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March Industrial Production: Inventories, Motor Vehicles Weigh On Manufacturing Sector

- › Industrial production **fell** by 0.1 percent in March, with manufacturing output **unchanged**
- › The overall capacity utilization rate **fell** to 78.8 percent, while the utilization rate in manufacturing **falling** to 76.4 percent
- › On a year-over-year basis, total industrial production was **up** by 2.8 percent in March, with manufacturing output **up** by 1.0 percent

Total output amongst the nation's factories, mines, and utilities fell by 0.1 percent in March, falling short of our below-consensus forecast of a 0.1 percent increase. While our forecast anticipated a dip in motor vehicle assemblies would act as a drag on growth in manufacturing output, that drag was more pronounced than we anticipated, which led to a flat read on manufacturing output. Excluding motor vehicles, manufacturing output was up by 0.2 percent, but the segments most directly tied to business capital spending posted stronger gains. Output in the mining sector fell by 0.8 percent in March, with declines in oil and gas extraction and coal extraction. Utilities output was up by 0.2 percent, with a jump in natural gas output – reflecting sterner winter weather across parts of the U.S. – more than offsetting lower electricity output. Total industrial production is up 2.8 percent year-on-year, but manufacturing output is up only 1.0 percent year-on-year. The overall capacity utilization rate fell to 78.8 percent, with the utilization rate in the manufacturing sector falling to 76.4 percent, the lowest since May.

Total motor vehicle assemblies slipped to an annual rate of 10.846 million units in March, the lowest monthly rate since July. While the drop in automobile assemblies is a continuation of an ongoing pattern, what is worth notice is that assemblies of SUVs/light trucks has begun to drift lower. As we've noted, though seasonal patterns overstated the strength of unit sales in March, motor vehicle sales are drifting down toward what we think is a more sustainable pace, and inventories remain somewhat elevated. This suggests we will see further declines in motor vehicle assemblies over coming months, which would in turn act as a persistent drag on the growth of manufacturing output as reported in the industrial production data. Of more interest, at least to us, over coming months will be the performance of the business equipment and computer and electronic products categories, which are closely aligned with the data on business investment spending in the GDP data. Output of computer and electronic products was up 1.1 percent in March, on the heels of a 0.8 percent increase in February, extending a run of monthly gains in this category. Output of business equipment rose by 0.4 percent in March, but this follows a 0.8 percent decline in February which ended a run of modest advances. As seen in our middle chart, after a nice run of growth, there has been a notable lack of conviction in the data on core capital goods orders over recent months, and that has coincided with a tailing off of growth in manufacturing output as reported in the industrial production data.

For Q1 as a whole, manufacturing output fell at an annualized rate of 1.1 percent, the softest quarter since Q3 2017. To a large degree, this is a reflection of what has been a persistent, and sizeable, build in business inventories over the past few quarters, which we discussed in our weekly *Economic Preview*. Though manufacturing output excluding motor vehicles rose modestly in March, stronger gains are unlikely until there has been a meaningful paring down of business inventories which, in an environment of slower domestic and foreign growth, could take some time to materialize. This is another reason why we do not expect anything resembling robust growth in manufacturing output over the next several months.

Given heightened fears of recession in some quarters of late, it is worth noting that industrial production is one of the four main indicators used by the National Bureau of Economic Research (NBER) to make calls on turns in the business cycle. Though industrial production has been weak over the past four months, we are not convinced that we've seen the cyclical peak in this series, particularly if our assessment of the root causes of the recent inventory build proves correct. The list of headwinds facing the factory sector is formidable – elevated inventories, uncertain trade policy, slower global growth, and receding motor vehicle sales – but our view is that the net result will be a slower pace of growth in manufacturing output rather than a sustained decline.

