

U.S. Housing Starts Jump in May; BoE Set to Lift Bank Rate by 25bps This Week

UNITED STATES: U.S. housing starts jumped 21.7% in May to 1.631 million annualized units from 1.340 million annualized units in April (revised lower from 1.401 million). This was much better than the consensus expectation for an increase to 1.4 million. Single-family starts rose 18.5% in May to 997,000 from 841,000 in April. Multi-family starts rose a big 27.1% on the month to 634,000 from 499,000 in April.

As widely expected, the Federal Open Market Committee (FOMC) kept the federal funds rate unchanged in a range between 5.00% and 5.25% at its June 13-14 meeting. This was the first FOMC meeting where the committee had not raised the rate since January 26, 2022, when the rate was in a range between 0.00% and 0.25% coming out of the pandemic. This tightening in monetary policy has weighed on economic growth, although the economy continues to expand, and the labor market remains very strong.

According to the policy statement, “holding the target range steady at this meeting allows the Committee to assess additional information and its implications for monetary policy.” But the FOMC is pointing to further near-term rate hikes given inflation that, although slowing, remains well above the FOMC’s 2% objective. The updated Summary of Economic Projections (SEP), or “dot plot,” revealed that FOMC members now favor additional fed funds rate hikes this year. The new dot plot has a median projected fed funds rate of 5.6% at the end of 2023, compared to a median of 5.1% in the previous dot plot, from mid-March. This suggests two additional fed funds rate hikes over the rest of 2023. But the dot plot does point to potential rate cuts in 2024, with the median rate at the end of next year at 4.6%.

Other changes to the dot plot were modest, generally reflecting recent data that show the economy is doing somewhat better in the second quarter of 2023 than expected in March. Real GDP growth in 2023 is somewhat higher in the current SEP compared to March (1.0% compared to 0.4%), with the median unemployment rate at the end of this year somewhat lower (4.1% compared to 4.5%). But the GDP and unemployment rate projections for 2024 and 2025 are little changed from March. FOMC participants expect core and overall inflation to gradually slow to 2% over the next couple of years. In his post-meeting press conference, Chair Powell said that getting inflation back to 2% would likely require below-trend economic growth and a softening in the labor market.

Consumer price index (CPI) inflation was mixed across categories for May 2023. Headline inflation came in at a 0.1% seasonally-adjusted gain for the month and 4.0% year-over-year, core CPI prices grew at a 0.4% pace for the month which matches the pace seen for the past six months running. The 5.3% annualized pace in core CPI, which removes the influence of food and energy price movements due to their volatile and policy-agnostic nature, remains well above the Federal Reserve’s 2.0% average inflation target. The 4.0% year-over-year pace of CPI growth formally fell below wage gains for the year in May 2023 (+4.3%). The U.S. labor market remains healthy and is likely feeding consumer confidence, resulting in continued demand-side pressure on inflation.

Nominal retail sales rose 0.3% in May from April after increasing 0.4% in April, according to data from the Commerce Department. The retail sales increase in April was unrevised at 0.4% while March’s decline was downwardly revised to 0.9% from 0.7%. The details of the May report were good; sales excluding autos were up 0.1% and sales excluding autos and gasoline were up 0.4%. Control sales, which strips out volatile components such as food services, autos, gasoline and

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building materials, rose 0.2% in May, after increasing 0.6% (revised from +0.7%) in April. Control sales go into nominal spending in GDP.

Nine out of 13 retail categories rose last month, including motor vehicle and part dealers (1.4%), building materials (2.2%), general merchandise (0.4%) and nonstore merchandise (0.3%). A lack of semiconductors and labor shortages weighed on auto production in the first couple of years of the pandemic. However, production has improved in the past year and sales of motor vehicles and parts were up 4.4% in May from May 2022, after rising 1% in 2022.

Nominal retail sales are up 2% this year thanks to a strong job market, price increases, and solid consumer balance sheets. With the Fed now signaling a higher fed funds rate at the end of 2023, PNC Economics expects retail sales to decline in the second half of 2023 as rising interest rates weigh on interest-sensitive goods such as autos, building materials and appliances. Spending will likely continue to shift away from goods toward services. Risks to the outlook are tilted to the downside. Persistent inflation, higher-than-expected interest rates or a substantial tightening in lending standards will result in a bigger decline in retail sales this year.

Industrial production fell 0.2% in May from April, according to data from the Federal Reserve. This was worse than the consensus expectation for a 0.1% increase. Industrial output rose 0.2% in May from a year ago.

Initial claims for unemployment insurance (UI) held steady at 262,000 in the week ending June 10, after a 29,000 jump in the previous week. The four-week moving average of claims, which smooths out some of the weekly volatility, increased by 9,000 to 247,000. Weekly claims are up from exceptionally low levels throughout 2022 which sometimes dipped below 200,000 per week.

UNITED KINGDOM: The U.K. labor market showed signs of resilience in May as the number of payrolled employees rose 23,000 from April. New data from the Office for National Statistics (ONS) showed job growth of 7,000 in April, revised higher from an initially reported decline of 136,000. The unemployment rate fell slightly to 3.8% in the three months to April from 3.9% in the preceding three-month period. Yearly wage growth (average weekly earnings) rose to 6.5% in the three months to April from 6.1% in the preceding three-month period. Yearly wage growth averaged 3.5% in 2019, peaked at 9.2% in 2021, and at 6.5% remains too strong for the Bank of England. Unlike the Fed, the Bank of England has a primary mandate to maintain consumer price index (CPI) inflation at 2%. With annual inflation at 8.7% in April and a red-hot labor market, PNC Economics expects the Bank of England to raise its bank rate by 25 basis points to 4.75% when policymakers meet on June 22.

EUROZONE: As forecasted by PNC Economics, the Governing Council of the European Central Bank (ECB) raised its three policy rates by 25 basis points at its meeting on June 15. The interest rate on the main refinancing operations and the interest rates on the marginal lending facility and deposit facility will be increased to 4.00%, 4.25% and 3.50% respectively, with effect from June 21. In the accompanying press release, policymakers noted that “indicators of underlying press pressures remain strong, although some show tentative signs of softening.” The Governing Council now expects inflation to average 5.4% in 2023, 3.0% in 2024 and 2.2% in 2025. Economic growth projections for 2023 and 2024 were lowered at the meeting.

The final release of the May CPI inflation report from the European Statistical Office (Eurostat) showed that annual inflation decelerated to 6.1% in May from 7.0% in April. Core inflation, which excludes volatile food and energy prices, eased to 5.3% in May from 5.6% in April.

CANADA: Housing starts fell 22.5% in May to 202,500 annualized units from 261,400 (revised lower from 261,600) in April. Housing starts are down 18.6% on a year-to-date basis. Existing-home sales rose 5.1% in May from April after rising 11.3% in April.

JAPAN: The Bank of Japan (BoJ) kept its monetary policy unchanged at its meeting on June 15. The BoJ's current monetary policy framework includes a negative interest rate policy, yield curve control and quantitative easing. The accompanying statement was dovish as policymakers noted that "the Bank will patiently continue with monetary easing while nimbly responding to developments in economic activity and prices as well as financial conditions."

MEXICO: Retail sales rose 1.5% in April from a month ago after falling 1.2% in March. On a year-over-year basis, retail sales were up 3.8% in April.

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