

North Carolina Economic Outlook

Mark Vitner, Managing Director & Senior Economist January 03, 2018

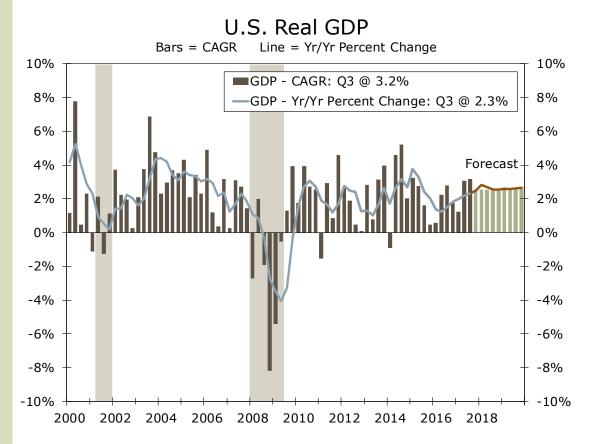


| Economic Outlook | Real GDP growth accelerated during the second and third quarters of 2017 and the improved pace of growth appears to be carrying over in 2018. Growth is not only stronger but much more broadly based. | | | | | | | |
|----------------------|--|--|--|--|--|--|--|--|
| Fiscal Policy | Tax cuts have finally become a reality and will likely be more impactful than consensus estimates. We looking for consumer spending and business investment to kick up a notch. An infrastructure program is likely in 2018. | | | | | | | |
| Monetary Policy | The post-financial crisis era is over and monetary policy is now focusing on normalizing interest rates and financial regulation. Inflation and interest rates may rise slightly more than currently expected in 2018. | | | | | | | |
| Soft Data Strength | The persistent strength in various economic surveys reflects improving job prospects, a lightening regulatory burden and a reviving manufacturing sector. A broader economic recovery will lift more industries and regions. | | | | | | | |
| North Carolina | North Carolina's economic recovery gained considerable strength during the past couple of years, although gains have largely been limited to the Triangle and Charlotte. Growth is now broadening to include most metro areas. | | | | | | | |

Real GDP growth accelerated during the spring and summer.

The improvement reflects stronger global growth and a lessening of burdensome regulations, which have helped revive capital spending.

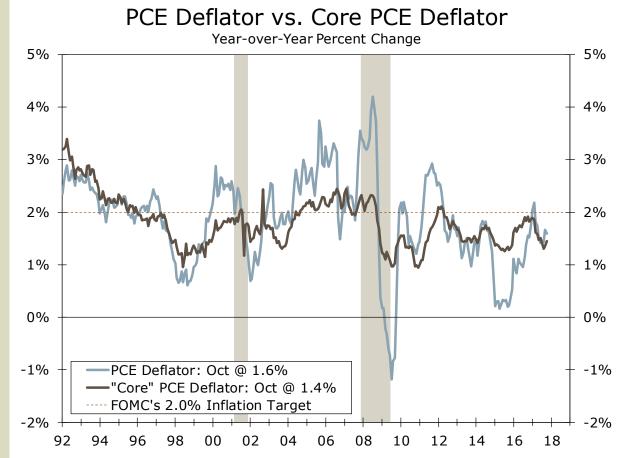
Real GDP growth has slowed during the first quarter of the past few years. This year may be an exception, as strong holiday season sales likely cleared inventories and bolstered company balance sheets.

