June 2022

NATIONAL ECONOMIC OUTLOOK

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Executive Summary

Job Growth Remains Strong in Mid-2022, But Inflation Remains at Decades-Long High

- Employment, as measured by a survey of firms by the Bureau of Labor Statistics, rose by a solid 390,000 in May from April, with average job gains of 408,000 over the past three months. Private-sector employment rose by 333,000 in May, while government employment rose by 57,000. Employment in May was about 800,000, or 0.5%, below its pre-pandemic level. Employment fell by 22 million (14%) in March and April 2020. Given the depth of the downturn, the recovery in the labor market has been extraordinary. The unemployment rate was 3.6% for a third straight month in May. The unemployment rate soared from 3.5% in February 2020 to 14.7% in April 2020 with the pandemic, and then steadily fell through the rest of 2020 and all of 2021. It is now just barely above the pre-pandemic rate but has been flat for three straight months. The labor force participation rate—the share of adults working or looking for work—ticked up by 0.1 percentage point to 62.3%. The labor force participation rate has been between 62.2% and 62.4% throughout 2022, well below the 63%+ rate before the pandemic.

- The consumer price index came in higher than expected in May. The overall CPI increased 1.0% in May from April, with a 3.9% increase in energy prices and a 1.2% increase in food prices. The core CPI, excluding food and energy prices, increased 0.6% for a second straight month. On a year-over-year basis overall CPI inflation was 8.5% in May, up from 8.2% in April but down from 8.6% in March, while core CPI inflation was 6.0% in May, down from 6.1% in April and 6.4% in both February and March. Although CPI inflation has slowed slightly on a year-ago basis in recent months, it remains near the strongest pace in four decades.

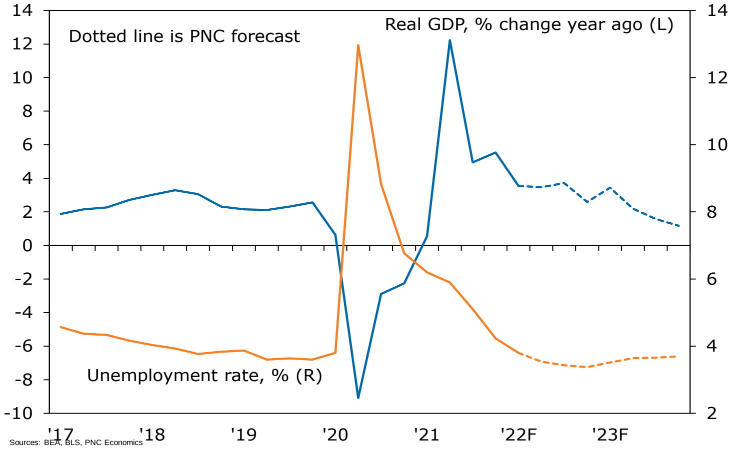
- Retail sales fell 0.3% in May from April, but the results were distorted by big swings in key components. Sales at gas stations rose 4.0% due to a huge jump in prices, while sales of autos and parts fell 3.5%. Sales excluding autos and parts were up 0.5% over the month, while sales excluding autos and gasoline were up 0.1%, below the pace of inflation. Control sales—retail sales excluding food service, autos, gasoline, and building materials, and which go into consumer goods spending in GDP—fell 0.1% in May from April. Household spending growth is slowing in mid-year as high inflation, in particular high gasoline prices, and higher interest rates weigh on consumers. Sales growth in May was anemic after accounting for much higher gasoline prices and was below the rate of inflation. There were also downward revisions to sales in April.

