WELLS FARGO SECURITIES

U.S. Economic Outlook

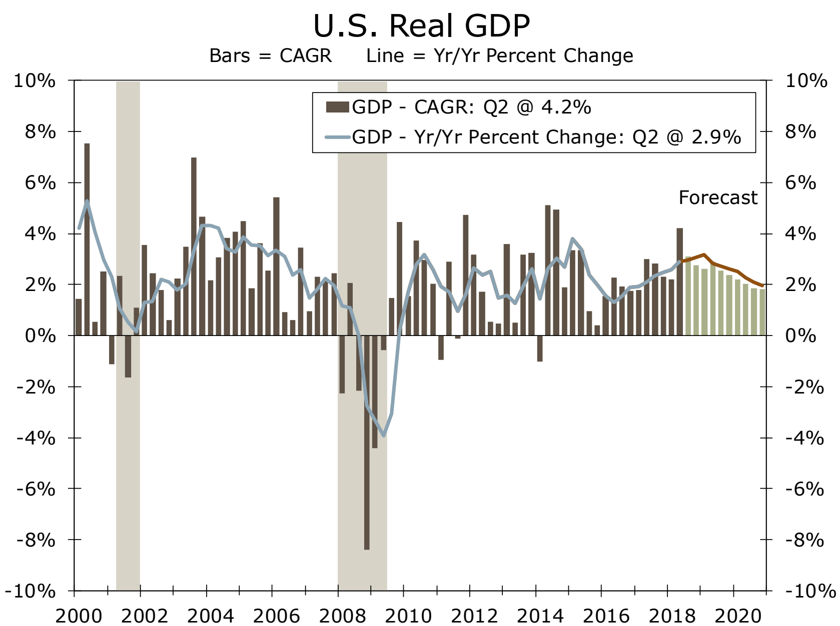
Mark Vitner, Managing Director & Senior Economist
September 18, 2018

Together we'll go far

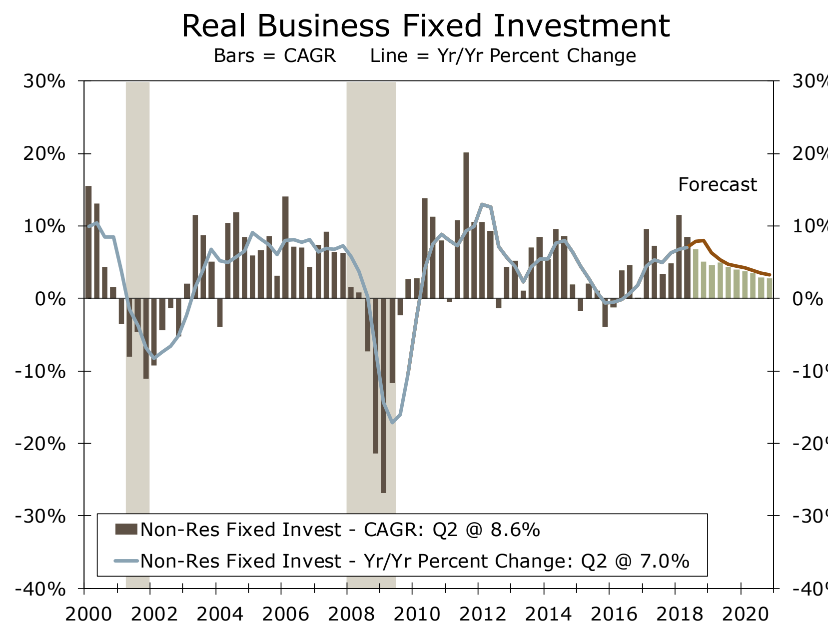
Economic Outlook	▪ Economic growth ramped up considerably in Q2, with activity getting a boost from tax cuts and a push to produce and ship goods ahead of tariff implementation. For the year, growth should come in around 3%.
Fiscal Policy	▪ Fiscal policy remains stimulative, with tax reform providing both a near-term and long-term growth boost. Federal, state and local government outlays are rising following the budget deal and stronger state tax receipts.
Monetary Policy	▪ With the economy strong, the Fed continues to push short-term rates higher. The Fed has to navigate some difficult shoals, with inflation low, emerging markets struggling and a relatively flat 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.
Carolinas	▪ The Carolinas continue to grow solidly, with the strongest gains concentrated in a handful of large metro areas. Flooding from Hurricane Florence will be a major hindrance to Eastern North Carolina and the Pee Dee.

Real GDP growth surged in Q2 as exporters rushed to produce and ship goods ahead of retaliatory tariffs. Consumption and business fixed investment were also strong. Tax reform likely contributed to the strength but the economy's underlying momentum has also improved.

Real GDP Forecast



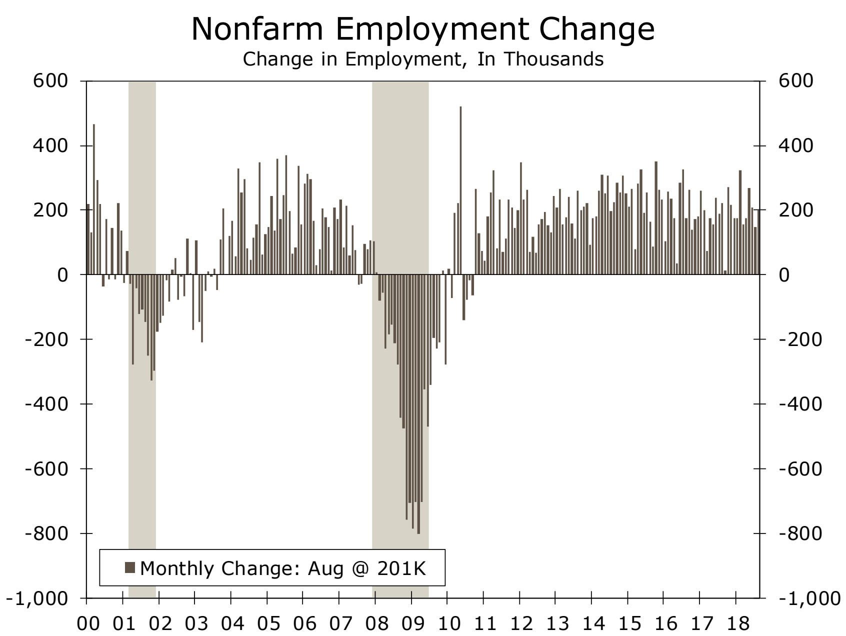
Business Fixed Investment



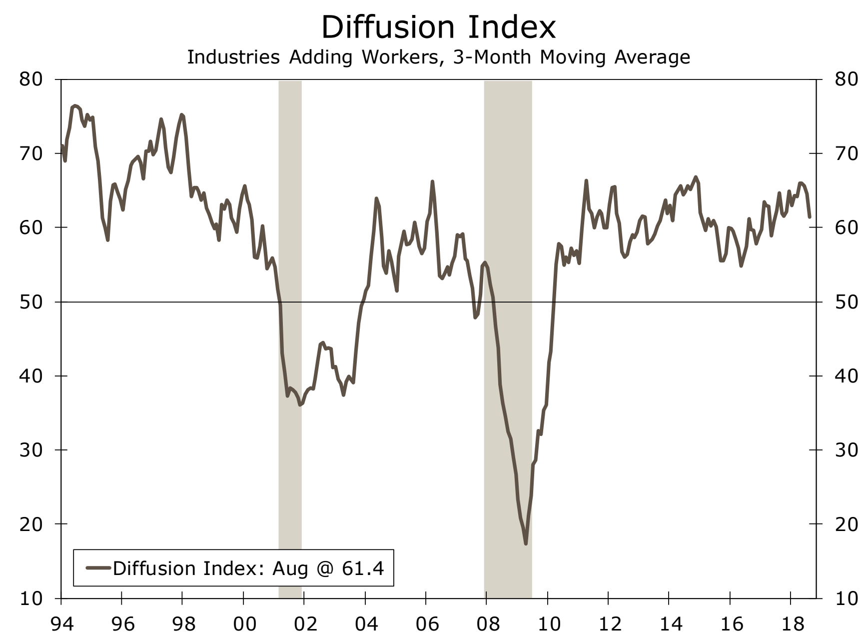
Source: U.S. Department of Commerce and Wells Fargo Securities

Nonfarm employment growth has maintained its recent strong pace, despite the seemingly low level of available workers. Job growth remains extraordinarily broad based, which suggests the recent improvement should prove durable. The diffusion index has recently turned lower.

Nonfarm Employment



Unemployment Rate

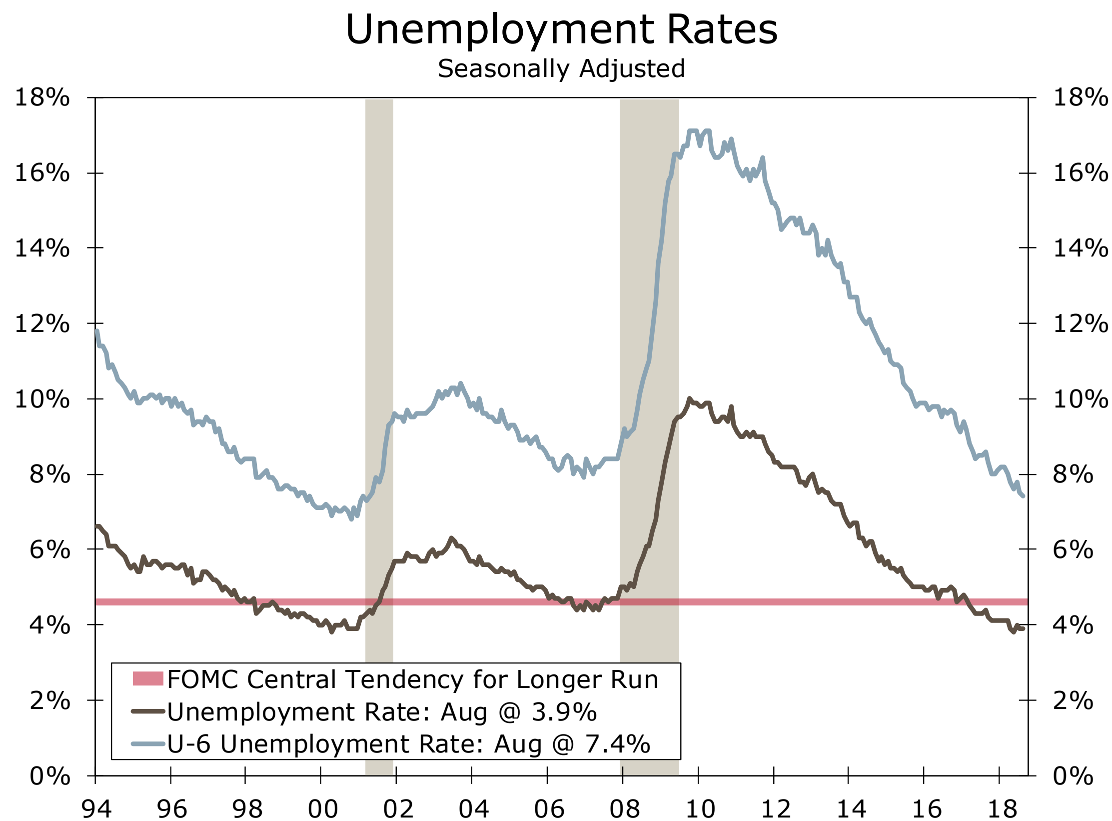


Source: U.S. Department of Labor and Wells Fargo Securities

The labor market has tightened substantially, with unemployment currently below the Fed's long run target rate.

