

NATIONAL ECONOMIC OUTLOOK

Gus Faucher
Chief Economist

Stuart Hoffman
Senior Economic Advisor

William Adams
Senior Economist

Kurt Rankin
Economist

THE PNC FINANCIAL SERVICES GROUP | The Tower at PNC Plaza | 300 Fifth Avenue | Pittsburgh, PA 15222-2401

Executive Summary

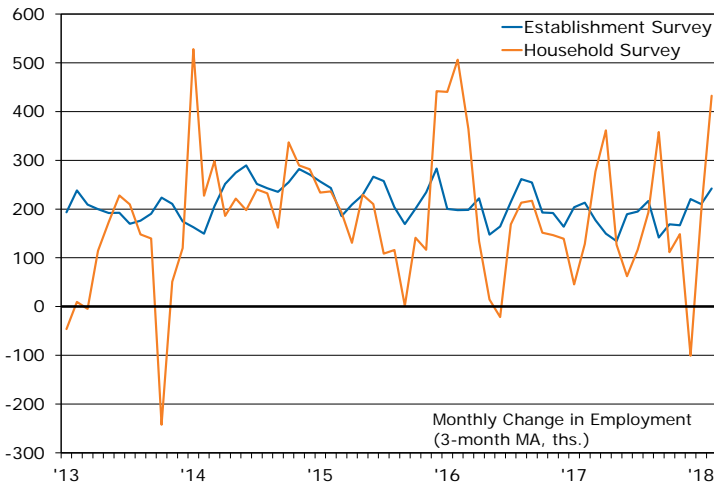
Job Growth Picks Up in 2018, Inflation Pressures Are Building

- U.S. job growth has accelerated in late 2017 and early 2018, with a very strong February jobs report. The U.S. economy added 239,000 jobs in January and 313,000 in February, compared to an average of 182,000 per month in 2017. The unemployment rate was 4.1 percent for a fifth straight month in February; 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, held steady from January to February at 8.2 percent, slightly above its low prior to the Great Recession. One recent positive is that labor force growth has picked up over the last few months, with the share of adults either working or looking for work jumping from 62.7 percent in January to 63.0 percent in February; stronger labor force growth allows for stronger overall economic growth.
- GDP growth, adjusted for inflation, was 2.5 percent at an annual rate in the fourth quarter of 2017 according to the second estimate. This was a slowing from 3.2 percent growth in the third quarter, but the details were good. Final sales of domestic product, which is GDP minus inventories and measures demand for U.S.-produced goods and services, increased 3.2 percent in the fourth quarter, up from 2.4 percent in the third quarter; inventories were a large positive for growth in the third quarter, but a big negative for growth in the fourth quarter. Consumer spending was up 2.5 percent annualized in the fourth quarter, while business fixed investment rose 6.6 percent. Investment in housing rose 13.0 percent, supported by rebuilding in the aftermath of Hurricanes Harvey and Irma. Government added to growth in the fourth quarter, while trade was a large drag.
- Inflation is slowly picking up. Wage growth, although uneven, has accelerated in recent months as the tight job market has forced employers to increase pay; higher labor costs will spur firms to raise prices. On a year-ago basis both overall and core (excluding food and energy) inflation, as measured by the consumer price index, accelerated in February. Inflation, as measured by the personal consumption expenditures price index, remains below the Federal Reserve's 2 percent goal, but should move toward it throughout 2018; this will lead the Federal Open Market Committee to gradually raise short-term interest rates to prevent the economy from overheating.

