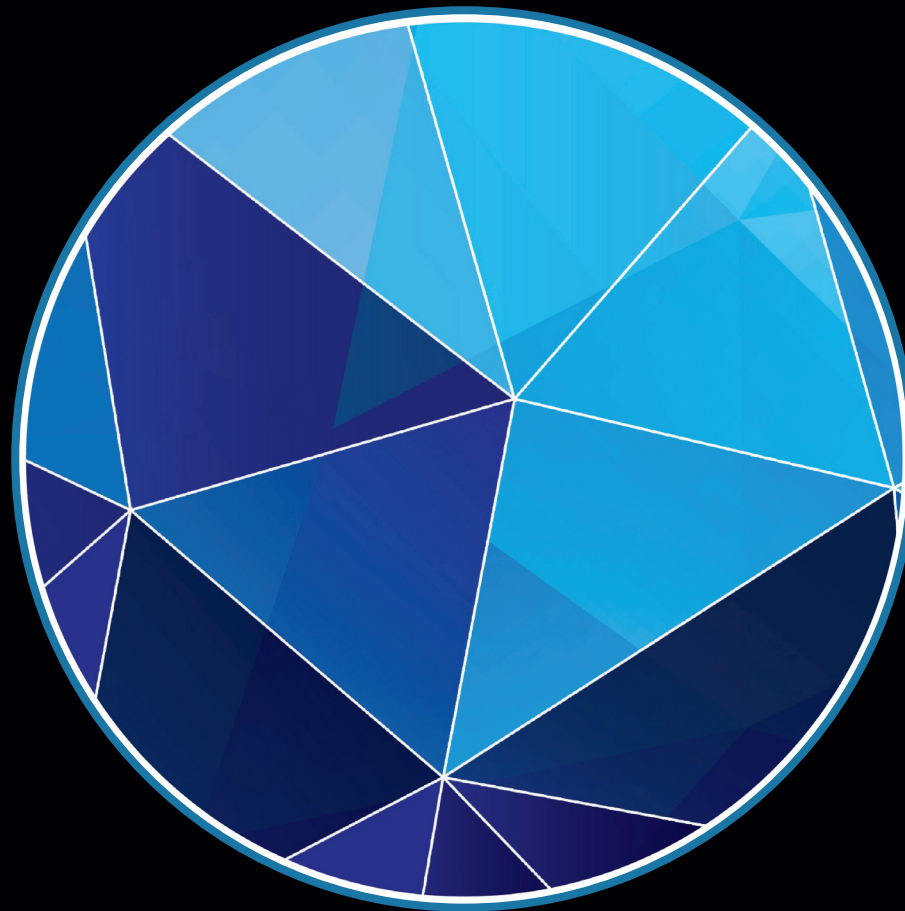


CFO *Sentiment*

It's now a glass half empty | H2 2018

The Leaders' Circle | Sharpening your edge



Optimism down,
uncertainty up

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diminished

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Deloitte has surveyed senior finance executives of major Australian listed companies since 2009. This CFO Sentiment survey covers the second half of 2018 and took place between the 3rd and 17th of December 2018.

Executive summary

A weaker domestic and global economic outlook weighed on Australian CFO sentiment in the final half of 2018. The US-China trade war and broader share market declines have emerged as major drivers of weaker confidence, and this is limiting risk appetite. This shift means CFOs are now looking to government to provide further economic support through investment activities.

The CFO outlook for the Australian economy has also become more subdued, with expectations of further house price declines. There are still some positives, with expectations of a stable dollar and share market recovery.

Given these challenges, CFOs continue to look to leverage the benefits of digital transformation to improve efficiency. They are also actively changing their talent acquisition processes to access people who can manage this transformation going forward.

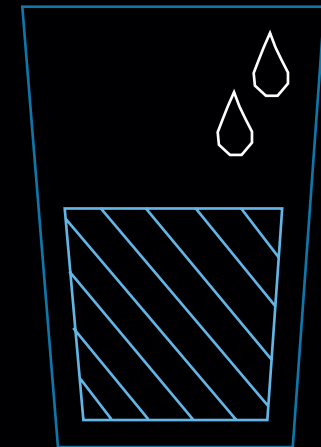
Overall, sentiment has shifted – from a glass half full on outlook and risk appetite, to more of a glass half empty.

Sentiment takes hit on the back of rising uncertainty

CFOs remained fairly optimistic in late 2018 (66% net optimism), but confidence has dropped compared to earlier in 2018 (when net optimism was 73%). Much of this is due to rising uncertainty, with 66% of CFOs uncertain about the economic and financial environment facing their company, up considerably from earlier in 2018.

Global economic concerns have increased

CFOs feel the global environment is hurting prospects for their businesses, with the US, European and Chinese economies all negatively impacting business confidence. The possibility of global economic slowdown has emerged at the forefront of CFO minds, with 42% considering this scenario when undertaking forward-looking strategic planning.



Trade wars

Rising trade tensions between China and the US pose multiple risks for CFOs, with 39% feeling they are negatively impacting their business now, and 66% feeling they will negatively impact their business over the next four-year period. On a positive note, the trade war has so far played out slightly better than feared, as 56% of CFOs expected the trade war would negatively impact their business when asked earlier in 2018.

Digital transformation front of mind

Transformation remains the number one issue facing companies over the next year. Most CFOs (net 84%) feel that leveraging digital transformation is key to becoming a trusted advisor to their business and delivering real time, accurate financial reporting at a low cost.

Domestic sentiment

Domestic sentiment matches global economic sentiment, with the number of CFOs feeling negatively about the Australian economy outnumbering those with a positive perspective. A key driver of weaker sentiment has been the downturn in the Australian share market, which has hurt the confidence of 47% of CFOs.

Getting the right people for the job

As a consequence of ongoing digital transformation, CFOs are changing (47%) or expecting to change (42%) their talent strategies as their finance operations continue to change. Despite evolving finance team skills needs, CFOs are confident about meeting their recruitment targets over the next two years (net optimism 37%).

