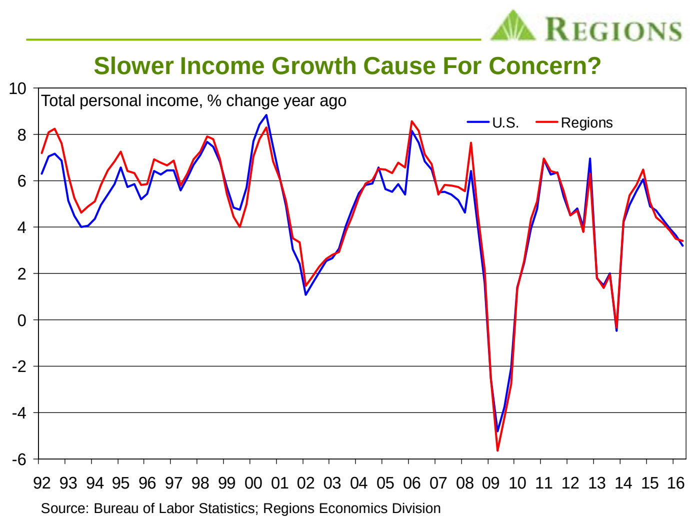
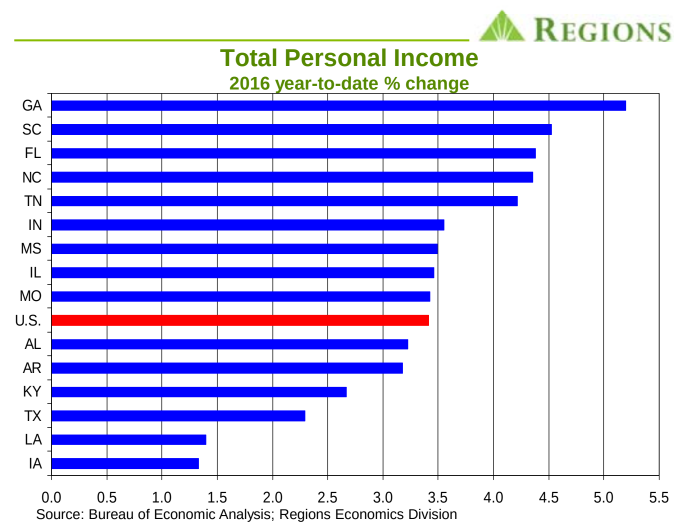
ECONOMIC UPDATE
REGIONS
October 2016

Regions Footprint Update: State Personal Income

With the state level data through Q2 2016 now at our disposal we thought we'd offer a brief summary of trends in personal income across the Regions footprint. That the state level come with such a lengthy lag is one of the ongoing frustrations we deal with in the wild but not so fast paced world of economic data, another frustration being comprehensive data are not available on the metro area level. Be that as it may, we analyze the data that come our way at the time they come our way, and do think it useful to offer periodic updates such as these as markers for those in the various lines of business across the footprint. We also think it useful to see how the various components of personal income are behaving, as the composition of personal income varies significantly on a state-by-state basis across our footprint. For instance, in those states in which transfer payments account for a significant portion of growth in total personal income, we can infer a given rate of income growth will yield less growth in discretionary consumer spending given that, while counted as personal income, many types of transfer payments do not reflect actual cash payments to recipients while those transfer payments that do reflect actual spending capacity are typically spent on necessities as opposed to discretionary purposes.





Through the first half of 2016 the rate of growth of personal income slowed both nationally and within the Regions footprint, as shown in the first chart above. Through the first half of 2016, total personal income in the Regions footprint rose by 3.4 percent compared to the same period of 2015, matching the increase for the U.S. as a whole. That income growth in the footprint and the U.S. as a whole are so closely aligned is to some extent a reflection of the fact that the footprint accounts for about 36 percent of total personal income for the U.S. as a whole, though this share is slightly below the footprint's share of population and total nonfarm employment. In any event, as seen in the chart income growth has steadily slowed over recent quarters.

