The Durable Goods Report

September 2009 Data

Source Data: US Census Bureau

Preliminary Data Release of 11/3/2009

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Highlights:

- **Industrial Production:** UP to $2.72 trillion from $2.69 trillion (+1.1%) from prior month.
- **Capacity Utilization:**
  - Manufacturing: UP to 67.5% from 66.8% prior month.
  - Durable goods manufacturing: UP to 61.2% from 50.4% prior month.
  - Iron and steel: UP to 55.9% from 51.9% prior month
  - Auto and light truck: UP to 52.1 from 45.2% prior month.
  - Machinery: DOWN to 57.1% from 57.5%
- **Durable Goods:**
  - New orders: UP to $ 166.2 billion from $164 billion from prior month (1.4%). Twelve month moving average 22% BELOW prior year.
  - Shipments UP to $173.2 billion from $171.3 billion (1.1%) from prior month. Twelve month moving average 16% BELOW prior year.
  - Unfilled Orders DOWN to $733.3 billion from $736.6 billion (-0.5%).
  - Inventory: DOWN to $304.9 billion from $308.1 billion (-1%).
  - Inventory to Shipments ratio: DOWN to 1.76 from 1.8 prior month.
- **Retail :**
  - Total retail (excl. food service): DOWN to $306.3 billion from $311.6 billion (-1.7%).
    - Autos and Parts: DOWN to $56.2 billion from $62.8 billion (-10.4%).
    - Gasoline: UP to $31.4 billion from $31.0 billion (+1.4%)
  - Core retail (Excl. food service, gas, autos and parts): UP to $218.7 billion from $217.8 billion (+0.4%). DOWN 2.2% from prior year.
- **Housing:**
  - New Single Family Homes (seasonally adjusted annual rate):
    - Starts: UP to 501,000 from 482,000 (+5.8%)
    - Sold DOWN to 402,000 from 417,000 (-3.6%)
    - For Sale: DOWN to 251,000 from 261,000 units (-3.5%).
  - Median Sales Price: DOWN to $208,300 from $210,200. 9% below prior year (3MMA).

By the Numbers:

Prevel Technology - Durable Goods & Retail Summary				Best Last 12 Mos.	
	Sep-09	Aug-09	Sep-08	Value	Month
New Orders-Durable	166,209	163,966	206,034	206,084	Aug-08
12 month moving average	167,024	170,343	214,557		
% Change from Prior Year	-22.2%				
Unshipped Orders - Durable	733,325	736,634	828,225		
% Change from Prior Year	-11.5%				
Value of Shipments - Durable	173,174	171,341	208,240	208,339	Aug-08
12 month moving average	178,770	181,692	212,221		
% Change from Prior Year	-15.8%				
Inventory - Durables	304,920	308,133	339,728		
% Change from Prior Year	-10.2%				
Retail Sales	306,336	-	328,469	334,273	Aug-08
12 month moving average	307,227		337,599		
% Change from Prior Year	-9.0%				
Inv to shipments ratio - Durable	1.76	1.80	1.63		
Growth Index - Durable New Ord	0.995	0.965	0.979		
Growth Index - Durable Shipmts	0.966	0.945	0.996		
Growth Index - Retail	1.007	0.999	0.988		
1. Preliminary release data (~5 wks after the end of the period).					
2. Seasonally Adjusted, millions					
3. Prevel Growth Index = 3MMA / 12MMA			John Layden	317-842-6417	

Summary and Analysis

Overview of the US Economy

US GDP grew by 3.5% (annualized) in the third quarter. Looking at the direct measurements, it was somewhat less spectacular. The Q to Q change was +1.1% with about half of that related to one time stimulus effects. That said, a positive move is better than negative.

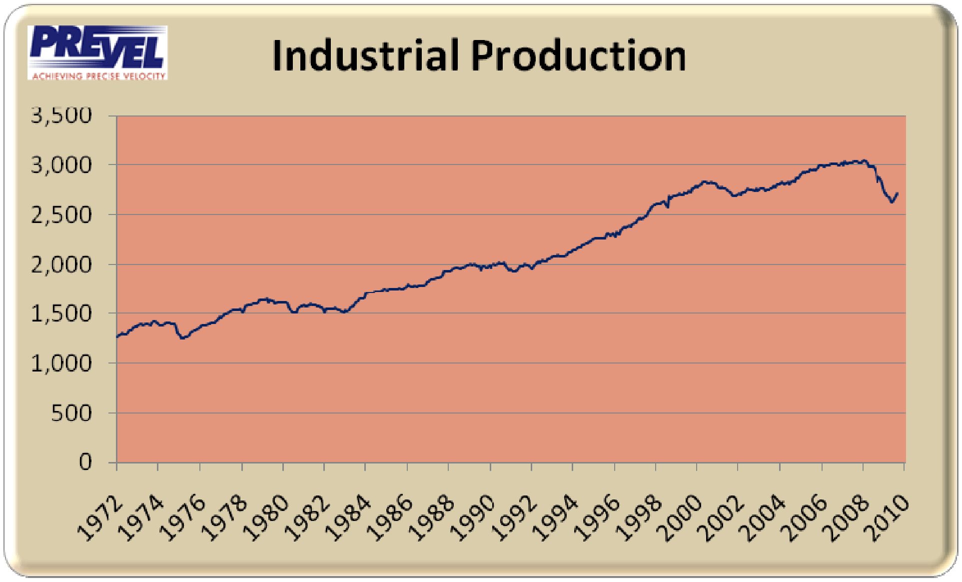
Year	Qtr	GDP $b (SAAR)	Chg from Prior Pd	Chg from Prior Year
2007	4	14,031.2	0.6%	4.9%
2008	1	14,373.9	2.4%	6.4%
2008	2	14,497.8	0.9%	5.5%
2008	3	14,546.7	0.3%	4.3%
2008	4	14,347.3	-1.4%	2.3%
2009	1	14,178.0	-1.2%	-1.4%
2009	2	14,151.2	-0.2%	-2.4%
2009	3	14,301.5	1.1%	-1.7%

There are already signs that the October performance is reversing some of the gains. The most impressive measurement is the year-to-year comparison. In the 63 year history of modern measurements of the GDP there have only been two other times (1949 and 1954) when year-to-year comparison was negative for three consecutive quarters.

