This Economic Outlook may include opinions, forecasts, projections, estimates, assumptions, and speculations (the "Contents") based on currently available information which is believed to be reliable and on past, current and projected economic, political, and other conditions. There is no guarantee as to the accuracy or completeness of the Contents of this Economic Outlook. The Contents of this Economic Outlook reflect judgments made at this time and are subject to change without notice, and the information and opinions herein are for general information use only. Regions specifically disclaims all warranties, express or implied, with respect to the use of or reliance on the Contents of this Economic Outlook or with respect to any results arising therefrom. The Contents of this Economic Outlook shall in no way be construed as a recommendation or advice with respect to the taking of any action or the making of any economic, financial, or other plan or decision.

2022 Economic Outlook: The New Normal Is Nothing Is Normal?

It may be a new year, but it kind of doesn't feel that much different than the last one. In our 2021 outlook, we noted that as 2020 came to a close the pandemic was still in the driver's seat, as was made clear by the late-year spike in COVID cases that impacted consumer and business behavior and led some state and local governments to impose new restrictions on certain activities. It's hard to avoid starting our 2022 outlook by noting that as 2021 came to a close the pandemic was still in the driver's seat, as was made clear by the late-year spike in COVID cases that impacted consumer and business behavior and led some state and local governments to impose new restrictions on certain activities. The late-2021 spike in case counts has intensified, at home and abroad, in early-2022, reflecting the rapid spread of the Omicron variant of the COVID-19 virus.

Clearly, the pandemic, its impacts on consumers and businesses, and the policy responses to it were the main storylines of the U.S. and global economies in both 2020 and 2021. At this point, there seems little reason to believe 2022 will prove to be any different in that regard. As such, any forecast of how the economy will fare in 2022 comes shrouded in an even thicker layer of uncertainty than would otherwise be the case. Still, whether it feels that way or not, the calendar says it's a new year, which means it's time for us to look ahead at how we see the U.S. economy faring in 2022. As our long-time readers know, our practice had always been to present our annual outlook in the form of a series of questions covering topics such as GDP growth, the labor market, business investment, housing, interest rates, and the exchange value of the U.S. dollar. Our answers to those questions laid down markers for how we expected the year to play out, and each year we'd look back at our questions and answers from the prior year. We've always thought it important to hold ourselves accountable for the calls that we make and have always been open about doing so.

We broke with that practice in our 2021 outlook, in a nod to the considerable degree of uncertainty around the course of the pandemic, progress on the vaccination front, and the responses of consumers, businesses, and governments. Instead of laying down specific markers, we posed a series of broad questions as to how the economy may play out in 2021 and offered our answers. We'll do the same this year, though one difference from our 2021 outlook is that some of the questions we pose this year will be answered over the course of 2022, while others will take longer to answer, with these answers impacting the longer-term path of the U.S. economy. One reason we think it useful to bring up some longer-term considerations is that, while the pandemic led to them becoming much more pronounced, imbalances between supply and demand in the labor market and the housing market were firmly entrenched well before the onset of the pandemic and, assuming we at some point settle back into some semblance of 'normality,' will continue to impact the economy. We've found that the degree to which these patterns have been amplified since the onset of the pandemic often causes people to lose sight of the fact that they've been in place for years. We can point to other factors, such as labor productivity growth and inflation, for which we think post-pandemic trends may look different than the long-running trends that held for years leading up to the pandemic. To be clear, we use the term "post-pandemic" in a broad sense that could, and likely will, mean learning to deal with the COVID-19 virus such that it is less disruptive to economic and social activity, rather than meaning the virus has been vanquished.

Before addressing what we see as some of the main drivers of the economy's course in 2022 and beyond, we'll offer a brief review of how well, or, sure, how badly, we did in last year's outlook in laying out the main themes of the U.S. economy in 2021. We expected 2021 to be a tale of two halves in terms of real GDP growth, and we were kind of, but not really, right on this point. Whereas we expected the pace of economic growth to accelerate over the course of 2021, with much stronger growth in the second half of the year than in the first half, what we got was the opposite. Real GDP growth topped 6.0 percent over 1H 2021 before slowing to an annualized rate of 2.3 percent in Q3. And, while we and most others expect annualized Q4 growth to have topped 6.0 percent (the BEA will release their initial estimate of Q4 GDP on January 27), that will still leave 2H 2021 growth easily below 1H growth.

Keep in mind that we produced our 2021 outlook prior to the runoff elections for Georgia's two U.S. Senate seats, which we pointed to as a source of uncertainty over our outlook given the implications for the course of fiscal policy. The Democratic sweep of these seats gave the party the 51-vote majority needed to pass the American Rescue Plan Act of 2021, a $1.9 trillion package which amongst other provisions included a third round of Economic Impact Payments (the second round was delivered in January 2021), an extension of supplemental unemployment insurance benefits, and an expansion of the Child Care Tax Credit. This additional round of transfers sparked faster growth in consumer spending – real consumer spending grew at an annualized rate of over 11 percent in 1H 2021 – which in turn led to faster real GDP growth over the first half of 2021 than we had anticipated going into the year.

