July 2016

NATIONAL ECONOMIC OUTLOOK

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Executive Summary

Concerns About Slowing Fade With Very Strong June Jobs Report

- After job gains of just 11,000 in May (after revisions), payroll job growth rebounded in June to 287,000, well above the market consensus of 195,000. Private-sector employment rose by 265,000 (230,000 adjusted for the roughly 35,000 returning Verizon strikers), with government employment up by 22,000. The monthly average payroll job gain for the first six months of 2016 was a solid 171,000, although down from an average of 228,000 per month during all of 2015. Average hourly earnings in the private sector rose by 0.1 percent in June and were up 2.6 percent from one year earlier, a slight pickup from 2.5 percent in May. Wage growth is slowly accelerating as the labor market tightens. The unemployment rate rose in June to 4.9 percent from 4.7 percent in May, but the increase came from a good reason: more people looking for work, a vote of confidence in the job market. The number of jobs reported in the household survey (different from the survey of employers) rose by 67,000 in June.

- Retail sales increased more than expected in June, up 0.6 percent for the month before adjusting for inflation. This easily bested the consensus expectation of a 0.1 percent increase. Sales excluding motor vehicles and parts rose a very good 0.7 percent in June, and sales excluding autos and gasoline also rose 0.7 percent. Control sales—retail sales excluding autos and parts, building materials, and gasoline, and which go into nominal consumer spending in GDP—rose 0.5 percent in June, and increased 7.8 percent at an annualized rate in the second quarter. Consumers continue to push the U.S. economy forward. Spending growth was very strong in the second quarter, and is likely to come in at a 4 percent annualized pace, after adjusting for inflation, when the advance estimate for second quarter GDP is released in late July.

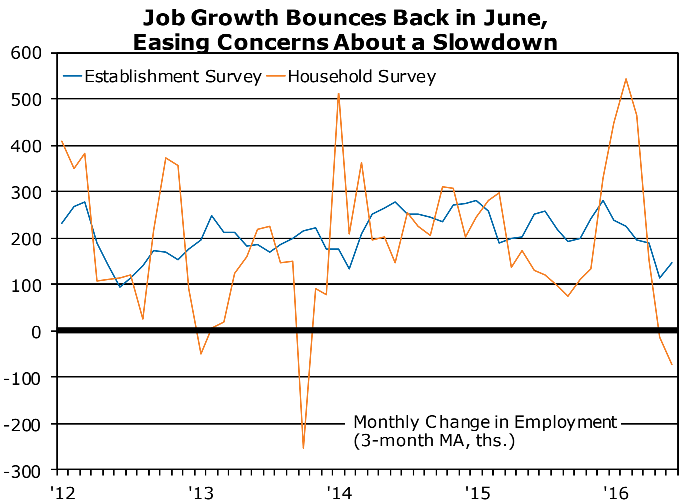
- Industrial production rose 0.6 percent in June, the largest increase since July 2015. This was better than the consensus expectation of a 0.2 percent increase. Manufacturing output rose 0.4 percent in June, while mining production rose 0.2 percent; mining output, after plunging almost 18 percent between December 2014 and April 2015, has now risen for two straight months, for the first time since the summer of 2015. After softness in late 2015 and early 2016, much of it tied to the downturn in energy production, the industrial side of the economy appears to be gradually coming back, as energy production is stabilizing now that prices have reached a bottom.

