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U.S. Economic Outlook

Charlie Dougherty, Vice President & Economist
September 18, 2018

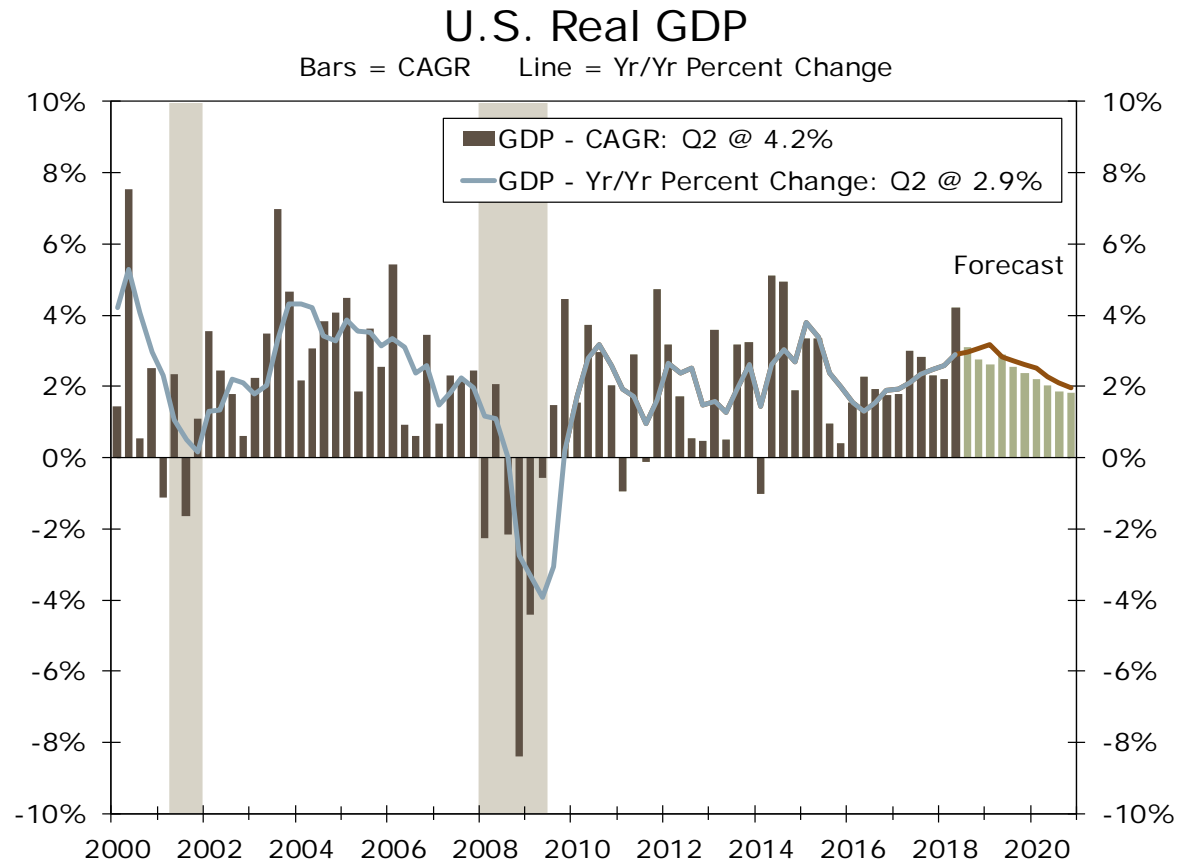
Together we'll go far



Economic Growth Expected to Accelerate in 2018

After a slow start, real GDP rebounded strongly in the second quarter.

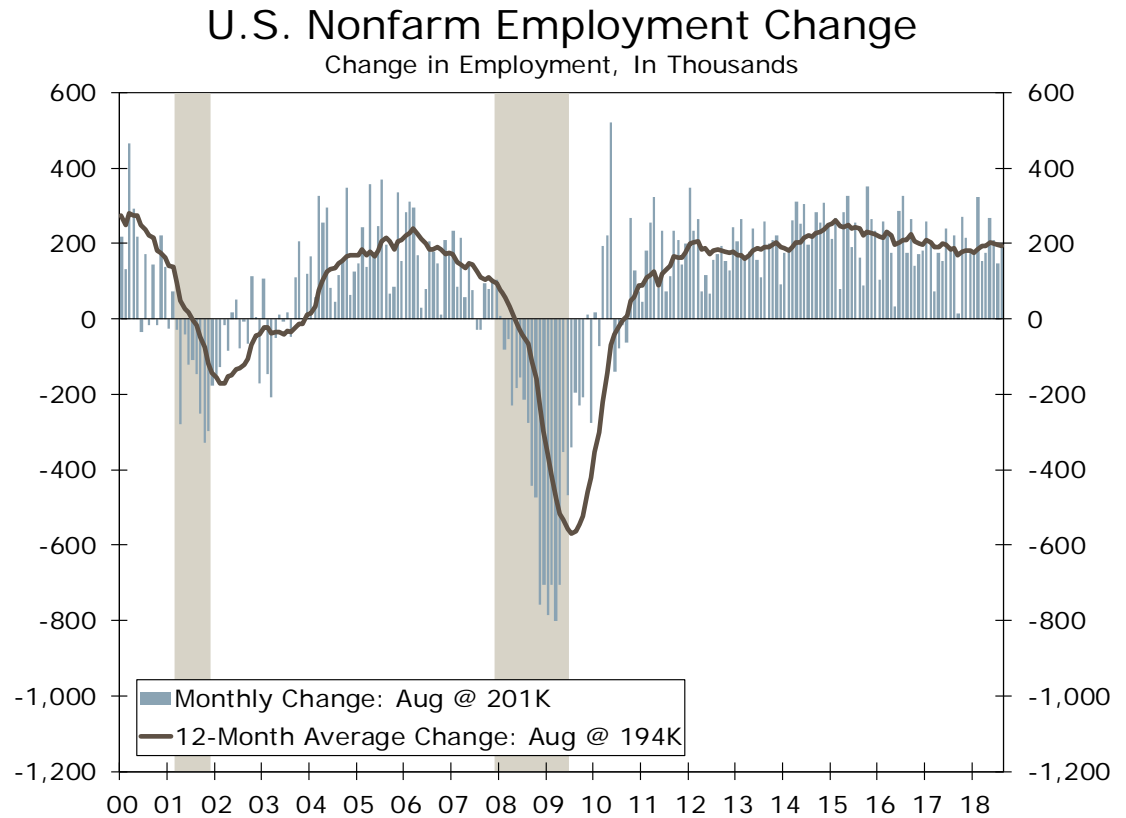
We expect the economy to continue to expand and grow nearly 3 percent for the year.



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

Employment Situation: Employment Growth Strong

Hiring has had a strong start to the year, continuing the streak of 90+ months of positive gains.

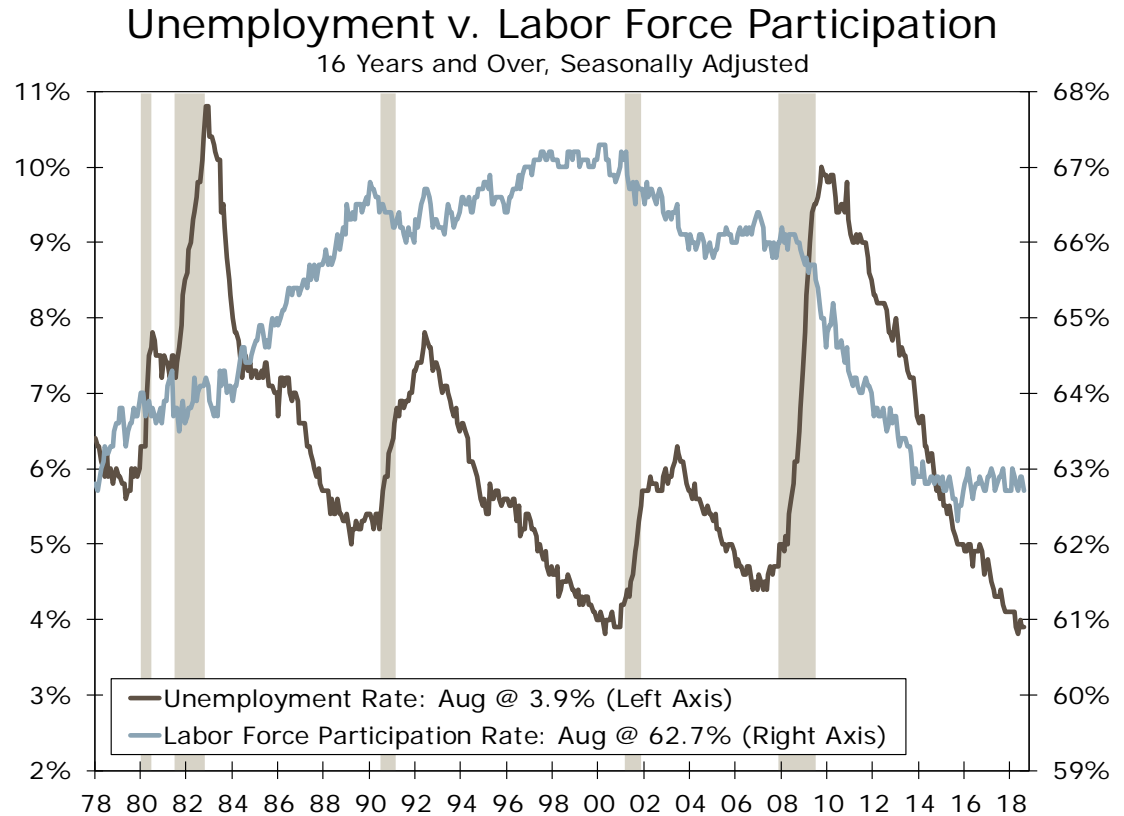


Source: U.S. Department of Labor and Wells Fargo Securities

Employment Situation: Tightening Labor Market

The unemployment rate has fallen considerably over the course of the recovery.

Strong employment growth has also helped counter the downward pressure on labor force participation from an aging population.

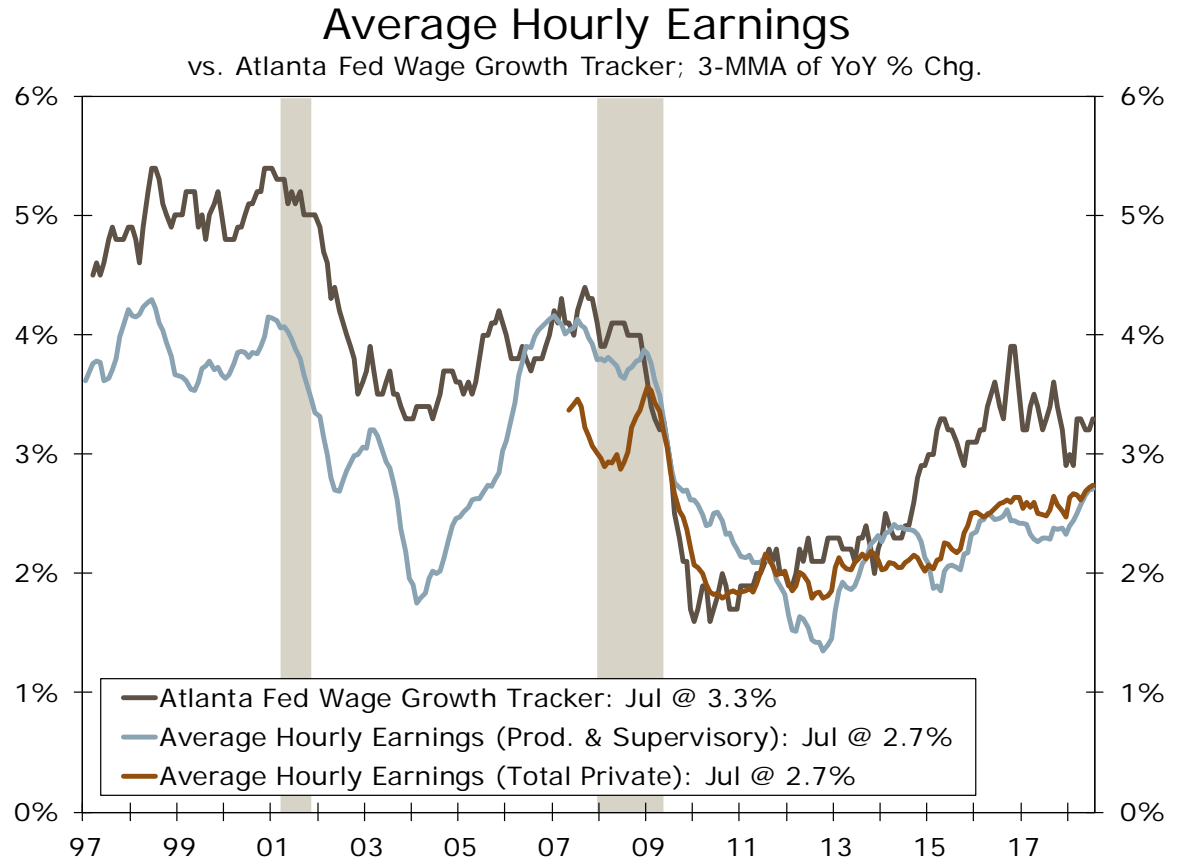


Source: U.S. Department of Labor and Wells Fargo Securities

Workers' Earnings Drift Upward

Wage growth has picked up modestly but remains a missing piece to the recovery thus far.

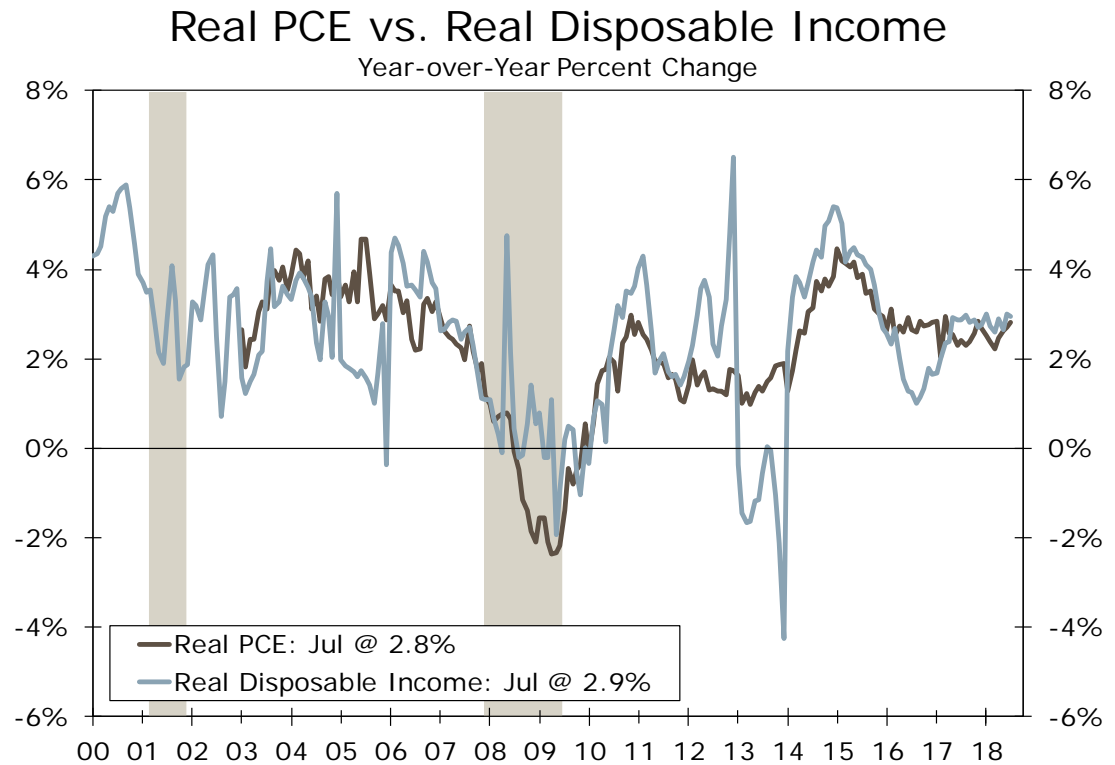
Earnings have been limited by lower-skilled workers entering the workforce and Baby Boomers beginning to retire.



