

NATIONAL ECONOMIC OUTLOOK

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Executive Summary

Revisions Paint Much Better Picture of Job Growth in Late 2021, Consumers Still Holding Up Despite High Inflation

- Employment surprised dramatically to the upside in January, increasing by 467,000 over the month, against expectations for a decline due to the omicron variant. In addition, job growth in November and December 2021 was revised higher by more than 700,000 combined. Job growth in the three months through January averaged a very strong 540,000. The unemployment rate increased slightly in January, to 4.0%, from 3.9% in December. The labor force participation rate, the share of adults working or looking for work, rose by 0.3 percentage point, to 62.2%. However, the January report also included revisions to account for new population numbers; after including those, the labor force participation rate was unchanged from December to January. The labor force remains much smaller than it was before the pandemic, causing hiring problems for businesses.
- Consumer spending increased an excellent 2.1% in January from December, the biggest gain since March 2021. Goods spending was up 5.2% over the month, while services spending increased 0.5%, despite concerns about the omicron variant. Even after accounting for high inflation in January, real consumer spending growth was still very good at 1.5%, more than making up for the 1.3% decline in December. The outlook for household incomes and spending remains positive. Job growth is strong and wages are rising quickly thanks to the tight labor market. Households have an extra \$2.5 trillion in saving compared to before the pandemic; this will allow them to continue to increase their spending, even as government support wanes. Consumer spending growth will shift from goods to services over the course of 2022; goods spending is well above its pre-pandemic level, even after adjusting for higher prices, while services spending is still 1% below its level in early 2020, before the pandemic.
- While consumer fundamentals are solid, inflation remains high. The personal consumption expenditures price index rose 0.6% in January from December, near the pace of the past few months, but well above the 0.1%-0.2% monthly average before the pandemic. The core PCE price index, excluding volatile food and energy prices, was up 0.5% in January; it has been running at this pace since October. Food prices rose 0.9% in January, with energy prices up 1.1%. On a year-ago basis overall PCE inflation was 6.1% in January, up from 5.8% in December. The core PCE price index was up 5.2% in January from a year earlier, an acceleration from 4.9% in December. Both year-over-year inflation rates were the highest since the early 1980s, and well above the Federal Reserve's 2% inflation objective.

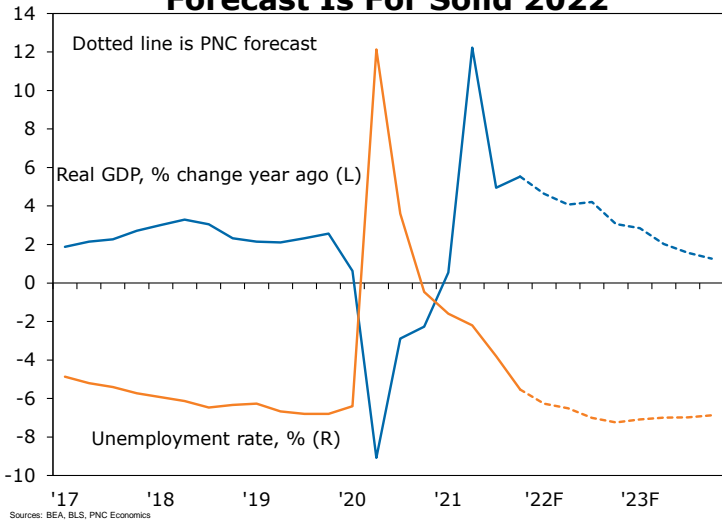
Baseline U.S. Economic Outlook, Summary Table*

