

# NATIONAL ECONOMIC OUTLOOK

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## Executive Summary

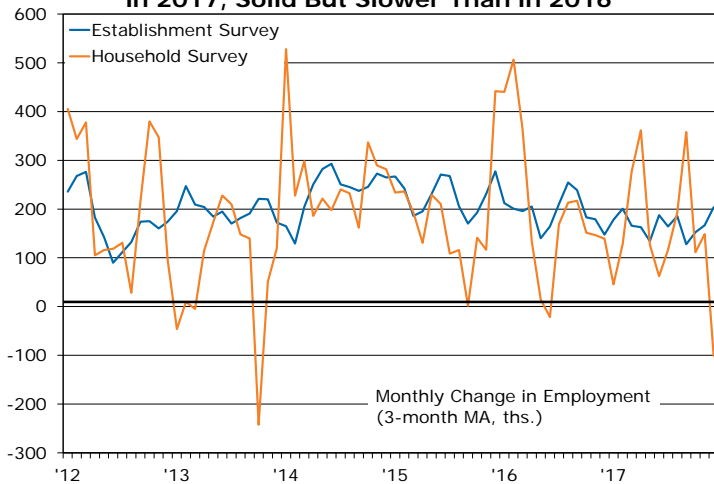
### Another Fed Rate Hike in December, Inflation Remains Tame

- The U.S. economy added 148,000 jobs in December, below the consensus of 188,000. The private sector added 146,000 jobs over the month, with government employment up by 2,000. There was a slight net downward revision to job growth in October and November. Job growth has been gradually slowing over the past few years: from an average of 250,000 per month in 2014, to 226,000 per month in 2015, to 189,000 per month in 2016, to 171,000 per month in 2017. Still, this is well above the pace needed to absorb new entrants into the workforce, and thus labor market slack continues to decline. The unemployment rate was 4.1 percent for a third straight month in December; this is the lowest the rate has been in 17 years. The broader U6 rate, which also includes the underemployed and those who would like to work but have given up looking for a job, ticked up slightly to 8.1 percent in December, and it has almost recovered to its level prior to the Great Recession.
- As widely expected, the Federal Open Market Committee raised the federal funds rate on December 13 by a quarter of a percentage point, to a range of 1.25 to 1.50 percent. That was the third increase in the funds rate in 2017, and the fifth since the current tightening cycle began in late 2015. The statement continued to say that further increases in the fed funds rate are likely to be “gradual,” and that the rate “is likely to remain, for some time, below levels that are expected to prevail in the longer run.” The Summary of Economics Projections, or “dot plot,” released along with the statement implied three more increases in the federal funds rate this year. Current Federal Reserve Governor Jerome Powell was confirmed by the Senate to be the new Chair of the Federal Reserve, and will take over from Janet Yellen in February.
- Inflation has been steady over the past few months. The consumer price index rose 0.1 percent in December, with core prices (excluding food and energy) up 0.3 percent. On a year-ago basis overall CPI inflation was 2.1 percent in December, around where it has been since September. Core CPI inflation was 1.8 percent year-over-year in December; it has been 1.7 or 1.8 percent every month since May. The FOMC would like to see a bit stronger core inflation. It has set an inflation goal of 2 percent using a different measure, the personal consumption expenditures price index, which tends to run a bit slower than CPI inflation.

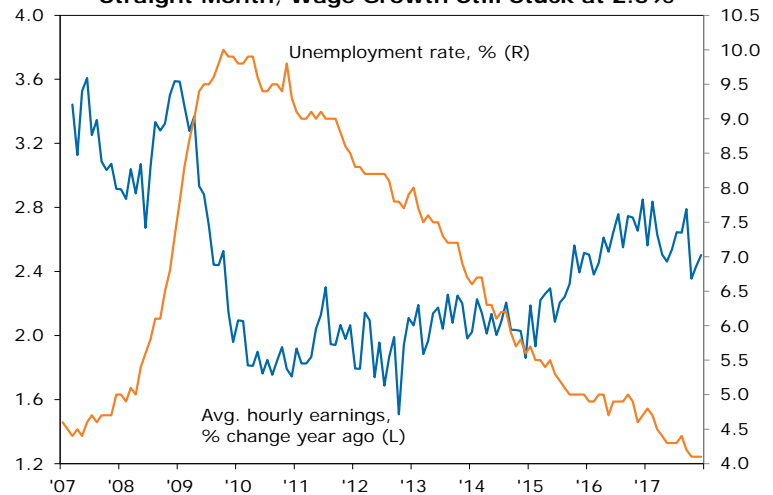
### Baseline U.S. Economic Outlook, Summary Table\*

