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So, 'Suddenly' Is Suddenly Here?

In a decidedly less interesting book, Bill Gorton's question might have been "how do expansions end?" and while Mr. Hemmingway, thankfully, opted to go a different route, Mike Campbell's reply would have been exactly the same: "two ways, gradually, and then suddenly." While history may, as we expect will be the case, prove otherwise, it sure seemed like "suddenly" got here at 8:30 AM on August 2 which, for those whose attention may have been focused on Paris, brought the release of the July employment report. The report showed a marked slowdown in nonfarm job growth, a jump in the unemployment rate, a drop in average weekly hours, and a deceleration in wage growth. That the July employment report is deeply flawed seemed to, with an assist from the BLS, have gone largely overlooked, as it triggered a stunning decline in yields on U.S. Treasury securities, a breathtaking selloff in equities, and a chorus of recession calls, many of which came from analysts whose calls were different at 8:29 AM on August 2.

Suddenly, indeed. We will have plenty to say about the July employment report and the labor market in general later on. For now, we think a discussion of the broader economic backdrop is in order, particularly around the question of whether the economy was really any different at 8:31 AM on August 2 than it was at 8:29 AM on August 2. To help set the stage for this discussion, recall that the July FOMC meeting concluded two days prior to the release of the July employment report. As was widely expected, the FOMC left the Fed funds rate unchanged at their July meeting but set the stage for a twenty-five basis point cut in the funds rate at their September meeting, an outcome that markets, and most analysts, seemed to have taken in stride.

The following day brought the release of the weekly data on initial claims for unemployment insurance benefits along with the July ISM Manufacturing Index. Initial claims rose by 14,000 in the week ending July 27, leaving them at their highest level since last August, while the ISM's July survey showed the factory sector to have been in contraction for the twentieth time in the past twenty-one months, the sole outlier being March 2024. While virtually no one expected the ISM's headline index to jump above the 50.0 percent break between contraction and expansion, we and most others did at least expect some modest improvement that would have offered hope of a turnaround on the horizon. Instead, the details of the July report were weak while comments from survey respondents suggested hopes of a turnaround in the factory sector were premature. That said, at 46.8 percent in July, the headline index remained above 42.5 percent, which ISM pegs as the line between contraction and expansion in the broader economy, a line that the headline index has not come close to crossing during this twenty-one month run of weakness.

As for the data on initial jobless claims, the increase to a nearly one-year high fueled concerns of a more pronounced deterioration

in labor market conditions than many had been anticipating and than had been implied by other labor market data, as if gradually might be turning into suddenly. We did not think too much of the increase in initial claims; not only were claims still being inflated by increased filings in Texas in the wake of Hurricane Beryl, but the pattern in claims over the prior several weeks was in keeping with the summer spikes seen over the past few years, spikes which receded in subsequent weeks, suggesting issues with the seasonal adjustment process. To that point, over the final two weeks of July the net change in not seasonally adjusted claims was minus 64,728 while the net change in seasonally adjusted claims was plus 4,000. While we of course were focused on the former, most of the attention was on the "one-year high" headlines that accompanied accounts of the data release.

Between initial jobless claims and the ISM Manufacturing Index, markets were already on edge on Thursday, August 1, with equity prices and yields on U.S. Treasury securities dropping during the day. That set the stage for what took place in the aftermath of the release of the July employment report the following day. Kind of. We can at least understand the reaction in equity markets, where many had for some time been expressing concerns that valuations may be on the lofty side. As such, the prospect of the economy shifting into a slower pace of growth would have meant that some resetting of valuations was in order. Moreover, recent earnings releases had raised the question of whether the magnitude of capital spending on the part of the tech giants would ever be justified by the returns on AI, which in turn led to questions as to whether valuations in this space were appropriate. So, one could argue that, while the stage was set for a pullback in equity prices, the only thing missing was a catalyst, which apparently arrived at 8:30 AM on August 2.

Still, even given concerns over valuations, one could argue that the magnitude of the decline in equity prices was overdone. It could be that what would have been a more orderly pullback in equity prices was amped up by the sudden chorus of recession calls in the wake of the release of the July employment report. As was pointed out to us, more than once, on August 2, perception can easily, and often does, become reality in the financial markets, and when that happens, actual reality doesn't tend to matter. So, while we found the July employment report as being easy to pick apart, a target-rich environment if ever there was one, that reality was no match for the perceptions fostered by the glaringly weak headline numbers attached to that report.

