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# U.S. Economic Outlook

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Mark Vitner, Managing Director & Senior Economist

April 11, 2018

Together we'll go far



## Economic Outlook

- **Real GDP appears to have gotten off to a slow start in 2018. The production side of the economy remains strong, however, and we are looking for real GDP to remain close to 3 percent through the end of the year.**

## Fiscal Policy

- **Fiscal policy has become much more stimulative, with tax reform providing both a near-term and long-term boost to growth. The budget deal will also promote growth via higher spending for many federal projects.**

## Monetary Policy

- **With more fiscal stimulus, the Federal Reserve is likely to be a little more aggressive at normalizing monetary policy. Short-term rates are likely to rise faster in the near term and rise to a higher long-term level.**

## Trade Policy

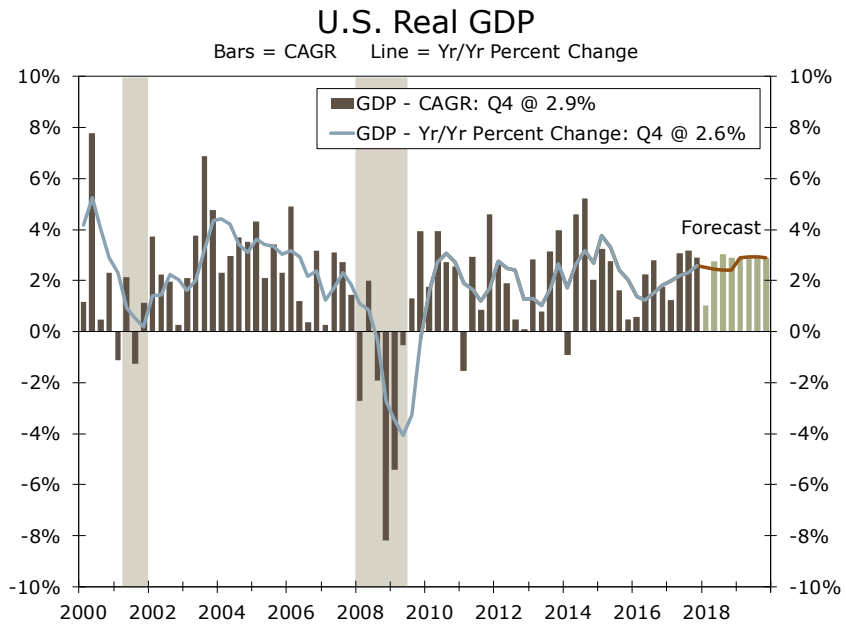
- **The Trump Administration has opted for a more confrontational negotiating stance on international trade. The goal is to improve trade relationships to reflect modern economic conditions, not protectionism.**

## Washington, D.C.

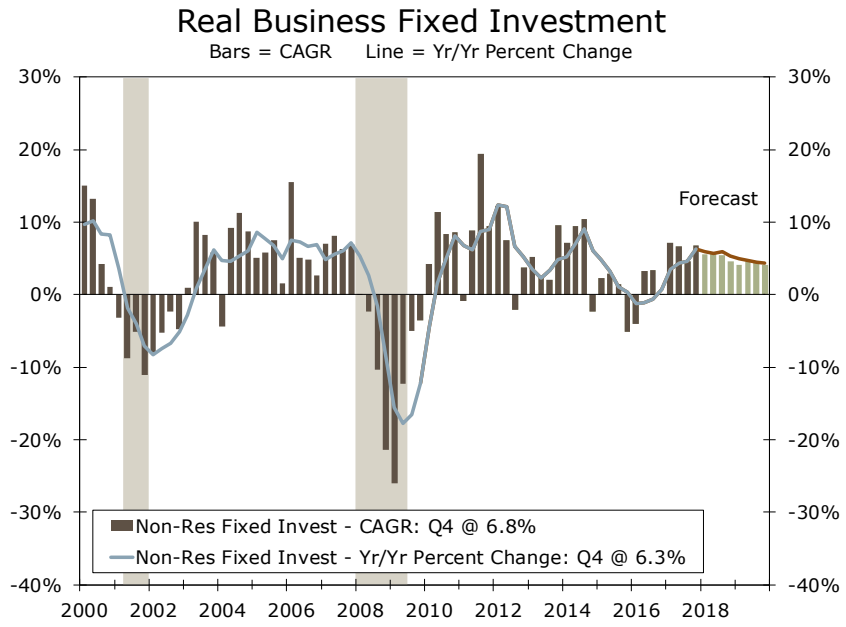
- **The strain from sequestration is easing, as the recently enacted budget deal lifts federal spending. Northern Virginia is poised for stronger gains, as affordability issues push development toward the suburbs.**

Real GDP growth likely slowed during the first quarter, largely reflecting some moderation in consumer spending. The production side of the economy remains strong, as evidence by the quarter's solid job gains and growth in aggregate hours. Tax cuts are expected to boost business fixed investment, accounting for much of the acceleration in real GDP growth.

**Real GDP Forecast**



**Business Fixed Investment**

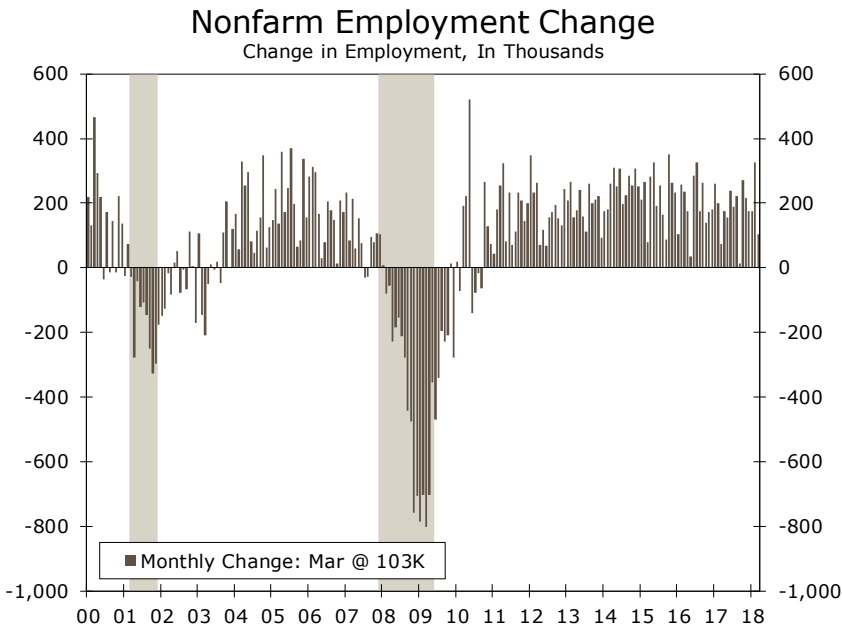


Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

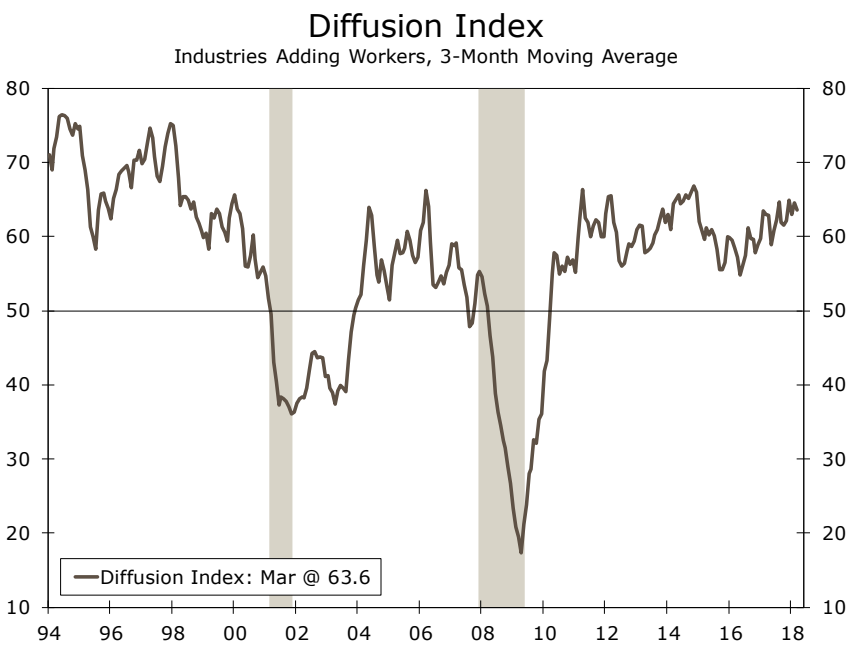
# Employment Situation: Broadening Growth

After surging in January and February, nonfarm employment growth pulled back in March. Part of the moderation is likely due to swings in the weather. Job gains remain extraordinarily broad based, which is consistent with recent strong readings from the ISM surveys.

