The Durable Goods Report

July 2010

Manufacturing Data Release of 7/2/2010 (May Preliminary)

Employment Data Release of 7/2/2010 (June Advanced)

Retail Data Release of 7/14/2010 (June Advanced)

Source Data: US Census Bureau, US Bureau of Labor Statistics,Department of Commerce, Federal Reserve Board, Baker Hughes

John E. Layden, Prevel Technology

By the Numbers:

Prevel Technology - Durable Goods & Retail Summary			
	Current Mo	Prior Mo	Prior Yr
New Orders-Durable	192,855	194,021	167,069
12 month moving average	181,225		187,671
% Change from Prior Year	-3.4%		
Unshipped Orders - Durable	802,805	800,948	828,981
% Change from Prior Year	-3.2%		
Value of Shipments - Durable	196,421	197,099	176,178
12 month moving average	188,509		199,651
% Change from Prior Year	-5.6%		
Inventory - Durables	304,706	301,985	314,153
% Change from Prior Year	-3.0%		
Retail Sales (June data)	316,220	322,693	304,851
12 month moving average	316,220		311,013
% Change from Prior Year	1.7%		
Inv to shipments ratio - Durable	1.55	1.53	1.78
Growth Index - Durable New Ord	1.058	1.063	0.871
Growth Index - Durable Shipmts	1.038	1.034	0.897
Growth Index - Retail (May)	1.023	1.033	0.953
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

Monthly Rate of Change				
	This period	Last period	Change	Comments
GDP Q1 vs. Q4	14,592.4	14,453.8	1.0%	
Industrial Production (May)	2460.5	2433.7611	1.1%	
Capacity Utilization % (May)	74.7	73.7	1.0	
Manufacturing %	72.0	71.3	0.8	
Durable Goods %	69.9	68.7	1.2	
Autos and Parts %	60.8	57.5	3.3	
Machinery %	71.7	70.1	1.5	
Durable Goods ($ Mil Seasonally adjusted) May Data				
New orders	192,855	194,021	-0.6%	
Shipments	196,421	197,099	-0.3%	
Inventory	304,706	301,985	0.9%	
Unshipped Orders	802,805	800,948	0.2%	828 bil 9/2008
Total Retail ($ Mil SA) June data	320,747	322,693	-0.6%	
Autos and Parts	60,997	62,408	-2.3%	
Gasoline	34,607	35,329	-2.0%	
Core retail	225,143	224,956	0.1%	
Employment (000's SA) June Data				
Non-Farm	130,470	130,595	(125)	138 mil 1/2008
Goods Producing	17,977	17,985	(8)	
Manufacturing	11,670	11,661	9	13.7 mil 1/2008
Construction	5,582	5,604	(22)	
Durable Goods Mfg	7,166	7,153	13	9.1 mil 6/2006
Housing (000s of Units SA) June Data				
Single family starts	468	565	-17.2%	
Single family sales (new)	300	446	-32.7%	
Single family for sale (new)	213	211	0.9%	570 in 8/2006

The concerns over a double dip recession continue to pile up. Retail suffered a second month of decline, driven by autos. Durable goods new orders declined in May followed by weaker hiring in June. Housing continues to set record lows. Construction employment continued to decline – so much for shovel-ready stimulus.

There is some good news. Construction machinery continues to firm and has returned to about 2007 levels. Asia must be the driver, since construction activity is down or flat in the US and EU. The US machine tool industry continues a modest recovery from record lows.

There is near universal agreement among CEOs in our survey that the current political climate is making the situation worse. Manufacturers are delaying hiring decisions until the last possible moment on the expectation of some new surprise from Washington that will put the economy back into a downward spiral. Investment decisions are spotty and targeted to clearly defined needs. Small business is on the sidelines on hiring.

Energy: The BP well seems to be capped, at least for the moment. But the threat of a moratorium on offshore drilling, currently being held at bay by the courts, has the expensive drilling rigs on the move out of the Gulf. Baker Hughes reports the number of offshore rigs working in the Gulf of Mexico at 16 for the most recent week. This compares to 37 in the same week last year and 22 at the beginning of the BP crisis. The unintended consequences of the political posturing continue to accumulate.

BP is probably the least admirable company in the energy industry, based on their reputation within the industry. But they are still a major player. Attempting to demonize a company that has already said they are will "make it right" is clear demonstration of why politicians can never be trusted with control of anything important. A robust and secure supply of energy is a foundation requirement of a successful economy. The current policies of the government seem intent on screwing it up.

Politicians World View and Political Effects on the Economy

Politicians play to the emotions of the electorate at exactly the time when they should be providing education and leadership.

This is not a new condition. Plato described it in "The Republic." The title of Book VIII is "How the Republic Dies" and talks about the demonizing of the productive class, in his example the bankers. When life is discovered to be imperfect (whatever that means) the politicians find someone to blame. Others have observed the same condition:

> From Robert Heinlein:
>
> "Throughout history, poverty is the normal condition of man. Advances which permit this norm to be exceeded — here and there, now and then — are the work of an extremely small minority, frequently despised, often condemned, and almost always opposed by all right-thinking people. Whenever this tiny minority is kept from creating, or (as sometimes happens) is driven out of a society, the people then slip back into abject poverty.
>
> This is known as "bad luck."

The real question is what should government do. Art Laffer offers the following suggestions:

> "Any government program that would reduce unemployment has to make working more attractive for both employer and employee. Since late 2007 the federal government has spent somewhere around $3.6 trillion to stimulate the economy. That is a lot of money.
>
> My suggestion would have been to take all $3.6 trillion and declare a federal tax holiday for 18 months. No income tax, no corporate profits tax, no capital gains tax, no estate tax, no payroll tax (FICA) either employee or employer, no Medicare or Medicaid taxes, no federal excise taxes, no tariffs, no federal taxes at all, which would have reduced federal revenues by $2.4 trillion annually. Can you imagine where employment would be today? How does a 2.5% unemployment rate sound?

It's not like there isn't a plan for how to fix it. But the federal policies are opposite of proven approaches. The rational plans are blocked by an incompatible economic world view. Instead of taking rational action to repair the economic damage caused by the government policies, we now hear that Cap-and-Trade will be passed in the lame duck session of congress. The administration and congress want to by-pass the will of the public to get one more policy in place. Their theory is that there won't be enough votes to repeal it once it passes, and that the public will eventually come to like the result.

It is clear that the result of these massive spending and taxation schemes is clear and obvious. The mystery is how this could emerge from people who claim to be well meaning. While there are certainly a few who are willing to place political gain above national interest, most seem to be driven by some other motivation. This has led to quite a few popular conspiracy theories.

