

NATIONAL ECONOMIC OUTLOOK

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Executive Summary

GDP Disappoints in the Second Quarter, But Another Great Jobs Report in July

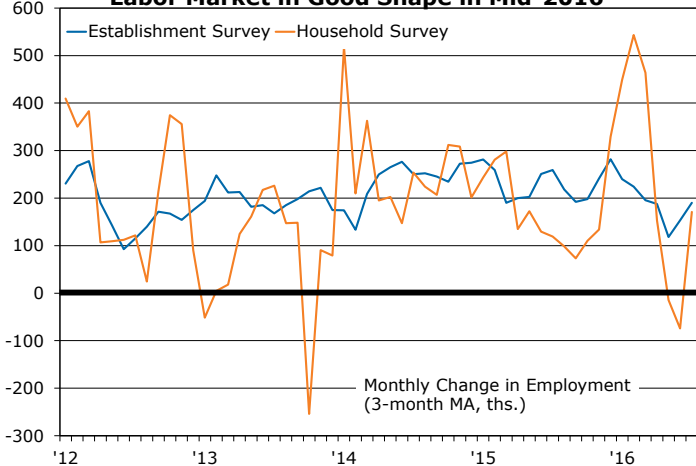
- Real GDP—economy-wide output of goods and services, adjusted for inflation—grew only 1.2 percent at an annual rate in the second quarter of 2016, according to the advance estimate, far below the consensus expectation for a 2.6 percent increase. This was a big disappointment, coming on the heels of weak growth in the prior two quarters. On a year-ago basis GDP growth in the second quarter was only 1.2 percent, the slowest pace in three years; this was down from 1.6 percent in the first quarter and 3.3 percent in the first quarter of 2015. The big drag on growth in the second quarter came from inventories; they reduced overall growth by 1.2 percentage points, the biggest subtraction since the first quarter of 2014. Fixed business investment was also a drag, subtracting 0.3 percentage point from growth. Housing was another drag, with residential investment spending down 6.1 percent at an annual rate in the second quarter, subtracting 0.2 percentage point from growth. Consumer spending was the big positive for growth, up 4.2 percent at an annual rate in the quarter after adjusting for inflation.
- Employment growth was much stronger than expected in July, with payrolls up by 255,000; this was well above the consensus forecast of 175,000. There were also upward revisions to job growth in May to 24,000 (from 11,000) and June to 292,000 (from 287,000), for a combined upward revision of 18,000. The three-month moving average of job growth in July was a very good 190,000, which is all the more remarkable given that it includes the very weak May number. The July unemployment rate held steady at 4.9 percent. The number of people who reported having jobs in the household survey (different from the survey of employers) rose by a whopping 420,000 in July, while the number of adults in the labor force rose by a large 407,000.
- Retail sales were flat from June to July, below the consensus expectation for a 0.4 percent increase. The big drag on the month was gasoline sales, which were down 2.7 percent as gas prices dropped in July by almost 5 percent. Motor vehicle and parts sales were up a good 1.1 percent as unit auto sales rose to 17.9 million units at an annual rate in July, up from 16.7 million in June. Retail sales excluding autos and parts were down 0.3 percent in July, and sales excluding autos and gasoline were down 0.1 percent. Retail sales rose 0.8 percent in June, revised up from a 0.6 percent increase. Retail sales were up 2.3 percent in July from one year earlier, down from 3.0 percent in June.