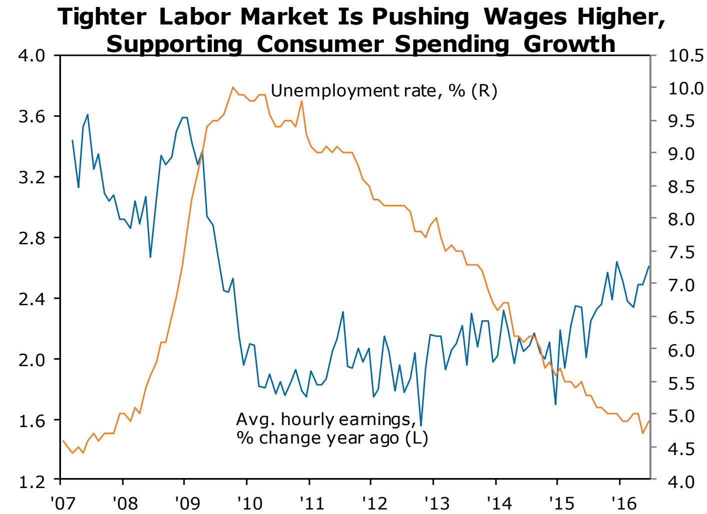
*Baseline U.S. Economic Outlook, Summary Table**

	1Q'16a	2Q'16f	3Q'16f	4Q'16f	1Q'17f	2Q'17f	3Q'17f	4Q'17f	2015a	2016f	2017f	2018f
Output & Prices												
Real GDP (*Chained 2009 Billions $*)	16515	16621	16721	16818	16910	17003	17097	17191	16349	16669	17050	17430
Percent Change Annualized	**1.1**	**2.6**	**2.4**	**2.4**	**2.2**	**2.2**	**2.2**	**2.2**	**2.4**	**2.0**	**2.3**	**2.2**
CPI (*1982-84 = 100*)	237.9	239.2	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**	**2.2**	**2.0**	**2.0**	**2.2**	**2.2**	**2.3**	**2.3**	**0.1**	**1.2**	**2.2**	**2.2**
Labor Markets												
Payroll Jobs (*Millions*)	143.5	144.0	144.4	144.9	145.4	145.9	146.4	146.9	141.8	144.2	146.1	148.0
Percent Change Annualized	**1.9**	**1.3**	**1.2**	**1.4**	**1.4**	**1.3**	**1.3**	**1.3**	**2.1**	**1.7**	**1.3**	**1.3**
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	1.60	1.84	2.04	2.15	2.27	2.44	2.14	1.78	2.22	2.68

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

PNC





Brexit: No Change to U.S. Outlook, But Increased Volatility and Greater Downside Risk

U.K. citizens voted in a referendum on June 23 to leave the European Union, surprising most observers and financial markets. British exit, or "Brexit," from the EU is not imminent, as it will need to be negotiated between the two parties. European Union rules call for a two-year negotiation period, which could be extended. It is also possible that the U.K. could end up staying in the European Union.

The direct fallout on the U.S. economy will be limited. U.S. exports to the U.K. make up only about 0.7 percent of U.S. GDP. So even if the U.K. falls into recession as a result of Brexit, which PNC now views as more likely than not, the hit to U.S. exporters will be small. Eurozone growth is also likely to suffer, although the currency union is less likely to fall into recession (20 percent probability). This could create another small drag on U.S. growth: exports to the Eurozone are about 2 percent of U.S. GDP.

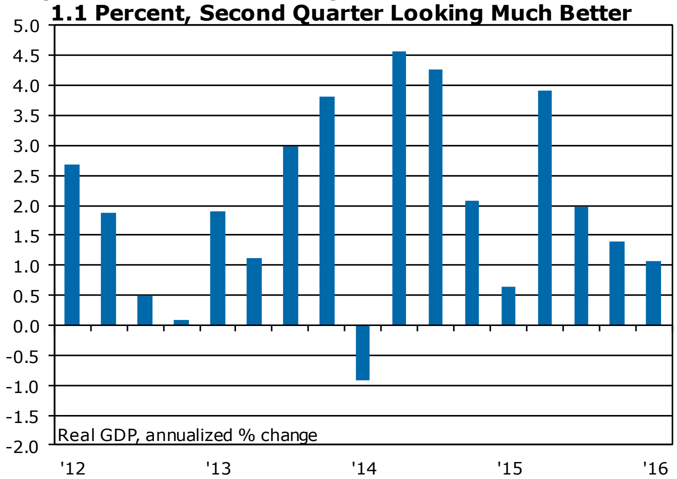
The more important risks to the U.S. are likely to be indirect. Greater uncertainty about the prospects for global growth and increased financial market volatility could make U.S. businesses more cautious in hiring and investing, and could make consumers less willing to spend. Uncertainty and volatility has pushed investors to seek the safety of the U.S. dollar, and the currency has strengthened in the wake of the Brexit vote, up almost 14 percent against the British pound, more than 3 percent against the euro, and about 4 percent against a broad basket of currencies. This will make U.S. exports abroad more expensive and imports to the U.S. less expensive, creating a drag on growth. But domestic demand, particularly consumer spending and housing, are the primary drivers of current U.S. growth, and so the impact of the stronger dollar will be muted.

