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October Industrial Production / Capacity Utilization

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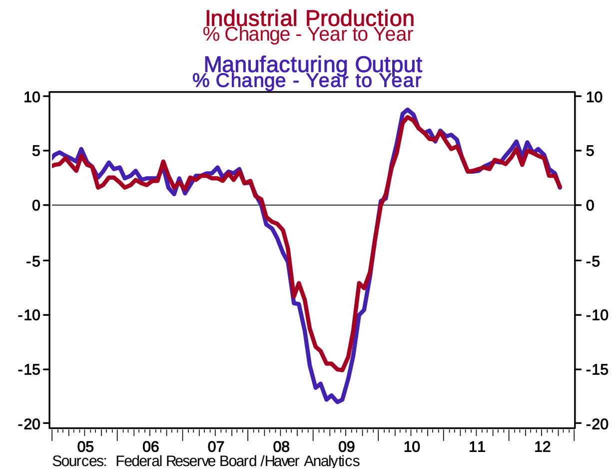
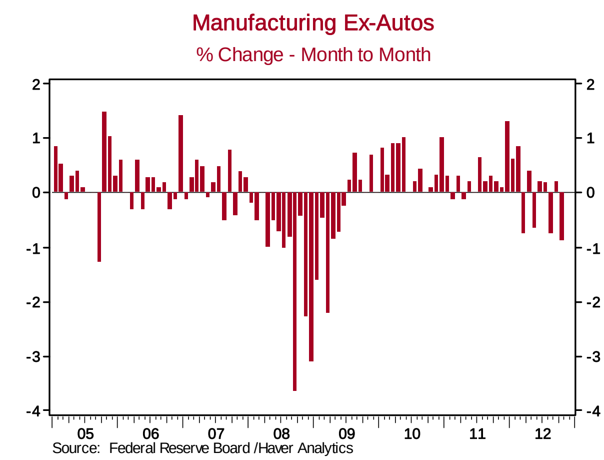
- Industrial production declined 0.4% in October coming in below the consensus expected gain of 0.2%. Production is up 1.8% in the past year.
- Manufacturing, which excludes mining/utilities, fell 0.9% in October. Auto production slipped 0.1% in October while non-auto manufacturing fell 0.9%. Auto production is still up 10.2% versus a year ago while non-auto manufacturing is up 1.0%.
- The production of high-tech equipment rose 1.1% in October but is down 1.7% versus a year ago.
- Overall capacity utilization moved down to 77.8% in October from 78.2% in September. Manufacturing capacity use fell to 75.9% in October from 76.7% in September.





Implications: It is no secret that the growth rate of production has been slowing down over the past year or so, but today's report, although still confirming some softness in the industrial sector, was influenced heavily by Hurricane Sandy. In fact, the Fed said the storm cut total production by almost 1% as power was knocked out in the Northeast. Looking back in 2005, when Hurricane Katrina struck the Gulf region, industrial output was hit very hard and showed a large negative for that month, but in the subsequent months bounced back. We believe the same will hold true for Sandy, although because of the timing of the storm, we would not be surprised if weakness lingers into November data. After that, expect a rebound in production as firms compensate for lost time and consumers replace vehicles and other goods ruined by the storm. Sandy was probably not the only factor limiting production in October. Future policy uncertainty, especially about the "fiscal cliff" is also playing a role. Auto production, which is very volatile, fell 0.1%, and is down at a 19.3% annual rate over the past three months. Manufacturing outside the auto sector – what we like to follow to reduce "statistical noise" – fell 0.9% and is at the lowest level since December of last year. We doubt the economy is in a recession right now and believe manufacturing will soon recover from Sandy. Capacity utilization fell to 77.8% in October, but still remains higher than the 20 year average of 77.7%. This means companies have an incentive to build out plant and equipment. Meanwhile, corporate profits and cash on the balance sheet show they have the ability to make these investments. However, if policymakers fail to resolve the "fiscal cliff" well into 2013, the risk of a mild recession would go up substantially.

Industrial Production Capacity Utilization *All Data Seasonally Adjusted*	Oct-12	Sep-12	Aug-12	3-mo % Ch *annualized*	6-mo % Ch. *annualized*	Yr to Yr *% Change*
Industrial Production	**-0.4%**	0.2%	-1.1%	-5.2%	-1.4%	1.8%
Manufacturing	**-0.9%**	0.1%	-1.0%	-6.1%	-2.9%	2.1%
Motor Vehicles and Parts	**-0.1%**	-1.7%	-3.5%	-19.3%	-5.1%	10.2%
Ex Motor Vehicles and Parts	**-0.9%**	0.2%	-0.7%	-5.4%	-3.2%	1.0%
Mining	**1.5%**	0.9%	-1.4%	4.0%	4.2%	3.4%
Utilities	**-0.1%**	0.0%	-2.1%	-8.7%	6.2%	0.5%
Business Equipment	**-1.2%**	0.5%	-1.0%	-6.7%	1.0%	7.5%
Consumer Goods	**-0.9%**	-0.1%	-1.1%	-7.8%	-1.7%	-0.9%
High-Tech Equipment	**1.1%**	-0.6%	-2.8%	-9.0%	-6.9%	-1.7%
Total Ex. High-Tech Equipment	**-0.4%**	0.2%	-1.0%	-4.9%	-1.0%	1.9%
				3-mo Average	6-mo Average	12-mo Average
Cap Utilization (Total)	**77.8**	78.2	78.2	78.1	78.5	78.5
Manufacturing	**75.9**	76.7	76.7	76.4	76.9	77.1

Source: Federal Reserve Board