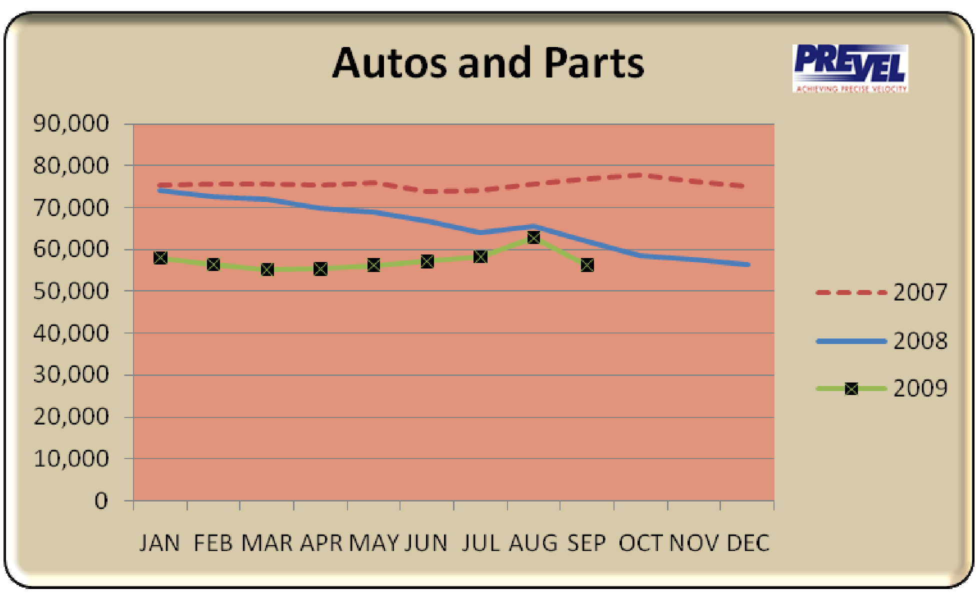
The Keynesian theory of government stimulus is that government spending can infuse money into the economy, which will then jump start private sector demand, which then requires private sector investment. The missing point in the chain is that the government has no money. It can only take money from the private economy. This comes in the form of taxes, borrowing or printing money. According to Milton Friedman, all of these methods have negative effects on the economy that exceed the short term stimulus benefit. There are a few exceptions, such as the construction of the interstate highway system that delivered an incremental 2% productivity growth for almost a decade. But these examples are extremely rare.

The justification for the current stimulus depends on the “multiplier effect” producing follow on jobs at a ratio of 4:1. This is a reasonable estimate of what the US private economy delivers. But stimulus-generated jobs are less productive. The only study I can find on the subject suggests that $1 of government spending delivers only $0.80 in total economic effect. The Cash-for-Clunkers program was even less effective. Nothing goes through Washington without shrinking.

Industrial production showed signs of life, with the third consecutive month above 1% growth. The most sobering observation is that the decline we're crawling out of is the worst recorded since 1972 when the measure was first compiled. It exceeds the effects of the oil shock in the mid 70s by three fold.



Auto Industry demand has returned to the low levels of the spring. The evidence is growing that the Cash for Clunkers program has had no positive effect. The net gain in sales was adjusted downward to $5 billion instead of the $15 billion expected.

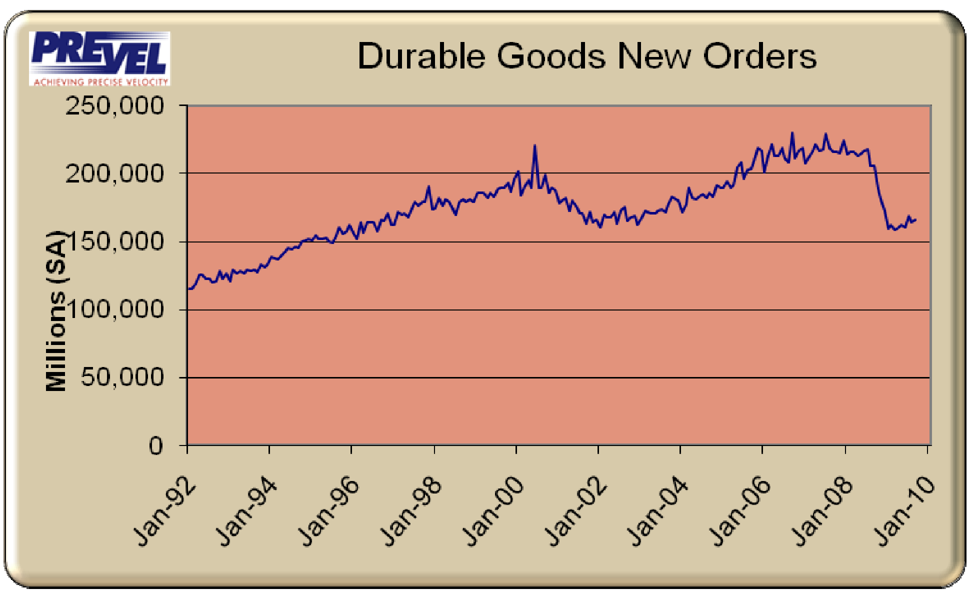


There is a strong suspicion from several economists that the net effect on auto unit volume has been zero or negative. We won't be sure for a couple more months. One positive aspect of the bankruptcy-related shutdowns of auto plants last spring was the depletion of inventories. But unless buyers come back into the showrooms it won't matter much.

Durable goods new orders increased $2.3 billion in September. Shipments grew by $1.8 billion. Backlogs of unfilled orders have stabilized and in key industries actually grew for the first time in 12 months (construction machinery, mining/oil/gas, fabricated metal, metalworking machinery). Shipments are now in balance with new orders in most of the key sub-segments. Inventories are in good control, although still high for the level of shipments. It is increasingly likely that the worst of the inventory retrenchment is done.