While the criteria for determining the unemployment rate have not changed, the growth in the Gig Economy suggests today's unemployment rate overstates the extent to which the labor market has tightened.

Job openings are also at a record high, indicating that the Fed is successfully working towards its employment mandate.

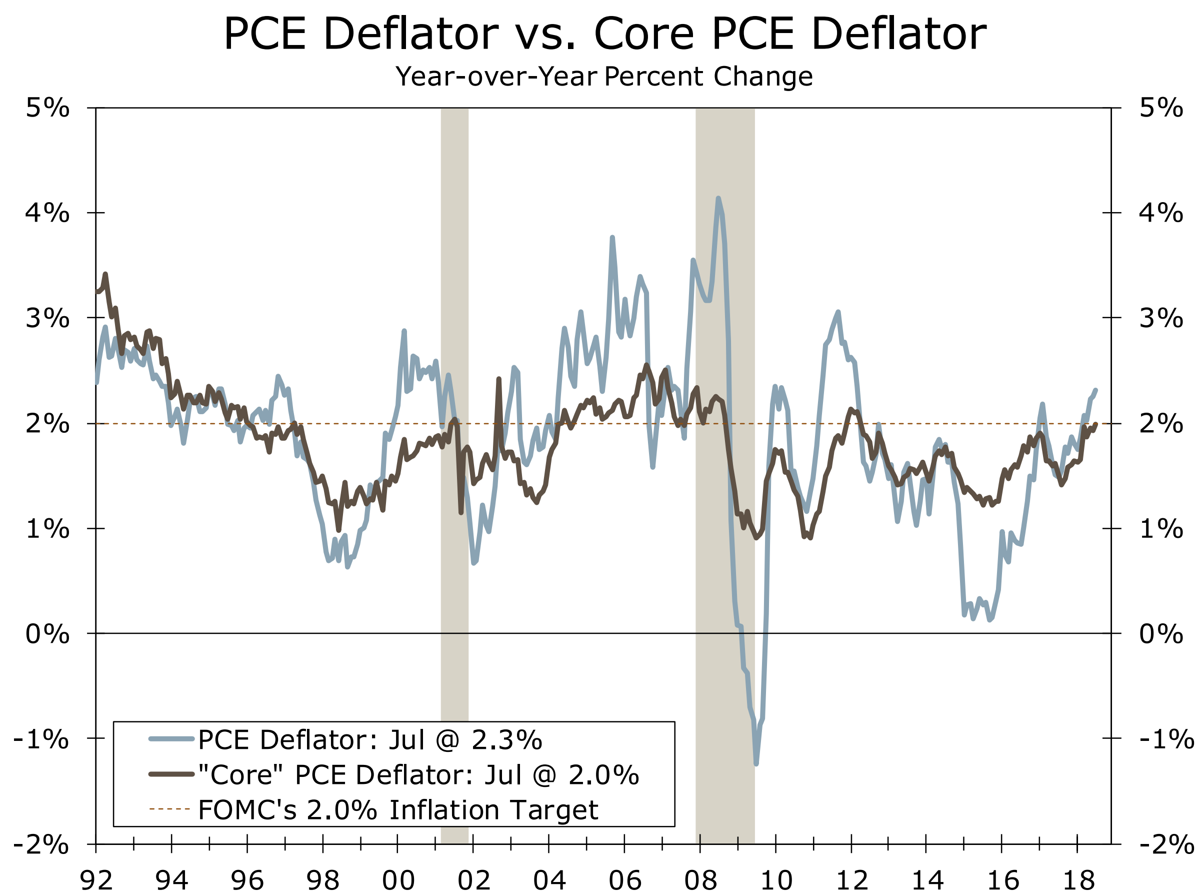


Source: U.S. Department of Labor and Wells Fargo Securities

Inflation has 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 and may tolerate inflation slightly above its target.

Chair Powell recently indicated that inflation may no longer be the best indicator of a tight labor market or resource utilization.

We believe there are a mix of long lasting structural and cyclical forces restraining inflation that will limit any acceleration in inflation.

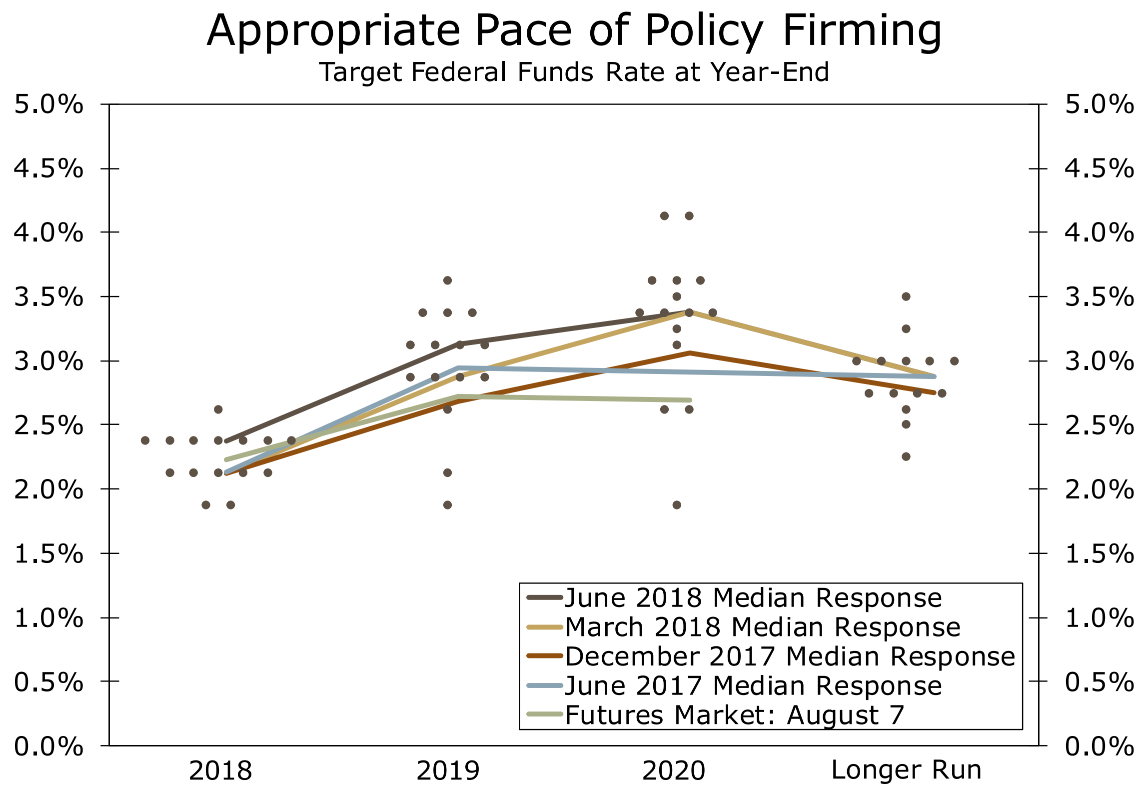


Source: U.S. Department of Commerce and Wells Fargo Securities

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 much inflation accelerates.

With the post-Financial Crisis period ending, the Federal Reserve now has to determine what the new normal for the federal funds rate is, while recognizing any estimate's imprecision and proceeding cautiously.

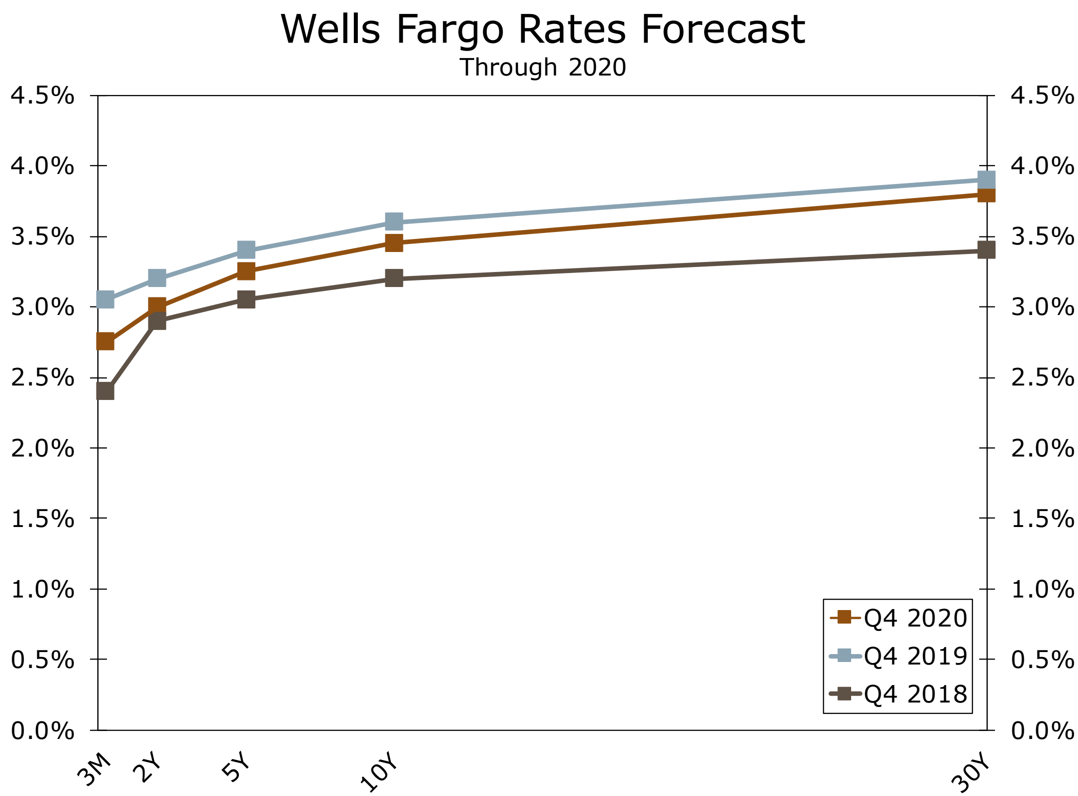


Source: Federal Reserve Board, Bloomberg LP and Wells Fargo Securities

Worries about the shape of the yield curve are pre-mature and we do not see the current flattening as indicative of an impending recession.