Again, those perceptions were likely influenced by the chorus of recession calls in the wake of the release of the July employment report coupled with a number of analysts suddenly deeming the FOMC to have fallen behind the curve in not having cut the Fed funds rate two days prior. That is the part of all of this that we continue to find puzzling. That perceptions of the state of the U.S. economy and the FOMC's performance could have been so

dramatically altered by a data release as questionable as the July employment report but yet which was seemingly accepted at face value despite those obvious flaws is, at least to us, difficult to understand. While the reaction in the financial markets may, and likely will to some degree, be reversed in coming sessions, it will be much harder for those analysts who made such sharp and sudden pivots on August 2 to reverse course in the weeks ahead.

Before shifting our focus to the July employment report and overall labor market conditions, we'll make the following points. First, this is by no means the only time in recent years that analysts have flocked into recession calls. By late-2018/early-2019, an increasing number of analysts had recession as their base case, on the grounds that the expansion which began in mid-2009 was bound to, effectively, die of old age. More recently, by late-2022 the vast majority of analysts had recession as their base case for the economy in 2023 on the grounds that the FOMC's aggressive course of Fed funds rate hikes would kill off the post-pandemic recovery. That we were on the other side of these calls means absolutely nothing in terms of our being right or wrong this time around, and while by no means dismissing the concerns expressed by others out of hand, despite how quickly they arose, we do not believe that the economy is on the verge of recession.

This is not a case of us "talking our book" and finding a way to twist each and every data release into a shape that supports our view. Indeed, we have for the past several weeks been pointing to signs of what to us has been a clear slowing in the pace of economic activity. Our sense has been, and remains, that after the significant distortions in economic activity over the past few years wrought by the pandemic and the policy response to it, the pace of economic activity is reverting back toward the roughly two percent trend rate seen over the decade prior to the pandemic. That those distortions would ultimately be worked out of the economy has always been a matter of when, not if, and while that may seem an obvious point, the extent to which signs of that "normalization" taking place are in many cases extrapolated into something far more ominous is nonetheless striking.

To be sure, it is more than fair to ask whether that "normalization" is what we are now seeing or whether/to what extent the added burdens of a prolonged period of rapidly rising prices and higher interest rates will push the economy past that point, to the downside that is. The answer to that question, however, does not come either quickly or easily. Obviously, in an economy as dynamic as is the U.S. economy, there do not exist stable resting, or, equilibrium, points where the economy stays for any length of time. It is also just as obvious that the economic data seldom, if ever, move in nice, straight lines – in either direction. We think the 1H 2024 data on real GDP growth to be a good illustration of these points. Recall that in Q1 real GDP grew at an annual rate of just 1.4 percent while in Q2 growth perked up to an annual rate of 2.8 percent. We noted upon the release of the Q2 data that we thought neither reflected the true state of the U.S. economy, with a growth rate right in the middle being a more apt depiction.

Even in the most "normal" of times it would take time to know whether we're in the midst of a normalization or trapped on a path to a less benign outcome. One thing making it even more difficult to make this call is that so much of the economic data that should be helping us and others do so have been riddled with noise,

making it difficult to discern the signals being sent. This is something we've seen almost across the board in data pertaining to the labor market, the housing market, consumer spending, foreign trade, and industrial production, with this issue more pronounced and more consistent in some series than in others.

While perhaps always having been so, we think this has been the case to a much greater since the onset of the pandemic. One point we've been making all along is that what for decades had been typical seasonal patterns in economic activity were significantly disrupted by the pandemic and the policy response to it, which has wreaked havoc on seasonal adjustment. This is why we are so insistent on going straight to the raw, or, not seasonally adjusted, data in any given data release before trying to draw any conclusions around the seasonally adjusted data. Being unaware of or simply ignoring these issues can easily lead one astray, as can treating each data point as though it's an independent entity, neither connected to prior observations from the same series nor to current observations from other series. That seems a fitting segue to our discussion of labor market conditions in general and the July employment report in particular.

Gradually Normalizing, Or Suddenly Sinking?

Perhaps nowhere are our frustrations with the reliability of the high frequency economic data as great as they are with the labor market data. The July employment report is a perfect, dare we use that term in this context, illustration. Total nonfarm payrolls are reported to have risen by just 114,000 jobs in July with private sector payrolls increasing by 97,000 jobs, each much smaller than expected. The average length of the private sector workweek fell by one-tenth of an hour, and average hourly earnings rose by only 0.2 percent. At the same time, the unemployment rate rose to 4.3 percent from 4.1 percent in June. As discussed above, the July employment triggered a violent reaction in the financial markets and led many analysts to change their calls on the course of the U.S. economy and the appropriate path of monetary policy.