## Nonfarm Employment



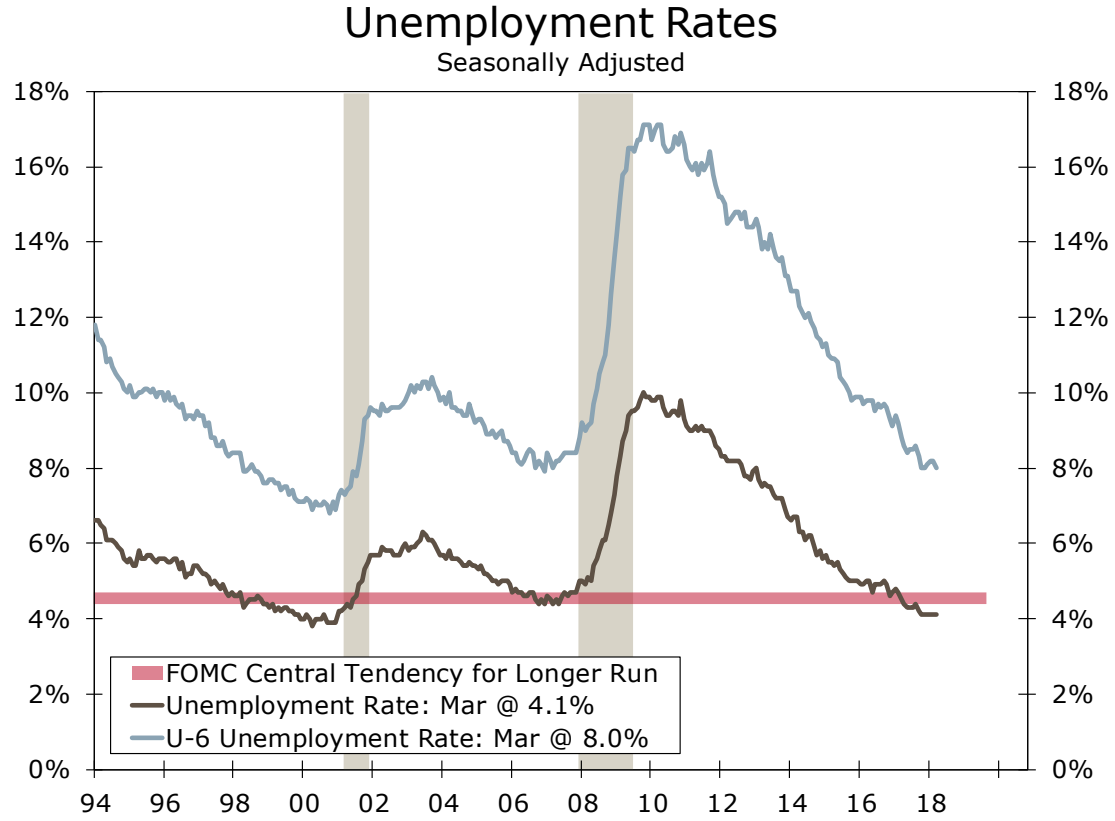
## Employment Diffusion Index



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

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 a much larger share of consumers believe jobs are plentiful today.



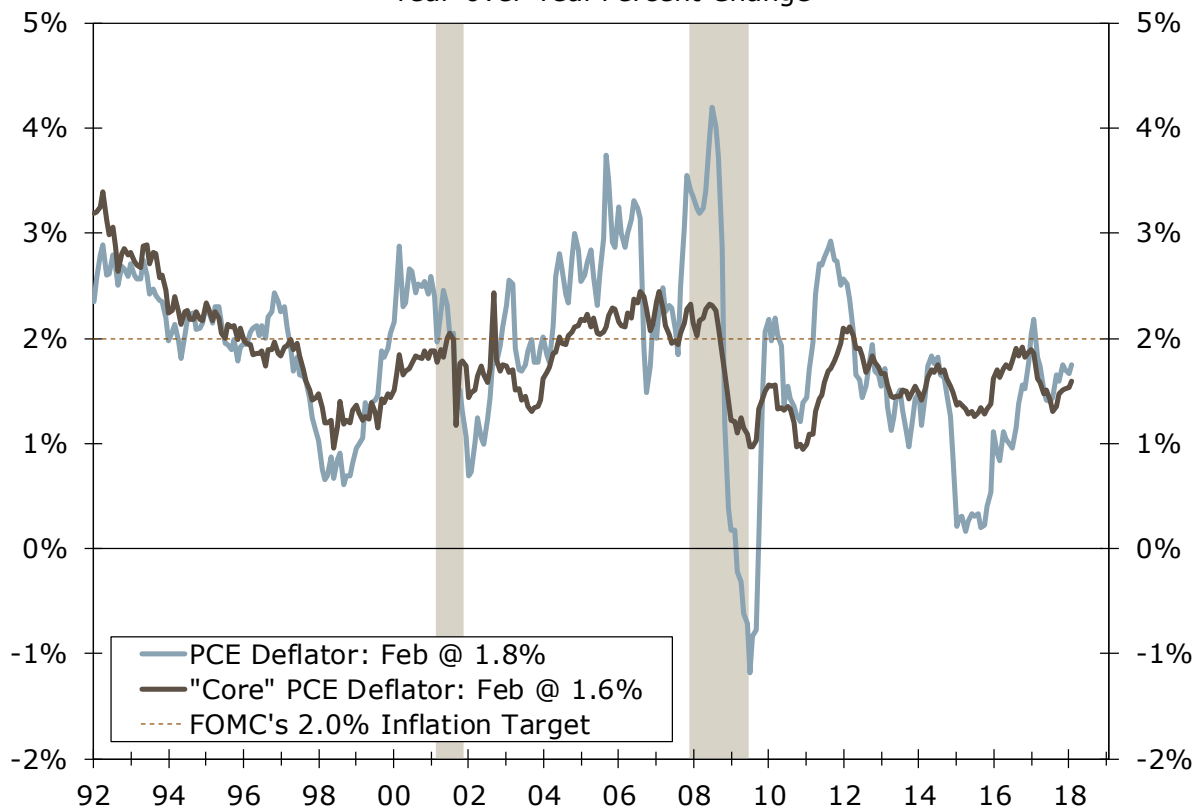
Source: U.S. Department of Labor and Wells Fargo Securities

Despite all the recent talk about accelerating inflation, the Fed's preferred price measure remains well below their objective.

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

## PCE Deflator vs. Core PCE Deflator

Year-over-Year Percent Change



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

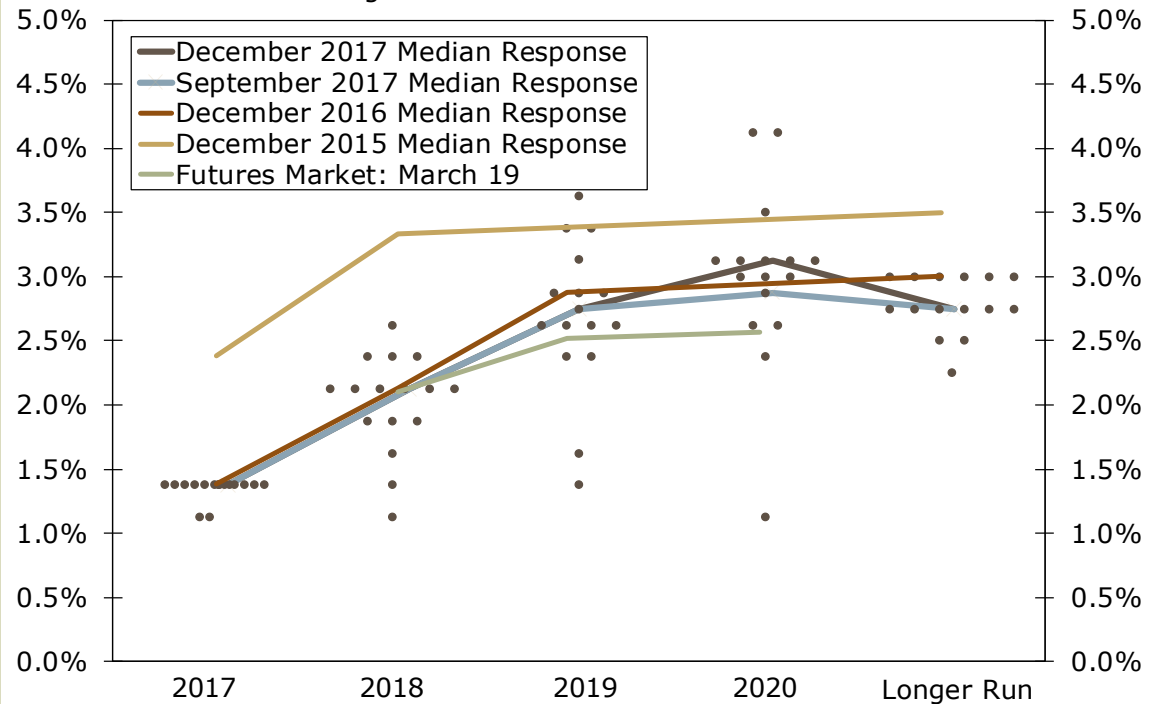
While the era of ultra-low interest rates has ended, the FOMC plans to be judicious in normalizing monetary policy.

