

# U.S. Economic Outlook

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Together we'll go far



## Economic Outlook

- Real GDP growth accelerated during the second and third quarters of 2017 and the improved pace of growth appears to be carrying over in 2018. Growth is not only stronger but much more broadly based.

## Fiscal Policy

- Tax cuts have finally become a reality and will likely be more impactful than consensus estimates. We look for consumer spending and business investment to kick up a notch. An infrastructure program is likely in 2018.

## Monetary Policy

- The post-financial crisis era is over and monetary policy is now focusing on normalizing interest rates and regulatory policy. Inflation and interest rates could modestly surprise to the upside in 2018.

## Soft Data Strength

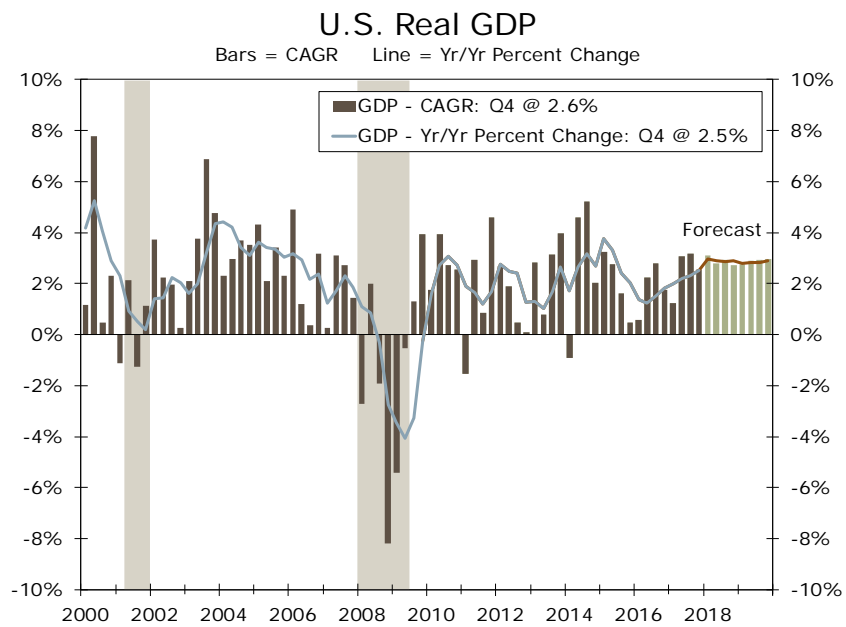
- The persistent strength in the 'soft data' reflects improving job prospects, some lightening of regulations and greater breadth in the manufacturing recovery.

## North Carolina

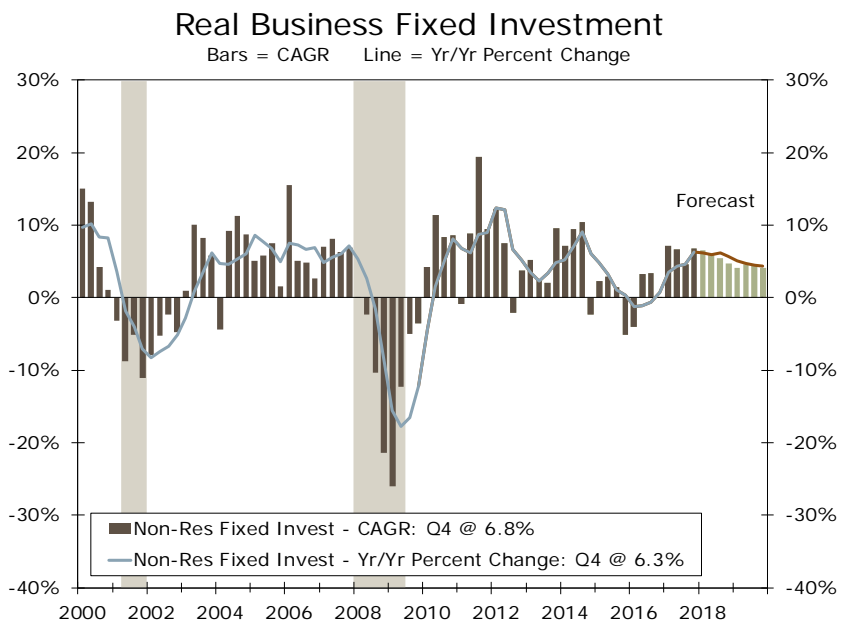
- North Carolina's economic recovery gained considerable strength during the past couple of years, although gains have largely been limited to the Triangle and Charlotte. Growth is now broadening to include most metro areas.

Real GDP growth accelerated during the spring and summer, as headwinds from slower global economic growth and cutbacks in energy production lessened. Business fixed investment has risen sharply over the past few quarters and is expected to strengthen further in 2018.

Real GDP Forecast



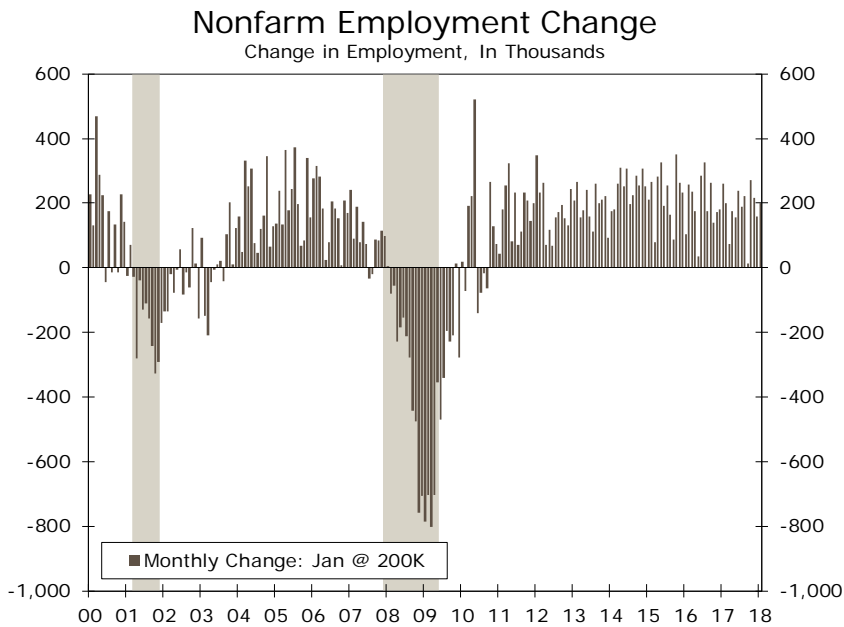
Business Fixed Investment



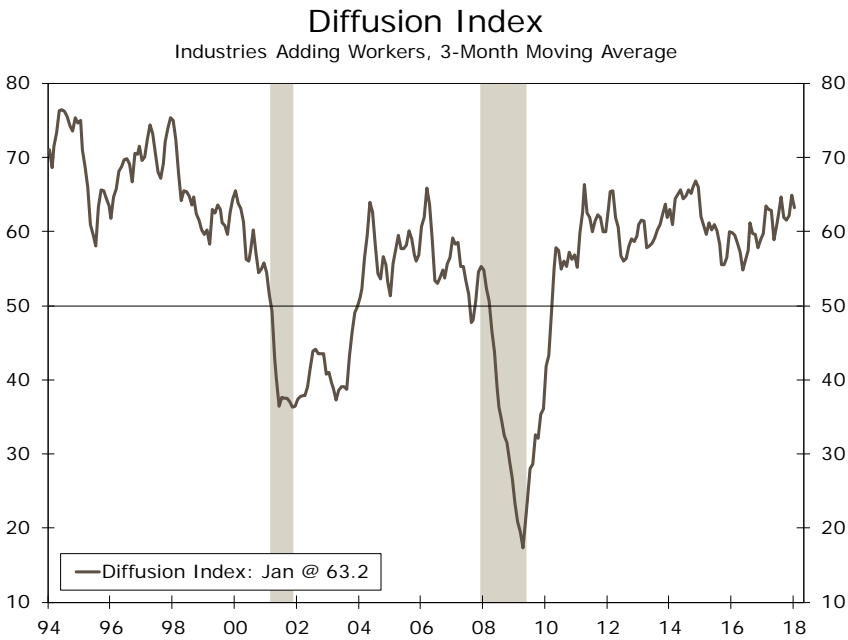
Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

While overall hiring moderated slightly this past year, the labor market remains remarkably strong. Hiring has picked up in many areas that had not seen much growth earlier in the recovery and the improvement in capital spending is boosting growth in manufacturing.