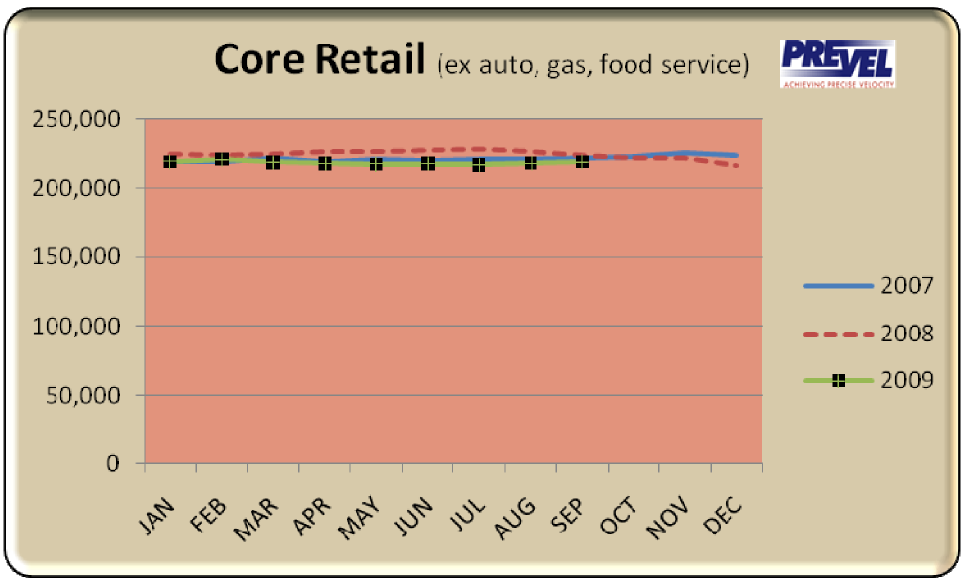
The auto sector may be the one exception. There is no clear indication of direction for the auto industry. But with the current global demand of 55 million units against capacity of 90 million units, there is one clear outcome. A third of the manufacturing capacity needs to be shuttered. And of course Congress is working overtime to avoid that inevitable event.

The growth in durable goods is very modest as the chart shows. At this rate it will take 10 years to recover. But the reversal of direction is now clear. Any increase in the growth rate will depend on a broader recovery in the global economy.



Housing industry numbers have shown some modest signs of life. Total housing starts and single family housing starts increased. The unsold inventory of new single family homes declined to 251,000, lowest in 30 years and the 28th consecutive monthly decline. That's the good news. The bad news is that the number of new single family homes sold declined for the second straight month. With the continued growth in the Census Bureau estimate for total households (averaging about 800,000 above 2008), housing starts (about 500,000) will eventually need to pick up. Part of the delay could be the movement of people back to apartments. But the current dynamic will soon produce a housing shortage. It may be a precursor of that move that Toll Brothers (luxury home builders) saw a 42% increase in orders in the 3rd quarter. The recent collapse in housing was most pronounced in the luxury segment.

Retail performance has been less than stellar, but core spending has held up reasonably well. Overall retail sales declined 1.7% in September due largely to the drop in auto sales after the end of the stimulus program. Core retail (excluding autos, gas and food service) actually increased 0.4%. This key measure now stands only 2.2% below last year.



Consumers have continued to pay down credit card debt at a surprising rate. Revolving credit declined from $975 billion to $889 billion (-8.8%) from the end of Q3 2008 to Q3 2009. Non-revolving credit decreased from $1,603 billion to $1,567 billion (-2.2%) in the same period.

Employment continues to erode, but at a slower rate. The weakness of the current recovery does not bode well for near term reduction in the pool of unemployed (10.2%) or underemployed (and additional 7.6%) of the workforce. The critical driver for any industrial economy is the durable goods sector. Since this sector routinely focuses on productivity improvement, the normal state is a gradual decline in employment for the same output. It means that at current recovery rates the need for hiring can be delayed for a surprisingly long time.

Health Care Legislation: The house passed a health care bill last Saturday night. To date there is no widely available summary of what it contains. It may not be important anyway, since the Senate bill will be greatly different. What seems to be the case is that the important issue of breaking the relationship between employment and health insurance has not been addressed. It sounds like that link will be even stronger, which then leaves the question of interim coverage unresolved.

One of the few consistent issues is the attempt to reduce the cost of health care by dictating prices. Instead of unleashing the power of free market competition on the cost problem, Congress chooses to dictate a reduction of payments to doctors and hospitals. Price controls have a detailed and unbroken recorded history since the 13th century. The price controlled commodity declines in both quality and availability.

If some version of the existing bills makes it to the President's desk, the world will be a much more complicated place for small and mid-sized businesses.

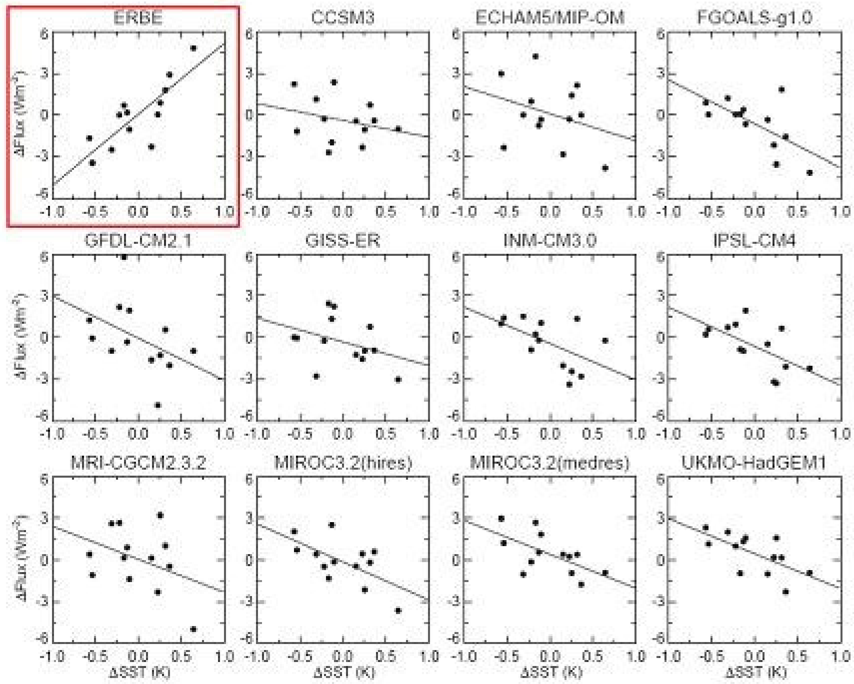
Cap and Trade and the Environment: It will probably not come as a surprise that this legislation has nothing to do with any environmental issue. It comes to light that the goal of the UN is to achieve a source of funding independent of the political decisions of the member states. There is still not a single piece of peer reviewed science that supports the claims of the UN report on the subject. The entire argument is based on a group of computer models. The flood of solid science refuting UN claims grows almost daily and we'll continue to report on the highlights.

The proponents of human caused global warming are fond of saying that the science is settled. It looks increasingly as if they are correct. But not in the way they intended. The latest setback relates to the "tipping point" hypothesis.

One of the core assumptions of UN report on climate change is the <u>*assumption*</u> that there is a "tipping point" in the climate. As temperature increases a positive feedback causes temperatures to increase faster. It is built into the computer models in the form of a positive feedback between temperature and outbound radiation. All of the computerized forecast models used by the UN accept this assumption. The claim is that we are at risk of a runaway greenhouse effect where temperature skyrockets.