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

With the post-Financial Crisis period ending, the new Fed chair and Fed board have a great deal of ground to recover in order to bring the federal funds rate back to its neutral level.

## Appropriate Pace of Policy Firming

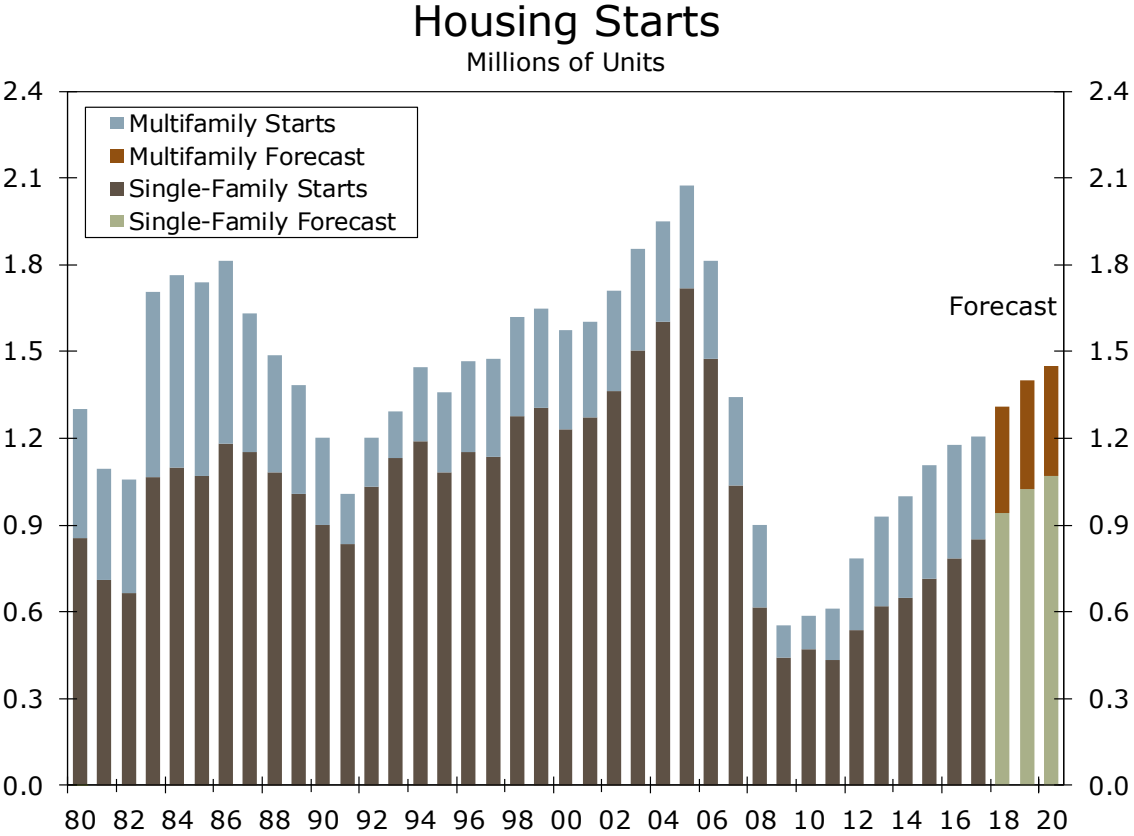
Target Federal Funds Rate at Year-End



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

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

The new normal for housing is clearly lower than in prior decades but higher than we have seen over the past ten years.

