# FINANCIAL SYMPOSIUM

October 1 & 2, 2019

CIA @ Copia, Napa



# **Economic Outlook**

Mark Vitner, Managing Director & Senior Economist October 02, 2019

Together we'll go far



# **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 and capital spending.

# Fiscal Policy

■ The short-term boost from tax reform is fading, which is taking some of the oomph out of consumer spending. Government spending has ramped up, however, and should grow solidly through the 2020 election.

# **Monetary Policy**

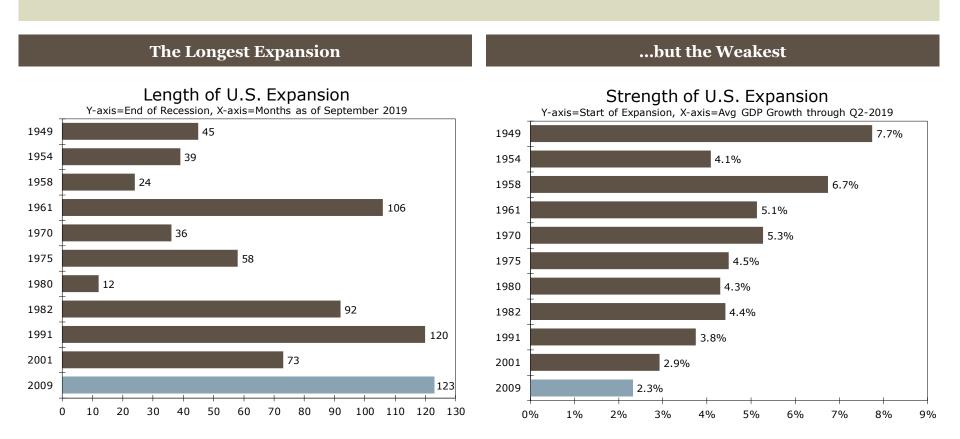
• The Fed appears to be set on reducing short-term interest rates at least a couple more times and may soon look to grow its balance sheet. The resistance by some regional Fed presidents is well within historic norms.

# **Trade Policy**

Views about the prospects for a trade deal with China appear to be too pessimistic. While a deal will take time, the framework to a deal might be revealed much sooner. Without a deal, the global economy will languish.

### Consumer

Consumers appear to be in fairly solid shape. Income growth is rising and the saving rate remains elevated for this point in the business cycle. The current expansion is now the longest on record, but has also been the weakest of the post-WWII era.



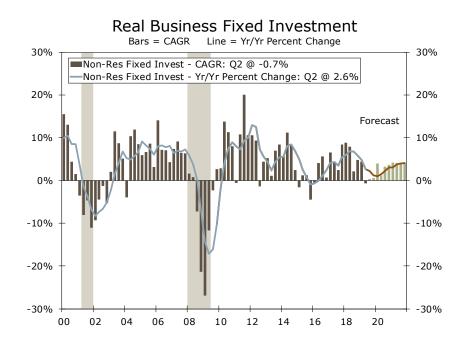
 $Source: U.S.\ Department\ of\ Commerce,\ National\ Bureau\ of\ Economic\ Research\ and\ Wells\ Fargo\ Securities$ 

Our forecast calls for real GDP growth to slow to less than a 2% pace in 5 of the next 6 quarters. Much of the slowdown is due to a widening in the trade deficit and a further deceleration in business fixed investment. Inventory swings tied to Boeing's 737 MAX shipments will also influence the quarterly data. Consumer spending and homebuilding should prove resilient.

### **Real GDP**

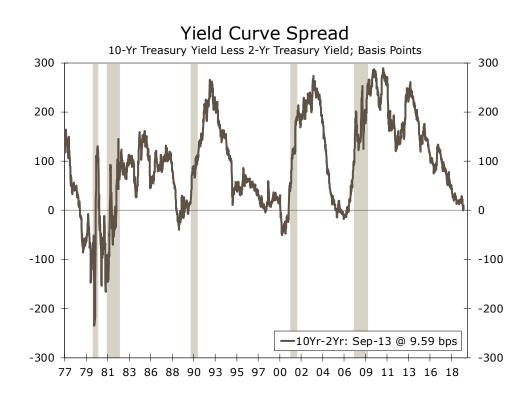
### U.S. Real GDP Bars = CAGRLine = Yr/Yr Percent Change 10% 10% ■GDP - CAGR: Q2 @ 2.0% —GDP - Yr/Yr Percent Change: Q2 @ 2.3% 8% 6% 6% Forecast 4% 4% 2% 2% 0% 0% -2% -2% -4% -4% -6% -6% -8% -8% -10% -10% 00 02 04 06 80 10 12 18 20 14 16