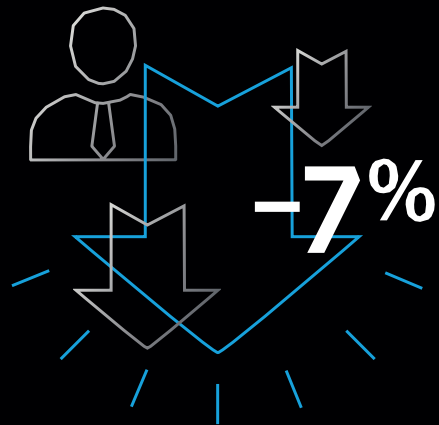
Government should take bigger role in supporting the economy

CFOs feel greater government emphasis should be put on assisting the economy given the improved federal budget position – and 55% feel additional revenue should be invested in areas such as infrastructure and education.

Outlook holds more challenges

CFOs feel the Australian economy will continue to face challenges for the foreseeable future. The majority (76%) think house prices will be lower in 12 months, and 50% are considering interest rate normalisation in their strategic planning. On a positive note, 53% feel the share market will recover somewhat over the next year.

Highlights



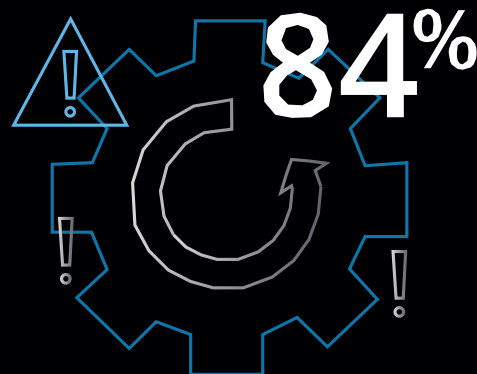
◀ CFO sentiment has taken a hit on the back of rising uncertainty
66% of CFOs – down from 73% in H1 over the horizon.



◀ CFOs feel government has the capacity to take a bigger role in supporting the economy
55% feel that the government should increase its support of the economy through investment.

▶ Digital transformation is front of mind

84% of CFOs think that leveraging digital transformation is key as the number one issue facing companies over the next year.



▶ Concerns around the global economy have increased
42% CFOs considering global economic slowdown scenario.



Trade wars

39% of CFOs feel tensions between China and US are currently affecting business.

Domestic sentiment

Australia reflects the global sentiment – downturn in share market affected **47%** of CFOs' confidence.

Businesses are able to get the right people for the job

47% are changing talent strategy while **42%** will change soon.

The outlook holds more challenges for CFOs

76% of CFOs think house prices will be lower in 12 months.

Macroeconomic update

Economic growth in Australia is maintaining a solid rate in the face of a slowing global economy. The labour market continues to outperform expectations and Australian exporters are benefiting from higher prices and steady demand from China. There are risks to the outlook, mainly in the falling housing market, and this will drive a more moderate rate of growth in 2019. Overall, the economic backdrop remains supportive, but will become more challenging in 2019.

The global economy continues to grow solidly, but the major growth engines are starting to lose some steam. The US economy is benefiting from the 2017 tax cuts, which are supporting job growth and flowing through to stronger wages. But the boost to activity may be short-lived, and US growth is easing back as higher interest rates and exchange rates take hold. Meanwhile, the slowdown in China's economy has accelerated more recently, despite increased monetary and fiscal stimulus measures.

On the trade front, the US-China trade war is creating concern, but the impact on Australian exporters has been limited to date, with commodity prices holding up. The risk is that as China's rate of growth continues to slow, so too will export demand and commodity prices. In that scenario, the Australian dollar may become collateral damage.

On the domestic front, Australia continues its long run of uninterrupted economic growth. Job growth is exceeding expectations, and while income growth remains subdued, there are signs that wages are starting to pick up as the labour market tightens. The weak wage environment has so far kept inflation at bay, and the Reserve Bank of Australia on the sidelines, with official interest rates on hold at a record low now for two-and-a-half years.

But as with the global economy, there are challenges ahead. Falling house prices have hurt household wealth and weighed on housing construction activity. This is exacerbated by a mini-credit crunch as higher global interest rates and the fallout from the financial services Royal Commission tighten credit conditions. The flow-on to consumer spending has been limited so far, but with one of the highest debt-to-income ratios in the world, the impact of declining wealth will likely create some headwinds for the year ahead.

“The weak wage environment has so far kept inflation at bay, and the Reserve Bank of Australia on the sidelines, with official interest rates on hold at a record low now for two-and-a-half years. But as with the global economy, there are challenges ahead.”

David Rumbens

Partner, Deloitte Access Economics



Global update

The global economy is still maintaining solid growth, although warning signs are appearing. The trade war between the US and China hasn't derailed activity yet, but China's economy is slowing and business investment is underperforming in the US. Adding to the mix, the looming Brexit deadline has been driving uncertainty in financial markets.



United States

The US economy is still going strong on the back of a wave of tax cuts. The impact of the trade war has been muted on the real economy so far, but there are concerns in financial markets, with US share markets both heading downward and becoming more volatile in recent months. Job growth continues to be strong which has started to boost wages, inflation and, in turn, interest rates. The US economy is likely to moderate in the near term as stimulus begins to taper off.



Europe and the United Kingdom

Brexit has dominated the political and economic landscape in the UK, and created significant volatility in European financial markets. As a result, UK economic growth has underperformed over the past two years, tempered by the decline in the pound. Economic growth through Europe is also now moderating amid trade tensions with the US, fiscal problems in Italy and social unrest in France.



East Asia – Malaysia, Indonesia, Thailand

East Asian economies are much more reliant on global trade than the rest of the globe as a whole. As a result, support for domestic drivers of growth has been seen in some economies with lower interest rates and tax cuts/fiscal stimulus.





India

The Indian rupee has been declining of late, which appears to be contagion from other emerging markets such as Turkey. Despite this, India is holding up relatively well, with increased export competitiveness and both business investment and consumer spending up. Moreover, given India's modest exposure to global trade, the burgeoning trade war by the US is likely to have a smaller impact on India than other emerging markets.

China

The Chinese economy has slowed recently, despite fiscal and monetary stimulus aimed at supporting growth. Growth has been dampened as the result of the slew of tariffs from the US and high private debt levels. Overall, economic growth remains strong compared to developed nations, however risks remain for the outlook, especially around high levels of debt and spare industrial capacity.