Ahead of the release of the July employment report, we pointed to several factors that could, and likely would, cloud the July data, making it more difficult to interpret the results. That included what have been notably low collection rates to the BLS's monthly establishment surveys from which estimates of nonfarm payrolls, hours, and earnings are derived, Hurricane Beryl having impacted millions of people and businesses during the July survey period, and higher than normal July temperatures that we thought could impact hours worked. There is ample evidence that these factors impacted the July data from both the establishment survey and from the household survey (the basis of estimates of the labor force, household employment, and the unemployment rate).

Low collection rates for the establishment survey are nothing new, as rates have been meaningfully lower since the onset of the pandemic than had been the case prior to the pandemic. We've been quite consistent in pointing to this issue as diminishing the reliability of the initial estimates of the change in nonfarm payrolls in any given month. One way to think about this is that the lower the initial collection rate, the bigger the gap left for the BLS to fill in with their own estimates. Moreover, second and third month

collection rates have also trended lower and are well below pre-pandemic norms (firms have three chances to report data for any given month), calling into question the second and third estimates of nonfarm employment, hours, and earnings for any given month.

To our point about the impact of low initial collection rates, the average first-to-third change in estimates of private sector job growth in 2023 was minus 41,250 jobs, and over the first five months of 2024 – the months for which we have three estimates – the average first-to-third change has been minus 39,800 jobs. This clear and consistent pattern seems to go largely unnoticed as analysts and market participants take in the headline job growth numbers for any given month. But, the diminished reliability of second and third estimates makes it even harder to get a handle on labor market conditions. We will note that on August 21 the BLS will release the preliminary estimates of the annual benchmark revisions to the establishment survey data, the process by which the establishment survey results are mapped to the universe of payroll tax returns. We expect the benchmark revisions to yield a large downward revision to the level of nonfarm employment between March 2023 and March 2024.

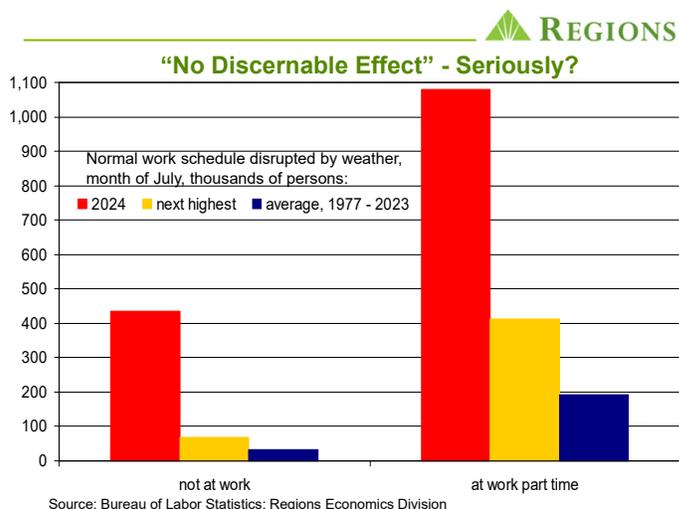
All that having been said, does the clear and consistent pattern of sizable downward revisions to the initial estimates of job growth mean that job growth was even weaker than implied by the paltry headline print on the July employment report? Any such concerns would seemingly be magnified by our noting that, at 56.9 percent, the initial collection rate for the July establishment survey is the lowest July collection rate since 1991. Perhaps not, as this is where the impacts of Hurricane Beryl likely come into play. Well, at least if one accepts the premise that Beryl impacted the July data.

Perhaps the most curious element of the July employment report is the BLS’s contention that Hurricane Beryl had “no discernable effect” on the July data despite storm damage that left millions of households and an unknown number of businesses without power for an extended period, a period which coincided with the July survey period. We think an initial collection rate for the July establishment survey well below an already low post-pandemic average is the first manifestation of the impact of Hurricane Beryl. Moreover, recall that one must be physically present at work at some point during the survey period in order to be counted as employed in the count of nonfarm payrolls. This makes it highly likely that at least some portion, perhaps a large portion, of those impacted by the storm were absent from work, including those employed at firms shut down during the survey period, and, as such, were not counted as employed in July.

It is worth noting that the not seasonally adjusted data show a spike in initial claims for unemployment insurance in Texas in the wake of Beryl, suggesting thousands of workers displaced by the hurricane were not counted as employed in July. Additionally, the data for the final week of July show initial claims in Texas still roughly ten thousand claims above the pre-hurricane run rate, which is relevant as this was one factor behind the “one year high” level of initial claims that week that rattled market participants.

We will also point out that the reported decline in average weekly hours in July is entirely accounted for by fewer hours worked in the goods producing industry groups – mining/natural resources, construction, and manufacturing. Though weaker conditions can account for fewer hours worked in manufacturing, construction

and mining/natural resources are the industry groups most susceptible to weather-related disruptions. Aside from the impact of Beryl, the six-tenths of an hour decline in average weekly hours worked in construction could also reflect higher than normal July temperatures across much of the U.S. limiting working hours.



