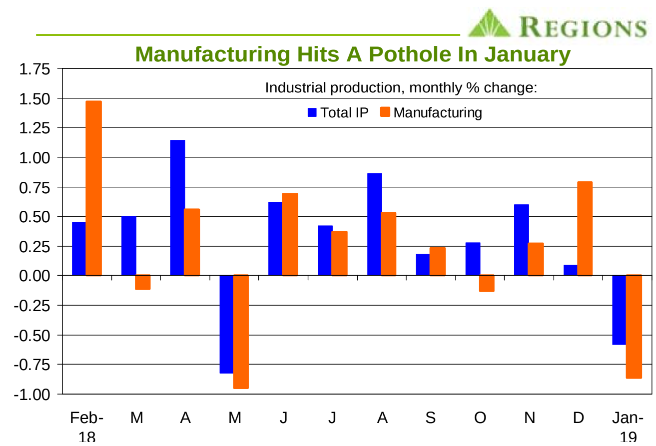
ECONOMIC UPDATE
REGIONS
February 15, 2019

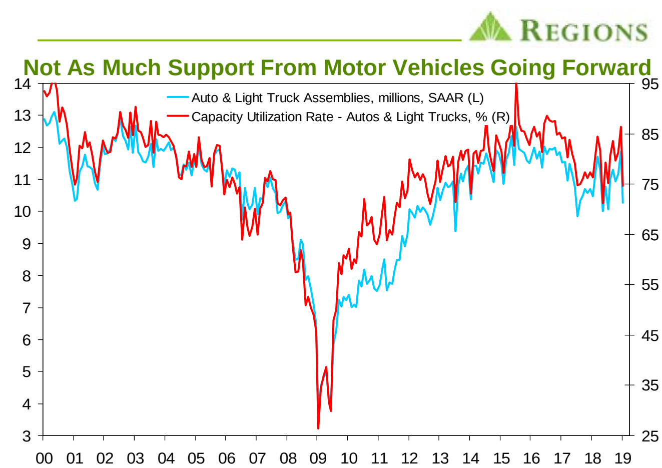
January Industrial Production: Manufacturing Hits A Pothole

- Industrial production fell by 0.6 percent in January, with manufacturing output down by 0.9 percent
- The overall capacity utilization rate fell to 78.2 percent, while the utilization rate in manufacturing fell to 75.8 percent
- On a year-over-year basis, total industrial production was up by 3.8 percent in January, with manufacturing output up by 2.9 percent

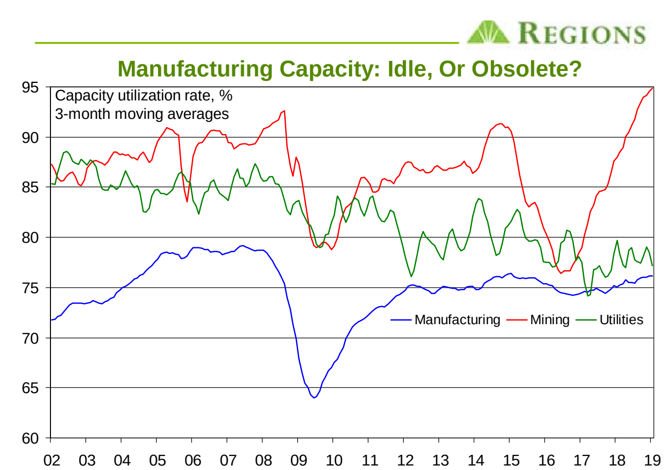
Total output amongst the nation's factories, mines, and utilities fell by 0.6 percent in January, dragged down by a 0.9 percent decline in manufacturing output which more than offset a 0.1 percent increase in mining output and a 0.4 percent increase in utilities output. Our below-consensus forecast anticipated a 0.1 percent decline in total industrial production, but the decline in manufacturing output was more severe than our forecast anticipated, hence our miss on the top-line number. As we noted in our weekly *Economic Preview*, we thought the polar vortex came too late in the month to have much of an impact in utilities output as measured in the industrial production data, but this is a potential source of upward revision to the initial January estimate over coming months. Total output was up 3.8 percent year-on-year in January, with manufacturing output up 2.9 percent. The overall capacity utilization rate slipped to 78.2 percent, with the utilization rate in manufacturing falling to 75.8 percent, the lowest since July.



The recent data on industrial production are a good illustration of a point we frequently make, which is that one should never draw any firm conclusions from a single month's data. Manufacturing output jumped by 0.8 percent in December then fell by 0.9 percent in January, and the main factor behind these swings is motor vehicle assemblies. Motor vehicle assemblies jumped to an annualized rate of 11.871 million units in December, the highest monthly rate since October 2016, but fell to an annualized rate of 10.273 million units in January. As a general rule, when you see such pronounced movements in opposite directions in back-to-back months, neither really tells you all that much. The real story, as always, can be found in the raw, or, not seasonally adjusted, data, though too few analysts bother to look there. The raw data show that December's decline in motor vehicle assemblies was smaller than normal for the month, which contributed to a smaller increase this January than is typical for the month. Through the magic of seasonal adjustment and annualizing monthly changes, we get the sharp swings in the data shown in our middle chart, neither of which tells us all that much.



There are two things going on with motor vehicle production – one is the steady shift in sales, and in turn production, away from smaller, more fuel efficient automobiles to SUVs/light trucks, and the second is a likely retreat in total unit sales, which we simply do not think can be sustained at the 17.2 million unit rate seen in 2017 and 2018. As such, motor vehicle assemblies are likely to drift lower and, if so, will not be as much of a support for overall manufacturing output in 2019 as has been the case in recent years. Trade and business investment spending will be critical drivers of manufacturing output in 2019, but at present there is considerable uncertainty on both of these fronts, so manufacturing output could be choppy over coming months.



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 has been slowly trending higher. We've 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.

A month ago we advised using caution when interpreting December's jump in manufacturing output, and we'll make the same point now regarding the sharp decline reported for January. We do think the expansion in the manufacturing sector has further to run. To be sure, our view is contingent upon a benign resolution of ongoing trade spats, but no single month's data will tell us whether or not we need to change our call.

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