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Economics Group

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Industrial Production Ends Q1 on a Weak Note

Industrial production fell 0.6 percent in March with all major industries reporting lower activity. Despite the drop in manufacturing production last month, we expect a modest pickup in factory activity in the near term.

Nearly as Bad as It Looks

Industrial production ended what was already shaping up to be a weak quarter on a particularly poor note. Production fell 0.6 percent in March, worse than even our below-consensus expectation for a 0.3 percent decline. The disappointing print comes on the heels of annual revisions that show production was materially weaker in 2014 and 2015 than previously estimated and puts IP figures more in line with the more downbeat readings on factory orders in recent months.

Some weakness was to be expected in light of the ongoing headwinds on the domestic energy sector. Mining production fell for the seventh straight month, and the 2.9 percent monthly drop was the largest since 2008. Not only does oil & gas extraction seem to finally be coming down after the drop in drilling activity over the past year, but mining production ex-oil & gas fell nearly 6 percent in March and is down 17 percent over the past year.

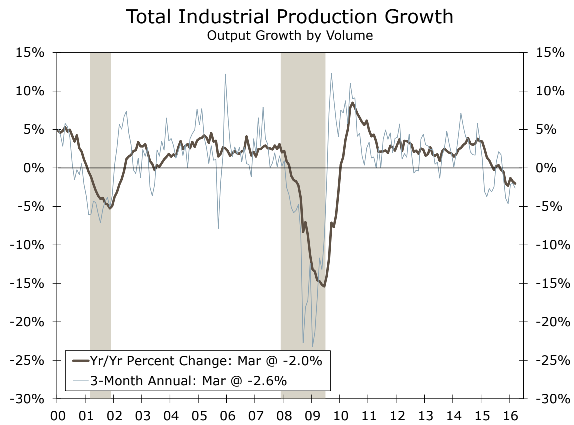
More surprising was the extent of the pullback in the manufacturing sector. Manufacturing production fell 0.3 percent on top of a downward revision to February that now shows factory output contracted that month. A 1.6 percent drop in motor vehicles & parts led the decline, but machinery and fabricated metals also fell.

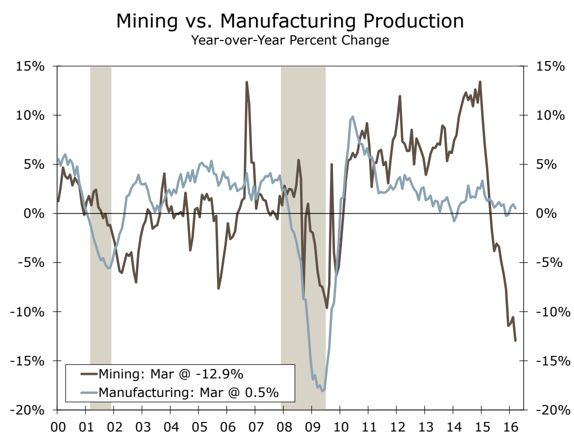
Nevertheless, manufacturing has performed better than other parts of the industrial sector in recent months. While total industrial production is down 2.0 percent over the past year, the most significant sources of weakness have been in the mining and utilities industries, the latter of which is not a useful bellwether of economic conditions in the short term.

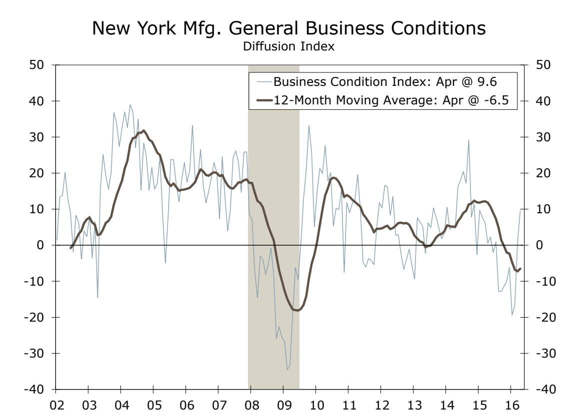
Outlook Improving, but Turnaround Will Be Underwhelming

As we noted in our update to Q1 business spending released earlier this week, *Light at the End of the Tunnel or Oncoming Train?*, there are some encouraging signs emerging for manufacturing and business spending. Included is about a 10 percent rebound in commodity prices and about a 5 percent decline in the dollar since earlier this year. Adding support to the view that the worst may be over for the manufacturing sector was an increase in the Empire State Manufacturing Index reported earlier this morning. The first of the April purchasing managers indices rose nearly nine points to its highest level in more than a year.

That said, even as the most significant headwinds of the past year are easing, there are few tailwinds out there for the factory sector. The modest rebound in commodity prices has offered some support to producers, but prices are not expected to climb meaningfully higher for some time. And while the dollar has given back some ground in recent months, it still sits at a relatively strong level. With global growth still sluggish, we believe that growth in the U.S. industrial sector will remain fairly tepid in the coming quarters.







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

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