Economic Outlook

Mark Vitner, Managing Director & Senior Economist
January 9, 2020
Economic Outlook

- Real GDP growth has decelerated from a 3% pace last year to around 2% and looks set to slow even further. Most of the slowdown is tied to weakening global growth and its impact on exports, capital spending and inventories.

Policy Environment

- Tax reform continues to bolster take-home pay but trade uncertainty upended capital spending. Capex should slowly grind higher. Fiscal policy remains expansionary. After cutting rates three times, the Fed is likely on pause.

Trade Policy

- An agreement in principle has been reached with China that should result in a lessening of trade tensions that have been weighing on the global economy. The USMCA is another near-term positive that reduces uncertainty.

Households

- Consumers remain optimistic about the economy and their finances. Wages & salaries are rising fastest at the lower end of the pay spectrum, which has boosted spending at discount stores and restaurant chains.

Recession Risk

- Recession concerns have abated significantly as the yield curve has normalized and equity markets have reached new all-time highs. There are few obvious imbalances present in the economy today and growth is broadening.
The current expansion is now the longest on record but has also been the weakest of the post-WWII era in terms of average GDP growth.

Source: U.S. Department of Commerce, National Bureau of Economic Research 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.
Hiring has reportedly picked up but will be revised lower in February. The quality of jobs being added is relatively good. Wage gains remain modest relative to prior periods when the labor market was this tight, but recent evidence suggests wage gains are accelerating for those at the lower end of the income spectrum and among younger workers, giving spending a boost.

Source: U.S. Department of Labor, National Federation of Independent Business and Wells Fargo Securities
After briefly rising above the Fed’s 2% target, core inflation appears to have decelerated once again, amid weakening final demand. Inflation expectations have also fallen over the past few months.

We see the Fed as being opportunistic in this environment, hoping to spur a broader and more durable economic expansion.

Source: U.S. Department of Commerce and Wells Fargo Securities
A rebound in the ISM is likely in store now that more firms believe they have too little inventory than believe they have too much. Orders are likely to surprise to the upside in coming months.
States that voted Republican in 2016 are generally more exposed to manufacturing.

Manufacturers are having a tough time finding workers, however, so the recent trade spat has not yet impacted staffing all that much.

Many firms are reluctant to let any workers go for fear they will not be able to hire them back when demand revives.

Source: Federal Election Commission, U.S. Department of Labor and Wells Fargo Securities
Monthly debt service remains fairly low, but has increased for non-mortgage debt. The rise in non-mortgage debt has almost entirely been driven by student and auto loans.
Overall building has remained relatively subdued this cycle. Much of the activity has been concentrated in several large markets, which may present some risks of a sharp or prolonged pullback in the tech and energy sectors.

Source: U.S. Department of Commerce and Wells Fargo Securities
Apartment development has been fairly strong the past few years, with a disproportionate share of activity devoted to luxury and lifestyle units in a handful of rapidly growing metropolitan areas.

Development is now shifting to more affordable projects in suburban areas and in lower cost parts of the country.

Source: CoStar, Inc. and Wells Fargo Securities
Single-family homebuilding has strengthened in recent months. Still, affordability concerns and development constraints will continue to limit new development.

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
Home price-to-income ratios, particularly in large metros, are rising towards mid-2000 levels.

Source: NAR, U.S. Department of Commerce and Wells Fargo Securities
Year-over-Year Percent Change in Real GDP by State (Q2-2019)

Economic Outlook

Source: U.S. Department of Commerce and Wells Fargo Securities
Employment growth is strongest in the South and West.

Source: U.S. Department of Labor and Wells Fargo Securities
Population Growth by State – 2019

- Greater than 2.0%
- 1.6%-2.0%
- 1.1%-1.5%
- 0.6%-1.0%
- 0.0%-0.5%
- Less than 0.0%

U.S. = 0.5%

States with population growth:
- WA 1.2
- OR 0.9
- NV 1.8
- AZ 1.7
- CA 0.1
- TX 1.3
- SC 1.3
- FL 1.1

States with population decrease:
- HI -0.3
- AK -0.5
- ID 2.1

Population growth ranges:
- Less than 0.0%
- 0.0%-0.5%
- 0.6%-1.0%
- 1.1%-1.5%
- 1.6%-2.0%
- Greater than 2.0%

Raleigh and Charlotte both rank among the top 10 fastest growing large metropolitan areas since 2010.

