

**WELLS
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SECURITIES

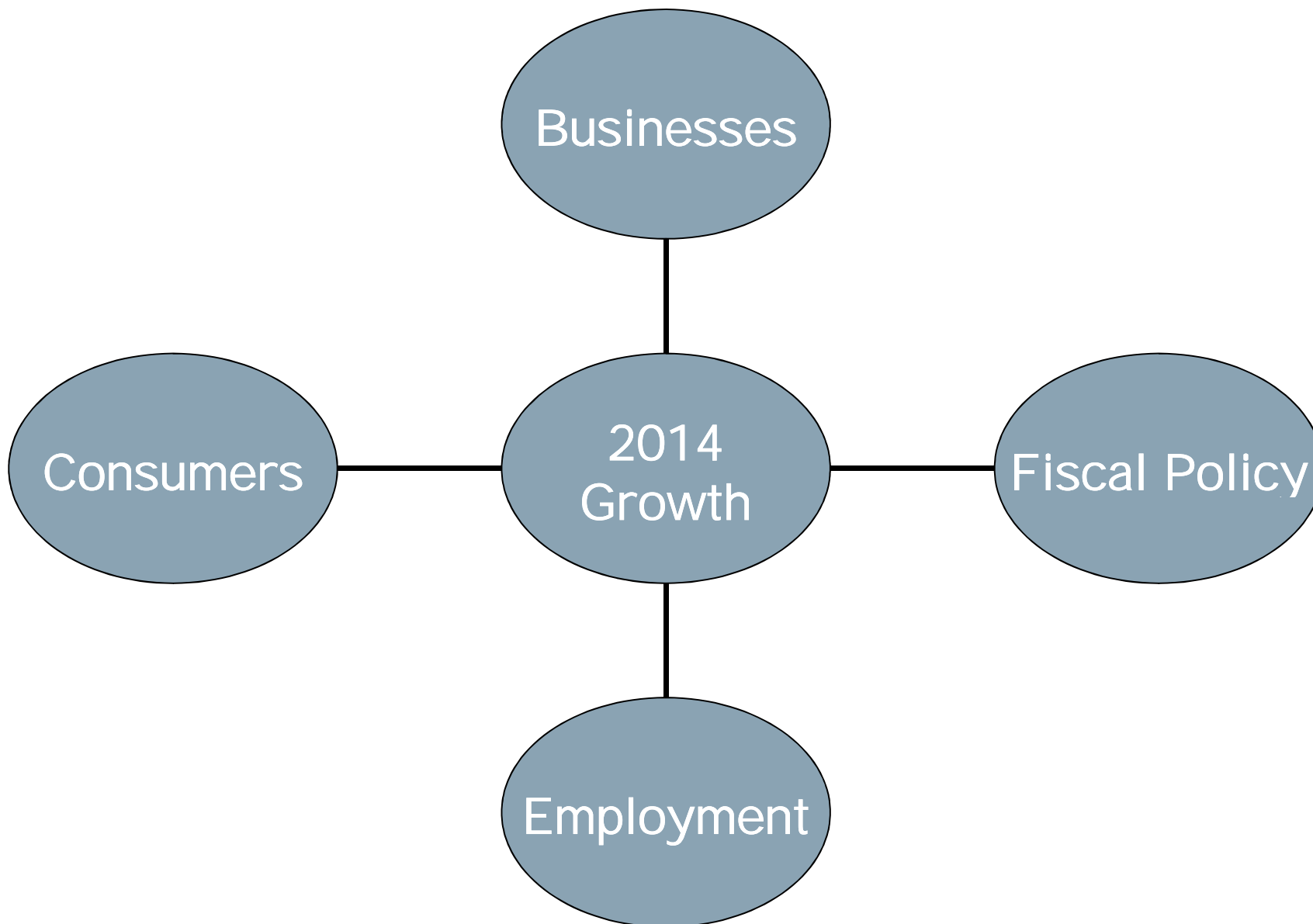
Economic Outlook for 2014 and Beyond

Michael A. Brown, Economist

October 8, 2013

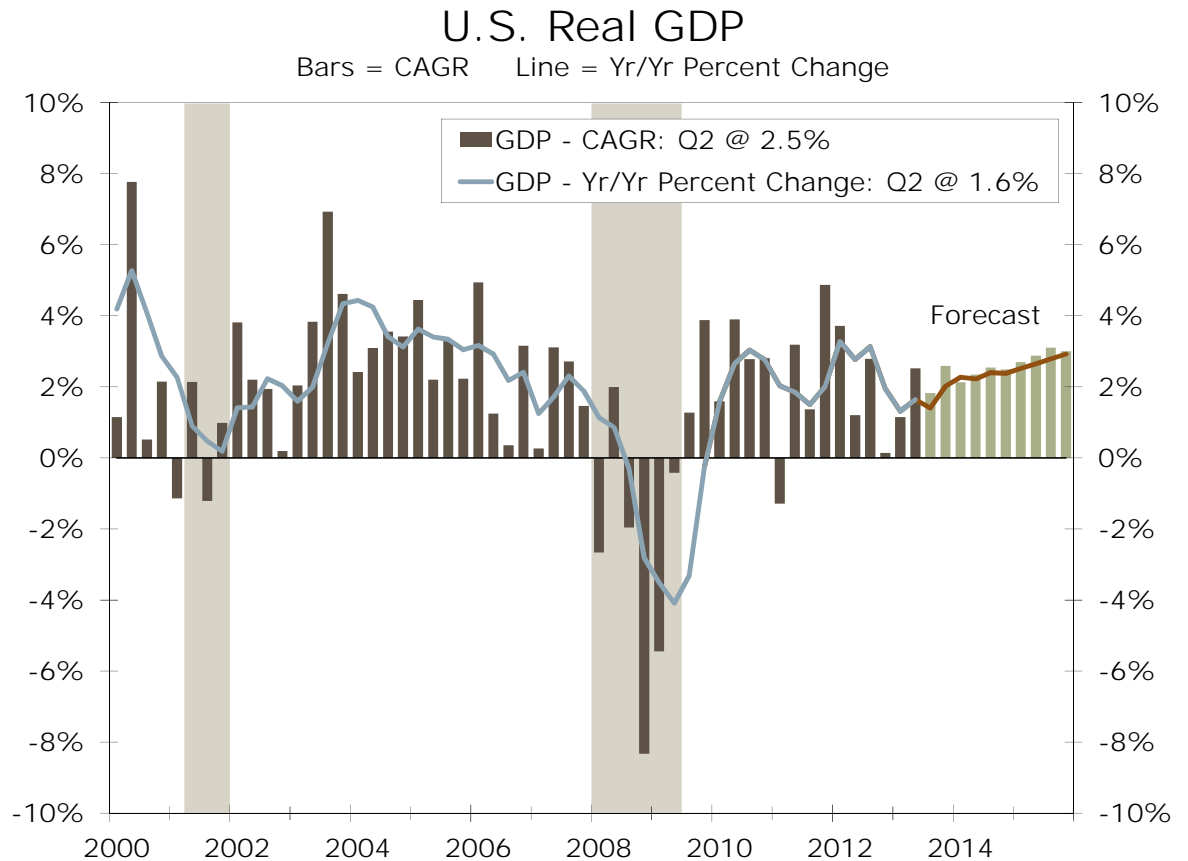
Together we'll go far





Where Are We Now?

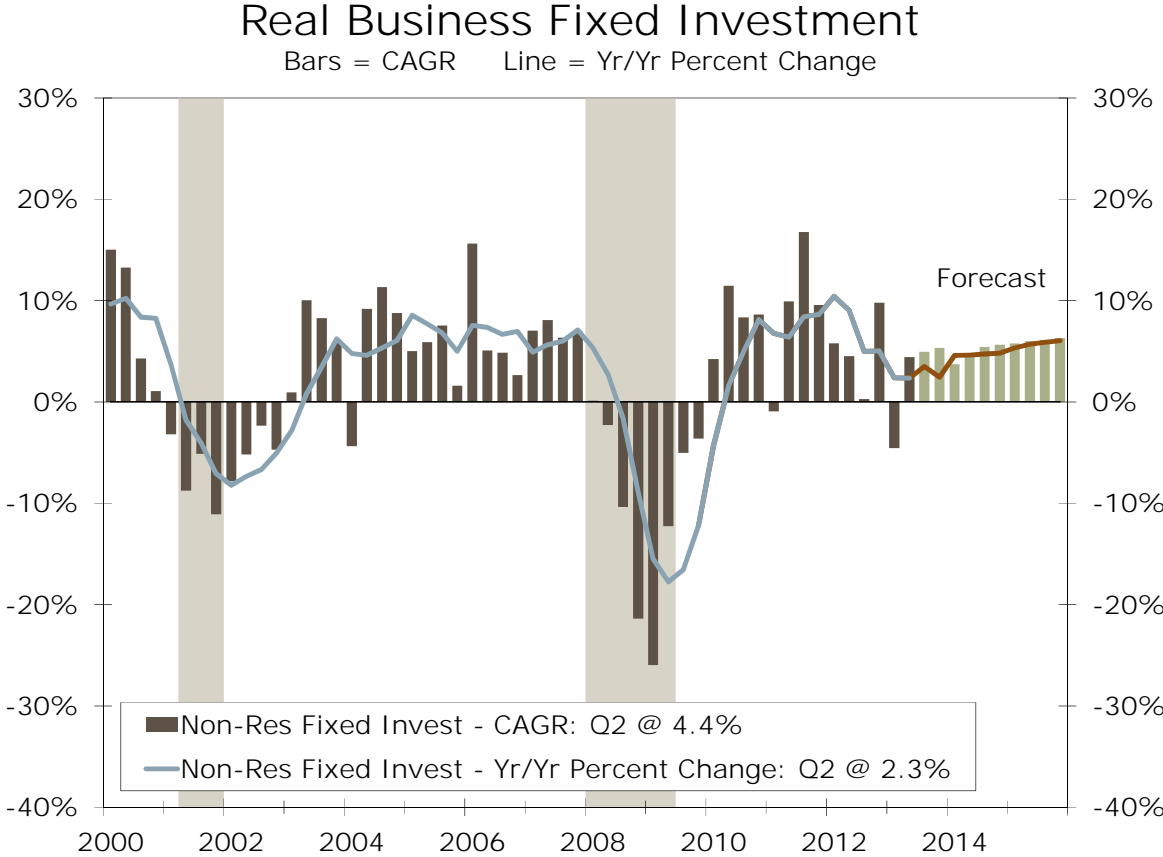
There will be a sustained recovery in 2014, but the pace of growth will still be below the historical average of 3.1 percent (1987-2007)



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

Capital Spending

Growth in business fixed investment spending will remain modest in the second half of the year

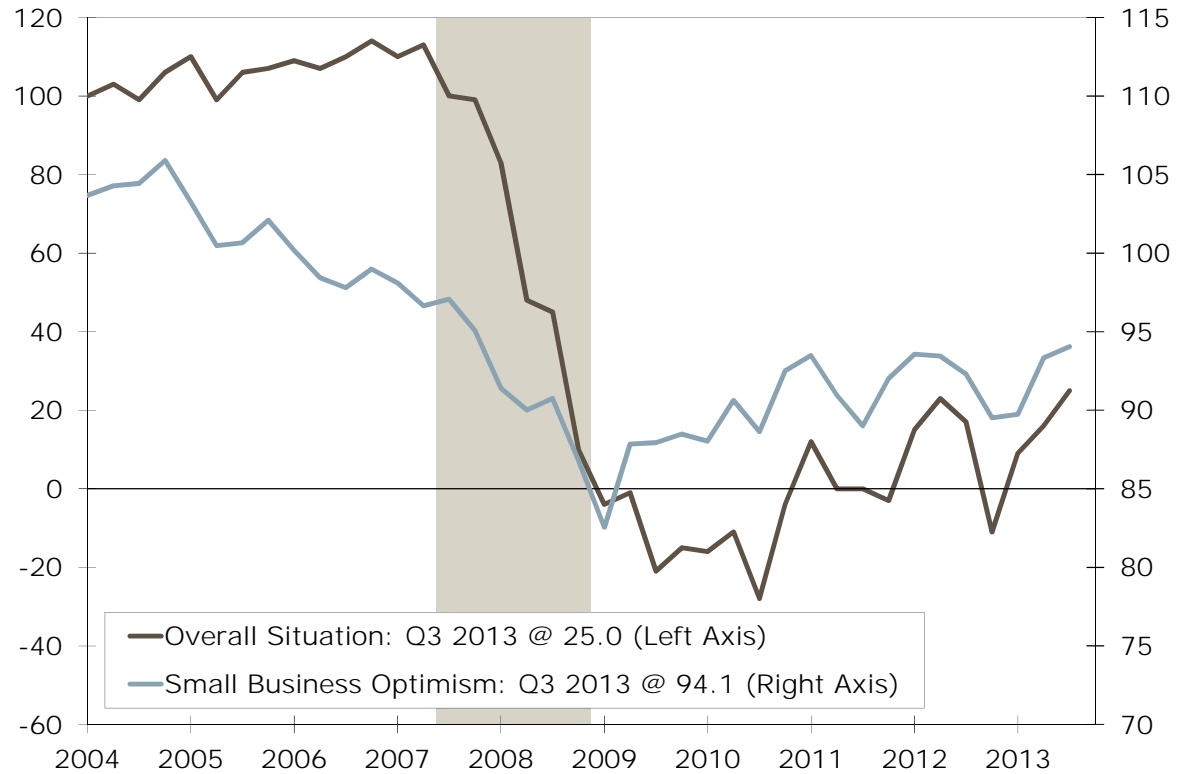


Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

The small business sector is improving but a full recovery in small business optimism is still distant

