

## US MANUFACTURING SENTIMENT AND PRODUCTION MIXED, OUTLOOK STILL BRIGHT

*\*Key regional manufacturing surveys were mixed in early February but generally pointed to further expansion and continued plans for robust capex in the months ahead*

*\*Industrial production started the year on slightly lower ground, declining 0.1% m/m in January, due to the frigid weather that halted activity in weather-sensitive sectors such as mining; following strong gains, this is a temporary pause (Chart 1)*

*\*The producer price final demand index (PPI) advanced 0.4% m/m and 2.7% yr/yr in January, continuing its streak of above-2.5% growth (Chart 2), and now points toward a further firming of underlying inflationary pressures*

*\*Producer price increases were broad-based as the core PPI final demand index (excludes foods, energy and trade services) also grew 0.4% m/m —a nine-month high that lifted the yr/yr to 2.5%, the highest gain in its short three-year history of the series (Chart 3)*

*\*Combined, the data suggest that continued strong gains in business fixed investment are likely, manufacturers feel more comfortable raising selling prices as real sales improve, but signs of overheating are not apparent*

### Manufacturing sentiment and Industrial production

Soft industrial production in January following four consecutive monthly gains is not concerning to us, considering that production declined in only one major sector — mining. Recent increases to multiyear highs in the weekly oil rig count point to a likely bounce-back in mining production in February.

Production of business equipment —5% yr/yr —and consumer goods —4% yr/yr —continue to increase robustly, reflecting expectations among producers for a further buildup in economic momentum (Chart 4).

Early month frigid winter temperatures drove up utilities production in January by 0.6% m/m — and this should lift the energy services consumption in January, offsetting the sluggish retail sales in the GDP accounts.

The details of the Empire State manufacturing sentiment survey read better than the headline decline of 4.6 pts in the manufacturing index to 13.1, as its average of new orders, production, employment, supplier deliveries, and inventories subindexes increased, remaining firmly above 50 (expansion level). The headline index is calculated based on one question, so its divergence with the details probably reflects the negative psychological effect of the financial market volatility. *Respondents to the Philly Fed manufacturing survey seemed to shrug off the financial market developments, with its headline index increasing 3.6pts to 25.8 and its ISM adjusted-index also remaining well above expansion.*

Six-month ahead expectations for business conditions in both surveys remained elevated, likely reflecting the benefits of the Tax Cuts and Jobs Act, favorably regulatory environment, anticipated increased government spending for defense and other infrastructure-related projects, strong global growth, and the weak U.S. dollar. We expect real business fixed investment to grow a robust 7% this year, with upside risks.

