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No No No . . . Holiday Sales Forecast This Year

It's the most wonderful time of the year. Unless, of course, it's not. Either way, it is time for the November *Monthly Economic Outlook*, which means it's also that time of the year when we take the pulse of the U.S. consumer, conduct extensive research, perform highly sophisticated statistical analysis, apply the collective force of our years of professional experience, and then basically guess how much consumers will spend over the holiday shopping season. At least that's what we do in November of a normal year. This being 2020, however, means that this year is about as far from normal as it is possible for a year to get, to the point that it isn't clear what a "normal" year will even look like once 2020 is behind us. If it ever really is behind us, that is.

Nothing being normal this year applies to the holiday shopping season. Anyone who didn't already realize that was rudely jolted into reality the instant several major retailers announced that they would remain closed on . . . Thanksgiving Day. Though it may be hard to imagine, this year's "holiday shopping season" will be even longer than is typically the case. Amidst the pandemic, retailers aimed to stretch this year's in-store holiday sales out over a longer period, the premise being that a lighter but steady flow of shoppers over a longer period would yield the same level of sales while avoiding the large crowds typically seen starting on "Black Friday." That Amazon shifted its Prime Day(s) from July to October this year simply served to reinforce the push by many retailers to pull in-store "holiday season" sales earlier into the year.

What remains to be seen is whether, or to what extent, earlier in-store sales and blowout online sales by Amazon and other retailers over the Prime Day event came at the expense of sales later in the season. The timing of the holiday shopping season isn't the only thing that is different this year. Indeed, the timing difference is itself a function of how profoundly the pandemic and the efforts to stem its spread have disrupted the economy. But, between the holiday shopping season having no clear boundaries this year, a much higher than normal degree of noise in the economic data, and the thick cloud of uncertainty that hangs over the economy, it simply isn't clear to us what a forecast of holiday season sales would even be measuring, let alone what it would actually mean. As such, this year will mark our first November without producing a holiday sales forecast.

Others, however, remain undaunted, and there is no shortage of holiday sales forecasts. Many that we've seen are calling for an increase of around 5.0 percent which, oddly enough, seems like a normal holiday sales forecast in a normal year. One forecast we've seen calls for a 9.0 percent increase in holiday sales, which would be the largest on record. Consumers themselves, however, seem

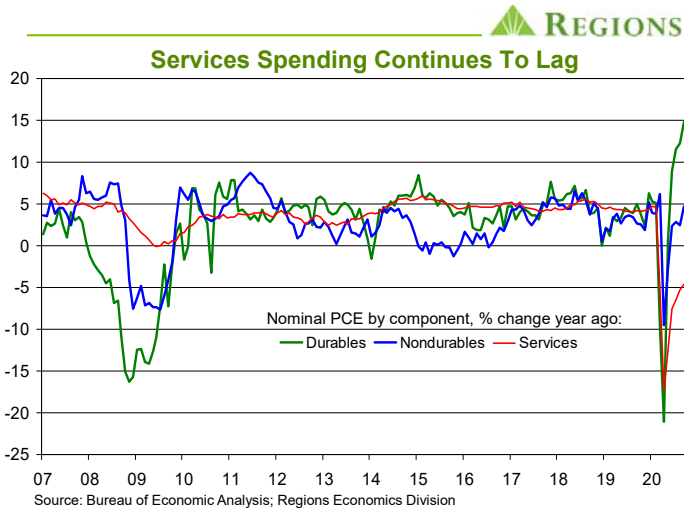
to be feeling a bit less festive, at least according to a survey by *Gallup*. Survey respondents estimated they would, on average, spend 14.5 percent less on gifts this year than they did last year, and more than twice as many respondents indicated they would spend less this year than indicated they would spend more. The wide range of forecasts goes right to our point about not knowing what a forecast of this year's holiday sales is actually measuring and what it means, hence our sitting this year out.

