November 2016

NATIONAL ECONOMIC OUTLOOK

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Executive Summary

Solid U.S. Growth in the Second Half of 2016, With a Fed Rate Hike Likely in December

- Real GDP expanded 2.9 percent at an annual rate in the third quarter, the largest increase since the third quarter of 2014, according to the advance estimate from the Bureau of Economic Analysis. It was also an acceleration after weak growth of 1.4 percent in the second quarter, and just 1.0 percent annualized over the three previous quarters. Consumer spending rose 2.1 percent at an annual rate in the third quarter, adding 1.5 percentage points to annualized growth, but down from 4.3 percent growth in the second quarter. This slowing was expected after the unsustainably strong increase in the second quarter. Inventories added 0.6 percentage point to growth in the third quarter, after five straight quarters of subtracting from growth. Businesses got ahead of themselves in 2014, leading to too much inventory. A gradual inventory correction more recently has been weighing on growth, but that has likely come to an end.

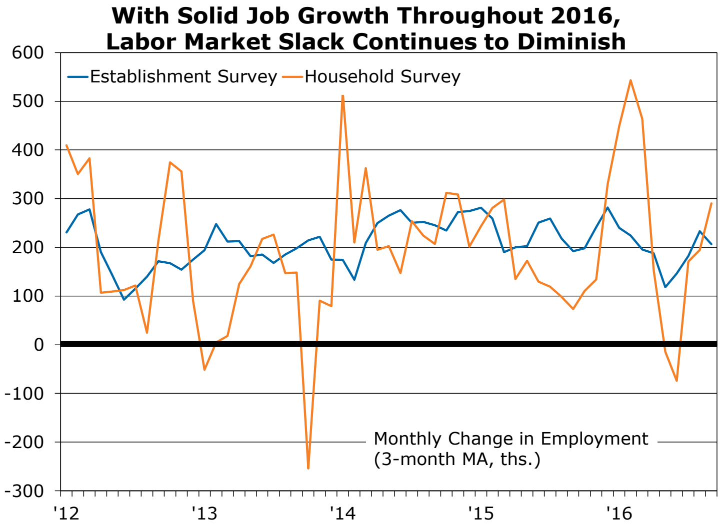
- October payroll jobs increased by 161,000, plus there were upward revisions to job growth in September of 35,000 and August of 9,000. Average monthly job growth in 2016, through October, was a solid 181,000, but a slowing from 229,000 in 2015. Perhaps the best news was that average hourly earnings in the private sector jumped by a large 0.4 percent in October and were up by 2.8 percent from one year earlier, the biggest year-over-year increase since June 2009. As the job market gets tighter, firms are responding to tougher competition for workers by raising pay.

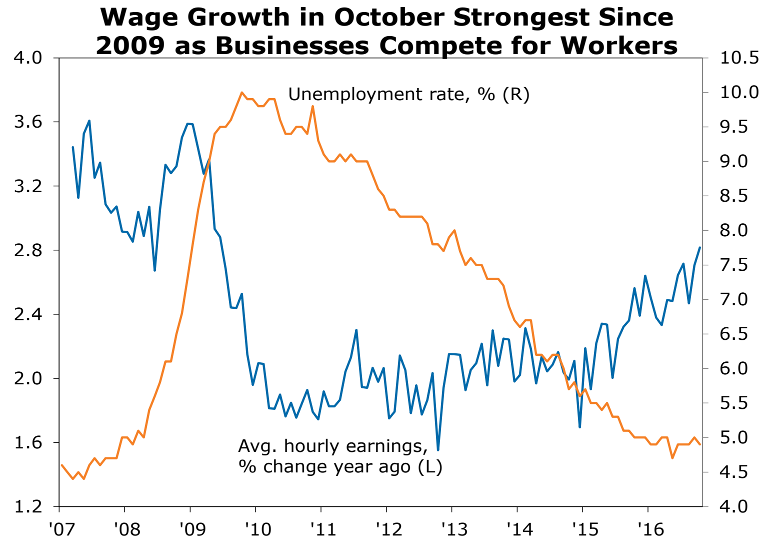
- In November 17 testimony before Congress's Joint Economic Committee, Federal Reserve Chair Yellen sent a strong signal that the Federal Open Market Committee will increase the federal funds rate by 0.25 percentage point (to a range of 0.50-0.75 percent) at the Federal Open Market Committee's next meeting on December 13 and 14. Yellen reiterated the language in the FOMC's last statement, from November 2, saying an increase in the fed funds rate would be appropriate "relatively soon if incoming data provide some further evidence of continued progress toward the Committee's objectives" of full employment and inflation of 2 percent. With the unemployment rate below 5 percent and inflation gradually trending higher, the conditions are in place for a near-term increase in the fed funds rate. There was no change in her mantra that the pace of rate hikes will be gradual thereafter; this is consistent with PNC's baseline forecast of two fed funds rate hikes in 2017 (June and December).

