

# NATIONAL ECONOMIC OUTLOOK

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## Executive Summary

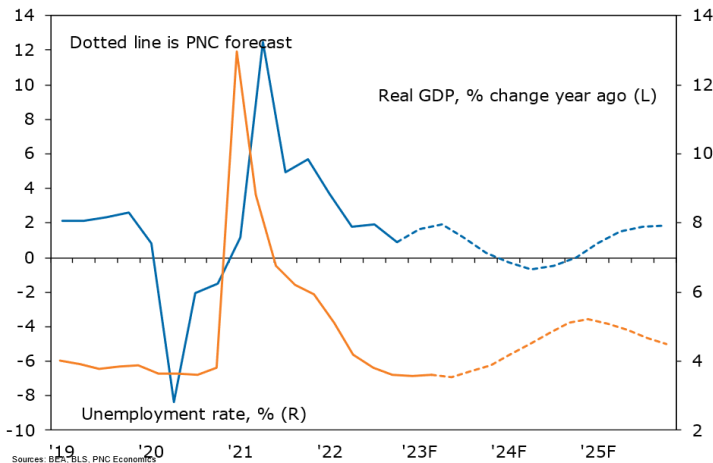
### **Labor Market Remains Very Strong in Early 2023; FOMC Hikes Rates in March, But Finance Woes Further Complicate the Picture**

- Job growth was stronger than expected once again in February, with the U.S. economy adding 311,000 jobs according to a survey of employers, compared to the consensus expectation of 205,000. There were small downward revisions to job growth in January and December, but over the last three months the economy has added more than 350,000 jobs per month on average. This is well above the economy's long-term potential, and too hot for the Federal Reserve. The unemployment rate rose to 3.6% in February from 3.4% in January, which was the lowest rate since 1969. The increase in the unemployment rate came primarily from 419,000 people entering the labor force in February from January. The labor force participation rate—the share of adults working or looking for work—rose to 62.5% in February from 62.4% in January, the highest this rate has been since before the pandemic. But given that the labor force participation rate was consistently above 63% before the pandemic, the labor market remains exceptionally tight in early 2023.
- Inflation remains much higher than the Federal Reserve would like. The overall consumer price index rose 0.4% in February from January, following a 0.5% increase in January. On a year-ago basis overall CPI inflation was 6.0% in February, down from 6.4% in January and a cyclical peak of 8.9% in June. The core CPI, excluding food and energy prices, rose a big 0.5% in February, up from 0.4% increases in December and January. Year-over-year core CPI inflation was 5.5% in February, down from 5.6% in January and a cyclical peak of 6.6% in September. Inflation remains concentrated in services. Services prices, excluding energy, increased 0.6% in February, including a 0.8% increase for shelter (primarily housing). This type of services inflation tends to be sticky from month to month, leading to concerns that high inflation could become persistent.
- The Federal Open Market Committee increased the federal funds rate, its key short-term policy rate, by 0.25 percentage point on March 22, to a range of 4.75% to 5.00%. The FOMC started to raise the fed funds rate just over one year ago, from essentially 0%, so there has been a very rapid increase in interest rates as the Fed works to cool off the economy and bring inflation back to its 2% objective. Recent bank failures (see next page) have made the FOMC's job more difficult. In early March, before the failures, the expectation was that the FOMC would increase the fed funds rate by 0.50 percentage point. But given the increased uncertainty the FOMC opted for a smaller rate hike, waiting to see how the current turmoil plays out.

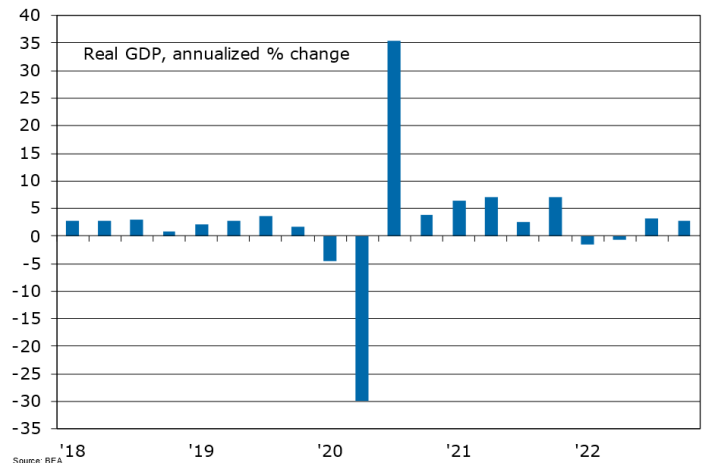
**Baseline U.S. Economic Outlook, Summary Table\***

