Economic Outlook: Cyclical Recovery, Structural Challenges
Federal Reserve Bank of Atlanta Annual Banking Outlook Conference

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Where Are We Now?

Five benchmarks for good decision making

- Inflation
- Interest Rates
- Growth
- Profits
- The Dollar
Wells Fargo vs. Consensus

How do we differ from consensus?

Expectations for the Future

- Sustained below-trend growth
- Still cautious on the consumer
- Still cautious on housing
- State and local governments—still restructuring
- Employment—cyclical and structural change
What We Get Versus What We Expect

Sustained recovery in 2012, but still below historical experience

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

Slow cyclical recovery, but GDP has overtaken its prerecession peak

U.S. Business Cycles
Real GDP, Peak Indexed to 100

Quarters From Peak

Source: U.S. Department of Commerce and Wells Fargo Securities, LLC
The outlook for growth ahead remains in tact

Source: Wells Fargo Securities, LLC
Manufacturing: Cyclical

Large, Global Businesses: Moderate growth in manufacturing

Source: Institute for Supply Management and Wells Fargo Securities, LLC
Initial Unemployment Claims: Cyclical

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

Employment will eventually regain its peak, but not quickly

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

A much lower base to support spending

Source: U.S. Department of Labor and Wells Fargo Securities, LLC
Participation Rate Change
By Age Cohort, Percentage Point Change since January 2002

16-19: Jan @ -14.2
20-24: Jan @ -5.1
25-54: Jan @ -2.1
55-64: Jan @ 3.0
65 and older: Jan @ 5.1

Secular shifts in labor force participation

Source: U.S. Department of Labor and Wells Fargo Securities, LLC
Debt Service Ratio: Cyclical or Structural?

Debt service has returned to more sustainable levels

Source: Federal Reserve Board and Wells Fargo Securities, LLC
Real income has remained relatively flat over the past year, except for those with a college degree.
Increased lending is offering some support to consumer spending

Source: Federal Reserve Board and Wells Fargo Securities, LLC
Credit card delinquencies have declined below prerecession rates, reflecting improvement in consumers’ balance sheets.
Credit Standards: A New Equilibrium

Demand for loans has picked up, but credit standards are slightly tighter

**Standards**

Net Percentage of Banks Tightening Standards
Commercial and Industrial Loans

**Demand**

Net Percent of Banks Reporting Stronger Demand
Commercial and Industrial Loans

Source: Federal Reserve Board and Wells Fargo Securities, LLC
Banks are lending and helping to support business operations.

C&I Lending and Business Inventories
Year-over-Year Percent Change

Source: Federal Reserve Board and Wells Fargo Securities, LLC
Banks of all types are integral to business lending

Source: Federal Reserve Board and Wells Fargo Securities, LLC
Real Estate: Structural

Retrenchment in real estate lending continues

Real Estate Lending
By Commercial Banks, Year-over-Year Percent Change

Source: Federal Reserve Board and Wells Fargo Securities, LLC
The initial boost to margins from a low fed funds rate is fading
Corporate Credit

Issuance is strong, spreads are declining

**Issuance**

**Investment Grade Corporate Issuance**
4-Week Moving Average, Billions of USD

- **Issuance: Feb-17 @ $28.2 B**

**Spread**

**Investment Grade Corporate Spread**
Basis Points

- **IG Corporate Spread: Feb-17 @ 176 Bps**

Source: Wells Fargo Securities, LLC
Foreign Investment

Foreigners continue to invest heavily in Treasuries; recent uptick in agency debt to watch

Source: U.S. Department of the Treasury and Wells Fargo Securities, LLC
Housing Starts
Millions of Units

Structural Challenge:
What is the new sustainable pace?

Source: U.S. Department of Commerce and Wells Fargo Securities, LLC
Delinquencies are falling from all-time highs, but are still elevated by historic standards.

Source: Mortgage Bankers Association and Wells Fargo Securities, LLC
The high inventory of discounted existing homes has led to a large price premium for new homes.

Source: U.S. Department of Commerce, National Association of Realtors and Wells Fargo Securities, LLC
Secular Shift?
Households are living in smaller homes with more people since the recession, but longer-term trends may win out.

