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Economics Group

Special Commentary

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Western Economic Outlook: August 2018

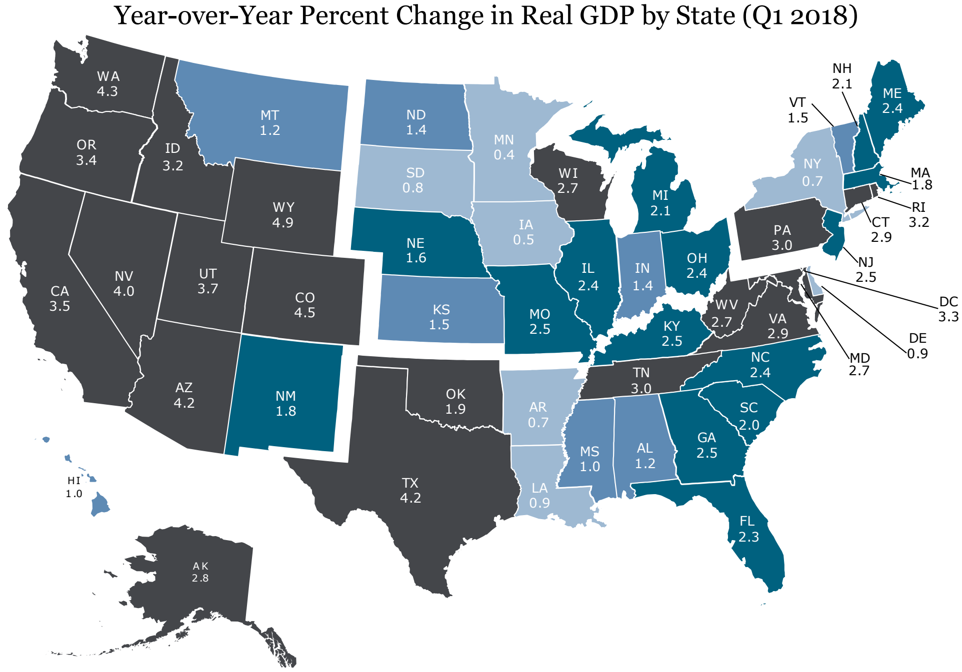
Growth Remains Exceptionally Strong in the West

The West's economy continues to outpace the rest of the country. Real GDP in the region grew 3.6 percent on a year-to-year basis in the first quarter, well ahead of the nation as a whole, which saw a 2.6 percent increase. Strong economic growth has become a familiar story and current economic conditions continue to be favorable for most Western states. On a year-to-year basis, real GDP growth in all but three of the thirteen states outpaced the national rate. Further, economic growth accelerated during the first quarter in the vast majority of Western states, and employment data for the more recent months suggest that growth has remained strong throughout the summer.

Western state economies continue to outpace the nation, led by tech, construction and energy.

The region's primary economic drivers continue to perform well. The tech sector continues to expand and draw in scores of young, educated workers to a whole host of Western metro areas. Construction is also booming thanks to a bevy of new residential and commercial projects underway to keep pace with all the new and expanding businesses and new residents. Commodity prices have also turned around, which was the one area that had been a bit of a drag for the region. In addition, the budget deal enacted earlier this year will boost defense spending, helping a number of regions. Agriculture is also having a very good year, but ongoing trade tensions will curb exports, restraining prices and incomes. Labor is also increasingly in short supply, lifting operating costs.

Figure 1
Year-over-Year Percent Change in Real GDP by State (Q1 2018)



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

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Employment growth also continues to exhibit exceptional strength. Labor market conditions are tracked on a more current basis, and the latest employment data suggest that the strong economic expansion in the region should continue. Employment growth in the West leads all other regions, expanding 2.5 percent on a year-over-year basis in July. Growth has continued to broaden, with every major industry posting gains over the past 12 months.

The tech sector continues to propel the West, but affordability is a concern.

The tech sector continues to propel the West, adding jobs and attracting new residents. Deteriorating affordability in several traditional tech centers, including Southern California, the San Francisco Bay area, Seattle and Denver, however, has caused firms to seek out more affordable locations. Utah is one beneficiary, as proximity to Silicon Valley, an educated talent pool and lower real estate costs have spurred development of the "Silicon Slopes" cloud-computing cluster around Salt Lake City. Relocating and expanding tech firms have also bolstered demand new demand for warehouse, distribution facilities and data centers in Nevada and brought diversity to that state's economy. Phoenix and Tucson are also seeing an influx of new investment.

The natural resources and mining sector appears to have regained its footing. Employment in the sector bottomed out in September 2016, following the collapse in oil prices. Higher commodity prices have led to a surge in energy production. Wyoming's 4.9 percent year-over-year real GDP growth not only topped all Western states, but was also the fastest growth in the country. Despite the improvement, employment in the West's natural resource sector has only regained roughly 25 percent of the jobs lost during the 2016 downturn as the industry focuses on efficiency.

Commercial and residential development continues to pick up across much of the West. Population growth has outpaced home building in many tech-driven markets, however, pushing home prices sharply higher and boosting development in more affordable parts of the West, such as the Inland Empire, Las Vegas and Phoenix. Apartment construction remains at a high level in the region's larger and more densely populated areas, including Los Angeles, San Francisco and Seattle.

Growth should remain strong, but we expect it to moderate as rising home prices and slowing immigration weigh on the region's outlook.

Western states should benefit from the recent passage of a new federal budget. The law removes the caps on defense and nondefense spending imposed by the Budget Control Act. Hawaii, New Mexico and Alaska receive a disproportionate amount of federal dollars compared to other states, receiving federal funds in excess of 10 percent of their respective state GDPs. Washington and Arizona are also home to many military bases and defense contractors.

While the outlook for the West remains bright, we expect growth to moderate relative to the rest of the country. Higher housing costs are crowding out growth in many of the region's fastest growing areas, leading many tech firms to relocate or expand in more affordable areas of the country. Amazon's search for a second headquarters is the greatest example of this but many others firms are also expanding or looking to expand outside the region. Slower immigration is another limiting factor for the West, negatively impacting agriculture, construction and the hospitality sector.

Figure 2

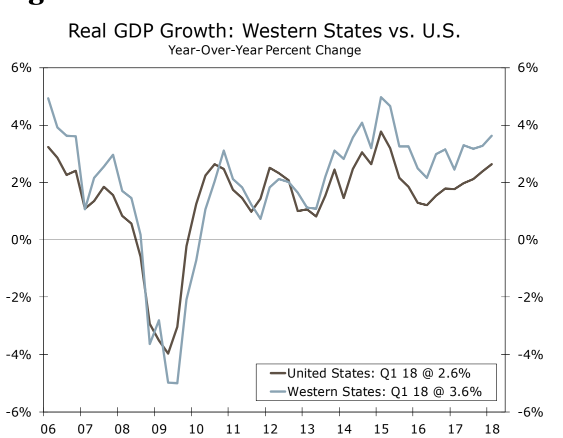
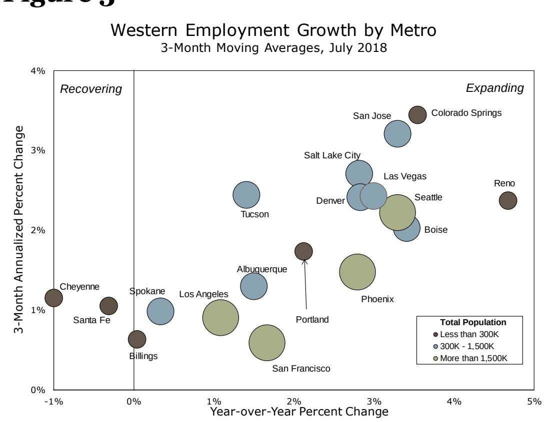


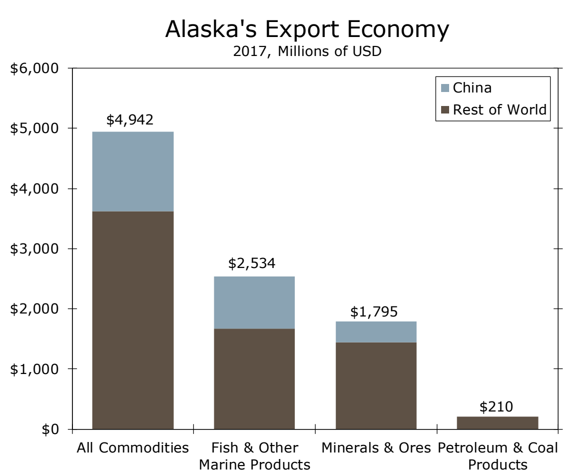
Figure 3

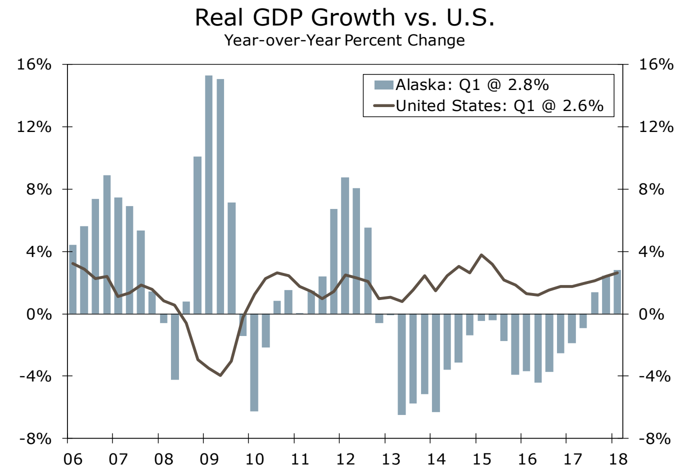


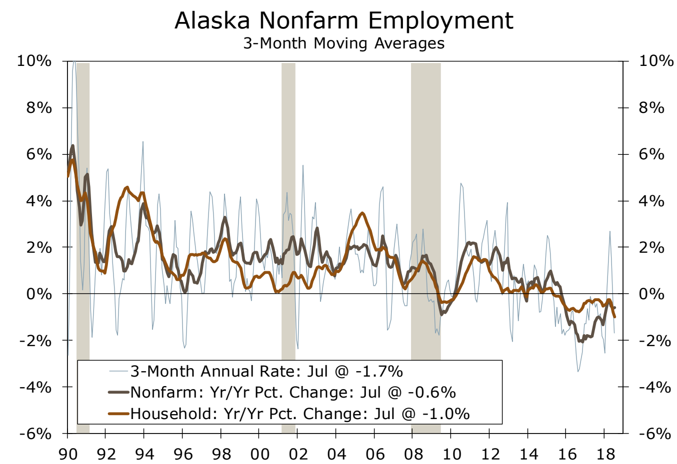
Source: U.S. Department of Commerce, Zillow Real Estate Research and Wells Fargo Securities

