ECONOMIC UPDATE

February 1, 2017

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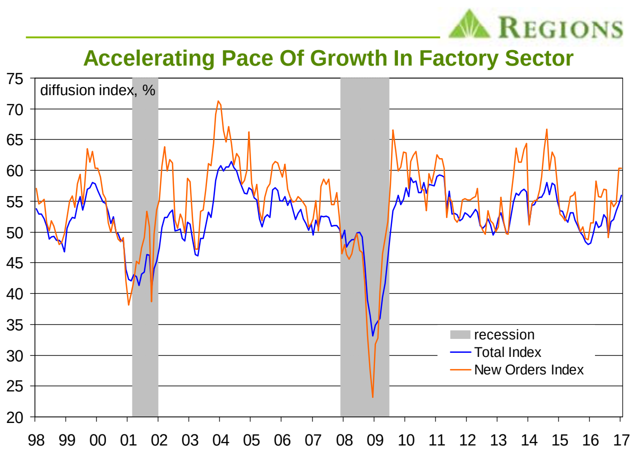
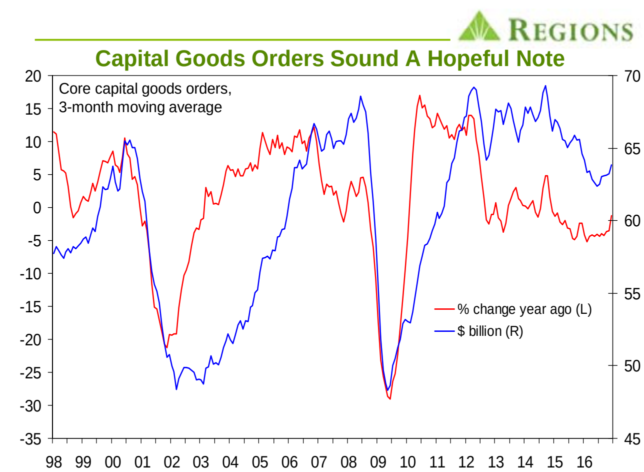
January ISM Manufacturing Index: Accelerating Pace Of Growth In The Factory Sector

- The ISM Manufacturing Index rose to 56.0 percent in January from 54.5 percent in December.
- The new orders component rose to 60.4 percent, the employment component rose to 56.1 percent, and new export orders rose.

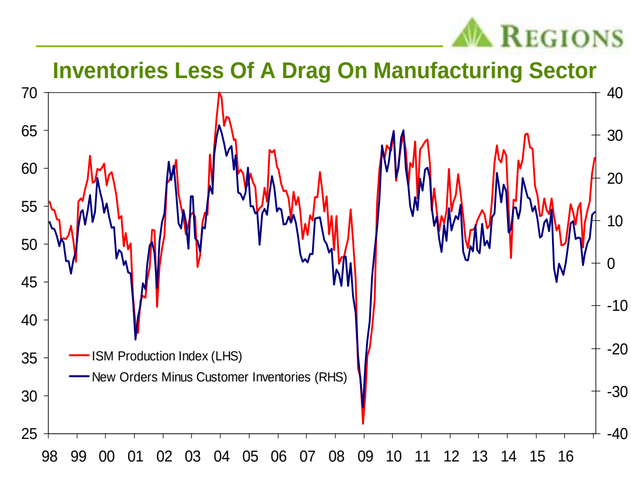
The ISM Manufacturing Index rose to 56.0 percent in January, topping our above-consensus forecast of 55.5 percent. The headline index now stands at its highest level since November 2014, and we'll note today's release incorporates revised seasonal adjustment factors so that the recent history of the data has been revised as well. While the headline index has been above the 50.0 percent break between expansion and contraction in each month since last August, the string of increases in the index over the past several months suggests a steadily accelerating pace of expansion in the factory sector. The underlying details of the January survey are generally positive and the comments by survey respondents are notably upbeat. Sentiment across the factory sector entered 2017 on a clear upswing but, as is the case in the broader economy, it will remain to be seen whether actual performance lives up to expectations for 2017 that are now much higher than was the case a few short months ago.



Of the 18 industry groups included in the ISM's survey, 12 reported growth in January, up from 11 in December and up from only seven last September. One common theme in the comments relayed by ISM is that demand is increasing and that overall business conditions are favorable. Improving demand is reflected in rising new orders for manufactured goods, and the index for new orders stands at 60.4 percent as of January, up slightly from December's reading of 60.3 percent. Twelve of the 18 industry groups reported rising orders in January, matching December but up from only nine in the November survey. Five industry groups reported contracting orders in January. Along with new orders comes rising production, and the index for current production rose from 59.4 percent in December to 61.4 percent in January, with ten industry groups reporting higher production levels in January. We have noted that the ISM's gauge of production had been running ahead of other indicators, most notably the monthly data on industrial production, and have questioned which series would move towards the other. Given the extent to which the ISM data point to a faster pace of expansion and the breadth of growth in new orders, production, and employment, it now seems likely the industrial production data will firm in the months ahead.



One reason to think so is that the growth in new orders reported in the recent ISM surveys is corroborated by the monthly data on new orders provided by the Commerce Department. Orders for core capital goods have pushed higher over the past few months after a sharp and protracted downturn. Another reason to think so is that January marks the fourth consecutive month in which survey respondents deem customer inventories to be too low which suggests coming months will bring further gains in orders, production, and employment. For some time inventories have been a drag on manufacturing activity, but with what had been a long-running inventory correction having run its course, it is reasonable to think inventory rebuilding will provide at least some support for the factory sector, even if at a cautious rate until there is more evidence of meaningful and sustained acceleration in demand growth.



Additionally, while much of the focus of late has been on improving prospects for capital spending amongst U.S. firms, do not overlook the extent to which firming global growth is helping brighten the outlook for the manufacturing sector. January saw the eleventh consecutive month of rising export orders after a string of declines. Still, we'll toss out what by now is a familiar caveat – further gains in foreign demand could be imperiled by a stronger U.S. dollar and/or moves by the U.S. to curb trade.

For now, the hard data are backing up the improved sentiment readings over the past few months. Firmer demand, domestic and foreign, is setting the stage for meaningful improvement in the manufacturing sector, but much depends on the evolution of U.S. fiscal, regulatory, and trade policy in the months ahead. Expectations are high; time will tell if these expectations are warranted or not.

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com