

## Tom Barkin

### What's Ahead? Learning From The CFO Survey



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**Tom Barkin**

**President, Federal Reserve Bank of Richmond**

Economic Club of New York

#### **Highlights:**

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- Firms are currently navigating extraordinary uncertainty. The decisions they make about hiring, spending and investment will have implications for GDP growth, employment and inflation.
- Business sentiment surveys like The CFO Survey help us understand those decisions.
- The latest survey shows that CFOs are feeling slightly more optimistic than they were last quarter, although they remain concerned about demand and revenue. Firms also remain cautious about investing.
- The survey also suggests that employment will lag spending. Many firms have streamlined their operations in response to the pandemic, and others report that they are concerned about the “availability and quality of labor” despite high unemployment.
- CFOs also raised their expectations for wage and price increases in 2021, potentially due to supply chain challenges. If demand were to resurge, we could see pressure on near-term pricing.

Thank you for inviting me to join you this afternoon (virtually). I thought today I would share some perspectives on where the economy is and what I look at in thinking about where it might be headed, though I'm very much looking forward to hearing your questions and comments. Before I say more, I have to note that the views I express are my own and not necessarily those of my colleagues on the Federal Open Market Committee (FOMC) or in the Federal Reserve System.<sup>1</sup>

My experience is different than most of those colleagues. Before coming to the Fed nearly three years ago, I was the chief financial officer (CFO) of a \$10 billion institution. As I

consider the path of the economy, I go back to that experience a lot and try to put myself in the shoes of a firm navigating what has been, and still is, extraordinary uncertainty — around the virus, around fiscal policy and around politics. Earlier this spring, in the immediate wake of the shutdown, I of course would have been thoughtful on hiring and spending. But now, in the midst of developing a budget for next year, how aggressive or conservative would I be on hiring? Or spending? Or capital investments? Would I be pushing to implement a normal January price increase? Would I be stocking the shelves for a strong holiday rebound or trimming inventories to be prudent? Would I be shifting my supply chain out of certain countries? How firms answer these questions has implications for GDP growth, employment and the pace of inflation.

But I wear a different hat now. To understand how and what firms are deciding, I've been helped greatly by my continual outreach in our district, which spans from Maryland to the Carolinas, and by keeping an eye on business sentiment surveys, particularly the Richmond and Atlanta Fed's partnership with Duke University's Fuqua School of Business on [The CFO Survey](#). This quarterly survey has tracked business sentiment for nearly 25 years, surveying CFOs and financial decision-makers across firms of all sizes and in all major industries. It gathers their views on the health of their own firms and of the overall economy. It delves into their expectations for hiring, spending, investment and pricing in real time, which is particularly important given the pace of change during the current economic crisis.

### **Current Results From The CFO Survey**

We released the results of the latest survey last week. What did it tell us about prospects for the economy?

First, CFOs' expectations are brightening, albeit gradually. Looking at the headline Optimism Index, CFOs are slightly more optimistic about the U.S. economy and their own company's prospects since our last survey in July. At that time, they estimated GDP growth over the next four quarters would be just 0.6 percent. They anticipate 2.2 percent now. Their expectations for their own revenue growth in 2021 have grown from 7.2 percent to 8.7 percent.

Firms are still worried about demand and revenue but a little less so than in the last quarter. In the open text question that asked about firms' most pressing concerns, the share that cited flagging demand and declining sales revenue was notably lower. Of course, "slightly more optimistic about revenue returning" doesn't necessarily mean that revenue growth will be quick. Only about 20 percent of firms that responded anticipated being at pre-COVID-19 levels of revenue any time before the middle of 2021.

This matches what I hear in conversations every week with business executives. In sectors that have largely reopened, executives tell me they have found a way to operate safely. And with the personal saving rate still elevated — at 26 percent in the second quarter and 14.1 percent in August, compared to the pre-crisis level of around 8.3 percent — executives see significant consumer spending potential that could bolster demand.

Second, we heard that firms still remain cautious about investing. More than 50 percent of firms reported a decreased willingness to spend compared to pre-COVID-19. Only about one-third of CFOs had plans to invest in structures over the next six months. And while more than 60 percent were planning to invest in equipment, most reported investing for maintenance. Those who are not investing primarily cited the uncertainty of the economy and a need to preserve cash. This sense of caution is natural given the breadth of potential paths for the virus, for the government response and consequently, for the economy. This uncertainty effectively increases discount rates.

Third, CFOs believe employment is likely to lag spending. In July, they expected a 4.2 percent increase in 2021 employment. That has dropped to 2.2 percent despite their increased optimism on revenue. Most businesses, even those less affected by the virus, tell me they have taken the opportunity to streamline their operations. A number of sectors, such as food services, are still operating at less than full capacity. And you've seen recently a number of sizable layoff announcements from airlines, theme park operators and even a major insurer.

At the same time, hiring is a challenge. Despite the fact that unemployment remains quite elevated at 7.9 percent, there was a large increase in the share of survey respondents citing the "availability and quality of labor" as a pressing concern. This mirrors what I hear in my interviews, particularly in sectors like manufacturing, technology and healthcare. Many of the people who lost their jobs don't yet have the skills to find employment in a different field. And, at a time when many schools, child care centers and elder care facilities are closed or struggling, we are seeing drops in labor force participation, particularly for prime-age women.

Finally, the CFOs in the survey see price pressure as increasingly tangible. Their expectations for 2021 wage increases have escalated from 4.4 percent to 5.4 percent, and their expected price increases rose from 2.9 percent to 4.3 percent. I don't take a lot of signal from the numbers themselves, but the directionality does support my view that supply chain challenges amidst all this uncertainty could put pressure on certain prices. We saw that with food over the summer and with lumber more recently. When I go to big-box retailers, the shelves look a bit bare. If demand were to resurge, say because of a successful vaccine, while supply chains are still stretched, we could see pressure on near-term pricing.

Speaking of pricing, the FOMC recently announced changes to its 2012 statement on Longer-Run Goals and Monetary Policy Strategy. We've said that in order to anchor inflation expectations at 2 percent, the Committee seeks to achieve inflation that *averages* 2 percent over time. As you know, it has modestly lagged that target for some time. In his [speech](#) announcing the changes, Chair Powell called this flexible average inflation targeting — the flexibility coming from the lack of a specific formula.<sup>2</sup> In addition, the Committee said that it will respond to shortfalls of employment from its maximum level; the previous version referenced deviations of employment. In other words, under the new framework, a low level of unemployment alone would not lead to preemptive increases in interest rates.

Finally, the Committee made explicit that meeting our mandate requires a stable financial system.

The net of all this is a message that the Fed will aim to keep rates low until we see moderate overshoots of inflation or the development of financial stability risks. Our statement last month reinforced that message, which was supported by our projections in which the median respondent didn't have a rate increase through 2023. We also continue to engage in significant bond purchases that provide additional accommodation.

I remain hopeful that we can put this virus and the related uncertainty behind us. If we can, there is untapped consumption that could give the economy a real lift. My hope then is that reduced uncertainty could get CFOs off the sidelines and propel the virtuous cycle of hiring and investment that moves the economy forward. In the interim, the Fed continues to do what it can to provide support.

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- 1 Thank you to Nina Mantilla, Jessie Romero and Sonya Ravindranath Waddell for assistance preparing these remarks.*
  - 2 Powell, Jerome H. "New Economic Challenges and the Fed's Monetary Policy Review." Speech at "Navigating the Decade Ahead: Implications for Monetary Policy," an economic policy symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming, August 27, 2020.*



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**Jim Strader**

(804) 697-8956

(804) 332-0207 (mobile)