

**WELLS
FARGO**

SECURITIES

Global Economic Outlook

Tim Quinlan, Senior Economist
July, 2017

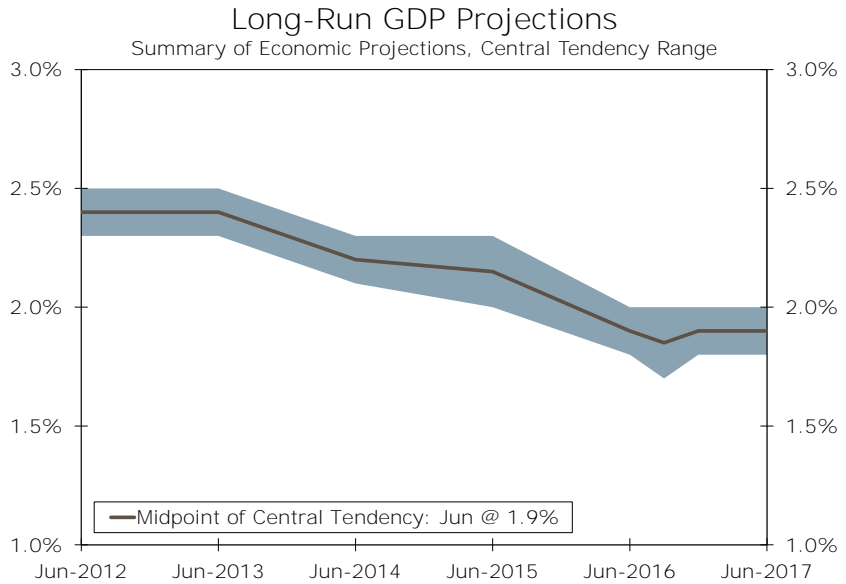
Together we'll go far



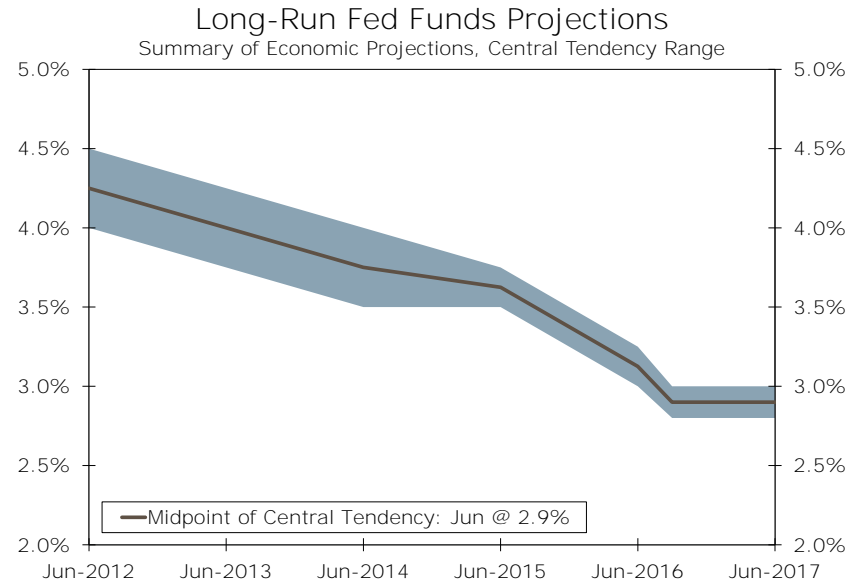
GDP and Fed Funds “Long-Run” Expectations from the Fed

Over the past several years, the Fed has dialed-back its own estimates of potential GDP growth as have private-sector economists and Congressional Budget Office

Openings



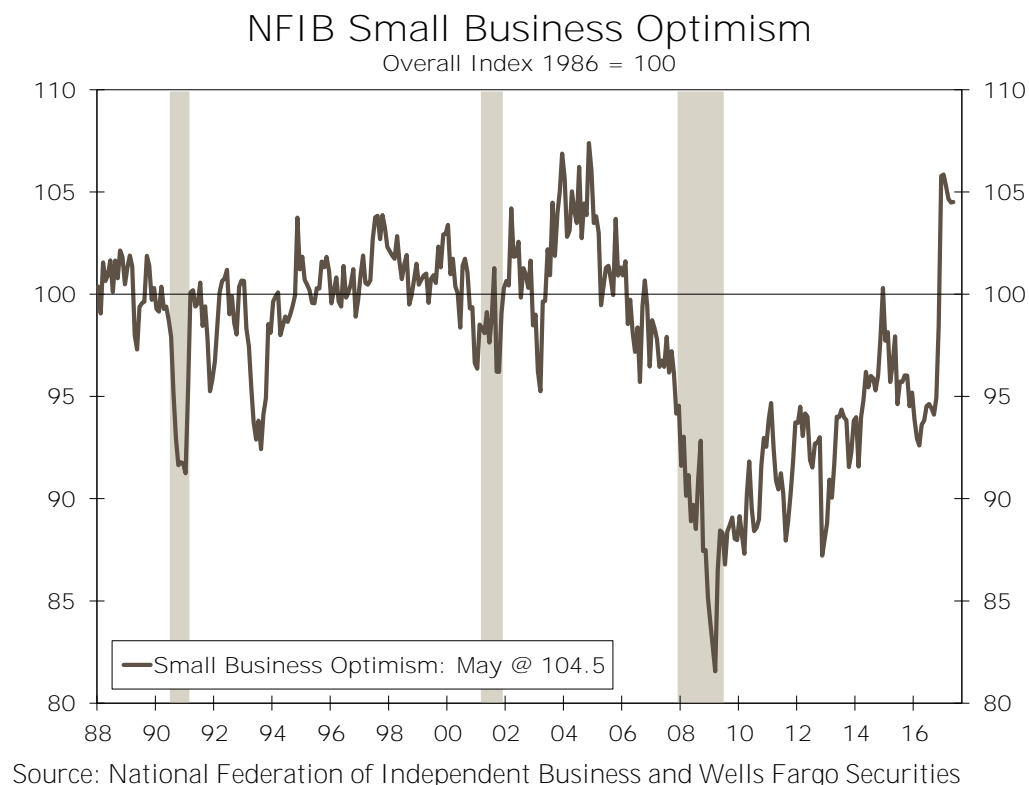
Separations



Source: Federal Reserve and Wells Fargo Securities

Post-Election Euphoria

- Many purchasing manager surveys and measures of consumer and business confidence have jumped to multi-year highs since the start of this year.
- The National Federation of Independent **Business**' measure of small business confidence reached the highest level in 13 years in January.
- Similarly, the ISM index touched a multi-year high in June.

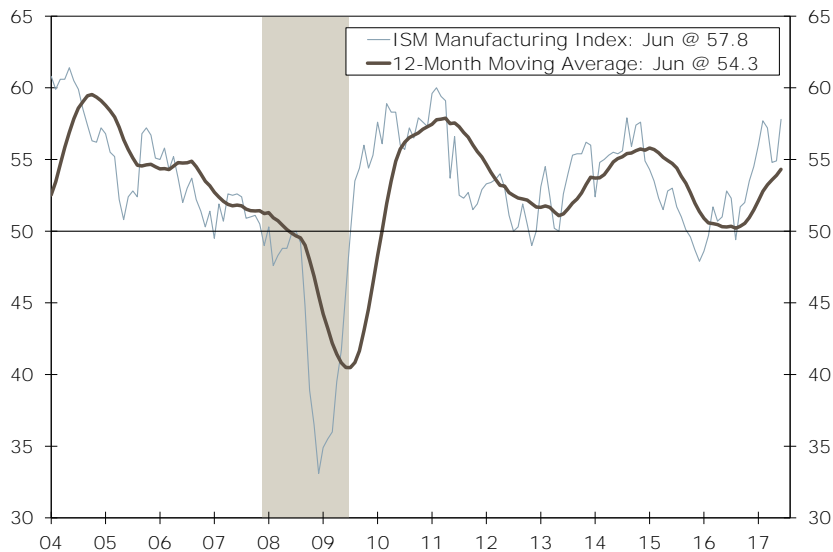


Renewed Strength?

- Survey data firmed in June after a temporary dip the previous two months.
- The June print for the ISM manufacturing index of 57.8 marked the third consecutive monthly increase and was strongest in three years.
- Factories indicate that production was strong in June, and the orders pipeline suggests that production will remain solid in coming months.

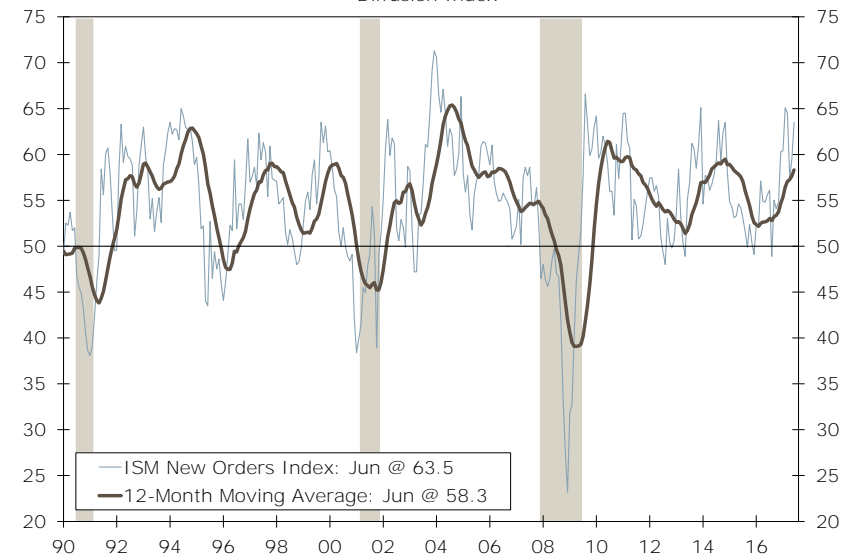
ISM Clearly Improved

ISM Manufacturing Composite Index
Diffusion Index



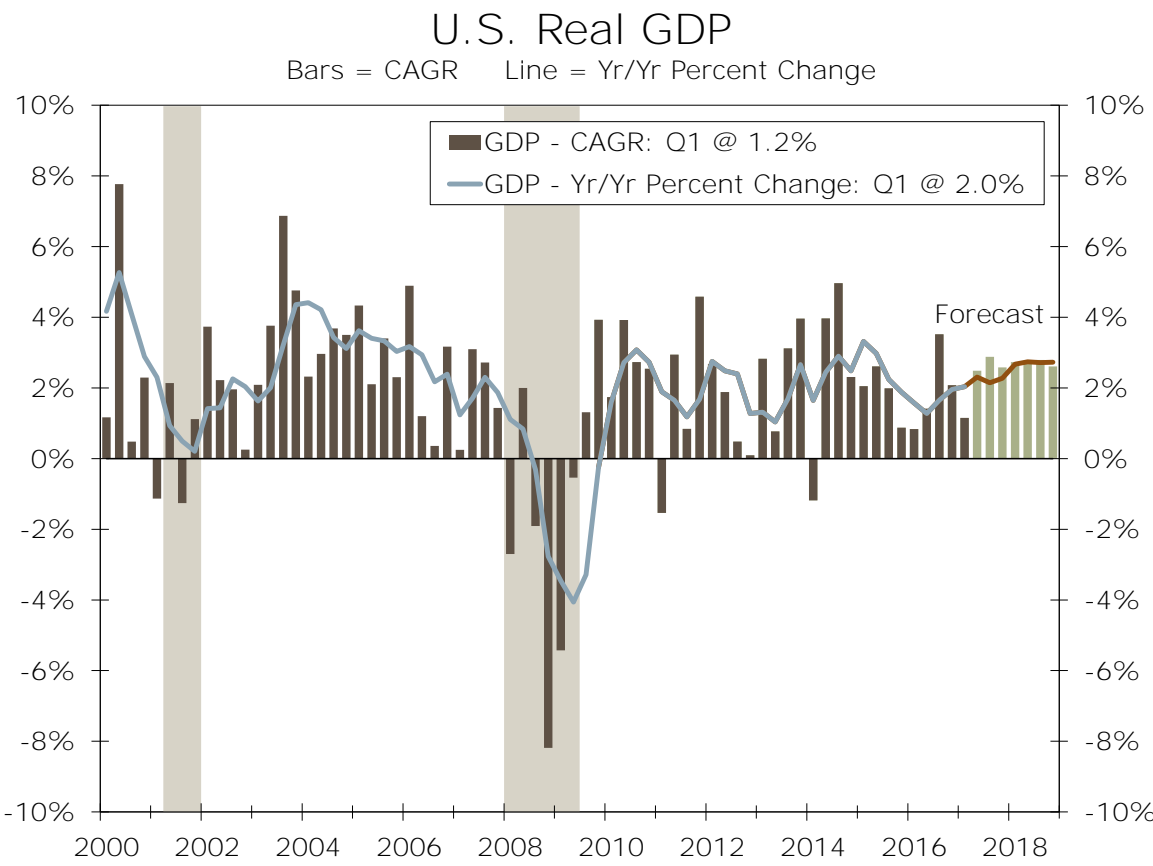
But Has Come Back Down to Earth

ISM New Orders Index
Diffusion Index



Source: Institute for Supply Management and Wells Fargo Securities

Outlook is for below-trend growth to continue



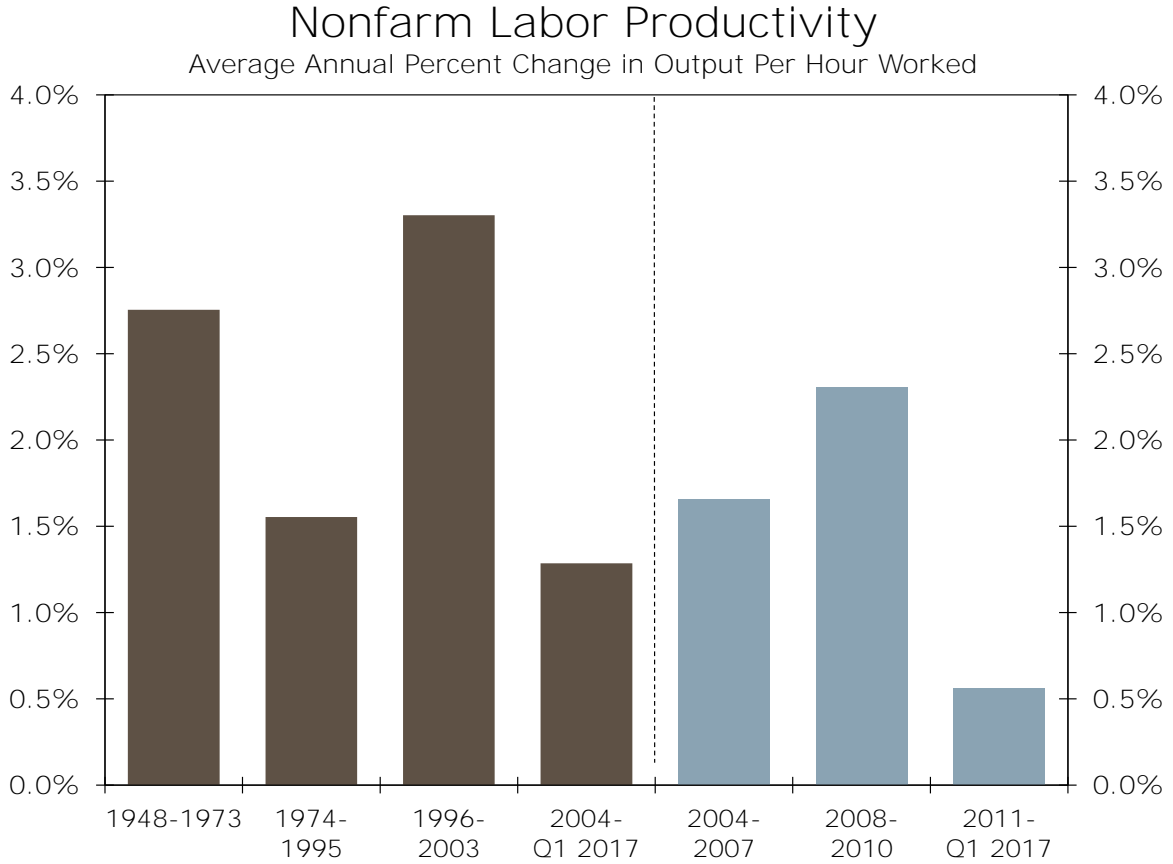
Source: U.S. Department of Commerce and Wells Fargo Securities

The fiscal policy checklist

Key Issues to Watch in the 115th Congress

- Budget Debates
 - Currently the government is funded through September 30
- Repeal & Replace the Affordable Care Act
 - Failure here raises doubts about Trump agenda
- Corporate Tax Reform
 - We are assuming the top statutory corporate tax rate is cut only modestly perhaps to 30% from the current 35% rate
 - The tax cut will be at least partially paid for by reducing the tax rate for repatriated corporate profits.
- Individual Tax Reform
 - Cuts are likely but reforms will not likely move quickly
 - We expect a total tax cut of roughly \$1.6 trillion over 10 years.