Japan

The Japanese economy has been steady of late, though risks remain from the growing US and China trade tensions, along with the impending GST hike. Traditionally Japan has been reliant on global trade as a primary driver of growth due to weak demographics. With the trade war dampening global trade flow, this may hurt the Japanese economy more than many others in the region.

[New Zealand](#)

Growth in New Zealand motored along in 2018, and looks set to stay relatively strong in both 2019 and 2020. World prices for major NZ exports are riding high, and interest rates remain low. More recently, house prices have begun to stagnate somewhat, with consumers spending less as wealth gains moderate.

Optimism down, uncertainty up

With both global and domestic conditions facing challenges in the year ahead, Australian CFOs feel less certain about the future, and this is hurting optimism heading into 2019. This backdrop is dampening risk appetite, with the majority of CFOs indicating now is not the time to take on more risk.

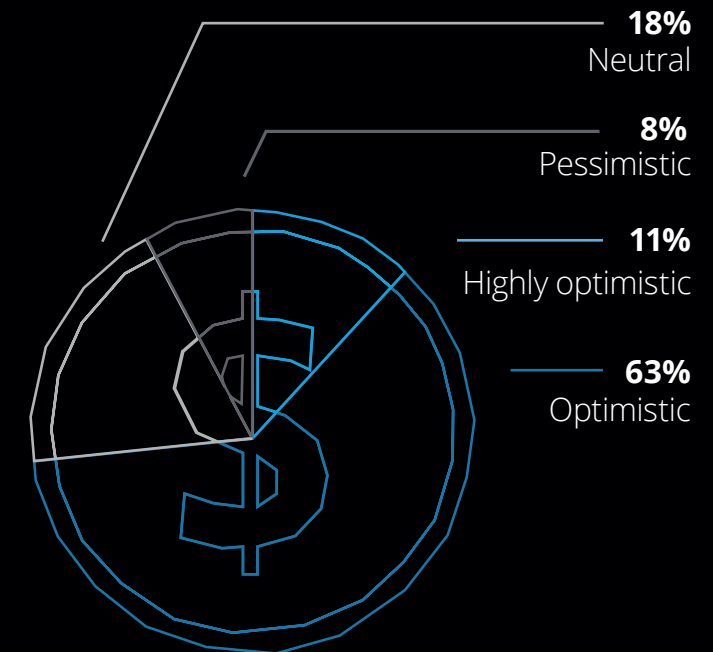
CFO optimism weakened in the last half of 2018 as difficult conditions both domestically and globally weigh on sentiment. Net optimism dipped to 66% from 73% earlier in 2018, with the share of CFOs feeling pessimistic about the future increasing. There was a substantial dip in the proportion of CFOs who were feeling highly optimistic about the future, down to just 11% from 21% previously.

The deterioration in optimism is also reflected in CFO sentiment regarding how the financial prospects of their companies have changed, with the number of CFOs feeling less optimistic outnumbering those that feel more optimistic. This is the weakest result since the end of 2011 with net optimism regarding change in prospects falling to -8% from 29% in the first half of 2018.

How do you feel about the financial prospects of your company going forward?

Chart 1

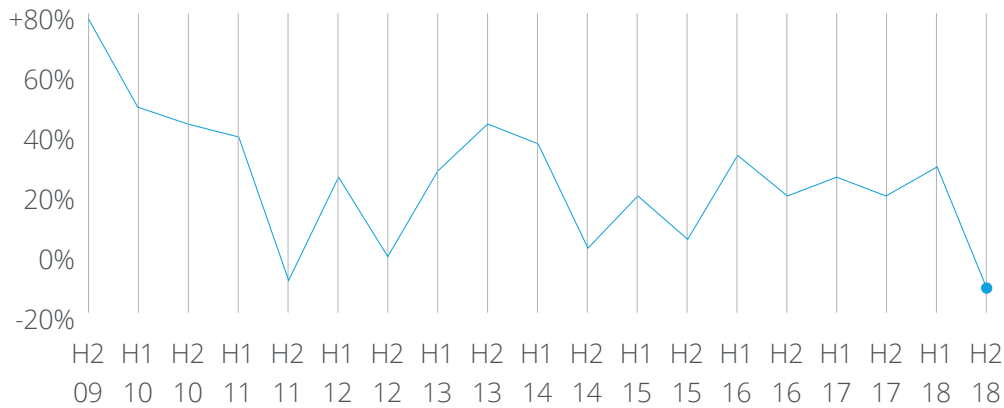
Business confidence



Compared to six months ago, how do you feel about the financial prospects of your company?

Chart 2

Net optimism for financial prospects compared to six months ago

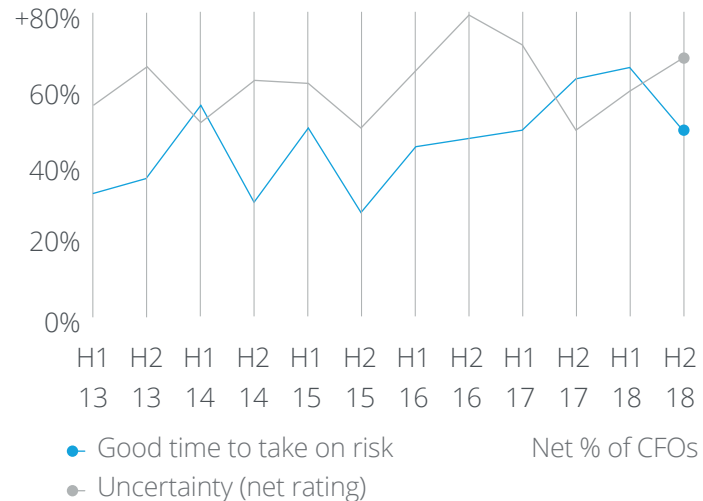


The fall in optimism comes at a time when CFOs are feeling less certain about the future. Net uncertainty has been steadily rising since the end of 2017, when just 50% of survey respondents rated the general level of external financial and economic uncertainty above normal. This has risen to 66% in the final half of 2018. Given higher uncertainty and weaker optimism, it is unsurprising that the majority of CFOs believe now is not a good time to be taking on risk (53%).

How would you rate the general level of external financial and economic uncertainty facing your company? Is this a good time to be taking greater risk on your balance sheet?

