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SECURITIES

# U.S. Economic Outlook

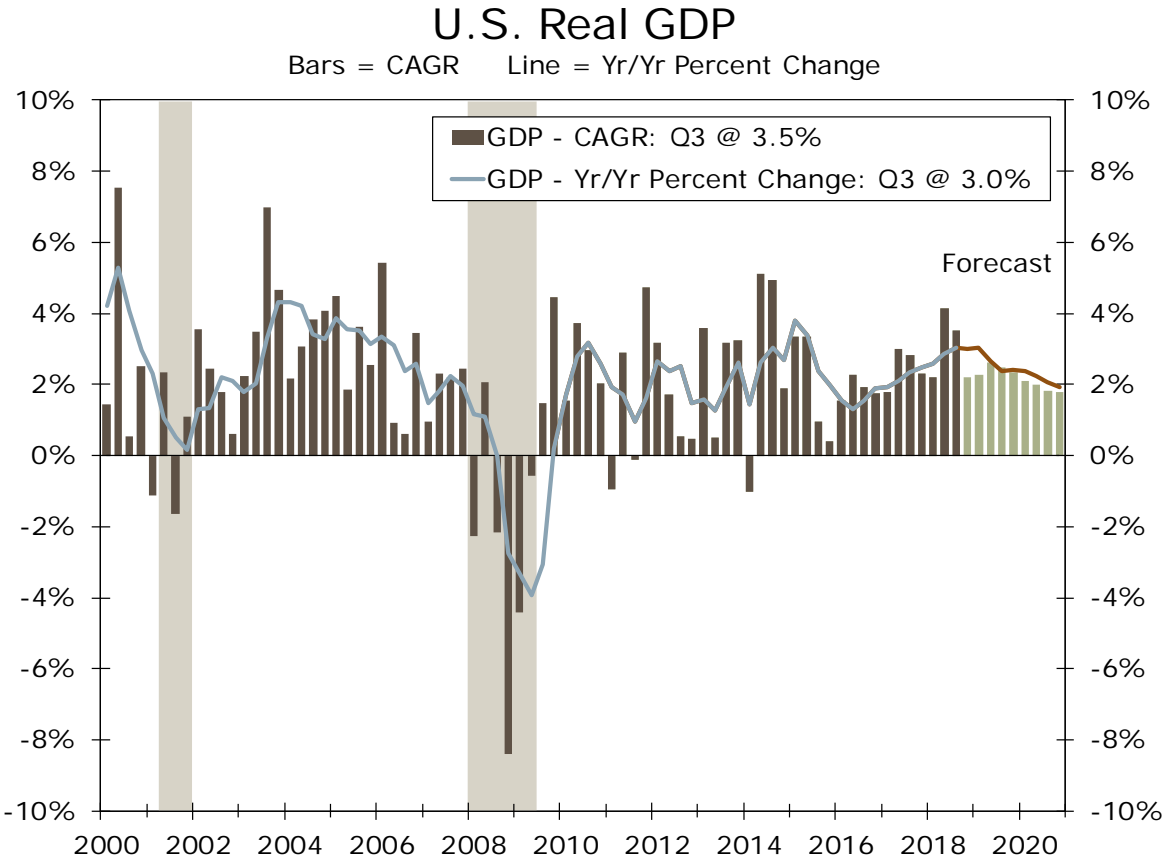
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Charlie Dougherty, Vice President & Economist  
December 6, 2018

Together we'll go far

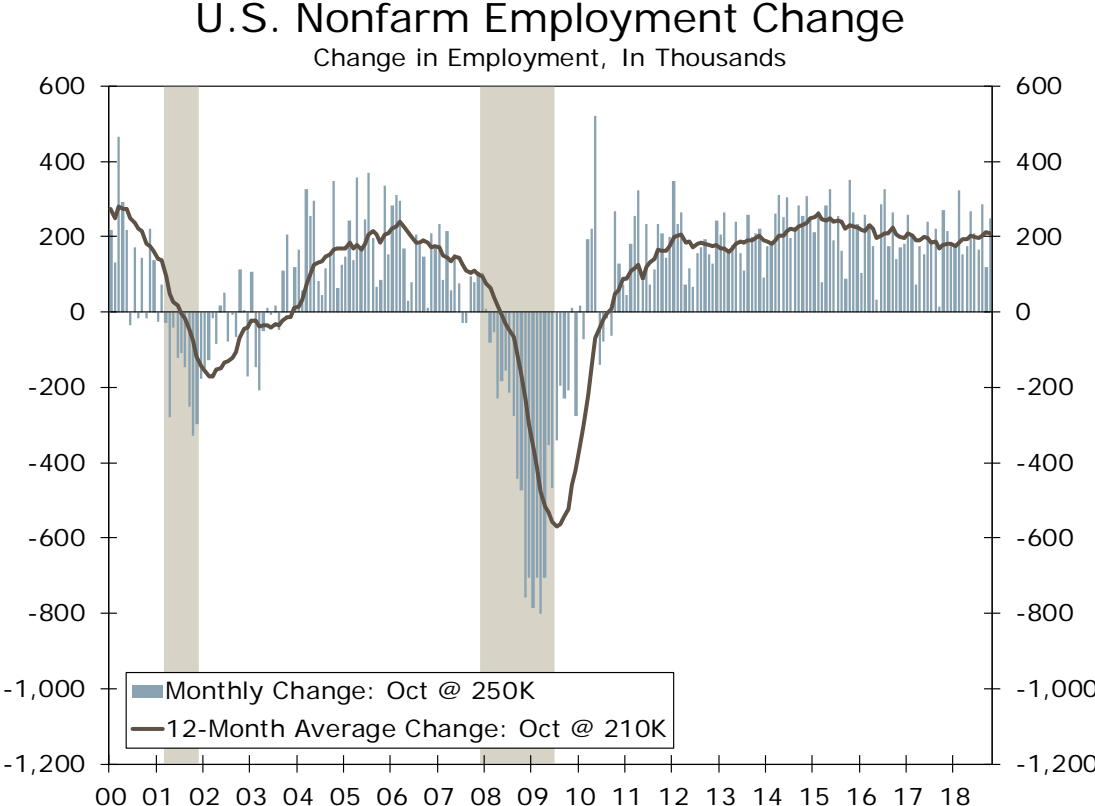


Real GDP growth has upshifted recently and should end the year at nearly a 3.0% pace.



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

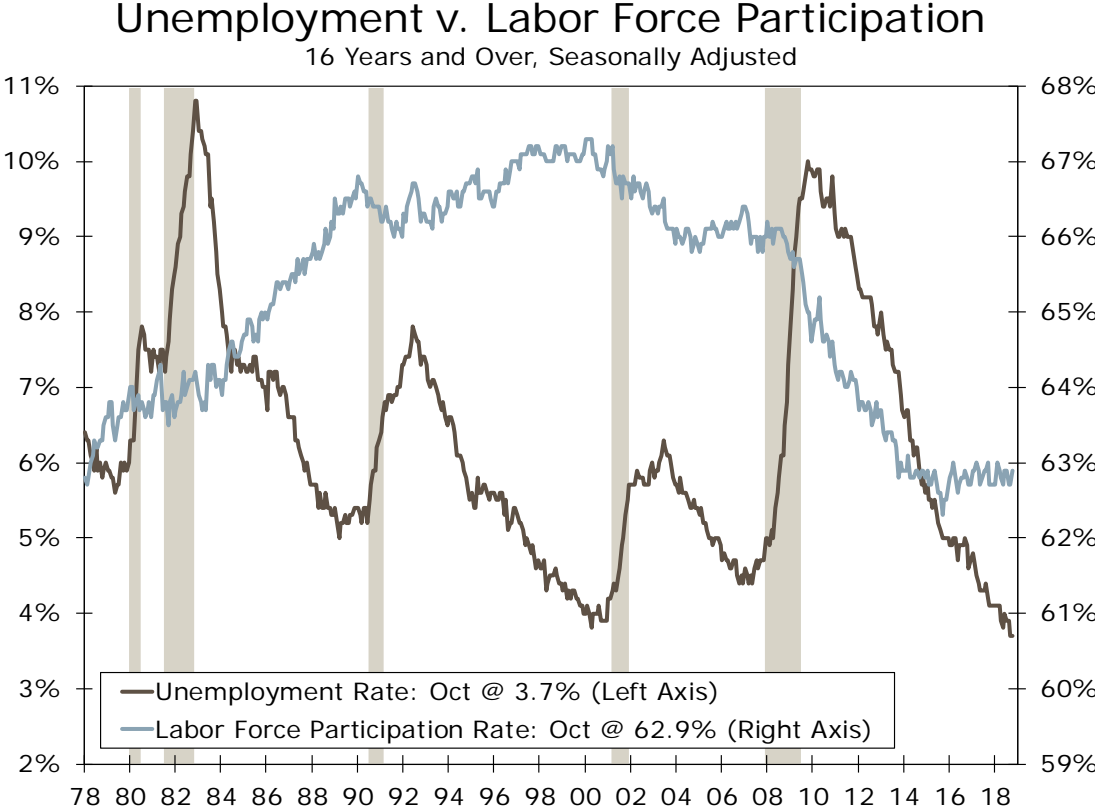
Hiring has not shown any signs of weakening continuing the streak of nearly 100 straight months of positive gains.



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

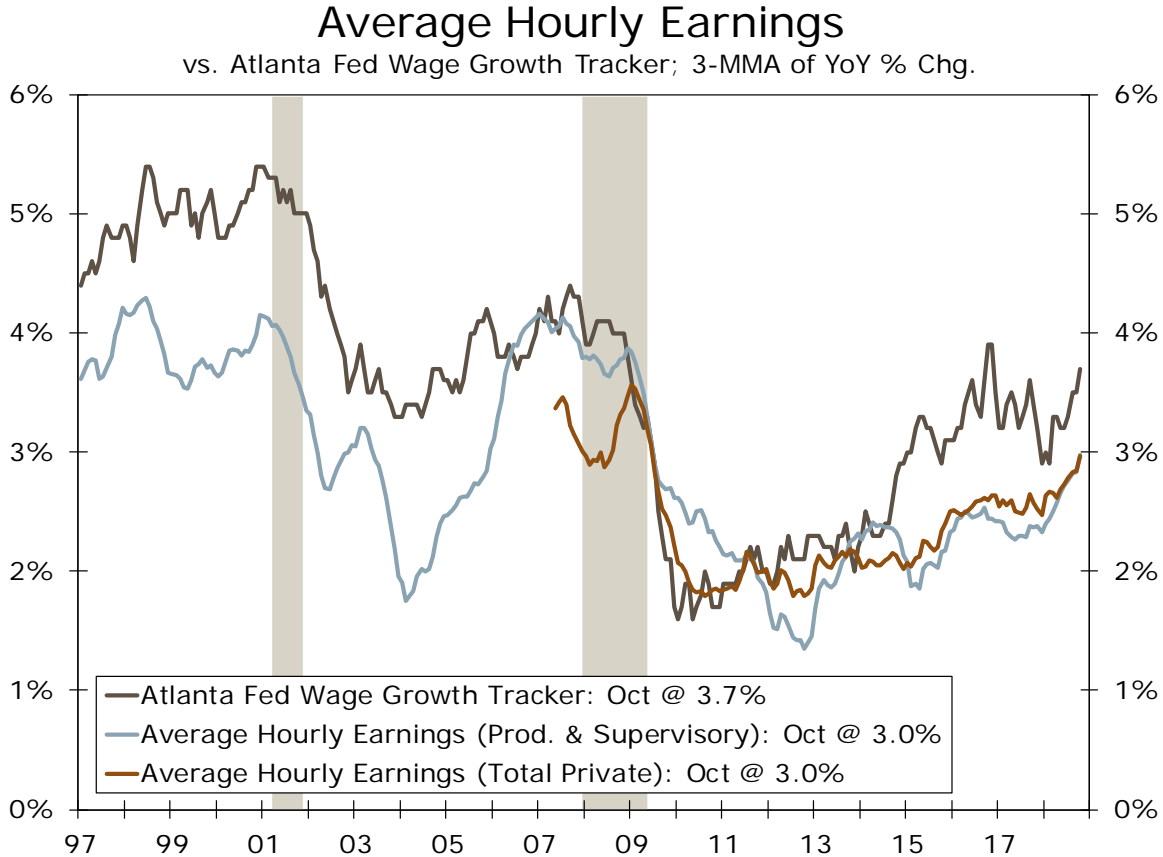
The unemployment rate has fallen considerably over the course of the recovery.

Strong employment growth has also helped counter the downward pressure on labor force participation from an aging population.



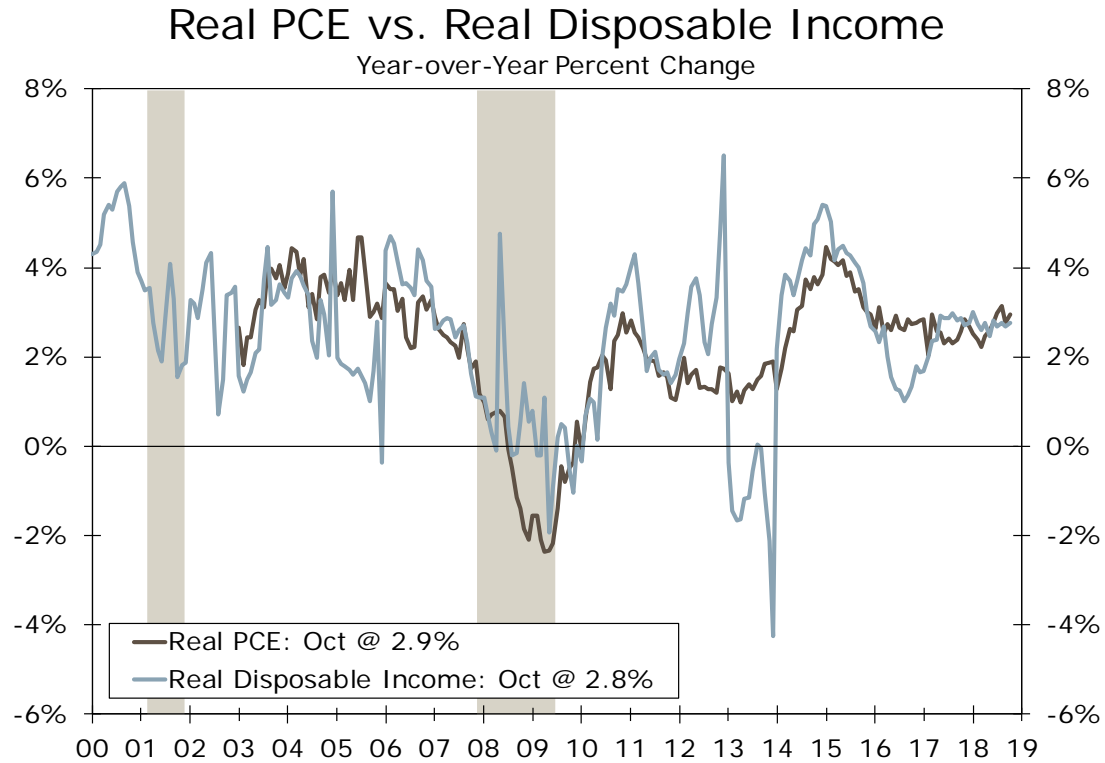
Source: U.S. Department of Labor and Wells Fargo Securities

Wage growth has picked up modestly but remains a missing piece to the recovery thus far due to slow productivity growth.



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

Stronger employment and wage growth has boosted incomes, which will support all-important consumer spending as we head into 2019.

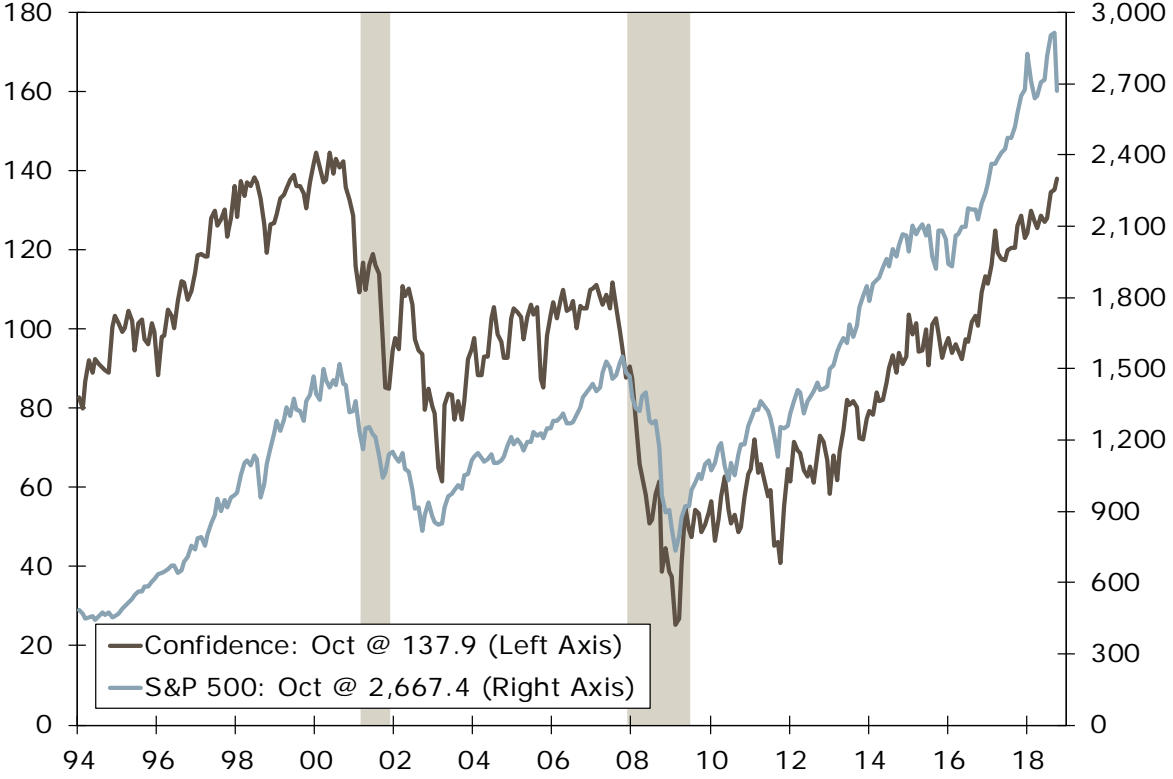


Source: U.S. Department of Commerce and Wells Fargo Securities

Solid job growth has also kept consumer confidence at sky-high levels. Higher stock market returns are also creating a wealth effect, providing support for further spending.