At least when it comes to producing a holiday sales forecast. Our practice has been to use our holiday sales forecast as the basis for a broader discussion of the state of household finances and consumer spending, and in more recent years we've also discussed patterns in holiday season hiring, which have changed along with shopping patterns. In these most not normal of times, that discussion is still worth having. So, the only real downside of us not producing a holiday sales forecast is that the holiday-themed chart we use to present our forecast won't be making an appearance this year. Sure, we've gotten enough feedback over the years to know that chart, not a holiday sales forecast that comes with laser-like precision or a carefully-crafted and insightful discussion of the state of U.S. consumers, is the most eagerly anticipated part of each year's November *Outlook*. Okay, fine, neither of those has ever been a part of a November *Outlook* that we've had anything to do with but, this being the holiday season, it would be rude of you to point that out. No, wait . . .

In any event, there has been a significant shift in consumer spending patterns in response to the pandemic and the efforts to stem its spread. Consumer spending on services, such as travel, tourism, dining out, recreation, sporting events, live arts performances, and outpatient health care, fell suddenly and sharply as the pandemic began to spread. Though the economy has partially reopened, ongoing restrictions on activity and still-wary consumers continue to weigh on services spending. As of September, the latest month for which complete data on consumer spending are available, the level of consumer spending on services remained 6.3 percent below the level as of February. Our view is that it will take considerable time to fill in this remaining gap.

In stark contrast, consumer spending on goods has raced past its pre-pandemic high; as of September, the level of spending on goods stood 7.7 percent above its pre-pandemic high. Initially, spending at grocery stores and personal care stores spiked, but as time has gone on spending on a broader range of consumer goods has risen sharply. This in part reflects consumers adapting to changes brought on by the pandemic, such as spending on home-office furniture and electronics and communications products in response to the increased incidence of working at home and school sessions taking place online rather than in classrooms. Notably strong home sales have led to increased spending on appliances and home furnishings, sales of home exercise equipment have surged, and changing commuter patterns have helped fuel motor

vehicle sales. To be sure, some of the funds that would otherwise have been spent on services have been diverted to spending on goods, with spending also supported by the unprecedented degree of financial assistance provided by the CARES Act.



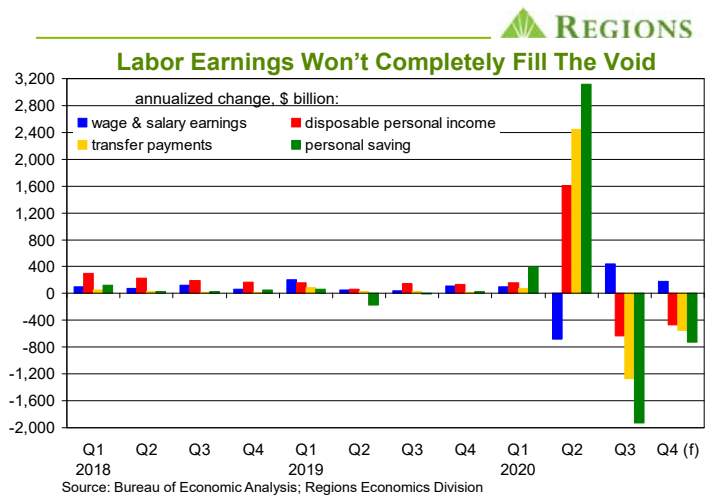
The strong rebound in consumer spending on goods might be seen as setting the stage for solid growth in holiday season sales. After all, though the specific definitions may vary, measures of “holiday sales” generally include only spending on goods, with no allowance for spending on services. For instance, our preferred measure of holiday sales is combined November and December retail sales excluding motor vehicle, gasoline, building materials, restaurant, grocery store, and drug store sales – things not typically given as holiday gifts. Okay, sure, the nonstop run of commercials showing surprised spouses gleefully rushing out to gift-wrapped cars could argue for including motor vehicles in our measure of holiday sales, but we simply refuse to budge on this point.

Either way, there are reasons to wonder how long the strength in spending on consumer goods can persist. One is the composition of the growth in spending on goods which, over the past several months, has been heavily weighted toward spending on consumer durable goods. This includes items such as motor vehicles, home furnishings, appliances, and in-home exercise equipment, which are big-ticket items but which at the same time tend to be one-off purchases. Earlier it was noted that, as of September, the level of consumer spending on goods stood 7.7 percent above the level as of February, and higher spending on consumer durable goods accounts for just over two-thirds of this increase.

