ECONOMIC UPDATE

REGIONS

May 16, 2017

April Industrial Production: Score One For The "Hard" Data

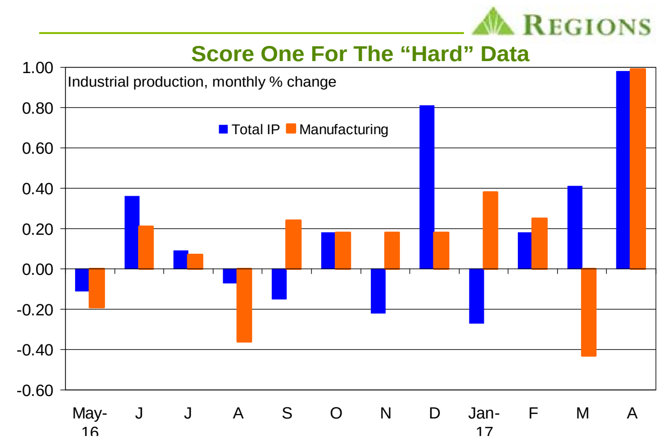
- Industrial production rose by 1.0 percent in April, with manufacturing output up by 1.0 percent.
- The overall capacity utilization rate rose to 76.7 percent, while the utilization rate in manufacturing rose to 75.9 percent.
- On a year-over-year basis, total industrial production was up by 2.2 percent in April, with manufacturing output up by 1.7 percent.

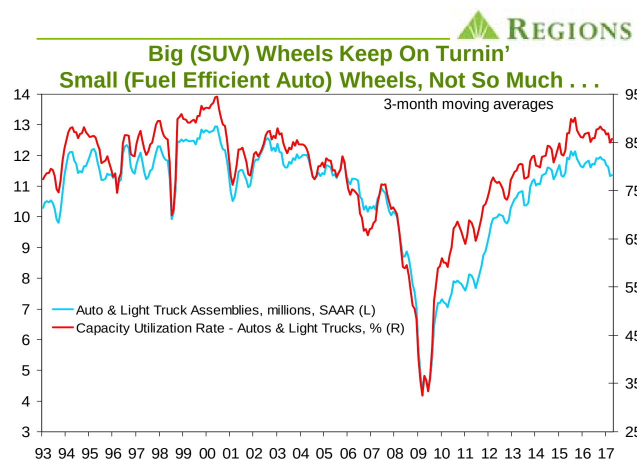
Score one for the "hard" data. Recent weeks have brought countless accounts of how sentiment or survey based, i.e., "soft," data were painting a misleadingly rosy view that was at odds with the "hard" data that actually measure economic activity. The report on April industrial production, however, should help allay concerns about the hard data not being all that solid. Total industrial production rose by 1.0 percent in April, the largest monthly gain since February 2014. That was also the last month in which manufacturing output rose as much as April's 1.0 percent increase, which more than made up for the 0.4 percent decline in March. Output in the mining sector rose by 1.2 percent in April, with utilities output rising 0.7 percent, which was somewhat of a surprise given that the 8.2 percent increase in utilities output in March is the largest on record.. Year-on-year, total industrial production was up 2.19 percent, the largest such gain since January 2015.

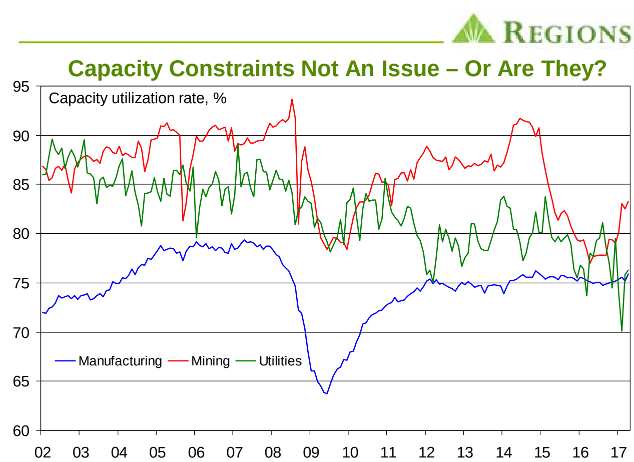
While it might be tempting to attribute the 1.0 percent increase in manufacturing output to a rebound in motor vehicle production, which was up 5.0 percent in April, it would be incorrect to do so. Gains in output were broad based, with most industry groups seeing increased output in April, even if those gains don't approach the magnitude of the increase in motor vehicle production. Still, it is worth making the following two points regarding manufacturing output, one backward looking and one forward looking. As for the former, April's increased production comes on the heels of broad based declines in March, so the overall health of the manufacturing sector is neither as weak as implied by the March data nor as strong as the April data, with the underlying trend pointing higher. Second, looking forward April could be as good as it gets for motor vehicle production, at least for some time to come. We have noted our view that motor vehicle sales have passed their cyclical peak and will continue to edge lower over coming months, in part because financing conditions are becoming less borrower friendly. The tapering off of sales has led to unwanted inventory accumulation, particularly of smaller fuel efficient vehicles, which has led to cutbacks in production schedules, which means job cuts will likely follow. As such, motor vehicle production will likely be a drag on overall manufacturing output over coming months, in stark contrast to earlier in this cycle when this industry group was one of the only supports for the manufacturing sector. This should not prove fatal to continued expansion of manufacturing output. One thing apparent in the ISM Manufacturing Index is that the improvement in manufacturing has become increasingly broad based over the past several months. A budding rebound in capital spending combined with firming global economic growth has contributed to this increasingly broad based improvement in conditions in the factory sector, and this should endure even with scaled back motor vehicle production.

One thing that will be interesting to watch over coming months is the capacity utilization rate in the manufacturing sector. As seen in our bottom chart, utilization is at present running at just over 75 percent, well below the threshold that in past cycles would have been associated with building inflation pressures. One often overlooked factor, however, is that at present the capital stock is notably old. Our question, which will be answered over coming months, is the extent to which what is now shown as idle capacity is actually deployable, and the answer has potentially large implications for the course of capital spending. If this idle capital is more or less obsolete, firms will have to spend more to right size their capital stocks in the face of rising demand; conversely, if this idle capacity is useable, firms can simply deploy it and not have to invest in new equipment. Our guess is it is more a case of the former than the latter, but time will tell.

Though the April report likely overstates the case, the industrial production data are in line with other data, of all degrees of firmness, showing broad based improvement in the manufacturing sector. Rising domestic and foreign demand means this improvement should continue over coming quarters, though motor vehicle production will likely sag.







Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com