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# Economics Group


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# The Best Defense Is No Offense for Capital Goods Spending

***Durable goods orders leapt 2.4% in December, but excluding the defense sector, orders fell 2.5%. Ex-aircraft, capital goods orders declined 0.9% and signal business spending is set to remain weak in the coming quarters.***

## Defense Orders Surge, but Private Capex Orders Still Struggling

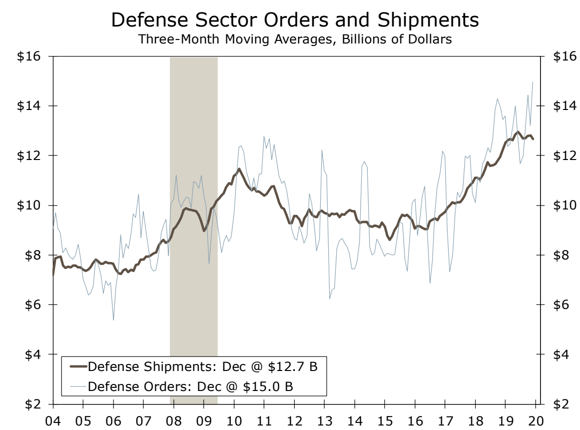
The headline beat on durable goods orders is not nearly as good as it seems. Total orders increased 2.4%, well above the consensus expectation for a 0.4% gain, but a number of factors take the shine off the increase. For starters, last month's 2.1% decline was revised down to an even worse 3.1% fall. Moreover, the beat came entirely from defense orders, with private business spending continuing to flounder.

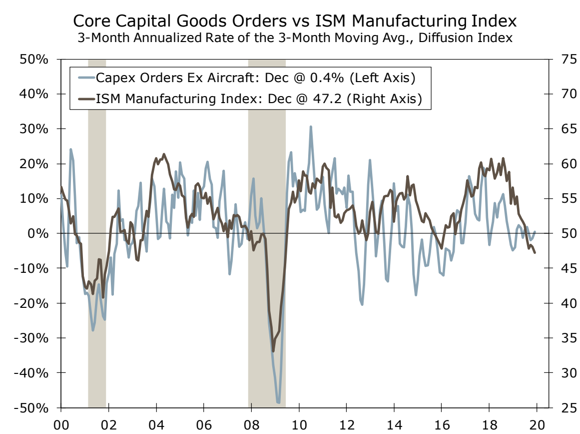
For a second straight month, defense orders roiled the headline, this time leaping more than 90%. That more than reversed last month's plunge and drove orders to the second highest level this cycle. Defense shipments, on the other hand, fell for a second straight month (down 2.5% in December) and suggest that the surge in orders will not be in time to fend off a slowdown in government spending in Q4's GDP report, to be released on Thursday.

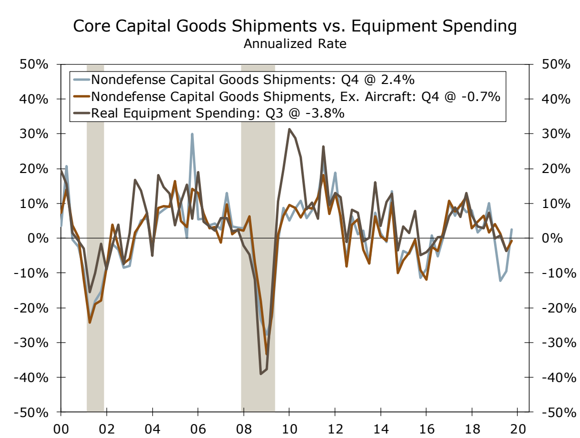
Excluding the defense sector, orders fell 2.5% and have not notched a gain since July. Civilian aircraft continues to be a major point of pressure amid the ongoing fallout of Boeing's 737 MAX issues. Boeing announced it received only three new orders in December 2019. Not only was that down from November's 63 orders, but it was scant compared to the 200+ orders booked in each of the prior four Decembers. With seasonal factors and a few net cancellations, by our tracking, the value of nondefense aircraft orders fell 75% in December.

Outside of aircraft, private capital goods orders also remained weak. Core capital goods orders fell 0.9% in December, while November is now reported to have barely notched a gain (up only 0.1%). On a three-month average annualized basis, nondefense orders ex-aircraft are running at only a 0.4% pace. That continues to look stronger than the widely watched ISM index, but is far from inspiring. Even as uncertainty surrounding trade policy has eased up a bit and global manufacturing activity has shown tentative signs of stabilizing over the past month or two, we still expect capital goods spending to remain weak in the coming quarters.

Business spending is far from collapsing, however, and today's report offers additional evidence that equipment outlays are at least beginning to steady. Nondefense capital goods shipments, which feed into the BEA's GDP calculations, rose 0.5% in December and at a 2.4% annualized pace in Q4. That suggests that the fourth quarter print for equipment spending is unlikely to repeat the nearly 4% annualized drop registered in the third quarter. We look for equipment spending growth to come in roughly flat in real terms in Thursday's GDP report. Equipment spending continues to be held down by Boeing's suspension of shipments, but the flip side is that inventories continued to grow through December, with total manufacturers' inventories up 0.5% and nondefense aircraft and parts inventories up 2.8%.




Source: U.S. Department Commerce, Institute for Supply Management and Wells Fargo Securities

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