15 February 2018

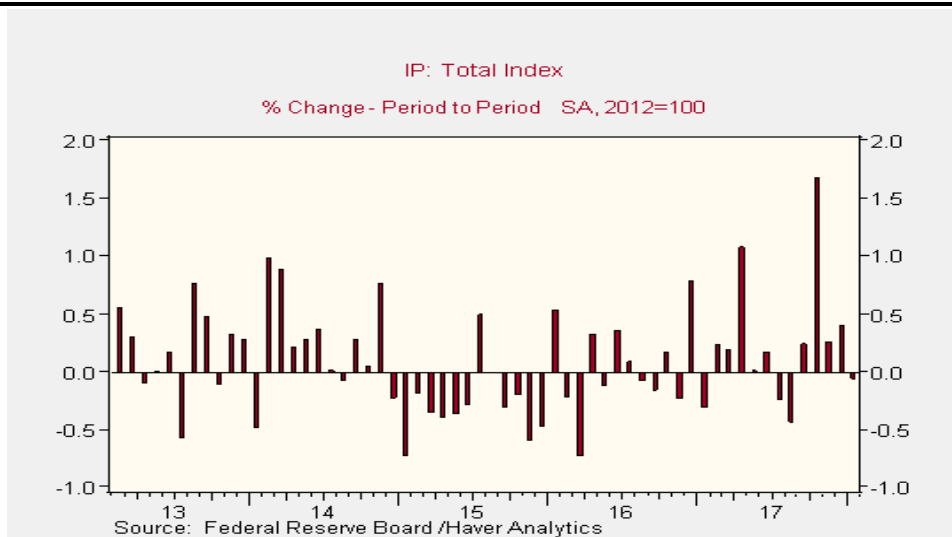
### Producer price index

Over the last 30 years, core finished goods PPI inflation 6-10 months ahead has been a fairly reliable leading indicator of the general direction of core CPI inflation, though the gap between both has been especially wide over the last few years. The same holds for the core goods PCE index. *In general, the upward trend in producer selling prices points toward a moderate rise in consumer price inflation* (Charts 5 and 6).

After accelerating over the last year, prices of processed and unprocessed goods that firms use for inputs to production have moderated and should constrain the rate of increase in the final demand index (Chart 7).

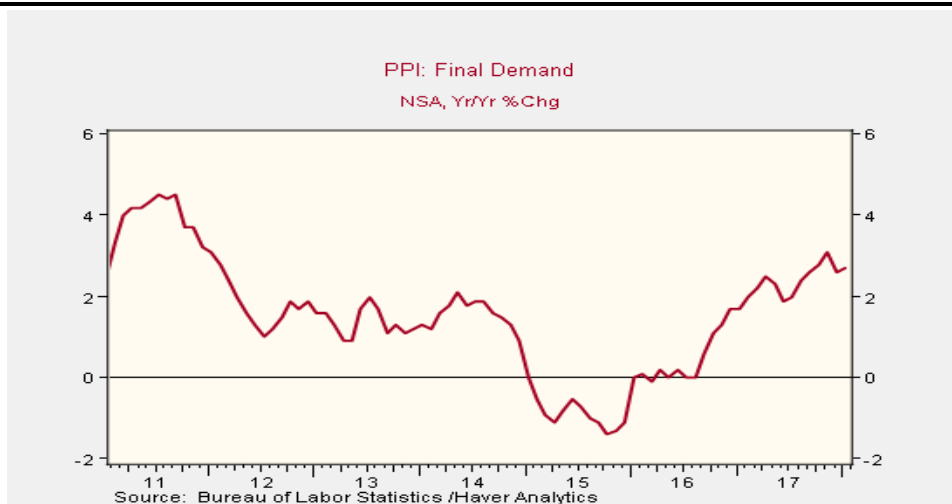
Increased prices are supported by the regional manufacturing surveys and various anecdotal reports: 1) more respondents to the Empire State and Philly Fed manufacturing surveys are paying higher prices for input materials; and 2) the latest Fed Beige Book **“Reports of pricing pressures were mixed across the country although several Districts noted increases in manufacturing, construction, or transportation input costs. Firms in some Districts noted an ability to increase selling prices.”**

Chart 1: Industrial Production (month-over-month, %)



