ECONOMIC UPDATE

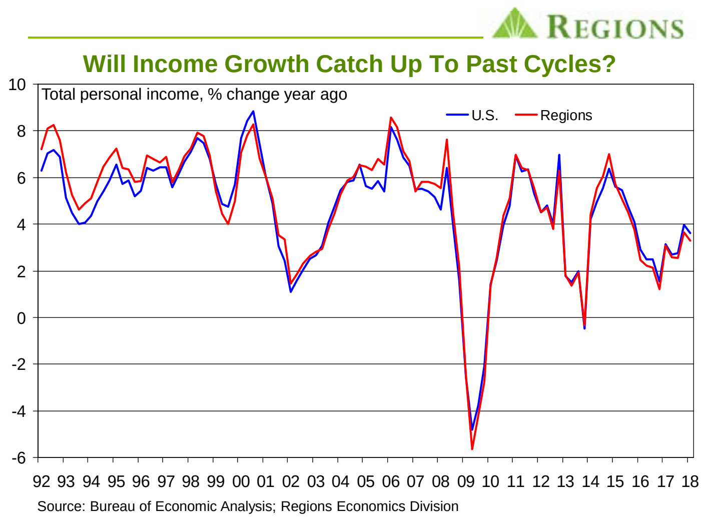
REGIONS

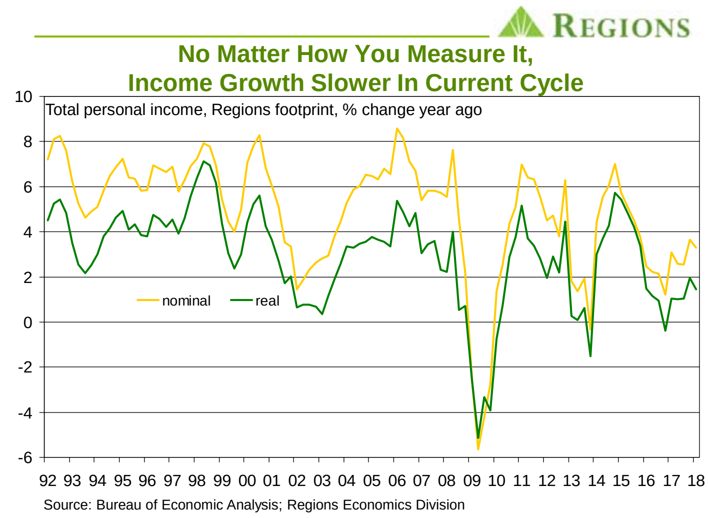
June 2018

Q1 2018 State Personal Income: Regions Footprint

The Bureau of Economic Analysis (BEA) has released its initial estimate of state-level personal income for Q1 2018. The Regions footprint as a whole saw a year-on-year increase in total personal income of 3.29 percent in Q1 2018, compared to a 3.63 percent increase for the U.S. as a whole. Growth in wage and salary earnings and in investment income (or, income from dividends, interest, and rents) were the main drivers of growth in overall personal income for the Regions footprint and for the U.S. as a whole. Florida, Georgia, Indiana, North Carolina, and Tennessee posted the fastest year-on-year growth in total personal income in Q1 2018 of the in-footprint states, with Alabama, Iowa, Louisiana, and Mississippi seeing the slowest growth. Across the board, however, growth in wage and salary earnings has switched into a faster gear over the past two quarters, reflecting further tightening of labor market conditions. That said, growth in labor earnings nonetheless continues to lag the pace seen in past cycles, most notably the expansion of the 1990s that also saw the national unemployment rate fall below 4.0 percent, but coming quarters should bring further acceleration. This is significant because labor earnings are far and away the largest single component of personal income.

Before going any further, we'll note one limitation of the state-level personal income data is the lack of a timely read on disposable, or, after-tax, personal income. This is relevant at present because it is growth in disposable personal income that best shows the effects of the lower individual income tax rates incorporated in the 2017 tax bill. In other words, total personal income is a before-tax measure which does not account for tax payments. With many individuals seeing lower personal income tax rates as of January 2018 (though lower withholding rates did not take effect until February for many individuals), it follows that growth in disposable personal income in Q1 2018 should be faster than growth in total personal income, which was indeed the case for the U.S. as a whole. To be sure, given that some individual deductions were either limited or eliminated altogether in the 2017 tax bill, increased tax payments at the time individual tax returns are filed could take a bite out of disposable personal income, but any such effects won't be visible until 2019. For our purposes, however, that state-level data on disposable personal income come only on an annual frequency means that it will be more difficult to assess how the 2017 tax bill impacts growth in disposable personal income on a state-by-state basis.