Somewhat offsetting the negative impacts will be lower interest rates, making it less expensive for U.S. businesses and consumers to borrow. Investors have flocked to the safety of U.S. government securities after the Brexit vote in a flight to quality, and rates have already come down dramatically. The yield on the 10-year Treasury fell from 1.75 percent before the vote to 1.36 percent in early July, before moving higher to around 1.56 percent in mid-July. This, in turn, has pushed down mortgage rates, providing support to an already-expanding housing market. In addition, refinance applications have surged, giving homeowners another big bite out of the low interest rate apple.

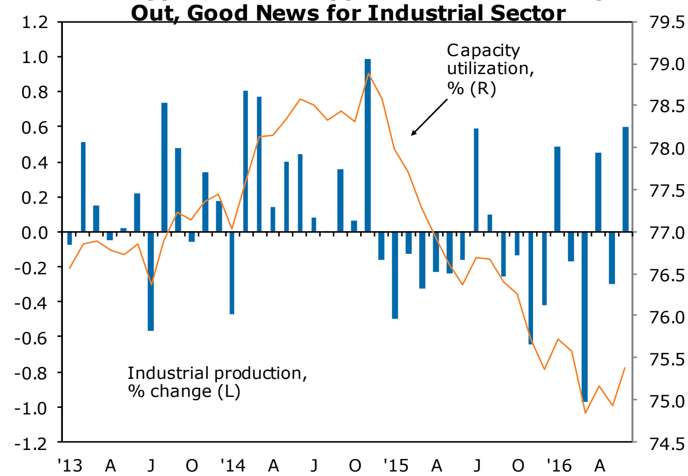
The Brexit vote also makes a near-term increase in the federal funds rate less likely. The Federal Open Market Committee held off on an increase in the fed funds rate at its meeting in mid-June, in part because of the uncertainty surrounding Brexit. With the U.K. vote roiling financial markets and additional uncertainty, the FOMC will await the fallout from Brexit before raising rates again. The uncertainty surrounding the upcoming U.S. presidential election will also make the FOMC cautious about near-term rate increases. PNC does not expect the FOMC to raise rates again until their December meeting. Fed funds futures markets are now pricing in a slightly less than 50 percent probability of a rate increase by the end of this year, although that is up from only an 18 percent probability in the immediate aftermath of the Brexit vote.

The fundamentals for the U.S. economy remain solid, and PNC has not significantly changed its U.S. forecast after the vote for Brexit. Real GDP growth appears to have been about 2.6 percent at an annual rate in the second quarter, after disappointing growth of 1.1 percent in the first quarter, thanks to a big gain in consumer spending and further improvement in the housing market. Growth in the second half of 2016 should be around 2.4 percent annualized, with consumer spending and housing continuing to lead growth. An end to the huge drop in energy production, now that energy prices have stabilized after two years of steep declines, will also support growth through the rest of 2016, as will the end to a year-long inventory drawdown. With continued solid improvement in the U.S. economy job growth will average around 160,000 per month in the second half of 2016. This is slower than the pace in 2015, but 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 tighter job market will spur stronger wage growth, allowing for continued improvement in consumer spending next year.

