ECONOMIC REPORT

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US ECONOMY AT A CROSSROADS: GREAT FEBRUARY JOBS REPORT, BUT COVID-19 CONCERNS INTENSIFYING

SUMMARY

- The February jobs report was very good, with the U.S. adding 273,000 net jobs over the month. The unemployment rate returned to a 50-year low and wage growth was solid.
- Despite the solid jobs report, COVID-19 continues to weigh on financial markets.
- COVID-19 has put the current U.S. economic expansion, the longest in history, at serious risk. The most vulnerable industries are high-tech manufacturing, travel and tourism, and energy.
- Given solid economic fundamentals a U.S. recession is not inevitable.
- Important indicators to watch in the weeks ahead are confidence surveys and weekly unemployment insurance claims.

The February jobs report was very strong, but that was before the COVID-19 outbreak started to weigh on the economic outlook. The U.S. economy added 273,000 jobs in February, the unemployment rate fell slightly to a 50-year low, and wage growth was decent. The labor market is in excellent shape. But that may not count for much if supply chain disruptions and restrictions on movement lead to reduced output, workers are unable to show up for their jobs, or there is a big drop in consumer spending.

Job growth of 273,000 in February, based on a survey of employers, was well above the consensus forecast of 170,000. Job growth was also a very strong 273,000 in January, a big upward revision from the initially reported 225,000. December job growth was 184,000, revised up from 147,000. Combined upward revisions to job growth in December and January were a very strong 85,000. Job growth over the last three months has averaged 243,000, the best three-month pace since September 2016, and well above the monthly pace of 178,000 for all of 2019. Some of the recent strength has come from hiring for Census 2020; government job growth was 45,000 in January and 51,000 in December. But private-sector job growth was excellent at 228,000 in February and 222,000 in January (see Chart 1). The employer survey was taken the week of February 10, before COVID-19 concerns intensified.

The unemployment rate returned to 3.5 percent in February from 3.6 percent in January. Along with three months in 2019, this is the lowest U.S. unemployment rate in 50 years. There was a modest increase in employment as measured in the household survey (different from the survey of employers) of 45,000, and a modest decrease in the labor force of 60,000. The labor force participation rate was unchanged in February at 63.4 percent, its highest level since mid-2013, but well below the 66 percent rate prior to the Great Recession. The U-6 rate, which includes unemployment, underemployment, and discouraged workers, was 7.0 percent in February, up from 6.9 percent in January and 6.8 percent in December.

Goods-producing industries added 61,000 jobs in February, the best month since January 2019. Construction employment saw another huge increase, rising 42,000 in February after a gain of 49,000 in January; strong demand for new homes, in large part because of record low mortgage rates, and mild winter weather have led to a pickup in homebuilding. There was a solid increase in manufacturing employment of 15,000 in February. Private services-providing industries added a net 167,000 jobs in February. This included decent gains of 54,000 in education and healthcare, 51,000 in leisure/hospitality services, 41,000 in professional/business services, and 26,000 in financial activities. Employment in retail trade continues to decline as online sales become ubiquitous.

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Average hourly earnings rose 0.3 percent in February, and were up 3.0 percent on a year-ago basis. This was a slight slowing from 3.1 percent growth in January. The average workweek increased to 34.4 hours in February from 34.3 hours in January. With jobs up sharply, and gains in both average wages and the average workweek, aggregate weekly earnings rose 0.8 percent in February. PNC expects no inflation in February—energy prices tumbled as COVID-19 reduced global oil demand—so real earnings likely jumped over the month. (The BLS will release the February consumer price index on March 11.)

But the strong February jobs report is secondary to the ongoing COVID-19 outbreak. Stock prices fell 1.7 percent on March 6, the day of the February jobs report, and financial markets plunged on March 9 as concerns about COVID-19 intensified. The S&P 500 fell 7.6 percent on the day, and was down 18 percent since February 21. The yield on the 10-year Treasury note closed at a record low of 0.57 percent on March 9. And crude oil prices fell 25 percent on the day, to $31 for a barrel of West Texas Intermediate, as Saudi Arabia said it would increase production in an effort to force other oil suppliers to cut production.