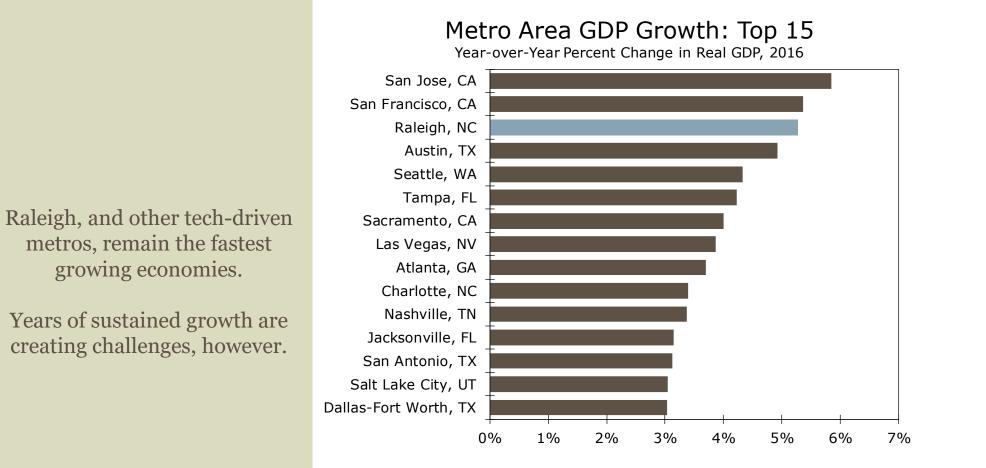


After making steady progress toward the Fed's 2 percent inflation objective, most broad inflation measures have remained below 2 percent since the last recession ended.

The recent moderation in core inflation is unnerving some members of the FOMC, suggesting the Fed may be even more cautious about raising short-term rates.

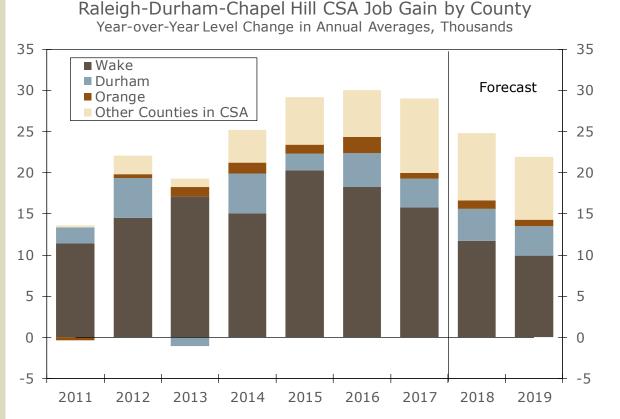
There are likely a mix of structural and cyclical forces restraining inflation that may prove to be long lasting.





Wake and Durham counties accounted for the bulk of job gains earlier in the expansion, as residents and businesses moved back toward the city center.

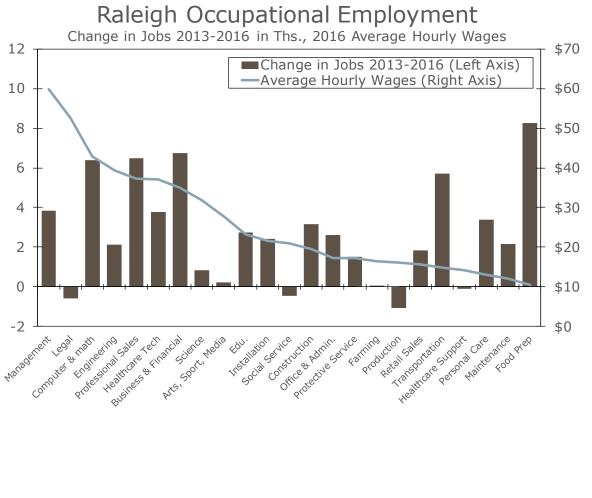
Job growth has since broadened and more growth is occurring in outlying areas. Job growth in Wake County is moderating.



While job growth has been solid, income gains have remained elusive for many workers.

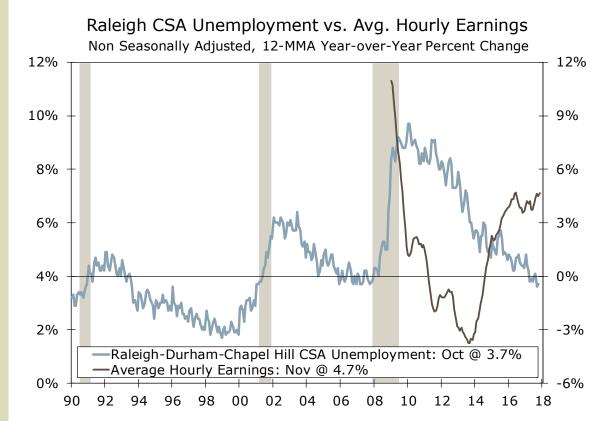
Job growth in Raleigh has been stronger at the high-end and low-end of the wage spectrum.