It is reasonable to wonder whether, or to what extent, this spending on big-ticket consumer durables will take away from holiday season spending. It isn’t an either-or proposition; after all, purchases of consumer durables are typically financed, and that interest rates are so low has helped keep monthly payments more manageable, particularly when combined with longer financing terms, as is increasingly the case with motor vehicle loans. That said, it is possible that, at least for some households, the holiday season came earlier than normal this year in the form of purchases of big-ticket items that will limit any additional spending.

There are more fundamental reasons to think spending may lose some momentum during the holiday shopping season. One is the

uncertain path ahead for personal income. Between the Economic Impact Payments (EIP) and the \$600 per week in supplemental unemployment insurance (UI) benefits provided under the CARES Act and the lift to nonfarm proprietors’ income from the Paycheck Protection Program (PPP), disposable (after-tax) personal income rose at an annualized rate of 44.3 percent in Q2 despite a sharp decline in aggregate wage and salary earnings. The surge in income helped push up the personal saving rate, which hit 33.6 percent in April. With the EIP having been one-off payments and the supplemental UI benefits having expired in late-July, transfer payments fell sharply in Q3, leading to a 17.2 percent annualized decline in disposable personal income despite the beginning of a recovery in labor earnings. That there was such a deep pool of savings, however, contributed to a sharp rebound in consumer spending despite the decline in disposable personal income.

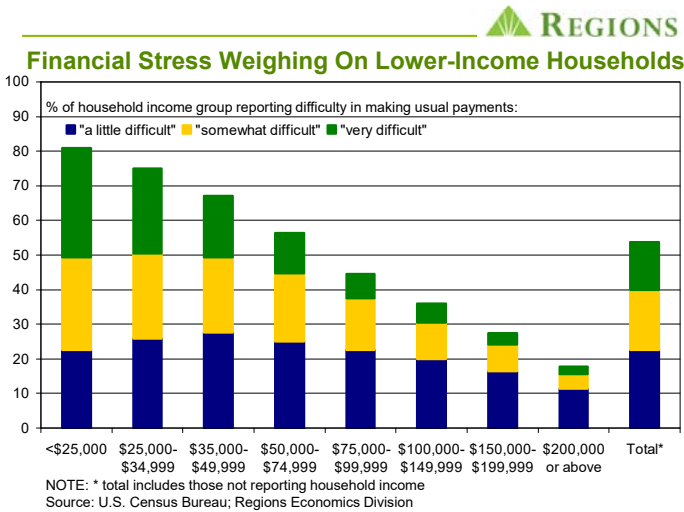


As can be seen in the above chart, the increase in aggregate wage and salary earnings in Q3 did not fully reverse the decline seen in Q2 and was not large enough to fill the void left by the sizable decline in transfer payments, hence the decline in disposable personal income. Though labor market conditions continue to improve, the pace of improvement is slowing, while the pace of layoffs remains significantly elevated. As such, our November baseline forecast anticipates a much smaller increase in aggregate wage and salary earnings in Q4 than that seen in Q3.

At the same time, however, the decline in personal saving in Q3 did not fully negate the increase seen in Q2. As such, despite falling during the quarter, the personal saving rate ended Q3 at 14.3 percent in September, still significantly higher than the rate that prevailed prior to the pandemic. Many of those expecting strong holiday season sales point to the elevated saving rate as factor in their forecast. We’re not so sure, and do not expect savings to be nearly as much of a support for holiday season sales as many analysts seem to be banking on.

