May 2023

NATIONAL ECONOMIC OUTLOOK

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Executive Summary

Job Growth Is Slowing to a More Sustainable Pace; FOMC Continues to Hike, But May Hold Steady in June

- The US economy added 253,000 jobs in April, according to a survey of employers from the Bureau of Labor Statistics, well above the consensus expectation of 180,000. However, there were substantial downward revisions to job growth in February and March, with average gains over the past three months of 222,000. This is down from around 300,000 at the end of 2022, indicating that higher interest rates are weighing on the labor market. Job growth is still running above its sustainable long-run pace of around 100,000 per month, based on growth in the labor force, but is easing. The unemployment rate fell to 3.4% in April from 3.5% in March. Outside of a 3.4% rate in January 2023, this is the lowest unemployment rate since 1969.

- On May 3, as widely expected, the Federal Open Market Committee raised the federal funds rate by 25 basis points, to a range of 5.00% to 5.25%. This is the highest the fed funds rate has been since early 2007. The FOMC has been raising the fed funds rate aggressively to combat inflation far above the committee's 2% objective. The fed funds rate was in a range of 0.00% to 0.25% in early 2022 after the FOMC quickly pushed it down in early 2020 to combat the pandemic-caused recession. This was the tenth straight meeting where the FOMC has raised the fed funds rate, although it has slowed the pace of rate hikes recently, with increases of 25 basis points at each of its three meetings this year. The minutes from this FOMC meeting suggest that the central bank could hold off on an interest rate increase at its next meeting, in mid-June, but the decision will depend on data on inflation and the labor market.

- Real GDP growth in the first quarter of 2023 was revised slightly higher in the second estimate, to 1.3% at an annual rate, from 1.1% in the advance estimate. There were upward revisions to investment in inventories, business fixed investment, consumer spending, and exports; these were partially offset by a downward revision to investment in housing. Demand in the first quarter was strong, with real final sales of domestic product (GDP minus the change inventories) up 3.4% annualized. In particular, consumer spending rose sharply, up 3.8% after adjusting for inflation, including a huge 16% increase in durable goods purchases as auto sales rose. But inventories were an enormous drag, subtracting more than 2 percentage points from growth in the quarter. On a year-ago basis real GDP growth in the first quarter was 1.8%, close to the economy's long-run potential. The revisions to GDP were released after PNC prepared the May baseline forecast.

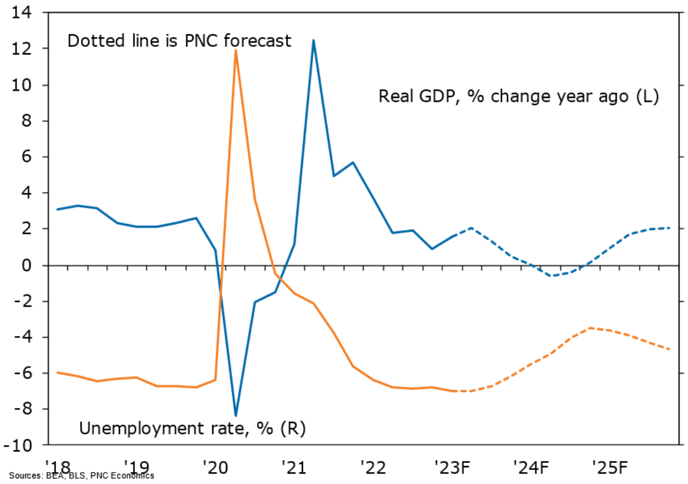
*Baseline U.S. Economic Outlook, Summary Table**

