August 2013

# NATIONAL ECONOMIC OUTLOOK

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### **Executive Summary**

### Soft Economic Growth in Mid-2013 Will Speed Up this Autumn

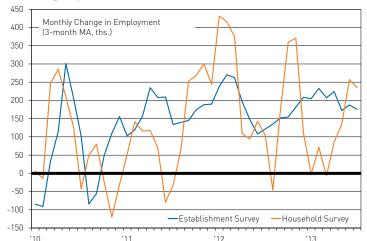
- The economy expanded more than expected in the second quarter of 2013, according to the Bureau of Economic Analysis's advance estimate, with real GDP growth of 1.7 percent at an annual rate. This was better than the consensus expectation of 1.0 percent growth, and an acceleration from the weak first quarter growth of 1.1 percent. Government and global trade once again were drags on growth in the second quarter. The drag from net exports appears to have been overstated last quarter and we expect an upward revision in real GDP growth to just over 2% per annum.
- Total payroll jobs rose by 162,000 in July. Private-sector employment was up by 161,000, while government added 1,000 jobs. Payroll jobs gains were revised down in June to 188,000 (from 195,000) and in May to 176,000 (from 195,000). The unemployment rate fell in July to 7.4 percent, from 7.6 percent in June. The unemployment rate fell for two reasons. The number of employed as measured by the household survey rose by 227,000 in July, while the labor force shrank by 37,000. The labor force participation rate fell by 0.1 percentage point to 63.4 percent, slightly above a decades-long low. The more indicative three-month moving average of payroll job growth has slowed from above 200,000 in the spring to 175,000 in July, a slight softening in the labor market. Still, the economy is creating enough jobs to keep the recovery going.
- In their July 31 statement the Federal Open Market Committee announced no change to monetary policy. In particular, the statement said that the Federal Reserve will continue to purchase \$85 billion of long-term Treasuries and mortgage-backed securities per month. The FOMC also said that it will keep the Federal funds rate near zero until at least either the unemployment rate falls below 6.5 percent or inflation one to two years out looks ready to rise above 2.5 percent. However, the FOMC added to the paragraph on the outlook for the Fed funds rate, saying "the Committee today reaffirmed its view that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens" (emphasis added). The section in bold replaced "expects" in the June 19 statement. The new wording is intended to reassure financial markets that there will be a considerable period of time between the end of long-run asset purchases and any increase in the Fed funds rate. The FOMC will likely begin to reduce its asset purchases at either its mid-September or late-October meeting, depending on the August employment report, and wrap them up completely by the middle of 2014.

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

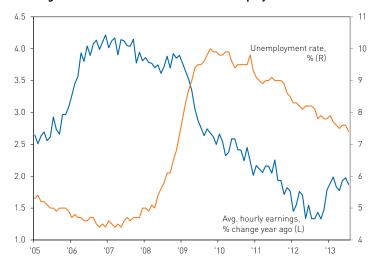
	1Q'13a	2Q'13p	3Q'13f	4Q'13f	1Q'14f	2Q'14f	3Q'14f	4Q'14f	2012a	2013f	2014f	2015f
Output & Prices												
Real GDP (Chained 2009 Billions \$)	15584	15649	15735	15815	15905	16014	16113	16211	15471	15695	16061	16465
Percent Change Annualized	1.1	1.7	2.2	2.0	2.3	2.8	2.5	2.5	2.8	1.5	2.3	2.5
CPI (1982-84 = 100)	232.1	232.1	233.7	234.9	236.3	237.7	239.2	240.6	229.6	233.2	238.4	244.3
Percent Change Annualized	1.4	0.0	2.8	2.1	2.3	2.5	2.5	2.5	2.1	1.6	2.2	2.5
Labor Markets												
Payroll Jobs ( <i>Millions</i> )	135.1	135.7	136.2	136.7	137.3	137.8	138.3	138.8	133.7	135.9	138.1	139.9
Percent Change Annualized	1.9	1.7	1.5	1.6	1.6	1.6	1.4	1.3	1.7	1.6	1.6	1.4
Unemployment Rate (Percent)	7.7	7.6	7.4	7.2	7.0	6.8	6.7	6.6	8.1	7.5	6.8	6.2
Interest Rates (Percent)												
Federal Funds	0.14	0.12	0.13	0.15	0.15	0.15	0.15	0.15	0.14	0.14	0.15	0.22
Treasury Note, 10-year	1.95	2.00	2.58	2.57	2.75	2.87	2.99	3.11	1.80	2.28	2.93	3.40
a = actual $f = forecast$ $p = preliminary$ * Please see the Expanded Table for more forecast series.												



