

# NATIONAL ECONOMIC OUTLOOK

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## Executive Summary

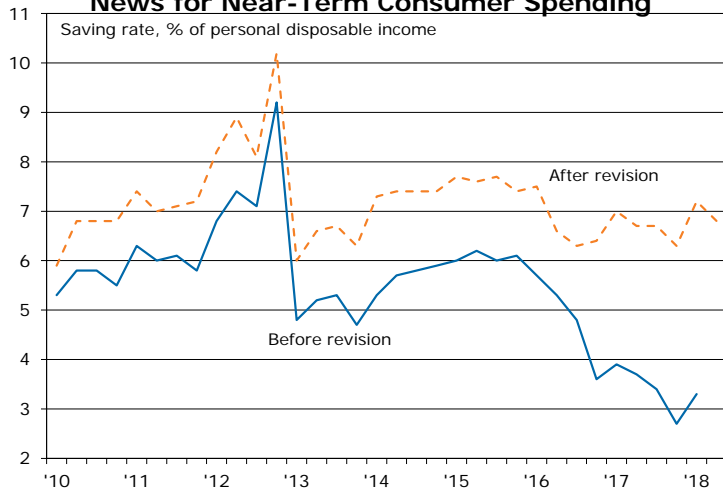
### Excellent Second Quarter Growth as Labor Market Continues to Strengthen

- The U.S. economy grew 4.2 percent at an annual rate in the second quarter of 2018, the best quarter in almost four years. On a year-over-year basis real GDP growth was 2.9 percent in the second quarter, the best pace since the first half of 2015. After a lackluster first quarter consumer spending grew 4.2 percent in the second quarter, adding 2.6 percentage points to growth. Private business fixed investment rose a very strong 8.5 percent in the second quarter, adding 1.1 percentage points to growth. Net exports were another big contributor, adding 1.2 percentage points to growth, as exports grew more than 9 percent (annualized) in the quarter. However, much of the increase in exports came as China imported soybeans ahead of increased tariffs, with exports set to decline in the third quarter.
- The U.S. economy added 157,000 jobs in July; the private sector added 170,000 jobs over the month, with government employment down by 13,000. There was a large upward revision to job growth in the prior two months of a combined 59,000. The U.S. economy has added an average of 215,000 jobs per month so far in 2018, well above last year's pace of 182,000. After rising 0.2 percentage point in June the unemployment rate fell 0.1 percentage point in July to 3.9 percent; except for May, this is the lowest the unemployment rate has been since the end of 2000. The broader U-6 unemployment rate (unemployed, underemployed and too discouraged to look for a job) fell 0.3 percentage point in July to a new cyclical low of 7.5 percent; it has not been this low since the spring of 2001.
- In an August speech at the annual Jackson Hole monetary policy conference, Federal Reserve Chair Powell argued that the central bank's current monetary policy is appropriate. Powell pointed out the risks of moving too aggressively in tightening monetary policy—causing a recession, and too slowly—causing the economy to overheat. Powell said that current “inflation may no longer be the first or best indicator of a tight labor market and rising pressures on resource utilization.” Instead, he mentioned “destabilizing excesses” in financial markets may now be the best signal that the economy is overheating, citing in particular the past two recessions. Powell then said that “risk management suggests looking beyond inflation for signs of excesses.” Powell's speech supports further gradual increases in the federal funds rate, consistent with PNC's forecast.

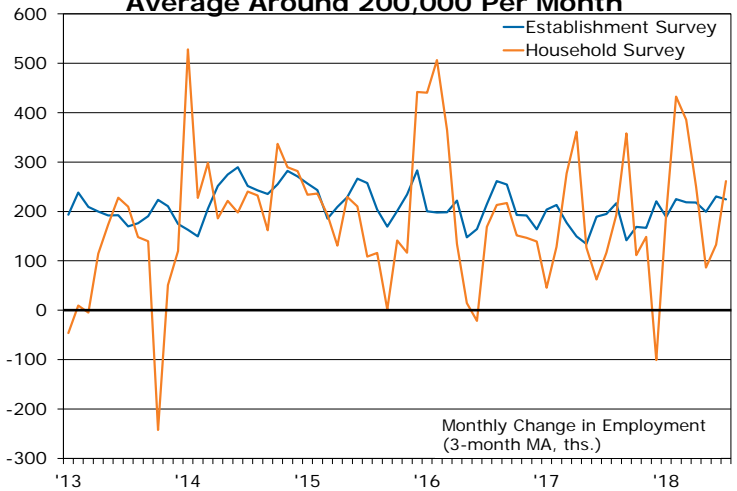
### Baseline U.S. Economic Outlook, Summary Table\*