	4Q'22a	1Q'23p	2Q'23f	3Q'23f	4Q'23f	1Q'24f	2022a	2023p	2024f	2025f
Output										
Real GDP (*Chained 2012 Billions $*)	20182	20236	20309	20317	20283	20232	20014	20286	20240	20582
Percent Change Annualized	**2.6**	**1.1**	**1.4**	**0.2**	**-0.7**	**-1.0**	**2.1**	**1.4**	**-0.2**	**1.7**
CPI (*1982-84 = 100*)	298.5	301.3	304.7	307.6	309.6	311	292.6	305.8	311.8	316.1
Percent Change Annualized	**4.2**	**3.8**	**4.6**	**3.8**	**2.6**	**1.3**	**8.0**	**4.5**	**2.0**	**1.4**
Labor Markets										
Payroll Jobs (*Millions*)	154.3	155.2	155.8	156.0	155.8	155.5	152.6	155.7	155.1	155.3
Percent Change Annualized	**2.5**	**2.5**	**1.5**	**0.4**	**-0.5**	**-0.8**	**4.3**	**2.0**	**-0.4**	**0.1**
Unemployment Rate (*Percent*)	3.6	3.5	3.5	3.7	3.9	4.3	3.6	3.6	4.8	4.9
Interest Rates (Percent)										
Federal Funds	3.65	4.52	5.02	5.12	5.12	4.90	**1.68**	**4.95**	**3.82**	**2.87**
10-Year Treasury Note	3.83	3.65	3.50	3.43	3.36	3.31	**2.95**	**3.48**	**3.30**	**3.34**

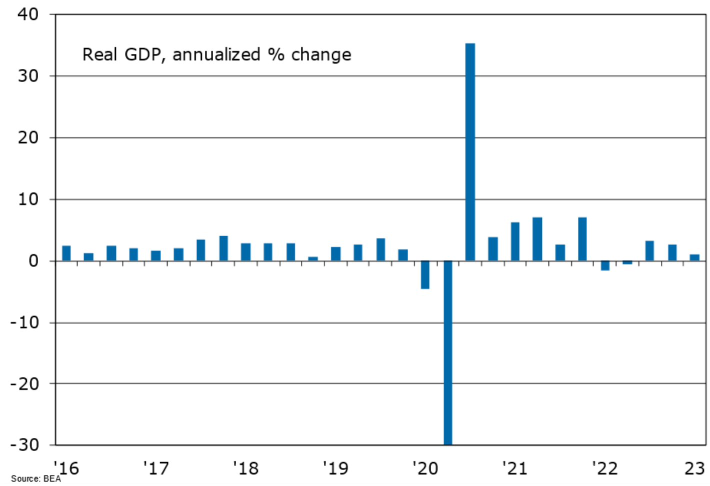
a = actual   f = forecast   p = preliminary   **Please see the Expanded Table for more forecast series.*

PNC

Forecast Remains for a Mild Recession Later This Year



Modest Growth to Start Off 2023



Debt Limit Agreement Removes One Big Obstacle, But U.S. Economy Still Headed for Recession

After an agreement between the Biden administration and House Republican leadership, Congress looks set to raise the debt limit in early June. A failure to raise the debt limit would have been disastrous for the U.S. economy, and the deal takes a potential U.S. government default off the table for the next couple of years, unequivocally good news for the outlook. But given underlying economic fundamentals, the debt limit agreement does not change PNC's view that a mild recession later this year is still the most likely outcome.

The debt limit, or debt ceiling, is a statutory cap on total federal government borrowing. Under the Constitution Congress is required to authorize federal borrowing. Until World War I Congress approved each individual debt issuance, but as borrowing increased with the war, Congress instead set a limit on the total level of federal debt. That system remains in place, and with the federal government consistently running large budget deficits (spending greater than tax revenues) the amount of federal debt has continued to increase. Congress has periodically raised the debt limit in response, occasionally with some partisan posturing.

Failure to raise the debt limit would leave the Treasury Department unable to make all of its payments. Crucially, this would include holders of Treasury securities, those who have lent money to the federal government. The U.S. government has consistently made all payments to its creditors for more than 200 years, and this record has helped make U.S. Treasury securities the global standard for safe assets. Failure to raise the debt limit would have put this reputation at risk, causing interest rates around the world to increase and likely quickly causing U.S. and global recessions. By suspending the debt limit until 2025 (not actually raising it) the agreement prevents a potential government default.