At the same time, however, faster growth in consumer spending intensified global supply chain and logistics constraints to a degree which we did not anticipate, contributing to sharply slower growth in consumer spending and real GDP growth in Q3 while helping push goods prices significantly higher. So, even though we anticipated inflation would be more of an issue than did most analysts, and the FOMC, we underestimated the extent to which inflation would accelerate in 2021. Under the heading of "for what it's worth which isn't much," when inflation first began to

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com

accelerate in the spring, many, including the FOMC, dismissed it as a "transitory" development that would soon fade. We were quick to take the other side of that argument, seeing reasons why inflation would be more persistent than was generally believed.

Supply-side constraints limited manufacturing output, particularly amongst motor vehicle producers, in 2021, and also became an increasing drag on single family residential construction as the year wore on. Still, single family housing starts and sales were, as of November, on pace to top our 2021 forecasts (the December data will be released later this month). This reflects the strength of construction and sales early in the year, with activity weakening meaningfully as 2021 wore on as growing supply-side constraints left builders facing increasingly large backlogs of unfilled orders. Worsening inventory constraints coupled with robust demand in the market for existing homes fueled a faster pace of house price appreciation than we had anticipated going into 2021.

We anticipated 2021 would see a more sluggish rebound in labor force participation than most others were expecting, and while that turned out to be the case, the unemployment rate still fell at a much faster pace than we expected. This reflects the demand for labor growing more rapidly than we anticipated, with growth in nonfarm payrolls handily beating our 2021 forecast, as was also the case with wage growth. Still, as of November (the latest available data), there were over 10.5 million open jobs across the U.S. economy while 2021 ended with roughly 2.3 million fewer people in the labor force than there were at the onset of the pandemic, meaning labor force participation will remain a key issue for the U.S. economy in 2022.

Additional financial transfers to the household sector, more intense supply chain and logistics constraints, growing supply/demand imbalances across much of the economy, including the labor market, and the course of the COVID-19 virus, here and abroad, shaped the course of the U.S. economy in 2021. These were, however, what we thought would be the main sources of uncertainty going into the year. Still, promising developments on the vaccine front as 2020 came to a close held out hope that the economy would be performing more strongly over the second half of 2021. But, as we noted in our 2021 outlook: ". . . even when a vaccine is widely available, there are other questions that will have to be answered. First, how many people will be willing to take the vaccine? Second, when will policy makers be confident enough to lift any remaining restrictions on economic activity? Third, when will consumers be confident enough to resume activities that were considered "normal" prior to the pandemic, or have there been lasting changes in consumers' attitudes and behaviors that will lead to a new, and as of yet undefined, normal?"

A year later, with a new and as of yet not fully understood variant of the COVID-19 virus making its way around the world, we find ourselves asking the same questions we asked a year ago. The term "vaccine," however, can now be understood to include booster shots which, as of this writing, are making their way into arms at a notably slow pace. For as long as the answers to these questions remain elusive, any forecasts of how the U.S. and global economies will perform in 2022 and beyond come with an even greater degree of uncertainty than would otherwise be the case. So, while we do indeed have a forecast for 2022, as laid out in the table on Page 7, we have little confidence in the specifics of that forecast. We've always found economic forecasting to be a rather humbling exercise, and it has been even more so since the onset of the pandemic. As such, we'll offer a very broad and brief summary of what we expect for the U.S. economy in 2022 before laying out what we think to be some of the key questions that, depending on how the answers play out, will shape the economy's path, not only in 2022, but beyond.

2022 Overview: After what we expect will be full-year 2021 real GDP growth of 5.6 percent, our baseline forecast anticipates real GDP growth of 4.1 percent in 2022. As in 2020 and 2021, intra-year growth patterns in 2022 will be shaped by the course of the pandemic. The surge in case counts that began in December has intensified in early-2022 and is weighing on consumer spending and labor force participation, though with very little January data at our disposal as of this writing, it is hard to quantify the effects. Still, our January baseline forecast anticipates significantly slower Q1 2022 real GDP growth than was the case in our December 2021 baseline forecast. While past spikes in case counts suggest patterns of economic activity will again shift as the current spike subsides, what isn't clear to us is whether the magnitude of these shifts will diminish with each successive episode. This is just one of many sources of uncertainty around our 2022 outlook.

As 2021 was coming to a close, there were signs that global supply chain and logistics bottlenecks were beginning to ease, and we expect further improvement as we move through 2022. Though there is still far to go before supply chains are functioning normally, further easing of remaining constraints will support stepped-up manufacturing activity. To that point, nonfarm business inventories were drawn down significantly over the course of 2021, and we anticipate restocking will be a meaningful tailwind for growth in 2022. Additionally, with production having been curtailed in 2021, manufacturers and homebuilders ended the year with sizable backlogs of unfilled orders and, with supply-side constraints easing, backfilling these orders will also be a tailwind for growth in 2022.