	4Q'21p	1Q'22f	2Q'22f	3Q'22f	4Q'22f	1Q'23f	2021p	2022f	2023f	2024f
Output & Prices										
Real GDP (Chained 2012 Billions \$)	19806	19940	20157	20299	20412	20507	19427	20202	20590	20800
Percent Change Annualized	6.9	2.7	4.4	2.8	2.2	1.9	5.7	4.0	1.9	1.0
CPI (1982-84 = 100)	278.6	283.5	287.0	289.7	292.0	294.0	271.0	288.1	296.6	303.7
Percent Change Annualized	8.2	7.2	5.2	3.8	7.1	2.8	4.7	6.3	3.0	2.4
Labor Markets										
Payroll Jobs (Millions)	148.6	149.9	151.0	151.8	152.6	153.1	146.1	151.3	153.6	154.6
Percent Change Annualized	4.8	3.5	3.0	2.2	2.0	1.3	2.8	3.6	1.5	0.7
Unemployment Rate (Percent)	4.2	3.9	3.7	3.5	3.4	3.5	5.4	3.6	3.5	3.5
Interest Rates (Percent)										
Federal Funds	0.08	0.14	0.57	0.90	1.17	1.42	0.08	0.69	1.87	2.13
10-Year Treasury Note	1.53	1.94	2.20	2.32	2.42	2.51	1.43	2.22	2.59	2.64

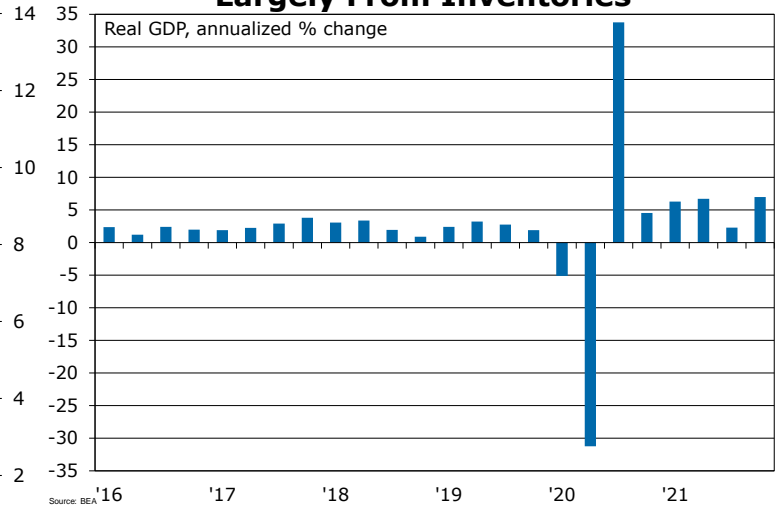
a = actual f = forecast p = preliminary

*Please see the Expanded Table for more forecast series.

Ukraine Crisis Adds Risk, But Baseline Forecast Is For Solid 2022



Better Fourth Quarter Growth, Largely From Inventories



Economy Still Looks Good, But Ukraine-Russia Adds Risks to the Outlook and Makes the Fed's Job Tougher

The fundamentals for the U.S. economy are solid in the first quarter of 2022. Consumers remain resilient despite high inflation, and the labor market continues its strong recovery from the Viral Recession. But there are some concerns, most notably high inflation, supply-chain problems, and worker shortages. On top of this the Russian invasion of Ukraine adds downside risk to the outlook. While the direct impact of the conflict in Eastern Europe on the U.S. economy is limited, it could be a much more significant drag on the European economy through its impact on global energy markets. And higher U.S. energy prices in the wake of the invasion, at a time of already-high inflation, makes an already difficult job for the Federal Reserve even trickier.

There should be very little direct fallout from the conflict on the U.S. economy. Russia makes up only 2% of global GDP, and exports to Russia are little more than a rounding error in the U.S. economy. Thus the impact of sanctions against Russia will do little to dent the U.S. recovery. The bigger concern is Europe. The European Union accounts for 18% of the global economy, with the United Kingdom adding another 3%. Exports to the E.U. and the U.K. combined, both goods and services, make up about 2% of U.S. GDP. Western Europe is much more directly vulnerable to the Ukraine-Russia conflict, particularly through energy. The European Union gets about one-quarter of its oil, 40% of its natural gas, and almost one-half of its coal from Russia. So far there has been little disruption of energy supplies from Russia to the E.U., and winter heating demand for natural gas in Europe is wrapping up. But a cutoff of energy from Russia to Western and Central Europe would greatly slow economies there, perhaps enough to tip the region into recession. This, in turn, would be a significant drag on U.S. growth.

