January 2017

NATIONAL ECONOMIC OUTLOOK

Stuart Hoffman Chief Economist | **Gus Faucher** Deputy Chief Economist | **William Adams** Senior Economist | **Kurt Rankin** Economist | **Mekael Teshome** Economist

THE PNC FINANCIAL SERVICES GROUP | The Tower at PNC Plaza | 300 Fifth Avenue | Pittsburgh, PA 15222-2401

Executive Summary

Fed Hikes Rates at the End of 2016 with Improving U.S. Economy; More Rate Increases to Come

- Real GDP growth for the third quarter of 2016 was revised up to 3.5 percent at an annual rate in the third estimate, from 2.9 percent in the advance estimate and 3.2 percent in the second estimate. This was the best quarter for economic growth since the fourth quarter of 2013. Consumer spending was up a solid 3.0 percent, down from the unstainable pace of 4.3 percent in the second quarter. Inventories were a positive, adding 0.5 percentage point to annualized growth, after subtracting from growth for five straight quarters. Trade also added to growth, thanks to a surge in soybean exports, but will become a drag in the fourth quarter. Real gross domestic income, another measure of the size of the economy measuring incomes of households and firms, rose 4.8 percent per annum in the third quarter, the strongest pace since the second quarter of 2014.

- Payroll employment increased by 178,000 in November, with a combined net downward revision to job growth in September and October of just 2,000. Average monthly job growth in 2016, through November, was a solid 180,000, but a slowing from 229,000 in 2015. The unemployment rate fell from 4.9 percent in October to 4.6 percent in November, but some of the drop came from a decline in the labor force participation rate. Average hourly earnings in the private sector fell 0.1 percent in November, but this followed large gains the two previous months. Average hourly earnings were up 2.5 percent in November from one year earlier. This was down from 2.8 percent growth in October, but up from around 2 percent from 2012 through 2014. The tighter job market is pushing firms to raise wages in order to retain their current workers and hire new ones.

- The Federal Open Market Committee raised the Federal funds rate by 0.25 percentage point on December 14, to a range of 0.50 to 0.75 percent. The vote was unanimous. This was the first increase in the Fed funds rate in a year; before December 2015 it had been in a range of 0 to 0.25 percent since late 2009. The projections released along with the FOMC statement indicate a faster pace of rate increases over the next few years compared to the previous projections, from September. The median Fed funds rate at the end of 2017 is now projected to be 1.4 percent, compared to 1.1 percent in September; the corresponding figures are 2.1 percent and 1.9 percent for 2018, and 2.9 percent and 2.6 percent for 2019. This implies three funds rate increases in 2017, three in 2018, and three in 2019.

Baseline U.S. Economic Outlook, Summary Table*

	1Q'16a	2Q'16a	3Q'16p	4Q'16f	1Q'17f	2Q'17f	3Q'17f	4Q'17f	2015a	2016f	2017f	2018f
Output & Prices												
Real GDP (*Chained 2009 Billions $*)	16525	16583	16713	16810	16895	16994	17107	17236	16397	16658	17058	17511
Percent Change Annualized	**0.8**	**1.4**	**3.2**	**2.4**	**2.0**	**2.3**	**2.7**	**3.0**	**2.6**	**1.6**	**2.4**	**2.7**
CPI (*1982-84 = 100*)	237.9	239.4	240.4	242.1	243.4	244.8	246.1	247.6	237.0	239.9	245.5	251.3
Percent Change Annualized	**-0.3**	**2.5**	**1.6**	**2.9**	**2.2**	**2.2**	**2.3**	**2.4**	**0.1**	**1.2**	**2.3**	**2.4**
Labor Markets												
Payroll Jobs (*Millions*)	143.5	144.0	144.6	145.2	145.7	146.2	146.7	147.2	141.8	144.3	146.4	148.4
Percent Change Annualized	**1.9**	**1.3**	**1.8**	**1.6**	**1.5**	**1.4**	**1.3**	**1.3**	**2.1**	**1.8**	**1.5**	**1.3**
Unemployment Rate (*Percent*)	4.9	4.9	4.9	4.8	4.7	4.6	4.6	4.6	5.3	4.9	4.6	4.5
Interest Rates (Percent)												
Federal Funds	0.37	0.37	0.40	0.44	0.63	0.67	0.88	0.92	0.13	0.39	0.77	1.54
Treasury Note, 10-year	1.91	1.75	1.56	2.10	2.45	2.54	2.63	2.71	2.14	1.83	2.58	3.02

