June 26, 2019

Economics Group

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Durables Goods: Not *Quite* as Bad as It Looks

The 1.3% drop in durable goods orders is mostly aircraft weakness amid Boeing's struggles. The details were better with upticks in core capital goods orders and shipments, but the factory sector remains under pressure.

Another Indicator, Another Downside Miss

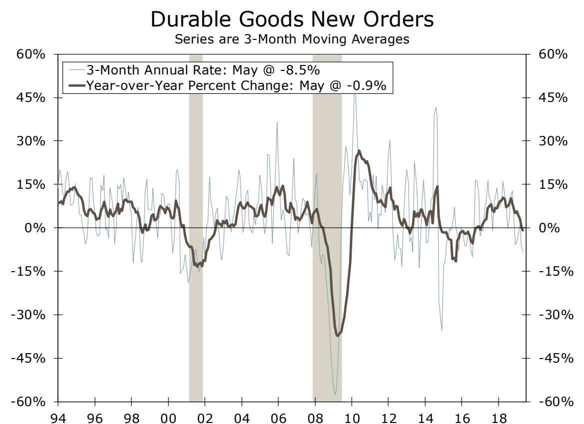
Durable goods orders for the month of May fell 1.3%, a full point worse than consensus expectations. The miss piles on to the recent run of worse than expected data coming from a broad swath of the economy, including the manufacturing sector but also housing and the consumer. Looking under the hood, however, suggests that capital spending is not falling off the rails, but equipment spending is still set to decline in the second quarter.

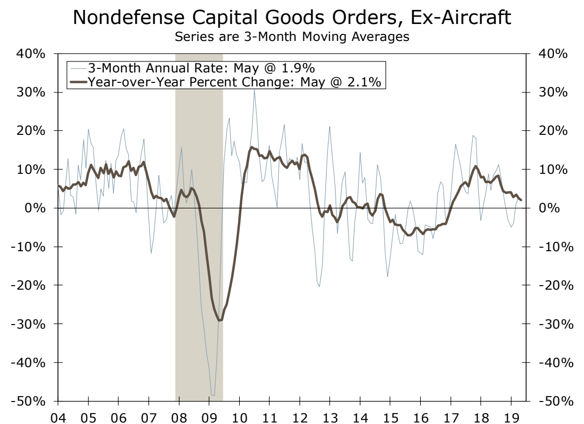
Durable goods orders are particularly prone to miss forecasts based on the volatility in the sizeable aircraft sector. Boeing's recent challenges with their 737 MAX model have amplified the importance of the transport sector on a month-to-month basis. Net cancellations led to nearly a 30% drop in nondefense aircraft orders over the month. That followed almost a 40% decline the previous month and obscures a modestly firmer trend in underlying core orders. Nondefense capital goods orders excluding aircraft—our preferred barometer of business investment—came in better-than-expected with a 0.4% rise in May. On a three-month average annualized basis, core orders remain mildly positive compared to total durable orders falling at the fastest pace since early 2016.

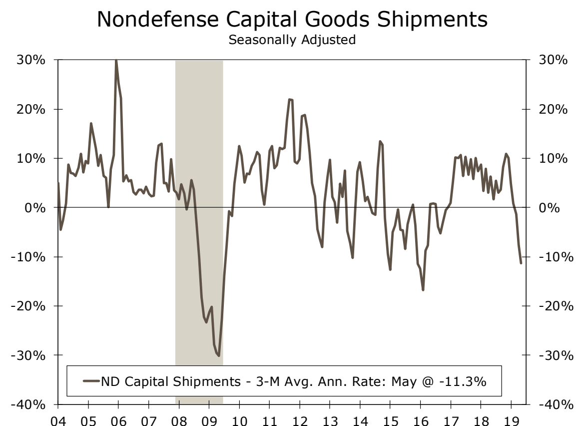
While core capital goods orders suggest businesses are not fully retrenching as they await clarity on trade and contend with slowing growth abroad, equipment spending still looks set to contract this quarter. Nondefense capital goods shipments, which feed into the BEA's estimates of equipment spending in the GDP report, rose 0.5% in May, barely chipping away at the 3.3% decline in April. On a three-month average annualized basis, shipments are down 11.3%, but that is entirely due to the halt in Boeing shipments; ex-aircraft, nondefense capital goods shipments are up at a 1.7% pace.

More recent readings on new orders from purchasing managers' indices suggest factory activity remains under pressure. A simple average of the four regional Fed PMIs released thus far for June fell to zero, a 5.5 point drop. Notably, the weakening in new orders has not been as pronounced as the deterioration in the headlines of these surveys. Only the Richmond Fed uses a composite index along the lines of the ISM for its headline, while the New York, Philadelphia and Dallas headlines are derived from a separate question on general business conditions, making them more prone to swings in sentiment. We suspect the threat of a multi-front trade war during parts of the survey period weighed down topline readings as a result.

The upshot is that the pipeline for manufacturing remains weak, but is likely not as dire as recent regional PMIs or total durable goods orders suggest. The tabling of Mexican tariffs points to some room for improvement, but without a resolution to trade disputes with China, we expect factory activity to continue to languish amid the resulting uncertainty and floundering global growth.







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

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