

WELLS
FARGO

SECURITIES

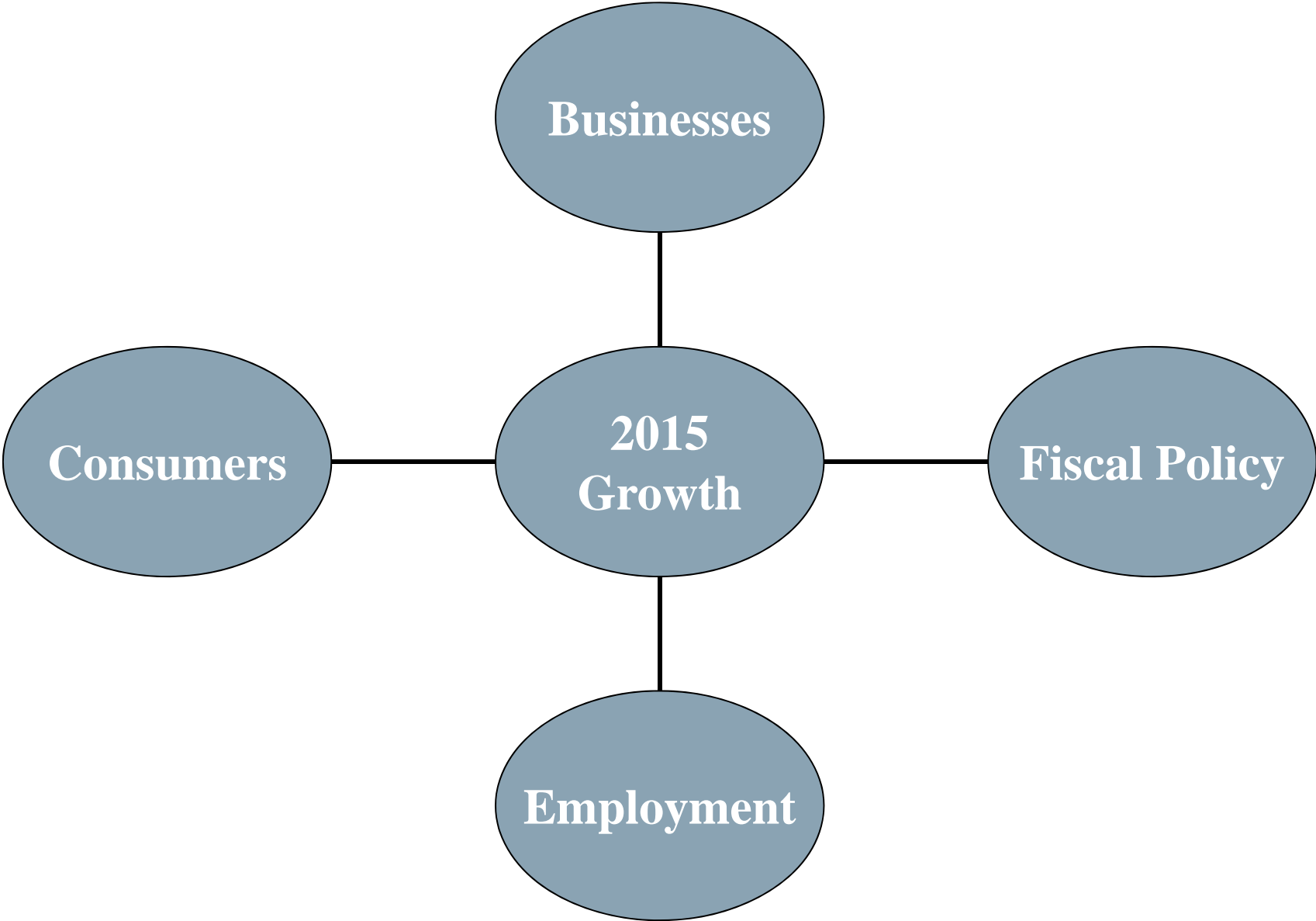
Economic Outlook for 2015 and Beyond

Michael A. Brown, Economist

October 22, 2014

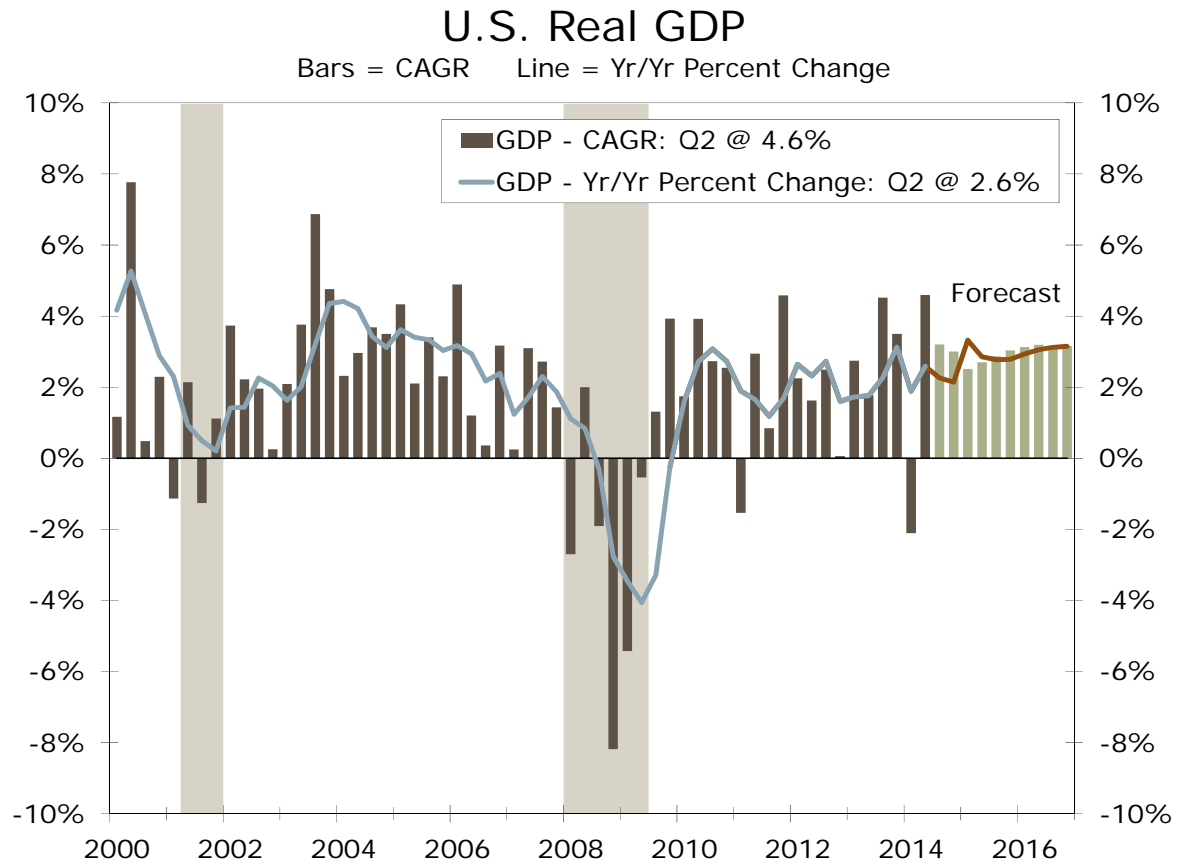
Together we'll go far





Where Are We Now?

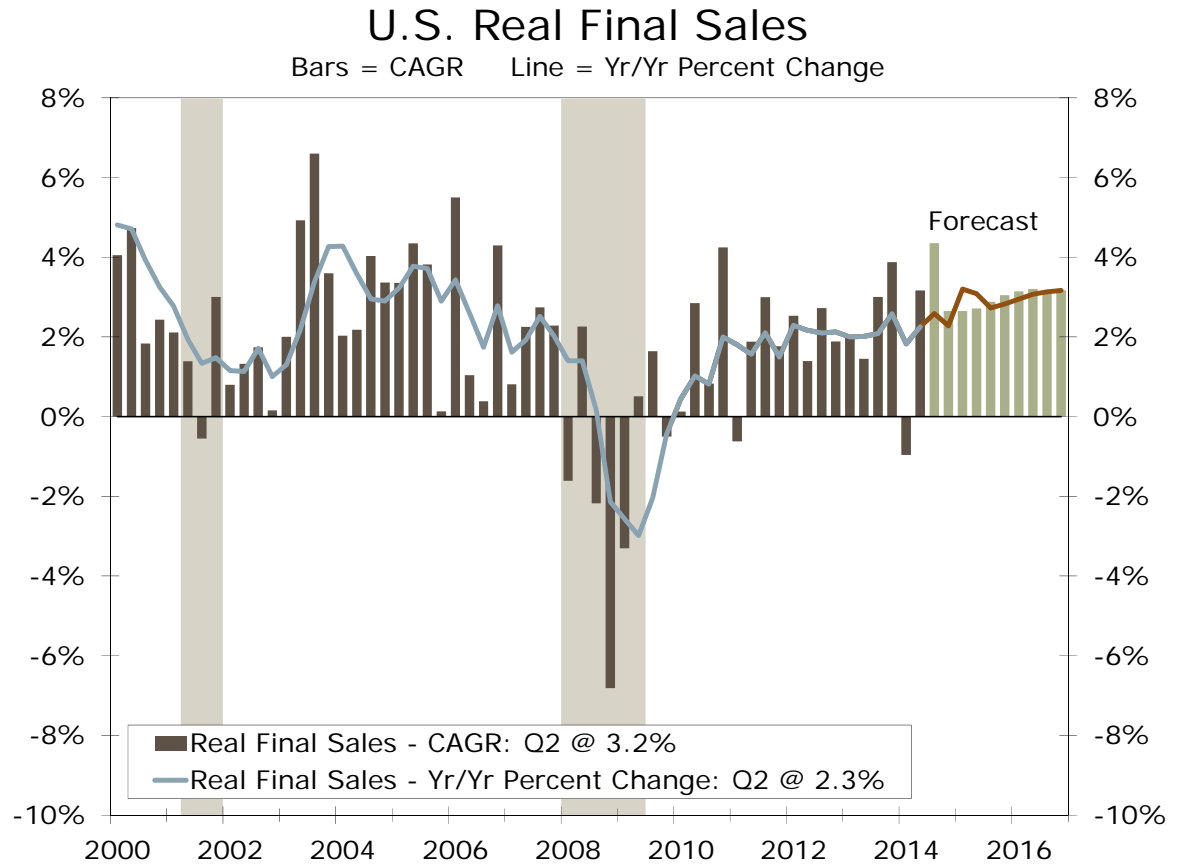
We expect economic activity to continue to accelerate in the second half of the year



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

Where Are We Now?

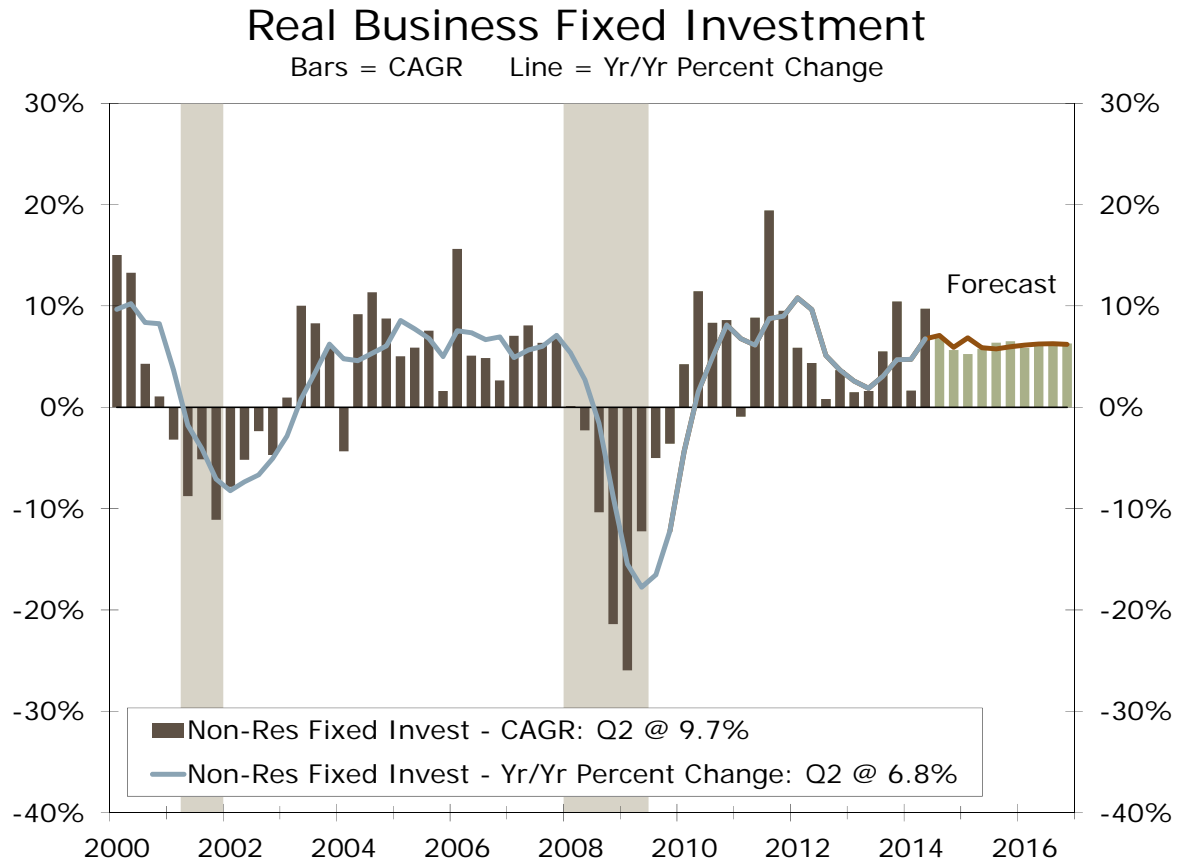
Underlying economic growth remains robust



