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U.S. Economic Outlook

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July 22, 2018



Tax Reform Becomes A Reality As The Economy Approaches Full Employment

Economic Outlook

- **Economic growth ramped up considerably in Q2, with activity getting a boost from tax cuts as well as a push to produce and ship goods ahead of the implementation of tariffs. For the year, growth should slightly top 3 percent.**

Fiscal Policy

- **Fiscal policy is now more stimulative, with tax reform providing both a near-term and long-term growth boost. Federal, state and local government outlays are rising following the budget deal and stronger revenue growth.**

Monetary Policy

- **With more fiscal stimulus, the Fed would like to be a little more aggressive in normalizing interest rates. With weaker global growth holding down long-term rates, the Fed is wary of intentionally inverting the yield curve.**

Trade Policy

- **The Trump Administration has opted for a more confrontational negotiating stance on international trade. The goal is to improve trade relationships to reflect modern economic conditions, not protectionism.**

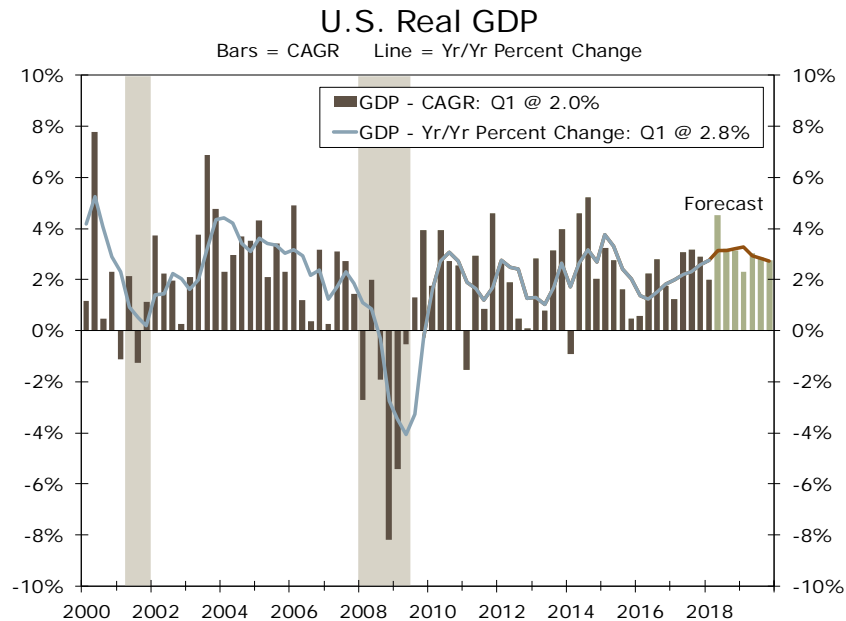
South

- **Stronger global growth boosted economic activity across the South. Manufacturing saw stronger output, while employment and investment are up. Trade disruptions are a significant threat.**

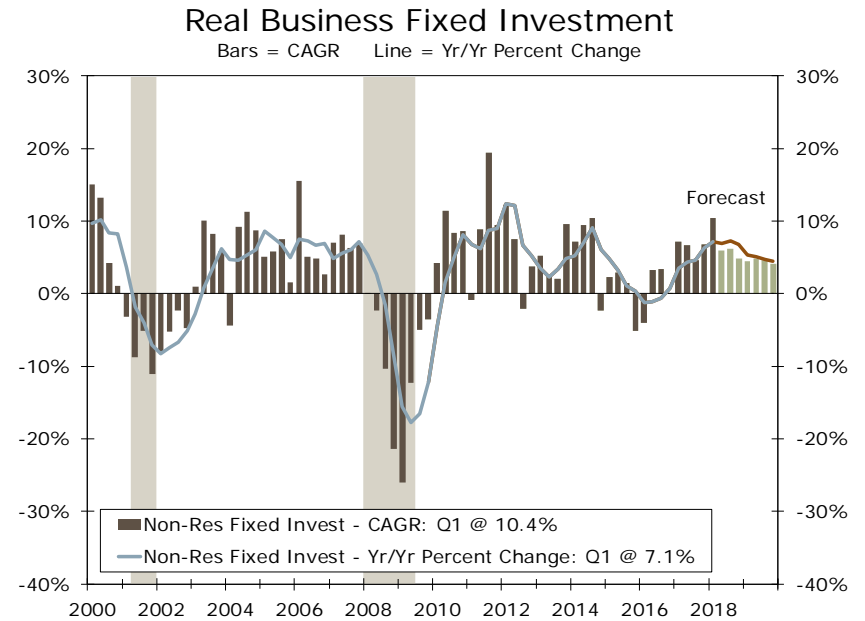
Economic Growth

Real GDP growth moderated slightly during the first quarter, reflecting seasonal influences and weak consumption. The production side of the economy and job growth remain strong. Stronger consumer spending and business fixed investment along with a surge in exports should contribute to an acceleration in growth in the second quarter.

Real GDP Forecast



Business Fixed Investment

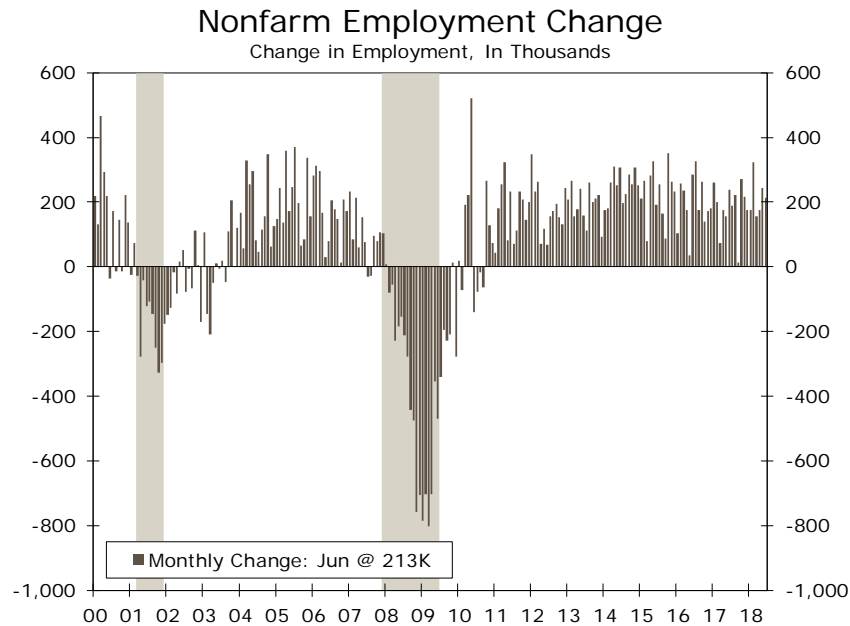


Source: U.S. Department of Commerce and Wells Fargo Securities

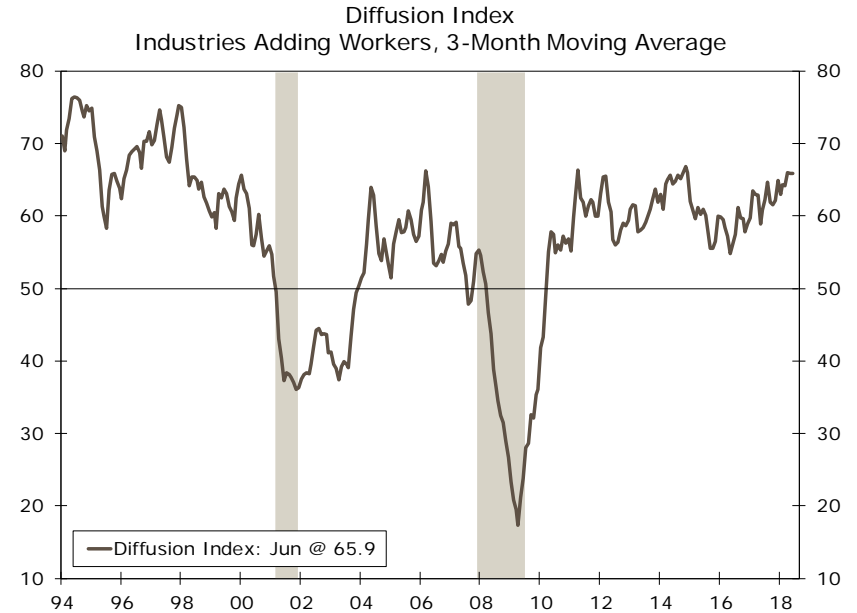
Employment Situation: Broadening Growth

Nonfarm employment continues to rise solidly, despite the continued decline in the unemployment rate and widespread reports of worker shortages. Job growth also continues to broaden, which is consistent with the recent strength in the ISM and regional Fed surveys.

