ECONOMIC UPDATE

REGIONS

October 16, 2018

September Industrial Production: Steady And Broad Based Growth In The Factory Sector

- Industrial production rose by 0.3 percent in September, with manufacturing output up by 0.2 percent
- The overall capacity utilization rate was unchanged at 78.1percent, while the utilization rate in manufacturing rose to 75.9 percent
- On a year-over-year basis, total industrial production was up by 5.1 percent in September, with manufacturing output up by 3.5 percent

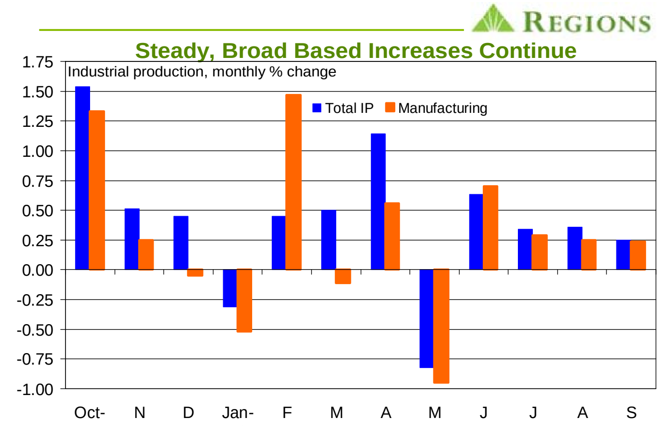
Total output amongst the nation's factories, mines, and utilities rose by 0.3 percent in September, besting the 0.2 percent increase we and the consensus expected. Output in the manufacturing sector rose by 0.2 percent and output in the mining sector was up by 0.5 percent, each matching our forecast, but in contrast to what our forecast anticipated would be a hurricane-related decline, utilities output was unchanged, hence our miss on our forecast of the headline number. Hurricane Florence had less than a one-tenth of a point impact on total industrial production, according to the Federal Reserve. Total output was up 5.1 percent year-on-year in September, with manufacturing output up 3.5 percent. The overall capacity utilization rate held steady at 78.1 percent, with the utilization rate in the factory sector edging up to 75.9 percent. Excluding motor vehicle production, total industrial production would have been up by 0.2 percent in September.

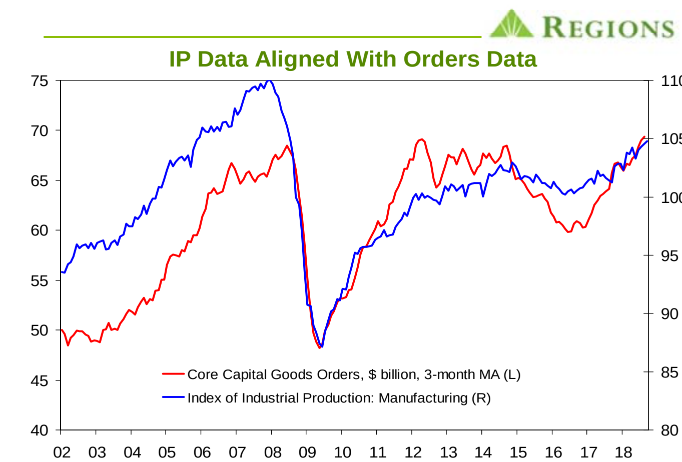
Motor vehicle production came in stronger than we had anticipated, with assemblies running at an annual rate of 11.405 million units. The bump in September unit sales notwithstanding, the pace of new motor vehicle sales is slowing and retail inventories are fairly elevated, particularly inventories of smaller automobiles. As such, we still look for overall production to drift lower over coming months as sales settle back to a more sustainable pace. That said, Hurricanes Florence and Michael will skew the data on sales over the next few months but should, given what are elevated inventories, have a lesser impact on production. Elsewhere in the manufacturing sector, output of wood products, furniture, and business equipment all posted sizeable advances; the latter is particularly notable as this is the component that has the biggest impact on labor productivity growth. Amongst the nondurable goods producing industry groups, output fell sharply in the apparel & leather and the textiles segments. Within the utilities sector, output of natural gas utilities rose but electricity output fell by 0.2 percent despite higher than normal temperatures for the month of September; it is here that Hurricane Florence came into play, having shut down electricity output across a segment of the Southeast.

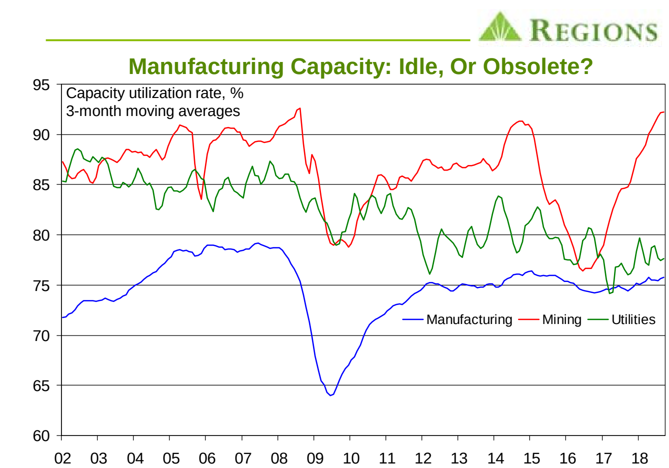
On a year-on-year basis, output of durable goods is up 4.1 percent, with machinery output up 5.2 percent. This is in line with the data on orders for core capital goods, which have been growing at a better than seven percent pace over the past 18 months. We note this to help put in better context what have been lofty readings on the ISM Manufacturing Index over this same time frame. 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 closely with the monthly data on core capital goods orders, lending credence to the ISM data despite some dismissing the latter as "soft" data which convey little meaningful information as to actual activity in the manufacturing sector.

Mining output is up solidly over the past eight months, reflecting firmer oil prices. 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 industrial production data are consistent with other indicators showing steady and broad based growth in the manufacturing sector, which in turn is supporting overall growth in the U.S. economy. Trade policy, though, looms as a major uncertainty.







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