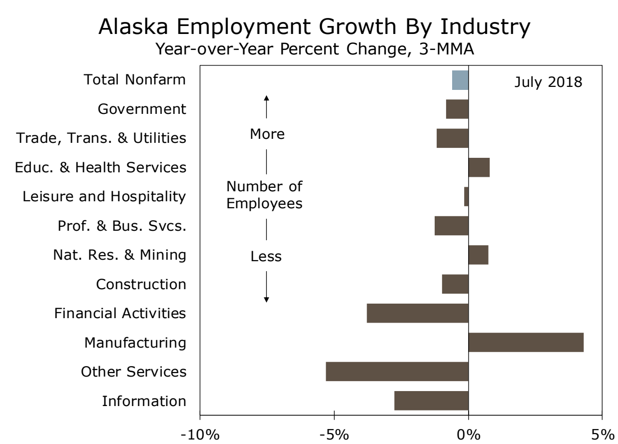
Alaska

- Alaska's economy appears to be climbing out of the hole left by the oil rout. After several years of declines, real GDP growth turned positive in the second half of 2017 before accelerating to a pace slightly exceeding the nation in Q1 of 2018. The upshift is mostly due to the recovery in energy sector output. Transportation and warehousing has also improved.
- Employment growth remains weak. Job losses are moderating, however, with payrolls down just 0.6 percent from July of last year. Hiring in the energy sector has picked up, while manufacturing and construction are also showing promising trends. Despite trending lower, Alaska's unemployment rate is still the highest of any state at 6.9 percent.
- A pull-back in oil production sent shockwaves through Alaska's economy in 2014. Oil production accounts for over 24 percent of the state's GDP. Production has rebounded, as oil prices have risen. New lands have also been opened for exploration, which may pull in additional investment. In terms of employment, however, the sector remains a shadow of its former self, as the industry remains focused on boosting efficiency and controlling costs.
- Trade tensions are looming large over Alaska's seafood industry. China is the state's top trading partner. Not only is China a primary consumer of Alaskan seafood but it is also a major processing hub. In 2017, over half of state exports were fish and other marine products.







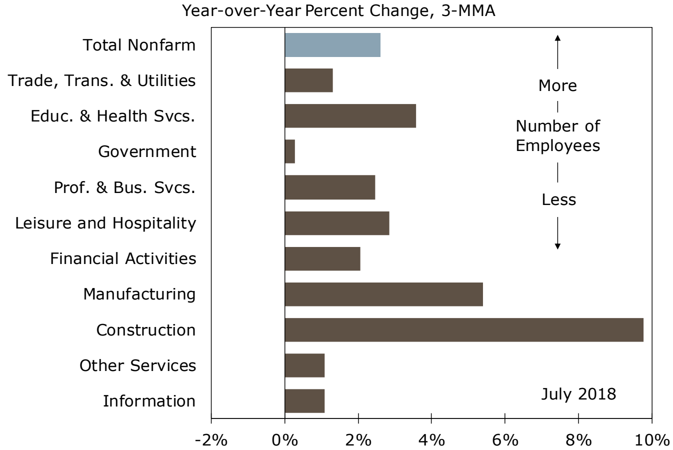


Source: U.S. Dept. of Labor, U.S. Dept. of Commerce and Wells Fargo Securities

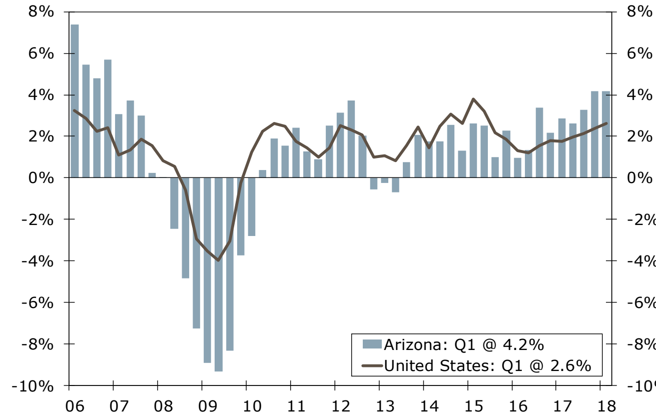
Arizona

- Arizona's economy started off the year on a high note, growing 4.2 percent year-over-year in Q1. Real GDP growth has now outpaced the nation for the past year and a half. Growth has been broad based, with nearly every sector posting gains. The breadth suggests the recent improvement in Arizona's economy should prove lasting.
- Hiring also continues to be exceptionally strong, with year-to-year employment growth reaching at 4.6 percent, higher than the U.S. rate, which may indicate Arizona still has some slack in its labor force to accommodate growth.
- Arizona's large and growing retiree base continues to drive growth in the health services sector. Construction employment has also strengthened, as homebuilding continues to improve alongside rapid in-migration.
- One of Arizona's key attractions is the relatively affordable cost of living, particularly relative to nearby California and Colorado. Strong employment growth has bolstered home sales and pulled prices higher. The latest data show prices rising 7.4 percent over the past year.
- The new budget deal, which lifts the caps on defense spending, will benefit the state's economy over the next few years. Arizona has long been a top recipient of defense dollars, which not only go towards the state's numerous military installations but also to the state's many defense contractors and manufacturers.

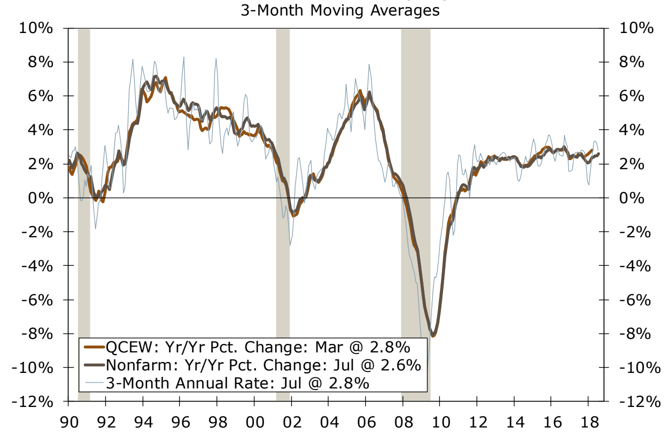
Arizona Employment Growth By Industry
Year-over-Year Percent Change, 3-MMA



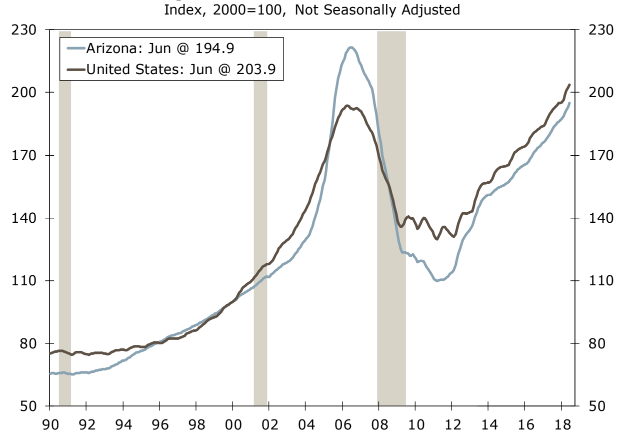
Arizona Real GDP Growth vs. U.S.
Year-over-Year Percent Change



Arizona Nonfarm Employment
3-Month Moving Averages



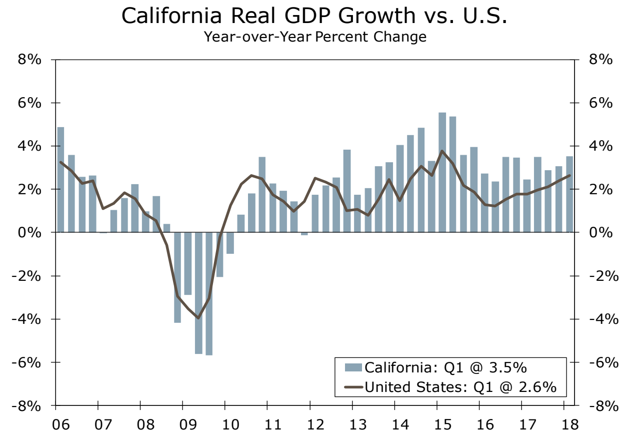
CoreLogic Home Price Index: AZ vs. US
Index, 2000=100, Not Seasonally Adjusted

