March 8, 2019

ECONOMIC REPORT

Gus Faucher Chief Economist | **Stuart Hoffman** Senior Economic Advisor | **William Adams** Senior Economist | **Kurt Rankin** Economist | **Abbey Omodunbi** Economist

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

FEBRUARY JOB GROWTH VERY WEAK, BUT LABOR MARKET STILL IN GOOD SHAPE; SOLID GROWTH AT END OF 2018

SUMMARY

- The U.S. economy added just 20,000 jobs in February, the smallest gain in more than one year.
- The unemployment rate fell to 3.8 percent in February.
- Average hourly earnings in February were up 3.4 percent from one year earlier, the biggest increase in almost a decade.
- The U.S. economy grew a solid 2.6 percent in the fourth quarter of 2018. Growth is set to slow in early 2019, in part because of the partial government shutdown in January.
- Despite weak February job growth, the U.S. labor market and economy are in good shape to start 2019.

The U.S. economy added just 20,000 jobs in February, according to the Bureau of Labor Statistic, far below consensus expectations for a gain of 180,000. This was the smallest number of net jobs created in a month since September 2017, when Hurricanes Harvey and Irma weighed on hiring. There were combined upward revisions of 12,000 in January (to 311,000 from 304,000) and December (from 222,000 to 227,000). Private-sector hiring was 25,000 in February, with job losses of 5,000 in government. Despite the very weak February, job growth has averaged 186,000 over the past three months, well above the pace needed to keep up with underlying growth in the labor force (see Chart 1).

The unemployment rate fell to 3.8 percent in February from 4.0 percent in January as government workers who had been on unpaid furlough because of the partial government shutdown, and were counted as unemployed in January, moved back into employed status. This is just slightly above the cyclical low unemployment rate of 3.7 percent in September and November of last year. The number of jobs in the household survey (different from the survey of employers) rose by 255,000 in February, more than reversing January's decline of 251,000 (largely because of the government shutdown). The labor force contracted by 45,000 in February, but the labor force participation rate held steady at 63.2 percent, staying at a cyclical high. However, the labor force participation rate is still well below its level of around 66 percent before the Great Recession. The broader U-6 unemployment rate (unemployed, underemployed and too discouraged to look for a job) fell to 7.3 percent in February from 8.1 percent in January. This is the lowest the U6 rate has been since March 2001. Some of the decline in the U6 rate in February is because of the end of the government shutdown, but it also reflects the improving job market.

Job growth was soft across most industries in February. Goods-producing industries lost 32,000 jobs, led by a decline of 31,000 jobs in construction due to bad weather. Manufacturing employment rose by 4,000 over the month. Private services-providing industries added 57,000 jobs in February, with business/professional services accounting for 42,000 of those (including 6,000 in temporary services). Retail trade employment fell by 6,000 over the month, and financial activities employment rose by 6,000. Jobs rose by 4,000 in education/health services, and were flat in leisure/hospitality services. Government employment fell by 5,000 in February; federal government employment was flat, with all of the losses coming in state and local government.

Wage growth was strong in February despite soft job growth. Average hourly earnings rose 0.4 percent over the month after a gain of less than 0.1 percent in January; the end of the government shutdown may have boosted wage growth in February. Year-over-year growth in wages was 3.4 percent in February, the strongest gain since March 2009, when the labor market was imploding during the Great Recession. The tighter job market is leading to stronger wage growth as

FEBRUARY JOB GROWTH VERY WEAK, BUT LABOR MARKET STILL IN GOOD SHAPE; SOLID GROWTH AT END OF 2018

businesses raise pay to retain their current workers and attract new ones.

The average workweek fell slightly in February to 34.4 hours; it has been between 34.4 and 34.5 hours for more than one year. With only slightly more jobs, a big increase in wages, and a slightly shorter workweek, aggregate weekly earnings were up 0.1 percent in February. As a result real consumer income was likely flat over the month, with the consumer price index set to increase slightly in February (to be released on March 12).

Despite weak February job growth the U.S. labor market is still in good shape. A number of factors weighed on job growth over the month, including bad weather and perhaps a delayed reaction to the partial government shutdown. In addition, slower job growth was expected after huge average gains of better than 250,000 over the preceding four months. Job growth should bounce back in March.

U.S. gross domestic product, adjusted for inflation, increased 2.6 percent at an annual rate in the fourth quarter of 2018, better than the 2.4 percent consensus. This was the “initial” estimate from the Bureau of Economic Analysis. It combined the “advance” and “second” estimates; the advance estimate was canceled due to the partial government shutdown earlier this year. This was a solid result, although growth slowed from 3.4 percent in the third quarter and 4.2 percent in the second quarter. Real GDP increased 2.9 percent in 2018 from 2017, averaged across the four quarters of the year. On a year-over-year basis real GDP growth was 3.1 percent in the fourth quarter, up from 3.0 percent in the third quarter (see Chart 2).

