July 2017

NATIONAL ECONOMIC OUTLOOK

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Executive Summary

Job Growth Picked Back Up Again in June, But Inflation Slowed

- The June jobs report was strong across the board. The U.S. economy added 222,000 jobs in June, well above the consensus expectation of 180,000. There were also big upward revisions to job growth in April and May, by a combined 47,000. Job growth has averaged an excellent 194,000 over the past three months, above the pace of 187,000 per month for all of last year. The unemployment rate rose to 4.4 percent in June from 4.3 percent in May. However, the increase in the unemployment rate was actually good news, as the number of people in the labor force rose by 361,000 in June, a vote of confidence in the job market after the labor force fell by 429,000 in May. The one disappointing aspect of the June jobs report was lackluster wage growth. Average hourly earnings were up 2.5 percent in June from one year earlier, but this is soft given that the expansion is now 8 years old.

- The consumer price index was flat in June, as energy prices fell 1.6 percent, holding down overall inflation. Core inflation, excluding food and energy, was 0.1 percent over the month. Year-over-year overall inflation was 1.6 percent in June, down from 1.9 percent in May and its recent high of 2.8 percent in February. Core inflation was 1.7 percent year-over-year in June, unchanged from May and down from 2.3 percent in January. The recent drop in energy prices and year-over-year comparisons overstate the slowing in broad inflation. In particular, core inflation has stabilized over the past few months, after it slowed in the early spring due to transitory factors that Federal Reserve Chair Yellen has mentioned in recent speeches, including price declines for cell phone plans and pharmaceuticals. PNC Economics expects inflation to pick up in the second half of 2017 as the tight labor market boosts wage pressures.

- The Federal Open Market Committee raised the federal funds rate by 0.25 percentage point on June 14, to a range of 1.00 to 1.25 percent. The FOMC also announced that it expects to start reducing the size of the Federal Reserve's balance sheet later this year. The central bank's balance sheet increased from less than a trillion dollars in 2008 to about $4.5 trillion by 2014 as the Fed created money electronically and used the funds to buy long-term securities in a successful effort to push down long-term interest rates and support economic growth. The Fed will not reinvest some of the principal payments on these securities, allowing the balance sheet to gradually shrink and putting modest upward pressure on long-term interest rates.

Baseline U.S. Economic Outlook, Summary Table*

	1Q'17a	2Q'17f	3Q'17f	4Q'17f	1Q'18f	2Q'18f	3Q'18f	4Q'18f	2016a	2017f	2018f	2019f
Output & Prices												
Real GDP (*Chained 2009 Billions $*)	16873	16986	17125	17225	17316	17441	17544	17644	16662	17052	17486	17868
Percent Change Annualized	**1.4**	**2.7**	**3.3**	**2.3**	**2.1**	**2.9**	**2.4**	**2.3**	**1.6**	**2.3**	**2.5**	**2.2**
CPI (*1982-84 = 100*)	244.1	243.9	244.6	245.8	247.2	248.7	250.2	251.7	240.0	244.6	249.5	255.5
Percent Change Annualized	**3.1**	**-0.3**	**1.1**	**1.9**	**2.4**	**2.4**	**2.4**	**2.4**	**1.3**	**1.9**	**2.0**	**2.4**
Labor Markets												
Payroll Jobs (*Millions*)	145.7	146.2	146.7	147.2	147.6	148.0	148.3	148.7	144.3	146.4	148.1	149.5
Percent Change Annualized	**1.5**	**1.4**	**1.4**	**1.3**	**1.1**	**1.0**	**1.0**	**1.0**	**1.8**	**1.5**	**1.2**	**0.9**
Unemployment Rate (*Percent*)	4.7	4.4	4.3	4.2	4.2	4.2	4.2	4.2	4.9	4.4	4.2	4.1
Interest Rates (Percent)												
Federal Funds	0.70	0.95	1.13	1.17	1.38	1.42	1.65	1.92	0.40	0.99	1.59	2.39
Treasury Note, 10-year	2.45	2.26	2.43	2.61	2.75	2.80	2.86	2.95	1.84	2.44	2.84	3.05