	1Q'17a	2Q'17a	3Q'17p	4Q'17f	1Q'18f	2Q'18f	3Q'18f	4Q'18f	2016a	2017f	2018f	2019f
<b>Output &amp; Prices</b>												
Real GDP (Chained 2009 Billions \$)	16903	17031	17164	17303	17412	17520	17619	17720	16716	17100	17568	17940
Percent Change Annualized	1.2	3.1	3.2	3.3	2.5	2.5	2.3	2.3	1.5	2.3	2.7	2.1
CPI (1982-84 = 100)	244.1	243.9	245.2	247.5	249.0	250.3	251.7	253.2	240.0	245.2	251.0	256.8
Percent Change Annualized	3.1	-0.3	2.0	3.8	2.6	2.0	2.3	2.3	1.3	2.1	2.4	2.3
<b>Labor Markets</b>												
Payroll Jobs (Millions)	145.7	146.2	146.7	147.2	147.7	148.1	148.5	148.9	144.3	146.4	148.3	149.6
Percent Change Annualized	1.5	1.3	1.3	1.4	1.3	1.2	1.1	1.0	1.8	1.5	1.3	0.9
Unemployment Rate (Percent)	4.7	4.3	4.3	4.1	3.9	3.9	3.9	3.8	4.9	4.4	3.9	3.8
<b>Interest Rates (Percent)</b>												
Federal Funds	0.70	0.95	1.16	1.20	1.38	1.42	1.65	1.92	0.40	1.00	1.59	2.39
Treasury Note, 10-year	2.45	2.26	2.24	2.37	2.43	2.46	2.55	2.74	1.84	2.33	2.54	2.95
a = actual    f = forecast    p = preliminary    * Please see the Expanded Table for more forecast series.												

**Job Growth Averages 171,000 Per Month in 2017, Solid But Slower Than in 2016**



**Unemployment Rate Holds at 4.1% for Third Straight Month; Wage Growth Still Stuck at 2.5%**



## **New Tax Law Will Boost Near-Term Growth, But Do Little for Economy's Long-Term Prospects**

The U.S. economy is on solid footing heading into 2018, and growth will get a boost from cuts to corporate and personal income taxes. Real GDP growth, which was 1.6 percent in 2016, came in at 2.3 percent in 2017, and will accelerate to 2.7 percent this year.

Business fixed investment will lead economic growth this year. With demand continuing to improve and the tight job market making it difficult to hire, businesses are investing to make their workers more productive and increase output. Although interest rates are rising they remain low on an historical basis, encouraging borrowing for investment; good business balance sheets are another positive. Near-record corporate profits and easing access to credit will also support business investment in 2018. Additional support will come from the corporate income tax cut that Congress passed and President Trump signed into law in late 2017. This will boost after-tax profits and provide more cash for investing. In particular, reduced taxes on corporate profits earned abroad will encourage U.S.-based businesses to repatriate profits from overseas, providing a source of investment funding. There are also incentives in the tax bill for near-term business investment.

However, the corporate tax cut is unlikely to provide much of a longer-term boost to business investment. Businesses are already making near-record corporate profits, and using much of them to fund dividend payments and stock buybacks to boost share prices. Given this, businesses are likely to use much of their tax savings to further boost dividends and buybacks, not for investment. That being said, higher equity prices will provide support to consumer spending among stock-holding households.

