

# The Economic Outlook

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Tim Quinlan, Senior Economist  
July 2019

Together we'll go far



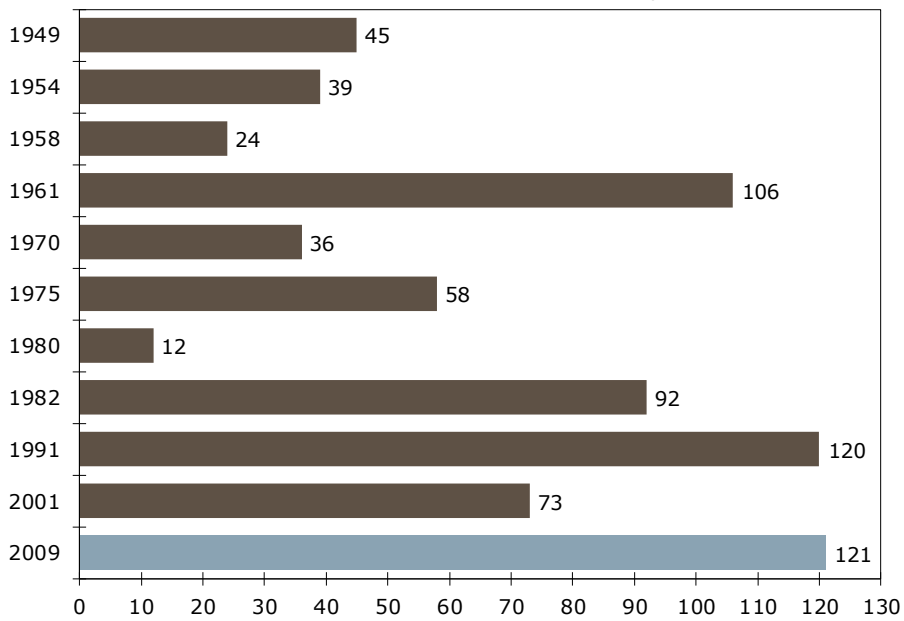
The current expansion is close to be becoming the longest on record, but has also been the weakest of the post-WWII era

Almost the Longest...

...but the Weakest

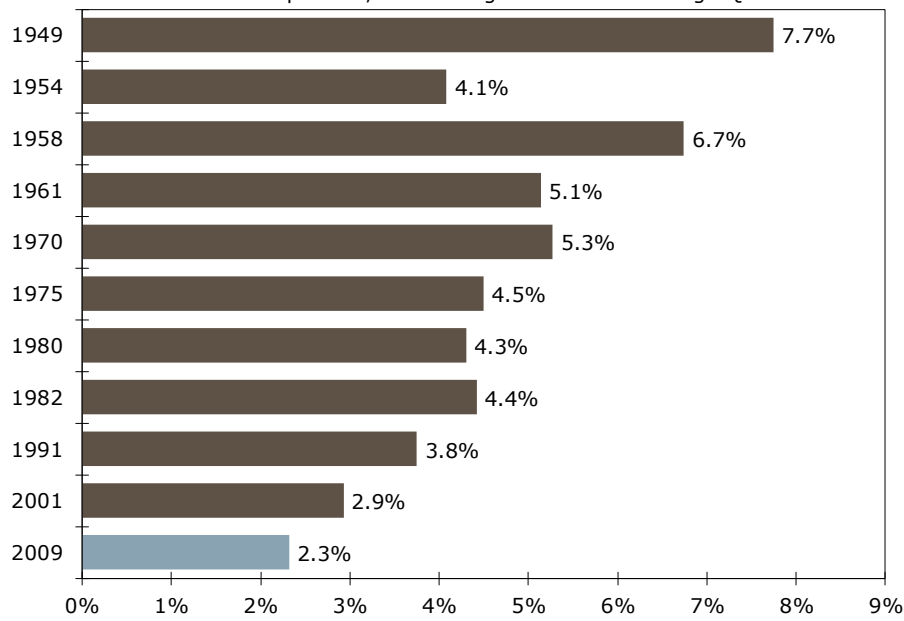
Length of U.S. Expansion

Y-axis=End of Recession, X-axis=Months as of July 2019



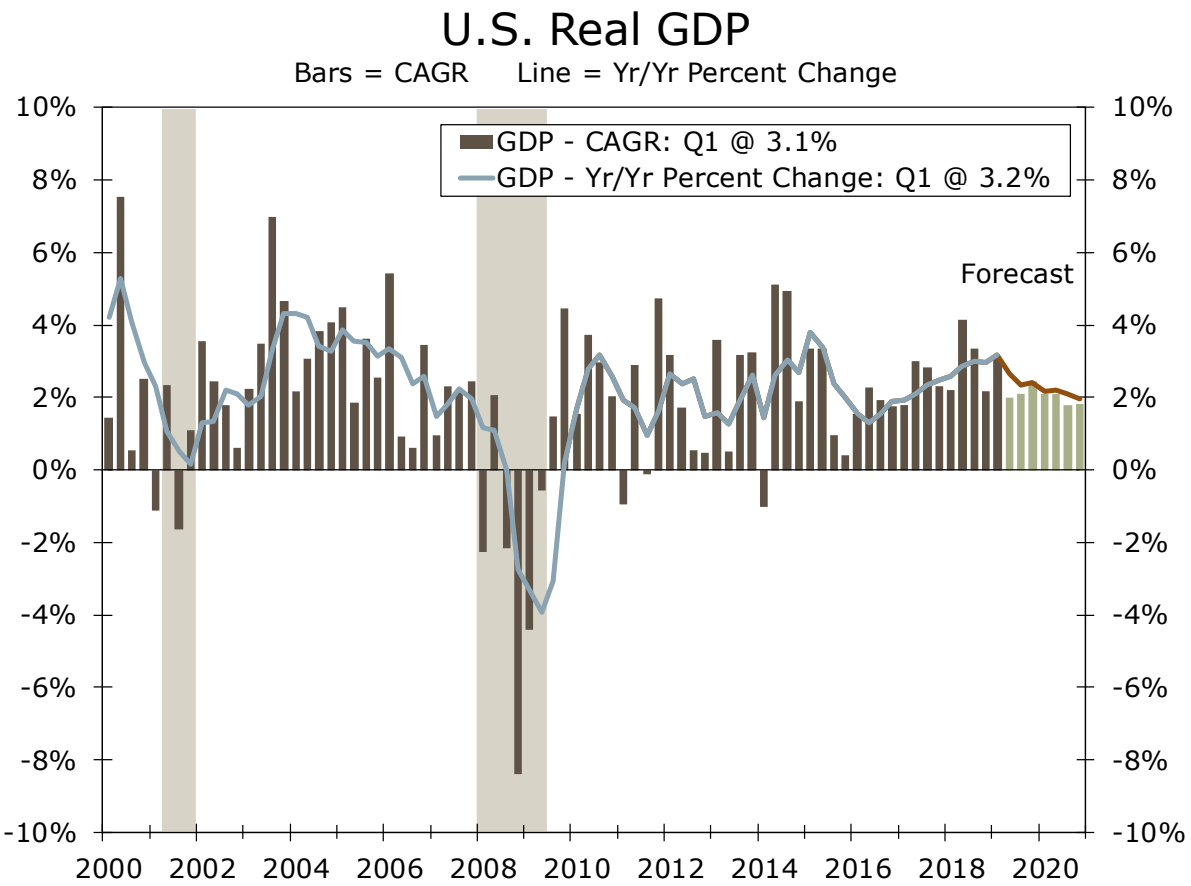
Strength of U.S. Expansion

Y-axis=Start of Expansion, X-axis=Avg GDP Growth through Q1-2019



Source: National Bureau of Economic Research, U.S. Department of Commerce and Wells Fargo Securities

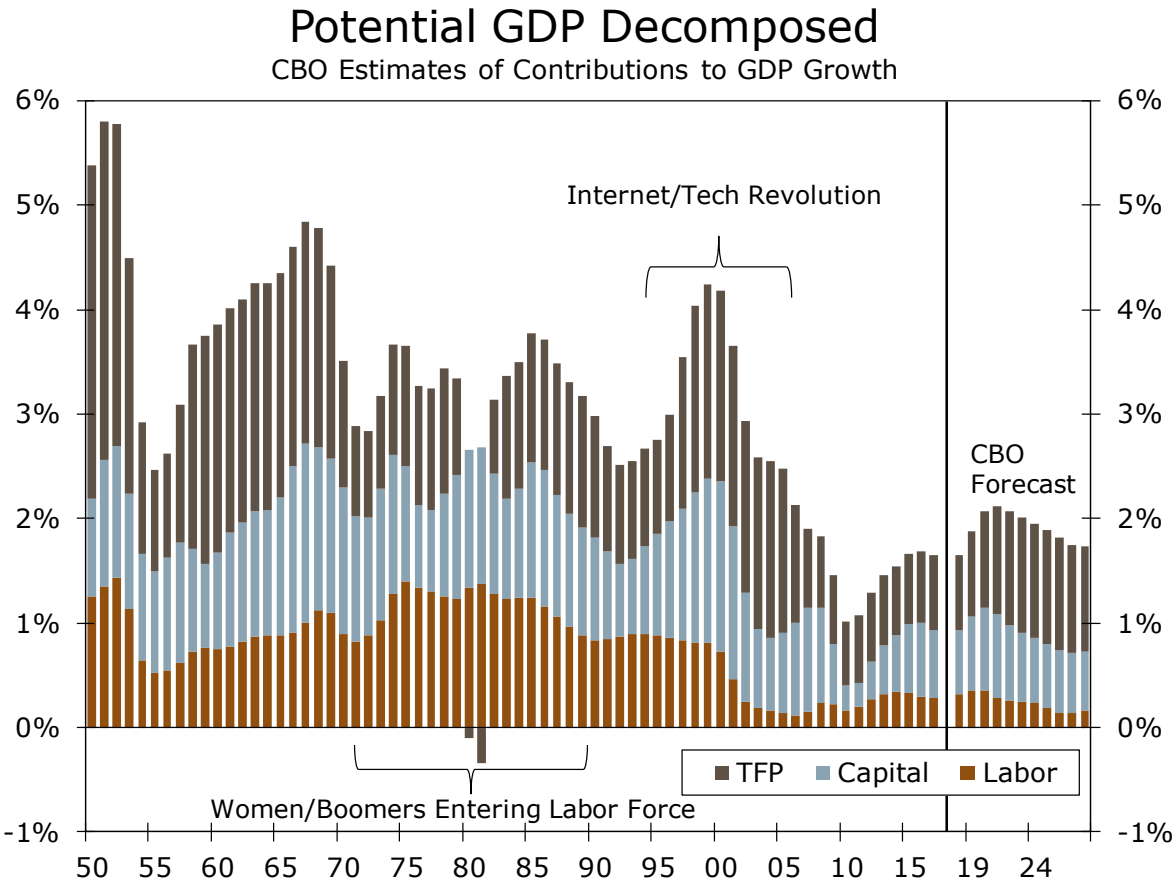
Near-term outlook is for trend-like growth to continue



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

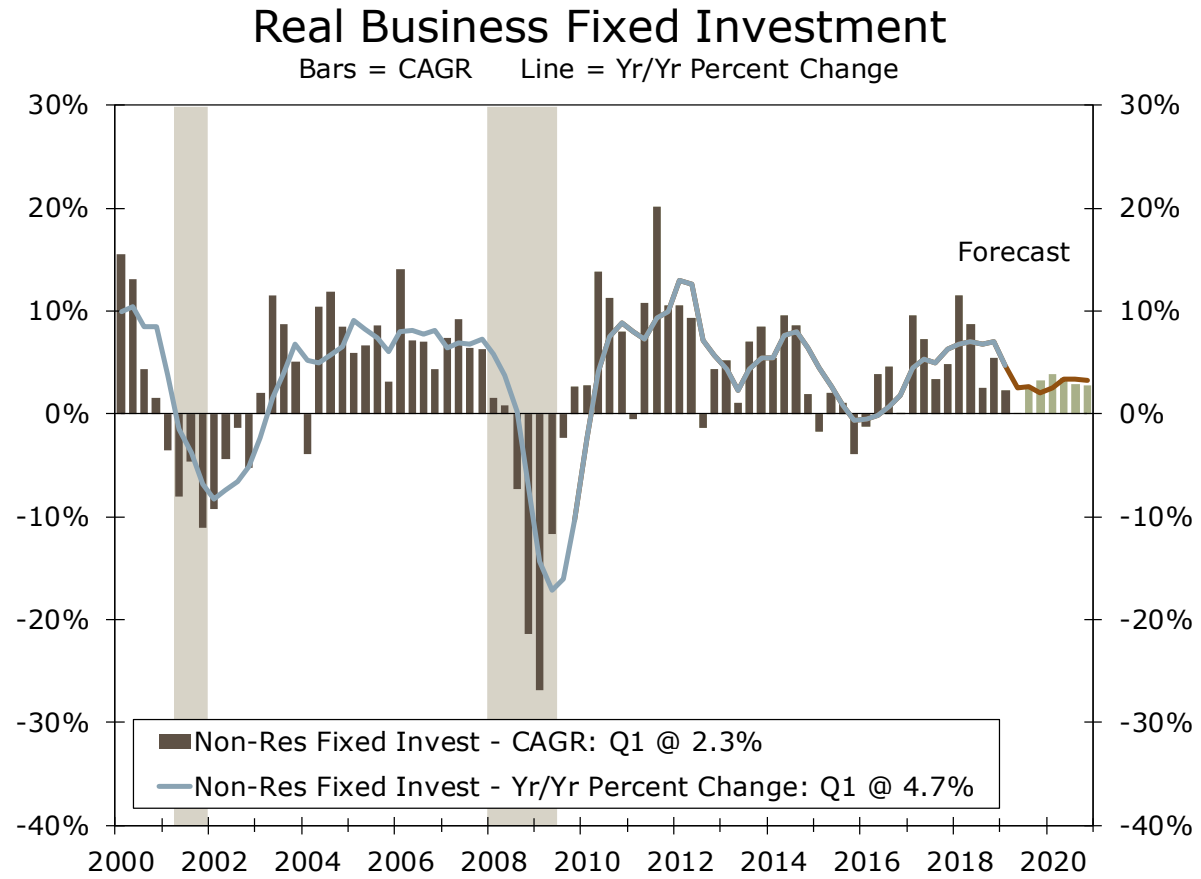
# Potential Growth: Labor Supply and Productivity

The Congressional Budget Office produces the gold standard for potential GDP estimates. By its projections, the sustainable pace of growth is a bit shy of 2 percent. Why? Primarily because of slower growth in the working-age population, but also because of somewhat slower capital and productivity growth.



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

Cap-ex had been surprising on the upside, but as the “bounce effect” fades, the pace of growth is expected to moderate



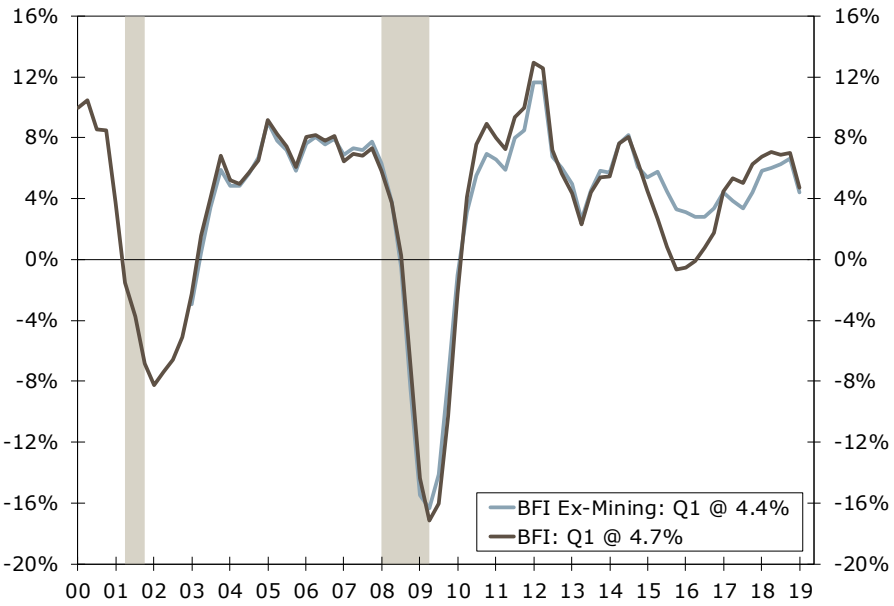
Source: U.S. Department of Commerce and Wells Fargo Securities

The rebound in energy prices and more specifically oil prices has boosted business investment

Business Investment Ex-Mining

Real Business Fixed Investment

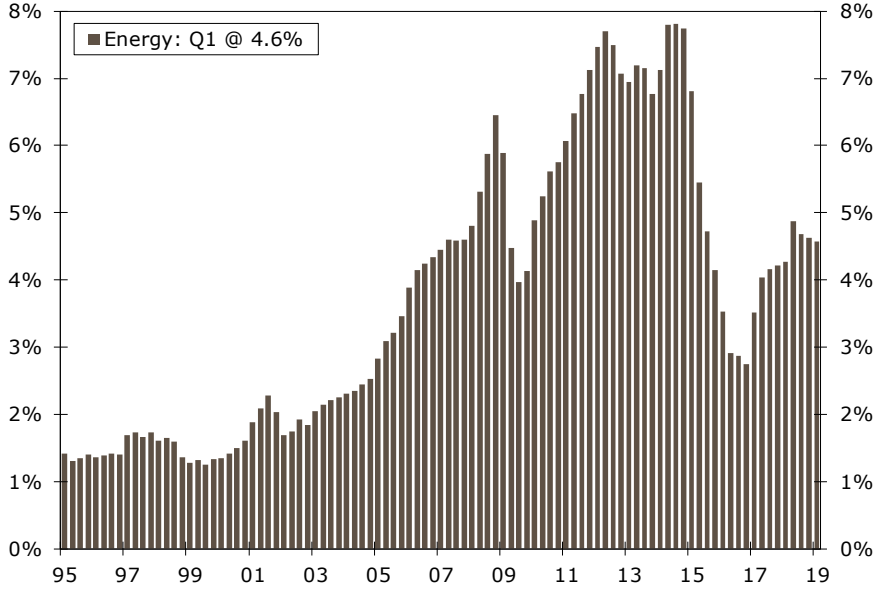
Year-over-Year Percent Change



Energy Share of Investment

Fixed Investment Spending on Energy

As Percent of Total BFI



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

# Impact of Tax Cuts & Job Act on Cap-ex Spending

Roughly two-thirds of respondents to the November Survey of Business Executives indicated that tax reform has not caused them to alter 2018 investment plans. If anything, the February survey revealed that firms have revised down expectations for this year.