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

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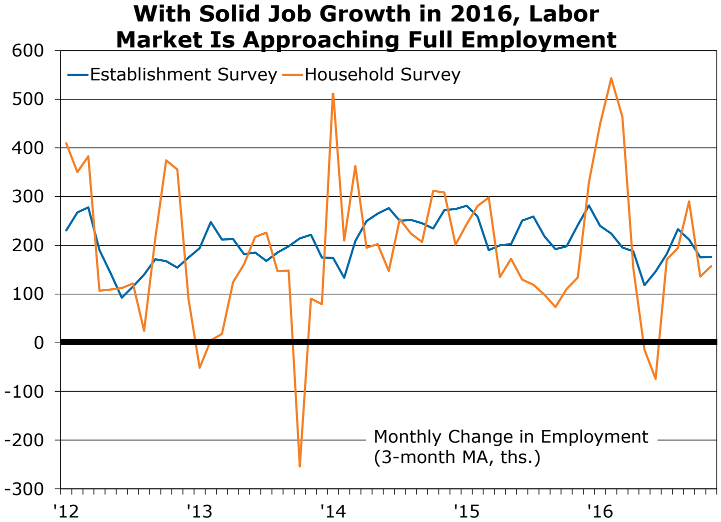
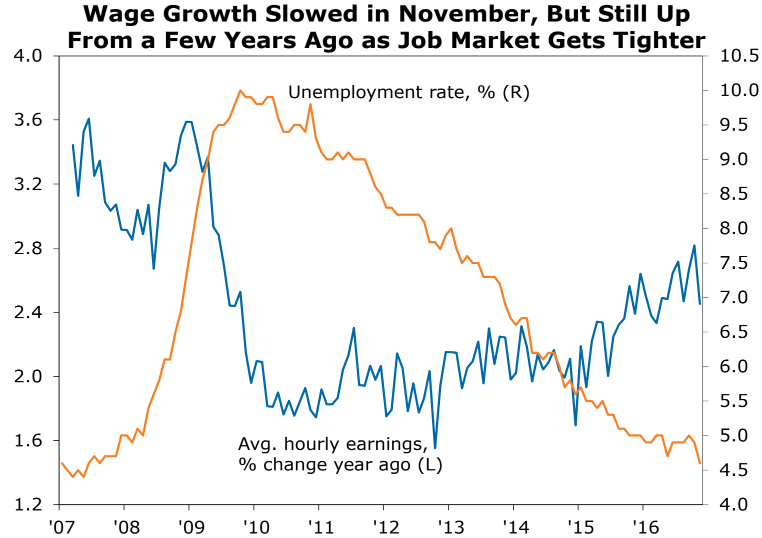




Fiscal Stimulus Will Prompt Stronger Economic Growth in 2017 and 2018, But Many Question Marks Remain

The U.S. economy is in solid shape at the start of this year, with the economic expansion set to continue throughout 2017 and into 2018. The big changes in policies that could come from a Trump administration also have created a great deal of uncertainty about what the economy will look like in a few years, but when was the future ever known with certainty?

Expansionary fiscal policy will likely add to economic growth in the latter half of 2017 and in 2018. President Trump and the Republican-controlled Congress will work together to cut personal and corporate income tax rates, increase federal spending on infrastructure and defense, and reduce regulations, starting with Obamacare. It will take some time for these policies to be enacted and then impact the economy, but by later this year these policies should be providing a noticeable boost to economic growth. PNC is forecasting real GDP growth of 2.4 percent for 2017 and 2.7 percent for 2018, up from a forecast of around 2¼ percent for both years prior to the election.

