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ECONOMIC REPORT

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JOB GROWTH REBOUNDS IN OCTOBER, ECONOMY SOLID; POWELL IS CONTINUITY CHOICE FOR FED CHAIR

SUMMARY

- The U.S. added 261,000 jobs in October. That was below the consensus, but there were big upward revisions to job growth in August and September and the labor market is healthy at the end of 2017.
- Real GDP rose 3.0 percent in the third quarter, the second straight solid gain, despite a drag from Hurricanes Harvey and Irma.
- President Trump nominated current Fed Governor Powell to replace Yellen as chair of the Federal Reserve. Powell is likely to maintain continuity in monetary policy.
- The FOMC left the fed funds rate unchanged in early November. PNC expects one more increase in the fed funds rate this year, and three increases in 2018.

The U.S. economy added 261,000 jobs in October, bouncing back from very weak job growth in September in the wake of Hurricanes Harvey and Irma. The October increase was below the consensus expectation of 315,000 jobs. September jobs were revised higher, however, from a loss of 33,000 to a small gain of 18,000. August job growth was also revised higher, by 39,000, to an increase of 208,000, for a very large combined upward revision of 90,000. Over the past three months, averaging through the hurricanes, the U.S. economy has added 162,000 jobs per month, very close to the average of 168,000 for all of 2017 (see Chart 1). This is down from the pace of 187,000 jobs per month in 2016. The private sector added 252,000 jobs in October, with government employment up by 9,000.

The unemployment rate fell to 4.1 percent in October from 4.2 percent in September; this is the lowest unemployment rate since December 2000. The hurricanes appear to have had little impact on the unemployment rate over the past couple of months. The number of jobs in the household survey of employment (different from the survey of employers) fell by 484,000 in October, but that followed an enormous gain of 906,000 in September. The labor force contracted by 765,000 in October, with the labor force participation rate falling to 62.7 percent, from 63.1 percent in September. The labor force participation rate remains well below its pre-recession level. The number of unemployed fell by 281,000 in October. The broader U-6 unemployment rate (unemployed, underemployed and too discouraged to look for a job) dropped to 7.9 percent in October from 8.3 percent in September and 8.6 percent in August, to its lowest since late 2007. The number of people working part-time for economic reasons (involuntary part-time employment) has fallen by 1.1 million over the past year, a further indication of a tightening job market. (Neither the employer survey nor the household survey includes results for Puerto Rico and the Virgin Islands, so Hurricane Maria did not impact the numbers.)

Job growth was mixed across industries in October. Goods-producing industries added 33,000 jobs, with construction employment up by 11,000 and manufacturing employment up by 24,000; manufacturing employment in September was revised higher from a small loss to a gain of 6,000. Private service-providing industries added 219,000 jobs in October. After a huge loss of 102,000 jobs in leisure/hospitality services in September (mostly at restaurants) tied to the hurricanes, the industry rebounded to add 106,000 jobs in October. Business/professional services added 50,000 jobs in October (including 18,000 temp jobs), eds and meds added 41,000 jobs, and financial services added 5,000. Retail trade lost 5,000 jobs over the month, the eighth time in the past nine months the industry has shed workers as consumer sales continue to move online. Federal government employment rose by 5,000 in October, with state and local government up by 4,000.

After surging by 0.5 percent in September, average hourly earnings were flat in October. The year-over-year pace slowed to 2.4 percent in October from 2.9 percent in September. The hurricanes have skewed the wage data over the past

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couple of months. There were huge job losses in restaurants in September, and then a big rebound in October. This is a low-paying industry, and the job losses pushed up average wages in September and then held them back in October. Wage growth remains disappointing given that the expansion is well into its eighth year.

The average workweek held steady in October at 34.4 hours, although in manufacturing it rose by two-tenths of an hour. With a big increase in jobs, the same average workweek, and flat wages, aggregate weekly earnings were up 0.1 percent in October from September. With gasoline prices down over the month as Gulf Coast refineries came back online after temporary shutdowns following Harvey, real earnings likely rose a solid 0.4 percent in October.

Looking through Hurricanes Harvey and Irma, the job market is healthy at the end of 2017. Although the headline number wasn't as good as expected, there were big upward revisions to job growth in August and September of a combined 90,000. Job growth over the past three months was close to the pace for all of 2017, and the unemployment rate continues to fall. 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. The one weak spot remains wage growth, but it should pick up as the labor market continues to tighten.

Job growth will remain at around 170,000 through the rest of this year as hurricane reconstruction efforts, funded by federal aid and insurance payments, provide a temporary boost to employment. Job growth will slow in 2018 as it becomes more difficult to find workers. However, migration from Puerto Rico to the mainland in the aftermath of Hurricane Maria could help alleviate hiring shortages and support job growth.

Real GDP increased at a very good 3.0 percent annual rate in the third quarter despite the drag from Hurricanes Harvey and Irma, just a slight slowing from 3.1 percent growth in the second quarter. On a year-ago basis real GDP was up 2.3 percent in the third quarter, close to its average pace during the current economic expansion (see Chart 2).