Baseline U.S. Economic Outlook, Summary Table*

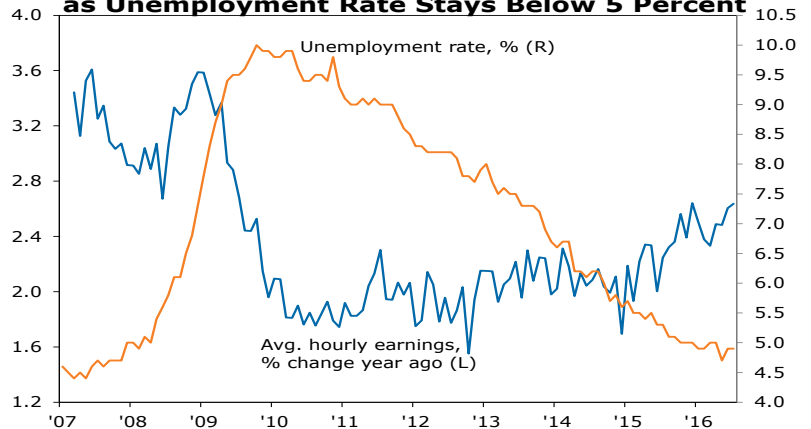
	1Q'16a	2Q'16p	3Q'16f	4Q'16f	1Q'17f	2Q'17f	3Q'17f	4Q'17f	2015a	2016f	2017f	2018f
Output & Prices												
Real GDP (Chained 2009 Billions \$)	16525	16575	16698	16793	16885	16979	17074	17168	16397	16648	17026	17408
Percent Change Annualized	0.8	1.2	3.0	2.3	2.2	2.2	2.3	2.2	2.6	1.5	2.3	2.2
CPI (1982-84 = 100)	237.9	239.4	240.4	241.6	242.9	244.3	245.6	247.0	237.0	239.8	245.0	250.4
Percent Change Annualized	-0.3	2.5	1.7	2.0	2.2	2.2	2.3	2.3	0.1	1.2	2.1	2.2
Labor Markets												
Payroll Jobs (Millions)	143.5	144.0	144.5	145.0	145.5	146.1	146.5	146.9	141.8	144.3	146.2	148.0
Percent Change Annualized	1.9	1.3	1.5	1.5	1.4	1.4	1.1	1.1	2.1	1.7	1.4	1.2
Unemployment Rate (Percent)	4.9	4.9	4.8	4.7	4.6	4.6	4.6	4.6	5.3	4.8	4.6	4.6
Interest Rates (Percent)												
Federal Funds	0.37	0.37	0.38	0.42	0.63	0.67	0.90	1.17	0.13	0.38	0.84	1.59
Treasury Note, 10-year	1.91	1.75	1.61	1.79	1.92	2.00	2.11	2.32	2.14	1.77	2.09	2.58

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

With Another Great Month of Job Growth in July, Labor Market in Good Shape in Mid-2016



Wage Growth Will Accelerate Further in 2017 as Unemployment Rate Stays Below 5 Percent



Thanks to Improving Labor Market, Consumer Spending Will Continue to Drive U.S. Growth Into 2017

Although second quarter growth was disappointing, with real GDP up just 1.2 percent at an annual rate, consumer spending was the bright spot. It increased an annualized 4.2 percent, the best growth since the fourth quarter of 2014. There were solid gains in all three major components of consumer spending in the second quarter: durable goods, nondurable goods, and services. Although consumer spending growth will slow in the near term from its unsustainable second-quarter pace, the fundamentals remain positive. In particular, the ongoing recovery in the labor market will support income growth through the rest of this year and into next, boosting household incomes and driving consumer spending forward.

The biggest positive for consumer spending in the second half of 2016 will remain the labor market. Job growth through the first seven months of 2016 has averaged 187,000, a slowing from 229,000 per month in 2015, but still very solid. PNC is forecasting average monthly job growth of 180,000 for all of this year. In addition, wage growth is picking up as the labor market tightens. With more competition for workers businesses are raising pay, as seen in recent announcements about higher starting wages from companies such as Starbucks, Target, and JPMorgan Chase. Average hourly earnings for private-sector workers have risen 2.9 percent at an annual rate in the first seven months of 2016, up from 2.6 percent growth in 2015 and 1.7 percent growth in 2014. Wage gains will continue to accelerate in the near term as the unemployment rate stays below 5 percent; PNC is forecasting wage growth of 2.8 percent in 2017 and 3.0 percent in 2018. Given solid job gains, accelerating wage growth, and low inflation, PNC is forecasting real (inflation-adjusted) after-tax income growth of 2.5 percent in 2016 and 2.6 percent in 2017.

