ECONOMIC OUTLOOK
REGIONS
April 2024

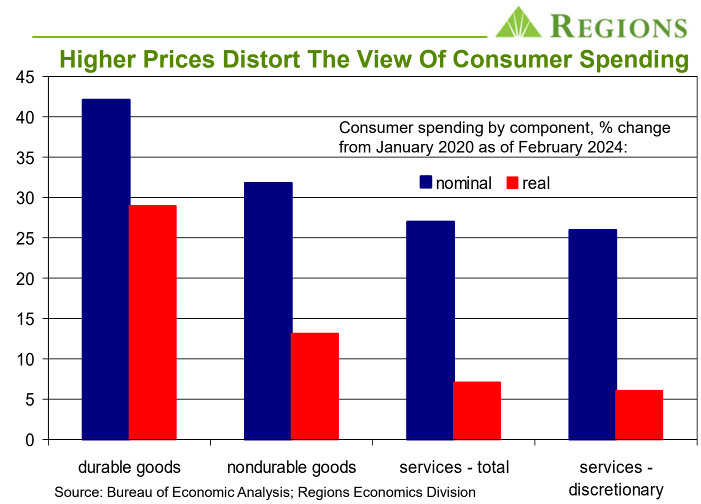
Spending More, Enjoying It Less?

One question stumping many observers over the past several months is why U.S. consumers don't feel better than they do, or at least better than implied by the various measures of consumer sentiment/confidence, particularly given the sharp deceleration in inflation after it touched a four-decade high. These measures show sentiment has been largely range-bound well below pre-pandemic levels, which is seemingly at odds with a labor market that remains notably tight and real GDP growth that has surprised to the upside. We discussed this topic in our September 2023 *Outlook* and touched on it again as part of our annual holiday sales outlook in last November's *Outlook*. This being an election year, this has, unsurprisingly, even become fodder for a political argument which basically boils down to one side arguing that things are golden but consumers either are not bright enough to recognize that or are not sufficiently grateful to acknowledge that, while the other side argues that downbeat consumer moods appropriately reflect how truly rotten things are. You can't make that stop, you can only try to hide from it.

In any event, from the first time we heard this question raised, we have pointed to the cumulative effects of higher prices, particularly for necessities such as food, shelter, and energy, over the past few years as a significant weight on household budgets and, in turn, consumer sentiment. These effects have been amplified for those households, particularly for those in the lower/lower-middle income groups, who have exhausted most, if not all, of any savings buffers they had built up on the basis of the financial transfers received as part of the fiscal policy response to the pandemic. That interest rates are meaningfully higher than had been the case prior to the onset of, and in the immediate aftermath of, the pandemic and that gasoline prices have turned sharply higher of late aren't exactly helping to brighten consumers' moods.

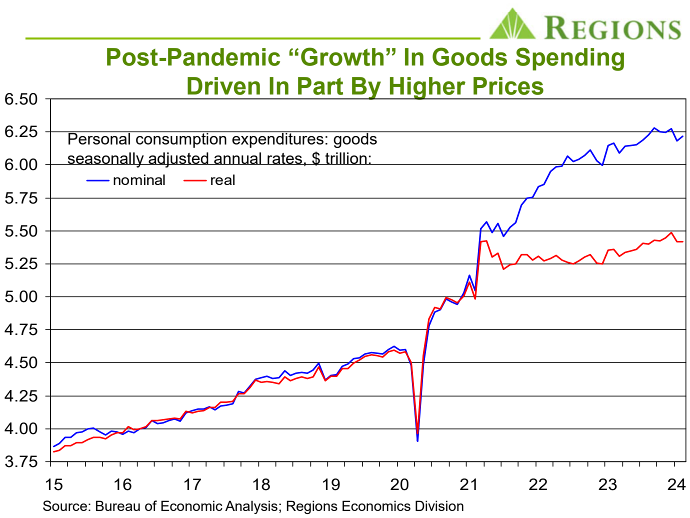
It is more than fair to ask whether part of the disconnect between consumers' moods and the marked deceleration in inflation reflects a disconnect between what is being measured by the inflation gauges and consumers' actual spending patterns. After all, the Consumer Price Index (CPI) measures changes in the cost of a specific basket of goods and services, and while that basket and the weights attached to each individual item are determined by surveys of consumer expenditure patterns, unless one actually purchases that basket, and in the same proportions, the CPI isn't necessarily a meaningful gauge of the change in costs of goods and services experienced by any given consumer. This leaves aside the question of how accurately the CPI, or the PCE Deflator for that matter, measure changes in costs. Anyone who has seen an annual increase of four-to-five times as much will think the 4.1 percent annual increase in homeowners' insurance premiums reported in the February CPI data to be more than a little funny, though not at all in a humorous sort of way.