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	16702	16795	16880	16978	17073	17167	16397	16651	17024	17408
Percent Change Annualized	**0.8**	**1.4**	**2.9**	**2.2**	**2.0**	**2.3**	**2.3**	**2.2**	**2.6**	**1.5**	**2.2**	**2.3**
CPI (*1982-84 = 100*)	237.9	239.4	240.4	242.1	243.4	244.8	246.1	247.5	237.0	239.9	245.5	250.9
Percent Change Annualized	**-0.3**	**2.5**	**1.6**	**2.9**	**2.2**	**2.2**	**2.3**	**2.3**	**0.1**	**1.2**	**2.3**	**2.2**
Labor Markets												
Payroll Jobs (*Millions*)	143.5	144.0	144.6	145.2	145.7	146.2	146.6	147.0	141.8	144.3	146.4	148.2
Percent Change Annualized	**1.9**	**1.3**	**1.7**	**1.5**	**1.4**	**1.4**	**1.2**	**1.2**	**2.1**	**1.8**	**1.4**	**1.2**
Unemployment Rate (*Percent*)	4.9	4.9	4.9	4.8	4.8	4.7	4.7	4.6	5.3	4.9	4.7	4.7
Interest Rates (Percent)												
Federal Funds	0.37	0.37	0.40	0.42	0.63	0.67	0.88	0.92	0.13	0.39	0.77	1.47
Treasury Note, 10-year	1.91	1.75	1.56	2.01	2.26	2.29	2.33	2.37	2.14	1.81	2.31	2.52

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





Solid Economy Heading Into 2017, And Trump Election Tilts Toward Reflation

With Donald Trump's victory in the presidential election, economic policy will change dramatically over the next four years. Although there is still a great deal of uncertainty about some of Trump's policies, his election represents a dramatic shift away from the bipartisan consensus that has existed around much of U.S. economic policy since World War II, especially on trade and immigration. However, with so much of the president-elect's policy agenda to be decided, and with many of the decisions to be implemented through legislation that could take months to get through Congress, PNC will not be making changes to its baseline economic forecast to reflect Trump policies until the outlook becomes clearer.

Democracies are ultimately biased toward inflation rather than deflation. Inflation over the past five years has been below the Federal Open Market Committee's 2 percent target, in part from a lack of federal fiscal stimulus; this has left the job to the Federal Reserve, which has used unconventional tactics and near-zero interest rate policies to generate faster inflation. The Fed is more effective at slowing high inflation than it is at speeding up low inflation. With the election of Trump and Republican control of Congress, fiscal neutrality is coming to an end. Reflation is likely over the next few years as a result of a more simulative fiscal policies that will not be negated by an aggressive tightening of monetary policy.

