



This Economic Outlook may include opinions, forecasts, projections, estimates, assumptions, and speculations (the "Contents") based on currently available information which is believed to be reliable and on past, current and projected economic, political, and other conditions. There is no guarantee as to the accuracy or completeness of the Contents of this Economic Outlook. The Contents of this Economic Outlook reflect judgments made at this time and are subject to change without notice, and the information and opinions herein are for general information use only. Regions specifically disclaims all warranties, express or implied, with respect to the use of or reliance on the Contents of this Economic Outlook or with respect to any results arising therefrom. The Contents of this Economic Outlook shall in no way be construed as a recommendation or advice with respect to the taking of any action or the making of any economic, financial, or other plan or decision.

Holiday Sales Outlook: How Much, And How, Will Consumers Spend?

It's the most wonderful time of the year. Unless of course it's not. Either way, it is time for the November *Monthly Economic Outlook*, which means it's also that time of the year when we take the pulse of the U.S. consumer, apply the collective force of our years of professional experience, conduct extensive research, perform highly sophisticated statistical analysis, and then basically guess how much consumers will spend over the holiday sales season.

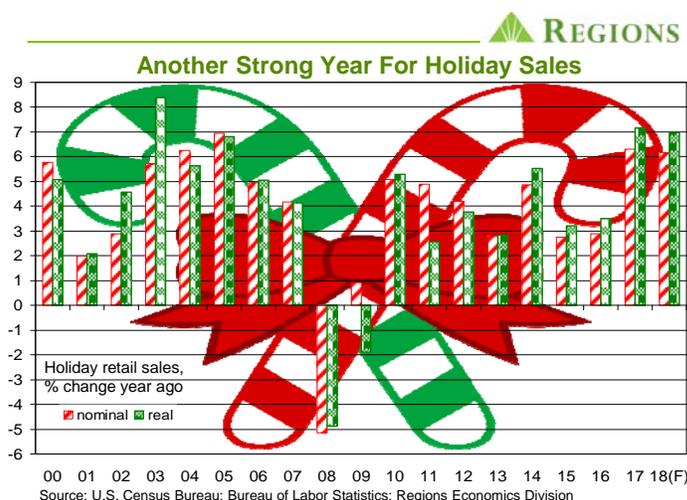
Okay, fine, it's still early and you may not quite feel the holiday spirit just yet. And we get that, because in many ways the holiday season has been ruined by the holiday shopping season, at least for us. But, just you wait – at some point, there's going to be one and only one of this year's must-have holiday toy left on the shelf. When that time comes, there's going to be a massive in-store brawl to decide which shopper, most moved by the holiday spirit, gets that last super hero economist action figure, a brawl which will be replayed endlessly on the national news. That's when the holiday spirit will hit you. Like a sack of bricks. Bah. And, while we'd like to say that the super hero economist action figures are very life-like, it isn't as though there's any actual basis of comparison, right? Feel free to draw your own conclusions.

In any event, in what follows, we'll discuss how we see the holiday shopping season shaping up for consumers and for retailers. Before proceeding, it's worth noting that the definition of "holiday sales" tends to vary considerably – for a quick empirical test of this just count how many estimates you see each year of sales on "Black Friday" or "Cyber Monday." As has always been our practice, our measure of holiday sales consists of combined November and December retail sales excluding motor vehicle, gasoline, building materials, restaurant, grocery store, and drug store sales – things not typically given as holiday gifts.

No matter which definition you prefer, 2018 is shaping up to be another strong year for holiday sales. That said, as has been the case over the past several years, this holiday season will feel better for consumers than it will for retailers. Not only does persistent goods price deflation continue to weigh on margins for those who sell goods, but higher costs for labor and transportation will put even more pressure on retailers' margins. So, despite what should be strong top-line growth in sales revenue, retailers may feel little cheer over how their bottom lines come out of this holiday sales season – retailers may be selling more but enjoying it less.

