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SECURITIES

U.S. Economic Outlook

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Together we'll go far



Economic Outlook

- After a strong Q2 and Q3, economic growth appears to be moderating. While consumer spending has remained strong, slower global growth is reducing factory orders and likely presages slower first quarter GDP growth.

Fiscal Policy

- The short-term boost from tax reform appears to be fading and smaller refunds may create some headwinds early next year. Government spending remains a powerful tailwind. Opportunity Zones also hold promise.

Monetary Policy

- The Fed has once again become data driven as opposed to target driven but appears to be behind the curve. The financial markets now seem to be priced for the Fed to keep interest rates unchanged this year.

Trade Policy

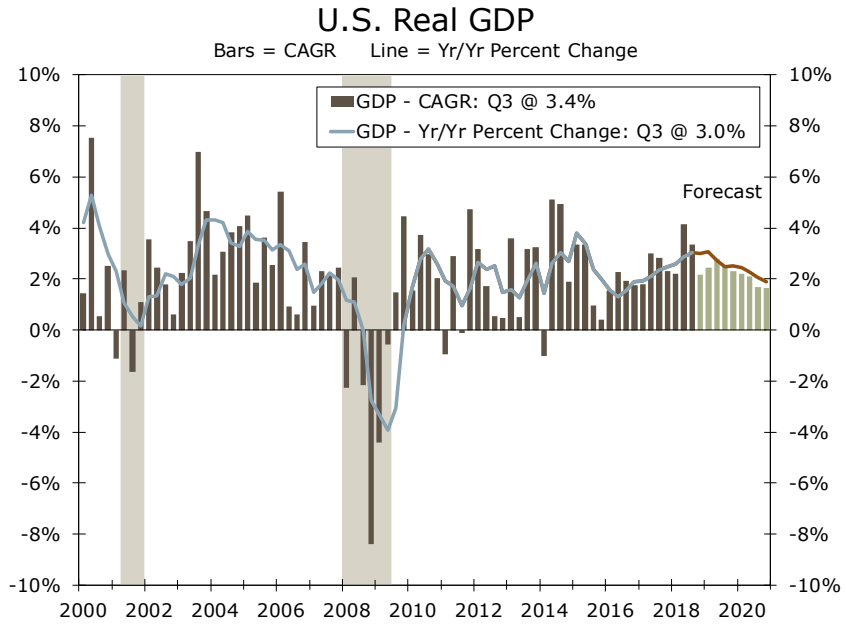
- The Trump Administration's confrontational negotiating tactics have led to increased uncertainty but may also bring about some much needed changes from China. Trade relations are likely to remain contentious.

Public Finance

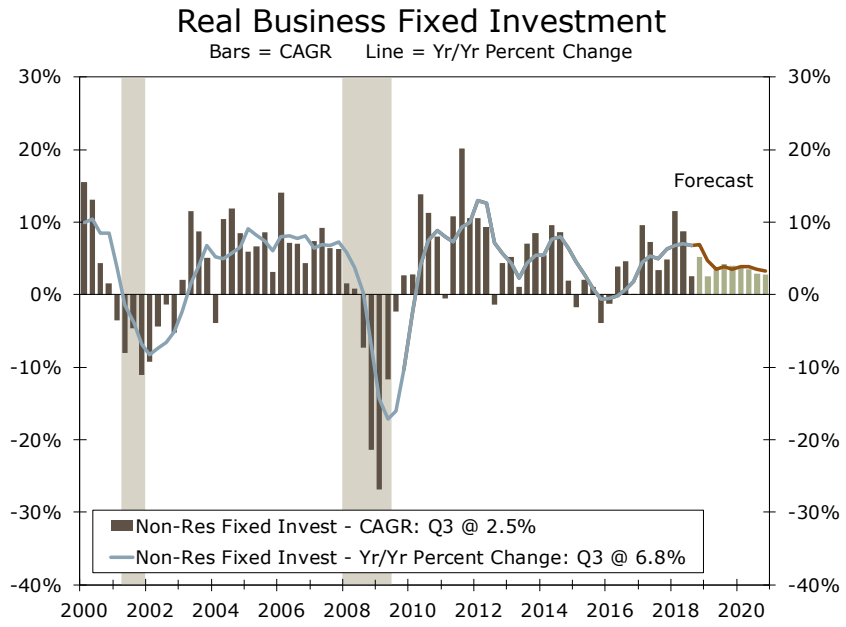
- State and local governments in general have had to tighten budgets to deal with rising healthcare and pension costs. Stronger economic growth has bolstered revenues more recently, leading to increased outlays.

Real GDP growth remained strong in Q3, led by consumer spending. Business fixed investment weakened substantially, however, and residential investment has now been a drag on growth for three consecutive quarters, reflecting the ongoing slowdown in home sales.

Real GDP



Business Fixed Investment

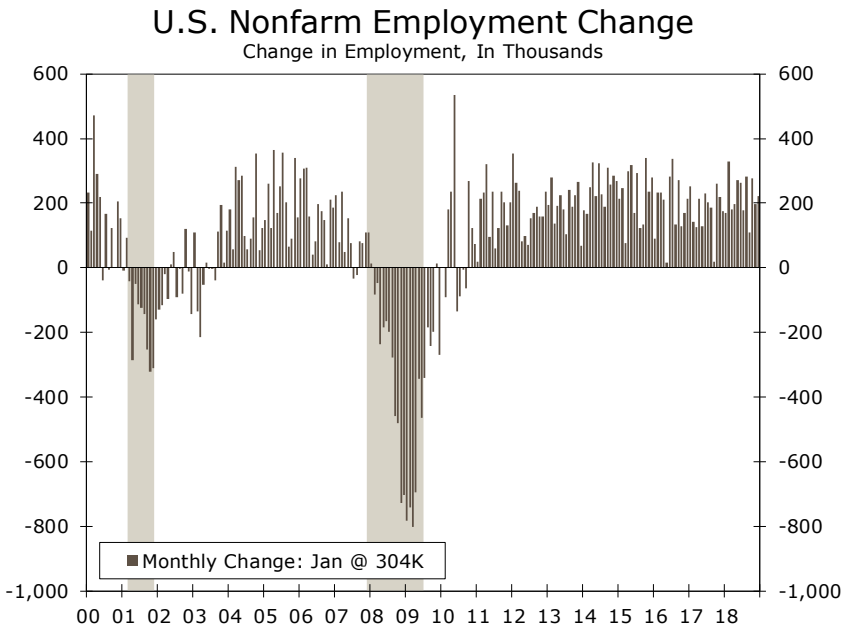


Source: U.S. Department of Commerce and Wells Fargo Securities

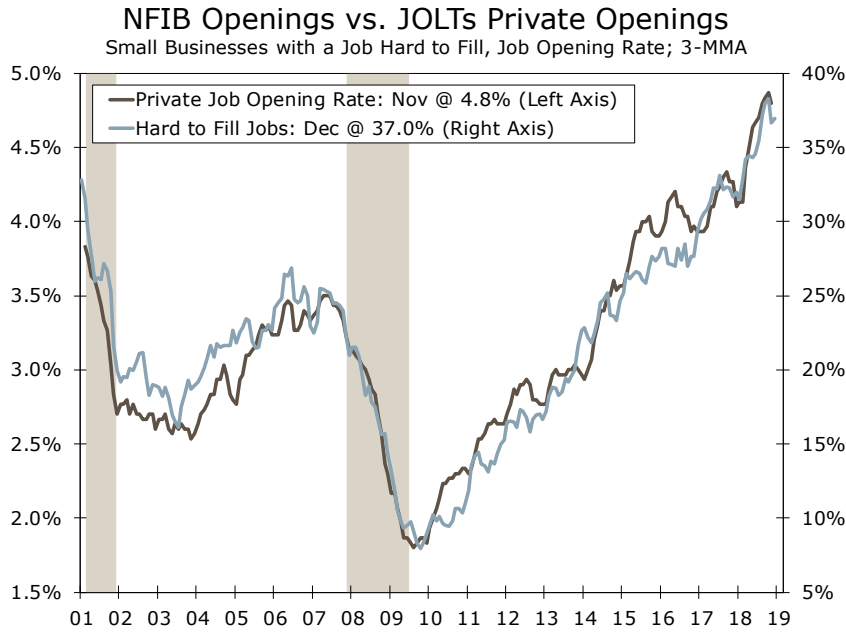
Employment Situation: Broadening Growth

Nonfarm employment growth has maintained its recent strong pace, despite the seemingly low level of available workers. Job growth remains extraordinarily broad-based, and the number of job openings continues to increase across nearly all industries. Wage growth has also rebounded but remains modest relative to prior periods when the labor market was this tight.

Nonfarm Employment



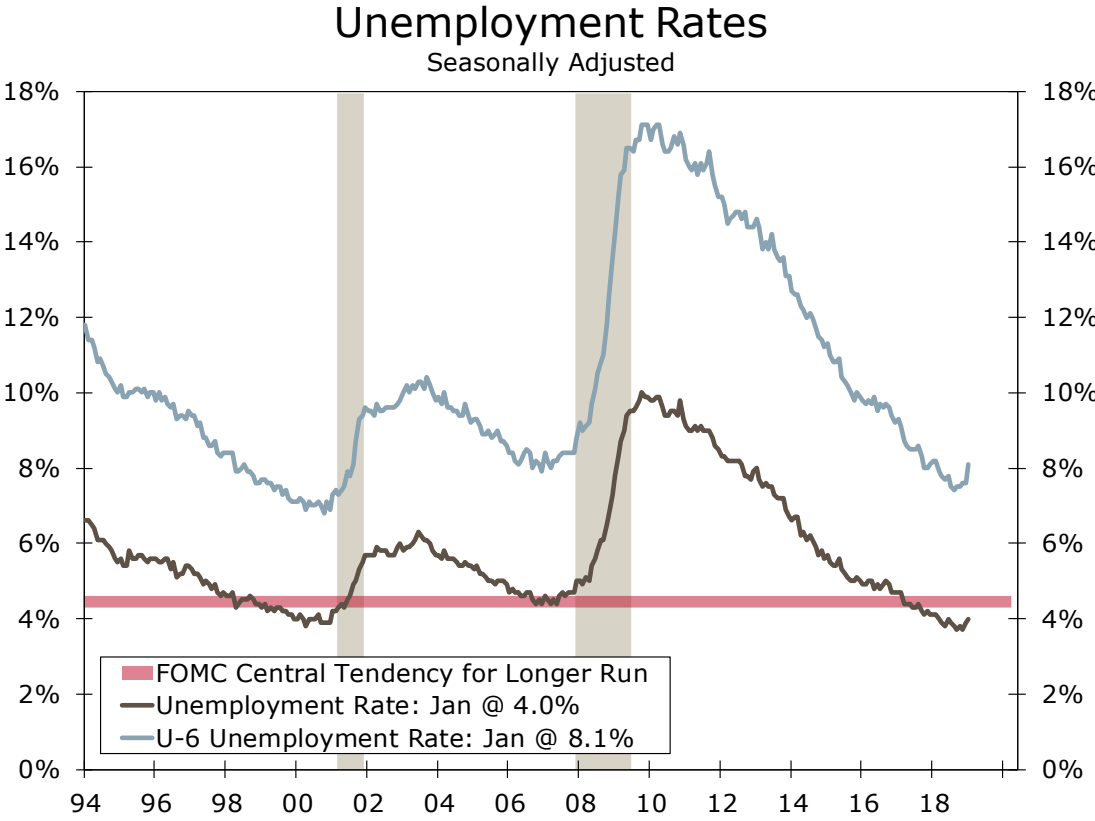
Job Openings



Source: U.S. Department of Labor, National Federation of Independent Business and Wells Fargo Securities

The labor market has tightened substantially, with the unemployment rate at 4.0%.

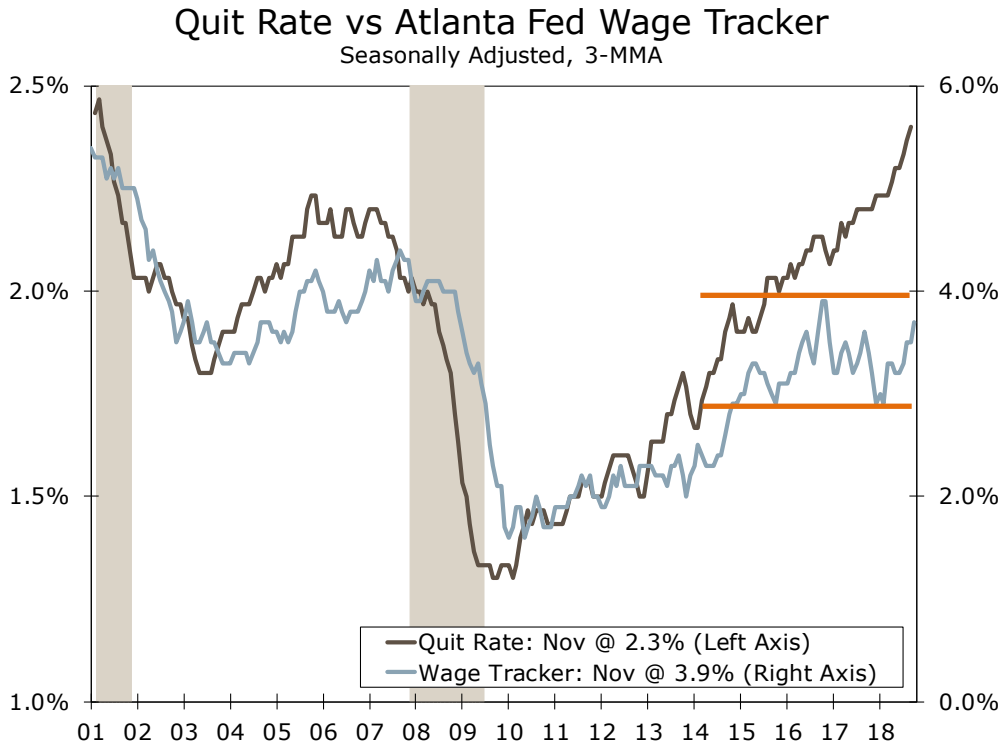
While the criteria for determining the unemployment rate have not changed, growth in the Gig economy, LinkedIn and the proliferation of online job search platforms have likely changed the way workers engage in the labor market, possibly biasing the unemployment significantly lower than in past business cycles.



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

The improvement in the labor market has led to a surge in voluntary quits, yet wage increases have not yet accelerated.

