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Economics Group

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Another Month, Another Disappointing Durables Report

Durable goods orders fell short of expectations. While much of the miss can be traced to aircraft and defense, core orders and shipments remain relatively weak, especially when compared to recent PMI readings.

Core Capital Goods Orders Better, but Still Weak

In what has become an all too familiar pattern, durable goods orders once again disappointed in June. New orders fell 4.0 percent versus expectations for around a one percent decline, while previous month's data were revised lower.

Much of the headline's miss can be traced to notoriously volatile aircraft orders. Nondefense aircraft orders fell nearly 60 percent. June can be a big month for aircraft orders depending on whether the major European air show is hosted in Paris in June or Farnborough in July, as it was this year. Boeing reported only 12 aircraft orders in June, down from 125 in May and 153 last June, leaving orders looking even worse after seasonal adjustment (without seasonal adjustment, nondefense aircraft orders were down 31 percent).

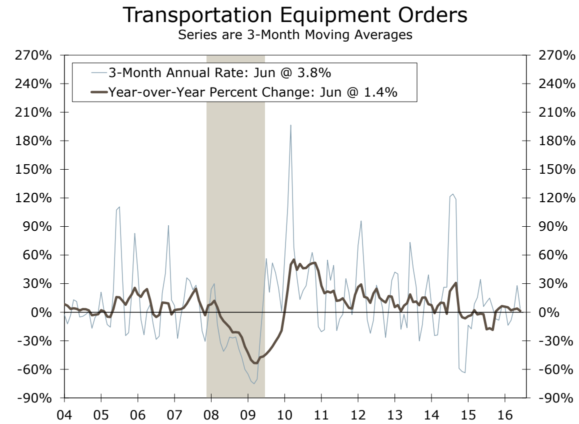
Stronger orders for motor vehicles offset some of the weakness in aircraft. Vehicles and parts orders rose 2.6 percent last month, but that only partially reverses May's decline and still leaves orders down 2 percent since February. With auto sales likely to move sideways over the remainder of the year, we do not expect motor vehicles orders to be a major source of support to durables orders like it was over the past two years.

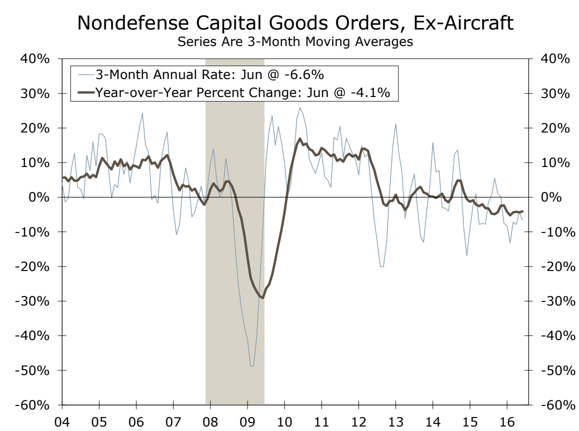
Ex-transportation, orders unexpectedly fell 0.5 percent. Moreover, May's decline was revised even lower, leaving non-transportation orders down at a 2.5 percent annual rate the past three months. Weakness in the defense space is partially to blame, after orders fell by more than 20 percent in each of the past two months. Core capital goods orders, however, remain soft. Nondefense capital goods orders ex-aircraft edged up 0.2 percent in June, but the gain follows two months of declines. On a three-month average annualized basis, orders are down 6.6 percent, which marks only a mild improvement from earlier in the year. While unfilled orders also fell in June, another decline in inventories at least suggests manufacturers are adjusting to the weaker pace of orders.

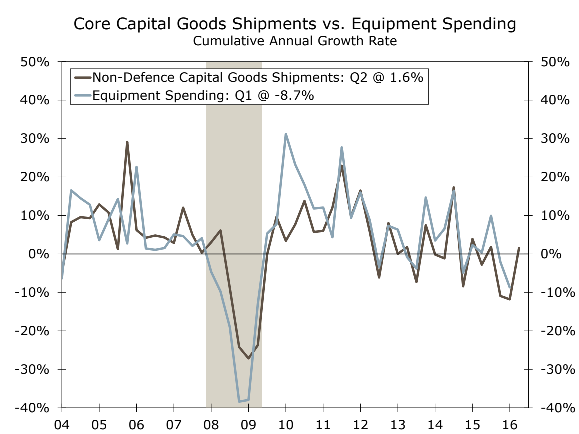
Q2 Equipment Spending Unlikely to Be as Weak as Core Orders

We have penciled in a modestly positive print for equipment spending in Friday's first look at Q2 GDP despite the softness in new orders. Nondefense capital goods shipments, which are more indicative of current business spending, fell 1.3 percent in June. The decline comes after two fairly strong months, however, and for the second quarter as a whole, nondefense capital goods shipments are up at a 1.6 percent annualized rate.

The decline in core orders in the second quarter hint that equipment spending may dip slightly again in the third quarter, but the modestly better trend and smaller inventories suggest that equipment spending should be stronger in the second half of the year.







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

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