CONFINDEX SURVEY REVEALS WANING CONFIDENCE IN CONSTRUCTION

Industry Outlook Dims as Fiscal Cliff Approaches

Though we are closing in on the fourth year of economic expansion, the U.S. construction industry continues to struggle to establish sustained momentum. While the nation added 146,000 jobs in November, the construction industry shed an estimated 20,000 jobs, essentially wiping out previous gains that have been registered during the past year. In November 2011, the industry employed 5.52 million workers. One year later, the corresponding figure is 5.51 million (60,000 obs). The industry’s unemployment rate now stands at 12.2%, 4.5 percentage points above the rate for all industries (7.7%).

Construction firms appear unserved by the possibility that the nation will fall off of its fiscal cliff, a combination of scheduled tax increases and federal spending cuts. The Congressional Budget Office among others predicts that if the nation fails to resolve its fiscal cliff issues, it will fall into another recession. That would represent a major setback for the nation’s construction industry, much of which has barely begun to recover and where many firms remain financially fragile. Construction firms stand to be disproportionately impacted by a prospective tumble off the fiscal cliff, with severe spending cuts hammering away at already weak state and local government capital budgets. Slower job growth (national unemployment would likely rise back above 9%) would also result in diminished commercial construction.

In the latest CONFINDEX survey, the Overall Confidence Index is down 2.6% from last quarter and now stands at 114, its lowest level since the third quarter of 2011. The Current Confidence Index rose slightly to 110, an increase of 1.9% from last quarter. The Business Conditions Index fell from 130 to 123 during the fourth quarter, a decline of 5.4%. The Financial Conditions Index remained at 106. Most importantly, the 2013 Outlook Index dropped to 118, 7.1 percentage points below last quarter’s reading. The implication is that many construction firms CFOs see the country’s fiscal cliff in Washington, D.C. as a serious threat to the economy, and that the manner in which various issues are resolved will be bad for business.

According to construction industry executives, the level of demand for construction and public policies impacting the nation’s construction industry represent the greatest sources of concern. During the fourth quarter, 50% of respondents reported that they were “very concerned” or “highly concerned” about the level of demand for construction, essentially unchanged from last quarter. Another 46% are watching with some concern while just 5% are not concerned at all. In the open-ended portion of the survey, respondents reported that “uncertainty in the economic and tax situation is preventing many owners from going forward with construction projects.” Another respondent suggested that there are “indications that things are improving slowly, but there are several potholes that must be avoided.”

With respect to public policy-oriented concerns, 46% of CFOs reported that there are either very or highly concerned, up significantly from 38% during the third quarter. An additional 41% are watching with some concern, while 11% are not concerned at all.

Despite the ongoing slow recovery in many construction segments, high industry unemployment, and concerns regarding demand in 2013, skills shortages remain a major concern among industry CFOs. During the fourth quarter, 51% of survey respondents reported that they were either very concerned or highly concerned regarding skills shortages, up 9 percentage points from the third quarter. Another 30% is watching with concern and 19% is not concerned at all regarding skills shortages. Among those who are concerned, common complaints include “it has become harder to find good employees” and “fewer young people are looking at construction as a career option.” One of the principal fears is that construction’s inability to generate a sustained recovery is inducing many workers to opt for other industries, including distribution, manufacturing, and retail, each of which has added employment over the past year.

On the positive side of the ledger, the availability of financing for projects appears to have improved since last quarter. During the fourth quarter, 37% of respondents reported that they are very concerned or highly concerned about the availability of financing, down 4% from the third quarter. Many construction executives that had been very/highly concerned last quarter appear to have shifted into the “watching with some concern” category (Q3: 43%; Q4: 54%). Five percent of respondents are not concerned at all about the availability of financing for construction projects.

Industry-wide profit margins, which are not encompassed in the CONFINDEX indices but are reflected in the survey results, failed to improve substantially during the fourth quarter. Thirty-six percent of survey participants report that profit margins at their companies are either slightly better (30%) or significantly better (6%) relative to last year. Thirty-four percent reported that their profit margins are the same, while 21% indicated their profit margins are slightly worse. An additional 10% of respondents report that profit margins are significantly worse than a year ago. Looking ahead, most respondents anticipate profit margins to be slightly better (41%) or the same (43%) one year from now. Two percent expect margins to be significantly better while 14% expect margins to deteriorate.

The level of concern regarding materials prices trended higher during the fourth quarter. Fifty-two percent of CFOs indicate that materials prices are about the same as a year ago, while only 1% reports that they are slightly lower. Forty-two percent report that materials prices are slightly higher, while 2% report prices are significantly higher. With respect to their annual outlook, 51% anticipate that materials prices will be slightly higher while another 43% expect prices to be roughly the same. In other words, as a group, construction industry CFOs do not anticipate large increases in materials prices next year.
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) 2012 Outlook – look ahead to December 2012

- **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.
FINANCIAL CONDITIONS INDEX (12/12)