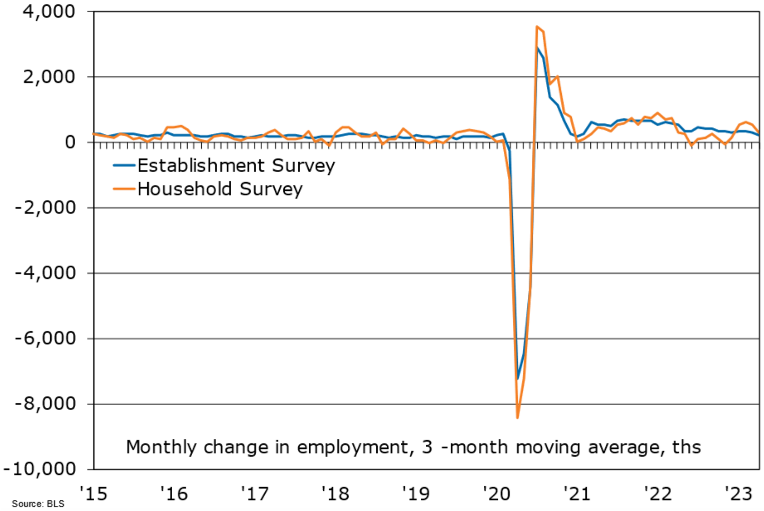
From an economic forecast perspective, the biggest impact from the agreement will come from spending constraints. The deal sets non-defense discretionary spending for fiscal year 2024 (starting October 1) at 2023 levels, with a 1% increase for fiscal year 2024. (Discretionary spending is that approved by Congress every year, and does not include entitlement programs like Social Security and Medicare.) Defense spending is set to increase 3.5% in fiscal year 2024.

PNC has incorporated the outlines of the deal into its baseline forecast for May, with a slightly smaller contribution to economic growth from non-defense federal spending in 2024 and 2025, of around 0.1 percentage point of real GDP each year, compared to the April forecast. But this is not a major change and is basically subsumed in the normal month-to-month changes to the forecast. Indeed, the baseline outlook has remained steady throughout 2023, with PNC expecting a mild recession starting in the second half of this year as the cumulative impact of the aggressive Federal Reserve tightening in monetary policy continues to weigh on the economy. Already higher interest rates have led to a significant contraction in housing activity, and higher rates are also becoming more of a drag on business investment and consumer spending, especially on durable goods. The biggest reason to expect recession remains the inverted yield curve, with yields on short-term Treasury securities remaining well above those on long-term Treasurys; this has historically been a very reliable signal of upcoming recession.

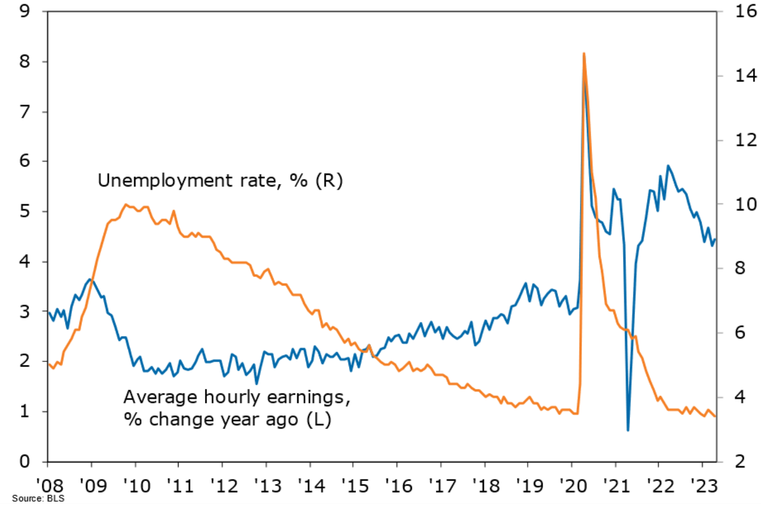
This recession should be mild, however, for four reasons: strong consumer balance sheets; the tight labor market that will discourage layoffs, limiting the hit to jobs and household incomes and spending; the current strength of the banking system, with the problems this spring apparently limited to a small number of banks with idiosyncratic problems, rather than more systematic issues; and a dearth of homebuilding over the last fifteen years and tight supplies that will limit the housing market downturn.

PNC's baseline forecast is for a small contraction in real GDP of less than 1% starting in the fall of this year and lasting into early 2024. The unemployment rate will increase in the second half of this year, ending 2023 at around 4%, and then peak at slightly above 5% in the second half of 2024. Inflation will slow with weaker demand from the recession, moving back to the Federal Reserve's 2% objective by this time next year. Slowing inflation and a deteriorating labor market will lead to Federal Reserve rate cuts starting in early 2024, allowing for an economic recovery beginning in the spring of 2024.

