August 2020

NATIONAL ECONOMIC OUTLOOK

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Executive Summary

Steepest Contraction in U.S. History in Second Quarter, But Economy Is Starting to Pick Up

- U.S. real GDP contracted 31.6 percent at an annualized rate in the second quarter, according to the second estimate from the Bureau of Economic Analysis. This was by far the worst quarter for GDP in the history of the series, going back to 1947. This does not mean the U.S. economy contracted by almost one-third in the second quarter; the annualized number means that the economy would have contracted by 32 percent if the pace of decline in the second quarter lasted for an entire year. Since real GDP fell 5.0 percent annualized in the first quarter, the U.S. economy contracted 10.2 percent at an unannualized pace in the first half of 2020; that is, the U.S. economy was about 10 percent smaller in the second quarter of 2020 than it was in the fourth quarter of 2019. To put that in context, during the Great Recession, the previous worst U.S. economic downturn since the Great Depression, real GDP fell a total of 4.0 percent over six quarters. PNC's August forecast was prepared before the release of the second estimate, so it shows a 32.9 percent decline in the second quarter, based on the BEA's advance estimate.

- Although there was a record contraction in real GDP in the second quarter as a whole, economic activity has been picking up since May as states have allowed more activity. Retail sales in July were almost 2 percent above their February, pre-recession level. Total consumer spending through July, adjusted for inflation, has made up about three-quarters of the initial plunge between February and April. Housing is a particular source of strength. Record-low mortgage rates have spurred homebuying and homebuilding. Sales of new and existing single-family homes were at their highest levels since 2006 in July, and housing starts have made up most of their losses since the spring.

- The improving labor market is another indicator of the nascent recovery. The U.S. added 1.76 million jobs in July. Although this was down from the record 4.79 million jobs added in June, it was still the third-largest gain on record. While employment has increased by 9.2 million in the three months through July, it is still down by 12.9 million, or 8.4 percent, from the all-time high in February. The unemployment rate fell to 10.2 percent in July, from 11.1 percent in June and a record-high 14.7 percent in April. Unemployment remains extremely elevated, however; the rate was as low as 3.5 percent in February.

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

	2Q'20a	3Q'20f	4Q'20f	1Q'21f	2Q'21f	3Q'21f	2019a	2020f	2021f	2022f
Output & Prices										
Real GDP (*Chained 2012 Billions $*)	17206	17894	18217	18440	18634	18808	19092	18082	18712	19336
Percent Change Annualized	**-32.9**	**17.0**	**7.4**	**5.0**	**4.3**	**3.8**	**2.2**	**-5.3**	**3.5**	**3.3**
CPI (*1982-84 = 100*)	256.8	259.3	260.0	260.4	261.1	262.1	255.7	258.7	261.7	267.2
Percent Change Annualized	**-2.7**	**3.9**	**1.1**	**0.7**	**1.0**	**1.5**	**1.8**	**1.2**	**1.2**	**2.1**
Labor Markets										
Payroll Jobs (*Millions*)	133.7	139.3	142.8	144.3	145.4	146.4	150.9	141.9	145.9	149.7
Percent Change Annualized	**-40.0**	**17.7**	**10.4**	**4.5**	**3.0**	**2.7**	**1.4**	**-6.0**	**2.8**	**2.6**
Unemployment Rate (*Percent*)	13.0	9.9	9.0	8.5	8.0	7.3	3.7	8.9	7.6	5.7
Interest Rates (Percent)										
Federal Funds	0.06	0.08	0.07	0.07	0.07	0.07	2.16	0.36	0.07	0.07
10-Year Treasury Note	0.68	0.58	0.62	0.68	0.73	0.78	2.14	0.81	0.75	0.94

a = actual f = forecast p = preliminary **Please see the Expanded Table for more forecast series.*