Several months ago we reported on a draft of a study from Lindzen and Choi at MIT. The study has now been released. It shows the opposite of the UN assumption. Dr Richard Lindzen took 30 years of satellite measurements from the Earth Radiation Balance Experiment (ERBE) satellite and constructed the actual relationship between surface temperature, inbound radiation and outbound radiation for the Earth.

In the charts below a declining line is a reduction of net outbound radiation with increasing temperature (a positive feedback effect). All 11 of the UN sponsored computer models show this pattern. In the upper left chart the Lindzen/Choi analysis of actual measurements shows the opposite relationship. In short there is no tipping point. The feedback is negative and the climate is self correcting.



The radiation balance of the Earth behaves exactly as the laws of thermodynamics require. If Congress wants to believe in a tipping point, they will need to start by repealing the laws of thermodynamics.

A second assumption of the modelers is the persistence of CO2 in the atmosphere. All UN sponsored models *assume* without evidence a 100 year residency. The evidence from 36 peer reviewed studies produce values of 3 to 23 years with an average of about 8. Only six studies came in over 10 years.

It is increasingly clear that the UN computer models are junk. Computer simulation models are not science. Science is about measuring something. It now seems likely that the parameters of the models were selected to produce the desired political outcome. This isn't science. It is at the very least academic dishonesty. When the actions are taken to achieve financial gain, it is fraud. We have a process that is supposed to prosecute Americans who commit fraud. Who prosecutes the UN? And for what violation?

Energy supply is growing dramatically if you look beyond the "proven reserves" definition dictated by the accountants. Total reserves (proven and estimated) have exploded. Last month we reported on the billion barrel megafield discovery in the Gulf of Mexico. The Baaken field in North Dakota, Montana and Saskatchewan has seen its estimated reserves increased again to 4 billion barrels of oil. Last week it was announced that a second field has been discovered a few thousand feet *below* the currently developed field. This field is available using the same technology deployed at Baaken.

Natural gas supplies have also exploded. By some estimates we have between 100 and 1,000 years supply at current consumption rates. The problem is that the Congress continues to block development and production in these fields. This is the legacy of the environmentalism of the 1970s carried to illogical extremes.

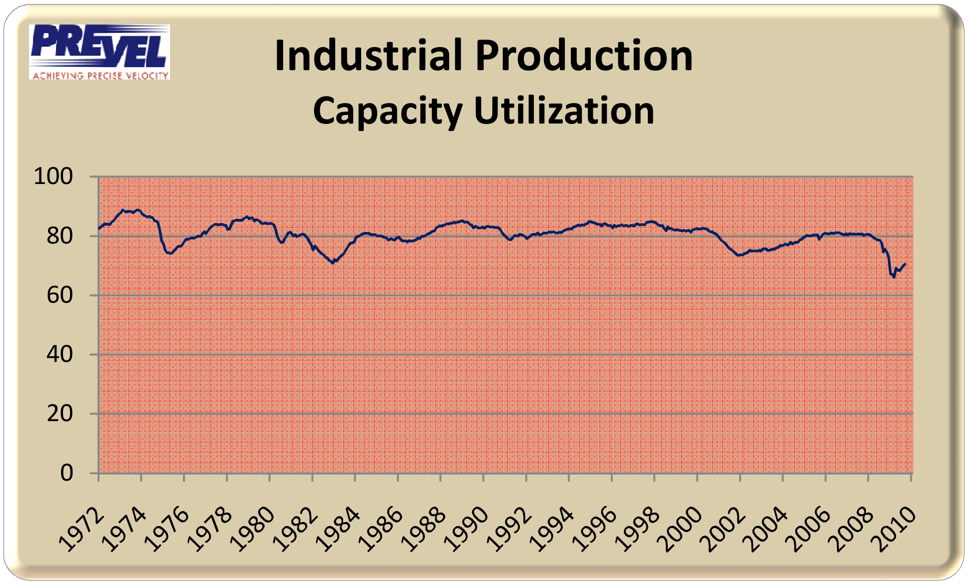
Environmental Impact took on new meaning on October 31st. The Columbia Falls Aluminum Company plant in Montana, the largest in the world, ceased operations permanently. They were forced to this action because they could no longer obtain the electricity necessary for operations. Their contract with Bonneville Power was declared invalid by the 9th US Circuit Court because it was incompatible with the Northwest Power Act. Their electricity supplier was blocked in expansion plans, so we will now buy aluminum from China.

The US has always had a creative energy sector skilled at staying ahead of the curve on supply problems like this. It is no longer possible in the face of lawsuits from the green industry (Sierra Club et.al.). Nuclear power was blocked in the 1970s on the basis of fictitious safety concerns. Coal-electric plants are being blocked by lawsuits over land use. Half of the 150 plants on the drawing boards in 2000 have been cancelled because of lawsuits.

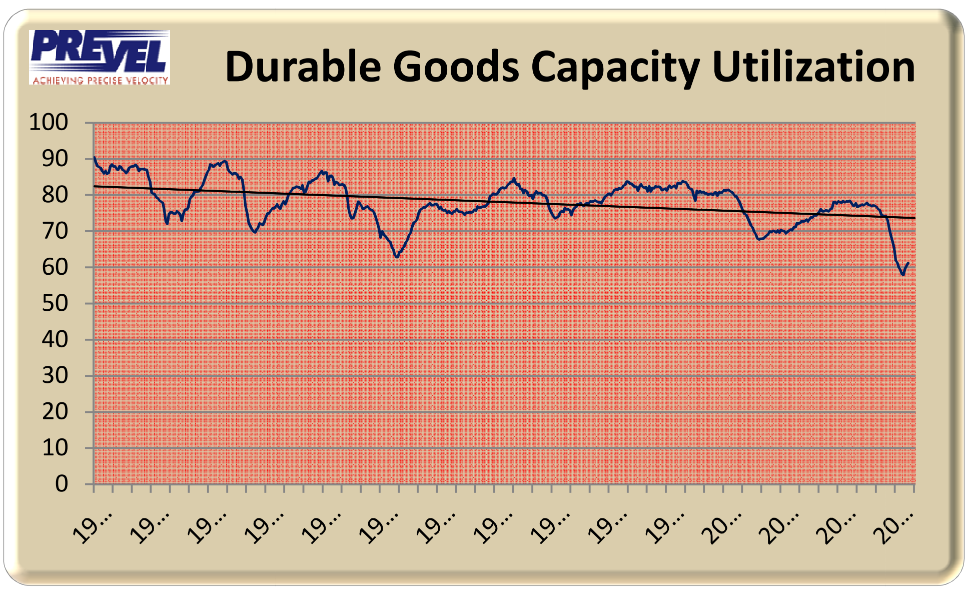
Without energy, there will be no growth. The green solution (wind, solar) is a complete fiction. There is no alternative to hydrocarbon and nuclear energy if that is defined as a technology that is a net producer of energy. All of the touted alternatives take more energy to build than they will produce in their useful life.

