WINE INDUSTRY Financial SYMPOSIUM

October 1 & 2, 2019

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Economic Outlook

Mark Vitner, Managing Director & Senior Economist

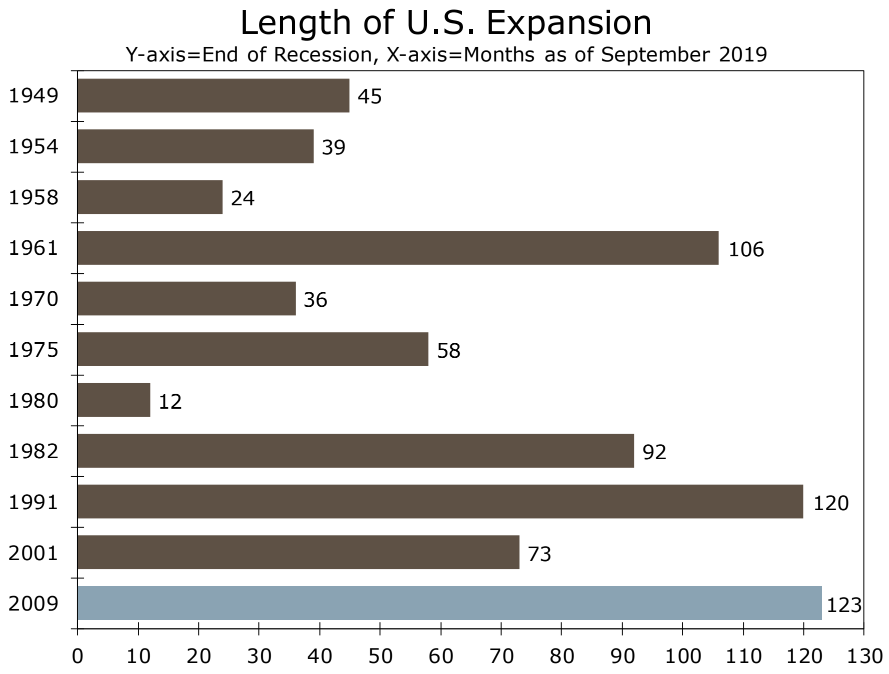
October 02, 2019

Together we'll go far

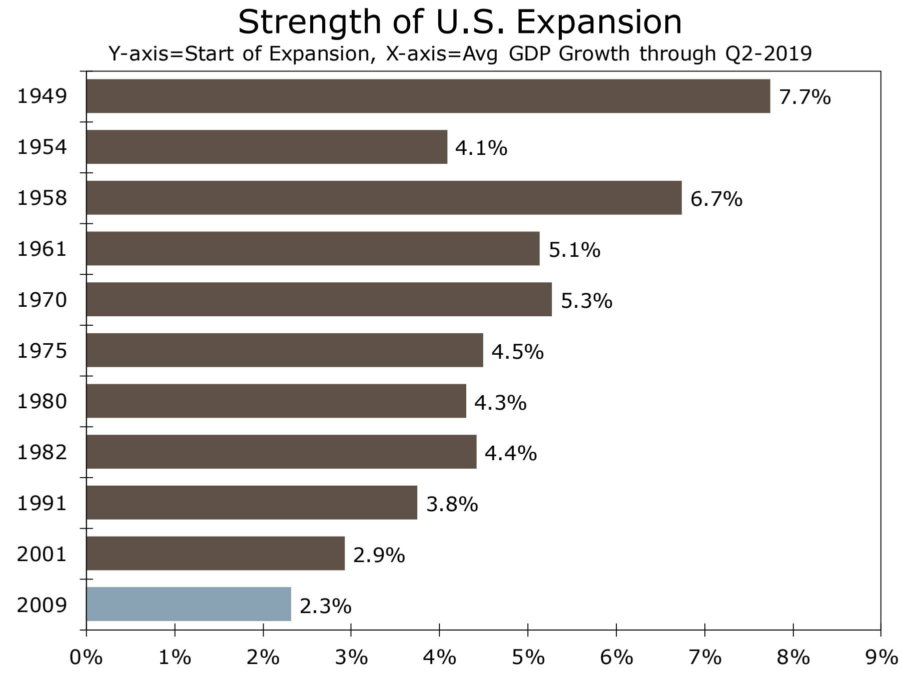
Economic Outlook	▪ Real GDP growth has decelerated from a 3% pace last year to around 2% and looks set to slow even further. Most of the slowdown is tied to weakening global growth and its impact on exports and capital spending.
Fiscal Policy	▪ The short-term boost from tax reform is fading, which is 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.

The Longest Expansion



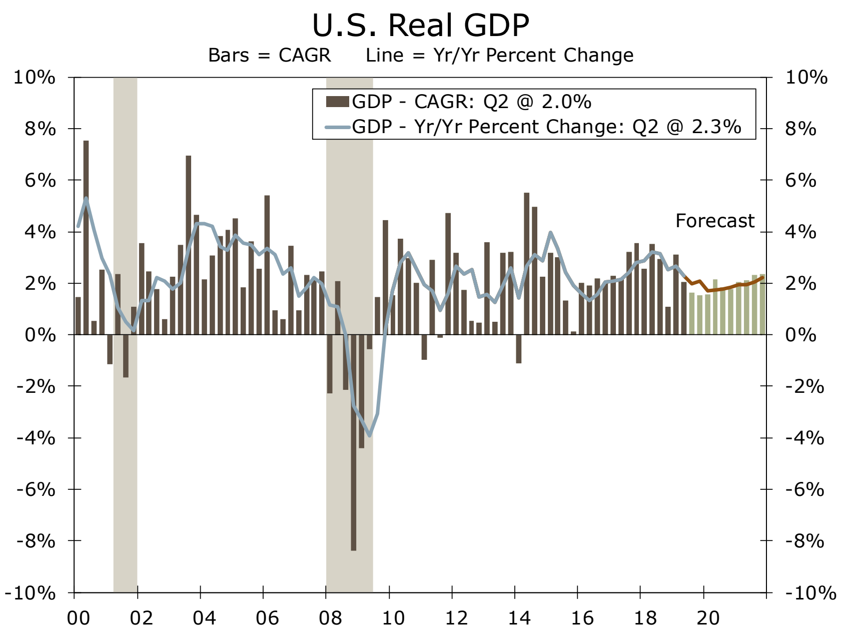
...but the Weakest



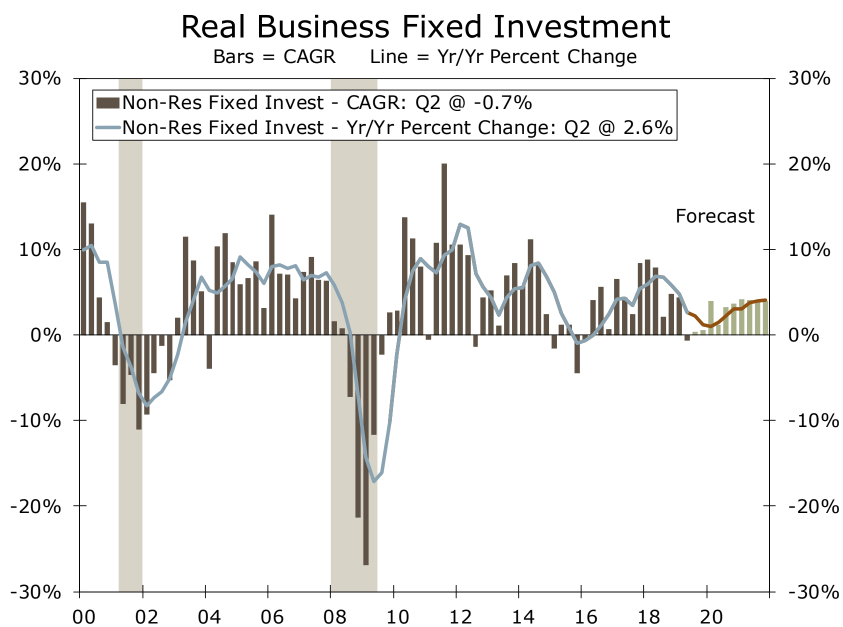
Source: U.S. Department of Commerce, National Bureau of Economic Research and Wells Fargo Securities

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



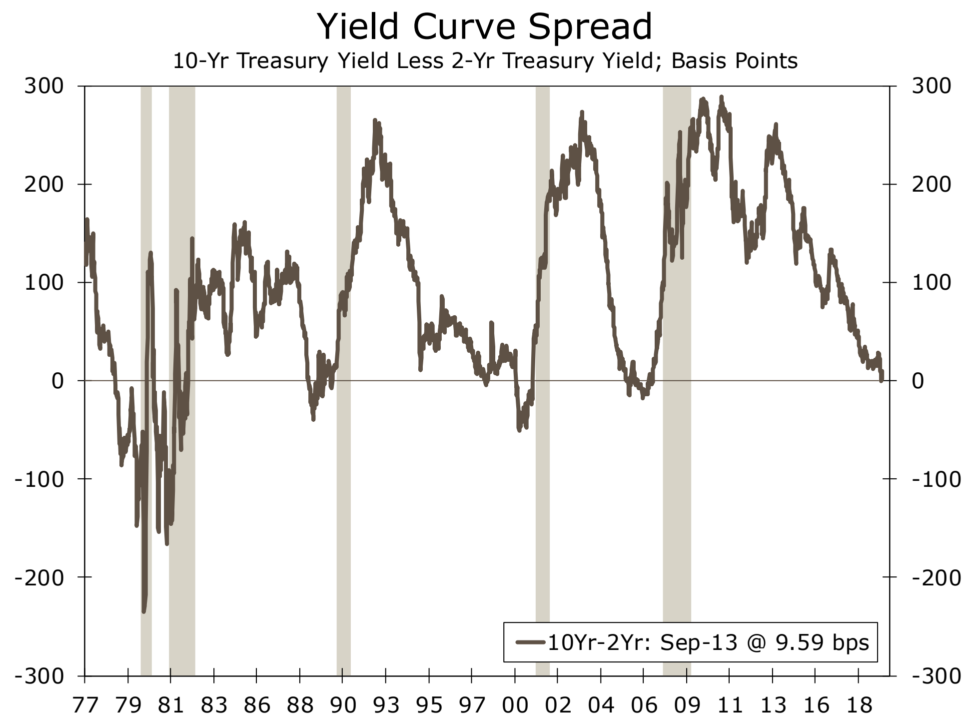
Business Investment



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

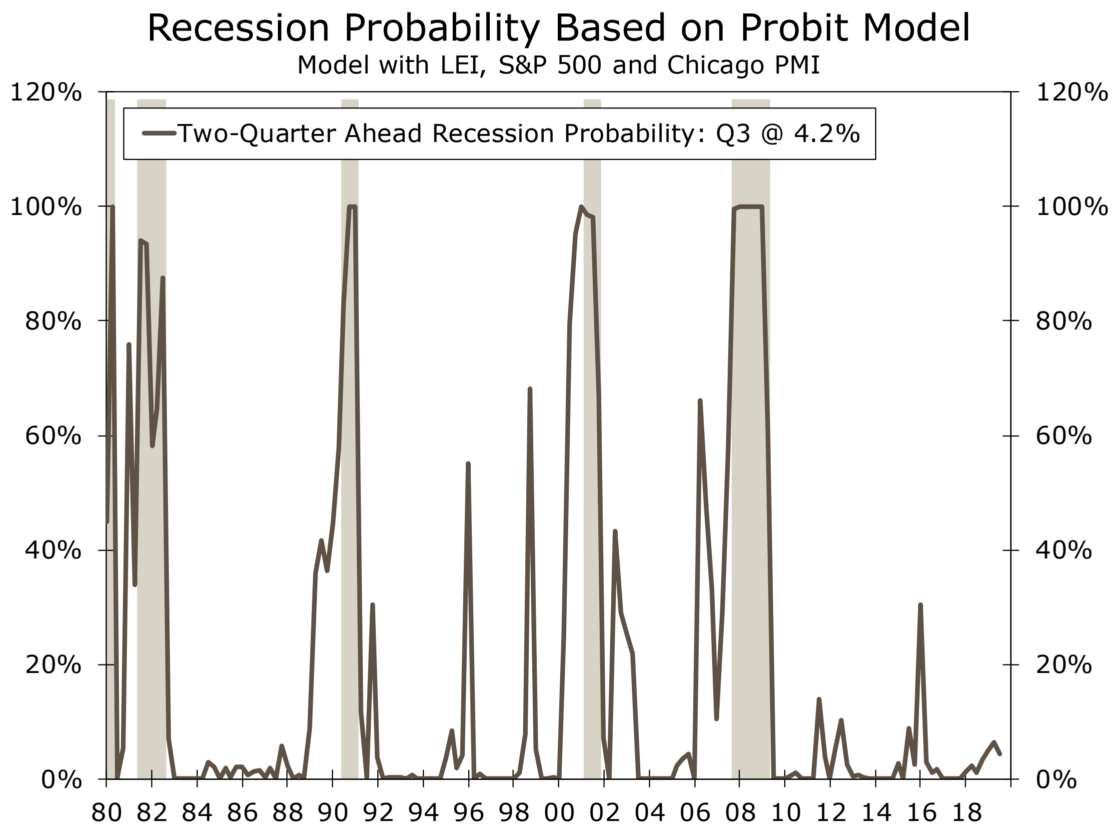
This marks the 10th time the curve has inverted in the past 50 years. A recession began within 2 years following 7 of the previous 9 inversions. The 2 exceptions were the mid 1960s and mid to late 1990s.

