ECONOMIC UPDATE

REGIONS

May 2017

Regions Footprint: 2016 State Personal Income

The Bureau of Economic Analysis (BEA) has released detailed data on state level personal income for 2016. For the 15-state Regions footprint as a whole, total personal income grew by 3.60 percent in 2016, slower than the 4.37 percent growth logged in 2015 and the 5.48 percent growth posted in 2014. For the U.S. as a whole, total personal income grew by 3.58 percent in 2016 after growth of 4.47 percent in 2015 and 5.21 percent in 2014. The state level income data come with useful details on the components of personal income as well as an industry breakdown of labor earnings. These details offer insight into the underlying trends in the economies of the individual states, particularly pertaining to the labor market, although to some extent the lagged release of the income data means they serve more to verify what we have already observed in the employment data. Still, we can gain insights from the paths of the various components of personal income – 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 than in those states in which income growth is driven by labor earnings or investment income. In what follows, we will highlight what we think are the more relevant aspects of the state level personal income data and what this tells us about economic conditions across the Regions footprint. Unfortunately, data on metro area personal income do not come with the same level of detail as the state level data, and the broader data are only released with a very lengthy lag, so there will not be a metro area counterpart to this piece. Though for anyone genuinely interested in the details of 2016 metro area personal income, we'll have plenty of answers – just as 2018 is coming to a close.

Total Personal Income, Regions Footprint

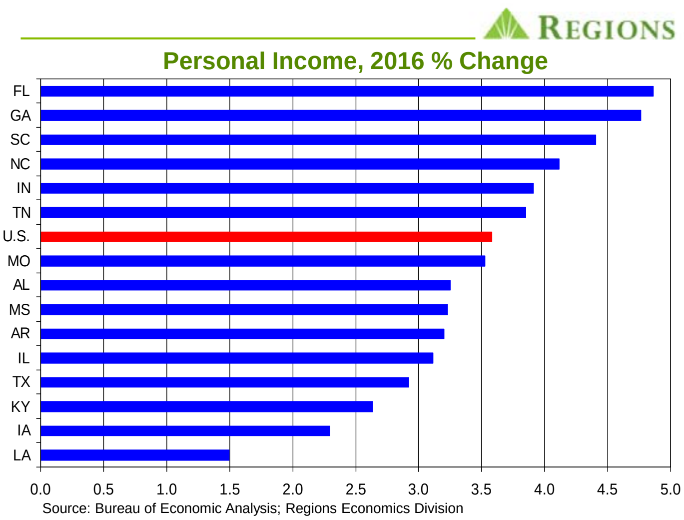
	Contribution to 2016 change in total personal income, % points				
STATE	Net Labor Earnings	Dividends, Interest, Rents	Transfer Payments	% change in Total Personal Income, 2016	% change in Total Personal Income, 2010-2016
Alabama	64.37	10.54	25.09	3.25	18.32
Arkansas	71.50	7.41	21.09	3.20	26.54
Florida	69.16	7.65	23.19	4.86	29.72
Georgia	78.33	5.51	16.16	4.76	28.18
Iowa	61.34	16.02	22.64	2.30	26.71
Illinois	72.76	9.05	18.19	3.11	24.55
Indiana	76.22	5.93	17.85	3.91	26.70
Kentucky	80.10	8.97	10.93	2.64	22.03
Louisiana	11.13	18.57	70.30	1.49	20.33
Missouri	74.16	6.22	19.62	3.52	20.96
Mississippi	68.16	6.77	25.07	3.23	18.28
North Carolina	72.39	7.56	20.05	4.12	26.19
South Carolina	72.31	6.70	20.99	4.40	31.31
Tennessee	79.68	6.63	13.69	3.85	27.37
Texas	58.97	9.46	31.57	2.92	38.75
U.S.	72.77	9.76	17.47	3.58	28.56