As the supply side of the economy normalizes further over the course of 2022, so too will the demand side, as demand is weaned from the considerable fiscal and monetary support seen in 2020 and 2021. Still, though to a lesser degree than was the case over the prior two years, we nonetheless expect fiscal policy and monetary policy to remain accommodative in 2022. With continued robust growth in labor earnings helping ease the transition away from generous transfer payments, a significant pool of excess saving, healthy household balance sheets, and still-favorable interest rates, there are plenty of supports for continued growth in consumer spending, though elevated inflation figures to weigh on growth in discretionary spending. With diminished affordability taking some of the steam out of growth in demand and inventory constraints gradually easing, for both new and existing homes, we expect the pace of house price appreciation to be slower in 2022 than was the case in 2021, but still substantial.

If we are correct in expecting further easing of supply chain and logistics bottlenecks, that would contribute to a sharp deceleration in goods price inflation, if not outright goods price deflation. While that would act as a drag on overall inflation, we nonetheless expect faster growth in services prices, including rent and medical care, and continued robust growth in labor costs to keep inflation

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com

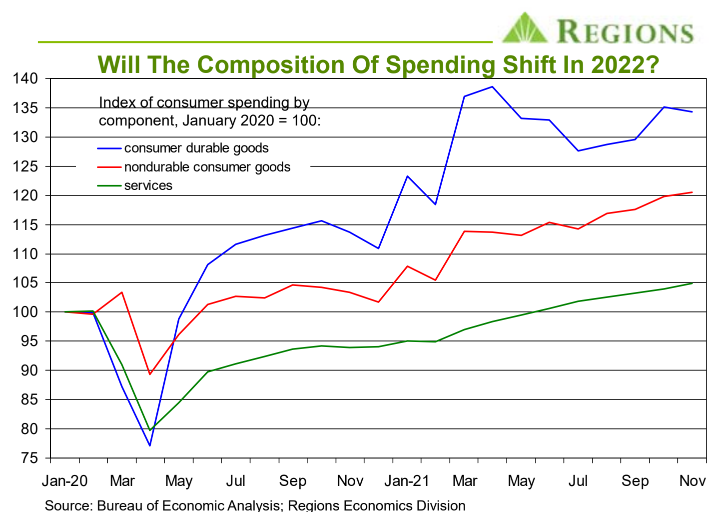
easily above the FOMC's 2.0 percent target rate through 2022. While we believe the FOMC will begin raising the Fed funds rate by mid-year 2022, we also believe that the changing composition of the FOMC, including three new members of the Federal Reserve's Board of Governors, will act as a brake on the extent to which the funds rate rises during this cycle. It also seems likely that the FOMC will allow the Fed's balance sheet to begin winding down not too long after the Fed's monthly asset purchases come to an end in March. Note that this would be a significant departure from the FOMC's playbook during the prior cycle, when the Fed's balance sheet was held steady for nearly three years after the asset purchases ended.

Question 1: What are the risks to the outlook laid out above? To be sure, the outlook we've outlined above seems too nice and neat in a world that, in case anyone still hasn't caught on, is seldom so. That raises the question of what could go wrong. The primary risk to the U.S. and global economies in 2022 remains the COVID-19 virus. That comes courtesy of our guest prognosticator, Captain Obvious who, by the way, has an outstanding track record in forecasting. The emergence of the Omicron variant of the virus in late-2021 was yet another reminder of the speed with which a new variant can work its way around the globe, and past spikes have impacted patterns in industrial production, shipping, labor force participation, inflation, and consumer spending, to name a few. To the extent global manufacturing and shipping hubs are subject to further spikes in case counts, any progress made in clearing supply chain/logistics bottlenecks could be quickly reversed, weighing on economic growth and keeping upward pressure on goods prices. It would seem foolish to presume that there won't be additional variants of the virus in the months (years?) ahead, meaning that how consumers, businesses, and governments respond is critical in determining the extent to which economic activity is disrupted.

While it seems clear that COVID-19 remains the biggest downside risk to our outlook, that doesn't mean it is the only downside risk. For instance, we and most others expect inventory restocking to contribute to real GDP growth in 2022. At the same time, we also respect how quickly inventories can swing, to the point that what begins as a restocking of depleted inventories turns into an inventory overhang, particularly when, as at present, businesses are unsure of the true level of demand. Rather than focusing on the level of inventories, particularly when higher prices are inflating measured stocks, one should focus on inventory-to-sales ratios which, at present, are meaningfully lower than pre-pandemic norms on the manufacturing, wholesale, and retail levels. It is reasonable to wonder whether demand for goods is due for a "correction," given the extent to which pandemic-related transfer payments coupled with restrictions on many segments of the services sector juiced consumer spending on goods (see Question 2 below). Not knowing the true level of demand makes it difficult for firms to correctly gauge the appropriate level of inventories. If inventories become too swollen, that could quickly lead to sharp cuts in output and employment which, if of sufficient magnitude, could trigger a recession.