Compounding any U.S. impact from a weaker European economy would be the potential for higher interest rates because of elevated inflation. With inflation already running well above the Federal Reserve's 2% objective, the central bank is wrapping up its purchases of longer-term Treasuries and mortgage-backed securities, which have been putting downward pressure on long-term interest rates. The Fed is also getting ready to increase the federal funds rate, its key short-term policy rate, by 0.25 percentage point in mid-March, after keeping it near zero since the beginning of the pandemic. Fed Chair Powell has ruled out a larger fed funds rate increase in March as the central bank waits to see what impact the invasion of Ukraine has on the U.S. and global economies.

But while the Fed is treading carefully now, it could soon face a serious dilemma. Inflation is already well above the central bank's 2% objective, and will remain elevated following a big jump in energy prices in the wake of the Ukraine conflict. In its February forecast PNC expects the Federal Reserve to raise the fed funds by a cumulative 1.25 percentage points over the course of 2022, to a range of 1.25% to 1.50% by the end of this year, and to a range of 2.00% to 2.25% in 2023. But continued high energy prices in the wake of the Ukraine-Russia conflict could force the Fed to raise rates even more aggressively to bring down inflation, even in the face of a drag from a slowing European economy. While it is not in PNC's baseline forecast, there is an increased risk that the Fed could raise rates so quickly in the face of higher inflation that U.S. economic growth could stall, or even that the economy could fall into recession.

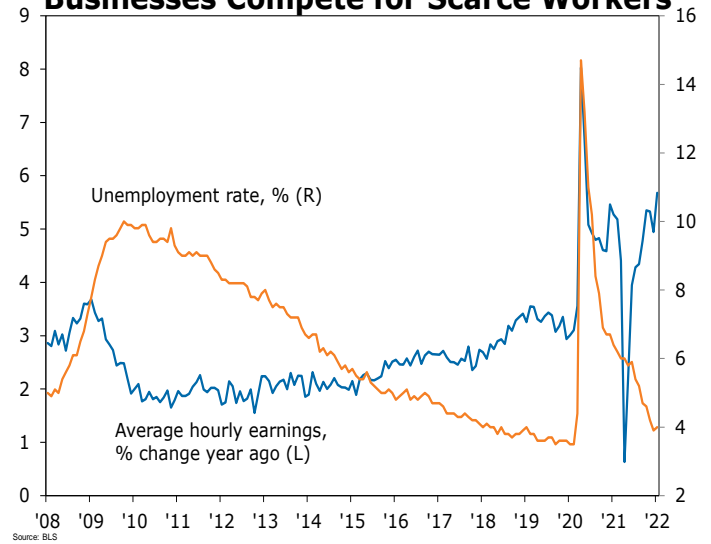
The baseline forecast, however, is that the Fed avoids a misstep and can raise rates gradually enough that inflation slows over the course of 2022 and 2023, while the economic recovery proceeds and the labor market continues to improve. PNC is forecasting economic growth of around 4% in 2022; while this would be down from growth of almost 6% in 2021, it would still be well above the economy's long-run average. Growth will then slow to below 2% in 2023 as consumers spend down their accumulated saving and higher interest rates weigh on industries like housing and business investment. Core PCE inflation, which was around 5% at the end of 2021 from one year earlier, is expected to slow to below 4% by the end of this year, and to the Fed's objective of around 2% by the end of 2023. The labor market will remain strong, with average job gains of better than 300,000 per month this year, and employment returning to its pre-pandemic peak in the fall. The unemployment rate should gradually decline to its pre-pandemic level of 3.5% in the second half of this year, even as the tight labor market and rising wages bring some people who dropped out of the labor force in the wake of the pandemic back into the job market.

