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Economics Group

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Durable Goods Orders Remain Weak in May

Durable goods orders came in weaker than expected, declining 2.2 percent in May. Core capital goods orders were also soft. While shipments data point to positive equipment spending in Q2, risks have been reignited.

Another Soft Report for the Industrial Sector

Piling on to the concerns about the near-term outlook for growth in light of the United Kingdom's vote to leave the European Union is the latest read on the U.S. factory sector. Durable goods orders fell 2.2 percent in May, missing market expectations for only a 0.5 percent decline.

Payback from exceptionally strong defense orders the prior two months led the decline, with orders down 28 percent in May. The weakness in defense orders was concentrated in aircraft, helping to push total transportation orders down 5.6 percent. Nondefense aircraft orders looked a bit stronger, up 1.0 percent. However, orders for vehicles & parts continued to look weak, falling 2.8 percent. The pullback follows a slowdown in sales and elevated inventories at retail dealers the past two months.

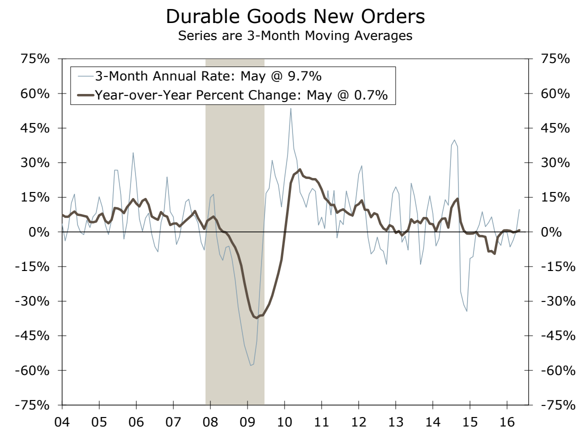
Most concerning was another decline in core capital goods orders. Orders for nondefense capital goods excluding aircraft fell 0.7 percent, the third decline in four months. On a three-month average annualized basis, orders are down 3.3 percent. That said, this marks an improvement in the trend, suggesting that while weak, the tide may be turning.

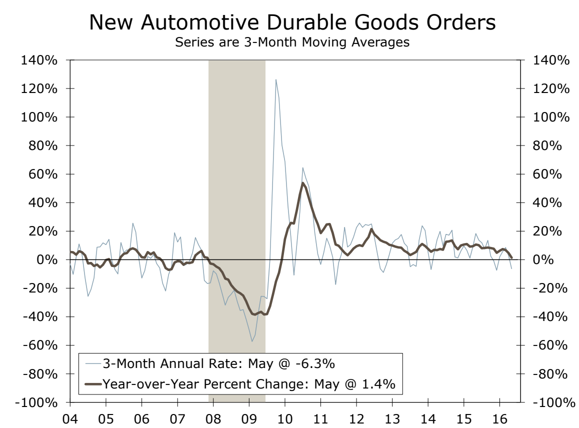
Nondefense capital goods shipments, which are more telling for business spending in the current quarter, offer some signs that equipment spending may still be positive in Q2. Shipments for this category were up 1.2 percent last month, which came on the heels of a similarly-sized gain in April. In addition, while new orders for core capital goods remained soft in May, unfilled orders edged higher.

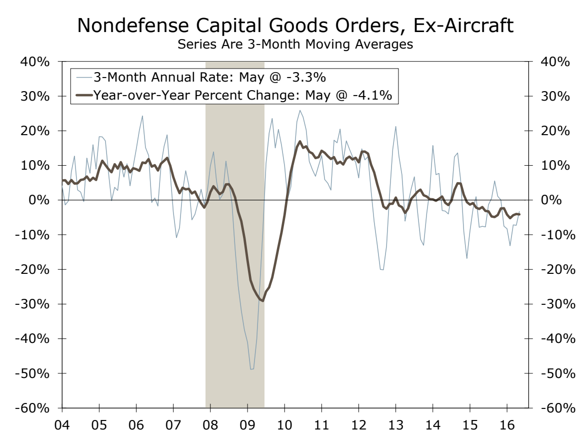
Renewed Risk to Business Spending Outlook

The referendum result in favor of the United Kingdom leaving the European Union has reintroduced some downside risks to our outlook for business spending. The headwinds from weaker global growth, the stronger dollar and lower commodity prices that challenged capital goods orders in 2015 and early 2016 had been easing the past few months, leading us to expect that equipment spending would turn positive after declining the past two quarters.

The referendum results risk igniting these threats again. While the overnight moves in the dollar and oil prices may be overstated given that it has been less than 24 hours since the vote came in, the direction is telling. The dollar has appreciated more than 2 percent against a major basket of currencies (led largely by strengthening against the pound). Oil prices have also moved lower, suggesting continued pressure on producers of commodity-related equipment. Perhaps most importantly for the U.S. industrial sector, the outlook for global demand looks weaker this morning than it did just a day ago given the added uncertainties surrounding the U.K. and euro area economies.







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

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