We do not see this as the most likely outcome, nor do we necessarily see it as a 2022 story, as opposed to a 2023 story, but we do think an inventory overhang looms as a downside risk that merits consideration. Additionally, should inflation prove to be more persistent than our baseline forecast anticipates, that could trigger a sharp decline in discretionary consumer spending, and it could also trigger a sharp increase in market interest rates that would weigh on activity in interest-sensitive segments of the economy. We also worry that with the high level of debt in the non-financial corporate sector, particularly amongst companies at the lowest "investment grade" rating level, sharply higher interest rates and slowing economic activity could trigger payment stresses that could weigh heavily on business investment spending. Finally, the combination of elevated inflation and the FOMC moving to lessen the degree of monetary accommodation opens the door for a policy mistake, real or perceived, triggering swings in market interest rates that would impact the broader economy.

Question 2: Will there be a "normalization" in consumer spending patterns in 2022? As noted above in the discussion of inventories, consumer spending on goods has risen significantly since the onset of the pandemic, particularly spending consumer durable goods. This in part reflects the extent to which pandemic-related transfer payments gave households greater wherewithal to spend, and with much of the services sector shut down or operating at only limited capacity for a good part of 2020 and 2021, much of the additional spending was diverted from services to goods. The following chart illustrates the extent to which consumer spending on goods has risen since the onset of the pandemic, with spending on both durable and nondurable consumer goods topping their pre-pandemic peaks in June of 2020 while, in contrast, consumer spending on services not recapturing its pre-pandemic peak until June 2021. To be sure, significantly higher goods prices are to some extent distorting the comparison. But, even after accounting for inflation, as of November (the latest month for which data are available) spending on consumer durable goods was 21.3 percent above its level as of January 2020, with spending on nondurable goods 13.5 percent above, while consumer spending on services was 0.7 percent below its January 2020 level.



Since the onset of the pandemic, spending patterns have shifted as case counts have risen and fallen. Spending on services such as travel, tourism, entertainment, recreation, and dining out has tended to wane during spikes in case counts then pick up as these spikes subside, which in part reflects decisions made by consumers and in part reflects policy decisions made by businesses and

governments. Indeed, there are signs that services spending has tailed off since the emergence of the Omicron variant. During these spikes in case counts, at least some of the foregone spending on services has made its way to spending on goods, but the question for 2022 is whether spending on goods, particularly durable goods, is due for a "correction."

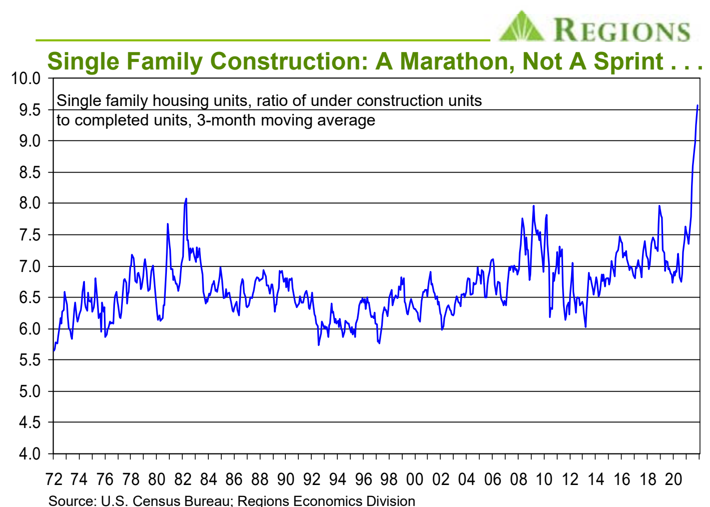
Spending on consumer durable goods is down from the peak reached in April 2021, but to some extent this reflects short supplies of goods, such as motor vehicles, that have held down spending. The more fundamental question is how much further upside room is left for spending on goods, particularly consumer durable goods. By their nature, consumer durable goods are long-lasting, so purchases don't tend to be repetitive, and while we think there is still some pent-up demand thanks to supply constraints, we question how deep that runs. With the financial buffers built up over the course of the pandemic starting to thin out and higher prices for necessities such as food, shelter, and energy, spending on consumer durable goods could fall quickly and sharply. While it does figure that there is ample upside room for spending on services, it's hard to argue that the path of services spending will be a straight line higher in light of what have been periodic spikes and subsequent declines in COVID case counts. Our baseline forecast anticipates only modest growth in real spending on consumer goods in 2022, with real spending on services growing much more rapidly though, again, services spending could remain prone to sharp swings. The extent to which there are shifts in the composition of consumer spending will complicate inventory management decisions for firms and could easily impact top-line real GDP growth, hence our pointing to an inventory correction as a potential downside risk to our outlook.

