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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

US LOST JOBS IN SEPTEMBER BECAUSE OF HURRICANES, BUT LABOR MARKET AND ECONOMY IN GOOD SHAPE

SUMMARY

- The U.S. economy lost 33,000 jobs in September, yet the unemployment rate fell to 4.2 percent and wages surged. The September jobs report was skewed by the recent hurricanes, so the results should be discounted.
- Job growth should bounce back at the end of 2017 as the economy recovers from the storms.
- Real GDP growth in the second quarter was revised up slightly to 3.1 percent annualized; gross domestic income rose 2.9 percent (unrevised).
- PNC expects real GDP growth of 2.7 percent in the third quarter, with stronger growth in the fourth quarter because of post-hurricane reconstruction.
- The Federal Open Market Committee will discount recent distortions in economic data and will raise the fed funds rate again in December.

The September jobs report was skewed by Hurricanes Harvey and Irma, with mixed results that should be discounted. The US economy lost 33,000 jobs in September, the first outright decline in employment since September 2010 (see Chart 1). The average consensus expectation was for job growth of 100,000, but the forecasts were all over the map. The private sector lost 40,000 jobs over the month, while government employment rose by 7,000. There was an upward revision to job growth in August (to 169,000 from 156,000) but a downward revision to July (to 138,000 from 189,000), for a total net downward revision of 38,000. Job growth has averaged 91,000 over the past three months, and 148,000 so far in 2017, down from the pace of 187,000 per month for all of last year.

The unemployment rate fell to 4.2 percent in September from 4.4 percent in August; this is the lowest unemployment rate since February 2001. The hurricanes appear to have had little impact on the unemployment rate. The number of jobs in the household survey of employment (different from the survey of employers) rose by a whopping 906,000, the biggest one-month jump since November 2013, in the aftermath of Superstorm Sandy. But about 4.4 million people reported either shorter hours or being employed but not reporting for work in September because of the weather, obviously tied to the hurricanes. The labor force grew by 575,000 in September, a vote of confidence in the job market. The labor force participation rate jumped by 0.2 percentage point over the month to 63.1 percent, its highest since early 2014, although it remains well below its pre-recession level. The broader U-6 unemployment rate (unemployed, underemployed and too discouraged to look for a job) dropped to 8.3 percent in September from 8.6 percent in August, the lowest since mid-2009. Neither the employer survey nor the household survey include results for Puerto Rico and the Virgin Islands, so Hurricane Maria did not impact the numbers.

Job growth was mixed across industries in September. Goods-producing industries added 9,000 jobs, with construction employment up by 8,000 and manufacturing employment down by 1,000. Private service-providing industries lost 49,000 jobs in September, the first one-month drop since December 2009. Job losses were in leisure/hospitality (a big industry in Florida, down 111,000), information (down 9,000), and retail (down 3,000). Other private service industries added jobs in September, but generally at a slower pace than in previous months. Employment rose by 22,000 in transportation and warehousing, 10,000 in financial activities, 13,000 in professional/business services (including an additional 6,000 temp jobs), and 27,000 in education/health care. Federal government jobs were flat in September, while state and local government jobs rose by 7,000.

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Wages surged in September, up 0.5 percent for the month (0.45 percent before rounding) and up 2.9 percent from one year earlier. This was the strongest year-over-year wage growth since mid-2009. However, September wage growth was likely overstated because of the hurricanes. There were huge job losses over the month in leisure/hospitality services, which is a low-paying industry, and the decline there skewed September wages. But average hourly earnings were revised higher in both July and August, and the tightening labor market is pushing up wages.

The average workweek held steady in September at 34.4 hours. With fewer payroll workers, the same average workweek, and a big jump in wages, aggregate weekly earnings were up 0.5 percent in September from August. With a surge in gasoline prices over the month, incomes adjusted for inflation were likely flat in September. On a year-over-year basis, average weekly earnings rose 2.9 percent in September, down from 3.0 percent in August.

Hurricanes Harvey and Irma skewed the September jobs report. The headline number was bad, the first outright month of job losses since the economy was recovering from the Great Recession in 2010. But the unemployment rate does not appear to have been affected by the storms, although its decline was perhaps a bit overstated given the monthly volatility in the household survey numbers.

Moreover, the household survey numbers can be volatile from month to month. Wage growth was very good, but compositional effects from the hurricanes likely made the number look somewhat better than it really was. There were net downward revisions to job growth in July and August, but upward revisions to wage growth.

Abstracting from the storms, the job market remains in good shape and the trends in 2017 are positive. The economy is still creating about double the number of jobs needed to keep up with underlying labor force growth and thus slack in the job market continues to decline. Wage growth has been soft, considering the economy is in its eighth year of recovery, but there are hopeful signs that it is picking up as the labor market tightens.

