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Things Are Different, Yet Oddly The Same, At Least Kind Of

The Bureau of Economic Analysis (BEA) recently released their annual revisions to the data from the National Income and Product Accounts (NIPA), the source of estimates of GDP, personal income, and many other series used to help assess the state of the U.S. economy. Ahead of the release, we and many others had expected the revised data to at least partially reconcile what was a notable disconnect between real GDP and real Gross Domestic Income (GDI) over the first half of 2022. Recall that real GDP was reported to have contracted in each of the first two quarters of 2022, while real GDI was reported to have expanded in each quarter. While some took the back-to-back declines in real GDP to mean the U.S. economy had slipped into recession, the data on real GDI told a different story, one which was also being told by a wide array of other data series, most notably nonfarm employment.

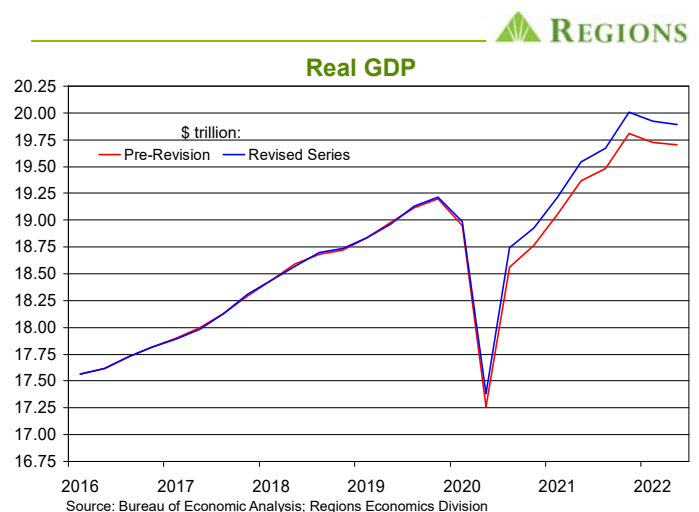
In principle, GDP and GDI are measuring the same thing, simply from different vantage points; GDP is an expenditures-based measure of all final goods and services produced in a given period, while GDI measures the income generated in the production of those final goods and services. One reason we expected the revised NIPA data to show higher real GDP over 1H 2022 is that, over time, when the two measures have diverged in the initial estimates, the revised GDP data have tended to lean toward the initial estimate of GDI.

We did have a more compelling, at least we thought we did, reason to expect an upward revision to real GDP over 1H 2022, which is that the GDI data seemed more closely aligned with the labor market data than did the GDP data. For instance, as the data now stand, total nonfarm payrolls increased by 2.663 million jobs over the first half of 2022. Moreover, the Bureau of Labor Statistics (BLS) released a preview of the upcoming benchmark revisions to the payroll employment data showing that as of March 2022, the level of nonfarm employment was 462,300 jobs higher than had previously been reported. When those jobs actually came on the books isn't really relevant here, the relevant point being that with even more people employed than had previously been thought, the reported contraction in real GDP over 1H 2022 seemed even more at odds with the data from the income side of the ledger.

As it turns out, prior estimates of real GDI over the period spanning Q1 2021 through Q2 2022 were revised lower. One of the key factors behind this downward revision was new data on employee compensation from the BLS's Quarterly Census of Employment and Wages (QCEW) showing that the BEA had overestimated private sector wage and salary earnings over this period. As this is the largest component of personal income, the downward revision to labor earnings had a meaningful impact on the estimate of nominal

Gross Domestic Income. At the same time, the revised NIPA data show inflation was higher over the Q1 2021-Q2 2022 period than had originally been reported, which in turn pushed the level of real (or, inflation adjusted) Gross Domestic Income even further below prior estimates. The revised data show that, as of Q2 2022, the level of real GDI was 1.6 percent lower than had previously been reported. In terms of growth rates, while the original data showed real GDI expanding at annualized rates of 1.8 percent and 1.4 percent, respectively, over the first two quarters of 2022, the revised data show growth of 0.8 percent and 0.1 percent.

