October 3, 2010

Cheap Debt for Corporations Fails to Spur Economy

By GRAHAM BOWLEY

As many households and small businesses are being turned away by bank loan officers, large corporations are borrowing vast sums of money for next to nothing — simply because they can.

Companies like Microsoft are raising billions of dollars by issuing bonds at ultra-low interest rates, but few of them are actually spending the money on new factories, equipment or jobs. Instead, they are stockpiling the cash until the economy improves.

The development presents something of a chicken-and-egg situation: Corporations keep saving, waiting for the economy to perk up — but the economy is unlikely to perk up if corporations keep saving.

This situation underscores the limits of Washington policy makers' power to stimulate the economy. The Federal Reserve has held official interest rates near zero for almost two years, which allows corporations to sell bonds with only slightly higher returns — even below 1 percent. But most companies are not doing what the easy monetary policy was intended to get them to do: invest and create jobs.

The Fed's low rates have in fact hurt many Americans, especially retirees whose incomes from savings have fallen substantially. Big companies like Johnson & Johnson, PepsiCo and I.B.M. seem to have been among the major beneficiaries.

"They are benefiting themselves by borrowing and keeping this cash, but it is not benefiting the economy yet," said Dana Saporta, an economist at Credit Suisse in New York.

American corporations have been saving more money since the financial collapse of 2008. But a recent rush of blue-chip bond offerings — including a $4.75 billion deal last month by Microsoft, one of the richest companies in the world — has put even more money in their coffers.

Corporations now sit atop a combined $1.6 trillion of cash, a figure equal to slightly more than 6 percent of their total assets. In the first quarter of this year it was 6.2 percent of assets, the highest level since 1964, when it was 6.4 percent.

When will they start spending that money — in particular, by hiring?

That is part of what has become the great question of this long, jobless recovery: When will corporate America start to feel confident enough to put its cash to work, building factories and putting some of the nation's 14.9 million unemployed to work?

Businesses are holding on to their protective cash cushions, worried perhaps that the economy could slip back into recession or at least grow too lethargically to make an investment worthwhile.

The nation's corporations will be strong, well capitalized and ready to act aggressively when executives finally decide it is time to expand their businesses.

After running up sharply every quarter since mid-2008, the ratio of cash holdings to assets by corporations fell slightly for the first time in the second quarter of this year.

Although investment in factories and plants still languishes, companies have spent some money on investment in new equipment and software. That spending grew at an annualized rate of more than 20 percent in the first two quarters of this year.

But economists say that such investment is still below its peak before the financial crisis.

In addition, many of the new machines and computers may be replacing older machines companies put off retiring in the recession. Businesses are playing catch-up, and little expansion is occurring.

"They may actually be using this new investment to be more efficient and cut jobs," said Michael Gapen, an economist at Barclays Capital. "The mix of signals right now is still telling corporations to sit tight and wait."

Mr. Gapen said those signals included the direction of the housing market, the outcome of midterm election, the effects on the economy as the fiscal stimulus wears off and any changes in tax policy.

They are deciding, "Why don't we just wait until the first quarter of next year?" he said.

The cheap money may be having yet another effect unintended by policy makers eager to cut the nation's 9.6 percent unemployment rate. Several of the corporations borrowing billions on bond markets are using the money to put their own financial house in order rather than to create jobs.

Microsoft said it was using some of its money to buy back shares, other companies are locking in longer-term borrowing, and some of the new borrowing is financing an increase in mergers and acquisitions.

All of this may enrich the corporations' shareholders and cut company costs in the long run, but it does not necessarily lead to more jobs and it does not represent the big investments in growth that could fuel a sharp economic recovery for everyone.

"They are still holding on to more cash in the same way that Noah built the ark," said David Rosenberg, chief economist at Gluskin Sheff & Associates in Toronto. "It is very telling."

In the case of Microsoft's bond offering, one factor might have been avoiding a big tax bill, said Richard J. Lane, who analyzes Microsoft for Moody's. If Microsoft had needed cash, it could have pulled some from its operations abroad, but "borrowing new money on the debt markets is now cheaper than bringing its own money back from overseas," Mr. Lane said.

Microsoft's offering was only its second; its first was last year. The second offering included three-year debt at an interest rate of 0.875, among the lowest on record for that type of borrowing.

According to the financial data provider Dealogic, United States companies have borrowed $488 billion on the American high-yield and investment grade bond markets so far this year, 7 percent more than businesses borrowed during all of 2009, and on track to at least match the $589 billion borrowed in the boom year in 2007, which was the highest on record.

Smaller companies continue to have trouble borrowing, and most of the new financing is limited to bigger corporations.

Their borrowing spree is in contrast to America's households, which continue to cut their debt and consumption. Perhaps unsure of the recovery, like the corporations hoarding cash, Americans are saving far more than they have in years, and some economists fear that consumers' frugality will further hobble growth.

One of the biggest corporations to borrow recently, the DuPont Company, said it was using the cheaper money to lock in borrowing over a longer period.

"The current low interest rate environment provides DuPont a great opportunity to refinance our long-term debt at lower rates," it said in a statement.

Conditions have become so good that some companies are borrowing money they will not have to repay until the next century. In August, the railroad Norfolk Southern Corporation borrowed $250 million in 100-year bonds at an annual rate of 5.95 percent.

Robin Chapman, a spokesman, said, "Opportunistic borrowing is a good way to characterize this." He said that the company was seeing a "slow and steady pickup" in rail traffic but that any hiring the company was doing was to replace workers lost through attrition.

Other companies are borrowing to finance acquisitions. PepsiCo borrowed recently to help pay for the takeover of two bottling plants. Hertz borrowed $300 million for its bid to buy a rival car rental company, Dollar Thrifty.

Economists say it is rational for companies to seize the opportunity to borrow at low interest rates and to buy back shares. But Guy LeBas, a fixed income strategist at Janney Montgomery Scott in Chicago, said, "It is not particularly beneficial for economic conditions."