



ECONOMIC REPORT

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ADP POINTS TO ANOTHER SOLID MONTH FOR JOBS; LABOR COSTS REMAIN CONTAINED; MANUFACTURING IS SLOWING

SUMMARY

- According to ADP, U.S. private-sector employment increased by 156,000 in July. PNC expects an increase of 160,000 in total employment when the BLS releases the jobs report for July on August 2.
- The labor market is very strong in mid-2019.
- The employment cost index was up 0.6 percent in the second quarter; wage pressures remain very low.
- The ISM manufacturing index fell again in July, and was just barely in expansionary territory. Proposed tariffs on Chinese-made goods would further weaken U.S. manufacturing.
- Construction spending fell 1.3 percent in June, with drops in all major components.

According to data from payroll-processing firm ADP, the U.S. private sector added 156,000 jobs in July. This is a pickup from May and June, but job growth has slowed in 2019. Private service-producing industries added 146,000 jobs over the month according to the ADP report, while goods-producing industries added 9,000. This is consistent with PNC's forecast for an increase of 160,000 in total nonfarm employment in July, including a private-sector gain of 165,000, when the Bureau of Labor Statistics releases the July jobs report on August 2. PNC is forecasting an unemployment rate of 3.6 percent in July, down from 3.7 percent in June.

The job market is in excellent shape in 2019. Job growth averaged 172,000 per month in the first half of this year according to the BLS. Although this is down from 223,000 per month in 2018, it is still well above the pace needed to keep up with underlying growth in the labor force. The unemployment rate has been at 4 percent or below since early 2018, and is near a five-decade low.

Wage pressures remain contained despite the very strong job market. The employment cost index, which attempts to track pay for individual workers over time, rose just 0.6 percent in the second quarter, taking into account both pay and benefits. Wages were up 0.7 percent, while benefit costs were up 0.5 percent.

On a year-ago basis total compensation was up 2.8 percent, with wages up 3.0 percent and benefits up 2.3 percent. Given the tight labor market and steep competition for workers, wage pressures remain remarkably contained; the ECI has seen no acceleration over the past year (see Chart 1). With wage pressures minimal, businesses are limiting price increases, keeping inflation in check. The PCE price index excluding food and energy, the Federal Reserve's preferred inflation measure, has been below the central bank's 2 percent objective throughout most of the current expansion, and has moved further below 2 percent this year. Low inflation gave the Federal Open Market Committee the leeway to cut the federal funds rate by one-quarter of a percentage point on July 31, to provide insurance against any downside risks to U.S. economic growth that might materialize in the second half of 2019.

The Institute for Supply Management's manufacturing index fell to 51.2 in July from 51.7 in June; a reading of above 50 indicates expansion in manufacturing. This was the fourth straight decline, and the lowest reading since 2016 (see Chart 2). There were big drops in the production and employment components of the ISM index in July, although of the five major components, only inventories were below the 50 mark. Other details were weak in July, with the imports, new export orders, order backlog, prices paid, and customer inventories subindices all below 50; none of these subindices are used in calculating the overall index.

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Nine of the 18 covered manufacturing industries reported expansion in July, with the strongest growth in wood products and printing. Nine reported contraction, with the biggest drops in apparel and leather and fabricated metal products.

U.S. manufacturing is still expanding in mid-2019, but growth in the industry has slowed over the past year. Slower global economic growth, tensions between the U.S. and its major trading partners, and a stronger dollar have all contributed to a slowing in manufacturing growth in recent months. With President Trump calling for additional 10

percent tariffs on \$300 billion of Chinese imports, effective September 1, U.S. manufacturing will likely outright contract in the second half of 2019, due to supply-chain disruptions, retaliatory actions from China, and increased uncertainty.

Construction spending fell 1.3 percent in June, the second straight monthly drop. Spending fell over the month for all three major components: private residential (down 0.4 percent), private nonresidential (down 0.3 percent), and public (down 3.7 percent).