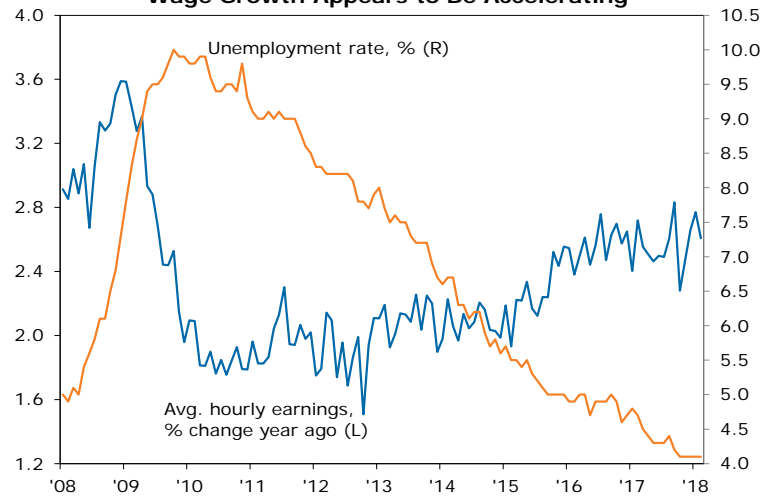
Baseline U.S. Economic Outlook, Summary Table*

	1Q'17a	2Q'17a	3Q'17a	4Q'17p	1Q'18f	2Q'18f	3Q'18f	4Q'18f	2016a	2017p	2018f	2019f
Output & Prices												
Real GDP (Chained 2009 Billions \$)	16903	17031	17164	17272	17357	17496	17632	17774	16716	17092	17565	18073
Percent Change Annualized	1.2	3.1	3.2	2.5	2.0	3.3	3.1	3.3	1.5	2.3	2.8	2.9
CPI (1982-84 = 100)	243.9	244.0	245.3	247.3	249.6	250.6	251.8	253.0	240.0	245.1	251.2	256.5
Percent Change Annualized	3.0	0.1	2.1	3.3	3.7	1.6	1.9	2.0	1.3	2.1	2.5	2.1
Labor Markets												
Payroll Jobs (Millions)	145.9	146.3	146.9	147.4	148.1	148.7	149.2	149.7	144.3	146.6	149.0	150.6
Percent Change Annualized	1.6	1.3	1.5	1.5	1.9	1.6	1.4	1.3	1.8	1.6	1.6	1.1
Unemployment Rate (Percent)	4.7	4.3	4.3	4.1	4.1	3.9	3.8	3.7	4.9	4.4	3.9	3.6
Interest Rates (Percent)												
Federal Funds	0.70	0.95	1.16	1.20	1.43	1.63	1.64	1.91	0.40	1.00	1.65	2.39
Treasury Note, 10-year	2.45	2.26	2.24	2.37	2.77	2.92	3.00	3.14	1.84	2.33	2.96	3.36
a = actual f = forecast p = preliminary * Please see the Expanded Table for more forecast series.												

Job Growth Has Picked Back Up in Recent Months



Unemployment Rate Again at 4.1%; Wage Growth Appears to Be Accelerating



Federal Spending Increases Another Positive for Growth in 2018, Although Trade War a Downside Risk

With strong support from fiscal policy, U.S. economic growth will accelerate in 2018 and remain strong into 2019. Corporate and personal income tax cuts were enacted in late 2017, and Congress raised spending caps in February for fiscal years 2018 and 2019. However, one downside risk to the outlook comes from trade; while the Trump administration's new tariffs on steel and aluminum will have little impact on the U.S. economy in and of themselves, the potential for larger trade disruptions looms over the U.S. and global economies.

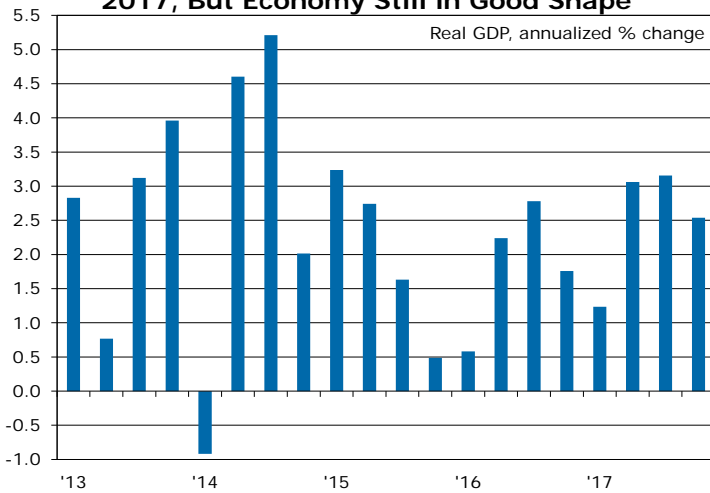
In 2013, amid concerns about the budget deficit, President Obama and Congress agreed to strict limits, or spending caps, on defense and nondefense discretionary spending; discretionary spending is that which Congress must vote on every year, as opposed to entitlement spending, which continues automatically. However, many in Congress chafed at these limits, arguing that they were making it difficult to adequately fund federal priorities. In February of this year, as part of a deal to pass a budget for fiscal year 2018 (which began on October 1, 2017), Congress voted to raise the caps on discretionary spending for fiscal years 2018 and 2019. Defense spending will receive a two-year boost of about \$165 billion, and non-defense spending of about \$130 billion. Because there were no offsetting spending cuts or tax increases, the federal government will fund the increased spending through borrowing, leading to larger budget deficits.