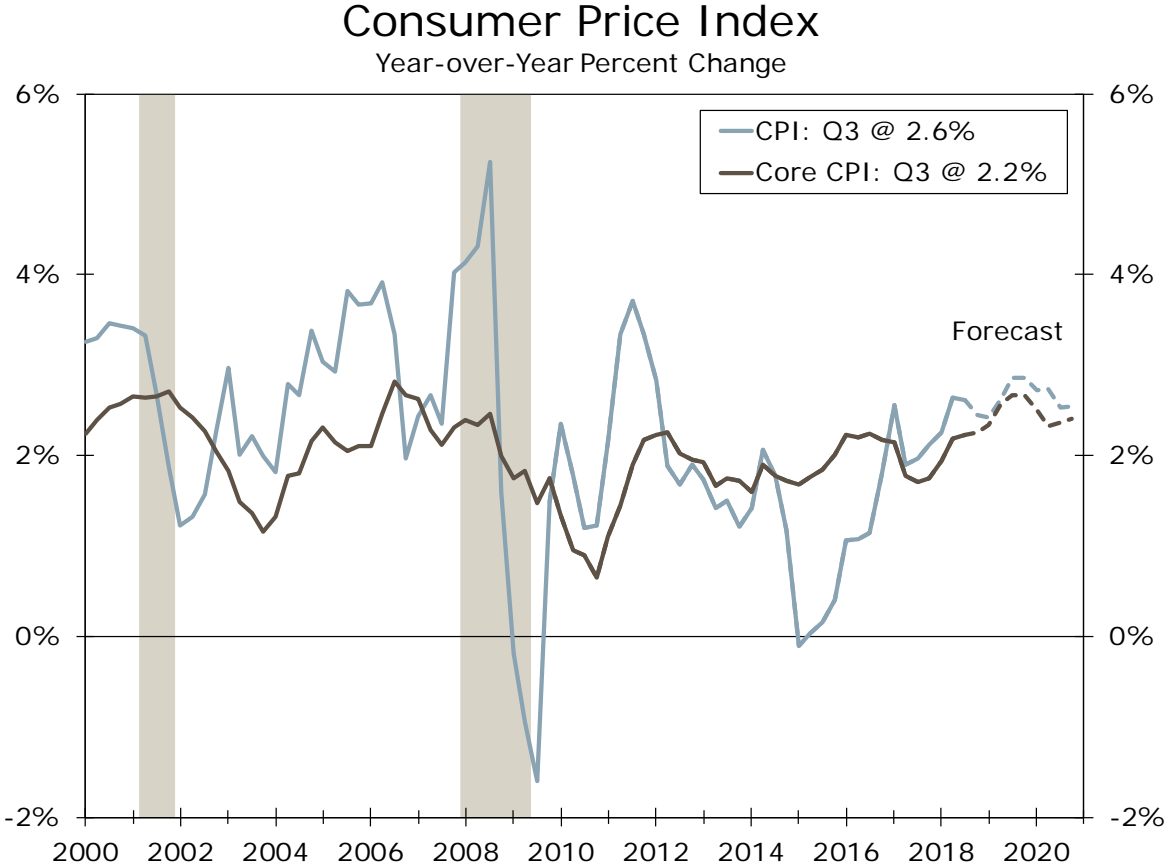
## Consumer Confidence Index and S&P 500

Conference Board



Source: Conference Board, S&P Indices and Wells Fargo Securities

Inflationary pressures have increased recently and are now at the Fed's 2 percent benchmark.

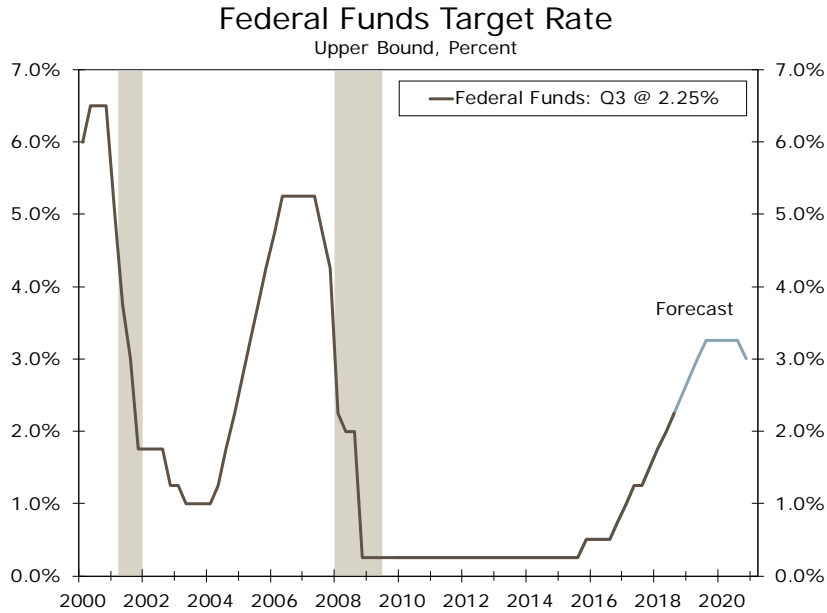


Source: U.S. Department of Commerce and Wells Fargo Securities

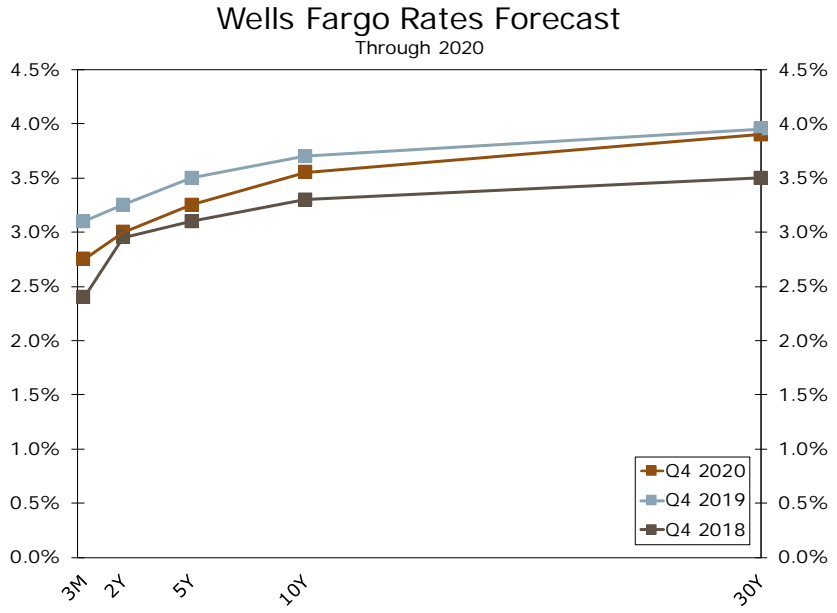


The Fed recently hiked rates at their September meeting and are expected to do the same thing in December, bringing the fed funds rate closer to a more “normal” level and flattening the yield curve.

## Monetary Policy

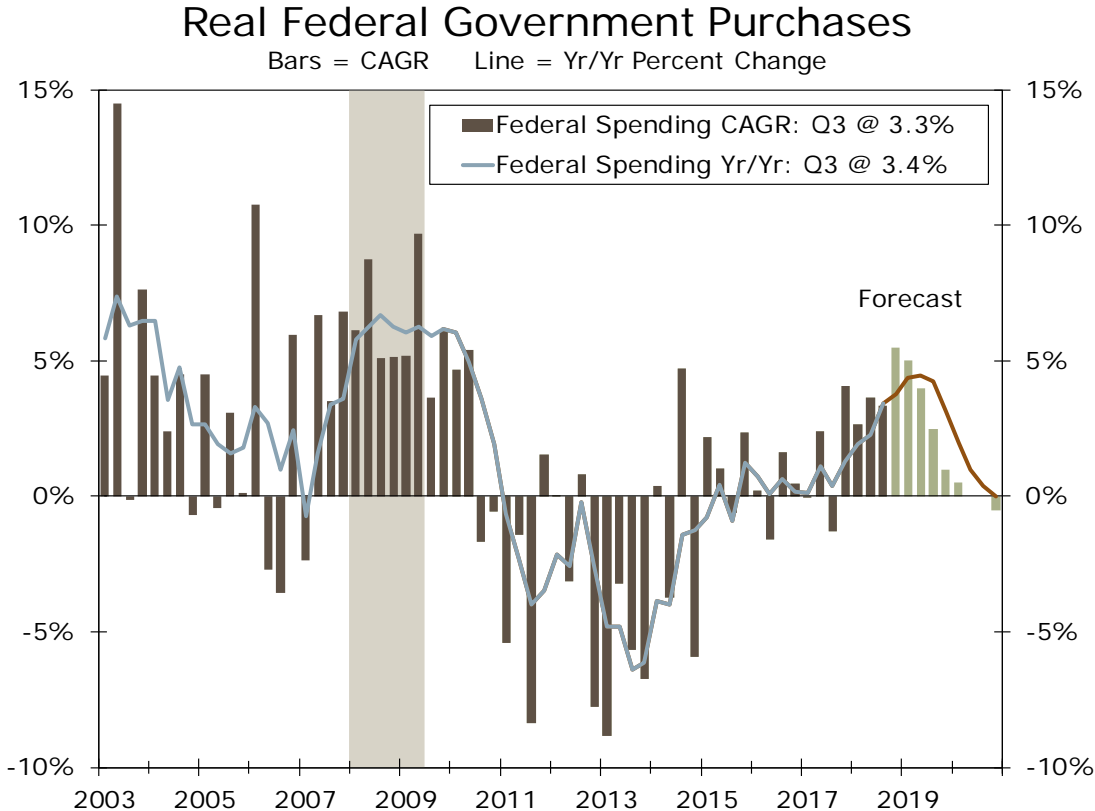


## Interest Rates



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

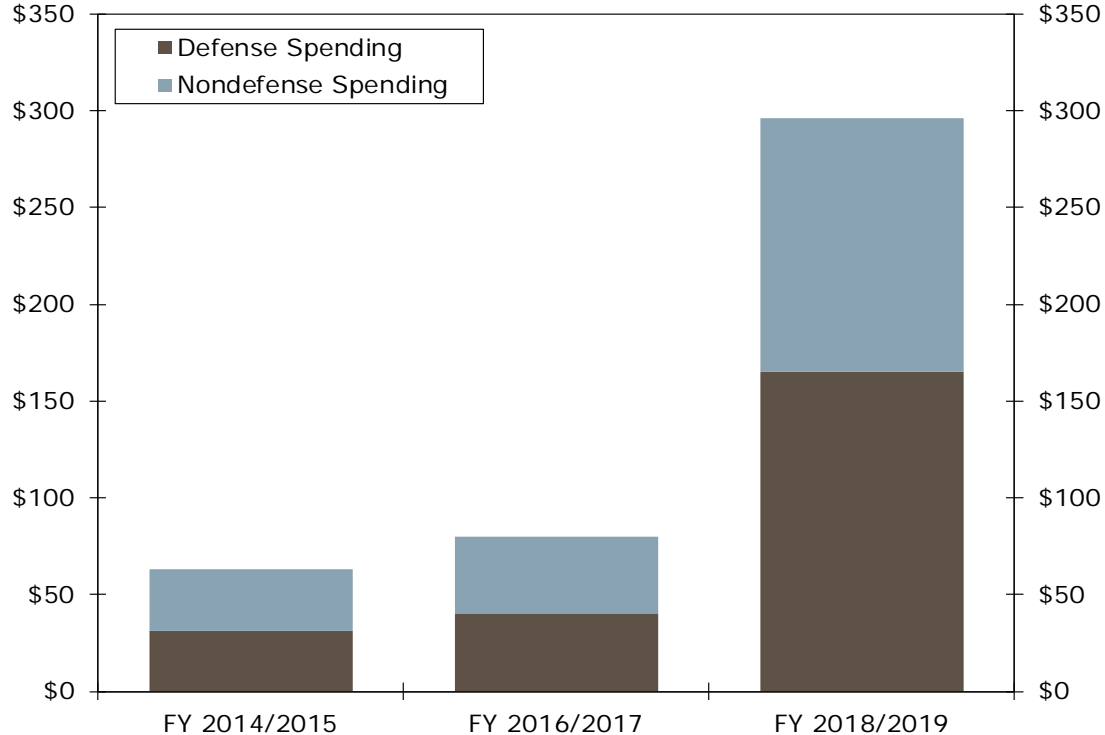
Tax reform and the recent budget deal will provide a short-term boost economic growth.



Source: Congressional Budget Office and Wells Fargo Securities

The budget deal reached in February provides additional fiscal stimulus to the U.S. economy

Increase in BCA Budget Caps  
Billions of USD



Source: Congressional Budget Office and Wells Fargo Securities

## Key Tax Law Changes

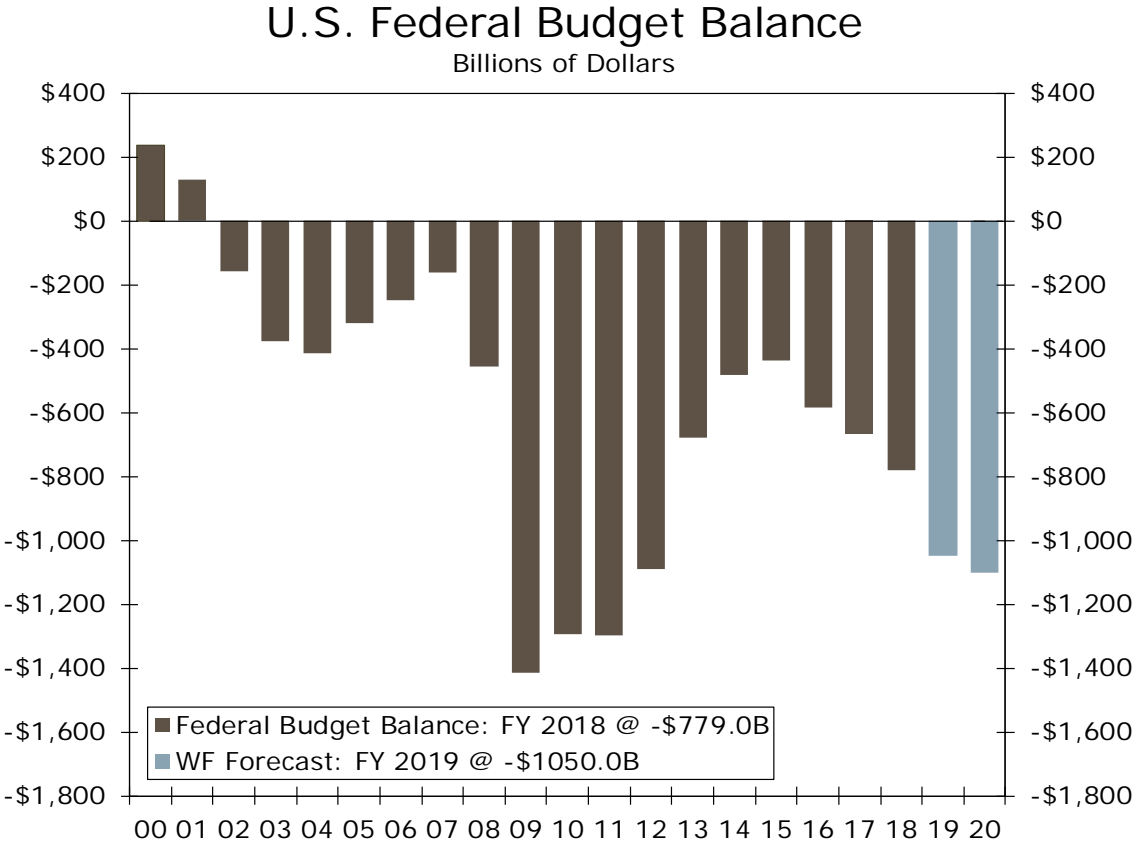
### **Individual Tax Code Changes**

- Bill slashes marginal tax rates across the board
- Limits state & local income and property tax deductions to \$10,000
- Pass-throughs would be allowed to deduct up to 20 percent of income
- Doubles the standard deduction and the child tax credit
- Caps mortgage interest deduction at \$750K
- Doubles the estate tax exemption
- Keeps the Alternative Minimum Tax (AMT) but lifts the threshold to \$500K
- Maintains several deductions including medical expenses, student loans and private activity bonds (PABs)
- Repeals Obamacare individual mandate
- Individual cuts expire on December 31, 2025

### **Business Tax Code Changes**

- Permanently reduces the corporate tax rate to 21% from the current 35% federal rate starting in 2018
- Corporate AMT repealed
- Business interest expense deductions are capped at 30 percent of EBITDA for 4 years and 30 percent of EBIT thereafter
- The bill allows for full and immediate expensing of business capital investments. This provision expires in five years.
- Ends the current worldwide corporate tax system by switching to a territorial system. Existing profits held abroad are taxed at 15.5 percent for cash and cash equivalents and 8 percent for reinvested foreign earnings.