Aside from these issues, we think there is an even bigger, not to mention seemingly obvious, distinction being missed by those confused by consumers not feeling better than they do, which is that lower inflation does not mean that prices are falling, it simply means prices are rising at a slower rate. So, in that sense, given the cumulative increases in prices seen since the onset of the pandemic, particularly prices for necessities, that prices are now rising by "just" 3.2 percent – the over-the-year change in the CPI as of the February data – isn't exactly cause for celebration.



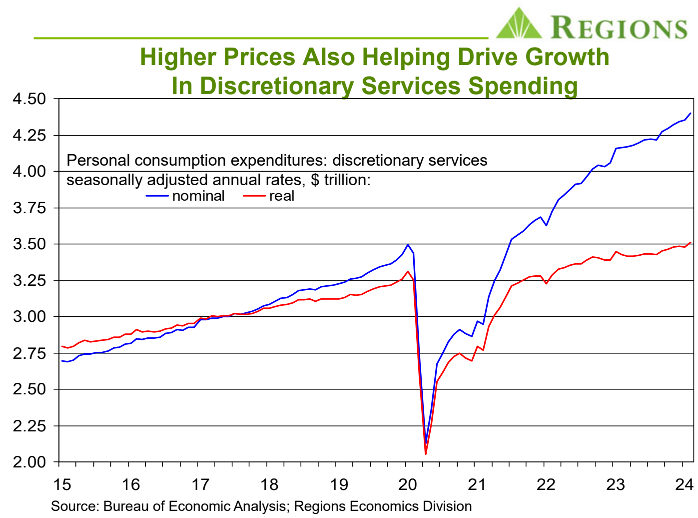
The chart above, based on the monthly data on personal income and spending from the Bureau of Economic Analysis (BEA), helps illustrate our point about cumulative price changes. The chart shows the level of spending on the three main components of consumer spending – consumer durable goods, nondurable goods, and services – in February 2024 indexed to the level as of January 2020. The blue bars show spending on a nominal basis, i.e., not adjusted for price changes, and the red bars show spending on a real basis, i.e., adjusted for price changes. For instance, as of February (the latest available data point), nominal spending on nondurable consumer goods was 31.7 percent higher than the level as of January 2020, but after accounting for higher prices spending was just 13.2 percent higher. We also highlight spending on discretionary consumer services (services excluding housing, utilities, health care, and financial services), as this remains one of the strongest segments of overall consumer spending. But, to some extent, this "strength" reflects the effects of higher prices; while nominal spending is 25.9 percent above the level as of January 2020, spending on discretionary services is only 6.0 percent higher after adjusting for higher prices.

Obviously, these are broad categories, and within each there will have been divergences in the behavior of prices. And, it's worth noting that the blue bars reflect the view from the perspective of sellers of goods and providers of services, i.e., growth in sales revenue. The wide gaps between the blue and red bars, however, better reflect the frustrations being felt by many consumers stemming from the cumulative increases in prices of goods and services seen over the past three years.



