Richmond Fed

Regional Matters

May 05, 2023

Are Capital Expenditures Getting Too Expensive?

By Zach Edwards

Introduction

Capital expenditure (CapEx) is business spending used to acquire, improve, and maintain physical assets, such as buildings and machinery. These projects often require extensive planning because once in motion, they tend to be expensive, drawn out, and costly to stop. As such, a firm's willingness to undertake capital expenditures can be indicative of its future economic outlook. For example, a retail business may be less likely to invest in opening a new storefront if it's pessimistic about future demand for its product. In our monthly Fifth District surveys, we regularly ask firms if they have made changes to their current and expected capital expenditures. Additionally, as part of the Q1 2023 CFO Survey, we asked firms about their capital expenditures expectations. We find evidence that firms are slowing their pace of capital investment; in our monthly business surveys, the share of firms reporting month-over-month increases in capital expenditures has been trending downward since April 2022.

Why Do We Measure Capital Spending on a Monthly Basis?

Capital expenditures are important for the long-run growth of most firms — investing in capital today boosts future output. Because of its impact on individual businesses and the economy more broadly, it is important for policymakers to understand how firms are adjusting capital expenditures in real time. As such, in our monthly business surveys, we ask firms whether their capital expenditures in the last month have increased, decreased, or stayed the same. Even if capital spending decisions aren't necessarily monthly, picking up on intentional changes relatively frequently can be useful.

Recent Change to Capital Expenditures in Our Monthly Surveys of Businesses

Since the second half of 2022, we have observed a drop in the manufacturing and services capital expenditures indexes. Both are currently hovering around 0, their lowest levels since the summer of 2020. The indexes are calculated by subtracting the share of firms that responded that capital expenditures decreased month-over-month from the share that responded that capital expenditures increased.

Richmond Fed Capital Expenditures Indexes

Line chart with 2 lines.
Seasonally Adjusted

The chart has 1 X axis displaying Time. Data range: 0 seconds.
The chart has 2 Y axes displaying values and values.

End of interactive chart.

While declines in the indexes do suggest that firms are generally pulling back on capital investments, we can examine changes in the shares of firms reporting "increased," "decreased," and "stayed the same" to obtain a more nuanced understanding of firms' capital expenditures decisions.

From March to April, the non-seasonally adjusted share of firms reporting "increased" capital expenditures fell from 22 percent to 13 percent, while the share of firms reporting no change increased from 63 percent to 75 percent. This suggests that recent declines in the capital expenditures indexes are primarily the result of a growing tendency for firms to keep capital spending steady rather than increase capital spending. One interpretation is a falling appetite among Fifth District firms to initiate new capital investment projects. Perhaps this is not surprising: These findings come amid rising interest rates (an important factor when evaluating the cost of capital borrowing and investment) and broad economic uncertainty around future demand.

This Evidence Adds New Flavor to Recent CFO Survey Findings

The idea that firms are pulling back from capital investments is corroborated by research published as part of the Q1 2023 CFO Survey. We found that although the share of firms planning to undergo capital investment over the next six months remained relatively unchanged since 2020, the expected growth rate of capital expenditures over the same period decreased notably from the second half of 2022. In other words, the same number of firms indicated that they planned capital expenditures in 2023, but the amount they are expecting to invest has fallen notably.

Capital Expenditures Growth: Comparing CFO Survey Expectations and NIPAs Actualizations

Bar chart with 3 data series.
Note: The CFO Survey asks firms twice a year about expectations for changes in capital spending over the next six months. The dates in this chart correspond to the six-months-ahead period in which these expectations would come to fruition, not the dates that the survey data was collected. This is so we can compare the expectations data with actualized data from the NIPAs.
The chart has 1 X axis displaying categories.
The chart has 1 Y axis displaying values. Data ranges from 2.1 to 13.3.
End of interactive chart.

Furthermore, we found that among firms that do not plan on investing in capital over the next six months, they were most likely to cite "no need to expand capacity," "need to preserve cash," and "uncertainty" as the reasons for not investing. But another 25 percent also reported that financing was unfavorable, which was a sharp increase from 15 percent in the second half of 2022. These findings corroborate the idea that rising interest rates and broad economic uncertainty play into firms' decisions not to take on new capital investments immediately.

Which of the following describe the reason(s) your business does not plan to make any equipment or structures expenditures over the next six months?

Bar chart with 2 data series.
Percent of Firms

Note: Data reflect results for firms that responded “no” to both equipment and structures planned investment over the next six months. Results from the Q3 2022 survey (August 24 - September 9, 2022) are shown for comparison. Percentages do not sum to 100 because respondents could report more than one reason.
The chart has 1 X axis displaying categories.
The chart has 1 Y axis displaying values. Data ranges from 5.2 to 61.2.
End of interactive chart.

Conclusion

Together, The CFO Survey and the Richmond Fed surveys of manufacturers and service providers indicate that firms have recently been less likely to take on new capital expenditures and are thus either slowing the pace of existing projects or pushing back the start of pending projects. There is some evidence that recent changes to capital investments are a product of rising interest rates or a more uncertain economic environment. It will be important for policymakers to continue to monitor firms' expectations for capital expenditures in the coming months.