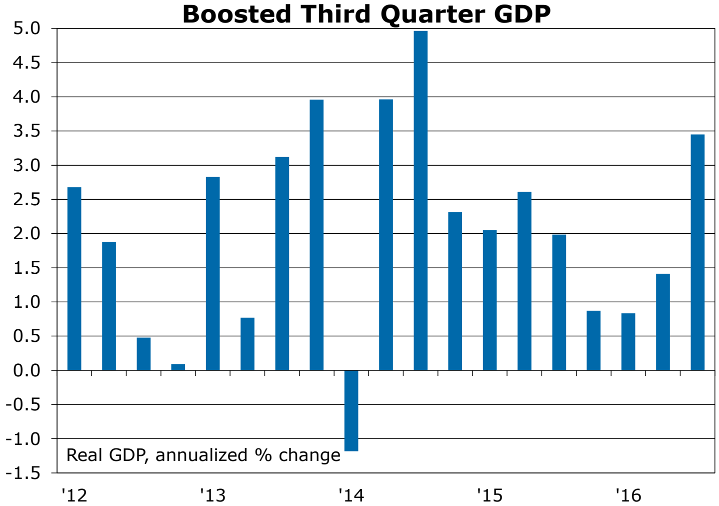
Current economic conditions are favorable. Job growth in 2016 was about double the pace of underlying labor force growth, allowing for further absorption of labor market slack that has persisted since the Great Recession. The unemployment rate has moved below 5 percent, and other measures of job market slack are returning to healthy levels. The job market should be close to full employment later this year, with most people who want a job, and have the necessary skills, able to find work. With the tighter job market increased competition for workers has pushed businesses to raise pay. Job and wage gains are boosting personal income, allowing households to increase their spending; many are also benefitting from higher stock and house prices. As a result consumer spending will continue to lead economic growth in 2017. Also, the housing market will continue to gradually recover from the Great Recession. And business investment is increasing, albeit more slowly compared to previous expansions.

Some drags on growth of the past few years are lifting. After adding too much inventory in 2015 and early 2016, businesses have cut orders to below sales to fix the problem. Indeed, inventory rebuilding will promote economic growth this year. With the stabilization in energy prices since mid-2016, energy production bottomed out last summer and the numbers of working oil and gas rigs are rising; this has contributed to a rebound in manufacturing. And the Federal government, which had been a weight on the economy because of spending cuts, tax increases and regulations, is now poised to promote economic and job growth.

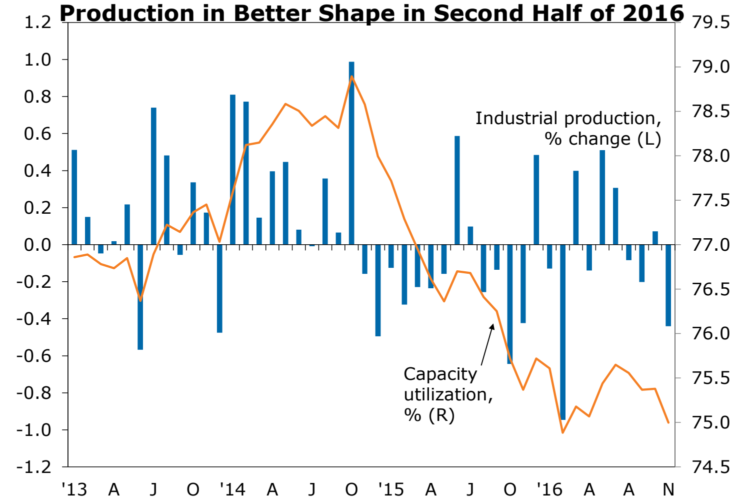
However, the risks to the outlook are now larger than they were previously. Although global economic growth is set to pick up in 2017, in part due to improvement in Europe, trade disputes could threaten the global economy and weigh on U.S. exports. In addition, the dollar has strengthened since the presidential election, on top of a sizable strengthening from 2014 to early 2016. The stronger dollar will encourage imports and discourage exports, leading to a larger trade deficit that will weigh on growth.

With further economic expansion in 2017 the labor market will continue to improve, with job growth of around 170,000 per month. There is little room for the unemployment rate to move lower, and it will end 2017 at around 4.5 percent. The Federal Open Market Committee will gradually increase the Federal funds rate over the next few years, with PNC expecting two 25 basis point Fed funds rate increases in 2017 (one fewer than in the latest FOMC median projection), and four 25 basis point funds rate increases in 2018 (one more than in the FOMC median projection), bringing the funds rate up to a range of 2.00 to 2.25 percent by the end of 2018. Longer-term interest rates will also increase, but not by as much as short-term rates. Given solid fundamentals, including good job growth, low inflation, and few indications of overvalued asset prices, the probability of recession this year is low, about 15 percent. But the probability of recession will build in 2018 because of a fiscal stimulus with an already-tight labor market, rising interest rates, and the potential for policy disruptions to global trade flows. With the job market already near full employment and expansionary fiscal policy likely, inflation is set to pick up over the next couple of years. Higher inflation expectations have already led to increases in both short-term and long-term interest rates. So far the increases have not been enough to create a significant drag on growth, but if inflation picks up more than expected and the Federal Reserve is forced to raise rates quickly, then the economic expansion could be in trouble down the road.