We expect the yield curve to steepen modestly later this year.

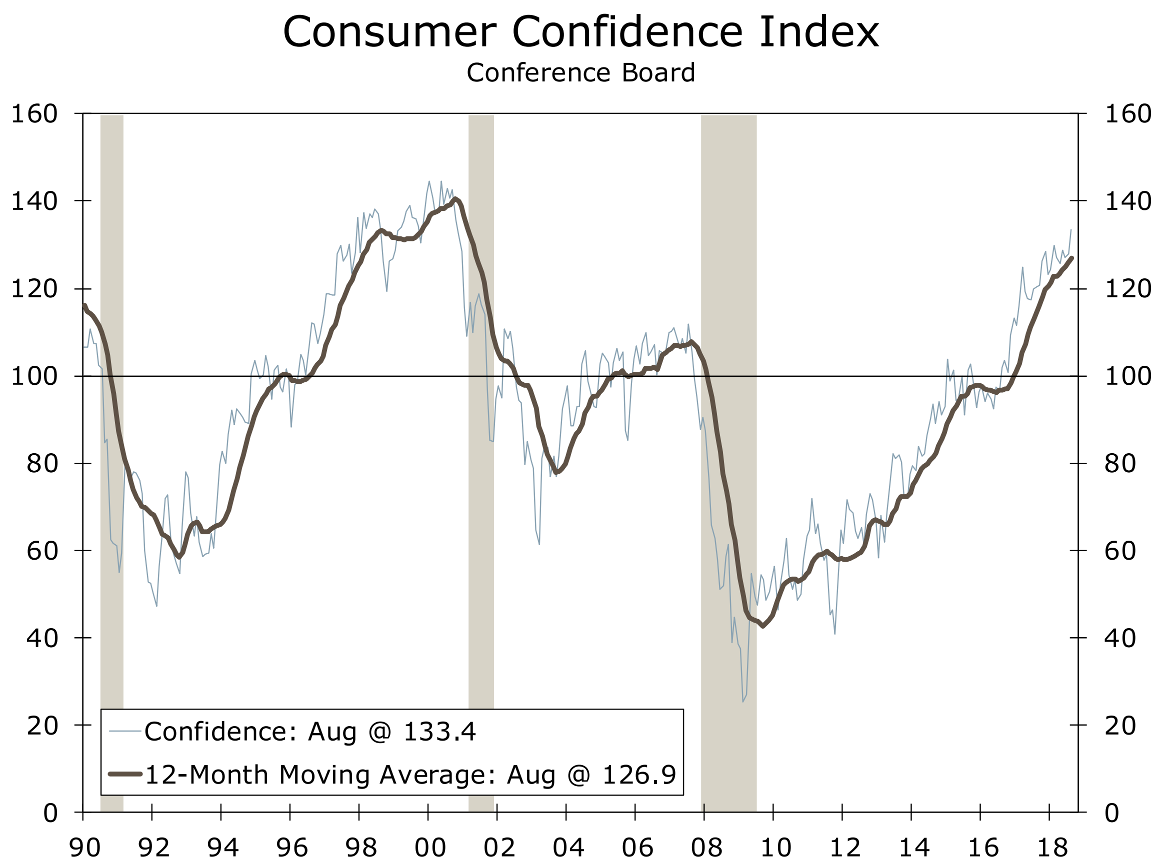
Stronger economic growth, the widening budget deficit, increased financing needs from the Treasury and accelerating inflation create upside risks to long rates in the near term.



Source: 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.

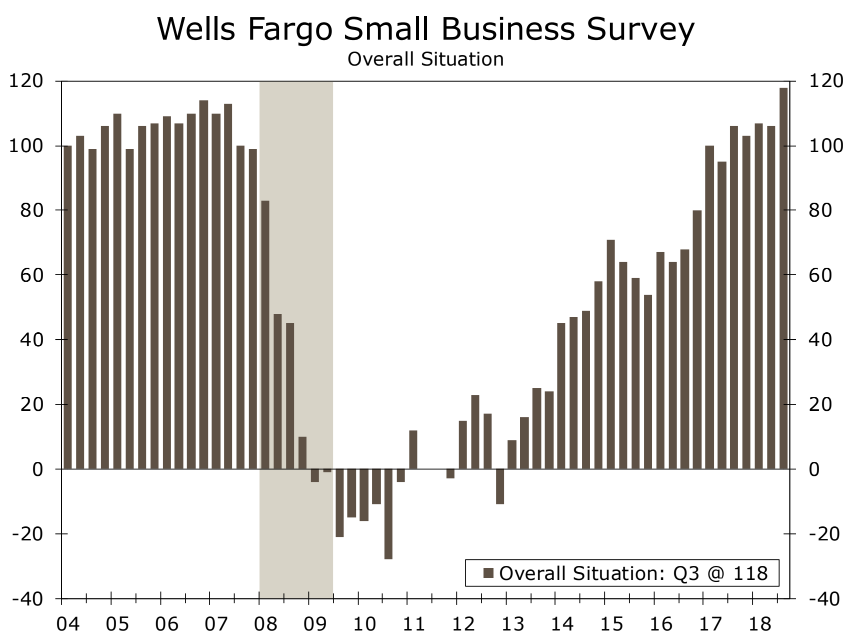
The acceleration in consumer confidence over the past couple of years resembles the pick up in confidence seen during the late 1990s and likely reflects a broadening of economic gains across more industries and geographies, making the expansion more durable.



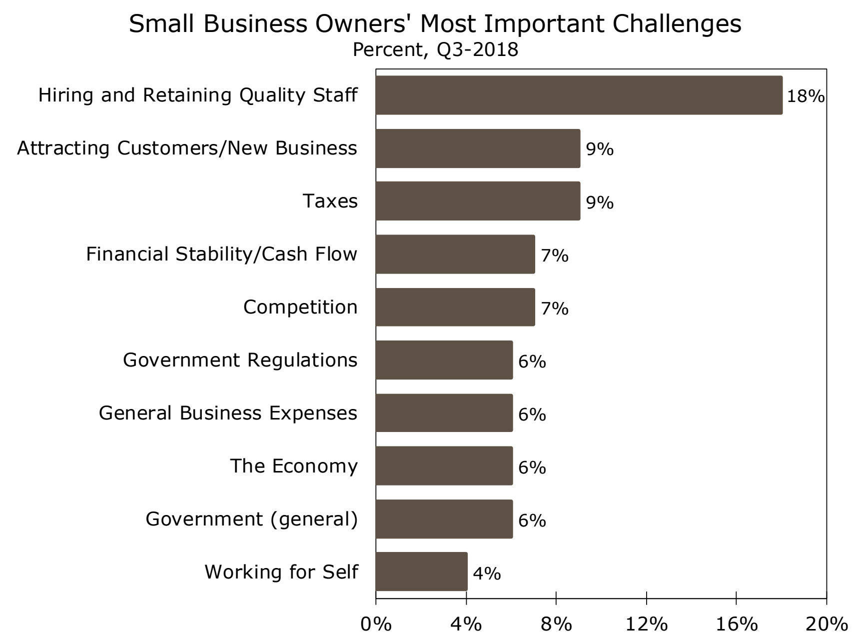
Source: Conference Board and Wells Fargo Securities

Both the Wells Fargo and NFIB surveys of Small Business Confidence have recently risen to all-time highs. More businesses are looking to expand. Finding and retaining workers has become a greater challenge, while concerns about taxes and regulations have receded.