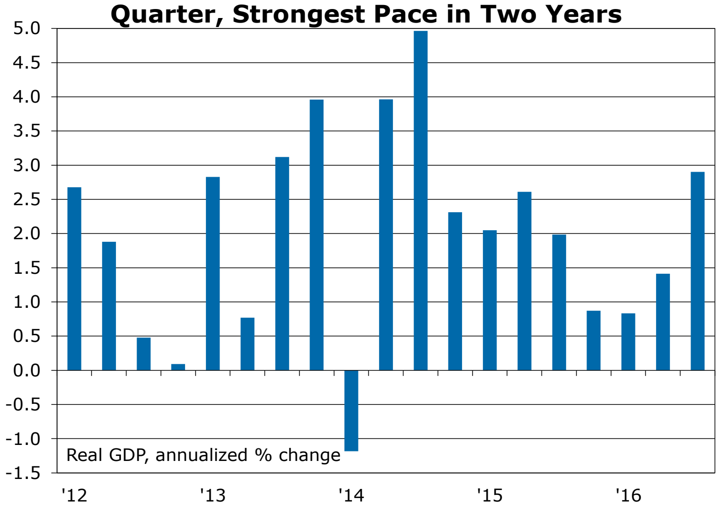
With Trump's election the risks to the forecast have increased, both to the upside and the downside. Personal income tax cuts and more jobs from increased infrastructure spending could boost consumer spending, as could greater wealth from the recent gain in stock prices following Trump's election. A deal to allow U.S. businesses to repatriate earnings from abroad at lower tax rates could lead to greater domestic business investment. However, if other countries respond to Trump's efforts to restrict imports by making it more difficult for the U.S. to export, some high-wage jobs could be at risk. The federal government's budget deficit is likely to increase substantially with Trump's plans for big tax cuts and spending increases on defense and infrastructure, and Trump's proposed expansionary policies have also pushed up inflation expectations. Long-term interest rates have already moved significantly higher since the election in response, and this could weigh on growth. The U.S. dollar has also strengthened since the election, which could widen the trade deficit. And greater restrictions on immigration could reduce labor force growth, imposing a significant constraint on the ability of the U.S. economy to expand over the long run.

The economy that will greet President Trump is in good shape. With employment growth running at about double the pace of long-run labor force growth, job market slack is rapidly diminishing, as seen in accelerating wage growth as businesses boost pay as they find it more difficult to hire. Real GDP growth in the second half of 2016 is running at about 2.5 percent per annum, more than double the pace in the first half of this year, as consumers increase their spending in response to more jobs and higher wages. Holiday spending should be up about 3.5 percent in 2016 compared to 2015, with about 2.5 percentage points of that from higher volumes, and 1 percentage point from higher prices. However, gains for traditional retailers will be much weaker due to the increasing reach of online sales.

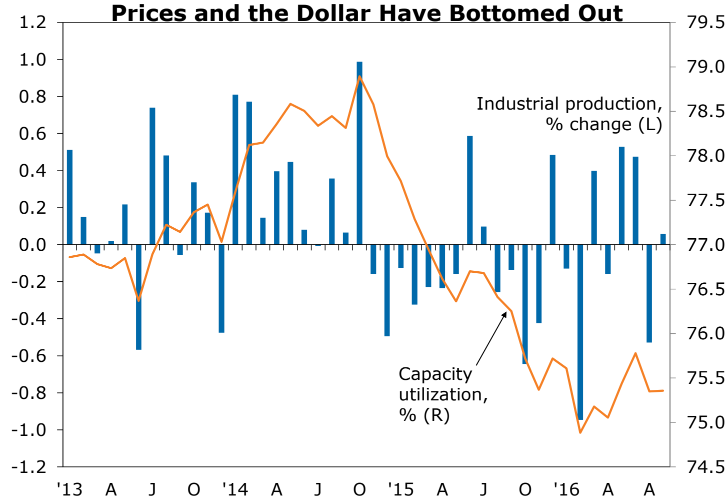
The drag from energy and other commodities is fading as production cuts have come to an end with energy prices stabilizing in early 2016. Manufacturing is doing better in the second half of 2016, after softness in late 2015 and early 2016 because of the stronger U.S. dollar and weaker demand for capital equipment from commodity-producing industries. Inventories are adding to growth in the second half of 2016, after subtracting from it over the previous year. The housing market will add to growth in the second half of 2016 and into 2017 as housing demand and homebuilding continue to recover from the Great Recession, supported by income growth and low mortgage rates.