This explanation has always seemed implausible for multiple reasons. It requires too much cooperation to pull off a conspiracy. Someone once said that you should never explain with conspiracy what can be equally well explained by ignorance. In the end it may not matter. The argument is about motivation, not effect. A CEO friend commented that he gave up trying to evaluate motivation when he realized that malice and ignorance produce the same outcome. No additional value was gained by trying to isolate which motivation was the driver.

We shouldn't expect that most politicians have read Plato's Republic. But we normally think they have some grasp of economics. They apparently do not. A recent study offered some insight. Published in the May issue of Econ Journal Watch (pp174-196) and authored by Buturovic and Klein, several disturbing conclusions jumped out.

First none of the 50 universities in the survey had a required econ course for graduation. Second, a college education did not improve understanding of economics. High school graduates had a slightly better grasp of the issues. Third as ideological beliefs moved from conservative to progressive, the number of wrong answers increased dramatically.

They asked eight questions on issues considered to be uncontroversial in the field of economics. Their measure was stated in terms of “Economic Un-enlightenment” or how many questions were answered wrong. The article analyzes the results from a variety of perspectives, and we recommend that you take the time to read the entire piece.

The Eight Questions and answers testing “Economic Un-enlightenment”

1. Restrictions on housing development make housing less affordable.

• Unenlightened answer: Disagree

2. Mandatory licensing of professional services increases the prices of those services.

• Unenlightened answer: Disagree

3. Overall, the standard of living is higher today than it was 30 years ago.

• Unenlightened answer: Disagree

4. Rent control leads to housing shortages.

• Unenlightened answer: Disagree

5. A company with the largest market share is a monopoly.

• Unenlightened answer: Agree

6. Third-world workers working for American companies overseas are being exploited.

• Unenlightened answer: Agree

7. Free trade leads to unemployment.

• Unenlightened answer: Agree

8. Minimum wage laws raise unemployment.

• Unenlightened answer: Disagree

Survey Results by Self-Identified Ideological Position:

	Progressive	Liberal	Moderate	Conservative	Very Conservative	Libertarian
Wrong Answers	**5.26**	**4.69**	**3.67**	**1.67**	**1.30**	**1.38**

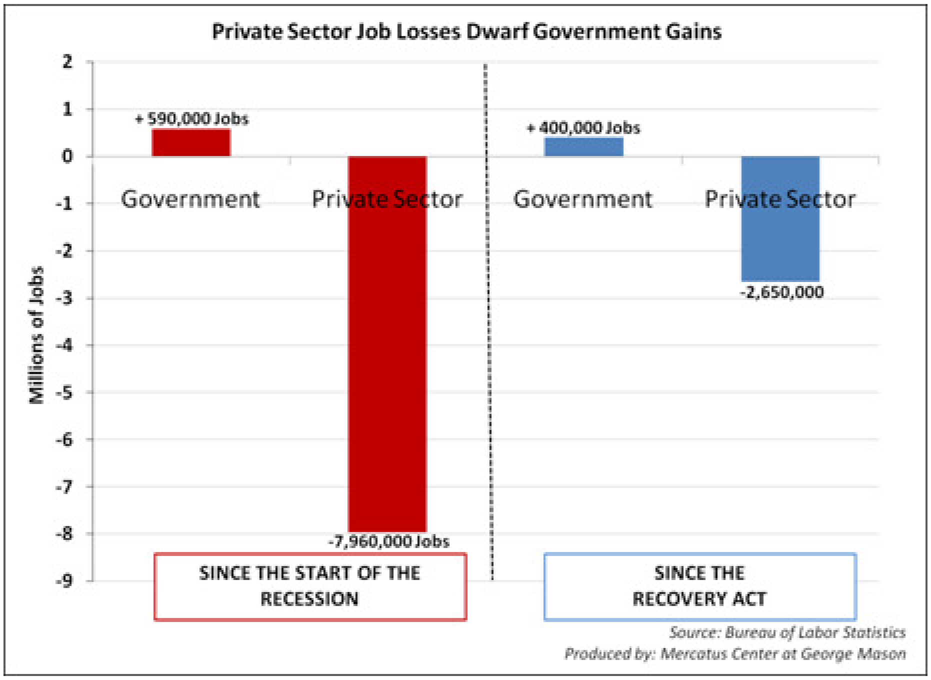
This is astounding on two fronts. How could anyone miss more than 5 of 8 questions? Equally astounding, how could libertarians miss an average of 1.38 questions? This may be the strongest argument yet for term limits.

People who devote their lives to “public service” do so in the firm belief that something good can be done in such a career. But when their understanding of economics is so far removed from reality, the amount of unintended damage can be staggering. It cannot be excused because it is unintended.

Employment: The numbers for June were bad on the surface and grim underneath. The economy lost 125,000 jobs in June, after gaining 433,000 jobs in May. The swings in census employment distorted both numbers (up in May, down in June). The grim reality lies under the surface. The goods-producing sector job growth went from +13,000 to -8,000. Durable goods produced a modestly healthy 30,000 jobs in May, but dropped to an anemic 13,000 in June.

The critical observation is that most jobs are being created in the government sector. These jobs a produce no wealth. The foundation of wealth creation is in the private sector jobs, especially in durable goods.

The tragic fact of the stimulus program is that the money has gone disproportionately to government employees. While many of these jobs make valuable contributions, none directly produce wealth. And when the funds to protect public sector employees simply delay hard decisions it serves no useful purpose. An example is reducing teacher payrolls in proportion to shrinking enrollment. While the wealth creation engine of the US economy has collapsed, the government sector has continued to grow. This model must change or it will not end well.



This is a prescription for a worsening economic outlook. Each government job added results in a loss of 1.5 jobs in the wealth-producing private sector (multiple studies disagree on a precise value, but agree on direction). A study in Spain showed that investment in Green Jobs resulted in a loss ratio of 2.2.

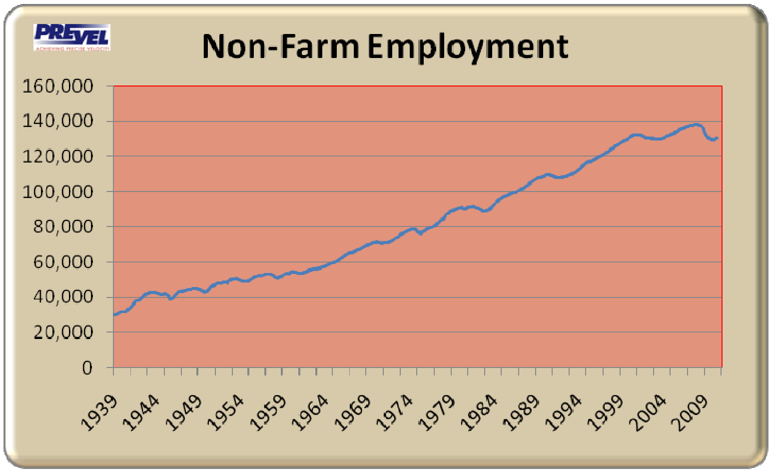
When coupled with the massive debt-funded spending increases and the outlook for added regulation, small businesses across America have decided to wait it out. As one CEO said recently "It no longer matters what they say. I no longer believe them."