	1Q'18a	2Q'18p	3Q'18f	4Q'18f	1Q'19f	2Q'19f	3Q'19f	4Q'19f	2017a	2018f	2019f	2020f
<b>Output &amp; Prices</b>												
Real GDP (Chained 2012 Billions \$)	18324	18507	18681	18832	18971	19098	19207	19301	18051	18586	19144	19494
Percent Change Annualized	2.2	4.1	3.8	3.3	3.0	2.7	2.3	2.0	2.2	3.0	3.0	1.8
CPI (1982-84 = 100)	249.4	250.5	251.4	252.7	254.1	255.7	257.2	258.7	245.1	251.0	256.4	262.4
Percent Change Annualized	3.5	1.7	1.5	2.1	2.3	2.4	2.4	2.4	2.1	2.4	2.2	2.3
<b>Labor Markets</b>												
Payroll Jobs (Millions)	148.1	148.7	149.3	149.7	150.1	150.4	150.7	151.0	146.6	148.9	150.6	151.4
Percent Change Annualized	1.7	1.8	1.5	1.3	1.1	0.8	0.8	0.6	1.6	1.6	1.1	0.5
Unemployment Rate (Percent)	4.1	3.9	3.8	3.6	3.5	3.5	3.5	3.5	4.4	3.8	3.5	3.7
<b>Interest Rates (Percent)</b>												
Federal Funds	1.45	1.74	1.97	2.13	2.24	2.49	2.68	2.75	1.00	1.82	2.54	2.75
Treasury Note, 10-year	2.76	2.92	3.00	3.07	3.13	3.18	3.16	3.12	2.33	2.94	3.15	3.10
a = actual    f = forecast    p = preliminary    * Please see the Expanded Table for more forecast series.												

**Chart 1: Upward Revision to Saving Rate Good News for Near-Term Consumer Spending**



**Chart 2: Job Growth Continues to Average Around 200,000 Per Month**



## **With Big Upward Revision to Saving Rate, Consumers Will Continue to Push the Economy Forward**

Consumer spending accounts for two-thirds of economic activity in the United States. For the past four years consumer spending has been leading overall economic growth, and the ability of households to increase their purchases is vitally important for a continuation of the current expansion. One recent concern was that a need to increase saving could constrain near-term consumer spending growth. But recent upward revisions to personal income and the saving rate are good news for household finances, consumer spending, and the economic expansion.

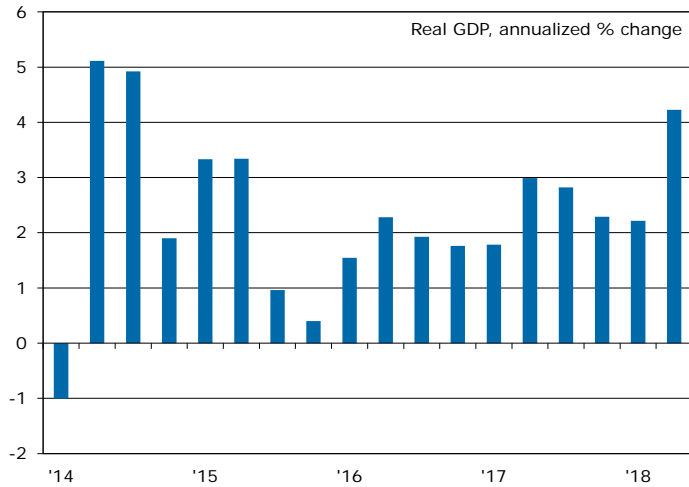
In the first half of 2018 the fundamentals for consumer spending were generally positive. The economy was adding jobs at a pace of around 200,000 per month and the unemployment rate was near a four-decade low. Wage growth, although still disappointing, was accelerating. Personal income tax cuts passed at the end of 2017 boosted paychecks. Household wealth was increasing thanks to record-high stock prices and rising home values; higher dividends were also a positive for stock-owning consumers. And by limiting borrowing households had historically low levels of debt as a share of after-tax incomes. But one concern was the apparent need for households to save more. The saving rate, which was almost 9 percent in 2012, appeared to have fallen to around 3 percent in early 2018. (The saving rate is calculated as households' after-tax income minus their spending, as a share of after-tax income.) Over the longer run households would need to boost their saving, which would mean that consumer spending would have to grow more slowly than after-tax income, constraining household purchases and overall economic growth.

