Global CFO Survey: Economic Optimism Drops as Risks Multiply for Corporate Sector

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GLOBAL CFO SURVEY: ECONOMIC OPTIMISM DROPS AS RISKS MULTIPLY FOR CORPORATE SECTOR

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DURHAM, N.C. –- Chief financial officers are growing more pessimistic about the U.S. economy, but still plan to increase capital spending and hiring this year. Their expansion plans will be in substantial jeopardy, however, if inflation, the Federal Funds rate or the price of oil continues to rise.

These are some of the conclusions of the June 2006 Duke University/CFO Magazine Business Outlook survey, which asked CFOs from a broad range of global public and private companies about their expectations for the economy. The survey concluded June 1 and generated responses from 980 CFOs, including 584 from the U.S., 215 from Asia and 181 from Europe. The survey of European CFOs was conducted jointly with RSM Erasmus University in the Netherlands. Results in this release are for the U.S. firms, unless stated otherwise.

The study's main findings are:

-- Only 24 percent of CFOs are more optimistic about the U.S. economy, in contrast with 42 percent last quarter;

-- 49 percent are more optimistic about their own companies, however, suggesting the pressures facing the economy have yet to affect most firms directly;

-- Rising wages, falling consumer demand, and increased fuel costs top CFOs' lists of concerns;

-- CFOs say their bottom lines will suffer if core inflation rises to 3.5 percent, the Federal Funds rate goes above 5.5 percent, or if the price of oil surpasses $75 a barrel;

-- Companies will increase capital spending 7.5 percent over the next 12 months, an increase from last quarter, when CFOs predicted a rise of 6.5 percent;

-- Earnings are expected to increase 10.4 percent over the coming 12 months;

-- Corporate cash balances will grow another 2.1 percent.

OPTIMISM ABOUT U.S. ECONOMY PLUMMETS

Business optimism about the U.S. economy declined sharply, with only 24 percent of U.S. CFOs more optimistic than they were last quarter; 46 percent are less optimistic. At the same time, CFOs' optimism about their own firms remained fairly steady, with 49 percent growing more optimistic and 28 percent becoming more pessimistic.

"CFOs are telling us that we are moving closer to the danger zone for the U.S. economy, but that their firms can ride it out for now," said John Graham, a finance professor at Duke's Fuqua School of Business and director of the survey. "There are several risk factors that are near the tipping point, and if any of them worsens, it would heighten the risk of a corporate slowdown."

CFOS WORRIED ABOUT WAGES, INFLATION, CONSUMER DEMAND

Corporations are worried about inflation and wages. U.S. companies expect to increase their prices by 3.1 percent over the next 12 months. This would put the U.S. economy dangerously close to 3.5 percent inflation, the level at which a majority of CFOs say their bottom lines would begin to suffer. Trouble may arrive even sooner as a result of oil prices; CFOs say prices above $75 per barrel will harm profits.

CFOs are similarly worried about the Federal Funds rate. "CFOs don't want any more Fed hikes," said Campbell R. Harvey, founding director of the survey and a finance professor at Duke. "The CFOs have drawn a line in the sand. Rates above 5.5 percent will be damaging and rates above 6 percent would cause substantial damage to their bottom lines. The Fed does not have much wiggle room left."

CFOs cited rising labor costs as their No. 1 concern for the first time in the history of the survey. The second highest-rated risk facing the corporate sector is waning consumer demand, followed closely by rising fuel costs, increasing interest rates, a shortage of skilled labor and high health care costs. Asian corporate concerns are similar, but with more emphasis on consumer demand and fuel. European CFOs list high wages and salaries at the top of their concerns, followed by waning consumer demand.

"The risk posed by rising health care costs has not gone away, but companies now have bigger worries," said Don Durfee, research editor at CFO magazine. "Rising wages and salaries are a problem because CFOs tell us that they can only pass along about 40 percent of increases in employment costs. Similarly, on average only about half of rising commodity prices show up in the final prices of the products that their companies sell. The companies have to eat the rest."

SPENDING AND HIRING PLANS; EARNINGS

Though they are concerned about the economy, U.S. corporations are still planning capital and workforce expansions. Capital spending is expected to increase 7.5 percent over the next 12 months, up from 6.5 percent last quarter and 5.7 percent six months ago.

Three-in-five companies expect to hire more employees this year, with the overall increase averaging 1.3 percent. In contrast, only one-in-five firms expects to reduce employment. The employment picture is much worse in Europe, with domestic employment expected to decline by 1.4 percent.

Earnings in the U.S. are expected to increase by double digits over the next 12 months (10.4 percent). Earnings projections are down from last quarter's 13 percent predicted growth.

CASH BALANCES, TERRORISM CONCERNS

Though already high by historic standards, U.S. corporations expect to increase cash holdings by another 2.1 percent over the next 12 months. Asian firms predict their cash holdings will increase by a whopping 6.3 percent. European firms will increase cash by one percent.

U.S. firms remain concerned about terrorism, with 28 percent saying that fears about terrorism significantly hurt their bottom lines. Finance and transportation firms express the greatest terrorism worries.

RESULTS UNIQUE TO EUROPE

Forty percent of European CFOs are more optimistic about their own countries' economies relative to last quarter, and 53 percent are more optimistic about the outlook for their own firms. However, the Europeans acknowledge that their current optimism should be viewed in relation to Europe's recent weak economic history.

RESULTS UNIQUE TO ASIA

Optimism among Asian firms slipped from 67 percent being more optimistic last quarter to 54 percent this quarter. Asian CFOs say the prices of their own products will increase by 4.6 percent in the coming year, and expect double-digit increases in earnings, capital spending and technology spending.

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Detailed results, including tabular summaries of the numbers in this release and results from previous surveys, are available at <http://www.cfosurvey.org>.

About the survey: This is the 41st consecutive quarter that the survey has been conducted. Among the industries represented in the survey are retail/wholesale, mining/construction, manufacturing, transportation/energy, communications/media, technology and banking/finance/insurance. Revenue-weighted mean growth rates are provided for earnings, revenues, capital spending, technology spending and prices of products. Employee-weighted mean growth rates are used for health care costs, productivity, number of employees and outsourced employment. The earnings, dividends and cash on balance sheet weighted numbers are for public firms only. Unless explicitly noted, all other numbers are for all firms, including private.

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