Our view is that the remaining pool of savings has become more and more concentrated amongst higher-income households than was initially the case. Data from the Census Bureau’s *Household Pulse Survey* show households across all income buckets diverted at least some portion of the aid payments provided under the CARES Act to saving. As those aid payments have run their course, however, lower-income households have been more likely to dip

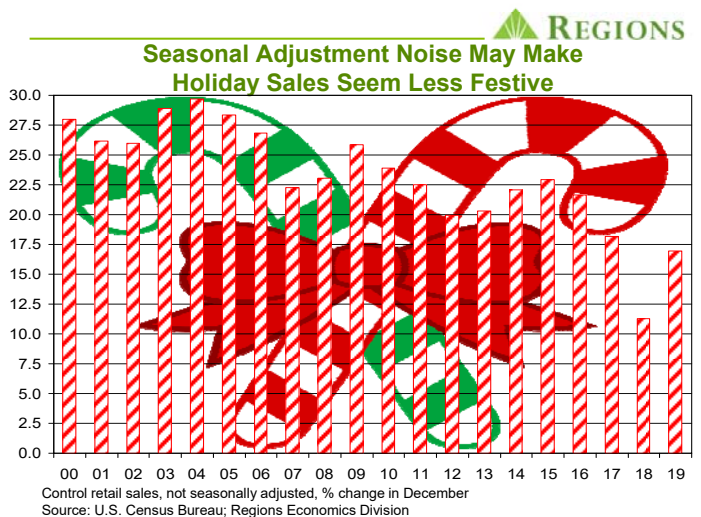
into savings to help fund current spending, particularly those with members who have been displaced from the labor market. Keep in mind that those in lower-income households were far less likely to have built up a meaningful level of saving prior to the pandemic-related aid payments. It should also be noted that, to the extent suppressed spending on discretionary services spending has contributed to increased personal saving, that block of increased saving is highly concentrated amongst upper-income households. So, while elevated savings may play a role in supporting holiday season sales, that is highly unlikely to be the case for households in the lower household income buckets.



More broadly, holiday shopping may seem a trivial concern for a growing number of lower-income households. Data from the *Household Pulse Survey* show significant shares of those in lower-income households are finding it difficult to make "usual" monthly payments, which include spending in areas such as housing, food, clothing, transportation, and medical care. Recall that the toll taken on the labor market by the pandemic and the efforts to stem its spread has fallen more heavily on those in lower-skill, lower-earning occupations, and this is the group most impacted by the absence of additional financial assistance. As such, those in lower-income households may have less capacity for holiday season spending than was true a year ago. While this doesn't mean total holiday season sales won't increase over last year, it does suggest a smaller increase than would otherwise be the case, posing a hurdle for the higher-end holiday sales forecasts.

We also think it worth pointing to an additional factor which, while having absolutely no impact on the amount actually spent, could at least make holiday season sales look less festive. As we've noted elsewhere, there has been a good deal of seasonal adjustment noise across much of the economic data over the past few months. What in past years had been usual seasonal patterns in economic activity have this year been disrupted by the pandemic, wreaking havoc on much of the economic data. That could very well be the case with holiday season spending, which goes to the point we made earlier about the efforts of retailers to pull sales forward this year. If this seems a bit too much "in the weeds," one needs to look back only to 2018 to see how deviations from typical seasonal patterns can deliver surprises, of the most unpleasant sort, when the data are reported on a seasonally adjusted basis.

The December 2018 retail sales data were not only weak, they were shockingly weak, and subsequent revisions have made them look even weaker. To be more precise, on a seasonally adjusted basis, total retail sales fell by 2.2 percent in December 2018, with control retail sales down by 3.4 percent. Any time we see numbers that far out of alignment with expectations, our first instinct is to go straight to the raw, or, not seasonally adjusted, data, which in this case show total retail sales rose by 7.4 percent in December 2018 and that control retail sales rose by 11.3 percent.