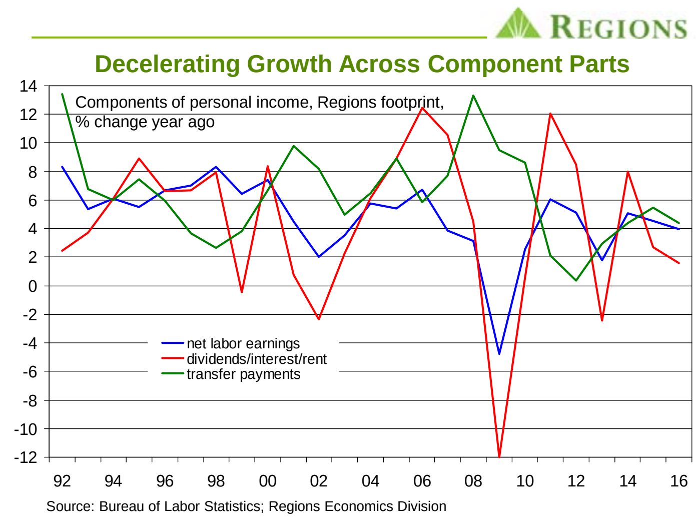
Source: Bureau of Economic Analysis; Regions Economics Division

As noted above, growth in total personal income decelerated in each of the past two years in the Regions footprint and the U.S. as a whole. To a large extent, this reflects a deceleration in net labor earnings, of which wage and salary earnings are the largest single component. If this seems at odds with what has been a good deal of discussion about the economy being near, if not at, full employment, it is in actually perfectly consistent with the trends we are seeing in the labor market. The biggest factor in decelerating growth in labor earnings is what has been a decelerating pace of job growth, which is the case nationally and in the footprint. For instance, in 2016 total nonfarm employment in the Regions footprint increased by 926,200 jobs, compared to the addition of 1.078 million jobs in 2015 and 1.369 million

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

jobs in 2014. At the same time, however, hourly wage growth has picked up only modestly but not by enough to compensate for the smaller incremental increases in employment. Additionally, industry-specific patterns of employment, such as sizeable job losses in higher earning industry groups such as mining/natural resources and information services, also help account for decelerating growth in net labor earnings. These industry specific patterns, however, are more visible on a state-by-state basis than for the footprint as a whole.



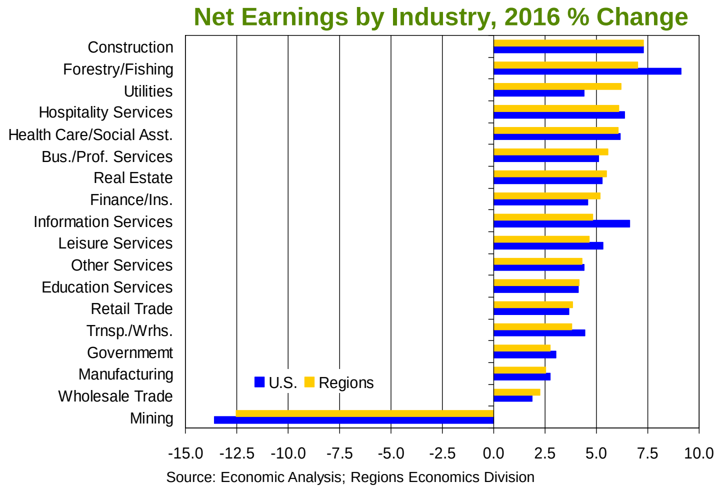


The charts above show state by state 2016 growth in personal income and, for the Regions footprint as a whole, annual growth in the main components of total personal income. There is a good deal of underlying detail for both net labor earnings and transfer payments, some of which we will discuss below for specific states. But, the deceleration in growth of total personal income can be seen through the broad components shown in this chart. In 2016, net labor earnings for the footprint as a whole grew by 3.94 percent, after growth of 4.52 percent in 2015. By comparison, for the U.S. as a whole net labor earnings grew by 4.08 percent in 2016, but the same deceleration in growth seen in the footprint is seen in the national data – net labor earnings grew by 4.70 percent in 2015.

