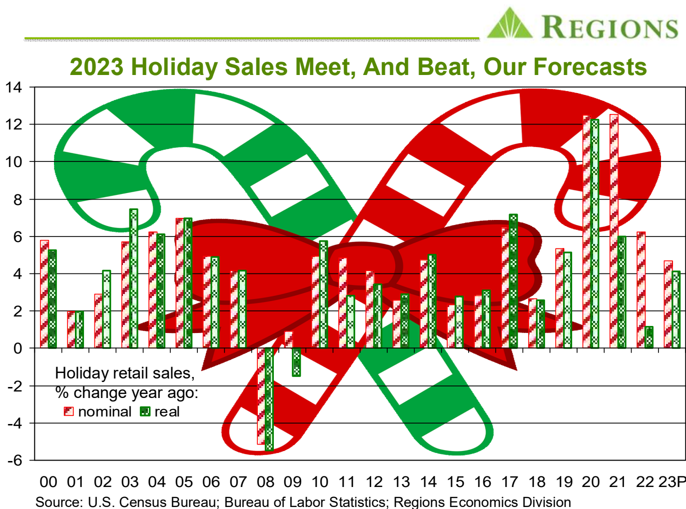
ECONOMIC OUTLOOK
REGIONS
February 2024

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.

The Odds And Ends Edition

We typically devote these monthly outlooks to detailed discussions of one or two specific topics. Every now and again, though, we like to use them to do some catching up on topics which we think to be of interest but that we don't always discuss elsewhere, or to bring up specific data points that have caught our eye and we think will be of interest to our readers. After the marathon January edition that was our 2024 outlook, we thought this month would be a good time to catch up on some odds and ends.

Holiday Sales Recap: With the December retail sales data now at our disposal, we can see how our forecast of 2023 holiday season sales fared. We discussed that forecast in detail in our November 2023 *Outlook*. Recall that our forecast had nominal holiday sales rising 4.7 percent from 2022, with real (i.e., adjusted for price changes) holiday sales up 3.1 percent. Our forecast drew some attention, not all of which was all that kind, for being well above almost all other forecasts. We were even asked if we'd been nipping at the holiday egg nogg while producing our forecast. For the record, we were, but, what was your point?



Source: U.S. Census Bureau; Bureau of Labor Statistics; Regions Economics Division

As it turns out, we perhaps should have hit the holiday egg nogg even harder, as nominal holiday sales rose by 5.7 percent while real holiday sales rose by 5.1 percent, well above our forecasts. Not only was nominal spending stronger than we had anticipated, but prices for core consumer goods excluding used motor vehicles (the series we use to deflate our measure of holiday sales) were weaker over the last months of 2023 than we anticipated. The caveat here is that the December retail sales data are still preliminary, so when all is said, done, and revised, the change may be a bit different than that yielded by the preliminary data, but even with any revisions the data are likely to show holiday season sales easily topping our forecast which, at the time we presented it, some found to be most implausible.

Recall that the theme of our holiday season sales outlook was that 2023 holiday season spending would come down to a battle of wallet versus will. We noted that while there were considerable financial supports for consumer spending, consumer sentiment was still in a not so festive place. We thought that, ultimately, wallet would win out over will, which set us apart from many narratives of downbeat and cash-strapped consumers lacking the means and the will to engage in holiday season shopping. What we did not anticipate at the time we made our forecast, however, was the late-year improvement in consumers' moods, which may have added to the strength of holiday season sales.

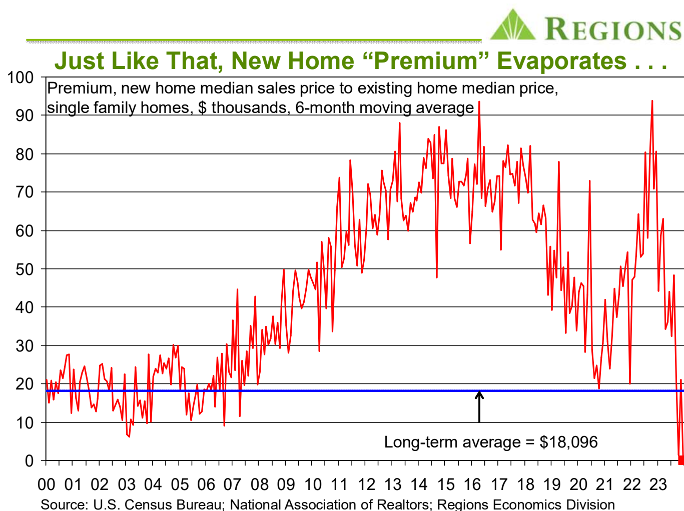
As a reminder, our measure of holiday season sales is combined November and December retail sales excluding drug store, grocery store, motor vehicle, gasoline, building materials, and restaurant sales. As we anticipated, online sales were a key driver of growth in overall holiday season sales. In addition to the other financial supports we thought would support holiday season spending, sharply lower gasoline prices over the last few months of 2023 freed up cash for consumers to spend elsewhere. We should also point out that not only was spending on goods notably strong over the 2023 holiday season, but so too was discretionary services spending, which is not captured in anyone's measure of holiday season sales. The strength in spending over the final two months of 2023 accounts for Q4 growth in real consumer spending and, in turn, real GDP, surprising to the upside.