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

Capital Spending

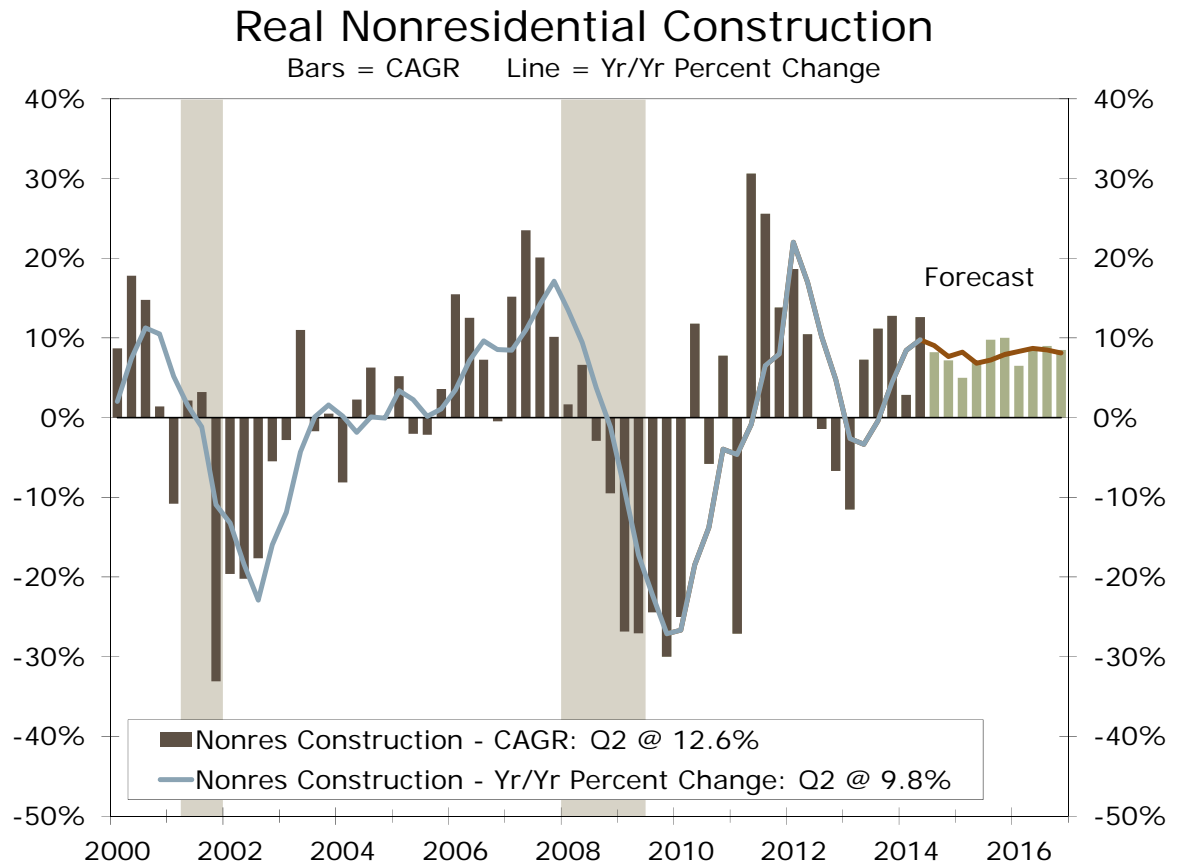
Growth in business fixed investment spending will continue to buoy growth in the coming years



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

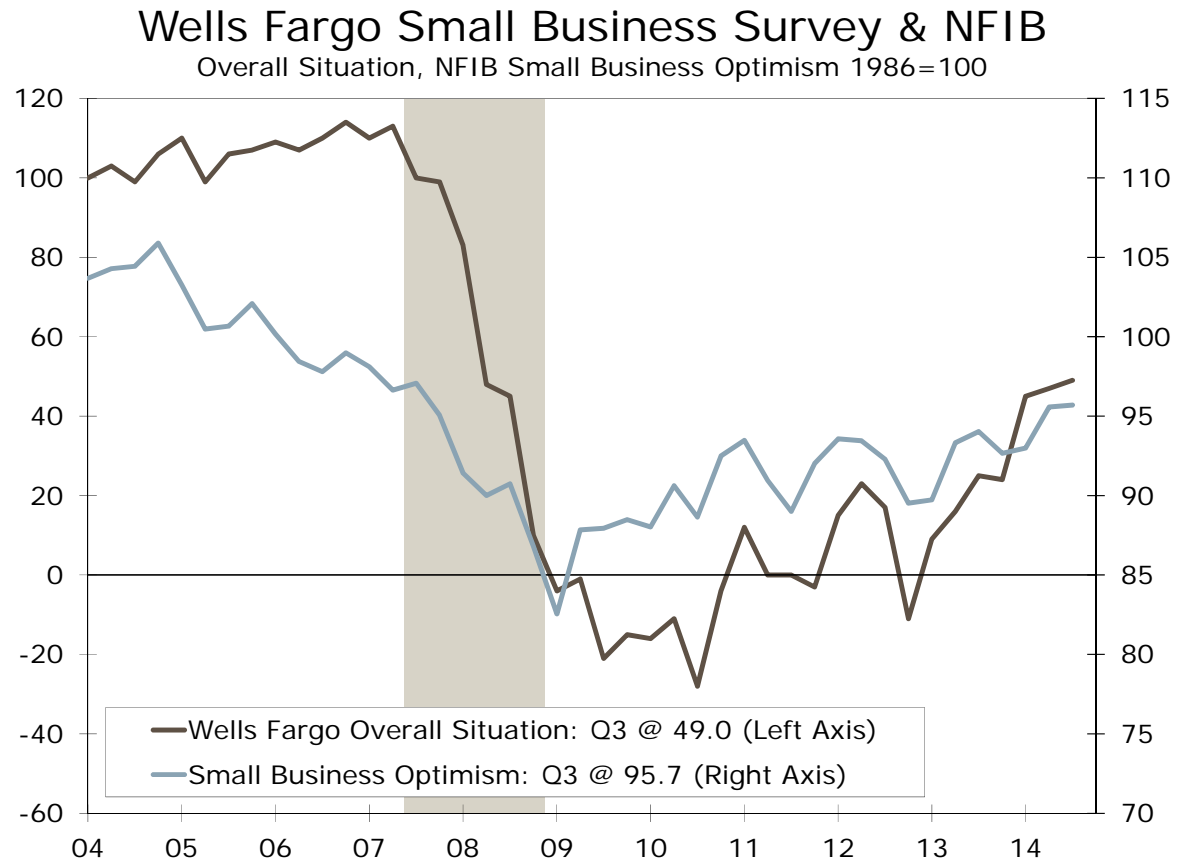
Nonresidential Construction

Commercial construction spending will help to perpetuate business investment in the year ahead



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

Small business optimism has begun to turn around

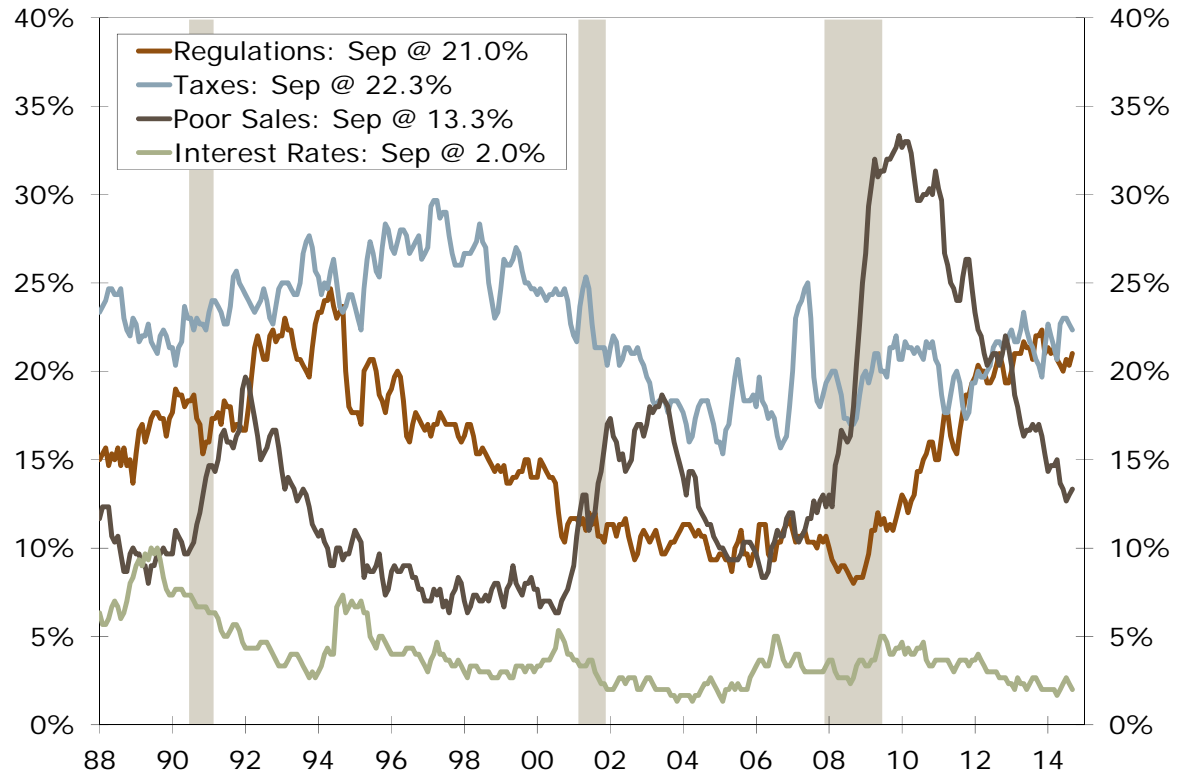


Source: National Federation of Independent Businesses, Gallup, Wells Fargo Bank and Wells Fargo Securities, LLC

Small business concerns have shifted from fears about sales to concerns about taxes and regulation

Small Business Important Problems

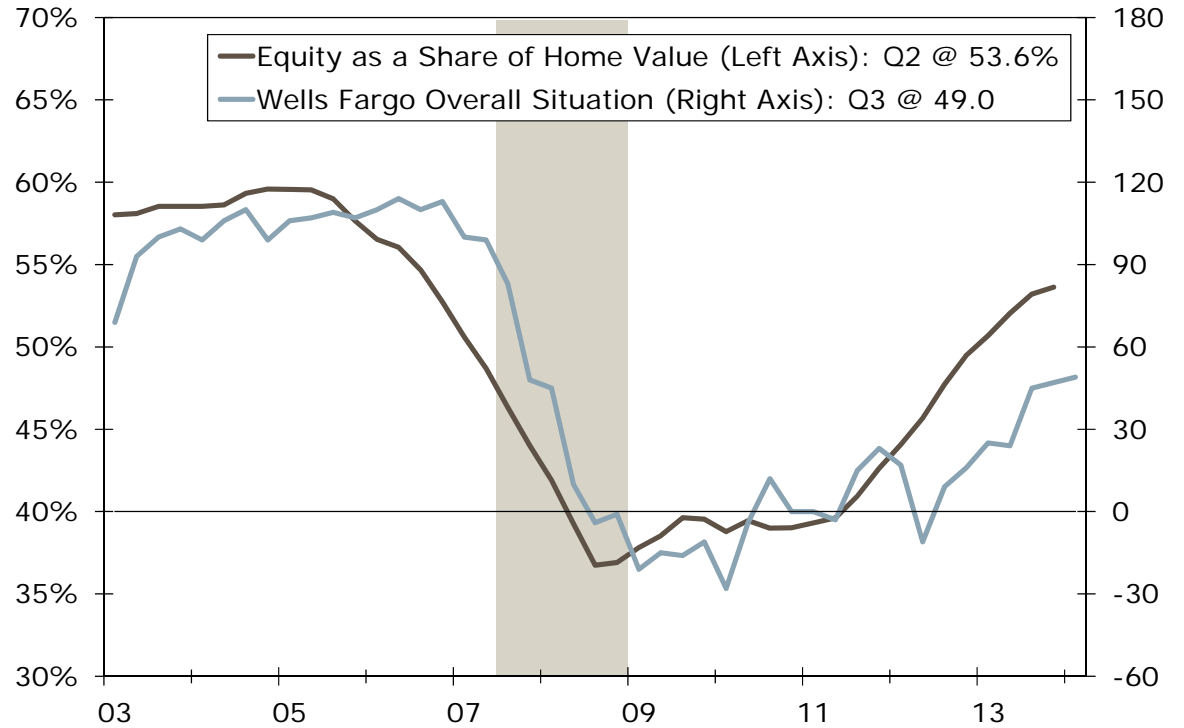
Single Most Important Problem Facing Firms, SA 3-MMA



Source: National Federation of Independent Business and Wells Fargo Securities, LLC

Recovery in home equity values has supported small business activity

Homeowners' Equity vs. WF Small Business Survey
Percent Share of Home Values, Index



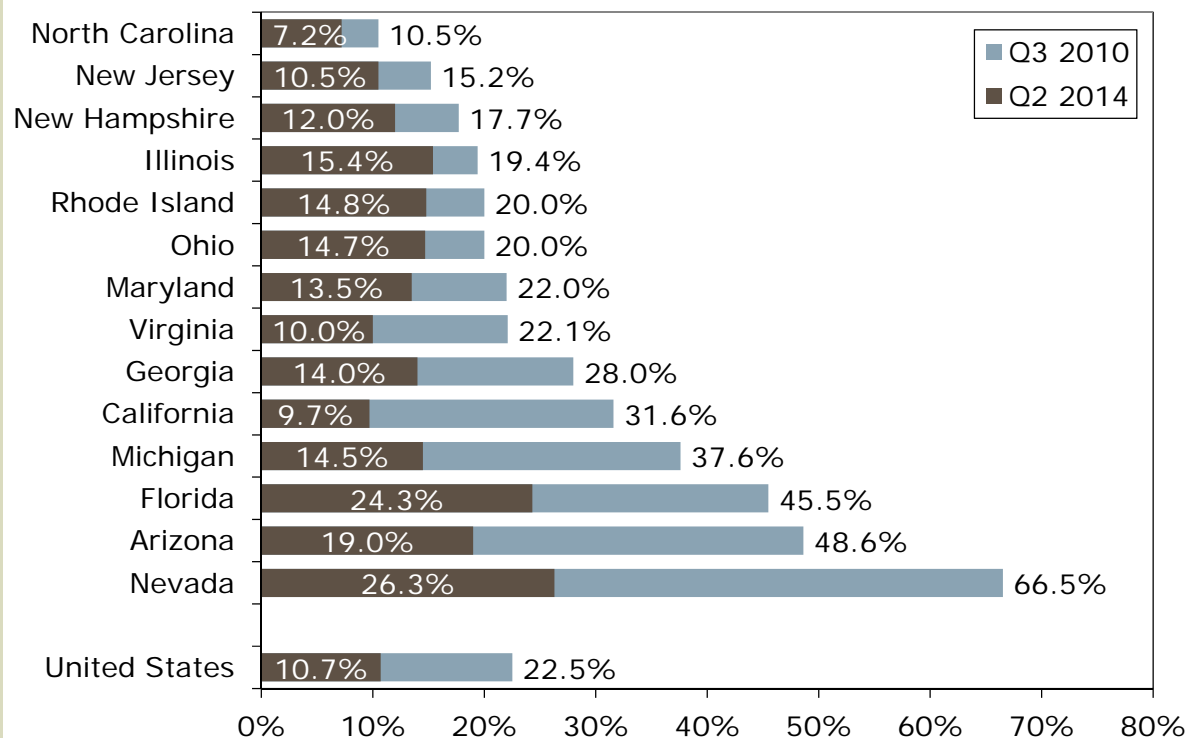
Source: Federal Reserve Board, Wells Fargo Bank, Gallup and Wells Fargo Securities, LLC

Negative Equity Mortgages

The rise in home prices has helped bring down the share of owners who owe more on their home than their home is worth

