

Business Investment: Stuck Between Uncertainty and Change

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Houston, Texas

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Conference Call

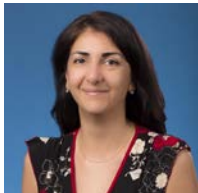
Business Investment: Stuck Between Uncertainty and Change

The depth of decline in aggregate demand during the Great Recession coupled with the subsequent slow recovery are the most common factors cited as the cause of weakness in business investment. Alternative factors to consider for the weak growth rate in business investment are policy uncertainty and financial market volatility.

When compared to past economic expansions the current expansion appears much weaker in terms of output growth than it does for business investment. The expansion-by-expansion capital stock analysis highlight that the U.S. has been undergoing long-term and sizable structural shifts in the economy's industry make-up.

Going forward, focusing on the broader weaknesses in economic activity could boost potential output and consequently encourage higher business investment.

Please join us for an informative discussion with Dr. Papanyan



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Thursday, April 7, 2016
10:00 am | CDT (GMT -05:00) | 30 min

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Elusive Growth in Business Investment

The Great Recession hit hard both aggregate output and investment; furthermore recovery growth rates have been weak, having a bearing on productivity and long-term economic growth prospects

Equipment and software investment is a predominantly productive contributor to productivity and economic growth

- Firms hold off business investing when aggregate demand is weak
- Weak business investment leads to weak output growth

Elusive Growth in Business Investment

Why is Equipment Investment growth weak?

- Policy Uncertainty
- Aggregate demand
- Financial Markets

Has the post-Great Recession recovery been different for GDP than for Equipment and Software Investment?

Have structural shifts within industry shares established a “new normal” for Equipment and Software Investment growth?

Elusive growth in Business Investment

Severe decline in both GDP and Investment during the Great Recession

Contributions to Real GDP Growth, Average of Quarterly Real Growth, SAAR, %

Recessions	Gross Domestic Product	Fixed Investment	Nonresidential Fixed Investment	Equipment Investment
Dec/1948-Oct/1949	-1.4	-0.8	-1.4	-1.1
Aug/1953-May/1954	-2.4	0.0	-0.2	-0.4
Sep/1957-Apr/1958	-3.8	-2.0	-1.7	-1.5
May/1960-Feb/1961	-0.4	-0.6	-0.5	-0.8
Jan/1970-Nov/1970	-0.1	-0.2	-0.5	-0.4
Dec/1973-Mar/1975	-2.5	-2.1	-0.9	-0.6
Feb/1980-Jul/1980	-4.3	-2.8	-1.2	-1.0
Aug/1981-Nov/1982	-2.0	-1.3	-0.9	-0.7
Aug/1990-Mar/1991	-2.7	-1.7	-0.9	-0.6
Apr/2001-Nov/2001	0.6	-1.1	-1.2	-0.7
Jan/2008-Jun/2009	-2.8	-2.6	-1.6	-1.2
Historic Average	-2.0	-1.4	-1.0	-0.8

Elusive growth in Business Investment

Anemic post-Great Recession recovery in GDP but not as much in Business and Equipment Investment

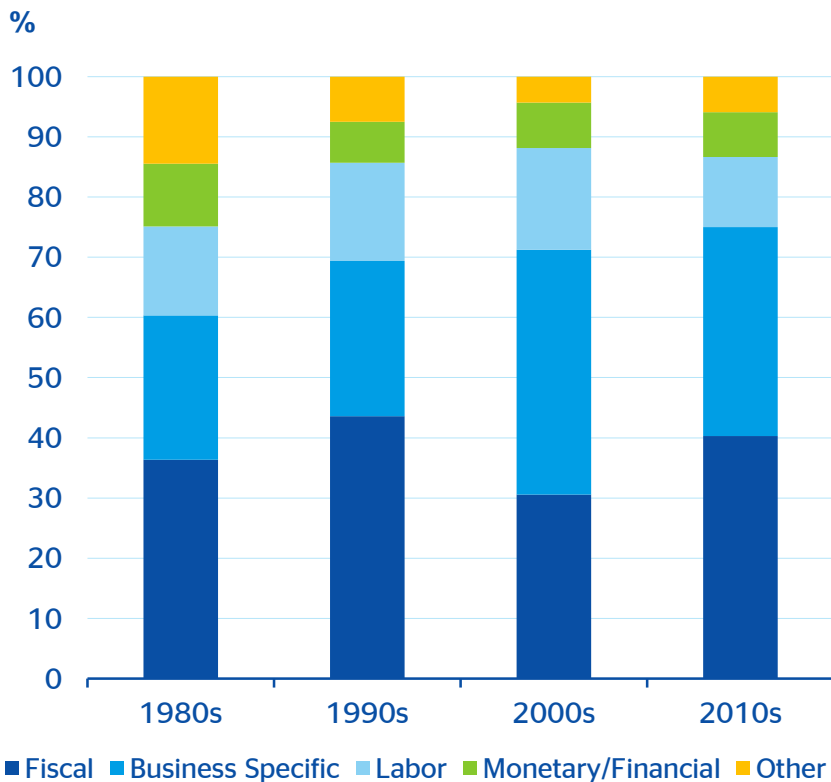
Contributions to Real GDP Growth, Average of Quarterly Real Growth, SAAR, %

Expansions	Gross Domestic Product	Fixed Investment	Nonresidential Fixed Investment	Equipment Investment
Nov/1949-Jul/1953	7.8	1.0	0.8	0.4
Jun/1954-Aug/1957	4.1	0.8	0.7	0.4
May/1958-Apr/1960	5.7	1.3	0.8	0.6
Mar/1961-Dec/1969	4.9	1.0	0.8	0.5
Dec/1970-Nov/1973	5.1	1.4	1.0	0.8
Apr/1975-Jan/1980	4.3	1.4	1.0	0.6
Aug/1980-Jul/1981	4.5	1.1	1.2	0.6
Dec/1982-Jul/1990	4.3	0.9	0.6	0.4
Apr/1991-Mar/2001	3.6	1.2	0.9	0.6
Dec/2001-Dec/2007	2.8	0.5	0.5	0.3
Jul/2009-Dec/2015	2.1	0.7	0.6	0.4
Historic Average	4.5	1.0	0.8	0.5

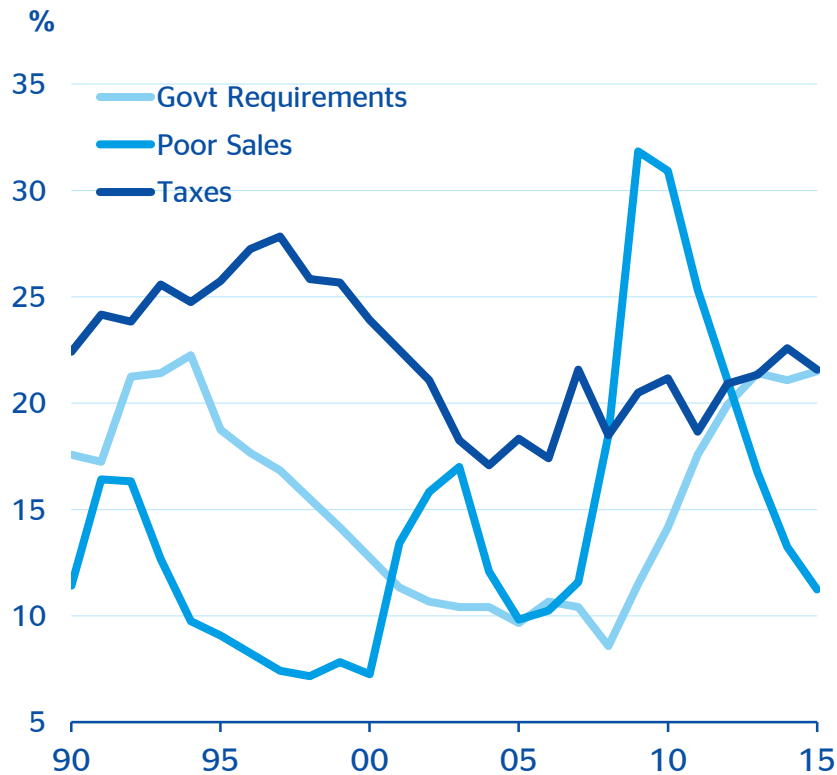
Why is Equipment Investment growth weak?

