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ECONOMIC REPORT

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DECENT DECEMBER JOBS REPORT: PAYROLLS UP 148,000 AND UNEMPLOYMENT RATE STEADY AT 4.1 PERCENT

SUMMARY

- The U.S. economy added 148,000 jobs in December, below the 190,000 consensus, but still a decent rise.
- The unemployment held steady at 4.1 percent in December for a third month.
- Average hourly earnings rose 0.3 percent in December and year-over-year growth remained at 2.5 percent.
- The job market is very healthy as 2018 begins.
- Solid economic and job growth this year will give the FOMC the green light to raise the federal funds rate by 25 bps three times in 2018 (June, September and December).

The U.S. economy added 148,000 jobs in December, below the 190,000 consensus, but still a decent rise. The private sector added 146,000 jobs in December, well below the ADP estimate of 250,000; Federal government employment rose 1,000 and state and local government jobs also rose 1,000. November jobs gains were revised up by 24,000 to 252,000 but October job growth was revised down by 33,000 to 211,000; thus, a net small downward revision of 9,000 jobs for the previous two months.

In the fourth quarter, the U.S. economy added an average of 204,000 jobs per month, above the average of 171,000 per month for all of 2017. This is down from a pace of 187,000 jobs per month in 2016. We forecast another small slowdown to near 140,000 jobs per month in 2018, more due to a lack of qualified workers rather than softer demand for qualified employees. However, migration from Puerto Rico to the mainland in the aftermath of Maria could help alleviate hiring shortages and support job growth.

The unemployment held steady at 4.1 percent in December for a third month; this is the lowest unemployment rate since December 2000. The number of jobs in the household survey of employment (different from the survey of employers) rose by 104,000 and the labor force rose by 64,000 in December; the labor force participation rate held steady at 62.7 percent in December and it remains well below its pre-recession level. The number of unemployed fell by 40,000 in December. The broader U-6 "under employment" rate (unemployed, underemployed and too discouraged to look for a job) edged up to 8.1 percent in December, but remains near a decade-long low point. Voluntary part-time jobs rose 100,000 and "involuntary" part-time jobs (unable to find full time jobs) rose 64,000 in December which accounts for the uptick in the U-6 rate. Still, total part-time workers in December 2017 fell 770,000 from December 2016, including a decline of 131,000 voluntary and a decline of 639,000 involuntary part-time workers.

Job growth was broad-based across private industries in December. Goods-producing industries added 55,000 jobs, with manufacturing employment up 25,000 and construction employment up 30,000. Private service-providing industries added only 91,000 jobs in December. Jobs declined in retail trade by 20,000 as brick and mortar stores continue to pare workers (this is before the store closings announced by Macys and Sears/Kmart). Business/professional services added 19,000 jobs (including 7,000 temp jobs), eds and meds added 28,000 jobs, leisure/hospitality services added 29,000 jobs, financial services added 6,000 jobs, and information services added 76,000 jobs. Average hourly earnings rose 0.3 percent in December, but were revised lower in November to a 0.1 percent rise, from 0.2 percent. Year-over-year growth in wages remained at 2.5 percent in December. Surprisingly, there are few indications that the tight labor market is leading to stronger wage growth, a disappointment given that the expansion is now more than eight-and-a-half years old.