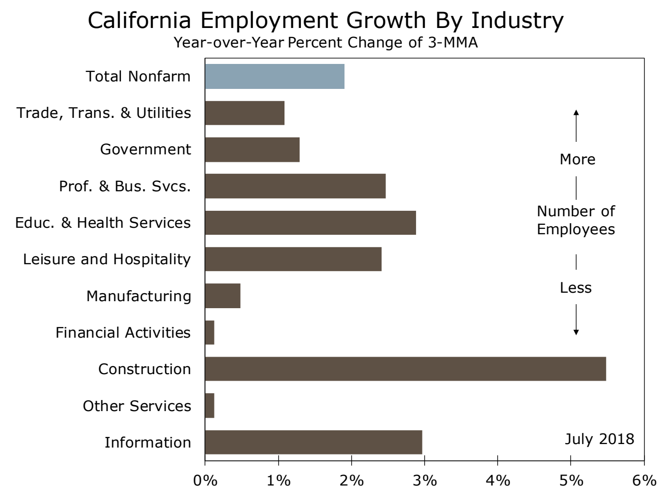


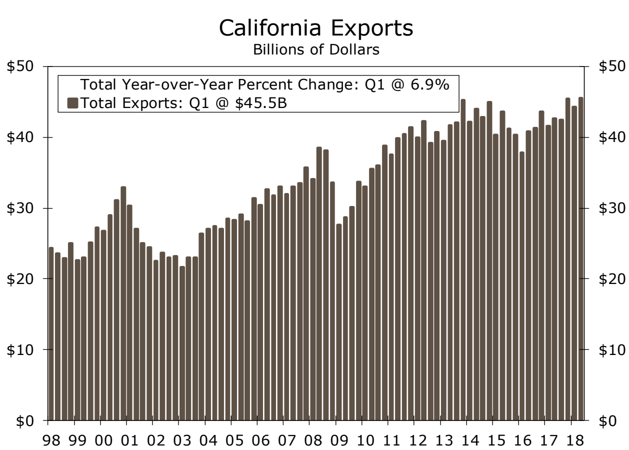
Source: U.S. Dept. of Labor, U.S. Dept. of Commerce and Wells Fargo Securities

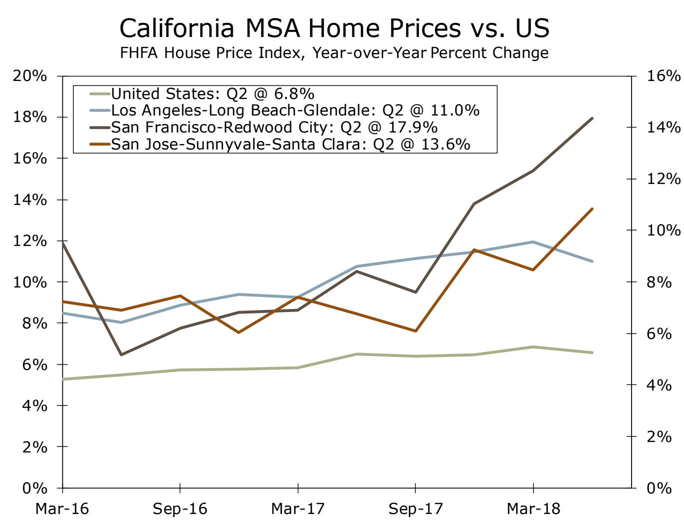
California

- The California economy continues to outperform the rest of the nation. Real GDP grew 3.5 percent on a year-to-year basis in Q1 and has now outpaced the country as a whole for nearly six years. While the tech sector remains the primary driver of growth, most other major industries are performing well.
- Employment growth has been more modest over the past year, with nonfarm payrolls rising 2.0 percent in July. Even that more moderate pace still slightly exceeds the nation, however, and the unemployment rate has fallen to a modern-era low of 4.2 percent. Every metro area in the state and nearly every major industry added jobs over the past year. Construction posted the largest year-over-year gains, reflecting a ramp-up in home construction and continued gains in commercial development.
- New housing supply should come as a welcome relief for Californians. Affordability remains a significant risk to the Golden State economy, as businesses are increasingly seeking more affordable options outside of the state. New supply has been slow to come back on track, which has helped drive home prices up much faster than income growth. The lack of affordable housing is causing younger workers to seek out alternative areas, such as Denver and Dallas.
- Trade disputes also pose a risk as California is home to some of the nation's busiest ports and is the second largest exporter behind Texas. NAFTA partners and China combined account for 34.9 percent of California's 2017 exports.





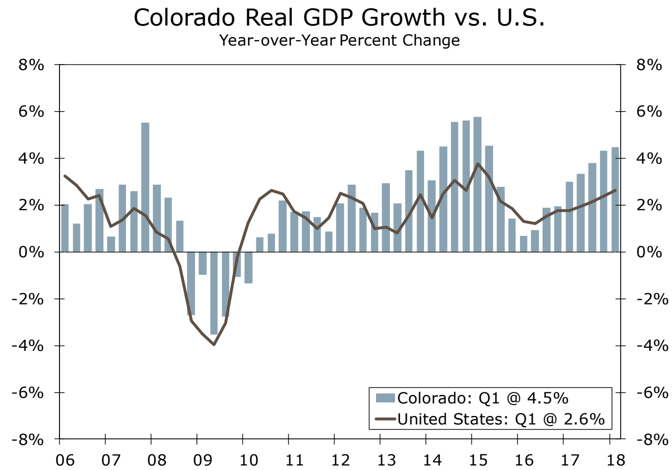


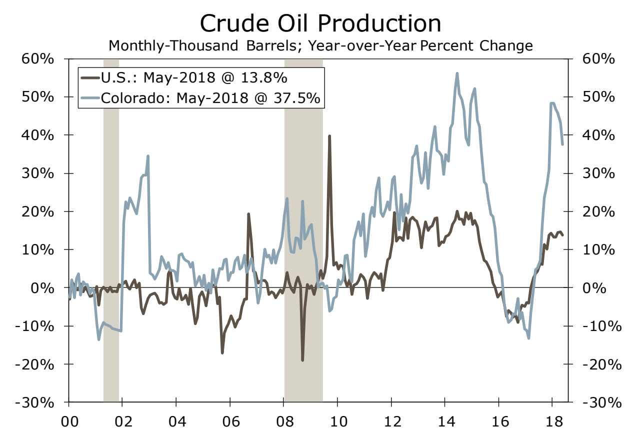


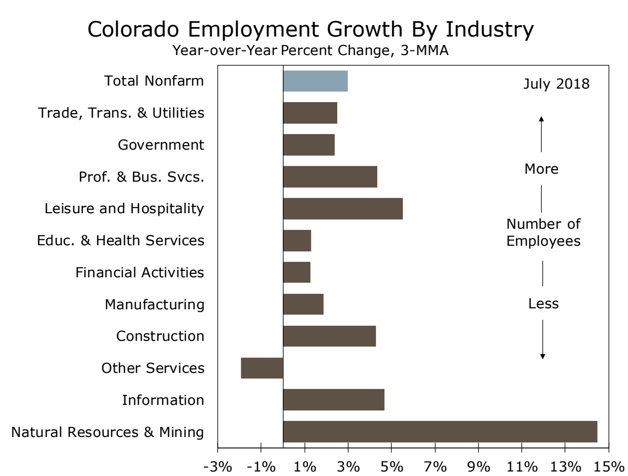
Source: U.S. Dept. of Labor, U.S. Dept. of Commerce and Wells Fargo Securities

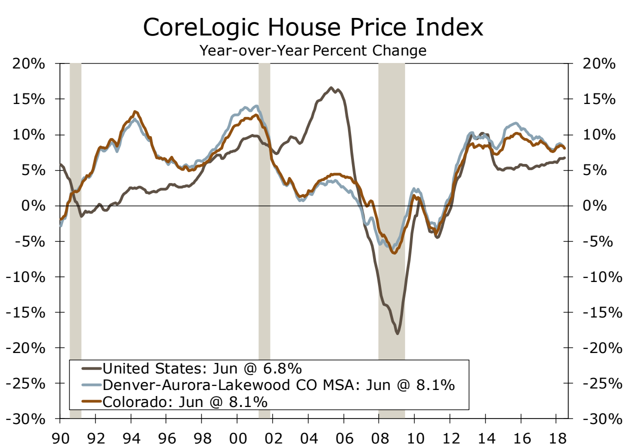
Colorado

- Colorado's economy continues to outpace the nation, led by a rebound in the energy sector and continued growth in construction. Real GDP grew at a 4.5 percent year-over-year rate in Q1, besting the nation for the seventh consecutive quarter. The tech and defense sectors, based in Denver, Boulder and Colorado Springs, continue to attract scores of highly skilled workers, which itself is a big draw for expanding businesses.
- Nonfarm employment has risen solidly over the past year, with payrolls rising 3.0 percent. Gains are evident across nearly all industries. Colorado has continued to see strong job gains, despite maintaining an exceptionally low 2.8 percent unemployment rate. The leisure & hospitality sector added the most jobs of any sector, as the state attracted a record 84.7 million tourists this past year. Technology and aerospace are seeing some of the fastest job gains.
- Affordability pressures are really starting to bite. Soaring housing costs, particularly in Denver and Boulder, have slowed net in-migration and also prompted many residents to move to more affordable parts of the state, providing a boost to Colorado Springs and Fort Collins.
- Canada and Mexico account for more than one-third of Colorado's exports, making a successful NAFTA renegotiation important to the state. China accounts for 7 percent of exports but shipments to China have actually declined modestly over the past five years.