Our forecast anticipates a 6.2 percent increase in holiday sales, a solid increase but nonetheless a bit shy of the 6.3 percent increase in holiday sales seen in 2017. In real terms, i.e., adjusted for price changes, our forecast anticipates a 7.0 percent increase in holiday sales which, as seen in the following chart, would mark the sixth

consecutive year in which growth in real holiday sales tops growth in nominal holiday sales. In keeping with our point about persistent goods price deflation, our forecast anticipates further declines in prices for core consumer goods (consumer goods excluding food and energy) this holiday season – even absent any holiday season discounting that may take place if retailers are having trouble clearing inventories. Our forecast anticipates no such discounting will be necessary on super hero economist action figures.

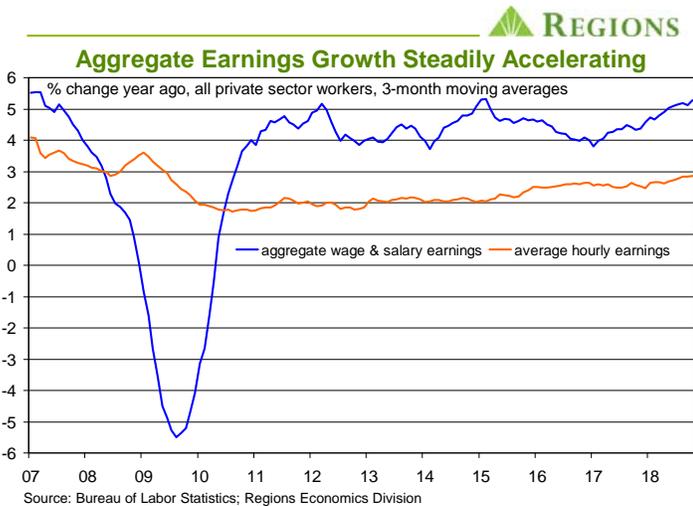


Even if, as our forecast anticipates, growth in holiday sales this year falls just short of 2017's growth, to us the bigger story is how strong holiday sales will have been in back-to-back years. To some extent, 2017 holiday sales benefited from easy comparisons, given how listless holiday sales were in 2016 (and 2015 for that matter). There was more to the story, however, than base effects. As we wrote last year at this time, consumers had not only the willingness but also the wherewithal to cut loose during the holiday sales season, and that is exactly what they did – to an even greater degree than we had anticipated. Our forecast for 2017 holiday sales called for a 4.9 percent increase in nominal sales and a 5.7 percent increase in real sales, both of which were trounced by actual sales. As noted above, nominal holiday sales rose by 6.3 percent in 2017 while real holiday sales rose by 7.2 percent.

Consumers are on even firmer footing as we head into the 2018 holiday shopping season and are feeling even better about it. As of October, the *Conference Board's* gauge of consumer confidence was at its highest point since September 2000. To be sure, the late-month tumble in equity prices was not fully captured in the October confidence data, and if share prices don't show at least some signs of bouncing back over coming weeks, that may cause some consumers to limit spending during the holiday season. We'd argue, however, that for most consumers their assessment of labor market conditions will be the more important driver of holiday spending. As of the *Conference Board's* October survey,

consumers are more upbeat on labor market conditions than at any time since January 2001, and feel increasingly confident in prospects for income growth. All in all, U.S. consumers seem more than willing to spend as we head into the holiday shopping season.

As to their wherewithal, financial conditions for U.S. consumers are better than has been the case for some time. To listen to some accounts, though, you'd never know this. For instance, many seem to base their entire assessment of the financial health of U.S. consumers on wage growth that, while having picked up some over recent months, nonetheless remains slower than would be implied by a headline unemployment rate below 4.0 percent. As we have discussed the reasons behind sluggish wage growth on numerous occasions, we won't go back over that ground here. We will, however, once again point out that when it comes to growth in personal income and, in turn, consumer spending, growth in aggregate wage and salary earnings is far more relevant than is growth in average hourly earnings.



