June 2023

NATIONAL ECONOMIC OUTLOOK

Gus Faucher, Chief Economist | Stuart Hoffman, Senior Economic Advisor | Kurt Rankin, Senior Economist | Abbey Omodunbi, Senior Economist | Ershang Liang, Economist

THE PNC FINANCIAL SERVICES GROUP | The Tower at PNC Plaza | 300 Fifth Avenue | Pittsburgh, PA 15222-2401

FOMC Pauses in June Even as Labor Market Remains Strong

- Employment growth was far stronger than expected in May, according to a survey of employers from the Bureau of Labor Statistics, with the economy adding a net 339,000 jobs over the month. This is well above the consensus expectation of 180,000. In addition, there were large upward revisions to job growth in both March and April of a combined 91,000. Over the last three months the economy has added more than 280,000 jobs on average, well above the economy's long-run potential. This is unwelcome news for the Federal Reserve, which would like to see job growth slow to a more sustainable monthly pace of around 125,000. The unemployment rate jumped 0.3 percentage point to 3.7%, the highest the rate has been since October 2022. This was also the biggest one-month increase in the unemployment rate since it soared in April 2020 at the beginning of the pandemic. The 3.4% rate in April 2023 matched the lowest unemployment rate since 1969.

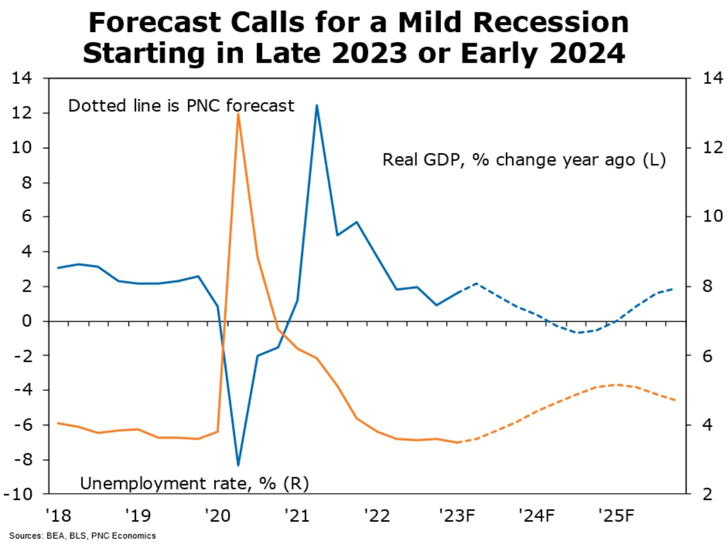
- The Federal Open Market Committee kept the federal funds rate unchanged in a range between 5.00% and 5.25% on June 14, as widely expected. This is the first FOMC meeting where the committee has not raised the fed funds rate since January 26, 2022, when the rate was in a range between 0.00% and 0.25% coming out of the pandemic. This tightening in monetary policy since the spring of 2022 has weighed on economic growth, although the economy continues to expand in mid-2023. While the FOMC kept the fed funds rate unchanged in June, it is likely to raise it again in the near term given the tight labor market and inflation that is running far too hot. FOMC participants' own projections, as well as speeches from Fed officials including Chair Powell, point to further increases in the fed funds rate this year.

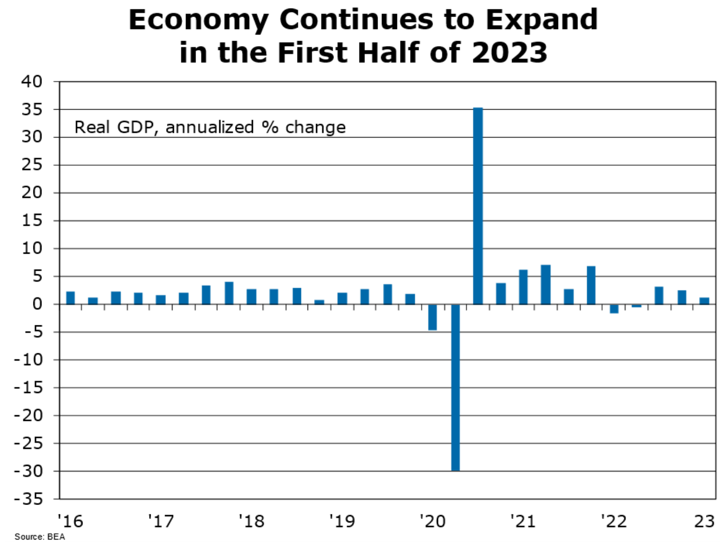
- Inflation is slowing but remains elevated. The overall consumer price index was up 4.1% in May from one year earlier. This was down from 4.9% in April and a peak of almost 9% in mid-2022. The core CPI, which excludes volatile food and energy prices and is a better measure of underlying inflation trends, was up 5.3% year-over-year in May. This was down from 5.5% in May and 6.6% in September 2022. Core inflation is easing only gradually. The central bank's preferred inflation gauge is a different measure, the personal consumption expenditures price index, which tends to run a bit below the CPI, but it is also well above the FOMC's 2% objective. Core services, including housing services, is the primary driver of high inflation in 2023; this is different from last year, when goods inflation was the dominant factor.