Net labor earnings account for roughly 63 percent of total personal income in the Regions footprint, a share that has been fairly steady in the post-recession years but that is slightly below the two-thirds share that prevailed in the years prior to the 2007-09 recession. For the U.S. as a whole, net labor earnings account for just over 64 percent of total personal income, down from just over 66 percent in the years prior to the 2007-09 recession. Given that net labor earnings comprise the bulk of total personal income, it is no surprise that growth in net labor earnings is the main contributor to growth in total personal income, as illustrated in the table on the prior page. One notable exception is Louisiana, for which net labor earnings accounted for just 11.1 percent of growth of total personal income in 2016, far and away the lowest of any state in the footprint. Total personal income grew by 1.49 percent in Louisiana in 2016, with net labor earnings increasing by only 0.26 percent. At the same time, transfer payments increased by 5.16 percent in 2016, accounting for 70.3 percent of the growth in total personal income.

To a large degree, these patterns simply reflect patterns in nonfarm employment in the state. For instance, Louisiana saw payrolls in natural resources/mining decline by 8,300 jobs in 2016 on the heels of a decline of 12,500 jobs in 2015, and the state also lost jobs in manufacturing, wholesale trade, and information services in 2016. The losses of these jobs in relatively higher paying industry groups took a toll on the growth in overall labor earnings, and had knock-on effects in other parts of the state's economy, thus further weighing on total employment and earnings. By year-end 2016 the state's employment base had stabilized and Q1 2017 saw modest but broad based job growth. But, the impact on growth in earnings, and in turn total personal income, will take longer to reverse even as the labor market improves. Reflecting underlying labor market conditions, Unemployment Insurance (UI) benefit payments increased in Louisiana in 2016, one of only three states in the Regions footprint in which UI benefits rose last year. In addition to the increase in UI benefits, Louisiana's growth in transfer payments in 2016 reflects growth in Medicare and Medicaid payments.

Kentucky and Texas are the other two footprint states in which UI benefit payments increased in 2016 and, as in Louisiana, growth in UI benefits in these states mainly reflects ongoing weakness in energy production, including coal as well as oil & gas. This is in line with what in 2016 were further job losses in mining/natural resources, albeit more modest than in 2015, and Texas also saw manufacturing payrolls decline for a second consecutive year, much of which likely reflects energy-related manufacturing. As such, Texas saw net earnings in the mining/natural resources sector decline by 12.3 percent in 2016 after a 14.0 percent decline in 2015; Kentucky saw net earnings in this sector fall by 24.2 percent in 2016 on the heels of a 20.3 percent decline in 2016.



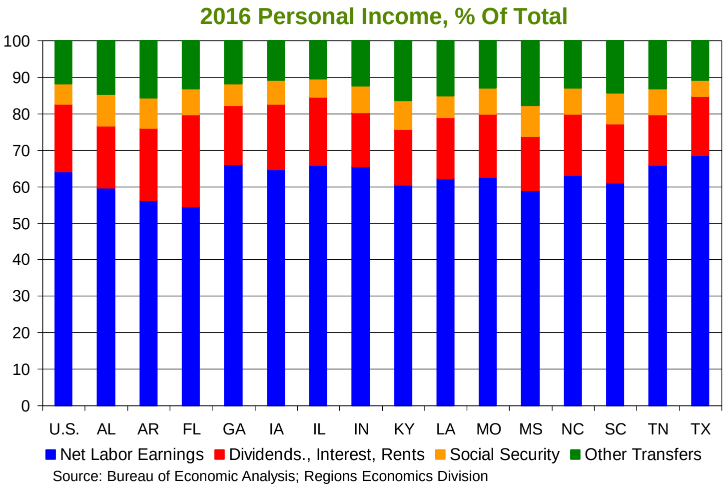
The chart to the side shows a breakdown of the percentage change in net earnings by industry groups for the Regions footprint and the U.S. as a whole for 2016. Keep in mind that this is a measure of aggregate earnings in each industry, which is a function of the number of people working, how many hours they work, and what they earn for each hour they work. In most discussions of labor earnings, the focus is hourly earnings but changes in hours worked have a powerful effect on total labor earnings. As we have noted in other forums, hours worked are still well below where they would be were the economy truly at full employment, so in addition to growth in average hourly earnings still shy of where it would be at full employment, it is the shortfall in hours worked that is holding growth in total labor earnings below where it would be had the slack been entirely wrung out of the labor market.

