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Economics Group

Special Commentary

Mark Vitner, Senior Economist
mark.vitner@wellsfargo.com • (704) 410-3277

A Rising Global Economy Supports Bay Area Growth

This past year saw a significant revival of the global economy take hold. For the first time in over a decade, all 35 OECD countries saw real GDP grow. The improvement has helped revive commodity prices and is allowing central banks in most major economies to either begin or begin to contemplate winding down their extraordinary stimulus policies, which is pushing interest rates higher. The major reforms to the U.S. tax system are also rippling through economies around the world. A large and growing number of companies have announced plans to repatriate billions of dollars in profits that had been parked overseas while the United States maintained the highest corporate rate in the world. Many firms have also announced plans to pay bonuses to their workers and significantly increase capital spending. With monetary and fiscal policy in flux, the Year of the Dog promises to be a much different year for the global economy and local economies tied to it.

The larger metropolitan areas along the West Coast have generally enjoyed a stronger recovery than the nation as a whole. The San Francisco Bay Area has consistently ranked among the nation's fastest growing metro areas, led by the continued expansion of the tech sector. San Francisco's economy averaged 4.8 percent real GDP growth from 2011-2016 and real GDP rose 5.4 percent in 2016, which is the latest year available. The only major metro area to grow faster was neighboring San Jose, which grew 5.9 percent. All this growth has created some strains, however. Traffic congestion has worsened and the region's already high housing costs have been pushed even higher.

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We believe growth remained strong this past year. California's year-to-year real GDP growth averaged 2.6 percent through the Q3-2017, which is a half a percentage point less than it was a year earlier but still well ahead of the nation as a whole. Growth has shifted within California, as the rising cost of living and increased traffic congestion have reignited the affordability migration back toward California's interior. Within the Bay Area, hiring momentum has shifted more toward Oakland and other East Bay communities. The Central Valley has also seen growth perk back up.

Figure 1

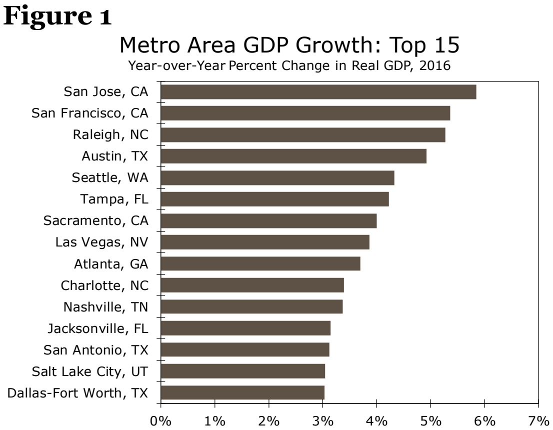
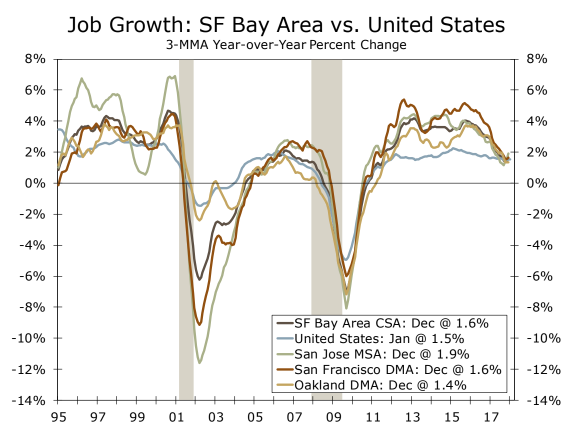


Figure 2



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

Together we'll go far

Labor Markets Tightened Even Further in 2017

Labor markets along the West Coast tightened considerably during 2017. Strong economic growth coupled with the rising cost of living has reduced the inflow of job seekers into many rapidly growing areas. The unemployment rate in the San Francisco-Redwood City-South San Francisco metropolitan division fell 0.6 percentage points over the past year to 2.2 percent in December 2017. San Rafael saw a similar drop and ended the year with a 2.3 percent unemployment rate, while the Oakland-Hayward-Berkeley metropolitan division also fell over the year to 3.0 percent.

Many Bay area firms are actively looking to expand in other parts of California or other parts of the country.

We noted last year that, with labor markets tightening, job growth was set to moderate across the Bay Area. Many Bay Area firms are actively looking to expand in other parts of California or other parts of the country where housing costs are lower, commute times are less and employees can be hired at considerably lower wages. The shift is apparent in the most recent data, which show slower overall employment growth, particularly for mid-skilled positions and many lower paying occupations. This is also apparent in Southern California and Seattle as well.

Employers added just 22,400 jobs in the San Francisco metropolitan division during 2017, down from 43,800 the prior year. The Oakland area saw a similar slowing, with 20,800 net new jobs added in 2017, down from 35,800 the prior year. The San Jose-Sunnyvale-Santa Clara metropolitan area added just 17,900 jobs this past year, after adding 31,900 jobs in 2016. Hiring also moderated in Los Angeles and Orange County but held up much better in the Inland Empire.