The revised NIPA data show the level of real GDP to be higher over the Q1 2020 through Q2 2022 period than had originally been reported. As of Q2 2022, the revised data show the level of real GDP to be 1.0 percent higher than had previously been reported. The revised NIPA data show faster growth in consumer spending, residential fixed investment, and government spending along with a smaller trade deficit than had been reported, which more than offset slower growth in business fixed investment. As shown in the following chart, the net result was a higher level of real GDP.

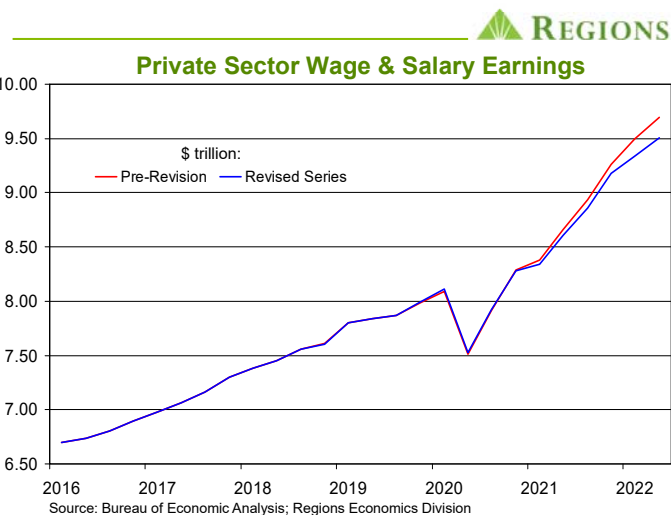
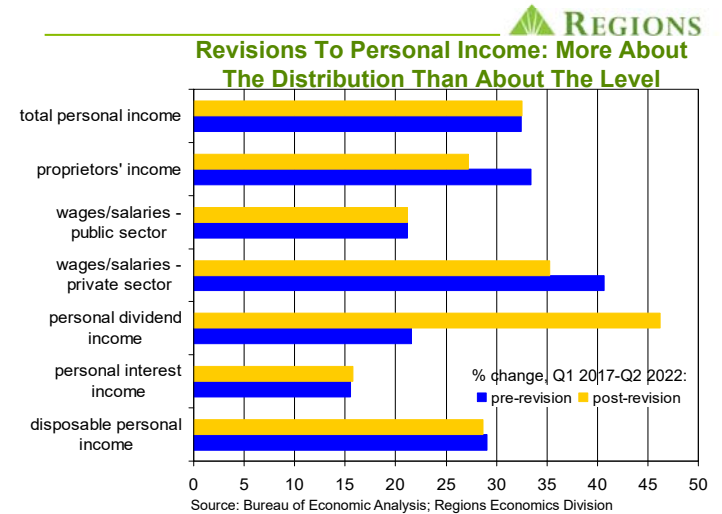


This is where things get, well, a little weird. While the revised NIPA data show the level of real GDP to have been higher over the past several quarters than originally reported, the annualized quarterly changes in real GDP in the revised data are almost identical to those previously reported. Indeed, over the three most recent quarters, they are exactly the same. In other words, real GDP is still reported to have contracted at annualized rates of 1.6 percent and 0.6 percent, respectively, over the first two quarters of 2022. So, even though the level of real GDP was revised higher, as we expected, the quarterly rates of change were the same, which we did not expect, while at the same time both the level and rate of growth of real Gross Domestic Income were revised lower. As the quarterly rates of change are the most commonly used measuring

sticks of the health of the economy, the revised NIPA data paint a bit of a weaker picture of the U.S. economy over 1H 2022 than had previously been the case, contrary to our expectations.