One plausible explanation is that workers are becoming ‘more fully employed’ by migrating away from temporary jobs to permanent positions more closely aligned with their career goals.



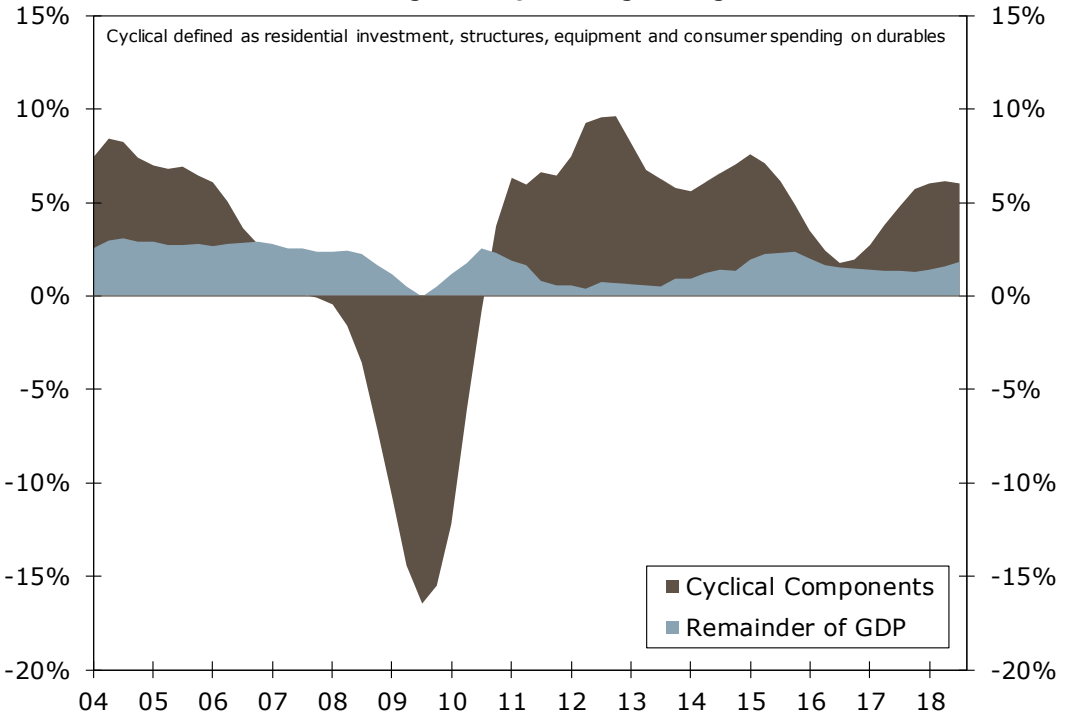
Source: U.S. Department of Labor, Federal Reserve Bank of Atlanta and Wells Fargo Securities

Consumer spending on durable goods, housing, capital spending and nonresidential structures collectively account for 20% of GDP but over 100% of the decline in GDP during recessions.

We have seen less of a boom in the most cyclical parts of the economy during this cycle, which may push a correction further out and ultimately make that correction less severe.

Cyclical Components vs. Rest of GDP

Year-over-Year Change of 4-Qtr Moving Average of Real GDP

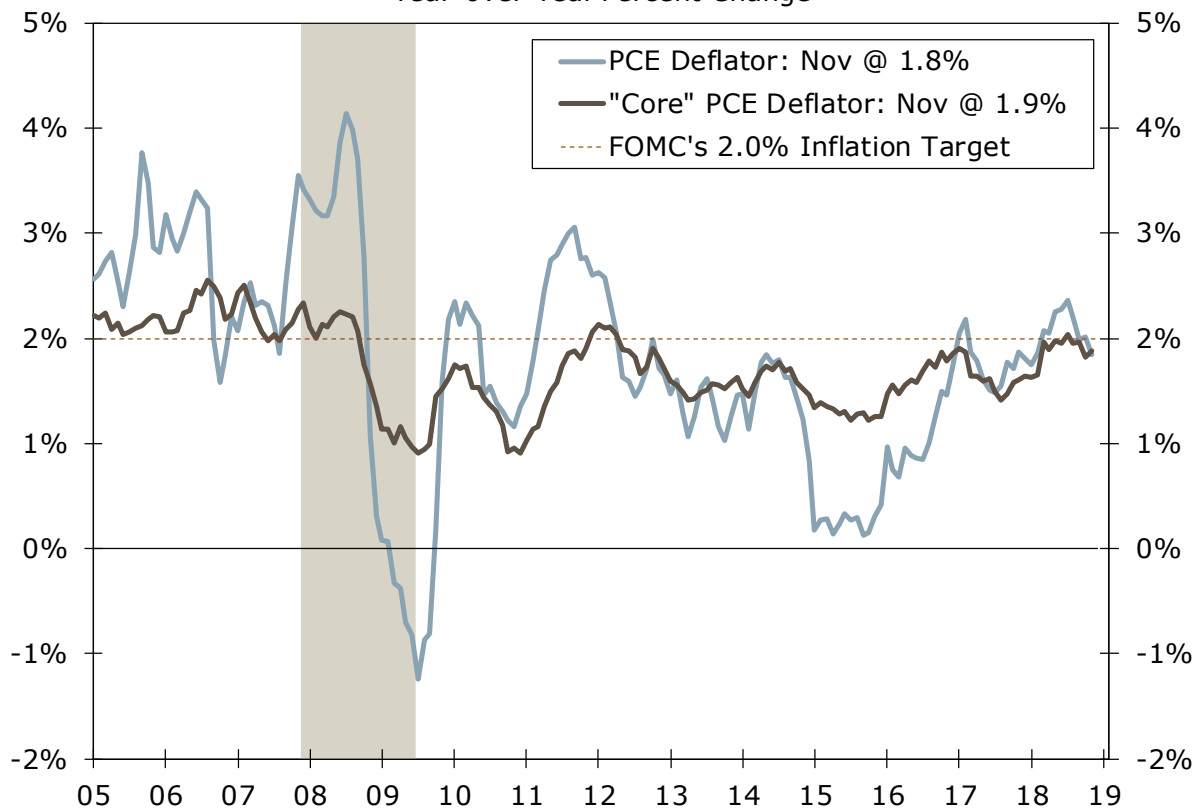


Source: U.S. Department of Commerce and Wells Fargo Securities

The Fed's preferred measure of inflation—the core PCE deflator—finally reached its 2% target before dipping again. With growth cooling off, pipeline inflationary pressures appear to be lessening, and inflation expectations have fallen in recent weeks.

PCE Deflator vs. Core PCE Deflator

Year-over-Year Percent Change



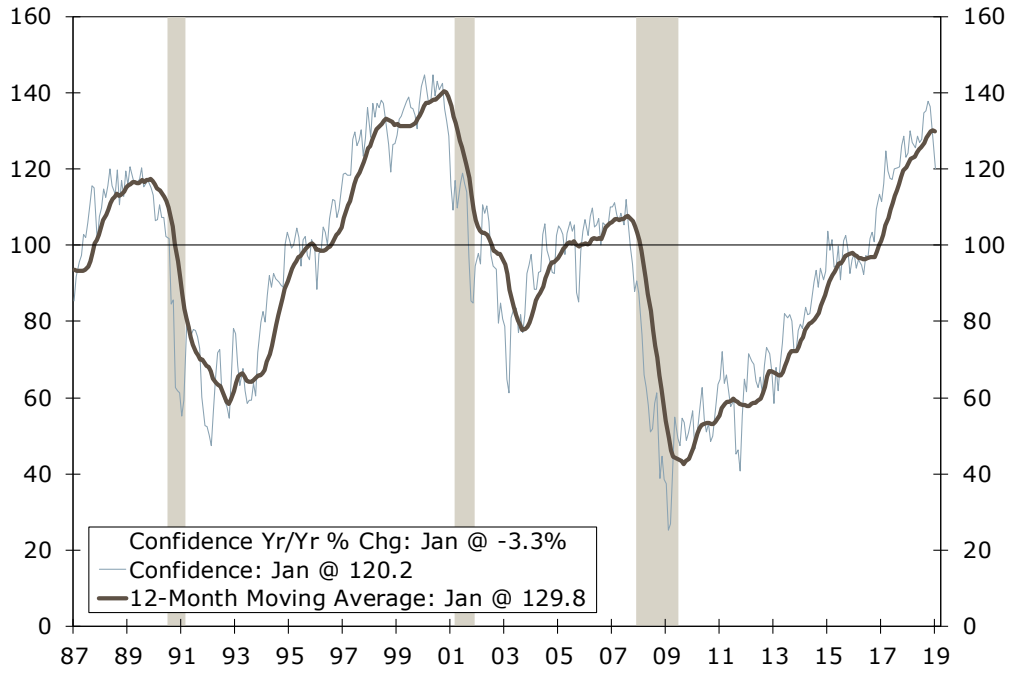
Source: U.S. Department of Commerce and Wells Fargo Securities

Despite a recent dip, consumer confidence is incredibly strong. Consumers are much more upbeat about current conditions than future conditions.

The Conference Board's survey closely tracks labor market conditions, which are the strongest they have been in decades.

Consumer Confidence Index

Conference Board

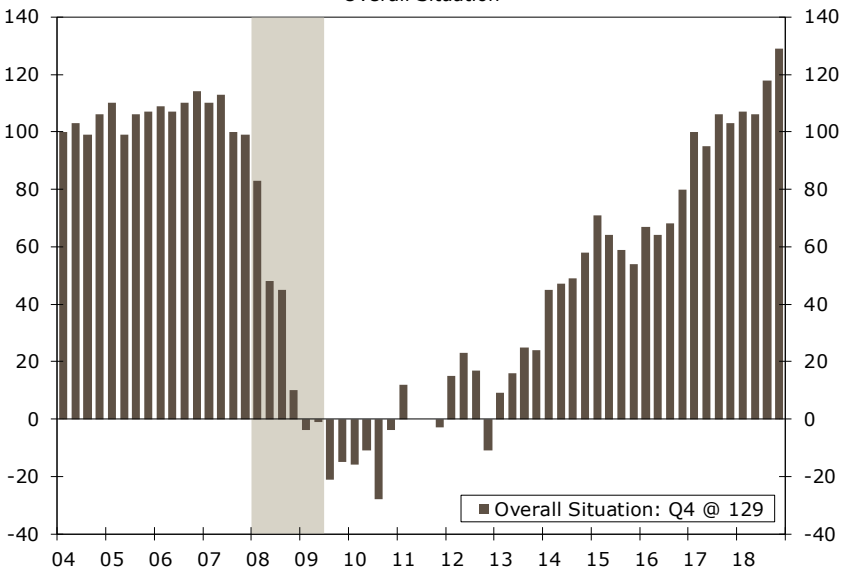


Source: Conference Board and Wells Fargo Securities

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.