The income divide is a national issue and has made economic mobility more challenging.



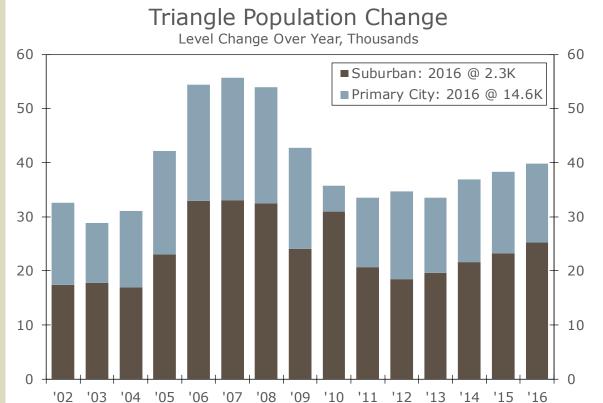
The Triangle's lower unemployment rate has pulled wage increases higher, which is something that much of the country has not yet seen.

While the labor market has certainly tightened, the Triangle has grown solidly for long periods of time with an even lower unemployment rate.



The movement back into the center city bolstered growth in Raleigh and Durham earlier in the cycle, setting off battles over redevelopment and gentrification.

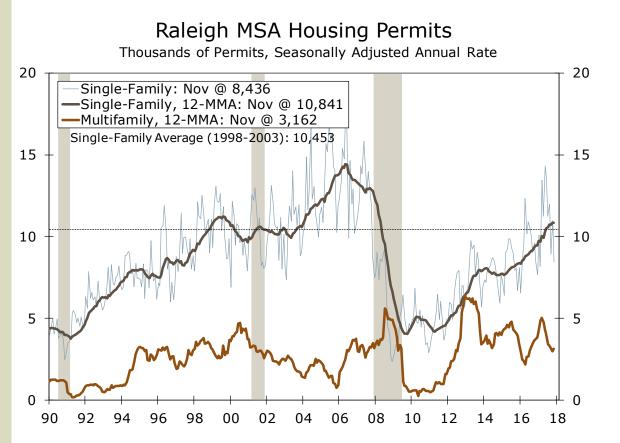
Rising housing costs and sluggish median income growth have spurred an affordability migration to outlying areas, raising a new set of challenges in regards to land use and zoning.



Source: CoreLogic and Wells Fargo Securities

2017 was a strong year for homebuilding in Raleigh.

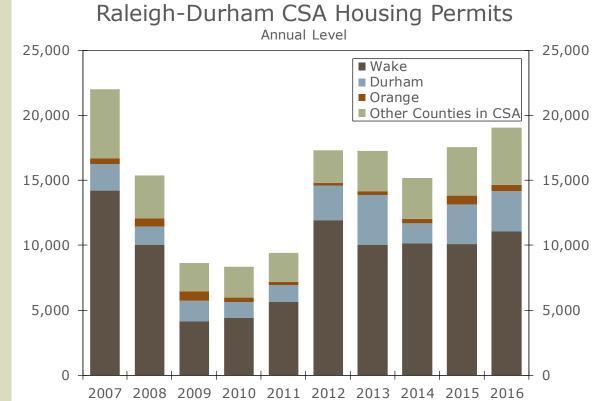
Single-family housing permits surpassed their long-run average and are now roughly in line with population gains.