Negative Equity by State

Percent of Mortgages Outstanding

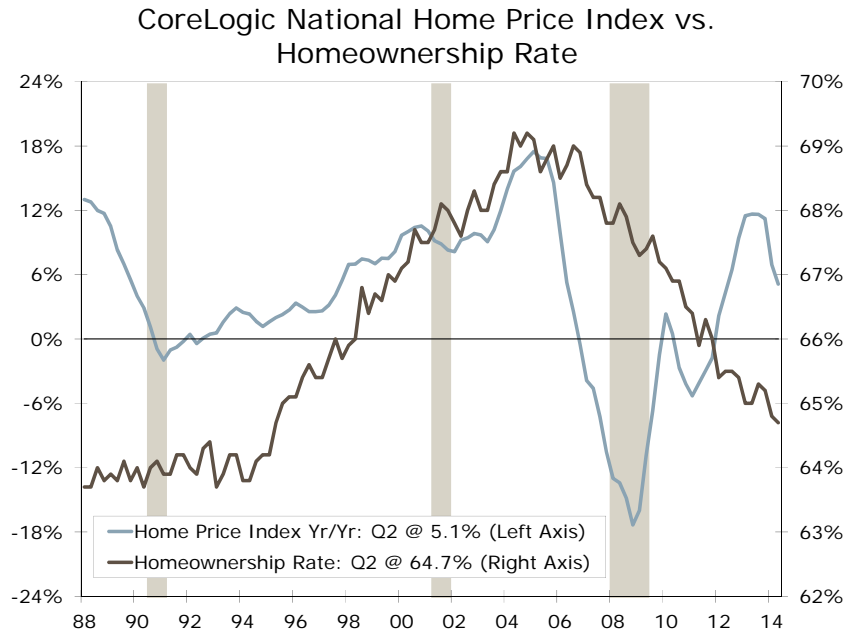


Source: CoreLogic and Wells Fargo Securities, LLC

U.S. Housing Market

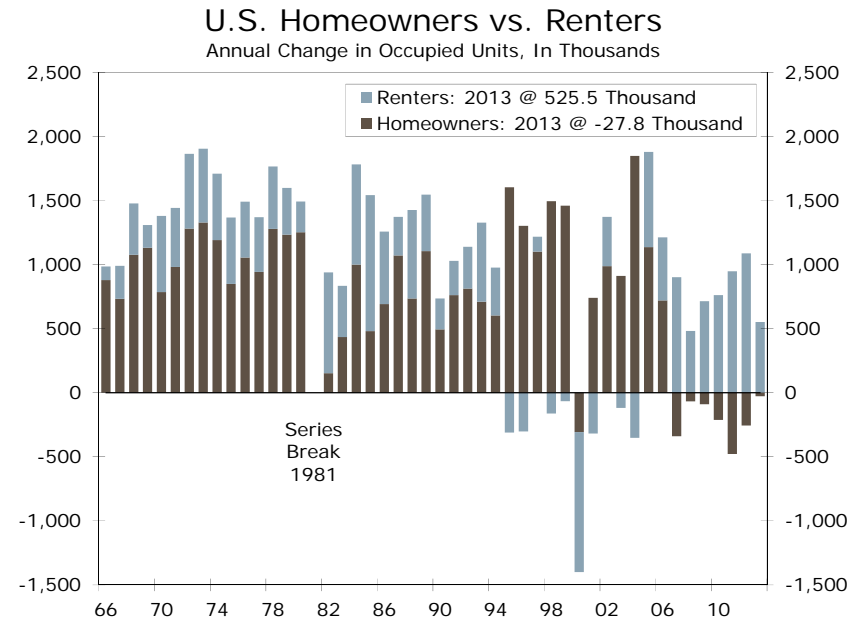
Despite some recent setbacks, we continue to look for a gradual recovery in homebuilding. The homeownership rate continues to come down.

Homeownership



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

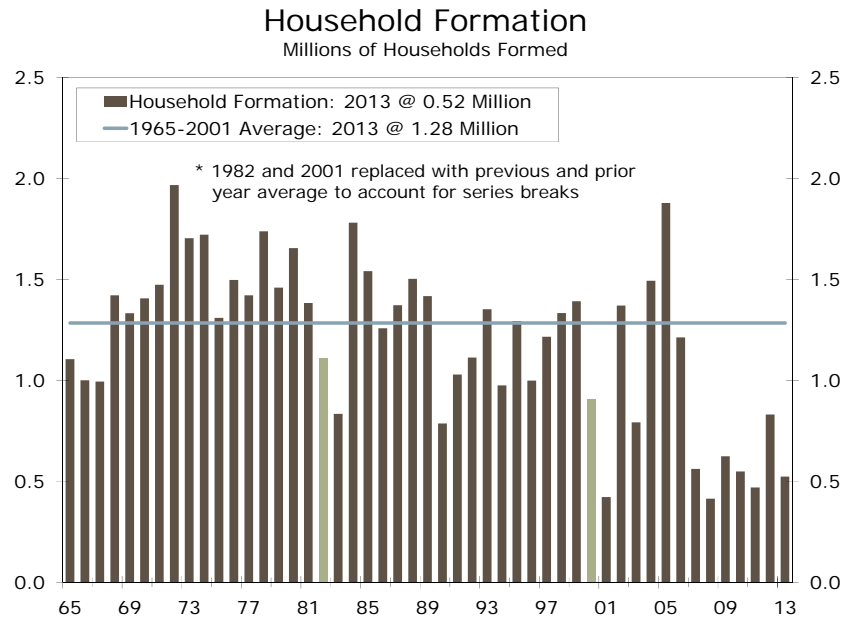
Owners vs. Renters



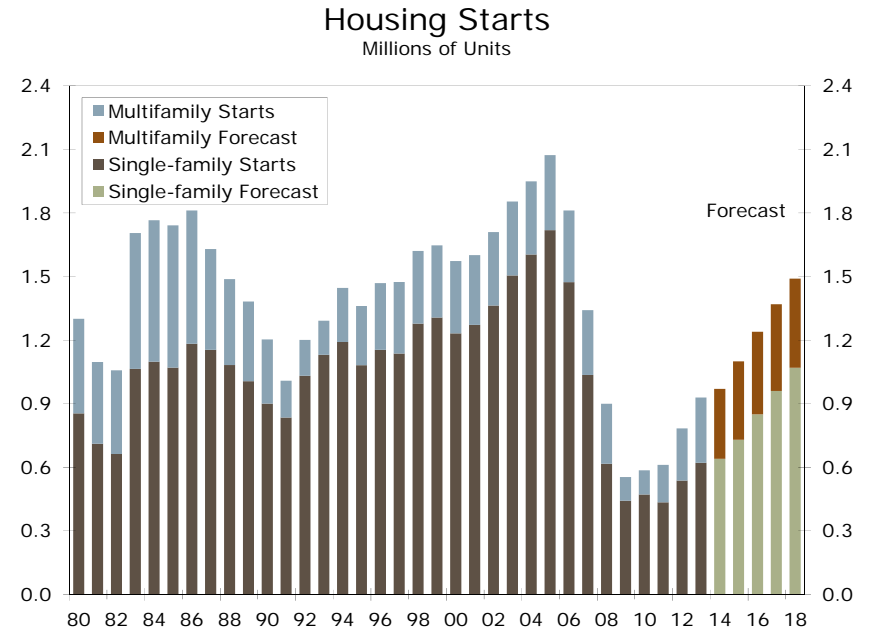
U.S. Housing Market

Household formations are rising, albeit slowly, however a larger share of new households are becoming renters rather than traditional homeowners

Household Formation

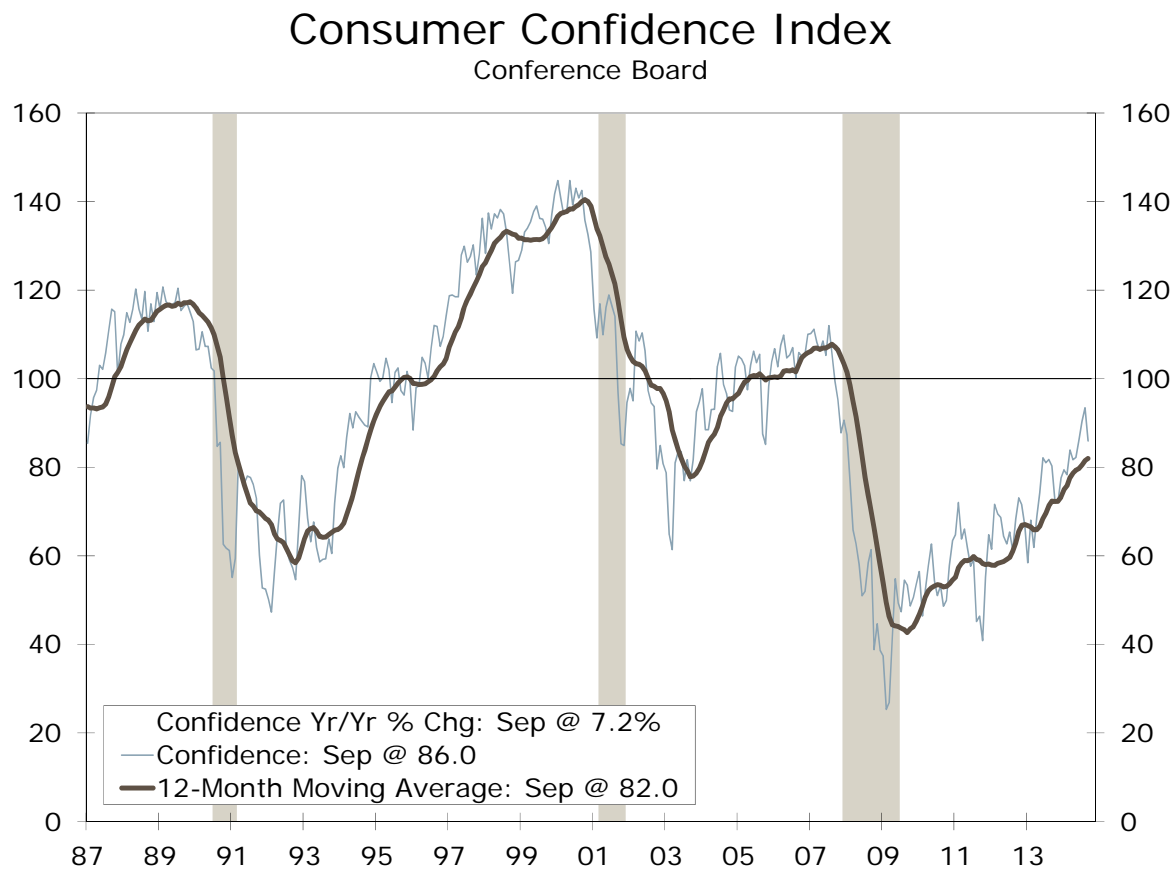


Housing Starts



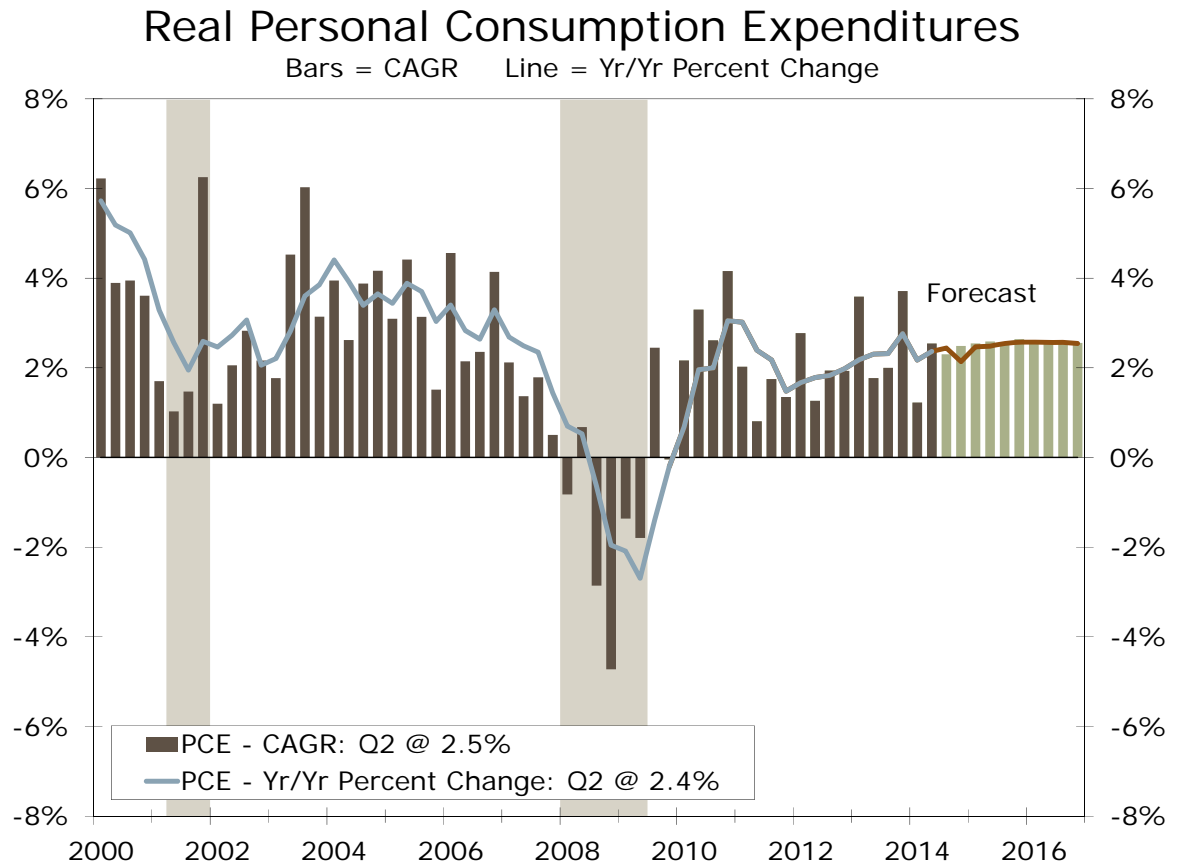
Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

Consumer confidence continues to rebound nicely



Source: The Conference Board and Wells Fargo Securities, LLC

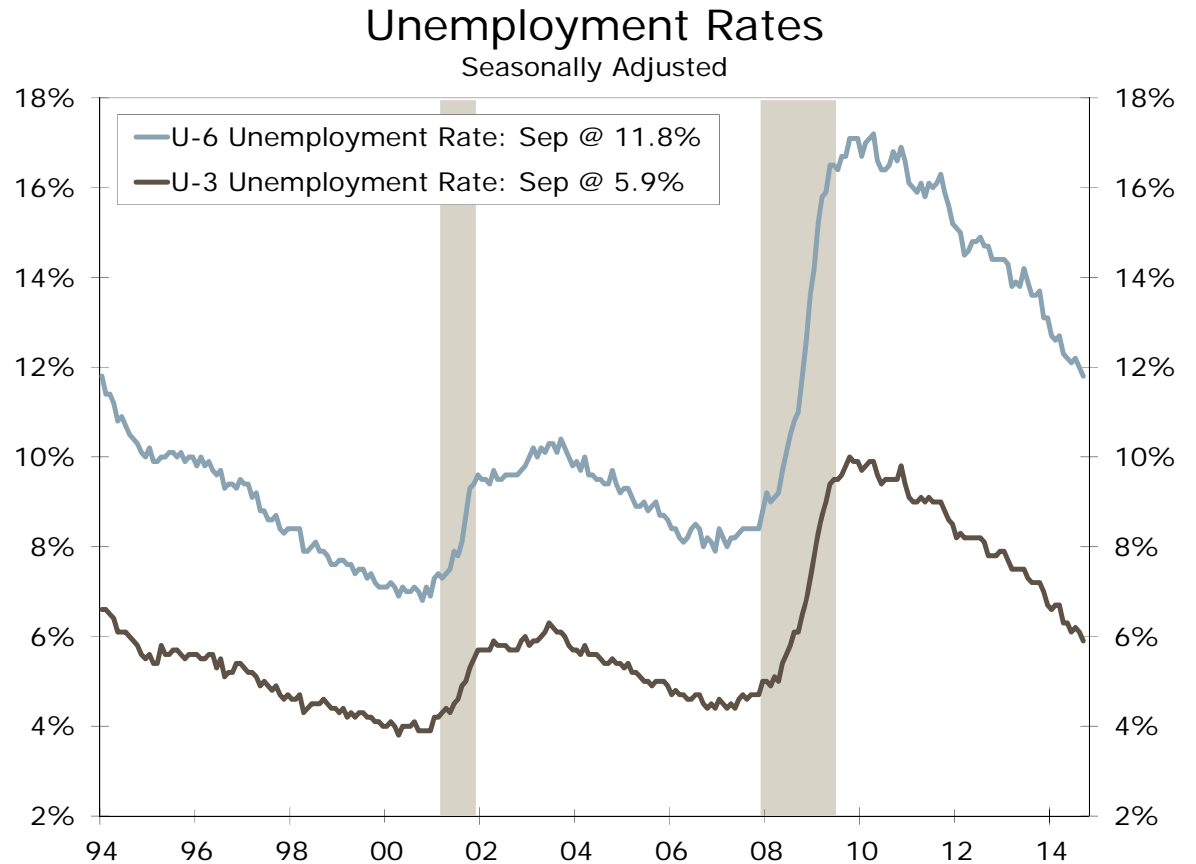
Consumer spending growth will continue to average around 2.5 percent



