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Economics Group

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Durable Goods Show Pickup in Manufacturing Still on Track

Durable goods orders rose 2.0 percent in July, beating expectations for a small decline. Defense orders and autos boosted the headline, but the increase in core orders points to factory activity gaining some momentum.

Good, But Not as Great as Headline Suggests

The 2.0 percent increase in durable goods orders in July suggests the modest pickup in the factory sector remains on track after a tough start to the year. Revisions were also positive, with new orders for June now reported to have risen 4.1 percent on stronger core capital goods and defense orders.

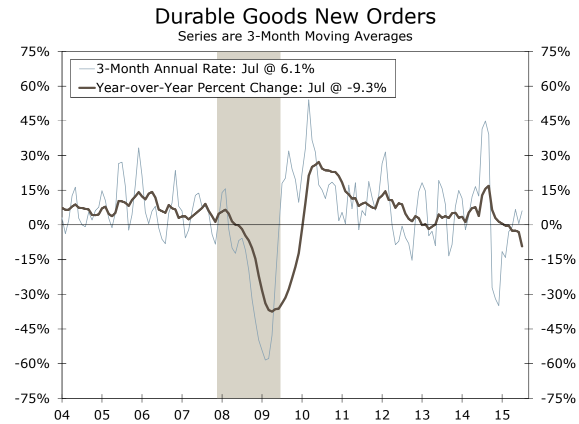
While July's report was better than the market's expectation for a small decline, a few categories take some of the shine off the gain. Transportation orders notched a solid increase thanks to a 4.0 percent jump in auto orders. While impressive, the rise in orders is likely inflated by the changing patterns of summer auto shutdowns. New orders for motor vehicles and parts on a non-seasonally adjusted basis actually fell nearly 20 percent in July, but the shortening, or in some cases forgoing, of plant closings for the model year changeover made the drop look relatively minor compared to prior years. That said, we would be wrong to completely dismiss this month's print. The shorter shutdowns are indicative of broader strength in the auto sector, where orders are up 6.5 percent over the past year versus a drop of 2.8 percent in ex-transportation orders.

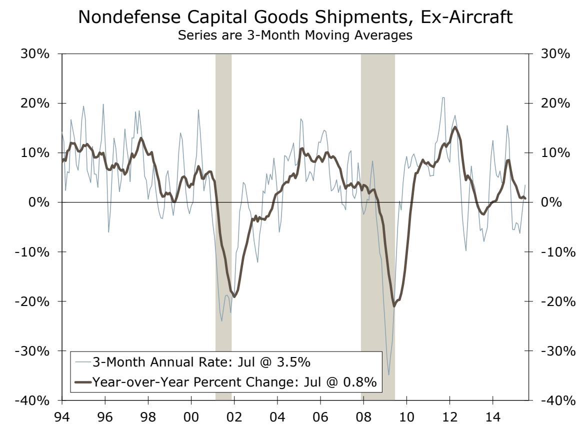
A 22.3 percent pop in defense orders, which are not indicative of businesses' willingness to invest, also contributed to the stronger outturn for July. That said, our preferred gauge of business spending, nondefense capital goods orders ex-aircraft, saw the largest increase in more than a year. With last month's upward revision, core orders are gaining momentum, even as the pace remains modest compared to last year's clip.

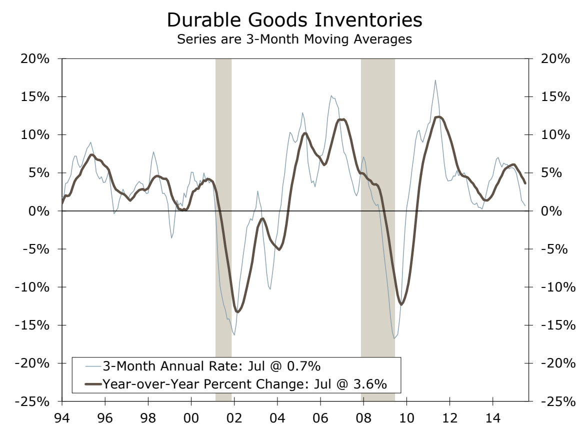
Shipments data suggest recent business spending has picked up, which should be positive for equipment spending. After largely moving sideways over the first half of the year, core capital goods shipments rose 0.6 percent in July on top of an upwardly revised figure for June. Inventory growth stalled in July, which should help businesses right-size stocks, but as we recently warned in "*Raining on the Parade*," the slower pace could be a significant drag on Q3 GDP.

Outlook for Business Spending Still Tepid

Despite today's better-than-expected report, the outlook for near-term capital spending remains rather soft. The first of the August PMIs showed new orders growing at a slower rate in the Philadelphia Federal Reserve District, nearly stalling in the Richmond District and contracting sharply in the New York region. In addition, the major headwinds that have weighed on the manufacturing sector this year have continued to blow, with growth overseas looking more fragile and the broad dollar index strengthening further in recent weeks. We expect equipment spending to rebound modestly in Q3, but to not fully reverse last quarter's 4.1 percent pullback.







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

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