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GLOBAL CFO SURVEY: CORPORATE OPTIMISM REBOUNDS; INFLATION TO RISE, BUT CFOS NOT CONCERNED

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DURHAM, N.C. –- Optimism from chief financial officers jumped this quarter. Even though CFOs expect higher inflation, they say that rising prices will not hurt their businesses and that the Federal Reserve should not raise interest rates anytime soon. Companies will continue to accumulate cash during 2006 and U.S. firms are willing to pay more than $70 per barrel to reduce U.S. dependency on Middle Eastern oil.

These are some of the findings of the Spring 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 was concluded March 5 and generated responses from 573 CFOs, including 323 from the U.S., 96 from Asia and 154 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.

CFO OPTIMISM REBOUNDS

Business optimism about the U.S. economy reached its highest level in a year, although it remains significantly lower than it was two years ago. Forty-two percent of U.S. CFOs are now more optimistic than they were last quarter, while one-fourth are less optimistic.

"Increased business optimism bodes well for the economy," said John Graham, a finance professor at Duke's Fuqua School of Business and director of the survey. "After several quarters of falling expectations, CFOs now see fewer reasons to hold back spending."

Historically, the survey's measure of CFO optimism has been highly correlated with future increases in capital spending and corporate earnings. "This is a sign that we can expect the economy to pick up over the rest of the year," Graham said.

Business optimism also surged in Asia (with two-thirds of CFOs more optimistic than last quarter) and Europe (with 46 percent of CFOs more optimistic).

HALT THE FEDERAL RESERVE RATE INCREASES

CFOs expect prices to rise by 3.3 percent over the next 12 months, a continuation of the upward trend of a 3 percent increase expected in December's survey and a 2 percent increase expected in last March's survey. Wages and salaries are expected to increase by 4.2 percent.

"Even though CFOs expect inflation well above the Fed's comfort level, the CFOs are sending a strong message to the new Federal Reserve Chairman to back off," said Campbell R. Harvey, a professor of international business at Duke's Fuqua School of Business and founding director of the Survey.

Two-thirds of CFOs reported that even a jump in the inflation rate to 3.5 percent would not hurt their firms' prospects.

"The CFOs say inflation in the 3 percent range is not a big deal for their firms. In contrast, such a breach would set off alarms at the Fed," Harvey said. "CFOs are telling the Fed to halt or reverse the rate increases – remarkably, nine out of 10 CFOs oppose a rate increase at the end of March."

CORPORATE CONCERNS FOR 2006

While not concerned about inflation, CFOs are concerned about other issues. The No. 1 risk factor for corporate America is intense global competition, listed by nearly half of CFOs as one of their top three worries. The second-biggest worry is rising health care costs. A cluster of other factors are also on the CFOs' radars, including increased interest rates, high fuel costs, economic stability and declining consumer demand. A notable portion of CFOs also list a shortage of skilled laborers as a concern.

Even though high fuel costs are a worry, U.S. CFOs also recognize the long-term risks to the U.S. economy of continued dependence on Middle Eastern oil. On average, CFOs say they would be willing to pay slightly more than $70 per barrel if that would reduce the country's dependence.

CASH HOARDING TO INCREASE IN U.S.AND ASIA, FALL IN EUROPE

Even with cash holdings at an all-time high, U.S. corporations expect to increase cash by another 2.6 percent over the next 12 months. Asian firms predict their cash holdings will increase by a staggering 8.7 percent. European firms, in contrast, will decrease cash by 4.3 percent.

"Historically, corporations have often held on to cash too tightly," said Don Durfee, research editor at CFO magazine. "We'd like to see them put this cash to good use, or return it to investors."

The survey asked the CFOs what their firms plan to do with their cash holdings. The majority report they simply plan to hold on to their cash. Only secondarily, some of the cash will be used to increase investment and acquisitions and, to a lesser extent, increase repurchases and dividends and pay down debt.

EARNINGS, EMPLOYMENT AND CAPITAL SPENDING EXPECTED TO REBOUND

Earnings are expected to increase at 81.2 percent of firms over the next 12 months, with an average jump of 13.1 percent. This is up from an expected increase of 11.4 percent predicted last quarter.

U.S. capital spending is on the rise. Sixty percent of CFOs say they will increase capital spending in the next 12 months, with the average increase 6.5 percent (up from 4.7 percent two quarters ago). Tech spending is expected to rise by 8.4 percent. European capital spending is expected to rise 6 percent, while Asian capital spending is expected to jump an astounding 17 percent.

Fifty-nine percent of U.S. firms plan to increase employment this year, while only 17 percent expect to reduce employment. Overall employment should increase 2 percent in the next 12 months, much higher than last quarter's predicted 0.6 percent increase. At the same time, outsourced employment should increase at 36 percent of firms, with growth averaging 6.5 percent. Among Asian firms, own-country employment is expected to grow 8.4 percent.

“Employment should be flat in Europe," Graham noted. "This is actually an improvement from last quarter, when the European workforce was expected to shrink.”

RESULTS UNIQUE TO EUROPE

The cost of labor and declining consumer demand are important concerns for European CFOs.

Nearly 40 percent of European CFOs say that protectionism is rising in their national economies, in contrast to only 15 percent who say that protectionism has declined.

Half of European CFOs say that their firm’s increased outsourcing of jobs will hurt domestic European employment.

RESULTS UNIQUE TO ASIA

Seventy-eight percent of Asian CFOs expect the U.S. dollar to appreciate relative to the Chinese Yuan over the next 12 months.

The primary planned use of cash holdings in Asia will be to increase capital investment, and the price of fuel remains a top concern of Asian CFOs.

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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 40th 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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