Productivity growth has downshifted over the past cycle

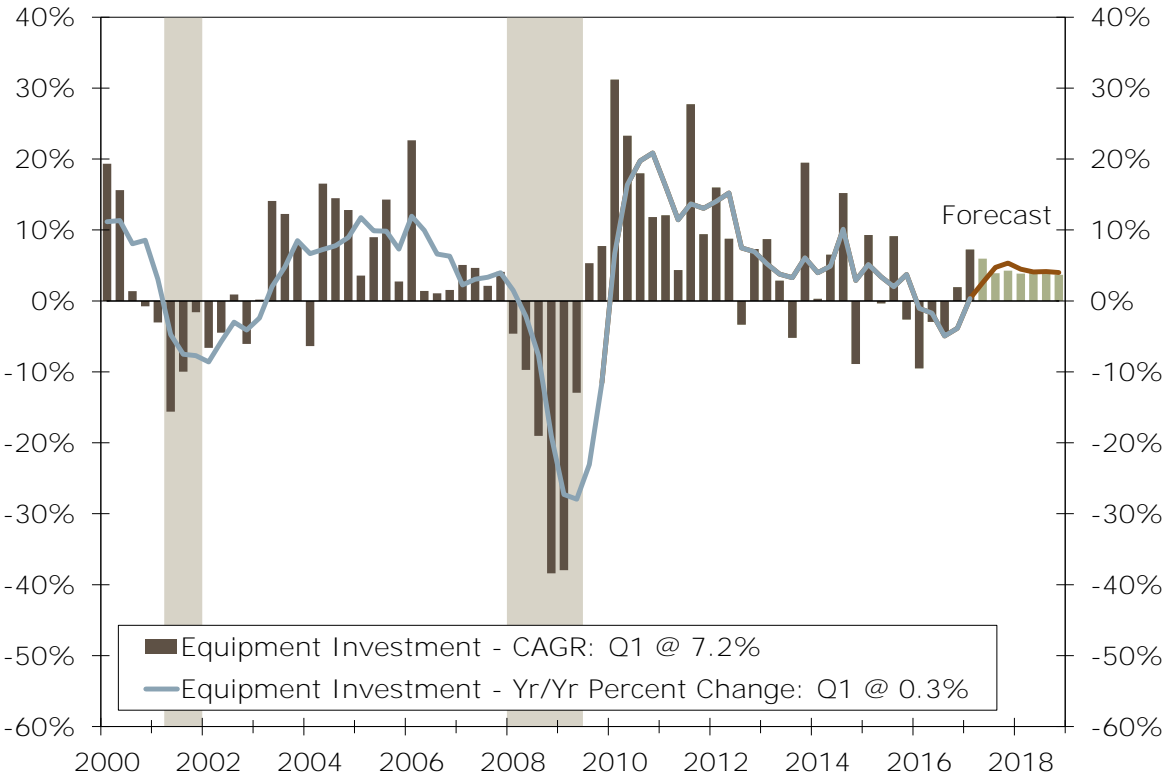


Source: U.S. Department of Labor and Wells Fargo Securities

Tough to find reasons to get excited about prospects for capital outlays

Real Equipment Investment

Bars = CAGR Line = Yr/Yr Percent Change



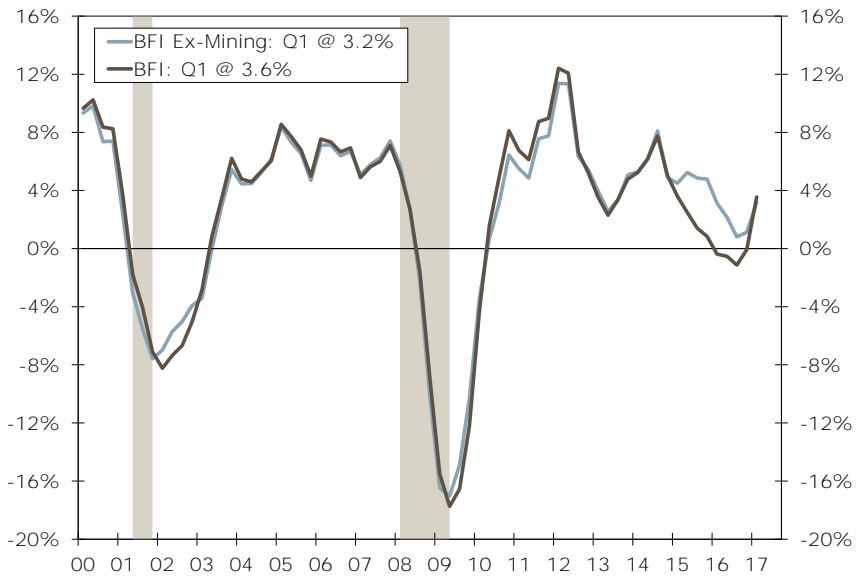
Source: U.S. Department of Commerce and Wells Fargo Securities

The rebound in energy prices and more specifically oil prices is starting to boost business investment. Trump Effect?

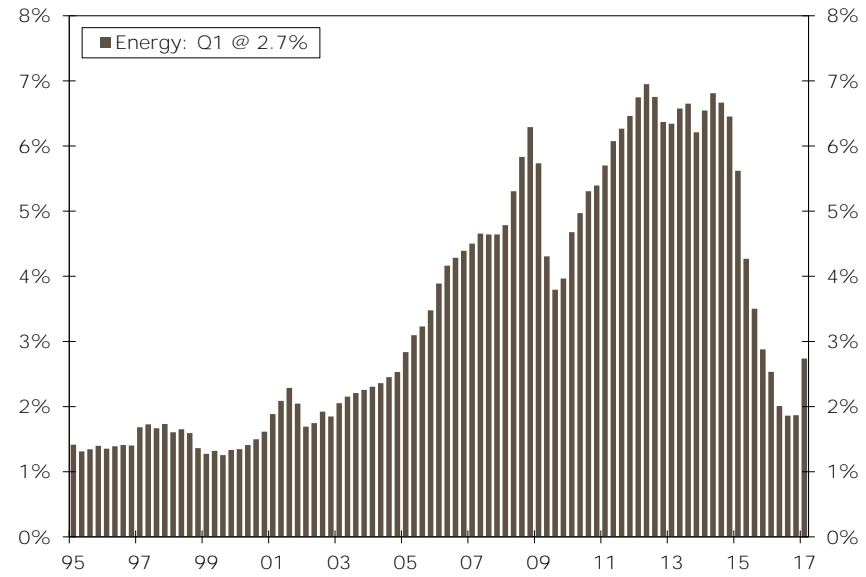
Business Investment Ex-Mining

Energy Share of Investment

Real Business Fixed Investment
Year-over-Year Percent Change



Fixed Investment Spending on Energy
As Percent of Total BFI

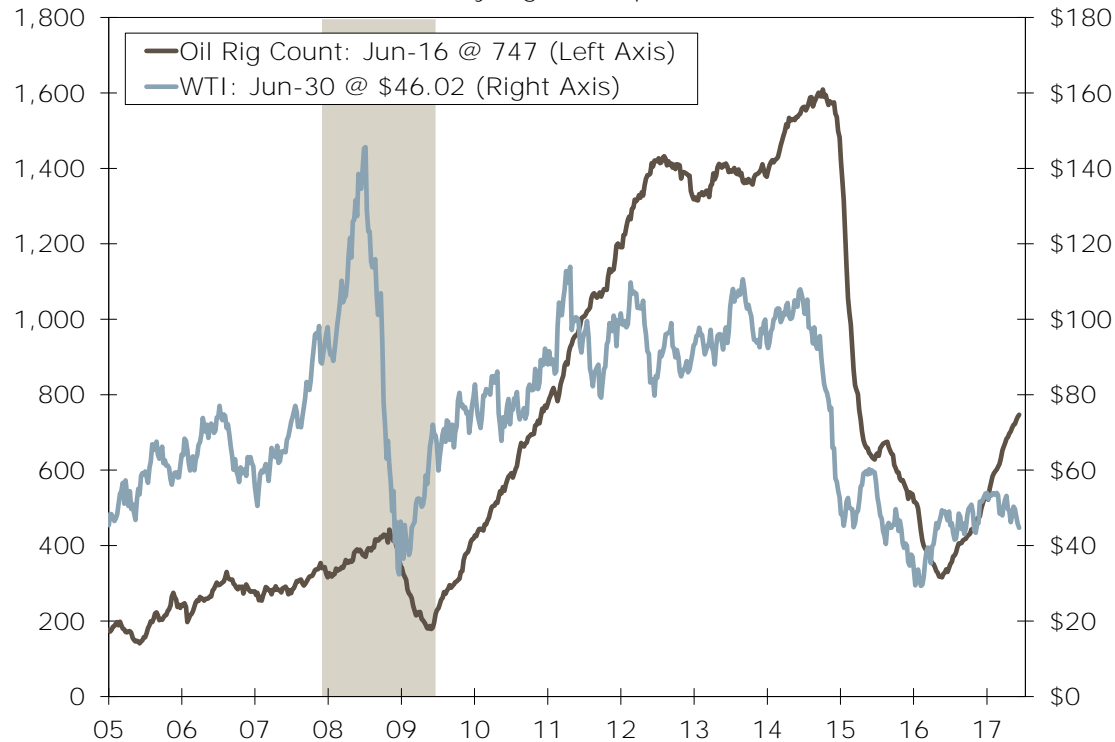


Source: U.S. Department of Commerce and Wells Fargo Securities

Oil prices have slipped since the OPEC meeting putting further pressure on the energy sector

Baker-Hughes Rig Count vs. Oil Prices

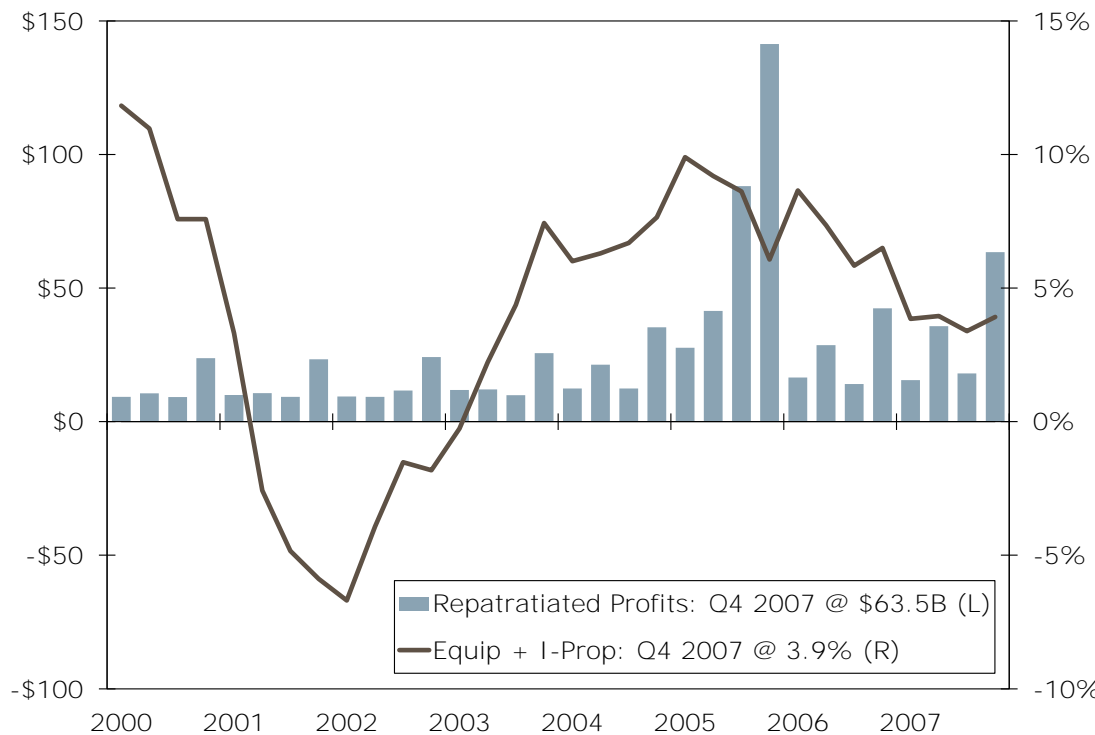
Oil Rotary Rigs: USD per Barrel



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

Our analysis suggests a tax repatriation may provide short-term revenue, but it will not make a material impact on capital spending

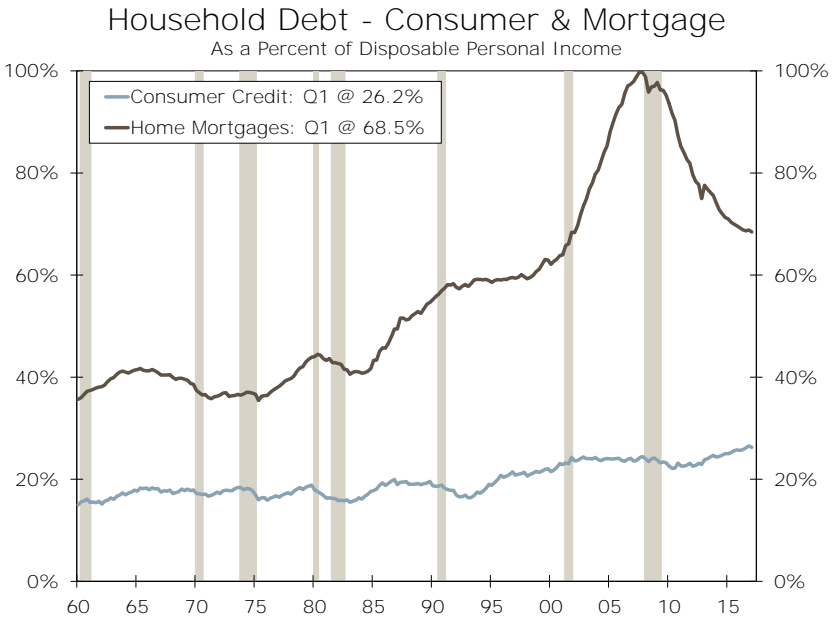
Repatriated Earnings vs. Business Spending
Billions of U.S. Dollars; Year-over-Year Percent Change



