

The Economic Outlook

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Together we'll go far



“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

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 Lum ber	Canada	0.25%	0.05%
Feb 7, 2018	20%	\$1.8	Washing Machines	Multiple	0.08%	0.02%
Feb 7, 2018	30%	\$8.5	Solar Panels	Multiple	0.36%	0.07%
Mar 23/Jun 1, 2018	25%	\$23.4	Steel	Multiple	1.00%	0.20%
Mar 23/Jun 1, 2018	10%	\$16.4	Aluminum	Multiple	0.70%	0.14%
Jul 6, 2018	25%	\$34.0	Variety Focus: Tech, Auto & Manuf.	China	1.45%	0.29%
Aug 23, 2018	25%	\$16.0	Variety	China	0.68%	0.13%
Sep 24, 2018	10%	\$200.0	Variety	China	8.54%	1.68%
Enacted Total	14%	\$305.9			13.06%	2.57%
Proposed	25%	\$51.8	Autos	E.U.	2.21%	0.44%
Proposed	10%	\$267.0	Variety	China	11.40%	2.25%
Proposed Total	12%	\$318.8			13.61%	2.68%
Enacted + Proposed	13%	\$624.7			26.67%	5.25%

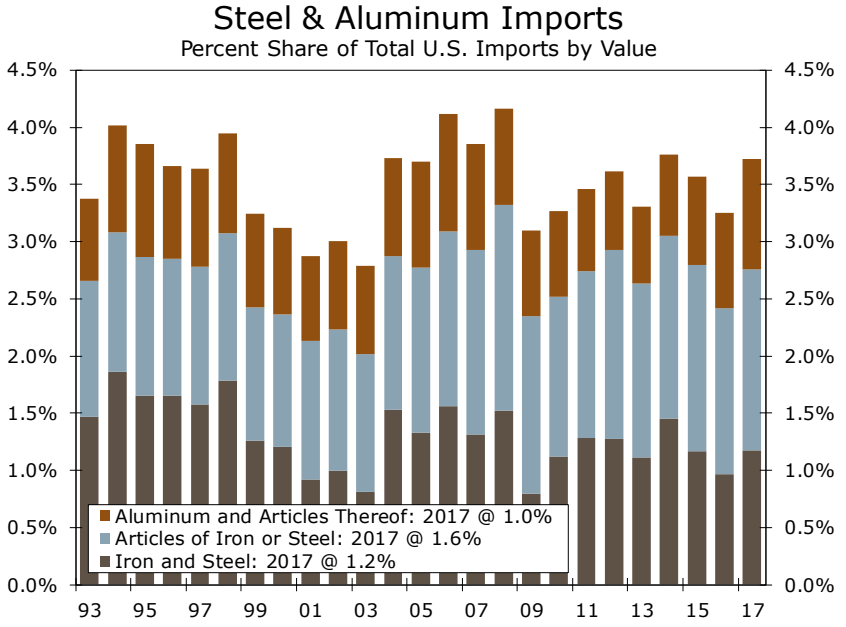
*Values based on 2017 trade data

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

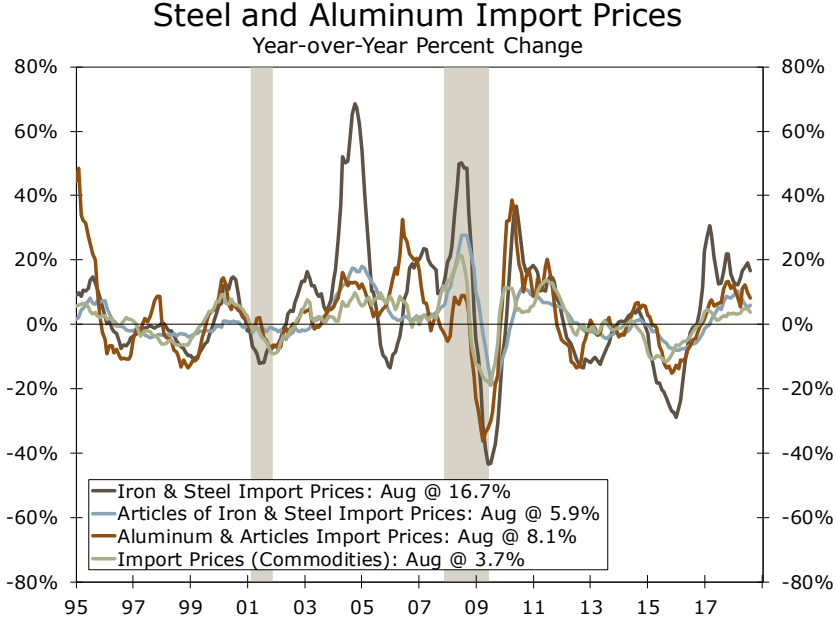
Steel and Aluminum Imports

The combined share of steel and aluminum hovers just below 4 percent of imports, which limits the degree to which price changes in these commodities affect overall U.S. import prices and inflation. There is a fair degree of correlation between the price of imported steel and aluminum and overall import price inflation.

Imports



Import Prices



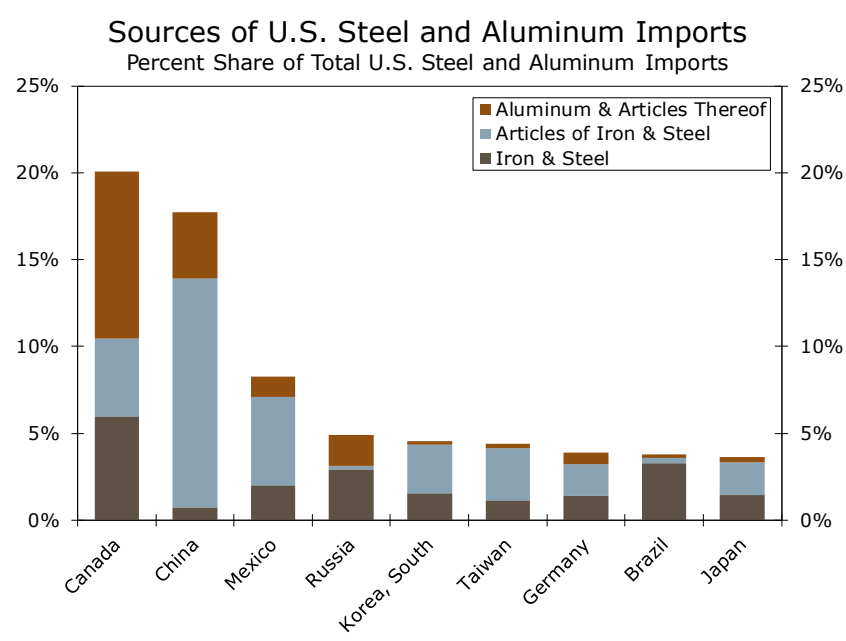
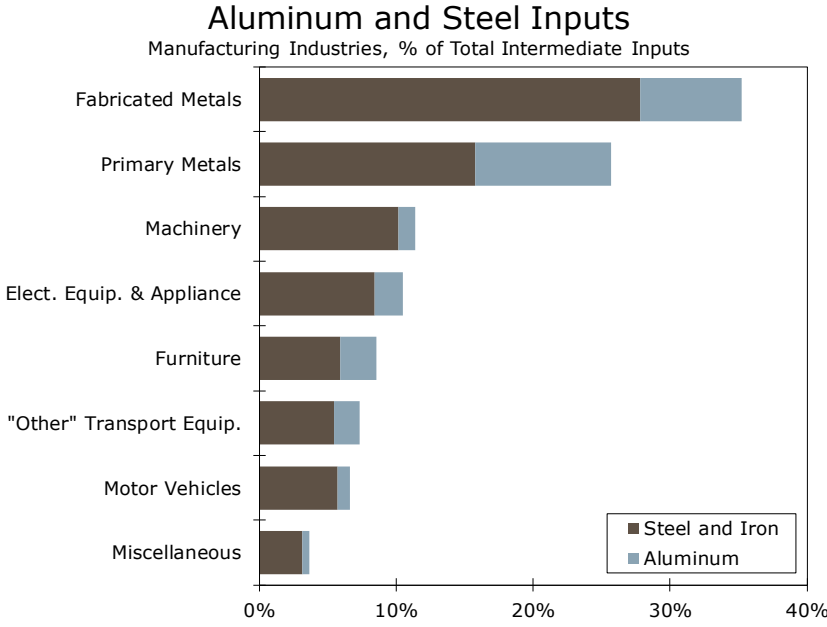
Source: U.S. Department of Commerce, U.S. Department of Labor and Wells Fargo Securities

Steel and Aluminum Imports

Manufacturers that transform metals into intermediate or end products, or 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

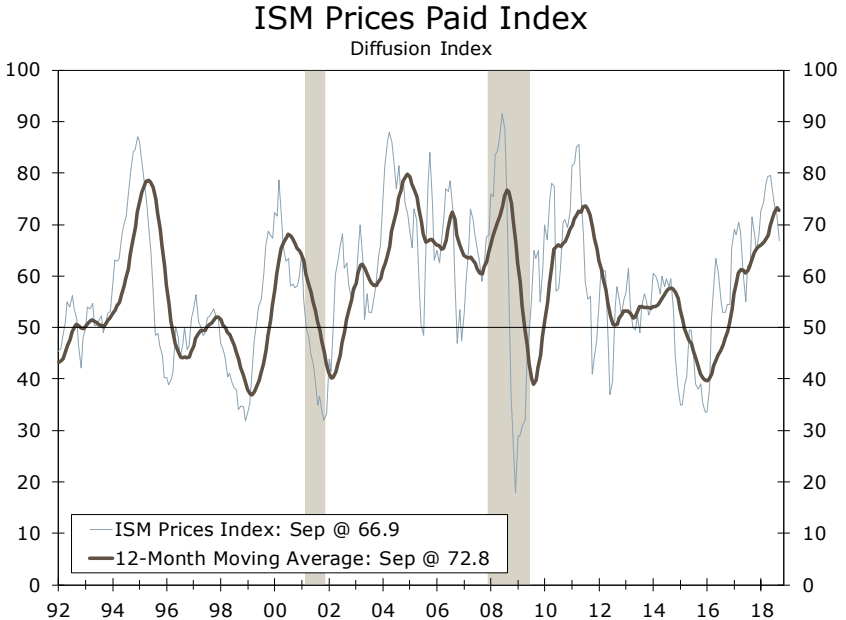
Import Prices



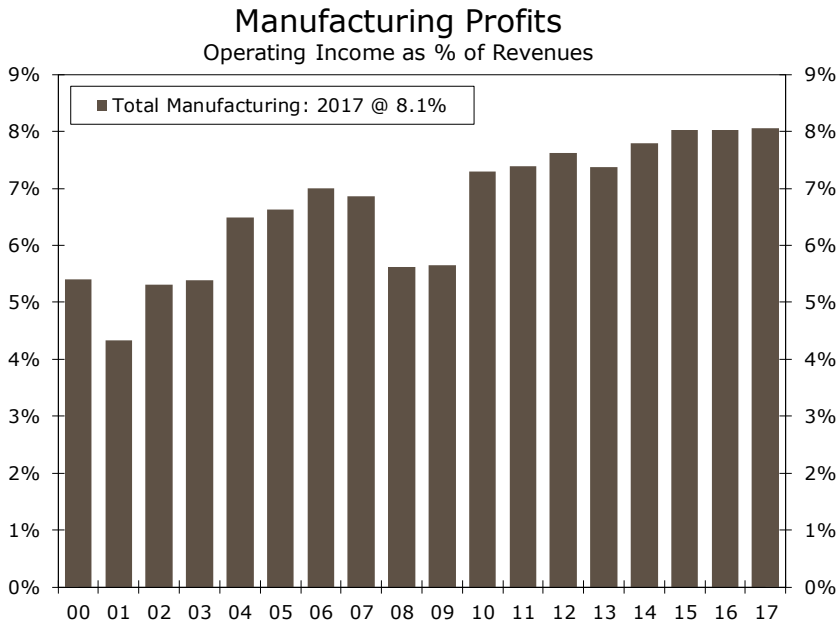
Source: U.S. Department of Commerce and Wells Fargo Securities

Prior to the Trump administration's announcement, 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



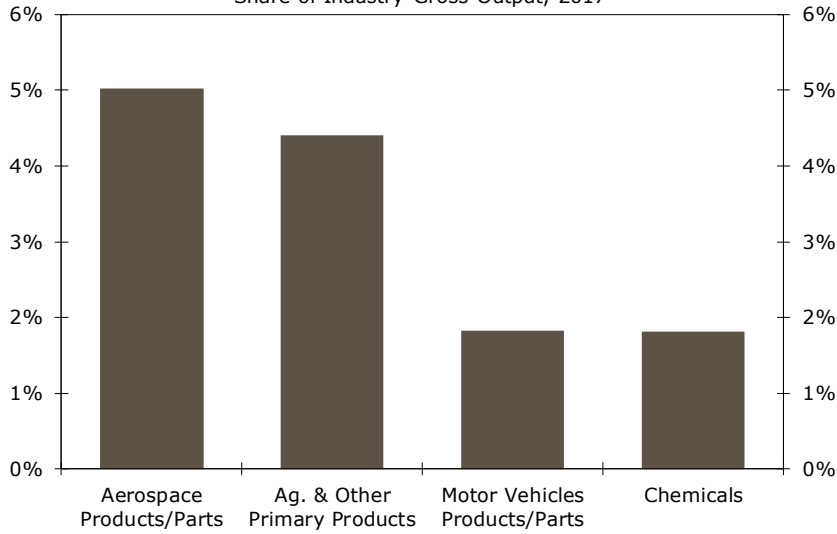
Source: Institute for Supply Management, U.S. Department of Commerce and Wells Fargo Securities

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.