Even more worrisome, total construction spending was

Chart 1: Few Wage Pressures Despite Tight Labor Market

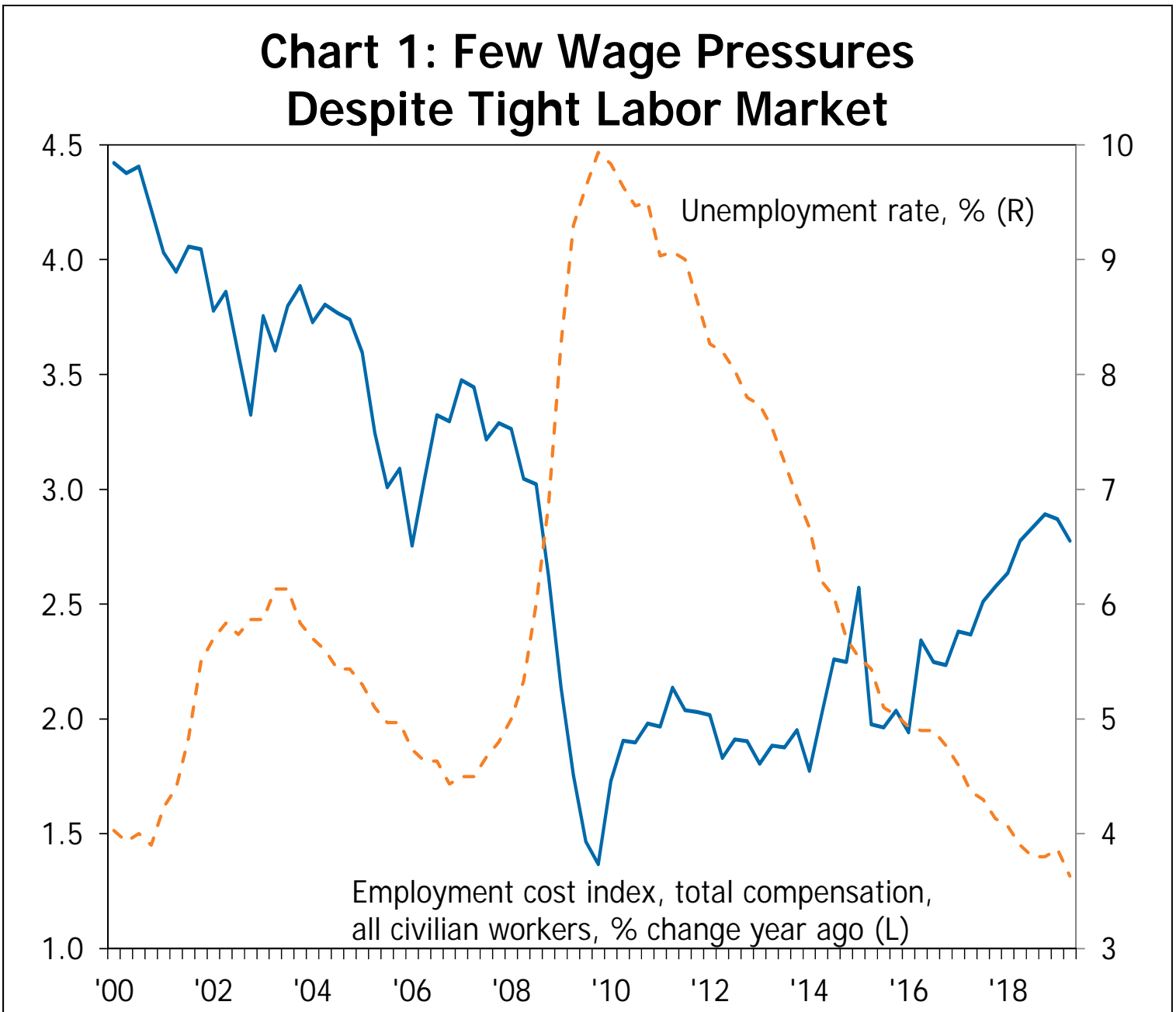


Chart source: Bureau of Labor Statistics

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down 2.1 percent in June from one year earlier. Private residential spending was down 8.1 percent year-over-year as the homebuilding recovery has reversed, and private nonresidential spending was down 0.4 percent. Public spending was up 6.1 percent year-over-year in June.

Construction spending has been falling in 2019. Labor shortages and tariffs on construction materials have weighed on the sector. Reduced affordability has been a

drag on homebuilding, although lower mortgage rates should provide a boost to residential construction in the second half of 2019. Drivers for nonresidential private construction are mixed. Low energy prices are weighing on construction in that sector, while low vacancy rates and rising rents are positives for the office market. The increasing prevalence of online sales has caused retail construction spending to fall by one-fifth over the past year.