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

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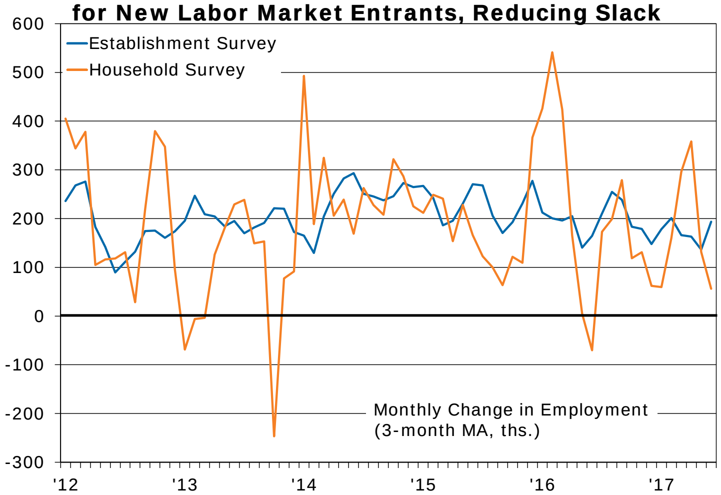
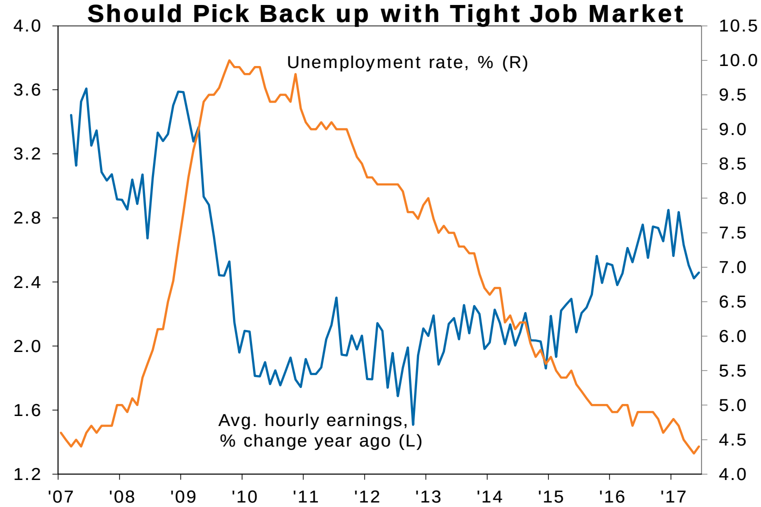
Economy Continues to Create More than Enough Jobs for New Labor Market Entrants, Reducing Slack



Wage Growth Has Slowed in 2017, But Should Pick Back up with Tight Job Market



As Expansion Hits Eight-Year Mark, U.S. Economy Still Has Room to Grow

According to the National Bureau of Economic Research, the current U.S. economic expansion began in June of 2009, meaning that it is now more than eight years old. It has lasted much longer than the 58-month average of post-World War II expansions. The better news is that the current expansion, now the third-longest in U.S. history, has the potential to become the longest, surpassing the expansions that lasted most of the 1960s (106 months) and the 1990s (120 months).

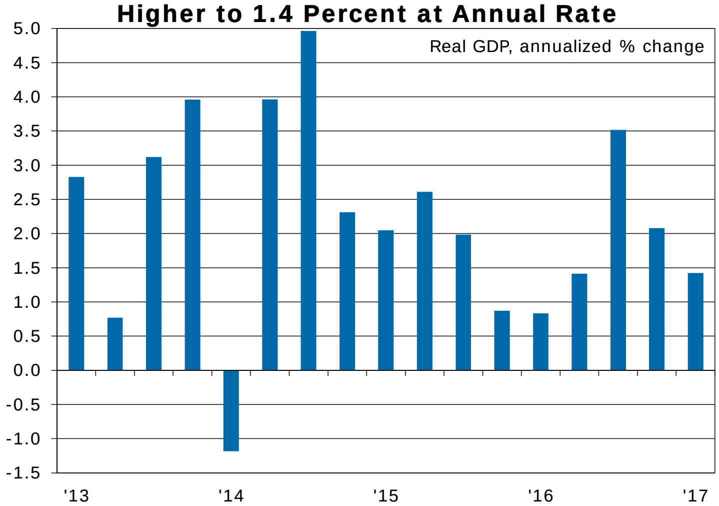
In some respects the current expansion has been disappointing. The Great Recession that began in late 2007 was the steepest U.S. downturn since the Great Recession, as measured by length (18 months), the peak-to-trough decline in inflation-adjusted GDP (4.2 percent), and the trough-to-peak increase in the unemployment rate (up 5.5 percentage points). Given the depth of the downturn, economists were generally expecting a strong recovery. But real GDP growth has averaged just 2.1 percent an annual rate during the expansion, far below the 3.3 percent average growth from the 1970s through the 1990s, a period that included five recessions. A number of factors have held back the expansion, including policy mistakes, weak productivity growth, political infighting in Washington, slow global economic growth, and business uncertainty that has weighed on investment. But even with mediocre growth the economy is in decent shape in mid-2017. As measured by real GDP the economy is about 13 percent larger than it was at its previous peak in late 2007. The economy lost 8.7 million jobs between early 2008 and early 2010, but has since added almost 17 million jobs. And the unemployment rate, which peaked at 10.0 percent in October 2009, is now down to 4.4 percent, and set to move even lower.

