



*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.*

## In Search Of The “Real” Unemployment Rate . . .

Seldom, if ever, has a decline in the unemployment rate been greeted with such disdain as was the decline reported for June. The unemployment rate fell to 5.3 percent in June from 5.5 percent in May, and now stands at its lowest point since April 2008. As we routinely point out, however, the unemployment rate can fall for the “right” reason (i.e., an increase in the number of people working) or it can fall for the “wrong” reason (i.e., a decline in the labor force). June’s decline was an instance of the unemployment rate falling for the wrong reason – a 432,000 person decline in the civilian labor force. Thus, even though the level of household employment fell, the labor force fell by a far greater magnitude, resulting in the decline in the unemployment rate. Indeed, over the course of the current recovery/expansion, declining labor force participation has been a key component of the decline in the unemployment rate from the cyclical peak of 10.0 percent seen in October 2009.

There has been no shortage of debate as to whether the decline in labor force participation is more structural or cyclical, and we have written about this topic in past editions of our monthly *Economic Outlook*. Either way, there is general agreement the headline unemployment rate (the “U3” measure) is not nearly as representative of underlying labor market conditions as has been the case in the past due to the drop in labor force participation.

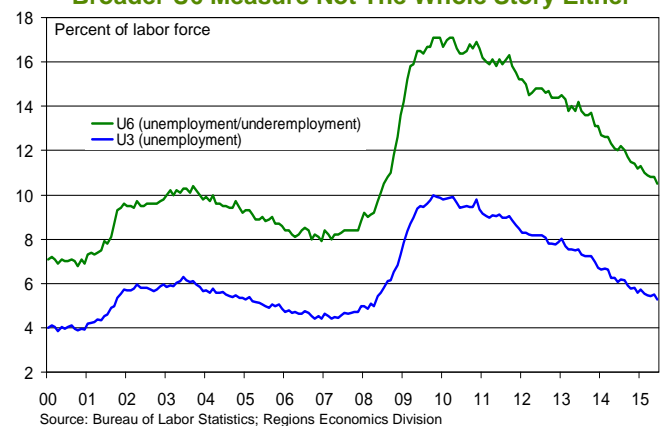
In light of the shortcomings, real or perceived, in the U3 measure of unemployment, many have pointed to the broader “U6” measure as the “real” unemployment rate. The U6 rate starts with the U3 measure of unemployment then adds to it by accounting for those who are working part-time for economic reasons (or, those who are underemployed) and those who are marginally attached to the labor force (or, those not currently in the labor force who are not actively looking for work but would be willing and able to start a job). While it is true the U6 measure conveys more information than the U3 measure, we would not go so far as to call it the “real” unemployment rate, mainly because doing so blurs the distinction between unemployment and underemployment – those working part-time but who would prefer to be working full-time are nonetheless employed, even if not fully so.

To be sure, we are not discounting the U6 measure, as it does convey useful information. As seen in the following chart, the U6 measure is showing the same general pattern as the U3 measure, with the U6 measure peaking at 17.1 percent but having since steadily declined, standing at 10.5 percent as of June. What is striking, however, is the spread between the two rates, which remains considerably wider than its historical

average. Between 1960 and year-end 2007, the average spread between the two rates was 405 basis points, while from January 2008 through June 2015 the spread averaged 632 basis points. The U6-U3 spread peaked at 730 basis points in September 2011 and as of June stood at 520 basis points.



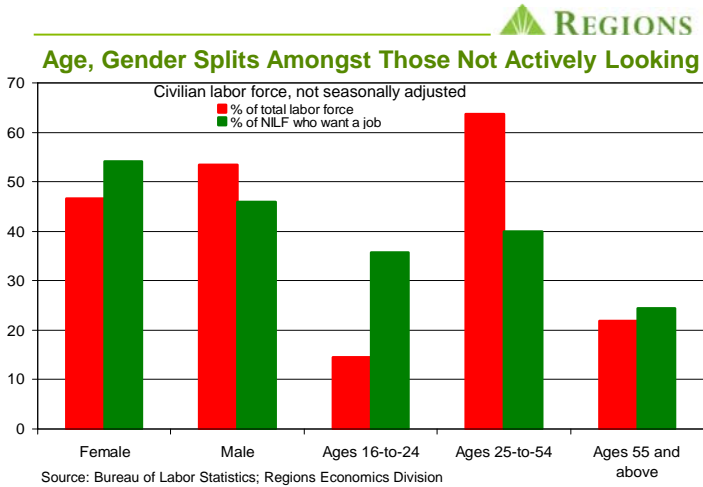
**Broader U6 Measure Not The Whole Story Either**