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

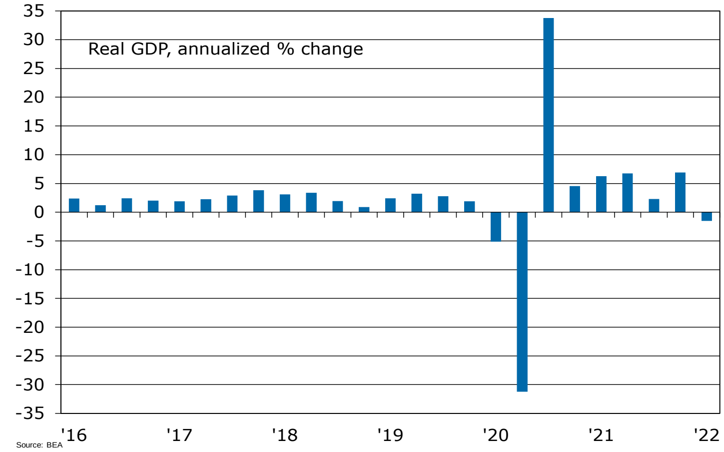
	1Q'22p	2Q'22f	3Q'22f	4Q'22f	1Q'23f	2Q'23f	2021a	2022f	2023f	2024f
Output & Prices										
Real GDP (*Chained 2012 Billions $*)	19731	19913	20045	20137	20220	20287	19427	19957	20305	20514
Percent Change Annualized	**-1.5**	**3.7**	**2.7**	**1.8**	**1.6**	**1.3**	**5.7**	**2.7**	**1.7**	**1.0**
CPI (*1982-84 = 100*)	284.6	288.6	291.7	294.5	296.6	298.5	271.0	289.9	299.3	305.9
Percent Change Annualized	**9.2**	**5.8**	**4.4**	**3.8**	**3.0**	**2.6**	**4.7**	**7.0**	**3.3**	**2.2**
Labor Markets										
Payroll Jobs (*Millions*)	150.4	151.6	152.2	152.7	153.0	153.2	146.1	151.7	153.3	154.3
Percent Change Annualized	**4.7**	**3.2**	**1.7**	**1.3**	**0.7**	**0.5**	**2.8**	**3.8**	**1.1**	**0.6**
Unemployment Rate (*Percent*)	3.8	3.6	3.5	3.5	3.6	3.7	5.4	3.6	3.7	3.9
Interest Rates (Percent)										
Federal Funds	0.12	0.77	2.03	2.99	3.54	3.63	0.08	1.48	3.59	2.81
10-Year Treasury Note	1.94	2.98	3.35	3.39	3.36	3.33	1.43	2.91	3.30	3.14

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

Economic Growth Will Continue to Slow, But No Recession



GDP Is Expanding Again in the Second Quarter



Higher Interest Rates Are Already Starting to Weigh on the Housing Market

With the Federal Open Market Committee now aggressively tightening monetary policy, both short-term and long-term interest rates have risen sharply in 2022. In particular, the interest rate on a typical 30-year fixed rate mortgage has increased from 3.2% at the beginning of the year to 5.8% by mid-June, according to Freddie Mac. Higher mortgage rates are now weighing on the housing market, contributing to the ongoing slowing in economic growth. The central bank is hoping that a softening in interest-rate sensitive industries, including housing, will bring inflation back down to 2% over the next couple of years, without pushing the U.S. economy into recession.

The FOMC moved quickly to support the economy when the coronavirus pandemic came to the United States. The committee rapidly cut the federal funds rate—their key short-term policy rate—to close to zero. It also expanded the central bank's balance sheet by creating money electronically, using the proceeds to purchase longer-term Treasurys and mortgage-backed securities. As a result, the interest rate on a typical 30-year fixed rate mortgage fell from around 3.6% in early 2020 before the pandemic, to a record low of 2.7% in early 2021. This, along with support for household incomes from the federal government, spurred a very strong housing market. With very low mortgage rates making it less expensive to buy a home, households used their stimulus funds to make down payments. Sales of existing home sales soared in 2021, as did prices. Construction of new single-family homes rose to 1.13 million in 2021, up from around 1 million in 2020 and below one million every year from 2008 to 2019. And low borrowing costs made it much less expensive for households to undertake home renovations and repairs. All of this supported economic growth during the first two years of recovery following the start of the pandemic.

