Coronavirus Begins to Impact Construction’s Outlook

The Black Swan Has Arrived
In his 2007 book, the former options trader turned world-class scholar Nasim Nicholas Taleb writes about black swans: rare and unpredictable outlier events that can generate massive impacts on people’s lives, financial markets and broader economies. The coronavirus seems to neatly fit this description and has already begun to reshape U.S. construction industry expectations.

To be sure, these expectations are susceptible to serial adjustments as new information pertaining to the global health crisis arrives. As a reminder that timing is everything, the most recent administration of the Confindex occurred in February. During the early weeks of the month, respondents were aware of the coronavirus, but were less likely to be significantly alarmed by the pandemic relative to the final days of February, which were associated with large-scale volatility in U.S. equity markets and the rapid spread of the virus in Washington state and other parts of the nation.

Accordingly, one can theorize that if the same survey were conducted today, construction financial executives would be somewhat less optimistic than reflected in this quarter’s results. That said, overall CFO confidence dipped according to the most recent survey, though the extent to which this is attributable to coronavirus vis-à-vis other factors is unclear.

The Overall Index reading declined during 2020’s initial quarter by 2.4 percent, to a reading of 120. But that is still 10 percent higher than a year ago. This means that even with the virus spreading, jeopardizing supply chains, travel, hospitality, and other economic segments in the process, the average construction CFO is still more confident today than they were in early 2019.

This is largely a reflection of how strong the construction economy was in the U.S. in 2019. Many CFOs entered that year filled with trepidation, as financial markets tumbled in late-2018 in the context of rising interest rates and what became the lengthiest federal government shutdown in history. Many construction industry leaders were also unnerved by large and growing skills shortages. While those shortages persisted, 2019 was associated with significant entry into the U.S. labor market. The use of independent contractors has also helped many construction firms meet demand, which resulted in many contractors boosting profit margins. Fully 48 percent of survey respondents indicate that their margins have improved over the past year, with only 16 percent indicating deterioration along this dimension.

This is consistent with results for the Business Conditions Index, which is up nearly 14 percent from a year ago. On a quarterly basis, however, this sub-index slipped 4 percent. Similarly, the financial conditions index fell 1.6 percent from the prior quarter, though it is up 7 percent on a year-ago basis.

Perhaps the most interesting reading is the Current Confidence Index, which was unchanged for the quarter and is up an astonishing 35 percent over the past year. While coronavirus is scary, as a practical matter the impact on construction activity to date has been quite minimal. This supplies further evidence that 2019 was a magical year for many contractors, resulting in an impressive increase in the Current Confidence Index over the course of the year. But current confidence is no longer climbing. Whether this is due to coronavirus, worsening skills shortages, or this year’s presidential elections is unclear. What is clear is that last year’s optimism is being supplanted with a growing dose of skepticism.

Nowhere is this more apparent than in the Year-Ahead Outlook Index, which declined nearly 7 percent on a quarterly basis. It seems likely that coronavirus is part of the explanation, but there are many factors at work. Despite the recent dip in forward-looking optimism, this sub-index is still nearly 15 percent ahead of its year-ago level. Again, one wonders what the reading would be were the survey to be conducted today as opposed to throughout February.

That notwithstanding, a growing fraction of construction CFOs are concerned regarding the future direction of margins. While 29 percent of respondents indicated that margins would either be significantly better (3%) or slightly better (26%) a year from now, fully 46 percent expect no change and 22 percent expect margins to deteriorate, though the vast majority of that group only expect slightly worse margins going forward. Nearly three in four respondents are either very or highly concerned by skills shortages which undoubtedly represents one of the primary factors shaping expectations.

Looking Ahead
After entering 2020 with considerable momentum, prospects for the U.S. economy have dimmed substantially of late. Coronavirus impacts to date represent just the tip of the iceberg. As the number of diagnosed cases inevitably expands and as more communities are impacted, U.S. economic growth can be expected to soften meaningfully. Economists at Goldman Sachs and elsewhere have already begun to predict that the global economy will shrink during 2020’s initial half.

Ultimately, this is likely to translate into diminished construction backlog. The good news is that the average U.S. contractor has plenty of backlog today. The hope is that that will provide enough cushion for the virus to pass and the U.S. and global economies to get back on track before much of that backlog runs out.
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 March 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.