Wells Fargo Small Business Survey & NFIB

Overall Situation, NFIB Small Business Optimism 1986=100

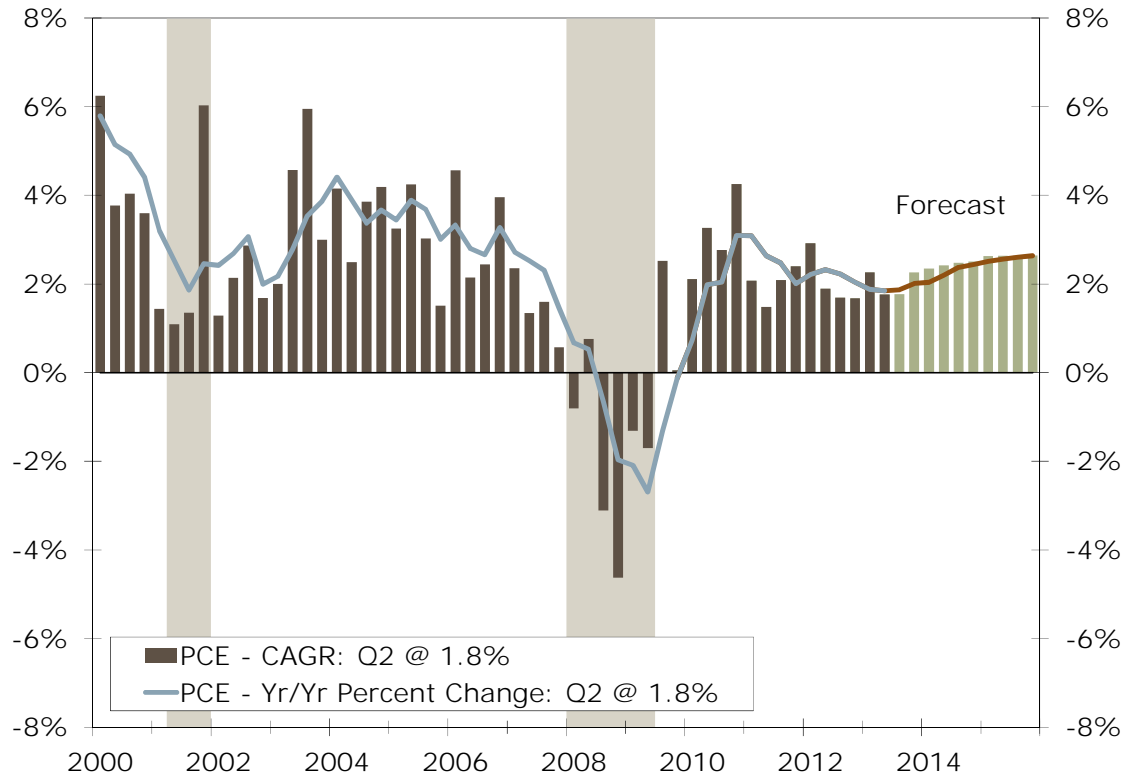


Source: National Federation of Independent Businesses, Gallup, Wells Fargo Bank and Wells Fargo Securities, LLC

Consumer spending will slowly begin to pick up in 2014

Real Personal Consumption Expenditures

Bars = CAGR Line = Yr/Yr Percent Change

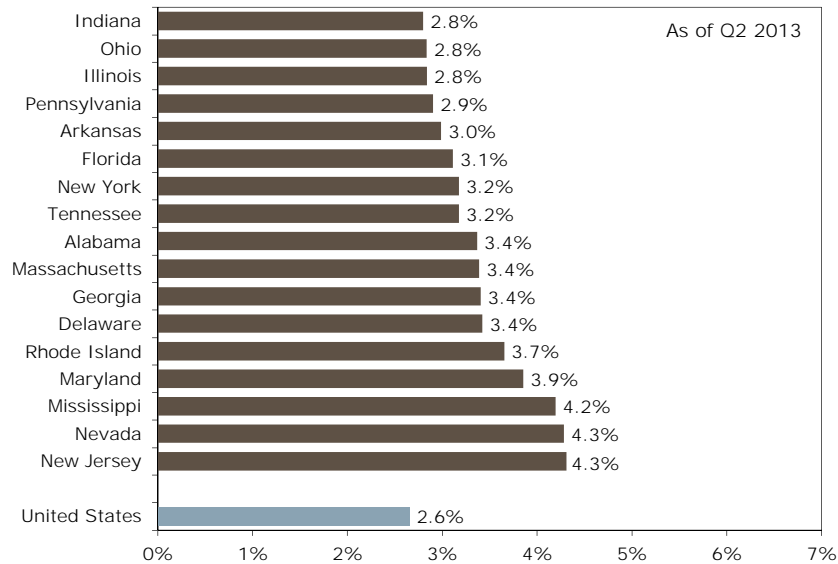


Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

Delinquencies remain elevated and inventory levels have come down

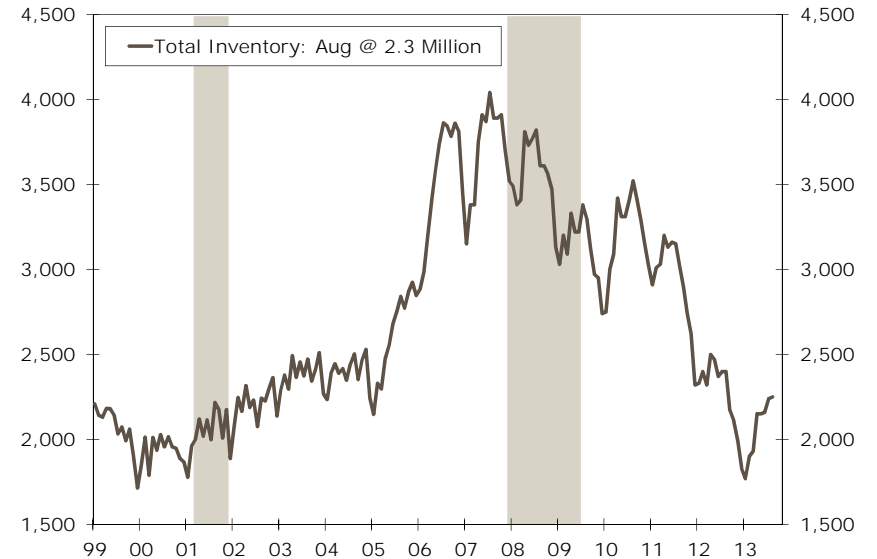
Delinquencies

Mortgages 90+ Days Delinquent - By State
Percent of Mortgages Outstanding



Inventory

Inventory of Existing Homes for Sale
Existing Homes for Sale at End of Month - In Thousands

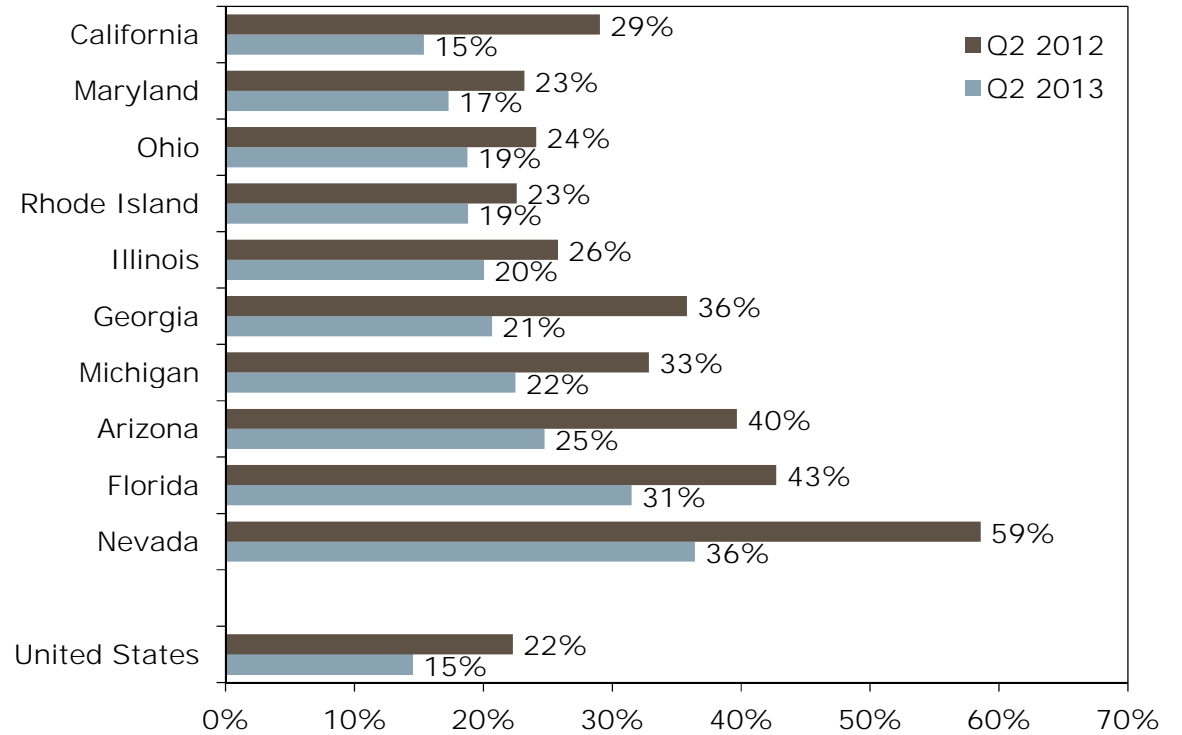


Source: Mortgage Bankers Association, National Association of Realtors and Wells Fargo Securities, LLC