The Tax Cuts and Jobs Act, budget deal and mandatory spending have the deficit on track to breach \$1 trillion while the economy is still in an expansion

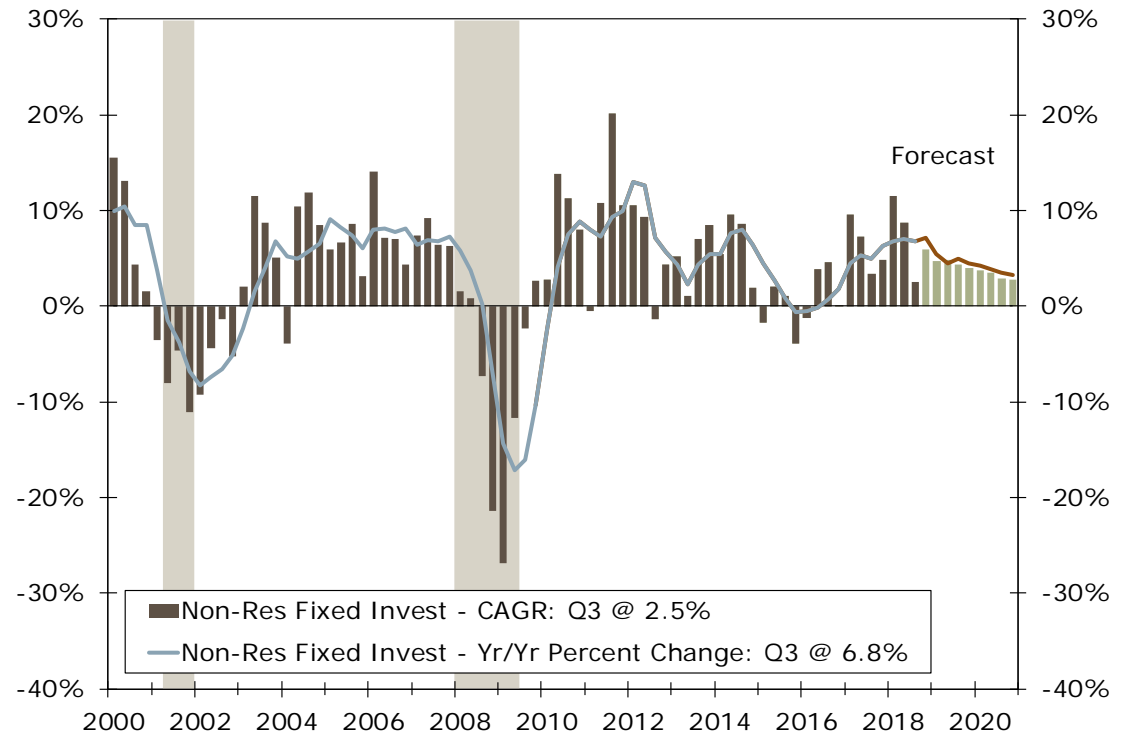


Source: U.S. Department of the Treasury and Wells Fargo Securities

Business fixed investment growth should be bolstered by tax reform, an area that has lagged outside of the tech and energy sector.

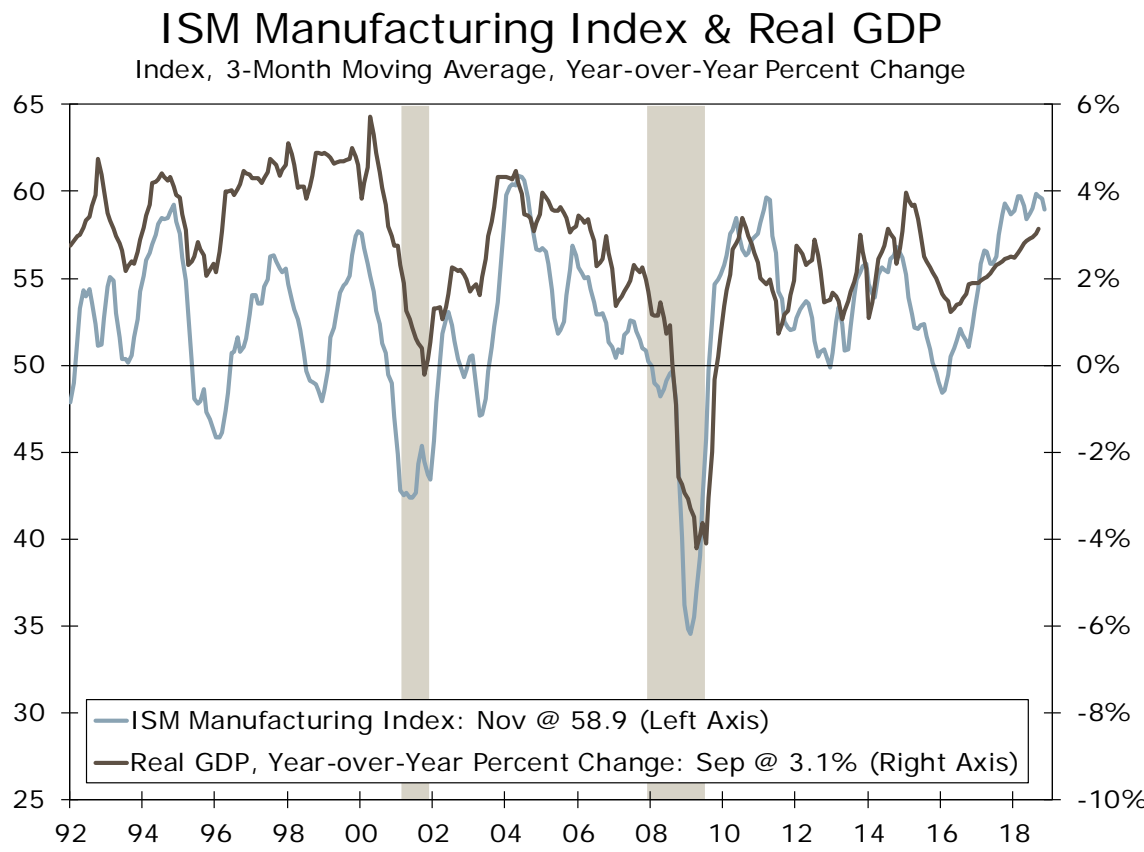
## Real Business Fixed Investment

Bars = CAGR    Line = Yr/Yr Percent Change



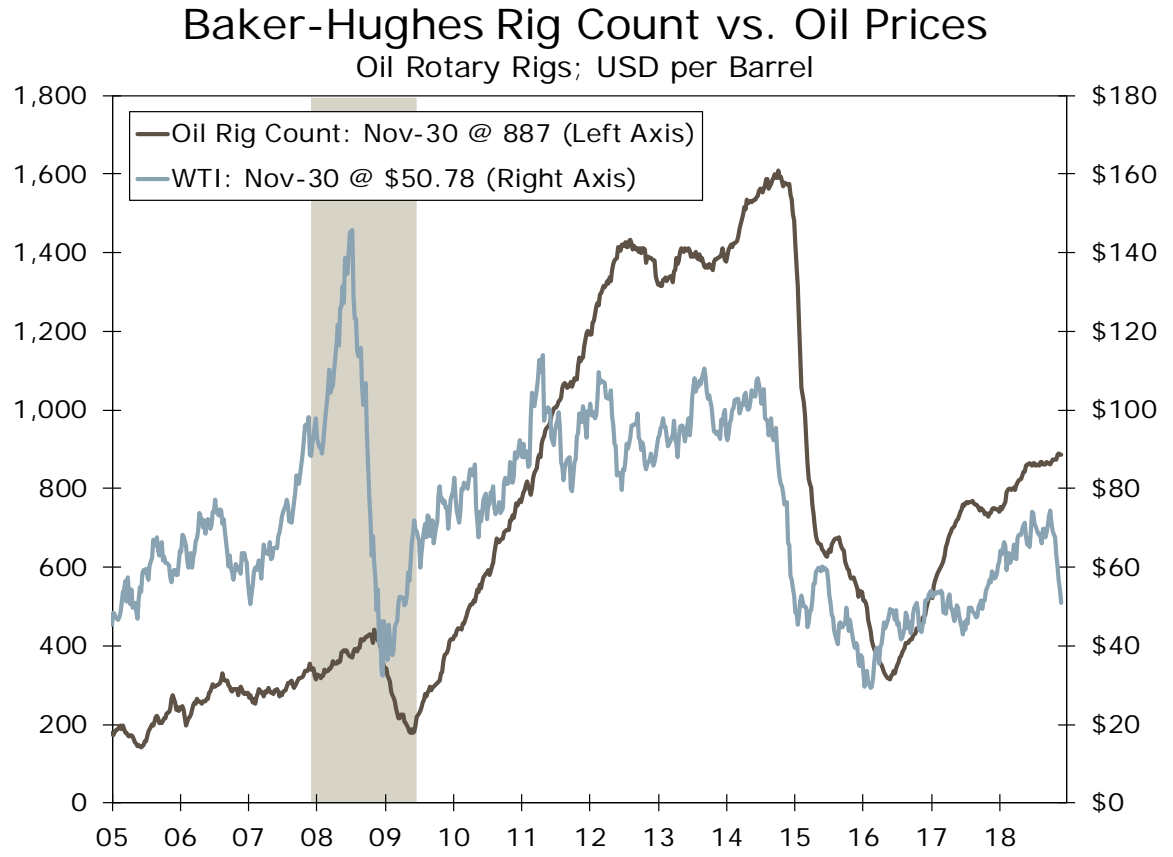
Source: U.S. Department of Commerce and Wells Fargo Securities

Underlying manufacturing activity continues to look strong, supporting the case for solid economic momentum.



Source: Institute for Supply Management and Wells Fargo Securities

The recent drop in oil prices may be good for consumers, but is concerning for new energy-related investment.

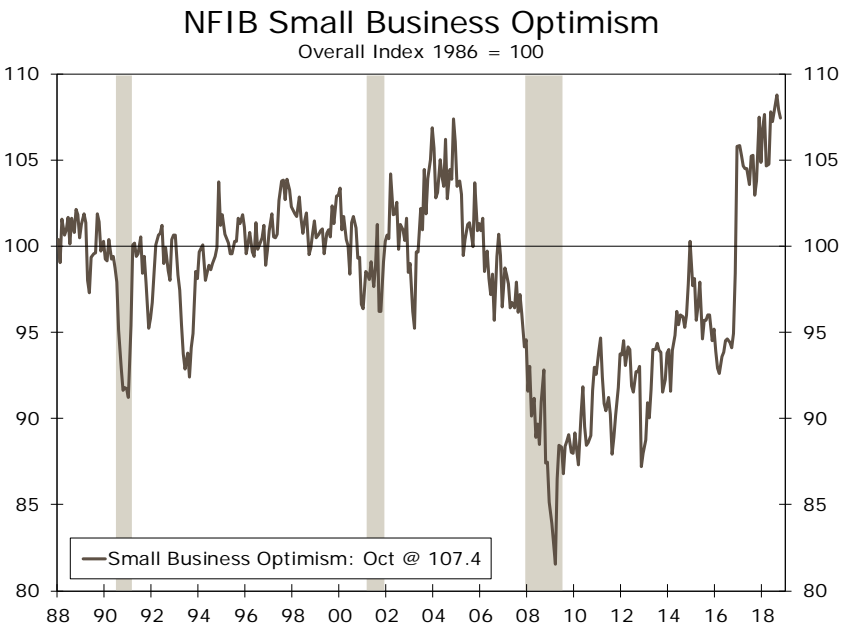


Source: Baker Hughes, Inc., Bloomberg LP and Wells Fargo Securities

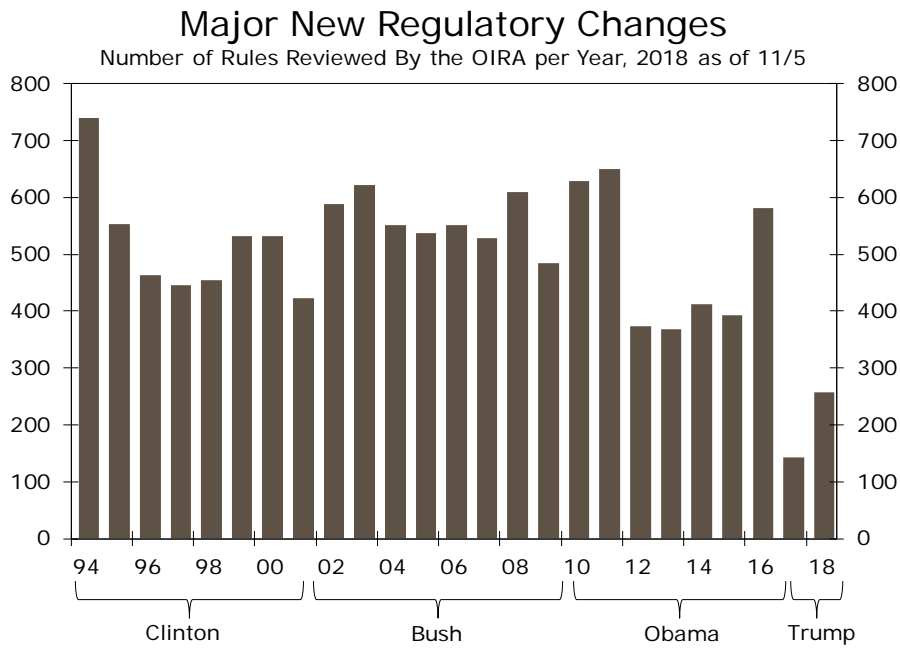


Small business optimism spiked following the presidential election and remains at an all time high. Business owners have become much less worried about the regulatory environment.

## Small Business Optimism



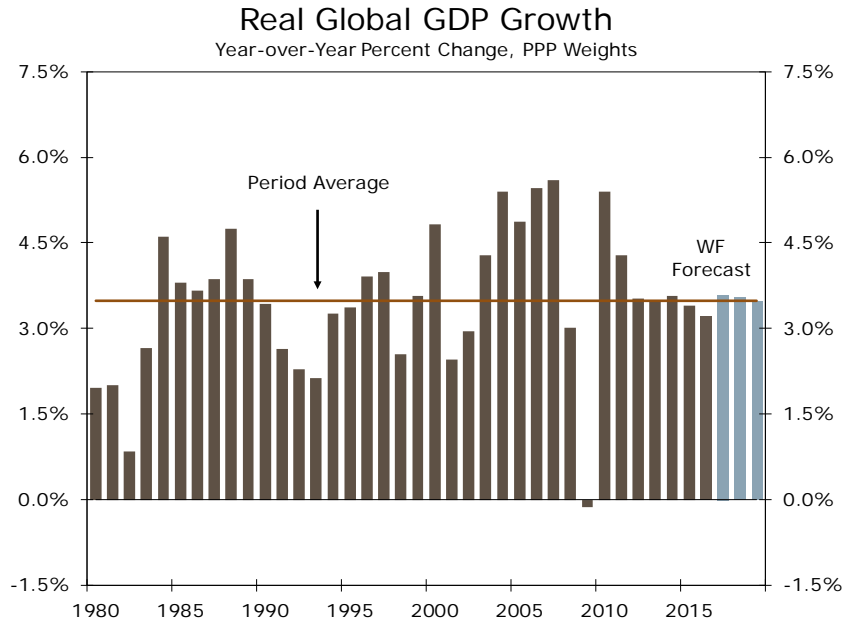
## Small Business Concerns



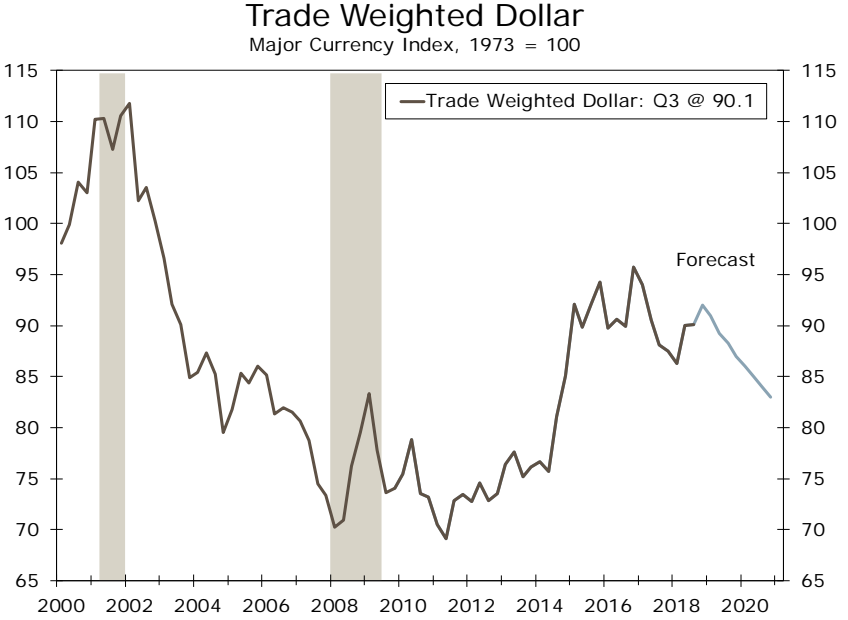
Source: National Federation of Independent Business (NFIB), Office of Information and Regulatory Affairs and Wells Fargo Securities

Global growth continues to be solid. Although many central banks have started to hike rates, monetary policy remains accommodative, which should keep the global expansion intact.

## Global Growth



## The Dollar

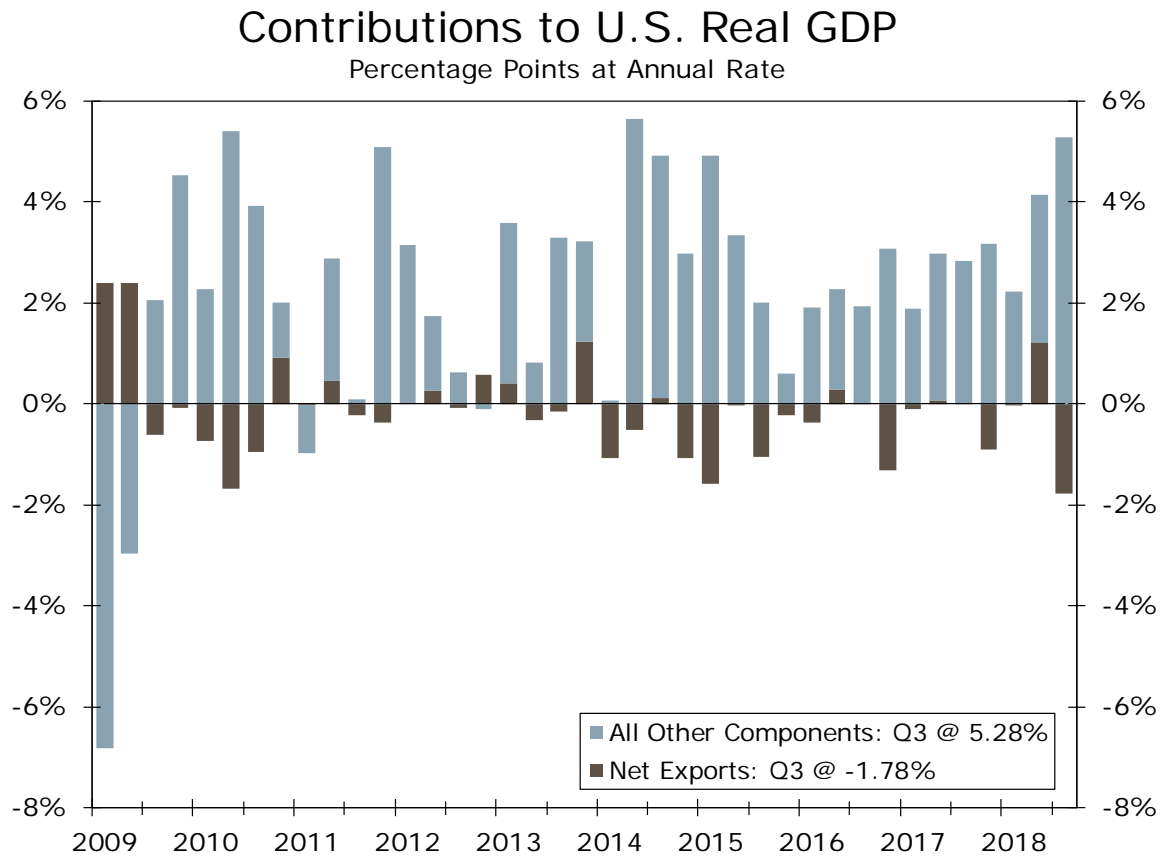


Source: International Monetary Fund, Federal Reserve Board and Wells Fargo Securities

# Trade Policy

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Of the multiple factors that drive the U.S. economy, trade is often the least consequential.