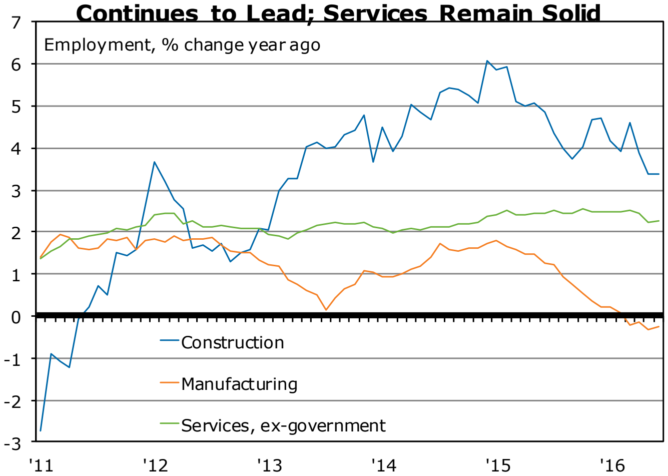
Upward Revision in First Quarter Economic Growth to 1.1 Percent, Second Quarter Looking Much Better



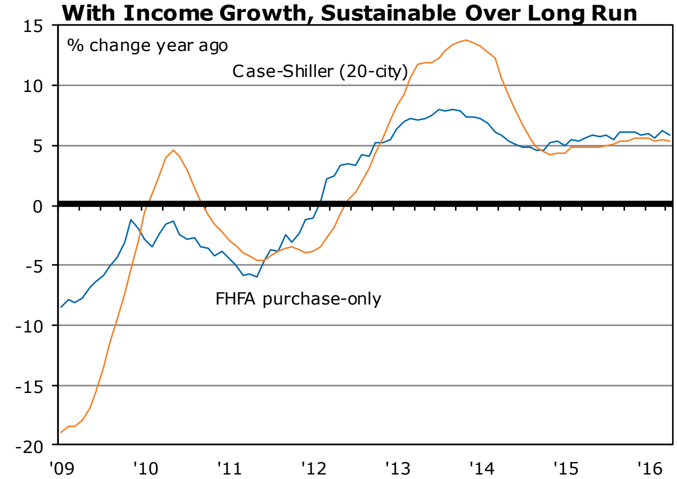
Energy Production Appears to Be Bottoming Out, Good News for Industrial Sector



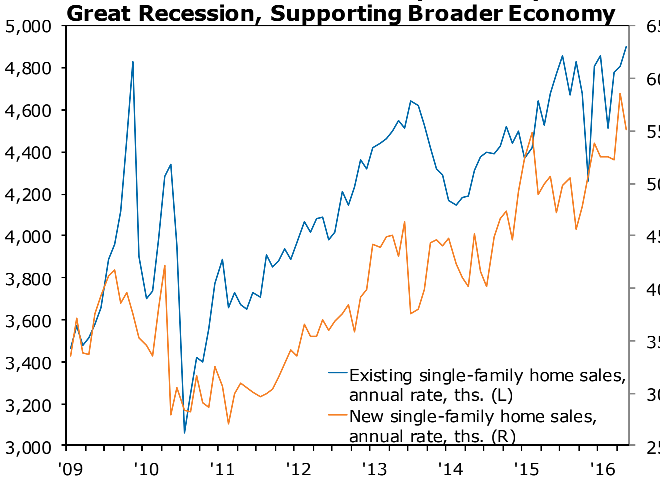
Construction Job Growth Has Slowed, But Continues to Lead; Services Remain Solid



