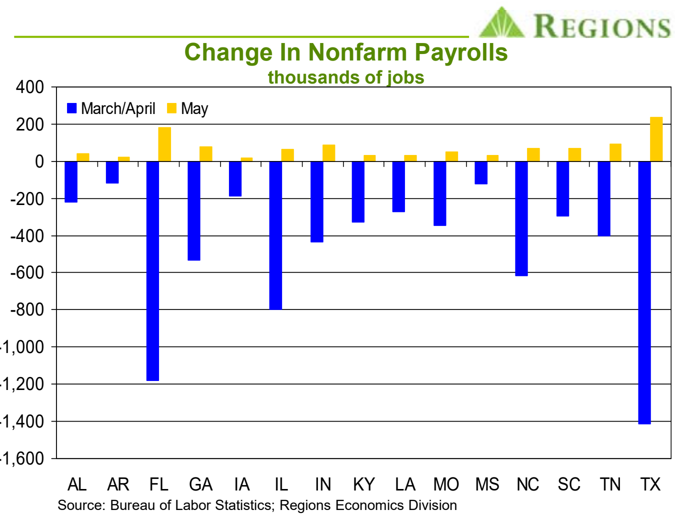
ECONOMIC UPDATE

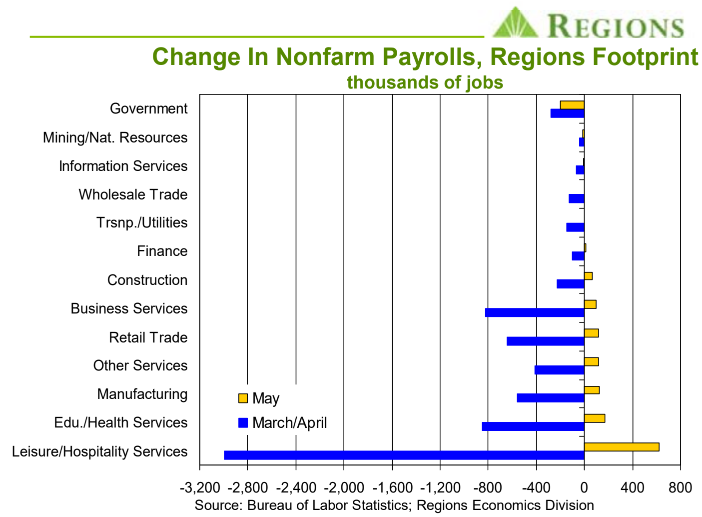
REGIONS

June 24, 2020

May 2020 Nonfarm Employment: Regions Footprint

For the Regions footprint as a whole, total nonfarm employment rose by 1.101 million jobs in May, with private sector payrolls up by 1.300 million jobs and public sector payrolls down by 0.199 million jobs. What was originally reported as a decline of 6.684 million jobs in April is now reported to be a decline of 6.752 million jobs. With the downward revision to April's job counts, total nonfarm employment for the footprint as a whole declined by a combined 7.262 million jobs over March and April, with 6.983 million of these lost jobs coming from private sector payrolls. Total nonfarm employment rose in each of the 15 in-footprint states in May. As would be expected given their size, Florida (182,900) and Texas (237,800) added the largest numbers of jobs in May, but on a percentage change (from April) basis, South Carolina (3.52 percent), Tennessee (3.41 percent), and Indiana (3.19 percent) posted the largest increases.





May's job gains were concentrated amongst a few of the thirteen broad industry groups, with leisure and hospitality services (624,000) seeing the largest increase. In addition to government, employment fell in the mining/natural resources, information services, wholesale trade, and transportation/utilities industry groups in May. The retail trade, education and health services, and leisure and hospitality services industry groups accounted for 64.3 percent of all private sector jobs lost in March and April but accounted for 70.2 percent of the private sector jobs added in May. As can be seen in the first chart above, while nonfarm employment rose in each of the 15 in-footprint states in May, that was but a small step in recouping the jobs lost in March and April, which is also the case nationally.

That employment rose at all in May came as a surprise, as the increase in nonfarm payrolls was at odds with other labor market indicators, including the weekly data on claims for Unemployment Insurance, the ISM's surveys of the manufacturing and services sectors, and the ADP National Employment Report. It is also worth noting that in both the establishment survey (used to estimate nonfarm employment) and the household survey (used to estimate the unemployment rate and related metrics), the response rates for May were notably low, thus lessening the reliability of the initial estimates of the metrics based on the surveys and opening up the possibility of potentially large revision. These issues become even more pronounced on the state level and metro area level, where even in the best of (sampling) times the revisions to the initial estimates tend to be larger than is the case on the national level.