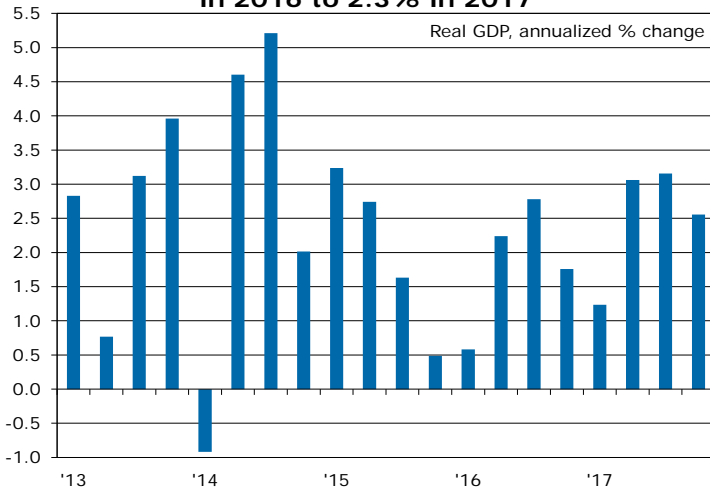
Consumer spending will also expand in 2018, supporting overall economic growth. The fundamentals for households remain solid: job and income gains, low interest rates, low levels of debt relative to income, and rising wealth. Personal income tax cuts in the new law will also provide a boost. However, with higher energy prices and mediocre wage growth, household spending rose more quickly than incomes in 2016 and 2017, causing the savings rate to decline from above 6 percent in late 2015 to 2.4 percent at the end of 2017. A need to boost saving will restrain spending growth this year.

Housing will be another positive for growth in 2018. Affordability remains good with the interest rate on a 30-year fixed mortgage near 4 percent. Lending standards have eased after they tightened dramatically following the housing bust, and single-family homeownership is coming back into favor after it plunged in the wake of the Great Recession. Rising house prices will also spur new construction, and building is getting an additional boost from reconstruction in the aftermath of Hurricanes Harvey and Irma. However, a lack of skilled construction workers will limit the improvement in homebuilding.

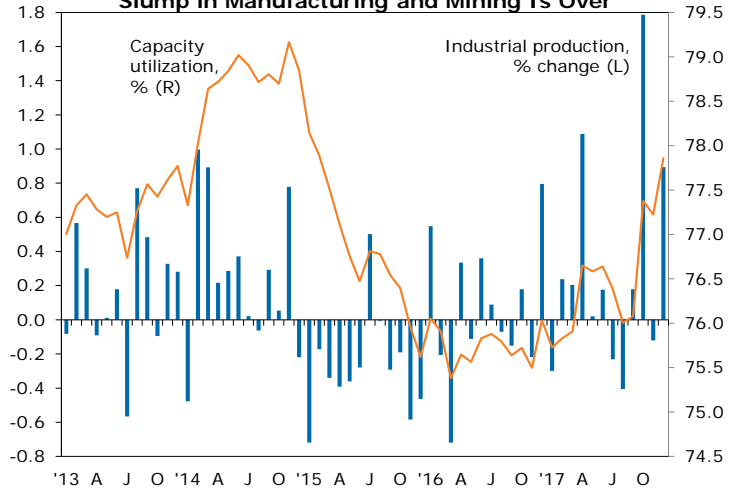
Although growth will accelerate in 2018, it will gradually return to its long-run level of around 2 percent in subsequent years. The current tax bill reduces corporate income tax rates, but will do little to boost investment that would raise the economy's capacity over the longer run. The tax code remains filled with special interest provisions that benefit favored constituencies, leading to an inefficient allocation of capital in the economy. In addition, larger budget deficits because of reduced revenues will put upward pressure on interest rates, offsetting much of the benefit of the tax cuts.

The job market will continue to improve in 2018. Job gains will slow, from around 170,000 per month in 2017 to 140,000 per month this year, as businesses find it more and more difficult to hire as the labor market further tightens. The unemployment rate will fall a bit, bottoming out at around 3.7%. As inflation pressures gradually build the Federal Open Market Committee will raise the federal funds rate three times this year, bringing it to a range of 2.00 to 2.25 percent at the end of 2018.