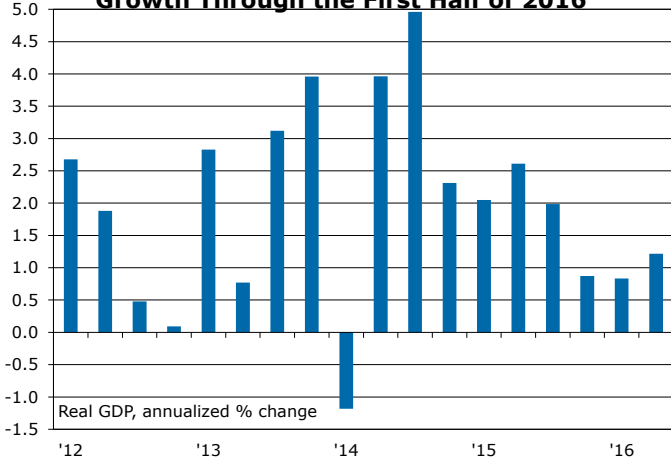
There are other positives for consumer spending as well. The decline in energy prices over the past two years has freed up cash for spending on other goods and services, and generally low inflation has boosted real incomes and spending. Rising stock and home prices have boosted household wealth, making consumers more willing to spend. Interest rates remain near historic lows, household balance sheets are in excellent shape, and lenders are gradually easing access to credit, all positives for consumer borrowing and consumer spending.

There are some negatives for consumer spending, including rising student loan balances and tight (albeit easing) credit, but the fundamentals are strongly weighted toward the positives. In addition, there is significant pent-up demand, as households are making up for some of the spending they put off during the Great Recession and early years of the slow recovery. Given this, consumer spending will remain the backbone of U.S. economic growth through the second half of this year and into next year. PNC is forecasting inflation-adjusted consumer spending growth of around 2.6 percent per annum in the second half of this year, and 2.5 percent in 2017; this will be slightly stronger than overall economic growth over the same period. Auto sales will run at a pace of 17.3 million units this year, down slightly from 2015, but still the second-best year for the industry on record. Sales should continue to hit 17 million over the next couple of years.

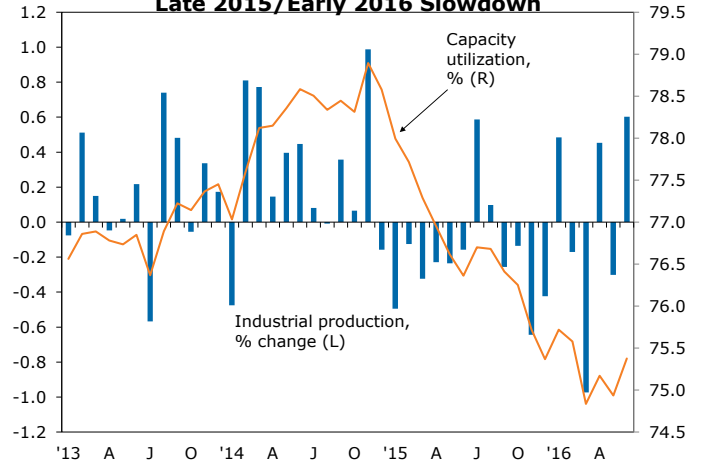
With consumers leading the way the U.S. expansion will continue into 2017. Real GDP growth will rebound to 3.0 percent in the third quarter of 2016 with a boost from inventories, and then settle in at its long-run average of around 2¼ percent in late 2016 and 2017. Housing will also be a positive for near-term growth, with a more modest contribution from business fixed investment. Trade will remain a near-term drag with the strengthening of the U.S. dollar since 2014 and ongoing soft global growth. Job growth will average around 170,000 per month in the second half of 2016, slowing to 150,000 in 2017. This is lower than the pace in 2015, but that is more because of difficulty in finding workers than a slowing in labor demand. The unemployment rate will slowly fall over the rest of 2016, ending this year at around 4.7 percent, consistent with nearly full employment. The Federal Open Market Committee will hold off on an increase in the federal funds rate when it meets in mid-September, given low inflation and soft July retail sales, and again in early November, right before the presidential election. But given continued improvement in the labor market and an expected acceleration in inflation, the next increase in the federal funds rate should come at the Federal Open Market Committee's mid-December meeting.