	4Q'22a	1Q'23f	2Q'23f	3Q'23f	4Q'23f	1Q'24f	2022a	2023f	2024f	2025f
<b>Output</b>										
Real GDP (Chained 2012 Billions \$)	20187	20246	20274	20282	20248	20189	20015	20263	20191	20491
Percent Change Annualized	2.7	1.2	0.6	0.2	-0.7	-1.2	2.1	1.2	-0.4	1.5
CPI (1982-84 = 100)	298.5	301.3	304.2	306.4	307.9	309	292.6	305.0	309.8	313.7
Percent Change Annualized	4.2	3.8	3.8	2.9	2.0	1.0	8.0	4.2	1.6	1.3
<b>Labor Markets</b>										
Payroll Jobs (Millions)	154.3	155.4	155.9	156.1	155.8	155.4	152.6	155.8	155.0	155.4
Percent Change Annualized	2.5	2.9	1.4	0.4	-0.8	-0.9	4.3	2.1	-0.5	0.3
Unemployment Rate (Percent)	3.6	3.5	3.7	3.9	4.2	4.5	3.6	3.8	4.9	4.8
<b>Interest Rates (Percent)</b>										
Federal Funds	3.64	4.52	4.88	4.88	4.88	4.85	1.68	4.79	4.46	3.88
10-Year Treasury Note	3.82	3.74	4.01	4.02	4.02	4.01	2.94	3.95	3.97	3.80
a = actual    f = forecast    p = preliminary										
*Please see the Expanded Table for more forecast series.										

## Mild Recession Starting Later This Year Is Still the Likeliest Outcome



## Small Contraction in GDP in First Half of 2022 Does Not Meet National Bureau of Economic Research Recession Definition



## Small Businesses Are Optimistic in Early 2023, But Financial Woes Have Upended the Outlook

Uncertainty surrounding the economic outlook has increased in the spring of 2023. The labor market is the strongest it has been in decades, consumers continue to spend, and small business optimism is historically strong. But the Federal Open Market Committee continues to aggressively raise interest rates to combat very high inflation, contributing to three bank failures in March. Although the banking system appears strong in aggregate, PNC expects a mild recession starting in the second half of this year, before recovery starts in mid-2024.

Small businesses are highly optimistic in early 2023, according to the results of PNC's latest semi-annual survey of small and mid-sized businesses. Business owner optimism about the outlook for their own businesses over the next six months reached a 20-year survey high. Six in 10 business leaders feel highly optimistic about the prospects for their own company despite remaining cautious about the national and their local economies. The gap between optimism for their company versus the broader U.S. economy is now at a survey high of 34 percentage points, nearly double the historic survey average (18 percentage points). The survey also revealed that leaders are expecting a better overall business environment, with nearly two-thirds expressing the belief that business conditions in the U.S. will improve in the next six months, and more than one-half expecting to see sales increases over the same timeframe.

Business owners also see an easing in pricing pressures. Fewer businesses than in the last three waves of the semi-annual survey report that they plan to increase their own prices to customers by 5% or more in the next six months. In addition, fewer than half (47%) anticipate supplier prices to increase in the next six months, down from over half (53%) last fall and returning to a level similar to a year ago (46%). More businesses expect supply chain timeliness to improve compared to six months ago, and fewer are experiencing inventory shortages. While supply chain disruptions remain the top worry for two in 10 owners, this area of concern no longer stands out significantly from others, and in fact matches the proportion concerned primarily about the cost of materials.

