ECONOMIC UPDATE

REGIONS

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May ISM Manufacturing Index: Manufacturing Remains On A Roll; Trade Risks Loom

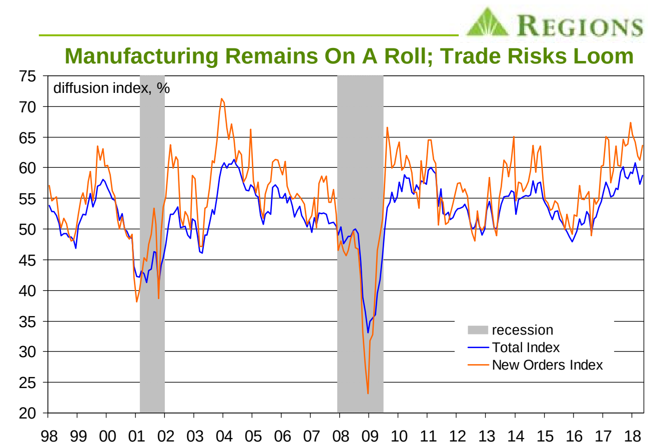
- The ISM Manufacturing Index rose to 58.7 percent in May from 57.3 percent in April
- The new orders component rose to 63.7 percent, the employment component rose to 56.3 percent, and new export orders rose.

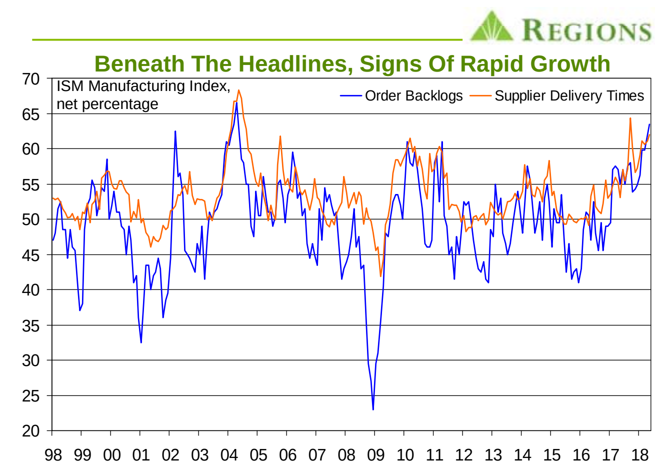
The ISM Manufacturing Index rose to 58.7 percent in May, matching our forecast, up from April's 57.3 percent reading. May marks the 21st consecutive month in which the headline index has been above the 50.0 percent break between contraction and expansion, and the details of the May data point to the steady growth in the factory sector seen over the past several quarters being sustained. This is not to say, however, there are not clouds forming on the horizon, most notably changes in U.S. trade policy that are likely to prompt counter measures from U.S. trading partners that could have an adverse impact on domestic manufacturing.

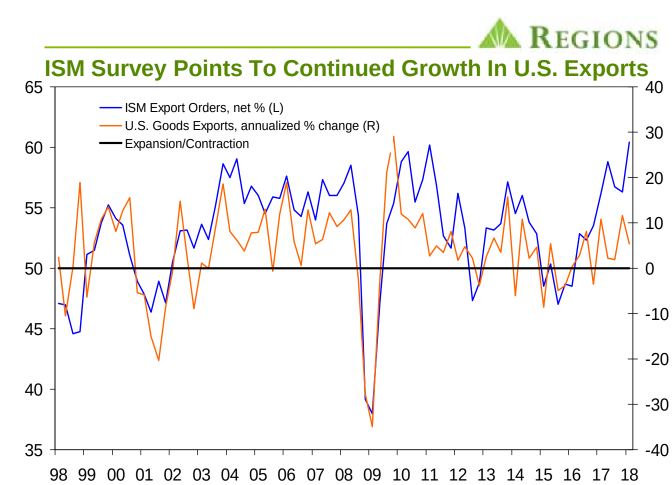
Of the 18 industry groups included in the ISM survey, 16 reported expansion in May with no industry group reporting contraction. As we have noted previously, over the past 21 months in which the headline index has indicated growth in manufacturing activity, the number of industry groups reporting growth in a given month has risen steadily – in September 2016, the first month the headline index climbed back over the 50.0 percent mark, only seven industry groups reported a higher level of activity. It is in this sense that the ongoing expansion can be considered to have become increasingly broad based. But, as could have been expected as the expansion in the factory sector endured, firms are becoming increasingly stretched to meet demand and are faced with accelerating growth in input costs. Additionally, trade policy, namely tariffs imposed by the U.S. and retaliatory tariffs imposed by U.S. trading partners, poses a threat to the expansion seen in the manufacturing sector, though it is too soon to assess the significance of this threat – unlike some analysts, we don't by default jump to the worst-case scenario, as there are simply too many issues yet to be resolved. In any event, comments from May survey respondents hammer on these basic themes – solid growth in demand, rising input costs, and concern over tariffs.

The index gauging growth in orders for factory goods rose to 63.7 percent in May, the 29th straight month of growth in new orders. In May, 15 of the 18 industry groups reported growth in new orders, with only one group – apparel, leather, & allied products – reporting lower orders. Consistent with ongoing growth in orders, the gauge of current production rose to 61.5 percent in May, with 15 industry groups reporting increased production during the month and only one industry group – again, apparel, leather, & allied products – reporting a lower level of output. At the same time, however, despite ongoing growth in production, firms continue to see rising backlogs of unfilled orders. The ISM's gauge of order backlogs rose to 63.5 percent in May, the highest reading since April 2004, with 13 industry groups reporting a greater backlog of unfilled orders. For the most part, growing backlogs of unfilled orders reflect capacity constraints amongst the various manufacturing industry groups, not unsurprising in a time of robust growth in demand. But, another factor contributing to order backlogs is that supplier delivery times, i.e., the time it takes for suppliers to deliver inputs to manufacturers, continue to slow. In May, the gauge of supplier delivery times rose to 62.0 percent, with 17 of the 18 industry groups reporting they faced slower delivery times. One issue is that suppliers themselves face labor shortages, while transportation bottlenecks are also leading to longer delivery times. Steadily increasing new orders and growing backlogs of unfilled orders suggest further gains in manufacturing employment in the months ahead – over the past 12 months U.S. manufacturers have added 259,000 jobs – and would also suggest further growth in capital spending, but the latter will only occur to the extent that firms are confident this run of growth will continue, which is one of the looming downside risks from trade policy.

For now, though, the U.S. manufacturing sector remains on an impressive roll. Solid growth in both domestic and foreign demand suggests this will remain the case, but our main concern is that trade policy could become a meaningful headwind to growth.







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