The green agenda is based on three core assumptions: The unmolested natural state of nature is best; the climate is fragile; all human influences are bad. Science makes no such assumptions. Science suggests that there is no such thing as an unmolested state of nature; the climate is not fragile; and human impact on the Earth can be either good or bad. These beliefs are more like religious dogma. But this pseudo-religion is about to bring down the US economy with the willing cooperation of the Congress.

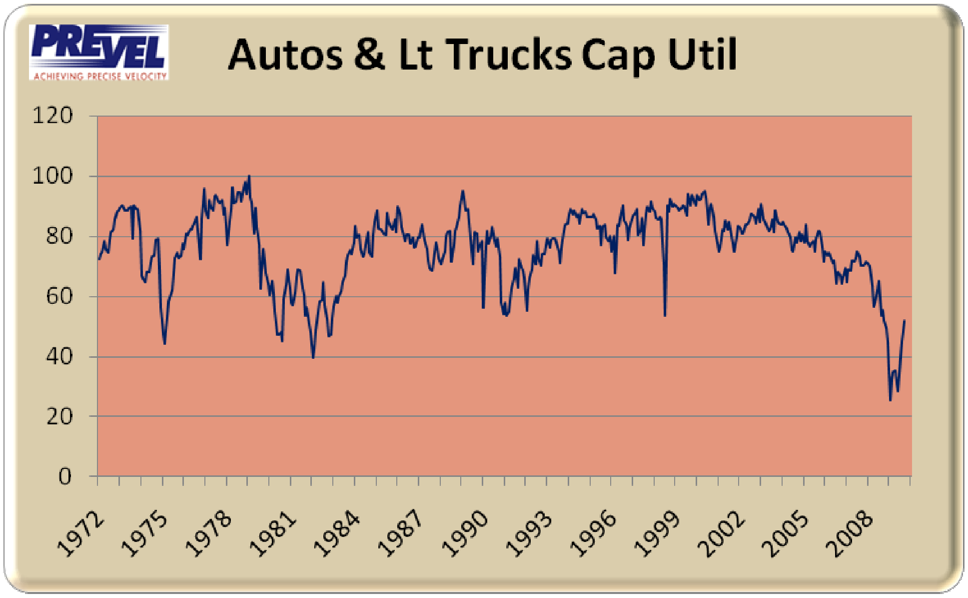
Industrial Production and Capacity Utilization



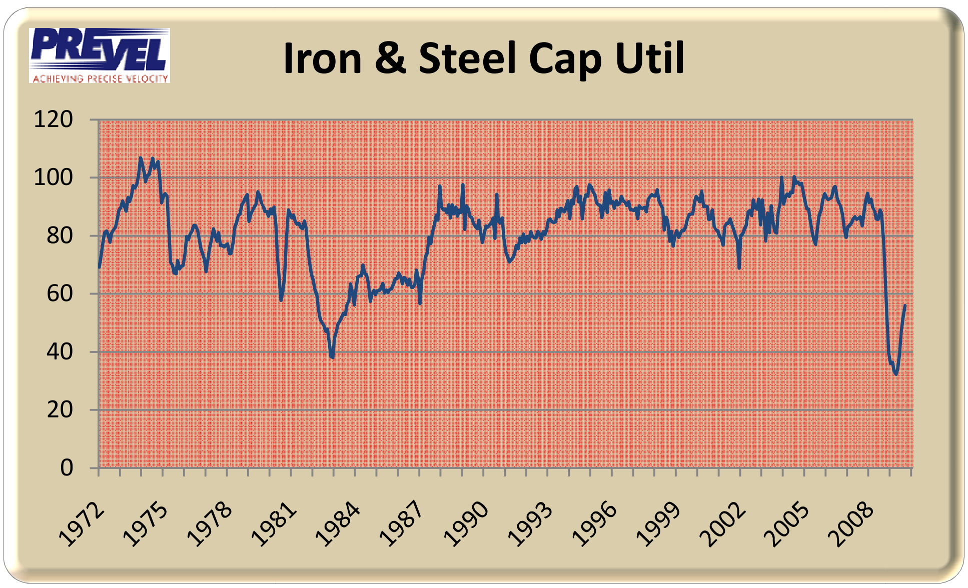
Capacity utilization for industrial production increased to 70.5% in September.



Capacity utilization in durable goods increased to 61.2% in September.

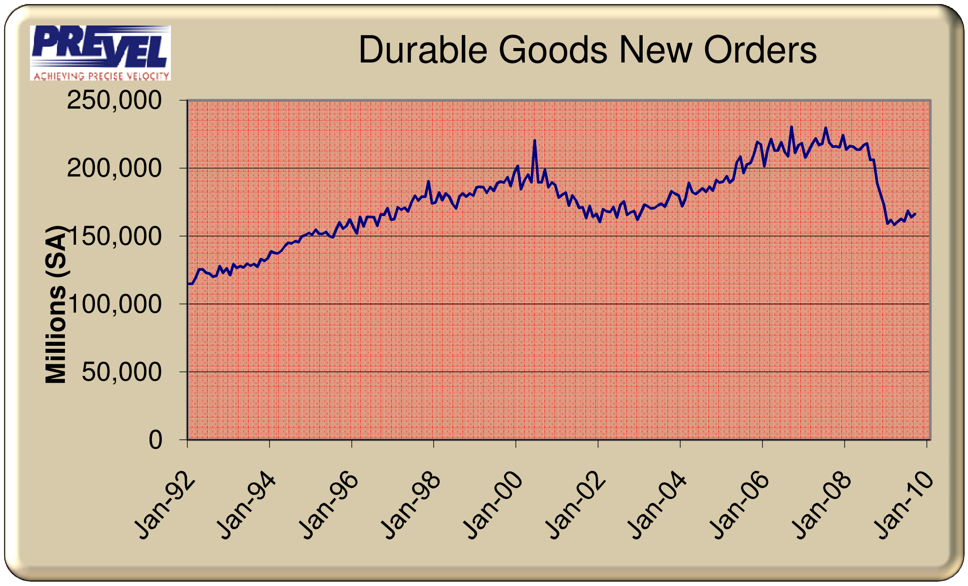


Auto and light truck capacity utilization increased to 52.1% in September.

