

Economics Group

Tim Quinlan, Economist
tim.quinlan@wellsfargo.com • (704) 410-3283
 Sarah Watt, Economist
sarah.watt@wellsfargo.com • (704) 410-3282

Dud Industrial Production Report Dashes Hopes for Pick-up

July industrial production was unchanged and June's gain was revised to a smaller increase. On the heels of better-than-expected survey data, this report is particularly disappointing.

Details Are Even Worse

Manufacturing output, which comprises more than three quarters of overall industrial production, fell 0.1 percent in July. The drop was driven primarily by a 1.7 percent decline in production of motor vehicles and parts. Sales from automakers to dealers did slip a bit in July, as did retail sales on dealer lots. Still, a 1.7 percent drop in output seems outsized here. The drop may have to do with seasonal adjustment issues related to the summer retooling period for automakers when temporary shutdowns become necessary to get ready for the new model year. Either way, the outlook for auto sales remains strong and we would expect to see some reversal in this component in coming months.

Economy Has Fully Recovered but Manufacturing Still Has Not

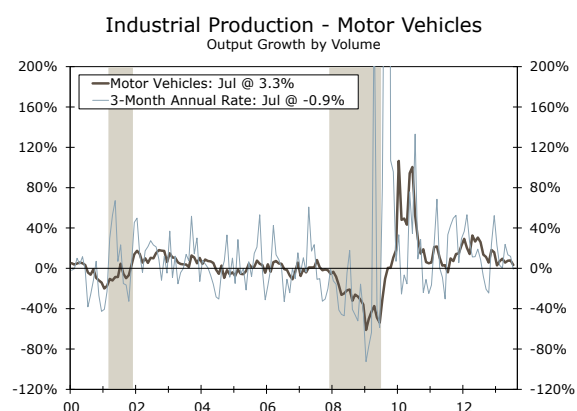
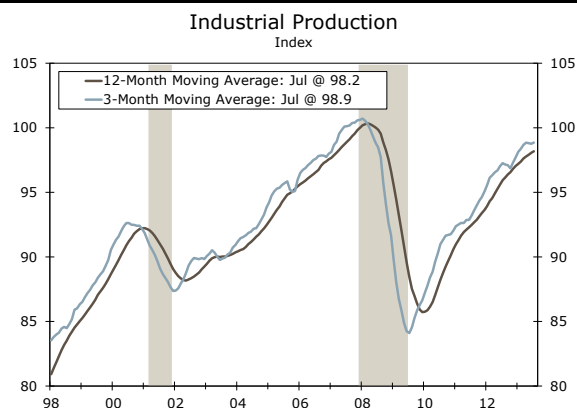
For a year and a half the U.S. economy has been cranking out more in terms of goods and services than it did before the recession began. Yet in the manufacturing sector, there are still signs of slack. Capacity utilization is still weak and fell even lower in July to 77.6 percent. This suggests unused potential output in the nation's factories, utilities and mines.

In a sense, today's report is something of a milestone. Industrial production is one of the four key indicators used by the dating committee of the National Bureau of Economic Research (NBER) when it identifies the official start and end dates of recessions. According to that body, July 2009 was the first month of expansion for the U.S. economy. So today's data provides a look at where we stand at the four year anniversary. It bears noting that four years down the road, industrial production is still 1.9 percent smaller than where it stood at its pre-recession peak in December 2008.

Output Is Poised to Grow in Coming Months

We expect to see industrial production continue to grow over the coming months. Purchasing managers' indexes (PMIs) for July, particularly the ISM, have improved, although many still linger near the breakeven level, which offered a clue to today's weaker-than-expected number. August PMIs have been lackluster with the Empire State Manufacturing Index, coming in roughly unchanged from where it stood in July while the Philadelphia Fed index indicated a slower pace of activity.

The bottom-line from today's report is that a substantial pickup in activity that will contribute to GDP in a meaningful way remains elusive. Global growth is still relatively weak, although the Eurozone has been surprising to the upside recently. Moreover, GDP growth of around 2 percent will likely keep many businesses relatively cautious with their investments. We look for industrial production to quicken to around a 3 percent annual pace in the third quarter.



Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio Aleman, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Anika Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Sarah Watt	Economist	(704) 410-3282	sarah.watt@wellsfargo.com
Michael T. Wolf	Economist	(704) 410-3286	michael.t.wolf@wellsfargo.com
Sara Silverman	Economic Analyst	(704) 410-3281	sara.silverman@wellsfargo.com
Zachary Griffiths	Economic Analyst	(704) 410-3284	zachary.griffiths@wellsfargo.com
Peg Gavin	Executive Assistant	(704) 410-3279	peg.gavin@wellsfargo.com
Cyndi Burris	Administrative Assistant	(704) 410-3272	cyndi.burris@wellsfargo.com

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