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CFO SURVEY: INTEREST RATE INCREASES, TERRORISM RISK THREATEN U.S. ECONOMIC GROWTH

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DURHAM, N.C. -- Although the economic recovery continues, with strong earnings growth predicted in the coming year, risks that include domestic terrorism, interest rate increases, and wage inflation could threaten both economic growth and earnings.

These are the findings of the latest Duke University CFO Outlook Survey, which asks chief financial officers from both public and private companies and from a broad range of industries, geographic areas and revenue levels about their economic projections. The survey, completed June 16, has been conducted quarterly for the past nine years by Duke's Fuqua School of Business.

Capital spending is expected to increase at two-thirds of companies over the next 12 months, with the increase averaging 4.3 percent. Eighty-seven percent of firms predict earnings will grow, with the increase averaging 13.2 percent. While still positive, these capital spending and earnings growth expectations are lower than reported last quarter.

"The CFOs are telling us that there are growing risks to a continued recovery," said Campbell Harvey, professor of finance at Duke and founder of the survey. "In addition to dampened capital spending growth, employment is expected to grow by only one percent next year, a notable worsening of the employment expectations expressed by CFOs just last quarter. Our analysis of this quarter's survey suggests the economic situation is growing more fragile."

The survey asked executives to choose the top three risks, from a list of 10, that could affect their companies in the coming year. "The threats to the economic recovery are more acute than have been characterized by Wall Street pundits, with domestic terrorism and increasing interest rates at the top of the list," noted Harvey.

According to the survey results, the most significant risk to the U.S. economy is domestic terrorism, which 43 percent of companies rank among their top three risks. Another 15 percent of respondents rank the situation in Iraq as one of the top risks to their firm. "I don't think anyone expected domestic terrorism to be the number one risk. These responses demonstrate that the economy may be extremely sensitive to such an event. An attack could derail the economic engine," said John Graham, professor of finance at Duke and director of the survey.

Thirty-eight percent of corporations list rising interest rates as one of their biggest concerns in the coming year. If interest rates were to increase by 125 basis points in the coming year, 56 percent of firms say their earnings growth would be dampened. Another 27 percent say their capital spending would grow more slowly, and 24 percent say that hiring would slow.

More than one-third of CFOs report that wage increases are among the top risks their corporations face in the next 12 months. Across the sample, 95 percent of firms predict that their wages will rise, with an average increase of about three percent.

One-third of CFOs cite price inflation as a top risk. Prices are expected to increase at 59 percent of firms in the next year, with price inflation averaging 2.1 percent.

Only one-in-five firms list the high price of oil as a major concern during the next 12 months. If the price of oil remains near its current level, half of the companies say their earnings will grow more slowly, and less than one in five say their investment spending and hiring plans would be dampened. "While the American public is up in arms about oil prices, financial executives are not, probably because most industries are less reliant on oil as a primary fuel source. Plus, the inflation-adjusted price of oil has not increased relative to 20 years ago," said Graham.

Rising health care costs remain a major concern for many firms. Increases in health care costs are expected to average 9.2 percent in the next 12 months.

Outsourcing of employment is expected to increase at about half of all firms, with the average number of outsourced employees increasing by nine percent.

One half of CFOs say their firm will increase their dividend payments in the coming year, a significant increase from last quarter's survey. Dividends should increase by a resounding 7.1 percent.

Three-in-four companies expect to increase their technology spending in the next 12 months, with the increase averaging 3.7 percent across all firms. A similar three-quarters of companies plan to increase advertising, by an average of 4.3 percent.

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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, inventory, merger and acquisition activity, and prices of products. Employee-weighted mean growth rates are used for health care costs, productivity, number of employees and outsourced employment.

Detailed results of this survey, as well as other outlook surveys, are available at <http://www.cfosurvey.org>

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