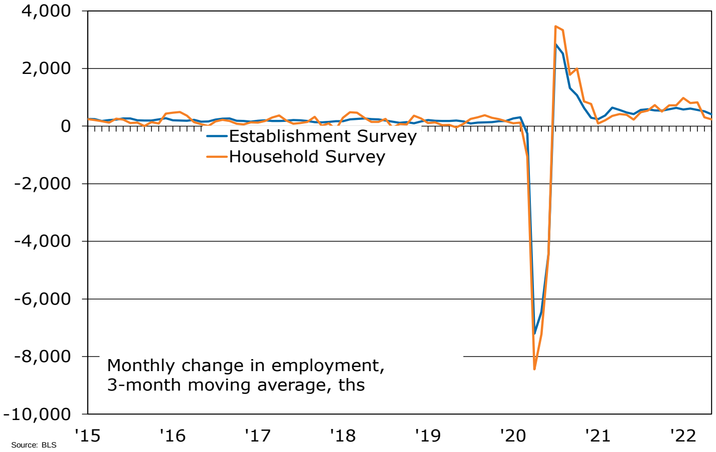
But with inflation now well above the FOMC's 2% objective, the Fed is trying to slow economic growth to reduce inflationary pressures in the economy. The FOMC has quickly raised the federal funds rate this year, including a 0.75 percentage point increase at the committee's meeting on June 15, the biggest increase in the rate since 1994; this has pushed up short-term borrowing costs. The FOMC is also pushing up long-term borrowing costs. Earlier this year the central bank ended its purchases of long-term securities, and in June the Fed stopped rolling over some maturing long-term Treasurys and mortgage-backed securities, up to a cap of $47.5 billion per month; that cap will increase to $95 billion per month in September. Because the Fed has been telegraphing these moves to financial markets since the beginning of the year, long-term interest rates, including mortgage rates, have increased throughout 2022.

Higher mortgage rates have led to a slowing in the housing market. Existing home sales fell 17% from January to May, while housing starts fell 13% from February to May. Although house price growth remains very strong, it appears to be peaking in mid-2022 as higher prices and mortgage rates have greatly reduced housing affordability. All of these factors are weighing on overall economic growth. Reduced housing starts show up directly in GDP and falling sales of existing homes reduce consumer spending on goods and services like furniture and renovations. Slower house price growth will weigh on household wealth, acting as a brake on consumer spending growth.

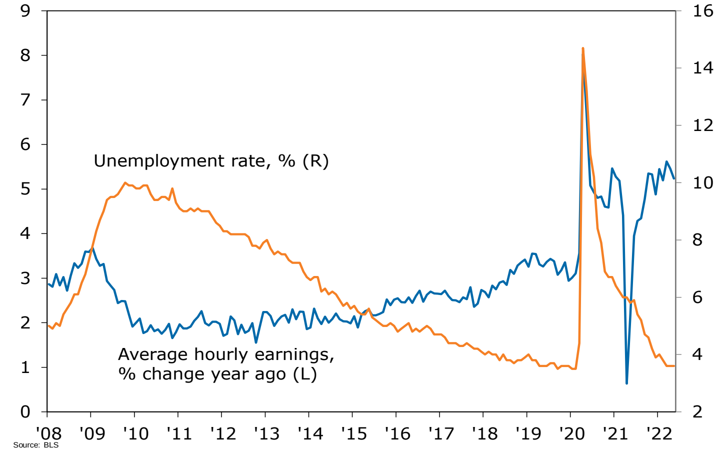
Housing activity will continue to slow over the next couple of years. Tighter monetary policy will also weigh on other interest-rate sensitive industries, like business capital spending and consumer purchases of durable goods. The Fed's hope is that this will slow economic growth to a more sustainable pace over the next couple of years and bring inflation back down to 2%, while avoiding recession—an outright contraction in the U.S. economy. But the central bank has little room for error, especially since the Russian invasion of Ukraine has pushed up inflation while simultaneously weighing on economic growth.

