ECONOMIC UPDATE

REGIONS

October 16, 2020

September Industrial Production: Industrial Sector Rebound Hits A Wall In September

- Industrial production fell by 0.6 percent in September, with manufacturing output down by 0.3 percent
- The overall capacity utilization rate fell to 71.5 percent, while the utilization rate in manufacturing fell to 70.5 percent
- On a year-over-year basis, total industrial production is down by 7.3 percent as of July, with manufacturing output down by 6.0 percent

Total output amongst the nation's factories, mines, and utilities fell by 0.6 percent in September, quite an unwelcome contrast to our forecast of a 0.6 percent increase. While a sharp decline in utilities output was a prime culprit, a surprising downturn in factory sector output also contributed to the weak headline print. Manufacturing output fell by 0.3 percent in September, dragged lower by a decline in motor vehicle assemblies that is at odds with industry data showing higher assemblies. Excluding motor vehicles, output in the manufacturing sector was unchanged in September, a fitting cap on what were decidedly mixed results across the individual industry groups. Output in the mining sector rose by 1.7 percent, reflecting remediation of the hurricane-related disruption to activity in August that pushed mining output down by 2.4 percent. The overall capacity utilization rate fell to 71.5 percent, with the utilization rate in the manufacturing sector falling to 70.5 percent. In all honesty, we're not quite sure what to make of the report on September industrial production. Given the brief but violent contraction associated with the COVID-19 virus and the efforts to stem its spread, it was to be expected that the initial months of recovery would see outsized increases but that the pace of the recovery would slow in subsequent months. That slowdown, however, has been more pronounced than we had anticipated. Even allowing for the outsized decline in utilities output and the surprising drop in motor vehicle assemblies in the industrial production data, the September report is surprisingly soft. Whether this reflects a temporary pause on the path to a fuller recovery or a more fundamental softening due to a slowing pace of recovery in the broader economy remains to be seen. At this point, we simply don't know, but the answer will become more and more apparent over the next few months.

Assemblies of autos and light trucks fell to an annualized rate of 10.212 million units in September from August's pace of 11.099 million units and July's pace of 11.937 million units. As noted above, the question is whether this reflects motor vehicle production simply settling into a more sustainable pace or something less benign. Given the still-strong pace of unit motor vehicle sales and what remain lean inventories of new motor vehicles, we tend to see September's decline in assemblies as a pause. But, it bears noting that assemblies of SUVs/light trucks took quite a tumble in September. While favorable financing terms, both rates and loan durations, have helped sustain rapid growth in sales despite the often heady sticker prices these vehicles carry, it could be that demand is starting to soften, so this is something to watch in the monthly data on motor vehicle sales as well as in the industrial production data.

Production of business equipment, a reliable indicator of business investment in equipment & machinery as reported in the GDP data, fell by 1.2 percent in September, ending a run of solid advances. What particularly stands out is the 5.7 percent decline in production of information processing equipment, with output of industrial equipment posting a much more modest decline. Production of aerospace equipment logged another increase, as did output of textiles and chemicals. We attach more significance to the data on business equipment, and, to reiterate a point made above, the question is what to make of the decline in September. Our view is that, despite business investment having surprised us to the upside in Q3, the path forward will be considerably rockier. The combination of a slow-growth environment and a considerable degree of idle capacity will, in our view, act as a considerable drag on business investment, though we continue to expect information processing and communications equipment to outperform as firms continue to push for productivity gains in what is likely to remain a shifting work landscape. We also continue to expect energy to be a laggard. Though oil prices have come back from April's steep decline, they nonetheless remain below what for many domestic producers are break-even prices, and active rig counts remain significantly depressed. If we are correct in expecting a slow recovery in the broader economy, that suggests limited upside for, and less capital spending in, the energy sector.

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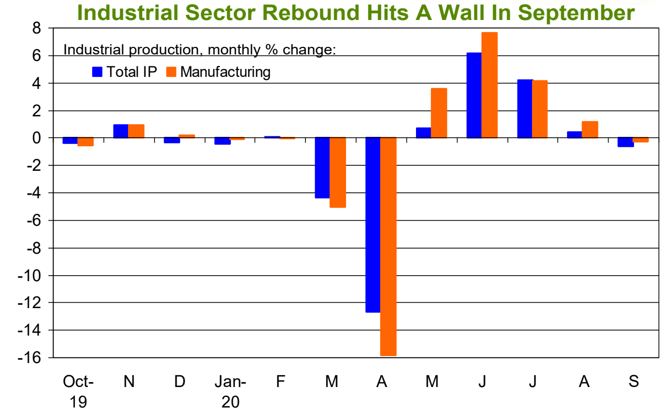
Industrial Sector Rebound Hits A Wall In September



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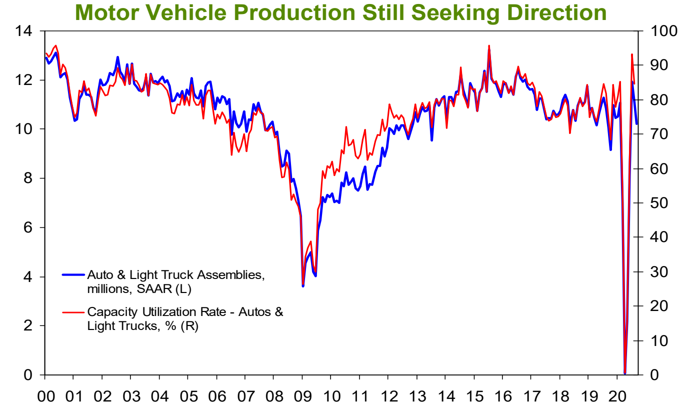
Motor Vehicle Production Still Seeking Direction



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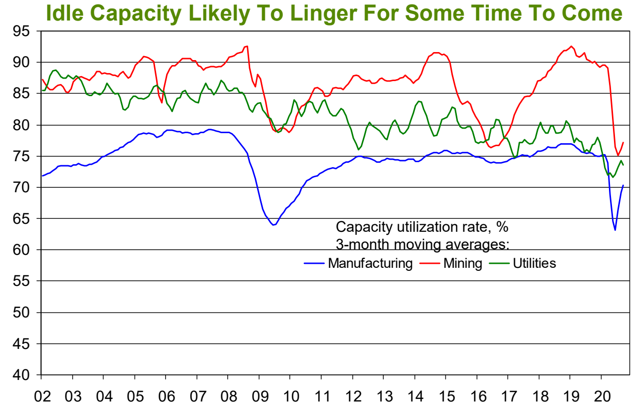
Idle Capacity Likely To Linger For Some Time To Come



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