ECONOMIC UPDATE

REGIONS

December 14, 2016

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December 2016 FOMC Meeting: A More Aggressive FOMC In 2017? Maybe Not So Fast . . .

- The FOMC raised the mid-point of the Fed funds rate target range by 25-basis points, to 0.625 percent.
- The implied trajectory of the Fed funds rate is slightly more aggressive than implied by the September 2016 projections.

As was widely expected, the FOMC raised the mid-point of the Fed funds rate target range by 25-basis points to 0.625 percent. Less expected, however, is the shift in the "dot plot" such that it now implies three quarter-point hikes in the target range mid-point in 2017 rather than the two hikes that were implied in the September version of the dot plot. While some had speculated the FOMC would point to potential changes in the fiscal and regulatory policy landscape in 2017 that would foster faster growth and higher inflation, there was no mention of that in the Committee's post-meeting policy statement. The Committee has basically taken a "wait and see" stance, and Dr. Yellen affirmed this in her post-meeting press conference. To us, this was the only reasonable stance to take, at least today. No one should have any doubt, however, that should the data point to faster growth and materially higher inflation expectations, the FOMC will react accordingly.

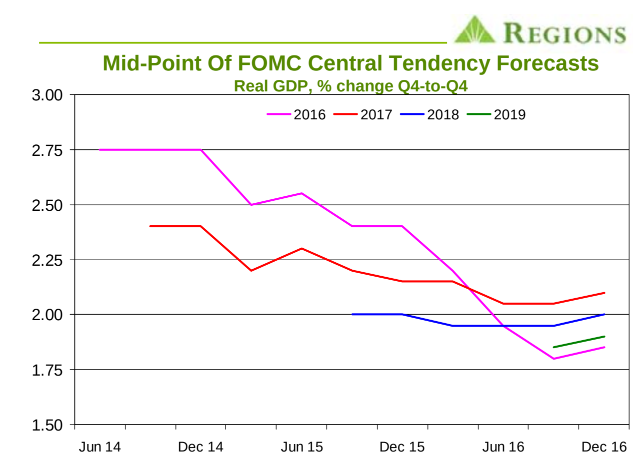
There were a few changes change in the Committee's assessment of current economic conditions. It was noted that economic activity has been expanding at a "moderate" pace and that labor market conditions have continued to strengthen. One change is that growth in household spending is now characterized as "rising moderately," somewhat of a downgrade from September's characterization of "growing strongly." As was the case in September, business investment spending is said to have "remained soft." The Committee does note that inflation has increased since earlier this year but remains below the Committee's 2.0 percent target rate; market-based measures of inflation are said to have "moved up considerably" but nonetheless are described as "still low."

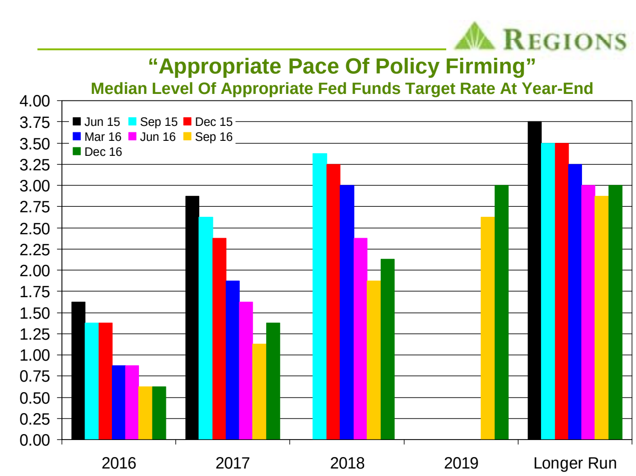
Projections for the path of real GDP growth for 2017, 2018, and 2019 were revised marginally higher relative to the September projections, while projections for the path of the unemployment rate were revised marginally lower. There were virtually no changes to the inflation outlook. The estimate for the economy's long-term "neutral" rate of growth remained at 1.9 percent.

In her post-meeting press conference, Dr. Yellen described today's vote to raise the funds rate target range as a sign of confidence in the progress the economy has made and the Committee's judgement that progress will continue. Or, as she put it, it is a "vote of confidence" in the economy. Where we go from here, however, remains uncertain, and the path of the funds rate will clearly be impacted by whatever changes we get in fiscal, regulatory, and trade policy next year. What is not clear, however, is what those policy changes will be. As Dr. Yellen noted, it would be premature to base monetary policy projections on nothing but speculation over any such changes. Dr. Yellen also dismissed the notion that the FOMC is already "behind the curve" in terms of inflation – some analysts make this argument, which to us is a very curious argument to make. Moreover, as Dr. Yellen noted, inflation is still running below the FOMC's target rate, and with there still being at least some degree of slack in the labor market, there is still some room to run before inflation becomes a pressing concern.

As for the "dot plot," which shows what each Committee member sees as the appropriate year-end value of the Fed funds rate range mid-point if the economy evolves as they now expect, the December projections imply three 25-basis point hikes in the target range mid-point in 2017. This is one additional hike relative to the September projections, but it probably is worth not reading too much into this change. After all, a year ago the dot plot implied four hikes in 2016 and the number varied between two and four over the course of the year, making this no different than any other year in that regard. Dr. Yellen did note some FOMC members did factor in some effects of fiscal stimulus, but also noted that, on the whole, the Committee's discussion of potential policy changes only served to highlight how much uncertainty there is now over the policy outlook and, in turn, how that will impact the economy.

We don't agree with those who see the additional rate hike implied by today's dot plot as sending a "hawkish" signal. The FOMC notes policy remains "accommodative" and that further rate hikes will come at a "gradual" pace. That will surely change should the data warrant it, but for now we don't see a material shift in how the FOMC sees the world.





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