PNC's baseline forecast is for slower growth over the next few years, but not recession. Real GDP growth is expected to slow from above 5% in 2021 to below 2% this year (Q4 to Q4 basis), and then to around 1% in both 2023 and 2024. Weaker growth will lead to a slight increase in the unemployment rate in 2023 and 2024, to around 4%, up from 3.6% in May 2022. Inflation will gradually ease to 2% by mid-2024 as economic growth softens, particularly in interest-rate sensitive industries like housing. While the risk of recession this year remains low given solid consumer fundamentals, the probability is around 40% for 2023 and 2024, about double what it was prior to the Russian invasion of Ukraine.

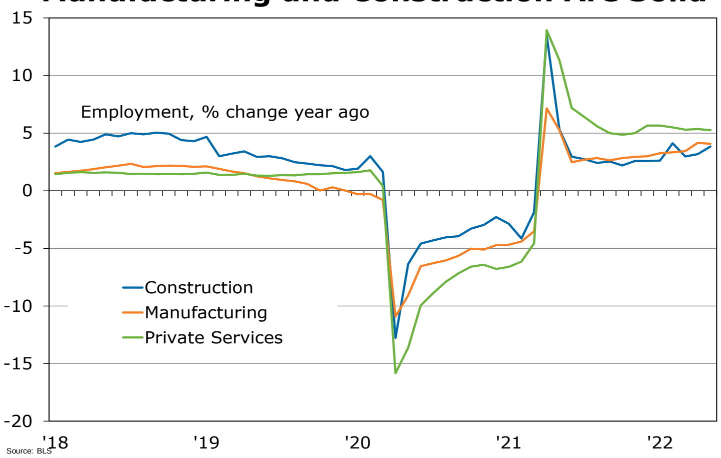
Very Strong Labor Market Is Best Indication of No Recession This Year



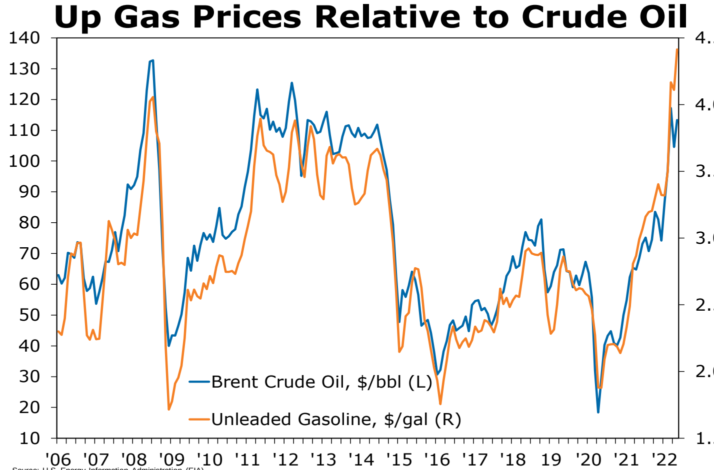
Unemployment Rate Remains Just Above Pre-Pandemic Level



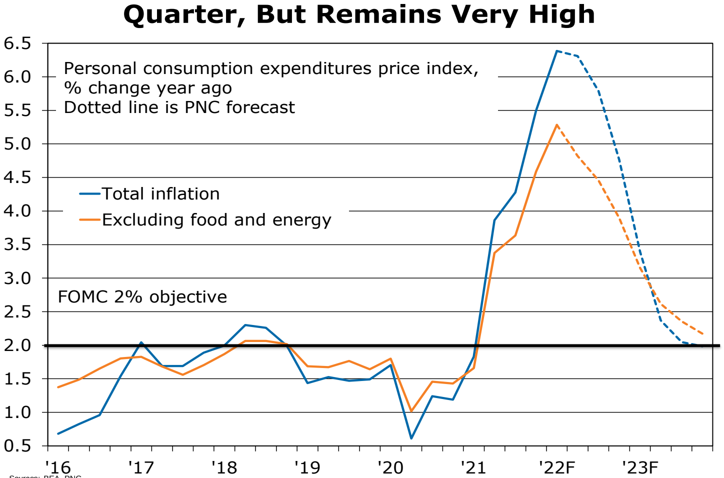
Services Continue to Lead Job Growth, But Manufacturing and Construction Are Solid



