

US IP FALTERED IN 2016 BUT REFORM LIKELY TO CAUSE TURNAROUND IN COMING YEARS

**US industrial production ended 2016 on a positive note, posting its first yr/yr gain since August 2015*

**However, details suggest that underlying manufacturing demand is still weak and that it will take some time for better sentiment to feed through to actual activity*

**Pro-business fiscal reform and higher energy prices should lead to a rebound in industrial production in 2017*

US industrial production ended 2016 on a positive note, increasing 0.8% m/m in December and posting its first yr/yr gain (+0.5% yr/yr) since August 2015 (see Chart 1). However, the strong gain in December was concentrated to a few sectors and was likely transitory:

- (1) Motor vehicle production up a strong 1.8% m/m in December but reports of auto factory shutdowns in January due to elevated inventory will probably lead to reversal in the next report (see Chart 2)
- (2) Utilities production was up a very strong 6.6% m/m as the temperature in December was more normal than an unusually warm November, so relative heating demand increased

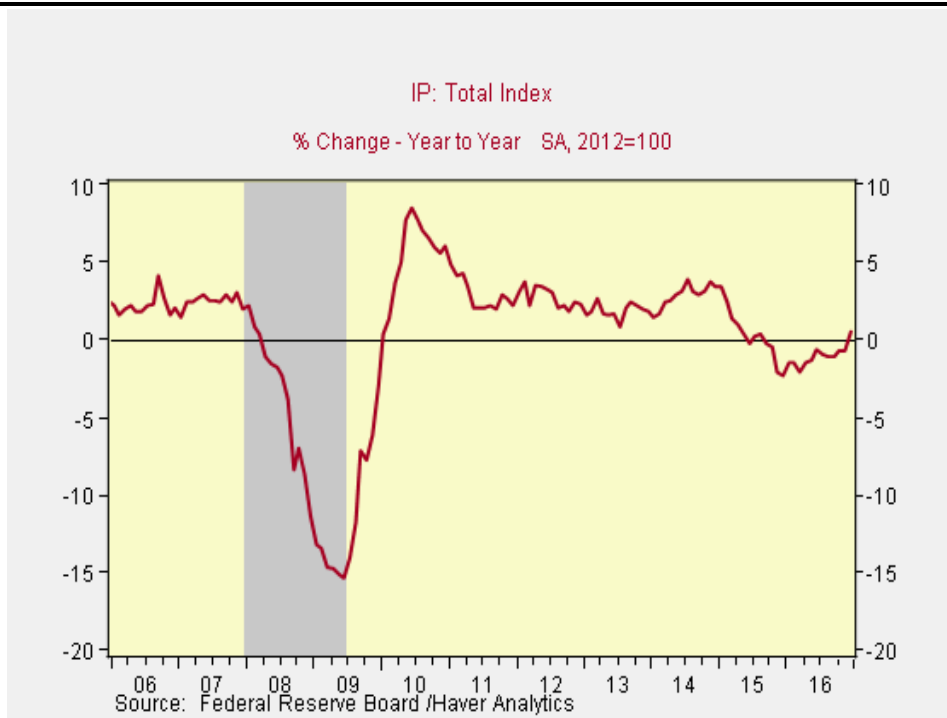
Elsewhere, manufacturing production excluding vehicles December (which gauges underlying manufacturing demand trend) was flat in December and suggests that firms **aren't ready to accelerate investment as yet** (see Chart 3). Although manufacturing sentiment has increased significantly, it will take some time for the higher expectations to feed through to actual economic activity – probably when new fiscal legislation is enacted (see [“US sentiment surges post-election”](#), January 9, 2017).

If pro-business fiscal reform is enacted as expected, factory output in 2017 should more than reverse its 2016 decline. In particular, expect increased government and infrastructure spending to boost aerospace production and production of construction materials. US capital goods, machinery and electrical equipment production should benefit significantly from the lower corporate tax rates and **expensing of new investment** (see [“US industries: gainers and losers from policy reform”](#) for an in-depth discussion of impact of economic regime change on US industries).