Job growth should bounce back from the hurricanes at the end of 2017 and the beginning of 2018. Many of the job losses in September were temporary as businesses closed from the storms, so job growth will recover in October. Reconstruction efforts, funded by federal aid and insurance payments, will provide a temporary boost to employment.

The US economy expanded 3.1 percent at an annual rate in the second quarter, according to the third estimate from the Bureau of Economic Analysis (see Chart 2). This is slightly higher than the 3.0 percent growth reported in the

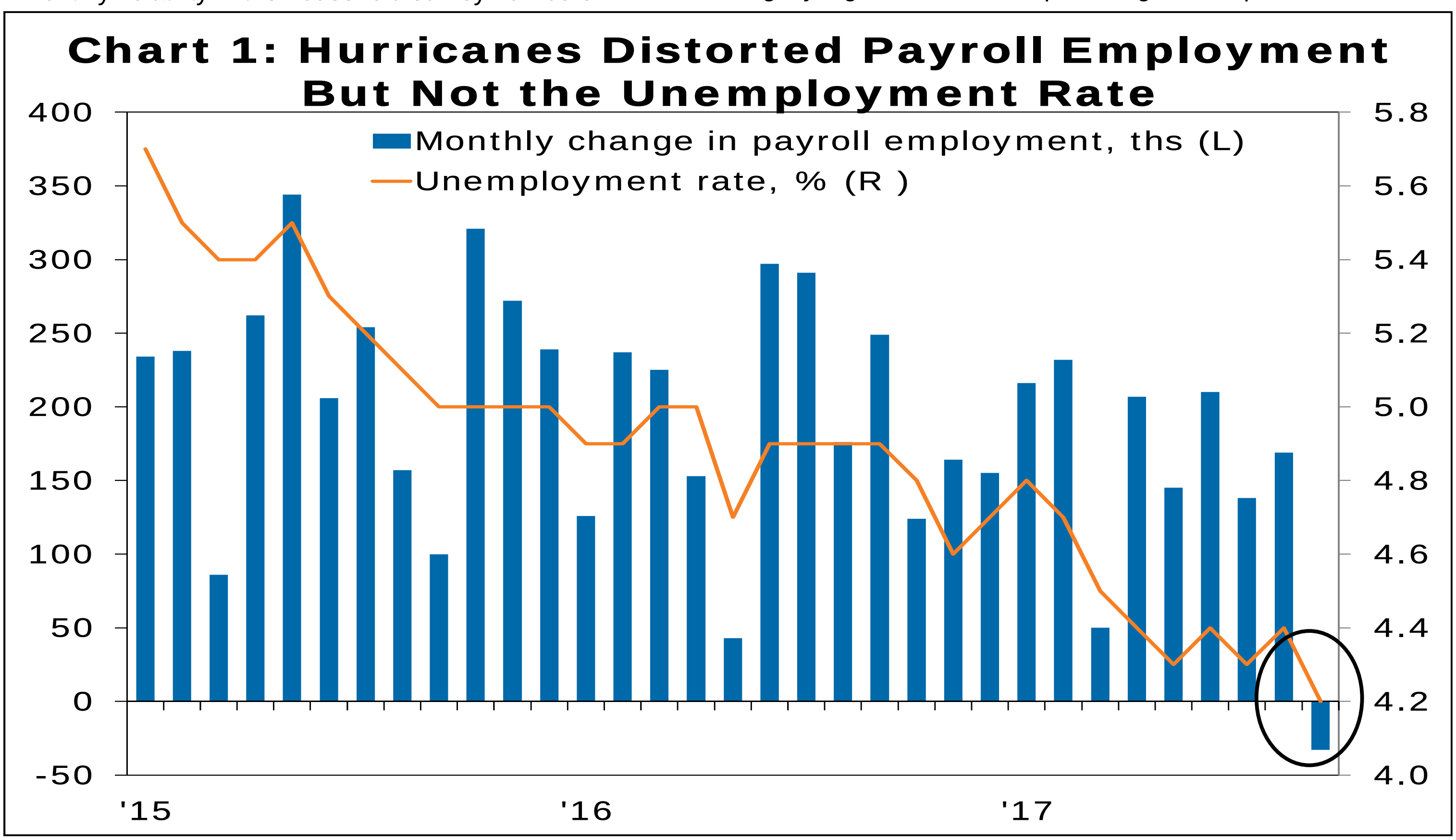

Chart source: Bureau of Labor Statistics

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second estimate; the preliminary estimate was 2.6 percent. In the third estimate there was an upward revision to investment in inventories. Growth in the first quarter was 1.2 percent.

Gross domestic income, an alternative measure of the size of the economy looking at income to households and firms, grew 2.9 percent annualized in the second quarter, unrevised from the second estimate. On a year-over-year basis real GDP was up 2.2 percent in the second quarter. Real GDI was up 2.0 percent.

Growth was solid in the second quarter, but that was after a soft first quarter. The economy has been expanding at a pace of between 2.0 and 2.5 percent throughout the current economic expansion, which started in 2009. This is below the pace of previous expansions partly because of demographic changes in the US, most notably slower labor force growth as baby boomers retire.

