

U.S. Economic Outlook: As Good As It Gets?

Sarah House, Economist
July 12, 2016



U.S. Growth Outlook

- **GDP growth of 2.0 percent in 2016—disappointing by historical standards, but above potential**
-

Global & Industrial Headwinds

- **Net exports and capital investment continue to be held down by weak global growth and low commodity prices**
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Domestic Tailwinds

- **Government spending picking up**
 - **Housing: cyclical pickup, structural headwinds**
 - **Consumer spending supported by balance sheets and jobs**
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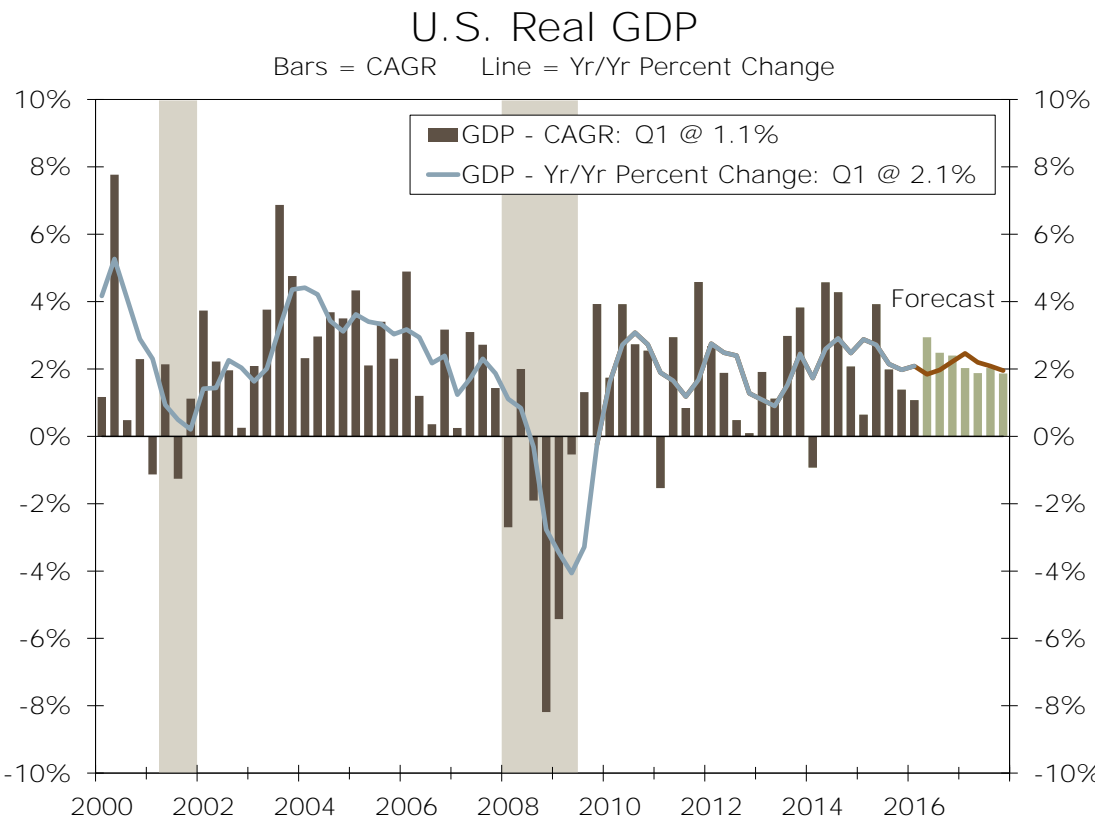
Labor Market & Inflation

- **Sustained—but slower—job growth and rising wages**
 - **Inflation moving back toward target as energy effects ease**
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Monetary Policy

- **Tightening in the labor market and rising inflation supportive of further rate increases this year**

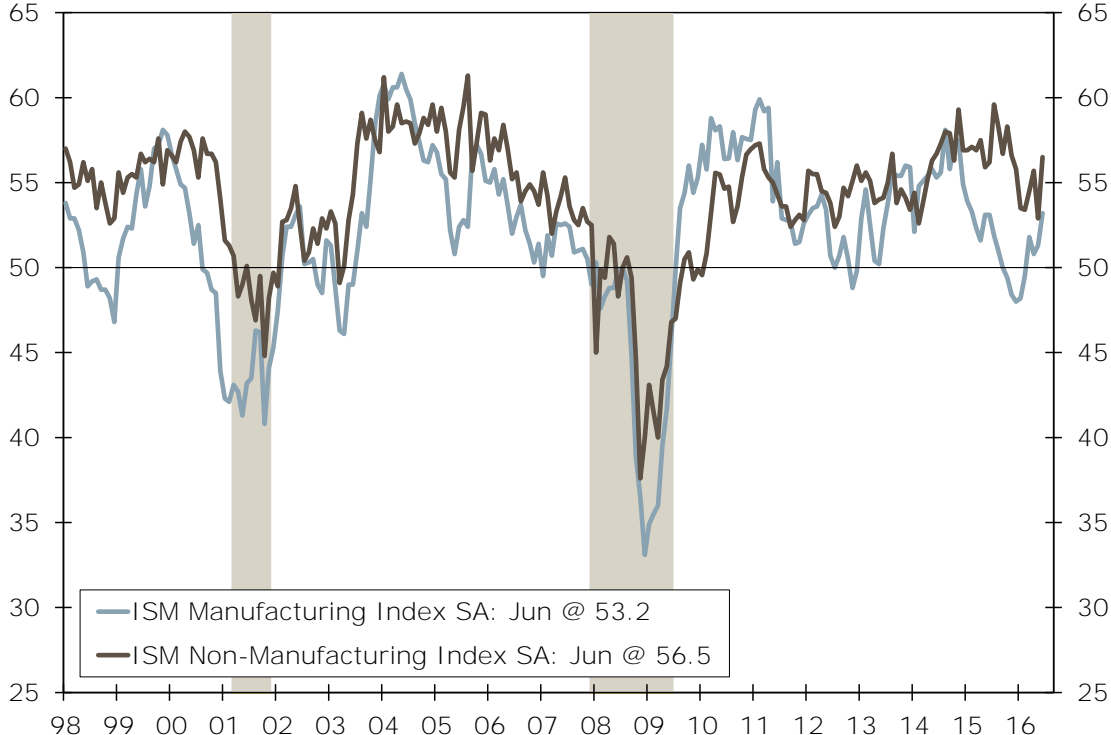
Our forecast looks for growth to remain around 2 percent over the next two years



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

Service-sector activity has slowed since the start of the year, but remains stronger than manufacturing

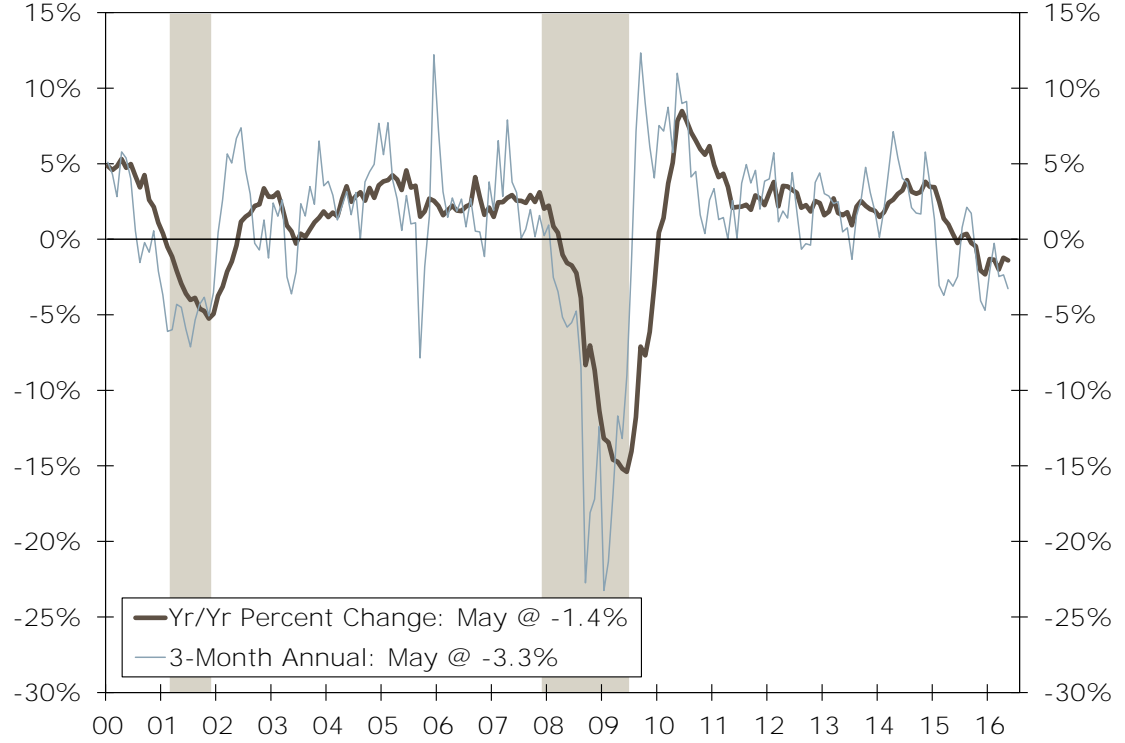
ISM Manufacturing & Non-Manufacturing Composite Index



