

Regional Commentary — January 21, 2021

North Carolina Is Well-Positioned to Move Past COVID

Summary

North Carolina's economy is well-positioned to thrive once the COVID pandemic is behind us. In this report, we review this past year's run of strong economic development and assess the prospects for the coming year. While manufacturing appears to have strong momentum, high-contact areas of the economy will not recover in a meaningful way until the COVID pandemic recedes. With the passage of the second stimulus act, we have slightly increased our 2021 economic forecast.

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Despite an Inauspicious Start, 2021 Will Be a Better Year

After an extraordinarily challenging year, the arrival of 2021 was anxiously anticipated. The new year, however, began much as the prior year ended, with concerns about a troubling resurgence in COVID infections causing consumers and businesses to pull back from high-contact activities, and state and local governments reinstating lockdowns as well as operating restrictions. The hangover from the presidential election also carried over into 2021. While some uncertainty cleared up with the results of the Georgia Senate runoffs, the disturbing events at the Capitol on January 6 quickly followed. Our forecast now includes the likelihood of more stimulus, yet the vaccine rollout is also likely to be more drawn out and mutations to the COVID virus add a little more uncertainty. Through all of this, the 2021 U.S. economic outlook remains promising, with real GDP expected to rise 4.6% and the unemployment rate falling to 6.2%.

North Carolinians were just as eager for the new year to begin as the rest of the country. COVID surged in December and Governor Cooper reinstated operating restrictions on restaurants and bars and brought back a 10 p.m. curfew. Economic engagement had already pulled back, however, with restaurant dining, small business operating hours and employment all declining from their mid-November levels. We expect 2021 to get off to a relatively sluggish start, as consumers spend more time at home and high-contact businesses hunker down for an extended slow period. While the year will start off lethargically, we expect the recovery to gain strength over the course of the year.

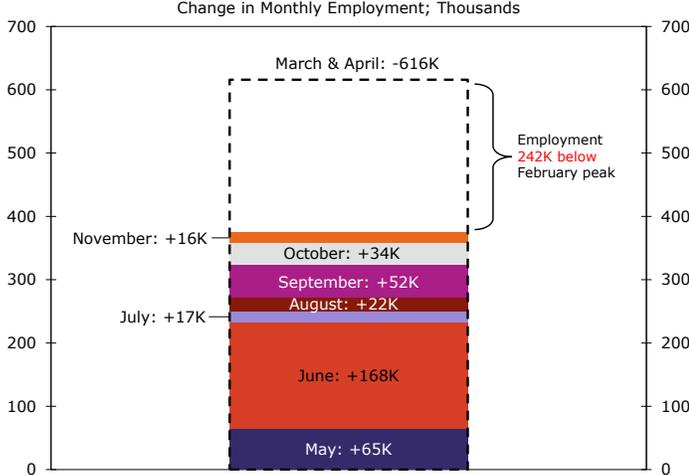
North Carolina Is Well-Positioned

North Carolina's economy is well-positioned to thrive once the COVID pandemic is behind us. Even during the worst of the pandemic, several businesses announced major relocations and expansions throughout the state. Net migration also remained solidly positive, and the state has also seen a large influx of temporary residents and remote workers. Employment has recovered a significant portion of the jobs lost during last spring's lockdowns in professional occupations, manufacturing, construction, logistics and warehousing and even some parts of retailing. Many employers are offering hiring bonuses to secure new workers. The same cannot be said about high-contact services, particularly the leisure & hospitality industry. While the industry had been on the mend, adding back close to 58% of the 269,000 jobs lost in March and April, the recent spike in COVID infections caused consumers to venture out less often, and we expect to see net job losses in both December and January.

The 2021 U.S. economic outlook remains promising, with real GDP expected to rise 4.6%.

