May 18, 2017

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

JOB MARKET REMAINS IN GOOD SHAPE, EVEN WITH SOFT FIRST QUARTER; INDUSTRIAL SECTOR IMPROVING

SUMMARY

- Job growth bounced back in April, with an increase of 211,000. The unemployment rate fell to a decade low of 4.4 percent.
- Real GDP rose a soft 0.7 percent in the first quarter, largely because of one-time factors. Growth should bounce back over the rest of this year.
- Consumer prices rose in April, after falling in March. Inflation will continue to gradually pick up into 2018.
- Industrial production rose 1.0 percent in April, with solid details. The industrial side of the economy is recovering after a slowdown from late 2014 to early 2016.
- The FOMC is on track to raise the fed funds rate two more times this year.

After a disappointing March, the labor market bounced back in April, with firms adding a net 211,000 workers, above the market consensus of 185,000 and PNC's forecast of 180,000. The private sector added 194,000 jobs in April, while government jobs rose by 17,000. March job growth was revised lower by 19,000 to 79,000 (the weakest month since May 2016) while February job growth was revised higher by 13,000 to 232,000, for a modest net downward revision of 6,000. Job growth has averaged 185,000 per month this year, very close to last year's pace of 187,000.

The unemployment rate fell to 4.4 percent in April, down from 4.5 percent in March and 4.7 percent in February; the last time the unemployment rate was this low was May 2007 (see Chart 1). The number of people who reported having jobs in the household survey (different from the survey of employers) rose by 156,000 in April, after big increases of more than 400,000 in both February and March. The labor force rose by a small 12,000 in April, and the labor force participation rate dipped 0.1 percentage point to 62.9 percent; it remains well below its pre-recession level. The broader U-6 unemployment rate (unemployed, underemployed and too discouraged to look for a job) fell to 8.6 percent in April from 8.9 percent in March and 9.4 percent in January, and is at its lowest since late 2007.

Most industries added jobs in April. Mining employment rose for a sixth straight month as energy prices have stabilized, but it is still down by a quarter from its peak in the fall of 2014. Construction job growth was 5,000 in April, after a gain of just 1,000 in March, but this followed increases of 54,000 in February and 34,000 in January; warmer-than-usual winter weather pushed building projects earlier into the year, and so the spring pickup in hiring is smaller than in years past. Manufacturing jobs rose by 6,000 in April, the fifth straight increase. Private service-providing industries added 173,000 jobs in April, more than triple the March pace of 54,000. This included gains of 39,000 in professional/business services (including 6,000 in temporary services); 41,000 in education and healthcare; a huge 55,000 in leisure/hospitality services; and 19,000 in financial activities. Retail trade employment rose by 6,000 in April after big drops of 27,000 in March and 29,000 in February; traditional retailers will remain under pressure from online sales. Employment was down 7,000 in information services in April.

With a tighter job market average hourly earnings rose 0.3 percent in April, although March wage growth was revised down to 0.1 percent, from 0.2 percent. Average hourly earnings were up 2.5 percent in April from one year earlier, down from 2.6 percent growth in March and 2.9 percent in December 2016, but up from sub-2 percent growth a few years ago. The tighter labor market is slowly pushing up wages. The average workweek rose 0.1 hour to 34.4 hours. With 211,000 new payroll workers and a longer average workweek total hours worked rose 0.5 percent in April, and with moderate wage growth aggregate weekly earnings were up 0.6 percent, the biggest increase since December.

JOB MARKET REMAINS IN GOOD SHAPE, EVEN WITH SOFT FIRST QUARTER; INDUSTRIAL SECTOR IMPROVING

The U.S. economy grew just 0.7 percent at an annual rate in the first quarter of 2017, according to the preliminary estimate of real GDP from the Bureau of Economic Analysis, well below the 2.8 percent pace in the second half of 2016. A number of one-time factors slowed growth in the first quarter. Consumers spent less on utilities because of the mild winter. There was also a drop in consumer spending on autos and other durable goods, in part because of delayed tax refunds. There was a big reduction in business investment in inventories in the first quarter. And the BEA has been having trouble with seasonal adjustment of the data; over the past 30 years growth in the first quarter has been significantly lower than in the other three quarters. The drags should fade in the second quarter, with growth rebounding to close to 4 percent.