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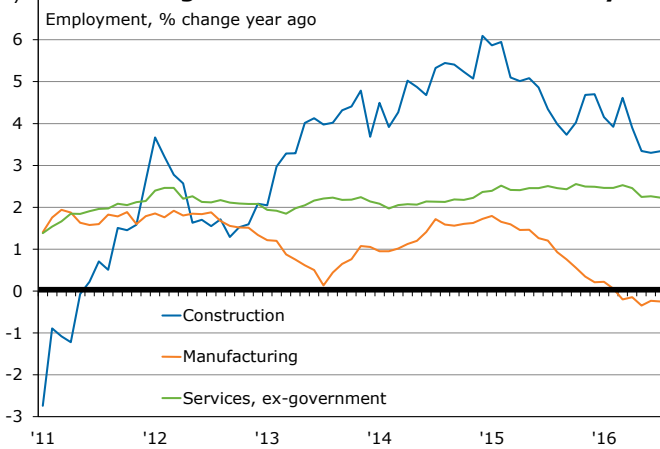
Three Straight Quarters of Weak Growth Through the First Half of 2016



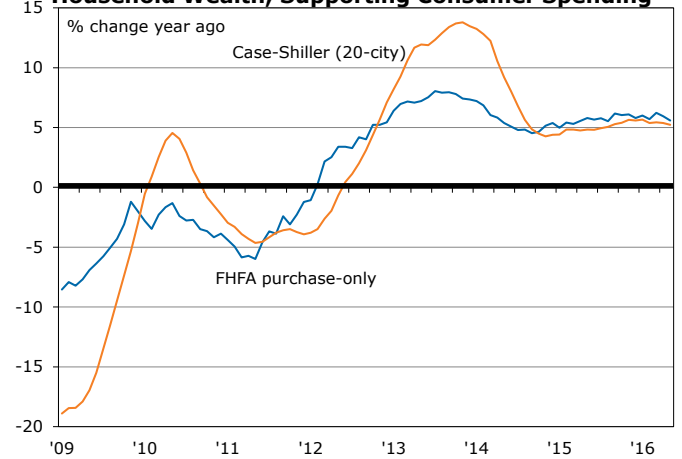
Manufacturing Has Come Out of Its Late 2015/Early 2016 Slowdown



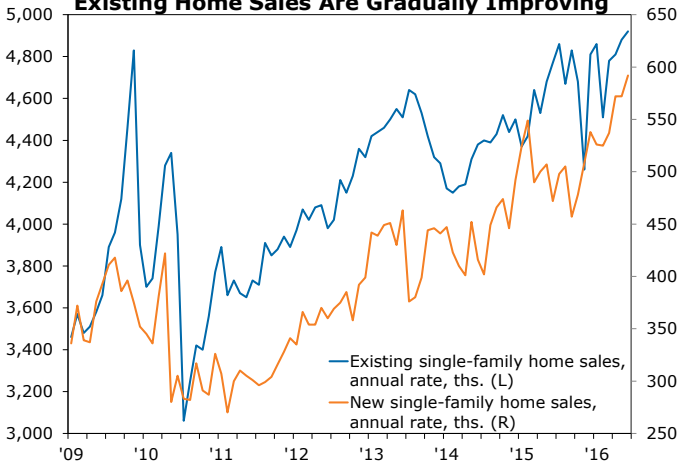
Small Decline in Manufacturing Employment Not Enough to Slow Labor Market Recovery