The flipside of the disappointing expansion is that the economy is well-poised to continue to grow at least throughout 2018. Recessions are caused by imbalances that develop in the economy: the Great Recession by problems in the housing market and the financial system; the 2001 recession by the bursting of the tech bubble; the 1990-91 recession by problems in commercial real estate markets and the savings and loan industry; and the double-dip recessions in the early 1980s by double-digit inflation and the Federal Reserve drastically increasing interest rates in response. But the U.S. economy is now on a pretty even footing. Consumer and corporate balance sheets are in great shape, housing and commercial real estate markets are well-balanced, inflation is under control, and global economic growth is picking up. Stocks might be a bit overpriced, but not by enough to cause significant problems in the broader economy.

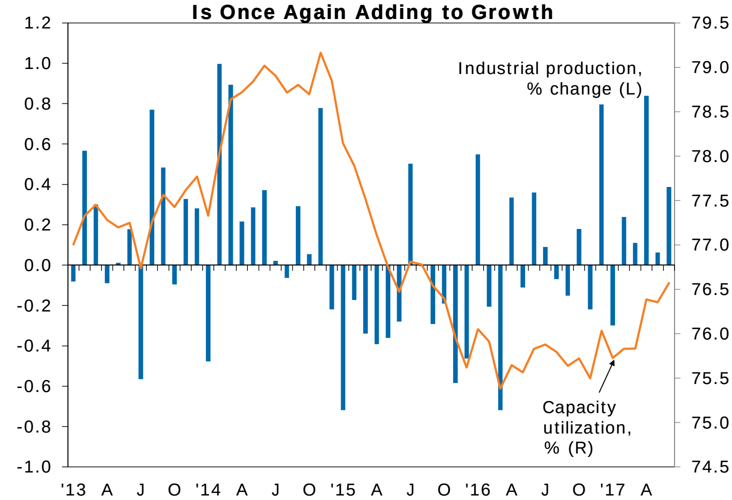
There are potential pitfalls, mostly on the policy side. The Federal Reserve could make a mistake, and either raise interest rates too quickly, choking off growth, or move too cautiously and allow inflation to accelerate, leading to a more significant tightening in monetary policy in a year or two. The Trump administration could miscalculate and cause a trade war, leading to a global economic slowdown and a U.S. recession. Or a geopolitical event, such as a terrorist attack or war on the Korean peninsula, could derail the economy.

But the fundamentals for continued economic expansion remain in place. Real GDP growth will average about 2.3 percent in 2017, up from 1.6 percent last year, as business investment recovers from the energy-induced slowdown of 2016. Growth should accelerate slightly in 2018 thanks to expected personal and corporate income tax cuts, and perhaps a boost to infrastructure spending. Job gains will gradually slow over the next few years as businesses find it more and more difficult to hire as the job market further tightens, from around 170,000 per month this year to 110,000 per month in 2019. The unemployment rate will fall a bit, bottoming out at close to 4 percent over the next couple of years; this will put upward pressure on wages. More jobs and higher pay will continue to support consumer spending growth. The FOMC is expected to raise the federal funds rate again at the end of this year, and three times in 2018, which would bring it to a range of 2.00 to 2.25 percent at the end of 2018.