We have for some time expected discretionary services spending to soften, and have for some time been wrong on this point. While only one month of data, the December data do show spending on food services and lodging was flat as 2023 closed, which may presage a broader slowdown in discretionary services spending in 2024. Still, with labor earnings continuing to easily outpace inflation, interest rates likely to drift lower, and strong household net worth, growth in consumer spending may prove stronger in 2024 than is generally expected. It is true that lower-to-middle income households are feeling more financial stress than are other income cohorts, but overall household financial conditions remain strong, which we think will support spending in 2024.

New Home "Premium" Evaporates: It will likely come as no surprise when we tell you that total home sales fell sharply in 2023. Combined sales of new and existing homes fell to 4.755 million units in 2023, a decline of 16.1 percent from 2022, a year in which combined sales fell by 17.8 percent. Sales of existing homes fell by 18.7 percent in 2023 while new home sales actually increased by 4.2 percent, and while the increase in new home sales may come as a surprise, it should not, at least for anyone who has followed the dynamics in the housing market over the

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

past several years. While higher mortgage rates on top of elevated prices made affordability constraints more binding, there is still a meaningful degree of pent-up demand for home purchases, a reflection of the market having been chronically undersupplied over the past several years. With higher mortgage interest rates effectively locking more and more homeowners into their current homes, thus acting as a further weight on already lean inventories of existing homes for sale, pent-up demand for home purchases has to an increasing degree been funneled to the market for new homes. With many builders having seen inventories of spec homes for sale climb to uncomfortably high levels, they were able and willing to offer incentives, including mortgage rate buydowns and concessions on pricing, in order to facilitate sales in 2023.



While we found very little about patterns in new and existing home sales in 2023 to be surprising, surprised may be too mild of a term to describe our reaction to the new home premium, i.e., the amount by which the median new home sales price exceeds the median existing home sales price, having evaporated. Historically, new homes have commanded a premium over existing homes, as we show in the above chart. While the chart shows this in terms of dollars, the premium averaged twenty percent from 1990 through 2022 (note that we use the median prices of single family homes, new and existing, as the basis of comparison). As seen in the chart, there is considerable month-to-month volatility in the size of the premium, which is why when we show this series we typically use the six-month moving average to do so, but we show the monthly data here for effect. Save for a few months over 1980-81 and a few months here and there in the early 1970s, the median price of an existing home has never been above that of a new home, so that the gap was washed away in December is, at the risk of engaging in hyperbole, remarkable.

No matter how one describes it, the evaporation of the new home premium reflects the extent to which prices of existing homes have been supported by the paucity of inventory and the extent to which builders have given ground on price to help close sales. Moreover, builders giving ground on price comes on top of what for many has been increased reliance on mortgage rate buydowns as a means of easing affordability constraints. For instance, the "3-2-1" buydown is a commonly used structure by which a builder absorbs three percentage points of the mortgage interest rate in the first year, two percentage points in the second year, and one percentage point in the third year, yielding lower monthly loan payments and offering buyers a window in which to refinance the loan at a lower permanent rate should mortgage interest rates fall, as we and most analysts expect to see over coming quarters.

That many builders are offering both rate buydowns and price concessions reflects how challenging affordability has become for many prospective buyers, a situation rooted in how chronically undersupplied the market has been over the past several years. While we expect mortgage interest rates to fall over coming quarters, we do not expect them to fall to a degree that would unlock significant inventories of existing homes for sale. As such, builders will continue to face growing demand as mortgage rates fall. Our baseline forecast anticipates another decline in existing home sales this year along with an increase in new home sales in the mid-single digits. But, as mortgage rates fall and spec inventories are pared down, it remains to be seen whether builders will remain as accommodative as they've been over recent months. If we're correct in our outlook, the new home premium could come back just as quickly in 2024 as it evaporated in 2023.