Source: Institute for Supply Management and Wells Fargo Securities

“Hard” data paints a bleaker picture of current industrial activity

Total Industrial Production Growth
Output Growth by Volume

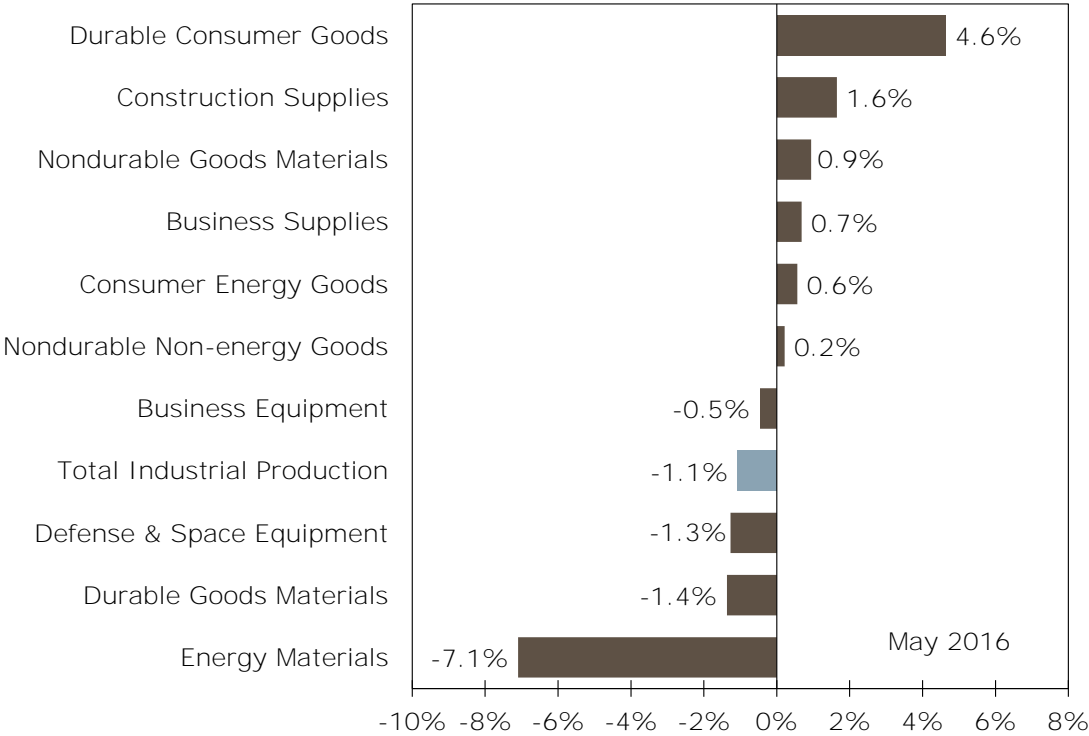


Source: Federal Reserve Board and Wells Fargo Securities

Pockets of strengths in the industrial space exist for domestic-facing markets

Industrial Production by Market Group

Year-over-Year Percent Change

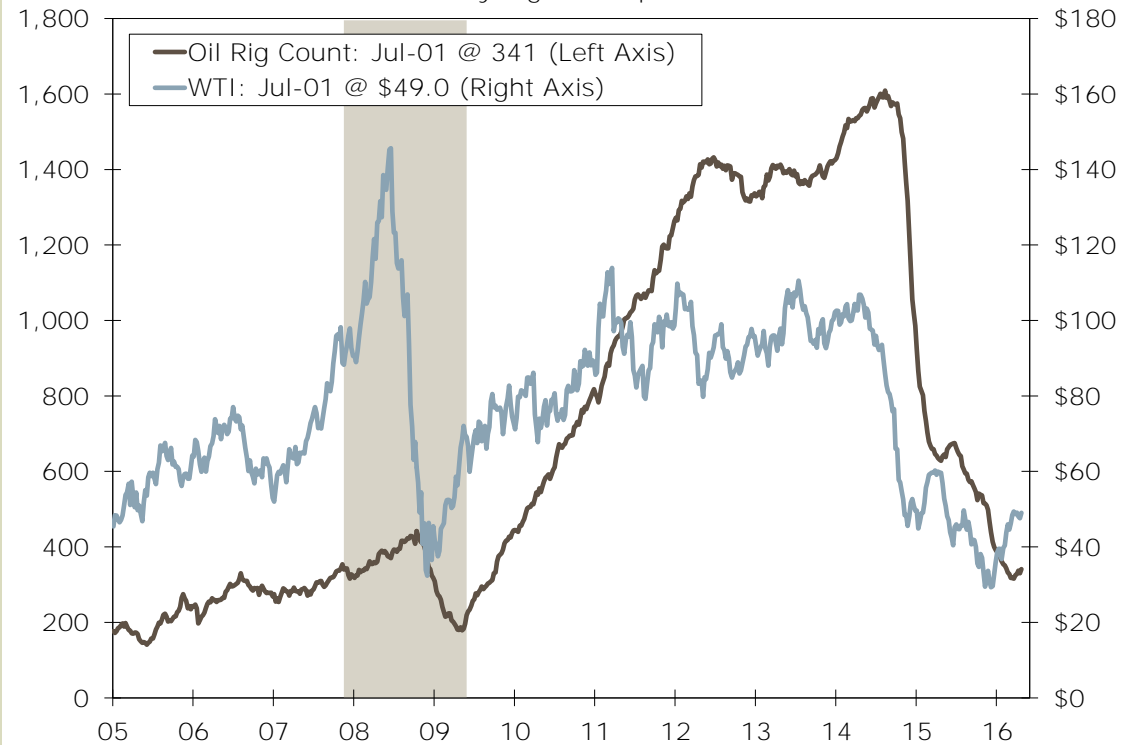


Source: Federal Reserve Board and Wells Fargo Securities

Energy prices have bottomed for this cycle, but production will continue to be held back by previous cuts in investment

Baker-Hughes Rig Count vs. Oil Prices

Oil Rotary Rigs: USD per Barrel



Source: Bloomberg LP and Wells Fargo Securities, LLC

Global growth and trade have slowed over the past year

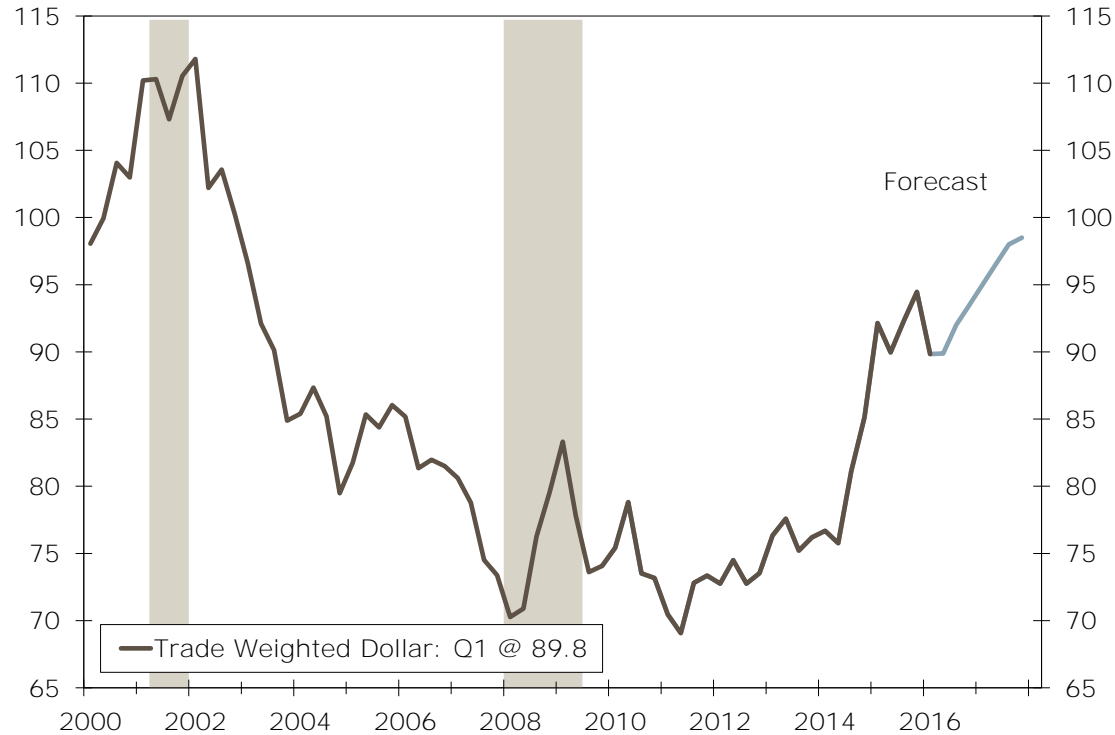
Global Export Volumes
Year-over-Year Percent Change



Source: IHS Global Insight and Wells Fargo Securities, LLC

Divergence between U.S. and global monetary policy should push the dollar up again later this year, but the rate of appreciation should be more gradual than in 2015

Trade Weighted Dollar
Major Currency Index, 1973 = 100

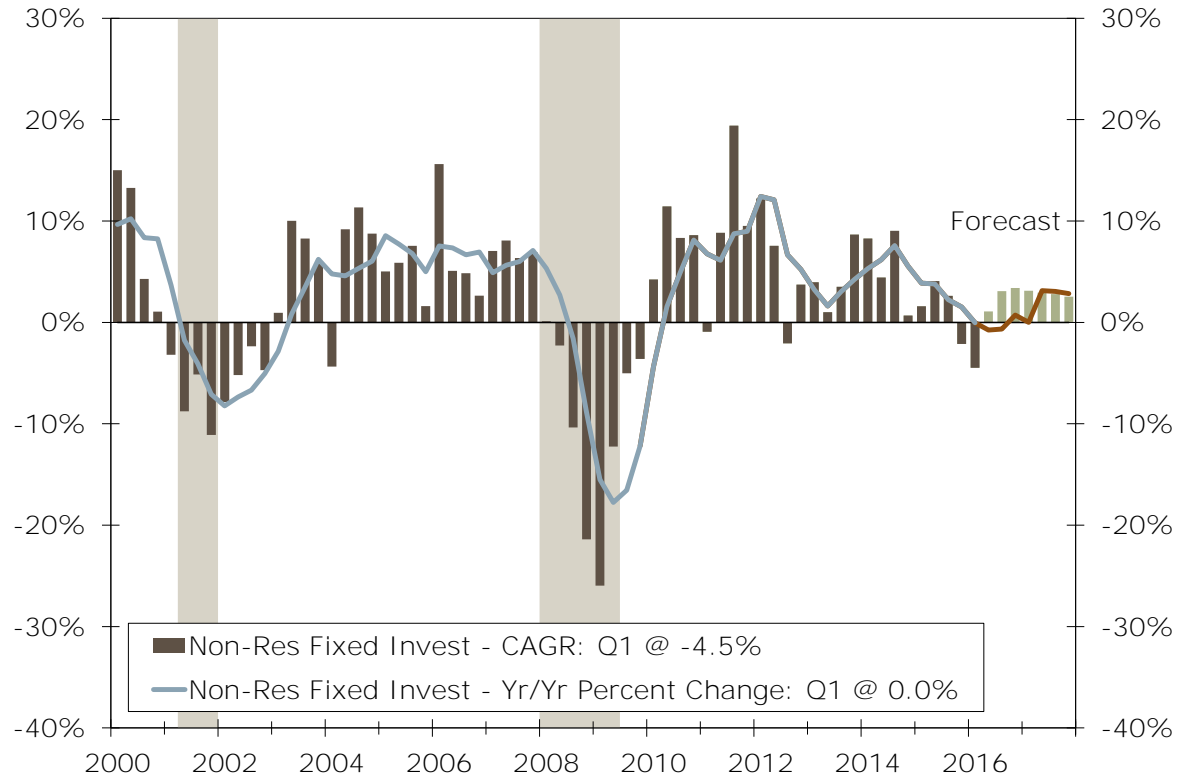


Source: Federal Reserve Board and Wells Fargo Securities

Business fixed investment spending should turn around in the coming quarters, but the pace is likely to remain fairly tepid