Nonfarm Employment



Employment Diffusion Index



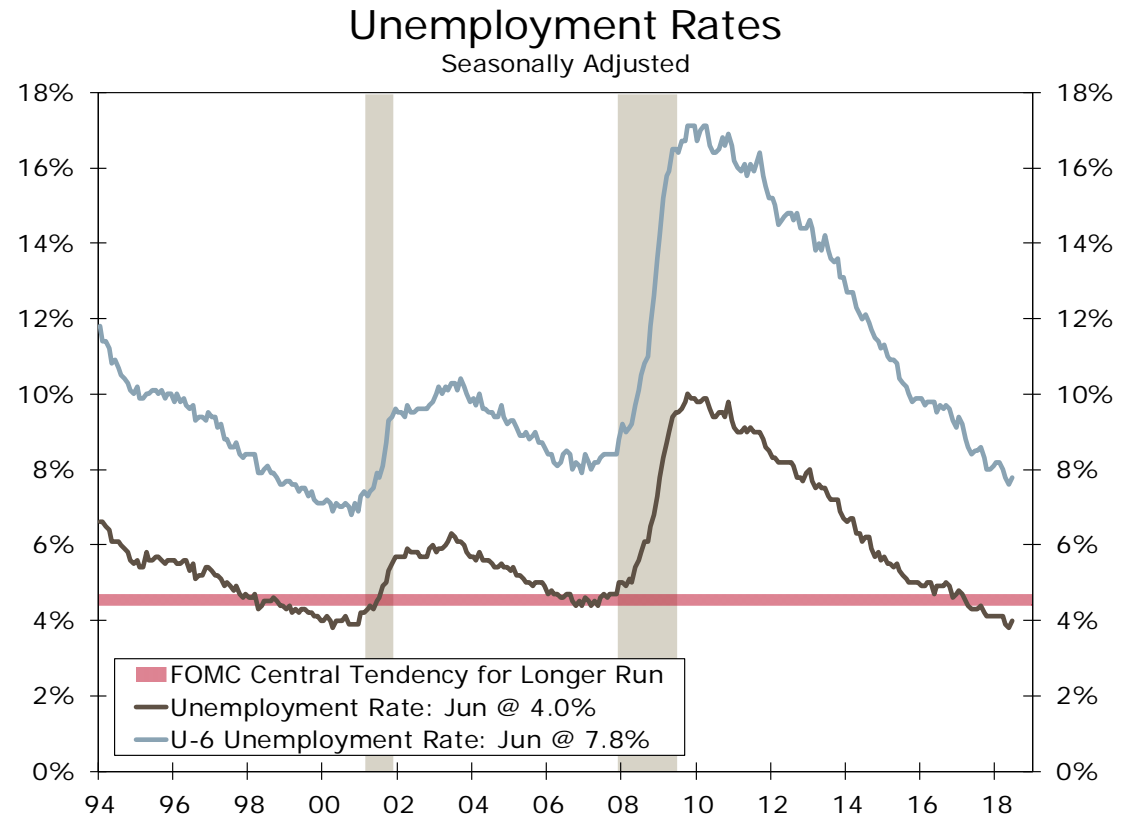
Source: U.S. Department of Labor and Wells Fargo Securities

Employment Situation: Tightening Labor Market

The unemployment rate has fallen below what the Fed considers to be its long-run objective, or 'full employment.'

Job openings remain near a record high and slightly exceed the number of unemployed.

A much larger share of consumers believe jobs are plentiful today, which may signal stronger labor force growth in coming months.

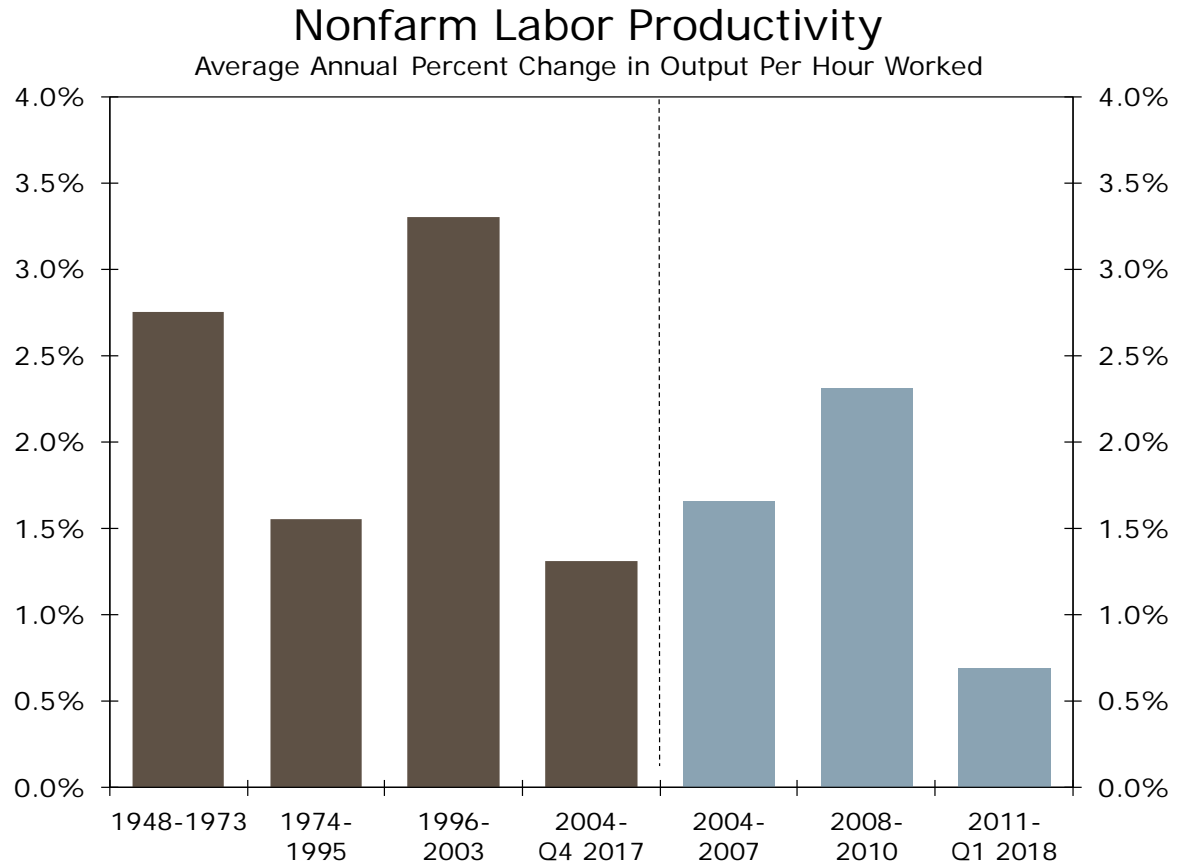


Source: U.S. Department of Labor and Wells Fargo Securities

Potential Growth—Little Help From Productivity

A downshift in productivity growth this cycle has weighed on potential GDP growth and made it more difficult for employers to increase wages.

We expect productivity growth to pick up this year, reflecting increased business fixed investment and a shift towards permanent workers rather than contract and temporary workers.

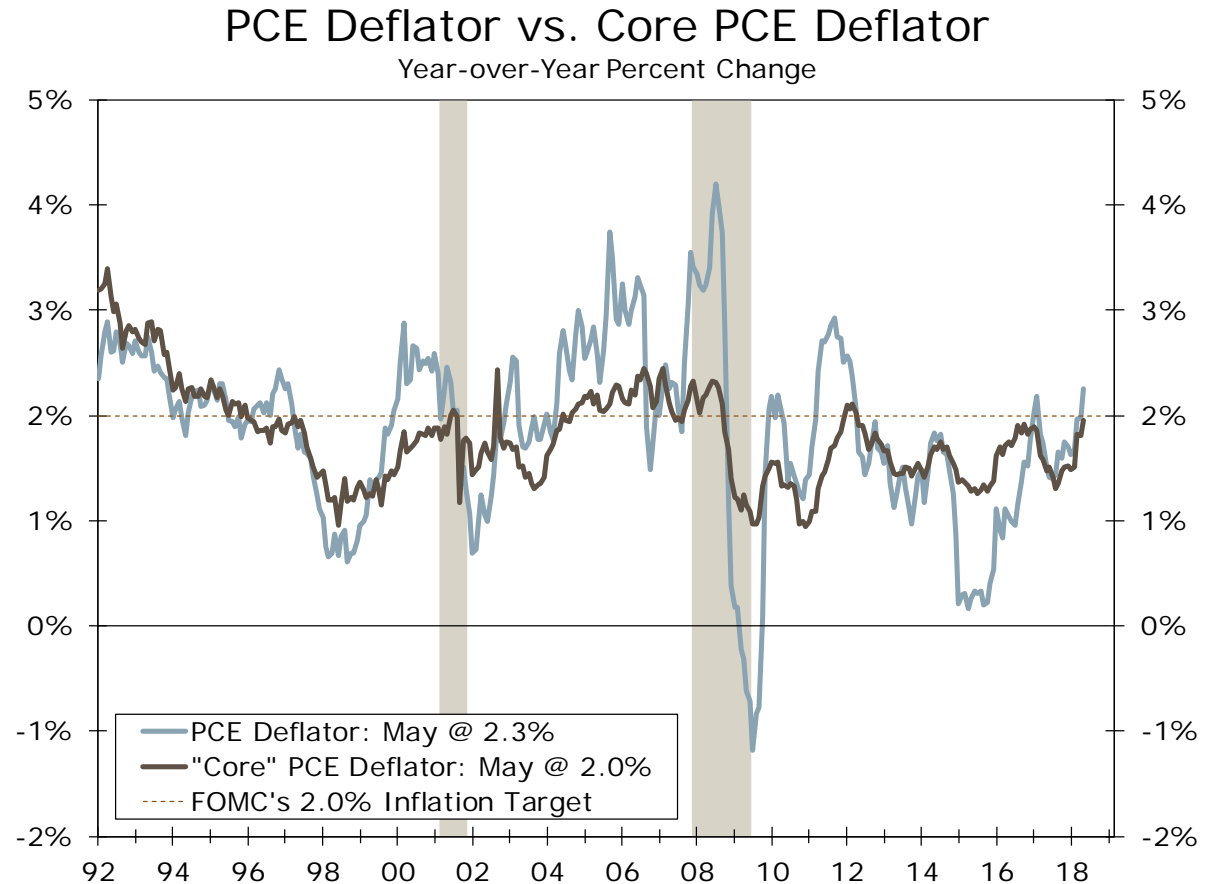


Source: U.S. Department of Labor and Wells Fargo Securities

Inflation

Inflation has indeed accelerated to the fastest pace in six years. For much of the past six years, however, the Fed has been concerned that inflation was too low. As a result, the Fed may tolerate inflation slightly above their target for an extended period of time.