Source: U.S. Department of Labor, Federal Reserve Bank of Atlanta and Wells Fargo Securities

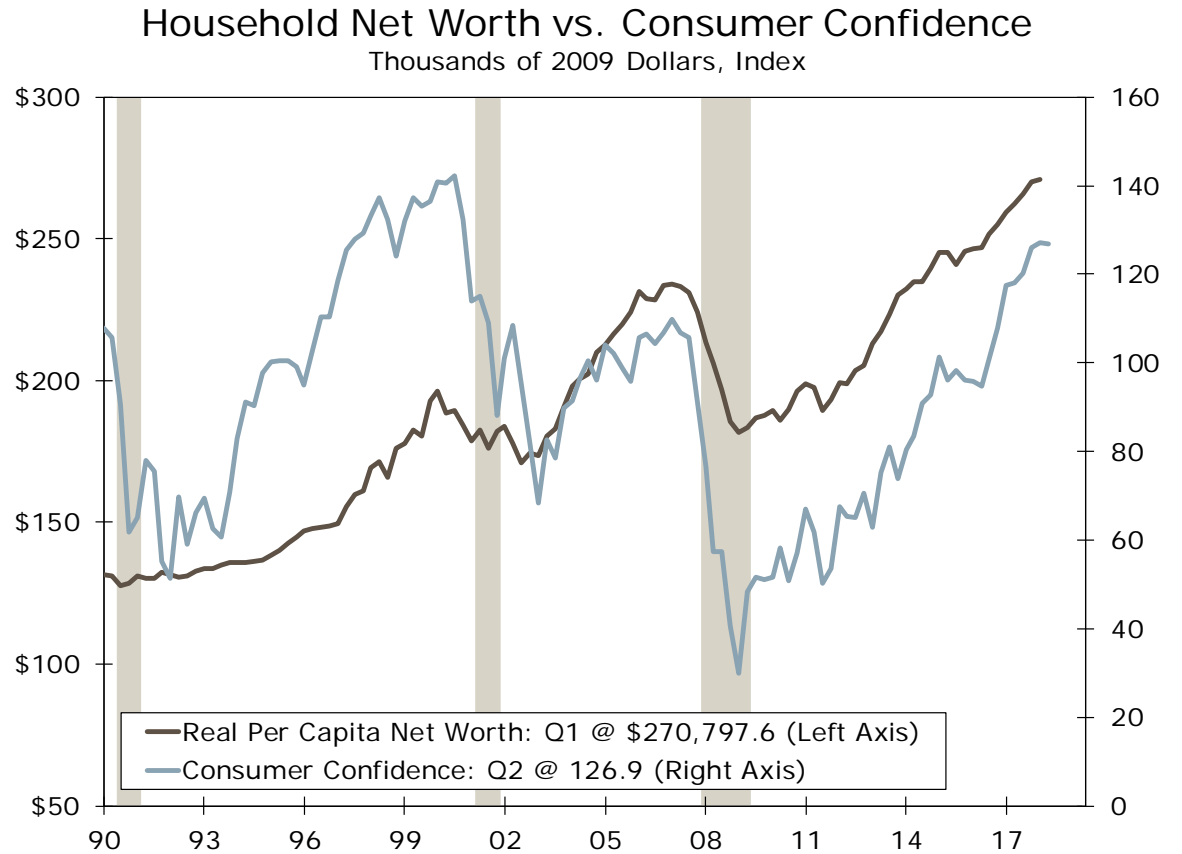
Income Growth

Stronger employment and wage growth has boosted incomes and supported consumer spending.



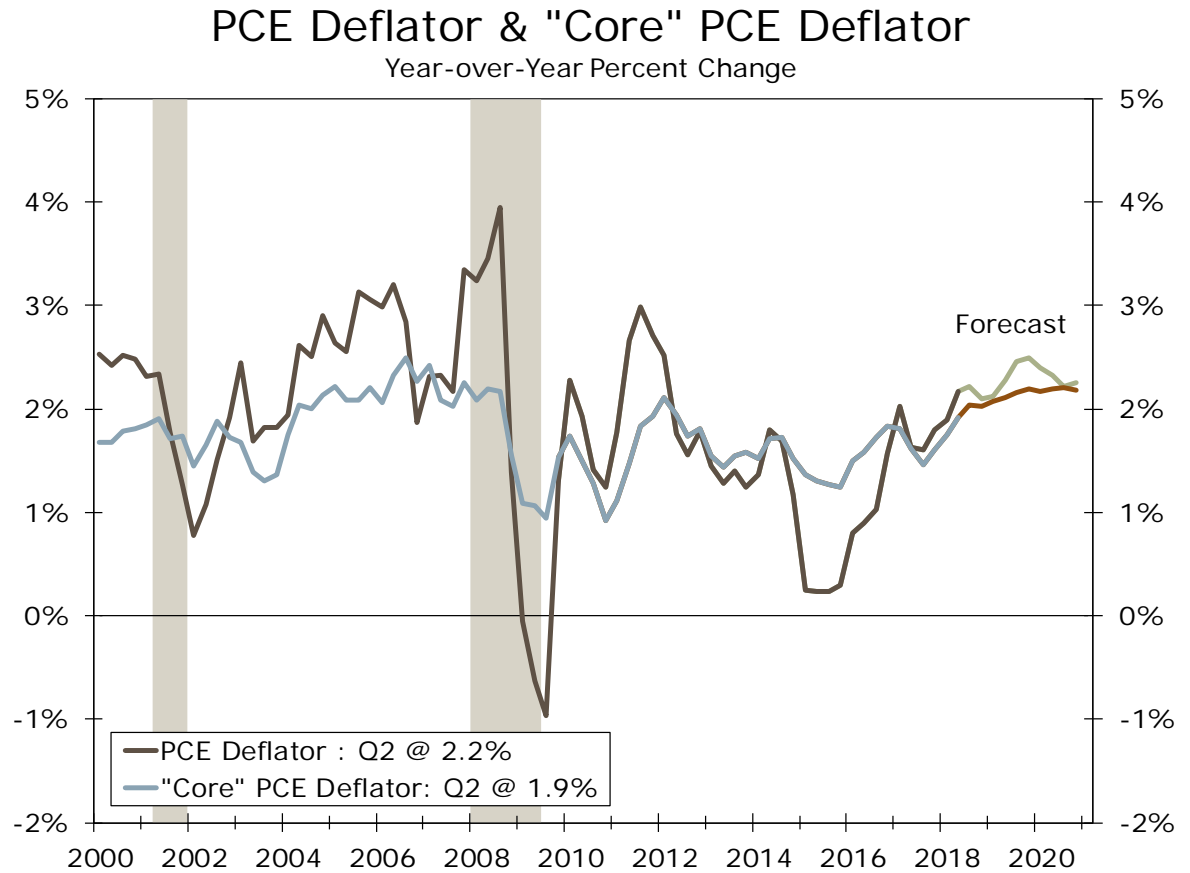
Source: U.S. Department of Commerce and Wells Fargo Securities

The recovery in household wealth has helped to fuel consumer confidence and spending



Source: Federal Reserve Board, Conference Board and Wells Fargo Securities

Inflationary pressures have increased recently and are now at the Fed's 2 percent benchmark.

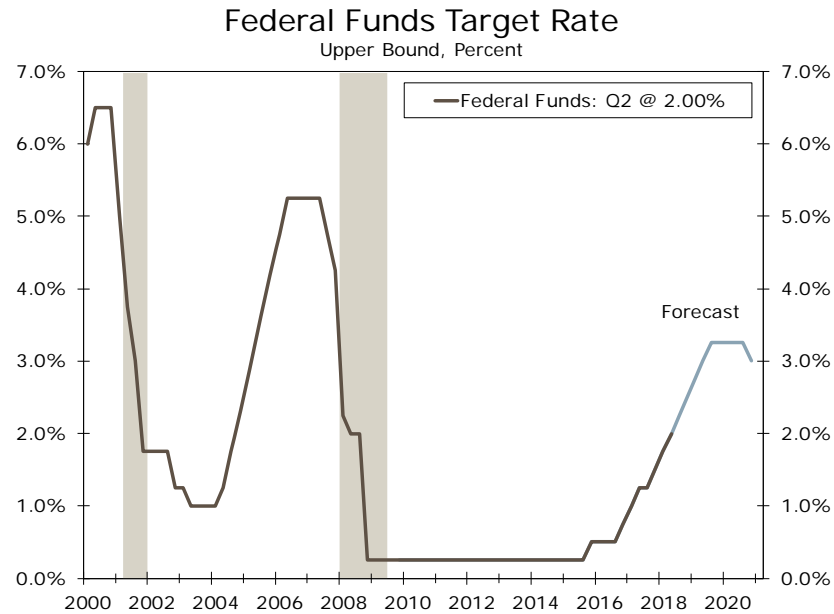


Source: U.S. Department of Commerce and Wells Fargo Securities

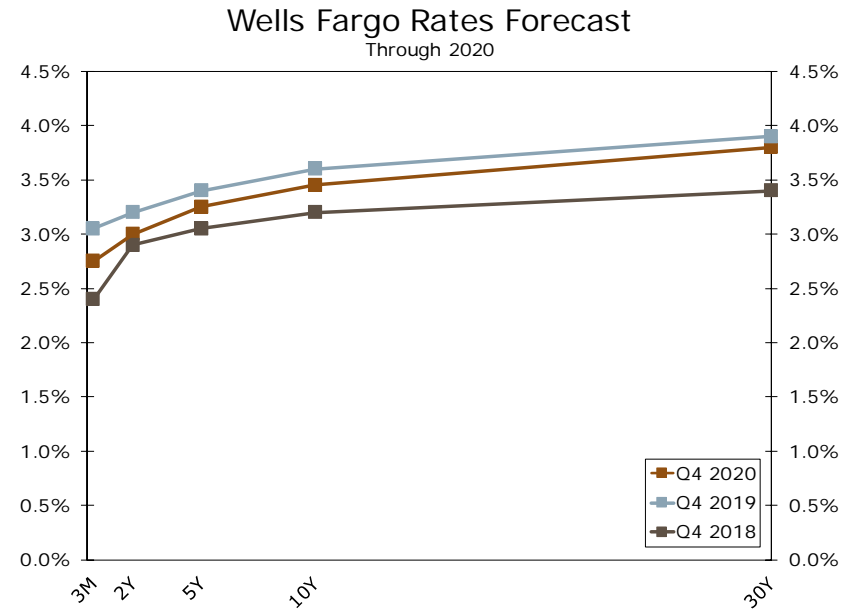
Interest Rates

The Fed is expected to hike rates two more times this year, bringing the fed funds rate closer to a more “normal” level and flattening the yield curve.

Monetary Policy



Interest Rates



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

Key Tax Law Changes

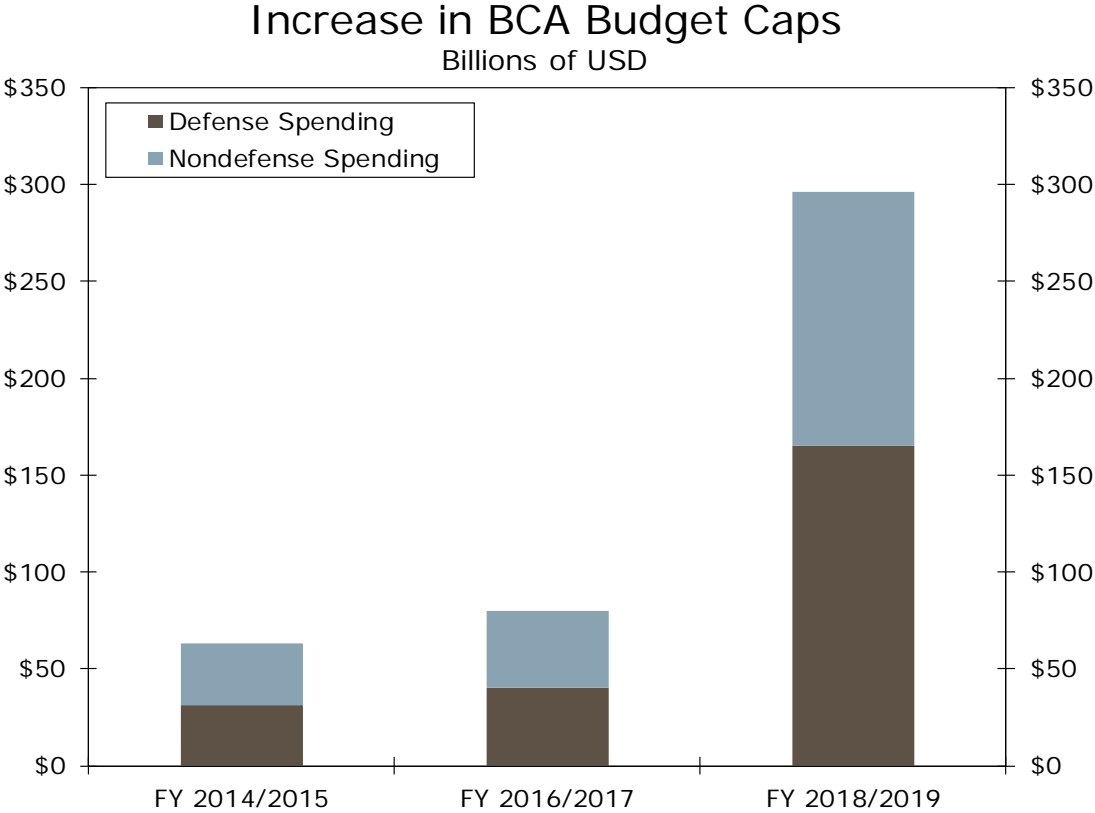
Individual Tax Code Changes

- Bill slashes marginal tax rates across the board
- Limits state & local income and property tax deductions to \$10,000
- Pass-throughs would be allowed to deduct up to 20 percent of income
- Doubles the standard deduction and the child tax credit
- Caps mortgage interest deduction at \$750K
- Doubles the estate tax exemption
- Keeps the Alternative Minimum Tax (AMT) but lifts the threshold to \$500K
- Maintains several deductions including medical expenses, student loans and private activity bonds (PABs)
- Repeals Obamacare individual mandate
- Individual cuts expire on December 31, 2025

Business Tax Code Changes

- Permanently reduces the corporate tax rate to 21% from the current 35% federal rate starting in 2018
- Corporate AMT repealed
- Business interest expense deductions are capped at 30 percent of EBITDA for 4 years and 30 percent of EBIT thereafter
- The bill allows for full and immediate expensing of business capital investments. This provision expires in five years.
- Ends the current worldwide corporate tax system by switching to a territorial system. Existing profits held abroad are taxed at 15.5 percent for cash and cash equivalents and 8 percent for reinvested foreign earnings.