Chart 3

Uncertainty and risk



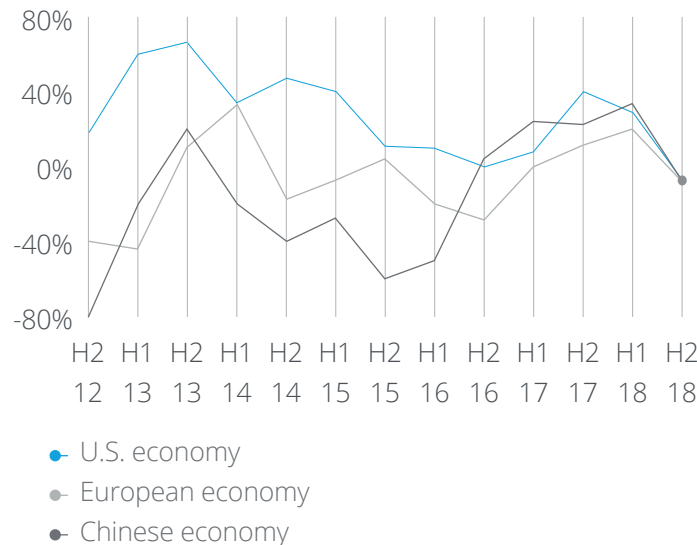
● Good time to take on risk
● Uncertainty (net rating)
Net % of CFOs

Global prospects diminished

Global sentiment has declined across the board from six months ago. The drama unfolding in the UK in trying to reach a Brexit deal with Europe has raised uncertainty in financial markets, while the trade war between the US and China continues to threaten global trade. CFOs are increasingly considering global growth stagnation when undertaking future strategic planning.

How has your level of optimism been impacted by the following factors?

Chart 4
Global factors impacting optimism



CFO optimism has been negatively impacted by the three major global economies – the US, Europe and China. Increased tensions unfolding as the EU and UK struggle to reach a Brexit deal has pulled down CFO net optimism towards Europe to -11%, while net optimism regarding both the US and China dipped to -8%, partly as a result of the rising trade tensions.



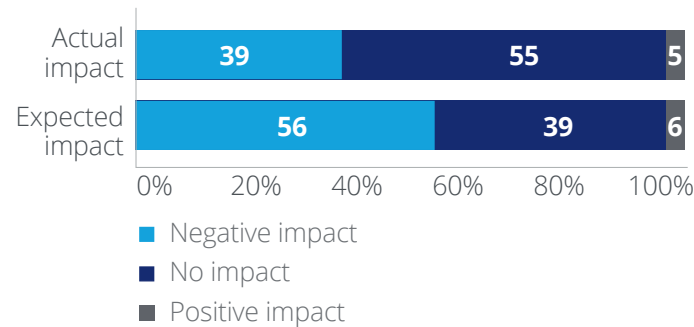
Developments around the global economy remain front of mind when it comes to future strategic planning. Global growth stagnation remains at the top of the list of CFO concerns as economic growth across more countries begins to wane.

The trade war between the US and China has accelerated over the past 12 months, with a slew of tariffs being applied by both sides, and this is something CFOs are keeping an eye on. The trade war has already negatively impacted 39% of respondents' business, while 66% feel they will be negatively impacted in the next 1-4 years. Although many are being negatively impacted, the reality has been better than what was expected earlier in 2018, when 56% of CFOs were expecting to be hurt by the trade war in 2018.

Is rising trade tension between the US and China in the form of tit-for-tat tariff increases impacting your business?

Chart 5

Actual vs. expected impact of trade war in 2018



Domestic sentiment follows stocks

Sentiment regarding the Australian economy has fallen compared to six months ago. The decline in the local share market has been a key driver, although a view that interest rates will remain low has provided something of a cushion. The rapidly approaching federal election is creating increased political uncertainty, and at a time when CFOs feel the improved federal budget position can be used to support the economy.

Domestic sentiment is down for the Australian economy, with net optimism at -8%. The large decline in the share market throughout the second half of 2018 is seen as a primary driver of this result, negatively impacting the confidence of 47% of CFOs, the weakest result since H2 2015.

Towards the end of 2018, financial market volatility picked up as a result of higher world interest rates and speculation around company profits. As a result, all gains from the year (and more) were erased in the final quarter of 2018, causing the worst share market downturn in seven years. The downturn has impacted the attractiveness of equity issuance as a source of funding for CFOs, declining to -19%.

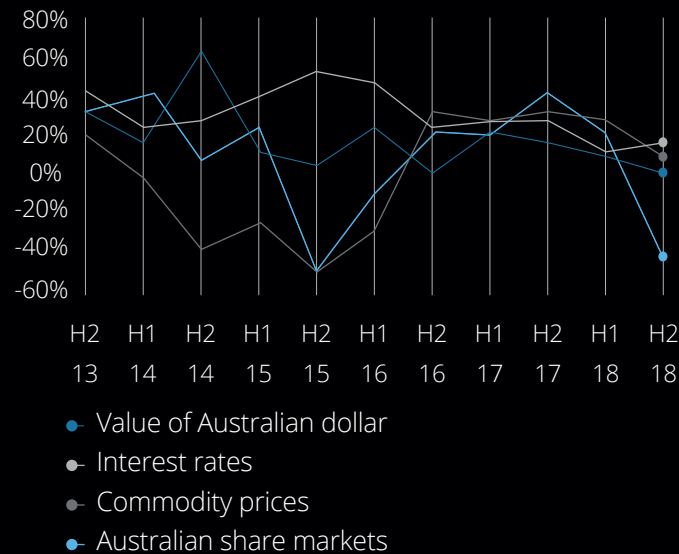


On the other hand, low interest rates are supporting optimism for a net of 16% CFOs. Short-term interest rates have risen recently as interbank credit spreads widen, despite the Reserve Bank of Australia not moving the official cash rate since August 2016. Although there is little expectation of an official cash rate hike in the near-term, it remains a primary scenario CFOs consider when undertaking future strategic planning. Moreover, tighter credit conditions have meant more CFOs feel Australian balance sheets are over-gearred compared to H1 2018 – net sentiment on this front moved from -24% (under-gearred) to 8% (over-gearred).

How has your level of optimism been impacted by the following factors?