Inflation picked back up in April, with the consumer price index up 0.2 percent over the month, after a fall in prices of 0.3 percent in March. Some of the stronger inflation came from higher energy prices; they rose 1.1 percent in April, after a 3.2 percent decline in March. But core inflation (excluding food and energy) also bounced back, with the core index up 0.1 percent, after a 0.1 percent drop in March. On a year-over year basis overall inflation slowed to 2.2 percent in April, from 2.4 percent in March, while core inflation slowed from 2.0 percent to 1.9 percent. Overall inflation has accelerated sharply since 2015 as energy prices have moved higher (see Chart 2). Core inflation has weakened in recent months, but will accelerate as the tighter labor market pushes up wages, leading firms to raise prices for their goods and services.

Industrial production rose 1.0 percent in April from March, the biggest one-month gain since February 2014. This was far above the consensus expectation for a 0.3 percent increase. There was strength in all major sectors: manufacturing production rose 1.0 percent, mining production was up 1.2 percent, and utilities production rose 0.7 percent. The March increase was revised slightly lower to 0.4 percent, from 0.5 percent.

The industrial side of the economy is strengthening in early 2017. Big drops in utilities production in the first two months of 2017, because of warmer-than-usual weather, restrained overall production growth. But production has risen in each of the last three months, and in four of the past five. After falling from late 2014 to early 2016, production has risen 2.3 percent since it bottomed out in May of last year. However, it is still down 1.4 percent from its all-time high in November 2014. A number of factors are behind the

