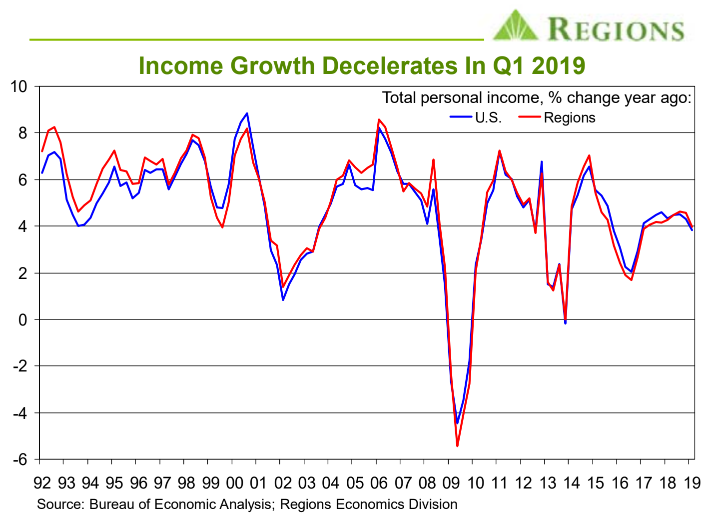
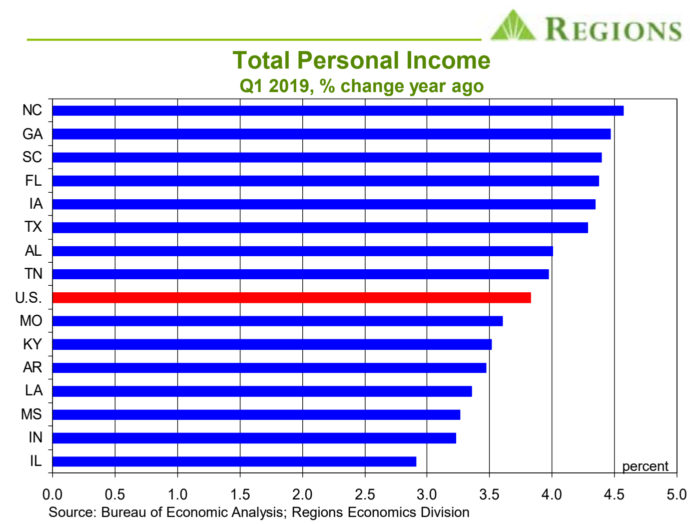
ECONOMIC UPDATE
REGIONS
July 2019

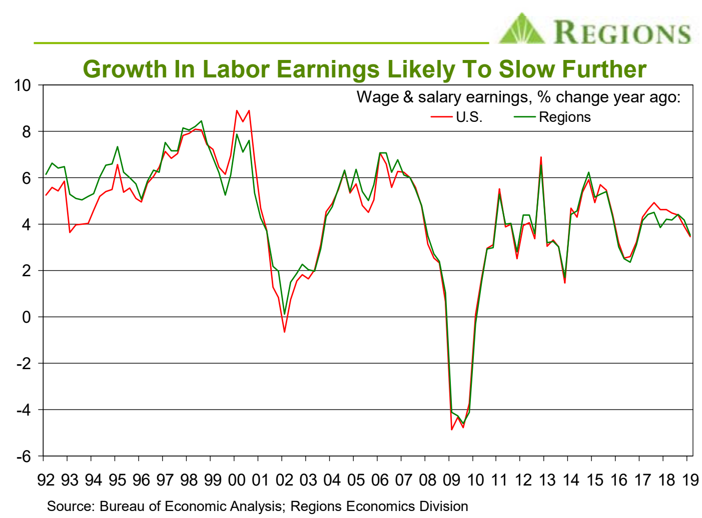
Q1 2019 State Personal Income: Regions Footprint

According to the Bureau of Economic Analysis (BEA), growth in total personal income decelerated in Q1 2019 both for the U.S. as a whole and for the Regions footprint. Nationally, total personal income grew by 3.83 percent year-on-year in Q1 2019, the smallest such increase since Q4 2016, while for the 15-state Regions Footprint the 3.98 percent year-on-year increase in Q1 is the smallest such increase since Q1 2017. A slower pace of growth in labor earnings and outright declines in farm income and in "asset-based" income, i.e., income from interest, dividends, and rents, acted as drags on growth in total personal income in Q1. One mitigating factor is that inflation also moderated in Q1, such that growth in real (or, inflation adjusted) personal income, at 2.6 percent in Q1, is in line with the rate of growth that has prevailed over the past several quarters. North Carolina (4.57 percent), Georgia (4.47 percent), South Carolina (4.39 percent), and Florida (4.37 percent) saw the largest year-on-year gains in total personal income in Q1, with Illinois (2.91 percent), Indiana (3.23 percent), Mississippi (3.26 percent), and Louisiana (3.35 percent) seeing the smallest increases.





