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The Fed Lowering Interest Rates Wouldn't Help, Company Executives Say

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DURHAM, N.C. (TheStreet) -- I hope members of the U.S. central bank's Federal Open Market Committee are reading this before their meeting today and Thursday. The Duke-CFO Survey, released Tuesday, provides irrefutable evidence that companies wouldn't increase spending on equipment and services if policy makers enter another round of bond purchases, or quantitative easing.

We asked chief financial officers a number of questions to determine the sensitivity of capital spending to changes in interest rates. In usual circumstances, there is a negative relation between interest rates and capital investment (lower interest rates means higher investment). However, our current economic environment is highly unusual and isn't reflective of a historical average. The benchmark 10-year Treasury, for example, stands at about 1.7%.

A key advantage of our survey is that we can get information about intentions given the current circumstances. The usual historical analysis looks at outcomes in various economic environments.

Our results suggest that planned capital investment is insensitive to rate changes. Investment hurdle rates are very high given the economic uncertainty, and these hurdle rates already include contingencies for interest-rate changes.

Will interest-rate decreases trigger investment?

In the survey released Tuesday, we asked about the possible stimulative effect of interest-rate decreases.

"By how much would your borrowing costs have to decrease to cause you to initiate, accelerate or increase investment projects in the next year?"

A total of 667 CFOs responded to the question. For a 50-basis-point reduction in borrowing costs, only 3% would initiate, accelerate or increase investment. For a 100-bp decrease in costs (which would be an extraordinary amount), an additional 5.7% would increase investment. In the current environment, investment is insensitive to interest-rate decreases. (Note: One hundred basis points is 1 percentage point.)

We asked a mirror question about interest-rate increases impacting delay or cancelation. For a 50-bp increase in rates, only 5.4% would delay or cancel their investments. For a 100-bp increase in rates, an additional 8.6% would consider delay or cancellation. Both questions suggest that investment is not responsive to modest to substantial changes in interest rates.

We were somewhat concerned that some of the respondents had no investment plans. We asked a separate question to isolate only those who planned to invest. We then recalculated the sensitivities in the previous paragraph. For those who will be investing, a decrease of 50 bp would lead only 2% to initiate, accelerate or increase investment. For those who will be investing, an increase in rates of 50 bp would cause only 5.3% to delay or abandon the investments.

In the words of the CFOs

Here is what the CFOs say. (We asked them to explain their responses.):

"Rates are already at historic lows, so lower rates would not impact our decision."

"Rates are too low now to create a stimulus with lower rates."

"We need to see reliable growth before we are willing to invest any further."

"The interest rate will not fluctuate that great to influence our decisions in this area. We already have exceptionally low financing available to us. Our weighted average interest rate on debt is currently the lowest in our history."

"Borrowing costs don't drive our investment decisions unless they rise dramatically."

"Interest rates are already at historic lows. It's not high interest rates that are holding us back, but uncertainty about federal policies and loss of financial wealth of our customers."

Implications for quantitative easing

The survey provides convincing evidence. Today's capital investment is remarkably insensitive to both increases and decreases in interest rates. The reason for this is that the effective hurdle rates are very high -- and builds in a buffer. In other words, before pursuing a project, the CFO already takes into account a plus or minus 100-bp change in the borrowing-cost environment.

The bottom line is grim for the prospects of additional QE being successful. Rates are already at 50-year historical lows. Many have noticed the diminished impacts of each non-conventional intervention since the original QE. Our survey shows that even an optimistic impact of 50-bp reduction in rates would have little measurable impact on capital spending.

Indeed, it is possible that the speculation about QE3 (or QE4) generates additional uncertainty -- over and above the heighted uncertainty that already exists in the current economic environment. Uncertainty, in the end, hurts capital investment.

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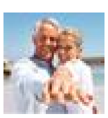

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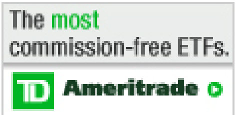

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