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Economics Group

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Slow Ride: Factory Orders Indicate Incremental Growth

A 0.2 percent decline in factory orders follows an upwardly revised increase in the prior month. The slow growth narrative for the manufacturing sector and business spending outlook remains intact.

Somewhat Better Than Expected…With Room for Improvement

The 0.2 percent increase in April factory orders was precisely in-line with consensus expectations, but the fact that the orders figures for March were revised higher makes today's report a bit better than expected.

That said, it is hardly a signal of the faster rate of activity in the manufacturing sector given the expansionary readings we have been receiving from some of the purchasing manager surveys. Last week, for example, we learned that the ISM manufacturing index strengthened in May and that the new orders component rose to 59.5 — a level that we would historically associate with a faster rate of orders growth. The top graph plots the three-month annualized growth rates for both ISM new orders, and while gaps are not completely unprecedented, they do tend to converge over time.

Slow Growth Rather Than Stagnation

This April report for factory orders follows up on the preliminary durable goods report released on May 26. In addition to offering new information on the nondurable side of factory orders, it also typically contains a revised look at the key core capital goods data on orders and shipments.

There was not much of a shift in these figures today, but we do see some incremental improvement. Core capital goods shipments for April were revised from a 0.1 percent decline to a 0.1 percent increase. Meanwhile, core capital goods orders went from "no change" in the advance durable goods report to a 0.1 percent increase in today's factory orders report.

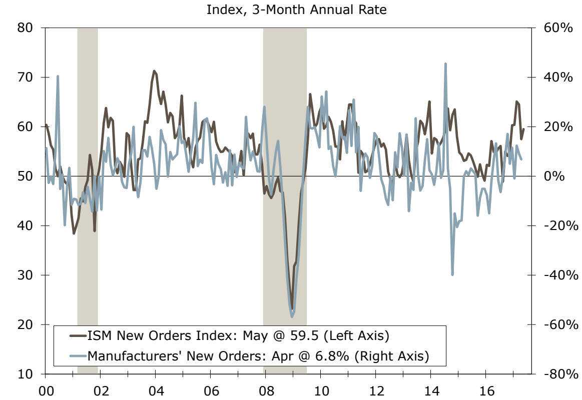
The revisions are subtle, but the take-away here is important because, modest as these core capital goods figures may be, they indicate slow growth rather than stagnation. These figures are for April, the first month of the second quarter, and they suggest that growth in equipment spending had at least some positive momentum heading into the second quarter.

Inventory Story

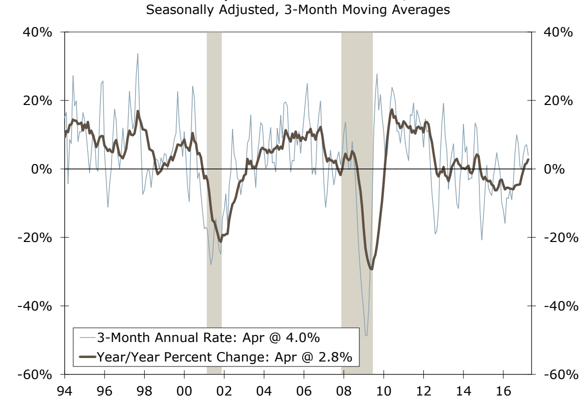
Speaking of implications for GDP, the inventory dynamic is likely to be a big factor in the second quarter. The change in inventory investment of $10.3 billion in the first estimate of GDP was already small. It got even smaller in the second estimate which put the inventory change at just $4.3 billion. Due to the way the GDP calculations work, (the change in the rate of inventory change), even a modest move in inventories in the second quarter could result in a big + or - contribution to the headline growth rate.

We learned today that nondurable inventories slipped 0.1 percent in April. Combined with the increase on the durables side, the overall inventory change was up 0.1 percent. The inventory-to-shipments ratio stayed flat at 1.38. Our forecast is for inventories to be a boost in Q2, but we will watch the data closely in coming months and hone our estimates accordingly.

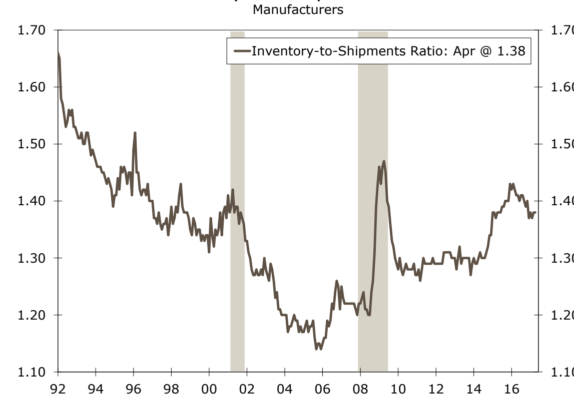
ISM New Orders & Manufacturers' New Orders
Index, 3-Month Annual Rate



Nondefense Capital Goods Orders, Ex-Aircraft
Seasonally Adjusted, 3-Month Moving Averages



Inventory-to-Shipments Ratio
Manufacturers



Source: U.S. Department of Commerce, Institute for Supply Management and Wells Fargo Securities

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