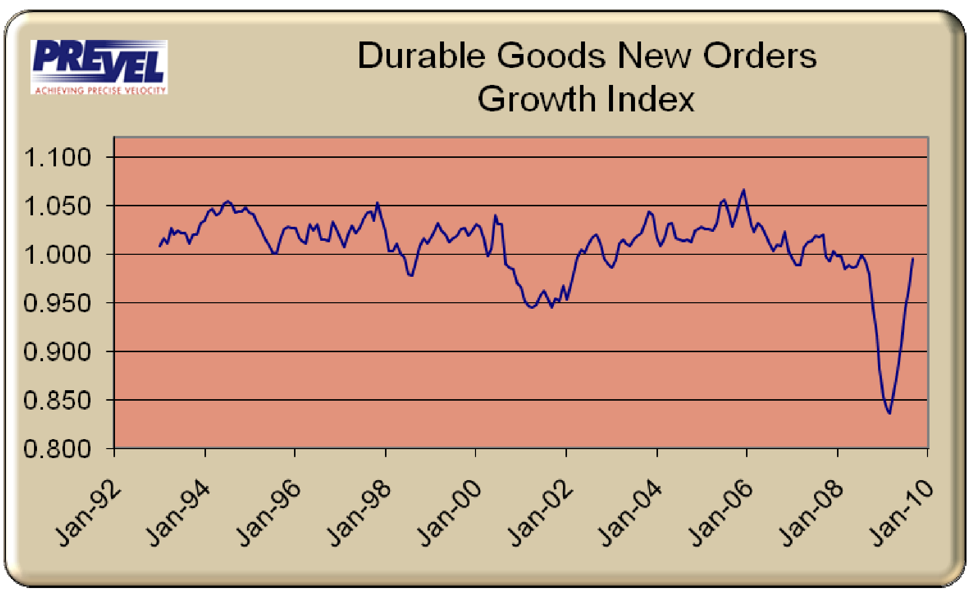


The steel industry increased to 55.9% in September.

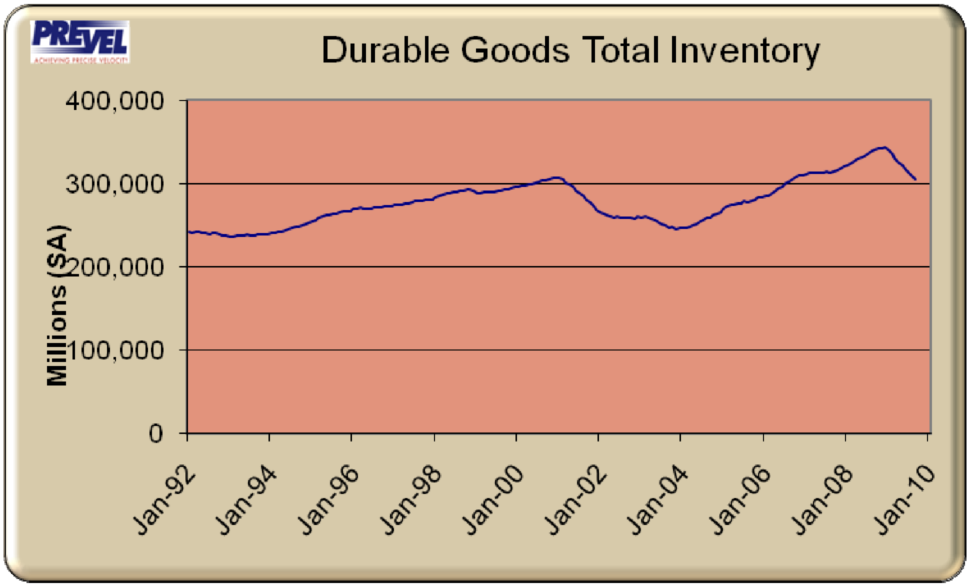
Durable Goods



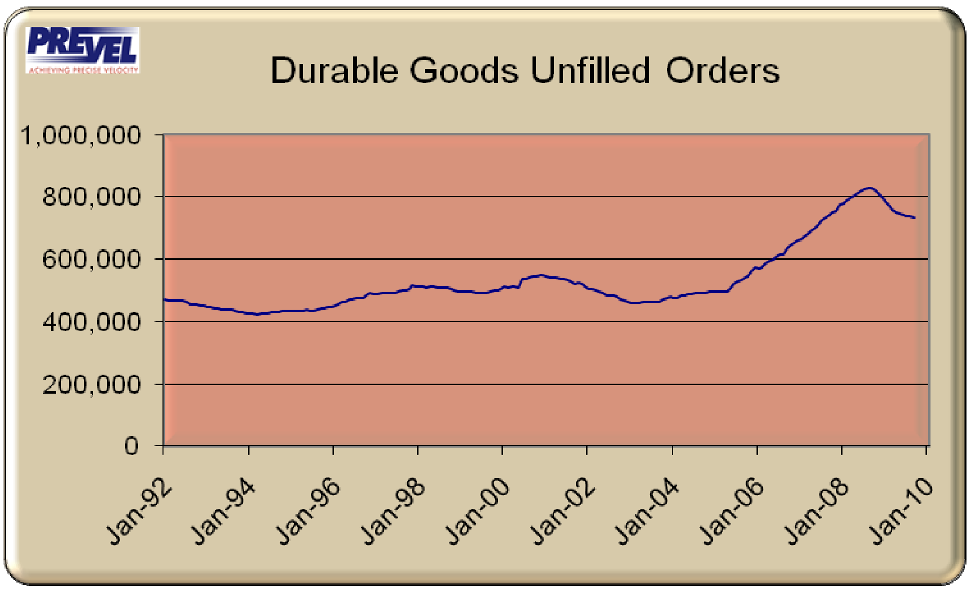
New orders for durable goods increased $2.3 billion (1.4%)