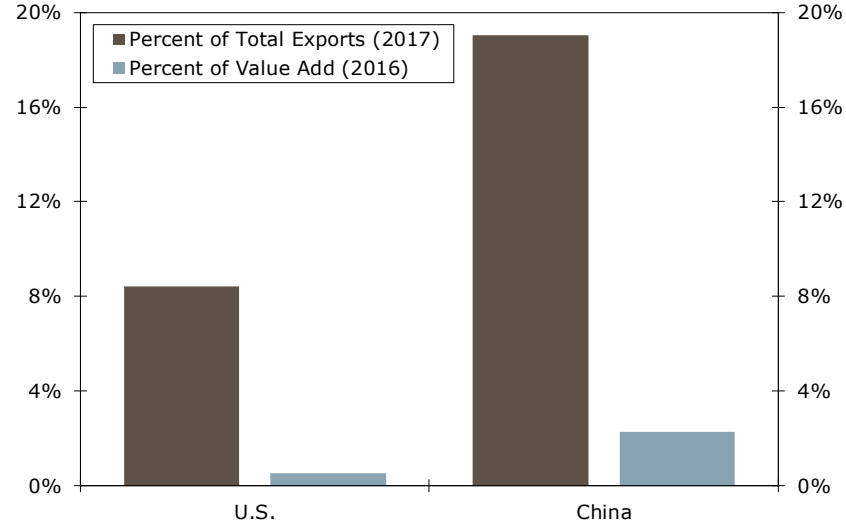
Exports

Exports to China by Industry
Share of Industry Gross Output, 2017



Exposure

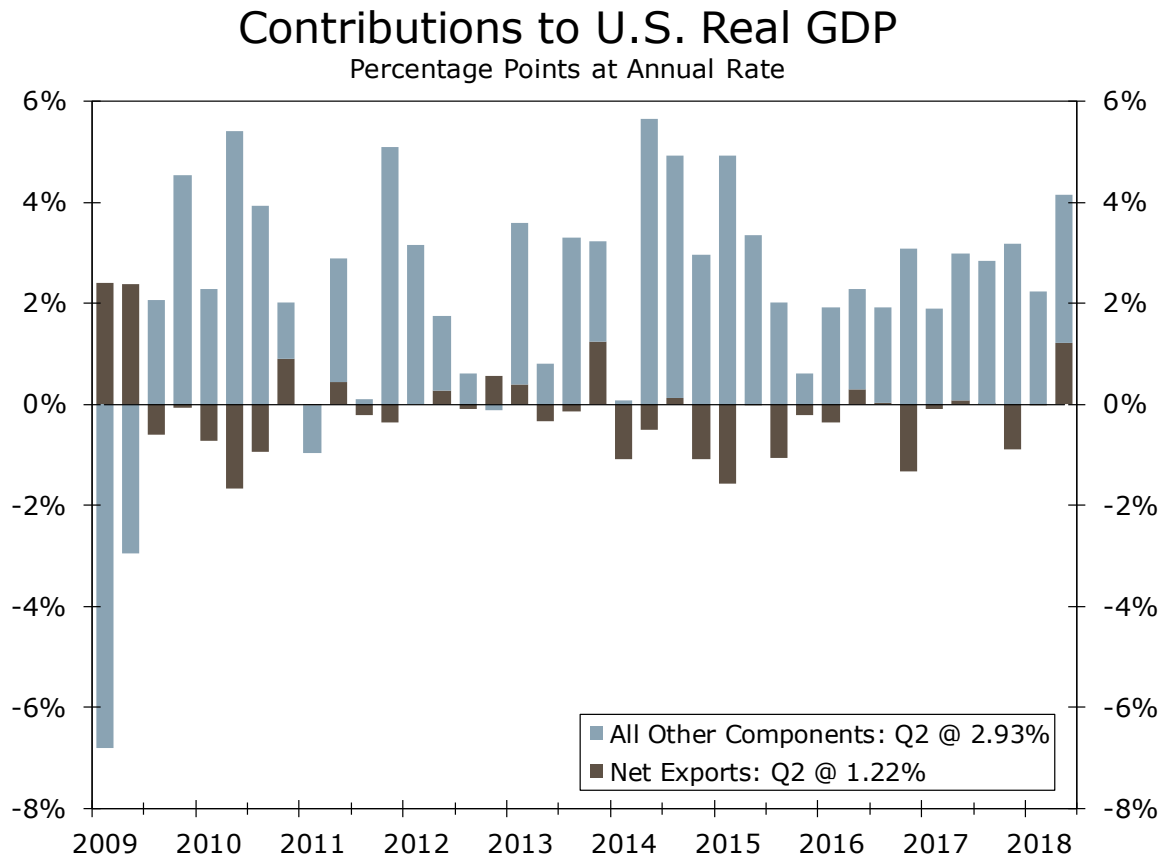
Bilateral Export Exposure
Percent



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.



Source: U.S. Department of Commerce 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%
Jun 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%
Enacted Total	-	\$134.3			8.69%
Proposed	5% - 50%	\$0.2	Variety	India	0.02%
Proposed Total	-	\$0.2			0.02%
Enacted + Proposed	-	\$134.5			8.70%

*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

“In the House of Representatives, in an effort to alleviate the effects ofAnyone? 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.

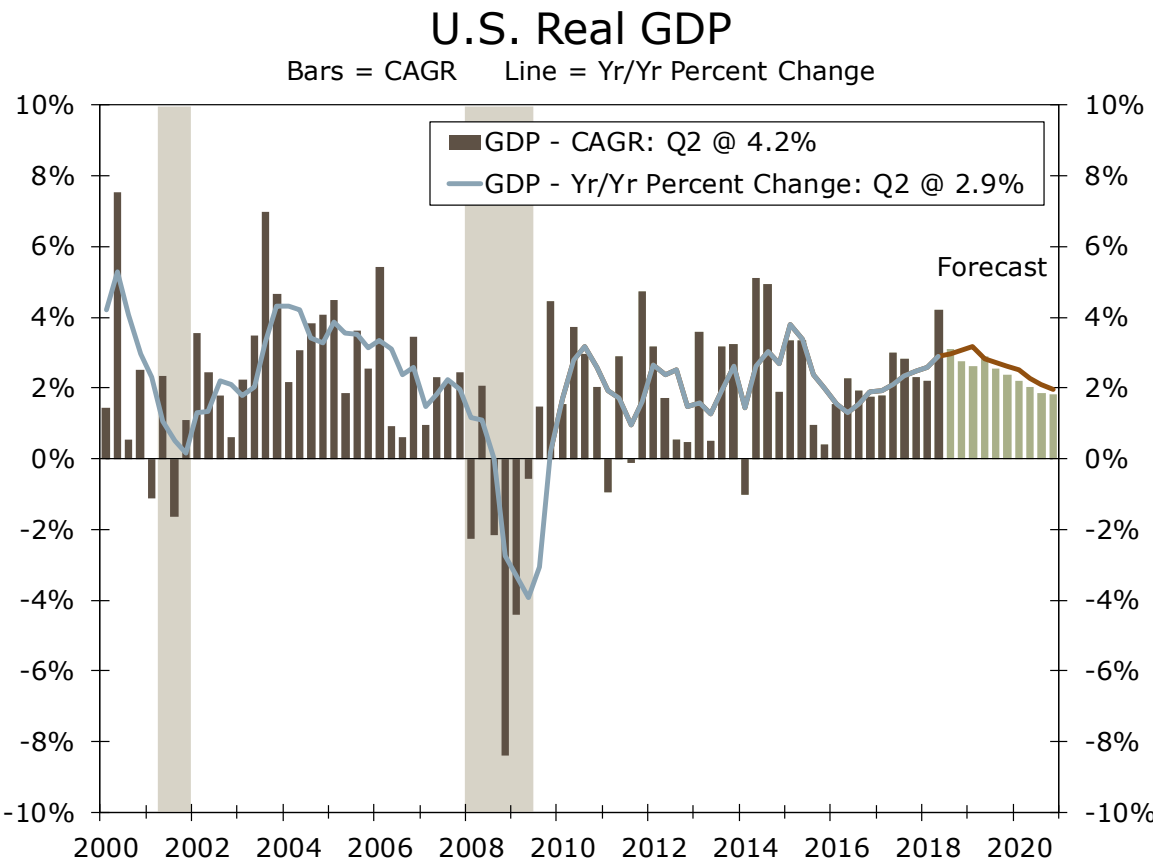
Did it work? Anyone know the effects? Anyone?

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**

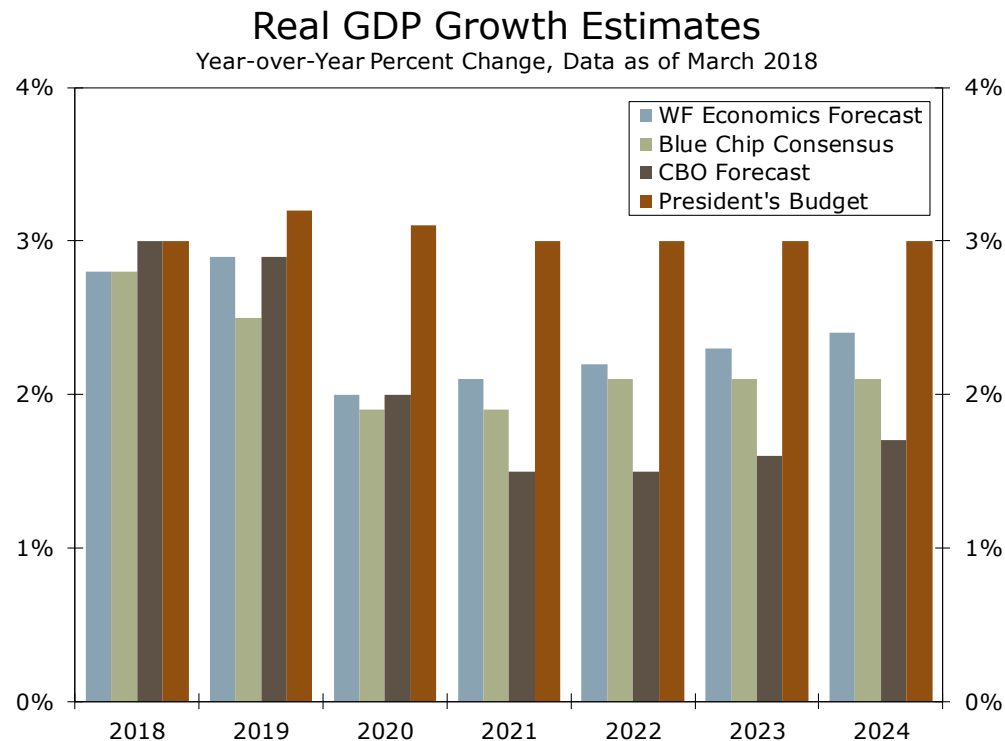
Domestic Outlook

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



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

- The Trump administration has repeatedly stated its goal of achieving real economic growth of 3-4 percent.
- In the president's FY 2018 budget, the administration assumed real GDP growth of 3 percent over the long-run.
- This is well above that of other forecasters. Why?

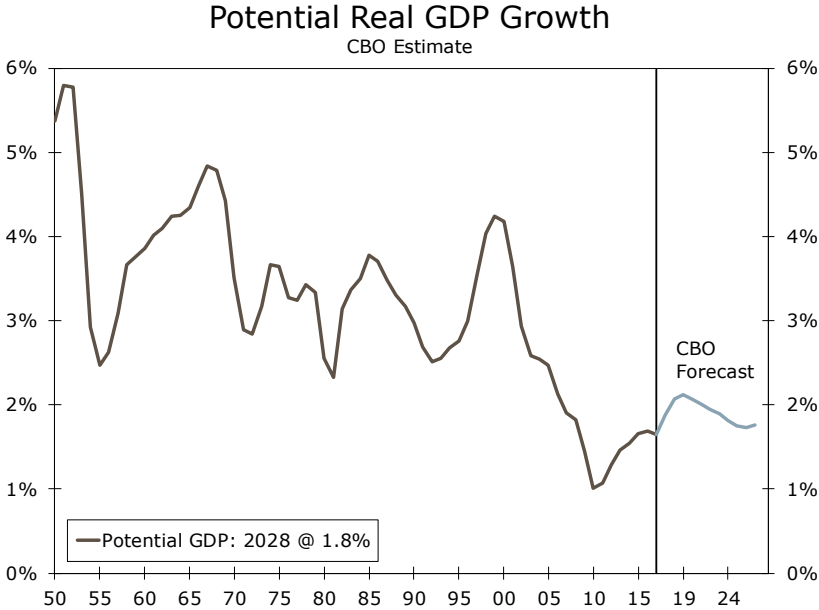


Source: Blue Chip, Congressional Budget Office (CBO), Office of Management and Budget and Wells Fargo Securities

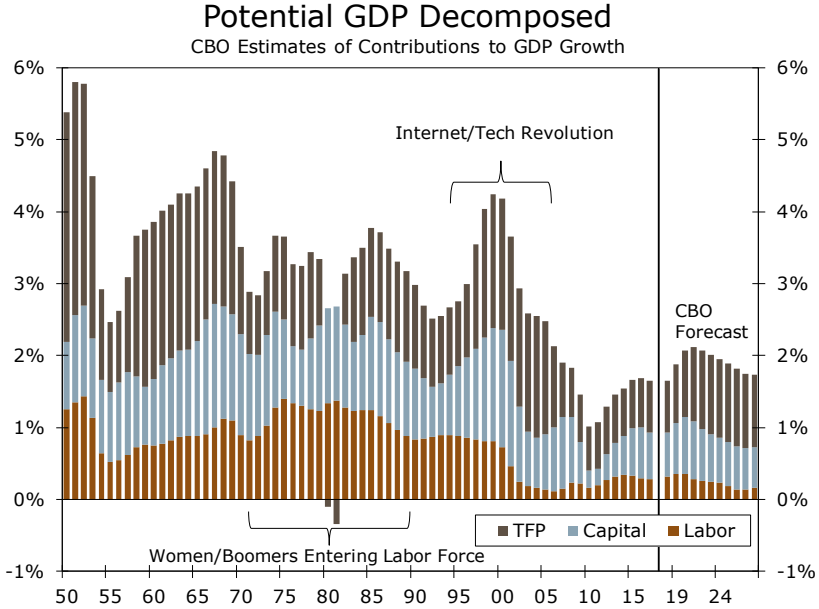
Why Is Potential Growth So Slow?