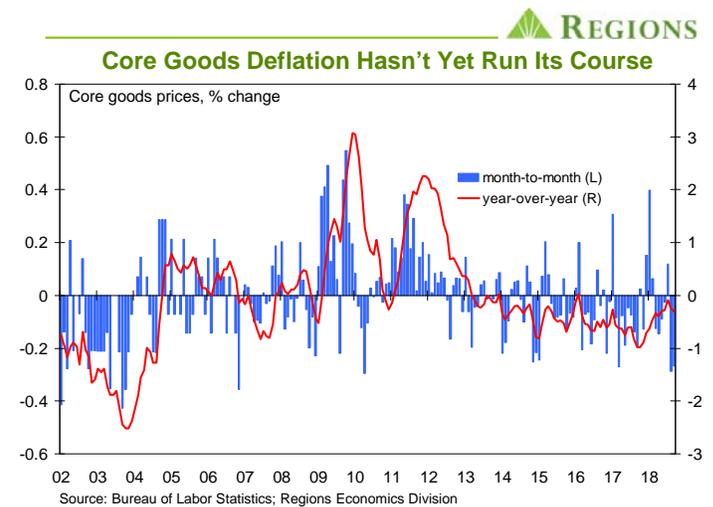
That distinction is illustrated in the above chart (using three-month moving averages to smooth out the month-to-month volatility). Though average hourly earnings get almost all of the attention, the reality is they are only one component of aggregate wage and salary earnings, which also account for the number of people working and the number of hours they work each period. As seen in the chart, aggregate wage and salary earnings have been growing at a better than 5.0 percent clip, easily outdistancing inflation. Aggregate wage and salary earnings are far and away the largest single component of personal income, and healthy growth in real labor earnings is underpinning faster growth in real total personal income. It is also worth noting that rising labor income is supporting growth in total income and spending across all income groups. Data from the 2017 *Consumer Expenditure Survey* show growth in spending across all income deciles, with the share of total spending accounted for by households in the bottom five income deciles rising to its highest in over a decade.

Healthy growth in labor earnings is one, but not the only, support for financial conditions in the household sector. Household net worth may or may not still be at a record-high when accounting for the late-October declines in equity prices, but, if not, then it won't be too far off. Either way, housing equity is a more important driver of net worth than stock holdings for many households, and

this has been a key driver of growth in household net worth over the past several quarters after having offered little support throughout much of the current expansion. As we discussed in our October *Outlook*, homeowners are sitting on roughly \$10 trillion of untapped housing equity, and while they seem uninterested in liquidating that equity to finance current consumption, it could be that improved equity positions are making homeowners more confident and, as such, more willing to spend out of current income than would otherwise be the case.

Though recent increases in interest rates may mean consumers will be either less willing or less able to take on additional debt to finance current consumption, it is also worth noting that with a preponderance of fixed rate debt on household balance sheets, higher interest rates are not pushing debt service burdens as high as would have been the case in past cycles. This is keeping at least some cash freed up for spending, which could also be a support for holiday spending.

All things considered, we feel comfortable with our holiday sales forecast, even if it seems a bit aggressive on the heels of such a large increase in sales during the 2017 holiday season. One caveat we'll toss out is that spending on consumer goods accounts for only about one-third of all consumer spending as measured in the GDP data. As is the case with most measures of holiday sales, our measure does not incorporate consumer spending on services, such as recreation, travel, dining out, and entertainment and, as such, will not fully capture the extent of consumer spending during the holiday season. This measurement issue is of course present each year, and only becomes meaningful to the extent the shares of holiday spending accounted for by goods and services shift sharply from one year to the next, but we would not be at all surprised to see such a shift this holiday season.



Even if our 2018 holiday sales forecast is on or close to the mark, how that will feel for retailers is an entirely different question. As noted above, persistent goods price deflation means most retailers have little, if any, pricing power, which continues to weigh on profit margins. As seen in the above chart, as measured by the Consumer Price Index, core goods prices have fallen on a year-on-year basis in 64 of the past 66 months (as measured by the PCE Deflator, core goods prices have been down year-on-year for 71

consecutive months). Any holiday season discounting would only compound pricing woes and add to margin pressures, thus taking even more joy out of the holiday season for retailers.