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

	1Q'23a	2Q'23f	3Q'23f	4Q'23f	1Q'24f	2Q'24f	2022a	2023f	2024f	2025f
Output										
Real GDP (*Chained 2012 Billions $*)	20246	20319	20346	20357	20324	20260	20014	20317	20261	20480
Percent Change Annualized	**1.3**	**1.4**	**0.5**	**0.2**	**-0.7**	**-1.2**	**2.1**	**1.5**	**-0.3**	**1.1**
CPI (*1982-84 = 100*)	301.3	304.1	306.5	308.4	309	310	292.6	305.1	310.2	314.1
Percent Change Annualized	**3.8**	**3.7**	**3.2**	**2.5**	**1.0**	**0.9**	**8.0**	**4.3**	**1.7**	**1.2**
Labor Markets										
Payroll Jobs (*Millions*)	155.2	155.8	156.0	156.0	155.8	155.6	152.6	155.8	155.4	155.3
Percent Change Annualized	**2.5**	**1.6**	**0.5**	**0.0**	**-0.6**	**-0.7**	**4.3**	**2.1**	**-0.2**	**-0.1**
Unemployment Rate (*Percent*)	3.5	3.6	3.9	4.1	4.4	4.6	3.6	3.8	4.8	5.0
Interest Rates (Percent)										
Federal Funds	4.52	4.99	5.08	5.08	4.88	3.97	**1.68**	**4.92**	**3.82**	**2.88**
10-Year Treasury Note	3.65	3.56	3.55	3.44	3.36	3.33	**2.94**	**3.55**	**3.35**	**3.44**

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





Recession Looms Despite Current Labor Market, Consumer Strength

The U.S. economy remains in good shape heading into the second half of 2023. In particular, the labor market is exceptionally strong, with job growth well above its pre-pandemic pace and the unemployment rate historically low. With the strong job market consumers continue to increase their spending, supporting overall economic growth. But inflation is much too high for the Federal Reserve, and the rapid tightening in monetary policy since early 2022 is likely to result in a recession later this year or early next. But there is still the possibility that the U.S. economy can avoid a recession, and even if a downturn does come, it is likely to be short and mild.

The biggest reason for optimism about the U.S. economy is the labor market. Although job growth has slowed from the initial recovery from the pandemic, it is still very strong. The U.S. economy has added an average of more than 300,000 jobs per month through the first five months of 2023; this compares to average gains of 400,000 per month in 2022, and 600,000 per month in 2021. But given that underlying growth in the labor force is only around 100,000 or 150,000 per month, the current pace of job gains is unsustainable over the longer run. The unemployment rate, which soared to almost 15% in April 2020 at the worst of the pandemic, was down to 3.4% in April of this year, matching the lowest rate since 1969. The unemployment rate rose slightly to 3.7% in May, but this is still below the approximately 4% rate that the Federal Open Market Committee views as consistent with its mandate of “maximum employment.”

