

ECONOMIC REPORT

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BEIGE BOOK REPORTS MODEST GROWTH, UI CLAIMS GRADUALLY FALLING, WIDEST TRADE DEFICIT SINCE 2008

SUMMARY

- The Federal Reserve's Beige Book reported improving economic conditions in July and August, with modest growth. However, continued uncertainty over the course of the pandemic was a negative.
- Initial claims for unemployment insurance are gradually falling, but remain far above their pre-pandemic levels. Unemployment remains exceedingly high.
- The U.S. trade deficit widened in July to the largest since 2008 as imports recovered faster than exports. Trade will be a drag on U.S. growth in the third quarter.
- PNC expects job gains of 1.5 million in the August employment report.

The U.S. economy generally improved in late July and August, according to the latest Federal Reserve Beige Book, but the pace of improvement was uneven across industries and economic activity remained well below its pre-pandemic level. The Beige Book described the gains as "generally modest." The overall outlook was "modestly optimistic," although there was pessimism in a few districts. Nationwide there was concern about "continued uncertainty and volatility related to the pandemic, and its negative effect on consumer and business activity."

Manufacturing picked up during the period covered in the Beige Book, as did port activity; there was also increased demand for transportation and distribution firms. Consumer spending rose, with large gains in vehicle sales. There was more modest growth in tourism and retail spending. However, many districts reported a slowing in consumer spending growth, and "total spending was still far below pre-pandemic levels." Commercial construction continued to contract, and commercial real estate activity was down. Residential construction, however, was a "bright spot, showing growth and resilience in many Districts." In addition, home sales were strong, with home prices rising due to high demand and tight inventories. In the banking sector loan demand was up slightly, led by rising mortgage lending. Both the agricultural and energy sectors remained weak, with low prices. The Beige Book said that there was "little expectation of near-term improvement for either sector."

Overall hiring was up, especially in manufacturing. Job growth slowed from its very strong pace in the late spring and early summer, however. There was also increased employment volatility, with some rehired workers being laid off permanently due to lower demand, especially in service industries. At the same time there were problems hiring, due to child care demands and uncertainties surrounding the start of the school year and the status of unemployment insurance benefits.

Price growth remained modest, outside of a few categories like personal protective equipment and freight transportation. Weak demand weighed on retail prices.

Growth was generally modest across Federal Reserve districts. The New York and Philadelphia districts reported that growth had stalled. Growth was strong in the Chicago district and moderate in the Kansas City district. All districts reported that overall economic activity was below its pre-pandemic level. A number of districts reported high levels of uncertainty.

Initial claims for unemployment insurance under regular state programs were 881,000 in the week ending August 29, down 130,000 from the previous week. This is only the second time since mid-March that initial claims have been below 1 million. In early 2020, before the pandemic, claims were a bit above 200,000 per week. They then surged to almost 7 million in late March and early April, and then started to fall quickly in mid-April. The pace of improvement has been more

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uneven since the summer, although claims are trending gradually lower. Initial claims have fallen in 19 of the past 22 weeks. Layoffs remain extremely high, however.

Without seasonal adjustment there was a small (0.9 percent) increase in initial claims for the week ending August 29. Non-seasonally adjusted claims have been below 1 million for five straight weeks, after peaking at above 6 million in early April.

Continuing claims for regular state unemployment insurance programs were 13.254 million in the week ending August 22, down 1.238 million from the previous week. Continuing claims were about 1.7 million in early 2020, then peaked at almost 23 million in mid-May. They have since fallen very gradually.

Without seasonal adjustment continuing claims were down 5.5 percent in the week ending August 22.

Under all programs, including the Pandemic Unemployment Assistance program, 29.2 million people were receiving UI benefits in the week ending August 15. This was up 2.2 million from the previous week. In the same period in 2019, there were a total of 1.6 million people receiving unemployment insurance benefits. These numbers are not

seasonally adjusted, given the lack of history for the PUA program.

Due to the coronavirus pandemic, the Department of Labor made a change in the way that UI claims are seasonally adjusted starting with this release. Thus, the level of claims in the week ending August 29 may not be directly comparable with earlier releases. Although the update to the seasonal adjustment methodology muddies the waters a bit, unemployment clearly remains extremely elevated at the end of the summer. Initial claims for unemployment insurance, while trending down, remain about four times higher than they were a year ago. Almost 30 million people are currently receiving some form of UI, eighteen times greater than before the pandemic (see Chart 1).