Chart 6

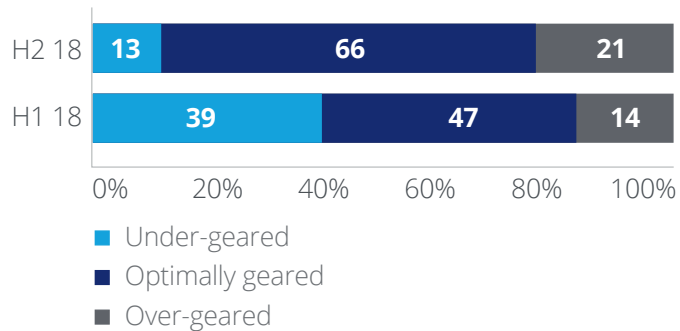
Domestic factors impacting optimism



What do you think of the level of gearing on Australian corporate balance sheets?

Chart 7

Financial gearing sentiment

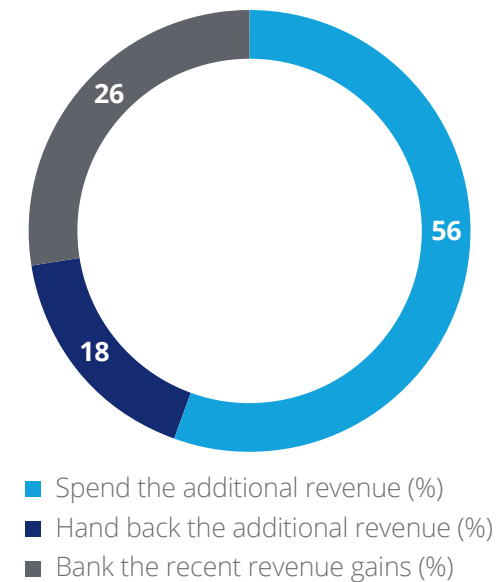


With more risks in the outlook for Australia, CFOs are feeling less confident about the future, and feel government stimulus would benefit the economy. Given the improved position of the federal budget, the majority of CFOs (56%) feel that additional revenue should be spent on worthwhile government investment projects in infrastructure or education, while 26% feel the revenue gains should be saved to move to a bigger budget surplus over time. This is a shift in sentiment compared to the first half of 2018, where most CFOs (57%) felt the government should use revenue gains to reduce the current deficit at a faster rate.

Strong revenue growth is allowing the Federal Budget position to improve. Going forward, what broad budget strategy do you feel the Federal government should adopt?

Chart 8

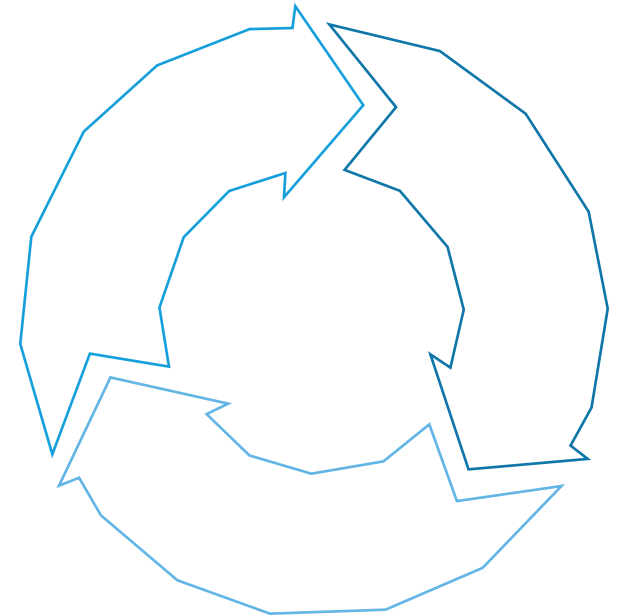
Budget strategy



The changing face of finance teams

The future of work in Australia continues to shift as technology changes how people work and the type of work they do. This provides both opportunities and risks for businesses, and Australian CFOs understand that finance operations and teams are not immune.

Half of CFOs surveyed believed the number one issue facing their company over the next two years is accelerated transformation. This is not a new concern, with transformation ranking as one of the top five issues in both early 2017 and early 2018. Transformation brings with it a number of other challenges for businesses, including customer engagement and organisation culture, which were also highlighted by CFOs as key issues.



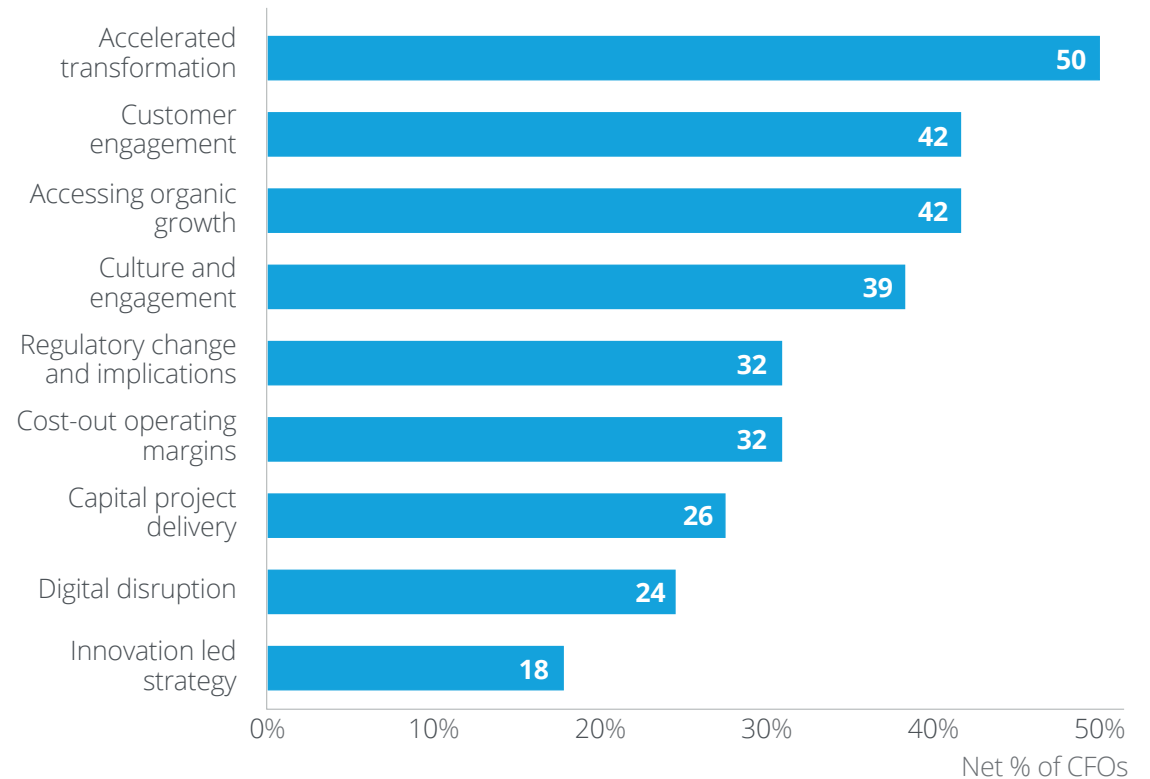
But it's not all risks when it comes to transformation, and the benefits of digital technologies are well understood by CFOs. New technologies are often implemented to deliver products or services in a timely and cost effective manner. The majority of CFOs believe this is also the case for delivering real time, accurate financial reporting services to their stakeholders (net 84%). In addition, a majority believe they can leverage digital technology to adopt an integrated and collaborative approach across the business (net 76%) and enable finance to become a trusted advisor (net 84%).