Small Business Optimism



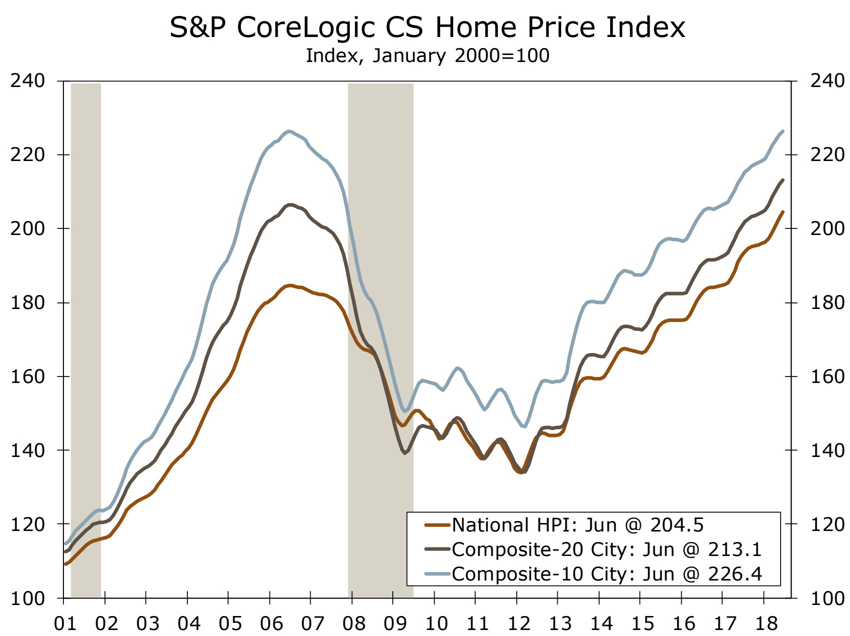
Small Business Challenges



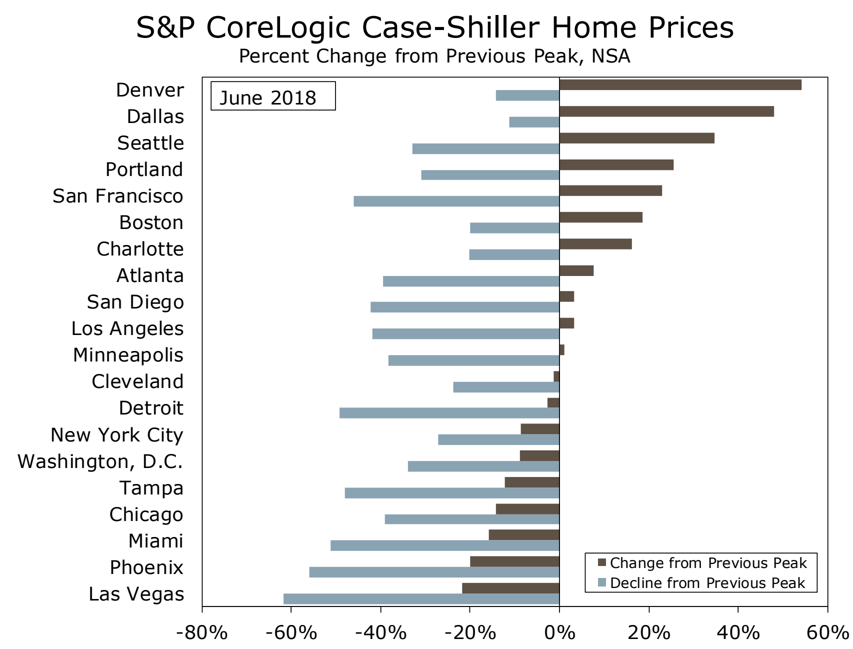
Source: Gallup, Wells Fargo Bank and Wells Fargo Securities

The recovery in home prices varies considerably throughout the country. Prices have risen fastest in rapidly growing tech-driven markets, mostly in the West. Several large East Coast markets have slowed, as foreign buying has dipped, slowing the rise in the 10-city index.

Home Prices



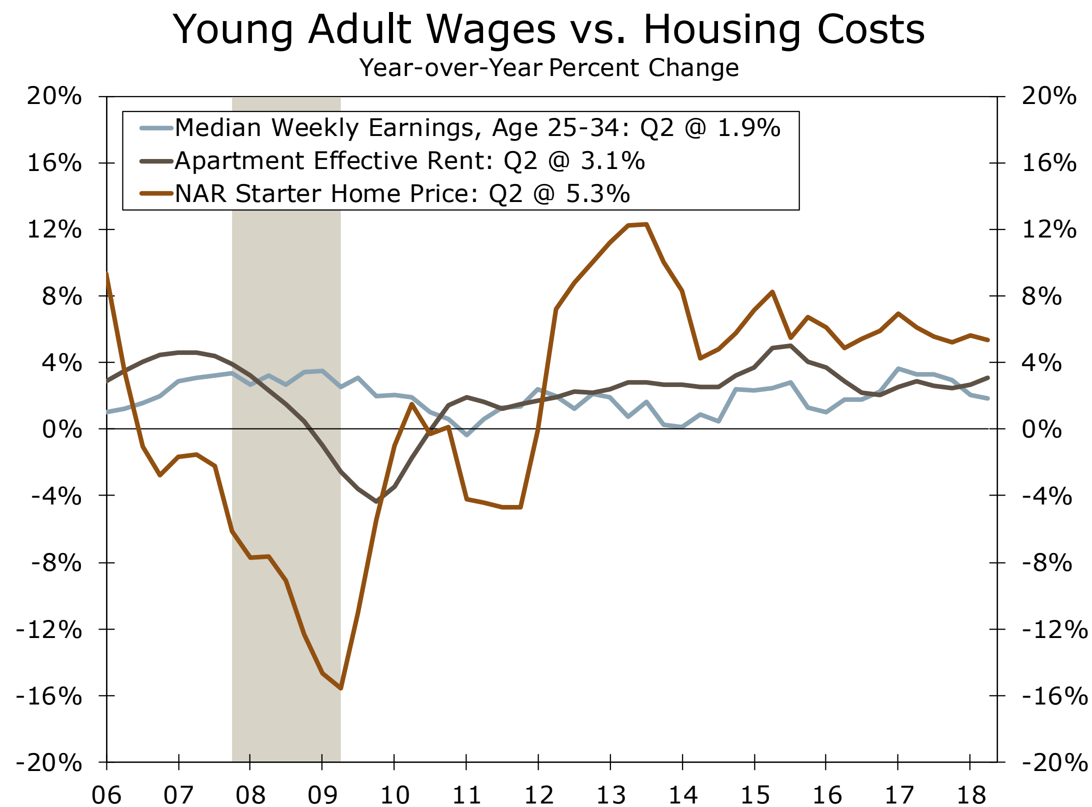
Regional



Source: S&P Case-Shiller, CoreLogic and Wells Fargo Securities

A major issue holding back housing is sluggish income growth compared to home price appreciation.

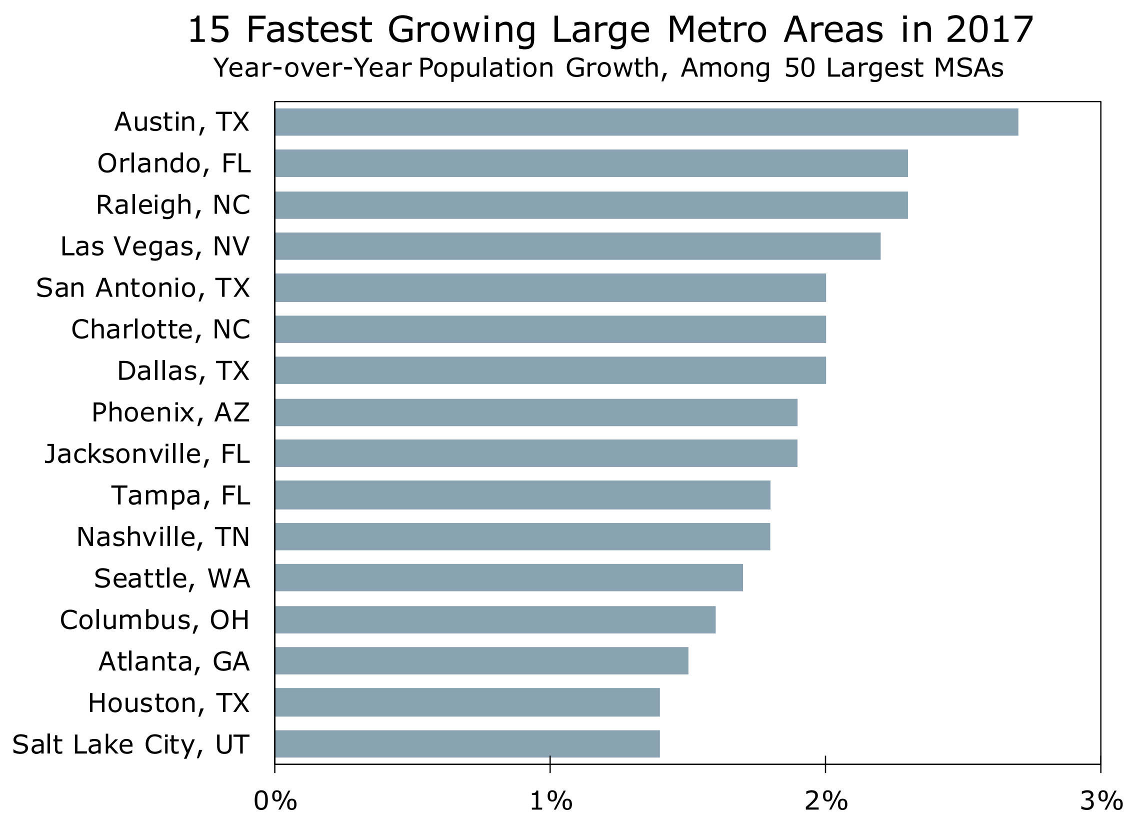
For young adults the challenge of sluggish income growth is compounded by high and more rapidly rising apartment rents, rising home prices, a dearth of entry-level homes, low savings and high student loan debt.



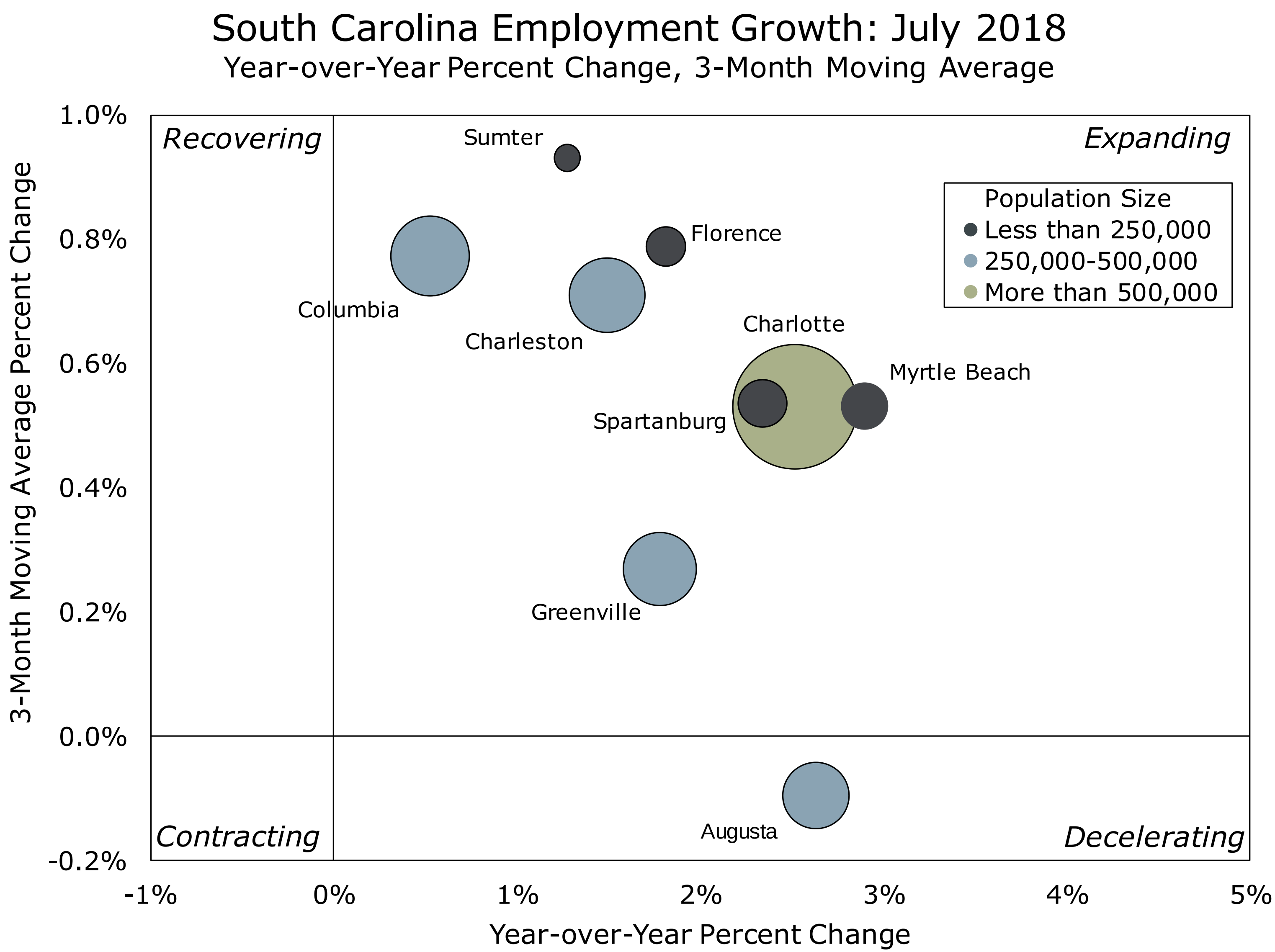
Source: U.S. Department of Commerce, National Association of Realtors and Wells Fargo Securities