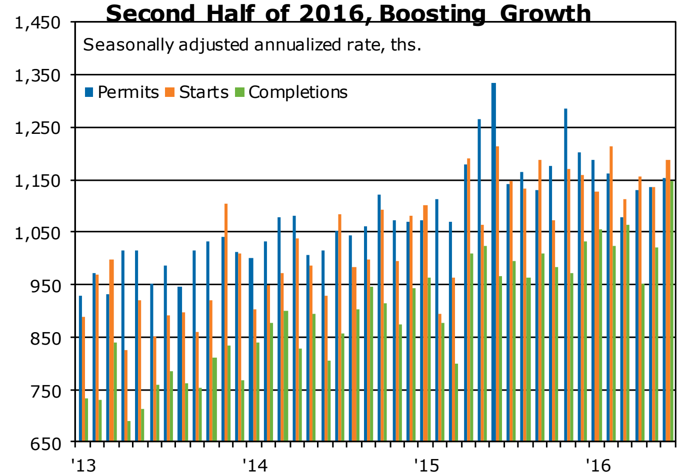
House Price Growth of 5 Percent Is Consistent With Income Growth, Sustainable Over Long Run



Home Sales Continue Their Steady Recovery From the Great Recession, Supporting Broader Economy



Gain in Homebuilding Will Continue in Second Half of 2016, Boosting Growth



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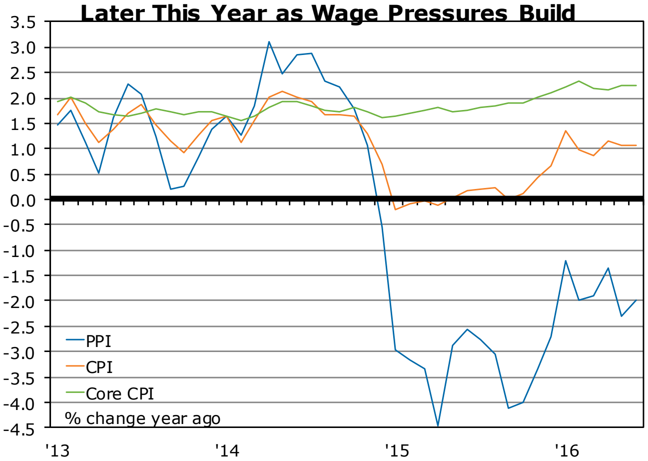
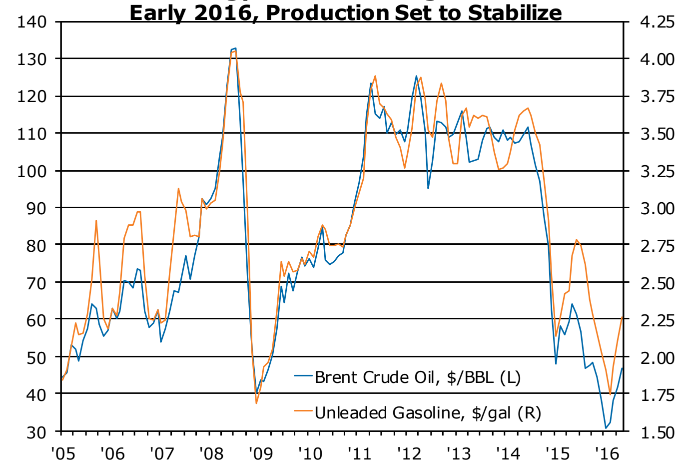
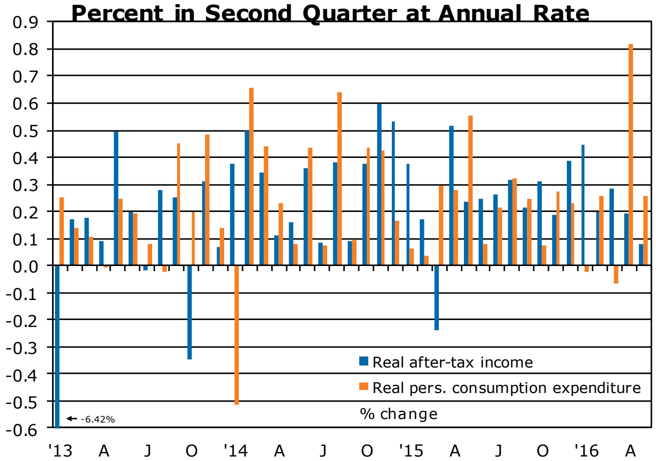
Inflation Stable Now, But Set to Pick Up Later This Year as Wage Pressures Build