North Carolina is the only state other than Texas and Florida to have more than one large metro area rank in the top 20.

Charleston, SC would have clearly made the cut if the criteria was reduced to areas with populations between 500,000 to 999,000.

Source: U.S. Department of Commerce and Wells Fargo Securities
Domestic migration is a good proxy for the relative attractiveness of a region’s labor markets. Retiree markets also rank among the leaders in attracting new residents.

Source: U.S. Department of Commerce and Wells Fargo Securities
North Carolina Job Growth

Raleigh recovered from the Great Recession much sooner than the rest of the state.

Areas outside of Raleigh and Charlotte gained momentum this past year and are poised for solid growth in 2020.

Source: U.S. Department of Labor and Wells Fargo Securities
Payrolls are expanding rapidly, led by professional & business services.

Source: U.S. Department of Labor and Wells Fargo Securities
The Tech sector continues to drive the region’s labor market

Source: U.S. Department of Labor and Wells Fargo Securities
Population growth has moderated the past two years, but remains relatively strong.

Source: U.S. Department of Commerce and Wells Fargo Securities
Residential construction remains strong.

Single-family housing permits exceed their long-run average, which is much stronger than what is occurring nationwide.

Source: U.S. Department of Commerce and Wells Fargo Securities
Home price appreciation has not seen the roller coaster ride that some other parts of the country have. Prices did not fall hard during the housing slump and have rebounded less dramatically than they have nationwide.

Home prices in Raleigh and Durham have risen past their previous highs, and affordability has become a bigger issue. Home prices are relatively affordable, however, compared to other rapidly growing technology centers.

Source: CoreLogic, Inc. and Wells Fargo Securities
The apartment vacancy has risen modestly amidst a surge in completions. Demand remains strong, however, fueled by the continued influx of job seekers.

Source: CoStar, Inc. and Wells Fargo Securities
Overall, vacancy rates remain low from a historical perspective.

Source: CoStar, Inc. and Wells Fargo Securities
Rent growth remains solid.

Raleigh CRE Asking Rents

Year-Over-Year Percent Change

- Apartment: Q3 @ 4.7%
- Office: Q3 @ 5.5%
- Retail: Q3 @ 6.7%
- Industrial: Q3 @ 5.0%

Source: CoStar, Inc. and Wells Fargo Securities
### U.S. Economic Forecast

#### Forecast as of: December 18, 2019

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#### Wells Fargo U.S. Economic Forecast

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#### Economic Outlook

**Actual**

- Real Gross Domestic Product: 2.6, 3.5, 2.9, 1.1
- Personal Consumption: 1.7, 4.0, 3.5, 1.4
- Business Fixed Investment: 8.8, 7.9, 2.1, 4.8
- Equipment: 6.6, 3.4, 2.9, 7.4
- Intellectual Property Products: 9.7, 11.9, 4.1, 11.7
- Structures: 12.1, 11.0, -2.1, -9.0
- Residential Investment: -5.3, -2.7, -4.0, -4.7
- Government Purchases: 1.9, 2.6, 2.1, -0.4
- Net Exports: 0.0, 0.7, -2.1, -0.4
- Inventories: 0.1, -1.2, 2.1, 0.1
- Nonfarm Payroll Change: 228, 243, 189, 233
- Unemployment Rate: 4.1, 3.9, 3.8, 3.8
- Consumer Price Index: 4, 2.2, 2.7, 6.2

**Forecast**

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**Quarter-End Interest Rates**

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- Conventional Mortgage Rate: 4.44, 4.57, 4.63, 4.64
- 2 Year Note: 2.27, 2.52, 2.81, 2.48
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**Forecast as of: December 18, 2019**

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Source: IHS Global Insight and Wells Fargo Securities
## A Sampling of Our Recent Special, Regional & Industry Commentary

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