### **Business Investment**



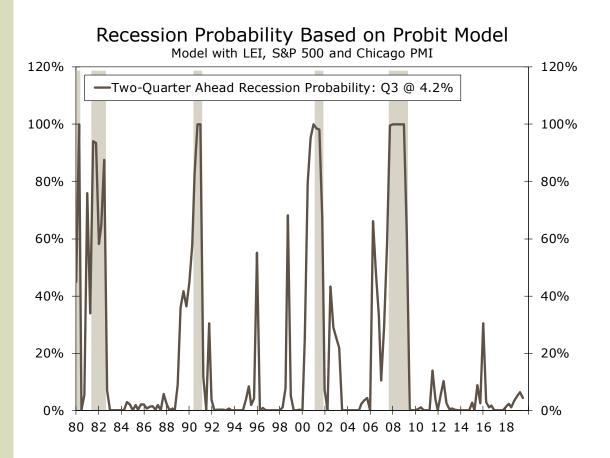
This marks the 10<sup>th</sup> time the curve has inverted in the past 50 years. A recession began within 2 years following 7 of the previous 9 inversions. The 2 exceptions were the mid 1960s and mid to late 1990s.

The current period looks similar to that of the late 1990s, when a slowdown in developing economies raised recession fears and even contributed to a liquidity squeeze.



Source: Bloomberg LP and Wells Fargo Securities

The probability of a recession over the next six months remains low according to our econometric models.



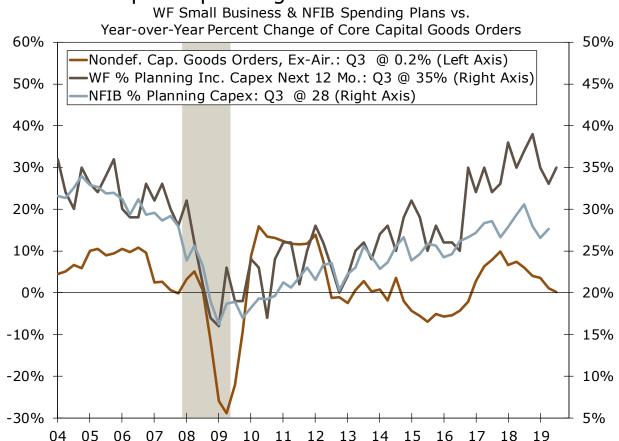
Source: Wells Fargo Securities

### **Investment Plans**

Small business capital spending plans have help up better than overall capex.

About the same share of businesses plan to increase capex spending in the coming year that increased spending this past year.

# Capital Spending Plans vs. Investment



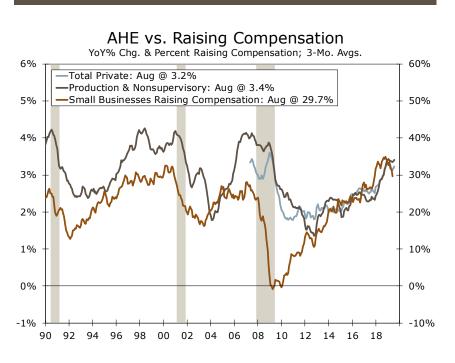
Source: Wells Fargo Bank, Gallup, NFIB, U.S. Department of Commerce and Wells Fargo Securities

Hiring has moderated over the past few months. Wage gains have rebounded but remain modest relative to prior periods when the labor market was this tight.

### **Nonfarm Employment**

### U.S. Nonfarm Employment Change Change in Employment, In Thousands Monthly Change: Aug @ 130K -12-Month Average Change: Aug @ 173K

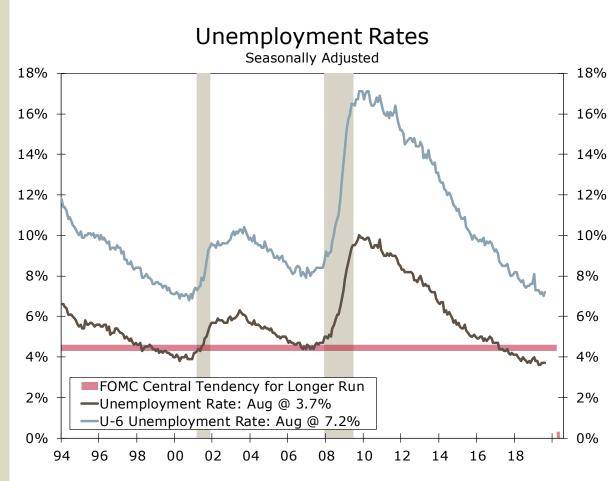
### Wages



 $Source: U.S.\ Department\ of\ Labor,\ National\ Federation\ of\ Independent\ Business\ and\ Wells\ Fargo\ Securities$ 

The labor market has tightened substantially, with the unemployment rate at 3.7%.

While the criteria for determining the unemployment rate have not changed, growth in the Gig economy, particularly ride sharing and the proliferation of online job search platforms, like Indeed and LinkedIn, have likely changed the way workers engage in the labor market. As a result, the economy can maintain relatively low inflation even with historically low unemployment.

