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ECONOMIC REPORT

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SOFTER AUGUST JOBS REPORT BUT LABOR MARKET IN GOOD SHAPE; ISM SURGES BUT CONSTRUCTION SLIPS

SUMMARY

- Employment rose by a disappointing 156,000 in August and the unemployment rate ticked up to 4.4 percent.
- Wage growth remains disappointing.
- The report does not include the impact from Hurricane Harvey; job growth will be weaker in September, but should quickly recover.
- One disappointing month does not change the trend: the labor market is in good shape.
- The ISM manufacturing index jumped in August to its highest level in more than six years.
- Manufacturing will continue to expand into 2018, but auto production is a downside risk.
- Construction spending fell for a second straight month in July, primarily because of a drop in private nonresidential activity.
- Construction spending will pick up from homebuilding and reconstruction after Harvey. There is also the potential for increased infrastructure spending in 2018.

The August jobs report was softer than expected, although the U.S. labor market remains in good shape. The U.S. economy added 156,000 jobs in August, below the consensus expectation of 185,000 and slightly below PNC's forecast of 160,000. The private sector did somewhat better, with job gains of 165,000, while government employment fell by 9,000 over the month. There were also big downward revisions to job growth in July (to 189,000 from 209,000) and June (to 210,000 from 231,000), for a total net downward revision of 41,000. Monthly job growth has averaged a very good 185,000 over the past three months, and 176,000 so far in 2017, close to the pace of 187,000 per month for all of last year.

The unemployment rate rose to 4.4 percent in August from 4.3 percent in July. The number of jobs in the household survey of employment (different from the survey of employers) fell by 74,000 in August, but that followed two months where growth averaged close to 300,000. The number of people in the labor force rose by 77,000 in August, after rising by an average of 355,000 in June and July. The labor force participation rate (share of adults either working or looking for work) held steady at 62.9 percent in August; it remains well below its pre-recession level and has been stuck around its current level for the past few years. The number of unemployed rose by 151,000 in August. The broader U-6 unemployment rate (unemployed, underemployed and too discouraged to look for a job) held steady at 8.6 percent in August, but is down from 9.4 percent in January.

Job growth was solid in most industries in August. Mining and logging employment fell by 3,000, the first monthly decline in that industry in almost a year. Construction jobs rose by 28,000 over the month. Manufacturing employment increased by 36,000, the biggest gain in four years; manufacturing employment can be volatile in August, tied to auto plant shutdowns and restarts for retooling. Private service-providing industries added 95,000 jobs in August, the smallest increase since May. This included gains of 40,000 in professional/business services (but no change in temporary services), 25,000 in education and healthcare, just 4,000 in leisure/hospitality services (the smallest increase in more than five years), and 10,000 in financial activities. Employment in trade, transportation and utilities rose by 8,000, with a gain of

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1,000 in retail trade; despite the small increase in August, retail trade jobs are down by almost 90,000, or 0.5 percent, since January as traditional retailers remain under pressure from online sales. Employment in information services fell by 8,000 in August. Federal government jobs fell by 1,000 in August, while state and local government jobs fell by 8,000.

Wage growth was once again disappointing. Average hourly earnings rose 0.1 percent in August, the smallest increase since March, following a 0.3 percent increase in July (unrevised). Average hourly earnings were up 2.5 percent in August from one year earlier, and have been stuck at that pace for most of 2017. 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.

The average workweek fell to 34.4 hours in August from 34.5 hours in July. With 156,000 new payroll workers, a shorter average workweek, and weak wage growth, aggregate weekly earnings were down 0.2 percent in August from July. However, on a year-over-year basis average weekly earnings grew 2.8 percent in August, unchanged from the July pace.

The jobs report for August was a bit soft. Not only was the headline number disappointing at 156,000, but the details were also mediocre. There were big downward revisions to job growth in June and July, wage growth slowed, the average workweek was shorter, and the unemployment rate rose. Still, this was just one month, and the job market remains in good shape (see Chart 1). Also, job growth in August is often revised higher in subsequent months. The economy is still creating about double the number of jobs needed to keep up with underlying growth in the labor force, and thus slack in the job market continues to decline. Soft wage growth remains the major disappointment, but that should pick up as businesses continue to hire and the labor market tightens.

This report does not include impact from Hurricane Harvey; the survey was taken a couple of weeks ago, before the storm hit. Job growth will weaken substantially in the wake of Harvey, and employment could even decline in September. But job growth will quickly pick back up as workers temporarily laid off in the immediate aftermath of the storm are rehired and reconstruction efforts begin. We will get a better sense of the impact of Harvey in the weeks ahead from initial claims for unemployment insurance.