The increase in spending will boost near-term economic growth. The federal government will be purchasing more goods and services, adding to overall economic demand, without offsetting spending cuts or higher taxes that would reduce economic activity. This spending increase comes on top of deficit-financed cuts to corporate and personal income taxes that Congress passed at the end of 2017. Fiscal policy will provide a big near-term boost to growth, and in response PNC has raised its forecast for real GDP growth in 2018 to 2.8 percent (averaged across the four quarters of the year) and in 2019 to 2.9 percent. On a year-over-year basis inflation-adjusted growth will peak at 3.2 percent in the first quarter of 2019, before slowing as the impact of the tax cuts and spending increases fades. Stronger economic growth will make the job market even tighter, with the unemployment rate projected to fall to a low of 3.5 percent in 2019; this would be the lowest unemployment rate in about 50 years.

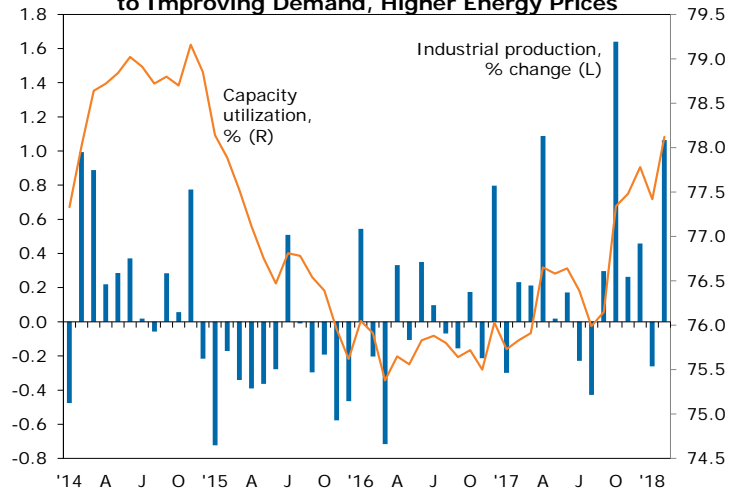
Although the near-term baseline outlook for the economy is very good, downside risks to the forecast have grown with the Trump administration's decision to impose import tariffs of 25 percent on steel and 10 percent on aluminum, citing national security. The actual impact of the tariffs on the economy will be very small; imports of steel and aluminum account for only 0.2 percent of U.S. GDP, and domestic production of the two for just 0.5 percent of GDP. In addition, the Trump administration has exempted Canada and Mexico from the tariffs, and could exempt other U.S. security partners, lessening their impact. The tariffs will lead to higher costs and reduced demand for U.S. industries that use steel and aluminum, including construction and vehicle manufacturing, leading to a small net loss in domestic output.

The larger concern is that the tariffs could spark a trade war, as other nations raise tariffs on U.S.-made goods in response, leading to further back-and-forth responses. The European Union has already threatened higher tariffs on politically sensitive U.S. industries. Right now the global economy is in good shape, with almost all of the world's major economies expanding; escalating trade restrictions could put the world expansion at risk. A weaker U.S. dollar and solid global growth are boosting U.S. exports, but an escalation of trade restrictions could quickly become a problem for U.S. exporters. This is not the most likely outcome, but is a concern.