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

Unemployment Rates

Alternative measures of unemployment show an historically high level of underemployment



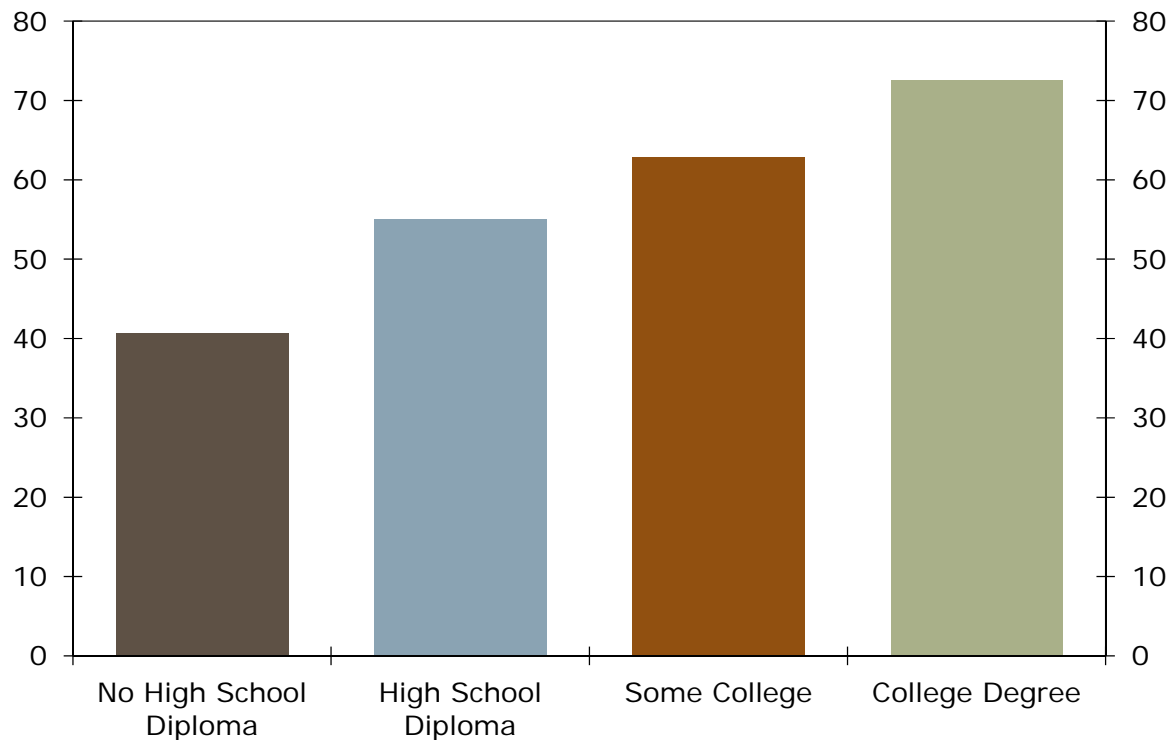
Source: U.S. Department of Labor and Wells Fargo Securities, LLC

The Employment Situation

The employment picture is mixed across different levels of education

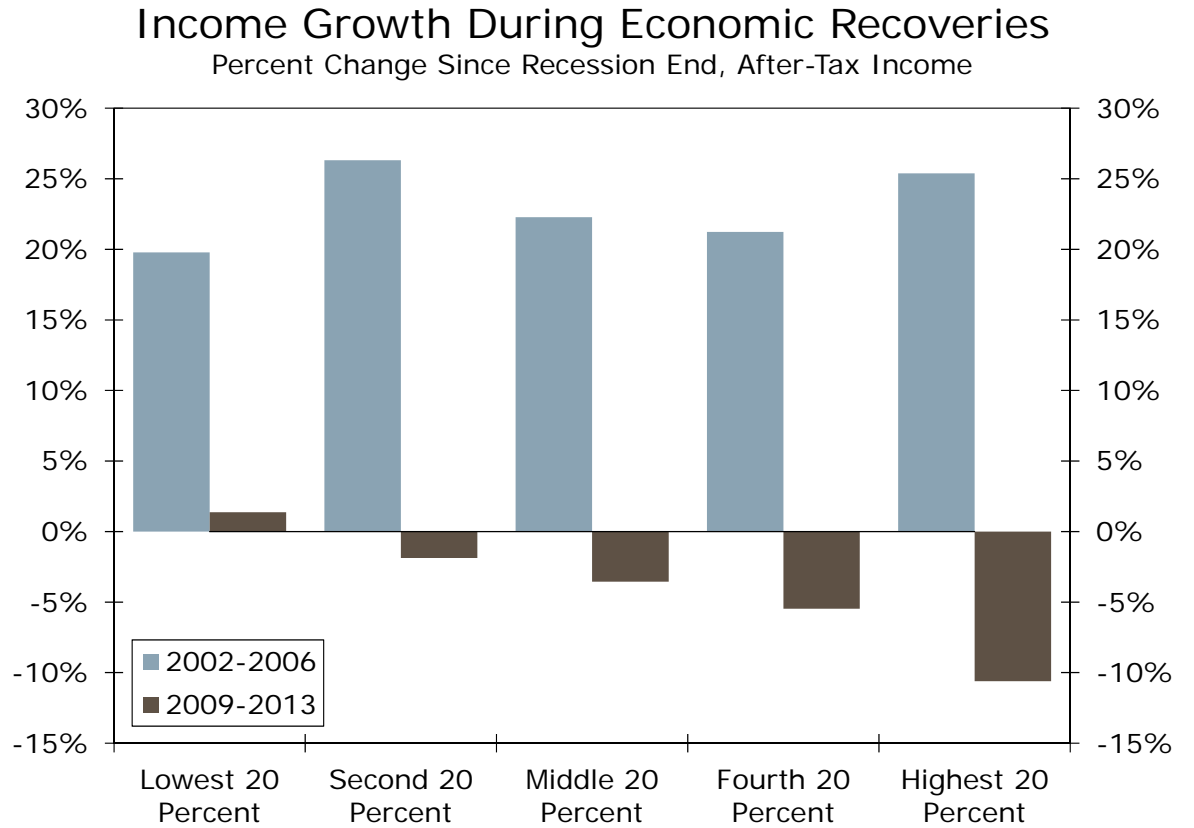
Employment-Population Ratio by Education

September 2014



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

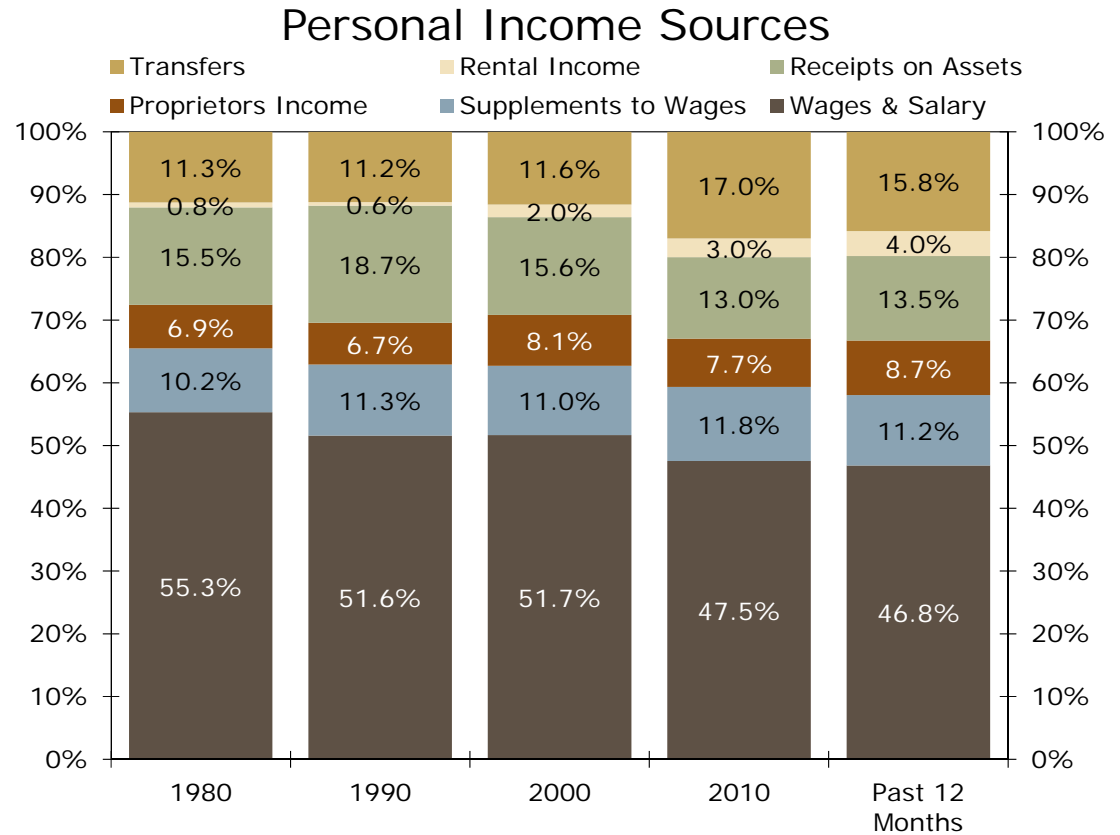
Average after-tax income has contracted 7.2 percent since 2009, compared to a 23.8 percent gain between 2002 and 2006



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

Personal Income

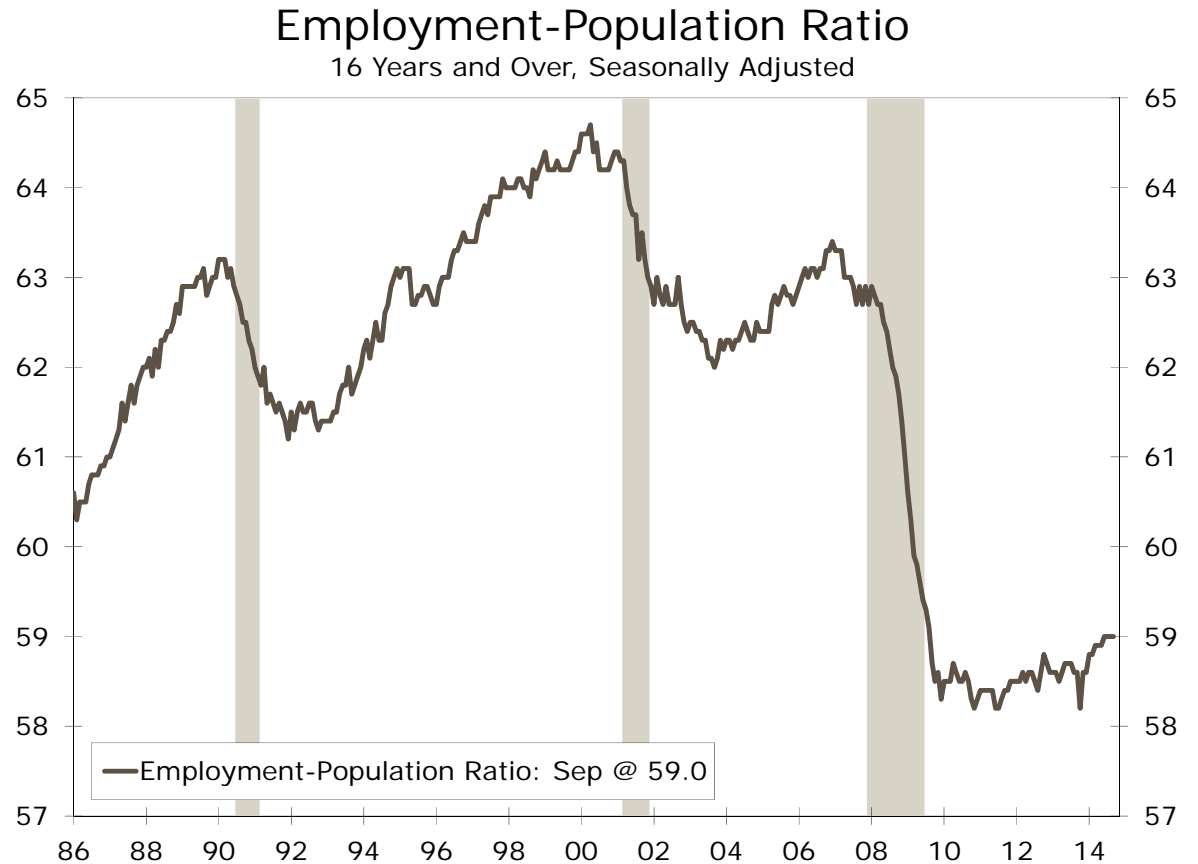
Wages and salaries now make up less than half of personal income as transfer payments make up a greater share of income over time



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

Employment Rate

The employment rate shows how dramatically the working population has shrunk following the recession

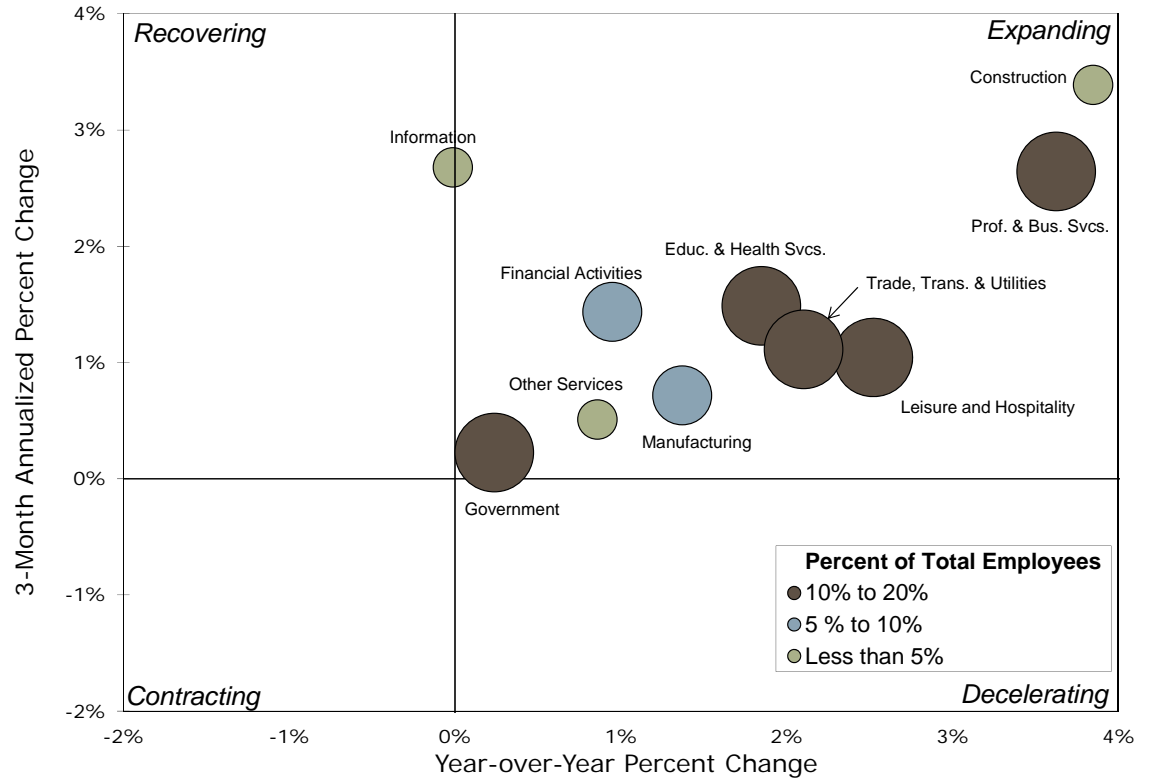


Source: U.S. Department of Labor and Wells Fargo Securities, LLC

Where is the Job Growth?