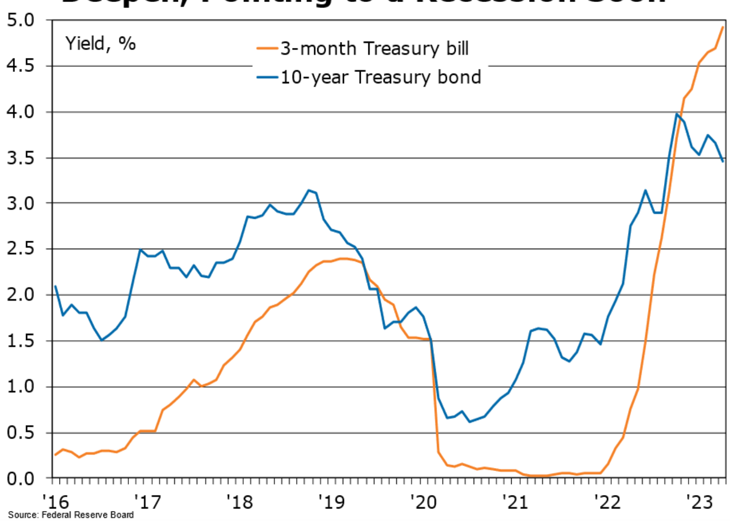
Job Growth Is Slowing to a More Sustainable Pace



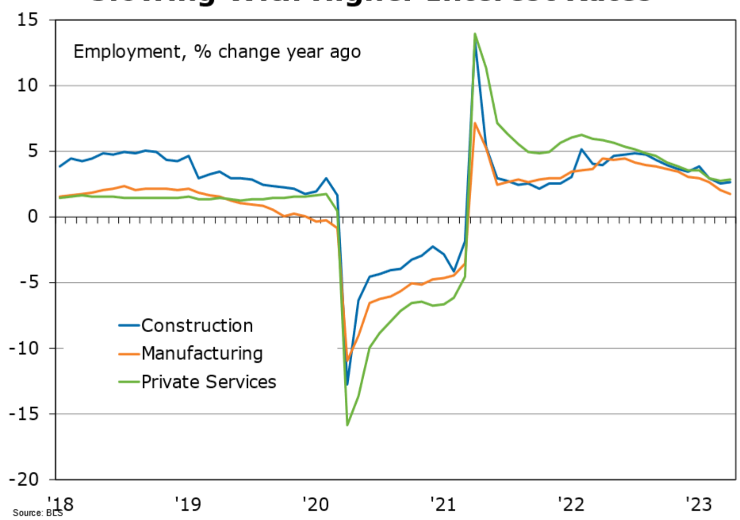
April Unemployment Rate of 3.4% Is Tied for Lowest Since 1969



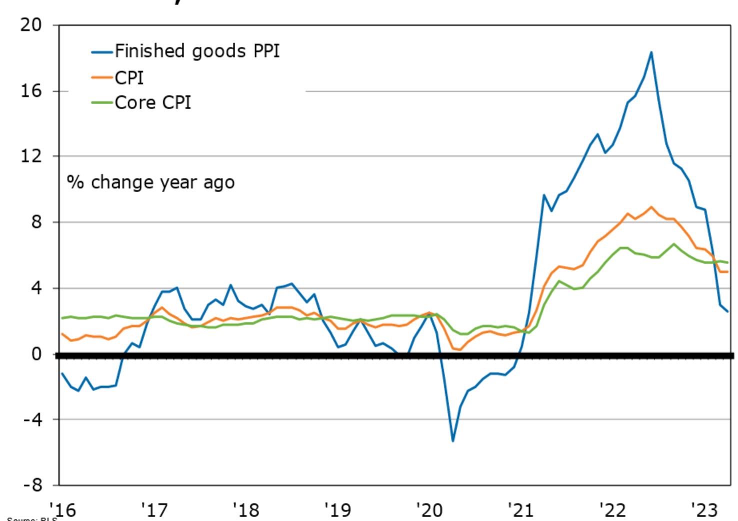
Yield Curve Inversion Continues to Deepen, Pointing to a Recession Soon