The Institute for Supply Management's manufacturing index rose to 58.8 percent in August from 56.3 in July, its highest level since April 2011 and well above the 50 mark that separates expansion from contraction. The August reading was even better than the consensus expectation and PNC's forecast for a rise to 57.5 percent. Four of the five components used to calculate the overall index increased in August, and all five were well above 50. The employment subindex surged to 59.9 from 55.2 in July (see Chart 2).

Chart 1: Job Growth Still Solid Despite Softer August

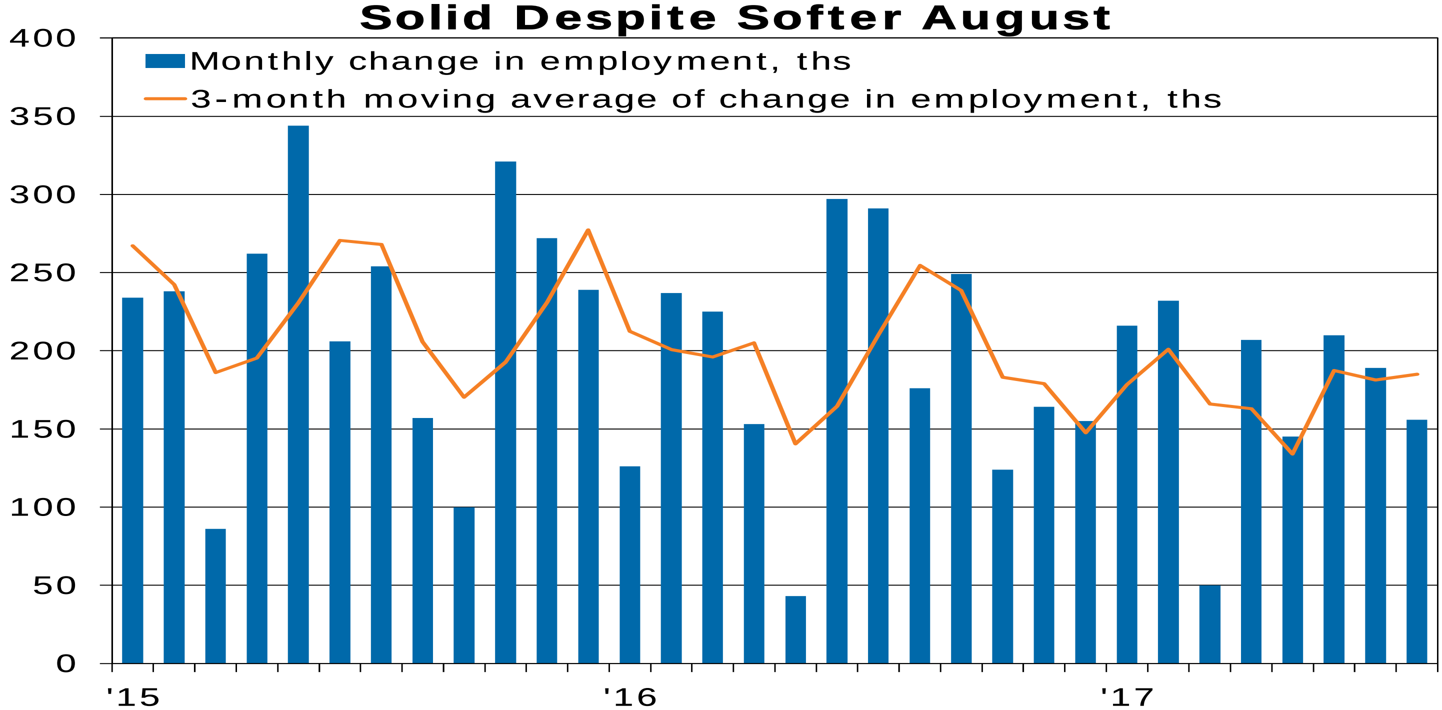

Chart source: Bureau of Labor Statistics

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The inventories, production and supplier deliveries components also rose, while new orders fell slightly. Both the new orders and production components have been above 60 for three straight months.

Conditions for manufacturers are improving. Demand for manufactured goods has strengthened as the U.S. and global economies gain traction. The dollar has depreciated by about 8 percent since late 2016, helping exporters regain some of the price competiveness they lost when the dollar appreciated by nearly 20 percent in 2015 and 2016. Auto production is one exception. Vehicle sales have disappointed as of late. Production could falter if incentives and discounts automakers are providing fail to shore up sales, although demand is likely to get a boost from sales in Texas to replace vehicles destroyed from Harvey-related flooding. Manufacturing is likely to expand moderately over the next few quarters, a little more slowly than the broader economy.