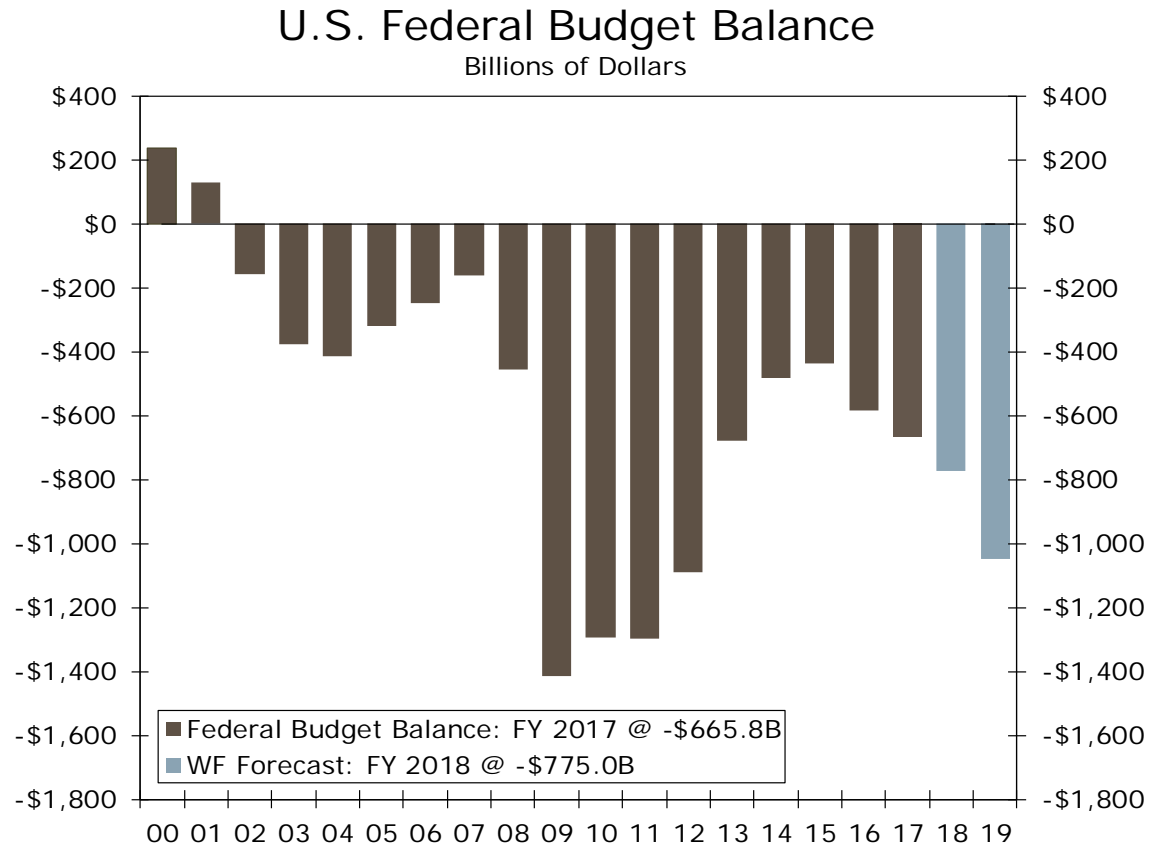
The budget deal reached in February provides additional fiscal stimulus to the U.S. economy



Source: Congressional Budget Office and Wells Fargo Securities

Budget Deficit

The Tax Cuts and Jobs Act, budget deal and mandatory spending have the deficit on track to breach \$1 trillion while the economy is still in an expansion

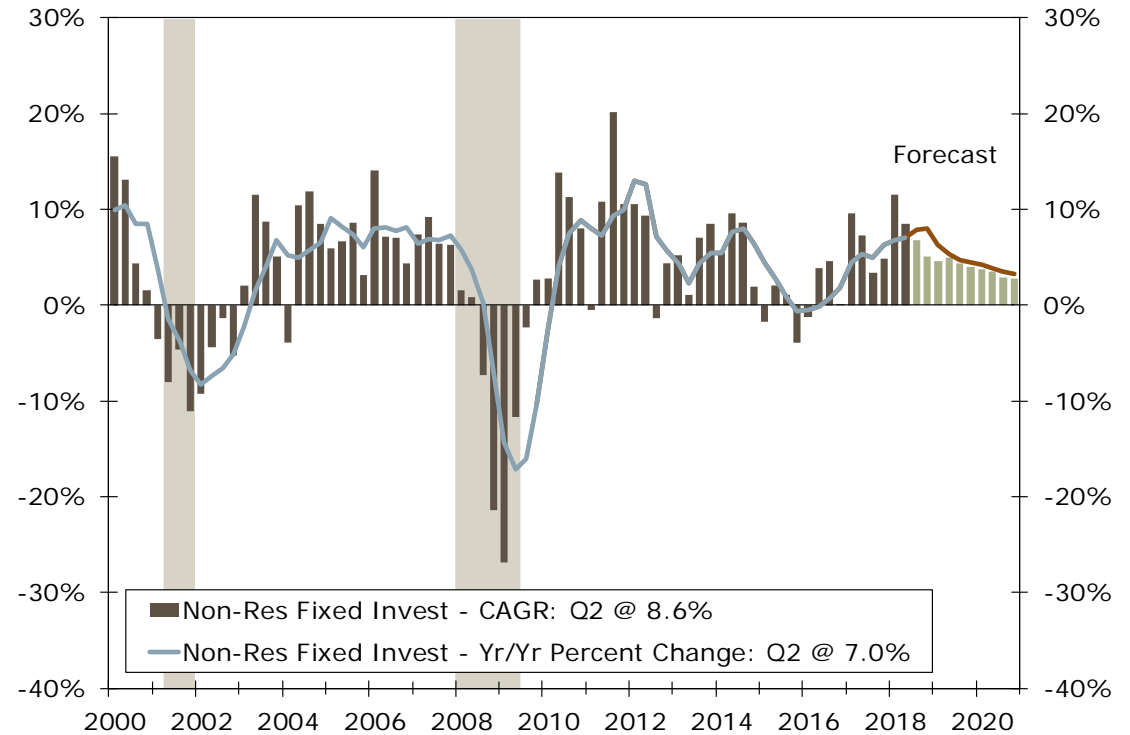


Source: U.S. Department of the Treasury and Wells Fargo Securities

Business fixed investment growth should be bolstered by tax reform, an area that has lagged outside of the tech and energy sector.

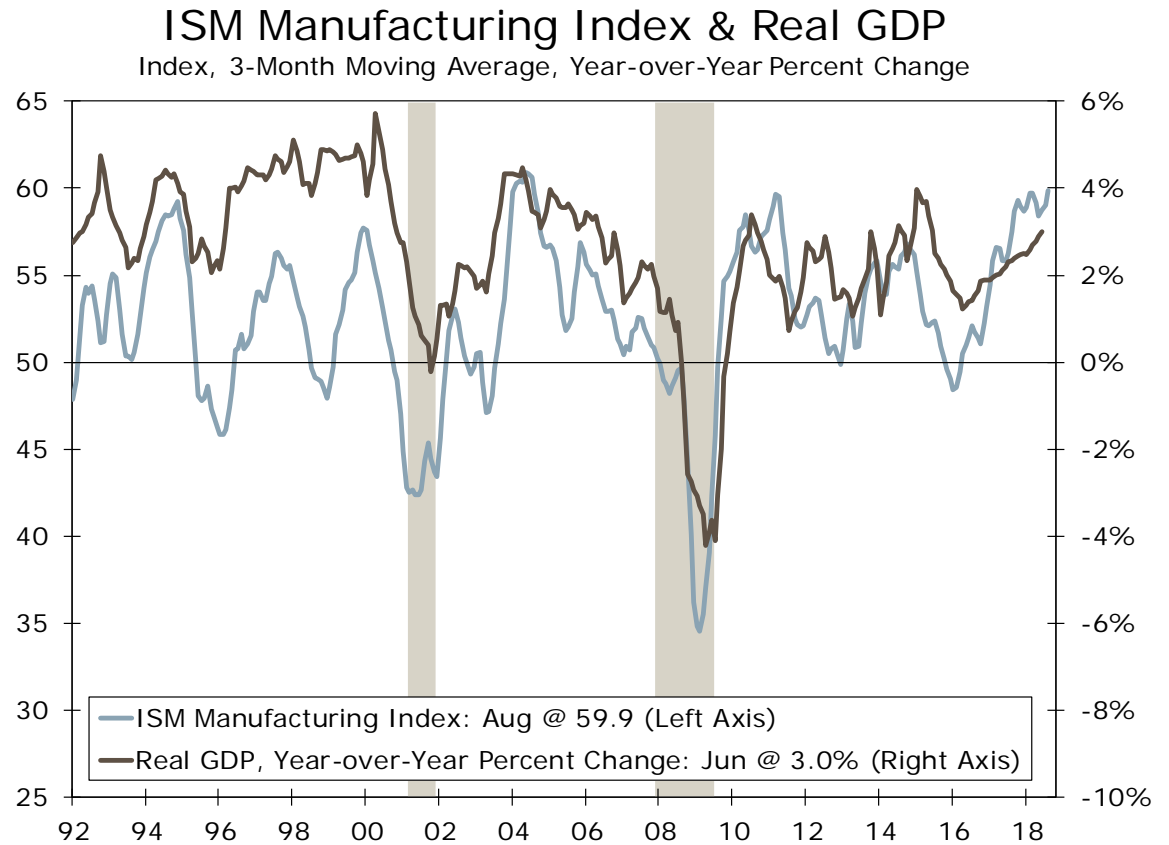
Real Business Fixed Investment

Bars = CAGR Line = Yr/Yr Percent Change



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

Underlying manufacturing activity continues to look strong, supporting the case for solid economic momentum.

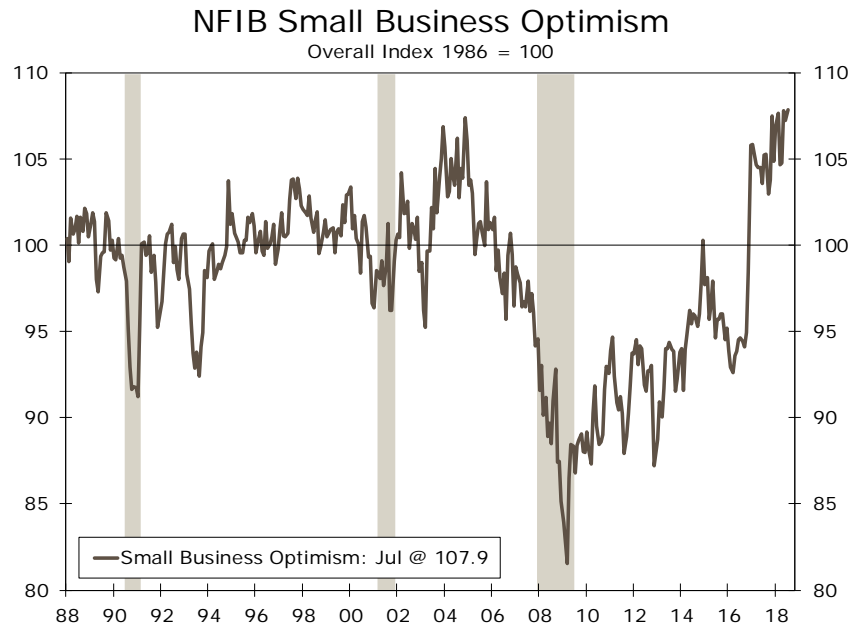


Source: Institute for Supply Management and Wells Fargo Securities

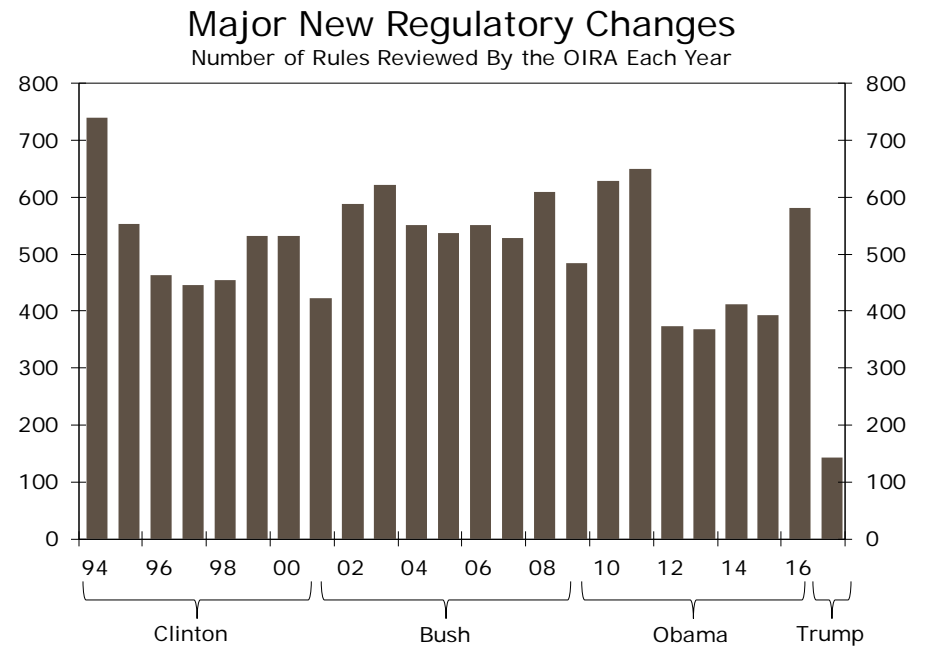
Small Business Optimism

Small business optimism spiked following the presidential election and remains at an all time high. Business owners have become much less worried about the regulatory environment.

Small Business Optimism



Small Business Concerns

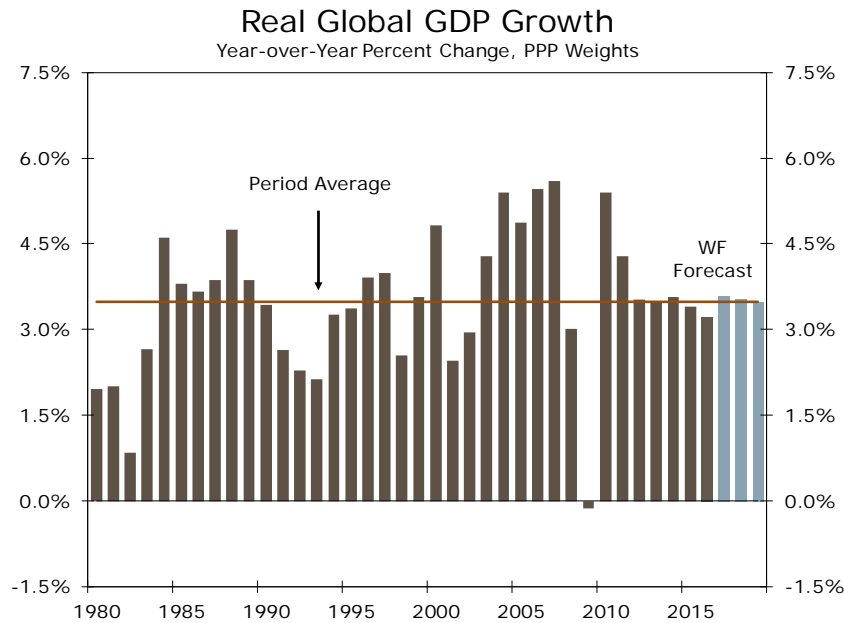


Source: National Federation of Independent Business (NFIB), Office of Information and Regulatory Affairs and Wells Fargo Securities

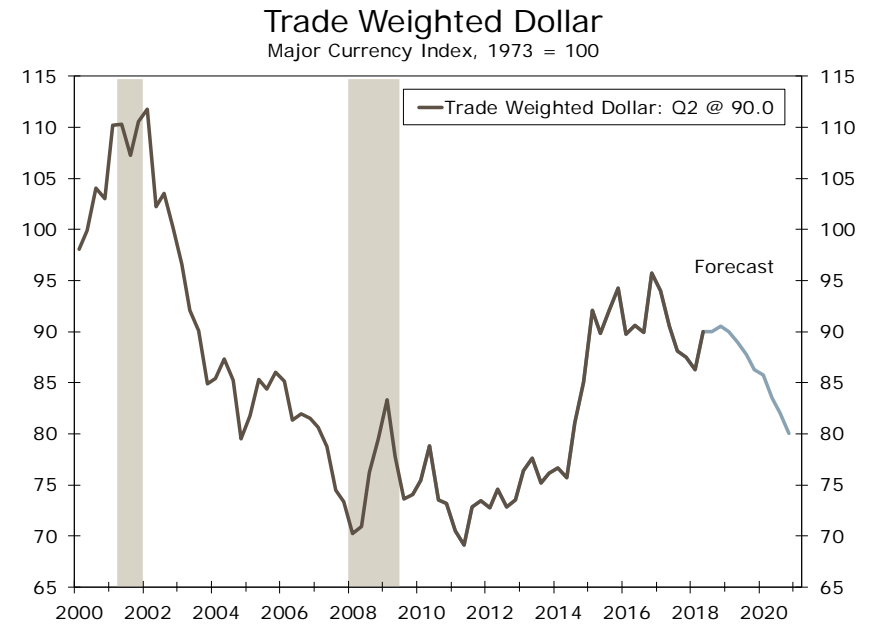
Global Growth

Global growth continues to be solid. Although many central banks have started to hike rates, monetary policy remains accommodative, which should keep the global expansion intact.