The increasing rate of technology adoption across the global economy is generating a growing volume of data, and businesses are looking to harness the opportunities this creates. However, with access to large amounts of data, especially in finance roles, comes the responsibility to ensure it is protected against misuse, damage, loss or theft. Most CFOs believed that digital technologies can enable their finance operations to maintain strong and effective internal controls (net 79%).

Which of the following issues do you consider to be the most important for your company over the next 12-24 months?

Chart 9

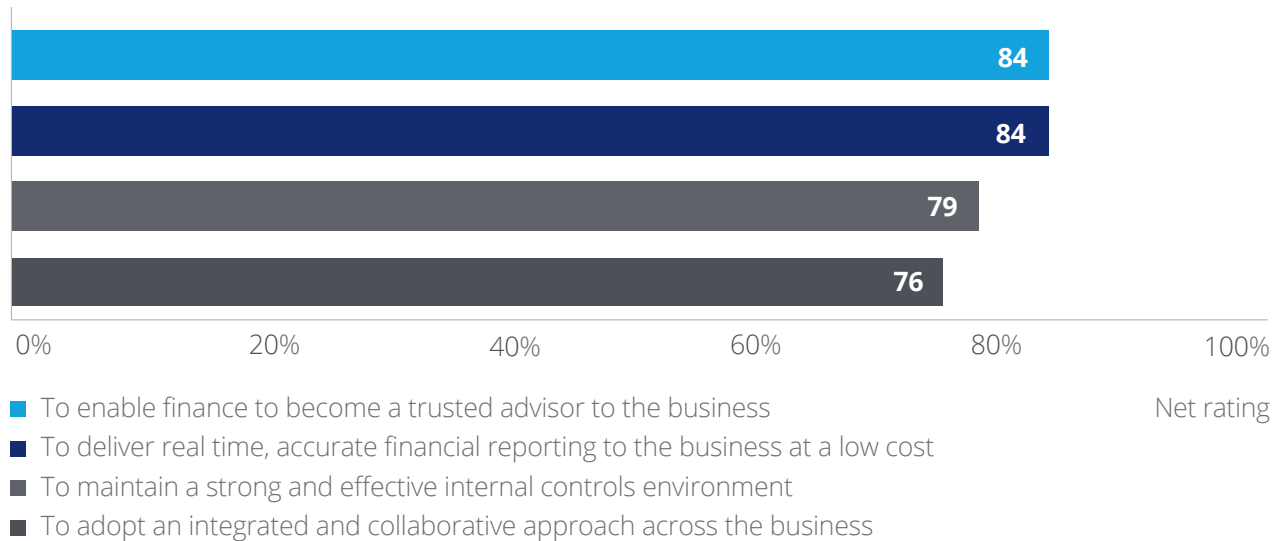
Top issues for business performance



How do you currently rate the perceived future benefit of leveraging digital technologies to the stakeholders finance serve?

