ECONOMIC UPDATE

REGIONS

June 15, 2016

May Industrial Production: Motor Vehicles Send Production In Reverse

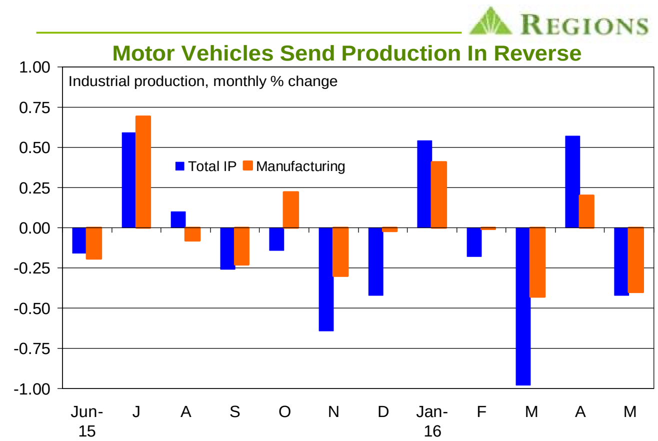
- Industrial production fell by 0.4 percent in May, with manufacturing output down by 0.4 percent.
- The overall capacity utilization rate fell to 74.9 percent, while the utilization rate in manufacturing fell to 74.8 percent.
- On a year-over-year basis, total industrial production was down by 1.4 percent in May, with manufacturing output down by 0.2 percent.

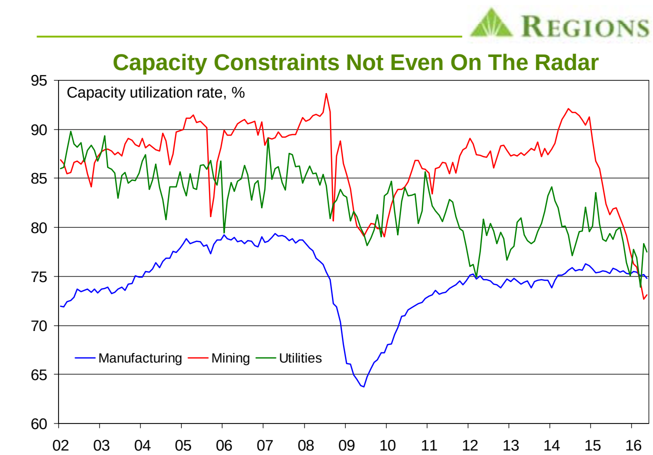
Output amongst the nation's factories, mines, and utilities fell by 0.4 percent in May, wiping out most of the 0.6 percent increase posted in April. May's decline exceeded the consensus estimate of a 0.1 percent decline but fell short of the 0.6 percent decline we expected. Manufacturing output was down 0.4 percent in May, with utilities output falling by 1.0 percent while mining output unexpectedly rose by a modest 0.2 percent – this increase explains our miss on the headline IP number as we had forecasted another decline in mining output. Capacity utilization rates fell in the manufacturing and utilities sectors in May while utilization in the mining sector advanced on the increase in output. On an over-the-year basis, output in the manufacturing sector was down 0.2 percent in May, with mining output down 11.5 percent and utilities output down by 0.8 percent, all of which adds up to an over-the-year decline of 1.4 percent in total industrial production. The performance of the manufacturing sector is concerning, and we see little clear path forward with continued risks to the downside.

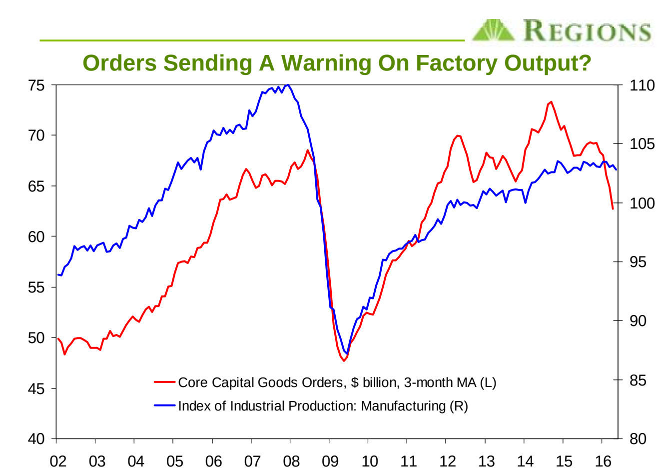
A sharp decline in motor vehicle production was a key culprit in the decline in total manufacturing output in May. Auto and light truck assemblies fell to an annualized rate of 11.1 million units, the lowest since February 2015. While unit sales have run at over a 17 million unit pace thus far in 2016, we see little room to the upside, and will note that fleet sales have accounted for a sizeable share of sales this year while inventories of finished motor vehicles remain on the high side. All of which suggests that while we could see a bounce in the June data, assemblies are unlikely to revisit the highs of around 12 million units (annualized) seen earlier in this cycle. Excluding motor vehicles, manufacturing output was down 0.1 percent in May with mixed results across the sector. Output of wood products, industrial machinery, furniture, fabricated metals, and apparel & leather products was down in May. Conversely, output of computer & electronic products, primary metals, and food & beverages was higher. As noted above, however, we see continued risks to the downside for the manufacturing sector. Global economic growth remains soft and uneven which, in terms of the impact on growth of U.S. exports, would easily offset any benefits from what has been a weaker U.S. dollar of late. Of even more concern is the gathering weakness in orders for core capital goods, as seen in our bottom chart. This does not bode well for producers of business equipment and machinery in the months ahead. We will note one bright spot in the data – output of information processing equipment has shown some strength over recent months, as have orders for such equipment. Whether or not this momentum is sustained over coming months will bear watching, particularly as it could be a harbinger of faster growth in labor productivity.

Utilities output was off by 1.0 percent in May, but this reflects nothing more than some payback for the outsized 6.1 percent increase seen in April. The mild increase in mining output in May likely reflects the upturn in oil prices and, while rig counts have recently edged higher, it is far too soon to draw any meaningful conclusions as to whether the gains in prices and output can be sustained. Utilization rates remain notably low across the manufacturing, mining, and utilities sectors. This reflects the high degree of slack remaining in the industrial sector of the economy – which is indeed a global story not solely a domestic story. But, along with what, at least in our view, remains a significant degree of slack in the U.S. labor market, and it is difficult to see a meaningful and sustained increase in inflation pressures in the near term.

With a soft and uneven global growth environment and a troubling trend in orders for core capital goods, it is hard to envision a meaningful rebound in manufacturing activity over coming quarters. While there may not be further deterioration, we could be bumping along a bottom for some time to come.







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