With continued solid economic growth in late 2016 and early 2017 the U.S. economy will approach full employment over the next year. Job growth will slow from around 180,000 per month in 2016 to around 160,000 per month in 2017, not because of weaker demand for labor, but from more difficulty in finding workers. The unemployment rate will end this year at 4.8 percent and next year at 4.6 percent. The tighter job market will push up wages, allowing for continued gains in consumer spending, supporting overall economic growth. Stronger wage gains will also contribute to a gradual acceleration in inflation over the next few years. The FOMC will increase the federal funds rate target range to 0.50-0.75 percent at their meeting in mid- December. The subsequent pace of fed funds rate hikes will remain very gradual, with two more 25 basis point hikes in 2017 and another three in 2018. However, with the potential that tax and spending policies will support near-term growth and boost inflationary pressures, risks to the forecast are for higher interest rates.

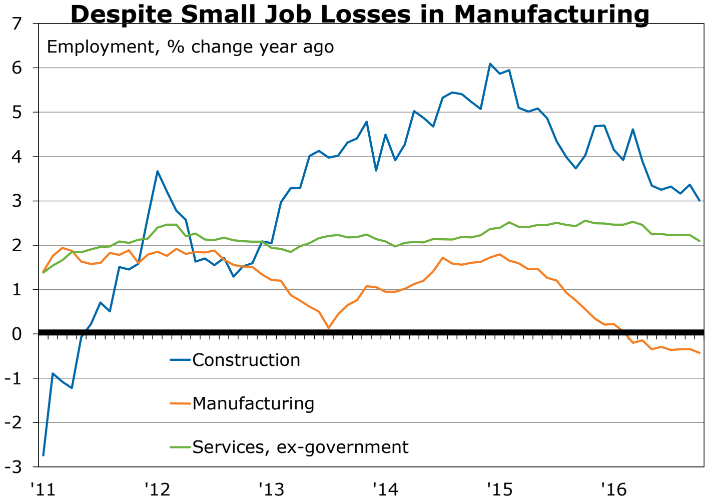
GDP Growth Bounces Back in Third Quarter, Strongest Pace in Two Years



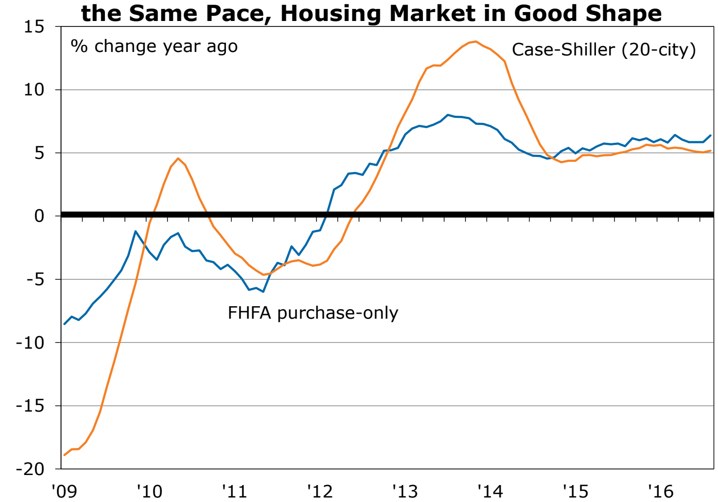
Industrial Conditions Have Stabilized as Energy Prices and the Dollar Have Bottomed Out



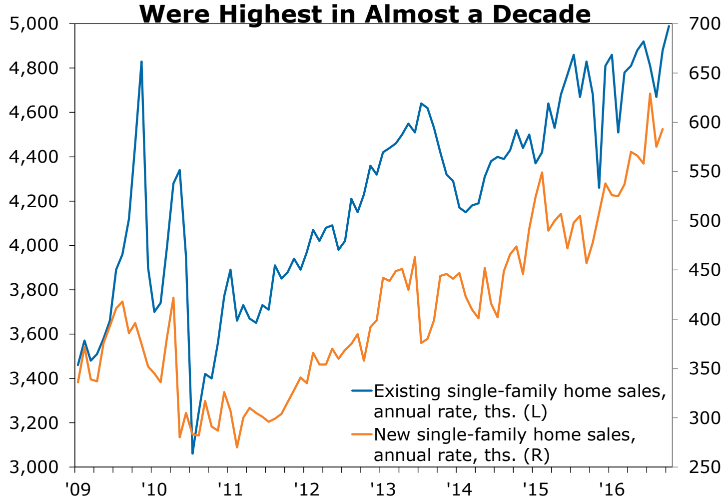
Labor Market Continues to Power Ahead Despite Small Job Losses in Manufacturing



