CONFINDEX UNCHANGED: THAT’S BIG NEWS

The Financial Conditions Index declined, however, to a reading of 119, down by nearly two percent on a quarterly basis and five percent on a year-over-year basis. This also represents a surprise given the widespread narrative suggesting that proposed and ongoing deregulation of financial services, coupled with phenomenal asset price performance, has expanded lending and investment capacity.

The Current Confidence Index rose 1.6 percent on a quarterly basis to 130 and is up by about one percent on a year-over-year basis. This is consistent with the notion that industry activity will remain elevated over the near-term; something that is also indicated by a variety of construction backlog surveys.

The Year-Ahead Outlook Index, by contrast, fell by 2.5 percent to a reading of 117 and is off by nearly six percent compared to last year. This represents the largest year-over-year decline of any index.

Why Are Construction Executives Expressing Growing Angst?

It is not easy to reconcile the positive indications flowing from broader economic data with the sense of growing angst that pervades many construction c-suites across the nation. Without question, CFOs and other construction executives remain unnerved by the growing inadequacies of the U.S. labor market and by the recent acceleration in construction material price expansion. Despite this, the outlook for profit margins is upbeat. There must be other explanations.

The most likely explanations revolve around the growing probability of significantly negative outcomes. Chastened by the commercial real estate downturn of the late-1980s, the dot-com bust of the early-2000s, and the most recent global financial crisis, construction executives are keenly aware that strong momentum can quickly dissipate. While that is unlikely in the near-term, there are reasons to believe that the next year could usher forth a period of higher volatility.

With asset prices rising so quickly, whether stock, bitcoin, or other prices, a growing fraction of construction financial professionals are likely concerned about significant corrections in asset prices, including those in various commercial real estate categories. This is consistent with the decline in the Financial Conditions Index, with financiers perhaps growing more cautious as asset prices continue to balloon without complete explanations for why this is occurring.

There is also, of course, the growing specter of political risk. While proposed tax cuts should be supportive of subchapter-S corporations and other flow-through tax entities, there are other things happening in the political environment that could be cause for concern. Among these are the uncertain outcomes of the 2018 mid-term elections, which are now encompassed by the Year-Ahead Outlook Index.

This combination of market and political uncertainty helps explain the lack of positive movement in the Overall Index, Financial Conditions Index, and “Year-Ahead Outlook Index. That said, the U.S. construction industry is set to enter 2018 with a considerable amount of momentum.

Concern Grows Even as Economy Improves

Viewed from a macroeconomic perspective, this should represent a time of expanding confidence among construction industry chief financial officers. Economic growth has recently accelerated, job growth remains robust, the nation’s official rate of unemployment is at a 17-year low, consumer confidence is at a 17-year high, and the nation approaches the onset of the tenth year of an economic expansion that has already added 17 million jobs on net since the end of the downturn. On top of that, construction backlog remains lofty, asset prices are rising, including commercial real estate values in many segments and in much of the nation, and interest rates remain stubbornly low.

Despite all these reasons to express growing optimism, construction industry leaders collectively chose not to do that during the most recent administration of CFMA’s CONFINDEX Survey. The Overall Index remained at 124 during 2017’s final quarter, down 2.4 percent from last year.

One might think that this has to do with the construction industry’s most pressing issue: the growing dearth of available skilled construction craft workers, project managers, estimators, etc. Expanding skills shortages presumably lead to higher human capital costs, which all things being equal, translates into shrunken profit margins. But survey respondents did not indicate shrinking profitability or profit margins – quite the opposite. In the most recent survey, 46 percent of respondents indicated that their margins are slightly or significantly better than a year ago. Only 24 percent indicated that they are worse. Moreover, 42 percent expect margins to have improved a year from now, compared to just 14 percent who expect some level of deterioration. This renders the lack of movement in the Overall Index even more mysterious.

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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 December 2018

• 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.