Confindex Dips to Multi-Year Lows

It wasn’t supposed to be this way. Coming into the year, construction spending was surging. Homebuilder confidence was at a 20-year high. Commercial construction was ramping higher as a 113-month job growth winning streak in America created new demands for space in which to host meetings, office workers, goods available for purchase, and shoppers. Healthy state and local government budgets were stimulating investment in a number of public categories ranging from flood control to water supply.

Even as America edged toward a 50-year low in unemployment of 3.5 percent, inflation remained benign, permitting interest rates to remain low. In short, it was an ideal environment for many contractors, a significant fraction of whom set records for revenues, earnings, and backlog last year.

While the early-year outlook was benign, economists often resort to referring to “Black Swans” when delivering forecasts, in part to shield themselves from accountability. These are the low probability events that can wreak havoc on financial markets, economies, and daily routines should they transpire. Out of nowhere came a Black Swan, COVID-19, and all prior forecasts were solemnly laid to rest.

While first and foremost a public health crisis, the economic implications are noteworthy, including for contractors. The Overall Confindex reading declined from 120 during 2020’s initial quarter to 87 by the second, a decline exceeding 27 percent. Confindex is down nearly 22 percent from its year-ago level, which that’s precisely what’s occurring now.

The Financial Conditions Index slipped from a first quarter reading of 123 to 99 during the second, a decline approaching 20 percent. The Index is down 16 percent on a year-ago basis and is up just 3 percent from its December 2008 reading of 96. In other words, construction financial professionals in the U.S. view the current financing environment as only a bit better than the one that prevailed during the worst of the global financial crisis.

Coming into this period, construction was generally associated with plentiful backlog. This represented one of many factors supporting what had been a rosy 2020 outlook. But with financial conditions tightening and many project owners reconsidering their decision to move forward, many construction executives are concerned that backlog will quickly erode. This is consistent with the sharp decline in the Current Confidence Index, which fell an astonishing 35 percent during the second quarter from a reading of 128 to 83.

For years, the number one challenge facing contractors was the growing skills shortage. But that has changed. During the first quarter, 73 percent of respondents were either highly or very concerned by skills shortages. Only 2 percent expressed no concern. By contrast, only 5 percent were highly or very concerned by the level of demand for construction during the first quarter.

One quarter later, “only” 44 percent of respondents were ether highly or very concerned by skills shortages while the share of those highly or very concerned by demand for construction had risen to 48 percent. Thus, in the span of a few weeks, contractors went from presuming steady demand for their services and difficulty finding workers to angst regarding demand for their services and less concern regarding their ability to cobble together and retain staff.

Apparently, this shifting dynamic does not inure to the benefit of profit margins. During the first quarter, 48 percent of respondents indicated that their profit margins were either significantly or slightly better. During the second quarter, that proportion fell to 15 percent, with nearly half of respondents indicating margin deterioration.

Matters will not have fully improved a year from now, at least according to current expectations. While 28 percent of respondents expect margins will be significantly (1%) or slightly (27%) better a year from now, 43 percent expect margins to be worse, with 13 percent expecting them to be significantly worse.

All of this is consistent with the notion that the year to come will be filled with challenges for the average American contractor. Earlier this year, the Year Ahead Outlook Index stood at 109. That was already down from 117 in late-2019. By the end of the first quarter, construction CFOs were already beginning to fret about the emerging pandemic. During the second quarter, the Index slipped further, this time to 91, actually below its December 2008 level (94).

If history is any indication, construction will be among the last segments of the economy to recover. That supplies even more reason for federal policymakers to consider an infrastructure-focused stimulus package in the effort to keep the fledgling, but fragile economic recovery intact.
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 June 2021

- 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.