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ECONOMIC REPORT

Gus Faucher Chief Economist | **Stuart Hoffman** Senior Economic Advisor | **William Adams** Senior Economist | **Kurt Rankin** Economist | **Mekael Teshome** Economist

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

EXCELLENT JUNE JOBS REPORT, BUT WAGE GROWTH STILL SLOW; ECONOMY SOLID AT MID-YEAR

SUMMARY

- Employment increased by 224,000 in June, well above expectations. The economy is adding jobs at a solid pace in 2017.
- The unemployment rate rose slightly in June because of more people looking for work. Wage growth remains modest eight years into the economic expansion.
- According to the Federal Reserve's Beige Book, economic growth continued at a slight to moderate pace in the late spring.
- In Congressional testimony, Fed Chair Yellen said that the recent slowing in inflation is likely transitory, and called for a gradual tightening in monetary policy.
- PNC expects the Federal Reserve will start to reduce the size of its balance sheet in October, with an increase in the federal funds rate at the end of the year.

The June jobs report was strong across the board. The US economy added 222,000 jobs in June, well above the consensus expectation of 180,000 and above PNC's forecast of 200,000. This was the best month for job growth since February. Some of the strength came from the public sector with government jobs up by 35,000, the biggest increase in almost a year, but private-sector job growth was very good at 187,000. There were also big upward revisions to job growth in May (to 152,000 from 138,000) and April (to 207,000 from 174,000), for a total net upward revision of 47,000. Job growth has averaged an excellent 194,000 over the past three months, above the pace of 187,000 per month for all of last year (see Chart 1).

The unemployment rate rose to 4.4 percent in June from 4.3 percent in May. However, the increase in the unemployment rate was actually good news. The number of people who reported having jobs in the household survey (different from the survey of employers) rose by 245,000 in June, after falling by 233,000 in May. The number of people in the labor force rose by 361,000 in June, after falling by 429,000 in May. The labor force participation rate rose 0.1 percentage point to 62.8 percent; it remains well below where it was before the Great Recession, and has been stuck around its current level for the past few years. The number of unemployed rose by 116,000 in June. The broader U-6 unemployment rate (unemployed, underemployed and too discouraged to look for a job) rose to 8.6 percent in June from 8.4 percent in May, but is down from 9.4 percent in January.

Job growth was good in most industries in June. Mining and logging employment rose by 8,000 in June, the eighth straight monthly increase, but it is still down by more than 20 percent from its peak in the fall of 2014. Construction jobs rose by 16,000 in June, and manufacturing jobs rose by 1,000. Private service-providing industries added 162,000 jobs in June. This included gains of 35,000 in professional/business services (including 13,000 in temporary services), 45,000 in education and healthcare, 36,000 in leisure/hospitality services, and 17,000 in financial activities. Retail trade employment rose by 8,000 in June, but that followed a combined drop of 80,000 over the preceding four months; traditional retailers remain under pressure from online sales. Employment in information services was down by 4,000 in June. Local government jobs rose by 35,000 in June, in part because of timing issues with the end of the school year, while federal government employment was up by 4,000 and state government employment fell by 4,000.

The one disappointing aspect of the June jobs report was lackluster wage growth. Average hourly earnings rose 0.2

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percent over the month, but just 0.153 percent before rounding. Wage growth in May was revised lower, to 0.1 percent from 0.2 percent. Average hourly earnings were up 2.5 percent in June from one year earlier, up from 2.4 percent growth in May, but this is soft given that the expansion is now 8 years old and the unemployment rate has been below 5 percent for more than a year. Wage growth has been stuck at around 2.5 percent for the past year, and has actually slowed a bit over the past few months (see Chart 2). The average workweek rose to 34.5 hours in June from 34.4 hours in May.

With 222,000 new payroll workers, a longer average workweek, and moderate wage growth aggregate weekly earnings were up 0.6 percent in June. With no inflation over the month, workers' real income was likely up a solid 0.5 percent over in June.

Economic growth was "slight to moderate" in June, according to the latest Beige Book from the Federal Reserve. The strongest growth was in the Chicago, Dallas, Kansas City, and San Francisco districts. Consumer spending continues to drive economic growth, but there was a softening in consumer demand in many districts, especially for autos. There was "modest to moderate growth" in manufacturing and nonfinancial services in most of the country, with construction flat or expanding.

Employment continued to increase in most of the United States, although it was flat in the Atlanta and St. Louis districts. Labor markets continued to tighten across a variety of occupations and industries, especially in construction and information technology. Wages increased at a "modest to moderate pace in most Districts" as job markets tightened. Prices increased modestly in most districts, with a few districts noting slowing inflation.