Unlike the establishment survey, the household survey directly tries to account for weather-related disruptions, whether keeping people from work all together or limiting the number of hours they worked during the survey period. The July household survey data show 436,000 people did not work due to adverse weather, while 1.079 million people who normally work full-time worked only part-time due to adverse weather. As illustrated in the chart above, both are far and away the highest July numbers on record in data that span 48 years, and even the second highest numbers on record are nowhere near this July’s counts. Though not directly transferable to the establishment survey data, the household survey results strongly suggest Hurricane Beryl had at least some role in the reported decline in average weekly hours worked.

Also unlike the establishment survey, one need not be physically present at work at some point during the survey period to be counted as employed in the household survey. As such, it may seem that Hurricane Beryl would not have any role in the increase in the unemployment rate in July. We, however, think there is a fairly clear connection. The number of those on “temporary layoff” rose by 249,000 persons in July, the largest monthly increase since the early stages of the pandemic and an increase which added two-tenths of a point to the July unemployment rate, i.e., the reported increase in the unemployment rate in July.

That, however, is not the only curious factor behind July’s increase in the unemployment rate. Though not something Hurricane Beryl would have had a discernable effect on, the household survey data show that combined employment amongst those twenty-four and younger and those fifty-five and older fell by 551,000 persons in July, while employment amongst those 25-to-54 years old, the “prime working age” cohort increased by 247,000 persons as the labor force participation rate amongst this cohort rose to 84.0 percent, the highest since March 2001. This dichotomy has been present in the household survey data for the past several months, and though we have largely pointed to it as a reason to question the increase in the unemployment rate over the past few months,

it has seemingly escaped broader notice. Our point all along has been that, were the labor market truly deteriorating to the extent being claimed by some, there should be evidence of that in the data pertaining to the prime working age cohort, a group that accounts for just under two-thirds of the entire labor force.

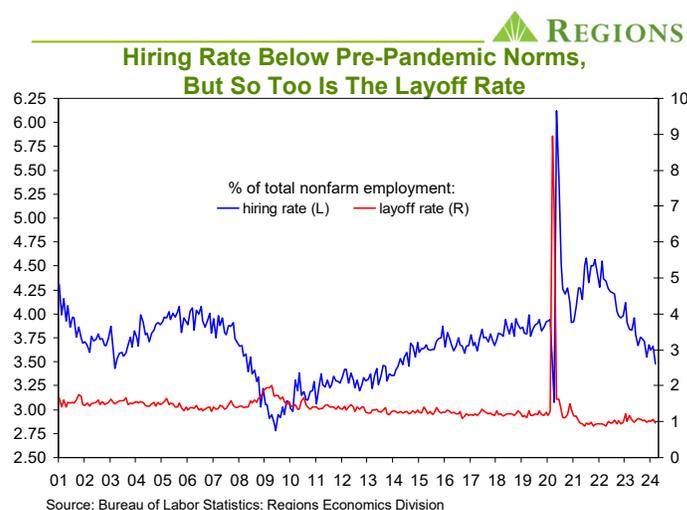
While the unemployment rate amongst this cohort has ticked up to 3.6 percent, that is a function of the rising participation rate amongst this cohort, as employment amongst this cohort has risen by 958,000 persons thus far in 2024. That ties into our point about the odd dichotomy across the age distribution; total household employment has risen by just 83,000 persons to date in 2024 which, given the increase amongst the prime working age cohort, means the youngest and oldest age cohorts have seen material declines. We find it a bit curious that those who point to virtually flat household employment in 2024 as being a truer representation of labor market conditions than is the increase in payroll employment never seem to mention this dichotomy, meaning they are either unaware of it or simply do not think it matters.

And, while we're on the topic, we can also point to what we see as another odd dichotomy in the household survey data, this one along gender lines rather than across age cohorts. According to the household survey data, employment amongst females has fallen by 404,000 persons thus far in 2024 while employment amongst males has risen by 487,000 persons. Historically, the only periods in which there have been such divergences in employment patterns amongst females and males have been periods in and around recessions. So, sure, in that sense those who even prior to the release of the July employment report were claiming the U.S. economy was in recession have a point in their favor, even if they are wholly unaware of that point.