Price appreciation over the last year has helped to reduce negative equity

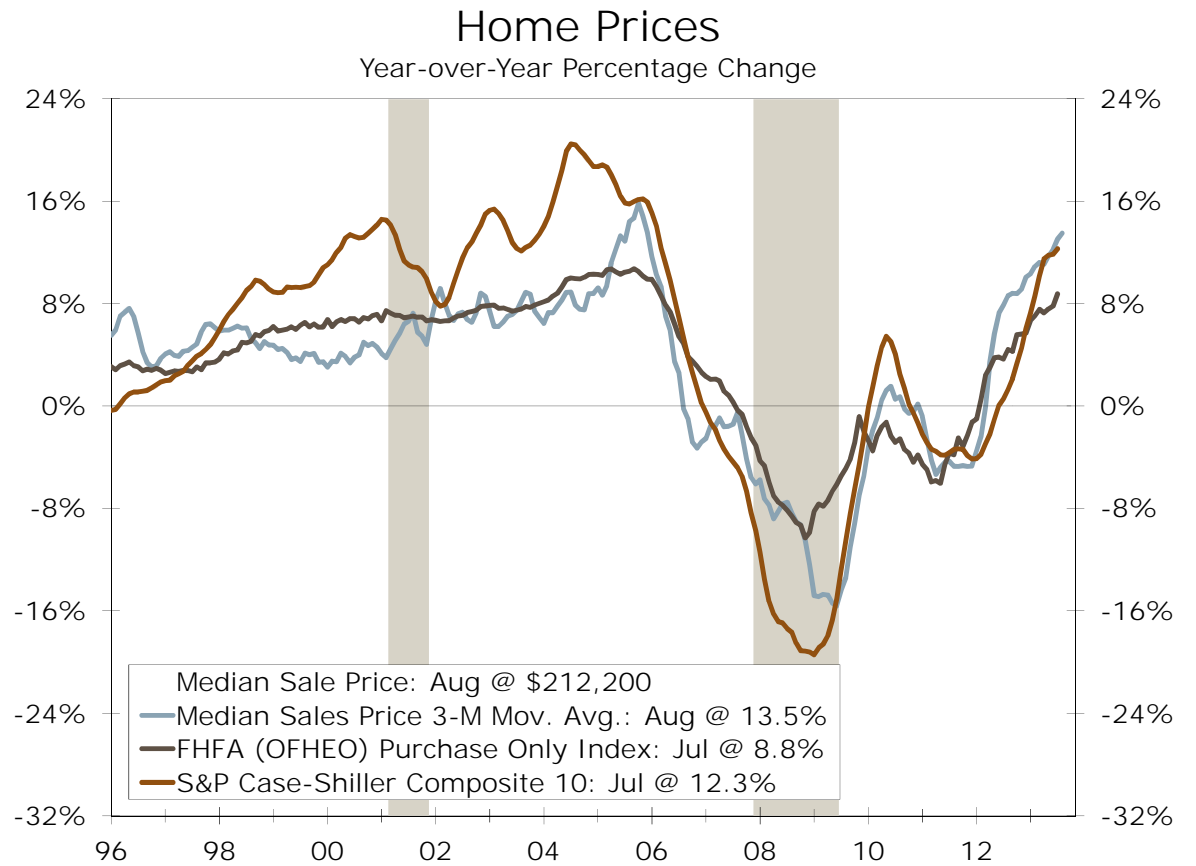
Negative Equity by State

Percent of Mortgages Outstanding



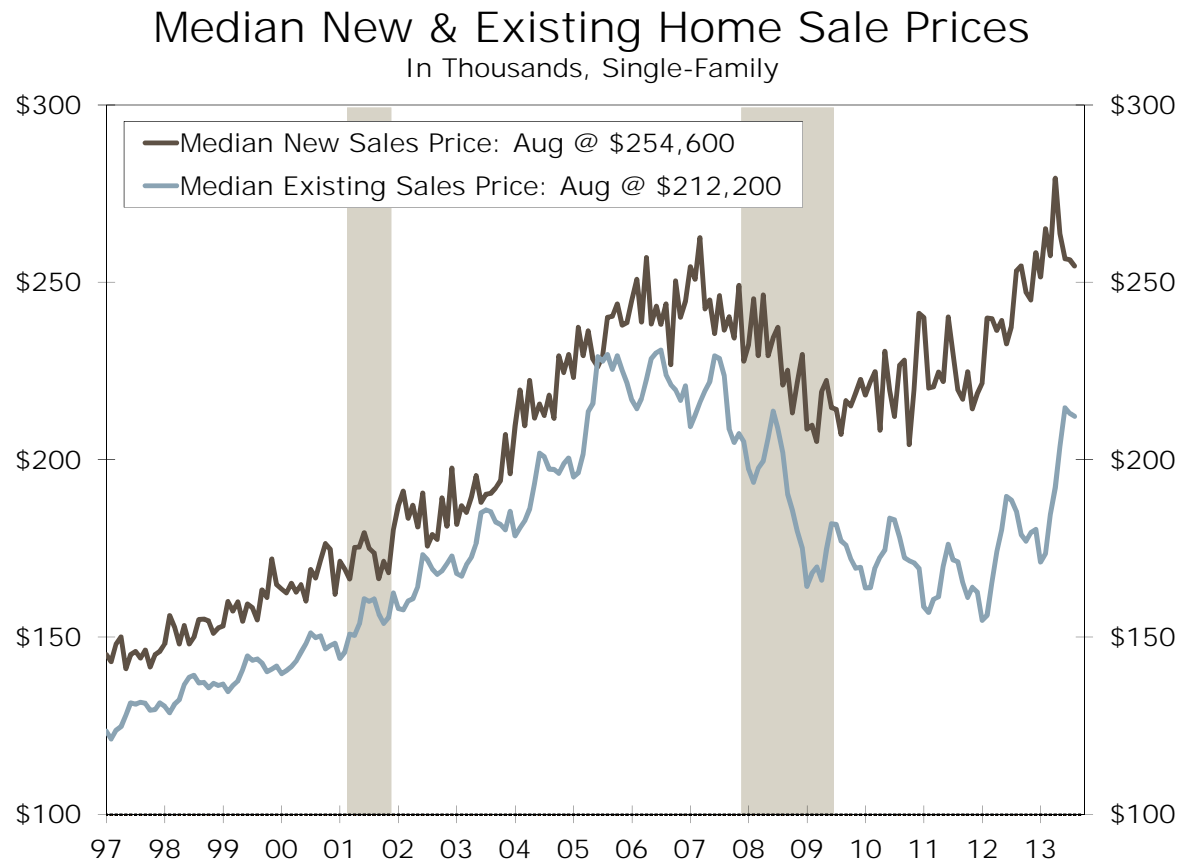
Source: CoreLogic, Inc. and Wells Fargo Securities, LLC

National home price appreciation remains robust



Source: Federal Housing Finance Agency, National Association of Realtors, S&P Corp. and Wells Fargo Securities, LLC

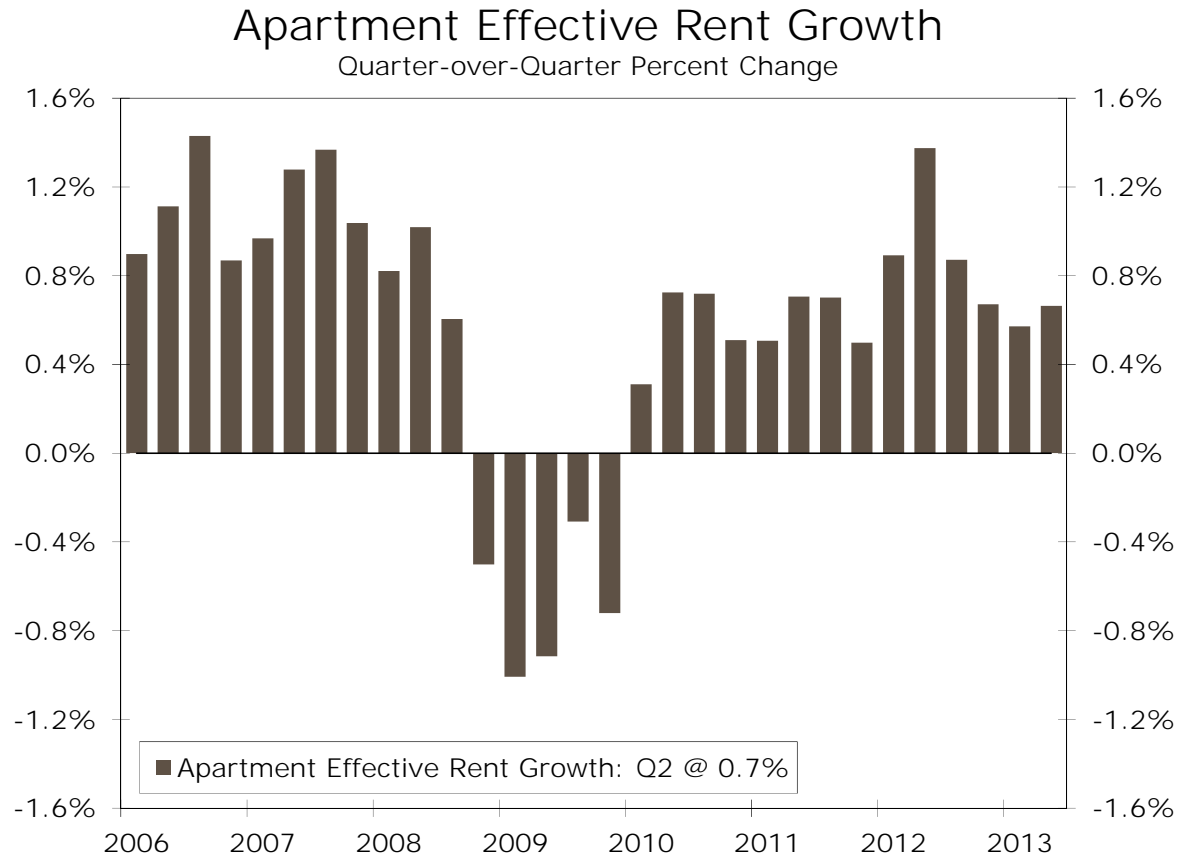
The gap between new and existing home prices remains wide



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

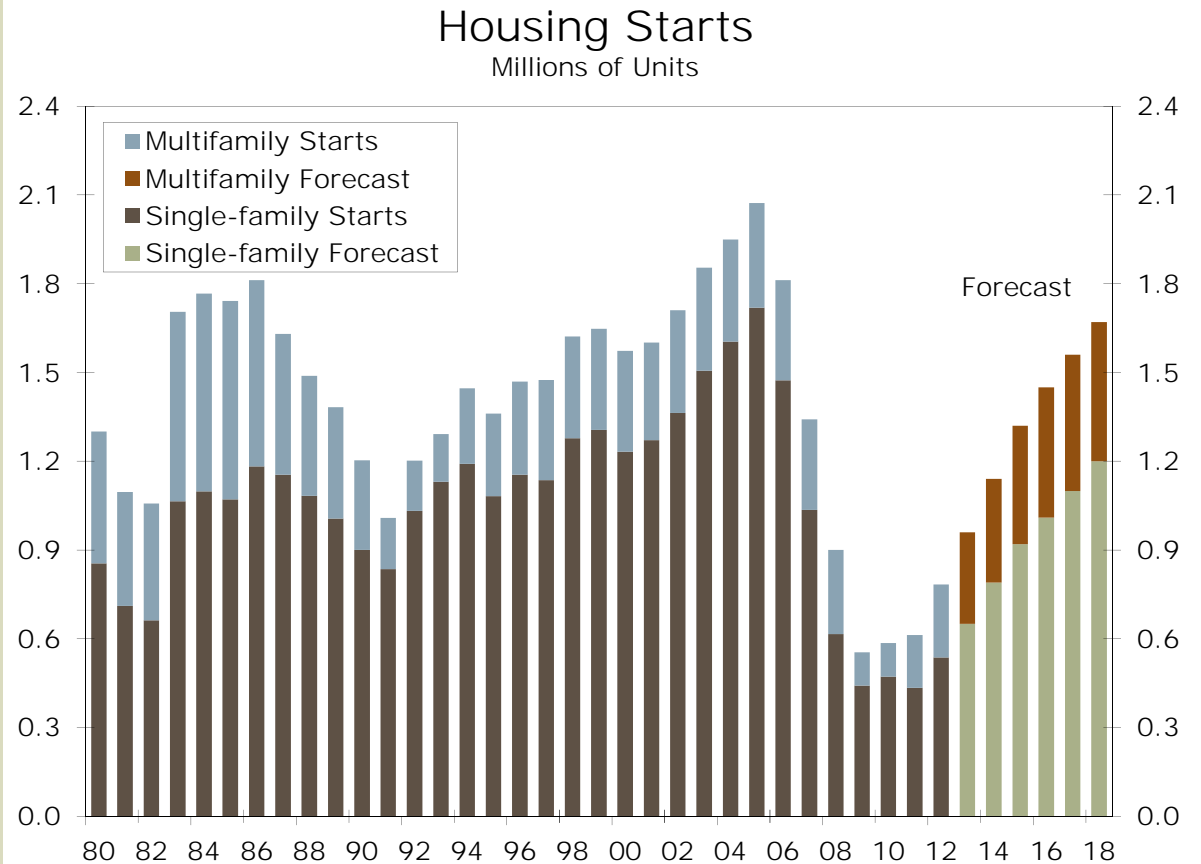
Commercial Real Estate: Apartments - Shift

The apartment market is strong as many would-be buyers remain in the rental market



Source: Reis, Inc. and Wells Fargo Securities, LLC

We continue to look for a gradual recovery in homebuilding. Apartments are playing a larger role than in the previous building cycle.