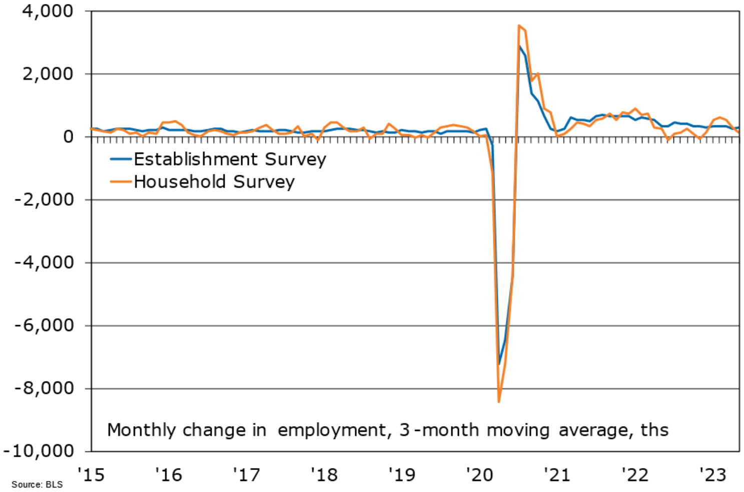
This very tight labor market is driving gains in consumer spending. Demand for labor remains strong, and businesses continue to increase pay to attract new workers. Average hourly earnings are up around 4.5% in the first half of 2023 relative to last year. While this is below the almost 6% pace in early 2022, it is well above pre-pandemic wage growth of around 3.5%. Wage and job gains are allowing households to increase their purchases, even after accounting for higher prices; inflation-adjusted consumer spending was up more than 2% in the first quarter of 2023 compared to a year earlier. With these purchases making up about two-thirds of the U.S. economy, this is supporting overall economic growth.

But the current situation is unsustainable. While the tight labor market and strong income gains are supporting consumer spending, they are also contributing to high U.S. inflation. The Fed wants to create a bit more slack in the job market and push wage growth down to around 3.5%, consistent with its inflation target of 2%. To do this job growth will need to slow substantially, to below 100,000 per month. And so the central bank has raised interest rates aggressively over the past couple of years in an attempt to cool off the economy, the labor market in particular.

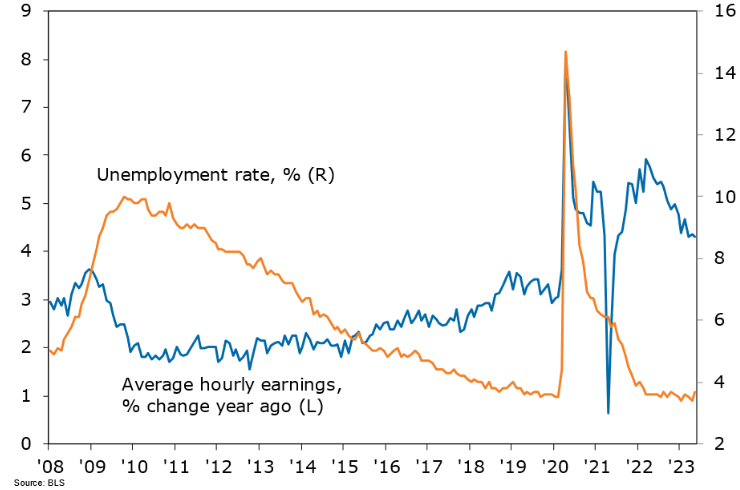
The FOMC has a delicate task. It wants to slow economic growth by raising interest rates, but not raise them by so much that the economy falls into a recession, when broad economic activity actually contracts, including declines in consumer spending, household incomes (excluding government aid), and employment. It is going to be very difficult for the Fed to achieve this balance, and the most likely outcome is a U.S. recession starting later this year or in early 2024. But recession is not imminent given the current strength of the job market. Nor is it inevitable. If the Fed gets a few lucky breaks on inflation it is possible that the economy could experience weak growth over the next year or two, a slight increase in the unemployment rate, and a gradual return to 2% inflation. It would not be a “soft landing,” more like a “bumpy landing,” but given the current strong situation for consumers the likelihood the economy avoids a near-term downturn is about one-in-three.

But given aggressive Fed tightening the more likely outcome is recession. However, it should be mild and short, with consumers a big reason why. Layoffs should be small because firms, having suffered through severe worker shortages, will want to avoid being caught flat-footed once the economy starts to pick up again; this will limit the hit to consumer incomes and consumer spending. In addition, households have generally been responsible, with low debt burdens and consumer delinquency rates, limiting the need for belt tightening during a downturn. PNC’s forecast is for a small contraction in real GDP of less than 1% starting in about six months and lasting into mid-2024. The unemployment rate will increase in the second half of this year, ending 2023 at above 4%, and then peak at slightly above 5% in early 2025. Core inflation will slow with weaker demand, moving back to the Federal Reserve’s 2% objective by this time next year. Slowing inflation and a deteriorating labor market will lead to Federal Reserve rate cuts starting in early 2024, allowing for an economic recovery beginning in mid-2024.

