

## 4Q18 Highlights: Tariff and gridlock expectations stoke recession fears

- Optimism regarding the North American, European, and Chinese economies declined; the US, Canadian, and Mexican economies are not expected to improve next year.
- More than half of CFOs expect a US recession by 2020.
- Own-company optimism declined sharply to its lowest level in nearly three years (second lowest in nearly six years).
- Growth expectations for revenue, earnings, and capex declined to equal/below the two-year averages. Hiring and wages rose.
- CFOs expect higher interest rates and bond yields; few cite company changes around debt, cash, and buybacks.
- CFOs expect new Chinese trade restrictions, but most expect elevated input prices without higher demand for their offerings.
- With a split Congress, CFOs do not expect changes around taxes or health care and are divided on infrastructure.
- CFOs' top hopes and fears revolve around Washington's ability to get meaningful legislation passed—and they express doubts.

### How do you regard the current/future status of the North American, European, and Chinese economies?

Perceptions of North America declined, with 88% of CFOs rating current conditions as good (down from 89% last quarter), and 28% expecting better conditions in a year (down from 45%, and a five-year low). Perceptions of Europe declined markedly to 23% and 7% (from 32% and 23%), and China also declined sharply to 24% and 12% (from 37% and 27%).

**What is your perception of the capital markets?** A four-year-low 62% of CFOs say debt financing is attractive (73% last quarter). Attractiveness of equity financing fell for public company CFOs (from 42% to 35%) and also for private company CFOs (53% to 37%). Sixty-five percent of CFOs now say US equities are overvalued—down from last quarter's 71%.

**Overall, what risks worry you the most?** Following the US midterm elections, external risks have become an even stronger focus. CFOs express concerns about trade policy and political turmoil, and rising worries about economic growth. Talent is again the top internal concern.

**Compared to three months ago, how do you feel about the financial prospects for your company?** The net optimism index fell drastically from last quarter's +36 to just +3 this quarter—the lowest reading in nearly three years. Just 26% of CFOs express rising optimism (48% last quarter), and 23% express declining optimism (12% last quarter).

**What is your company's business focus for the next year?** CFOs indicate lower biases toward growth over cost reduction (50% vs. 21%) and investing cash over returning it (48% vs. 18%). The bias toward current offerings over new ones shifted toward new (43% vs. 40%), and the bias toward current geographies over new ones decreased (60% vs. 17%).

**Compared to the past 12 months, how do you expect your key operating metrics to change over the next 12 months?** Revenue growth expectations declined from 6.1% to 5.5%, and earnings growth fell from 8.1% to 7.3% (their lowest levels in one and two years, respectively). Capital investment slid from 9.4% to 5.0% (the lowest level in two years). Domestic hiring rose from 2.7% to 3.2% (matching its high). Dividend growth fell to 4.5% from last quarter's 7.4%.

**What are your expectations for the macroeconomy in 2019?** The vast majority of CFOs do not expect the US, Canadian, or Mexican economies to improve, and 55% expect a US recession by 2020. Expectations for business spending declined sharply, and those for labor costs rose.

**What are your expectations for the capital markets in 2019?** CFOs expect substantially higher interest rates and 10-year bond yields, and they expect the US dollar to remain strong relative to other major currencies.

**What are your expectations for your company in 2019?** CFOs expect industry revenue and prices to rise as M&A fuels consolidation. Few expect higher debt, cash, and buyback levels, and fewer expect to take above-normal risk than in 4Q17. They plan to hire mostly highly skilled workers and implement technology to replace talent.

**What are your expectations for US trade policy over the next two years?** CFOs overwhelmingly expect new Chinese tariffs and the NAFTA replacement (USMCA) to pass the US Congress. Overall, many expect tariffs to elevate input prices without aiding demand for their own products/services.

**What are your expectations for other US policy over the next two years?** With a split US Congress, CFOs do not expect changes related to tax rates or health care. They are split on what might happen around infrastructure and regulation, but overwhelmingly expect the US national debt to continue to rise.

**What are your hopes and fears for Washington?** CFOs' top hopes and fears revolve around Washington's ability to cooperate in getting meaningful legislation passed—and they express overwhelming doubts. Many express specific fears about trade restrictions and hopes for stabilization of trade agreements.

\*Averages have been adjusted to eliminate the effects of stark outliers.

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