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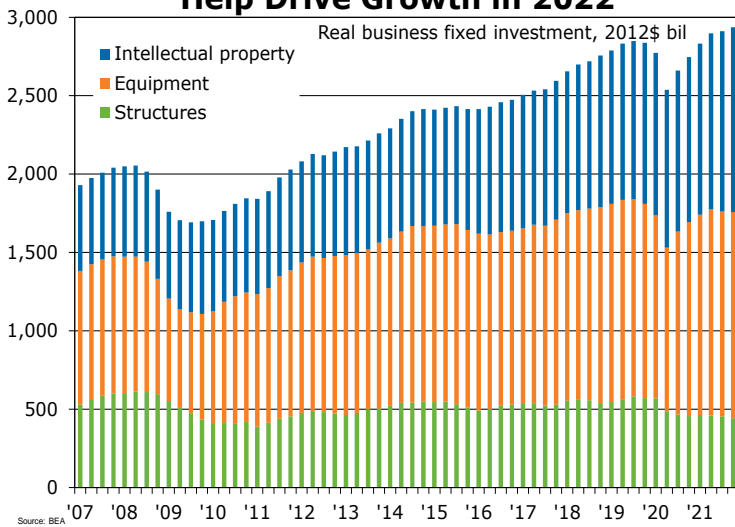
Revisions Paint Better Picture of Job Market in Late 2021



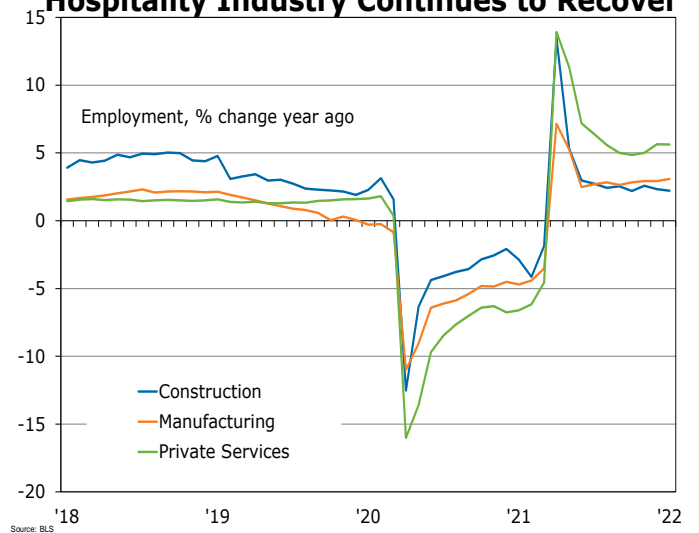
Strongest Wage Growth in Decades as Businesses Compete for Scarce Workers



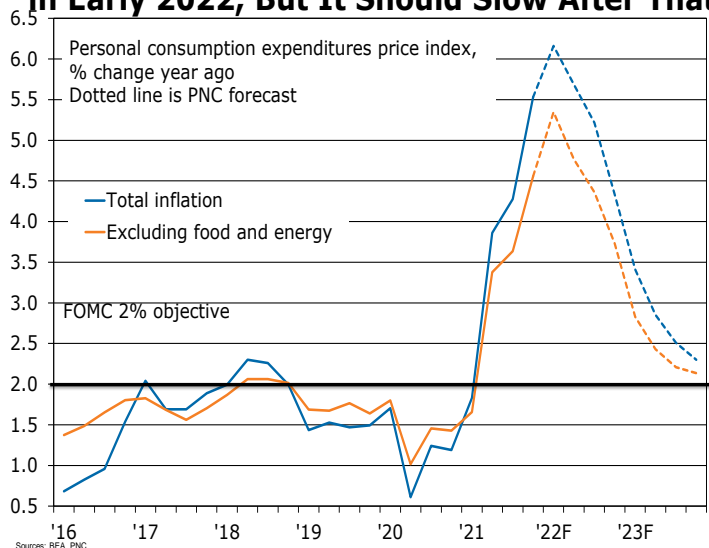
Strong Business Investment Will Help Drive Growth in 2022