Tax reform is likely to set off a capital spending boom that should be good news for many tech and aerospace companies.

The coming year will bring many opportunities and challenges. Tax reform is likely to set off a capital spending boom that should be good news for many tech and aerospace companies. Stronger economic growth overseas coupled with the lower dollar should also bolster exporters. We expect the trade deficit to worsen in the near term, however, as stronger U.S. economic growth pulls in more imports. Growing trade volumes should be good news for the nation's top export markets. Houston has recently retaken the No. 1 spot among major metropolitan export markets. The rebound in oil prices and resurgence in petrochemical production are driving the improvement. Los Angeles, Seattle and San Francisco are also poised to benefit from stronger global growth.

The biggest challenge for many businesses this year will be finding the skilled workers they need. Unemployment rates have tumbled across the country but are particularly low in rapidly growing tech centers like San Jose, San Francisco and Seattle. Moreover, in-migration has slowed, as fewer job seekers are relocating. Tightening labor markets are pushing wages higher, which will affect profit margins and likely spur more firms to substitute capital for labor. While challenges have increased, the Bay area and most of the larger metro areas along the West Coast should see another strong year of economic gains. Overall job growth will moderate further but should still keep pace with the nation as a whole. Job gains should continue to be broadly based and some of the exceptionally strong growth that has been centered in the Bay area, Seattle and Los Angeles will find its way to other part of country that still have some idle capacity available.

Figure 3

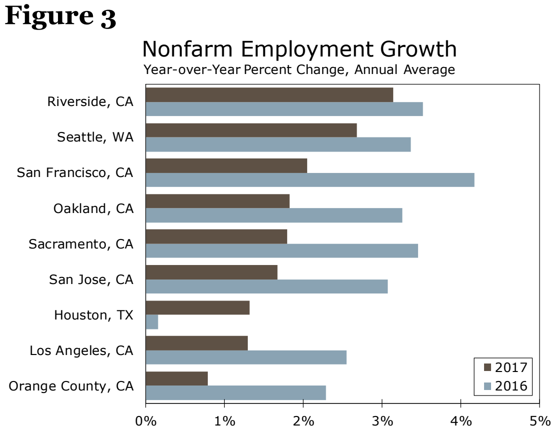
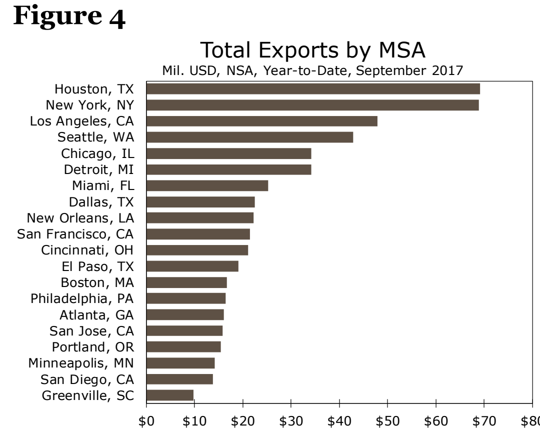


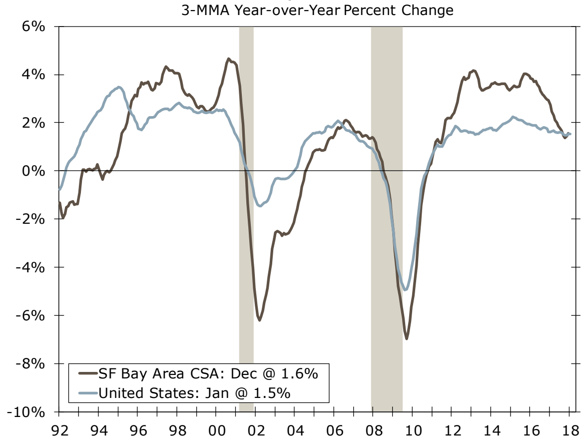
Figure 4



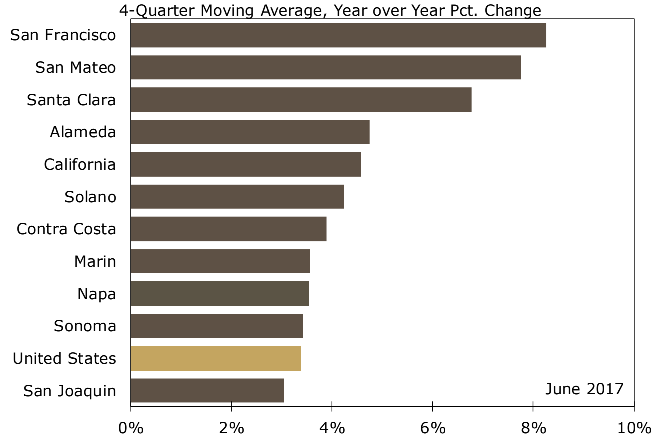
Source: U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities