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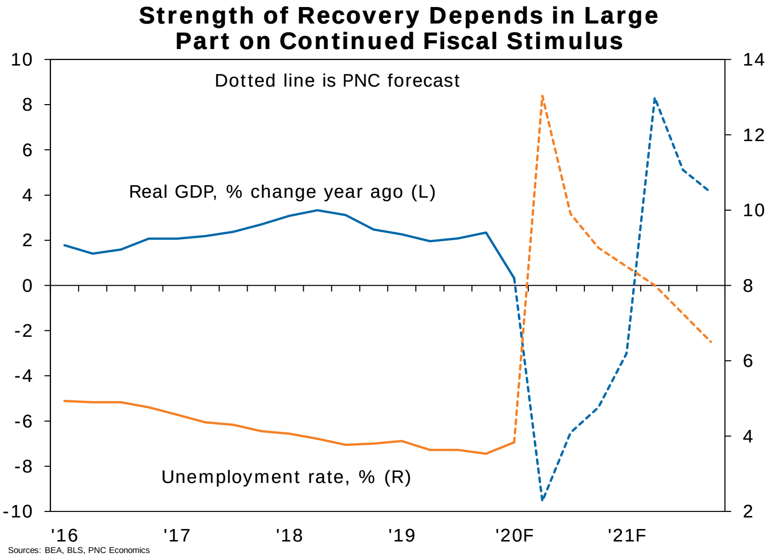
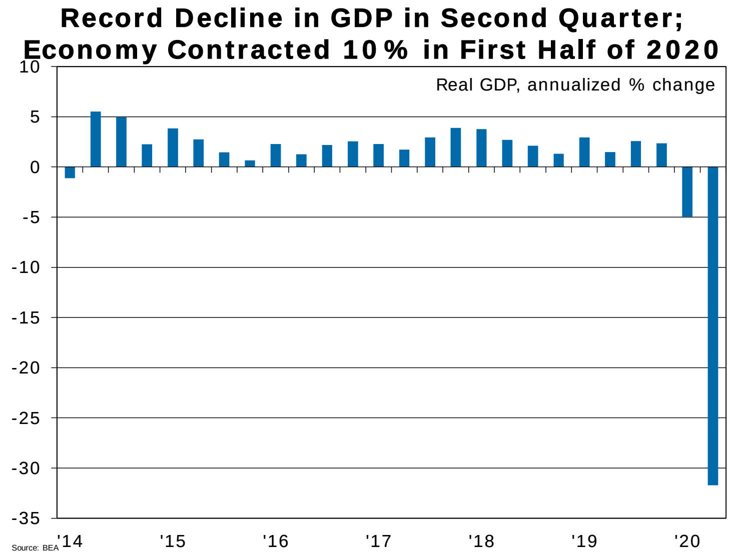




Expiration of Bonus Unemployment Benefits a Drag on Growth; Fed Changes Policy Framework

A recovery from the Viral Recession is underway in the United States, but the expiration of bonus unemployment insurance benefits at the end of July will weigh on household incomes and be a drag on near-term growth. Some support for economic recovery will come from the Federal Reserve; the central bank recently announced a new policy framework that points to extremely low interest rates for an extended period of time.

Consumer spending makes up about two-thirds of U.S. GDP, and thus households are vital to ensuring a strong recovery. The major reason why the economy started to bounce back in May is income support from the federal government. Although employment fell by 22 million, or 15 percent, between February and April of this year, real (inflation-adjusted) after-tax income surged by 14 percent over the same period as Congress and the Trump Administration responded quickly to the crisis. Transfer payments from the government more than doubled between February and April as many households received one-time stimulus checks, more people were made eligible for unemployment insurance (UI), and UI recipients received an extra $600 per week in benefits.

Although transfer income has since fallen because of the end of the one-time payments, real after-tax income in July was still up 6 percent from February; this is despite an unemployment rate of above 10 percent. This increase in household income during a downturn is unprecedented. As a result consumers have been able to increase their spending from April as businesses have reopened. However, some areas of consumer spending remain very weak, particularly services spending. Spending on restaurants, hotels, entertainment, air transportation, and travel remain far below their pre-recession levels, and will likely remain so until a vaccine is developed.

