Economic Indicator — March 18, 2025

Overdue Bounce in Autos Gives One-Off Boost to Industrial Production

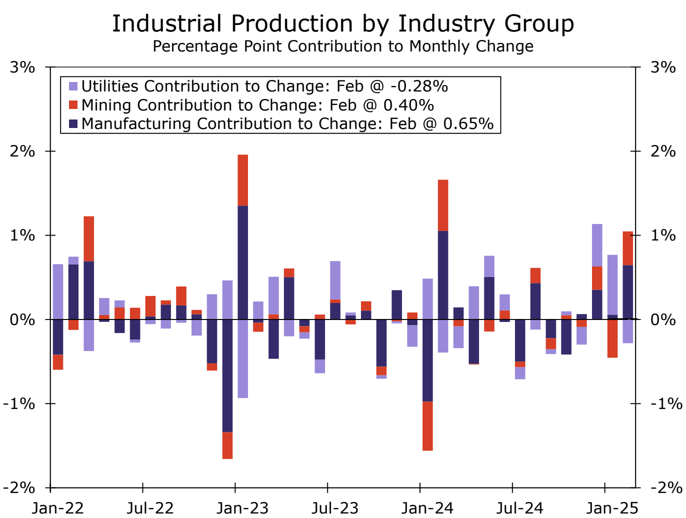
Summary

Despite tariff uncertainty, an overdue bounce in auto manufacturing lifted manufacturing output by the most in a year in February. We do not see this as a sustainable driver of production and remain cautious on prospects for a continued recovery until the dust settles on trade policy.

Economist(s)

Shannon Grein
Economist | Wells Fargo Economics
shannon.grein@wellsfargo.com | 704-410-0369

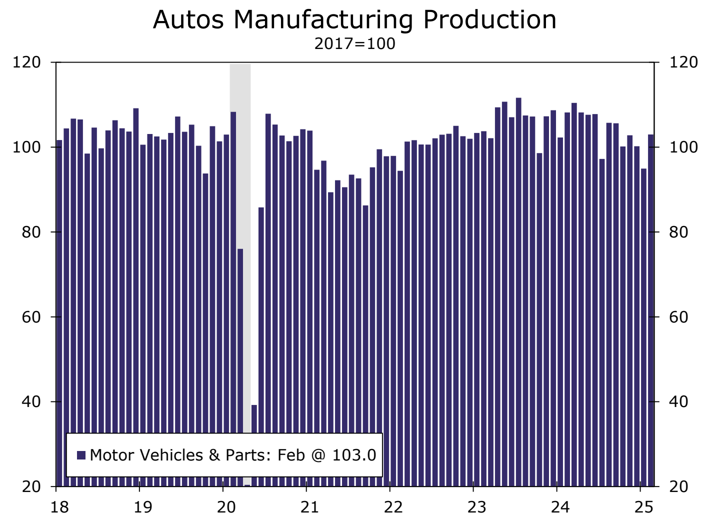
Tim Quinlan
Senior Economist | Wells Fargo Economics
Tim.Quinlan@wellsfargo.com | 704-410-3283



