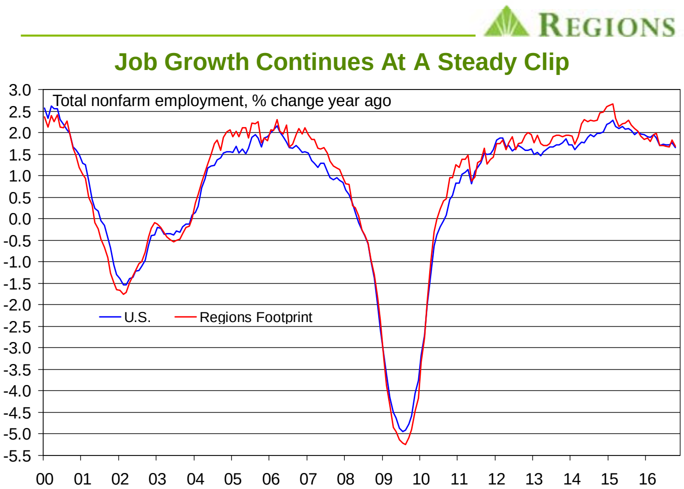
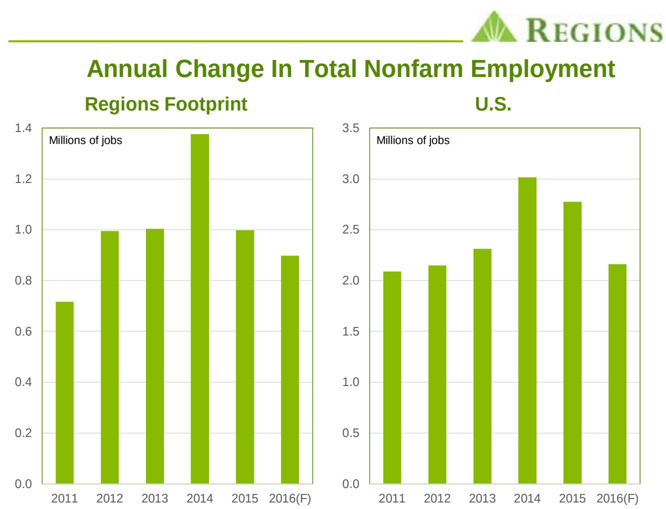
ECONOMIC UPDATE
REGIONS
December 2016

Update On Labor Market Conditions: Regions Footprint

As we get ready to close the books on 2016 and look ahead to 2017 we thought this would be a good time to summarize some of the main trends in labor market conditions across the Regions footprint in 2016. To be sure, with the 15-state footprint accounting for just under 40 percent of total nonfarm employment for the U.S. as a whole, it will come as no surprise when we say trends in the footprint look very much like those seen nationally. For instance, on a year-to-date basis through October total nonfarm employment had risen by 1.8 percent for the 15-state footprint and 1.8 percent nationally, However, as we frequently note, there is a great deal of variation within the footprint as we look across states and across metro areas. What follows is a summary of what we see within the footprint. One caveat is the numbers discussed herein are based on preliminary data which will over coming months go through the annual benchmark revision process, the results of which will be available on the state level in February 2017 and on the metro area level in March 2017. Experience tells us the benchmark revisions may alter the absolute numbers cited below but are unlikely to alter the broader trends apparent in the preliminary data.