So, while narrowing, the U6-U3 spread nonetheless remains well above its historical average, the difference being a much larger than normal number of those working part-time for economic reasons (which stood at 6.5 million as of June). The broader U6 measure supports the premise of a still elevated degree of slack in the labor market. Our point here, however, is even the U6 number ignores a sizeable number of people who, while not in the labor force, nonetheless indicate they currently want a job. This group includes but is not limited to the widely discussed “discouraged workers” – those who are not actively looking for work due to discouragement over their prospects for finding a job. The overall group of those not in the labor force who want a job is much larger than the group of discouraged workers, but yet is typically overlooked in discussions of labor market slack.

The obvious question may be why, if they do indeed want a job, members of this group are not in the labor force – were they conducting an active job search they would be classified as in the labor force and unemployed. It could be some respondents feel the “socially acceptable” reply is to state they want a job even if they truly do not, so the official measurement of “not in the labor force currently want a job” overstates the true number of those not actively looking despite wanting a job. Or, it could be scheduling and/or transportation issues, child care constraints, health issues, or other factors preclude members of this group from actively looking for work. Though there is no way to verify this, our sense is those with legitimate reasons for not being actively engaged in a job search significantly outnumber those

simply stating they want a job because they see that as the more acceptable reply.

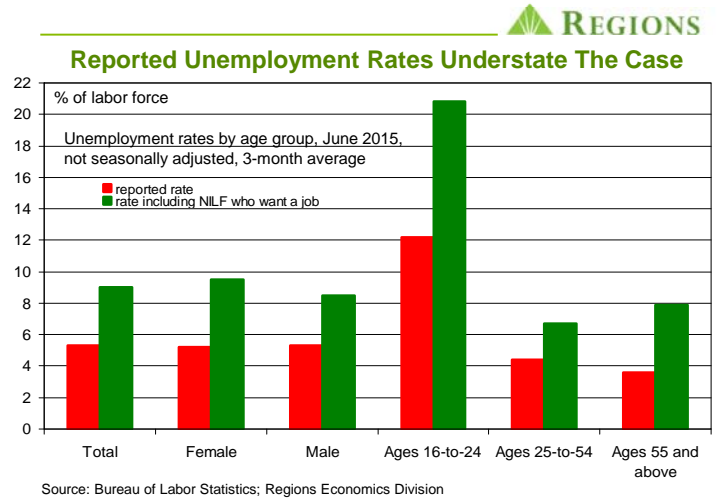


As of June, there were 6.561 million people classified as not in labor force who currently want a job, compared to a measured labor force of 158.283 million persons (note all data in this discussion are not seasonally adjusted as data limitations preclude seasonal adjustment on the various splits into gender, ethnic, and age groups). The group of those not in the labor force (or, NILF) but who want a job is equivalent to just over 7 percent of the total number of those not in the labor force. For comparison, the number of those NILF who do not want a job – at 85.819 million persons as of June – is vastly larger in any given month.

Though a smaller share of the NILF pool than those who do not want a job, those who do want a job nevertheless comprise a sizeable block of potential entrants into the labor force. Indeed there has been considerable speculation over the past few years as to at what point improving labor market conditions would trigger an inflow of job seekers into the labor force. To the extent this has been or will be the case, this group would seem the most likely source of these new labor force entrants, and in this sense could be seen as representing “slack” that will, at some point, have to be absorbed and, as such, could act as a drag on growth in hourly earnings.