For the Regions footprint, the construction sector posted the fastest growth in total labor earnings in 2016, with growth of 7.3 percent. This comes after growth of 9.3 percent in 2014 and 8.8 percent in 2015, and it is growth in the number of people working in this sector and increased hours worked that is driving growth in total earnings. This is interesting in light of repeated accounts of labor shortages – it is possible the number of construction jobs could have increased at an even faster pace (the footprint added over 412,000 construction jobs from 2013 through 2016), but hourly wage growth has not accelerated to the extent implied by the steady stream of stories about labor shortages. The decline in aggregate earnings in mining/natural resources comes as no surprise, but the anemic growth in aggregate earnings in manufacturing may seem at least a bit surprising. The reality is that outside of motor vehicle production, conditions in manufacturing have been very much of a mixed bag and the Regions footprint as a whole saw only modest job gains in 2015 and 2016, as energy related manufacturing and durable goods manufacturing (excluding motor vehicles) have been notable weak spots. What will be interesting to see is whether the improvement in overall manufacturing conditions over the past several months, as indicated by the ISM Manufacturing Index, will translate into improved earnings growth for 2017.

Despite posting one of the largest increases in employment of all industry groups in the footprint in 2016, retail trade saw slightly below average growth in total labor earnings, with a 3.8 percent increase. Higher entry level wages, whether via mandated minimum wage hikes or voluntary hikes by individual chains would, in conjunction with hefty job gains, imply faster growth in overall earnings. It is true that aggregate earnings in retail trade posted an above-average gain of 5.4 percent in 2015, which implies some deceleration in 2016 might have been expected, but the main culprit behind the deceleration seen in 2016 is what was, on average, a significantly shorter average workweek, which fell over four-tenths of an hour relative to 2015. This is a significant change, particularly when compounded by the number of people working in this industry group. In other words, higher wages and higher job counts were neutralized to a considerable degree by a shorter workweek. Retail trade is another industry to watch in 2017, as what figure to be sizeable job losses will act as a weight on growth in aggregate labor earnings. On a related point, given the shifts in consumer buying habits that have led to increased prominence of on-line shopping, it would figure that job counts and hours worked in the transportation/warehousing sector would increase which in turn would lead to faster growth in aggregate earnings than the 3.8 percent increase seen in 2016.

It is unclear at this point whether growth in aggregate labor earnings will slow further or accelerate in 2017, as there will be forces pulling in both directions. In other words, the number of net new nonfarm jobs added in 2017 is likely to be smaller than the number added in 2016, which in turn was smaller than the number added in 2015. This is consistent with a mature business cycle such as the one the economy is now in. At the same time, however, growth in hourly earnings is likely to continue improving, although at a halting pace, which would help compensate for fewer new jobs being added. The real wild card, however, will be the length of the workweek. We have consistently argued that firms have the latitude to use current workforces more intensively, i.e., increase the number of hours being worked, than they have done so to date. Should firms truly begin running short on new workers to hire, the logical response is for them to increase hours worked of existing workers. To the extent this happens in conjunction with better growth in average hourly earnings, the bottom line should be at least moderately faster growth in aggregate labor earnings in 2017, both in the Regions footprint and for the U.S. as a whole.