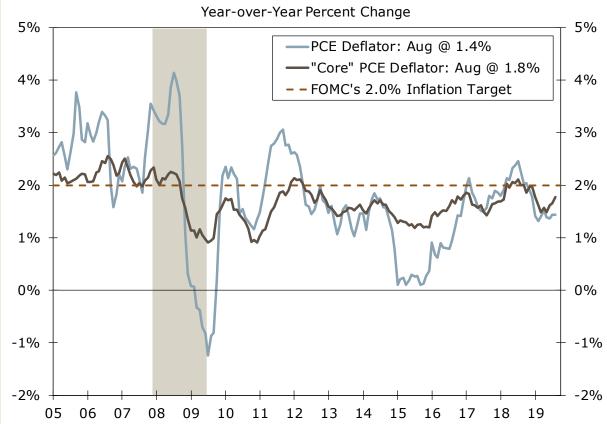


Source: U.S. Department of Labor and Wells Fargo Securities

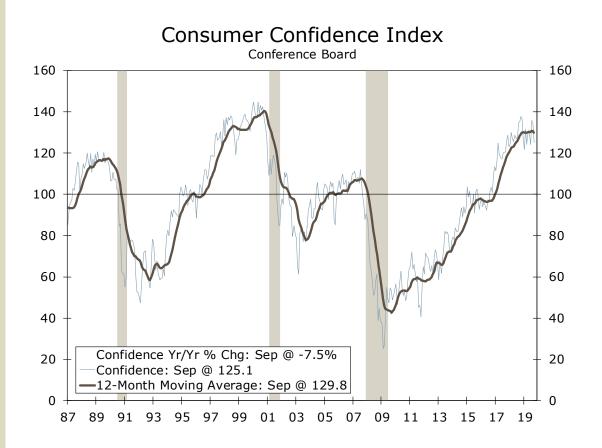
After briefly rising above the Fed's 2% target, core inflation appears to have decelerated once again, amid weakening final demand. Inflation expectations have also fallen over the past few months.

The deceleration in inflation and inflation expectations was cited by the Fed as one of the primary reasons the Fed has adopted a more accommodative stance.

# PCE Deflator vs. Core PCE Deflator

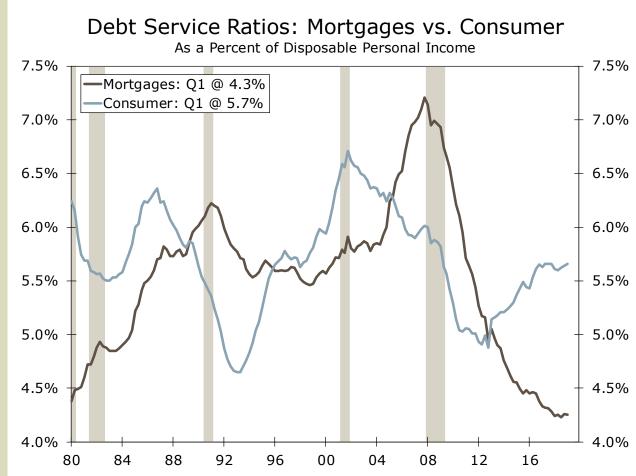


The Conference Board's survey closely tracks labor market conditions, which are the strongest they have been in decades.



Source: Conference Board 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.



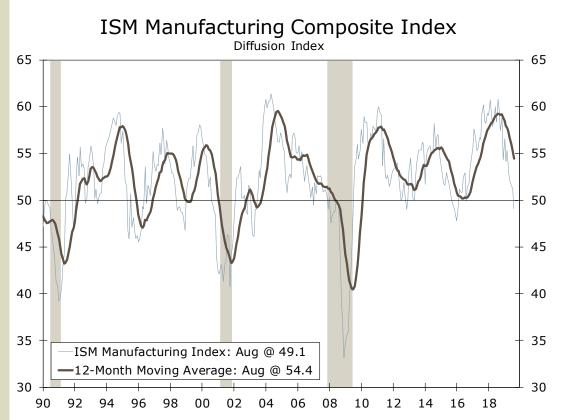
Source: Federal Reserve Board and Wells Fargo Securities

Household balance sheets remain strong, and the financial obligations ratio is low.