We believe there are a mix of structural and cyclical forces restraining inflation that may prove to be long lasting and will help limit any acceleration in underlying inflation.



Source: U.S. Department of Commerce and Wells Fargo Securities

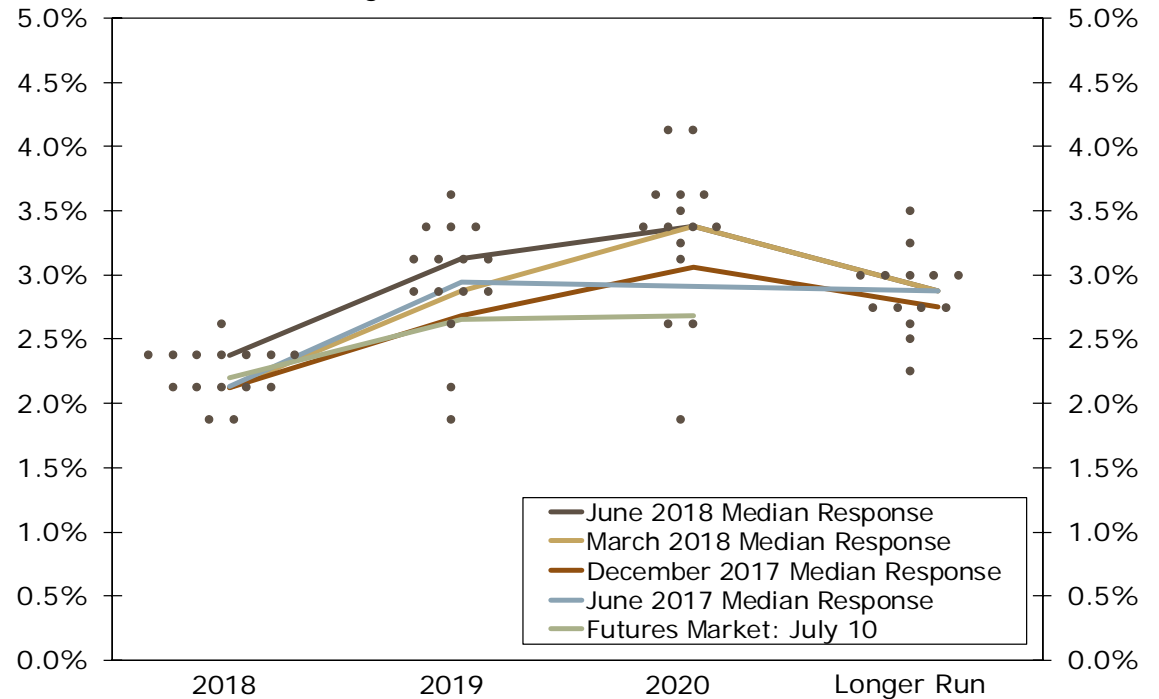
While the era of ultra-low interest rates has ended, the FOMC plans to be judicious in normalizing monetary policy.

The pace and magnitude of interest rate increases remain in question and will be limited by how quickly and how much inflation rebounds in 2018.

With the post-Financial Crisis period ending, the Federal Reserve now has to figure out what the new normal for the federal funds rate is.

Appropriate Pace of Policy Firming

Target Federal Funds Rate at Year-End



Source: Federal Reserve Board, Bloomberg LP and Wells Fargo Securities

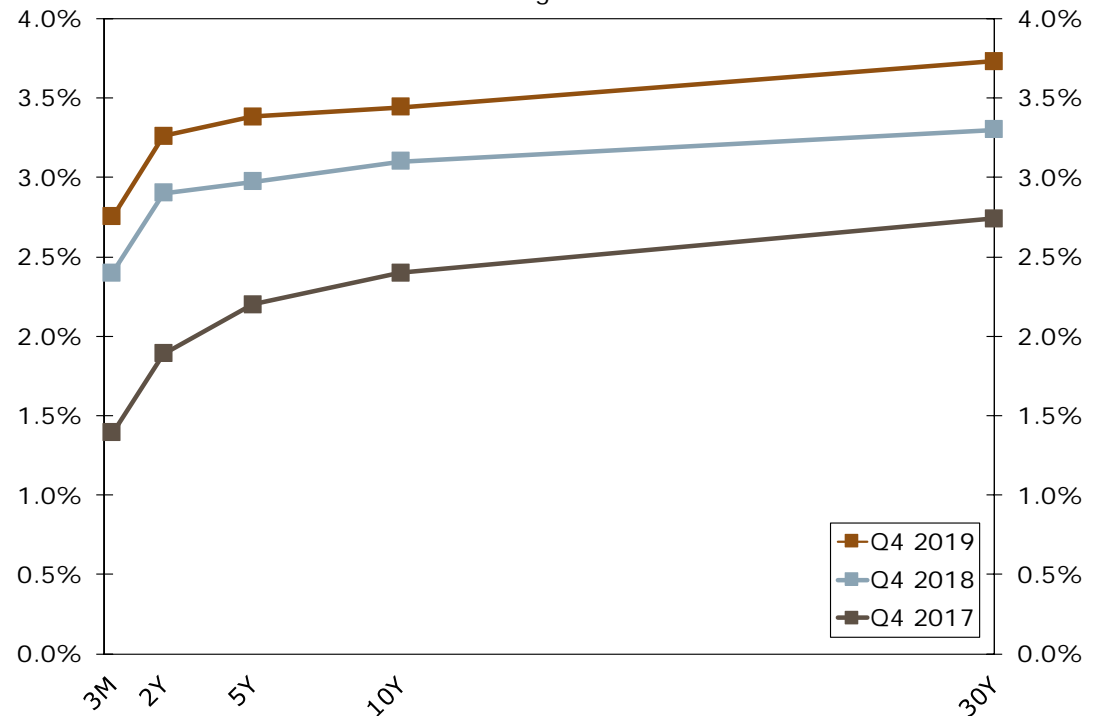
Yield Curve

We expect the yield curve to flatten as short term rates rise faster than long term rates.

Worries about the shape of the yield curve are pre-mature. The spread between the 10-Year and 2-Year notes has been compressed by the low absolute level of yields.

The widening budget deficit, increased financing needs from the Treasury, accelerating inflation and the recent trade spat create upside risk to long-term rates in the near term.