San Francisco Bay Area Economic Conditions

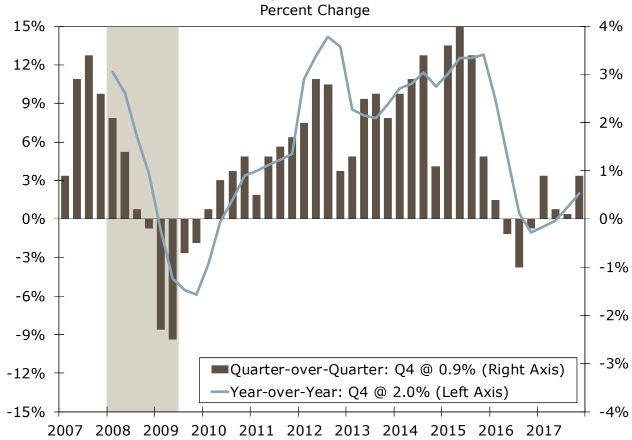
Job Growth: SF Bay Area vs. United States
3-MMA Year-over-Year Percent Change



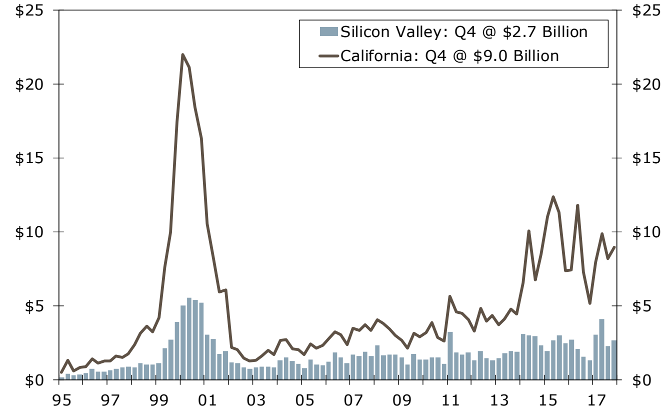
Average Weekly Wage Growth by County
4-Quarter Moving Average, Year over Year Pct. Change



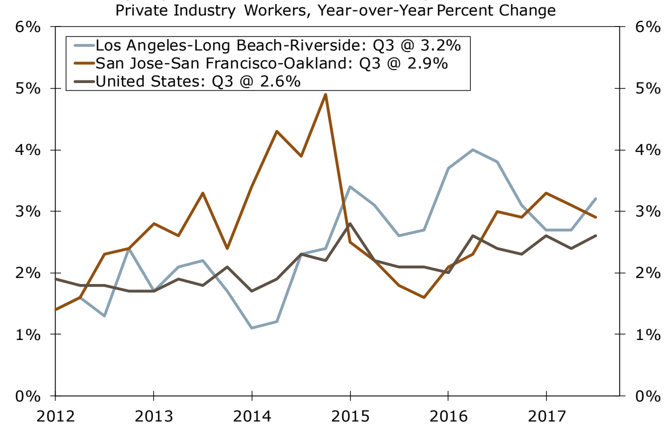
San Francisco Apartment Effective Rent
Percent Change



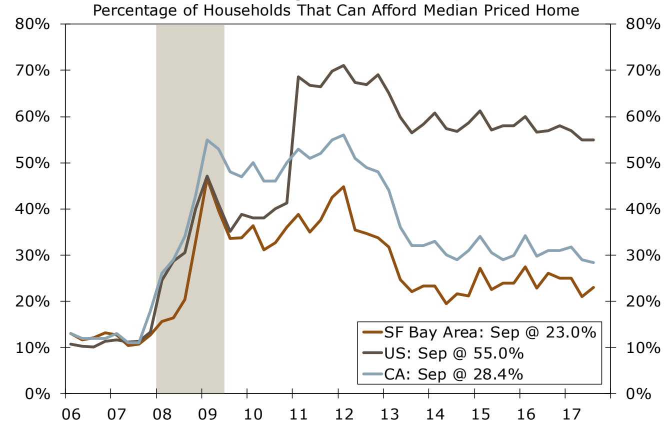
California Venture Capital
In Billions of Dollars



Employment Cost Index: Wages & Salaries
Private Industry Workers, Year-over-Year Percent Change



Housing Affordability
Percentage of Households That Can Afford Median Priced Home



Source: CAR, PwC/MoneyTree, Reis, Inc., U.S. Dept. of Labor and Wells Fargo Securities

Wells Fargo Securities Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Jamie Feik	Economist	(704) 410-3291	jamie.feik@wellsfargo.com
Erik Nelson	Currency Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
Harry Pershing	Economic Analyst	(704) 410-3034	harry.pershing@wellsfargo.com
Hank Carmichael	Economic Analyst	(704) 410-3059	john.h.carmichael@wellsfargo.com
Ariana Vaisey	Economic Analyst	(704) 410-1309	ariana.b.vaisey@wellsfargo.com
Abigail Kinnaman	Economic Analyst	(704) 410-1570	abigail.kinnaman@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

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