We are not by any means pointing to this split along gender lines as evidence of recession. We are, however, pointing to it and the dichotomy across age cohorts as reasons to question the reliability of the household survey data, as we've been doing for the past several months. The broader point is that these splits along with what, at least to us, are clear impacts of Hurricane Beryl should be more than enough to call into question the reliability of the July employment report. Instead, many analysts and market participants seem to have gone no further than the headline numbers atop the July employment report as a basis on which to alter their calls on the state of the U.S. economy and the course of monetary policy. Sure, perception can become reality, or at least close enough to it to drive markets. And, it could be that while some suspected ahead of time that Hurricane Beryl would have had an impact on the July employment report, the BLS stating that there was "no discernable effect" on the July data made them more willing to accept the data at face value than would otherwise have been the case.

Be that as it may, we're not simply tossing the July employment report aside and claiming all is well with the labor market. As our regular readers know, we have for the past several months pointed to signs of cooling labor demand. We've also noted, however, that cooling demand is not in and of itself a sign that the labor market is on the verge of collapsing. In part, what we've seen in the labor market simply goes to our point about normalizing after as the pandemic-related distortions of the past few years run their course. That includes industries which, in hindsight, hired too aggressively in late-2020/early-2021, such as information services

and transportation/warehousing/distribution, and which recently have been attempting to right-size payrolls with where demand is rather than where they expected demand to be. Still, one point we've made consistently is that the slowing trend rate of job growth has been a function of a slower rate of hiring – again, part of what we see as normalizing conditions – as opposed to a rising rate of layoffs, which we illustrate in the following chart.



We think this is an important distinction, in that while firms may be sensing that demand has softened, they still anticipate needing workers in the future. Given how difficult, and costly, it has been for firms to not only find labor but also to retain labor over the past few years, the bar for them to begin laying workers off is perhaps higher than has been the case in past cycles, hence firms continuing to engage in "labor hoarding." It is also important to note that along with layoffs comes the loss of income to displaced workers, which in turn contributes to either slower growth in or outright declines in consumer spending, which in turn has ripple effects elsewhere in the economy. To be sure, a slowing hiring rate coupled with continued inflows into the labor force puts upward pressure on the unemployment rate and yields a slower pace of growth in aggregate labor earnings, the largest single component of personal income. Slower growth, however, is a decidedly different outcome than an outright decline.

As we have often discussed, however, an intermediate step firms take before resorting to layoffs is to manage hours worked by their current workforces. After all, firms manage total labor input, the product of the number of workers and the number of hours worked in any given period. The establishment survey data do show a downward drift in average weekly hours over the past year but – barring July's decline, which we completely discount – this leaves average weekly hours in line with pre-pandemic norms. So, again, the question is whether we are seeing the normalization we've for some time expected or something much less benign.

No single month's data will answer that question, particularly when the data are as flawed as we've for some time seen the data in the monthly employment reports as being. But, we have noted two things that would lead us to alter our view of the labor market, and in turn our outlook for the broader economy, to the downside. Further reductions in average weekly hours would be a sign that firms continue to perceive softening demand. There is, however,

a limit as to how extensively firms will cut hours worked before deciding the more feasible route is to start laying off workers. As such, what would give us even greater pause than further cuts in hours worked would be a significant, sustained, and broadly based increase in layoffs. As such, the weekly data – the not seasonally adjusted data that is – on initial claims for unemployment insurance will remain a key indicator to watch in the weeks ahead.

We've also expressed concern over growth in nonfarm payrolls being highly concentrated amongst three industry groups – health care, leisure and hospitality services, and government. Prior to July, these industry groups had accounted for just under two-thirds of all nonfarm job growth in 2024. In some sense, this high concentration is not much of a concern, as these three industry groups were clear laggards when it came to filling in the jobs shed in the early phase of the pandemic. With payrolls in other industry groups at or above pre-pandemic peaks, it made sense that hiring in those industry groups would slow – or in some cases that payrolls would be falling as a result of having hired to aggressively in earlier periods. As hiring continued in lagging industries, they'd naturally account for a rising share of overall job growth.

But, we have been noting that should the pace of hiring slow in one, let alone all, of these industry groups the result would be a marked slowdown in the pace of overall job growth. Though hiring in health care has held up, hiring in leisure and hospitality services and government has slowed. Again, though, that we have so little faith in the July data makes it too soon to draw broad conclusions. We will, however, note that seasonal adjustment worked against the data in leisure and hospitality services in both June and July, i.e., smaller than normal increases in unadjusted payrolls yielding smaller increases in the seasonally adjusted data. That was also the case in local government employment excluding education in the July data, acting to hold down total job growth.