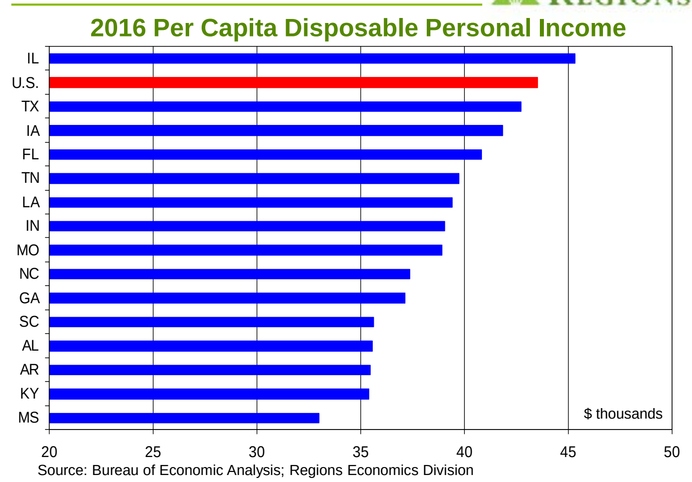
Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com



Still, it is important not to lose sight of non-labor income which, for the footprint and the U.S. as a whole, represents a sizeable share of total personal income. Higher interest rates figure to support at least modestly faster growth in interest income, but with rent growth slowing and an uncertain outlook for growth in dividend income, growth in overall "investment income" in 2017 may be hard pressed to top the 1.6 percent growth seen for the footprint as a whole in 2016. In Florida, dividends/interest/rent combine to account for 25.3 percent of total personal income, far and away the largest such share in the footprint and significantly larger than the national average of 18.5 percent. Conversely, labor earnings account for 54.6 percent of total personal income in Florida, easily the lowest in the footprint and far below the national average of 64.2 percent. Still, Florida saw net labor earnings grow by 6.3 percent in 2016, a testament to how rapidly the state has been adding nonfarm jobs.

Transfer payments are the last main component of personal income, accounting for 18.7 percent of 2016 personal income for the Regions footprint and 17.3 percent for the U.S. as a whole. Within the Regions footprint, Mississippi is the most reliant on transfer payments, with 26.2 percent of the state's total personal income in the form of these transfers in 2016 while Illinois and Texas are, at just over 15 percent of total personal income, the least reliant on transfer payments. It is, however, important to understand that not all transfer payments represent cash transfers – which tend to be fully spent by the recipients – but instead some come in the form of the provision of services for which payments are made directly to the providers of those services. Medicare and Medicaid would be the main examples of these non-cash transfers, while Social Security benefits and Unemployment Insurance benefits are the main examples of cash transfers. This distinction matters, in the sense that in a state such as Mississippi, where non-cash transfers account for an above-average share of total personal income, the actual spending capacity of state residents is less than what is implied by measured personal income. In Florida, Social Security payments accounted for seven percent of total personal income in 2016 which, along with the high share of income accounted for by investment income, is simply a reflection of the state's demographic composition, i.e., its high share of retirees.

Finally, it is worth noting that while the growth of total personal income for the Regions footprint as a whole has for many years been in close alignment with growth for the U.S. as a whole, there are stark differences in the level of per capita disposable personal income, as seen in the chart to the side. Illinois is the only state in the footprint in which the level of per capita income tops that for the U.S. as a whole. At the other end of the spectrum, Mississippi's level of per capita income stood at $32,980 in 2016, or, only 75.6 percent of the national average. It is interesting to note that the level of per capita income in Florida stood at 93.8 of the national average as of 2016, which is a hangover from the 2007-09 recession. This reflects below-average growth in net labor earnings in Florida, mainly due to the composition of jobs being added, in the early year of the recovery, and also slower growth in investment income – our thought is this reflects the impact of low interest rates on what is an above-average block of personal savings. The state saw a similar dip in investment income following the stock market downturn of the late-1990s which for the subsequent few years pushed the level of per capita income below the national average. Given Florida's ongoing and increasingly broad based job growth, coming years should see its level of per capita income catch back up to the national average, particularly to the extent we see further increases in interest rates.



Although they come with somewhat of a lag, the data on personal income can nonetheless add to our understanding of the underlying economic trends in the states that comprise the Regions footprint. In particular, the income data reinforce the importance of economic diversity and healthy demographics, two of the most important determinants of longer-term growth on the state and metro area levels.

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