All of these are potential precursors to a recession. The current U.S. expansion is the longest in U.S. history, but the risk of recession is higher than it has been at any time since the expansion started in June 2009. There are a number of potential catalysts: supply chain disruptions that force manufacturers to stop production; restrictions on movement that prevent workers from getting to their jobs and consumers from making purchases; business uncertainty that leads to a sharp drop in investment; and reduced household wealth from plunging stock prices that drags on spending. If there is a recession, it would start first in high-tech manufacturing, which depends on imports for many of

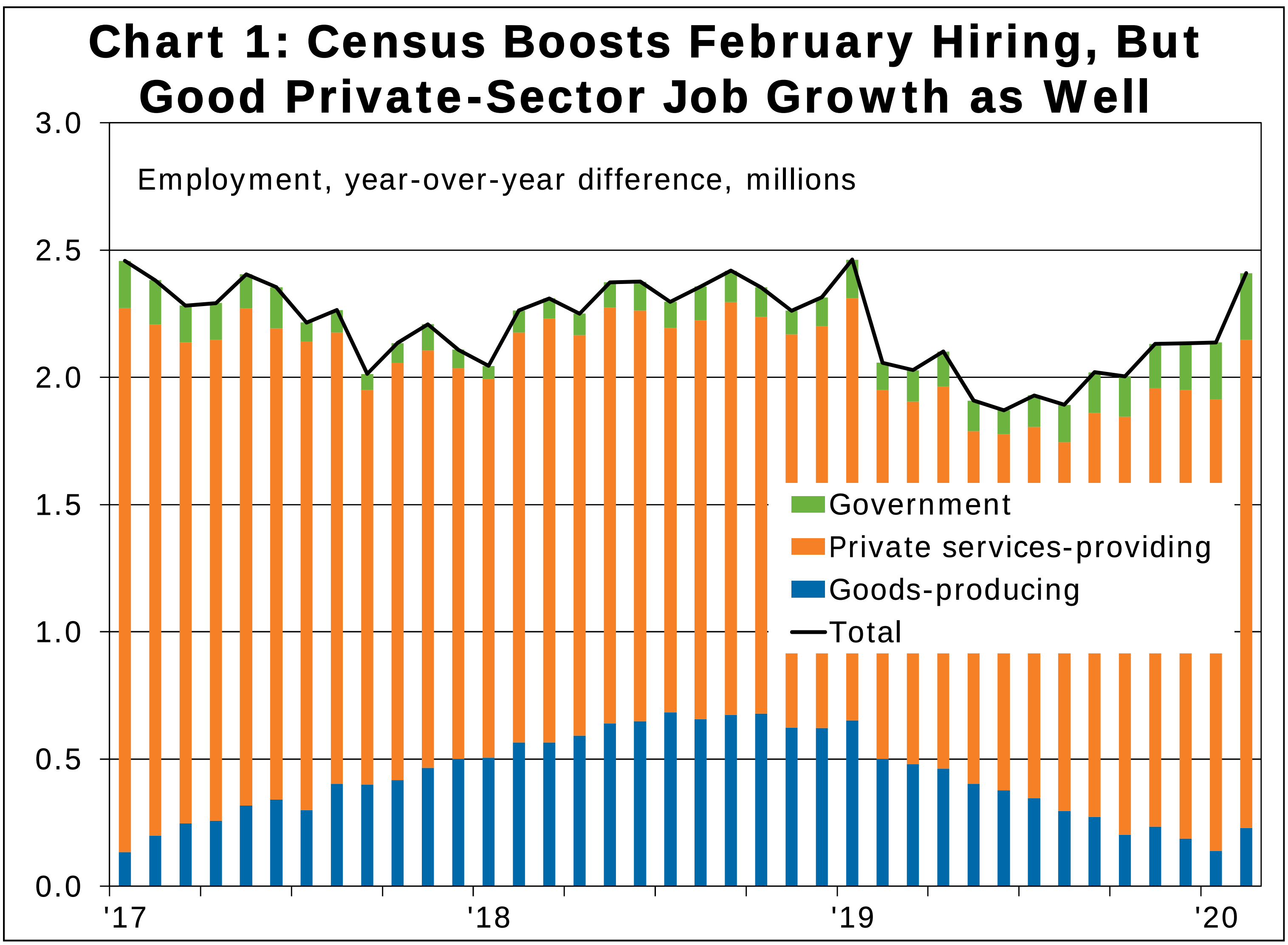

Chart source: Bureau of Labor Statistics

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its parts; travel and tourism; and energy.

But financial markets, and the stock market in particular, are not the economy, and right now the economic fundamentals are still solid. COVID-19 has upped the odds of a U.S. recession in 2020, but one is not inevitable. The U.S. labor market is in great shape: excellent job growth, the lowest unemployment rate in 50 years, and good wage gains. Consumer savings are high, and household debt burdens are low. This situation is very different than it was ahead of the Great Recession, when households were financially stretched (see Chart 2). The housing market is doing well, and homebuilding has picked up since mid-2019, thanks to low mortgage rates and good demand.