Global Growth



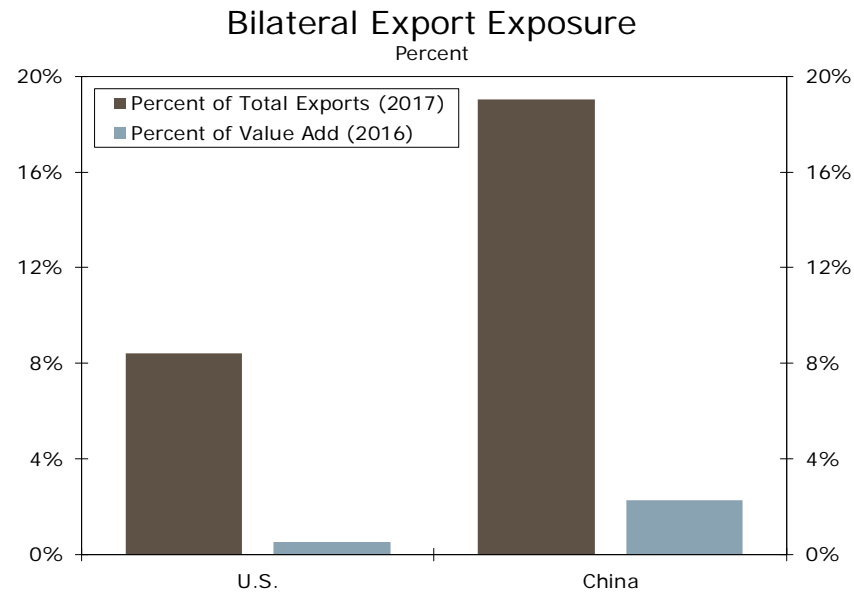
The Dollar



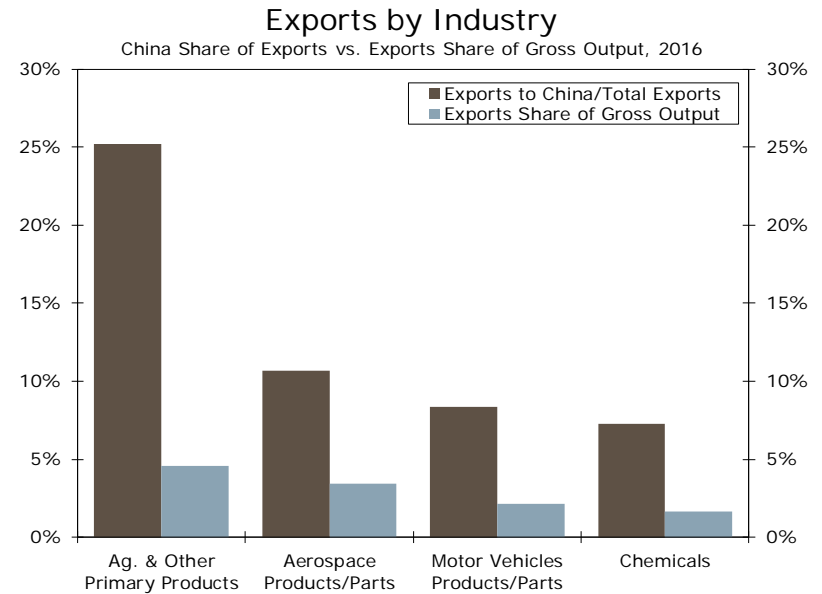
Source: International Monetary Fund, Federal Reserve Board and Wells Fargo Securities

Trade tensions continue to escalate. China appears to have more to lose if a full-blown trade war were to develop, but such an event would not be costless for the United States

U.S.-China Export Exposure



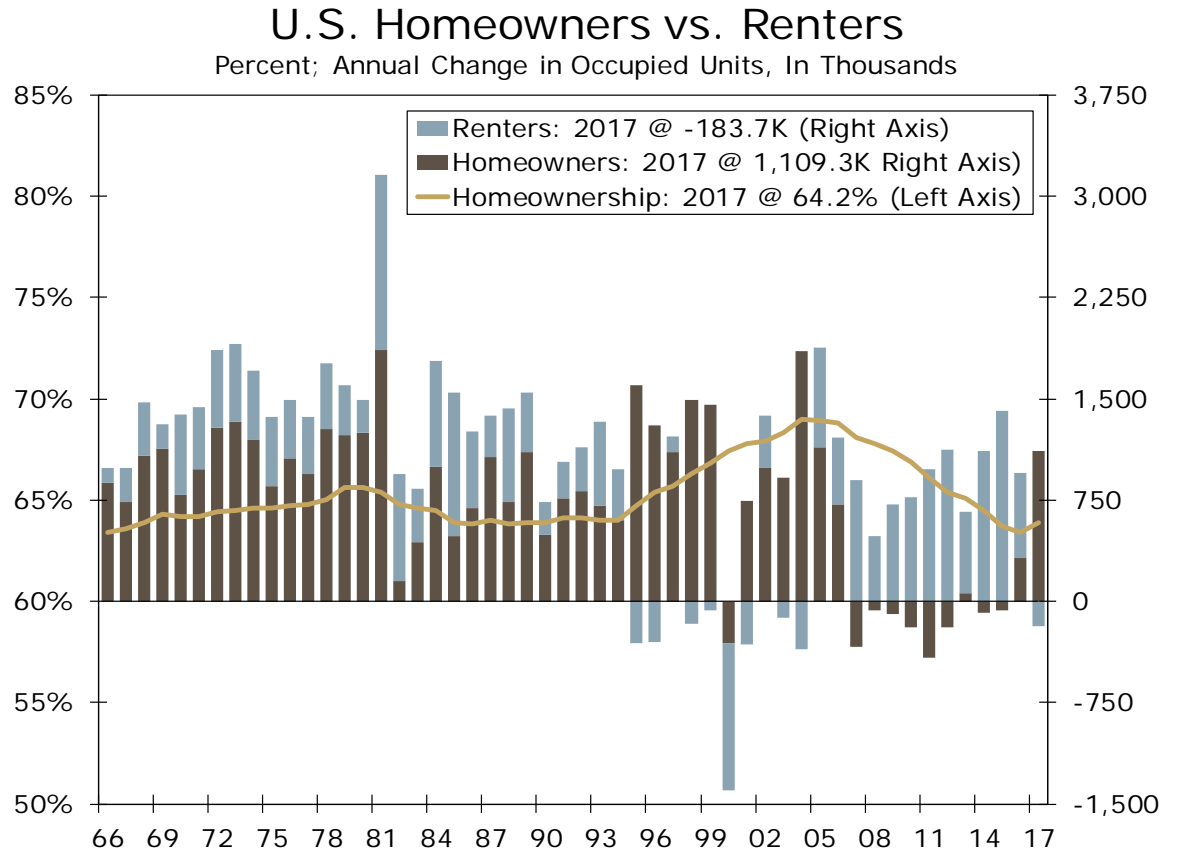
U.S. Industry Exposure



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

Household Formation

Household formation has improved over the past few years but generally remains below prior decades. Still, the homeownership rate appears to be reversing course.

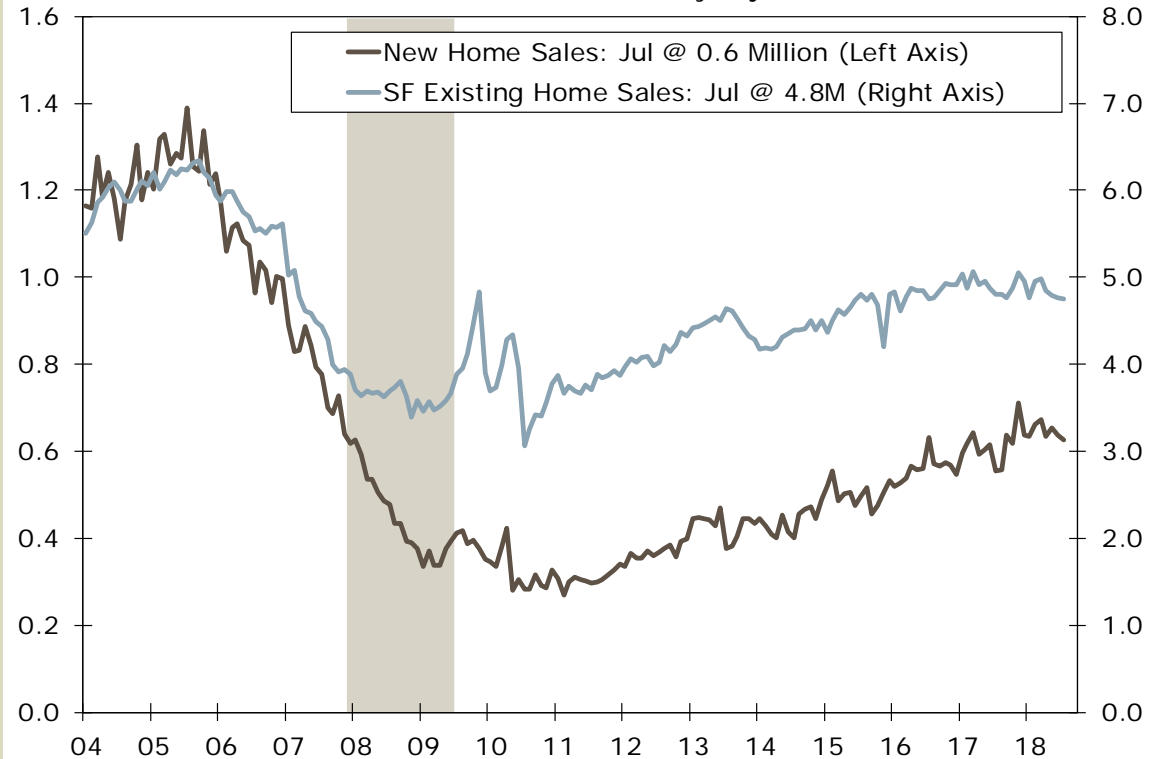


Source: U.S. Department of Commerce and Wells Fargo Securities

Low inventories and high prices have restrained sales so far in 2018. Demand should continue to be strong and keep activity trending higher.

Existing & New Single-Family Home Sales

Both Series in Millions of Units, Seasonally Adjusted Annual Rate



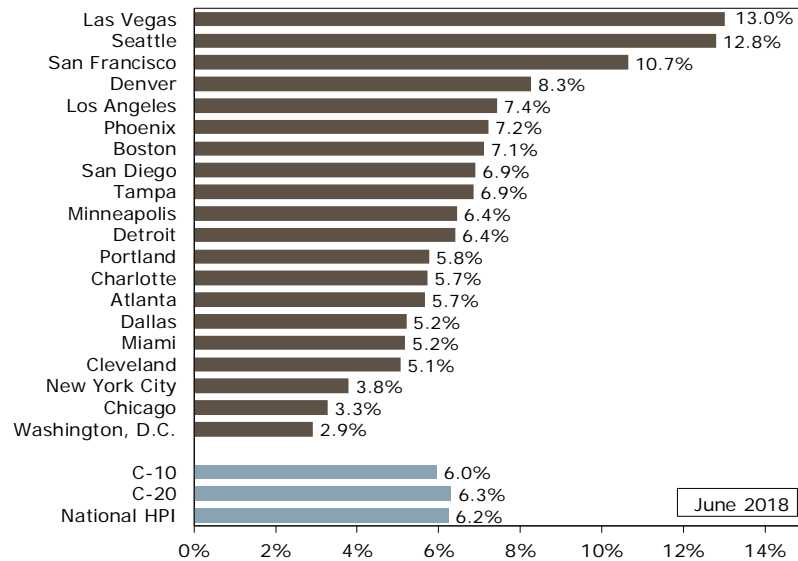
Source: National Association of Realtors, U.S. Department of Commerce and Wells Fargo Securities

Lack of Inventory Pushing Prices Higher

Although starting to rise, mortgage rates are still relatively cheap. More of an issue is the shortage of inventory pushing up prices, especially in the West where shortfalls are most acute.