## November 2017 Survey

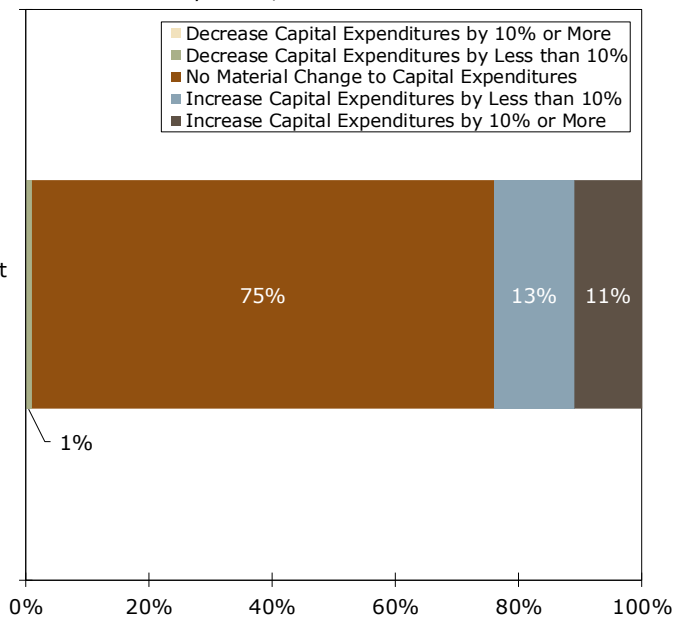
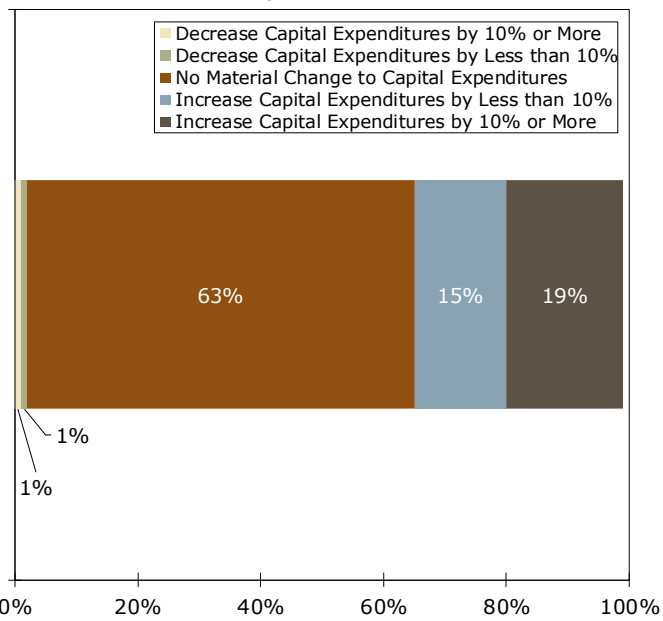
## February 2018 Survey

Survey of Business Executives  
November 13-24, 2017

Survey of Business Executives  
February 12-23, 2018

If passed in its current form, how would the Tax Cuts and Jobs Act affect your capital expenditures in 2018?

How has the recently enacted Tax Cuts and Jobs Act led you to revise your plans for capital expenditures in 2018?

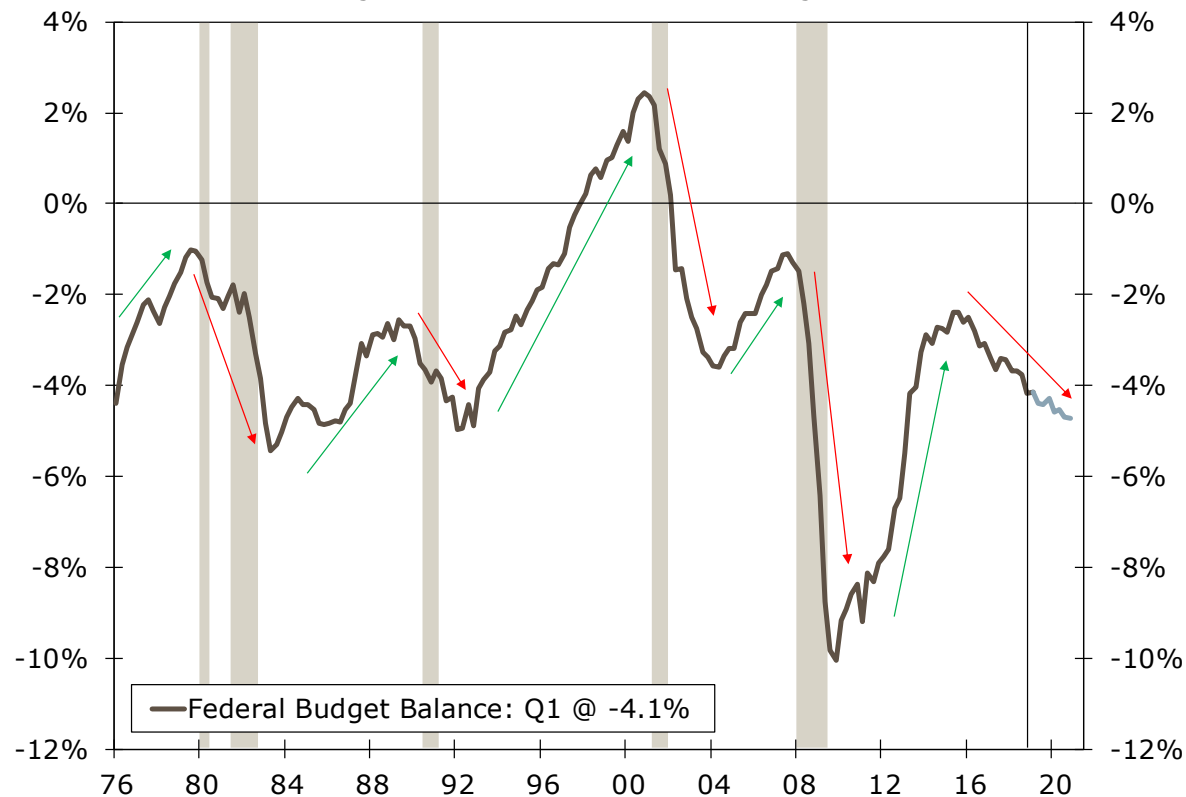


Source: Federal Reserve Bank of Atlanta, Survey of Business Executives (SBE), Stanford University, University of Chicago and Wells Fargo Securities

Expansions have traditionally been associated with balanced budgets and low unemployment. However, since 2016, that has changed. What does this new deteriorating federal budget dynamic mean for the next recession?

## Federal Budget: Deteriorating in an Expansion

4-Quarter Moving Sum, Percent of GDP, Wells Fargo Forecast in Blue



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

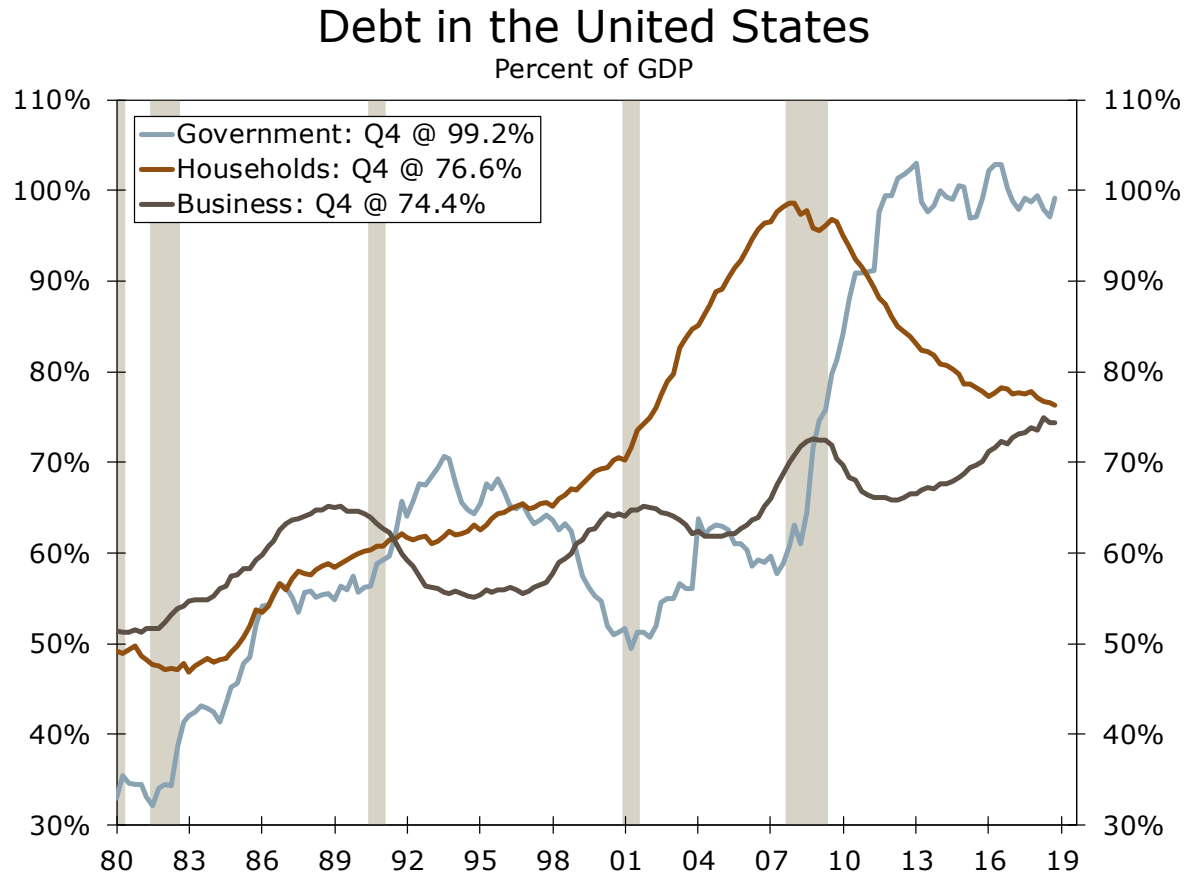


The United States is currently running the largest budget deficit among the world's major developed economies

<b>IMF Budget Deficit Forecasts</b>			
<i>General Government, % of GDP, Negative = Deficit</i>			
	<b>2018</b>	<b>2019</b>	<b>2020</b>
<b>Australia</b>	-1.2%	-1.5%	-0.7%
<b>Canada</b>	-0.4%	-0.6%	-0.6%
<b>France</b>	-2.6%	-3.3%	-2.4%
<b>Germany</b>	1.7%	1.1%	1.1%
<b>Italy</b>	-2.1%	-2.7%	-3.4%
<b>Japan</b>	-3.2%	-2.8%	-2.1%
<b>Korea</b>	2.8%	2.1%	1.5%
<b>Spain</b>	-2.7%	-2.3%	-2.3%
<b>Sweden</b>	0.8%	0.5%	0.3%
<b>Switzerland</b>	0.3%	0.3%	0.2%
<b>United Kingdom</b>	-1.4%	-1.3%	-1.2%
<b>United States</b>	-4.3%	-4.6%	-4.4%

Source: International Monetary Fund and Wells Fargo Securities

Corporate debt is trending higher while government debt ratios have not improved with the stronger economy

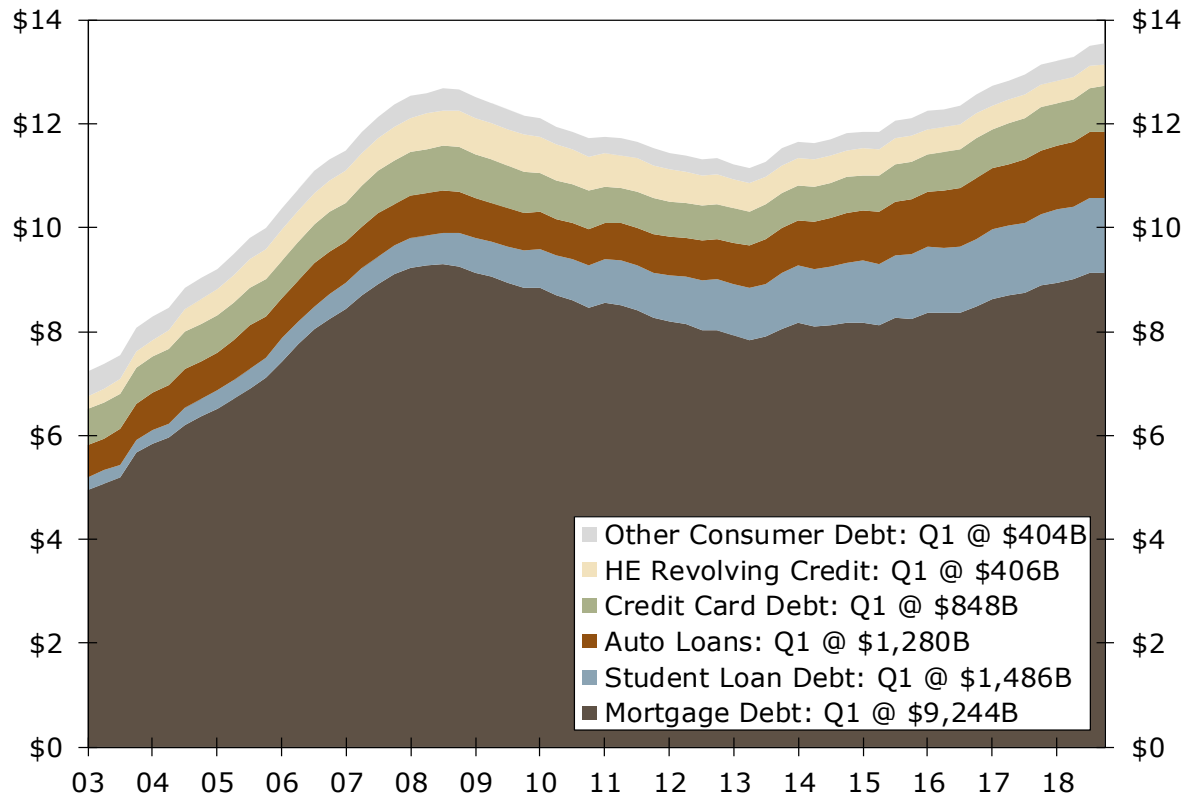


Source: Bank for International Settlements and Wells Fargo Securities

Household debt in the United States is higher now than it was at the height of the prior cycle, which has brought dire warnings about leverage and the inevitable comparisons to debt levels in 2008. Are such concerns justified?

### U.S. Household Debt

Trillions of Dollars



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

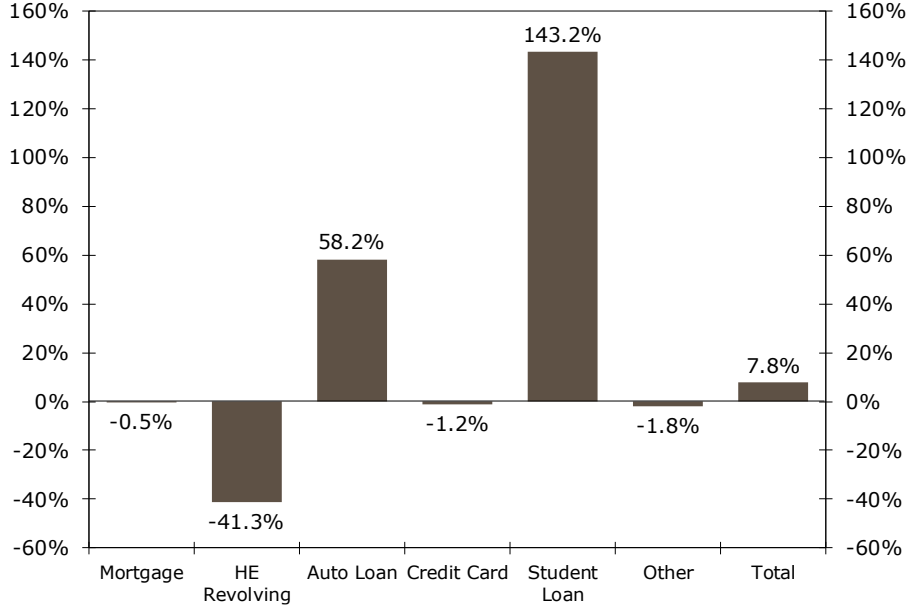
# The Shifting Composition of Debt is more Troubling

Since Q3-2008—the prior peak in household debt—almost all of the growth in household debt has been concentrated in student and auto loans. Younger households tend to experience this in more pronounced ways—they owe more in student loans than they do on a mortgage.