## Nonfarm Employment



## Employment Diffusion Index

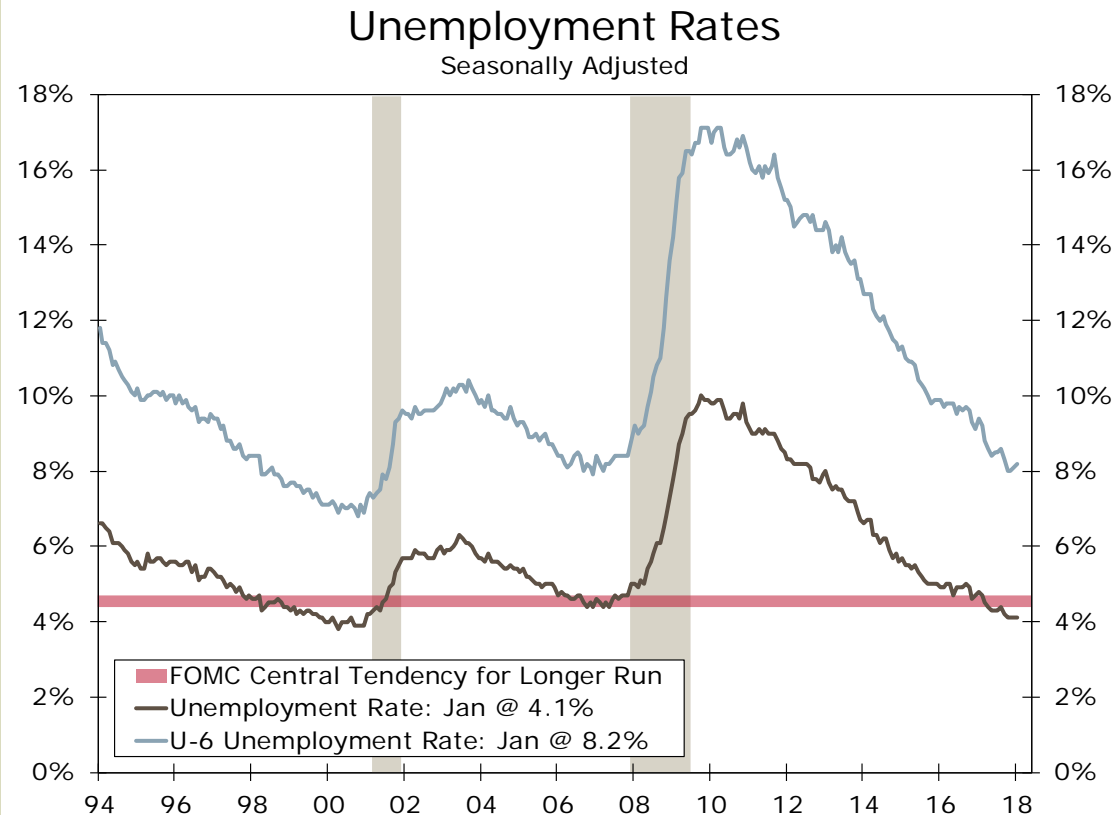


Source: U.S. Department of Labor and Wells Fargo Securities

The unemployment rate is now substantially below the Fed's long run target and at its lowest level since 2001.

Job openings are also at a record high and a rising proportion of businesses are experiencing difficulty finding and keeping qualified workers.

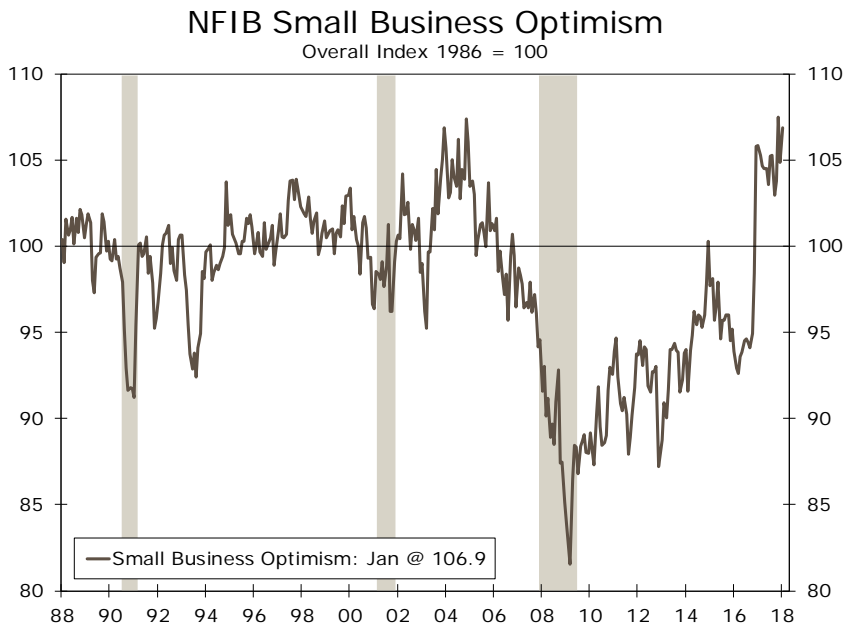
The coming year will mark a bit of an experiment for the Fed. Tax reform might encourage more workers to join or remain in the workforce but it might also heighten labor shortages and drive wages higher.



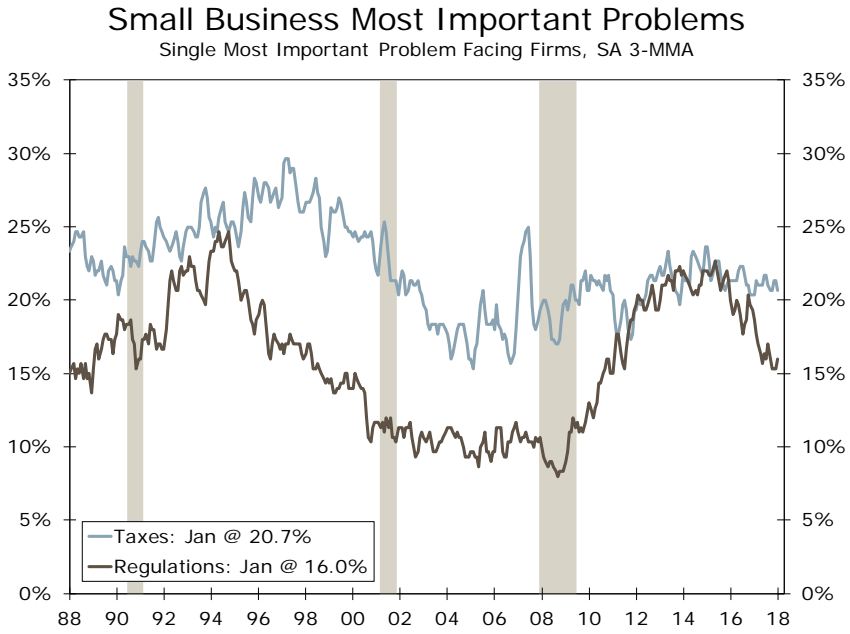
Source: U.S. Department of Labor and Wells Fargo Securities

Small business optimism spiked following the presidential election and rose even higher as the prospects for significant tax reform increased. Business owners are already benefitting from a rollback in burdensome regulations and a lessening in the pace of new regulations.

## Small Business Optimism



## Small Business Concerns

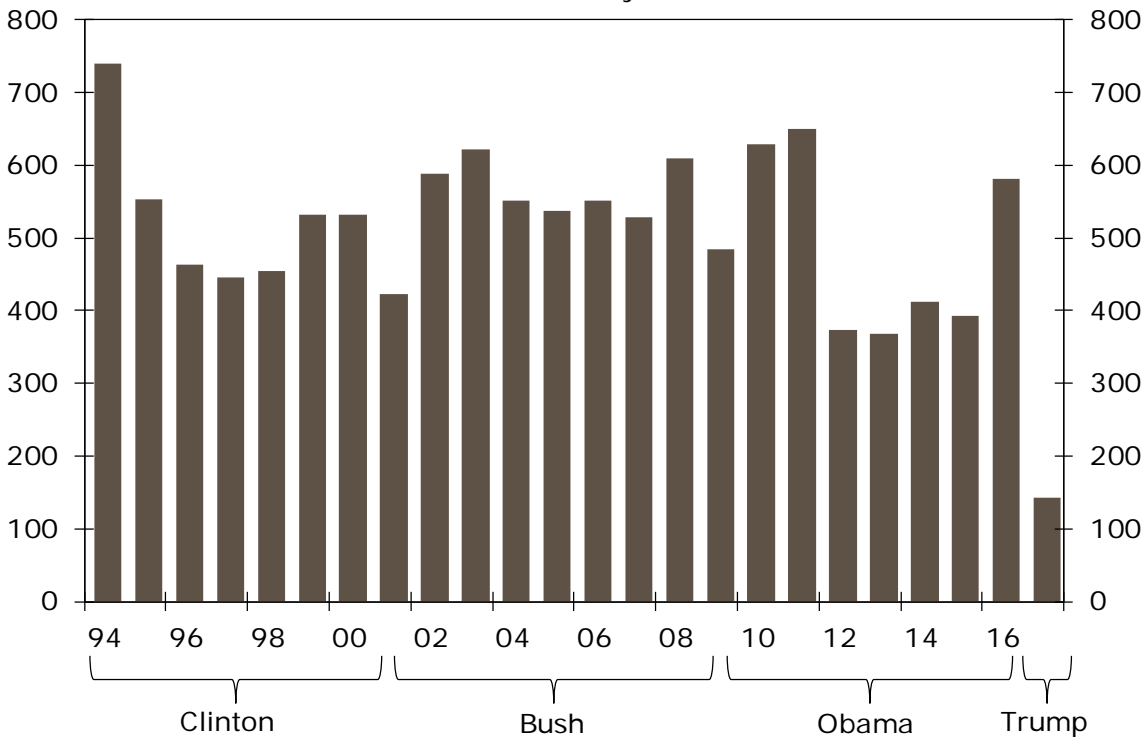


Source: National Federation of Independent Business (NFIB) and Wells Fargo Securities

The number of major new regulations put in place in the first year of the Trump administration was substantially less than any year of the three previous presidents.

