confindex™

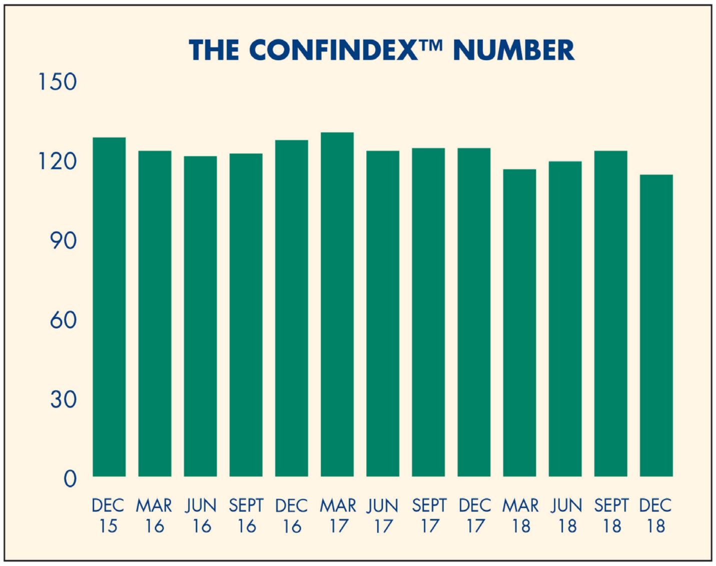
CFMA's Construction Financial Executives Confidence Index

sponsored by BKD CPAs & Advisors AND VIEWPOINT A TRIMBLE COMPANY

CURRENT CONFINDEX™ **114** Since Last Reading

Anirban Basu
CFMA's Economic Advisor

CONFINDEX Slips to Lowest Level Since Late 2012



Construction CFO confidence declined across the board during 2018's fourth quarter. The overall CONFINDEX reading slipped to 114, the lowest reading since December of 2012 when CONFINDEX also stood at 114. In percentage terms, the overall CONFINDEX reading fell 7.3 percent on a quarterly basis and is down 8.1 percent on a year-ago basis.

One might suspect that an unusually large decline in construction CFO confidence would be attributable to a major, identifiable event. But qualitative information acquired through the survey reveals no major single factor – not tariffs, investigations, hurricanes, wildfires, market volatility, trade wars, or inverted yield curves. Rather, the decline in confidence appears to be related to simple economics, with more CFOs concerned that the workings of the economy will continue to grind profit margins lower. There also appears to be intensifying concern that the construction spending cycle is manifesting late-cycle dynamics.

The Logic Driving Growing Share of CFO Expectations

Presently, the U.S. economy is expanding. During recent quarters, economic growth has been brisk, as has the expansion of nonresidential construction spending. Spending growth has been apparent in a number of private and public construction segments, including water systems, lodging, transportation, and office, a segment that encompasses data centers.

Through November 2018, America has added net new jobs for an unrivalled 97 consecutive months. The official rate of unemployment stands at its lowest level since December 1969. There are 7.08 million available, unfilled jobs in America, with the number of unfilled construction positions continuing to expand, despite the fact that the U.S. construction sector has added nearly 300,000 net new jobs over the past 12 months.

These dynamics have resulted in significant growth in per worker compensation costs which, all things being equal, squeezes profit margins. However, that is not where the story ends. Borrowing costs have also risen in conjunction with interest rates. Add in materials price dynamics and profit margins are under growing pressure.

Two years ago, survey respondents indicating that profit margins were improving either significantly or slightly stood at 55 percent. By December 2018, this number had slipped to 43 percent. Conversely, two years ago, the percentage indicating that profit margins were deteriorating stood at just 19 percent. During the most recent survey, this number had risen to 33 percent.

While virtually all stakeholders would agree that construction worker compensation costs are set to rise during the quarters to come, the trajectory of construction materials prices are much less clear. In recent months, construction materials price increases have reversed in many cases, including with respect to fuel and softwood lumber.

Nonetheless, 80 percent of CFOs indicated that construction materials prices were slightly or significantly worse during the most recent survey. Even more telling, 50 percent expect them to be slightly or significantly worse a year from now compared to just four percent who expect some relief from rising materials prices.

Dip in Construction CFO Confidence Is Extraordinary

All sub-indices fell during the most recent survey. The Business Conditions Index dipped to 113, down nearly 10 percent on a quarterly basis and by more than 13 percent on a year-ago basis. The Financial Conditions Index fell 4.2 percent during the quarter to a reading of 115, with more CFOs indicating that financing available for construction had become both more expensive and somewhat scarcer. The Current Confidence Index is down by nearly seven percent on both quarterly and year-over-year bases. Perhaps most importantly, the Year Ahead Outlook Index now stands at just 105, down seven percent on a quarterly basis and by more than 10 percent on a year-ago basis.

The upshot is that CFOs are becoming increasingly nervous. With the cost of delivering construction services on the rise, more projects are likely to prove too expensive for owners to move ahead. The implication is that not only will profit margins be under pressure, but so, too, might be the absolute volume of work. With backlog still lofty, there is little concern regarding near-term construction spending, but a number of CFOs indicated concern regarding the latter stages of 2019.

Will Pessimism Continue?

For a variety of reasons, people in a variety of industries have become more pessimistic. That could easily change – a trade deal with China, removal of tariffs on steel and aluminum, an end to Federal Reserve rate increases, and a federal infrastructure package could serve to reverse emerging gloominess. It will be interesting to see if CFOs collectively become even more pessimistic during the first quarter of 2019, or whether there will be a return of the assuredness that characterized the early stages of 2018.

confindex™

CFMA's Construction Financial Executives Confidence Index

A SIMPLE EXPLANATION OF CONFINDEX™

- **The Overall CONFINDEX™ Number**
  - Composite Index Comprised of 4 Sub Indices
    1) Business Conditions
    2) Financial Conditions
    3) Current Conditions
    4) Year Ahead Outlook – look ahead to December 2019
- **Measurements Taken Using 8 Questions**
  - Current Business Conditions
  - Future (1 year) Business Conditions
  - Current Bank Credit Availability
  - Future (1 year) Bank Credit Availability
  - Future (1 year) Bonding Credit Availability
  - Line of Credit Status
  - Current Backlog
  - Future (1 year) Backlog
- We calculate indices by taking the "net" of positive responses minus negative responses and adding 100. (Neutral and No Answers are excluded)
- Any index greater than 100 reflects more positives than negatives. Any index less than 100 reflects more negatives than positives.