The chart above not only illustrates the degree to which prices for consumer goods have risen over the past few years but also helps highlight how out of line this has been with the experiences of the several years prior to the pandemic. The blue line shows the level of nominal spending on goods, reported at annual rates by the BEA in their monthly data, while the red line shows the level of real spending on goods. Note that while prices for goods rose sharply in 2021 (up 4.9 percent for the year as a whole) and 2022 (up 8.6 percent for the year as a whole), real spending on goods was basically flat over this same period. It wasn't until the second quarter of 2023, when goods prices began falling, that real goods spending began to trend higher again. You can also see that prices for consumer goods were flat to lower over the several years prior to the pandemic, as evidenced by the red and blue lines being basically right on top of each other over this entire period. As a side note, you can see the effects of the three rounds of Economic Impact Payments – March 2020, December 2020, and March 2021 – in the above chart, as evidenced in the spikes in both real and nominal spending on consumer goods in these months.

More recently, higher interest rates have compounded the effects of higher prices of consumer durable goods such as appliances, furniture, motor vehicles, and other long-lasting goods, purchases which tend to be financed. The combination of higher prices and higher financing costs has left many consumers feeling as though such purchases are out of reach, a frustration which may be seeping into the monthly confidence/sentiment surveys. It could be that spending on consumer durable goods has become more concentrated amongst consumers in the higher ranges of the income distribution. It seems likely that this is the case with consumer spending on discretionary services such as travel, tourism, entertainment, recreation, and dining out. As was noted above, this has been one of the strongest segments of overall consumer spending which, at least to us, has been somewhat of a surprise as we had expected that discretionary services spending would soften at the end of last summer. Either way, we can make the same point here as we made with spending on goods, which is that higher prices have been a key factor in the "growth" in spending on discretionary consumer services. One difference here, as seen in the following chart, is that even after accounting for the effects of higher prices, spending on discretionary services began to trend higher in 2021 as the services sector began to come back online after pandemic-related shutdowns. With so much spending having been diverted to the goods sector in 2020 and early-2021, services spending began to capture an increasing share of total consumer spending, a shift which is still taking place.



Though maybe not the only reason, we can't help but think that consumers feeling the financial stress of a prolonged period of rising prices helps account for why consumers don't feel better than they do. It is also reasonable to think that these stresses are being felt most acutely amongst lower-income households who have largely, or fully, exhausted whatever financial buffers they had built up with the help of pandemic-related transfers. To that point, the University of Michigan's monthly survey of consumer sentiment shows that while consumers across all income buckets have a much less favorable view of economic conditions than they did prior to the pandemic, those in the bottom third of the income distribution have a much less favorable view than those in the upper two-thirds. And, while we know that growth in aggregate private sector wage and salary earnings has outpaced inflation over this entire period of elevated inflation, more than one-third of all households say high prices are eroding their living standards, with those in the lowest income group much less likely to expect gains in real (inflation-adjusted) income in the year ahead. So, while things are clearly not terrible, there are pockets of financial stress, which is something we've been pointing out for some time now. What remains to be seen is whether these pockets of stress will ease for those households currently most impacted, or whether these pockets of stress will expand and envelop a wider swath of U.S. households.

Inflation: Higher For Longer?

