January’s Signs of Stronger Core Capex Orders May Not Last

Efforts to contain the spread of COVID-19 bring the potential to disrupt U.S. manufacturing. Ahead of the outbreak, core durable goods orders showed some signs of firming, but capex spending is set to remain weak.

Uncertainty in Manufacturing Sector Reigns

The manufacturing sector cannot catch a break. As soon as the risk of a further escalation in the trade war with China cooled with the signing of the Phase 1 trade deal, the COVID-19 virus emerged. The outbreak has brought the potential for severe disruptions to supply chains and, depending on the path of the virus and measures taken to contain its spread, demand. Uncertainty remains a major headwind to capex spending as a result.

For now, there is little data available to discern how the measures being taken to contain the virus—including travel restrictions and extended factory shutdowns in China—are affecting the U.S. manufacturing sector. Only a handful of purchasing managers’ indices are available for February. On an ISM-weighted basis, an average of the New York, Philadelphia, Richmond and Dallas Fed surveys showed activity edging up a touch to a 17-month high. However, the surveys are skewed heavily toward activity early in the month and are more oriented to the East Coast.

The nationally representative preliminary Markit manufacturing PMI slipped more than a point in February and suggests U.S. factory activity is barely expanding. We will closely look at the February ISM manufacturing index and final Markit print on Monday, but even then we would expect to see few hints of how the outbreak is affecting production at this point.

Capex Spending WAS Beginning to Firm

That leaves us with assessing the state of the U.S. manufacturing going into the outbreak. Durable goods orders in January edged down 0.2%, beating consensus expectations of a 1.4% decline. Orders for December also looked slightly stronger, revised up from 2.4% to 2.9%.

The better-than-expected print stemmed in part from a jump in aircraft orders (after seasonal adjustment at least). Notably, however, there were signs that the underlying trend in capital spending was at least beginning to improve through January, likely helped by waning trade tensions. Orders for nondefense capital goods orders ex-aircraft jumped 1.1%, while December’s drop is now reportedly smaller. On a three-month average annualized basis, core capital goods orders are up 1.8%, the strongest showing since the trade war flared up again last August.

The better orders numbers in January may not be in time to save capex spending for the current quarter, however. Nondefense capital goods shipments, which feed into the BEA’s estimates of equipment spending, started the quarter on an abysmal footing, dropping 1.7%. That points to some risk of a third straight quarterly decline in real equipment outlays, even before the potential for capex spending to be hit by production disruptions and added uncertainty for businesses in light of the fluid COVID-19 situation.

Source: ISM, Federal Reserve Board, IHS Markit, U.S. Dept. of Commerce and Wells Fargo Securities