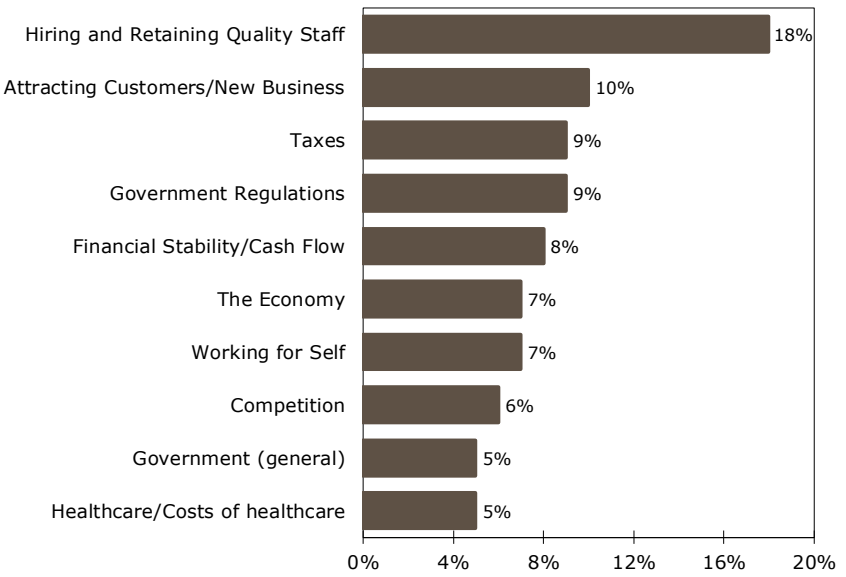
Small Business Optimism

Wells Fargo Small Business Survey
Overall Situation



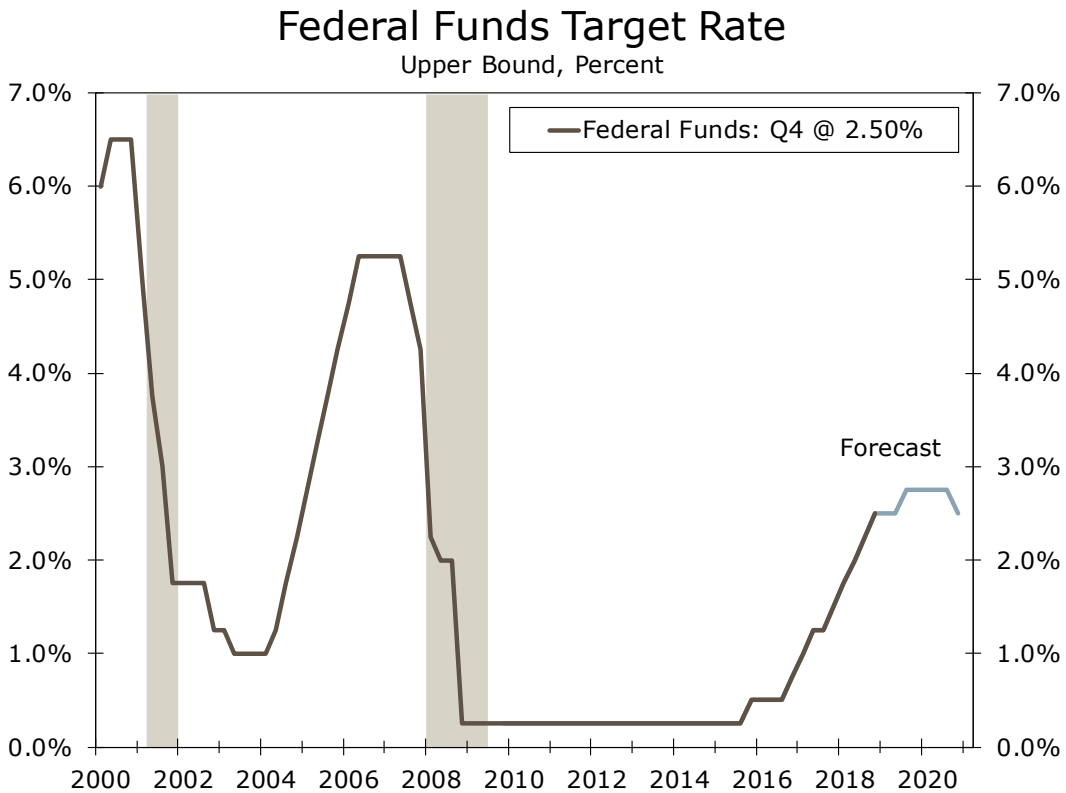
Small Business Challenges

Small Business Owners' Most Important Challenges
Percent, Q4-2018



Source: Gallup, Wells Fargo Bank and Wells Fargo Securities

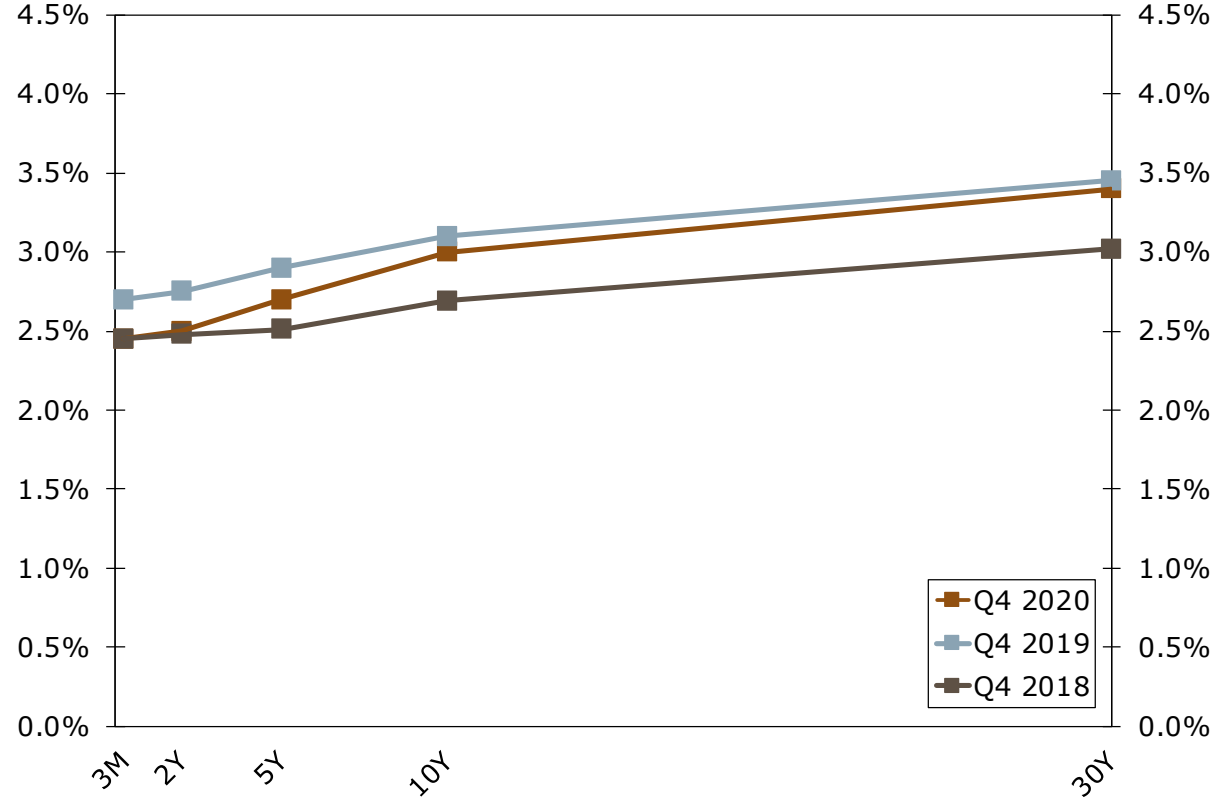
The Fed appears to be rethinking the pace at which it will seek to ‘normalize’ interest rates. Recent statements by Fed Chair Jerome Powell emphasized maintaining flexibility in light of tightening financial conditions and lingering uncertainty surrounding trade policy.



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

The yield curve has flattened and while we expect it to steepen over the next few quarters, an outright inversion is possible if the economy weakens more than is currently expected.

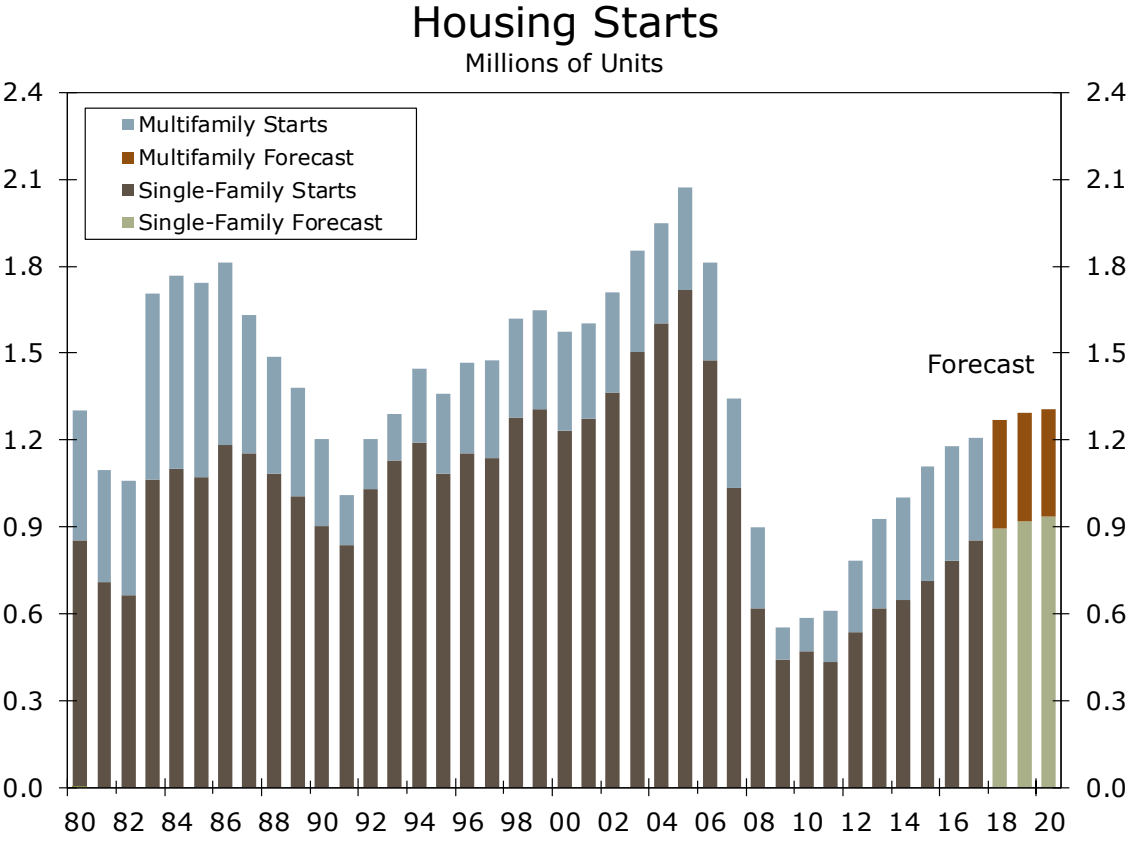
Wells Fargo Rates Forecast Through 2020



Source: Bloomberg LP and Wells Fargo Securities

Even with demand cooling off, we see single-family housing starts rising modestly in 2019.

Overall homebuilding is still lagging household formation and there are too few homes available in markets where population and employment are growing rapidly. Apartment construction is pivoting toward more affordable units.

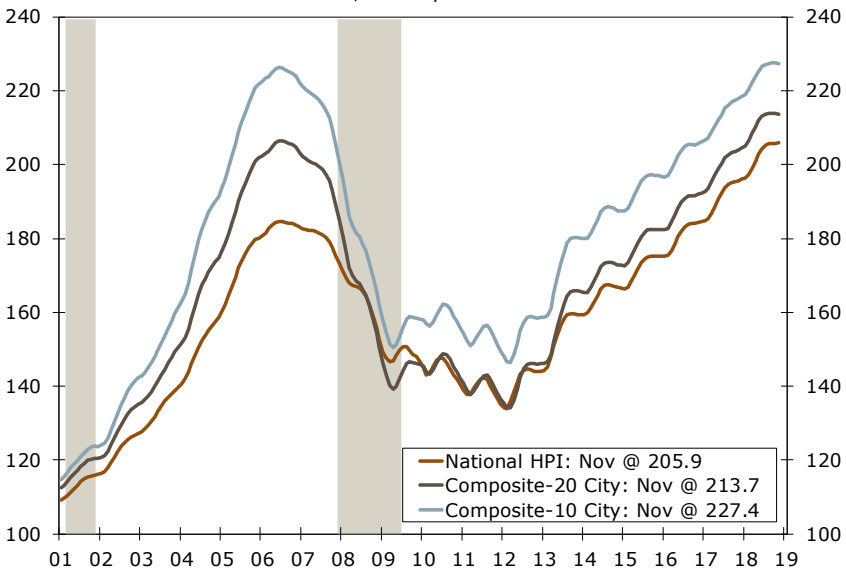


Source: U.S. Department of Commerce and Wells Fargo Securities

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, reflecting less foreign buying and possibly the impact of tax reform.

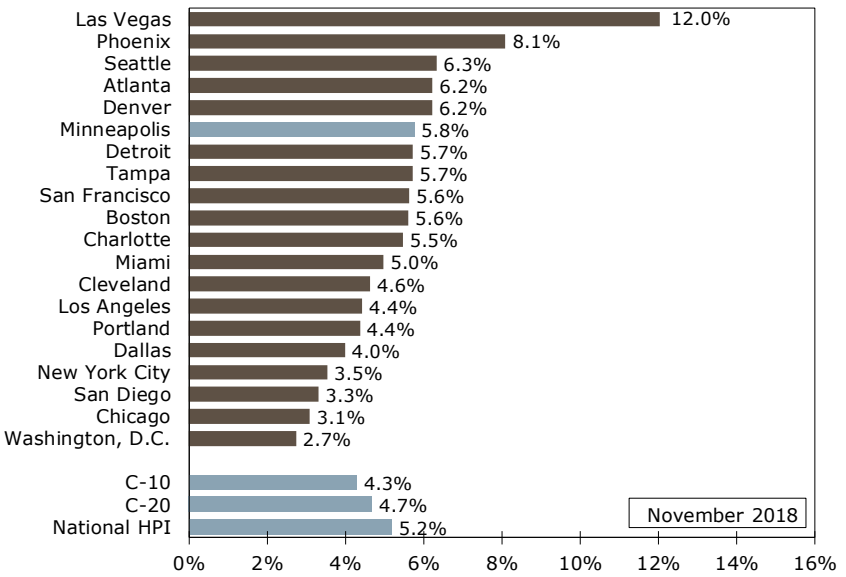
Home Prices

S&P CoreLogic CS Home Price Index
Index, January 2000=100



Regional

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

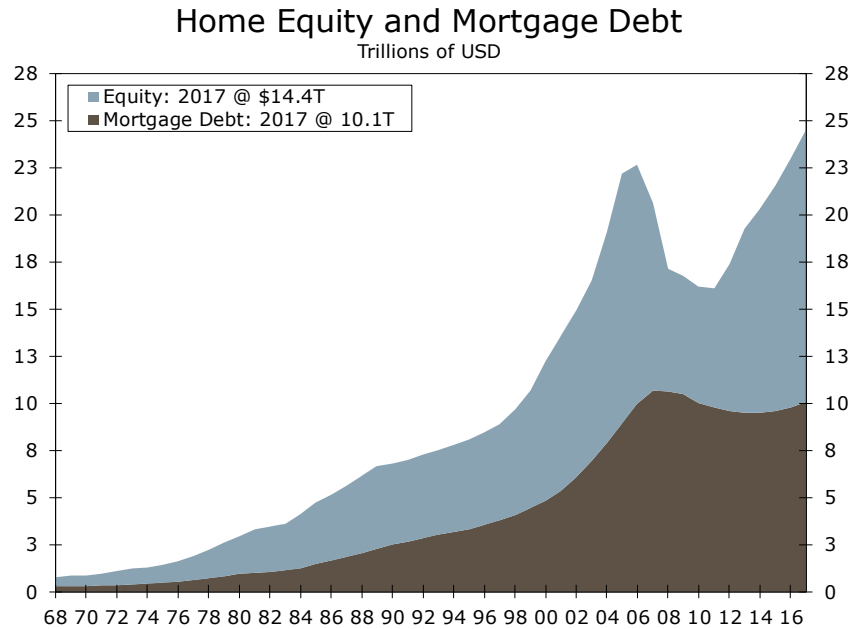
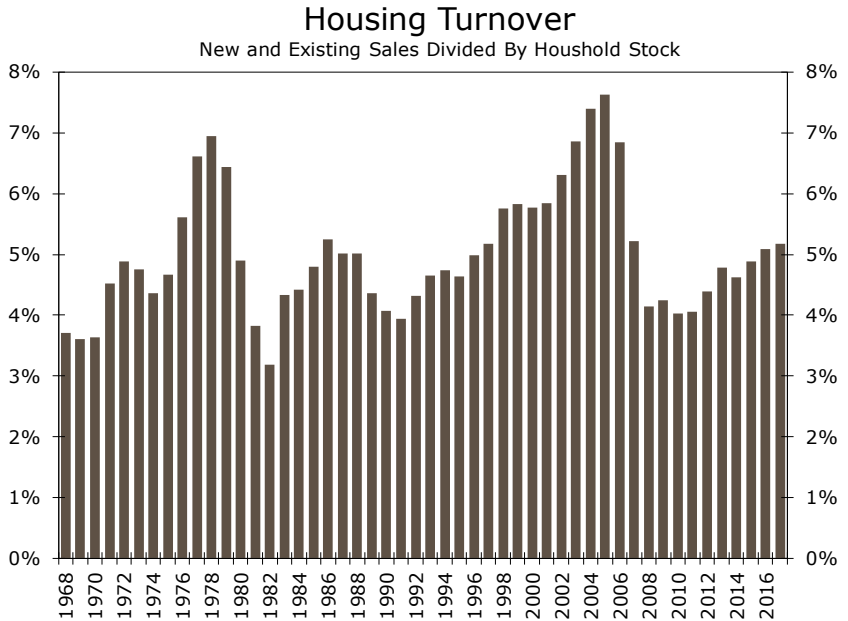


Source: S&P Case-Shiller and Wells Fargo Securities

Housing turnover has slowly risen back near its long-term norm. We suspect many current homeowners are opting to remain in homes that they refinanced at near generational low mortgage rates. The rise in home equity provides a much needed cushion for Baby Boomers.