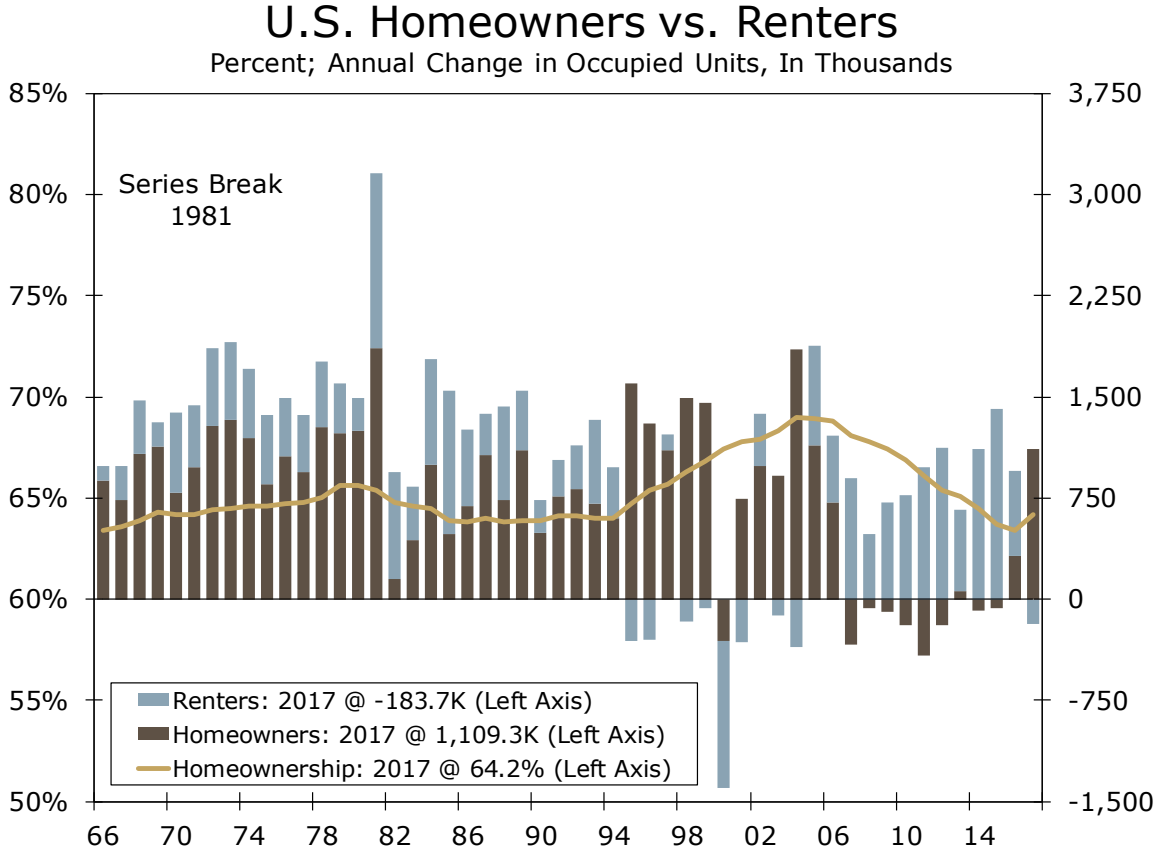


Source: U.S. Department of Commerce and Wells Fargo Securities



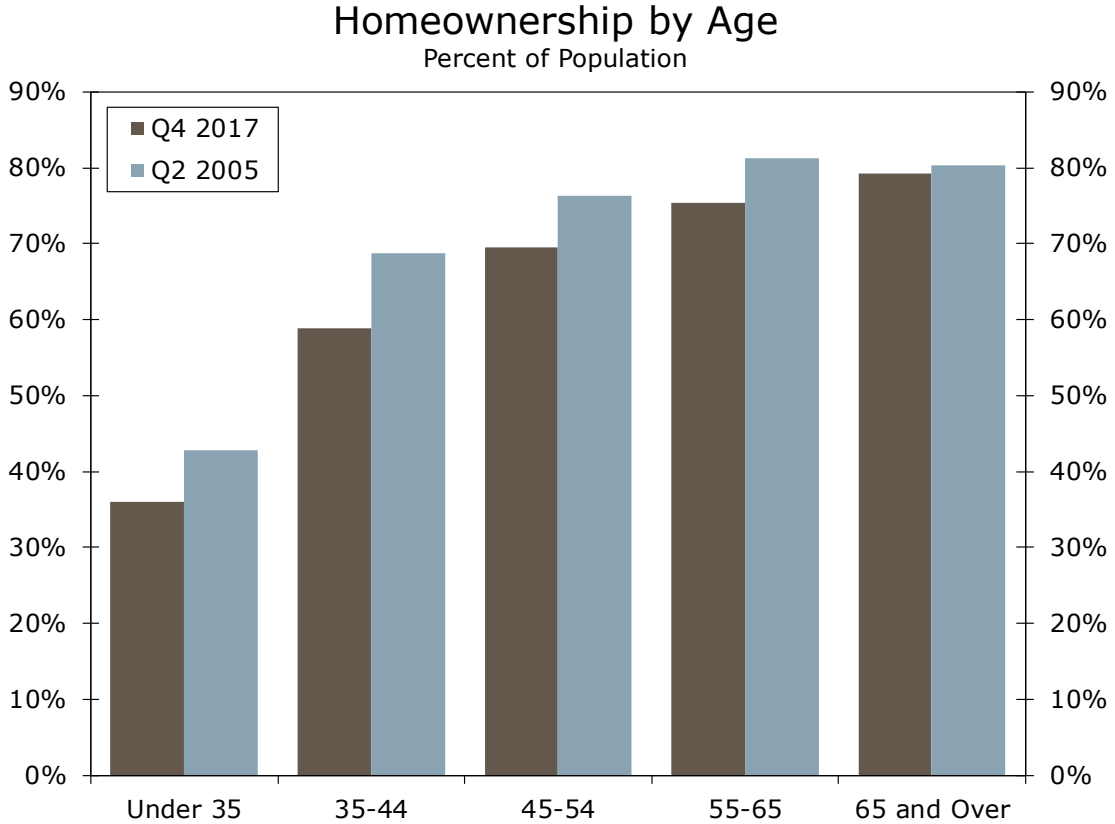
Household formation has improved over the past few years but generally remains below prior decades.

Recent gains in homeownership have provided a slight boost to the homeownership rate.



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

Homeownership has declined among all age cohorts but the largest declines have clearly been among younger households.



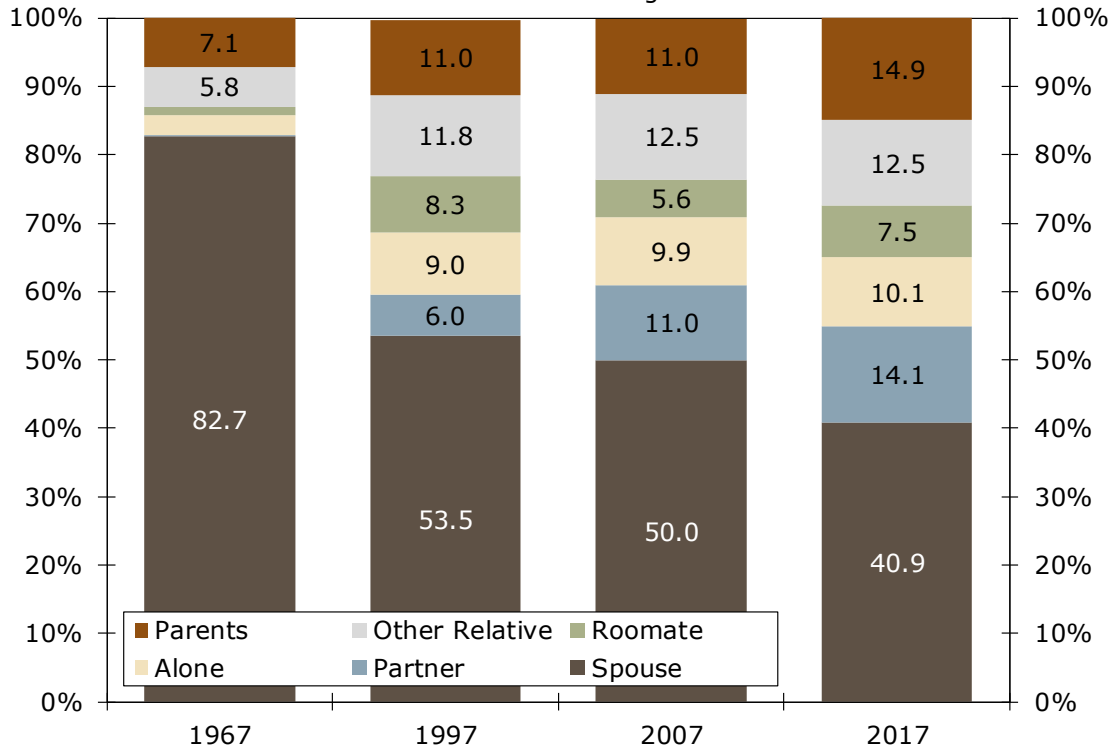
Source: U.S. Department of Commerce and Wells Fargo Securities

More young adults are putting off marriage and homeownership.

All alternatives have gained popularity since the 1960s, while young adults living with parents has more than doubled.

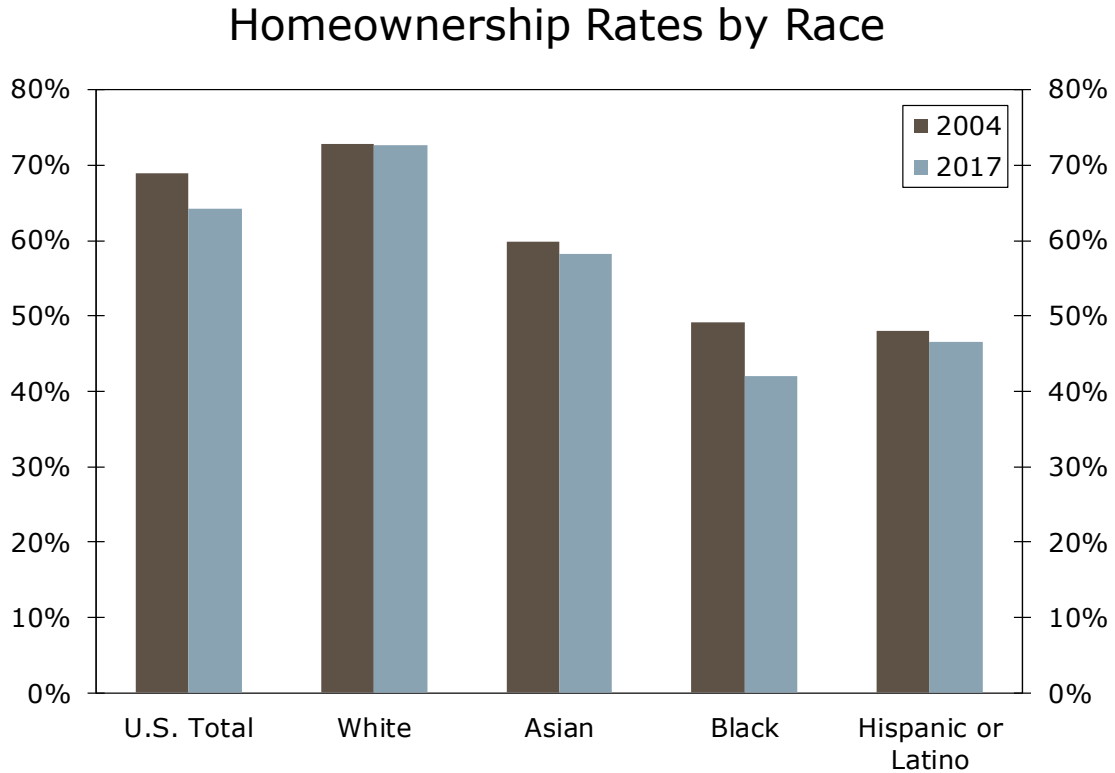
### Living Arrangements of Young Adults

Percent of Households Aged 25-34



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

African American and Hispanic homeownership rates are the lowest of all ethnicities. These two groups are also growing rapidly and account for a larger proportion of Millennials.