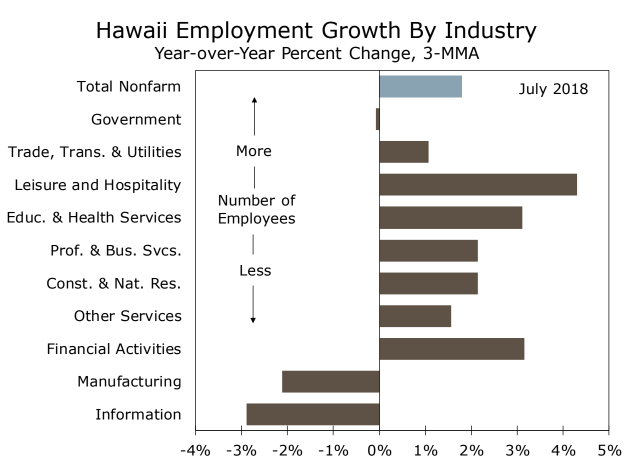


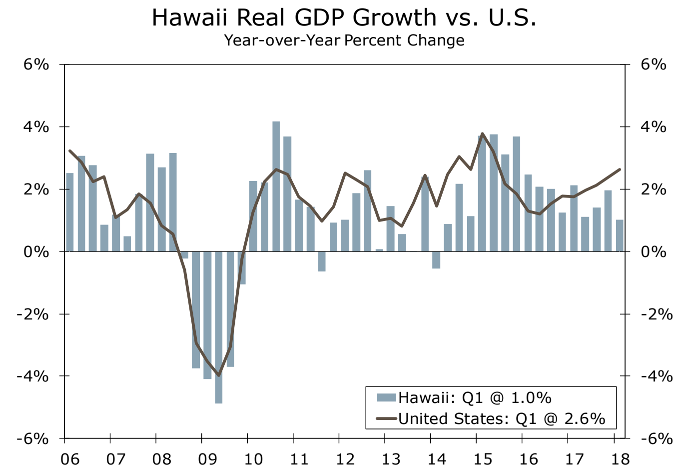


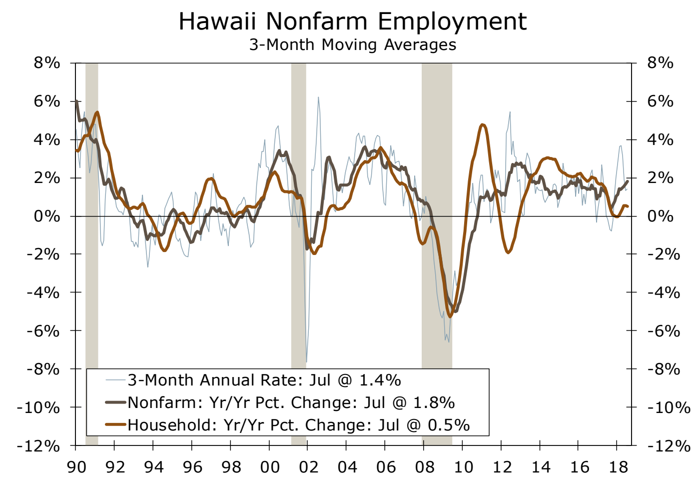
Source: U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities

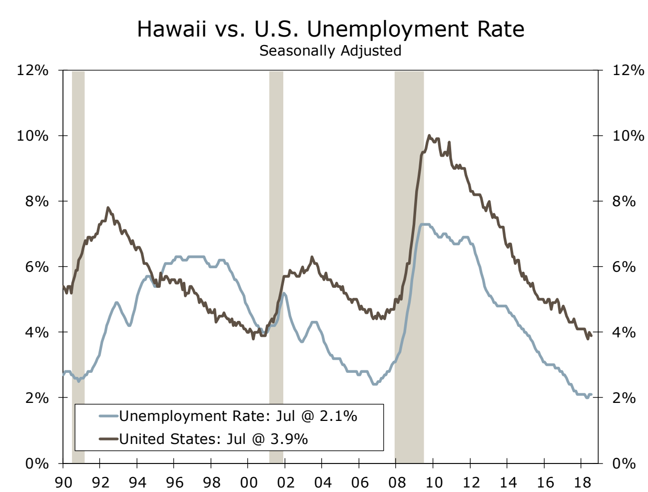
Hawaii

- After accelerating for two consecutive quarters, real GDP growth in Hawaii moderated to 1.0 percent year-to-year in Q1. After several years of double-digit growth, construction spending has slowed considerably and become a drag on the broader economy, as a number of new commercial and residential projects have been completed. The leisure & hospitality, wholesale trade and education & health sectors have added jobs at a steady pace, while government payrolls contracted slightly.
- Hawaii's labor market remains exceptionally tight, with an unemployment rate of 2.1 percent as of July. Job growth has also improved in recent months, with nonfarm payrolls rising 1.8 percent on a year-to-year basis, led by hiring in the state's key leisure & hospitality sector.
- Tourism was up solidly ahead of the recent volcano eruption and hurricane. Total visitor expenditures rose 10.3 percent year-to-year in June, with the average length of stay increasing over that same period. Through July of this year, hotel occupancy remained elevated at 83.8 percent, while RevPAR grew 3.6 percent.
- The increase in defense spending afforded by the new budget deal should be a boon to the state's economy over the next few years. Hawaii ranks behind only Virginia in terms of defense spending as a percentage of total state economic output (roughly 10 percent) and is home to many military installations and defense contractors.





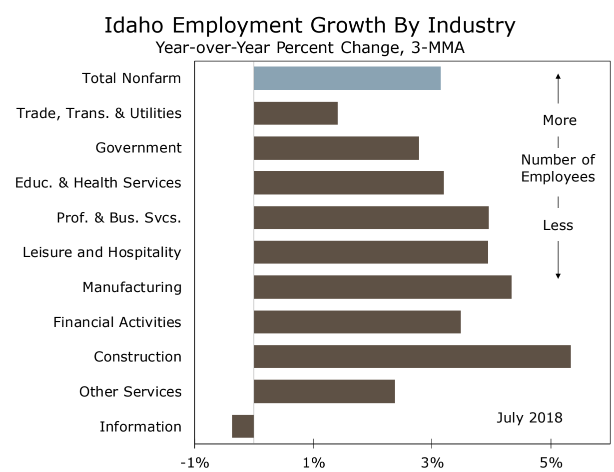


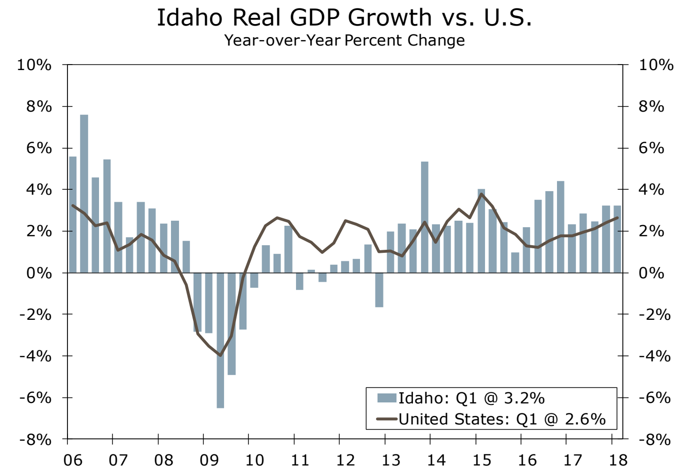


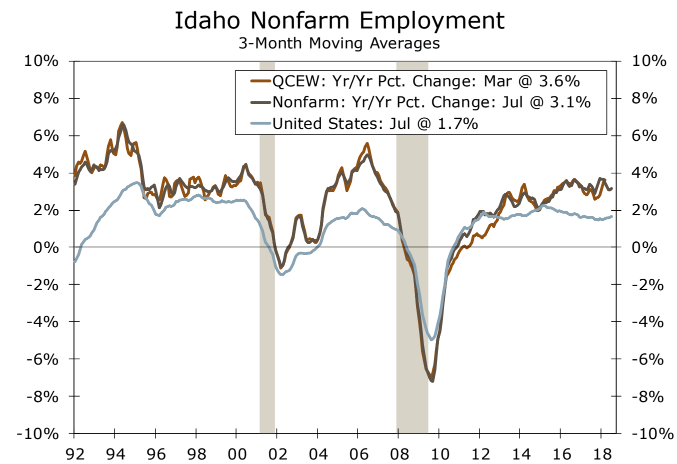
Source: U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities

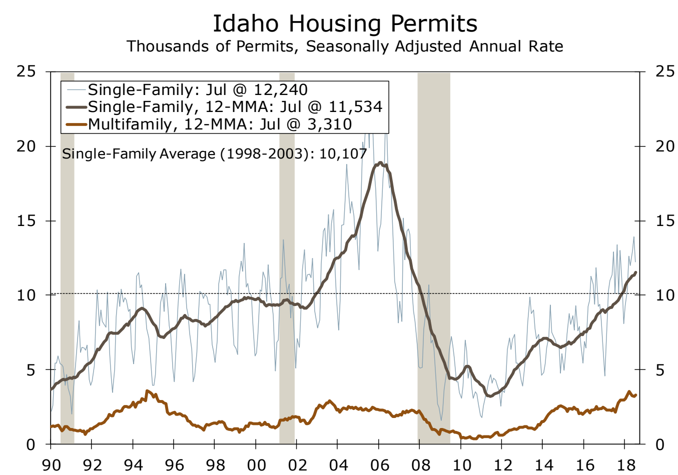
Idaho

- Idaho had a banner year in 2017, as it posted the highest year-over-year growth rate of any state, both in employment, up 3.1 percent, and earnings, up 5.3 percent.
- The Gem State also saw population growth accelerate to 37,000 in 2017, with more than half of that increase in the southwest, near Boise and the Treasure Valley. In the northwest corner of the state, Coeur d'Alene is increasingly attracting residents from higher cost states such as California and Washington, making it the fifth fastest growing metro area in the country in 2017.
- That said, housing in Idaho is not all that affordable. With inventories exceptionally low and home prices surging 11.4 percent over the past year, affordability is rapidly becoming a concern. The housing situation and the ultra-low unemployment rate of 2.9 percent likely portend some moderation in overall growth in coming quarters, although real GDP growth should still outpace the nation.
- Idaho is estimated to have the highest bilateral trade exposure to China of any state, at 2.7 percent of GDP, according to Fitch. Agriculture makes up about 16 percent of the state's economy, with potatoes and dairy notable standouts. Electronics are an area threatened by the simmering trade dispute with China. Micron Technology, based in Boise, has significant exposure, as it exports more than 60 percent of its output to China.





