ECONOMIC UPDATE

REGIONS

September 17, 2019

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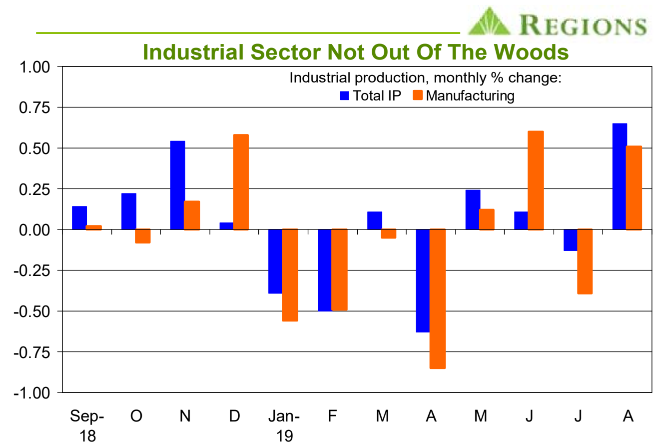
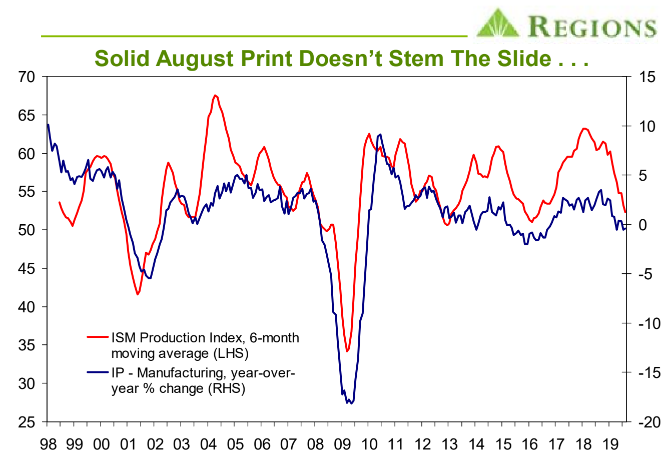
August Industrial Production: Industrial Sector Not Out Of The Woods

- Industrial production was up by 0.6 percent in August, with manufacturing output up by 0.5 percent
- The overall capacity utilization rate rose to 77.9 percent, while the utilization rate in manufacturing rose to 75.7 percent
- On a year-over-year basis, total industrial production was up by 0.4 percent in August, with manufacturing output down by 0.4 percent

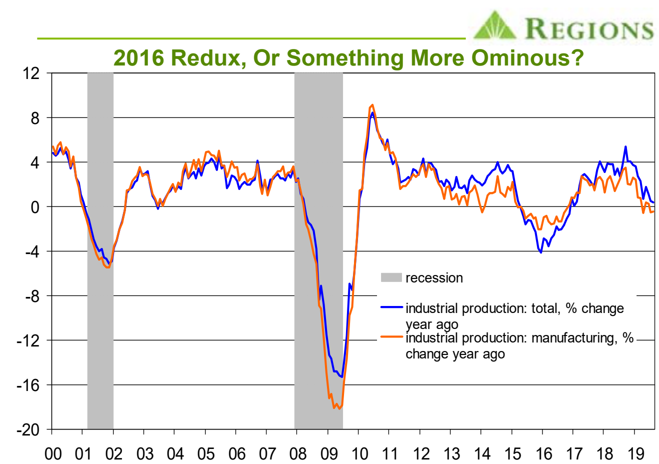
Total output amongst the nation's factories, mines, and utilities rose by 0.6 percent in August, better than the 0.4 percent increase we expected and the consensus forecast of a 0.2 percent increase. Output in the manufacturing sector rose by 0.5 percent despite a sharp decline in motor vehicle production, with utilities output up by 0.6 percent and output in the mining sector rising by 1.4 percent. That mining output was much stronger than expected accounts for the miss on our forecast of the headline number, though the August data mainly reflect a reversal of the disruption caused by Hurricane Barry in July. The overall capacity utilization rate rose to 77.9 percent in August, with the utilization rate in the manufacturing sector rising to 75.7 percent. The August data on industrial production are a welcome contrast to the ISM Manufacturing Index, which dipped below the 50.0 percent break between contraction and expansion in August. That said, the data on new orders concern us, and the slump in global manufacturing has shown no signs of subsiding. U.S. manufacturers are still facing an inventory overhang, uncertainty surrounding trade policy and less support from motor vehicle production. As such, while the August data on industrial production are a relief from what have been negative headlines and soft data, we're not by any means convinced that the August data are more than an outlier in what remains a downward trend in manufacturing activity.



On a seasonally adjusted basis, motor vehicle assemblies fell by 4.0 percent in August and are down 0.7 percent on a year-to-date basis. There is a good deal of noise in the seasonally adjusted data, however, as what had been long-standing seasonal patterns in motor vehicle production have been shaken up. Manufacturers facing slowing sales and rising inventories have been adjusting production on more of a real-time basis, meaning the typical July shutdown/August rebound were both much less pronounced this year than has typically been the case. The not seasonally adjusted data show motor vehicle assemblies down 1.6 percent on a year-to-date basis through August, and we expect that decline to get larger through year-end. We'll caution, however, that the GM strike will make the near-term data look weaker than would otherwise be the case.



Elsewhere in the manufacturing sector, August was a solid month, with output excluding motor vehicles rising by 0.6 percent. Machinery output jumped by 1.6 percent, but this does not fully erase July's 1.7 percent decline. Output in the broad business equipment category, which provides insight into the data on labor productivity, rose by 1.0 percent in August. This is, however, less encouraging than it may seem given how uneven performance in this category has been over the past several months – on an over-the-year basis, output of business equipment is up just 0.4 percent. Indeed, this is a pattern seen throughout the data from the monthly industrial production reports – uneven month-to-month performance with less than robust results on an over-the-year basis. Even with the 0.5 percent increase in August, manufacturing output is still down on an over-the-year basis in each of the past two months, and total industrial production is up only nominally. Keep in mind that industrial production is one of the main indicators used by NBER to make calls on turns in the business cycle. As such, it is reasonable to ask whether the data are pointing to a repeat of the transitory downturn seen in the industrial sector in 2016 or something more ominous.



Something else that will bear watching in the months ahead is whether, or to what extent, U.S. producers will step up oil production given the recent attack on Saudi Arabia's oil fields that has disabled over five percent of capacity. U.S. producers have some room to expand output, but perhaps not as much as is commonly assumed. Larger and more sustained increases would likely require greater capital investment, and those domestic producers who are strapped for cash may instead use higher prices to build cash. So, along with motor vehicle production, mining output will be a prime driver of the headline industrial production number in the months ahead.

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