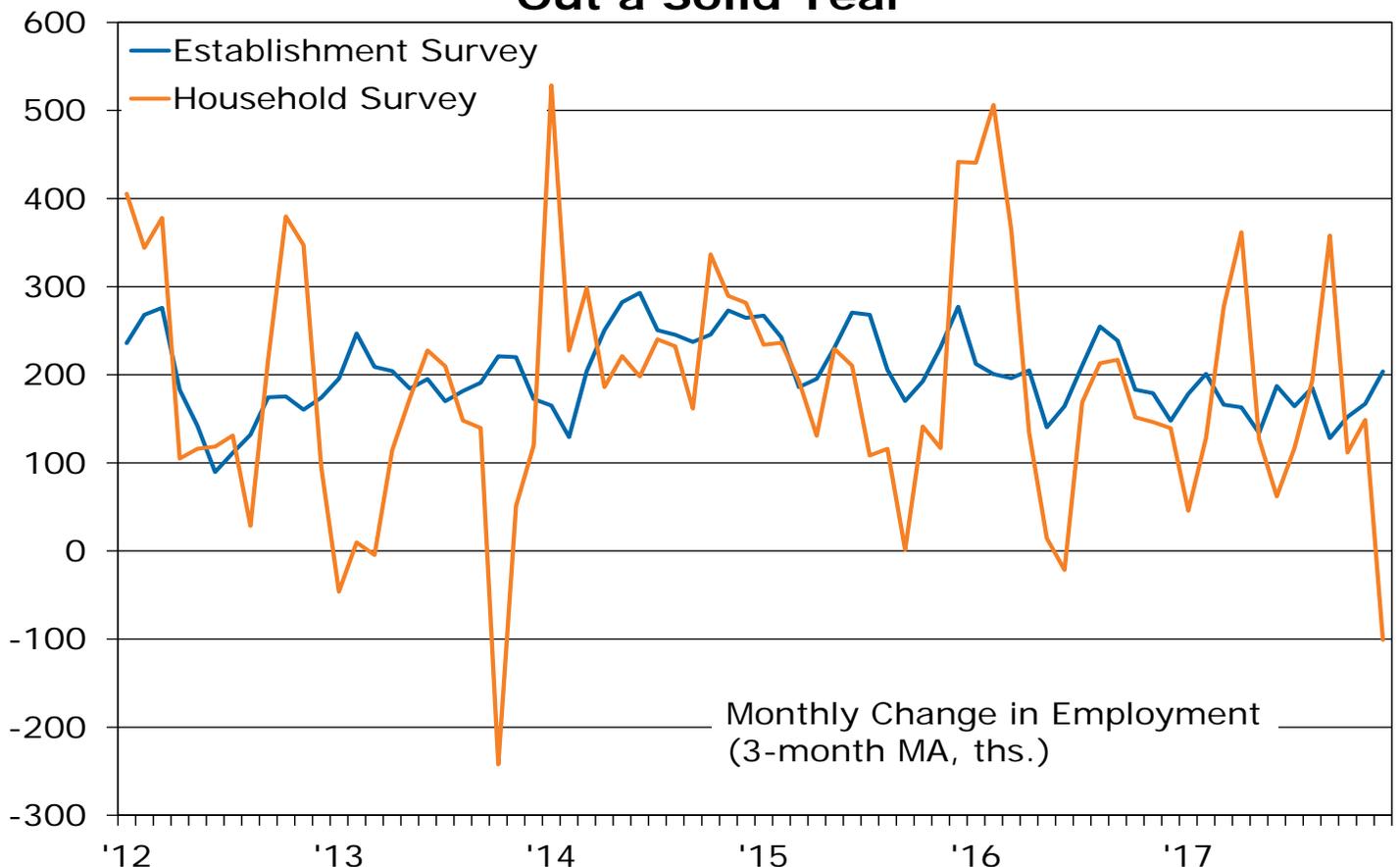
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The average workweek held steady at 34.5 hours in December. With a moderate increase in jobs, a stable workweek, and a rise in wages, aggregate weekly earnings were up 0.4 percent in December, which should allow for a large real income gain in December given that the consumer price index was likely unchanged last month, held down by a nearly 3 percent decline in gasoline prices. Caveat: The December income data could be temporarily depressed by the income tax cuts for 2018 that will likely lead to many year-end bonuses being delayed until January 2018.

In summary, the job market is very healthy as 2018 begins. The solid economy will add about 140,000 jobs per month this year, well above the pace of the underlying growth in the labor force, so the unemployment rate will decline to 3.7 percent by year-end 2018. The one weak spot in 2017 remained only modest wage growth, but wage gains should pick up to nearly 3.0 percent as the labor market continues to tighten this year and some of the corporate tax cut gets passed along to workers.

Inflation has remained below the FOMC's 2.0 percent goal, but given the increasingly tight job market, that will not deter the FOMC from continued "gradual" funds rate hikes in 2018. Solid economic and job growth this year will give the FOMC the green light to raise the federal funds rate by 25 bps three times in 2018 (June, September and December). Right now the Fed funds futures market is pricing in a 67 percent probability of a 25 basis point rate increase at the March 2018 FOMC meeting. We expect them to remain on hold at that meeting awaiting further evidence on inflation and the impact of the tax cuts on economic growth. With WTI oil prices topping \$60/barrel, there will be a speed-up in headline CPI/PCE inflation in the first quarter and some will be passed along to core inflation which will keep the FOMC on a June, September and December "gradual" rate hike path. Also, the rotation in FOMC voters from two doves last year (Kashkari and Evans) to two "hawks" this year (Mester and Williams) will tilt the FOMC in the direction of gradual but persistent funds rate hikes.

