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Economics Group

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How Is Today's Decline in Factory Orders Good for GDP?

After three-straight monthly gains, factory orders gave back 0.5 percent in May. Despite cutbacks in defense spending (which we already knew about from durables) the new data in today's report is good for growth.

Look Past the Decline

As first impressions go, today's factory orders report is not who you want to find standing in your lobby with an update on the manufacturing sector, reporting a larger-than-expected decline. But the more you dig into this report, the more you find encouraging details.

For starters, the decline is coming off a higher base, thanks to an upward revision to April's previously-reported increase. Additionally, after stringing together three-straight monthly gains, factory orders were vulnerable to a modest payback. In fact, we already knew that durable goods fell 1.0 percent in May, but that decline was revised to 0.9 percent in today's report. Other than revisions, the "new" data in today's report is what happened with nondurable goods; what we learned today is that nondurable goods orders increased 1.1 percent in May, the third-straight monthly gain. As we said about the durables report last week, the details of the report are broadly encouraging and we continue to expect activity in the factory sector to pick up in the months ahead.

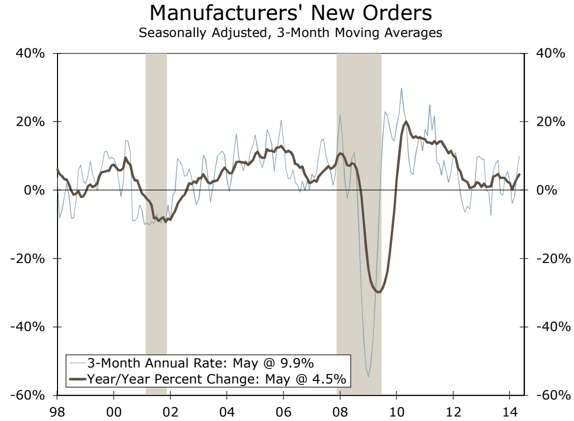
Auto sales at the retail level jumped above an annualized rate of 16 million in May and we found out yesterday that June sales figures lifted that rate to 16.9 million—the fastest clip in more than eight years. Wholesale orders for motor vehicles and parts increased for the fourth-straight month, adding another 0.5 percent in May. The strength for retail vehicle sales in June raises prospects for this summer's industrial production numbers and suggests the recent surge in wholesale motor vehicle orders is justified.

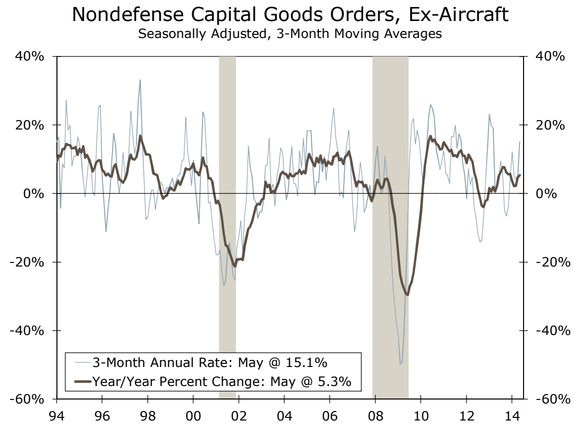
Core capital goods orders, which exclude the defense and aircraft sectors, shows momentum in the manufacturing sector is picking up. Core capital goods orders rebounded in May and after accounting for upward revisions to prior months data are now rising at a 15.1 percent rate on a three-month annualized basis.

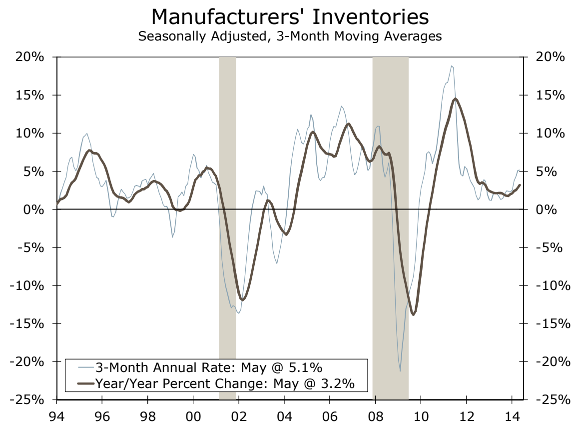
Second Quarter Is Looking Better

With another modest gain in May, shipments are up for four straight months and core capital goods shipments, which still offer a good preview for business spending in GDP, have risen to an 8.4 percent annualized rate, and bode well for Q2 growth.

Speaking of GDP, inventories were the largest overall drag on first quarter GDP, subtracting 1.7 percentage points from what was already a lousy start to the year. Inventories increased 0.5 percent in April and today's report showed that stockpiles increased another 0.8 percent in May. The takeaway here is that inventories are poised to go from zero to hero in terms of contribution to GDP in the second quarter.







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

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