To a large extent, this deceleration in the rate of income growth reflects a natural "evening out" of the data following the sharp swings seen during and immediately after the 2007-09 recession. Another factor, though more prevalent in some states than others depending on the composition of personal income, is the increase in tax rates that took effect on January 1, 2013 which altered the timing of realized income flows – a significant amount of income was pulled forward into Q4 2012 in order to beat the higher tax rates, but in terms of growth rates, this skewed over-the-year comparisons in 2012, 2013, and 2014, as is apparent in the above chart. So, after better than four percent growth in both 2014 and 2015, both in the Regions footprint and nationally, a slower pace of income growth in 2016 would not come as a surprise, particularly at this late stage in the economic expansion. It is also worth noting that even with the deceleration in income growth seen over the first half of 2016, growth in personal income remains easily ahead of the rate of inflation, even if not by the same margin as in the past two years. This means that households are able to stretch their income further and this is the primary reason that inflation adjusted consumer spending has held up so well and indeed remains the main driver of overall economic growth.

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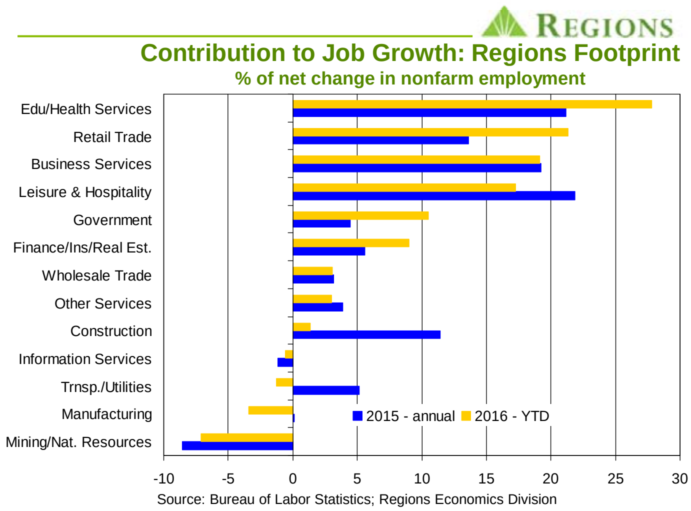
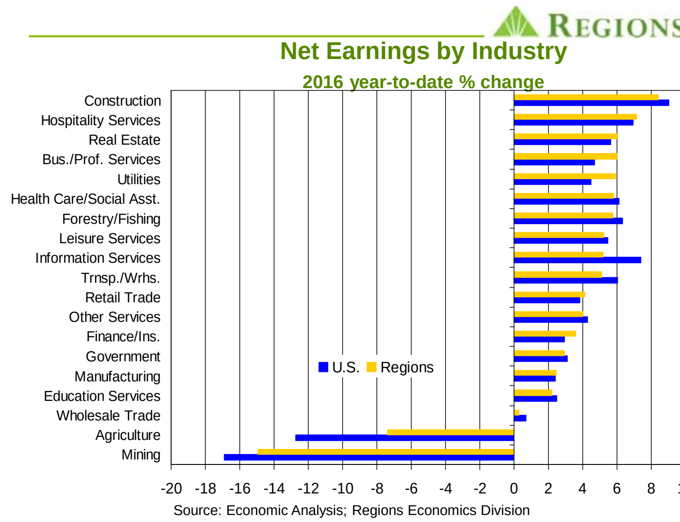




This of course does not mean there is no cause for concern over the deceleration in the rate of income growth. Given that labor earnings, which include wage and salary payments as well as supplements, such as bonus payments, far and away account for the largest share of total personal income, then to a considerable degree patterns in income growth reflect underlying patterns in the labor market. This includes patterns in job creation across industry groups as well as earnings growth across industry groups. Within the Regions footprint, there are sharp differences on both fronts when one looks at the data on a state-by-state basis and relative to national averages.

For instance, the first chart above shows the contribution of each industry group to the net change in nonfarm employment for the Regions footprint as a whole, for 2015 as a whole and for 2016 on a year-to-date basis. As seen in the chart, retail trade and leisure & hospitality services are amongst the main drivers of growth in total employment across the footprint, but jobs in these industry groups tend to come with significantly lower average hours worked and significantly lower average hourly earnings than do jobs in other industry groups. Conversely, three of the industry groups in which earnings tend to be significantly above average – manufacturing, information services, and mining/natural resources – have seen job counts decline thus far in 2016 for the footprint as a whole (job losses in the broader transportation & utilities sector reflect job losses in transportation).