Source: Bureau of Labor Statistics; Regions Economics Division



Source: Bureau of Labor Statistics; Regions Economics Division

As seen in the charts above, the rate of job growth in the Regions footprint remains on par with that for the U.S. as a whole. For both the footprint and the U.S. as a whole, however, 2016 is on course to mark the second consecutive year in which the number of jobs added is less than the prior year. The Regions footprint was on course to add just over 898,000 jobs in 2016, based on the year-to-date total through October, compared to the 1.376 million jobs added in 2014; the U.S. was on course to add around 2.148 million jobs in 2016, compared to the 3.015 million jobs added in 2014. With both the raw number of jobs and the rate of job growth slowing, it is natural to question whether this reflects the deceleration in job growth typically seen late in a typical business cycle or whether it reflects some other factor(s). For instance, it could be that firms are having a harder and harder time finding skilled labor, hence the slowdown in the pace of hiring. While this may be true of some industry groups, it is not generally the case across all industry groups. It is true that, as an expansion matures and the labor market approaches full employment, firms face increasingly binding labor supply constraints. Whether, or to what extent, that is true of the current cycle is a matter of debate. Our view is there is much more slack in the labor market than is implied by the headline unemployment rate, both for the U.S. as a whole and for the Regions footprint, and that overall patterns in job growth reflect the patterns of broader economic growth.

It is worth noting that the Regions footprint saw a much more rapid deceleration in job growth in 2015 than was true for the U.S. as a whole, but the slowdown in job growth in 2016 has been much less pronounced in the footprint than for the U.S. as a whole. We believe this reflects the impact of the energy sector which has accounted for a larger share of employment in the Regions footprint than has been the case nationally, even if most of that exposure is concentrated in Louisiana and Texas. Keep in mind that it was November 2014

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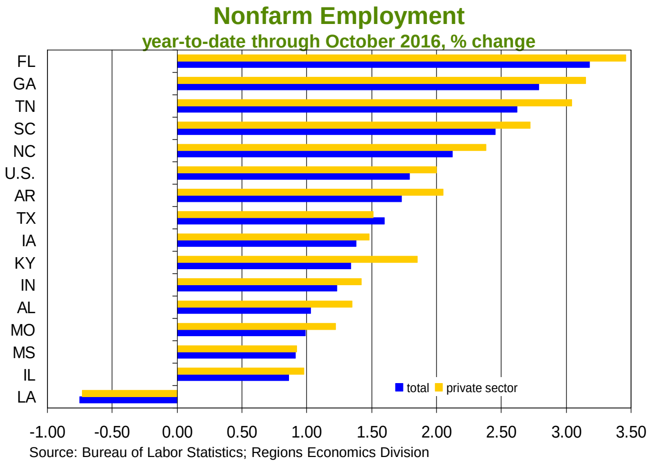
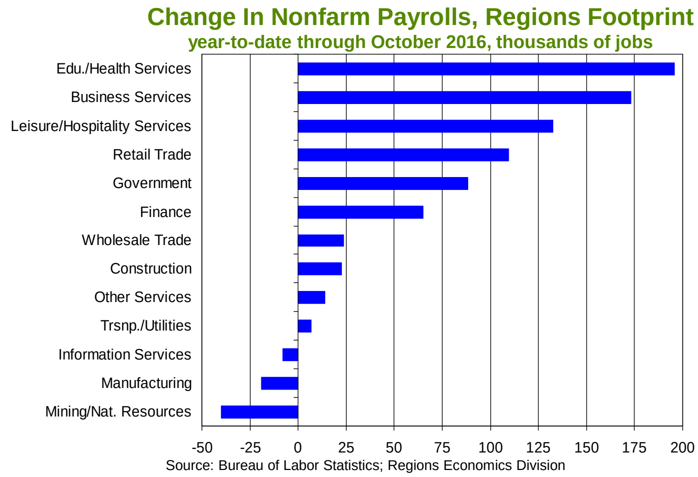
that crude oil prices began a precipitous decline from which they have not fully recovered. That rocked domestic producers, who began cutting payrolls and investment outlays sharply in 2015. In 2015, payrolls in the *Mining & Natural Resources* industry group, which captures energy exploration and production jobs, fell by 84,800 jobs in the Regions footprint (Louisiana and Texas accounted for 76,100 of these job losses), while employment in energy-related categories such as manufacturing of mining equipment and construction of energy platforms, also suffered. Again, with the footprint having an above-average exposure to energy, these job losses were felt more acutely within the Regions footprint in 2015, as reflected in the more pronounced slowdown in overall job growth within the footprint. Overall job growth in the footprint slowed from 2.6 percent in 2014 to 1.8 percent in 2015, while for the U.S. as a whole job growth slowed from 2.2 percent in 2014 to 2.0 percent in 2015. Still, over the two-year period this has been pretty much of a wash as job growth in the footprint is again on par with that of the U.S. as a whole.