Major New Regulatory Changes

Number of Rules Reviewed By the OIRA Each Year

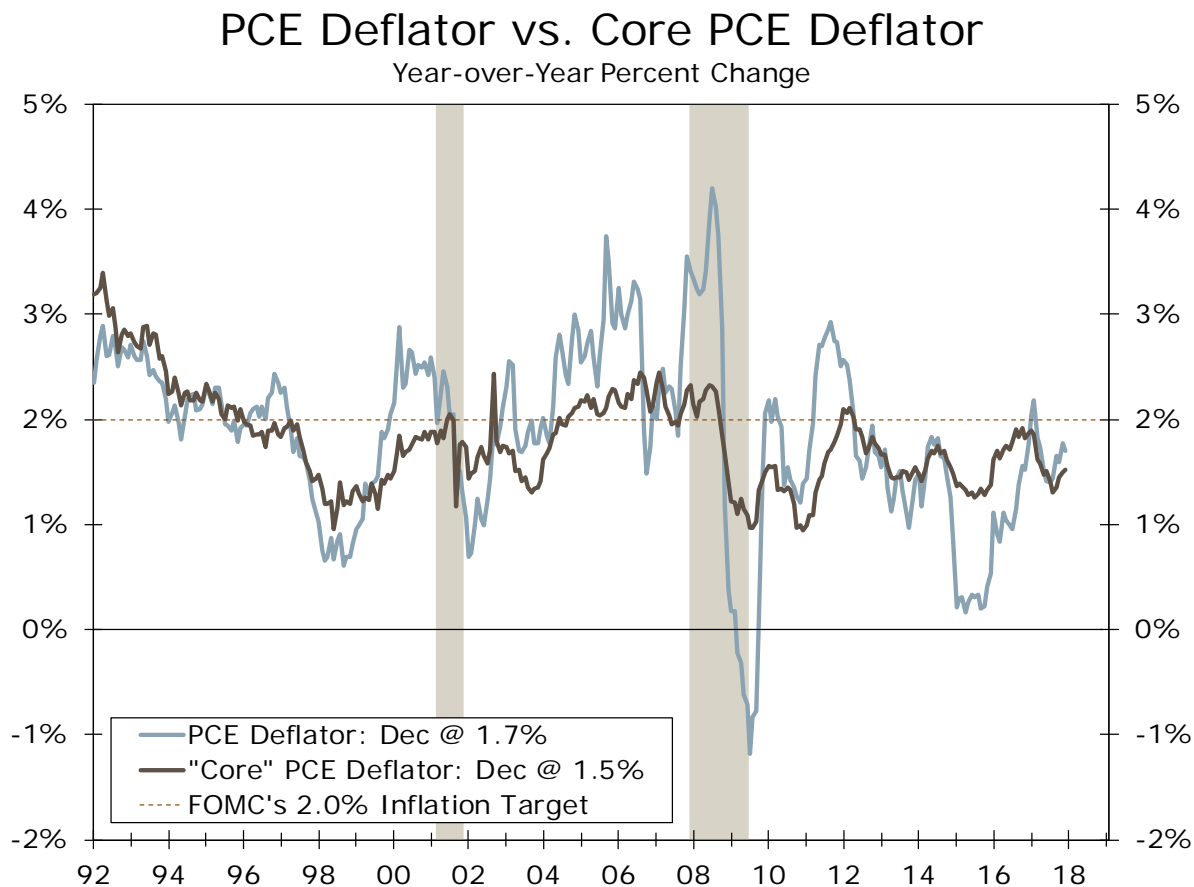


Source: Office of Information and Regulatory Affairs and Wells Fargo Securities

After making steady progress toward the Fed's 2 percent inflation objective, most broad inflation measures have remained below 2 percent since the last recession ended.

The recent moderation in core inflation is unnerving some members of the FOMC, suggesting the Fed may be even more cautious about raising short-term rates.

We believe there are a mix of structural and cyclical forces restraining inflation that may prove to be long lasting.



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



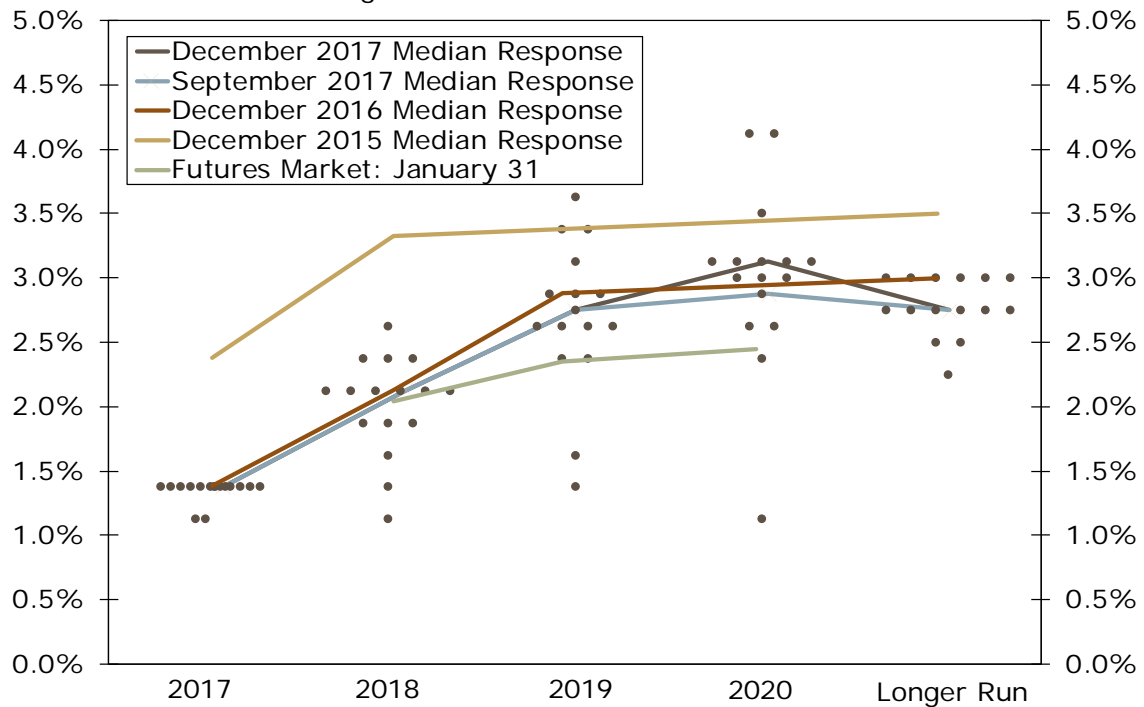
While the era of ultra-low interest rates has ended, the FOMC plans to be judicious in normalizing monetary policy.

The pace and magnitude of interest rate increases are two important variables to watch.

With the post-Financial Crisis period ending, the next Fed chair and Fed board will determine what the new normal for interest rates and the inflation-unemployment relationship will be.