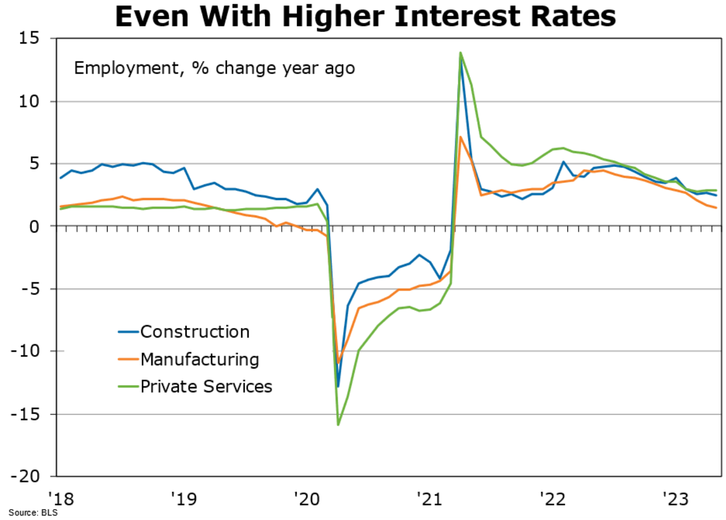
Job Growth Remains Too Hot for the Fed



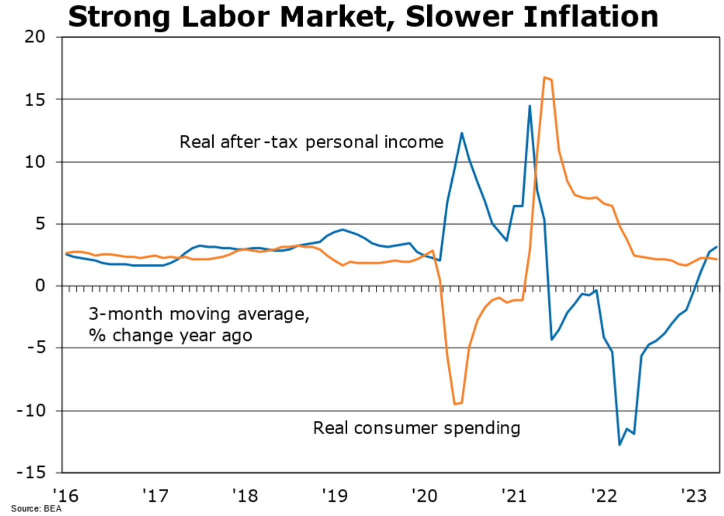
Wage Growth Is Slowing, But Is Far Above Its Pre-Pandemic Pace



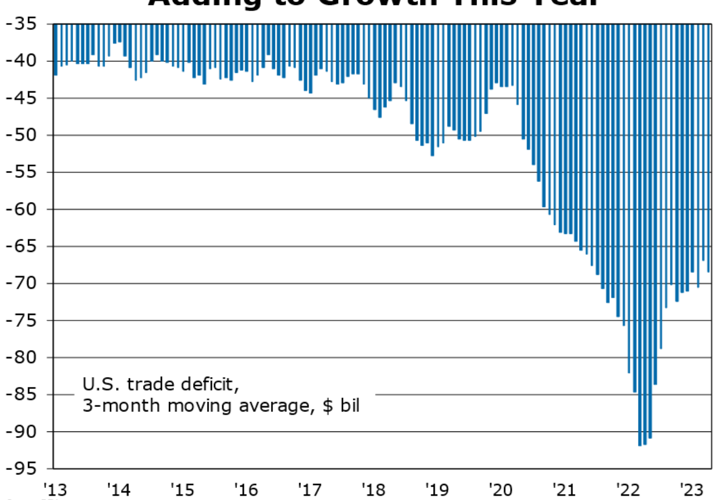
Construction Job Growth Continues Even With Higher Interest Rates



