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ECONOMIC REPORT

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JOB GROWTH REBOUNDS IN JUNE AFTER SOFT MAY; POWELL INDICATES FED LIKELY TO CUT RATES IN JULY

SUMMARY

- The U.S. labor market rebounded in June, with job gains of 224,000.
- The unemployment rate rose slightly in June to 3.7 percent, still near a 49-year low.
- Average hourly earnings rose 0.2 percent in June from May, and were up 3.1 percent from one year earlier.
- The risks to economic growth are weighted to the downside in mid-2019.
- Congressional testimony from Fed Chair Powell, as well as minutes from the June FOMC meeting, indicate that the central bank is ready to cut the fed funds rate later this month.

After a weak May jobs report, the U.S. labor market rebounded in June, with job gains of 224,000. The private sector added 191,000 jobs, while government employment rose by 33,000. May job growth was revised down to 72,000, from 75,000, and April job growth to 216,000, from 224,000. Job growth has averaged 172,000 per month so far this year, down from 223,000 last year, but still well above the pace needed to keep up with underlying growth in the labor force. Job growth has slowed this year in both goods-producing and services-providing industries (see Chart 1).

The unemployment rate rose to 3.7 percent in June, from 3.6 percent in April and May, which was a 49-year low. However, the increase in the unemployment rate came from an increase in the labor force of 335,000, as more people looked for work, drawn in by rising wages and the tight job market. Employment in the household survey (different from the survey of employers) increased by 247,000 in June; however, average monthly growth in employment in the household survey has been just 10,000 so far this year. With more people in the labor force the participation rate rose to 62.9 percent in June, from 62.8 percent in April and May. However, the labor force participation rate is still far 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) rose to 7.2 percent in June from 7.1 percent in May, which was the lowest the rate had been since December 2000.

Job growth improved across most industries in June. Goods-producing industries added 37,000 jobs over the month, after a gain of 11,000 in May. Construction employment rose by 21,000 in June, after an increase of just 5,000 in May. After a few months of soft gains, manufacturing added a solid 17,000 jobs over the month, despite uncertainty over trade. Employment in private service-providing industries increased by 154,000 in June, up from 72,000 in May. Eds and meds added 61,000 jobs in June, with professional/business services employment up by 51,000 over the month. However, temporary services employment rose by just 4,000 in June, and the industry has averaged monthly job losses of 4,000 so far this year; last year average monthly job growth in the industry was 7,000. Temp services is often a leading indicator of the overall job market. Employment in transportation/warehousing was up by 24,000 in June, while employment in leisure/hospitality services rose by 8,000, below the recent trend. Retail trade employment fell by 6,000 in June, and was down by 48,000 from one year ago; the increasing prevalence of online sales continues to weigh on traditional brick-and-mortar retailing.

Wage growth remains solid with the tight labor market, but has not accelerated in 2019. Average hourly earnings rose 0.2 percent in June, after a 0.3 percent increase in May (revised higher from 0.2 percent). Year-over-year growth in wages was 3.1 percent for a second straight month in June, down from a cyclical peak of 3.4 percent in February (distorted in part by the end of the government shutdown). Wage growth remains well above the pace of inflation.

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After the soft May jobs report raised concerns about a slowing in the economy, very good job growth in June of 224,000 has allayed concerns that the current expansion, now the longest in U.S. history, is coming to an end. Economic growth is set to slow this year as fiscal policy becomes less expansionary; slowing global economic growth and trade tensions are also headwinds. But with the labor market in great shape households will continue to spend; consumer spending makes up more than two-thirds of the U.S. economy, and thus provides a solid basis for continued growth.

Job growth is slowing from its pace of 223,000 per month last year to around 150,000 for all of this year, as the tighter labor market constrains hiring. The unemployment rate may move down in a bit over the next few months, but will end 2019 at around 3.6 percent. Wage growth will pick up somewhat in the second half of 2019 as businesses find it more and more difficult to attract qualified workers.

In his prepared testimony before the House Financial Services Committee on July 10, Fed Chair Powell indicated that a fed funds rate cut is coming soon. Powell's testimony noted that the Federal Open Market Committee indicated in its June 18 statement that "in light of increased uncertainties about the economic outlook and muted inflation pressure [the FOMC] would closely monitor the implications of incoming information for the economic outlook and would act as appropriate to sustain the expansion. Many FOMC participants saw that the case for a somewhat more accommodative monetary policy had strengthened. Since then, based on incoming data and other developments, it appears that uncertainties around trade tensions and concerns about the strength of the global economy continue to weigh on the U.S. economic outlook. Inflation pressures remain muted."