But revisions to personal income and the saving rate, released by the Bureau of Economic Analysis this summer, have dramatically changed this picture. There were large upward revisions to personal income from 2012 on. In 2017, the level of personal income was revised higher by 2.4 percent compared to pre-revision estimates. Annual growth in inflation-adjusted after-tax income from 2012 to 2017 was revised up to 2.2 percent, from 1.8 percent. With the upward revision to personal income over the past five years the saving rate was also revised higher; the reported rate doubled in 2017 to 6.7 percent (see Chart 1). With the higher saving rate consumers are in good financial shape and can thus increase their spending roughly in line with their incomes. And with the saving rate well above where it was during the previous expansion in the early and mid-2000s, households have much more of a financial cushion should the economy start to slow.

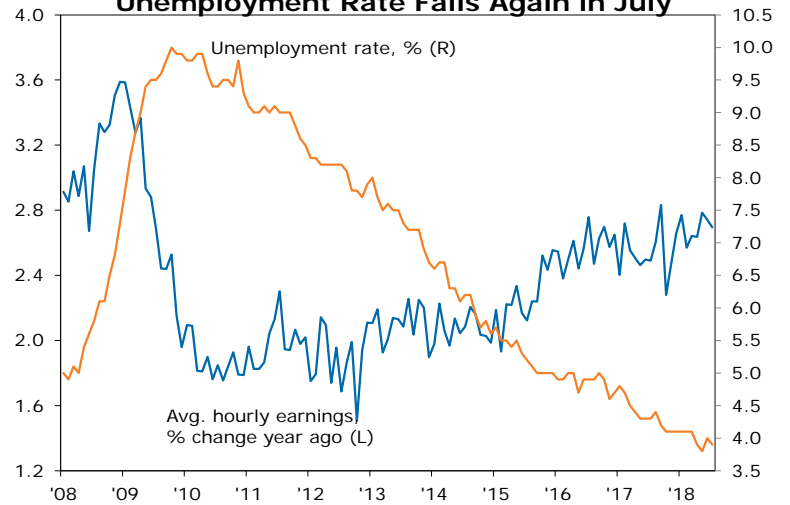
There are still some negatives for consumer spending in the second half of 2018 and into 2019. Rising interest rates are making borrowing more expensive and banks have also tightened credit standards recently; these factors will weigh on purchases of big-ticket items such as cars, appliances, and vacations. Higher gasoline prices this year have constrained spending on other goods and services. Tariffs imposed by the Trump administration have already raised prices on some consumer goods, and there is talk of additional tariffs that would further boost prices and crimp spending. But the positives of an improving labor market and rising household wealth should outweigh these negatives. According to the Conference Board, consumer confidence in August was at a cyclical high, with especially strong results for expected purchases.

With consumers in good shape the U.S. economic expansion will continue through the rest of this year and at least through mid-2019. Real U.S. GDP growth will be above 3 percent annualized in the second half of 2018 and early 2019. Business investment and consumer spending will both get boosts from the tax cuts, and the housing market will gradually improve despite higher mortgage rates. A large increase in federal government spending will also be a near-term positive. Assuming no significant disruptions trade will be a slight negative as growth in imports is stronger than growth in exports. Growth will slow in 2019 as fiscal stimulus wears off. Monthly job growth this year will average close to 200,000, and the unemployment rate will move lower, to around 3.5 percent by the end of the year. The Federal Open Market Committee will raise the federal funds rate at its next meeting, on September 26, to a range of 2.00 to 2.25 percent.