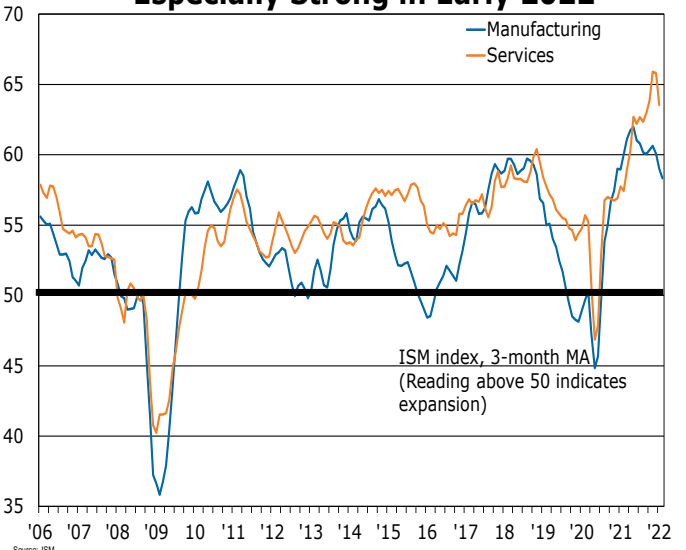
Services Are Driving Job Growth as Leisure/Hospitality Industry Continues to Recover



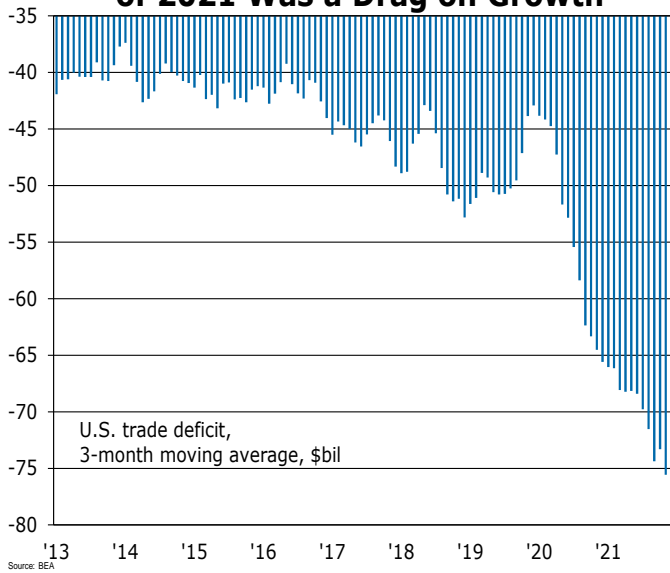
Ukraine-Russia Conflict Will Add to Inflation in Early 2022, But It Should Slow After That



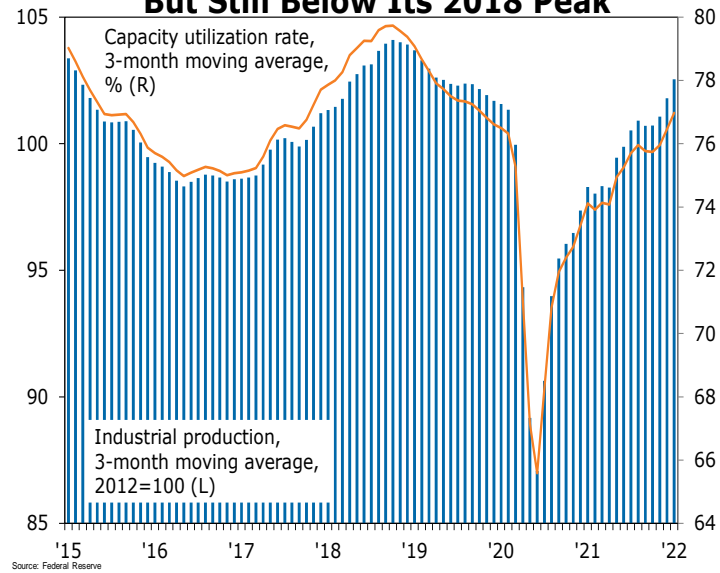
Service Industry Growth Is Especially Strong in Early 2022