We've argued that the May nonfarm employment data were likely impacted by the Paycheck Protection Program (PPP). Recall that under the PPP, firms had the incentive to retain workers or to rehire workers they had let go so that what began as loans made under the PPP would be converted into grants. At the time of the May establishment survey, the original set of conditions for this conversion were still in place, i.e., firms had to spend at least 75 percent of the loan on payroll and the funds had to be used within eight weeks of receipt. In our view, this increased the likelihood that the PPP would have impacted the May nonfarm employment data – keep in mind that in order for the BLS to consider someone as being employed, they only had to be paid for any one day during the survey period, regardless

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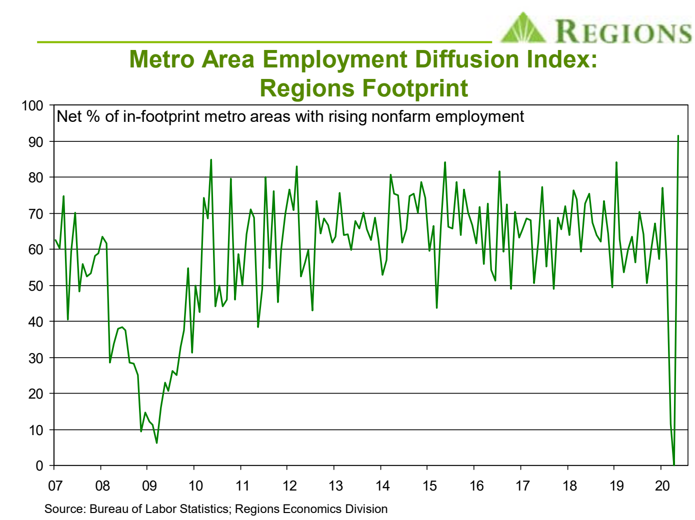
of whether or not they actually worked, and the household survey showed a jump in the number of people reporting they were being paid but were nonetheless absent from work. Moreover, that May's job gains, nationally and within the Regions footprint, were heavily concentrated amongst retail trade, education and health services, and leisure and hospitality services also supports our view, as these were the industry groups most immediately and most severely impacted by the shutdowns in economic activity that took hold over the last half of March and into early April.

To be clear, this is not intended as a criticism of the PPP, quite to the contrary, if we are correct in our view, that would be a sign of the PPP having the desired effect on private sector payrolls. Instead, we raise this point as a caution against drawing firm conclusions on the underlying health of the economy based on the increase in nonfarm employment in May. Some have been quick to point to the increase in nonfarm employment in May as "proof" that things are well on the way back to normal. We'd simply offer the following observations. First, the conditions under which PPP loans are eligible to be converted into grants have been relaxed, including lowering the percentage of funds that must be spent on payroll and lengthening the time in which the funds had to be spent. This suggests that, with less of a sense of urgency on the part of firms, the PPP is unlikely to have nearly as large of an impact on the June nonfarm employment data as was the case with the May data. More fundamentally, the large share of respondents to the household survey reporting they were being paid but were absent from work is a sign that May's headline job growth number outperformed underlying economic conditions. To be sure, as economic activity continued to increase during June, you'd expect some share of this group to have actually returned to work, so this is one element of the June data that will be of great interest. But, to the extent that the recovery in the broader economy will be relatively slow and uneven, as we anticipate will be the case, this raises the risk that once the PPP has expired, firms may conclude they need less labor than was the case prior to the COVID-19 virus disrupting the economy and, as such, may implement a second round of layoffs that would most likely see more permanent job losses as opposed to temporary layoffs than was true in the initial round of layoffs.



Job gains were broad based across the in-footprint metro areas in May, with only a handful of metro areas seeing further declines in nonfarm employment. One notable exception is the Orlando metro area, where nonfarm employment fell by 56,300 jobs in May, though we suspect this reflects layoffs at the theme parks that took place in April after the conclusion of the April establishment survey, thus turning up as May job losses. Our metro area employment diffusion index goes to our point about the geographic breadth of job gains in May. After falling to zero in April – meaning that not a single metro area saw nonfarm payrolls increase in April – the metro area employment diffusion index sprang up to 91.45 percent in May, easily the highest reading in the life of the data which go back to January 1990.

Though the strong rebound in May is obviously an encouraging sign, it is worth noting that the diffusion index tells us the breadth, but not the intensity, of hiring across in-footprint metro areas. It would be reasonable to expect widespread but modest increases in employment as economic activity began to come back online over the course of May, particularly later in the month. It would also be reasonable to expect that the intensity of hiring would have increased in June. But, the points we've made about the likely effects of the PPP on the national and state level data hold here as well, meaning that any bounce in nonfarm employment in June stemming from economic activity coming back online may be partially, or fully in some metro areas, negated by the unwinding of any PPP effects in the May data.

Another point we think worth discussing is the further loss of public sector jobs in May, and the discussion here holds for both the state and metro area levels. Even as economic activity comes back online, state and local tax revenues remain significantly depressed. On the state government level, income taxes and sales taxes are generally the largest revenue sources, and both revenue streams remain significantly impaired. Given the magnitude of job losses, income tax collections have taken a significant hit, and with consumer spending also remaining far below pre-virus levels, sales tax collections may be off the bottom but are nowhere near normal. Consumer spending on goods did rebound smartly in May, with retail sales up by over 17 percent for the month, but this leaves the dollar volume of retail sales eight percent below February's level. To some extent, that states now collect sales tax on purchases made online has mitigated the hit to sales tax revenue collections, but this nonetheless leaves a significant gap to fill. An additional source of stress on revenue streams in energy-producing states – Louisiana and Texas within the Regions footprint – is that lower prices and diminished production have dented severance tax revenues.