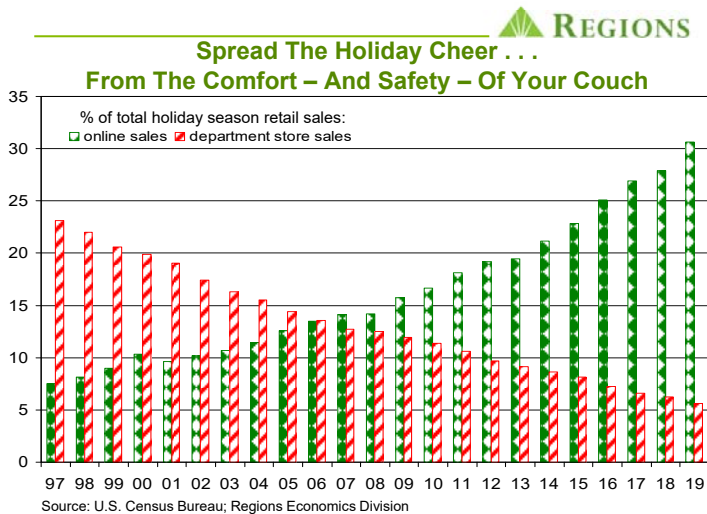


This raises the obvious question of how the increases reported in the unadjusted data could turn into the declines reported in the seasonally adjusted data. The chart above (come on, did you really think we wouldn't find a way to work in our always popular holiday-themed chart?) helps answer that question. As seen in the chart, the increase in unadjusted control retail sales in December 2018 was much smaller than the "typical" December increase – an average increase of 21.0 percent over the prior five years. The seasonal adjustment factors used to "smooth out" typical seasonal variations in the data were geared toward an increase significantly larger than the 11.3 percent increase seen in December 2018, hence the reported decline in the seasonally adjusted data.

This "weak" December data point in turn made 2018 holiday sales look much weaker than was actually the case. To the extent that 2020 "holiday season" came earlier in the year than is typically the case, we expect there to be seasonal adjustment noise in the retail sales data for November and December, which will hold down holiday season sales reported on a seasonally adjusted basis. As such, we will reserve judgment on 2020 holiday season sales until we have examined the not seasonally adjusted data.

Between the shift in the timing of holiday sales, the recovery in the labor market shifting into a lower gear, and heightened financial stress amongst a significant share of households, there are reasons to think holiday season sales will be less cheerful than many analysts are expecting. And that's even aside from whatever degree of seasonal adjustment noise may plague the data. The collective weight of these factors led us to conclude that trying to weave together a forecast of how much consumers will spend in this decidedly not normal holiday season just didn't make sense.

Time, and the not seasonally adjusted data, will ultimately answer the question of how much, but another question is how U.S. consumers will spend during the holiday sales season. This seems a much simpler question to answer.



Online sales have accounted for an increasingly larger share of holiday season sales over the past two decades, with department store sales accounting for a steadily shrinking share. These patterns of course are not limited to holiday season sales – the chart above would look pretty much the same regardless of how you delineate the time periods or define the base – control retail sales or holiday season sales. In 2019, online sales accounted for 30.6 percent of total holiday season sales, up from 27.9 percent in 2018. Department store sales accounted for only 5.6 percent of total holiday season sales in 2019, the 22nd consecutive year in which this share was smaller than that of the previous year.

This year, it seems far more a matter of how much, not whether, the share of holiday season sales accounted for by online sales will increase. After all, online sales got off to a head start this year, having accounted for an even higher share of control retail sales over the past six months than had been the case prior to the pandemic. Part of that increase reflects stepped-up efforts on the part of many retailers to enhance their online platforms, something that many retailers had deftly, albeit somewhat curiously, managed to avoid doing over the past several years. Moreover, with the recent, and ongoing, upturn in COVID-19 cases, it could be that shoppers will be even less willing to venture out to stores during this year’s holiday sales season. As such, it seems likely that online sales will account for a significantly higher share of holiday season sales than was the case last year, regardless of how much consumers end up spending this year.

This calls to mind the one fundamental truth that even the most successful of online retailers must contend with, which is that free shipping isn’t actually free, as someone must pay for it. That someone, especially during the holiday shopping season, is typically the retailer – we’re not legal scholars, nor do we play legal scholars on TV, but we’re fairly sure free shipping is guaranteed somewhere in the Constitution. Either way, with online sales likely to account for a significantly higher share of this year’s holiday season sales, increased shipping costs figure to take a meaningful