#### Slightly Softer Job Growth in the Middle of 2013



#### Wage Growth Remains Weak Even as Unemployment Rate Falls



#### After Disappointing First Half of the Year, Better Real GDP Growth in the Second Half of 2013 and into 2014

Although inflation-adjusted GDP growth in the second quarter came in above expectations, combined with the downward revision to first quarter growth the story remains the same. The economy is expanding but growth remains disappointing, although there does appear to be some positive momentum. Real GDP growth in the first half of 2013 averaged a soft 1.4 percent at an annual rate. Real GDP growth should pick up to near 2.1 percent per annum in the second half of this year as the drags from higher taxes and sequester cuts subside, and be even stronger in 2014, allowing for continued gradual improvement in the labor market.

The GDP release in late July included revisions to the historical data. The biggest change was the incorporation of research and development, including intellectual property, into GDP. The addition raised the measured level of GDP by about 3 percent, but did not significantly change the pattern of GDP growth. With the revisions the Great Recession was slightly less severe than previously reported. Additionally, growth was slightly better than reported in early 2012, but subsequent growth has been a bit weaker.

Weak income growth is restraining consumer spending. With moderate job growth, weak wage gains, higher taxes at the beginning of 2013, and unpaid furloughs for many federal workers, personal disposable income was up just 1.9 percent in June from one year earlier, and just 0.6 percent after adjusting for inflation. Consumer spending was up 3.3 percent year-over-year in June, with real spending up 2.0 percent. Consumers have reduced their saving to make up for weakness in income, but that is not a sustainable long-term strategy, and labor income fell in July according to the employment report. Both wages and consumer spending will grow modestly through the rest of this year, restraining overall economic growth. Some support to consumer spending is coming from higher home values and stock prices, which are boosting wealth and making households a little more willing to spend, although consumer spending will continue to lag behind overall economic growth.

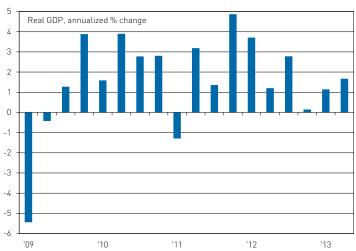
The housing market will remain a key driver of economic and job growth over the next year. In addition to the support to consumer spending from rising house prices, homebuilding is also boosting growth. Residential construction has added to GDP growth for 11 straight quarters. Housing starts are up almost 20 percent over the past year, but are about one-third below their long-run average, meaning there is still plenty of room for growth. Housing affordability is still high, even as prices and mortgage rates have risen recently, and the improving job market and gradually easing lending standards are also boosting home sales and prices.

Business investment growth picked up in the second quarter of 2013, offsetting the decline in the first quarter. Uncertainty about Federal tax and spending policies in late 2012 and early 2013 made firms cautious, but now reduced policy uncertainty, an expanding economy, and low interest rates are all supporting investment. Business spending will continue to reaccelerate over the next few quarters, supporting overall economic growth.

