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Economics Group

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Utilities Output Weighs on Industrial Production in January

Industrial production fell 0.3 percent in January, led lower by a steep decline in utilities output. Manufacturing output continued to trek higher, signaling some underlying strength beneath the headline.

Warm Weather Cools Industrial Production Growth

Industrial production declined 0.3 percent in January. The notoriously volatile utilities segment of the index accounted for the entirety of the decline. Unseasonably warm weather reduced the demand for heating and led to the steepest monthly decline in utilities output since January 2006.

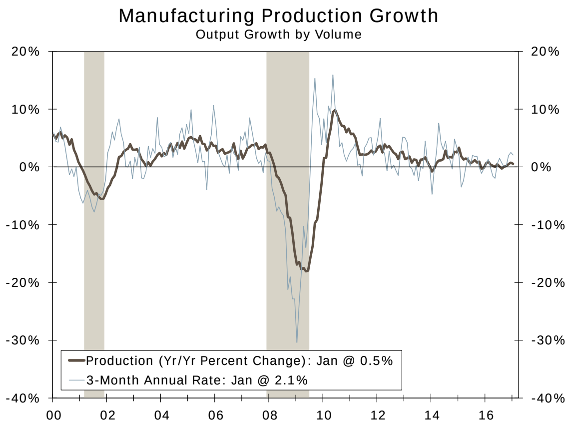
Looking beyond this noisy quirk in the data, the report signaled that the gradual recovery in the industrial sector remains intact. Manufacturing production, which accounts for a little over three-quarters of the index, rose 0.2 percent. This gain was particularly impressive as motor vehicles and parts, which have been a key support to manufacturing output over the past couple of years, declined 2.9 percent in the month. Excluding this component, manufacturing production rose a strong 0.5 percent, the best reading for this subset of the index since November 2014. Machinery output helped lead the way, increasing 0.9 percent in January on the heels of a solid 1.0 percent jump in December. The gradual but steady rebound in machinery production is an encouraging sign for capital demand.

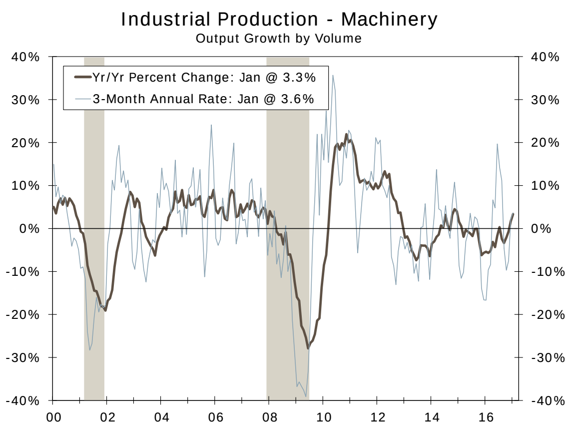
Unlike other factory sector indicators, industrial production is a measure of volume rather than dollars, suggesting that higher prices are not overstating the recent improvement. As a whole, manufacturing output continued to creep higher and has only declined once since last May.

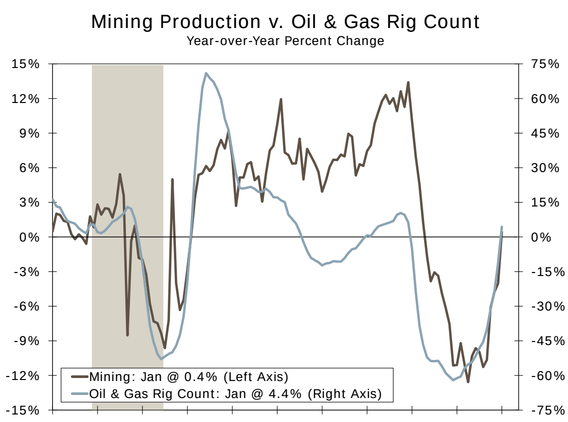
Mining output also increased in January, rising 2.8 percent. The stabilization in the energy sector and favorable base effects caused mining production to return to positive territory on a year-ago basis in January. We expect oil prices to rise gradually over our forecast horizon through the end of 2018. Although we do not expect the mining component of industrial production to return to its robust contributions achieved early in the cycle, mining should act as a modest tailwind to the overall index in the months to come.

Outlook Improving, but Keep Expectations in Check

On balance, the slowdown in factory activity that began in mid-2014 appears to be slowly growing distant in the rearview mirror. Improving growth prospects and stable energy prices have helped the sector find its footing after a wobbly past few years. That said, a breakout seems unlikely in the foreseeable future. The dollar remains at a relatively high level, and our currency strategists expect some moderate appreciation over the next year. In addition, although we expect economic growth at home and abroad to pick-up this year and next, the pace will likely remain far from robust. These factors, coupled with the long-term, secular challenges facing the industrial sector and the uncertainty surrounding the Trump administration's approach to trade policy, lead us to keep our factory sector recovery expectations in check.







Source: Federal Reserve Board, Baker Hughes and Wells Fargo Securities

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