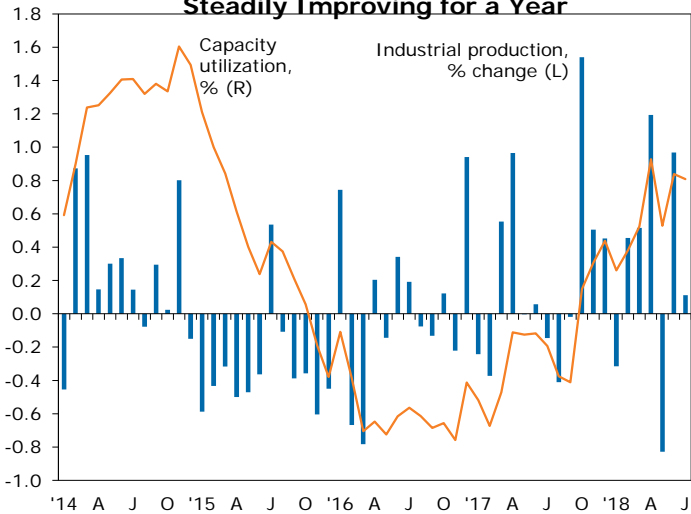
**Chart 3: Excellent Growth in the Second Quarter**



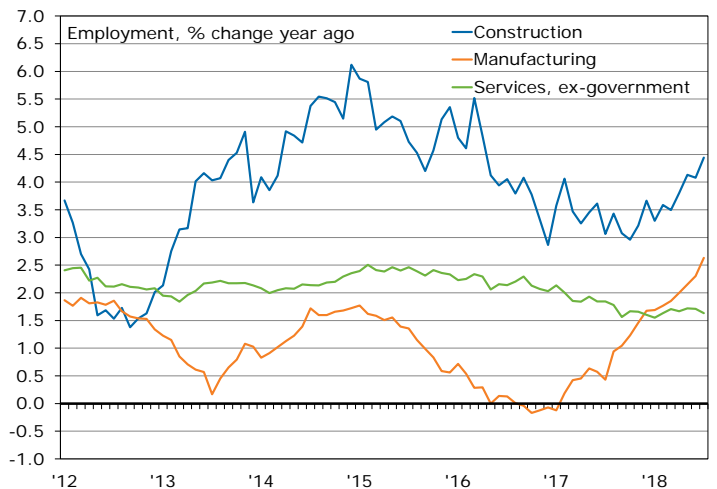
**Chart 4: After June Increase, Unemployment Rate Falls Again in July**



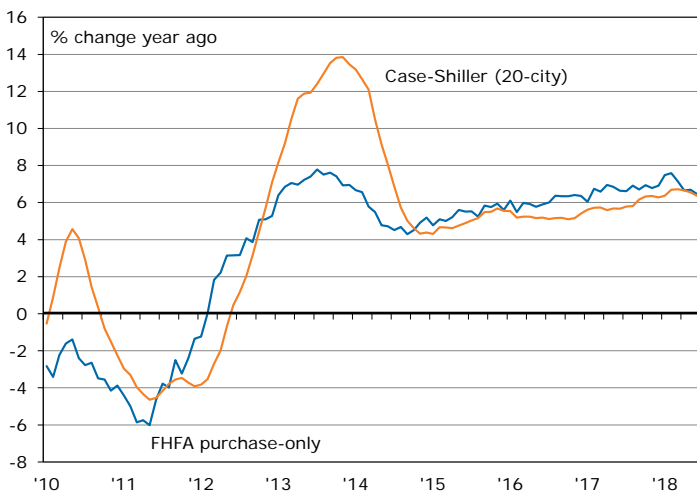
**Chart 5: Industrial Sector Has Been Steadily Improving for a Year**