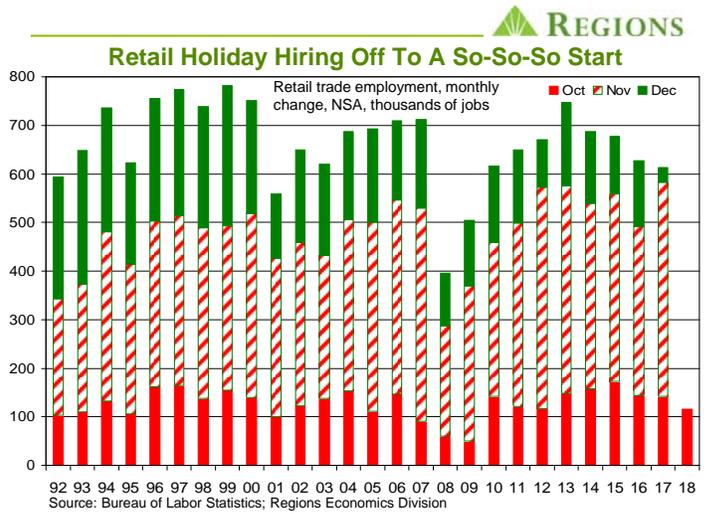
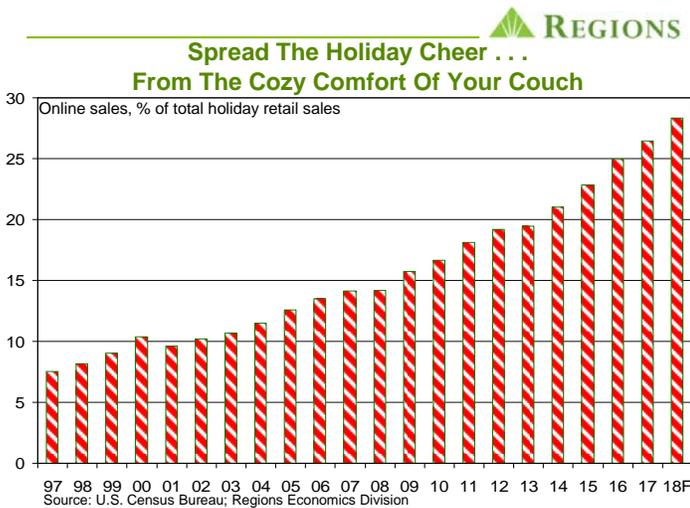
This is why we stress the significance of looking at retail sales on a price adjusted basis even though the data are reported on a nominal (or, not adjusted for price changes) basis, and this is our practice year-round, not just during the holiday shopping season. Margin pressures don't end here, however, as rising labor costs are further intensifying the squeeze on retailers' profit margins. While tightening labor market conditions are providing some of the push for rising labor costs, perhaps a bigger factor in retail trade is that minimum wages have gone up in many parts of the U.S. over the past two years, and many national retail chains have implemented voluntary entry level wage hikes, wage hikes which tend to filter up through the ranks of existing workers, making all labor more expensive. For instance, data from the Employment Cost Index, show that since Q1 2015 retail trade has seen the second fastest wage growth of any industry group, though the level of hourly wages still remains well below average.

As if falling goods prices and rising labor costs weren't enough, retailers must also contend with a fundamental truth: free shipping isn't really free, someone actually has to pay for it. That someone, especially during the holiday shopping season, is typically the retailer. This matters, of course, given the steadily rising share of consumer spending on goods done online, particularly during the holiday shopping season, when speed of delivery takes on added importance for many consumers. Higher fuel costs and higher shipping rates, reflecting capacity constraints in many segments of the transportation industry, mean "free" shipping will put even more pressure on retailers' margins this holiday season.

steadily larger the rate of growth will tend to slow, but, even so, online sales will still account for over one-quarter of holiday sales during the 2018 season even if that share falls short of our forecast of 28.3 percent of total holiday season sales.

So, let's review: labor costs and shipping costs are rising as online sales capture an increasingly larger share of holiday sales. All of which suggests the best strategy for retailers to follow this holiday season would be to simply fire all of their workers, bar their doors, and make sure they have a really cool online platform, right? Of course not, given that in-store sales still account for over 70 percent of holiday sales and are still easily the most profitable distribution channel for retailers. As such, retailers will continue to do it the old-fashioned way, i.e., hire holiday season workers and try to lure shoppers into their stores with promotions and, if necessary, holiday season discounting.