Turnover

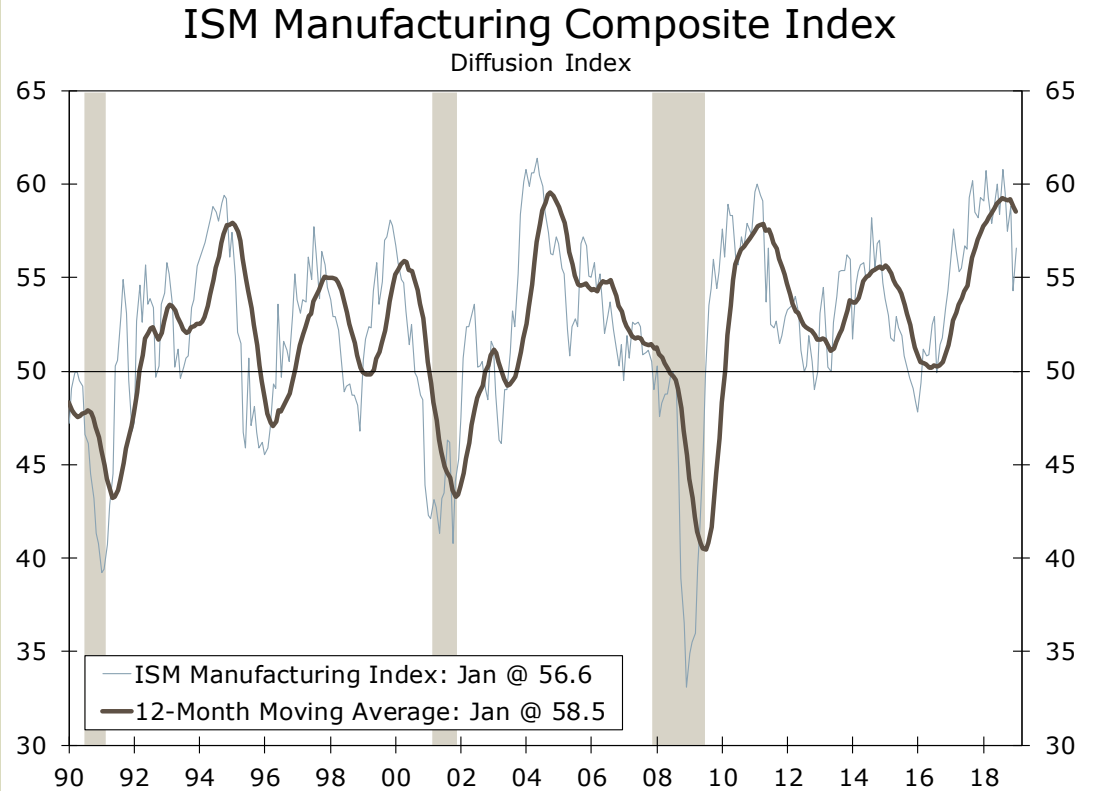
Equity



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

The ISM manufacturing survey has certainly come down, adding to fears of a slowdown.

The reading still remains consistent with expansion, however.

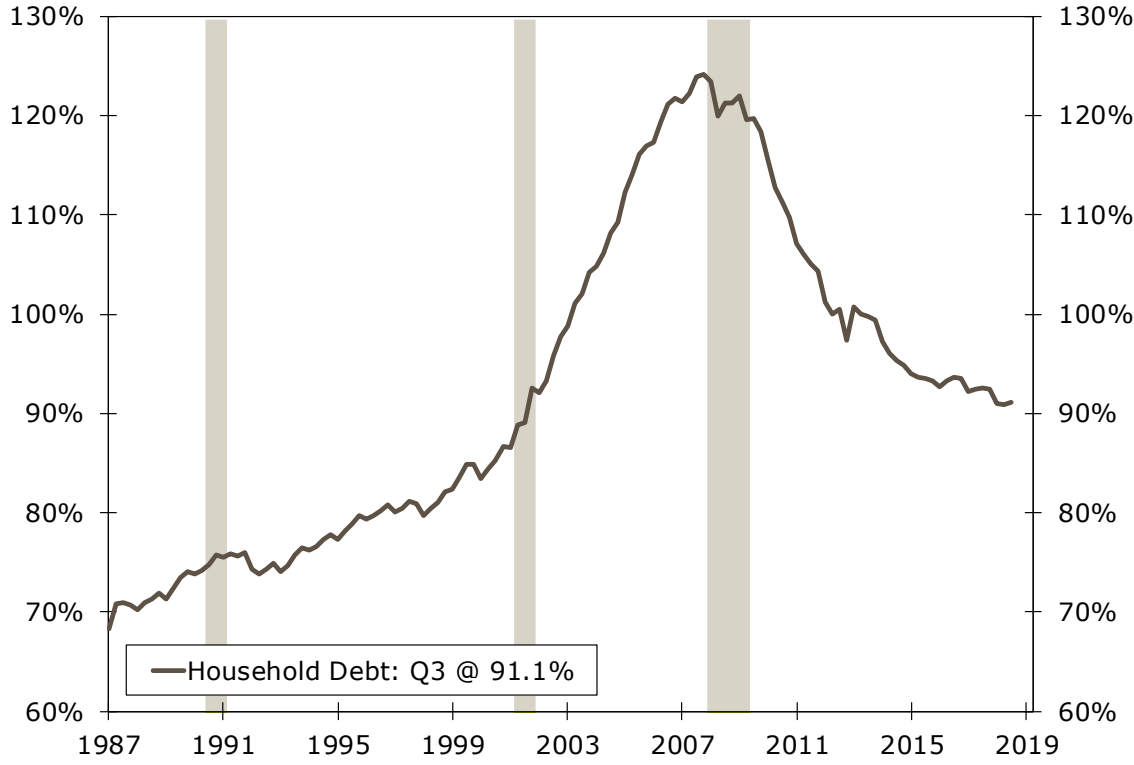


Source: Institute for Supply Management and Wells Fargo Securities

The household sector remains in very good shape.

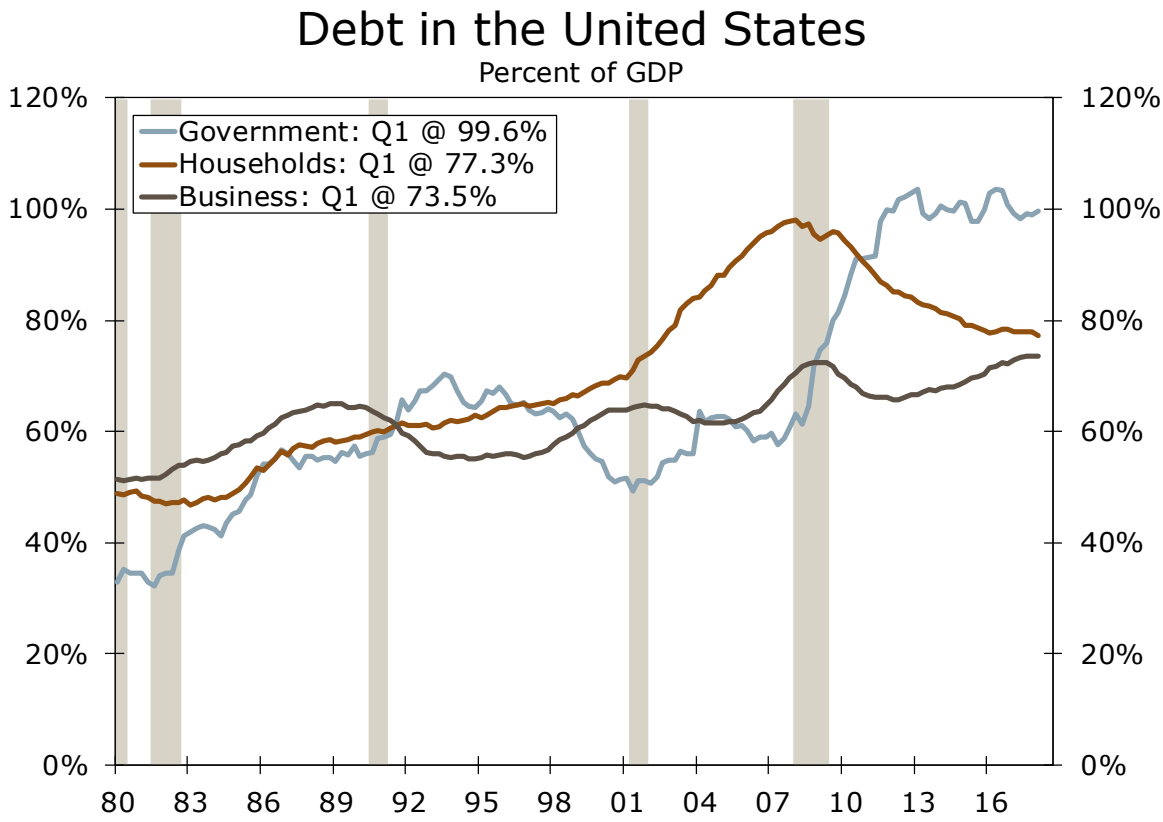
U.S. Household Debt to Disposable Income

Household Debt/After-Tax Income, Percent



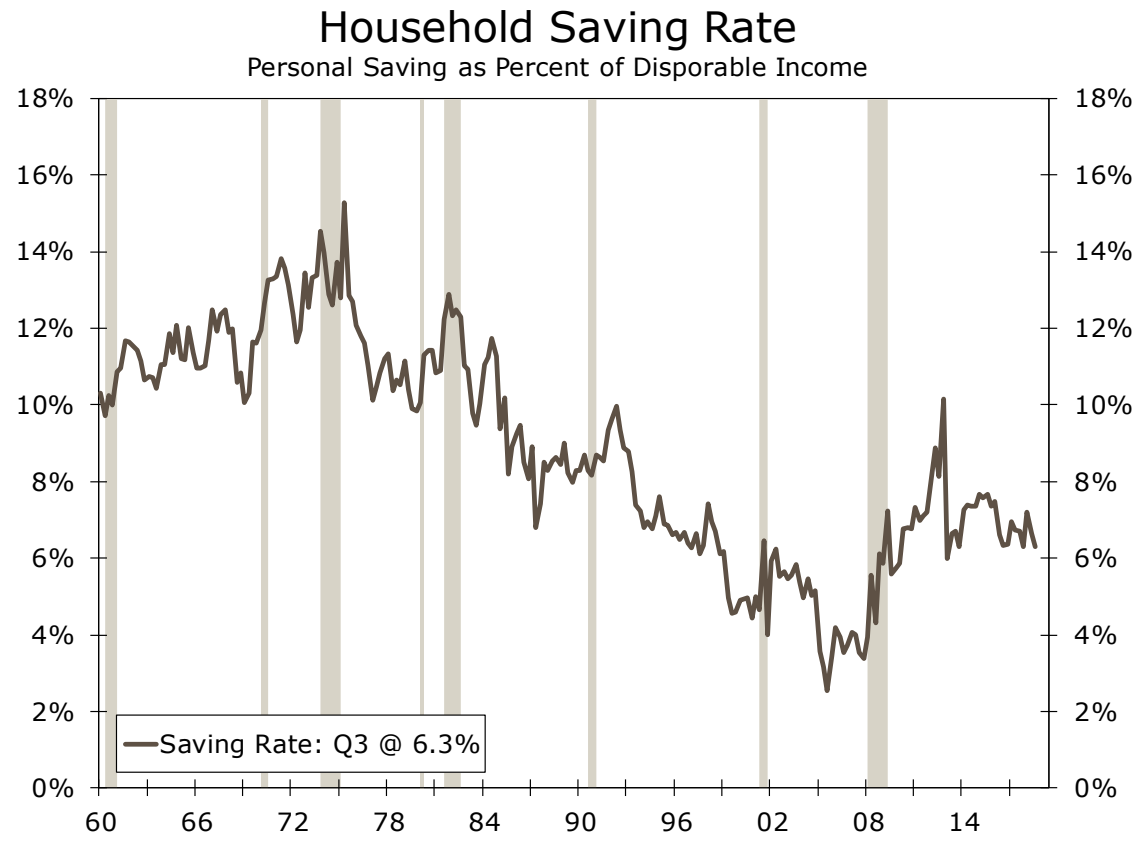
Source: Federal Reserve Board and Wells Fargo Securities

The government debt ratio has stabilized, albeit at a high level, but the debt ratio in the business sector is trending higher.



Source: Bank for International Settlements and Wells Fargo Securities

The savings rate remains high for this point in the cycle.

