Tax

CFOs Bullish on 2018

Buoyed by the Tax Cuts and Jobs Act, U.S. CFOs project sizable increases in earnings, capital spending, and technology outlays this year.

Chris Schmidt

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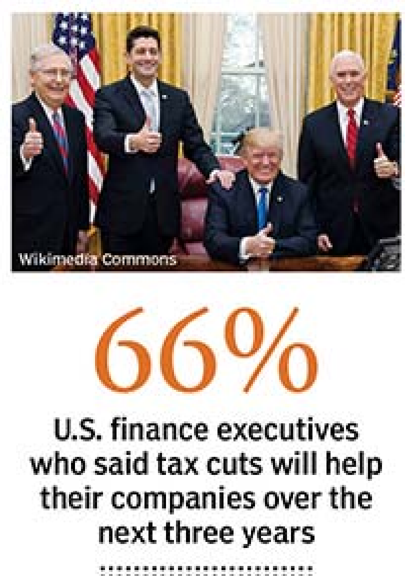
The Tax Cuts and Jobs Act may be getting a lukewarm reception from consumers, but CFOs are clearly over the moon about the lower corporate income tax rate and other provisions in the new law. In the first quarter, CFO optimism in the United States climbed to its highest level since 1996, and finance chiefs laid out their concrete plans for spending the tax cut windfall, which should be a shot in the arm for the U.S. economy.



According to the results of the latest Duke University/*CFO* Global Business Outlook survey, which ended March 2, more than 40% of U.S. companies plan to boost wages and 38% to increase hiring in 2018 because of the recent tax cuts. About 36% will increase domestic investment and 31% will increase cash holdings. And, among companies with defined benefit pension plans, 29% said they will boost pension contributions.

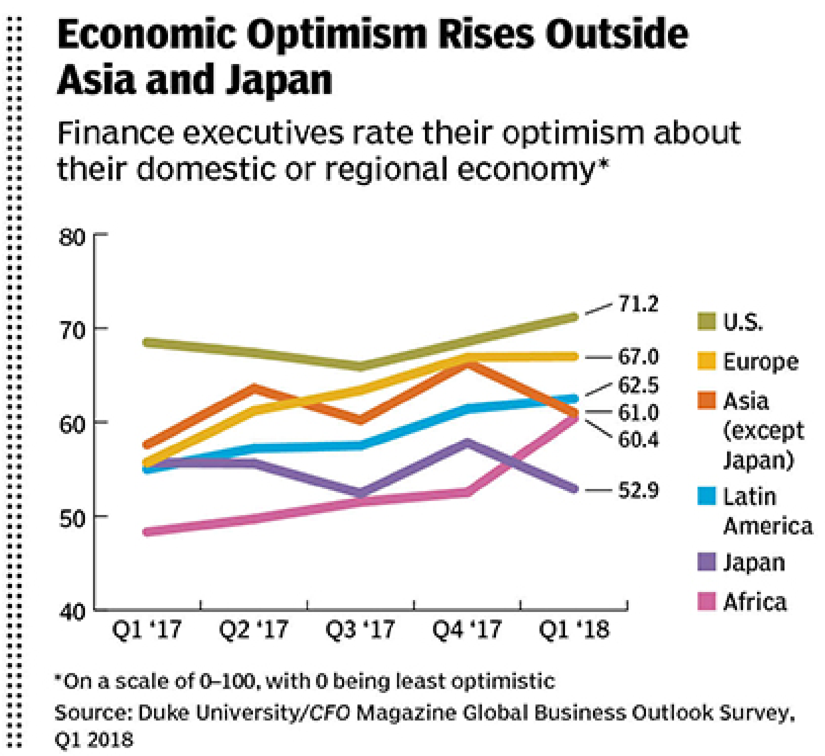
Sixty-six percent of U.S. CFOs said corporate tax cuts will help their companies over the next three years, with 36% saying the overall benefit will be medium or large. Only 14% rated the overall effect as negative. "Some benefits of tax reform are already being felt, while others will unfold over the next several years," said John Graham, a finance professor at Duke's Fuqua School of Business.

Among companies that plan to increase investment in the United States, 53% said the reduced corporate income tax rate was the reason. Forty-four percent indicated the immediate expensing of capital expenditures enacted under the new law was driving their change in U.S. investment plans. Full expensing of qualified capital expenditures lasts for only five years, however, and 37% of companies indicated they would shift investment so that it occurs sooner.

Due to tax reform, CFOs expected the effective (or average) tax rate for U.S. companies to fall by about 5 percentage points, to 18.8% from 24%. The lower U.S. tax rate increases the after-tax return on investments, so it's no surprise that about half of Canadian, Latin American, and Asian CFOs responding to the Duke/*CFO* survey said that the reduced rate makes the United States a more attractive place to do business.

Record-High Optimism

The CFO optimism index in the United States increased to 71.2 on a 100-point scale in the first quarter, an all-time high. Optimism among finance chiefs remains elevated around the world, anticipating strong global economic conditions this year.



"Our analysis of past results shows the CFO optimism index is an accurate predictor of future economic growth and hiring, therefore 2018 looks to be a very promising year," said Graham. However, "promising" doesn't mean without challenges.

With the United States at or near full employment, the proportion of firms indicating they were having difficulty hiring and retaining qualified employees remained at a two-decade high, with 45% of CFOs calling it a top concern during the past quarter, up from 43% in the last period of 2017. At the median, U.S. companies planned to increase employment by 3% in 2018.