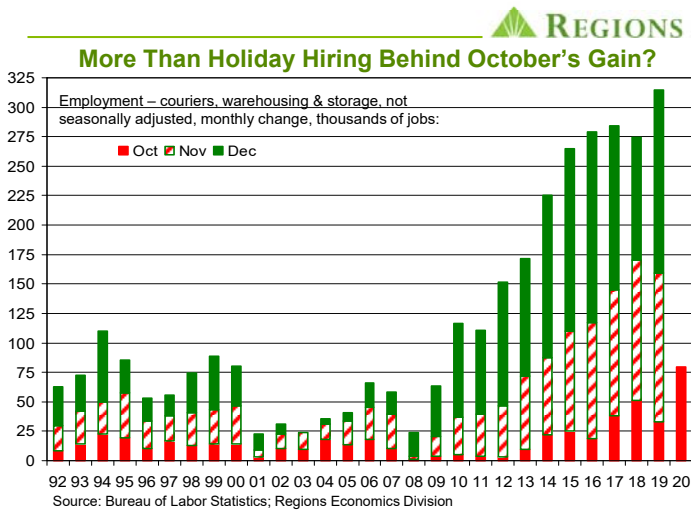
bite out of retailers’ margins. These margins are, in many cases, already razor-thin given what has been long-running weakness in core goods prices, which is another way of saying retailers have had little to no pricing power over the past several years. It is true that significant excess capacity in freight markets could ease shipping-related cost pressures confronting retailers, though the degree of this excess capacity could decline rapidly as we get into the heart of the holiday shopping season.

This goes to an important, but often overlooked, point, which is that in-store sales remain the most profitable distribution channel for retailers. In a normal year, this would be apparent in a rush of seasonal hiring that begins in October, increases dramatically in November, and tops off in December. In case we haven’t yet made this point, however, this year is anything but normal, meaning that holiday season hiring patterns will be disrupted just like so many other forms of economic activity. The reopening of the economy has led to hiring in retail trade being stronger than normal over the past few months, so it could be that retailers will see less of a need to take on additional workers for the holiday season. That retailers have tried to lengthen the shopping season to make the flow of in-store customers more manageable also augurs less seasonal hiring than is typically the case. The outsized increase in unadjusted retail trade payrolls in October may seem at odds with this conclusion, but part of this increase reflects retailers still adjusting to the economy reopening, while an earlier start to in-store holiday shopping would also mean earlier than normal hiring. We continue to think total holiday season hiring in retail trade this year will fall short of that seen in 2019.



More broadly, the steadily increasing prominence of online sales over the past several years has taken away from seasonal hiring in retail trade. But, once the goods have been ordered, they must be packaged, then transported, then delivered to customers (or be stolen by porch pirates). As such, to get a full measure of hiring related to holiday season shopping, we must account for hiring in warehousing, distribution, and delivery (as porch pirates tend to be independent contractors, they are not covered in the BLS employment data). It should come as no surprise that holiday season hiring in these industry groups has grown significantly over the past several years. What remains to be seen is whether the typical seasonal patterns in hiring in these industry groups will hold

this year. As with hiring in retail trade, the not seasonally adjusted data show that hiring in transportation, warehousing, and delivery operations was much stronger than normal in October.



The strong hiring in transportation, warehousing, and delivery in October continues what has been a strong run; the not seasonally adjusted data show hiring in these industry groups was much stronger in August and September than is typical for these months. Rather than getting an early start on holiday season hiring, this stronger hiring more likely reflects the significant increase in online sales activity over the course of the pandemic, which we noted above. This still leaves room for holiday season hiring, but it remains to be seen whether total holiday season hiring in these industry groups will top that seen last year which, as seen in the above chart, was easily the strongest on record. Admittedly, we were a bit surprised by the strength of seasonal hiring last year; we for some time have been expecting hiring in warehousing, distribution, and delivery to become a bit more evenly spaced throughout the year given the steadily rising share of consumer spending on goods being conducted online.