Real Business Fixed Investment

Bars = CAGR Line = Yr/Yr Percent Change

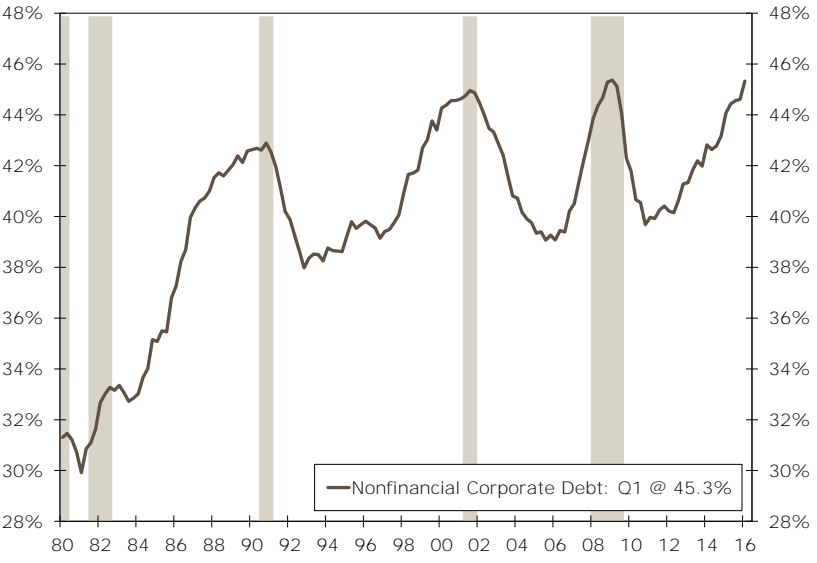


Source: U.S. Department of Commerce and Wells Fargo Securities

Businesses have levered up and financing conditions have tightened over the past few years

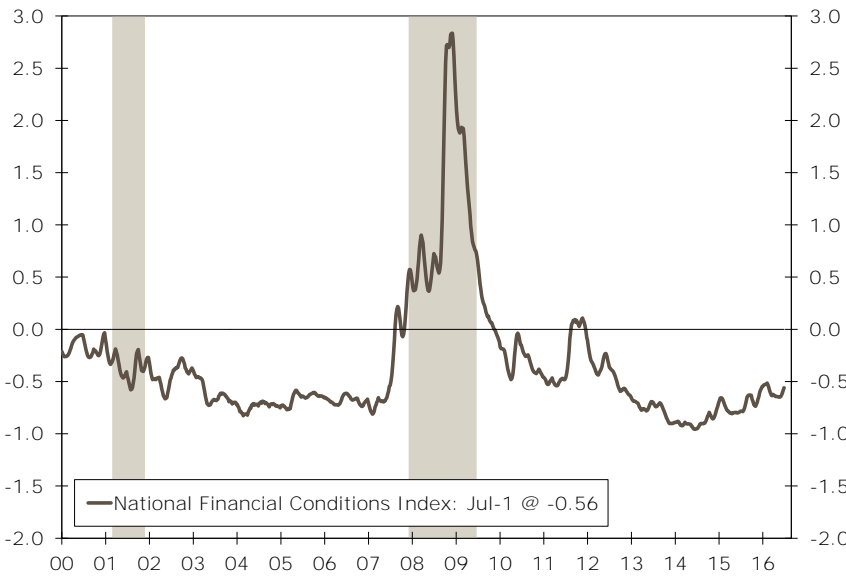
Corporate Debt

Corporate Debt as a Share of GDP
Nonfinancial Corporations



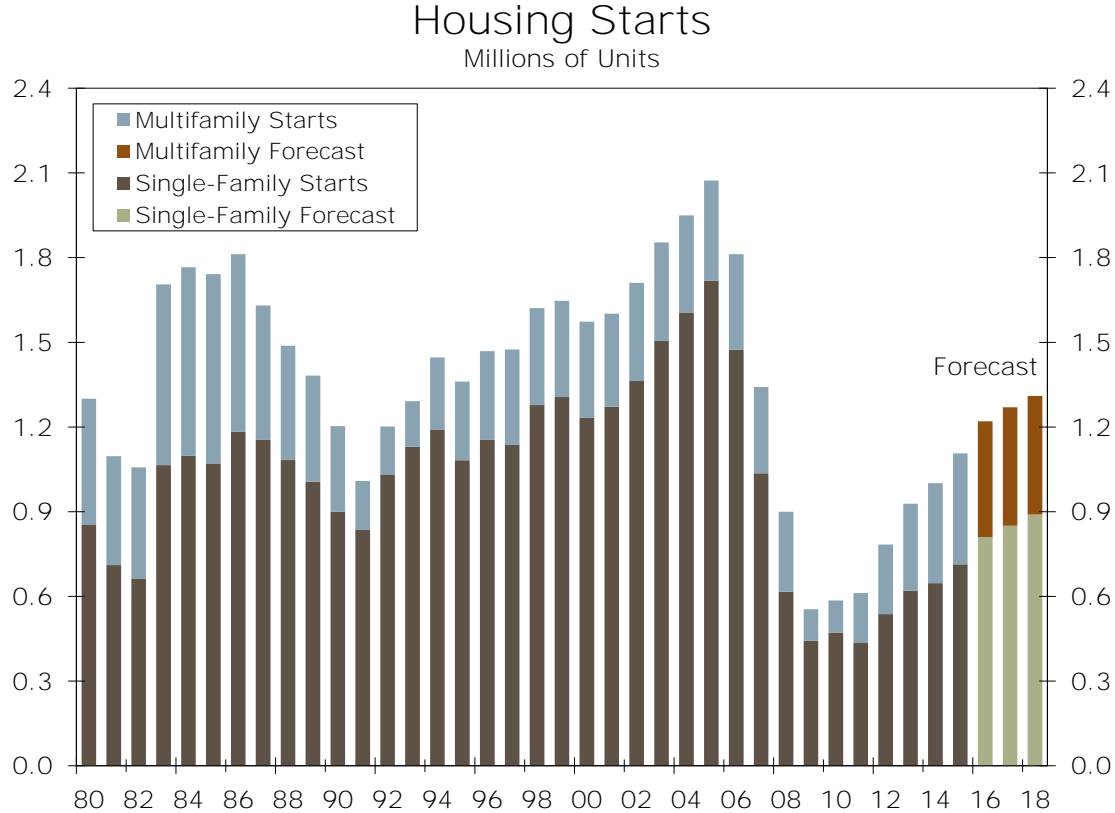
Financial Conditions

National Financial Conditions Index
Normalized, Positive Values Reflect Tighter Than Average Conditions



Source: Federal Reserve Board, Federal Reserve Bank of Chicago and Wells Fargo Securities

Multifamily housing should continue to account for a historically large share of new residential construction, but the mix is shifting back toward single-family construction

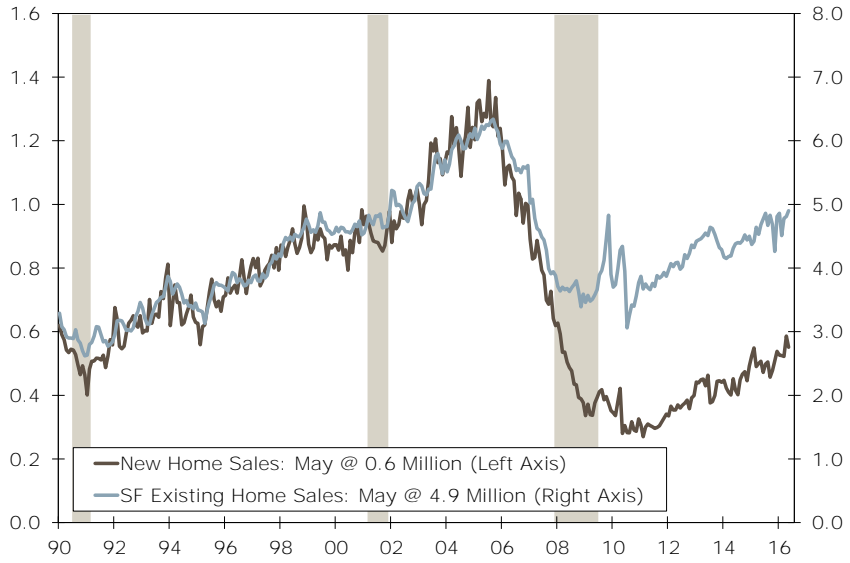


Source: U.S. Department of Commerce and Wells Fargo Securities

Low mortgage rates and rising incomes have boosted home sales. Limited inventories of new homes on the market will support new construction.