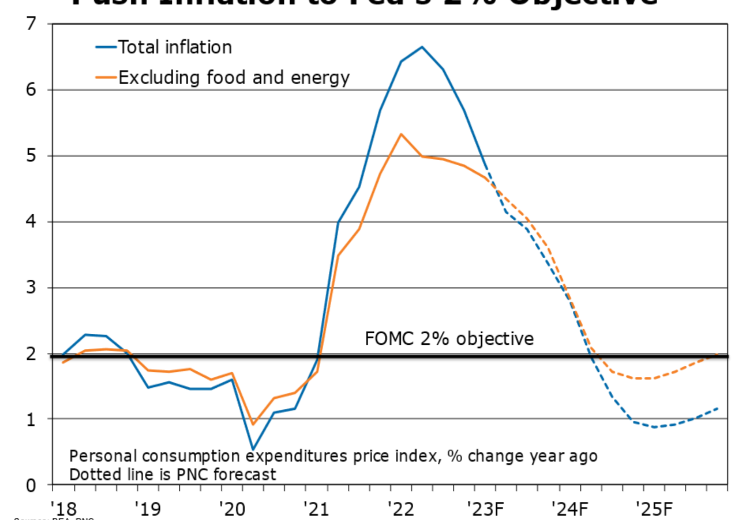
Manufacturing Job Growth Is Slowing With Higher Interest Rates



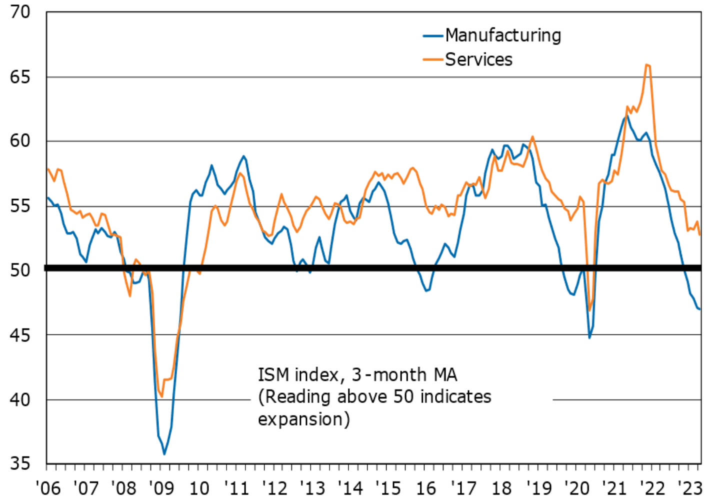
Dramatic Slowing in Wholesale Goods Inflation, But Less So on the Consumer Side



Recession Starting Later This Year Will Push Inflation to Fed's 2% Objective

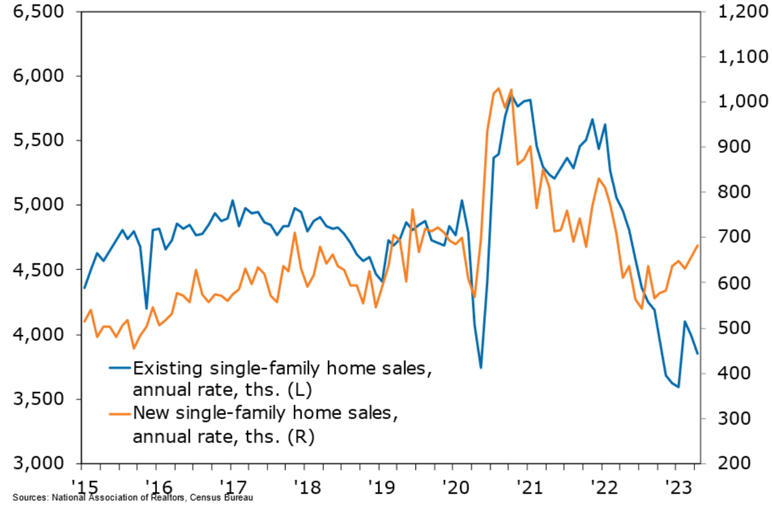


Services ISM Index Continues to Soften, But Is Still in Expansion; Manufacturing Is in Contraction