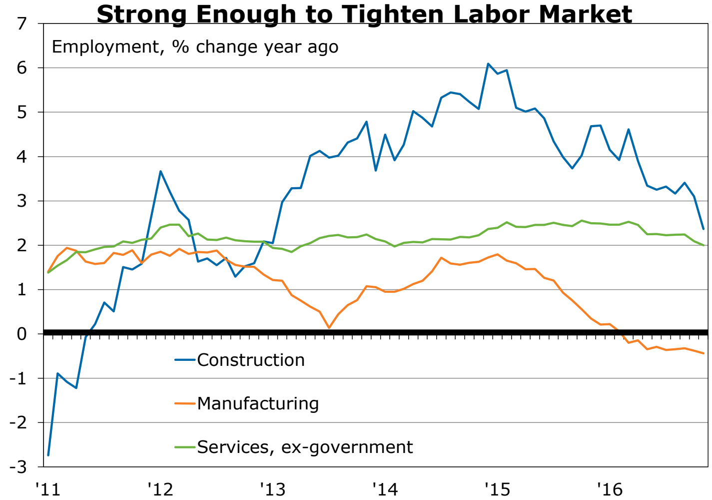
End to Inventory Correction Boosted Third Quarter GDP



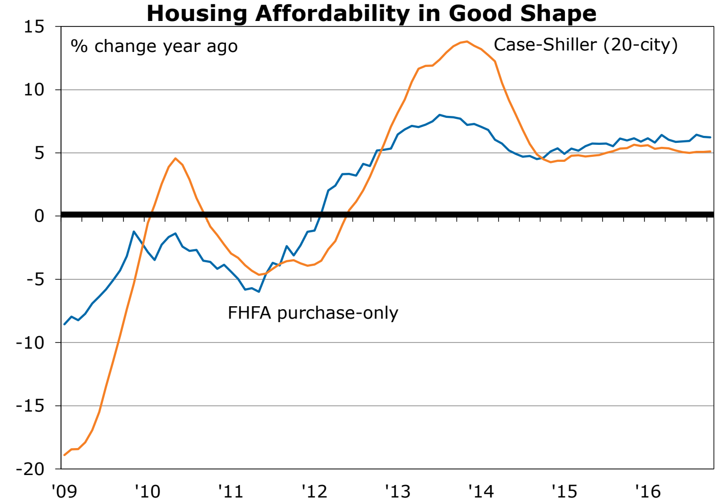
Utilities a Big Drag in November, But Industrial Production in Better Shape in Second Half of 2016



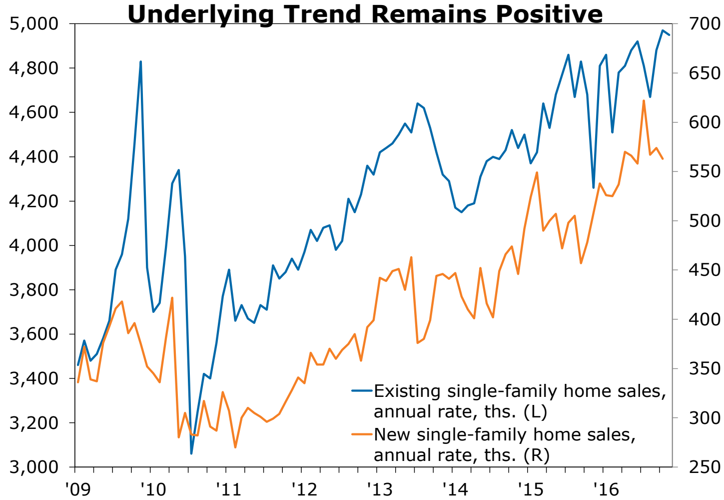
Job Growth Has Slowed in 2016, But Still Strong Enough to Tighten Labor Market