Labor earnings are the largest single component of total personal income, and wage and salary earnings in turn account for the bulk of overall labor earnings. For both the U.S. as a whole and the Regions footprint, growth in aggregate wage and salary earnings slowed in Q1, with year-on-year increases of 3.45 percent nationally and 3.52 percent for the Regions footprint as a whole. This somewhat soft start to 2019 will make it harder for growth in aggregate wage and salary earnings to top the 4.0 percent mark as it did in both 2017 and 2018 for the U.S. as a whole and for the Regions footprint. Though average hourly earnings is seen by many as a marker of how vibrant the labor market is, this is only one of three components of aggregate wage and salary earnings, a broader measure that accounts for the number of people working, the number of hours they work, and what they earn for each hour worked. In Q1, the rate of job growth slowed from the heady pace of 2018, which in turn led to slower growth in aggregate hours worked than seen in 2018. At the same time, growth in average hourly earnings also slowed, and the net result of slower growth in aggregate hours

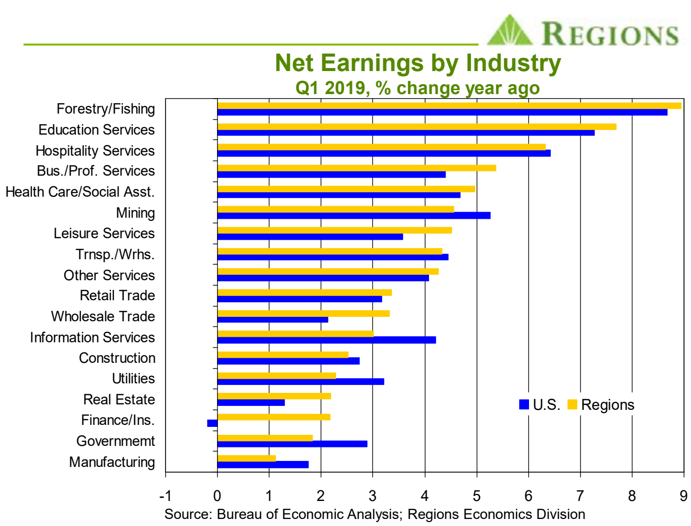


worked and in average hourly earnings was a slowdown in the growth of aggregate wage and salary earnings. These patterns held nationally and for the Regions footprint.

At 4.50 percent, North Carolina saw the fastest year-on-year growth in aggregate wage and salary earnings within the footprint in Q1, with Georgia and Texas both posting gains of 4.30 percent, with Louisiana (2.42 percent), Mississippi (2.44 percent), and Arkansas (2.62 percent) seeing the slowest growth. The drop-off in growth from 2018's pace was most pronounced in Florida, which saw year-on-year growth of 3.67 percent in Q1 after full-year 2018 growth of 5.16 percent, and Texas, which saw full-year 2018 growth of 5.26 percent. We repeatedly stress the importance of aggregate wage and salary earnings because, as noted above, it is the largest single contributor to and a key driver of growth in total personal income, which in turn is a key driver of growth in consumer spending.

Over the remainder of 2019, we look for further deceleration in growth of aggregate wage and salary earnings. Though complete Q2 data on the state level are not yet available, we do have complete Q2 data for the U.S. as a whole, which show that growth in average hourly earnings slowed further, as did the pace of job growth, and these same patterns will show in the state level data for the Regions footprint (which accounts for roughly 39 percent of nonfarm employment and roughly 36 percent of aggregate wage and salary earnings for the U.S. as a whole). Though the slower pace of job growth has been part of our baseline 2019 outlook for about as long as we've had a baseline 2019 outlook, the slowdown in growth of average hourly earnings is somewhat perplexing. We've argued that there is in most cases more slack in labor markets (on the national, state, and metro area levels) than implied by notably low unemployment rates, which is acting as a drag on wage growth, but this does not account for the sequential slowdown in growth in average hourly earnings.