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

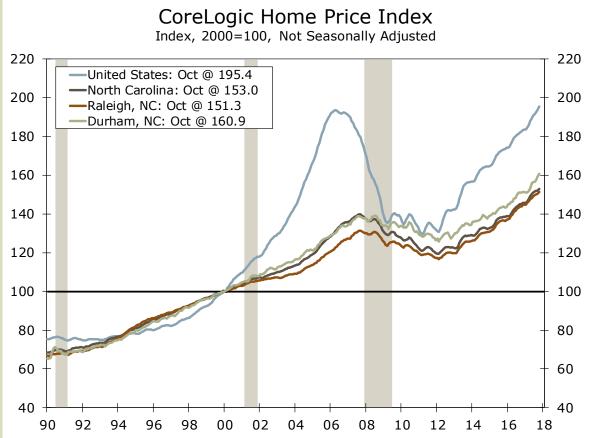
Wake and Durham Counties accounted for the bulk of housing starts earlier in the recovery, led by a boom in apartment building and redevelopment of single-family homes in closer-in neighborhoods.

More recently, growth has been shifting to the suburbs and outlying areas.



Home price appreciation has not seen the roller coaster ride that some other parts of the country have. Prices did not fall as hard during the housing slump and have rebounded less dramatically than they did nationwide.

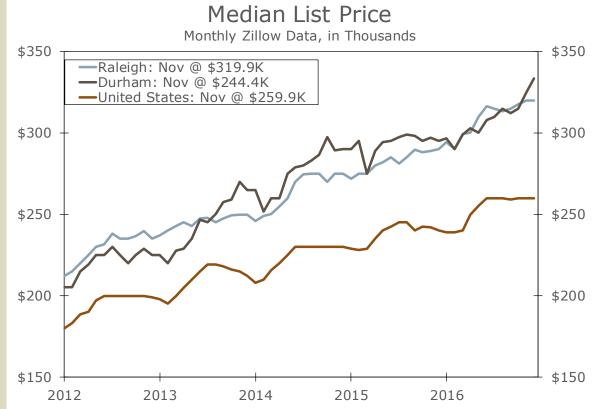
Home prices in Raleigh and Durham have risen past their previous highs, and affordability has become a bigger issue.



Source: CoreLogic and Wells Fargo Securities

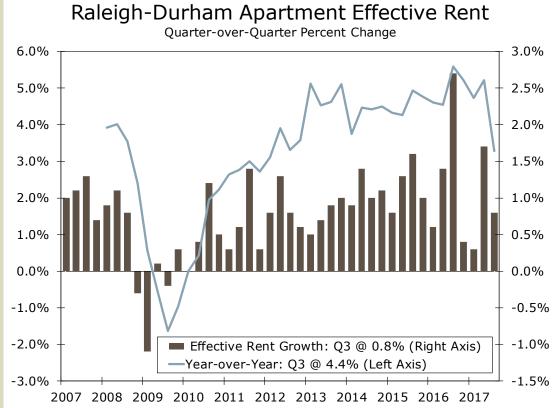
Home prices in the Triangle are now higher relative to the national average, making the region less of a bargain compared to similar sized markets in the Sunbelt.

While homes are less expensive in some neighboring areas, the Triangle still has lower home prices relative to other major tech hubs such as San Jose, Austin, Denver and Boston.



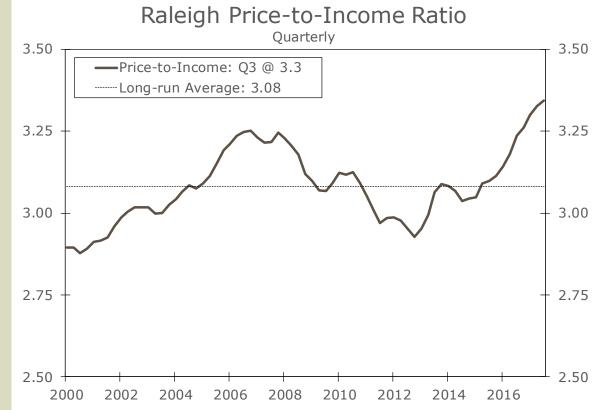
Source: CoreLogic and Wells Fargo Securities

The Triangle has seen a deluge of apartments come to market in recent years. Many of these units have been high-end urban developments, resulting in much higher average rents.



