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GLOBAL CFO SURVEY: CAPITAL SPENDING AND EMPLOYMENT GROWTH TO SLOW DUE TO INTEREST RATES, HIGH FUEL COSTS, HEALTH CARE COSTS, LACK OF PRICING POWER

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DURHAM, N.C. –- Chief financial officers say that employment and capital spending will slow over the next year. The CFOs point to inflationary pressures on input costs, such as high fuel and health care costs, as well as increased costs of short-term borrowing. They also say they lack the pricing power to make price increases stick for their own products.

These are some of the findings of the June 2005 Duke University/CFO Magazine Business Outlook survey, which asks chief financial officers from a broad range of public and private companies globally about their economic projections. The survey was concluded May 30 and generated responses from 602 CFOs, including 365 from the United States, 153 from Asia and 84 from Europe. Results in this release are for the U.S. firms unless explicitly stated otherwise.

BUSINESS OPTIMISM AT A THREE-YEAR LOW

This quarter, 40 percent of U.S. CFOs are more optimistic about the economy than they were last quarter, while 26 percent are less optimistic. This continues the downward trend in optimism over the past year. Forty-six percent of CFOs were more optimistic last quarter, 54 percent were more optimistic two quarters ago and more than 70 percent were more optimistic a year ago.

"This is a new low for CFO optimism," said John Graham, professor of finance at Duke's Fuqua School of Business and director of the survey. "We've found that this optimism index predicts future economic growth quite well. In a situation like this, where the optimists barely outweigh the pessimists, we can expect to see sluggish economic growth."

Asian CFOs share the same muted optimism. "In contrast, European CFOs are explicitly pessimistic," Graham said. "About half of the European CFOS are more pessimistic about their national economies relative to how they felt last quarter. Only 16 percent are more optimistic."

To understand the causes of this reduced optimism, the survey asked executives to choose the top three items, from a list of 15, that are concerns for their companies. For the second quarter in a row, health care costs top the list of concerns. In the United States, nearly 40 percent of CFOs cite high health care costs as a top issue. CFOs expect health care costs to increase by almost 9 percent in the coming year. High fuel prices, increased interest rates and reduced pricing power round out the top four concerns for U.S. CFOs.

European CFOs list increased global competition, salaries and wages, increased regulation and world economic stability as their top concerns. Asian firms are concerned about high fuel prices, increased global competition, world economic stability and reduced pricing power.

RISING INTEREST RATES TO SLOW GROWTH, CAPITAL SPENDING

Not only do U.S. CFOs list rising interest rates as one of their top current concerns, they say additional interest rate increases will slow U.S. economic growth. “The Fed has raised interest rates eight times with no impact on the economy. The CFOs are telling us that the next volley of rate increases will do some damage to GDP growth,” said Duke finance professor Campbell R. Harvey, founding director of the survey.

Of the CFOs surveyed, 83.2 percent say a Federal Funds rate of 4 percent will slow U.S. economic growth. The CFOs are somewhat more optimistic about prospects for their own firms, but 43 percent still say that increased interest rates will slow growth at their own firms. “The easy part of the Fed strategy is over -– the next phase will take a bite out of investment and employment plans,” Harvey said.

In part due to higher interest rates, corporate executives are reducing capital spending plans. While two-thirds say they will increase capital spending in the next 12 months, the increase will average only 4.5 percent (down from 5.4 percent last quarter).

“This rate of capital spending increase is barely sufficient to replace depreciated assets,” noted Don Durfee, research editor of CFO Magazine. “On the bright side, we expect to see a 10 percent increase in earnings next year, down slightly from an expectation of 10.4 percent expressed last quarter.”

PRICE INFLATION, EMPLOYMENT AND OUTSOURCING

Price increases at U.S. firms are expected to average 2.1 percent next year, up slightly from the 1.95 percent price increase anticipated last quarter. In part, this low level of price inflation reflects the inability of U.S. firms to make price increases stick due to a highly competitive economy. At the same time, input costs are increasing, putting the squeeze on corporate profits. In addition to rising health care costs, 53 percent of U.S. CFOs say rising energy and raw materials costs are the main reason that companies feel the need to increase prices, while 18 percent say labor costs are leading to higher input costs.

Domestic employment is expected to increase by 1.4 percent this year, down from plans expressed last quarter to increase employment by 1.7 percent. Forty-three percent of companies say they will increase employment by a small amount in the third quarter of 2005, 16 percent by a moderate amount and only 2 percent by a large amount. Employment growth will slow moderately in the fourth quarter of 2005.

While domestic employment growth is slowing, outsourcing plans are again increasing. The number of outsourced employees is expected to rise by 6.5 percent during the next 12 months, up from expected growth of 2.7 percent in last quarter’s survey.

DEPRECIATION OF CHINESE CURRENCY

Few CFOs think that a revalued Chinese Yuan would offer any relief to their firms. “The revaluation of the Yuan is being portrayed as urgent by many of our political leaders. The CFOs have a different opinion,” Graham said. Fifteen percent believe that revaluation of the Yuan would help their firms, but 11 percent said a revaluation would hurt their firms. “It’s a wash -- certainly no economic panacea,” Graham noted.

RESULTS UNIQUE TO EUROPE

Thirty-eight percent of European firms expect to lay off employees, with the decrease in employment across all firms averaging 0.7 percent.

Fifty-three percent of European CFOs say that consolidation of European stock exchanges would be a positive development, compared to only 16 percent who say it would not be. The remaining 31 percent are not sure.

More than one in five European CFOs say the transition to international accounting standards has been more difficult than they expected. One-third say that investors and financial analysts are not at all knowledgeable about international standards, and only 11 percent say they are very knowledgeable.

RESULTS UNIQUE TO ASIA

More than 90 percent of Asian CFOs say that unit labor costs are beginning to increase at their firms. Forty seven percent say labor costs are increasing a little, 37 percent say a moderate amount and 9 percent say labor costs are increasing a lot. Among those who say unit labor costs are increasing, 30 percent say this presents a small problem for their firm's bottom line, 33 percent say a moderate problem and 8 percent say a big problem.

Seventy-four percent of Asian firms say they will increase employment, with the increase in employment across all firms averaging nearly 3 percent.

Twenty-eight percent of Asian CFOs say a revaluation of the Chinese currency would hurt their firms, compared to 24 percent who say it would help.

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About the survey: 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. All of these weighted numbers are for public firms only. Except if explicitly noted, all other numbers are for all firms, including private.

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

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