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December Durable Goods

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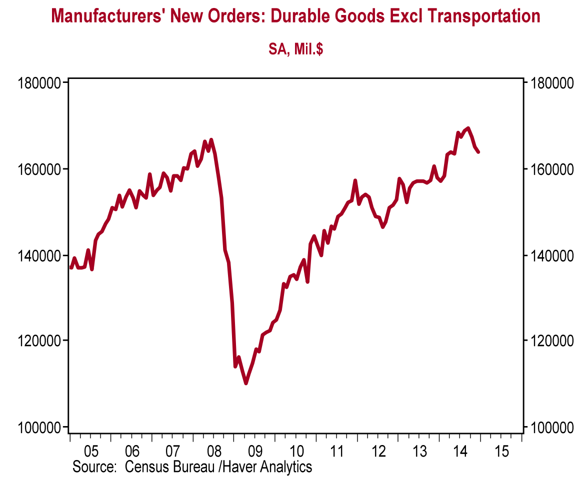
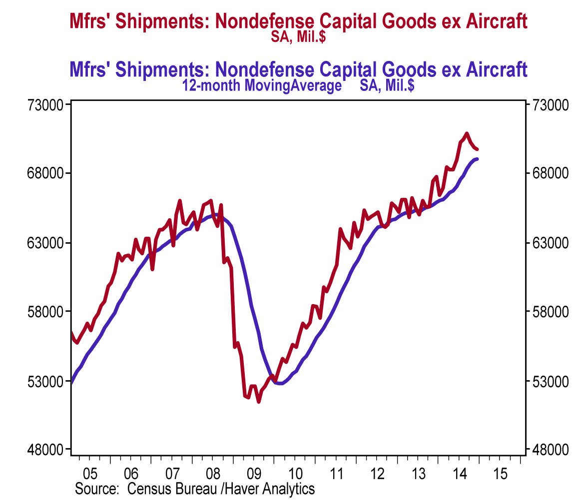
- New orders for durable goods declined 3.4% in December (-4.6% including revisions to prior months), well below the consensus expected gain of 0.3%. Orders excluding transportation declined 0.8% in December, below the consensus expected gain of 0.6%. Orders are up 0.3% from a year ago while orders excluding transportation are up 3.8%.
- The decline in overall orders was led by aircraft and machinery. The largest gain was for autos.
- The government calculates business investment for GDP purposes by using shipments of non-defense capital goods excluding aircraft. That measure declined 0.2% in December (-0.6% including revisions to prior months). These shipments declined at a 3.3% annual rate in Q4 versus the Q3 average.
- Unfilled orders slipped 0.8% in December but are up 10.1% from last year.





Implications: It's certainly not good when orders for durable goods decline rather than rise, but we would take the 3.4% drop in December with a big grain of salt. Almost all of the decline was in the transportation sector, led by aircraft, orders for which are extremely volatile from month to month. Outside the transportation sector, orders still slipped 0.8%, but are up 3.8% from a year ago. Orders ex-transportation are down three months in a row, but these orders were down five months in a row in mid-2012 even as the economy was expanding at a 2% annual rate. What we're probably seeing is some reaction to lower oil prices, which is reducing orders for equipment used to explore for oil. Next week's report on factory orders will provide more details. The worst news in today's report was that "core" shipments," which exclude defense and aircraft, declined 0.2% in December and were down at a 3.3% annual rate in Q4 versus the Q3 average. As a result, it now looks like business investment in equipment shrank at a 3.5% annual rate in Q4. In turn, we're marking down our forecast for Q4 real GDP growth to a still healthy 3.1% annual rate from a prior estimate of 3.3%. Keep in mind, though, that the drop in orders is not consistent with ongoing gains in manufacturing production. Signaling future gains in output, unfilled orders for "core" capital goods rose 0.2% in December, hit a new record high, and are up 8.6% from a year ago. Expect more of the same, as lower oil prices mean higher production outside the oil sector. Orders and shipments for durables should accelerate in the year ahead. Consumer purchasing power is growing with more jobs and higher incomes, while debt ratios remain very low, leaving room for an upswing in big-ticket spending. Meanwhile, profit margins are high, corporate balance sheets are loaded with cash, and capacity utilization is breaching long-term norms, leaving more room (and need) for business investment. In other news this morning, the Richmond Fed index, which measures mid-Atlantic manufacturing sentiment, came in at +6 in January versus +7 in December, signaling continued growth.

Durable Goods *All Data Seasonally Adjusted*	Dec-14	Nov-14	Oct-14	3-mo % ch. annualized	6-mo % ch. annualized	Yr to Yr % Change
New Orders for Durable Goods	**-3.4%**	-2.1%	0.3%	-19.3%	-11.4%	0.3%
Ex Defense	**-3.2%**	-1.4%	-0.7%	-19.5%	-10.1%	-0.7%
Ex Transportation	**-0.8%**	-1.3%	-1.2%	-12.3%	-5.5%	3.8%
Primary Metals	**-1.5%**	-3.4%	-2.0%	-24.6%	-8.9%	2.6%
Industrial Machinery	**-3.7%**	-0.9%	-2.1%	-23.8%	-18.3%	-6.2%
Computers and Electronic Products	**-1.3%**	-0.5%	0.0%	-7.0%	-5.8%	6.8%
Transportation Equipment	**-9.2%**	-3.9%	3.5%	-33.7%	-23.7%	-7.2%
Capital Goods Orders	**-9.3%**	-2.6%	1.0%	-36.6%	-25.3%	-9.1%
Capital Goods Shipments	**0.4%**	-1.0%	-1.0%	-6.1%	3.6%	3.6%
Defense Shipments	**2.2%**	1.5%	1.5%	22.8%	16.7%	3.0%
Non-Defense, Ex Aircraft	**-0.2%**	-0.6%	-0.9%	-6.4%	2.3%	3.0%
Unfilled Orders for Durable Goods	**-0.8%**	0.2%	0.5%	-0.6%	12.8%	10.1%

Source: Bureau of the Census