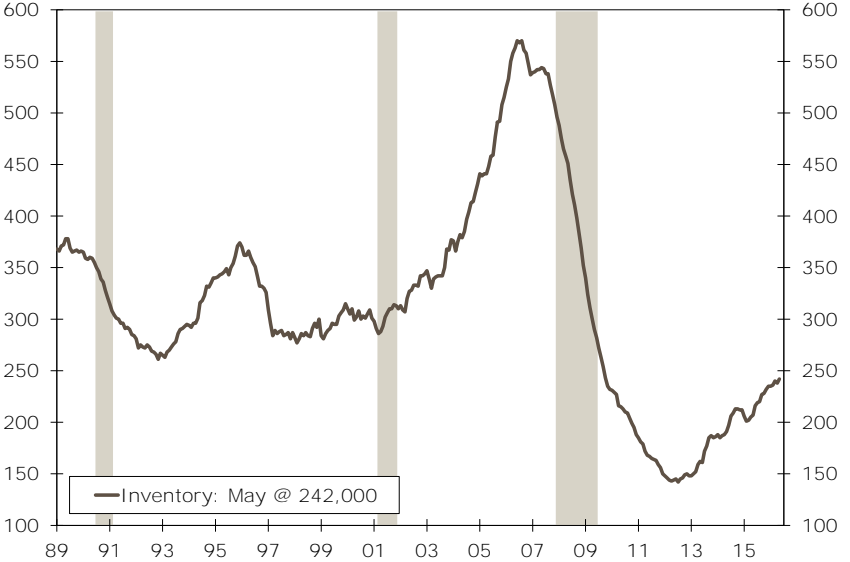
Home Sales

Existing & New Single-Family Home Sales
In Millions, Seasonally Adjusted Annual Rate



Inventories

Inventory of New Homes for Sale
Non-Seasonally Adjusted, In Thousands

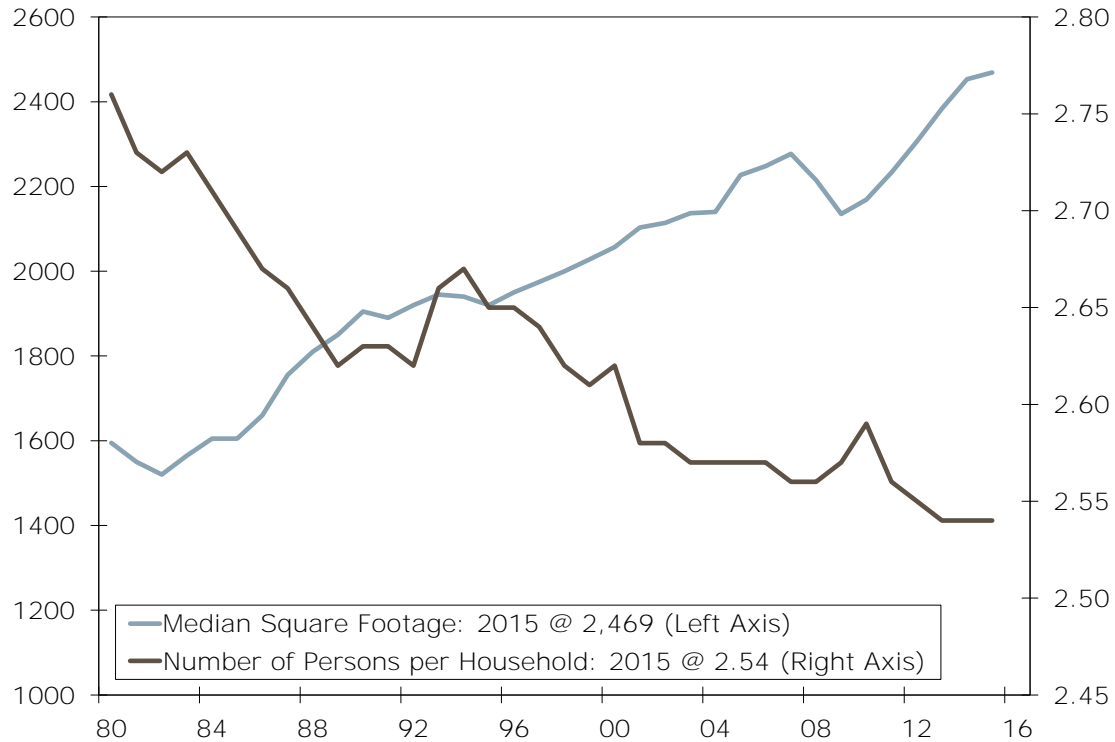


Source: U.S. Department of Commerce, S&P Case-Shiller, Federal Reserve Board and Wells Fargo Securities

The size of new single-family homes continues to climb

Home Size vs. Household Size

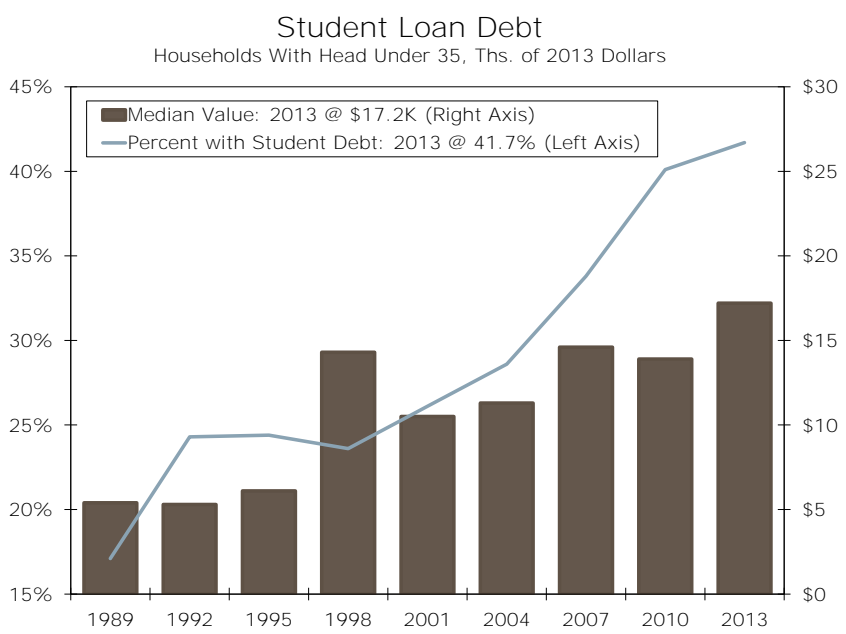
Median Square Feet, Average Number of Persons



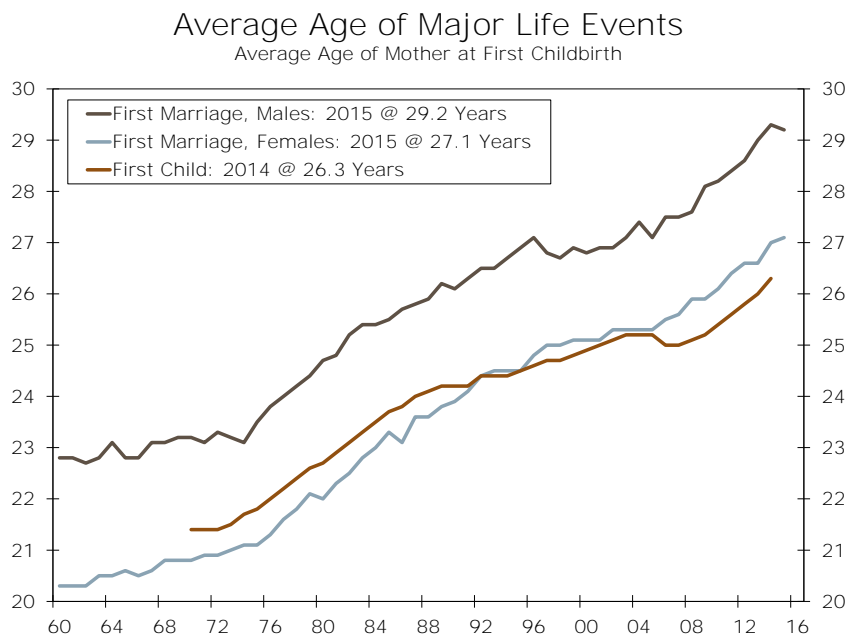
Source: U.S. Department of Commerce and Wells Fargo Securities

Secular trends are delaying young adults' ability and need to buy a home

Student Loan Debt



“Delayed Adulthood”

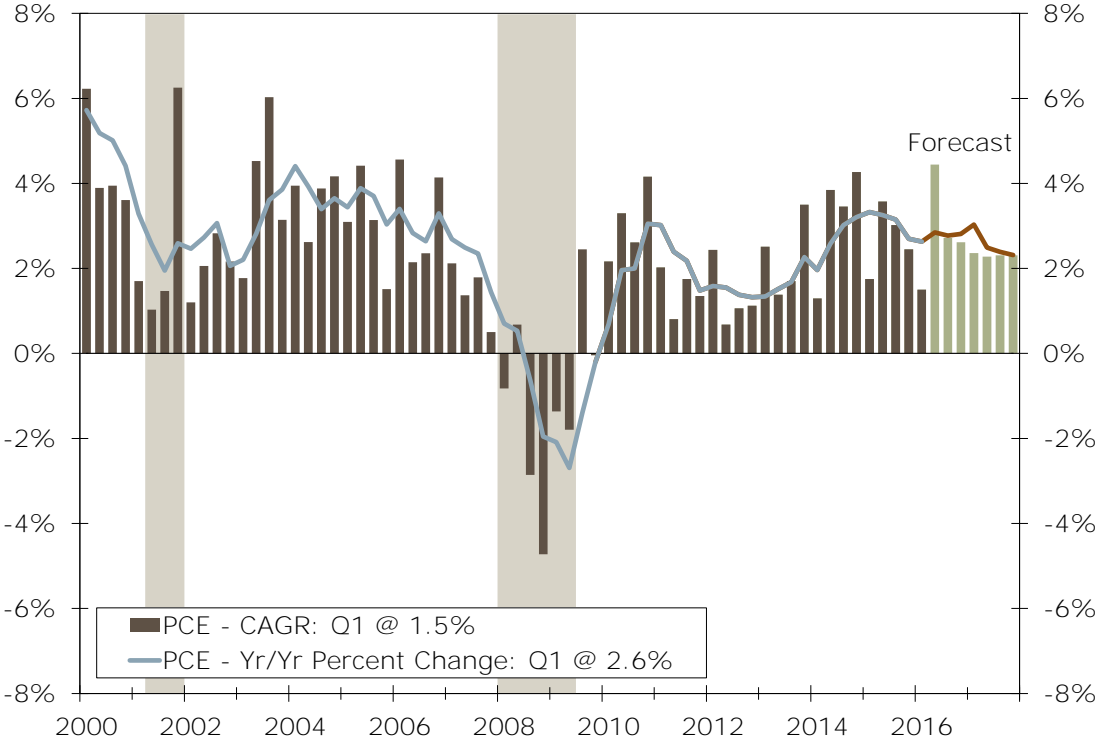


Source: Federal Reserve Board, U.S. Department of Commerce and Wells Fargo Securities