- The Congressional Budget Office (CBO) 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.

Potential GDP Growth Has Fallen



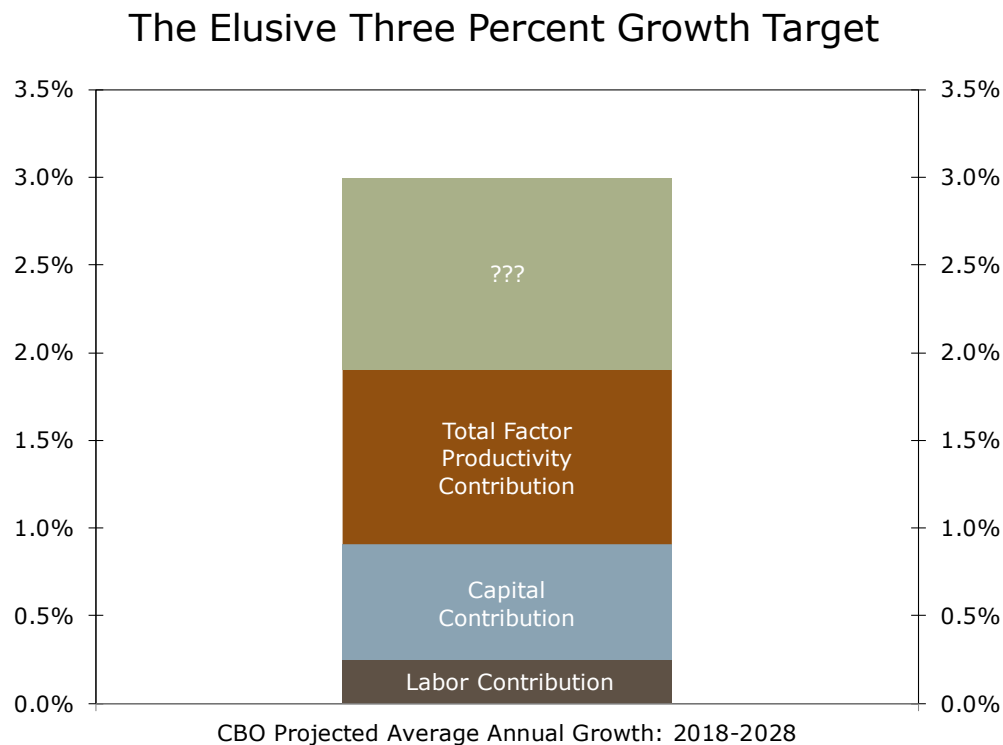
Both Aging and Productivity to Blame



Source: Congressional Budget Office (CBO) and Wells Fargo Securities

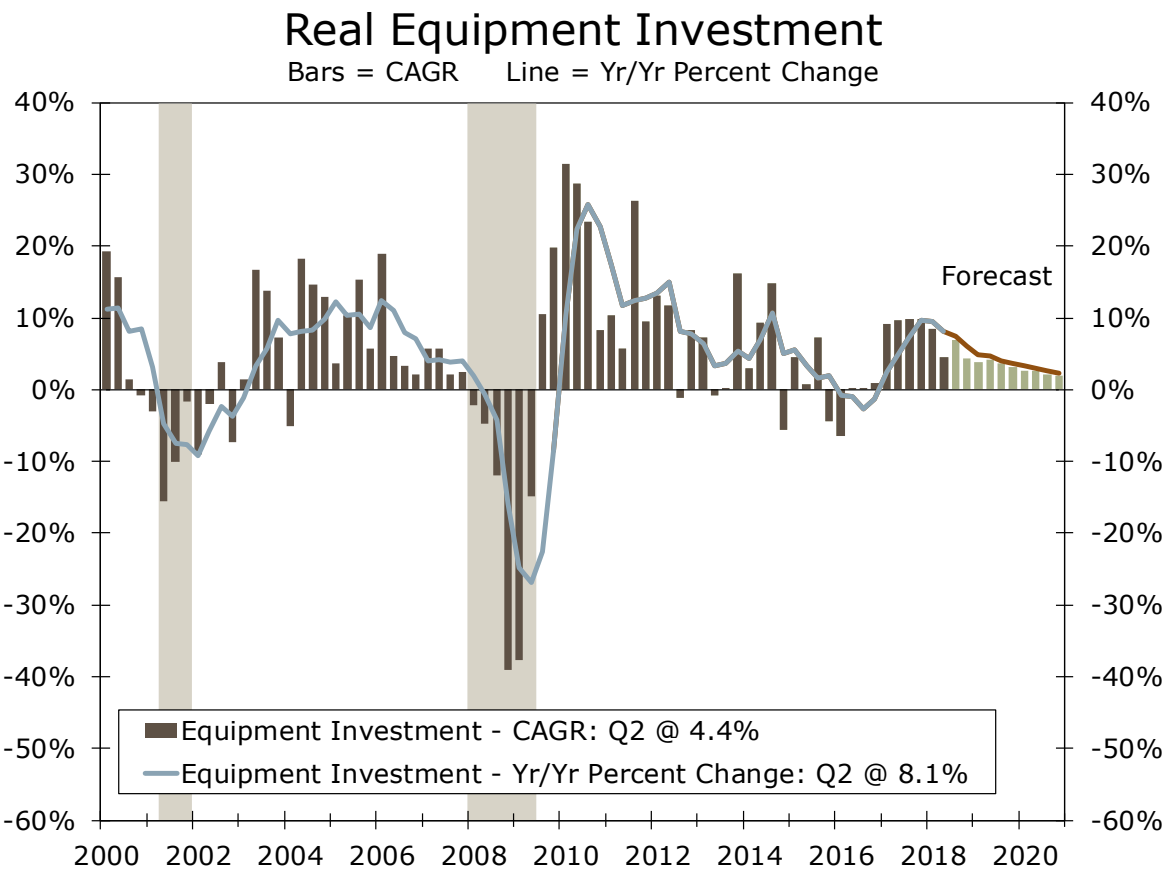
What Would It Take to Get to 3 Percent Growth?

- Let's say the CBO baseline proves to be too pessimistic.
- Given a potential GDP estimate of about 1.9 percent, how much faster would growth need to be in the three key inputs (labor, capital and total factor productivity) to reach 3 percent plus?



Source: Congressional Budget Office (CBO) and Wells Fargo Securities

Cap-ex has been surprising on the upside, but as the “bounce effect” fades, will the pace of growth moderate?

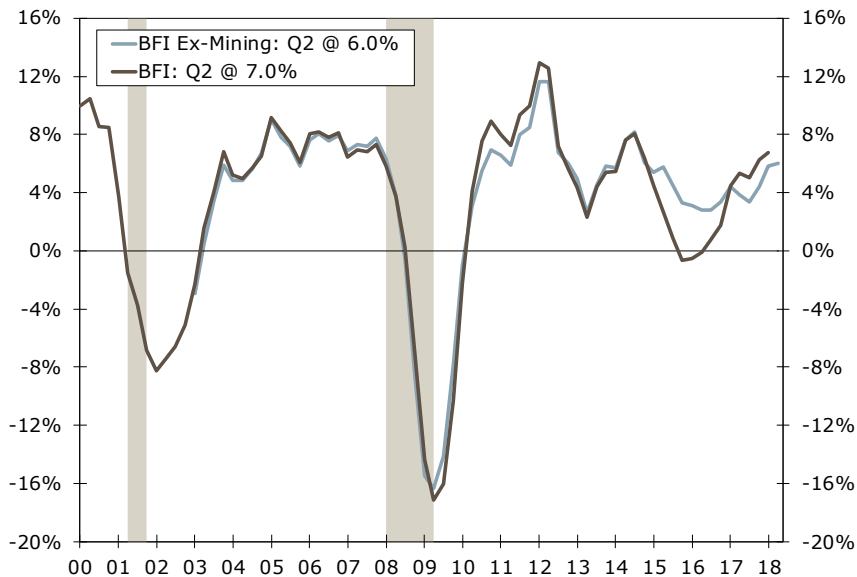


Source: U.S. Department of Commerce and Wells Fargo Securities

The rebound in energy prices and more specifically oil prices is starting to boost business investment.

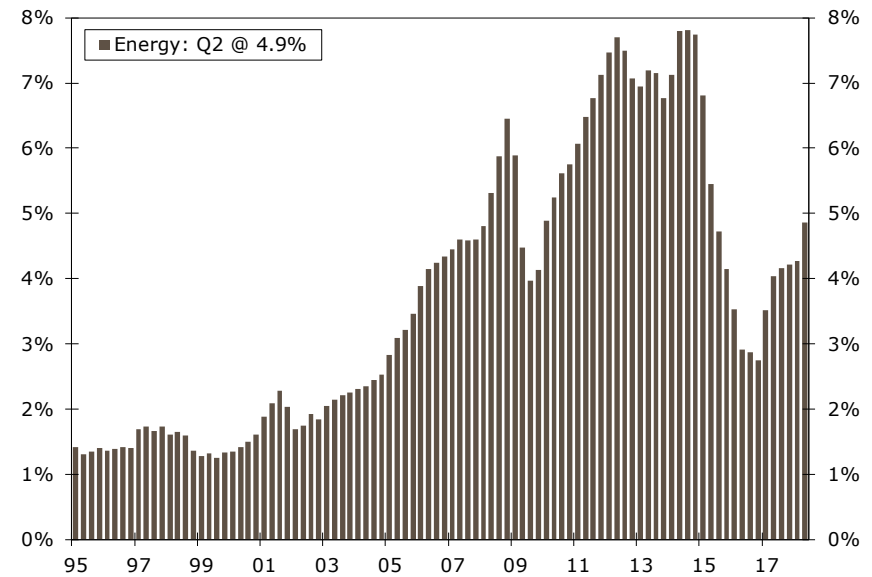
Business Investment Ex-Mining

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

Survey of Business Executives

November 13-24, 2017

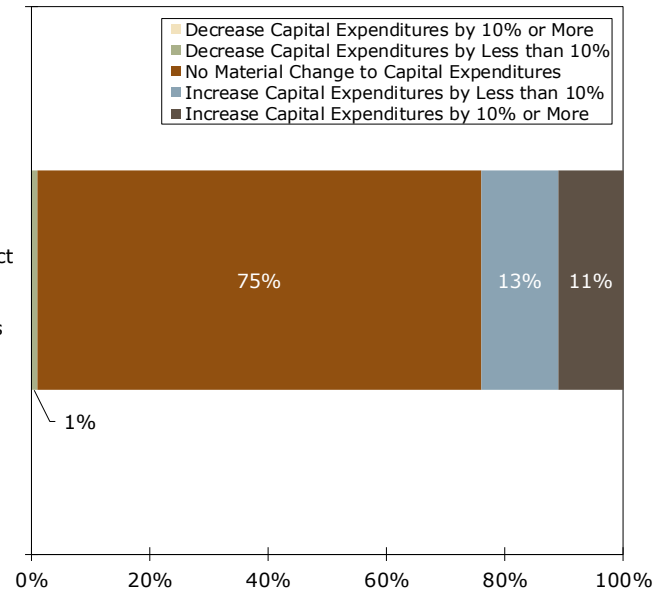
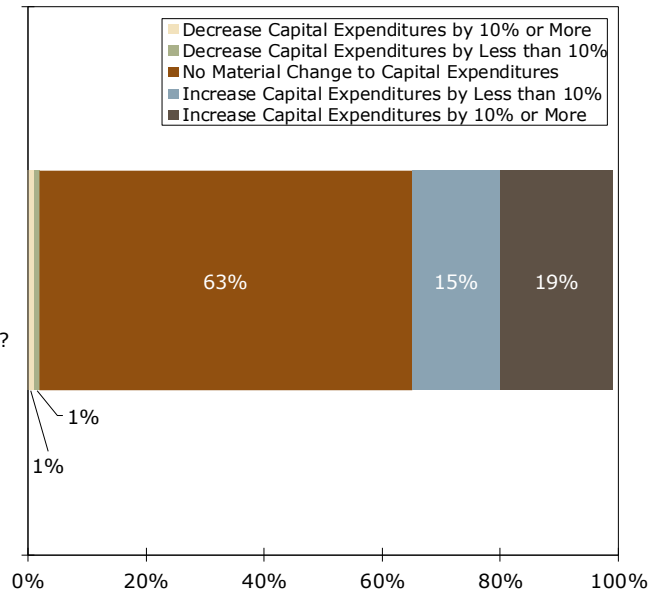
February 12-23, 2018

- Decrease Capital Expenditures by 10% or More
- Decrease Capital Expenditures by Less than 10%
- No Material Change to Capital Expenditures
- Increase Capital Expenditures by Less than 10%
- Increase Capital Expenditures by 10% or More

- Decrease Capital Expenditures by 10% or More
- Decrease Capital Expenditures by Less than 10%
- No Material Change to Capital Expenditures
- Increase Capital Expenditures by Less than 10%
- Increase Capital Expenditures by 10% or More

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?



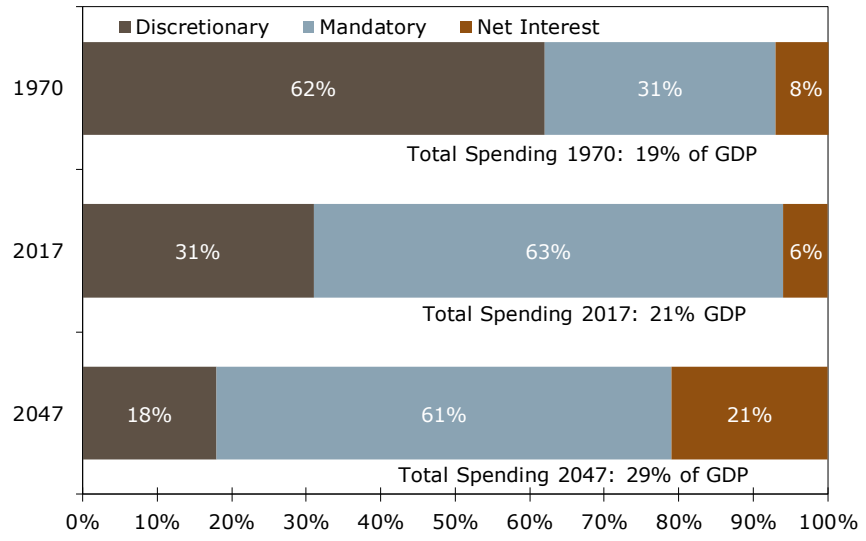
Source: Federal Reserve Bank of Atlanta, Survey of Business Executives (SBE), Stanford University, University of Chicago and Wells Fargo Securities

The composition of federal spending has shifted dramatically. The CBO projects that the debt-to-GDP ratio will surpass 96 percent by 2028.