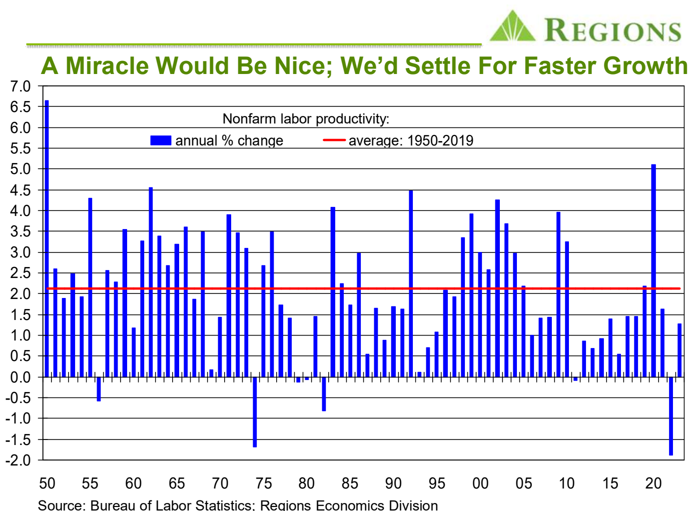
Faster Productivity Growth A Must: It isn't a miracle, at least not yet, but the acceleration in labor productivity growth over the past three quarters is at least a start. Over the last three quarters of 2023, nonfarm labor productivity grew at annual rates of 3.6 percent, 5.2 percent, and 3.2 percent, a stretch last seen in 2019. Full-year 2023 growth was quite a bit more tempered, with an increase of 1.2 percent, the smallest gain since 2016 In last month's edition we noted that 2023 was a very good year for the supply side of the economy and pointed to three main factors behind that – supply chains and logistics networks normalizing, faster than expected labor force growth, and faster than expected growth in labor productivity.

We've offered up the improvement on the supply side of the economy as being the most under-appreciated storyline of the U.S. economy in 2023, in part because so many seem unaware that there actually is a supply side to the economy. Either way, the marked improvement on the supply side of the economy allowed for faster GDP growth and faster deceleration in inflation than would otherwise have been the case. That said, we've also questioned how much room there is for further improvement on the supply side of the economy in 2024 and beyond. The boost from supply chains and logistics networks normalizing is behind us, and that the progress made on this front is now threatened by geopolitical tensions poses a downside risk to our baseline 2024 forecast. Additionally, we do not harbor much hope that the faster labor force growth seen over the past two years can be sustained.

That leaves the faster productivity growth as the sole, or, at the very least the main, channel trough which we can see further improvements on the supply side of the U.S. economy over coming quarters. More fundamentally, the sustainable rate at which any economy can grow over time without sparking inflation pressures is governed by two factors – the rate of growth in total labor input, and the rate of productivity growth. We refer to this sustainable rate of growth as an economy's "speed limit," and over the past decade the speed limit of the U.S. economy has been painfully slow and well below historical norms. That reflects sharply slower rates of growth of both labor input and productivity. While policy,

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

particularly immigration policy, can impact the longer-term rate of labor force growth, that is largely a function of demographics, and for years the demographic handwriting has been on the wall, both in the U.S. and around the globe, heralding the marked slowdown in labor force growth.



Productivity growth tends to move in long cycles, and for the past decade-plus that cycle has been characterized by weak-to-anemic productivity growth. From 2011 through 2019, average annual productivity growth was 1.0 percent, far below historical norms. As with most of the economic data, the productivity data was radically altered by the pandemic, with the 5.1 percent growth recorded for 2020 more a reflection of millions of jobs being shed with the onset of the pandemic while real GDP rebounded strongly over the second half of the year. Productivity growth slowed sharply in 2021 as firms brought workers back, before productivity declined by 1.9 percent in 2022. Productivity growth came back to life in 2023 as private sector job growth and growth in aggregate hours worked slowed markedly and real GDP grew by 2.5 percent.