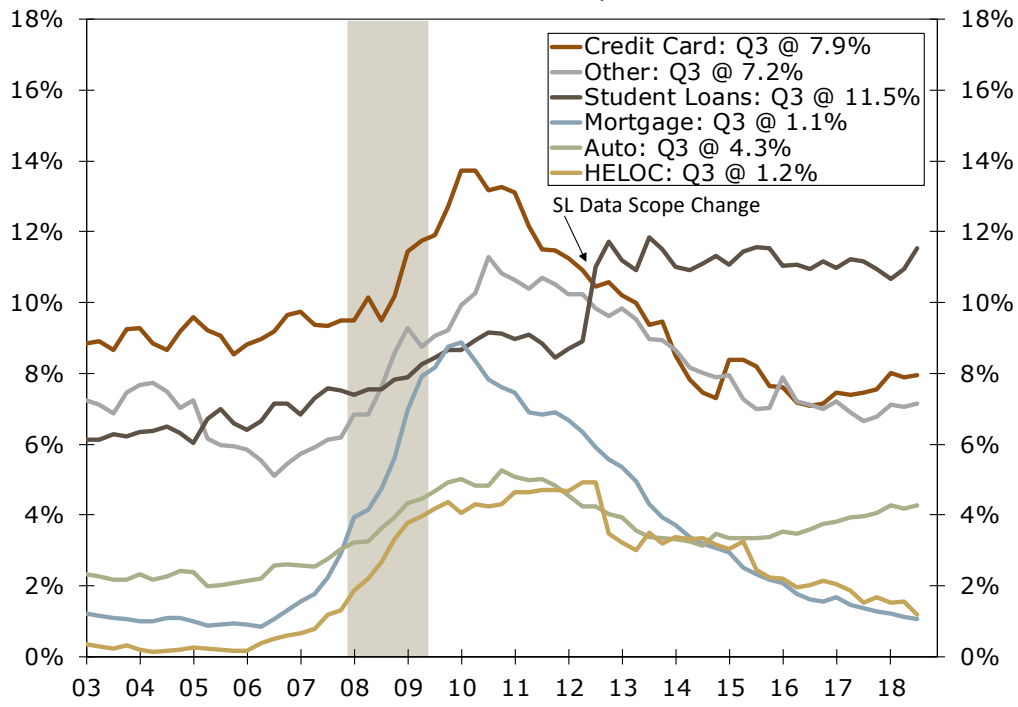


Source: Federal Reserve Board and Wells Fargo Securities

Delinquency rates remain low. Student and auto loan delinquencies have begun to tick up modestly.

Household Debt Delinquencies

Percent of Balance 90+ Days Past Due

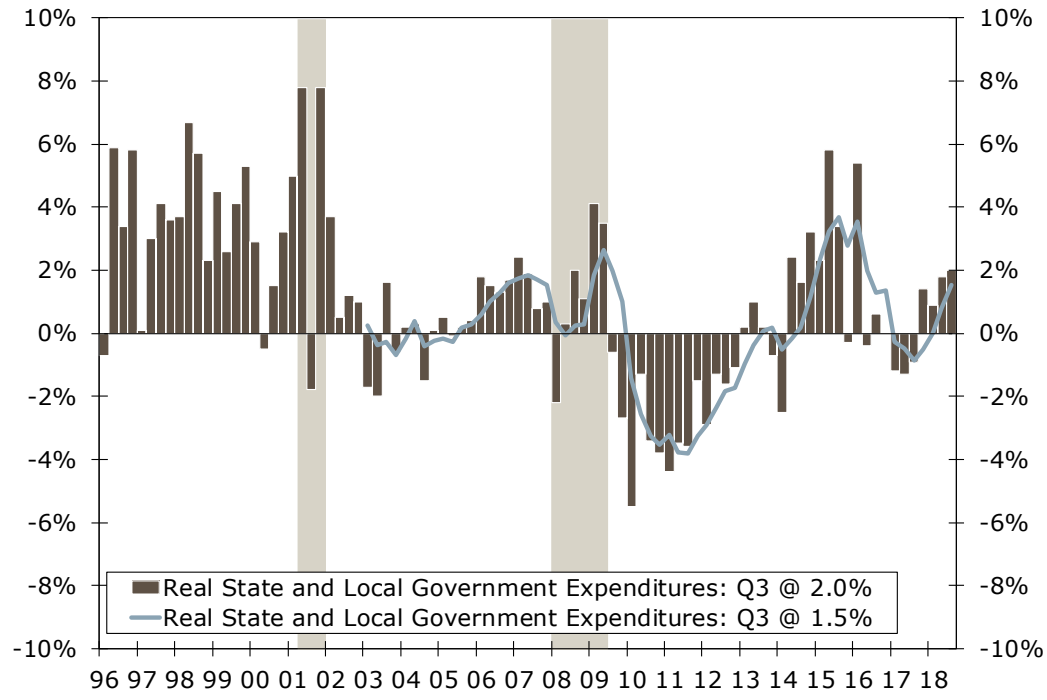


Source: Federal Reserve Bank of New York and Wells Fargo Securities

State and local government spending has been rising.

Real State & Local Government Expenditures

Bars = Compound Annual Rate Line = Yr/Yr % Change

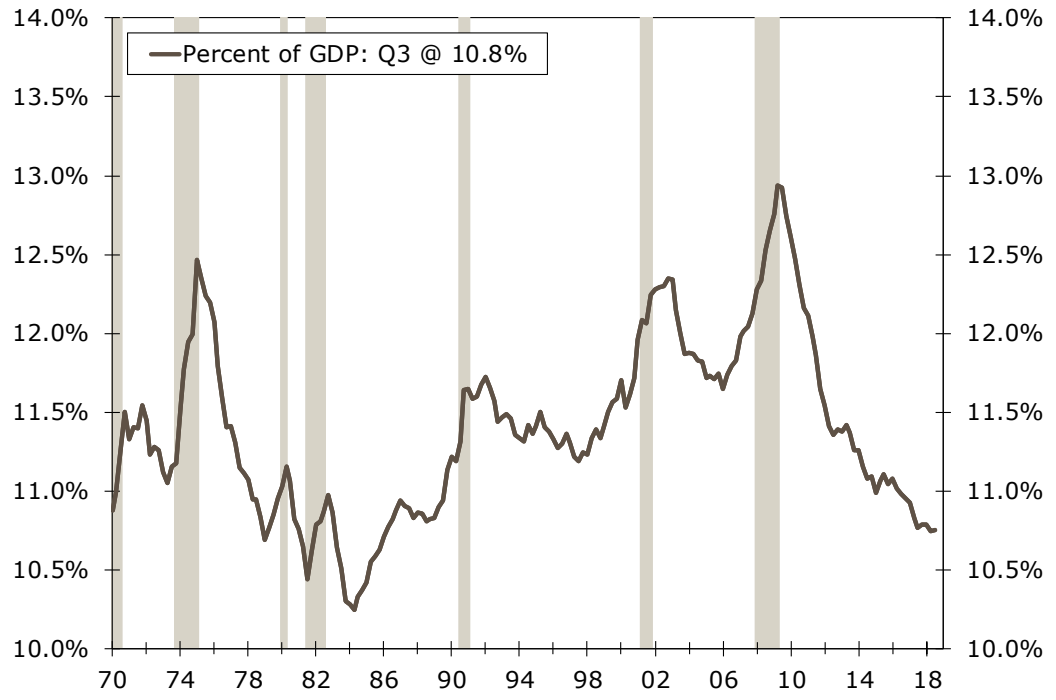


Source: U.S. Department of Commerce and Wells Fargo Securities

However, as a share of GDP municipal spending has been falling.

State & Local Government Expenditures

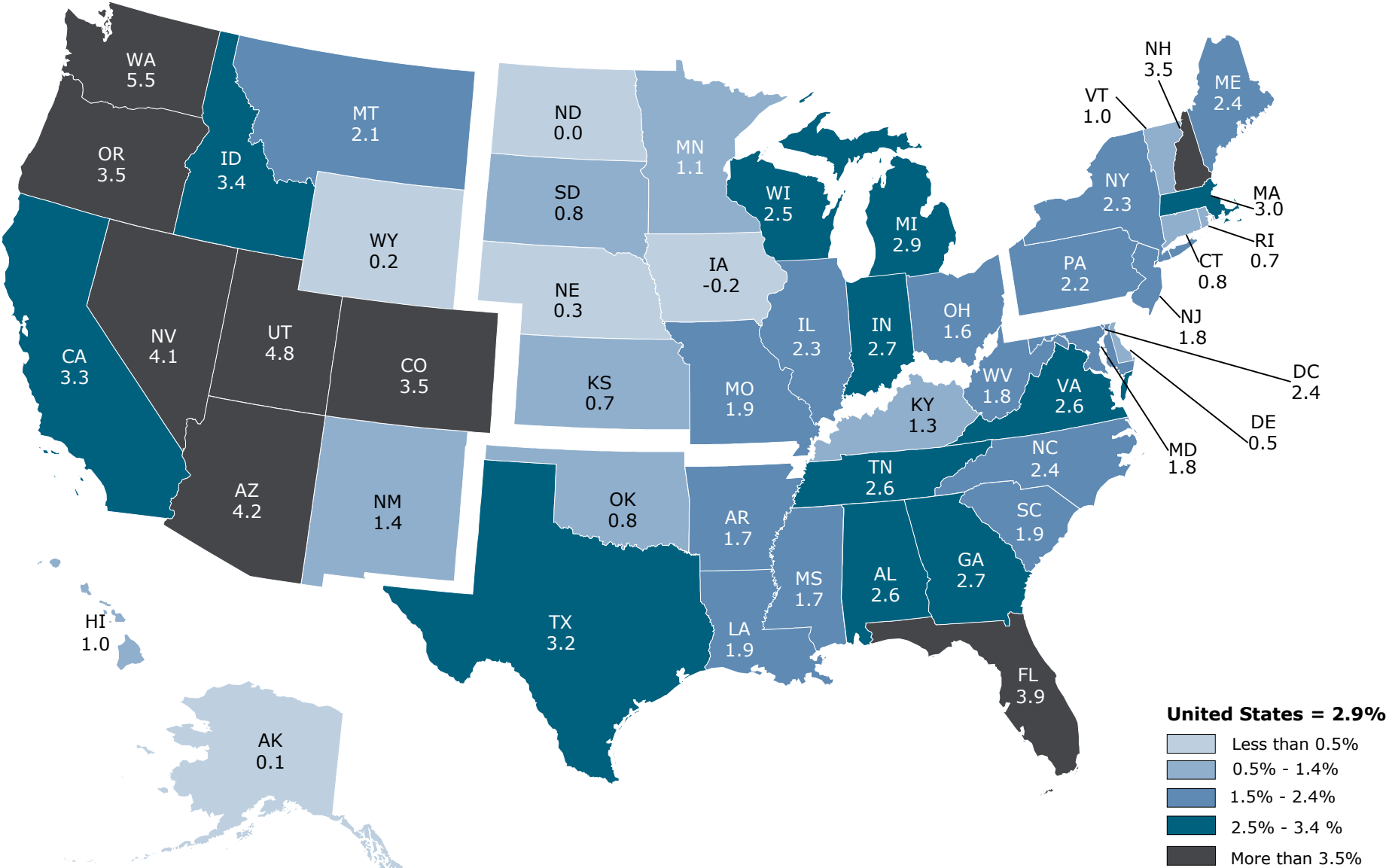
As a Percent of GDP



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

Regional Commentary

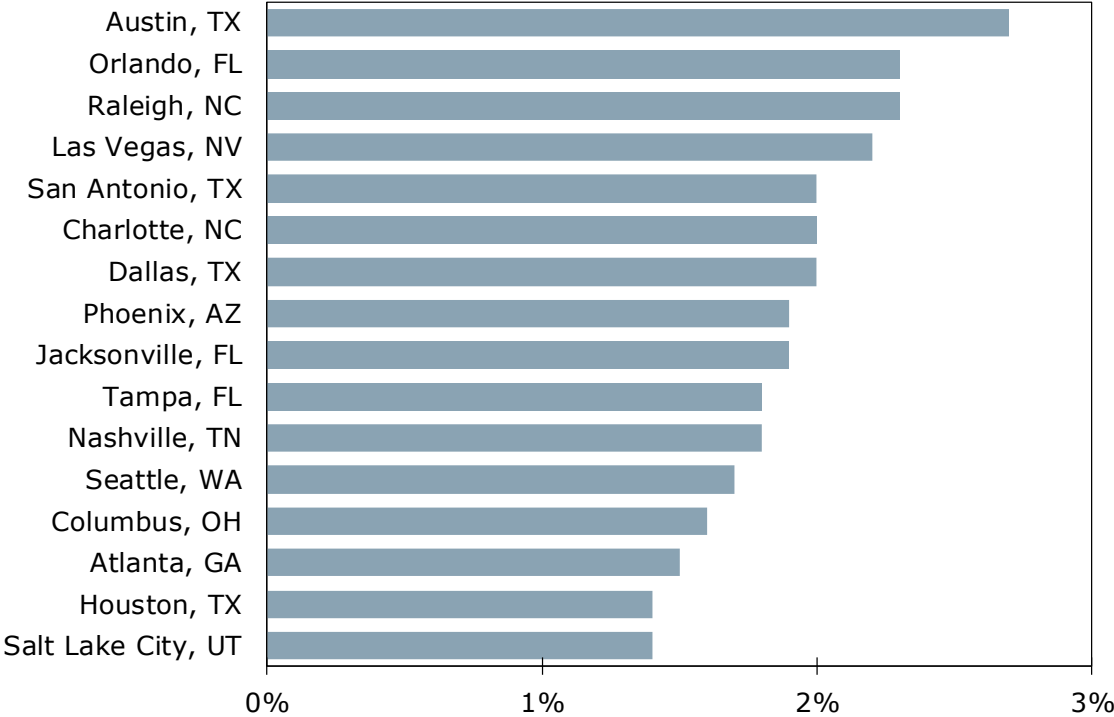
Year-over-Year Percent Change in Real GDP by State (Q2-2018)



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

Many of the fastest growing metros are in affordably priced regions in the South and West.