Small businesses in the U.S. consistently reported two areas of concern: fiscal policy and poor sales

Business Survey on Most Important Problem



3 Major Single Most Important Problems

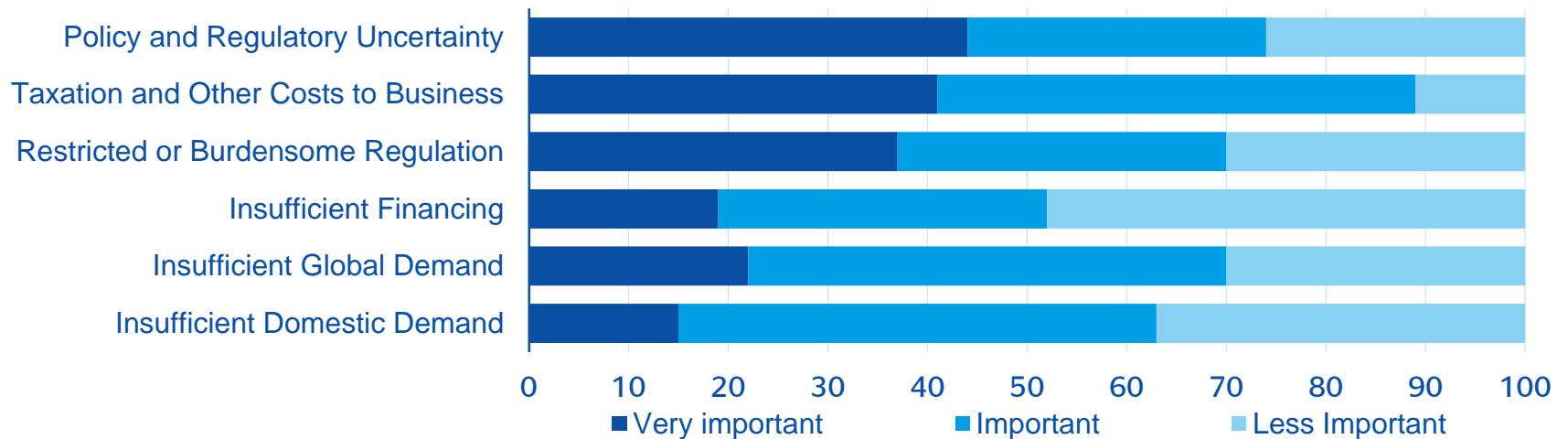


Why is Equipment Investment growth weak?

Unease with fiscal policy uncertainty is similar across borders and all sizes of firms

2015 The Business and Industry Advisory Committee to the OECD Business Climate Survey, %

What are the most important factors that may be constraining investment in your country at present, if any?

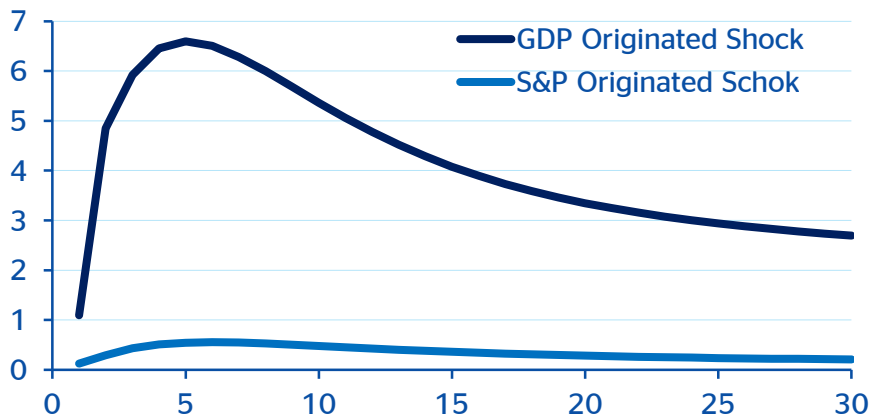


Why is Equipment Investment growth weak?

Equipment Investment is the most sensitive to shocks in aggregate demand, followed by financial market and policy uncertainty

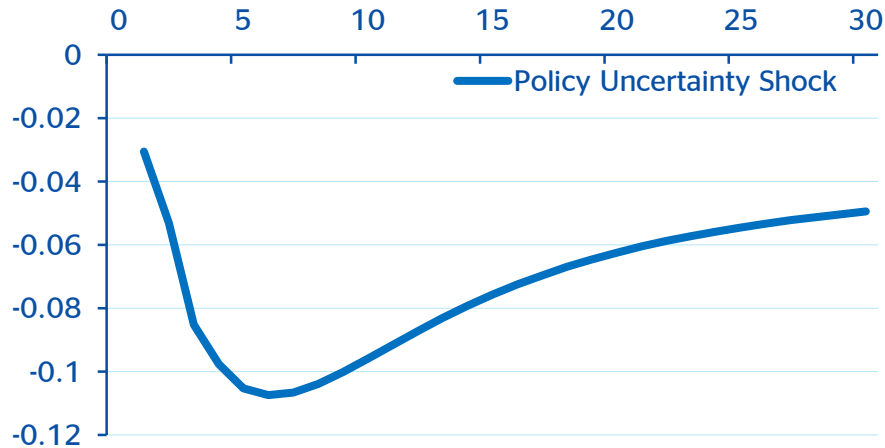
Equipment Investment Response Function

Real Quarterly, %



Equipment Investment Response Function

Real Quarterly, %



Equipment Investment Variance Decomposition

Equipment Investment, GDP and S&P 500 in real logs, Policy Uncertainty in logs, 1985-2015

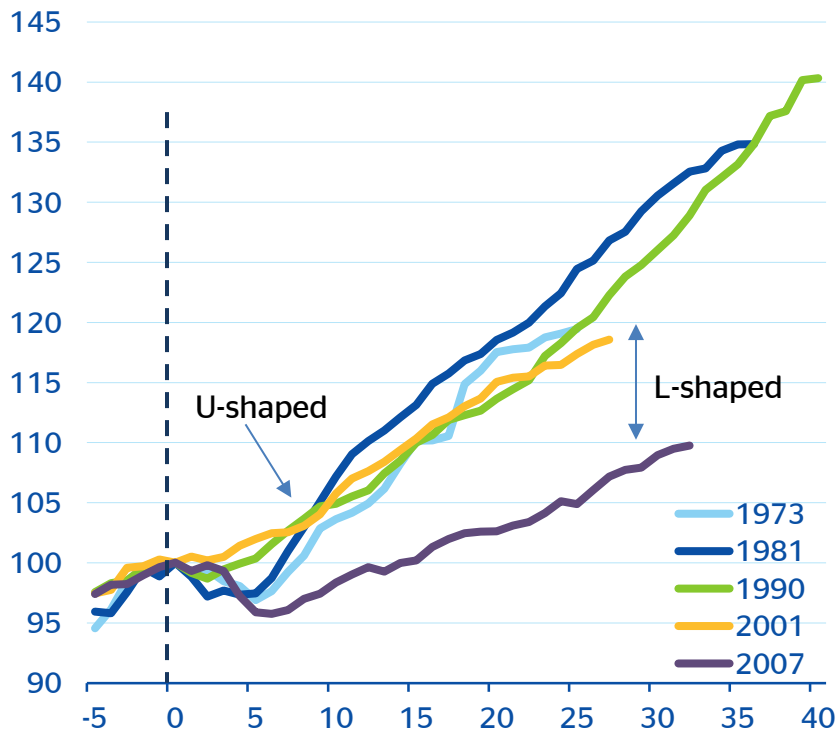
	Equipment Investment	Gross Domestic Product	Policy Uncertainty	S&P 500
GDP Originated Shock	22.0	55.6	3.1	19.2
S&P Originated Shock	31.4	12.4	0.7	55.5
Policy Uncertainty Shock	49.4	15.3	16.1	19.2
No Shocks	32.6	35.5	5.4	26.5

Has recovery been different for GDP and Equipment and Software Investment?