In some sense, measurement issues account for the wide swings in productivity over the past few years, given the erratic paths of real GDP and private sector employment and hours worked. There is considerable debate over the effects of the increased incidence of remote work since the onset of the pandemic, with some arguing it enhanced productivity growth and some arguing it detracted from productivity. It can be argued that the wave of departures of older workers from the labor force was a drag on productivity, as these departures left gaps in experience that were not immediately filled. We can make the same argument about the sharply higher degree of labor turnover over the past two-plus years, as measured by the quits rate from the JOLTS data, with repeated rounds of workers coming and going likely disrupting productivity. To the extent these factors were drags, however, they clearly have abated, particularly in the latter case as the quits rate is back at pre-pandemic norms.

Where does this leave us, in terms of productivity growth going forward? Specifically, can the surge in productivity growth seen over the final three quarters of 2023 be sustained? We think that it can but, more importantly, think it has to be. We're not arguing that we'll see a repeat of the "productivity miracle," i.e., the ten-year period from 1996 through 2005 that saw average annual productivity growth of 3.0 percent, but we do think it possible that we'll see a sustained period of productivity growth well ahead of the paltry annual growth seen in the years prior to the pandemic. We were arguing years before the pandemic that labor supply constraints and faster growth in labor costs would at some point lead firms to invest in technology/automation to enhance labor productivity or to substitute capital for labor, and we continue to think that will be the case. Moreover, further development of AI capabilities has the potential to significantly enhance productivity growth over time, though it is clearly too early to be able to quantify the magnitude and timing of any such boost.

As for why we think faster productivity growth on a sustained basis is a must, we'll go back to our earlier point about the economy's speed limit, and we'll repeat something we've said countless times over the years, which is that the economy does not grow over time because consumption grows; consumption grows over time because the economy grows. Far too many analysts and policy makers seem to think that the measure of an economy is how much households, businesses, and governments spend, which is one reason we think last year's significant improvement on the supply side of the economy was so overlooked. With little leeway on the labor force growth portion of the equation, faster growth in labor productivity is an absolute must if the economy is to avoid being terminally stuck in the slow lane, suffering weaker growth and higher inflation with constant pressure on corporate profit margins, all of which can be alleviated by faster productivity growth. If we are correct in expecting continued strong growth in business investment in intellectual property products and stronger growth in business investment in equipment and machinery over coming quarters, faster productivity growth will ultimately follow.

Trying To Make Sense Of The Labor Market: The operative word here being "trying." Over the last several months of 2023, all signs pointed to cooling demand for labor, with a slowing trend rate of job growth, job growth becoming more and more concentrated amongst a small number of industry groups, wage growth moderating, declining job postings, and the rate at which workers were voluntarily quitting jobs settling back in line with pre-pandemic norms. To be sure, there were no straight lines here; as with most of the economic data, the labor market data often throw us curves, but the trends in the labor market data were all pointing in the same direction. Until they weren't.

As if to remind us of the general rule that in economics you seldom know what you at first think you know, along came the January employment report, showing total nonfarm employment rose by 353,000 jobs with private sector payrolls up by 317,000 jobs, while average hourly earnings rose by 0.6 percent. At the same time, the January data incorporated the annual benchmark revisions to the data on nonfarm employment, hours, and earnings, which showed job growth to be stronger and more broadly based over the latter part of 2023 than had previously been reported. The January employment report didn't just have us questioning what we thought we knew about the labor market, it had us questioning whether we actually knew anything at all about anything, while rattling the fixed-income markets and leading many analysts to change their thoughts on when the FOMC would begin cutting the Fed funds rate and how extensively they would do so.

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

Our point isn't to relitigate the relitigate the January employment report in this space. We've noted elsewhere that a low response rate to the January establishment survey calls into question how reliable the initial estimate of January job growth is, that there is ample evidence of reported January job growth being significantly bolstered by favorable seasonal adjustment, that weather effects held down job counts and hours worked in certain industry groups, and that the reported 0.6 percent jump in average hourly earnings is largely a product of the sharp decline in aggregate hours worked. Sort through all the noise, and the January employment report was still stronger than we and most others expected.

There are a few elements of the benchmark revisions, a process in which the BLS's establishment survey is benchmarked to the universe of payroll tax returns as of the previous March, we think are worth noting. This year's revisions covered the seasonally adjusted data going back to January 2019, and the revised data show that over the 2019-2023 period the economy added a total of 116,000 more nonfarm jobs than had previously been reported. Not a big difference by any means, but it is interesting that almost all of that difference is accounted for by job growth in 2022 being marked down by 265,000 jobs and job growth in 2023 being marked up by 359,000 jobs, with most of the upward revision to 2023 job growth accounted for by just two months – June and December. The benchmark revisions also show that aggregate private sector hours worked grew by less in 2023 than had been reported. If that seems at odds with the upward revision to 2023 job growth, the two can be reconciled by noting that retail trade and leisure and hospitality services – the two industry groups with far and away the lowest average weekly hours – accounted for over forth-five percent of the upward revision to 2023 job growth.

