

Economics Group

Tim Quinlan, Economist

tim.quinlan@wellsfargo.com • (704) 374-4407

Sarah Watt, Economic Analyst

sarah.watt@wellsfargo.com • (704) 374-7142

Jump in Durable Goods Belies Weakening Business Spending

A 1.6 percent jump in June durables goods orders was substantially better than the 0.3 percent gain the consensus expected. However, our key yardstick of business spending is signaling increasing weakness.

Headline Number Seems Out of Step With Other Recent Reports

Durable goods orders started the year on shaky footing. A 4.9 percent decline in January kicked off a run that resulted in shrinking orders for three out of the first four months of the year. Ironically, as other parts of the economy have faltered in recent months, durable goods orders have been picking up steam. Not only did today's print beat consensus forecasts, the increase in the prior month was upwardly revised. So what explains this apparent strength in an otherwise softening economy?

Aircraft and Defense Orders

The answer lies in a surge in transportation orders. These types of orders by their nature have an exceptionally long lead time, which explains why these components seem out of step with more recent trends. Defense capital goods orders, which comprise about 5 percent of total durables orders, surged a staggering 62.0 percent in the month. We do not have an immediate explanation for the jump here, but the last time we had an increase of this magnitude was in 2007 when we were actively fighting two wars. With a gradual drawdown of military presence overseas and looming potential defense spending budget cuts, it hardly seems reasonable to expect this to be a sign of things to come.

The other major jump in today's report was in nondefense aircraft, where orders increased 14.3 percent in June. A major domestic aircraft manufacturer has reported steady (though not overwhelming) increases in orders in recent months, so this increase does not come as a complete surprise.

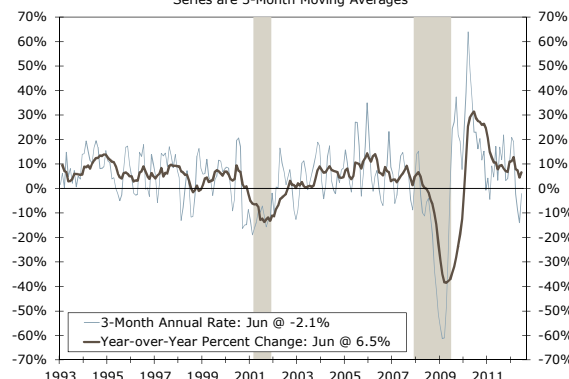
What Does This Tell Us About Business Spending?

When you exclude the volatile transportation sector, orders actually fell 1.1 percent, making June the weakest month for ex-transport orders since the 4.1 percent nosedive reported in January.

Our favored gauge of future business spending also fell into negative territory. Nondefense capital goods orders ex-aircraft fell 1.4 percent. On a 3-month annualized basis, this series has contracted at a 3.1 percent rate. Unfilled ex-defense orders also fell and have been weak for several months. What is particularly troubling now is that there appears to be few orders in the pipeline to sustain future growth. The reason we care so much about orders for non-defense capital goods orders, ex-aircraft is that, over time, it leads shipments of the same category which goes into the calculations for GDP. Keep in mind that it is not a perfect leading indicator. After all, orders can be cancelled, and that is more likely to happen in times when things are cooling off in the broader economy. Given the weakness in the orders components of recent purchasing managers' indices, we are getting worried about business spending.

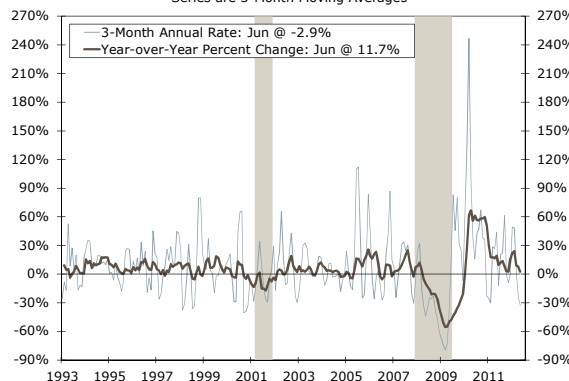
Durable Goods New Orders

Series are 3-Month Moving Averages



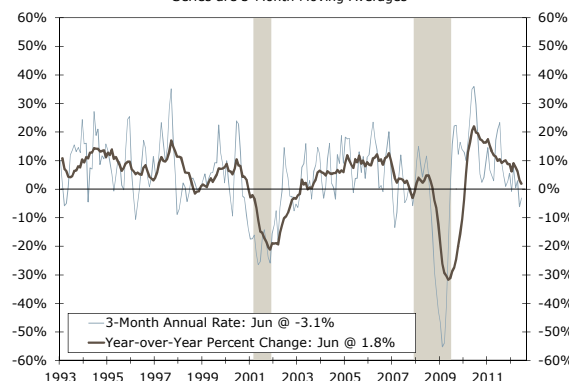
Transportation Equipment Orders

Series are 3-Month Moving Averages



Nondefense Capital Goods Orders, Ex-Aircraft

Series are 3-Month Moving Averages



Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research & Economics	(704) 715-8437 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wellsfargo.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wellsfargo.com
Scott Anderson, Ph.D.	Senior Economist	(612) 667-9281	scott.a.anderson@wellsfargo.com
Eugenio Aleman, Ph.D.	Senior Economist	(704) 715-0314	eugenio.j.aleman@wellsfargo.com
Sam Bullard	Senior Economist	(704) 383-7372	sam.bullard@wellsfargo.com
Anika Khan	Senior Economist	(704) 715-0575	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 374-4407	tim.quinlan@wellsfargo.com
Michael A. Brown	Economist	(704) 715-0569	michael.a.brown@wellsfargo.com
Sarah Watt	Economic Analyst	(704) 374-7142	sarah.watt@wellsfargo.com
Kaylyn Swankoski	Economic Analyst	(704) 715-0526	kaylyn.swankoski@wellsfargo.com
Peg Gavin	Executive Assistant	(704) 383-9613	peg.gavin@wellsfargo.com
Cyndi Flowe	Administrative Assistant	(704) 715-3985	cyndi.h.flowe@wellsfargo.com

Wells Fargo Securities Economics Group publications are produced by Wells Fargo Securities, LLC, a U.S broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes these publications directly and through subsidiaries including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Advisors, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. The information and opinions herein are for general information use only. Wells Fargo Securities, LLC does not guarantee their accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company © 2012 Wells Fargo Securities, LLC.

Important Information for Non-U.S. Recipients

For recipients in the EEA, this report is distributed by Wells Fargo Securities International Limited (“WFSIL”). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Services Authority. The content of this report has been approved by WFSIL a regulated person under the Act. WFSIL does not deal with retail clients as defined in the Markets in Financial Instruments Directive 2007. The FSA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, not will the Financial Services Compensation Scheme be available. This report is not intended for, and should not be relied upon by, retail clients. This document and any other materials accompanying this document (collectively, the “Materials”) are provided for general informational purposes only.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE