July 24, 2020

ECONOMIC REPORT

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RETAIL SALES, HOUSING STARTS, INDUSTRIAL PRODUCTION ALL RISE IN JUNE, BUT ACTIVITY STILL VERY LOW

SUMMARY

- Total retail sales increased for the second straight month in June, and are now 1 percent below their pre-recession level, but the composition of sales has shifted greatly.
- Housing starts jumped in June, and residential construction will be a driver of recovery in the second half of 2020.
- Industrial production rose 5 percent in June, but remains well below its pre-recession level. Weak demand for manufactured goods and low energy prices will limit the rebound in the industrial sector.
- Despite improvements in data, the continued spread of the coronavirus is a significant downside risk for the outlook.

Retail sales (including food service) jumped 7.5 percent in June, and were down less than 1 percent from their level in February, before the Viral Recession. However, there have been big shifts in consumer spending in the wake of the pandemic, away from most categories of in-store retail, gasoline, and restaurants, and towards groceries and online sales.

Retail sales growth in May was revised higher, to 18.2 percent, from 17.7 percent. Retail sales plunged 8.2 percent in March and 14.7 percent in April as the pandemic and restrictions on economic activity caused consumers to stay at home and spend less. Total retail sales in June were just 0.6 percent below their February level, before the Viral Recession (see Chart 1). Sales excluding autos were up 7.3 percent in June from May, and sales excluding autos and gasoline were up 7.5 percent. Control sales—sales excluding autos, gasoline, food service, and building materials, and which go into nominal consumer spending in GDP—were up 5.7 percent in June.

Many retail segments saw big increases in sales from May to June as consumers ventured out. Sales at clothing and accessories stores were up more than 100 percent over the month, while electronics sales were up 37 percent and furniture and home furnishings sales were up 32 percent. Restaurant sales rose 20 percent. Non-store sales (primarily online) were down slightly over the month as consumers purchased more in-person.

On a year-ago basis total retail sales and food service were up 1.1 percent. Sales excluding autos were down 0.5 percent, while sales excluding autos and gasoline were up 1.6 percent. Control sales were up 6.3 percent year-over-year, led by a 12 percent increase for grocery stores. But there have been huge shifts in the patterns of consumer spending. On a year-ago basis grocery sales were up 12 percent, non-store sales (primarily online) were up 23 percent, specialty store sales up 21 percent (perhaps as households had more leisure time), and building materials sales up 17 percent. But restaurant sales were down 26 percent, clothing store sales were down 23 percent, and gasoline sales were down 19 percent (due to both reduced driving and lower gas prices). Department store sales dropped 11 percent over the year.

One big reason for the rapid recovery in sales since April is income support from the federal government. With one-time stimulus payments for most households and expanded unemployment insurance benefits, after-tax income was actually up in April from February, despite the loss of tens of millions of jobs. While these payments are bolstering spending now, the expanded unemployment insurance benefits are set to expire at the end of July, which could lead consumers to pull back given that the unemployment rate is still well above 10 percent. Another big downside risk is the potential for consumers to stay at home as the pandemic continues, even absent additional state restrictions on movement.

Housing starts jumped 17.3 percent in June to 1.186 million at a seasonally-adjusted annualized rate. Housing starts fell 40 percent between February and April as construction sites closed due to the coronavirus pandemic, but they have since

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made up about 40 percent of that decline (see Chart 2). Starts are still down 24 percent from their February level, however. Single-family starts were up 17.2 percent over the month, while multifamily (condominium and apartment) starts rose 17.5 percent. Housing permits rose 2.1 percent in June, to 1.241 million at a seasonally-adjusted annualized rate. After falling 26 percent between February and April, permits have since risen 16 percent. Permits are about 14 percent lower than they were in February. Single-family permits rose 11.8 percent in June from May, while the more volatile multifamily permits fell 13.4 percent. Rising permits point to further near-term gains in housing starts.

Residential construction is rebounding after a huge plunge in activity in the spring because of the pandemic and state restrictions on economic activity. PNC expects housing to lead the nascent economic recovery. Demand for new homes was strong heading into the Viral Recession, with a lot of pent-up demand given the slow recovery in housing during the previous economic expansion. Record-low mortgage rates in mid-2020 will provide a further boost to homebuilding, and it could be that families are more interested in homeownership because of the pandemic. However, the pace of the recovery in residential construction depends on the strength of the labor market and the path of the virus, with risks to the downside.

Industrial production rose 5.4 percent in June, following a 1.4 percent increase in May. This was the largest one-month increase in industrial production since 1959. But industrial production is still down 10.9 percent from February, before the Viral Recession began. Industrial production fell 4.4 percent in March and then 12.7 percent in April as factories closed and demand plummeted.