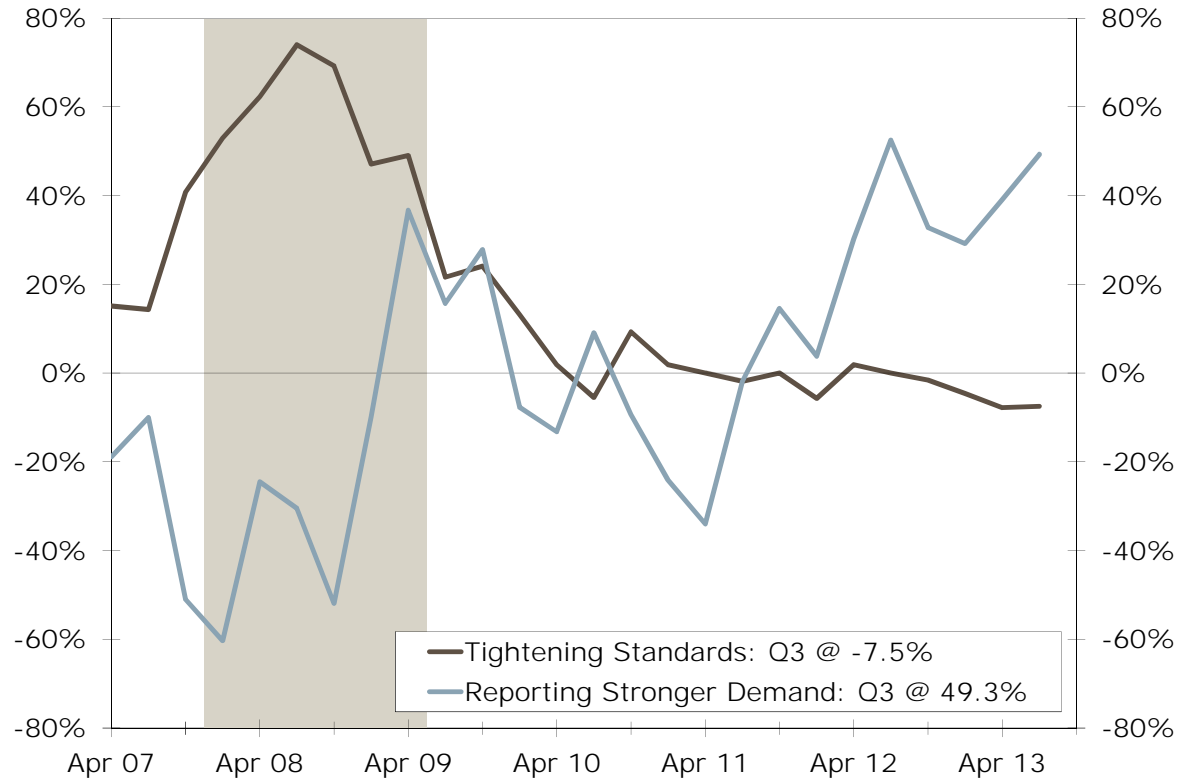


Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

Residential loan demand is strengthening while lending standards are loosening

Residential Loan Standards and Demand

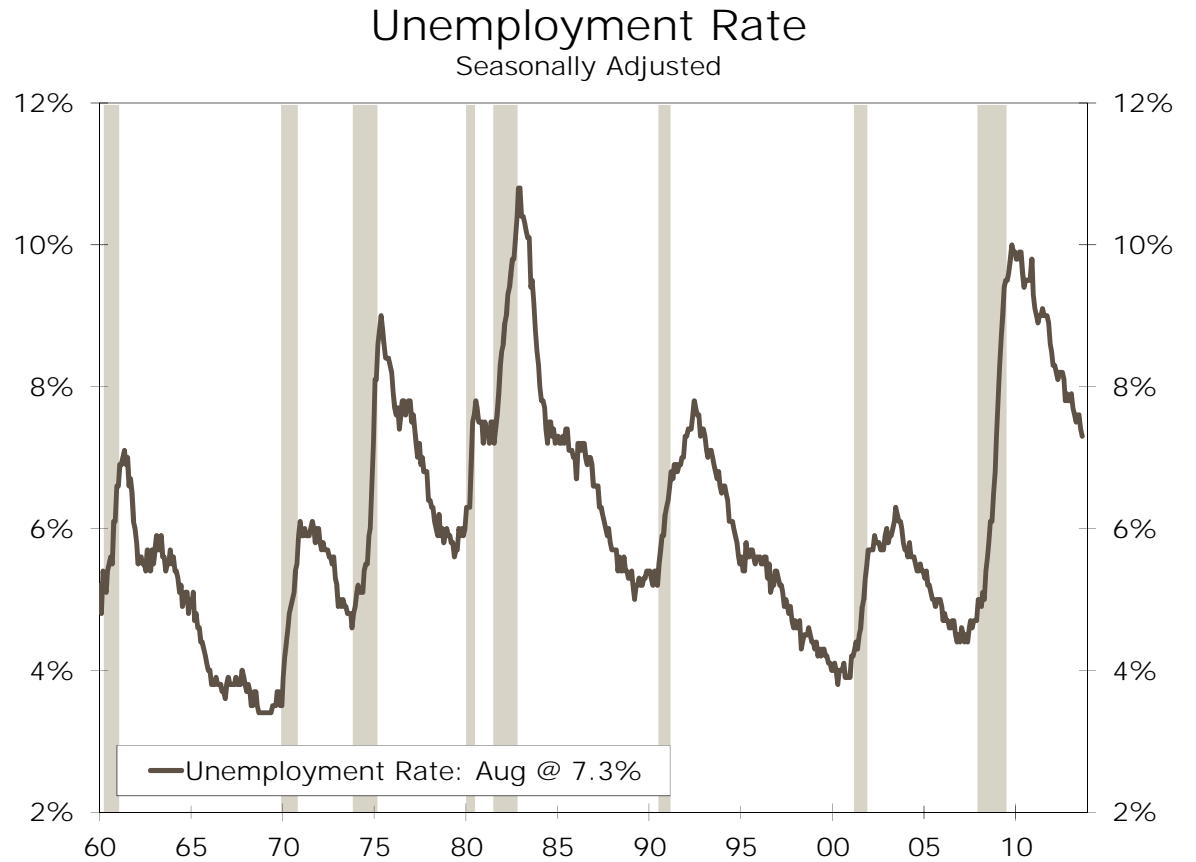
Prime Mortgages, Net Percent of Banks Reporting Change



Source: Federal Reserve Board and Wells Fargo Securities, LLC

The Employment Situation

The unemployment rate remains elevated due to structural factors



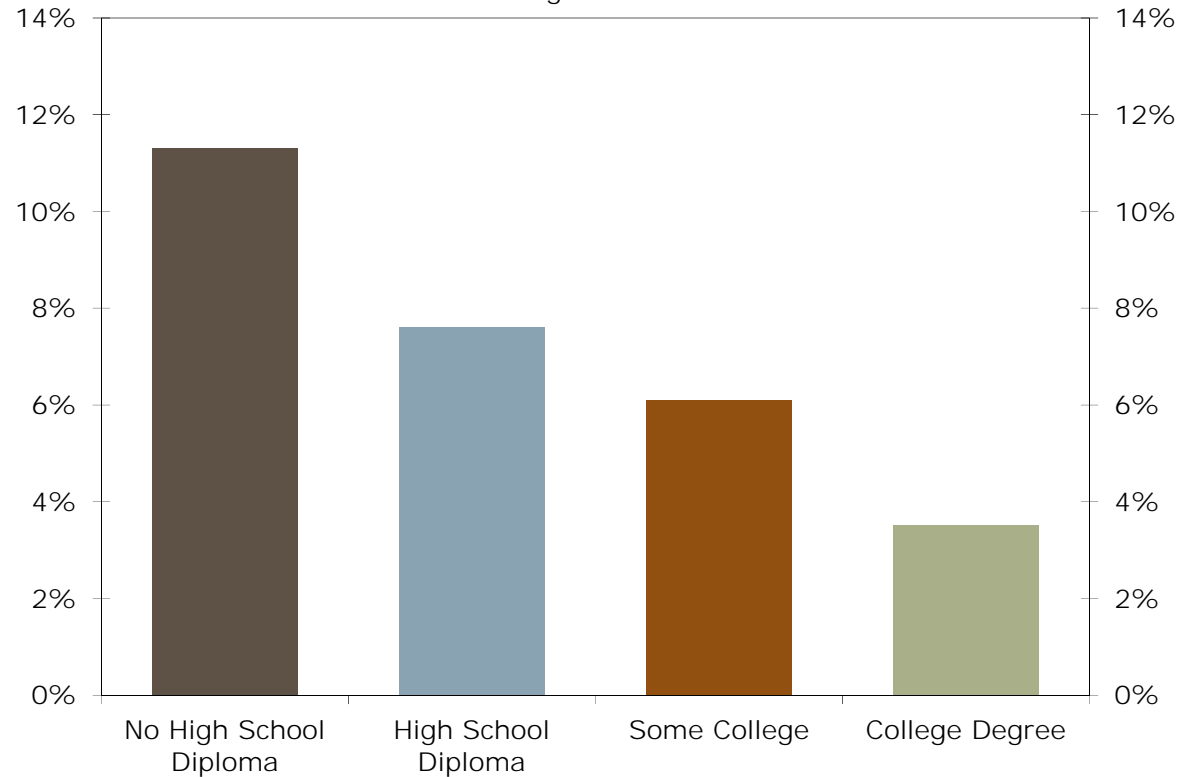
Source: U.S. Department of Labor and Wells Fargo Securities, LLC

The Employment Situation

The unemployment rate for college-educated workers remains low around 4 percent, while the unemployment rate for workers with less than a high school diploma is over 11 percent

