Construction CFOs will Enter 2020 with Confidence

Industry Outlook Brightens Considerably
Perhaps one should have seen this coming. Despite all the talk about a weaker global economy, a domestic manufacturing sector already in or teetering on the verge of recession, indications of weaker investment in structures, and ongoing political drama emerging from Washington, D.C., CFOs collectively expressed substantially greater confidence during 2019’s final quarter than they had previously. The overall CONFINDEX reading was up 7 percent (to 123) during the fourth quarter relative to the third, and is up nearly 8 percent on a year-ago basis.

Fully 44 percent of respondents to the most recent CFMA survey indicated that construction industry business conditions are significantly (12%) or slightly (32%) better than they were a year ago. Another 35 percent indicated that business conditions are approximately the same. Only 21 percent indicated that business conditions have worsened (20% slightly worse; 1% significantly worse).

Accordingly, the Business Conditions sub-index expanded 11 percent to a reading of 121 during the fourth quarter after declining meaningfully during prior quarters. Despite the quarterly surge in this sub-index reading, the reading is up only 7 percent on a year-ago basis, an indication of just how substantial the loss of momentum had been previously.

It is likely that one of the factors engendering greater confidence are the three interest rate cuts initiated by the Federal Reserve over the last several months. Not only has this breathed life into U.S. equity markets, it also helps reduce the cost of capital borne by developers and other purchasers of construction services. Thus, many CFOs may have come to believe that the recent softening in private construction spending is attributable to the nine rate hikes implemented by America’s central bank between December 2015 and December 2018. With that tightening cycle now over and partially reversed, there may be an expectation that private construction spending volumes are set to re-accelerate.

This hypothesis seems consistent with respondents’ answers to questions regarding current financial conditions facing the U.S. construction industry. On a quarterly basis, the Financial Conditions sub-index expanded a bit better than 4 percent during 2019’s final quarter to a reading of 125. That’s nearly 9 percent better than at the same time a year ago, when the Federal Reserve was still in the midst of its tightening cycle and signaling that additional rate hikes were likely in 2019. Those rate hikes failed to transpire.

The Current Confidence sub-index also expanded and remains elevated. This reading rose nearly 2 percent for the quarter to 128, and is up by nearly 6 percent on a year-ago basis. This sub-index incorporates a variety of considerations, and strongly suggests that the U.S. construction industry will enter 2020 with momentum.

This is not to suggest that CFOs and other financial professionals working in the construction industry have become complacent. As of the fourth quarter of 2019, 64 percent of respondents were watching “Demand for Construction” with some concern, while another 8 percent were either very or highly concerned. As always, skills shortages rank at the top of concerns, with 78 percent expressing a substantial level of concern regarding worker availability. This proportion was up 3 percent from the prior quarter, consistent with low rates of construction unemployment and ongoing industry job growth that is rapidly soaking up the balance of the remaining workforce.

Despite still worsening skills shortages and rising worker compensation costs, 46 percent of CFOs indicate that profit margins have been improving. A year ago, the corresponding proportion was 43 percent. Only 24 percent indicate that margins have deteriorated, with only 1 percent indicating significant deterioration. A year ago, 33 percent of respondents expected some level of decline in margins.

However, circumstances could be a bit different during the year ahead as cost pressures continue to climb. Twenty-nine percent of respondents expect profit margins to be significantly or slightly better a year from now. That is matched by the 29 percent who expect profit margins to worsen during the year ahead.

Still, 2020 is shaping up to be another year of progress for the U.S. construction industry. The big news in the quarter’s survey was the growth that is rapidly soaking up the balance of the remaining workforce.

Looking Ahead
There have been other occasions in recent years during which CFOs entered the New Year with significant confidence only to have that confidence abate during ensuing quarters. Time will tell whether we are in for a repeat performance. However, to date, the surprises have generally been to the upside, with available financing, supportive Federal Reserve policy, an ongoing economic expansion, and a booming stock market helping to bolster CFO confidence.
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 2020

• 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.