## Change since 2009

### U.S. Household Debt by Category

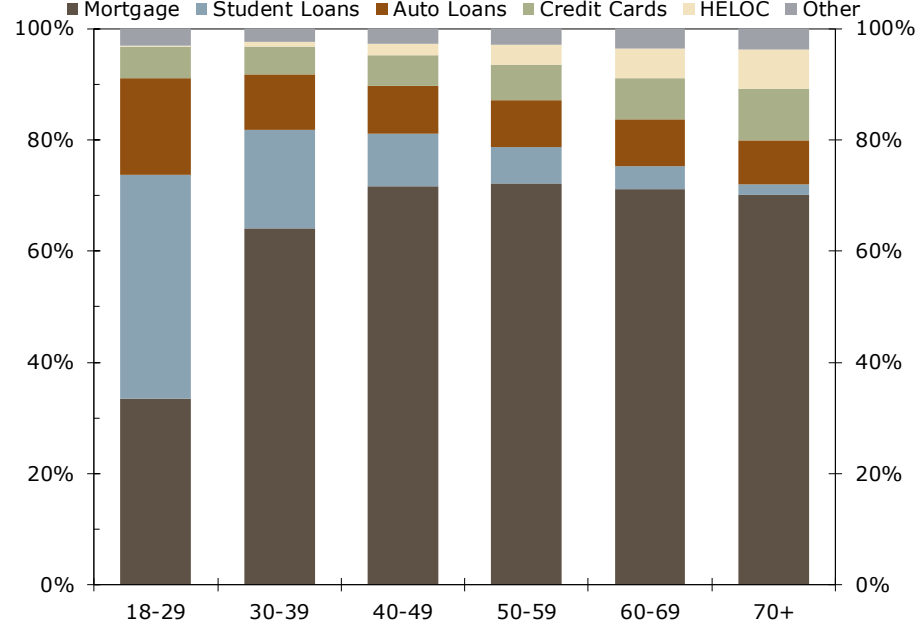
Percent Change from Q3-2008 to Q1-2019



## Debt by Age

### Debt Share by Product Type and Age

Q1-2018



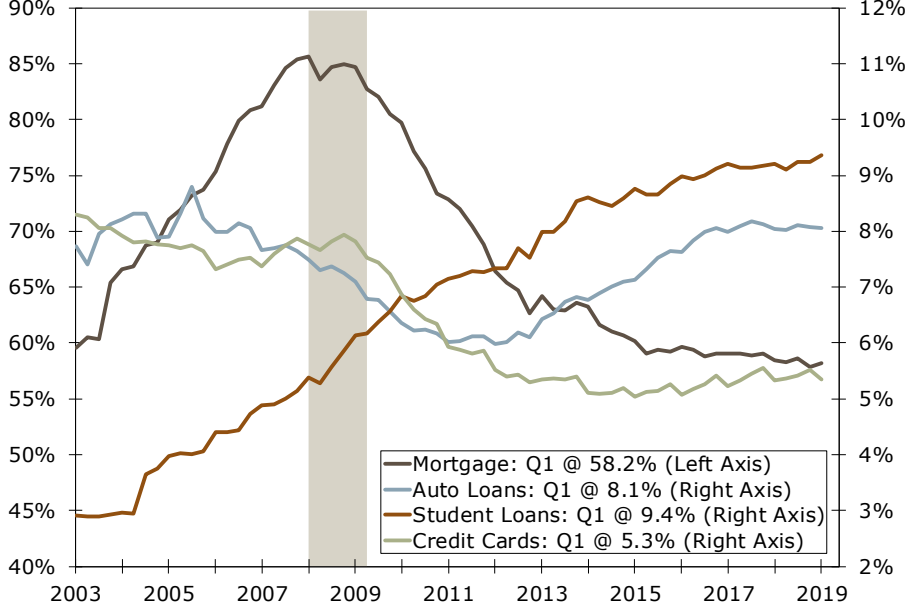
Source: Federal Reserve Bank of New York and Wells Fargo Securities

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

## Household Debt

### Household Debt

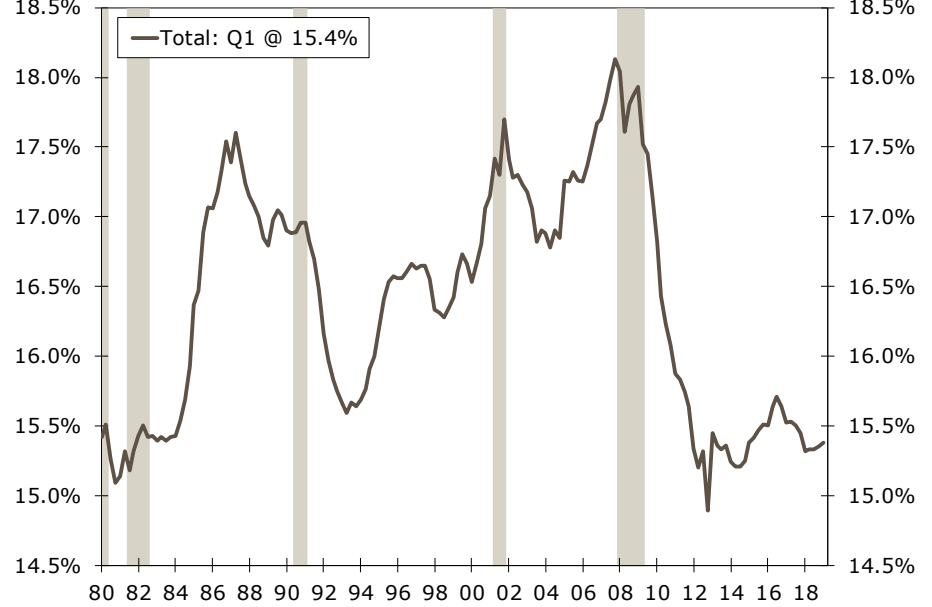
Percentage of Disposable Income



## Financial Obligations Ratio

### Household Financial Obligations Ratio

As a Percent of Disposable Personal Income

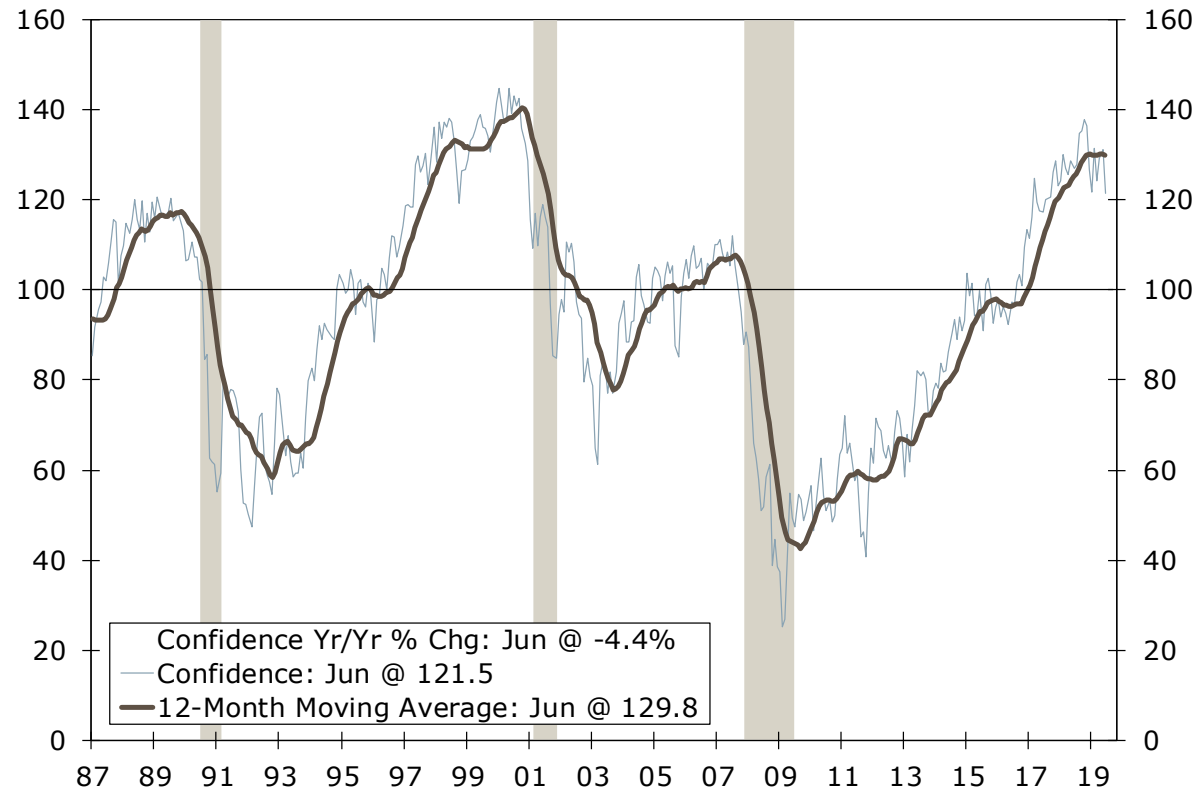


Source: Federal Reserve Bank of New York, Federal Reserve Board and Wells Fargo Securities

Despite a more recent moderation, consumer confidence remains near a 16-year high

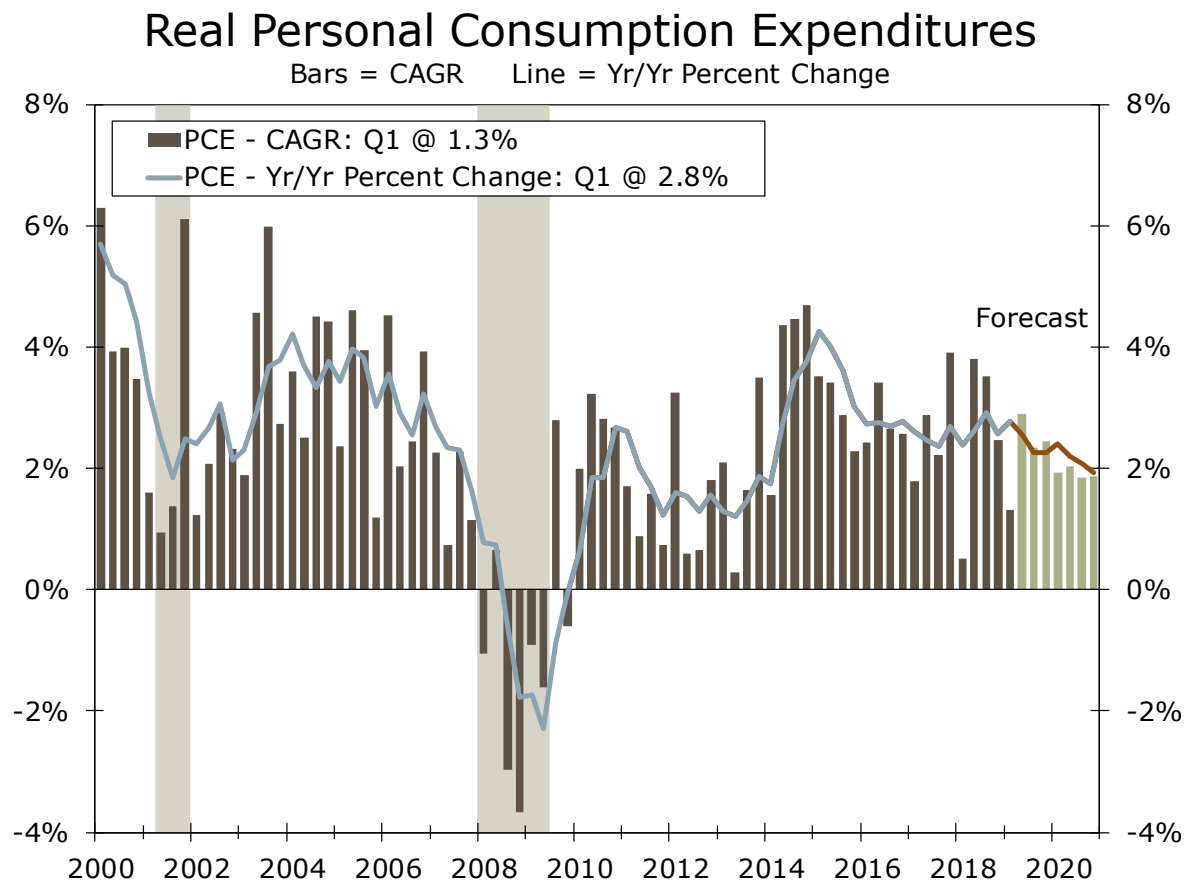
### Consumer Confidence Index

Conference Board



Source: The Conference Board and Wells Fargo Securities

Rather than seeing household debt as an immediate catalyst for recession, we see a shift in the composition of debt which will likely weigh on consumer spending for years to come. Consumer spending growth is set to moderate but remain positive throughout the forecast horizon.

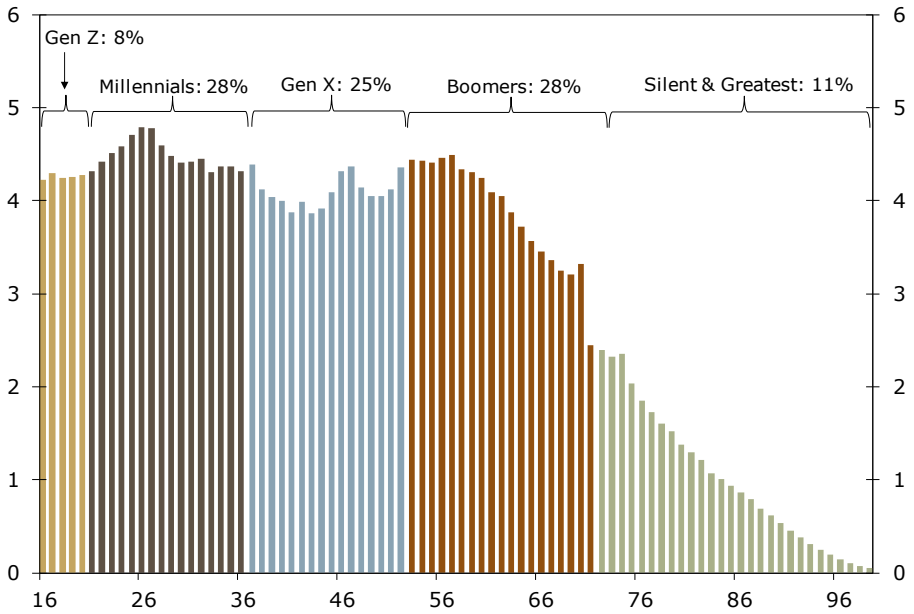


Source: U.S. Department of Commerce and Wells Fargo Securities

Demographics are slowly shifting back toward homeownership. The oldest cohort of Millennials will turn 38 this year, which is an age at which, historically, homeownership trends increase.

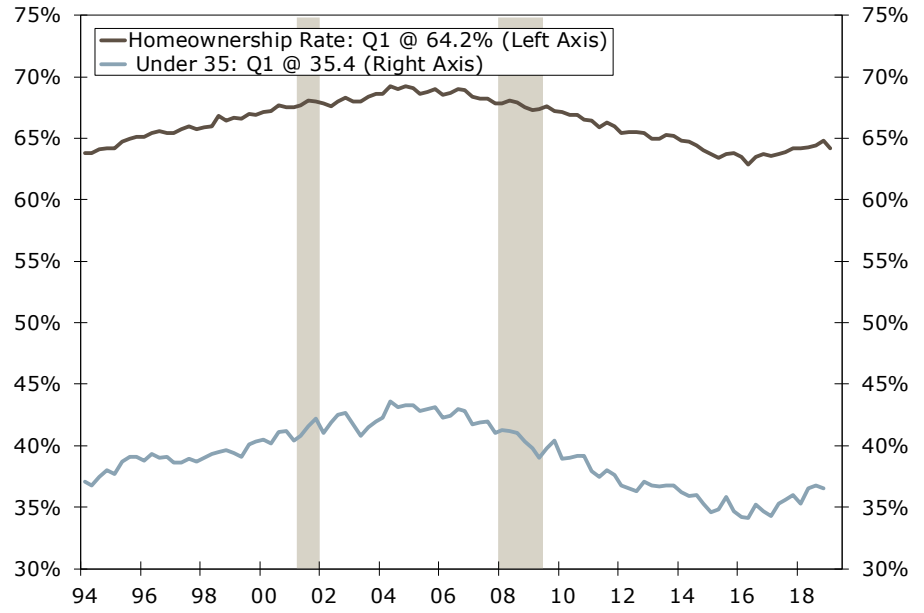
Population

U.S. Adult Population Distribution  
Millions of Persons in Age Group, 2017



Under 35

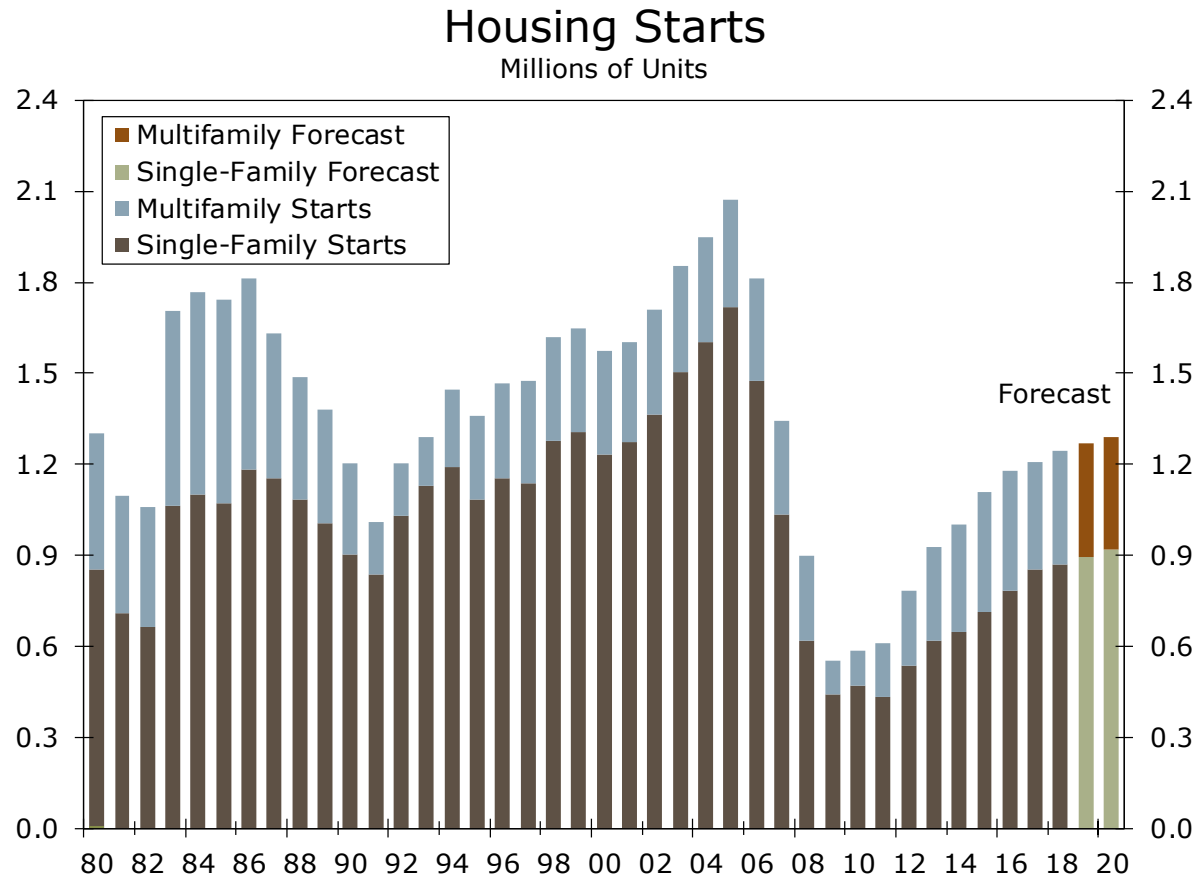
U.S. Homeownership Rate  
Percent



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



We see single-family homebuilding gaining momentum over the next few years. Apartment construction is showing signs of topping out but should remain near recent levels.



