

Economics Group

Special Commentary

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Minnesota Economic Outlook: July 2014

Output Accelerates in the North Star State

Minnesota's economy does not always get the attention it deserves as a consistently solid performer, with a diverse economy and an unemployment rate that has typically remained well below the national average. The state's real GDP grew a full percentage point faster than the nation in 2013, and the unemployment rate has tumbled to 4.5 percent, one of the lowest in the country. The low unemployment rate is all the more impressive given that the state has the nation's third-highest labor force participation rate, 70.3 percent. The majority of states with similarly favorable labor markets have large oil and gas reserves, which helped them weather the recession and spurred growth in related industries. Minnesota has also benefitted from the energy boom, which has lifted parts of the factory sector and boosted mining activity. The state's strong economic performance, however, primarily reflects built-in advantages, including major research institutions, several large corporate headquarters, and a diverse and growing industrial base.

Manufacturing is bouncing back strongly, thanks to solid gains in fabricated metal, transportation and food production. The state is home to food giants such as General Mills, Hormel Foods and Cargill. Healthcare facilities play a major role, including United Healthcare and the Mayo Clinic. Construction has also strengthened, thanks to a bevy of heavy and civil engineering projects like the new Vikings football stadium underway in Minneapolis. There are also some soft spots. Retail trade and financial services have struggled of late and some agricultural producers are also facing headwinds. Medical device makers, which have an outsized presence in the state, have also come under pressure. Nevertheless, the outlook remains bright for the North Star State, and we expect economic growth to remain solid over the next few years. The billions of dollars being spent on infrastructure projects and sports facilities not only provides some visible evidence of these gains but also lays the groundwork for more private investment.

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Figure 1

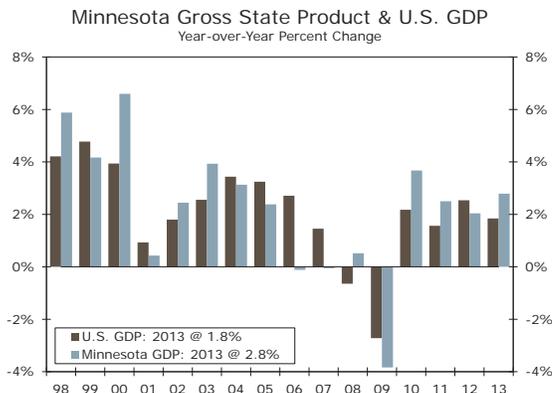


Figure 2



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



Healthcare Opportunities Knock

The healthcare industry has an outsized presence in Minnesota, which is home to the Mayo Clinic, United Healthcare and several major medical device manufacturers. Health services employment continues to make solid gains and is up 1.7 percent from a year ago. Job growth has moderated more recently, however, and a divergence within the industry has opened up. Considering that Minnesota is home to the prestigious Mayo Clinic, which is embarking on a massive expansion, it comes as somewhat of a surprise that hospital employment is slightly lower than it was a year ago. Mayo's multibillion dollar expansion is a long-term project that has only recently gotten underway. An expansion of St Marys Hospital and Mayo Medical Laboratories are among the first projects, and although these have bolstered construction payrolls, sizable additions to hospital staff have yet to be made. The hospital's massive expansion project is already fueling growth in the surrounding area, including restaurants and hotels that expect a boost from the influx of new hospital staff, patients and visitors. Cranes are dotting the landscape, as builders rush to develop land near the hospital.

After posting strong gains throughout the recovery, nursing and residential care facilities employment has begun to dip and is now slightly below its year-ago level. Medical equipment and supplies manufacturing has been gradually declining since the recession hit the state, although payrolls have remained generally flat for the past year. Medtronic, a major medical device maker based in Minnesota, recently acquired Covidien and is moving its headquarters to Ireland. The firm has said that the acquisition will not result in a workforce reduction in the state and that the company should add another 1,000 workers in Minnesota over the next five years. Cardiovascular Systems Inc. is building a new headquarters near its current facility in New Brighton and should expect to add another 200 workers.

Other parts of the health care sector are growing more rapidly. Ambulatory healthcare employment, which includes offices of physicians, dentists and chiropractors; outpatient care centers; medical and diagnostic laboratories; and home health care services, is up 3.6 percent from a year ago, thanks in part to the growing use of outpatient centers. Social assistance employment, which includes services provided to the elderly and disabled, has surged 3.2 percent since last year.