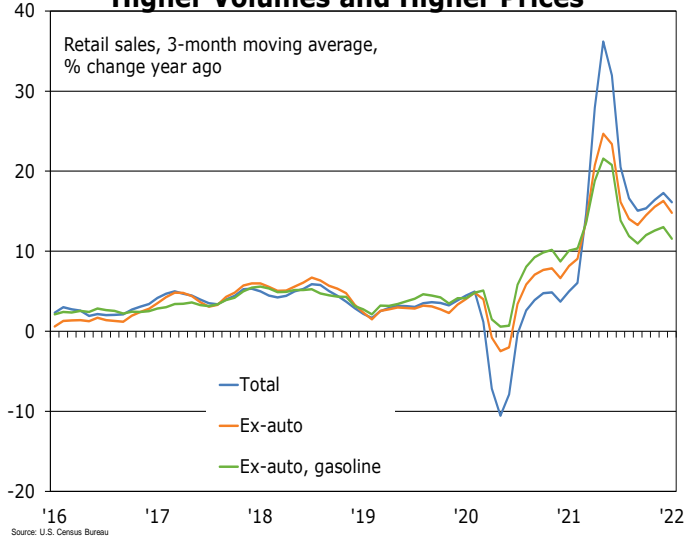
Larger Trade Deficit at the End of 2021 Was a Drag on Growth



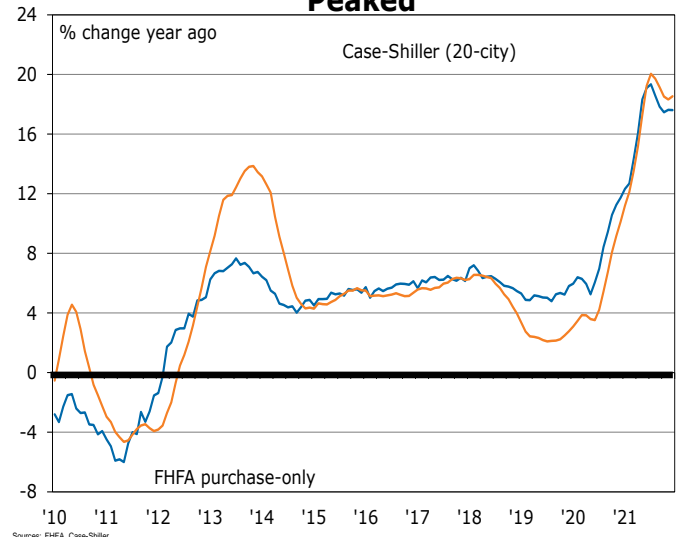
Industrial Production Recovering, But Still Below Its 2018 Peak



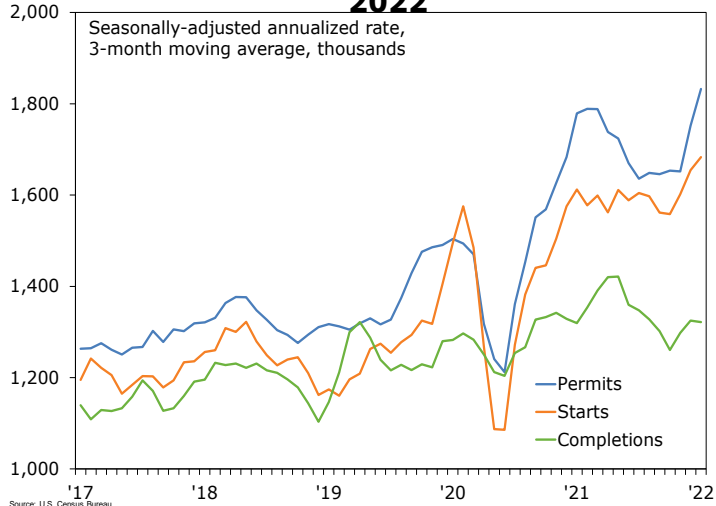
Growth in Retail Sales Coming From Both Higher Volumes and Higher Prices