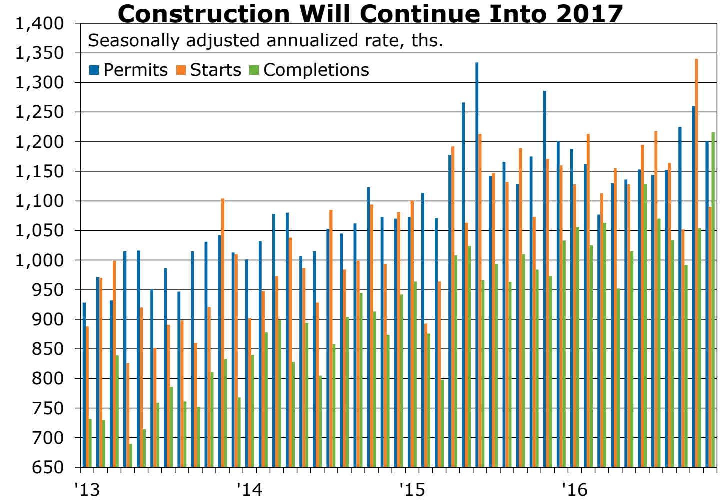
With Sustainable House Price Growth, Housing Affordability in Good Shape



Home Sales Slowed in November, But Underlying Trend Remains Positive



Gradual Recovery in Residential Construction Will Continue Into 2017



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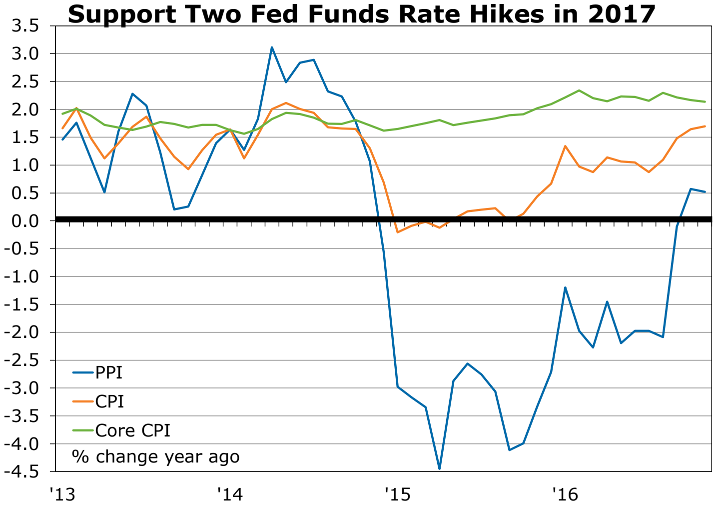
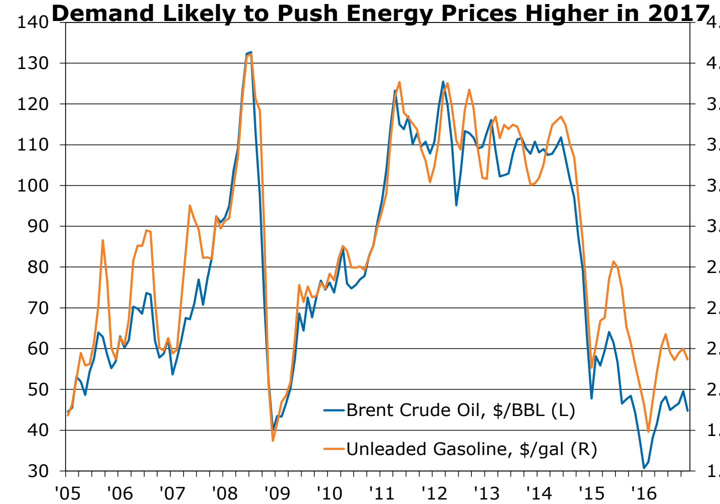
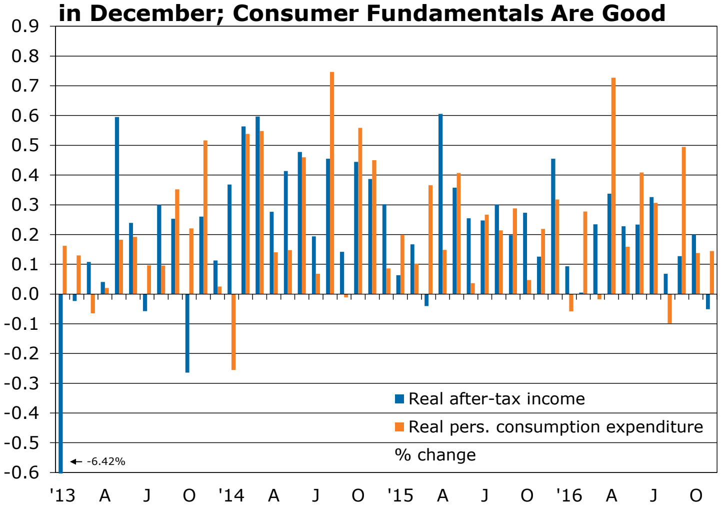
Further Strengthening in Inflation Will Support Two Fed Funds Rate Hikes in 2017