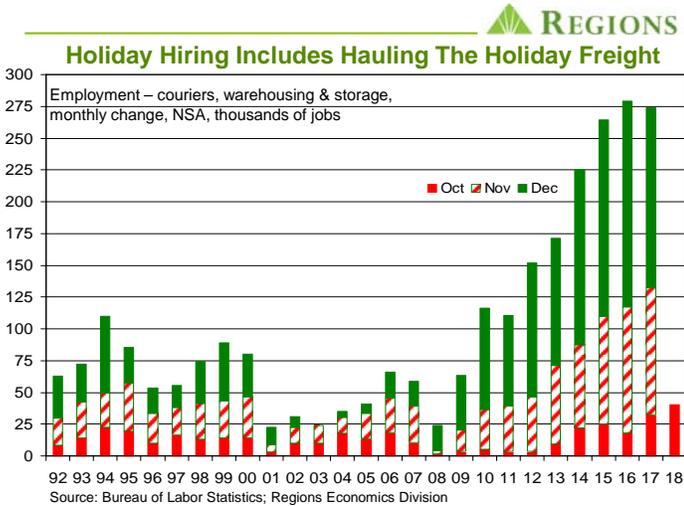
Which in turn means we will continue to track holiday season hiring which, for the retail sector, typically begins in October, with larger increases in staffing in November before hiring tapers off in December. The following chart shows seasonal holiday hiring (October through December) in retail trade, but for consistency we've excluded hiring in those categories we exclude from our measure of holiday sales. Also, the data shown in the chart are not seasonally adjusted, which is the proper basis on which to compare data for the same months across different years.



As seen in the chart, holiday hiring in retail hit a post-recession high of 746,800 workers in 2013 but has tailed off in each year since, with the 613,600 holiday season hires in 2017 marking the smallest number since 2009 (excluding recession years – 2001, 2008, and 2009 – 2017's total was the smallest since 1992). While it may seem that 2018 holiday hiring got off to a slow start, this may simply reflect the October establishment survey having fallen so early in the month rather than low expectations for holiday sales – seasonal hiring that occurred later in the month may not have been captured in the October data. On the whole, however, we expect less seasonal hiring in retail trade this year than in 2017.

Keep in mind, however, that the tailing off of holiday hiring in retail trade over the past few years has coincided with the rising share of holiday sales accounted for by online sales. Just as holiday shopping patterns have changed, so too have holiday season

hiring patterns. After all, once the goods have been ordered, they have to be packaged, then transported, then delivered to customers (or stolen by porch pirates). To get a measure of the full extent of holiday hiring we must also account for warehousing, distribution, and delivery, which we do in the following chart.



As with our chart on holiday hiring in retail trade, the above chart uses not seasonally adjusted data to compare the same months over different years, and we narrow the broad transportation sector down to the “couriers and messengers” industry group as this is the category into which home delivery services fall. As can be seen from the above chart, the amount of holiday season hiring in these industry groups has risen dramatically over recent years, but holiday season hiring doesn’t really ramp up until November.

During the 2017 holiday season, these industries added a total of 273,800 workers, down slightly from a peak of 278,900, but this decline could reflect a point we raised in last year’s holiday sales outlook. Specifically, given the ongoing shifts in shopping patterns over recent years, hiring in transportation, warehousing, and distribution has been so strong over the course of the year that we may have reached the point where incremental holiday hiring needs are less than they have been in the past. That said, hiring in the couriers and warehousing groups this October was the strongest on record for the month, but we’ll wait to see the data for the entire holiday season before conceding defeat on this point.

It is also worth noting that, as with retail trade, labor costs across the broad transportation, warehousing, and delivery sector are rising, and at an increasingly rapid rate of late. Indeed, as of Q3 2018 this industry group displaced retail trade as having the largest increase in wages of any industry group since Q1 2015. Unlike retail trade, however, there is pricing power in the transportation, warehousing, and distribution sector, meaning rising labor (and fuel) costs pose less of a threat to margins.

On the whole, 2018 should prove to be another strong year for holiday sales and hiring. To be sure, 2018 as a whole is shaping up to be a solid year in terms of growth in consumer spending, and what is encouraging to us is that consumers are not digging themselves into a financial hole in order to facilitate current consumption. We find this encouraging in the sense that it comes as such a stark contrast to the years prior to the 2007-09

recession. We also think it worth making this point given the constant references to record-high levels of household debt. As we’ve noted in our write-ups of the Federal Reserve Bank of New York’s quarterly reports on household debt, yes, household debt is at a record-high. To which our reply is: “and . . .?” We bet that, like us, you’ve seen countless stories referencing the record-high level of household debt, but we’ll also bet that you have yet to see one of those stories mention disposable personal income excluding transfer payments is also at a record high, because we sure haven’t seen one. This omission is even more egregious given that, while the level of household debt is 4.9 percent above its prior cyclical peak, the level of disposable personal income excluding transfer payments is 38.4 percent above its prior cyclical peak.

