What is Manufacturing Production Telling Us?

Yesterday’s drop in the December industrial production figures were noteworthy because they typically do not occur outside of recession. Headline production was down 0.8% after falling 0.6% in November and remaining flat in October. More importantly, **manufacturing output was even weaker than headline production**. Since this series is highly cyclical, its movements tend to forecast that of the broader economy.

Last month, manufacturing production was down 1.3%. This followed a 1.1% decline in November and a 0.3% increase in October. **Over the last three months, manufacturing production is down 8% at an annualized rate**. As illustrated in the chart below, the current decline generally does not happen outside of recession.

Moreover, the back-to-back declines in manufacturing output corroborate the back-to-back sub-50 readings on the manufacturing ISM survey. **The factory sector appears to have entered the early stages of a downturn**. In addition, the January production data are likely to show further contraction. Both the New York and Philadelphia area purchasing managers reports remained in negative territory.

While monetary policymakers often given the “qualitative” purchasing managers type releases short shift, this will not be the case with the industrial production release since the Fed produces the data. **Another likely decline in industrial production in January will not go unnoticed at the Fed** because it implies another large decline in the capacity utilization rate. Remember capacity usage measures slack in the factory sector, so a falling utilization rate means that inflation pressure is dissipating.

Given rising recessionary risks and the current bond bullish trend in various inflation metrics, **current hawkish Fed rhetoric appears out of place**. But this could be due to policymakers’ concerns that a pivot in language will cause financial conditions to ease significantly further. For example, the futures market is already discounting 75 basis points (bps) in rate cuts by next January after peaking at around 4.90% sometime this spring. While this may appear aggressive, history tells us that when recession comes and the Fed begins cutting, it is a lot more than just 75 bps. Bond bears have been forewarned.
Disclaimer

This presentation is for discussion purposes only and is not intended to be an offer to sell or the solicitation of an offer to buy any securities, or any commitment to underwrite, subscribe for or place any securities, is not an offer or commitment to provide any financing or extension of credit or service, and does not contain any tax or legal advice. This presentation has been prepared by SMBC Group (which may include, collectively or individually, any of the following entities in the Americas Division: Sumitomo Mitsui Banking Corporation ("SMBC"), SMBC Nikko Securities America, Inc. ("SMBC Nikko"), SMBC Nikko Securities Canada, Ltd. ("Nikko Canada"), SMBC Capital Markets, Inc. ("SMBC-CM"), SMBC Leasing and Finance, Inc., JRI America, Inc., and SMBC Rail Services LLC) and is being furnished by SMBC Group solely for use by the client or potential client to whom such materials are directly addressed and delivered. This presentation is confidential and is the property of SMBC Group subject to copyright. Any reproduction of this presentation, in whole or in part, is prohibited, and you may not release these materials to any person, except to your advisors and professionals to assist you in evaluating these materials, provided that they are obligated, by law or agreement, to keep the presentation confidential. These materials do not constitute research, a recommendation or an offer or solicitation to any person to enter into any transaction or adopt any hedging, trading, or investment strategy. Prior to participating in any such transaction, you should consult your own independent, competent, legal, tax, accounting, and other professional advisors.

In preparing this presentation, SMBC Group has relied upon information available from third parties, including public sources, and we have assumed, without independent verification, the accuracy and completeness of such information. Specific prices, indices, or measures, including ranges, listed in this document were prepared at the time the document was prepared, and are subject to change without notice. SMBC Group makes no representations to and does not warrant this presentation's accuracy or completeness. SMBC Group expressly disclaims any liability for any use of the information set forth herein, including, without limitation, any use of the information set forth herein in the preparation of financial statements or accounting material.

These materials may contain forward-looking statements, which may include projections, forecasts, income estimates, yield or return, future performance targets or similar analysis. These forward-looking statements are based upon certain assumptions. All forward-looking statements are based upon currently available information and SMBC Group is not obligated to provide an update. Actual events may differ from those assumptions. Opinions, projections, price/yield information and estimates are subject to change without notice. There can be no assurance that estimated returns or projections will be realized, that forward-looking statements will materialize or that actual results will not be materially lower than those presented. Past performance is not necessarily indicative of future results. Any transactions or strategies addressed may not be suitable for all parties. The value, price or income from transactions or strategies may fall as well as rise. SMBC Group or an affiliate may have a position in any of the underlying instruments, assets, indices, or rates mentioned in this document. You should make your own independent judgment or seek independent financial and tax advice with respect to any matter contained herein.

SMBC is subject to Japanese firewall regulations and therefore absent client consent, non-public client information may not be shared with SMBC Nikko Securities Inc.

SMBC Nikko is a U.S. registered broker-dealer of SMBC Group. Nikko Canada is a U.S. and Canadian registered broker-dealer of SMBC Group. SMBC-CM is provisionally registered as a U.S. swap dealer with the CFTC. Capital markets and other investment banking activities for SMBC Group are performed by a combination of SMBC Nikko, Nikko Canada, SMBC Nikko Securities Inc. and SMBC-CM. Lending and other commercial banking activities are performed by SMBC and its banking affiliates. Derivative activities may be performed by SMBC-CM or SMBC. SMBC Group deal team members may also be employees of any of the foregoing entities. SMBC Group does not provide tax advice. Accordingly, any discussion of U.S. tax matters contained herein (including any attachments) is not intended or written to be used, and cannot be used, in connection with the promotion, marketing or recommendation by anyone unaffiliated with SMBC Group or for the purpose of avoiding U.S. tax-related penalties. © 2022 SMBC Group. All rights reserved.