In her semiannual testimony before Congress, Federal Reserve Chair Janet Yellen called for "gradual increases in the federal funds rate over time." She also reiterated the

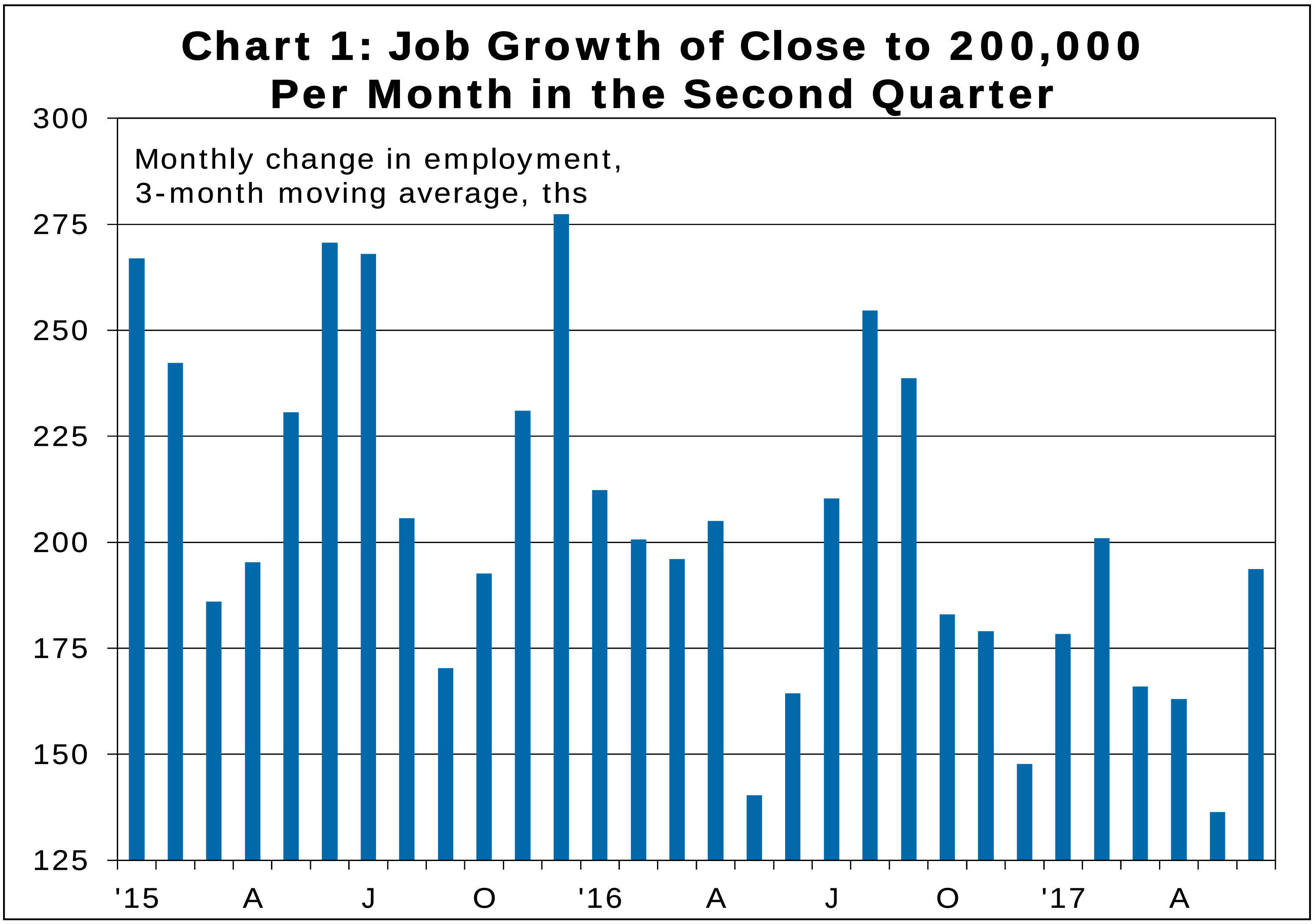

Chart source: Federal Reserve

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announcement from the Federal Market Committee that the Fed will begin to reduce the size of its balance sheet this year, gradually allowing long-term Treasuries and mortgage-backed securities to roll off the balance sheet as they mature.

Yellen said, as she has previously, that she and other FOMC members view recent slower inflation as transitory, “partly the result of a few unusual reductions in certain categories of prices,” and that she expects inflation to pick back up. However, she did say that the FOMC will “carefully monitor actual and expected progress toward our symmetric inflation goal” of 2 percent, using the personal consumption expenditures price index.