Regional Commentary

Raleigh and Charlotte were two of the fastest growing metro areas by population in 2017 behind strong job growth and affordable cost of living.



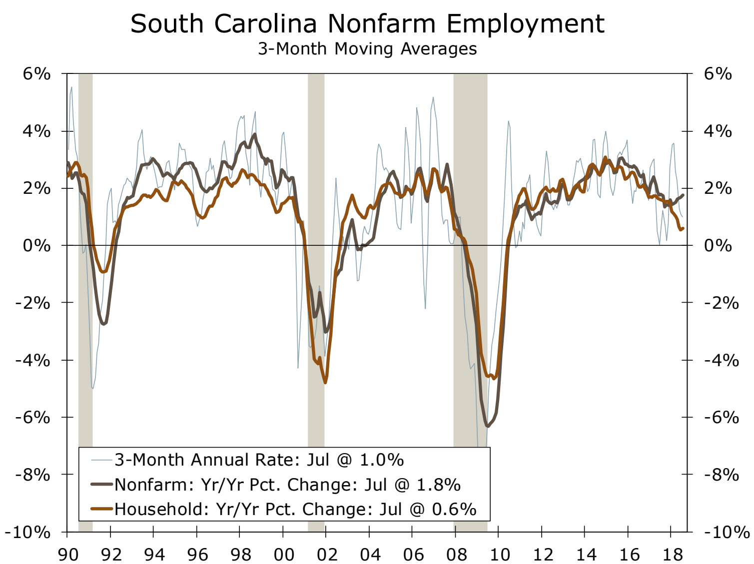
Source: U.S. Census Bureau and Wells Fargo Securities



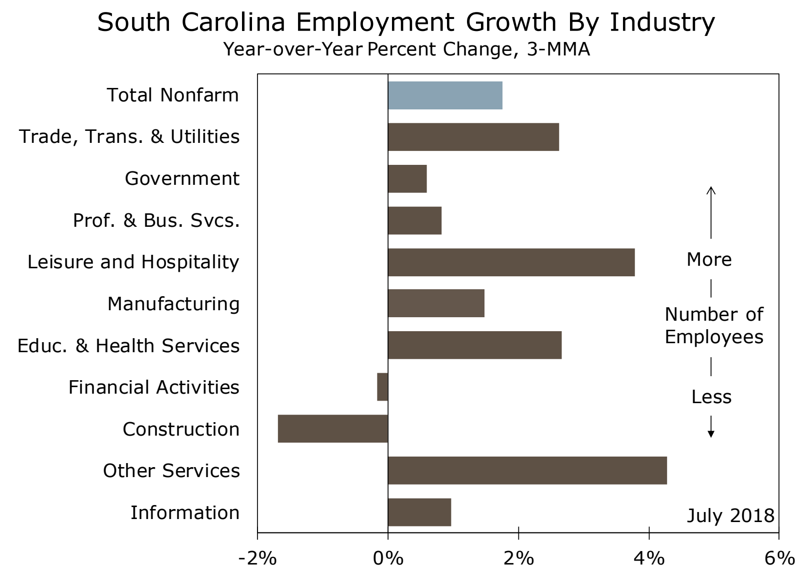
Source: U.S. Department of Labor and Wells Fargo Securities

Employment growth in South Carolina has been trending steadily lower since 2014.

Nonfarm Employment



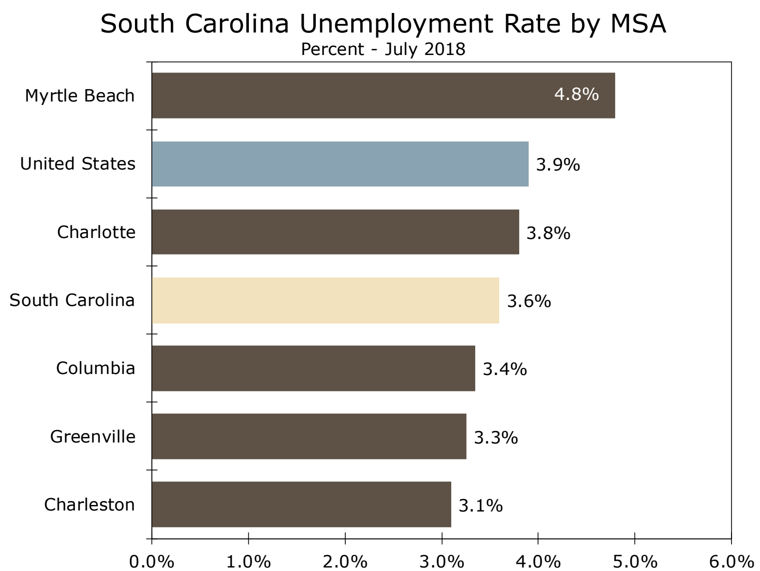
Employment by Industry



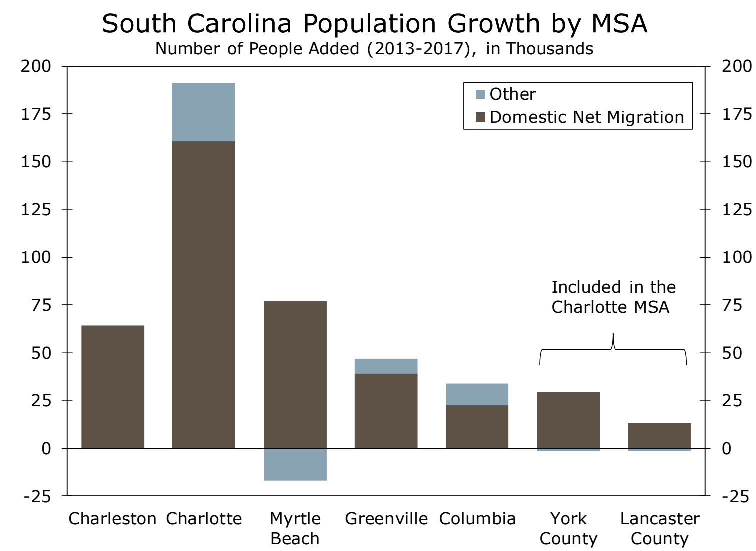
Source: U.S. Department of Labor and Wells Fargo Securities

The South Carolina labor market is tight, with unemployment below 4% in the biggest metros. Charlotte's population has been booming.

Unemployment Rate



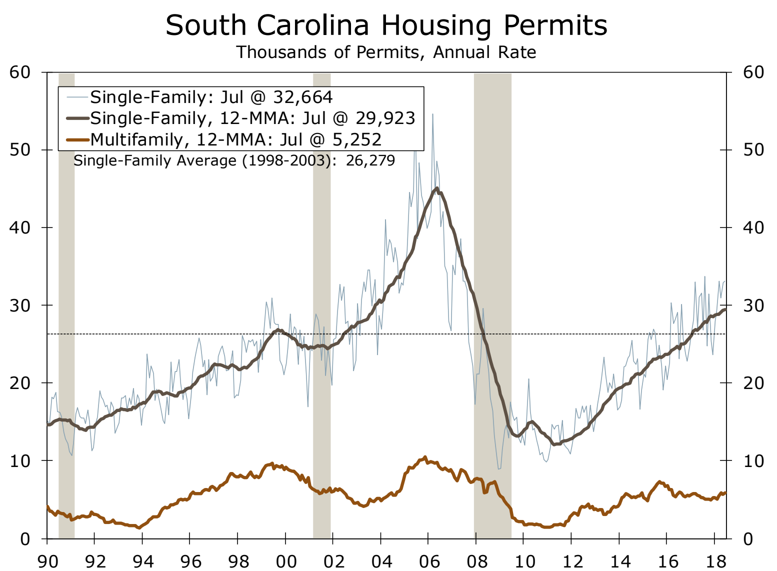
Population Growth



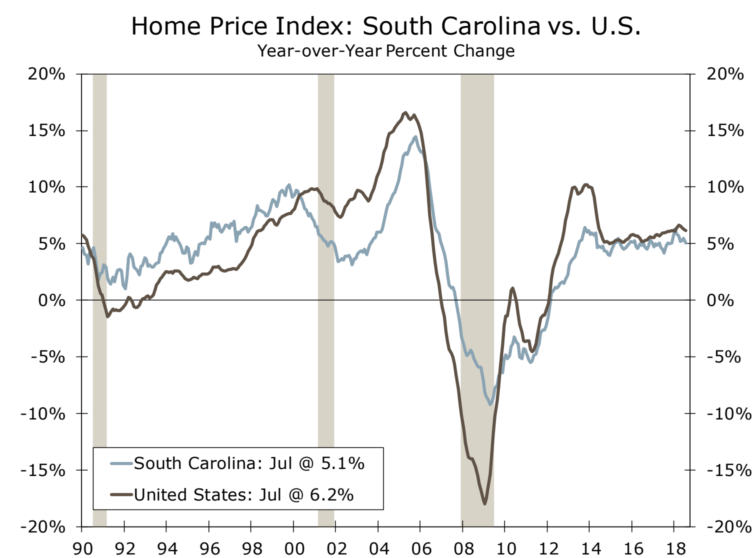
Source: U.S. Department of Commerce, CoreLogic, Inc. and Wells Fargo Securities

South Carolina is one of only a handful of states in the nation where the pace of single-family home building has surpassed its long term average. Housing remains affordable. Price appreciation slightly trails the nation, even though prices are rising off a lower base.