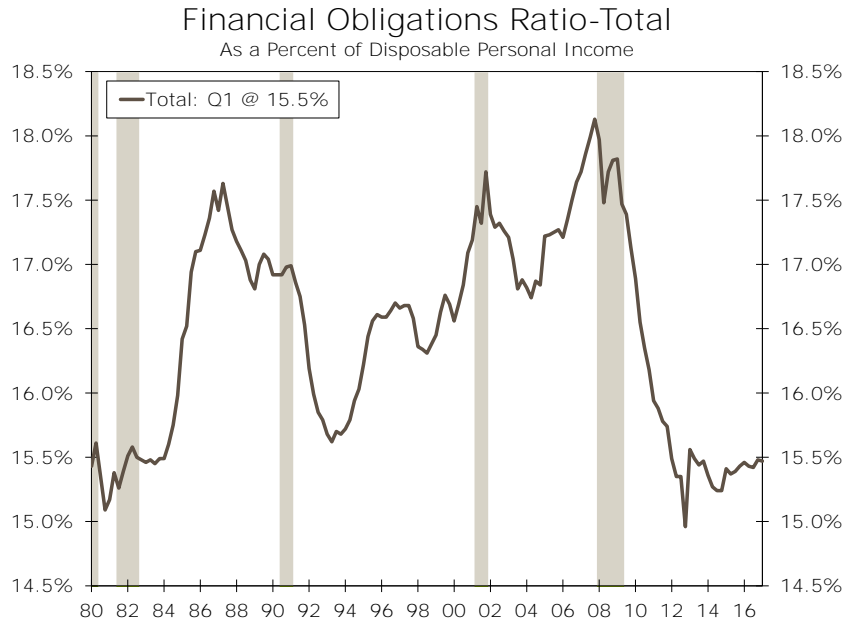
Source: Baker Hughes Inc., Bloomberg LP and Wells Fargo Securities

Consumer deleveraging may be nearing an end, but monthly debt and other financial obligation payments remain near historic lows

Household Debt



Financial Obligations Ratio

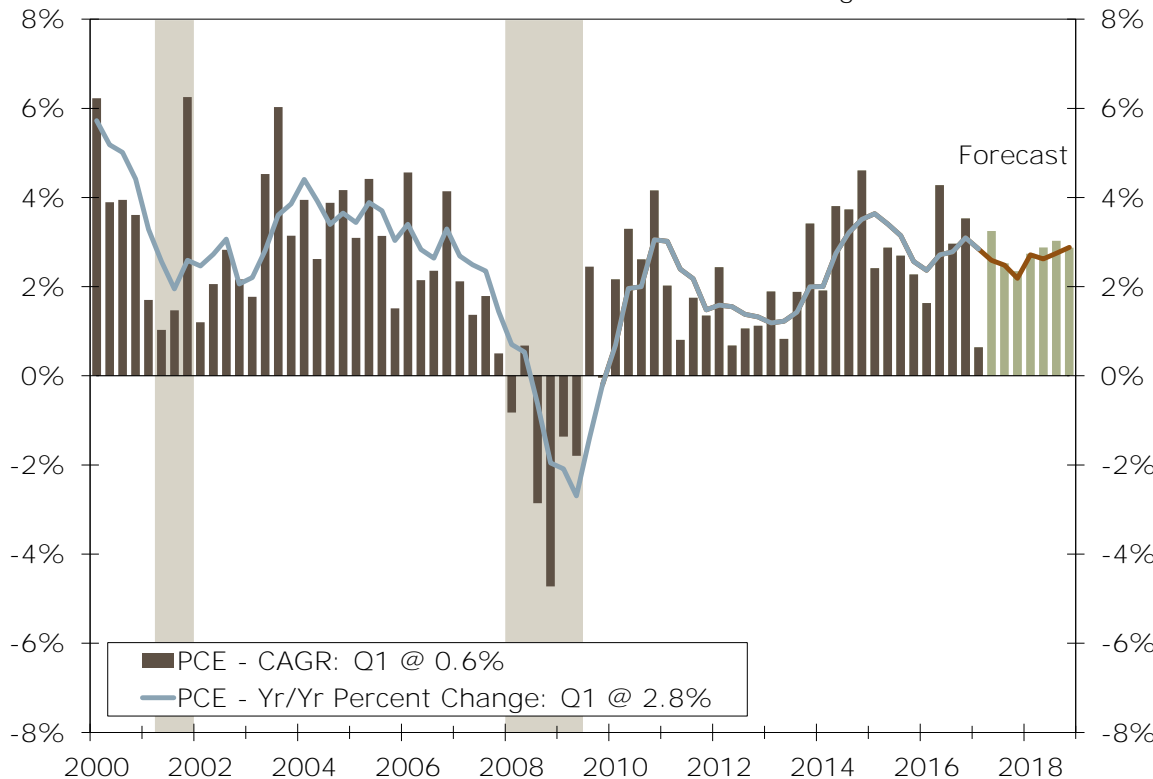


Source: Federal Reserve Board and Wells Fargo Securities

Consumer spending growth is set to moderate but remain positive throughout the forecast horizon

Real Personal Consumption Expenditures

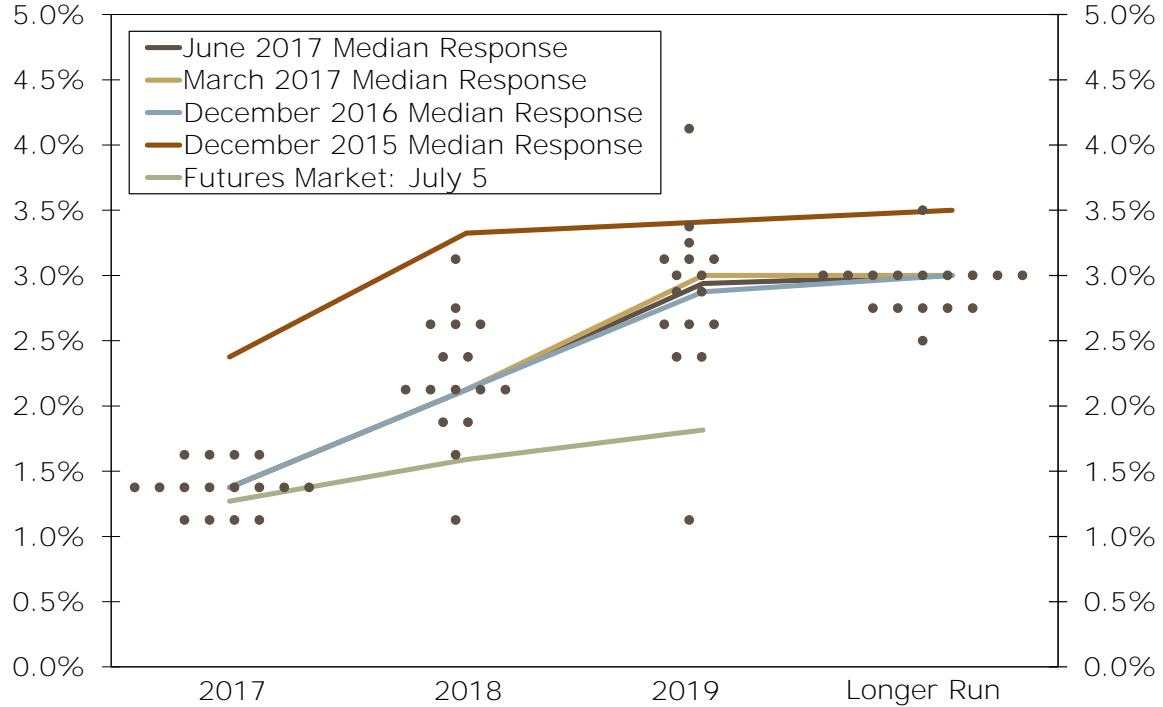
Bars = CAGR Line = Yr/Yr Percent Change



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

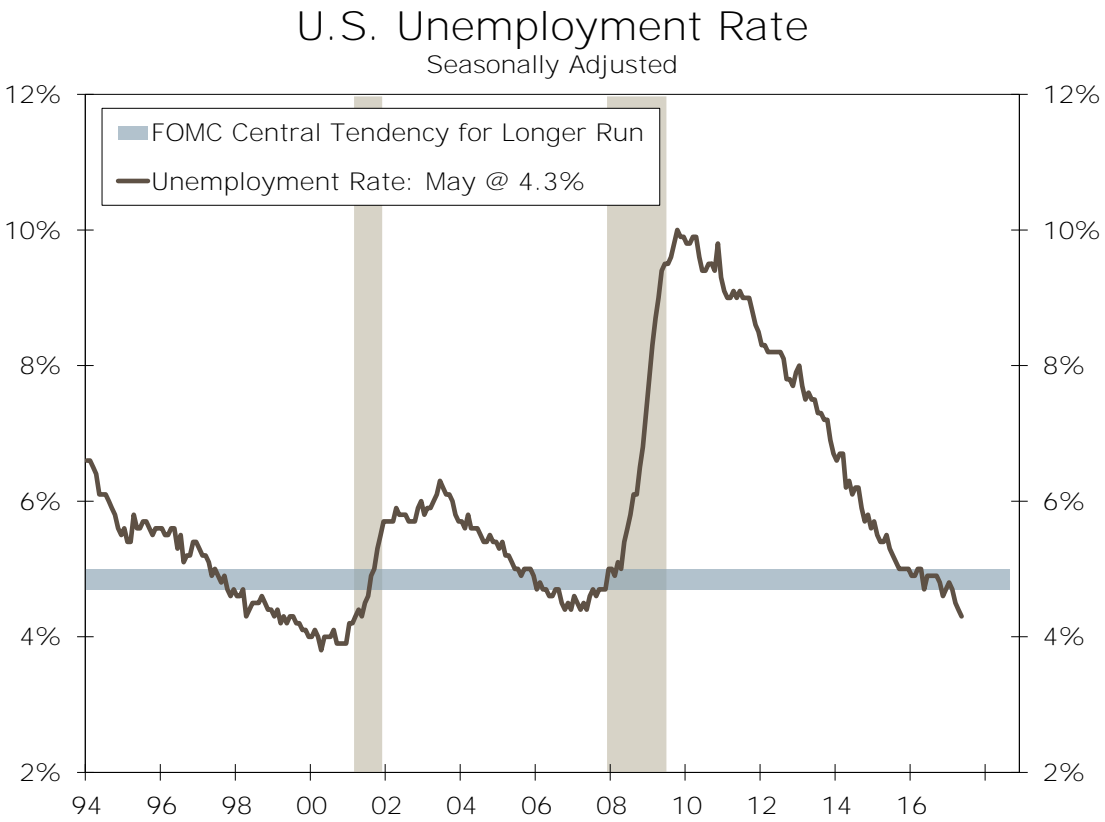
Normalization is underway,
another rate hike in June

Appropriate Pace of Policy Firming
Target Federal Funds Rate at Year-End



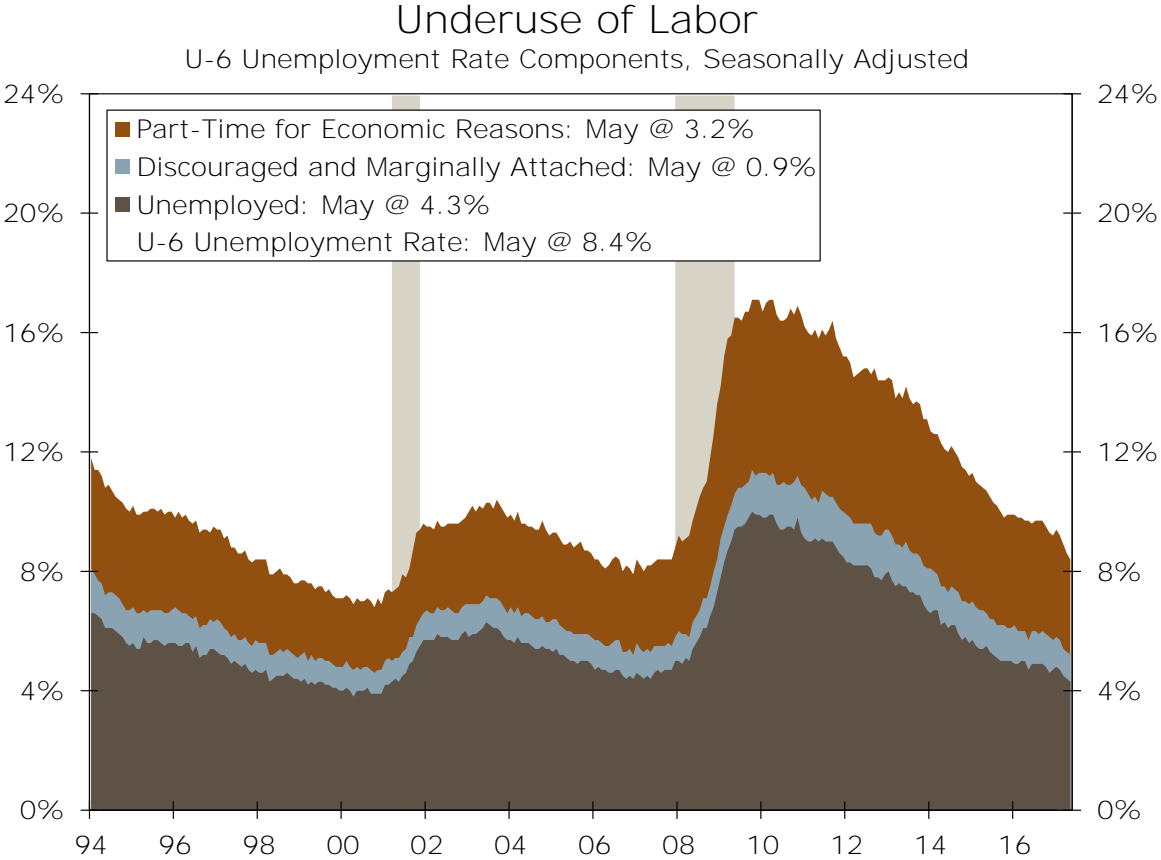
Source: Federal Reserve Board, Bloomberg LP and Wells Fargo Securities

The labor market is steadily firming, the unemployment rate is in line with **the FOMC's** central tendency target



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

Even the broadest measures of unemployment are roughly in line with prior cycles although **“part-time for economic reasons”** remains high