Consumer spending will be a key driver of growth over the next year

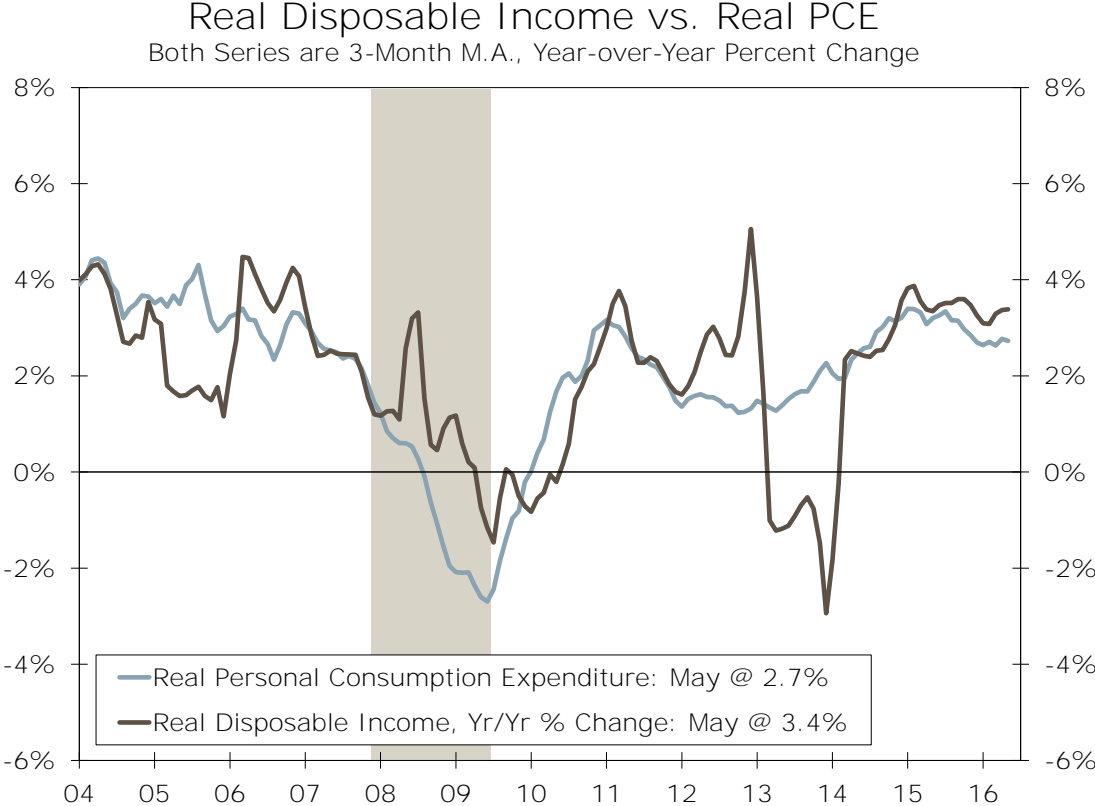
Real Personal Consumption Expenditures

Bars = CAGR Line = Yr/Yr Percent Change



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

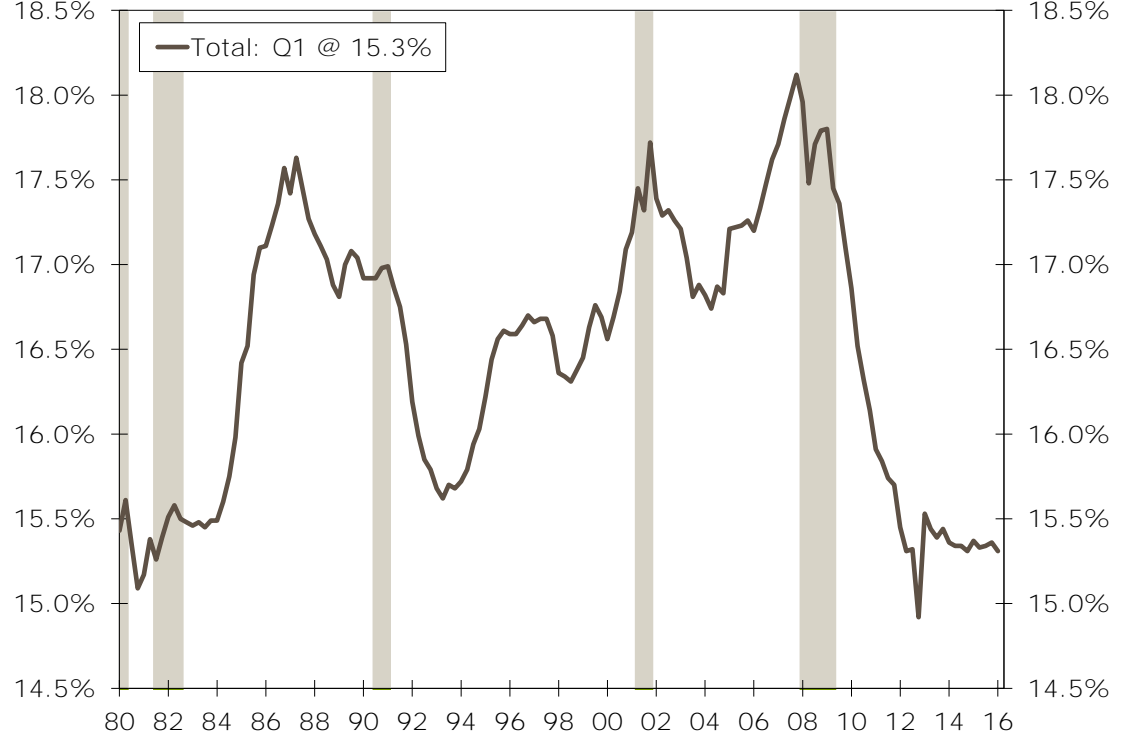
Strong growth in disposable income is helping to support consumer spending



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

Household debt has returned to more sustainable levels

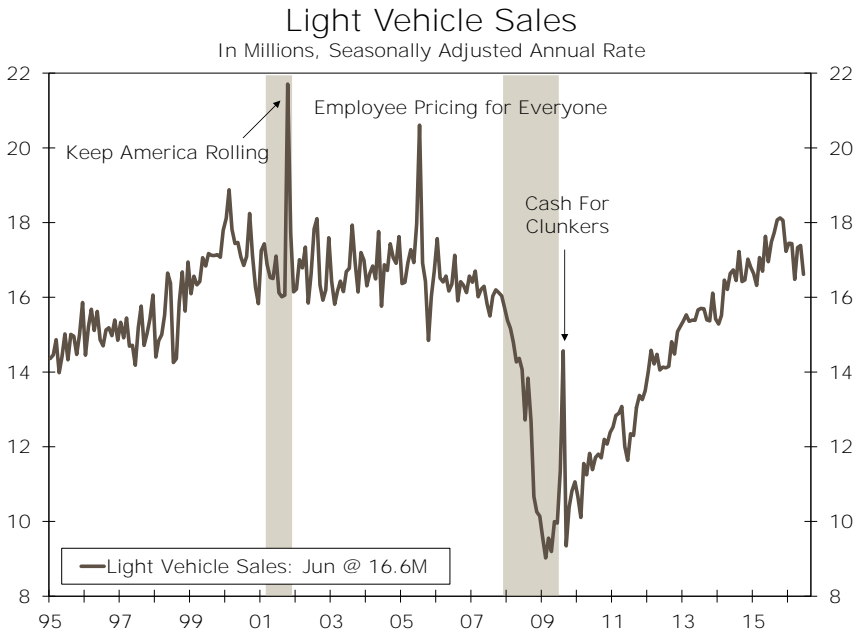
Financial Obligations Ratio-Total
As a Percent of Disposable Personal Income



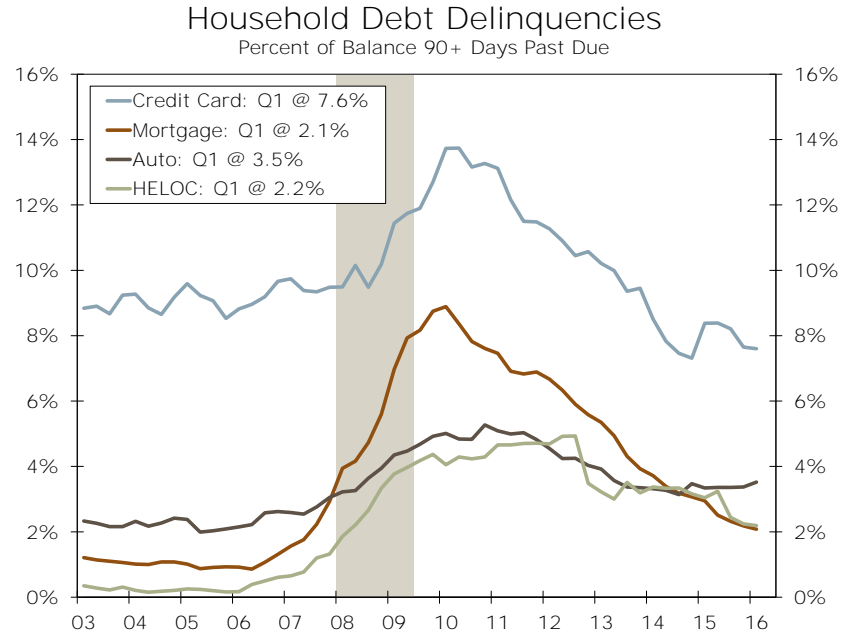
Source: Federal Reserve Board and Wells Fargo Securities

Auto sales have likely peaked for this cycle as pent-up demand has been released. Credit standards for autos are no longer easing following an uptick in delinquencies.