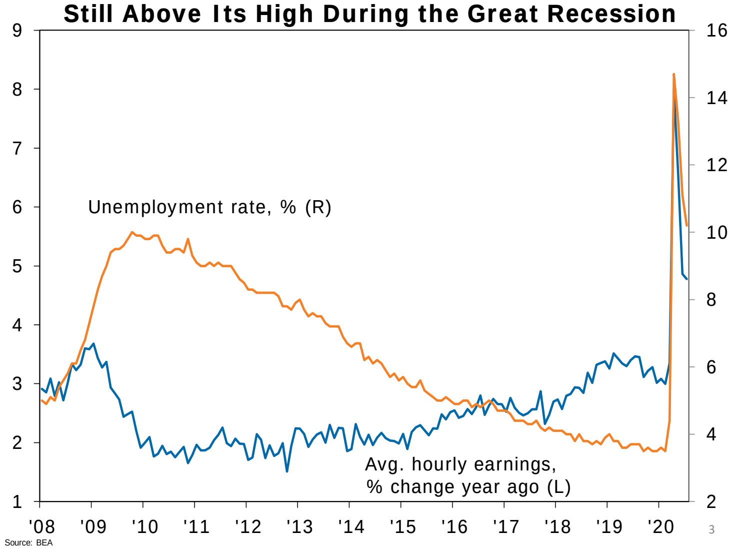
The extra $600 per week in UI benefits expired at the end of July, costing households about $70 billion in income a month, and Congressional negotiations to extend them have stalled. As a result many households with unemployed workers are cutting back on their spending. The Trump administration has attempted to replace at least some of those benefits through executive orders. As of late August 40 states have signed on to pay the extra benefits, covering about 80 percent of UI recipients. But the level of benefits will only be about one-half of what they were, only a few states have paid out benefits so far, and current funding would only allow for a few weeks of benefits. As a result, consumer spending growth is likely to weaken until there is a more permanent resolution, weighing on the overall economic recovery.

In a speech on August 27 Federal Reserve Chair Jerome Powell announced a shift in the Federal Reserve's monetary policy framework, with the Federal Open Market Committee adopting average inflation targeting. The inflation target remains 2 percent, but the FOMC will try to achieve inflation of around 2 percent "over time." According to the FOMC's statement, "following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time." Powell emphasized that average inflation targeting will be "flexible," not targeting the average to any particular formula.

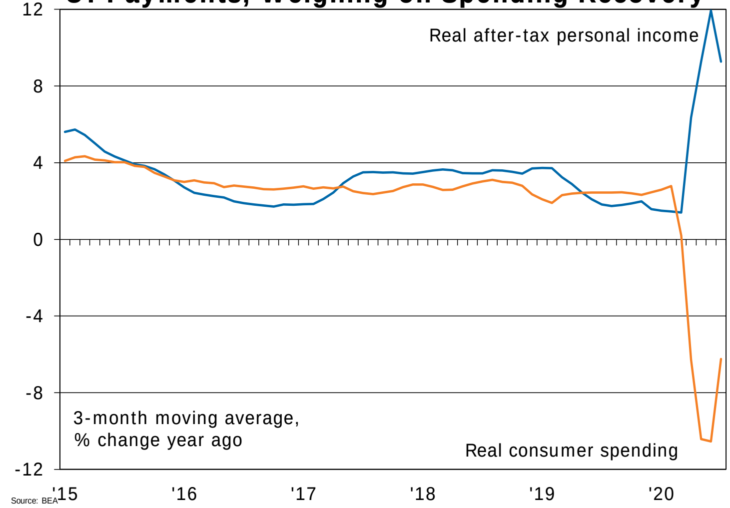
Also, the new policy will focus on "shortfalls" of employment from its full-employment level, rather than "deviations" as in the earlier policy. According to Powell, the use of "shortfalls" means that the FOMC may be less concerned about robust employment growth as long as inflation remains low and other economic imbalances do not develop. Taken together, along with very low current inflation, the policy changes indicate that the Fed will keep the federal funds rate, the central bank's short-term policy rate, near zero for an extended period of time, until there is a noticeable acceleration in inflation. PNC does not expect the next increase in the fed funds rate until 2024.

PNC's baseline forecast calls for economic growth of above 10 percent annualized in the second half of 2020, and of around 4 percent in 2021; this is well above the economy's long-run potential growth rate. Even so, real GDP is not expected to return to its pre-recession level until the first half of 2022. The unemployment rate will fall below 9 percent later this year, and end 2021 at above 6 percent and 2022 at above 5 percent. Risks to the outlook are weighted toward slower economic growth than expected, possibly due to continued spread of the coronavirus or an inability to provide the economy with sufficient fiscal stimulus.