You could argue that the revisions to the NIPA data offer little more than a revised look in the rear view mirror at a time when the road ahead is looking rockier and more uncertain. To some extent that is true, but the downward revisions to real Gross Domestic Income suggest less momentum as we head down this rockier and more uncertain road than had been thought. That said, we do think it worth highlighting some of the details of the revised NIPA data. While in many cases the revisions yielded little change in top-line metrics, such as personal income and corporate profits, over the Q1 2017-Q2 2022 period (the span of the revisions), there are some notable changes in the underlying details that we find of interest. Moreover, in many cases the revised data show more growth over the early quarters and less over the latter quarters of the revision window, which goes to our point about having less momentum as we head down a rockier and more uncertain road.

inflation. In each of the past five quarters, aggregate private sector wage and salary earnings have posted double-digit year-on-year increases. As we routinely note, while many focus on average hourly earnings as the main gauge of how workers are faring, it is the aggregate measure of labor earnings, covering how many people are working, how many hours they work, and how much they earn for each hour worked, that matters for growth in personal income and, in turn, consumer spending.



To our earlier point about the data from the Quarterly Census of Employment and Wages (QCEW), the chart above shows the downward revisions to private sector wage and salary earnings, the largest component of personal income. One thing worth noting is that the QCEW data are not only the basis of the downward revision to the BEA's estimates of wage and salary earnings but are also the basis of the annual benchmark revisions to the BLS's estimates of nonfarm employment. As we noted above, the BLS's preview of the pending benchmark revisions shows the level of nonfarm employment as of March 2022 being revised higher by 462,300 jobs. While that number may change slightly when the final results are released in February 2023, the combination of more people working and lower wage and salary earnings over 1H 2022 suggests either less vigorous hourly wage growth or fewer hours worked than has thus far been reported, if not a combination of the two (these series are also included in the BLS's annual benchmark revisions of the establishment survey data).

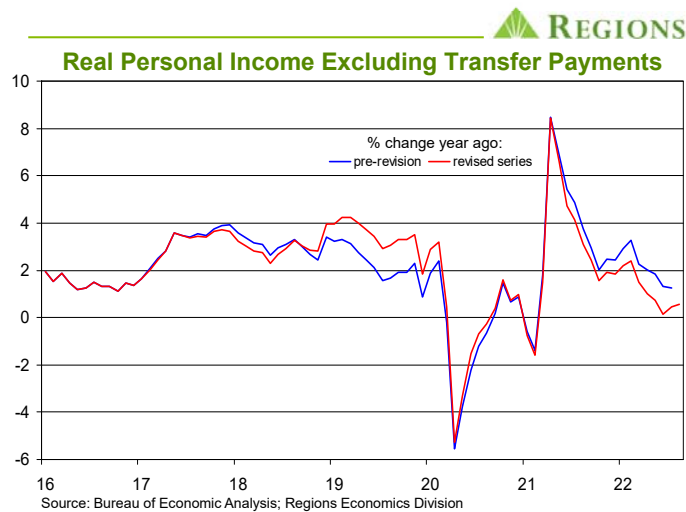
It is also worth noting that while the level of private sector wage and salary earnings over the past few quarters is now shown to be lower than had been reported previously, the revised data still show notably rapid growth that remains far above the rate of

Using the data on personal income, the chart above illustrates our point that the revisions did not result in major changes in many of the broad measures from the NIPA data over the Q1 2017 through Q2 2022 period. For instance, growth in total personal income over this entire period was little changed in the revised data relative to what had previously been reported. That said, many of the details that make up the broader measures did change. The most obvious instance in the personal income data is that dividend income is now shown to have grown much more rapidly than had previously been reported. At the same time, private sector wage and salary earnings, proprietors' income (a proxy for small business profits), and interest income grew by less than previously reported. Note that dividend income accounts for a smaller share of personal income than any of the components for which growth was marked lower, which helps account for the modest revision to growth in top-line personal income over the Q1 2017-Q2 2022 period.