Construction spending fell 0.6 percent on a month-over-month basis in July, worse than the PNC and consensus forecasts of a 0.5 percent gain. The decline was driven largely by a 1.9 percent drop in private nonresidential building (see Chart 2). Public construction fell by 1.4 percent in July following a 4.4 percent drop in June. In contrast, total residential construction rose 0.8 percent over the month, up 0.5 percent after excluding home improvements. Also, residential spending in June was revised up to a gain of 0.4 percent from the preliminary estimate of a 0.2 percent drop. On a year-over-year basis, total construction spending rose 1.8 percent in July, a significant deceleration from its recent peak of 9.9 percent growth in November 2016.

PNC expects construction spending to pick up in the months ahead. Strong housing demand, tight inventories and continued price increases will entice builders to increase residential construction. Also, reconstruction efforts in the wake of Hurricane Harvey will boost spending. Looking further ahead, there is some potential for increased federal infrastructure spending in 2018. Two constraints that could limit growth in construction spending are an ongoing shortage of skilled construction workers and a shortage of land available for development in some parts of the country.

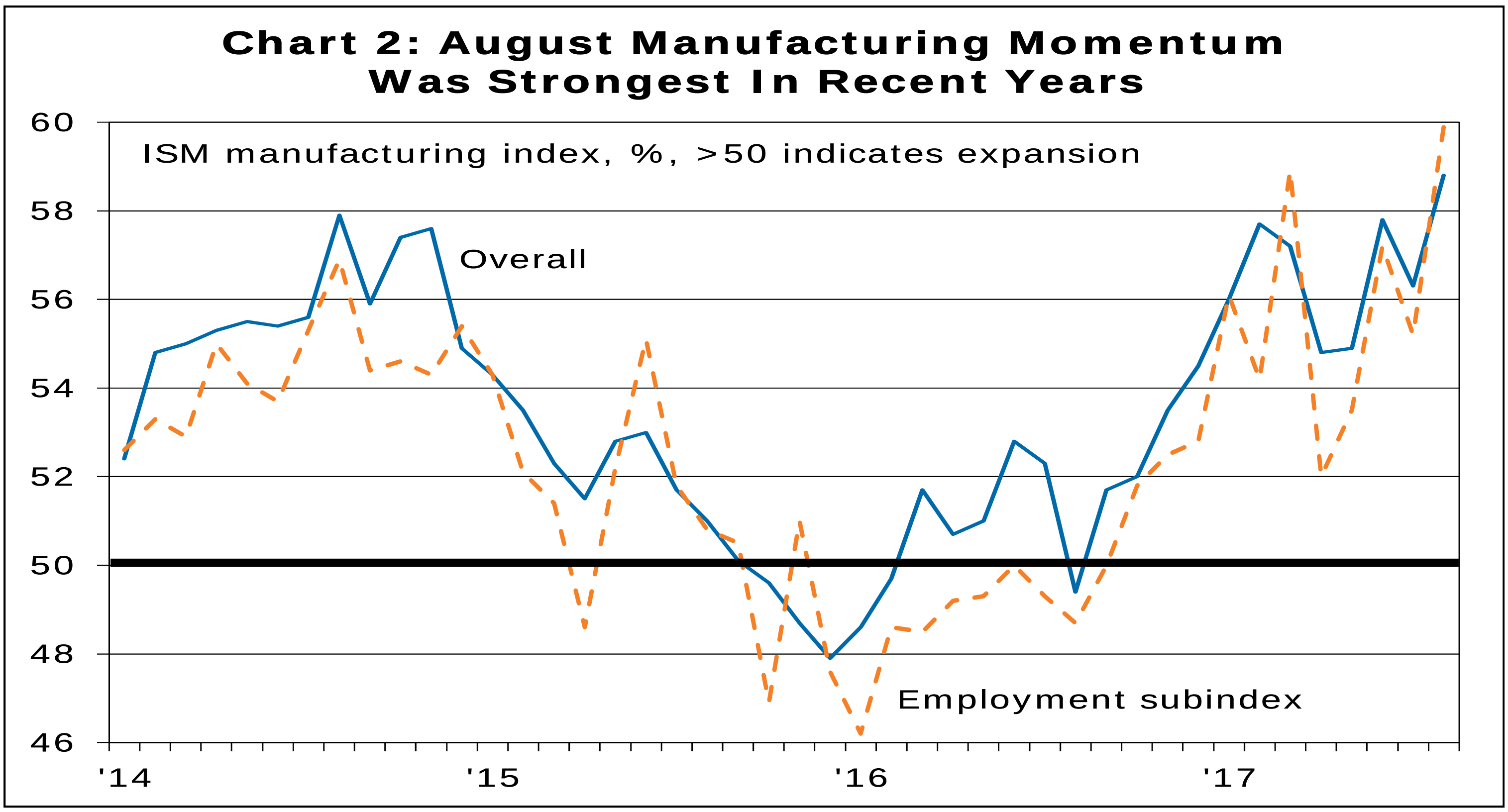

Chart source: Institute for Supply Management

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