April 04, 2016

Economics Group

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Factory Orders Revisions Are Killing Outlook for Q1 Spending

With prospects for only scant gains in first quarter equipment spending, today's report on the factory sector indicates an increased risk that equipment outlays will decline again in the first quarter.

Revisions Are Killing First Quarter Business Spending Estimates

We already knew from the last advance manufacturing report that durable goods orders dropped in February. The magnitude of that decline was revised to a larger 3.0 percent from 2.8 percent previously. More troubling is the fact that a lot of the downward revision showed up in non-defense capital goods, ex-aircraft. In the advance report, the dip for core capital goods orders was just 1.8 percent; today's report marked that down to a 2.5 percent drop. Shipments of core capital goods are a reliable bellwether for business spending in the GDP report. The three-month annualized rate of decline for core capital goods orders is now at 10.2 percent while shipments are now falling at a 7.7 percent clip.

Based on firming in the orders components of some of the purchasing manager surveys, many analysts penciled in modest improvement in first quarter business investment spending figures. Based on this latest read and downward revisions to previously reported figures, those estimates will likely be coming down, and with prior estimates already just barely positive, that likely means outright declines now for equipment outlays in the first quarter. Any expected firming based on the improvement in the PMIs is delayed until the second quarter.

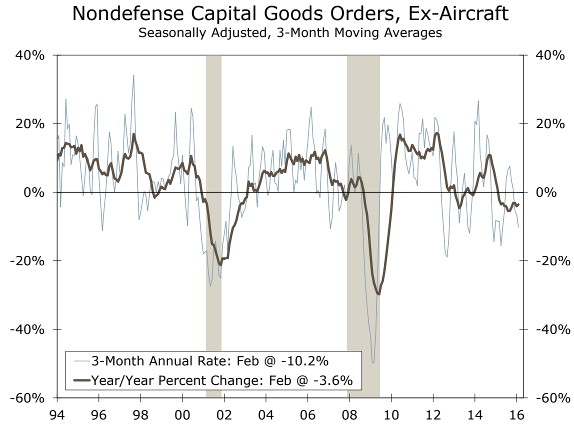
Inventories Still a Drag Too

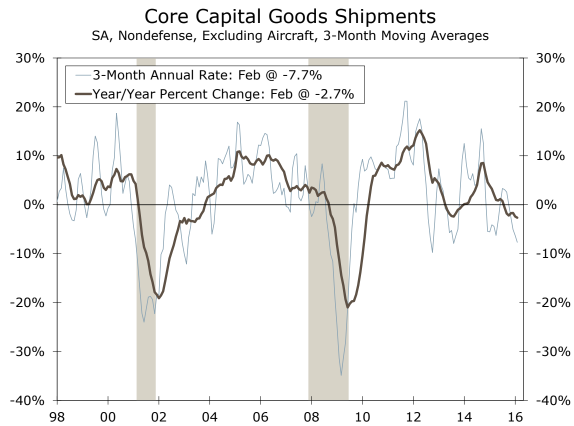
The inventory correction continues and that was evident in the 0.4 percent decline in factory inventories in February. This is consistent with our expectation that inventories will also be a drag on headline GDP growth again in the first quarter.

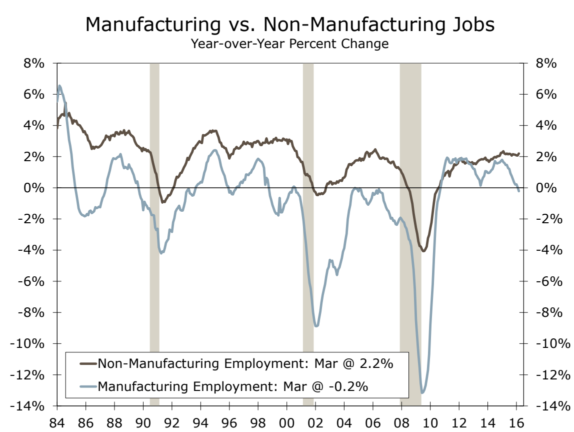
We have noted previously that manufacturers are doing a better job rightsizing production to a slower pace of demand. The inventory-to-shipments ratio held at 1.37 for the third straight month. Another piece of evidence to support this view is the fact that manufacturing payrolls have declined for the past two months. The net loss of 47,000 manufacturing jobs in the past two months alone has been overshadowed by stronger job growth in other industries, but it points to another challenge that the Fed will face as it tries to raise rates this year.

A Springtime Thaw?

The turning of the calendar to 2016 did not change the downward momentum in the factory sector. But as winter turns to spring, some of the headwinds may be calming. The dollar remains strong, on balance, but relative to our major trading partners the greenback is actually down about 4.5 percent since January. Commodities are still depressed, but the CRB index has gained more than 8 percent since January. The return to expansion in a number of Fed surveys (New York, Philadelphia, Richmond) may reflect this relative improvement.







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

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