Consumer spending increased a good 2.8 percent at an annual rate in the fourth quarter, adding 1.9 percentage points to growth. Fixed business investment grew 3.9 percent, adding 0.7 percentage point to growth, although business investment in structures was a small negative. Inventories added 0.1 percentage point to growth in the fourth quarter, after adding a big 2.3 percentage points in the third quarter. Investment in residential structures fell 3.5 percent annualized in the fourth quarter, subtracting 0.1 percentage point from growth. This was the fourth straight quarter of decline for residential structures, and the sixth decline in the last seven quarters, as the housing market has slowed, in part because of higher mortgage rates.

Trade subtracted 0.2 percentage point from growth in the fourth quarter, after subtracting almost 2 points in the third quarter. Exports rose 1.6 percent in the fourth quarter, but imports, which are a drag on GDP, rose even more, by 2.7 percent. Government was a small positive for growth in the fourth quarter, with a small increase in federal purchases offsetting a small decline in state and local spending. The fourth quarter data included one week of the partial federal government shutdown at the end of 2018.

The U.S. economy remained solid at the end of 2018, although growth slowed from the unsustainable pace in the middle of the year. Consumer spending and business investment were both positives for growth in the fourth quarter, but housing and trade were drags.

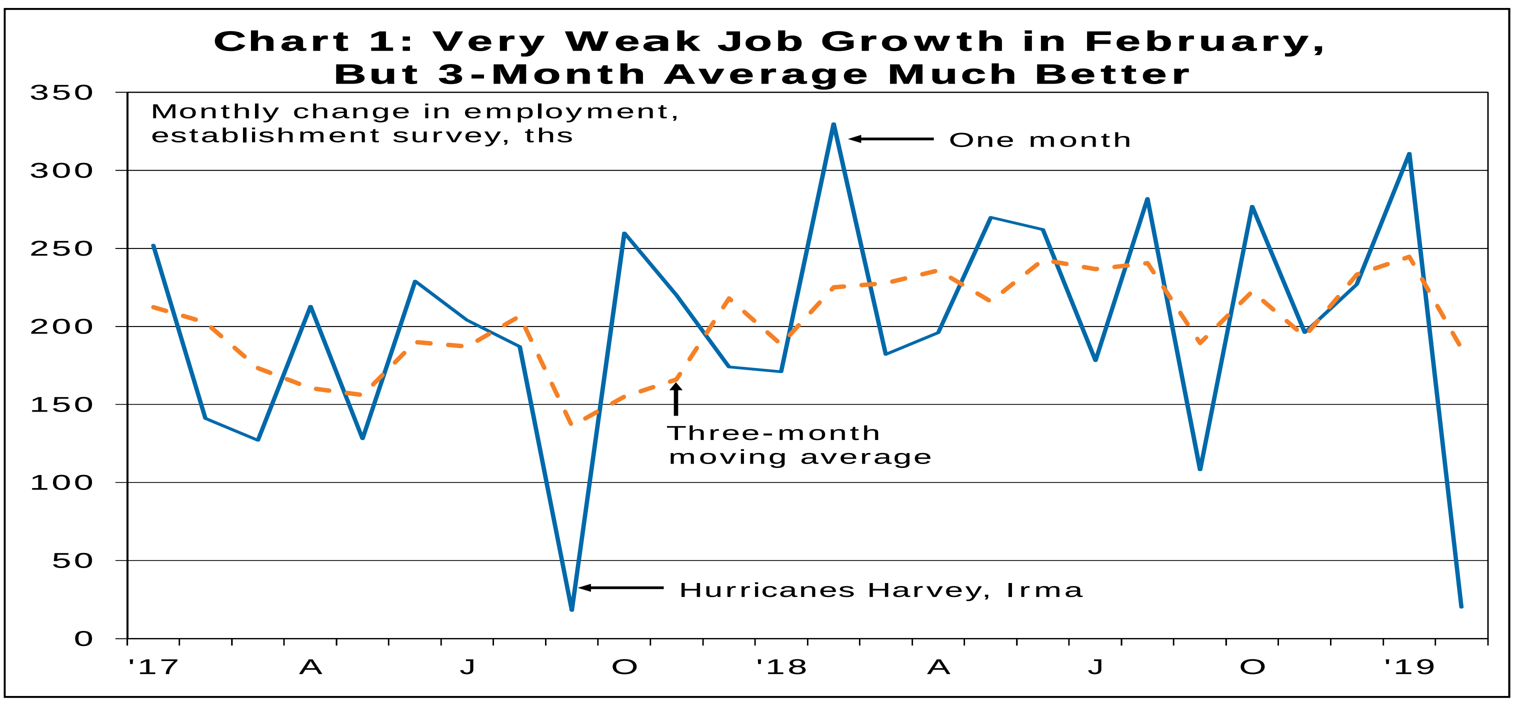

Chart source: Bureau of Labor Statistics

FEBRUARY JOB GROWTH VERY WEAK, BUT LABOR MARKET STILL IN GOOD SHAPE; SOLID GROWTH AT END OF 2018

The U.S. economic expansion will continue in 2019, and by the middle of the year this will become the longest in U.S. history. First quarter growth will be soft because of the partial government shutdown; the Congressional Budget Office estimates that it will subtract about 0.4 percentage point from growth in the quarter, although that should be made up in the second quarter. Consumer spending growth will remain solid this year thanks to the improving labor market, including good job growth and rising wages. Business investment will also add to growth. Trade will remain a drag, especially with the uncertainty surrounding ongoing trade talks between the U.S. and its major trading partners. The drag from housing will likely fade as mortgages rates have declined over the past few months.