Consumer spending growth slowed in the third quarter to 2.4 percent annualized from 3.3 percent in the second quarter, held back by the hurricanes. Investment in housing fell 6.0 percent, pushed lower by the storms. Business fixed investment rose a solid 3.9 percent. Investment in

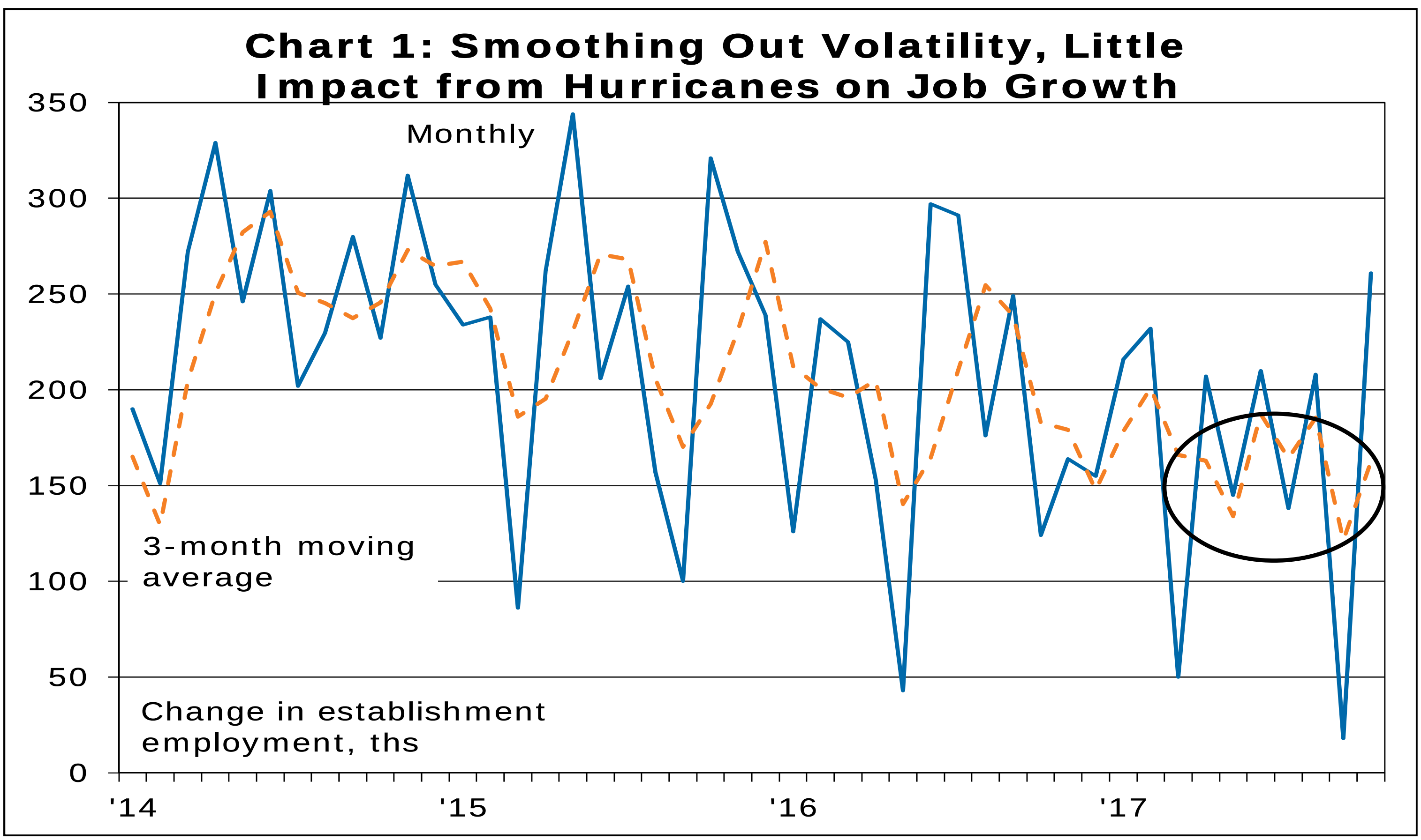

Chart source: Bureau of Labor Statistics

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inventories added 0.7 percentage point to growth, but is likely to subtract from growth at the end of the year.

President Trump nominated current Federal Reserve Governor and former investment banker and Treasury Department official Jerome Powell to be chair of the Federal Reserve Board when current chair Janet Yellen's term expires early next year. Powell is a continuity choice, with monetary policy likely to be similar to that under Yellen. The Federal Open Market Committee is expected to continue along the path of gradual rate increases as has been the case over the past couple of years. Governor Powell should be easily confirmed by the Senate, given that he is currently on the Board, has received bipartisan support previously (he is a Republican, but was appointed to the Board by President Obama), and represents continuity with Chair Yellen.

