February 27, 2013

Economics Group

WELLS FARGO SECURITIES

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Durable Goods Soar and Plunge in the Same Report

Today's big drop in durable goods is mostly a reflection of weak aircraft orders and a giveback in defense spending after a large gain last month. But, a huge jump in core capital goods orders gives a mixed message.

The Headline Decline Overstates the Weakness

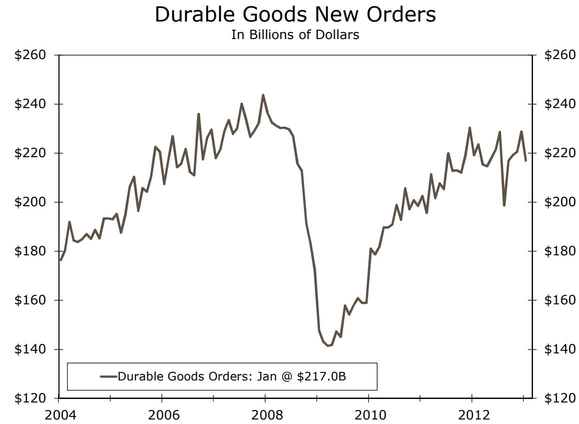
The 5.2 percent drop in durable goods orders was the second largest monthly decline since the financial crisis in the autumn of 2008. The decline was enough to offset three consecutive months of increases and sets the overall level of durable goods orders back to a level last seen in September. The weakness was primarily attributable to the transportation sector where we have seen ongoing weakness in recent months. As a whole, transport orders fell 19.8 percent, the third monthly decline in the past four months. Orders for motor vehicles stalled, but the big area of transport weakness was in nondefense aircraft, where orders dropped 34.0 percent in January.

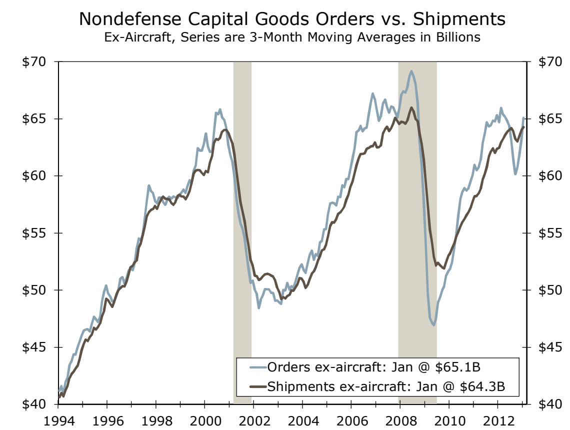
Defense orders dropped 69.5 percent in January, which would ordinarily be alarming, but after defense orders more than doubled last month, a big payback is not nearly as unnerving as it might be otherwise.

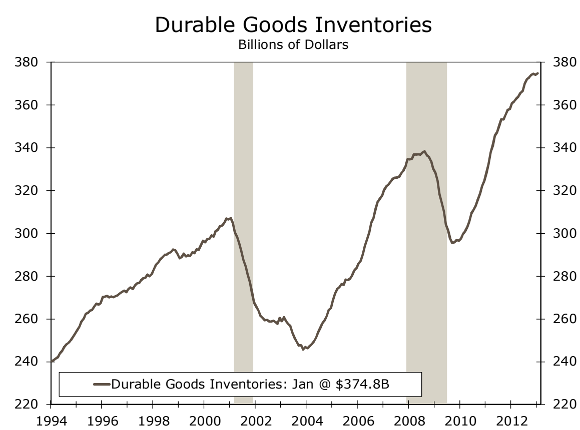
The final troubling aspect of this report is that shipments of non-defense capital goods ex-aircraft fell 1.0 percent in January. This series rolls up into BEA calculations for business spending in the GDP report and suggests a soft start to business spending in the new year, which is what we have been warning about for months. Having said that, some clear positives in today's report suggest that while there is still a lot of uncertainty, the clouds may be lifting somewhat.

What About That Stellar Gain in Core Capital Goods Orders?

While *shipments* for core capital goods fell in the month, *orders* for this series posted a much better-than-expected gain. Indeed the 6.3 percent month-over-month increase for core capital goods orders in January is spitting distance from the eight-year high of 6.7 percent set back in March 2010. It is difficult to reconcile such a surge in capex spending when there are so many indications of apprehension in various measures of business confidence. The Philadelphia Fed index, for example, signaled contraction in its new orders component for January, and then, an even faster rate of contraction in February. Other measures, such as the New York Fed's Empire State index, have showed growing confidence. The national ISM manufacturing index for February is due out on Friday and may give a better indication of where orders are headed after this apparent surge in January. We would be remiss to dismiss the gains offhand, although we suspect that the euphoria may be short lived and some payback may be lurking in February. The inventories-to-shipments ratio climbed to 1.66 from 1.64 suggesting that stockpile building is outpacing demand. This could be trouble considering that unfilled orders also fell in the month. We look for business fixed investment spending to firm as the year goes on, but the jump in core capital goods orders in today's report does not quite signal the all clear.







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

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