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CFMA's Construction Financial Executives Confidence Index

CURRENT CONFINDEX™ 116

Since Last Reading

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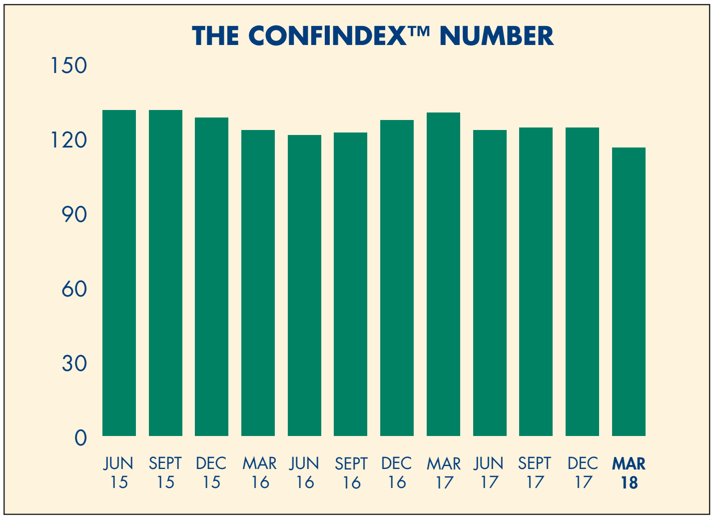
CONFIDENCE SAGS IN EARLY 2018



Economic Expansion Cycle Continues

Within a few months, the current, much critiqued, intensely reviled economic expansion will begin its tenth year. Already, 104 months of economic recovery/expansion have been completed. Given the level of economic momentum as we entered 2018, there is good reason to believe that the current expansion cycle will become the longest in U.S. economic history.

There is also good reason to believe that 2018 will be a fine year for the U.S. economy and America's construction sector. Even prior to the federal tax cut that lowers the official U.S. corporate tax rate from 35% to 21%, doubles the standard deduction while reducing marginal tax rates, and introduces a new 20% deduction for pass-through business income, the U.S. economy was humming. The U.S. economy expanded at better than a 3% annualized rate during both the second and third quarters of 2017 and finished the year with 2.5% growth in the final quarter of 2017.

Monthly employment growth has remained solid despite growing difficultly finding people to fill available job openings. February 2018 was spectacular, with the U.S. economy adding 313,000 net new jobs according to the preliminary estimate from the Bureau of Labor Statistics. The most recently available data indicate that there are still 5.8 million available job openings in America, nearly one job opening for every unemployed person in the U.S.

American wealth is also on the rise. Recently released data from the Federal Reserve Bank indicate that a surging stock market and healthy home price gains lifted the net worth of Americans to nearly ninety-nine trillion dollars during last year's final quarter. That represents a record high for American net worth.

Construction industry-specific data have also remained upbeat, with contractors reporting healthy backlog. Construction spending growth has also been apparent, including in a growing number of publicly-financed categories.

CFOs Express Growing Worry and Concern

That is the context that renders the most recent CONFINDEX results so remarkable. Rather than expressing ongoing optimism, CFOs indicated a flurry of concern during 2018's initial quarter, much of it related not only to lingering issues such as human capital shortfalls, but also emerging concerns regarding tariffs and rapidly rising materials prices.

The Overall Index reading slipped from 124 at the end of 2017 to 116 during the first quarter of 2018. The Overall Index is down by nearly 11% relative to a year ago, even as many contractors have become busier and U.S. economic growth has accelerated.

Undoubtedly, construction CFOs, who were concerned about profit margins in earlier quarters given expanding worker shortages, are now even more concerned given recent spikes in fuel and softwood lumber prices and the implications of recently enacted tariffs on steel and aluminum. One CFO summed it up as feeling "worried that the tariff on metals will increase cost and reduce availability to the point that some projects will not be built."

This represents an important consideration. The imposition of tariffs on steel and aluminum will presumably raise construction materials prices. Anecdotal evidence indicates that some of this has already occurred. But there are broader potential implications, including higher inflation, rising interest rates, diminished developer and financier confidence, and ultimately fewer projects. The proportion of CONFINDEX survey respondents indicating that they were very or highly concerned about demand for construction rose from 5% to 11% during 2018's first quarter.

Some of this concern may also be linked to the lack of progress regarding an American infrastructure package. Infrastructure has been at the center of considerable discussion, but little action.

These dynamics likely also help explain the dip in the Business Conditions Index, which slid nearly 9% on a quarterly basis and is down by approximately 13% on a year-ago basis. The Financial Conditions Index, which one might have thought would have been improving post-tax cut and in the context of banking regulations, fell 4.2% during the quarter and is nearly 9% lower relative to its level last year.

Similarly, the Current Confidence Index fell more than 5% during the quarter. It is also down on a year-over-year basis. Comments supplied by survey respondents collectively suggest that uncertainty emerging from the federal policymaking environment may be dampening prospects in the immediate near-term.

However, nothing is as revealing regarding recent construction CFO attitudes than the Year-Ahead Outlook Index, which declined by nearly 8% for the quarter and is down by 18% on a year-over-year basis. That represents the largest year-over-year decline in any of the CONFINDEX readings. Public policy is clearly at the heart of expanding angst, with one in five CFOs now indicating that they are very or highly concerned about public policy regarding construction. During the prior quarter, the corresponding proportion was one in seven.

Issues related to worker shortages remain front and center. A quarter ago, 81% of respondents indicated that they were very or highly concerned by skills shortages. That percentage has not changed.

What has changed is the outlook for profit margins. While 47% of respondents indicate that their margins have been widening recently, only 21% expect them to improve over the next year. It is likely that many of these CFOs are unnerved by rising materials prices and prospects for further appreciation.

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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) 2018 Outlook – look ahead to March 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.

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