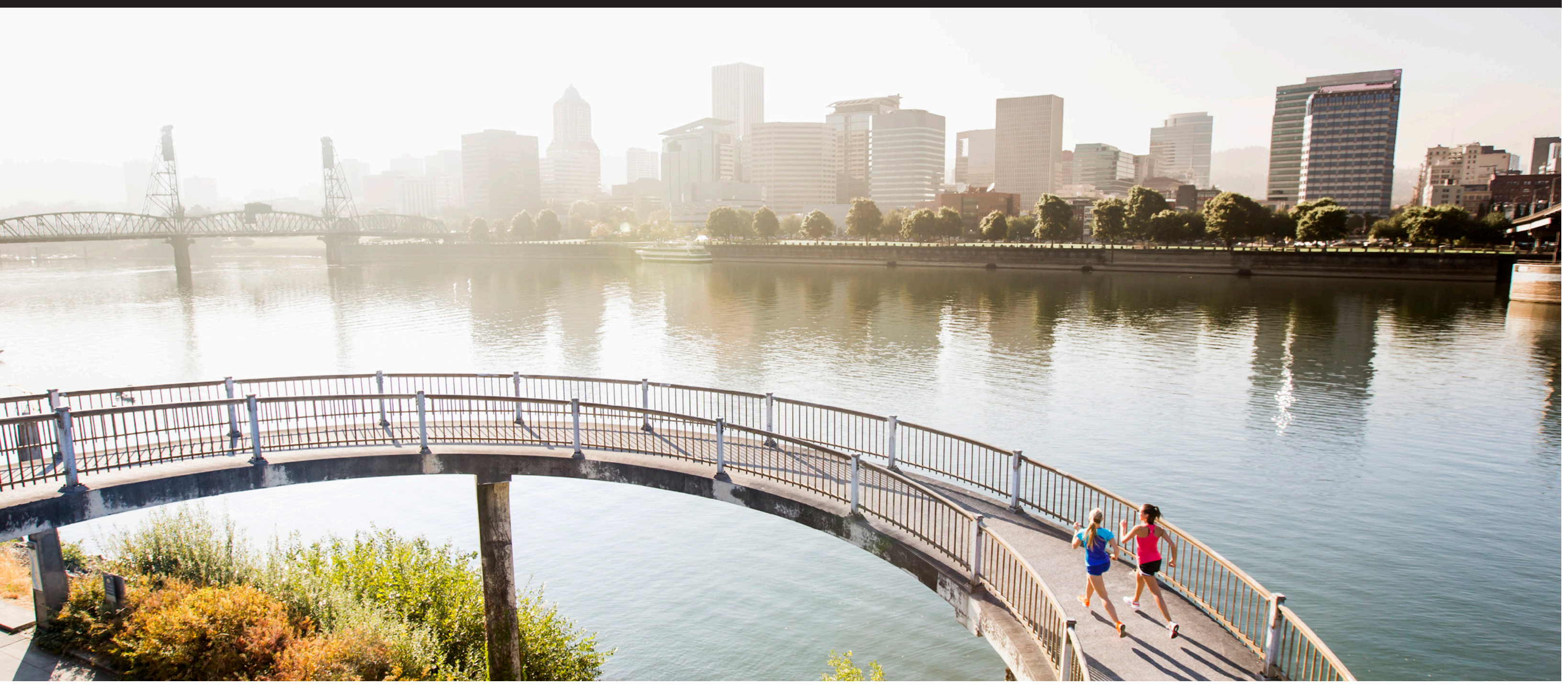
In summary, the labor market has kept in step with construction activity during 2024. Workforce growth slowed rapidly in the 4th quarter.

Earnings growth has remained in line with the national trend, although localized rapid growth is continuing to take place in states including Arizona, Maine, and Oregon.

With no immediate evidence of a broadly based pick-up in construction activity, our view is that demand-led, above-trend labor cost inflation is unlikely to affect markets in 2025.

With the Trump Administration enacting an aggressive tariff-based trade policy, it is possible that domestic inflation will take off in 2025. This is not included in forecasts and as a result we hold our forecast at 3-4% but highlight a greater upside risk associated with general living costs.

Feature: Dynamic Construction Markets



In our first U.S. Market View Report, we published analysis highlighting a big divergence in growth rates between U.S. states. Having developed a comprehensive inflation-adjusted database, we can zoom into the states with the fastest growth rates. What are their characteristics and what might be the impact of their rapid growth?

Our analysis is based on growth since Q1 2023, which coincides with a broadly-based recovery in output. Table 4 summarizes the fastest growing and slowest growing states.

Fast-growing states		Slow-growing states	
State	Cumulative growth, 1Q2023 to 3Q2024 (%)	State	Cumulative growth, 1Q2023 to 3Q2024
Alaska	24.7	New York	1.8
Louisiana	18.0	Washington	1.8
Kentucky	14.9	Oregon	1.0
West Virginia	13.8	Maryland	0.4
Mississippi	13.4	New Jersey	0.3
South Dakota	13.4	Nevada	-0.4
Wyoming	12.8		

Table 4: Relative growth rates, fastest and slowest growing U.S. states, Q1 2023 to present **|** *Source: Federal Reserve Economic Data, Arcadis*

All the fast-growing states are very small construction markets. Five of the top seven range in output from $3-5 billion per annum. The total value of these fast-growing markets was $48.5 billion in 2023, 4% of the total U.S. market. By contrast, the slow growing states have a total annual market size of $185 billion.

The smaller markets have relatively large workforces and are less productive. Annual output per head typically ranges between $80,000 to $100,000. By contrast, output per capita in the low-growth states ranges from $100,000 to $115,000.