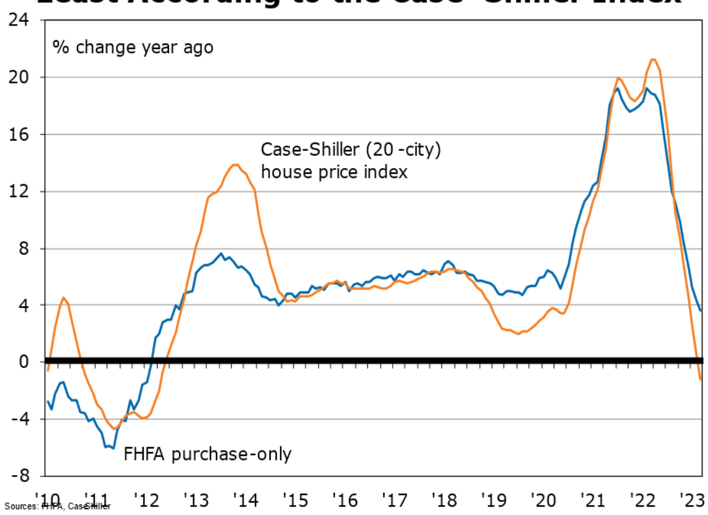
Source: ISM

Easing in Pipeline Woes Has Temporarily Boosted New Home Sales, But Existing Sales Remain Soft



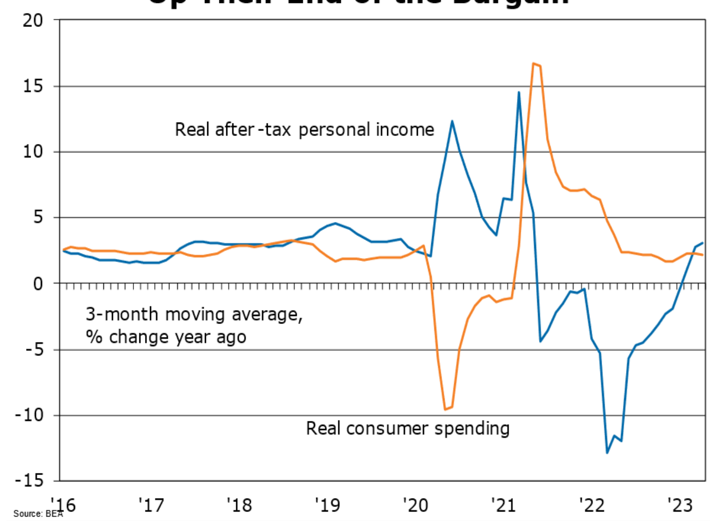
Sources: National Association of Realtors, Census Bureau

House Prices Are Down From a Year Ago, At Least According to the Case-Shiller Index



