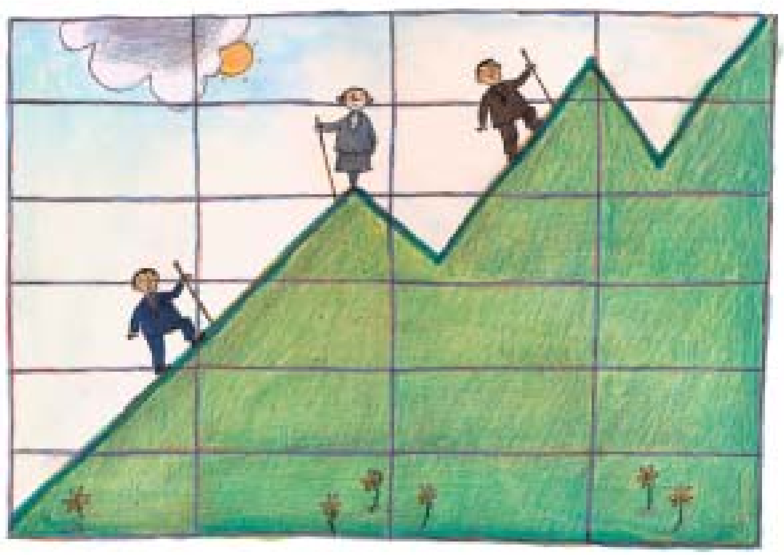
Economic Expansion Is Expected to Widen

➤ **AT THE END OF THIS YEAR'S FIRST** quarter in March, the U.S. economic outlook for nine and 12 months forward was solidly optimistic. CEOs' confidence in the U.S. economy rose to the highest level in 20 years; CFOs expect robust growth in annual earnings, capital spending, and employment; and the Dow Jones Industrial Average is predicted to top 11,000 at year-end.

The confidence of chief executives in the U.S. economy surged to the highest level in 20 years, according to the Conference Board. The organization's quarterly index of business confidence rose to 73 in the first quarter, a substantial increase from 66 in the fourth quarter of 2003. Chief executives haven't been as optimistic about the economy since the last quarter of 1983, when the index stood at 74. A reading above 50 reflects more positive than negative responses from more than 100 CEOs from various industries. Looking to the next six months, these CEOs foresee the economy improving, with a reading of 72, up from 66, the survey said. Expectations for their own industry stood at 70 vs. 63 in the final quarter of 2004.



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The CEOs' outlook is consistent with GDP growth of 4.6% predicted for this year by economists and investment strategists from 30 financial institutions that KPMG Investment Advisors polled. That compares to last year's actual GDP growth of 3.1%.

Meanwhile, the confidence of CEOs may be due to soaring profits. Corporate profits last year rose 29% over 2002, according to the U.S. Department of Commerce. That was the biggest quarterly increase in profits since the first quarter of 1984, when pretax profits jumped 36%.

Looking forward, chief financial

officers reported that they expect earnings to increase by an average of 30.6% with median growth of 15%, according to a quarterly survey from Financial Executives International (FEI) and Duke University's Fuqua School of Business. Earnings increases are expected to average more than 30% for smaller firms (sales of less than $1 billion) and about 20% for larger firms (sales of at least $1 billion), the study showed. Sales revenue is expected to increase by 10%, with large firms expecting an increase in revenues of about 7% and smaller firms expecting an increase of about 15%.

Here are some other CFO predictions from the FEI/Duke survey:

- Technology spending: Three-fourths of firms expect to increase tech spending, with an average expected increase of 4%.
- Healthcare costs are expected to increase 10.2%.
- Price inflation: Prices of products are expected to rise 2.8%, the highest level of "pricing power" expressed in at least two years.
- Wages are expected to increase by an average of 3.5%.
- Mergers and acquisitions: A 16% increase in activity is expected.
- The U.S. dollar will appreciate relative to the euro. By the end of the year the dollar is expected to appreciate 7% and reach an exchange rate of 0.86 dollars to 1.0 euros.

The FEI/Duke survey electronically interviewed 216 CFOs of U.S. companies the third week of March. CFO interviewees came from large and small public and private companies in a broad range of industries and geographic areas. Among the industries represented were retail/wholesale, mining/construction, manufacturing, transportation/energy, communications/media, technology, and banking/finance/insurance.

Other observers say that actual and predicted growth in profits is due to higher sales, automation, more effective use of information technology, and other efficiency gains that allow many companies to increase sales without hiring more people. Productivity jumped 4.4% in 2003 and 5% in 2002, compared with an average of just 2.3% in the past 55 years.

Robust sales, profits, productivity, and continued low borrowing costs may help explain finance officers' plans for spending and hiring. CFOs at 69% of the companies surveyed said they'll increase capital spending over the next 12 months, with an average increase of 11%, more than double the 5% increase they expected three months ago.

CFOs also predicted strong employment growth. Nearly three-fourths of those plan to increase the number of their employees in the coming year, while only 7% expect to reduce employment, according to the FEI/Duke survey. Overall, the number of employees should increase by 5%, which is a significant improvement over expectations of the past three years when forecasts ranged from a decline to less than 2% growth. In the second quarter of this year, 20% of employers plan to increase payrolls, the highest number since the first quarter of 2001, according to data compiled by Manpower. In another way of viewing the employment outlook, the proportion of chief executives anticipating a decrease in hiring fell significantly to less than 12% from about 47% in the first quarter of 2003, according to the Conference Board's measure of CEO confidence.

In the capital markets, the average respondent to the KPMG 2004 economic and capital markets survey predicted the Dow Jones Industrial Average will end the year at 11,204, up from 10,453 in 2003, the second year in a row since 1999 that the index ended the year higher. These respondents are also expecting the U.S. equity market to be less volatile for both the short and long term. They forecast U.S. large capitalized companies to return 10% annualized in 2004 and 8% annualized over the next five years, which is dramatically lower than the 28.7% annual return posted in 2003 but much higher than the -1.6% annual return posted by U.S. large cap equities over the last five years. KPMG Investment Advisors, a unit of KPMG LLP, helps companies manage their investment portfolios.

More than half the respondents from the FEI/Duke survey said a second-term Bush administration would do a better job than a John Kerry administration in the areas of GDP growth and the stock market. Four out of five respondents to the KPMG survey thought George Bush would be reelected President. ■