February 4, 2019

ECONOMIC REPORT

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STRONG JANUARY JOBS REPORT DESPITE SHUTDOWN; UNEMPLOYMENT RATE RISES, BUT WILL FALL IN FEBRUARY

SUMMARY

- The US economy added 304,000 jobs in January, despite the government shutdown, well above expectations.
- The unemployment rate rose slightly in January to 4.0 percent, in large part because of the shutdown, but the rate should fall again in February. The labor force rose in January, a positive for near-term economic growth.
- Wage growth was modest in January, but the tight job market is pushing up pay.
- The labor market will continue to improve throughout 2019, although job growth will slow over the year.
- Risks to the job market are weighted to the downside.
- PNC expects one increase in the fed funds rate in 2019.

The U.S. economy added a very strong 304,000 jobs in January despite the partial federal government shutdown, the biggest gain since February 2018. Federal government workers who were on furlough or working without pay because of the partial government shutdown were counted as employed in the employer survey of jobs. January job growth was well above the consensus expectation and PNC's forecast of 160,000. The private sector added 296,000 jobs in January, with government employment up by 8,000. December's job gain was revised down from a very strong 312,000 to a still-solid 222,000, while November job growth was revised higher to 196,000 from 176,000, for a net downward revision of 70,000. Even so, the three-month moving average of job growth through January was a very good 241,000, above 2018's average monthly pace of 223,000 (Chart 1).

The unemployment rate rose 0.1 percentage point in January to 4.0 percent, the highest the unemployment rate has been since June. The unemployment rate rose in part because federal government workers on furlough were counted as unemployed (on temporary layoff) in the household survey of employment (different from the survey of employers). After accounting for new population controls, employment in the household survey rose by 237,000 even with furloughed federal government employees counted as unemployed. The civilian labor force increased by almost 500,000 in January after adjustment for population controls, and the labor force participation rate rose 0.1 percentage point to 63.2 percent, the highest it has been since February 2013 (Chart 2). The broader U-6 unemployment rate (unemployed, underemployed and too discouraged to look for a job) jumped from 7.6 percent in December to 8.1 percent in January, the highest it has been February 2018. The rise in the U6 rate reflects federal government employees who were working but not paid during the shutdown. Both the unemployment rate and the U6 rate should move lower in February now that the government shutdown has ended.

Job growth was broad-based across industries in January. Goods-producing industries added 72,000 jobs over the month, with increases of 52,000 in construction and 13,000 in manufacturing. Private service-providing industries added 224,000 jobs in January, including huge gains of 74,000 in leisure/hospitality services (despite the closure of many national parks from the shutdown), 55,000 in education/healthcare services, 30,000 in professional/business services (although temporary help jobs rose by just 1,000), 27,000 in transportation/warehousing, and 21,000 in retail trade. Federal government employment was up by 1,000 in January (again, federal employees on furlough and working without pay were counted as employed in the employer jobs survey), and state and local employment rose by 7,000.

Average hourly earnings rose 0.1 percent in January, after gains of 0.4 percent in December and 0.3 percent in

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November. The shutdown may have weighed on wage growth over the month. Year-over-year growth in wages was 3.2 percent in January, down from 3.3 percent in December. Wage growth has been 3.2-3.3 percent for the past four months, after being below this since early 2009 when the labor market was imploding from the Great Recession. The tighter job market is leading to stronger wage growth as businesses raise pay to retain their current workers and attract new ones.

The average workweek held steady in January at 34.5 hours; it has been between 34.4 and 34.5 hours for more than one year. With many more jobs, a small increase in wages, and an unchanged workweek, aggregate weekly earnings were up 0.1 percent in January. As a result real consumer income was likely flat over the month, with the consumer price index set to increase slightly in January (to be released on February 13, not affected by the federal government shutdown); the ongoing decline in energy prices is restraining inflation in early 2019.

This release included the annual benchmark revisions to the employment data. The changes were small, with the number of jobs at the end of 2018 higher by only 7,000 with the revisions.

Even with the partial federal government shutdown the labor market is in great shape in early 2019, perhaps the best it has been in 50 years. Job growth was again strong in January, and the long-awaited acceleration in wage growth is firming as the job market tightens. Job growth has averaged 243,000 over the past three months, far above the pace needed to reduce labor market slack. With the partial government shutdown over the unemployment rate is set to move lower, to around 3.4 percent at the end of 2019. Job growth will slow to around 150,000 per month this year as businesses find it more and more difficult to hire. Job gains and wage growth will power increases in consumer incomes and spending, and business investment will also be a positive for growth this year. However, growth will slow over the course of 2019 and into 2020 as fiscal stimulus from federal spending increases fades.