The shape of recovery is different for GDP and Equipment Investment:
L-shaped vs. U-shaped

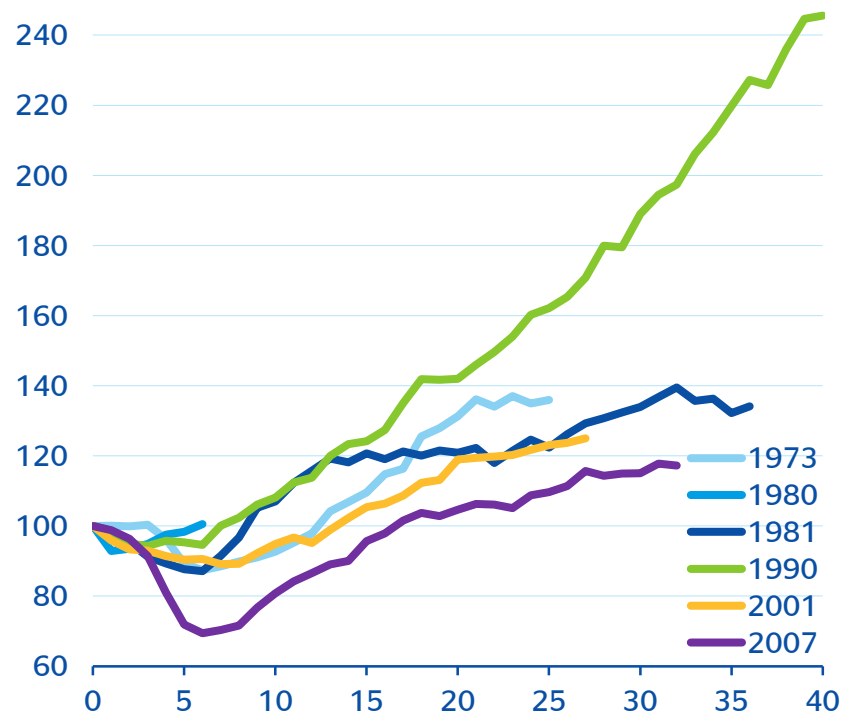
Real GDP Cycles

Normalized, Peak=100, Peak Date= 0



Real Equipment Investment Cycles

Normalized, Peak=100, Peak Date= 0

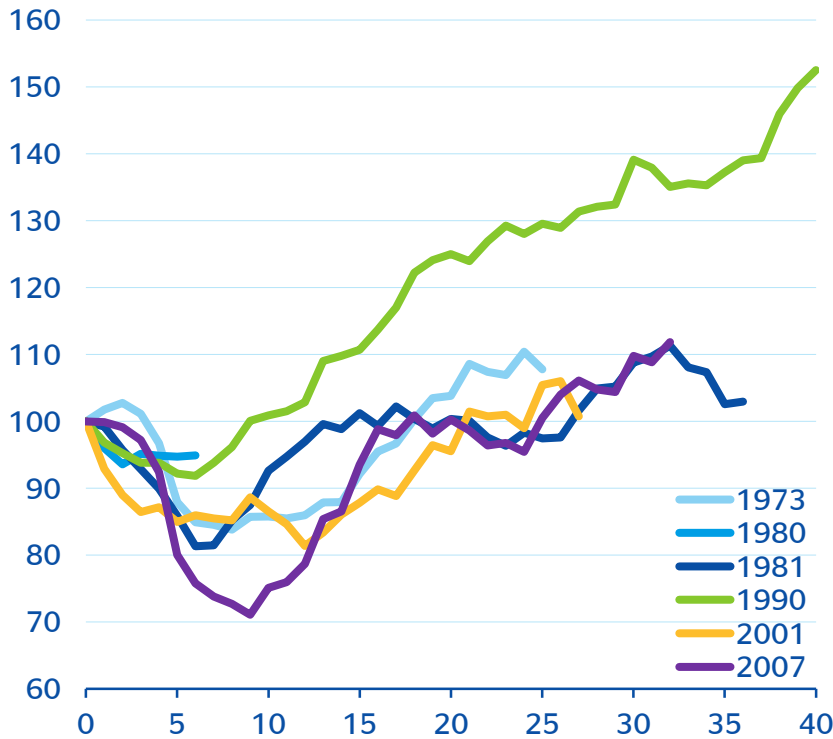


Has recovery been different for GDP and Equipment and Software Investment?

Industrial Equipment and Transportation Equipment had U-shaped recoveries with growth rates similar to previous cycles

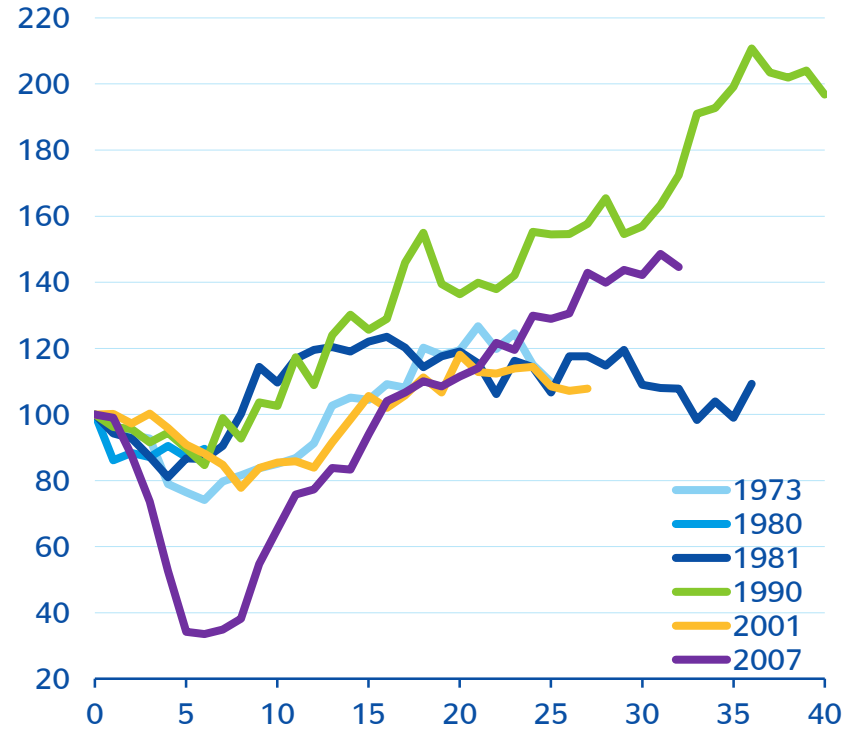
Real Industrial Equipment Cycles

Normalized, Peak=100, Peak Date= 0



Real Transportation Equipment Cycles

Normalized, Peak=100, Peak Date= 0

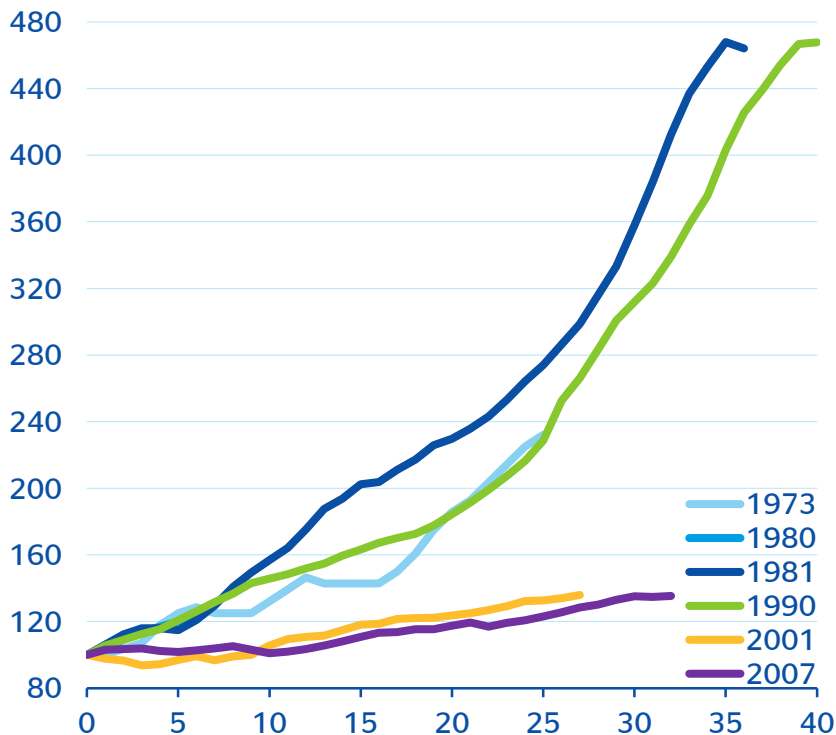


Has recovery been different for GDP and Equipment and Software Investment?