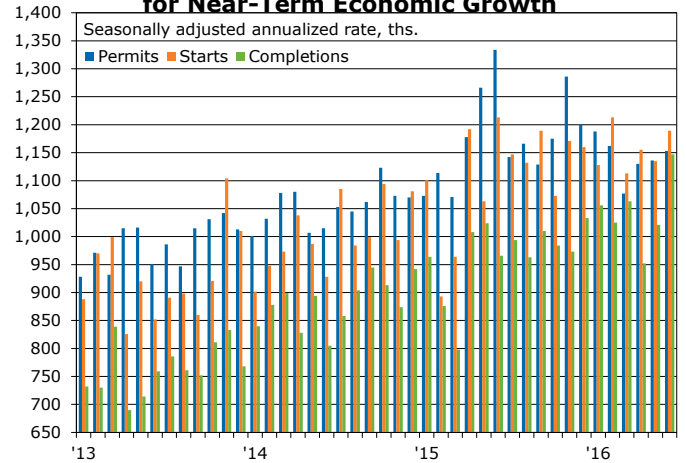
Gradually Rising House Prices Are Boosting Household Wealth, Supporting Consumer Spending



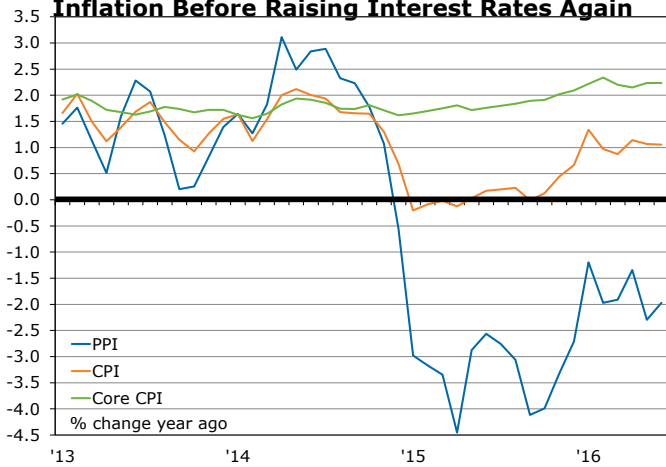
With Good Fundamentals, Pent-Up Demand, New and Existing Home Sales Are Gradually Improving



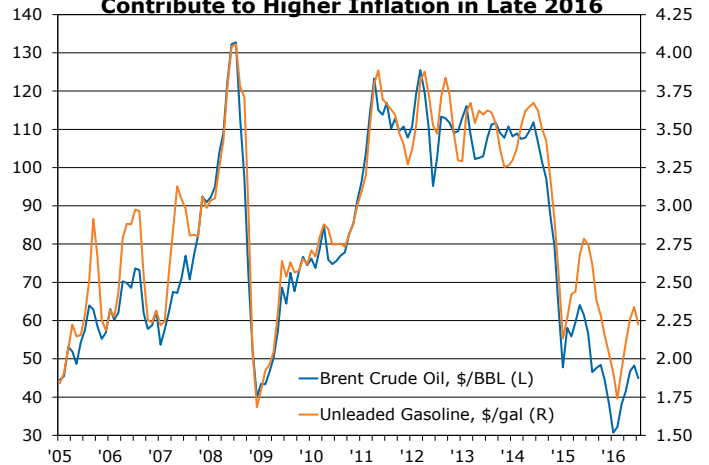
Homebuilding Will Be a Positive for Near-Term Economic Growth