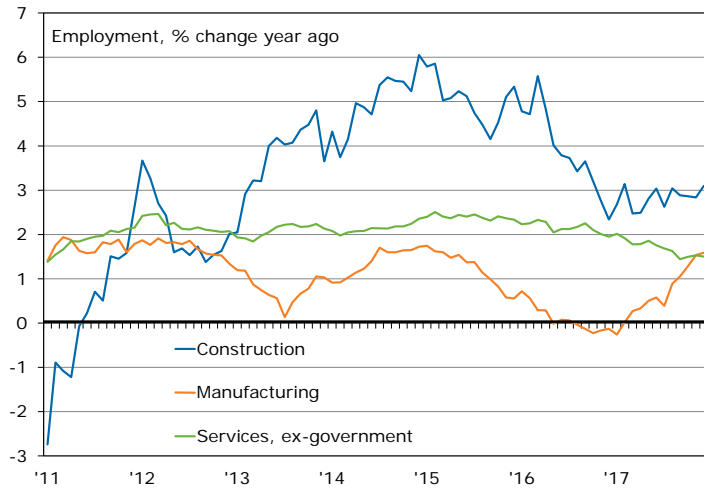
**Growth Picks Up From 1.6% in 2016 to 2.3% in 2017**



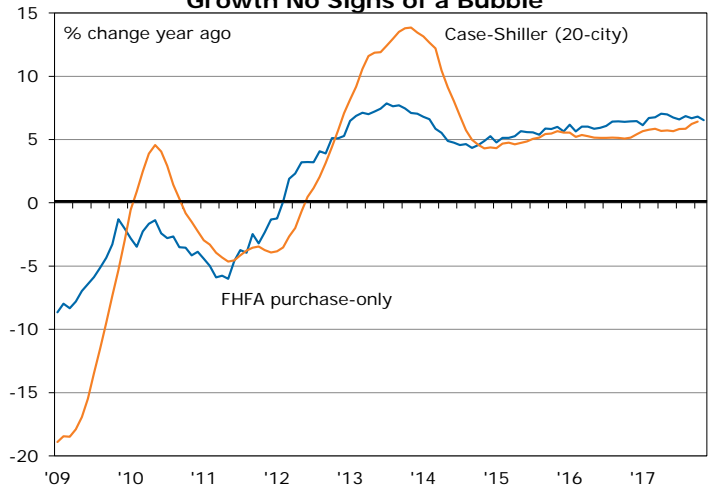
**With Higher Energy Prices, Weaker Dollar, Slump in Manufacturing and Mining Is Over**



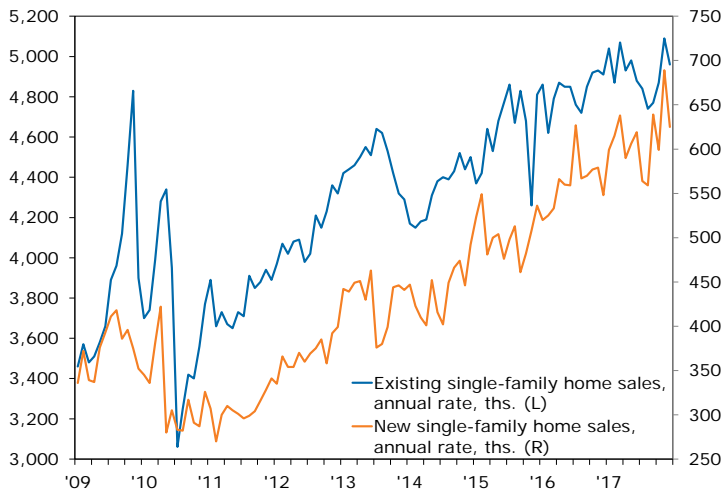
**Tight Labor Market Will Restrain Job Growth in 2018**