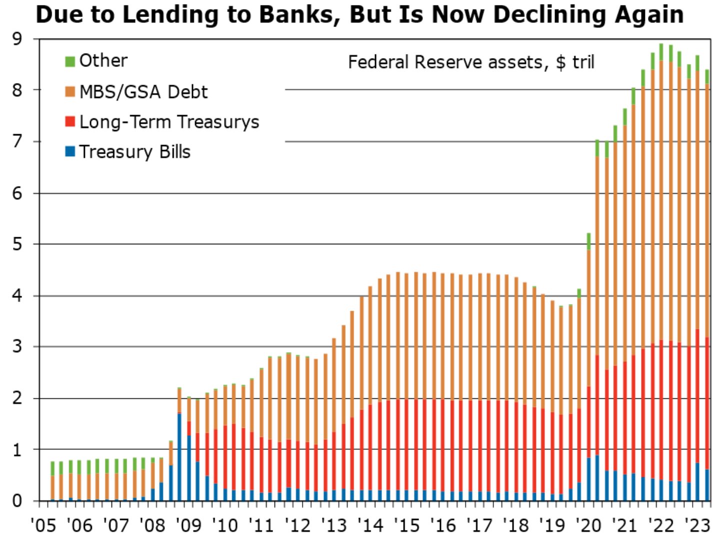
Sources: FHFA, Case-Shiller

Consumers Continue to Hold Up Their End of the Bargain



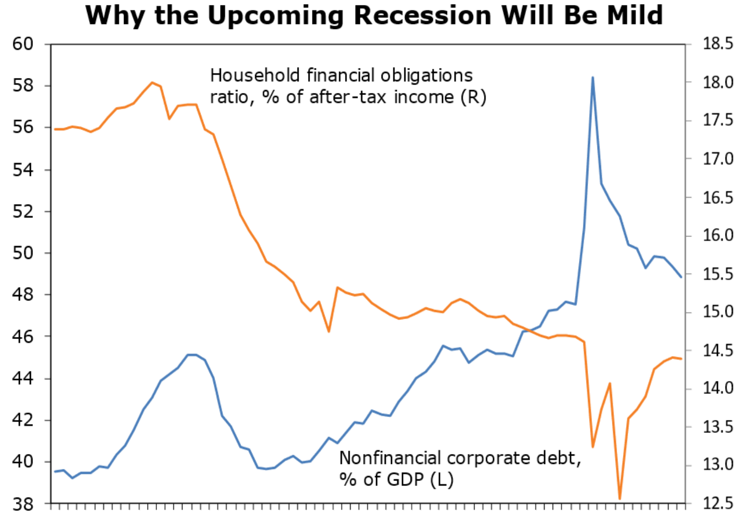
Source: BEA

Fed Balance Sheet Temporarily Increased in March Due to Lending to Banks, But Is Now Declining Again



Source: Federal Reserve

Strong Households Balance Sheets a Big Reason Why the Upcoming Recession Will Be Mild