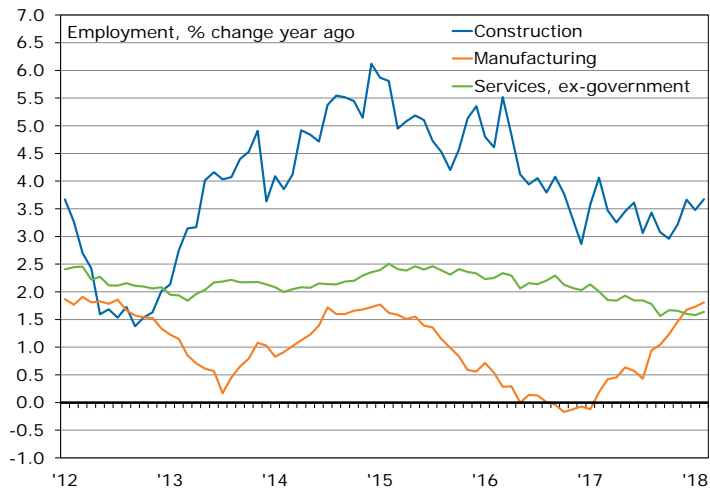
Inventories Weighed on Growth in Late 2017, But Economy Still in Good Shape



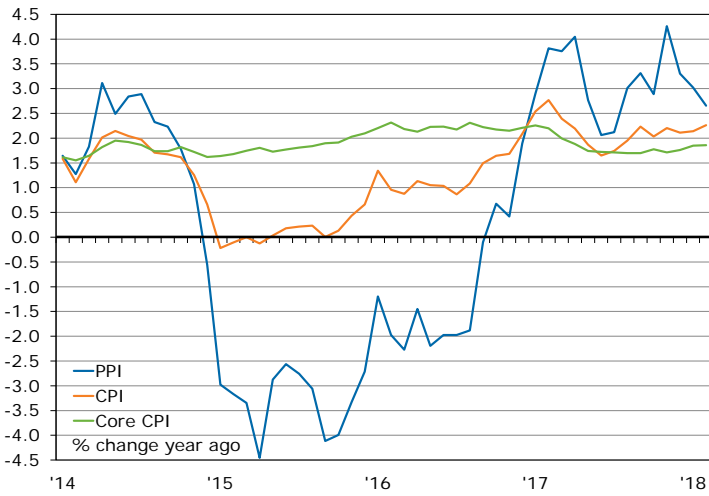
Steady Expansion in Industrial Sector Thanks to Improving Demand, Higher Energy Prices



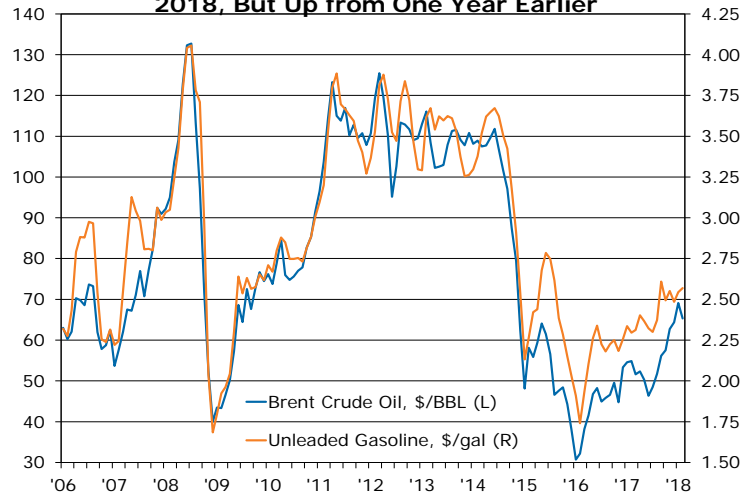
Job Growth Is Broad-Based Across Industries