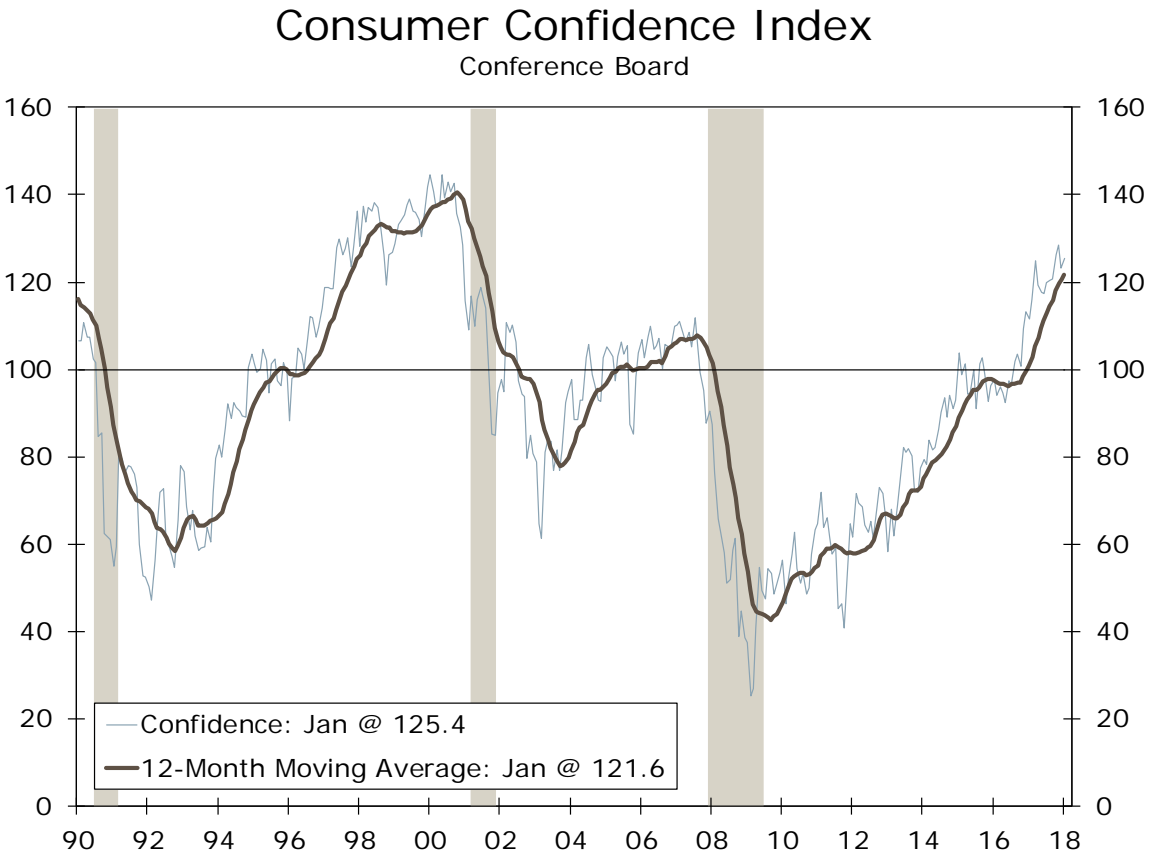
Appropriate Pace of Policy Firming

Target Federal Funds Rate at Year-End



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

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

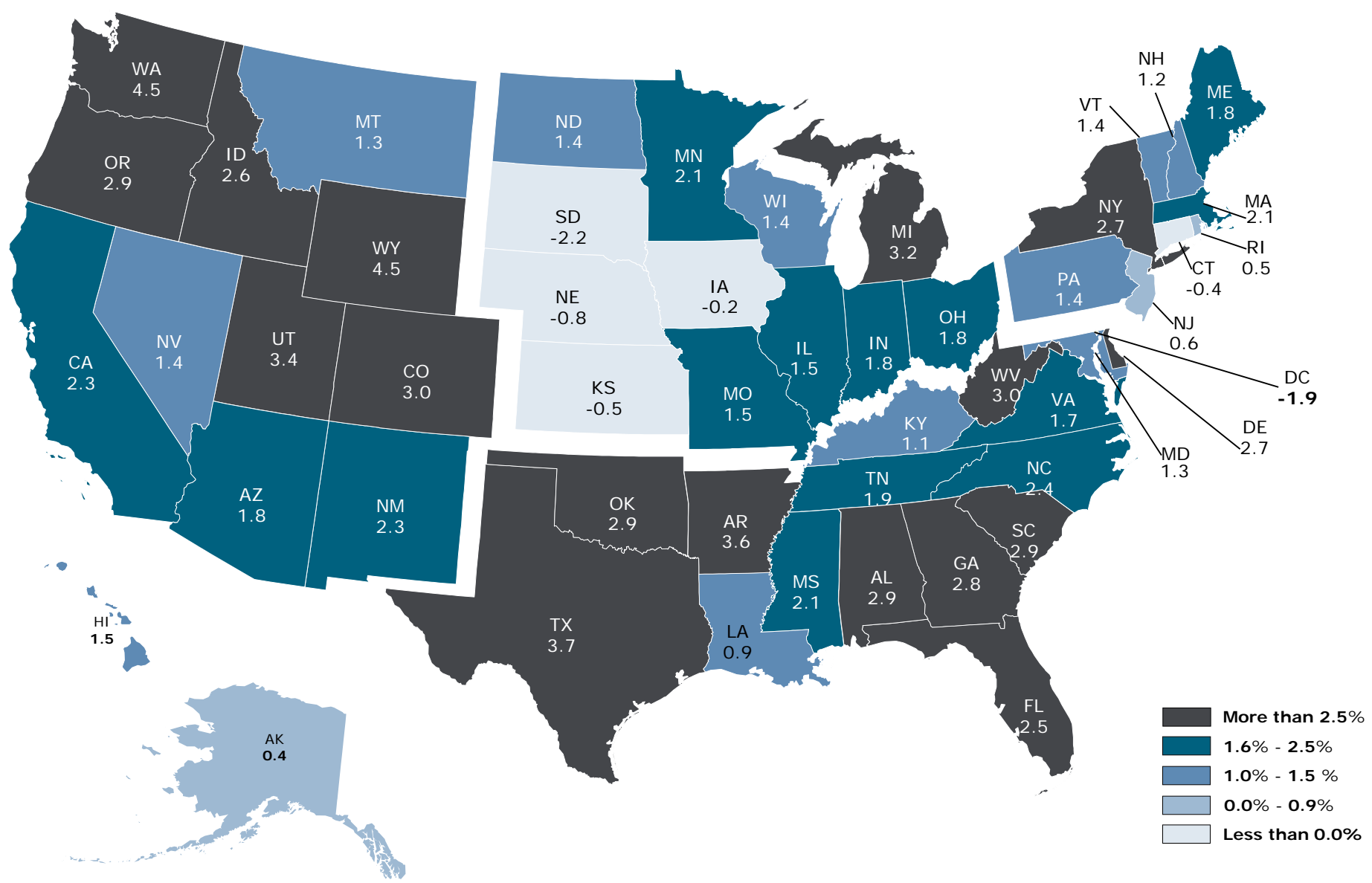


Source: Conference Board and Wells Fargo Securities

# Regional Commentary

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# Year-over-Year Percent Change in GDP by State (3Q-2017)

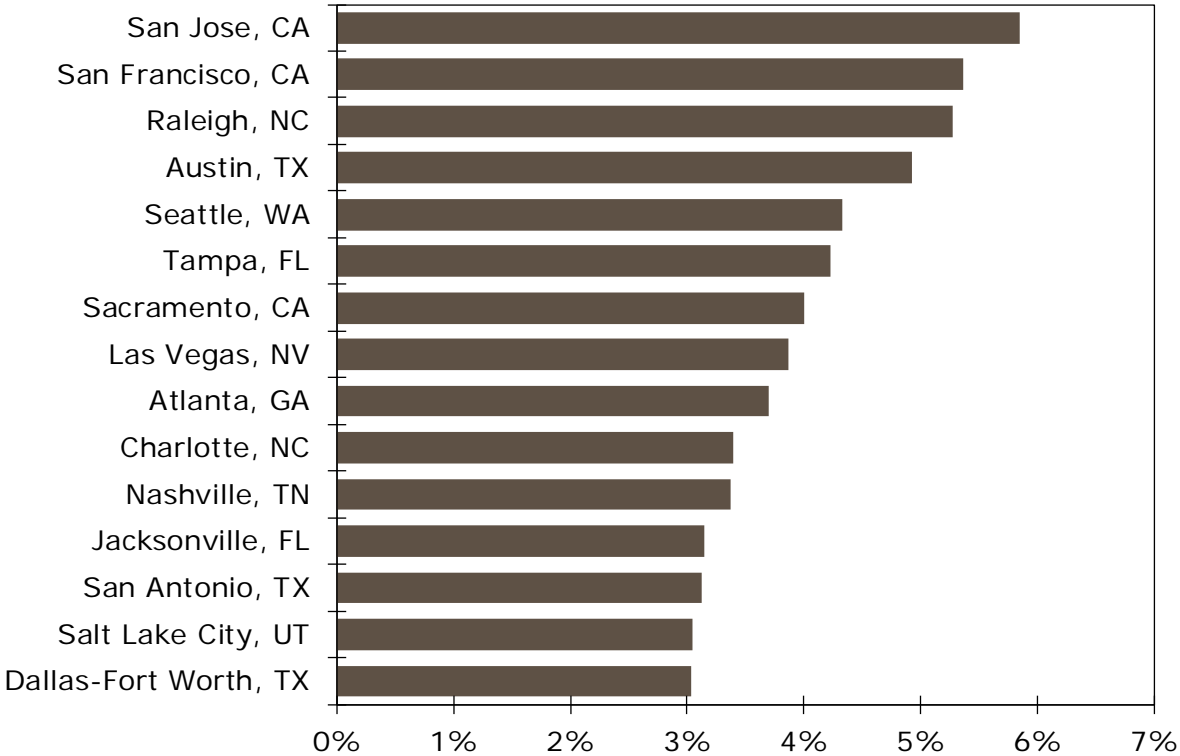


Raleigh, and other tech-driven metros, remain the fastest growing economies.