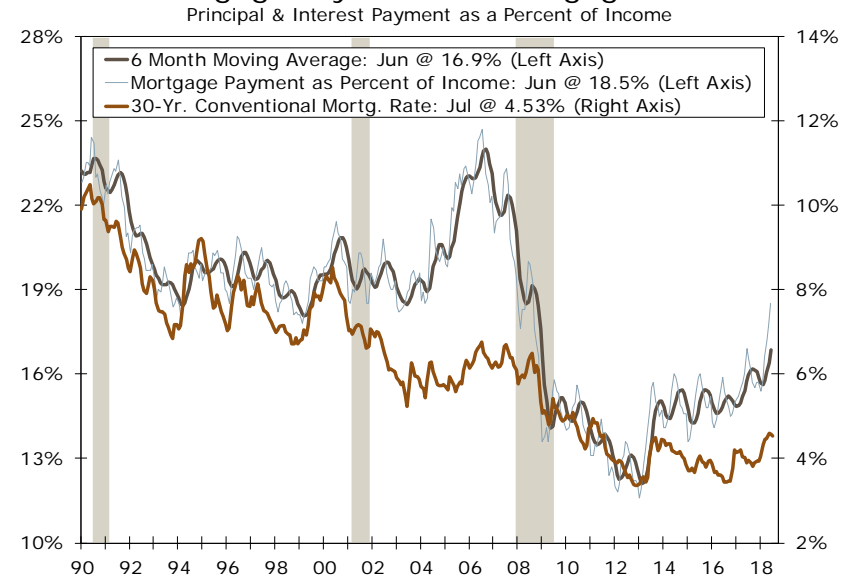
Home Prices

S&P CoreLogic Case-Shiller Home Prices
Year-over-Year Percent Change, NSA



Mortgage Rates

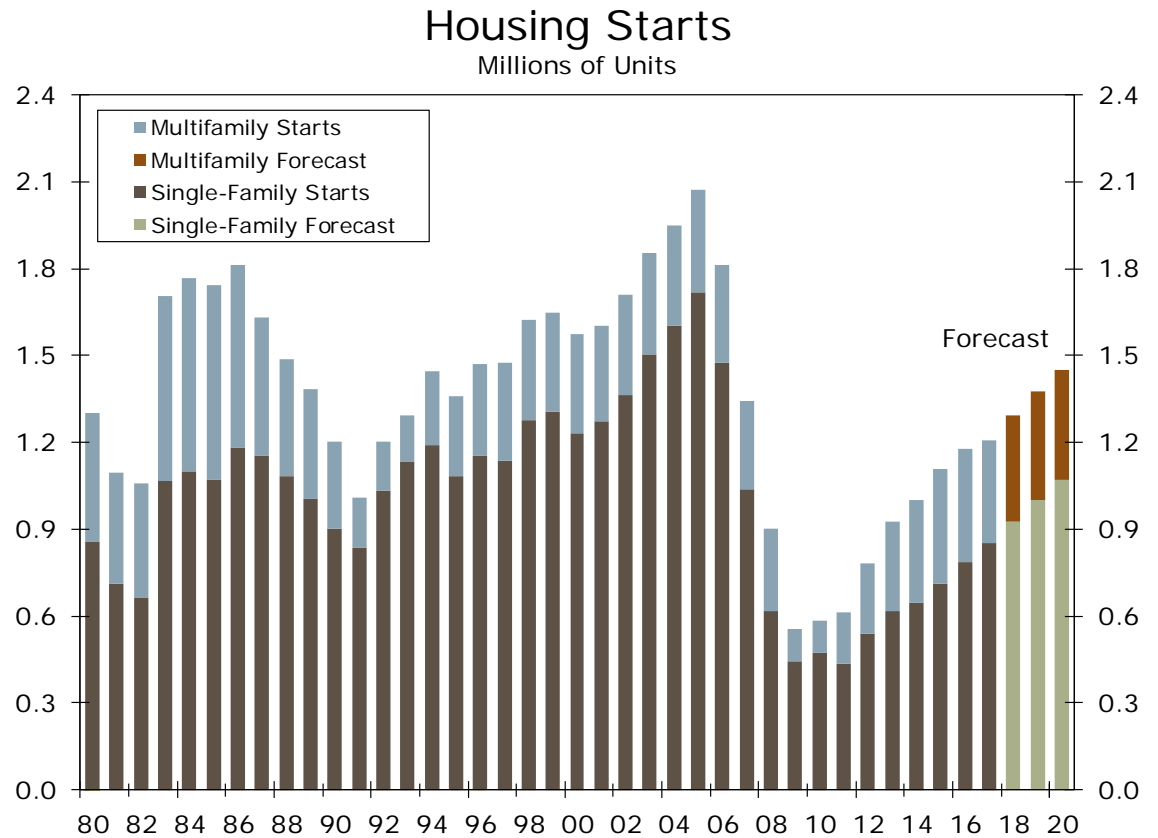
Mortgage Payment vs. Mortgage Rate



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

Single-Family Starts Are Gaining Momentum, as Apartments Begin to Moderate

The housing market is at a key turning point where the momentum will shift more toward single-family construction.



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

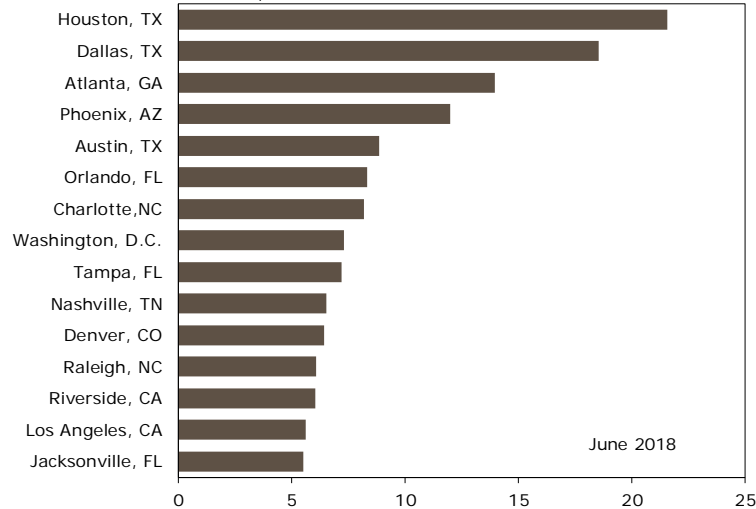
Housing Permits

Houston & Dallas continue to be the leader in single-family housing permits. Multifamily construction is concentrated in large cities, however is spreading towards smaller and more affordable markets.

Single Family

Single-Family Housing Permits by MSA

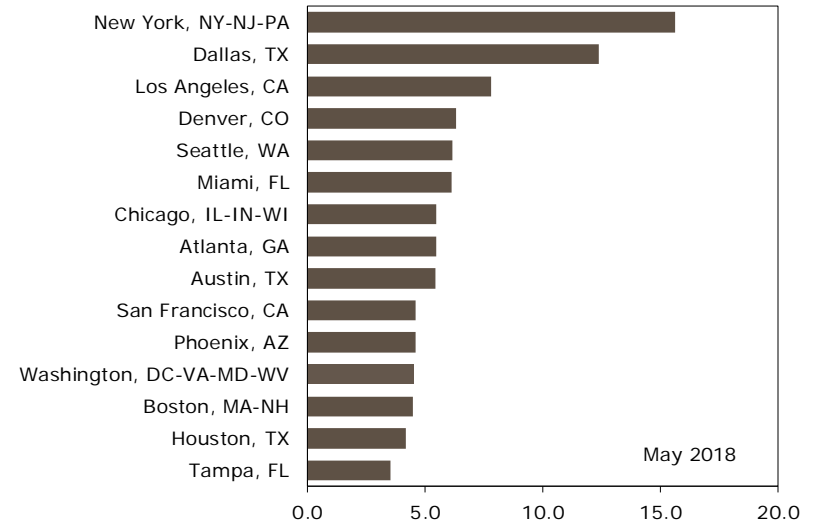
Year to Date, Total Number of Permits in Thousands



Multifamily

Multifamily Housing Permits by MSA

Year to Date, Total Number of Permits in Thousands



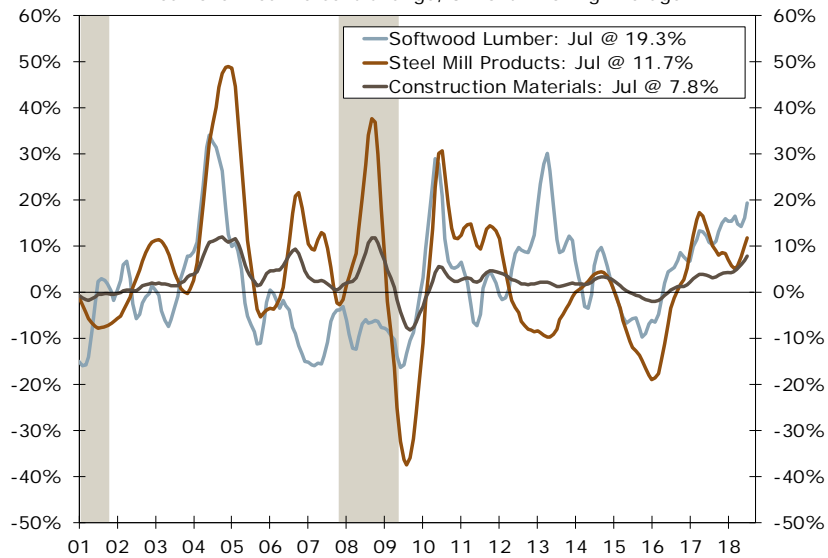
Source: U.S. Department of Commerce and Wells Fargo Securities

Construction Constraints: Higher Costs

Tariffs on lumber and steel have pushed up prices, however strong demand has caused building material prices to rise across the board. A shortage of skilled labor is putting upward pressure on overall construction wages.

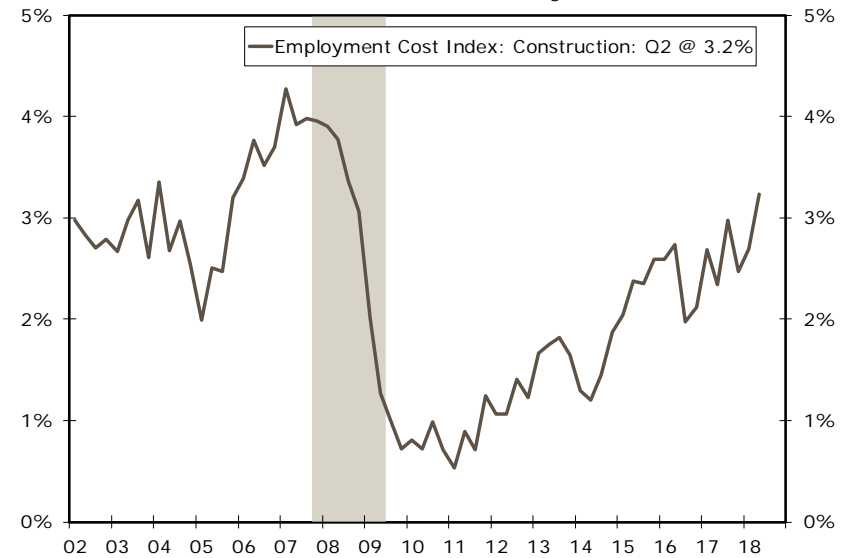
Higher Material Prices

Construction, Lumber & Steel Prices
Year-over-Year Percent Change, 3-Month Moving Average



Higher Labor Costs

Employment Cost Index: Construction
Year-Over-Year Percent Change

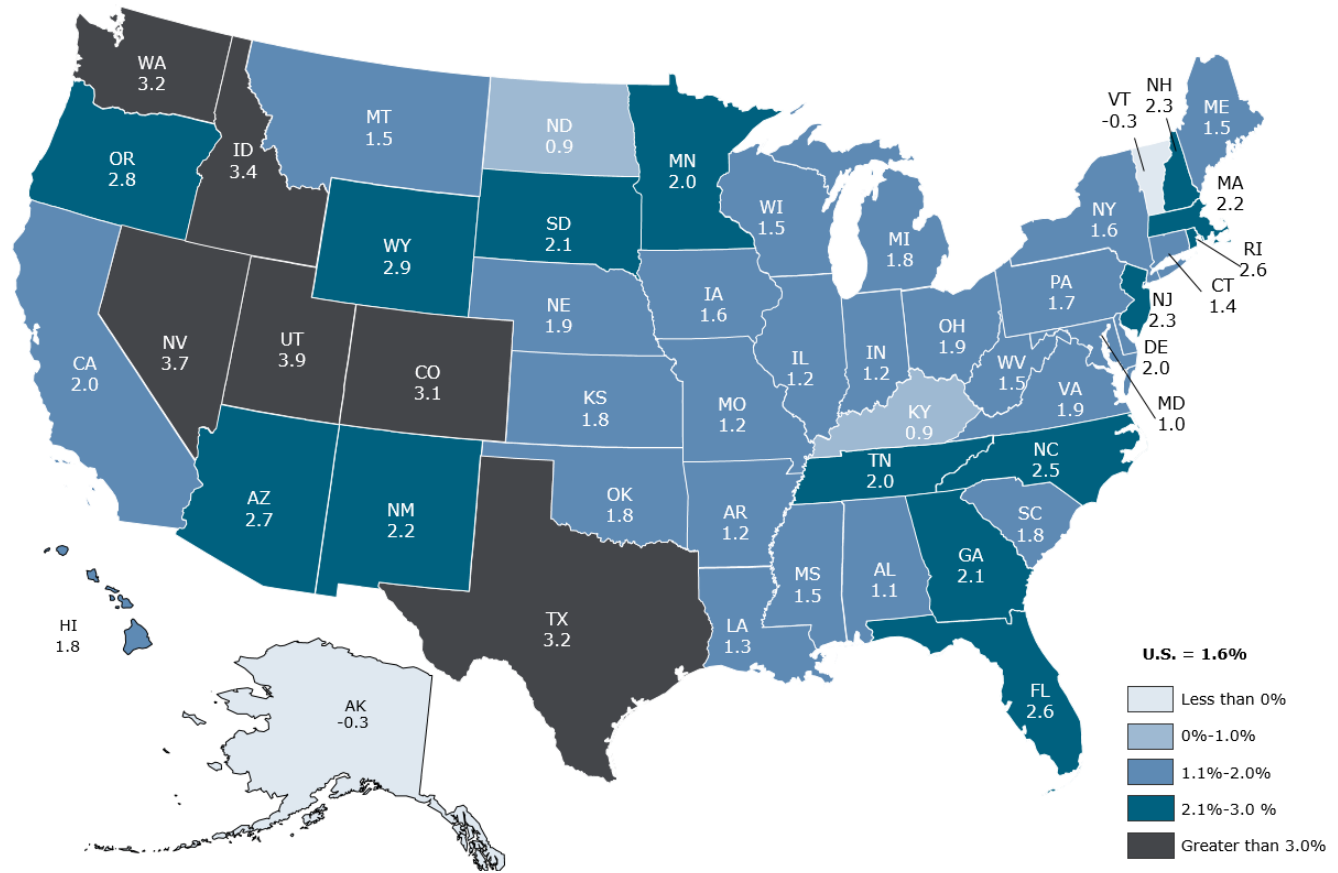


Source: U.S. Department of Commerce and Wells Fargo Securities

Texas Outlook

Year-over-Year Employment Growth: July 2018

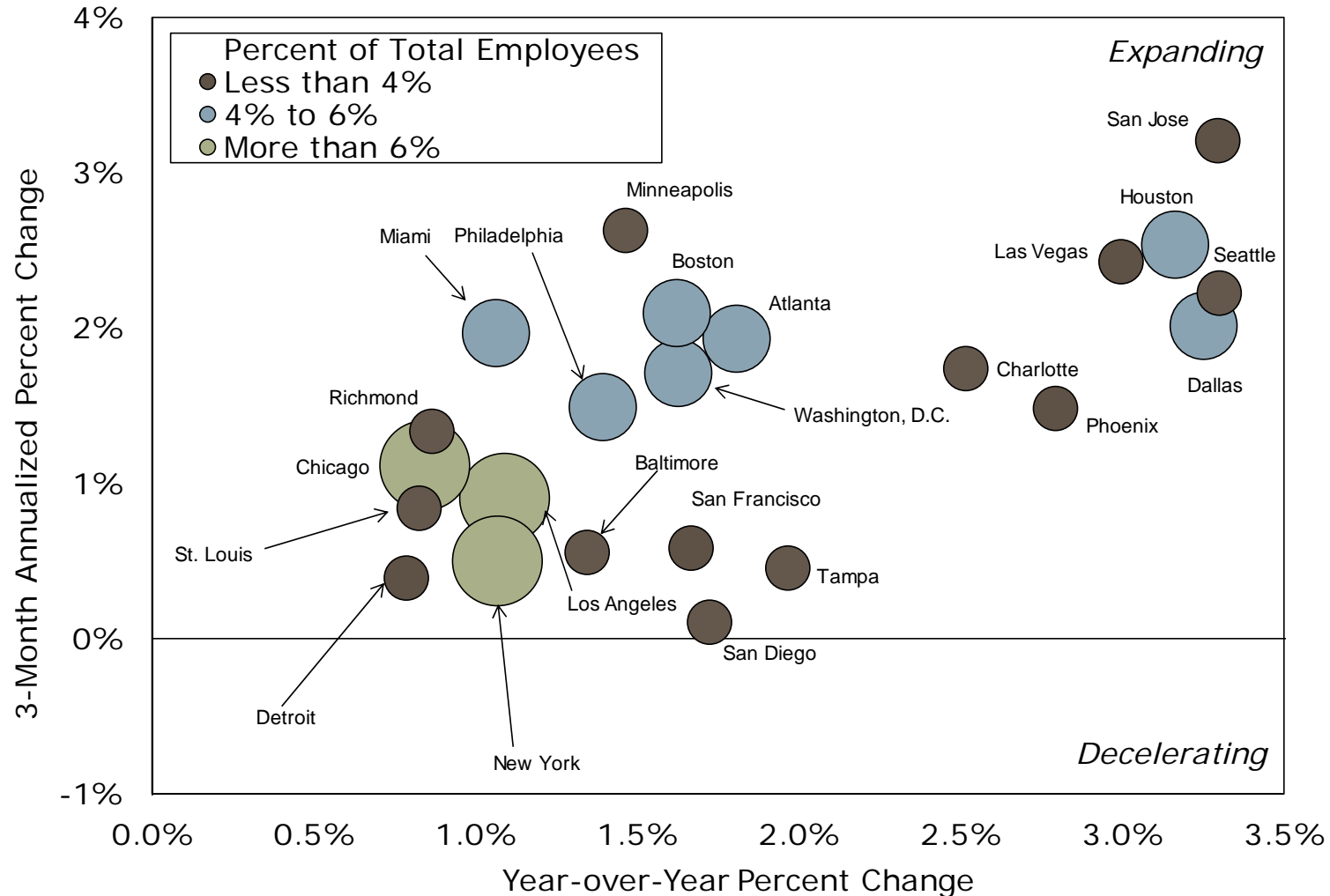
The West Coast is growing solidly, led by the gains in the tech sector. The Southeast is also doing well thanks to a relatively low cost of living.