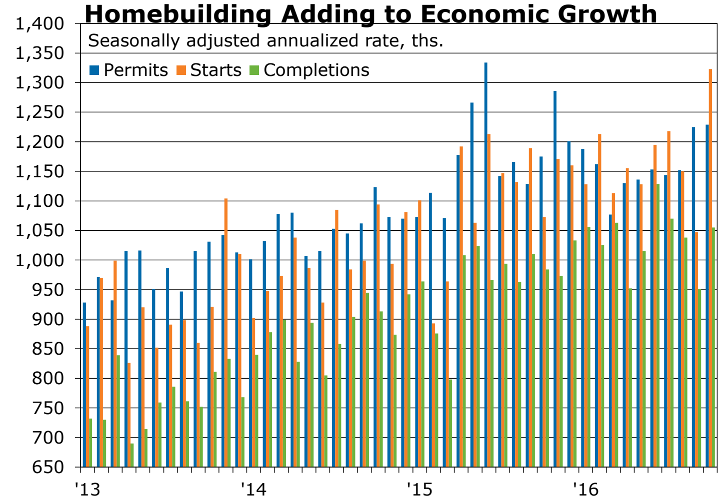
With House Prices and Incomes Increasing at Roughly the Same Pace, Housing Market in Good Shape

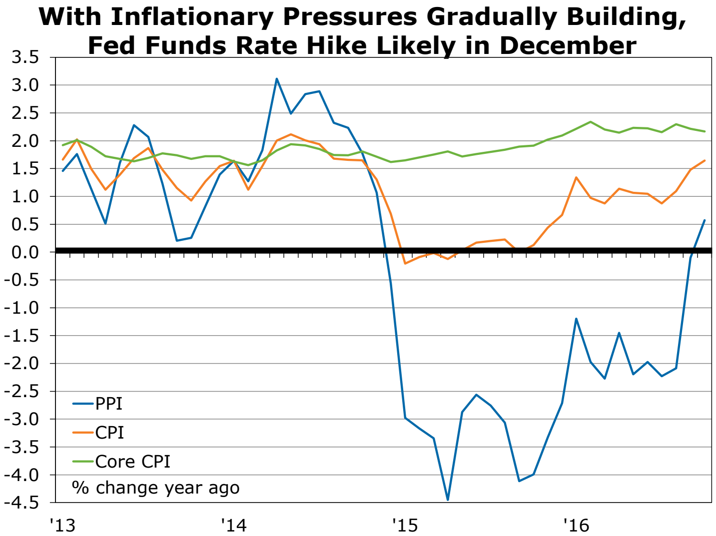


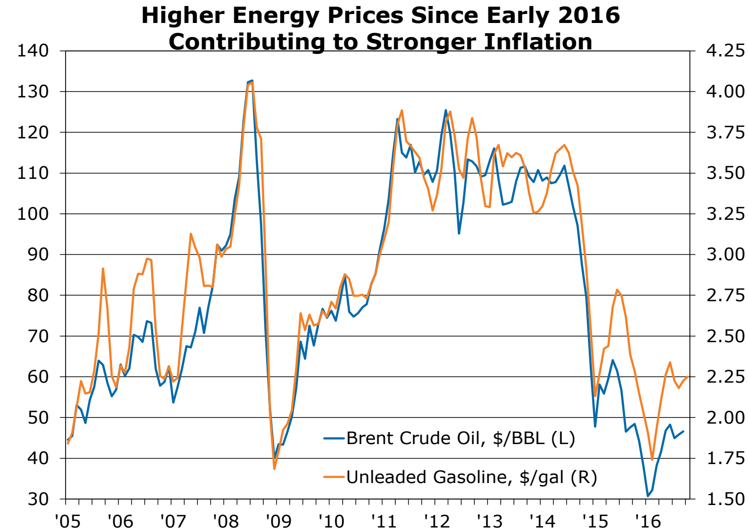
October Existing Home Sales Were Highest in Almost a Decade