Making this even more perplexing is that growth in average hourly earnings has finally broadened to the point that workers across all skill levels are seeing faster wage growth, which has not been the case for most of the current economic expansion, while the expansion has also become more broad based geographically over time. If there is one channel through which we could see at least a modest reacceleration in the growth of aggregate wage and salary earnings, it is via an increase in the average length of the workweek. We've often argued that the workweek is shorter than would be the case if the economy were truly operating at full employment, which is an underappreciated form of labor market slack. If firms were truly "running out of workers" to hire, a common but quite inaccurate reaction to low headline unemployment rates, they still have the capacity to add to total labor input by increasing the workweek. Though the math obviously varies from state to state or metro area to metro area, in terms of aggregate hours worked for the U.S. as a whole, each one-tenth of an hour change in the workweek is equivalent to over 300,000 private sector jobs, the point being that even a small change in average weekly hours can have a profound impact on growth of aggregate wage and salary earnings. Barring such an increase in the workweek, however, growth in aggregate wage and salary earnings will slow further as 2019 progresses.



The chart to the side shows year-on-year growth in labor earnings by industry in Q1 2019. Though the growth in earnings in the forestry/fishing industry group is for sure impressive, this industry group accounts for less than one-half of one percent of total labor earnings, and an even smaller share of total employment, for the Regions footprint as a whole. Growth in earnings in education services reflects a faster pace of job growth to some extent, but the year-on-year comparison for this industry group is an easy one due to how weak earnings growth in this industry had been for several quarters until perking up in Q4 2018 and Q1 2019. There are some industries, such as leisure & hospitality services and retail trade, in which higher minimum wages and/or firms pushing entry level wages higher voluntarily (the latter of which tends to filter up through the seniority chain) have clearly boosted growth in aggregate labor earning, though one difference is that leisure & hospitality services continues to add jobs at a steady pace within the Regions footprint, while payrolls in retail trade fell slightly during Q1. At the other end of the spectrum, earnings growth in the manufacturing sector has slowed markedly, both within the Regions footprint and nationally. Job growth within manufacturing has slowed significantly in 2019, thus holding down growth in aggregate labor earnings. Thus far, the slowdown in labor earnings growth amongst producers of nondurable goods has been more pronounced than that amongst producers of durable goods, but a decelerating pace of motor vehicle sales poses a downside risk to employment and wage growth in the durable goods manufacturing segment. Given that the Regions footprint has an above average exposure to motor vehicle production, any slowdown in labor earnings amongst those employed in the production of durable goods will likely be more pronounced within the footprint than is the case nationally.

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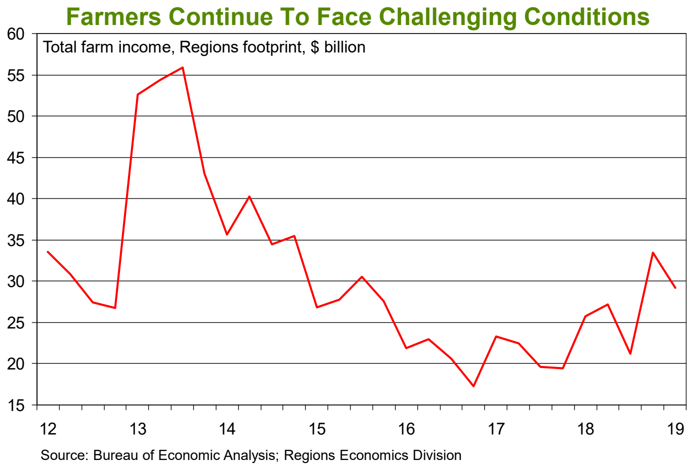
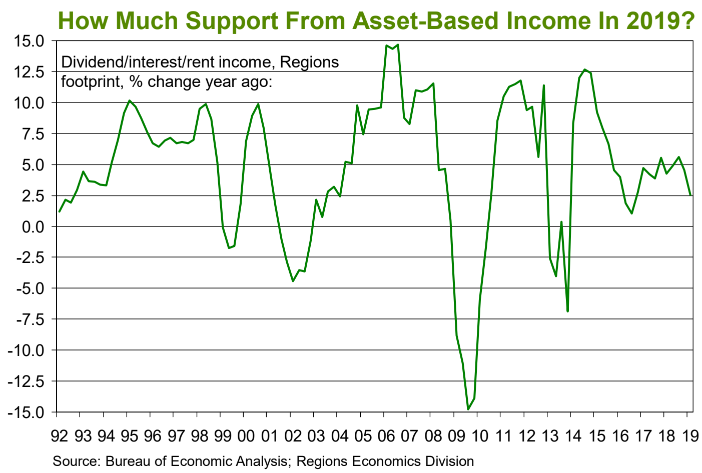


