ECONOMIC UPDATE

REGIONS

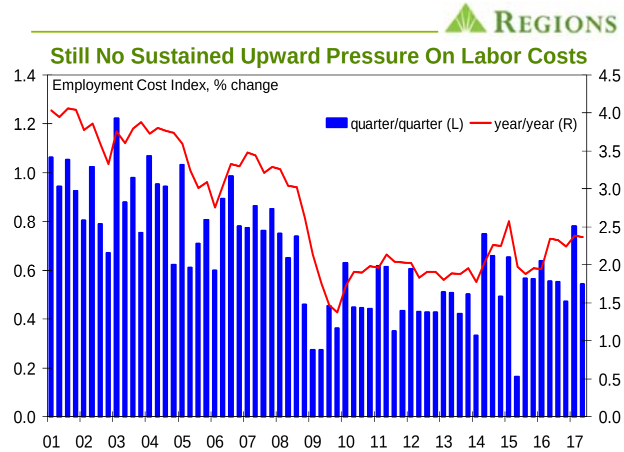
July 28, 2017

This Economic Update 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 Update. The Contents of this Economic Update 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 Update or with respect to any results arising therefrom. The Contents of this Economic Update 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.

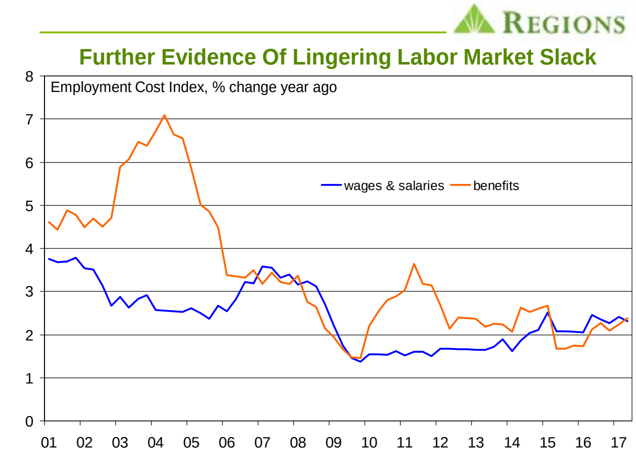
Q2 2017 Employment Cost Index: Still No Sustained Upward Pressure On Labor Costs

- The total ECI was up 0.5 percent in Q2 2017, with the wages/salaries component up 0.5 percent and the benefits component up 0.6 percent.
- Year-on-year, the total ECI was up by 2.4 percent in Q1 with wage costs up 2.3 percent and benefit costs up 2.4 percent.

Total compensation costs, as measured by the Employment Cost Index (ECI), rose by 0.5 percent in Q2 2017, falling between our forecast of 0.4 percent growth and the consensus forecast of 0.6 percent growth. The wage component of the ECI was up 0.5 percent and the benefits component was up 0.6 percent. Year-on-year, the total ECI is up 2.4 percent, with the wage component up 2.3 percent and the benefits component up 2.4 percent. Ahead of today's set of data releases, there were some analysts of the opinion that the Q2 ECI report would be a bigger story for the FOMC than the report on Q2 real GDP. As it turns out, neither report changed the underlying narrative. In the case of the labor market, the ECI shows that growth in labor compensation costs remains restrained, which suggests far more labor market slack than implied by a 4.4 percent unemployment rate.



After the Q1 ECI data, there were some analysts who thought the underlying narrative of the labor market had indeed changed, as evidenced by the 0.8 percent jump in the total ECI, the largest increase since Q4 2007. As we noted at the time, however, our view was that the Q1 data, specifically the 0.8 percent increase in the wage component, significantly overstated the degree of underlying wage pressures. To a large extent, reported Q1 wage growth was driven by three industry groups – retail trade, leisure & hospitality services, and construction. The sizeable gains in wages in the first two of these industry groups were more a reflection of mandated increases in minimum wages in many parts of the U.S., as opposed to meaningful wage pressures. Growth in construction wages was more a reflection of ongoing labor shortages. As such, we did not expect nearly the degree of wage growth in retail trade and leisure & hospitality services in Q2 that was seen in Q1; while we were correct on this point wage growth in other industry groups, most notably finance and information services, was a bit firmer than our forecast anticipated.



The ECI is one of the three main data series – the others being average hourly earnings from the monthly employment report and unit labor costs from the quarterly labor productivity and costs report – showing trends in labor costs. The ECI tends to get less attention than its two counterparts but to us is the most meaningful of the three series. The ECI is designed to measure changes in total labor costs, for both money wages and salaries and noncash fringe benefits (such as health insurance and pensions). One distinction between the wage component of the ECI and the more widely followed average hourly earnings metric is the ECI is not affected by shifts in the composition of employment across industry groups. Instead, the wage component of the ECI effectively measures wage costs for the same jobs over time and the total ECI measures labor costs (i.e., wages and benefits) for the same jobs over time. One drawback of the average hourly earnings metric is that it is skewed by changes in the composition of employment and hence will mask differentials in earnings across industry groups. These differences aside, the alternative series are at present showing wage growth remains well below what we would expect to see in a fully healthy labor market or, if you prefer, at full employment.

As seen in our bottom chart, there is a good deal of variance in wage growth across industry groups. Since Q2 2012, wages in transportation/warehousing, utilities, and retail trade have grown the fastest the slowest growth has come in education services, health care, and business services despite these industries posting some of the most rapid job growth over the same period. Much of the wage growth in retail trade and leisure & hospitality services reflects higher minimum wages in many parts of the U.S. and also what have been voluntary boosts in entry level wages on the part of several national chains, increases that have filtered up the pay scale to more experienced workers.

What we are waiting for, however, are signs that genuinely tighter labor market conditions are pushing wage growth higher across all industry groups. We have argued it will not be until at least late-2017 that wage growth approaches what would be considered normal. The Q2 ECI data suggest it may take even longer to get to that point than we had thought.

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

Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com