When thought of in these terms, it seems somewhat odd those who talk about the “real” unemployment do not account for those NILF who do want a job. True, the U6 measure captures the discouraged workers but this group accounts for a relatively small share of the entire group of those who want a job – just over 29 percent as of June. It is, however, fairly straightforward to calculate unemployment rates that take account of those stating they want a job but who are not currently in the labor force. The following chart shows a comparison between reported rates and our calculations of unemployment rates adjusted to account for those NILF who currently want a job, broken down by gender and across three broad age cohorts. The rates shown are three-month averages as of June. As noted above the data used in this discussion are not seasonally adjusted and there are clear seasonal trends, particularly for those in the 16-to-24 year-

old age group in the months of May and June – the start of the summer employment season. While simply using the data for June would not have altered the broader point here, it would have overstated the effect for the younger age cohort.



In June, the not seasonally adjusted unemployment rate stood at 5.3 percent but, when accounting for those not in the labor force who want a job, the unemployment rate stood at 9.0 percent (again, all rates stated here are three-month averages). While there is little difference between reported unemployment rates for females and males, when accounting for the higher number of females not in the labor force who want jobs, the adjusted unemployment rate is much higher – 9.5 percent for females, 8.5 percent for males. It is interesting to note, without having a satisfactory explanation for why this is the case, females account for a higher share of NILF who want a job than males but are less likely to be included in the “discouraged workers’ category.

Across age groups, those in the 16-to-24 year-old age cohort are significantly over-represented in the pool of NILF who want a job relative to their share of the total labor force. Accounting for this yields an adjusted unemployment rate of 20.8 percent, well above the reported rate of 12.2 percent. By contrast those in the 25-to-54 year-old age cohort are under-represented in the pool of NILF who want a job relative to their share of the total labor force, and the 230 basis point disparity between adjusted (6.7 percent) and reported (4.4 percent) unemployment rates is the smallest of any block.

Interestingly enough, the 55-and older age cohort is almost as equally represented in the pool of NILF and want a job as they are in the overall labor force. Nonetheless, there is a sizeable gap of 420 basis points between the adjusted (7.8 percent) and reported (3.6 percent) unemployment rates. One take on this is a nontrivial share of retirements reported amongst this age cohort during and in the aftermath of the 2007-09 recession were involuntary. Also, it seems likely the number of those reporting to be NILF and currently desiring a job could be understated amongst this age cohort, i.e., there could be a perhaps significant number who actually do want a job but perceive, rightly or wrongly, their chances of landing another job are remote and, as such, report they do not want a job. Either way,

it seems unlikely a sizeable number of those in this age cohort who are not currently in the labor force, whether stating they want a job or not, will ever return to the labor force.

There seems to be fairly broad agreement the headline (or, U3) unemployment rate does not adequately account for the degree of slack still present in the labor market. What is less clear is the proper way to account for this slack. While the broader U6 measure is one possibility, this ignores a sizeable group of people who do want jobs despite not being included in the measured labor force. Of the total pool of those not in the labor force, the share that reports wanting a job remains well above that which prevailed prior to the 2007-09 recession, so it is plausible to see this group as representing a nontrivial element of labor market slack. Whether, to what extent, and at what rate these individuals return to the labor force over coming months will have an impact on the reported headline unemployment rate and could also weigh on growth in average hourly earnings. As such, this is a group that merits more attention than they typically get upon the release of the monthly employment reports.

## *U.S. Dollar: Still Our Currency, Still Your Problem?*

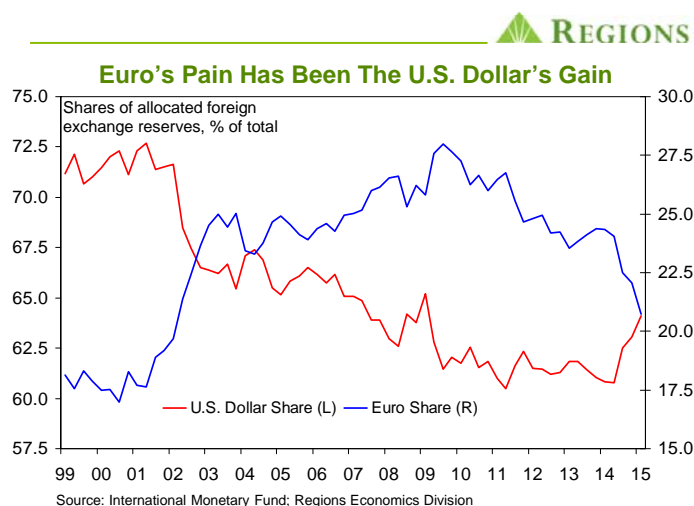
Speaking to a meeting of the G-10 Finance Ministers in Rome in November 1971, then-U.S. Treasury Secretary John Connally famously told the rest of the group the U.S. dollar is “our currency but it’s your problem.” This was of course just a few short months after the U.S. announced the end of the Bretton Woods system under which the U.S. dollar, fully convertible to gold, acted as the world’s reserve currency. From that point on, the U.S. dollar and the currencies of other advanced economies have floated freely in global markets, though, admittedly, more freely at some times than at others. Mr. Connally’s remark, characteristically blunt and to the point, was a rebuke to complaints by his counterparts about sharp swings in the value of the U.S. dollar and the sense that the U.S. had abused its status of being the world’s reserve currency.