Clearly, there have been causes for concern as to the state of the labor market over recent months. But, going to the point of this discussion, did labor market conditions suddenly deteriorate to the extent implied by the July employment report, or, should more people have asked more questions about the data contained in that report rather than leaping to conclusions so dramatically at odds with their views as of 8:29 in the morning on August 2? Our answer is clear, but the only answer that matters will take time to know and will be delivered by the economic data over the weeks and months ahead. That so much of the data have been riddled with so much noise, however, means the answer is unlikely to be as clear as we'd like, or to come as soon as we'd like. Moreover, those who go no further than the headline numbers that come with the economic data releases may hear an entirely different answer from the data than we do. All of which is fine, as neither how we analyze the data nor how we see the economy evolving was any different at 8:31 AM on August 2 than it was at 8:29 AM on August 2.

Economic Outlook: Gradual Changes, At Least For Now . . .

That how we see the economy evolving was no different at 8:31 AM on August 2 than it was at 8:29 AM on August 2 does not mean our outlook has not changed. It has, but those changes are mostly the result of adapting to the evolution of the economic data at our

disposal prior to the release of the July employment report. Most notably, our expectations for business investment spending and the construction and sales of new single family homes have adapted along with the incoming data. The same is true of our forecast of the unemployment rate, though as the preceding discussion hopefully made clear, this isn't necessarily a reflection of our view of the labor market having changed. The reality is that, regardless of whether we believe the data or not and regardless of whether or not we can point to what seem clear issues with the data, whether they are collection and/or measurement issues or seasonal adjustment issues, the data that are published are the data that we have to feed into our forecasting models on the input side. It is exactly as a wise old economist told us very early on in our career – the numbers are what the numbers are. As such, our August baseline forecast, summarized on Page 7, shows a higher full-year 2024 unemployment rate and a higher cyclical peak unemployment rate than have our prior forecasts. To be sure, our forecasts can, and do, incorporate our expectations of how the already published data will be subsequently revised, but there is a limit as to the extent to which we can do so.

Along those same lines, we noted earlier that we thought neither the Q1 nor the Q2 data on real GDP growth portrayed the path the economy was actually on, which we saw as pretty much right in the middle of the two quarterly growth rates. That said, the BEA's initial estimate of annualized growth of 2.8 percent in Q2 sets a higher base for real GDP growth over 2H 2024 than our previous forecasts had anticipated. As such, our August baseline forecast anticipates full-year 2024 real GDP growth of 2.6 percent, higher than the 2.3 percent growth our July forecast anticipated. Again, though, this is more a reflection of the GDP math than it is our suddenly seeing brighter prospects for the economy over the second half of this year. Moreover, with the inevitable revisions to the BEA's initial estimate of Q2 GDP, as happens every quarter, our September forecast will likely show at least a modest change from our August forecast of full-year 2024 real GDP growth.

One reason we discounted the reported 2.8 percent annualized growth in real GDP in Q2 is that we heavily discounted the reported 2.3 percent annualized growth in real consumer spending. As we noted at the time of their release, we did not buy the data on June control retail sales, a direct input into the GDP data on consumer spending on goods. The reported 0.9 percent increase in control retail sales (retail sales excluding building materials, restaurant, motor vehicle, and gasoline sales, for which BEA relies on sources other than the retail sales data) in June was no more than a gift of seasonal adjustment. But, to our earlier point, the June print on control retail sales fed into the Q2 GDP data, one factor behind the faster than anticipated growth in real GDP in Q2 which also set a higher base for growth in real consumer spending over 2H 2024 than our July forecast anticipated. More significantly, if the economy is indeed normalizing, as we believe, that means we should see growth in consumer spending realign with growth in disposable personal income after significant distortions stemming from the pandemic and the policy response to it. If we are correct on this point, growth in consumer spending going forward will be slower than has been the case over the past few years.

That we did not anticipate mortgage interest rates being more or less stuck at or slightly above seven percent for three straight months – April through June – means that we've had to adapt our

forecasts of construction and sales of new single family homes. As that run of seven percent mortgage rates endured, it took an increasing toll on new home sales as well as on builder confidence. Mortgage interest rates did ease slightly in July, and with yields on 10-year U.S. Treasury notes plummeting over the early days of August, mortgage interest rates seem poised to fall further, which we think would draw out more of the pent-up demand for home purchases that has been an element of our forecasts for some time now. That said, if we are correct in thinking that the world, or at least the outlook for the U.S. economy, did not suddenly crumble at 8:30 AM on August 2, there should be at least somewhat of a correction in yields, limiting the extent to which mortgage interest rates actually fall. Again, we try to gauge such factors as best we can and incorporate that into our forecasts. But, where we are as of our August baseline forecast is with construction and sales of new single family homes lower than had been anticipated in prior vintages of our baseline forecasts.