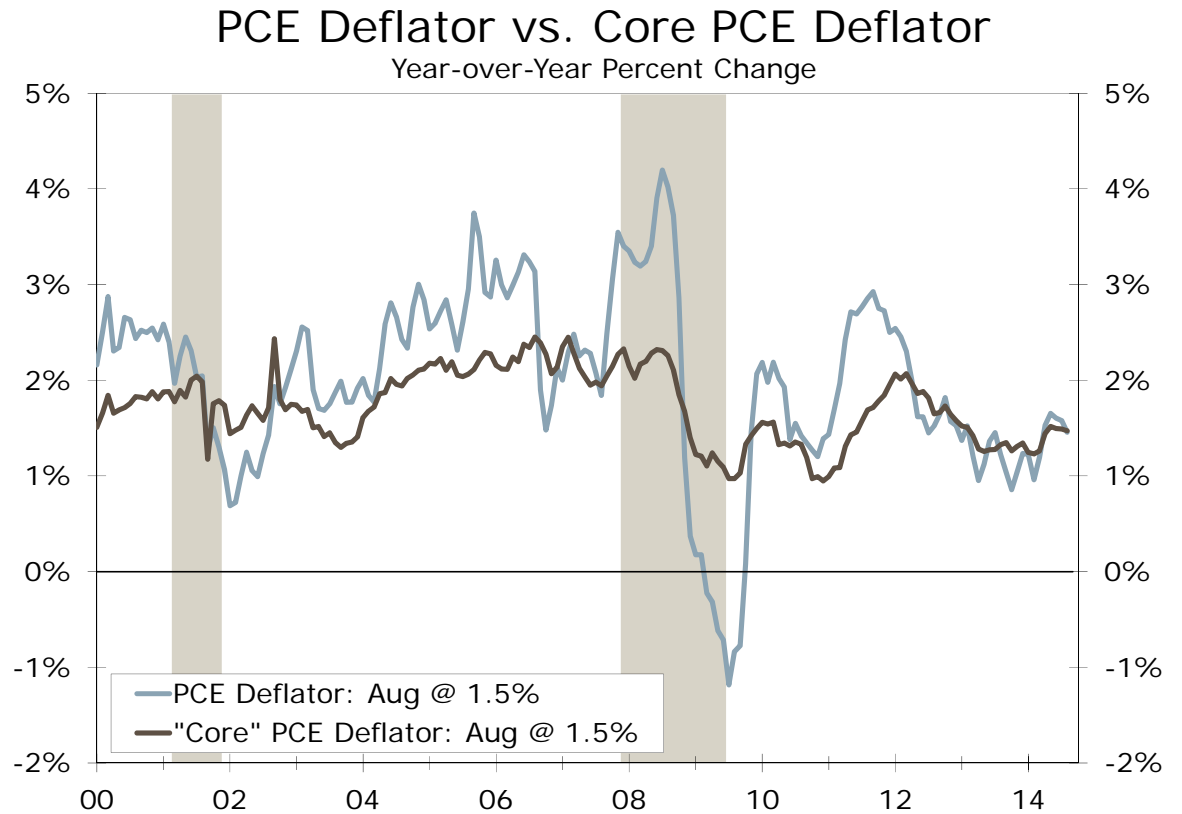
The services sector continues to lead job growth

U.S. Employment Growth by Industry
3-Month Moving Averages, September 2014



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

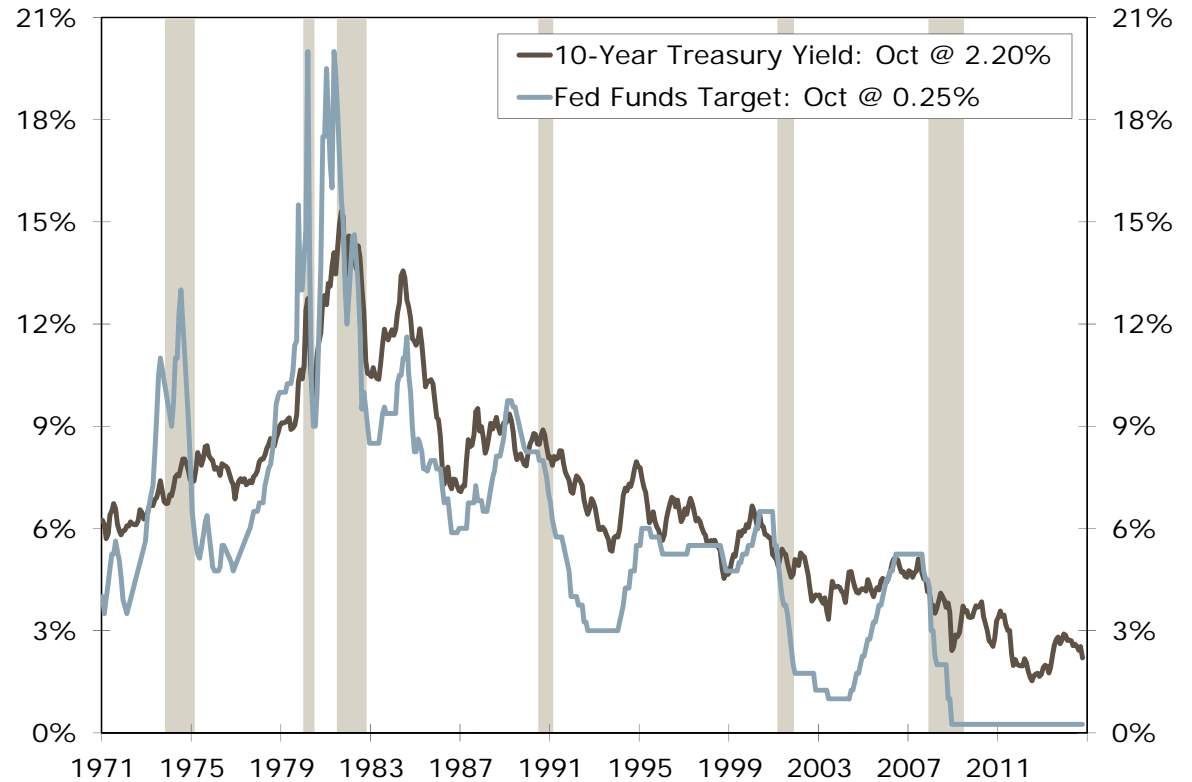
Inflation remains in check



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

Fed “tapering” of asset purchases is nearly complete, but a hike in the fed funds rate likely will not be seen until mid-2015

10-Year Treasury & Fed Funds Target Yield



Source: Federal Reserve Board, IHS Global Insight and Wells Fargo Securities, LLC

Changes to monetary policy are on the horizon

Monetary Policy Summary

October – QE Program Ends

- The FOMC is expected to end its bond buying program.

September through June 2015 – Rates Likely to Start Rising

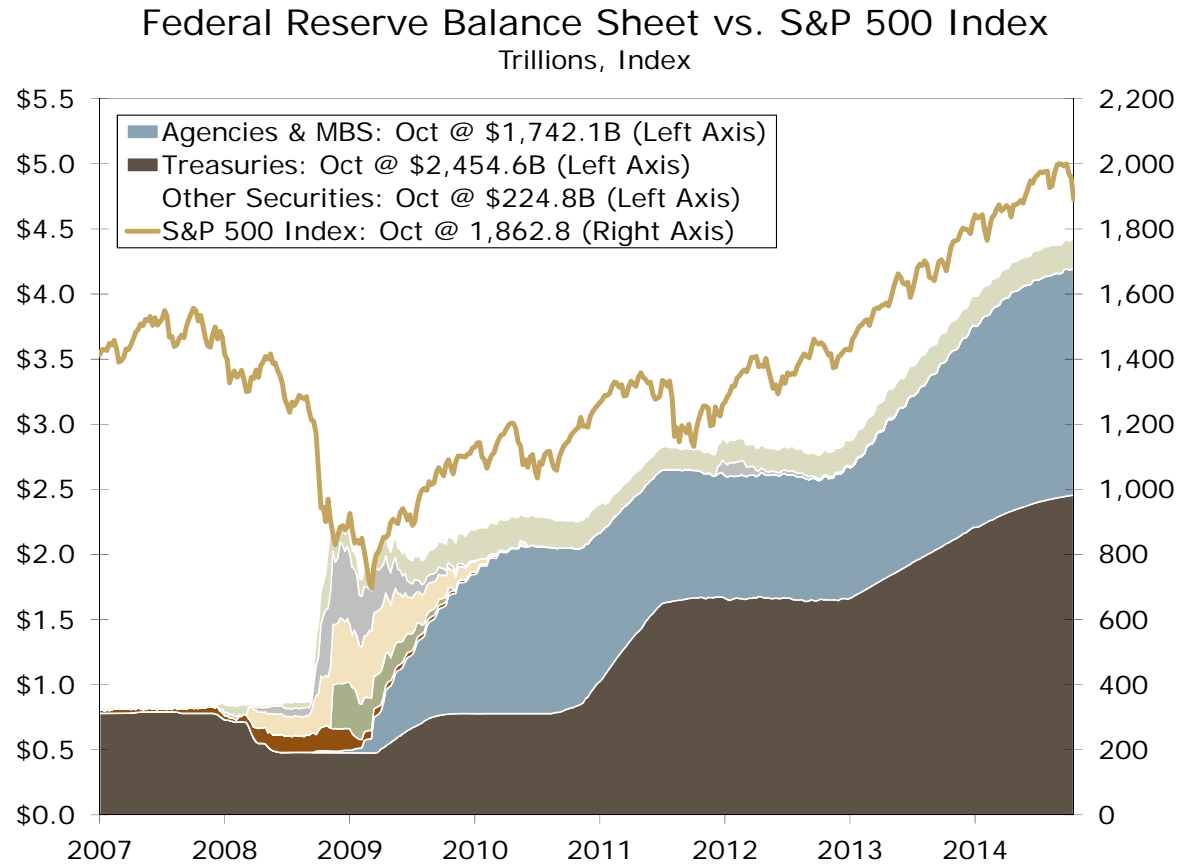
- We expect rates to begin to slowly rise reflecting the first Fed Funds target rate hike in June.

June 2015 – Expected First Fed Funds Target Rate Hike

- We expect the Fed to announce a 25 bps rise in the Fed Funds target rate.

Fed Balance Sheet: Challenge to Asset Values

We have seen a strong correlation in the expansion of the Fed's balance sheet and the rise in the S&P 500

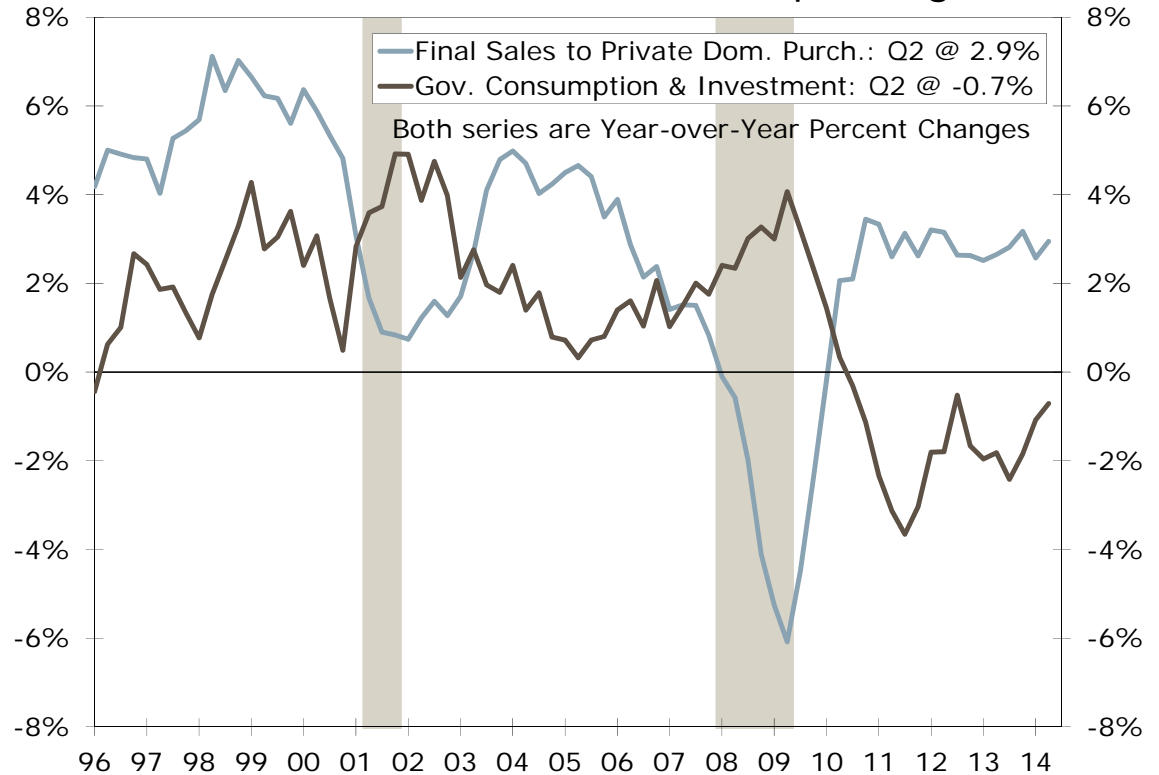


Source: Federal Reserve Board, IHS Global Insight and Wells Fargo Securities, LLC