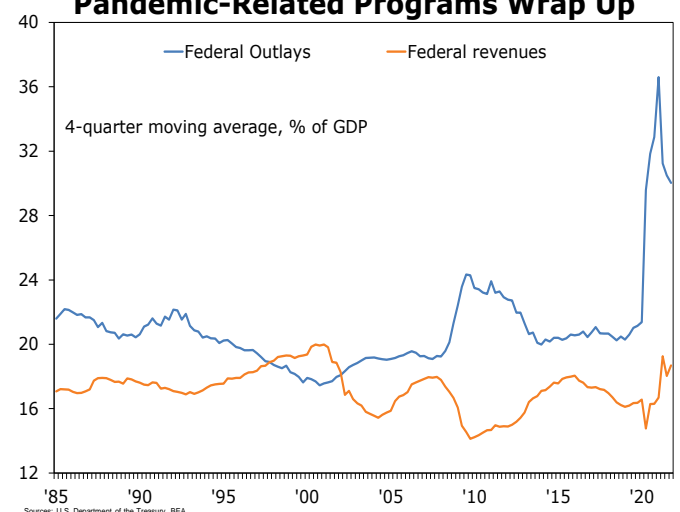
House Price Growth Appears to Have Peaked



Strong Homebuilding to Add to Growth in 2022



Federal Spending Is Falling as Pandemic-Related Programs Wrap Up



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PNC Economics Group

February 2022

Baseline U.S. Economic Outlook, Expanded Table

	4Q'21p	1Q'22f	2Q'22f	3Q'22f	4Q'22f	1Q'23f	2021p	2022f	2023f	2024f
Output										
Nominal GDP (Billions \$)	23992	24497	25073	25520	25886	26192	22993	25244	26512	27292
Percent Change Annualized	14.3	8.7	9.7	7.3	5.9	4.8	10.0	9.8	5.0	2.9
Real GDP (Chained 2012 Billions \$)	19806	19940	20157	20299	20412	20507	19427	20202	20590	20800
Percent Change Annualized	6.9	2.7	4.4	2.8	2.2	1.9	5.7	4.0	1.9	1.0
Pers. Consumption Expenditures	13843	13968	14087	14197	14286	14356	13631	14134	14433	14580
Percent Change Annualized	3.3	3.7	3.5	3.2	2.5	2.0	7.9	3.7	2.1	1.0
Nonresidential Fixed Investment	2899	2920	2946	2985	3025	3058	2867	2969	3097	3219
Percent Change Annualized	2.0	2.9	3.5	5.4	5.4	4.4	7.3	3.6	4.3	3.9
Residential Investment	693	718	748	765	775	777	706	751	758	714
Percent Change Annualized	-0.8	15.0	18.2	9.2	5.4	1.3	9.0	6.4	0.9	-5.7
Change in Private Inventories	174	169	180	155	145	124	-38	162	115	78
Net Exports	-1338	-1369	-1333	-1335	-1349	-1337	-1281	-1346	-1338	-1330
Government Expenditures	3357	3356	3351	3353	3352	3351	3376	3353	3348	3360
Percent Change Annualized	-2.9	-0.1	-0.5	0.3	-0.2	-0.2	0.5	-0.7	-0.2	0.4
Industrial Prod. Index (2012 = 100)	101.7	103.1	104.3	105.4	106.4	106.9	100.2	104.8	107.2	107.7
Percent Change Annualized	4.0	5.4	4.9	4.3	3.8	2.0	5.5	4.6	2.3	0.5
Capacity Utilization (Percent)	76.4	77.4	78.2	79.0	79.6	79.9	75.4	79.9	79.9	79.8
Prices										
CPI (1982-84 = 100)	278.6	283.5	287.0	289.7	292.0	294.0	271.0	288.1	296.6	303.7
Percent Change Annualized	8.2	7.2	5.2	3.8	7.1	2.8	4.7	6.3	3.0	2.4
Core CPI Index (1982-84 = 100)	283.2	288.3	291.6	294.2	296.3	298.3	277.3	292.6	301.2	308.8
Percent Change Annualized	5.5	7.3	4.7	3.6	2.9	2.7	3.6	5.5	2.9	2.5
PCE Price Index (2012 = 100)	118.1	119.9	121.3	122.3	123.2	124.0	115.5	121.7	125.1	127.8
Percent Change Annualized	6.5	6.4	4.6	3.5	3.0	2.6	3.9	5.3	2.8	2.2
