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ECONOMIC REPORT

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DECEMBER JOBS REPORT DISAPPOINTS BUT DOES NOT SIGNAL PROBLEMS; RETAIL SALES GREW AT END OF 2013

SUMMARY

- Employment increased by 74,000 in December, well below expectations for a gain of 200,000. The unemployment rate fell by 0.3 percentage point to 6.7 percent, in large part because of a contraction in the labor force.
- Although the December jobs number is disappointing it is at odds with other data indicating solid economic growth in the fourth quarter of 2013.
- Retail sales increased 0.2 percent in December, with a 0.7 percent increase in sales excluding autos. These numbers were above expectations and consumers continued to boost their spending in late 2013.
- The economy likely grew at a roughly 3 percent pace in the fourth quarter of 2013. Growth in 2014 will be stronger than in 2013.

Total payroll jobs rose by only 74,000 in December, well below the market consensus and PNC's forecast for a gain of 200,000. Private-sector employment was up by 87,000, well below the ADP figure of 238,000, while government jobs fell by 13,000. Payroll jobs gains were unrevised in October at 200,000, but revised up in November to 241,000 (from 203,000). For October and November combined, private payroll jobs were revised up by 33,000 and government jobs were revised up by 5,000. Despite the "disappointing" December, fourth quarter payroll jobs rose by 515,000 (172,000 per month) and for 2013 payroll jobs rose by 2,190,000 (183,000 per month).

The December unemployment rate fell to 6.7 percent. The number of employed as measured by the household survey rose by 143,000 in December, while the labor force fell by 347,000, with the labor force participation rate falling to 62.8 percent. This decline in the unemployment rate overstates the improvement in the job market last month and the rate will likely rise in January as the labor force rebounds. Cold weather played a bigger role in December's job weakness than expected with 273,000 workers reporting they could not work because of the weather, 165,000 more than normal for December. The polar vortex caused bitterly cold weather through much of the U.S. in January, but not during the week when the BLS surveys employers and households for the jobs report, so weather should be less of an issue for employment this month.

December payroll job gains were mixed across industries. Construction jobs fell by 16,000 (cold weather played a big role here) but manufacturing jobs rose by 9,000, the fifth straight monthly rise totaling 80,000. Private service-producing industries added only 90,000 jobs in December. This included gains of 19,000 in professional/business services (including a rise of 40,000 temp jobs), 69,000 in trade/transportation, 9,000 in leisure/hospitality services, and 4,000 in financial services. Payroll jobs declined by 12,000 in information services and eds and meds jobs were unchanged, which is highly unusual and due for big gains in January and/or February. Government jobs fell by 13,000 as state and local government employment fell by 11,000 and Federal government employment fell by 2,000.

Another weak sign from the December jobs report is that average hourly wages rose by only 0.1 percent and the average workweek moved down to 34.4 hours, from 34.5 hours in November. With the combination of more jobs and rising wages, but a shorter average workweek, workers' earned income rose by only 0.1 percent in December, below our estimate for December CPI inflation (due January 16) of 0.3 percent.

In summary, the December jobs report was "disappointing" with jobs and wages up only slightly and average hours worked down for the first time in four months. This report is a reminder against taking any one month of data too seriously.



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Averaged across the fourth quarter payroll jobs gains were 172,000 per month, not far from the 2013 average (see Chart 1). There will also likely be an upward revision to December job growth in next month's report. Moreover, this weak December jobs report is out of synch with real GDP growth of close to 3 percent per annum in the fourth quarter.

The apparent decline in real labor market income in December is likely temporary and did not prevent a decent gain in holiday sales. Retail sales rose 0.2 percent in December, while sales excluding autos and parts were up a very good 0.7 percent; these both beat consensus expectations. Sales excluding autos and gasoline were up 0.6 percent in December. November sales were revised somewhat lower, with overall retail sales increasing 0.4 percent, revised down from 0.7 percent, and sales excluding autos up 0.1 percent, revised down from 0.4 percent. Sales of motor vehicles and parts were down 1.8 percent in December as auto sales dropped, not surprising

given that November was the best month for unit vehicle sales in almost seven years.

December results were mixed across retailers. Sales of food and beverages were up 2.0 percent. Sales at clothing and accessory stores were up 1.8 percent, and sales at gasoline stations were up 1.6 percent (primarily because of higher prices). Sales at nonstore retailers were up 1.4 percent as internet shopping continues to expand. Sales at restaurants were up 0.4 percent, while sales at general retailers were up just 0.1 percent. Sales fell for retailers of home furnishings, electronics and appliances, and building materials, perhaps in part due to colder than usual weather. Sales were also down at sporting goods and hobby stores.