Vehicle Sales



Debt Delinquencies

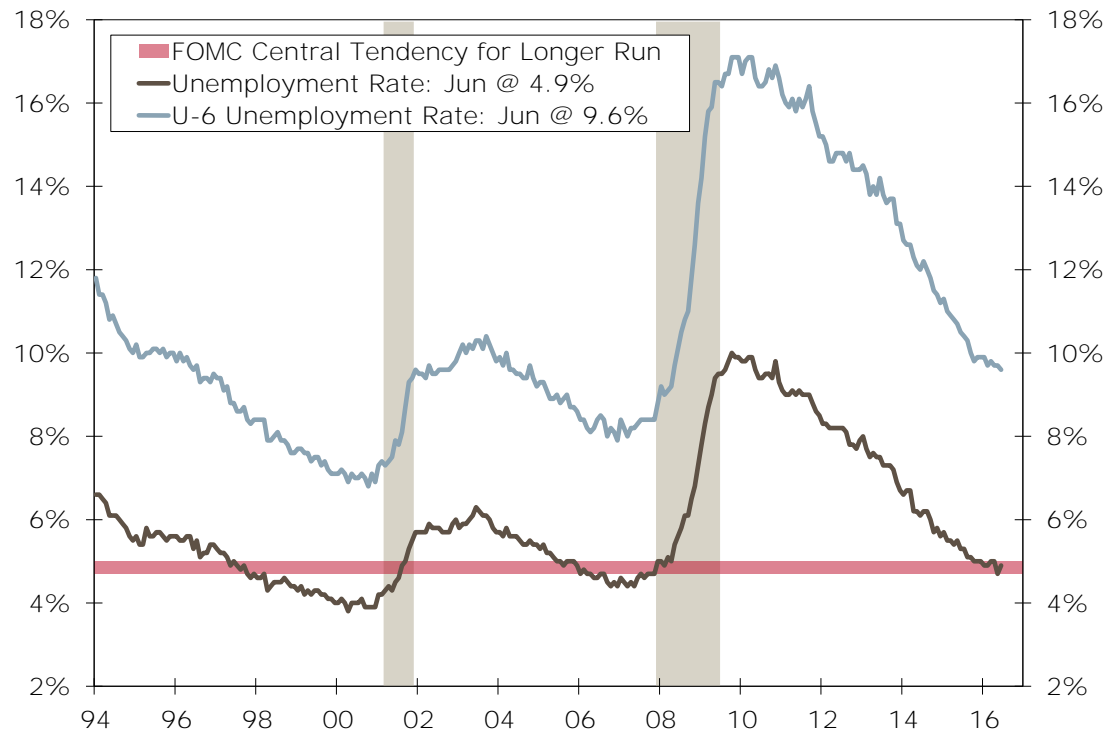


Source: U.S. Department of Commerce, Federal Reserve Bank of New York and Wells Fargo Securities

The labor market is around the **Fed's estimates for full employment**, although underemployment remains high

Unemployment Rates

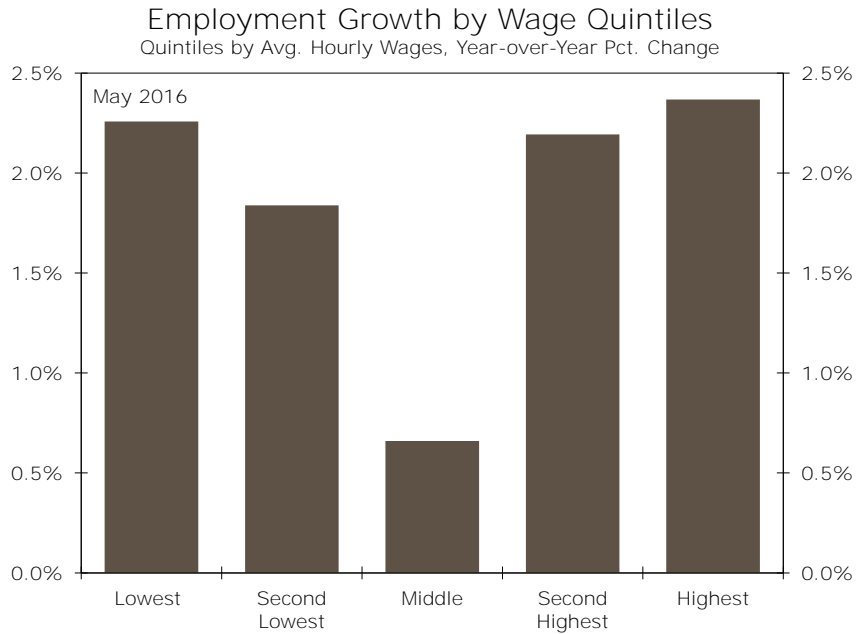
Seasonally Adjusted



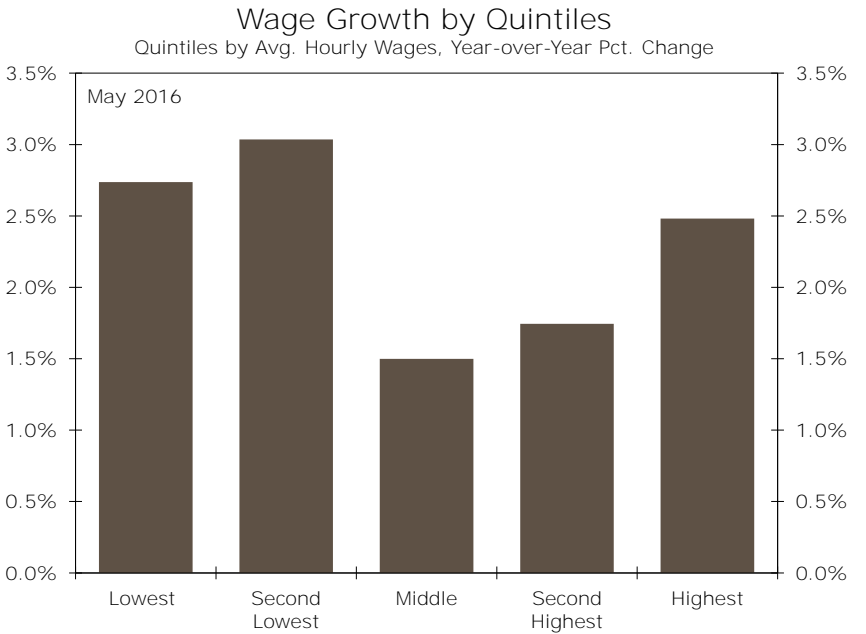
Source: U.S. Department of Labor, Federal Reserve Board and Wells Fargo Securities

Job growth has shifted toward higher paying industries, while lower-paying industries have seen the strongest wage growth over the past year

Employment Growth

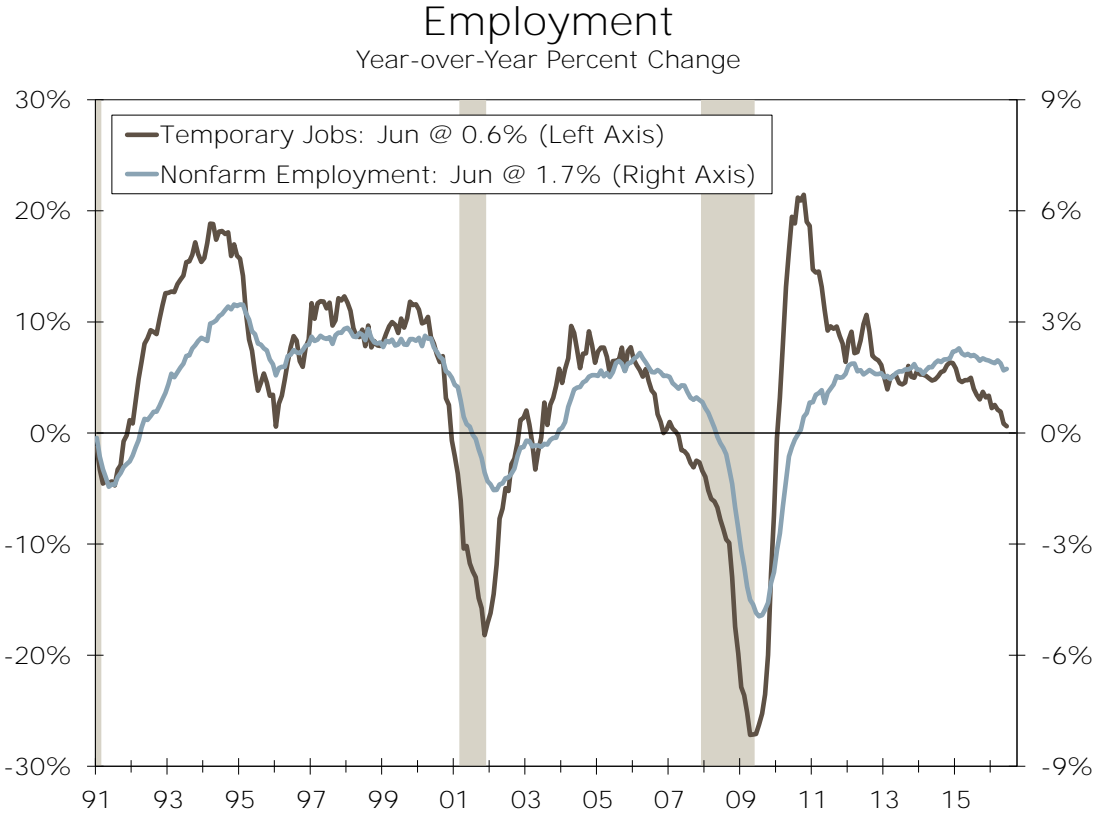


Wage Growth



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

Employment growth remains strong, but temporary employment signals a slower pace ahead

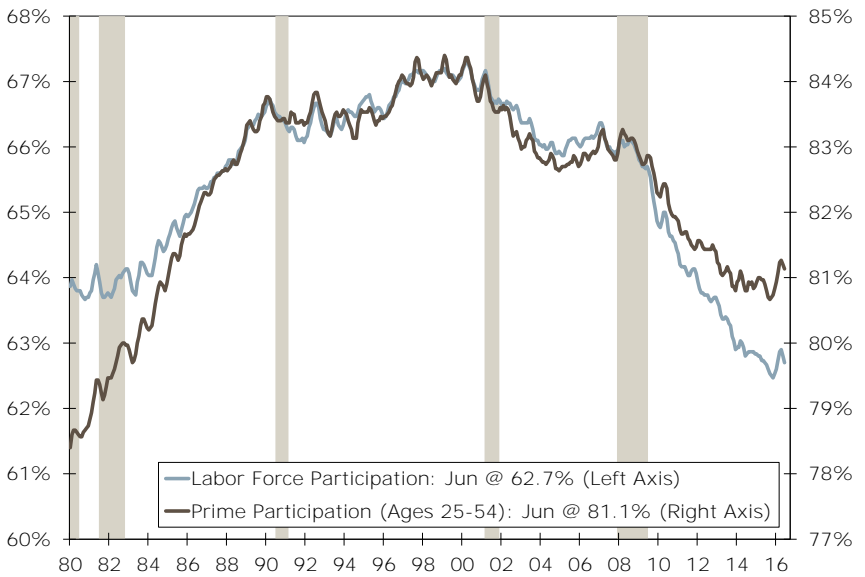


Source: U.S. Department of Labor and Wells Fargo Securities

Without a significant rebound in labor force participation, growth in the labor supply is expected to slow in the coming years