Source: Federal Reserve

PNC Economics Group
May 2023

Baseline U.S. Economic Outlook, Expanded Table

	4Q'22a	1Q'23p	2Q'23f	3Q'23f	4Q'23f	1Q'24f	2022a	2023p	2024f	2025f
Output										
Nominal GDP (*Billions $*)	26138	26466	26861	27083	27166	27229	25463	26894	27355	28187
Percent Change Annualized	**6.6**	**5.1**	**6.1**	**3.3**	**1.2**	**0.9**	**9.2**	**5.6**	**1.7**	**3.0**
Real GDP (*Chained 2012 Billions $*)	20182	20236	20309	20317	20283	20232	20014	20286	20240	20582
Percent Change Annualized	**2.6**	**1.1**	**1.4**	**0.2**	**-0.7**	**-1.0**	**2.1**	**1.4**	**-0.2**	**1.7**
Pers. Consumption Expenditures	14215	14344	14402	14408	14395	14365	14130	14387	14363	14517
Percent Change Annualized	**1.0**	**3.7**	**1.6**	**0.2**	**-0.4**	**-0.8**	**2.7**	**1.8**	**-0.2**	**1.1**
Nonresidential Fixed Investment	2989	2994	2984	2958	2926	2896	2945	2965	2895	2994
Percent Change Annualized	**4.0**	**0.7**	**-1.4**	**-3.4**	**-4.2**	**-4.0**	**3.9**	**0.7**	**-2.4**	**3.4**
Residential Investment	577	571	555	543	532	529	643	550	534	558
Percent Change Annualized	**-25.1**	**-4.2**	**-10.3**	**-8.8**	**-7.6**	**-2.4**	**-10.6**	**-14.4**	**-3.0**	**4.6**
Change in Private Inventories	137	-2	54	54	35	17	125	35	-3	36
Net Exports	-1239	-1236	-1254	-1206	-1160	-1125	-1357	-1214	-1098	-1098
Government Expenditures	3442	3482	3486	3479	3473	3468	3406	3480	3467	3492
Percent Change Annualized	**3.8**	**4.7**	**0.5**	**-0.9**	**-0.6**	**-0.6**	**-0.6**	**2.2**	**-0.4**	**0.7**
Industrial Prod. Index (*2012 = 100*)	102.7	102.7	102.4	101.7	100.5	99.3	102.6	101.8	99.4	102.4
Percent Change Annualized	**-2.5**	**0.2**	**-1.0**	**-2.9**	**-4.5**	**-4.8**	**3.4**	**-0.8**	**-2.4**	**3.0**
Capacity Utilization (*Percent*)	79.9	79.6	79.2	78.4	77.3	76.2	80.3	78.6	76.2	78.4
Prices										
CPI (*1982-84 = 100*)	298.5	301.3	304.7	307.6	309.6	311	292.6	305.8	311.8	316.1
Percent Change Annualized	**4.2**	**3.8**	**4.6**	**3.8**	**2.6**	**1.3**	**8.0**	**4.5**	**2.0**	**1.4**
Core CPI Index (1982-84 = 100)	300.4	304.0	307.7	310.2	311.9	313	294.3	308.4	314.8	320.5
Percent Change Annualized	**5.1**	**5.0**	**4.9**	**3.4**	**2.1**	**1.6**	**6.1**	**4.8**	**2.0**	**1.8**
PCE Price Index (*2012 = 100*)	124.9	126.2	127.5	128.6	129.1	129.7	122.9	127.8	130.1	131.4
Percent Change Annualized	**3.7**	**4.2**	**4.3**	**3.3**	**1.7**	**1.8**	**6.3**	**4.1**	**1.8**	**1.0**
Core PCE Price Index (*2012 = 100*)	125.3	126.9	127.9	129.0	129.9	130	123.3	128.4	131.1	133.4
Percent Change Annualized	**4.4**	**4.9**	**3.4**	**3.5**	**2.7**	**1.8**	**5.0**	**4.2**	**2.1**	**1.8**
GDP Price Index (*2012 = 100*)	129.5	130.8	132.3	133.3	133.9	134.6	127.2	132.6	135.2	136.9
Percent Change Annualized	**3.9**	**4.0**	**4.6**	**3.2**	**1.9**	**2.0**	**7.0**	**4.2**	**1.9**	**1.3**
Crude Oil, WTI (*$/Barrel*)	82.6	76.0	73.5	71.8	70.6	69.3	94.4	73.0	72.9	78.6
Labor Markets										
Payroll Jobs (*Millions*)	154.3	155.2	155.8	156.0	155.8	155.5	152.6	155.7	155.1	155.3
Percent Change Annualized	**2.5**	**2.5**	**1.5**	**0.4**	**-0.5**	**-0.8**	**4.3**	**2.0**	**-0.4**	**0.1**
Unemployment Rate (*Percent*)	3.6	3.5	3.5	3.7	3.9	4.3	3.6	3.6	4.8	4.9
Average Weekly Hours, Prod. Works.	33.9	34.0	33.9	33.9	33.8	33.8	34.0	33.9	33.7	33.7
Personal Income										
Average Hourly Earnings (*$*)	28.1	28.4	28.8	29.1	29.5	29.8	27.6	28.9	30.1	30.8
Percent Change Annualized	**5.0**	**4.6**	**5.2**	**5.1**	**4.6**	**4.1**	**6.4**	**5.0**	**4.0**	**2.4**
Real Disp. Income (*2012 Billions $*)	15325	15622	15622	15702	15760	15751	15149	15677	15813	16077
Percent Change Annualized	**5.0**	**8.0**	**0.0**	**2.1**	**1.5**	**-0.2**	**-6.1**	**3.5**	**0.9**	**1.7**
Housing										
Housing Starts (*Ths., Ann. Rate*)	1398	1395	1347	1175	1111	1090	1554	1257	1052	1094
Ext. Home Sales (*Ths., Ann Rate*)	4197	4330	3983	3923	3870	3820	5081	4027	4014	5115
New SF Home Sales (*Ths., Ann Rate*)	598	651	635	612	598	591	641	624	591	629
Case/Shiller HPI (*Jan. 2000 = 100*)	297.9	294.0	286.9	278.7	270.6	262.6	297.9	270.6	264.3	271.4
Percent Change Year Ago	**7.4**	**1.1**	**-5.5**	**-7.6**	**-9.1**	**-10.7**	**7.4**	**-9.1**	**-2.3**	**2.7**
Consumer										
Auto Sales (*Millions*)	14.3	15.2	15.2	14.9	14.4	13.9	13.8	14.9	13.5	13.6
Consumer Credit (*Billions $*)	4786	4851	4906	4953	4991	5026	4786	4991	5108	5336
Percent Change Year Ago	**8.0**	**7.3**	**6.3**	**5.4**	**4.3**	**3.6**	**8.0**	**4.3**	**2.4**	**4.5**
Interest Rates (Percent)										
Prime Rate	6.82	7.69	8.16	8.25	8.25	8.02	**4.85**	**8.09**	**6.95**	**6.00**
Federal Funds	3.65	4.52	5.02	5.12	5.12	4.90	**1.68**	**4.95**	**3.82**	**2.87**
3-Month Treasury Bill	4.04	4.63	4.96	4.95	4.95	4.66	**2.03**	**4.87**	**3.62**	**2.74**
10-Year Treasury Note	3.83	3.65	3.50	3.43	3.36	3.31	**2.95**	**3.48**	**3.30**	**3.34**
30-Year Fixed Mortgage	6.69	6.36	6.30	6.16	5.98	5.78	**5.33**	**6.20**	**5.53**	**5.23**

a = actual f = forecast p = preliminary

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