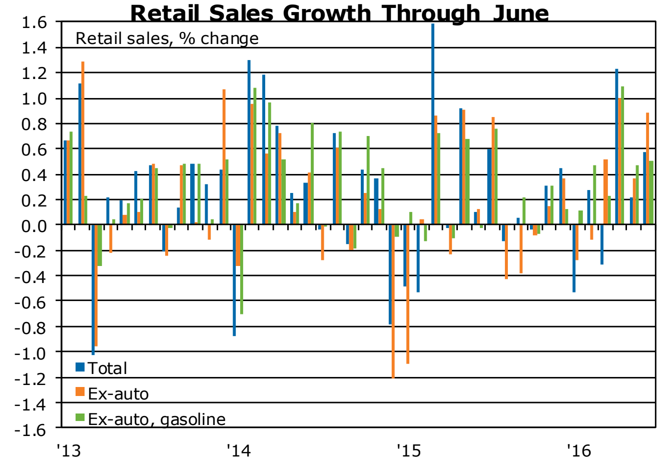
With Energy Prices Reaching a Bottom in Early 2016, Production Set to Stabilize



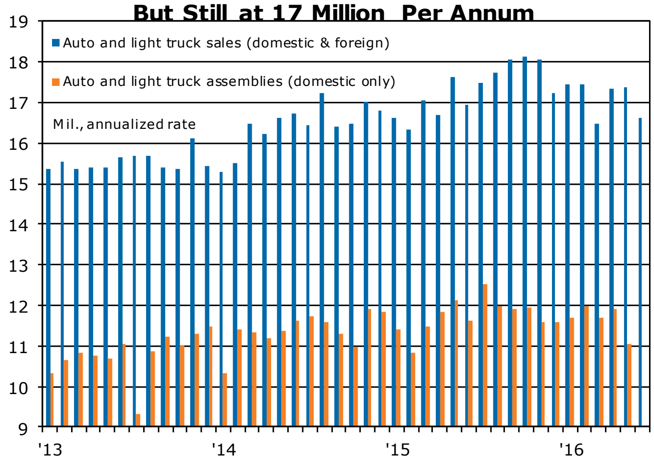
After-Inflation Consumer Spending Likely Up 4 Percent in Second Quarter at Annual Rate



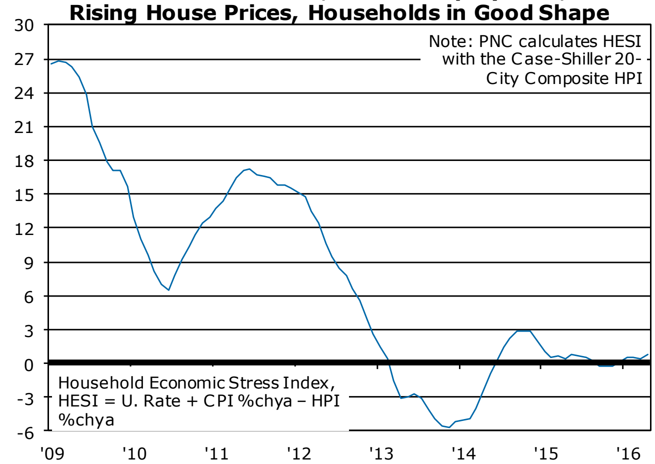
Three Straight Months of Solid Retail Sales Growth Through June



Auto Sales Have Slowed a Bit in 2016, But Still at 17 Million Per Annum



With Low Inflation, Low Unemployment, Rising House Prices, Households in Good Shape



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Baseline U.S. Economic Outlook, Expanded Table

