ECONOMIC UPDATE

REGIONS

March 15, 2019

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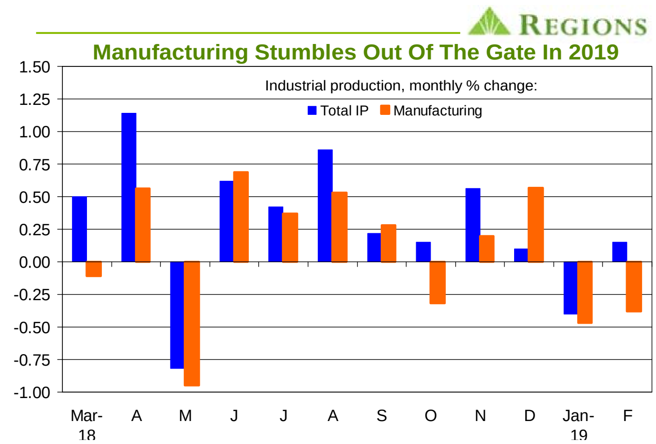
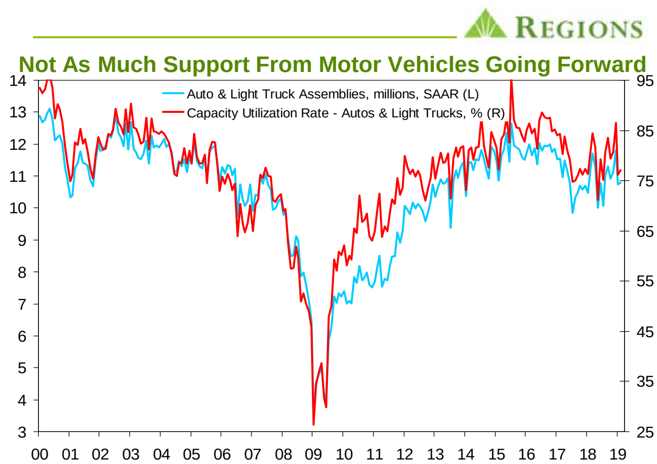
February Industrial Production: Manufacturing Stumbles Out Of The Gate In 2019

- Industrial production <u>rose</u> by 0.1 percent in February, with manufacturing output <u>down</u> by 0.4 percent
- The overall capacity utilization rate <u>fell</u> to 78.2 percent, while the utilization rate in manufacturing <u>fell</u> to 75.4 percent
- On a year-over-year basis, total industrial production was <u>up</u> by 3.5 percent in February, with manufacturing output <u>up</u> by 1.0 percent

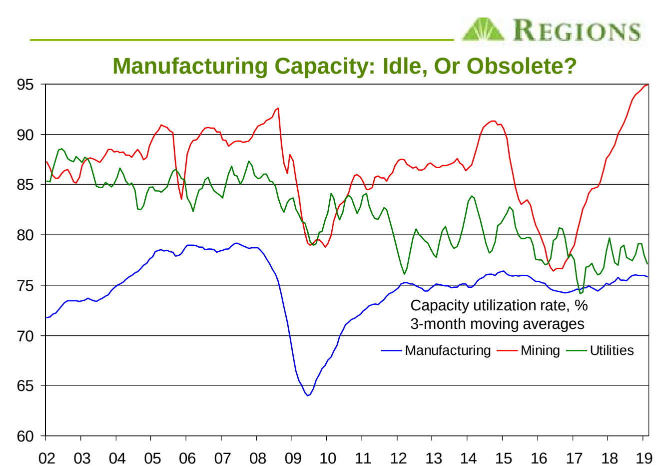
Total output amongst the nation's factories, mines, and utilities rose by 0.1 percent in February, below the 0.4 percent increase we and the consensus expected. Manufacturing output fell by 0.4 percent, double the decline our forecast anticipated, but the decline in manufacturing output in January was less severe than initially reported, with a 0.5 percent decline rather than the 0.9 percent decline initially reported (the decline in total industrial production in January is now put at 0.4 percent rather than the 0.6 percent decline initially reported). Utilities output rose by 3.7 percent, matching our forecast, while output in the mining sector notched a 0.3 percent increase. Total industrial production is up 3.5 percent year-on-year, but output in the manufacturing output is up only 1.0 percent compared to a year ago. The overall capacity utilization rate fell to 78.2 percent, with the utilization rate in the manufacturing sector falling to 75.4 percent, the lowest since May.



Unlike in January, when the decline in manufacturing output was largely a function of a sharp decline in motor vehicle assemblies, February's decline in manufacturing output reflects some steep declines in several industry groups offsetting small increases in other industry groups. Total motor vehicle assemblies were little changed, at an annualized rate of 11.13 million total vehicles compared to 11.11 million in January, but amongst autos and light trucks there was a distinct shift, with a sharp decline in production of automobiles and a jump in production of SUVs/light trucks, a shift which will be sustained over coming months though likely not at the same pace seen in February. Overall, however, with total unit sales tapering down over the course of 2019, so too will overall motor vehicle assemblies, which will be a modest drag on overall manufacturing output. As was the case in January, the not seasonally adjusted data show a much smaller increase in vehicle assemblies than is normal for the month of February, and these patterns in the unadjusted data make us comfortable with our outlook for vehicle production in 2019. Elsewhere in the manufacturing sector, machinery output, production of furniture products and electrical equipment declined sharply, while on the flip side output of computers, paper products, and aerospace equipment rose. The February industrial production data for the manufacturing sector are in line with the February employment data, i.e., sharply divergent patterns across individual industry groups with no clear direction for the sector as a whole, which we think in part reflects a downshifting into a slower pace of growth.



Spurred on by considerably colder temperatures, utilities output jumped by 3.7 percent in February, with electricity output up 4.1 percent and natural gas output up 1.5 percent. The capacity utilization rate in the utilities sector rose from 75.9 percent in January to 78.6 percent in February. Output in the mining sector rose by 0.3 percent, matching the increase seen in January, with the utilization rate in this sector slipping to 94.6 percent. 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. Capacity utilization in the manufacturing sector remains low on an absolute basis and has been basically flat over recent months. We've argued that measured utilization 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.



The list of headwinds facing the manufacturing sector is formidable – uncertainty over trade policy, slower global growth, and a slower pace of motor vehicle sales to name a few. As such, while we look for the expansion in manufacturing output to continue in 2019, it will do so at a considerably slower pace than that seen in 2018.

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