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

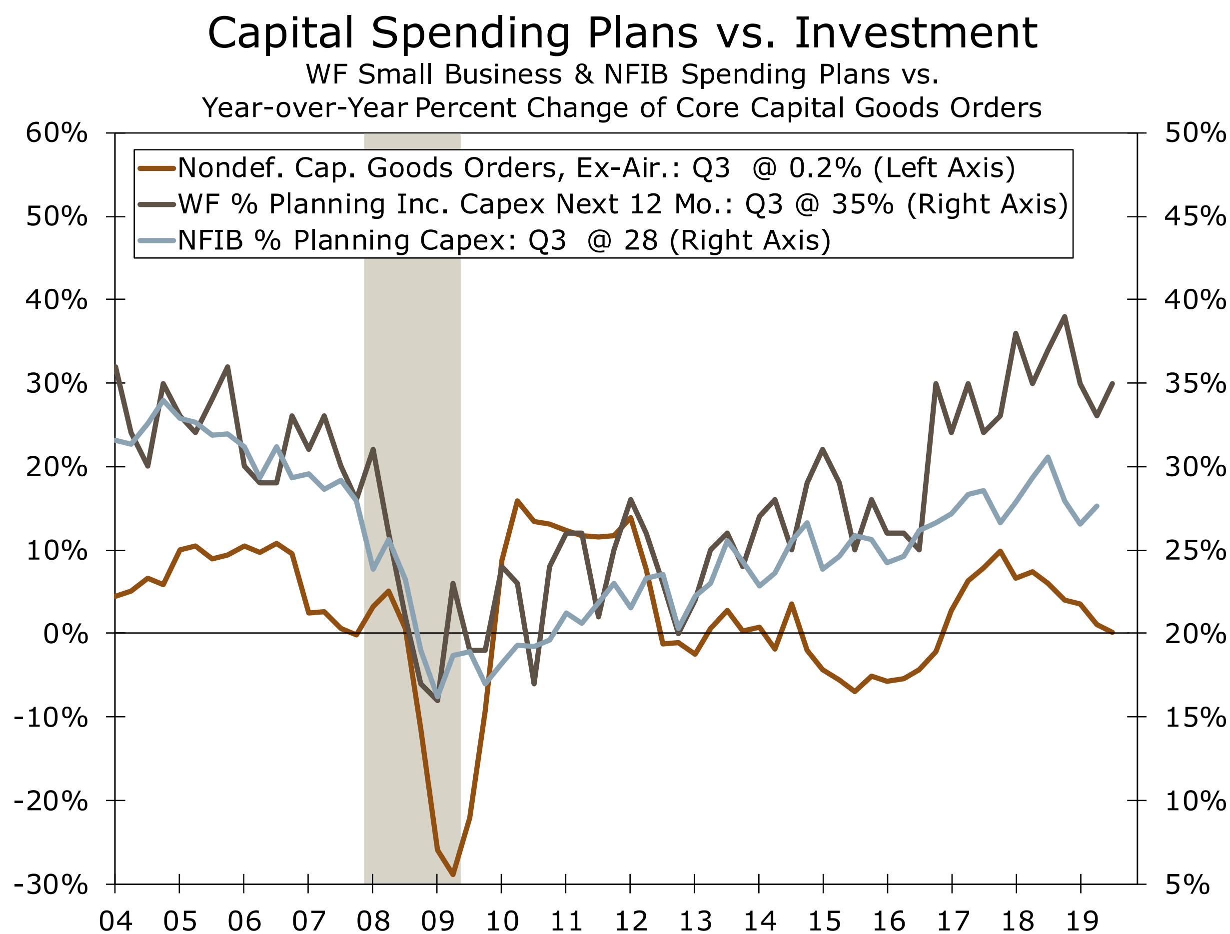
The probability of a recession over the next six months remains low according to our econometric models.



Source: Wells Fargo Securities

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

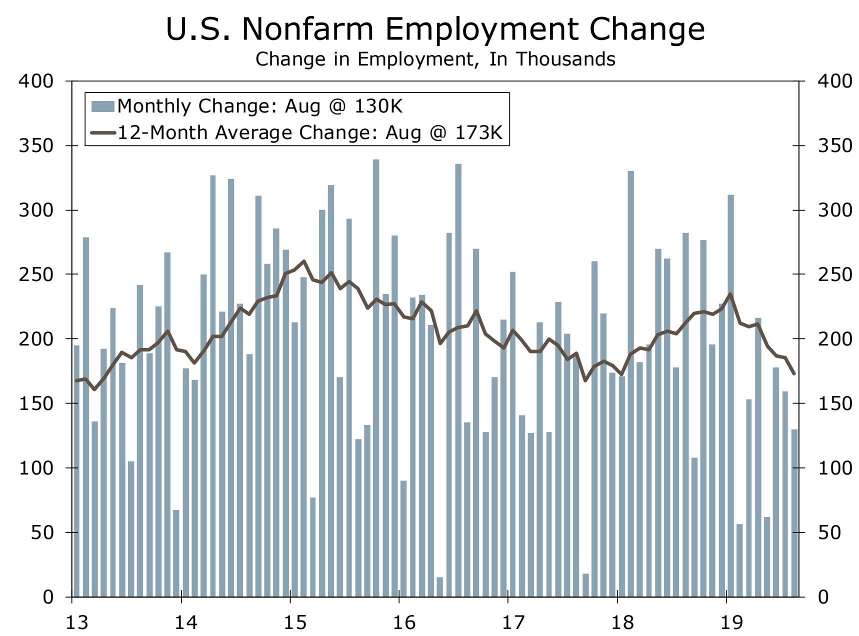
About the same share of businesses plan to increase capex spending in the coming year that increased spending this past year.



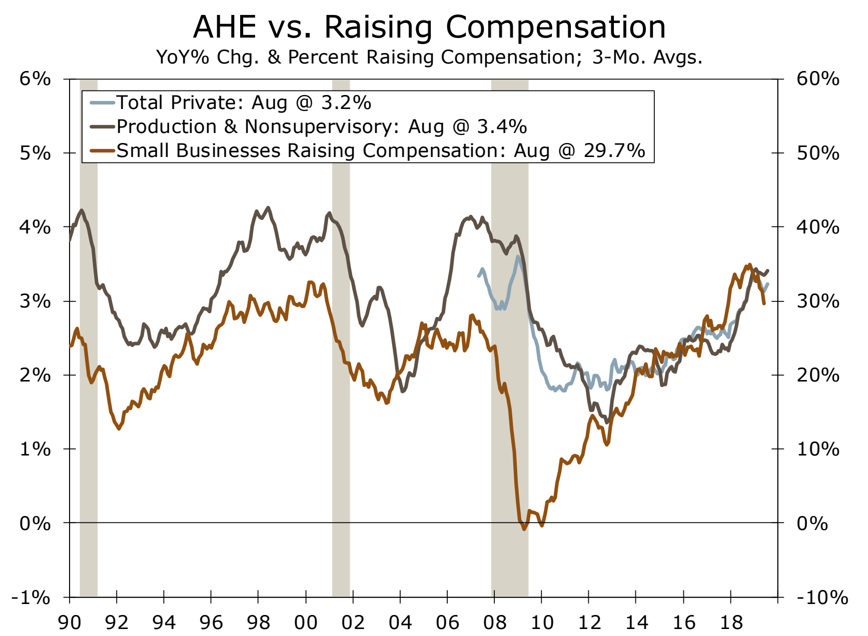
Source: Wells Fargo Bank, Gallup, NFIB, U.S. Department of Commerce and Wells Fargo Securities

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



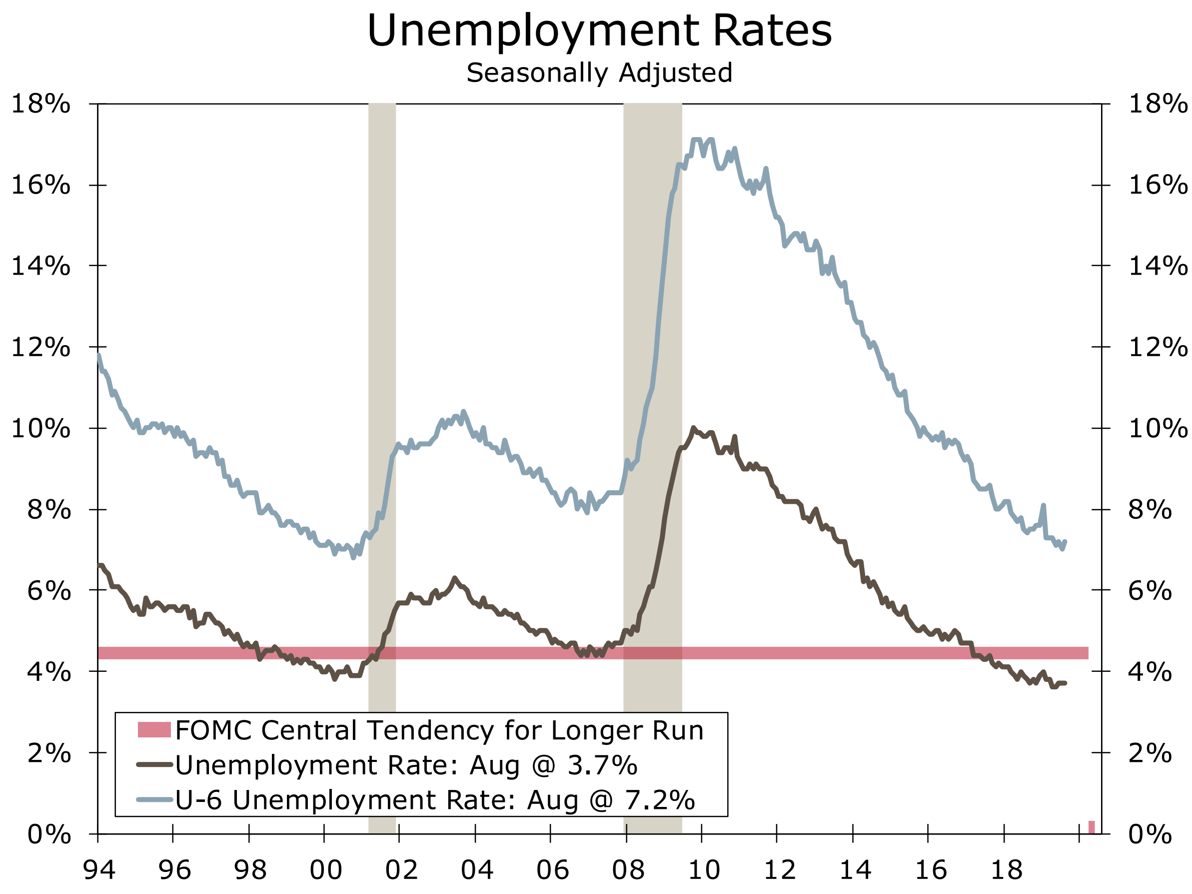
Wages



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%.

