ECONOMIC UPDATE
REGIONS
July 17, 2018

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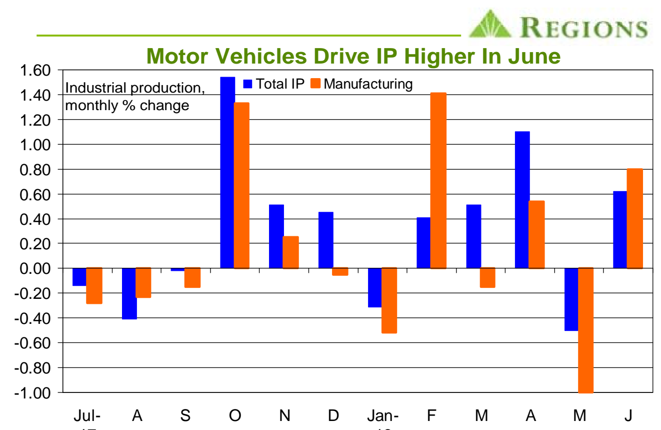
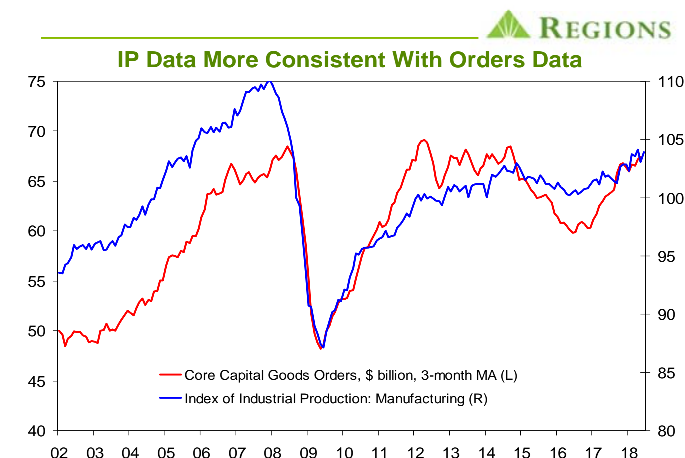
June Industrial Production: Motor Vehicles Drive IP Higher In June (yes, sadly, we did just say that)

- Industrial production rose by 0.6 percent in June, with manufacturing output up by 0.8 percent
- The overall capacity utilization rate rose to 78.0 percent, while the utilization rate in manufacturing rose to 75.5 percent
- On a year-over-year basis, total industrial production was up by 3.8 percent in June, with manufacturing output up by 1.9 percent

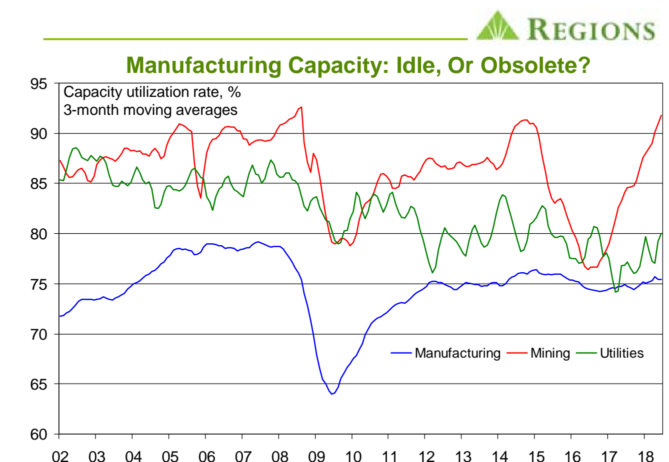
Total output amongst the nation's factories, mines, and utilities rose by 0.6 percent in June, matching our forecast but below the consensus forecast of a 0.5 percent increase. Manufacturing output rose by 0.8 percent in June thanks in part to a rebound in motor vehicle assemblies after a fire had disabled a major producer of parts for light trucks and held down assemblies in May, with mining output up by 1.2 percent and utilities output down by 1.5 percent on lower electricity usage. Excluding motor vehicle production, total industrial production would have been up by 0.2 percent in June.



In the wake of the distortions caused by the May fire, SUV/light truck assemblies are running well ahead of the pace seen at the start of 2018 while automobile assemblies have trended lower over recent months. The patterns in automobile and truck assemblies are consistent with those seen in the sales data. Sales of SUVs/light trucks accounted for a record high share of total unit sales in June and, higher gasoline prices aside, the mix of sales is not likely to shift back toward automobiles to any appreciable degree over coming quarters. Elevated inventories of smaller, more fuel efficient automobiles have led to production cutbacks in recent months. While higher gasoline prices have thus had little impact on demand for SUVs/light trucks, higher interest rates could easily have an impact. Producers will be monitoring sales and inventories over coming months to decide whether, or to what extent, to pull back production of SUVs/light trucks.



Aside from motor vehicles, manufacturing activity was decidedly mixed in June as measured in the industrial production data. Output in the broad industrial machinery category was up 0.7 percent in June, but is up only 2.7 percent year-on-year, reflecting the highly uneven month-to-month performance seen over recent months. Ongoing trade battles are likely having an impact on the production of metals and capital equipment, but there is little in the data thus far that suggests any material boost to domestic output in those industries designated for protection in the form of tariffs. It is worth noting that as of June manufacturing output stood just 1.9 percent higher on an over-the-year basis, compared to over-the-year increases of 12.9 percent in the mining sector and 5.0 percent in the utilities sector. We note this to help put in better context what have been lofty readings on the ISM Manufacturing Index over the past several months. As we often note, the ISM data are presented in the form of a diffusion index, which signals the direction but not the intensity of activity. As seen in our middle chart, the industrial production data for the manufacturing sector align more closely with the monthly data on core capital goods orders, which is not to suggest there has not been solid growth, but simply that growth is not as robust as may be inferred from the ISM data.



After having declined in June utilities output will surely notch a sizeable increase in July given the heat wave that has gripped large portions of the U.S. Mining output is up solidly over the past five months, reflecting higher oil prices. But, as seen in our bottom chart, capacity constraints could soon impinge upon domestic energy production, further complicating matters for producers already running into storage and transportation constraints. Assuming stable, if not higher, oil prices, one would expect to see higher capital spending in the energy sector. Looking at the capacity utilization rate in the manufacturing sector, one might conclude there is little need for firms to invest in new capacity when they are sitting on so much idle capacity. Our counter, however, is that the age of the capital stock calls into question the extent to which this idle capacity simply reflects obsolete stock with limited scope for more intense utilization, which would argue for stronger, and broader, growth in capital spending over coming quarters.

The distortions over the past two months have masked more gradual growth in factory output consistent with the underlying health of the U.S. economy. Trade policy, though, looms as a major uncertainty.

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