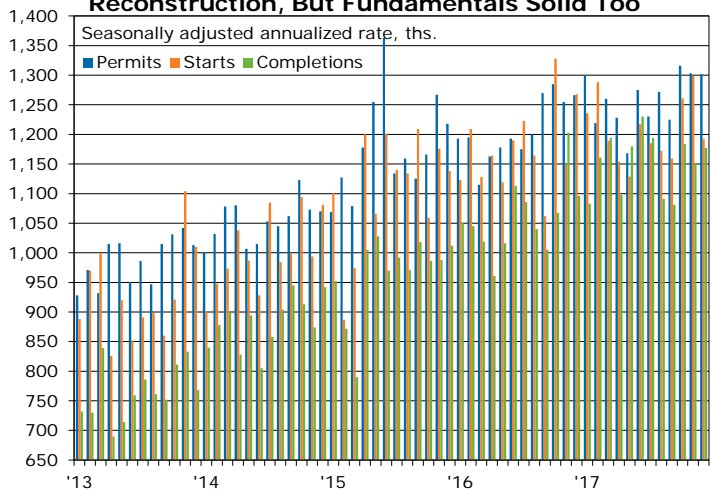
**With Moderate House Price Growth No Signs of a Bubble**



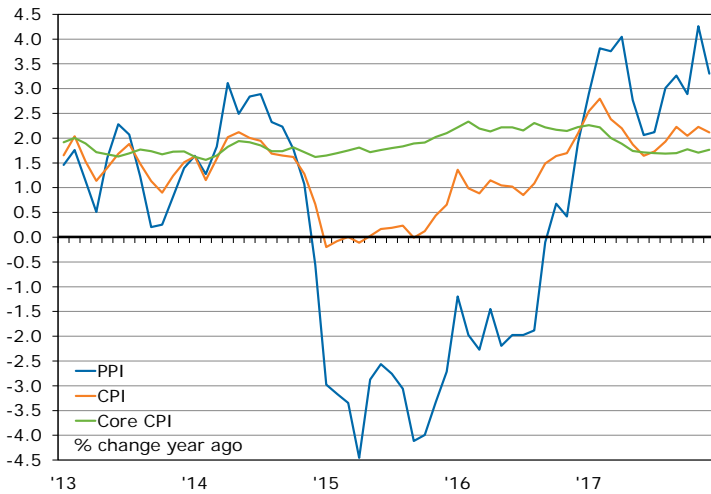
**Housing Recovery in Its Seventh Year**



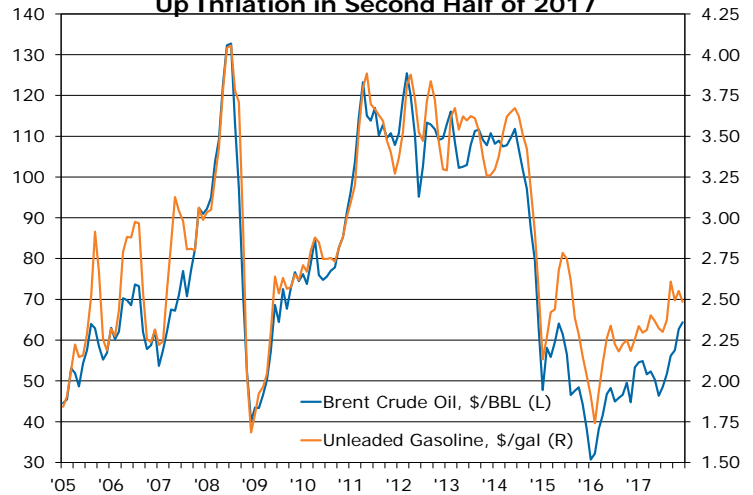
**Homebuilding Gets a Boost From Hurricane Reconstruction, But Fundamentals Solid Too**



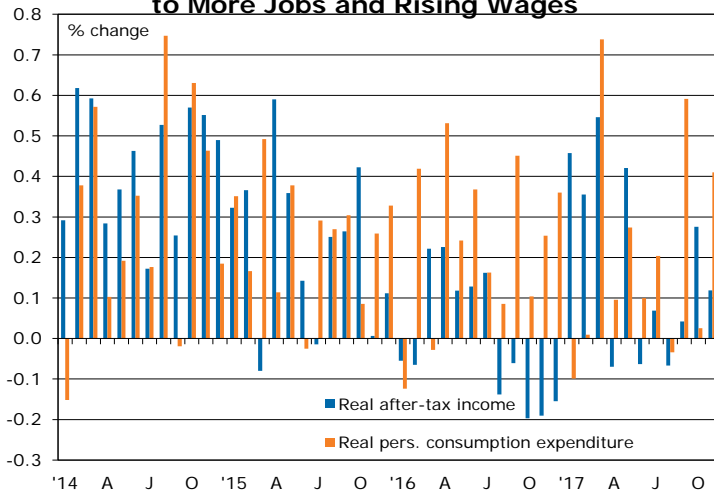
## No Signs Yet of a Pickup in Core Inflation