The relatively small decline in continuing claims since May indicates that many of those who lost jobs because of the pandemic remain unemployed. There was some thought that bonus unemployment insurance payments of \$600 per week were causing some of the unemployed to put off looking for a job; according to a study from the University of Chicago, in May about two-thirds of those receiving benefits were getting more from UI than they made while they were working. But there has been no big shift in unemployment trends since these bonus payments expired at the end of

Chart 1: Fewer People Filing for UI, But Unemployment Still Extremely High

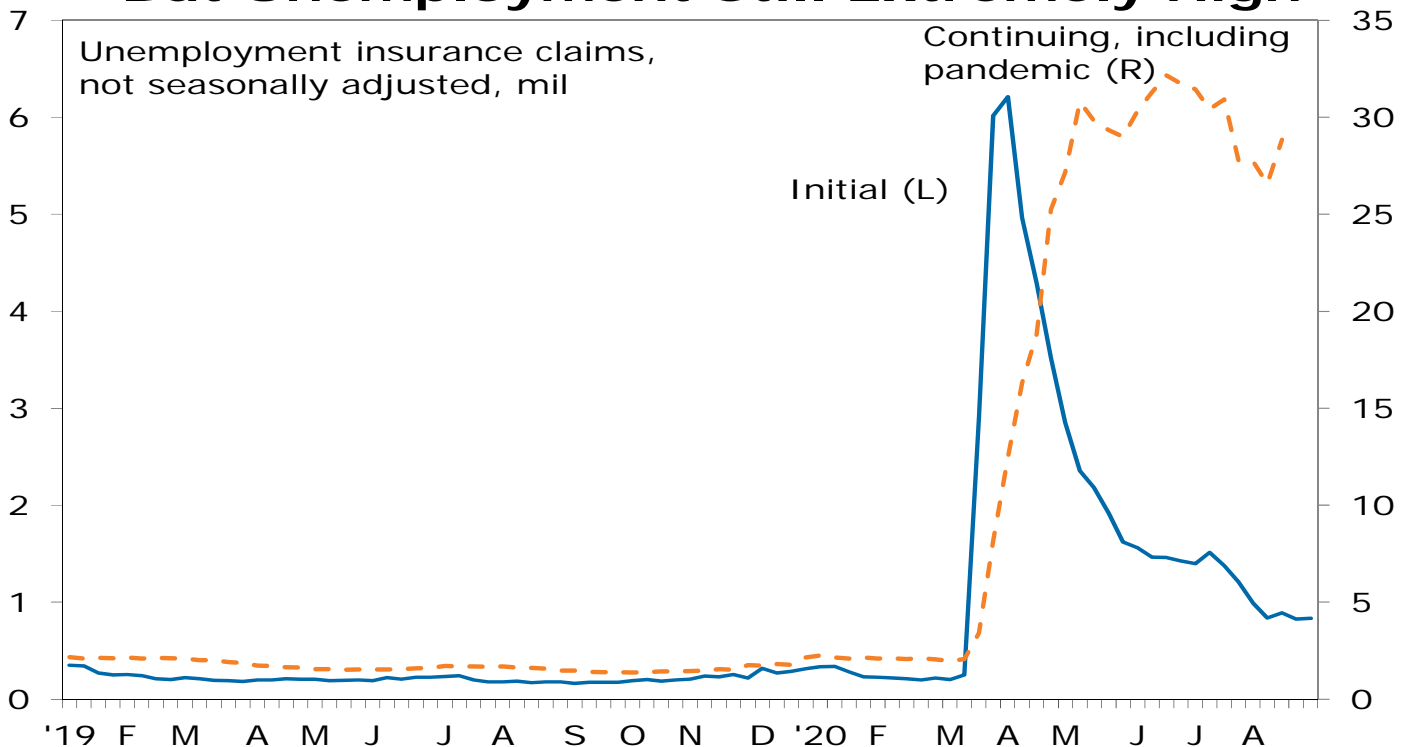


Chart source: Employment and Training Administration

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July, although the Trump administration has worked with states to jury-rig a partial and temporary alternative.

PNC expects job growth of 1.5 million when the Bureau of Labor Statistics releases the August employment report on September 4. PNC expects that the unemployment rate fell to 9.8 percent in August, down from 10.2 percent in July and a peak of 14.7 percent in April.

The U.S. trade deficit increased to \$63.6 billion in July, up \$10.1 billion from June. This was the largest nominal trade deficit since 2008 (see Chart 2). The June trade deficit was \$53.6 billion, revised wider from \$50.7 billion. The trade deficit for July was much larger than the consensus expectation of about \$52 billion.

Imports rose 11 percent over the month to \$231 billion, while exports rose 8 percent to \$168 billion. Both exports and imports plunged during the initial stages of the coronavirus pandemic, as supply chains were disrupted;

U.S. consumers and businesses cut back on all sorts of purchases, including those from abroad; and foreign economies fell into deep recessions. Now that U.S. and global growth are picking up trade volumes are starting to recover. In particular, a strong rebound in consumer spending is boosting imports. But U.S. exports and imports both remain far below their levels in early 2020.