QUESTION 3: How much will labor force participation increase in 2022? We devoted our December 2021 *Monthly Economic Outlook* to detailed discussions of the supply/demand imbalances in the labor market and the housing market, pointing out that in each case the imbalance was firmly entrenched long before the onset of the pandemic. As such, we won't go into great detail in our answers to Questions 3 and 4, but do at least want to pose these questions here, as the answer to each will impact the path of the economy, not only in 2022 but beyond. As for Question 3, while we do expect participation to increase, we nonetheless expect that at year-end 2022 the labor force participation rate will still be well below the pre-pandemic rate.

At year-end 2021, there were roughly 2.3 million fewer people in the labor force than was the case at the onset of the pandemic. We have always expected the rebound in labor force participation to be somewhat slow and uneven. As the financial buffers built up during 2020-2021 thin out, we expect more people will migrate back into the labor force, but at the same time we've argued that there will be increasing numbers of older workers exiting the labor force, unlikely to return, a pattern which was amplified by the pandemic. What we've always thought would be somewhat of a wild card was participation amongst females. While progress against the COVID-19 virus, more certainty around educational arrangements, and increased provision of childcare would enable greater numbers of females to return to the labor force, repeated spikes in cases has made it hard for any rebound in participation amongst females to gain much traction.

We've seen nothing thus far that would make us inclined to change our view of trends in labor force participation. But, the rate at which participation actually increases will have implications for the paths of wage growth and the unemployment rate as well as the path of real GDP growth. Again, there was a growing imbalance between labor supply and labor demand well before the pandemic, and labor force participation returning to its pre-pandemic rate will ease, but not eliminate, this imbalance. Demographic trends were working against labor force participation prior to the pandemic, and that hasn't changed. As such, trends in labor force participation will remain an important issue well beyond 2022.

QUESTION 4: How much relief on the supply side of the housing market will we see in 2022? Again, as we discussed housing supply in great detail in our December 2021 *Outlook*, we won't repeat a lot of that here. Our short answer to Question 4 would be "some, but not enough." We have for the past several years pointed to what we've seen as significant under-construction of new single family homes. With inventories of existing homes for sale setting new all-time lows while demand for home purchases has been stoked by low mortgage interest rates and greater freedom in work arrangements for many, the supply/demand imbalance in the housing market has intensified since the onset of the pandemic. We do expect there to be some relief on the supply side of the market in 2022, while at the same time diminished affordability will weigh on growth in demand for home purchases. Still, while the supply/demand imbalance in the housing market will narrow a bit in the year ahead, it will persist well beyond 2022.

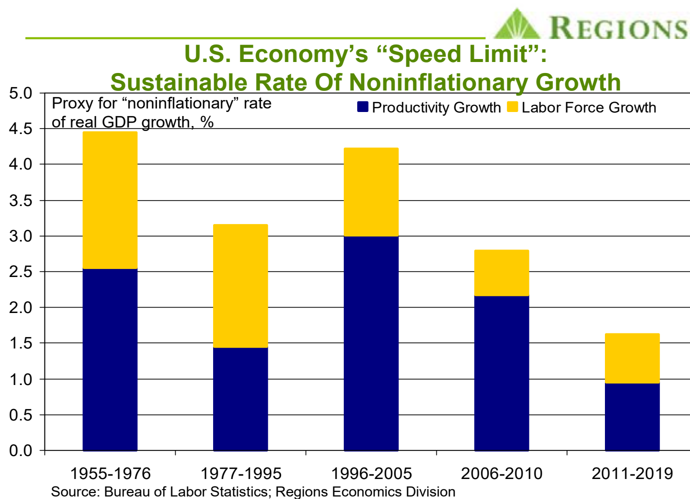


Supply side constraints, particularly shortages of materials and labor, intensified as 2021 wore on, leaving builders with larger and larger backlogs of unfilled orders, even though many builders began limiting sales around mid-year, with delivery dates getting pushed further out. The chart above shows the ratio of single family units under construction to single family units completed, using a three-month moving average to even out some of the inherent volatility in the monthly not seasonally adjusted data. For each single family unit completed in November, there were 9.9 units under construction, the highest ratio in the life of the data.

To the extent supply-side constraints ease over the course of 2022, the pace of single family completions will pick up. But, with

over 140,000 single family units permitted but not yet started as of November 2021 (the latest available data), builders may feel as though they are running as fast as they can run but yet not getting anywhere. At the same time, while we look for inventories of existing homes for sale to increase in 2022, any such increase will come off of what at year-end 2021 were near-record lows. As of November, the Core Logic House Price Index was on course to rise by around 15 percent for full-year 2021, and while we expect some moderation in 2022, that still leaves us expecting a double-digit increase. As such, even without an appreciable increase in mortgage interest rates, affordability will become even more challenging for many prospective buyers in 2022, and any increase in mortgage rates will only amplify affordability issues. Clearly, then, the rate at which housing inventory rises in 2022 will impact the number of home sales and the rate of house price appreciation, with implications that spill into the broader economy. This is one reason we spend so much time discussing housing inventories but, as we've noted, this was an issue well before the onset of the pandemic and will remain an issue well beyond 2022.