Years of sustained rapid growth are creating challenges in many parts of the country.

Metro Area GDP Growth: Top 15

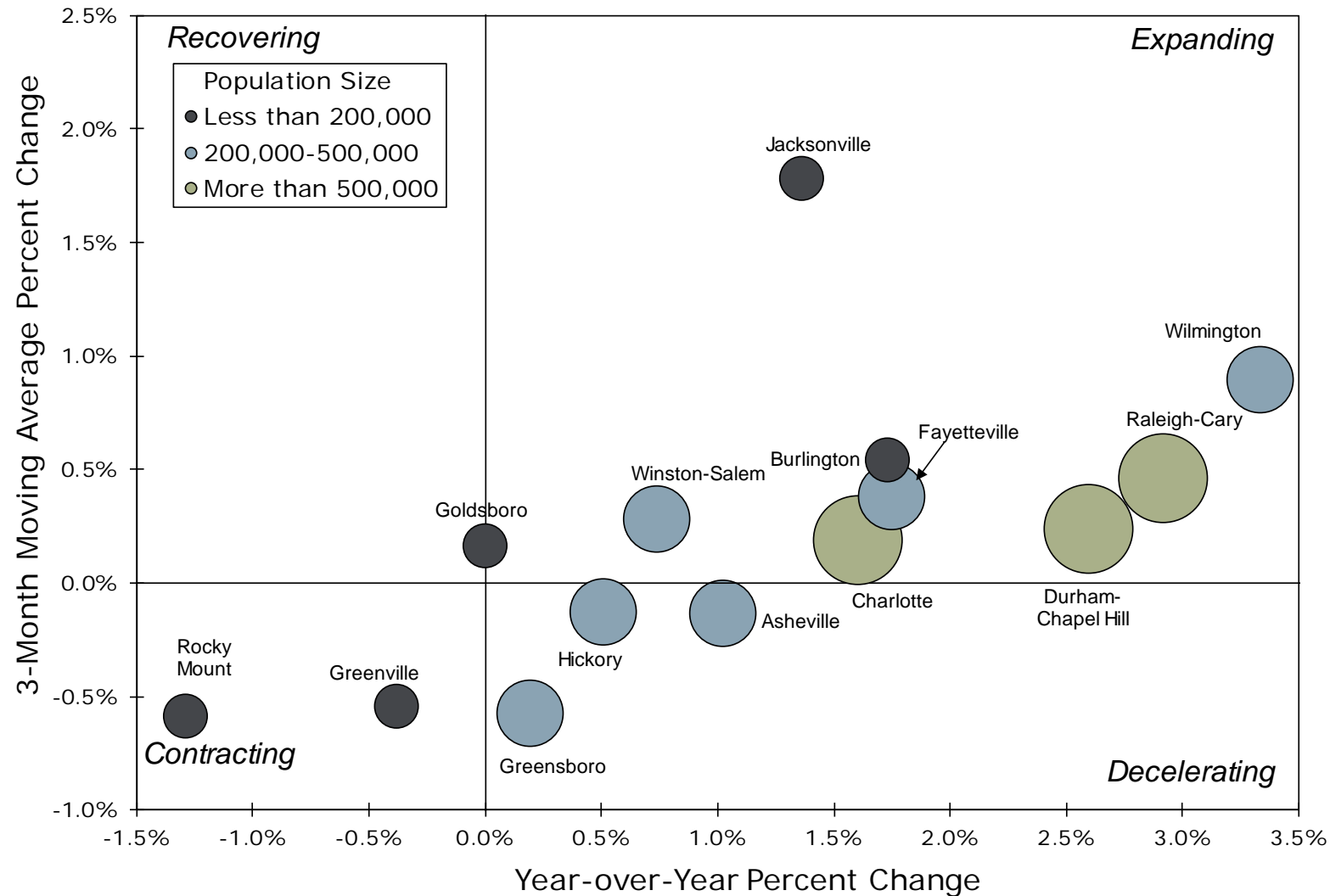
Year-over-Year Percent Change in Real GDP, 2016



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

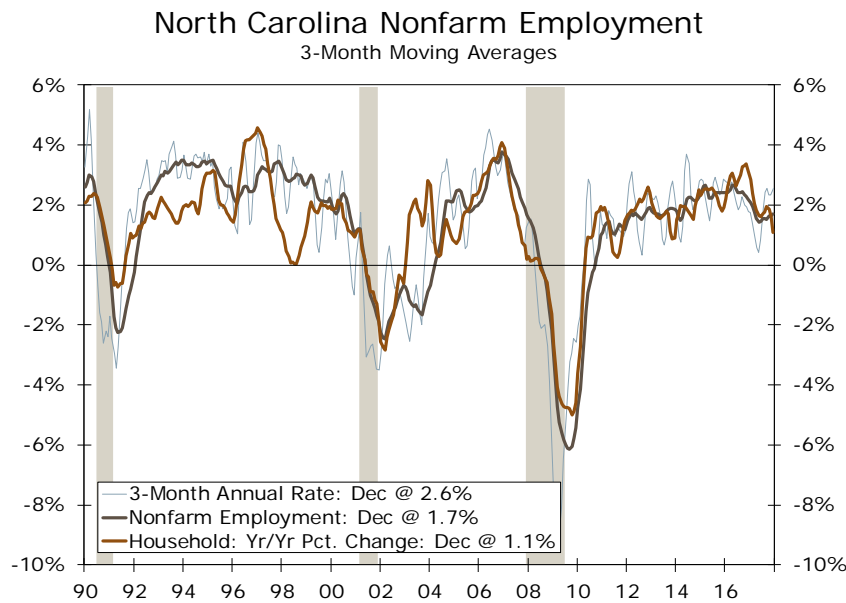
North Carolina Job Growth: December 2017

Year-over-Year Percent Change, 3-Month Moving Average

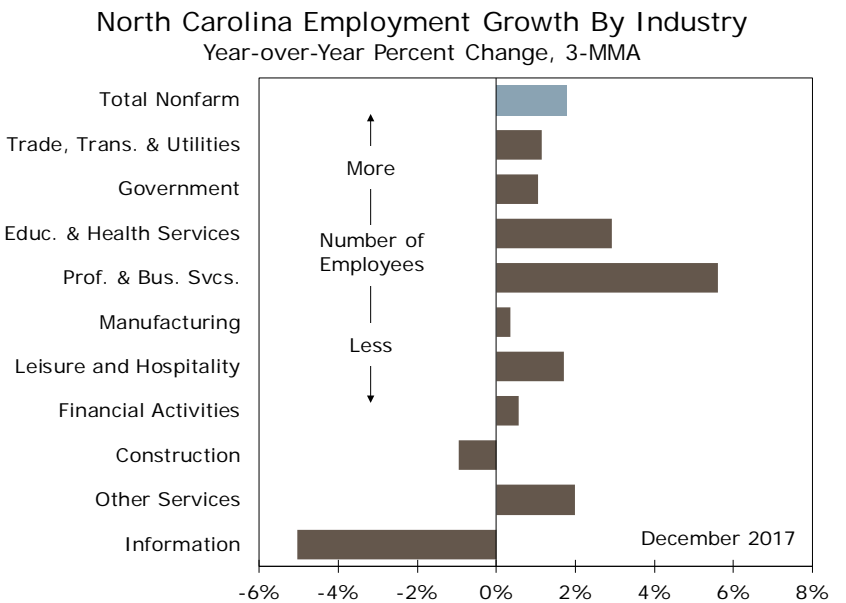


Employment growth remained slightly ahead of the nation in 2017. The Triangle and Charlotte have enjoyed the lion’s share of job growth, driven by strong gains in the tech and professional sectors. Growth is now broadening to other industries and other parts of the state as well.