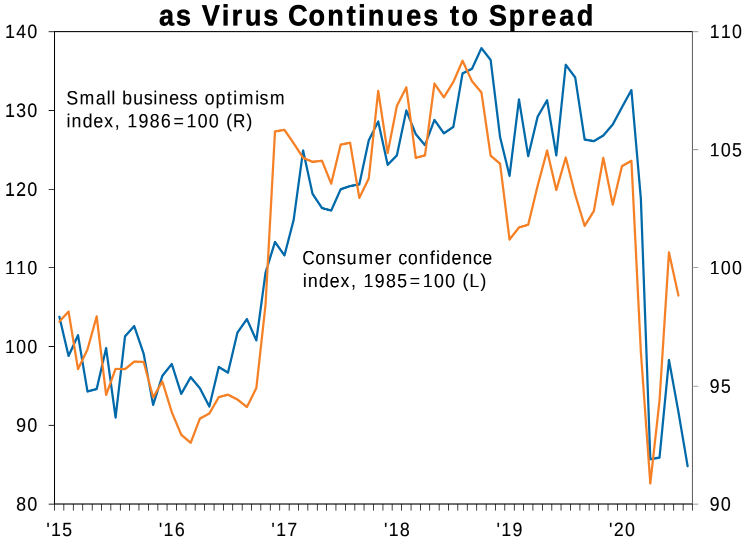
Unemployment Rate Has Fallen Quickly, But Is Still Above Its High During the Great Recession



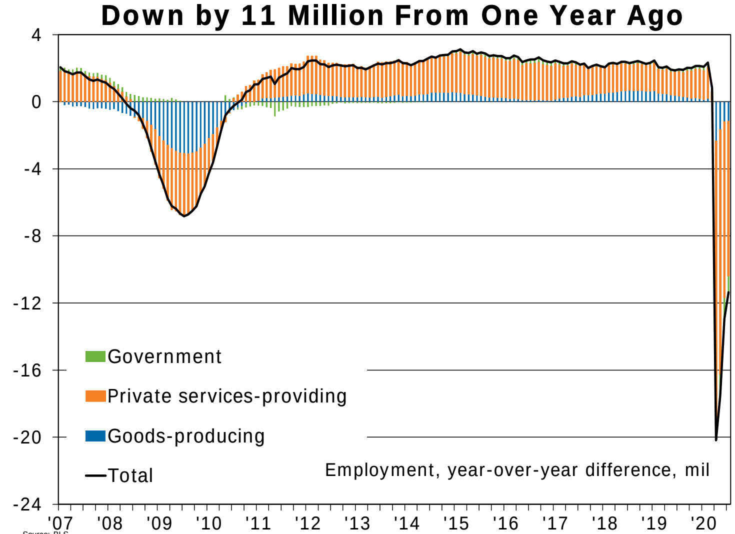
Big Income Gain at Risk With Expiration of Bonus UI Payments, Weighing on Spending Recovery



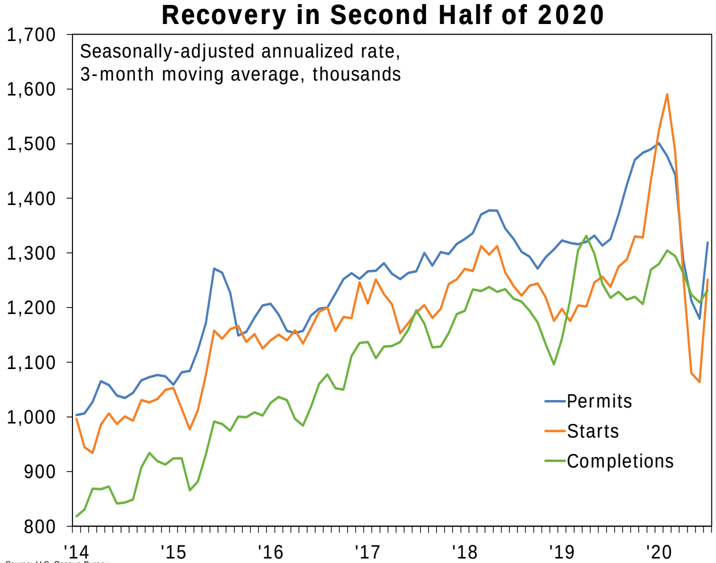
Confidence Measures Down as Virus Continues to Spread