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

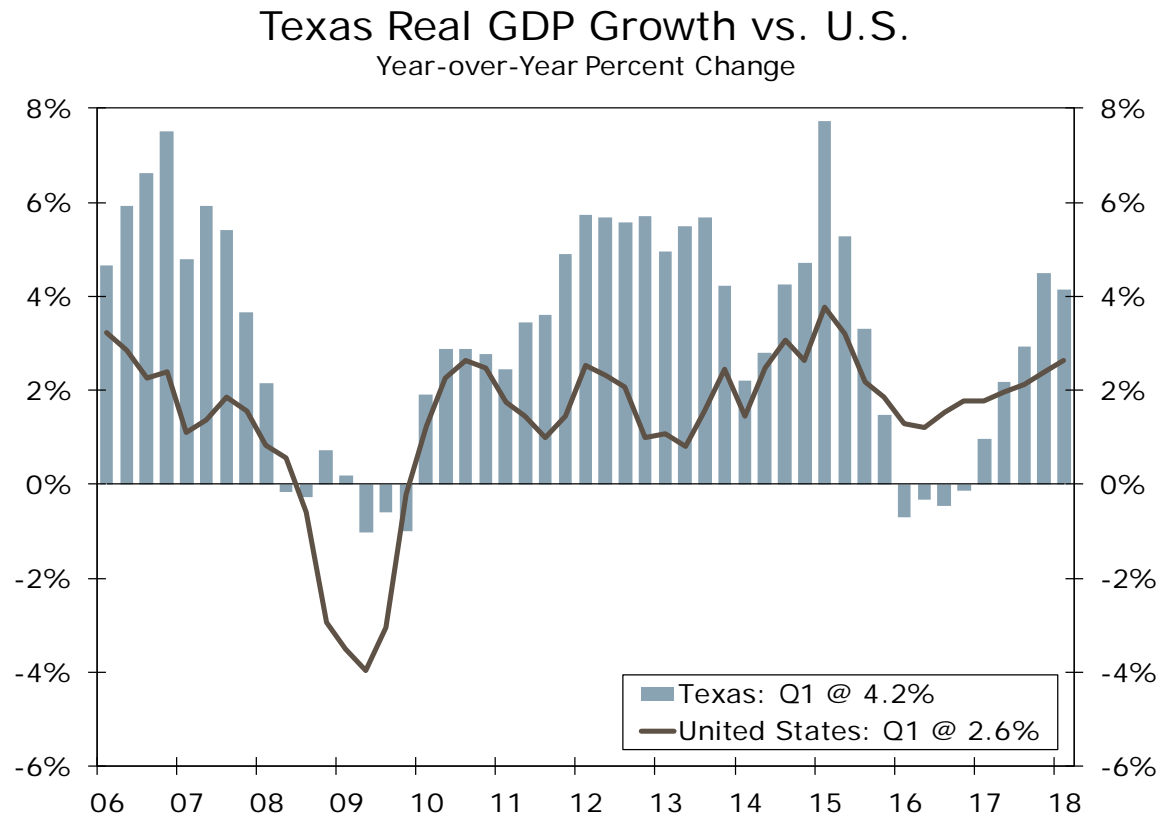
Employment Growth by MSA

U.S. Employment Growth by MSA 3-Month Moving Averages, July 2018



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

The Texas economy regained a lot of ground in 2017, rebuilding momentum lost following the plunge in oil prices around the middle of the decade.

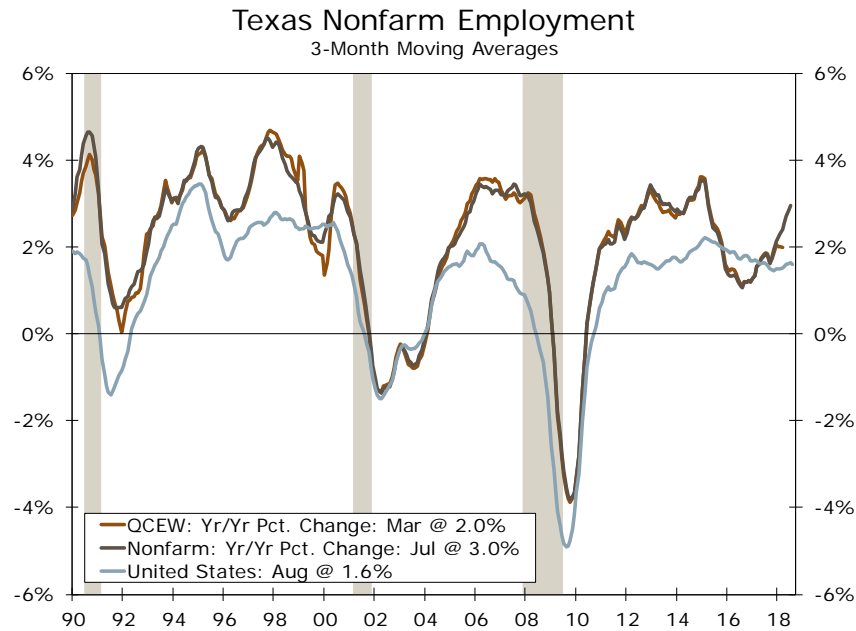


Source: U.S. Department of Commerce and Wells Fargo Securities

Texas Employment

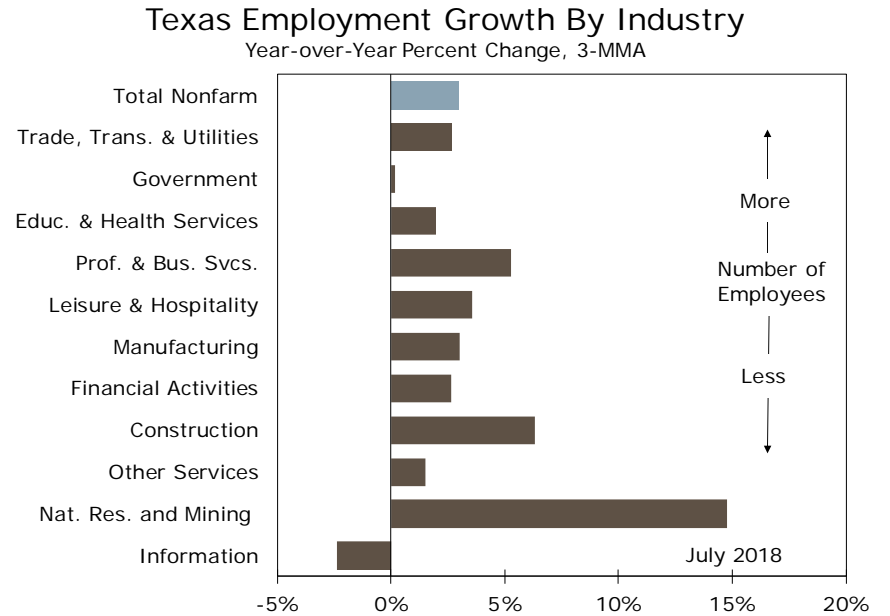
The Texas job market is back to firing on all cylinders. Recent improvement have been broad-based across many industries and regions, which should keep payroll growth strong.

Employment



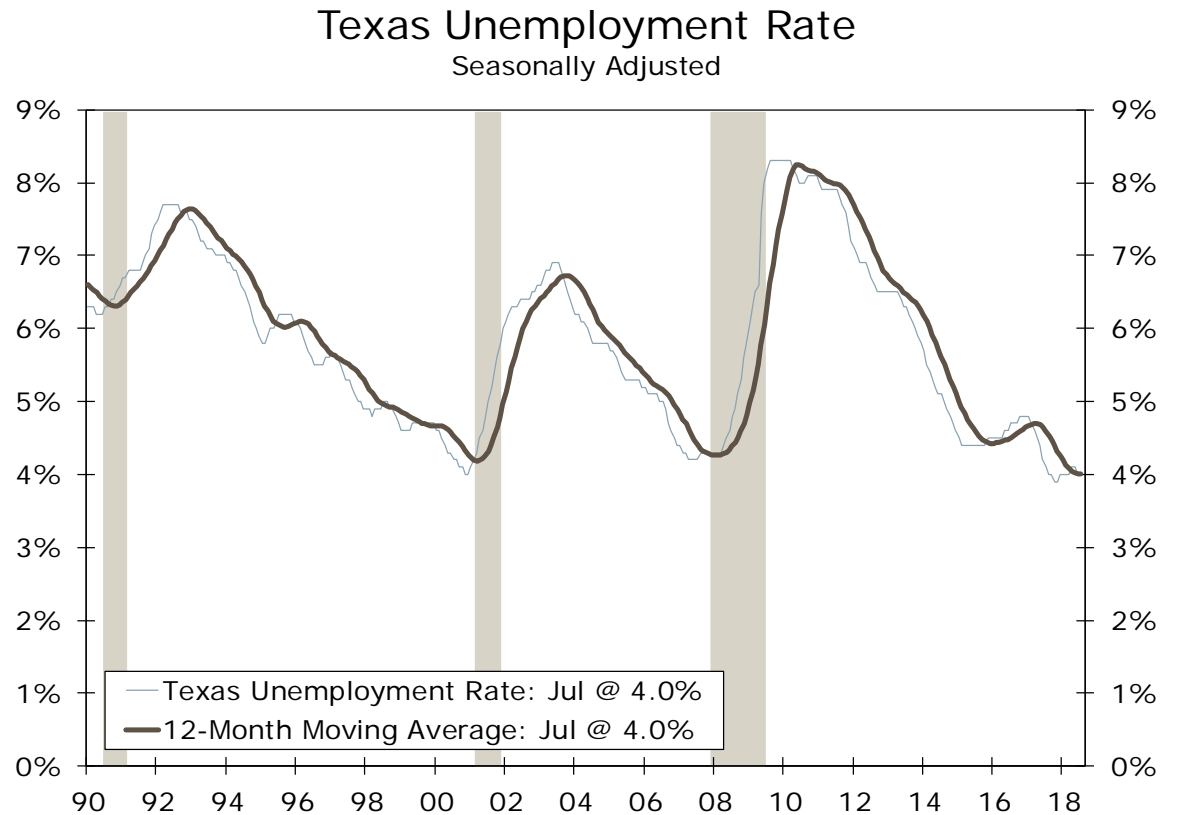
Source: U.S. Department of Labor and Wells Fargo Securities

Employment by Industry



Unemployment Rate

The Texas jobless rate has recovered from the upward spurt caused by the oil downturn, and now sits at a near record low. A tightening labor market has caused a shortage of skilled workers.

