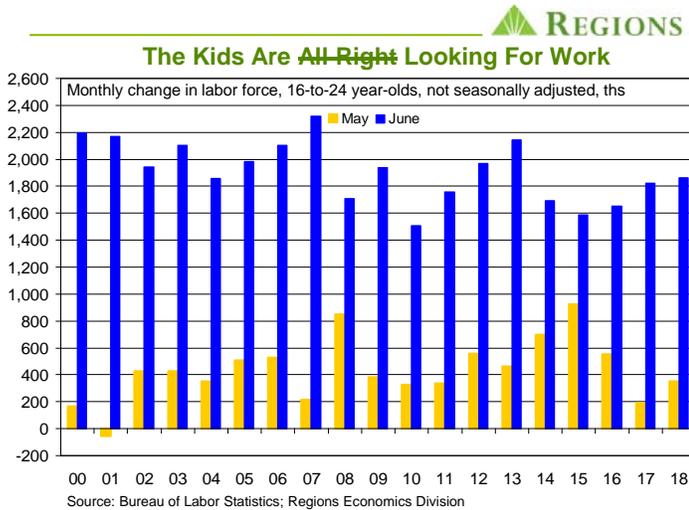


larger than the 191,000 person increase seen in May 2017. At the same time, employment amongst those 16-to-24 years old increased by 1.348 million in June, so that the number of people in this age cohort counted as unemployed rose by 514,000 in June.



Clearly, the degree to which the changes in the raw data are adequately accounted for by seasonal adjustment will impact the seasonally adjusted data reported in media accounts, such as the “headline” unemployment rate. Our point here, and one we frequently make, is that changes in the headline numbers cannot be properly understood without looking at changes in the not seasonally adjusted data, and the magnitude and timing of the outflow of younger adults from the labor force in the fall could impact the reported headline unemployment rate in those months. If it does, however: a) it likely won’t even be mentioned in many accounts of the change in the jobless rate; and b) noticed or not, it won’t change the actual narrative of the labor market in any way, shape, or form.

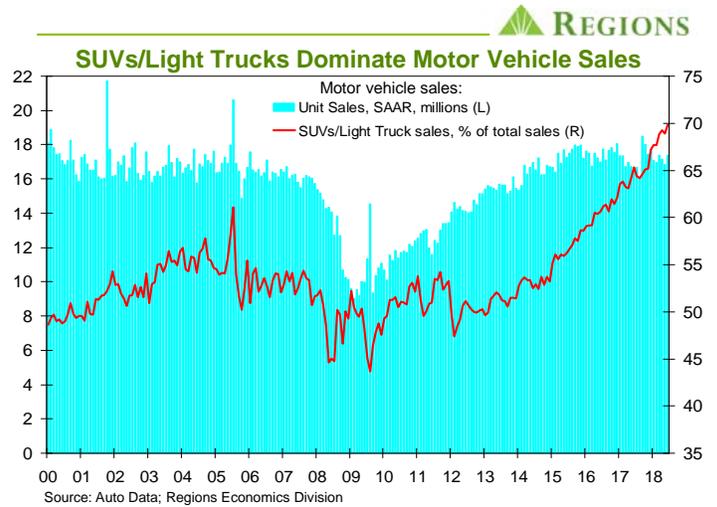
What’s Driving Motor Vehicle Sales?

We have to admit to being a bit surprised at how well motor vehicle sales have held up over recent months. It isn’t as though we thought sales would go into the tank this year – our forecast going into this year was for sales to slow from 17.2 million units in 2017 to 16.9 million units in 2018 – but sales have nonetheless surprised us to the upside. For instance, June’s annual sales rate of 17.381 million units was well above what we and the consensus had expected. Indeed, sales were strong enough over the first half of 2018 to lead us to up our full-year forecast to 17.1 million units.

If you recall, prior to Hurricanes Harvey and Irma sales seemed to be aligned with our view that, with the pent-up demand that had accumulated during the 2007-09 recession and the early phases of what had been a notably weak recovery having largely been sated, motor vehicle sales were gradually trending back to what we saw as their longer-term “equilibrium” pace of around 16 million units per year. After the hurricanes, however, sales spiked to an annual rate of over 18 million units in both September and October 2017 (September’s sales rate of 18.57 million units was

the highest monthly sales rate since July 2005), reflecting post-hurricane replacement demand.