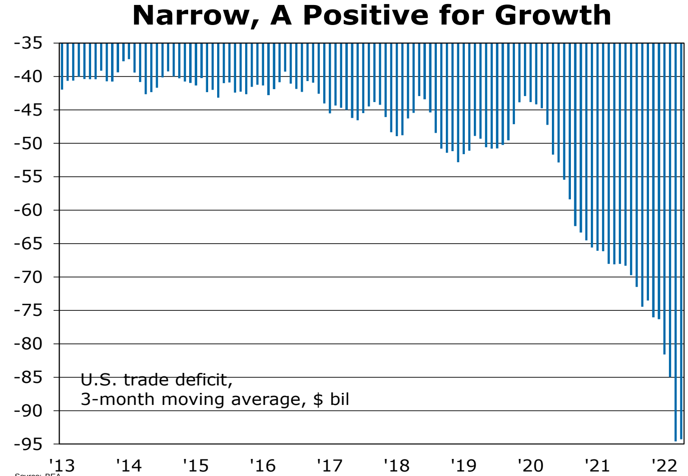
Tight Refinery Capacity Is Pushing Up Gas Prices Relative to Crude Oil



Inflation Is Peaking in the Second Quarter, But Remains Very High



Trade Deficit Is Starting to Narrow, A Positive for Growth



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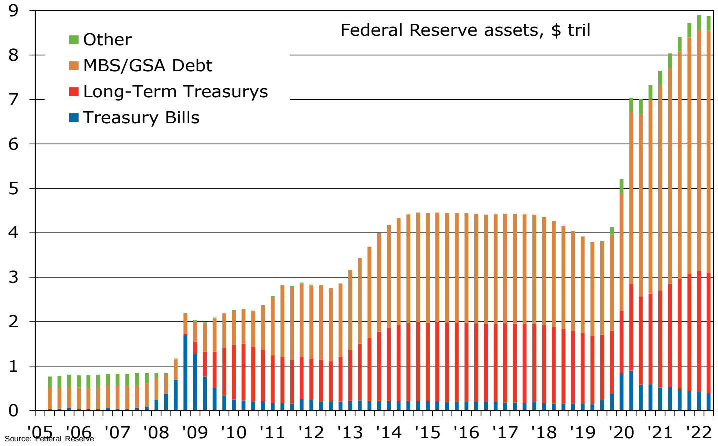
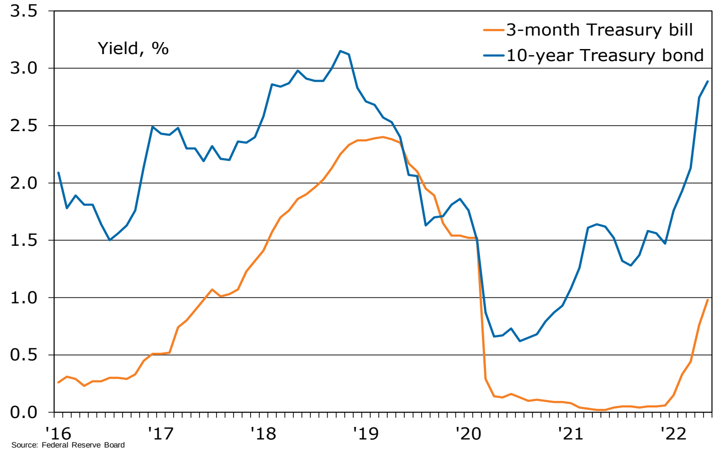
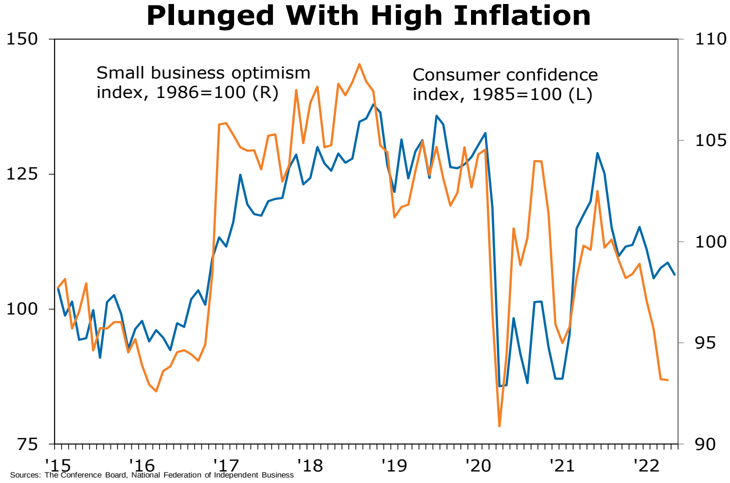
Plans for Further Reduction in Fed Balance Sheet Have Pushed Up Long-Term Rates...