Elsewhere in his testimony Powell noted that "uncertainties about the economic outlook have increased in recent months," citing slower global economic growth, trade tensions between the U.S. and its major trading partners, the debt ceiling, and Brexit. It is these uncertainties, rather

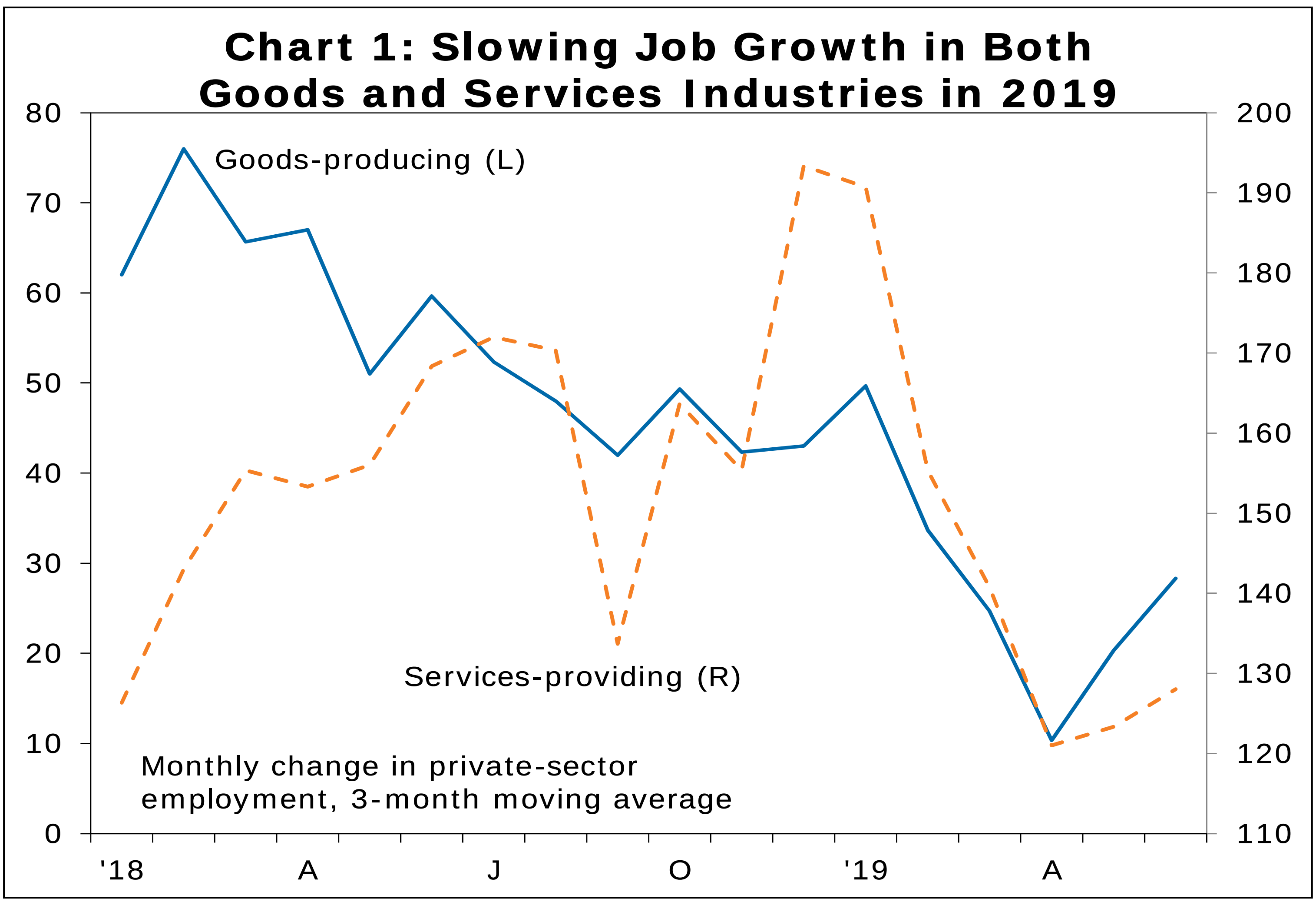

Chart source: Bureau of Labor Statistics

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than current economic conditions, that are moving the Fed to a more expansionary monetary policy.

This view was confirmed the same day with the release of the minutes from the FOMC's June 17-18 meeting, which makes numerous references to downside risks to growth, particularly trade tensions and slower global economic expansion. Powell's testimony and the minutes both indicate that the FOMC is ready to cut the fed funds rate when it meets at the end of July, even with the strong June jobs report.