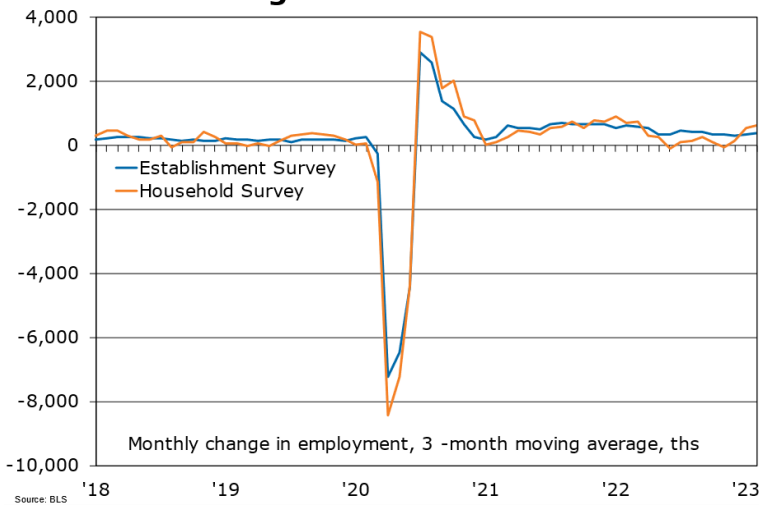
But the survey wrapped up in early February, before recent problems emerged in the U.S. and global banking systems. In March the Federal Deposit Insurance Corporation took over Silicon Valley Bank and Signature Bank, and Silvergate Bank voluntarily liquidated. The FDIC guaranteed all deposits at Silicon Valley and Signature, not just those covered by the agency's \$250,000 insured limit. In addition, a consortium of large banks provided \$30 billion in deposits to threatened First Republic Bank to help alleviate liquidity concerns. And the Federal Reserve has expanded its credit offerings to U.S. banks, making it easier for them to borrow to meet any increased demand for deposits. The expectation is that these steps will increase confidence in the U.S. banking system and encourage depositors to keep their funds in banks. In Europe, the Swiss government brokered a deal for UBS to take over its competitor Credit Suisse, which was near collapse after U.S. banking woes exacerbated concerns about the bank, which had been struggling for years.

Right now the banking problems appear confined to a few institutions that had specific problems. In aggregate U.S. banks hold a lot of capital relative to deposits, and the FDIC and Fed have moved aggressively to prevent additional bank runs. But the aggressive tightening in monetary policy over the past year is exposing the financial system to increased stress, creating further uncertainty. This is weighing on confidence, and the U.S. economy is likely to enter recession later this year as consumers and businesses absorb the full impact of higher interest rates.

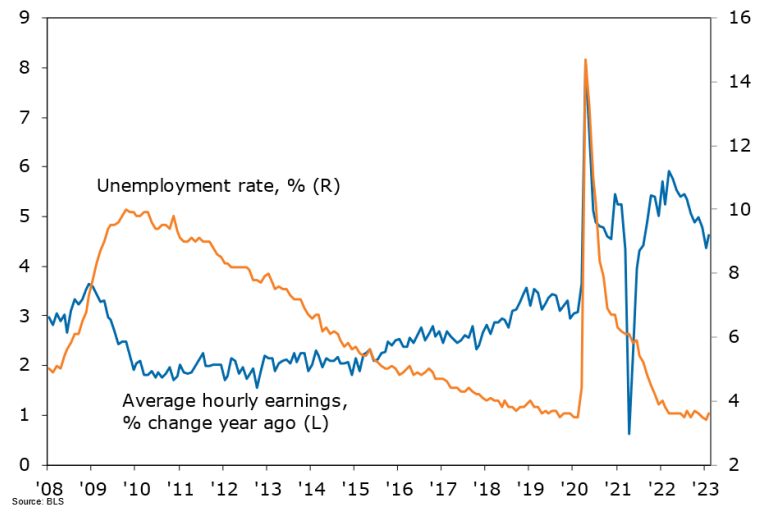
With inflation still elevated PNC expects an additional 0.25 percentage point increase in the federal funds rate at the FOMC's next meeting in early May. By that point high interest rates and financial stress will be substantial drags on the economy, and PNC expects the FOMC to keep the fed funds rate unchanged through the rest of 2023, in a range between 5.00% and 5.25%. The U.S. economy is likely to enter recession in the second half of 2023, leading to job losses and an unemployment rate of above 5% in 2024, slowing wage growth and inflation. But because businesses have had such difficulties in hiring over the past couple of years they will be reluctant to lay workers off during the downturn. Thus job losses in the upcoming recession will be smaller than in other recessions, limiting the depth of the overall downturn. The recession is expected to end by mid-2024 as the FOMC begins to cut interest rates in response to the deteriorating labor market and a slowing in inflation.