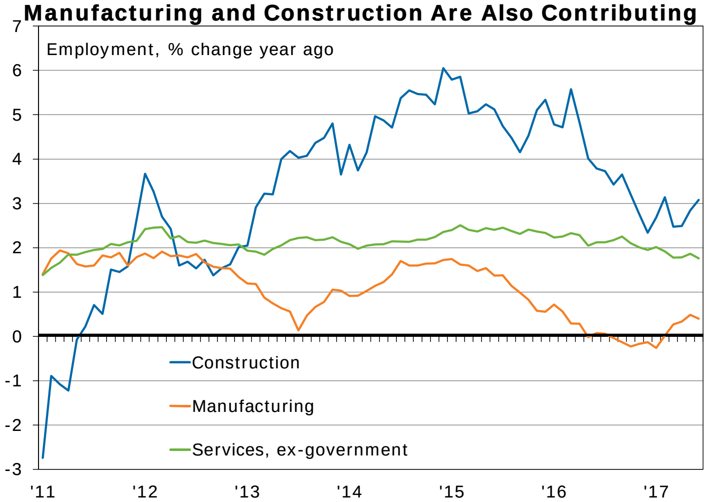
GDP Growth in First Quarter Revised Higher to 1.4 Percent at Annual Rate



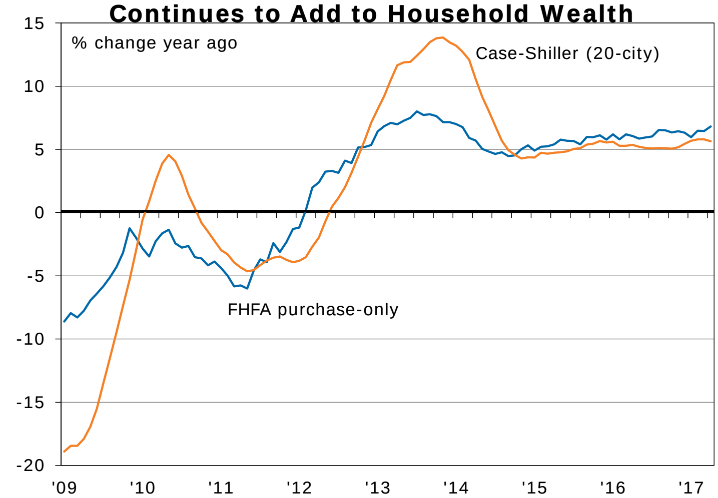
Industrial Side of the Economy Is Once Again Adding to Growth



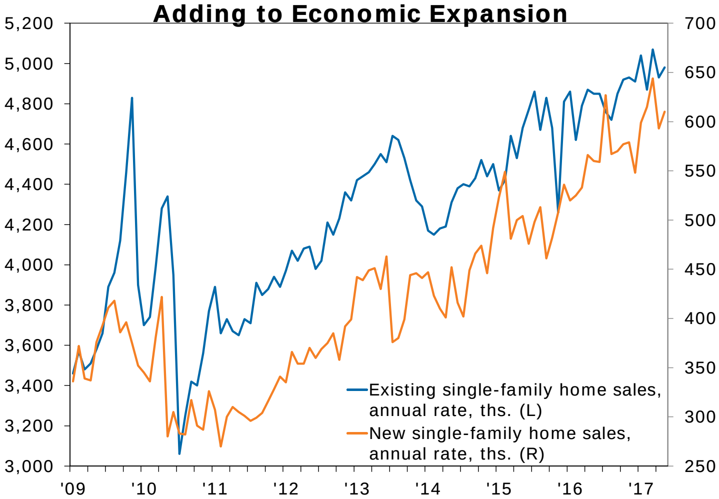
Services Accounting for the Bulk of Job Growth, But Manufacturing and Construction Are Also Contributing



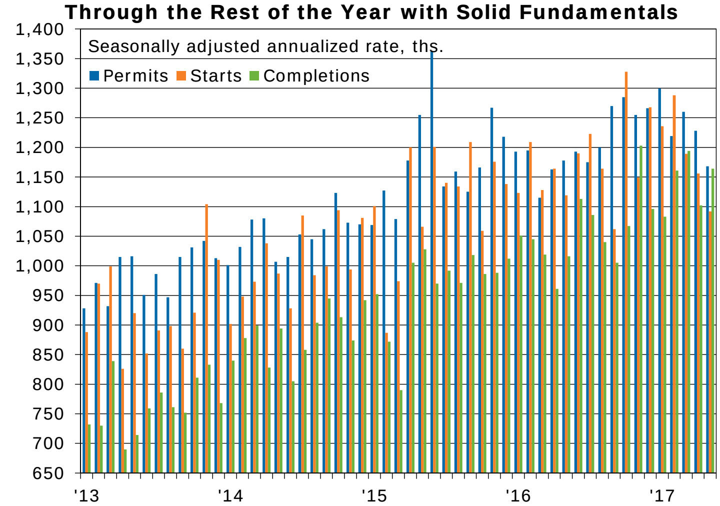
Moderate House Price Growth Continues to Add to Household Wealth