As seen in the above charts, income growth during the current cycle is lagging growth seen during past cycles, both nationally and within the Regions footprint. There are several factors that can help account for this. One main factor is that for much of the current expansion, now in its ninth year, a significant degree of labor market slack has acted as a drag on growth in wage and salary earnings which, as noted above, constitute the largest single block of total personal income. Additionally, a prolonged period of artificially low interest rates has been a persistent drag on growth in investment income, specifically interest income. One could point to what for much of the current expansion has been notably low inflation, which in many years has led to miniscule cost of living increases in certain forms of transfer

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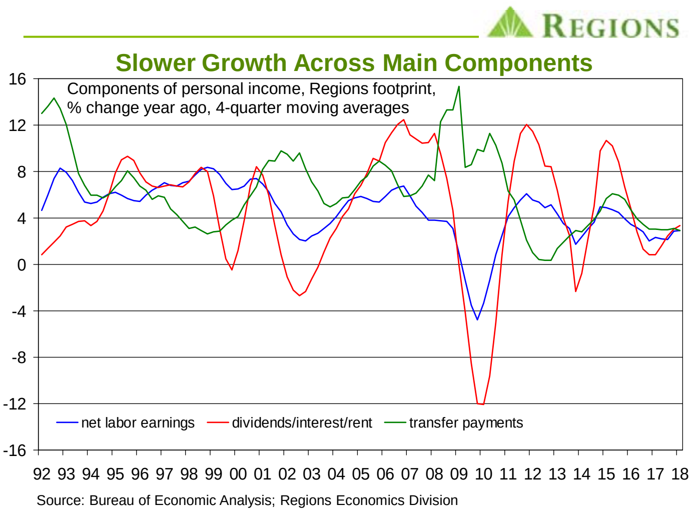
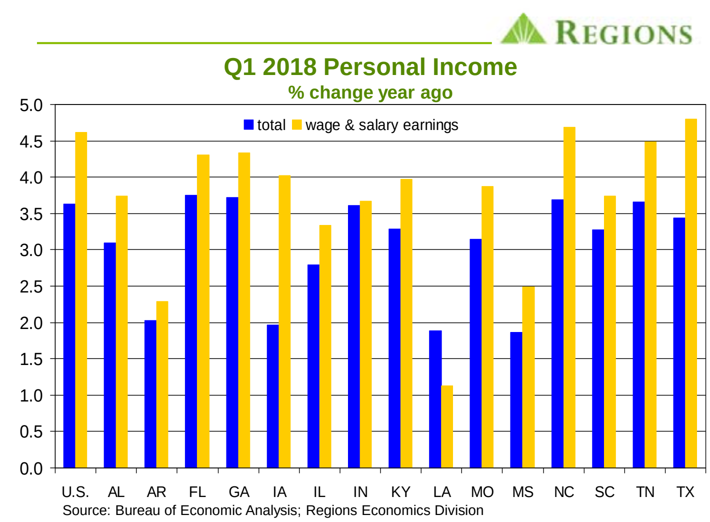
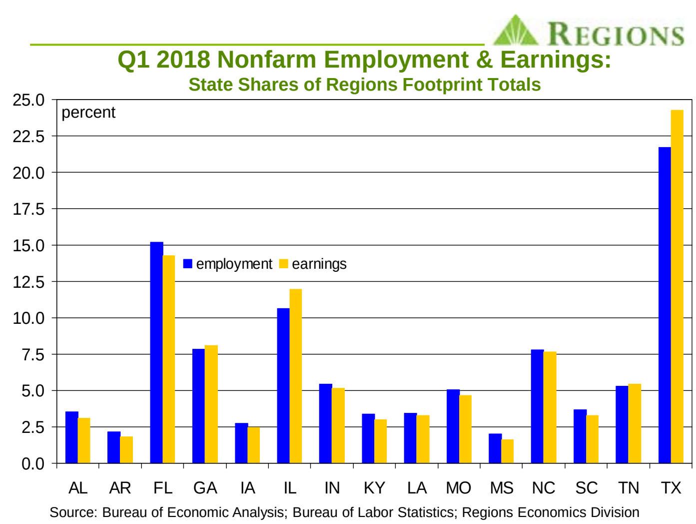
payments, most notably Social Security benefits, and thus has weighed on growth in total personal income. But, as the second chart above shows, growth in real (or, inflation adjusted) personal income during the current expansion has lagged that of past cycles, just as is the case with growth in nominal personal income. In any event, income growth figures to pick up steam over coming quarters as labor market conditions tighten further and higher interest rates lift growth in investment income, but it remains to be seen whether or not income growth will match, at least on any kind of sustained basis, the rate of growth seen during the storied 1990s expansion.