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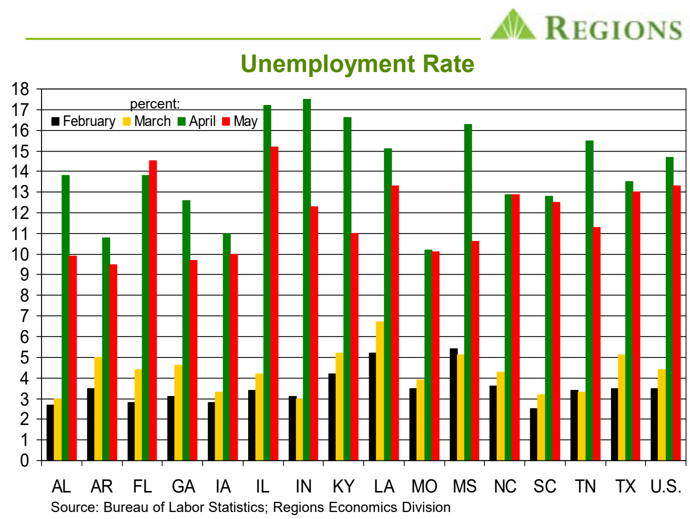
To this point, house prices have held up, which is important on the local government level given the significance of property tax revenue. While our baseline forecast does not at this time anticipate a significant decline in house prices on the national level, those metro areas in which the recovery lags may be more vulnerable to smaller increases/larger declines in house prices than will be true of the U.S. as a whole, particularly those metro areas with higher exposures to leisure and hospitality services and retail trade. As such, there are some downside risks to house prices and, in turn, local government tax revenue. The bottom line is that it is likely to be some time before state and local government tax revenue returns to, or comes close to, pre-virus levels, meaning that further public sector job losses cannot be ruled out over coming months even as private sector payrolls continue to recover.

Unemployment rates fell nationally and across the Regions footprint in May with the exception of Florida, which saw its unemployment rate rise from 13.8 percent in April to 14.5 percent in May as the increase in the labor force easily outran the increase in household employment. At the same time, however, April unemployment rates were revised higher for every state in the footprint, significantly so in many cases. This goes to a point made earlier – even in the best of times, state level and metro area level unemployment rates are volatile from one month to the next, and the initial estimate in any given month is prone to sizable revision, which simply reflects the thinner sample on which these estimates are based. This is compounded at present by what are notably low response rates to the household survey, and it will be interesting to see how these initial May estates are revised.



This brings up another relevant point, which is that BLS reports that reporting errors led to the national unemployment rate being understated in May, the third consecutive month in which this was the case. BLS reports large numbers of people who have been laid off due to the COVID-19 virus and the efforts to stem its spread have incorrectly reported their status as "absent from work" rather than "unemployed." As such, the measured unemployment rate has been understated; nationally, BLS estimates the March jobless rate was understated by one percentage point, the April rate by five percentage points, and the May rate by three percentage points. So, while the unemployment rate did decline in May, it did so from a higher base and, by the BLS estimate, stands closer to 16.3 percent than the reported rate of 13.3 percent. It is not possible to quantify the extent to which state and metro area unemployment rates have been understated.

The broader point is that, even allowing for the actual rate to be higher than the reported rate, the U3, or, "headline," unemployment rate is not an adequate measure of the degree of labor market slack. Though nationally and across most of the Regions footprint – Iowa and Kentucky being the exceptions – labor force participation rose in May, the size of the labor force remains well below that of February, which is acting to hold down measured unemployment rates. Moreover, millions of people remain employed but have had their hours cut to the point they are working less than full-time, while others have only been able to secure part-time employment. Nationwide, the number of people working part-time for economic reasons (i.e., they would prefer to be working full-time but are working only part-time) has risen from 4.318 million people in February to 10.633 million people in May, while a significant number remain only marginally attached to the labor force. While the broader U6 rate captures these effects, the U6 rate is not available on a monthly frequency on the state level and is not available at all on the metro area level. As such, we are unable to adequately quantify the degree of labor market slack on the sub-national level. Nationally, the U6 rate stood at 21.2 percent in May, and the spread between the U6 rate and the U3 rate was abnormally high, indicative of a much greater degree of labor market slack than implied by the "headline" unemployment rate of 13.3 percent (note that the reporting errors that have held down the U3 rate have also held down the U6 rate). This is also the case on the sub-national level, though the degree to which this is the case will vary across states and metro areas.

In addition to these monthly updates of the state level employment data, we continue to produce our regular updates of state level claims for Unemployment Insurance upon the release of the data each Thursday, and will continue to provide our regular monthly updates of state and metro area labor market, housing market, and personal income data, updates which can be found at either of the following sites:

https://www.regions.com/about-regions/economic-update or http://lifeatregions/Finance/MonthlyEconomicReports.rf

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