Decent December Payroll Job Gains Closes Out a Solid Year



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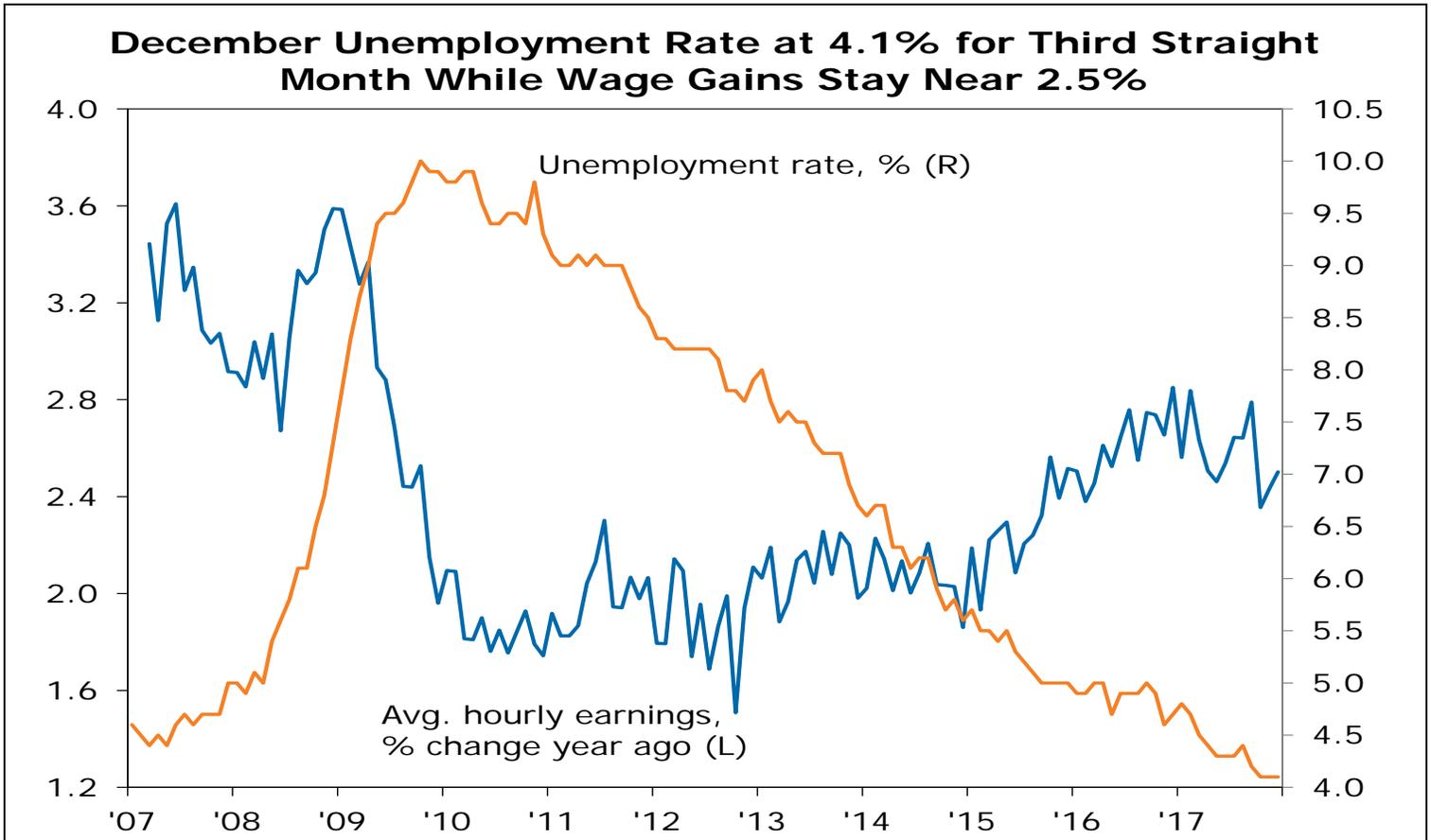


Chart source: Bureau of Economic Analysis

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