QUESTION 5: Will the economy's post-pandemic "speed limit" be higher or lower than before? One topic we've discussed quite frequently over the years is the economy's "speed limit," or, the rate at which the economy is capable of growing at on a sustained basis. That we return to this topic so often reflects the importance we attach to it; the economy's speed limit has implications for, among other things, the rate at which living standards increase over time and the path of inflation. For any economy, there are two main drivers of the sustainable rate of growth – the rate of labor force growth and the rate of productivity growth.



We use the chart above to illustrate how the economy's speed limit can, and does, vary over time, with the time periods delineated in terms of productivity growth cycles, which tend to be prolonged. As can be seen in the chart, the U.S. economy had been stuck in the slow lane in the years leading up to the pandemic. It helps to keep in mind that, to the degree there is slack in the economy, an economy can grow at a rate above its speed limit without sparking inflation pressures, but as that slack is pared down, inflation becomes more of a concern.

We think this is a good time to revisit the topic of the economy's speed limit. Obviously, the pandemic and the policy response to it, including considerable fiscal and monetary support, have largely shaped the economy's path over the past two years. But, with support from fiscal and monetary policy fading in the quarters to come and the pandemic becoming less disruptive (recall our broad definition of the term "post-pandemic"), it is useful to ask whether, or to what extent, the economy's speed limit has changed. That our longer-term forecast anticipates real GDP growth slowing back toward the 2.0 percent growth rate we all came to know but not necessarily love in the years prior to the pandemic would imply that our answer to this question is "no," but that isn't necessarily the case. Instead, we think it likely that the trend rates of labor force growth and productivity growth will change, but in opposite directions, such that they largely negate each other with little net change in the economy's speed limit.

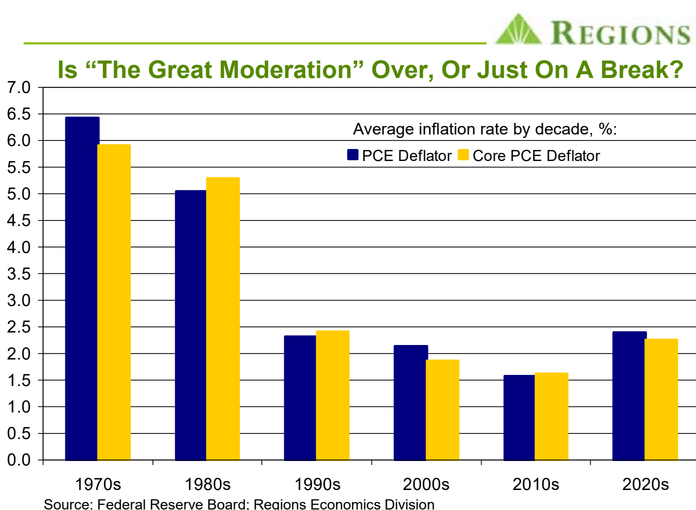
It will take time for any changes in the trend rates of growth of the two drivers of the economy's speed limit to emerge. From our earlier discussion (Question 3), it seems likely that labor force growth in 2022 will be much faster than the longer-term trend rate which, given demographic trends, we expect will be lower in the post-pandemic years than was the case prior to the pandemic. At the same time, chronic labor supply shortages and rapidly rising labor costs have led firms to step up investment in technology and automation, in part to enhance labor productivity but also in part to replace labor. This should result in a trend rate of productivity growth that is faster than the trend rate that prevailed in the years prior to the pandemic which, admittedly, is a very low bar to clear. We've argued that in the years prior to the pandemic, firms had already been making such investments in technology, but the pandemic has accelerated the rate at which they've done so. As with labor force growth, however, it will take time for a new trend rate of productivity growth to emerge, as the productivity data have been significantly distorted since the onset of the pandemic. For instance, in Q2 2020, when real GDP contracted at an annualized rate of 31.2 percent, labor productivity was reported to have risen at an annualized rate of 11.2 percent, with sharp swings in subsequent quarters mirroring changes in real GDP growth.

It should also be stressed that the rates of labor force growth and productivity growth are not immune to policy choices that impact labor force participation and capital formation. We're almost tempted to say that, if there is a silver lining to the supply chain and logistics bottlenecks that have hampered the economy over the past several months, it is that they have at least made more people aware that there is actually a supply side of the economy. We won't say so, however, because being aware of something and grasping the significance of something aren't exactly the same thing. Amid continued discussion of the prospects for further fiscal policy measures, we still hear very little of discussion of the potential impacts on the supply side of the economy. Which leads us to once again point out that the economy does not grow over time because consumption grows, rather, consumption grows over time because the economy grows. Failing to understand how policy changes may impact labor force participation and capital formation (and in turn business investment), as opposed to how much may or may not be spent, may lead to these policies having effects quite contrary to expectations. That will be a useful point to keep in mind in the months ahead.