Even so, sales in the aftermath of the post-hurricane spike have held up better than we had expected. What is even more striking than the level of sales has been the ongoing shift in the mix of sales, i.e., the split between automobiles and SUVs/light trucks. In June, SUVs/light trucks accounted for 69.82 percent of unit motor vehicle sales, the highest share in the life of the data (which date back to 1976). As seen in the chart below, the shift in the sales mix began in early-2015 and shows no signs of abating.



That SUVs/light trucks began to account for a higher share of sales in 2015 is not all that surprising given the precipitous decline in retail gasoline prices – for a good portion of 2015 retail gasoline prices were down 30 percent year-on-year. What is surprising, however, is that this shift has endured even as retail gasoline prices have rebounded – up 20.7 percent year-on-year as of June. To be sure, fuel mileage has improved across the board, including for SUVs/light trucks, and retail pump prices have yet to cross the \$3 per gallon threshold that many think will, uh, drive a shift in consumer behavior (okay, fine, that you knew a bad pun was coming made it no less annoying). Even if prices push above that threshold, however, it isn’t clear to us that there will be a pronounced shift away from SUVs/light trucks to automobiles.

Many domestic producers seem to agree, as some have cut back on production of smaller, more fuel efficient automobiles and others have totally eliminated certain models. So, even if sales do turn lower and drift back to what we see as a more sustainable pace, it seems likely that SUVs/light trucks will account for a much higher share of sales than has historically been the case. While lower gasoline prices may have been an early catalyst of the shifting sales mix, one factor that has likely helped sustain it is the recovery, such as it is, in residential construction.

Historically, sales of light trucks have been closely aligned with the fortunes of residential construction, specifically construction of single family homes. You can see in the chart above that the sales mix tilted increasingly towards SUVs/light trucks, albeit to nowhere near the extent seen now, during the housing “boom” that preceded the 2007-09 recession. More recently, in the early phases of the recovery, single family construction was notably

weak thanks to the vast backlog of foreclosed homes and what were much more stringent mortgage underwriting standards. It wasn't until the back half of 2014 and into 2015 that we began to see a meaningful rebound in single family construction, which coincides with the timing of the shift in the mix of vehicle sales.

So, shifting consumer preferences supported by lower gasoline prices and a meaningful recovery in single family construction (even if still below what would be considered "normal" levels) can perhaps account for much of the shift in the motor vehicle sales mix. That this shift has become even more pronounced in 2018 leads us to wonder if there isn't another factor at work here. To be perfectly clear, this is simply us thinking, or, in this case, writing, out loud and there is really no way to quantify this, otherwise we would. But, we can't help but wonder whether, or to what extent, the 2017 tax bill is supporting light truck sales.

Specifically, the provision in the 2017 tax bill allowing for immediate expensing of capital investment. For instance, small business owners, whether in construction or energy or other industry classifications, could be taking advantage of the tax bill to expand or update vehicle "fleets." Even if these sales are booked as retail sales (and, as such, would turn up in the consumer spending data rather than the capital spending data), they would be eligible for the full depreciation allowance if the vehicles are purchased for business purposes. Again, we may not be able to quantify any such effect, but think it more than reasonable to assume there is such an effect in play. To the extent there is, however, it suggests that at some point the sales mix will begin to shift back towards automobiles as the boost to demand from the tax bill begins to fade.

It should be noted that another factor that could be in play here is rental fleets – fleet sales are included in overall vehicle sales as reported each month. It could be that rental car companies are also shifting their vehicle mix, which would support the shift seen in total motor vehicle sales, though, again, the 2017 tax bill could also be a factor here. To the extent this is a factor, however, it is one that would seem to also have a limited duration.

So, over coming months we'll be interested in not only the level of motor vehicle sales but also the composition of sales. Even should total sales settle back to what we see as the sustainable longer-term rate, what looks to be a structural shift in the sales mix means a higher share, even if not as high as in recent months, of those sales will be accounted for by SUVs/light trucks than has been the case in the past.

Upon Further Review, Inventories Are Exceptionally Lean

One topic to which we've devoted considerable attention over the past few years is the housing market. More specifically, the extent to which lean inventories of both new and existing homes have acted as a drag on home sales. As we've done so in more than one past edition of our *Outlook* and in our regular monthly write-ups of the data on new and existing home sales, we won't re-cover that ground here.