Risks are weighted to the downside, including a trade war, slower global growth, another government shutdown, and geopolitical concerns. Stronger labor force growth than expected, as higher wages bring more people into the job market, is the major upside risk.

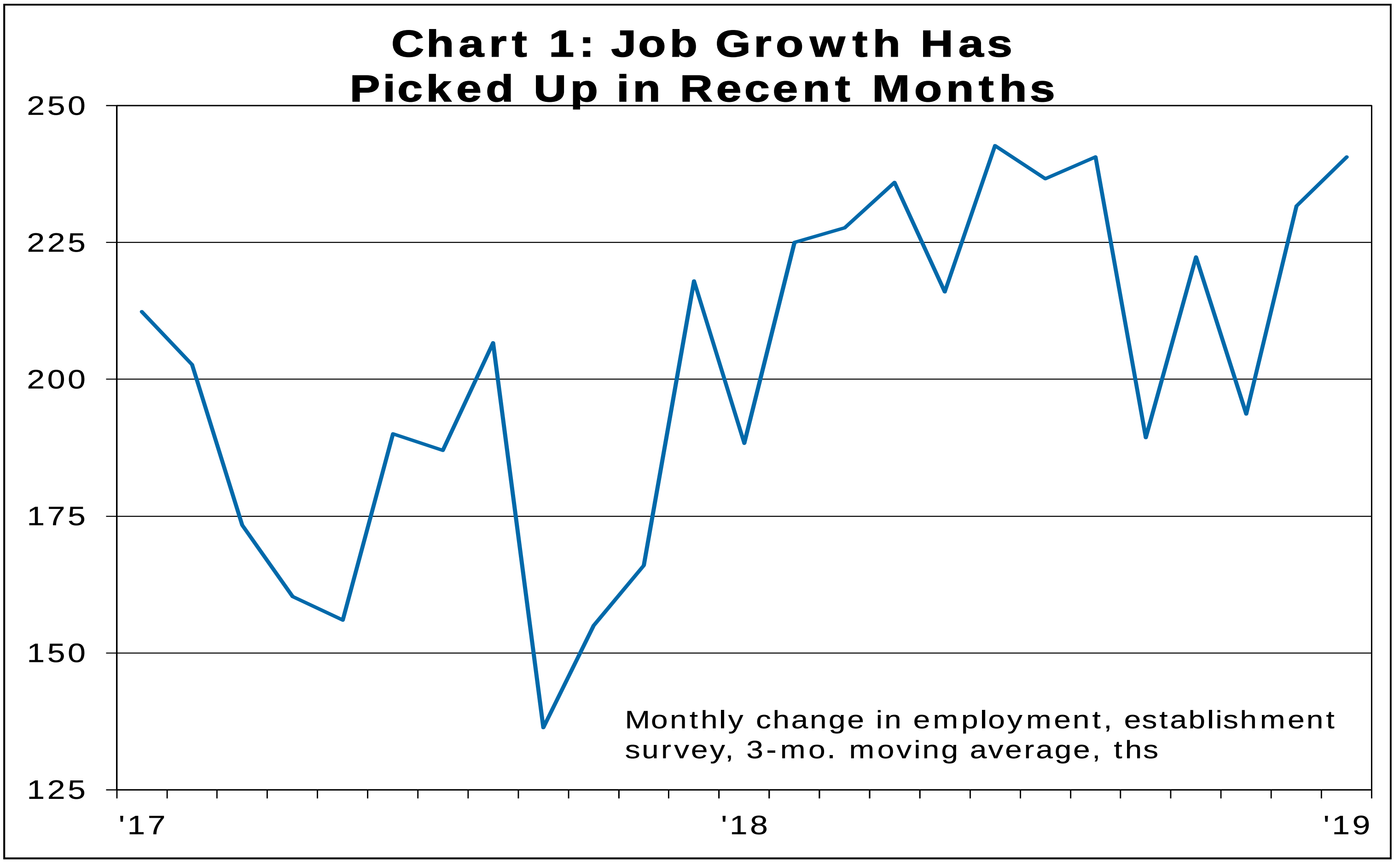

Chart source: Bureau of Labor Statistics

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The current economic expansion, which began in June 2009, is now in its ninth year, making it the second-longest expansion in U.S. economic history. With the job market in great shape right now it is set to become the longest expansion ever; the longest expansion lasted 120 months, from 1991 to 2001.

In late January the Federal Open Market Committee said that it could be "patient" with further increases in the federal funds rate. Even with the stellar January jobs report, the FOMC can afford a wait-and-see approach to monetary policy. US economic fundamentals remain good, and growth will likely be solid in the first half of 2019 thanks to gains in consumer spending and business investment. Any economic impact from the shutdown should be made up quickly in the second quarter. And inflation is near the FOMC's 2 percent objective and set to move lower, given the big drop in energy prices in recent months. Thus the FOMC has the luxury of time. If it becomes apparent over the next few months that growth remains solid and the labor market is continuing to improve, the FOMC can raise the fed funds rate toward the middle of this year before inflation revs up.

