ECONOMIC UPDATE

REGIONS

August 15, 2019

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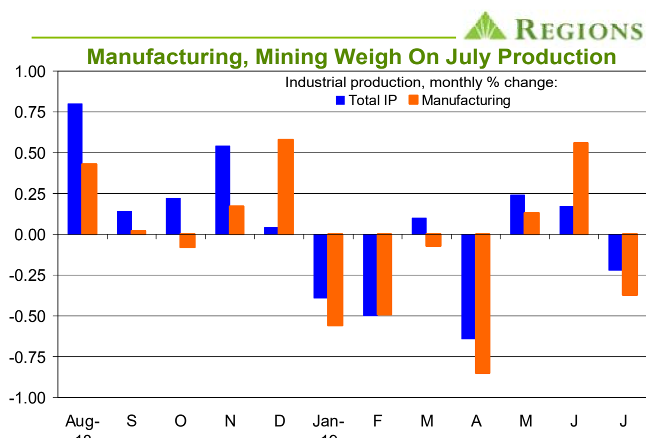
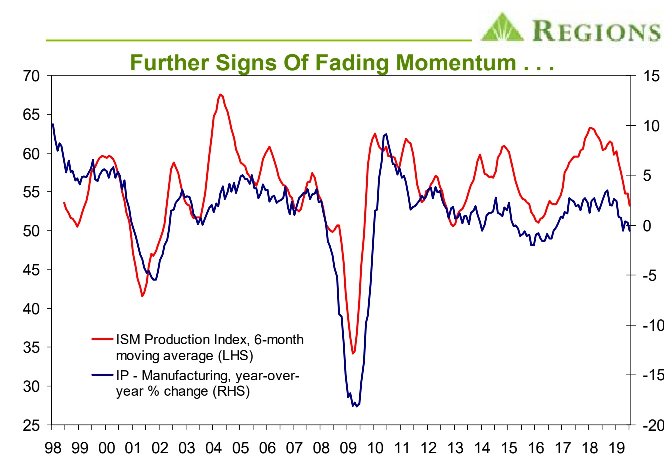
July Industrial Production: Manufacturing, Mining Weigh On July Production

- Industrial production was down by 0.2 percent in July, with manufacturing output down by 0.4 percent
- The overall capacity utilization rate fell to 77.5 percent, while the utilization rate in manufacturing fell to 75.4 percent
- On a year-over-year basis, total industrial production was up by 0.5 percent in July, with manufacturing output down by 0.5 percent

Total output amongst the nation's factories, mines, and utilities fell by 0.2 percent in July, underperforming our below-consensus forecast of a 0.1 percent increase. As our forecast anticipated, manufacturing output fell by 0.4 percent in July, but the 3.1 percent increase in utilities output was shy of our forecast while mining output plummeted by 1.8 percent. On an over-the-year basis, total industrial production is up by 0.5 percent while manufacturing output is down by 0.5 percent. The overall capacity utilization rate fell to 77.5 percent in July, the lowest rate since October 2017, with the utilization rate in the manufacturing sector slipping to 75.4 percent, the lowest rate since September 2017. Clearly, the industrial sector has softened over recent months, which reflects an ongoing inventory correction, uncertainty surrounding trade policy and less support from motor vehicle production. That said, there is little evidence that this softening in the industrial sector has spilled over into the broader economy, but the reality is that the factors acting as drags on the industrial sector are unlikely to respond to however much more accommodation global central bankers try to throw at them.

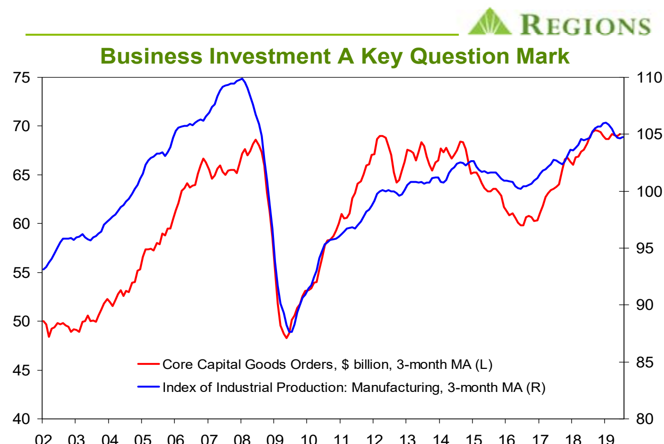


The seasonally adjusted data show output of motor vehicles and parts fell by 0.2 percent in July. In recent years, it has been trickier to properly seasonally adjust the July data for this industry group. Traditionally, manufacturers have halted production in early-July for maintenance and to prepare for production of the new model year, hence the 14.9 percent decline in motor vehicle assemblies in the not seasonally adjusted data. But, this decline is significantly smaller than has historically been the case for the month of July, which reflects more frequent disruptions in production during the year, particularly as inventories of smaller, more fuel efficient vehicles have piled up, leading to cuts in production. The broader point is that with the pace of motor vehicle sales easing off, output will follow and hence this industry group is likely to act as a drag on growth in total industrial production in the months ahead. Still, even outside of motor vehicle production, July was a weak month across the manufacturing sector. Machinery output fell by 1.1 percent after having declined by 0.3 percent in June, and output of business equipment, a gauge of business investment spending, was down by 0.4 percent. That the utilization rate in the manufacturing sector has been so persistently low has been a drag on growth in business investment in machinery & equipment over much of the current expansion. With business sentiment flagging under the weight of uncertainty over trade policy and a material slowdown in the pace of global economic growth, firms now have even less incentive to embark on capital expansion.



The 1.8 percent decline in mining output is the largest monthly decline since April 2016, with weakness in commodity prices weighing on the sector. Though output in the mining sector is up 5.5 percent year-on-year, this is the smallest such increase in over two years. Hotter than normal weather across much of the U.S. led to the 3.1 percent in utilities output, though this does not fully capture the 3.3 percent decline in June.

We've argued that, after a sizable build-up of inventories over the back half of 2018 and the first quarter of 2019, there would be a period of time during which the right sizing inventories would act as a drag on production, and employment in the manufacturing sector and would contribute to diminishing freight volumes. Lesser flows of global trade are having the same effects. While the inventory drawdown is temporary – we think it has further to run, meaning inventories will be a drag on real GDP growth – and motor vehicle production will eventually stabilize, there is no clear resolution in sight for the various trade disputes. To the extent this weighs on global business sentiment and global economic growth, trade poses a headwind for the manufacturing sector. While there are signs of stabilization in the regional Federal Reserve manufacturing surveys, this is at best a thin reed of hope unless and until there is some resolution of trade disputes and firmer global business sentiment.



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