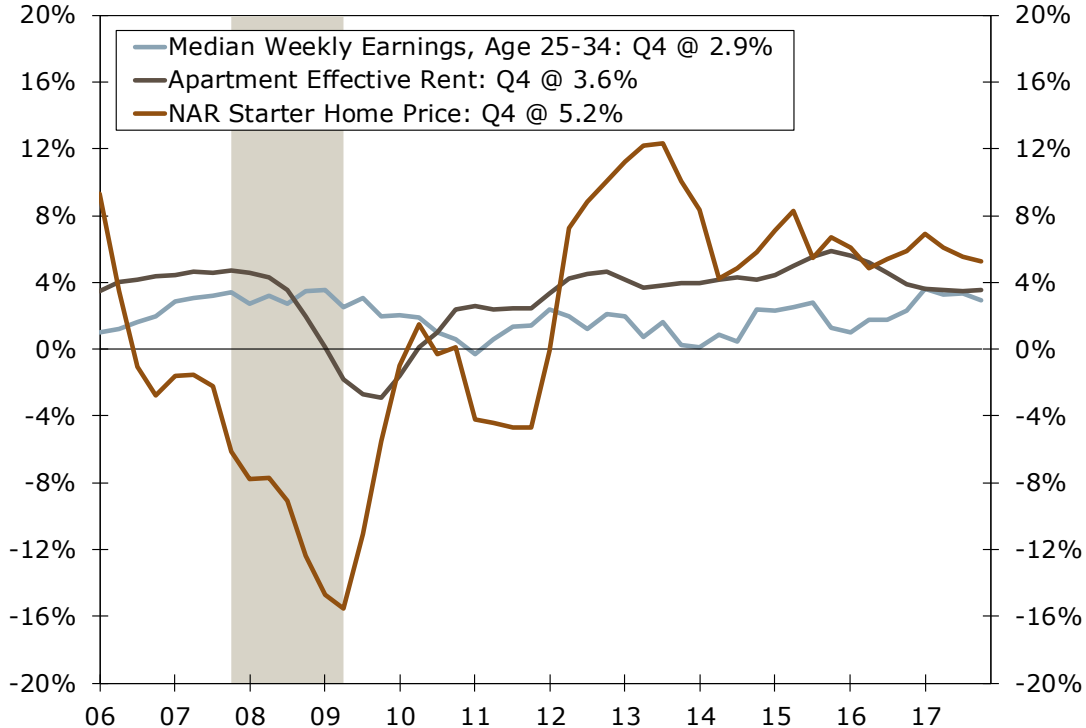
Source: U.S. Department of Commerce and Wells Fargo Securities

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.

## Young Adult Wages vs. Housing Costs

Year-over-Year Percent Change

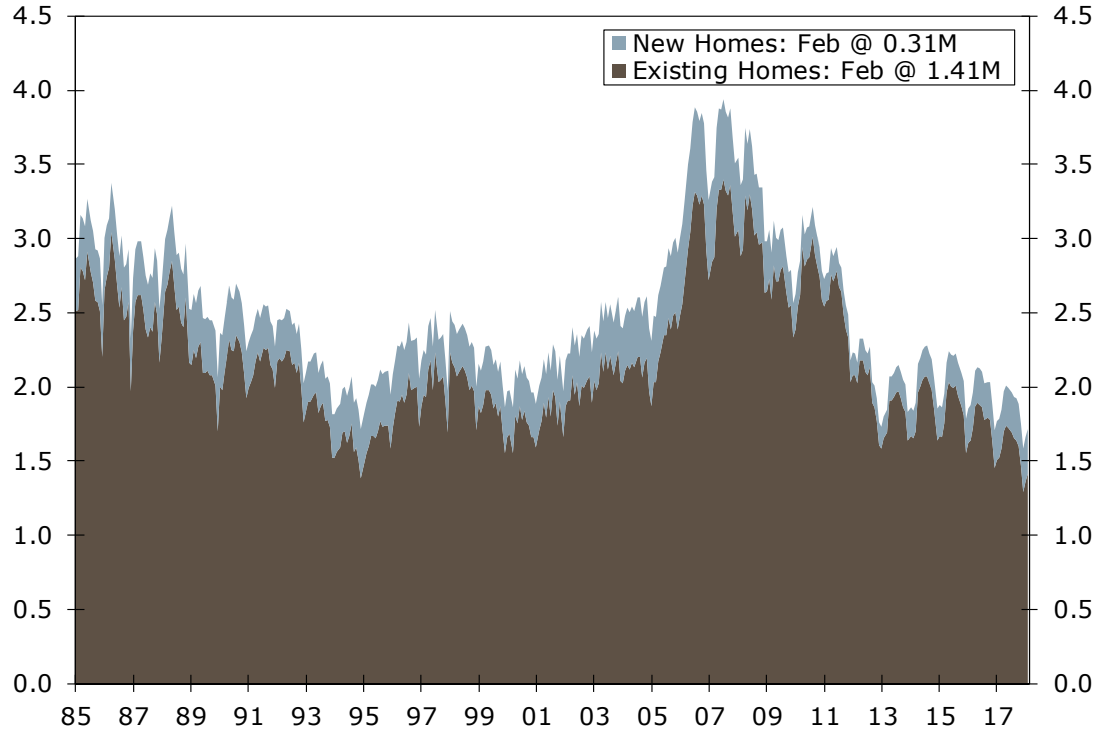


Source: U.S. Department of Commerce, National Association of Realtors and Wells Fargo Securities

Housing inventories remain exceptionally low. A larger proportion of current homeowners are opting to remain in place, while higher development costs and labor shortages continue to hold back new home construction.

## Single-Family Home Inventory

Millions of Units



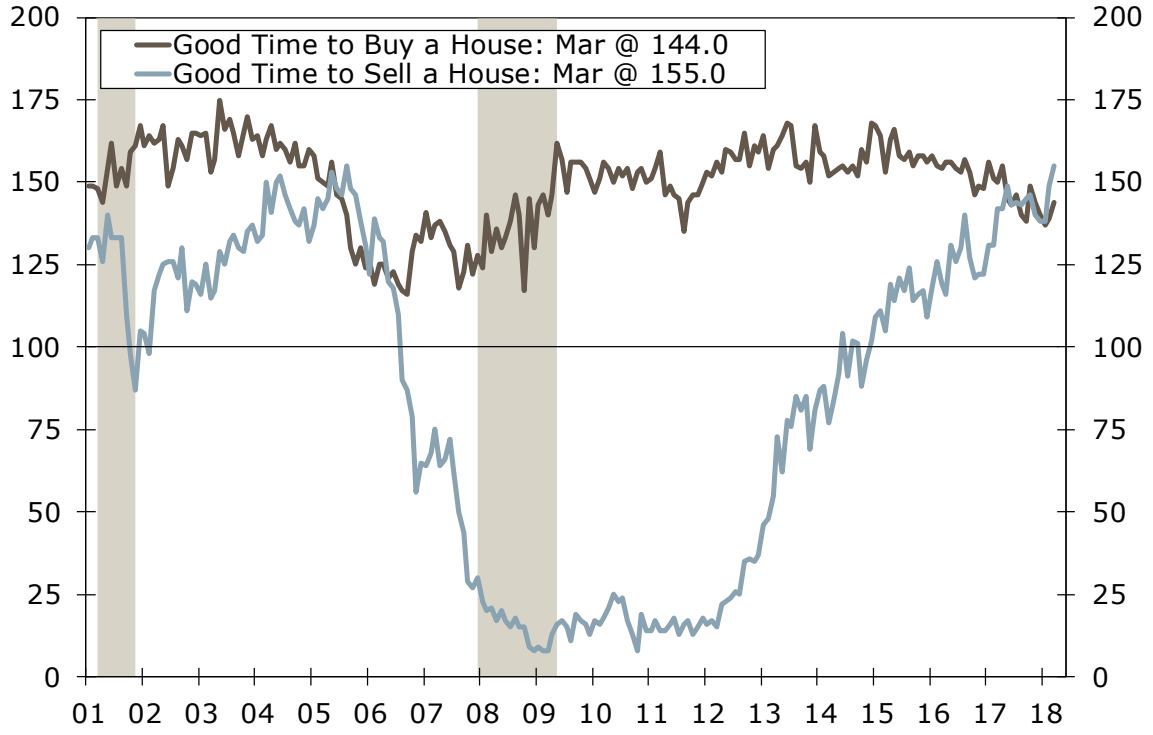
Source: National Association of Realtors, U.S. Department of Commerce and Wells Fargo Securities

There is a growing mismatch between the share of consumers that feel now is a good time to sell a house and those that feel that now is a good time to buy.

The decline in the share that feel now is a good time to buy is reminiscent of what is seen at the end of the housing cycle, while the rise in the proportion that feel now is a good time to sell is more typical of what is seen early on in the cycle.