Private Sector vs. Public Sector

The economy is rebalancing back to private sector demand

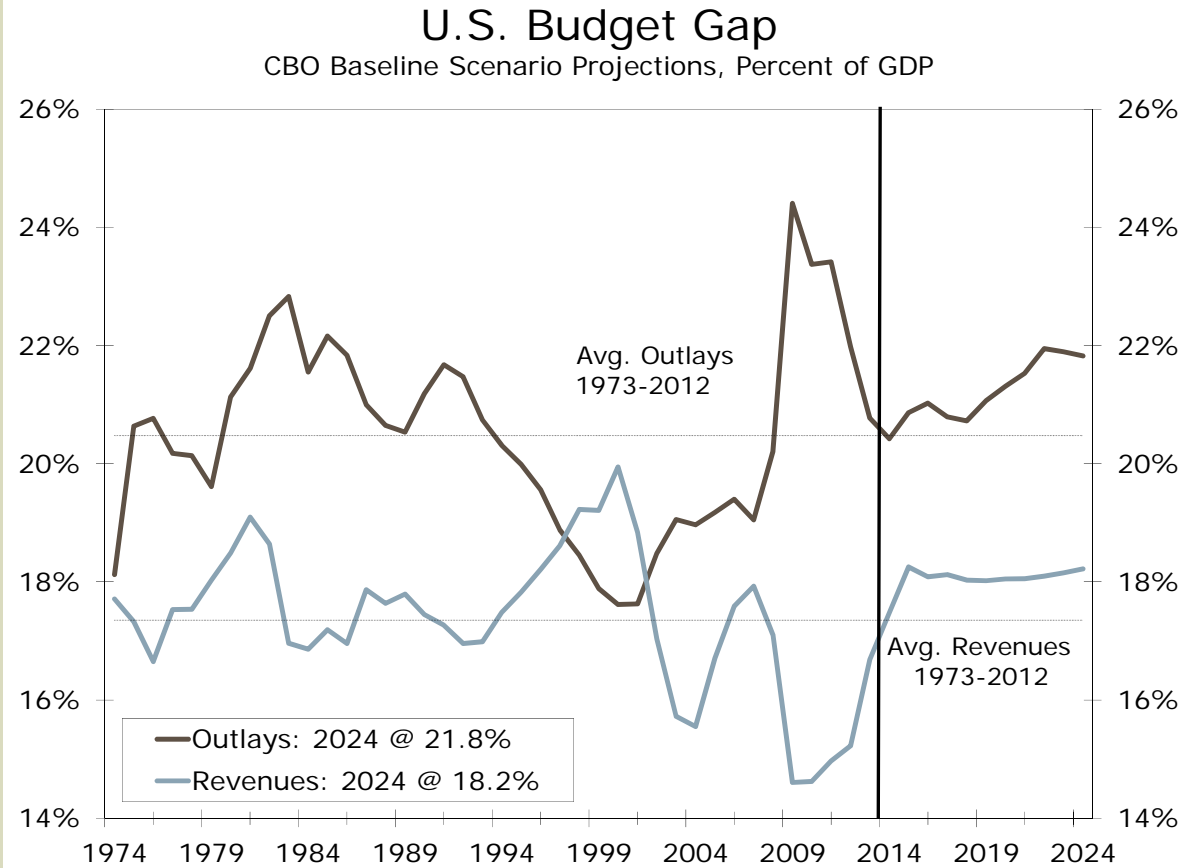
Real Final Sales to Private Domestic Purchasers vs. Government Spending



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

U.S. Budget Gap

The federal government faces some significant fiscal challenges—the current path is not sustainable



Source: Congressional Budget Office and Wells Fargo Securities, LLC

Fiscal policy issues that could impact our outlook

Fiscal Policy Summary

November – Mid-Term Elections

- Could introduce fiscal policy or regulatory uncertainty, slowing business investment.

After Mid-Term Elections

- Tax extenders legislation likely to be considered, may support business investment and consumer spending.

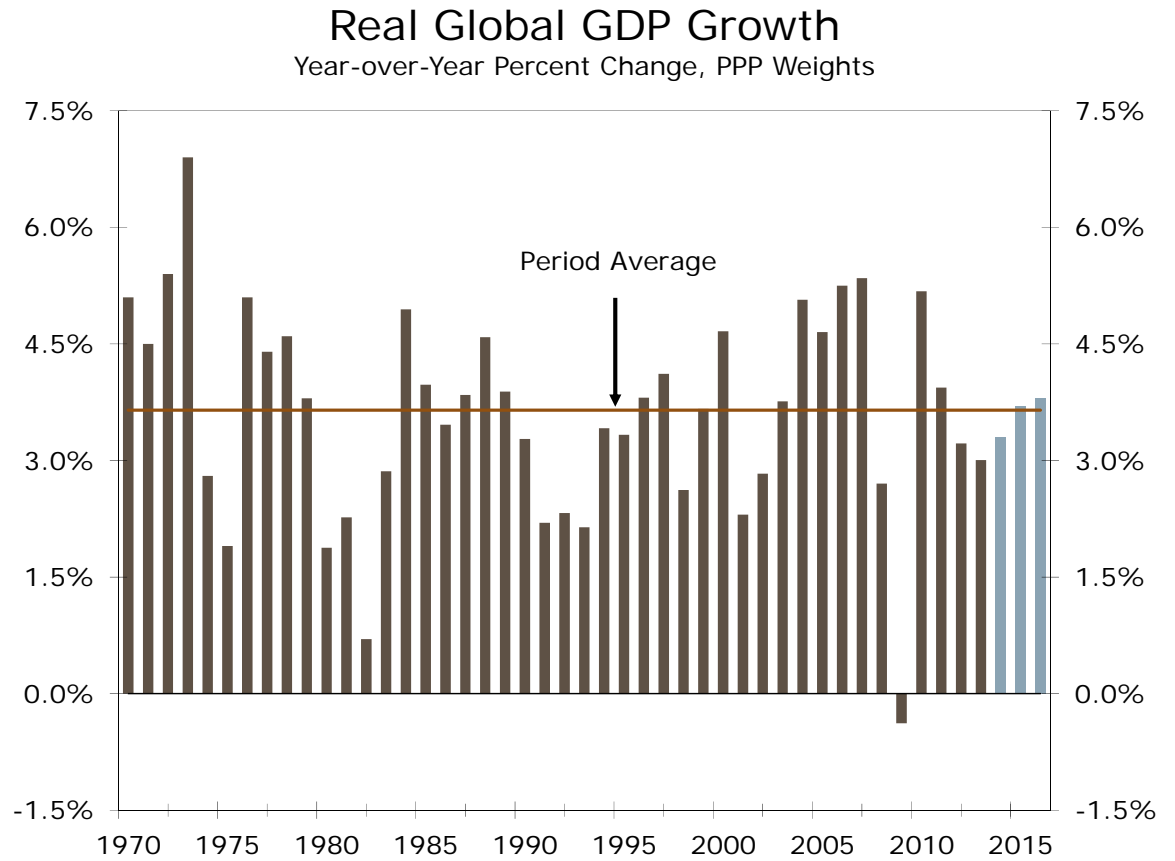
December 11th – FY 2015 Appropriation Bills (or CR)

- Would introduce economic uncertainty & negatively impact government spending.

First Half 2015 – Debt Ceiling

- More of a financial market impact, but could also affect both consumer and business spending.

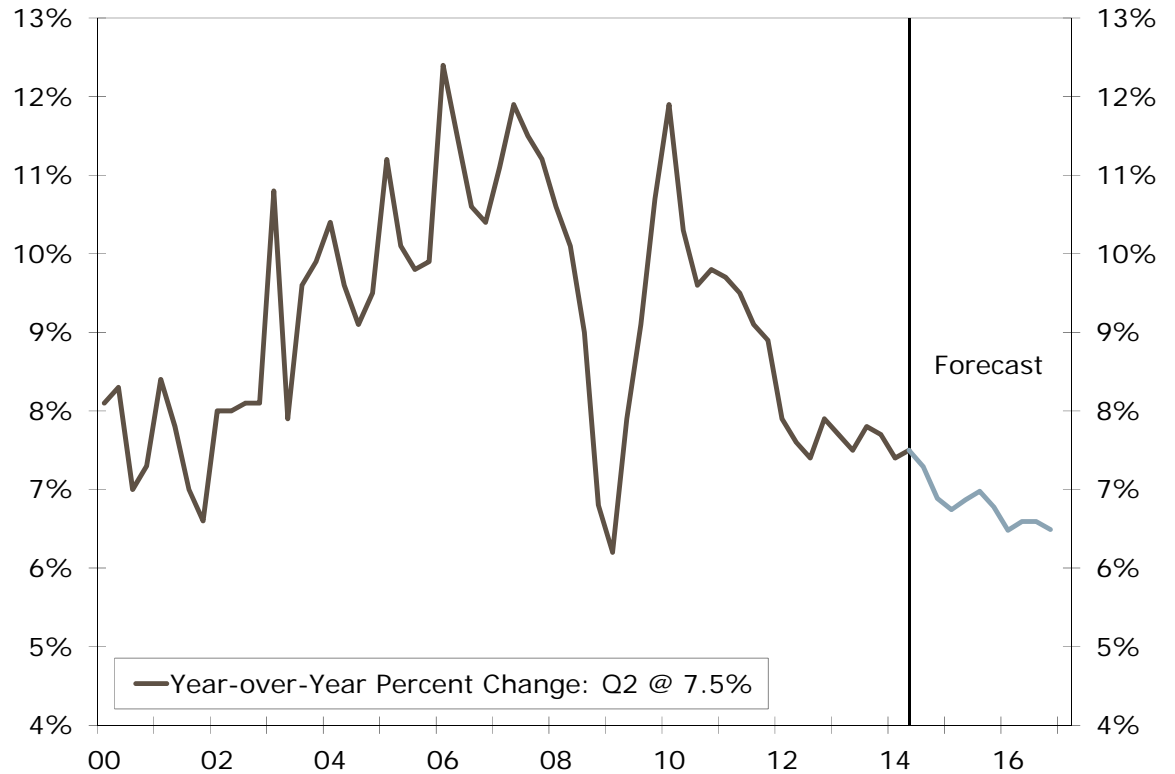
Growth in the global economy likely will pick up somewhat this year



Source: International Monetary Fund and Wells Fargo Securities, LLC

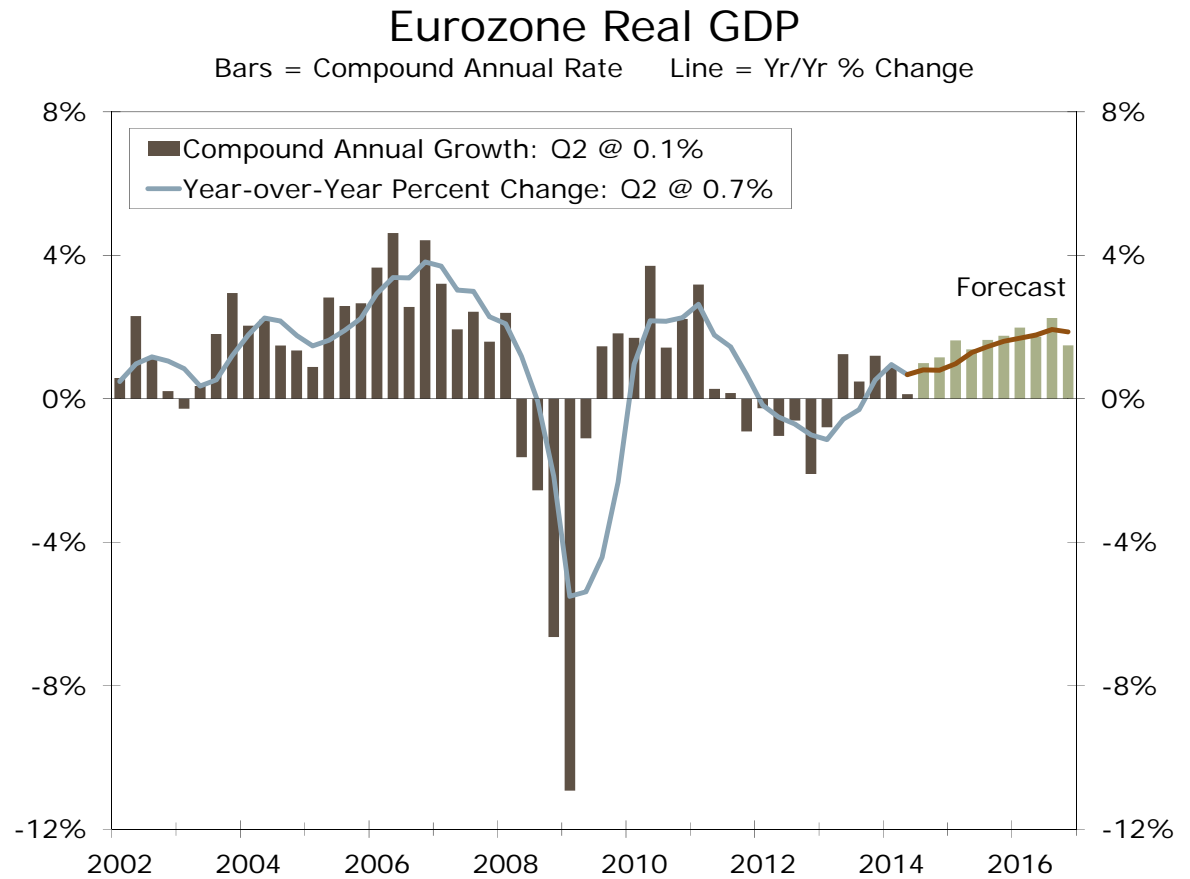
Growth in China will likely continue to downshift to a more sustainable pace

Chinese Real GDP Forecast
Year-over-Year Percent Change



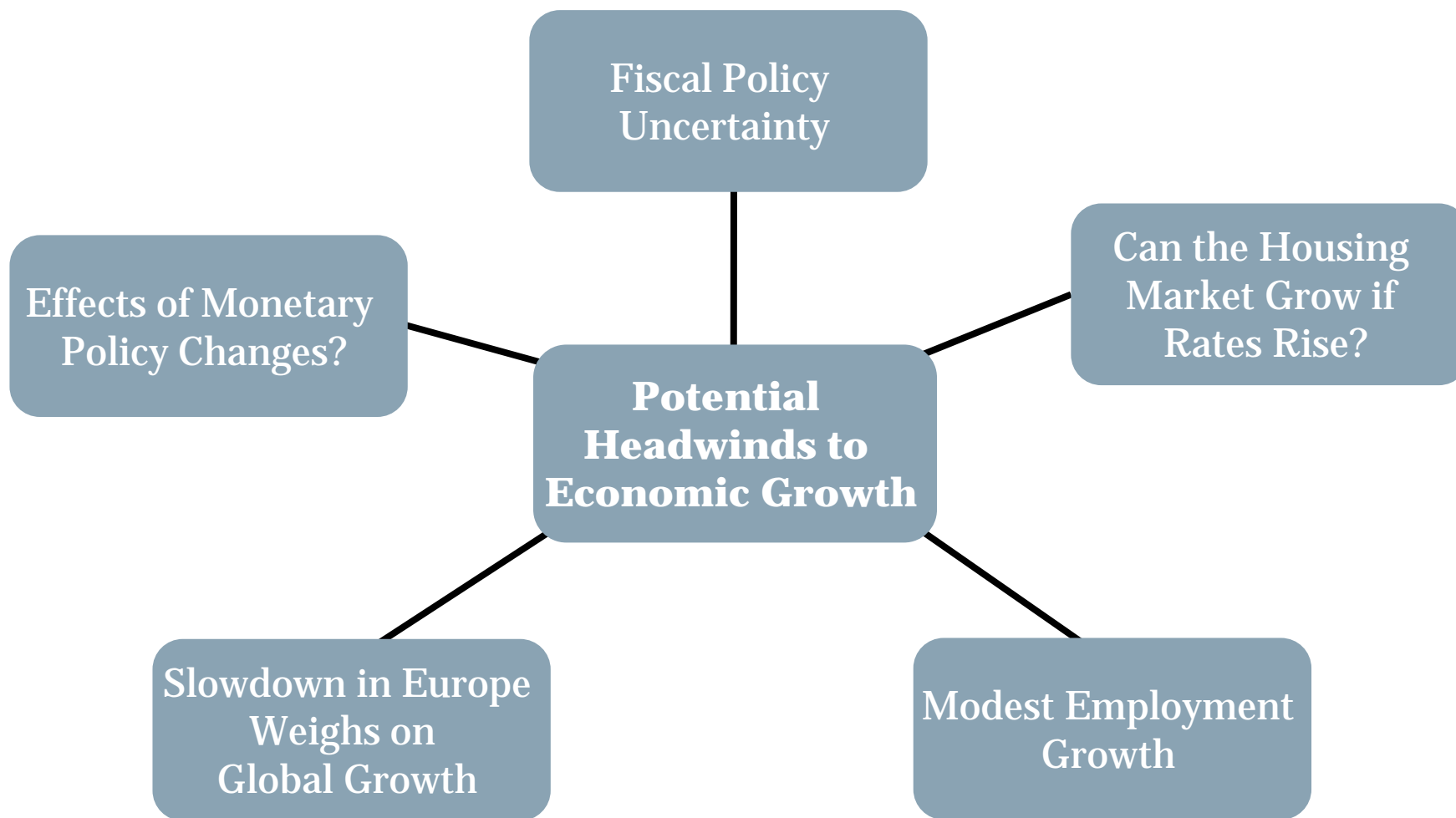
Source: Bloomberg LP and Wells Fargo Securities, LLC