The most important indicators to watch over the next few weeks are "soft" measures of consumer and business confidence, which indicate turning points sooner than "hard" measures of actual economic activity, such as production, consumer spending, and jobs; and initial unemployment insurance claims, which are released on Thursday morning for the preceding week, and provide a very timely look at the labor market, especially layoffs.

Chart 2: Consumers in Much Better Shape Than Heading Into Great Recession

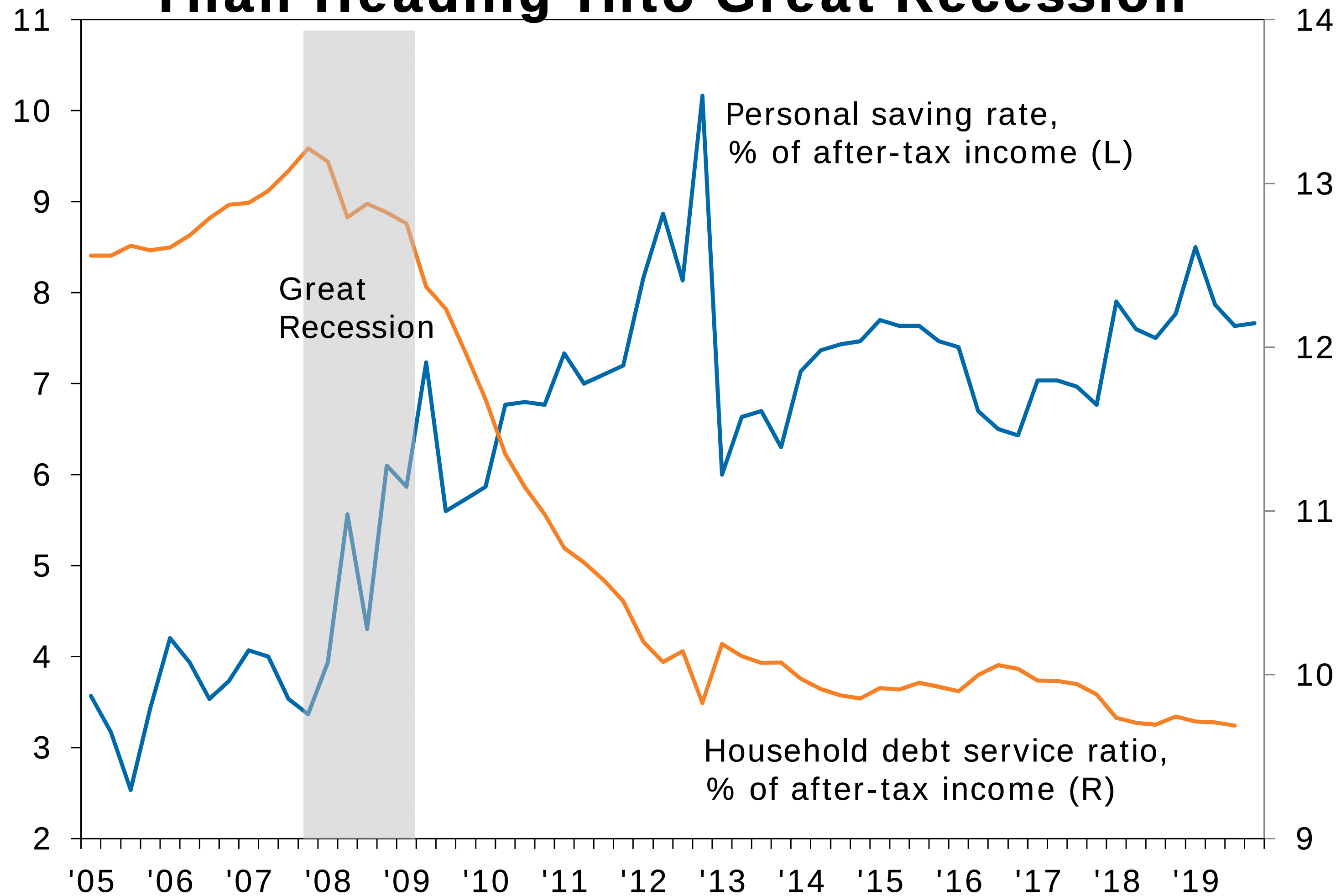

Chart sources: Bureau of Economic Analysis, Federal Reserve Board

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