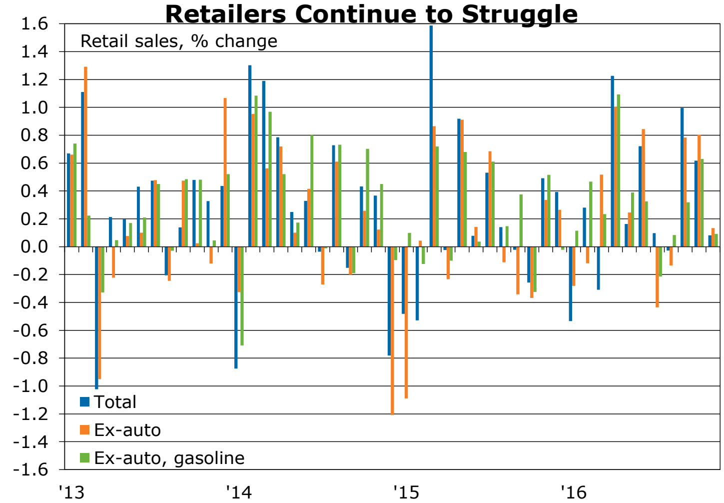
OPEC Agreement on Production Cuts, Stronger Demand Likely to Push Energy Prices Higher in 2017



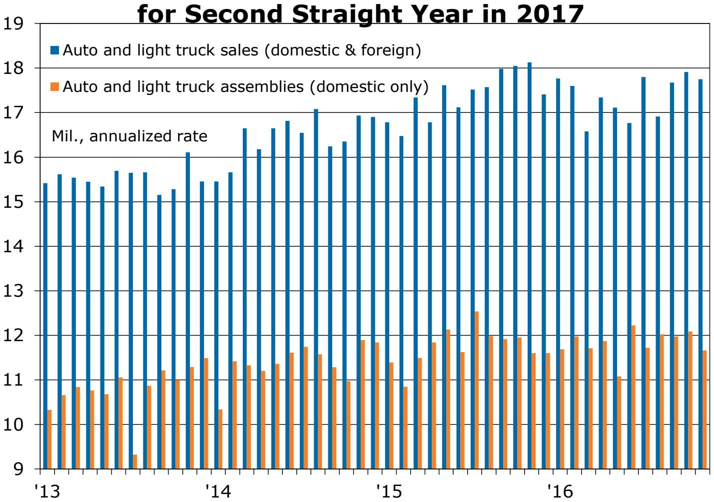
After Small November Decline, Income to Bounce Back in December; Consumer Fundamentals Are Good



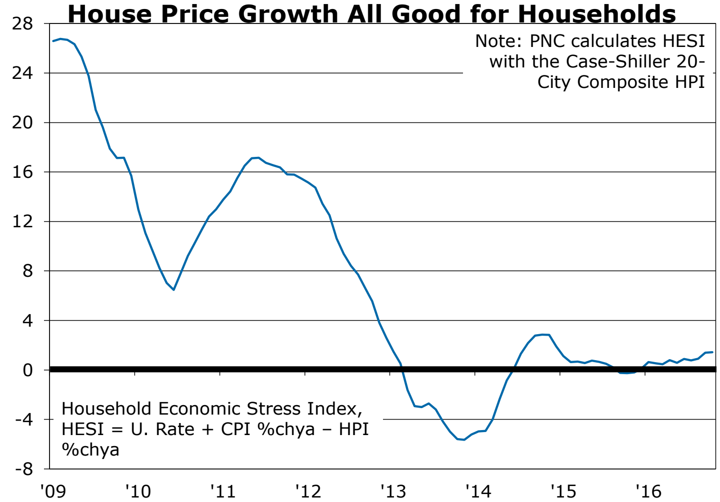
A Solid Holiday Season, But Traditional Retailers Continue to Struggle



Auto Sales Should Hit 17.5 Million for Second Straight Year in 2017



Low Unemployment, Low Inflation, Solid House Price Growth All Good for Households