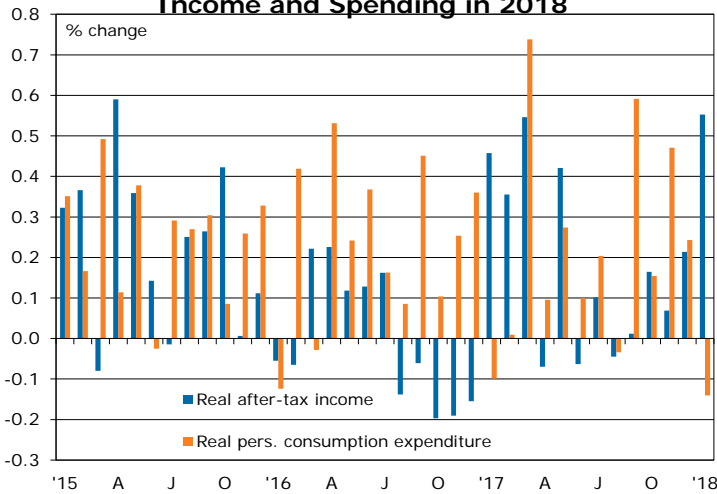
Consumer Inflation May Be Picking Up



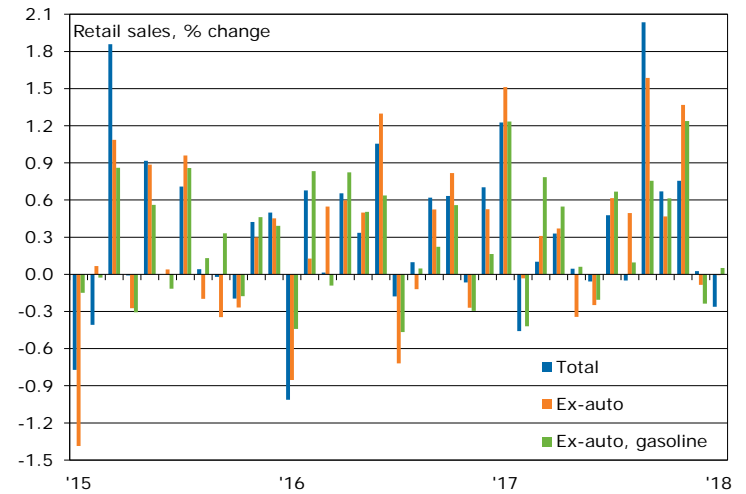
Energy Prices Are Flat in Early 2018, But Up from One Year Earlier



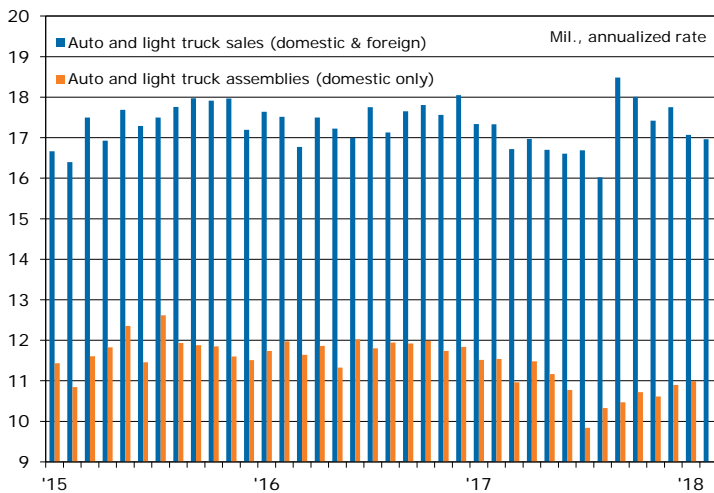
Tax Cuts Will Boost Consumer Income and Spending in 2018



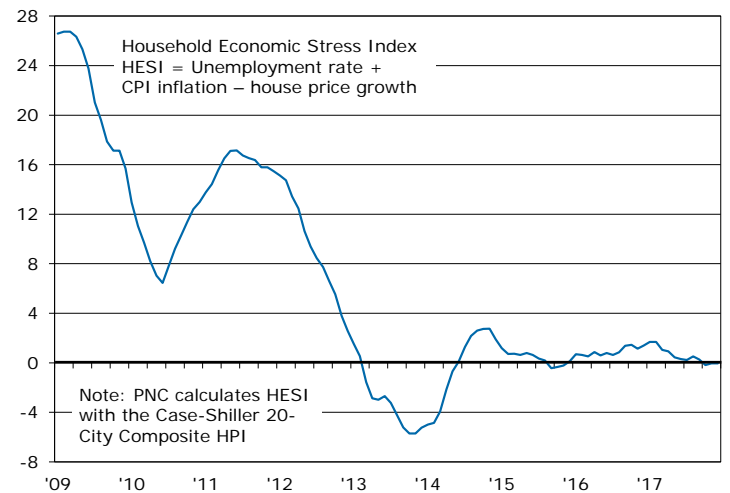
No Sign of Tax Cuts in Retail Sales, Yet