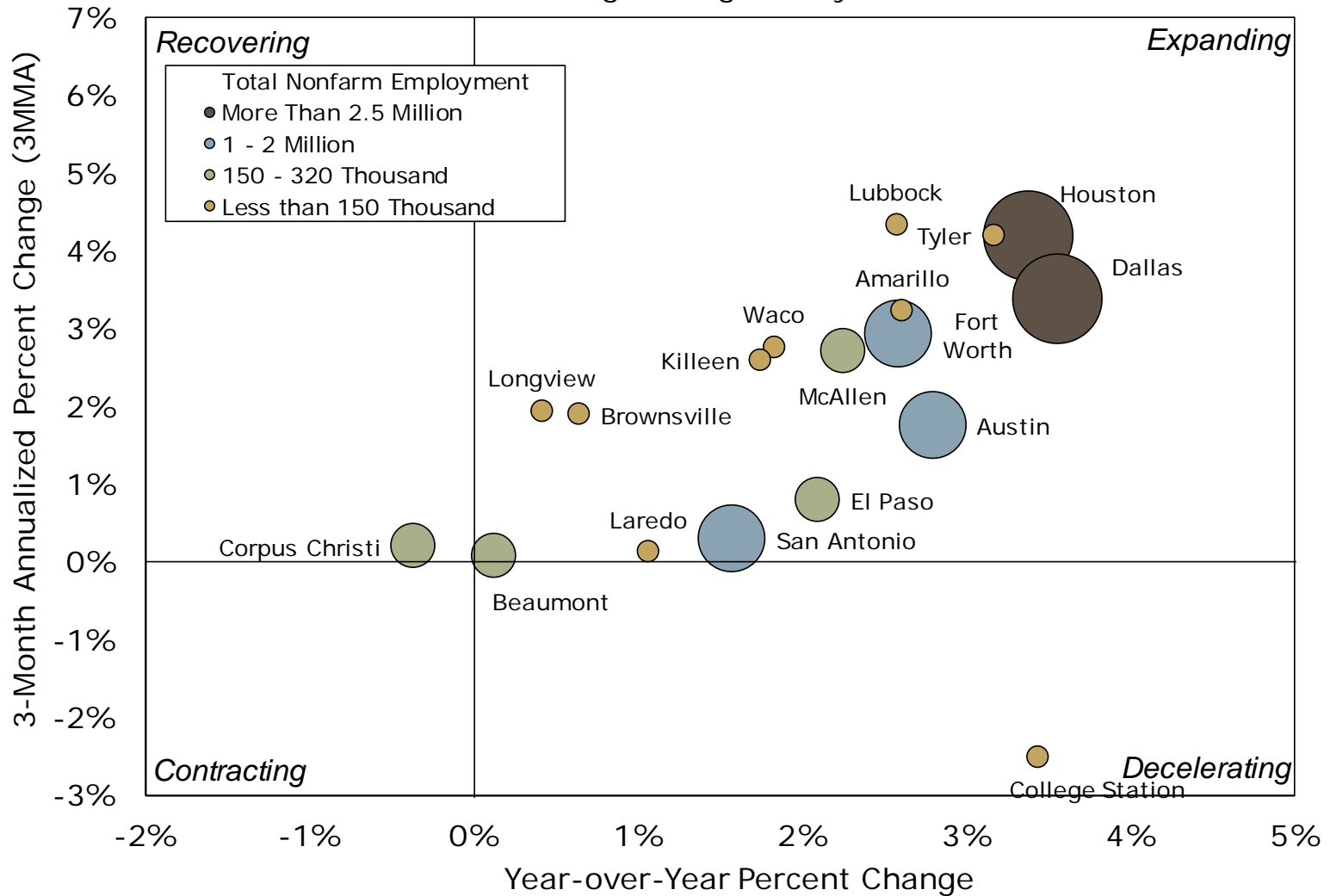


Source: Baker Hughes, Inc., Bloomberg LP and Wells Fargo Securities

Texas Employment by Metropolitan Area

Texas Employment Growth by Metro

3-Month Moving Averages, July 2018

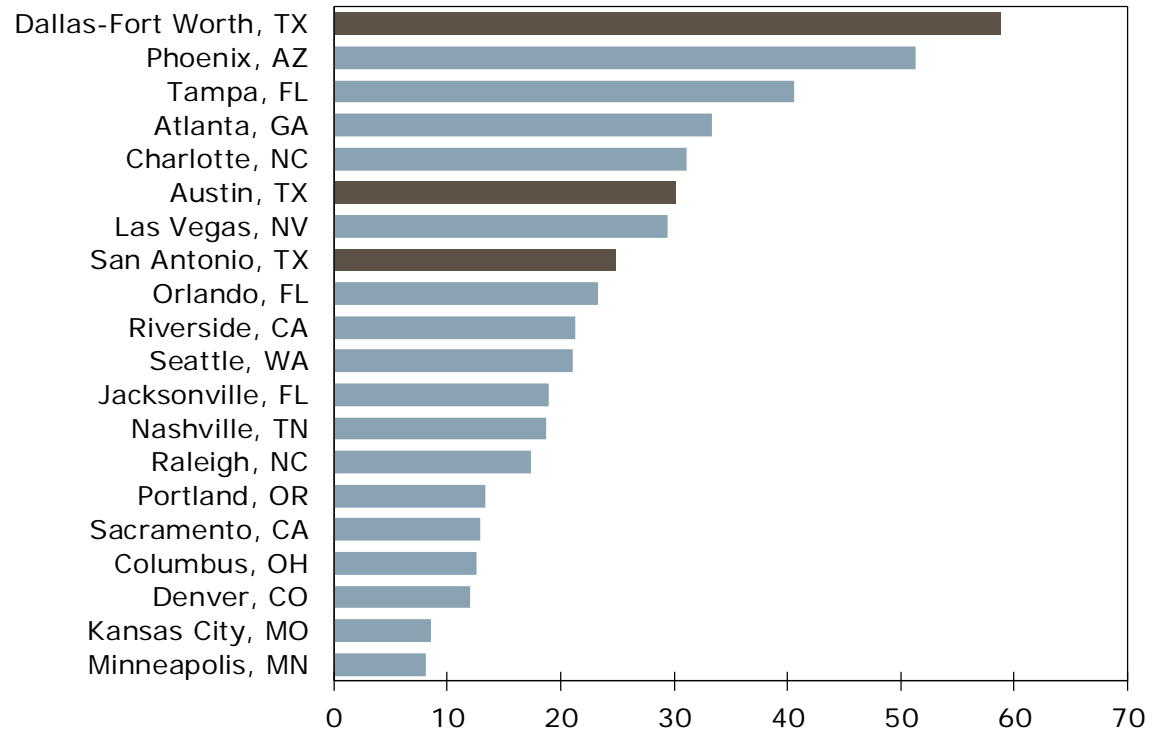


Source: U.S. Department of Labor, U.S. Dept. of Commerce and Wells Fargo Securities

Net Migration

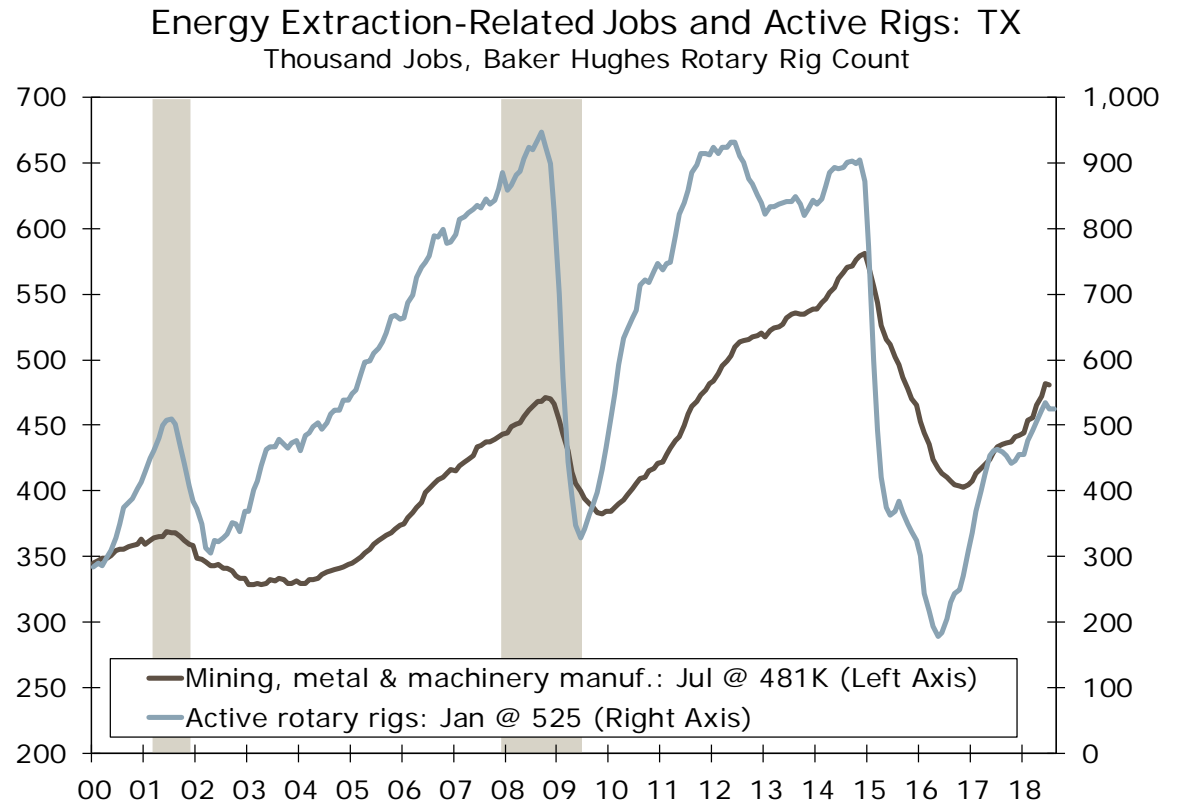
Several Texas metros continue top the list of destinations for state-to-state movers.

Metro Area Net Domestic Migration: Top 20 Thousands, 2017



Source: Baker Hughes, Inc., Bloomberg LP and Wells Fargo Securities

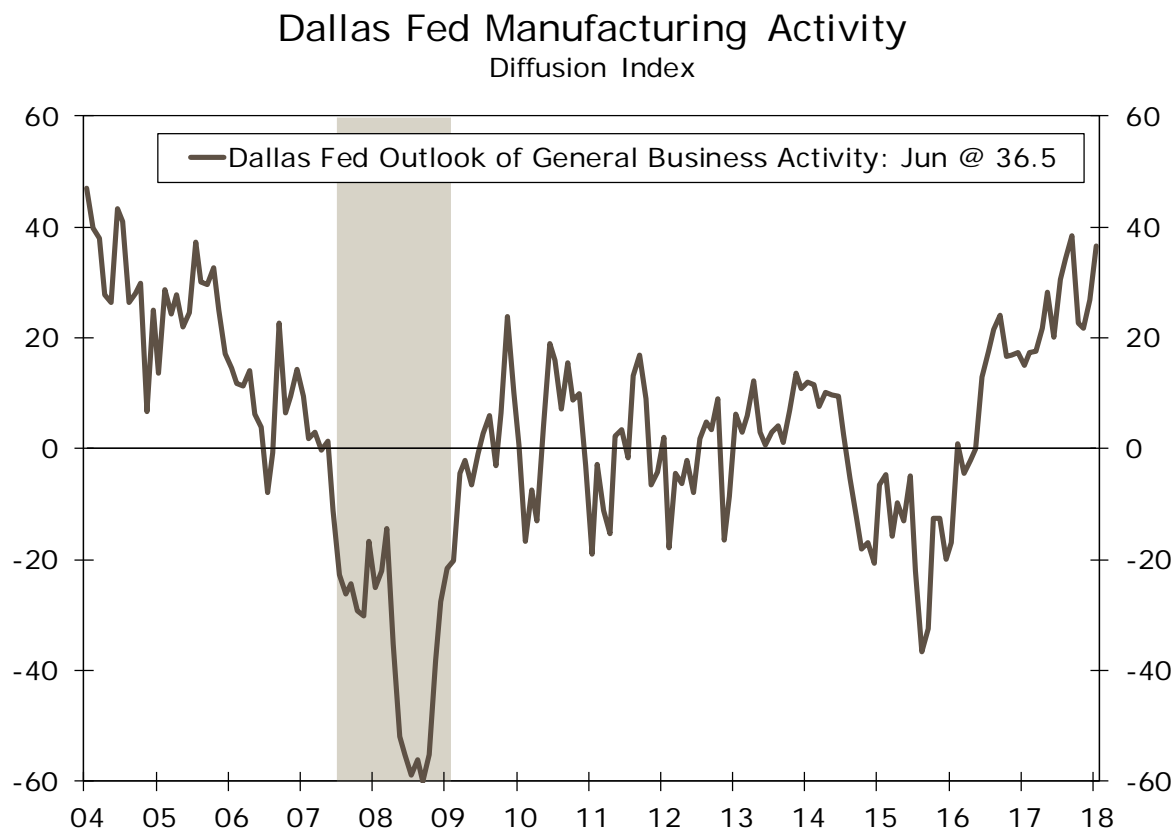
The rebound in commodity prices since early 2016 has supported new investment spending. However, extraction-related employment has not returned to prior peak levels.



Source: Baker Hughes, Inc., Bloomberg LP and Wells Fargo Securities

Manufacturing

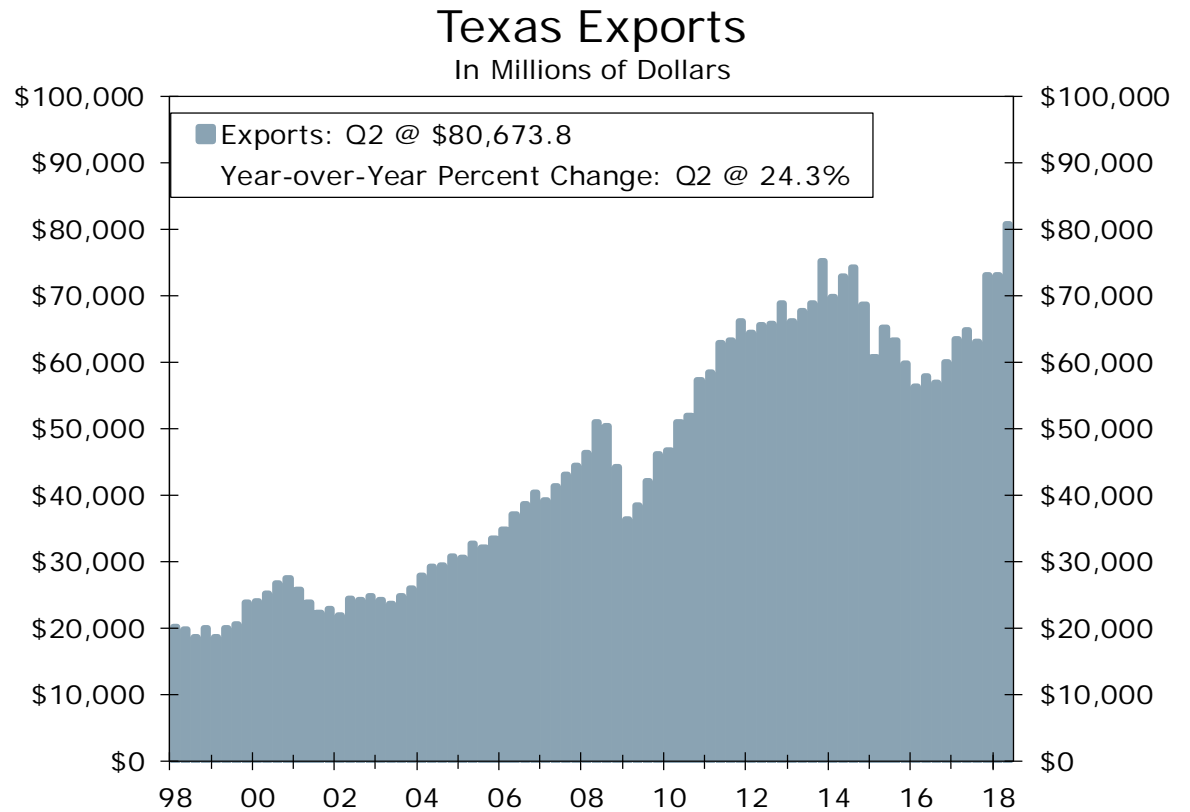
Texas manufacturers continue to report expanding activity, however tariffs and uncertainty surrounding trade policy are creating headwinds.



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

Exports

Firmer commodity prices are also boosting exports, as oil and gas exports nearly doubled last year. Trade is vital to the Texas economy, with exports accounting for roughly 15 percent of total economic output.

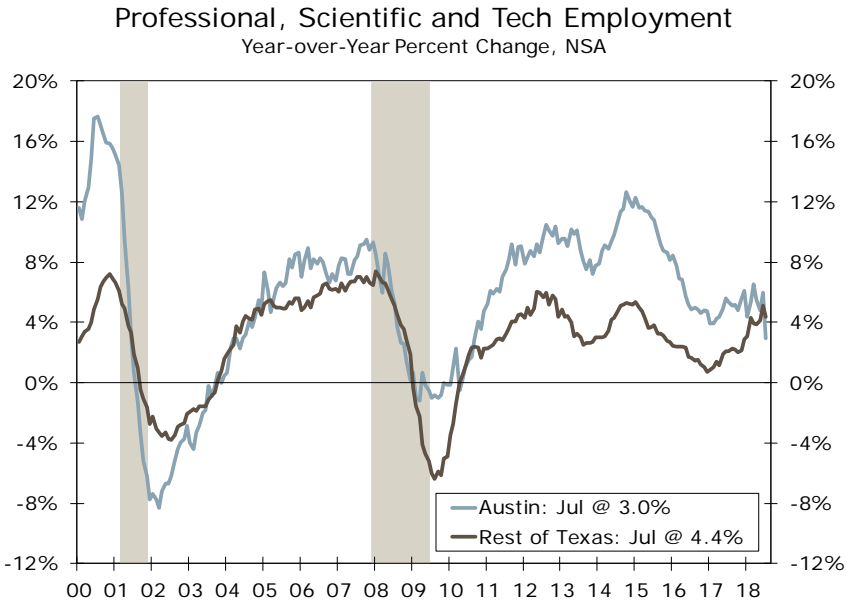


Source: U.S Department of Commerce and Wells Fargo Securities

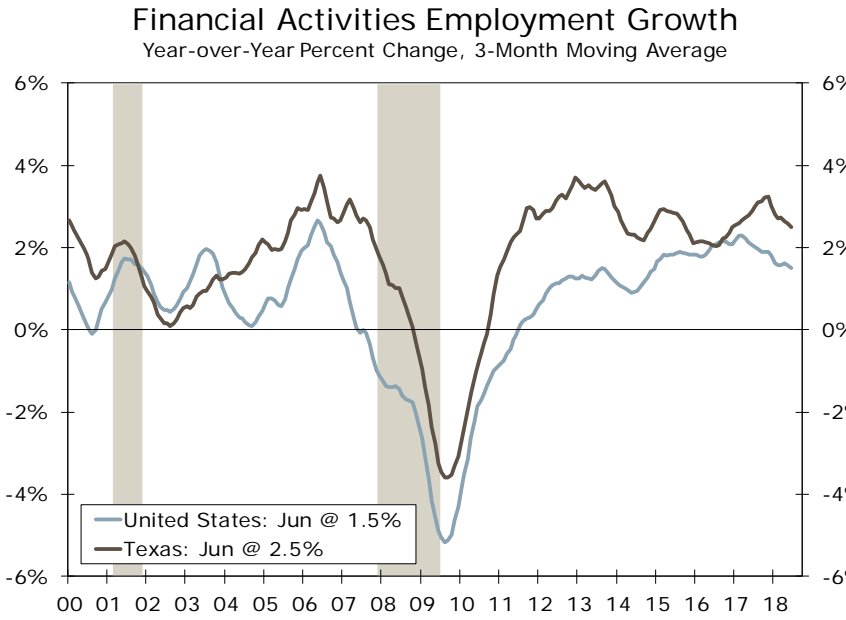
Tech and Financial Activities

Tech sector employment has moderated recently, with stronger growth outside of Austin. Financial activities employment also continues to expand at a pace ahead on the nation.

