

US FEB. DURABLE GOODS MANUFACTURING STRONG AMID GROWN UNCERTAINTIES

**U.S. durable goods orders and shipments were strong in February, putting real business fixed investment on track for sustained healthy gains in Q1. Durable orders advanced 3.1% m/m, with the volatile nondefense aircraft category (+26% m/m) responsible for a large chunk of the gains, but orders excluding transportation rose by a solid 1.2% m/m, the best gain since October*

**Durable goods shipments increased 0.9% m/m and core shipments (nondefense capital goods ex aircraft), a proxy for business equipment investment in GDP, advanced 1.4% m/m, the best gain since December 2016. Core shipments have grown over 9% yr/yr in four of the last five months (Chart 1), reflecting business confidence in the economic outlook and suggests that businesses are responding positively to the Tax Cuts and Jobs Act. These trends support our expectation that real business fixed investment will grow 7% this year*

The robustness in core durable goods shipments is noteworthy, as it has increased for 13 consecutive months, the longest streak in the 26-year history of the series (Chart 2). The outsized 1.8% m/m (+7% yr/yr) gain in core durable orders suggests that underlying manufacturing demand is strong and factory activity is poised to remain elevated in coming months.

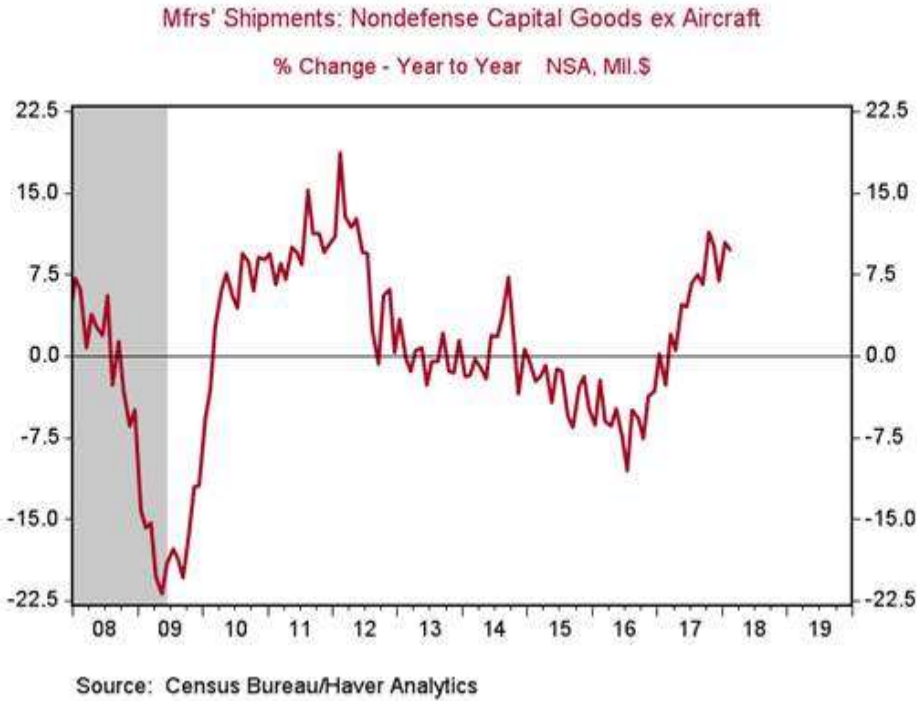
The outperforming durable shipments reflect the strength in the global industrial sector: primary metals (+13% yr/yr), fabricated metals (+9% yr/yr), and machinery (+11% yr/yr). Shipments of defense capital goods, which have accelerated since mid-2017, should benefit from the \$165bn increase in the budget authority for defense and national security spending in fiscal years 2018 and 2019 (Chart 3).

Durable goods inventories advanced by a moderate 0.4% m/m, but with the inventories-to-shipments ratio for durable goods now at a three-year low, a continued ramp-up in near-term production will be needed to meet demand (Chart 4).

Other business indicators reflect solid activity: Industrial production of business equipment advanced 1% m/m in February and manufacturing sentiment surveys through the first half of March have remained elevated (Chart 5). But risks abound: 1) the unease and uncertainties surrounding global trade policy; and 2) higher supply chain prices, input and labor costs for manufacturing industries. At the moment, we expect the impact of tariffs to be small and input price inflation to be manageable for firms, but we will continue to monitor these headwinds closely. Positive developments such as increased government spending for defense and other infrastructure-related projects will provide an additional boost for businesses.