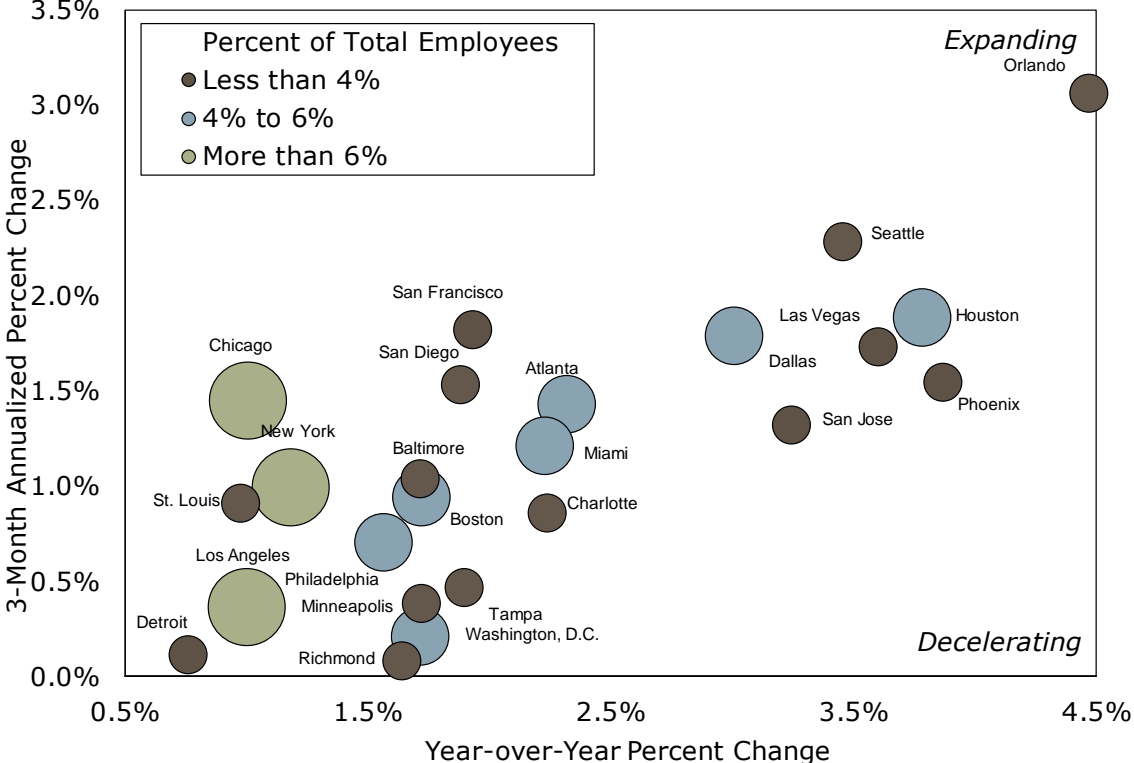
15 Fastest Growing Large Metro Areas in 2017
Year-over-Year Population Growth, Among 50 Largest MSAs



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

Employment growth is strongest in the South and West.

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

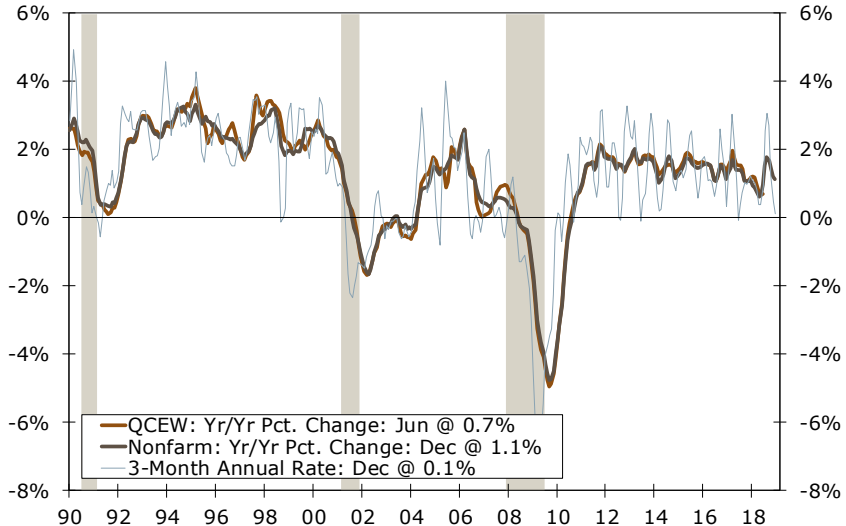


Source: U.S. Department of Labor and Wells Fargo Securities

Employment growth in Minnesota has begun to moderate in the midst of an extremely tight labor market.

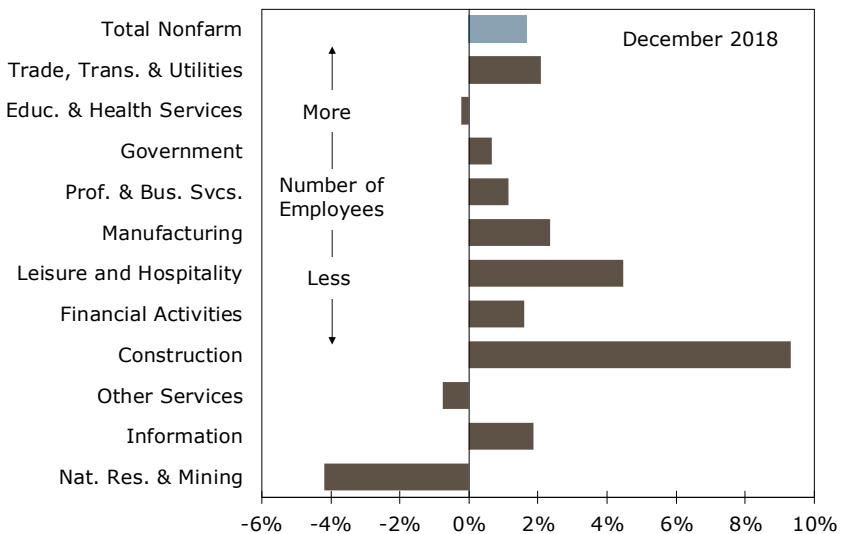
Employment Growth

Minnesota Nonfarm Employment
3-Month Moving Averages



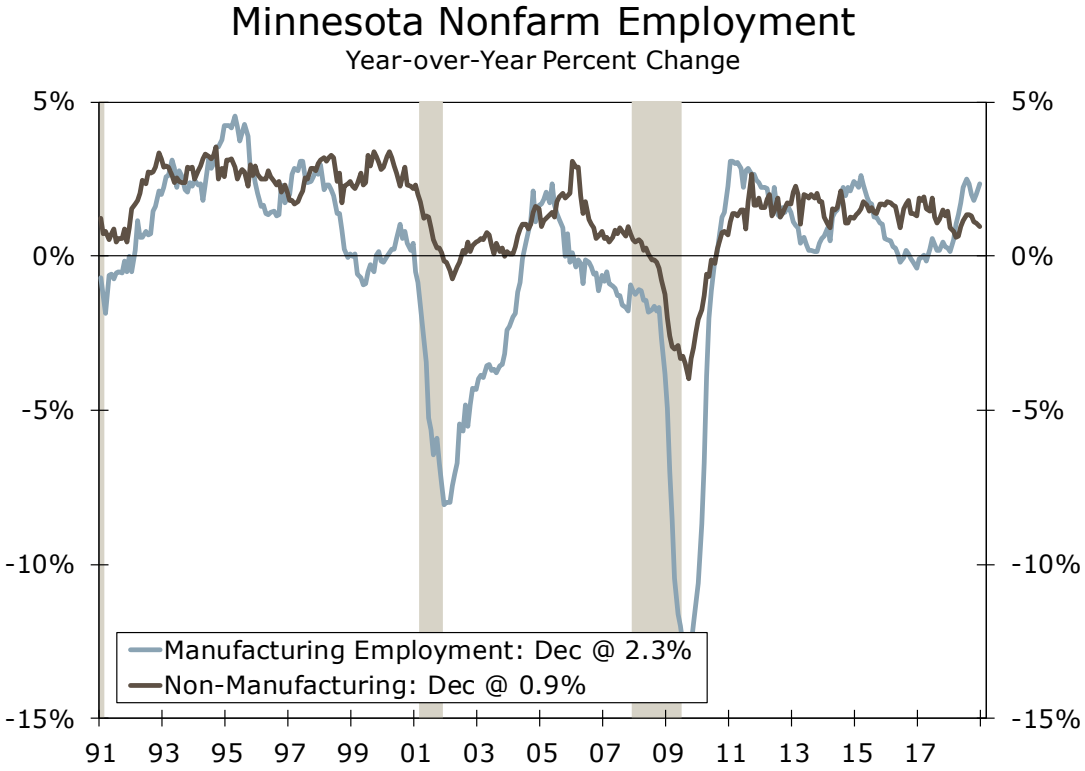
Employment by Industry

Minnesota Employment Growth By Industry
Year-over-Year Percent Change, 3-MMA



Source: Department of Labor and Wells Fargo Securities

Manufacturing employment has picked up and now outpaces overall job growth.

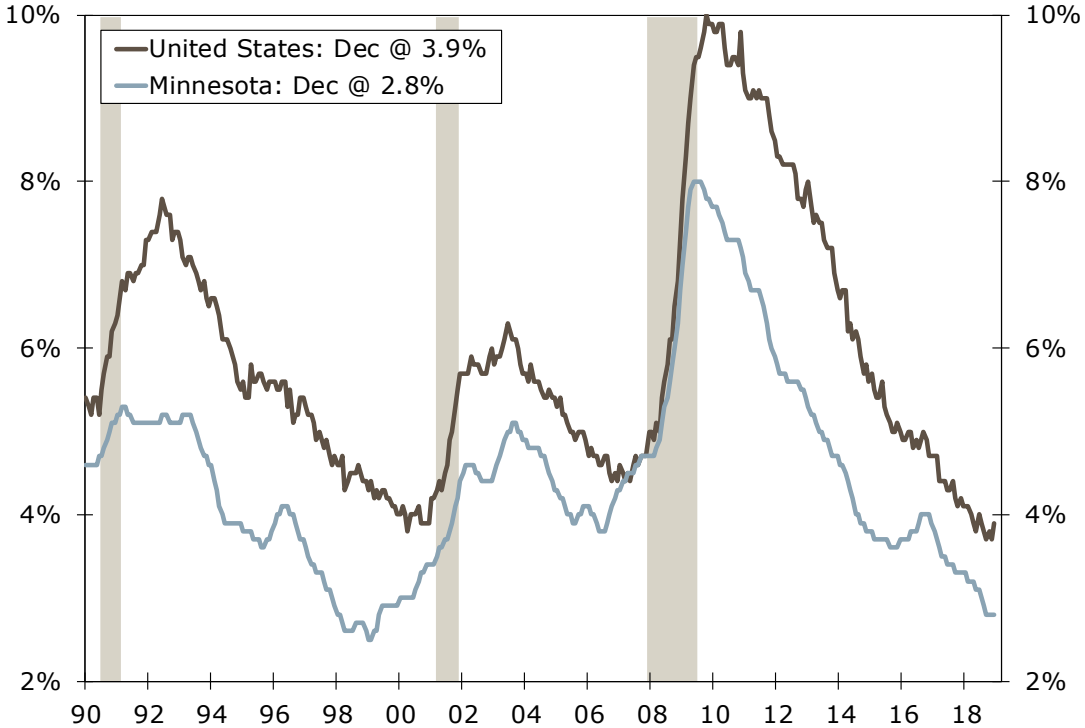


Source: U.S. Department of Labor and Wells Fargo Securities

Minnesota has the sixth lowest unemployment rate of any state. Finding skilled labor has become increasingly challenging.

Minnesota vs. U.S. Unemployment Rate

Seasonally Adjusted

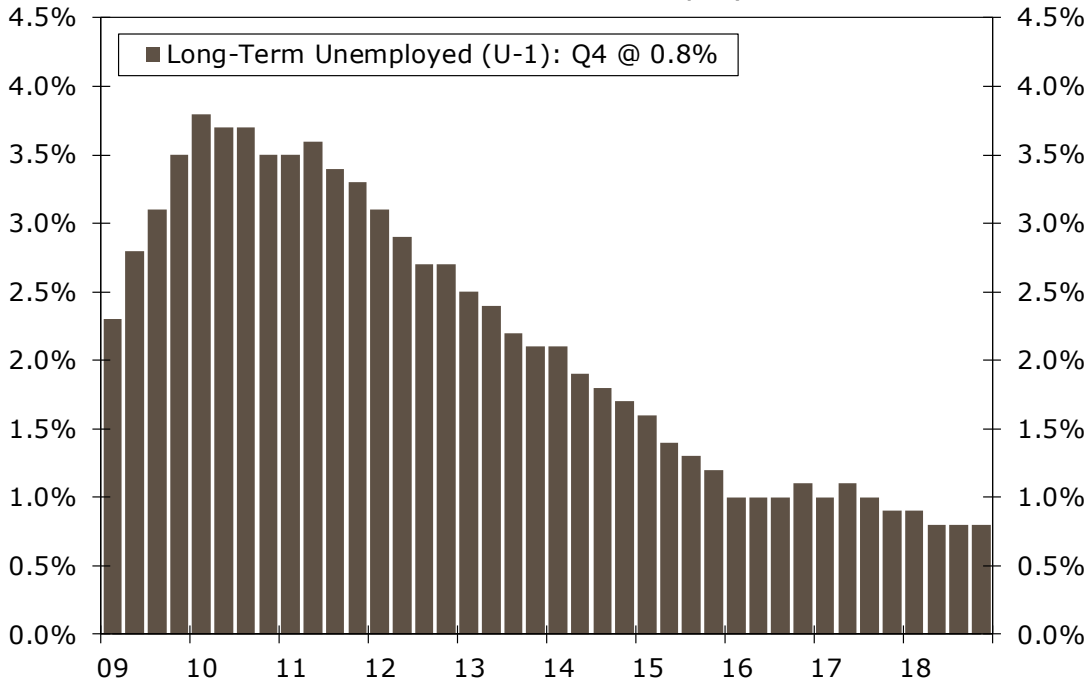


Source: U.S. Department of Labor and Wells Fargo Securities

Very few Minnesotans who have been seeking a job for a long period of time have been unable to find one.