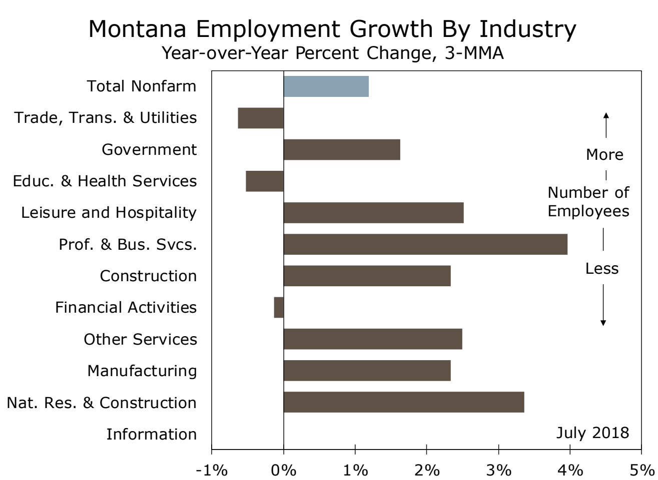


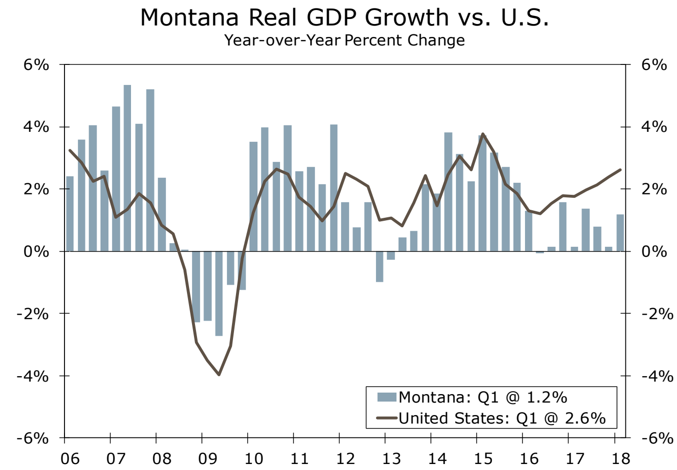


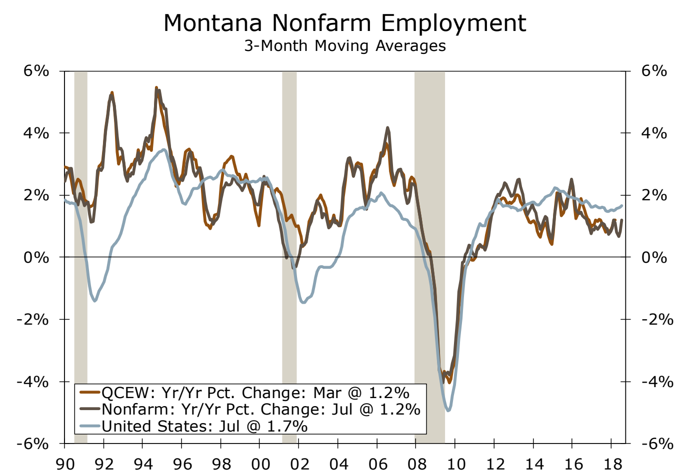
Source: U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities

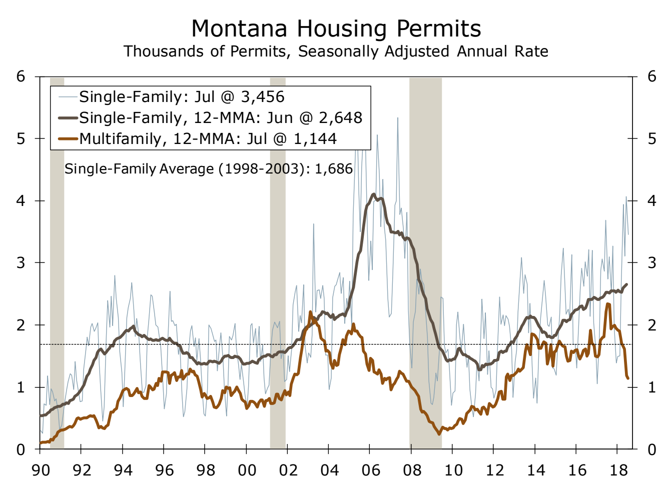
Montana

- Montana's economy has lagged the nation the past two years, as the state's energy sector has struggled to regain momentum following the collapse in oil prices earlier in the decade. Richland County and the Bakken oil fields have seen only a modest rebound in oil output. The agricultural sector, already reeling from a glut of grains and cattle, has also had to deal with severe drought in the northwest corner of the state and wildfires that covered over one million acres.
- While agriculture continues to struggle, Montana has seen manufacturing employment increase nearly 26 percent since 2010, compared to an 8.3 percent increase nationwide. Boeing, Applied Materials and Newport have all expanded into the state, and the western areas around Missoula and Bozeman have attracted a cluster of tech firms and seen a surge in entrepreneurship. Similar to national surveys, employers are experiencing difficulty finding skilled workers. The state's unemployment rate remains fairly low at 3.7 percent.
- Tourism remains a major bright spot for the state, but the outlook has clouded a bit as the major wildfires deterred visitors from Glacier National Park and the rest of Big Sky Country. That said, 47 percent of tourism business owners expect business to improve in 2018.
- Despite the haze of wildfires, population growth continues to increase. Housing costs are relatively modest compared to other Western states and the median rent is around 35 percent lower than the median rent of Western states.





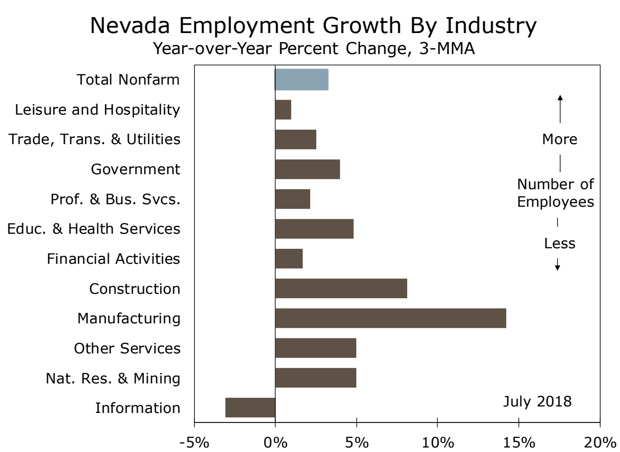


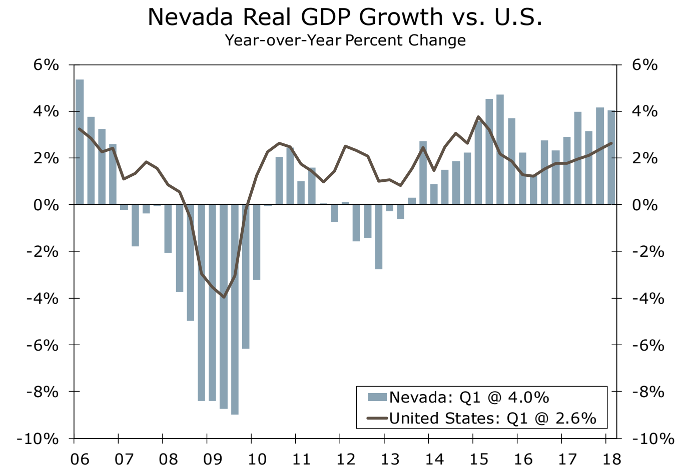


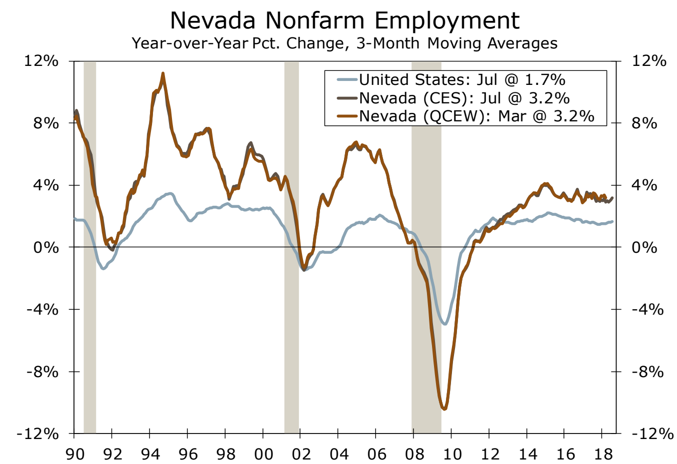
Source: U.S. Dept. of Labor, U.S. Dept. of Commerce and Wells Fargo Securities

