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OUTLOOK
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Update: Building Materials — US

Positive outlook at risk from threat of US steel tariff

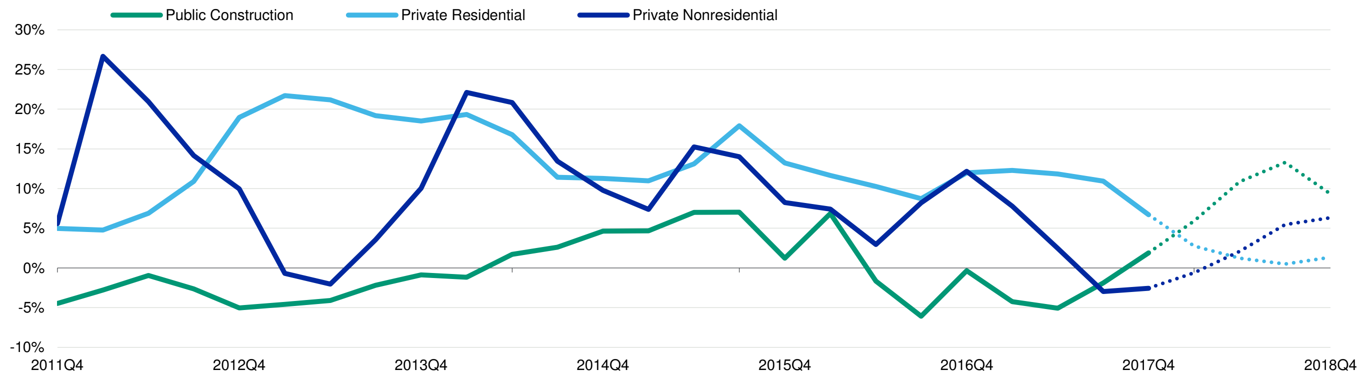
Our outlook for the US Building Materials sector is positive. This outlook reflects our expectations for the fundamental business conditions in the industry over the next 12 to 18 months

Our positive outlook remains supported by increasing public spending, momentum in single-family home construction spending, and indicators of growth for nonresidential construction spending. However, if 25% tariffs on imported steel proposed by President Trump are instituted, we could revise our outlook to stable based on our expectation for decelerating growth.

The tariffs will undermine nonresidential construction spending and public construction spending, because costs will increase for those projects that require using steel. That will cover a large percentage of projects since the construction industry consumes approximately 50% of steel production. Higher costs could impede projects starts and would also consume a higher percentage of available funding, which would diminish funds available for future projects. We would expect demand for aggregates, concrete, cement, and asphalt to moderate as a result. Steel tariffs would also raise the cost of equipment for building materials companies, but the deduction for capital outlays under the Tax Cuts and Jobs Act (TCJA) passed in late December could be a buffer against the impact over the short-term. If revised to stable from positive, the outlook would be supported by still favorable underlying demand in construction end markets, but reflect a slower rate of spending growth.

In recent earnings calls, the rated building material companies indicated good visibility into their business over the next 12-24 months. Construction end markets are positive, and public construction spending, in particular, is likely to be a more-significant driver of overall spending in 2018. Backlogs are growing and a number of highway projects have begun. Moody's Analytics' outlook calls for public spending to post a nearly double-digit gain in 2018, as benefits from the Fixing America's Surface Transportation Act (FAST Act) and state and local infrastructure initiatives finally emerge. In addition, the TCJA also included $20 billion for infrastructure programs and any infrastructure package passed based on the Trump administration's $1.5 trillion plan would be viewed as a positive factor in our outlook.

Exhibit 1
Public, private nonresidential construction both forecast to climb absent tariffs



Source: U.S. Census Bureau and Moody's Analytics

On the residential side, momentum is building in single-family home construction spending — which is more aggregates-intensive than multifamily — as a diminished supply of existing homes results in more new home construction. An improving economy, increasing household formation and household real-income growth underpins momentum. We expect modest growth in nonresidential spending, which is supported by recent strength in the Dodge Momentum and Architectural Billings Indices — which both point to increased spending in 2018. As a result, volumes for building materials will rise on strong demand and catch-up on 2017 shipment delays from inclement weather. Prices will also increase on solid demand and inflationary pressures.

The building materials industry is already facing cost headwinds, including for freight and diesel. For now, pricing improvement across materials should offset these rising costs. Average selling prices improved across all products during 2017. Labor constraints with contractors and state Departments of Transportation have already contained growth. Also, wage pressure could become more pronounced in 2018 if inflation accelerates.

Since outlooks represent our forward-looking view on business conditions that factor into our ratings, a negative (positive) outlook suggests that negative (positive) rating actions are more likely on average. However, the industry outlook does not represent a sum of upgrades, downgrades or ratings under review, or an average of rating outlooks of issuers in the industry, but rather our assessment of the main direction of business fundamentals within the overall industry.

Moody's related publications

Outlook

» Homebuilding, Building Materials - North America: 2018 outlook - housing expansion continues, overall construction spend grows (slides), December 2017

» Update: Homebuilding - North America: Positive outlook remains, despite blow from tax law changes, January 2018

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