### Household Financial Obligations Ratio Percent of Disposable Personal Income 18.5% 18.5% —Total FOR: Q1 @ 15.4% 18.0% 18.0% 17.5% + 17.5% 17.0% 17.0% 16.5% 16.5% 16.0% 16.0% 15.5% 15.5% 15.0% 15.0% 14.5% 14.5% 80 84 88 92 96 00 04 08 12 16

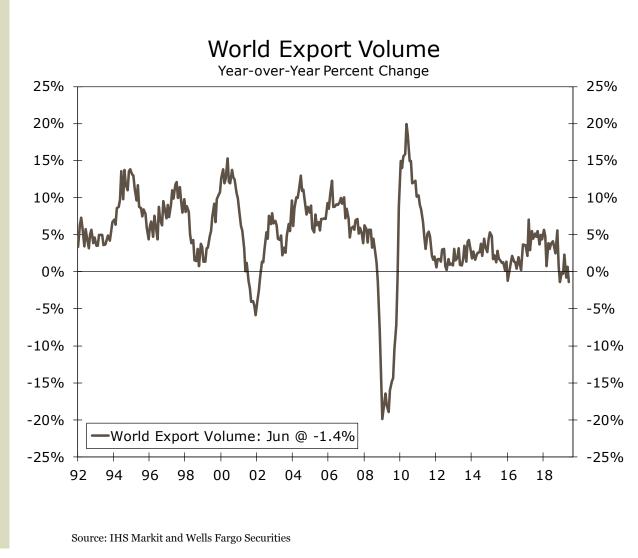
Source: Federal Reserve Board and Wells Fargo Securities

Manufacturing activity has weakened over the past year and is near levels that have prompted the Fed to become much more accommodative in the past.



Source: Institute for Supply Management and Wells Fargo Securities

Trade tensions have escalated, and uncertainties have increased, weighing on economies—manufacturing in particular.



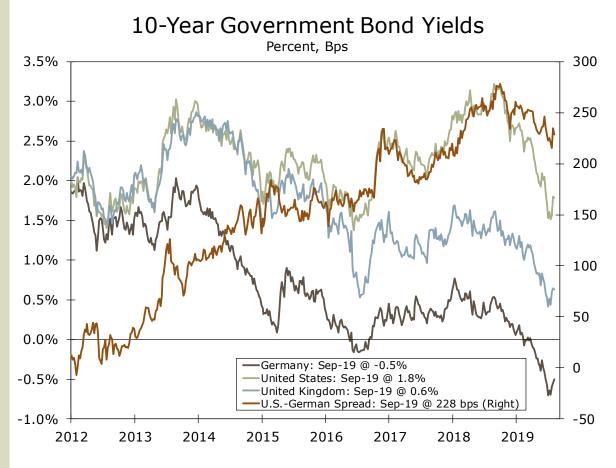
American exports to China are equivalent to roughly ½ percent of U.S. GDP.

# U.S. Goods Exports to China



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

Global interest rates continue to plunge. Over \$15 trillion of debt worldwide now has a negative yield, which has increased demand for U.S. bonds.



Source: Bloomberg LP 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.

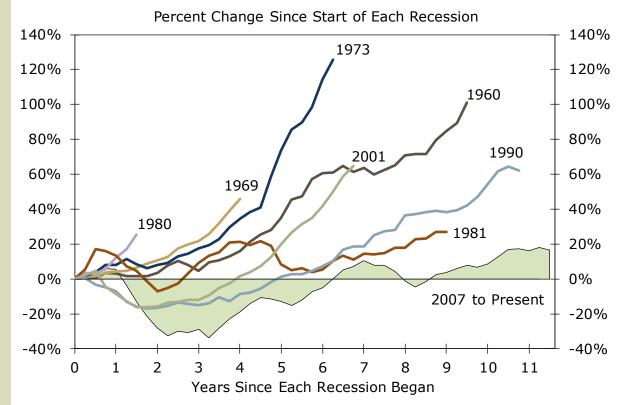
We have seen less of a boom in the most cyclical parts of the economy during this cycle, which may push a correction further out and ultimately make that correction less severe.

### Cyclical Components vs. Rest of GDP Year-over-Year Change of 4-Qtr Moving Average of Real GDP 15% 15% Cyclical defined as residential investment, structures, equipment and consumer spending on durables 10% 10% 5% 5% 0% 0% -5% -5% -10% -10% -15% -15% ■ Cyclical Components Remainder of GDP -20% -20% 05 06 08 09 10 11 12 13 15 07 14 16 17 18

Overall building has remained relatively subdued this cycle.

Much of the activity has been concentrated in several large markets, which may present some risks to a sharp or prolonged pullback in the tech and energy sectors.

## Nonresidential Structures Investment



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 costs parts of the country.