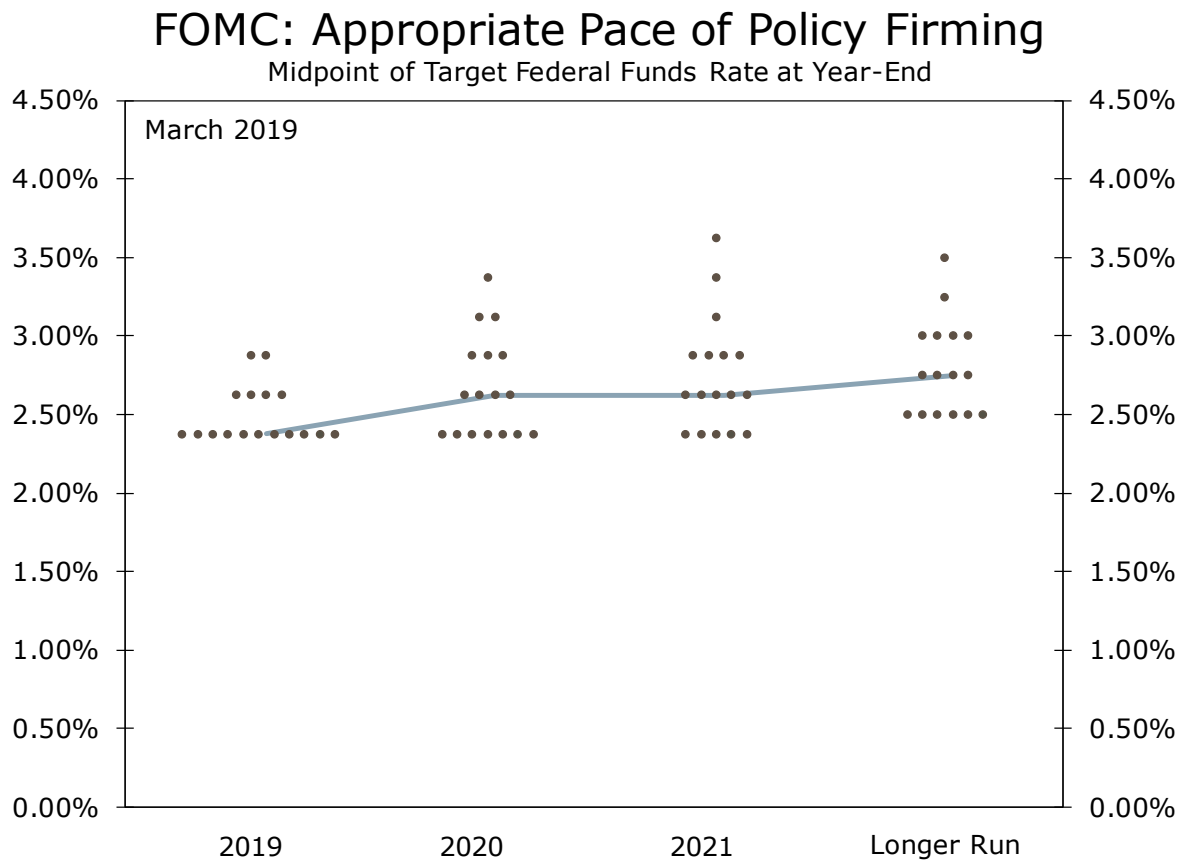
Source: U.S. Department of Commerce and Wells Fargo Securities

# Monetary Policy & Rates

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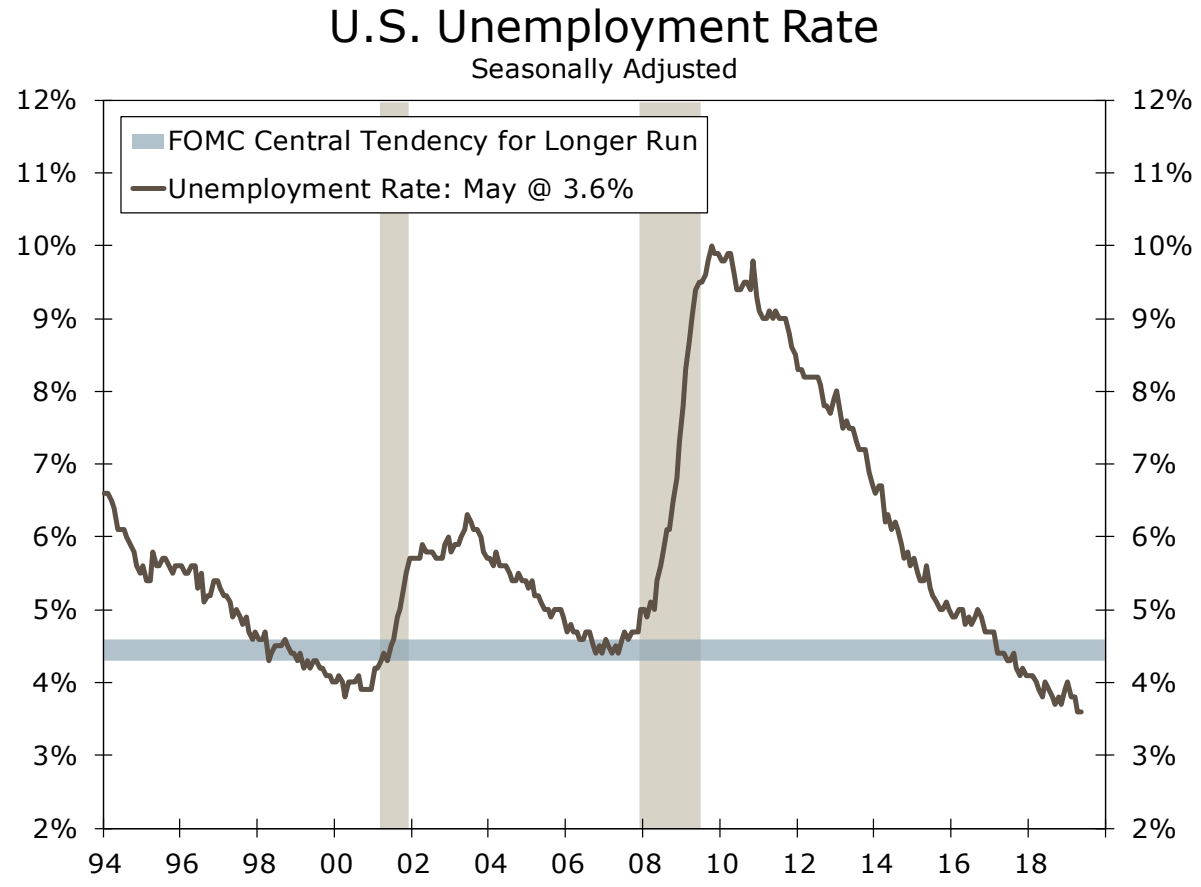
# How Did the Fed Get Stuck in Neutral?

The FOMC is closing in on its neutral rate for fed funds. With most dots clustered around 2.50-3.00% in the longer run how many rate hikes are left to go in the current cycle?



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

The labor market is steadily firming. The unemployment rate is currently at 3.6 percent, which is well-below the FOMC's central tendency target.



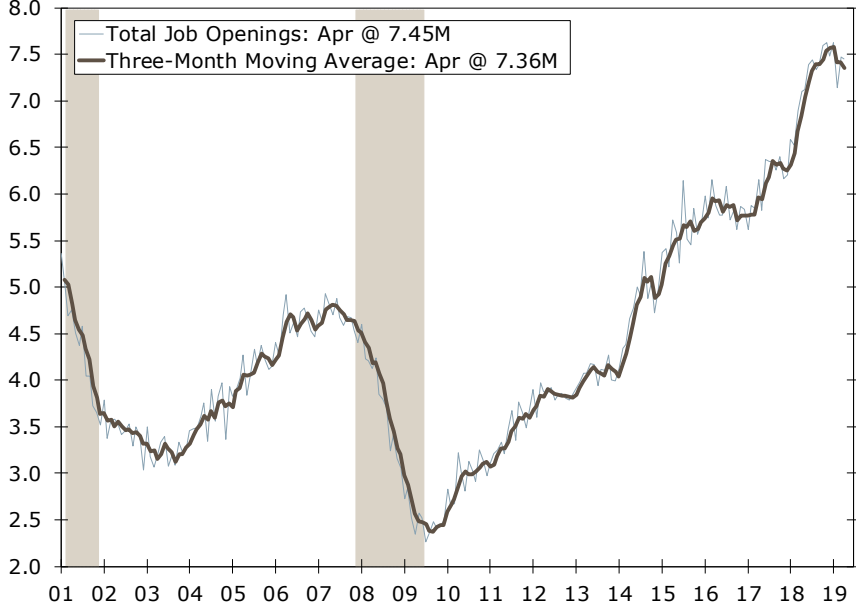
Source: Federal Reserve Board, U.S. Department of Labor and Wells Fargo Securities

Job openings remain near a record high, while quits are near levels last seen in 2001. Has such labor conditions translated to wage growth?

## Openings

### Job Openings

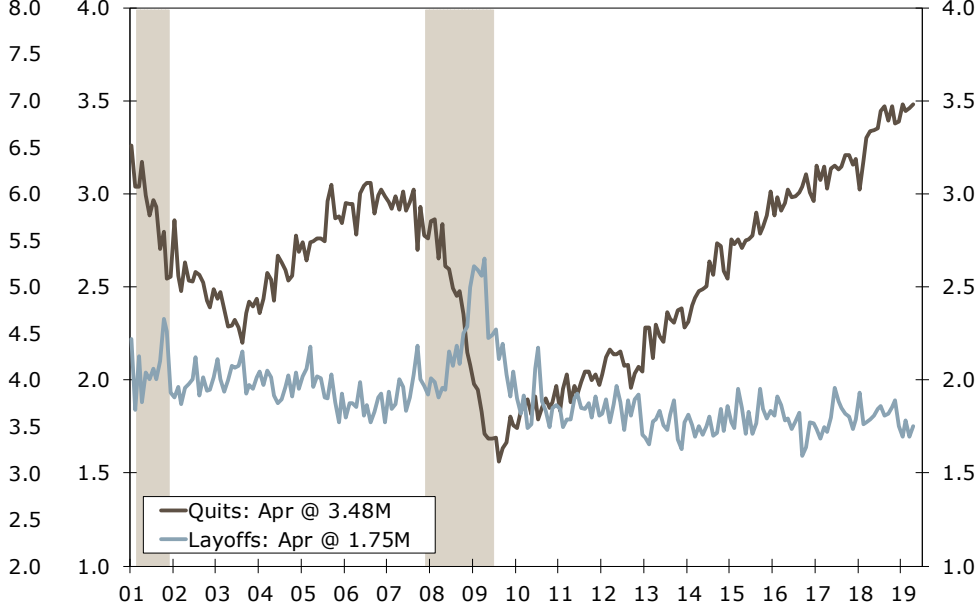
Millions of Openings, Seasonally Adjusted