Trade will be a drag on growth in the third quarter with imports increasing more than exports. Real GDP declined a record 32 percent annualized in the second quarter of 2020. But with businesses reopening and consumers increasing their spending, the U.S. economy is still on track for a strong rebound in the third quarter, with growth of better than 20 percent annualized. Growth should remain well above the economy's long-term trend in the rest of 2020 and throughout 2021. But risks to the outlook are generally to the downside, including the potential for an increase in coronavirus cases and an inability of Congress to pass additional fiscal stimulus.

Chart 2: Largest Monthly Trade Deficit Since 2008 in July as Imports Surge

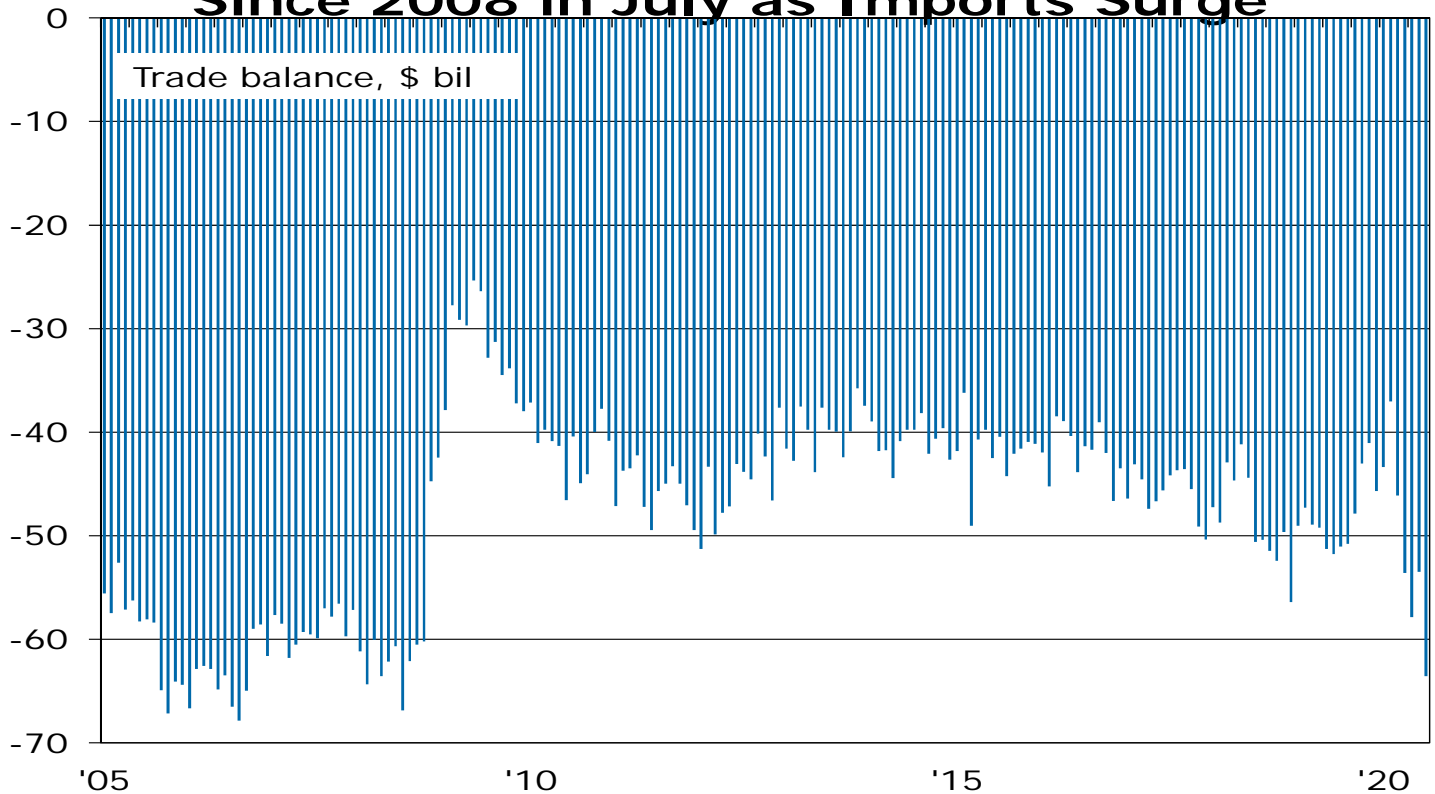


Chart source: Census Bureau

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