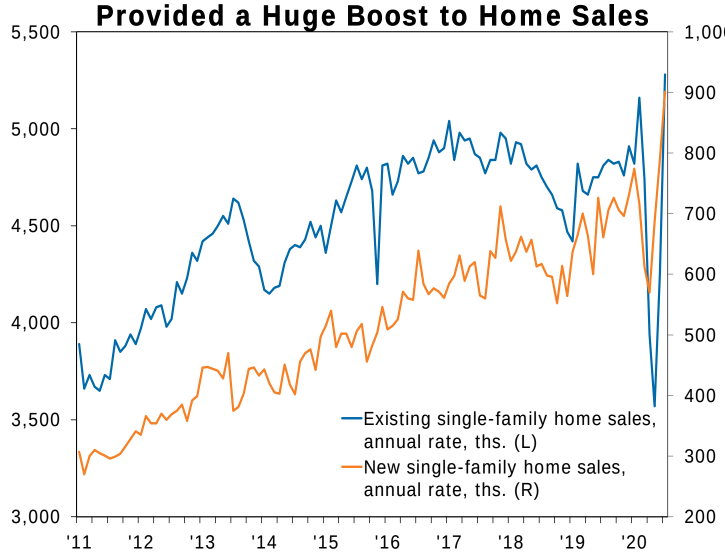
Jobs Up by 9 Million From April, But Still Down by 11 Million From One Year Ago



Homebuilding Will Be Key to Recovery in Second Half of 2020



Record-Low Mortgage Rates Have Provided a Huge Boost to Home Sales



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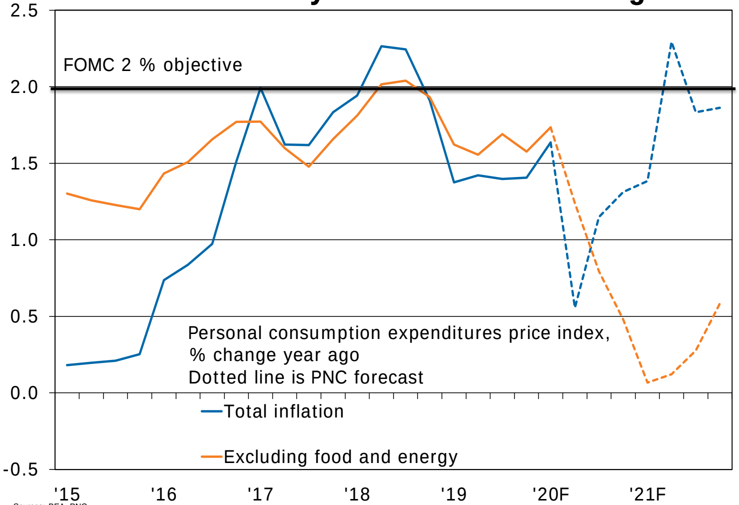
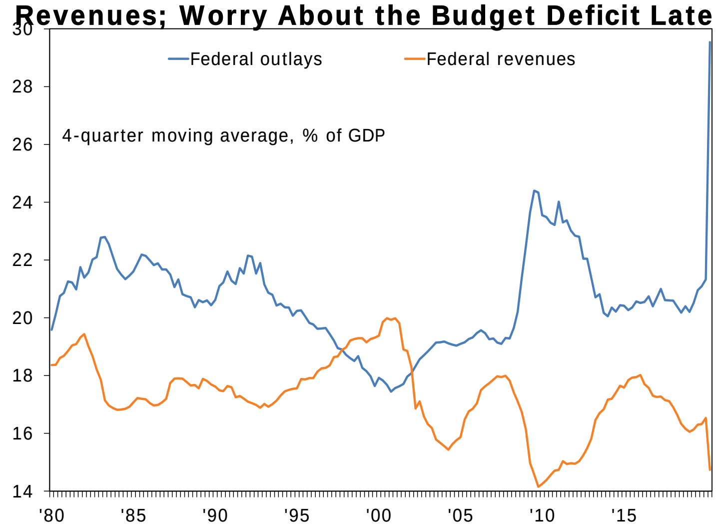
With Switch to Average Inflation Targeting, Fed Funds Rate Will Stay Near Zero for a Long Time