Core PCE Price Index (2012 = 100)	119.5	121.2	122.3	123.2	123.9	124.6	117.3	122.6	125.6	128.3
Percent Change Annualized	4.9	5.8	3.8	3.0	2.4	2.2	3.3	4.5	2.4	2.1
GDP Price Index (2012 = 100)	121.1	122.9	124.4	125.7	126.8	127.7	118.3	124.9	128.8	131.2
Percent Change Annualized	7.0	5.8	5.1	4.3	3.6	2.9	4.1	5.6	3.1	1.9
Crude Oil, WTI (\$/Barrel)	77.2	90.0	89.0	85.6	82.9	79.9	68.0	86.9	77.1	74.8
Labor Markets										
Payroll Jobs (Millions)	148.6	149.9	151.0	151.8	152.6	153.1	146.1	151.3	153.6	154.6
Percent Change Annualized	4.8	3.5	3.0	2.2	2.0	1.3	2.8	3.6	1.5	0.7
Unemployment Rate (Percent)	4.2	3.9	3.7	3.5	3.4	3.5	5.4	3.6	3.5	3.5
Average Weekly Hours, Prod. Works.	34.2	34.1	34.0	34.0	33.9	33.9	34.3	34.0	33.8	33.7
Personal Income										
Average Hourly Earnings (\$)	26.6	26.8	27.2	27.5	27.9	28.3	25.9	27.4	28.9	30.1
Percent Change Annualized	7.3	3.5	5.6	5.7	5.8	5.6	4.9	5.6	5.5	4.4
Real Disp. Income (2012 Billions \$)	15401	15305	15402	15511	15628	15747	16015	15462	15912	16278
Percent Change Annualized	-5.8	-2.5	2.5	2.9	3.1	3.1	2.2	-3.5	2.9	2.3
Housing										
Housing Starts (<i>Ths., Ann. Rate</i>)	1644	1706	1796	1829	1801	1723	1598	1783	1596	1414
Ext. Home Sales (<i>Ths., Ann. Rate</i>)	6333	6763	6609	6413	6158	5738	6132	6486	5462	5307
New SF Home Sales (<i>Ths., Ann. Rate</i>)	728	781	789	790	763	736	765	781	701	653
Case/Shiller HPI (<i>Jan. 2000 = 100</i>)	276.3	282.3	287.4	290.9	292.9	293.9	276.3	292.9	296.1	299.2
Percent Change Year Ago	18.9	16.6	12.8	9.0	6.0	4.1	18.9	6.0	1.1	1.0
Consumer										
Auto Sales (Millions)	12.9	14.2	15.2	16.5	17.2	17.4	15.0	15.8	16.8	15.1
Consumer Credit (Billions \$)	4421	4504	4598	4692	4784	4870	4421	4784	5081	5302
Percent Change Year Ago	5.7	6.7	6.7	7.6	8.2	8.1	5.7	8.2	6.2	4.3
Interest Rates (Percent)										
Prime Rate	3.25	3.29	3.70	4.02	4.30	4.54	3.25	3.83	5.00	5.25
Federal Funds	0.08	0.14	0.57	0.90	1.17	1.42	0.08	0.69	1.87	2.13
3-Month Treasury Bill	0.04	0.33	0.76	1.05	1.27	1.51	0.03	0.85	1.81	1.98
10-Year Treasury Note	1.53	1.94	2.20	2.32	2.42	2.51	1.43	2.22	2.59	2.64
30-Year Fixed Mortgage	3.08	3.79	4.09	4.15	4.20	4.26	2.96	4.06	4.34	4.39
<i>a = actual f = forecast p = preliminary</i>										

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