Upward Trend in Home Sales Continues, Adding to Economic Expansion



Homebuilding Has Slowed Recently, But Should Improve Through the Rest of the Year with Solid Fundamentals



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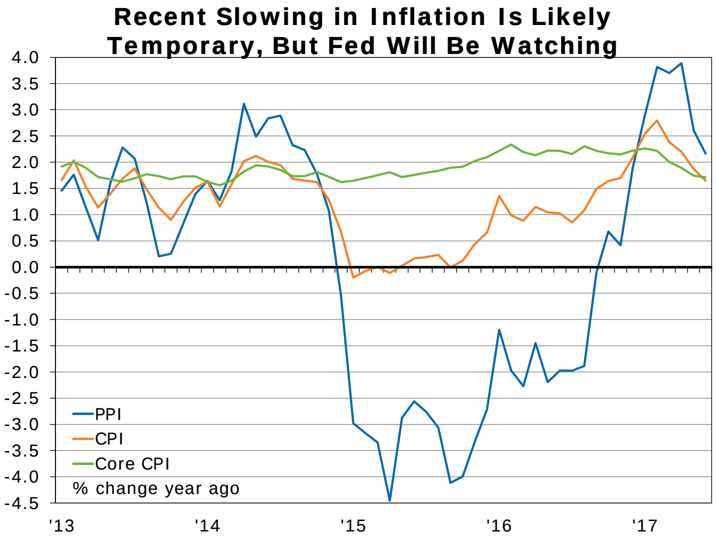