Nonfarm Employment



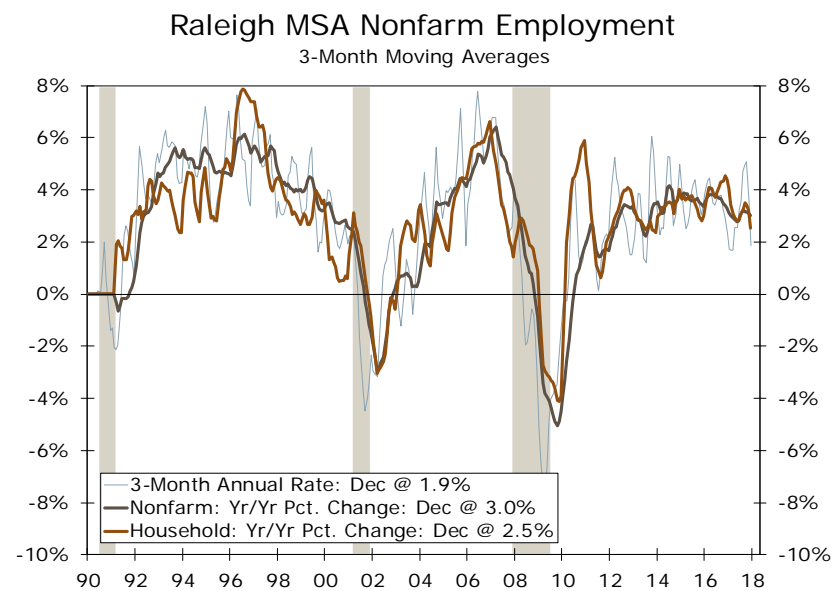
Employment by Industry



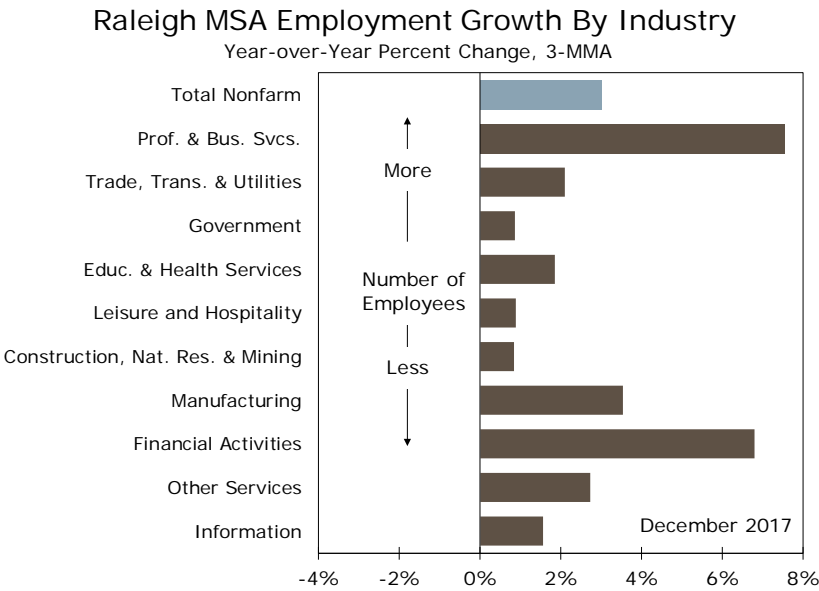
Source: U.S. Department of Labor and Wells Fargo Securities

Raleigh’s employment growth remained exceptionally strong in 2017. It’s large professional & business services sector has grown at an eye-popping 8 percent over the year, largely reflecting gains in the tech sector. Every major industry category saw an increase in employment in 2017.

## Nonfarm Employment



## Employment by Industry



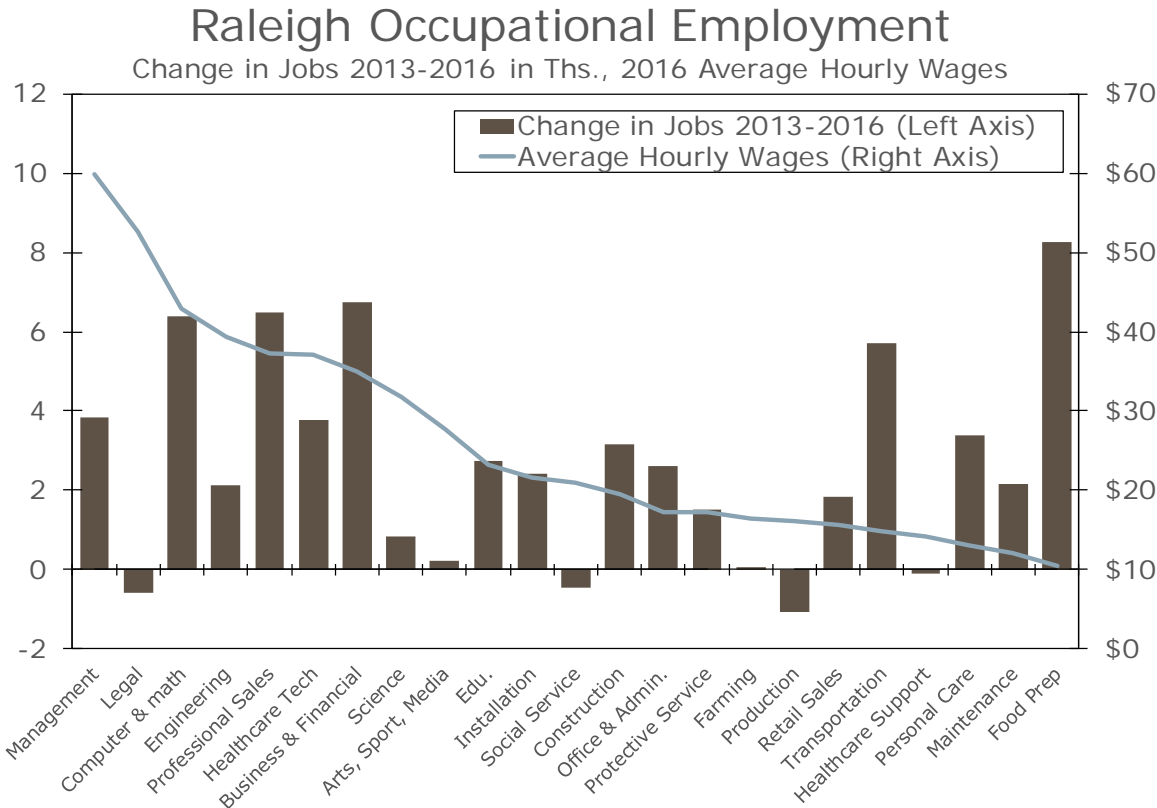
Source: U.S. Department of Labor and Wells Fargo Securities



While job growth has been solid, income gains have remained elusive for many workers.

Job growth in Raleigh has been strongest at the high-end and low-end of the wage spectrum.

The income divide is a national issue and has made economic mobility more challenging.



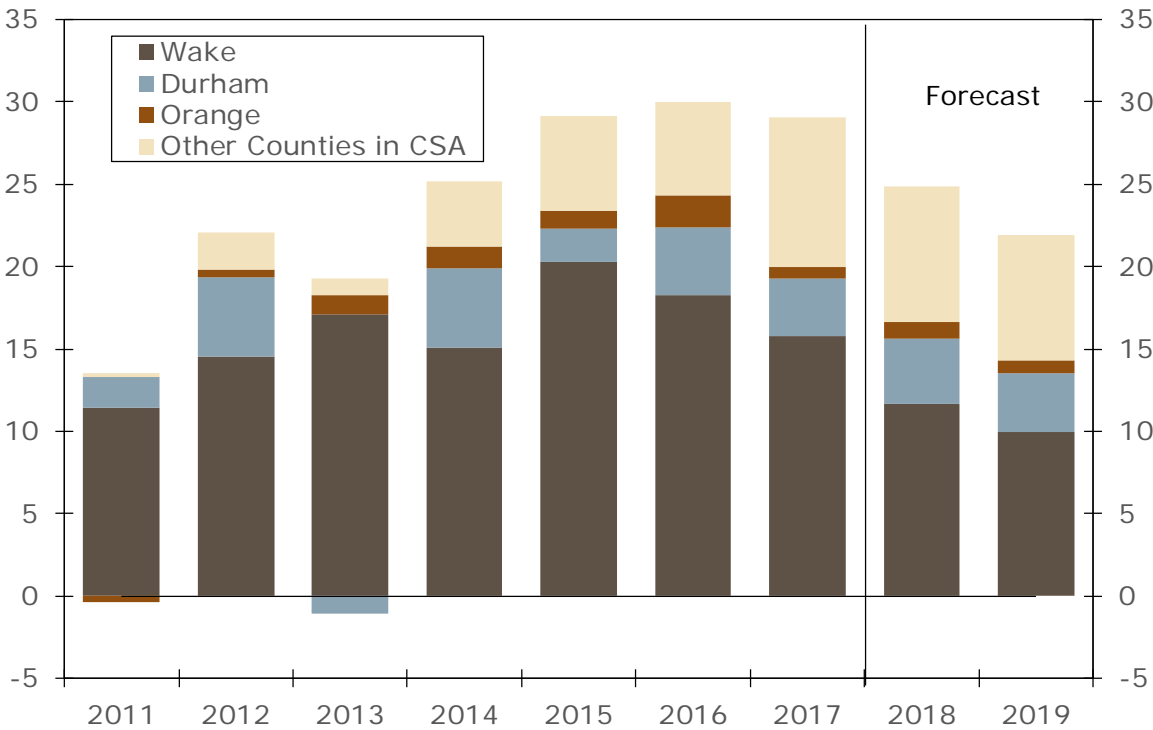
Source: U.S. Department of Labor and Wells Fargo Securities

# The Geographic Mix of Growth Has Shifted

Wake and Durham counties accounted for the bulk of job gains earlier in the expansion, as residents and businesses moved back toward the city center.