Yellen’s testimony reinforces PNC’s view that the FOMC will call for reducing the size of the Fed’s balance sheet at its September policy meeting, with the actual reduction to start on October 1. This will put modest upward pressure on interest rates. The FOMC will hold off on raising the fed funds rate until its December meeting, waiting to see both how markets respond to the balance sheet reduction and what happens to inflation in the second half of 2017. The FOMC has raised the fed funds rate twice so far this year, to a range of 1.00 to 1.25 percent.

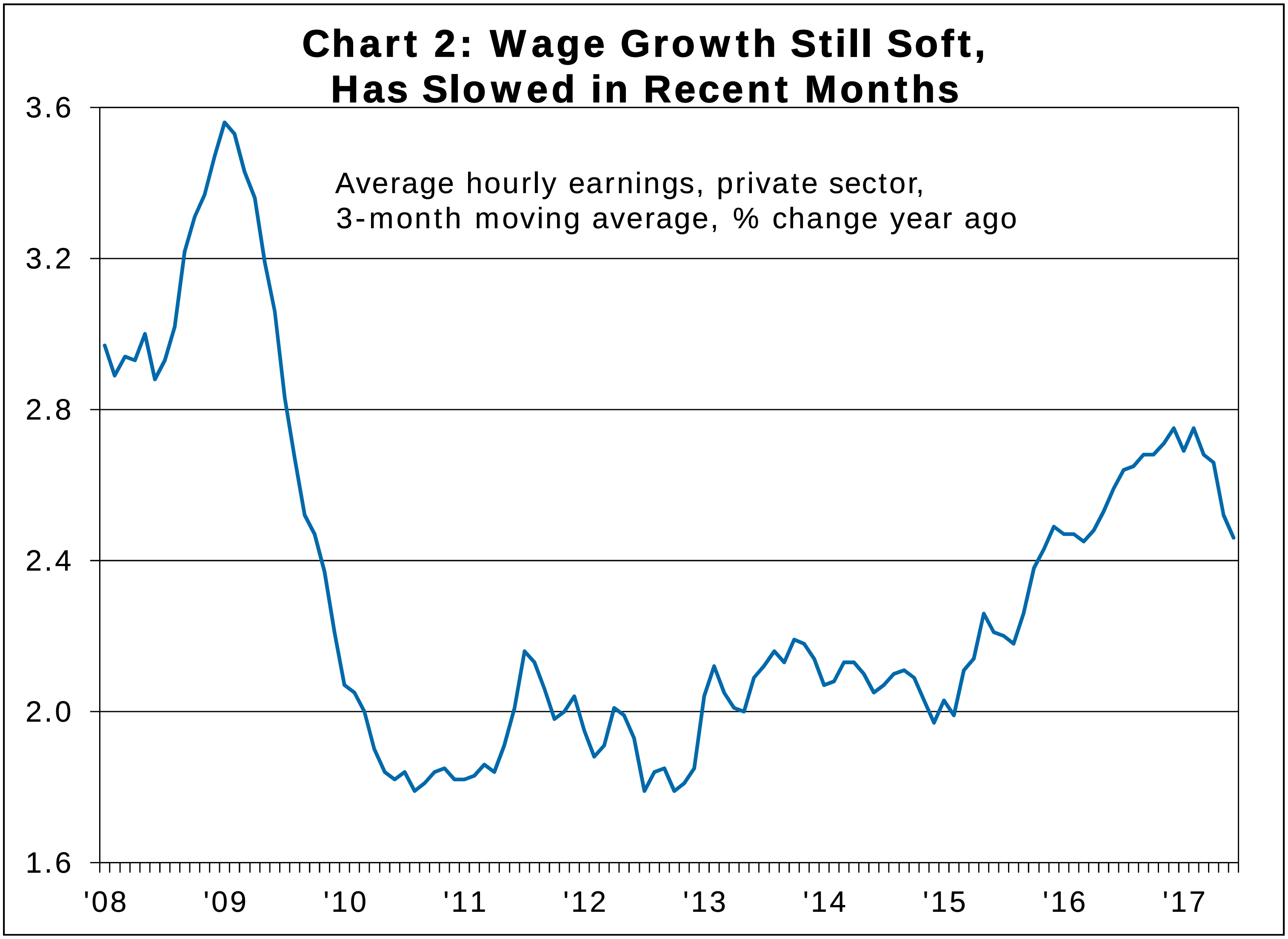

Chart source: Bureau of Labor Statistics

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