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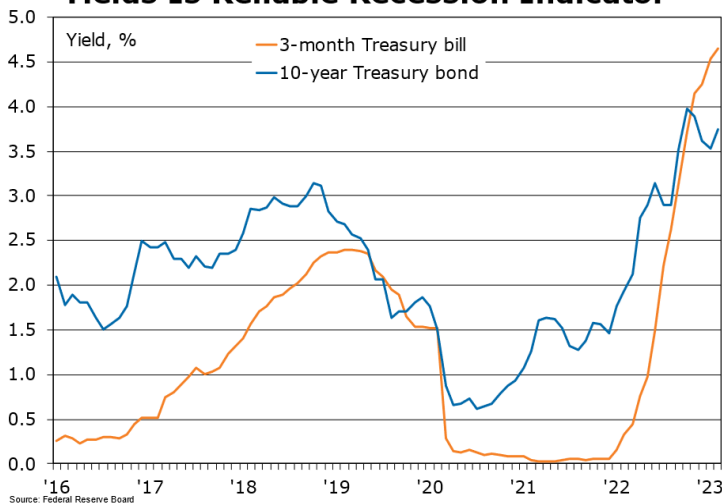
## Job Growth in Early 2023 Still Running Too Hot for the Fed



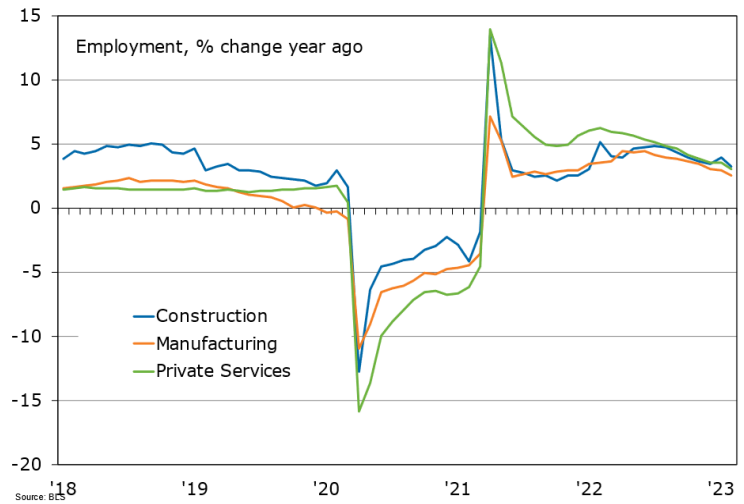
## Increase in Unemployment Rate in February Came From More People Looking for Work, A Good Sign



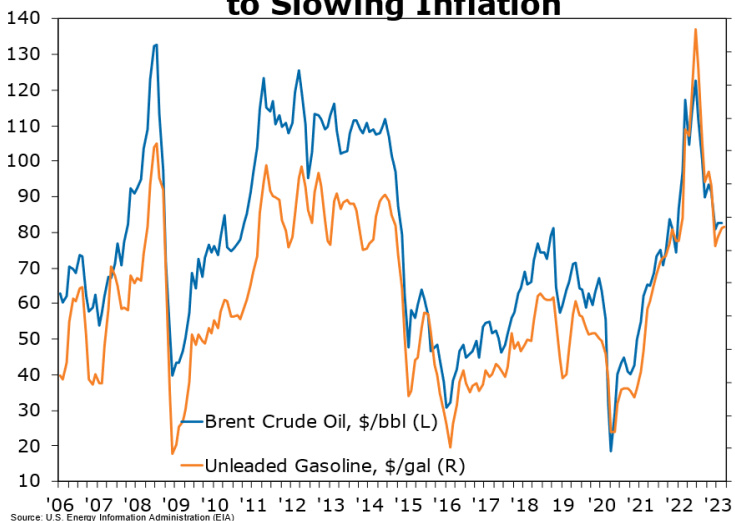
## Short-Term Yields Above Long-Term Yields Is Reliable Recession Indicator