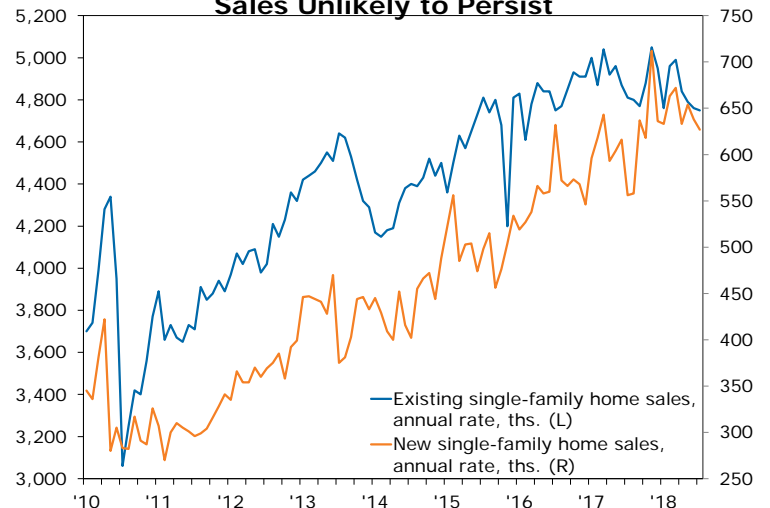
**Chart 6: Construction Job Growth Is Picking Up**



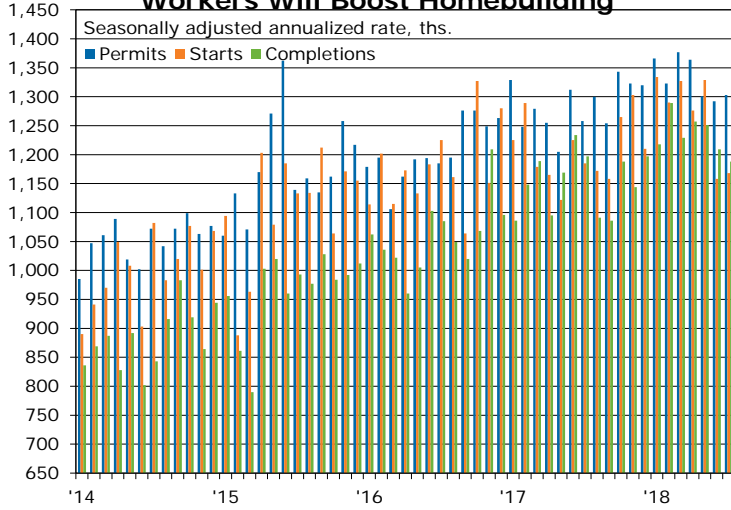
**Chart 7: House Price Growth May Be Leveling Off**



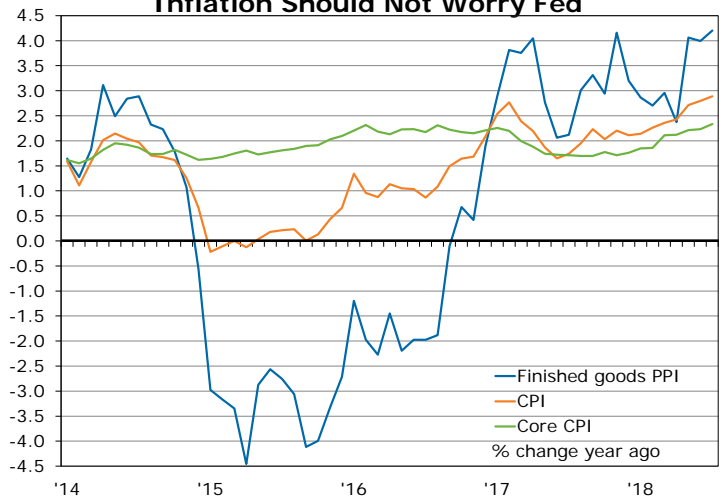
**Chart 8: Slowdown in Home Sales Unlikely to Persist**