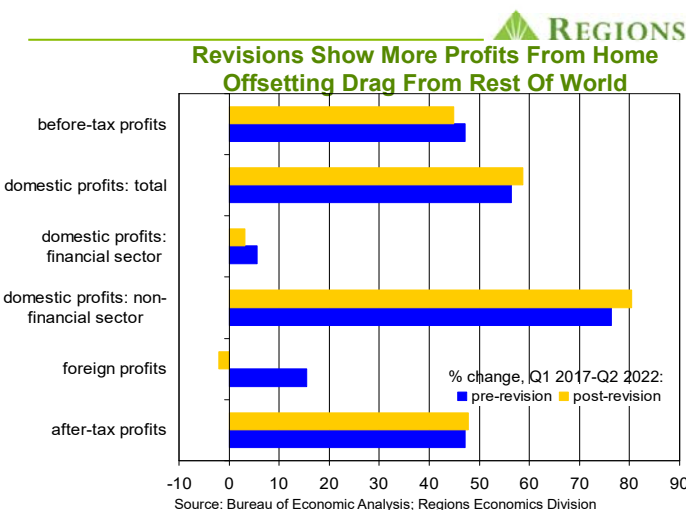
Where we do see a bigger difference in the revised, however, is in the more recent quarters, particularly after accounting for what is now reported to have been higher inflation over those quarters. That is evident in the data on real personal income excluding transfer payments, which is one of the series monitored by the National Bureau of Economic Research (NBER) as they make their calls on turns in the business cycle. This is also a series we put considerable stock in as an indicator of the capacity of the household sector to engage in discretionary spending and service debt. As noted above, the downward revision to private sector labor earnings weighed on growth in nominal income, while the upward revision to inflation over the past several quarters added to that weight in the inflation adjusted series.

The net result is slower growth in real personal income excluding transfer payments over the past several quarters in the revised

NIPA data than had first been reported. Moreover, the monthly data show real personal income excluding transfer payments peaking in November 2021, which is relevant in that NBER uses the peaks in the series to help date the transition from expansion to recession in the broader economy. Using the monthly data, the chart below illustrates the sharp deceleration in growth in this series, with real personal income excluding transfer payments up only 0.56 percent year-on-year in August.



Another instance in which the revisions to the NIPA data yielded little change in a broad metric despite larger changes in some of the underlying details is corporate profits. As shown in the next chart, growth in before-tax corporate profits as measured in the NIPA data (a much broader measure of corporate profits than the measure based on the S&P 500) is virtually identical over the Q1 2017-Q2 2022 period in the original and revised NIPA data. What is different, though, is the composition of profits, with profits from domestic operations now shown to have grown more strongly than had been previously reported, while profits from foreign operations are now shown to have declined over this period.



Much of the downward revision to foreign profits comes from the quarters since the onset of the pandemic. This makes sense given the much more aggressive policy response in the U.S. and faster

reopening of the U.S. economy than was generally the case in the rest of the world. It makes even more sense when looking at the industry-level profit data, which show sizable upward revisions to prior estimates of profit growth in wholesale trade, retail trade, and transportation and warehousing services. These sectors were the biggest beneficiaries of the changes in consumer spending patterns after the onset of the pandemic that were triggered by substantial financial support for U.S. households and much of the services sector either being shut down or operating at only limited capacity for some time after the onset of the pandemic. We'll also note that, with the revised NIPA data showing little change in profit growth, that leaves profit margins (both before and after tax) below the recent peaks but nonetheless significantly higher than historical norms, as in the original data.

While there may not be many meaningful macro implications from the revisions to the corporate profit data, the revised data are at least in line with how the economy played out after the onset of the pandemic. As for other elements of the revised NIPA data, if anything they brought more confusion than clarity, at least for anyone trying to refine their view on the underlying health of the economy as it headed into the back half of 2022. Oh well, we can always wait for next year's comprehensive revisions to the NIPA data and see if they bring any more clarity. By then, of course, the economy will likely look significantly different than it looks today, which will make for a challenging environment for those who don't do well with confusion.