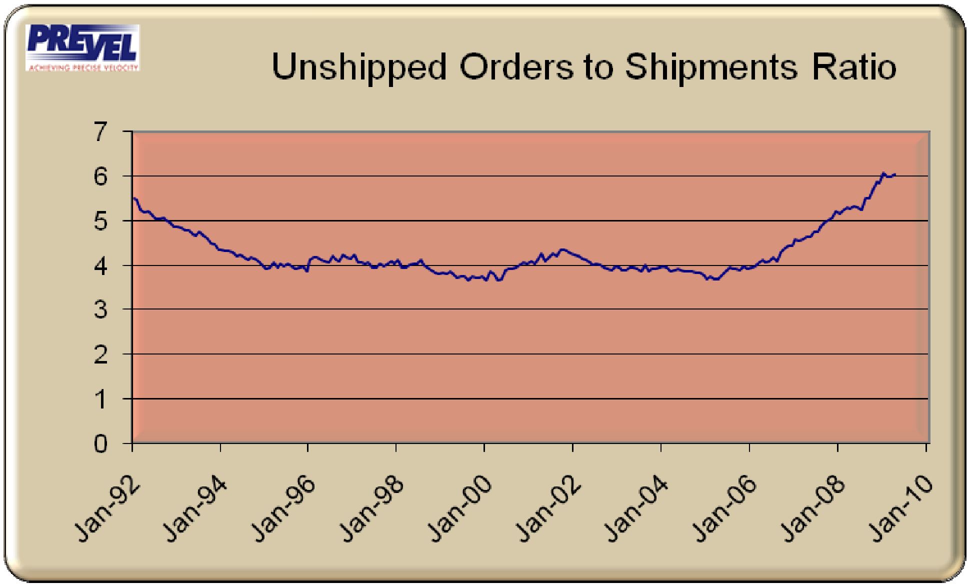
The growth index, a measure of acceleration, increased for the fourth month to 0.995.



Inventory continued to decline. The indications are that most of the inventory cuts are completed. As new orders improve there will be less pressure for further cuts.

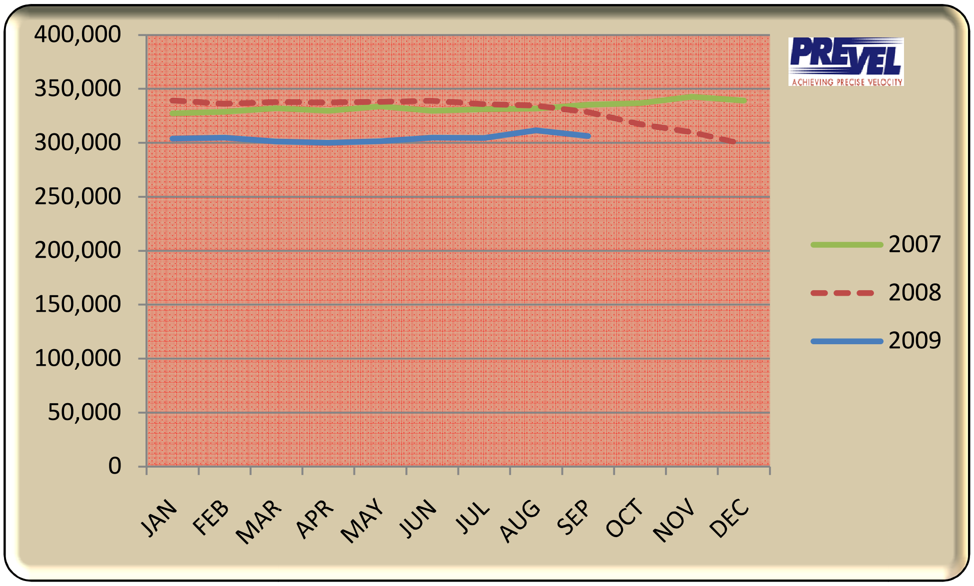


Unfilled orders declined for the 12th consecutive month by $3.3 billion. The rate of decline has slowed in the past four months.

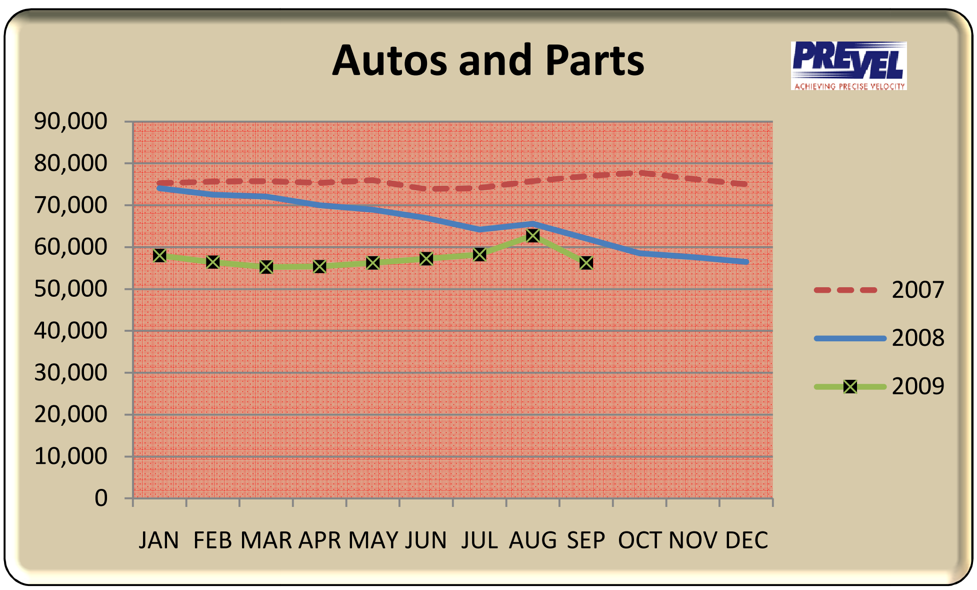


Unfilled orders to shipments ratio is a measure of order velocity. The measure declined slightly to 5.83 months. This measure remains well above the traditional value of 4 months.

