



Economics Group

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Don't Overreact to the Big Drop in Durable Goods Orders

Today's 5.7 percent drop in durable goods orders was a much larger decline than had been expected. Core capital goods orders were weak as well, and last month's gain in orders was revised down. Do not panic.

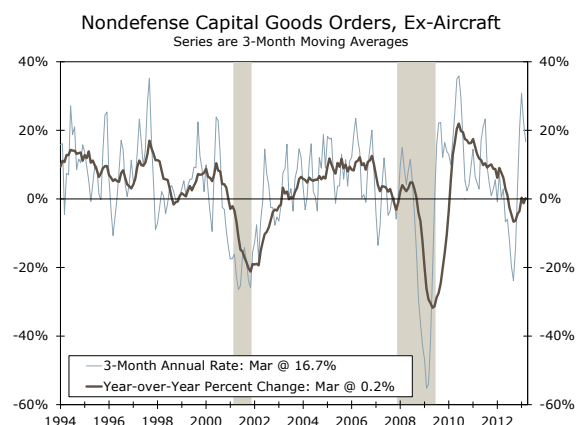
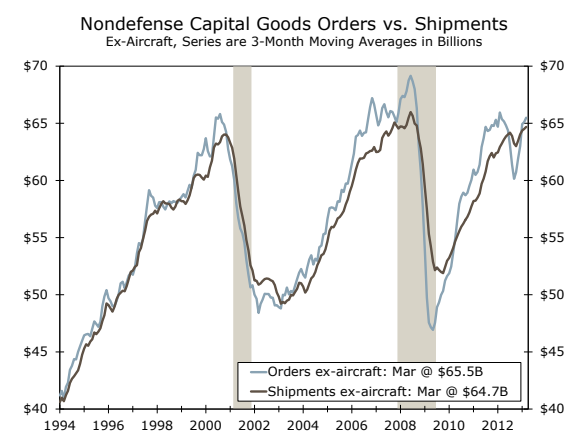
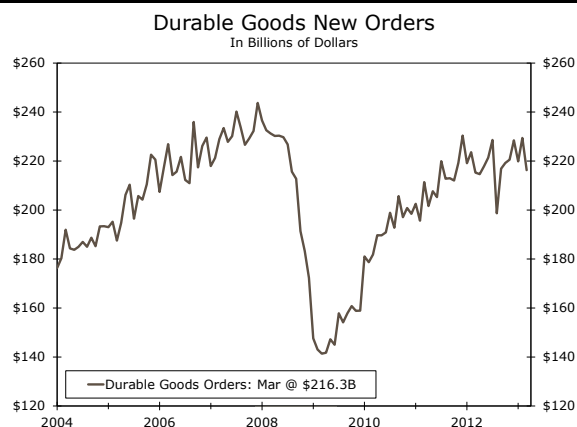
Look Past the Flashy Volatility to Find the Boring Trend

In August of last year, we rang the warning bell on the outlook for business spending as survey data and our read of the landscape in the factory sector signaled weakness. In the ensuing months, we saw the momentum in orders begin to slow and then fall outright. By autumn, the level of core capital goods shipments began to exceed the level of orders—never a good sign. The trend was not looking good either, as evidenced by the plunge in the 3-month annualized rate of change in core capital goods orders which fell to a negative 23.8 percent in September of last year. At that point we became slightly more concerned about the business spending outlook, but it was difficult to separate a temporary setback related to anxiety over the fiscal cliff and the ongoing slowdown in Europe from something more fundamental and long lasting in the final months of the year. Sure enough, a few months later, core capital goods snapped back and today are growing at 3-month annualized rate of more than 15 percent and orders are once again greater than shipments. This is a positive for business spending in the second quarter.

Our overall sense is that the month-to-month volatility in these orders figures is a manifestation of fiscal cliff worry/relief combined with some quirkiness in the seasonal adjustment. January tends to be a weak month for durable goods orders as bookings typically fall off in the first month of the new year. Due to substantial drops in January of 2009 (right after the financial crisis) the seasonal adjustment can lead to big swings in the early months of the year. On a non-seasonally adjusted basis, durable goods orders actually increased in March to approximately \$234 billion, down just 2.1 percent from \$239 billion in December. That tells us that the business spending environment is simply off to a slow start at the beginning of this year, which has been our forecast throughout these monthly ups and downs.

That is not to say that things are fine. It is clear to us that the contribution to overall economic growth from business fixed investment spending is not going to be what it was in 2010 and 2011. In those years right after the recession, large percentage gains were rather easy coming off the low base made possible by massive declines in business spending in 2009.

Survey data like the ISM manufacturing index and the various regional PMIs are generally positive, though not at levels we would expect to see in order to be consistent with robust spending. In terms of total output, we have turned the corner from recovery to expansion. We still expect to see slow overall economic growth of roughly 2 percent this year and while business spending will not be a drag on GDP growth, do not look for it to be the key locomotive as it was early on in the recovery.



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