# Apartment Supply & Demand Percent, Thousands of Units 8.5% 180 Apartment Net Completions: Q2 @ 81.5K (Right Axis) Apartment Net Absorption: Q2 @ 112.5K (Right Axis) Apartment Vacancy Rate: Q2 @ 5.7% (Left Axis) 8.0% 150 7.5% 120 7.0% 90 6.5% 60 6.0% 30

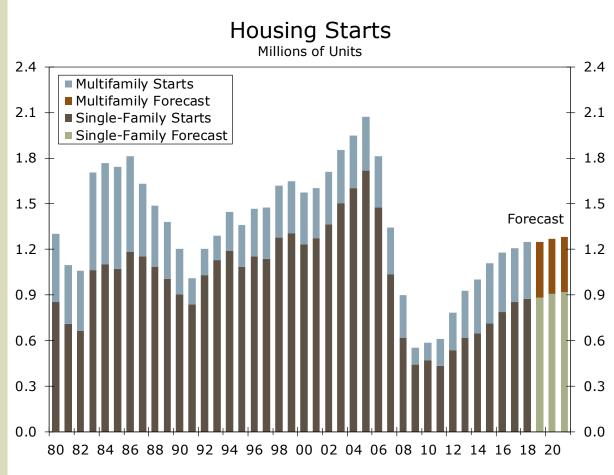
02 03 04 05 06 07 08 09 10 11 12 13 14 15 16

Source: CoStar, Inc. and Wells Fargo Securities

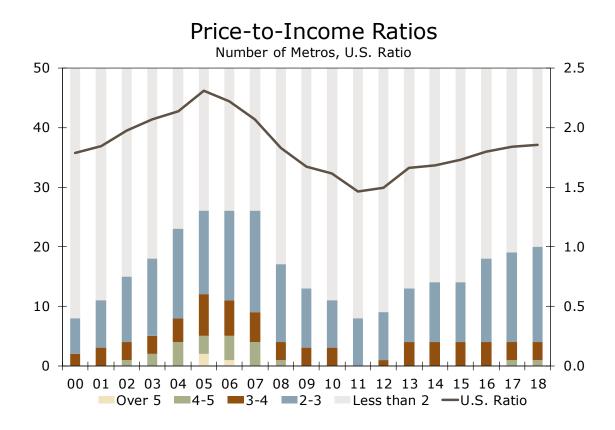
5.5%

Affordability constraints will continue to keep a low ceiling on home sales and new home construction.

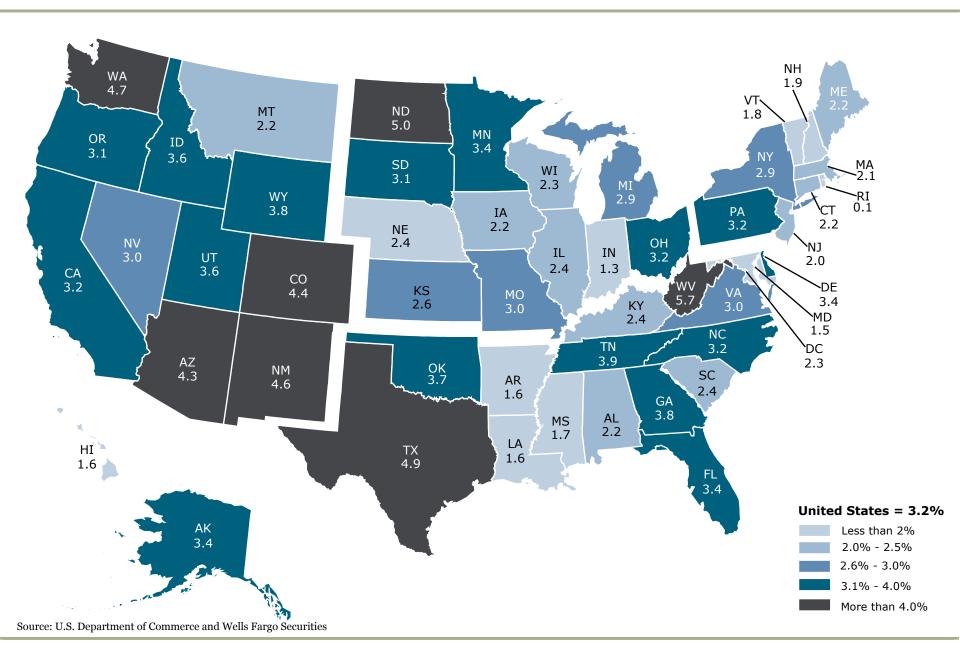
Overall homebuilding is still lagging household formation and there are too few homes available in markets where population and employment are growing rapidly. Apartment construction is pivoting toward more affordable units.



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



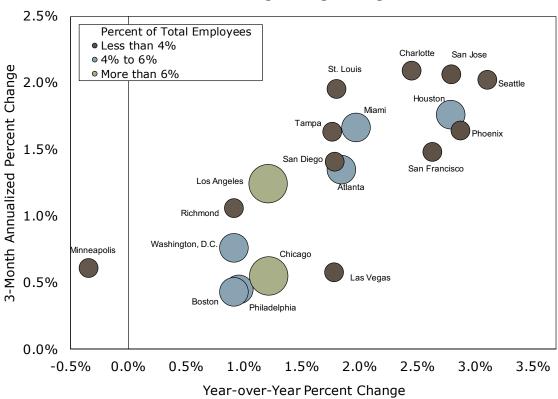
# Year-over-Year Percent Change in Real GDP by State (Q1-2019)



Employment growth is strongest in the South and West.