Chart 10

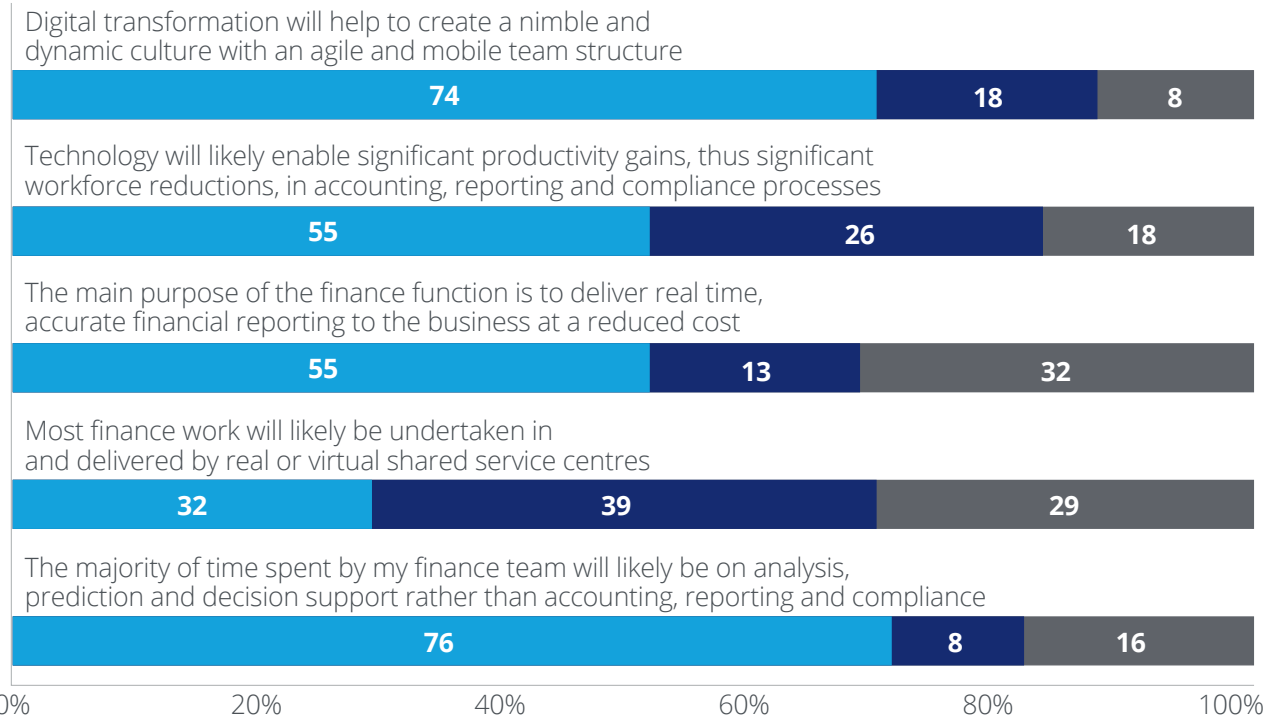
Benefits of digital technologies



Digital technology and transformation is also expected to change the type of work that finance teams undertake. CFOs agree that digital transformation will help create a nimble and dynamic culture with an agile and mobile team structure in the next three years (net 66%). These teams are expected to focus on analysis, prediction and decision support rather than accounting, reporting and compliance (net 61%).

Where do you currently rate your level of agreement with the following statements about your finance team's operations, three years from now?

Chart 11



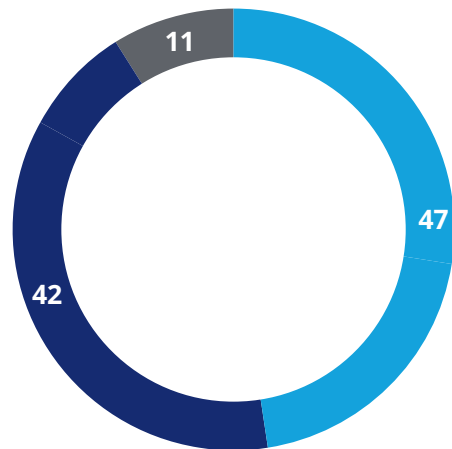
- Agree
- Neutral
- Disagree

But not all CFOs are clear on how the role of finance teams is likely to change, with mixed sentiment when it comes to the role of shared service centres. Of CFOs surveyed, 32% agreed that most finance work will be undertaken in, and delivered by, real or virtual shared service centres, while 39% were neutral and 29% disagreed.

In the face of changing operations and digital transformation, most CFOs are actively adjusting how they attract, train, and retain their staff to ensure success for their business. A large share of CFOs have already changed their talent strategy (47%) and a similar number expect to change in the next two years (42%), with only a small portion stating it is not a foreseeable priority (11%).

Has your talent strategy changed to facilitate the digital transformation of your finance function?

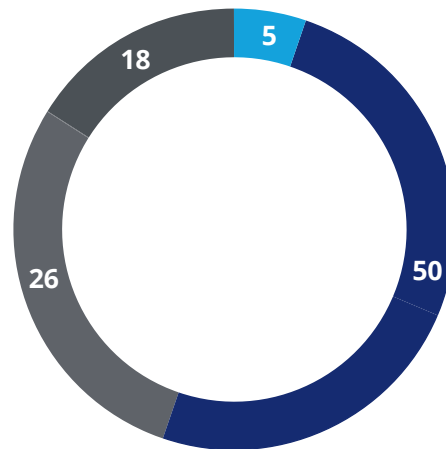
Chart 12
Talent strategy



- Has changed (%)
- Is expected to change (%)
- No change expected (%)

How do you feel about your capacity to meet your recruitment targets of skilled people of your finance function of the business in the next 2 years?

Chart 13
Ability to fill recruitment targets



- Highly optimistic (%)
- Optimistic (%)
- Neutral (%)
- Pessimistic (%)

Despite the changing role of finance teams, CFOs are confident that they can find people with the right skills for these jobs. Most CFOs (55%) are optimistic or highly optimistic about meeting their finance function recruitment targets for the next two years. In addition, most feel that the skilled migration program is able to support Australia's skill needs in its current format, with 68% comfortable with the current level of permanent migration.

Looking ahead

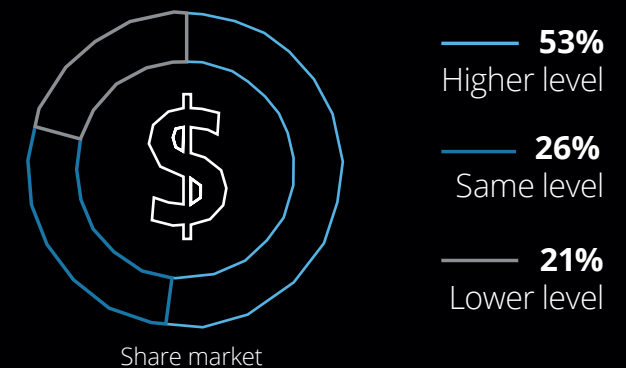
The Australian economy remains on a positive trajectory in the near term. CFOs are expecting interest rates to increase to more normal levels, while the share market is expected to recover and the exchange rate is anticipated to remain stable. On the other hand, further house price declines are expected over the coming 12 months, which poses some risks for consumer wealth.

Australia's economic outlook remains broadly positive, although risks remain that could threaten growth. First and foremost, the widely reported and discussed house price tumble continues to be front of mind for CFOs. Sydney and Melbourne experienced the largest run-up in house prices relative to all other Australian cities, and now are experiencing some decline. As such, only 5% of CFOs feel that house prices will increase over the coming 12 months, while 76% think prices have further to fall.

What is your outlook for the Australian share market/house prices in 12 months time?