Importantly, the higher energy prices, will lead to a rebound in mining production, which posted its largest decline in the history of the series in 2016 and whose weakness spilled over to other manufacturing sectors (see Chart 4).

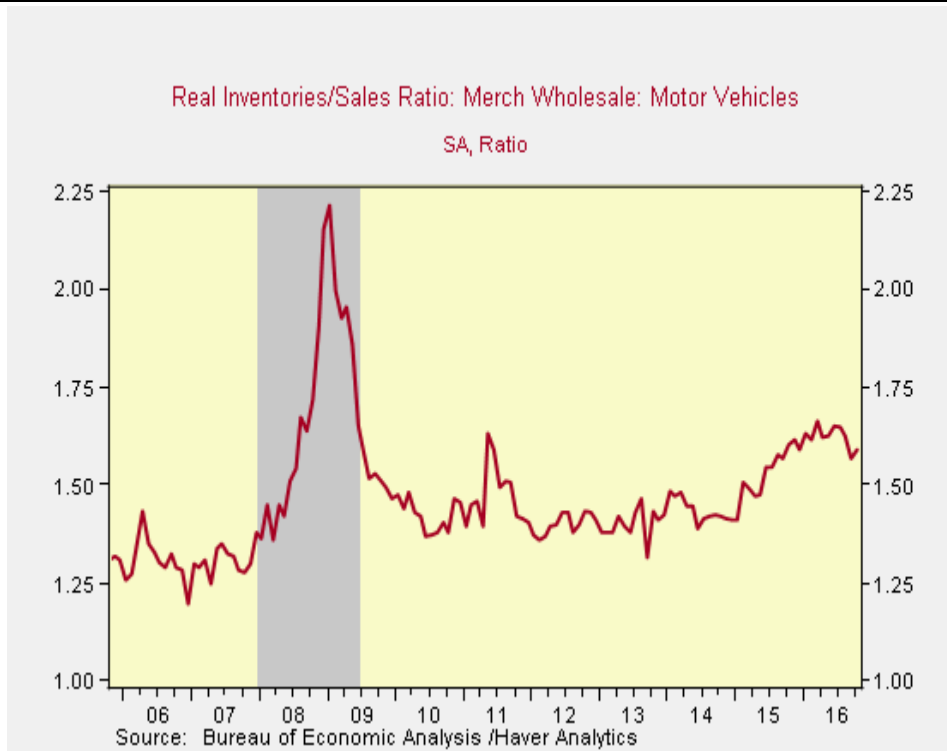
18 January 2017

Chart 1: Industrial Production (Year-Over-Year, %)



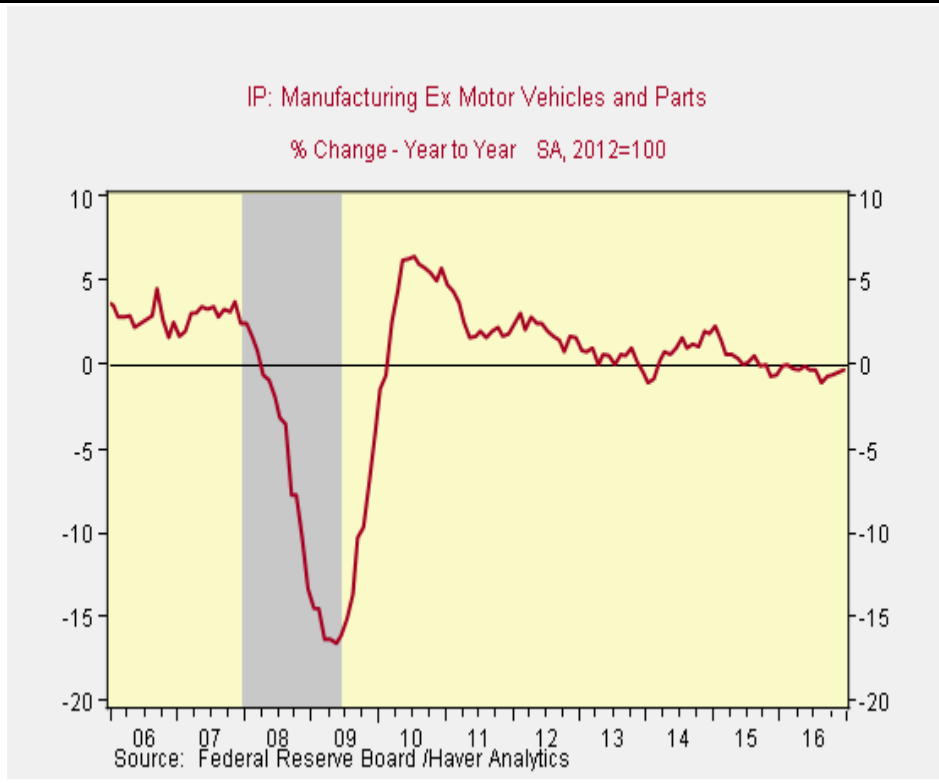
Source: Monthly data. Source: Federal Reserve Board and Haver Analytics