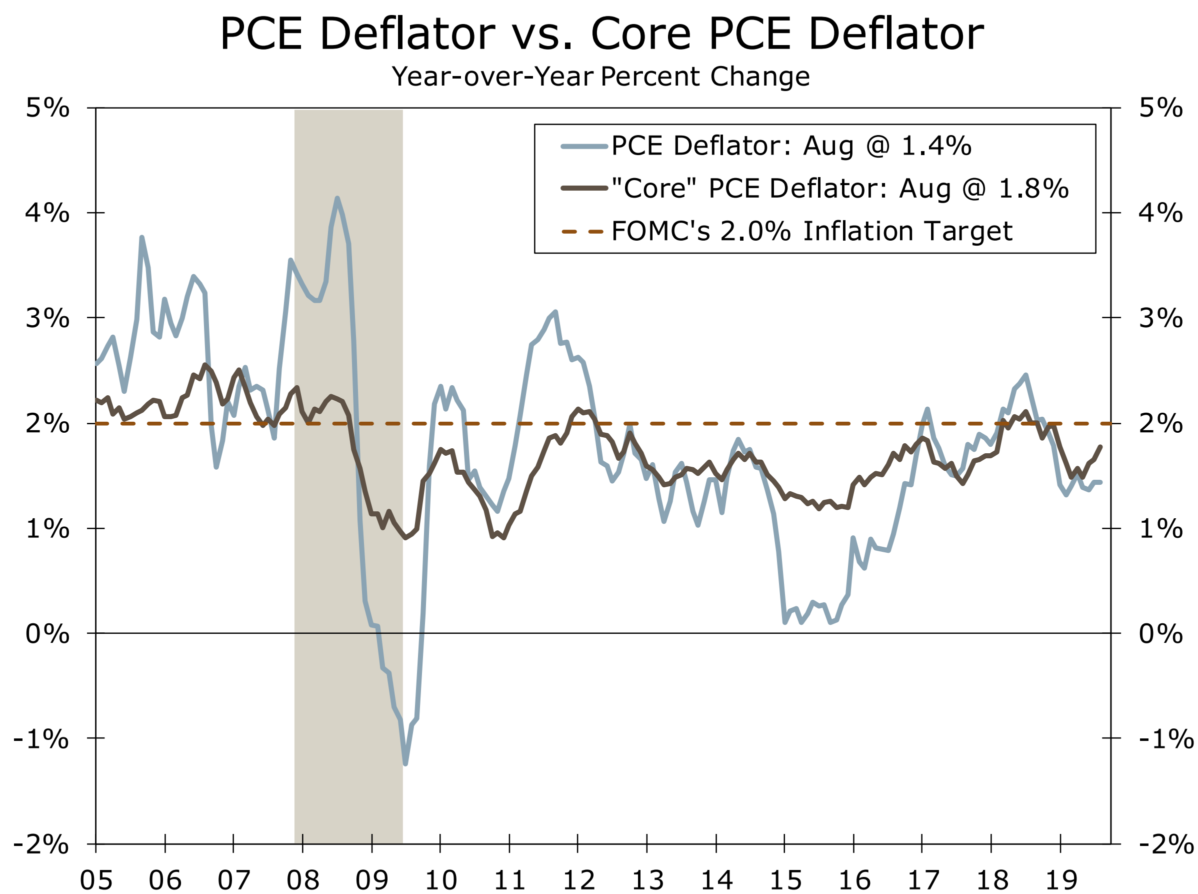
While the criteria for determining the unemployment rate have not changed, growth in the Gig economy, particularly ride sharing and the proliferation of online job search platforms, like Indeed and LinkedIn, have likely changed the way workers engage in the labor market. As a result, the economy can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



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

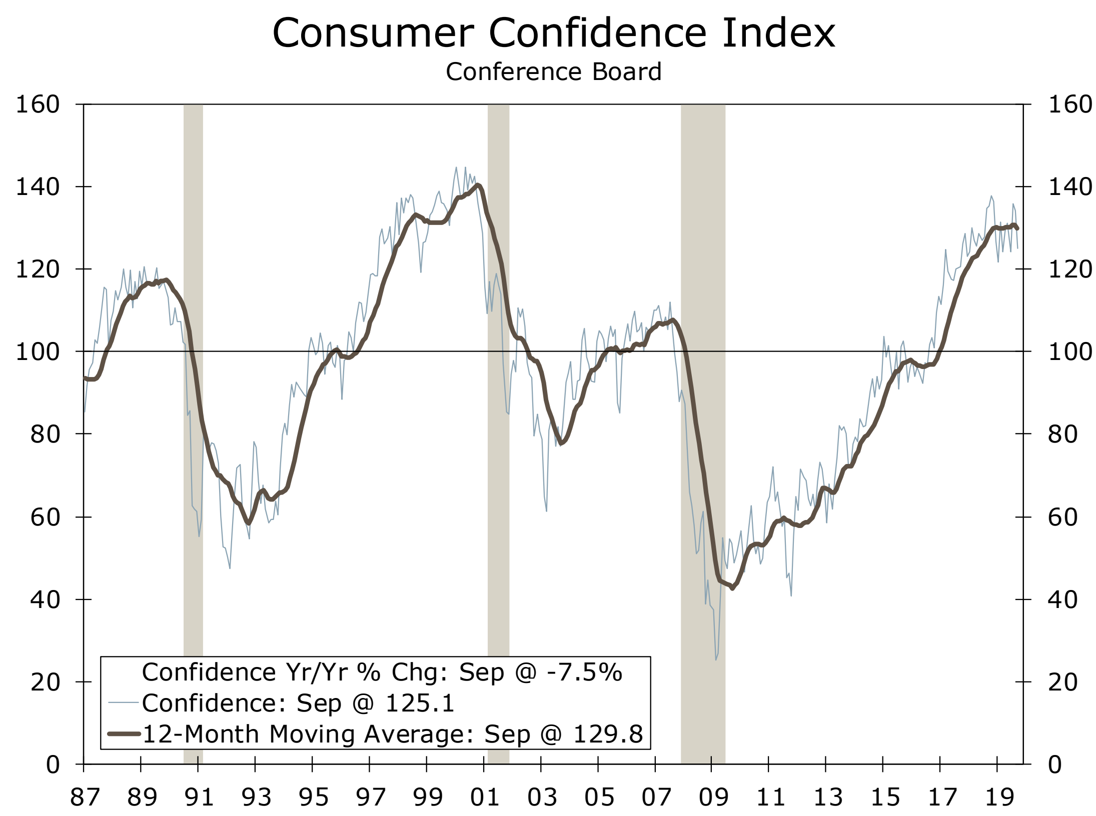
After briefly rising above the Fed's 2% target, core inflation appears to have decelerated once again, amid weakening final demand. Inflation expectations have also fallen over the past few months.

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.



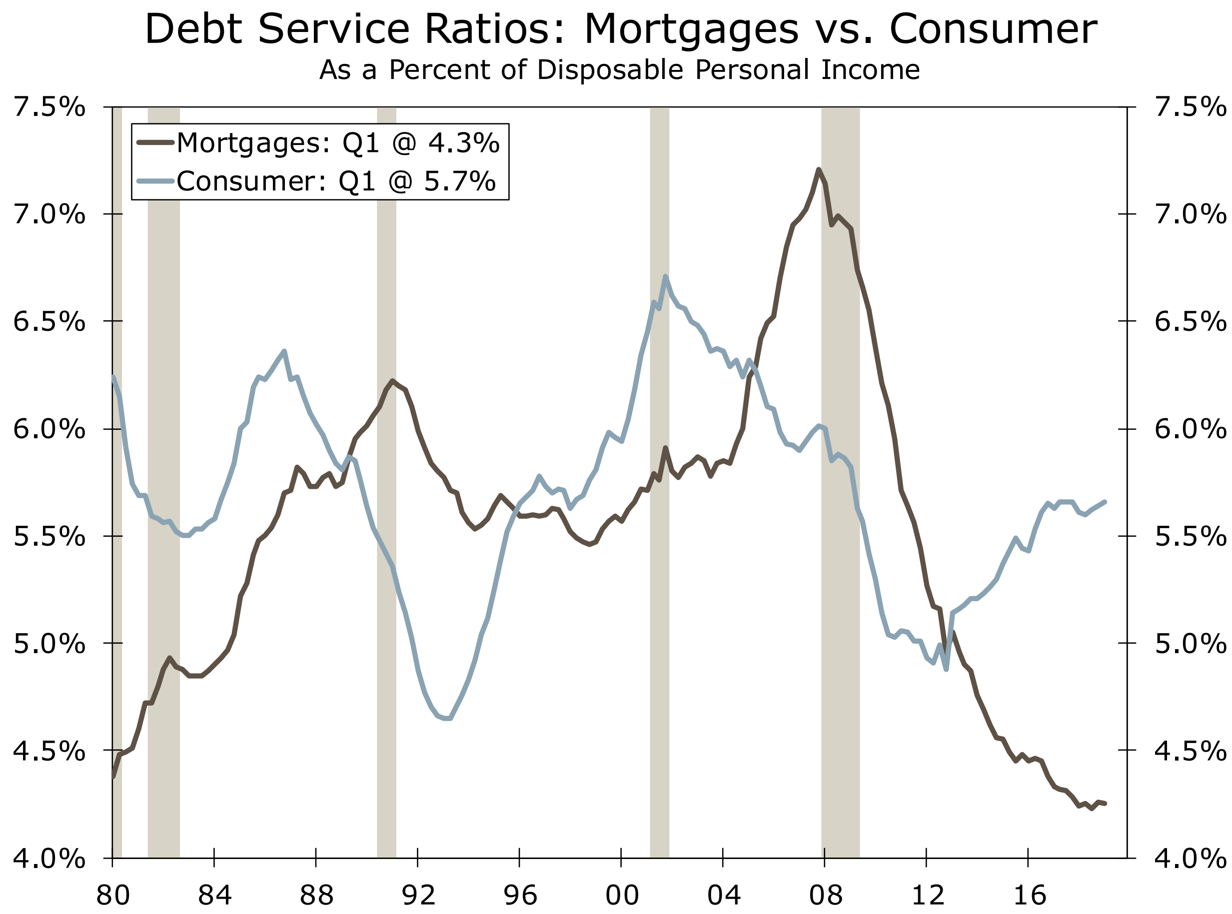
Source: U.S. Department of Commerce and Wells Fargo Securities

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



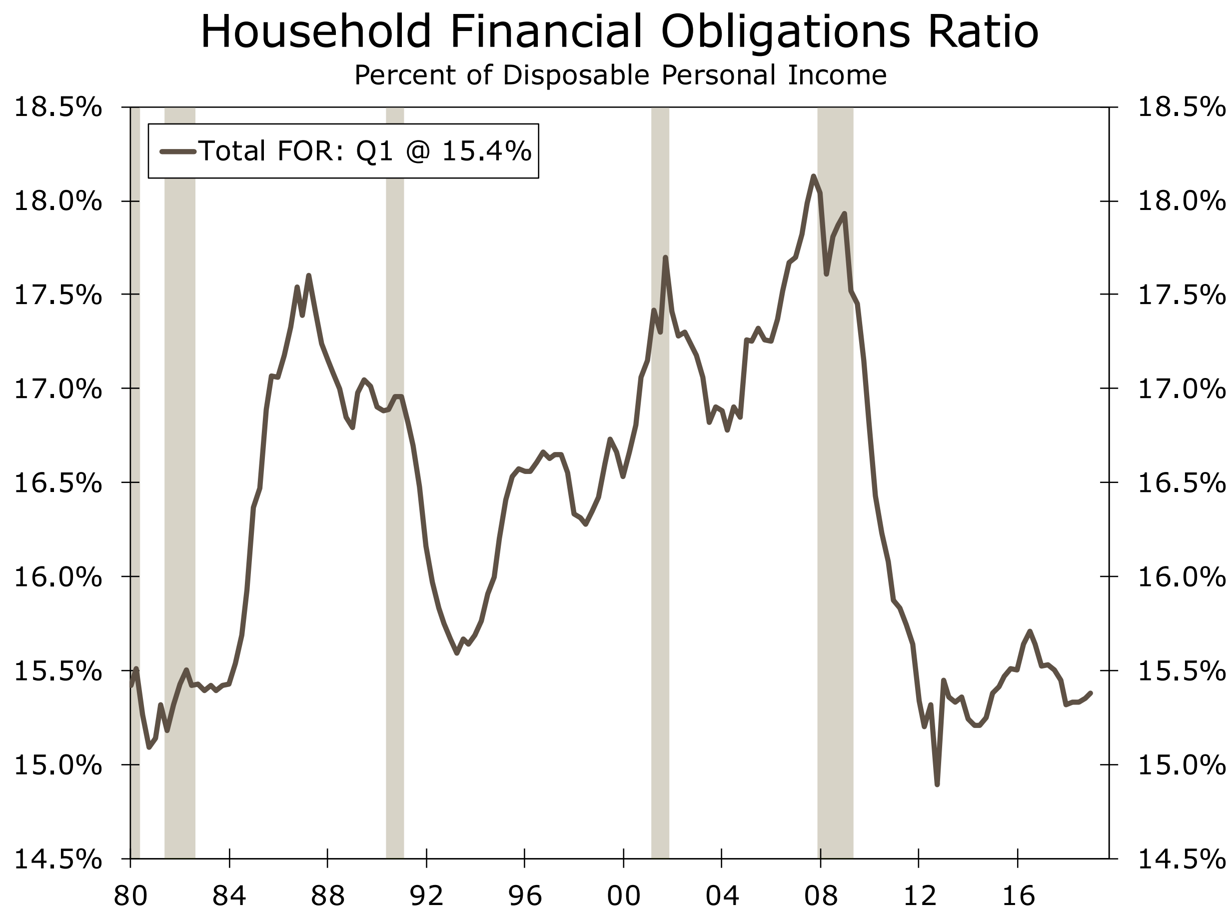
Source: Conference Board and Wells Fargo Securities

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.



