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Economics Group

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Mixed Report on Industrial Production

The 0.9 percent increase in industrial production for December handily exceeded expectations, but the strength was largely a function of a weather-related utilities surge.

What Utilities Say About the Weather and About the Cycle

The 0.9 percent pick-up in industrial production was largely due to a weather-related payback in utilities production. Temperatures in December were actually a bit above average, but that followed a November which was a particularly warm month (the sixth warmest on record). The result was a 5.6 percent surge in utilities output for December following a 3.1 percent decline in the prior month.

While we admit that we tend to focus on the weather influence with utilities production, it bears noting that aside from the month-to-month noise, the utility component does contribute to a broader view of the industrial landscape. The top chart plots the index level for utilities, and we can see that this cycle has not seen as robust growth as the two prior cycles. That said, the index is now retesting the highest levels of the current expansion.

Mining

Mining production, which had surged earlier in this cycle only to decline when oil prices fell between 2014 and 2015, has been on an upward trend more recently. Mining increased another 1.6 percent in December notching the fourth straight monthly gain.

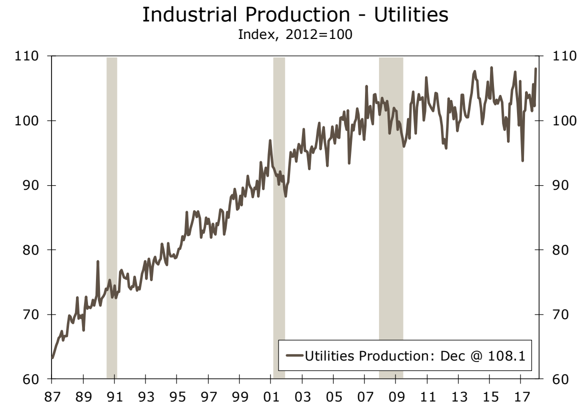
Manufacturing Slower than Survey Data Indicate

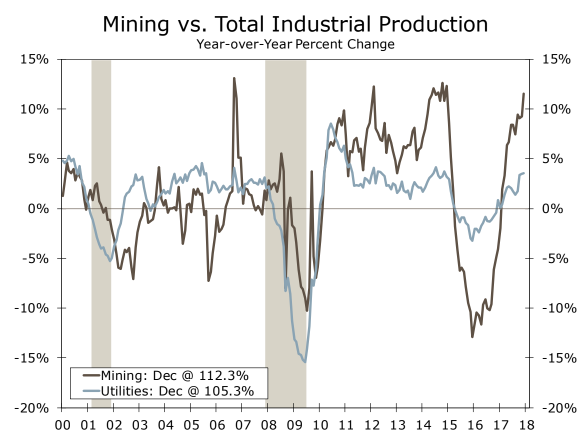
More than three quarters of all output is concentrated in the manufacturing sector. This heavyweight category came in a bit below expectations, adding just 0.1 percent in the final month of 2017. We note, however, that the 0.2 percent increase in November was bumped up in the revisions to a 0.3 percent gain. Coming on the heels of a 1.5 percent surge in October, the three-month annualized growth rate, now at 7.8 percent, is about as strong as we have seen since the very early days of the current expansion.

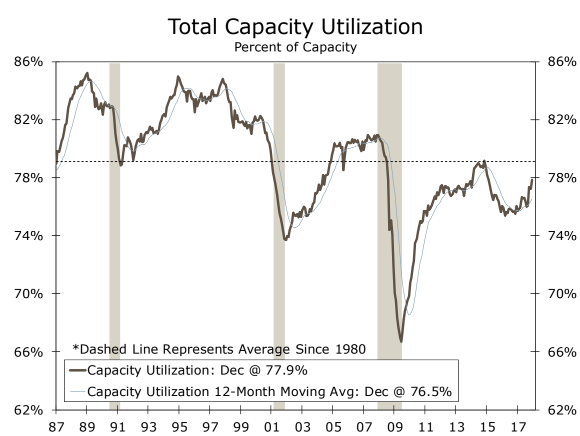
Still, the fact that the production component of the ISM index has been trending higher in recent months should indicate bigger gains for actual manufacturing output. The fact that the 65.8 reading for ISM production in December is met with only a 0.1 percent increase in December is a tad underwhelming. Last week, we upped our forecast for equipment spending in 2018, and as momentum builds in the manufacturing sector we expect to see a faster pace of expansion in manufacturing output in the months ahead.

Slack Means Little in the Way of Price Push from Factory Sector

Capacity utilization has been slow to return to pre-recession highs in this cycle. The peak for the current expansion was in 2014 when there was very little spare capacity in the mining sector. Broadly, capacity use is now at 77.9 percent, although both mining and utilities are north of 80 percent. Manufacturing was unchanged at 76.4 percent and suggests little inflation pressure from the manufacturing sector—at least for now.







Source: Federal Reserve Board and Wells Fargo Securities

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