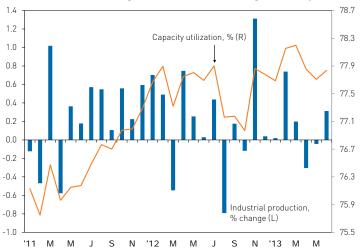
The drags from government and global trade are gradually lifting. Households are adjusting to tax increases at the beginning of 2013, while the drag from Federal spending cuts under the sequester is at a maximum now and they will be less of a weight on growth going forward. The recession in Europe looks to be coming to an end, which should boost overseas sales; the region accounts for one-fifth of U.S. exports. Slower growth in China and the rest of Asia remains a near-term concern, however.

With the Federal Reserve committed to highly expansionary monetary policy, historically low interest rates will support economic growth over the next few years. We forecast that real GDP growth will be 2.1 percent per annum in the second half of 2013, noticeably better than the first-half pace. Economic growth will be even stronger next year as fiscal policy becomes more neutral for the economy and recovery takes hold in Europe, with U.S. real GDP growth of 2.5 percent from the fourth quarter of 2013 to the fourth quarter of 2014. Monthly job growth in the second half of 2013 will average around 175,000, slightly weaker than in the first half of this year. The unemployment rate will continue its gradual decline, ending this year at 7.2 percent, on its way to below 7.0 percent by mid-year 2014 and to 6.5 percent at the beginning of 2015.

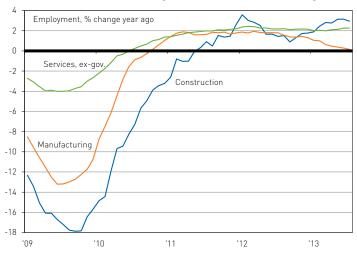
#### Sub-2% Growth in Four of Past Five Quarters



#### Manufacturing Looks to Be Picking Back Up



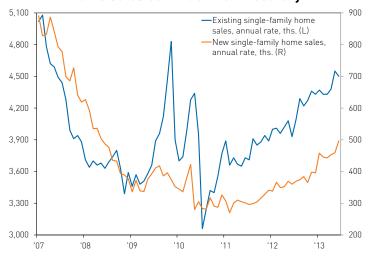
#### **Construction Taking Over for Manufacturing**



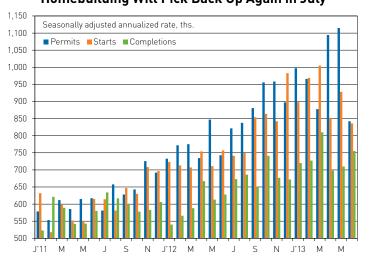
#### **Double-Digit House Price Gains Good for Consumers**



#### Home Sales Continue Their Recovery



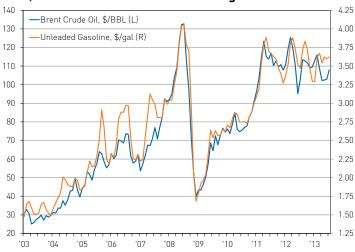
#### Homebuilding Will Pick Back Up Again in July



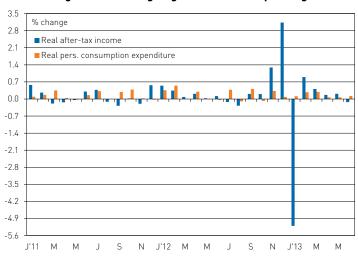
#### **Despite Higher Gasoline Prices Inflation Under Control**



#### Oil, Gasoline Prices in Narrow Range in Recent Years



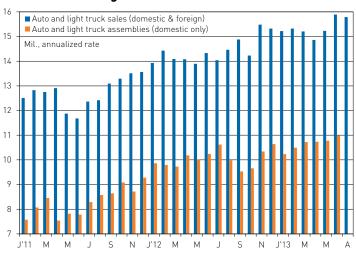
#### **Higher Taxes Weighing on Household Spending**



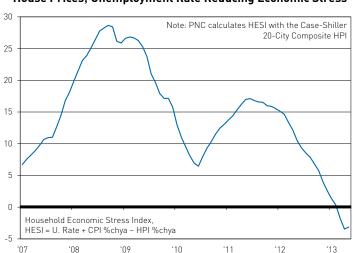
#### Slow, Steady Growth in Retail Sales