Tech Sector

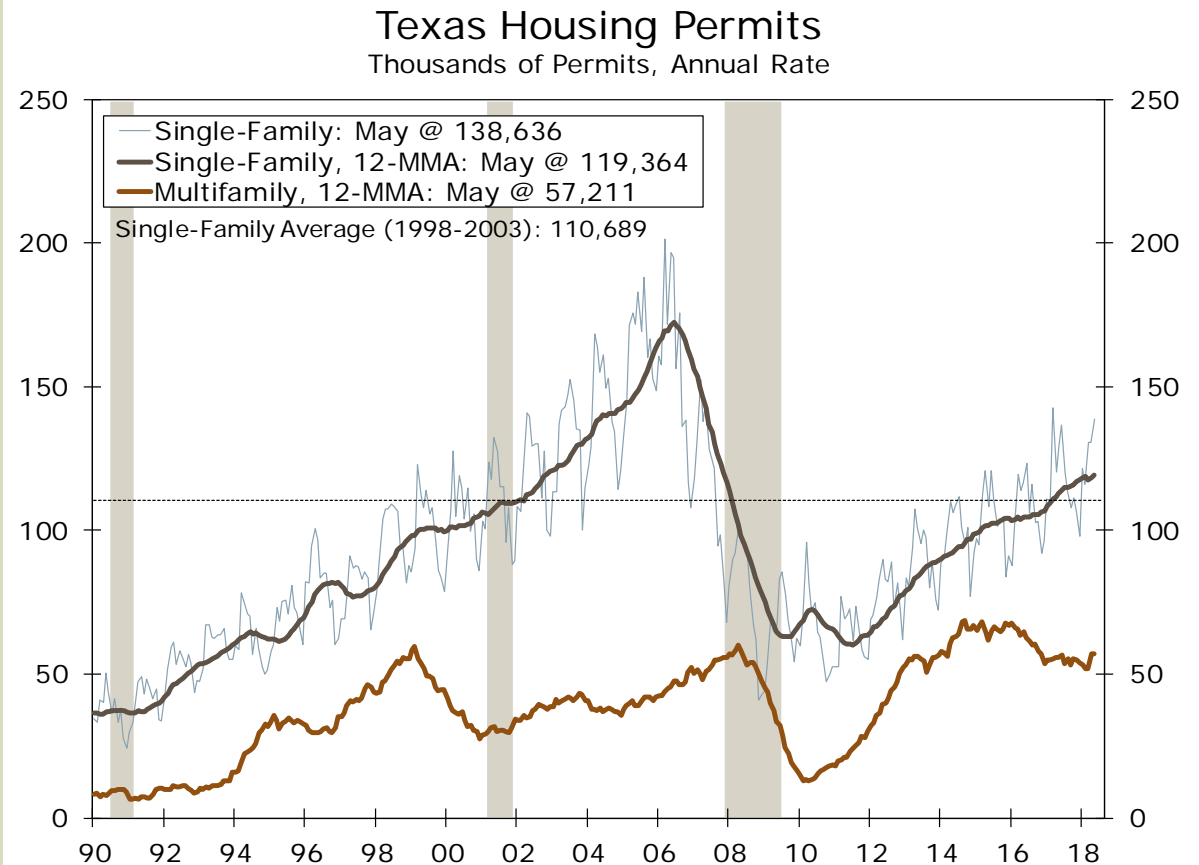


Financial Activities



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

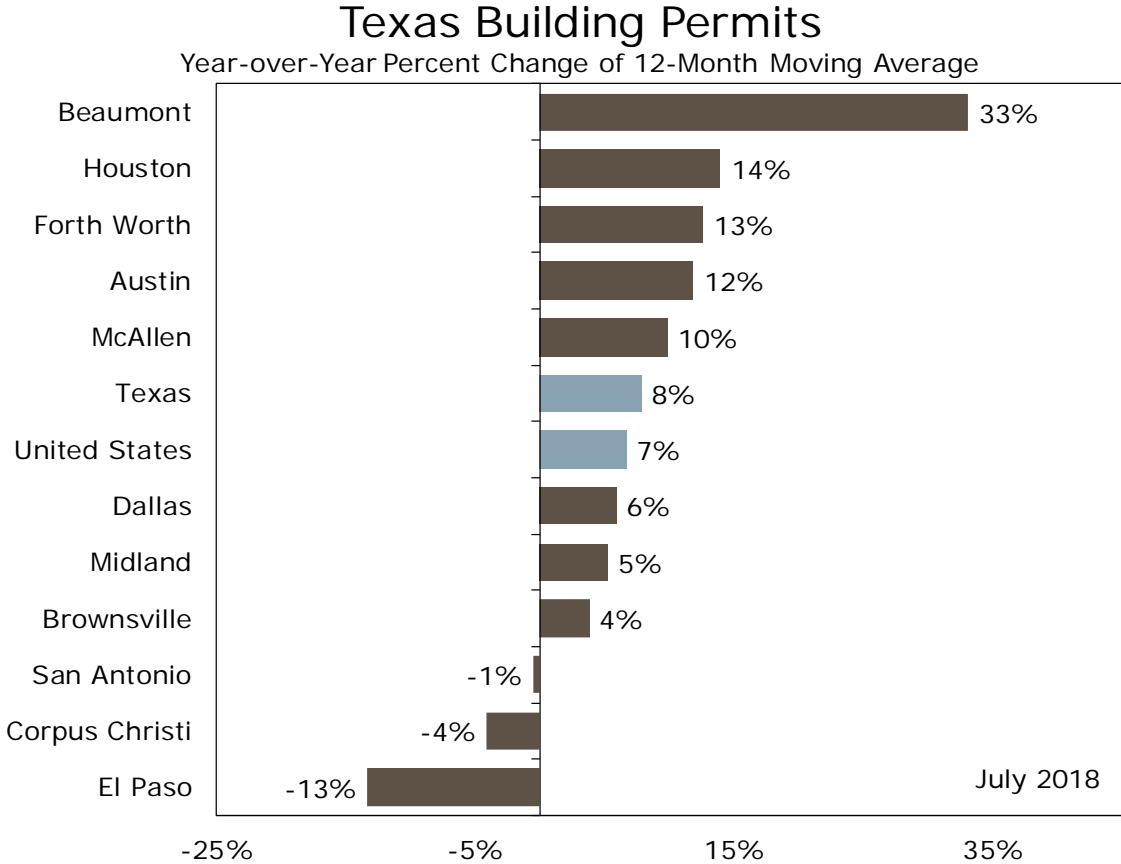
Homebuilding moderated somewhat last year, however Texas remains the largest market for new residential construction, supported by strong employment and population growth.



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

Housing Activity by Metro

Houston, Dallas, and Austin continue to lead both the state and nation in terms of new homebuilding.

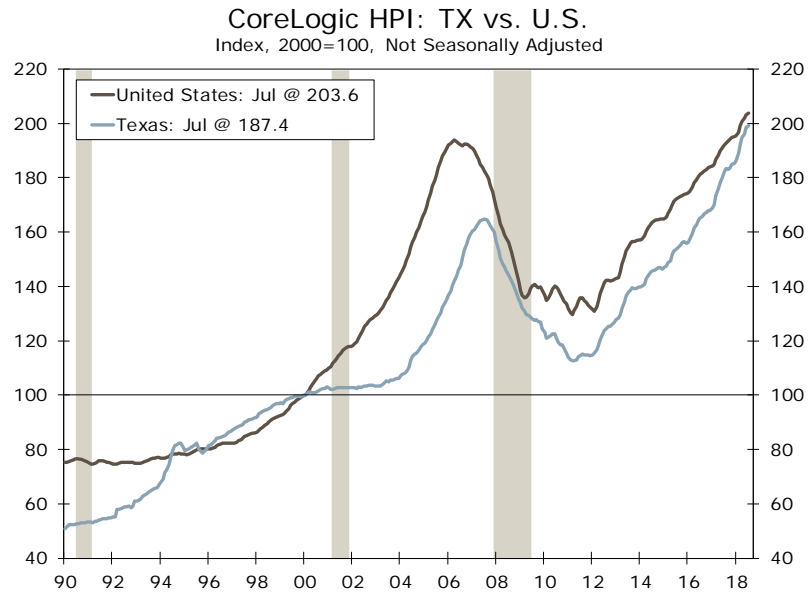


Source: U.S Department of Commerce and Wells Fargo Securities

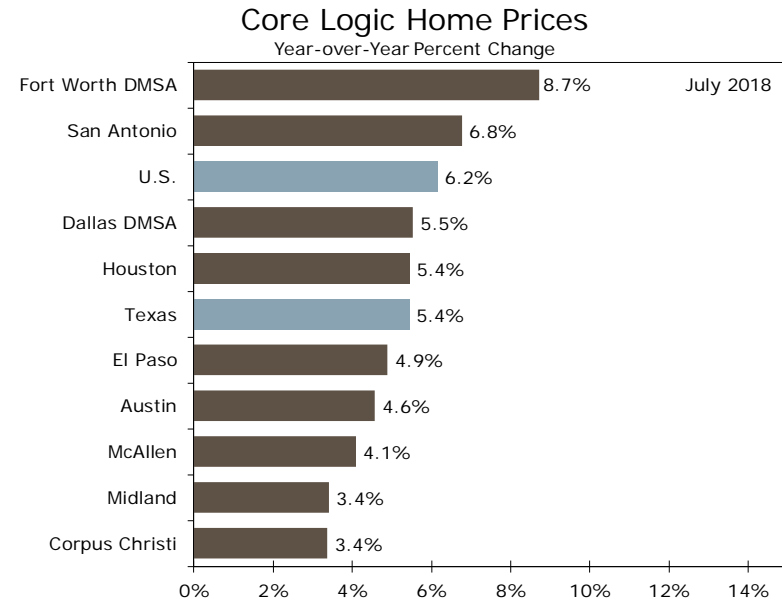
Texas Home Prices

Housing affordability is a major advantage for Texas. Relatively low land costs and an entitlement process that works closely with builders helps keep the housing market in balance.

Home Price Index

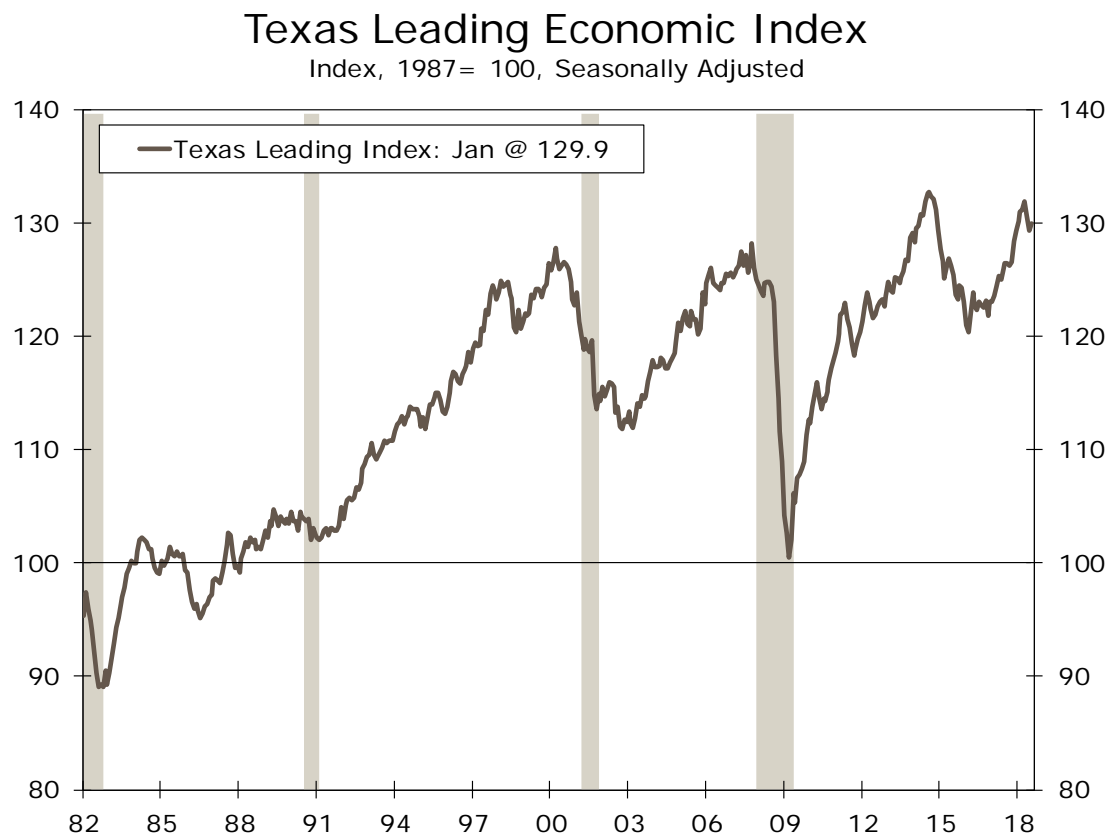


Home Price Growth by MSA



Source: CoreLogic and Wells Fargo Securities

Texas has strong momentum headed into the second half of 2018 and we are looking for Texas to continue to grow solidly over the next couple of years.



Source: The Federal Reserve Bank of Dallas and Wells Fargo Securities

Appendix

U.S. Economic Forecast

Wells Fargo U.S. Economic Forecast																
	Actual				Forecast								Actual		Forecast	
	2018				2019				2020				2016	2017	2018	2019
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Real Gross Domestic Product ¹	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
Personal Consumption	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
Business Fixed Investment	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
Equipment	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
Intellectual Property Products	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
Structures	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
Residential Construction	-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
Government Purchases	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
Net Exports ²	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
Inventories ²	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
Nominal GDP ¹	4.3	7.6	4.6	5.0	5.3	5.5	5.2	4.8	4.4	4.3	4.0	4.4	2.7	4.2	5.2	5.3
Corporate Profits Before Taxes ³	5.9	7.7	8.0	6.2	5.6	1.8	0.5	-0.8	-1.6	-2.2	-2.6	-3.4	-1.1	3.2	6.9	1.7

Forecast as of: September 12, 2018

¹ Compound Annual Growth Rate Quarter-over-Quarter ² Percentage Point Contribution to GDP ³ Year-over-Year Percentage Change

Source: IHS Global Insight and Wells Fargo Securities

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August-09	Housing Remains in the Slow Lane	Vitner, Dougherty & Honnold
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