Chart 2: Real Inventories-Sales Ratio for Motor Vehicles at Wholesalers



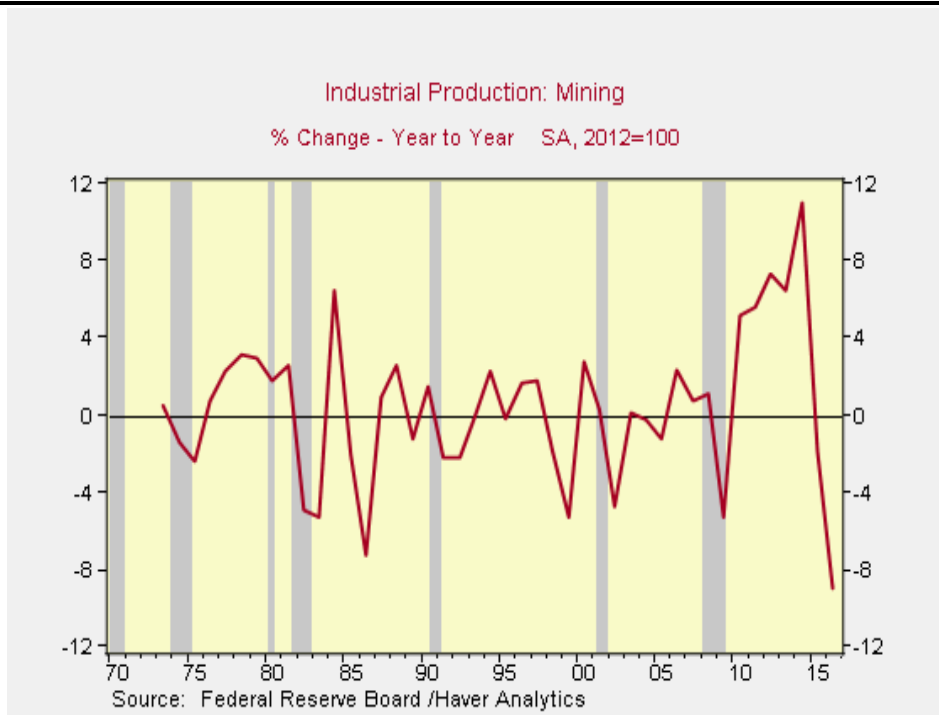
Source: Monthly data. Bureau of Economic Analysis and Haver Analytics

Chart 3: Manufacturing Production Excluding Motor Vehicles and Parts (Year-Over-Year, %)



Source: Monthly data. Source: Federal Reserve Board and Haver Analytics

Chart 4: Mining Production (Year-Over-Year, %)



Source: Annual data. Source: Federal Reserve Board and Haver Analytics

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