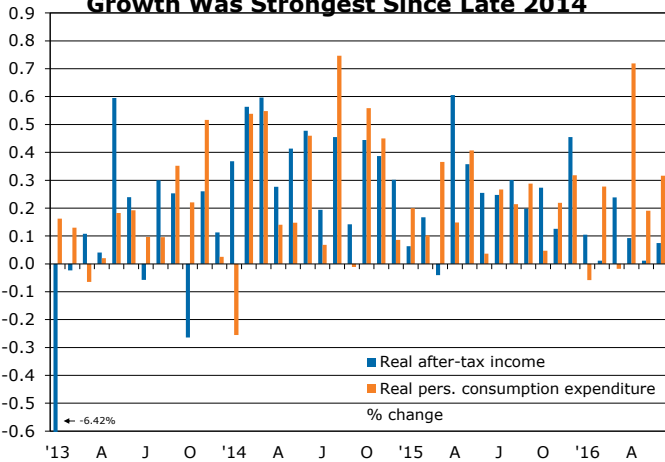
Federal Reserve Would Like to See Higher Inflation Before Raising Interest Rates Again



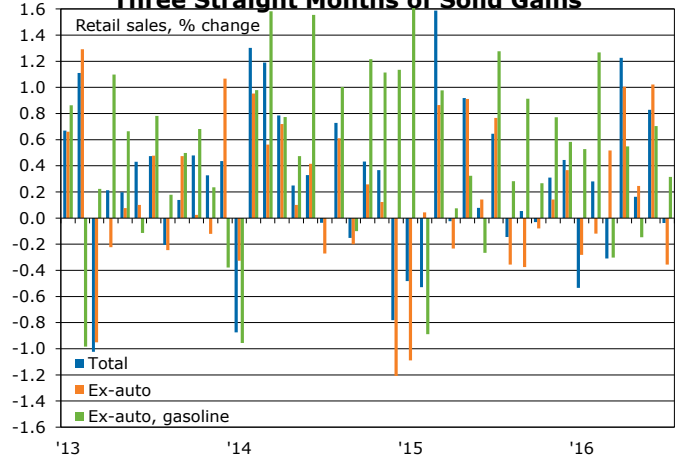
Stabilization in Energy Prices Will Contribute to Higher Inflation in Late 2016



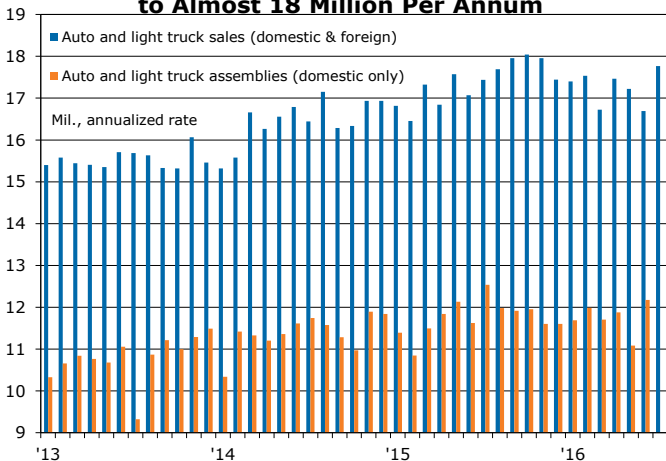
Second Quarter Real Consumer Spending Growth Was Strongest Since Late 2014



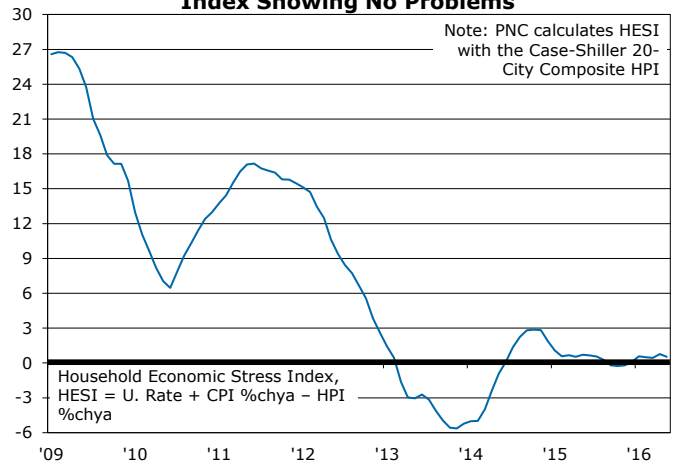
Weaker Retail Sales in July Followed Three Straight Months of Solid Gains