Unemployment Rate by Education Level

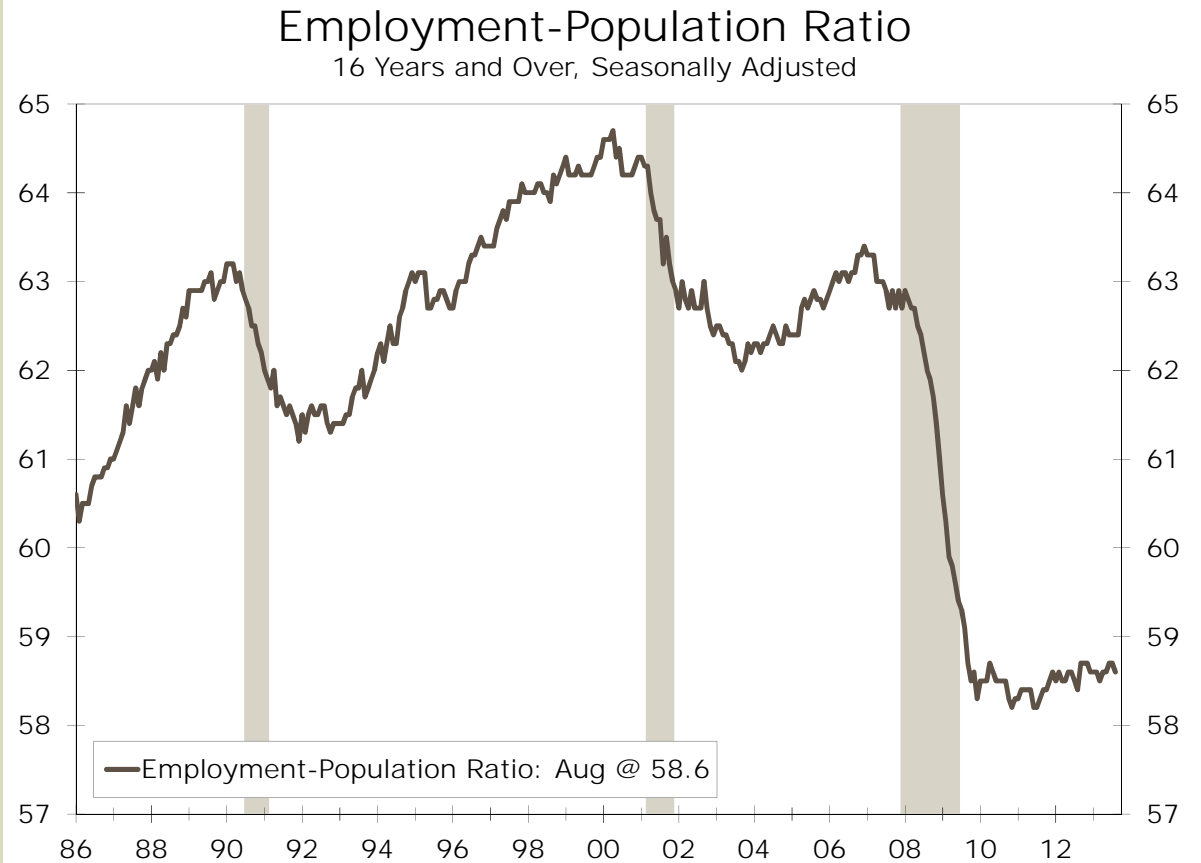
August 2013



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

Employment Rate

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



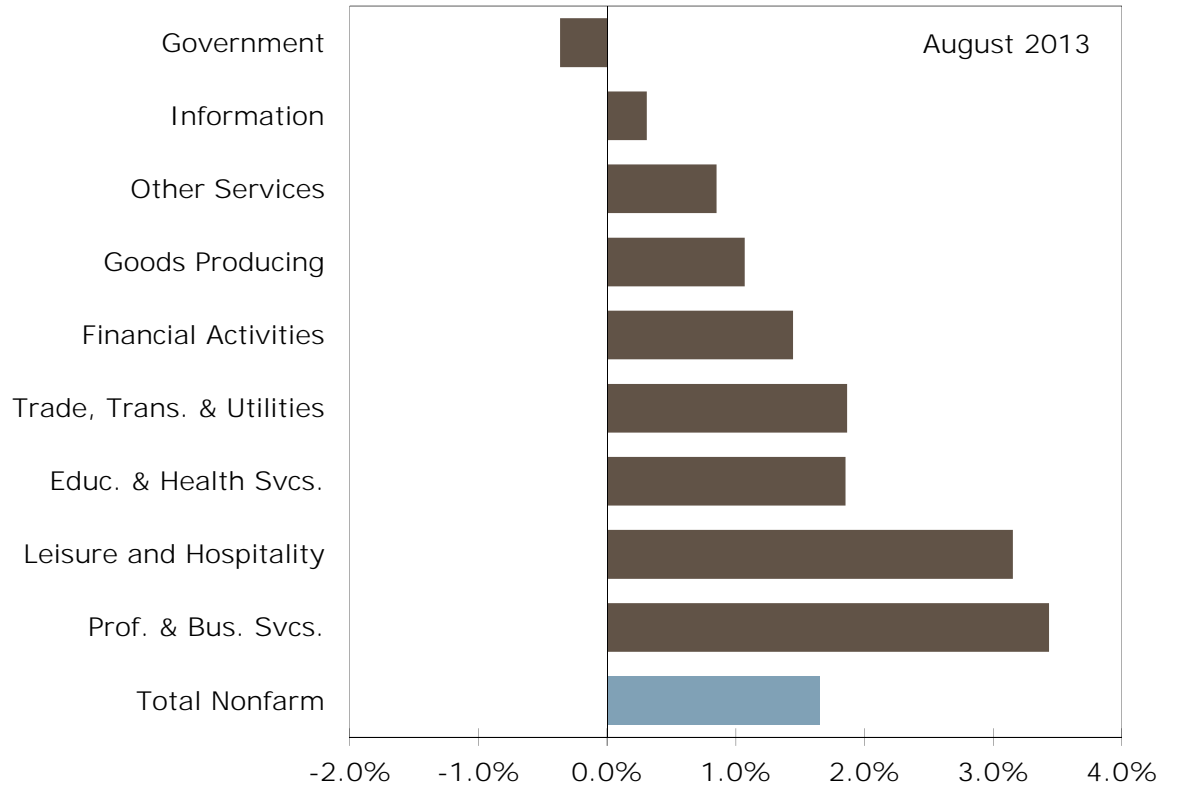
Source: U.S. Department of Labor and Wells Fargo Securities, LLC

Where is the Job Growth?

The service sector continues to lead job growth

United States Employment by Industry

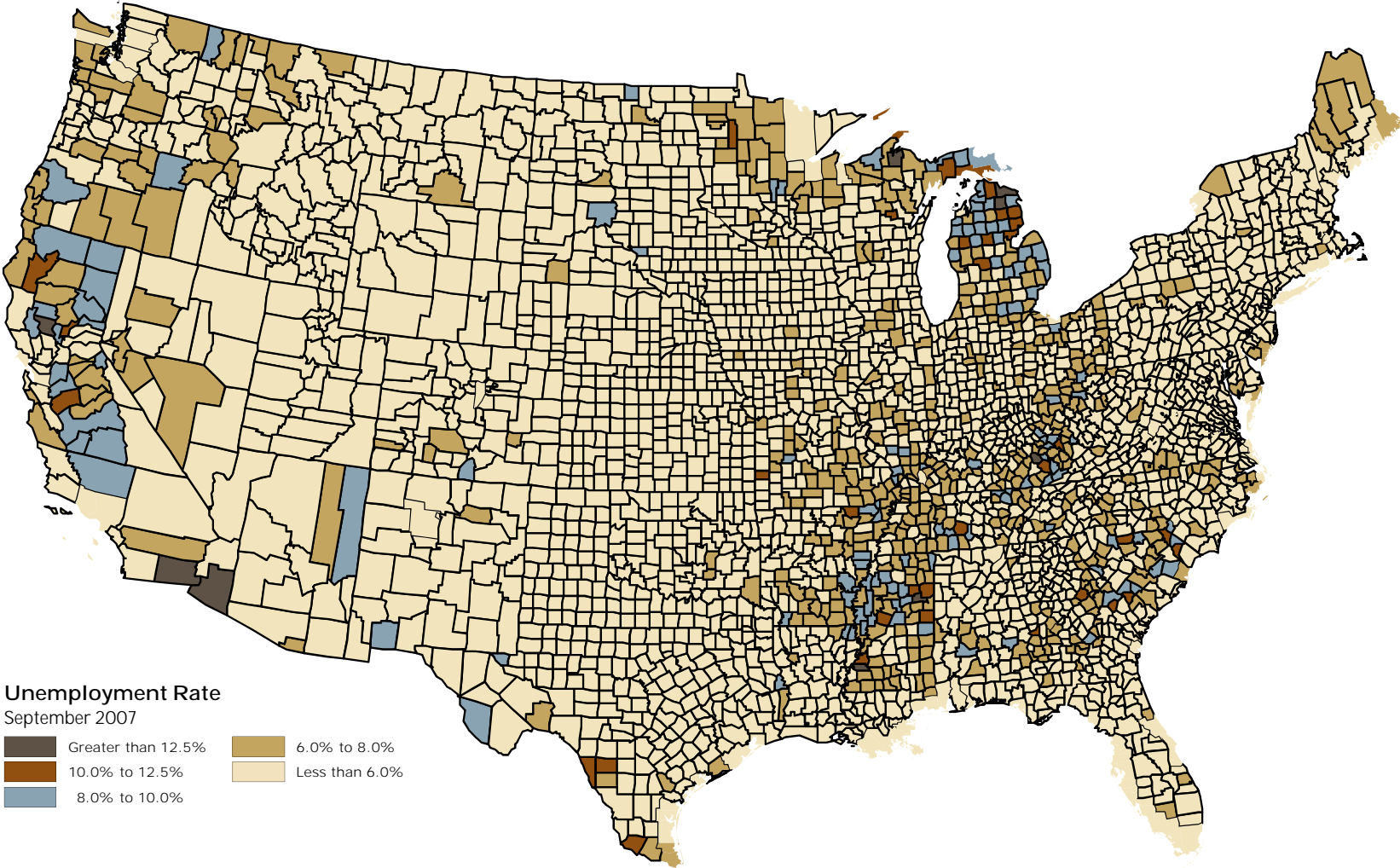
Year-over-Year Percent Change, 3-Month Moving Average