Manufacturing production rose 7.2 percent in June, also the biggest gain since 1959. A huge 91.5 percent in auto output led manufacturing growth in June, as auto plants were open for the entire month, after reopening in mid-May. Mining

Chart 1: Retail Sales Just Below February Level, But Industrial Production Has a Long Road Back

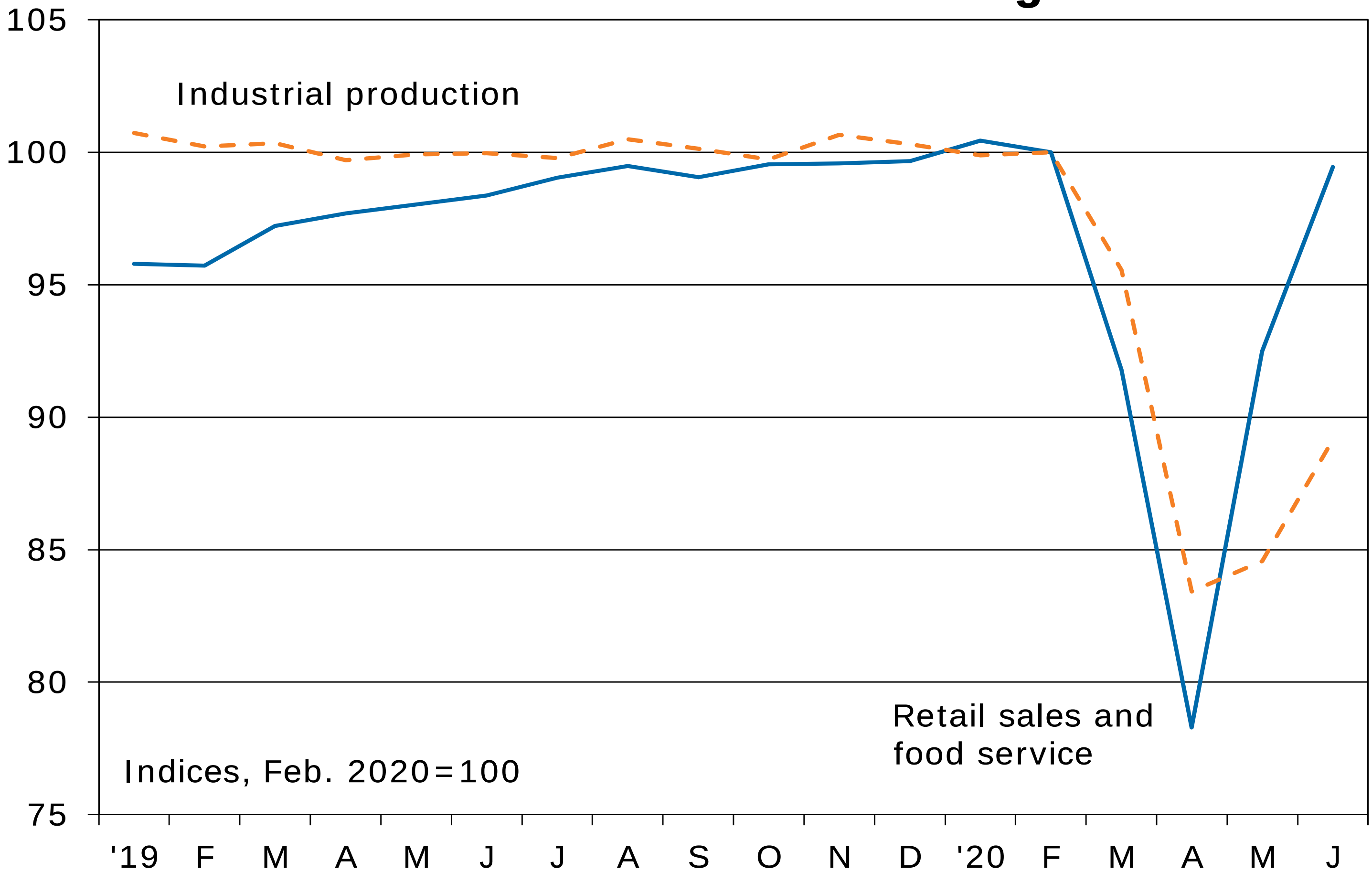

Chart sources: Census Bureau, Federal Reserve Board

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output fell 2.9 percent in June, the fifth straight decline, as low energy prices continue to result in production cuts. Utilities production jumped 4.2 percent, driven by warmer weather.

On a year-ago basis total output was down 10.8 percent in June, with manufacturing output down 11.2 percent. Mining output was down an even larger 16.9 percent, but utilities output was up 0.6 percent from one year earlier. The capacity utilization rate rose to 68.6 percent in June, from 65.1 percent in May and 64.2 percent in April. Still, it is far lower than the 76.9 percent rate in January and February. Huge swathes of excess capacity throughout the economy will keep inflation very low in the near term. The industrial sector is in the early stages of recovery, but it still has a long way to go.