Chart 14

Housing and share market expectations

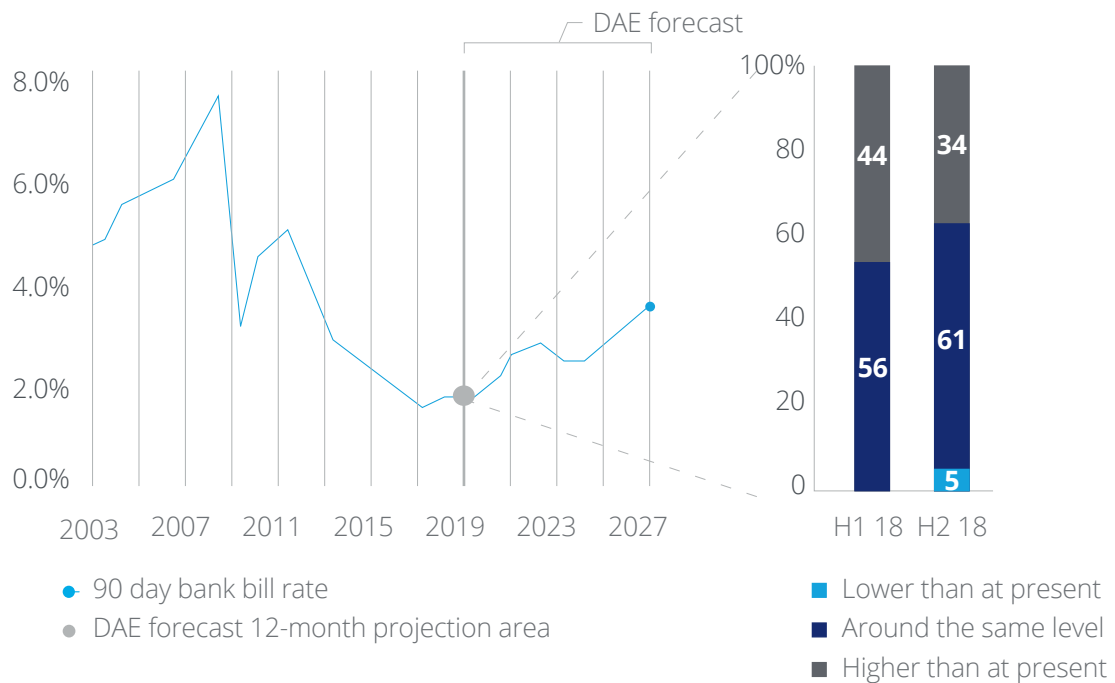


Expectations for interest rates over coming months are predominantly that they will be either the same or higher (95%). The housing downturn has raised some doubt that the Reserve Bank of Australia will be able to raise interest rates because broader economic activity will not be strong enough to create pricing pressure. Deloitte Access Economics forecasts expect interest rates to remain stable in the near term, and begin to increase throughout 2020.

Given the large decline in the share market through 2018, just over half of CFOs (53%) feel the share market will recover over the coming 12 months. The less optimistic among them may feel the end to low interest rates and quantitative easing in the US, which had boosted asset prices over recent years and is now unwinding, still has a way to go.

Where do you expect to see interest rates in 12 months time?

Chart 15
Interest rate expectations

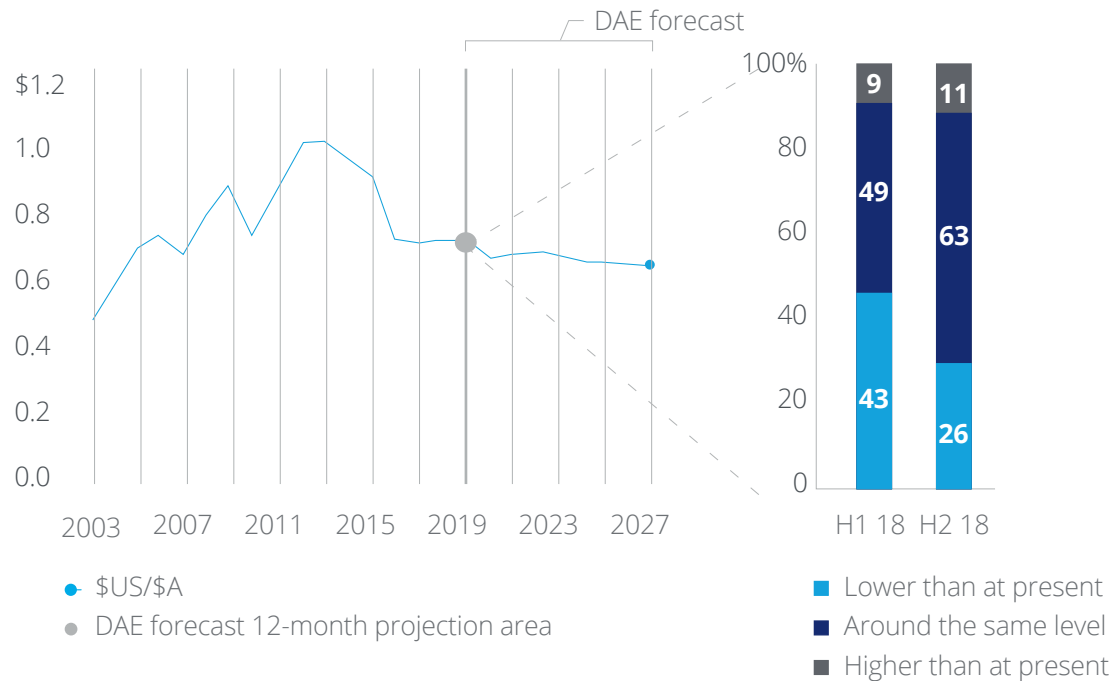


The exchange rate expectation among most CFOs (63%) is that it will be unchanged over the coming 12 months. The most recent falls in the Australian dollar have largely been due to solid economic growth and inflationary pressure in the US, which in turn has meant the Federal Reserve has been raising interest rates. As the Reserve Bank of Australia has seen no need to increase interest rates so far, and change isn't anytime soon, there has been downward pressure on the Australian dollar.

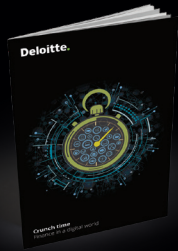
However looking forward, it appears that stimulus to the US economy will moderate through 2019, and the Federal Reserve has stated interest rates will not increase as fast as they did throughout 2018. This is approximately in line with Deloitte Access Economics forecasts, which expect the exchange rate to remain around the same level for the near-term.

Where do you expect to see the value of the Australian dollar in 12 months time?

Chart 16
Australian dollar expectations



Other publications you may be interested in



Crunch time

From cloud computing and robotics to analytics, artificial intelligence and automation, a new class of digital disruptors is transforming how business gets done. Expect these disruptors to have a big impact on the future of finance organisations. But what exactly will their impact be? What is the future of finance in the face of these developments?



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