The five coastal states in the slow-growing category are associated with relatively high levels of union representation in the construction sector – typically 17-18% of the workforce. By contrast, the fast-growing states typically have levels of union representation in the sector of between 5 and 7%. Alaska is the exception, with a Unionization rate of nearly 20%.

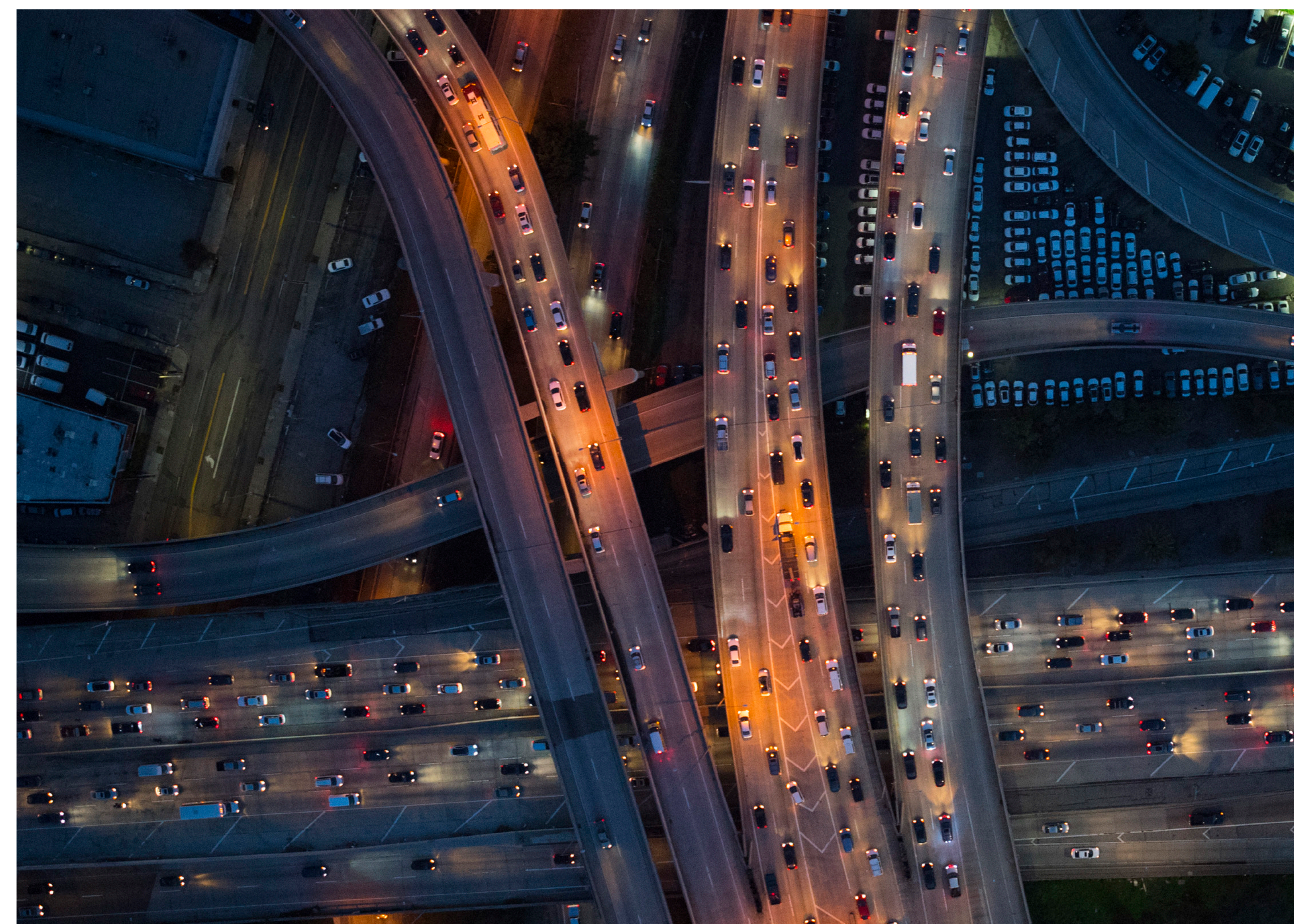
There is no data on the sector breakdown of construction at a state level. Fast growing states including South Dakota and Wyoming are locations that have emerged as frontiers for DC development based on access to free-cooling. By contrast, Louisiana and Mississippi have seen significant growth through industrial and energy sector investment over the past few years. Both of these trends are set to continue under the Trump presidency.

Conclusion

Construction is growing at around 4% per annum. The states that are smashing the average are relatively small and could face capacity constraints if this growth rate continues.

Some of the U.S.' largest state markets are lagging the wider economy. Most of these markets are in coastal zones, and are associated with major economic centers including New York and Seattle. Clearly the extended slowdown in commercial property has led to underperformance in these markets.

With relatively low productivity in the fastest growing U.S. markets, there is potential to absorb further demand through the adoption of efficient construction practices.



About Arcadis

Arcadis is the world's leading company delivering data-driven sustainable design, engineering, and consultancy solutions for natural and built assets. We are more than 36,000 architects, data analysts, designers, engineers, project planners, water management and sustainability experts, all driven by our passion for improving quality of life. As part of our commitment to accelerating a planet positive future, we work with our clients to make sustainable project choices, combining digital and human innovation, and embracing future-focused skills across the environment, energy and water, buildings, transport, and infrastructure sectors. We operate in over 30 countries, and in 2023 reported €5.0 billion in gross revenues.

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