While energy related job losses have abated over recent months, payrolls in Mining & Natural Resources will post a sizeable decline for 2016 as a whole and this will be reflected in a drop, on an annual average basis, in total nonfarm employment in Louisiana. Florida is on course to post the fastest job growth in the Regions footprint for a second consecutive year. Note that with the exception of Texas, private sector job growth is again easily outpacing job growth in the public sector, though the government sector has gone from being an outright drag on job growth through 2013 to being an increasingly firm support to overall job growth and is on course to contribute more than 100,000 jobs to overall job growth in the footprint in 2016.

The chart to the right above shows the year-to-date change (through October) in employment broken out by industry for the Regions footprint as a whole. Health care, business services, leisure & hospitality services, and retail trade remain the key drivers of overall job growth with, as noted above, a more substantial contribution by the government sector this year. While we by no means intend to downplay job growth from any source, we will point out that the composition of job growth within the footprint, as illustrated in the above chart, has less favorable implications for income growth than is true of the U.S. as a whole, where the mix of job growth is somewhat different. For instance, jobs within leisure & hospitality services and retail trade come with average workweeks that lead them to be classified as part-time, rather than full-time, jobs while at the same time hourly earnings in these industry groups are well below average. True, this gap has narrowed over the past few quarters, but nonetheless persists. Thus, a significant concentration of jobs in these industries can act as a drag on growth in aggregate wage and salary earnings even in a state in which job growth is above average.

At the other end of the spectrum, the three industry groups in which average earnings are amongst the highest – mining & natural resources, manufacturing, and information services – are on course to see employment declines for 2016, while payrolls in utilities, which also boasts well above-average earnings, will basically be flat. As noted above, energy related job losses have abated in recent months and the prospect of at least nominally higher crude oil prices in 2017 raises the possibility of at least limited hiring in this industry group, while recent months have also seen signs that conditions in the manufacturing sector are stabilizing. But, it is unlikely that either will be a significant support for overall job growth in 2017, particularly given the dual dark clouds of a stronger U.S. dollar and the possibility of trade disputes that bite into U.S. exports loom over the factory sector as we head into 2017. Growth in construction employment has slowed sharply in 2016, both nationally and within the Regions footprint. Over the past several years residential construction has been plagued by labor shortages, and those shortages seem to have become more acute in 2016. It is also worth noting that residential construction activity remains fairly uneven across the Regions footprint. For instance, the larger Florida metro areas, Texas, and larger

