CONSTRUCTION CFOs ARE HOPEFUL DESPITE BROADER ECONOMIC UNCERTAINTY

Another Significant Downturn Not Anticipated

While the national economy struggles to stave off yet another recession, the construction industry has arguably yet to exit recession and has scarcely begun to recover. Both residential and nonresidential construction volumes are flat to declining and the near-term outlook is not sanguine. One prominent leading economic indicator, the Architecture Billings Index, has declined for five consecutive months, suggesting that commercial and institutional construction spending is likely to decline over the next several months.

Given this economic context, it would be simple for the nation’s top construction CFOs to express a sense of despair. But that’s not what happened in the latest CONFINDEX survey, which suggests that, while the level of construction activity is unlikely to materially improve anytime soon, the sector is not poised for another substantial downturn. The overall Confidence Index now stands at 111, unchanged from the previous quarter and 4.7 percent higher than last year’s reading of 106. The Current Confidence Index now stands at 105, a 9.4 percent improvement from last quarter’s reading of 96.

It is worth noting that construction spending often lags behind business cycles. Therefore, the construction volumes being observed today are largely a reflection of the performance of the economy several months ago when Gross Domestic Product (GDP) was expanding more than 2 percent and job creation was far more rapid. The economy has weakened significantly over the course of 2011, with GDP expanding less than one percent on an annualized basis during the year’s first half and with no jobs added nationally in August.

The implication is that construction spending may stagnate further during the year ahead. Correspondingly, the Outlook Index fell 6.3 percent from last quarter’s reading of 126. That said, half of survey respondents expect that construction industry business conditions will be slightly better a year from now while 33 percent believe conditions will be about the same. This represents a particularly important reading since CONFINDEX survey participants are heavily influenced by actual data regarding financial performance rather than media speculation.

Respondents are also reasonably confident with respect to the stability of financial conditions. The Financial Conditions Index rose 11.5 percent this quarter to 107 and is up 5.9 percent relative to a year ago. Sixty-eight percent of respondents believe that bank credit availability is roughly the same as it was one year ago, while 14 percent believe it is slightly better and 13 percent believe it is slightly worse. Looking forward, 72 percent of respondents expect credit availability to be roughly the same a year from now, while 18 percent believe it will be slightly or significantly better. Only 5 percent believe that credit availability will deteriorate substantially.

With respect to backlog, the bulk of respondents expect backlog revenue to be either higher (37%) or the same (45%) one year from now. This is hardly consistent with recession and reflects a level of confidence that may surprise some. It may be that certain firms are gaining market share as competitors fade due to a lack of bank credit and bonding and the associated capacity to compete for large construction projects. The implication is that backlog among responding firms can rise even in the absence of general construction spending growth.
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 September 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.