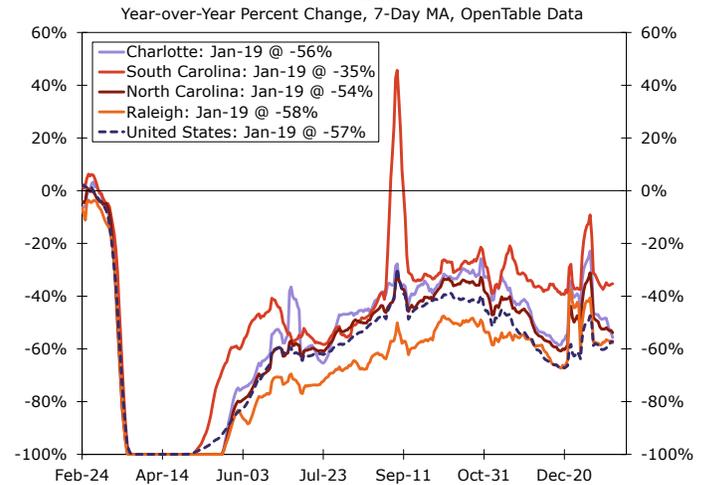
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Tracking the North Carolina Recovery



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

Seated Diners



Source: OpenTable and Wells Fargo Securities

Restaurants Are Struggling, but Other Industries Are Clearly Recovering

The economy that emerges from a recession typically differs greatly from the one that preceded it. Emerging trends evident at the end of the last cycle tend to be amplified and accelerated. Conversely, areas of the economy that were in decline tend to see the pace of that decline accelerate. Recessions brought about by unforeseen, exogenous shocks also tend to bring about significant changes in societal norms, business practices and the role of government. Our experience with COVID clearly shows this to be true. Prior to the recession, we were beginning to see the benefits of North Carolina's strong economic growth spread beyond Raleigh and Charlotte. This trend has become much more apparent during the pandemic, as the accelerated shift to online shopping and manufacturing reshoring fueled warehouse and industrial development. While Raleigh and Charlotte have seen their share of development, some of the largest projects have been in the Triad, Hickory and many of the state's other mid-sized metro areas.

Manufacturing has clearly been a bright spot, but rebounded more slowly in North Carolina this past year. While manufacturers slashed jobs at the onset of the recession, the rapid depletion of inventories and disruptions to supply chains sowed the seeds for a speedy recovery. Manufacturers cut 1,363,000 jobs nationwide in March and April, then regained 40% of those jobs as factories re-opened in May and June. North Carolina mirrored this trend, with manufacturers eliminating 53,700 jobs in March and April before hiring back just over one-third of those workers the following two months.

The larger swing in the national numbers reflects the more immediate bounce back at large motor vehicle assembly plants, which North Carolina does not have. North Carolina manufacturing still posted substantial gains. Efforts to secure personal protection equipment (PPE) provided an early offset to some of the state's textile producers. Poultry, pork and beef processing plants also ramped up output to meet strong demand from grocery chains, as did producers of paper products and other consumer products. The furniture industry also got a boost, as consumers updated their homes to incorporate remote work, remote learning and home entertainment.

North Carolina Continues to Attract New Industry

While manufacturing employment has rebounded slower than overall payrolls, the state continues to see a steady inflow of capital investment. North Carolina consistently ranks as one of the best states for manufacturers, and maintains several key comparative advantages, including a large highly-skilled workforce, a central location that enables producers to reach key markets in the South, Northeast and Midwest, low corporate tax rates and a culture where business, government and labor often work together rather than against one another.

Manufacturing employment was gradually edging higher prior to the pandemic, after having declined for the prior 15 years. The modest uptick largely reflects an influx of higher-value-added, capital-intensive manufacturers and a continued decline in low-value-added, labor-intensive firms. The new mix largely favored the state's larger metropolitan areas, which have a deeper pool of skilled workers and more job training resources. The mix of manufacturers expanding in the state began to shift around the middle of the past decade, as concerns increased about the resiliency of supply chains, rising shipping costs and a diminishing labor-cost differential with emerging nations. The bulk of these reshoring firms are located in parts of the state with a rich manufacturing legacy, including the Piedmont Triad, Hickory and other smaller towns and mid-sized metro areas.