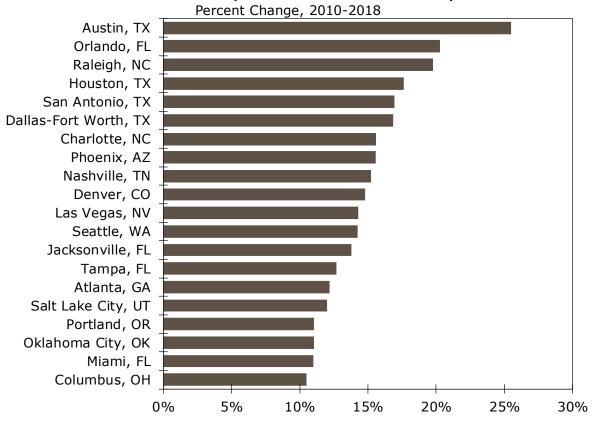
# U.S. Employment Growth by MSA

3-Month Moving Averages, August 2019



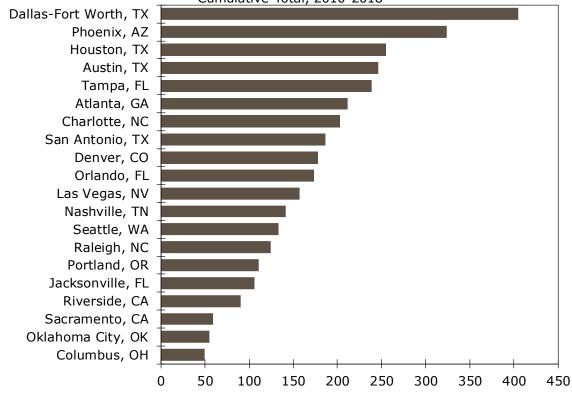
Affordability has been a major driver of migration flows.

# Metro Area Population Growth: Top 20



We view net domestic migration as a proxy for the relative attractiveness of a region to jobseekers.

# Net Domestic Migration Cumulative Total, 2010-2018 Dallas-Fort Worth TX

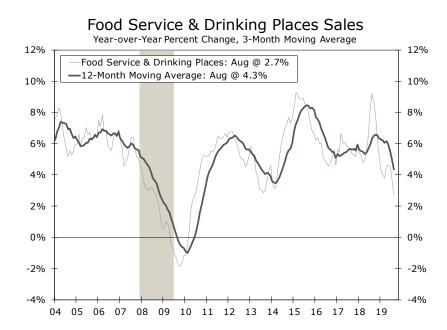


The share of total spending for food & drink away from home continues to climb. However sales at food & drinking places have begun to moderate.

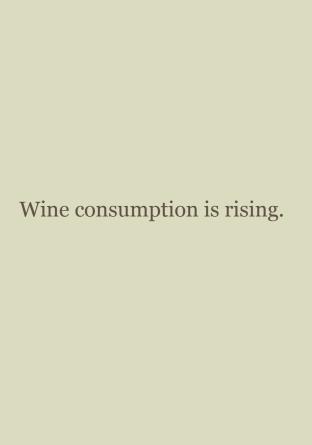
### **Consumer Spending: Secular Change**

### Food Dollars Spent at Home Share of Total Food Spending 100% 100% 80% 80% 60% 60% 40% 40% 20% 20% Food Dollars Spent At Home: Jul @ 54.3% Food Dollars Spent Away From Home: Jul @ 45.7% 0% 65 60 70 85 90 05 10 15

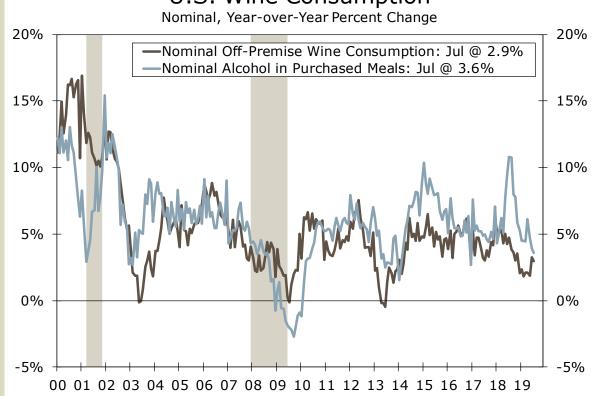
### **Food Service & Drinking Places Sales**