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

Unemployment by County

Unemployment Rate

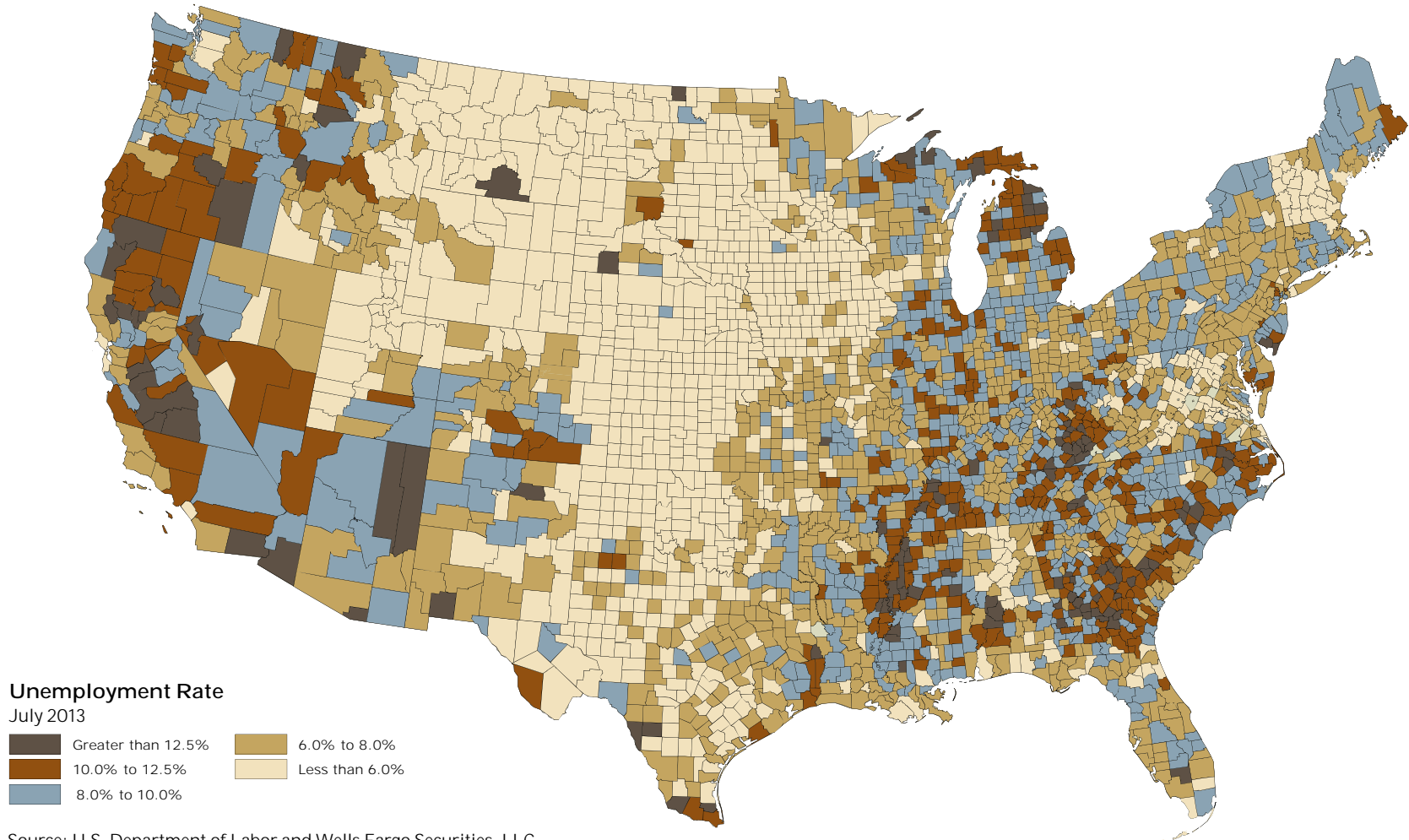


Source: U.S. Department of Labor and Wells Fargo Securities, LLC

Unemployment by County

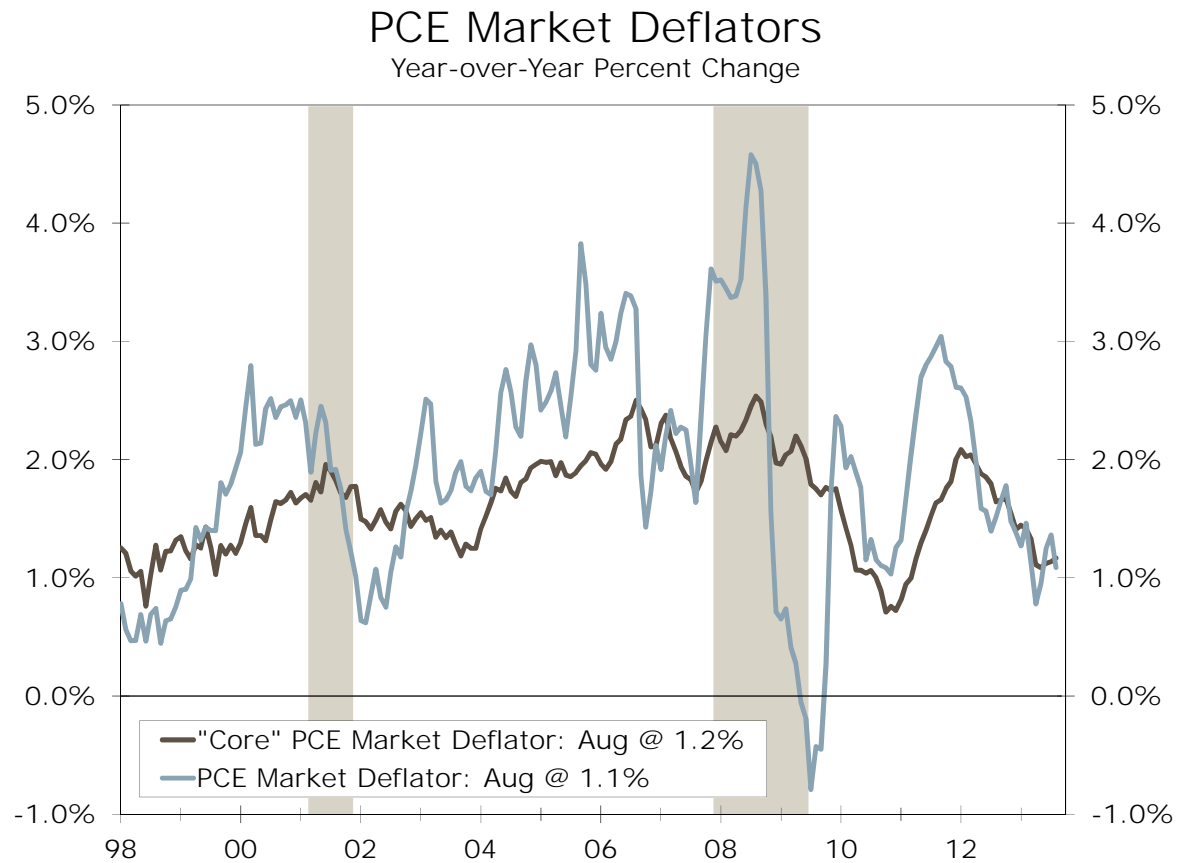
Large Portions of the United States Continue to Face Serious Unemployment Issues

Unemployment Rate



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

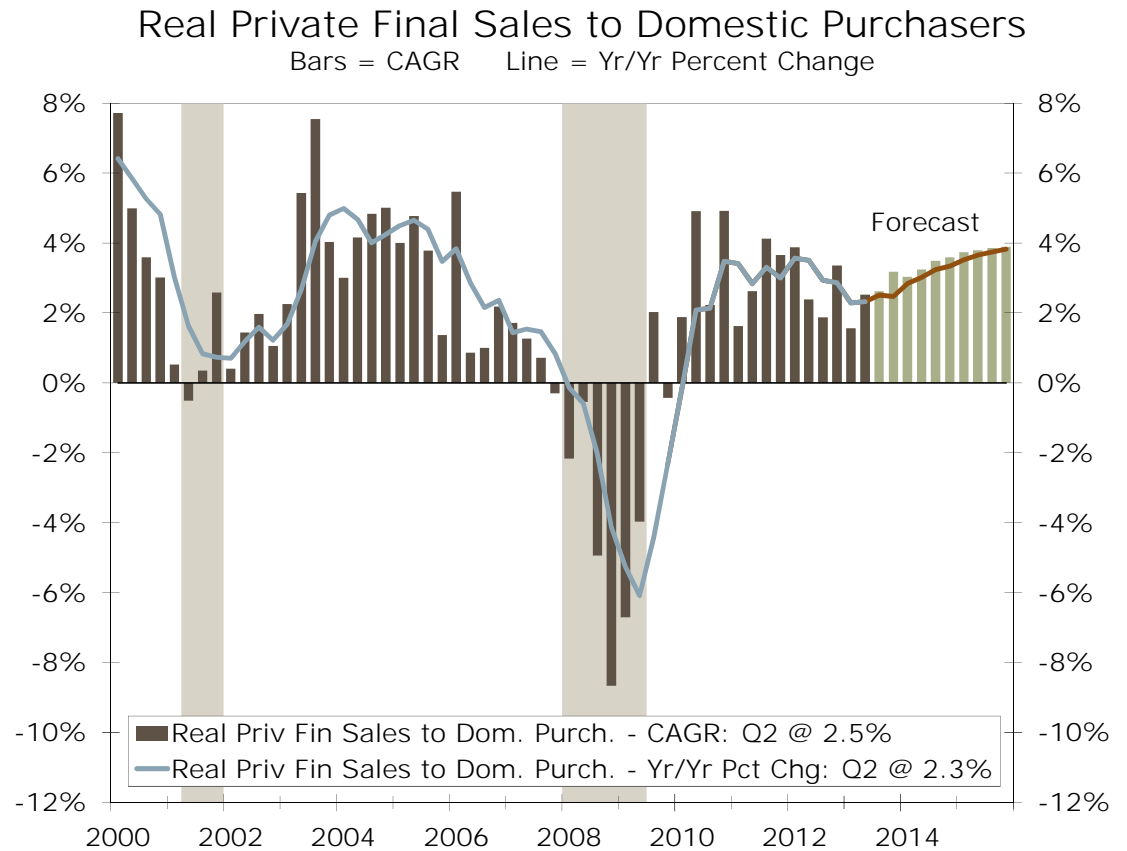
Inflation should not pose a barrier to easier Federal Reserve policy



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

Real Private Demand

Real private demand in the economy remains robust and is expected to accelerate



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

Political uncertainty will continue in the months ahead

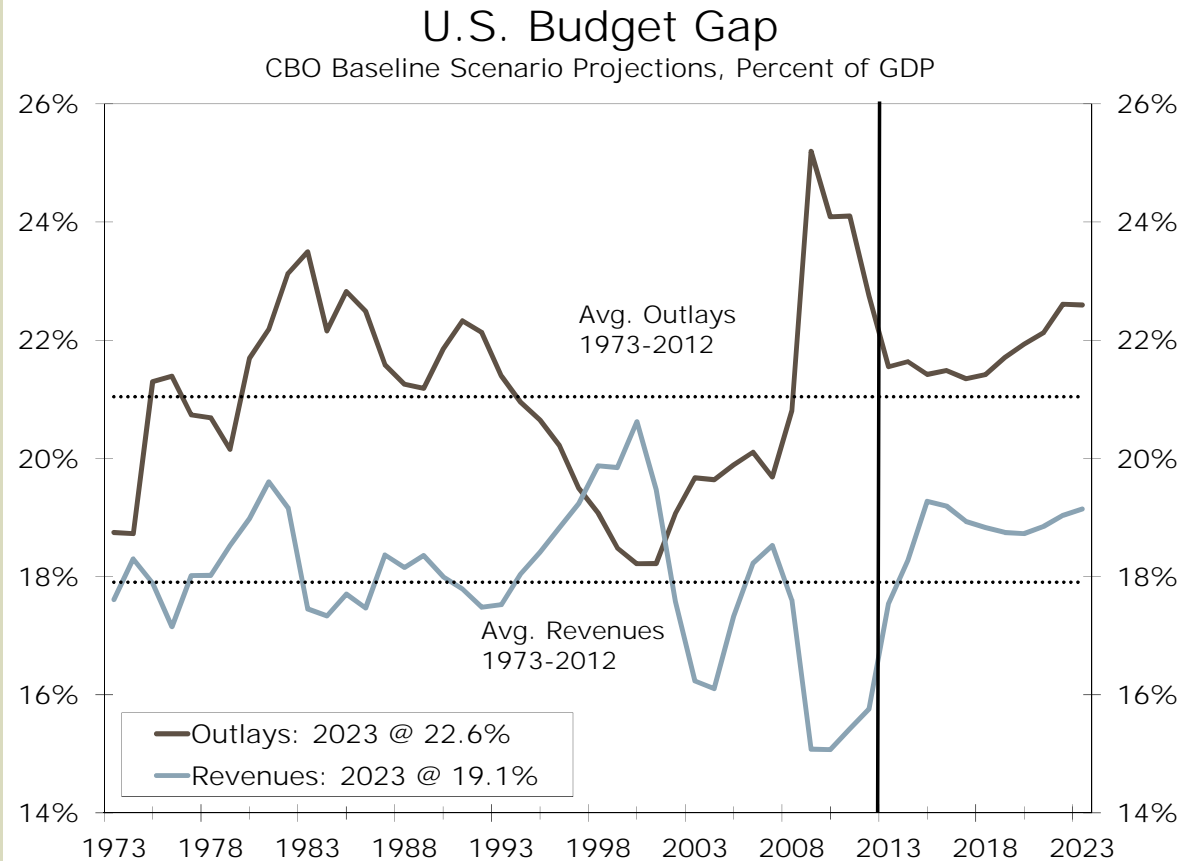
Fiscal Policy Summary

- § Short-term deal to avoid the cliff
 - Ø Taxes on income, capital gains and dividends rise
 - Ø (\$400,000 individuals/\$450,000 families)
 - Ø Alternative minimum tax patched
 - Ø Accelerated depreciation credit extended for businesses
 - Ø Payroll tax cut expires
 - Ø Long-term unemployment benefits extended
 - Ø Spending cuts rolled back for two months