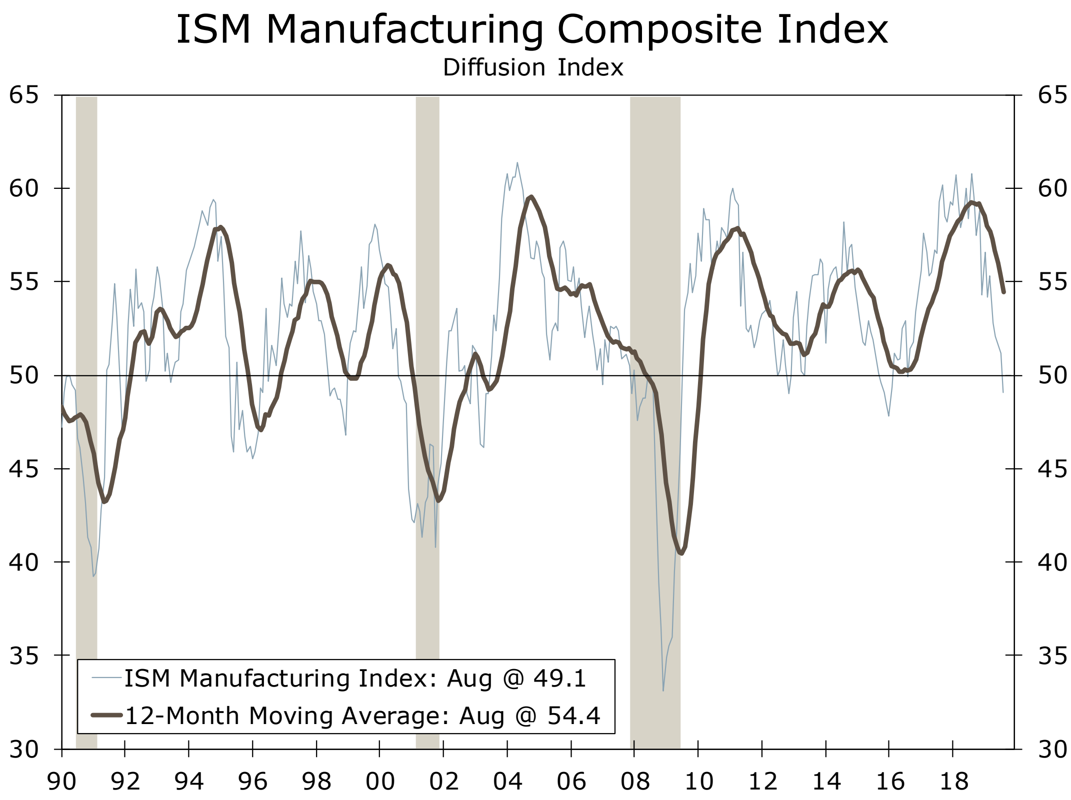
Source: Federal Reserve Board and Wells Fargo Securities

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



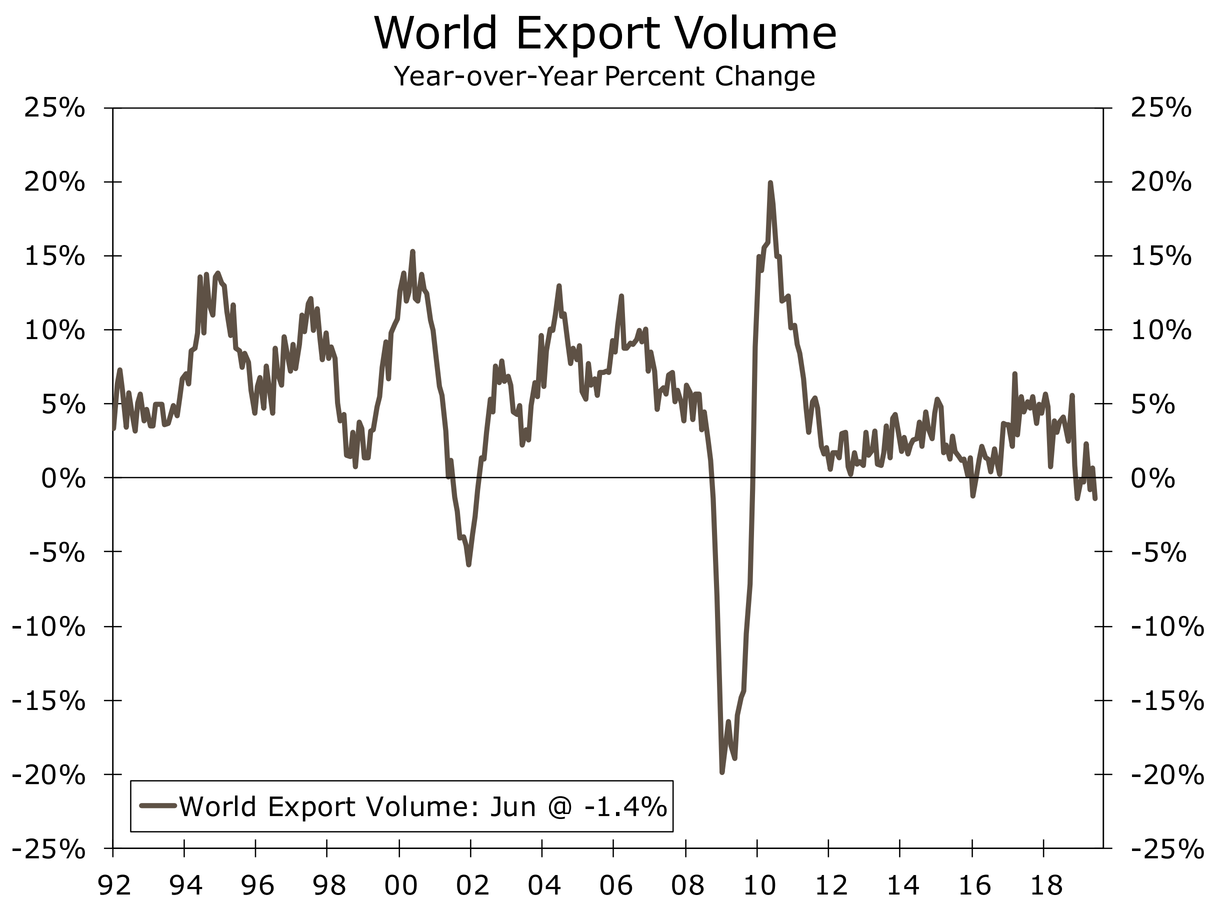
Source: Federal Reserve Board and Wells Fargo Securities

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.

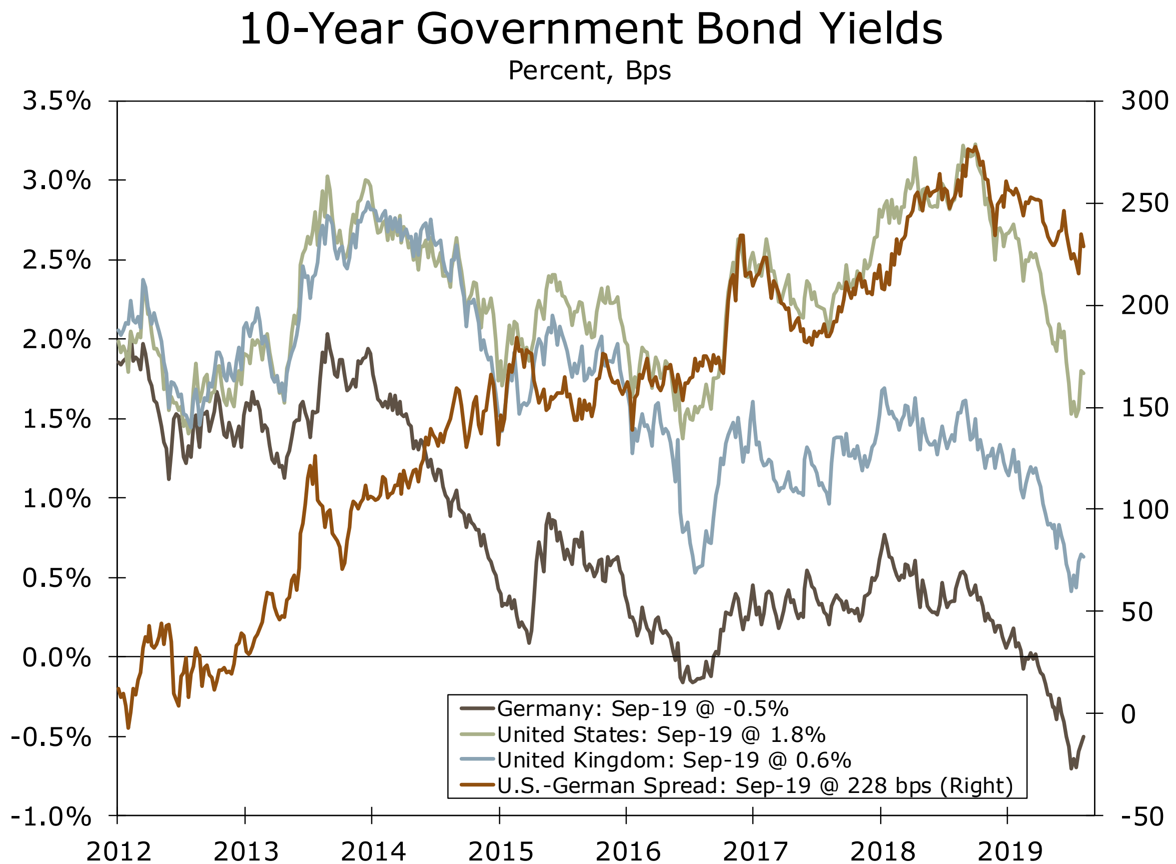


Source: IHS Markit and Wells Fargo Securities

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

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

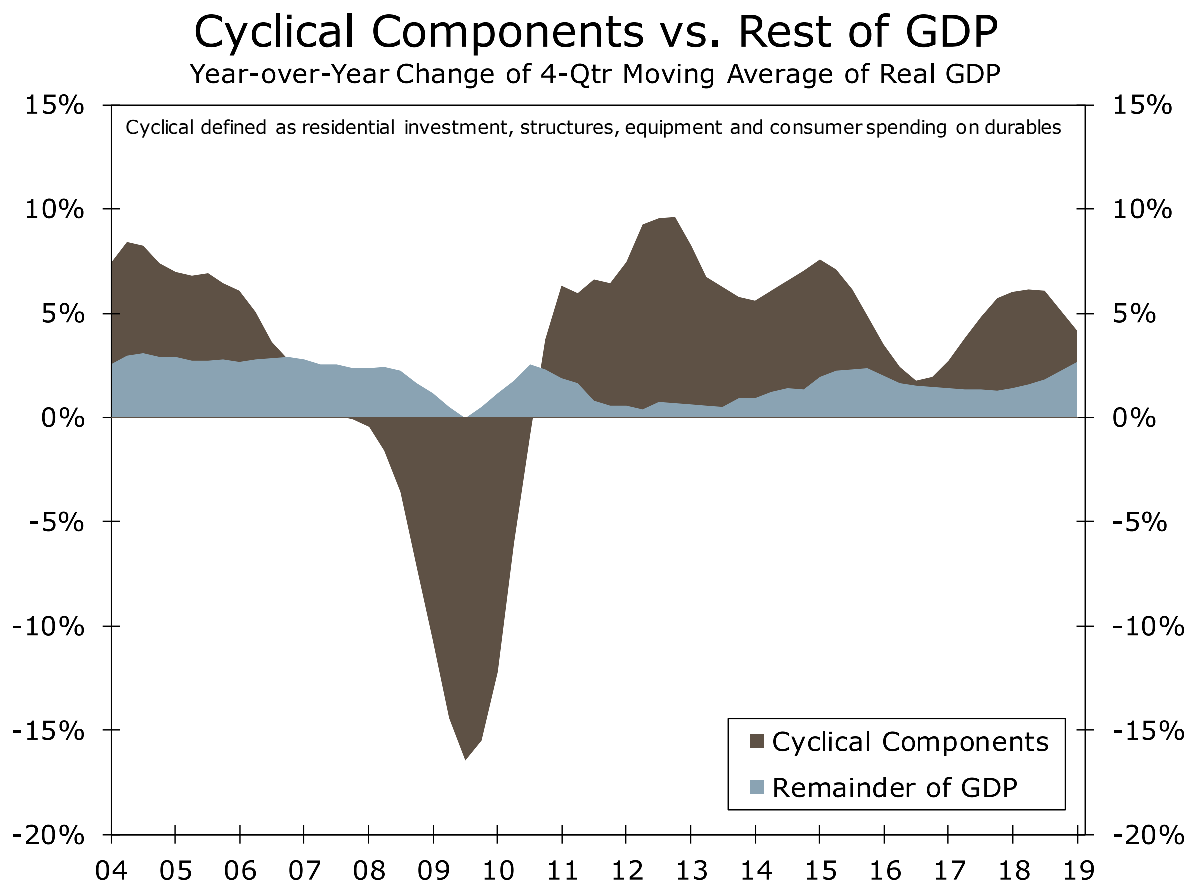
Global interest rates continue to plunge. Over $15 trillion of debt worldwide now has a negative yield, which has increased demand for U.S. bonds.