#### Strong Vehicle Sales in Mid-2013



#### House Prices, Unemployment Rate Reducing Economic Stress



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PNC Economics Group August, 2013

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

	1Q'13a	20'13n	3Q'13f	4Q'13f	1Q'14f	2Q'14f	3Q'14f	4Q'14f	2012a	2013f	2014f	2015f
Output	TULIDA	ZQ 10p	30(13)	40(13)	IG Im	ZG( 141	36 141	46(14)	2012a	20131	20141	20101
Nominal GDP (Billions \$)	16535	16633	16818	16974	17143	17347	17543	17739	16245	16740	17443	18243
Percent Change Annualized	2.8	2.4	4.5	3.8	4.0	17347 <b>4.8</b>	1/543 <b>4.6</b>	4.6	4.6	3.1	17443 <b>4.2</b>	4.6
Real GDP (Chained 2009 Billions \$)	15584	15649	15735	15815	15905	16014	16113	16211	15471	15695	16061	16465
Percent Change Annualized	1.1	1.7	2.2	2.0	2.3	2.8	2.5	2.5	2.8	1.5	2.3	2.5
Pers. Consumption Expenditures	10644	10691	10746	10796	10845	10909	10969	11029	10518	10719	10938	11186
Percent Change Annualized	2.3	1.8	2.1	1.9	1.9	2.4	2.2	2.2	2.2	1.9	2.0	2.3
Nonresidential Fixed Investment	1949	1971	1995	2018	2038	2055	2069	2084	1932	1983	2062	2119
Percent Change Annualized	-4.6	4.6	5.0	4.6	4.1	3.4	2.8	2.9	7.3	2.7	4.0	2.8
Residential Investment	471	486	494	502	504	510	521	528	434	488	516	546
Percent Change Annualized	12.5	13.4	7.0	5.9	1.9	5.1	8.4	6.0	12.9	12.6	5.6	5.9
Change in Private Inventories	42	57	55	46	41	43	37	33	58	50	38	25
Net Exports	-422	-451	-455	-449	-437	-429	-421	-412	-431	-444	-425	-392
Government Expenditures	2907	2904	2908	2912	2923	2935	2947	2959	2963	2908	2941	2989
Percent Change Annualized	-4.2	-0.4	0.5	0.5	1.6	1.6	1.6	1.6	-1.0	-1.9	1.1	1.6
Industrial Prod. Index (2007 = 100)	98.7	98.9	99.5	100.2	101.1	102.0	102.9	103.8	97.0	99.3	102.4	105.9
Percent Change Annualized	4.2	0.6	2.6	3.0	3.3	3.7	3.8	3.4	3.6	2.4	3.1	3.4
Capacity Utilization (Percent)	78.0	77.8	77.9	78.1	78.3	78.5	78.7	78.9	77.6	78.0	78.6	79.4
Prices												
CPI (1982-84 = 100)	232.1	232.1	233.7	234.9	236.3	237.7	239.2	240.6	229.6	233.2	238.4	244.3
Percent Change Annualized	1.4	0.0	2.8	2.1	2.3	2.5	2.5	2.5	2.1	1.6	2.2	2.5
Core CPI Index (1982-84 = 100)	232.5	233.3	234.3	235.4	236.6	237.9	239.3	240.6	229.8	233.9	238.6	244.1
Percent Change Annualized	2.1	1.4	1.8	1.9	1.9	2.3	2.3	2.3	2.1	1.8	2.0	2.3
PCE Price Index (2009 = 100)	106.9	106.9	107.5	108.0	108.4	109.0	109.6	110.2	106.0	107.3	109.3	111.8
Percent Change Annualized	1.1	0.0	2.2	1.7	1.7	2.2	2.2	2.2	1.8	1.2	1.9	2.2
Core PCE Price Index (2009 = 100)	105.5	105.8	106.2	106.6	106.9	107.5	108.0	108.6	104.6	106.0	107.8	110.0