Source: Zillow, Inc. and Wells Fargo Securities

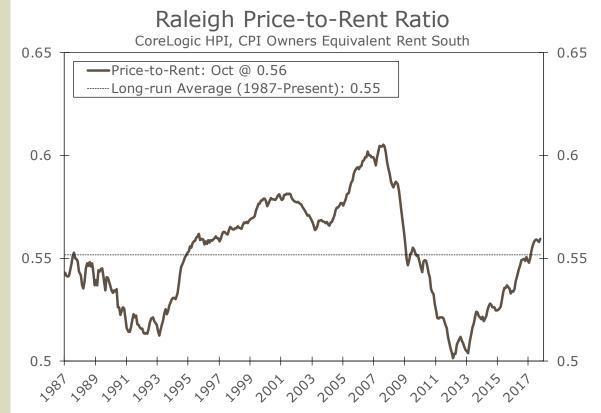
While home prices have risen modestly in Raleigh relative to other rapidly growing markets, affordability has still become a critical issue. This is true across the nation, as wage growth has lagged and income mobility appears to have slowed.



Source: Zillow, Inc. and Wells Fargo Securities

If you can afford to buy a home, homeownership makes economic sense.

With rents rising so rapidly, the ratio of home prices to rents remains only slightly above its long-run average.



Source: Zillow, Inc. and Wells Fargo Securities

| Economic Outlook | The Triangle has been growing roughly twice as fast as the nation and will continue to do so this year. Tax reform is expected to meaningfully boost capital spending, which will provide an added boost to the tech sector. | | | | | | |
|-------------------------------|---|--|--|--|--|--|--|
| Employment & Income Growth | Job growth is expected to be slightly stronger in 2018, with the metro area adding close to 25,000 net new jobs. Employment growth remains skewed toward the upper and lower end but income gains should be larger in 2018. | | | | | | |
| Interest Rates & Housing | The Federal Reserve will likely hike interest rates at least three times this year but mortgage rates will rise only modestly. We look for single-family construction to rise solidly in 2018 but apartment construction will cool. | | | | | | |
| Affordability Migration | Years of strong growth have pushed housing costs higher, particularly in areas close to city centers. Higher housing costs have set off an affordability migration to the suburbs, fueling numerous zoning battles. | | | | | | |
| Infrastructure | President Trump has hinted that his attention is to shift toward boosting infrastructure investment. There is no pot of money to fund infrastructure, however, and much of the responsibility will fall back to local governments. | | | | | | |

