ECONOMIC UPDATE

REGIONS

July 16, 2019

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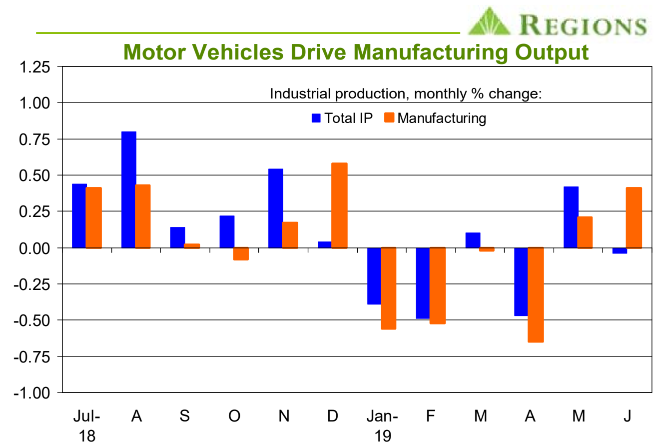
June Industrial Production: Motor Vehicles Drive Manufacturing, Utilities A Big Drag

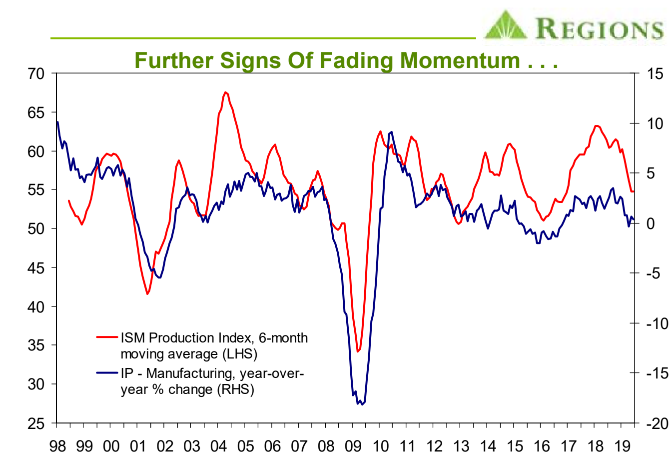
- Industrial production was unchanged in June, with manufacturing output up by 0.4 percent
- The overall capacity utilization rate fell to 77.9 percent, while the utilization rate in manufacturing rose to 75.9 percent
- On a year-over-year basis, total industrial production was up by 1.3 percent in June, with manufacturing output up by 0.4 percent

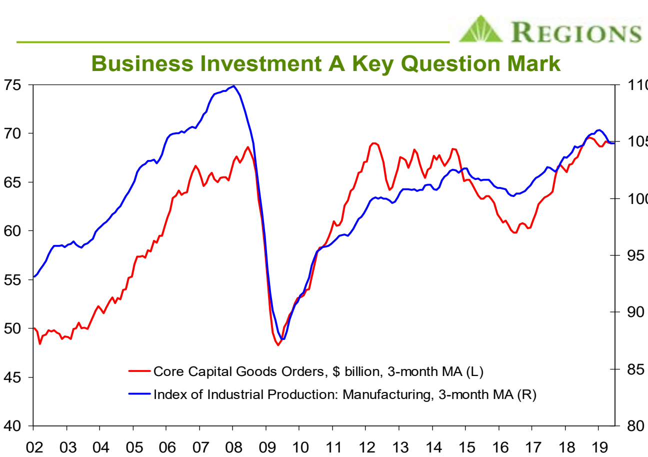
Total output amongst the nation's factories, mines, and utilities was unchanged in June, coming in below our forecast of a 0.3 percent increase. Utilities output, however, is reported to have fallen by 3.6 percent, which acted as a sizable drag on total industrial production, while manufacturing output was up by 0.4 percent and mining output was up by 0.2 percent. Total industrial production is up 1.3 percent year-on-year, with manufacturing output up by just 0.4 percent. The overall capacity utilization rate fell to 77.9 percent, with the utilization rate in the manufacturing sector rising to 75.9 percent. Clearly, the industrial sector has softened over recent months, which in part – but only in part – reflects uncertainty surrounding trade policy. That said, there is little evidence that this softening in the industrial sector has spilled over into the broader economy, and the factors acting as drags on the industrial sector of the economy will not be at all impacted by however much more accommodation global central bankers try to throw at them.

Oil and gas extraction jumped in June, but a sharp decline in coal mining held down the gain in the broad mining category, up just 0.2 percent. Given above-average temperatures during the month, the reported 3.6 percent decline in utilities output is a bit surprising. While output in the manufacturing sector rose by 0.4 percent in June, much of that gain was driven by motor vehicle assemblies, which were up by 2.9 percent in June after a 2.3 percent increase in May. As we have noted before, however, this type of growth simply cannot be sustained with the pace of motor vehicle sales slowing and inventories of unsold vehicles getting larger. One curious aspect of motor vehicle assemblies, as reported in the industrial production data, is that the production of automobiles has been rising over recent months, despite a marked and ongoing shift in the mix of motor vehicle sales away from automobiles and toward SUVs/light trucks. And, even as SUVs/light trucks continue to capture a higher share of overall sales (at present, over 70 percent of total motor vehicle sales), there too we are seeing rising inventories. We have noted that we see the slowing pace of motor vehicle sales as reflecting nothing more than what had been a considerable degree of pent-up demand having largely been sated, as opposed to reflecting weakness in consumer spending, with sales simply settling back to a more sustainable pace. Either way, we do not look for motor vehicle sales to be nearly as much of a support for growth in manufacturing output as has been the case over the past few years.

This is one of what we have noted are three drags on manufacturing at present, with trade obviously another. The third drag is that after a sizable build-up of inventories over the back half of 2018 and the first quarter of 2019, what we are seeing now is the flip side of that, i.e., inventories being drawn down. This is acting as a drag on production, and employment, in the manufacturing sector, and is contributing to diminishing freight volumes. While this inventory drawdown will be a material drag on Q2 real GDP growth, we think it has further to run. In the sense that at some point inventories will be more right-sized, this is a transitory drag but one which nonetheless will continue to weigh on the industrial production data. Excluding motor vehicle production, output in the manufacturing sector rose by 0.2 percent in June. What stands out to us amongst an uneven performance across industry groups is that output of business equipment, which is a marker for business investment spending, was up 0.5 percent after a 0.4 percent gain in May. To be sure, output in this category has been all over the map over the past several months, but gains in the last two months are somewhat reassuring in the midst of sagging business sentiment and lingering uncertainty over trade. The broader question, however, is the extent to which the softening seen in the industrial and transportation sectors of late reflects the transitory effects of an ongoing inventory correction and the extent to which trade policy has done deeper damage. We lean more towards the former explanation than the latter, but coming months will deliver the ultimate verdict.







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