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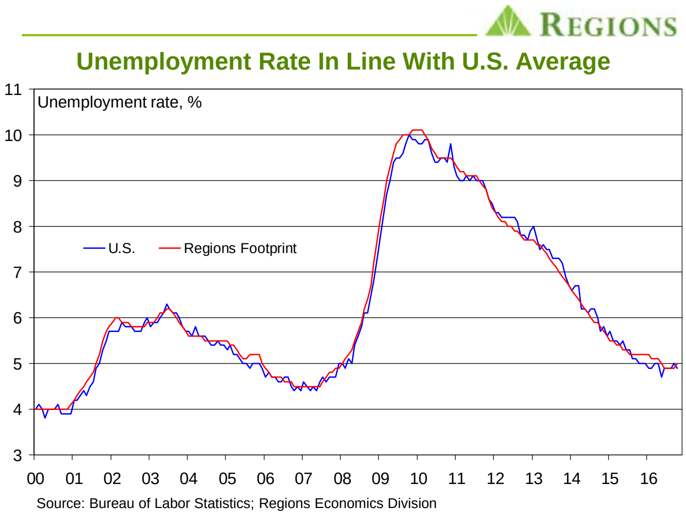
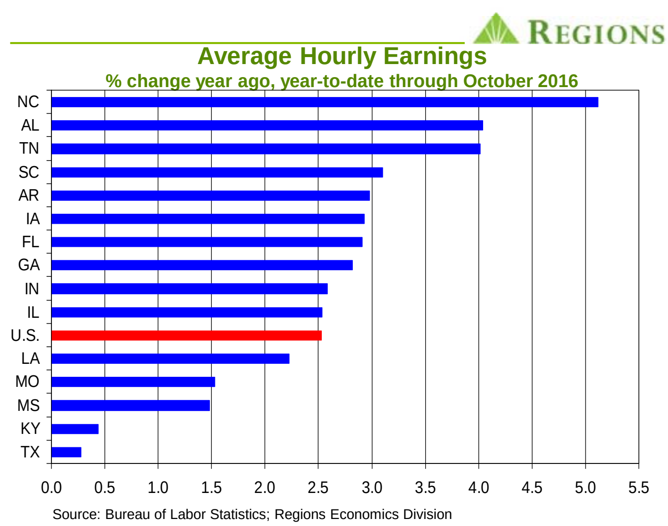
metro areas such as Atlanta and Nashville, continue to see steady growth in residential construction but other parts of the footprint, primarily the smaller metro areas with less favorable demographic trends, are seeing little growth in residential construction, meaning construction will have contributed little, if anything, to overall job growth in 2016. This is a prime illustration of our point about there being differences between the footprint as a whole and the individual states/metro areas that make up the footprint.

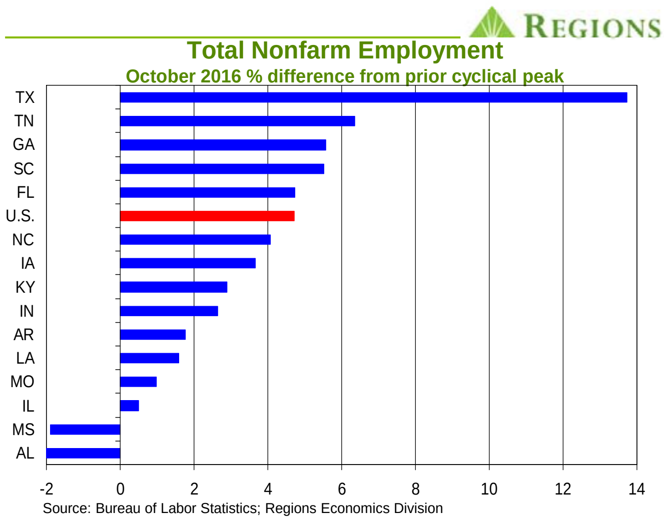


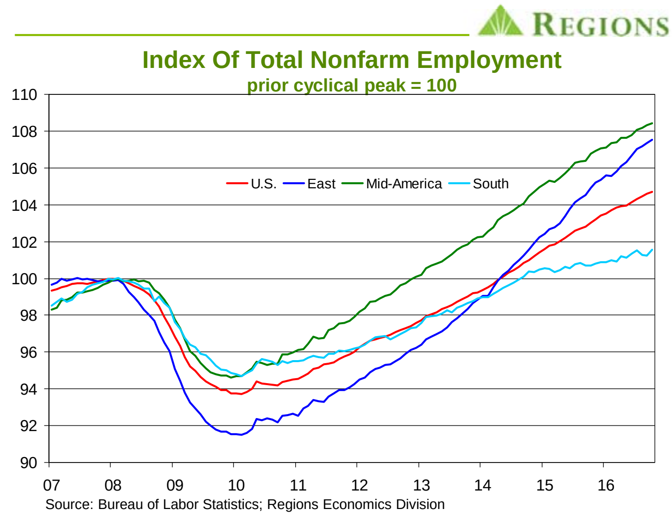
The unemployment rate for the Regions footprint remains in line with the national average, as seen in the chart to the side (note that while we know the national unemployment rate fell to 4.6 percent in November we do not yet have the state level data). We will note that the footprint has seen faster growth in both the labor force and household employment than has been the case for the U.S. as a whole over the course of 2016 even though there has been little difference in the movement of the unemployment rates. Within the footprint, Arkansas, Tennessee, and South Carolina have seen the largest declines in the unemployment rate thus far in 2016 while Texas has seen a slight uptick in its unemployment rate on a year-to-date basis. Louisiana's unemployment rate remains above six percent, reflecting the ongoing struggles of the energy industry, and Mississippi's unemployment rate, while below that of 2015, is also likely to top six percent for full-year 2016.