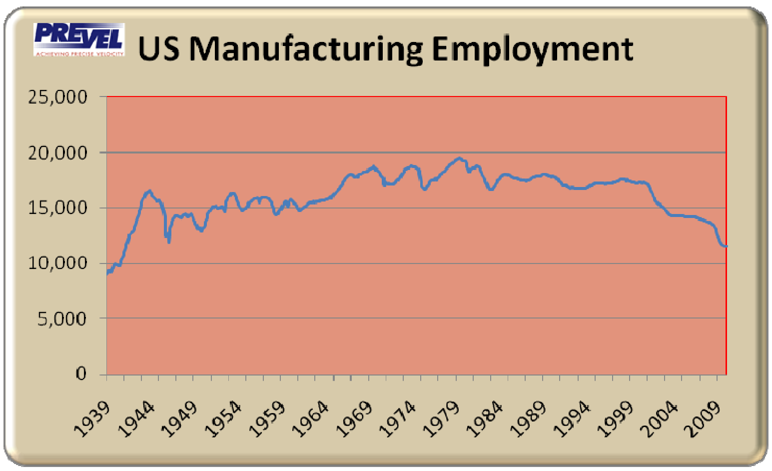
The bottom line is that we need to see Durable goods hiring at a level of about 50,000 per month to have a robust recovery. This would translate into about 400,000 jobs created across the entire economy. We have no reason to expect that anytime soon.

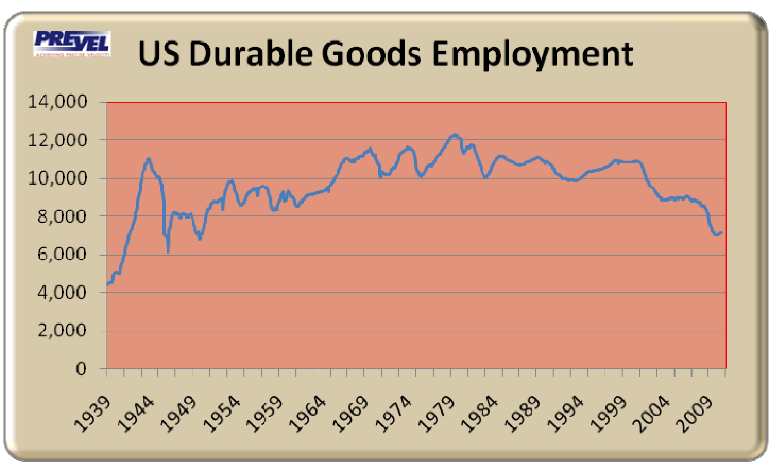
The unemployment numbers have become a useless measure. But then long term readers of the DGR have heard this before. Last month the drop from 9.7% to 9.5% resulted entirely from the more than 650,000 unemployed who reported that they had given up looking for a job.

The best analysis of unemployment available comes from John Williams Shadow Statistics web site (www.shadowstats.com). He puts current unemployment at 22% when all discouraged workers are included. We're quite close to the 25% of the great depression.

The DGR has always emphasized the total employment number since it is the best signal of the effectiveness of wealth generation in the economy, and least subject to manipulation. Our current position on that measure is pretty grim. It is clear from these graphs that government spending hasn't fixed anything.







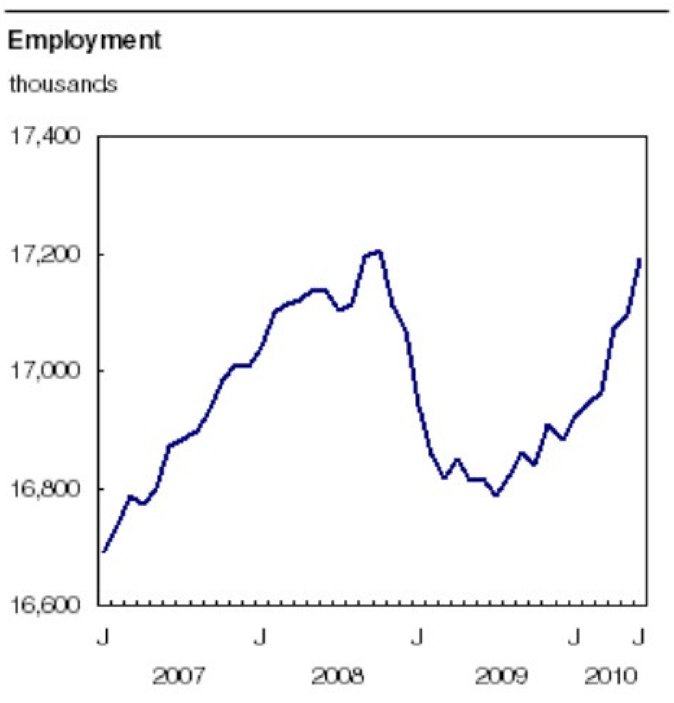
A dramatic example of the effects of government decisions on employment comes from a comparison to Canada. The economy there is growing robustly (about 6%) and *all of the jobs lost in the recession have been recovered*. No Canadian bank has failed and the government has not intervened with massive stimulus spending and bailouts.

US growth rates remain anemic and we hear from Vice President Biden that we may never recover all the lost jobs.

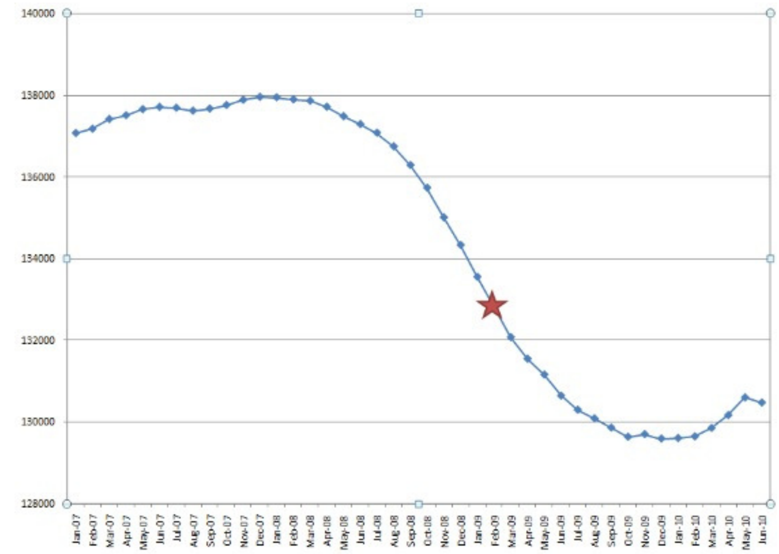
Both banking systems suffer from roughly the same degree of regulation. The critical difference is that Canadian banks didn't get (or resisted) political pressure to take on risky mortgages. Their lending leverage remained constant and restrained throughout the go-go years. They were ridiculed in those heady days as stodgy.