Job growth has since broadened and more growth is occurring in outlying areas. Job growth in Wake County is moderating.

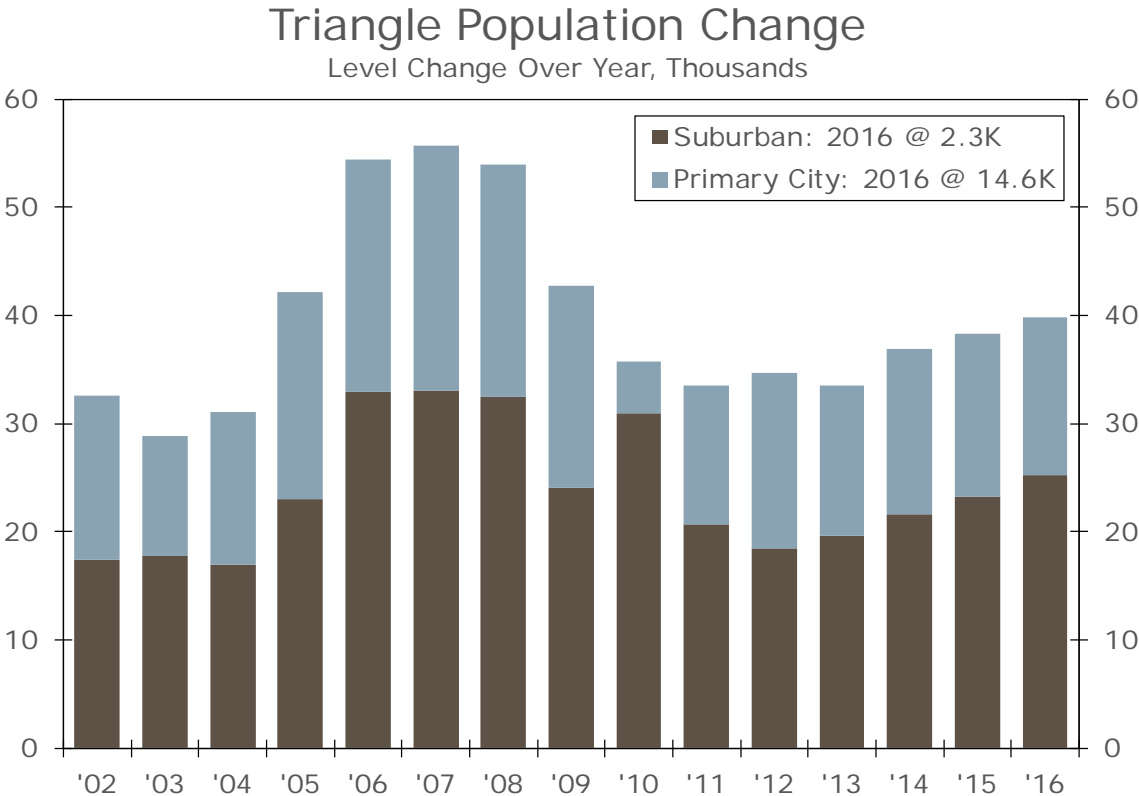
Raleigh-Durham-Chapel Hill CSA Job Gain by County  
Year-over-Year Level Change in Annual Averages, Thousands



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

The movement back into the center city bolstered growth in Raleigh and Durham earlier in the cycle, setting off battles over redevelopment and gentrification.

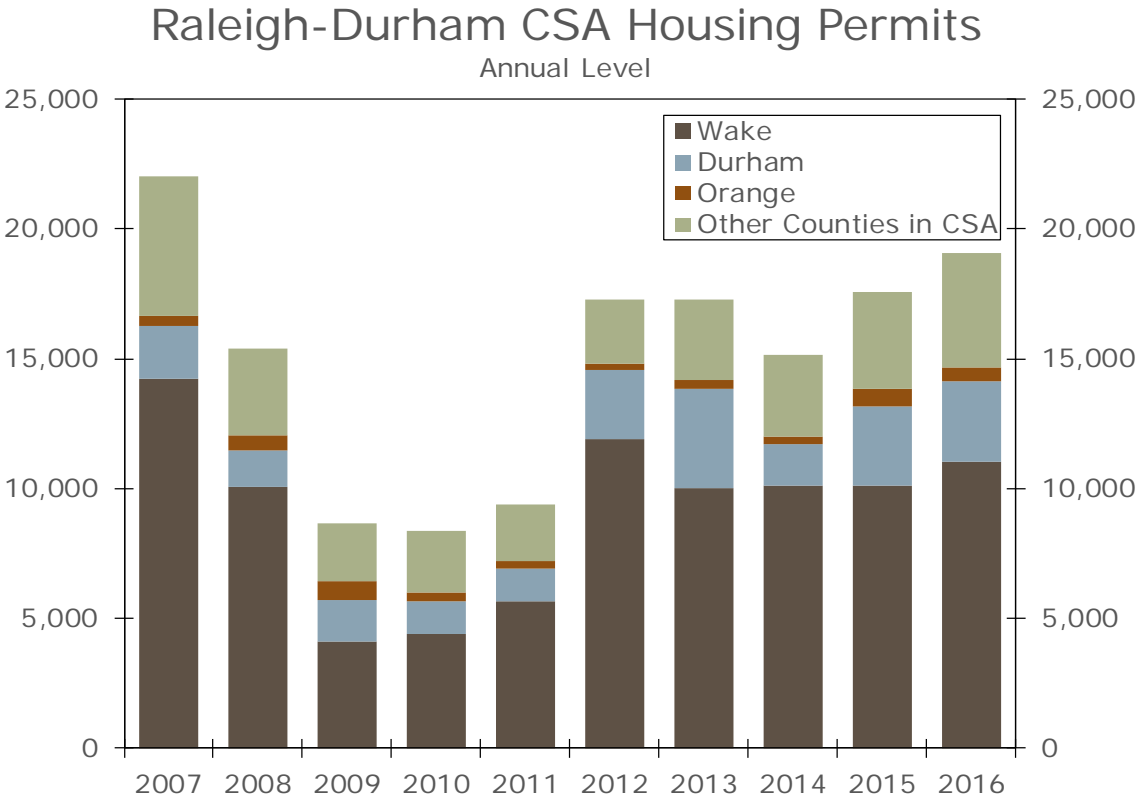
Rising housing costs and sluggish median income growth have spurred an affordability migration to outlying areas, raising a new set of challenges in regards to land use and zoning.



Source: CoreLogic and Wells Fargo Securities

Wake and Durham Counties accounted for the bulk of housing starts earlier in the recovery, led by a boom in apartment building and redevelopment of single-family homes in closer-in neighborhoods.

More recently, growth has been shifting to the suburbs and outlying areas.

