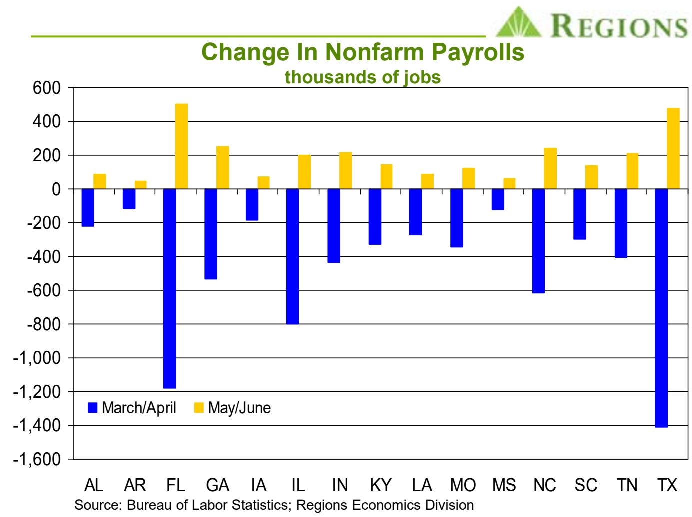
ECONOMIC UPDATE

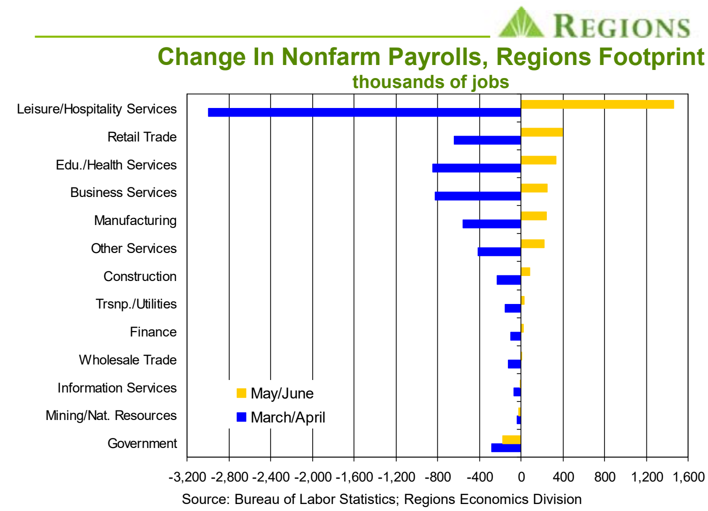
REGIONS

July 20, 2020

June 2020 Nonfarm Employment: Regions Footprint

For the Regions footprint as a whole, total nonfarm employment rose by 1.682 million jobs in June, with private sector payrolls up by 1.663 million jobs and public sector payrolls up by 18,800 jobs. What was originally reported as an increase of 1.101 million jobs in May is now reported to be an increase of 1.169 million jobs, consistent with the upward revision to the initial estimate of national job growth in May. Between May and June combined, nonfarm payrolls for the footprint as a whole rose by 2.851 million jobs which, when set against the loss of 7.262 million jobs over March and April, leaves total nonfarm employment 4.411 million jobs below February's level. Total nonfarm employment rose in each of the 15 in-footprint states in May. On a percentage change basis, Kentucky (6.59 percent), Indiana (4.57 percent), and North Carolina (4.26 percent) posted the largest increases in nonfarm employment in June.





Apart from mining/natural resources and information services, each of the thirteen broad industry groups added jobs in June. The leisure and hospitality services industry group added 796,200 jobs, retail trade added 267,500 jobs, while manufacturing, education and health services, businesses, and other services each saw payrolls rise by better than 100,000 jobs. We will note that the reported modest increase in government sector payrolls is mainly a reflection of seasonal adjustment noise, and while the July data could show an even larger increase, that too would likely be a function of seasonal adjustment noise (the normal timing of the school year relative to when teachers actually fell off of payrolls this year is the root cause of this noise), the trend in this sector over coming months will be downward, reflecting heightened budgetary stresses amongst many state and local governments. Payrolls in mining/natural resources remain under pressure as a fairly weak demand outlook and prices which, while having rebounded since April, nonetheless remain below what are break-even prices for many domestic producers. The impact within the footprint is largely, though not totally, confined to Texas and Louisiana, and in addition to the effects on employment, severance tax revenue collections are also hurting from the one-two punch in the form of lower output and lower (relative to pre-pandemic levels) prices.