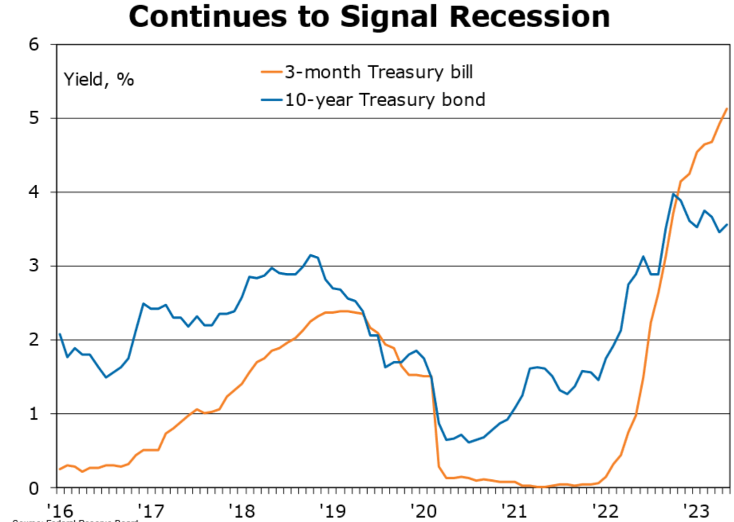
Real Incomes Are Growing Thanks to Strong Labor Market, Slower Inflation



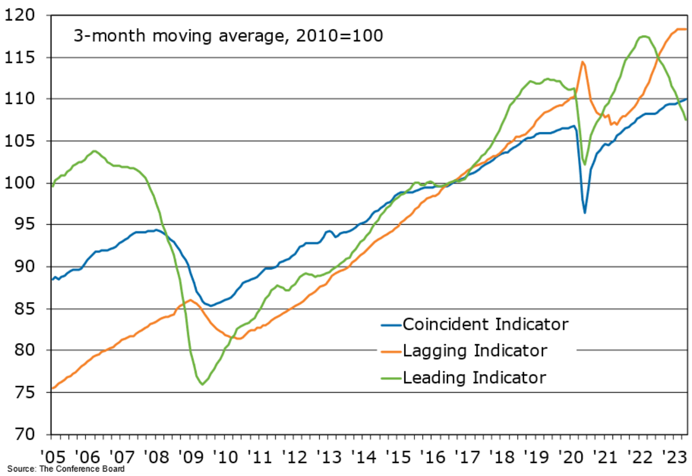
A Shrinking Trade Deficit Is Adding to Growth This Year



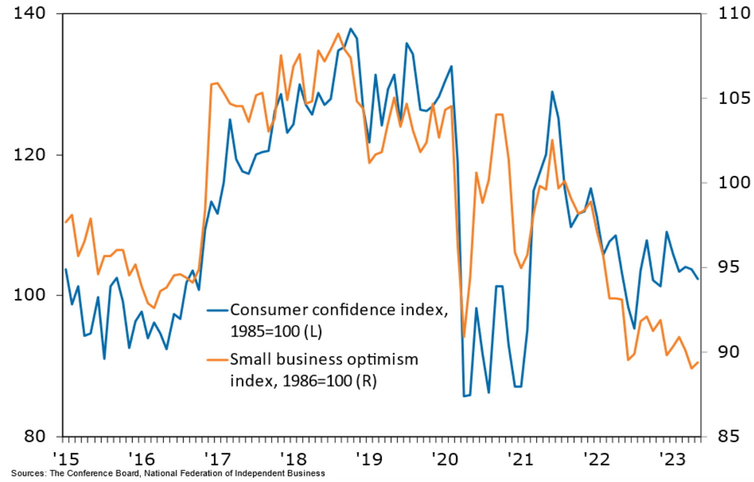
Inverted Yield Curve Continues to Signal Recession



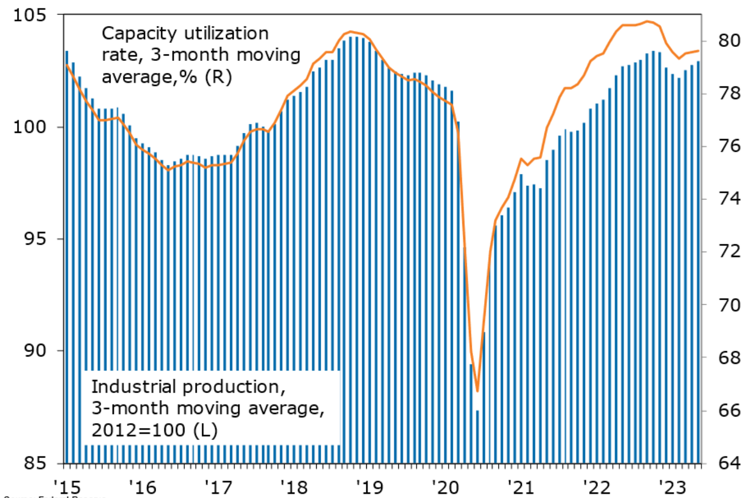
Leading Indicators Have Been Falling for a Year, But Expansion is Continuing in Mid-2023