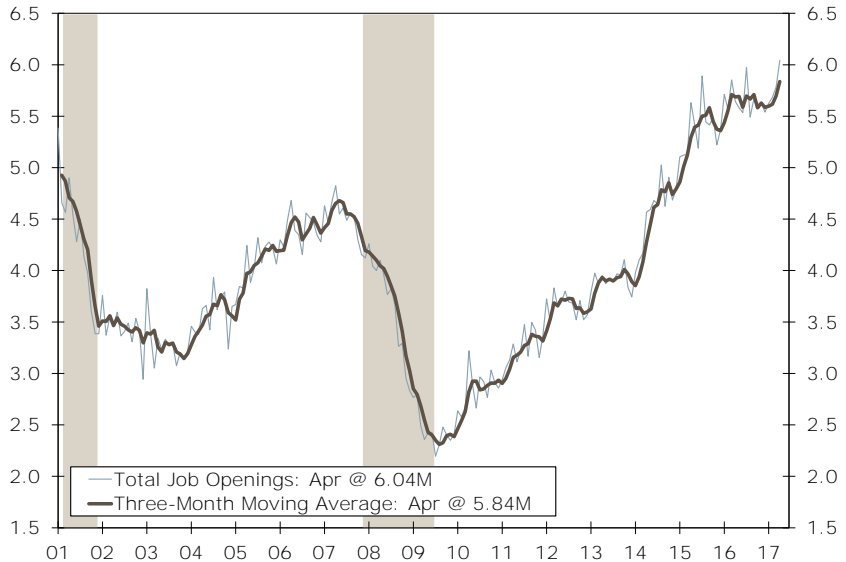


Source: U.S. Department of Labor and Wells Fargo Securities

Job openings appear to be leveling off, while the mix of turnover in the labor market remains healthy

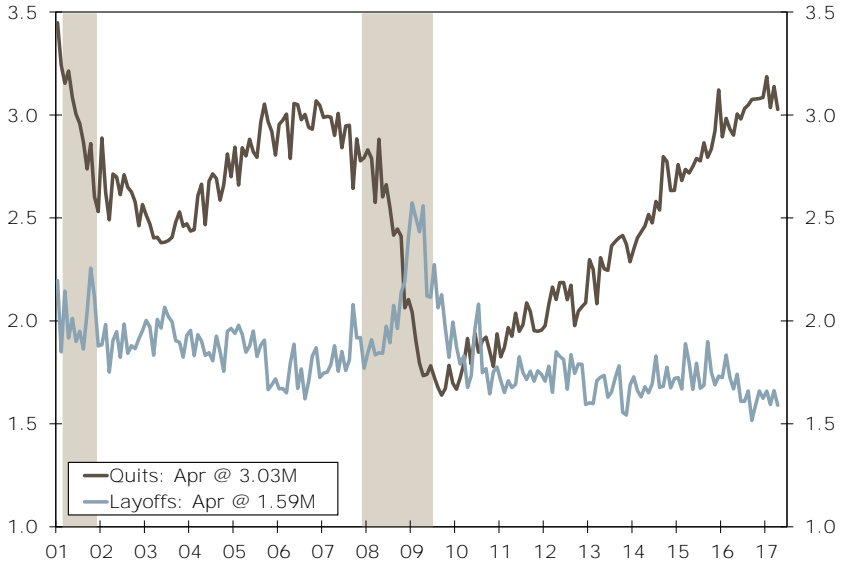
Openings

Job Openings
Millions of Openings, Seasonally Adjusted



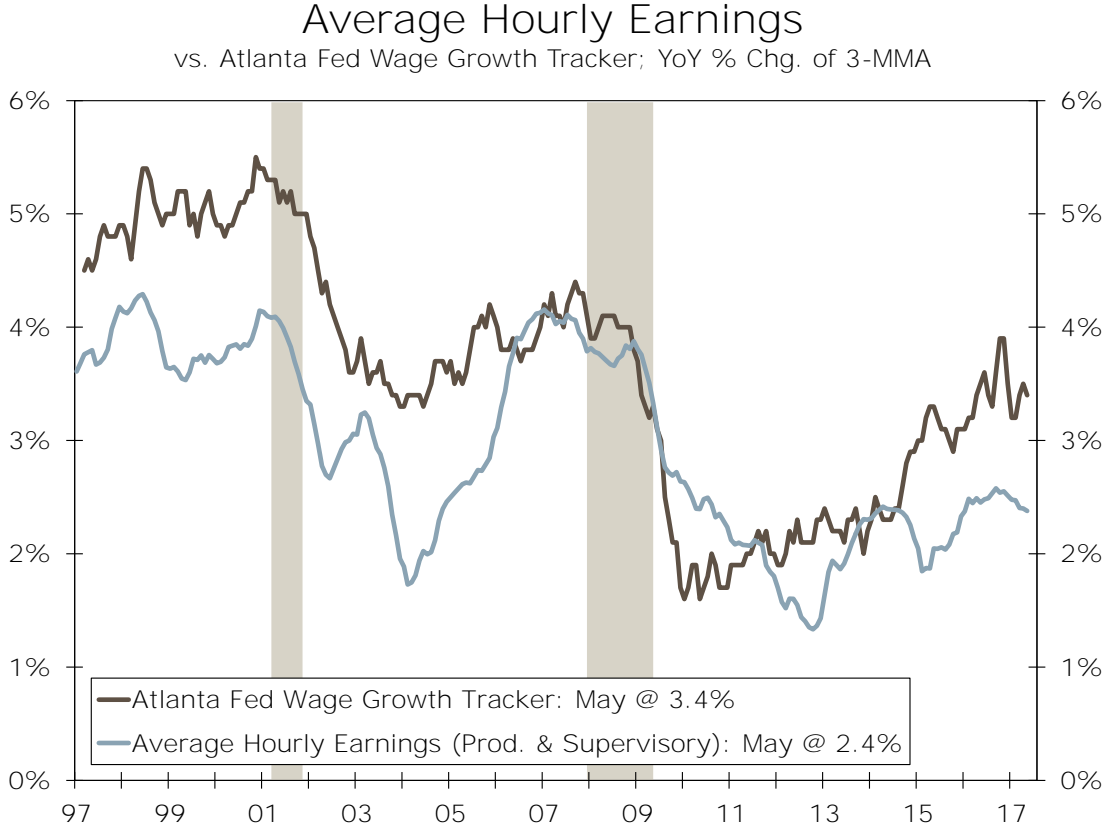
Separations

Quits vs. Layoffs
Millions of Workers, SA



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

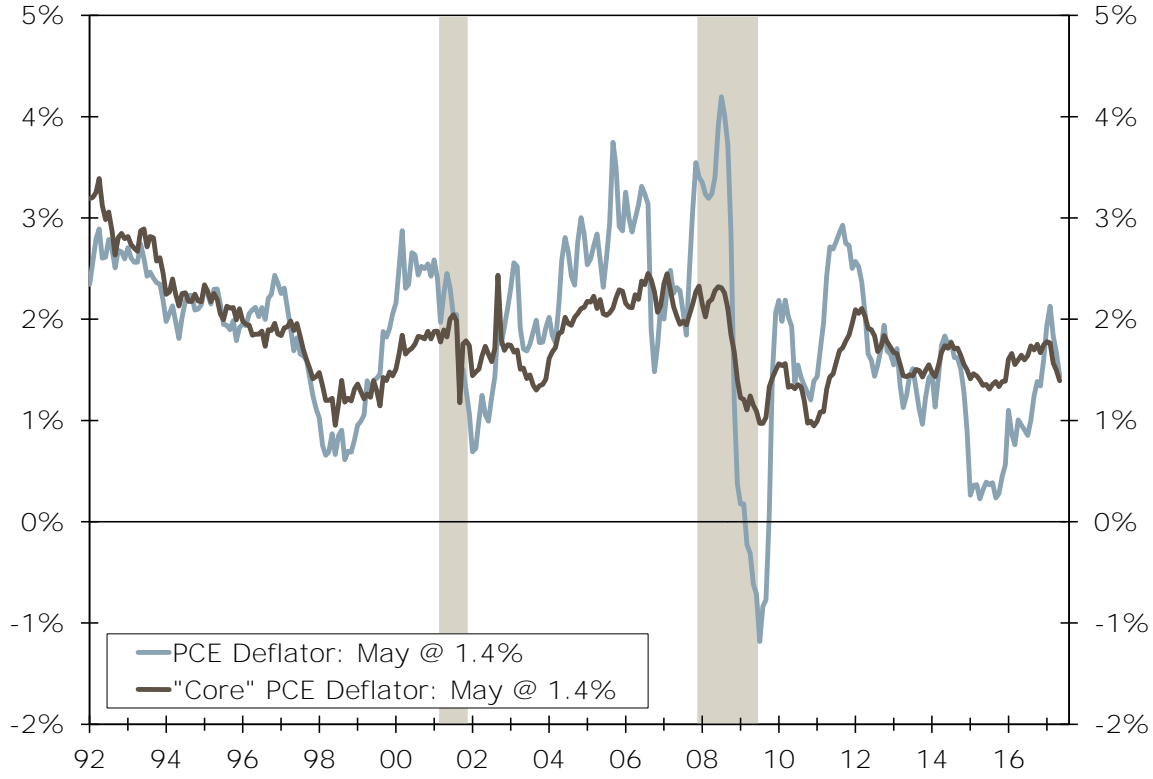
Wage growth has picked up modestly but remains limited by lower-skilled workers entering the workforce and Baby Boomers beginning to retire



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

Inflation has moved higher but **remains below the Fed's 2 percent target**

PCE Deflator vs. Core PCE Deflator
Year-over-Year Percent Change

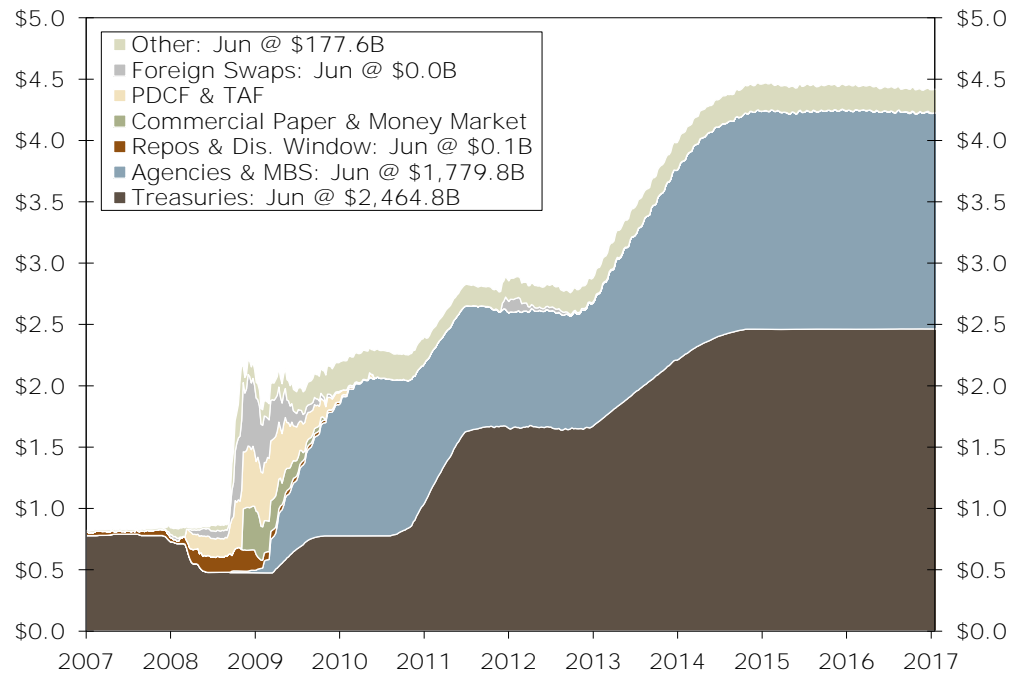


Source: U.S. Department of Commerce and Wells Fargo Securities

“It’s easier to get into something than to get out of it” – Donald Rumsfeld

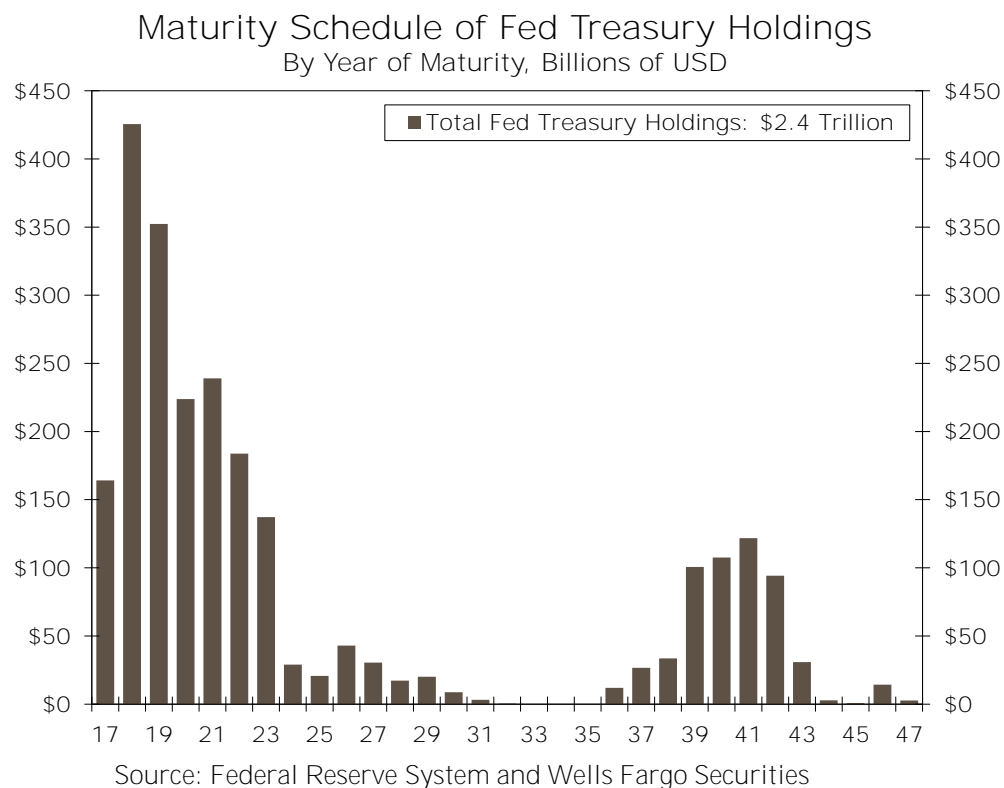
- Prior to the 2008, **Fed’s** holdings were about \$900 of mostly Treasuries
- Balance sheet briefly held a diverse selection of financial instruments, such as commercial paper and currency swaps, to help mitigate the liquidity challenges in the financial system.
- Current size is roughly \$4.5 trillion, comprised mostly of Treasuries and mortgage-backed securities (MBS).