The implication is the mix of jobs being added across the footprint is weighing on growth in aggregate labor earnings and, in turn, on growth in total personal income. Note for instance that retail trade is accounting for a significantly greater share of growth in total nonfarm employment in 2016 than was the case in 2015. The one saving grace is that in retail trade and leisure & hospitality services, higher minimum wages, whether mandated by law or raised voluntarily by employers, are boosting aggregate earnings. The downside, of course, is that this boost won't be sustained, at least not to the same degree seen this year, and that higher wages can be expected to ultimately depress job counts, if they have not already done so. The point being that earnings growth in these industry groups will likely be slower going forward than has been the case thus far in 2016.

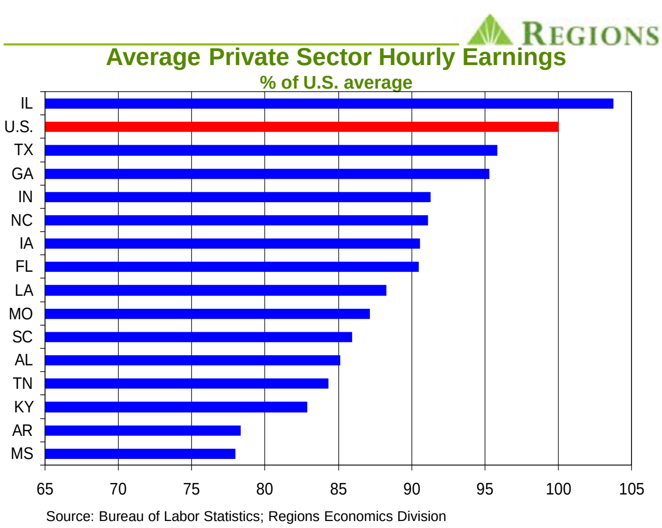
To that point, the second chart above shows the percentage change in earnings by industry group, both for the U.S. as a whole and the Regions footprint. What jumps out immediately are the large declines in earnings in the agriculture and mining industry groups (note the mining sector contains energy exploration and production jobs). After declining by 21.9 percent nationally and by 26.4 percent within the Regions footprint in 2015, earnings in the agricultural sector are declining further in 2016, by 12.7 percent nationally and by 7.4 percent in the footprint. These declines are a reflection of broader trends in agricultural prices stemming from excess supplies and only modest growth in global demand and, while prices are showing some signs of stabilizing, this won't be enough to salvage earnings for 2016 as a whole and, at least at present, the outlook for 2017 is for modest growth at best.

In the mining sector, we're seeing the opposite patterns play out, i.e., the declines are much more severe in 2016 than was the case in 2015. For instance, in 2015 earnings in the mining sector declined by 5.2 percent both nationally and within the footprint, but in 2016 earnings have declined by 16.9 percent nationally and 14.9 percent in the footprint. To some extent, this reflects the patterns in employment seen over time, as job losses came steadily over the course of 2015 and continued, though to a lesser degree, in 2016, so that 2016 earnings reflect the full impact of this prolonged period of job cuts. We will note that September was the first month in two years in which payrolls in the mining industry did not decline (nationally, state level data for September are not yet available), which is a reflection of what has been a brief period of stability in crude oil prices. Whether or not that persists is another question, but either way 2016 should mark the cyclical low for earnings in the mining sector.

It is worth noting that despite not having made a significant contribution to job growth thus far in 2016 the construction industry has posted the fastest growth in labor earnings, both nationally and in the Regions footprint. This tells us that hourly earnings are responding to what industry and anecdotal reports repeatedly tell us are shortages of labor, particularly skilled construction labor. Builders of single family homes may get some relief as multi-family construction eases over coming quarters, but not much, as multi-family construction is far less labor intensive than is single family construction, so the number of workers freed up by fading multi-family construction may not be all that large. More importantly, however, continued growth in construction employment and earnings will be far more reliant on the single family segment of the housing market than has been the case in the past, which raises some concerns should mortgage interest rates drift higher. At the same time, however, heavier infrastructure spending would mean greater demand for nonresidential construction workers, suggesting shortages may also materialize in this space, which would ultimately drive up earnings.