Of course, the distributions of income and the distribution of debt are not synched, but “record high” level of household debt in and of itself tells us nothing of value in terms of assessing financial conditions in the household sector. Wage growth that is broad based and accelerating, rising income and spending across all income groups, and rising consumer confidence across all income groups combine to tell us that consumers are willing and able to spend during this holiday season. While the risks to our forecast of growth in holiday sales may be to the downside, this will still prove to be a strong year for holiday sales. The main takeaway here: don’t wait too long to run out and buy that super hero economist action figure (it’s been said that they’re very life-like).

Wage Growth Picking Up, But . . .

The October employment report is further affirmation that the labor market remains rock solid. Total nonfarm employment rose by 250,000 jobs, with job growth remaining notably broad based. October’s job growth does reflect some payback for Hurricane Florence having held down job growth in September. Still, over the past 12 months the U.S. economy has added an average of 210,000 jobs per month.

At first glance, the 3.1 percent increase in average hourly earnings in October may be seen as a sign that wage growth is finally responding to tighter labor market conditions, particularly as the “headline” unemployment rate stands at 3.7 percent. While wage growth is accelerating, however, the reality is that the year-on-year increase in average hourly earnings has more to do with how weak hourly earnings were last October than with how strong they were this October. Last October saw sizeable numbers of lower-wage workers return to the employment rolls after having been displaced by Hurricanes Harvey and Irma. This biased hourly earnings lower – they fell by 0.2 percent last October, thus setting up the large year-on-year increase seen this October.

This points to the inherent flaw in the average hourly earnings metric, i.e., its sensitivity to the mix of employment. Data from the Q3 Employment Cost Index, a superior measure of growth in labor compensation costs that is not affected by shifts in the composition of employment across industry groups, show wage growth is accelerating, but remains shy of the 3.0 percent mark. In other words, the Employment Cost Index shows faster, but still not full employment fast, wage growth. We see it as only a matter of time before wage growth is more in line with that of past cycles when the economy was at or near full employment, but we’re not there just yet, the October data on hourly earnings notwithstanding.