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.

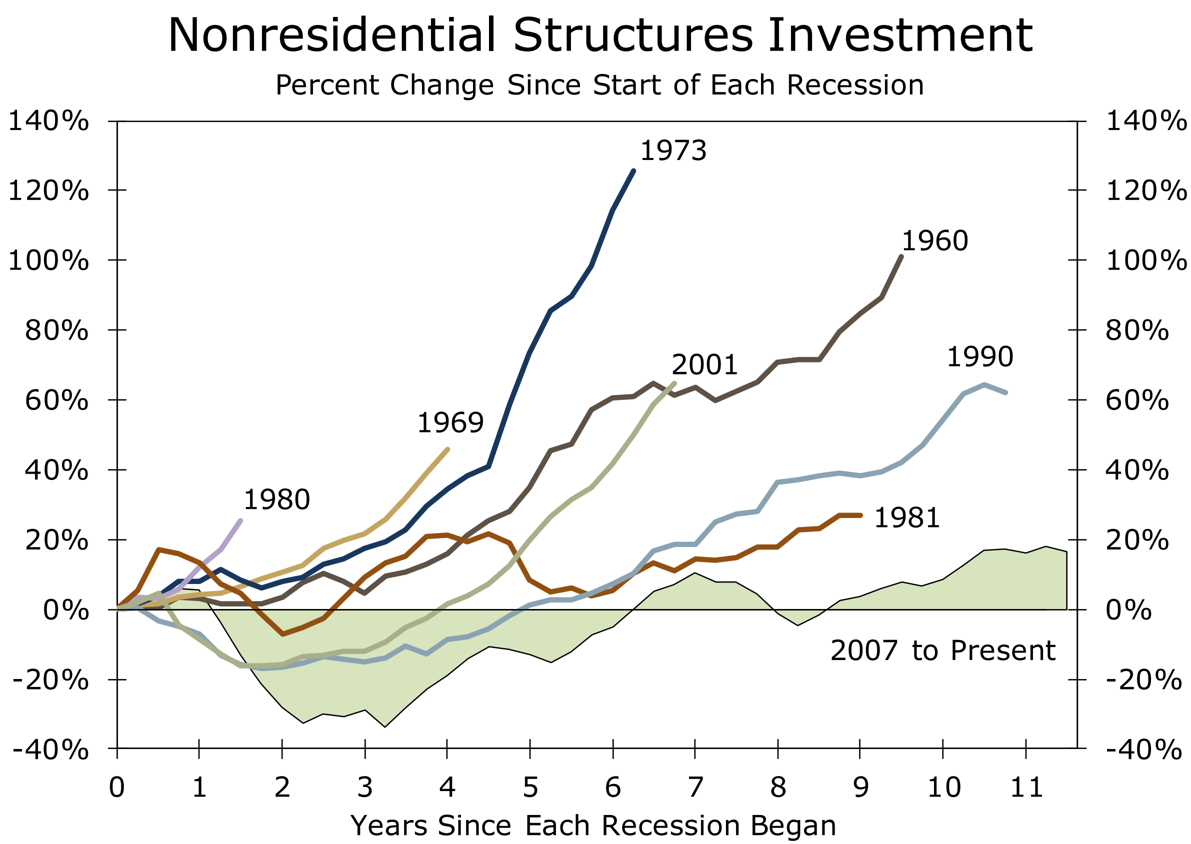
We have seen less of a boom in the most cyclical parts of the economy during this cycle, which may push a correction further out and ultimately make that correction less severe.



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

Overall building has remained relatively subdued this cycle.

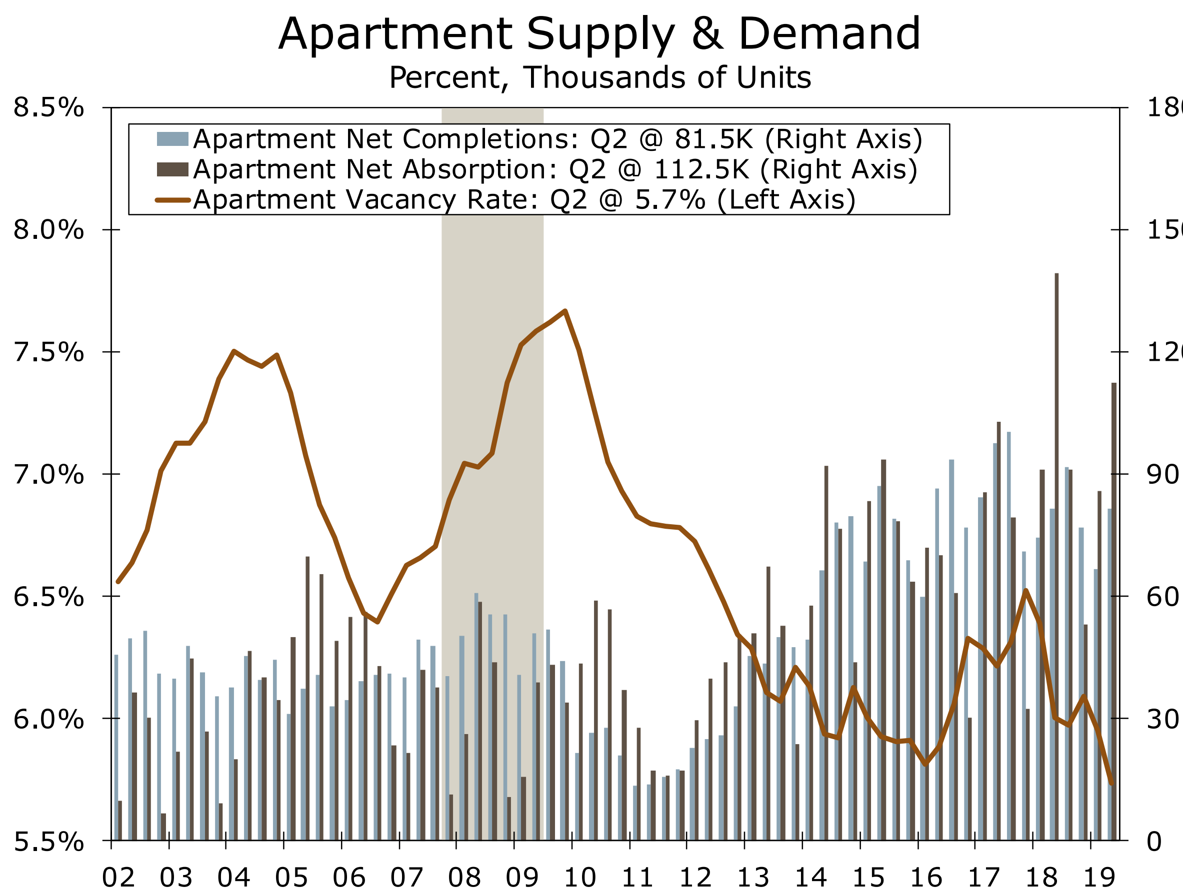
Much of the activity has been concentrated in several large markets, which may present some risks to a sharp or prolonged pullback in the tech and energy sectors.



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.

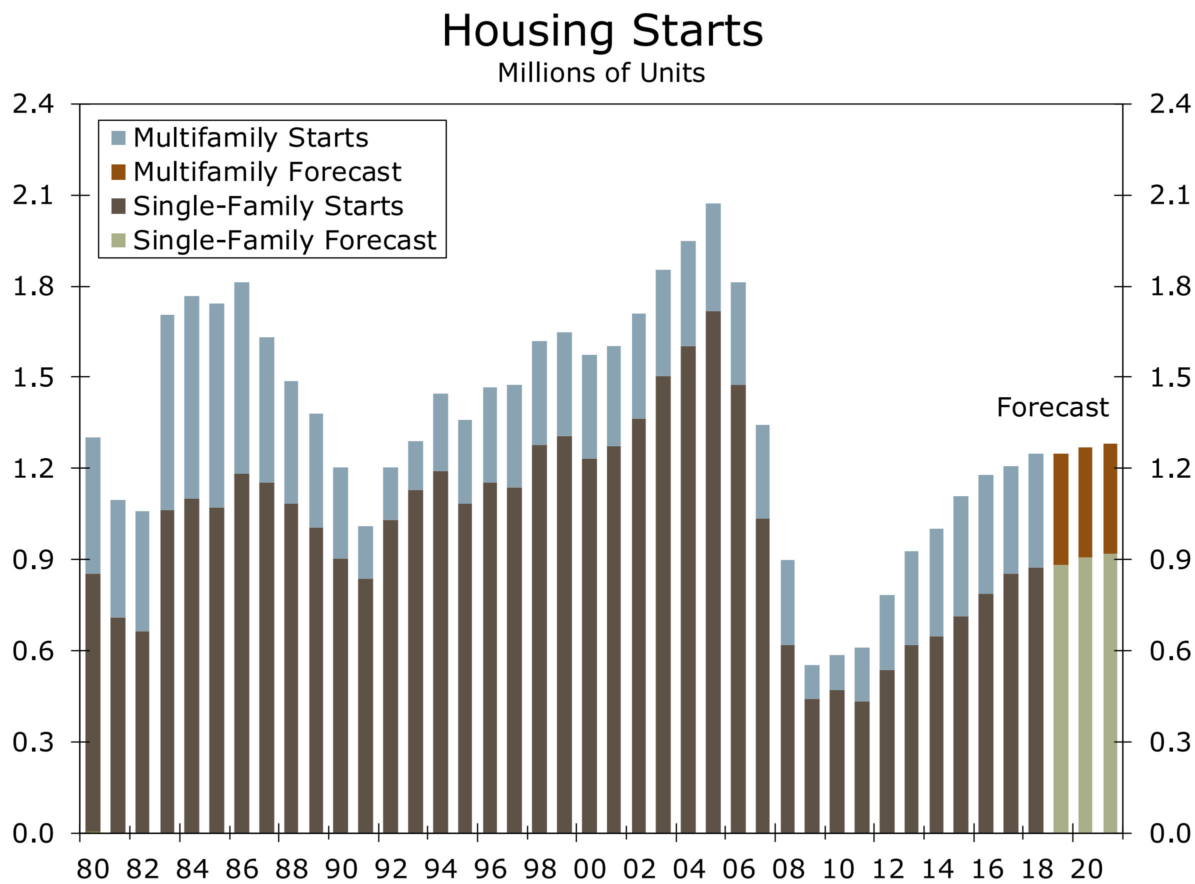
Development is now shifting to more affordable projects in suburban areas and in lower costs parts of the country.



Source: CoStar, Inc. and Wells Fargo Securities

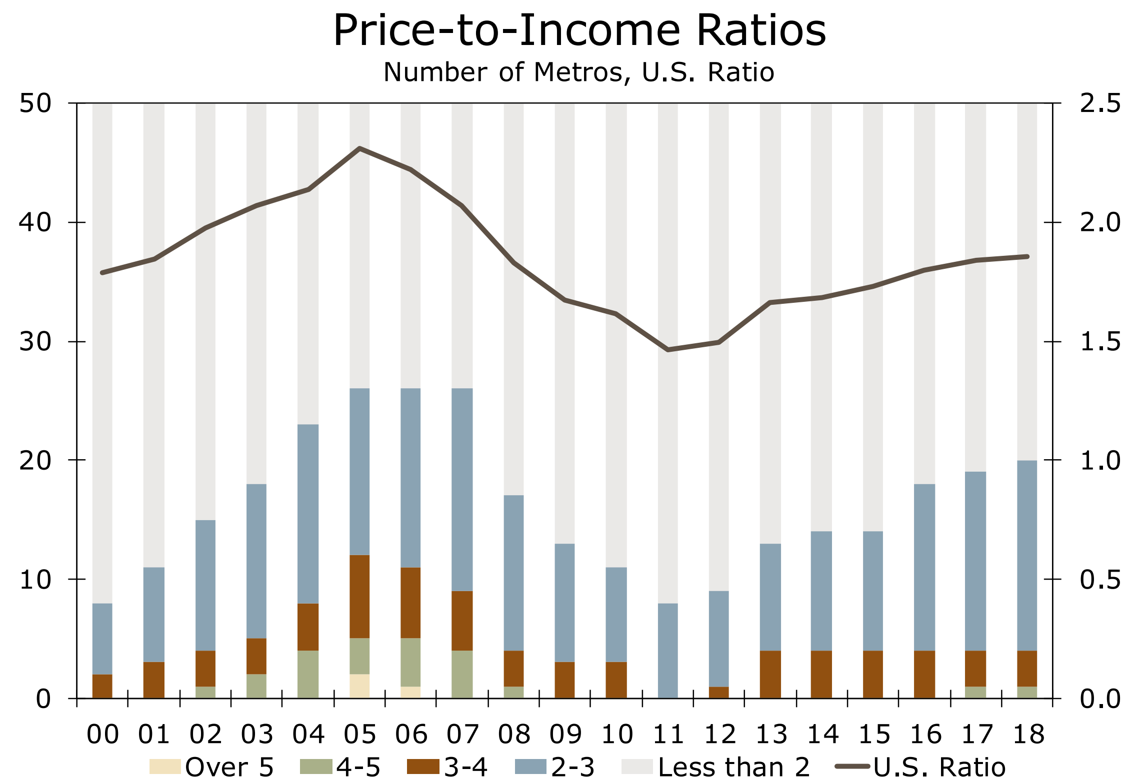
Affordability constraints will continue to keep a low ceiling on home sales and new home construction.