Aggregate labor earnings in the hospitality industry have also shown solid growth in 2016, which is a continuation of what we saw last year. Keep in mind 2015 was a record year for the lodging industry, in terms of occupancy rates and revenue per available room nights and growth thus far in 2016 has fallen off only slightly. This has led to increased hiring in the industry and wages have also risen, which likely reflects the combination of greater demand for workers coupled with higher entry level wages. The growth in this industry reflects what has been healthy growth in consumer spending on services, such as travel and tourism, which in turn is a function of healthy underlying growth in real personal income. With the outlook for further improvement in labor market conditions over coming quarters underpinning continued growth in personal income, we should see continued growth in discretionary spending in this category.

Conversely, with manufacturing payrolls having declined thus far in 2016, nationally and within the Regions footprint, aggregate labor earnings in the factory sector have posted only an anemic gain this year. This reflects a mix of jobs lost/added as well as some increases in hourly earnings. For instance, one segment of manufacturing still holding its own is motor vehicle production, a key industry group in our footprint. Hours worked and hourly earnings are higher than in other manufacturing industry groups, so even modestly higher payrolls in this group can compensate for job losses in many nondurable goods manufacturing industry groups, which tend to come with lower hours and hourly earnings. Still, with retail vehicle sales likely having seen their cyclical peak and the manufacturing sector on the whole basically treading water at present, there seems little to suggest any meaningful pick up in total labor earnings in this sector.



As a final point on the labor market and its role in driving growth in total personal income, one indication of a still-elevated degree of slack in the labor market is that growth in average hourly earnings remains well off the growth that would be seen were we at, or even closer to, full employment. Over time growth in hourly earnings within the Regions footprint has tended to lag behind the U.S. average, and it is also the case that the level of hourly earnings within the footprint is lower than that for the U.S. as a whole. This is seen in the chart to the side. A lesser degree of unionization in most states, the industrial mix of each state economy, and the mix of jobs being added/lost over time all combine to yield the results seen in the chart. To be sure, that the level of hourly earnings is lower than for the U.S. as a whole does not mean labor markets in individual states, or metro areas, are immune to wage pressures as existing slack is absorbed. But, given the prominence of labor earnings as a component of total personal income, that the level of hourly earnings is lower is a driver of differentials in metrics such as per capita income. With the exception of Illinois, the level of per capital disposable income in each state in the footprint is below the U.S. average. These differentials are not quickly closed, particularly with overall economic performance in individual states remaining so uneven.

While labor earnings may be the main component of total personal income, they are by no means the only component. To differing degrees in different states, non-labor income from sources such as dividends, interest, rental income, and transfer payments also contribute to total personal income. But, not all non-labor income is created equally, and the specific forms of such income have different implications for the overall level of economic activity in a given state. The chart on the following page shows a comparison across the states in our footprint, as well as the U.S. average, of personal income by source as of Q2 2016 – though this is obviously a point in time

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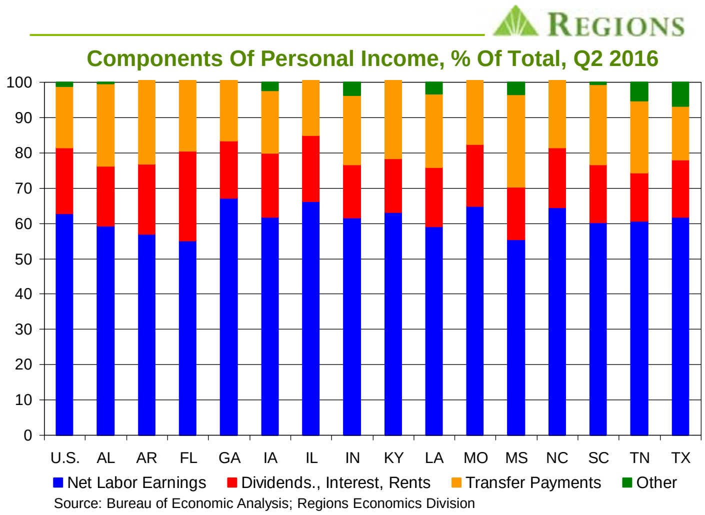

snapshot, we know from ongoing monitoring of the data that even were one to use longer term averages the chart would look very much the same as it does here.