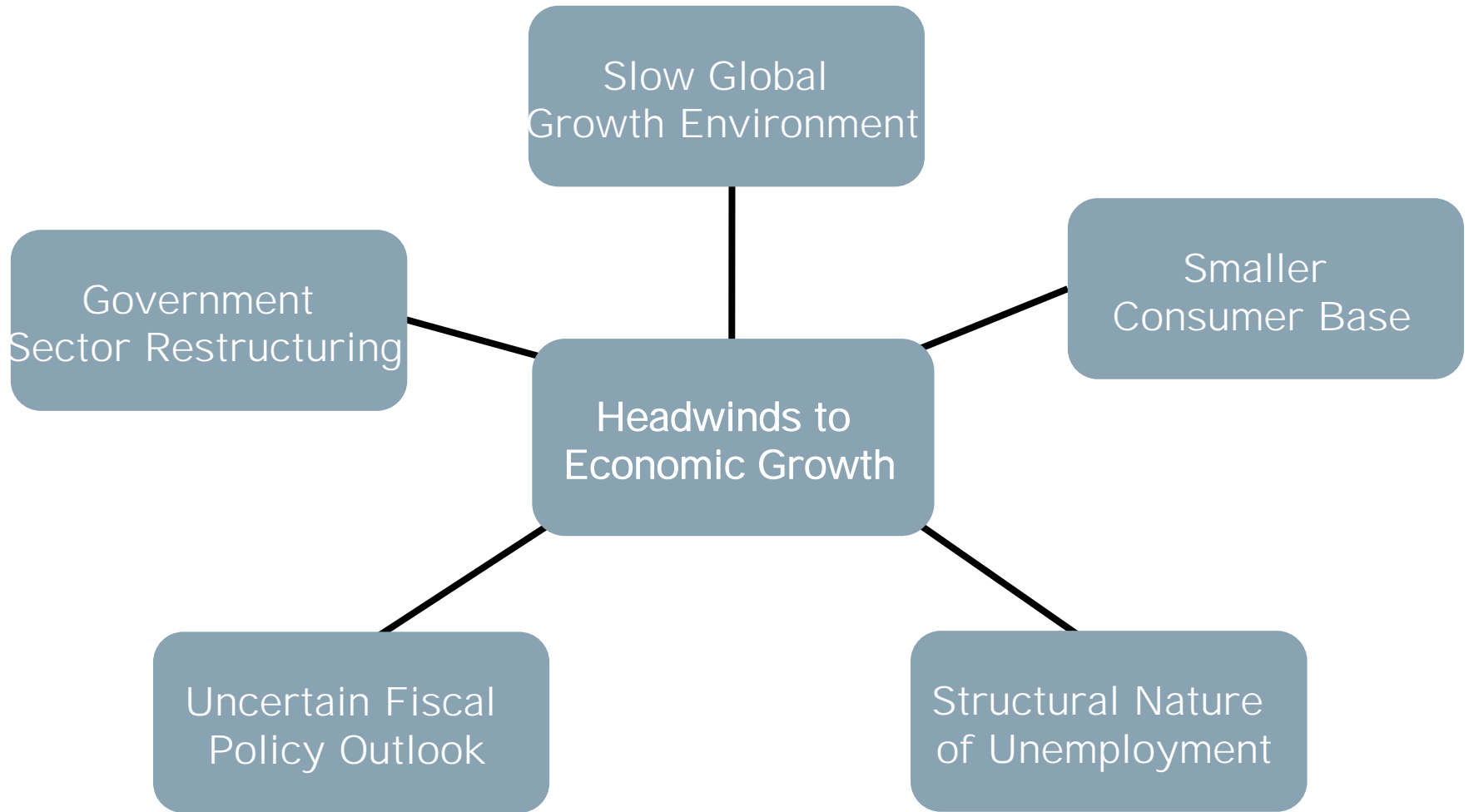
§ What is next?

U.S. Budget Gap

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



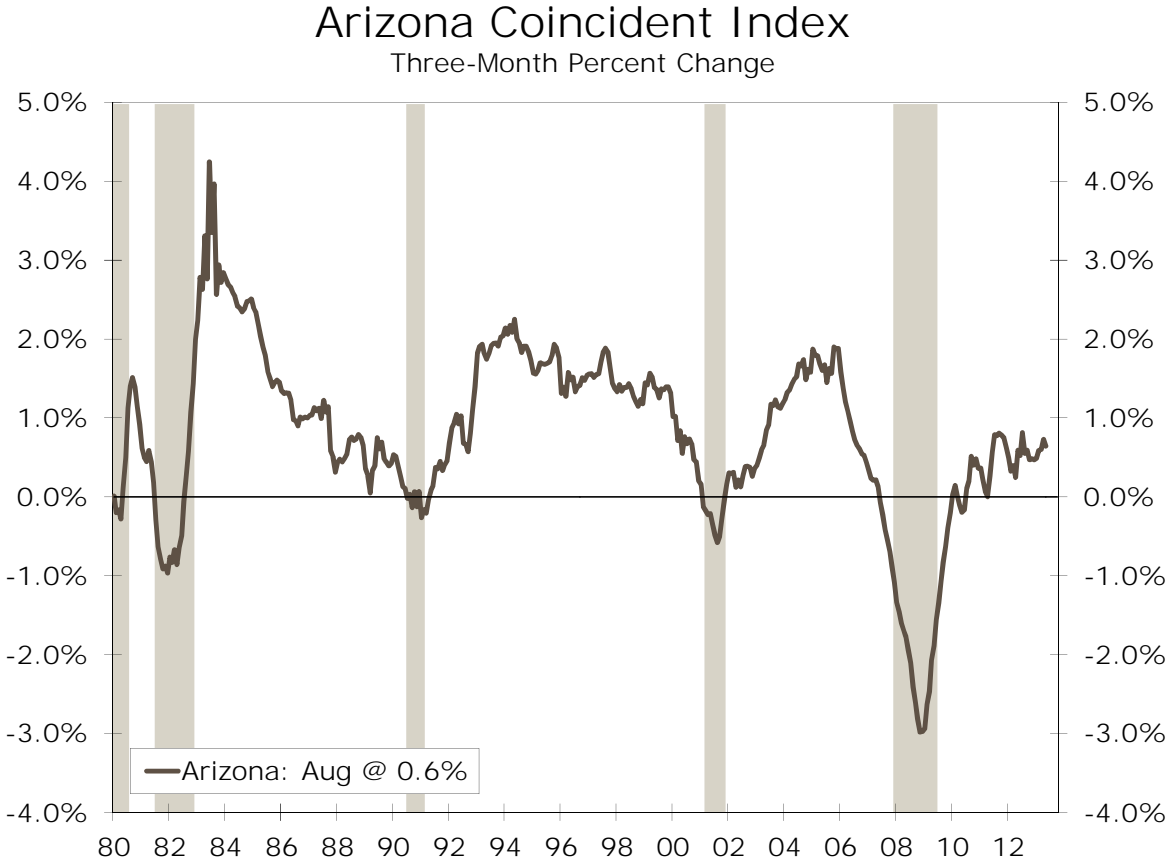
Source: Congressional Budget Office, U.S. Department of the Treasury and Wells Fargo Securities, LLC



The Arizona Economy

Arizona – Current Economic Conditions

Economic conditions across the state continue to gradually improve



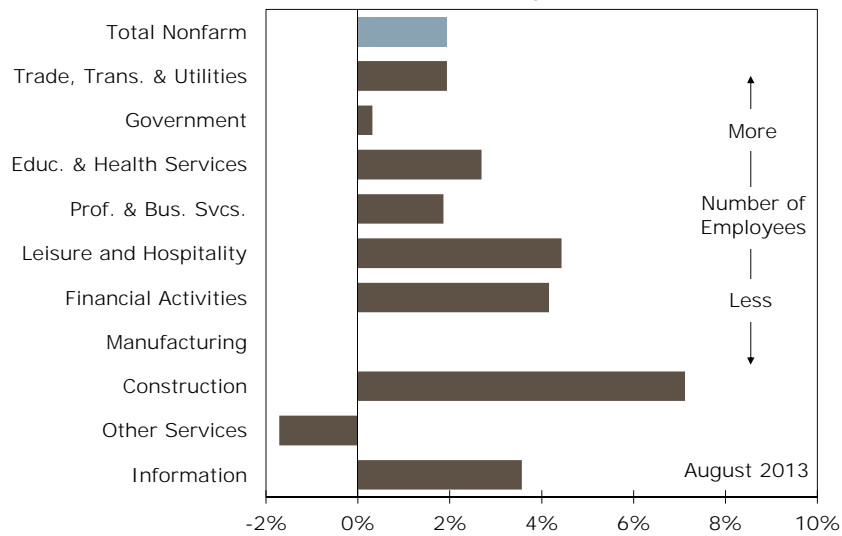
Source: Federal Reserve Bank of Philadelphia and Wells Fargo Securities, LLC

Arizona – Employment Growth & Unemployment Rate

Job growth is slowly picking up, led by a sharp turn around in the construction sector. The unemployment rate remains above the national average.

Employment

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



Unemployment Rate

Arizona vs. U.S. Unemployment Rate
Seasonally Adjusted

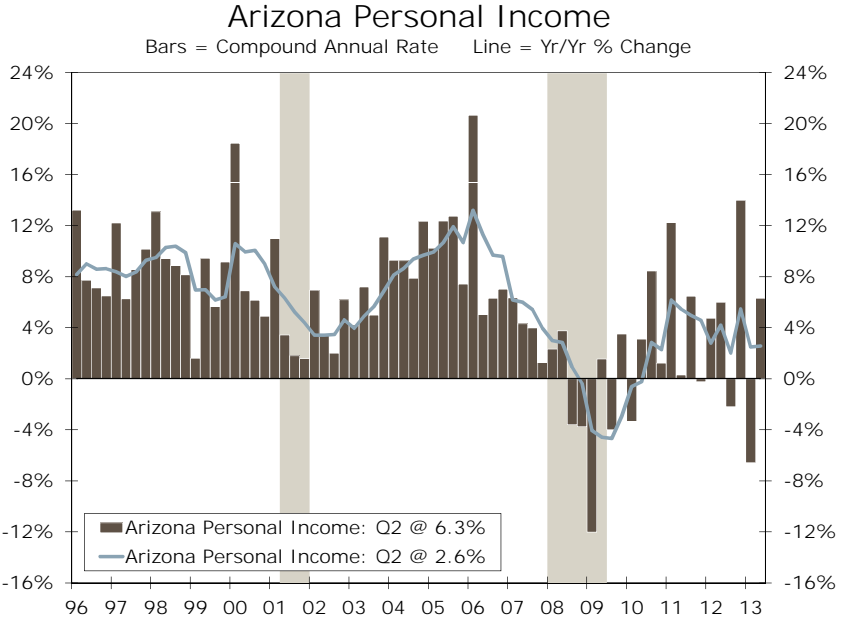


Source: U.S. Department of Labor and Wells Fargo Securities, LLC

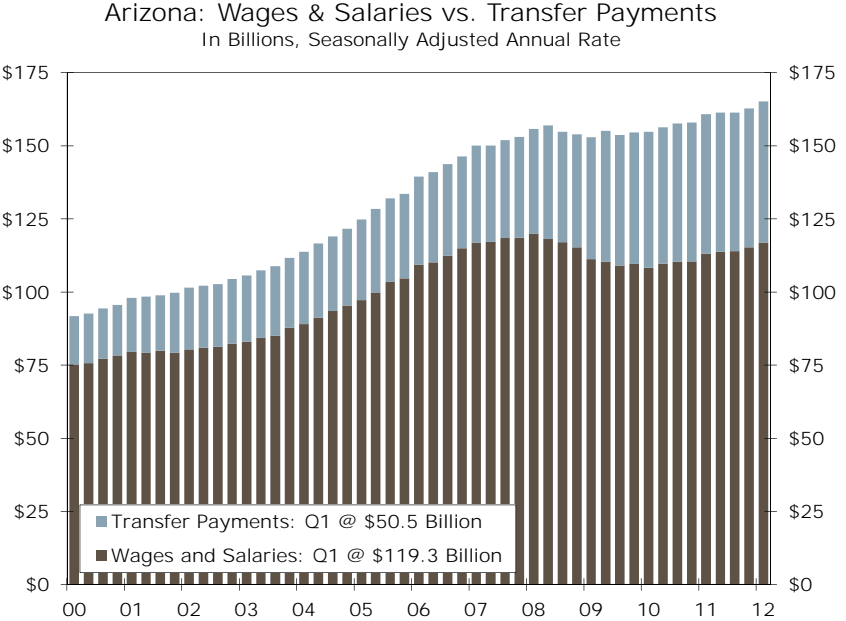
Arizona – Personal Income Situation

Personal income growth has recently seen volatility, and transfer payments account for 30 percent of personal income in the state

Personal Income



Composition of Income Growth



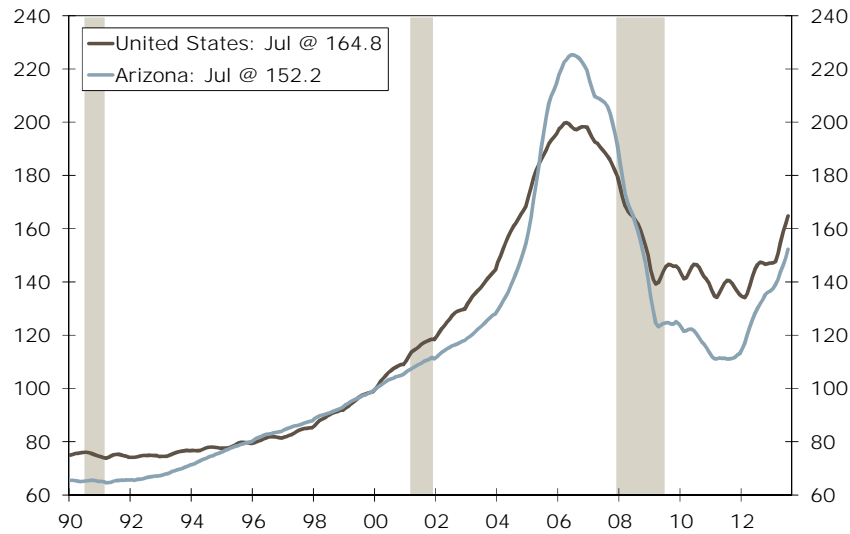
Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

Arizona – Home Prices and Construction

Home prices are continuing to appreciate in Arizona due to a decrease in unsold inventory. Housing construction has also picked up slightly.