With inflation slowing in 2019 further below the central bank's 2 percent objective and no indication of accelerating wage pressures, the FOMC has the leeway to cut rates this year (see Chart 2). The fed funds rate is currently in a range between 2.25 and 2.50 percent. PNC's baseline forecast is for one 0.25 percentage cut in the fed funds rate at the FOMC's next meeting, on July 31, and another 0.25 percentage point cut in October; this would bring the rate to a range of 1.75 to 2.00 percent by the end of this year. Powell's testimony and the minutes are viewed as supportive of rate cuts; as of the afternoon of July 10 the fed funds futures market is pricing in a 73 percent probability of a 0.25 percentage point cut in the fed funds rate in July, and a 27 percent probability of a 0.50 percentage point cut; one day earlier, the probability of a 0.50 percentage point cut was just 3 percent.

Stocks responded positively to Powell's testimony and the release of the minutes, with the S&P 500 hitting an all-time high on July 10, before retreating slightly.

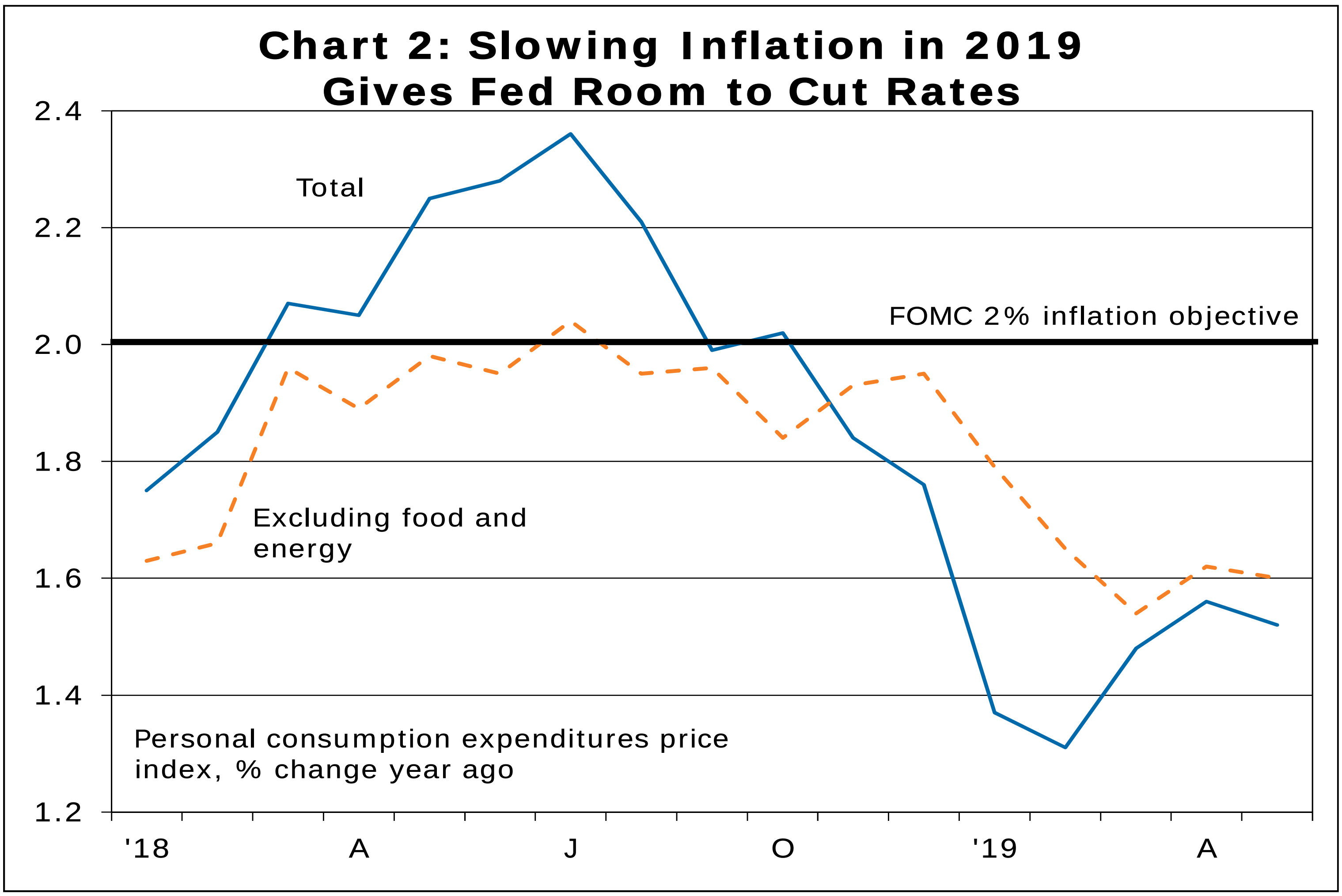

Chart source: Bureau of Economic Analysis

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