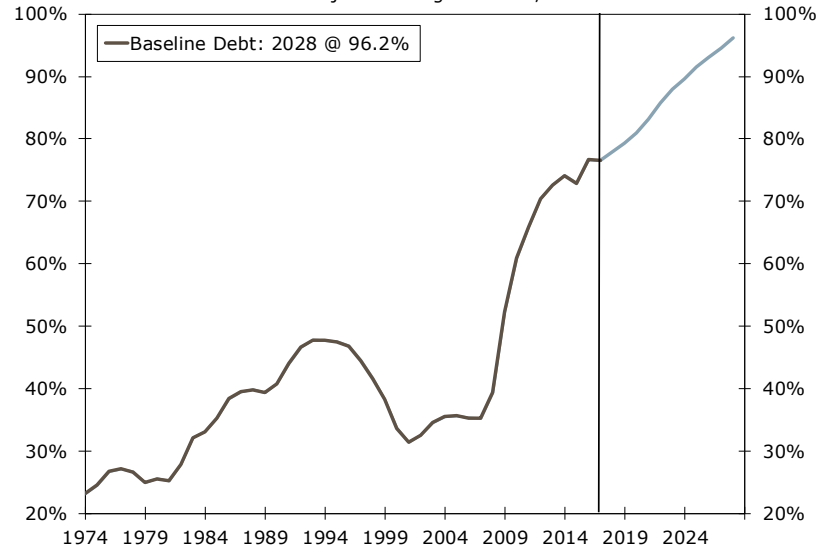
Composition of Federal Spending

Federal Debt Continues to Rise

Federal Spending
Percent of Total



U.S. Debt Held By The Public
CBO Baseline Projections Begin in 2018, Percent of GDP



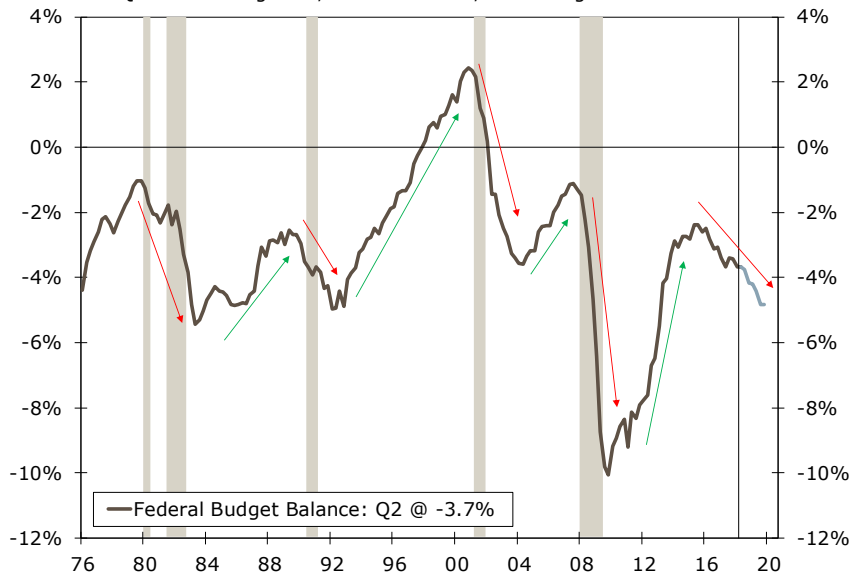
Source: Congressional Budget Office (CBO) and Wells Fargo Securities

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?

Budget as Percent of GDP

Federal Budget: Deteriorating in an Expansion

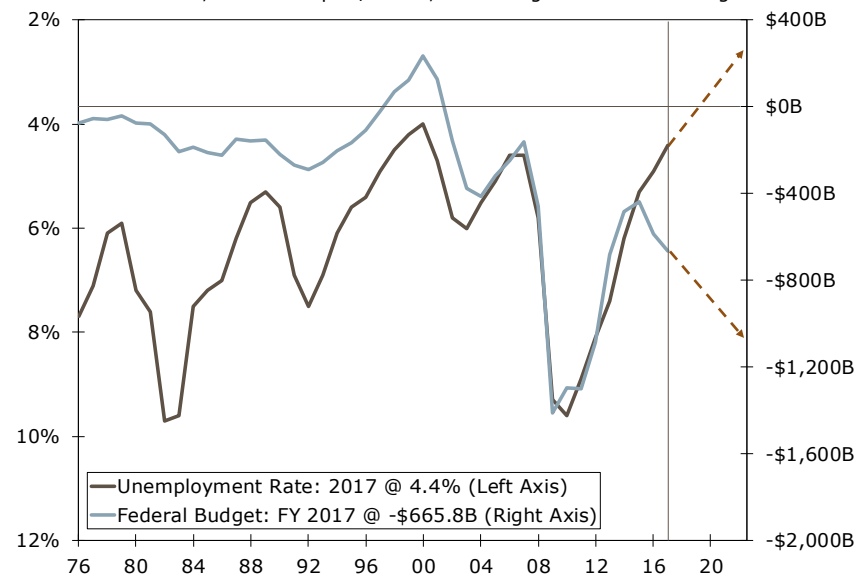
4-Quarter Moving Sum, Percent of GDP, Wells Fargo Forecast in Blue



Budget Compared to Unemployment

Unemployment Rate & Federal Budget Balance

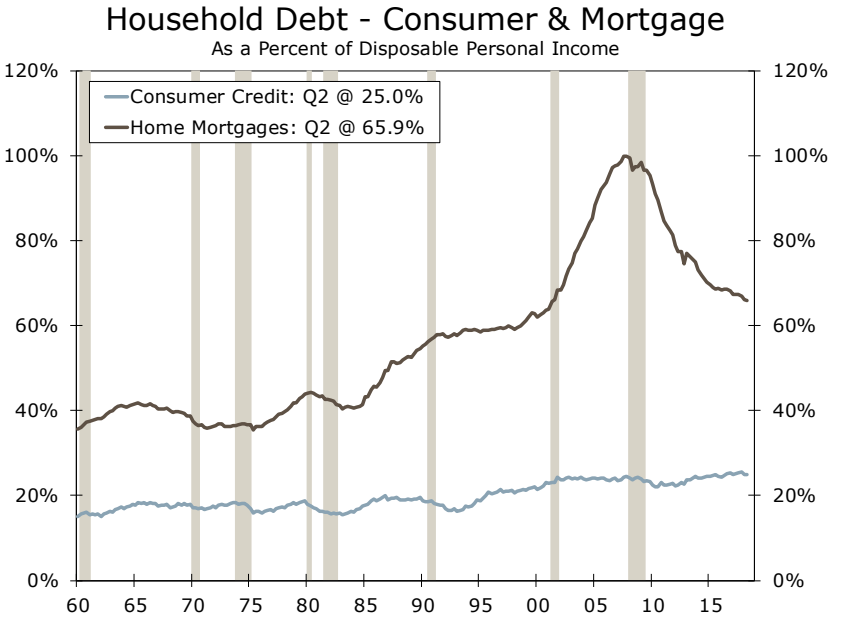
Inverted, Annual Surplus/Deficit, Wells Fargo Forecast in Orange



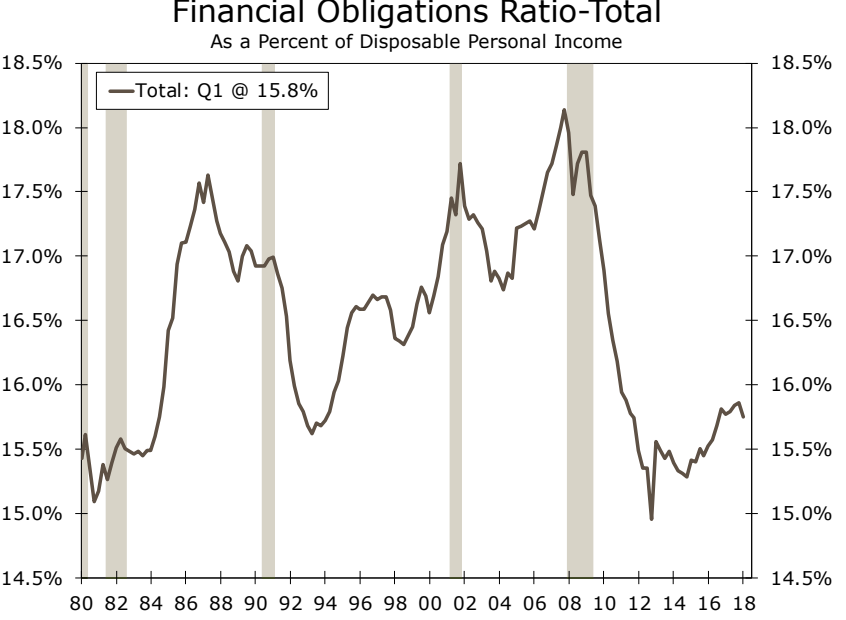
Source: U.S. Department of Commerce, U.S. Department of Labor, U.S. Department of Treasury and Wells Fargo Securities

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

Household Debt



Financial Obligations Ratio

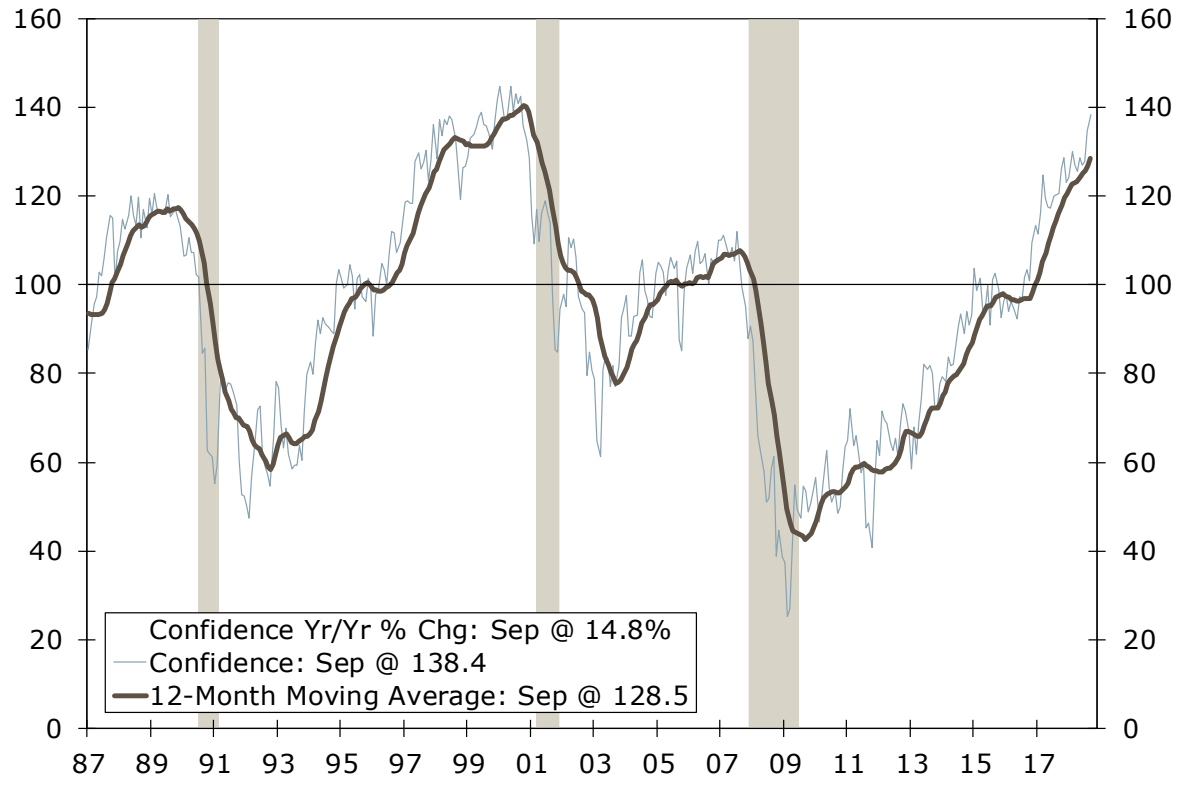


Source: Federal Reserve Board and Wells Fargo Securities

Consumer confidence has jumped post-election. Will more upbeat sentiment translate into an acceleration in personal consumption?

