

ECONOMIC REPORT

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FOMC MINUTES POINT TO A DECEMBER RATE HIKE; LOTS OF GOOD DATA ON HOUSING, JOBS, AND MANUFACTURING

SUMMARY

- The minutes from the FOMC's meeting in early November support PNC's forecast for an increase in the federal funds rate in mid-December.
- Existing home sales jumped 2.0 percent in October, to their highest level in almost a decade. A limited supply of new homes for sale is putting upward pressure on prices.
- New home sales fell 1.9 percent in October from September, but were still up 18 percent from one year earlier.
- The housing market will continue to strengthen in 2017 thanks to solid fundamentals.
- Initial claims for unemployment insurance rose in the week ending November 19, but are still near their lowest level in more than four decades. The labor market continues to improve.
- Consumer sentiment jumped in November, to its highest level since May.
- Holiday sales are set to increase 3.5 percent this year from 2015.

Sales of existing homes rose 2.0 percent in October from September, to 5.60 million at a seasonally-adjusted annualized rate, according to the National Association of Realtors. This was the strongest pace of existing home sales since February 2007 (see Chart 1). Sales rose in all four regions of the country, with the biggest increase in the South. Sales of existing single-family homes rose 2.3 percent in October to 4.99 million, while sales of condominiums and coops were flat over the month at 0.61 million.

The median sale price for an existing home was \$232,300 in October (not seasonally adjusted), up 6.0 percent from one year earlier. The supply of existing homes for sale was 4.3 months in October at the current sales pace, down from 4.4 months in September and 4.7 months in the spring and summer; tight inventories are pushing up prices for existing homes.

The housing market recovery is continuing in the fourth quarter of 2016. Fundamentals for the housing market are good, with job and income gains and low mortgage rates supporting demand. There is also a great deal of pent-up demand, with potential purchasers who put off buying a home earlier now moving into the market to beat the ongoing rise in mortgage rates. Tight supplies of homes for sale could be a near-term constraint, however. PNC is forecasting total existing home sales of 5.42 million in 2016, up 3.5 percent from the 5.23 million sales last year. Sales are expected to increase a further 5 percent in 2017, to 5.68 million, despite somewhat higher mortgage rates.

Sales of new single-family homes fell 1.9 percent in October from September, to 563,000 at a seasonally-adjusted annualized rate. Sales in September were revised lower, to 574,000 from 593,000. Despite the monthly decline and the downward revision, sales in October were still up 17.8 percent from one year earlier. Sales rose 9 percent in the West over the month, but fell in the Northeast, Midwest and South.

The inventory of new homes for sale in October was 5.2 months at the current sales pace, up from 5.0 months in September and 4.6 months in July. Still, the inventory of new homes for sale remains tight, putting upward pressure on prices. The median sale price for a new single-family home was \$310,300 in October, up 2.1 percent from a year prior.

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As with existing homes, the fundamentals support growth in new home sales in the near term. PNC is forecasting total new single-family home sales of 571,000 this year, up 14 percent from last year, with another increase of 6 percent expected in 2017, to 608,000.

Initial claims for unemployment insurance benefits rose by 18,000 in the week ending November 19 to 251,000. Claims for the prior week were revised slightly lower by 2,000 to 233,000, the lowest level of claims since the summer of 1973; seasonal adjustment around the Veterans Day holiday likely added to the volatility of claims. The four-week moving average, which smoothes out some of the volatility, fell by 2,000 in the week ending November 19 to 251,000, near its lowest level in more than four decades. Claims have been below 300,000 for 90 straight weeks, the longest-such stretch since 1970, when the labor force was much smaller. The current extremely low level of claims demonstrates that the labor market remains solid at the end

of 2016: PNC is forecasting job growth of 180,000 in November, with the unemployment rate edging down to 4.8 percent, when the Bureau of Labor Statistics releases the monthly employment report on Friday, December 2.

Orders for durable goods jumped 4.8 percent in October, well above the consensus expectation of a 0.4 percent increase. A 94 percent increase in orders for civilian aircraft powered the gain; orders excluding transportation goods were up 1.0 percent. Core capital goods orders—nondefense capital goods excluding aircraft, and a proxy for business investment in equipment—were up 0.4 percent. Shipments of durable goods rose 0.1 percent in October, with core capital goods shipments up 0.2 percent.