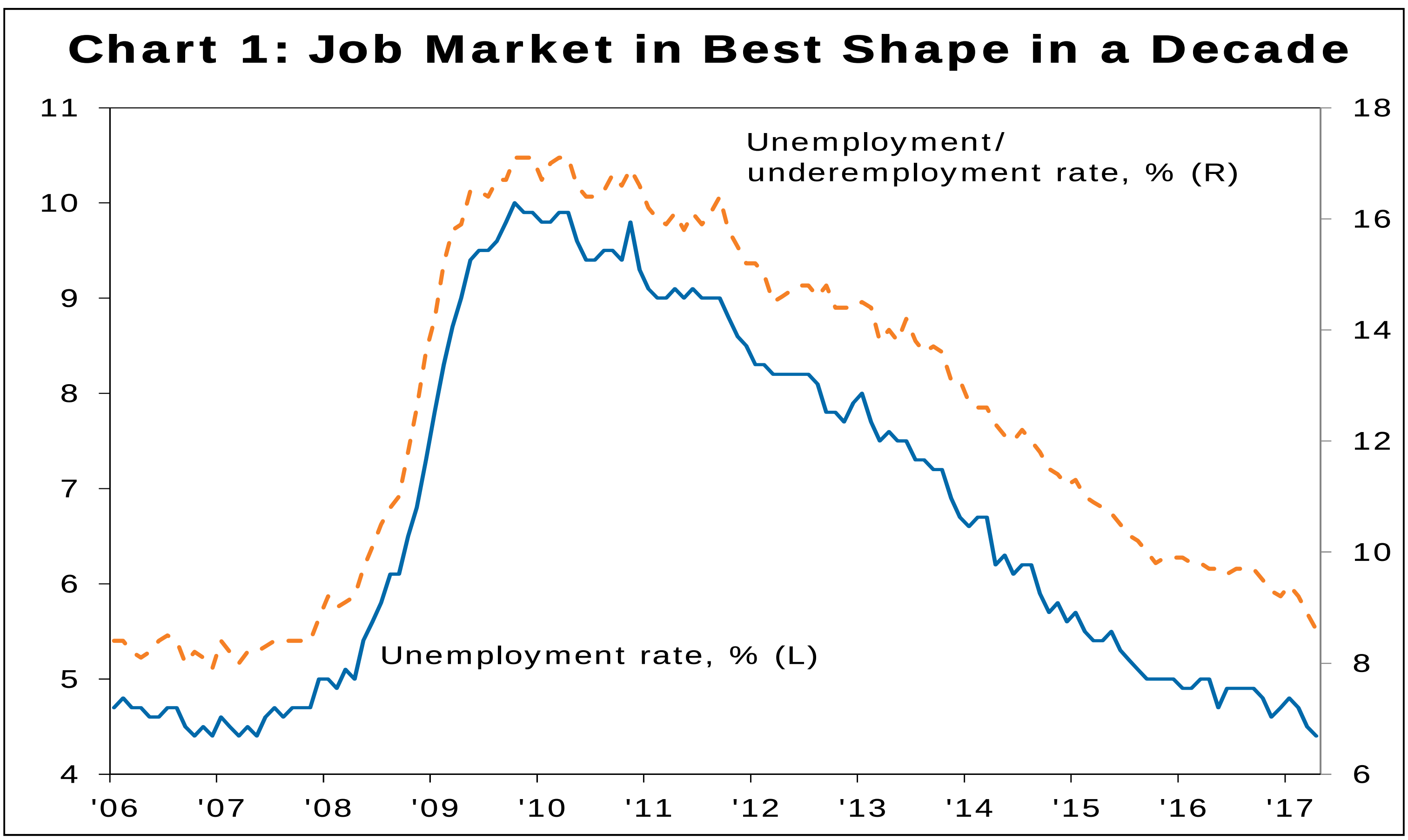

Chart source: Bureau of Labor Statistics

JOB MARKET REMAINS IN GOOD SHAPE, EVEN WITH SOFT FIRST QUARTER; INDUSTRIAL SECTOR IMPROVING

improvement in industrial production over the past year. Mining production fell 18 percent from late 2014 to mid-2016 as energy prices plunged, but now that energy prices have bottomed out, mining output is steadily rising. Manufacturing is expanding with greater demand from the energy industry, an end to the strengthening of the U.S. dollar, and steady growth in consumer spending.

Housing starts and permits both fell in April. Starts fell 2.6 percent to 1.172 million at a seasonally-adjusted annualized rate, although single-family starts were up 0.4 percent. Permits were down 2.5 percent to 1.229 million at a seasonally-adjusted annualized rate, including a 4.5 percent drop in single-family permits.

Despite the April decline, the trend in homebuilding is positive. A decade after the housing bust started households are becoming more enthusiastic about homeownership. With an improving economy, especially a job market near full employment, good affordability, low mortgage rates, and easing access to credit, households are moving away from renting and towards buying, supporting residential construction, especially of single-family homes. On a year-over-year basis starts were up 0.7 percent in April, with single-family starts up 8.9 percent. Permits were up 5.7 percent in April from one year earlier, with single-family permits up 6.2 percent. Starts and permits will both move higher over the rest of 2017. The major downside risk to the outlook for homebuilding is higher-than-expected mortgage rates.

With the job market very close to full employment and inflation gradually rising, the Federal Open Market Committee will raise the federal funds rate two more times this year, each time by a quarter of a percentage point. The funds rate is currently in a range of 0.75 to 1.00 percent, after the FOMC kept it unchanged at its early May meeting. The next increase is likely to come at the FOMC's next meeting, in mid-June.