To our earlier point that there is more labor market slack than implied by the headline unemployment rate, that will be reflected in growth in average hourly earnings remaining well below the rate that would be associated with full employment. This is true for both the U.S. as a whole and for the Regions footprint. The chart to the side shows, again on a year-to-date basis through October, growth in average hourly earnings for all private sector workers. The first point we'll make here is base effects matter – in other words, the states in the footprint in which hourly earnings are growing at the fastest rate thus far in 2016 are pretty much those in which hourly earnings grew the slowest in 2015, particularly Alabama, North Carolina, and Tennessee. We think it more relevant to look at performance over the past several years, and for the 2010-2016 period Georgia has posted the most consistent growth in average hourly earnings of any state in the Regions footprint. While to some extent this reflects the dominant Atlanta metro area, Georgia has nonetheless posted consistent and broad based job growth across the private sector. Other states have exhibited dependence on only a few industry groups or, as is the case with Florida, have above-average concentrations of jobs in low wage, low hours, industries which has weighed on growth in overall hourly earnings. We'll also note that, with the exception of Illinois, the level of average hourly earnings in each state in the Regions footprint is lower than the U.S. average.

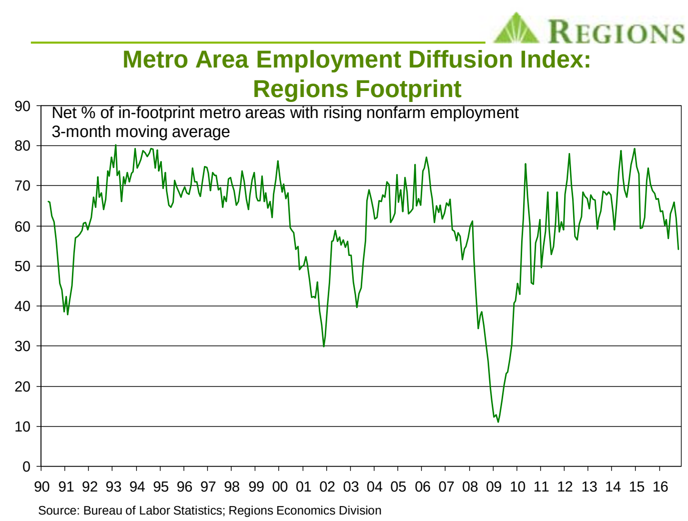


One marker which we have frequently pointed to over the past few years is the relationship between the current level of total nonfarm employment and the pre-recession peak. Some states, most notably Texas, saw employment breeze past that pre-recession peak some time ago, while others – Alabama and Mississippi – have yet to regain that prior peak level of employment. For the U.S. as a whole, as of October the level of total nonfarm employment was 4.7 percent above the pre-recession peak, while in Texas total nonfarm employment stood 13.7 percent above the pre-recession peak as of October. Tennessee (6.4 percent), Georgia (5.6 percent), and South Carolina (5.5 percent) have seen employment climb further above the pre-recession peak than is true for the U.S. as a whole, while Florida (4.7 percent) has matched the U.S. in this regard. On the other hand, while Alabama and Mississippi have yet to regain the pre-recession peak, employment is above that peak by less than two percent in Arkansas, Missouri, and Illinois. There are many considerations that come into play here – how diverse is a given economy, how broad based is growth, what does the demographic profile look like, what is the overall business climate like, and each state has its own story. But, to reiterate a point we have made repeatedly, the larger, more economically diverse markets with better demographic profiles are generally the economies that perform better.





