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Economics Group

WELLS FARGO SECURITIES

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Slump in May Manufacturing Production Could Be Temporary

Production increases in utilities and mining offset a 0.4 percent drop in manufacturing to result in an "unchanged" print for May. But, a brightening in June survey data suggest the weakness will be short-lived.

Firming in Utilities and Mining Output Offset Factory Slump

The official headline print for industrial production was "unchanged" in May following a slightly upwardly revised gain of 1.1 percent the prior month. Utilities production and mining output, each of which comprise about an 11 percent share of overall production, performed rather well on the month. Utilities grew 0.4 percent and mining output increased 1.6 percent. After dragging down production for much of last year, mining has added to output in four out of five months so far in 2017 and is up 8.3 percent from where it was at this time last year.

While we are encouraged by the firming in these smaller categories, the takeaway from today's industrial production report is that manufacturing output fell 0.4 percent in May. That makes two declines in the past three months and serves as the most recent reminder that the factory sector is struggling to put points on the board in a climate of pronounced fiscal policy and political uncertainty.

The underlying details for the industry groups within the manufacturing sector indicated broadly based weakness with only a few areas reporting scant gains. The biggest declines from an industry perspective were motor vehicles and parts, which fell 2.0 percent in the month, as well as wood products and primary metals, which each posted declines of 1.4 percent. The giveback in autos production may sound ugly, but it follows a 4.1 percent pick-up in the prior month, so the softness here is only a partial payback.

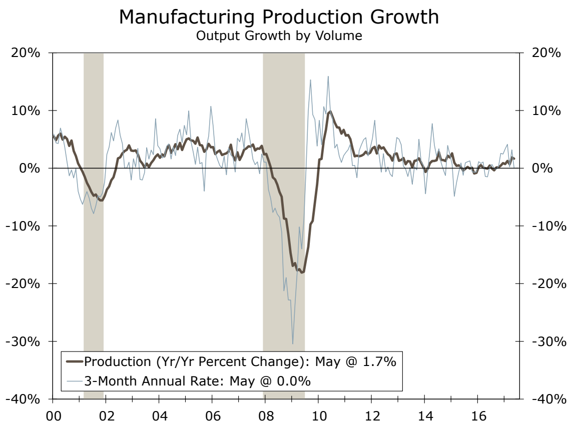
More Disinflation?

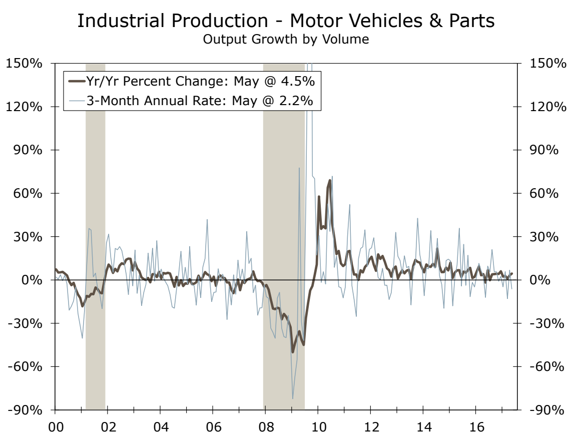
After Fed speaker comments in recent weeks about a potential softening in inflation data, there has been a piling-on of softer inflation pressures this week. We learned yesterday that CPI inflation slipped 0.1 percent in May, and a separate report this morning revealed a 0.3 percent May decline in import prices. In this report, we learned that capacity utilization fell to 76.6 percent overall and just 75.5 percent for the manufacturing sector specifically. This kind of slack in the nation's production capacity indicates little to no inflationary pressure.

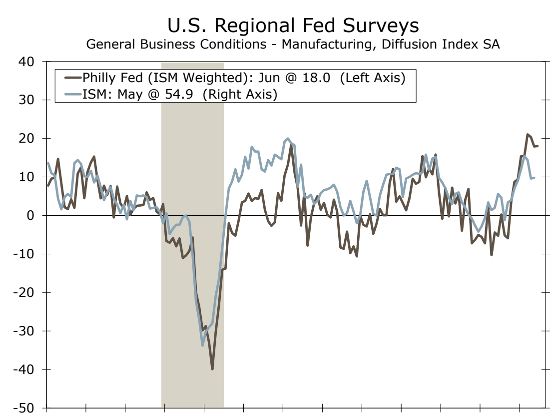
Still Holding to Slow Growth Call

The New York Fed's Empire Index and the Philadelphia Fed's Business Outlook Survey were both also released in separate reports earlier this morning and both solidly exceeded consensus expectations for June.

Although we maintain a healthy degree of skepticism about the weak hard data/strong soft data disconnect, the improvement in these regional surveys would be consistent with some additional firming in the pace of expansion and upside potential for the June print for ISM. We maintain our forecast for incremental manufacturing improvement, even in the face of this soft report for industrial production.







Source: Federal Reserve System, ISM, and Wells Fargo Securities

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