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.



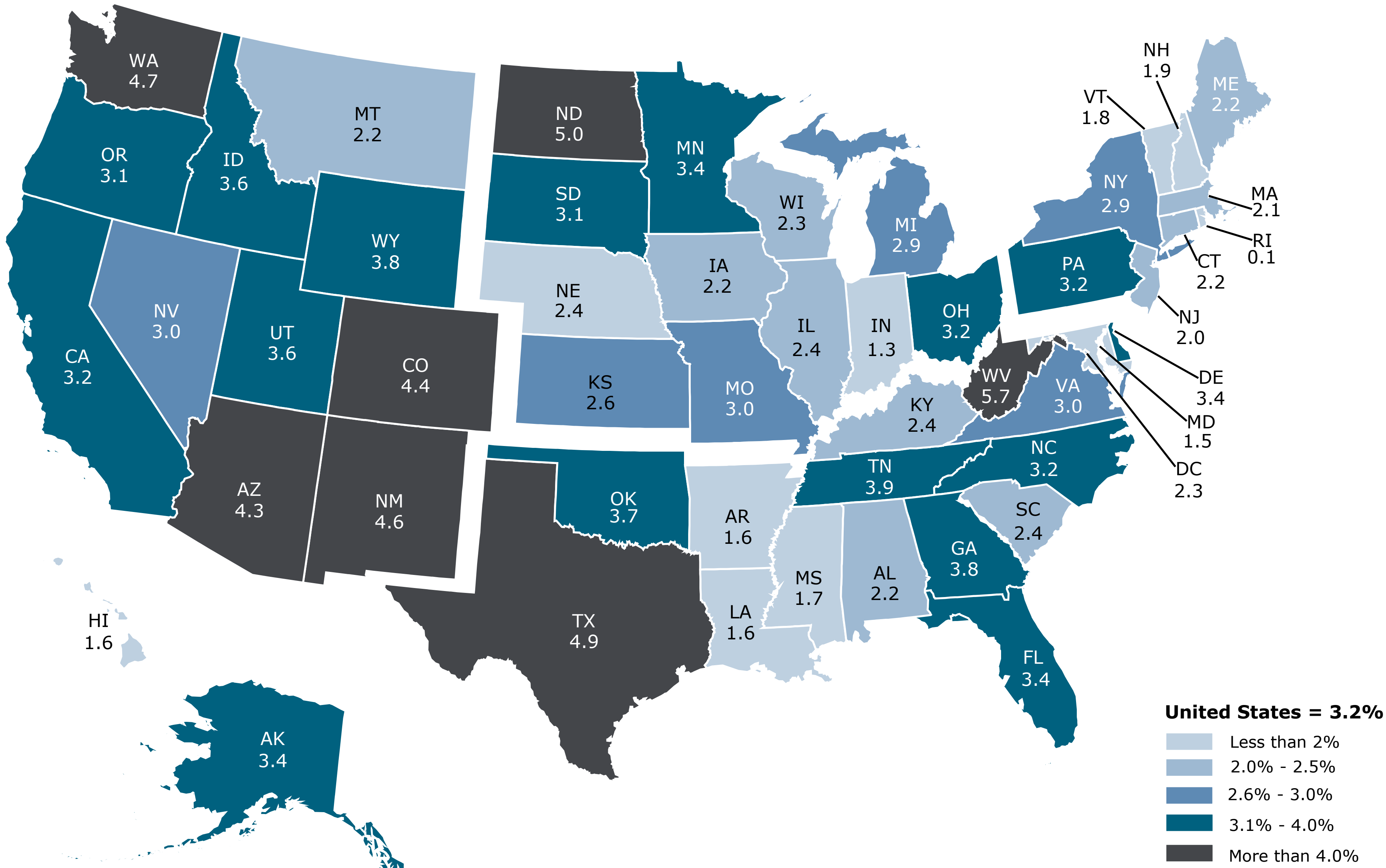
Source: U.S. Department of Commerce and Wells Fargo Securities

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



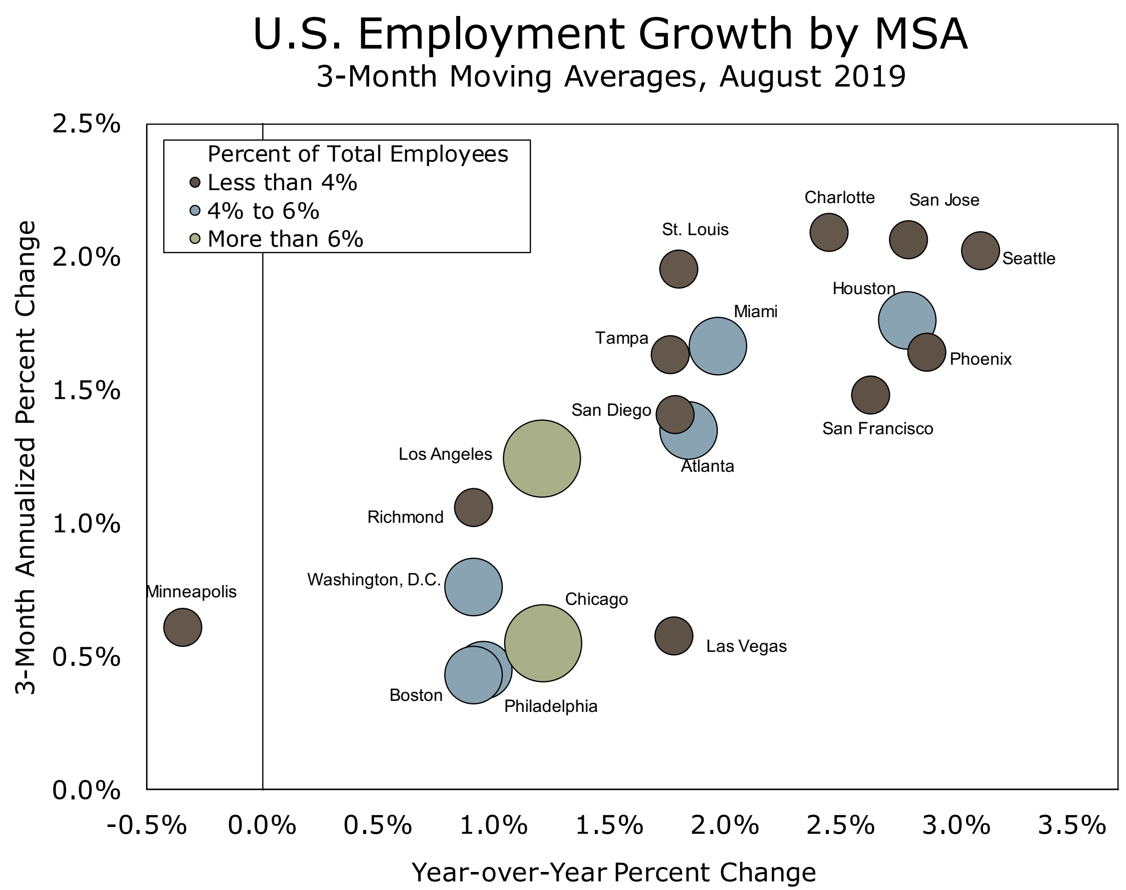
Source: NAR, U.S. Department of Commerce and Wells Fargo Securities

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



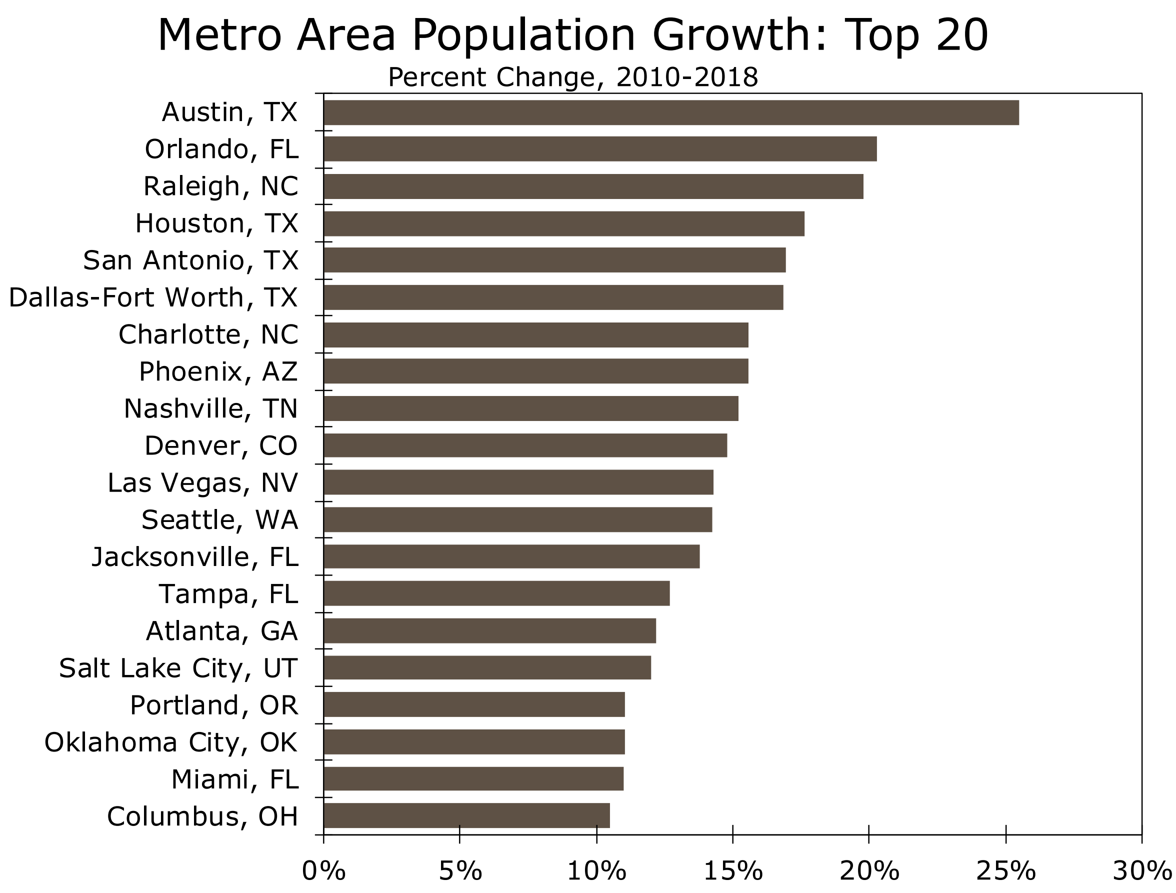
Source: U.S. Department of Commerce and Wells Fargo Securities

Employment growth is strongest in the South and West.