### Good Time to Buy vs. Good Time to Sell

University of Michigan Consumer Sentiment Survey

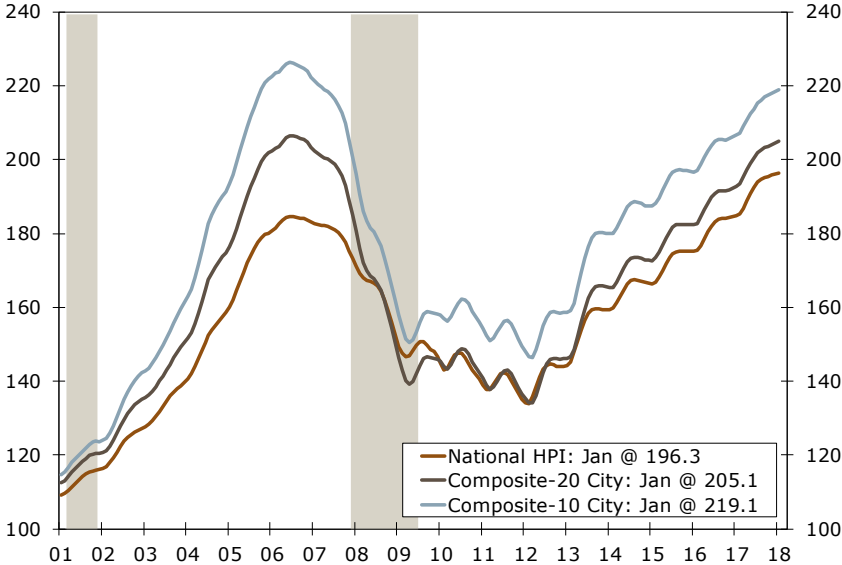


Source: University of Michigan and Wells Fargo Securities

The recovery in home prices varies considerable 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.

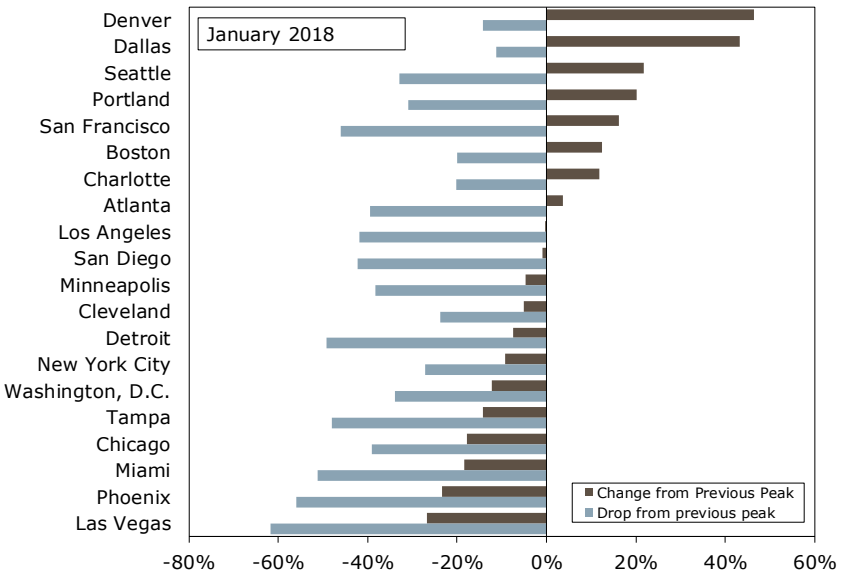
## Home Prices

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



## Regional

S&P CoreLogic Case-Shiller Home Prices  
Percent Change from Previous Peak, NSA



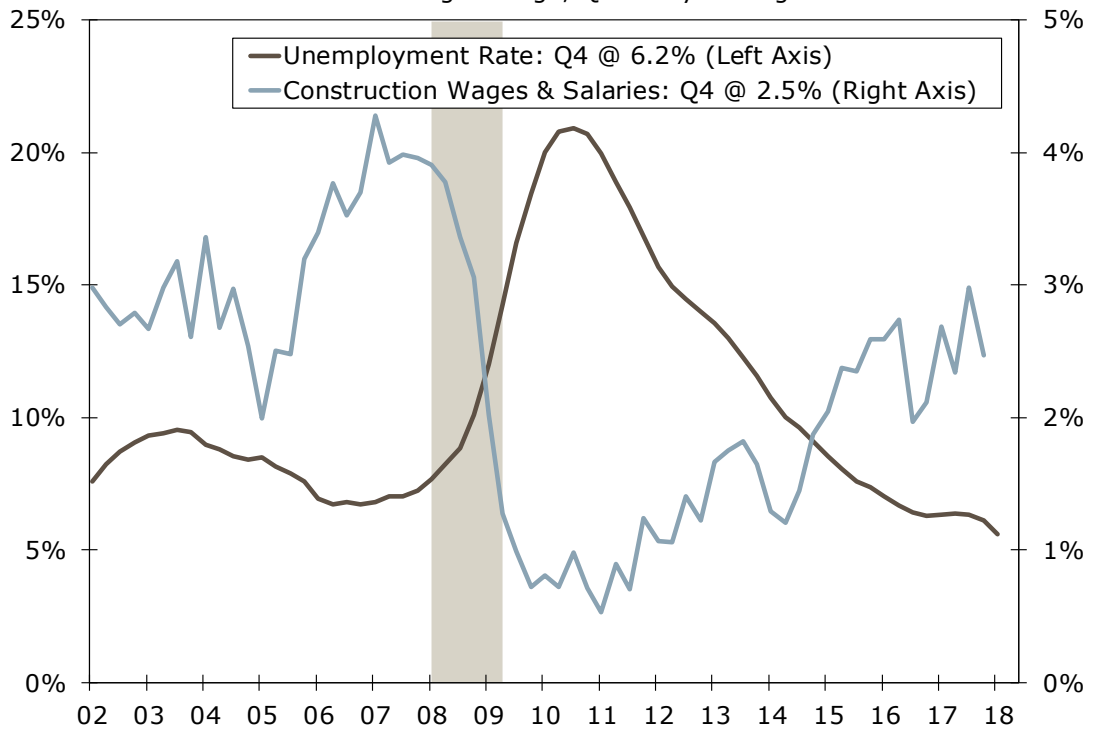
Source: S&P Case-Shiller, CoreLogic and Wells Fargo Securities



Construction workers are in short supply across most of the country, which is pushing compensation costs higher.

## Construction Unemployment Rate

12-Month Moving Average, Quarterly Averages



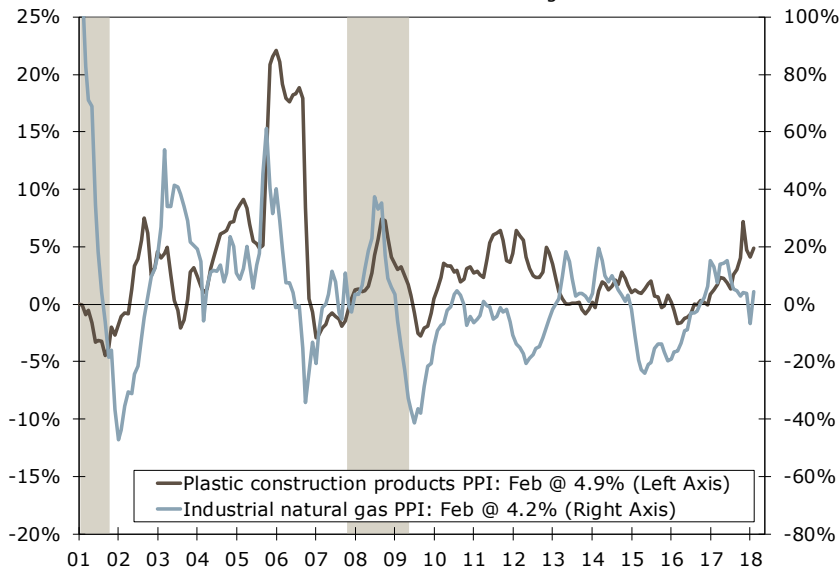
Source: U.S. Department of Commerce and Wells Fargo Securities

Construction materials prices have spiked recently, particularly plastic products. Natural resource prices directly affect these material prices, which began spiked following last summer's hurricanes but have risen further as petroleum prices have increased.