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

# 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%	\$5.9	Softwood Lumber	Canada	0.25%	0.05%
Feb 7, 2018	20%	\$1.8	Washing Machines	Multiple	0.08%	0.01%
Feb 7, 2018	30%	\$8.5	Solar Panels	Multiple	0.36%	0.07%
Mar 23/Ann 1, 2018	25%	\$23.4	Steel	Multiple	1.00%	0.19%
Mar 23/Ann 1, 2018	10%	\$16.4	Aluminum	Multiple	0.70%	0.13%
Jul 6, 2018	25%	\$34.0	Variety Focus: Tech, Auto & Manuf.	China	1.45%	0.27%
Aug 23, 2018	25%	\$16.0	Variety	China	0.68%	0.13%
Sep 24, 2018	10%	\$200.0	Variety	China	8.54%	1.59%
<b>Enacted Total</b>	<b>14%</b>	<b>\$ 305.9</b>			<b>13.06%</b>	<b>2.44%</b>
Proposed	25%	\$51.8	Autos	E.U.	2.21%	0.41%
Proposed	10%	\$267.0	Variety	China	11.40%	2.13%
<b>Proposed Total</b>	<b>12%</b>	<b>\$ 318.8</b>			<b>13.61%</b>	<b>2.54%</b>
<b>Enacted + Proposed</b>	<b>13%</b>	<b>\$ 624.7</b>			<b>26.67%</b>	<b>4.97%</b>

\*Values based on 2017 trade data

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

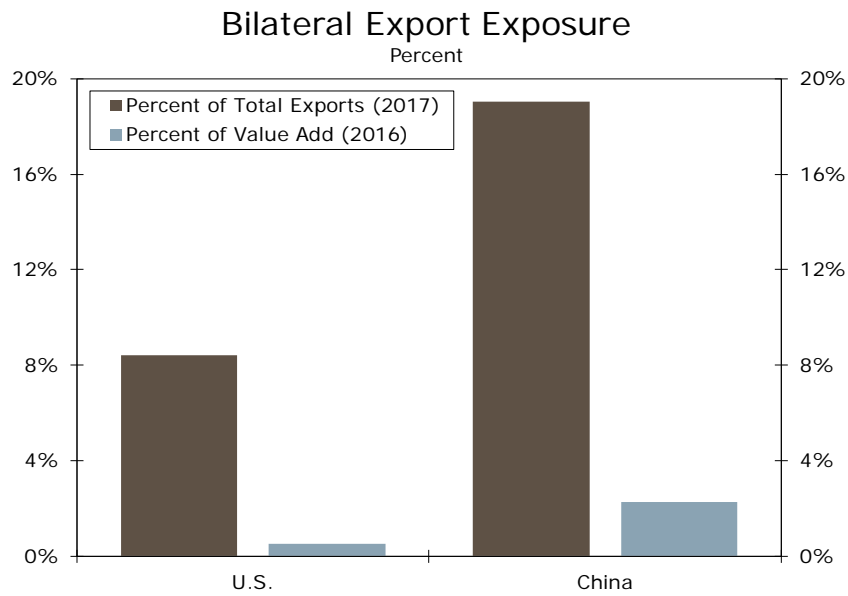
Retaliatory Tariff Timeline					
Date in Effect	Size	Value of Goods* (Billions )	Goods Targeted	Country	% of Exports
Apr 2, 2018	15% - 25%	\$3.0	Variety	China	0.19%
Jun 5 / Jul 5, 2018	7% - 25%	\$3.6	Variety	Mexico	0.23%
Jun 21, 2018	4% - 70%	\$1.8	Variety	Turkey	0.12%
Jun 22, 2018	25%	\$3.2	Variety	EU	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>8.69%</b>
Proposed	5% - 50%	\$0.2	Variety	India	0.02%
<b>Proposed Total</b>	-	<b>\$0.2</b>			<b>0.02%</b>
<b>Enacted + Proposed</b>	-	<b>\$134.5</b>			<b>8.70%</b>

\*Values based on 2017 trade data

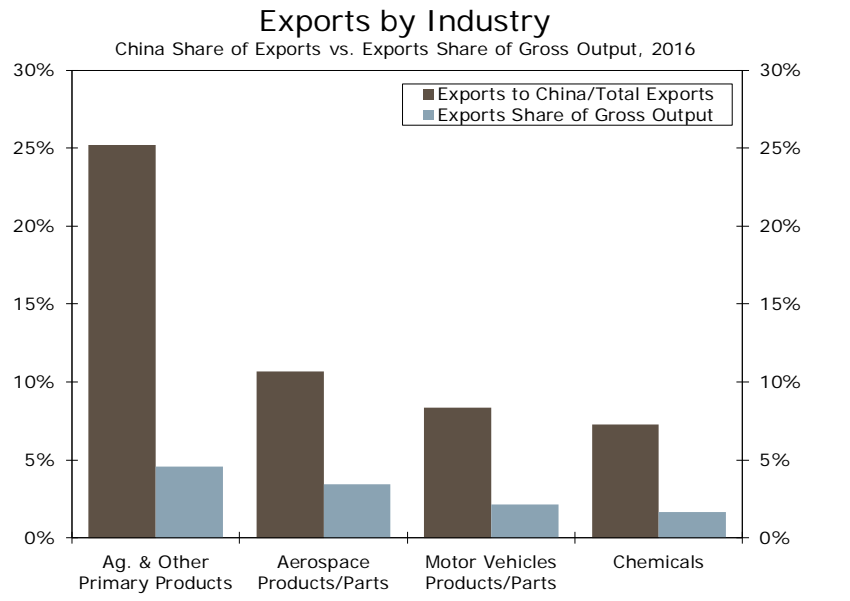
Source: Office of the United States Trade Representative, U.S. Department of Commerce, Pearson Institute for International Economics, Washington Post, Reuters, Ministry of Economic Development of the Russian Federation and Wells Fargo Securities

China appears to have more to lose if a full-blown trade war were to develop, but such an event would not be costless for the United States.

**U.S.-China Export Exposure**



**U.S. Industry Exposure**

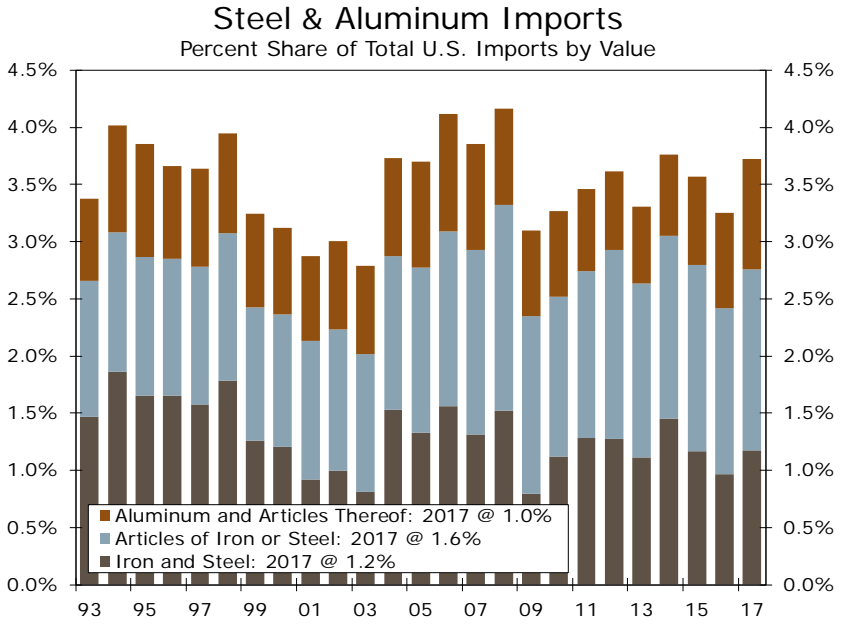


Source: International Monetary Fund, OECD, United Nations, U.S. Department of Commerce and Wells Fargo Securities

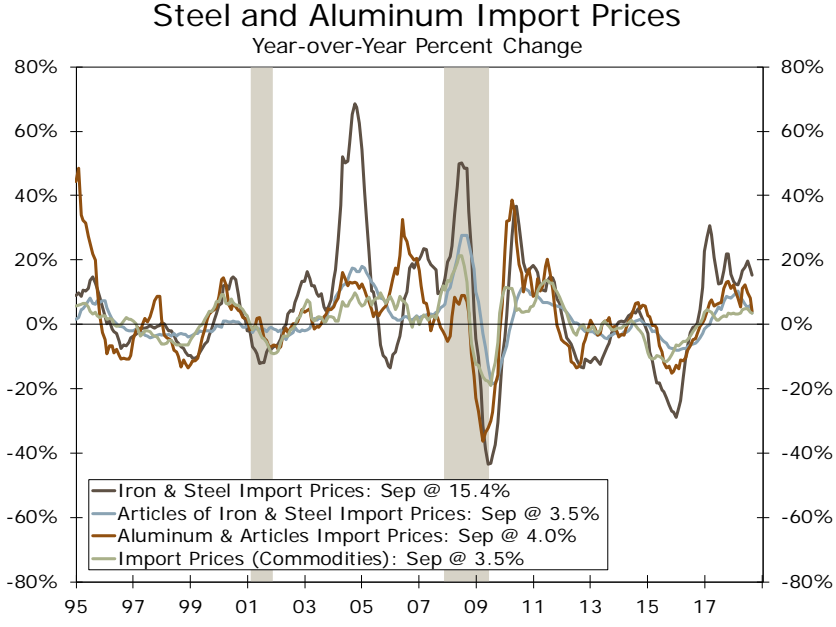
# Steel and Aluminum Imports

The combined share of steel and aluminum is roughly 4% of imports, which limits the degree to which price changes in these commodities affect overall U.S. import prices and inflation.

## Imports



## Import Prices



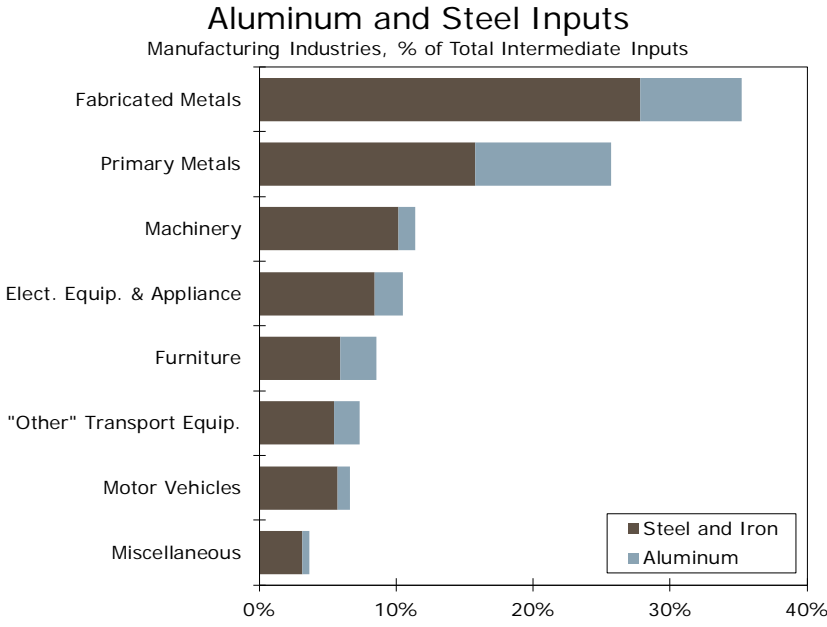
Source: U.S. Department of Commerce, U.S. Department of Labor and Wells Fargo Securities



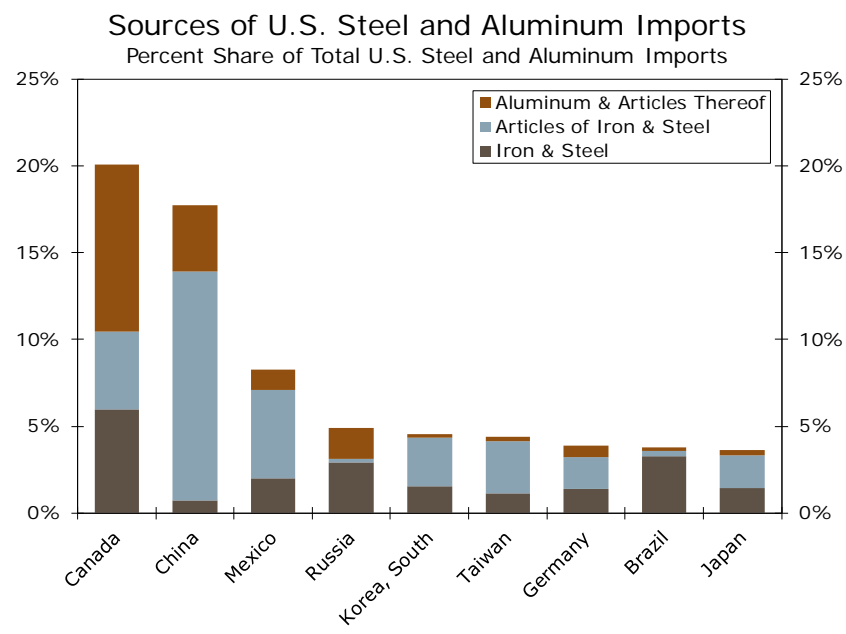
# Steel and Aluminum Imports

Manufacturers that use steel and aluminum would see their production costs rise as the tariffs go into effect. Canada is the largest source of steel and aluminum imports, while Mexico is the third-largest exporter to the U.S. for both products.

## Imports



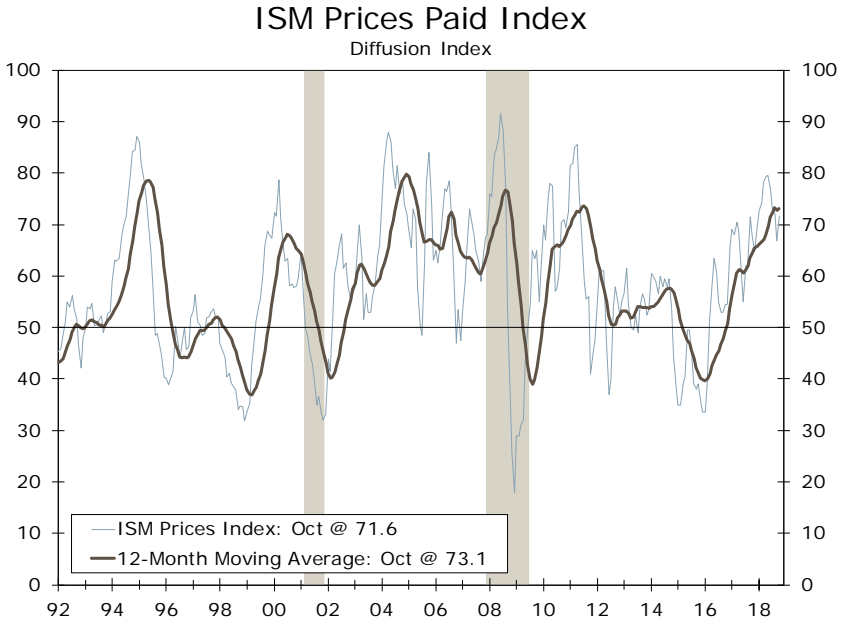
## Global Sources of Steel



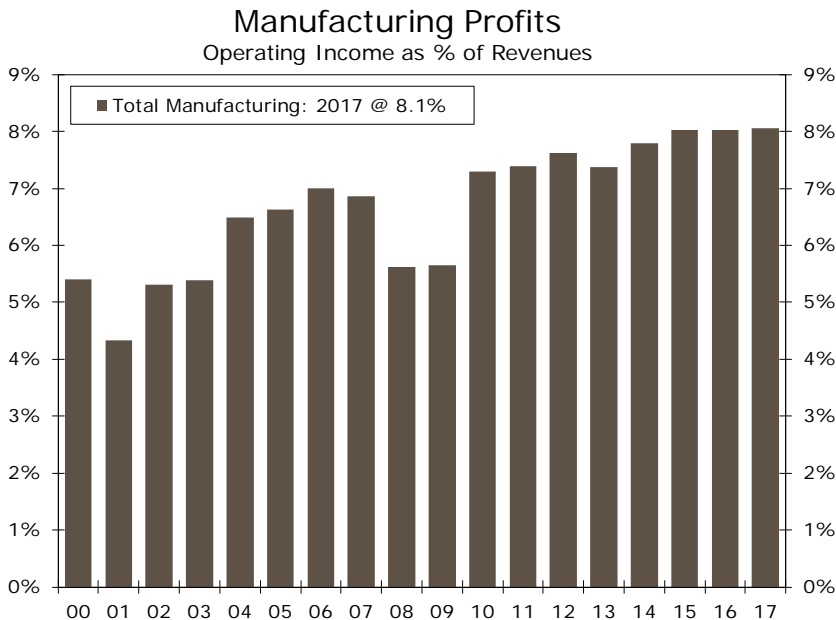
Source: U.S. Department of Commerce and Wells Fargo Securities

Input prices for manufacturers were already rising at the fastest pace in nearly seven years. However, manufacturers' margins currently sit at a 17-year high, suggesting some scope to absorb higher input costs.