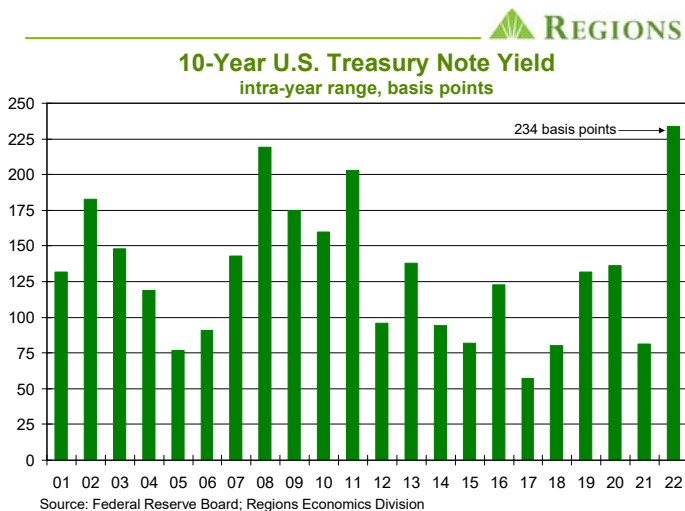
People Find (Lose) Jobs. Markets Tank (Soar). Seriously?

Speaking of confusion, if you're confused by how the financial markets are reacting of late to each bit of economic data that hits the wires, you're not alone. There are two components of these reactions that stand out – the magnitude and the direction. It seems as though each piece of data, no matter how modest it may be in the grand scheme of things, generates an outsized reaction in both the equity and fixed income markets. At the same time, the movement in the markets seems to go in the opposite direction of the data, which is another way of saying that we've fallen, once again, into a "good (bad) data are bad (good) news" pattern. As anyone who has followed the economic data for any length of time knows, even in the best (worst) of times, the data are never uniformly good (bad). At present, however, with so much uncertainty over the outlook for monetary policy and the broader economy, the normal ebbs and flows of the data are triggering outsized reactions in the markets. Other than fostering heightened volatility in asset prices, it isn't clear what is being accomplished by these wild swings.

For instance, on October 3 the Institute for Supply Management (ISM) released their September survey of the manufacturing sector. The headline index came in at 50.9 percent, below expectations, while the indexes of employment and new orders came in below the 50.0 percent break between contraction and expansion, sending an ominous signal for the prospects of output and employment in the factory sector in the months ahead. So, naturally, markets rallied on this news, though the markets also got a boost that day as the British Prime Minister withdrew her plan to cut taxes (a different story for a different day). Later that week the BLS reported the number of open jobs across the U.S.

economy fell by over one million positions in August. While this was a notably large decline, what apparently escaped notice is that the initial estimate of job openings in any given month has been prone to sizable revision, as the markets rallied strongly after the data hit. The week was capped off by the release of the September employment report showing a slower but still strong pace of job growth and the jobless rate falling to 3.5 percent from 3.7 percent in August. That news sent the markets reeling, with the Dow Jones Industrial Average falling by more than six hundred points and yields on U.S. Treasury securities jumping.

It isn't so much that market participants think more people finding jobs is a bad thing or that the factory sector falling into contraction is a good thing, at least we hope not. Instead, market participants are on edge over the extent to which the FOMC will continue pushing the Fed funds rate higher. What is less clear is whether market participants are afraid the FOMC may go so far as to tip the economy into recession or whether they are hoping that the FOMC will execute a quick pivot from raising rates to cutting rates. Either way, each new piece of data triggers a reaction seemingly far out of alignment with its actual significance, especially given that no single piece of data "seals the deal" for the FOMC to move in one direction or the other.



All of which has led to an undue degree of volatility in the markets. For instance, the chart above shows the intra-year range between the lowest and highest daily (closing) yields on 10-year U.S. Treasury notes. With still three months more to go, this year has already seen the widest range, 234 basis points, of any year in the 2001-2022 period. Indeed, daily changes of 15 to 20 basis points now seem almost common. So, while it may indeed be the case that the headline number on any economic release tells you very little of value, that any given headline number will be revised, in most cases more than once, and that the FOMC does not make decisions based on any single data point in any given month, none of that seems to matter to market participants these days. Did someone mention something about efficient markets?