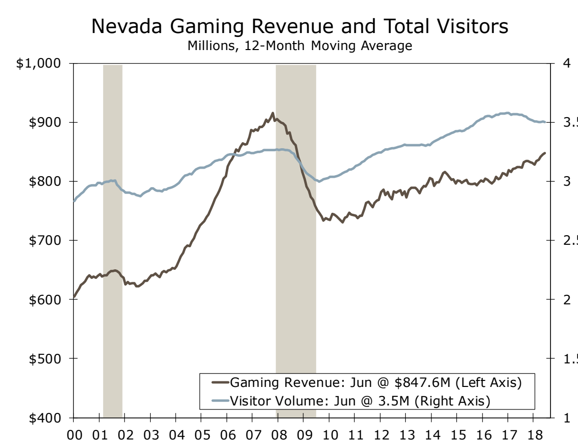
Nevada

- Nevada has seen sustained momentum over the past few years, with GDP growth outpacing the nation for six consecutive quarters. Moreover, the Silver State tied for the second strongest year-over-year job growth of any state in July.
- Much of that employment growth has been in Nevada's booming manufacturing and logistics sector, up more than 14 percent over the year. Recognizing the need to diversify away from leisure & hospitality, the Governor's Office of Economic Development was created in 2011 with the explicit goal of attracting advanced manufacturing. This has largely come to fruition, as Tesla continues to expand its $3.5 billion and 6,500-employee Gigafactory in Sparks. Amazon is also planning a fourth fulfillment center in North Las Vegas, employing 1,000 workers.
- Builders, many of whom have long been hesitant following the astounding 62 percent drop in Las Vegas home prices a decade ago, are finally starting to build again. With the improvement, there is now an acute shortage of construction labor, with an estimated 10,000-worker shortfall in the Las Vegas Valley alone, according to Applied Analysis. That said, work continues on the $1.8 billion and 65,000-seat future venue of the Las Vegas Raiders and other large events. The gaming industry has also posted solid gains and is expanding again.
- The northern part of the state has played a key role in the diversification effort, with Reno now home to a self-styled "Startup Row".





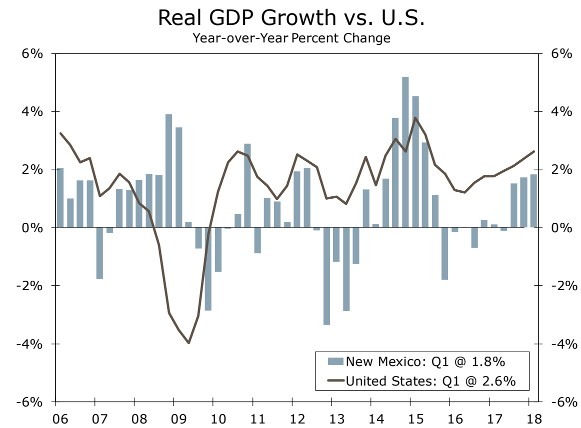


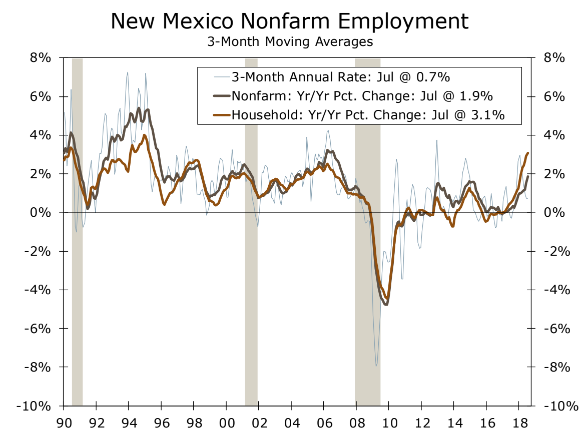


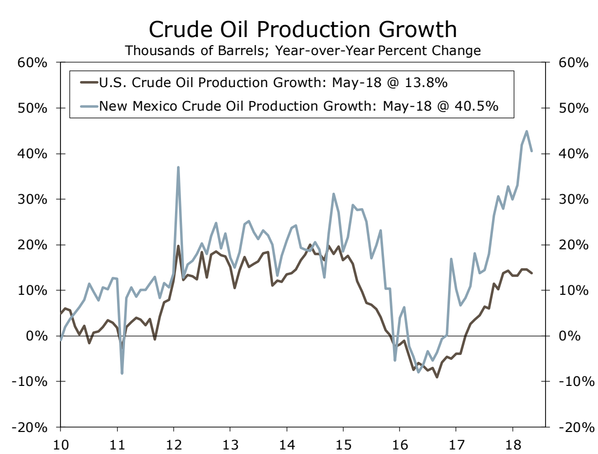
Source: U.S. Dept. of Labor, U.S. Dept. of Commerce, Las Vegas Convention & Visitors Authority and Wells Fargo Securities

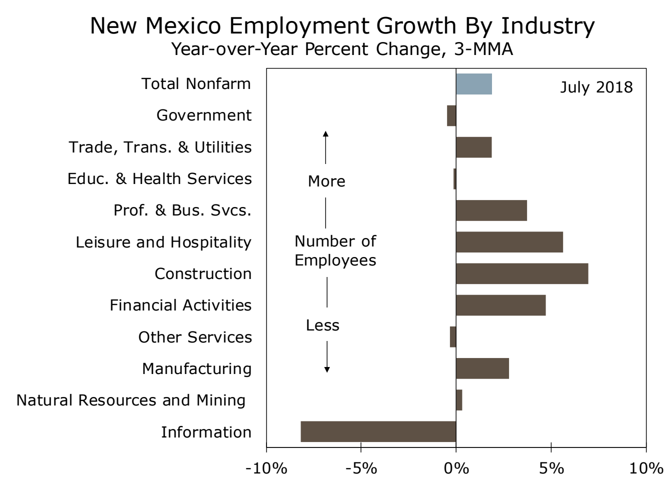
New Mexico

- New Mexico's economy finally appears to be building momentum on the back of higher oil prices and some loosening of the federal purse strings. Real GDP began to improve during the second half of 2017 and was up 1.8 percent year-over-year in Q1. Output in the energy sector has now posted three straight quarters of double-digit growth.
- More recent employment data also suggest that growth is continuing to trend higher. On a year-over-year basis in July, payrolls accelerated 1.9 percent with most major industry sectors posting gains. New Mexico's unemployment rate, while still among the highest in the country, is now below 5 percent for the first time since 2008.
- Rising oil prices have spurred drilling activity. The state's rig count, the majority of which are in the Permian Basin, has nearly doubled over the past 12 months. Production of crude oil also surged, growing 40.5 percent over the past year.
- Rising labor costs in neighboring California and other Western states should spur more relocations, benefitting the industrial sector. A positive resolution to the NAFTA negotiations would also benefit the state, particularly the manufacturing and logistics sectors.
- Increases in federal spending will be a positive for the state economy in coming years. Home to the Los Alamos National Laboratory and numerous military bases, the federal government plays an outsized role in New Mexico's economy.





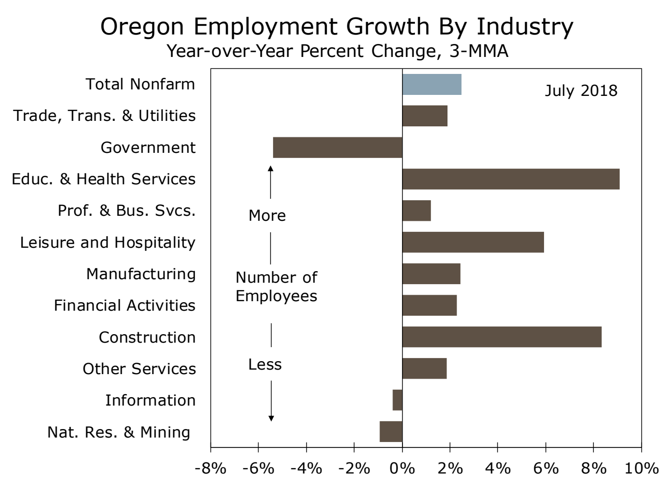


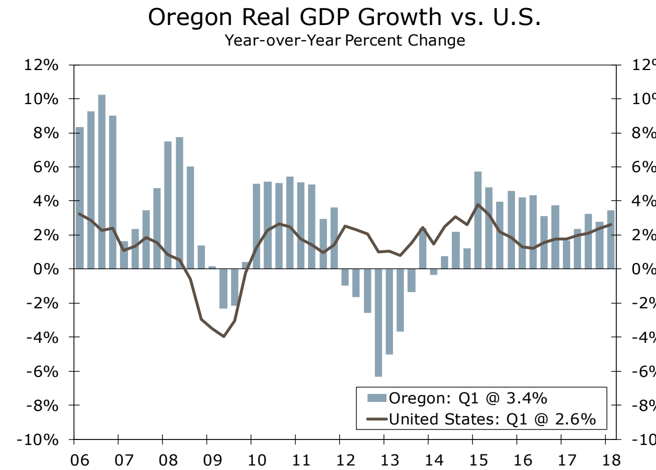


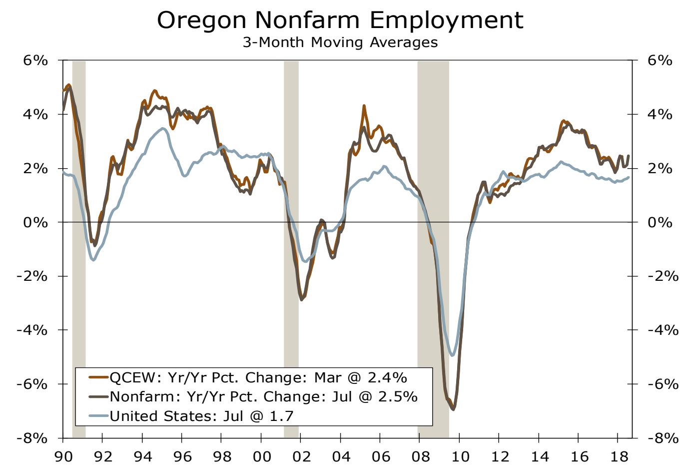
Source: U.S. Dept. of Labor, U.S. Dept. of Commerce and Wells Fargo Securities