Businesses and New Residents Continue to Flow Into the State

The bulk of manufacturing operations reshored this past decade were relatively small wins. In addition to a flurry of textile firms shifting to produce PPE, a number of furniture companies opened plants to assemble foreign-made components into furniture or furniture kits for sale via online merchants. As the decade progressed, however, investment shifted toward larger factories, and the pandemic-driven furniture boom has fueled additional new investment. Some of the more notable expansions this past year include Craftmaster Furniture, which opened a new facility in Lenoir this past fall, which should create 100 jobs by the end of 2021, and Prepac Manufacturing, which is investing \$27 million to build a new furniture factory outside Greensboro that will create 200 jobs.

Companies are also increasingly consolidating headquarters and sales operations closer to their factories. Sedia Systems, a manufacturer of lecture hall and auditorium furniture, recently announced plans to consolidate its Chicago headquarters and North Carolina operations into a 60,000-square-foot building in Asheboro. Burkle North America, which makes laminating equipment for the furniture,

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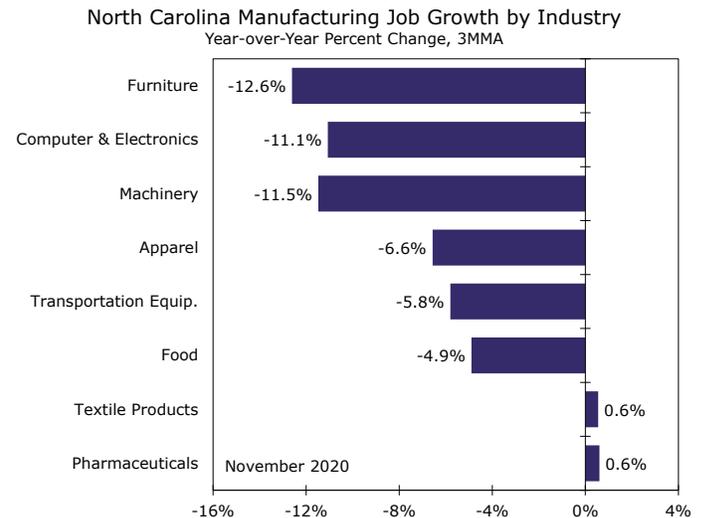
Companies are increasingly consolidating headquarters and sales operations closer to their factories.

flooring, circuit board and several other markets, is moving its headquarters from Southern California to Greensboro so that it can be closer to its factories.

Bioscience and pharmaceuticals, particularly firms harnessing gene-editing technologies, is another rapidly growing industry. The bulk of these new projects have been in and around Research Triangle Park (RTP), which has deep roots in this industry and possesses a rich ecosystem, as well as a deep pool of skilled workers. Pfizer, which maintains gene-editing research facilities in Chapel Hill and Morrisville, announced a \$500 million expansion of its state-of-the-art gene-therapy plant in Sanford. Other gene-therapy projects include San Francisco-based Audentes Therapeutics, which is investing \$109.4 million to build a new gene-therapy manufacturing facility that will ultimately employ 200 workers, also in Sanford; and Beam Therapeutics, Taysha Gene Therapies, and Adverum; all of which are building new manufacturing facilities in Durham. These three projects alone reflect a combined investment \$200 million and are expected to create 600 jobs. Durham and RTP look to be a key hub for gene-editing firms, both for R&D and manufacturing.



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



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

There is an exhaustive list of expansions in the pharmaceutical industry that should fuel growth for years to come. One of the most consequential is Eli Lilly, which is investing \$474 million to build a manufacturing complex in RTP to make diabetes drugs, creating 460 new jobs. There were also a few notable deals outside RTP, including Thermo Fisher Scientific’s \$500 million expansion of its massive Greenville manufacturing complex, which will create 500 new jobs; and Grifols, which announced a \$351.6 million expansion of its plasma-derived medicines plant in Clayton that should create another 300 jobs.