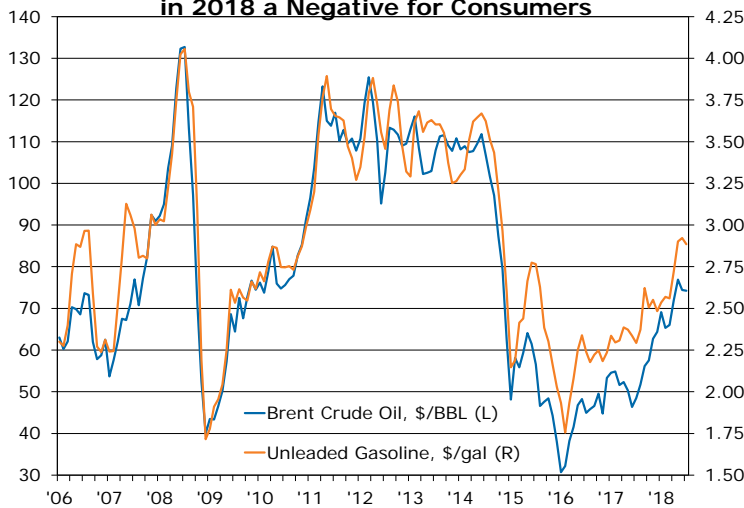
**Chart 9: More Construction Workers Will Boost Homebuilding**



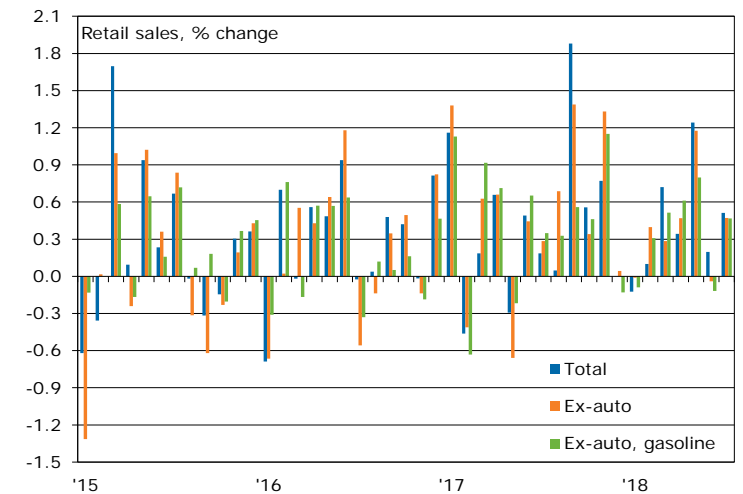
**Chart 10: Gradual Acceleration in Inflation Should Not Worry Fed**



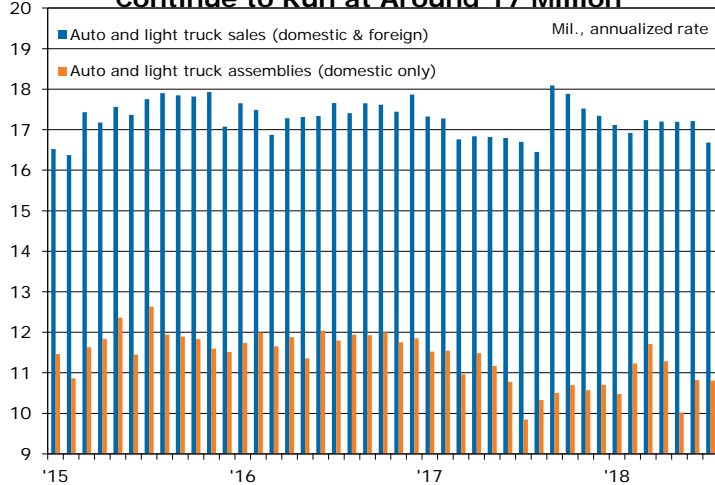
**Chart 11: Higher Gasoline Prices in 2018 a Negative for Consumers**



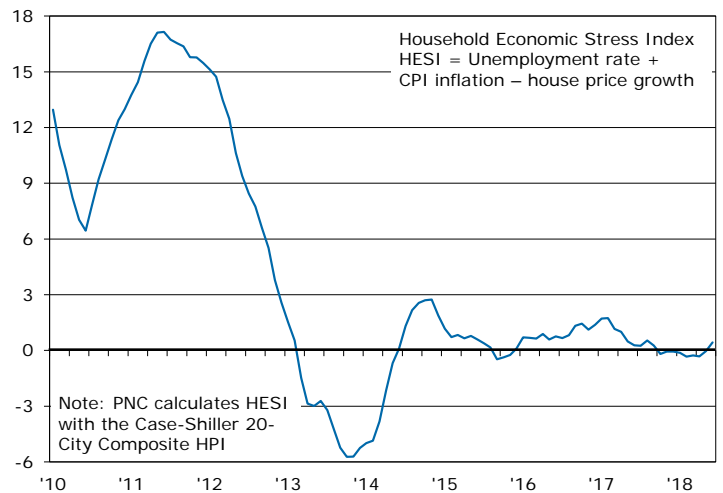
**Chart 12: Solid Growth in Retail Sales in 2018**