As is clear from the two charts above, whether looking at individual states or industries, while the job gains in May and June are a good start, the level of employment remains far below that of February. For instance, payrolls in the leisure and hospitality services industry group increased by a total of 1.466 million jobs over May and June, but when coupled with the loss of a total of 2.997 million jobs over March and April, this leaves the level of employment in this industry group 1.531 million jobs below that of February. Or, as of June, the level of employment in the leisure and hospitality services industry group was 22.8 percent below that of February, easily the largest disparity of any industry group, with the 2.25 percent disparity in finance the smallest of any industry group. Payrolls for the private sector within the Regions footprint are 7.89 percent below February's level. As for the individual states, as of June private sector payrolls in Louisiana stood 10.16 percent below February's level, with Illinois (9.80 percent) and Kentucky (9.56 percent) seeing the next largest disparities; Alabama has the smallest the disparity between the June and February levels of private sector employment, at 6.36 percent.

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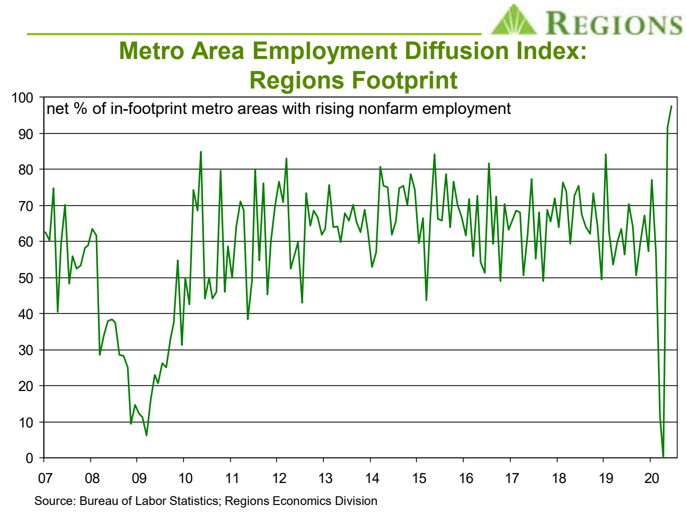
Though by no means dismissing the job gains seen over May and June, there are several points we think it important to keep in mind. First, the degree to which the Paycheck Protection Program (PPP) lifted measured job growth in May and June is quite uncertain. As we noted last month, under the PPP firms had the incentive to retain workers or to rehire workers they had previously 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 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.

The initial conditions for conversion were relaxed in June –the time frame for utilizing the funds was expanded and a smaller share had to be used on payroll – so it could be that the PPP would have had a smaller impact on measured job growth in June than in May. But, the job gains seen over May and June, nationally and within the Regions footprint, were heavily concentrated amongst retail trade, education and health services, and leisure and hospitality services, which supports our premise that the PPP has skewed the employment data, as these were the industry groups most immediately and most severely impacted by the shutdowns in economic activity in place from mid-March into May. If we are correct, the risk is 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

Another important, and not unrelated, point to keep in mind is that the June employment data were collected before the jump in COVID-19 cases over the latter part of the month, with the spike in the number of cases having persisted into July. Thus far, policy makers have responded with targeted interventions, as opposed to the more sweeping restrictions on economic activity that were imposed in the early phases of the pandemic. While this should result in significantly less disruption in economic activity, the targeted interventions have been aimed primarily at restaurants and bars, which were a significant source of the job growth seen over May and June as establishments called previously laid-off workers back to work. Within the Regions footprint, leisure and hospitality services accounted for 48.5 percent of the growth in private sector payrolls seen in May and June, and while there is no comparable number on the state level, we know that nationally restaurants and bars accounted for over 83 percent of the jobs added in the broad leisure and hospitality services group over this two-month period. So, any new layoffs amongst these establishments in the wake of the recent spike in COVID-19 cases will clearly impact measured job growth, and our sense is that any increase in nonfarm employment in July, nationally and within the Regions footprint, will be much smaller than that seen in June.