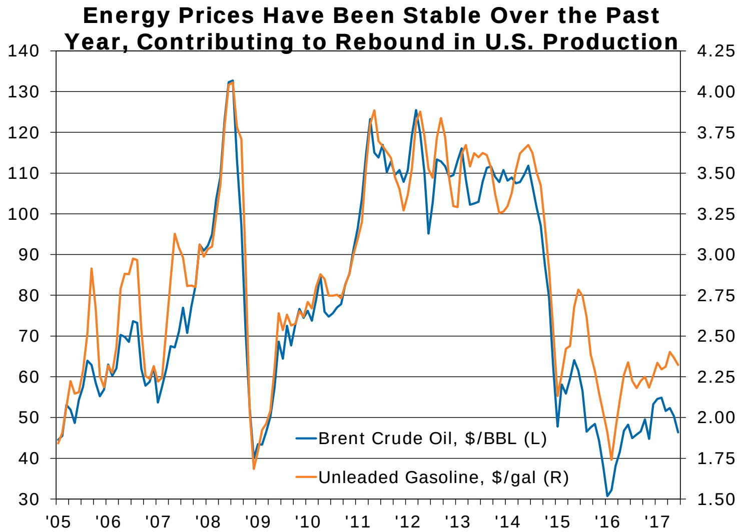

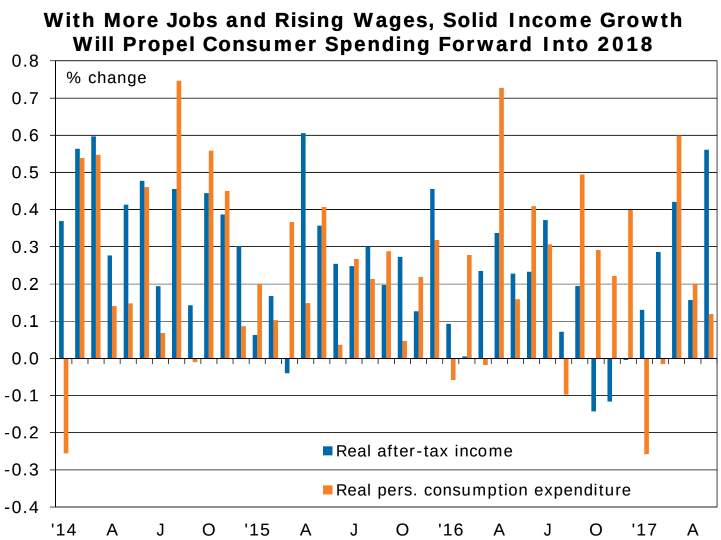

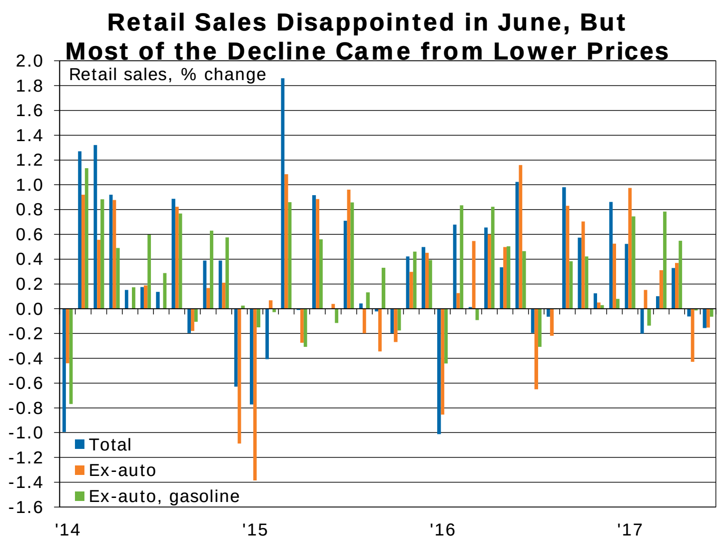

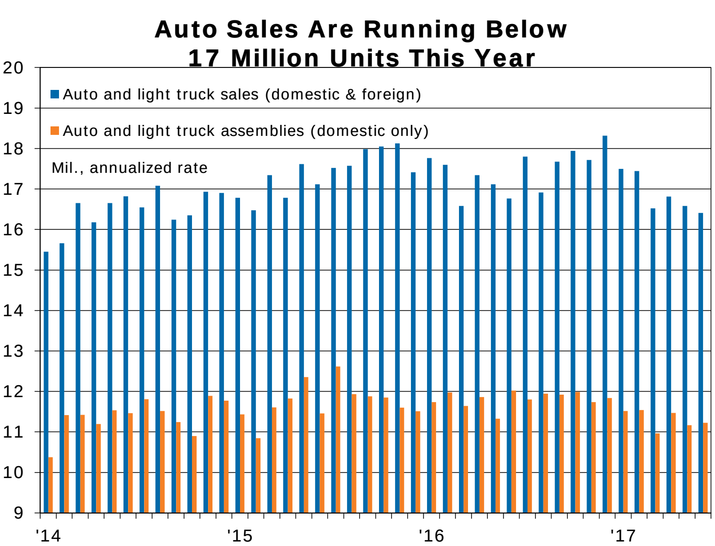

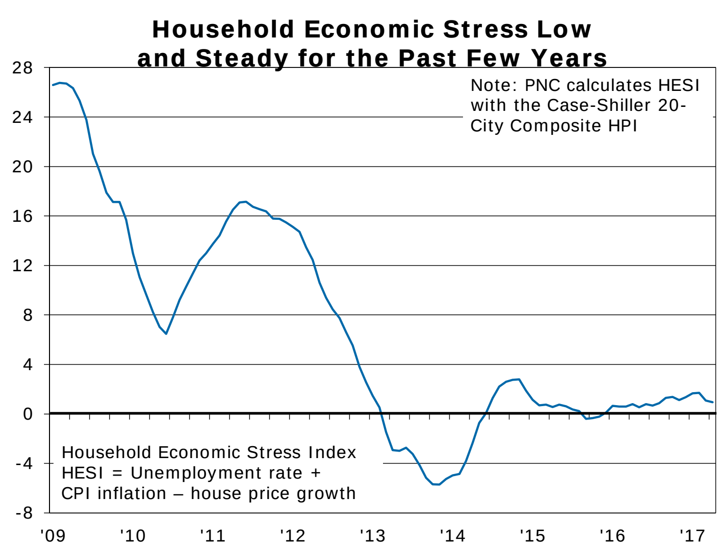

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Baseline U.S. Economic Outlook, Expanded Table

