Mild Disappointment in Evidence

The current year will go down as yet another during which CFO confidence steadily slipped over the course of the spring and summer after beginning the year at a high level. According to the Q3:2013 CONFINDEX Survey, there was no significant improvement along any dimension of performance in the U.S. construction industry. Margins failed to thicken, business conditions modestly deteriorated, financial conditions flattened, and the outlook dimmed just a bit.

The last six months represent a period of deflating CFO confidence. After witnessing an increase in only one CONFINDEX subindex during the second quarter, all five survey subindices declined during the third. The Overall Confidence Index declined 0.8% from last quarter, falling to 127 after an equivalent decline of 0.8% from Q1 to Q2. Despite the six-month slump, on a year-over-year basis the Overall Confidence Index is up 8.5% (from 117 in September 2012).

The Business Conditions Index declined 1.4% last quarter from 144 to 142. Perhaps somewhat surprisingly, the Financial Conditions Index fell 1.7% in the third quarter (116 to 114) after representing the only sub-index to rise during the previous quarter. For many months, the conventional wisdom has been that lenders are flush with cash and are now ready to begin to deploy additional capital in support of loan-making. But that logic did not play out during the third quarter. Despite the recent setback, the Financial Conditions Index is up 7.5% from a year ago.

The Current Confidence Index fell 0.8% during the third quarter, dipping from a reading of 121 to 120. This same index stood at only 108 a year ago, however. Significantly, the Year-Ahead Outlook Index also dipped. This index fell 1.4% during the second quarter and declined another 1.5% during the third quarter (137 to 135). The Outlook Index is still 6.3% higher than it was a year ago.

Despite the fact that the nation is in its fifth year of recovery, 17% of respondents are still very concerned about the level of demand for construction, 6% are highly concerned, and 66% are watching with some concern. Only 10% are not concerned at all. Some contractors are predictably observing a decrease in government work given still constrained state and local government budgets and the realities of federal sequestration. Contractors also have been unnerved by an increase in interest rates, which would impact the level of demand for private work.

One implication of this is that competition for available work is expected to remain intense. Stiff competition translates into slender profit margins. Accordingly, the proportion of respondents indicating better profit margins fell from 47% during the second quarter survey to 38% during the third. About 36% report that their profit margins are roughly the same as last year. Moreover, the number of respondents reporting that profit margins had substantially deteriorated rose to 23% during the third quarter from 19% in the second.

That said, 50% of respondents expect that their profit margins will be slightly better next year. Only 3% believe that they will be significantly better, but virtually no one believes that they will be significantly worse. One supposes that margins remain so low that even somewhat smaller margins are hard to imagine.

With respect to the availability of financing for projects, only 13% are not concerned. Six% are highly concerned and 13% are very concerned. Fully two-thirds of respondents continue to watch with some concern, which means that many CFOs remain unconvinced that financing conditions have returned to normalcy.

The level of concern regarding the impact of public policy impact on construction remains elevated. Eight percent (8%) of respondents are highly concerned, 15% are very concerned and 54% are watching with some concern. Primary concerns included the impact of Detroit’s bankruptcy and the likely ripple effects of the bankruptcy on capital budgeting in other communities, the potential impacts of the Patient Protection and Affordable Care Act, and policy regarding the construction labor market.

Remarkably, despite the apparent lack of strong construction demand growth, CFOs continue to worry about looming skills/labor shortages. Forty-five percent (45%) of respondents are very concerned with another 15% being highly concerned. Another 30% are watching with some concern, which means that 9 out of 10 CFOs are concerned by potential skills shortages and their potential impact on business performance. Some CFOs indicate that the nation needs an immigration bill and that “we are already seeing a shortage of applicants.”

One category of stable concern is materials prices. Fifty-three percent (53%) think that prices will either rise moderately or significantly over the next year, but that figure stood at 58% a quarter ago. Another 38% of third quarter respondents believe they will be approximately the same a year from now and only 4% expect them to be slightly lower. Materials prices have been notoriously volatile over the past decade and it remains to be seen whether this relatively benign outlook proves justified.
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) 2013 Outlook – look ahead to December 2013

• 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.