

Macro Keys

What's capital spending really doing?

Economics

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Is capex up or down?

On November 30 a lead article in *The Wall Street Journal* was titled "Companies Shy Away From Spending. It began by proclaiming that "Business investment across the U.S. is fizzling out". However, just two days later on December 2 Fed Chair Janet Yellen stated that "Outside of the drilling and mining sector, where lower oil prices have led to substantial cuts in outlays for new structures, business investment spending has posted moderate gains"

Looking at the latest national data through Q3(15) in Figure 1, the growth of overall current dollar nonresidential private fixed investment has slowed to 2.3% from a year earlier from 8.7% growth from a year earlier in Q3(14). However, excluding the mining, exploration, shafts and wells component that reflects energy exploration, current dollar business fixed investment has grown 5.8% from a year earlier. That was a still reasonably respectable growth pace, albeit down from a very fast 9.1% in the year ending in Q3(14).

Consequently, it appears that *Ms. Yellen's observation about "moderate gains" outside of energy exploration is correct*. That said, there will remain widely varying assessments about the current state of capital spending. One reason is that the national data favoured by most economists encompass a broad range of investment activities including software and research and development, which together are just over a fourth of government-reported national business fixed investment. (See Figure 3.) Much public discussion about capital spending, though, is focused on industrial equipment that is just a tenth of overall business fixed investment. Considerable attention also is given to the plunging energy exploration sector, which represents only just over 3% of broadly defined national business fixed investment.

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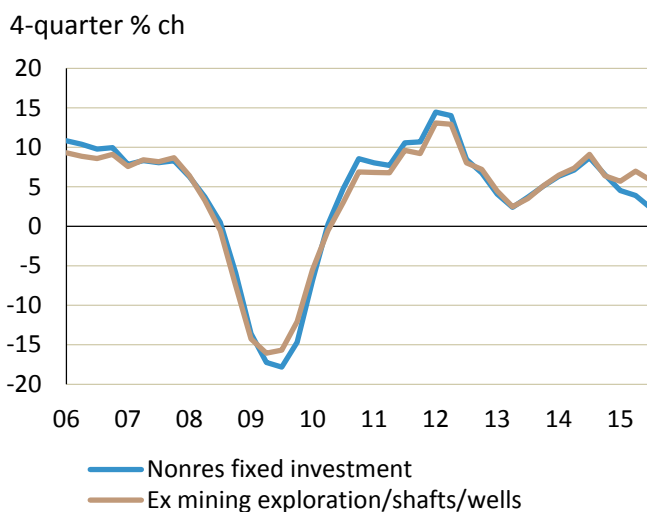
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Figure 1: Business fixed investment growth outside of energy exploration has only moderately slowed.



Source: Bureau of Economic Analysis

Figure 2: Core capital goods orders recently edged up following earlier sharp declines.



Source: Census Bureau

Where is it headed?

Looking into 2016, a strong dollar and very depressed crude oil prices are often cited reasons for expecting weak capital spending. However, some perspective on the role of these two considerations is provided by government data on who does capital spending on equipment and structures. (See Figure 4 on next page. Note: The data in the preceding Figure 3 instead represent what is purchased but not who purchases it.) Around 30% of capital spending in 2013, the latest date for which such data are currently available, was conducted by the manufacturing and mining sectors. Capex in the manufacturing sector—around 16% of equipment and structures purchases—will continue to be dogged by a strong dollar. However, after plunging with crude oil prices in 2015, the mining sector's capex is apt to stabilize, albeit at a relatively low level, in 2016 when we expect no further declines in already very low crude oil prices. Moreover, around 70% of business spending on equipment and structures is done by purchasers outside of the troubled manufacturing and energy sectors.

Note: Why was the 2013 mining share of capex spending in Figure 4 much larger than the earlier discussed Q2(15) energy exploration share of nonresidential business fixed investment? This is because of different definitions of overall capex and sharp declines in the energy sector share of spending since 2013.

As for statistical leading indicators of capex, we suggest two in particular. First, current dollar orders for nondefense capital goods excluding the volatile civilian aircraft sector recently have started to edge slightly higher. (See Figure 2.) Second, since the bulk of capital spending is conducted by firms outside of manufacturing and mining, it is useful to focus on the nonmanufacturing ISM data that continue to signal decent growth.

Figure 3: Current Dollar Private Nonresidential Spending (Q3-15)

	y/y % change	Nonresidential Share
Private fixed investment		
Nonresidential	2.3	
Structures	-1.8	21.4
Commercial and health care	14.3	6.4
Manufacturing	55.5	3.8
Power and communication	-3.1	4.1
Mining exploration shafts, and wells	-48.6	3.2
Other structures	20.4	3.8
Equipment	3.2	47.0
Information processing equipment	8.3	14.2
Computers and peripheral equipment	2.2	3.5
Other	10.7	10.7
Industrial equipment	2.0	10.0
Transportation equipment	5.6	13.1
Other equipment	-8.7	9.6
Intellectual property products	5.2	31.6
Software	3.9	14.2
Research and development	7.1	13.8
Entertainment, literary, and artistic originals	3.3	3.5

Source: Bureau of Economic Analysis

Figure 4: Who does capital spending?

Industry	Mill \$ 2013	Share of total (%)
Total expenditures: Structures & Equipment	1,397,769	
Manufacturing	219,767	15.7
Mining	198,060	14.2
Utilities	111,680	8.0
Wholesale & retail trade	115,802	8.3
Transportation and warehousing	93,397	6.7
Information (*)	123,057	8.8
Finance & insurance	139,947	10.0
Real estate, rental & leasing	113,901	8.1
Health care and social assistance	93,265	6.7
Others	188,895	13.5

Source: Annual Survey of Capital Expenditures, 2013, Bureau of Economic Analysis

*Includes publishing, motion pictures, broadcasting, telecommunications and data processing.

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