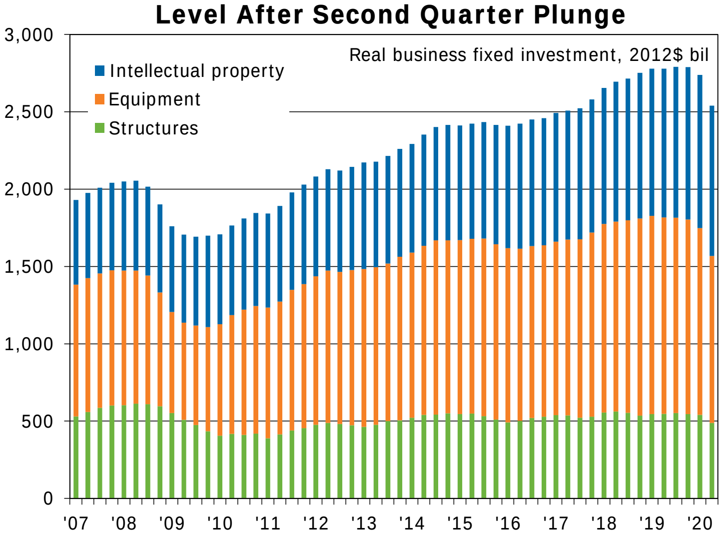
Sources: BEA, PNC

Huge Increase in Federal Spending, Drop in Tax Revenues; Worry About the Budget Deficit Later



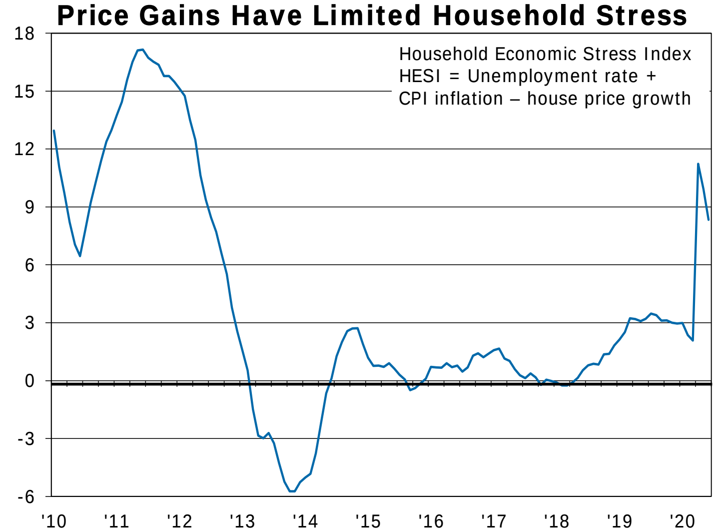
Sources: U.S. Department of the Treasury, BEA

Business Fixed Investment Back to 2017 Level After Second Quarter Plunge



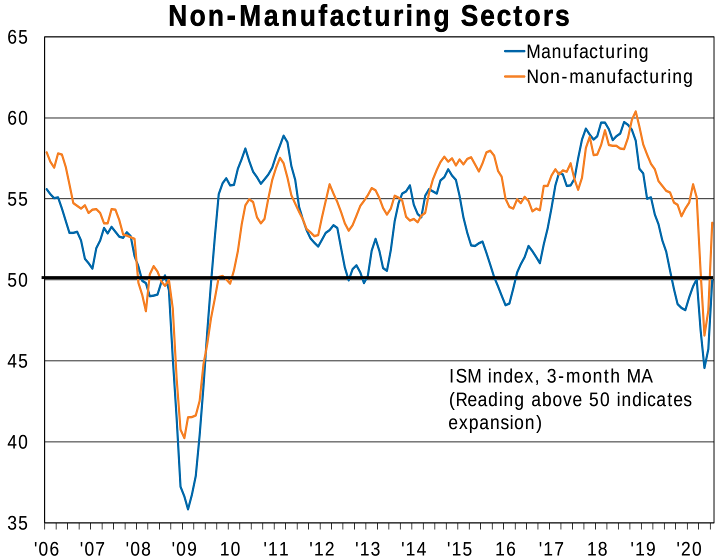
Source: BEA

Despite Very High Unemployment Rate, House Price Gains Have Limited Household Stress