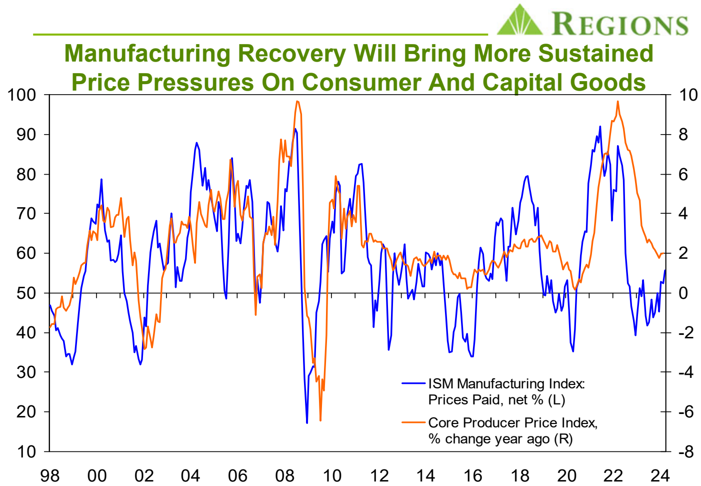
To some extent, the answer to the question raised at the end of the prior section will depend on the path of inflation going forward. Coming into this year, many expected inflation would continue to decelerate as it did during 2023, which we also expected would be the case even though we expected inflation to still be above the FOMC's 2.0 percent target rate at year-end 2024. Our premise was that while prices of core consumer goods would not continue to fall as they did over the latter months of 2023, they would be more or less flat and, as such, be a largely neutral factor in the path of overall inflation, with deceleration in core services inflation being the primary factor behind overall inflation slowing further. With the first quarter of 2024 now behind us, the outlook for inflation seems much less clear-cut than it did when the year began.

With core CPI inflation coming in hotter than many anticipated in both January and February, it didn't take long for the premise of further deceleration in inflation in 2024 to be called into question. Mindful that residual seasonality in the inflation data for January and, to a lesser degree, February has been an issue, our forecasts for core CPI inflation in each month were above consensus. As such, we thought little of core CPI inflation topping the consensus forecast in January, as there were few other signs of anything more than amped-up seasonal noise. But, despite our forecast of the February core CPI being above consensus, by the time the data were released we saw plenty of cause for concern.

For instance, after having fallen to their lowest point since June 2021 in the middle of the month, retail gasoline prices began to rise over the back half of January and rose steadily through February. That increase coincided with, but was not fully caused by, crude oil prices beginning to rise steadily. At the same time, prices of imported consumer goods excluding food jumped, and the prices paid component of the ISM Manufacturing Index rose above the 50.0 percent mark, indicating firms were paying higher prices for non-labor inputs. As these data points came in through the month of February, we began to question whether inflation would cooperate with forecasts anticipating further deceleration over the course of this year. As evidenced in market pricing of the path of the Fed funds rate, market participants are entertaining the same doubts, with markets pricing in fewer than three twenty-five basis point funds rate cuts by year-end as we write this.

In early-April remarks at Stanford University, Fed Chair Powell noted that it was too soon to know whether higher than expected inflation over the first two months of this year was "more than just a bump." While we don't disagree with that assessment, we do see reasons to think the higher inflation prints are more than just bumps on the path downward. Both crude oil prices and retail gasoline prices have continued to push higher. While ongoing tensions in the Middle East have injected a risk premium into crude oil prices, it also seems that OPEC has gotten firmer control over production which, if global economic growth is firming as seems to be the case, could sustain higher prices that will in turn help sustain higher retail gasoline prices. To the extent that is the case, it will result in steady upward pressure on headline inflation, moving it further away from, rather than closer toward, the FOMC's 2.0 percent target rate.

Some will argue that the FOMC would look past any increase in headline inflation caused by rising gasoline prices, but that would only be the case if there are signs that core inflation is slowing, if even then. That, however, is far from a done deal. The ISM's monthly surveys of the manufacturing sector have now shown three straight months of rising prices for non-labor inputs and, perhaps more significantly, the underlying details show input price pressures becoming more broadly based across the manufacturing sector. One reason we pay attention to this is that rising prices for non-labor inputs are a harbinger of upward pressure on goods prices, whether capital goods or consumer goods. As such, this calls into question our premise that goods prices would be more or less a neutral factor in the path of overall inflation in 2024.



Source: Institute for Supply Management®; Bureau of Labor Statistics; Regions Economics Division

To some extent, the recent upward movement in the ISM's prices paid index in the manufacturing survey mirrors the firming in commodity prices we began pointing to back in February as an early warning sign of building upward pressure on goods prices. At the same time, higher global shipping costs are being reflected in prices coming in (commodity prices) and prices going out (goods prices), adding to inflation pressures. And, while reads on inflation pressures in the broad services sector continue to be clouded by measurement issues tied to rents, price pressures on core services excluding shelter have proven to be surprisingly persistent and remain the single biggest pocket of overall inflation pressures.

