ECONOMIC UPDATE

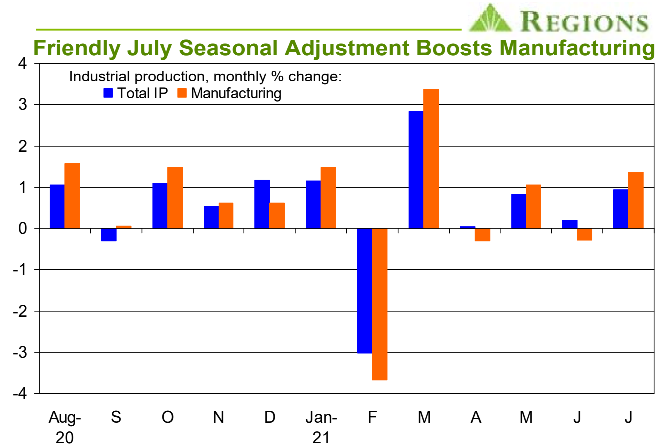
REGIONS

August 17, 2021

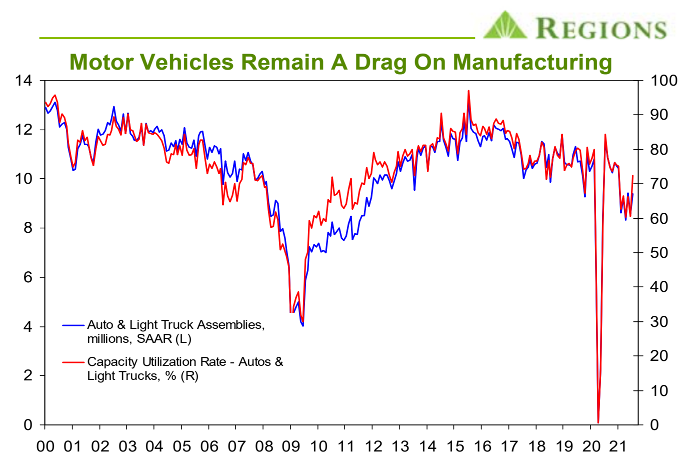
July Industrial Production: Broad Based Growth Despite Supply-Side Constraints

- Industrial production rose by 0.9 percent in July, with manufacturing output up by 1.4 percent
- The overall capacity utilization rate rose to 76.1 percent, while the utilization rate in manufacturing rose to 76.6 percent
- On a year-over-year basis, total industrial production is up by 6.6 percent as of July, with manufacturing output up by 7.4 percent

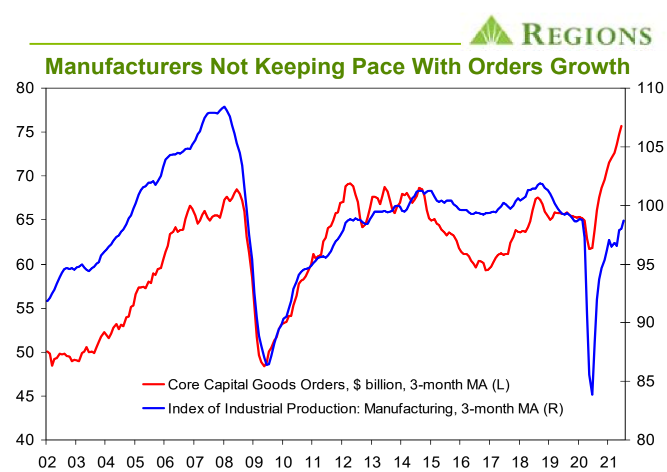
Total output amongst the nation's factories, mines, and utilities rose by 0.9 percent in July, besting our above-consensus forecast of a 0.7 percent increase, with manufacturing output up by a stronger than expected 1.4 percent. Mining output rose by 1.2 percent in July while utilities output fell by 2.1 percent. The initial estimate of total industrial production in June was revised lower, as downward revisions to manufacturing and mining output more than offset a modest upward revision to utilities output. We will note, however, that the reported increase in manufacturing output in July is flattered by seasonal adjustment of motor vehicle production. That said, output nonetheless increased across a wide swath of the manufacturing sector in July, including in the key business equipment segment, a harbinger of movements in business investment as measured in the GDP data. Perhaps the broader point to make here is that growth in manufacturing output would be faster were it not for ongoing supply chain and logistics bottlenecks, as demand remains solid. These supply-side issues could easily persist into 2022, thus contributing to price pressures in the broader economy.



July is typically the month in which producers shut down production to gear up for production of the new model year. As such, the July seasonal adjustment factors anticipate a steep decline in motor vehicle output. This year, however, the global chip shortage has wreaked havoc on production schedules of motor vehicle producers, to the point where production has for some time been impaired. While the not seasonally adjusted data show assemblies of automobiles and SUVs/light trucks fell by 12.1 percent in July, this is far smaller than the typical July decline, to the point that the seasonally adjusted data show a 9.7 percent increase in assemblies. Note that data on capacity utilization amongst vehicle producers is similarly impacted. Either way, however, motor vehicle production remains far below normal, pre-pandemic levels, and inventory constraints are plainly evident in the monthly data on motor vehicle sales. As is the case more broadly across the factory sector, the chip shortage figures to linger into 2022, thus holding down output and adding to upward pressure on prices.



To our earlier point, manufacturing output excluding motor vehicles and parts rose by 0.7 percent in July after a 0.1 percent increase in June, with gains across a wide array of industry groups, including machinery, primary metals, plastics, and electrical equipment and appliances. Production of business equipment, a reliable indicator of business investment in equipment & machinery as reported in the GDP data, rose by 2.8 percent in July, the largest increase since March. Information processing equipment remains a key source of growth in the broader business equipment category, which in part reflects businesses continuing to stress enhancing labor productivity. Though uneven from month to month of late, business equipment output continues to trend higher, which supports our view that business investment in equipment and machinery will remain a key contributor to real GDP growth over coming quarters.



More broadly, there are few signs that the story in the manufacturing sector is set to change any time soon. Growth in new orders remains robust, but producers have simply been unable to keep pace, hence growing backlogs of unfilled orders for manufactured goods. Shortages of inputs, shipping delays, and labor supply constraints continue to weigh on output, and higher costs for inputs, shipping, and labor are to some extent being passed along in the form of higher output prices. Another way to see this is by looking at capacity utilization. While the overall capacity utilization rate rose to 76.1 percent in July with the utilization rate in the manufacturing sector rising to 76.6 percent, utilization remains below pre-pandemic norms. It seems clear that were producers able to procure desired quantities of materials and labor, utilization rates would be higher than they are. At some point, utilization rates and output will normalize, but it is looking more and more likely that will not be until 2022.

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