While the past two months of industrial production data are encouraging, especially for manufacturing, there is still a great deal of uncertainty about the strength of the rebound. With coronavirus cases increasing in many parts of the country, demand for many types of manufactured goods is likely to remain weak in the near term. There is also the increasing likelihood that manufacturing plants could be forced to close again. While overall industrial production is increasing, mining will remain a drag on the industrial sector throughout 2020. Energy prices have rebounded from their lows in the spring but are still much lower than they were at the beginning of the year, and many energy projects that were previously viable are not anymore. This, in turn, is weighing on production of manufactured goods like industrial equipment and pipeline materials.

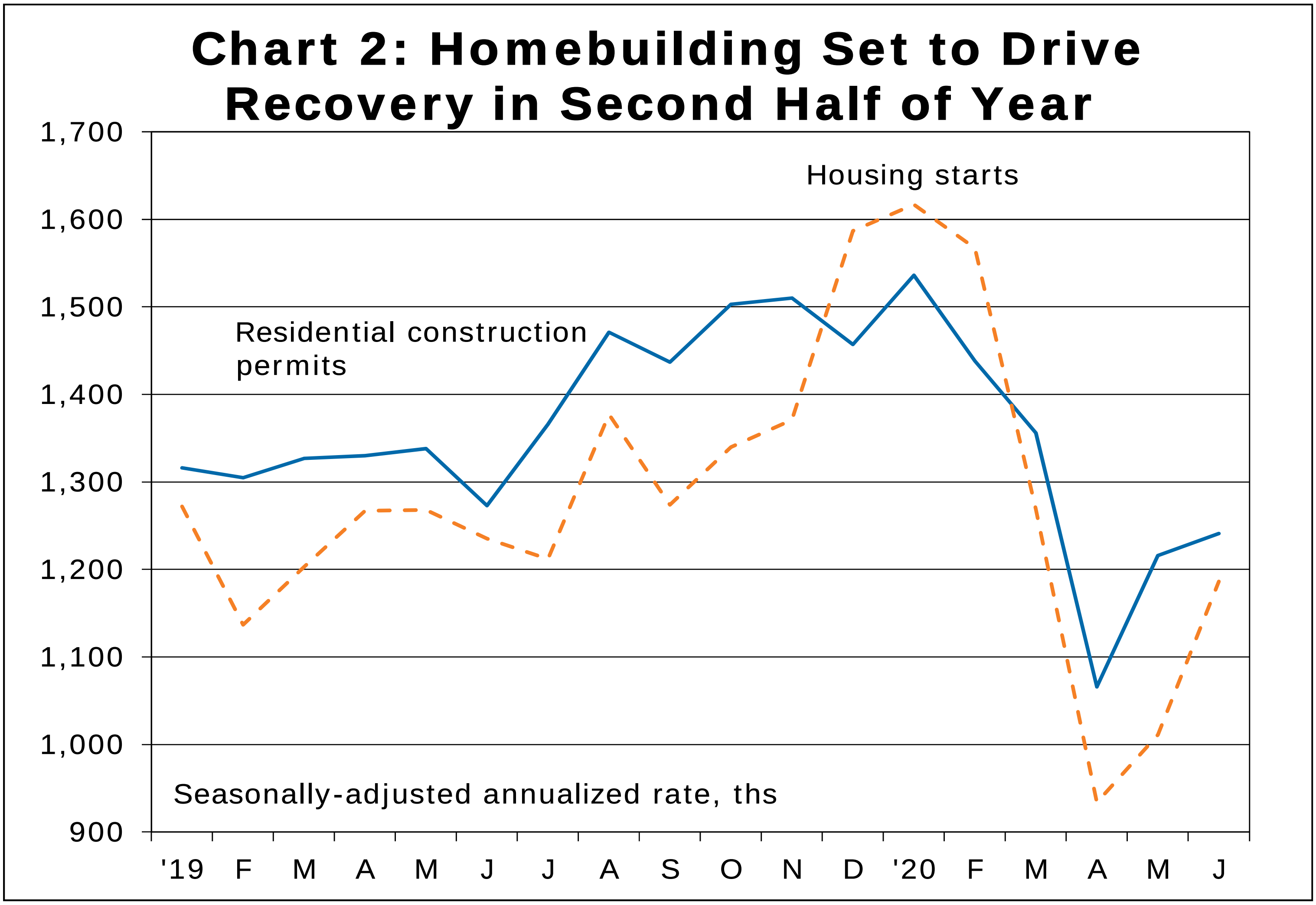

Chart source: Census Bureau

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