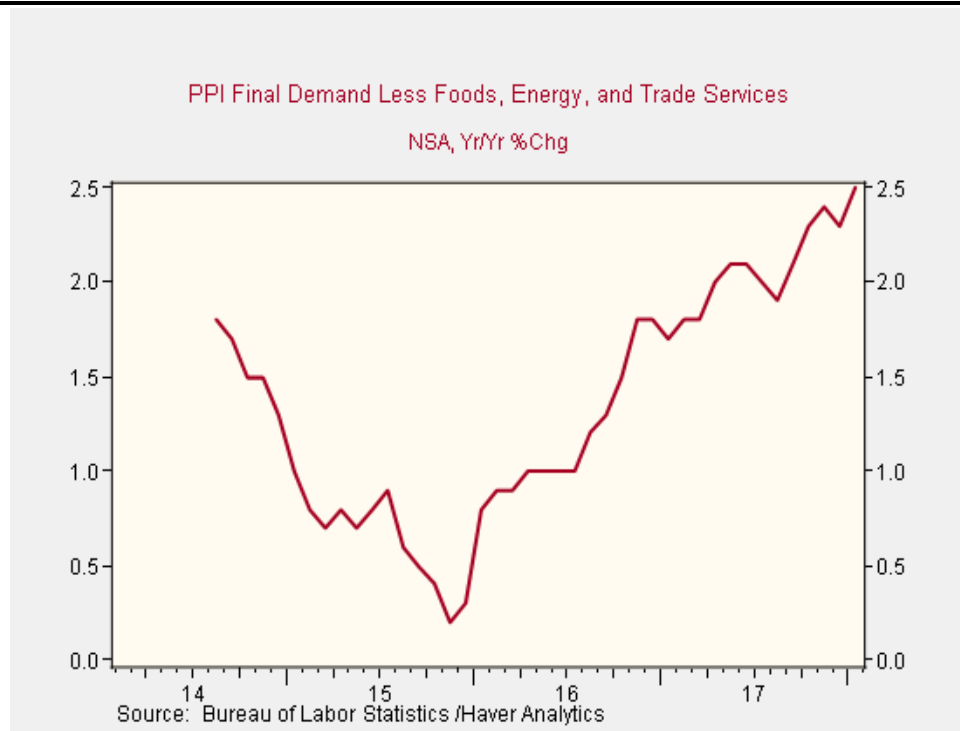
Source: Monthly data. Source: Federal Reserve Board and Haver Analytics

Chart 2: Producer Price Final Demand Index (year-over-year, %)



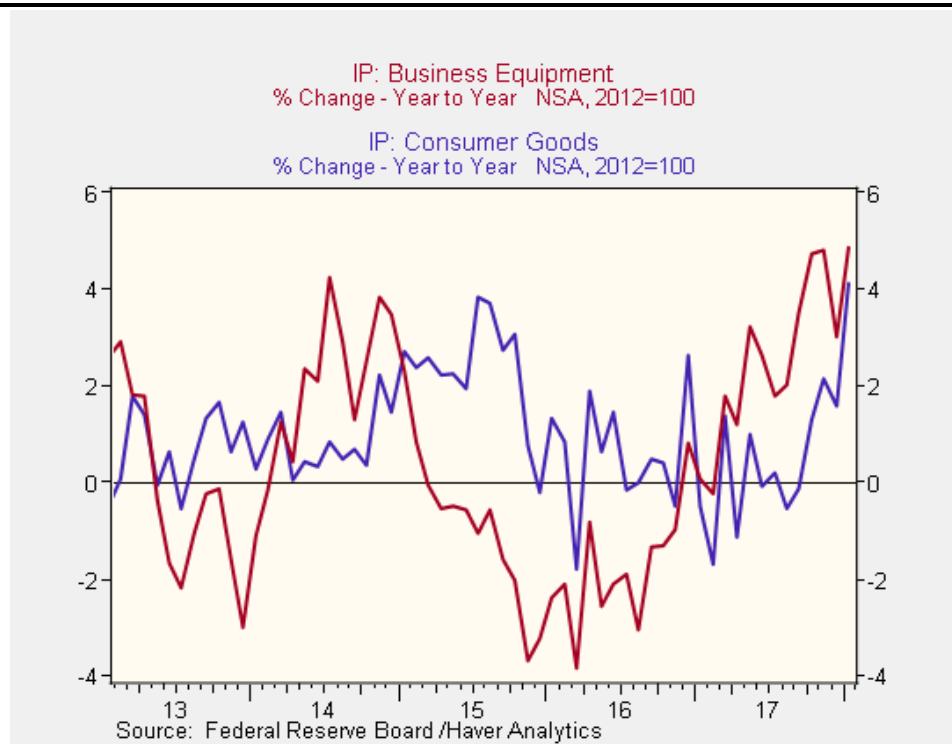
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 3: Core Producer Price Final Demand Index (year-over-year, %)