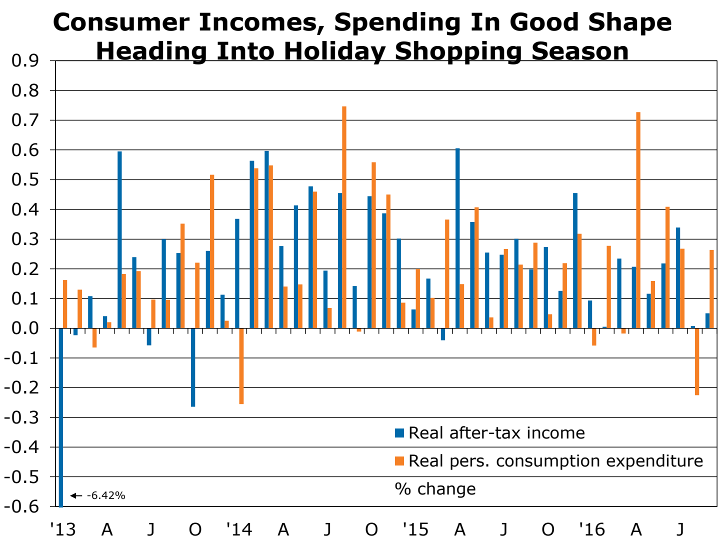


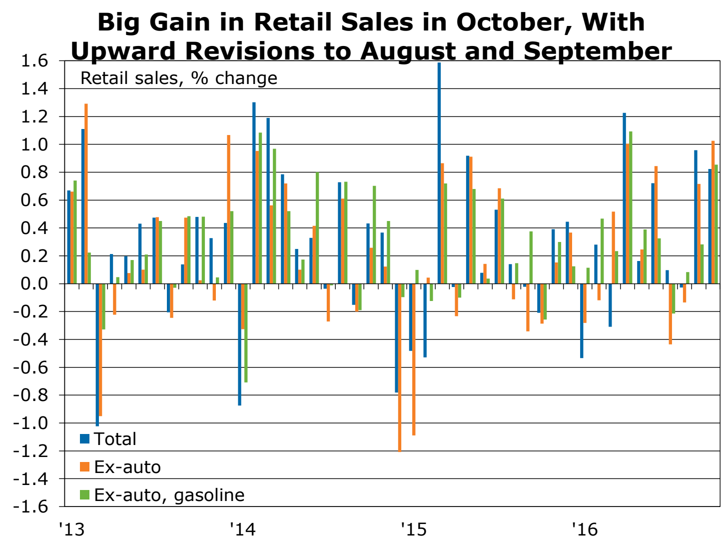
With Huge Jump in Housing Starts in October, Homebuilding Adding to Economic Growth