Federal Reserve Balance Sheet
Trillions

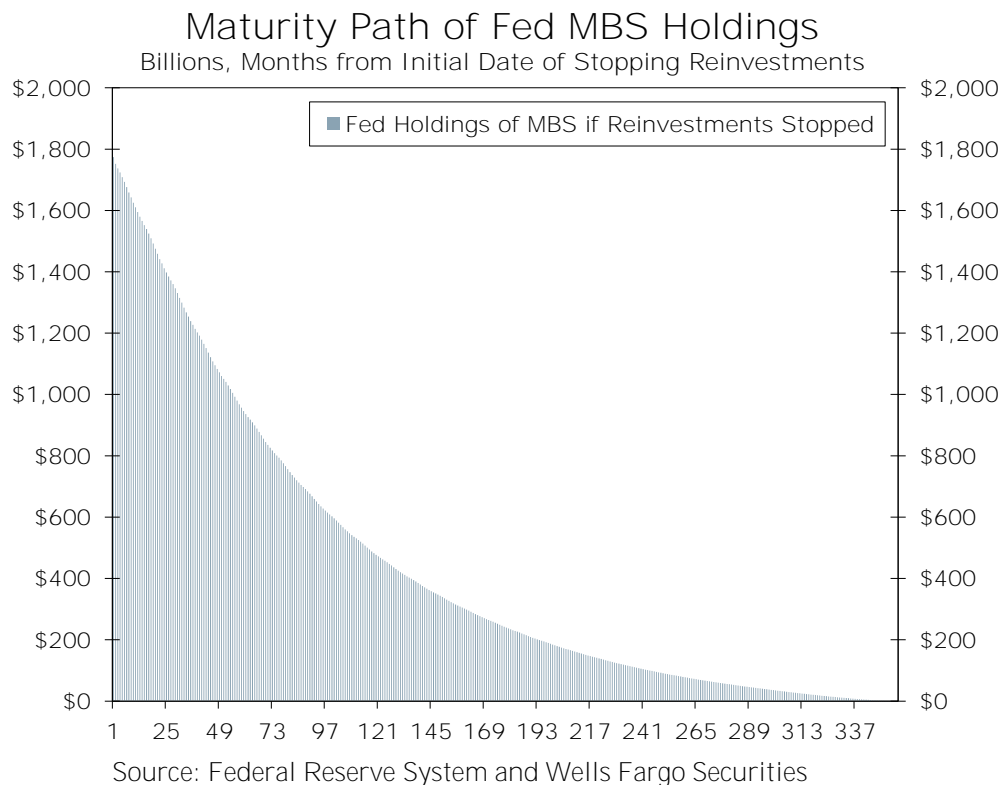


Source: Federal Reserve System and Wells Fargo Securities

- More Treasury securities come due in 2018 than any other year
- Roughly half the **Fed's** Treasury holdings come due between now and 2020
- Right now Fed is still reinvesting as these Treasuries come due, by year end we suspect it will reinvest less than 100% of maturities and eventually let them roll off the balance sheet altogether



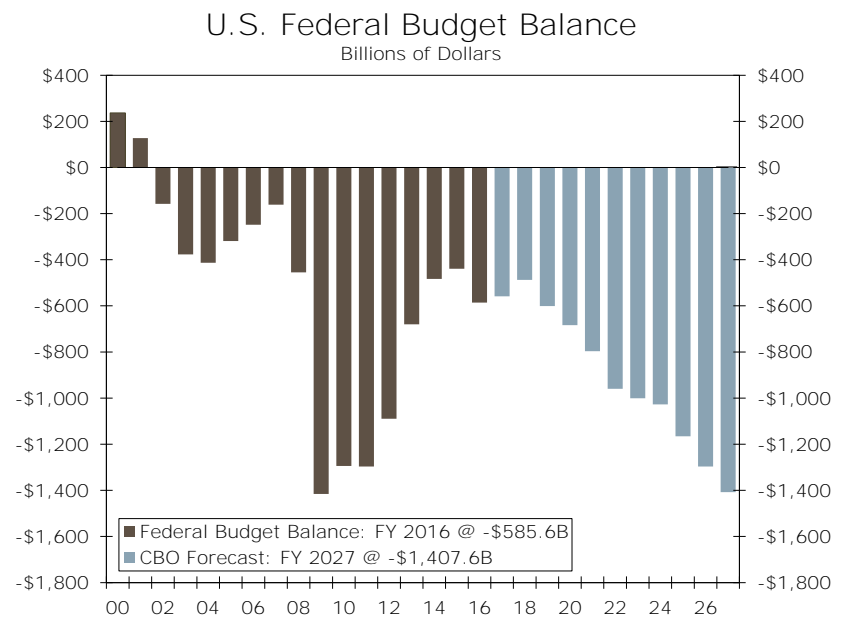
- Treasury market is highly liquid, but not MBS
- A hypothetical illustration of MBS pre-payments suggests similar front-loaded “**maturity path**” for MBS
- In order to prevent taper tantrum repeat, Fed will signal this well in advance and likely choose to reinvest a sizable percentage of the maturing MBS assets, smoothing the transition



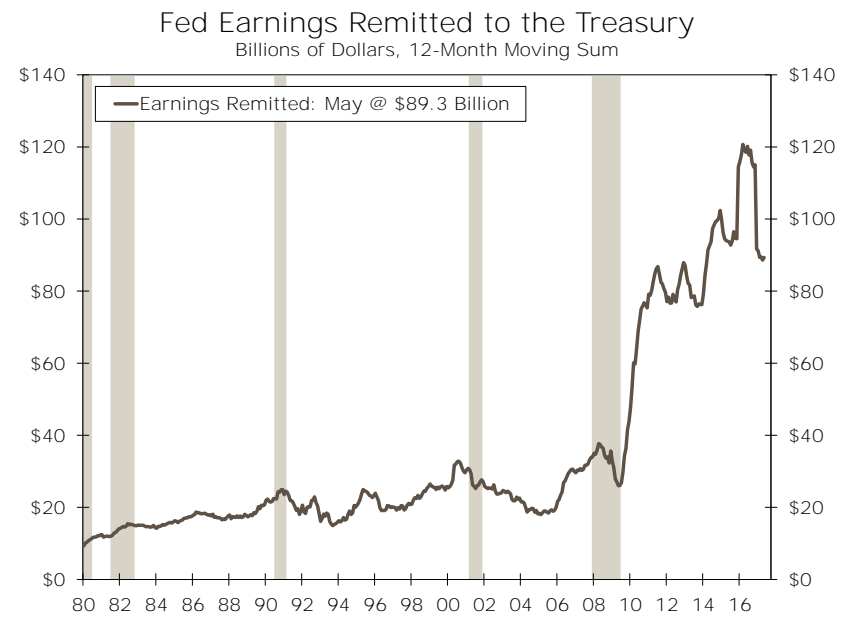
Where Fiscal and Monetary Policy Are Intertwined

- Like it or not, Fed's large holdings currently help reduce the budget deficit
- With rising deficits and trouble finding the funding for policy proposals, reduced remittances to the Treasury cannot be ignored
- Fed earnings remitted to the Treasury in past year add up to roughly \$90 billion
- Without it, **last year's fiscal budget deficit** would have been 16 percent larger

U.S. Federal Budget



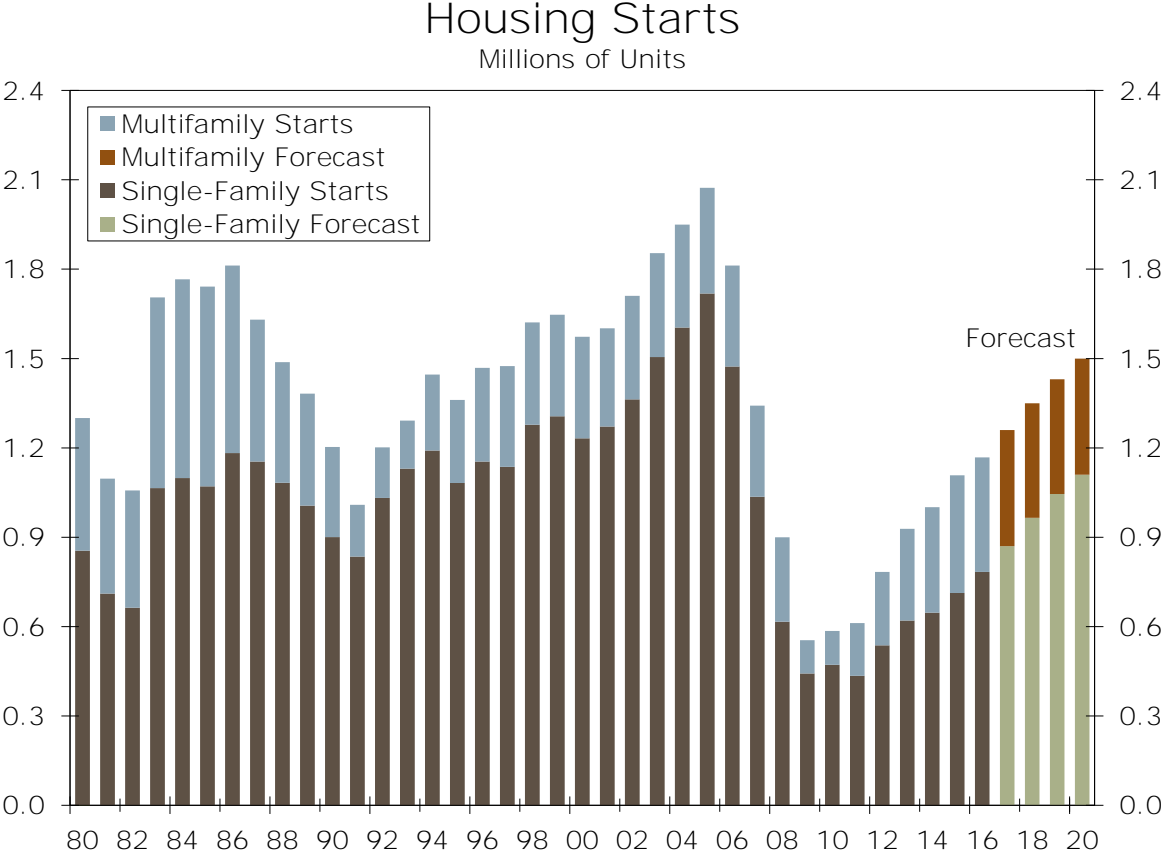
Fed Earnings Remitted



Source: U.S. Department of the Treasury, Congressional Budget Office and Wells Fargo Securities

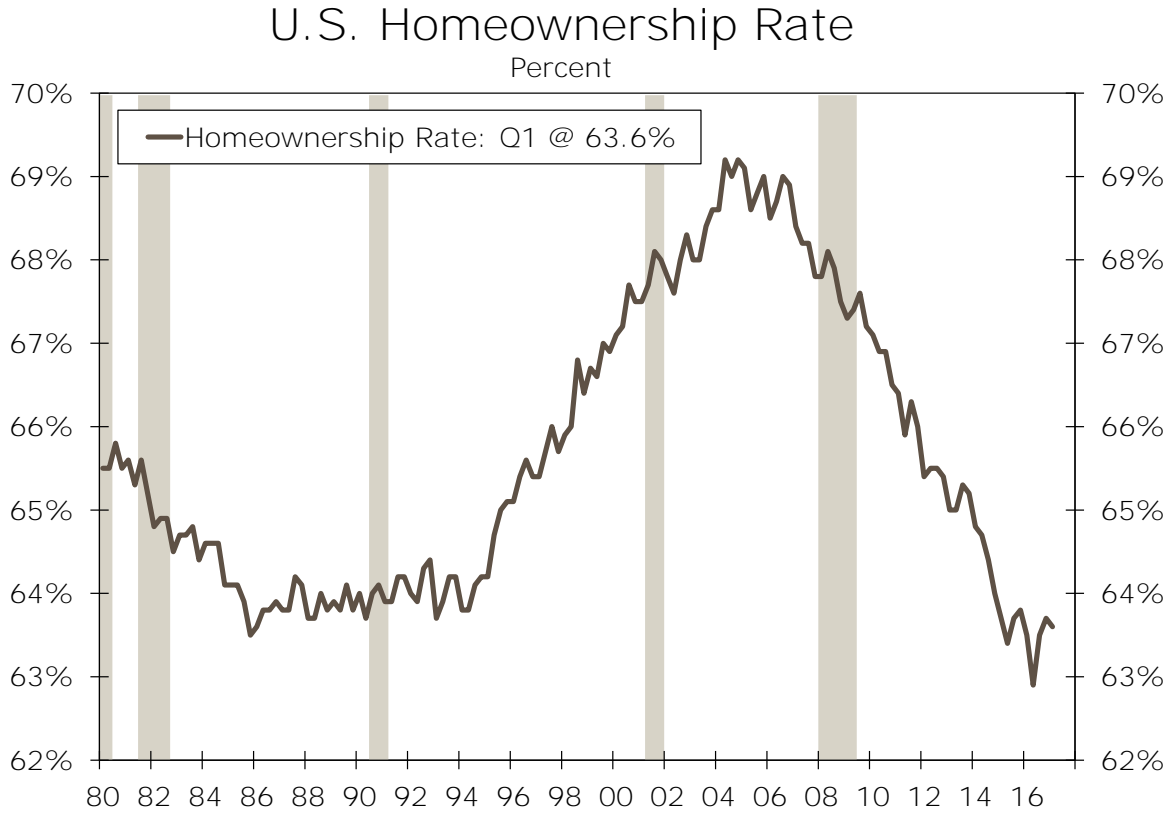
After a very slow start, we see single-family homebuilding steadily gaining momentum over the next few years

Apartment construction is showing signs of topping out but should remain near recent levels



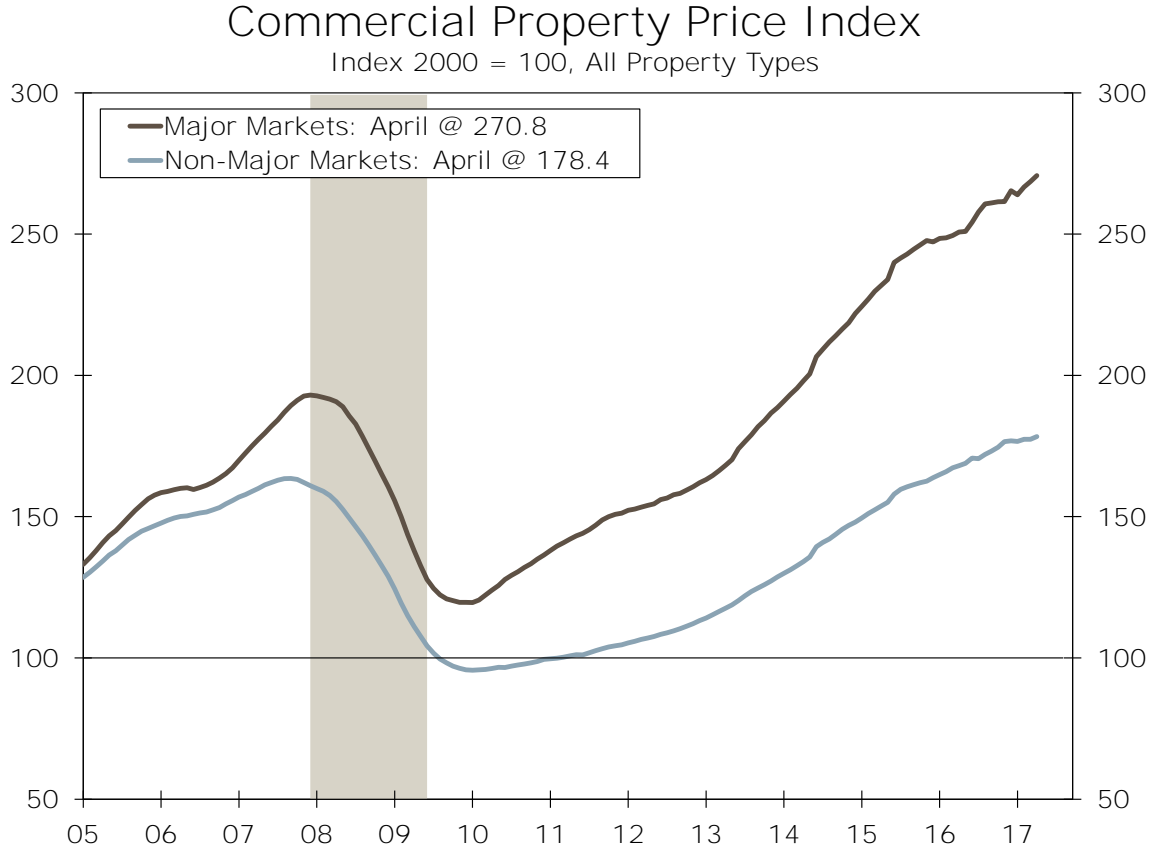
Source: U.S. Department of Commerce and Wells Fargo Securities