September Employment Report

Total nonfarm payrolls rose by 263,000 jobs in September, with private sector payrolls up by 288,000 jobs and public sector payrolls down by 25,000 jobs. Breaking with historical patterns,

there was no large upward revision to the initial estimate of August job growth; prior estimates of job growth in July and August were revised up by a net 11,000 jobs for the two-month period. This miniscule change, however, masks some big swings, as net job growth in the private sector was revised down by 62,000 jobs and net job growth in the public sector was revised up by 73,000 jobs. Despite the slower pace, job growth remains notably broad based across private sector industry groups, which is a sign that the broader economy isn't ready to roll over just yet.

The reported increase in construction employment raised more than a few eyebrows, with some questioning the validity of the data. A quick look at the details, however, shows that not seasonally adjusted basis, construction payrolls fell as they have in every single September since 1990, but this year's decline was the smallest September decline in that entire period, hence the reported increase in the seasonally adjusted data. Many seem to think that the sharp declines in home sales brought on by higher mortgage interest rates should be leading to cuts in construction payrolls. What they are overlooking, however, is that the backlog of housing under construction is at present the largest on record, at over 1.7 million units. Moreover, builders are sitting on notably large backlogs of units on which they have yet to start work. So, unless builders walk away from under construction units in large numbers and even more buyers cancel orders for new homes, we may not see large-scale layoffs in construction any time soon.

As noted in the prior section, the unemployment rate fell to, or, perhaps we should say, back to, 3.5 percent in September from 3.7 percent in August. As we noted at the time, the "surge" in labor force participation that pushed the jobless rate up to 3.7 percent in August, from 3.5 percent in July, was largely a seasonal adjustment mirage. Two groups – the 16-to-19 year-old age cohort and females in the 45-to-54 year-old age cohort – accounted for the bulk of the reported increase in the seasonally adjusted labor force in August. We expected these spikes to be mostly unwound in the September data, thus pushing the jobless rate lower. To our earlier point about reacting to headline numbers, the data from the BLS's household survey are inherently volatile from one month to the next. As such, any given change in any given number in any given month is just as likely to be noise as it is to be signal, a point apparently lost on those on edge about what any given number might mean for the FOMC.

The broad U6 measure, which accounts for both unemployment and underemployment, fell 6.7 percent from 7.0 percent in August. This decline was triggered by a decline in the number of people working part-time for economic reasons, including a decline in the number reporting they worked part-time due to slack business conditions. Again, given the inherent volatility in the household survey data, we look to the three-month moving averages of these series for signals on changes in conditions but, even on that basis, there has been no meaningful change in the number of people working part-time due to slack business conditions over the past several months. Not what you'd expect if broader economic activity were slowing significantly. To be sure, that can and might change in the months ahead, making this metric one to track.

Even with a slowing pace of job growth, the reality is that labor supply remains no match for labor demand. Job growth will slow further in the months ahead but will likely remain above what is needed to keep the unemployment rate from spiking higher.