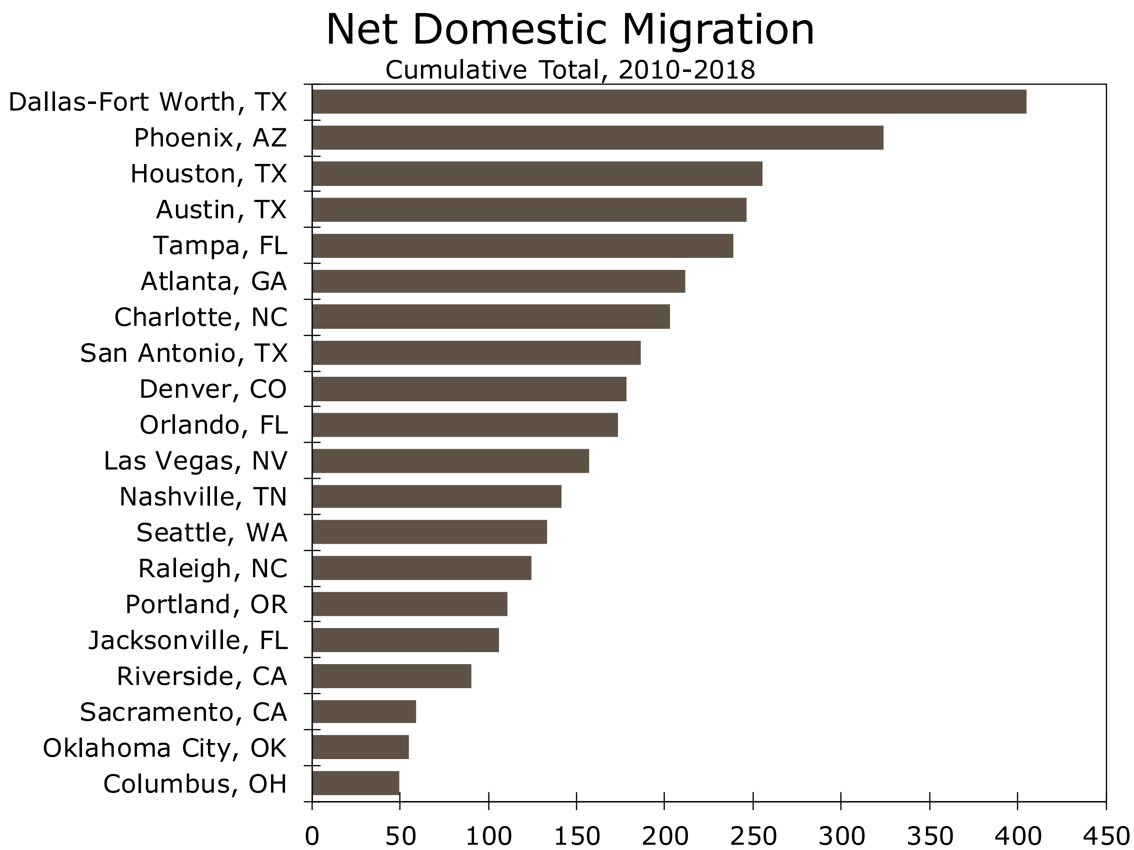
Source: U.S. Department of Labor and Wells Fargo Securities

Affordability has been a major driver of migration flows.



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

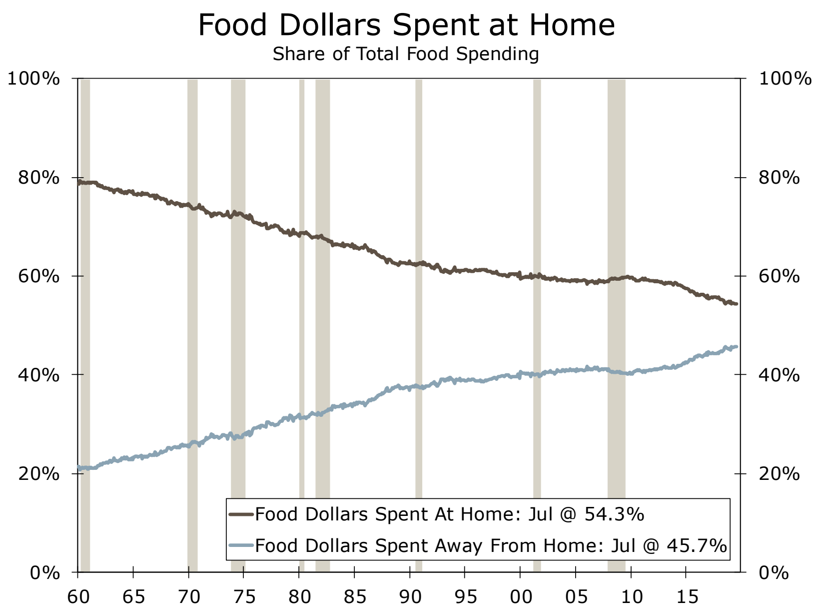
We view net domestic migration as a proxy for the relative attractiveness of a region to jobseekers.



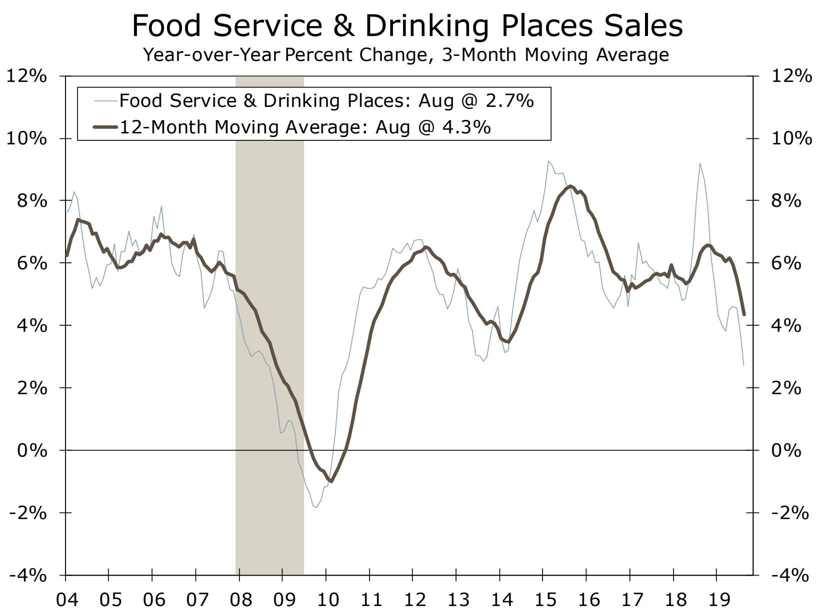
Source: U.S. Department of Commerce and Wells Fargo Securities

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

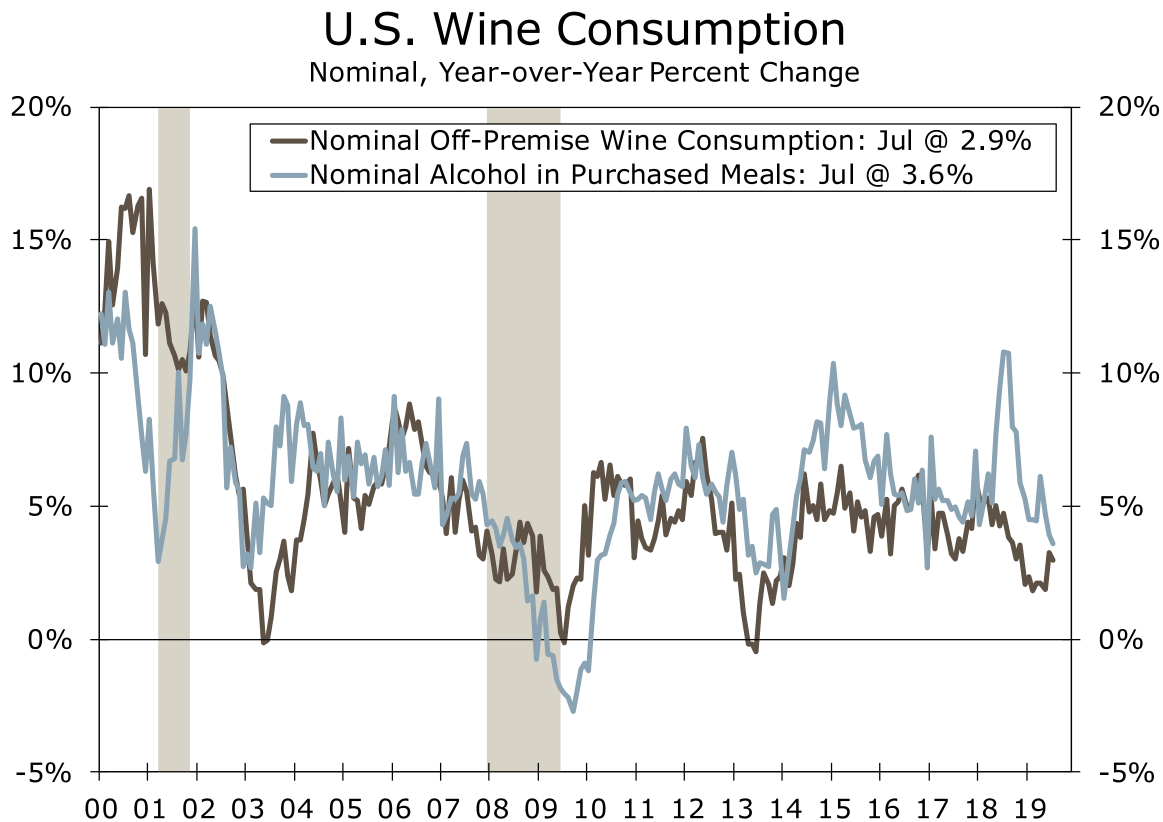


Food Service & Drinking Places Sales



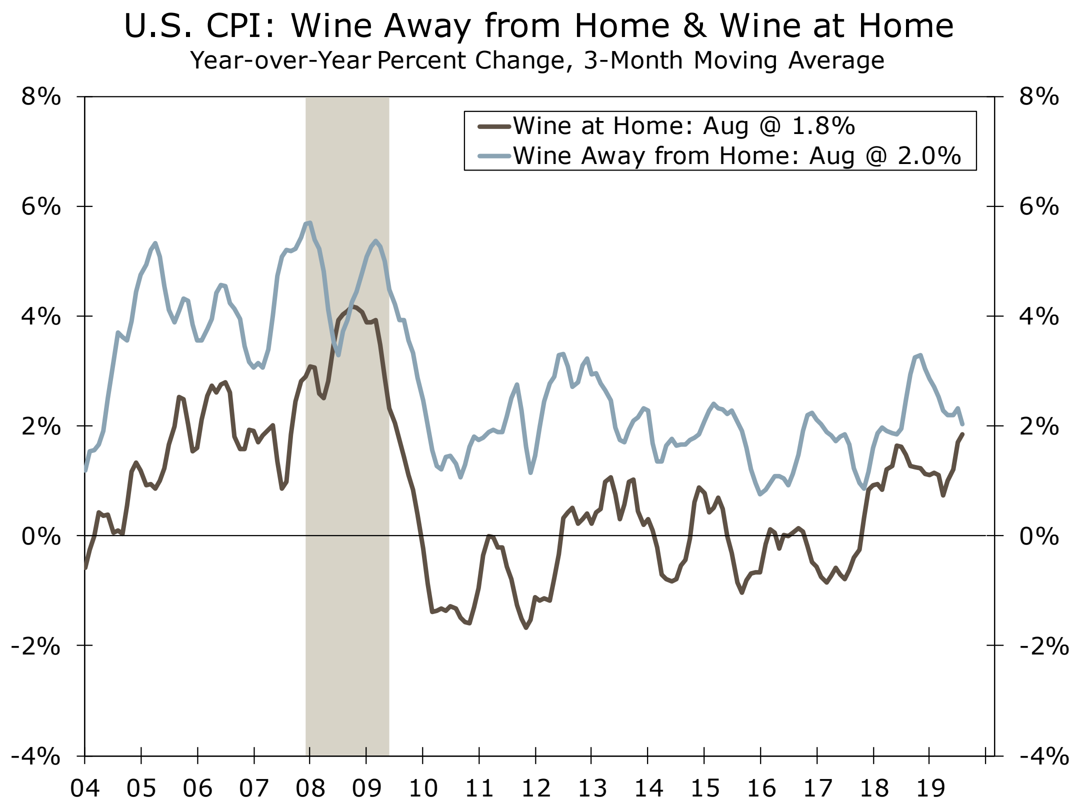
Source: U.S. Department of Commerce, U.S. Department of Labor and Wells Fargo Securities

Wine consumption is rising.