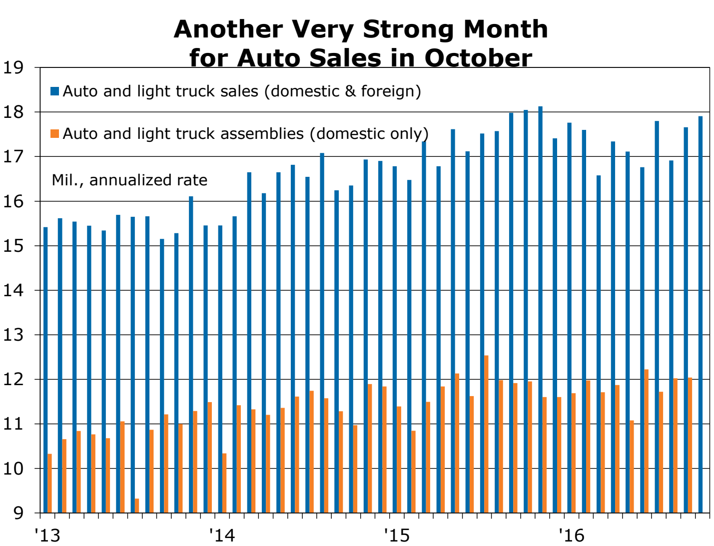


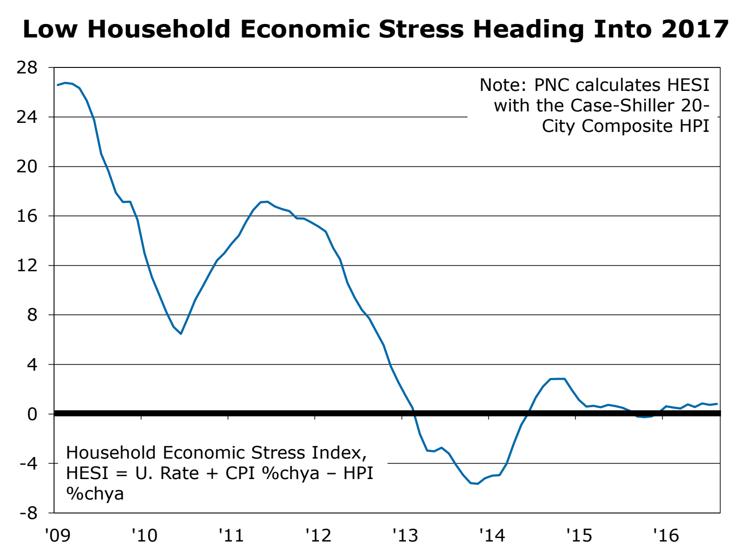












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PNC Economics Group
November, 2016