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PNC Economics Group
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Baseline U.S. Economic Outlook, Expanded Table

	1Q'16a	2Q'16a	3Q'16p	4Q'16f	1Q'17f	2Q'17f	3Q'17f	4Q'17f	2015a	2016f	2017f	2018f
Output												
Nominal GDP (*Billions $*)	18282	18450	18658	18887	19070	19272	19492	19739	18037	18569	19393	20310
Percent Change Annualized	**1.3**	**3.7**	**4.6**	**5.0**	**3.9**	**4.3**	**4.7**	**5.1**	**3.7**	**3.0**	**4.4**	**4.7**
Real GDP (*Chained 2009 Billions $*)	16525	16583	16713	16810	16895	16994	17107	17236	16397	16658	17058	17511
Percent Change Annualized	**0.8**	**1.4**	**3.2**	**2.4**	**2.0**	**2.3**	**2.7**	**3.0**	**2.6**	**1.6**	**2.4**	**2.7**
Pers. Consumption Expenditures	11365	11485	11564	11644	11713	11783	11852	11928	11215	11514	11819	12099
Percent Change Annualized	**1.6**	**4.3**	**2.8**	**2.8**	**2.4**	**2.4**	**2.4**	**2.6**	**3.2**	**2.7**	**2.6**	**2.4**
Nonresidential Fixed Investment	2180	2185	2186	2198	2210	2225	2242	2258	2200	2187	2234	2288
Percent Change Annualized	**-3.4**	**1.0**	**0.1**	**2.3**	**2.2**	**2.7**	**2.9**	**2.9**	**2.1**	**-0.6**	**2.1**	**2.4**
Residential Investment	601	589	582	595	602	608	614	619	565	592	611	626
Percent Change Annualized	**7.8**	**-7.8**	**-4.4**	**9.1**	**4.9**	**3.9**	**4.0**	**3.5**	**11.7**	**4.8**	**3.2**	**2.5**
Change in Private Inventories	41	-10	8	20	25	32	35	45	84	15	34	48
Net Exports	-566	-559	-521	-552	-568	-579	-582	-586	-540	-549	-579	-587
Government Expenditures	2913	2901	2903	2914	2921	2933	2955	2980	2884	2908	2947	3045
Percent Change Annualized	**1.6**	**-1.7**	**0.2**	**1.5**	**1.1**	**1.6**	**3.0**	**3.5**	**1.8**	**0.8**	**1.4**	**3.3**
Industrial Prod. Index (*2012 = 100*)	104.1	103.9	104.4	104.8	105.3	105.9	106.4	107.1	105.2	104.3	106.2	108.7
Percent Change Annualized	**-1.7**	**-0.8**	**2.0**	**1.5**	**1.9**	**2.0**	**2.2**	**2.4**	**0.3**	**-0.8**	**1.8**	**2.4**
Capacity Utilization (*Percent*)	75.4	75.2	75.5	75.8	76.0	76.3	76.6	77.0	76.7	75.5	76.5	77.7
Prices												
CPI (*1982-84 = 100*)	237.9	239.4	240.4	242.1	243.4	244.8	246.1	247.6	237.0	239.9	245.5	251.3
Percent Change Annualized	**-0.3**	**2.5**	**1.6**	**2.9**	**2.2**	**2.2**	**2.3**	**2.4**	**0.1**	**1.2**	**2.3**	**2.4**
Core CPI Index (1982-84 = 100)	245.8	247.0	248.2	249.5	250.8	252.2	253.6	255.1	242.2	247.6	252.9	258.7
Percent Change Annualized	**2.7**	**2.1**	**1.9**	**2.1**	**2.2**	**2.2**	**2.3**	**2.3**	**1.8**	**2.2**	**2.1**	**2.3**
PCE Price Index (*2009 = 100*)	110.0	110.5	110.9	111.6	112.1	112.6	113.1	113.7	109.5	110.7	112.9	115.2
Percent Change Annualized	**0.3**	**2.0**	**1.4**	**2.5**	**1.8**	**1.8**	**1.9**	**2.0**	**0.3**	**1.1**	**1.9**	**2.0**
Core PCE Price Index (*2009 = 100*)	110.7	111.2	111.6	112.1	112.6	113.1	113.6	114.2	109.5	111.4	113.4	115.6