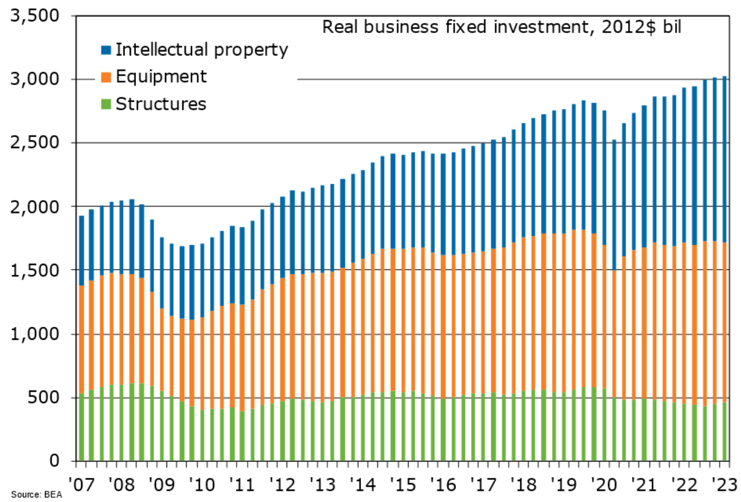
Consumer Confidence Is Up With Slowing Inflation, But Small Business Confidence Continues to Weaken



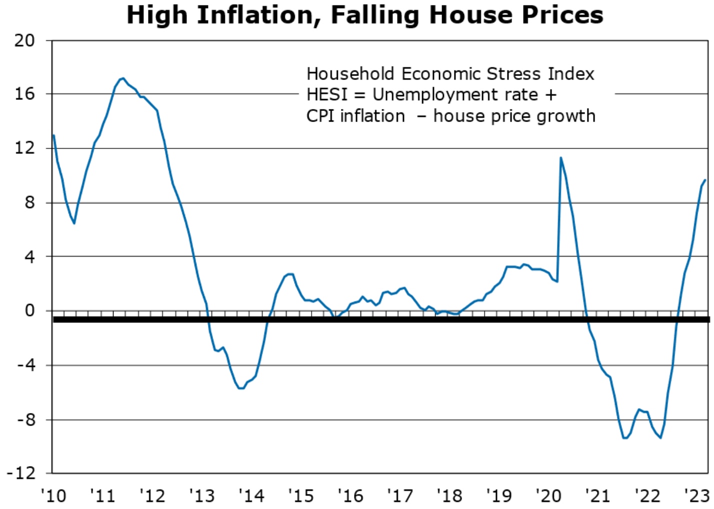
Industrial Production Has Been Flat for a Year



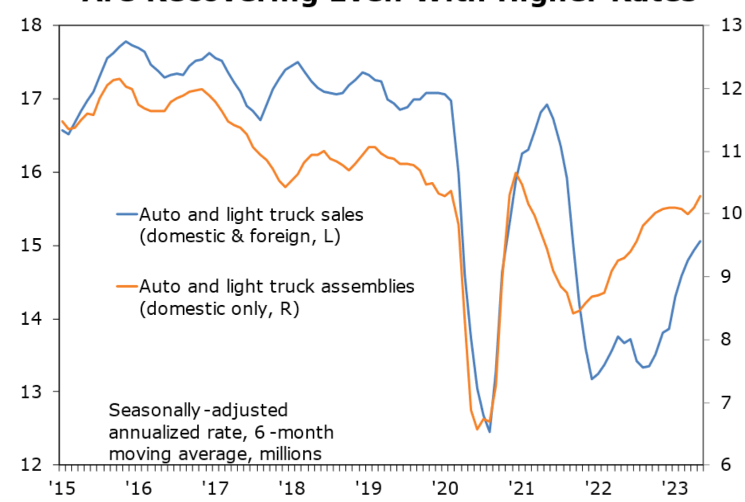
Business Investment Growth Has Slowed



Household Economic Stress Is Up With High Inflation, Falling House Prices



Auto Supply Chain Problems Are Easing, Sales Are Recovering Even With Higher Rates



Visit http://www.pnc.com/economicreports to view the full listing of economic reports published by PNC's economists.