Chart 2: U.S. Manufacturing Just Barely Expanding in Mid-2019, With New Orders Soft

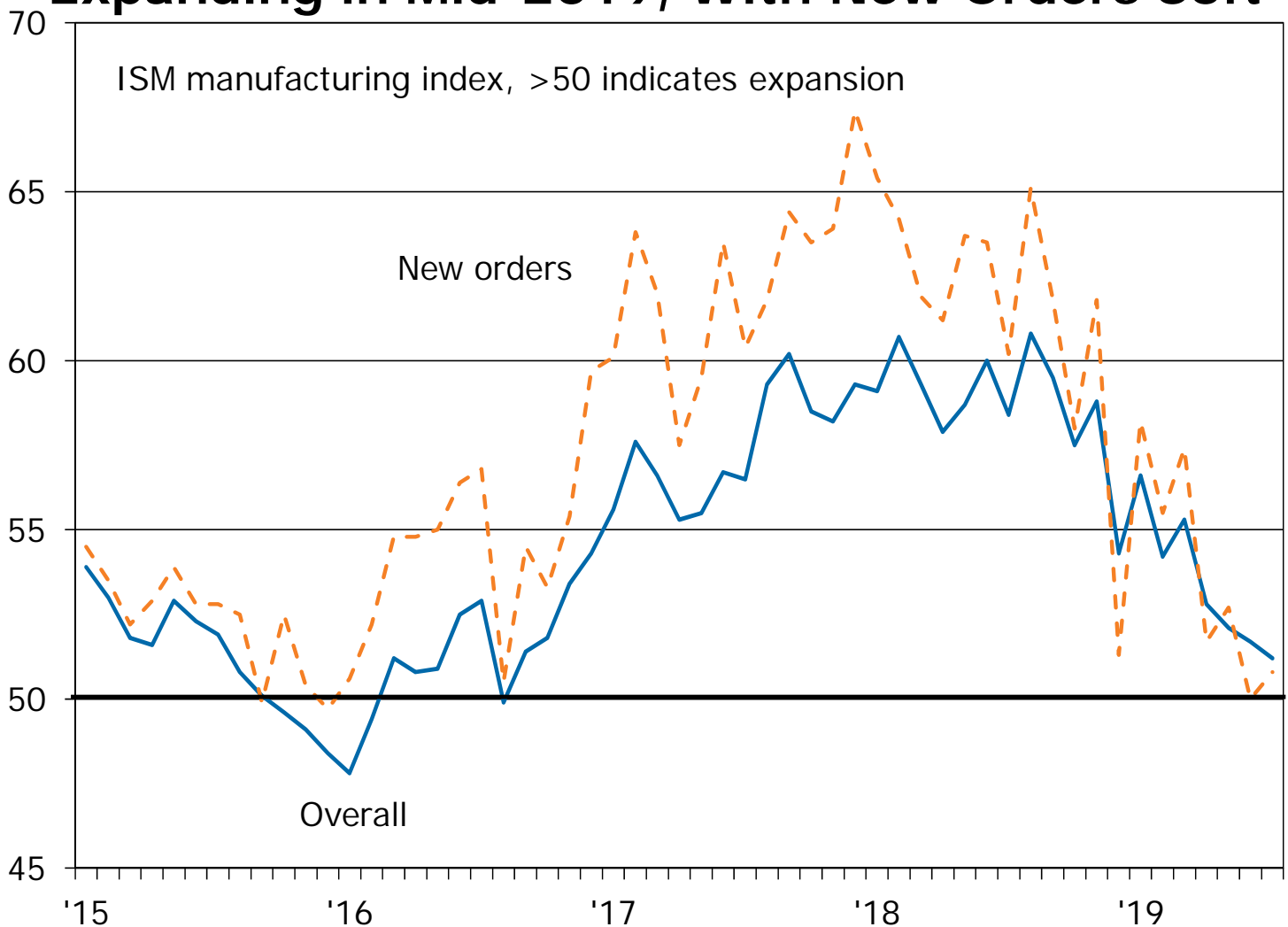


Chart source: Institute for Supply Management

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