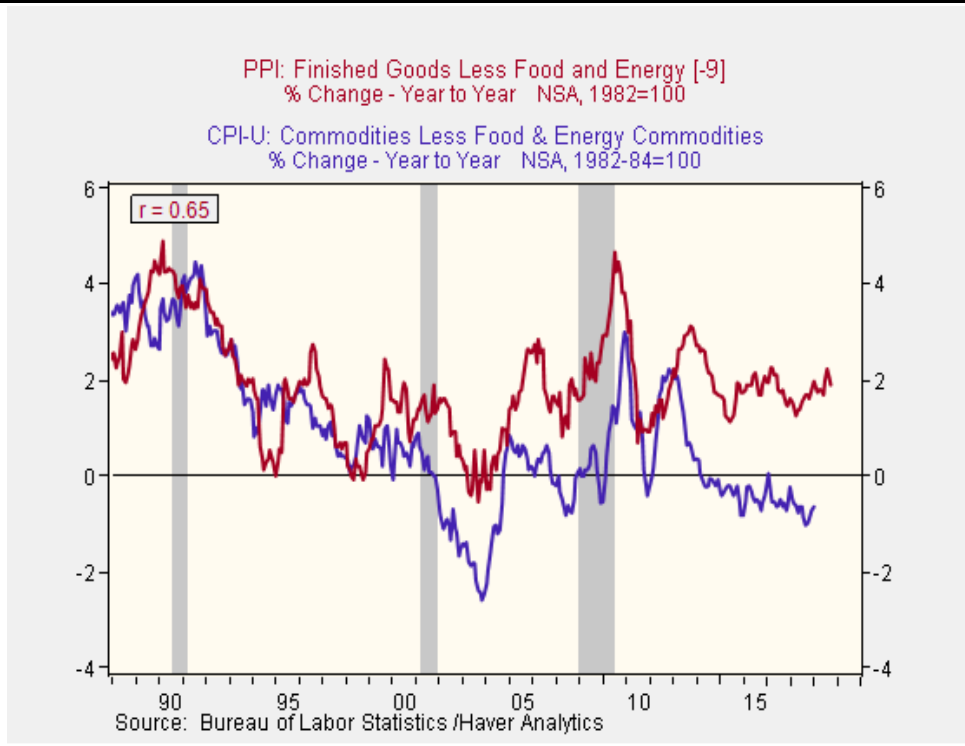
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 4: Industrial Production: Business Equipment and Consumer Goods (year-over-year, %)



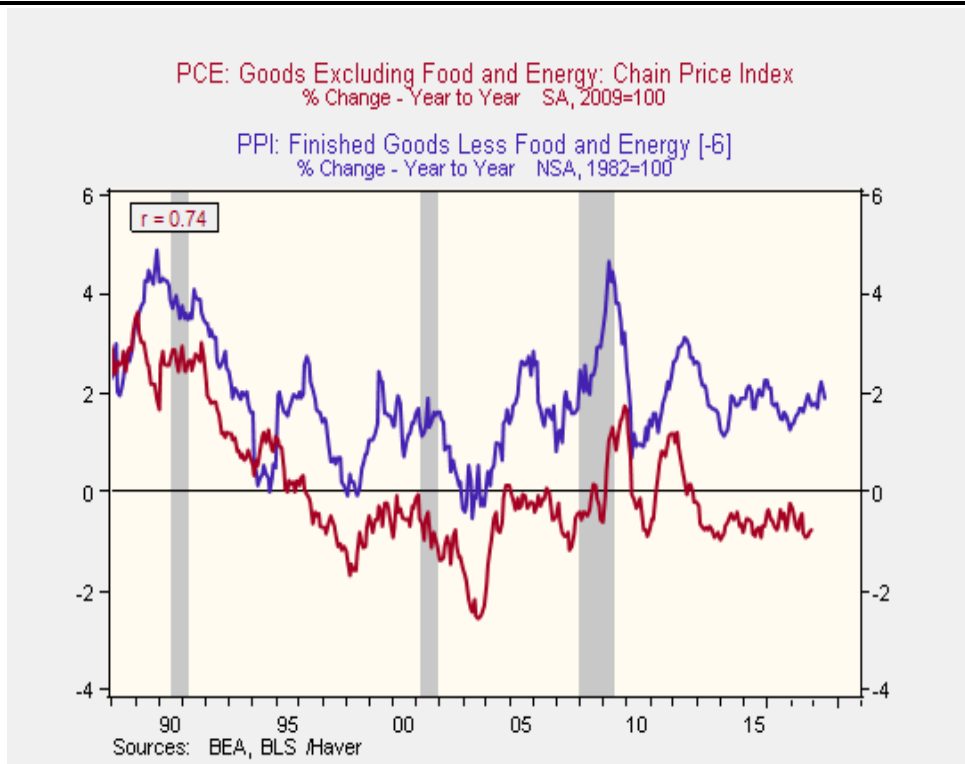
Source: Monthly data. Source: Federal Reserve Board and Haver Analytics