That decision was controversial then and, all this time later, remains so. By now you’re probably wondering why on earth we’re dredging up something so distant, and, no, we do not want to weigh in on the relative merits of the gold standard or whether or not the U.S. and other major economies will or should return to such a system. Instead, the recent events in Greece and the possible ramifications for the euro can’t but remind us of a question we often field from clients. Specifically, we are often asked how much longer the U.S. dollar will serve as the world’s main reserve currency and what foreign currencies are viable candidates to replace the U.S. dollar in this role.

This question is often motivated by concerns over the course of U.S. fiscal and monetary policy, particularly amongst those worried about the potential growth in U.S. government debt over the next decade tied to spending on entitlements. No matter the motivation behind the question, however, our answer is always pretty much the same – name a viable alternative. And, as a side note, the return to a gold standard isn’t necessarily the answer to this concern, as pegging your currency to gold doesn’t all the

sudden make it credible if your underlying mix of fiscal and monetary policies is not itself credible. We know of few who would look at the potential explosion of entitlement spending over the next several years and describe U.S. fiscal policy as being credible.

But, to tie this back to Greece, it wasn’t that long ago when many thought the euro would give the U.S. dollar a run for its money, so to speak, as the world’s main reserve currency. Indeed, in the years following the launch of the euro, its share of global foreign exchange reserves jumped from just under 18 percent in 1999 to 25 percent in 2003 then rose over the next several years, peaking at 28 percent in Q3 2009. As the euro became more widely utilized as a means of holding foreign exchange reserves the share accounted for by the U.S. dollar fell steadily. For instance, the share of (allocated) foreign exchange reserves accounted for by the U.S. dollar fell from over 70 percent as late as Q1 2002 to a low of 60.5 percent in Q2 2011.



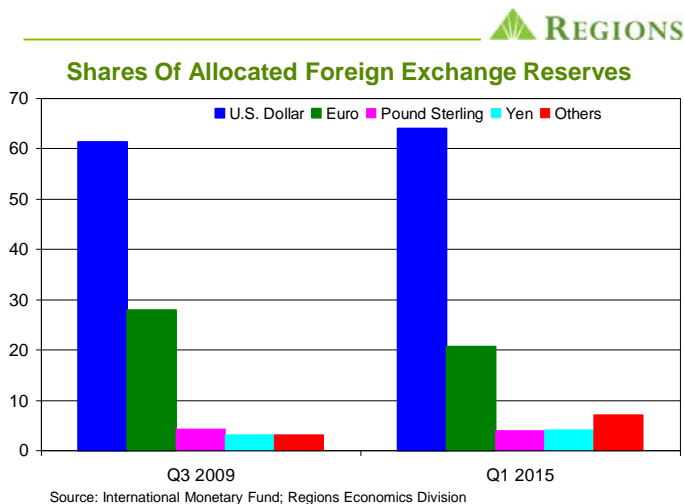
It is interesting, however, that as the euro’s share of foreign exchange reserves began to decline steadily in 2H 2009 this did not result in a steady flight back into dollar holdings of foreign exchange reserves. Instead, over this time the Japanese yen and the British pound, amongst other currencies, played a bigger role in the composition of foreign exchange reserves. Of course, “bigger” is a relative term, with the U.S. dollar and the euro far and away remaining the dominant vehicles for holding foreign exchange reserves. As of Q1 2015 the Japanese yen accounted for 4.2 percent of allocated foreign exchange reserves while the pound sterling accounted for 3.9 percent.