The corporate and personal income tax cuts passed in late 2017, and a big increase in federal spending passed in 2018, are boosting growth now, but that lift will dissipate over the course of 2019. The reduced ability to hire because of the tighter labor market will also slow economic growth later this year. Job growth is set to slow from its pace of 223,000 per month last year to around 175,000 this year. The unemployment rate will fall to a low of around 3.4 percent at the end of this year. Wage growth will continue to pick up as businesses find it more and more difficult to attract qualified workers.

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

In late January the Federal Open Market Committee said that it could be “patient” with further increases in the federal funds rate. After the softer February jobs report the FOMC will take a wait-and-see approach to monetary policy. U.S. 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 hit from the government shutdown should be made up quickly in the second quarter. And inflation is slightly below 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.

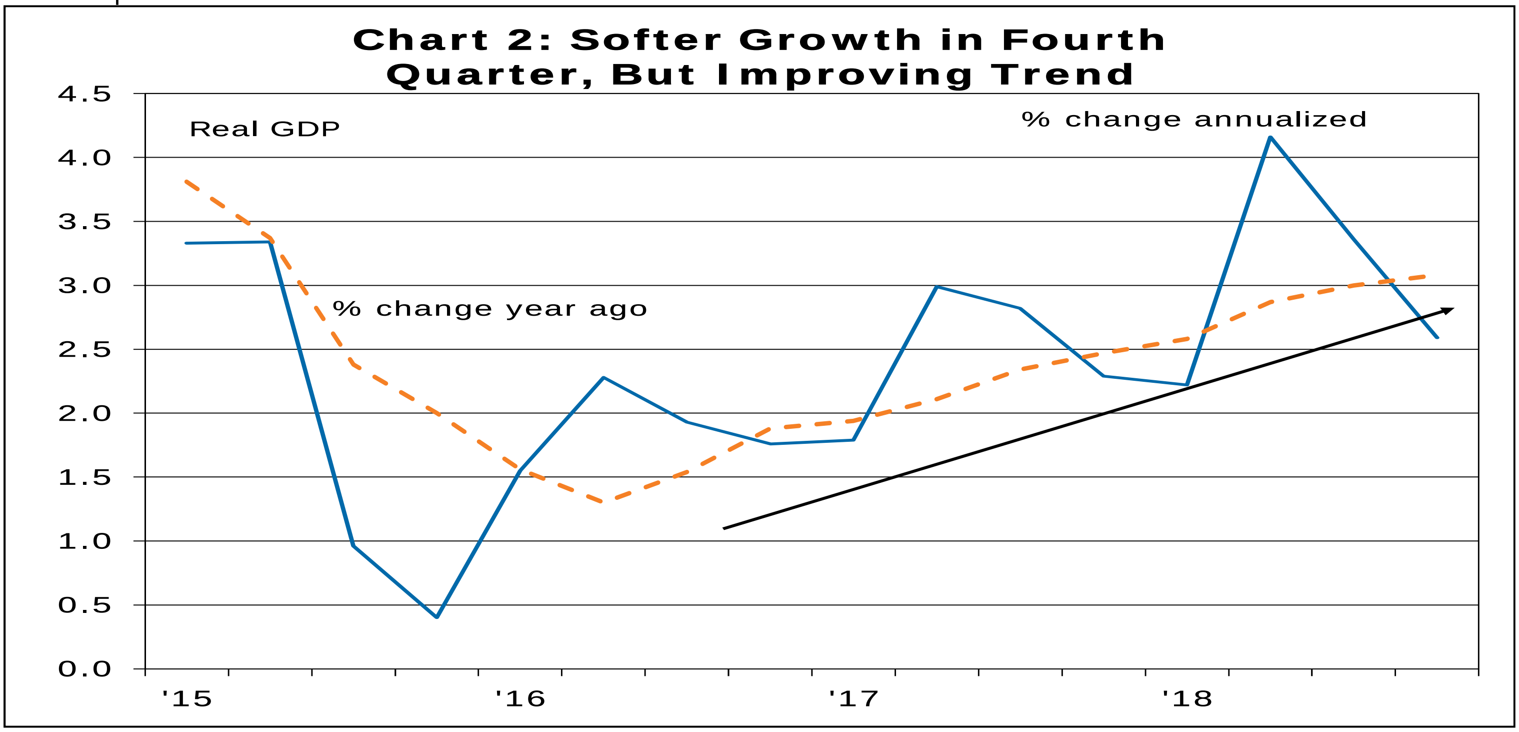

Chart source: Bureau of Economic Analysis

Visit http://www.pnc.com/economicreports to view the full listing of economic reports published by PNC’s economists.