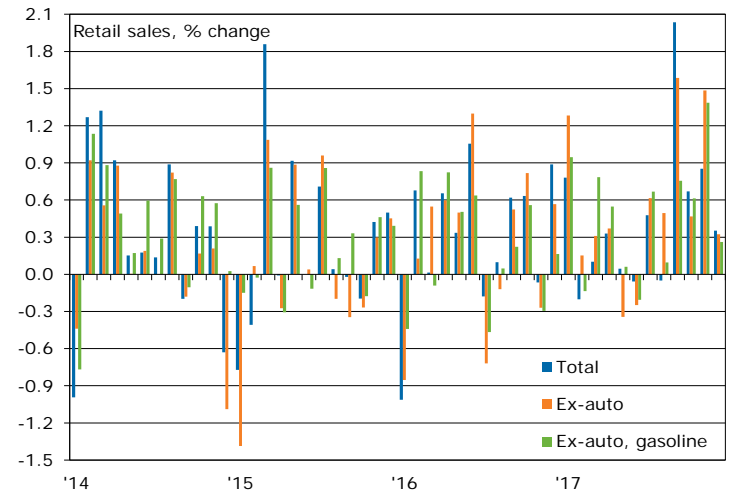
## Higher Oil and Gasoline Prices Pushed Up Inflation in Second Half of 2017



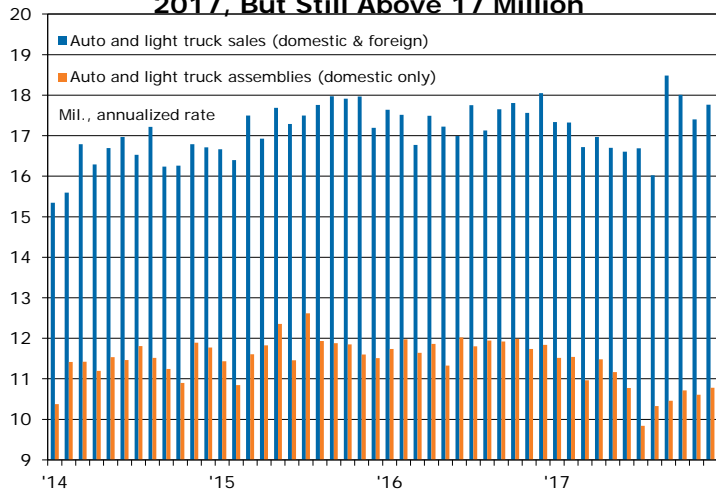
## Consumers Are Spending Thanks to More Jobs and Rising Wages



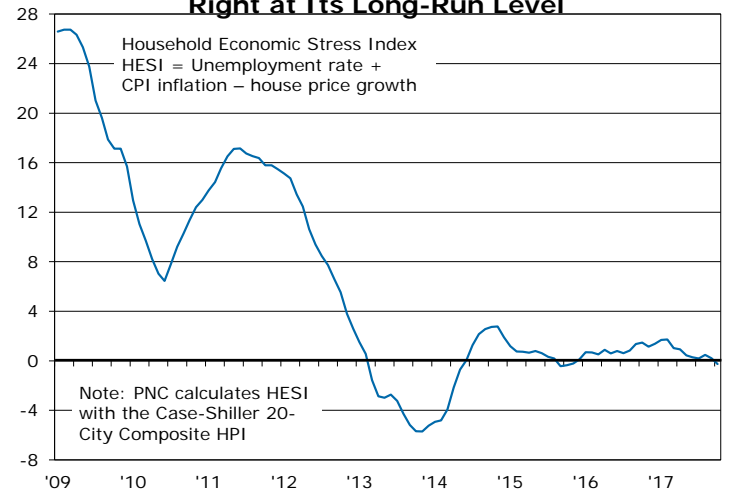
## Another Good Month for Retail Sales in December