Those stodgy Canadians are starting to look pretty smart. (charts via Ed Morrissey at Hot Air)

Canadian Employment



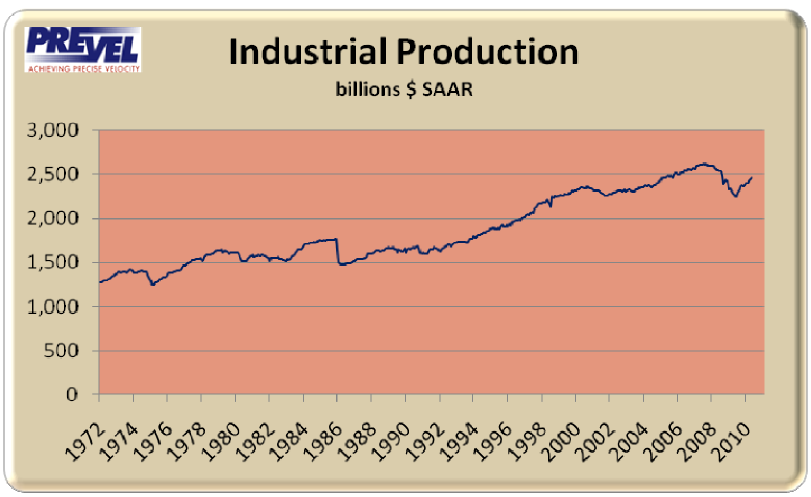
US Employment (red star indicates stimulus bill)



Summary and Sector Analysis

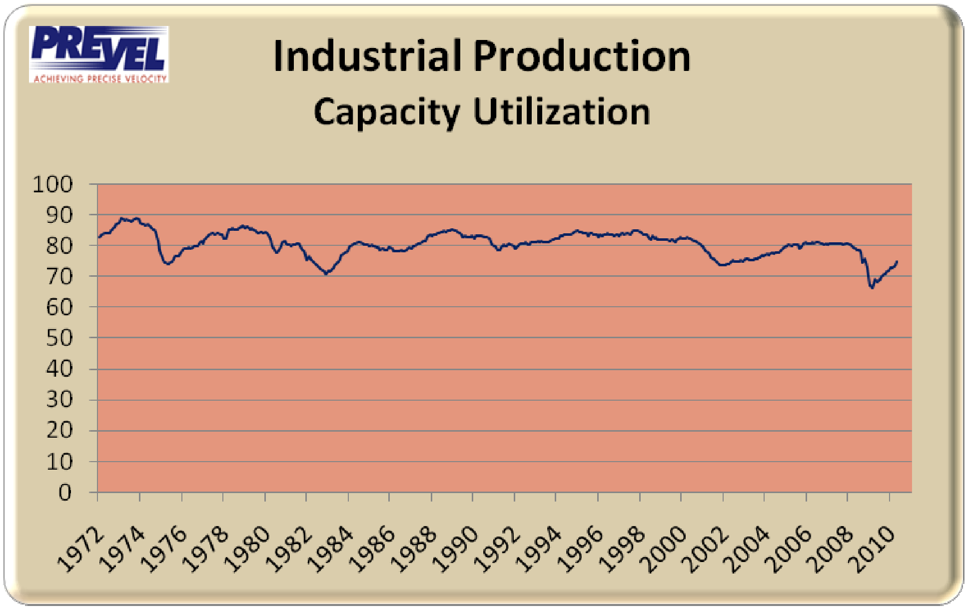
Industrial Production increased by 1.1% in May following a revised 0.5% April increase. The performance from May data do not yet show any signs of a reversal into a double dip recession, but most of the other signals are included in the early June data. June industrial production will be important to watch.

Industrial Production $b SAAR				
Year	Mo	Ind Prod - Value of Prod	Chg from Prior Pd	Chg from Prior Year
2009	5	2,257.3	-1.6%	-11.2%
2009	6	2,249.1	-0.4%	-11.3%
2009	7	2,297.3	2.1%	-9.3%
2009	8	2,328.4	1.4%	-6.2%
2009	9	2,364.4	1.5%	-1.3%
2009	10	2,377.5	0.6%	-2.5%
2009	11	2,369.6	-0.3%	-2.3%
2009	12	2,380.9	0.5%	-1.7%
2010	1	2,400.7	0.8%	3.1%
2010	2	2,396.8	-0.2%	2.5%
2010	3	2,422.4	1.1%	4.7%
2010	4	2,433.8	0.5%	6.1%
2010	5	2,460.5	1.1%	9.0%



Capacity Utilization:

Industrial production capacity utilization increased to 74.7% in May. The recovery continues in this important measure, but capacity expansion rarely occurs at utilization rates below 80%. After the recession of 2000-2003, capacity remained flat until mid-decade when utilization topped 80%. Then capacity expanded to hold utilization at that level. While the numbers vary by sub-sector, the concept is the same.



Similar patterns showed in key sub sectors:

Manufacturing: 72.0% (+0.8)

Durable goods: 68.9% (+1.2)

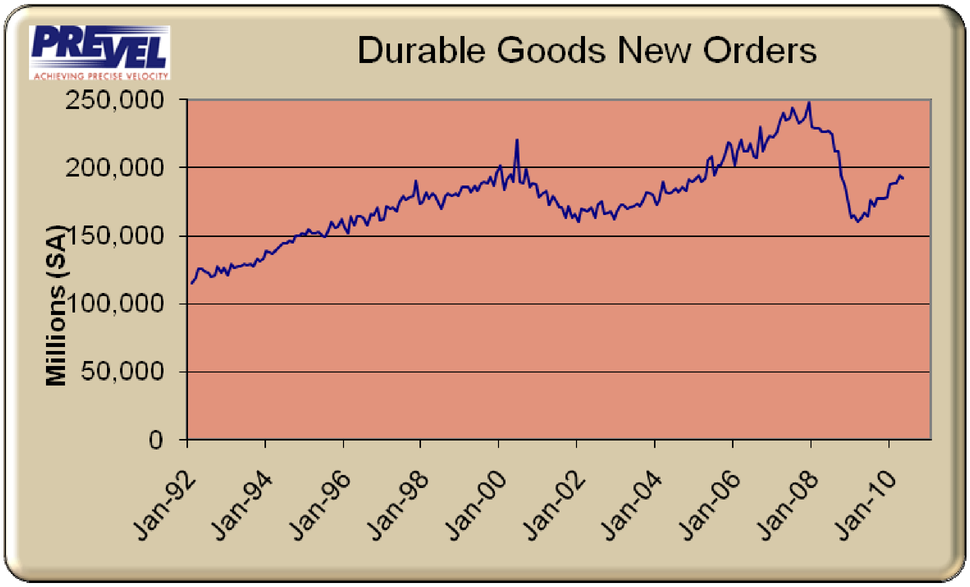
Primary Metals: 71.7% (+1.1)