**Chart 13: Light Vehicle Sales Continue to Run at Around 17 Million**



**Chart 14: Few Signs of Household Economic Stress**



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PNC Economics Group  
August, 2018

## Baseline U.S. Economic Outlook, Expanded Table

	1Q'18a	2Q'18p	3Q'18f	4Q'18f	1Q'19f	2Q'19f	3Q'19f	4Q'19f	2017a	2018f	2019f	2020f
<b>Output</b>												
Nominal GDP (Billions \$)	20041	20403	20680	20953	21220	21484	21733	21969	19485	20519	21602	22505
Percent Change Annualized	4.3	7.4	5.5	5.4	5.2	5.1	4.7	4.4	4.2	5.3	5.3	4.2
Real GDP (Chained 2012 Billions \$)	18324	18507	18681	18832	18971	19098	19207	19301	18051	18586	19144	19494
Percent Change Annualized	2.2	4.1	3.8	3.3	3.0	2.7	2.3	2.0	2.2	3.0	3.0	1.8
Pers. Consumption Expenditures	12723	12848	12921	13000	13072	13136	13198	13256	12559	12873	13165	13397
Percent Change Annualized	0.5	4.0	2.3	2.5	2.3	2.0	1.9	1.8	2.5	2.5	2.3	1.8
Nonresidential Fixed Investment	2654	2701	2745	2790	2829	2862	2891	2915	2538	2723	2874	2956
Percent Change Annualized	11.5	7.3	6.6	6.8	5.6	4.9	4.1	3.4	5.3	7.3	5.6	2.8
Residential Investment	615	614	618	624	631	637	641	645	611	618	639	654
Percent Change Annualized	-3.4	-1.1	2.5	4.2	4.6	4.0	2.8	2.3	3.3	1.1	3.4	2.4
Change in Private Inventories	30	-28	29	33	42	54	55	51	23	16	51	42
Net Exports	-902	-850	-875	-894	-912	-924	-933	-935	-859	-880	-926	-934
Government Expenditures	3152	3169	3190	3225	3257	3280	3301	3315	3130	3184	3288	3327
Percent Change Annualized	1.5	2.1	2.6	4.5	4.0	2.9	2.5	1.7	-0.1	1.7	3.3	1.2
Industrial Prod. Index (2012 = 100)	105.9	107.5	108.2	108.7	109.2	109.5	109.8	110.1	103.7	107.6	109.7	110.7
Percent Change Annualized	2.4	6.0	2.7	2.1	1.7	1.3	1.1	0.9	1.6	3.7	2.0	0.9
Capacity Utilization (Percent)	77.2	77.9	78.2	78.3	78.6	78.8	78.8	79.0	76.1	77.9	78.8	79.0
<b>Prices</b>												
CPI (1982-84 = 100)	249.4	250.5	251.4	252.7	254.1	255.7	257.2	258.7	245.1	251.0	256.4	262.4
Percent Change Annualized	3.5	1.7	1.5	2.1	2.3	2.4	2.4	2.4	2.1	2.4	2.2	2.3
Core CPI Index (1982-84 = 100)	255.7	256.9	258.2	259.7	261.2	262.8	264.5	266.1	252.2	257.6	263.7	270.0
Percent Change Annualized	3.0	1.8	2.1	2.3	2.4	2.5	2.5	2.5	1.8	2.2	2.3	2.4
PCE Price Index (2012 = 100)	107.5	108.0	108.4	108.9	109.5	110.1	110.7	111.3	106.1	108.2	110.4	112.8
Percent Change Annualized	2.5	1.8	1.4	2.0	2.1	2.2	2.3	2.3	1.8	2.0	2.0	2.2
Core PCE Price Index (2012 = 100)	109.2	109.8	110.3	110.9	111.6	112.2	112.8	113.5	108.0	110.1	112.5	115.0