It is also worth revisiting a concern we raised over the course of 2023, which is job growth becoming increasingly concentrated amongst a small number of industry groups. To that point, the revised data show that the three industry groups which added the most jobs – health care and social services (690,400), government (688,000), leisure and hospitality services (558,000) – accounted for 72.5 percent of all nonfarm job growth in 2023. The share accounted for by the top-three industry groups in 2022 was 54.8 percent. While that jump in share may seem to validate our concerns, one point we had overlooked is that these industry groups had/have been laggards in seeing job counts return to where they were at the onset of the pandemic. Leisure and hospitality services is one of three industry groups, the other two being mining/natural resources and "other" services, in which payrolls are still below the level as of February 2020; of those industry groups in which payrolls have surpassed the level as of February 2020, the last two to do so were health care and social services (October 2022) and government (September 2023).

Think about it this way – during 2021 and 2022, when almost all industry groups were playing catch-up, it figured that job growth would be broadly based. As employment returned to/surpassed pre-pandemic levels, however, it followed that job growth would slow in most industry groups and that hiring would be increasingly accounted for by those industry groups still lagging. In that sense, the increased concentration of job growth in 2023 was less of a concern than we had believed, but this also raises the point that hiring in these three industry groups is bound to slow, perhaps soon, and when that does occur the pace of overall job growth will also slow, perhaps sharply. While it is true that the one-month hiring diffusion index, a measure of the breadth of job growth across private sector industry groups, rose to 65.6 percent in January, the highest level in a year, we're not sure how reliable that number is given the high volume of noise in the January data. This is, however, something to follow over the course of 2024.

Even if the January employment report somewhat overstates the case, it may seem as though the labor market has caught a second wind. There are, however, some caution signs to be aware of. One is that recent weeks have seen a number of layoff announcements, leading some to wonder if the labor market is on the verge of rolling over. Thus far, however, those announcements have been highly concentrated amongst the tech sector, though UPS announcing 12,000 layoffs certainly merits attention. These are two industry groups – information services and transportation and warehousing services – that saw robust hiring beginning in the early phases of the pandemic, with payrolls in transportation and warehousing surpassing its pre-pandemic peak in November 2020. That we are now seeing layoffs, or, in the case of information services, layoffs in addition to those seen in 2023, is a sign that firms in these two industry groups overestimated longer-term demand as they were hiring robustly and now are adjusting job counts accordingly. Moreover, UPS is digesting the labor contract recently signed with its delivery drivers, which significantly boosted wages amongst those workers, so job cuts amongst management and contract workers are part of that process. There have been layoff announcements in other industry groups, but thus far there have been no significant concentrations outside of the two industry groups noted here. Again, though, this is something to watch in the months ahead.

It also bears noting that the number of people working part-time for economic reasons has been drifting higher over recent months and is, as of January, at its highest since September 2021. Of this group, the number working part-time due to slack business conditions has also been drifting higher and is now higher than at any point since October 2021. Though these figures come from the household survey, they suggest firms cutting back on hours, which is consistent with the weakening trend in aggregate private sector hours worked in the establishment survey data. That the decline in aggregate hours worked in January was largely a function of unusually foul winter weather should not deflect attention away from the weakening trend that we pointed to several times over the course of 2023.

We have for some time argued that cooling demand for labor would manifest sequentially in the form of declining job vacancies, reduced hours worked, and, finally, layoffs. While the first two steps were in evidence over the course of 2023, it is too soon to know whether recent layoff announcements are industry/firm specific or are a harbinger of the third, and most consequential, manifestation of diminishing demand for labor. The weekly data on jobless claims will help answer that question.

The question we're now trying to answer is whether the January employment report truly shows the labor market being much stronger than we had thought to be the case or was just the data throwing another curve our way. We're leaning toward the latter, but with the broader economy having been much more resilient than we had anticipated, it would be foolish to rule out the former.