Turning to the metro area level, it can be unwieldy analyzing, let alone discussing, the large number of metro areas contained within the 15-state Regions footprint. As a means of conveying a sense of the level of broader economic activity across the footprint we have constructed an employment diffusion index based on data for 152 within footprint metro areas, with the diffusion index showing the net percentage of these metro areas adding jobs in a given month. The chart here illustrates a few points we have made in various forums over the years. First, one reason many of us just can't quit the 1990s, at least the economy of the 1990s, is not only the duration of but also the breadth of the economic expansion seen over the course of that decade. That is seen here by the high share of metro areas consistently adding jobs over an extended period. Second, the chart illustrates another point we have made about the expansion leading up to the 2007-09 recession, specifically, how short and concentrated it was. We show it here in terms of the net percentage of metro areas adding jobs over the 2004-07 period (note the 2001 recession ended in November of that year but employment growth did not resume until September 2003), which on average was significantly lower than that seen during the 1990s. Moreover, if we look at hiring across industry groups, the expansion was also narrow in that sense as growth was heavily concentrated in housing and related industries, meaning those metro areas with weaker demographic trends missed out on a good deal of the expansion.



As for the current cycle, while we have frequently noted that broad based hiring across private sector industry groups has been one of the hallmarks of the current expansion, hiring has been fairly broad based geographically as well, both across the Regions footprint and across the U.S. But, just as recent months have seen the breadth of hiring across industry groups narrow, hiring has become less geographically dispersed. Our chart shows the three-month moving average of our diffusion index, as a means of filtering through the inherent volatility in the index. Still, there is a good deal of volatility even in the three-month moving average, but after accounting for this we can see a downward drift in the index over the past several months, i.e., employment growth has become more geographically concentrated. As of October, the raw level of our hiring diffusion index stood at 50.99 percent, while over the 2012 through 2015 period the index averaged 67.69 percent. The metro area employment diffusion index for the U.S. as a whole, which is constructed with data from 371 metro areas, slipped to 48.38 percent in October, the lowest reading since May 2011 (for comparison, the broader index for the U.S. averaged 67.17 percent from 2012 through 2015).

While it would perhaps be premature to say we're alarmed, we nonetheless are concerned over the increasingly narrow geographic disbursement of hiring, again both nationally and within the Regions footprint. We'll also reiterate that the narrowing geographic base of hiring has come in conjunction with a narrower base of hiring across industries so in that sense the downturn in the geography-based diffusion index could simply be a natural extension. But, we'll also note that with the geography based diffusion index, it has been an "all or nothing" proposition – the index is either persistently above 60 percent during expansions or it is on a steady downward drift as the economy heads into a recession. To be sure, the consistent data on metro area employment only go back to 1990 so history is limited, and we do not think this is the signal the index is now sending, but it nonetheless is worth paying attention to over coming months.

Total Nonfarm Employment, Regions Metro Areas
% change year ago, year-to-date through October 2016

