



# Economics Group

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## Industrial Production Surges: Recovery or Head Fake?

*Industrial production rebounded 0.6% in August, with widespread gains. The 0.5% rise in manufacturing alleviates concerns about the factory sector’s slowdown, but manufacturing is not out of the woods yet.*

### Surge in IP is Not the All Clear for Manufacturing and Capex

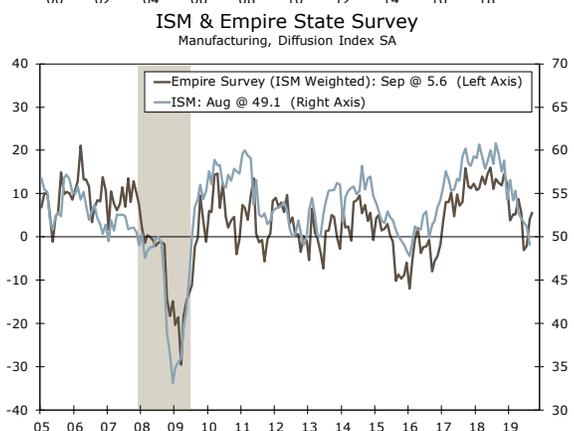
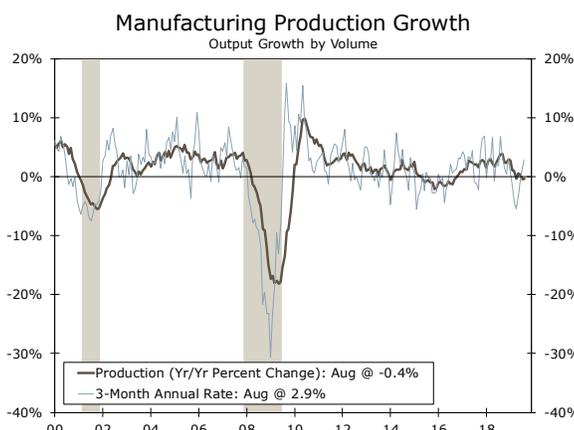
Activity in the industrial sector firmed in August, with production coming in well ahead of expectations and July’s pullback revised up a tick. Total production rose 0.6%. Utilities gave a boost to the headline, up 0.6%, amid above-average temperatures in August. More importantly, however, was a 0.5% rebound in manufacturing production, which slightly more than offset July’s decline. What’s more, gains were broad based across industries. The one notable exception was in the motor vehicles industry, where dealer inventories remain elevated and therefore a pullback in production is not wholly surprising. Compared to a year ago, manufacturing production is still down, but August’s report suggests the situation is at least not worsening at the moment.

Yesterday’s September Empire Manufacturing Index also offered evidence that activity in the manufacturing activity is not in free fall, but it does continue to struggle. The headline number—taken from a single question on general business conditions—slid to a three month low. On an ISM-weighted basis (averaging the subcomponents of production, new orders, supplier deliveries, employment and inventories), however, the index rose for a second straight month. Outlook components suggest any improvement in activity is likely to be modest, with the expectations index falling 12 points and capital spending plans plummeting 18 points to the lowest reading in three years.

Although trade tensions have eased up a bit in recent weeks, we expect manufacturing and capex spending to remain under pressure over the next few months as trade uncertainty still swirls, global growth remains meager and the strong dollar creates an added hurdle for U.S. exporters.

Mining production also bounced back in August, up 1.4%, as crude production rebounded after being suppressed by Hurricane Barry in July. Support activities for drilling new wells, however, were down again in August. Overall mining production is up 5.1% over the past year, but that has slowed from 15% as recently as January.

It is still too early to tell if the outages stemming from Saturday’s attacks on Saudi Arabian facilities will reverse the trend in U.S. mining—the bulk of which is oil-related. Oil prices are up about 10% since the attack to around \$60 per barrel for WTI, but would likely need to be sustained at that level, either due to a prolonged outage or perceived risks to future supply, before U.S. production would ramp up meaningfully in response. According to the latest Dallas Fed Energy Survey, the price needed to profitability drill new wells in the United States varies by area from a median of \$48-54. As such, there would be some scope for investment and production to rise if U.S. firms do not view the price jump as temporary, but at the very least U.S. producers should see somewhat stronger profits.



Source: Federal Reserve Board, Federal Reserve Bank of New York, ISM and Wells Fargo Securities

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