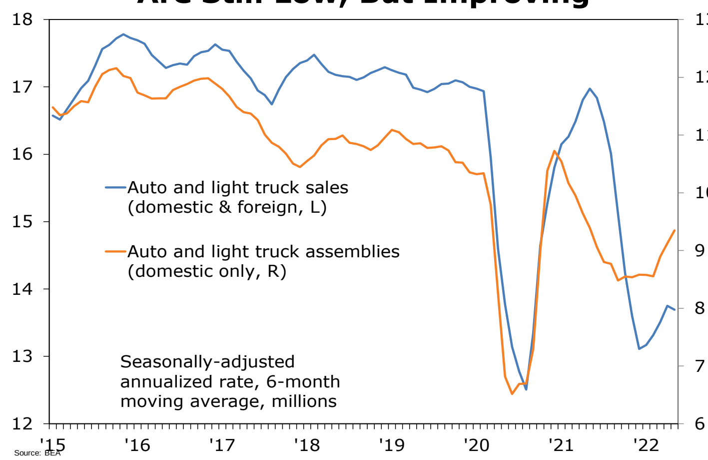
...And Short-Term Rates Are Up As Well As Fed Funds Rate Rises



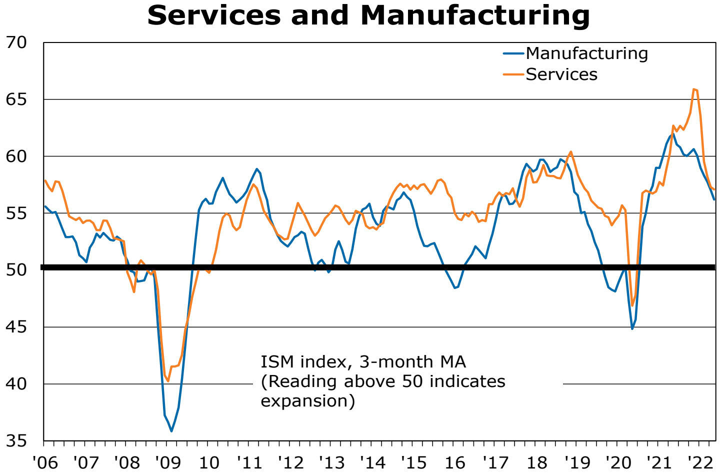
Small Business Confidence Has Plunged With High Inflation



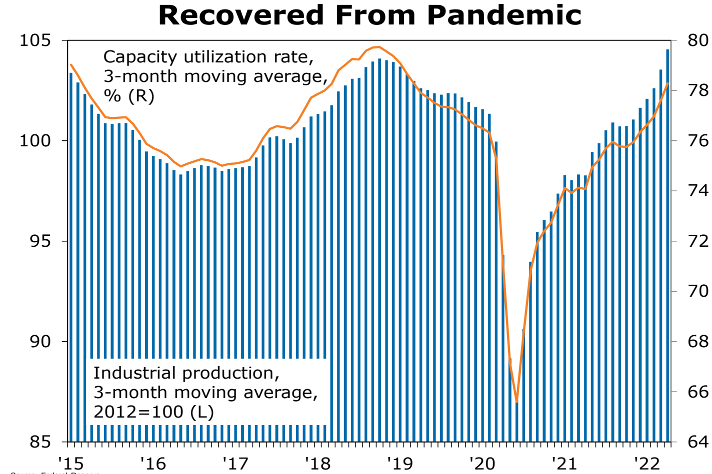
Auto Production and Sales Are Still Low, But Improving



