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Economics Group

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Commodity Prices Drive Losses in Manufacturing & Mining

Lower commodity prices and a stronger dollar weighed on profit margins for manufacturers, particularly in the durables sector. Mining companies posted an after-tax loss of $37.6 billion in Q1, the largest on record.

Bottom Lines Leveled by Commodity Price Declines

Mining companies reported a $37.6 billion after-tax loss in Q1 2015, according to the Census Bureau's Quarterly Financial Report (top chart). This was even more significant than the losses seen in the depths of the prior recession, and comes on the heels of an after-tax loss of $16.3 billion in Q4 2014. Net sales fell 26 percent from a year earlier to $69.3 billion, the lowest quarterly reading in nearly four years. While we expect a gradual stabilization in oil prices in the coming quarters will make future losses for the sector less dramatic, a return to the heady pace of profit growth seen in prior years does not seem likely in the near future.

Primary metals also fell into the red in the prior two quarters, recording back-to-back after-tax losses of $1.1 billion. Margins in this sector were likely hit by the sizable decline in prices for most industrial metals, which has largely been overshadowed by the collapse in oil prices. Bloomberg's industrial metals index is down more than 25 percent since last summer.

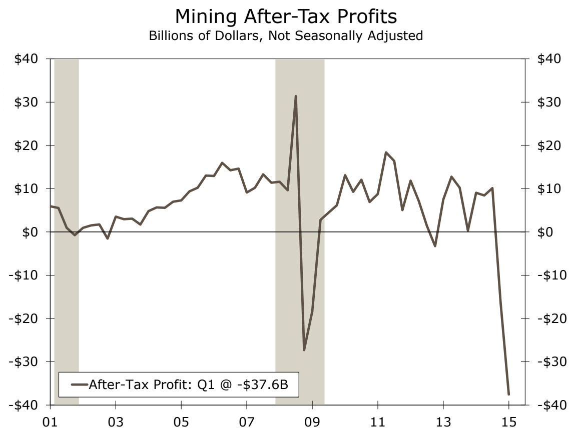
A number of other sectors saw weakness in profit growth as well. After-tax profits in the professional and technical services sector fell 6.5 percent from a year earlier, while margins fell to 2.9 percent of sales from 3.2 percent in Q1 2014. Wholesale trade corporations reported an after-tax profit of $7.4 billion, down nearly 25 percent from a year ago, while margins fell 4.4 percentage points over the same period to 12.6 percent.

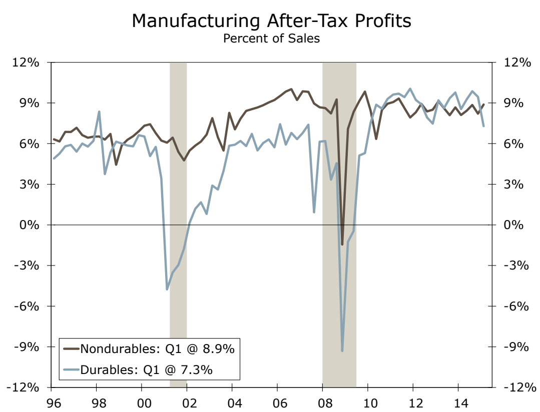
Strong Dollar and Lower Oil Prices Hit Durables Producers

After-tax profit margins in the manufacturing sector fell to 8.1 percent of sales in Q1, the lowest level in nearly five years (middle chart). Net sales dropped 6.2 percent from a year earlier, while after-tax profits were down a steeper 9.7 percent year over year. Durable goods manufacturers saw their profits decline to 7.3 percent of sales from 9.5 percent as profits fell 13.3 percent year over year, accounting for the entire decline in margins for all manufacturers (bottom chart). Meanwhile, profits for producers of nondurable goods actually increased to 8.9 percent of sales from 8.2 percent in Q4 2014, even as profits fell 6.4 percent from a year earlier on a level basis.

Divergent Directions: Manufacturing and Services

This represents another chapter in the story of divergent fates for the manufacturing and services sectors of the domestic economy. Indeed, while the ISM manufacturing index fell more than six index points earlier in the year, the non-manufacturing index has been considerably more stable. On the plus side, weakness in the manufacturing sector has become less pronounced recently, and the ISM manufacturing index has actually rebounded since April. We suspect the stronger dollar has played a key role in the subdued factory activity we saw earlier this year, although we suspect weakness in the manufacturing sector may persist for quite some time.





Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

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