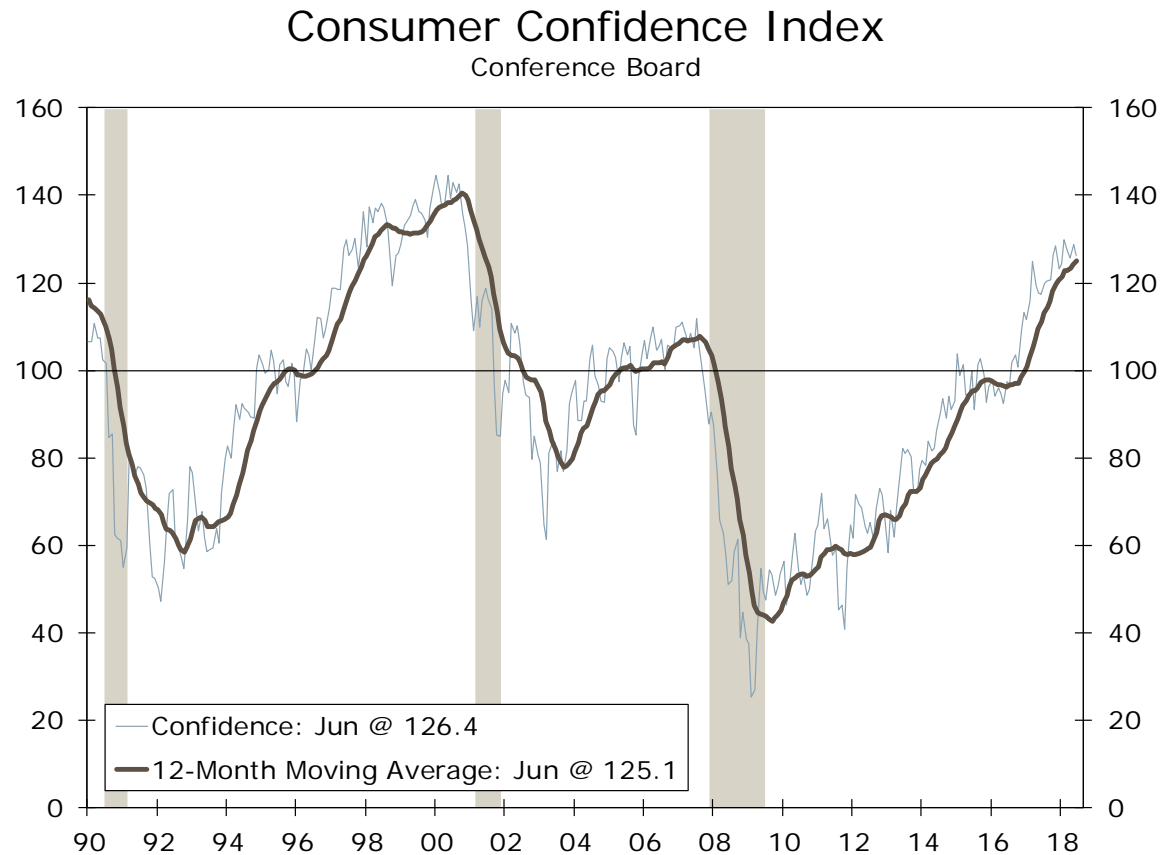
Wells Fargo Rates Forecast Through 2019



Source: Bloomberg LP and Wells Fargo Securities

Consumer Confidence

The recent acceleration in consumer confidence has largely been driven by a growing share of consumers expressing more optimism about employment and income prospects.

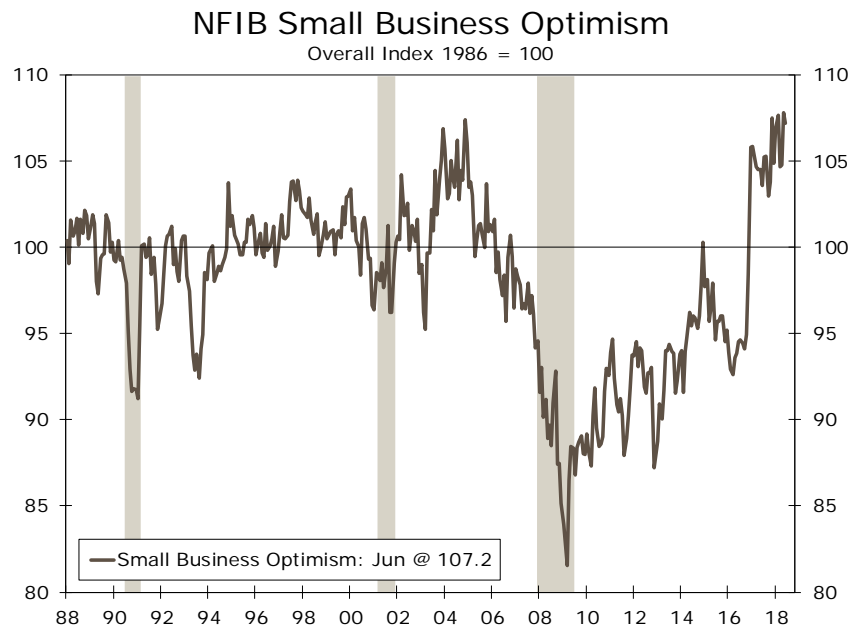


Source: The Conference Board and Wells Fargo Securities

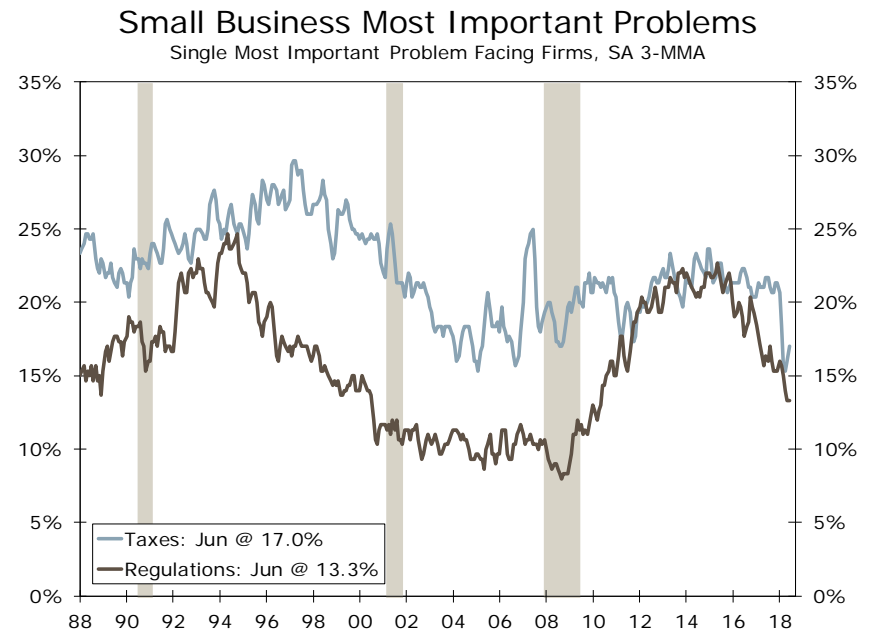
Small Business Optimism

Small business optimism spiked following the presidential election. Taxes and regulations had previously been the two largest issues facing small business owners. Those concerns have significantly subsided. Sales and earnings trends also look more positive, but business owners state they are having a difficult time finding and holding onto the skilled workers they need.

Small Business Optimism



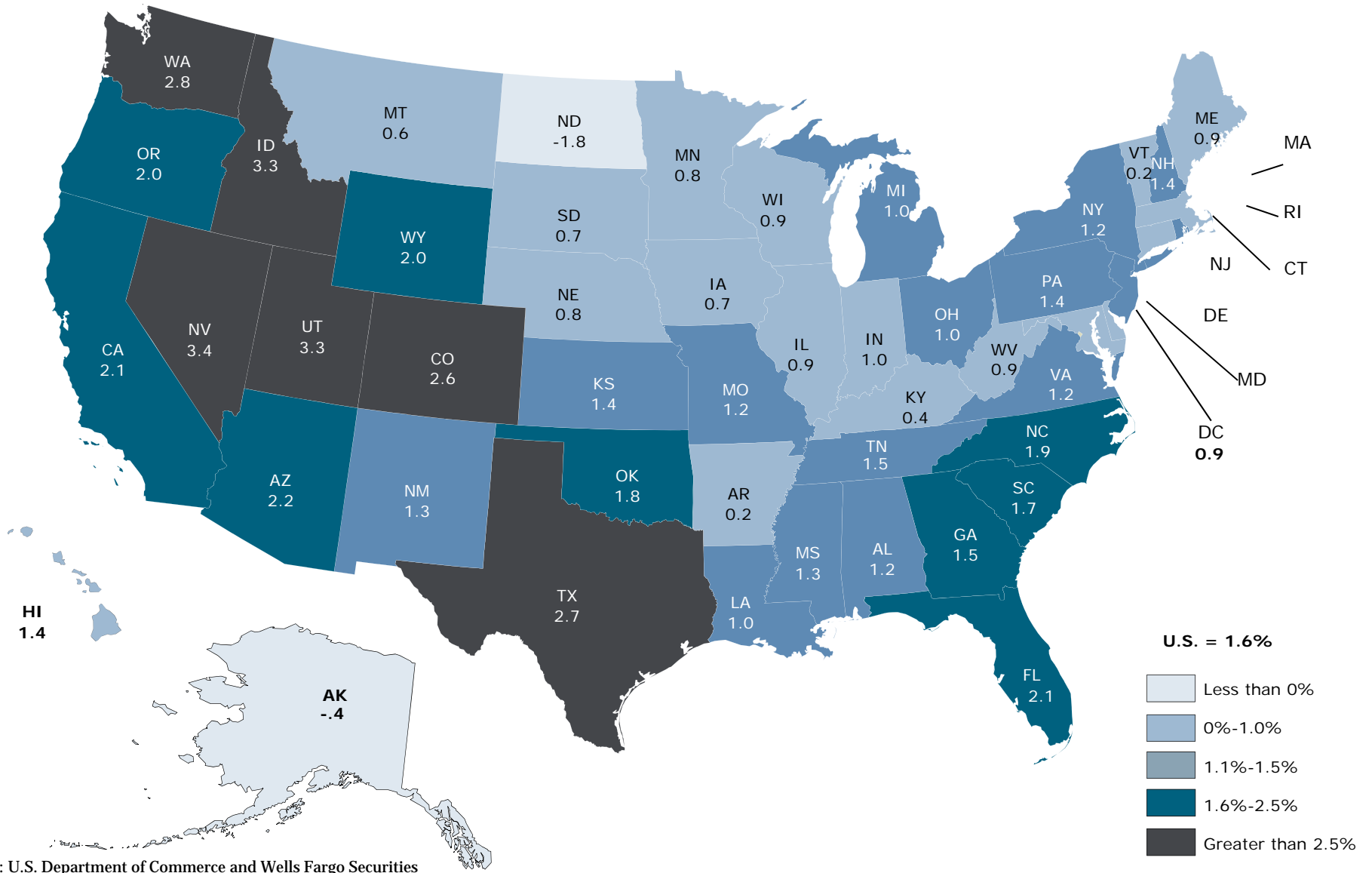
Small Business Concerns



Source: National Federation of Independent Business (NFIB) and Wells Fargo Securities