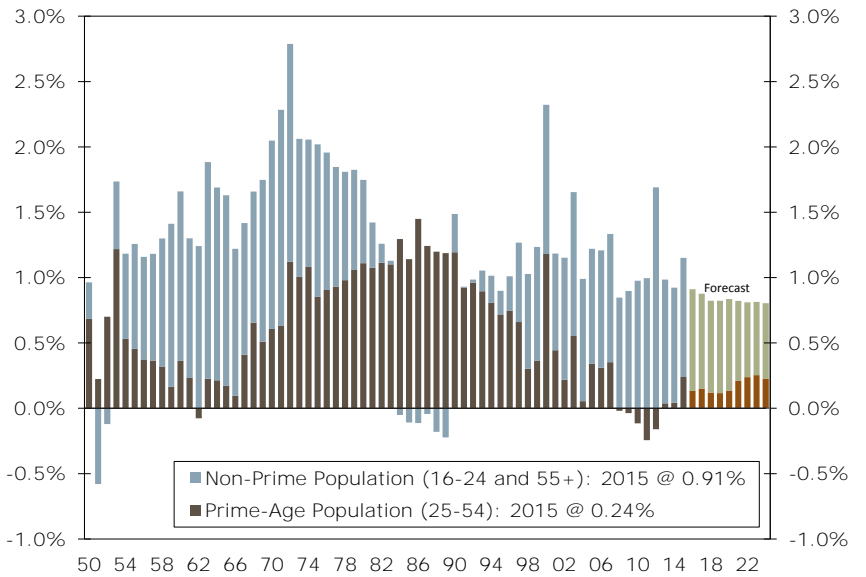
Labor Force Participation

Labor Force Participation Rate
Prime vs. Total, Seasonally Adjusted 3-MMA



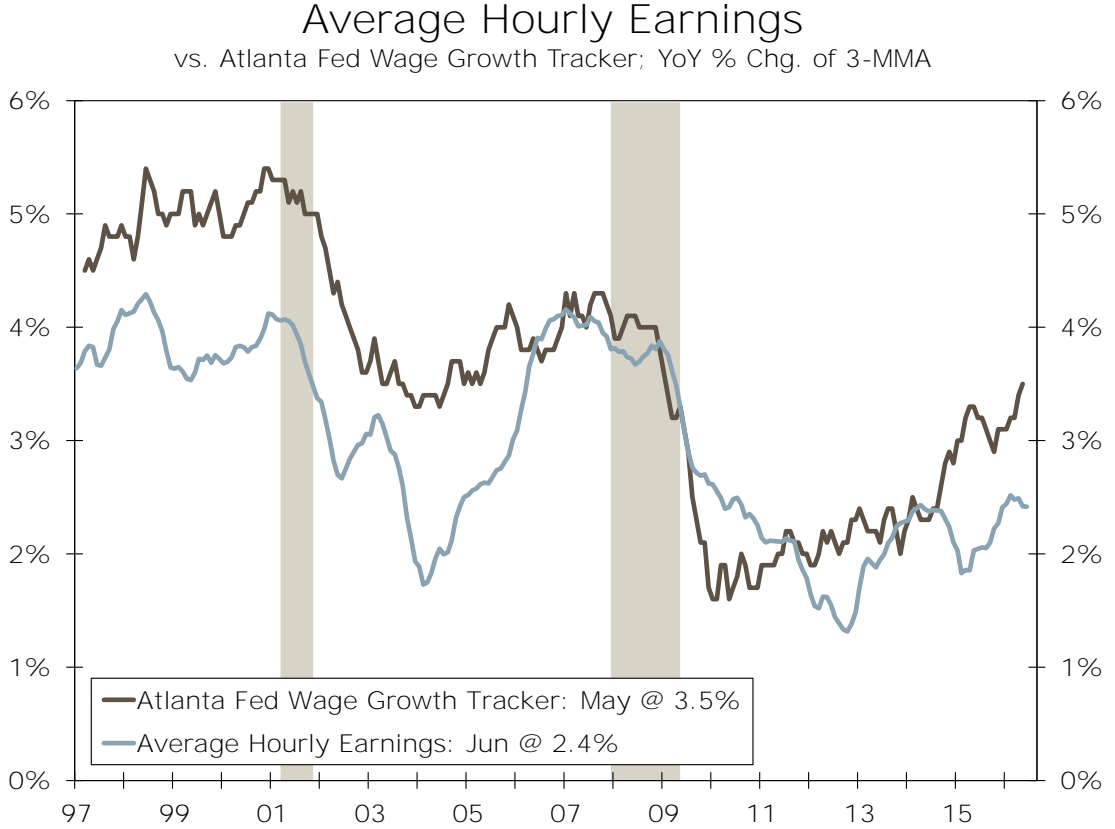
Working Age Population

Working Age Population Growth
Percentage Point Contribution to Population Age 16 and Older



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

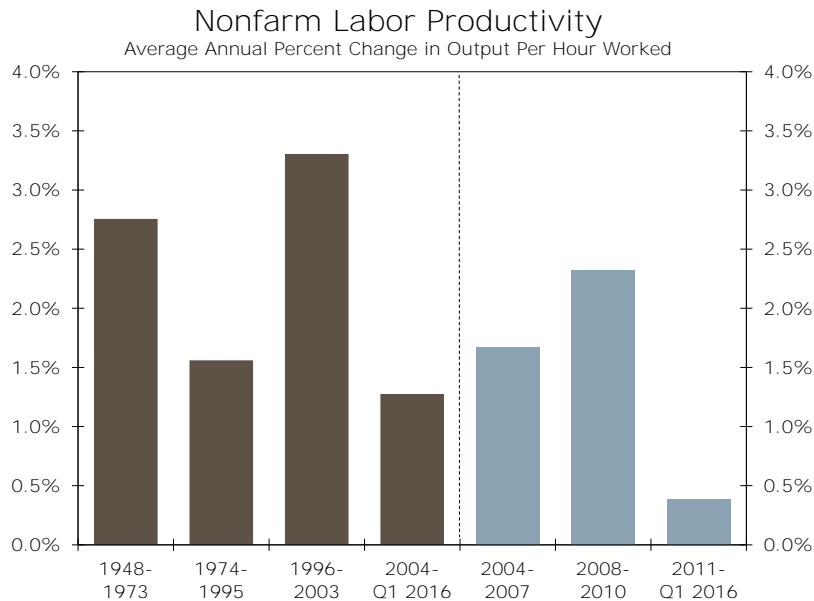
Average hourly earnings' growth has picked up modestly but remains limited by lower-skilled workers entering the workforce and Baby Boomers beginning to retire



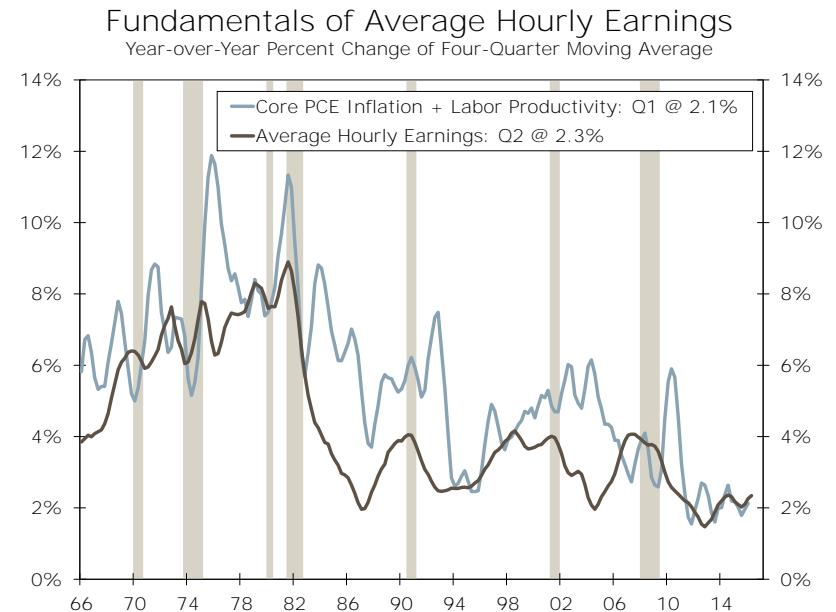
Source: Federal Reserve Bank of Atlanta, U.S. Department of Labor and Wells Fargo Securities

Weaker productivity is limiting potential GDP and wage growth

Productivity



Productivity & Wages

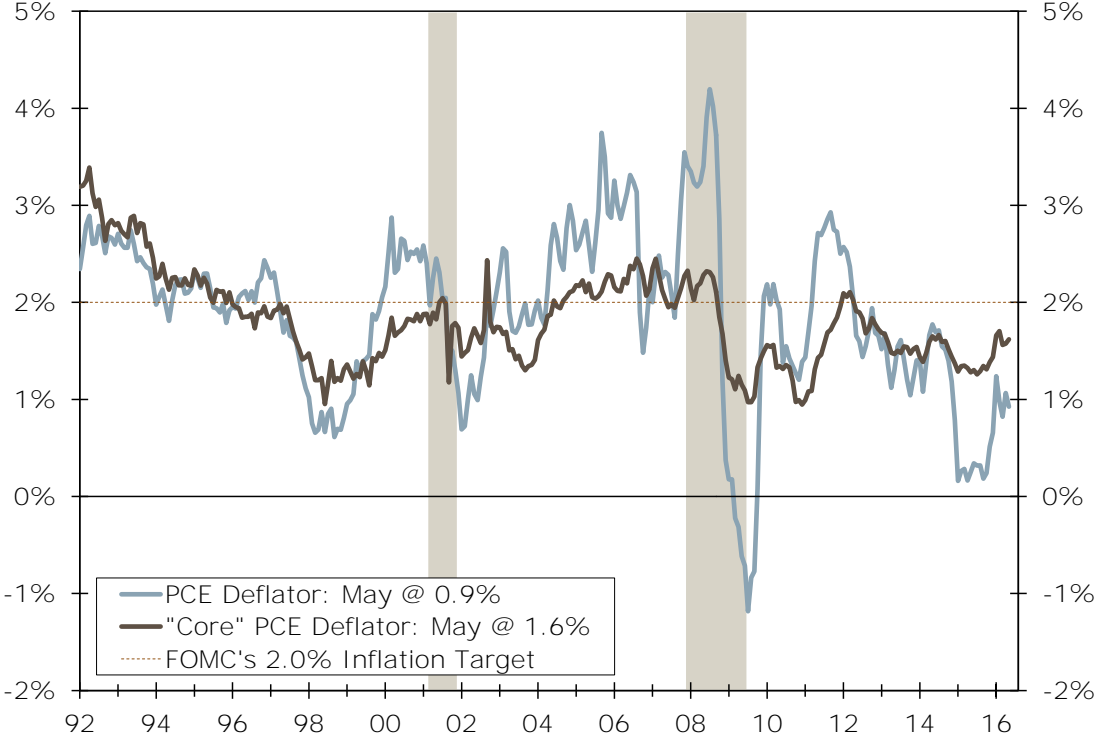


Source: U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities

Inflation is moving back toward the Fed's target as the drag from energy fades and slack is slowly diminishing