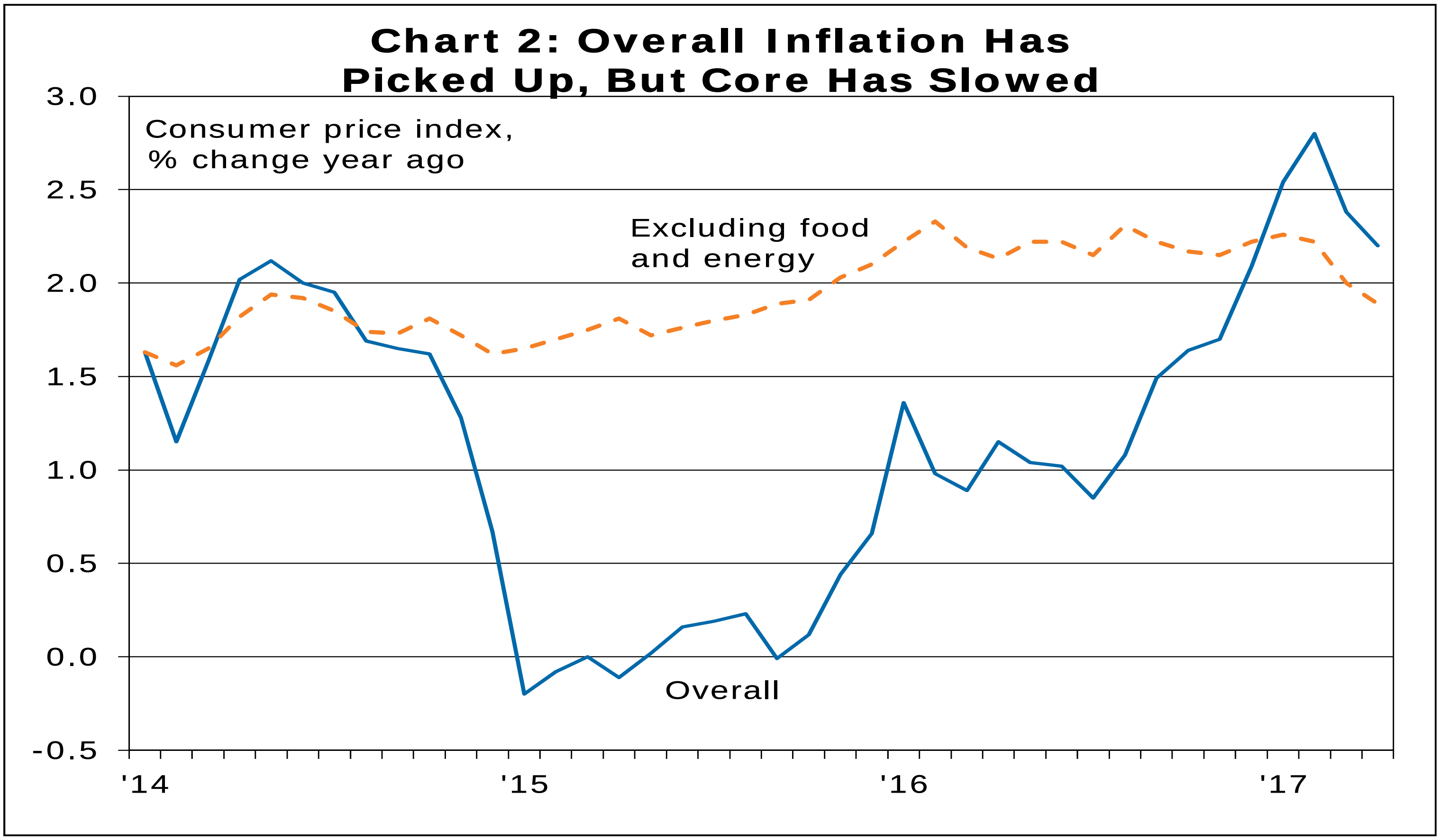

Chart source: Bureau of Labor Statistics

Visit http://www.pnc.com/economicreports to view the full listing of economic reports published by PNC's economists.