Regional Commentary

Year-over-Year Percent Change in Real GDP by State: Q4-2017



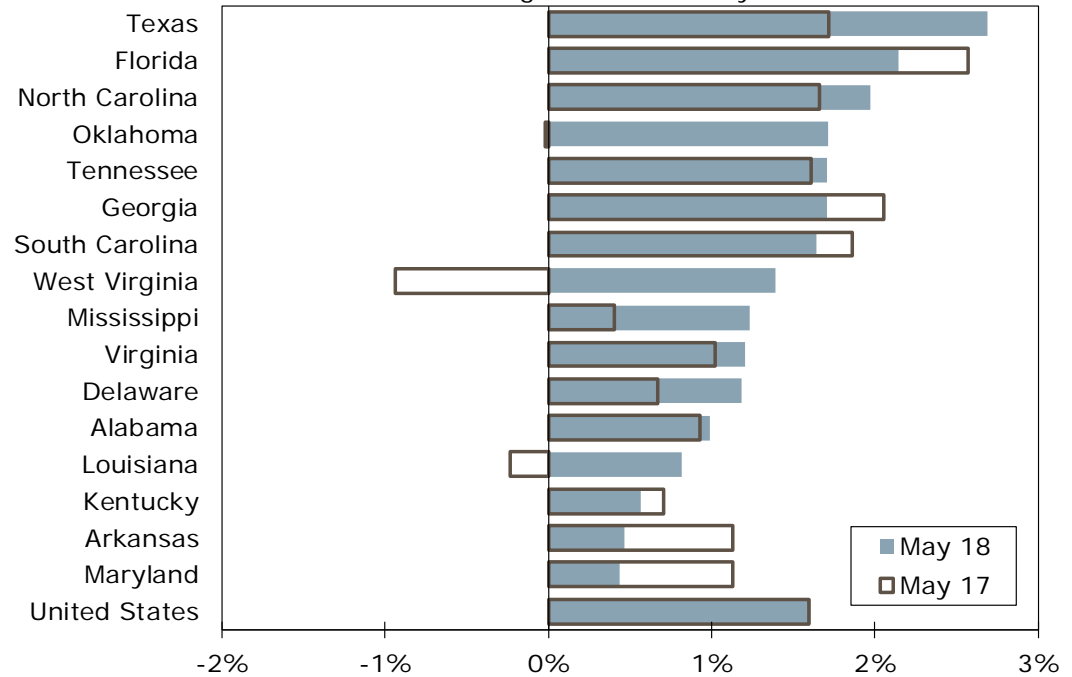
Source: U.S. Department of Commerce and Wells Fargo Securities

Payroll growth remains strong, helped by the resurgent energy and manufacturing sectors.

Skilled labor is increasingly hard to find, as the labor market continues to tighten.

Payroll Growth by Southern State

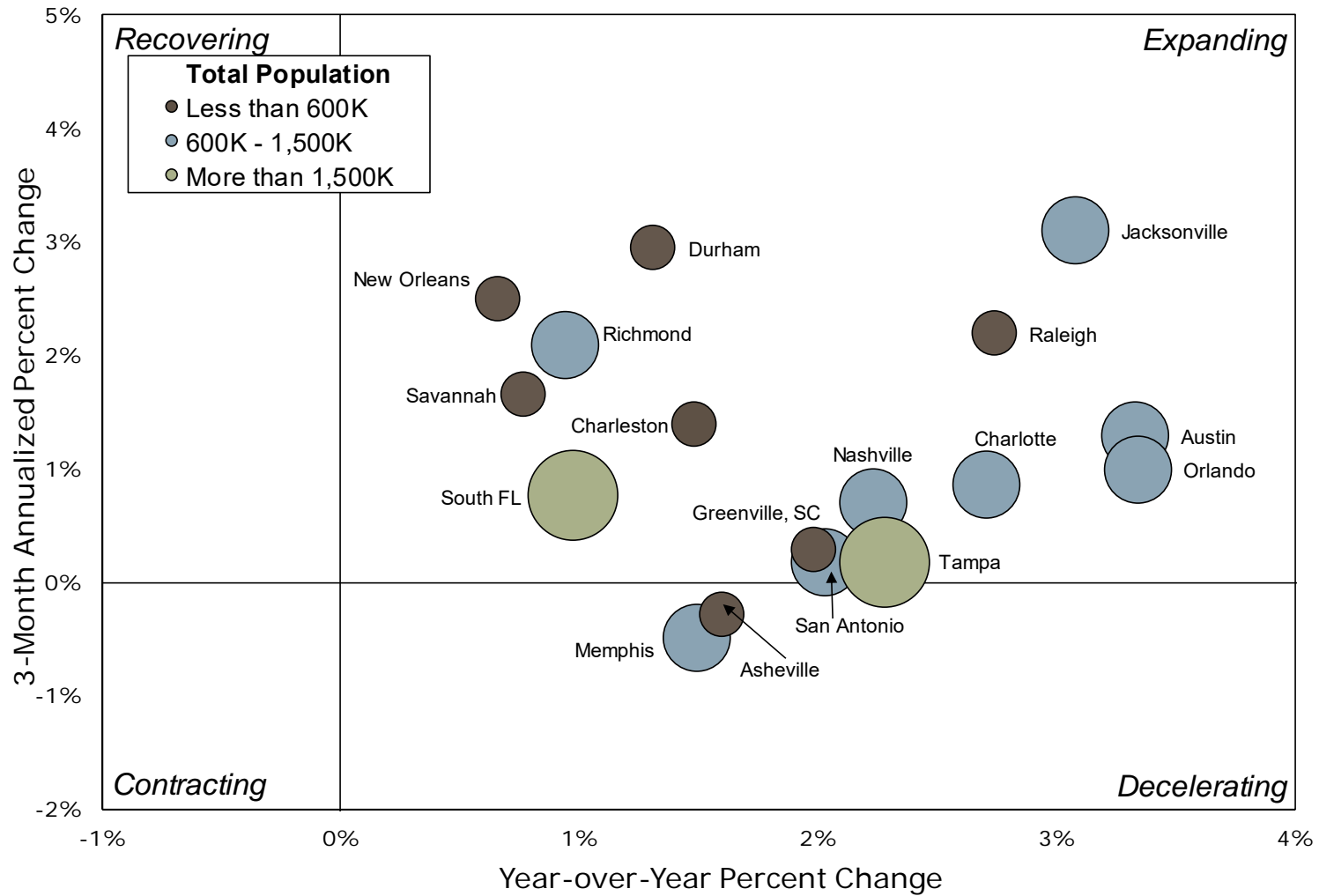
Year-over-Year Percent Change in Nonfarm Payrolls, 3-MMA