## Separations

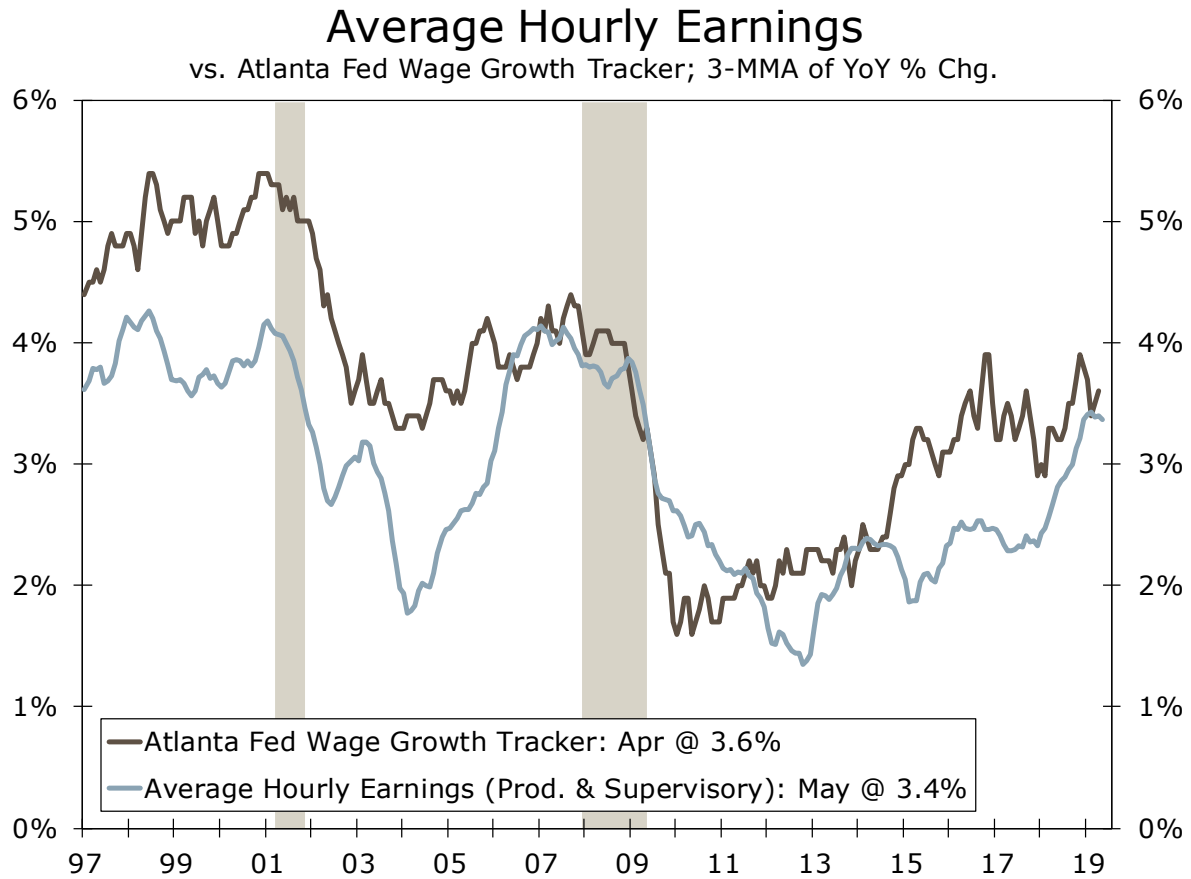
### Quits vs. Layoffs

Millions of Workers, SA



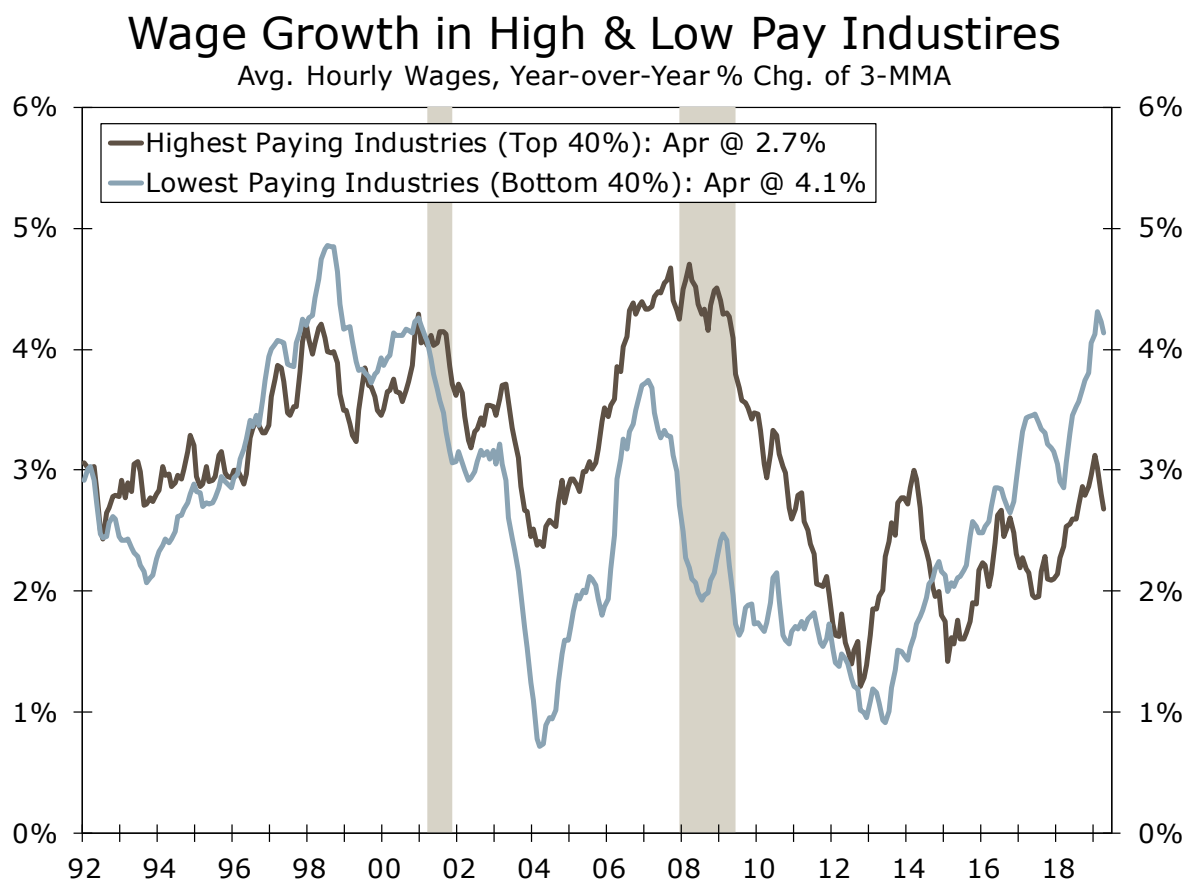
Source: U.S. Department of Labor and Wells Fargo Securities

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



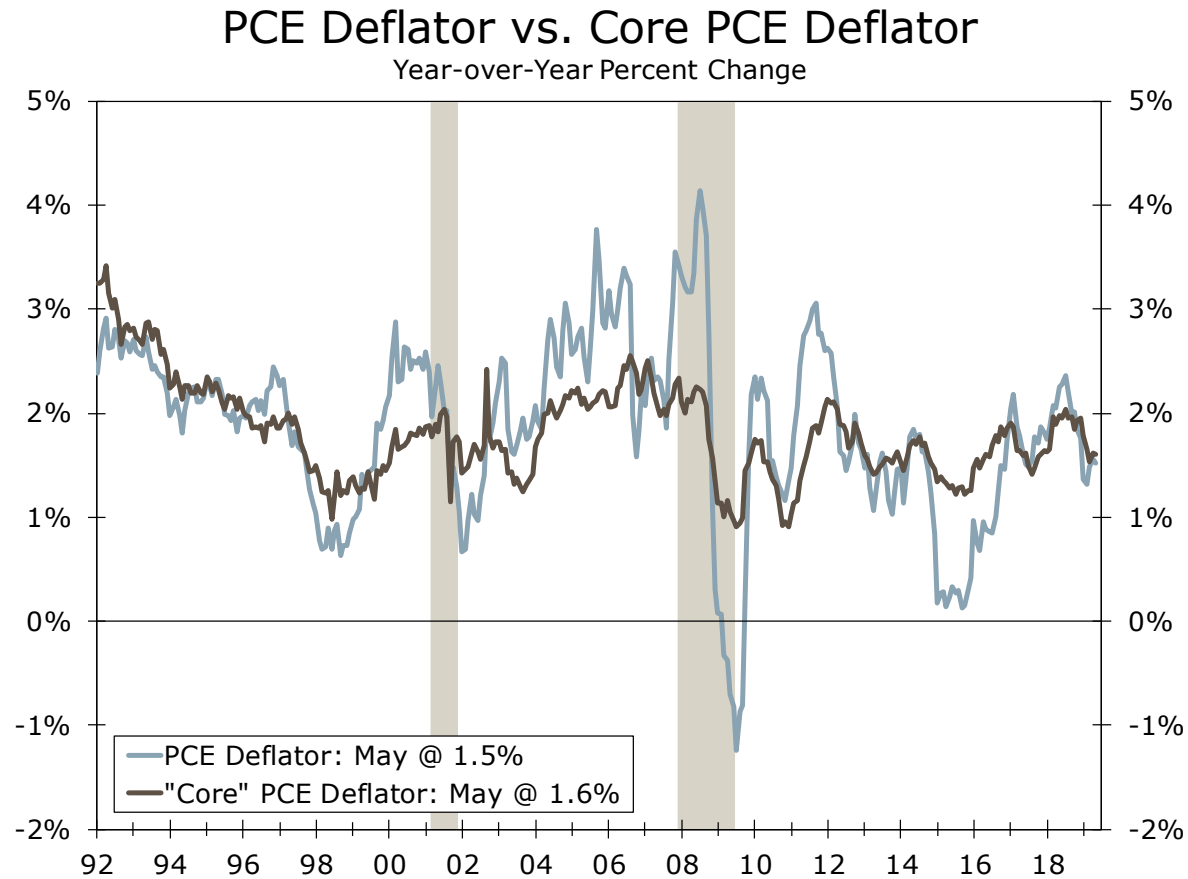
Source: Federal Reserve Bank of Atlanta, U.S. Department of Labor and Wells Fargo Securities

Wages are really picking up for workers in lower-paying industries



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

Inflation remains below the Fed's 2% target, a key reason the Fed has been patient with further rate hikes



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

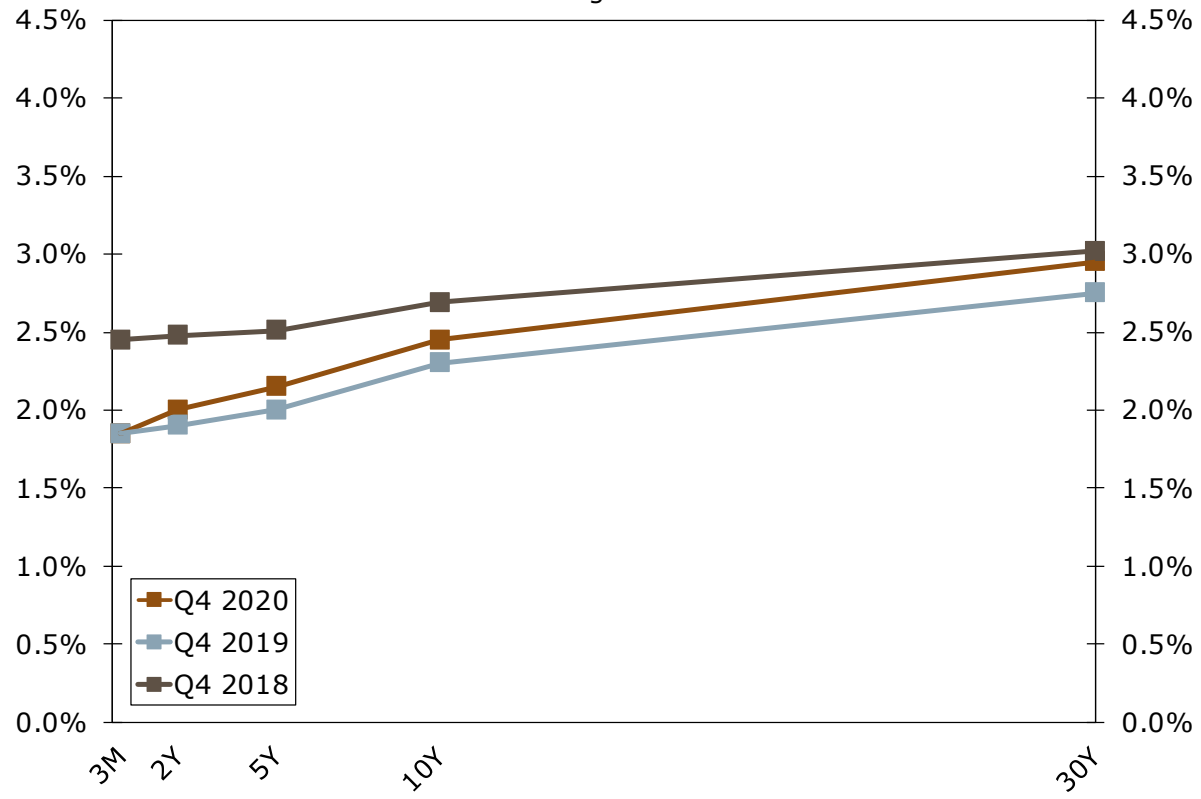


# Yield Curve: Flatter and Higher, At Least in the Near Term

The yield curve is expected to flatten in the near-term. Further out, the curve will steepen after the Fed eventually takes back one of its rate hikes, even as longer term rates remain more or less anchored.

## Wells Fargo Rates Forecast

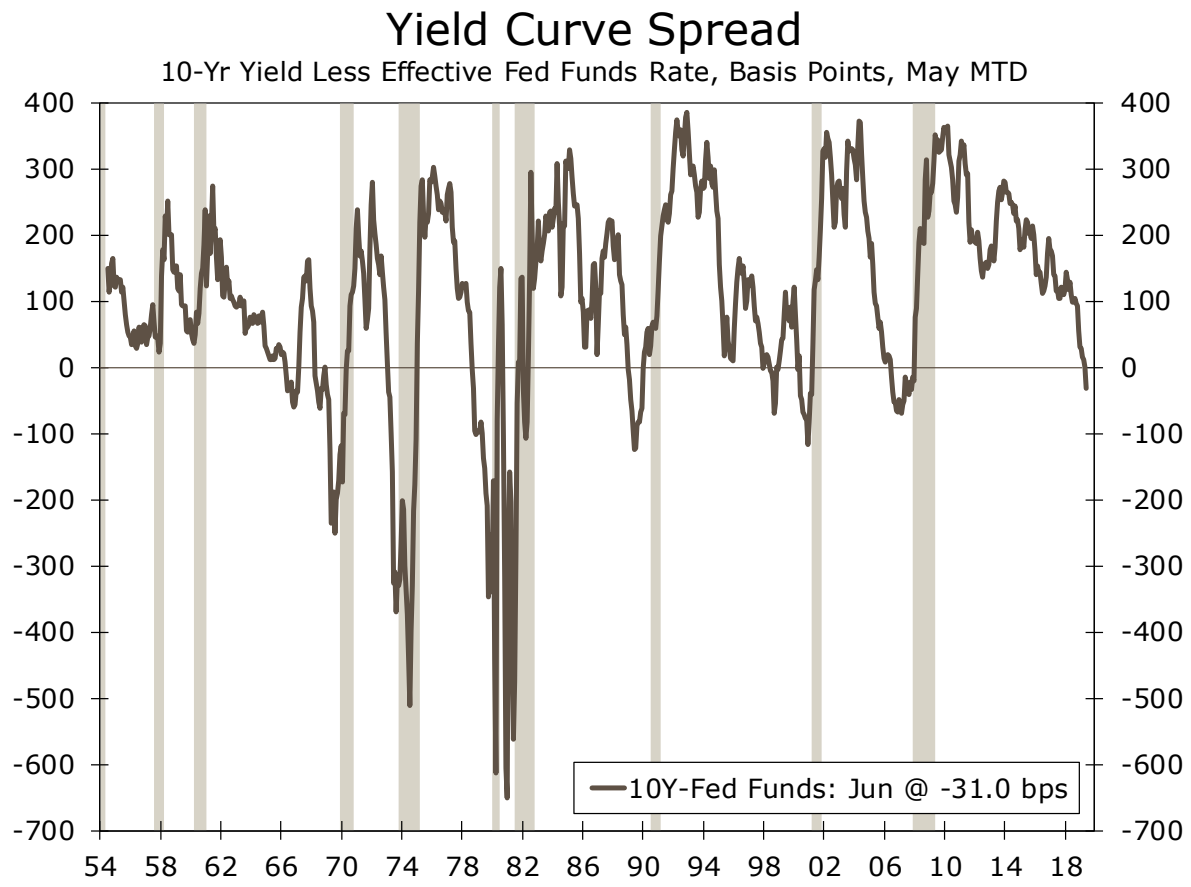
Through 2020



Source: HIS Markit and Wells Fargo Securities

# “Don’t Cross the Streams” The Yield Curve and Recession Predictions

The yield curve inverted before each of the past seven recessions (with a range of 8-23 months). However, the yield curve did not invert during the 1954-1965 period and missed two recessions. It also gave false signals in 1966, 1986 and 1998.



Source: IHS Markit and Wells Fargo Securities

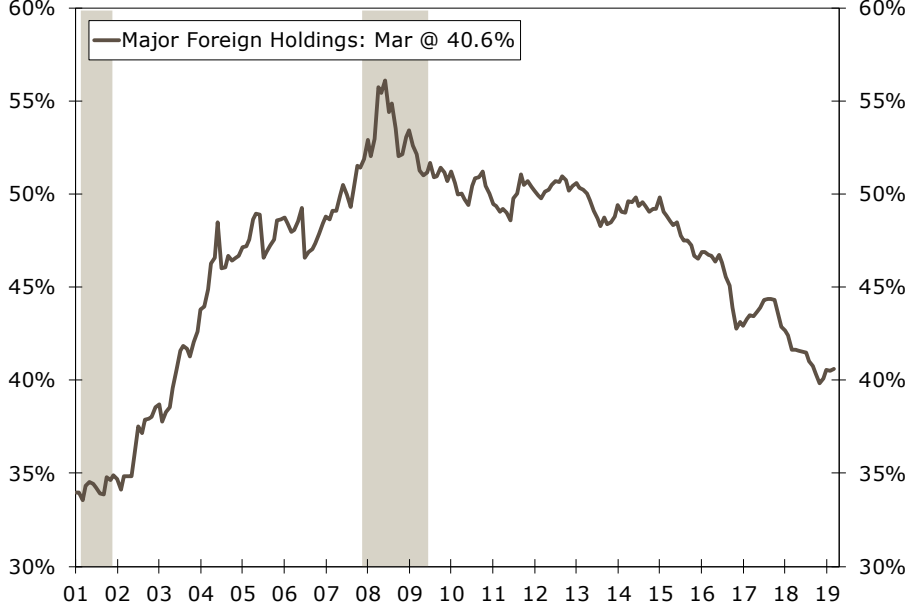
Foreign ownership of U.S. Treasuries has begun to decline.  
Who will become the next marginal buyer of U.S. Treasuries?