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

February 2024

	Q3 '23 (a)	Q4 '23 (p)	Q1 '24 (f)	Q2 '24 (f)	Q3 '24 (f)	Q4 '24 (f)	Q1 '25 (f)	Q2 '25 (f)	2021 (a)	2022 (a)	2023 (p)	2024 (f)	2025 (f)
Real GDP[1]	4.9	3.3	2.0	1.8	2.0	2.4	2.6	2.5	5.8	1.9	2.5	2.6	2.4
Real Personal Consumption[1]	3.1	2.8	2.9	2.4	2.2	2.5	2.6	2.6	8.4	2.5	2.2	2.6	2.5
Real Business Fixed Investment[1]	1.4	1.9	1.2	0.4	2.1	3.6	4.5	4.2	5.9	5.2	4.4	1.8	3.6
Equipment[1]	-4.4	1.0	-2.0	-2.2	2.4	5.7	6.4	5.9	6.4	5.2	-0.1	-0.2	4.8
Intellectual Property and Software[1]	1.8	2.1	4.4	3.0	3.6	4.4	4.6	4.6	10.4	9.1	4.3	3.2	4.4
Structures[1]	11.2	3.2	0.5	-0.4	-1.8	-2.0	0.4	0.0	-3.2	-2.1	12.7	2.6	-0.5
Real Residential Fixed Investment[1]	6.7	1.1	6.4	5.3	3.2	3.5	3.2	3.3	10.7	-9.0	-10.7	4.1	3.1
Real Government Expenditures[1]	5.8	3.3	2.7	2.7	2.4	1.3	1.1	1.3	-0.3	-0.9	4.0	3.1	1.5
Real Net Exports[2]	-930.7	-908.2	-918.9	-936.2	-955.8	-963.9	-978.8	-995.3	-933.8	-1,051.0	-925.5	-943.7	-1,003.5
Single Family Housing Starts, ths. of units[3]	967	1,042	979	1,008	1,009	1,014	1,017	1,019	1,132	1,004	943	1,002	1,020
Multi-Family Housing Starts, ths. of units[3]	403	412	396	392	384	379	375	373	474	547	472	388	373
CoreLogic House Price Index[5]	4.5	5.6	5.4	5.1	3.7	2.6	2.5	2.8	15.5	13.3	3.8	4.2	3.1
Vehicle Sales, millions of units[3]	15.7	15.7	15.6	15.8	16.1	16.3	16.5	16.6	14.9	13.8	15.5	16.0	16.6
Unemployment Rate, %[4]	3.7	3.7	3.7	3.8	3.9	4.0	4.0	4.0	5.4	3.6	3.6	3.8	4.0
Non-Farm Employment[5]	2.1	1.9	1.8	1.6	1.4	1.2	0.9	0.9	2.9	4.3	2.3	1.5	0.9
Real Disposable Personal Income[1]	0.3	2.5	3.3	2.7	2.0	3.0	3.6	2.8	3.2	-5.9	4.2	2.5	2.9
GDP Price Deflator[5]	3.2	2.6	2.1	2.4	2.3	2.5	2.7	2.6	4.6	7.1	3.6	2.3	2.6
PCE Deflator[5]	3.3	2.7	2.1	2.1	2.1	2.2	2.4	2.3	4.2	6.5	3.7	2.1	2.3
Consumer Price Index[5]	3.6	3.2	2.9	2.9	2.5	2.4	2.4	2.4	4.7	8.0	4.1	2.7	2.5
Core PCE Deflator[5]	3.8	3.2	2.4	2.1	2.2	2.3	2.4	2.4	3.6	5.2	4.1	2.2	2.4
Core Consumer Price Index[5]	4.4	4.0	3.5	2.8	2.7	2.4	2.4	2.5	3.6	6.1	4.8	2.8	2.6
Fed Funds Target Rate Range Mid-Point, %[4]	5.30	5.38	5.38	5.13	4.92	4.59	4.34	4.07	0.13	1.73	5.07	5.00	3.97
10-Year Treasury Note Yield, %[4]	4.15	4.44	4.03	4.01	4.06	4.12	4.10	4.12	1.44	2.95	3.96	4.06	4.10
30-Year Fixed Mortgage, %[4]	7.04	7.30	6.62	6.52	6.44	6.37	6.29	6.29	2.96	5.34	6.81	6.49	6.26
Current Account, % of GDP	-2.9	-3.2	-3.3	-3.2	-3.1	-3.0	-2.9	-2.9	-3.5	-3.8	-3.1	-3.2	-2.8

a = actual; f = forecast; p = preliminary

Notes: 1 - annualized percentage change 2 - chained 2017 $ 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