	1Q'16a	2Q'16f	3Q'16f	4Q'16f	1Q'17f	2Q'17f	3Q'17f	4Q'17f	2015a	2016f	2017f	2018f
Output												
Nominal GDP (*Billions $*)	18230	18418	18601	18782	18971	19167	19365	19563	17947	18508	19267	20074
Percent Change Annualized	**1.4**	**4.2**	**4.0**	**3.9**	**4.1**	**4.2**	**4.2**	**4.2**	**3.5**	**3.1**	**4.1**	**4.2**
Real GDP (*Chained 2009 Billions $*)	16515	16621	16721	16818	16910	17003	17097	17191	16349	16669	17050	17430
Percent Change Annualized	**1.1**	**2.6**	**2.4**	**2.4**	**2.2**	**2.2**	**2.2**	**2.2**	**2.4**	**2.0**	**2.3**	**2.2**
Pers. Consumption Expenditures	11373	11485	11552	11621	11688	11755	11823	11888	11213	11508	11788	12056
Percent Change Annualized	**1.5**	**4.0**	**2.4**	**2.4**	**2.3**	**2.3**	**2.3**	**2.2**	**3.1**	**2.6**	**2.4**	**2.3**
Nonresidential Fixed Investment	2188	2197	2220	2237	2254	2271	2287	2303	2209	2211	2279	2334
Percent Change Annualized	**-4.5**	**1.7**	**4.4**	**3.0**	**3.1**	**3.1**	**2.9**	**2.9**	**2.8**	**0.1**	**3.1**	**2.4**
Residential Investment	568	575	584	592	599	604	606	609	530	579	605	616
Percent Change Annualized	**15.6**	**5.0**	**6.4**	**5.6**	**4.9**	**4.0**	**1.2**	**1.9**	**8.9**	**9.4**	**4.4**	**1.9**
Change in Private Inventories	68	45	40	40	40	41	40	41	98	48	41	44
Net Exports	-547	-550	-561	-570	-584	-594	-598	-602	-543	-557	-594	-603
Government Expenditures	2880	2885	2901	2914	2928	2940	2954	2966	2859	2895	2947	2997
Percent Change Annualized	**1.3**	**0.7**	**2.2**	**1.8**	**2.0**	**1.7**	**1.8**	**1.7**	**0.7**	**1.3**	**1.8**	**1.7**
Industrial Prod. Index (*2012 = 100*)	104.1	103.8	104.4	104.9	105.4	106.0	106.4	107.0	105.2	104.3	106.2	108.5
Percent Change Annualized	**-1.6**	**-1.2**	**2.2**	**1.9**	**1.9**	**2.3**	**1.8**	**1.9**	**0.3**	**-0.9**	**1.8**	**2.2**
Capacity Utilization (*Percent*)	75.4	75.3	75.8	76.2	76.6	77.0	77.3	77.6	76.7	75.7	77.1	78.3
Prices												
CPI (*1982-84 = 100*)	237.9	239.2	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**	**2.2**	**2.0**	**2.0**	**2.2**	**2.2**	**2.3**	**2.3**	**0.1**	**1.2**	**2.2**	**2.2**
Core CPI Index (1982-84 = 100)	245.8	247.0	248.2	249.4	250.7	252.0	253.3	254.7	242.2	247.6	252.7	258.1
Percent Change Annualized	**2.7**	**2.0**	**2.0**	**1.9**	**2.1**	**2.1**	**2.2**	**2.2**	**1.8**	**2.2**	**2.1**	**2.1**
PCE Price Index (*2009 = 100*)	109.9	110.3	110.8	111.2	111.7	112.2	112.8	113.3	109.4	110.6	112.5	114.7
Percent Change Annualized	**0.2**	**1.6**	**1.6**	**1.6**	**1.8**	**1.9**	**1.9**	**1.9**	**0.3**	**1.0**	**1.8**	**2.0**
Core PCE Price Index (*2009 = 100*)	110.5	111.0	111.4	111.9	112.4	112.9	113.5	114.0	109.4	111.2	113.2	115.3