## Foreign Ownership of U.S. Treasuries

## Domestic Ownership of U.S. Treasuries

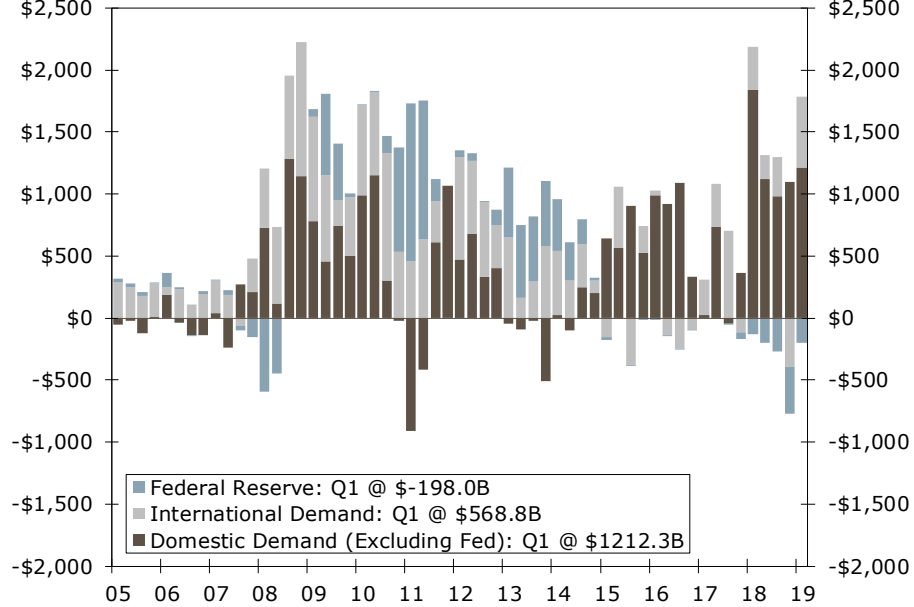
### Foreign Ownership of U.S. Treasuries

Percent of Total Marketable Debt Outstanding



### Marketable U.S. Treasury Demand

Net Purchases, Billions of U.S. Dollars

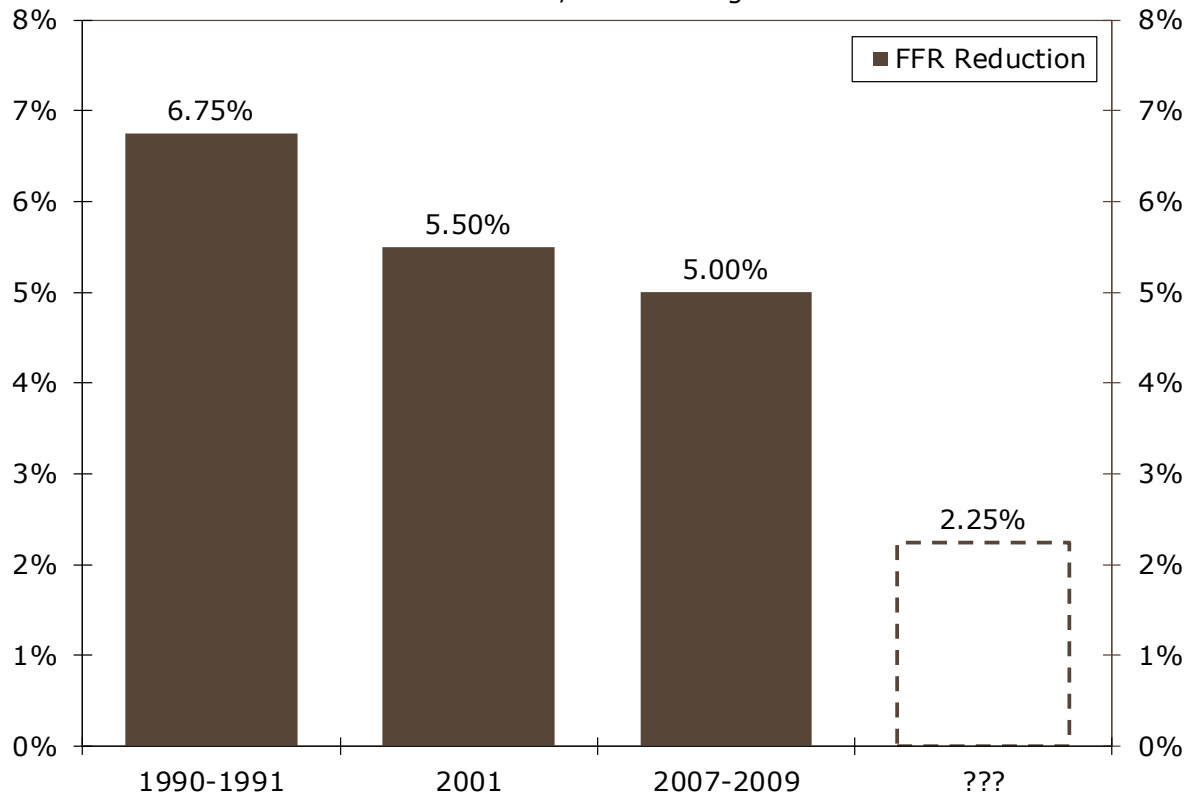


Source: Bloomberg LP, Federal Reserve Board, U.S. Department of Treasury and Wells Fargo Securities

Low on ammo

### Federal Funds Rate Cuts By Cycle

Cumulative Cuts, in Percentage Points

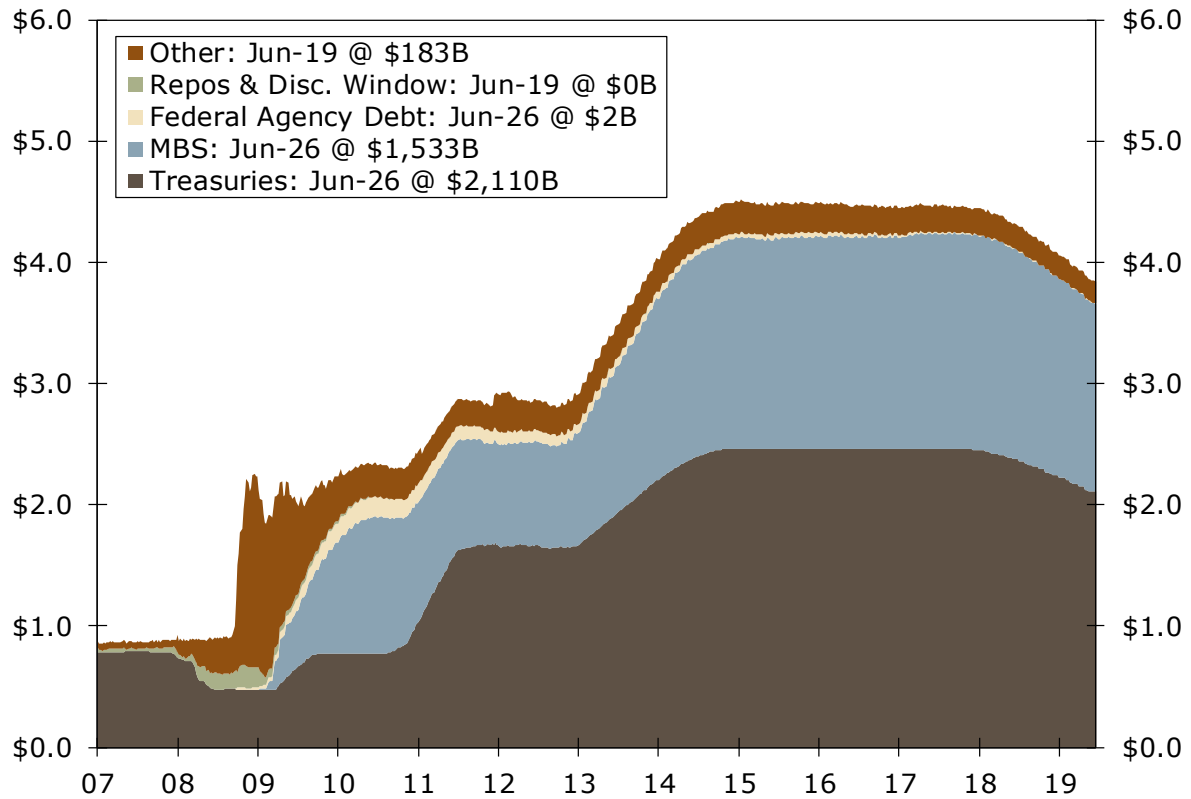


Source: Bloomberg LP and Wells Fargo Securities

Prior to the 2008, Fed’s holdings were about \$900B of mostly Treasuries. Balance sheet briefly held a commercial paper and currency swaps to help mitigate the liquidity challenges in the financial system. Now mostly MBS and Treasuries.

### Federal Reserve Total Assets

Trillions of U.S. Dollars



Source: Federal Reserve System and Wells Fargo Securities

## Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual			Forecast	
	2018				2019				2016	2017	2018	2019	2020
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product <sup>1</sup>	2.2	4.2	3.4	2.2	3.1	2.0	2.1	2.4	1.6	2.2	2.9	2.6	2.1
Personal Consumption	0.5	3.8	3.5	2.5	1.3	2.9	2.4	2.4	2.7	2.5	2.6	2.5	2.1
Inflation Indicators <sup>2</sup>													
PCE Deflator	1.9	2.2	2.2	1.9	1.4	1.5	1.5	1.6	1.1	1.8	2.0	1.5	2.0
Consumer Price Index	2.2	2.7	2.6	2.2	1.6	1.9	1.8	2.0	1.3	2.1	2.4	1.8	2.3
Industrial Production <sup>1</sup>	2.3	4.6	5.2	3.9	-1.9	-1.8	1.6	1.9	-2.0	2.3	3.9	1.1	0.7
Corporate Profits Before Taxes <sup>2</sup>	5.9	7.3	10.4	7.4	3.1	2.7	3.5	2.1	-1.1	3.2	7.8	2.8	-0.9
Trade Weighted Dollar Index <sup>3</sup>	103.1	107.3	107.6	110.1	109.8	107.3	107.0	106.5	109.4	108.9	106.4	107.6	103.6
Unemployment Rate	4.1	3.9	3.8	3.8	3.9	3.6	3.6	3.6	4.9	4.4	3.9	3.7	3.5
Housing Starts <sup>4</sup>	1.32	1.26	1.23	1.19	1.20	1.27	1.31	1.30	1.17	1.20	1.25	1.27	1.29
Quarter-End Interest Rates <sup>5</sup>													
Federal Funds Target Rate	1.75	2.00	2.25	2.50	2.50	2.50	2.25	2.00	0.52	1.13	1.96	2.31	2.00
Conventional Mortgage Rate	4.44	4.57	4.63	4.64	4.28	3.75	3.80	3.90	3.65	3.99	4.54	3.93	4.00
10 Year Note	2.74	2.85	3.05	2.69	2.41	2.15	2.20	2.30	1.84	2.33	2.91	2.27	2.40

Forecast as of: June 12, 2019

<sup>1</sup> Compound Annual Growth Rate Quarter-over-Quarter

<sup>3</sup> Federal Reserve Advanced Foreign Economies Index, 2006=100 - Quarter End

<sup>2</sup> Year-over-Year Percentage Change

<sup>4</sup> Millions of Units

<sup>5</sup> Annual Numbers Represent Averages

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

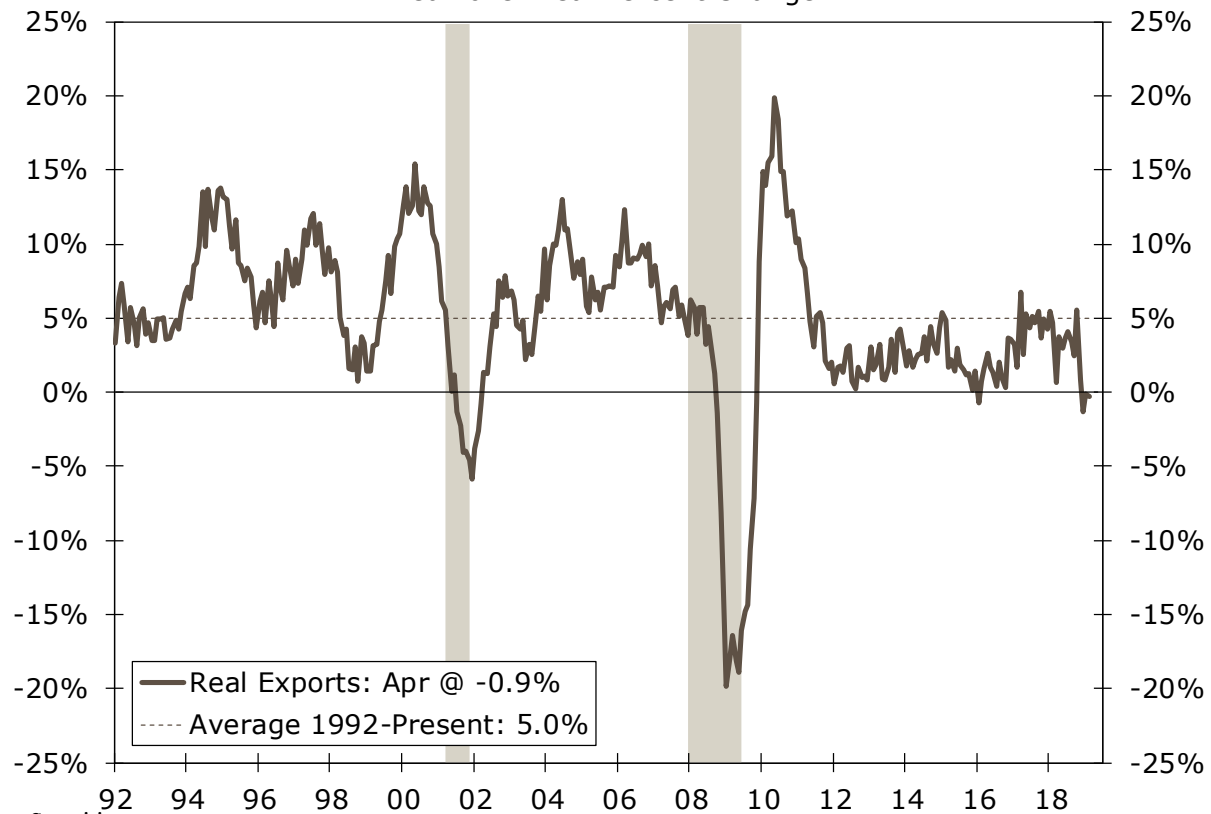
## So Why the Shift to Neutral?

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Global trade has stabilized over the past year

### Global Export Volume

Year-over-Year Percent Change



Source: IHS Markit and Wells Fargo Securities



“We should beware of the demagogues who are ready to declare a trade war against our friends—weakening our economy, our national security, and the entire free world—all while cynically waving the American flag.

The expansion of the international economy is not a foreign invasion; it is an American triumph, one we worked hard to achieve, and something central to our vision of a peaceful and prosperous world of freedom.”

**-President Ronald Reagan, 1988**

“Tariffs don’t work. If anything, they hurt the economy because if you’re a typical American worker, you have a finite amount of income to spend. If you have to spend more on the necessity products that you need to live, you have less to spend on the services that you want to buy.”

**-Gary Cohn, Former NEC Director & Chief Economic Adviser  
March 13, 2019**

# Tariff Timeline

Tariff Timeline						
Date in Effect	Avg. Size	Value of Goods (Billions)	Goods Targeted	Country	% of Imports	% of Consumer Spending
Nov 2, 2017	21%	\$4.6	Softwood Lumber	Canada	0.18%	0.04%
Feb 7, 2018	20%	\$1.8	Washing Machines	Multiple	0.07%	0.01%
Feb 7, 2018	30%	\$8.5	Solar Panels	Multiple	0.33%	0.07%
Mar 23/ Jun 1, 2018	25%	\$15.5	Steel	Multiple	0.61%	0.12%
Mar 23/ Jun 1, 2018	10%	\$9.4	Aluminum	Multiple	0.37%	0.07%
Jul 6, 2018	25%	\$30.1	Variety Focus: Tech, Auto & Manuf.	China	1.18%	0.23%
Aug 23, 2018	25%	\$15.3	Variety	China	0.60%	0.12%
Sep 24, 2018	25%	\$200.0	Variety	China	7.87%	1.55%
<b>Enacted Total</b>	<b>25%</b>	<b>\$285.2</b>			<b>11.22%</b>	<b>2.21%</b>
Proposed	25%	\$51.8	Autos	E.U.	2.04%	0.40%
Proposed	25%	\$300.0	Variety	China	11.81%	2.33%
Proposed	-	\$25.0	Variety Focus: Aircrafts	E.U.	0.98%	0.19%
<b>Proposed Total</b>	<b>23%</b>	<b>\$376.8</b>			<b>14.83%</b>	<b>2.92%</b>
<b>Enacted + Proposed</b>	<b>24%</b>	<b>\$662.0</b>			<b>26.05%</b>	<b>5.14%</b>

Source: U.S. Department of Commerce, Office of the United States Trade Representative, Pearson Institute for International Economics and Wells Fargo Securities

# How Costly Would a Full-Blown Trade War Be?

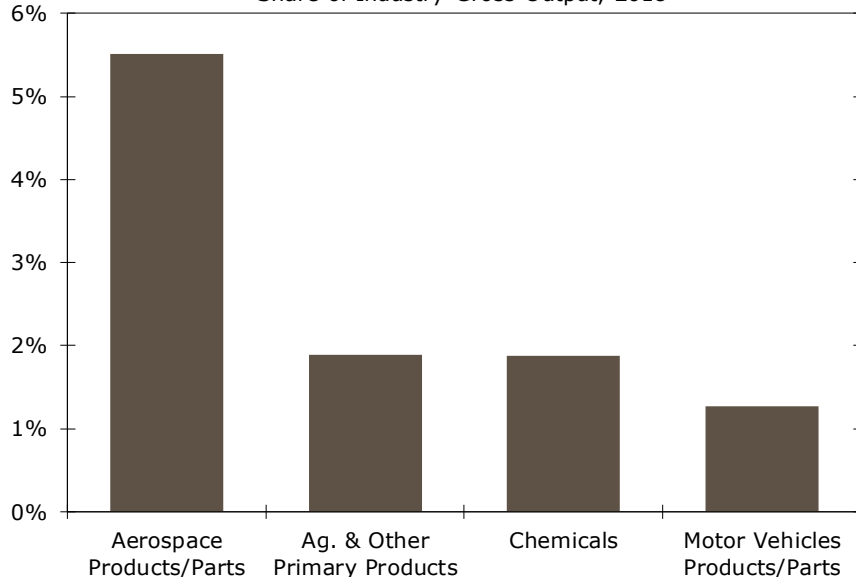
While exports to China of the industries in question are sizeable, they represent a relatively small proportion of total industry output. We estimate that the value added that is embodied in American exports to China accounts for only 0.5 percent of total value added in the U.S. economy.