Percent Change Annualized	**2.1**	**1.8**	**1.7**	**1.8**	**1.8**	**1.8**	**1.9**	**1.9**	**1.4**	**1.7**	**1.8**	**2.0**
GDP Price Index (*2009 = 100*)	110.6	111.3	111.6	112.4	112.9	113.4	114.0	114.6	110.0	111.5	113.7	116.1
Percent Change Annualized	**0.5**	**2.3**	**1.4**	**2.6**	**1.9**	**2.0**	**2.0**	**2.1**	**1.1**	**1.3**	**2.0**	**2.1**
Crude Oil, WTI (*$/Barrel*)	33.2	45.4	44.9	48.8	49.0	49.0	49.5	50.0	48.7	43.1	49.4	53.4
Labor Markets												
Payroll Jobs (*Millions*)	143.5	144.0	144.6	145.2	145.7	146.2	146.7	147.2	141.8	144.3	146.4	148.4
Percent Change Annualized	**1.9**	**1.3**	**1.8**	**1.6**	**1.5**	**1.4**	**1.3**	**1.3**	**2.1**	**1.8**	**1.5**	**1.3**
Unemployment Rate (*Percent*)	4.9	4.9	4.9	4.8	4.7	4.6	4.6	4.6	5.3	4.9	4.6	4.5
Average Weekly Hours, Prod. Works.	33.7	33.6	33.6	33.7	33.7	33.7	33.8	33.8	33.7	33.6	33.8	33.9
Personal Income												
Average Hourly Earnings ($)	21.36	21.49	21.63	21.78	21.94	22.09	22.25	22.42	21.04	21.56	22.18	22.85
Percent Change Annualized	**2.4**	**2.4**	**2.7**	**2.8**	**2.9**	**2.9**	**3.0**	**3.1**	**2.1**	**2.5**	**2.8**	**3.0**
Real Disp. Income (*2009 Billions $*)	12556	12647	12731	12800	12884	12971	13072	13169	12343	12683	13024	13399
Percent Change Annualized	**2.1**	**2.9**	**2.7**	**2.2**	**2.7**	**2.7**	**3.1**	**3.0**	**3.5**	**2.8**	**2.7**	**2.9**
Housing												
Housing Starts (*Ths., Ann. Rate*)	1151	1159	1145	1182	1185	1194	1209	1221	1108	1160	1202	1236
Ext. Home Sales (*Ths., Ann Rate*)	5300	5503	5390	5556	5657	5733	5784	5816	5233	5437	5748	5941
New SF Home Sales (*Ths., Ann Rate*)	529	565	588	579	588	594	604	612	502	565	600	614
Case/Shiller HPI (*Jan. 2000 = 100*)	178.5	179.4	181.7	183.8	185.1	186.7	188.3	189.9	172.3	180.9	187.5	193.6
Percent Change Year Ago	**5.2**	**5.0**	**5.2**	**4.4**	**3.7**	**4.1**	**3.6**	**3.3**	**4.6**	**4.9**	**3.7**	**3.3**
Consumer												
Household Economic Stress Index	0.8	0.9	0.9	2.1	3.3	2.8	3.4	3.5	0.8	1.2	3.3	3.6
Auto Sales (*Millions*)	17.3	17.1	17.5	17.8	17.6	17.5	17.5	17.5	17.4	17.4	17.5	17.6
Consumer Credit (*Billions $*)	3585	3643	3707	3752	3795	3837	3878	3919	3459	3672	3857	4024
Percent Change Annualized	**5.8**	**6.6**	**7.2**	**4.9**	**4.7**	**4.5**	**4.4**	**4.3**	**6.9**	**6.1**	**5.1**	**4.3**
Interest Rates (Percent)												
Prime Rate	3.50	3.50	3.50	3.55	3.75	3.79	4.00	4.05	3.26	3.51	3.90	4.67
Federal Funds	0.37	0.37	0.40	0.44	0.63	0.67	0.88	0.92	0.13	0.39	0.77	1.54
3-Month Treasury Bill	0.29	0.26	0.30	0.43	0.68	0.83	0.97	1.10	0.05	0.32	0.89	1.60
10-Year Treasury Note	1.91	1.75	1.56	2.10	2.45	2.54	2.63	2.71	2.14	1.83	2.58	3.02
30-Year Fixed Mortgage	3.74	3.59	3.45	3.76	4.10	4.18	4.25	4.31	3.85	3.64	4.21	4.54

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

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