ECONOMIC OUTLOOK



November 2018

| Q2 '18 (a) | Q3 '18 (p) | Q4 '18 (f) | Q1 '19 (f) | Q2 '19 (f) | Q3 '19 (f) | Q4 '19 (f) | Q1 '20 (f) | | 2016 (a) | 2017 (a) | 2018 (f) | 2019 (f) | 2020 (f) |
|------------|------------|------------|------------|------------|------------|------------|------------|---|----------|----------|----------|----------|----------|
| 4.2 | 3.5 | 3.0 | 2.2 | 2.6 | 2.4 | 1.9 | 1.6 | Real GDP ¹ | 1.6 | 2.2 | 2.9 | 2.7 | 1.6 |
| 3.8 | 4.0 | 3.2 | 2.5 | 2.3 | 2.3 | 2.2 | 2.1 | Real Personal Consumption ¹ | 2.7 | 2.5 | 2.7 | 2.8 | 2.1 |
| | | | | | | | | Business Fixed Investment: | | | | | |
| 7.0 | 3.5 | 6.9 | 4.9 | 4.1 | 3.5 | 3.1 | 2.6 | Equipment, Software, & IP ¹ | 2.1 | 5.5 | 7.3 | 4.8 | 2.8 |
| 14.5 | -7.9 | 4.9 | 2.4 | 1.7 | 1.6 | 2.0 | 1.4 | Structures ¹ | -5.0 | 4.6 | 4.9 | 2.0 | 1.3 |
| -1.3 | -4.0 | 0.9 | 0.3 | 0.8 | 2.1 | 1.5 | 2.1 | Residential Fixed Investment ¹ | 6.5 | 3.3 | 0.0 | 0.1 | 1.8 |
| 2.5 | 3.3 | 2.6 | 2.0 | 1.7 | 1.6 | 0.2 | -0.7 | Government Expenditures ¹ | 1.4 | -0.1 | 1.7 | 2.1 | -0.2 |
| -841.0 | -939.0 | -924.1 | -897.5 | -910.6 | -922.4 | -941.7 | -960.7 | Net Exports ² | -786.2 | -858.7 | -901.6 | -918.0 | -993.9 |
| 1.261 | 1.218 | 1.219 | 1.241 | 1.245 | 1.259 | 1.273 | 1.287 | Housing Starts, millions of units ³ | 1.177 | 1.208 | 1.254 | 1.255 | 1.306 |
| 17.2 | 16.9 | 17.2 | 16.8 | 16.6 | 16.5 | 16.5 | 16.4 | Vehicle Sales, millions of units ³ | 17.5 | 17.1 | 17.1 | 16.6 | 16.3 |
| 3.9 | 3.8 | 3.7 | 3.7 | 3.6 | 3.6 | 3.6 | 3.6 | Unemployment Rate, % ⁴ | 4.9 | 4.4 | 3.9 | 3.6 | 3.6 |
| 1.6 | 1.7 | 1.7 | 1.6 | 1.4 | 1.2 | 1.1 | 1.0 | Non-Farm Employment ⁵ | 1.8 | 1.6 | 1.6 | 1.3 | 0.8 |
| 2.5 | 2.5 | 3.0 | 2.7 | 2.0 | 2.5 | 2.4 | 2.5 | Real Disposable Personal Income ¹ | 1.7 | 2.6 | 2.9 | 2.5 | 2.2 |
| 2.5 | 2.4 | 2.2 | 2.3 | 2.1 | 2.4 | 2.5 | 2.4 | GDP Price Index ⁵ | 1.1 | 1.9 | 2.2 | 2.3 | 2.4 |
| 2.2 | 2.2 | 1.8 | 1.8 | 1.9 | 2.0 | 2.2 | 2.1 | PCE Deflator ⁵ | 1.1 | 1.8 | 2.0 | 2.0 | 2.1 |
| 2.6 | 2.6 | 2.2 | 1.8 | 2.0 | 2.0 | 2.0 | 2.0 | Consumer Price Index ⁵ | 1.3 | 2.1 | 2.4 | 2.0 | 1.9 |
| 1.9 | 2.0 | 1.9 | 1.9 | 1.9 | 2.1 | 2.2 | 2.2 | Core PCE Deflator ⁵ | 1.7 | 1.6 | 1.9 | 2.0 | 2.2 |
| 2.2 | 2.2 | 2.2 | 2.0 | 2.2 | 2.3 | 2.4 | 2.4 | Core Consumer Price Index ⁵ | 2.2 | 1.8 | 2.1 | 2.2 | 2.3 |
| 1.68 | 1.89 | 2.16 | 2.43 | 2.66 | 2.91 | 3.13 | 3.13 | Fed Funds Target Rate Range Mid-Point, % ⁴ | 0.39 | 0.98 | 1.78 | 2.78 | 3.13 |
| 2.92 | 2.92 | 3.20 | 3.30 | 3.35 | 3.45 | 3.50 | 3.50 | 10-Year Treasury Note Yield, % ⁴ | 1.84 | 2.33 | 2.95 | 3.40 | 3.49 |
| 4.54 | 4.57 | 4.78 | 4.93 | 4.95 | 5.07 | 5.18 | 5.16 | 30-Year Fixed Mortgage, % ⁴ | 3.65 | 3.99 | 4.54 | 5.03 | 5.14 |
| -2.0 | -2.3 | -2.4 | -2.4 | -2.5 | -2.7 | -2.8 | | Current Account, % of GDP | -2.3 | -2.3 | -2.4 | -2.6 | -2.9 |

a = actual; f = forecast; p = preliminary

- Notes:
- 1 - annualized percentage change
 - 2 - chained 2012 \$ billions
 - 3 - annualized rate
 - 4 - quarterly average
 - 5 - year-over-year percentage change

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203

Richard F. Moody
Chief Economist

Greg McAtee
Senior Economist