The last recession and recovery growth have been almost flat for Software and Information Processing Investment

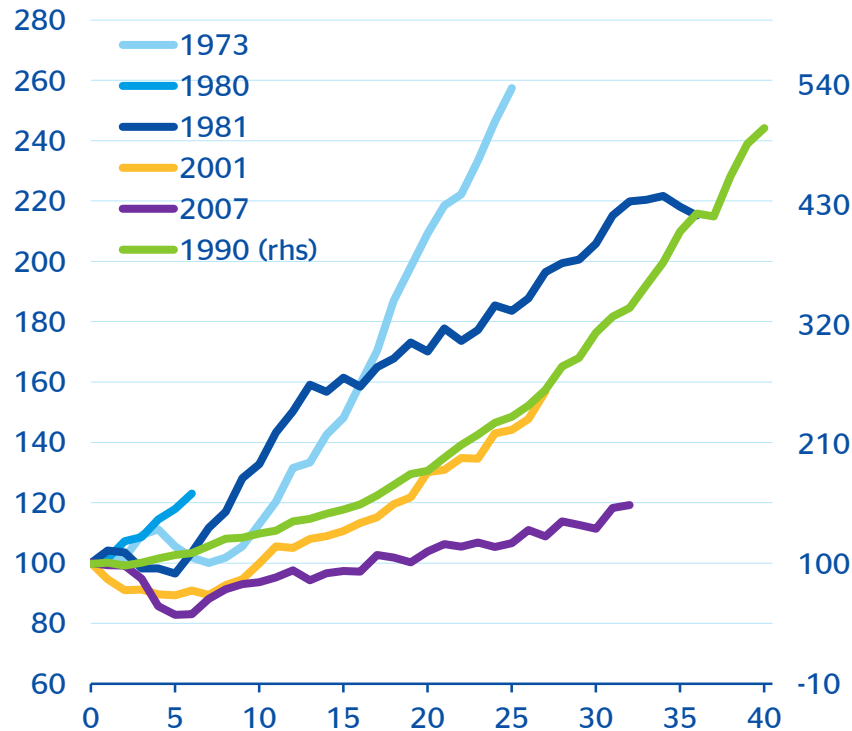
Real Software Investment Cycles

Normalized, Peak=100, Peak Date= 0



Real Information Processing Cycles

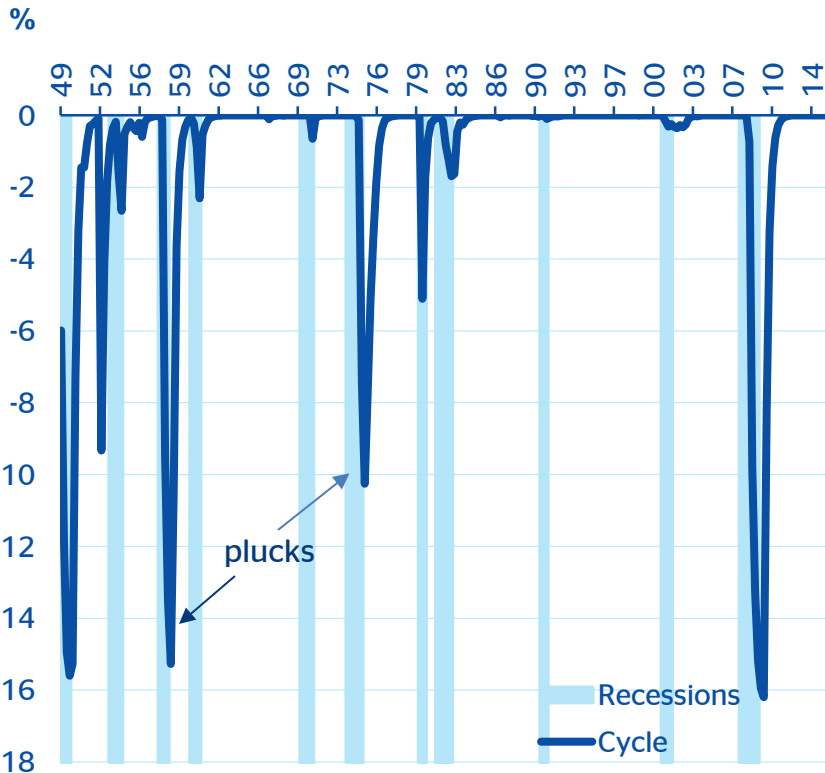
Normalized, Peak=100, Peak Date= 0



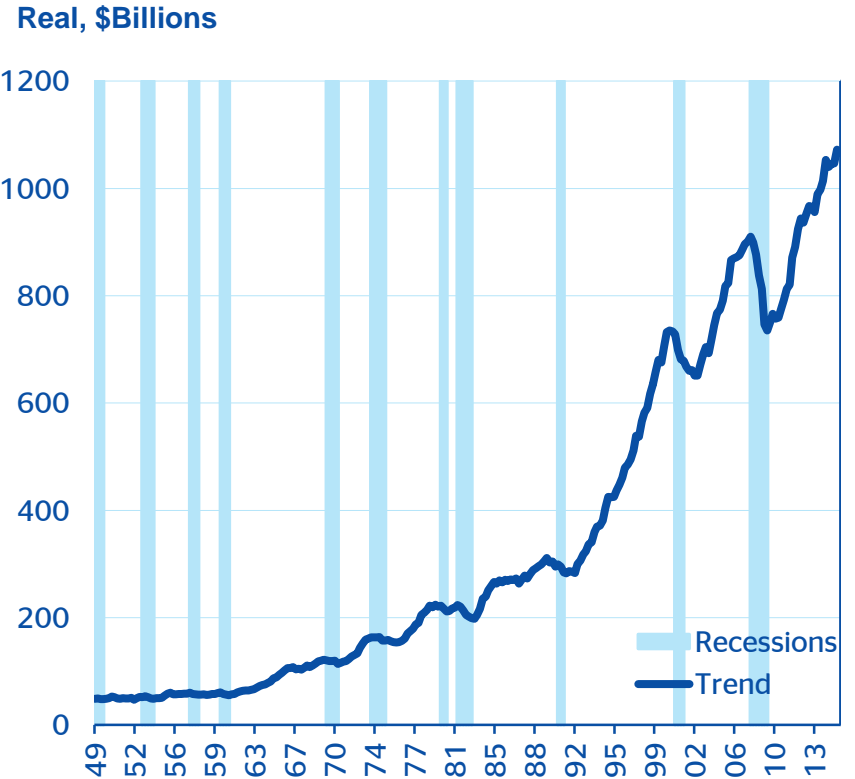
Has recovery been different for GDP and Equipment and Software Investment?

“Plucking Model” estimation reveals evidence of a U-shaped recovery in equipment investment with a return to the long-term trend in 4Q10

Equipment Investment Decomposition: Cycle



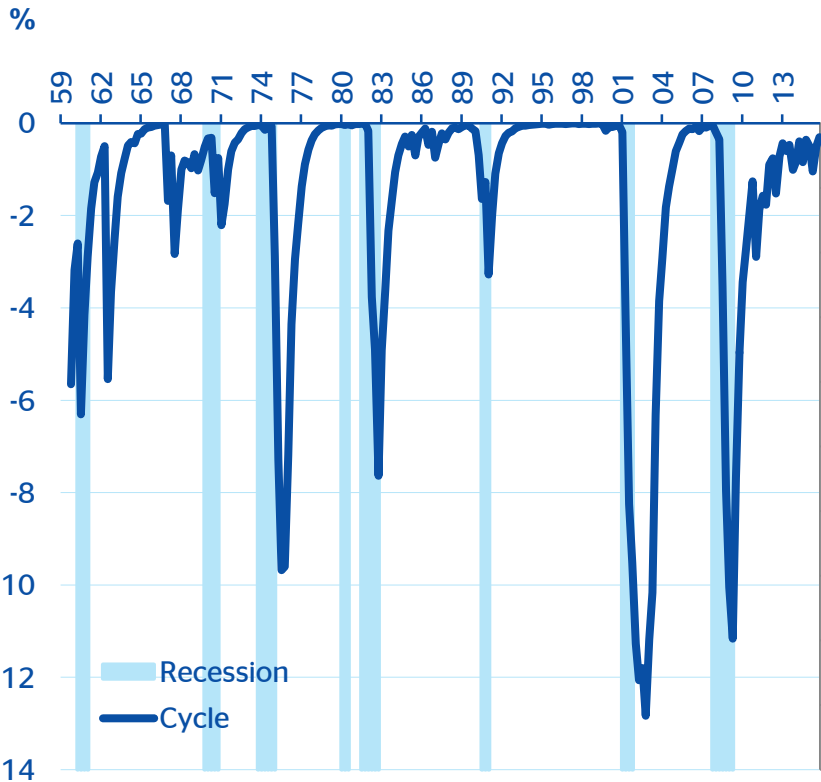
Equipment Investment Decomposition: Trend



