October 25, 2012

Economics Group

WELLS FARGO SECURITIES

Tim Quinlan, Economist
tim.quinlan@wellsfargo.com • (704) 374-4407
Sarah Watt, Economic Analyst
sarah.watt@wellsfargo.com • (704) 374-7142

Look Past Defense and Aircraft to See the Trend in Durables

The 9.9 percent bounce in durable goods orders in September was helped by the notoriously volatile aircraft and defense categories. Stripping out bookings for aircraft and defense, durable goods orders stalled.

Businesses Spending Stuck in Neutral

After plummeting 13.1 percent in August, durable goods order retraced some of the lost ground in September, with a headline increase of 9.9 percent. While that represents the largest monthly increase since January 2010, the details of this report take most of the shine off the apple.

With all the “soaring” and “plunging” in the durable goods reports lately, it is a good time to reflect on the fact that aircraft orders bring a certain amount of choppiness to the data. However in recent months, this series has become the tail that wags the dog. When you take defense spending and aircraft orders out of the report, we are left with an increase in capital goods orders of just 0.2 percent in August, and no change in orders for September.

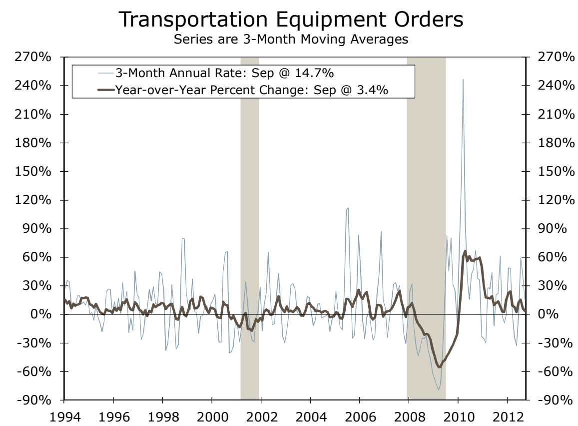
That is not to say that there are no pockets of strength. Machinery orders and primary metals orders both increased in September but, in both instances, the gains were set up by declines in these categories in August.

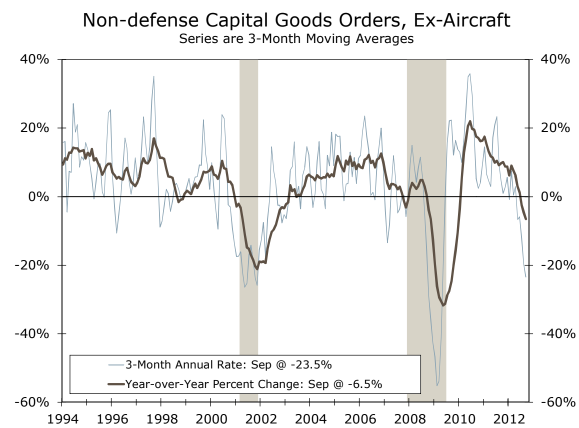
Other sectors revealed weakness in various durable goods categories. Orders for vehicles and parts, fabricated metals as well as computers and electronics all posted declines for the second consecutive month. Electrical equipment, which had increased 2.8 percent in August following back-to-back declines in the prior two months, gave back most of the August bump, falling 2.7 percent in today’s September report.

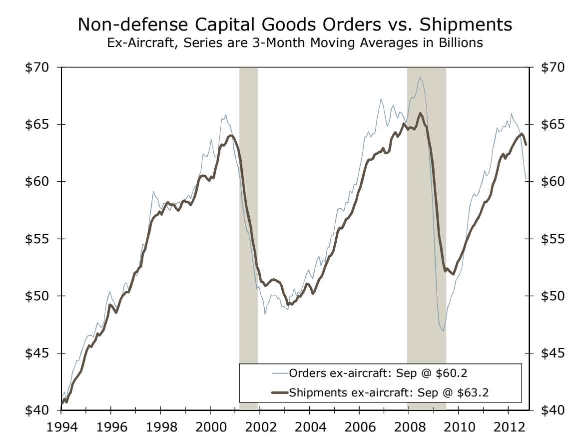
Non-Defense Capital Goods Orders and Shipments

Today’s report confirms our warnings over the past few months about a potential weakening in the pace of business spending. Non-defense capital goods orders ex-aircraft are now falling at a 23.7 percent pace on a three-month average annualized basis. In the past 20 years, declines of that magnitude have always been followed by recession. We do not think that will be the case in this cycle as growth in consumer spending and trade will likely offset the weakness in business spending. We also suspect that the weakness may be temporary, reflecting a bit of “wait-and-see” mentality from business leaders as we approach the election and the fiscal cliff.

The shipments of non-defense capital goods, which feeds into the GDP report, is now off 4.9 percent on a 3-month annualized basis. One take-away here is that equipment and software spending will likely post a modest decline in the third-quarter GDP report. Somewhat more alarming is that with orders falling faster than shipments (see bottom graph at right), it is possible that business spending will fall even more in the final quarter of the year. That said, a year-end expiration of a tax credit for business spending may pull forward some demand into the final months of the year and somewhat offset the slowdown.







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

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(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
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
Sara Silverman	Economic Analyst	(704) 715-7395	sara.silverman@wellsfargo.com
Zachary Griffiths	Economic Analyst	(704) 715-1030	zachary.griffiths@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