We do, however, want to address a point we heard an analyst raise in the wake of the report on May existing home sales. Recall

that existing home sales fell to an annualized rate of 5.430 million units, well below what we and the consensus expected. Our preferred gauge of the underlying trend rate of sales – the running 12-month sum of not seasonally adjusted sales – fell to 5.482 million units as of May, well off of the high point thus far in the cycle of 5.529 million units. We've been consistent in our view that notably lean inventories of existing homes for sale have been a persistent drag on sales and, as we have noted, 2018 is on course to be the fourth consecutive year in which the seasonal peak in listings of existing homes for sale is lower than that of the prior year. Indeed, our view that there is not likely to be much relief on the inventory front has led us to wonder whether existing home sales have already passed their peak for the current cycle.

Not everyone sees it this way, however. One analyst largely dismissed concerns over inventories as being overblown, on the grounds that owners bypassing the traditional MLS system and selling their homes on their own are distorting the inventory data. In other words, simply relying on the MLS data to measure listings is leading to inventories being undercounted. Admittedly, this is an angle we had not given much consideration to, and it is a plausible argument. But, the question is the extent to which these sales-by-owner are distorting the regularly reported inventory data. To the extent there is such a distortion, however, we would not think it to be a material one.

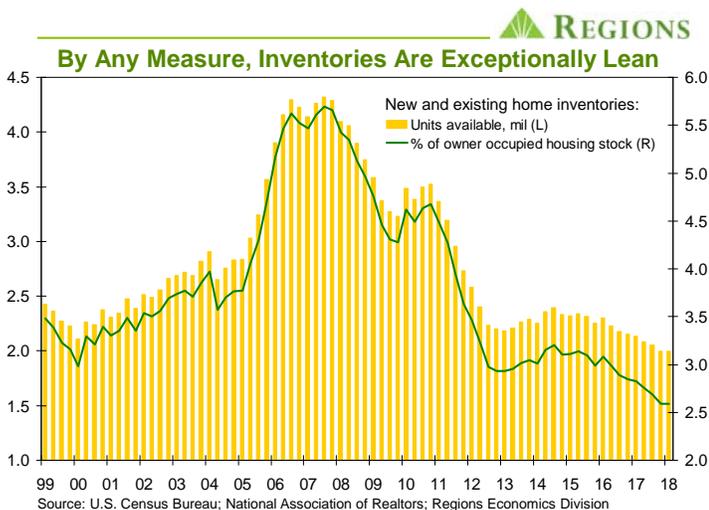
Rather than just leave it at that, we thought one way to assess the degree to which sales-by-owner are distorting the inventory data would be to compare sales as reported by the National Association of Realtors (NAR), which is the source of the monthly reports on existing home sales, and sales as reported by one of the real estate data providers who report sales on the basis of publicly recorded transactions data. In our case, we examined the data from our preferred source of housing market data, CoreLogic. To be clear, while we have access to the CoreLogic data we are not allowed to reproduce it here nor do we intend to, but we can at least report on what we see in the data.

Our premise is that if sales-by-owner were accounting for a significant share of overall home sales, that should result in there being a material discrepancy in sales trends as reported by NAR and CoreLogic. Sales-by-owner that bypass the traditional MLS system would not turn up in the NAR data but would turn up in the public records captured in the CoreLogic data. As such, were sales-by-owner accounting for a significant share of total existing home sales, you would expect to see a divergence in trends in existing home sales as reported by NAR and CoreLogic.

This is decidedly not the case. Indeed, though the level of existing home sales reported by the two entities differs, as is to be expected, the patterns in the data are pretty much the same. For instance, looking at the not seasonally adjusted data reported by NAR, sales have been declining year-on-year over the past several months, and the running 12-month total of not seasonally adjusted sales has turned lower. The same is true of sales as reported by CoreLogic, though the declines have lagged those in the NAR data by a few months (i.e., the high point of the running 12-month total of sales in the CoreLogic data came a few months after that in the NAR data). Again, were sales-by-owner playing a large role in overall existing home sales, you'd expect sales as reported in the CoreLogic data to still be trending higher, which is not the case.