	1Q'17a	2Q'17f	3Q'17f	4Q'17f	1Q'18f	2Q'18f	3Q'18f	4Q'18f	2016a	2017f	2018f	2019f
Output												
Nominal GDP (*Billions $*)	19027	19193	19437	19647	19851	20095	20317	20538	18569	19326	20200	21068
Percent Change Annualized	**3.4**	**3.5**	**5.2**	**4.4**	**4.2**	**5.0**	**4.5**	**4.4**	**3.0**	**4.1**	**4.5**	**4.3**
Real GDP (*Chained 2009 Billions $*)	16873	16986	17125	17225	17316	17441	17544	17644	16662	17052	17486	17868
Percent Change Annualized	**1.4**	**2.7**	**3.3**	**2.3**	**2.1**	**2.9**	**2.4**	**2.3**	**1.6**	**2.3**	**2.5**	**2.2**
Pers. Consumption Expenditures	11701	11784	11851	11918	11986	12064	12147	12221	11522	11813	12105	12381
Percent Change Annualized	**1.1**	**2.9**	**2.3**	**2.3**	**2.3**	**2.6**	**2.8**	**2.5**	**2.7**	**2.5**	**2.5**	**2.3**
Nonresidential Fixed Investment	2252	2266	2290	2309	2323	2339	2352	2365	2189	2279	2345	2395
Percent Change Annualized	**10.4**	**2.5**	**4.1**	**3.4**	**2.4**	**2.8**	**2.2**	**2.3**	**-0.5**	**4.1**	**2.9**	**2.2**
Residential Investment	614	613	619	624	628	635	638	643	592	618	636	659
Percent Change Annualized	**12.9**	**-1.1**	**4.0**	**3.5**	**2.8**	**4.5**	**1.8**	**3.3**	**4.9**	**4.3**	**3.0**	**3.6**
Change in Private Inventories	3	16	52	53	55	59	59	61	22	31	59	63
Net Exports	-596	-602	-608	-616	-623	-623	-633	-644	-563	-605	-631	-658
Government Expenditures	2901	2912	2926	2939	2950	2970	2985	3000	2907	2920	2976	3032
Percent Change Annualized	**-0.9**	**1.5**	**1.9**	**1.9**	**1.5**	**2.6**	**2.0**	**2.1**	**0.8**	**0.4**	**1.9**	**1.9**
Industrial Prod. Index (*2012 = 100*)	103.7	104.9	105.2	105.6	106.0	106.7	107.4	108.2	103.1	104.8	107.1	109.6
Percent Change Annualized	**1.5**	**4.6**	**1.2**	**1.5**	**1.7**	**2.4**	**2.7**	**3.0**	**-1.2**	**1.7**	**2.1**	**2.4**
Capacity Utilization (*Percent*)	75.8	76.4	76.5	76.7	76.9	77.1	77.3	77.5	75.7	76.4	77.2	78.0
Prices												
CPI (*1982-84 = 100*)	244.1	243.9	244.6	245.8	247.2	248.7	250.2	251.7	240.0	244.6	249.5	255.5
Percent Change Annualized	**3.1**	**-0.3**	**1.1**	**1.9**	**2.4**	**2.4**	**2.4**	**2.4**	**1.3**	**1.9**	**2.0**	**2.4**
Core CPI Index (1982-84 = 100)	251.0	251.4	252.3	253.7	255.1	256.6	258.1	259.5	247.6	252.1	257.3	263.3
Percent Change Annualized	**2.5**	**0.6**	**1.5**	**2.2**	**2.3**	**2.3**	**2.3**	**2.3**	**2.2**	**1.8**	**2.1**	**2.3**
PCE Price Index (*2009 = 100*)	112.1	112.2	112.5	113.0	113.6	114.2	114.8	115.4	110.7	112.4	114.5	116.9
Percent Change Annualized	**2.4**	**0.2**	**1.0**	**1.9**	**2.1**	**2.1**	**2.1**	**2.1**	**1.1**	**1.6**	**1.8**	**2.1**
Core PCE Price Index (*2009 = 100*)	112.5	112.7	113.1	113.7	114.3	114.8	115.4	116.0	111.4	113.0	115.1	117.5
Percent Change Annualized	**2.0**	**0.7**	**1.4**	**2.1**	**2.0**	**2.0**	**2.0**	**2.0**	**1.7**	**1.5**	**1.9**	**2.0**