Finally, we have downgraded our expectations of growth in real business investment in equipment and machinery over coming quarters. That may seem odd in light of the GDP data showing annualized 11.6 percent growth in Q2, but that growth was driven by computer equipment and nondefense aircraft, the latter of which will surely not be replicated. Our adjustment is based more on the monthly data on core capital goods orders which, as we've noted elsewhere, has been oddly rangebound since January 2023. We had expected that by now we would have seen growth in core capital goods orders, which would presage growth in business investment as reported in the GDP data. Whether it is persistently high financing costs or lack of confidence in/uncertainty over the economic outlook, orders growth has not yet materialized. That has led us to downgrade our forecast for 2H 2024 into 2025.

The kinds of changes we've outlined here are part of the normal ebbs and flows of forecasting. None of the changes are large, one way or the other, and other than having to feed the published labor market data into our forecasting model, none have been triggered by the July employment report. We did, however, think it worth noting them here, in part because we now have a full complement of data for the first half of 2024 at our disposal, and in part because we see this as a means of emphasizing how little the July employment report actually changed for how we see the economy. It will be interesting to see how the forecasts of those who so dramatically changed their calls on the Fed in the wake of the July employment report revise their economic forecasts to align with their new Fed calls, given that they changed the latter – basically on the fly – before they changed the former.

FOMC Suddenly Behind The Curve Or Correctly On A Gradual Path?

The speed with and the extent to which several shops changed their calls on the stance of monetary policy in the wake of the July employment report was breathtaking. Some shops who at 8:29 AM on August 2 had base cases of fifty basis points of Fed funds rate cuts by year-end were by mid-day August 2 forecasting 125 basis points of cuts, with some going so far as to call for the FOMC to implement a fifty basis point cut prior to their September meeting. We think it more than reasonable to ask what could possibly have changed so dramatically and what was suddenly seen at 8:30 AM

on August 2 that wasn't seen at 8:29 AM on August 2. We could make the same point of those who after the July FOMC meeting felt the FOMC was on course to engineer a "soft landing" but were proclaiming the FOMC to be "behind the curve" just two days later.

Be that as it may, in the wake of the July employment report we have been asked whether the FOMC should have cut the funds rate at their July meeting and whether we now expect the FOMC to move more aggressively over the remainder of this year than we expected prior to the July employment report. Prior to the July FOMC meeting, we characterized monetary policy as needlessly restrictive. In other words, the pronounced deceleration in inflation coupled with what we thought were clear signs of a slowing pace of economic activity gave the FOMC grounds to begin cutting the Fed funds rate. Again, our point wasn't that monetary policy should suddenly become accommodative to fend off recession, but that monetary policy should gradually become less restrictive in keeping with patterns in inflation and economic growth.

While we did not expect the FOMC to cut the funds rate at their July meeting, we thought a cut should have been on the table and expected at least some members to push for a cut. In that sense, the unanimous vote to keep the funds rate unchanged was a bit of a surprise. But, we have for some time had twenty-five basis point rate cuts at the September and December FOMC meetings penciled into our baseline forecasts, so while we didn't necessarily agree with the decision to hold pat at the July meeting, neither did we think holding pat left the FOMC "behind the curve."

Really, if the economy is indeed barreling toward recession as many are now claiming, the thought that a twenty-five basis point rate cut at the July FOMC meeting was going to change that is nonsensical. Cushion the impact, perhaps, but stop the train? No. Amid a slowing pace of economic activity, funds rate cuts would, via reductions in rates either tied to or which move with the funds rate, such as the prime rate and SOFR, have beneficial effects in many parts of the economy. In an economy barreling toward recession, however, those lower interest rates wouldn't have all that much of an impact. Perhaps the question now becomes which economy are we truly in, and whether that is any different after the July employment report than it was prior to that report.

For those still reading, our view is by now hopefully quite clear. That, however, does not necessarily mean we should continue to expect nothing more than twenty-five basis point funds rate cuts at the September and December FOMC meetings. It could be that enough FOMC members see the July employment report as a clear signal rather than a batch of noise and, as such, now feel that a more aggressive course of rate cuts is in order. And, while we do not expect it, we would not rule out the FOMC moving prior to their September meeting. Again, this isn't about what we think the FOMC should do; what we think the FOMC should do is irrelevant when it comes to making our forecasts, which are instead based on what we see as the most likely path of monetary policy. Once again, perception, or in this case positioning, tends to create its own reality and, in that sense, unless markets begin to reverse course, markets pricing in a recessionary outlook can make that outcome more likely to actually happen. That in and of itself could steer the FOMC down a different path than the one they were on at 8:29 AM on August 2. That we don't see the July employment report as having actually changed the economic landscape does not, in that sense, matter.