As seen in the chart, labor earnings account for 55.1 percent of total personal income in Florida, the lowest in the Regions footprint and well below the U.S. average of 62.8 percent. Mississippi has the second lowest share, with labor earnings accounting for 55.5 percent of total personal income for the state as a whole. But, while non-labor income accounts for roughly the same share of total personal income in Florida and Mississippi, the composition of non-labor income varies sharply, illustrating our point that not all non-labor income is created equally. For instance, in Florida income from dividends, interest, and rents accounts for 25.4 percent of total personal income, far above any other state in the footprint and also far above the national average of 18.6 percent. In contrast, income from dividends, interest, and rents accounts for only 14.8 percent of total personal income in Mississippi, with only Texas having a smaller contribution. The high share in Florida reflects the share of the state's total population accounted for by retirees more apt to be reliant on such income.

Transfer payments account for 26.1 percent of total personal income in Mississippi, far and away the largest share in the Regions footprint and well ahead of the national average of 17.4 percent. In Florida, transfer payments account for 20.3 percent of total personal income, which may seem on the low side. But, this is where the composition of transfer payments comes into play. Nationally, Social Security payments account for just over 32 percent of all transfer payments to individuals; in Florida that share stands at around 35 percent while in Mississippi that share stands at roughly the national average. In Mississippi, however, Medicare and Medicaid combine to account for about 44 percent of all transfer payments, compared to a share of 40 percent in Florida and a national average of 43 percent. Why this is significant is that while booked as part of personal income, Medicare and Medicaid provide no cash payments to residents, but instead reflect payments to service providers and as such add no spending power to the recipients of those services. While a smaller share of total personal income relative to Mississippi, Florida's profile of transfer payments is more heavily weighted to those that put actual cash in the pockets of recipients and, as such, are more supportive of consumer spending. Additionally, looking over the composition of the state's transfer payments helps explain the seemingly low share of total personal income accounted for by transfer payments – the seeming shortfall stems from below average shares of non-cash transfers, specifically Medicaid payments.

And, speaking of Social Security, it is worth noting that this is one culprit behind slower growth in total personal income to date in 2016. Thanks to persistently low inflation, there was no cost of living adjustment (COLA) in Social Security payments in 2016. To be sure, one way to rile up a senior citizen is to tell them their cost of living has not gone up despite the fact they are likely paying much more in the way of costs related to health care. But, at least as measured in the basket of goods used in the calculation of the Consumer Price Index, the data say otherwise. Either way, the absence of any COLA in Social Security payments to existing recipients has acted as a drag on growth in total personal income – what growth there has been in total Social Security payments largely reflects a growing base of recipients, but this still leaves year-on-year growth in these payments much slower than has been the case in recent years. And, with a COLA of just 0.3 percent, there will be little growth in total Social Security payments in 2017.

Hopefully, the preceding discussion helps offer a view of the path of total personal income across the Regions footprint. Clearly, continued growth will be largely dependent upon further improvement in labor market conditions that would lead to faster growth in labor earnings, stemming from more people working and, ultimately, faster growth in hourly earnings. With little change in the outlook as to the main drivers of broader economic growth, i.e., consumer spending and housing, industries such as construction and, albeit to a lesser degree, leisure & hospitality services should continue to post above-average growth in aggregate labor earnings, while manufacturing will continue to lag. As we move into and through 2017 the drags from agriculture and energy should fade, but that does not mean either industry group will see significant growth in labor earnings. Health care should continue to post steady growth in labor earnings as demand for services continues to expand which in turn is supporting ongoing hiring in the industry. To the extent interest rates do rise, that will benefit those households who have accumulated larger pools of savings, though any such relief will be more along the lines of a few drops of rain after a prolonged period in the desert as opposed to a steady downpour. On the whole, though, given our forecast of continued divergences in growth across the individual states across the Regions footprint, income growth will vary across states, and the differences in the composition of personal income will continue to impact underlying patterns of economic activity.

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