The long slide in the homeownership rate may have finally ended. The recovery in homeownership is likely to be protracted due to a combination of cyclical and structural factors



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

Valuations have grown the fastest in major markets



Source: RCA and Wells Fargo Securities

Wells Fargo U.S. Economic Forecast

| | Actual | | | | Forecast | | | | Actual | | | Forecast | |
|---|--------|------|------|------|----------|------|------|------|--------|------|------|----------|------|
| | 2016 | | | | 2017 | | | | 2014 | 2015 | 2016 | 2017 | 2018 |
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | | | | | |
| Real Gross Domestic Product ¹ | 0.8 | 1.4 | 3.5 | 2.1 | 1.2 | 2.5 | 2.9 | 2.6 | 2.4 | 2.6 | 1.6 | 2.2 | 2.7 |
| Personal Consumption | 1.6 | 4.3 | 3.0 | 3.5 | 0.6 | 3.3 | 2.5 | 2.3 | 2.9 | 3.2 | 2.7 | 2.5 | 2.7 |
| Inflation Indicators ² | | | | | | | | | | | | | |
| PCE Deflator | 0.9 | 1.0 | 1.0 | 1.4 | 2.0 | 1.7 | 1.8 | 1.8 | 1.5 | 0.3 | 1.1 | 1.8 | 2.0 |
| Consumer Price Index | 1.1 | 1.1 | 1.1 | 1.8 | 2.6 | 2.1 | 2.2 | 2.0 | 1.6 | 0.1 | 1.3 | 2.2 | 2.1 |
| Industrial Production ¹ | -1.3 | -0.7 | 0.8 | 0.7 | 1.8 | 6.0 | 2.4 | 2.4 | 3.1 | -0.7 | -1.2 | 2.2 | 2.6 |
| Corporate Profits Before Taxes ² | -6.6 | -4.3 | 2.1 | 9.3 | 3.7 | 3.7 | 3.2 | 3.1 | 5.9 | -3.0 | -0.1 | 3.4 | 3.0 |
| Trade Weighted Dollar Index ³ | 89.8 | 90.6 | 90.0 | 95.8 | 94.0 | 92.3 | 93.0 | 94.5 | 78.4 | 91.1 | 91.6 | 93.4 | 93.4 |
| Unemployment Rate | 4.9 | 4.9 | 4.9 | 4.7 | 4.7 | 4.3 | 4.2 | 4.2 | 6.2 | 5.3 | 4.9 | 4.4 | 4.1 |
| Housing Starts ⁴ | 1.15 | 1.16 | 1.15 | 1.25 | 1.24 | 1.22 | 1.26 | 1.27 | 1.00 | 1.11 | 1.17 | 1.26 | 1.35 |
| Quarter-End Interest Rates ⁵ | | | | | | | | | | | | | |
| Federal Funds Target Rate | 0.50 | 0.50 | 0.50 | 0.75 | 1.00 | 1.25 | 1.50 | 1.50 | 0.25 | 0.27 | 0.52 | 1.31 | 1.88 |
| Conventional Mortgage Rate | 3.69 | 3.57 | 3.46 | 4.20 | 4.20 | 4.19 | 4.33 | 4.36 | 4.17 | 3.85 | 3.65 | 4.27 | 4.48 |
| 10 Year Note | 1.78 | 1.49 | 1.60 | 2.45 | 2.40 | 2.40 | 2.55 | 2.60 | 2.54 | 2.14 | 1.84 | 2.49 | 2.79 |

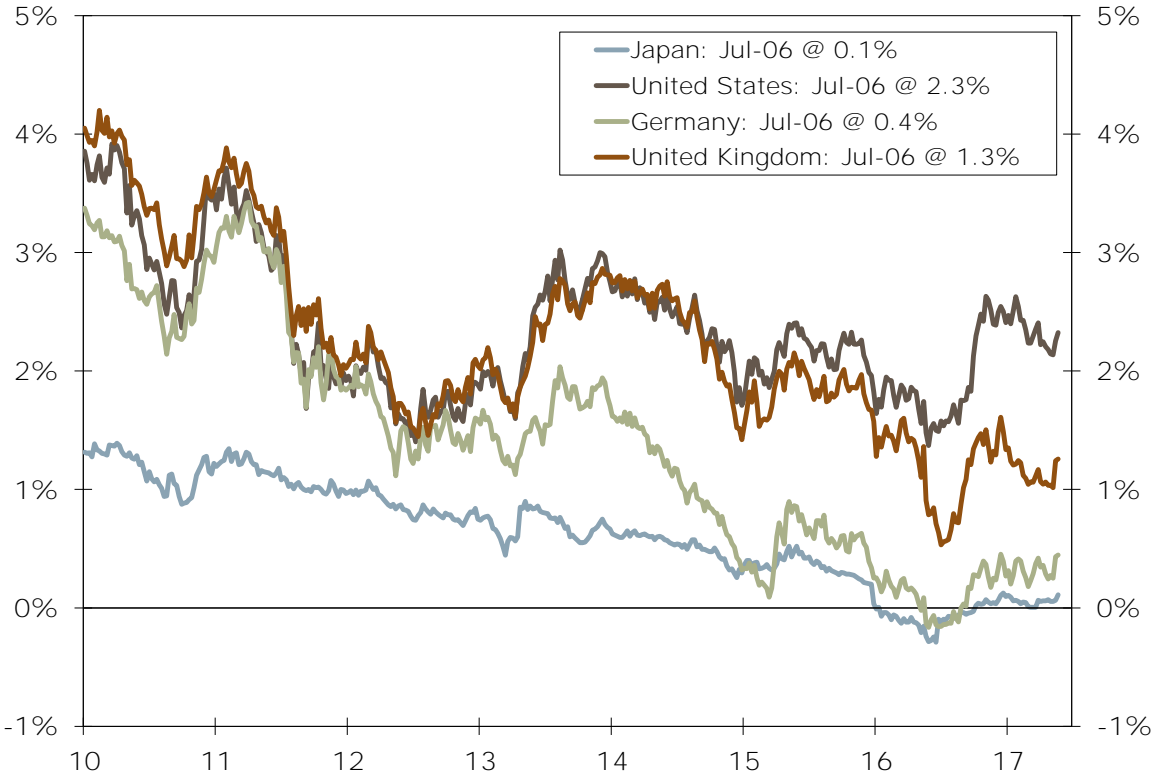
Forecast as of: June 7, 2017

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

International Developments

10-Year Government Bond Yields

Percent

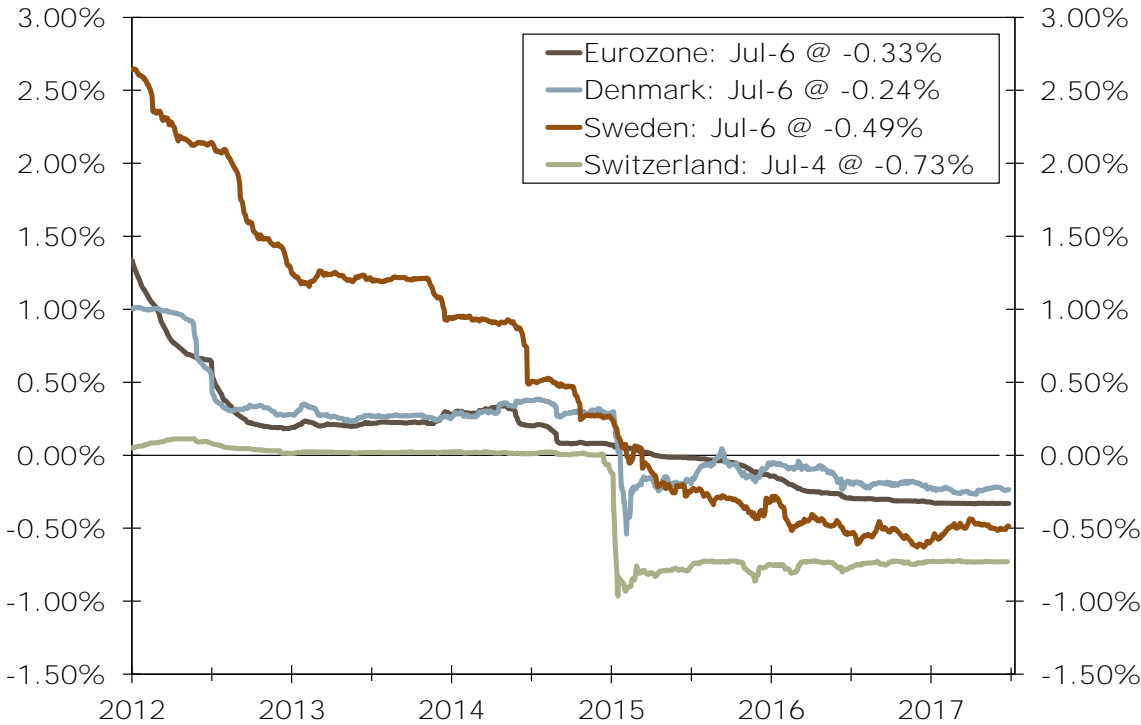


Government bond yields have declined across the globe but have jumped since the election

Source: Federal Reserve Board, IHS Global Insight and Wells Fargo Securities

But short-term rates remain firmly negative

3-Month Interbank Offered Rates

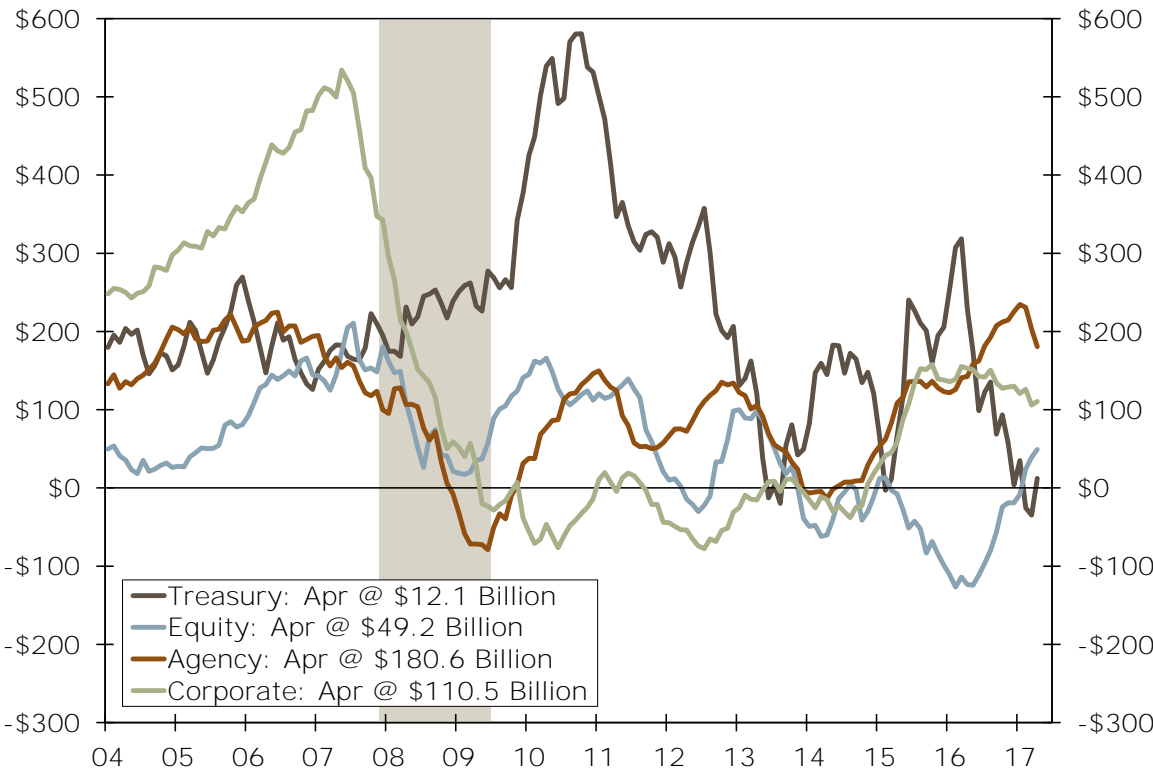


Source: Bloomberg LP and Wells Fargo Securities

Capital flows and asset allocation by global investors play a strong role in rate determinations

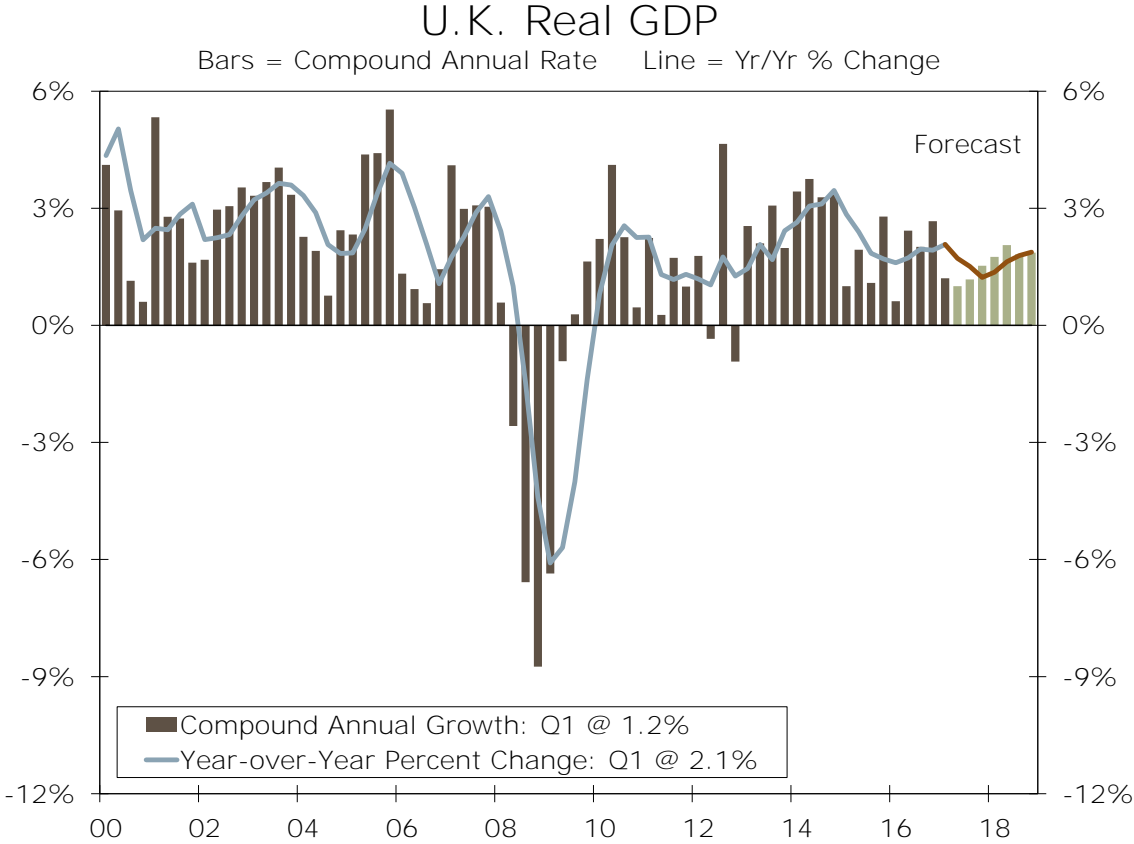
Less appetite for Treasuries
growing appetite for Agencies