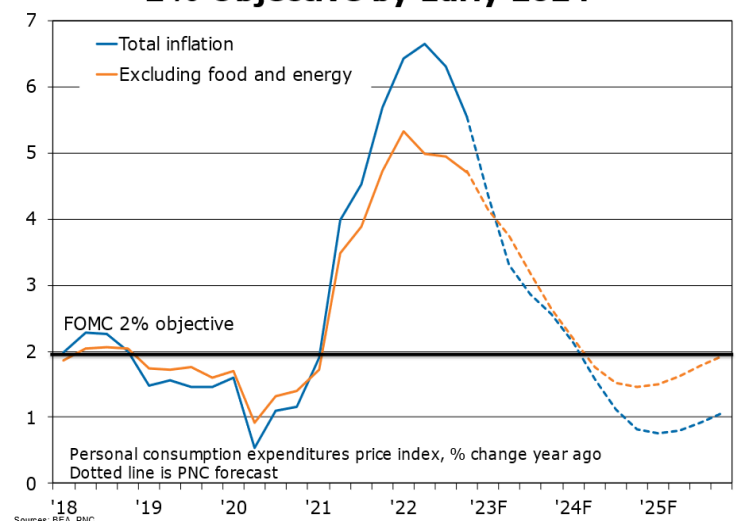
## Construction Employment Continues to Increase in Early 2023 Even as High Mortgage Rates Weigh on Housing