Overall sales were good in the fourth quarter, up 4.2 percent at an annual rate, and up 4.0 percent excluding autos. With inflation low this implies a strong increase in real consumer spending at the end of 2013, a good but not great season for holiday sales, and solid fourth quarter

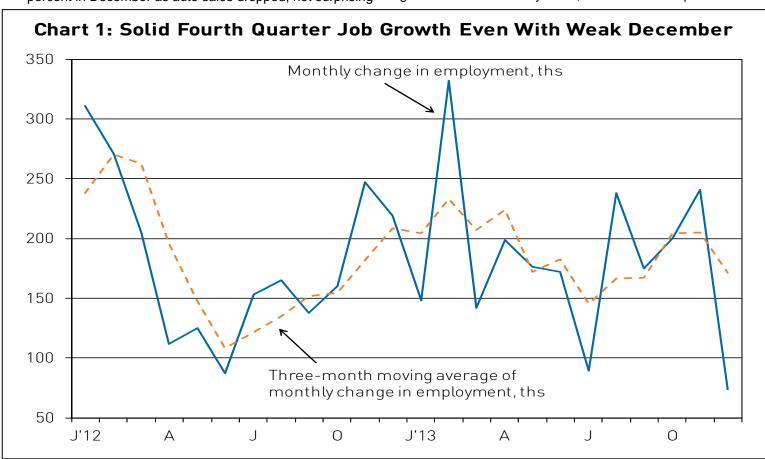


Chart source: BLS

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GDP growth (see Chart 2). Job growth, small but positive wage increases, lower gasoline prices, and big gains in stock and house prices over the past year supported consumer spending at the end of 2013.

That momentum will carry into this year, with a bit stronger growth in consumer spending compared to last year as the impact of the early 2013 increases in personal income taxes and the Social Security payroll tax fade. With consumers cautious in their outlays for the last eight years there is significant pent-up demand for big-ticket consumer items, especially vehicles. And continued low interest rates, low consumer debt burdens, and gradually easing lending standards will allow households to take on a bit more debt to boost their spending.

In addition new vehicle sales rose to an average of 15.9 million per annum in November and December combined; Ford and other automakers upped vehicle production in the fourth quarter, boosting overall manufacturing jobs and

production. Given recent better data PNC has revised up our estimate for real GDP growth in the fourth quarter to 2.8 percent at an annual rate. Vehicle production plans for the first quarter are down, which will be a temporary drag on economic growth, but we are forecasting auto production and sales growth of close to 5 percent for all of 2014.

The FOMC will not be impressed by the decline in the December unemployment rate to 6.7 percent, but nor will they be discouraged by the weak rise in December payroll jobs. They will see through both those contrary signals (really more noise than signal) and remain on the path of tapering they began in December. Thus the FOMC will reduce long-run asset purchases by \$10-15 billion a month over the next half dozen or so of their meetings, and wrap up the purchases completely by November 2014. Our outlook for short-term rates has not changed, with the first increase in the Fed funds rate still not expected until the final quarter of 2015.

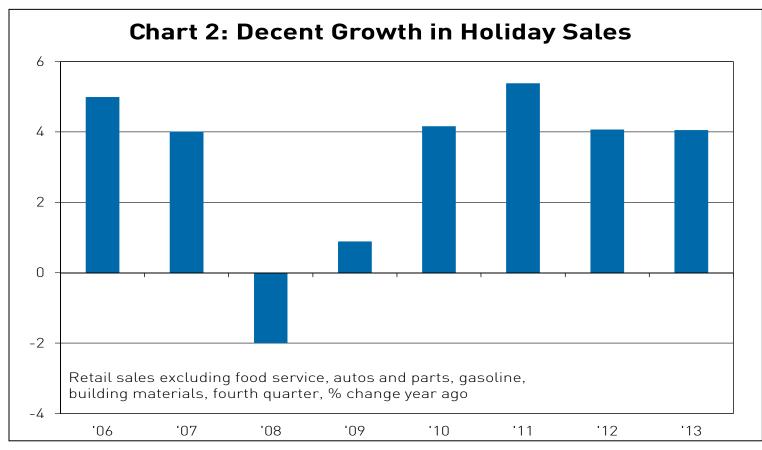


Chart source: Census

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