Continued Expansion in Both Services and Manufacturing



Industrial Production Has Fully Recovered From Pandemic



PNC Economics Group
June 2022

Baseline U.S. Economic Outlook, Expanded Table

	1Q'22p	2Q'22f	3Q'22f	4Q'22f	1Q'23f	2Q'23f	2021a	2022f	2023f	2024f
Output										
Nominal GDP (*Billions $*)	24383	25015	25465	25805	26106	26346	22996	25167	26432	27185
Percent Change Annualized	**6.5**	**10.8**	**7.4**	**5.4**	**4.8**	**3.7**	**10.1**	**9.4**	**5.0**	**2.8**
Real GDP (*Chained 2012 Billions $*)	19731	19913	20045	20137	20220	20287	19427	19957	20305	20514
Percent Change Annualized	**-1.5**	**3.7**	**2.7**	**1.8**	**1.6**	**1.3**	**5.7**	**2.7**	**1.7**	**1.0**
Pers. Consumption Expenditures	13925	14016	14111	14179	14237	14287	13625	14058	14308	14461
Percent Change Annualized	**3.1**	**2.7**	**2.7**	**1.9**	**1.7**	**1.4**	**7.9**	**3.2**	**1.8**	**1.1**
Nonresidential Fixed Investment	2970	2988	3007	3026	3050	3077	2868	2998	3091	3200
Percent Change Annualized	**9.2**	**2.4**	**2.6**	**2.5**	**3.2**	**3.6**	**7.4**	**4.5**	**3.1**	**3.5**
Residential Investment	699	694	691	687	680	669	708	693	663	621
Percent Change Annualized	**0.4**	**-2.3**	**-2.1**	**-2.0**	**-4.5**	**-6.2**	**9.2**	**-2.1**	**-4.4**	**-6.2**
Change in Private Inventories	150	157	147	130	114	109	-33	146	103	78
Net Exports	-1544	-1464	-1431	-1402	-1374	-1364	-1284	-1460	-1371	-1372
Government Expenditures	3336	3326	3324	3321	3317	3313	3376	3327	3315	3330
Percent Change Annualized	**-2.7**	**-1.2**	**-0.2**	**-0.3**	**-0.5**	**-0.5**	**0.5**	**-1.5**	**-0.3**	**0.4**
Industrial Prod. Index (*2012 = 100*)	103.6	104.8	105.8	106.3	106.6	106.8	100.1	105.1	106.9	107.8
Percent Change Annualized	**8.1**	**4.7**	**3.6**	**2.1**	**1.0**	**0.9**	**5.5**	**5.0**	**1.7**	**0.8**
Capacity Utilization (*Percent*)	77.7	78.5	79.0	79.3	79.3	79.4	75.4	79.4	79.4	79.7
Prices										
CPI (*1982-84 = 100*)	284.6	288.6	291.7	294.5	296.6	298.5	271.0	289.9	299.3	305.9
Percent Change Annualized	**9.2**	**5.8**	**4.4**	**3.8**	**3.0**	**2.6**	**4.7**	**7.0**	**3.3**	**2.2**
Core CPI Index (1982-84 = 100)	287.7	291.6	294.9	297.7	300.2	302.7	277.3	293.0	303.8	311.8
Percent Change Annualized	**6.5**	**5.5**	**4.6**	**3.8**	**3.5**	**3.3**	**3.6**	**5.7**	**3.7**	**2.6**
PCE Price Index (*2012 = 100*)	120.1	122.1	123.4	124.5	125.3	125.9	115.5	122.5	126.2	128.6
Percent Change Annualized	**7.0**	**6.9**	**4.3**	**3.5**	**2.8**	**2.0**	**3.9**	**6.0**	**3.0**	**1.9**
Core PCE Price Index (*2012 = 100*)	121.0	122.4	123.8	124.8	125.7	126.3	117.3	123.0	126.6	129.2
