

Economics Group

Tim Quinlan, Senior Economist

tim.quinlan@wellsfargo.com • (704) 410-3283

Michael Pugliese, Economic Analyst

michael.d.pugliese@wellsfargo.com • (704) 410-3156

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.

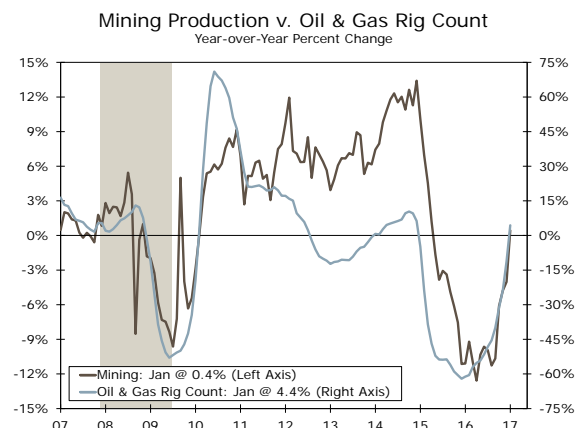
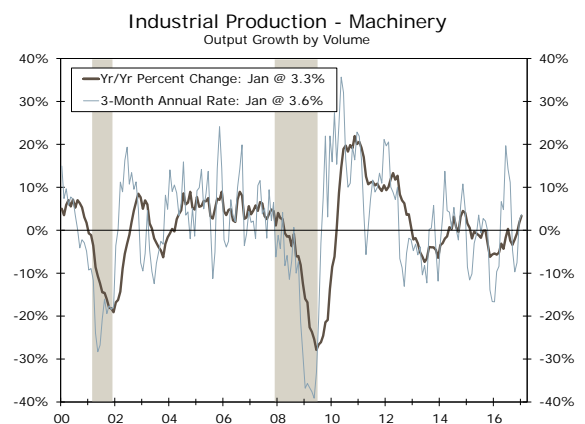
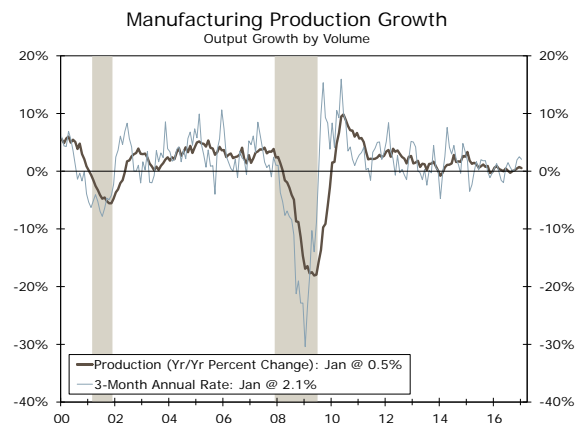
Looking beyond this noisy quirk in the data, the report signaled that the gradual recovery in the industrial sector remains intact. Manufacturing production, which accounts for a little over three-quarters of the index, rose 0.2 percent. This gain was particularly impressive as motor vehicles and parts, 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.



Wells Fargo Securities Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Anika R. Khan	Senior Economist	(212) 214-8543	anika.khan@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Jamie Feik	Economist	(704) 410-3291	jamie.feik@wellsfargo.com
Erik Nelson	Currency Analyst	(212) 214-5652	erik.f.nelson@wellsfargo.com
Misa Batcheller	Economic Analyst	(704) 410-3060	misa.n.batcheller@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
Julianne Causey	Economic Analyst	(704) 410-3281	julianne.causey@wellsfargo.com
E. Harry Pershing	Economic Analyst	(704) 410-3034	edward.h.pershing@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

Wells Fargo Securities Economics Group publications are produced by Wells Fargo Securities, LLC, a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes these publications directly and through subsidiaries including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Advisors, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC, is registered with the Commodities Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. Wells Fargo Bank, N.A. is registered with the Commodities Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC, and Wells Fargo Bank, N.A. are generally engaged in the trading of futures and derivative products, any of which may be discussed within this publication. Wells Fargo Securities, LLC does not compensate its research analysts based on specific investment banking transactions. Wells Fargo Securities, LLC's research analysts receive compensation that is based upon and impacted by the overall profitability and revenue of the firm which includes, but is not limited to investment banking revenue. The information and opinions herein are for general information use only. Wells Fargo Securities, LLC does not guarantee their accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company © 2017 Wells Fargo Securities, LLC.

Important Information for Non-U.S. Recipients

For recipients in the EEA, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority. The content of this report has been approved by WFSIL a regulated person under the Act. For purposes of the U.K. Financial Conduct Authority's rules, this report constitutes impartial investment research. WFSIL does not deal with retail clients as defined in the Markets in Financial Instruments Directive 2007. The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. This report is not intended for, and should not be relied upon by, retail clients. This document and any other materials accompanying this document (collectively, the "Materials") are provided for general informational purposes only.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE

**WELLS
FARGO**

SECURITIES