Construction Executives Express More Optimism During 2019’s Third Quarter

The Run of Growing Pessimism is Over, For Now

After revealing an abundance of growing pessimism over the past year, construction financial executives collectively expressed more upbeat sentiment regarding the current performance of the U.S. construction industry during the most recent Confindex survey. During the third quarter of 2019, the Overall Confindex reading rose 3.6 percent on a quarterly basis from 111 to 115.

A number of CFOs, controllers, and other financial professionals indicated that deal flow remains solid. The proportion of respondents indicating that profit margins have been expanding rose during the third quarter relative to the second (from 39 percent to 45 percent), providing further evidence that the construction industry continues to perform.

During prior quarters, CFO sentiment had been dampened by a combination of worsening skills shortages, concerns regarding trade wars, inverted yield curves, and volatile financial markets. While these remain matters of concern, CFOs and other financial professionals also noted positive aspects of the current economic environment, with some indicating that they foresee no real downturn in activity for at least two years. Despite the quarterly increase in the Overall Index, Confindex is still down nearly 7 percent from its year-ago level of 123.

The Business Conditions Index, a subcomponent of the overall index, rose 6.9 percent during the third quarter. It is still down 12.8 percent on a year-over-year basis, however, a reflection of ongoing skills shortages and expanding compensation costs, including from overtime associated with a dearth of available, dependable workers.

One of the hallmarks of economic downturns is a sudden withdrawal of capital availability. Through the third quarter of 2019, there is little evidence that capital available to finance construction projects and the delivery of construction services is becoming scarcer. The Financial Conditions Index rose 1.7 percent during the third quarter and in unchanged from a year ago. Very few CFOs indicated that financing has emerged as a significant issue. The proportion of respondents indicating that the availability of financing represents a source of concern declined from 7 percent to 6 percent during the most recent survey.

With the Federal Reserve now ratcheting down short-term rates and given the recent decline in interest rates generally, the low cost of capital should generally be viewed as a positive factor in driving the ongoing construction expansion cycle. An expanding economy working in conjunction with available capital should continue to translate into ongoing construction starts.

Accordingly, the Current Confidence Index rose 7.7 percent on a quarterly basis, the largest quarterly expansion registered in any of the indices. CFOs and other financial professionals expect their firms to remain busy for the foreseeable future, though some indicated that profit margins may begin to slip going forward as competitors begin more aggressively adding to backlog in advance of a potential downturn in economic activity in 2020 or shortly thereafter.

There is in fact some concern regarding the longer-term future. The Year-Ahead Outlook Index declined nearly 2 percent on a quarterly basis and is down 11 percent on a year-ago basis. The current reading stands at 101 and is now just 7 percent above its December 2008 reading. Many CFOs, along with many economists, suspect that the risks of recession are elevated in 2020. Given the role of backlog, this would translate into a loss in activity levels at some point in 2021 and/or 2022.

A number of CFOs expressed concern regarding the following dynamic. With skills shortages still severe and with subcontractors in particular scrambling for talent and capacity, the cost of delivering construction services continues to rise in America. Eventually, construction could become sufficiently costly to induce many project owners to postpone projects, helping to trigger the next construction downturn.

Such a dynamic could be exacerbated by a sea of unknowns, including the effects of trade disputes, a softening global economy, massive indebtedness among many economic actors, and next year’s elections, which are sure to boost uncertainty among key decision-makers, including developers. The impending insolvency of the nation’s Highway Trust Fund represents another source of uncertainty.

It remains to be seen whether the persistent pessimism expressed by CFOs and other construction financial professionals regarding the year-ahead outlook will prove justified. There are certainly many risks to the economic expansion, which has successfully reached its 11th year and has emerged as the lengthiest expansion cycle in America’s history. There are certainly plenty of warning signs, whether in the form of inverted yield curves, attacks on global oil facilities, strikes, elections, and rapidly expanding wage pressures.
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 September 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.