## Lower Energy Prices Contributing to Slowing Inflation

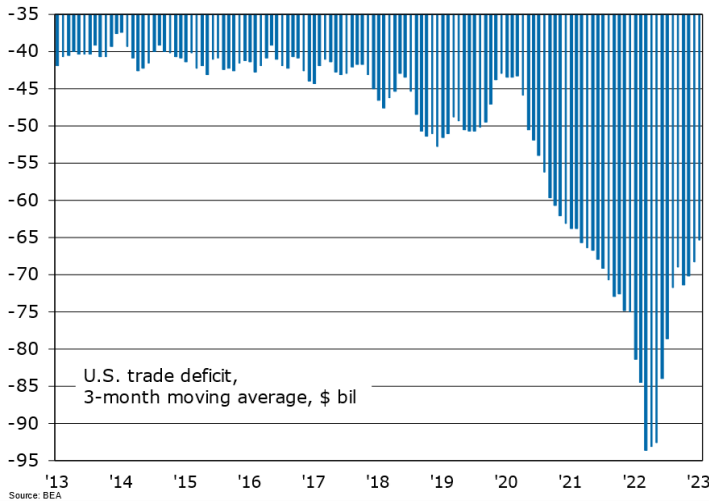


## Inflation Should Be Back to Fed 2% Objective by Early 2024

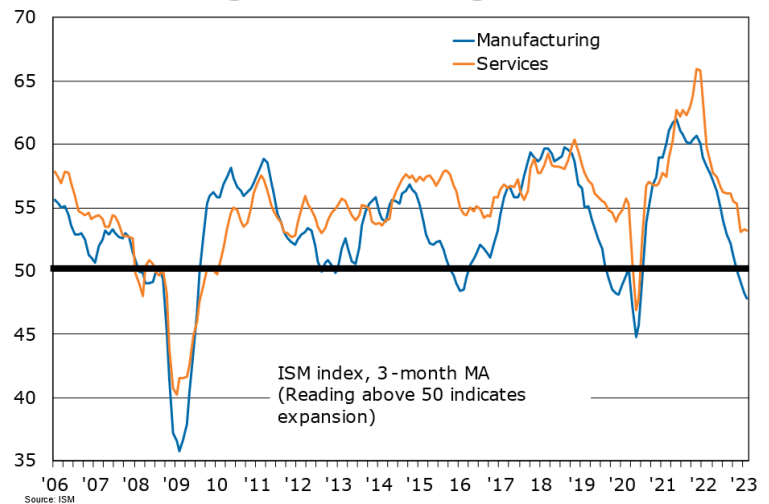


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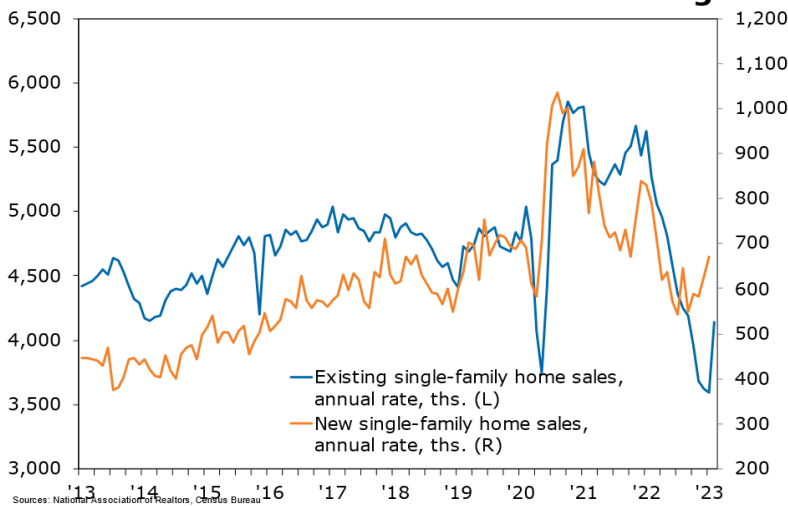
## Trade Deficit Continues to Decline, But at a Much Slower Pace



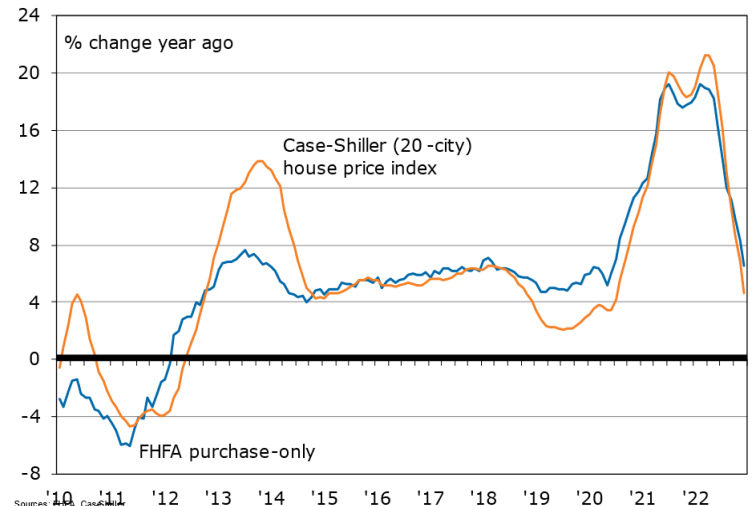
## Services Are Holding Up, But ISM Index Showing Manufacturing in Decline



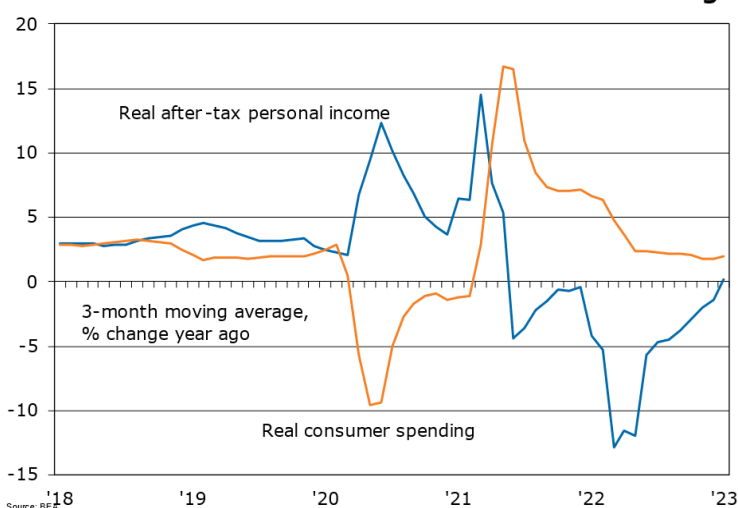
## Lower Mortgage Rates in Early 2023 Have Provided Modest Boost to Housing...



