ECONOMIC UPDATE

REGIONS

May 15, 2020

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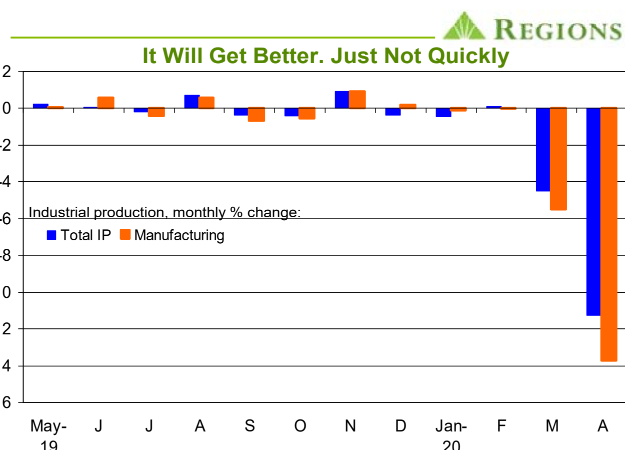
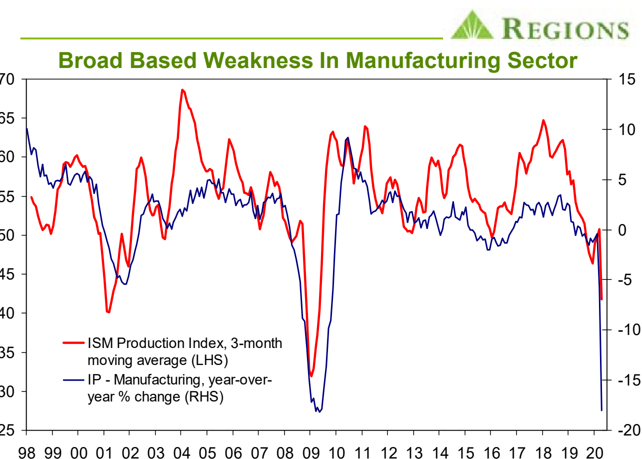
April Industrial Production: It Will Get Better. Just Not Quickly

- Industrial production fell by 11.2 percent in April, with manufacturing output down by 13.7 percent
- The overall capacity utilization rate fell to 64.9 percent, while the utilization rate in manufacturing fell to 61.1 percent
- On a year-over-year basis, total industrial production was down by 15.0 percent in April, with manufacturing output down by 18.0 percent

Total output amongst the nation's factories, mines, and utilities fell by 11.2 percent in April, a less harsh decline than we and the consensus expected but nonetheless the largest decline on record in data that go back to 1919. Output in the manufacturing sector was down by 13.7 percent, output in the mining sector was down 6.1 percent, and utilities output was down by 0.9 percent. The overall capacity utilization rate dropped to 64.89 percent in April, the lowest on record, while the utilization rate in the manufacturing sector fell to 61.09 percent, also the lowest on record. During April, for virtually every data release we covered, including the industrial production data, we warned that, while the March data were bad, the April data would be far worse. That has proven to be the case, across the board. At this point, the general theme is that, while the data should start to improve with economic activity beginning to open up again, the question is the rate at which the data will get better. Our take is that it will be a long and frustratingly slow process, and the industrial production data will be no exception.

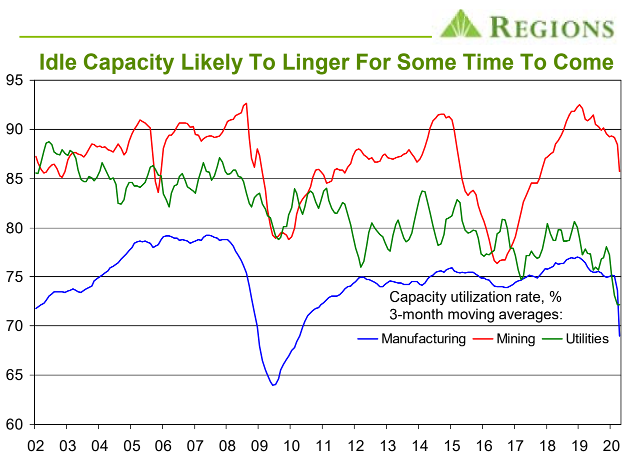


Assemblies of autos and light trucks fell to an annualized rate of 72,000 units in April – in February, assemblies ran at an annual rate of 11.066 million units. The capacity utilization rate amongst producers of autos and light trucks fell to 0.68 percent in April. Sure, we get the meaning of the term "shutdown," but that makes seeing a capacity utilization rate of 0.68 percent no less striking. While motor vehicle production will come back on line in the weeks ahead, keep in mind that prior to the effects of the COVID-19 virus, retail motor vehicle inventories were elevated, and the break in production did nothing to remedy that given how sharply demand has dropped off over the past two months. So, while motor vehicle production will come back online, it is likely to do so at a restrained pace given that demand is likely to remain weak for some time to come.



There was much more to the decline in manufacturing output in April than sharply lower motor vehicle production. Manufacturing output excluding motor vehicles and parts fell by 10.3 percent, leaving it down 13.3 percent year-on-year. Production of business equipment, a reliable indicator of business investment in equipment & machinery as reported in the GDP data, fell by 17.3 percent in April, an ugly sequel to the 8.0 percent decline in March. Clearly, with domestic and global economies in the midst of a short but violent recession and an uncertain path forward on the other side, business investment will remain weak, possibly for some time to come.

Aside from diminished demand, another constraint on business investment going forward will be strikingly low utilization rates, as seen in our bottom chart. Keep in mind that our chart shows the three-month moving average utilization rate in each sector, which we do to account for what can be a high degree of volatility from one month to the next. As such, the April rates are even lower than indicated in the chart. Either way, if we are correct that the subsequent recovery will be somewhat slow paced, that implies utilization rates will be similarly slow to return to more normal levels. If so, there is little incentive for firms to invest in additional capital, and replacement investment, i.e., replacing equipment and machinery at the end of its useful life, simply will not be sufficient to make up the shortfall. We have on many occasions discussed how underinvestment in the years following the 2007-09 recession weighed on labor productivity growth, with consequences for both near-term and long-term real GDP growth. That story is likely to be repeated in this cycle, though to what degree and for how long is obviously highly uncertain at this point.



As the economy digs its way out of a very deep hole, there will be differences in the rate of recovery across the manufacturing sector. On the whole, however, work protocols will be very different, and it will take time to adapt. This is yet another reason we've consistently argued the subsequent recovery will be a long, slow climb.

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