PCE Deflator vs. Core PCE Deflator

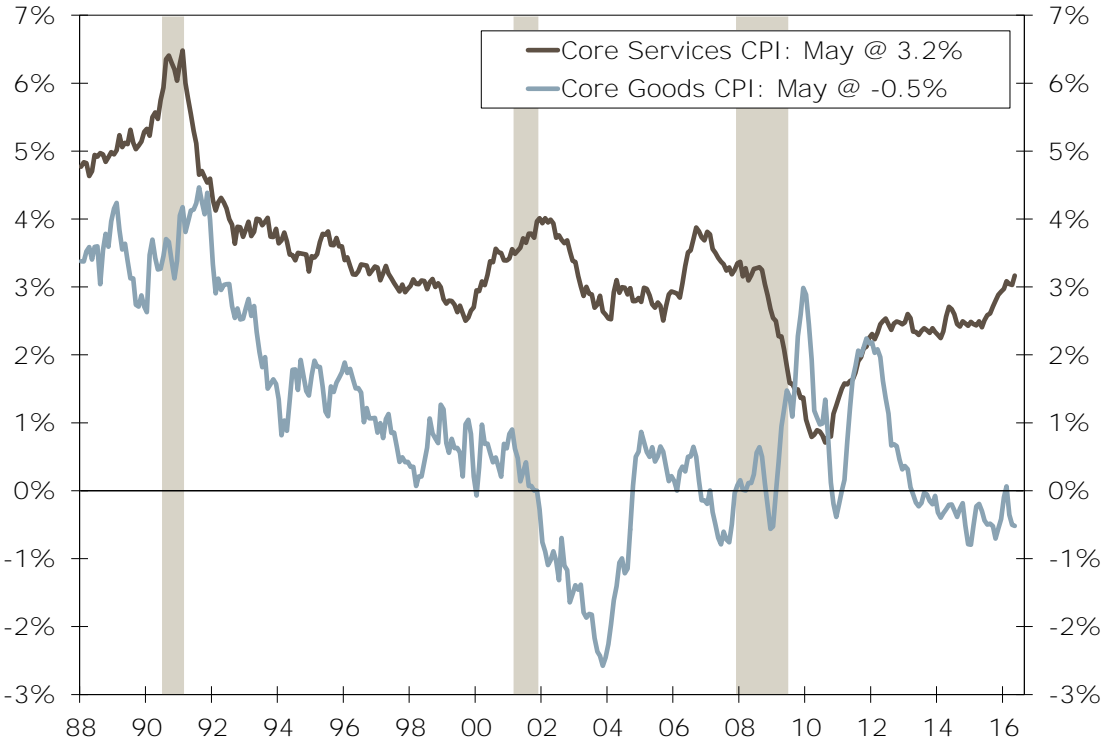
Year-over-Year Percent Change



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

The services sector has pricing power, while goods prices are declining

Core Goods vs. Core Services CPI
Year-over-Year Percent Change

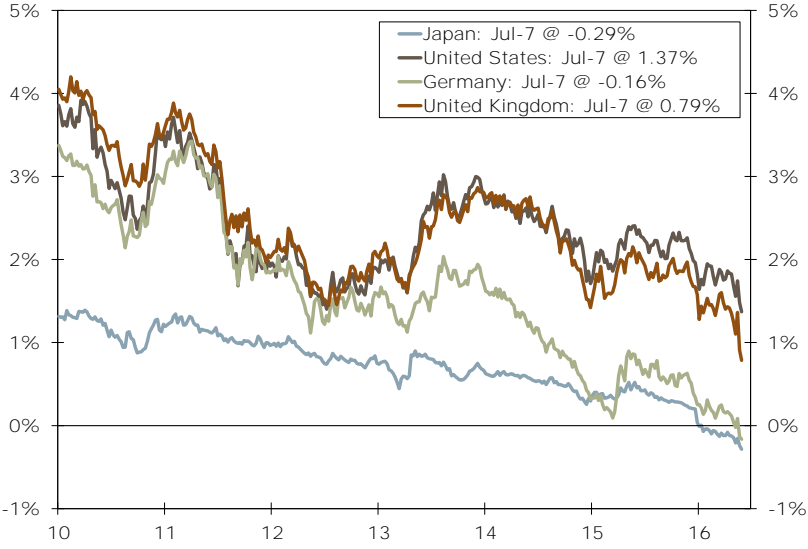


Source: U.S. Department of Commerce and Wells Fargo Securities

Low interest rates around the world will limit how quickly the Fed can further raise rates and keep the long end of the yield curve from rising significantly

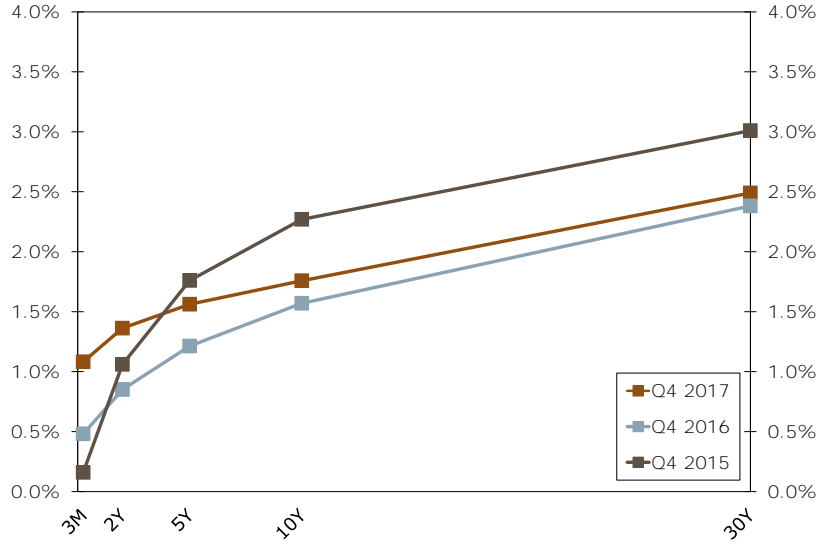
Global Yields

10-Year Government Bond Yields
Percent



Yield Curve

Wells Fargo Rates Forecast
Through 2017



Source: Bloomberg LP and Wells Fargo Securities

Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual			Forecast	
	2015				2016				2013	2014	2015	2016	2017
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product ¹	0.6	3.9	2.0	1.4	1.1	2.9	2.5	2.4	1.5	2.4	2.4	2.0	2.2
Personal Consumption	1.8	3.6	3.0	2.4	1.5	4.4	2.7	2.6	1.7	2.7	3.1	2.8	2.6
Inflation Indicators ²													
PCE Deflator	0.2	0.3	0.3	0.5	1.0	1.0	1.1	1.5	1.4	1.4	0.3	1.1	2.0
Consumer Price Index	-0.1	0.0	0.1	0.4	1.1	1.1	1.3	1.7	1.5	1.6	0.1	1.3	2.3
Industrial Production ¹	-1.9	-2.7	1.5	-3.3	-1.6	-1.2	1.8	2.5	1.9	2.9	0.3	-0.9	2.1
Corporate Profits Before Taxes ²	4.6	0.6	-5.1	-11.5	-4.3	-0.6	1.9	1.9	2.0	1.7	-3.1	-0.3	1.7
Trade Weighted Dollar Index ³	92.1	90.0	92.3	94.5	89.8	89.9	92.0	93.5	75.9	78.4	91.1	91.3	97.0
Unemployment Rate	5.6	5.4	5.2	5.0	4.9	4.8	4.8	4.7	7.4	6.2	5.3	4.8	4.5
Housing Starts ⁴	0.99	1.16	1.16	1.13	1.15	1.19	1.23	1.24	0.92	1.00	1.11	1.22	1.27
Quarter-End Interest Rates ⁵													
Federal Funds Target Rate	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.75	0.25	0.25	0.27	0.56	1.00
Conventional Mortgage Rate	3.77	3.98	3.89	3.96	3.69	3.60	3.55	3.60	3.98	4.17	3.85	3.61	3.68
10 Year Note	1.94	2.35	2.06	2.27	1.78	1.49	1.50	1.57	2.35	2.54	2.14	1.59	1.69

Forecast as of: July 1, 2016

¹ Compound Annual Growth Rate Quarter-over-Quarter² Year-over-Year Percentage Change³ Federal Reserve Major Currency Index, 1973=100 - Quarter End⁴ Millions of Units⁵ Annual Numbers Represent Averages

Source: U.S. Dept. of Commerce, U.S. Dept. of Labor, Federal Reserve Board, Bloomberg LP and Wells Fargo Securities

Growth in the global economy likely will grind closer to long term trend

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP			CPI		
	2015	2016	2017	2015	2016	2017
Global (PPP Weights)	3.0%	2.9%	3.1%	2.6%	3.2%	3.4%
Global (Market Exchange Rates)	2.8%	2.7%	2.9%	n/a	n/a	n/a
Advanced Economies ¹	1.9%	1.8%	2.2%	0.3%	0.9%	1.5%
United States	2.4%	2.0%	2.2%	0.1%	1.4%	2.4%
Eurozone	1.5%	1.6%	1.9%	0.0%	0.2%	1.2%
United Kingdom	2.3%	1.6%	1.9%	0.0%	0.6%	1.4%
Japan	0.6%	0.3%	1.2%	0.8%	0.0%	1.0%
Korea	2.6%	2.6%	2.8%	0.7%	0.9%	1.9%
Canada	1.1%	1.9%	2.7%	1.1%	1.3%	1.9%
Developing Economies ¹	4.0%	3.9%	4.0%	4.7%	5.5%	5.3%
China	6.9%	6.5%	5.7%	1.4%	2.1%	2.0%
India ²	6.6%	7.2%	7.6%	6.0%	4.9%	5.2%
Mexico	2.5%	2.6%	2.8%	2.7%	2.9%	2.8%
Brazil	-3.9%	-4.2%	-1.0%	9.0%	9.0%	7.2%
Russia	-3.7%	0.3%	1.7%	15.6%	7.3%	5.9%

Forecast as of: June 8, 2016

¹Aggregated Using PPP Weights

²Forecasts Refer to Fiscal Year

Source: International Monetary Fund and Wells Fargo Securities

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