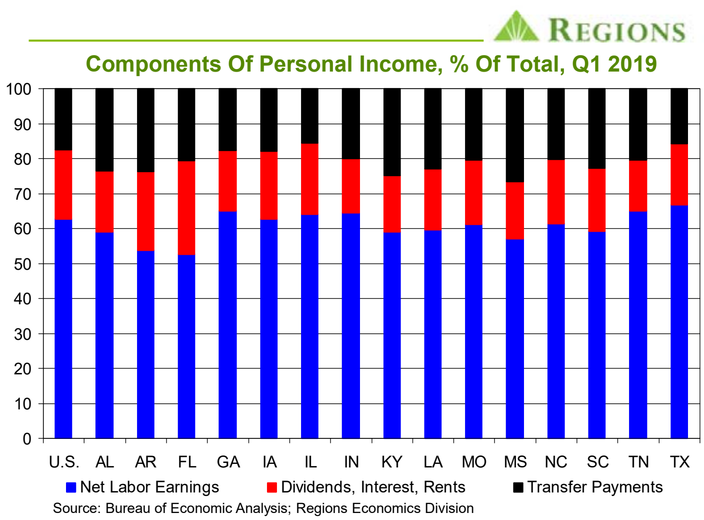


It was noted earlier that both farm income and asset-based income (again, interest from dividends, income, and rents) both declined in Q1 2019. Despite these declines, however, both farm income and asset-based income were up on an over-the-year basis in Q1. Recall that farm income was propped up in Q4 2018 thanks to subsidy payments for farmers who had lost sales to foreign buyers due to trade disputes, and these subsidies carried into Q1 before expiring. In that sense, the sequential decline in farm income is understandable. More fundamentally, farmers will face challenging conditions in 2019. Trade disputes are ongoing and many farmers have suffered from the loss of sales to foreign buyers. While a second subsidy payment program will help make up for any income shortfalls due to trade, this is not likely to fully compensate farmers for such losses and with no clarity on the shape or timing of a resolution to ongoing trade disputes, farmers will continue to operate under a cloud of uncertainty. Moreover, weather has wreaked havoc on planting in many parts of the U.S. in 2019, meaning that the resulting hit to farm income will likely be felt most acutely in 2020.

Though having fallen by 1.0 percent from Q4 2018, total income from dividends, interest, and rents was still up 2.52 percent on an over-the-year basis in Q1. Note that unlike on the national level, asset-based income is not broken out into its individual components on the state level, which limits the scope of our analysis of the state level data. For instance, while for each state we know the level of asset-based income, we do not know the composition of that asset-based income, and to the extent there are material differences in that composition compared to the U.S. as a whole, making inferences from the national level data can easily lead to faulty conclusions. Still, we do what we can. From the national data, we know that interest income was very weak in Q4, having declined at an annualized rate of 7.4 percent, while dividend income declined at an annualized rate of 6.3 percent. Interest rates declined during Q1, though not nearly to the same extent as was the case in Q2, meaning interest income will be a bigger drag on asset-based income in the Q2 data before being at best a neutral factor over the back half of 2019. Corporate profits, both before-tax and after-tax, dipped in Q1 which can help account for the decline in dividend income. There isn't a lot of clarity on the path forward for dividend income. Though the economy is expected to continue along a path of steady, but by no means spectacular, growth, faster growth in input costs, particularly labor, threatens to weigh on profit margins. Still, while off of what we think is the cyclical peak, margins remain elevated relative to historical norms. All in all, we look for growth in dividend income to remain somewhat rangebound over coming quarters, with neither material and sustained declines nor meaningful acceleration. Rental income posted an annualized increase of 5.6 percent in Q1 after having been virtually flat in Q4 2018. Our best sense is that rental income will continue to grow at a moderate rate as long as the economy continues to expand, but growth is unlikely to approach the rapid pace seen earlier in the expansion.

Of all of the individual components, transfer payments made the largest contribution to growth in total personal income in Q1 2019, which is the case both nationally and for the Regions footprint as a whole. For the Regions footprint, personal transfer receipts rose by 3.96 percent between Q4 2018 and Q1 2019, the largest such increase since Q1 2010, and personal transfer receipts stand 7.4 percent higher year-on-year. There are clear seasonal patterns in transfer payments, even in the seasonally adjusted data, which in large measure reflects annual cost of living adjustments being made to various payments to individuals, such as Social Security. The 2.8 percent cost of living adjustment for Social Security payments in 2019 is the largest since 2012, so it follows that the 3.49 percent (quarter/quarter) increase in Social Security benefits for the Regions footprint as a whole is the largest Q1 increase since 2012.