## Exports

## Exposure

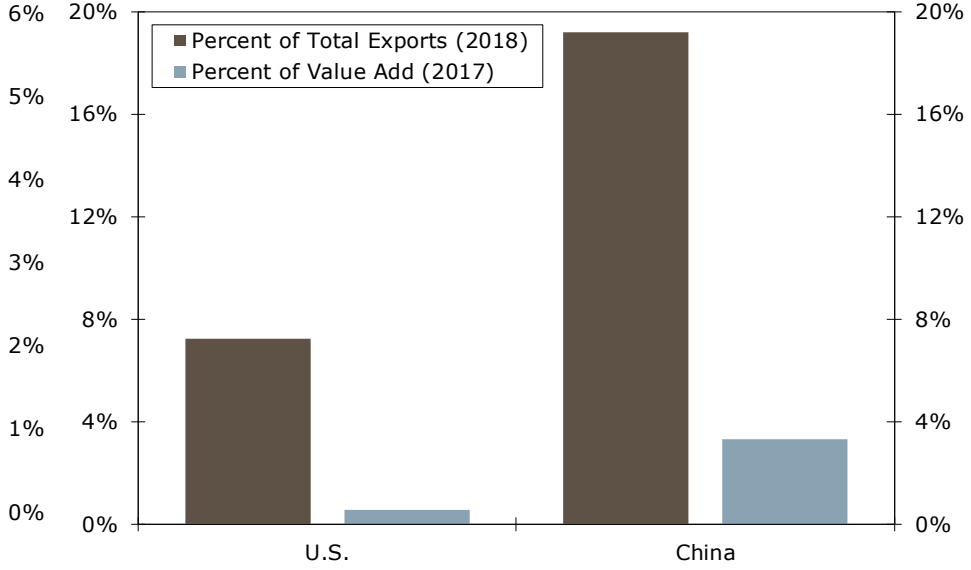
### Exports to China by Industry

Share of Industry Gross Output, 2018



### Bilateral Export Exposure

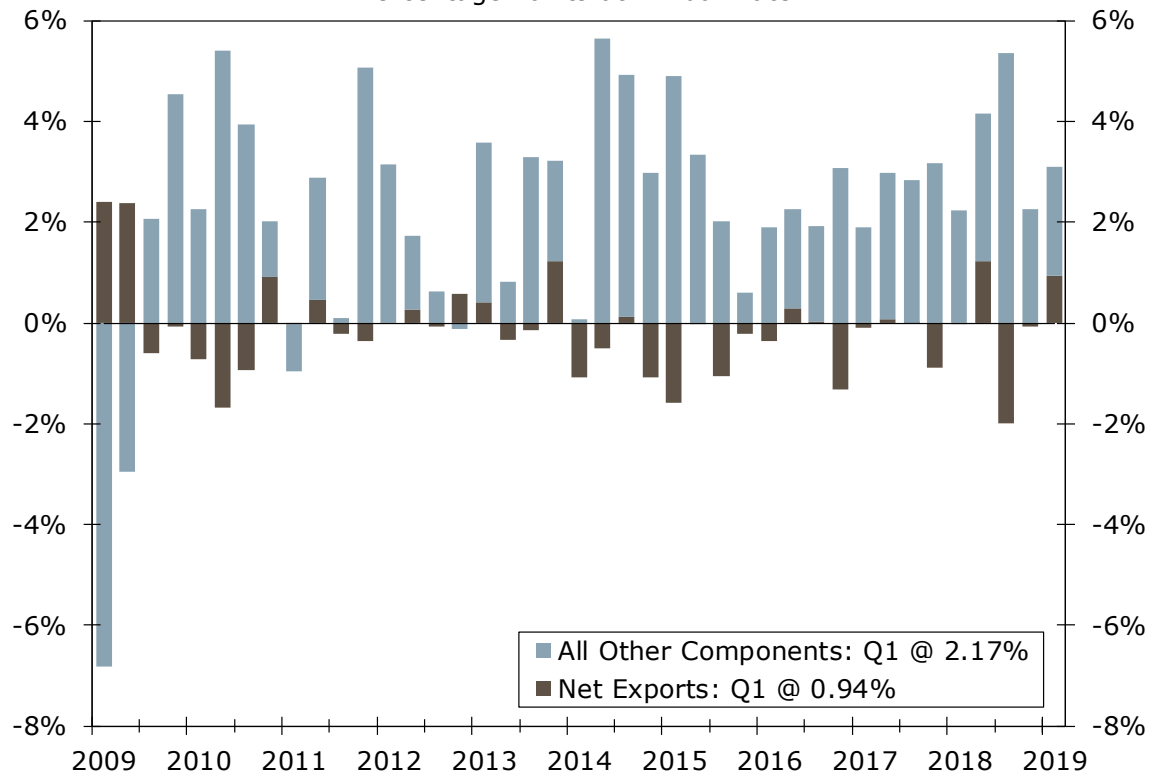
Percent



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

At the risk of sounding complacent...  
Of the **C+I+G+NX**,  
the **NX** is often the least consequential factor

Contributions to U.S. Real GDP Growth  
Percentage Points at Annual Rate



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

## Retaliatory Tariff Timeline

Retaliatory Tariff Timeline					
Date in Effect	Size	Value of Goods (Billions)	Goods Targeted	Country	% of Exports
Apr 2, 2018	15% - 25%	\$3.0	Variety	China	0.19%
Jun 5/ Jul 5, 2018	7% - 25%	\$3.6	Variety	Mexico	0.23%
Jun 21, 2018	4% - 70%	\$1.8	Variety	Turkey	0.12%
Jun 22, 2018	25%	\$3.2	Variety	E.U.	0.21%
Jul 1, 2018	10% - 25%	\$12.7	Variety	Canada	0.82%
Jul 6, 2018	25%	\$34.0	Variety	China	2.20%
Jul 6, 2018	25% - 40%	-	Variety	Russia	-
Aug 23, 2018	25%	\$16.0	Variety	China	1.03%
Sep 24, 2018	5% - 10%	\$60.0	Variety	China	3.88%
<b>Enacted Total</b>	-	<b>\$134.3</b>			<b>8.07%</b>
Proposed	5% - 50%	\$0.2	Variety	India	0.02%
Proposed		\$20.0	Variety	E.U.	1.29%
<b>Proposed Total</b>	-	<b>\$ 20.2</b>			<b>1.22%</b>
<b>Enacted + Proposed</b>	-	<b>\$154.5</b>			<b>9.29%</b>

Source: Office of the United States Trade Representative, U.S. Department of Commerce, Pearson Institute for International Economics, Washington Post, Reuters, Ministry of Economic Development of the Russian Federation, European Commission and Wells Fargo Securities

“In the House of Representatives, in an effort to alleviate the effects of ....Anyone? Anyone? ..the Great Depression

The House passed the...Anyone.. Anyone? The Smoot-Hawley Tariff Act, Which *raised* or *lowered*?

It *raised* tariffs in an effort to collect more government revenue.

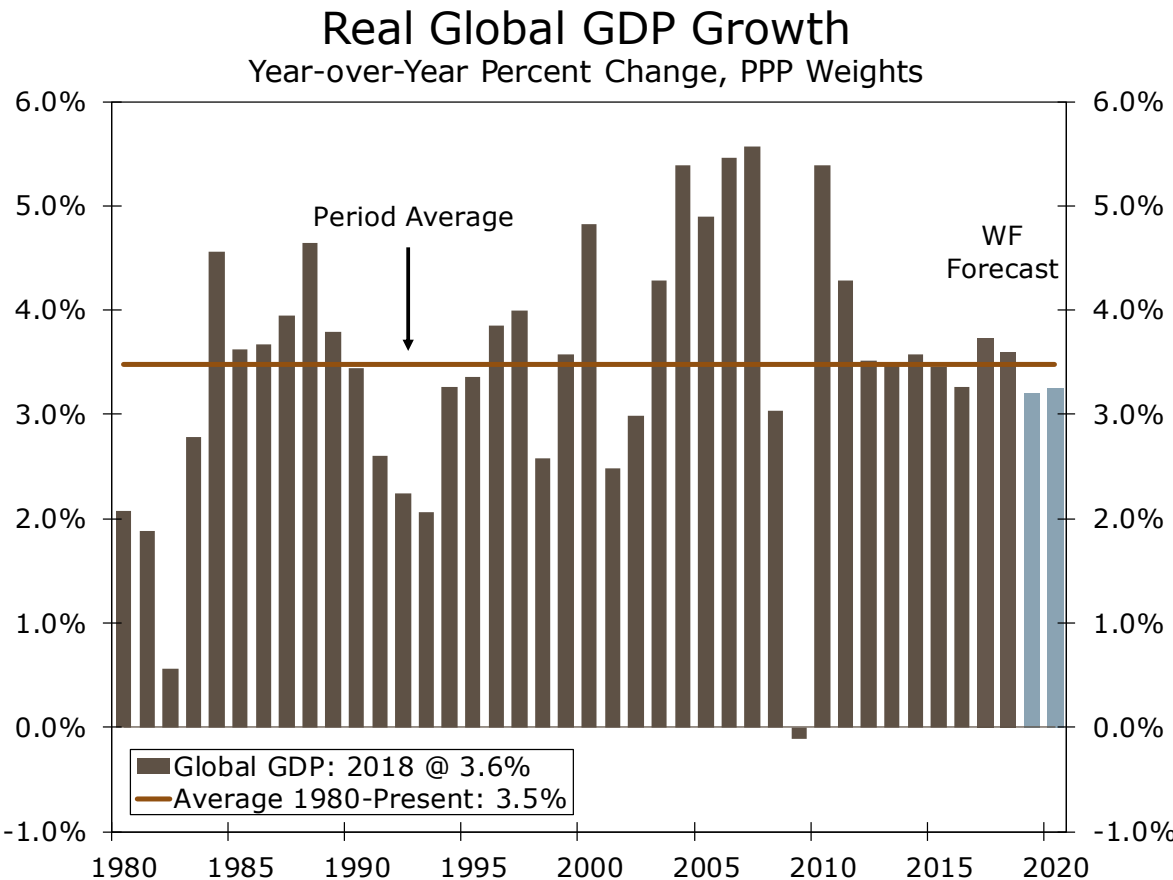
Did it work? Anyone know the effects? Anyone?

It did not work and the United States sank deeper into the Depression”

**-Economics Teacher as played by Ben Stein,  
*Ferris Bueller’s Day Off*, 1986**

We expect to see trend-like growth in coming years.

**IMF 2019 Global Growth Forecast 3.3%**  
**OECD 2019 Global Growth Forecast 3.2%**



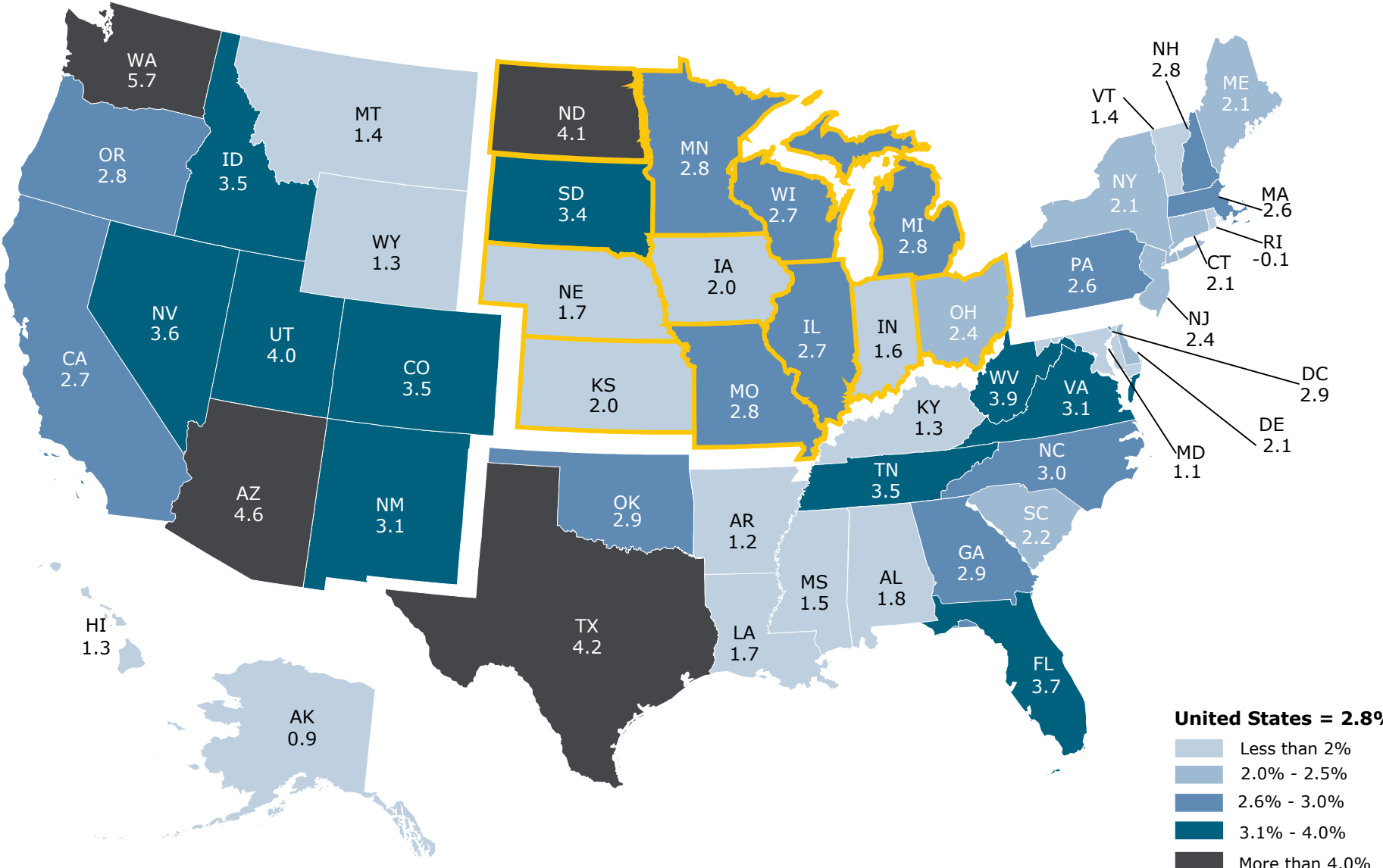
Source: International Monetary Fund and Wells Fargo



# Economic Trends in the Midwest

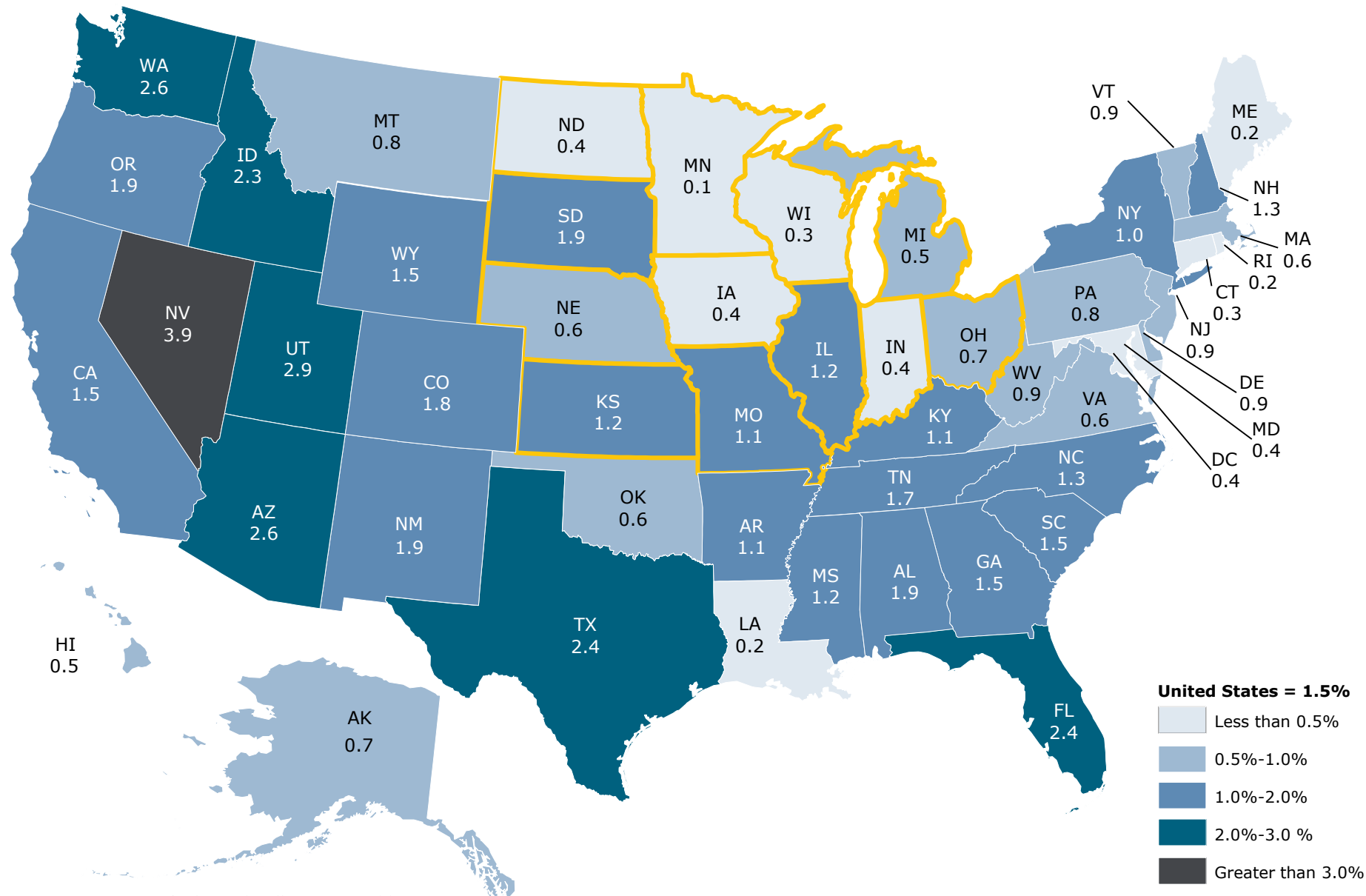
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# Year-over-Year Percent Change in Real GDP by State, Q4-2018



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

# Year-over-Year Employment Growth by State, May 2019



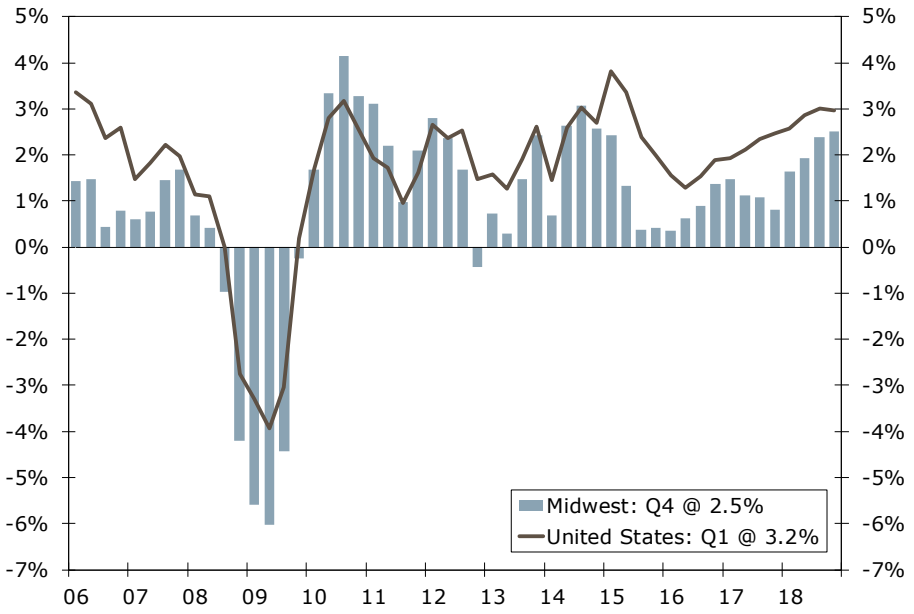
Source: U.S. Department of Labor and Wells Fargo Securities

The Midwest's economy is growing at a solid rate. Real GDP expanded 2.5% over the past year compared to a 3.2% gain nationwide in the fourth quarter. The Dakota's led growth, seeing faster GDP than the national average.