One of this past year’s largest manufacturing announcements came from Pratt & Whitney, which is investing \$650 million to build a one-million-square foot facility to produce a new high-tech turbine airfoil in Asheville and ultimately create 800 jobs. Another major project is Nestle Purina Pet Care’s \$450 million investment in Eden, which will rework the former MillerCoors Brewery into a technologically advanced pet food manufacturing facility and create 300 jobs.

Economic Growth Should Ramp up Once the Country Moves Past COVID

While a strengthening manufacturing sector is building more around advanced manufacturing, life sciences and reinvigorated traditional industries will provide a strong tailwind to North Carolina’s economy in coming years. The state also continues to see a huge influx of investment in professional services, finance and other rapidly growing areas of the tech sector, including fintech, data analytics, digital entertainment and telecommunications. Charlotte and Raleigh continue to attract corporate and regional headquarters from other parts of the country and are also growing their own businesses. Centene, a managed care provider and specialty insurer, is investing more than \$1 billion to build an East Coast Headquarters and Technology Center in Charlotte’s University Research Park. The one-million-square foot campus is expected to host at least 3,200 workers as it is built out over the next decade. Other notable expansions include Raleigh-based Bandwidth, which announced a major

Life sciences and reinvigorated traditional industries will provide a strong tailwind to North Carolina’s economy in coming years.

expansion this past year that will include a new corporate campus and 1,165 new jobs, and Epic Games, which recently announced it would purchase the Cary Town Center and redevelop it into its new corporate headquarters campus.

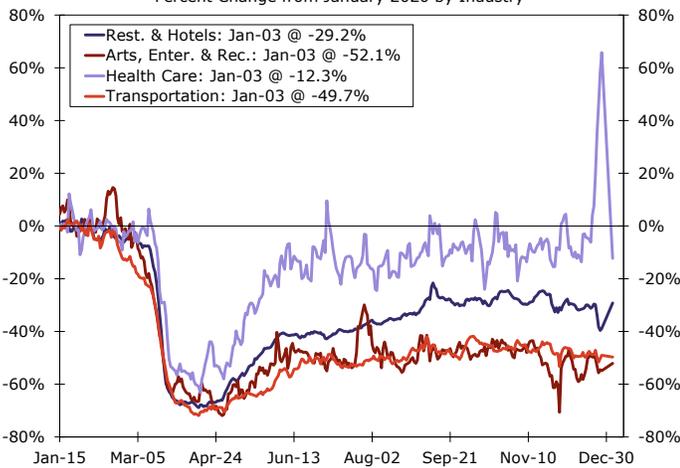
The slew of capital project announcements the state saw in the midst of the pandemic offers important clues about how North Carolina’s economy is likely to perform once the country moves past COVID. The bulk of this investment has been in advanced manufacturing and professional services, both of which should strengthen. Overall employment, however, will recover more slowly. Nonfarm employment remains 5.2% below its pre-pandemic level, with just over 60% of the 241,500 missing jobs in high-contact parts of the economy, most notably restaurants, bars, hotels, entertainment venues, barber shops and hair salons, fitness centers and a myriad of other household and personal services.

The bulk of capital investment has been in advanced manufacturing and professional services.

The recovery in high-contact areas of North Carolina’s economy will take longer to take hold. Substantially more success at combating the COVID pandemic will need to be achieved before enough consumers feel safe enough to venture out again in order for businesses to feel they can safely and profitably re-open. Here too, the state appears to be at a key pivot point. The pace of new COVID infections appears to have peaked in mid-January, while the pace of vaccinations is ramping up. After enduring a lull in January and February, we expect economic activity to ramp back up this spring and summer, helped along by another round of stimulus payments.

