ECONOMIC UPDATE

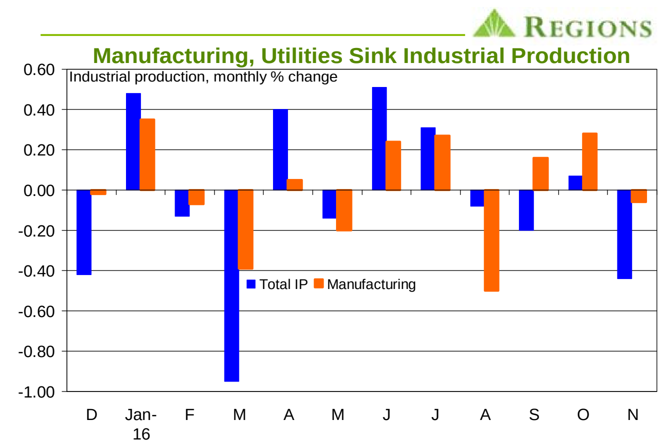
REGIONS

December 14, 2016

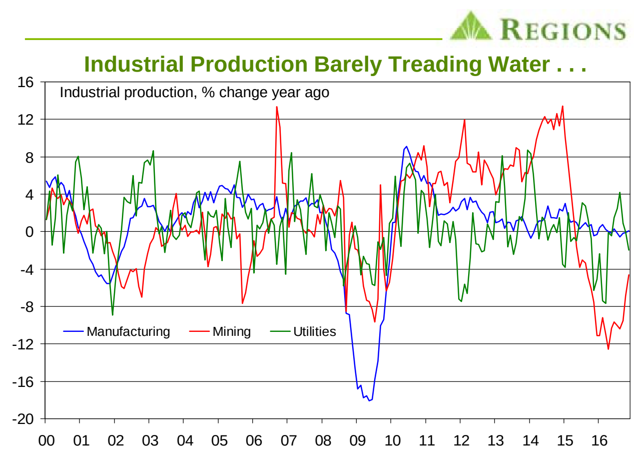
November Industrial Production: Manufacturing, Utilities Sink Total Output

- Industrial production <u>fell</u> by 0.4 percent in November, with manufacturing output <u>down</u> by 0.1 percent.
- The overall capacity utilization rate <u>fell</u> to 75.0 percent, while the utilization rate in manufacturing <u>fell</u> to 74.8 percent.
- On a year-over-year basis, total industrial production was <u>down</u> by 0.6 percent in November, with manufacturing output <u>up</u> by 0.1 percent.

Output amongst the nation's factories, mines, and utilities fell by 0.4 percent in November, larger than the consensus estimate of a 0.2 percent decline but a bit better than our forecast for a 0.5 percent decline. There was a modest upward revision to the initial estimate for October, with total output now reported to have risen by 0.1 percent instead of being unchanged as initially reported. The overall capacity utilization rate fell to 75.0 percent in November from October's upwardly revised reading of 75.4 percent. On an over-the-year basis, total industrial output was down 0.6 percent in November, marking the 15th consecutive month in which total industrial production has fallen on an over-the-year basis. Manufacturing output was up a slight 0.1 percent year-on-year, with mining output down 4.6 percent and utilities output down 1.9 percent.

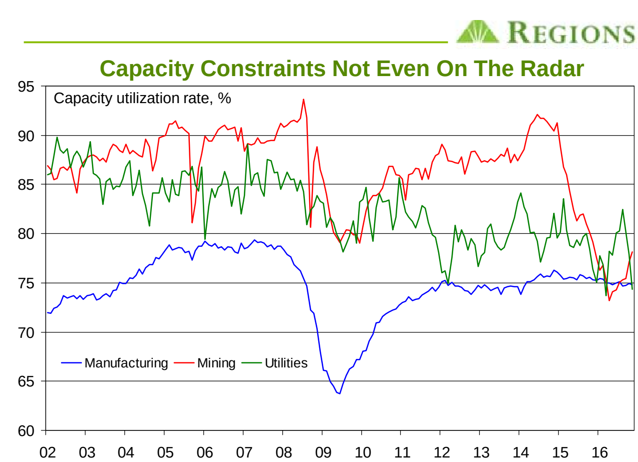


Mining output, which includes oil and natural gas extraction, notched a second consecutive monthly gain in November, with an increase of 1.1 percent. Recent firming in market prices has drawn more domestic capacity on line, but this of course raises the question as to whether the recent firming in market prices will withstand increasing production on the part of U.S. producers even if – and that's a bigger "if" than we could possibly fit on this page – the recent agreement amongst OPEC and non-U.S. producers holds up (which we'll believe when we see). Still, should the agreement hold and prices post even modest gains over coming months, more actively engaged U.S. producers could provide some, well, energy to business capital spending, which has been sagging badly over recent quarters. One metric to watch is the utilization rate in the mining sector, which stands at 78.16 percent as of November. This is the highest in a year though still considerably below the better than 90 percent utilization rates consistently seen prior to the precipitous decline in prices. While the still-low rate may make it seem unlikely we will see a meaningful rebound in capital spending amongst domestic producers, there are some questions over the extent to which maintenance has been kept up and whether capacity that has been taken off line has been, in essence, cannibalized to maintain the capital stock still in use. This will clearly impact energy related cap-ex..



Milder than normal weather held down utilities output in November, and the 4.6 percent decline from October marks the largest monthly decline since March 2007. With the steep decline in output, the capacity utilization rate in the utilities sector fell to 74.35 percent, the lowest reading in eight months. It is also worth noting that the sharp drop in utilities output poses a downside risk to November consumer spending, as utilities outlays are a key component of spending on household services. Clearly the onset of harsh winter weather of late will lead to a sizeable boost in utilizes output in December.

The drop in aggregate hours worked in the manufacturing sector reported in the monthly employment data tipped the decline in manufacturing output in November, though that 0.1 percent decline is smaller than we had anticipated, which accounts for our miss on the headline IP forecast. It is worth noting that while recent measures of sentiment in the factory sector have improved, we continue to put more stock in the industrial production data as the more relevant gauge of the health of the manufacturing sector. To be sure, recent signs of life in core capital goods orders are encouraging, but at the same time we remain concerned about the adverse effects of further appreciation of the U.S. dollar, which will make U.S. produced goods less competitive in global markets. We think it also worth noting that motor vehicle assemblies fell in November, though at an annual rate of 11.7 million units assemblies remain at a fairly high level. But, retail inventories of motor vehicles are somewhat elevated, and we have questions as to how much longer sales can be sustained at the rates seen over the past few months.



While there is some upside potential from energy, we expect manufacturing to weigh on total industrial production through at least the first quarter of 2017.

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