But, as seen in the above chart the last few quarters have seen a spike in the dollar share of foreign exchange reserves, which has corresponded with a sharp decline in the euro share. As of Q2 2014, the U.S. dollar accounted for 60.8 percent of allocated foreign exchange reserves, with the euro accounting for 24.1 percent. As of Q1 2015, however, these shares stood at 64.1 percent for the dollar and 20.7 percent for the euro. To be sure, changes in the relative values of the U.S. dollar and the euro contribute to the shifts seen in the above chart. For instance, the dollar strengthened relative to the euro as the ECB embarked on

its own version of “quantitative easing.” But, there is more to the shifts shown above than fluctuating exchange rates, with the U.S. dollar and dollar denominated assets serving as safe havens for foreign exchange reserves in what have been increasingly volatile global financial markets.

One thing that could well drive further shifts in the composition of foreign exchange reserves away from the euro is the ongoing Greek drama. With the recent vote by Greece to reject the terms of the most recent bailout package there is considerable speculation as to whether or not Greece will remain part of the euro block. This would be a jolt not so much on economic grounds, given the relatively small share of Euro Zone economic activity accounted for by Greece, but more on the grounds that the euro has been seen as more or less set in stone.

Think of it as the currency equivalent of the *Hotel California* – you can check out any time you like but you can never leave. If indeed it turns out you, or, in this case, Greece, actually can leave, the precedent is set and that won't do much to inspire confidence in the staying power of the euro. To be sure, a “Grexit” would not in and of itself mean the demise of the euro but neither does it have to in order to see foreign central banks less willing to hold reserves in euros and/or euro denominated assets. The main beneficiary, even if out of nothing more than default, of any such move would surely be the U.S. dollar.



The above chart helps illustrate our point that there are simply not many, if any, viable alternatives to the U.S. dollar. Even before the recent uncertainty stemming from Greece, we always saw it as unlikely the euro would eventually surpass the dollar as the main reserve currency, though the apparent lack of will in the U.S. to address its entitlement issues may have ultimately made that a close call. Another question on this topic we are often asked is “what about China?” As in, is there a chance China will displace the U.S. in the role of the world's main reserve currency.

The short answer is “no” but the question is at least understandable given the rapid rise of China as a global economic force, even if somewhat less forceful as of late. Sure, it seems each decade brings new fears of a new global hot spot that will sap more life out of the U.S. economy – remember when

all of the U.S. factory jobs were going to end up in Mexico, or how one day the U.S. would be no more than a subsidiary of Japan? Still, as China's economy continues to evolve and mature it is reasonable to wonder, if not worry, whether at some point in the future China will be the dominant global economic power.

That may happen, but not any time soon and, sure, one day China's yuan may displace the U.S. dollar as the main global reserve currency. But, again, not any time soon. There are necessary preconditions that must be satisfied for any currency to be widely utilized as a reserve currency. Start with open, transparent, and flexible financial markets in which capital is allowed to flow freely, into and out of, the country. Then add a sufficient volume of sovereign debt, denominated in the home currency, seen as being risk-free (or, at least as close to risk-free as can plausibly be considered the case), and widely traded in global markets. Next, add in a transparent and credible legal and institutional framework. Finally, have goods and services widely traded in global markets priced in terms of your currency. Once all of these boxes have been checked and sufficient history established, such a currency can serve as a viable reserve currency. Even then, however, there would still be a long way to go before any currency unseats the U.S. dollar as the main global reserve currency.

For anyone thinking the yuan is that currency, ask yourself where China is on any of these markers, let alone all of them. This of course is not to say it will never happen, just that it won't happen any time soon. And, more generally, it is conceivable that at some point the U.S. dollar will no longer play the role of the main global reserve currency. The consequences of the loss of this status are not pleasant to think about – for instance, think of the cost of servicing U.S. government debt if that status were to be lost.

This of course reinforces that point that along with the privilege of being the main global reserve currency comes the responsibility of being the main global reserve currency. In many, if not most, instances in which people worry the U.S. may lose this status, their root worry is the U.S. exploiting the privilege without living up to the responsibility, and we won't necessarily argue with that. But, the reality is at present, and for seemingly many years to come, there does not seem to be a viable alternative, and the latest goings on in Europe only reinforce that point. That said, without the U.S. exhibiting a greater commitment to getting its fiscal house in order, the rest of the world will have considerable incentive to keep on looking for alternatives.