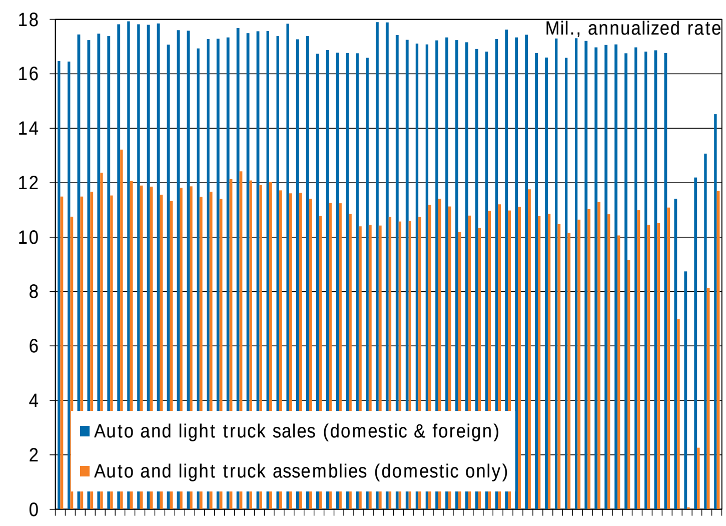
Sources: BLS, S&P CoreLogic Case-Shiller, PNC

Worst Appears Over for Both Manufacturing, Non-Manufacturing Sectors



Source: ISM

Auto Sales and Production Are Coming Back



Source: Bureau of Economic Analysis, Federal Reserve Board

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Baseline U.S. Economic Outlook, Expanded Table

