In recent years, a dominant pattern has been that construction industry leaders would enter the new year with plentiful optimism, and then manifest a sense of disappointment as hoped for dynamics remained elusive. This year is different. If anything, economic and construction industry performance has outstripped all but the most ambitious expectations. To date, the nation has added jobs for 95 consecutive months. Unemployment remains below four percent. Stock prices have been surging, and interest rates have risen only gradually despite monetary tightening and growing inflationary pressures. Recent tax reform appears to have successfully induced a surge in capital expenditures. Consumer confidence remains at multi-year highs as does small business confidence. Industrial production, which was in decline for much of 2015-16, is rebounding robustly. These and other factors, including improving state and local government finances, have set the stage for stronger construction spending.

Accordingly, construction CFO confidence has been rising through the middle months of 2018, a stark departure from prior trends. The Overall CONFINDEX rose during the third quarter to 123, up 3.4 percent from the second quarter’s reading of 119. Though essentially unchanged from a year ago, the Overall Index is up 56 percent from its December 2008 reading.

The Business Conditions Index, which reflects how well matters are progressing presently, rose during the third quarter by nearly a percentage point to 125. This reading is down two percent from a year ago. One might be tempted to conclude that, based on these survey results, matters are virtually unchanged over the past year. In some sense, that’s true. CFOs expressed comfort with conditions that prevailed in mid-2017 and feel similarly now.

**Broader Economic Momentum Likely to Persist in the Near-Term**

One of the reasons for this sense of comfort is the ongoing availability of financing. The Financial Conditions Index rose 3.4 percent during the third quarter. While it is down slightly compared to a year ago, it is still up 25 percent since December 2008’s reading of 96.

All of this sounds upbeat. Leading indicators, including the Conference Board’s Index of Leading Economic Indicators, suggest that broader economic momentum will persist in the near-term. With the nation continuing to add jobs rapidly, the implication is that the demand for new commercial space, whether in the form of office buildings or fulfillment centers, will remain elevated in much of the nation.

Therefore, it may come as a surprise that the Year-Ahead Outlook Index slipped during the third quarter to a reading of 113. The decline was hardly steep on a quarterly basis—a bit less than a percentage point. But the Year-Ahead Outlook Index is down nearly 6 percent from last year’s reading of 120. This represents the most significant year-over-year decline in any of the indices.

Initially, this seems at odds with the current trajectory of the economy and construction spending. But this may not be a function of concerns regarding demand for construction services. During the most recent survey, only 10 percent of CFOs indicated that they were very or highly concerned about demand for construction. Only nine percent were very or highly concerned about the availability of financing for projects.

No, this is not about demand—it is about growing concerns regarding the ability of firms to profitably supply construction services given exacerbated skills shortfalls and rising materials prices. 85 percent of construction CFOs are very or highly concerned about skills shortages. Perhaps these shortages, working in conjunction with higher steel, softwood lumber, and petroleum prices, help explain why the share of respondents indicating that profit margins are worse than last year’s rose from 26 percent to 31 percent during the third quarter.

Profit margins are likely to encounter additional downward pressure. Nearly two-thirds (65%) of respondents expect that construction materials prices will be worse next year, though the bulk of this group expects only modest inflation.

There are other sources of concern, including policies regarding tariffs and the direction of interest rates. Many CFOs also expressed concern regarding the outcome of mid-term elections, and what these would portend for what is presently viewed as a supportive business climate. Some even expressed concern regarding the next recession, though this is hardly a dominant sentiment. Still others indicated that many projects are being delayed, perhaps because the construction industry simply lacks the capacity to complete, in a timely manner, all of the work now poised to move ahead.

**Intensifying Pressure on Profit Margins**

The average construction firm is associated with plentiful backlog. Construction spending is positioned to remain elevated for the foreseeable future. But it is also foreseeable that labor shortages will worsen and that the costs of delivering construction services will likely continue to rise. With borrowing costs on the rise, purchasers of construction services will be even more interested in squeezing construction costs lower, implying that already apparent pressure on profit margins among many contractors is set to intensify.
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 September 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.