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ECONOMIC REPORT

**Gus Faucher**
Chief Economist

**Stuart Hoffman**
Senior Economic Advisor

**William Adams**
Senior Economist

**Kurt Rankin**
Economist

THE PNC FINANCIAL SERVICES GROUP | The Tower at PNC Plaza | 300 Fifth Avenue | Pittsburgh, PA 15222-2401

# EXCELLENT MAY JOBS REPORT, LOWEST UNEMPLOYMENT RATE IN 18 YEARS; GOOD NEWS ON MANUFACTURING

## SUMMARY

- The U.S. economy added 223,000 jobs in May, well above the consensus expectation.
- The unemployment rate fell to 3.8 percent, its lowest since mid-2000.
- Average hourly earnings were up a solid 2.7 percent in May.
- The excellent May jobs report supports a mid-June fed funds rate hike.
- The ISM manufacturing index rose in May, and indicates solid growth.
- Construction spending jumped 1.7 percent in April, and was up almost 8 percent from one year earlier.

The U.S. economy added 223,000 jobs in May, well above the consensus expectation for an increase of 185,000 and PNC's forecast of 195,000. The private sector added 218,000 jobs over the month, with government employment up by 5,000. April job growth was revised down by 5,000 to 159,000, while March growth was revised up by 20,000 to 155,000, for a combined upward revision to job growth over the two months of 15,000. The U.S. economy has added an average of 207,000 jobs per month so far in 2018, above last year's pace of 182,000.

The unemployment rate fell 0.1 percentage point in May to 3.8 percent. This is the lowest the unemployment rate has been since April 2000. The details on the unemployment rate were mixed. The number of people employed in the household survey (different from the survey of employers) rose by a very good 293,000 in May, after a net loss of 34,000 in the two previous months. But the labor force only grew by 12,000 in May, and has contracted by a combined 382,000 over the past three months. The labor force participation rate (share of adults either working or looking for a job) was 62.7 percent in May, down from 62.8 percent in April and 63.0 percent in February. The broader U-6 unemployment rate (unemployed, underemployed and too discouraged to look for a job) fell to 7.6 percent in May from 7.8 percent in April and 8.2 percent in February; it is now at its lowest since mid-2001.

Job growth was good in almost all industries in May. Goods-producing industries added 47,000 jobs over the month, including 25,000 in construction and 17,000 in manufacturing. Private service-providing industries added 171,000 jobs in May, the best month since February. Retail employment rose by 31,000 over the month; this is the ninth increase in the last 10 months, after job losses in much of 2017 tied to the increasing prevalence of online sales. Professional/business services added 31,000 jobs in May, although temp jobs declined by 8,000. Eds and meds added 39,000 jobs, while leisure/hospitality services added 21,000. Federal government employment fell by 3,000 in May, but state and local government employment rose by 8,000.

Average hourly earnings rose 0.3 percent in May, up from 0.1 percent growth in April. Year-over-year growth in wages was 2.7 percent in May, up from 2.6 percent in April. Slowly but surely the tighter job market is leading to bigger pay increases, as businesses raise wages to retain their current workers and attract new ones (see Chart 1).

The average workweek held steady at 34.5 hours for a fourth straight month. With more jobs, a steady workweek, and good growth in wages, aggregate weekly earnings were up 0.3 percent in May. This should result in flat real income over the month; the consumer price index likely rose 0.3 percent on higher energy prices.

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The job market is in excellent shape in the spring of 2018. Job growth continues to run above the pace needed to reduce labor market slack, the unemployment rate is at its lowest in 18 years, and wage growth is picking up. The only big negative in the jobs report was weak labor force growth; this could constrain hiring. However, higher wages could encourage more people to join the labor force.

PNC expects job growth of around 190,000 per month this year, slightly above last year's pace; it will slow through the end of 2018 as businesses find it more and more difficult to hire. Stimulus from the recent corporate and personal income tax cuts, as well as increased federal spending, will boost the economy and labor market in 2018 and into 2019. Wage growth will accelerate this year as employers compete for workers; PNC's spring 2018 survey of small and medium-sized businesses finds that one-half of firms expect to raise compensation over the next six months.

The excellent May employment report supports an increase in the federal funds rate when the Federal Open Market Committee meets on June 13, by one-quarter of a percentage point to a range of 1.75 to 2.00 percent. Inflation has moved to the FOMC's 2 percent goal this spring, and the tight job market is raising concerns that building wage pressures could lead to higher inflation. The FOMC will try to let some of the steam off the economy, concerned that letting the labor market run too hot could push inflation well past the committee's 2 percent goal. Right now the fed funds futures market is pricing in a 91 percent probability of a rate increase at the mid-June meeting.