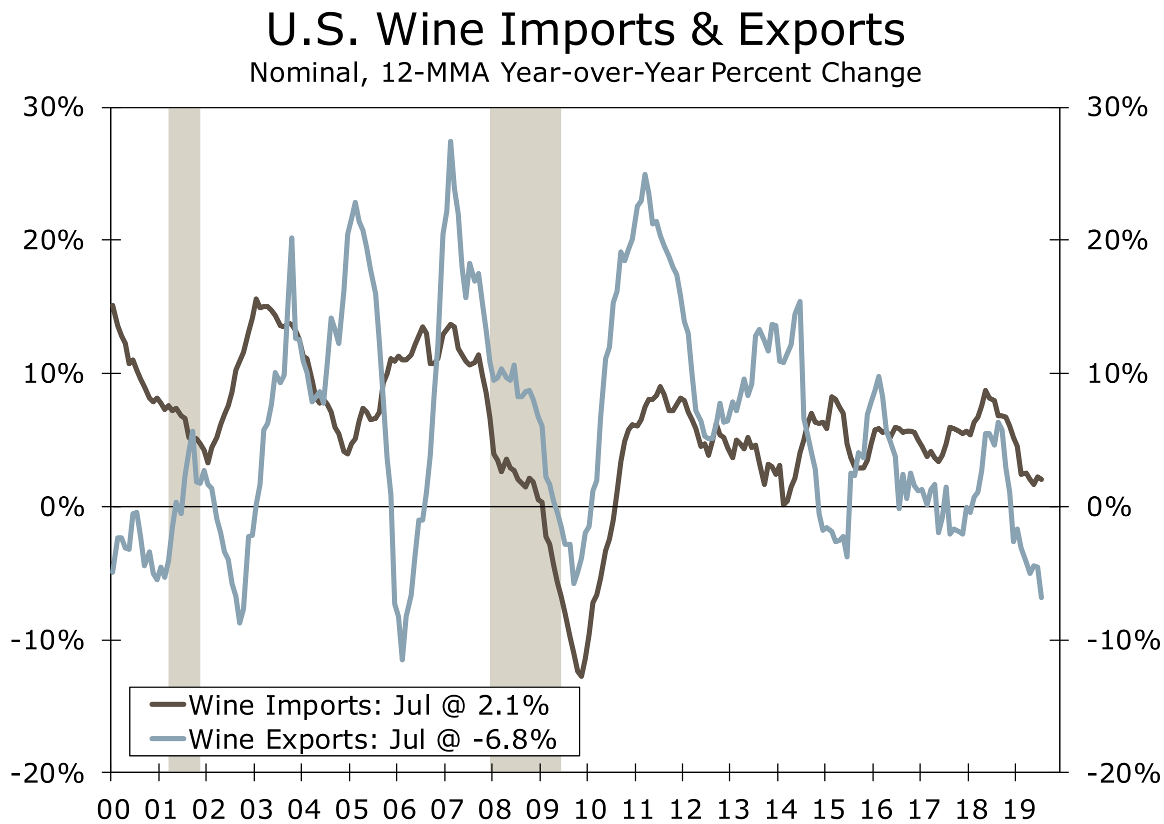
Source: U.S. Department of Labor and Wells Fargo Securities

Prices are rising faster for wine away from home



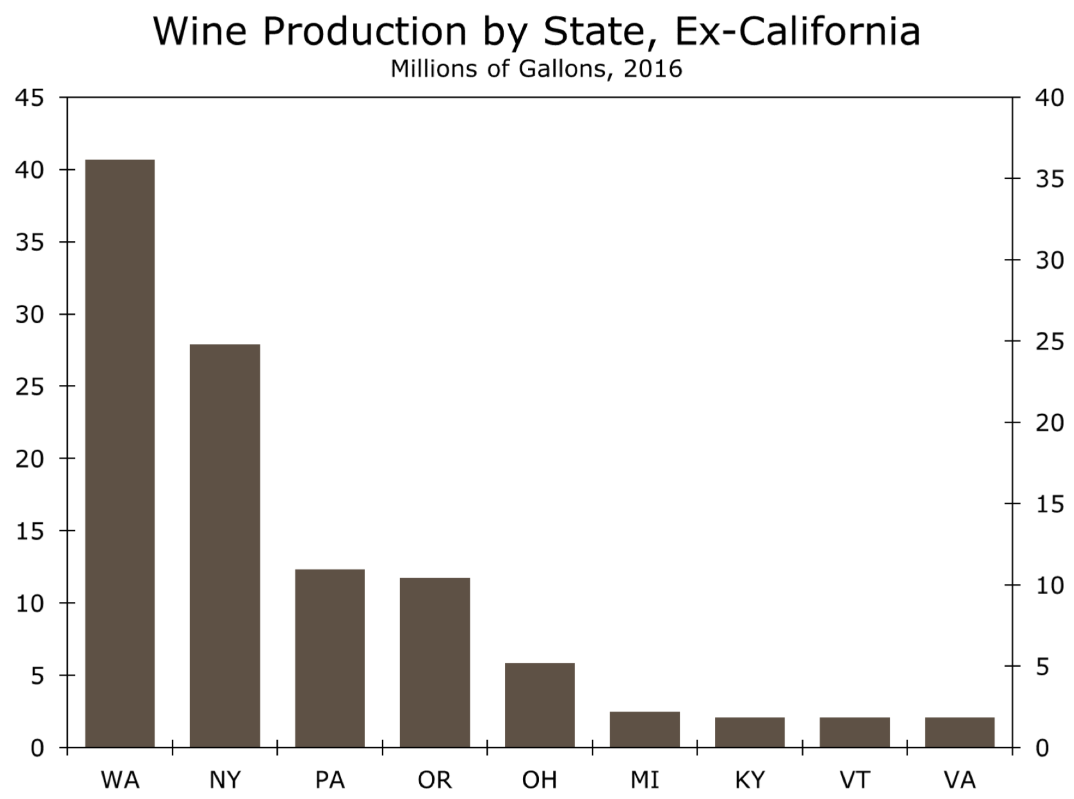
Source: U.S. Department of Labor and Wells Fargo Securities

Wine exports are outright falling.



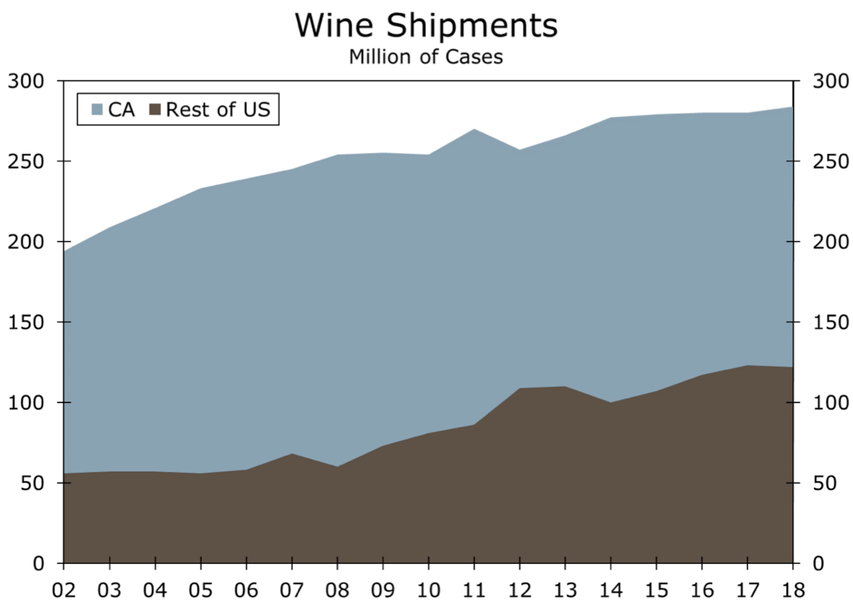
Source: U.S. Department of Commerce and Wells Fargo Securities

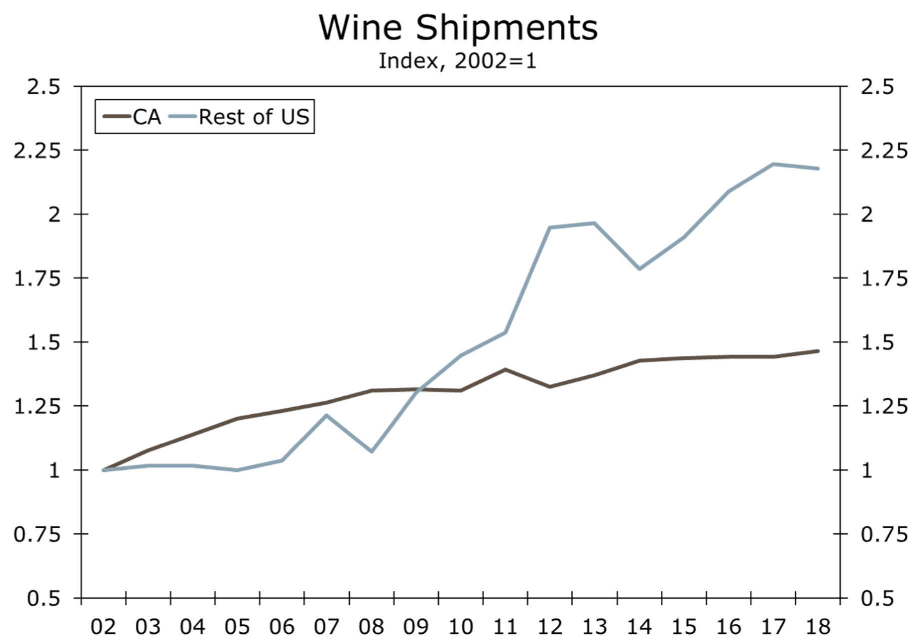
California produces more than 15x as much wine as any other state.



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

Wells Fargo U.S. Economic Forecast

	Actual						Forecast										Actual	Forecast		
	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 [1]	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 [2]	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 [2]	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 [3]	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 [5]																				
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

[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Percentage Point Contribution to GDP
[3] Average Monthly Change
[4] Year-over-Year Percentage Change
[5] Annual Numbers Represent Averages

Source: IHS Global Insight and Wells Fargo Securities

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A Sampling of Our Recent Special, Regional & Industry Commentary

Recent Special Commentary

Date	Title	Authors
	U.S. Macro	
September-18	Fed Cuts Rates 25 bps. Is Further Easing on the Way?	Bryson
September-16	Oil Is Back into the Inflation Fold	House & Seery
September-10	September Flashlight for the FOMC Blackout Period	Bryson, Quinlan & House
September-05	Stars Update: Optimal Levels of GDP, UR and Policy Rate	Iqbal
August-29	Counting Throes: August & Everything After	Quinlan, House & Seery
	U.S. Regional	
September-20	California Payrolls Jump in August	Vitner & Dougherty
September-20	Florida Continues To See Strong Job Growth Across the State	Vitner & Dougherty
September-20	Texas Posts Solid Payroll Gain in August	Vitner & Dougherty
September-20	North Carolina Continues to See Modest Employment Gains	Vitner & Dougherty
September-19	Minnesota Adds 1,100 Jobs, Unemployment Rate Falls	Vitner, Dougherty & Honnold
	Global Economy	
September-19	Norges Bank, the Lone G10 Hawk?	Licis & Nelson
September-12	Draghi Delivers in Swan Song to Markets	Nelson
September-11	Is There Too Much Debt in the Eurozone?: Part IV	Bryson, Pugliese & Mathews
September-04	Is There Too Much Debt in the Eurozone?: Part III	Bryson, Pugliese & Mathews
August-30	India: In-dire Shape	McKenna & Bennenbroek
	Interest Rates/Credit Market	
September-17	Repo Running Wild	Pugliese
July-31	FOMC Cuts Rates 25 bps, but Two Members Dissent	Bryson
July-31	Treasury Refunding Highlights	Bryson & Pugliese
July-30	Was the Fed's Rate Hike in December a "Policy Mistake"?	Iqbal & Licis
July-29	Rate Cuts & Consumers: Will the Medicine Take?	Quinlan & Seery
	Real Estate & Housing	
July-30	Housing Demographics Turn More Positive	Vitner, Dougherty & Honnold
July-09	Housing Chartbook: July 2019	Vitner, Dougherty & Honnold
June-18	Housing Chartbook: June 2019	Vitner, Dougherty & Honnold
March-20	Q4 CRE Chartbook: Construction Outlook	Vitner, Dougherty & Honnold
March-18	Housing Chartbook: March 2019	Vitner, Dougherty & Honnold

Economists & Macro Strategists	
Jay H. Bryson, Acting Chief Economist	jay.bryson@wellsfargo.com
Mark Vitner, Senior Economist	mark.vitner@wellsfargo.com
Sam Bullard, Senior Economist	sam.bullard@wellsfargo.com
Nick Bennenbroek, Macro Strategist	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan, Senior Economist	tim.quinlan@wellsfargo.com
Azhar Iqbal, Econometrician	azhar.iqbal@wellsfargo.com
Sarah House, Senior Economist	sarah.house@wellsfargo.com
Charlie Dougherty, Economist	charles.dougherty@wellsfargo.com
Erik Nelson, Macro Strategist	erik.f.nelson@wellsfargo.com
Michael Pugliese, Economist	michael.d.pugliese@wellsfargo.com
Brendan McKenna, Macro Strategist	brendan.mckenna@wellsfargo.com

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

Administrative Assistants	
Coren Burton, Administrative Assistant	coren.burton@wellsfargo.com