So, all of this may ultimately amount to no more than a bump, but, you'd have to admit, that'd be one heck of a bump. Several FOMC members have adopted a more guarded tone of late, which for some is along the lines of "rate cuts are still likely this year, but we're in no hurry" and which for others is along the lines of "we may not cut the funds rate at all this year." To be sure, that the labor market and the broader economy are holding up as well as they are in the face of elevated interest rates gives the FOMC latitude to be patient. After all, what the FOMC strongly wishes to avoid is having to reverse course, specifically, cutting the funds rate only to subsequently see inflation reaccelerate to the point that rate hikes may be warranted. At the same time, the FOMC also wants to avoid keeping the funds rate too high for too long. To the extent inflation does slow further in the months ahead, absent rate cuts monetary policy would effectively become more restrictive via a rising real Fed funds rate, which at present is above anyone's estimate of what the neutral real funds rate would be. This is a topic we discussed in last month's edition.

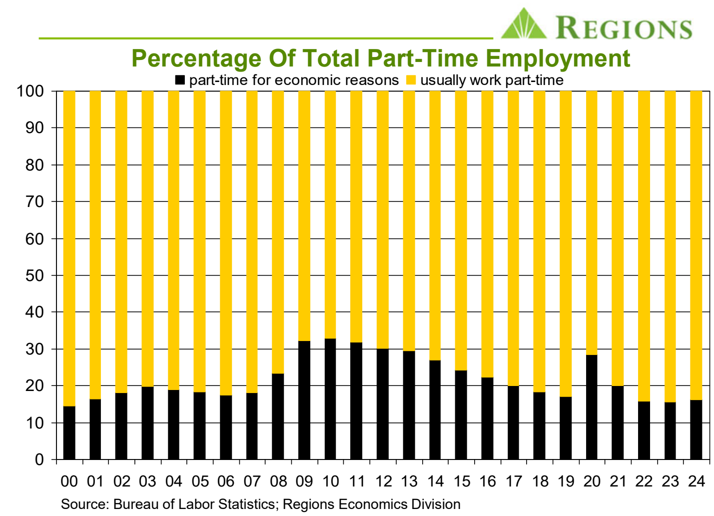
Market participants have significantly scaled back expectations of the extent of Fed funds rate cuts likely to be implemented by year-end. Whereas at year-end 2023 market pricing implied six twenty-five basis point cuts in the Fed funds rate by year-end 2023, current pricing implies fewer than three full cuts. However grudgingly, market participants seem to have come to terms with the premise of fewer rate cuts starting later than had previously been anticipated. We think it useful to remind people that fewer, or no, funds rate cuts this year would not be a death knell for the economy. Indeed, we often point out that the lack of rate cuts can be looked at in two different ways. One is disappointment over the lack of rate cuts, as though that in and of itself means economic growth and profit growth come to a screeching halt; the other is seeing the lack of rate cuts as a sign that the labor market and the broader economy remain resilient and that perhaps monetary policy is less restrictive than many have thought to be the case. Moreover, broad measures of financial conditions continue to show easing conditions despite the absence to date of funds rate cuts, which supports the argument that the FOMC can stand pat.

Not to say there are not potential pockets of pain should interest rates remain elevated, such as certain segments of commercial real estate, the significant volume of debt in the nonfinancial corporate sector coming due for refinancing in the quarters ahead, and the for-sale segment of the housing market. But, households and businesses will adapt should interest rates settle in where they now are. For instance, firms which have had capital spending plans on hold will ultimately have to decide whether to abandon them or whether they can still be profitable at a higher financing rate, with the latter case becoming more plausible as the economy continues to grow and create jobs. We think it also useful to note that higher interest rates should bring more discipline to the allocation of capital, a discipline that wasn't necessarily there, or at least not to the same degree, with interest rates having been held down at artificially low levels for a prolonged period.