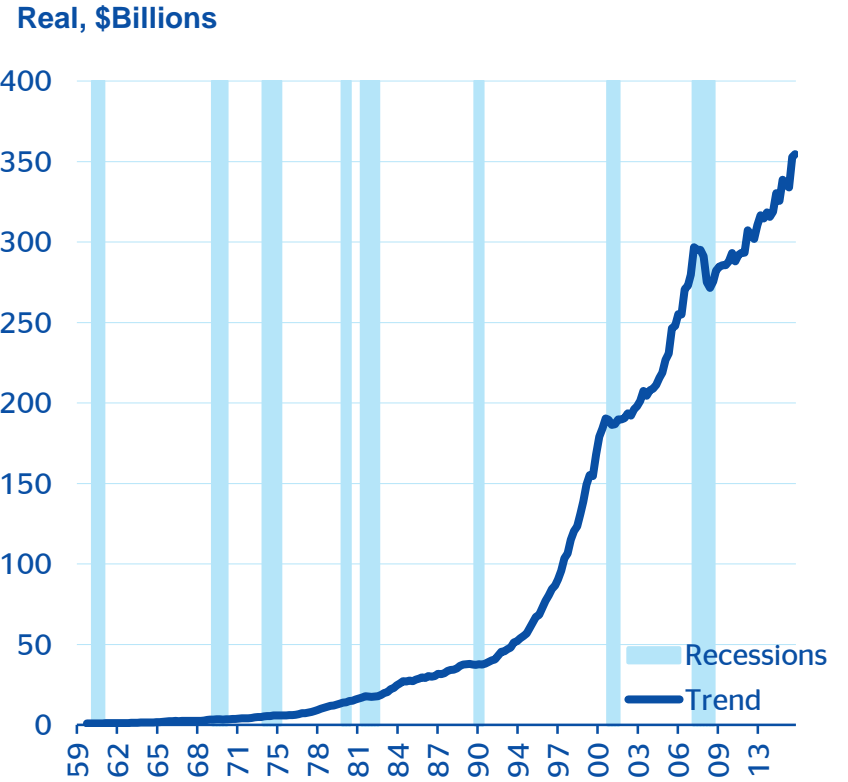
Has recovery been different for GDP and Equipment and Software Investment?

“Plucking Model” estimation reveals evidence of an L-shaped recovery in Information Processing Investment

Information Processing Equipment: Cycle



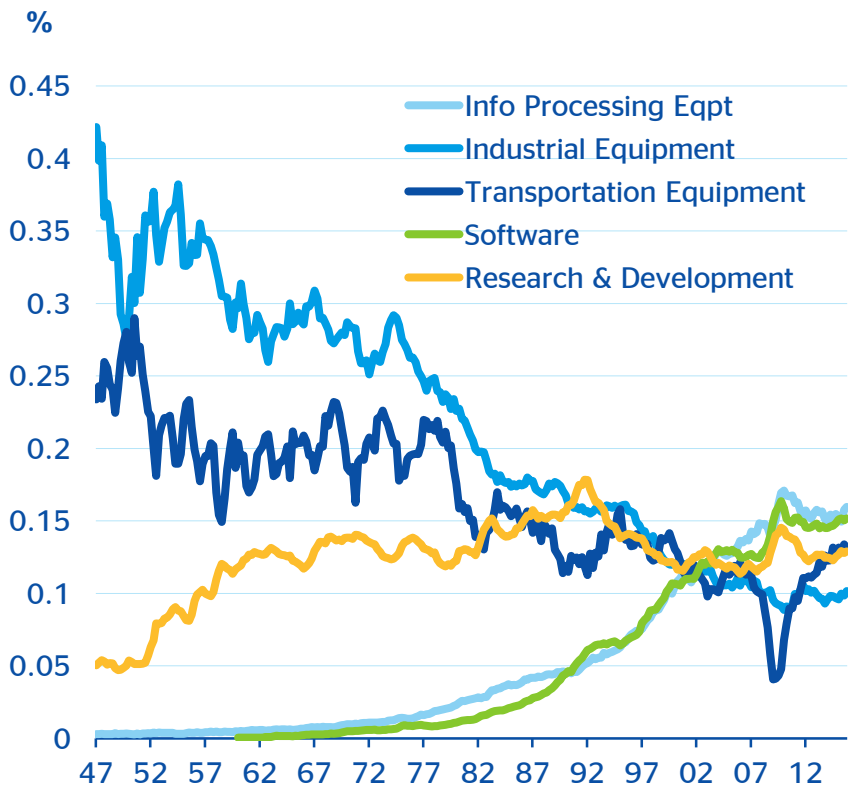
Information Processing Equipment: Trend



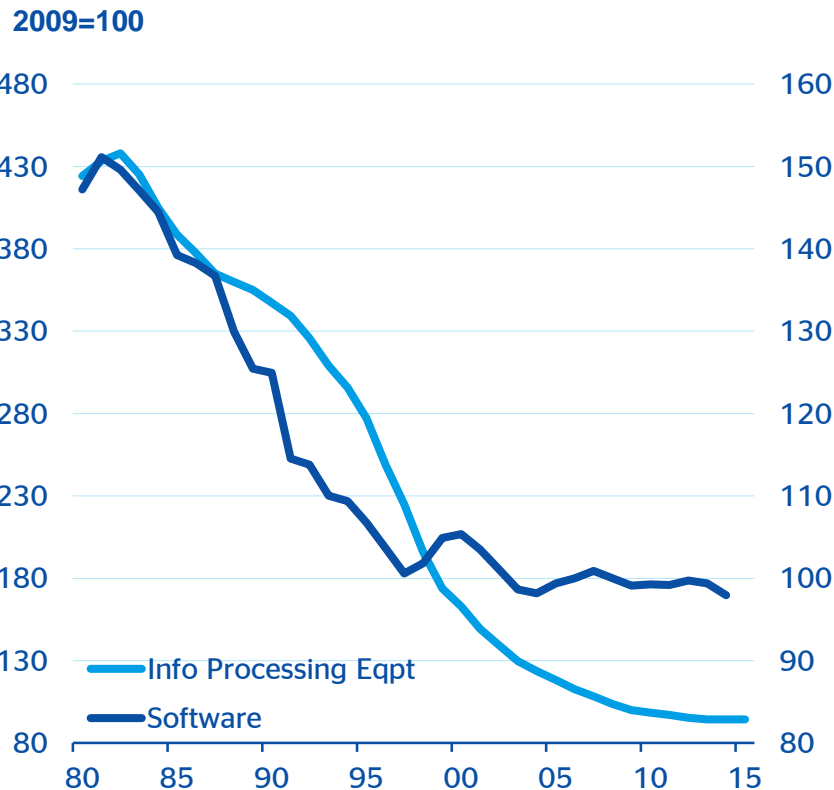
Have structural shifts established a “new normal”?

The Software and Information Processing Investment recovery dynamics should be assessed in conjunction with the long-run change in prices and shares

Ratios to Real Nonresidential Fixed Investment



Private Invest Chain Price Index

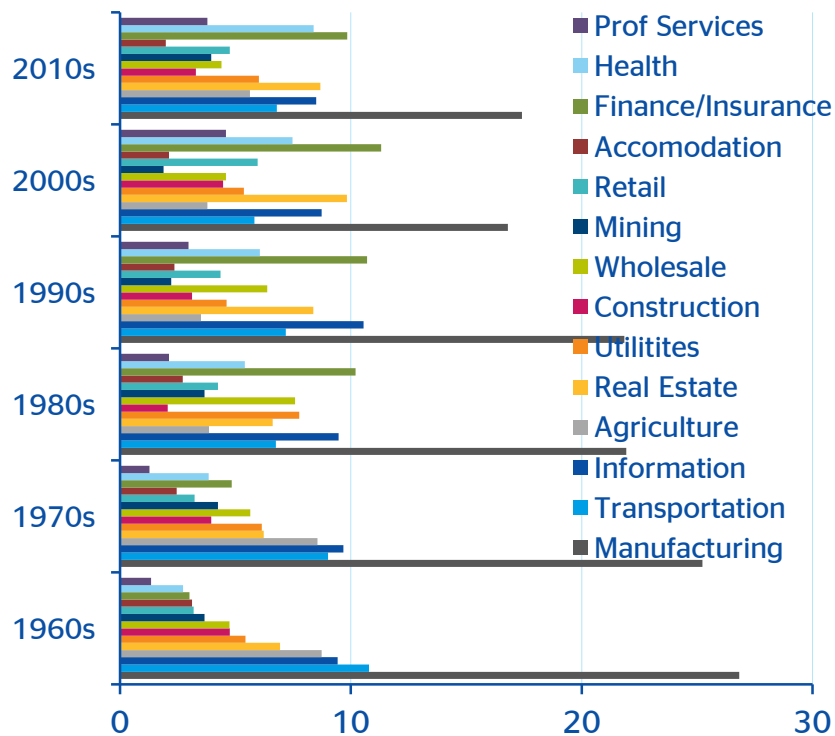


Have structural shifts established a “new normal”?