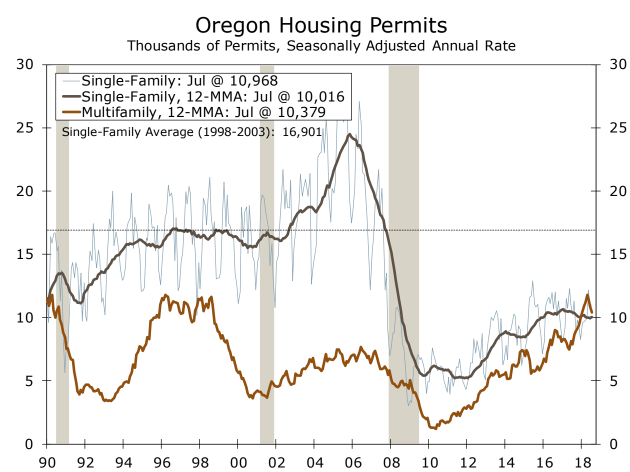
Oregon

- Oregon's outlook remains bright, as its economy continues to diversify. Real GDP growth has moderated to a more sustainable but still-strong pace from the nearly 5 percent averaged a few years ago. Employment growth remains strong and broad-based, with particularly strong gains in construction and the education & health sectors, reflecting strong population growth.
- Home to 60 percent of the state's population, the Portland MSA is a hub for both businesses and Millennial in-migrants. Longtime stalwarts Intel, Google and Oracle have been supplemented by eBay, Mozilla and Salesforce, hence the "Silicon Forest" moniker. Young people are no doubt attracted to these high-paying jobs as well as the unique culture and mix of the region's trendy and quirky hospitality industry.
- The Urban Growth Boundary, however, continues to contribute to skyrocketing home prices. A sizeable jump in multifamily permits has been unable to quell the city's growing affordability crisis and homelessness.
- Oregon had the 15th highest state exposure to international trade in 2017, with exports comprising 9.3 percent of GDP. Top categories include electronics, semiconductors and wheat. Nearly 20 percent of all exports go to China, the state's top trading partner.
- Tourism is another bright spot, but this past season was threatened by wildfires and reduced air quality.





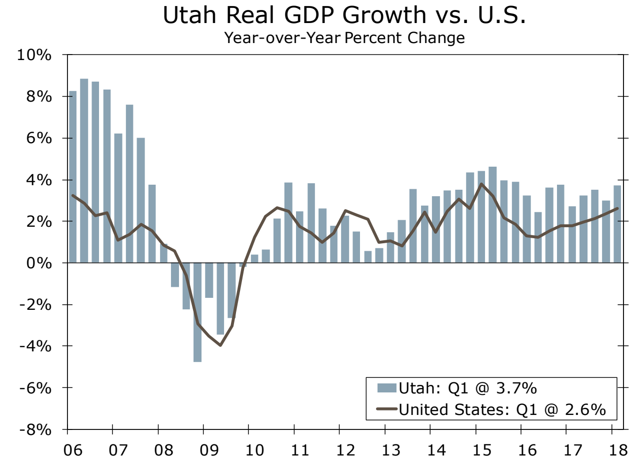


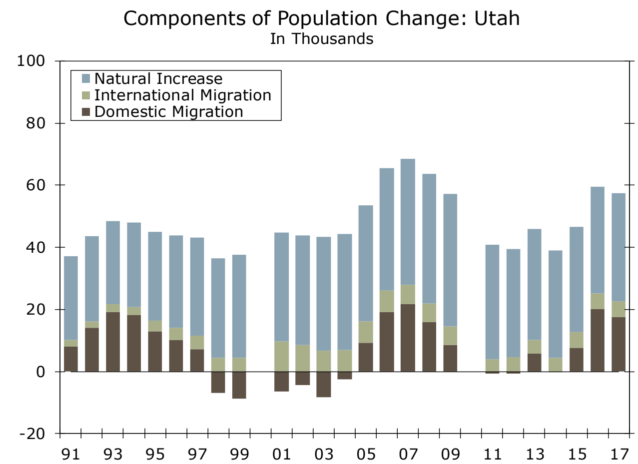


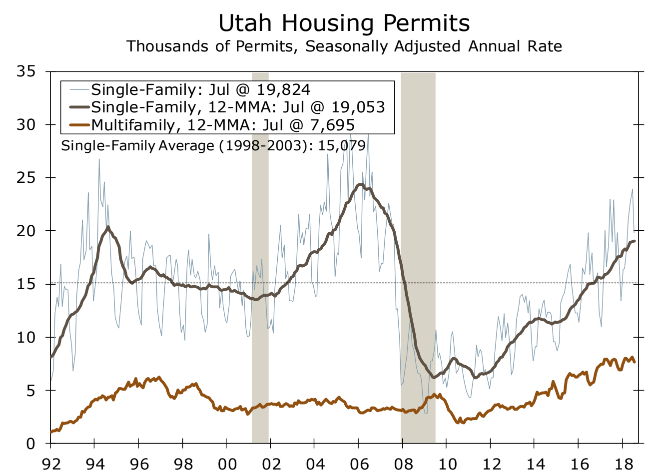
Source: U.S. Dept. of Labor, U.S. Dept. of Commerce and Wells Fargo Securities

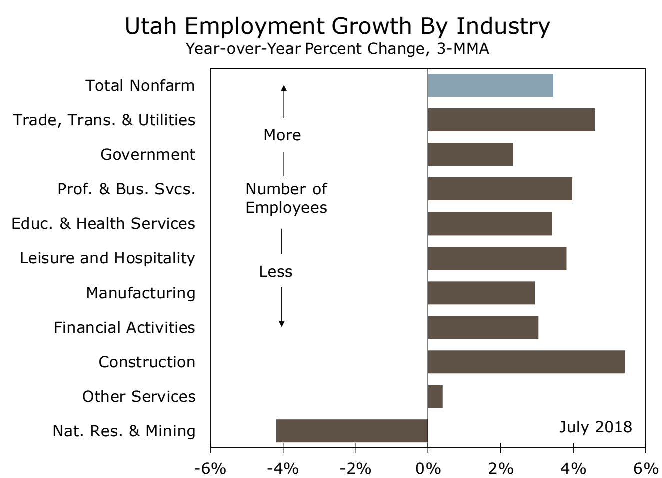
Utah

- Few states have performed as solidly and consistently as the Beehive State over the past five years. Real GDP growth in Utah remained one of the fastest growing in the nation in Q1, expanding 3.7 percent on a year-over-year basis. The state's burgeoning tech sector is driving much of the growth, helped by its deep talent pool and relative affordability compared with other growing tech hubs. Production out of the mining sector, backed by higher commodity prices, has also been supportive of growth. A sharp decline in the price of copper leading into the summer, however, may stymie production in coming quarters.
- Utah payrolls grew 3.4 percent in July on a year-over-year basis. With the exception of natural resources & mining, most major industries added jobs over the past year. The state's service sectors are especially healthy, driven by professional & technical services. The construction sector has also been leading in terms of job growth, a consequence of several years of robust new residential building activity. Utah's lack of physical land constraints is an ongoing competitive advantage.
- Utah's growing population and highly educated workforce remain valuable assets. Utah has the third fastest growing population in the country, driven by both a rapid in-migration and a high birth rate. The young and rapidly growing workforce is a durable competitive advantage over less demographically robust areas and is helping attract new employers.