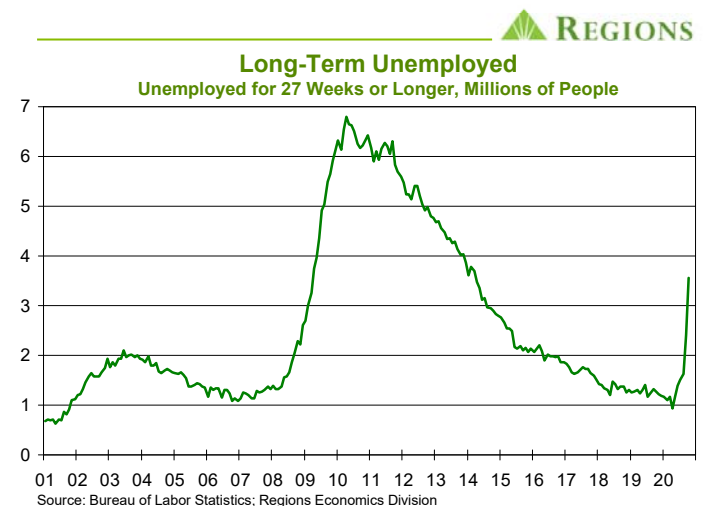
We'd also been expecting hiring in warehousing, distribution, and delivery to be impacted by the increased use of automation. Prior to the pandemic, whether due to the inability to find workers or in an attempt to mitigate increases in wage bills, more firms had been testing the automated waters. Whether, or to what extent, that impacted last year's seasonal hiring is an open question. But, we thought it unlikely that firms would have attempted to integrate increased automation into their operations during the busiest shopping, and shipping, time of the year, and last year's strength in holiday season hiring supports that view. That said, there could be a bigger push toward automation in the post-pandemic world, which going forward may lead to less hiring in warehousing and distribution around the holiday season.

If there is a common theme in our take on the 2020 holiday shopping season, it is that in a year in which little, if anything, is normal, holiday sales are unlikely to be an exception. Like much else about the rebound from the brief but violent recession triggered by the pandemic and the efforts to stem its spread, the holiday shopping season will likely be two-tiered. While we do not have the capacity to track holiday season spending for those in the

various household income buckets, we do think that the aggregate data will reflect the two-tiered nature of this recovery, which would mean a smaller increase in holiday season sales than many seem to be expecting. We will also caution that, as with much of the economic data these days, the seasonally adjusted data on holiday season spending and holiday season hiring are likely to be much less reliable this year, given the extent to which what in the past have been typical seasonal patterns have been disrupted this year. This of course will not dissuade those intent on spinning narratives around whatever the seasonally adjusted data happen to say. For us, however, it will be the unadjusted data on spending and hiring that will tell the true tale of the 2020 holiday shopping season.

October Employment Report

Total nonfarm employment rose by 638,000 jobs in October, a total held down by public sector payrolls having declined by 268,000 jobs. This decline reflects 147,000 temporary jobs tied to the 2020 Census running off the books and seasonal adjustment noise that led to a reported decline in state and local government payrolls. The real story of the October employment report is that private sector payrolls rose by 906,000 jobs, a larger increase than had been expected, with job growth broad based across the main industry groups. At the same time, the unemployment rate fell to 6.9 percent, continuing a much faster than anticipated descent from the peak rate of 14.7 percent in April.



Still, the level of nonfarm employment remains 10.090 million jobs below that of February, a gap that will not close any time soon. Also, the duration of unemployment continues to climb, with the median duration rising to 19.3 weeks in October. The number of people out of work for 15 weeks or longer rose to 3.556 million in October, which is the highest number since March 2014, and this number will rise higher in the months ahead. As the above chart shows, duration peaked well after the end of the 2007-09 recession, and that will again be the case in the current cycle. One reason this is troubling is that there is ample empirical evidence showing that the longer one is out of work, the lower their odds of landing another job. The October employment report reinforces what has been a common theme in the recent economic data – while the economy has come a long way since the depths of the downturn, there is a long way to go before it is fully healthy.