Consumer Confidence Index

Conference Board

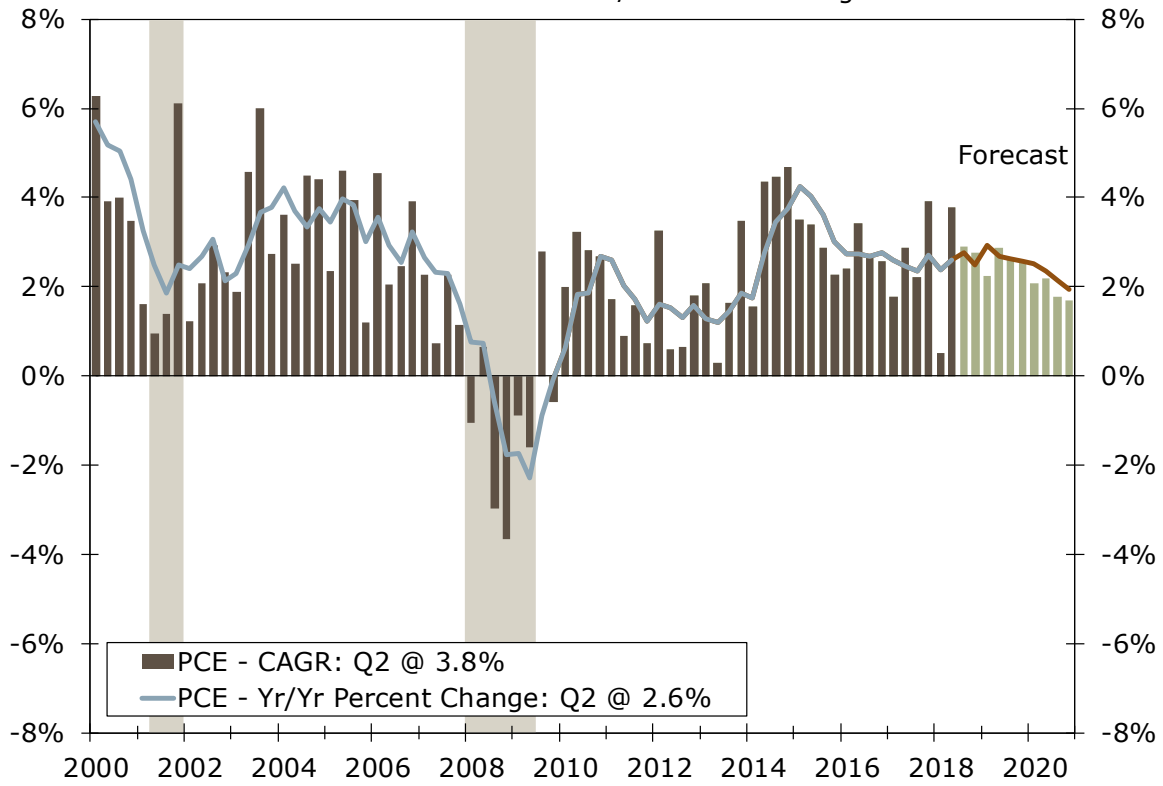


Source: The Conference Board and Wells Fargo Securities

Consumer spending growth is set to moderate but remain positive throughout the forecast horizon.

Real Personal Consumption Expenditures

Bars = CAGR Line = Yr/Yr Percent Change



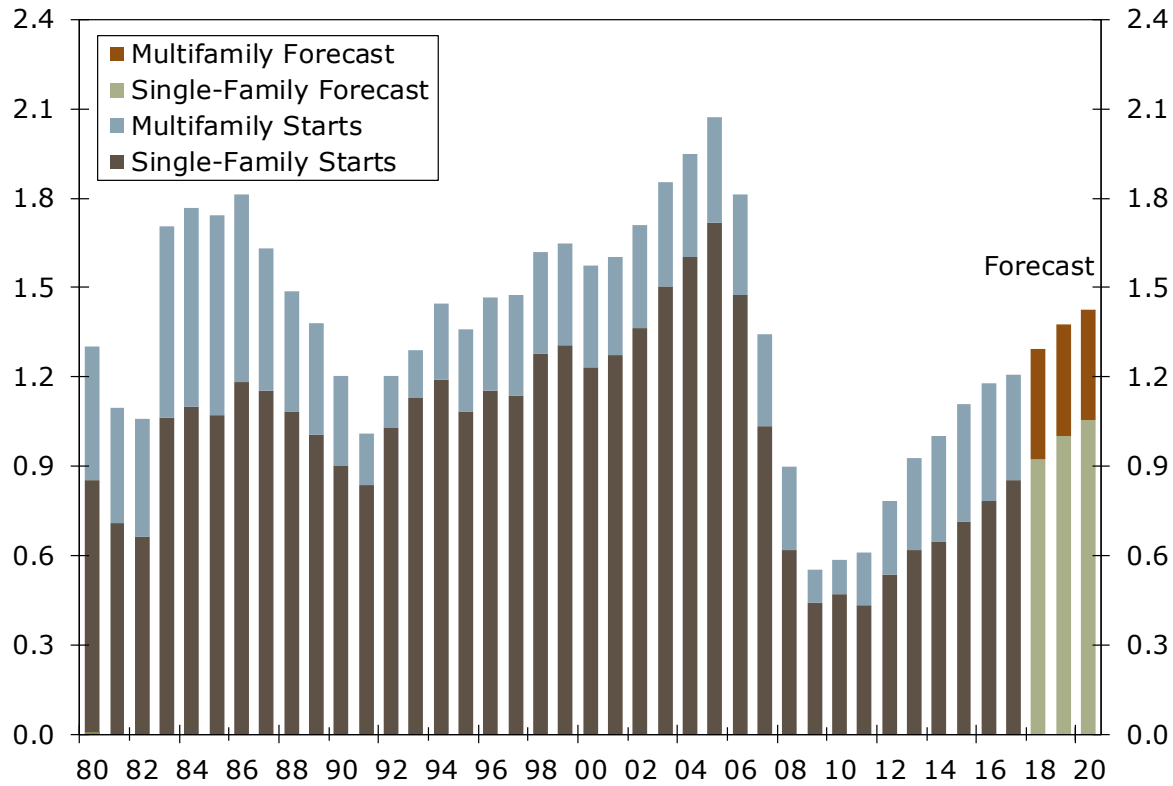
Source: U.S. Department of Commerce and Wells Fargo Securities

After a very slow start, we see single-family homebuilding steadily gaining momentum over the next few years.

Apartment construction is showing signs of topping out but should remain near recent levels.

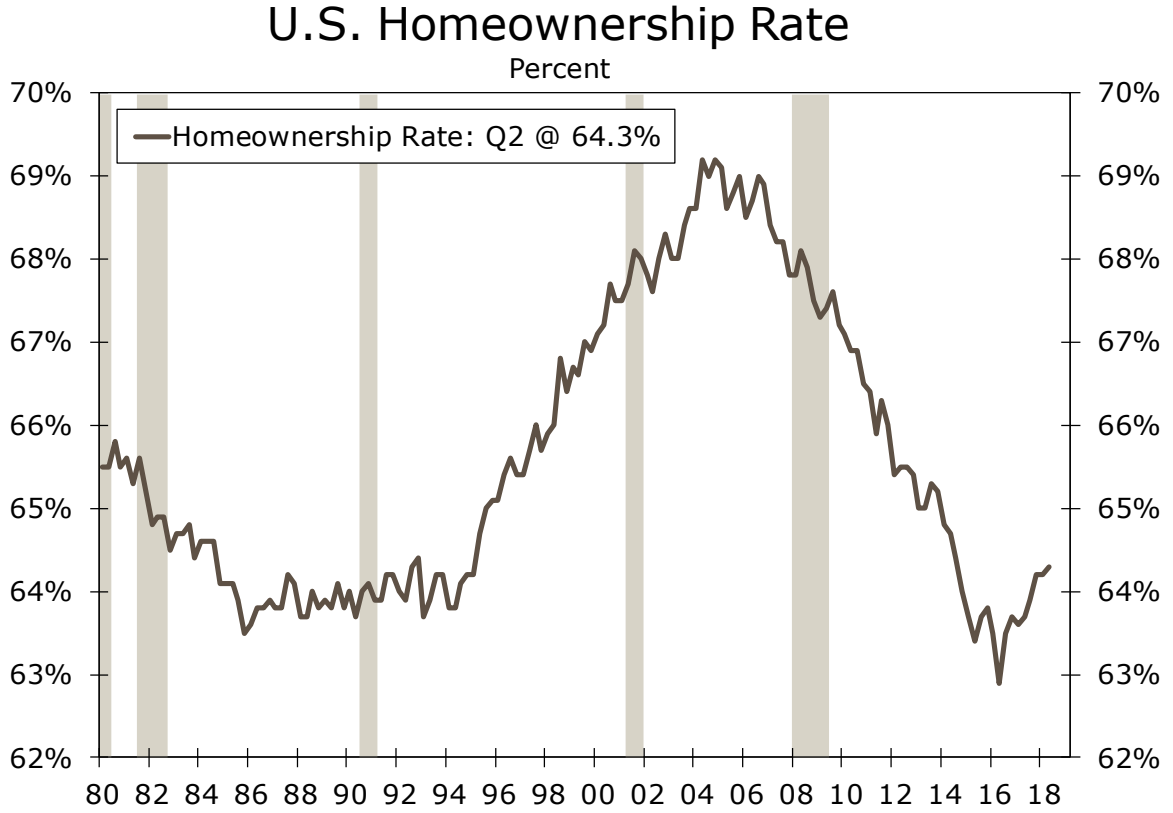
Housing Starts

Millions of Units



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

The long slide in the homeownership rate may have finally ended. The recovery in homeownership is likely to be protracted due to a combination of cyclical and structural factors.



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

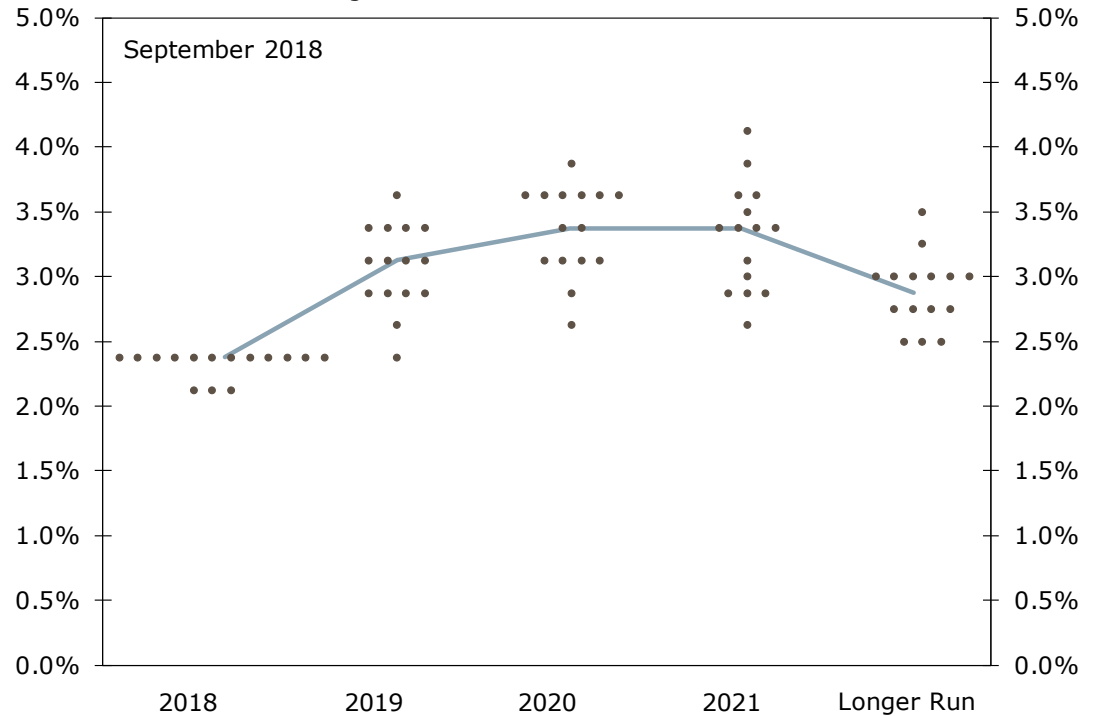
Monetary Policy & Rates

The FOMC is closing in on its neutral rate for fed funds.

With most dots clustered around 3.00 – 3.25% in the longer run how many rate hikes are left to go in the current cycle?

Appropriate Pace of Policy Firming

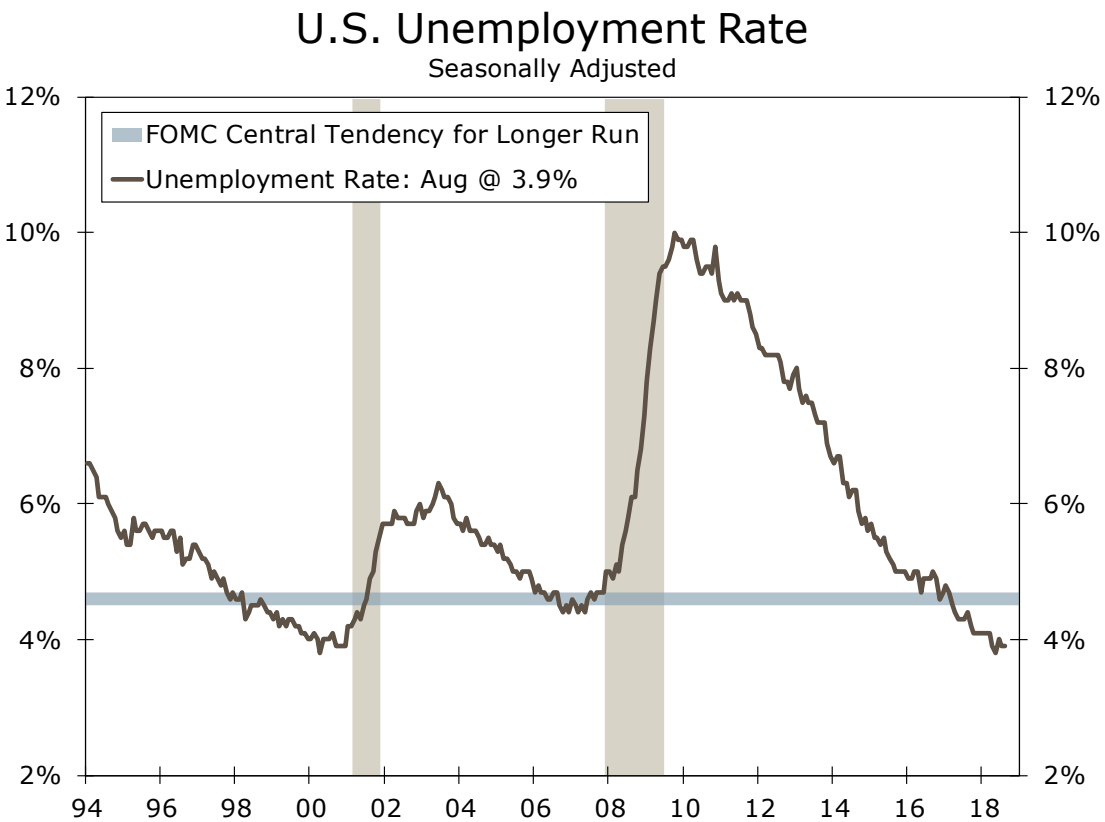
Target Federal Funds Rate at Year-End



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

The labor market is steadily firming.