Housing Permits



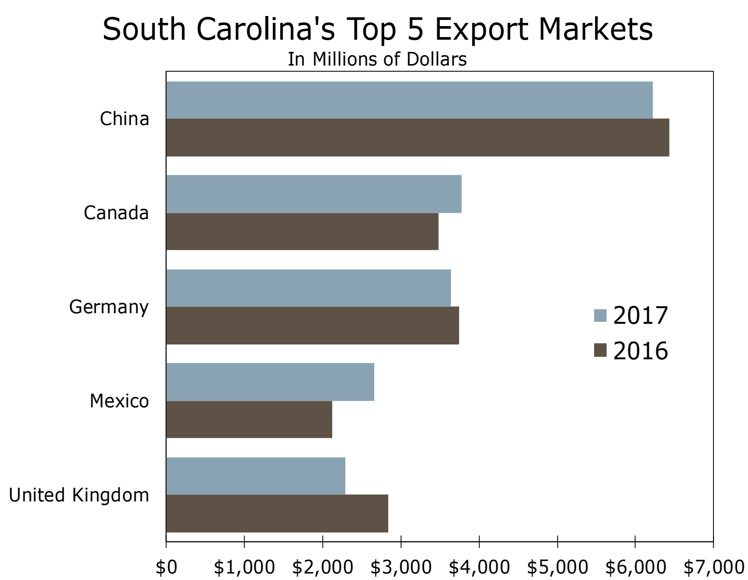
Home Prices



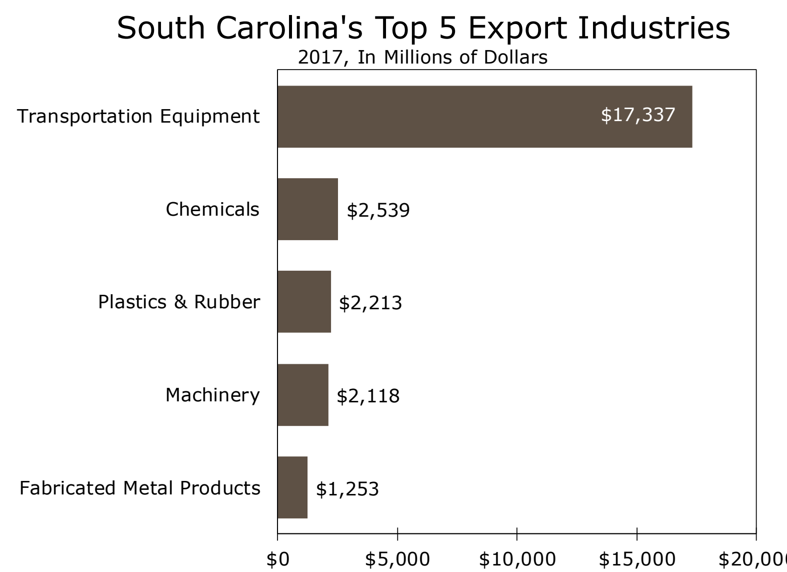
Source: U.S. Department of Commerce, CoreLogic, Inc. and Wells Fargo Securities

The slow approach of Hurricane Florence allowed exporters and the Port of Charleston to prepare well in advance, which should minimize storm-related disruptions. Ongoing trade discussions with China present a threat to exports but also a possible long-term upside benefit.

Export Destinations



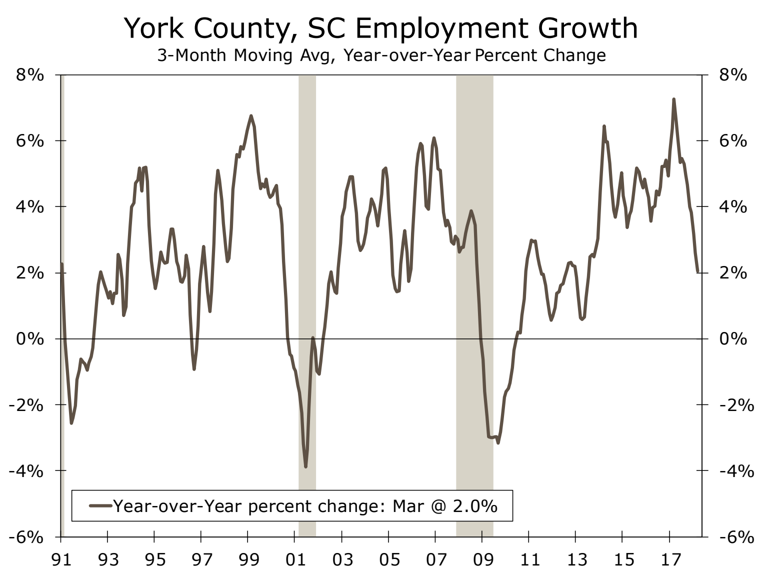
Export Products



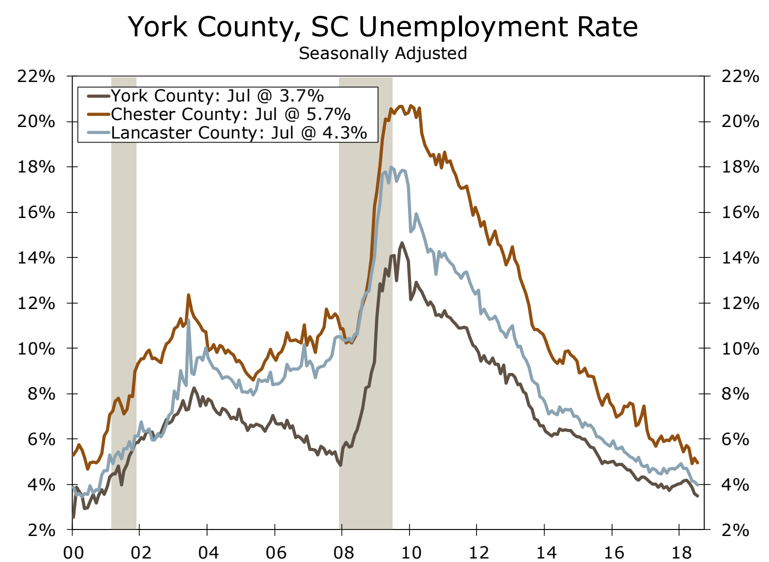
Source: U.S. Department of Commerce and Wells Fargo Securities

Employment growth in York County had moderated as the labor market continues to tighten.