Source: U.S. Department of Labor and Wells Fargo Securities

Southeast Employment Growth by MSA

Southeast Employment Growth by Metro 3-Month Moving Averages, May 2018

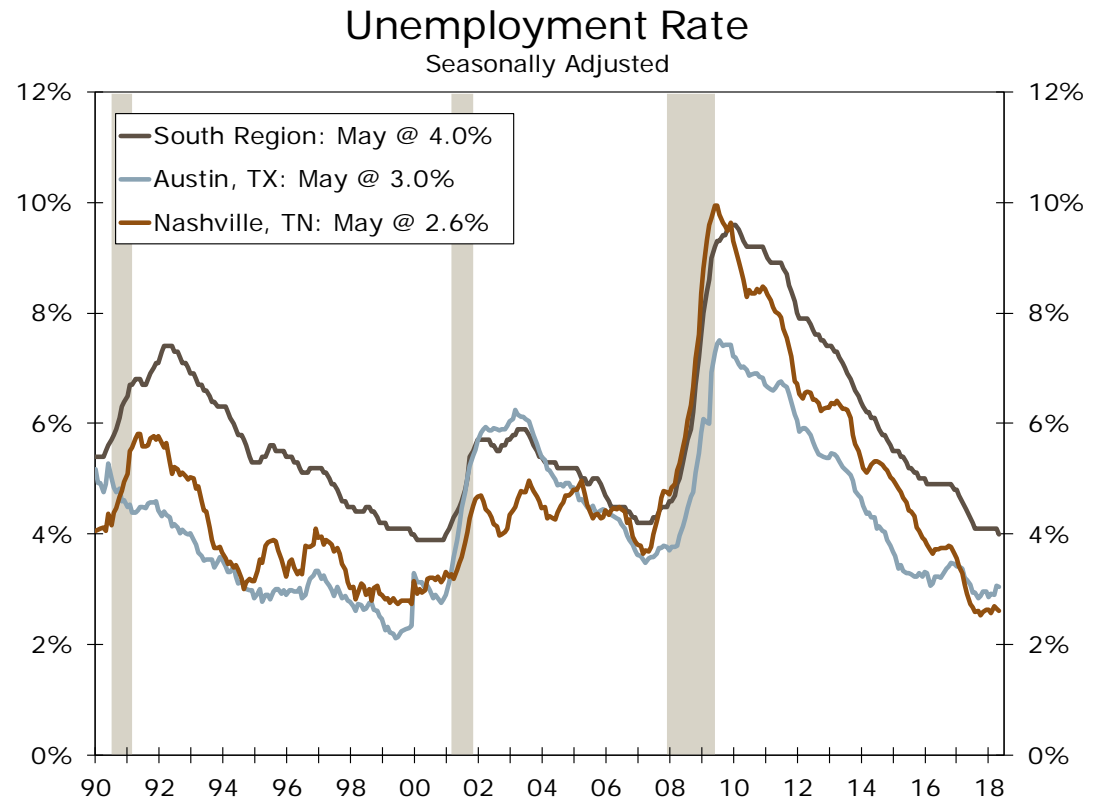


Source: U.S. Department of Labor and Wells Fargo Securities

Unemployment

Unemployment in the South fell 0.4 percentage points over the past year to 4.0 percent.

Nashville and Austin posted two of the lowest unemployment rates of any major cities, buoyed by booming tech sectors and the stability provided by the state government and public universities.

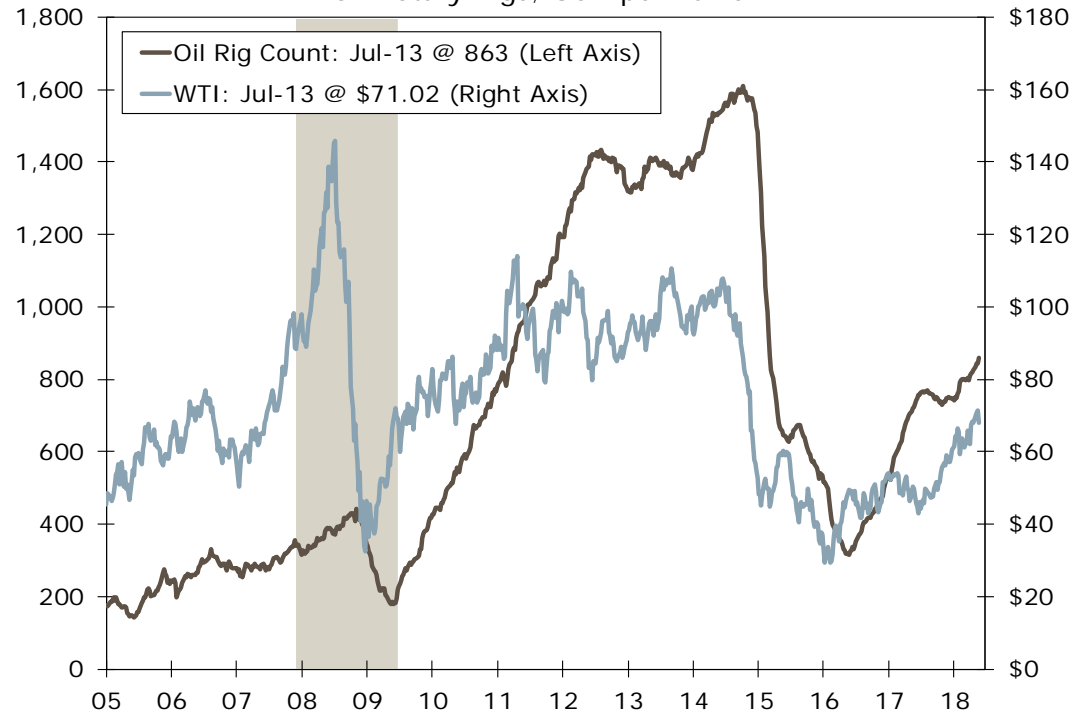


Source: U.S. Department of Labor and Wells Fargo Securities

The rebound in the energy sector has been a major driver of strong economic performance, particularly in Texas, Oklahoma and Louisiana.

Baker-Hughes Rig Count vs. Oil Prices

Oil Rotary Rigs; USD per Barrel



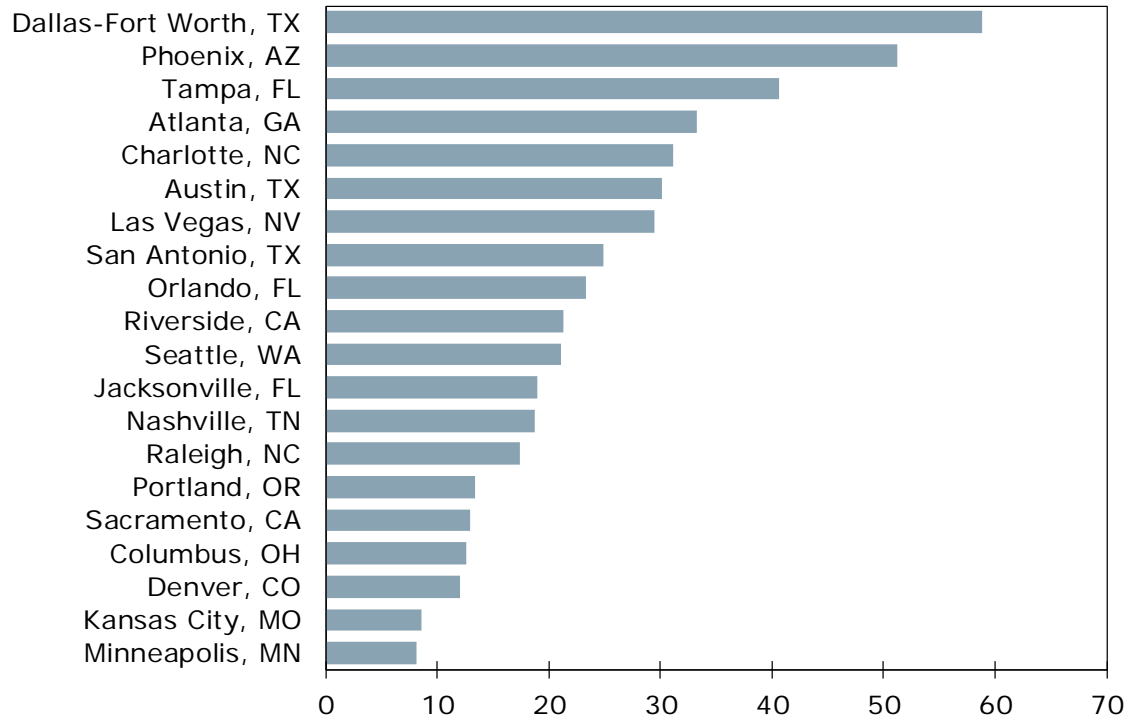
Source: Baker Hughes Inc., IHS Markit and Wells Fargo Securities

The South is well represented in the list of the twenty fastest growing cities, ranked by domestic net migration.

Job seekers and retirees account for the bulk of state-to-state movement, which remains unusually low from a historical perspective.