## Imports



## Import Prices

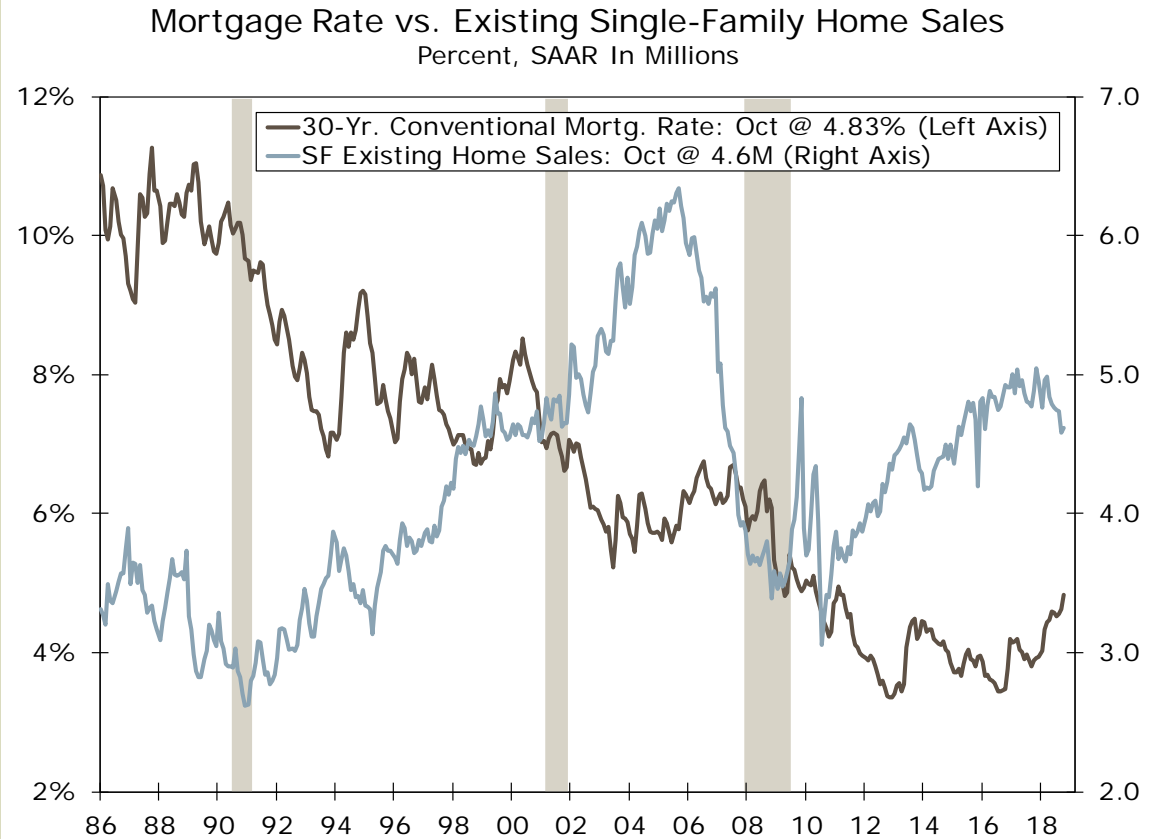


Source: Institute for Supply Management, U.S. Department of Commerce and Wells Fargo Securities

# Real Estate & Housing

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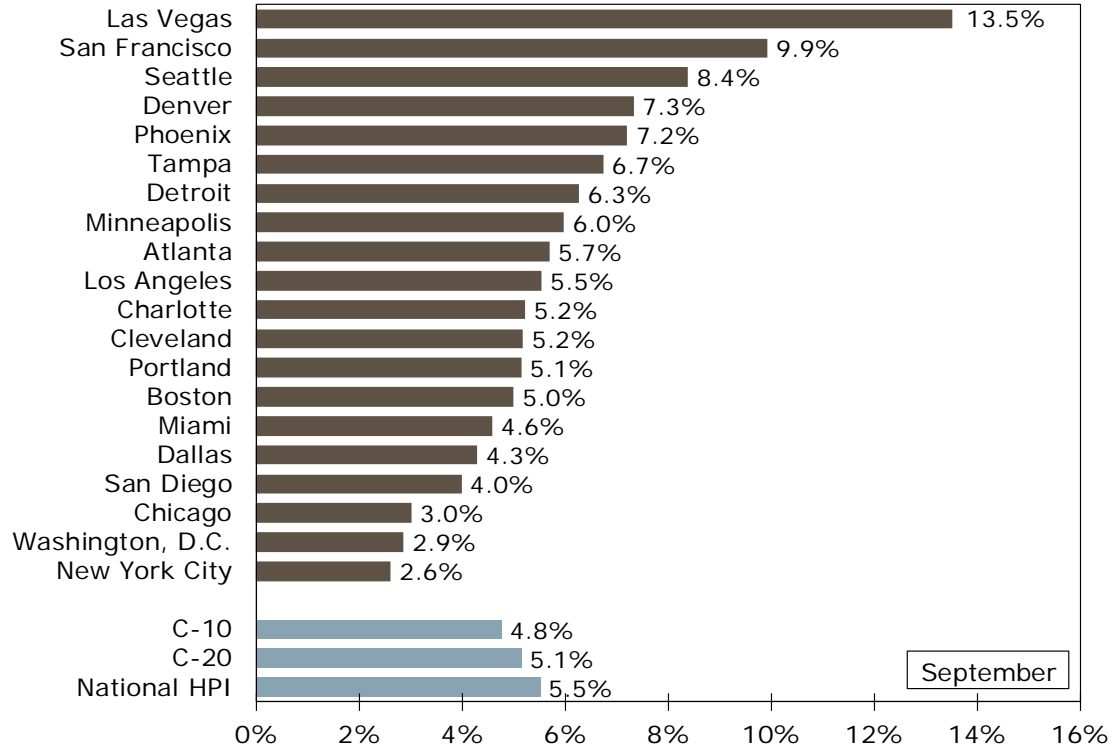
A combination of rising home prices and higher mortgage rates have restrained sales in 2018.



Source: National Association of Realtors, U.S. Department of Commerce and Wells Fargo Securities

Prices have risen fastest in rapidly growing tech-driven markets, mostly in the West where shortages are most acute.

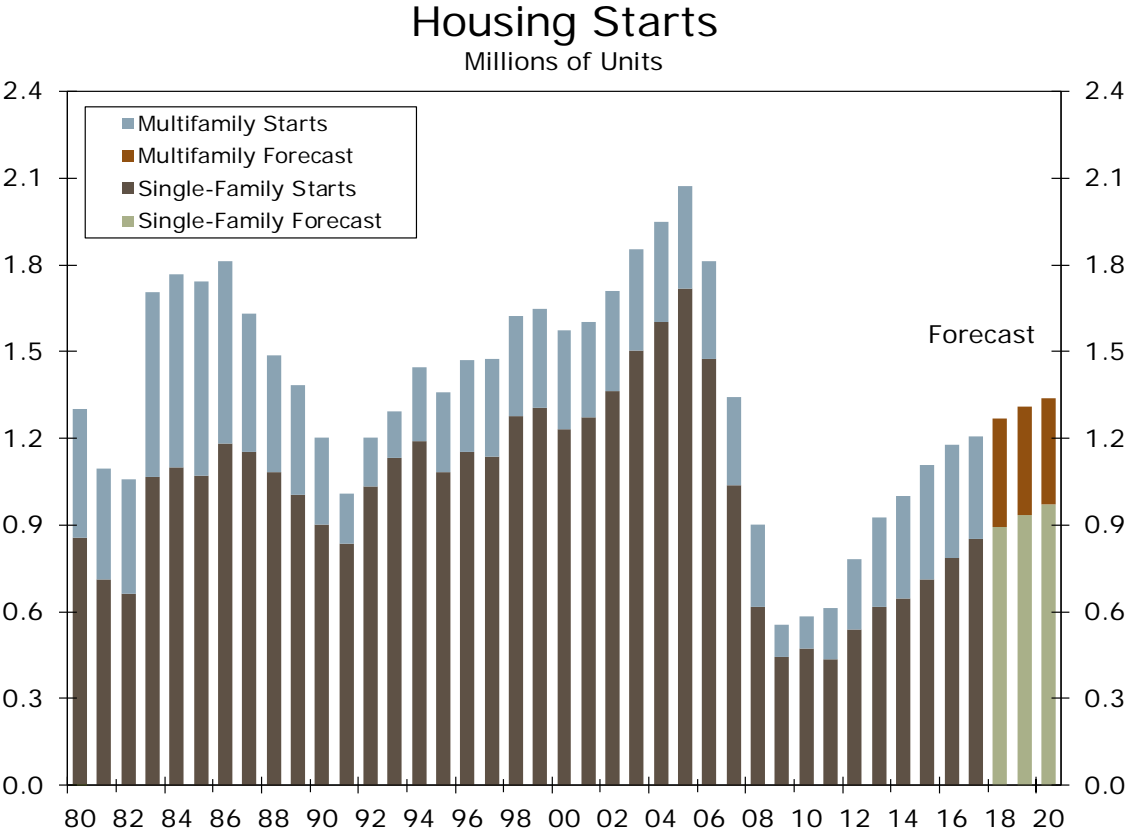
S&P CoreLogic Case-Shiller Home Prices  
Year-over-Year Percent Change, NSA



Source: S&P Dow Jones Indices and Wells Fargo Securities

# Single-Family Starts Are Gaining Momentum, as Apartments Begin to Moderate

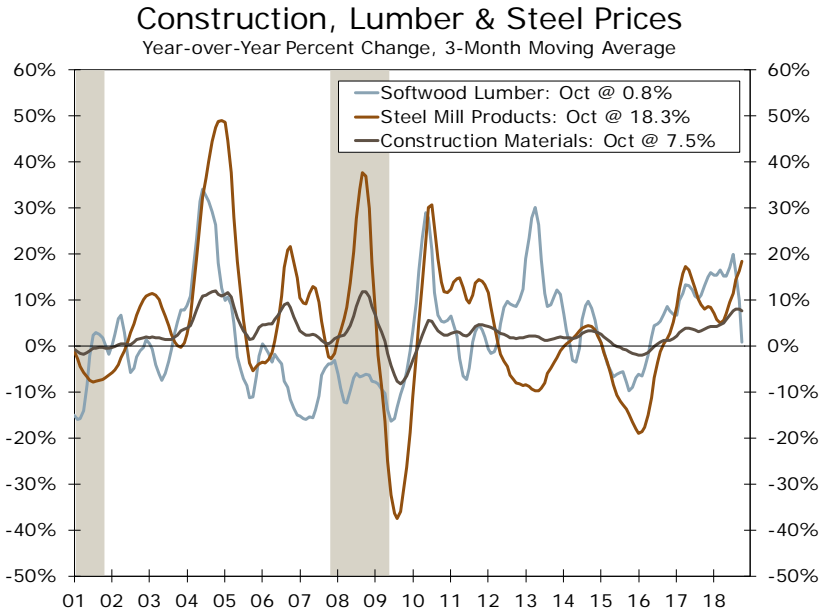
The housing market is at a key turning point where the momentum will shift more toward single-family construction.



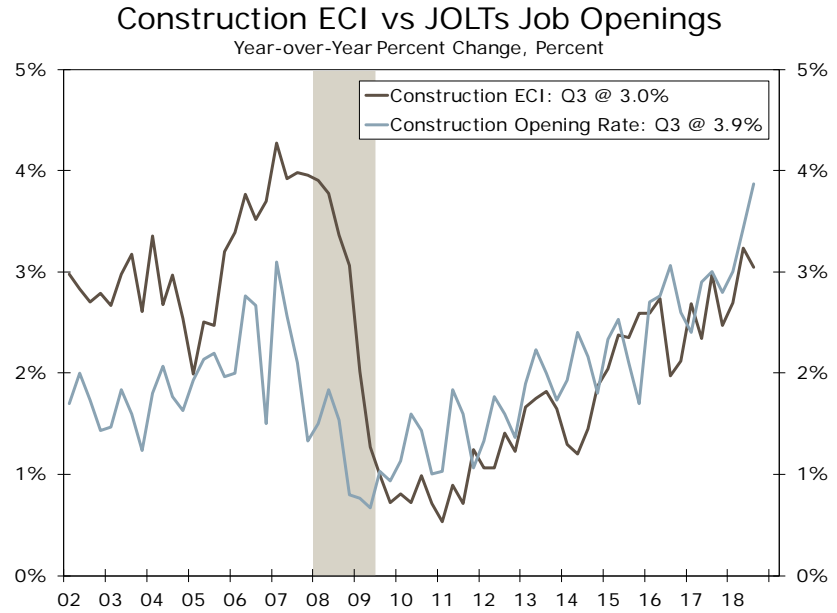
Source: U.S. Department of Commerce and Wells Fargo Securities

Tariffs on lumber and steel have pushed up prices, however strong demand has caused building material prices to rise across the board. A shortage of skilled labor is putting upward pressure on overall construction wages.

## Higher Material Prices

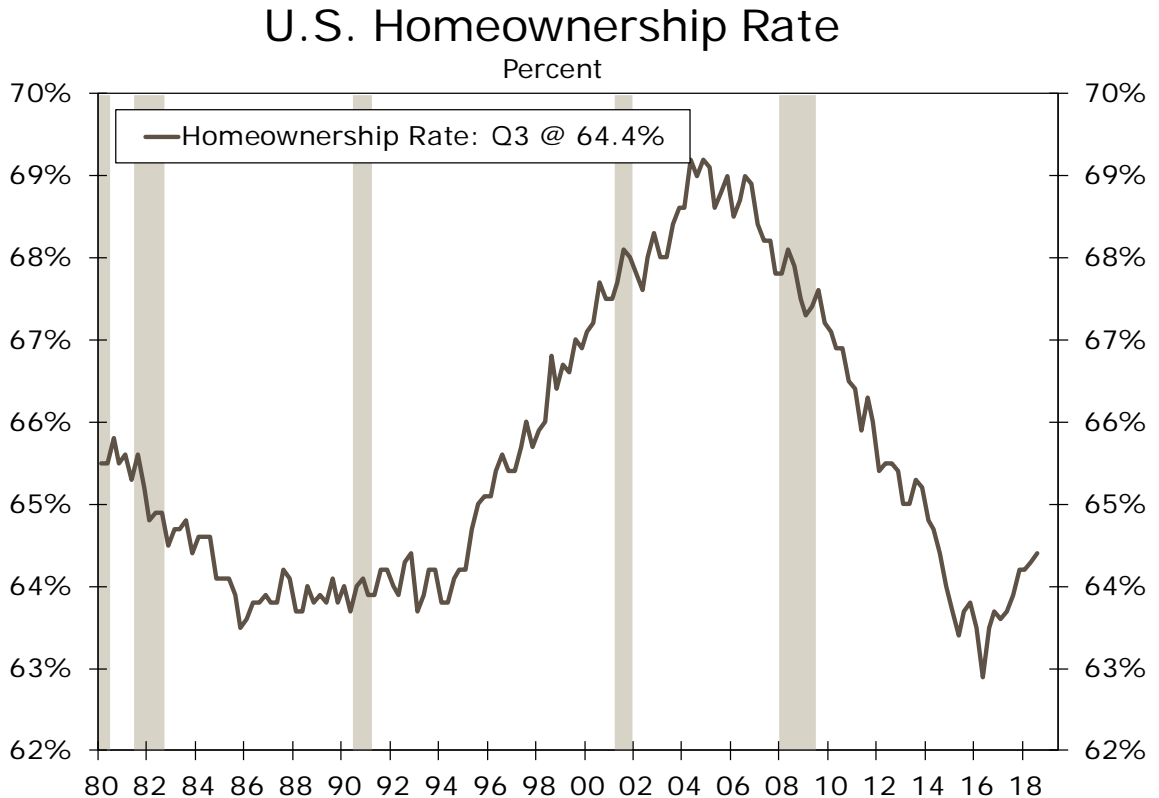


## Higher Labor Costs



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

Household formation has improved over the past few years but generally remains below prior decades. Still, the homeownership rate appears to be reversing course.