Auto Sales Bounced Back in July to Almost 18 Million Per Annum



PNC's Household Economic Stress Index Showing No Problems



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PNC Economics Group
August, 2016

Baseline U.S. Economic Outlook, Expanded Table

	1Q'16a	2Q'16p	3Q'16f	4Q'16f	1Q'17f	2Q'17f	3Q'17f	4Q'17f	2015a	2016f	2017f	2018f
Output												
Nominal GDP (Billions \$)	18282	18438	18633	18816	19007	19203	19403	19602	18037	18542	19304	20115
Percent Change Annualized	1.3	3.5	4.3	4.0	4.1	4.2	4.2	4.2	3.7	2.8	4.1	4.2
Real GDP (Chained 2009 Billions \$)	16525	16575	16698	16793	16885	16979	17074	17168	16397	16648	17026	17408
Percent Change Annualized	0.8	1.2	3.0	2.3	2.2	2.2	2.3	2.2	2.6	1.5	2.3	2.2
Pers. Consumption Expenditures	11365	11483	11559	11629	11697	11766	11834	11901	11215	11509	11800	12071
Percent Change Annualized	1.6	4.2	2.7	2.5	2.4	2.4	2.4	2.3	3.2	2.6	2.5	2.3
Nonresidential Fixed Investment	2180	2167	2173	2186	2202	2219	2235	2250	2200	2176	2227	2280
Percent Change Annualized	-3.4	-2.3	1.0	2.4	3.1	3.1	2.9	2.9	2.1	-1.1	2.3	2.4
Residential Investment	601	591	603	611	618	624	626	629	565	601	624	636
Percent Change Annualized	7.8	-6.1	8.0	5.5	4.8	3.9	1.2	1.9	11.7	6.5	3.8	1.9
Change in Private Inventories	41	-8	25	25	25	26	25	26	84	21	26	29
Net Exports	-566	-556	-575	-585	-599	-610	-613	-618	-540	-571	-610	-619
Government Expenditures	2913	2907	2923	2936	2950	2962	2976	2988	2884	2920	2969	3019
Percent Change Annualized	1.6	-0.9	2.2	1.8	2.0	1.7	1.8	1.7	1.8	1.2	1.7	1.7
Industrial Prod. Index (2012 = 100)	104.1	103.8	104.6	105.1	105.6	106.2	106.7	107.2	105.2	104.4	106.4	108.7
Percent Change Annualized	-1.8	-1.0	3.0	1.9	1.9	2.3	1.8	1.9	0.3	-0.8	1.9	2.2
Capacity Utilization (Percent)	75.4	75.2	75.8	76.0	76.2	76.4	76.6	76.8	76.7	75.6	76.5	77.4
Prices												
CPI (1982-84 = 100)	237.9	239.4	240.4	241.6	242.9	244.3	245.6	247.0	237.0	239.8	245.0	250.4
Percent Change Annualized	-0.3	2.5	1.7	2.0	2.2	2.2	2.3	2.3	0.1	1.2	2.1	2.2
Core CPI Index (1982-84 = 100)	245.8	247.0	248.3	249.6	251.0	252.3	253.8	255.2	242.2	247.7	253.1	258.6
Percent Change Annualized	2.7	2.1	2.1	2.1	2.2	2.2	2.3	2.3	1.8	2.2	2.2	2.2
PCE Price Index (2009 = 100)	110.0	110.5	110.8	111.3	111.8	112.3	112.8	113.3	109.5	110.6	112.5	114.7
Percent Change Annualized	0.3	1.9	1.2	1.6	1.8	1.8	1.9	1.9	0.3	1.0	1.7	2.0