## Auto Sales Dipped Slightly in 2017, But Still Above 17 Million



## Household Economic Stress Right at Its Long-Run Level



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# NATIONAL ECONOMIC OUTLOOK

PNC Economics Group  
January, 2018

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

	1Q'17a	2Q'17a	3Q'17p	4Q'17f	1Q'18f	2Q'18f	3Q'18f	4Q'18f	2016a	2017f	2018f	2019f
<b>Output</b>												
Nominal GDP (Billions \$)	19058	19250	19501	19778	19984	20224	20454	20680	18624	19397	20336	21222
Percent Change Annualized	3.3	4.1	5.3	5.8	4.2	4.9	4.6	4.5	2.8	4.1	4.8	4.4
Real GDP (Chained 2009 Billions \$)	16903	17031	17164	17303	17412	17520	17619	17720	16716	17100	17568	17940
Percent Change Annualized	1.2	3.1	3.2	3.3	2.5	2.5	2.3	2.3	1.5	2.3	2.7	2.1
Pers. Consumption Expenditures	11758	11853	11917	12011	12066	12119	12186	12254	11572	11885	12156	12409
Percent Change Annualized	1.9	3.3	2.2	3.2	1.8	1.8	2.2	2.3	2.7	2.7	2.3	2.1
Nonresidential Fixed Investment	2264	2301	2327	2356	2389	2418	2443	2460	2210	2312	2428	2488
Percent Change Annualized	7.2	6.7	4.7	5.0	5.9	4.9	4.1	2.9	-0.6	4.6	5.0	2.5
Residential Investment	606	594	587	600	606	612	617	622	587	597	614	631
Percent Change Annualized	11.1	-7.3	-4.7	9.1	4.0	4.0	3.4	3.1	5.5	1.6	2.9	2.8
Change in Private Inventories	1	5	39	41	55	63	57	54	33	22	57	52
Net Exports	-622	-614	-598	-616	-628	-631	-636	-637	-586	-612	-633	-639
Government Expenditures	2897	2895	2900	2919	2931	2947	2961	2975	2900	2903	2954	3007
Percent Change Annualized	-0.6	-0.2	0.7	2.6	1.8	2.2	1.9	2.0	0.8	0.1	1.8	1.8
Industrial Prod. Index (2012 = 100)	103.7	105.1	104.9	106.4	106.5	107.0	107.6	108.1	103.1	105.0	107.3	109.3
Percent Change Annualized	1.5	5.6	-0.9	5.9	0.3	2.0	2.3	1.9	-1.2	1.9	2.2	1.8
Capacity Utilization (Percent)	75.8	76.6	76.2	78.0	78.1	78.3	78.4	78.5	75.7	76.7	78.3	78.9
<b>Prices</b>												
CPI (1982-84 = 100)	244.1	243.9	245.2	247.5	249.0	250.3	251.7	253.2	240.0	245.2	251.0	256.8
Percent Change Annualized	3.1	-0.3	2.0	3.8	2.6	2.0	2.3	2.3	1.3	2.1	2.4	2.3
Core CPI Index (1982-84 = 100)	251.0	251.4	252.4	253.7	255.0	256.4	257.8	259.2	247.6	252.1	257.1	262.7
Percent Change Annualized	2.5	0.6	1.7	2.1	2.0	2.2	2.2	2.2	2.2	1.8	2.0	2.2
PCE Price Index (2009 = 100)	112.2	112.3	112.7	113.4	113.8	114.3	114.9	115.4	110.8	112.6	114.6	116.9
Percent Change Annualized	2.2	0.3	1.5	2.6	1.4	1.7	2.0	2.0	1.2	1.7	1.7	2.0
Core PCE Price Index (2009 = 100)	112.6	112.8	113.2	113.7	114.2	114.8	115.4	116.0	111.4	113.1	115.1	117.4