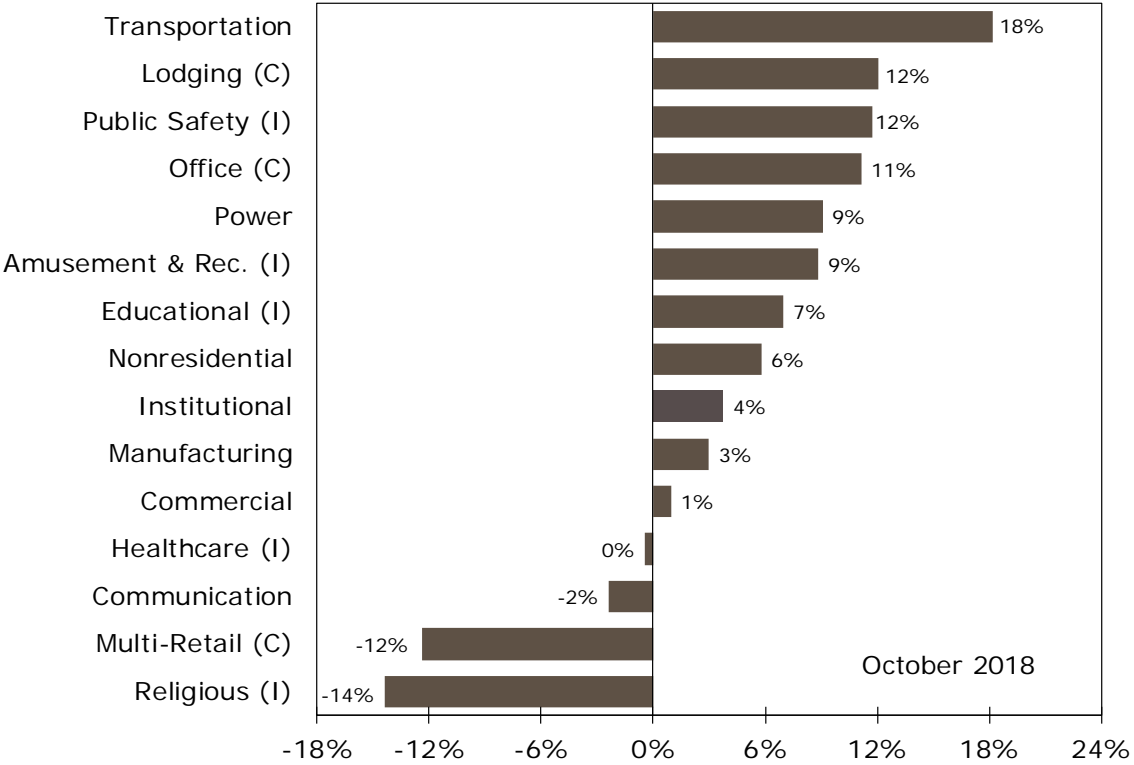


Source: U.S. Department of Commerce and Wells Fargo Securities



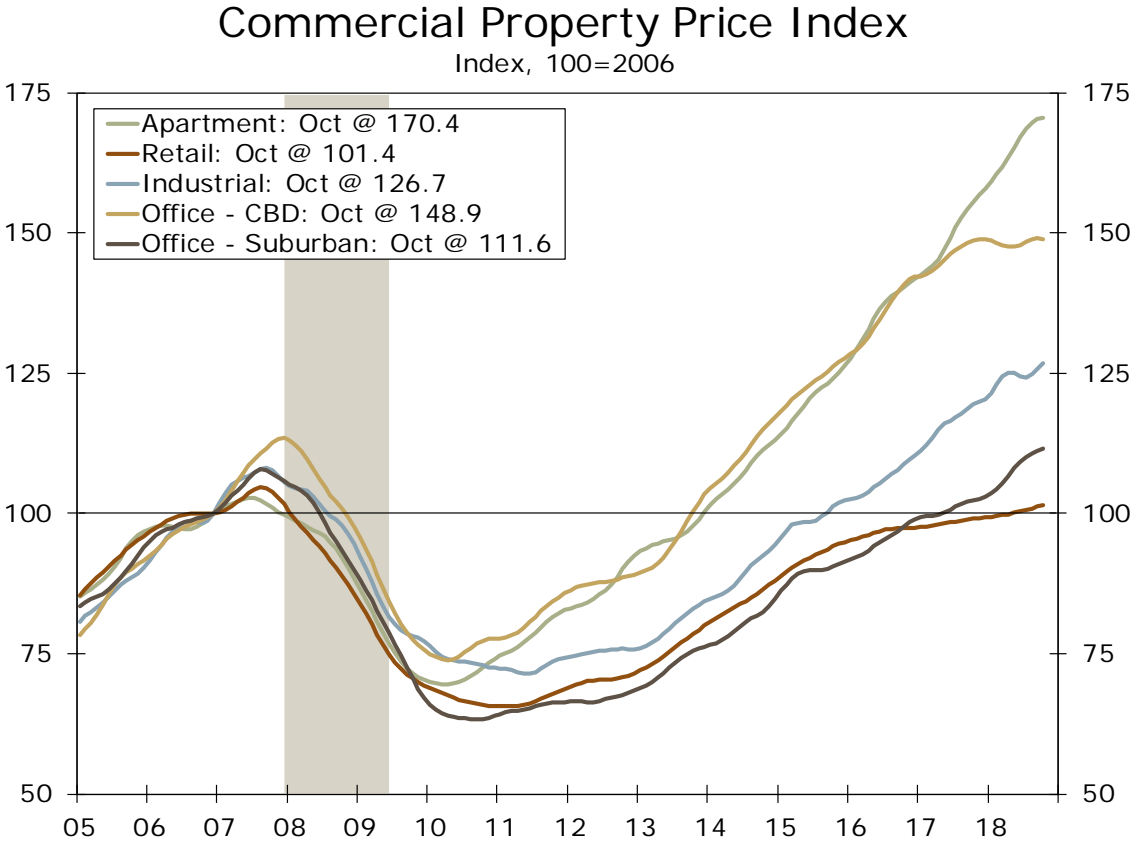
Transportation projects, especially at airports, continue to trend higher. Lodging has also been a bright spot.

Private Nonresidential Construction Put-in-Place  
 Year-over-Year Percent Change of a 3-MMA, Seasonally Adjusted  
 (C) = Commercial, (I) = Institutional



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

Strong real GDP growth, formidable employment gains and rising wages will be the positive undercurrents that propel commercial real estate throughout the next few years. Apartments and industrial properties will remain a growth area.

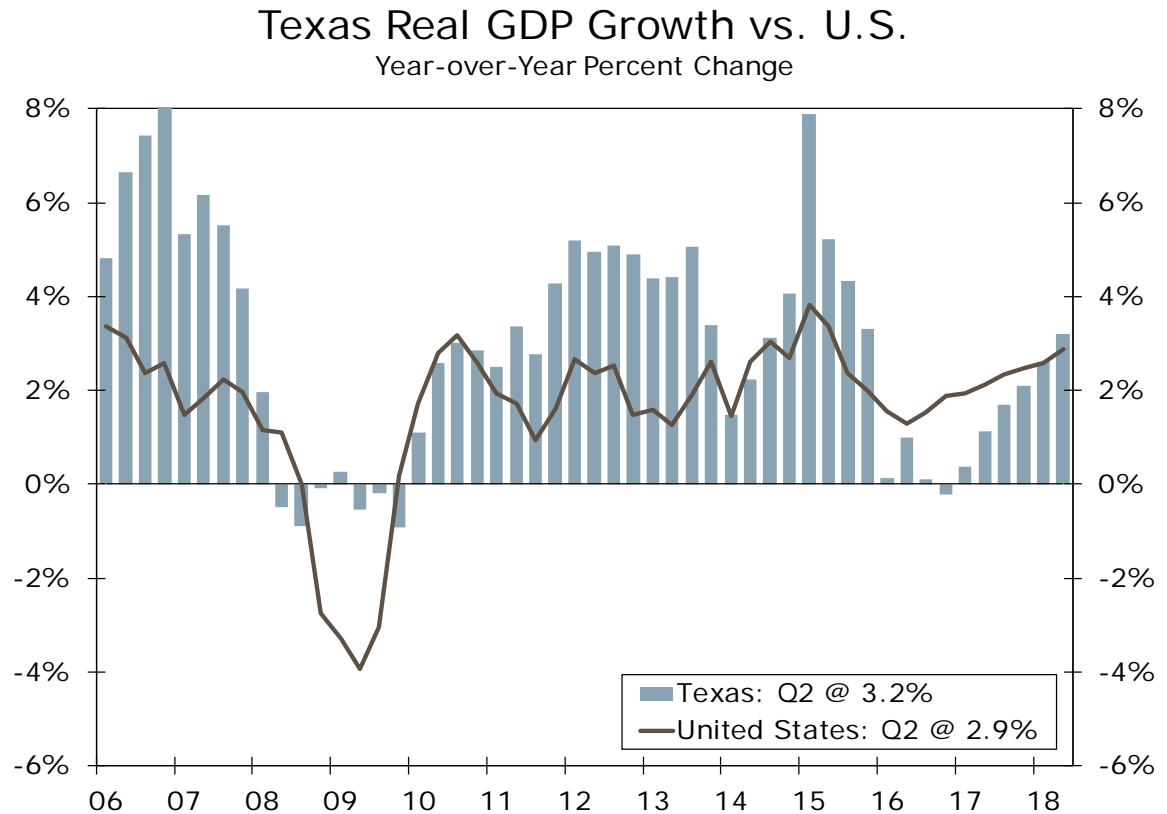


Source: U.S. Department of Commerce and Wells Fargo Securities

# Texas Outlook

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The Texas economy has regained a lot of ground over the past year and a half, rebuilding momentum lost following the plunge in oil prices around the middle of the decade.

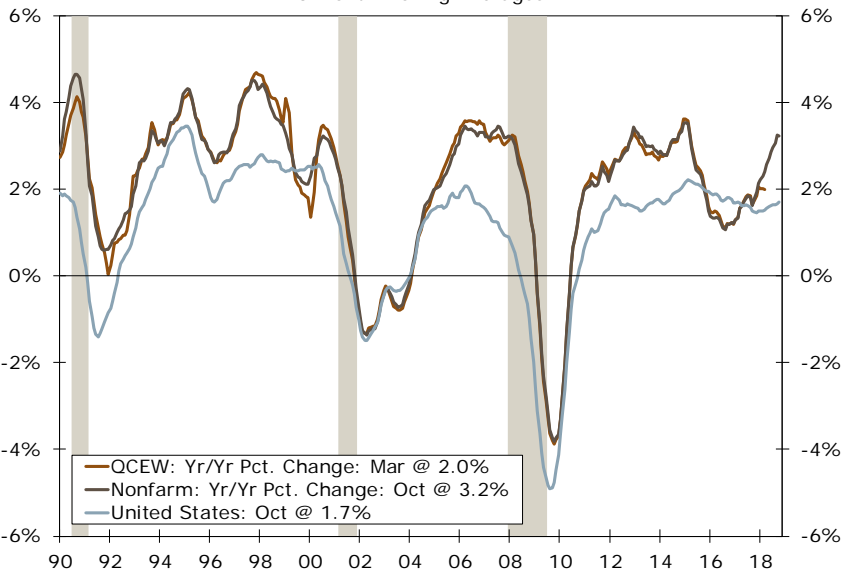


Source: U.S. Department of Commerce and Wells Fargo Securities

The Texas job market is back to firing on all cylinders. Recent improvement have been broad-based across many industries and regions, which should keep payroll growth strong.

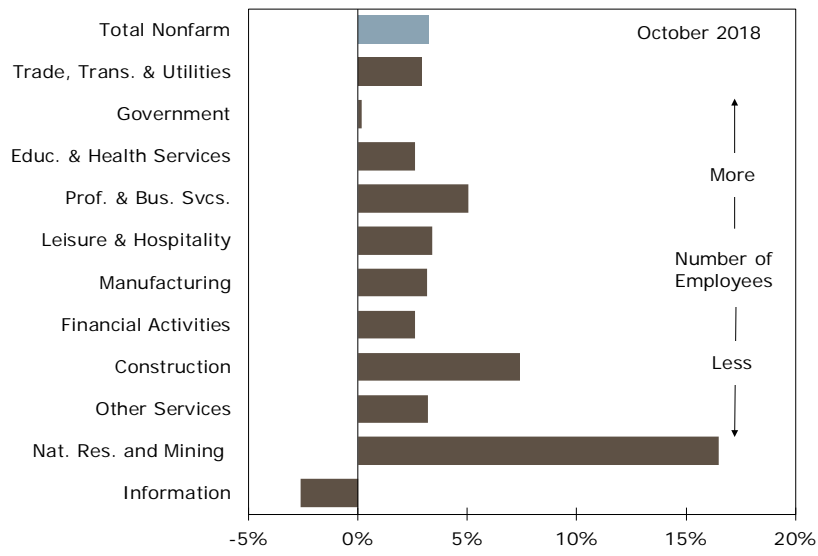
## Employment

Texas Nonfarm Employment  
3-Month Moving Averages



## Employment by Industry

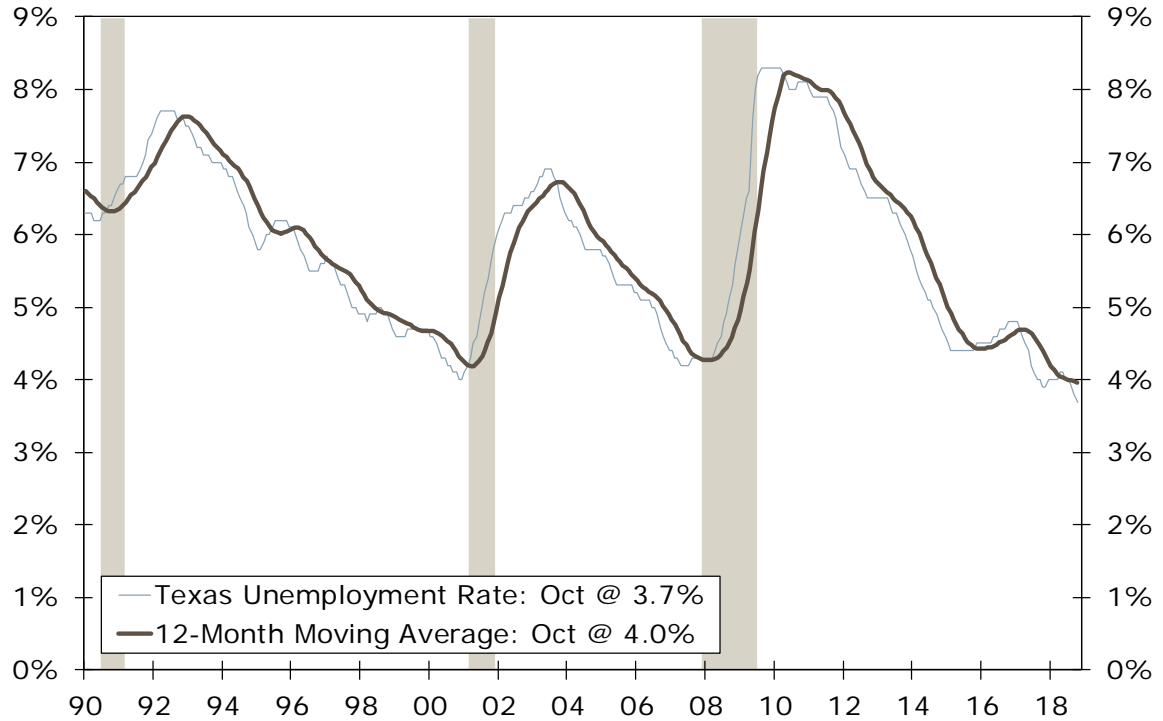
Texas Employment Growth By Industry  
Year-over-Year Percent Change, 3-MMA



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

The Texas jobless rate has recovered from the upward spurt caused by the oil downturn, and now sits at a near record low. A tightening labor market has caused a shortage of skilled workers.

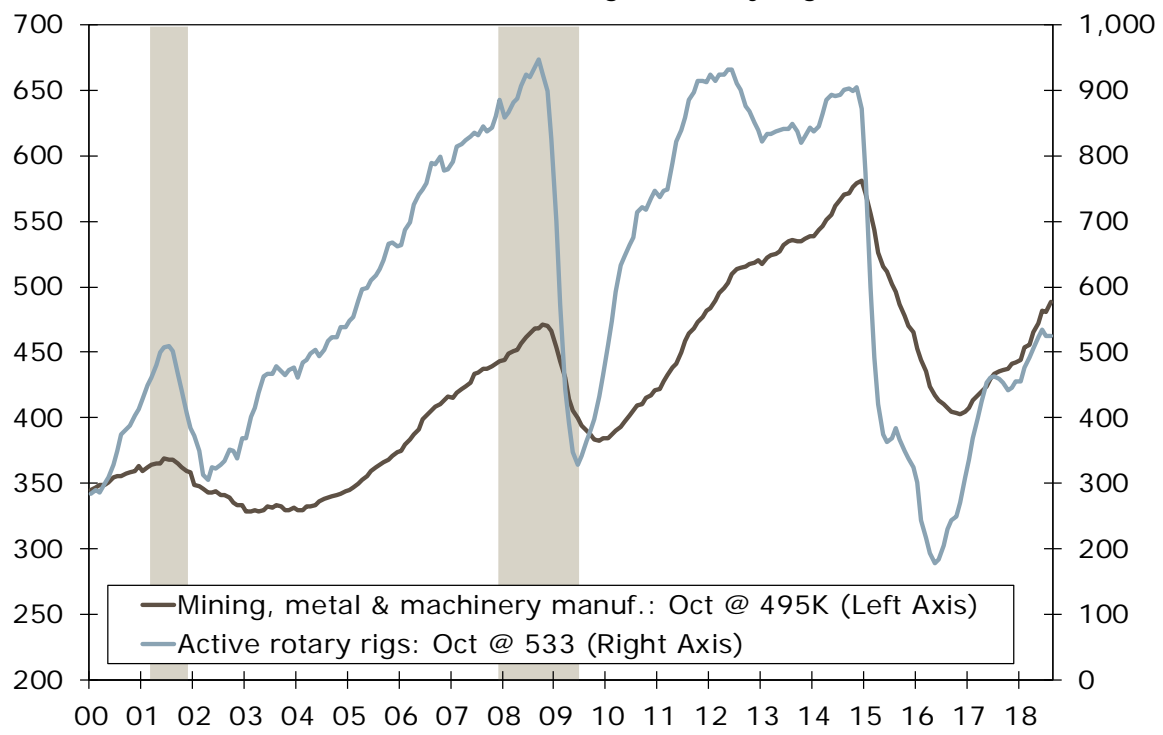
### Texas Unemployment Rate Seasonally Adjusted



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

The rebound in commodity prices since early 2016 has supported new investment spending. However, extraction-related employment has not returned to prior peak levels.

Energy Extraction-Related Jobs and Active Rigs: TX  
Thousand Jobs, Baker Hughes Rotary Rig Count

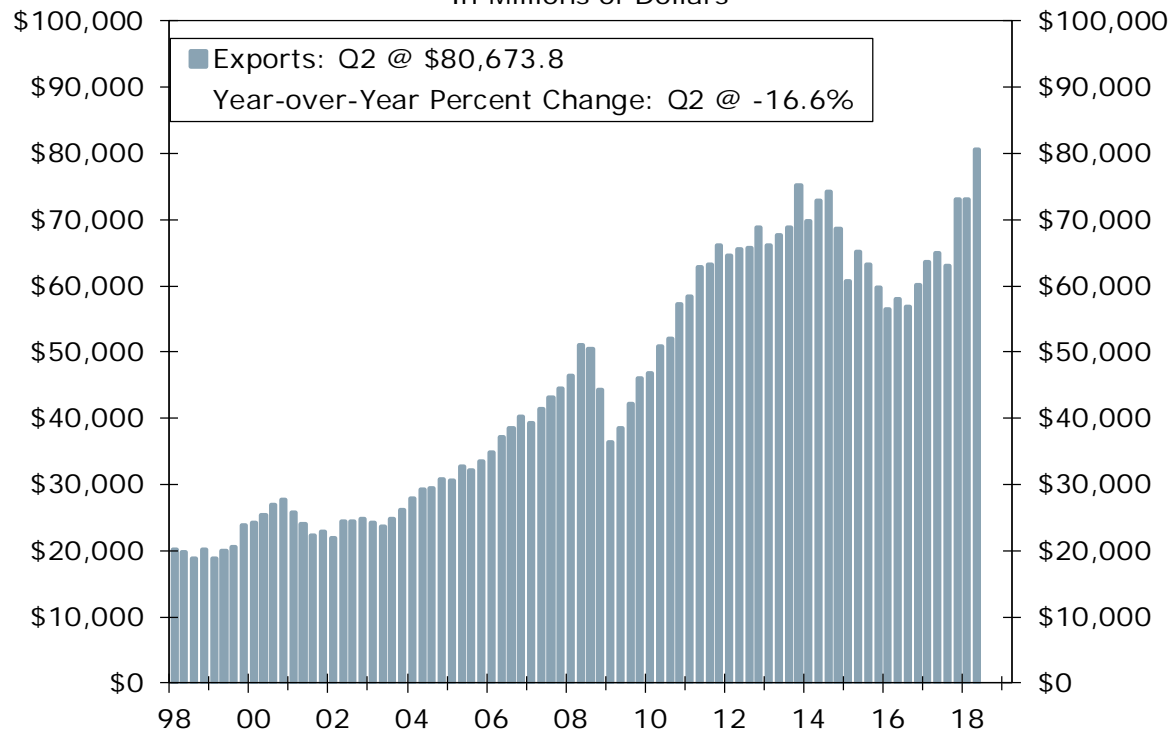


Source: Baker Hughes, Inc., Bloomberg LP and Wells Fargo Securities

Firmer commodity prices are also boosting exports, as oil and gas exports nearly doubled last year. Trade is vital to the Texas economy, with exports accounting for roughly 15 percent of total economic output.

