ECONOMIC UPDATE

REGIONS

June 14, 2019

May Industrial Production: Better Than Expected, But Trend Still Weak

- Industrial production rose by 0.4 percent in May, with manufacturing output up by 0.2 percent
- The overall capacity utilization rate rose to 78.1 percent, while the utilization rate in manufacturing rose to 75.7 percent
- On a year-over-year basis, total industrial production was up by 2.0 percent in May, with manufacturing output up by 0.7 percent

Total output amongst the nation's factories, mines, and utilities rose by 0.4 percent in May, better than our forecast of a 0.1 percent decline and the consensus forecast of a 0.2 percent increase. Manufacturing output was up by 0.2 percent, output in the mining sector rose by 0.1 percent, and utilities output rose by 2.1 percent. Despite May's report being better than anticipated, total industrial production is up by only 2.0 percent year-on-year, with manufacturing output up just 0.7 percent year-on-year. This is in line with other indicators pointing to steadily weakening conditions in the industrial sector of the economy, and while May's report was better than expected, the weakening trend remains in place. The overall capacity utilization rate rose to 78.1 percent, with the utilization rate in the manufacturing sector edging up to 75.7 percent.

In our weekly *Economic Preview*, we noted that motor vehicle assemblies posed an upside risk to our forecast of May industrial production, and this proved to be the case. Total motor vehicle assemblies rose to an annual rate of 11.327 million units in May from April's pace of 10.649 million units. Output of both automobiles and SUVs/light trucks rose in May. Still, both production and capacity utilization in the motor vehicles industry group are well off of their cycle highs, and while the monthly assembly rates will vary, we still look for motor vehicle production to be a modest drag on growth in manufacturing output over coming months given that a decelerating rate of motor vehicle sales comes amidst what are elevated inventories. Excluding motor vehicle production, manufacturing output was flat in May after having declined by 0.5 percent in April, and has been fairly listless over the past several months. That said, amongst production workers, employment and aggregate hours worked declined in May, so flat ex-vehicles output is better than our forecast anticipated. It is worth noting that production of business equipment, an useful gauge of trends in both growth in business investment spending in the GDP data and productivity growth, rose by 0.2 percent in May, leaving it up 3.0 percent year-on-year. Output of computer and electronic products, also a gauge of trends in business investment, was up 0.5 percent in May, which extends a run of solid growth over the past six months. While growth in these two categories is encouraging amidst indications that business investment in equipment and machinery is softening, we think it too soon to declare that all is clear given what remains considerable uncertainty over the course of trade policy and what has been a marked slowdown in the pace of global economic growth.

Mining output rose by 0.1 percent in May, better than our forecast had anticipated given the sizable decline in aggregate hours worked in this industry group in May and the behavior of crude oil prices over the past several weeks. Though mining output has fallen in three of the past six months, it nonetheless stands 10.0 percent higher on an over-the-year basis, and the capacity utilization rate in this sector stands at 91.3 percent as of May. Compare this to the utilization rate of 75.7 percent in the manufacturing sector. Despite a modest increase in May, the utilization rate in manufacturing has been drifting lower since hitting a post-recession high of 77.255 percent in December 2018. Still, one caveat we have raised is that given the advanced age of the capital stock in the factory sector, it is likely that much of what is being recorded as idle capacity is actually obsolete, so what looks to be a low utilization rate need not rule out growth in capital spending amongst U.S. manufacturers.

That of course will depend on the broader economic outlook and the degree to which the headwinds facing the manufacturing sector abate in the months ahead. Those headwinds take the form of an inventory overhang, uncertainty over trade policy, and a decelerating pace of motor vehicle sales. Our view has been that these headwinds are largely transitory, so that a meaningful and sustained downturn in the factory sector should be avoided. While we may be less comfortable with it, that does remain our view.

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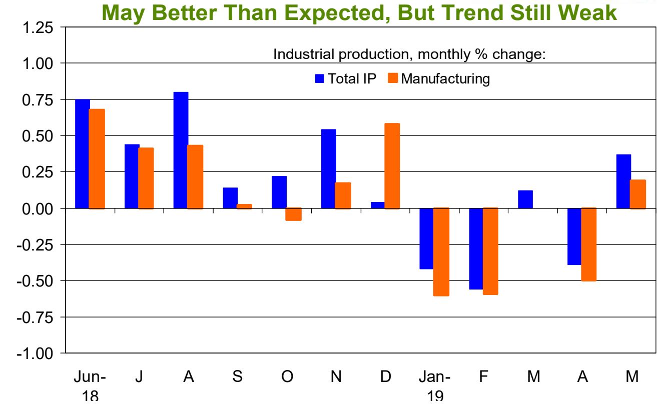

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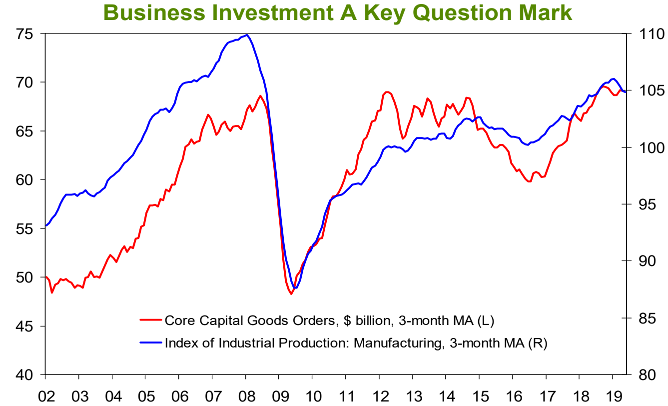
Business Investment A Key Question Mark



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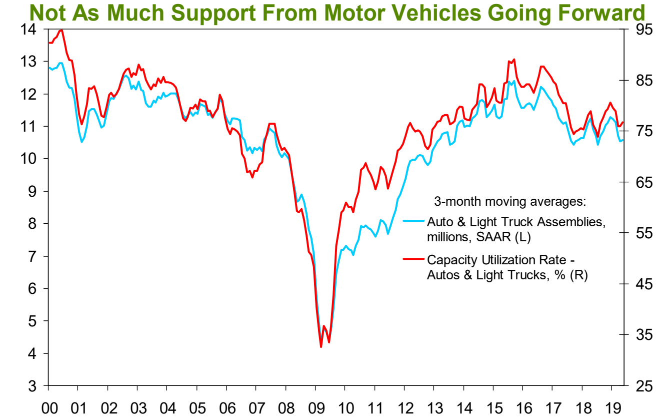
Not As Much Support From Motor Vehicles Going Forward



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