Slower, But Still Solid, Auto Sales So Far This Year



Households Will Remain in Good Shape in 2018



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PNC Economics Group
March, 2018

Baseline U.S. Economic Outlook, Expanded Table

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Output												
Nominal GDP (Billions \$)	19058	19250	19501	19736	19968	20232	20494	20763	18624	19386	20364	21400
Percent Change Annualized	3.3	4.1	5.3	4.9	4.8	5.4	5.3	5.4	2.8	4.1	5.0	5.1
Real GDP (Chained 2009 Billions \$)	16903	17031	17164	17272	17357	17496	17632	17774	16716	17092	17565	18073
Percent Change Annualized	1.2	3.1	3.2	2.5	2.0	3.3	3.1	3.3	1.5	2.3	2.8	2.9
Pers. Consumption Expenditures	11758	11853	11917	12028	12067	12143	12220	12295	11572	11889	12181	12454
Percent Change Annualized	1.9	3.3	2.2	3.8	1.3	2.5	2.6	2.5	2.7	2.7	2.5	2.2
Nonresidential Fixed Investment	2264	2301	2327	2364	2387	2426	2471	2515	2210	2314	2450	2597
Percent Change Annualized	7.2	6.7	4.7	6.6	3.9	6.8	7.6	7.3	-0.6	4.7	5.9	6.0
Residential Investment	606	594	587	605	616	616	619	626	587	598	619	641
Percent Change Annualized	11.1	-7.3	-4.7	13.0	7.4	-0.4	2.4	4.2	5.5	1.8	3.6	3.5
Change in Private Inventories	1	5	39	8	38	55	57	54	33	13	51	57
Net Exports	-622	-614	-598	-652	-680	-691	-706	-720	-586	-621	-699	-743
Government Expenditures	2897	2895	2900	2921	2932	2950	2972	3006	2900	2903	2965	3069
Percent Change Annualized	-0.6	-0.2	0.7	2.9	1.6	2.4	3.1	4.6	0.8	0.1	2.1	3.5
Industrial Prod. Index (2012 = 100)	103.7	105.1	104.8	106.9	107.5	108.4	109.2	109.8	103.1	105.1	108.7	110.9
Percent Change Annualized	1.5	5.6	-1.2	8.3	2.3	3.2	3.0	2.3	-1.2	2.0	3.4	2.0
Capacity Utilization (Percent)	75.8	76.6	76.2	77.5	78.0	78.4	78.7	78.9	75.7	76.5	78.5	79.3
Prices												
CPI (1982-84 = 100)	243.9	244.0	245.3	247.3	249.6	250.6	251.8	253.0	240.0	245.1	251.2	256.5
Percent Change Annualized	3.0	0.1	2.1	3.3	3.7	1.6	1.9	2.0	1.3	2.1	2.5	2.1
Core CPI Index (1982-84 = 100)	250.9	251.4	252.5	253.9	255.7	257.2	258.7	260.1	247.6	252.2	257.9	263.7
Percent Change Annualized	2.2	0.8	1.8	2.2	2.8	2.5	2.3	2.2	2.2	1.8	2.3	2.2
PCE Price Index (2009 = 100)	112.2	112.3	112.7	113.5	114.3	114.7	115.1	115.6	110.8	112.7	114.9	117.1
Percent Change Annualized	2.2	0.3	1.5	2.7	2.9	1.4	1.6	1.8	1.2	1.7	2.0	1.9
Core PCE Price Index (2009 = 100)	112.6	112.8	113.2	113.8	114.5	115.1	115.7	116.3	111.4	113.1	115.4	117.7
Percent Change Annualized	1.8	0.9	1.3	1.9	2.6	2.2	2.1	2.0	1.8	1.5	2.0	2.0