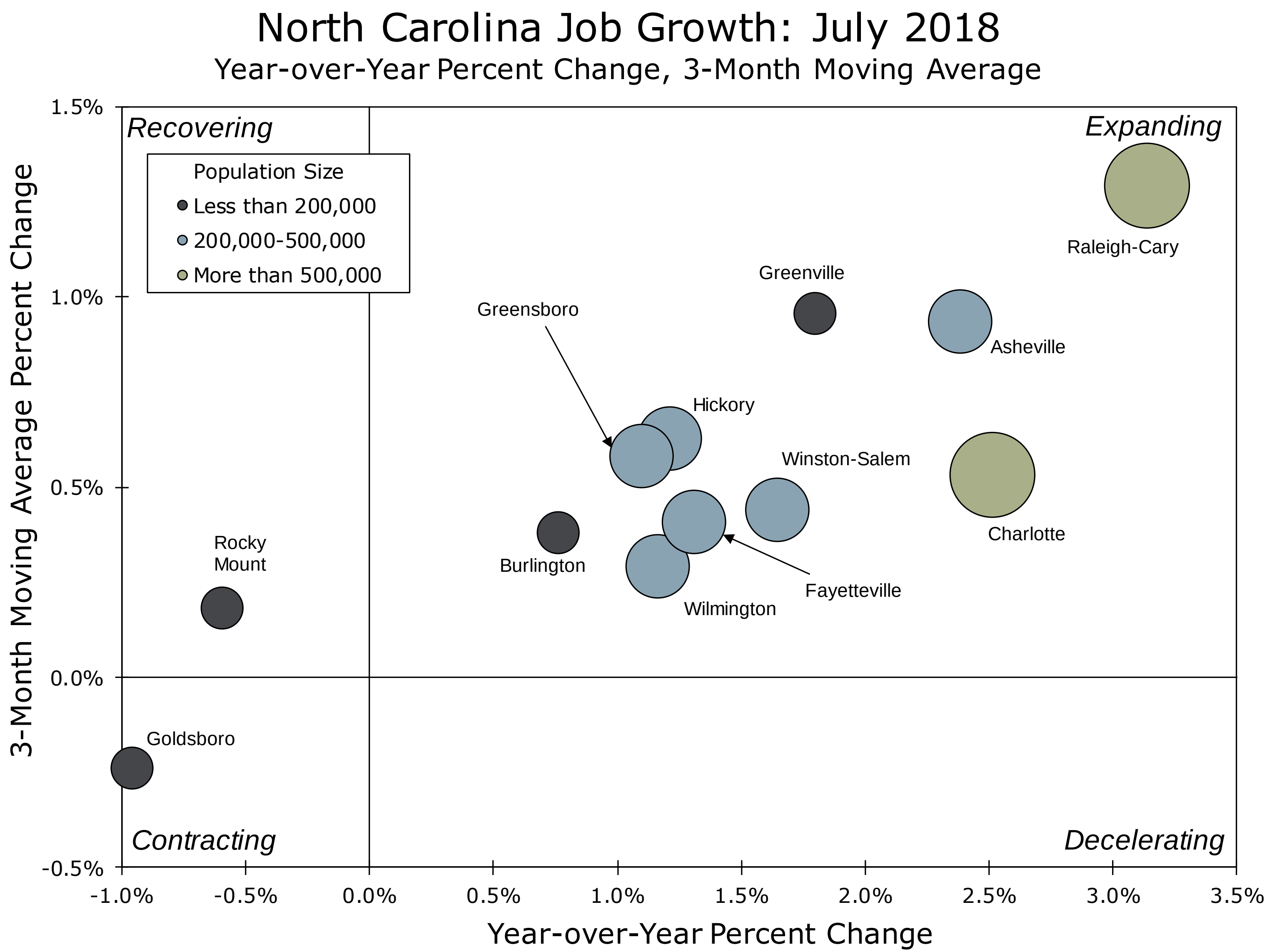
Employment



Unemployment Rate

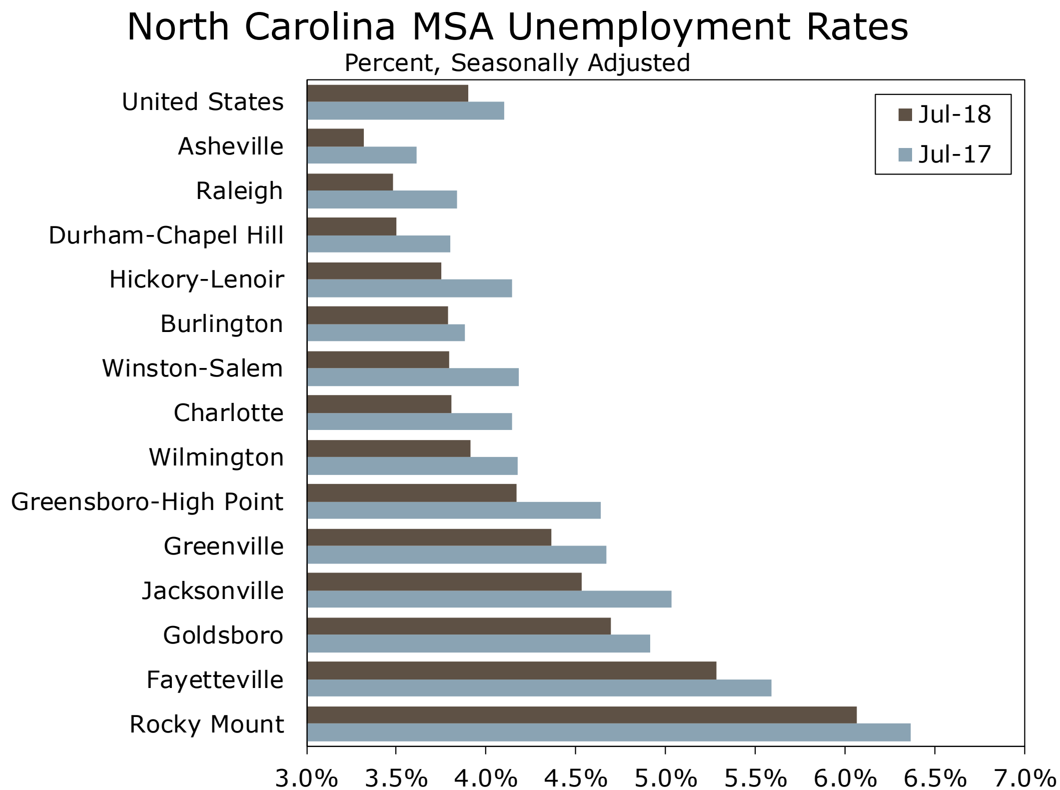


Source: U.S. Department of Commerce, U.S. Department of Labor and Wells Fargo Securities



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

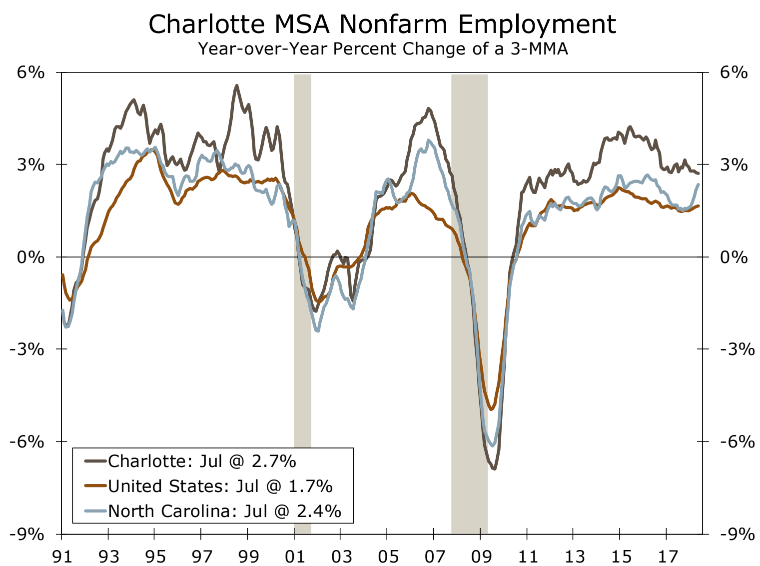
Unemployment rates have fallen significantly across the state over the past year, even in areas with chronically high unemployment.



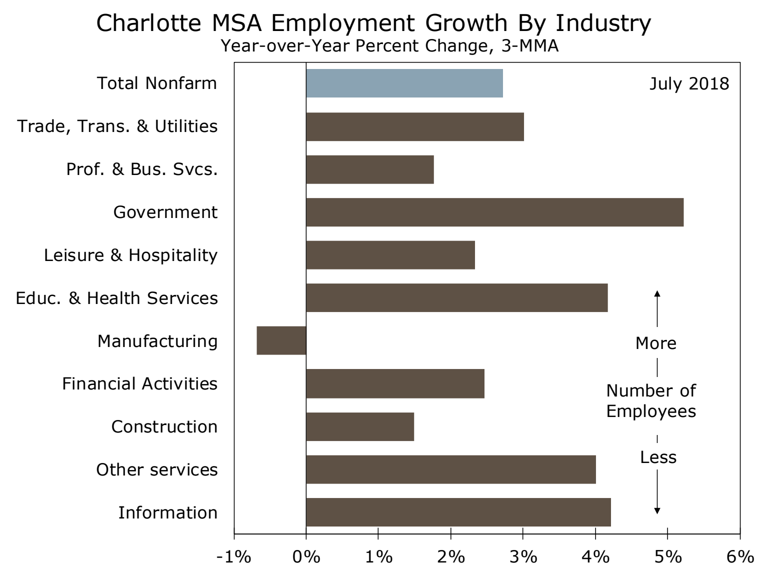
Source: U.S. Department of Labor and Wells Fargo Securities

Charlotte job growth leads the nation and the rest of the state. Nearly every industry in the metro area is growing, with the government and information sectors leading gains.

Nonfarm Employment



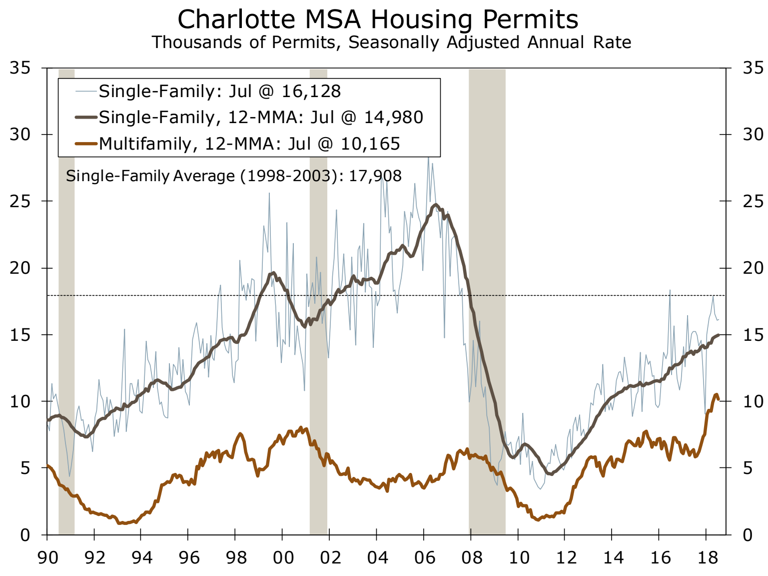
Employment by Industry



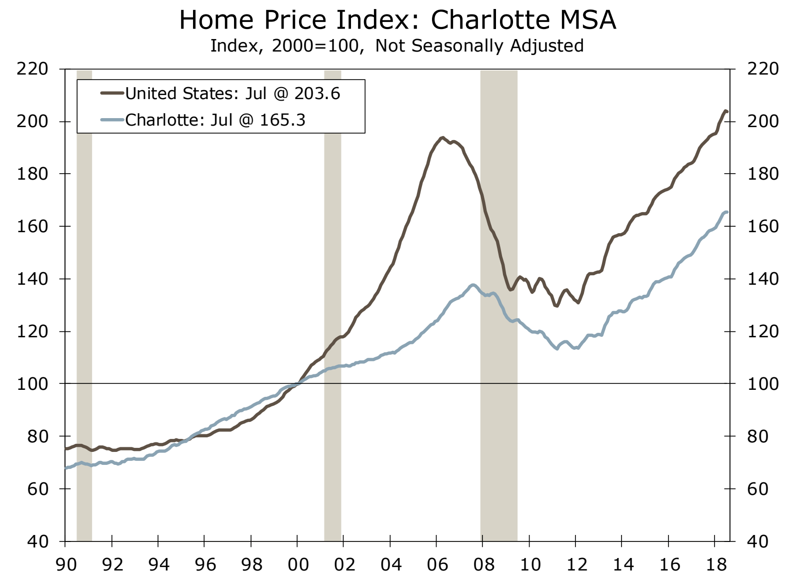
Source: U.S. Department of Labor and Wells Fargo Securities

Apartment construction has been incredibly strong during the past few years, with much of the development in and around downtown. Single-family permits posted consistent gains, but remain below their long-run average still. Home prices are rising solidly but Charlotte remains affordable relative to the nation and comparably sized areas around the country.