Figure 3

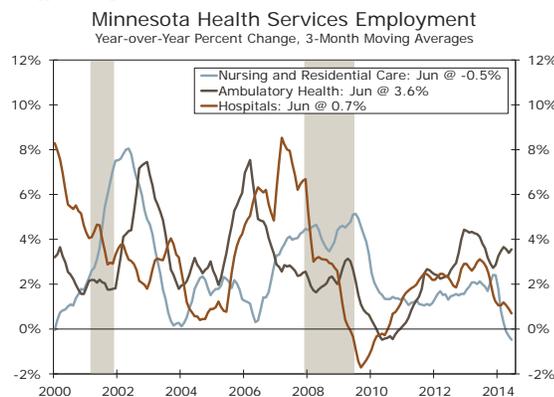
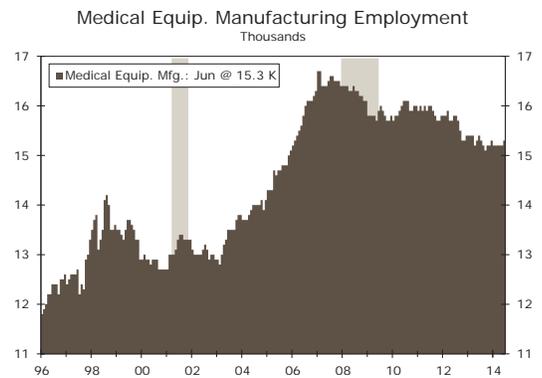


Figure 4



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

Temporary Lull in Nonresidential Construction

Minnesota's construction industry has experienced a resurgence recently, with employment rising 7.8 percent over the past year. Construction payrolls are still 17.5 percent below their prerecession peak, and although this is a large differential, it is not as severe as the nation's 22.1 percent gap. Heavy and civil engineering projects have posted some of the strongest gains, with employment up 23.1 percent year over year. Although this breakneck pace is unlikely to be

Minnesota's construction industry has experienced a resurgence recently.

sustained, growth in the sub-industry should continue to drive gains moving forward. Governor Dayton recently signed a bill that will provide \$1 billion of funding to infrastructure projects, which include water pipelines, civic centers, higher education expansions, museums and government building renovations. The additional funding comes partially thanks to the state posting its first budget surplus in seven years. In addition, the construction of the Vikings stadium is now underway and will have a growing effect on employment.

Other nonresidential construction employment has fallen off recently, however. After posting relatively strong gains in 2013 and Q1 2014, nonresidential construction of buildings employment is down 11.5 percent from a year ago. This drop should prove temporary. Several major projects have been announced in the greater Minneapolis area, including the massive Downtown East being built near the new Vikings stadium site. Downtown East is expected to include 1.1 million square feet of office space, 193 apartments and 24,000-square-foot of retail space. Other major developments include a new 240,000-square foot building that will house the headquarters of the Be the Match facility operated by the National Marrow Donor Program, being built in the North Loop area of downtown, near Target Field.

Residential building construction employment also continues to make solid gains and is up 9.3 percent from a year earlier. Apartment construction continues to ramp up in Minneapolis, although at a slightly more modest pace than what was seen at the end of 2013. A large proportion of the new apartments are being built in and around the central business district of Minneapolis. There are also sizable additions taking place in Anoka County and in the West, which includes Minnetonka.

Figure 5

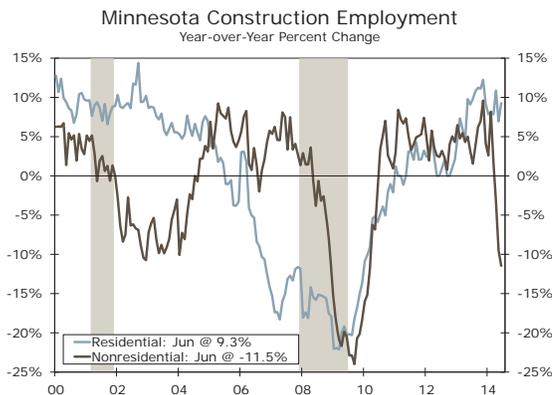
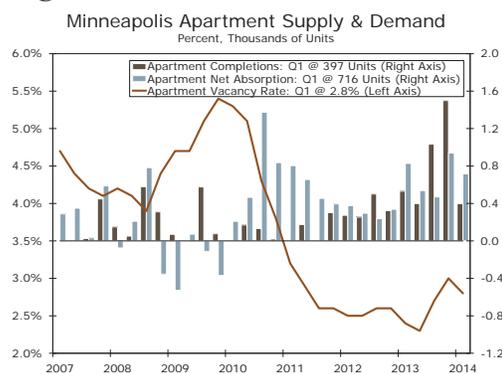


Figure 6



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

Housing Market Recovery Remains Slow

The pace of single-family homebuilding has not improved all that much, with single-family permits flat for the past six months. Relatively slow population growth has kept homebuilding considerably below its historical norms but growth has picked up a bit more recently. After trailing U.S. population growth for 11 straight years, Minnesota's population finally grew slightly faster than the nation in 2013. Much of the growth has occurred in the greater Minneapolis area.