Percent Change Annualized	1.4	0.8	1.5	1.5	1.5	2.0	2.0	2.0	1.8	1.3	1.7	2.0
GDP Price Index (2009 = 100)	106.1	106.3	106.9	107.4	107.8	108.4	108.9	109.5	105.0	106.7	108.7	110.9
Percent Change Annualized	1.7	0.7	2.3	1.7	1.7	2.1	2.1	2.1	1.7	1.6	1.9	2.1
Crude Oil, WTI (\$/Barrel)	94.4	93.6	102.0	100.0	99.0	99.0	99.0	99.0	94.2	97.5	99.0	102.0
Labor Markets												
Payroll Jobs (Millions)	135.1	135.7	136.2	136.7	137.3	137.8	138.3	138.8	133.7	135.9	138.1	139.9
Percent Change Annualized	1.9	1.7	1.5	1.6	1.6	1.6	1.4	1.3	1.7	1.6	1.6	1.4
Unemployment Rate (Percent)	7.7	7.6	7.4	7.2	7.0	6.8	6.7	6.6	8.1	7.5	6.8	6.2
Average Weekly Hours, Prod. Works.	33.7	33.7	33.7	33.8	33.8	33.8	33.8	33.8	33.7	33.7	33.8	33.9
Personal Income												
Average Hourly Earnings (\$)	20.02	20.10	20.22	20.34	20.47	20.60	20.73	20.86	19.76	20.17	20.66	21.19
Percent Change Annualized	2.8	1.6	2.5	2.5	2.5	2.5	2.5	2.5	1.5	2.1	2.4	2.6
Real Disp. Income (2009 Billions \$)	11495	11591	11649	11704	11764	11833	11902	11971	11551	11610	11868	12149
Percent Change Annualized	-8.2	3.4	2.0	1.9	2.1	2.4	2.3	2.3	2.0	0.5	2.2	2.4
Housing												
Housing Starts (Ths., Ann. Rate)	957	872	942	953	975	1015	1050	1056	783	931	1024	1079
Ext. Home Sales (Ths., Ann Rate)	4943	5063	5086	5126	5165	5211	5309	5412	4661	5055	5274	5592
New SF Home Sales (Ths., Ann Rate)	449	470	492	486	482	493	504	513	368	474	498	522
Case/Shiller HPI (Jan. 2000 = 100)	141.2	145.5	146.5	147.5	148.5	151.7	152.1	152.7	131.9	145.2	151.2	156.2
Percent Change Year Ago	10.2	10.9	10.4	8.6	5.2	4.3	3.8	3.5	2.8	10.0	4.2	3.3
Consumer												
Household Economic Stress Index	-0.8	-1.9	-1.5	0.1	3.6	5.0	5.2	5.5	7.3	-1.0	4.8	5.5
Auto Sales (Millions)	15.2	15.5	15.8	15.9	15.9	16.0	16.0	16.1	14.4	15.6	16.0	16.3
Consumer Credit (Billions \$)	2807	2848	2883	2919	2959	2997	3038	3080	2708	2864	3019	3174
Percent Change Annualized	5.7	6.0	5.0	5.1	5.6	5.2	5.6	5.6	5.2	5.8	5.4	5.2
Interest Rates (Percent)												
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.29
Federal Funds	0.14	0.12	0.13	0.15	0.15	0.15	0.15	0.15	0.14	0.14	0.15	0.22
3-Month Treasury Bill	0.09	0.05	0.04	0.09	0.15	0.21	0.27	0.33	0.09	0.07	0.24	0.47
10-Year Treasury Note	1.95	2.00	2.58	2.57	2.75	2.87	2.99	3.11	1.80	2.28	2.93	3.40
30-Year Fixed Mortgage	3.50	3.69	4.37	4.33	4.48	4.60	4.71	4.83	3.66	3.97	4.66	5.16
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a = actual $f = forecast$ $p = preliminary$												

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