



Economics Group

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Tempest-Tossed: Industrial Production Notches Small Gain

The modest 0.3 percent gain in industrial production could have been larger had it not been for the quarter percentage point drag from Hurricanes Harvey and Irma.

Look In...to the Eye of the Storm

Do not “rush” to judgment on the modest gain in industrial production for September. Overall output increased 0.3 percent as the Fed estimated a quarter percentage point drag from the effects of hurricanes. Industrial production fell at a 1.5 percent annualized rate in the third quarter, but according to Fed estimates, this figure would have been an increase of at least 0.5 percent had it not been for the effects of the storms.

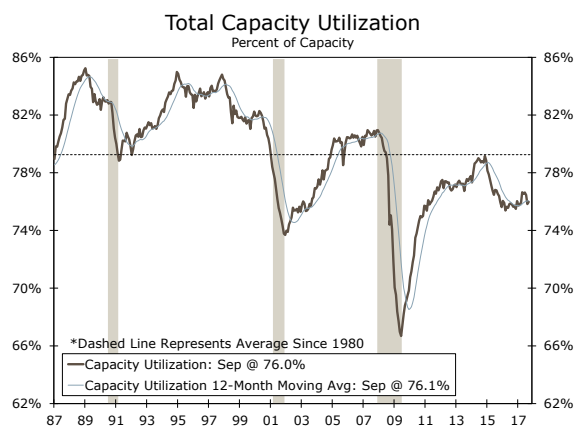
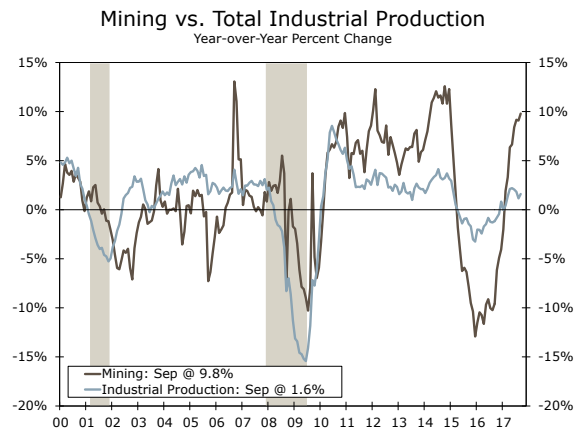
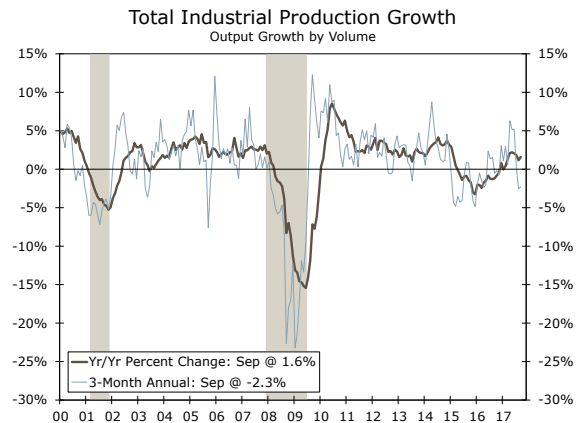
We had forecast a pullback in today’s report for September industrial production. Our admittedly pessimistic view was informed by the experience around Hurricane Katrina in 2005. At that time, the Fed estimated Katrina shaved off 0.3 percentage points in August, then another 1.7 percentage points in September for a total of two percentage points over the two months. Fast forward to this cycle and the Fed already estimated a 0.75 percentage point drag from Harvey in August. There is also the matter of Hurricane Irma which followed Harvey roughly two weeks later. (We say “roughly” because both storms made landfall on multiple dates as they hovered along the coasts.) Similarly back in 2005, Katrina was followed to shore by Rita, but there were almost four weeks between the storms back then. The drags from the 2017 storms turned out to be only about half as much of a negative impact as we experienced 12 years ago.

Look Out...for the Force Without Form

In 2015, industrial production fell in 11 out of 12 months as a retrenchment in the energy sector weighed on mining output along with other factors like a (then) stronger dollar and weak global growth backdrop. In 2016, output fell only six out of 12 months as that rebalancing in the energy sector was still a factor, but the global backdrop was showing improvement as industrial production was regaining its footing. This year, there had been only one monthly slip (in January) before Harvey knocked industrial production into negative territory.

Looking into the remaining months of the year and considering the outlook for 2018, we look for industrial production to ramp-up modestly. The factors that weighed on growth in recent years have either reversed altogether or at least faded. The dollar’s march higher has reversed this year, global growth has been firming and energy prices have broadly stabilized, which has lifted mining output again. On that basis our outlook is for 2.0 to 2.5 percent growth for industrial production in 2018.

Capacity utilization moved slightly higher and at 76.0 percent, it remains well-below its pre-recession peak. Among other factors, this excess slack could be an impediment to the Fed’s elusive 2.0 percent price inflation target. We will delve deeper into the drivers of capacity utilization in a forthcoming special report later today.



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