QUESTION 6: Inflation: what comes after not-so-transitory inflation subsides? One of the main economic stories of 2021 was

inflation that turned out to be higher and more persistent than many had anticipated would be the case. Indeed, it seems likely that, as measured by the Consumer Price Index, inflation will top 7.0 percent either in the data for December 2021 (due on January 12) or January 2022. Beyond that, inflation will begin to slow but, as we noted in the brief discussion of our 2022 outlook, we expect it to remain above the FOMC's 2.0 percent target rate through year-end 2022. In raising our question about inflation here, however, our focus isn't so much on 2022, but rather what comes beyond. As with the rates of productivity growth and labor force growth, our question here is whether inflation trends in the post-pandemic world will look different than they did in the years, or decades, prior to the pandemic.

Another way of putting the question is to ask whether the persistent deceleration in inflation seen over the past several decades has run its course, leaving us with a higher trend rate of inflation. Some argue that "the great moderation," a term often used to describe the long-running deceleration in inflation, resulted from more adept, more decisive, and more credible central banking, here and abroad, having led to considerably more control over inflation than had historically been the case. Others, us included, argue that the main drivers of inflation over recent decades have been: 1) technology; 2) demographics; and 3) globalization. While each of these factors would have on its own worked to push inflation lower, they have combined to exert a strong downward push on inflation, globally, over the past few decades. Even an unprecedented degree of monetary accommodation from central banks across the globe since the "Great Financial Crisis" wasn't enough to stir inflation pressures to any meaningful degree. Indeed, prior to the distortions resulting from the pandemic and the policy response to it, inflation in the U.S. was below the FOMC's 2.0 percent target rate almost constantly since that target was adopted in 2012.



In the decade prior to the pandemic, inflation as measured by the PCE Deflator, the FOMC's preferred gauge, averaged 1.6 percent, as did core PCE inflation. Clearly, the observations from the 2020s bear the marks of the pandemic and the policy response to it, which will remain the case for several more months. To be clear, our asking whether the so-called great moderation has run its course is not us (over)reacting to the spike in inflation over the past several months, as we had posed this same question prior to the onset of the pandemic. Instead, it is based on what have become unfavorable demographic trends – globally – that will lead to slower labor force growth. And, in the years leading up to the pandemic, there was a growing push against globalization, in part because some see this as deepening, as opposed to narrowing, income inequality. Moreover, the experience of the pandemic has caused many to question the notion of globalized supply chains, which for years functioned smoothly, until suddenly they didn't. To the extent these factors persist, it would suggest a faster trend rate of inflation once the pandemic-related distortions fade from the data.

At the same time, if we are correct in thinking that firms will continue to invest intensively in technology and automation which will lead to faster productivity growth, that would work to hold down inflation. It would remain to be seen, however, whether there would be a short-lived burst of productivity growth after which it settles into a slower trend rate, or whether a faster trend rate can be sustained over time. It would also remain to be seen whether such a faster trend rate of productivity growth would be sufficient to overcome the effects of slower labor force growth and diminished globalization.

It seems reasonable to think, then, that inflation may be persistently higher in the years to come than was the case in the years prior to the pandemic. Obviously, it will take years for the answer to this question to become clear. But, to the extent the frame of reference is the FOMC's 2.0 percent target rate, a prolonged period of inflation above 2.0 percent, even if not as dramatically above as seen over the past several months, may have implications for the course of monetary policy, market interest rates and, in turn, the broader economy.

Final Thoughts: As a general rule, it's never wise to get too attached to any forecasts one makes, at least any economic forecasts. That there are so many variables that can change so quickly tends to give these forecasts a short shelf life, even under the best of circumstances. It goes without saying that the last two years have been anything but the best of circumstances. Given the considerable cloud of uncertainty hanging over the economy at present, it would be hard, if not foolish, to have a high degree of confidence in any forecast for 2022, let alone further out into the future.

We've found ourselves wondering whether we've settled into a new normal in which the only thing normal is that nothing is normal. That's why we took a bit of a different course with our 2022 "outlook," focusing less on specific numbers and more on general themes and posing a series of questions for which there will be no clear answers for some time to come. We do think the themes we've chosen to focus on here are important, in that they will help shape the economy's path not only this year but in the years that follow. Still, here's hoping that when it comes time for the 2023 outlook, things will feel normal enough for a return to our long-time format, even if that does open us up to being wrong in ways that posing a series of broad questions without giving definitive answers to them does not.