The share of Manufacturing has consistently declined

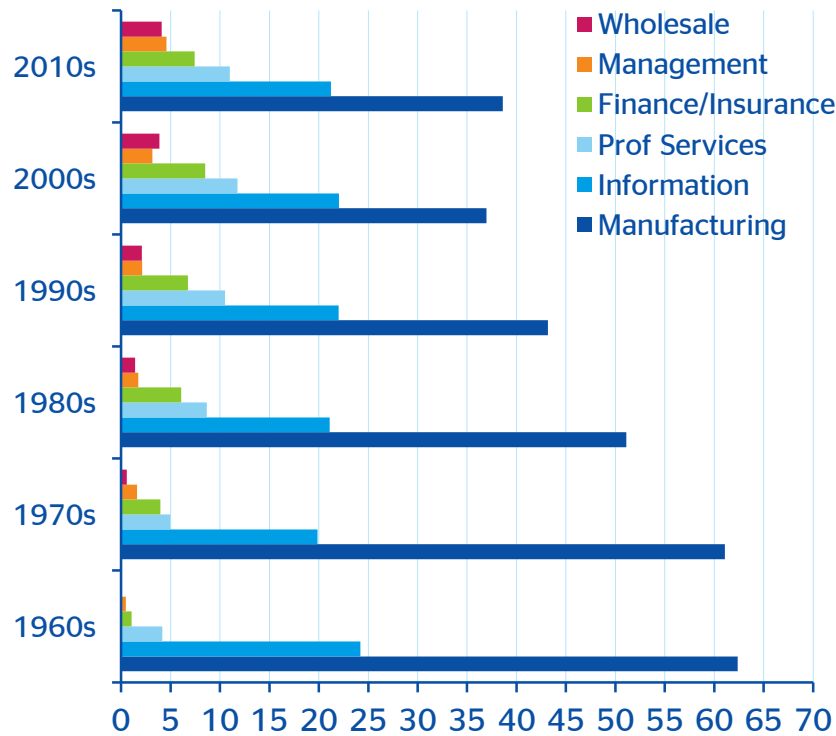
Expansions' Nominal Equipment Investment by Industry, Share of Total Equipment

Capital Stock, Private Fixed Assets, Average, %



Expansions' Nominal Intellectual Prop. Investment by Industry, Share of Total Intel. Prop.

Capital Stock, Private Fixed Assets, Average, %

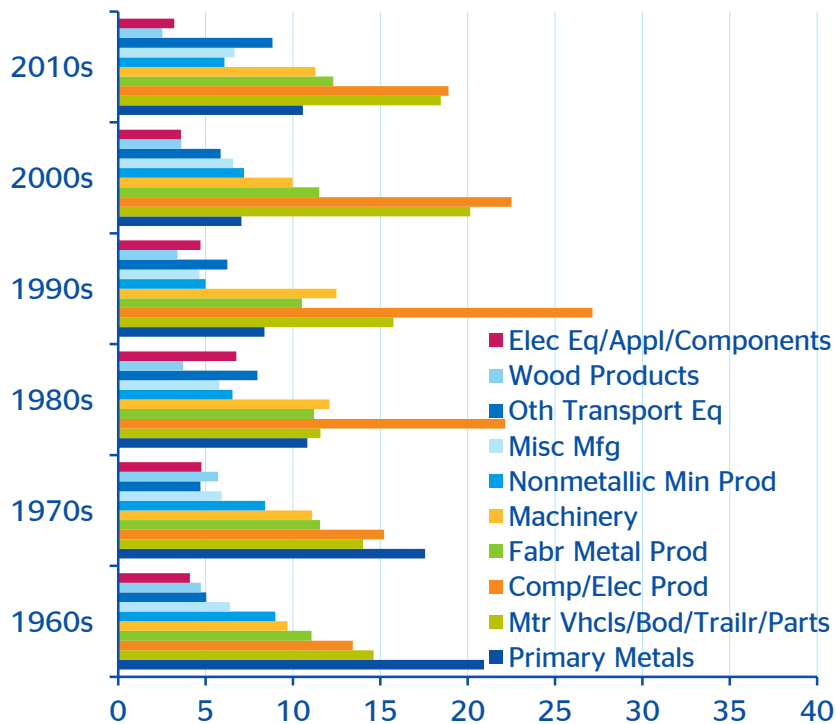


Have structural shifts established a “new normal”?

The lead shares remain unchanged within Nondurable Manufacturing Industries

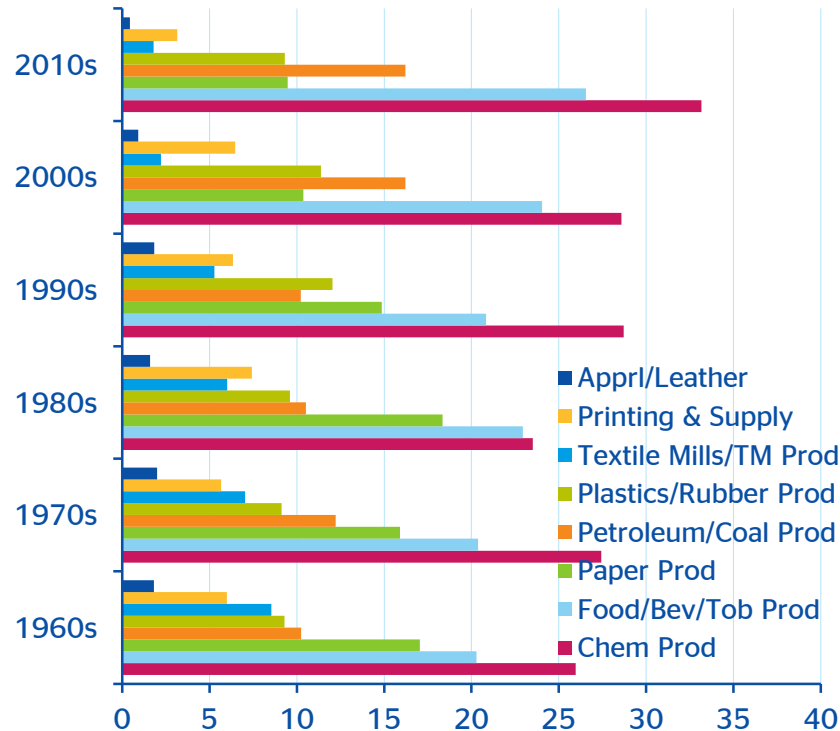
Expansions' Nominal Equipment Investment by Industry, Share of Total Durable

Capital Stock, Private Fixed Assets, Average, %



Expansions' Nominal Equipment Investment by Industry, Share of Total Nondurable

Capital Stock, Private Fixed Assets, Average, %

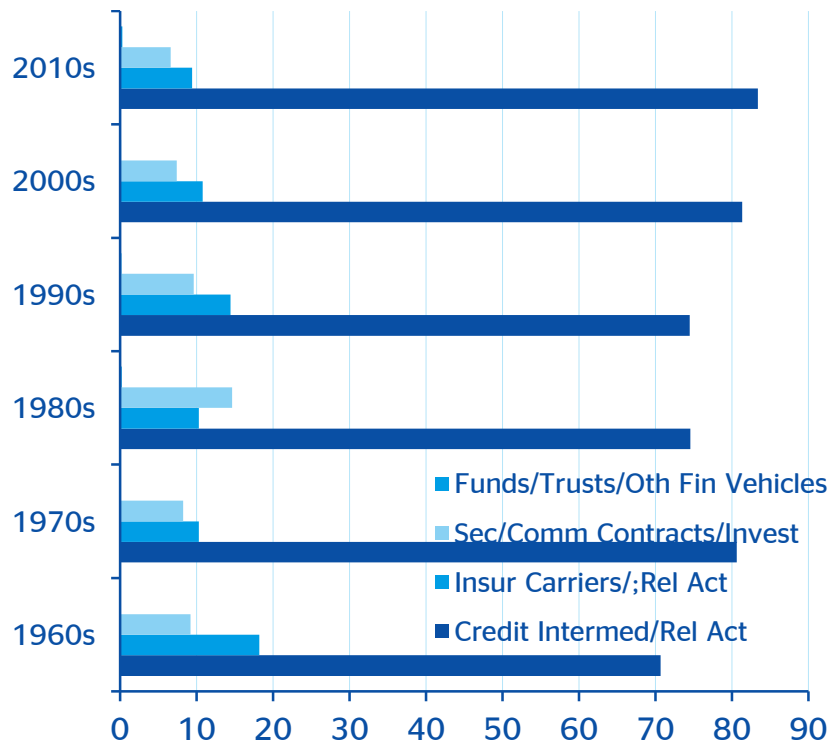


Have structural shifts established a “new normal”?