Top Twenty	% change	Bottom Twenty	% change
Orlando, FL	4.52	Mobile, AL	0.69
Cleveland, TN	4.45	Decatur, AL	0.45
Dallas, TX	4.34	Houston, TX	0.37
Daytona Beach, FL	4.14	Fort Smith, AR-OK	0.35
Athens-Clarke County, GA	4.05	Terre Haute, IN	0.31
Savannah, GA	3.89	Dothan, AL	0.26
Cape Coral, FL	3.88	Alexandria, LA	0.23
Fort Lauderdale, FL	3.87	Anniston-Oxford, AL	0.19
Jacksonville, FL	3.81	New Orleans, LA	0.09
Austin, TX	3.68	Gulfport-Biloxi, MS	-0.09
Jonesboro, AR	3.65	Longview, TX	-0.36
Fayetteville, AR-MO	3.57	Bloomington, IN	-0.42
Richmond, VA	3.49	Peoria, IL	-0.67
Gainesville, GA	3.47	Decatur, IL	-0.76
Raleigh-Cary, NC	3.13	Shreveport, LA	-0.82
Nashville, TN	3.12	Waterloo, IA	-0.91
Tampa, FL	3.09	Evansville, IN-KY	-0.99
Morristown, TN	3.02	Bloomington, IL	-2.06
Atlanta, GA	2.90	Lafayette, LA	-3.90
Charleston, SC	2.89	Houma, LA	-4.67

Source: Bureau of Labor Statistics; Regions Economics Division

Through October, the Orlando-Kissimmee-Sanford, FL Metropolitan Statistical Area had posted the most rapid job growth of the in-footprint metro areas in our coverage, with 4.5 percent growth (as a side note, the table to the side uses the name of the primary city rather than the proper metro area name, in the interest of space, not because we don't actually know the proper metro area names). Of the 20 metro areas with the fastest job growth, six are in Florida. We'll note that, with all due respect to smaller metro areas, swings of a few hundred jobs in the smaller markets can yield large percentage changes, in either direction, and we'll also note that it is the smaller metro areas that can take on a completely different look in the benchmark revision process. In other words, we have more confidence in the data from the larger metro areas ahead of the annual benchmark revisions. That said, our "Top 20" list this year is more concentrated amongst the larger metro areas than was the case a year ago when we did a similar update. This could simply be a sign that, as the expansion has matured and takes on late-cycle dimensions, the larger, more diversified markets will be the markets where job growth remains the most robust, perhaps in part because these larger markets are less prone to the labor supply constraints that in smaller markets may inhibit job growth.

On the other end of the spectrum, with the energy sector stabilizing but not yet fully back on its feet, energy and related industries continue to weigh on overall job growth in the Houston metro area and in many of the Louisiana metro areas. In general, job growth in the South region lags that seen in the Mid-America and East regions, in part because the South has a higher share of smaller, less economically diverse metro areas with lagging demographic trends. In many such markets, even this long after the end of the 2007-09 recession no clear-cut driver of overall economic activity has emerged, while weaker demographic trends cap housing market activity as well as growth in areas such as retail trade and personal services.

As noted at the outset when taken as a whole the Regions footprint looks very much like the U.S. in terms of rates of job and income growth but across our footprint there are stark differences. While the current expansion should endure – barring a severe adverse shock – at least through 2017 we do look for the rate of job growth to decelerate further. As the labor market continues to tighten wage pressures will ultimately build, though we don't expect this to begin in earnest until late-2017 and, as wage growth accelerates, firms will have renewed incentive to bolster worker productivity in favor of adding as many new workers. In 2017 services will again drive overall job growth. Energy and non-auto manufacturing should stabilize but it is unlikely either will emerge as a significant driver of overall job growth. We expect these trends nationally and within the Regions footprint, and we also expect the larger, more diverse metro areas to post the most rapid job growth in 2017. However, many of the smaller less diverse metro areas will continue to struggle to get the level of employment back to the pre-recession peak. Finally, we have noted in other forums that with Republicans in control of the White House and both houses of Congress beginning in 2017, we will likely see changes, potentially significant changes, in fiscal, regulatory, and trade policy. We see upside risk to our baseline outlook from fiscal and trade policy, but downside risk from trade policy. That said, we do not believe any such changes will be meaningfully reflected in the economic data until Q4 2017 at the earliest. Hence, we have not yet changed our baseline forecast for 2017 that calls for real GDP growth of 2.1 percent.

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