Autos & Lt. Trucks: 60.8% (+3.3)

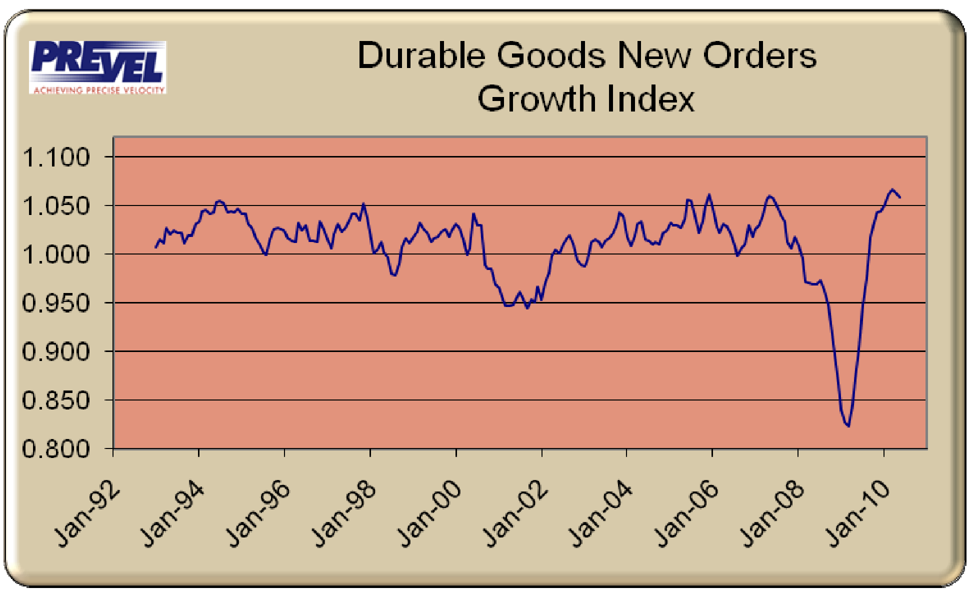
Machinery: 71.6% (+1.5)

The direction is encouraging, but the absolute values are still in terrible shape. There is nothing here to recommend investment in plant and equipment.

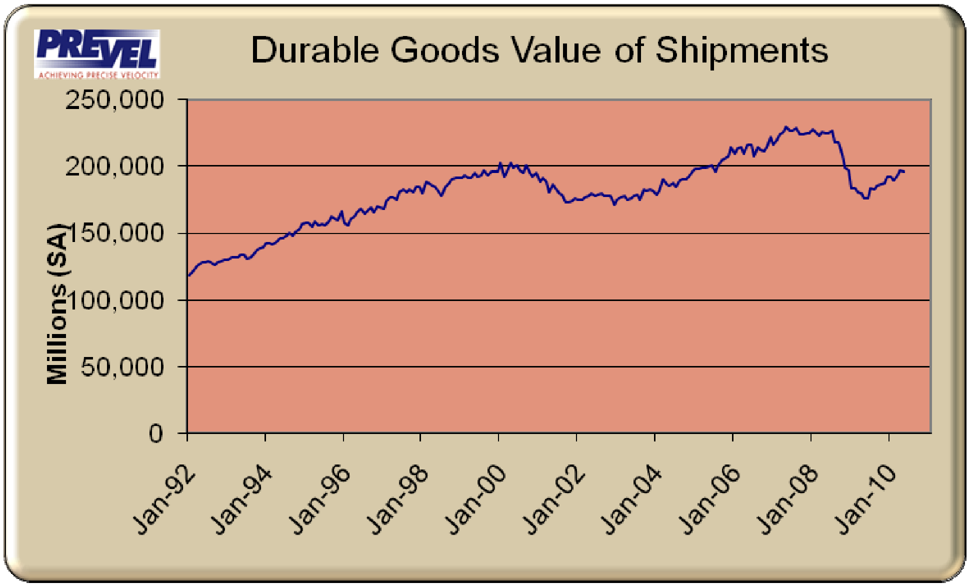
Of serious concern for the global economy is that China is in a similar situation. Their GDP growth rate has been held at unusually high levels by huge investment in excess industrial capacity now sitting idle. There are also reports of a much larger sub-prime problem that the US faced. There are signs that they are moving to reign in the artificial inflation of GDP.



Durable Goods New Orders: A decline of 0.6% in the May numbers followed a revised increase of 2.9% in April. There are other signs that more cutbacks may be coming. Consumer confidence is dropping, factory hiring has slowed significantly and supply chain response has been lagging. Construction machinery continues to counter the trend and remains solid.