To us, this is an indication that, rather than such concerns being overblown, extraordinarily lean inventories are indeed acting as a drag on existing home sales. Another way in which one can see this is to simply look at the robust rate of house price appreciation reported in the CoreLogic data. Whether as reported on the basis of the median existing home sales price or on the basis of their repeat sales price index, the CoreLogic data show not only that house price appreciation has been robust, but also that house price appreciation has accelerated over recent months. Again, this is not what you'd expect in a well-supplied market.

To be sure, given that demand for home purchases remains strong and homes are, if not literally then at least figuratively, flying off the market in terms of the number of days on market (and, again, the patterns in the NAR and the CoreLogic data are the same on this metric), it almost seems that all one would need to do to sell their home is to make it available, with or without listing it on the MLS and using an agent. In that sense, it seems plausible that sales-by-owner would be accounting for a greater share of overall sales. That could well be the case, but, coming from a very low base, that greater share may still not be all that great of a share. Moreover, those who sell a home via that route are left with the problem of finding another home to move into which, regardless of whether or not one enlists a real estate agent to help them find a home, is increasingly difficult given, you know, the relative lack of inventory.



So, while it's always a good exercise to have your assumptions and conclusions put to the test, in this case we remain comfortable with what for some time now has been our underlying premise when it comes to home sales. The above chart is one we've used before, most recently in our February 2018 *Outlook*, and after our comparison of the home sales data we think it still tells the most meaningful story when it comes to inventories of homes for sale. Our chart shows combined inventories of new and existing homes for sale, both the level and scaled to the size of the owner occupied housing stock. As seen in the chart, that ratio remains the lowest on record (history is limited by the fact that the NAR inventory data only go back to 1999).

We think the inescapable conclusion is that exceptionally lean inventories are acting as a material drag on home sales. Builders are in many cases being hamstrung by shortages of labor and

buildable lots or encumbered by regulatory constraints, thus holding down inventories of new homes. With many home owners being "locked" in place by low mortgage interest rates on an existing mortgage and others trapped by little or no equity in their current home (though the scope of this problem has narrowed significantly over recent quarters), and (as we have argued) with for-sale inventories being structurally lower after single family REITs snapped up sizeable numbers of single family homes in the wake of the foreclosure crisis and placed them on the rental market, existing home inventories continue to hover just above historical lows. While we do expect some improvement over the months ahead, perhaps more on the new homes front than on the existing homes front, we don't expect much improvement. As such, limited inventories will continue to act as a drag on the number of sales and as a boost to house price appreciation.

U.S. Economy Humming Along, But For How Long?

Recent months have seen considerable angst over trade wars, geopolitical tensions, diminishing monetary accommodation, and other factors that pose risks to the economic expansion. At this point, however, this has all been little more than background noise in a U.S. economy that keeps humming along, and our view is that it will take much more than this to trigger a significant slowdown in an economy amped up on fiscal stimulus. The caveat here is that the boost from fiscal stimulus will fade as we move through 2019, meaning that should the current trade battles intensify and endure, the downside risks to the U.S. economy will rise.

This is not to say that there haven't already been impacts from the initial rounds of U.S. tariffs and retaliatory tariffs imposed by our trading partners. There have, but the significant dose of fiscal stimulus coursing through the U.S. economy will for a time offset adverse effects from trade. Again, though, as fiscal stimulus fades so too will the buffer provided against adverse effects of trade battles. Moreover, the downside impact of trade could become more and more apparent well before the fiscal stimulus has run its course. The reality is that no one knows what the end game is here; many have taken the U.S. moves on trade to be part of a broader negotiating tactic that will lead to meaningful agreements on trade policy with China, our North American neighbors on both sides, and the European Union before these initial trade battles escalate into an all-out trade war. That remains to be seen, but if it begins to look as though trade wars are more likely than trade deals, that will exact a toll on both business and consumer confidence and, in turn, U.S. economic growth. For now, though, we remain comfortable with our baseline forecast of real GDP growth of 3.0 percent this year, but see the risks to our forecast of 2.5 percent growth in 2019 beginning to tilt to the downside.

