Economic Indicator — April 15, 2021

Soft Rebound in Industrial Production Suggests Bigger Problems Than Weather

Summary

Despite the euphoria signaled by various purchasing manager surveys, overall March industrial production only partly recovered the output lost in February. Some the softness is attributable to utilities, but we are more concerned that manufacturing output was not stronger.

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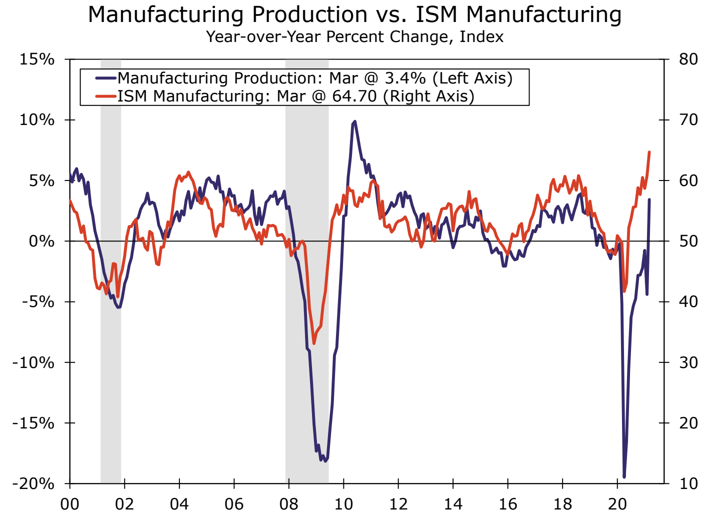
Strange Times

A 1.4% monthly increase in industrial production would normally be a stellar report, but alas things still far from normal. March's increase fell more than a percentage point short of expectations (2.5%), and came on top of a downwardly revised figure for February (-2.6% vs. -2.2% as initially reported), making today's report a bit of disappointment. Total industrial production remains 3.4% below its February 2020 level, and is down 1.2% since January as production has been held back by a range of issues, including parts shortages, shipping times, staffing and mother nature, in recent months.

The anticipated snapback from February's partly weather-induced decline in industrial activity was held down in part by an 11.4% drop in utilities output as temperatures heated up. However, mining activity nearly recovered back to January's levels as oil and gas extraction resumed. But the source of disappointment in today's numbers can be traced to the manufacturing sector, which comprises roughly three quarters of output.



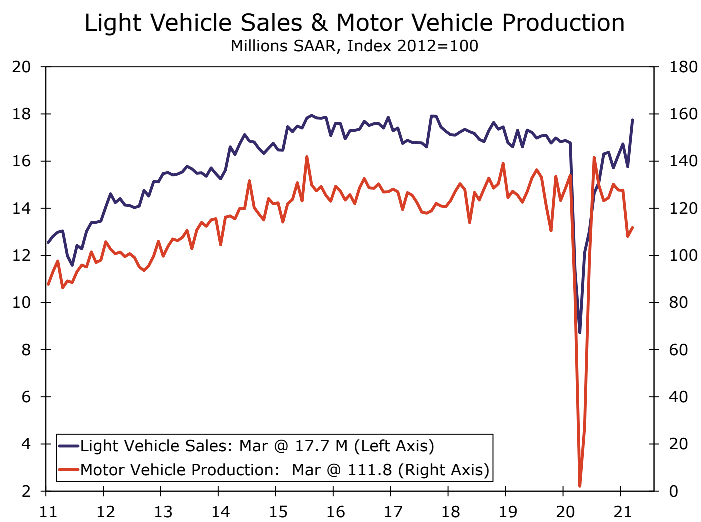
Source: Federal Reserve Board, ISM and Wells Fargo Securities

Some Supply Challenges Melted Away, but Many Remain

Manufacturing is supposed to be booming right now. A key bellwether for the sector, the ISM manufacturing index, rose to 64.7 in March—its highest since the 1980s. Against that backdrop, you would expect to see a surge in output, yet the increase for manufacturing output in March was just 2.7%, which is not even enough to fully offset the 3.7% decline in February.

We had argued last month that the softness in the February data was about more than just weather. As we describe below and have tackled in recent reports, supply chain constraints are standing in the way of a more robust rebound in manufacturing.

The poster-child for this is the auto sector. Production for motor vehicles and parts rose 2.8%, but that paled in comparison to the 10.0% drop in February. Production has been pummeled by the global semiconductor shortage, which kept output depressed despite sales climbing to a three-and-a-half-year high last month. In a separate report this morning retail sales of motor vehicles shot up more than 15% in March after a modest decline in February. The demand for autos remains robust and elevated pricing for used autos suggests a lack of availability for new cars, which we see through anecdotal reports of vehicle shortages and news stories about Detroit automakers having to temporarily idle plants due to parts shortages highlight this problem. In short, the biggest problem for manufacturing is getting the needed input components for the manufacturing process.



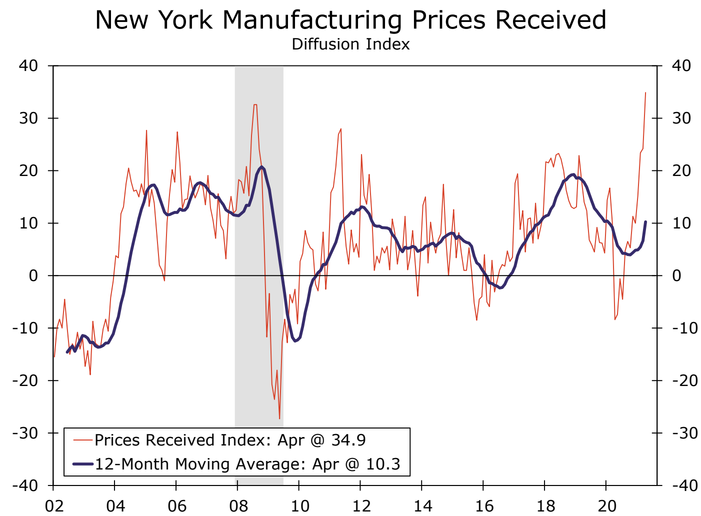
Source: U.S. Department of Commerce, Federal Reserve Board and Wells Fargo Securities

Disappointing March Figures Give Boost to Outlook

The current supply and logistics challenges facing manufacturing look likely to persist for over the next few months, but will eventually ease. Not only have facilities impacted by February's rough winter weather largely gotten back online, but there are some indications that staffing challenges are easing up. Manufacturers hired 53K in March, the most since September. Yesterday's Beige Book from the Federal Reserve noted that absenteeism due to COVID was down and manufacturers are in some cases boosting pay.

Nevertheless, supply chain disruptions remain widespread, which will limit the pace of production and add to inflation pressures in the near term. To that end, the April Empire State Manufacturing Survey released earlier this morning indicated that manufacturers are increasingly able to pass rising input costs on. Selling prices rose at the fastest pace in the survey's 20+ year history.

Production may be picking up, but it is still not high enough to satiate demand. Inventories climbed in February, but businesses across the supply chain are still struggling to restock. The eventual rebuilding in inventories is getting pushed back by ongoing supply chain challenges and stellar pace of consumer spending illustrated in today's retail sales report. That will keep manufacturers busy for months to come, even as spending shifts back toward services.



Source: New York Federal Reserve and Wells Fargo Securities

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