Core PCE Price Index (2009 = 100)	110.7	111.1	111.6	112.1	112.6	113.1	113.6	114.2	109.5	111.4	113.4	115.5
Percent Change Annualized	2.1	1.7	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	111.2	111.6	112.1	112.6	113.1	113.7	114.3	110.0	111.4	113.4	115.6
Percent Change Annualized	0.5	2.2	1.3	1.7	1.9	2.0	2.0	2.0	1.1	1.3	1.8	2.0
Crude Oil, WTI (\$/Barrel)	33.2	45.4	45.0	47.0	47.0	48.0	49.0	50.0	48.7	42.7	48.5	53.4
Labor Markets												
Payroll Jobs (Millions)	143.5	144.0	144.5	145.0	145.5	146.1	146.5	146.9	141.8	144.3	146.2	148.0
Percent Change Annualized	1.9	1.3	1.5	1.5	1.4	1.4	1.1	1.1	2.1	1.7	1.4	1.2
Unemployment Rate (Percent)	4.9	4.9	4.8	4.7	4.6	4.6	4.6	4.6	5.3	4.8	4.6	4.6
Average Weekly Hours, Prod. Works.	33.7	33.6	33.6	33.7	33.7	33.7	33.7	33.7	33.7	33.6	33.7	33.8
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 \$)	12558	12594	12687	12769	12851	12934	13018	13097	12343	12652	12975	13287
Percent Change Annualized	2.2	1.2	3.0	2.6	2.6	2.6	2.6	2.5	3.5	2.5	2.6	2.4
Housing												
Housing Starts (Ths., Ann. Rate)	1151	1160	1181	1195	1199	1208	1212	1217	1108	1172	1209	1232
Ext. Home Sales (Ths., Ann Rate)	5300	5503	5571	5614	5698	5742	5758	5781	5233	5497	5745	5905
New SF Home Sales (Ths., Ann Rate)	529	579	574	578	587	593	599	604	502	565	596	605
Case/Shiller HPI (Jan. 2000 = 100)	178.8	179.6	181.4	183.9	185.9	187.6	188.9	190.8	172.4	180.9	188.3	195.2
Percent Change Year Ago	5.2	5.1	5.1	4.4	4.0	4.5	4.2	3.7	4.6	5.0	4.1	3.7
Consumer												
Household Economic Stress Index	0.8	0.8	0.8	1.8	2.7	2.1	2.6	3.1	0.8	1.0	2.6	3.2
Auto Sales (Millions)	17.2	17.1	17.5	17.4	17.4	17.3	17.1	17.1	17.4	17.3	17.2	17.1
Consumer Credit (Billions \$)	3587	3634	3680	3727	3773	3818	3860	3902	3459	3657	3838	4010
Percent Change Annualized	5.9	5.4	5.1	5.3	5.0	4.8	4.5	4.4	6.9	5.7	5.0	4.5
Interest Rates (Percent)												
Prime Rate	3.50	3.50	3.50	3.55	3.75	3.79	4.03	4.30	3.26	3.51	3.97	4.72
Federal Funds	0.37	0.37	0.38	0.42	0.63	0.67	0.90	1.17	0.13	0.38	0.84	1.59
3-Month Treasury Bill	0.29	0.26	0.32	0.47	0.61	0.74	0.91	1.16	0.05	0.33	0.86	1.63
10-Year Treasury Note	1.91	1.75	1.61	1.79	1.92	2.00	2.11	2.32	2.14	1.77	2.09	2.58
30-Year Fixed Mortgage	3.74	3.59	3.51	3.60	3.67	3.71	3.80	3.96	3.85	3.61	3.78	4.16

a = actual f = forecast p = preliminary

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