A big October increase in aircraft orders, which can be lumpy, overstated the improvement in durable goods. But conditions are generally improving for manufacturers of big-ticket items (see Chart 2). With energy prices up from

Chart 1: With Good Fundamentals, Housing Market Continues to Improve

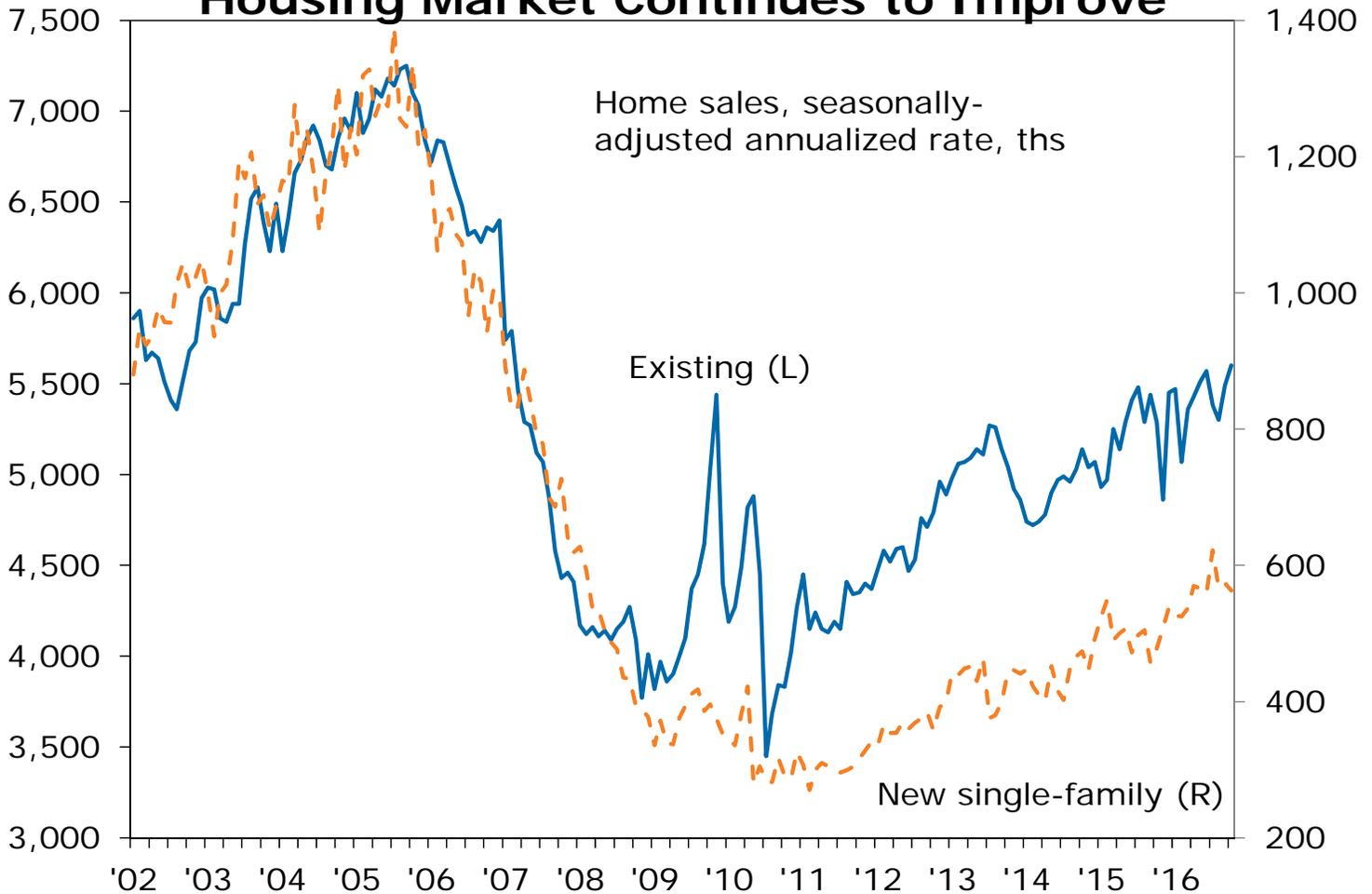


Chart sources: National Association of Realtors, Census Bureau

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earlier in 2016, the drag from cutbacks in demand for mining and drilling equipment is fading. The strengthening in the U.S. dollar that started in 2014 also came to an end earlier this year, a positive for U.S. manufacturers that export and face import competition. However, the dollar strengthening in the wake of the presidential election could become a drag on manufacturing once again. Rising interest rates could also be a weight on durable goods demand. Business investment in equipment will contribute modestly to economic growth in 2017, supporting a slow recovery in manufacturing.