ECONOMIC OUTLOOK



August 2024

Q1 '24 (a)	Q2 '24 (p)	Q3 '24 (f)	Q4 '24 (f)	Q1 '25 (f)	Q2 '25 (f)	Q3 '25 (f)	Q4 '25 (f)		2021 (a)	2022 (a)	2023 (a)	2024 (f)	2025 (f)
1.4	2.8	1.8	2.3	1.9	2.0	2.1	2.3	Real GDP ¹	5.8	1.9	2.5	2.6	2.1
1.5	2.3	2.5	2.1	1.9	2.0	2.2	2.3	Real Personal Consumption ¹	8.4	2.5	2.2	2.3	2.1
4.4	5.2	2.0	2.2	2.5	3.0	3.5	3.5	Real Business Fixed Investment ¹	5.9	5.2	4.5	3.8	2.8
1.6	11.6	1.1	0.1	0.3	1.7	3.2	3.3	Equipment ¹	6.4	5.2	-0.3	2.3	1.8
7.7	4.5	5.3	5.1	5.0	4.9	4.9	4.8	Intellectual Property and Software ¹	10.4	9.1	4.5	4.9	5.0
3.4	-3.3	-3.4	0.1	1.3	1.0	1.0	1.1	Structures ¹	-3.2	-2.1	13.2	4.0	0.1
16.0	-1.4	-4.9	0.3	1.6	0.4	2.2	1.9	Real Residential Fixed Investment ¹	10.7	-9.0	-10.6	4.1	0.2
1.8	3.1	0.3	1.4	1.4	1.7	1.3	1.1	Real Government Expenditures ¹	-0.3	-0.9	4.1	2.9	1.4
-960.3	-1,007.0	-1,003.4	-986.9	-985.2	-985.6	-1,000.2	-1,001.4	Real Net Exports ²	-933.8	-1,051.0	-928.1	-989.4	-993.1
1,062	1,006	978	983	984	987	990	993	Single Family Housing Starts, ths. of units ³	1,131	1,006	949	1,007	989
345	342	315	309	305	300	302	304	Multi-Family Housing Starts, ths. of units ³	474	546	473	328	303
5.3	4.5	2.8	1.8	1.5	1.6	2.0	2.2	CoreLogic House Price Index ⁵	15.4	13.2	3.9	3.6	1.8
15.3	15.7	15.9	15.9	15.9	15.9	16.0	16.1	Vehicle Sales, millions of units ³	14.9	13.8	15.5	15.7	16.0
3.8	4.0	4.2	4.2	4.3	4.4	4.4	4.3	Unemployment Rate, % ⁴	5.4	3.6	3.6	4.1	4.3
1.8	1.7	1.6	1.4	1.1	1.0	0.9	0.8	Non-Farm Employment ⁵	2.9	4.3	2.3	1.6	1.0
1.3	1.0	2.0	2.6	3.4	2.7	2.8	2.8	Real Disposable Personal Income ¹	3.2	-5.9	4.1	1.4	2.7
2.4	2.6	2.2	2.3	2.1	2.1	2.2	2.3	GDP Price Deflator ⁵	4.6	7.1	3.6	2.4	2.2
2.6	2.6	2.4	2.5	2.2	2.1	2.3	2.2	PCE Deflator ⁵	4.2	6.5	3.7	2.5	2.2
3.2	3.2	2.7	2.6	2.3	2.2	2.4	2.4	Consumer Price Index ⁵	4.7	8.0	4.1	2.9	2.3
2.9	2.7	2.7	2.8	2.4	2.3	2.3	2.3	Core PCE Deflator ⁵	3.6	5.2	4.1	2.8	2.3
3.8	3.4	3.2	3.0	2.7	2.5	2.6	2.6	Core Consumer Price Index ⁵	3.6	6.2	4.8	3.4	2.6
5.38	5.38	5.34	4.85	4.59	4.32	4.09	3.82	Fed Funds Target Rate Range Mid-Point, % ⁴	0.13	1.73	5.07	5.24	4.20
4.16	4.44	4.04	3.93	3.98	4.04	4.05	4.08	10-Year Treasury Note Yield, % ⁴	1.44	2.95	3.96	4.14	4.04
6.75	7.00	6.55	6.31	6.28	6.26	6.18	6.15	30-Year Fixed Mortgage, % ⁴	2.96	5.34	6.81	6.65	6.22
-3.4	-3.3	-3.1	-3.1	-3.1	-3.1	-3.0	-3.0	Current Account, % of GDP	-3.7	-3.9	-3.3	-3.2	-3.0

a = actual; f = forecast; p = preliminary

Notes: 1 - annualized percentage change 2 - chained 2017 \$ billions 3 - annualized rate 4 - quarterly average 5 - year-over-year percentage change

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