Chart 5: Core Goods PPI and Core Goods CPI (year-over-year, %)



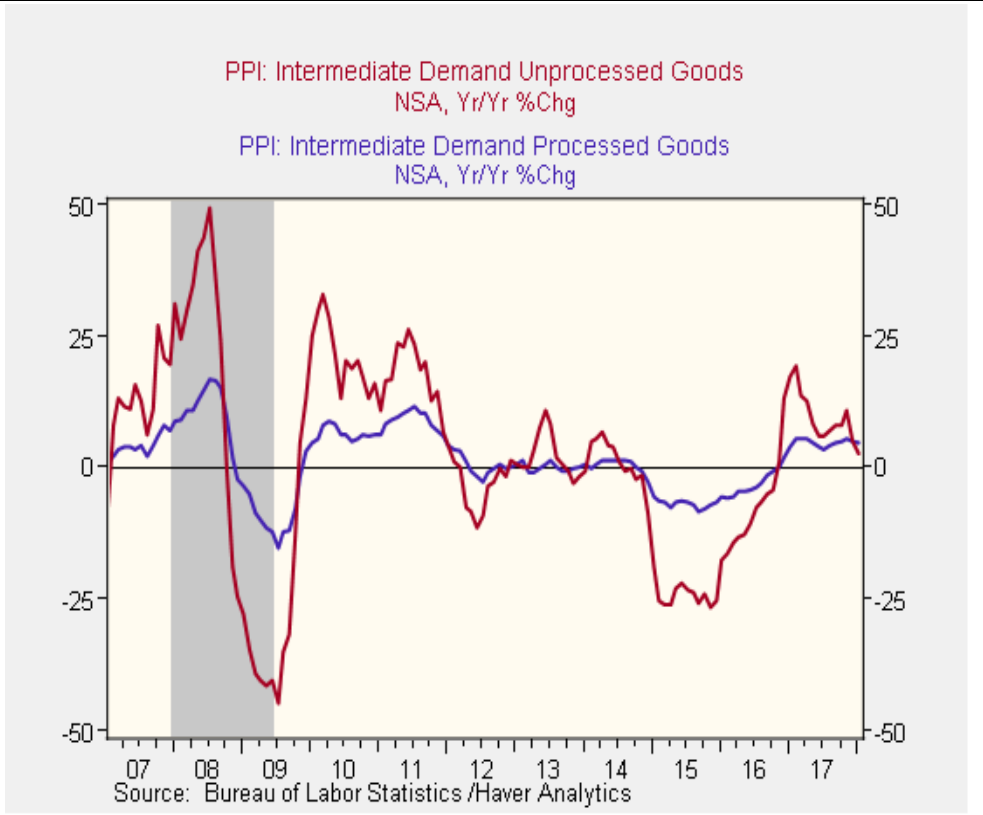
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 6: Core Goods PPI and Core Goods PCE (year-over-year, %)



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

Chart 7: PPI: Intermediate Demand for Unprocessed and Processed Goods (year-over-year, %)



Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

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