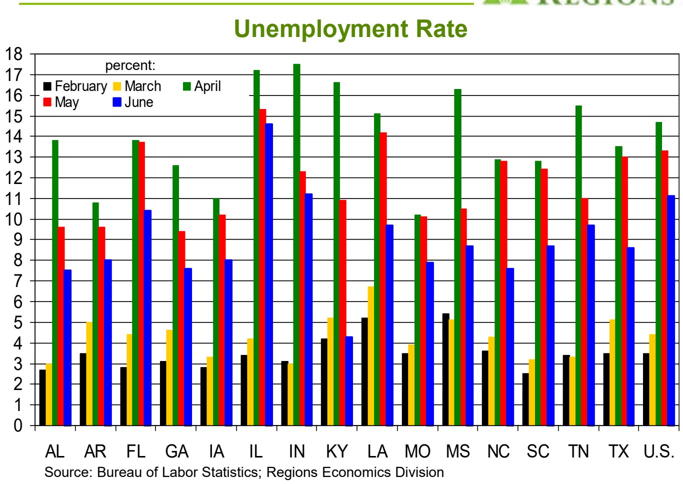


Job gains were broad based across the in-footprint metro areas in June, with only four metro areas – Auburn, AL, Bloomington, IN, Jefferson City, MO, and Tuscaloosa, AL – seeing declines (very modest declines) in nonfarm employment. Our metro area employment diffusion index illustrates the geographic breadth of job gains in May and June. 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 91.44 percent in May then rose to 97.37 percent in June, the highest reading in the life of the data which go back to January 1990.

Though the strong rebound is obviously encouraging, it is worth noting that the diffusion index tells us the breadth of, but not the intensity of, hiring across in-footprint metro areas. It was 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, and it was also 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 at least some of the job growth seen over May and 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 data. More immediately, the July employment data may be impacted by the recent upturn in COVID-19 cases.

It is also worth reiterating our earlier point about the modest increase in public sector payrolls seen in the June data. Our sense is that this is mainly a reflection of seasonal adjustment noise resulting from teachers having fallen off of payrolls earlier this year than is normally the case – if we are correct on this point, the seasonally adjusted July data are likely to show an even larger increase in public sector payrolls than that reported in the June data. This should not deflect attention from what we think remains a more negative outlook for public sector payrolls over coming quarters. 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 impaired. Given the magnitude of job losses in March and April, income tax collections have taken a significant hit. Though the gains in retail sales in May and June offer encouragement for sales tax revenue collections, with the dollar volume of total retail sales in June just 0.6 percent below that of February, uncertain paths for employment and income (with the $600 per week in supplemental Unemployment Insurance benefits set to expire at the end of July) raise doubts as to the extent to which retail sales will continue to increase over coming months.

Up until this point, house prices have held up, in many metro areas better than expected, 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 approaches 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 June, with Kentucky (650 basis points), North Carolina (520 basis points), and Louisiana (460 basis points) posting the largest over-the-month declines. Illinois (14.6 percent) and Indiana (11.2 percent) are the only two in-footprint states with unemployment rates above the national average of 11.1 percent. Still, the declines in Kentucky, Louisiana, and, to a lesser extent, North Carolina seem a bit suspicious, as each state saw a significant decline in the size of its labor force. We will once again note that, 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 June estates are revised.

It also helps to recall that, at present, the U3, or, "headline," unemployment rate is not an adequate measure of the degree of labor market slack on the national, state, or metro area level. Though labor force participation rates have generally risen over the past two months, 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) stood at 9.062 million people in June, up 4.318 million in February, 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 18.0 percent in June, and the spread between the U6 rate and the U3 rate remains abnormally high, indicative of a much greater degree of labor market slack than implied by the "headline" unemployment rate of 11.1 percent. 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 Thursday updates of state level claims for Unemployment Insurance, 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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