While we do expect inflation to slow further over the remainder of this year, the path may be bumpier and longer than many others are anticipating. Moreover, we continue to question whether 2.0 is still a viable target rate of inflation for the FOMC and other central banks, a point we first raised all the way back in 2018. As such, it seems more reasonable to expect fewer, rather than more, Fed funds rate cuts and a higher, rather than lower, terminal funds rate than many came into this year expecting. And, to anyone still clamoring for more rate cuts, we'd offer some time-tested advice: careful what you wish for. After all, the set of conditions that would warrant a large number of Fed funds rate cuts by year-end 2024 are probably not conditions you actually want to see develop.

MarchEmployment Report

Total nonfarm employment rose by 303,000 jobs in March, once again handily beating expectations. In a break with a long-running pattern, estimates of job growth over the prior two months were revised up by a net 22,000 jobs, with the modest upward revision (+4,000) to prior estimates of private sector job growth only the second time in the past fourteen months the revision has been upward rather than downward. One long-running pattern that, unfortunately, still has not changed is that the initial response rates to the BLS's monthly establishment survey remain so low that it calls into question the reliability of the initial estimates of job growth in any given month. That was again the case with the March survey; at 65.0 percent, the March response rate is far below pre-pandemic norms and also below a notably low post-pandemic average. We'll also note that there is evidence that the March headline job growth number was flattered by seasonal adjustment. The not seasonally adjusted data show total nonfarm employment rose by 0.42 percent in March, easily below the typical March increase, yet the seasonally adjusted data show the largest monthly increase in nonfarm payrolls since last May. That said, we will repeat what we have said for the past several months, which is that filtering through what remains a high volume of noise in the data still shows a labor market that remains tight, and while the trend rate of job growth is slowing, we see nothing in the data that suggests a labor market on the verge of rolling over.



We also see nothing in the data that supports a narrative that has become increasingly common over the past several months, which is that while employment is rising rapidly, job growth is being driven by part-time employment, with many people so strapped for cash by high inflation that they have to string together multiple part-time jobs just to barely make ends meet. If nothing else, this is yet another illustration of what is apparently a general rule that actually being valid is not a prerequisite for a narrative taking hold and being repeated as though it is gospel. We know from the data from the BLS's household survey that, as of Q1 2024, 16.63 percent of those employed in nonagricultural industries worked par-time, a share slightly higher than in Q4 2019 but easily below the 17.50 percent average over the 2000-2019 period. Moreover, as the above chart shows, the vast majority of those working part-time typically work part-time, as opposed to involuntarily working part-time due to economic reasons. At 83.7 percent as of Q1 2024, the share who typically work part-time is right in line with the share typically seen during mature expansions. From the chart, one can see that the share of those working part-time for economic reasons typically rises in times of recession and stays elevated during the early phases of the recovery in the broader economy, which was the case around the 2001 and the 2007-09 recessions as well as around the pandemic-related downturn in 2020. That share has risen only marginally over the past several months

To that point, within the "part-time for economic reasons" bucket there is a sub-grouping – those involuntarily working part-time due to slack business conditions. We have been tracking this metric carefully, and often highlight it in our write-ups of the monthly employment reports, as a significant, sustained increase would be a clear sign of something being amiss in the broader economy. Thus far, there are no such signals being sent by this metric, however popular the narrative to the contrary may be.