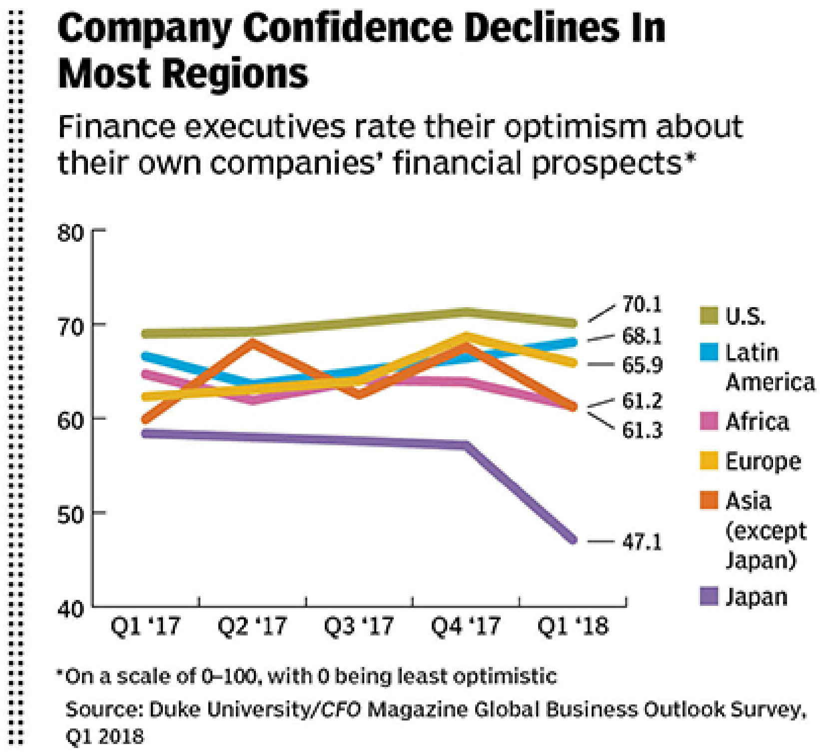
The tight labor market also continues to put upward pressure on wages, with wage inflation now listed seventh among the concerns of U.S. CFOs. U.S. companies expect to pay higher wages, with median wage growth of about 3% over the next 12 months. Wage growth is projected to be strongest in the technology, energy, and service/consulting industries.

After difficulty finding the right employees, the next biggest concern among U.S. CFOs in the past quarter was the cost of employee benefits, which 33% of finance chiefs cited. Regulatory requirements, government policies, and data security rounded out the top five.

Adopting Innovation

The first-quarter Duke/*CFO* survey asked a series of special questions about blockchain and cryptocurrencies. Blockchain is the distributed ledger technology widely expected to disrupt business models as it is adopted for verifying ownership and allowing secure and nearly instant transactions with low fees.

Seventy-eight percent of U.S. finance chiefs responding to the survey said they don't expect to be affected — or aren't sure how they'll be affected — by blockchain. Seventeen percent said their firms will be affected but haven't yet adapted their business model in response. Four percent said they are working to adopt blockchain, and just 1% said they have already adopted the technology. Only 3% of U.S. CFOs claimed to understand it.



"The U.S. needs to wake up in the fintech space," said Cam Harvey, a founding director of the survey, who teaches a blockchain innovation course at Duke's Fuqua School of Business. "China is doing nearly $10 trillion in mobile payments, while the U.S. is barely over $100 billion. Most of the big innovations over the past 25 years have originated in the U.S., but this time is different. There is a lot at stake and, right now, it looks like China will be eating our lunch."

Twenty-seven percent of survey respondents said they have already reduced their finance workforce or will within five years because of finance technology, or "fintech," advances. However, more than 70% of finance executives said they do not expect to cut finance employees because of fintech. "Finance back-office jobs are low-hanging fruit for the fintech disruption," Harvey said. "It's logical to expect that 70% of firms will cut finance employees, not the other way around."

In contrast to the United States, nearly 20% of European CFOs said they understand blockchain technology well, up from only 8% who said they did two years ago.

Global Bumps

Elsewhere around the world, economic optimism among CFOs in Canada dropped to 59 from 64 (on a scale of 0 to 100). Capital spending is expected to shrink and hiring will be flat in 2018, but earnings are expected to grow above 7%.

Optimism in Europe remains high at 67, although CFOs in the United Kingdom recorded an optimism level of only 60, thanks to ongoing distress over Britain's forthcoming exit from the European Union. CFOs across the pond estimated capital spending will grow about 5% in 2018, with employment growth flat.

Optimism in Asia (except Japan) fell to 61 from 66.3 last quarter. Economic uncertainty, access to capital, difficulty attracting qualified employees, low employee morale, and currency risk were top concerns in the region. Still, the Japanese economy remains on a prolonged expansion streak, the longest in 30 years. Capital spending was expected to grow about 10%, and employment 3%, in 2018.

In Latin America, CFO optimism about the domestic economy continued to rebound in most countries, rising to 70 in Mexico, 69 in Chile, and 62 in Brazil. Economic uncertainty was the top concern among CFOs in the region. Despite the positive trend of higher prices for key commodities, Latin American economies expanded less than expected at the end of 2017. While the region is expected to benefit from strong global growth in 2018, most governments in the region still face large budget deficits.

*Source for all charts: Duke University/*CFO *Magazine Global Business Outlook Survey of finance and corporate executives. Responses for the current quarter include 263 from the U.S., 63 from Asia (outside of Japan), 16 from Japan, 106 from Europe, 86 from Latin America (including Mexico), and 47 from Africa.*

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