GDP Price Index (*2009 = 100*)	112.8	113.0	113.5	114.1	114.7	115.3	115.9	116.5	111.4	113.3	115.6	118.0
Percent Change Annualized	**1.9**	**0.8**	**1.9**	**2.0**	**2.1**	**2.1**	**2.1**	**2.1**	**1.3**	**1.7**	**2.0**	**2.1**
Crude Oil, WTI (*$/Barrel*)	51.8	48.3	48.0	49.0	50.5	51.0	52.3	53.5	43.1	49.3	51.8	55.7
Labor Markets												
Payroll Jobs (*Millions*)	145.7	146.2	146.7	147.2	147.6	148.0	148.3	148.7	144.3	146.4	148.1	149.5
Percent Change Annualized	**1.5**	**1.4**	**1.4**	**1.3**	**1.1**	**1.0**	**1.0**	**1.0**	**1.8**	**1.5**	**1.2**	**0.9**
Unemployment Rate (*Percent*)	4.7	4.4	4.3	4.2	4.2	4.2	4.2	4.2	4.9	4.4	4.2	4.1
Average Weekly Hours, Prod. Works.	33.6	33.7	33.7	33.7	33.7	33.8	33.8	33.8	33.6	33.7	33.8	33.9
Personal Income												
Average Hourly Earnings (*$*)	21.86	21.99	22.15	22.31	22.48	22.66	22.84	23.03	21.56	22.08	22.75	23.50
Percent Change Annualized	**2.0**	**2.4**	**2.8**	**3.0**	**3.1**	**3.2**	**3.3**	**3.3**	**2.5**	**2.4**	**3.0**	**3.3**
Real Disp. Income (*2009 Billions $*)	12783	12919	13032	13123	13212	13294	13383	13463	12667	12964	13338	13636
Percent Change Annualized	**1.7**	**4.3**	**3.6**	**2.8**	**2.8**	**2.5**	**2.7**	**2.4**	**2.6**	**2.3**	**2.9**	**2.2**
Housing												
Housing Starts (*Ths., Ann. Rate*)	1238	1171	1223	1251	1268	1289	1302	1315	1177	1221	1293	1344
Ext. Home Sales (*Ths., Ann Rate*)	5620	5608	5765	5827	5898	5954	6011	6058	5440	5705	5980	6135
New SF Home Sales (*Ths., Ann Rate*)	619	605	620	637	647	651	656	663	561	620	654	679
Case/Shiller HPI (*Jan. 2000 = 100*)	188.2	190.1	192.4	193.8	195.1	196.4	197.7	198.9	181.2	191.1	197.0	201.8
Percent Change Year Ago	**5.6**	**5.9**	**5.9**	**4.6**	**3.7**	**3.3**	**2.8**	**2.6**	**5.1**	**5.5**	**3.1**	**2.4**
Consumer												
Household Economic Stress Index	1.7	0.4	0.1	1.1	1.8	2.8	3.7	4.0	1.0	0.8	3.1	4.1
Auto Sales (*Millions*)	17.2	16.6	16.8	16.9	17.1	17.2	17.3	17.3	17.5	16.9	17.2	17.2
Consumer Credit (*Billions $*)	3813	3849	3891	3932	3975	4017	4060	4105	3677	3871	4039	4212
Percent Change Annualized	**5.1**	**3.9**	**4.4**	**4.3**	**4.4**	**4.2**	**4.4**	**4.5**	**6.2**	**5.3**	**4.3**	**4.3**
Interest Rates (Percent)												
Prime Rate	3.80	4.05	4.25	4.30	4.50	4.54	4.78	5.05	3.51	4.10	4.72	5.45
Federal Funds	0.70	0.95	1.13	1.17	1.38	1.42	1.65	1.92	0.40	0.99	1.59	2.39
3-Month Treasury Bill	0.61	0.89	1.09	1.21	1.33	1.47	1.65	1.90	0.32	0.95	1.59	2.34
10-Year Treasury Note	2.45	2.26	2.43	2.61	2.75	2.80	2.86	2.95	1.84	2.44	2.84	3.05
30-Year Fixed Mortgage	4.17	3.99	4.13	4.28	4.38	4.40	4.43	4.51	3.65	4.14	4.43	4.58

a = actual *f = forecast* *p = preliminary*

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