## Texas Exports

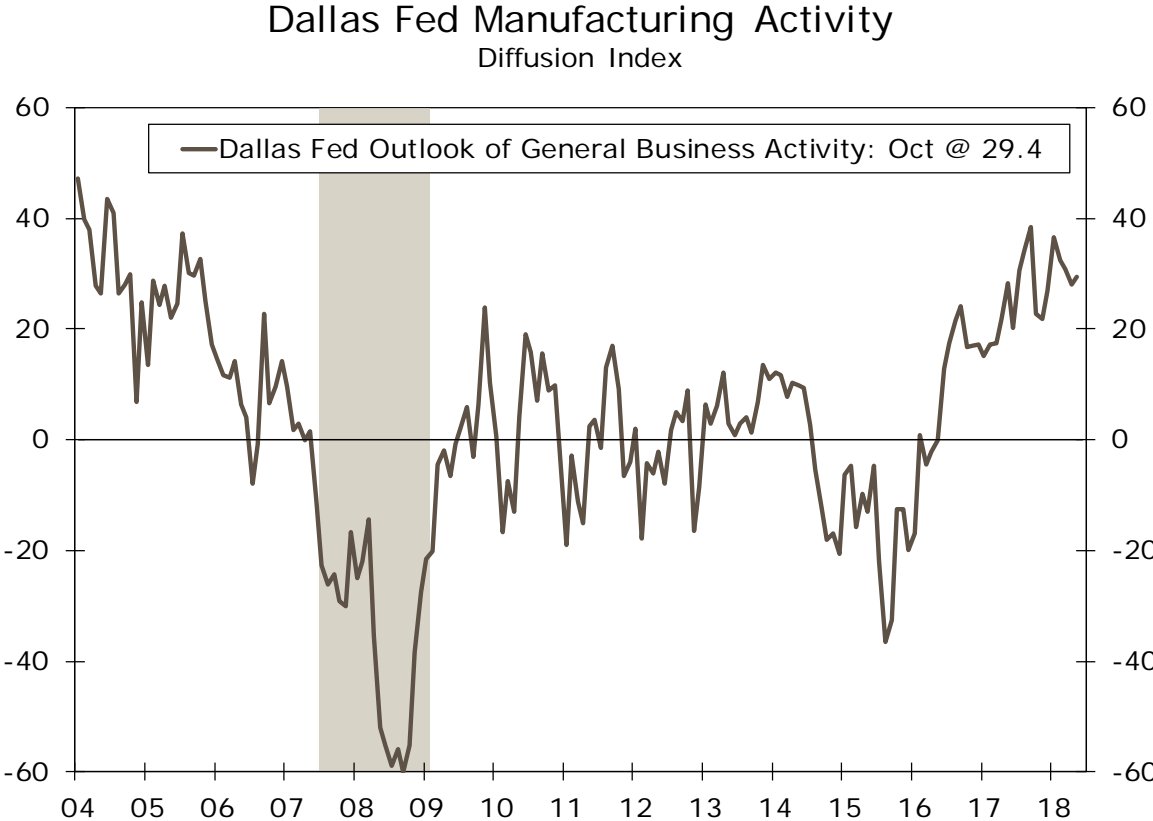
In Millions of Dollars



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



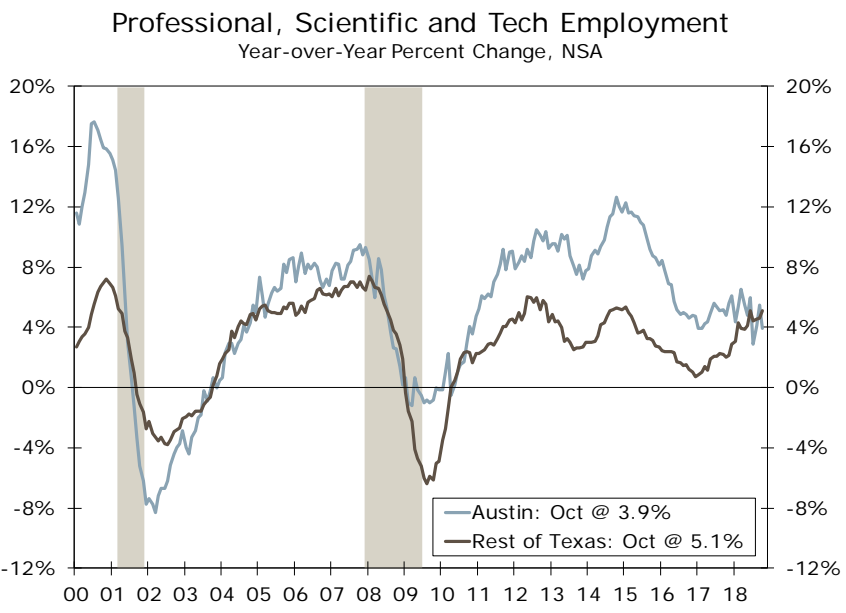
Texas manufacturers continue to report expanding activity, however tariffs and uncertainty surrounding trade policy are creating headwinds.



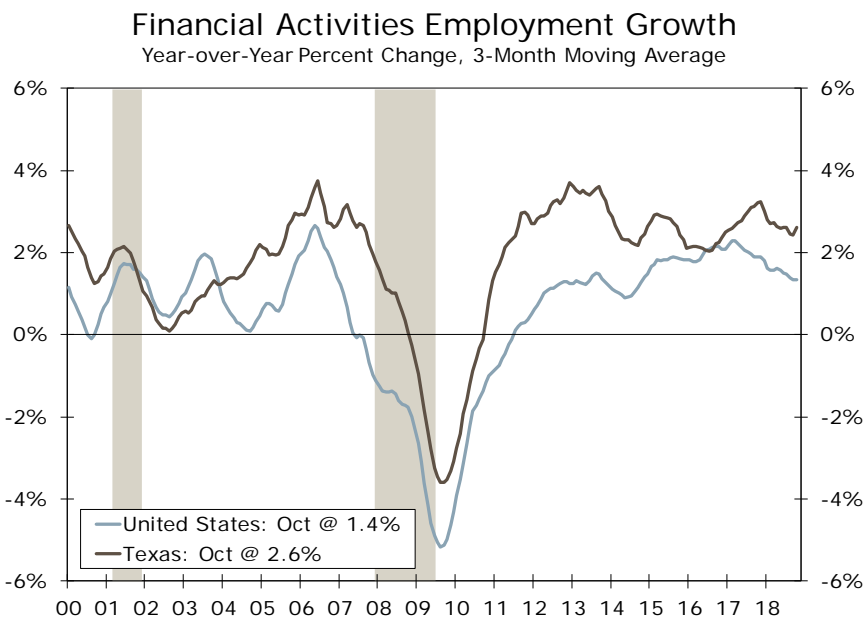
Source: U.S Department of Commerce and Wells Fargo Securities

Tech sector employment has moderated recently, with stronger growth outside of Austin. Financial activities employment also continues to expand at a pace ahead on the nation.

## Tech Sector



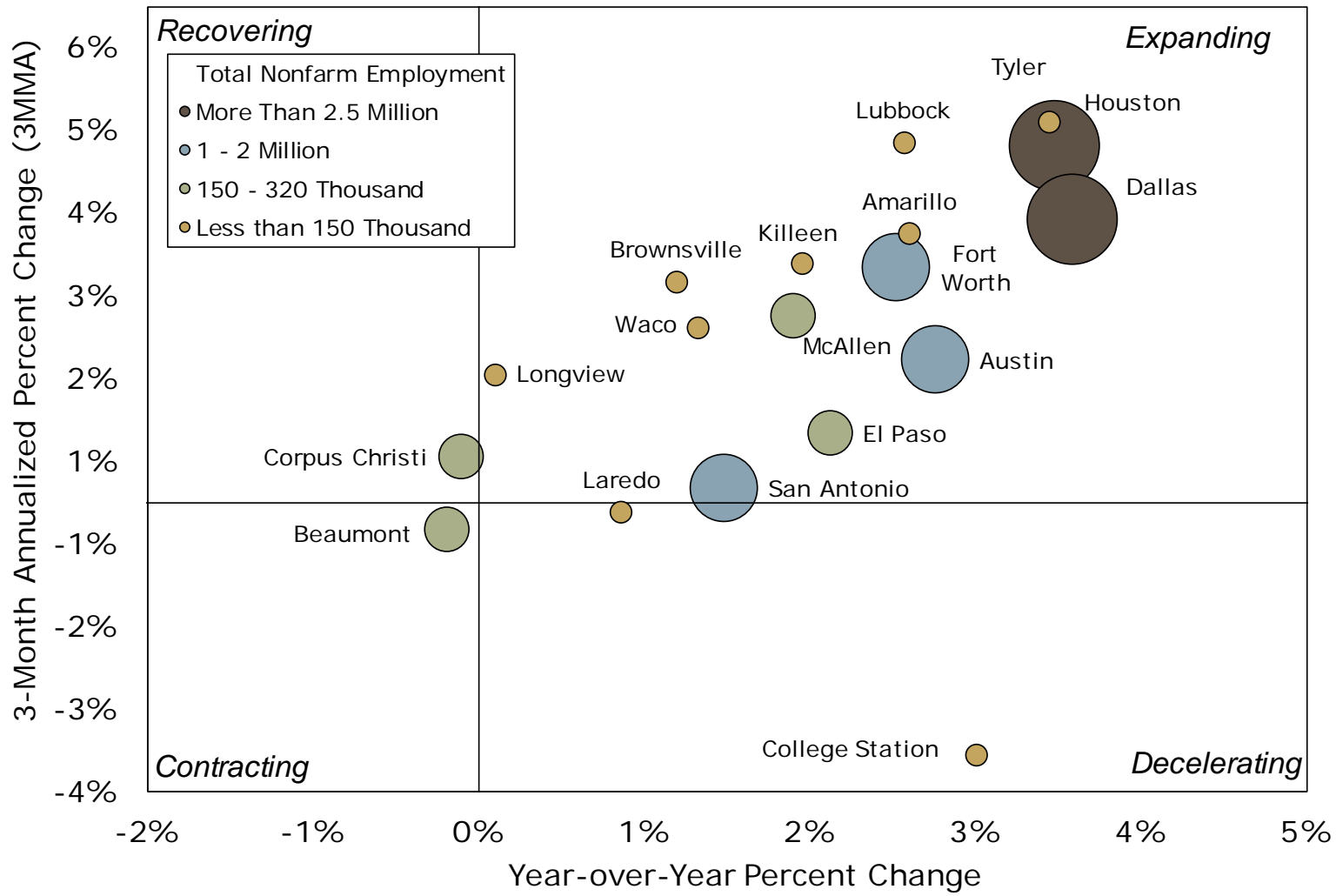
## Financial Activities



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

# Texas Employment Growth by Metro

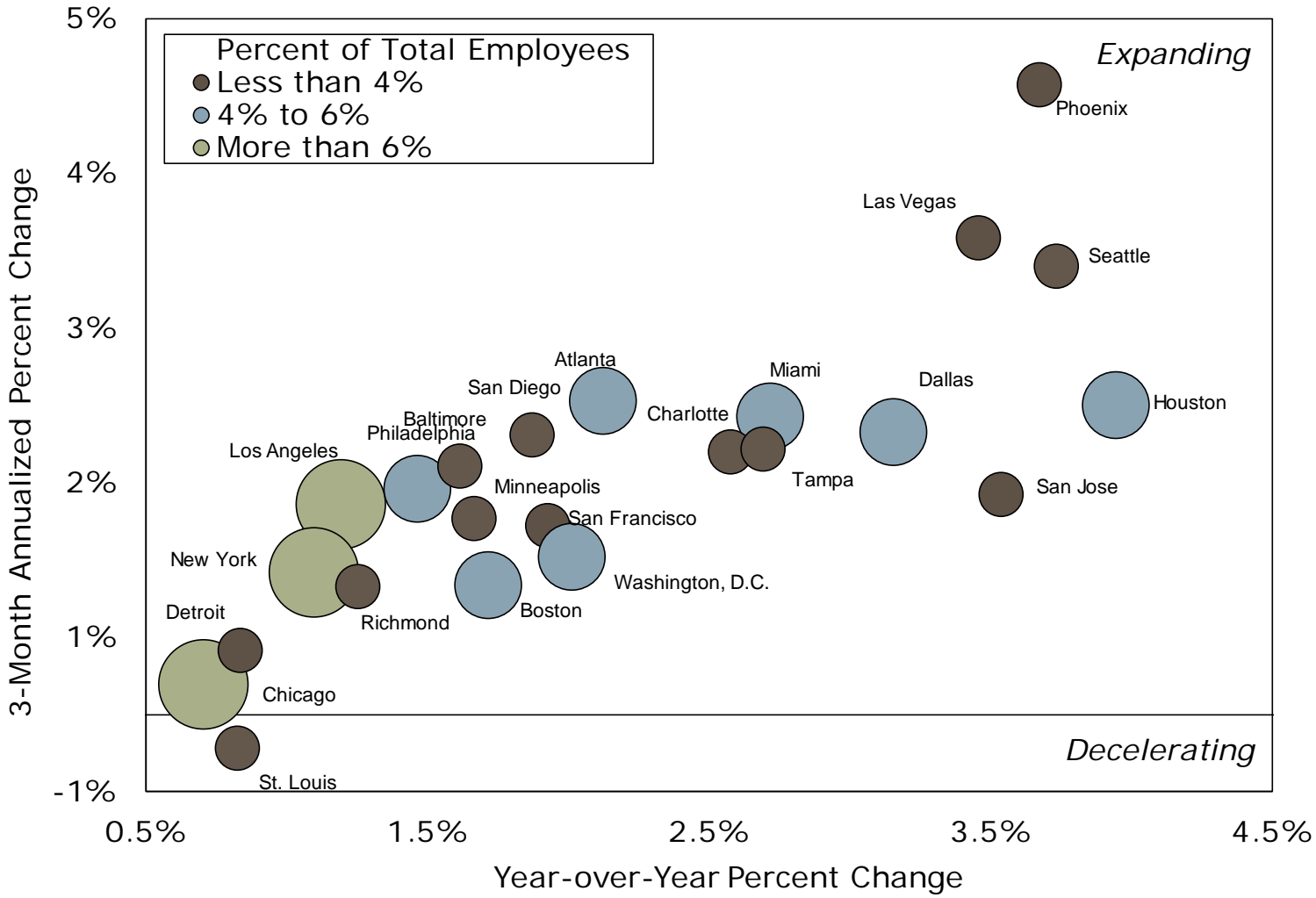
3-Month Moving Averages, October 2018



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

# U.S. Employment Growth by MSA

3-Month Moving Averages, October 2018

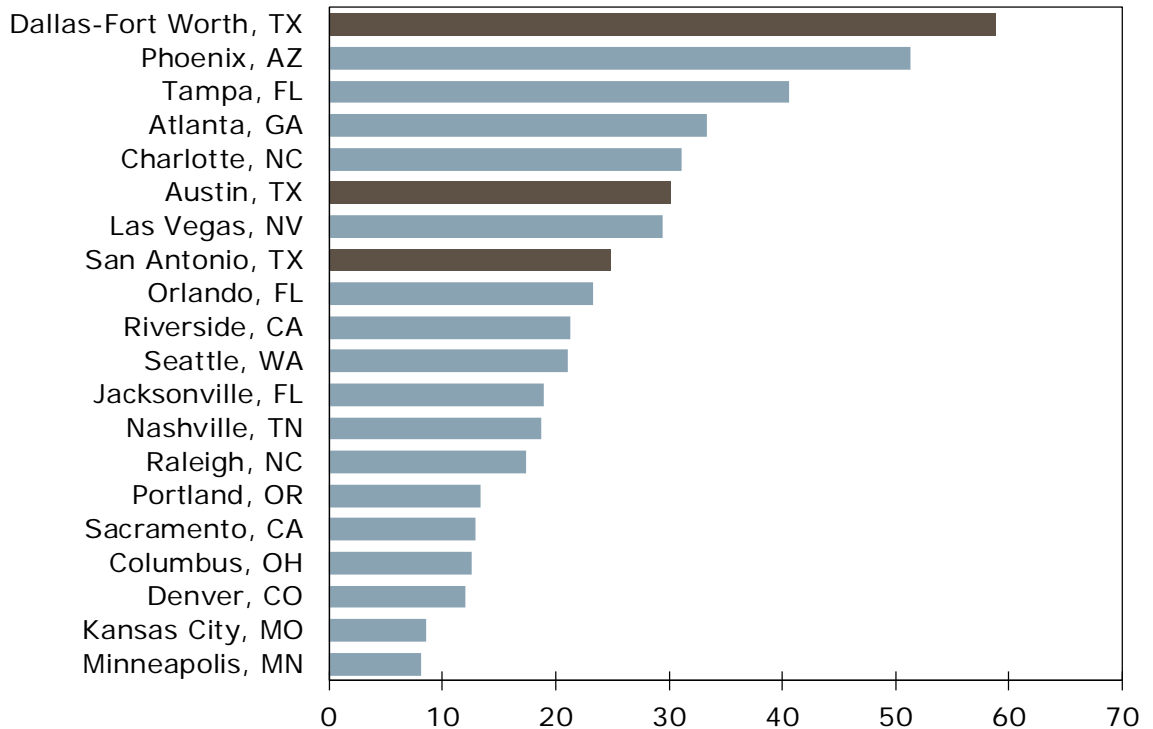


Source: U.S. Department of Labor and Wells Fargo Securities

Several Texas metros continue top the list of destinations for state-to-state movers.