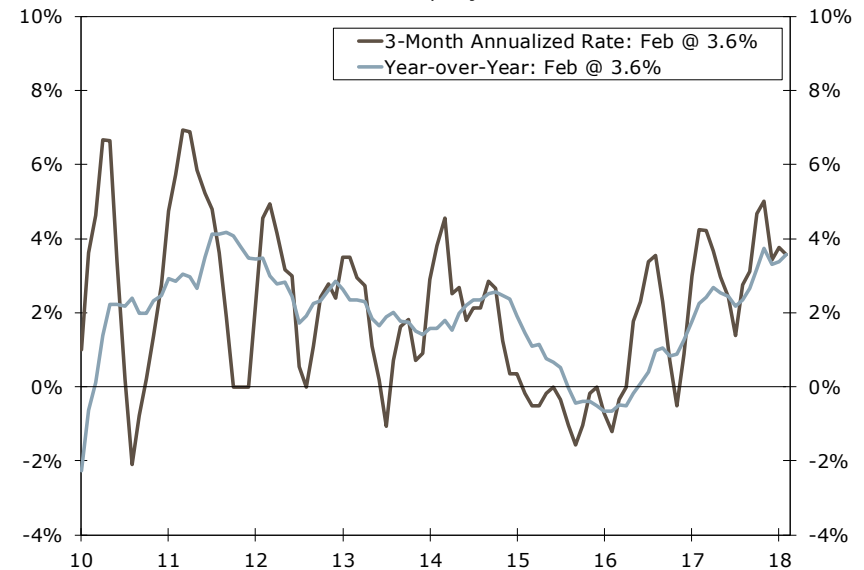
### Plastic Construction Products

### Construction Materials

Plastic Constr. Products vs. Natural Gas Prices  
Year-over-Year Percent Change



PPI: Materials & Components for Construction  
Seasonally Adjusted

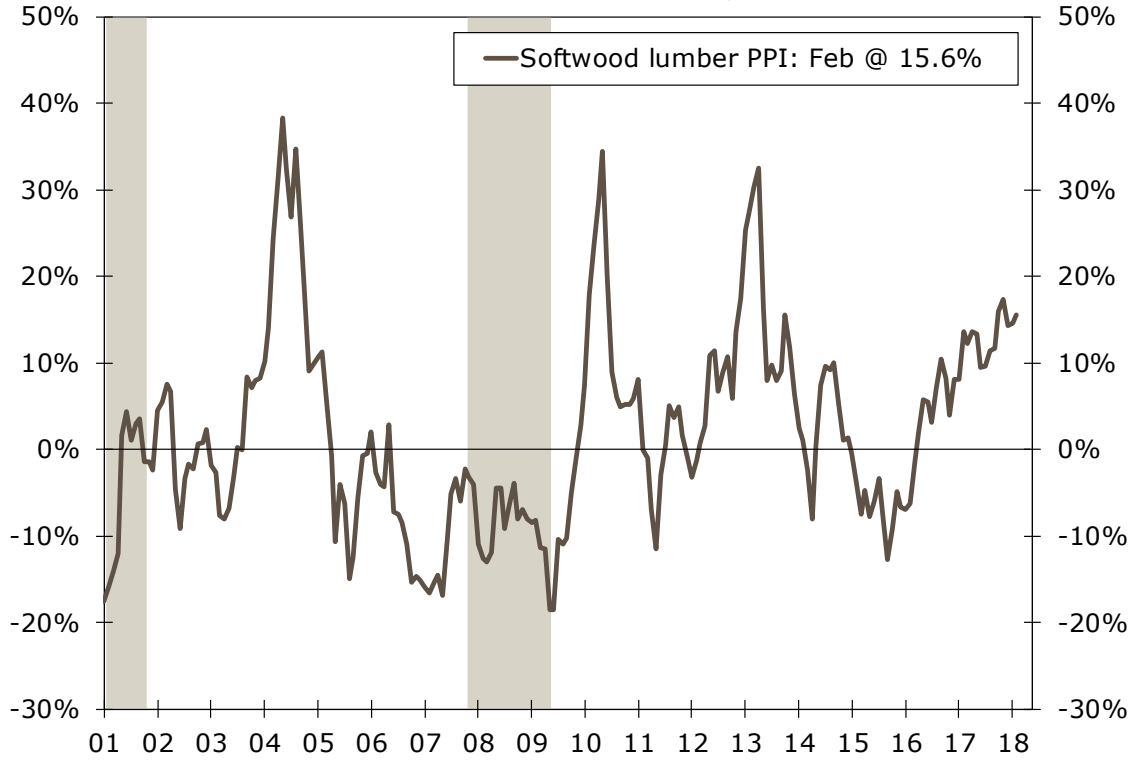


Source: U.S. Department of Commerce and Wells Fargo Securities

Wood prices have come back sharply over the past year. This has been driven by increased tariffs on Canadian imports of lumber and stronger demand.