Metro Area Net Domestic Migration: Top 20

Thousands, 2017

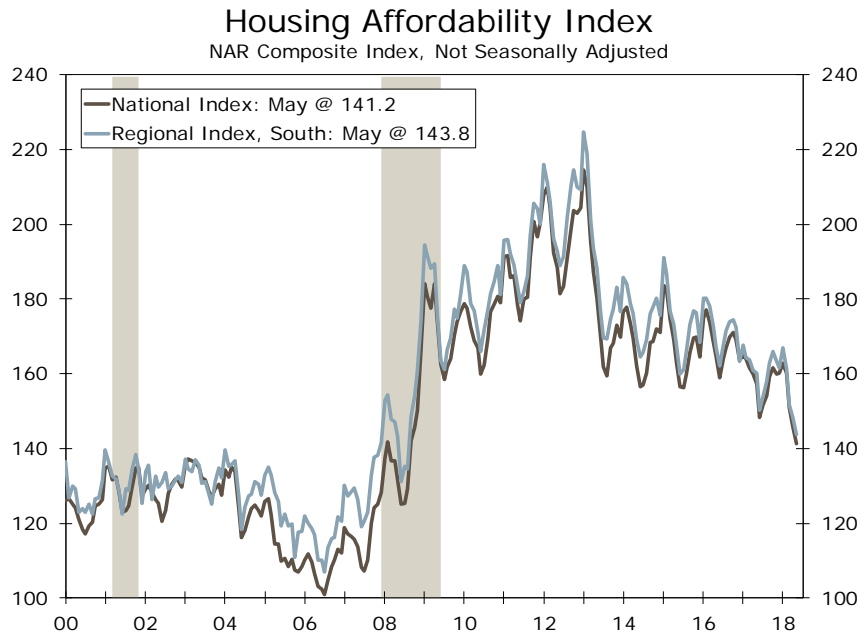


Source: U.S. Census Bureau and Wells Fargo Securities

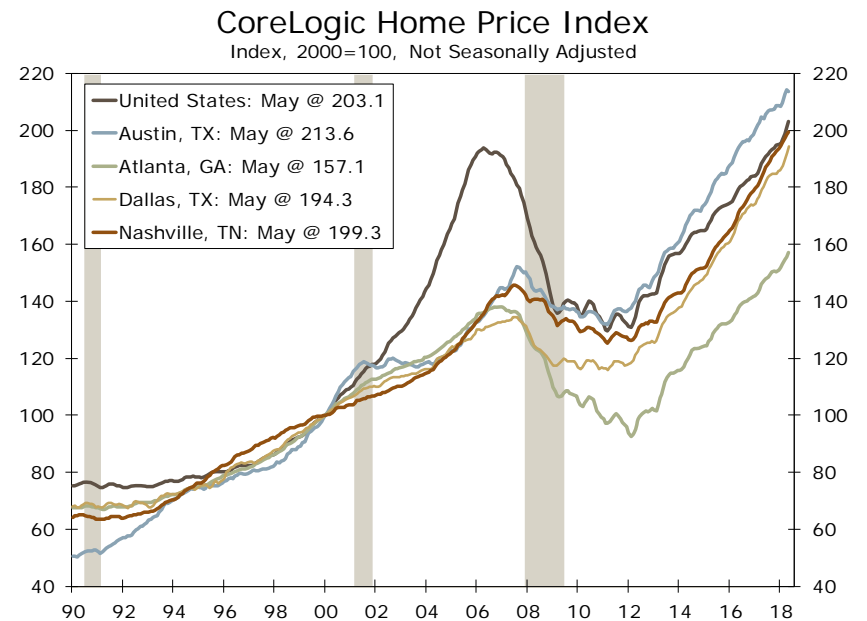
Housing Market

Relative housing affordability is becoming a more potent advantage for much of the South due to land availability and favorable local development policies. That said, price appreciation has ramped up in many costal markets and in tech-driven markets like Austin and Nashville.

Housing Affordability



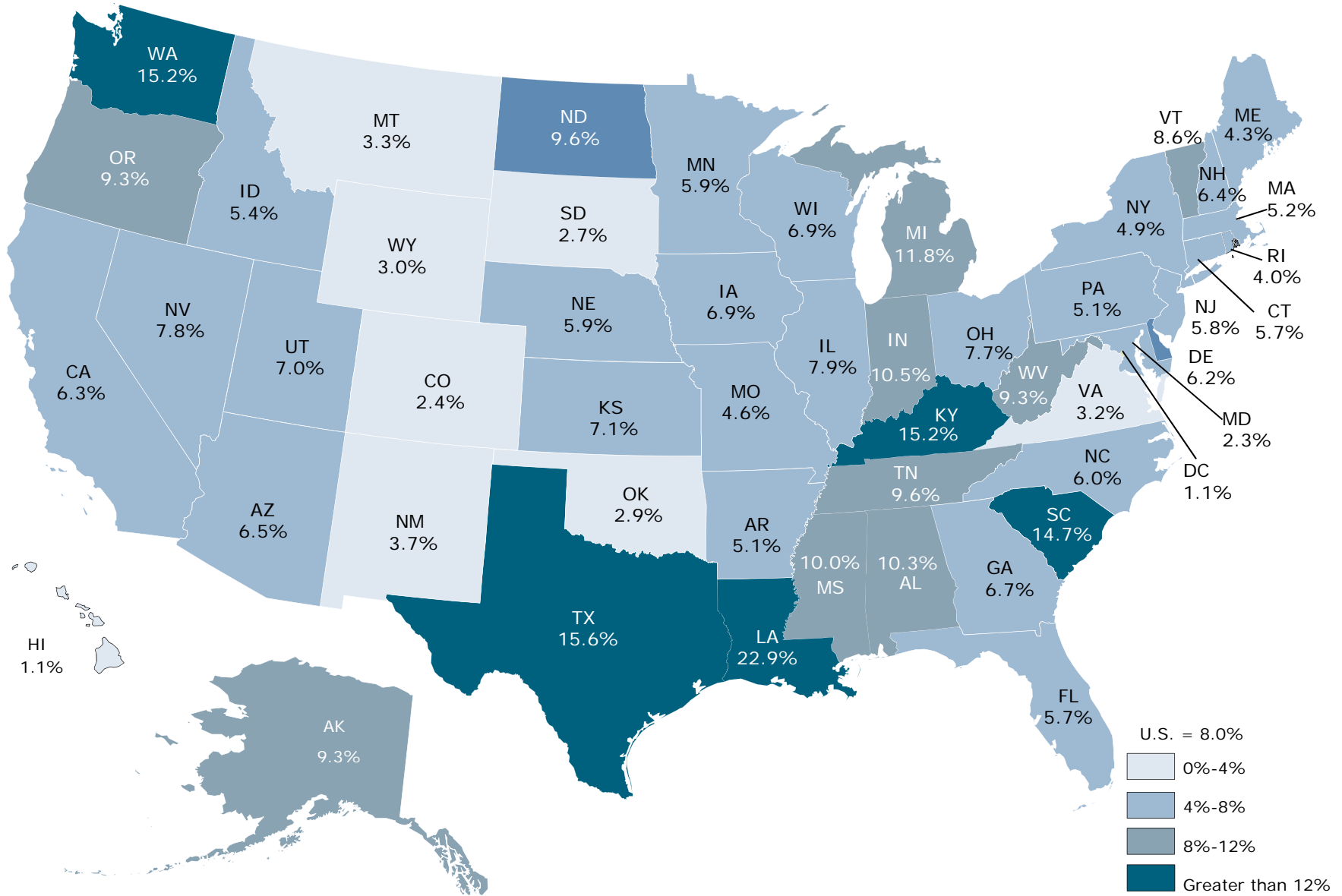
Home Prices



Source: National Association of Realtors, CoreLogic Inc. and Wells Fargo Securities

International Trade Commentary

Exports as a % of GDP (2017)

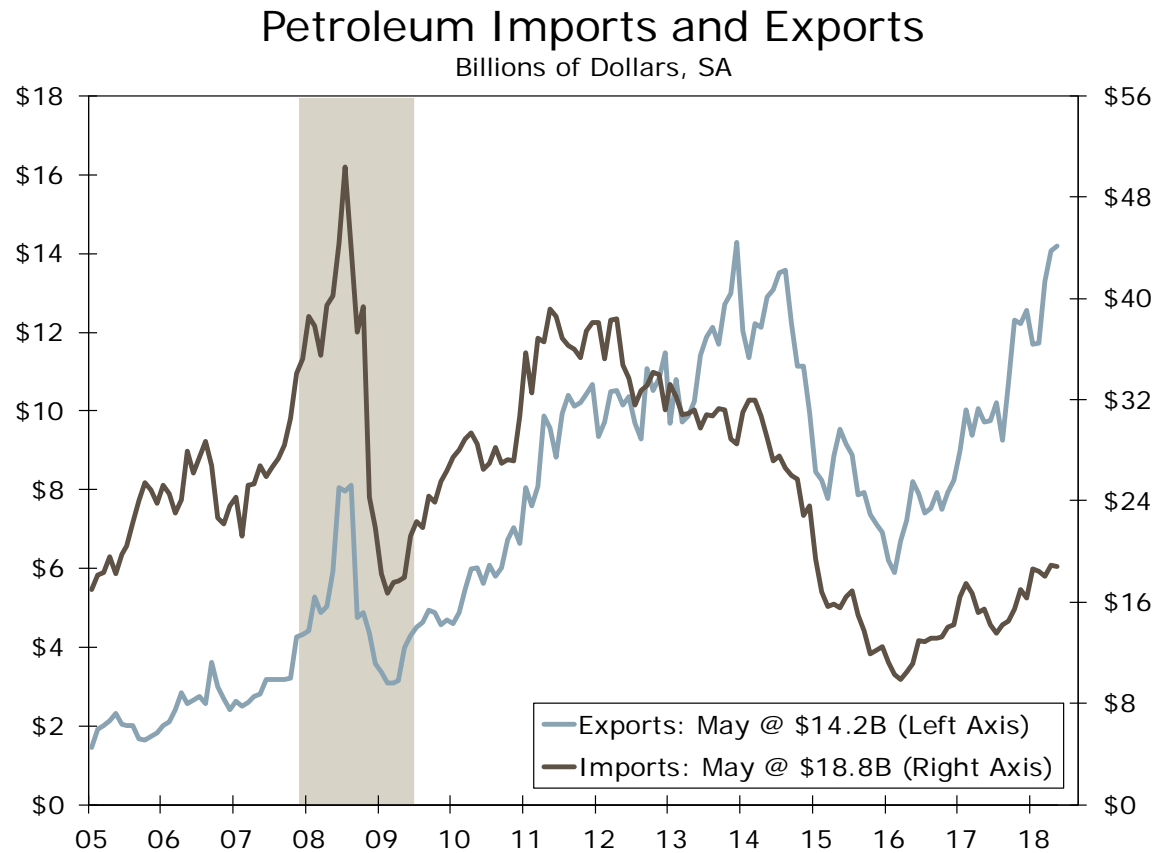


Source: U.S. Census Bureau and Wells Fargo Securities

Energy Imports & Exports

Petroleum exports surged during the second quarter, benefitting from supply outages in Venezuela and Libya, as well as production cutbacks in Russia and Saudi Arabia.

