

ECONOMIC UPDATE

REGIONS

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Data Summary: Q3 Real GDP; October-November Personal Income/Spending

Revised and more complete source data show **real GDP** grew at an annual rate of 4.4 percent in Q3 2025, matching our above-consensus forecast and up slightly from the initial estimate of 4.3 percent growth. Growth in business fixed investment was revised modestly higher and the draw in nonfarm business inventories was a bit smaller than was first reported, while faster growth in U.S. exports and a smaller decline in imports into the U.S. left the original estimate of the trade deficit largely unchanged. Real consumer spending grew at an annual rate of 3.5 percent, matching the original estimate despite some minor shifts in the composition of spending. That the revisions to the prior estimate of Q3 GDP are so modest basically reflects the BEA having combined the first two estimates into one due to disruptions in the flow of data caused by the government shutdown; in any given quarter, the revisions between the BEA's first and second estimates of GDP can be sizable while the revisions between the second and third estimates tend to be modest.

Real private domestic demand, i.e., combined household and business spending adjusted for price changes, grew at an annual rate of 2.9 percent in Q3, while real Gross Domestic Income (GDI) grew at a 2.4 percent rate. We typically point to the changes in real private domestic demand as a better gauge of the underlying health of the economy than real GDP, and when growth in real GDP and real GDI diverge, as has been the case over the past few quarters, the data tend to ultimately tend to wind up closer to where real GDI was. We make these points to illustrate the extent to which wide swings in net exports and business inventories drove top-line real GDP growth over the first three quarters of 2025, which can be seen in our first chart below. These swings mainly reflected both households and businesses adjusting behavior in anticipation of and then in reaction to changes in U.S. tariff rates. While an oddity in the data on imports of prescription drugs could lead to net exports making an outsized contribution to Q4 real GDP growth, we don't expect such wide swings in inventories and net exports over the course of 2026, which would in turn mean a smoother quarterly real GDP growth profile.

Using the GDP measure of profits most consistent with the S&P measure, before-tax profits rose by 6.4 percent in Q3 while after-tax profits rose by 7.0 percent, which yielded year-on-year increases of 3.9 percent and 4.2 percent, respectively. Though having narrowed a bit from those seen

over the past few years, corporate profit margins nonetheless remain significantly elevated relative to historical norms, which has helped fuel further accumulation of cash on corporate balance sheets. This is one thing we've been pointing to as allowing firms to absorb, at least for a time, higher tariff costs while continuing to engage in capital spending and not ramping up layoffs. We've also argued that the changes in the corporate tax code enacted last summer would further boost cash flows and support further growth in capital spending which, in turn, will help sustain the acceleration in labor productivity growth seen over the past several quarters. Healthy corporate cash flows have been a key, albeit overlooked, buffer in a more uncertain operating environment, and if we're correct in our outlook for revenue growth and labor productivity growth, profits and cash flows should post healthy gains in 2026.

Total **personal income** rose by 0.1 percent in October and 0.3 percent in November, the data having been delayed by the government shutdown. Note that October income growth took a hit from a 0.7 percent decline in public sector wage and salary earnings, reflecting the impact of the government shutdown, and a sharp drop in dividend income also weighed on October income growth. Growth in private sector wage and salary earnings, far and away the largest block of total personal income, held up despite slower and more uneven job growth and continues to run ahead of inflation. Total **personal spending** rose by 0.5 percent in both October and November which, after accounting for price changes, yields 0.3 percent increases in each month. As of November, Q4 growth in real consumer spending was tracking at an annual rate of 2.5 percent, slower than Q3 growth but matching Q2's pace. Our proxy for discretionary services spending softened a bit over the first two months of Q4, while growth in spending on nondurable consumer goods also slowed.

Growth in real consumer spending settling into a slower pace is in line with what we've been expecting. Spending patterns in 2025 were disrupted by higher tariffs, disruptions in income, and the cumulative effect of price increases, the latter of which has been a source of rising financial stress amongst lower-to-middle income households. This quarter will see a sizable boost in after-tax personal income, which will help alleviate this stress. The biggest risks to our forecast of growth in consumer spending are rising layoffs and a sharp decline in equity prices.