PNC is forecasting real GDP growth of 2.7 percent in the third quarter in the latest forecast, prepared after Hurricanes Harvey, Irma, and Maria. The forecast was revised down by about 0.5 percentage point from the pre-storms forecast because data in the wake of the hurricanes have so far been weaker. However, the growth forecast for the subsequent few quarters has been revised up because of expected rebuilding, and by mid-2018 the economy will be back to its pre-hurricanes path.

The next move from the Federal Open Market Committee is likely to come in December, when PNC expects the FOMC to again raise the federal funds rate, to a range of 1.25 to 1.50 percent, up a quarter of a percentage point from the current range. By that time two more jobs reports should show the labor market bouncing back from the hurricanes. Inflation has been well below the FOMC's 2 percent goal this year, but given the tight job market that will not deter the FOMC.

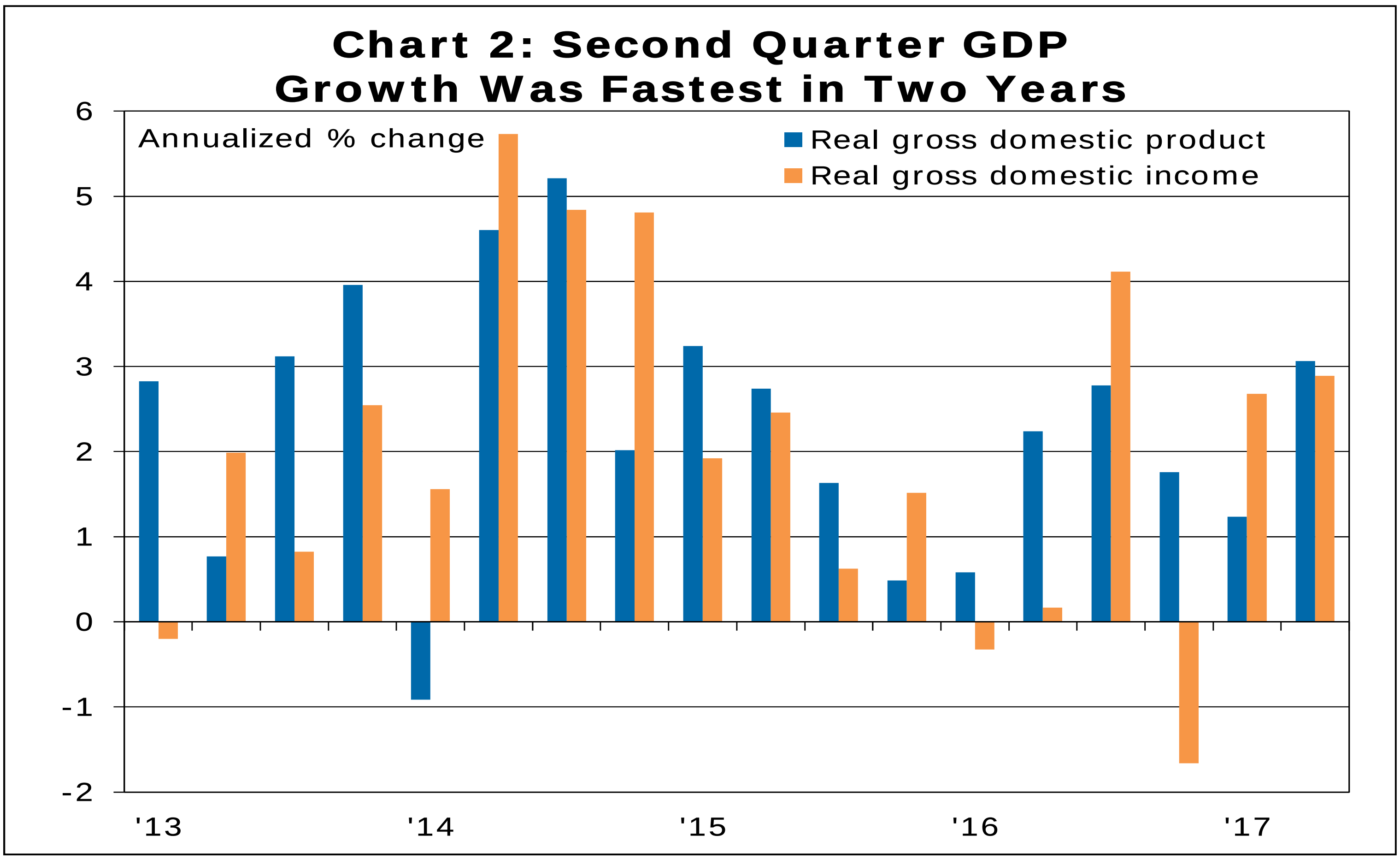

Chart source: Bureau of Economic Analysis

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