The rush of oil exports has further strained pipeline capacity and set off a wave of pipeline projects.



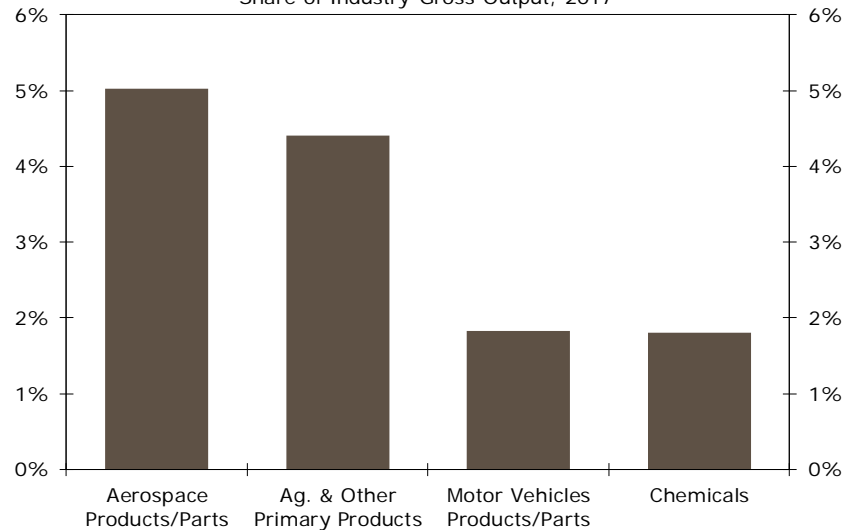
Source: Bloomberg LP and Wells Fargo Securities

How Costly Would a Full-Blown Trade War Be?

While exports to China are sizeable, they represent a relatively small proportion of total industry output. We estimate the value added that is embodied in American exports to China accounts for only 0.5 percent of total value added in the U.S. economy.

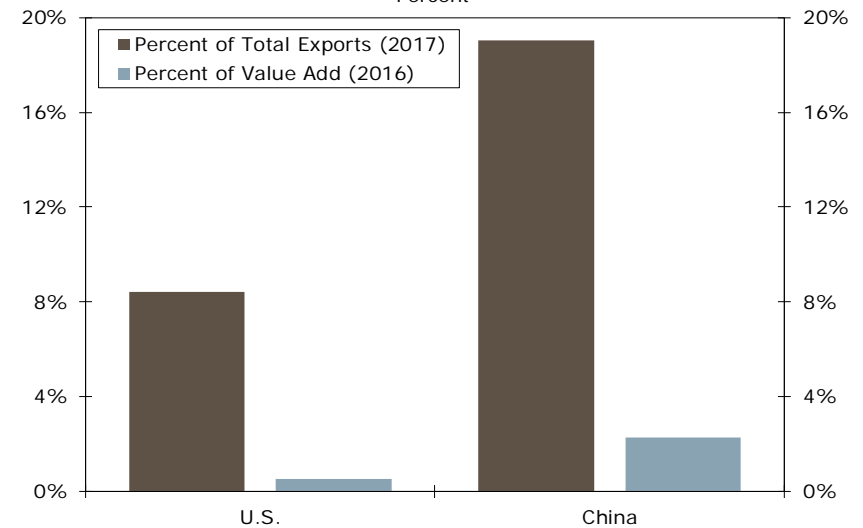
Exports

Exports to China by Industry
Share of Industry Gross Output, 2017



Exposure

Bilateral Export Exposure
Percent



Source: International Monetary Fund, OECD, United Nations, U.S. Department of Commerce and Wells Fargo Securities

U.S. Economic Forecast

Wells Fargo U.S. Economic Forecast																	
	Actual								Forecast				Actual			Forecast	
	2017				2018				2019				2015	2016	2017	2018	2019
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product ¹	1.2	3.1	3.2	2.9	2.0	4.7	3.2	3.1	2.3	3.0	2.9	2.7	2.9	1.5	2.3	3.1	2.9
Personal Consumption	1.9	3.3	2.2	4.0	0.9	3.3	2.8	2.8	2.1	3.0	2.7	2.6	3.6	2.7	2.8	2.6	2.7
Business Fixed Investment	7.2	6.7	4.7	6.8	10.4	5.9	6.2	4.9	4.5	4.8	4.6	4.2	2.3	-0.6	4.7	7.1	4.9
Equipment	4.4	8.8	10.8	11.5	5.8	5.1	5.5	4.2	3.7	4.1	4.0	3.3	3.5	-3.4	4.8	7.4	4.2
Intellectual Property Products	5.7	3.7	5.2	0.8	13.2	4.0	5.4	5.3	4.9	5.4	5.3	5.1	3.8	6.3	3.9	6.0	5.1
Structures	14.8	7.0	-7.0	6.3	16.2	11.0	9.0	6.0	5.5	5.5	5.0	4.5	-1.8	-4.1	5.6	8.2	6.2
Residential Construction	11.1	-7.3	-4.7	12.8	-1.1	3.5	7.5	7.5	6.5	7.0	7.0	6.0	10.2	5.5	1.8	2.9	6.7
Government Purchases	-0.6	-0.2	0.7	3.0	1.3	2.1	3.5	2.6	1.3	1.1	1.0	0.7	1.4	0.8	0.1	1.9	1.8
Net Exports ²	0.2	0.2	0.4	-1.2	0.0	1.2	-0.8	-0.3	-0.2	-0.2	-0.1	-0.1	-0.7	-0.2	-0.2	-0.1	-0.2
Inventories ²	-1.5	0.1	0.8	-0.5	0.0	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.2	-0.4	-0.1	0.1	0.1
Nonfarm Payroll Change ³	177	190	142	221	218	211	190	180	170	170	160	160	226	195	182	200	165
Unemployment Rate	4.7	4.3	4.3	4.1	4.1	3.9	3.9	3.8	3.7	3.7	3.6	3.5	5.3	4.9	4.4	3.9	3.6
Consumer Price Index ⁴	2.6	1.9	2.0	2.1	2.3	2.7	2.7	2.5	2.3	2.5	2.6	2.6	0.1	1.3	2.1	2.5	2.5
Quarter-End Interest Rates ⁵																	
Federal Funds Target Rate	1.00	1.25	1.25	1.50	1.75	2.00	2.25	2.50	2.50	2.75	2.75	3.00	0.27	0.52	1.13	2.13	2.75
Conventional Mortgage Rate	4.20	3.90	3.81	3.94	4.44	4.57	4.59	4.70	4.85	4.94	4.99	5.04	3.85	3.65	3.99	4.58	4.96
2 Year Note	1.27	1.38	1.47	1.89	2.27	2.52	2.70	2.90	3.05	3.12	3.19	3.26	0.69	0.83	1.40	2.60	3.16
10 Year Note	2.40	2.31	2.33	2.40	2.74	2.85	2.94	3.10	3.25	3.34	3.39	3.44	2.14	1.84	2.33	2.91	3.36

Forecast as of: July 11, 2018

¹ Compound Annual Growth Rate Quarter-over-Quarter

² Percentage Point Contribution to GDP

³ Average Monthly Change

⁴ Year-over-Year Percentage Change

⁵ Annual Numbers Represent Averages

Source: IHS Markit and Wells Fargo Securities

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Date	Title	Authors
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June-21	Logjam: Tight Supply Chain Effects on Prices & Capex	Quinlan, House & Seery
June-15	Oil: Lubricating the Wheels of U.S. Export Growth	Bryson
U.S. Regional		
June-15	California Posts Modest Payroll Gains in May	Vitner, Feik & Carmichael
June-15	Texas Continues its Soaring Hiring Run	Vitner, Feik & Carmichael
June-15	North Carolina Payrolls Surge in May	Vitner, Feik & Carmichael
June-15	Florida Sees Further Payroll Gains in May	Vitner, Feik & Carmichael
June-14	New Jersey Adds to Payrolls Amid Labor Force Contraction	Vitner, Feik & Carmichael
Global Economy		
July-12	Uncertainty of Trade Tension Keeps Rates Steady for BoK	Quinlan & Seery
July-11	Bank of Canada Hikes Rates Despite Worries About Trade	Quinlan & Vaisey
July-03	RBA Keeps Rates Steady as Economic Uncertainties Persist	Quinlan, Bennenbroek & Seery
June-14	ECB: Making Plans to Dial Back Policy Accommodation	Bryson & Kinnaman
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Interest Rates/Credit Market		
July-11	The Flattening Yield Curve: To Worry or Not to Worry?	Silvia, Iqbal & Seery
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Real Estate & Housing		
June-29	Housing Chartbook: June 2018	Vitner & Dougherty
June-12	Q1 CRE Chartbook: Property Prices	Vitner, Dougherty, Carmichael & Vaisey
May-02	Tax Reform: Regional Real Estate Impact	Vitner & Dougherty
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