At the same time, growth in Medicare and Medicaid payments also accelerated in Q1, thus supporting growth in personal transfer receipts. It should be noted, however, that while recorded as personal income, benefit payments in programs such as Medicare and Medicaid take the form of payments to service providers as opposed to cash payments to individuals. One reason this distinction matters is that if one is trying to get a sense of growth in total spending power of residents of a given state or metro area, or if one is trying to get a sense of the ability of residents of a given state or metro area to service their debts, simply looking at growth in total personal income without making an allowance for non-cash transfer payments will yield an inflated estimate of spending power/capacity to service debt. This is one reason we routinely point to personal income excluding transfer payments as the more meaningful metric. By way of comparison, while total personal income for the Regions footprint as a whole rose by 3.98 percent year-on-year, total personal income excluding transfer payments rose by 3.21 percent year-on-year. We'll also note that the distinction between total and ex-transfers personal income will become more and more meaningful over coming years, as the rate of growth of outlays on programs such as Medicare and Medicaid will increase significantly. While this will, by definition, lead to a faster rate of growth in total personal income, growth in ex-transfers personal income will likely be meaningfully slower, and it is the latter that should be the basis of any assessments of the capacity for residents of a given state or metro area to spend and/or meet debt service obligations.



The chart to the side shows the shares of total personal income accounted for by each of the three broad components as of Q1 2019 (though the relative shares within and across states have been little changed for quite some time). Labor earnings accounted for 52.70 percent of total personal income in Florida, the lowest share in the Regions footprint (Arkansas is next at 53.73 percent) and far below the U.S. average of 62.76 percent. At 66.81 percent, labor earnings accounted for a higher share of total personal income in Texas than in any other in-footprint state. Conversely, income from dividends, interest, and rents accounted for 26.71 percent of total personal income in Florida, the highest share in the footprint and well above the U.S. average of 19.79 percent. This mix reflects Florida's demographic make-up. Personal transfer receipts accounted for 26.61 percent of total personal income in Mississippi as of Q1 2019, well above the U.S. average of 17.75 percent.

The mix of income can help shape the assessment of growth of total personal income in a given state of metro area. For instance, Medicare and Medicate combine to account for more than 11 percent of total personal income in Mississippi but, as noted above, this block of measured personal income does not reflect cash to Mississippi residents (the U.S. average is 7.78 percent). A heavier reliance on Social Security receipts in a given state or metro area leaves income growth in those areas vulnerable to a smaller cost of living adjustment, which will almost surely be the case with the 2020 adjustment relative to this year's. Florida's greater reliance on asset-based income leaves it vulnerable to a sustained and broad based decline in equity markets, while interest rates turning lower will pretty much erase what had been some progress towards interest income contributing a larger share of growth in overall personal income.

More broadly, with growth in labor income likely to decelerate over coming quarters, so too will growth in total personal income, and we think it unlikely that asset-based income will totally take up the slack. While growth in personal transfer receipts does figure to accelerate steadily over coming quarters (or, more likely, over the next several years), understanding the specific nature of those transfer payments will be even more critical in any assessment of the extent to which growth in personal income will support growth in overall economic activity. 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

year-on-year % change as of Q1 2019

STATE	Net Labor Earnings	Dividends, Interest, Rents	Transfer Payments	Total Personal Income	Total Personal Income Ex-Transfers
Alabama	3.52	2.03	6.80	4.01	3.18
Arkansas	2.70	2.97	5.77	3.47	2.78
Florida	3.57	2.75	8.75	4.37	3.29
Georgia	3.96	2.84	8.05	4.47	3.72
Iowa	3.45	2.38	9.96	4.35	3.20
Illinois	2.44	2.52	5.41	2.91	2.46
Indiana	2.34	2.42	6.87	3.23	2.36
Kentucky	2.94	2.43	5.65	3.52	2.83
Louisiana	2.49	2.01	6.74	3.35	2.38
Missouri	3.02	2.52	6.44	3.60	2.91
Mississippi	2.53	1.84	5.79	3.26	2.38
North Carolina	4.27	2.71	7.30	4.57	3.90
South Carolina	3.42	2.87	8.32	4.39	3.29
Tennessee	3.18	2.39	7.81	3.97	3.03
Texas	3.98	2.43	7.82	4.29	3.65
U.S.	3.35	2.72	6.91	3.83	3.20

Source: Bureau of Economic Analysis; Regions Economics Division

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