The University of Michigan's consumer sentiment index

rose 6.6 points to November to 93.8, the best reading since May. The present conditions component jumped more than four points to 107.3, while the expectations component rose by more than eight points to 85.2. The end to the presidential election likely contributed to the improvement in sentiment, as did the ongoing recovery in the job market.

The improvement in sentiment supports PNC's forecast for a 3.5 percent increase in holiday sales this year from 2015. About 2.5 percentage points of that will come from higher volumes, and 1 percentage point from higher prices. However, gains for traditional retailers will be much weaker due to the increasing reach of online sales.

Chart 2: Downturn in Business Capital Spending Appears to Be Ending

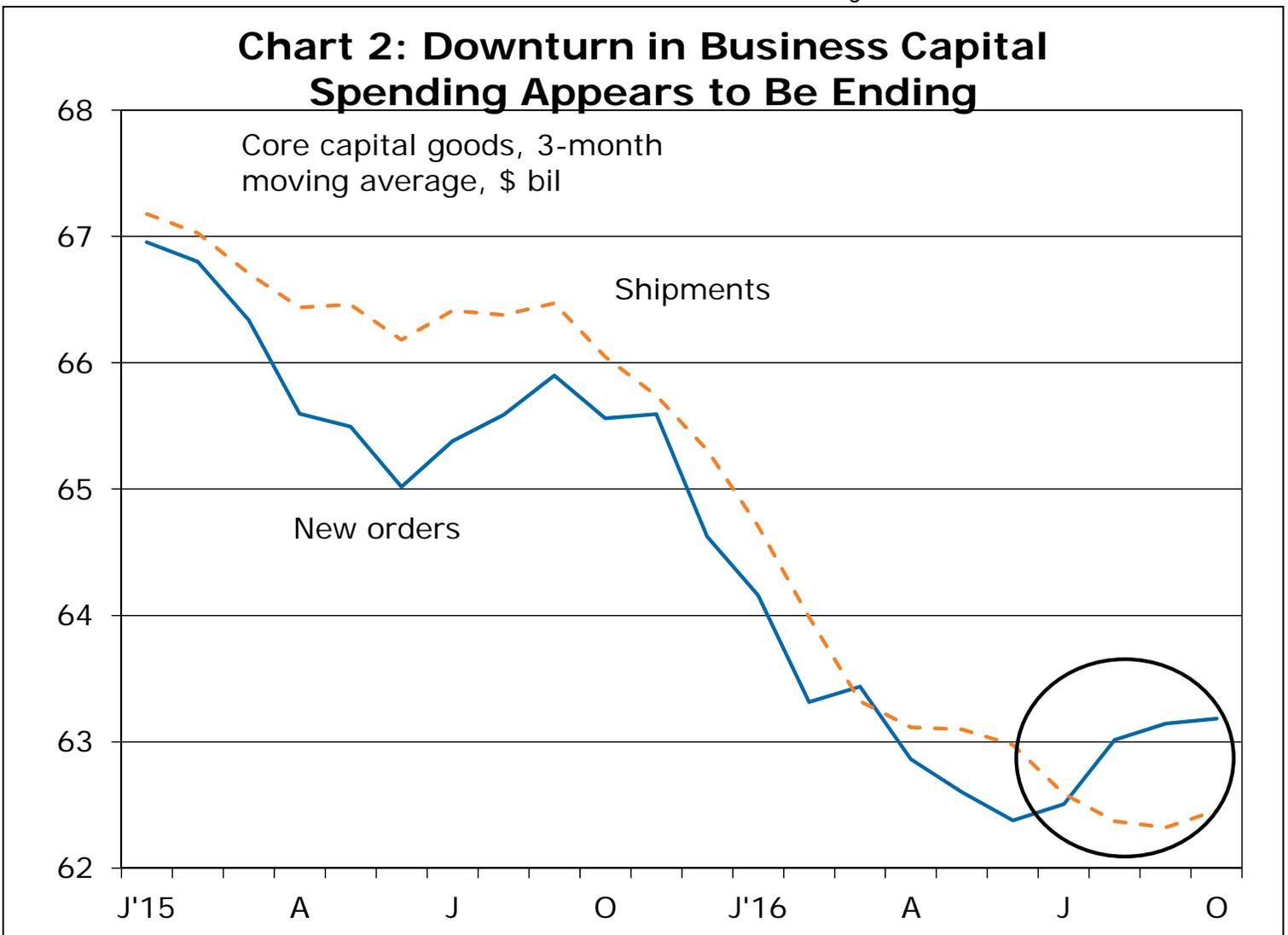


Chart source: Census Bureau

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