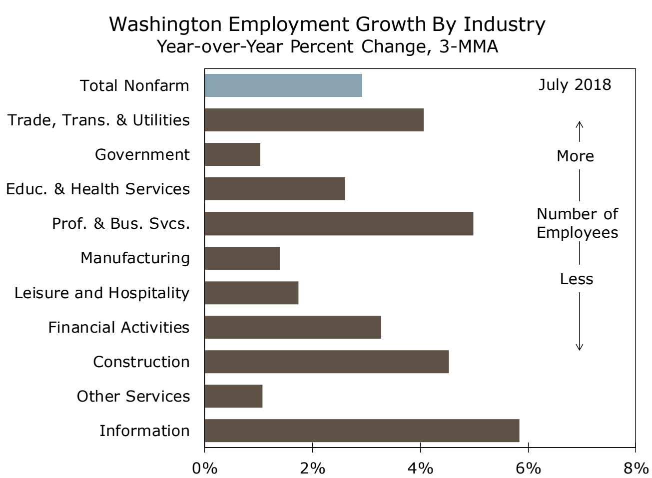


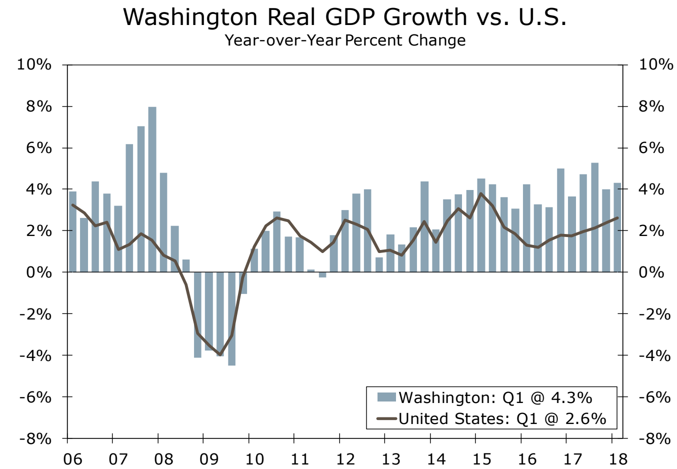


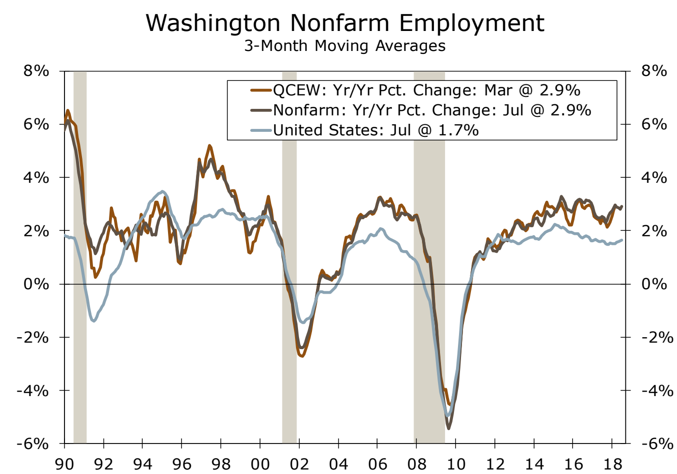
Source: U.S. Dept. of Labor, U.S. Dept. of Commerce and Wells Fargo Securities

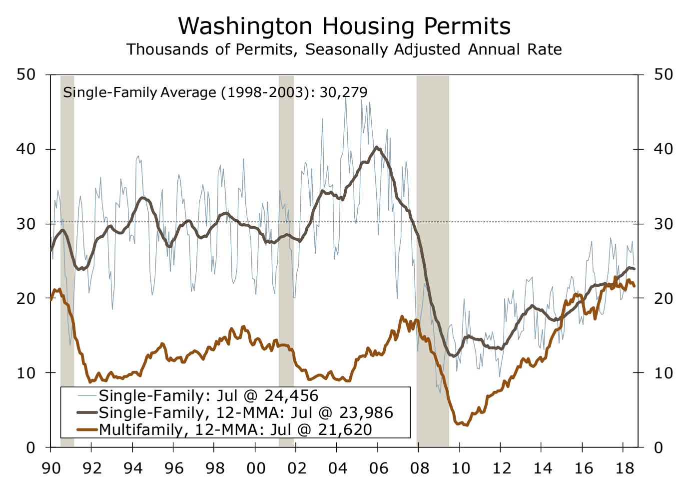
Washington

- The Washington economy continues to outperform nearly every state in the nation. In Q1, the state achieved real GDP growth of 4.3 percent on a year-over-year basis, well above the national rate of 2.6 percent, and the third highest pace among all states. This is not an aberration. Real GDP growth has ranked in the top ten in each quarter going back to 2016. What sets Washington apart is that the information and retail trade sectors are driving much of this growth, two sectors that are generally declining throughout the rest of the country. The tech sector is behind most of this growth, driven by Amazon's expanding presence in Seattle and continued growth at Microsoft.
- Total payrolls expanded 2.9 percent over the past 12 months in July, with gains occurring across every major industry. Hiring is especially strong in construction, as both residential and commercial development attempt to keep pace with rapid population and employment growth.
- Multifamily building activity remains at an elevated level. Single family construction, however, has been slower to recover. Housing shortages have led to Seattle topping the list of metro home price appreciation.
- Washington also stands to be adversely impacted by heightened trade tensions as it leads all other states in terms of total value of goods exported to China. Much of this reflects shipments of commercial aircraft. Boeing remains a top employer in the state and has a long backlog.





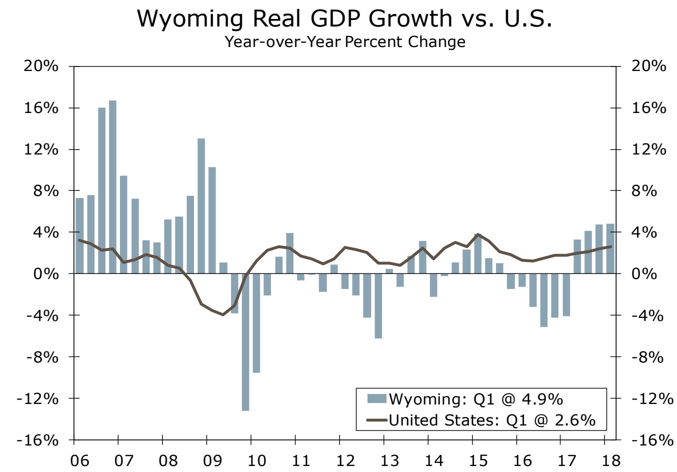


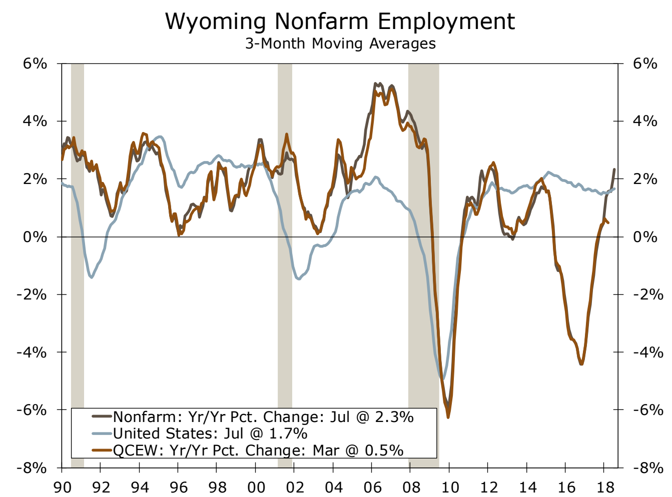


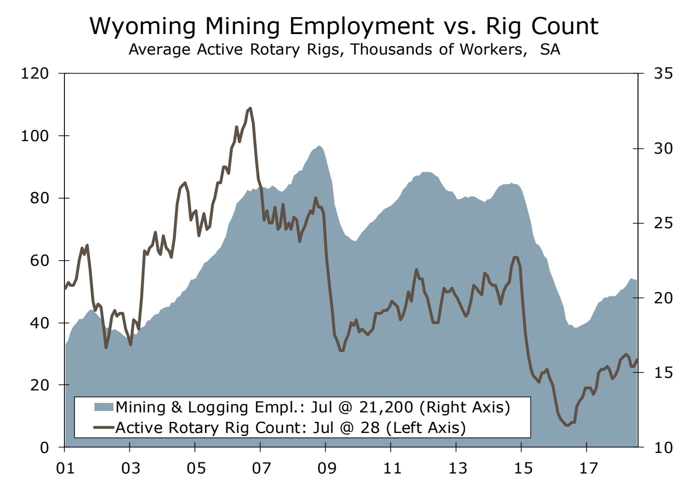
Source: U.S. Dept. of Labor, U.S. Dept. of Commerce and Wells Fargo Securities

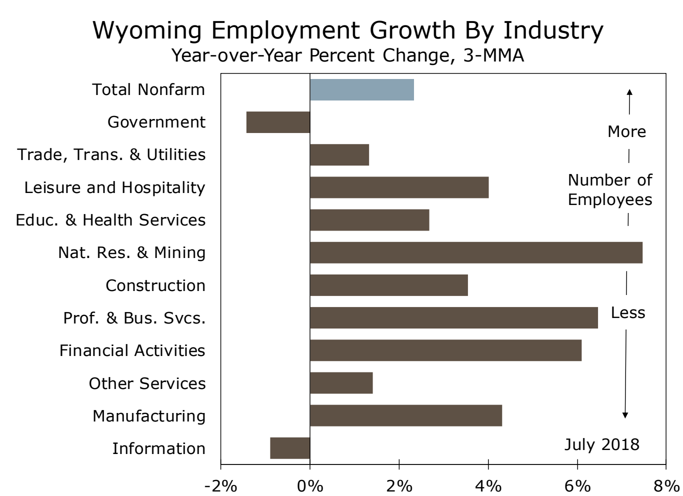
Wyoming

- Wyoming's economy is making significant progress recovering from the mining downturn that hit the state around the middle of the decade. First quarter real GDP grew 4.9 percent from the prior year and has now outpaced national growth in each of the past four quarters. Much of the growth in output occurred in the state's large natural resources and mining sector.
- Wyoming's labor market has also improved. Nonfarm employment has shown a strong recovery from the dip in 2016. Employment in the natural resources and mining sector has slowly and steadily improved alongside the number of rigs in operation. The unemployment rate has fallen modestly over the past year to 3.8 percent. The labor force has been on a downward trend for the past couple of years. With relatively few young people entering the workforce, replacing retiring workers remains difficult.
- Overdependence on the energy sector remains a top risk for Wyoming. The natural resources & mining sector comprises nearly 30 percent of economic output, making the state vulnerable to volatile energy prices. Along with oil, Wyoming is also a major natural gas, renewable energy and coal producer. The state accounts for around 40 percent of total U.S. coal production. Despite an administration friendly to coal, a high degree of uncertainty surrounds its long-term viability. Coal production rose 6 percent in 2017 but has slipped slightly in recent months.









Source: U.S. Dept. of Labor, Baker Hughes, U.S. Dept. of Commerce and Wells Fargo Securities

Wells Fargo Securities Economics Group

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