The unemployment rate is currently at 3.9 percent, which is well-below the FOMC's central tendency target.



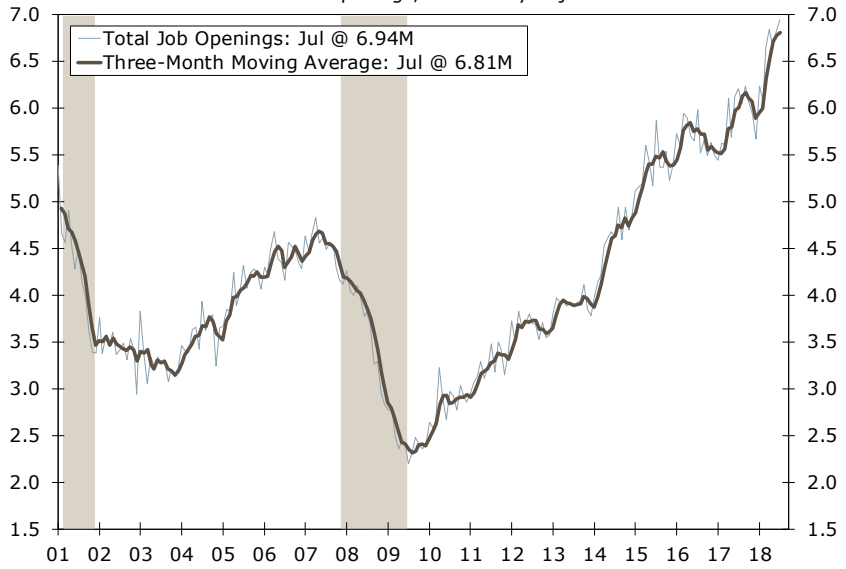
Source: Federal Reserve Board, U.S. Department of Labor and Wells Fargo Securities

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

Openings

Job Openings

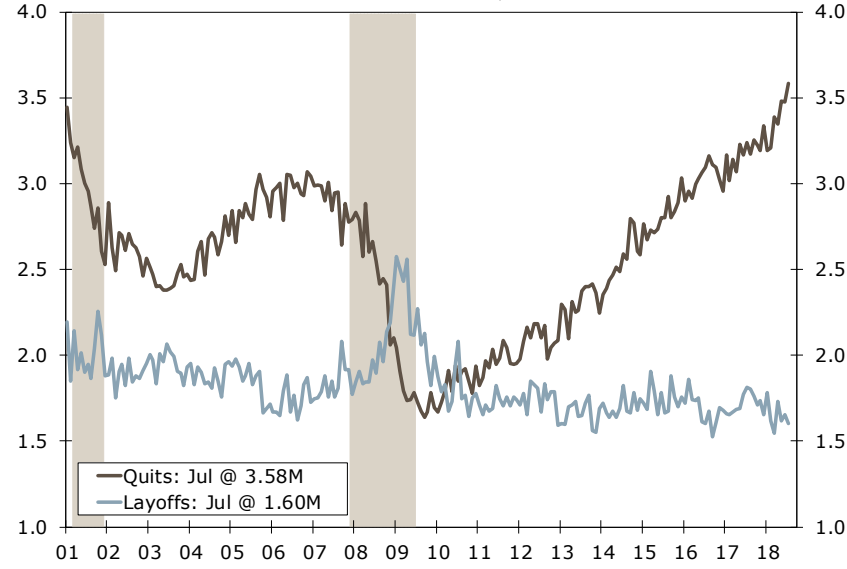
Millions of Openings, Seasonally Adjusted



Separations

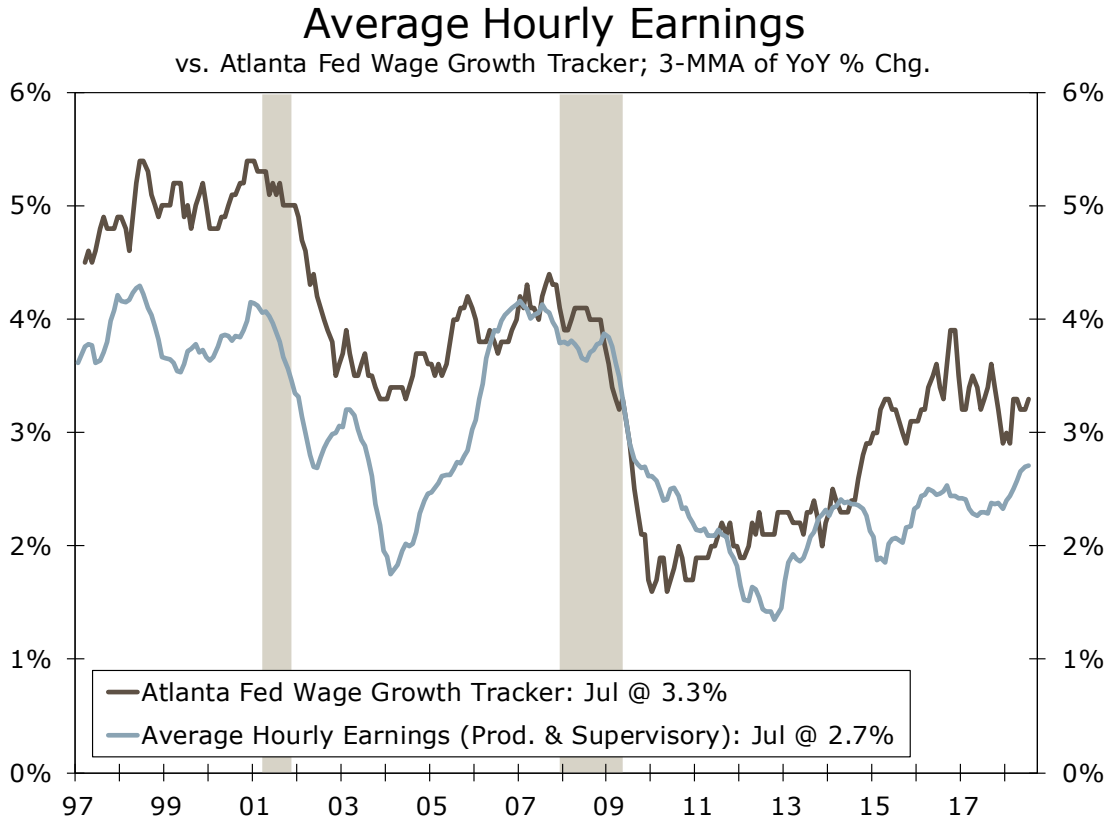
Quits vs. Layoffs

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.

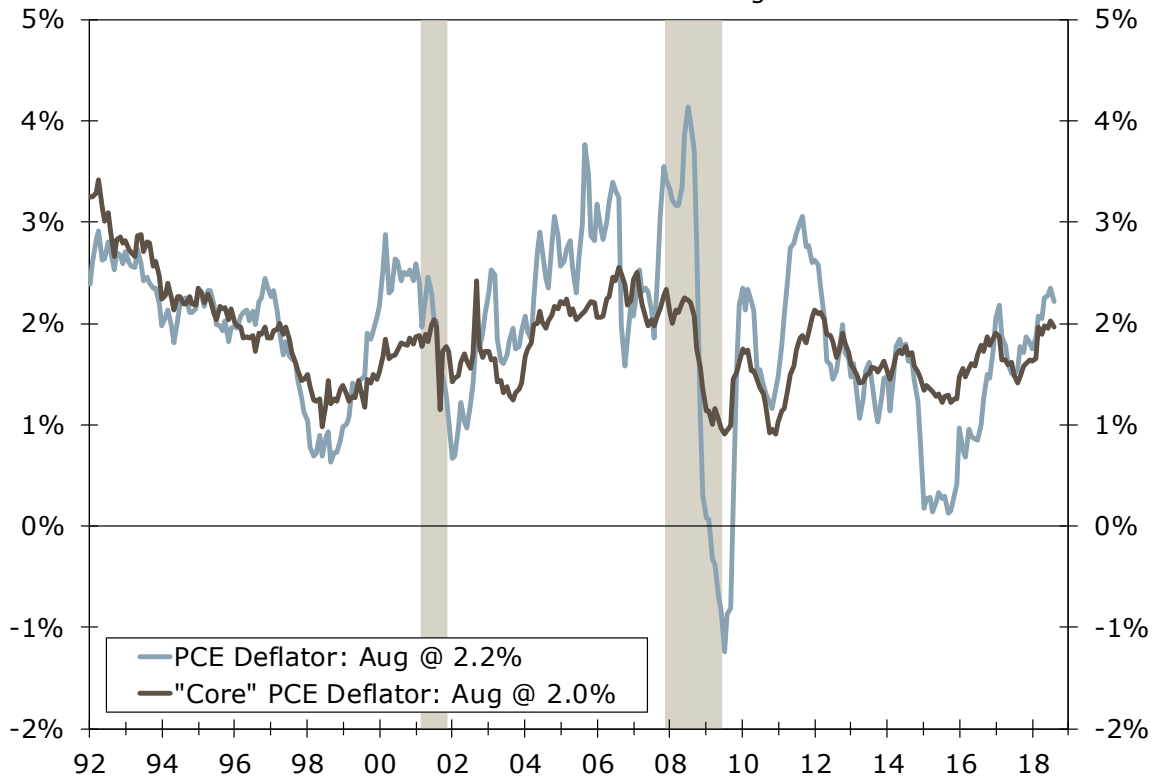


Source: Federal Reserve Bank of Atlanta, U.S. Department of Labor and Wells Fargo Securities

Rising material and labor costs have pushed inflation back up to the Fed's 2 percent target.

PCE Deflator vs. Core PCE Deflator

Year-over-Year Percent Change

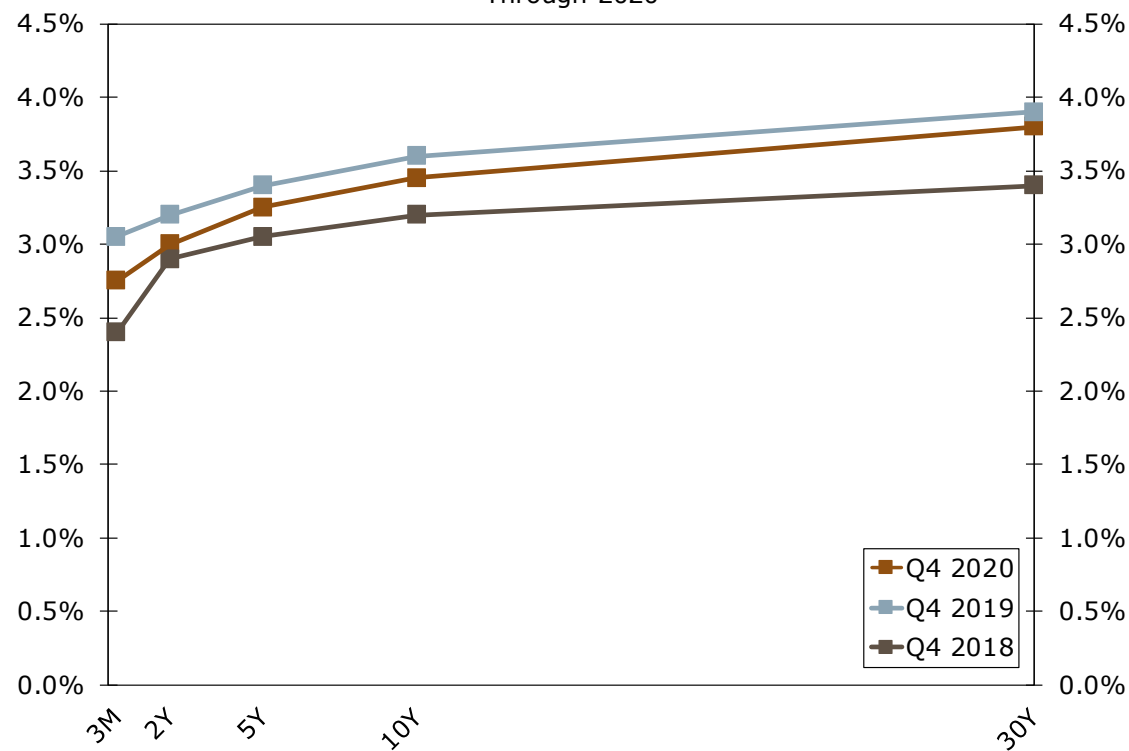


Source: U.S. Department of Commerce and Wells Fargo Securities

The yield curve is expected to flatten in the near-term as the Fed continues to raise short-term interest rates.

Further out, the curve will steepen after the Fed eventually takes back one of the rate hikes, even as longer term rates remain more or less anchored.