Percent Change Annualized	1.8	0.9	1.3	1.7	1.9	2.0	2.0	2.0	1.8	1.5	1.8	2.0
GDP Price Index (2009 = 100)	112.7	113.0	113.6	114.3	114.8	115.5	116.2	116.8	111.4	113.4	115.8	118.4
Percent Change Annualized	2.0	1.0	2.1	2.5	1.7	2.4	2.4	2.2	1.3	1.8	2.1	2.2
Crude Oil, WTI (\$/Barrel)	51.6	48.1	48.1	56.0	60.4	59.7	60.5	61.7	43.2	51.0	60.6	63.9
<b>Labor Markets</b>												
Payroll Jobs (Millions)	145.7	146.2	146.7	147.2	147.7	148.1	148.5	148.9	144.3	146.4	148.3	149.6
Percent Change Annualized	1.5	1.3	1.3	1.4	1.3	1.2	1.1	1.0	1.8	1.5	1.3	0.9
Unemployment Rate (Percent)	4.7	4.3	4.3	4.1	3.9	3.9	3.9	3.8	4.9	4.4	3.9	3.8
Average Weekly Hours, Prod. Works.	33.6	33.7	33.6	33.7	33.7	33.7	33.8	33.8	33.6	33.7	33.8	33.8
<b>Personal Income</b>												
Average Hourly Earnings (\$)	21.86	21.99	22.15	22.28	22.48	22.69	22.91	23.12	21.56	22.07	22.80	23.65
Percent Change Annualized	2.0	2.4	2.9	2.4	3.6	3.8	3.8	3.8	2.5	2.4	3.3	3.7
Real Disp. Income (2009 Billions \$)	12680	12765	12782	12798	12924	13022	13122	13213	12608	12756	13070	13392
Percent Change Annualized	2.9	2.7	0.5	0.5	4.0	3.1	3.1	2.8	1.4	1.2	2.5	2.5
<b>Housing</b>												
Housing Starts (Ths., Ann. Rate)	1238	1167	1172	1220	1256	1278	1302	1319	1177	1199	1289	1344
Ext. Home Sales (Ths., Ann Rate)	5620	5563	5387	5522	5627	5719	5800	5857	5440	5523	5751	5930
New SF Home Sales (Ths., Ann Rate)	617	605	586	616	639	649	660	667	561	606	654	679
Case/Shiller HPI (Jan. 2000 = 100)	188.0	189.9	192.6	194.0	195.2	196.1	197.1	197.9	181.1	191.1	196.6	199.9
Percent Change Year Ago	5.6	5.8	6.0	4.8	3.8	3.3	2.3	2.0	5.1	5.5	2.8	1.7
<b>Consumer</b>												
Household Economic Stress Index	1.6	0.5	0.3	1.4	2.1	3.2	4.2	4.1	1.0	1.0	3.4	4.4
Auto Sales (Millions)	17.1	16.8	17.1	17.7	17.3	17.0	16.9	16.9	17.5	17.2	17.0	16.7
Consumer Credit (Billions \$)	3693	3736	3782	3866	3885	3927	3970	4014	3559	3769	3949	4118
Percent Change Annualized	5.3	4.8	5.0	9.2	2.0	4.3	4.5	4.6	3.7	5.9	4.8	4.3
<b>Interest Rates (Percent)</b>												
Prime Rate	3.80	4.05	4.25	4.29	4.50	4.54	4.78	5.05	3.51	4.10	4.72	5.45
Federal Funds	0.70	0.95	1.16	1.20	1.38	1.42	1.65	1.92	0.40	1.00	1.59	2.39
3-Month Treasury Bill	0.61	0.91	1.05	1.23	1.43	1.52	1.66	1.91	0.32	0.95	1.63	2.34
10-Year Treasury Note	2.45	2.26	2.24	2.37	2.43	2.46	2.55	2.74	1.84	2.33	2.54	2.95
30-Year Fixed Mortgage	4.17	3.99	3.90	3.92	3.95	4.01	4.11	4.29	3.65	3.99	4.09	4.50
a = actual    f = forecast    p = preliminary												

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