## Metro Area Net Domestic Migration: Top 20

Thousands, 2017

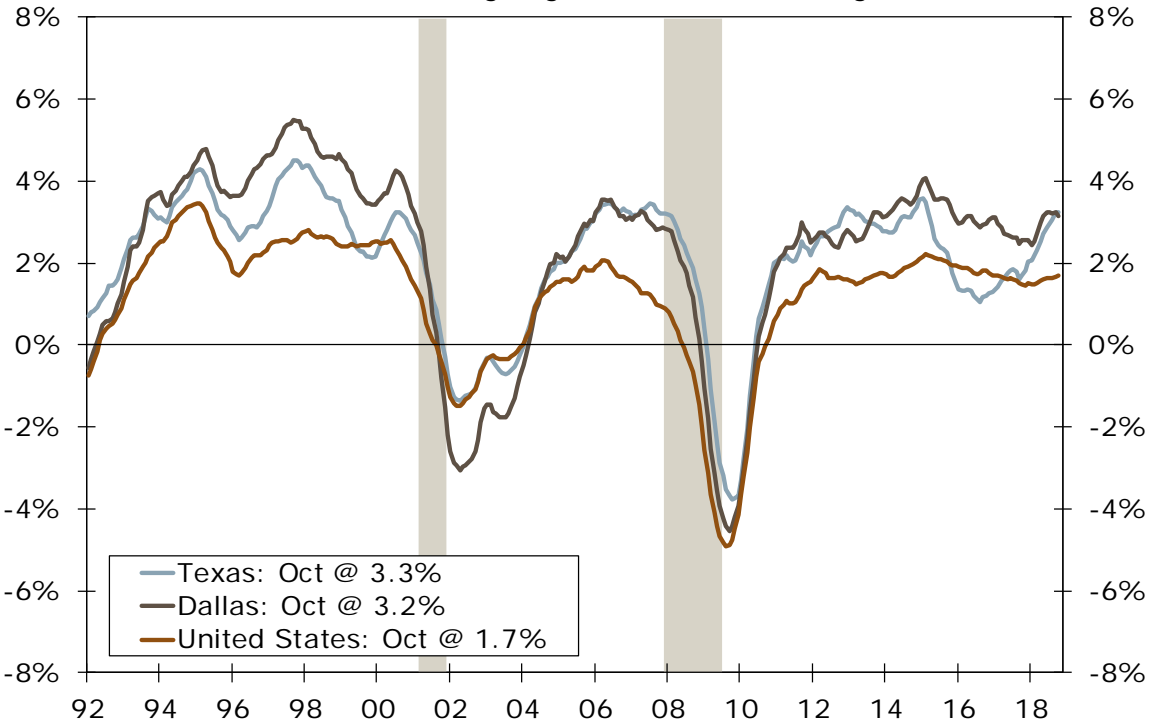


Source: Baker Hughes, Inc., Bloomberg LP and Wells Fargo Securities

Employment growth in Dallas has been incredibly resilient.

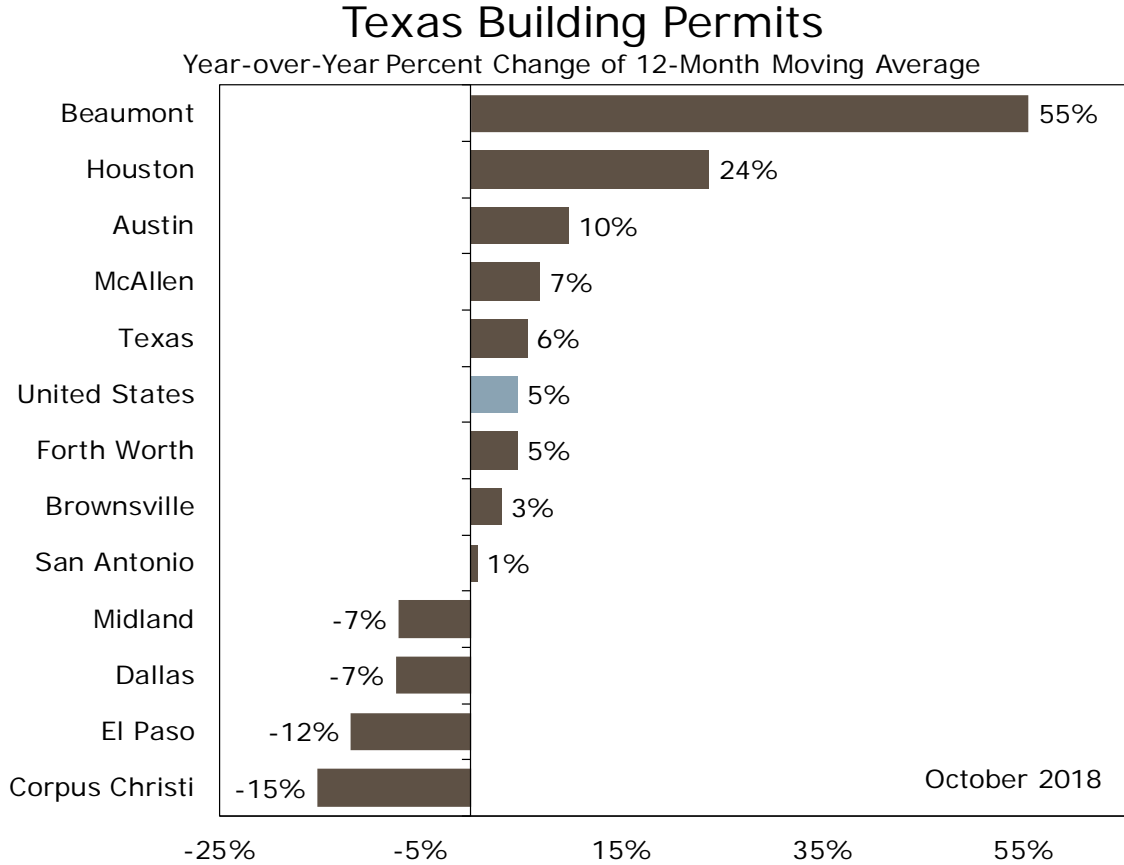
### Dallas MSA vs. U.S. Nonfarm Employment

3-Month Moving Avs. Yr/Yr Percent Change



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

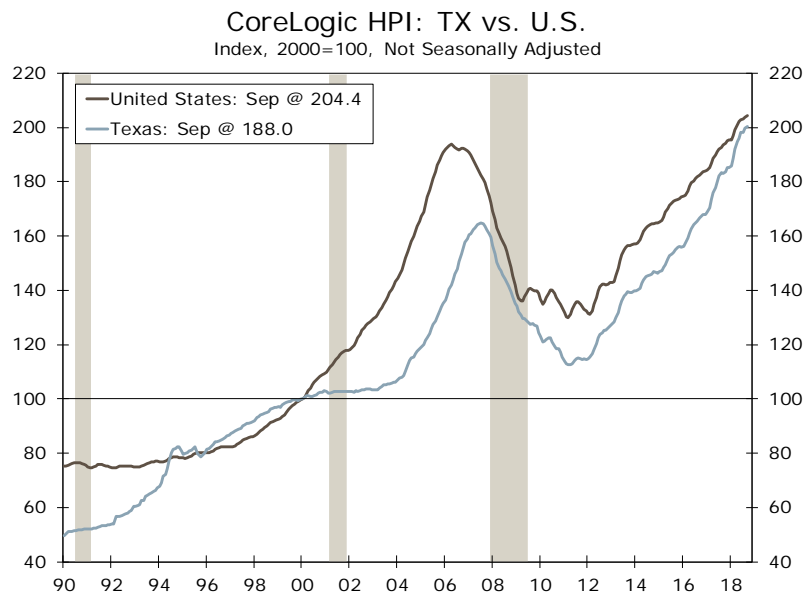
Houston, Dallas, and Austin continue to lead both the state and nation in terms of new homebuilding.



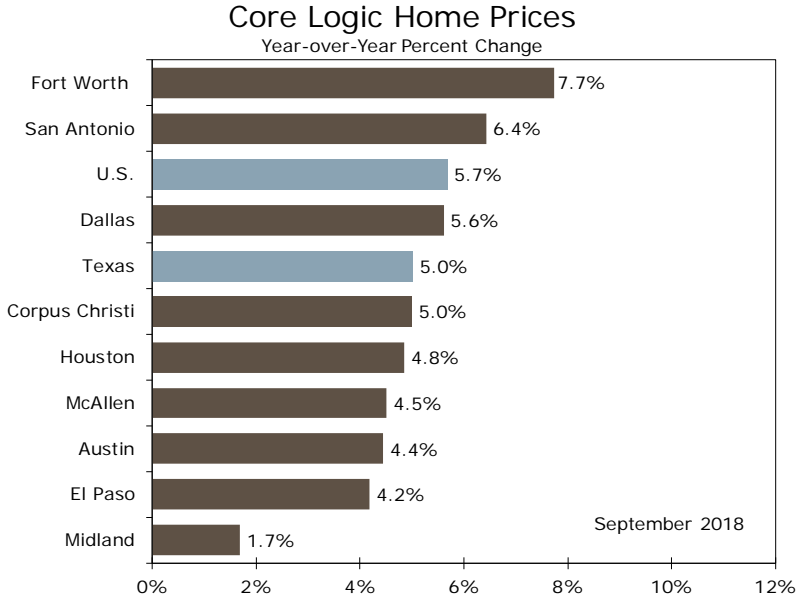
Source: U.S Department of Commerce and Wells Fargo Securities

Housing affordability is a major advantage for Texas. Relatively low land costs and an entitlement process that works closely with builders helps keep the housing market in balance.

## Home Price Index



## Home Price Growth by MSA



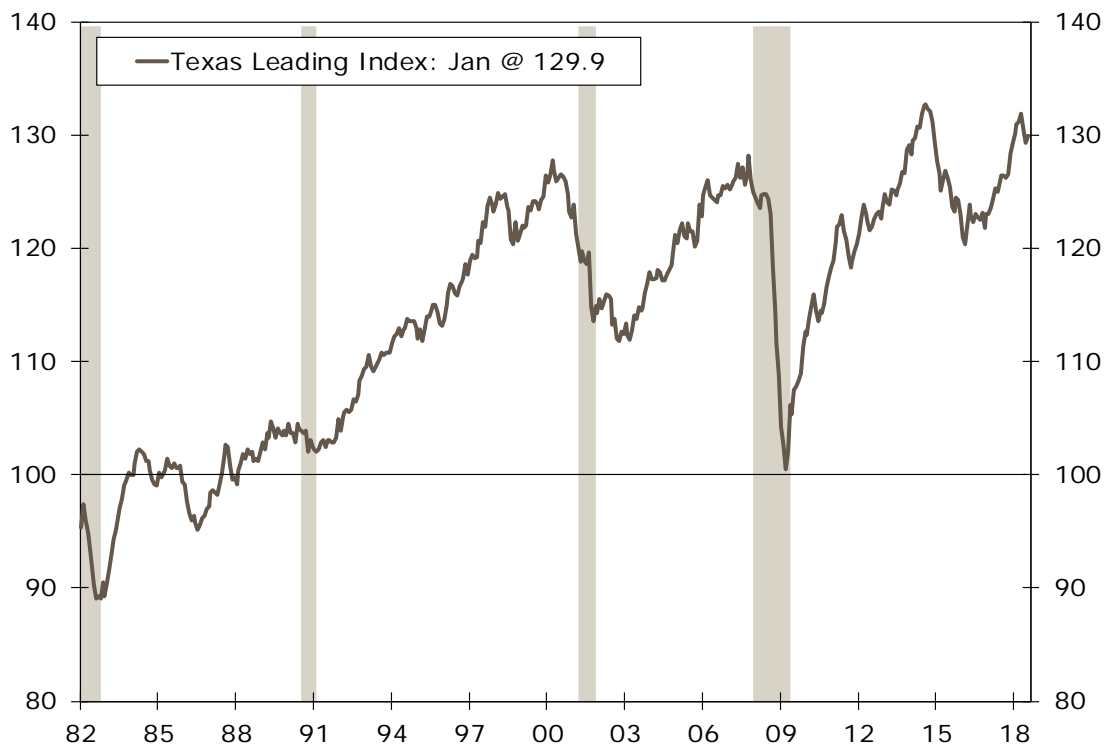
Source: CoreLogic and Wells Fargo Securities



Texas has strong momentum headed into 2019 and we are looking for Texas to continue to grow solidly over the next couple of years.

## Texas Leading Economic Index

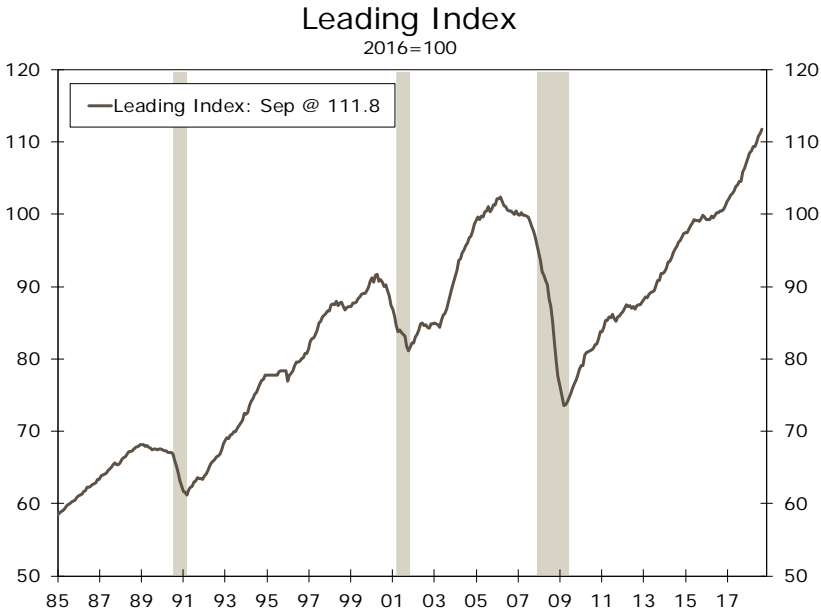
Index, 1987= 100, Seasonally Adjusted



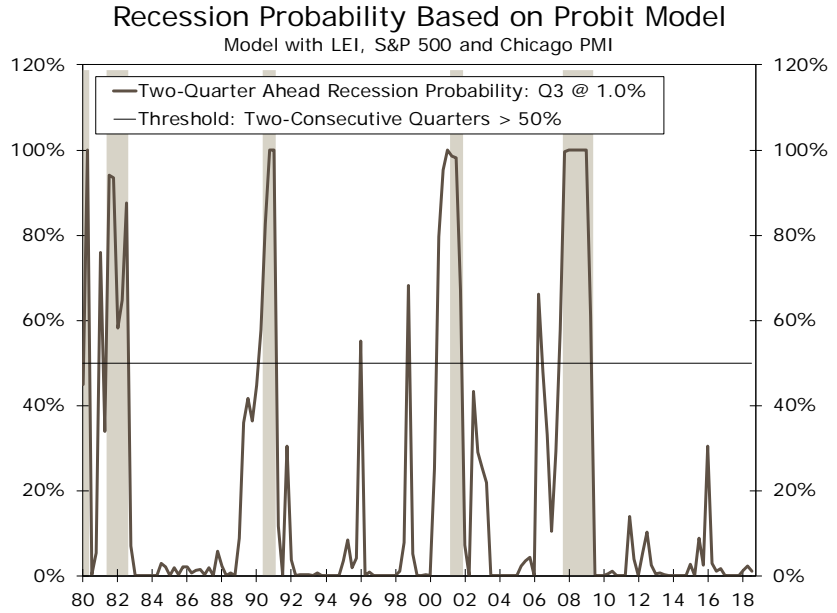
Source: The Federal Reserve Bank of Dallas and Wells Fargo Securities

The economy currently appears strong with few imbalances. According to our more comprehensive model, the near-term risk of a recession remains close to zero.

Leading Economic Index



Probability of a Recession



Source: National Bureau of Economic Research and Wells Fargo Securities

# Appendix

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## Wells Fargo U.S. Economic Forecast

	Actual				Forecast								Actual		Forecast	
	2018				2019				2020				2016	2017	2018	2019
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Real Gross Domestic Product <sup>1</sup>	2.2	4.2	3.5	2.2	2.3	2.6	2.5	2.3	2.1	2.0	1.8	1.8	1.6	2.2	2.9	2.6
Personal Consumption	0.5	3.8	3.6	2.7	2.2	2.9	2.6	2.5	2.1	2.2	1.8	1.7	2.7	2.5	2.7	2.8
Business Fixed Investment	11.5	8.7	2.5	5.9	4.7	4.9	4.4	4.0	3.7	3.6	2.9	2.8	0.5	5.3	6.9	4.9
Equipment	8.5	4.6	3.5	5.3	3.9	4.2	3.7	3.1	2.7	2.6	2.1	2.0	-1.5	6.1	7.4	4.1
Intellectual Property Products	14.1	10.5	4.3	8.6	4.8	5.3	4.7	4.6	4.7	4.6	3.7	3.6	7.5	4.6	7.2	5.8
Structures	13.9	14.5	-1.7	3.0	6.5	6.0	5.5	5.0	4.5	4.0	3.5	3.5	-5.0	4.6	5.7	4.9
Residential Construction	-3.4	-1.3	-2.6	-2.0	0.5	1.5	2.0	2.0	2.0	2.0	1.5	1.5	6.5	3.3	0.0	0.0
Government Purchases	1.5	2.5	2.6	3.0	2.7	2.3	1.6	0.8	0.7	0.5	0.3	0.1	1.4	-0.1	1.7	2.4
Net Exports <sup>2</sup>	0.0	1.2	-1.9	-0.6	-0.3	-0.5	-0.3	-0.2	0.0	-0.2	0.0	0.1	-0.4	-0.4	-0.3	-0.5
Inventories <sup>2</sup>	0.3	-1.2	2.3	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.6	0.0	0.1	0.2
Nominal GDP <sup>1</sup>	4.3	7.6	5.0	3.7	5.1	5.3	5.1	4.9	4.4	4.6	4.1	4.4	2.7	4.2	5.2	5.0
Corporate Profits Before Taxes <sup>3</sup>	5.9	7.3	10.3	6.2	5.6	1.8	0.5	-0.8	-1.6	-2.2	-2.6	-3.4	-1.1	3.2	7.4	1.7

Forecast as of: November 30, 2018

<sup>1</sup> Compound Annual Growth Rate Quarter-over-Quarter    <sup>2</sup> Percentage Point Contribution to GDP    <sup>3</sup> Year-over-Year Percentage Change

Source: IHS Global Insight and Wells Fargo Securities

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