Wells Fargo Rates Forecast Through 2020

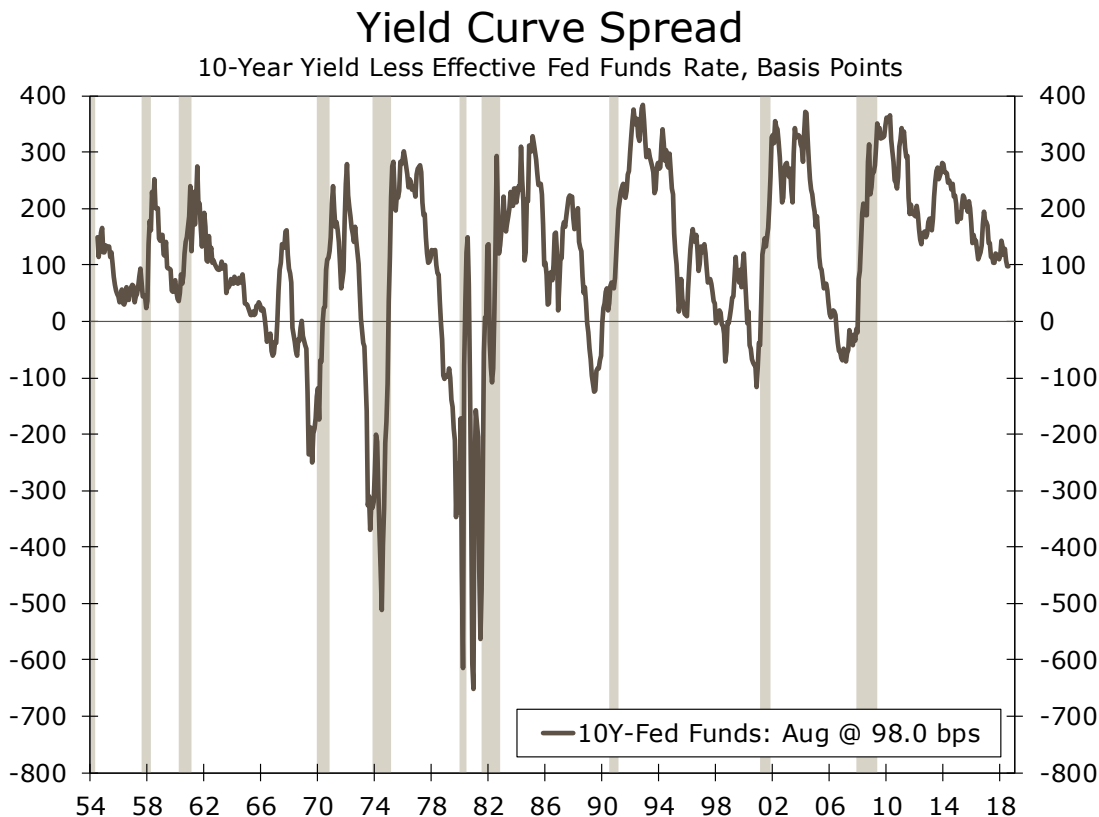


Source: IHS Markit and Wells Fargo Securities

The yield curve inverted before each of the past seven recessions (with a range of 8-23 months).

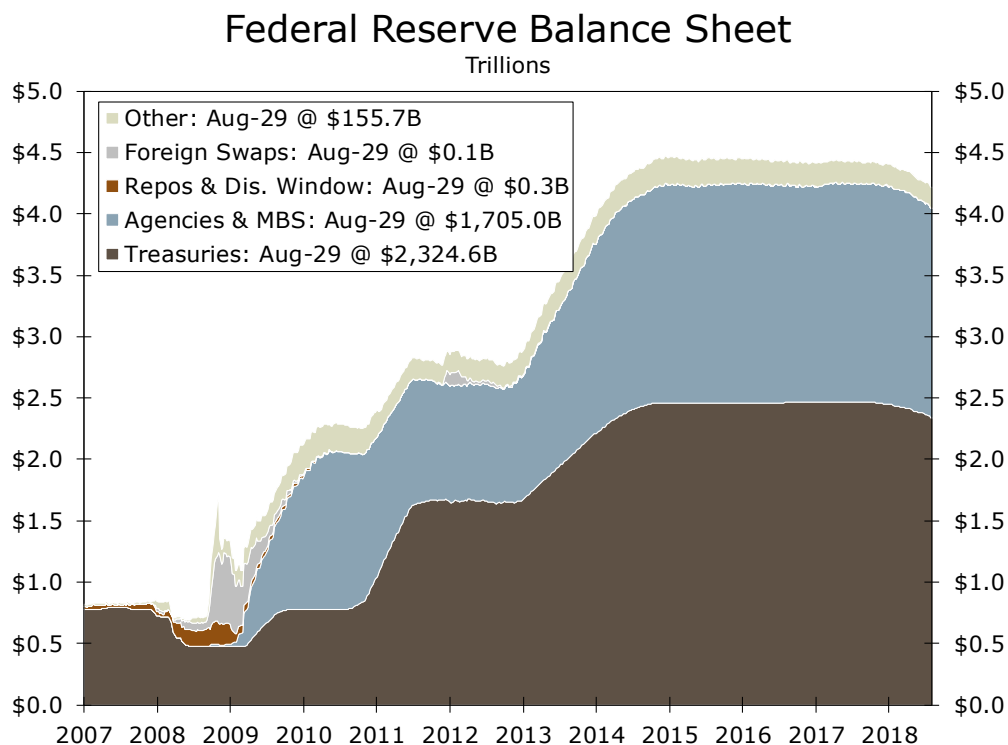
However, the yield curve did not invert during the 1954-1965 period and missed two recessions.

It also gave false signals in 1966, 1986 and 1998.



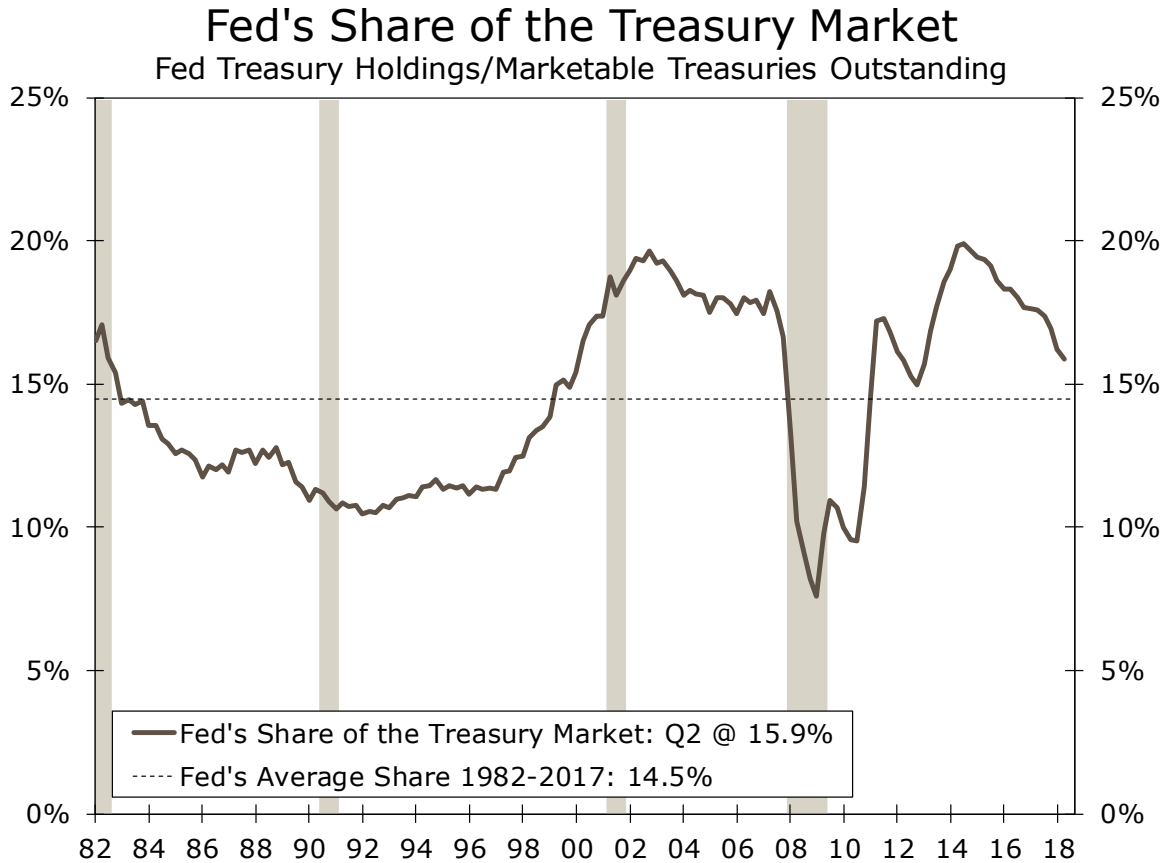
Source: Wells Fargo Securities

- Prior to the 2008, Fed’s holdings were about \$900 of mostly Treasuries.
- Balance sheet briefly held a diverse selection of financial instruments, such as commercial paper and currency swaps, to help mitigate the liquidity challenges in the financial system.
- Current size is roughly \$4.2 trillion, comprised mostly of Treasuries and mortgage-backed securities (MBS).



Source: Federal Reserve System and Wells Fargo Securities

The Fed holds a historically high share of the Treasury market—but perhaps not as high as one might think.



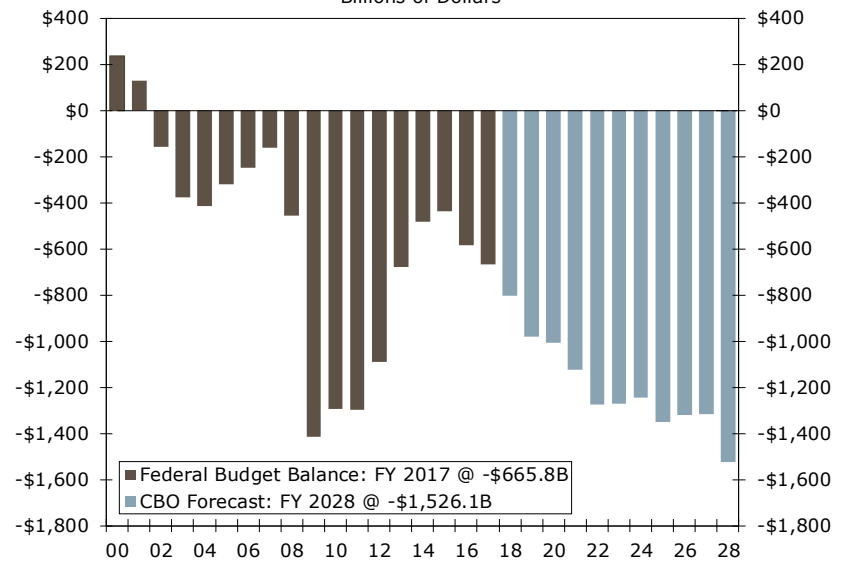
Source: Federal Reserve Board, U.S. Department of the Treasury and Wells Fargo Securities

Where Fiscal and Monetary Policy Are Intertwined

- Like it or not, Fed's large holdings currently help reduce the budget deficit.
- With rising deficits and trouble finding the funding for policy proposals, reduced remittances to the Treasury cannot be ignored.
- Fed earnings remitted to the Treasury in the past year add up to roughly \$80 billion.
- Without it, last year's fiscal budget deficit would have been 16 percent larger.

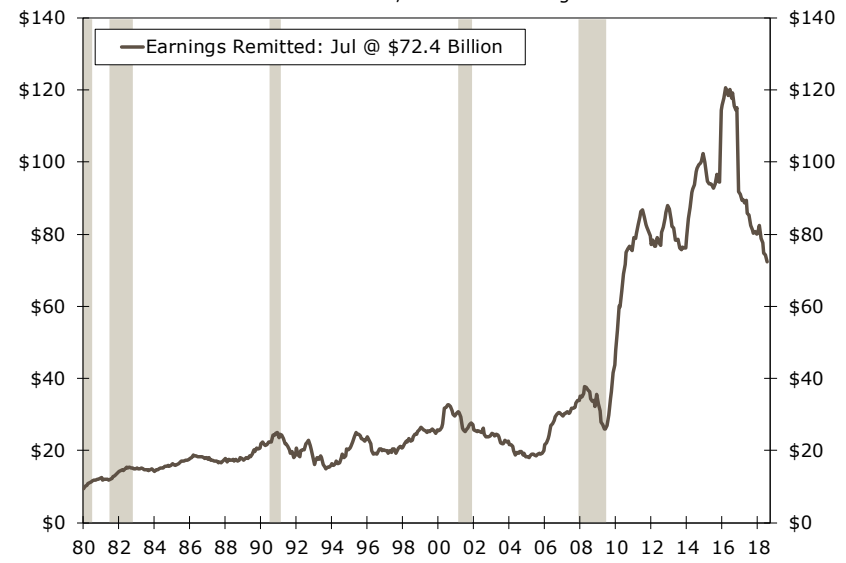
U.S. Federal Budget

U.S. Federal Budget Balance
Billions of Dollars



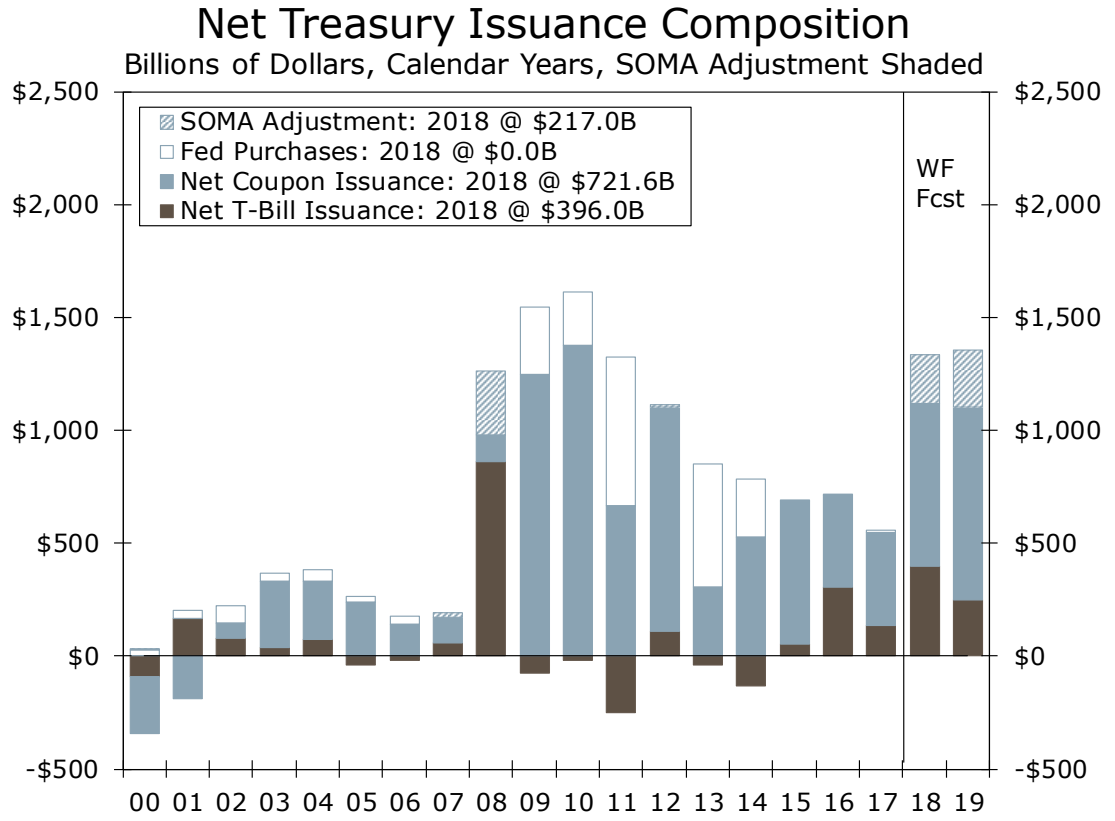
Fed Earnings Remitted

Fed Earnings Remitted to the Treasury
Billions of Dollars, 12-Month Moving Sum



Source: Congressional Budget Office (CBO), U.S. Department of the Treasury and Wells Fargo Securities