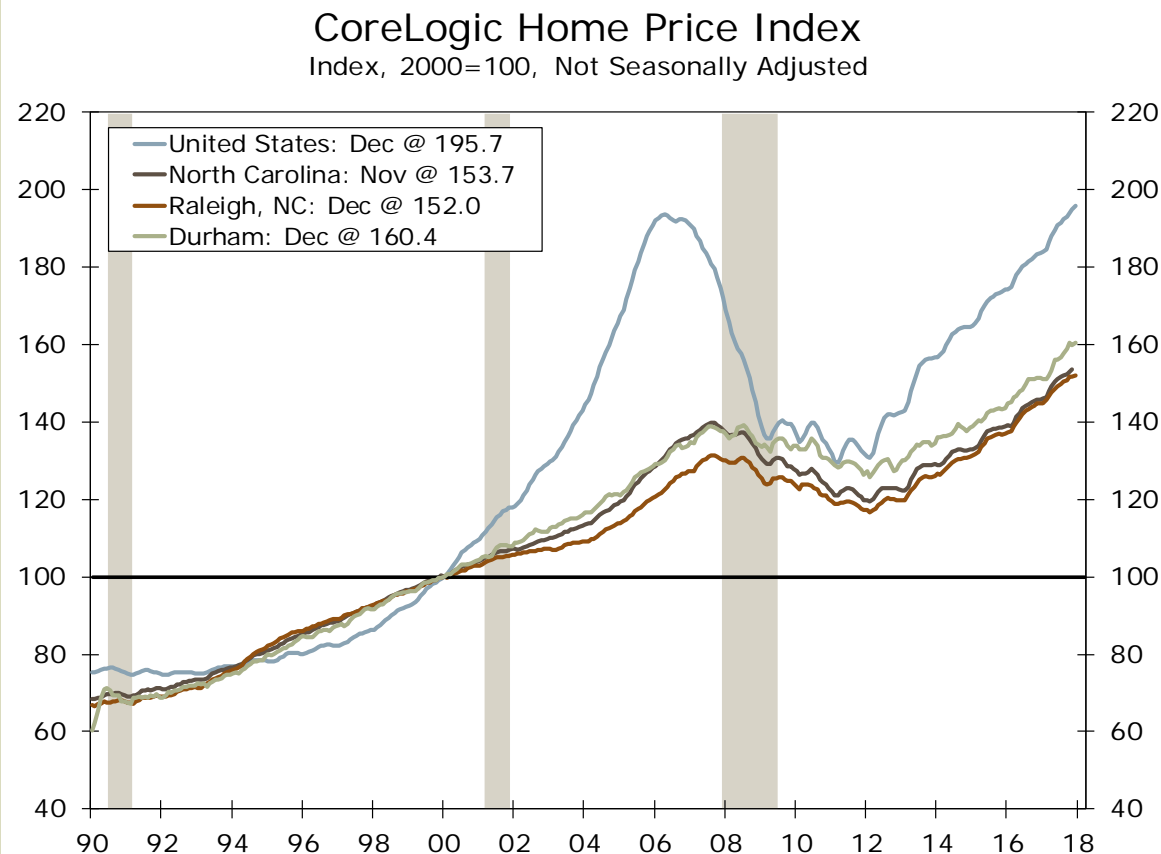


Source: U.S. Department of Commerce and Wells Fargo Securities

Home price appreciation did not see the roller coaster ride that many other parts of the country did. Prices did not fall as hard during the housing slump and have rebounded less dramatically than they have nationwide.

Home prices in Raleigh and Durham have risen past their previous highs, and affordability has become a larger issue.

The Triangle remains affordable relative to other major tech hubs, however, which continues to draw new businesses and residents to the region.



Source: CoreLogic and Wells Fargo Securities

## 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 <sup>1</sup>	1.2	3.1	3.2	2.6	3.1	2.8	2.9	2.7	2.8	2.9	2.9	3.0	2.9	1.5	2.3	2.9	2.8
Personal Consumption	1.9	3.3	2.2	3.8	3.0	2.5	2.5	2.5	2.7	2.6	2.5	2.5	3.6	2.7	2.7	2.9	2.6
Business Fixed Investment	7.2	6.7	4.7	6.8	6.6	5.9	5.4	4.7	4.2	4.6	4.5	4.1	2.3	-0.6	4.7	6.0	4.7
Equipment	4.4	8.8	10.8	11.4	8.0	6.9	6.0	4.7	4.0	4.6	4.4	3.8	3.5	-3.4	4.8	8.3	4.7
Intellectual Property Products	5.7	3.7	5.2	4.5	6.0	6.5	6.5	6.2	5.4	6.0	5.9	5.6	3.8	6.3	4.2	5.6	5.9
Structures	14.8	7.0	-7.0	1.4	2.0	2.4	2.4	2.2	2.5	2.4	2.4	2.4	-1.8	-4.1	5.3	1.1	2.4
Residential Construction	11.1	-7.3	-4.7	11.6	9.0	8.0	7.5	7.0	6.5	7.0	7.0	5.5	10.2	5.5	1.7	6.1	6.9
Government Purchases	-0.6	-0.2	0.7	3.0	0.8	1.2	1.2	0.9	0.8	0.8	0.8	0.8	1.4	0.8	0.1	1.3	0.9
Net Exports <sup>2</sup>	0.2	0.2	0.4	-1.1	-0.4	-0.3	-0.2	-0.1	-0.1	0.0	0.1	0.2	-0.7	-0.2	-0.2	-0.4	-0.1
Inventories <sup>2</sup>	-1.5	0.1	0.8	-0.7	0.7	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.2	-0.4	-0.1	0.2	0.1
Nonfarm Payroll Change <sup>3</sup>	177	190	142	216	180	165	160	155	150	150	145	145	226	195	181	165	148
Unemployment Rate	4.7	4.3	4.3	4.1	4.1	4.0	3.9	3.8	3.8	3.7	3.8	3.7	5.3	4.9	4.4	4.0	3.8
Consumer Price Index <sup>4</sup>	2.6	1.9	2.0	2.1	2.3	2.8	2.6	1.9	1.6	1.7	2.1	2.3	0.1	1.3	2.1	2.4	1.9
Quarter-End Interest Rates <sup>5</sup>																	
Federal Funds Target Rate	1.00	1.25	1.25	1.50	1.75	2.00	2.25	2.25	2.50	2.50	2.75	2.75	0.27	0.52	1.13	2.06	2.63
Conventional Mortgage Rate	4.20	3.90	3.81	3.94	4.25	4.25	4.35	4.45	4.55	4.60	4.72	4.77	3.85	3.65	3.99	4.33	4.66
2 Year Note	1.27	1.38	1.47	1.89	2.20	2.30	2.45	2.55	2.70	2.80	2.93	3.00	0.69	0.83	1.40	2.38	2.86
10 Year Note	2.40	2.31	2.33	2.40	2.80	2.85	2.95	3.05	3.15	3.20	3.32	3.37	2.14	1.84	2.33	2.91	3.26

Forecast as of: February 7, 2018

<sup>1</sup> Compound Annual Growth Rate Quarter-over-Quarter

<sup>2</sup> Percentage Point Contribution to GDP

<sup>3</sup> Average Monthly Change

<sup>4</sup> Year-over-Year Percentage Change

<sup>5</sup> Annual Numbers Represent Averages

Source: IHS Global Insight and Wells Fargo Securities

# Appendix

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A Sampling of Our Recent Special, Regional & Industry Commentary

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Recent Special Commentary		
Date	Title	Authors
U.S. Macro		
February-09	Economic and Fiscal Implications of the Budget Deal	Brown, Pugliese & Kinnaman
February-08	Is the U.S. Consumer Running on Fumes?	Alemán & Seery
February-08	U.S. Export Outlook: Let the Good Times Roll?	Bryson & Kinnaman
February-07	Challenges to Rebuilding America's Infrastructure	Brown & Kinnaman
February-06	Technology Is a-Changin': Employment Impact	House & Vaisey
U.S. Regional		
January-23	North Carolina Payrolls End 2017 on a Solid Note	Vitner, Feik & Carmichael
January-18	California Employment Conditions: December 2017	Vitner, Feik & Carmichael
January-18	Texas is Still Firing on All Cylinders	Vitner, Feik & Carmichael
January-18	Florida Shifts Back Into Expansion Mode	Vitner, Feik & Carmichael
January-18	Employers Cut Jobs in New York	Vitner, Feik & Carmichael
Global Economy		
February-06	Australia's Reserve Bank Leaves Rates Unchanged	Quinlan & Seery
January-31	Can Taiwan's Economy Maintain Its Momentum?	Bryson & Pugliese
January-30	Eurozone Economic Outlook: Does Monetary Tightening Lie Ahead?	Bryson & Kinnaman
January-26	The U.K. Economic Outlook: What About Brexit Uncertainty?	Bryson & Kinnaman
January-24	BoJ: Don't Even Think About Normalization	Quinlan & Seery
Interest Rates/Credit Market		
January-31	Revisiting Our Rates Forecast	Silvia, Iqbal & Pershing
January-24	Too Much Recession: How About Price Cycles?	Silvia, Iqbal & Pershing
January-17	Cycles in Credit, Economics and National Finance	Silvia, Iqbal & Seery
January-16	Forward Rates: Are They Really Like a Magic-8 Ball?	Silvia, Iqbal & Kinnaman
January-10	Widening Net Interest Margins Boost Bank Revenue	Silvia & Pershing
Real Estate & Housing		
January-17	Housing Chartbook: February 2018	Vitner & Carmichael
January-17	Tax Reform and Housing	Vitner
December-14	Housing Chartbook: December 2017	Vitner & Carmichael
December-12	Construction Costs Continue to Increase	Vitner
December-06	The State of CRE: Q3 Chartbook	Vitner, Carmichael & Vaisey



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