GDP Price Index (2009 = 100)	112.7	113.0	113.6	114.3	115.1	115.7	116.3	116.9	111.4	113.4	116.0	118.5
Percent Change Annualized	2.0	1.0	2.1	2.3	2.8	2.2	2.1	2.1	1.3	1.8	2.3	2.2
Crude Oil, WTI (\$/Barrel)	51.6	48.1	48.1	55.3	62.7	61.9	62.7	63.9	43.2	50.8	62.8	66.1
Labor Markets												
Payroll Jobs (Millions)	145.9	146.3	146.9	147.4	148.1	148.7	149.2	149.7	144.3	146.6	149.0	150.6
Percent Change Annualized	1.6	1.3	1.5	1.5	1.9	1.6	1.4	1.3	1.8	1.6	1.6	1.1
Unemployment Rate (Percent)	4.7	4.3	4.3	4.1	4.1	3.9	3.8	3.7	4.9	4.4	3.9	3.6
Average Weekly Hours, Prod. Works.	33.6	33.7	33.6	33.7	33.7	33.8	33.8	33.8	33.6	33.7	33.8	33.9
Personal Income												
Average Hourly Earnings (\$)	21.85	21.98	22.12	22.24	22.39	22.58	22.80	23.02	21.55	22.05	22.70	23.57
Percent Change Annualized	2.2	2.4	2.6	2.1	2.7	3.4	4.0	3.9	2.5	2.3	2.9	3.8
Real Disp. Income (2009 Billions \$)	12680	12765	12787	12822	12931	13005	13090	13167	12608	12763	13048	13345
Percent Change Annualized	2.9	2.7	0.7	1.1	3.4	2.3	2.6	2.4	1.4	1.2	2.2	2.3
Housing												
Housing Starts (Ths., Ann. Rate)	1238	1167	1172	1256	1311	1278	1299	1325	1177	1208	1303	1365
Ext. Home Sales (Ths., Ann Rate)	5600	5547	5403	5593	5672	5670	5760	5853	5441	5536	5739	5962
New SF Home Sales (Ths., Ann Rate)	617	605	587	652	672	659	671	686	561	615	672	707
Case/Shiller HPI (Jan. 2000 = 100)	188.1	189.9	192.5	196.3	198.8	200.9	202.5	203.6	181.1	191.7	201.5	205.9
Percent Change Year Ago	5.6	5.8	5.9	6.1	5.7	5.8	5.2	3.7	5.1	5.9	5.1	2.2
Consumer												
Household Economic Stress Index	1.6	0.5	0.3	0.1	0.7	0.8	1.2	2.3	1.0	0.6	1.2	3.4
Auto Sales (Millions)	17.1	16.8	17.1	17.7	16.9	16.9	16.9	16.9	17.5	17.2	16.9	16.7
Consumer Credit (Billions \$)	3692	3735	3768	3841	3862	3921	3980	4046	3559	3759	3952	4192
Percent Change Annualized	5.3	4.7	3.6	8.0	2.2	6.3	6.1	6.8	3.7	5.6	5.1	6.1
Interest Rates (Percent)												
Prime Rate	3.80	4.05	4.25	4.29	4.53	4.75	4.76	5.03	3.51	4.10	4.77	5.44
Federal Funds	0.70	0.95	1.16	1.20	1.43	1.63	1.64	1.91	0.40	1.00	1.65	2.39
3-Month Treasury Bill	0.61	0.91	1.05	1.23	1.61	1.88	1.98	2.15	0.32	0.95	1.90	2.45
10-Year Treasury Note	2.45	2.26	2.24	2.37	2.77	2.92	3.00	3.14	1.84	2.33	2.96	3.36
30-Year Fixed Mortgage	4.17	3.99	3.88	3.92	4.26	4.46	4.56	4.72	3.65	3.99	4.50	4.93
<i>a = actual f = forecast p = preliminary</i>												

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