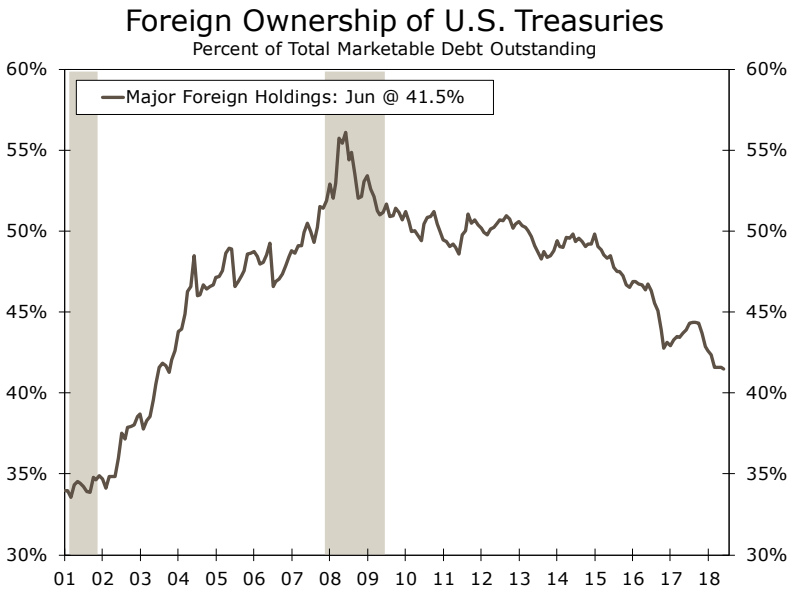
Swelling deficits have led to a surge in net Treasury issuance.



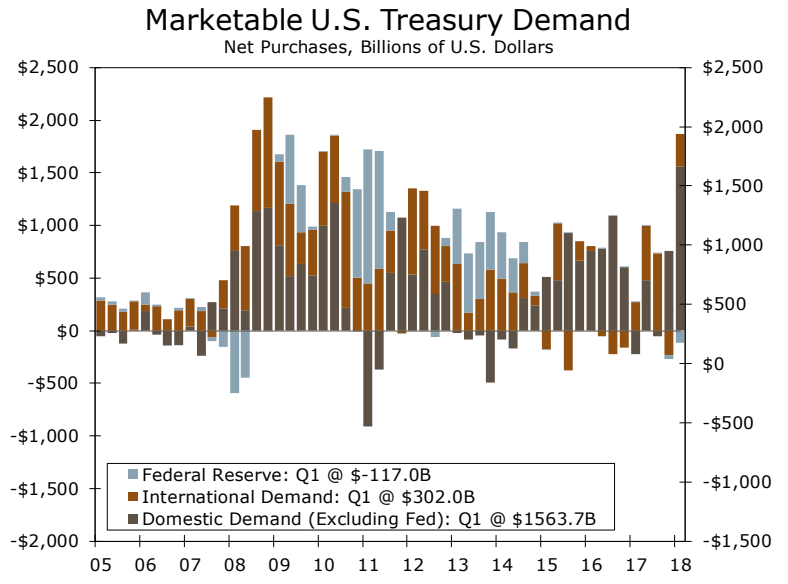
Source: U.S. Department of the Treasury and Wells Fargo Securities

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



Source: Bloomberg LP, Federal Reserve Board, U.S. Department of the Treasury 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 ¹	2.2	4.2	3.1	2.8	2.6	2.9	2.6	2.4	1.6	2.2	2.9	2.8	2.2
Personal Consumption	0.5	3.8	2.9	2.8	2.2	2.9	2.6	2.5	2.7	2.5	2.6	2.7	2.2
Inflation Indicators ²													
PCE Deflator	1.9	2.2	2.2	2.1	2.1	2.3	2.5	2.5	1.1	1.8	2.1	2.3	2.3
Consumer Price Index	2.3	2.6	2.6	2.4	2.2	2.4	2.6	2.7	1.3	2.1	2.5	2.5	2.5
Industrial Production ¹	2.5	6.0	3.0	3.3	2.4	4.2	1.2	4.0	-1.9	1.6	3.9	3.1	2.8
Corporate Profits Before Taxes ²	5.9	7.7	8.0	6.2	5.6	1.8	0.5	-0.8	-1.1	3.2	6.9	1.7	-2.4
Trade Weighted Dollar Index ³	86.3	90.0	90.0	90.5	90.0	89.0	87.8	86.3	91.5	91.1	89.2	88.3	82.8
Unemployment Rate	4.1	3.9	3.9	3.8	3.7	3.6	3.6	3.5	4.9	4.4	3.9	3.6	3.3
Housing Starts ⁴	1.32	1.25	1.27	1.33	1.34	1.37	1.39	1.42	1.17	1.20	1.30	1.38	1.43
Quarter-End Interest Rates ⁵													
Federal Funds Target Rate	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	0.52	1.13	2.13	3.06	3.19
Conventional Mortgage Rate	4.44	4.57	4.60	4.80	4.95	5.05	5.15	5.20	3.65	3.99	4.60	5.09	5.11
10 Year Note	2.74	2.85	3.00	3.20	3.35	3.45	3.55	3.60	1.84	2.33	2.95	3.49	3.51

Forecast as of: September 12, 2018

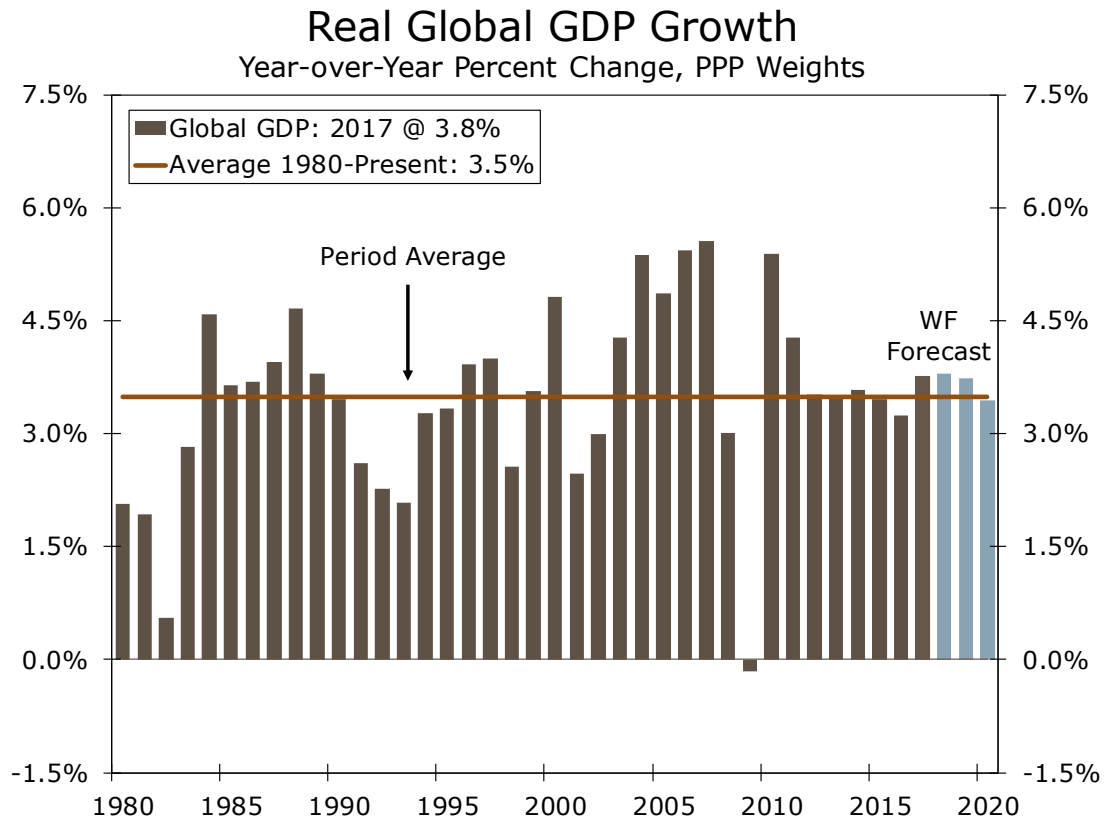
¹ Compound Annual Growth Rate Quarter-over-Quarter² Year-over-Year Percentage Change³ Federal Reserve Major Currency Index, 1973=100 - Quarter End⁴ Millions of Units⁵ Annual Numbers Represent Averages

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

International Outlook

2017 marked the fastest year for the global economy since 2011.

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

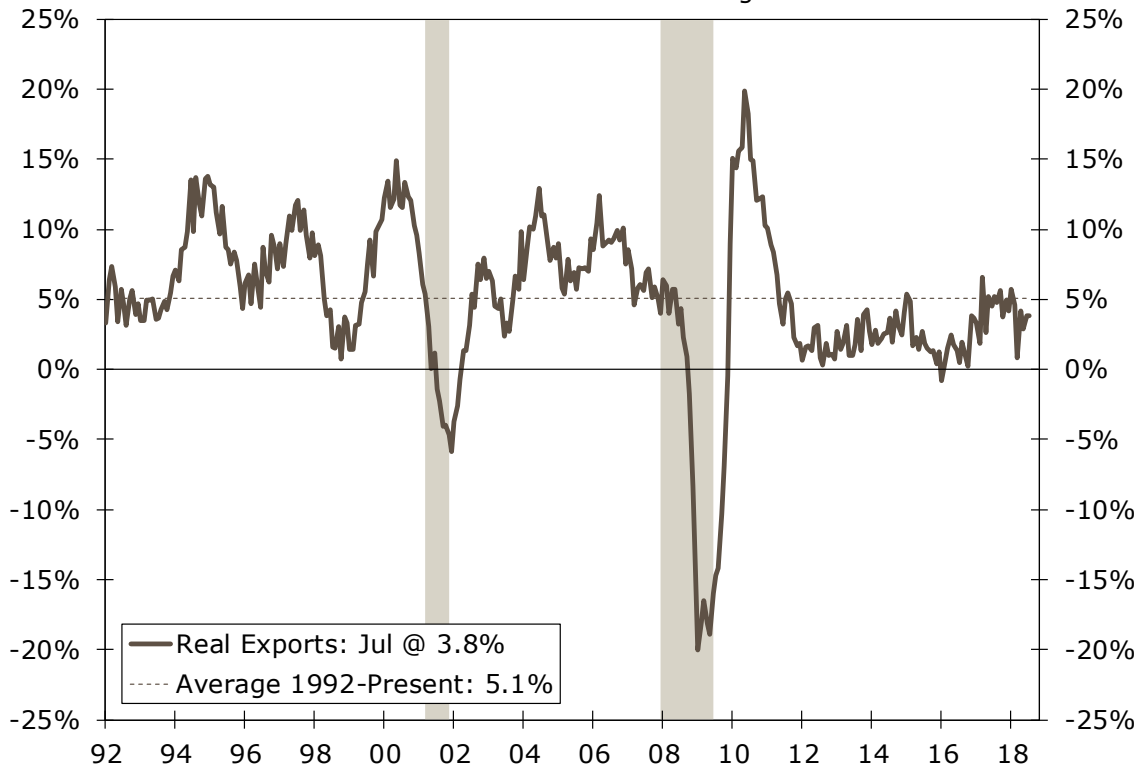


Source: International Monetary Fund (IMF) and Wells Fargo

Global trade has stabilized over the past year.

Global Export Volume

Year-over-Year Percent Change



Source: IHS Markit and Wells Fargo Securities

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP			CPI		
	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>
Global (PPP Weights)	3.8%	3.7%	3.4%	3.5%	3.7%	3.7%
Advanced Economies ¹	2.5%	2.5%	2.0%	2.2%	2.2%	2.3%
United States	2.9%	2.8%	2.2%	2.5%	2.5%	2.5%
Eurozone	2.1%	2.1%	1.7%	1.7%	1.8%	1.9%
United Kingdom	1.3%	1.5%	1.5%	2.3%	2.0%	2.0%
Japan	1.2%	1.2%	0.6%	1.0%	1.1%	2.0%
Canada	1.9%	2.0%	1.6%	2.3%	2.1%	2.0%
Developing Economies ¹	4.7%	4.6%	4.4%	4.5%	4.8%	4.7%
China	6.6%	6.3%	6.1%	2.1%	2.3%	2.3%
India	7.5%	7.4%	7.2%	4.7%	5.0%	4.8%
Mexico	2.2%	2.7%	2.4%	4.7%	3.9%	3.7%

Forecast as of: September 12, 2018

¹Aggregated Using PPP Weights

Source: International Monetary Fund and Wells Fargo Securities

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