The chart to the side breaks total personal income for the Regions footprint as a whole down into the main components – net labor earnings, investment income, and transfer payments – to illustrate our point that there are several factors that have weighed on growth in total personal income over the current expansion. As the chart shows, growth in each component during the current expansion has lagged growth seen in past cycles (we use 4-quarter moving averages here simply to smooth out what can be a high degree of volatility in the income data). This is more apparent in the growth in net labor earnings, which tends to be less inherently volatile than the other components, and the personal income data are consistent with broad measures of wage growth. Keep in mind, though, that the earnings component of the aggregate personal income data incorporates not only hourly wages but also the number of people working and the number of hours each person works during each period. As we routinely note in our write ups of the monthly employment reports, while wage growth during the current cycle continues to lag that seen in past cycles, the average length of the workweek in the current cycle is also shy of that seen in past cycles, which is an often overlooked factor behind slower growth in aggregate labor earnings during the current cycle.

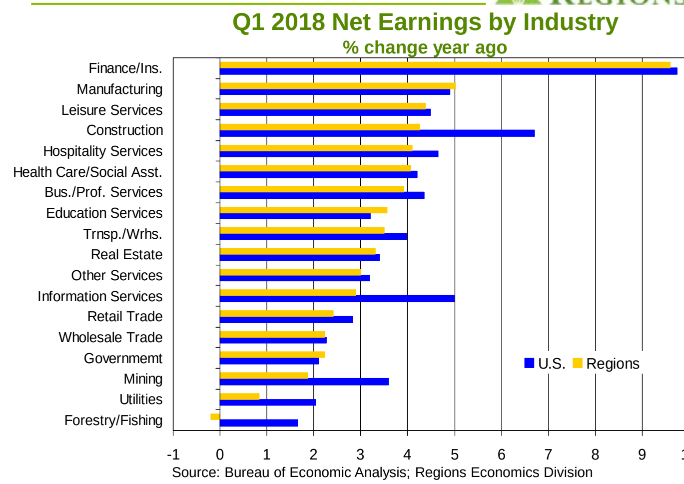


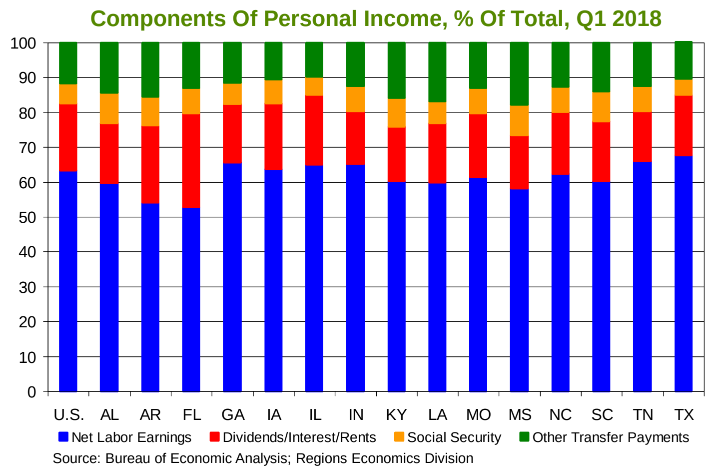




The first chart above shows year-on-year growth for total personal income and aggregate wage and salary earnings for each state in the Regions footprint as of Q1 2018. As seen in the chart, though posting only the sixth fastest growth in total personal income in the footprint in Q1, Texas posted the most rapid growth in wage and salary earnings of any in-footprint state, with North Carolina a close second. Louisiana was the only state in the footprint in which year-on-year growth in wage and salary earnings was slower than growth in total personal income in Q1 2018, which is simply a reflection of how weak the state's labor market has been over the past several quarters. Even so, in each state in the Regions footprint, year-on-year growth in wage and salary earnings has accelerated over the past two quarters, even in states such as Arkansas, Louisiana, and Mississippi in which growth in wage and salary earnings is well below average. The second chart above shows each state's share, as of Q1 2018, of total nonfarm employment and total wage and salary earnings for the Regions footprint. As seen in the chart, Texas easily accounts for the largest share of both employment and earnings; that its share of earnings exceeds its share of employment points to above-average employment shares in in higher value industry groups.

The chart to the side shows the year-on-year percentage change in labor earnings by industry for the U.S. as a whole and the Regions footprint. Earnings in the Finance/Insurance industry group grew by better than nine percent nationally and within the Regions footprint in Q1 2018, easily besting growth in all other industry groups. With a few exceptions, earnings growth in the footprint is fairly aligned with national averages. Construction is one exception to this pattern, with earnings growth in the Regions footprint lagging the U.S. average by a good measure. This mostly reflects uneven construction patterns, commercial and residential, across the Regions footprint. While states with faster rates of household formation and overall economic growth, such as Florida, Georgia, the Carolinas, Tennessee, and Texas, have seen robust growth in both commercial and residential construction activity, other states have seen far less activity on both fronts, and in turn have seen only minimal growth in net labor earnings in the construction activity. Nationally, growth in earnings in the information services industry group is dominated by a few large technology hubs, such as California, Massachusetts, New York, and Washington state, where earnings in this industry group are well above the U.S. average. With relatively less exposure to technology, the Regions footprint has seen slower growth in employment and earnings in the information services industry group. One industry group in which earnings growth in the Regions footprint tops the U.S. average, albeit modestly, is manufacturing, in part reflecting the above-average share of nonfarm employment accounted for by manufacturing within the Regions footprint.