The ISM manufacturing index rose to 58.7 percent in May from 57.3 percent in April; a reading above 50 indicates expansion in the industry. The details were good, with four of the five major components improving over the month.

**Chart 1: With Tight Labor Market, Wage Growth Will Accelerate Further Into 2019**

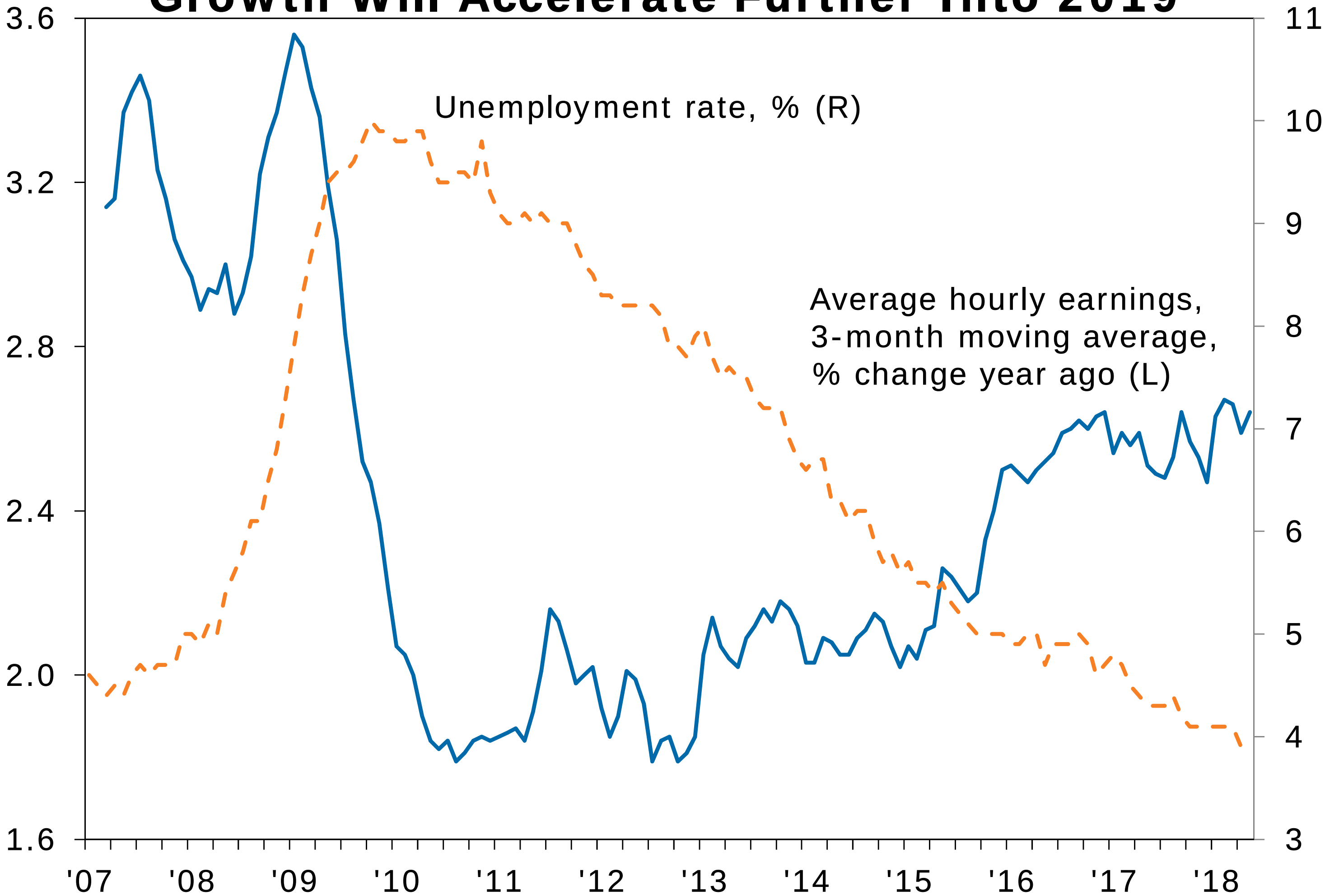


Chart source: Bureau of Labor Statistics

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The production, new orders, and supplier deliveries components were all above 60, and employment and inventories were both above 50. Sixteen of the 18 industries covered reported growth in May, with the biggest gains in textiles; nonmetallic mineral products; and electrical equipment, appliances and components.

Manufacturing will continue to expand through the rest of this year and into next thanks to stronger consumer and business demand. However, a potential trade war between the U.S. and its trading partners is a downside risk. In addition, a lack of skilled labor could limit manufacturers' ability to expand.