ECONOMIC OUTLOOK



October 2022

Q1 '22 (a)	Q2 '22 (a)	Q3 '22 (f)	Q4 '22 (f)	Q1 '23 (f)	Q2 '23 (f)	Q3 '23 (f)	Q4 '23 (f)		2020 (a)	2021 (a)	2022 (f)	2023 (f)	2024 (f)
-1.6	-0.6	2.7	0.4	0.4	0.6	0.9	1.1	Real GDP ¹	-2.8	5.9	1.8	0.8	1.5
1.3	2.0	0.5	0.7	1.2	1.1	1.2	1.2	Real Personal Consumption ¹	-3.0	8.3	2.5	1.0	1.6
7.9	0.1	4.5	3.7	3.0	2.6	2.7	3.0	Real Business Fixed Investment ¹	-4.9	6.4	3.6	3.0	3.1
11.4	-2.0	2.3	1.3	0.5	0.4	0.6	0.9	Equipment ¹	-10.5	10.3	3.6	0.8	1.7
10.8	8.9	6.8	5.7	4.9	4.5	4.6	4.5	Intellectual Property and Software ¹	4.8	9.7	8.8	5.4	4.5
-4.3	-12.7	4.5	4.6	4.3	3.1	3.1	4.2	Structures ¹	-10.1	-6.4	-6.2	2.9	2.7
-3.1	-17.8	-21.1	-8.7	-5.2	-5.4	-2.8	-1.3	Real Residential Fixed Investment ¹	7.2	10.7	-8.7	-8.5	1.5
-2.3	-1.6	1.1	0.0	0.4	1.1	1.2	0.8	Real Government Expenditures ¹	2.6	0.6	-1.1	0.5	1.0
-1,488.7	-1,430.5	-1,331.0	-1,347.3	-1,374.9	-1,386.7	-1,397.2	-1,404.8	Real Net Exports ²	-922.6	-1,233.4	-1,399.4	-1,390.9	-1,423.7
1,187	1,086	914	900	888	879	879	890	Single Family Housing Starts, ths. of units ³	1,002	1,131	1,022	884	948
533	561	562	538	520	487	473	465	Multi-Family Housing Starts, ths. of units ³	393	474	548	486	457
19.8	17.5	11.4	4.3	-2.3	-5.6	-4.7	-1.9	CoreLogic House Price Index ⁵	6.7	15.7	13.0	-3.7	1.9
14.1	13.3	13.3	13.8	14.3	14.7	15.0	15.3	Vehicle Sales, millions of units ³	14.5	14.9	13.6	14.8	15.8
3.8	3.6	3.6	3.5	3.7	3.9	4.0	4.2	Unemployment Rate, % ⁴	8.1	5.4	3.6	3.9	4.3
4.6	4.4	4.0	3.2	2.2	1.6	0.9	0.5	Non-Farm Employment ⁵	-5.8	2.8	4.0	1.3	0.4
-10.6	-1.5	1.0	0.0	4.9	1.5	2.5	2.9	Real Disposable Personal Income ¹	6.2	1.9	-6.5	2.0	3.3
6.9	7.6	7.0	6.6	5.6	4.1	3.6	2.9	GDP Price Deflator ⁵	1.3	4.5	7.0	4.0	1.9
6.4	6.6	6.3	6.0	5.3	4.4	4.0	3.3	PCE Deflator ⁵	1.1	4.0	6.3	4.3	2.1
8.0	8.6	8.2	7.5	6.5	4.9	4.2	3.5	Consumer Price Index ⁵	1.2	4.7	8.1	4.8	2.2
5.3	5.0	4.9	4.9	4.6	4.3	3.9	3.2	Core PCE Deflator ⁵	1.3	3.5	5.0	4.0	2.3
6.3	6.0	6.2	6.0	5.5	4.7	3.9	3.3	Core Consumer Price Index ⁵	1.7	3.6	6.1	4.3	2.5
0.17	0.81	2.24	3.71	4.38	4.38	4.38	4.38	Fed Funds Target Rate Range Mid-Point, % ⁴	0.42	0.13	1.73	4.38	3.39
1.94	2.93	3.11	3.88	3.95	3.95	3.94	3.83	10-Year Treasury Note Yield, % ⁴	0.89	1.44	2.96	3.92	3.42
3.82	5.27	5.62	6.61	6.65	6.60	6.55	6.39	30-Year Fixed Mortgage, % ⁴	3.12	2.96	5.33	6.55	5.77
-4.6	-4.0	-3.3	-3.5	-3.7	-3.6	-3.6	-3.5	Current Account, % of GDP	-2.9	-3.6	-3.7	-3.6	-3.4

a = actual; f = forecast; p = preliminary

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

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