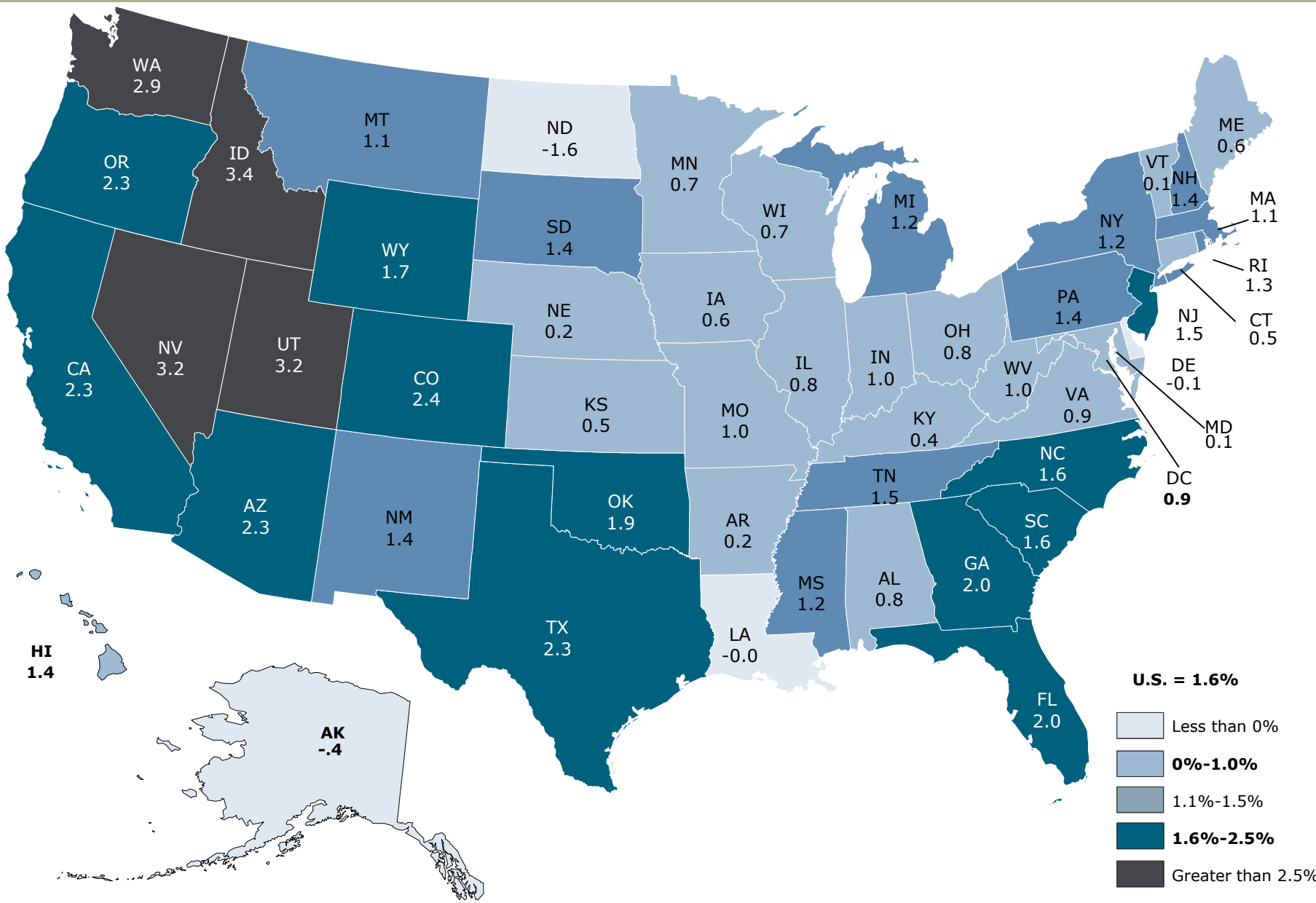
### Softwood Lumber Prices

Year-over-Year Percent Change



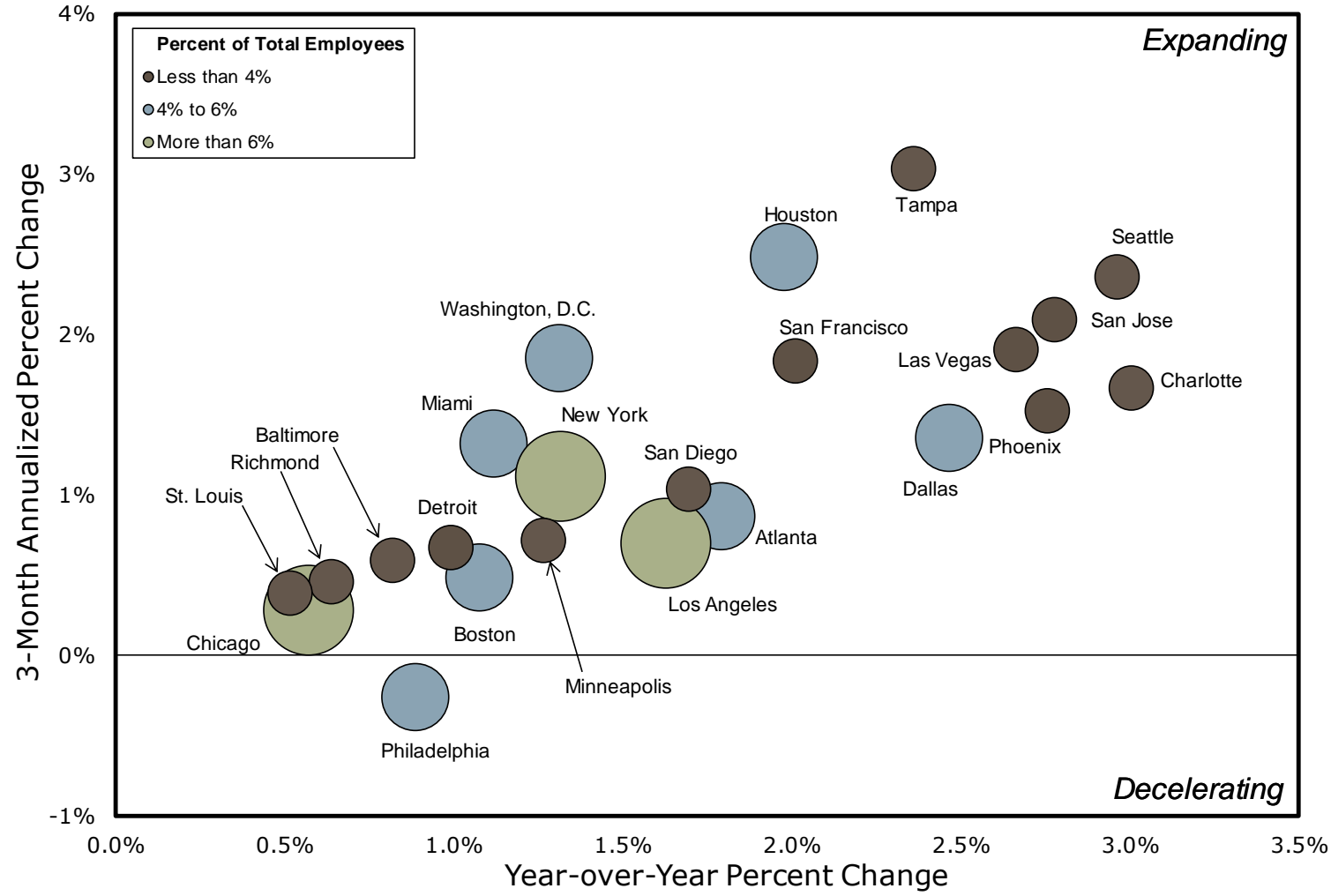
Source: Bloomberg LP and Wells Fargo Securities

# Year-over-Year Employment Growth: February 2018



## U.S. Employment Growth by MSA

3-Month Moving Averages, February 2018



Source: U.S. Department of Labor 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	2.9	1.3	2.9	2.9	3.1	2.6	3.1	2.9	2.9	2.9	1.5	2.3		2.6	2.9
Personal Consumption	1.9	3.3	2.2	4.0	1.1	2.8	2.5	2.8	2.0	3.0	2.5	2.5	3.6	2.7	2.8		2.5	2.6
Business Fixed Investment	7.2	6.7	4.7	6.8	5.5	5.9	5.4	4.7	4.1	4.6	4.5	4.1	2.3	-0.6	4.7		5.7	4.6
Equipment	4.4	8.8	10.8	11.5	6.6	6.9	6.0	4.7	4.0	4.6	4.4	3.8	3.5	-3.4	4.8		8.0	4.7
Intellectual Property Products	5.7	3.7	5.2	0.8	4.8	6.5	6.4	6.1	5.3	5.9	5.8	5.5	3.8	6.3	3.9		4.6	5.9
Structures	14.8	7.0	-7.0	6.3	2.5	2.4	2.4	2.2	2.5	2.4	2.4	2.4	-1.8	-4.1	5.6		2.2	2.4
Residential Construction	11.1	-7.3	-4.7	12.8	-3.8	8.0	7.0	7.0	6.5	7.0	7.0	5.5	10.2	5.5	1.8		3.0	6.8
Government Purchases	-0.6	-0.2	0.7	3.0	1.0	1.6	1.6	2.4	2.1	1.7	1.4	1.2	1.4	0.8	0.1		1.5	1.9
Net Exports <sup>2</sup>	0.2	0.2	0.4	-1.2	-0.6	-0.1	-0.2	-0.2	0.0	-0.2	0.0	0.1	-0.7	-0.2	-0.2		-0.4	-0.1
Inventories <sup>2</sup>	-1.5	0.1	0.8	-0.5	1.0	-0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.2	-0.4	-0.1		0.2	0.0
Nonfarm Payroll Change <sup>3</sup>	177	190	142	221	202	175	170	160	155	155	150	150	226	195	182		177	153
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	2.7	2.7	2.3	2.1	2.3	2.5	2.5	0.1	1.3	2.1		2.5	2.3
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	2.50	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	4.32	4.45	4.60	4.72	4.77	4.82	4.87	3.85	3.65	3.99		4.45	4.80
2 Year Note	1.27	1.38	1.47	1.89	2.27	2.47	2.67	2.90	3.05	3.12	3.19	3.26	0.69	0.83	1.40		2.58	3.16
10 Year Note	2.40	2.31	2.33	2.40	2.74	2.90	3.05	3.20	3.32	3.37	3.42	3.47	2.14	1.84	2.33		2.97	3.40

Forecast as of: April 11, 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
<b>U.S. Macro</b>		
March-29	Were Corporate Tax Cuts Evident in Fourth Quarter Profits?	Silvia, Iqbal & Seery
March-26	Who Faces the Risk of Collateral Damage from the U.S. Tariffs?	Bryson & Kinnaman
March-23	Capitol Hill Update: Funding Extended Until September 30	Brown, Pugliese & Kinnaman
March-23	Which American Industries Are Vulnerable to Tariff Retaliation?	Bryson & Kinnaman
March-22	Prime-Time Focus on Labor Force Participation	House & Vaisey
<b>U.S. Regional</b>		
March-23	California Employment Conditions: February 2018	Vitner, Feik & Carmichael
March-23	Texas Leads February Job Gains with 40,500 Jobs	Vitner, Feik & Carmichael
March-23	Florida Employers Boost Payrolls in February	Vitner, Feik & Carmichael
March-23	February Payrolls Rise in North Carolina	Vitner, Feik & Carmichael
March-23	Savannah and Charleston Industrial Market	Vitner & Dougherty
<b>Global Economy</b>		
March-29	Turkish Economy Ended 2017 on a Solid Note	Bryson & Pugliese
March-23	Rate Hike in May by the MPC Still in Play	Bryson
March-16	Indian Economy Gaining Momentum	Quinlan
March-16	Global Chartbook: March 2018	Quinlan, Pugliese, Kinnaman & Seery
March-09	Despite Speedbumps, Eurozone Expansion Continues	Bryson
<b>Interest Rates/Credit Market</b>		
March-28	Corporate Finance Part II: Trends in Corporate Leverage	Silvia
March-28	Corporate Finance Part I: Thinking Long Term	Silvia
March-21	Short-term Credit: Dispersion in Performance - Part II	Silvia & Pershing
March-21	Short-term Credit: Cycles and Trends - Part I	Silvia & Pershing
March-14	Interest Rates: Ending the Financial Repression Era	Silvia
<b>Real Estate &amp; Housing</b>		
March-01	Tax Reform Effect on CRE: Q4 Chartbook	Vitner, Carmichael & Vaisey
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



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