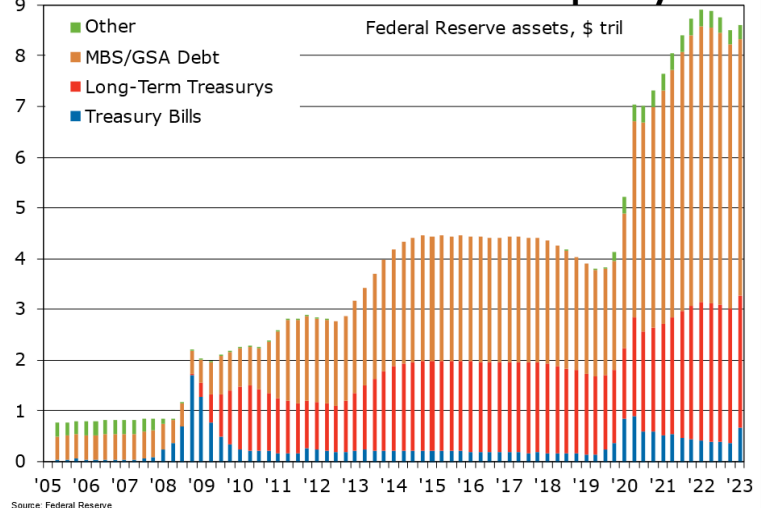
## ...But House Prices Are Falling on a Month-to-Month Basis