As labor earnings account for the largest share of total personal income, the industrial make-up of a given state is a key driver of growth in total personal income. Still, it is important to account for non-labor income when analyzing patterns in personal income growth. The chart to the side shows the shares of total personal income in each in-footprint state accounted for by labor earnings, investment income, and transfer payments as of Q1 2018. At just under 53 percent, labor earnings account for a smaller share of total personal income in Florida than any other in-footprint state, while investment income accounts for 26.9 percent of total personal income, well ahead of the U.S. average of 19.3 percent. This reflects Florida's demographic make-up, i.e., the high share of the state's population comprised of retirees, and our earlier point about how low interest rates have been a persistent drag on growth in investment income means Florida has seen slower growth in total personal income over recent years than would have otherwise been the case.

Note that in the chart we split transfer payments into two blocks – Social Security benefits and all other transfer payments. This is to illustrate a point we frequently make in discussions of personal income, which is that while booked as personal income, most transfer payments do not actually reflect cash payments to individuals but instead reflect government payments to service providers in programs such as Medicare and Medicaid. This distinction matters when assessing the potential for growth in consumer spending, for instance, as any such assessment based on total personal income can yield different conclusions than a similar assessment based on personal income excluding transfer payments. We isolate Social Security benefits because they do represent a cash transfer and the vast majority of these benefits are spent relatively quickly by recipients, even if such spending is heavily skewed towards spending on necessities and not discretionary spending. It is also worth noting that over the past several years transfer payments related to health care programs have accounted for an increasing share of total state government spending and, as such, have added to growth in measured personal income, but this has overstated the growth in spending power of state residents. This distortion will only intensify over coming years as state spending on health care programs grows at an increasingly rapid rate, meaning that growth in total personal income will be less useful as a gauge of overall economic vitality in any given state.

At 26.53 percent, total transfer payments accounted for a higher share of total personal income in Mississippi than in any other in-footprint state in Q1 2018 (the U.S. average is 17.29 percent). Social Security benefits accounted for 8.85 percent of total personal income in Mississippi in Q1 2018 with other forms of transfer payments accounting for 17.68 percent, both the highest shares in the footprint (note that while the shares shift from quarter to quarter, the relative rankings across states have not changed materially over the past several years). At the other end of the spectrum, at 15.20 percent, transfer payments accounted for a smaller share of total personal income in Texas in Q1 than in any other in-footprint state, while labor earnings accounted for 67.80 percent of total personal income, the highest of any in-footprint state.

In closing, with labor markets tightening in each of the states in the Regions footprint, though obviously to different degrees, we expect to see firmer growth in net labor earnings and, in turn, total personal income over coming quarters. To the extent interest rates rise further over coming quarters, which we expect but only in fits and starts as opposed to interest rates rising steadily, this will also help buttress growth in total personal income. But, as the latter part of this discussion hopefully helps illustrate, differences in the composition of growth in personal income across individual states matter, and should be accounted for by anyone relying on growth in personal income as a gauge of overall economic activity, and in particular consumer spending, in any given state.

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TOTAL PERSONAL INCOME, REGIONS FOOTPRINT

STATE	Shares of Total Personal Income, Q1 2018, % of total: Net Labor Earnings	Dividends, Interest, Rents	Transfer Payments	Q1 2018, % change year ago: Total Personal Income	Total Personal Income Ex-Transfers
Alabama	59.71	17.13	23.16	3.09	3.06
Arkansas	54.28	22.03	23.69	2.02	2.18
Florida	52.95	26.90	20.15	3.75	3.86
Georgia	65.68	16.85	17.48	3.72	3.79
Iowa	63.71	18.97	17.31	1.97	2.19
Illinois	65.04	20.00	14.97	2.80	2.76
Indiana	65.24	15.03	19.73	3.61	3.09
Kentucky	60.27	15.65	24.08	3.28	3.41
Louisiana	59.95	16.92	23.12	1.89	1.30
Missouri	61.44	18.28	20.28	3.15	3.41
Mississippi	58.20	15.27	26.53	1.86	1.93
North Carolina	62.45	17.79	19.77	3.68	3.85
South Carolina	60.36	17.19	22.44	3.27	3.53
Tennessee	66.07	14.20	19.74	3.66	4.02
Texas	67.80	17.00	15.20	3.44	3.90
U.S.	63.37	19.34	17.29	3.63	3.82

Source: Bureau of Economic Analysis; Regions Economics Division

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