Percent Change Annualized	**5.2**	**4.8**	**4.4**	**3.5**	**2.7**	**2.1**	**3.3**	**4.8**	**2.9**	**2.0**
GDP Price Index (*2012 = 100*)	123.5	125.6	127.0	128.1	129.1	129.9	118.3	126.1	130.2	132.5
Percent Change Annualized	**8.0**	**6.9**	**4.6**	**3.5**	**3.1**	**2.3**	**4.1**	**6.5**	**3.2**	**1.8**
Crude Oil, WTI (*$/Barrel*)	95.0	107.1	110.0	115.0	111.0	104.0	68.0	106.8	100.5	85.9
Labor Markets										
Payroll Jobs (*Millions*)	150.4	151.6	152.2	152.7	153.0	153.2	146.1	151.7	153.3	154.3
Percent Change Annualized	**4.7**	**3.2**	**1.7**	**1.3**	**0.7**	**0.5**	**2.8**	**3.8**	**1.1**	**0.6**
Unemployment Rate (*Percent*)	3.8	3.6	3.5	3.5	3.6	3.7	5.4	3.6	3.7	3.9
Average Weekly Hours, Prod. Works.	34.1	34.1	34.0	34.0	33.9	33.8	34.3	34.0	33.8	33.7
Personal Income										
Average Hourly Earnings (*$*)	26.9	27.3	27.7	28.2	28.6	29.0	25.9	27.6	29.2	30.6
Percent Change Annualized	**5.8**	**6.0**	**6.1**	**6.2**	**6.0**	**5.7**	**4.9**	**6.4**	**5.9**	**4.8**
Real Disp. Income (*2012 Billions $*)	15339	15465	15603	15731	15863	16008	16021	15535	16084	16594
Percent Change Annualized	**-2.0**	**3.3**	**3.6**	**3.3**	**3.4**	**3.8**	**2.2**	**-3.0**	**3.5**	**3.2**
Housing										
Housing Starts (*Ths., Ann. Rate*)	1753	1664	1608	1572	1484	1205	1605	1649	1341	1120
Ext. Home Sales (*Ths., Ann Rate*)	6063	5730	5761	5711	5662	5527	6127	5816	5584	5485
New SF Home Sales (*Ths., Ann Rate*)	814	758	729	711	678	616	774	753	623	559
Case/Shiller HPI (*Jan. 2000 = 100*)	288.2	290.4	292.1	292.6	291.0	287.2	276.5	292.6	280.9	286.5
Percent Change Year Ago	**19.0**	**14.0**	**9.4**	**5.8**	**1.0**	**-1.1**	**18.9**	**5.8**	**-4.0**	**2.0**
Consumer										
Auto Sales (*Millions*)	14.1	13.9	15.5	16.3	16.6	17.2	15.0	14.9	16.5	15.9
Consumer Credit (*Billions $*)	4539	4637	4730	4817	4895	4964	4432	4817	5092	5320
Percent Change Year Ago	**7.3**	**7.9**	**8.6**	**8.7**	**7.8**	**7.1**	**5.9**	**8.7**	**5.7**	**4.5**
Interest Rates (Percent)										
Prime Rate	3.29	3.94	5.15	6.12	6.66	6.75	**3.25**	**4.62**	**6.72**	**5.93**
Federal Funds	0.12	0.77	2.03	2.99	3.54	3.63	**0.08**	**1.48**	**3.59**	**2.81**
3-Month Treasury Bill	0.28	1.07	2.09	2.95	3.45	3.47	**0.03**	**1.60**	**3.41**	**2.69**
10-Year Treasury Note	1.94	2.98	3.35	3.39	3.36	3.33	**1.43**	**2.91**	**3.30**	**3.14**
30-Year Fixed Mortgage	3.79	5.27	5.61	5.59	5.52	5.44	**2.96**	**5.07**	**5.40**	**5.08**

a = actual   f = forecast   p = preliminary

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