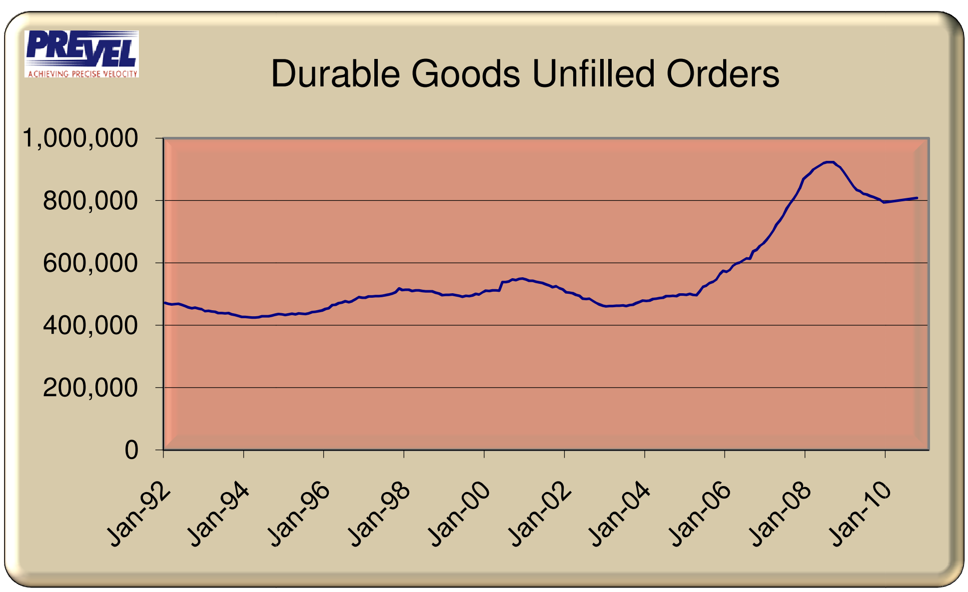


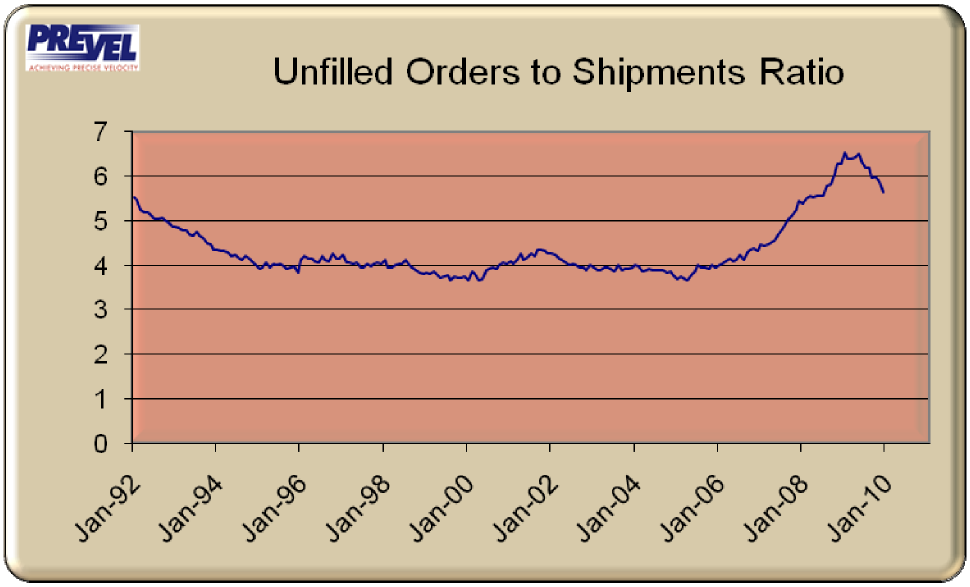
Durable Goods Growth Index (3mma/12mma): This measure of acceleration remained at elevated levels in spite of the second monthly decline.



Durable Goods Shipments: Declined by 0.3% after a 2% increase in the prior month. Shipments will respond more slowly than orders since the backlog of unfilled orders remains high.

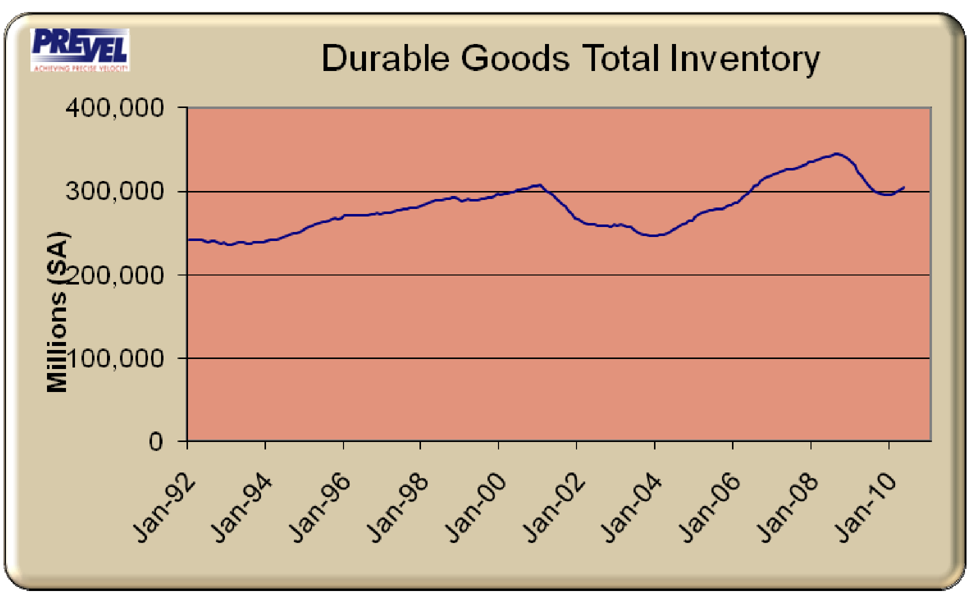
Backlogs:

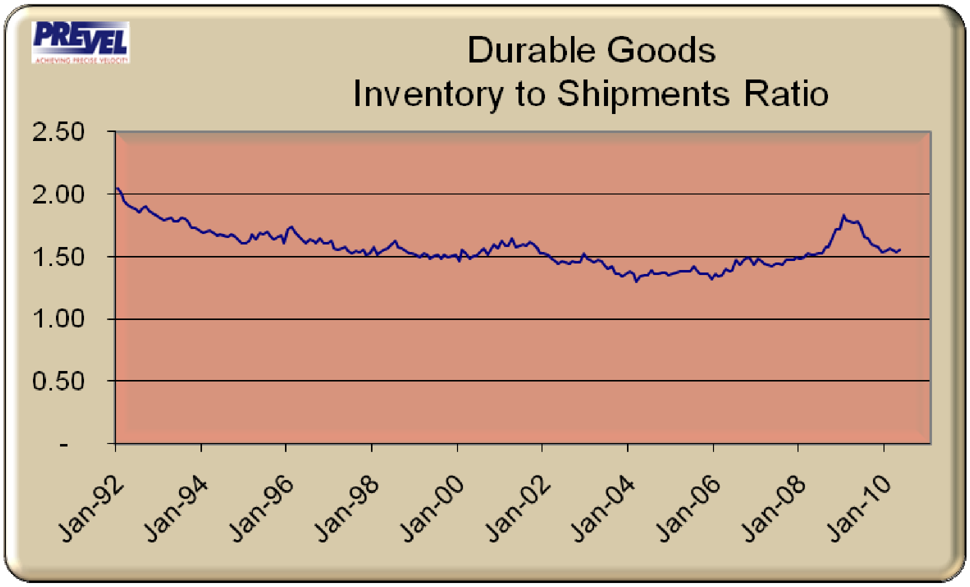




Durable Goods Unfilled Orders: Unfilled orders declined slightly, but remained at high levels by traditional standards. The ratio of unfilled orders to shipments, a measure of factory lead time, remained flat at 5.6 months for the third month. This measure had shown some improvement in recent months but remains far above the 4 month value considered "normal" in the industry. Manufacturers remain unwilling to increase production rates enough to drive backlogs down.