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REGIONS

April 2024

Q3 '23 (a)	Q4 '23 (a)	Q1 '24 (f)	Q2 '24 (f)	Q3 '24 (f)	Q4 '24 (f)	Q1 '25 (f)	Q2 '25 (f)		2021 (a)	2022 (a)	2023 (a)	2024 (f)	2025 (f)
4.9	3.4	1.8	2.0	2.2	2.4	2.4	2.3	Real GDP[1]	5.8	1.9	2.5	2.6	2.3
3.1	3.3	2.3	2.1	2.1	2.1	2.2	2.1	Real Personal Consumption[1]	8.4	2.5	2.2	2.4	2.2
1.4	3.7	2.8	1.2	3.0	3.6	4.0	3.8	Real Business Fixed Investment[1]	5.9	5.2	4.5	2.8	3.5
-4.4	-1.1	1.9	-1.2	2.7	3.4	4.1	4.4	Equipment[1]	6.4	5.2	-0.3	0.5	3.5
1.8	4.3	4.1	3.4	3.7	4.4	4.6	4.6	Intellectual Property and Software[1]	10.4	9.1	4.5	3.6	4.4
11.2	10.9	1.7	0.7	2.0	2.2	2.4	0.9	Structures[1]	-3.2	-2.1	13.2	5.2	1.5
6.7	2.8	10.9	5.2	3.3	2.2	3.8	2.7	Real Residential Fixed Investment[1]	10.7	-9.0	-10.6	5.4	2.8
5.8	4.6	1.4	2.1	1.9	2.3	1.8	1.7	Real Government Expenditures[1]	-0.3	-0.9	4.1	2.9	1.8
-930.7	-918.5	-957.8	-953.7	-957.6	-963.6	-976.5	-977.8	Real Net Exports[2]	-933.8	-1,051.0	-928.1	-958.2	-982.3
967	1,055	1,061	1,010	1,007	1,010	1,009	1,009	Single Family Housing Starts, ths. of units[3]	1,132	1,004	946	1,022	1,010
403	430	384	388	378	376	372	369	Multi-Family Housing Starts, ths. of units[3]	474	547	476	381	369
4.5	5.5	5.4	4.8	3.3	2.4	2.2	2.6	CoreLogic House Price Index[5]	15.4	13.3	3.8	3.9	2.9
15.7	15.7	15.4	15.6	15.8	15.9	16.0	16.1	Vehicle Sales, millions of units[3]	14.9	13.8	15.5	15.7	16.2
3.7	3.7	3.8	3.8	3.9	4.0	4.0	4.1	Unemployment Rate, %[4]	5.4	3.6	3.6	3.9	4.1
2.1	1.9	1.8	1.7	1.6	1.5	1.2	1.0	Non-Farm Employment[5]	2.9	4.3	2.3	1.7	1.0
0.5	2.0	1.4	2.4	2.7	2.6	3.2	2.5	Real Disposable Personal Income[1]	3.2	-5.9	4.2	1.9	2.8
3.2	2.6	2.4	2.7	2.6	2.8	2.7	2.5	GDP Price Deflator[5]	4.6	7.1	3.6	2.6	2.5
3.3	2.8	2.5	2.7	2.7	2.9	2.7	2.5	PCE Deflator[5]	4.2	6.5	3.7	2.7	2.4
3.6	3.2	3.2	3.5	3.3	3.3	3.0	2.6	Consumer Price Index[5]	4.7	8.0	4.1	3.3	2.6
3.8	3.2	2.8	2.5	2.6	2.8	2.5	2.5	Core PCE Deflator[5]	3.6	5.2	4.1	2.7	2.4
4.4	4.0	3.8	3.4	3.4	3.2	2.8	2.7	Core Consumer Price Index[5]	3.6	6.2	4.8	3.4	2.7
5.30	5.38	5.38	5.38	5.34	5.09	4.84	4.57	Fed Funds Target Rate Range Mid-Point, %[4]	0.13	1.73	5.07	5.29	4.45
4.15	4.44	4.16	4.33	4.33	4.26	4.19	4.16	10-Year Treasury Note Yield, %[4]	1.44	2.95	3.96	4.27	4.18
7.04	7.30	6.75	6.82	6.74	6.61	6.49	6.42	30-Year Fixed Mortgage, %[4]	2.96	5.34	6.81	6.73	6.43
-2.8	-2.8	-3.3	-3.2	-3.1	-3.0	-2.9	-2.9	Current Account, % of GDP	-3.5	-3.8	-3.0	-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

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