Percent Change Annualized	2.2	2.0	2.1	2.2	2.3	2.3	2.3	2.4	1.6	2.0	2.2	2.2
GDP Price Index (2012 = 100)	109.4	110.2	110.7	111.3	111.9	112.6	113.2	113.9	107.9	110.4	112.9	115.6
Percent Change Annualized	2.0	3.2	1.7	2.1	2.2	2.4	2.4	2.4	1.9	2.3	2.3	2.4
Crude Oil, WTI (\$/Barrel)	62.9	68.1	69.5	69.2	70.0	70.9	71.8	72.7	50.8	67.4	71.4	73.6
<b>Labor Markets</b>												
Payroll Jobs (Millions)	148.1	148.7	149.3	149.7	150.1	150.4	150.7	151.0	146.6	148.9	150.6	151.4
Percent Change Annualized	1.7	1.8	1.5	1.3	1.1	0.8	0.8	0.6	1.6	1.6	1.1	0.5
Unemployment Rate (Percent)	4.1	3.9	3.8	3.6	3.5	3.5	3.5	3.5	4.4	3.8	3.5	3.7
Average Weekly Hours, Prod. Works.	33.7	33.8	33.8	33.9	33.9	33.9	33.9	33.9	33.7	33.8	33.9	33.9
<b>Personal Income</b>												
Average Hourly Earnings (\$)	22.40	22.57	22.75	22.93	23.13	23.32	23.51	23.70	22.05	22.66	23.41	24.17
Percent Change Annualized	2.8	3.2	3.2	3.3	3.4	3.4	3.3	3.3	2.3	2.8	3.3	3.3
Real Disp. Income (2012 Billions \$)	14219	14309	14350	14387	14427	14466	14497	14528	13949	14316	14479	14622
Percent Change Annualized	4.4	2.6	1.1	1.0	1.1	1.1	0.9	0.9	2.6	2.6	1.1	1.0
<b>Housing</b>												
Housing Starts (Ths., Ann. Rate)	1317	1262	1283	1309	1331	1347	1355	1361	1208	1293	1348	1370
Ext. Home Sales (Ths., Ann. Rate)	5507	5413	5507	5596	5653	5688	5714	5737	5536	5506	5698	5780
New SF Home Sales (Ths., Ann. Rate)	656	646	658	673	685	692	696	699	616	658	693	700
Case/Shiller HPI (Jan. 2000 = 100)	199.8	202.0	204.3	206.5	208.5	210.3	212.0	213.4	191.6	203.2	211.1	216.4
Percent Change Year Ago	6.4	6.4	6.2	5.2	4.3	4.1	3.8	3.4	5.8	6.0	3.9	2.5
<b>Consumer</b>												
Household Economic Stress Index	0.0	0.1	0.1	0.6	1.1	1.4	2.0	2.5	0.6	0.2	1.8	3.5
Auto Sales (Millions)	17.1	17.2	17.2	17.2	17.1	17.1	17.0	17.0	17.1	17.2	17.1	16.9
Consumer Credit (Billions \$)	3863	3926	3986	4045	4105	4161	4220	4274	3755	3955	4190	4390
Percent Change Annualized	3.4	6.7	6.3	6.1	6.0	5.6	5.8	5.1	5.6	5.3	5.9	4.8
<b>Interest Rates (Percent)</b>												
Prime Rate	4.53	4.80	5.09	5.25	5.36	5.61	5.75	5.75	4.10	4.92	5.62	5.75
Federal Funds	1.45	1.74	1.97	2.13	2.24	2.49	2.68	2.75	1.00	1.82	2.54	2.75
3-Month Treasury Bill	1.58	1.87	1.99	2.07	2.25	2.48	2.59	2.63	0.95	1.88	2.49	2.61
10-Year Treasury Note	2.76	2.92	3.00	3.07	3.13	3.18	3.16	3.12	2.33	2.94	3.15	3.10
30-Year Fixed Mortgage	4.27	4.54	4.64	4.71	4.77	4.82	4.80	4.75	3.99	4.54	4.79	4.74
a = actual    f = forecast    p = preliminary												

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