# ECONOMIC OUTLOOK



REGIONS

July 2015

Q4 '14 (a)	Q1 '15 (a)	Q2 '15 (f)	Q3 '15 (f)	Q4 '15 (f)	Q1 '16 (f)	Q2 '16 (f)	Q3 '16 (f)		2013 (a)	2014 (a)	2015 (f)	2016 (f)
2.2	-0.2	2.6	2.7	2.7	2.6	2.6	2.5	Real GDP <sup>1</sup>	2.2	2.4	2.3	2.6
4.4	2.1	2.7	3.1	2.8	2.7	2.7	2.6	Real Personal Consumption <sup>1</sup>	2.4	2.5	3.0	2.8
								Business Fixed Investment:				
4.3	3.5	2.5	4.1	5.2	5.1	5.2	5.4	Equipment, Software, & IP <sup>1</sup>	4.1	5.8	4.8	4.9
5.9	-18.8	2.9	2.8	6.0	5.3	5.3	5.8	Structures <sup>1</sup>	-0.5	8.2	-1.6	5.0
3.8	6.4	8.3	6.9	10.3	9.5	9.0	8.5	Residential Fixed Investment <sup>1</sup>	11.9	1.6	6.3	9.0
-1.9	-0.6	-1.1	-0.2	-1.3	-1.0	-1.4	-1.1	Government Expenditures <sup>1</sup>	-2.0	-0.2	-0.2	-1.1
-471.4	-548.0	-516.4	-509.4	-503.7	-506.1	-507.1	-510.0	Net Exports <sup>2</sup>	-420.5	-452.6	-519.4	-508.7
1.055	0.978	1.094	1.077	1.115	1.140	1.164	1.192	Housing Starts, millions of units <sup>3</sup>	0.928	1.001	1.066	1.180
16.7	16.6	17.1	17.0	16.9	16.8	16.7	16.6	Vehicle Sales, millions of units <sup>3</sup>	15.5	16.4	16.9	16.6
5.7	5.6	5.4	5.4	5.3	5.2	5.2	5.1	Unemployment Rate, % <sup>4</sup>	7.4	6.2	5.4	5.1
2.1	2.3	2.1	2.1	2.0	1.9	1.9	1.9	Non-Farm Employment <sup>5</sup>	1.7	1.9	2.1	1.9
1.3	0.9	0.7	0.8	1.2	1.7	1.9	1.9	GDP Price Index <sup>5</sup>	1.5	1.5	0.9	1.9
1.1	0.3	0.2	0.4	1.1	2.1	2.1	2.0	PCE Deflator <sup>5</sup>	1.2	1.3	0.5	2.0
1.2	-0.1	0.0	0.5	1.6	2.9	2.6	2.2	Consumer Price Index <sup>5</sup>	1.5	1.6	0.5	2.4
1.4	1.3	1.2	1.3	1.4	1.7	1.7	1.7	Core PCE Deflator <sup>5</sup>	1.3	1.4	1.3	1.7
1.7	1.7	1.8	2.1	2.3	2.3	2.1	1.8	Core Consumer Price Index <sup>5</sup>	1.8	1.7	2.0	2.0
0.13	0.13	0.13	0.29	0.54	0.93	1.17	1.42	Fed Funds Target Rate, % <sup>4</sup>	0.13	0.13	0.27	1.30
2.28	1.97	2.17	2.43	2.56	2.69	2.80	2.92	10-Year Treasury Note Yield, % <sup>4</sup>	2.35	2.54	2.28	2.86
3.97	3.73	3.83	4.17	4.26	4.35	4.45	4.56	30-Year Fixed Mortgage, % <sup>4</sup>	3.98	4.17	4.00	4.50
-2.6	-2.5	-2.2	-2.2	-2.4	-2.4	-2.4	-2.5	Current Account, % of GDP	-2.4	-2.3	-2.3	-2.4

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

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

Richard F. Moody  
Chief Economist

Constantine Soras  
Senior Economist

Greg McAtee  
Economist