Many FOMC members have expressed concern over the potential adverse impacts of tariffs, but at this point it seems unlikely that such concerns will alter the path of the Fed funds rate. At least in 2018. With the economy growing at a well above-trend rate, the FOMC's focus at present remains squarely on inflation. But, if we are correct that the downside risks to the U.S. economy rise the longer the trade battles run and the more intense they become, this makes it more likely that at some point the FOMC will feel compelled to act on their concerns over trade.

ECONOMIC OUTLOOK



REGIONS

July 2018

Q4 '17 (a)	Q1 '18 (a)	Q2 '18 (f)	Q3 '18 (f)	Q4 '18 (f)	Q1 '19 (f)	Q2 '19 (f)	Q3 '19 (f)		2016 (a)	2017 (a)	2018 (f)	2019 (f)
2.9	2.0	4.4	3.1	2.6	2.5	2.1	1.8	Real GDP ¹	1.5	2.3	3.0	2.5
4.0	0.9	2.9	2.1	2.3	2.1	2.1	1.9	Real Personal Consumption ¹	2.7	2.8	2.4	2.1
								Business Fixed Investment:				
7.1	8.7	5.0	6.2	5.0	4.3	4.6	3.8	Equipment, Software, & IP ¹	0.3	4.4	7.0	4.7
6.3	16.2	3.5	5.8	5.0	4.0	2.6	1.6	Structures ¹	-4.1	5.6	6.3	3.6
12.8	-1.1	1.2	1.8	4.5	3.9	4.8	4.5	Residential Fixed Investment ¹	5.5	1.8	1.6	3.8
3.0	1.3	2.4	1.9	2.6	1.8	1.6	1.4	Government Expenditures ¹	0.8	0.1	1.8	1.8
-653.9	-656.8	-601.4	-601.9	-609.8	-618.8	-628.8	-641.5	Net Exports ²	-586.3	-621.8	-617.5	-636.2
1.259	1.317	1.310	1.301	1.313	1.325	1.342	1.354	Housing Starts, millions of units ³	1.177	1.208	1.310	1.346
17.7	17.1	17.1	17.0	17.0	16.8	16.7	16.5	Vehicle Sales, millions of units ³	17.5	17.2	17.1	16.6
4.1	4.1	3.9	3.9	3.8	3.7	3.7	3.7	Unemployment Rate, % ⁴	4.9	4.4	3.9	3.7
1.5	1.5	1.6	1.6	1.5	1.4	1.2	1.1	Non-Farm Employment ⁵	1.8	1.6	1.6	1.2
1.2	3.6	1.9	2.3	2.8	2.9	2.3	2.5	Real Disposable Personal Income ¹	1.4	1.2	2.2	2.5
1.9	1.9	2.0	2.1	1.9	1.9	2.1	2.1	GDP Price Index ⁵	1.3	1.8	2.0	2.1
1.7	1.8	2.2	2.3	2.1	2.0	2.0	2.0	PCE Deflator ⁵	1.2	1.7	2.1	2.0
2.1	2.3	2.7	2.8	2.5	2.1	2.2	2.0	Consumer Price Index ⁵	1.3	2.1	2.6	2.1
1.5	1.6	1.9	2.1	2.2	2.1	2.1	2.1	Core PCE Deflator ⁵	1.8	1.5	2.0	2.1
1.7	1.9	2.2	2.3	2.3	2.2	2.3	2.4	Core Consumer Price Index ⁵	2.2	1.8	2.2	2.3
1.18	1.41	1.68	1.90	2.13	2.17	2.42	2.63	Fed Funds Target Rate, % ⁴	0.39	0.98	1.78	2.46
2.37	2.76	2.92	2.85	2.90	3.00	3.10	3.15	10-Year Treasury Note Yield, % ⁴	1.84	2.33	2.86	3.11
3.92	4.28	4.54	4.47	4.52	4.63	4.73	4.79	30-Year Fixed Mortgage, % ⁴	3.65	3.99	4.45	4.75
-2.4	-2.5	-2.2	-2.3	-2.4	-2.4	-2.5	-2.7	Current Account, % of GDP	-2.3	-2.3	-2.4	-2.6

a = actual; f = forecast; p = preliminary

- Notes:
- 1 - annualized percentage change
 - 2 - chained 2009 \$ billions
 - 3 - annualized rate
 - 4 - quarterly average
 - 5 - year-over-year percentage change