The Eurozone will see some improvement in the year ahead



Source: IHS Global Insight and Wells Fargo Securities, LLC

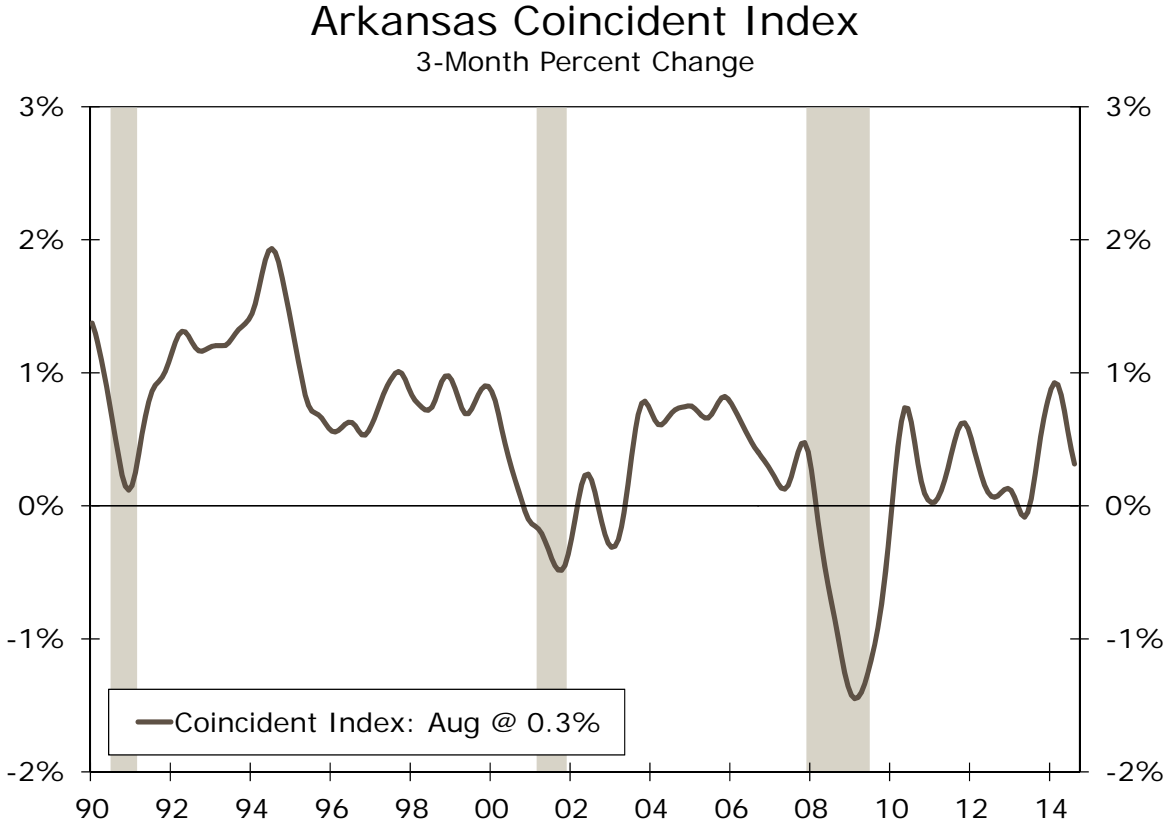
Headwinds to Economic Growth



The Arkansas Economy

Arkansas – Current Economic Conditions

Economic growth in Arkansas has moderated so far this year



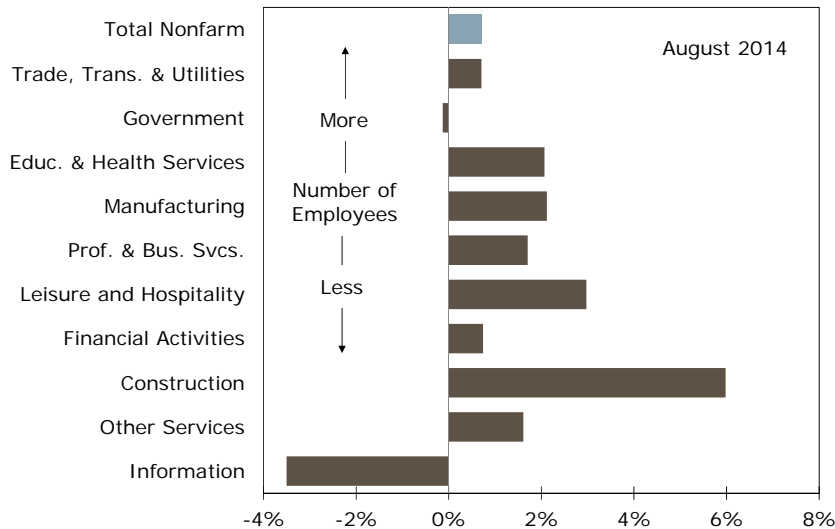
Source: Federal Reserve Bank of Philadelphia and Wells Fargo Securities, LLC

Arkansas – Employment Growth & Unemployment Rate

Employment is growing nicely in most sectors, yet the unemployment rate is still above the national rate

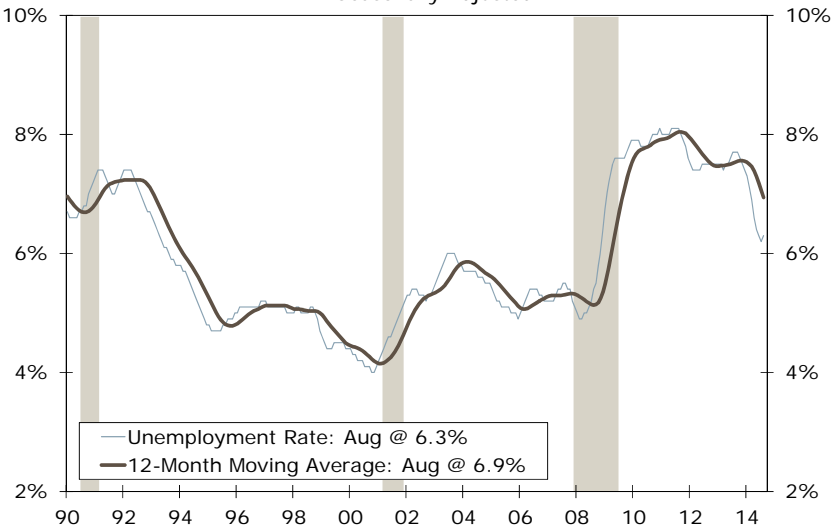
Employment

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



Unemployment Rate

Arkansas Unemployment Rate
Seasonally Adjusted

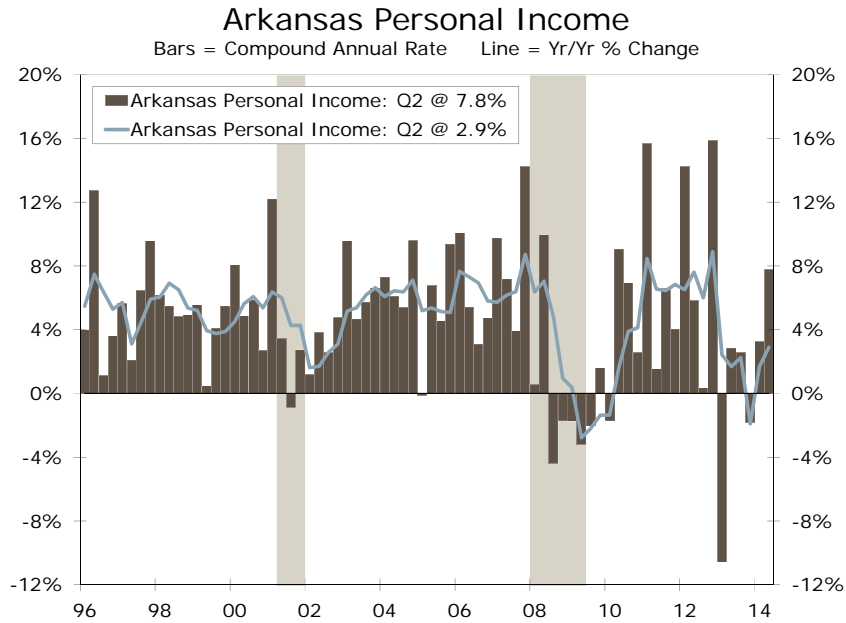


Source: U.S. Department of Labor and Wells Fargo Securities, LLC

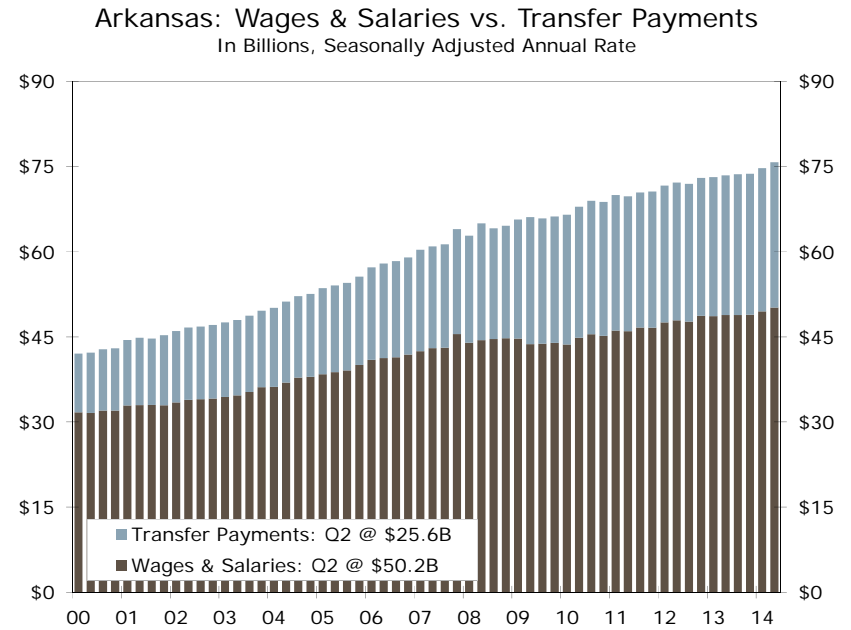
Arkansas – Personal Income Situation

Income growth has returned, however the bulk of the gains in personal income have come from transfer payments

Personal Income



Composition of Income Growth



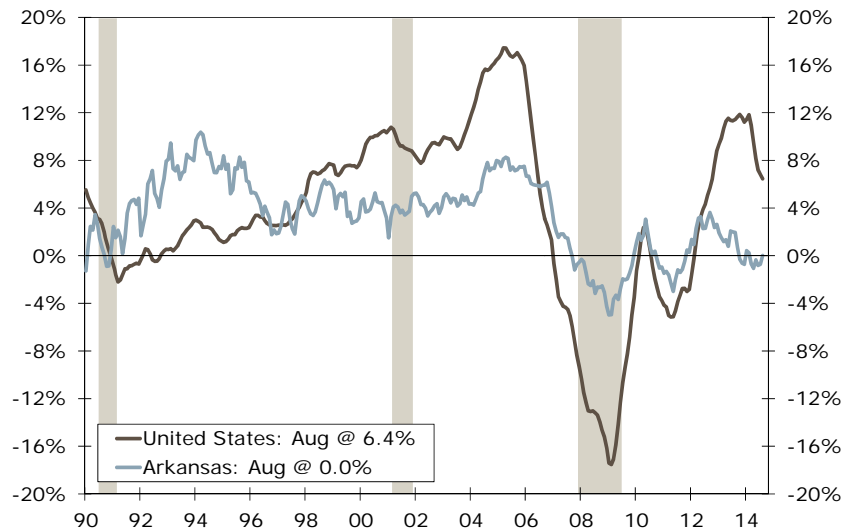
Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

Arkansas – Home Prices and Construction

Home prices are stable in the state as building activity remains constrained

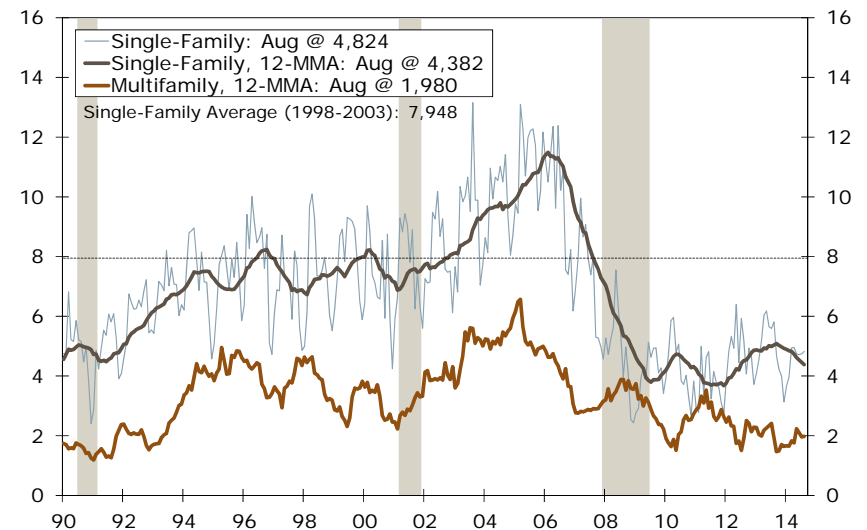
Home Prices

Core Logic HPI: AR vs. U.S.
Year-over-Year Percent Change



Housing Permits

Arkansas Housing Permits
Thousands of Permits, Seasonally Adjusted Annual Rate



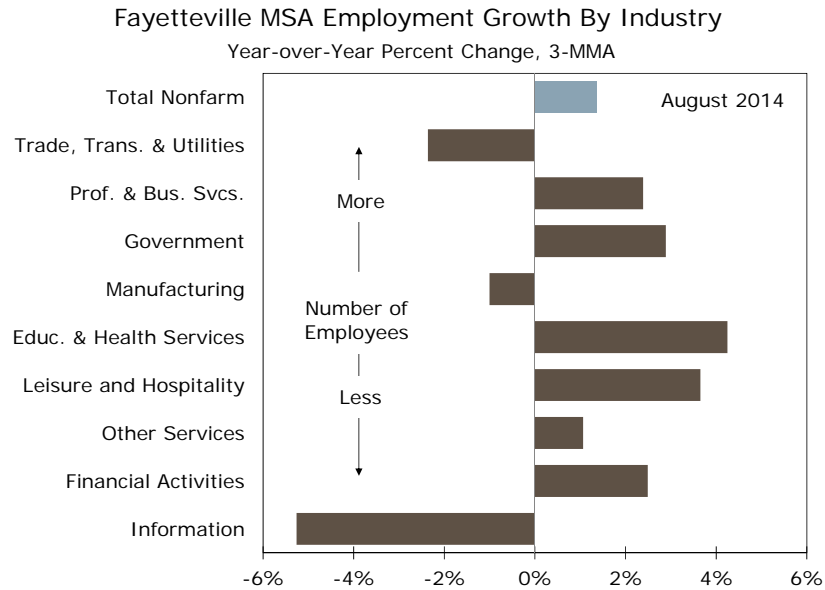
Source: CoreLogic, Inc., U.S. Department of Commerce and Wells Fargo Securities, LLC