The share of the Finance within industries has increased;
Growth is mostly contributed by the Credit Intermediation subsector

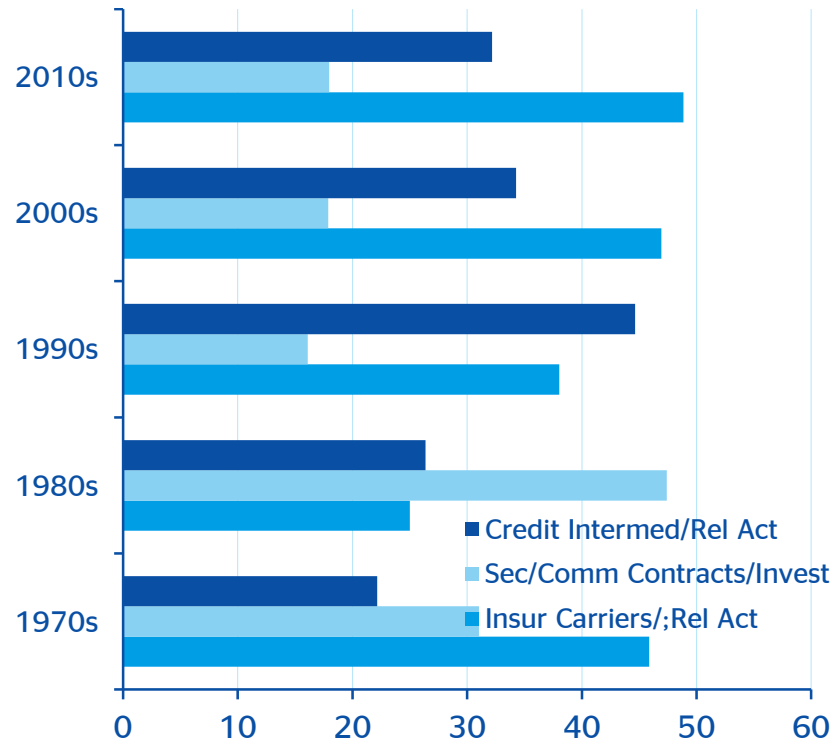
Expansions’ Nominal Equipment Investment by Industry, Share of Total Finance

Capital Stock, Private Fixed Assets, Average, %



Expansions’ Nominal Intellectual Property Investment by Industry, Share of Total Finance

Capital Stock, Private Fixed Assets, Average, %

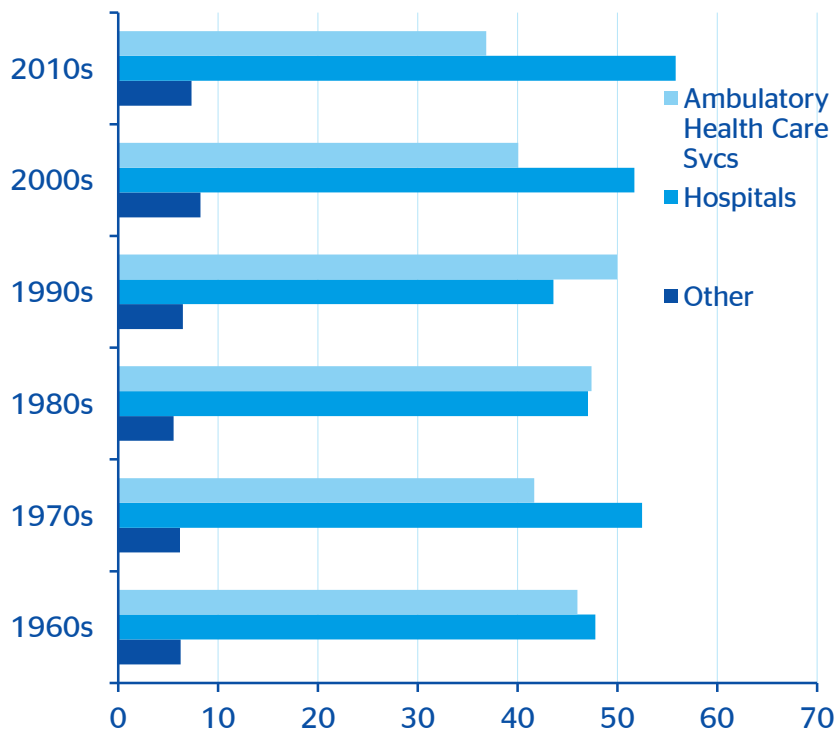


Have structural shifts established a “new normal”?

The share of the Health Care within industries has increased;
Growth is mostly contributed by Hospitals

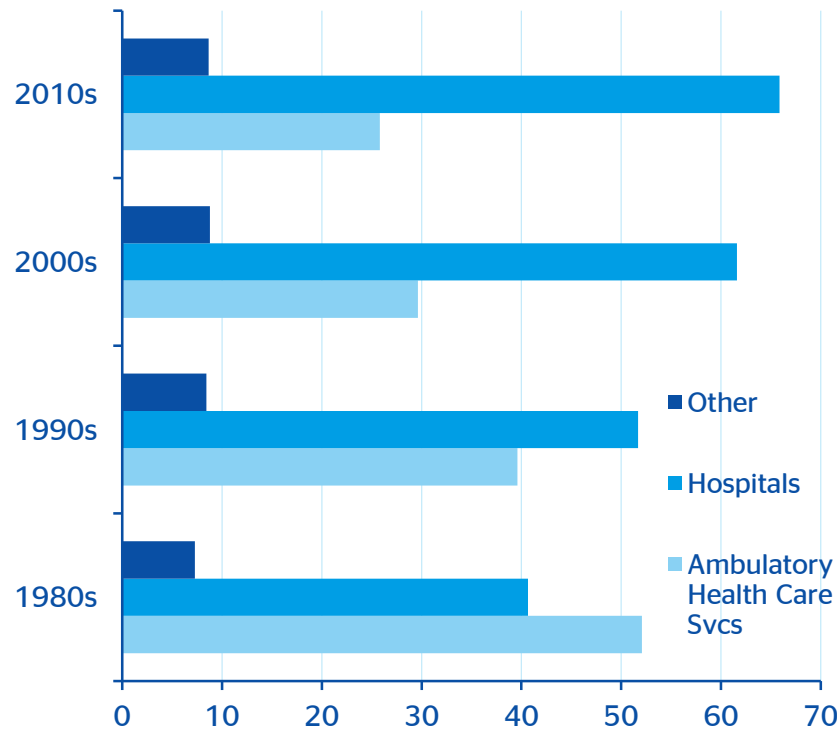
Expansions’ Nominal Equipment Investment by Industry, Share of Total Health Care

Capital Stock, Private Fixed Assets, Average, %



Expansions’ Nominal Intel. Prop. Investment by Industry, Share of Total Health Care