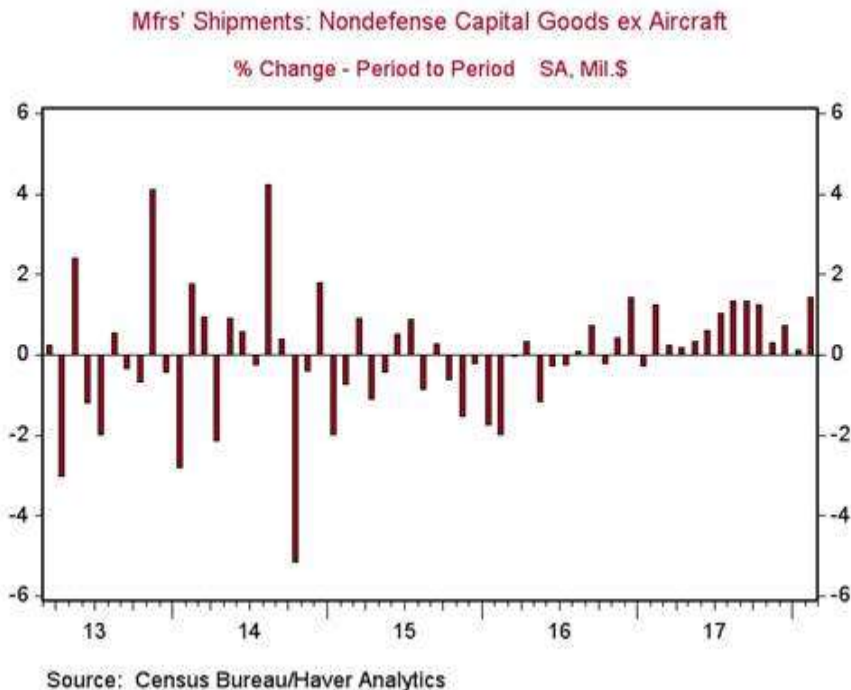
23 March 2018

Chart 1: Shipments of Nondefense Capital Goods Ex Aircraft (year-over-year, %)



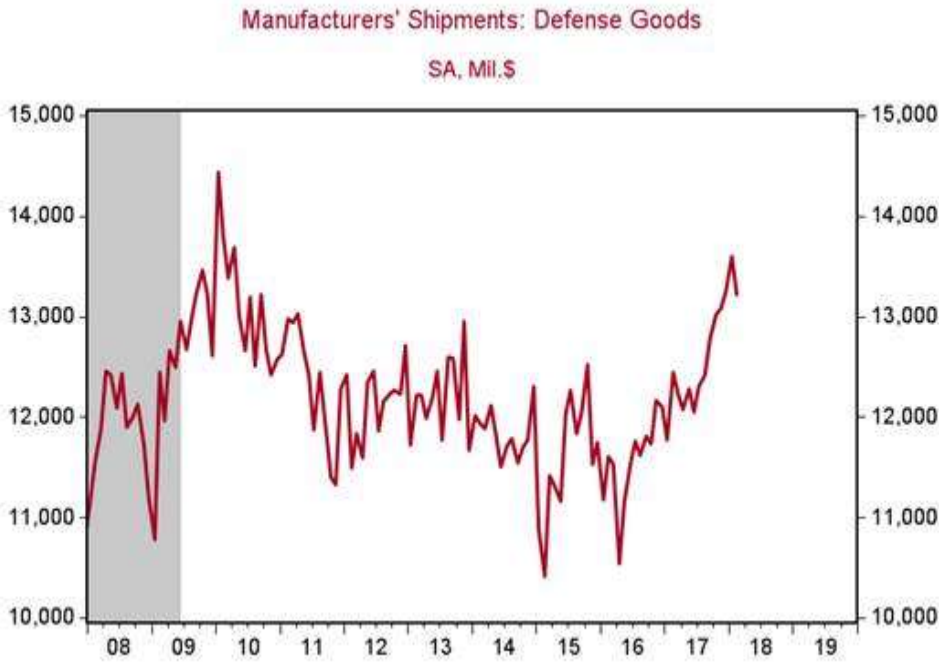
Source: Monthly data. Source: Census Bureau and Haver Analytics

Chart 2: Shipments of Nondefense Capital Goods Ex Aircraft (month-over-month, %)



