ECONOMIC UPDATE

REGIONS

January 18, 2019

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December Industrial Production: Manufacturing Ends 2018 On A Strong Note

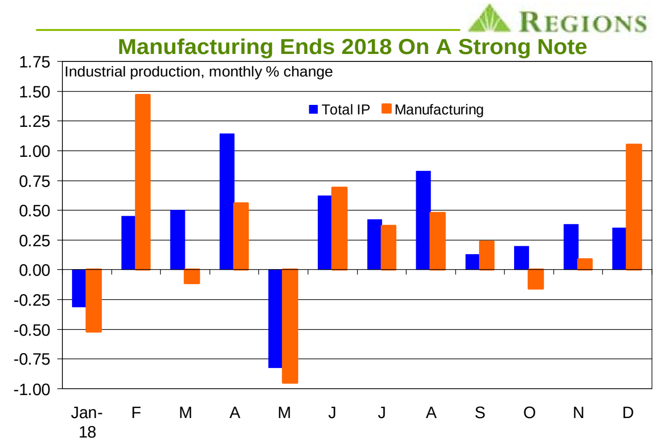
- Industrial production rose by 0.4 percent in December, with manufacturing output up by 1.1 percent
- The overall capacity utilization rate rose to 78.7 percent, while the utilization rate in manufacturing rose to 76.5 percent
- On a year-over-year basis, total industrial production was up by 4.0 percent in December, with manufacturing output up by 3.2 percent

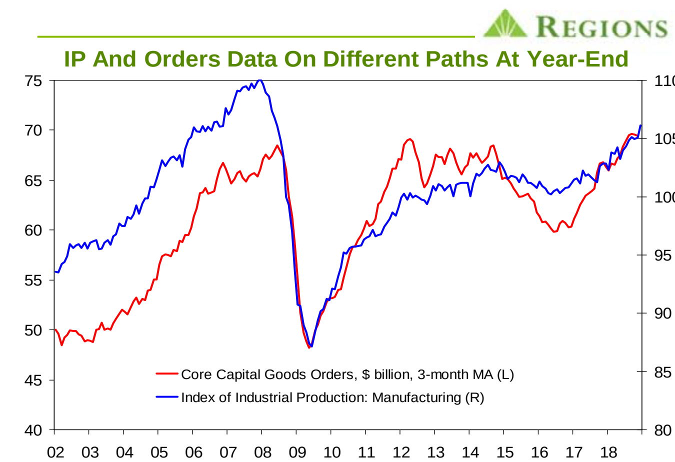
Total output amongst the nation's factories, mines, and utilities rose by 0.3 percent in December, just shy of our above-consensus forecast of a 0.4 percent increase. Output in the manufacturing sector jumped by 1.1 percent in December while output in the mining sector advanced by 1.5 percent, with these two components more than offsetting a 6.3 percent decline in utilities output due to unusually mild winter weather (which today seems like a distant memory for many parts of the U.S.). Total output was up 4.0 percent year-on-year in December, with manufacturing output up 3.2 percent. The overall capacity utilization rate rose to 78.7 percent in December, with the utilization rate in the factory sector increasing to 76.5 percent, the highest since November 2014.

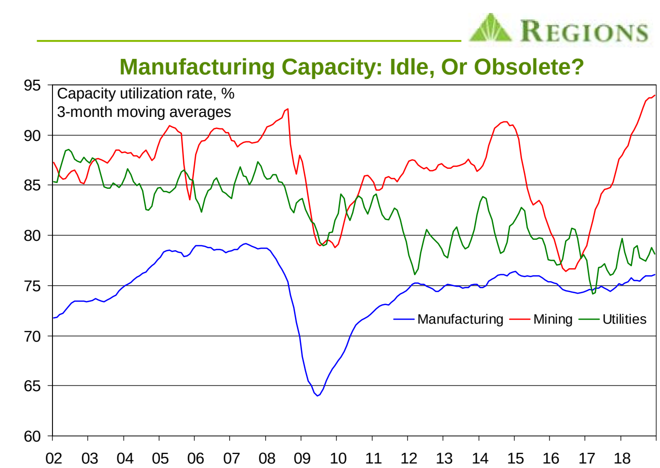
A jump in motor vehicle assemblies boosted manufacturing output in December, with assemblies rising to an annualized rate of 11.866 million units. While there was a modest increase in automobile assemblies, it was assemblies of SUVs/light trucks that (apologies in advance) drove total motor vehicle assemblies higher in December. This of course simply reflects the patterns seen in retail sales over the past several quarters, in which SUVs/light trucks have accounted for a steadily rising share of total motor vehicle sales. What remains to be seen in 2019, however, is how motor vehicle sales hold up after having surprised us and many others to the upside in 2018. Though we would not necessarily expect to see a meaningful shift in the mix of sales, we do think the level of total motor vehicle sales will drift lower over the course of this year. To be sure, there was more, much more, to the increase in manufacturing output in December than motor vehicles. Excluding motor vehicle production, manufacturing output would have been up by 0.8 percent in December. Output of computer and electronic products jumped by 1.3 percent, leaving it up 6.5 percent year-on-year. Production of industrial machinery did slip by 0.6 percent in December, but this followed a run of solid increases and output in this category was still up 4.9 percent year-on-year. Increased oil and gas extraction pushed mining output higher in December; whether, or to what extent, this is sustained will largely depend on whether the recent firming in prices continues, and we see some, but by no means unlimited, upside here. Output amongst electric utilities providers fell by 4.2 percent in December, while output of gas utilities providers plummeted by 17.5 percent on atypically mild December weather, but this will at least to some degree be reversed in the January data.

The path of energy prices will help set the path of capital spending over coming months. As seen in our bottom chart, there is very little spare capacity in the mining sector, and if prices rise further over coming months, so too will output, which will in turn lead to further capital outlays. While still low on an absolute basis, capacity utilization in the manufacturing sector is steadily, albeit slowly, rising. We have argued that the measured utilization rate in manufacturing overstates the degree of idle capacity, as years of underinvestment and an aged capital stock mean that least some of this "idle" capacity is actually obsolete capital with limited scope for more intense utilization. This would argue for further growth in capital spending in manufacturing over coming quarters.

In a sense, the December industrial production data come as a relief, given the sharp decline in the ISM Manufacturing Index in December along with what were generally weak surveys of regional manufacturing activity. Still, we think that caution is in order when interpreting the December industrial production data. Keep in mind that other manufacturing sector indicators had shown sizeable backlogs of unfilled orders while new orders dropped off, in some cases sharply, in December. As such, the December industrial production data could simply reflect firms working off backlogs of orders, and without a bounce back in new orders the industrial production data could deteriorate over coming months. We do think the expansion in the manufacturing sector has further to run, though our view is contingent upon a benign resolution of ongoing trade spats.







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