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

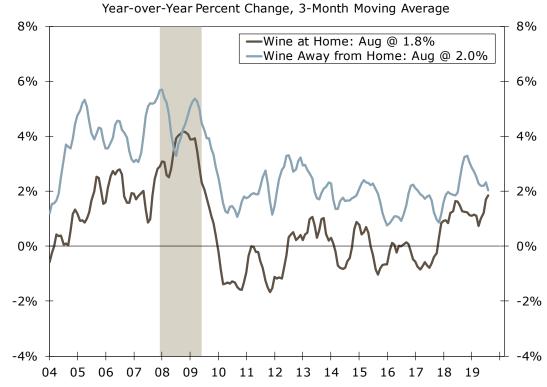


# U.S. Wine Consumption

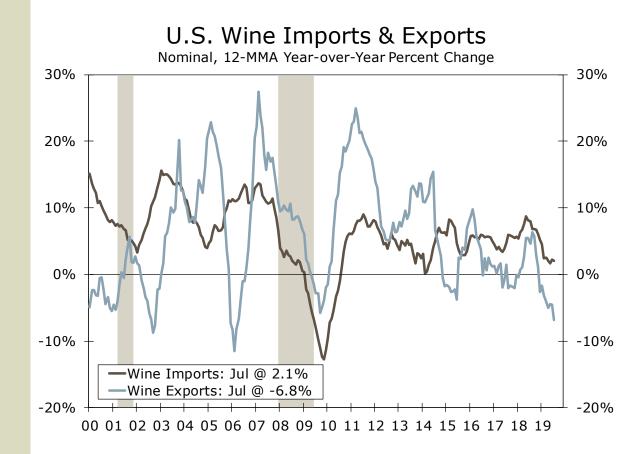


Prices are rising faster for wine away from home

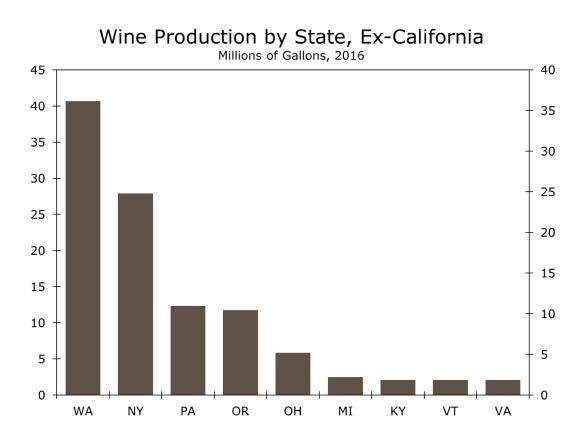
# U.S. CPI: Wine Away from Home & Wine at Home



Wine exports are outright falling.

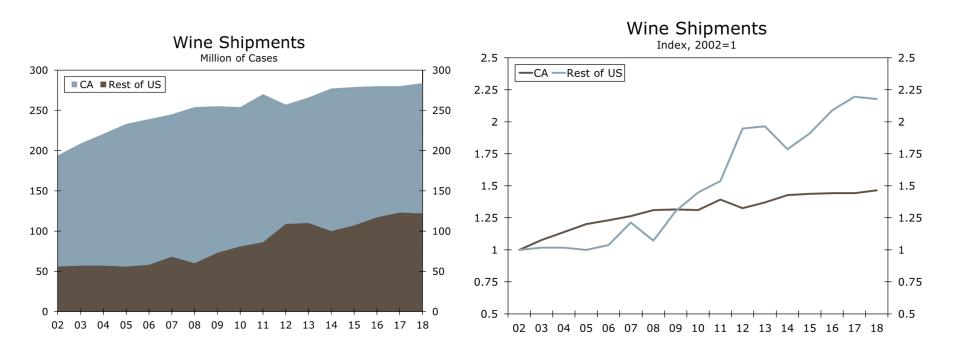


California produces more than 15x as much wine as any other state.