Source: Monthly data. Source: Census Bureau and Haver Analytics

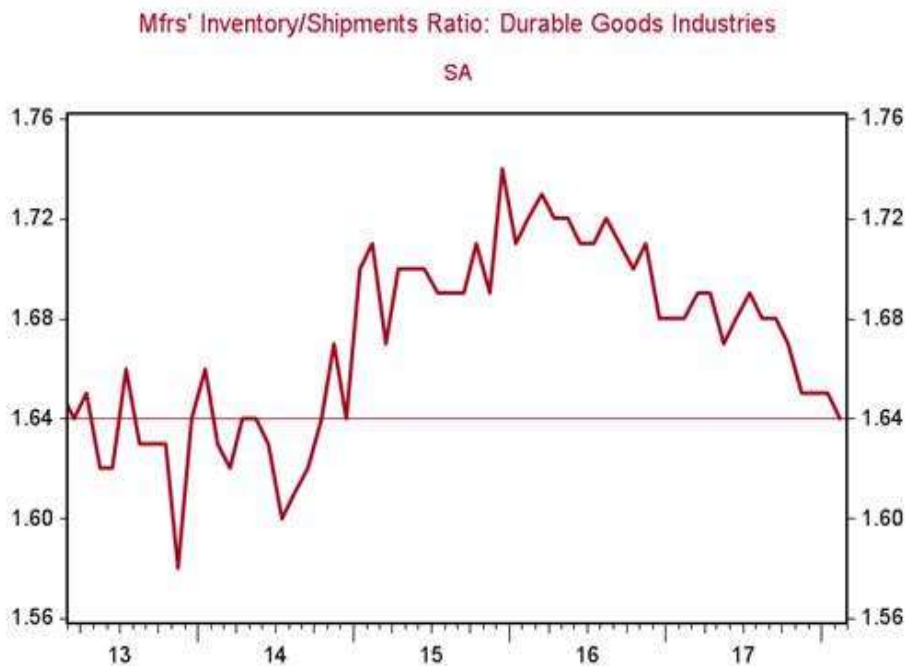
Chart 3: Manufacturing Shipments of Defense Goods



Source: Census Bureau/Haver Analytics

Source: Monthly data. Source: Census Bureau and Haver Analytics

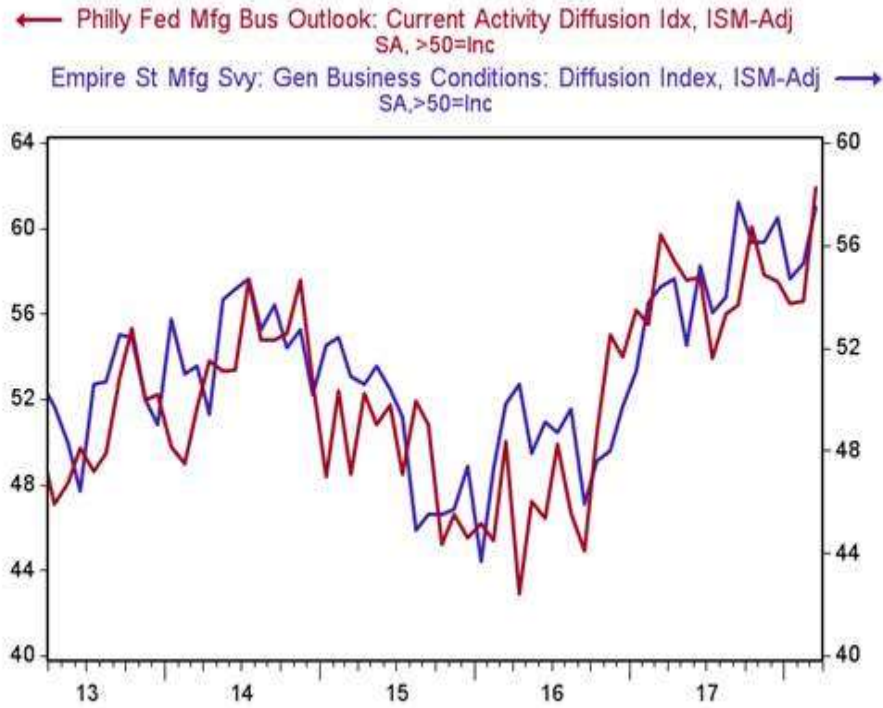
Chart 4: Inventory-Shipments Ratio for Durable Goods Industries



Source: Census Bureau/Haver Analytics

Source: Monthly data. Source: Census Bureau and Haver Analytics

Chart 5: Philly Fed and Empire State Manufacturing: ISM-Adjusted Business Conditions Indexes



Sources: FRBPHL/H, FRBNY/H/Haver

Source: Monthly data. Source: Federal Reserve Banks of Philadelphia and New York, and Haver Analytics

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