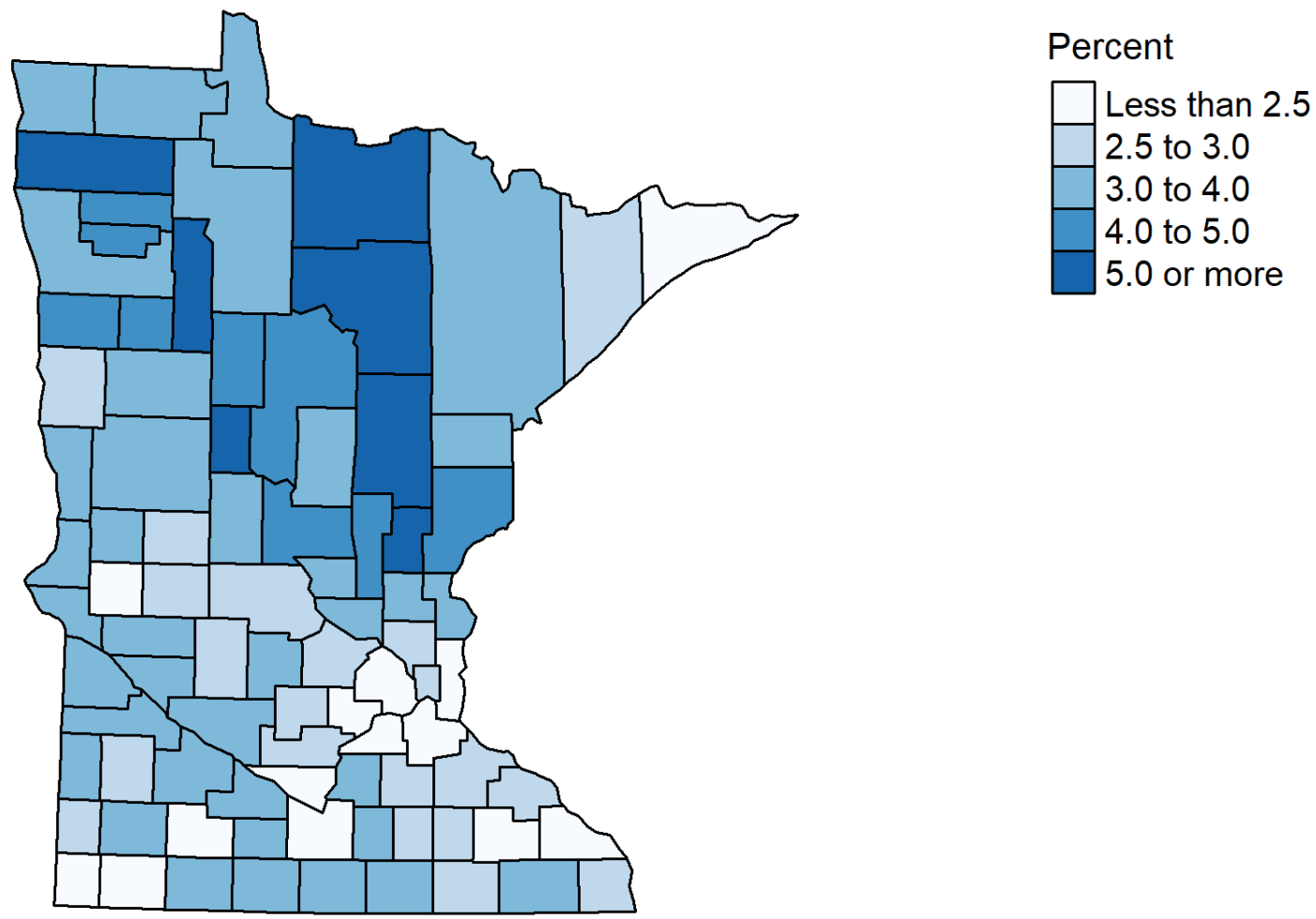
Minnesota Long-Term Unemployment

Percent of Civilian Labor Force Unemployed 15+ Weeks



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

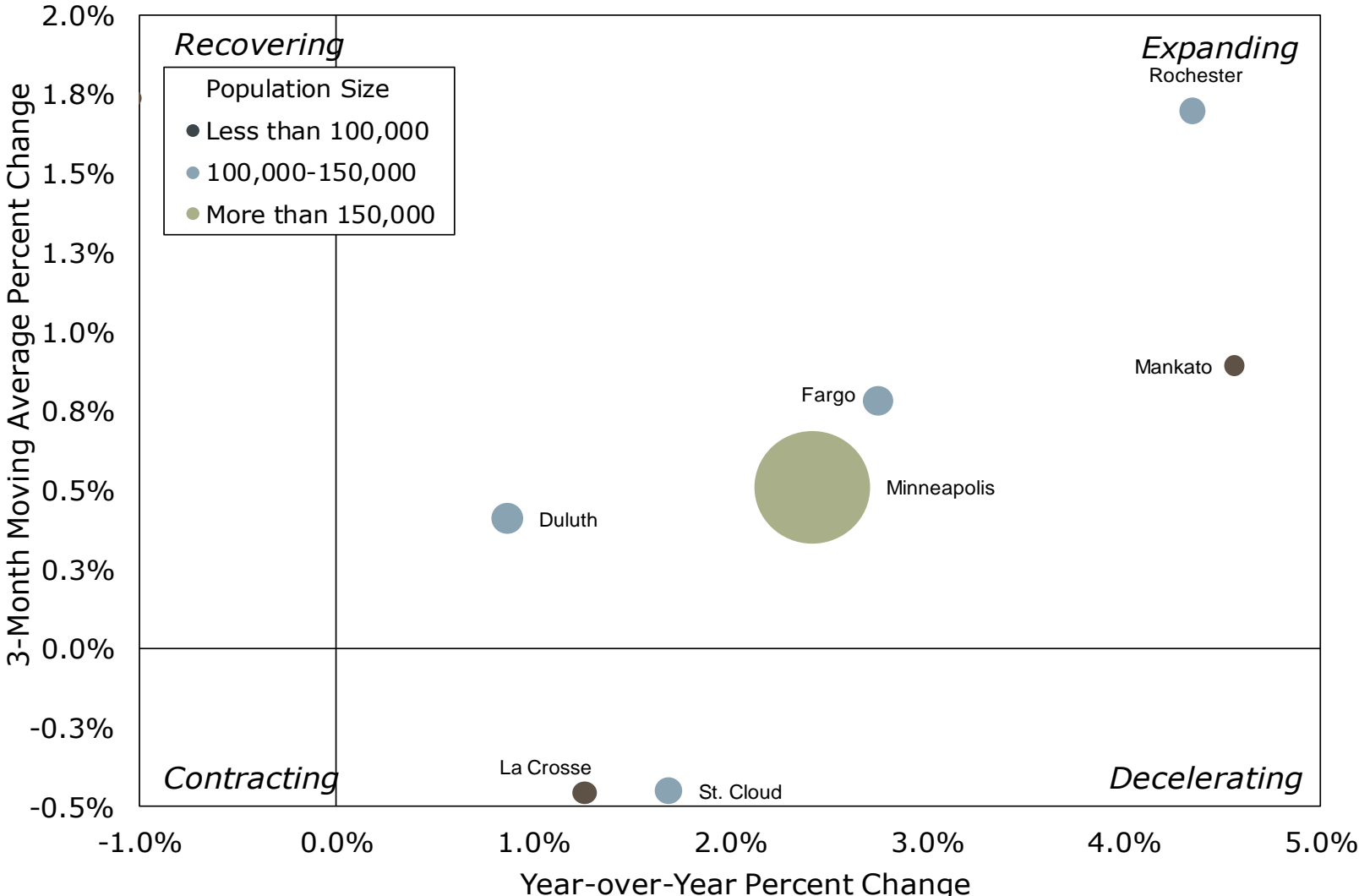
Minnesota Unemployment Rates



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

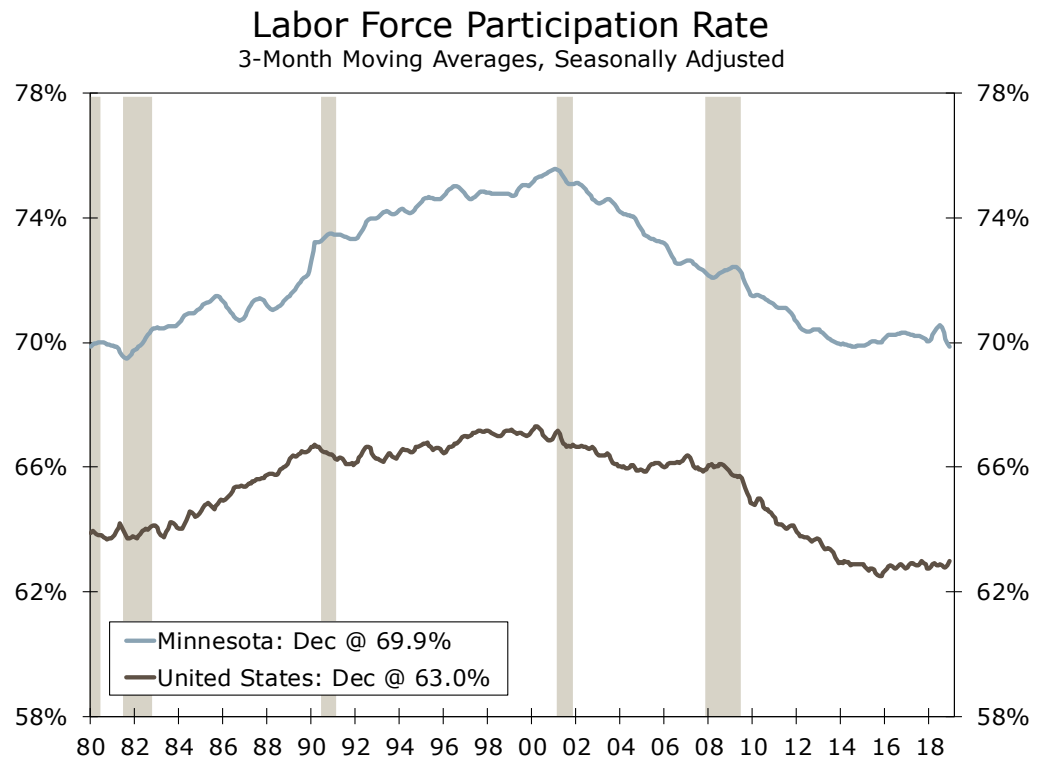
Minnesota Employment Growth: December 2018

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



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

Labor force participation rates across the Midwest are higher than the national rate.

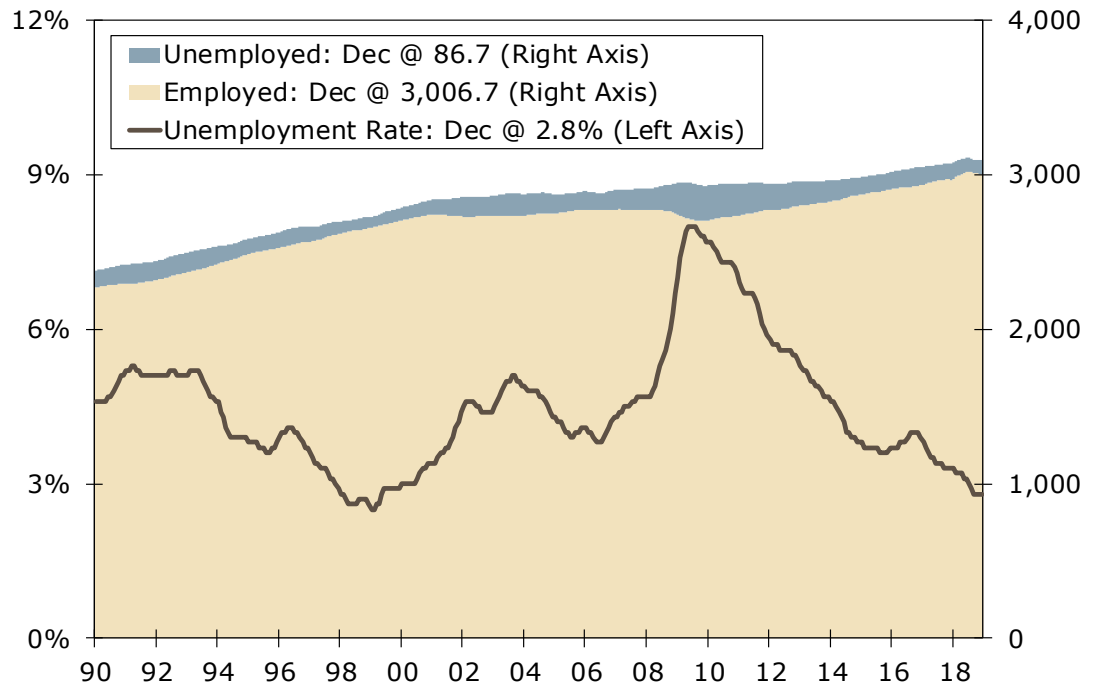


Source: U.S. Department of Labor and Wells Fargo Securities

Further employment gains are likely to be constrained by the already low unemployment rate and the already high labor force participation rate.

Minnesota Unemployment & Labor Force

Percent, Thousands of Workers, Seasonally Adjusted

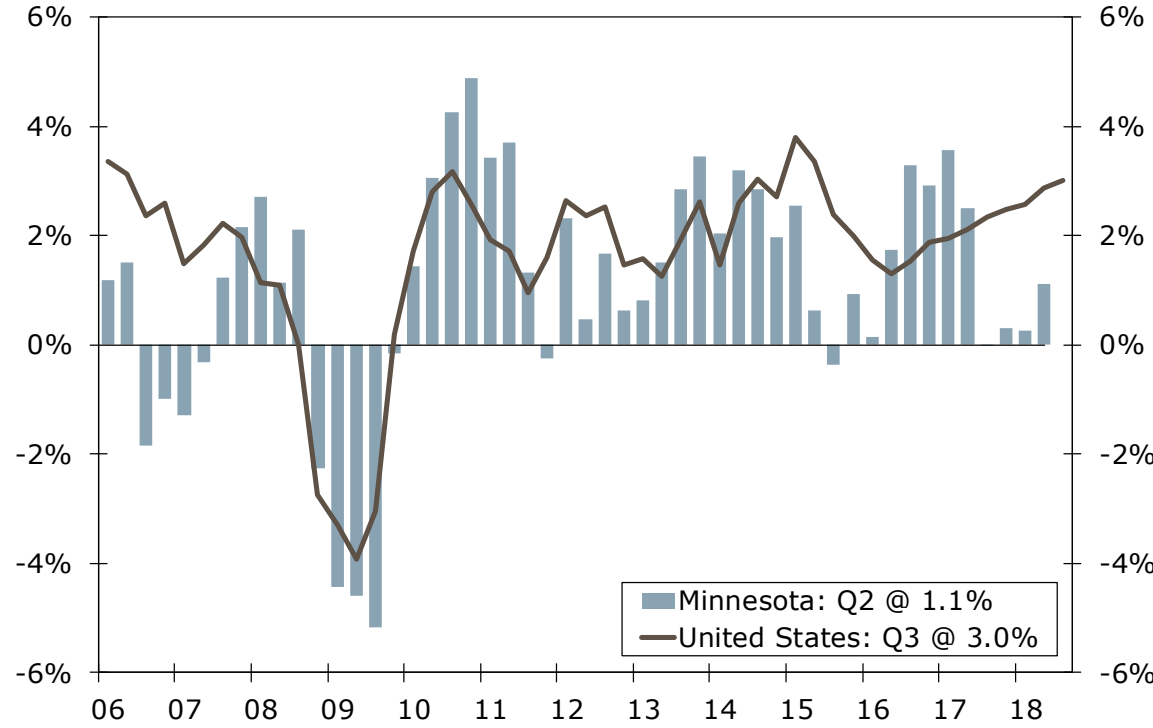


Source: U.S. Department of Labor and Wells Fargo Securities

Minnesota's economy has trailed the national economy for four consecutive quarters.