PNC's baseline forecast is for one fed funds rate hike this year, in September, to a range of 2.50 to 2.75 percent. That would take the fed funds rate to roughly its neutral level, where it is neither adding to nor subtracting from growth.

The S&P 500 was flat on the day. The yield on the 10-year Treasury note rose slightly to end the day at 2.68 percent; short-term rates rose by a smaller amount, so the yield curve steepened a bit. The price of a barrel of West Texas Intermediate crude oil rose by almost 3 percent to above $55; it is up by about $12 a barrel since Christmas. The U.S. dollar rose slightly against a basket of currencies.

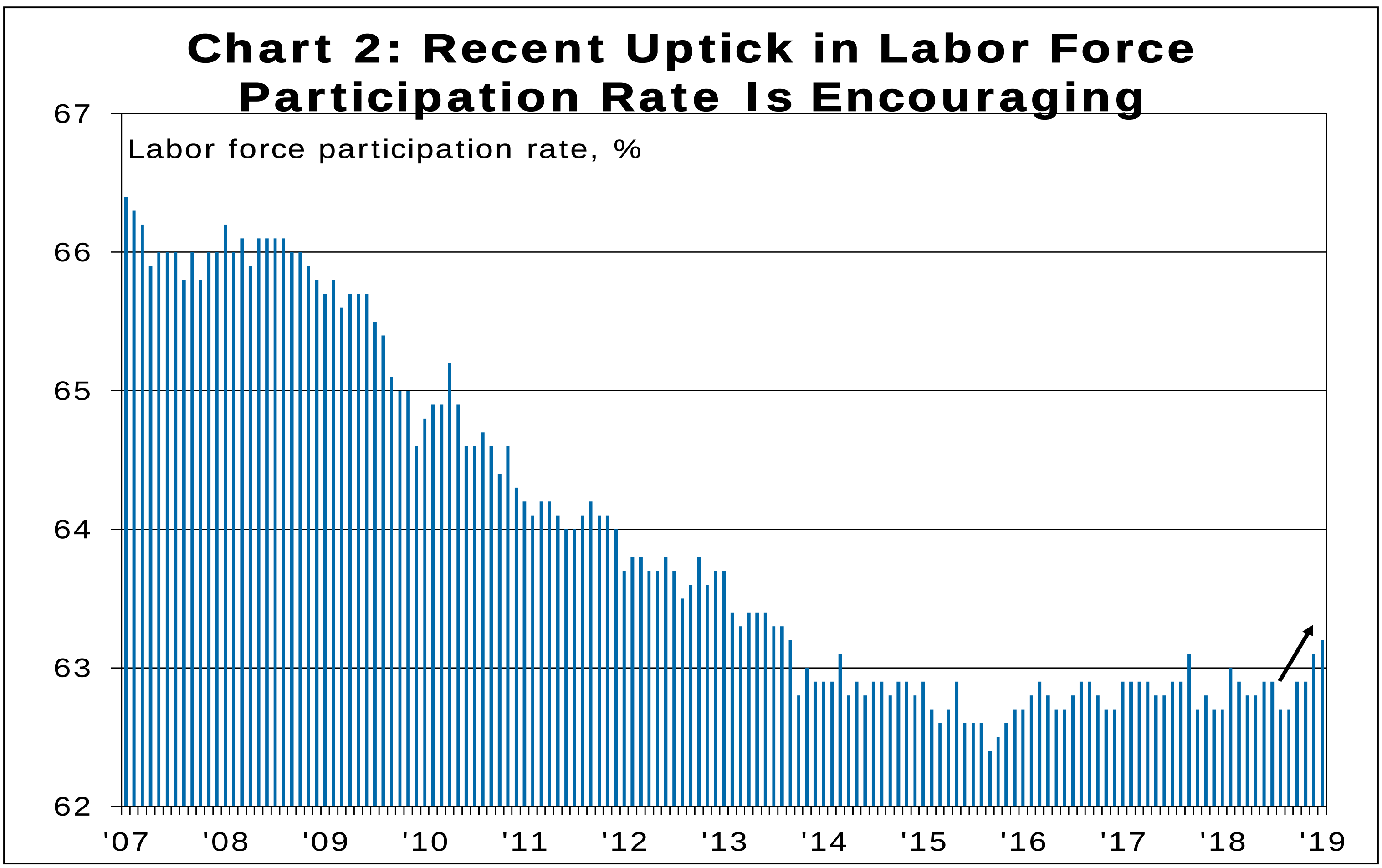

Chart source: Bureau of Labor Statistics

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