Source: Alcohol and Tobacco Tax and Trade Bureau and Wells Fargo Securities

# Non-California producers have gained market share.



Source: Wine Institute and Wells Fargo Securities

# U.S. Economic Forecast

						Wel	ls Farg	o U.S. E	conom	ic Fore	ecast									
			Actual Forecast							Actual		Forecas	t							
		2018			2019			2020				2021				2018	2019	2020	2021	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Real Gross Domestic Product <sup>1</sup>	2.6	3.5	2.9	1.1	3.1	2.0	1.6	1.5	1.6	2.2	1.9	1.8	2.0	2.1	2.3	2.3	2.9	2.2	1.8	2.0
Personal Consumption	1.7	4.0	3.5	1.4	1.1	4.7	2.9	1.7	2.0	2.0	1.9	1.9	1.8	2.1	2.2	2.2	3.0	2.6	2.2	1.9
Business Fixed Investment	8.8	7.9	2.1	4.8	4.4	-0.6	0.4	0.6	3.9	1.2	3.3	3.7	4.2	4.1	4.0	4.0	6.4	2.7	2.0	3.7
Equipment	6.6	3.4	2.9	7.4	-0.1	0.7	-3.5	-2.7	3.4	-2.2	1.2	2.0	3.4	3.4	3.2	3.0	6.8	1.4	-0.2	2.5
Intellectual Property Products	9.7	11.9	4.1	11.7	10.8	3.7	5.6	5.0	5.4	4.7	6.2	6.5	6.4	6.2	6.1	6.2	7.4	7.8	5.3	6.2
Structures	12.1	11.0	-2.1	-9.0	4.0	-9.4	-3.0	0.5	2.5	3.0	2.5	2.2	1.8	1.9	2.0	2.1	4.1	-2.6	0.7	2.1
Residential Construction	-5.3	-3.7	-4.0	-4.7	-1.0	-2.9	1.5	2.0	2.0	1.5	1.5	1.5	1.0	1.0	1.0	1.0	-1.5	-2.1	1.4	1.2
Government Purchases	1.9	2.6	2.1	-0.4	2.9	4.5	0.8	1.2	1.0	1.0	0.9	0.8	0.8	0.8	0.7	0.7	1.7	2.1	1.2	0.9
Net Exports <sup>2</sup>	0.0	0.7	-2.1	-0.4	0.7	-0.7	-0.1	-0.1	0.3	-0.2	-0.2	-0.4	-0.2	-0.1	0.0	0.0	-0.4	-0.3	-0.1	-0.2
Inventories <sup>2</sup>	0.1	-1.2	2.1	0.1	0.5	-0.9	-0.3	0.1	-0.9	0.5	0.1	0.1	0.2	0.0	0.0	0.0	0.1	0.1	-0.2	0.1
Nonfarm Payroll Change <sup>3</sup>	228	243	189	233	174	152	145	130	170	395	-115	0	100	105	110	110	223	150	113	106
Unemployment Rate	4.1	3.9	3.8	3.8	3.9	3.6	3.7	3.6	3.6	3.5	3.6	3.7	3.7	3.7	3.7	3.7	3.9	3.7	3.6	3.7
Consumer Price Index 4	2.2	2.7	2.6	2.2	1.6	1.8	1.8	2.0	2.4	2.2	2.2	2.3	2.2	2.2	2.2	2.1	2.4	1.8	2.3	2.2
Quarter-End Interest Rates <sup>5</sup>																				
Federal Funds Target Rate	1.75	2.00	2.25	2.50	2.50	2.50	2.00	1.75	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.96	2.19	1.50	1.50
Conventional Mortgage Rate	4.44	4.57	4.63	4.64	4.28	3.80	3.25	3.35	3.40	3.50	3.60	3.70	3.75	3.85	3.90	3.95	4.54	3.67	3.55	3.86
2 Year Note	2.27	2.52	2.81	2.48	2.27	1.75	1.55	1.60	1.60	1.65	1.65	1.70	1.75	1.75	1.80	1.80	2.53	1.79	1.65	1.78
10 Year Note	2.74	2.85	3.05	2.69	2.41	2.00	1.60	1.70	1.75	1.85	1.95	2.05	2.10	2.20	2.25	2.30	2.91	1.93	1.90	2.21

Forecast as of: September 11, 2019

Source: IHS Global Insight and Wells Fargo Securities

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

<sup>&</sup>lt;sup>4</sup> Year-over-Year Percentage Change

<sup>&</sup>lt;sup>2</sup> Percentage Point Contribution to GDP <sup>5</sup> Annual Numbers Represent Averages

<sup>&</sup>lt;sup>3</sup> Average Monthly Change

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## Wells Fargo Securities Economics Group

### **Economists & Macro Strategists**

Jay H. Bryson, Acting Chief Economist
Mark Vitner, Senior Economist
Sam Bullard, Senior Economist
Nick Bennenbroek, Macro Strategist
Tim Quinlan, Senior Economist
Azhar Iqbal, Econometrician
Sarah House, Senior Economist
Charlie Dougherty, Economist
Erik Nelson, Macro Strategist
Michael Pugliese, Economist
Brendan McKenna, Macro Strategist

jay.bryson@wellsfargo.com
mark.vitner@wellsfargo.com
sam.bullard@wellsfargo.com
nicholas.bennenbroek@wellsfargo.com
tim.quinlan@wellsfargo.com
azhar.iqbal@wellsfargo.com
sarah.house@wellsfargo.com
charles.dougherty@wellsfargo.com
erik.f.nelson@wellsfargo.com
michael.d.pugliese@wellsfargo.com
brendan.mckenna@wellsfargo.com

### **Economic Analysts**

Shannon Seery, Economic Analyst Matthew Honnold, Economic Analyst Jen Licis, Economic Analyst Hop Mathews, Economic Analyst shannon.seery@wellsfargo.com matthew.honnold@wellsfargo.com jennifer.licis@wellsfargo.com hop.mathews@wellsfargo.com

### **Administrative Assistants**

Coren Burton, Administrative Assistant <u>coren.burton@wellsfargo.com</u>

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