Gross State Product & U.S. GDP

Year-over-Year Percent Change



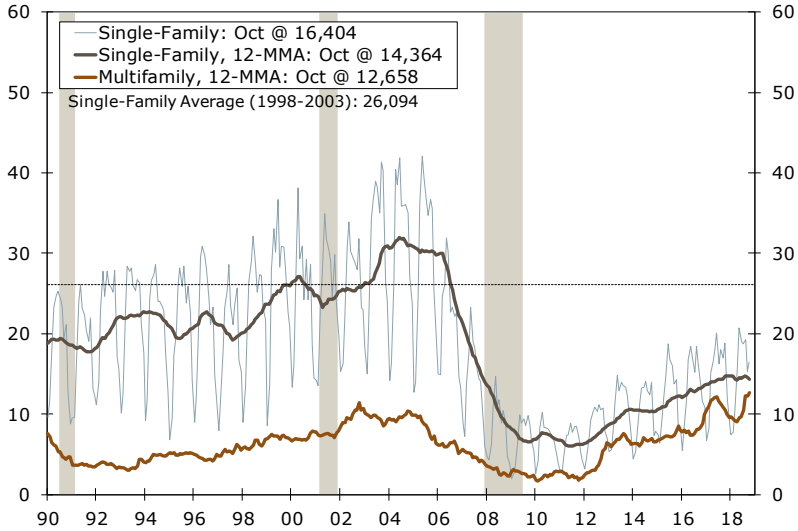
Source: U.S. Department of Commerce and Wells Fargo Securities

Single-family construction has steadily climbed upwards but remains below its prior peak as well as its long-run average. Apartment construction has been strong.

Home Permits

Minnesota Housing Permits

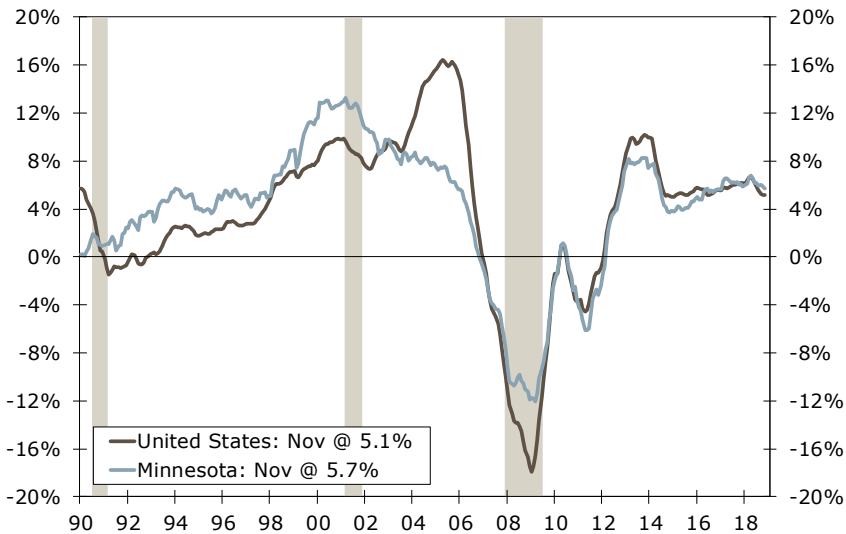
Thousands of Permits, Seasonally Adjusted Annual Rate



Home Prices

CoreLogic HPI: MN vs. U.S.

Year-over-Year Percent Change

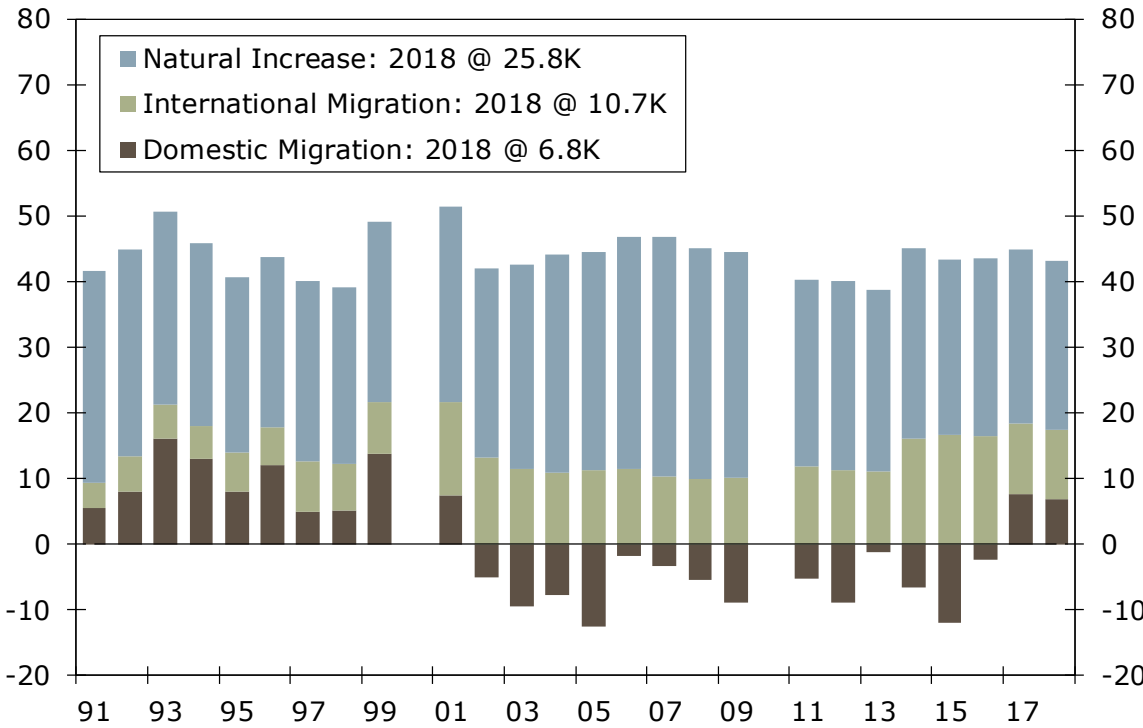


Source: Department of Commerce, CoreLogic, Inc. and Wells Fargo Securities

Overall population growth has been fairly consistent. Net domestic migration has recently turned positive after more than a decade of losses.

Components of Population Change: Minnesota

In Thousands



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

NAFTA members Canada and Mexico are the top two destinations for the state's exports, followed by China.

MN Top Export Countries

<u>Country</u>	<u>Export Value in 2017 (\$B)</u>	<u>% of Total</u>
All Exports	20.69	100.0%
Exports: Total to Canada	4.30	20.8%
Exports: Total to Mexico	2.43	11.8%
Exports: Total to China	1.99	9.6%
Exports: Total to Japan	1.36	6.6%
Exports: Total to Germany	0.89	4.3%
Exports: Total to South Korea	0.86	4.1%
Exports: Total to Belgium	0.66	3.2%
Exports: Total to United Kingdom	0.59	2.9%
Exports: Total to Singapore	0.56	2.7%
Exports: Total to Netherlands	0.50	2.4%
Exports: Total to Taiwan	0.48	2.3%
Exports: Total to Philippines	0.43	2.1%
Exports: Total to Hong Kong	0.43	2.1%
Exports: Total to Australia	0.43	2.1%
Exports: Total to Ireland	0.40	1.9%
Exports: Total to France	0.35	1.7%
Exports: Total to Italy	0.24	1.2%

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

MN Top Export Industries

<u>Export</u>	<u>Export Value in 2017 (\$Bil)</u>	<u>% of Total</u>
All Exports	21.33	100.0%
Computer and Electronic Product Manufacturing	3.65	17.1%
Machinery Manufacturing	3.27	15.3%
Miscellaneous Manufacturing	2.08	9.8%
Transportation Equipment Manufacturing	2.08	9.7%
Food Manufacturing	1.69	7.9%
Chemical Manufacturing	1.66	7.8%
Electrical Equipment; Appliance; and Component Manuf	1.09	5.1%
Paper Manufacturing	0.79	3.7%
Fabricated Metal Product Manufacturing	0.78	3.6%
Plastics and Rubber Products Manufacturing	0.73	3.4%
Agriculture Forestry Fishing and Hunting	0.67	3.2%
Crop Production	0.62	2.9%
Nonmetallic Mineral Product Manufacturing	0.45	2.1%
Mining	0.42	2.0%

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

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

Wells Fargo U.S. Economic Forecast

	Actual				Forecast												Actual 2017	Forecast			
	2017		2018		2019				2020				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	3.4	2.3	1.9	2.8	2.4	2.4	2.3	2.1	1.7	1.7	2.2	2.9	2.5	2.2	
Personal Consumption	1.8	2.9	2.2	3.9	0.5	3.8	3.5	3.6	2.4	2.6	2.5	2.4	2.2	2.1	1.8	1.7	2.5	2.7	2.9	2.2	
Business Fixed Investment	9.6	7.3	3.4	4.8	11.5	8.7	2.5	4.4	2.8	3.5	4.2	4.0	3.7	3.6	2.9	2.8	5.3	6.8	3.8	3.6	
Equipment	9.1	9.7	9.8	9.9	8.5	4.6	3.4	5.3	0.6	2.3	3.7	3.1	2.7	2.6	2.1	2.0	6.1	7.4	2.9	2.7	
Intellectual Property Products	8.0	6.6	1.7	0.7	14.1	10.5	5.6	6.8	6.0	5.3	4.7	4.6	4.7	4.6	3.7	3.5	4.6	7.3	6.0	4.5	
Structures	12.8	3.8	-5.7	1.3	13.9	14.5	-3.4	-1.5	2.5	3.5	4.5	5.0	4.5	4.0	3.5	3.5	4.6	5.1	2.3	4.2	
Residential Construction	11.1	-5.5	-0.5	11.1	-3.4	-1.3	-3.6	-4.5	-3.6	2.6	2.0	1.5	1.5	1.5	1.0	1.0	3.3	-0.3	-1.5	1.5	
Government Purchases	-0.8	0.0	-1.0	2.4	1.5	2.5	2.6	2.3	1.3	4.0	1.5	1.2	0.7	0.7	0.3	0.1	-0.1	1.6	2.2	1.0	
Net Exports ²	-0.1	0.1	0.0	-0.9	0.0	1.2	-2.0	-0.9	-0.2	-0.1	-0.1	-0.1	0.1	0.0	-0.1	0.0	-0.4	-0.3	-0.5	0.0	
Inventories ²	-0.8	0.2	1.0	-0.9	0.3	-1.2	2.3	0.1	-0.1	-0.1	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.0	
Nonfarm Payroll Change ³	173	190	136	218	228	243	189	232	221	170	160	160	150	140	100	90	179	223	178	120	
Unemployment Rate	4.6	4.4	4.3	4.1	4.1	3.9	3.8	3.8	3.9	3.7	3.6	3.5	3.4	3.4	3.4	3.4	4.4	3.9	3.7	3.4	
Consumer Price Index ⁴	2.6	1.9	2.0	2.1	2.3	2.6	2.6	2.2	1.7	2.0	2.2	2.4	2.8	2.7	2.5	2.4	2.1	2.4	2.1	2.6	
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	2.50	2.75	2.75	2.75	2.75	2.75	2.50	1.13	1.96	2.63	2.69	
Conventional Mortgage Rate	4.20	3.90	3.81	3.94	4.44	4.57	4.63	4.64	4.45	4.55	4.65	4.70	4.70	4.65	4.65	4.60	3.99	4.54	4.59	4.65	
2 Year Note	1.27	1.38	1.47	1.89	2.27	2.52	2.81	2.48	2.65	2.70	2.75	2.75	2.70	2.65	2.60	2.50	1.40	2.53	2.71	2.61	
10 Year Note	2.40	2.31	2.33	2.40	2.74	2.85	3.05	2.69	2.85	2.95	3.05	3.10	3.10	3.05	3.05	3.00	2.33	2.91	2.99	3.05	

Forecast as of: February 6, 2019

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

Appendix

A Sampling of Our Recent Special, Regional & Industry Commentary

Recent Special Commentary		
Date	Title	Authors
U.S. Macro		
January-31	Myth Busting Real-Time Recession Predictors	Iqbal, Kinnaman & Seery
January-28	Dating Advice	Quinlan, House & Seery
January-28	The Government Shutdown: An Update	Bryson & Pugliese
January-24	Productivity: Back from the Dead or Dead Cat Bounce?	House & Seery
January-18	Trade Outlook: In Low Visibility, Trust Your Gauges	Quinlan
U.S. Regional		
January-18	California Payrolls Remain Solid in 2018	Vitner & Dougherty
January-18	Mixed Results For December Job Growth in the Carolinas	Vitner & Dougherty
January-18	Texas Payrolls End 2018 On a Strong Note	Vitner & Dougherty
January-18	Florida Ends 2018 On a High Note	Vitner & Dougherty
January-17	A Modest Expansion of Minnesota Payrolls to End 2018	Vitner & Dougherty
Global Economy		
February-05	Australia: Nothing Happening Down Under	McKenna
January-31	Asking Some Critical Questions about Our European Economic Views	Nelson
January-22	Is the Eurozone Economy Close to Recession?	Bennenbroek & Pugliese
December-11	Will Europe's Slowdown Restrain the ECB?	Kinnaman & Nelson
December-05	Japan: Further Tweaks to Monetary Policy?	McKenna, Nelson & Kinnaman
Interest Rates/Credit Market		
January-30	Fed Balance Sheet Shrinking Inches Closer Towards Ending	Bryson & Pugliese
January-30	FOMC Adopts a "Patient" Stance	Bryson
January-30	Treasury Refunding Highlights	Bryson & Pugliese
January-03	Time To Press Pause? Financial Conditions & the FOMC	Bryson, House & Seery
December-19	The Fed Hikes, But Acknowledges Risks	Bryson
Real Estate & Housing		
January-16	What's Ahead for Housing in 2019?	Vitner, Dougherty & Honnold
December-07	Q3 CRE Chartbook: Outlook	Vitner, Dougherty & Honnold
December-05	Housing Chartbook: December 2018	Vitner, Dougherty & Honnold
November-26	Does CRE Pose a Risk to the Financial System?	Bryson, Dougherty & Honnold
November-07	Home Sales Remain Soft	Vitner, Dougherty & Honnold

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