The Fayetteville Economy

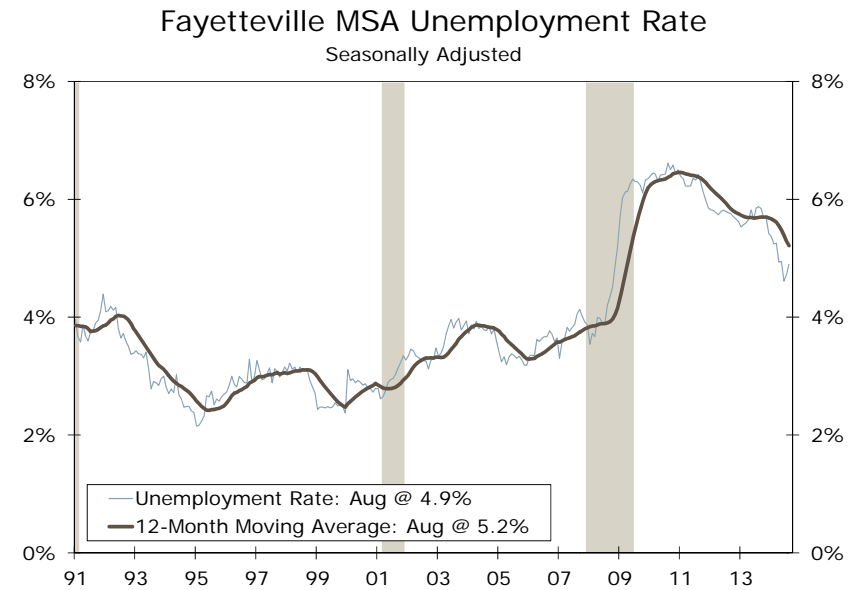
Fayetteville – Employment Growth & Unemployment Rate

Solid growth in the services sector has helped bring down the area's unemployment rate down below the nation's

Employment



Unemployment Rate



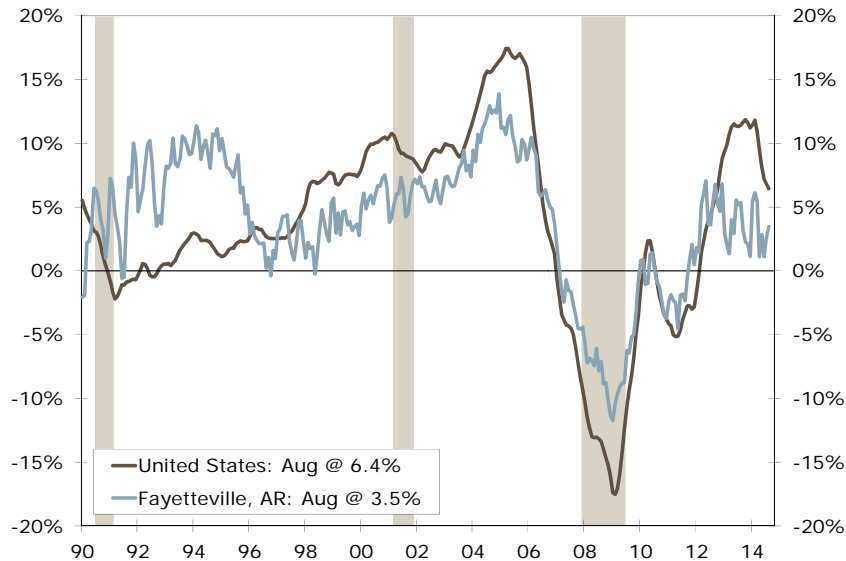
Source: U.S. Department of Labor and Wells Fargo Securities, LLC

Fayetteville – Home Prices and Construction

Home prices continue to appreciate and construction activity continues to pick up

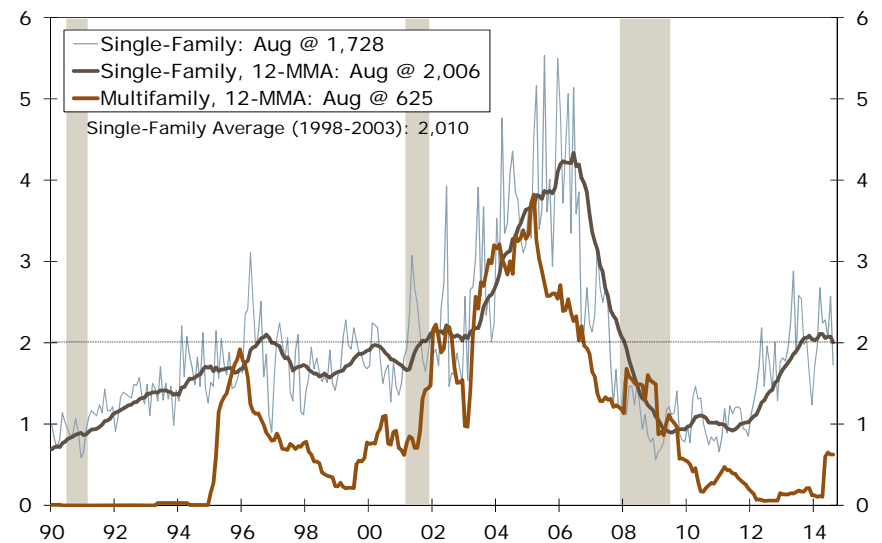
Home Prices

CoreLogic HPI: U.S. vs. Fayetteville
Year-over-Year Percent Change



Housing Permits

Fayetteville MSA Housing Permits
Thousands of Permits, Seasonally Adjusted Annual Rate



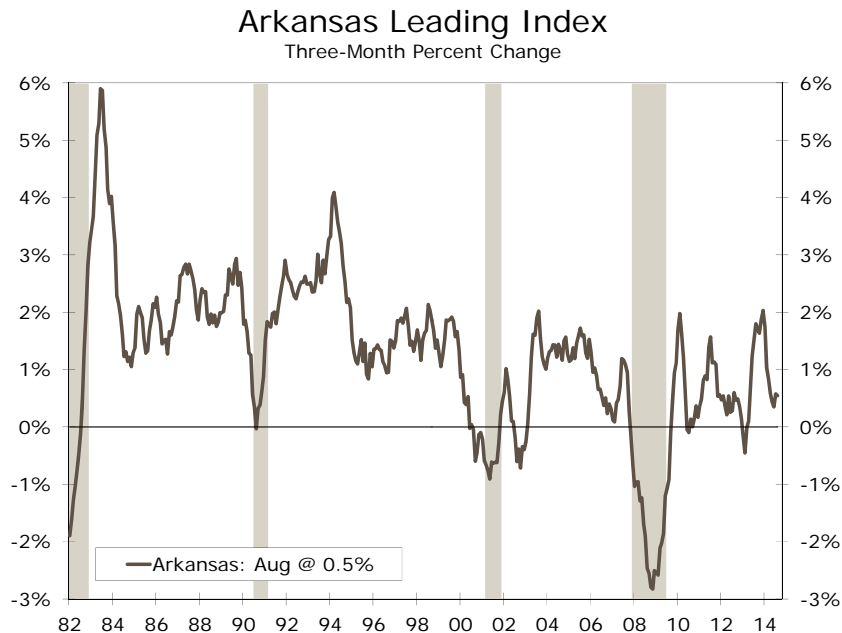
Source: CoreLogic, U.S. Department of Commerce and Wells Fargo Securities, LLC

Arkansas – Economic Outlook

The leading index signals modest growth ahead. The education and healthcare services sector will continue to provide most of the job growth for the state.

Leading Index

Outlook



- Growth will likely pick up in the months ahead as U.S. growth picks up.
- The state unemployment rate remains above the national average, but should continue to trend downward.
 - Job growth will be driven by the education and healthcare along with the professional & business services sector.
 - The manufacturing sector will continue to play a key role in the state's economy.
 - The state's declining labor force remains the most significant challenge for future economic growth.

Source: Federal Reserve Bank of Philadelphia and Wells Fargo Securities, LLC

What should we look for in the U.S. economy in the next few quarters?

Expectations for the Future

- **A sustained modest pace of economic growth**
 - Slightly stronger pace of GDP growth but below trend

- **Business spending will improve over the next year**
 - Investment in commercial real estate will support growth

- **Consumer spending will begin to pick up**
 - Income growth remains a challenge

- **The housing market continues to improve**
 - Some regions will recover faster than others

- **Employment growth will remain robust**
 - Structural issues remain

Outlook Summary

Wells Fargo U.S. Economic Outlook

	Actual				Forecast								Actual 2013	Forecast		
	2014				2015				2016					2014	2015	2016
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		2014	2015	2016
Real Gross Domestic Product ¹	-2.1	4.6	3.1	2.6	2.5	2.7	2.9	3.0	3.1	3.2	3.1	3.2	2.2	2.2	2.8	3.1
Personal Consumption	1.2	2.5	2.1	2.3	2.5	2.6	2.5	2.6	2.5	2.5	2.5	2.6	2.4	2.2	2.5	2.6
Business Fixed Investment	1.6	9.7	6.8	5.6	5.2	5.8	6.4	6.5	5.8	6.3	6.4	6.3	3.0	6.1	6.1	6.2
Equipment	-1.0	11.2	8.8	5.8	5.8	6.0	6.0	6.1	6.0	6.0	6.0	6.0	4.6	6.5	6.6	6.0
Intellectual Property Products	4.7	5.5	2.9	4.2	4.5	4.6	4.6	4.6	5.0	5.0	5.0	5.0	3.4	3.7	4.3	4.9
Structures	2.9	12.6	8.2	7.2	5.0	7.0	9.8	10.0	6.5	8.5	9.0	8.5	-0.5	8.7	7.6	8.4
Residential Construction	-5.3	8.8	12.7	9.0	9.0	10.0	11.0	12.0	14.0	14.5	15.0	15.0	11.9	3.1	10.1	13.3
Government Purchases	-0.8	1.7	2.0	0.9	1.1	1.2	1.4	1.6	1.8	2.0	2.2	2.4	-2.0	-0.3	1.3	1.8
Net Exports ²	-1.7	-0.3	0.9	-0.2	-0.3	-0.3	-0.3	-0.3	-0.2	-0.2	-0.4	-0.4	0.2	-0.1	-0.1	-0.3
Inventories ²	-1.2	1.4	-0.4	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nonfarm Payroll Change ³	190	267	224	225	210	212	210	210	200	197	195	190	194	226	210	195
Unemployment Rate	6.7	6.2	6.1	5.9	5.8	5.7	5.6	5.5	5.4	5.4	5.3	5.3	7.4	6.2	5.7	5.4
Consumer Price Index ⁴	1.4	2.1	1.8	1.9	1.9	1.7	2.0	2.2	2.3	2.3	2.4	2.5	1.5	1.8	2.0	2.4
Quarter-End Interest Rates ⁵																
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.25	1.75	2.25	2.75	0.25	0.25	0.63	2.00
Conventional Mortgage Rate	4.34	4.16	4.16	4.06	4.11	4.24	4.26	4.42	4.64	4.87	5.12	5.38	3.98	4.18	4.26	5.00
2 Year Note	0.44	0.47	0.58	0.35	0.87	1.32	1.38	1.99	2.08	2.31	2.81	3.21	0.31	0.46	1.39	2.60
10 Year Note	2.73	2.53	2.52	2.17	2.51	2.64	2.66	2.82	3.04	3.27	3.52	3.78	2.35	2.49	2.66	3.40

Forecast as of: October 17, 2014

¹ Compound Annual Growth Rate Quarter-over-Quarter

² Percentage Point Contribution to GDP

³ Millions of Units

⁴ Year-over-Year Percentage Change

⁵ Annual Numbers Represent Averages

Source: Wells Fargo Securities, LLC

Appendix

A Sampling of Our Recent Special, Regional & Industry Commentary

To view any of our past research
please visit:
[http://www.wellsfargo.com/
economics](http://www.wellsfargo.com/economics)

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distribution lists please visit:
[http://www.wellsfargo.com/
economicsemail](http://www.wellsfargo.com/economicsemail)

Recent Special Commentary

Date	Title	Authors
U.S. Macro		
October-20	Income Growth: The Taxman Cometh	Silvia & Nelson
September-29	Population Trends Alter the Growth of Federal Revenues	Silvia, Brown & Miller
September-25	Labor Force Flows: Movement Behind the Headlines	Silvia & House
September-24	The Face of Job Polarization	Alemán & Khan
U.S. Regional		
October-17	California Employment Conditions: September 2014	Vitner & Wolf
October-17	Texas Payrolls Charge Ahead	Vitner & Wolf
October-17	Florida Payrolls Push Higher	Vitner & Wolf
September-19	California Employment Conditions: August 2014	Vitner & Wolf
Global Economy		
October-15	Economic Growth in Singapore Remains Lackluster	Bryson & Griffiths
October-10	Is the Eurozone Slipping Back Into Recession?	Bryson
October-08	RBA Sits Tight Amid High Home Prices & a Soft Aussie Dollar	Quinlan
October-01	Slow Foreign Growth: Should America Worry?	Bryson
Interest Rates/Credit Market		
October-14	Support for Economic Growth: Bank Lending Improves	Silvia & Griffiths
October-08	Federal Deficits Expected to Grow Along with Higher Rates	Silvia, Vitner & Brown
October-03	FDIC Quarterly Banking Profile	Silvia & Moehring
October-01	Notes on the Fed's Exit Strategy, Part II	Silvia, Vitner & Brown
Real Estate		
October-16	Homebuilder Sentiment Softens in October	Vitner & Moehring
October-09	Housing Chartbook: October 2014	Vitner & Khan
October-01	Nonresidential Construction Recap: September	Khan
September-02	Commercial Real Estate Chartbook: Q2	Vitner & Khan

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