Foreign Private Purchases of U.S. Securities
12-Month Moving Sum, Billions of Dollars



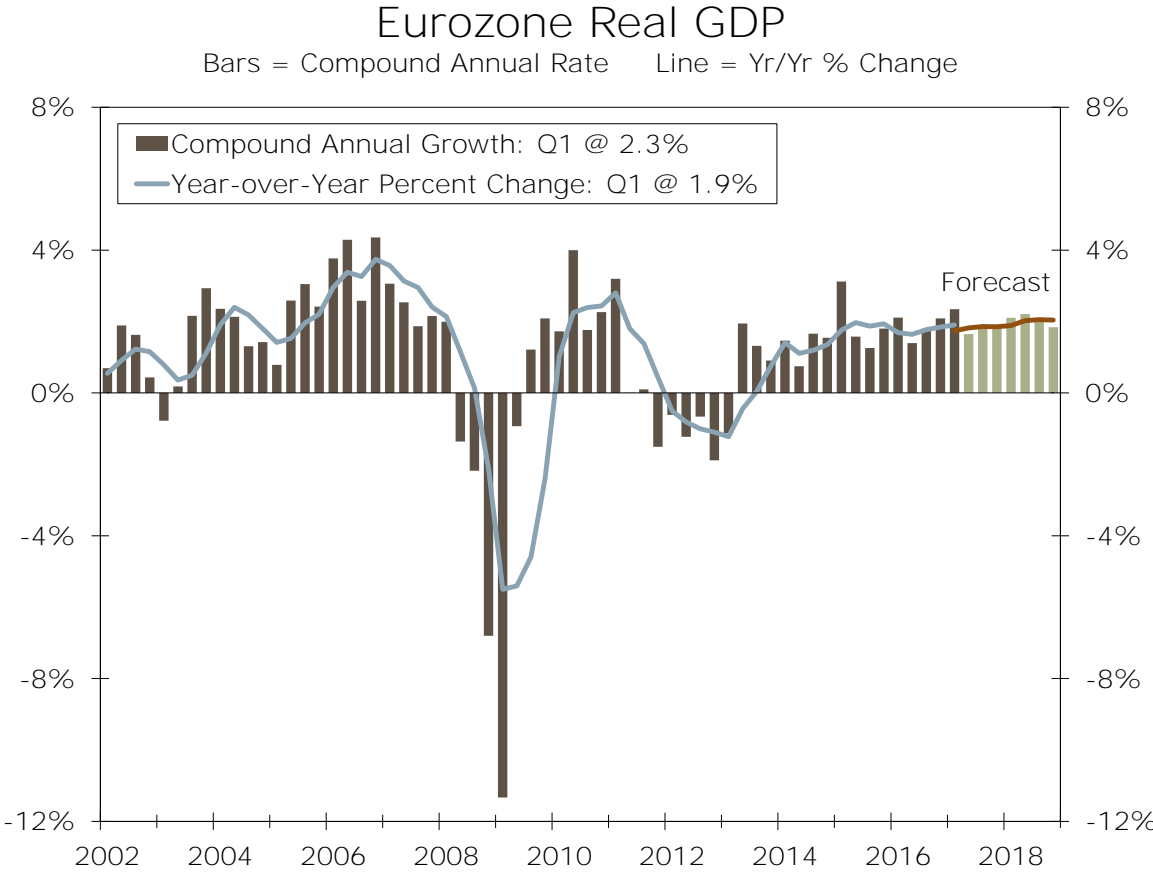
Source: U.S. Department of the Treasury and Wells Fargo Securities

Implications of Brexit have not been as bad as feared



Source: IHS Global Insight and Wells Fargo Securities

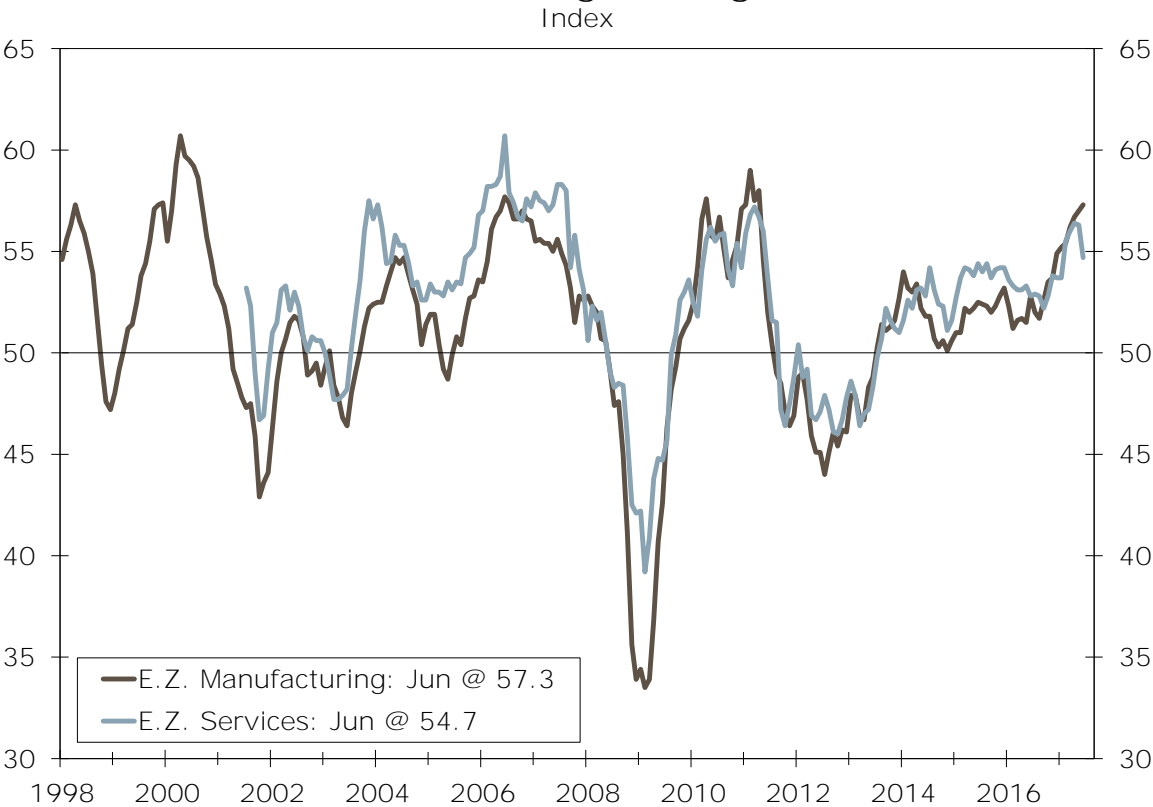
3+ Years of Uninterrupted Growth



Source: IHS Global Insight and Wells Fargo Securities

The Eurozone purchasing managers' indices are pointing to continued recovery

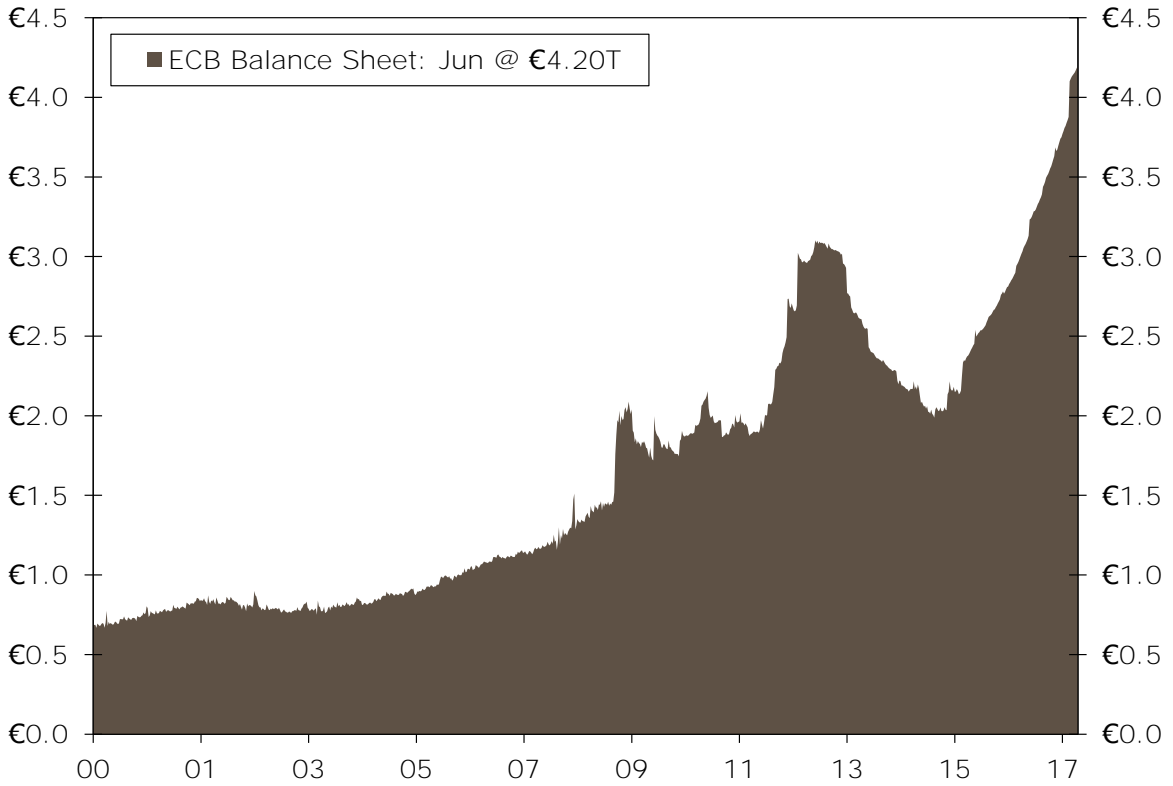
Eurozone Purchasing Managers' Indices



Source: Bloomberg LP and Wells Fargo Securities

The ECB's QE program should remain operational through at least March 2017

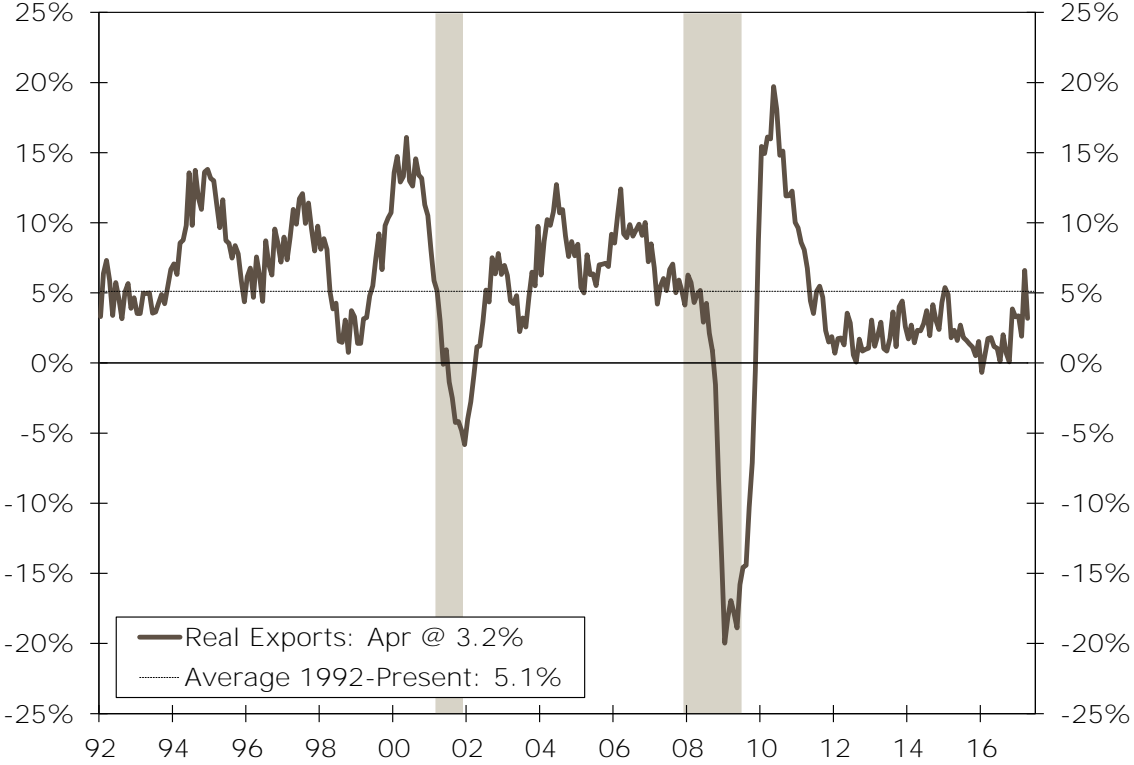
ECB Balance Sheet
Trillions of Euros



Source: IHS Global Insight and Wells Fargo Securities

Global trade has slowed over the past year

Global Export Volumes Year-over-Year Percent Change

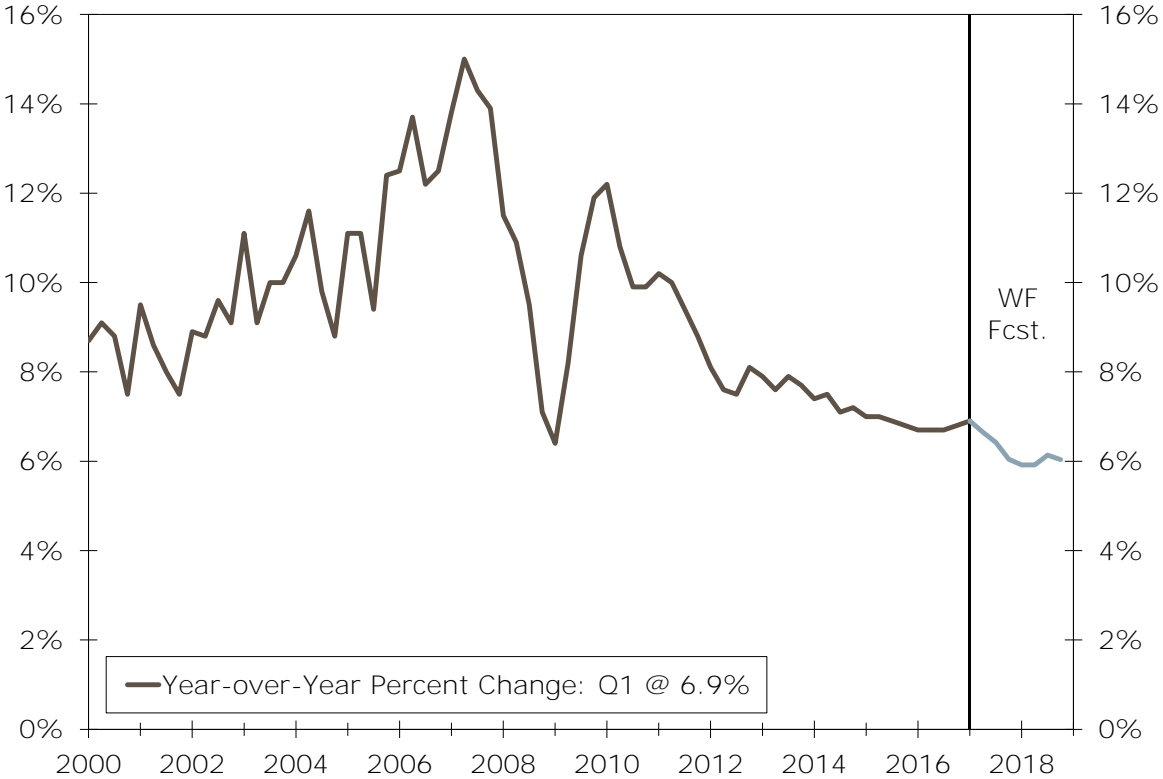


Source: IHS Global Insight and Wells Fargo Securities

Growth in China has stabilized, but we do not expect it to return to the double-digit growth rates seen in the past