| Wells Fargo U.S. Economic Forecast | | | | | | | | | | | | | | | | | |
|---|------|--------|------|------|----------|------|------|------|------|------|--------|------|----------|------|------|------|------|
| | | Actual | | | Forecast | | | | | | Actual | | Forecast | | | | |
| | | 2017 | | | 2018 | | | | 2019 | | | 2015 | 2016 | 2017 | 2018 | 2019 | |
| | 1Q | 2Q | ЗQ | 4Q | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | | | | | |
| Real Gross Domestic Product 1 | 1.2 | 3.1 | 3.2 | 2.5 | 2.6 | 2.5 | 2.6 | 2.5 | 2.7 | 2.6 | 2.6 | 2.7 | 2.9 | 1.5 | 2.3 | 2.7 | 2.6 |
| Personal Consumption | 1.9 | 3.3 | 2.2 | 3.0 | 2.3 | 2.5 | 2.5 | 2.5 | 2.7 | 2.6 | 2.5 | 2.5 | 3.6 | 2.7 | 2.7 | 2.6 | 2.6 |
| Business Fixed Investment | 7.2 | 6.7 | 4.7 | 5.4 | 4.8 | 4.1 | 4.0 | 3.7 | 3.7 | 3.6 | 3.6 | 3.7 | 2.3 | -0.6 | 4.6 | 4.7 | 3.7 |
| Equipment | 4.4 | 8.8 | 10.8 | 7.6 | 5.4 | 4.3 | 4.2 | 3.7 | 3.7 | 3.3 | 3.5 | 3.7 | 3.5 | -3.4 | 4.6 | 6.2 | 3.7 |
| Intellectual Property Products | 5.7 | 3.7 | 5.2 | 4.1 | 5.2 | 4.8 | 4.7 | 4.5 | 4.6 | 4.6 | 4.6 | 4.6 | 3.8 | 6.3 | 4.1 | 4.7 | 4.6 |
| Structures | 14.8 | 7.0 | -7.0 | 1.0 | 3.0 | 2.4 | 2.4 | 2.2 | 2.5 | 2.4 | 2.4 | 2.4 | -1.8 | -4.1 | 5.3 | 1.3 | 2.4 |
| Residential Construction | 11.1 | -7.3 | -4.7 | 9.0 | 6.0 | 8.0 | 7.5 | 7.0 | 5.5 | 5.0 | 5.0 | 4.5 | 10.2 | 5.5 | 1.6 | 4.9 | 6.0 |
| Government Purchases | -0.6 | -0.2 | 0.7 | 2.5 | 0.2 | 0.8 | 0.8 | 0.8 | 0.7 | 0.7 | 0.7 | 0.7 | 1.4 | 0.8 | 0.1 | 0.9 | 0.7 |
| Net Exports ² | 0.2 | 0.2 | 0.4 | -0.5 | -0.2 | -0.1 | -0.1 | 0.0 | 0.0 | 0.0 | 0.1 | 0.2 | -0.7 | -0.2 | -0.2 | -0.1 | 0.0 |
| Inventories ² | -1.5 | 0.1 | 0.8 | 0.0 | 0.2 | 0.0 | 0.0 | -0.1 | 0.0 | 0.0 | -0.1 | 0.0 | 0.2 | -0.4 | -0.1 | 0.2 | 0.0 |
| Nonfarm Payroll Change ³ | 166 | 187 | 128 | 212 | 170 | 165 | 160 | 155 | 150 | 150 | 145 | 145 | 226 | 187 | 173 | 163 | 148 |
| Unemployment Rate | 4.7 | 4.4 | 4.3 | 4.1 | 4.1 | 4.0 | 3.9 | 3.8 | 3.8 | 3.7 | 3.8 | 3.7 | 5.3 | 4.9 | 4.4 | 4.0 | 3.8 |
| Consumer Price Index 4 | 2.6 | 1.9 | 2.0 | 2.1 | 2.0 | 2.6 | 2.7 | 2.1 | 2.0 | 2.1 | 2.2 | 2.3 | 0.1 | 1.3 | 2.1 | 2.3 | 2.1 |
| Quarter-End Interest Rates ⁵ | | | | | | | | | | | | | | | | | |
| Federal Funds Target Rate | 1.00 | 1.25 | 1.25 | 1.50 | 1.75 | 2.00 | 2.25 | 2.25 | 2.50 | 2.50 | 2.75 | 2.75 | 0.27 | 0.52 | 1.25 | 2.06 | 2.63 |
| Conventional Mortgage Rate | 4.20 | 3.90 | 3.81 | 3.89 | 4.06 | 4.20 | 4.30 | 4.35 | 4.45 | 4.50 | 4.62 | 4.67 | 3.85 | 3.65 | 3.95 | 4.23 | 4.56 |
| 2 Year Note | 1.27 | 1.38 | 1.47 | 1.80 | 2.00 | 2.25 | 2.45 | 2.60 | 2.70 | 2.80 | 2.93 | 3.00 | 0.69 | 0.83 | 1.48 | 2.33 | 2.86 |
| 10 Year Note | 2.40 | 2.31 | 2.33 | 2.49 | 2.66 | 2.80 | 2.90 | 2.95 | 3.05 | 3.10 | 3.22 | 3.27 | 2.14 | 1.84 | 2.38 | 2.83 | 3.16 |

Forecast as of: December 21, 2017

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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