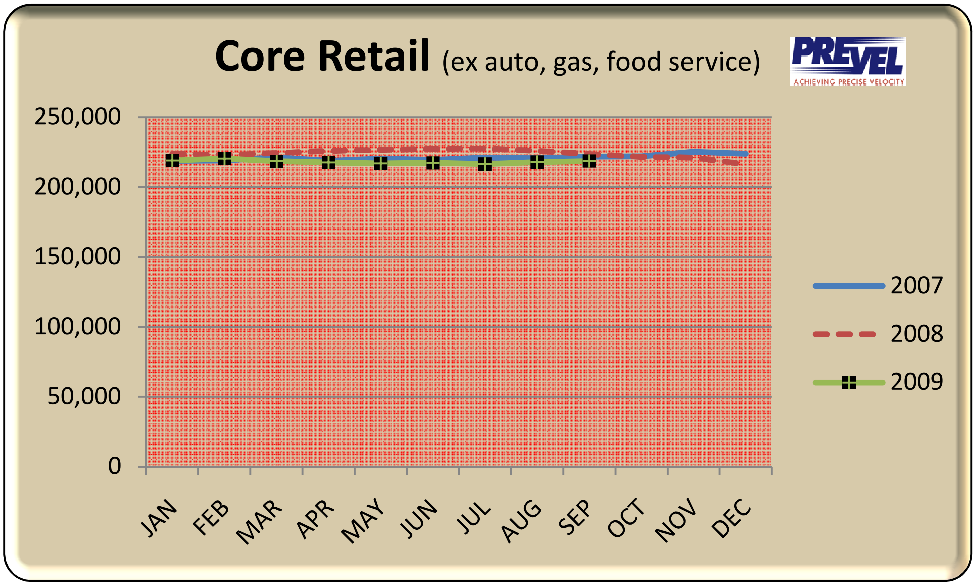
Retail:



Retail sales decreased in September due largely to the drop in auto sales.



Auto and parts sales returned to the pre-stimulus levels after a $5 billion surge in the prior month. Note that August also marked the new model introductions which always produce a small bump.



Core retail (excl. autos, gas, food service) increased by 0.4% in August. The measure remains 2.2% below last year.

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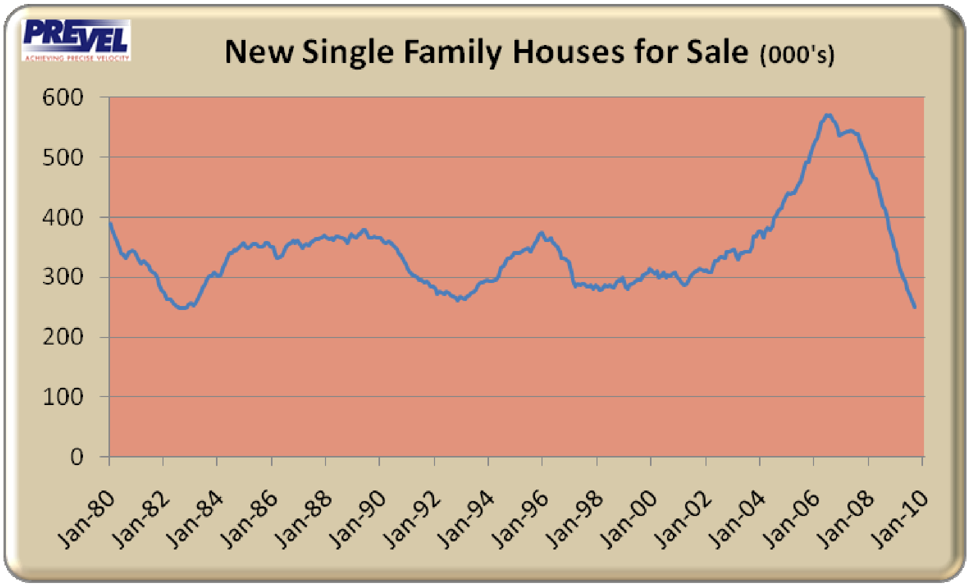
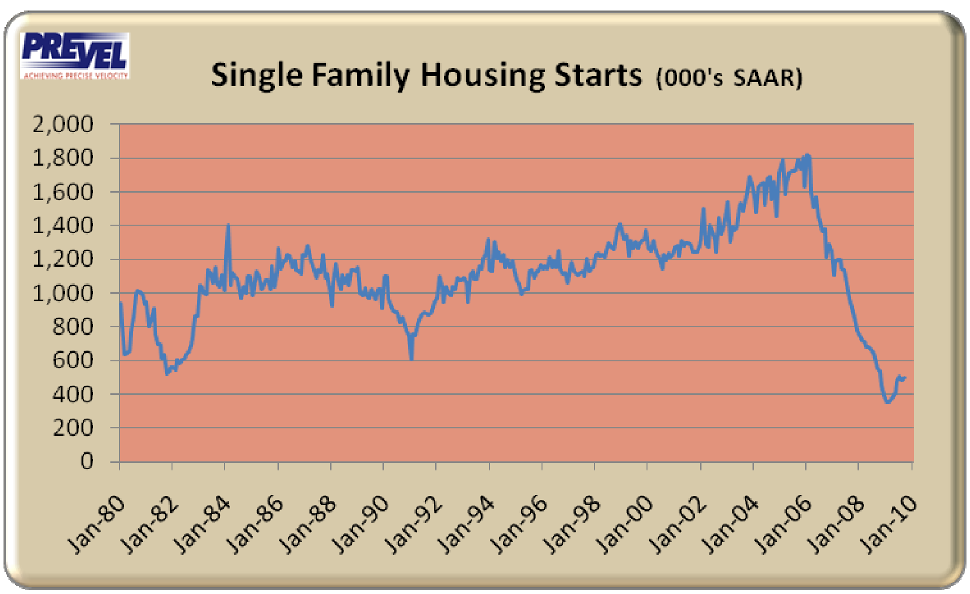
Housing:



The number of unsold new single family houses declined for the 28th consecutive month, to 251,000 units. Lowest level since 1980.



Single family housing starts increased slightly.

About Prevel and The Durable Goods Report

Prevel Consulting supports manufacturing transitions to High Velocity Manufacturing. Prevel Technology delivers software applications and custom solutions in support of data driven decisions, real-time operations and rapid business response metrics.

The goal of the Prevel DGR is to offer context for the published monthly statistics on durable goods manufacturing in the US. The analysis is historical in nature, and includes no forecasts beyond what may be obvious from the current state. The analysis of historical patterns provides a necessary framework for understanding plausible scenarios. Since a high percentage of durable goods go through retail, this analysis offers a leading indicator of future durable goods activity.

Prevel uses source data from the US Census Bureau, Bureau of Labor Statistics, and the Federal Reserve. Rig count data source is the Baker Hughes Corp. For data sourced from the US government, the preliminary publication is used, available about 5 weeks after the end of the period. An earlier publication (advanced release) is available about 3 weeks after the end of the period, but is often subject to substantial revisions, and is not considered adequately reliable for growth trend analysis.

A similar analysis is available for many industry sub-sectors. Contact Prevel for details about this subscription based service.

Technical Note: The "Prevel Growth Index" is measured as the ratio of the 3 month moving average divided by the 12 month moving average. This removes some of the natural noise in the industry data, but also results in a slight response lag. An index value greater than 1.000 is a sign of recent growth.

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