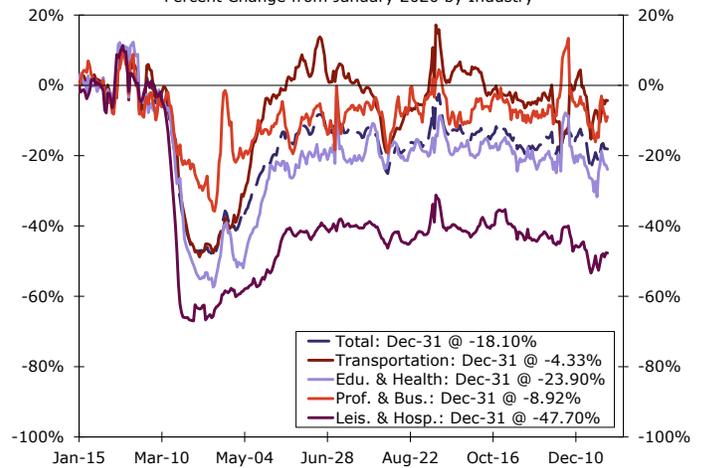
Even prior to the pandemic, there had been a notable shift toward fast casual restaurants and this category of restaurant held up better during the pandemic. Full-service restaurants were hit the hardest, particularly independently run restaurants, which often lacked the capital to purchase and install all the necessary safety equipment. Hotels have also been hit particularly hard, as business travel ground to a halt and leisure travel slowed and shifted more toward short-term rentals. The trend is most apparent in parts of the state traditionally favored by seasonal residents, such as the mountains and the coast. Business travel should slowly begin to recover later this year, while leisure travel should rebound somewhat faster.

North Carolina Consumer Spending
Percent Change from January 2020 by Industry



Source: Opportunity Insights and Wells Fargo Securities

North Carolina Small Business Revenue
Percent Change from January 2020 by Industry



Source: Opportunity Insights and Wells Fargo Securities

The Recovery Is Taking Shape

We have made some slight adjustments to our 2021 forecast. The passage of the second stimulus act and intentions to implement additional stimulus by President Biden should lift consumer spending a little more robustly once consumers feel safe to re-engage in their day-to-day activity and businesses more fully re-open. North Carolina’s economy is expected to quickly regain its place as one of the nation’s fastest growing states, led by the influx of new businesses, new residents and resurgence in traditional sectors.

North Carolina Economic Outlook

	Actual			Forecast		
	2017	2018	2019	2020	2021	2022
Real Gross Domestic Product by State, \$ Millions	489,027	501,955	511,540	496,980	522,823	547,918
Annual Rate	2.4%	2.6%	1.9%	-2.8%	5.2%	4.8%
Nominal Personal Income, \$ Millions	455,997	479,792	500,974	532,560	563,500	588,500
Percent Change	4.9%	5.2%	4.4%	6.3%	5.8%	4.4%
Median Household Income, Year-End \$	51,674	54,336	61,159	65,225	63,725	63,965
Percent Change	1.5%	5.2%	12.6%	6.6%	-2.3%	0.4%
Population, Thousands	10,276	10,391	10,501	10,590	10,720	10,845
Change in Thousands	114	116	110	89	130	125
Percent Change	1.1%	1.1%	1.1%	0.8%	1.2%	1.2%
Nonfarm Employment, Thousands	4,407	4,488	4,574	4,334	4,510	4,670
Change in Thousands	72	82	86	-240	176	160
Percent Change	1.7%	1.9%	1.9%	-5.3%	4.1%	3.5%
Unemployment Rate, Annual Average	4.5%	4.0%	3.9%	7.2%	5.5%	4.8%
Total Housing Permits	65,009	68,375	68,674	72,000	74,000	75,000
Single-Family Permits	46,500	48,071	49,237	55,000	58,500	59,000
Multi-Family Permits	18,509	20,304	19,437	17,000	15,500	16,000
FHFA Home Price Index, Percent Change	5.6%	6.6%	5.8%	5.4%	5.9%	5.8%

Forecast as of: January 21, 2020

Source: National Association of Realtors, Federal Housing Finance Authority, U.S. Departments of Commerce and Labor, Moody's Analytics, RL Polk and Wells Fargo Securities

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