Percent Change Annualized	**2.0**	**1.6**	**1.7**	**1.7**	**1.8**	**1.8**	**1.9**	**1.9**	**1.3**	**1.7**	**1.8**	**1.9**
GDP Price Index (*2009 = 100*)	110.4	110.8	111.3	111.7	112.2	112.8	113.3	113.9	109.8	111.0	113.1	115.3
Percent Change Annualized	**0.4**	**1.6**	**1.6**	**1.6**	**1.9**	**2.0**	**2.0**	**2.0**	**1.0**	**1.2**	**1.8**	**2.0**
Crude Oil, WTI (*$/Barrel*)	33.2	45.5	47.0	47.0	47.0	48.0	49.0	50.0	48.7	43.2	48.5	53.4
Labor Markets												
Payroll Jobs (*Millions*)	143.5	144.0	144.4	144.9	145.4	145.9	146.4	146.9	141.8	144.2	146.1	148.0
Percent Change Annualized	**1.9**	**1.3**	**1.2**	**1.4**	**1.4**	**1.3**	**1.3**	**1.3**	**2.1**	**1.7**	**1.3**	**1.3**
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	33.7	33.7	33.8	33.8	33.8	33.9	33.9	33.7	33.7	33.9	34.0
Personal Income												
Average Hourly Earnings (*$*)	21.36	21.50	21.65	21.79	21.95	22.10	22.26	22.43	21.04	21.58	22.18	22.84
Percent Change Annualized	**2.4**	**2.7**	**2.7**	**2.8**	**2.8**	**2.8**	**2.9**	**3.0**	**2.1**	**2.6**	**2.8**	**3.0**
Real Disp. Income (*2009 Billions $*)	12513	12580	12645	12715	12792	12869	12950	13027	12247	12613	12909	13211
Percent Change Annualized	**4.0**	**2.2**	**2.1**	**2.2**	**2.5**	**2.4**	**2.5**	**2.4**	**3.5**	**3.0**	**2.3**	**2.3**
Housing												
Housing Starts (*Ths., Ann. Rate*)	1151	1165	1191	1205	1209	1217	1222	1227	1108	1178	1219	1242
Ext. Home Sales (*Ths., Ann Rate*)	5300	5377	5536	5580	5664	5707	5723	5747	5233	5448	5710	5871
New SF Home Sales (*Ths., Ann Rate*)	524	563	555	560	569	575	580	585	502	551	577	586
Case/Shiller HPI (*Jan. 2000 = 100*)	178.8	179.5	181.2	183.7	185.5	187.2	188.0	190.5	172.4	180.8	187.8	194.8
Percent Change Year Ago	**5.2**	**5.1**	**5.0**	**4.2**	**3.8**	**4.3**	**3.7**	**3.7**	**4.6**	**4.9**	**3.9**	**3.7**
Consumer												
Household Economic Stress Index	0.8	0.8	0.9	2.0	3.0	2.4	3.1	3.1	0.8	1.1	2.9	3.2
Auto Sales (*Millions*)	17.1	17.1	17.3	17.4	17.3	17.2	17.1	17.0	17.3	17.2	17.2	17.0
Consumer Credit (*Billions $*)	3588	3609	3637	3662	3685	3708	3732	3758	3459	3624	3721	3835
Percent Change Annualized	**6.2**	**2.4**	**3.1**	**2.8**	**2.6**	**2.5**	**2.6**	**2.8**	**6.9**	**4.8**	**2.7**	**3.0**
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	0.33	0.46	0.59	0.73	0.90	1.16	0.05	0.34	0.85	1.61
10-Year Treasury Note	1.91	1.75	1.60	1.84	2.04	2.15	2.27	2.44	2.14	1.78	2.22	2.68
30-Year Fixed Mortgage	3.74	3.59	3.49	3.64	3.76	3.82	3.92	4.06	3.85	3.61	3.89	4.26

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

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