## With Strong Labor Market, Lower Inflation, Real Household Income Is Now Even From One Year Ago



## Fed Balance Sheet Growing Again As Banks Borrow to Increase Liquidity



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

	4Q'22a	1Q'23f	2Q'23f	3Q'23f	4Q'23f	1Q'24f	2022a	2023f	2024f	2025f
<b>Output</b>										
Nominal GDP (Billions \$)	26132	26399	26630	26827	26925	26931	25461	26695	27035	27752
Percent Change Annualized	6.5	4.1	3.6	3.0	1.5	0.1	9.2	4.8	1.3	2.7
Real GDP (Chained 2012 Billions \$)	20187	20246	20274	20282	20248	20189	20015	20263	20191	20491
Percent Change Annualized	2.7	1.2	0.6	0.2	-0.7	-1.2	2.1	1.2	-0.4	1.5
Pers. Consumption Expenditures	14227	14326	14376	14391	14384	14354	14133	14369	14352	14510
Percent Change Annualized	1.4	2.8	1.4	0.4	-0.2	-0.8	2.8	1.7	-0.1	1.1
Nonresidential Fixed Investment	2984	2990	2979	2954	2921	2889	2943	2961	2883	2969
Percent Change Annualized	3.3	0.9	-1.5	-3.3	-4.3	-4.4	3.8	0.6	-2.6	3.0
Residential Investment	575	547	526	508	494	487	643	519	487	505
Percent Change Annualized	-25.9	-18.0	-15.0	-13.0	-10.0	-6.0	-10.7	-19.3	-6.1	3.6
Change in Private Inventories	136	75	50	50	36	18	125	53	-3	29
Net Exports	-1238	-1209	-1176	-1131	-1094	-1063	-1357	-1153	-1034	-1051
Government Expenditures	3441	3454	3457	3448	3444	3441	3406	3451	3443	3467
Percent Change Annualized	3.6	1.5	0.3	-1.0	-0.5	-0.3	-0.6	1.3	-0.2	0.7
Industrial Prod. Index (2012 = 100)	104.1	104.6	104.2	103.2	101.7	100.0	103.9	103.4	100.0	103.9
Percent Change Annualized	-1.7	1.7	-1.5	-3.9	-5.7	-6.3	3.9	-0.5	-3.3	3.9
Capacity Utilization (Percent)	79.4	80.3	79.4	78.0	76.8	75.4	79.7	78.6	75.0	76.9
<b>Prices</b>										
CPI (1982-84 = 100)	298.5	301.3	304.2	306.4	307.9	309	292.6	305.0	309.8	313.7
Percent Change Annualized	4.2	3.8	3.8	2.9	2.0	1.0	8.0	4.2	1.6	1.3
Core CPI Index (1982-84 = 100)	300.4	303.7	306.7	308.9	310.2	311	294.3	307.4	312.8	318.3
Percent Change Annualized	5.1	4.5	4.0	2.9	1.8	1.4	6.1	4.4	1.8	1.8
PCE Price Index (2012 = 100)	124.7	125.6	126.5	127.3	127.9	128.2	122.8	126.8	128.6	129.7
Percent Change Annualized	3.2	2.7	3.0	2.6	1.9	1.0	6.2	3.3	1.4	0.9
Core PCE Price Index (2012 = 100)	125.2	126.2	127.2	127.9	128.5	129	123.2	127.5	129.7	131.9
Percent Change Annualized	3.9	3.4	3.1	2.4	1.7	1.5	5.0	3.4	1.7	1.7
GDP Price Index (2012 = 100)	129.4	130.4	131.4	132.3	133.0	133.4	127.2	131.7	133.9	135.4
Percent Change Annualized	3.5	3.2	3.0	2.8	2.1	1.3	7.0	3.6	1.6	1.1
Crude Oil, WTI (\$/Barrel)	82.6	81.0	79.5	75.0	72.0	71.0	94.4	76.9	75.3	81.5
<b>Labor Markets</b>										
Payroll Jobs (Millions)	154.3	155.4	155.9	156.1	155.8	155.4	152.6	155.8	155.0	155.4
Percent Change Annualized	2.5	2.9	1.4	0.4	-0.8	-0.9	4.3	2.1	-0.5	0.3
Unemployment Rate (Percent)	3.6	3.5	3.7	3.9	4.2	4.5	3.6	3.8	4.9	4.8
Average Weekly Hours, Prod. Works.	33.9	33.8	33.8	33.8	33.7	33.6	34.0	33.8	33.6	33.6
<b>Personal Income</b>										
Average Hourly Earnings (\$)	28.1	28.4	28.8	29.1	29.4	29.7	27.6	28.9	30.0	30.7
Percent Change Annualized	4.9	5.0	4.9	4.9	4.4	3.8	6.4	5.0	3.8	2.3
Real Disp. Income (2012 Billions \$)	15181	15397	15495	15593	15640	15703	15092	15531	15806	16259
Percent Change Annualized	3.3	5.8	2.6	2.5	1.2	1.6	-6.4	2.9	1.8	2.9
<b>Housing</b>										
Housing Starts (Mil., Ann. Rate)	1403	1163	1057	1009	992	975	1555	1055	930	936
Ext. Home Sales (Mil., Ann Rate)	4177	4117	4105	4250	4473	4672	5094	4236	4846	5324
New SF Home Sales (Mil., Ann Rate)	605	523	504	473	455	445	642	489	437	460
Case/Shiller HPI (Jan. 2000 = 100)	298.6	294.7	287.2	278.7	270.2	261.7	298.6	270.2	262.3	268.7
Percent Change Year Ago	7.7	1.4	-5.4	-7.7	-9.5	-11.2	7.7	-9.5	-2.9	2.4
<b>Consumer</b>										
Auto Sales (Millions)	14.3	14.6	14.5	14.4	14.0	13.4	13.8	14.4	13.0	13.3
Consumer Credit (Billions \$)	4763	4814	4864	4908	4944	3885	4763	4944	5052	5282
Percent Change Year Ago	7.5	6.4	5.2	4.4	3.8	-19.3	7.5	3.8	2.2	4.5
<b>Interest Rates (Percent)</b>										
Prime Rate	6.82	7.69	8.00	8.00	8.00	7.98	4.85	7.92	7.59	7.00
Federal Funds	3.64	4.52	4.88	4.88	4.88	4.85	1.68	4.79	4.46	3.88
3-Month Treasury Bill	4.06	4.75	4.93	4.90	4.89	4.80	2.00	4.87	4.40	3.74
10-Year Treasury Note	3.82	3.74	4.01	4.02	4.02	4.01	2.94	3.95	3.97	3.80
30-Year Fixed Mortgage	6.66	6.34	6.22	5.80	5.82	5.83	5.32	6.04	5.81	5.69
a = actual    f = forecast    p = preliminary										

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