Economic Indicator — May 25, 2022

Durables Demand Remains Steady

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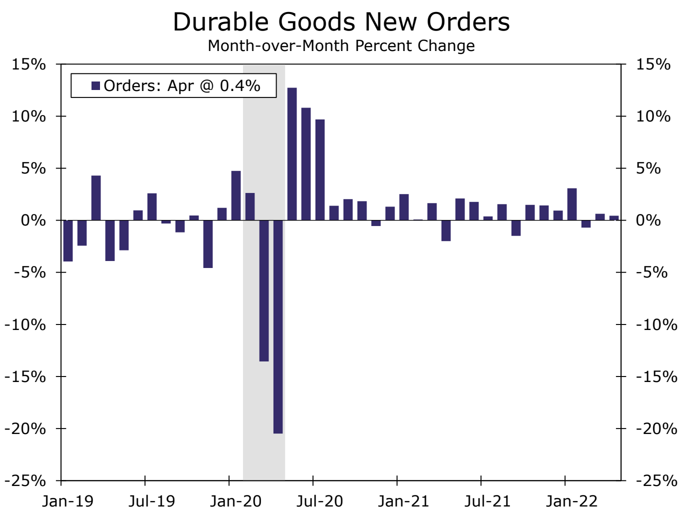
Summary

The April durable goods data suggest demand remains broadly intact in the factory sector. Orders continued to roll in at a decent clip and capital goods shipments point to a decent start to the second quarter for equipment spending. Recent regional Fed manufacturing surveys signal weaker activity, but we are not convinced that a cooling in demand is imminent.



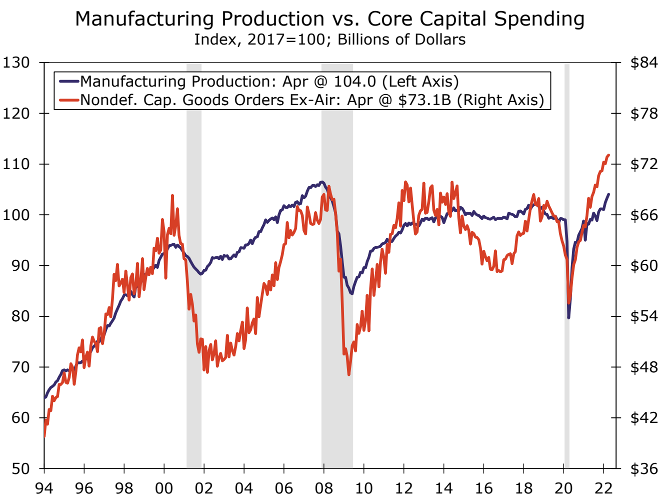
Source: U.S. Department of Commerce and Wells Fargo Securities

Demand Intact in Factory Sector

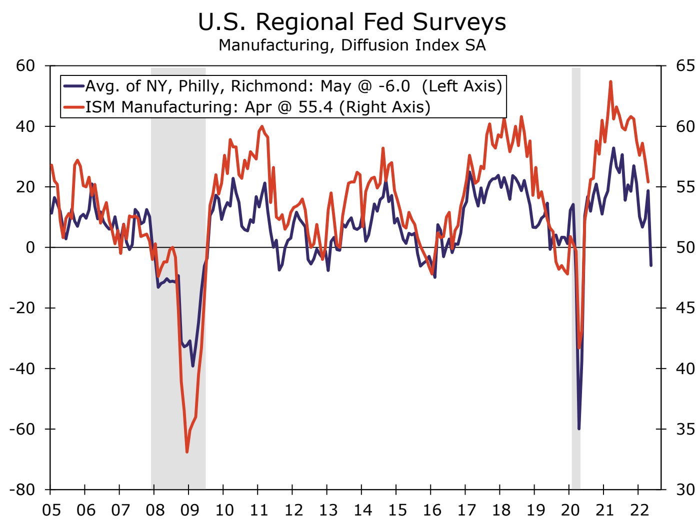
Orders for durable goods continued to roll in at a steady pace in April, rising 0.4% from a month earlier. There were modest downward revisions to March orders, but the details of the report suggest demand for production remains intact.

Orders were broadly positive across major categories, with just electrical equipment and fabricated metals orders moving only modestly lower last month. The typically volatile transportation sector boosted the headline last month, largely due to a 4.3% surge in nondefense aircraft orders, while new orders for autos pulled back 0.2% after a sizable gain in March. After stripping transportation and defense from the estimates, core capital goods orders rose 0.3% last month, leaving orders a whopping 19.3% above their pre-pandemic level. The steady march higher in orders emphasizes the resilient demand in the sector.

Shipments eked out only a modest 0.1% gain in April, but non-defense capital goods shipments were up 0.6%. As these estimates are used in the equipment spending estimates for GDP, they suggest spending is off to a decent start in the second quarter. But manufacturers are still struggling with limited supply and unfilled orders leaped another 0.5% last month. Durables backlog has now risen in each of the past twenty months as a lack of inputs and labor continue to limit activity.



Source: Federal Reserve Board, U.S. Department of Commerce and Wells Fargo Economics



Source: Institute for Supply Management, Federal Reserve System and Wells Fargo Economics

One thing to take note of is that the durables data have recently undergone benchmark revisions, which go as far back as 2012 for some data series. The revisions did not do much to the recent growth rates, but on balance, they resulted in a downshift in many of the levels. The level of durable goods orders for example is about 4% lower as of March post-revision while the level of nondefense capital goods orders is now 10% lower. The shipments data saw similar downward revisions, and while total unfilled orders were revised lower as well by nearly 15%, core capital goods unfilled orders (nondefense, ex aircraft) were revised higher by about 7% and still comfortably sit at an all-time high. As such, our broad outlook remains intact.

With the pandemic-related run up in orders having been revised down a bit, it narrows the gap between orders and production. But we still expect the need for manufacturers to meet record order backlog will keep production strong for some time. The regional Fed manufacturing surveys reported thus far for May (Philadelphia, New York and Richmond Feds) suggest a cooling in demand. While the observed weakness cannot be ignored and the Fed's efforts to fight inflation will inevitably cool demand, we are not convinced a slowdown in the sector is imminent. Not only do manufactures have plenty of unfilled orders to keep factories running at full tilt (even in the event of a slowdown in demand), but we expect sky-high labor costs and limited availability of workers to motivate businesses to seek labor-saving technologies and support demand for equipment.

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