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

Source: U.S. Department of Commerce and Wells Fargo Securities, LLC
Inflation: Were the 1970s an Aberration?

Rising volatility for headline inflation as food and energy prices are increasingly dependent on global demand.

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

Inflation expectations are rising

10-Year Implied Inflation Expectations
10-Year Treasury Yield Less 10-Year TIPS Yield

Source: Federal Reserve Board and Wells Fargo Securities, LLC
Global Inflation: Structural

Moderating global inflation

Source: International Monetary Fund and Wells Fargo Securities, LLC
Inflation expectations exceed nominal returns. What is the real risk-free rate?

Source: Federal Reserve Board and Wells Fargo Securities, LLC
Risk remains elevated despite falling in recent weeks

Source: Federal Reserve Board and Wells Fargo Securities, LLC
Corporate Spreads: Positive for Issuance

Spreads have returned to a more normal level; bond issuance is strong

Aaa and Baa Corporate Bond Spreads
Over 10-Year Treasury, Basis Points

Source: Federal Reserve Board and Wells Fargo Securities, LLC
GDP & Interest Rates

Disconnect: cyclical or secular?

5-Year Treasury Yield and Nominal GDP

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

Uncertainty driven by the Eurozone debt crisis is keeping risk heightened

Source: Federal Reserve Board and Wells Fargo Securities, LLC
The global recovery is being driven by emerging markets.

Global Growth: Structural Shift?

GDP Growth Post-Recession
Average Annual Percent Change for 2010 and 2011

- United Kingdom: 1.2%
- Euro area: 1.7%
- Japan: 1.7%
- United States: 2.3%
- South Africa: 3.1%
- Russia: 4.1%
- Brazil: 5.6%
- Indonesia: 6.3%
- Turkey: 7.8%
- India: 9.0%
- China: 9.9%

Source: International Monetary Fund and Wells Fargo Securities, LLC
Difficult Choices: Structural

The nation has entered uncharted waters in fiscal policy.

Source: U.S. Department of Commerce, U.S. Department of the Treasury and Wells Fargo Securities, LLC
Difficult Choices: Structural Deficit

Even with the automatic budget stabilization measures, outlays are projected to run above revenues over the next decade.

Source: Congressional Budget Office and Wells Fargo Securities, LLC
State and local fiscal conditions will limit expenditures and will be a drag on GDP.

Source: U.S. Department of Commerce and Wells Fargo Securities, LLC
What are the primary risks to the outlook?

- Easier monetary policy brings questions for the dollar, inflation, interest rate and outlook.
- Stronger job recovery takes hold.
- Fiscal policy: spending completely unconstrained.
- Housing: unable to sustain growth on its own.
- European debt crisis weighs on global growth.
- Rising oil and gasoline prices drag down real consumption.
## Outlook Summary

### Wells Fargo U.S. Economic Outlook

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<th>Actual</th>
<th>Forecast</th>
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<tr>
<td></td>
<td>2008</td>
<td>2009</td>
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<tr>
<td>Real Gross Domestic Product&lt;sup&gt;1&lt;/sup&gt;</td>
<td>-0.4</td>
<td>-3.6</td>
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<td>Personal Consumption</td>
<td>-0.7</td>
<td>-2.0</td>
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<td>Equipment and Software</td>
<td>-4.1</td>
<td>-16.3</td>
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<tr>
<td>Government Purchases</td>
<td>2.5</td>
<td>1.7</td>
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<tr>
<td>Consumer Price Index&lt;sup&gt;2&lt;/sup&gt;</td>
<td>3.8</td>
<td>-0.3</td>
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<tr>
<td>Corporate Profits Before Taxes&lt;sup&gt;2&lt;/sup&gt;</td>
<td>-16.4</td>
<td>9.1</td>
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<td>10-Year Treasury Note</td>
<td>3.66</td>
<td>3.26</td>
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Forecast as of: February 24, 2012

1. Compound Annual Growth Rate Quarter-over-Quarter
2. Year-over-Year Percentage Change

Source: U.S. Department of Commerce, U.S. Department of Labor, Federal Reserve Board and Wells Fargo Securities, LLC
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A Sampling of Our Recent Special, Regional & Industry Commentary

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