President Trump has another three seats on the board to fill, and will have a fourth if Yellen leaves the Board (she could choose to stay on as a Board member, but is more likely to leave it entirely). Thus the FOMC, and monetary policy, have the potential to look very different over the next few years.

At the conclusion of its meeting on November 1 the FOMC kept the federal funds rate unchanged in a range of 1.00 to 1.25 percent. Given solid GDP growth in the third quarter and the good October jobs report, the FOMC is set to raise the fed funds rate by 25 basis points at its next meeting, on December 12 and 13; Yellen will chair that meeting. PNC then expects three 25 basis point fed funds rate increases in 2018, bringing it to a range of 2.00 to 2.25 percent at the end of 2018. These rate increases are penciled in for June, September, and December, allowing Powell to ease into his new role. PNC's forecast is for the fed funds rate to reach its long-run value of 2.50 percent in mid-2019; this is slightly below the median long-run rate of 2.75 percent from the latest Summary of Economic Projections from FOMC participants (the "dot plot"), released in mid-September.

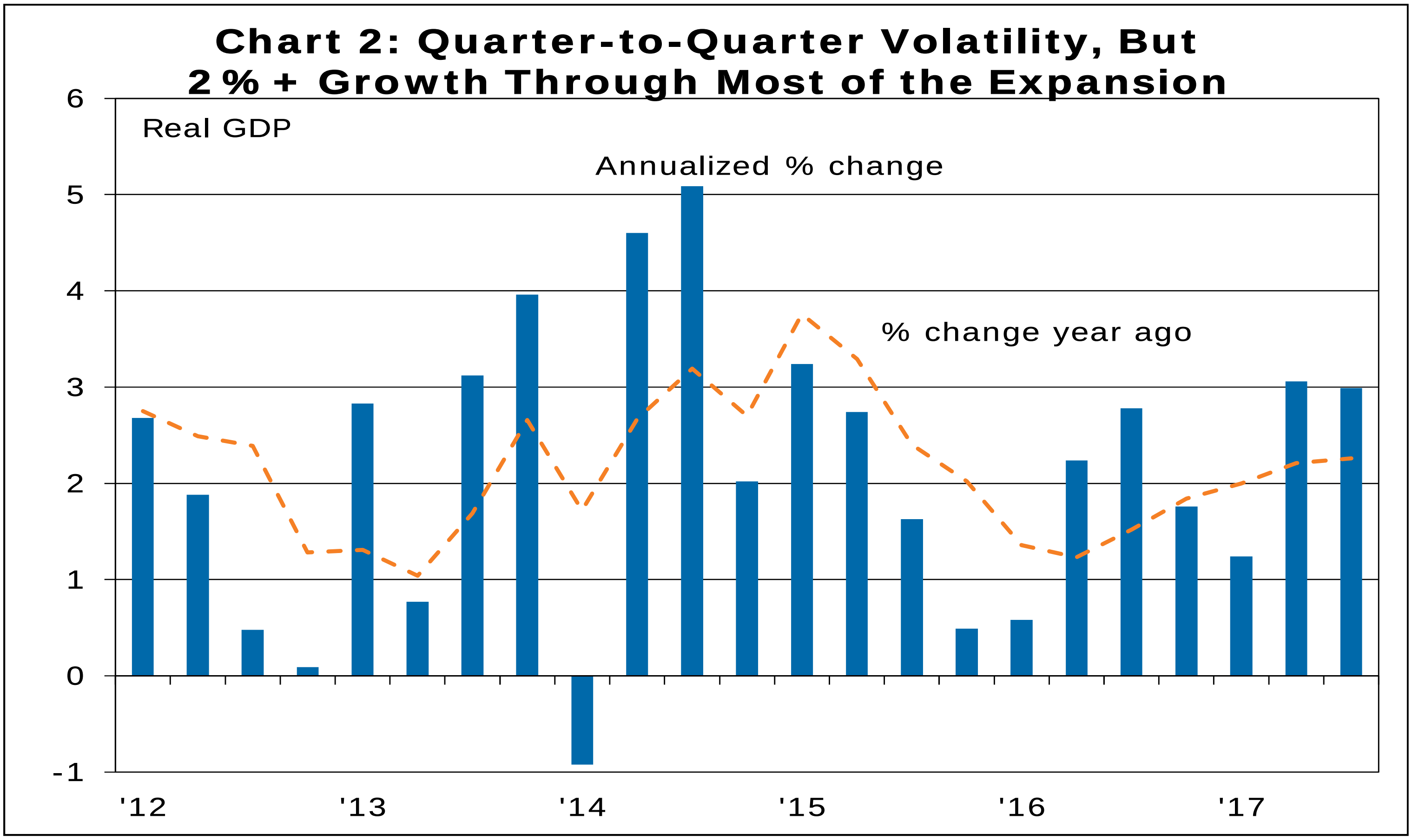

Chart source: Bureau of Economic Analysis

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