ECONOMIC UPDATE

REGIONS

June 17, 2014

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May Housing Starts/May Consumer Price Index

- Total housing starts fell to an annualized rate of 1.001 million units; total housing permits fell to an annualized rate of 991,000 units.
- The total CPI rose 0.4 percent in May, with the core CPI up 0.3 percent; on a year-over-year basis, these translate into increases of 2.1 percent and 2.0 percent, respectively.

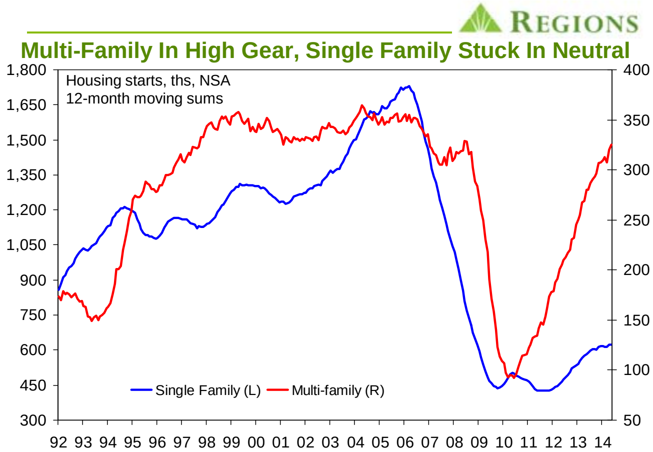
Housing Starts: Total housing starts fell to an annualized rate of 1.001 million units in May with total housing permits dropping to an annual rate of 991,000 units. Both figures are below expectations. While revisions to prior estimates for April resulted in virtually no change in the total number of starts, there were sizeable revisions to the mix of starts, with single family starts revised higher and multi-family starts revised lower. Estimates for housing permits issued in April were lowered mainly due to downward revisions in single family permits.

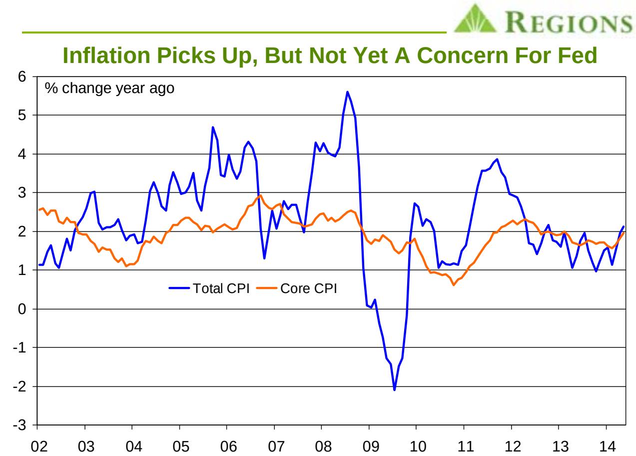
In May starts of both single family and multi-family units declined. We had expected the decline in single family starts, as the spurt in starts in March and April reflected catch up from distortions stemming from harsh winter weather. This burst of new single family starts left them running well ahead of permits and it should have been expected the May data would show starts back in alignment with permits, which is indeed the case. We were, however, surprised by the decline in multi-family starts in May, as permit issuance had been running at an annual rate in excess of 400,000 units. Nonetheless, multi-family starts fell to a seasonally adjusted annual rate of 376,000 units in May which is still easily ahead of trend. It is notable that on a not seasonally adjusted basis multi-family starts fell in May, counter to the large increase typically seen in the month. Multi-family starts rose in the South but fell in the West, Midwest, and Northeast regions. Multi-family permits fell in all four Census regions with the largest decline coming in the South region.

Our preferred way around the month-to-month volatility in the starts data is to look at the 12-month moving sums of the raw data, as shown in the chart below. Clearly the multi-family segment of the housing market is in high gear while the single family segment remains stuck in neutral. There are a number of factors at play here, including still tight mortgage credit conditions, demographic factors that favor multi-family housing, income growth that has yet to accelerate, and lingering shortages of lots and labor (single family construction is more labor intensive than is multi-family). As such, forecasts for single family construction in 2014, including ours, were too aggressive and based on permit issuance to date, single family starts will struggle to hit the 650,000 unit mark for the year as a whole. Ongoing strength in the multi-family segment will still get us to better than 1 million total starts for the year, but the softness in the single family segment is concerning.

CPI: The total Consumer Price Index (CPI) rose by 0.4 percent in May with the core CPI rising by 0.3 percent, ahead of expectations for 0.2 percent increases in each. Price increases were broad based in May. Counter to our expectations of moderation, food prices rose at an even faster rate with a 0.5 percent increase in May, driven by a 0.7 percent increase in prices for food consumed at home. While prices for food consumed away from home did rise at a slightly slower pace in May, restaurants will have more latitude to push price increases in the months ahead if prices for food consumed at home continue to rise at such a rapid rate. Airfares rose 5.8 percent in May, the largest monthly increase since July 2009, and energy prices rose 0.9 percent bolstered by a 2.3 percent increase in electricity prices. Rents continue to post steady advances, with market rents up 3.1 percent on a year-over-year basis for the second consecutive month. The split between prices for core goods and core services remains intact, with core goods prices falling on an over-the-year basis for the 13th consecutive month while the rate of core services inflation ticked up to 2.7 percent, the fastest pace since November 2008.

The May CPI figures will no doubt catch the attention of the Fed but won't set off any panic alarms. The CPI continues to run ahead of the Fed's preferred inflation gauge – the PCE deflator – and the FOMC has signaled its willingness to let inflation run above target in the short run. Many FOMC members would likely argue there is too much slack in the economy for the recent acceleration in inflation to persist, which is a question that will be answered over coming months.





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