Source: Federal Reserve Board and Wells Fargo Economics

A Big Lift from a Long-Suffering Sector

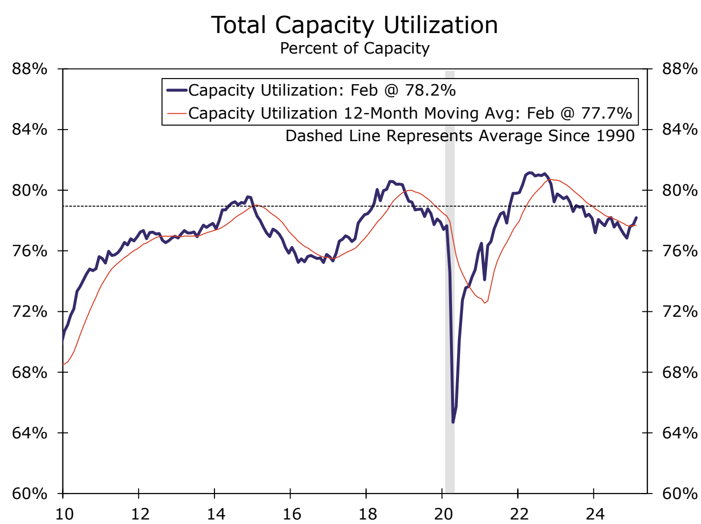
On the surface, today's industrial production report was largely better than expected, though trade uncertainty and one-off dynamics disrupt rational efforts to make definitive takeaways. Start with the headline increase of 0.7% for overall industrial production in February. That is a far better outcome than the 0.2% gain that had been expected by the Bloomberg consensus and, while a downward revision to January's production numbers cools the soup a bit, the production numbers are still plenty hot. Attribute a big step up in manufacturing activity for that. Manufacturing output rose 0.9%, the biggest sequential gain in twelve months, as a big 8.5% increase in motor vehicle & parts production lifted the sector after back-to-back declines in the prior-two months. Before we celebrate the resurgence of the auto-sector, recall that motor vehicle production was down in four of the five previous months, and even after this February surge, auto production remains in the red on a year-ago basis (down 4.8% since February of last year, chart). It's possible this pop is part of a strategy to front-run tariffs by auto manufacturers, but even so, it's unlikely to be sustained source of activity. Elsewhere, gains were mixed among manufacturing industries.



Source: Federal Reserve Board and Wells Fargo Economics

Utilities production fell 2.5% in February, an outcome that was almost inevitable after extra-cold January weather resulted in a 6.1% pop in utility demand. Mining output rose 2.8% in February, sufficient to recoup some, but not all, of January's 3.2% decline.

There are also no shortage of headwinds facing manufacturing activity today, including a still-high cost of capital, strong dollar and some persistent industry-specific labor shortages. Yet the largest burden is uncertainty, namely around trade policy. The Trump Administration has promised tariffs on key trading partners, yet much policy has been delayed with early April now being the date circled for tariff implementation. It remains to be seen which tariffs actually go into place on which countries, but the proposals are wide-reaching and would slow growth while coming with added price pressure.



Source: Federal Reserve Board and Wells Fargo Economics

The threat of tariffs and the on-again off-again implementation style is likely more damaging for manufacturers who are trying to operate in this environment. Trying to navigate supply snarls and cost pressure is hard in normal times; adding the uncertainty of tariffs only exacerbates that challenge.

From the mid-1980s to the early 2000s, overall capacity utilization generally lived in a range between 80-85%. For the past 15 years, there has been more slack with utilization generally between 75-80%. That may be changing. Lately, manufacturers don't have as much spare capacity as they've become accustomed to in recent years. Capacity utilization rose to the highest rate since June, signaling that even if firms wanted to onshore *all* operations, the economy may not have the capacity to do so, at least not without new investment (chart). Firms will likely require a firmer long-term view on the tariff backdrop before they commit to that sort of capital investment.

We therefore remain cautious on the outlook for manufacturing activity this year. The Fed's easing cycle is translating to somewhat easier lending conditions among banks, which could be a modest tailwind, but we're unlikely to see many firms make large capital outlays until the dust settles on trade and economic uncertainty.

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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Jeremiah Kohl	Economic Analyst	212-214-1164	Jeremiah.J.Kohl@wellsfargo.com
Aubrey Woessner	Economic Analyst	704-410-2911	Aubrey.B.Woessner@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Anna Stein	Economic Analyst	212-214-1063	Anna.H.Stein@wellsfargo.com
Ali Hajibeigi	Economic Analyst	212-214-8253	Ali.Hajibeigi@wellsfargo.com
Coren Miller	Administrative Assistant	704-410-6010	Coren.Miller@wellsfargo.com

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