ECONOMIC OUTLOOK



November 2020

Q2 '20 (a)	Q3 '20 (p)	Q4 '20 (f)	Q1 '21 (f)	Q2 '21 (f)	Q3 '21 (f)	Q4 '21 (f)	Q1 '22 (f)		2018 (a)	2019 (a)	2020 (f)	2021 (f)	2022 (f)
-31.4	33.1	4.4	4.4	3.4	3.4	3.1	2.5	Real GDP ¹	3.0	2.2	-3.5	4.3	2.7
-33.2	40.7	5.2	5.0	3.8	3.6	3.5	2.9	Real Personal Consumption ¹	2.7	2.4	-3.7	5.3	3.0
-27.2	20.3	4.0	2.9	3.8	4.9	5.6	4.5	Real Business Fixed Investment ¹	6.9	2.9	-4.8	3.4	4.3
-35.9	70.1	4.1	-2.4	-1.6	1.8	3.6	2.8	Equipment ¹	8.0	2.1	-6.0	4.1	2.2
-11.4	-1.0	3.0	7.2	6.9	6.8	7.4	6.2	Intellectual Property and Software ¹	7.8	6.4	0.1	4.0	6.1
-33.6	-14.6	-3.1	8.5	12.2	8.9	6.6	5.2	Structures ¹	3.7	-0.6	-10.5	0.4	5.9
-35.6	59.3	13.0	3.9	2.8	1.6	1.2	0.7	Real Residential Fixed Investment ¹	-0.6	-1.7	4.4	7.2	1.2
2.5	-4.5	-1.5	-0.3	-2.6	0.3	1.8	1.5	Real Government Expenditures ¹	1.8	2.3	1.1	-1.1	0.7
-775.0	-1,010.8	-1,044.1	-1,058.9	-1,062.7	-1,064.5	-1,064.6	-1,047.7	Real Net Exports ²	-877.7	-917.6	-904.5	-1,062.7	-1,044.0
766	1,040	1,046	1,052	1,054	1,054	1,064	1,073	Single Family Housing Starts, ths. of units ³	872	893	955	1,056	1,086
313	390	379	379	395	412	412	402	Multi-Family Housing Starts, ths. of units ³	376	403	400	400	401
11.3	15.3	16.0	16.0	16.3	16.5	16.6	16.6	Vehicle Sales, millions of units ³	17.2	17.0	14.4	16.3	16.7
13.0	8.8	6.8	6.6	6.4	6.2	5.9	5.7	Unemployment Rate, % ⁴	3.9	3.7	8.1	6.3	5.4
-11.2	-6.9	-5.8	-4.9	8.9	4.1	3.2	2.6	Non-Farm Employment ⁵	1.6	1.4	-5.7	2.6	2.1
46.6	-16.3	-11.5	35.6	-27.8	-0.4	0.9	2.4	Real Disposable Personal Income ¹	3.6	2.2	5.6	-0.6	-0.7
0.6	1.2	1.3	1.1	2.1	1.7	1.6	1.7	GDP Price Deflator ⁵	2.4	1.8	1.2	1.6	1.7
0.6	1.2	1.2	1.1	1.9	1.5	1.7	1.9	PCE Deflator ⁵	2.1	1.5	1.2	1.5	1.9
0.4	1.3	1.3	1.5	2.8	2.0	1.9	1.9	Consumer Price Index ⁵	2.4	1.8	1.3	2.1	1.8
1.0	1.4	1.6	1.7	2.3	1.9	1.8	1.9	Core PCE Deflator ⁵	2.0	1.7	1.5	1.9	1.9
1.3	1.7	1.9	1.9	2.8	2.2	2.1	2.1	Core Consumer Price Index ⁵	2.1	2.2	1.8	2.2	2.2
0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	Fed Funds Target Rate Range Mid-Point, % ⁴	1.78	2.16	0.42	0.13	0.13
0.69	0.65	0.85	0.95	1.05	1.12	1.19	1.27	10-Year Treasury Note Yield, % ⁴	2.91	2.14	0.89	1.08	1.37
3.24	2.95	2.87	2.94	3.10	3.20	3.24	3.32	30-Year Fixed Mortgage, % ⁴	4.54	3.94	3.15	3.12	3.41
-3.5	-2.1	-2.3	-2.2	-2.4	-2.4	-2.5	-2.5	Current Account, % of GDP	-2.2	-2.2	-2.5	-2.4	-2.5

a = actual; f = forecast; p = preliminary

- Notes: 1 - annualized percentage change 4 - quarterly average
 2 - chained 2012 \$ billions 5 - year-over-year percentage change
 3 - annualized rate

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