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com

ECONOMIC OUTLOOK

REGIONS

January 2022

Q2 '21 (a)	Q3 '21 (a)	Q4 '21 (f)	Q1 '22 (f)	Q2 '22 (f)	Q3 '22 (f)	Q4 '22 (f)	Q1 '23 (f)		2019 (a)	2020 (a)	2021 (f)	2022 (f)	2023 (f)
6.7	2.3	6.4	2.4	4.5	4.0	3.7	2.6	Real GDP[1]	2.3	-3.4	5.6	4.1	3.0
12.0	2.0	4.8	1.5	4.0	4.1	3.6	2.7	Real Personal Consumption[1]	2.2	-3.8	8.0	3.7	3.0
9.2	1.7	8.1	7.2	7.6	7.0	6.4	5.6	Real Business Fixed Investment[1]	4.3	-5.3	7.7	6.8	5.7
12.1	-2.3	7.6	8.1	8.0	8.1	7.4	6.2	Equipment[1]	3.3	-8.3	13.4	6.9	6.1
12.5	9.1	8.7	6.8	7.5	6.5	5.6	5.2	Intellectual Property and Software[1]	7.2	2.8	10.0	7.8	5.5
-3.0	-4.1	7.7	5.3	6.1	4.7	5.0	4.6	Structures[1]	2.0	-12.5	-7.1	4.1	4.7
-11.7	-7.7	0.8	0.9	0.8	2.0	2.0	1.7	Real Residential Fixed Investment[1]	-0.9	6.8	9.1	-0.9	2.3
-2.0	0.9	1.5	0.7	1.7	1.7	2.0	1.9	Real Government Expenditures[1]	2.2	2.5	0.7	1.1	1.7
-1,244.5	-1,316.6	-1,320.4	-1,353.0	-1,365.6	-1,379.8	-1,383.5	-1,407.5	Real Net Exports[2]	-905.3	-942.7	-1,276.9	-1,370.5	-1,423.3
1,107	1,096	1,169	1,172	1,174	1,182	1,189	1,197	Single Family Housing Starts, ths. of units[3]	889	1,004	1,132	1,179	1,207
482	465	474	469	467	460	459	457	Multi-Family Housing Starts, ths. of units[3]	403	393	466	464	453
14.6	17.3	17.8	16.5	12.5	8.4	5.3	3.7	CoreLogic House Price Index[5]	3.9	6.0	15.0	10.5	3.2
16.9	13.3	12.8	13.3	13.9	14.8	15.3	15.6	Vehicle Sales, millions of units[3]	17.0	14.5	15.0	14.3	15.8
5.9	5.1	4.2	3.8	3.6	3.5	3.5	3.5	Unemployment Rate, %[4]	3.7	8.1	5.4	3.6	3.5
8.5	4.7	4.3	4.3	3.8	2.8	2.4	2.2	Non-Farm Employment[5]	1.3	-5.7	2.7	3.3	1.6
-29.0	-4.3	-6.2	-2.3	3.6	3.8	3.8	4.7	Real Disposable Personal Income[1]	2.3	6.2	2.1	-3.2	4.0
4.0	4.6	5.5	5.6	4.9	4.1	3.4	2.8	GDP Price Deflator[5]	1.8	1.2	4.1	4.5	2.4
3.9	4.3	5.5	5.7	5.0	4.3	3.4	2.9	PCE Deflator[5]	1.5	1.2	3.9	4.6	2.5
4.8	5.3	6.7	7.2	5.9	4.9	3.5	2.8	Consumer Price Index[5]	1.8	1.2	4.7	5.4	2.4
3.4	3.6	4.6	5.0	4.3	3.8	3.3	2.8	Core PCE Deflator[5]	1.7	1.4	3.3	4.1	2.6
3.7	4.1	5.0	5.9	4.6	4.1	3.5	3.0	Core Consumer Price Index[5]	2.2	1.7	3.6	4.5	2.8
0.13	0.13	0.13	0.17	0.42	0.65	0.92	1.17	Fed Funds Target Rate Range Mid-Point, %[4]	2.16	0.42	0.13	0.54	1.46
1.59	1.32	1.54	1.84	1.99	2.09	2.17	2.24	10-Year Treasury Note Yield, %[4]	2.14	0.89	1.44	2.02	2.30
3.00	2.87	3.08	3.42	3.56	3.67	3.78	3.86	30-Year Fixed Mortgage, %[4]	3.94	3.12	2.96	3.61	3.96
-3.5	-3.7	-3.3	-3.4	-3.3	-3.4	-3.4	-3.5	Current Account, % of GDP	-2.2	-2.9	-3.3	-3.4	-3.5

a = actual; f = forecast; p = preliminary

Notes: 1 - annualized percentage change 2 - chained 2021 $ billions 3 - annualized rate 4 - quarterly average 5 - year-over-year percentage change

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203

Richard F. Moody
Chief Economist

Greg McAtee
Senior Economist