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Economics Group

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Industrial Production Report Is Better Than It Looks

The 0.4 percent decline in August industrial production follows the second-highest monthly increase since 2010. Manufacturing can be volatile, but this choppiness is caused by math.

Every Motive Escalate, Automotive Incinerate

Before any navel-gazing discussion of the implications of this "disappointing" figure for Fed policy, it pays to consider what special factors might be at play in boosting July's output at the expense of August. On that basis, we believe it is helpful to think about how this report measures the output of motor vehicles.

Historically, automakers shut down in the summer months to retool factories for the new model year. However, as any automaker can tell you, the summer shutdowns are increasingly becoming a thing of the past as technology improves and the retooling process is either shorter or no longer tied exclusively to the summer months.

The trouble is, the seasonal adjustment process does not yet know that. In the top chart, we have plotted the month-over-month change in motor vehicle assemblies for July and August since 1998 on a *non*-seasonally adjusted basis. What you see is that the July shutdowns get smaller over time and the August bounce is less of a factor as well. The obvious exception is 2009 when the "Cash for Clunkers" auto stimulus program threw a wrench into the works that year. Ex-motor vehicles and parts, industrial production growth has been flat to slightly positive over the past two months.

Not the End of the World As We Know It

More broadly, the trends in industrial production have become a bit more positive in recent months. The three-month annualized rate of growth is back up to 1.9 percent after dipping into negative territory earlier this year. Our outlook for industrial production is slow growth on the order of about 3 percent for the next year or so.

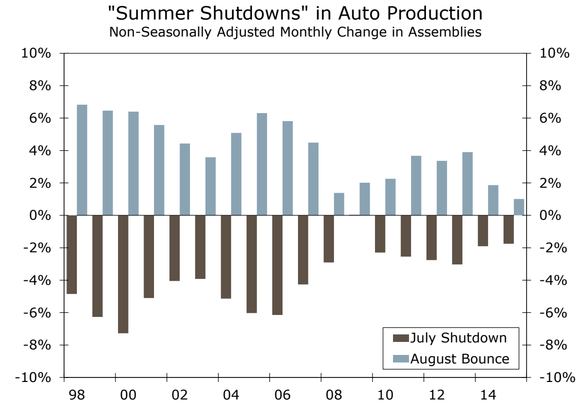
Mining Still a Challenge

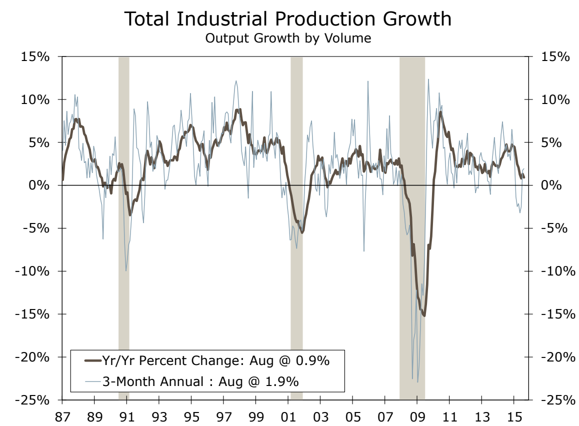
Utilities output, a notoriously volatile component, increased 0.6 percent in August after contracting slightly in July. That gain was swamped by a 0.6 percent decline in mining output, which comprises a larger share of overall production than utilities.

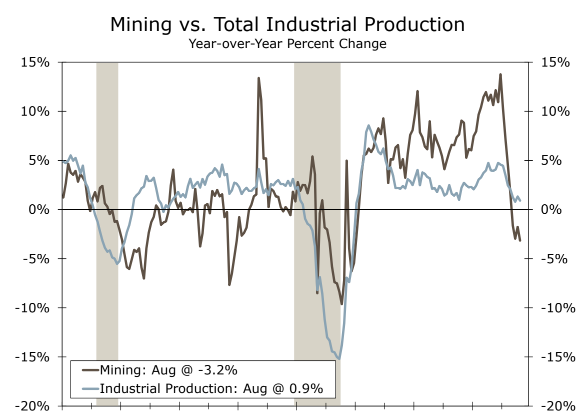
Mining had been a major positive driver from 2010 until the middle part of last year when oil prices began their long decline. Since then, mining output has fallen steeply.

Capacity Utilization

If there is an aspect of today's report that will raise eyebrows among members of the Federal Open Market Committee (FOMC), it is perhaps the weakening trend in capacity utilization. From a cycle high of 79.0 in November 2014, utilization has declined on trend to its present reading of 76.1 percent, which suggests there is little in the way on inflationary pressure in the factory sector.







Source: U.S. Department of Commerce, Federal Reserve Board and Wells Fargo Securities, LLC

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