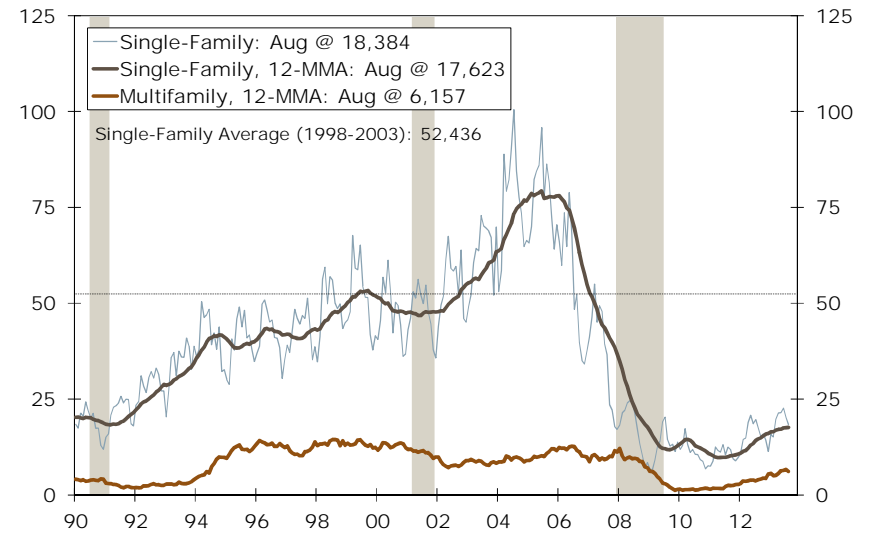
Home Prices

CoreLogic HPI: AZ vs. U.S.
Index, 2000=100, Not Seasonally Adjusted



Housing Permits

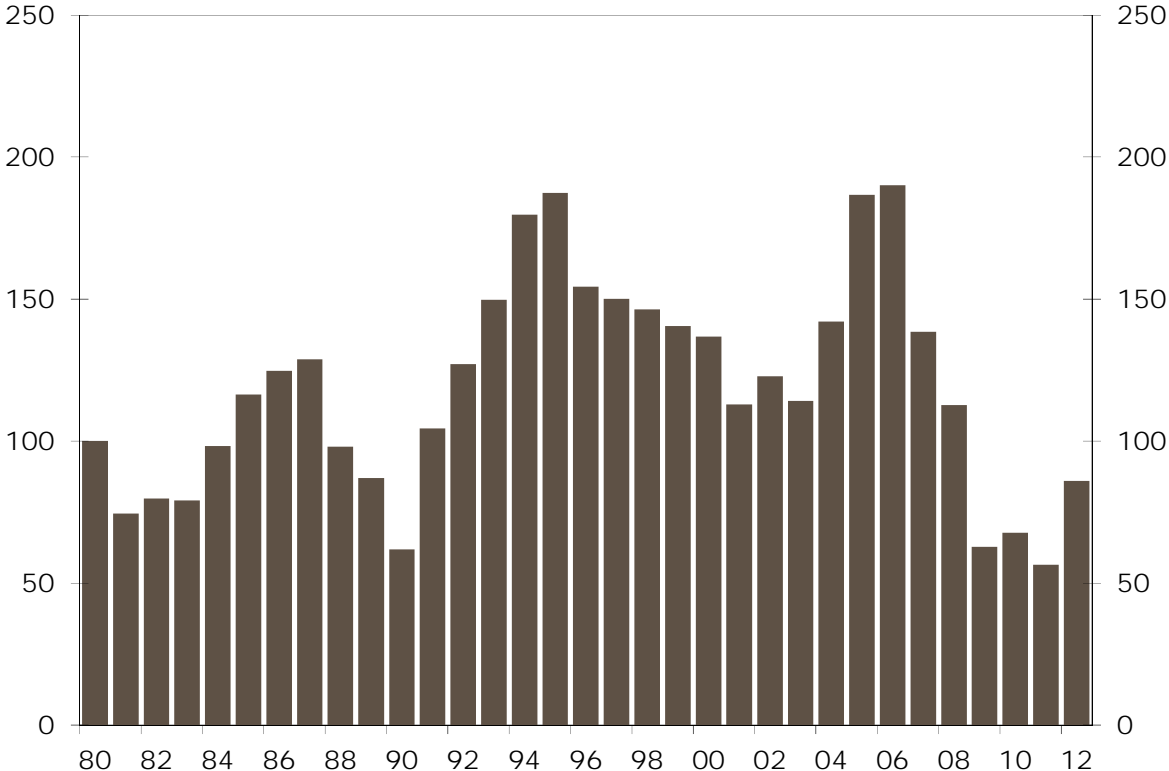
Arizona Housing Permits
Thousands of Permits, Seasonally Adjusted Annual Rate



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

Increased population growth over the past year, among the fastest in the country, will help to perpetuate economic activity

Arizona Population Growth
In Thousands



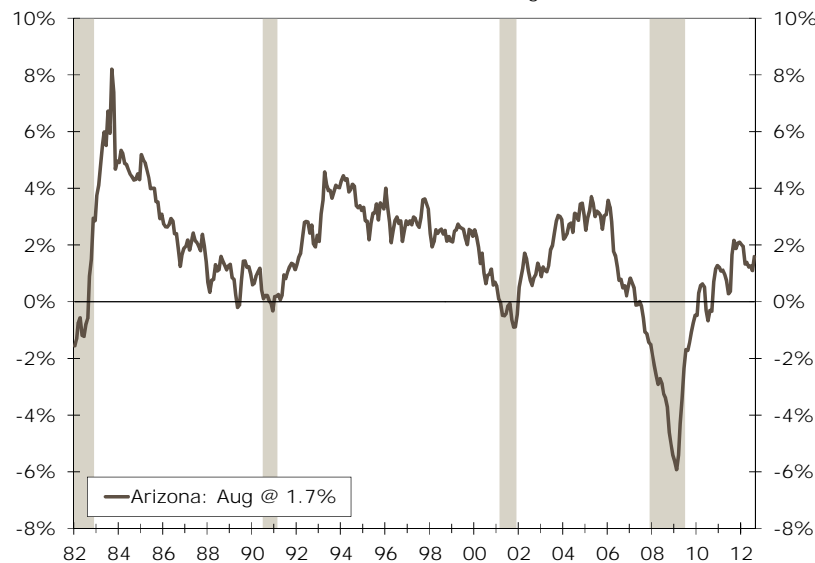
Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

Economic activity around the state is expected to pick up modestly in months ahead

Leading Index

Outlook

Arizona Leading Index
Three-Month Percent Change



Growth should accelerate in the second half of 2013

- § The state GDP growth will likely outperform that of the nation's again this year.
- § Growth in payrolls will continue with job gains in the construction and financial services sectors. The leisure and hospitality sector will also help to support job growth.
- § The housing market will continue to improve at a gradual pace over the next twelve months, however negative equity remains a concern.

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 sub-par pace of economic growth
 - Ø More of the same

- § Business spending will continue to add to growth
 - Ø Investment in equipment & software will continue

- § Consumer spending will remain modest
 - Ø Deleveraging and rebuilding of wealth will continue

- § The housing market continues to face many challenges
 - Ø Some regions will recover faster than others

- § The employment picture will slowly continue to improve
 - Ø Structural issues remain

Outlook Summary

Wells Fargo U.S. Economic Outlook

	Actual			Forecast		
	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Real Gross Domestic Product ¹	2.5	1.8	2.8	1.6	2.3	2.7
Personal Consumption	2.0	2.5	2.2	1.9	2.3	2.6
Business Fixed Investment	2.5	7.6	7.3	2.7	4.7	5.7
Inventory Change	58.2	33.6	57.6	55.7	53.9	52.0
Government Purchases	0.1	-3.2	-1.0	-2.3	-2.1	-1.4
Residential Construction	-2.5	0.5	12.9	14.0	15.4	17.4
Net Exports	-462.6	-445.9	-430.8	-417.7	-397.4	-417.4
Consumer Price Index ²	1.6	3.1	2.1	1.5	2.0	2.4
Corporate Profits Before Taxes ²	25.0	7.9	7.0	4.6	5.3	5.9
10-Year Treasury Note	3.22	2.78	1.80	2.52	3.15	3.65

Forecast as of: September 20, 2013

¹ Compound Annual Growth Rate Quarter-over-Quarter

² Year-over-Year Percentage Change

Source: Wells Fargo Securities, LLC

Appendix

A Sampling of Our Recent Special, Regional & Industry Commentary

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Recent Special Commentary

Date	Title	Authors
September-03	Midyear Consumer Spending Outlook	Aleman & Brown
September-03	Swiss Economy Continues to Chug Along	Bryson
August-30	Housing Data Wrap-Up: August 2013	Vitner, Khan & Silverman
August-30	Trends in Regional Energy Production	Vitner & Brown
August-29	Preemption is the Rule at Brazilian Central Bank	Aleman
August-28	Life After Ben: Choosing the Next Fed Chair	Silvia, Khan & Silverman
August-26	Commercial Real Estate Chartbook: Quarter 2	Vitner, Khan & Silverman
August-26	2013 Local Budget Outlook	Silvia & Brown
August-23	Mexican GDP: Fooled by Outsized Expectations	Aleman
August-22	Is Abenomics Working?	Quinlan
August-20	North Carolina Economic Outlook	Vitner & Wolf
August-19	Fall Fiscal Policy Update: More Uncertainty Ahead	Silvia & Brown
August-16	Health Care Inflation and the Federal Budget	Bryson & Brown
August-07	Colorado Economic Outlook	Vitner & Silverman
August-07	Inflation Chartbook: August 2013	Bullard & Watt
August-05	Minnesota Economic Outlook	Vitner & Wolf
August-02	Housing Chartbook: July 2013	Vitner, Khan & Silverman
August-02	U.S. Job Growth and Average Wages	Bryson & Watt
July-26	Are Concerns About Increased Apartment Supply Overblown?	Silvia & Khan
July-24	Economic Western Round Up	Vitner, Wolf & Silverman
July-19	New Jersey Economic Outlook: July 2013	Vitner, Wolf & Silverman
July-19	Is India Still a BRIC?	Bryson
July-17	Fed Midyear Outlook: Breaking Up Is Hard to Do	Vitner
July-10	How Much Does Slower Chinese Growth Matter?	Bryson & Griffiths
July-09	FY 2014 State Budgets and Beyond	Silvia & Brown
July-08	Housing Data Wrap-Up: June 2013	Vitner, Khan & Silverman
June-28	Business Spending Midyear Outlook	Quinlan & Watt
June-28	Chile: Too Much of A Good Thing? Not Really!	Aleman
June-27	Georgia Economic Outlook	Vitner, Wolf & Silverman
June-17	Federal Budget Deficit Outlook	Silvia & Brown
June-14	Housing Chartbook: May 2013	Vitner, Khan & Silverman
June-13	Is a Lack of New Businesses Holding Back Hiring?	Silvia & Watt
June-03	Commercial Real Estate Chartbook: Quarter 1	Vitner, Khan & Silverman
June-03	Credit Trends: Easier Standards, Rising Demand	Silvia & Griffiths
May-31	Does Faster Growth in Canada Mean Rate Hikes?	Quinlan
May-28	The Structure of U.S. Capital Flows and the Dollar	Bryson, Bennenbroek & Griffiths
May-08	Florida Economic Outlook: May 2013	Vitner & Silverman
May-08	Inflation Chartbook: May 2013	Bullard & Watt
May-02	May Fiscal Policy Outlook: More Uncertainty Ahead	Silvia & Brown
May-02	Character of the Recovery VII: Sector and Employment Differences	Silvia & Iqbal
May-02	Effects of Fiscal Tightening on Consumption	Aleman & Brown
May-01	The Evolution of U.S. Manufacturing	Quinlan & Brown

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