PNC Economics Group
June 2023

Baseline U.S. Economic Outlook, Expanded Table

	1Q'23a	2Q'23f	3Q'23f	4Q'23f	1Q'24f	2Q'24f	2022a	2023f	2024f	2025f
Output										
Nominal GDP (*Billions $*)	26466	26814	27044	27228	27271	27263	25463	26888	27298	27933
Percent Change Annualized	**5.1**	**5.4**	**3.5**	**2.7**	**0.6**	**-0.1**	**9.2**	**5.6**	**1.5**	**2.3**
Real GDP (*Chained 2012 Billions $*)	20246	20319	20346	20357	20324	20260	20014	20317	20261	20480
Percent Change Annualized	**1.3**	**1.4**	**0.5**	**0.2**	**-0.7**	**-1.2**	**2.1**	**1.5**	**-0.3**	**1.1**
Pers. Consumption Expenditures	14347	14409	14447	14457	14447	14419	14130	14415	14415	14499
Percent Change Annualized	**3.8**	**1.7**	**1.1**	**0.3**	**-0.3**	**-0.8**	**2.7**	**2.0**	**0.0**	**0.6**
Nonresidential Fixed Investment	2999	2986	2969	2944	2911	2878	2945	2974	2880	2930
Percent Change Annualized	**1.4**	**-1.7**	**-2.3**	**-3.3**	**-4.3**	**-4.5**	**3.9**	**1.0**	**-3.2**	**1.7**
Residential Investment	569	560	550	537	524	522	643	554	526	552
Percent Change Annualized	**-5.4**	**-6.0**	**-7.0**	**-8.9**	**-9.8**	**-1.3**	**-10.6**	**-13.9**	**-5.1**	**5.0**
Change in Private Inventories	7	54	54	54	35	5	125	42	0	28
Net Exports	-1243	-1262	-1239	-1194	-1148	-1115	-1357	-1235	-1113	-1107
Government Expenditures	3486	3490	3483	3477	3472	3469	3406	3484	3471	3496
Percent Change Annualized	**5.2**	**0.5**	**-0.9**	**-0.6**	**-0.6**	**-0.4**	**-0.6**	**2.3**	**-0.4**	**0.7**
Industrial Prod. Index (*2012 = 100*)	102.7	102.5	101.9	101.1	99.9	98.3	102.6	102.1	98.6	101.6
Percent Change Annualized	**0.2**	**-0.8**	**-2.2**	**-3.0**	**-5.0**	**-6.0**	**3.4**	**-0.5**	**-3.4**	**3.1**
Capacity Utilization (*Percent*)	79.6	79.3	79.0	78.2	77.3	76.4	80.3	79.0	76.4	77.5
Prices										
CPI (*1982-84 = 100*)	301.3	304.1	306.5	308.4	309	310	292.6	305.1	310.2	314.1
Percent Change Annualized	**3.8**	**3.7**	**3.2**	**2.5**	**1.0**	**0.9**	**8.0**	**4.3**	**1.7**	**1.2**
Core CPI Index (1982-84 = 100)	304.0	307.7	310.1	311.5	313	314	294.3	308.3	314.2	319.8
Percent Change Annualized	**5.0**	**4.9**	**3.2**	**1.8**	**1.5**	**1.3**	**6.1**	**4.8**	**1.9**	**1.8**
PCE Price Index (*2012 = 100*)	126.2	127.1	127.9	128.6	128.9	129.2	122.9	127.4	129.3	130.5
Percent Change Annualized	**4.2**	**2.8**	**2.6**	**2.2**	**1.0**	**0.8**	**6.3**	**3.7**	**1.4**	**0.9**
Core PCE Price Index (*2012 = 100*)	126.9	127.9	128.6	129.2	130	130	123.3	128.1	130.4	132.5
Percent Change Annualized	**4.9**	**3.3**	**2.4**	**1.7**	**1.6**	**1.4**	**5.0**	**3.9**	**1.7**	**1.6**
GDP Price Index (*2012 = 100*)	130.8	132.0	132.9	133.8	134.2	134.6	127.2	132.4	134.7	136.4
Percent Change Annualized	**4.0**	**3.7**	**2.9**	**2.5**	**1.3**	**1.1**	**7.0**	**4.0**	**1.8**	**1.2**
Crude Oil, WTI (*$/Barrel*)	76.0	72.0	70.0	68.0	67.0	69.0	94.4	71.5	70.8	78.6
Labor Markets										
Payroll Jobs (*Millions*)	155.2	155.8	156.0	156.0	155.8	155.6	152.6	155.8	155.4	155.3
Percent Change Annualized	**2.5**	**1.6**	**0.5**	**0.0**	**-0.6**	**-0.7**	**4.3**	**2.1**	**-0.2**	**-0.1**
Unemployment Rate (*Percent*)	3.5	3.6	3.9	4.1	4.4	4.6	3.6	3.8	4.8	5.0