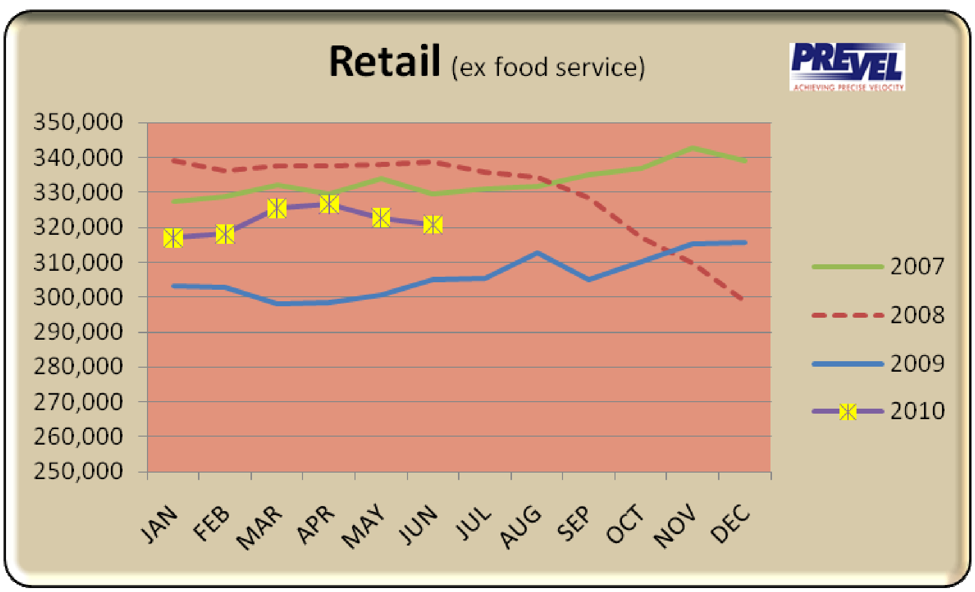
Inventories:



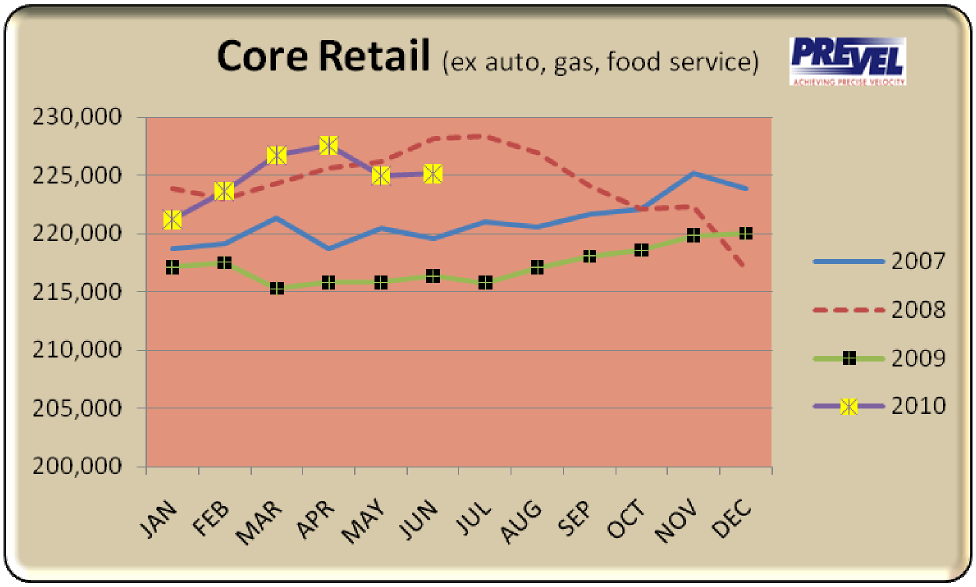


Durable Goods Inventory: Inventory grew faster than shipments in May. Even though the inventory to shipments ratio is at reasonable levels, this could be another cautionary signal to factory executives.

Retail Data (June)



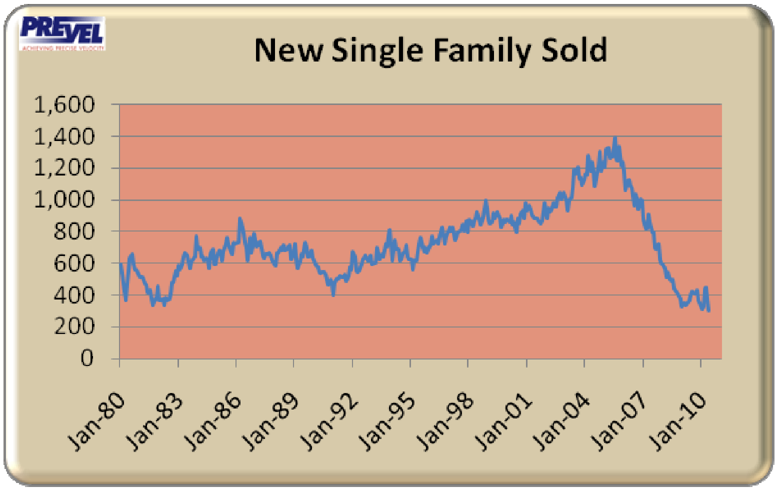
Retail Sales: Retail declined again in June. The entire decline was a result of a drop in auto and parts sales. The improvement in auto capacity utilization mentioned above (May data) will likely be reversed when June is released.

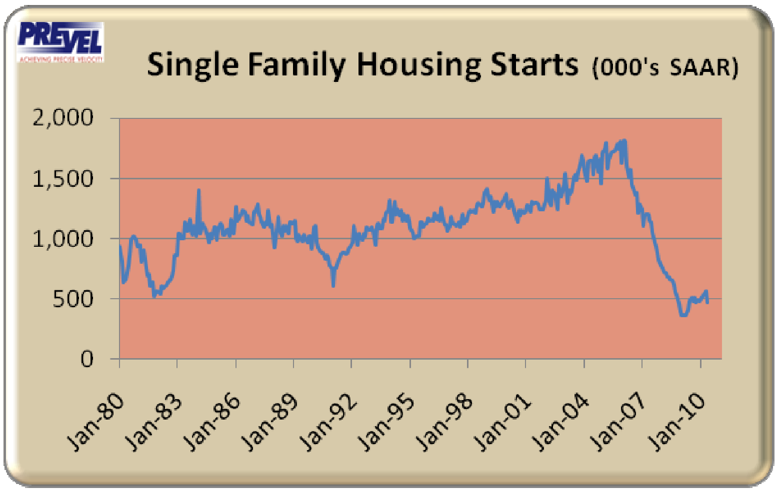


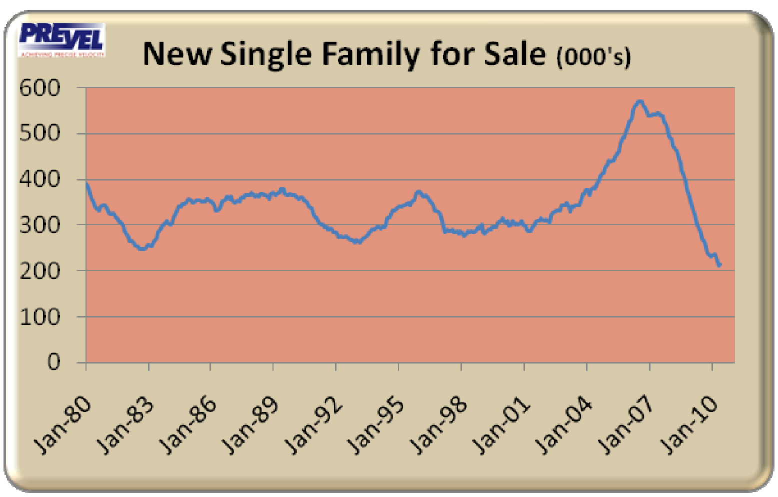
Core Retail Sales (excluding food service, autos, gas): The June core retail performance remained flat. The decline in consumer confidence is being reflected in big ticket purchases like autos, but not as dramatically in everyday purchases. Economic recovery will depend on a more robust performance at retail.