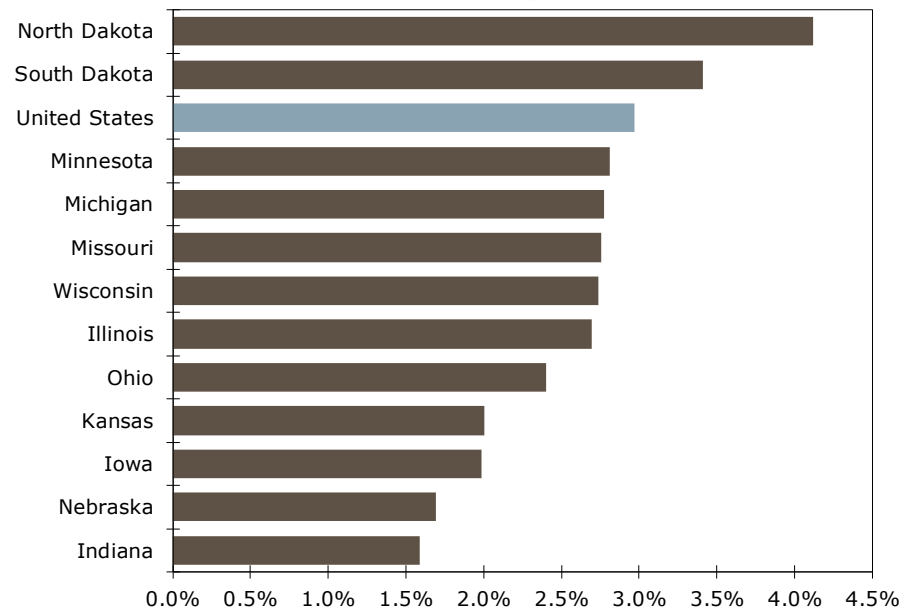
## Midwest

## By State

Gross State Product & U.S. GDP  
Year-over-Year Percent Change

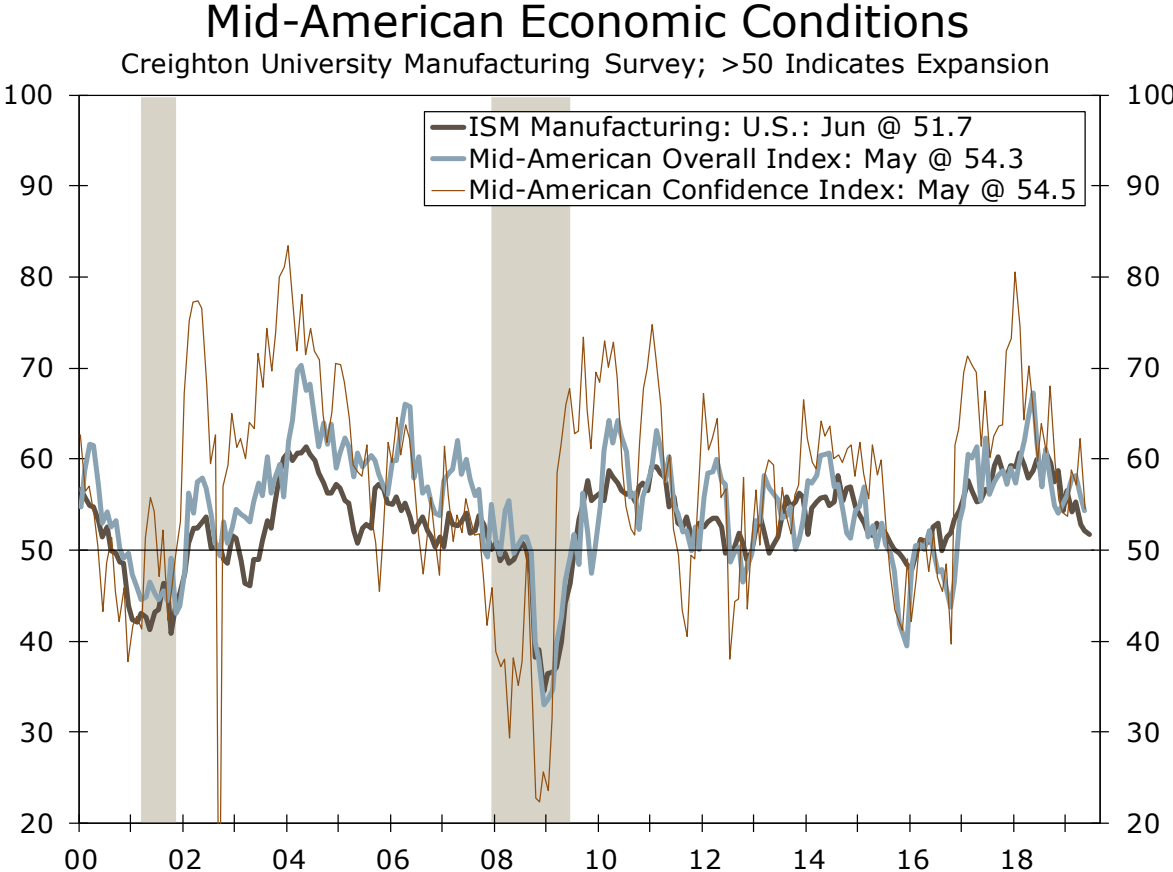


Real GDP by State: Midwest  
Year-over-Year Percent Change, Q4-2018



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

Creighton University's survey of purchasing managers remains above the ISM but has also descended from last year's highs.

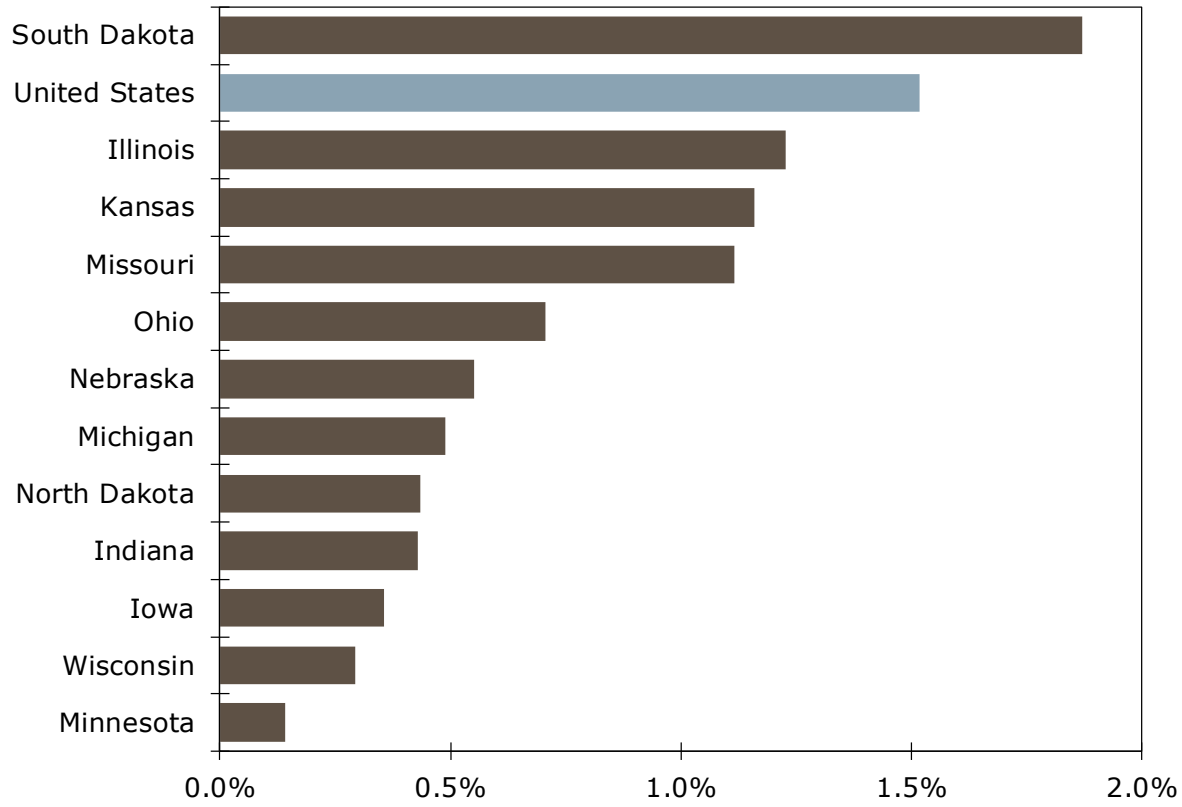


Source: U.S. Department of Labor and Wells Fargo

All states in the Midwest have seen steady employment growth over the past year

## Midwest Employment by State

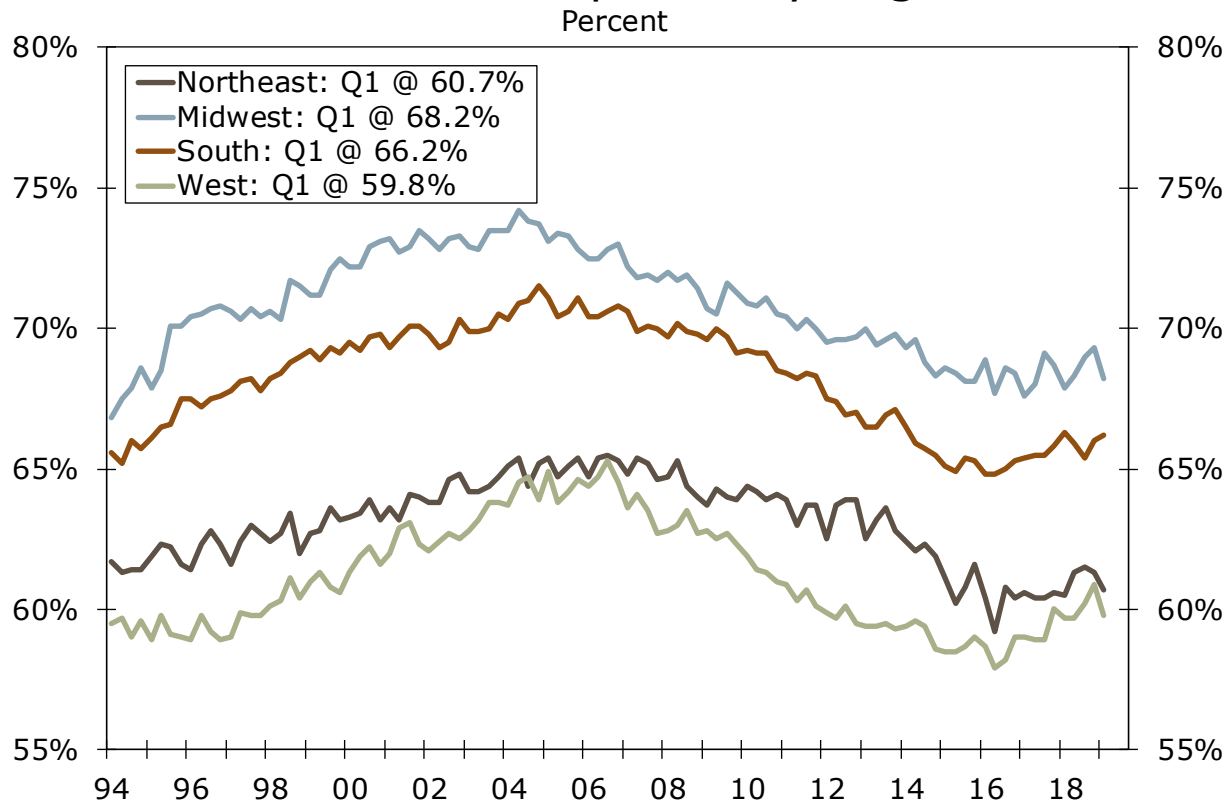
Year-over-Year Percent Change, May 2019



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

Consistent with steady employment, the Midwest has the highest homeownership rate of any region.

## Homeownership Rate by Region



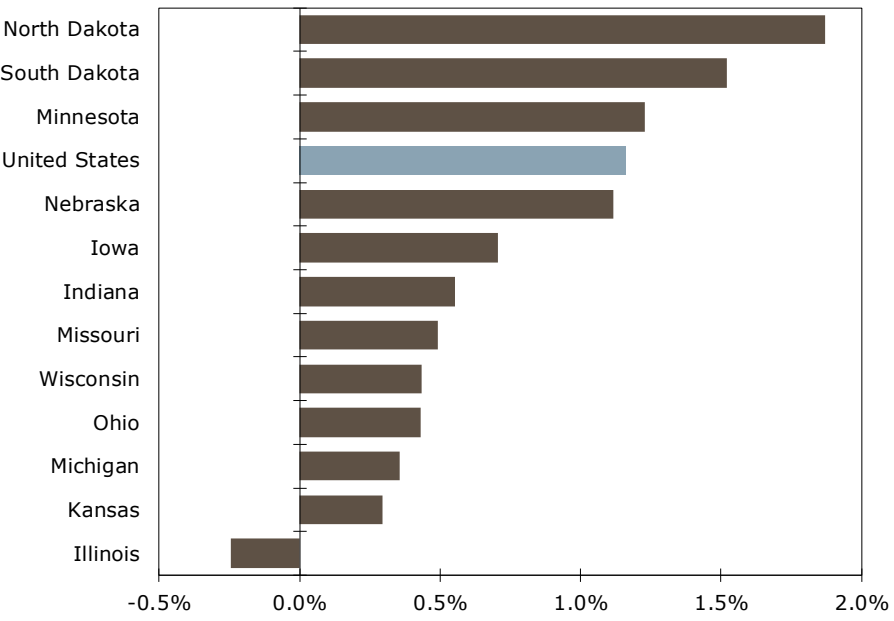
Source: U.S. Department of Labor and Wells Fargo

Steady employment gains have also supported broadly positive population growth in the Midwest. At 62.6%, the Midwest has the highest employed-to-population ratio of any region and is higher than the 60.4% ratio nationwide.

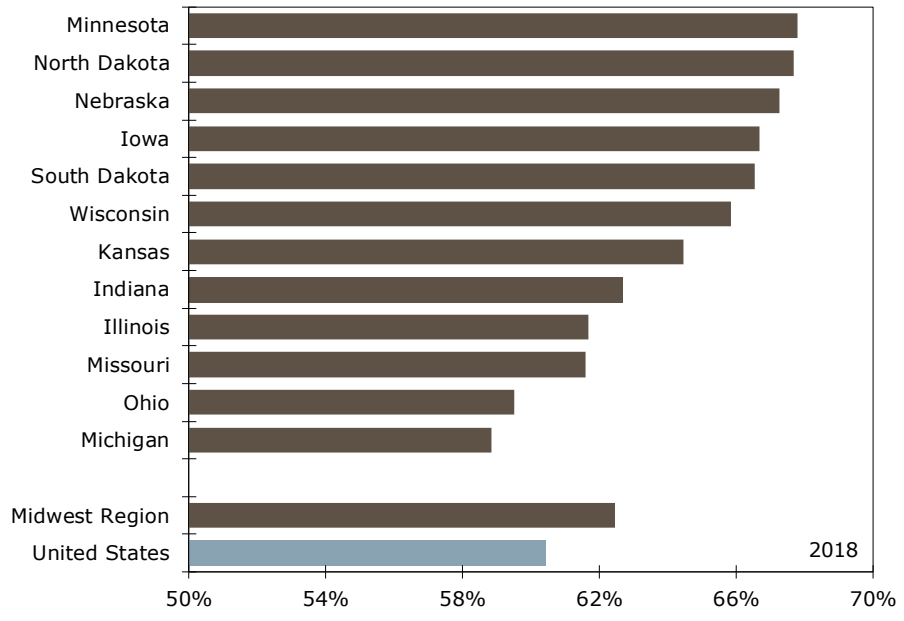
## Population

## Employed-Population Ratio

**Population Growth by State: Midwest**  
Annual Average Percent Change, 2013-2018



**Employed to Population Ratio in the Midwest**  
Total Household Employment as Share of the Civilian Population, SA



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



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