Average Weekly Hours, Prod. Works.	34.0	33.9	33.9	33.9	33.8	33.7	34.0	33.9	33.7	33.7
Personal Income										
Average Hourly Earnings ($)	28.4	28.8	29.1	29.4	29.7	30.0	27.6	28.9	30.1	30.8
Percent Change Annualized	**4.6**	**5.0**	**4.9**	**4.5**	**4.0**	**3.5**	**6.4**	**5.0**	**4.0**	**2.3**
Real Disp. Income (*2012 Billions $*)	15622	15678	15758	15796	15803	15797	15149	15714	15827	16188
Percent Change Annualized	**8.0**	**1.4**	**2.1**	**1.0**	**0.2**	**-0.2**	**-6.1**	**3.7**	**0.7**	**2.3**
Housing										
Housing Starts (*Ths., Ann. Rate*)	1395	1352	1171	1107	1073	1050	1554	1257	1052	1116
Ext. Home Sales (*Ths., Ann Rate*)	4330	3984	3920	3860	3888	4035	5081	4024	4149	5212
New SF Home Sales (*Ths., Ann Rate*)	651	641	612	592	586	587	641	624	595	647
Case/Shiller HPI (*Jan. 2000 = 100*)	297.1	293.7	289.5	283.6	277.0	268.1	297.9	283.6	266.4	273.8
Percent Change Year Ago	**2.1**	**-3.2**	**-4.0**	**-4.8**	**-6.8**	**-8.7**	**7.4**	**-4.8**	**-6.1**	**2.8**
Consumer										
Auto Sales (*Millions*)	15.2	15.1	15.0	14.6	14.2	13.7	13.8	15.0	13.6	13.4
Consumer Credit (*Billions $*)	4851	4902	4953	4996	5033	5059	4786	4996	5103	5309
Percent Change Year Ago	**7.3**	**6.2**	**5.4**	**4.4**	**3.8**	**3.2**	**8.0**	**4.4**	**2.1**	**4.0**
Interest Rates (Percent)										
Prime Rate	7.69	8.16	8.25	8.25	8.02	7.09	**4.85**	**8.09**	**6.95**	**6.00**
Federal Funds	4.52	4.99	5.08	5.08	4.88	3.97	**1.68**	**4.92**	**3.82**	**2.88**
3-Month Treasury Bill	4.68	5.18	5.22	5.04	4.63	3.77	**2.00**	**5.03**	**3.61**	**2.74**
10-Year Treasury Note	3.65	3.56	3.55	3.44	3.36	3.33	**2.94**	**3.55**	**3.35**	**3.44**
30-Year Fixed Mortgage	6.32	6.54	6.53	6.25	5.98	5.75	**5.32**	**6.41**	**5.67**	**5.33**

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

Disclaimer: The material presented is of a general nature and does not constitute the provision of investment or economic advice to any person, or a recommendation to buy or sell any security or adopt any investment strategy. Opinions and forecasts expressed herein are subject to change without notice. Relevant information was obtained from sources deemed reliable. Such information is not guaranteed as to its accuracy. You should seek the advice of an investment professional to tailor a financial plan to your needs.

Forward-looking statements are necessarily subject to numerous assumptions, risks and uncertainties, which change over time. Future events or circumstances may change our outlook and may also affect the nature of the assumptions, risks and uncertainties to which our forward-looking statements are subject. Forward-looking statements speak only as of the date made. We do not assume any duty and do not undertake any obligation to update forward-looking statements. Actual results or future events could differ, possibly materially, from those anticipated in forward-looking statements, as well as from historical performance. As a result, we caution against placing undue reliance on any forward-looking statements.

Visit pnc.com/economicreports for more information from PNC Economics.

PNC