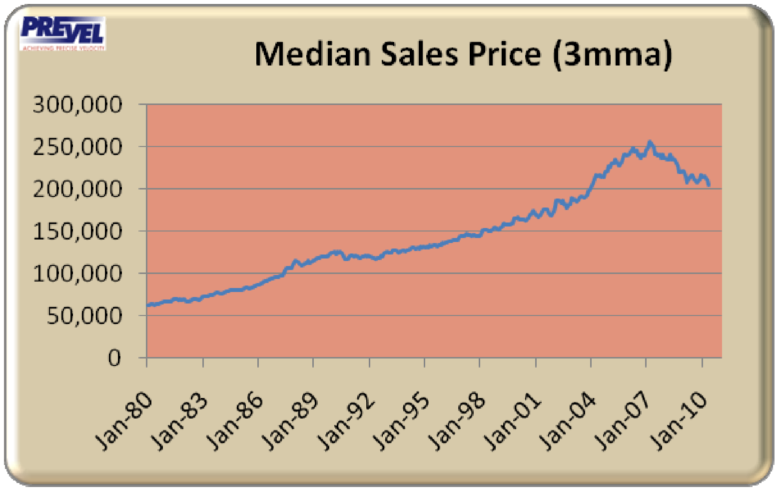
Housing: The housing industry remains stubbornly resistant to a turnaround. Sales of new single-family homes dropped by 33%, to 300,000 units. This is the lowest since 1963. It is a further signal of the futility of government stimulus programs. In a repetition of the Cash-for-Clunkers results, the housing incentives did nothing but borrow demand from future months. There is no "pent up demand" for housing that is being held back because of affordability. It's much simpler than that. There isn't any demand. Until potential buyers feel more confident about the future of the US economy, the housing industry is unlikely to change.

Single family home starts dropped 17%, but more importantly the dramatic drop in sales suggests further cuts in starts. There are no signs in current data to suggest a turnaround.


New Single Family Sold
1,600
1,400
1,200
1,000
800
600
400
200
0
Jan-80
Jan-83
Jan-86
Jan-89
Jan-92
Jan-95
Jan-98
Jan-01
Jan-04
Jan-07
Jan-10


Single Family Housing Starts (000's SAAR)
2,000
1,500
1,000
500
0
Jan-80
Jan-83
Jan-86
Jan-89
Jan-92
Jan-95
Jan-98
Jan-01
Jan-04
Jan-07
Jan-10


New Single Family for Sale (000's)
600
500
400
300
200
100
0
Jan-80
Jan-83
Jan-86
Jan-89
Jan-92
Jan-95
Jan-98
Jan-01
Jan-04
Jan-07
Jan-10


PREVEL
Median Sales Price (3mma)
300,000
250,000
200,000
150,000
100,000
50,000
0
Jan-80
Jan-83
Jan-86
Jan-89
Jan-92
Jan-95
Jan-98
Jan-01
Jan-04
Jan-07
Jan-10

About Prevel and The Durable Goods Report

Prevel Technology provides business consulting and information technology tools in support of high performance organizations. Our focus is on manufacturing and telecom, and through our business partners we support health care and other high-demand business environments.

The goal of the Prevel Durable Goods Report 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 current conditions. 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.

About the Author:

John Layden serves as CEO of Prevel Technology, a management consulting and technology consulting firm serving manufacturing, distribution, and their supporting technologies. Prevel has developed a suite of high-performance real-time applications systems in support of their client industries.

Prior to launching Prevel, Layden’s career included 22 years’ in manufacturing and another 20 years in enterprise software. Most recently he has served as VP of Supply Chain Management for SAP and VP of Supply Chain Market Development for Frontstep, Inc. He served as President of Pritsker Corporation, an early innovator in discrete event simulation and Advanced Planning and Scheduling fields. He negotiated the Pritsker acquisition by Frontstep. He was a founder and CEO of Automated Technology Associates, Inc., a leader in the development of real-time quality control systems and factory management applications.

Layden has authored over 40 articles and papers on both the theory and practice of manufacturing and supply chain operations. He was described by one editor as one of the “founding fathers” of the Advanced Planning and Scheduling (APS) industry. He also authored the supply chain chapter in Maynard’s Industrial Engineers Handbook. He speaks worldwide on the subject of world class operating strategies. He has been the keynote speaker at numerous conferences including the Automation Hall of Fame Awards.

As a software company CEO, Layden delivered to market the first real-time advanced planning and scheduling system; the first real-time SPC system; and the first real-time, fourth-normal-form database system. He is the originator of the Return on Capacity modeling process for analysis and improvement of supply chain profitability and delivery performance.

As a key partner to Motorola, Layden developed the quality control concepts that became the Six Sigma Initiative. He introduced the same concepts to GE and the Cadillac Division of General Motors. These initiatives contributed to the Malcom Baldrige awards won by Motorola and Cadillac, and to the highly publicized Six Sigma program at GE. He introduced the Six Sigma concepts to software development and delivered the only application software release to meet these exacting quality standards. Layden holds three patents and is the only American to hold a Japanese patent in quality control.

Prior to his tenure in manufacturing software, Layden spent 20 years as an engineer, operating executive and board member with three Fortune 200 manufacturing companies. The advisory services of Prevel retain the practical, no-nonsense approach familiar to world class operating executives. His operating roles included plant manager, director of business planning, and VP of Supply Chain Management.

Layden currently serves on 3 boards, and advises several high-tech startup companies.

Mr. Layden holds a BS degree from Purdue University in Electrical Engineering and an MBA from the University of Wisconsin-Milwaukee (Executive Program). He is active with the Purdue University President’s Council, and has served as a guest lecturer in the MBA programs of Villanova University, Columbia University, New York University, Ball State University, and others. He can be reached at jlayden@preveltech.com or 317-842-6417.

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