	2Q'20a	3Q'20f	4Q'20f	1Q'21f	2Q'21f	3Q'21f	2019a	2020f	2021f	2022f
Output										
Nominal GDP (Billions $)	19602	20478	20947	21302	21627	21939	21428	20642	21776	23012
Percent Change Annualized	**-31.4**	**19.1**	**9.5**	**6.9**	**6.3**	**5.9**	**4.1**	**-3.7**	**5.5**	**5.7**
Real GDP (Chained 2012 Billions $)	17206	17894	18217	18440	18634	18808	19092	18082	18712	19336
Percent Change Annualized	**-32.9**	**17.0**	**7.4**	**5.0**	**4.3**	**3.8**	**2.2**	**-5.3**	**3.5**	**3.3**
Pers. Consumption Expenditures	11797	12260	12449	12605	12744	12857	13240	12406	12789	13178
Percent Change Annualized	**-34.6**	**16.7**	**6.3**	**5.1**	**4.5**	**3.6**	**2.4**	**-6.3**	**3.1**	**3.0**
Nonresidential Fixed Investment	2527	2535	2558	2589	2619	2648	2777	2588	2638	2844
Percent Change Annualized	**-27.0**	**1.3**	**3.8**	**4.9**	**4.7**	**4.6**	**2.9**	**-6.8**	**1.9**	**7.8**
Residential Investment	564	603	632	647	664	669	602	609	663	687
Percent Change Annualized	**-38.7**	**30.3**	**20.5**	**9.8**	**11.5**	**3.0**	**-1.7**	**1.2**	**8.9**	**3.5**
Change in Private Inventories	-315	-176	-117	-74	-31	11	49	-172	-16	46
Net Exports	-781	-781	-787	-812	-818	-828	-918	-784	-825	-886
Government Expenditures	3370	3409	3437	3441	3412	3406	3304	3391	3418	3423
Percent Change Annualized	**2.7**	**4.7**	**3.4**	**0.4**	**-3.3**	**-0.7**	**2.3**	**2.6**	**0.8**	**0.2**
Industrial Prod. Index (2012 = 100)	94.3	95.5	97.9	99.0	99.8	100.6	109.5	98.8	100.2	102.7
Percent Change Annualized	**-41.1**	**5.2**	**10.6**	**4.6**	**3.3**	**3.1**	**0.9**	**-9.7**	**1.3**	**2.5**
Capacity Utilization (Percent)	68.2	69.1	71.1	72.1	72.9	73.6	77.8	71.0	73.2	75.8
Prices										
CPI (1982-84 = 100)	256.8	259.3	260.0	260.4	261.1	262.1	255.7	258.7	261.7	267.2
Percent Change Annualized	**-2.7**	**3.9**	**1.1**	**0.7**	**1.0**	**1.5**	**1.8**	**1.2**	**1.2**	**2.1**
Core CPI Index (1982-84 = 100)	266.5	266.5	266.5	266.4	266.5	267.2	263.2	266.5	267.0	270.7
Percent Change Annualized	**-0.5**	**0.0**	**0.0**	**0.0**	**0.1**	**1.0**	**2.2**	**1.3**	**0.2**	**1.4**
PCE Price Index (2012 = 100)	110.1	111.2	111.7	112.2	112.7	113.2	109.7	110.9	113.0	115.6
Percent Change Annualized	**-1.9**	**3.9**	**2.0**	**1.6**	**1.7**	**2.0**	**1.4**	**1.2**	**1.8**	**2.3**
Core PCE Price Index (2012 = 100)	112.8	112.9	112.9	112.9	112.9	113.2	111.7	112.9	113.1	114.7
Percent Change Annualized	**-0.1**	**0.3**	**0.0**	**0.0**	**0.1**	**1.0**	**1.6**	**1.1**	**0.3**	**1.4**
GDP Price Index (2012 = 100)	113.9	114.4	115.0	115.5	116.1	116.6	112.3	114.2	116.4	119.0
Percent Change Annualized	**1.5**	**1.8**	**2.0**	**1.9**	**1.9**	**2.0**	**1.7**	**1.7**	**1.9**	**2.3**
S&P Stock Price Index	2928.8	2969.6	2916.9	3021.0	3073.7	3125.6	2912.5	2971.1	3099.0	3295.6
Crude Oil, WTI ($/Barrel)	28.1	40.3	42.8	43.9	45.0	46.2	57.0	39.3	45.7	54.5
Labor Markets										
Payroll Jobs (Millions)	133.7	139.3	142.8	144.3	145.4	146.4	150.9	141.9	145.9	149.7
Percent Change Annualized	**-40.0**	**17.7**	**10.4**	**4.5**	**3.0**	**2.7**	**1.4**	**-6.0**	**2.8**	**2.6**
Unemployment Rate (Percent)	13.0	9.9	9.0	8.5	8.0	7.3	3.7	8.9	7.6	5.7
Average Weekly Hours, Prod. Works.	33.8	33.3	33.4	33.5	33.5	33.6	33.6	33.5	33.5	33.7
Personal Income										
Average Hourly Earnings ($)	24.9	24.9	24.8	24.5	24.3	24.5	23.5	24.6	24.5	25.1
Percent Change Annualized	**17.1**	**-0.7**	**-2.4**	**-4.0**	**-2.8**	**2.8**	**3.5**	**4.8**	**-0.6**	**2.3**
Real Disp. Income (2012 Billions $)	16595	15567	15448	15155	14877	14787	14979	15684	14908	15046
Percent Change Annualized	**45.0**	**-22.6**	**-3.0**	**-7.4**	**-7.1**	**-2.4**	**2.9**	**4.7**	**-4.9**	**0.9**
Housing										
Housing Starts (*Ths., Ann. Rate*)	1138	1224	1493	1628	1592	1598	1295	1335	1607	1667
Ext. Home Sales (*Ths., Ann Rate*)	4623	5359	5821	5883	5928	5806	5330	5322	5845	5419
New SF Home Sales (*Ths., Ann Rate*)	429.3	674.2	804.8	870.7	842.8	861.4	684.8	652.2	859.1	877.5
Case/Shiller HPI (*Jan. 2000 = 100*)	216.1	216.1	216.1	217.4	218.7	219.5	212.7	216.1	220.4	225.5
Percent Change Year Ago	**3.6**	**2.8**	**1.6**	**0.7**	**1.2**	**1.6**	**3.4**	**1.6**	**2.0**	**2.3**
Consumer										
Auto Sales (Millions)	11.4	15.0	15.9	16.5	16.6	16.6	16.9	14.3	16.5	16.3
Consumer Credit (Billions $)	4007	3956	3940	3995	4037	4085	4186	3940	4135	4395
Percent Change Year Ago	**-2.1**	**-4.5**	**-5.9**	**-4.9**	**0.8**	**3.3**	**4.6**	**-5.9**	**5.0**	**6.3**
Interest Rates (Percent)										
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	**5.28**	**3.54**	**3.25**	**3.25**
Federal Funds	0.06	0.08	0.07	0.07	0.07	0.07	**2.16**	**0.36**	**0.07**	**0.07**
3-Month Treasury Bill	0.12	0.10	0.11	0.12	0.12	0.12	**2.09**	**0.36**	**0.12**	**0.12**
10-Year Treasury Note	0.68	0.58	0.62	0.68	0.73	0.78	**2.14**	**0.81**	**0.75**	**0.94**
30-Year Fixed Mortgage	3.23	2.89	2.76	2.69	2.68	2.67	**3.93**	**3.10**	**2.68**	**2.72**

a = actual f = forecast p = preliminary

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