Construction spending rose 1.8 percent in April, more than offsetting March's 1.7 percent decline. Construction spending has risen in eight of the past nine months, and was up 7.6 percent in April from one year earlier.

Private residential spending jumped 4.5 percent in April, although much of the gain came from home improvements. Private nonresidential spending rose 0.8 percent, and public spending rose 1.3 percent. All major components were up on a year-over-year basis in April (see Chart 2).

Construction will continue to add to economic growth this year. Residential construction, particularly single-family homebuilding, continues its gradual recovery from the housing bust. Low vacancy rates and rising rents are supporting commercial development, outside of retail.

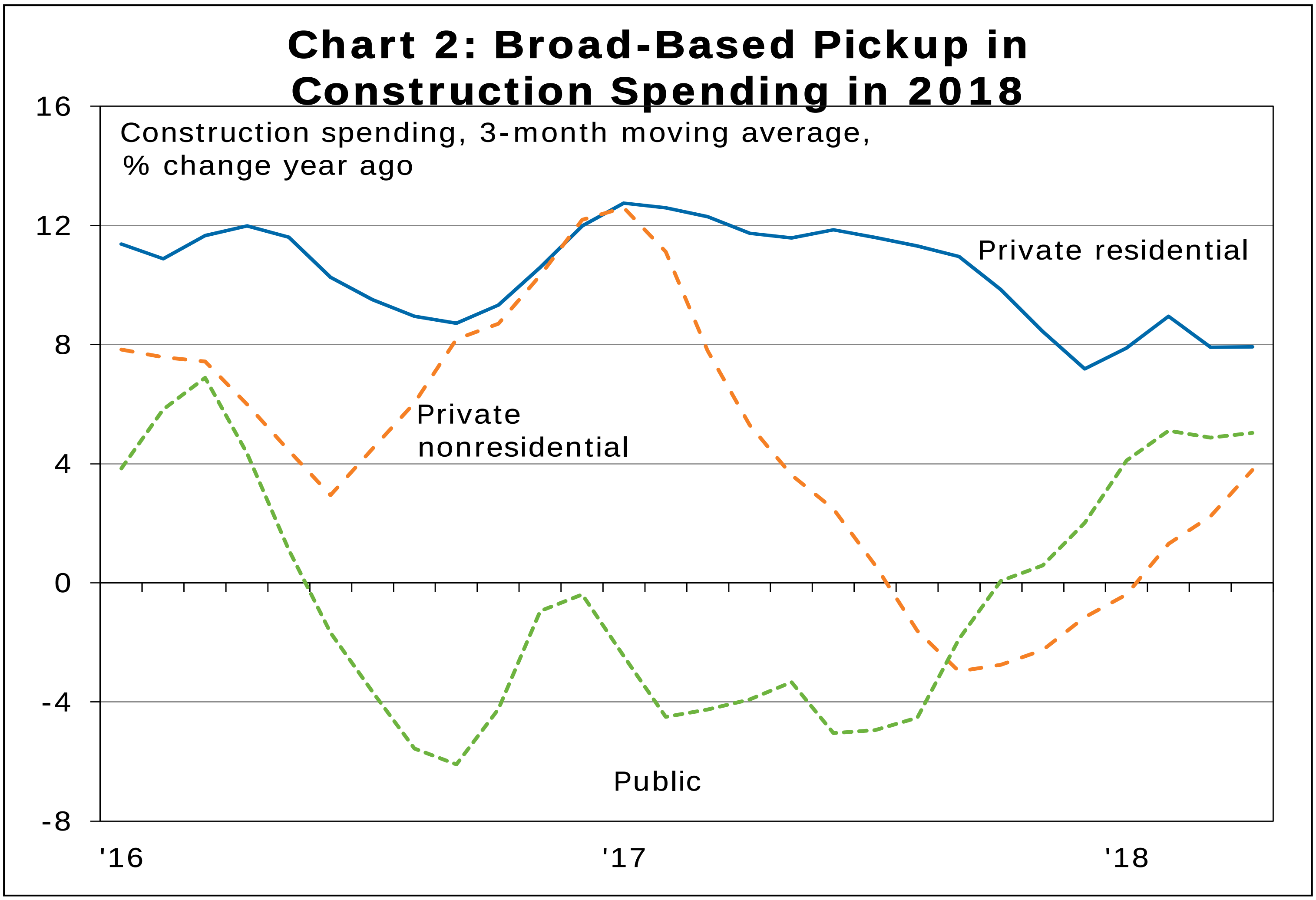


Chart source: Census Bureau

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