Housing Permits

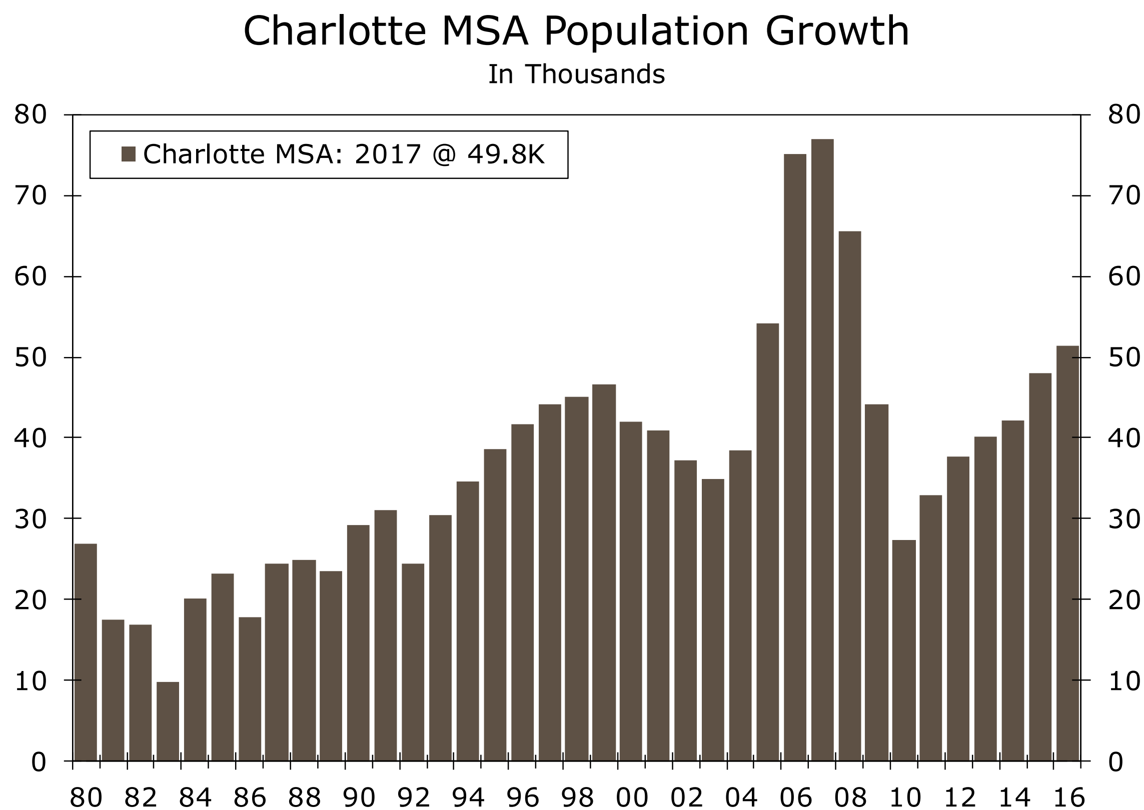


Home Prices



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

Charlotte population growth has accelerated for six straight years, reflecting strong job growth and the region's desirable quality of life. Both young and older residents are relocating to the region, with retirees clustering in Charlotte's South Carolina suburbs and many in-town submarkets.



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

Wells Fargo U.S. Economic Forecast

	Actual						Forecast										Actual		Forecast		
	2017				2018				2019				2020				2016	2017	2018	2019	2020
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product [1]	1.8	3.0	2.8	2.3	2.2	4.2	3.1	2.8	2.6	2.9	2.6	2.4	2.2	2.0	1.9	1.8	1.6	2.2	2.9	2.8	2.2
Personal Consumption	1.8	2.9	2.2	3.9	0.5	3.8	2.9	2.8	2.2	2.9	2.6	2.5	2.1	2.2	1.8	1.7	2.7	2.5	2.6	2.7	2.2
Business Fixed Investment	9.6	7.3	3.4	4.8	11.5	8.5	6.8	5.1	4.7	4.9	4.4	4.0	3.7	3.6	2.9	2.8	0.5	5.3	7.4	5.2	3.7
Equipment	9.1	9.7	9.8	9.9	8.5	4.4	6.9	4.3	3.8	4.2	3.7	3.1	2.7	2.6	2.1	2.0	-1.5	6.1	7.7	4.3	2.8
Intellectual Property Products	8.0	6.6	1.7	0.7	14.1	11.0	7.1	5.2	4.8	5.3	4.7	4.6	4.7	4.6	3.7	3.6	7.5	4.6	7.5	5.6	4.5
Structures	12.8	3.8	-5.7	1.3	13.9	13.2	7.0	7.0	6.5	6.0	5.5	5.0	4.5	4.0	3.5	3.5	-5.0	4.6	6.8	6.7	4.5
Residential Construction	11.1	-5.5	-0.5	11.1	-3.4	-1.6	2.0	4.0	5.5	5.0	4.5	4.0	3.5	3.0	2.5	2.0	6.5	3.3	0.9	4.0	3.5
Government Purchases	-0.8	0.0	-1.0	2.4	1.5	2.4	3.4	2.9	2.2	1.4	0.8	0.7	0.7	0.5	0.3	0.1	1.4	-0.1	1.7	2.1	0.6
Net Exports [2]	-0.1	0.1	0.0	-0.9	0.0	1.2	-1.2	-0.6	-0.3	-0.5	-0.3	-0.2	0.0	-0.2	0.1	0.1	-0.4	-0.4	-0.2	-0.4	-0.1
Inventories [2]	-0.8	0.2	1.0	-0.9	0.3	-1.0	1.2	0.1	0.1	0.2	0.1	0.0	0.0	0.0	0.0	0.0	-0.6	0.0	0.0	0.2	0.0
Nonfarm Payroll Change [3]	177	190	142	221	218	217	179	180	170	170	160	160	150	140	100	90	195	182	199	165	120
Unemployment Rate	4.7	4.3	4.3	4.1	4.1	3.9	3.9	3.8	3.7	3.6	3.6	3.5	3.4	3.3	3.3	3.3	4.9	4.4	3.9	3.6	3.3
Consumer Price Index [4]	2.6	1.9	2.0	2.1	2.3	2.6	2.6	2.4	2.2	2.4	2.6	2.7	2.6	2.5	2.3	2.4	1.3	2.1	2.5	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	2.75	3.00	3.25	3.25	3.25	3.25	3.25	3.00	0.52	1.13	2.13	3.06	3.19
Conventional Mortgage Rate	4.20	3.90	3.81	3.94	4.44	4.57	4.60	4.80	4.95	5.05	5.15	5.20	5.15	5.15	5.10	5.05	3.65	3.99	4.60	5.09	5.11
2 Year Note	1.27	1.38	1.47	1.89	2.27	2.52	2.75	2.90	3.05	3.10	3.20	3.20	3.15	3.15	3.10	3.00	0.83	1.40	2.61	3.14	3.10
10 Year Note	2.40	2.31	2.33	2.40	2.74	2.85	3.00	3.20	3.35	3.45	3.55	3.60	3.55	3.55	3.50	3.45	1.84	2.33	2.95	3.49	3.51

Forecast as of: September 12, 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 Global Insight and Wells Fargo Securities

Appendix

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A Sampling of Our Recent Special, Regional & Industry Commentary

Recent Special Commentary

Date	Title	Authors
	U.S. Macro	
August-03	The Animal Spirits Index A Update	Iqbal & Vaisey
August-01	FOMC Remains on Hold, But More Rate Hikes Clearly on the Way	Bryson
August-01	The Low-Skill Labor Crunch	House & Vaisey
August-01	Treasury Refunding Preview	Bryson & Pugliese
July-31	Is the FOMC Overly-Optimistic	Silvia, Iqbal & Kinnaman
	U.S. Regional	
July-19	California Payrolls Flat in June	Vitner & Dougherty
July-19	Solid Gain for Texas Payrolls in June	Vitner & Dougherty
July-19	North Carolina Job Growth Picked Up Considerably in June	Vitner & Dougherty
July-19	Florida Employment Ramps Up in June	Vitner & Dougherty
July-19	Minnesota Payrolls Expand in June	Vitner & Dougherty
	Global Economy	
July-31	Taiwanese GDO Growth Tops Expectations in Q2	Bryson & Pugliese
July-31	Eurozone Mid-Year Economic Outlook	Bryson & Kinnaman
July-30	Swedish GDP Grew Strongly in Q2-2018	Bryson
July-27	South Korea as Yardstick for Measuring Trade Tension	Quinlan
July-16	China Mid-Year Economic Outlook	Bryson & Pugliese
	Interest Rates/Credit Market	
August-01	Corporate Loans in a World of Rising Rates	Silvia & Vaisey
July-25	Household Balance Sheets Remain Solid in Q1	Silvia & Kinnaman
July-18	Is Credit Growth Driving Economic Growth?	Silvia, Iqbal, Kinnaman & Seery
July-11	The Flattening Yield Curve: To Worry or Not to Worry?	Silvia, Iqbal & Seery
June-27	Rising Rates and Corporate Balance Sheets: The Long View	Silvia & Kinnaman
	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
April-19	Southern States: 2018 Economic Outlook	Vitner, Feik & Carmichael
April-06	Housing Chartbook: April 2018	Vitner, Dougherty & Carmichael

Wells Fargo Securities Economics Group

Global Head of Research, Economics & Strategy	
Diane Schumaker-Krieg	diane.schumaker@wellsfargo.com
Global Head of Research, Economics & Strategy	

Senior Economists	
Jay H. Bryson, Global Economist	jay.bryson@wellsfargo.com
Mark Vitner, Senior Economist	mark.vitner@wellsfargo.com
Sam Bullard, Senior Economist	sam.bullard@wellsfargo.com
Nick Bennenbroek, Currency Strategist	nicholas.bennenbroek@wellsfargo.com
Azhar Iqbal, Econometrician	azhar.iqbal@wellsfargo.com
Tim Quinlan, Senior Economist	tim.quinlan@wellsfargo.com
Sarah House, Senior Economist	sarah.house@wellsfargo.com

Economists	
Charlie Dougherty, Economist	charles.dougherty@wellsfargo.com
Erik Nelson, Currency Strategist	erik.f.nelson@wellsfargo.com
Michael Pugliese, Economist	michael.d.pugliese@wellsfargo.com

Economic Analysts	
Ariana Vaisey, Economic Analyst	ariana.b.vaisey@wellsfargo.com
Abigail Kinnaman, Economic Analyst	abigail.kinnaman@wellsfargo.com
Shannon Seery, Economic Analyst	shannon.seery@wellsfargo.com
Matthew Honnold, Economic Analyst	matthew.honnold@wellsfargo.com

Administrative Assistants	
Donna LaFleur, Executive Assistant	donna.lafleur@wellsfargo.com
Dawne Howes, Administrative Assistant	dawne.howes@wellsfargo.com