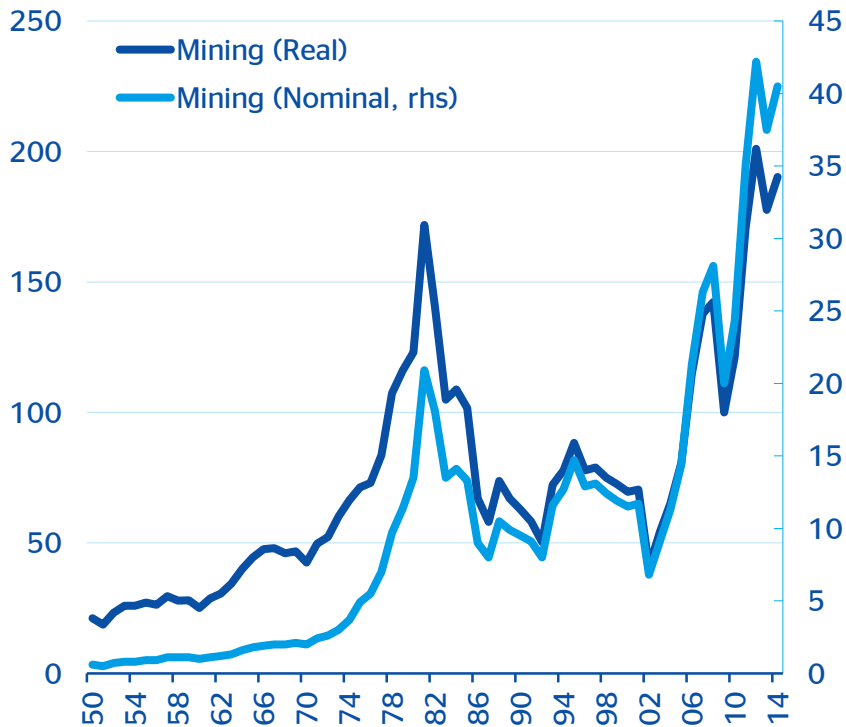
Capital Stock, Private Fixed Assets, Average, %



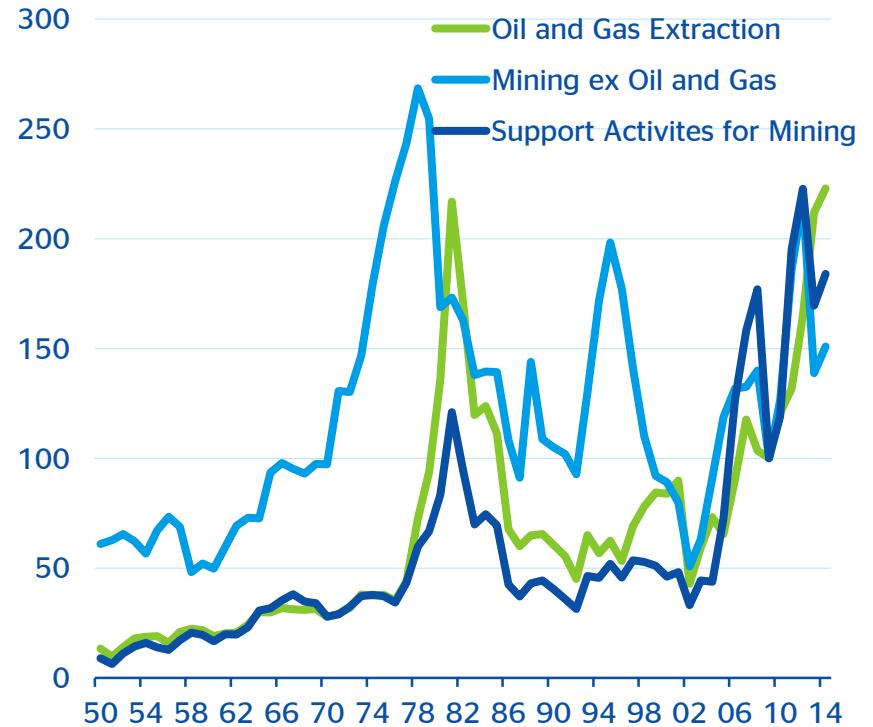
Have structural shifts established a “new normal”?

The 2014-2015 oil price decline led to a slowdown in Business Investment in the Mining industry

Investment: Private Fixed Assets
\$Billions, Chained Quantity Index, 2009=100



Investment: Private Fixed Assets
Chained Quantity Index, 2009=100

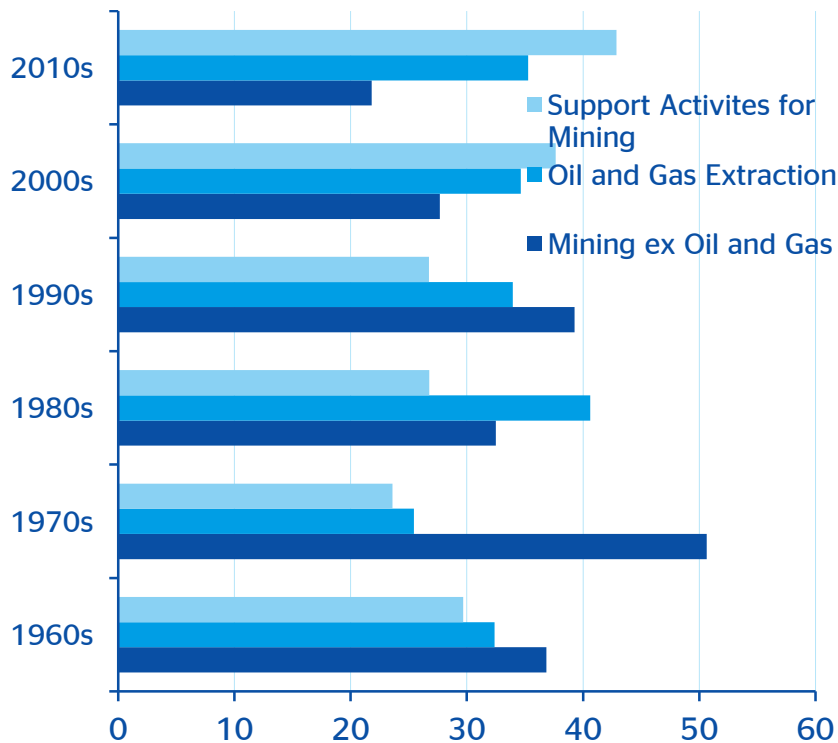


Have structural shifts established a “new normal”?

The share of Support Activity for Mining within the Mining industry’s Equipment Investment has increased

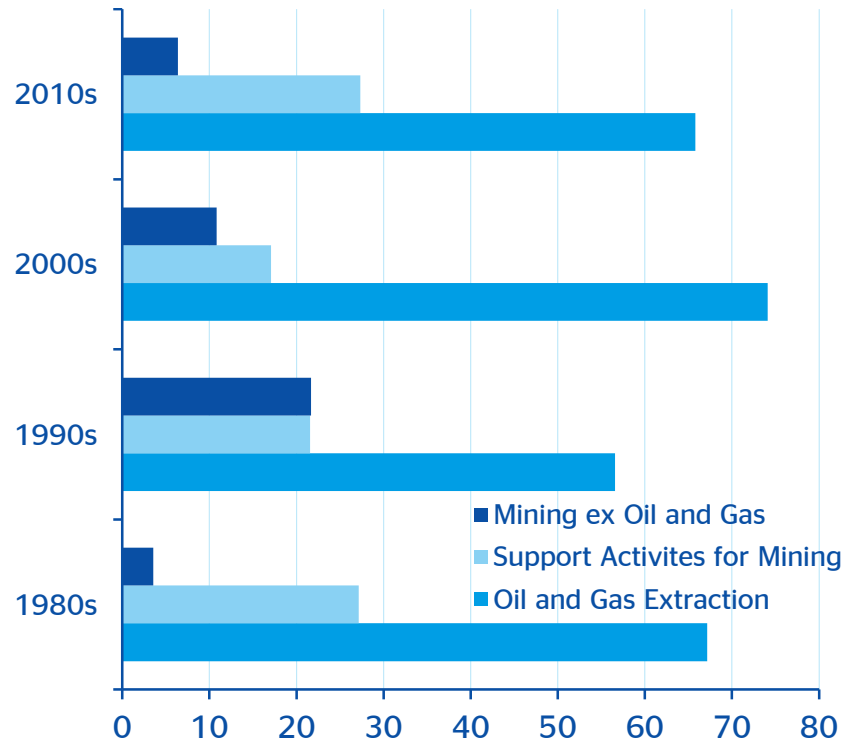
Expansions Nominal Equipment Investment by Industry, Share of Total Mining

Capital Stock, Private Fixed Assets, Average, %



Expansions Nominal Intellectual Property Investment by Industry, Share of Total Mining

Capital Stock, Private Fixed Assets, Average, %



Key Points

The Equipment Investment has returned to its pre-Great Recession long-term trend while gross output has converged to a growth rate below its historic trend

Higher rates of Equipment and Software Investment growth are necessary to boost productivity

Difficult to achieve because:

- Manufacturing is losing its lead to the service sector industries as the primary contributor to Equipment and Software expenditures
- The industry shares of equipment investment capital stock have become more dispersed as industries with a share below 10% make up 81% of equipment investment in the 2010s expansion

The implementation of measures that increase the long-term economic outlook of potential output can bring the necessary boost to Business Investment

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