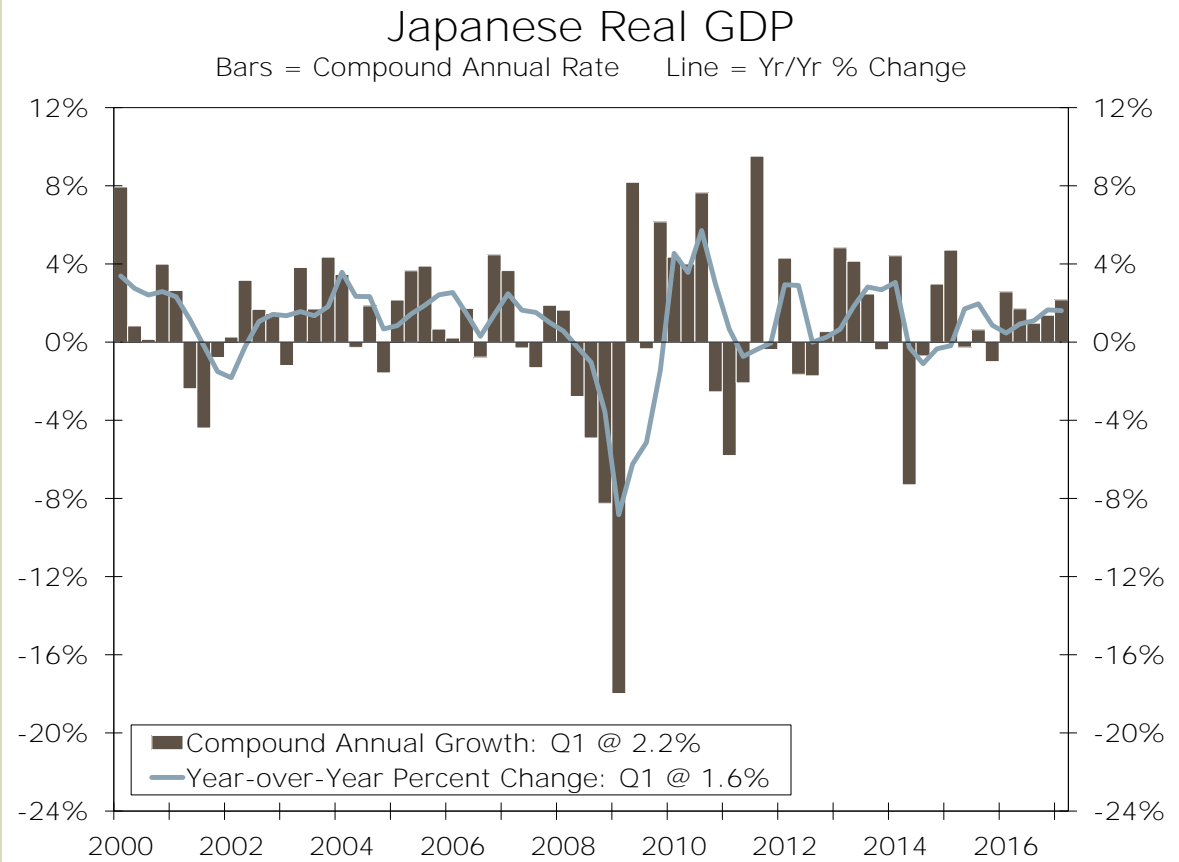
Chinese Real GDP Forecast

Year-over-Year Percent Change



Source: Bloomberg LP and Wells Fargo Securities

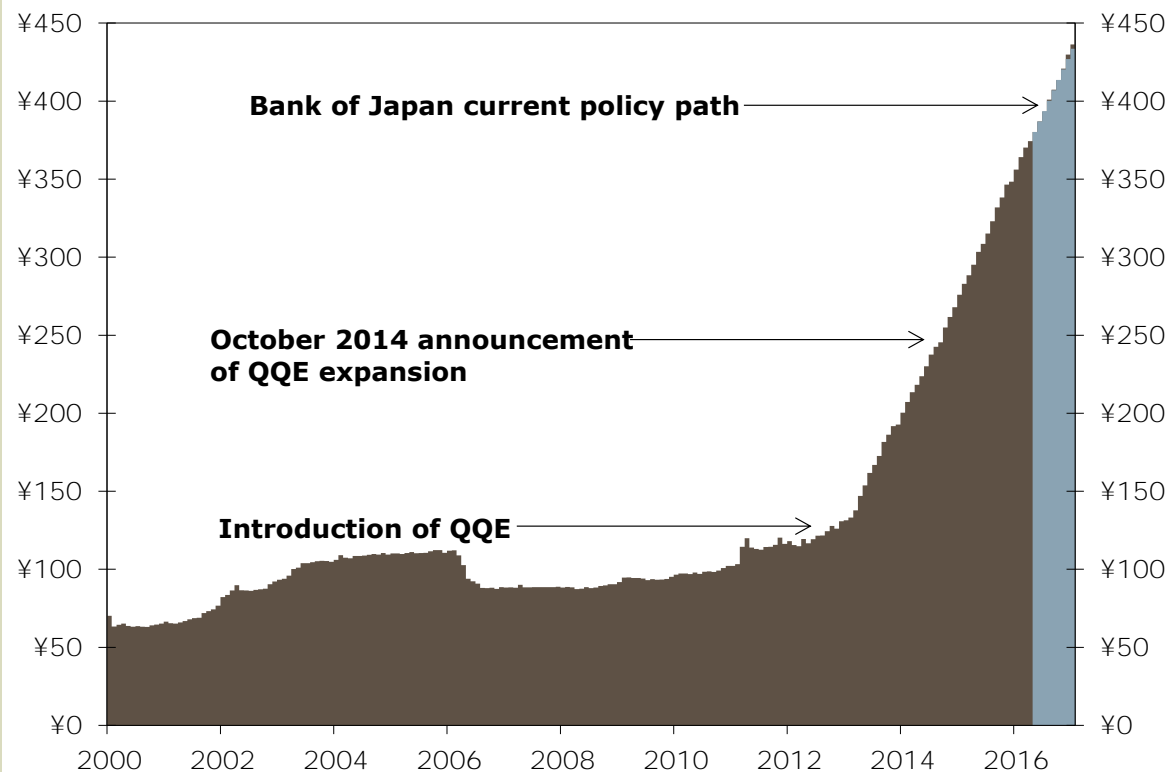
Mixed track record for Abenomics



Source: Bank of Japan, IHS Global Insight and Wells Fargo Securities

The expansion of the monetary base will continue to expand the size of the BoJ's balance sheet considerably;
The move into negative rates is dangerous and uncharted ground

Japan's Monetary Base Trillions of Yen

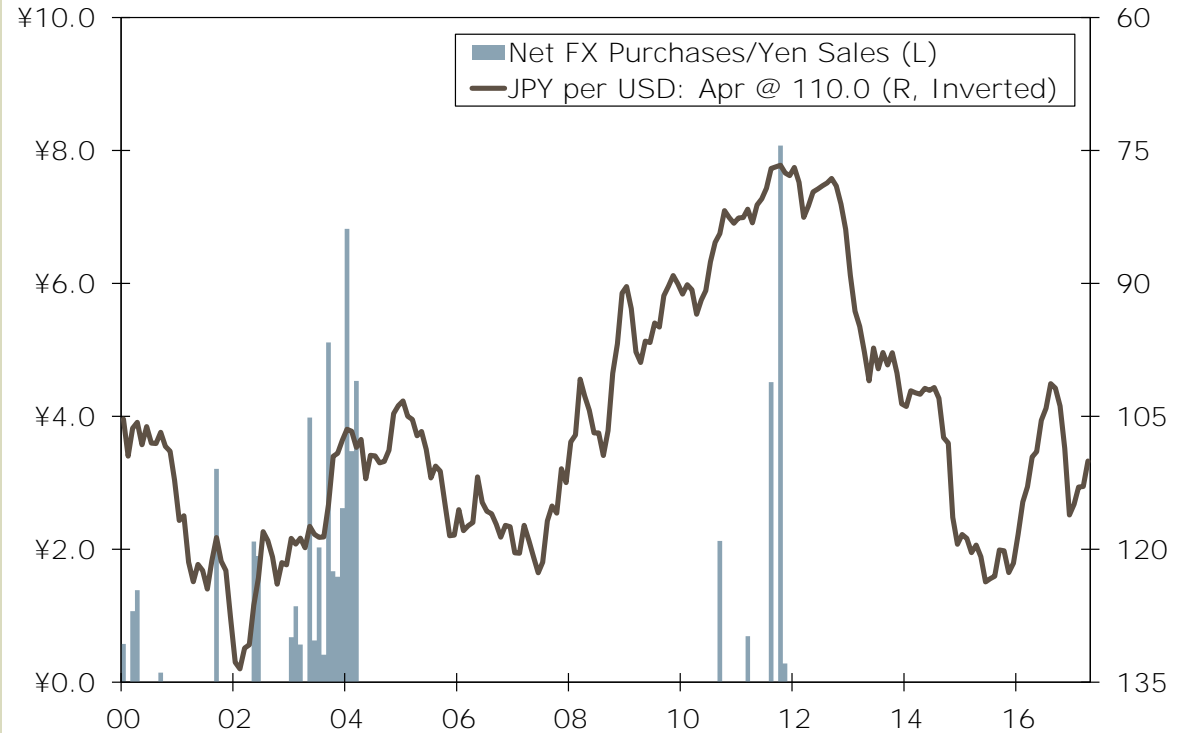


Source: Bank of Japan, IHS Global Insight and Wells Fargo Securities

Talk of currency intervention is misplaced, in our view

Japanese Currency Intervention vs. Yen

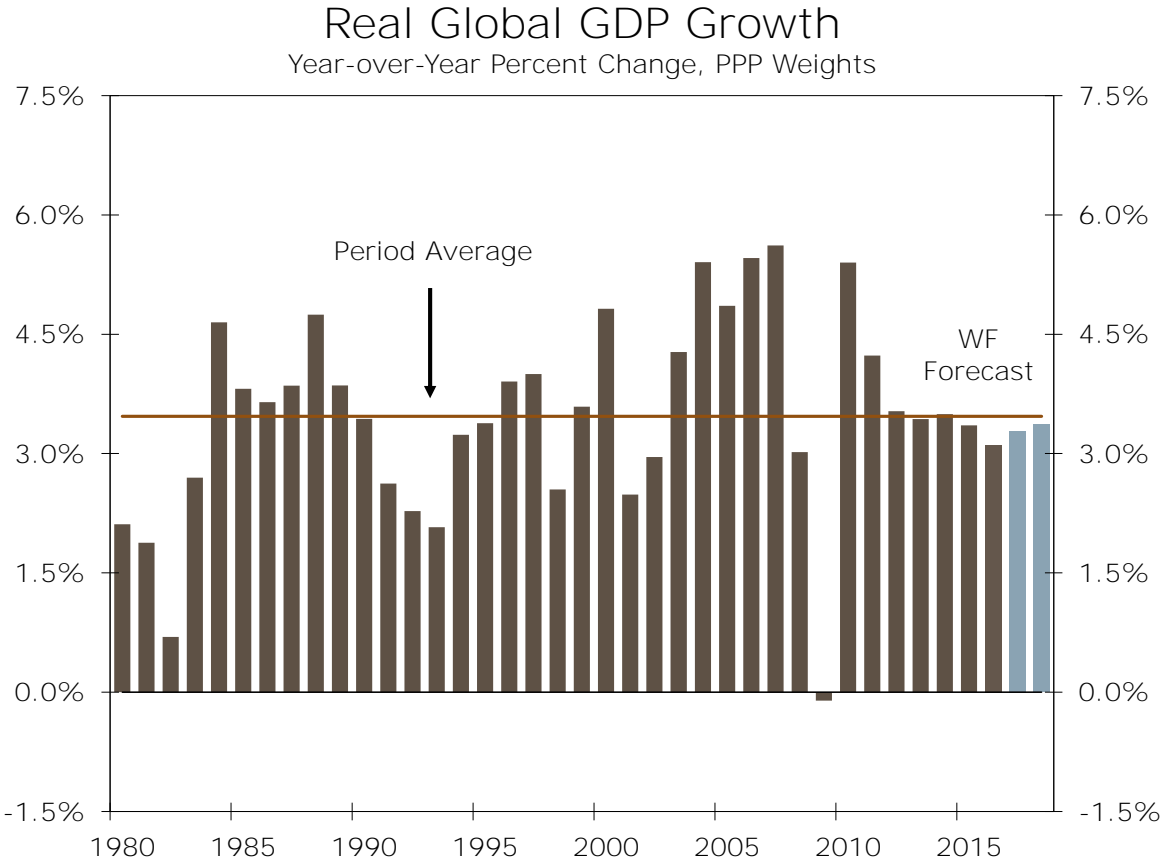
Trillions of Yen, Purchases of Foreign Exchange; JPY per USD



Source: Bank of Japan, IHS Global Insight and Wells Fargo Securities

2016 will likely mark the weakest year for global economy since 2009, but we see gradual improvement in coming years

OECD's updated forecast:
3.3% in 2017
3.6% in 2018



Source: International Monetary Fund 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 | | |
|-----------------------------------|-------|------|------|-------|------|------|
| | 2016 | 2017 | 2018 | 2016 | 2017 | 2018 |
| Global (PPP Weights) | 3.1% | 3.3% | 3.4% | 3.1% | 3.2% | 3.5% |
| Global (Market Exchange Rates) | 2.7% | 3.0% | 3.2% | 3.1% | 3.2% | 3.5% |
| Advanced Economies ¹ | 1.8% | 2.1% | 2.3% | 0.7% | 1.9% | 2.0% |
| United States | 1.6% | 2.2% | 2.7% | 1.3% | 2.2% | 2.1% |
| Eurozone | 1.7% | 1.8% | 2.0% | 0.2% | 1.8% | 2.0% |
| United Kingdom | 1.8% | 1.5% | 1.7% | 0.7% | 2.4% | 1.9% |
| Japan | 1.0% | 1.2% | 0.9% | -0.1% | 0.2% | 0.8% |
| Korea | 2.8% | 2.8% | 2.7% | 1.0% | 2.0% | 1.7% |
| Canada | 1.4% | 2.3% | 1.9% | 1.4% | 1.8% | 2.1% |
| Developing Economies ¹ | 4.3% | 4.4% | 4.4% | 5.5% | 4.4% | 5.1% |
| China | 6.7% | 6.5% | 6.0% | 2.0% | 1.3% | 2.1% |
| India ² | 8.2% | 7.1% | 7.0% | 5.0% | 3.5% | 5.0% |
| Mexico | 2.3% | 1.9% | 2.4% | 2.8% | 6.0% | 5.0% |
| Brazil | -3.6% | 0.7% | 2.1% | 8.7% | 4.2% | 4.3% |
| Russia | -0.2% | 1.2% | 2.0% | 7.1% | 4.2% | 4.5% |

Forecast as of: June 7, 2017

¹Aggregated Using PPP Weights

²Forecasts Refer to Fiscal Year

Source: International Monetary Fund and Wells Fargo Securities

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