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	18651	18875	19057	19259	19460	19660	18037	18564	19359	20175
Percent Change Annualized	**1.3**	**3.7**	**4.4**	**4.9**	**3.9**	**4.3**	**4.2**	**4.2**	**3.7**	**2.9**	**4.3**	**4.2**
Real GDP (*Chained 2009 Billions $*)	16525	16583	16702	16795	16880	16978	17073	17167	16397	16651	17024	17408
Percent Change Annualized	**0.8**	**1.4**	**2.9**	**2.2**	**2.0**	**2.3**	**2.3**	**2.2**	**2.6**	**1.5**	**2.2**	**2.3**
Pers. Consumption Expenditures	11365	11485	11546	11626	11695	11764	11833	11900	11215	11505	11798	12071
Percent Change Annualized	**1.6**	**4.3**	**2.1**	**2.8**	**2.4**	**2.4**	**2.4**	**2.3**	**3.2**	**2.6**	**2.5**	**2.3**
Nonresidential Fixed Investment	2180	2185	2191	2204	2216	2231	2247	2263	2200	2190	2239	2294
Percent Change Annualized	**-3.4**	**1.0**	**1.1**	**2.3**	**2.2**	**2.7**	**2.9**	**2.9**	**2.1**	**-0.5**	**2.3**	**2.4**
Residential Investment	601	589	579	592	599	605	607	609	565	590	605	616
Percent Change Annualized	**7.8**	**-7.8**	**-6.2**	**9.1**	**4.9**	**3.9**	**1.1**	**1.9**	**11.7**	**4.5**	**2.5**	**1.8**
Change in Private Inventories	41	-10	13	20	25	32	30	30	84	16	29	33
Net Exports	-566	-559	-523	-554	-570	-581	-584	-588	-540	-550	-581	-589
Government Expenditures	2913	2901	2905	2915	2923	2935	2948	2960	2884	2908	2942	2991
Percent Change Annualized	**1.6**	**-1.7**	**0.5**	**1.5**	**1.1**	**1.6**	**1.8**	**1.6**	**1.8**	**0.9**	**1.1**	**1.7**
Industrial Prod. Index (*2012 = 100*)	104.1	103.9	104.4	104.8	105.3	105.8	106.3	106.9	105.2	104.3	106.1	108.4
Percent Change Annualized	**-1.7**	**-0.8**	**1.8**	**1.5**	**1.9**	**2.0**	**2.1**	**2.1**	**0.3**	**-0.9**	**1.7**	**2.2**
Capacity Utilization (*Percent*)	75.4	75.2	75.5	75.7	76.0	76.2	76.5	76.8	76.7	75.5	76.4	77.4
Prices												
CPI (*1982-84 = 100*)	237.9	239.4	240.4	242.1	243.4	244.8	246.1	247.5	237.0	239.9	245.5	250.9
Percent Change Annualized	**-0.3**	**2.5**	**1.6**	**2.9**	**2.2**	**2.2**	**2.3**	**2.3**	**0.1**	**1.2**	**2.3**	**2.2**
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	258.4
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**	**2.2**
PCE Price Index (*2009 = 100*)	110.0	110.5	110.9	111.6	112.1	112.6	113.1	113.6	109.5	110.8	112.9	115.1
Percent Change Annualized	**0.3**	**2.0**	**1.4**	**2.5**	**1.8**	**1.8**	**1.9**	**1.9**	**0.3**	**1.1**	**1.9**	**1.9**
Core PCE Price Index (*2009 = 100*)	110.7	111.2	111.6	112.1	112.6	113.1	113.7	114.2	109.5	111.4	113.4	115.5
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**	**1.9**
GDP Price Index (*2009 = 100*)	110.6	111.3	111.7	112.4	112.9	113.5	114.0	114.6	110.0	111.5	113.8	116.0
Percent Change Annualized	**0.5**	**2.3**	**1.5**	**2.6**	**1.9**	**2.0**	**2.0**	**2.0**	**1.1**	**1.4**	**2.0**	**2.0**
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	146.6	147.0	141.8	144.3	146.4	148.2
Percent Change Annualized	**1.9**	**1.3**	**1.7**	**1.5**	**1.4**	**1.4**	**1.2**	**1.2**	**2.1**	**1.8**	**1.4**	**1.2**
Unemployment Rate (*Percent*)	4.9	4.9	4.9	4.8	4.8	4.7	4.7	4.6	5.3	4.9	4.7	4.7
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	33.7	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	22.84
Percent Change Annualized	**2.4**	**2.4**	**2.7**	**2.8**	**2.9**	**2.9**	**3.0**	**3.0**	**2.1**	**2.5**	**2.8**	**3.0**
Real Disp. Income (*2009 Billions $*)	12556	12620	12688	12756	12840	12926	13012	13093	12343	12655	12968	13287
Percent Change Annualized	**2.1**	**2.1**	**2.2**	**2.2**	**2.6**	**2.7**	**2.7**	**2.5**	**3.5**	**2.5**	**2.5**	**2.5**
Housing												
Housing Starts (*Ths., Ann. Rate*)	1151	1159	1138	1175	1178	1187	1191	1195	1108	1156	1188	1210
Ext. Home Sales (*Ths., Ann Rate*)	5300	5503	5383	5548	5649	5725	5760	5783	5233	5434	5729	5908
New SF Home Sales (*Ths., Ann Rate*)	529	565	599	590	599	605	611	616	502	571	608	617
Case/Shiller HPI (*Jan. 2000 = 100*)	178.5	179.5	181.6	183.8	185.6	187.6	189.5	191.4	172.3	180.9	188.5	195.9
Percent Change Year Ago	**5.2**	**5.0**	**5.2**	**4.4**	**4.0**	**4.5**	**4.4**	**4.1**	**4.6**	**4.9**	**4.2**	**3.9**
Consumer												
Household Economic Stress Index	0.8	0.9	0.9	2.1	3.1	2.4	2.7	2.8	0.8	1.2	2.8	3.0
Auto Sales (*Millions*)	17.3	17.1	17.5	17.8	17.6	17.5	17.5	17.4	17.4	17.4	17.5	17.4
Consumer Credit (*Billions $*)	3585	3643	3683	3728	3771	3813	3853	3893	3459	3660	3832	3996
Percent Change Annualized	**5.8**	**6.6**	**4.5**	**5.0**	**4.7**	**4.5**	**4.3**	**4.2**	**6.9**	**5.8**	**4.7**	**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	4.60
Federal Funds	0.37	0.37	0.40	0.42	0.63	0.67	0.88	0.92	0.13	0.39	0.77	1.47
3-Month Treasury Bill	0.29	0.26	0.30	0.47	0.63	0.76	0.89	1.01	0.05	0.33	0.82	1.48
10-Year Treasury Note	1.91	1.75	1.56	2.01	2.26	2.29	2.33	2.37	2.14	1.81	2.31	2.52
30-Year Fixed Mortgage	3.74	3.59	3.45	3.72	3.88	3.90	3.91	3.93	3.85	3.62	3.90	4.01

a = actual   f = forecast   p = preliminary

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