The sluggish pace of single-family homebuilding also reflects still weak demand for single-family homes. The first half of 2014 saw 7.6 percent fewer home sales than over the same period in 2013. Existing and new home sales both appear to be weaker this year. Nationwide, some of the soft home sales numbers can be blamed on falling investor demand amid a smaller distressed inventory. Distressed homes are in short supply in Minnesota. The share of homeowners delinquent for 90 or more days is 2.1 percentage points lower than the national average and the foreclosure rate is a third of the national average.

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Home prices are 8.7 percent higher than a year ago and have generally lagged the national pace. The small share of distressed homes and the slower-than-average pace of price appreciation have likely pushed investors into other states. The number of new listings posted continues to rise, thanks to the improving price environment and relatively low inventories. The rise of homes available for sale may provide enough options to attract buyers back into the market. The housing recovery has had a hard time reaching the key tipping point level, where homeowners feel confident that they can sell their current home at a good enough price to make it worthwhile to move. Given that year-to-date sales are the lowest in at least two years, it does not seem like traditional homebuyers are rushing back into the housing market just yet, however. Some areas have improved ahead of the overall market. Closed sales have risen in the Arrowhead region and were up 2.8 percent in June year to date. There was also a small gain in the West Central Region of 1.7 percent year over year. However, sales have fallen in every other region.

Figure 7

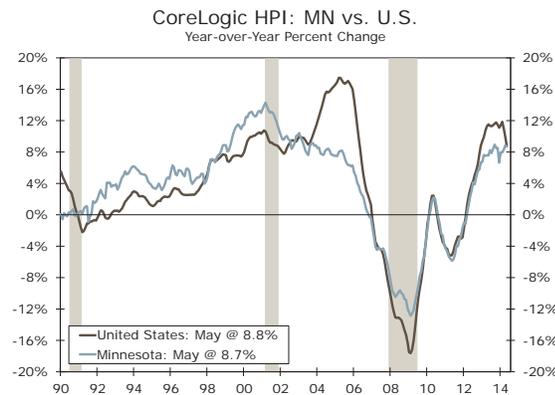
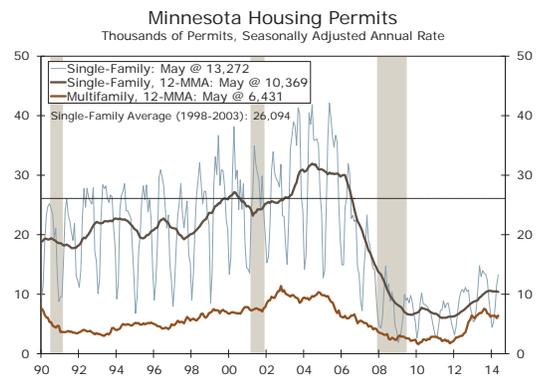


Figure 8



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

Some Agriculture Prices Go Up, Some Go Down

Food manufacturers have been expanding and employment was 3.1 percent higher than a year ago in June.

Minnesota is one of the nation's largest agricultural producers, with more than \$20 billion worth of products sold in 2013. About two-thirds of farm revenues come from crops, with corn and soybeans being the two-largest revenue generators. Minnesota is one of the top five producers of these two crops. Hogs are another large source of revenue for the state's farmers. With such a large agricultural sector, it comes as no surprise that major food manufacturers, such as General Mills, Cargill and Hormel, are located in the state. Food manufacturers have been expanding and employment was 3.1 percent higher than a year ago in June.

Farmers themselves do not appear to be faring quite as well. Lower corn prices mean lower incomes for farmers. The fall in prices came as yields declined from last year. Grain corn production fell 1.304 billion bushels in 2013, from 1.374 billion bushels in 2012. The fall in prices pushed the value of corn grain production to just less than \$6 billion from more than \$9 billion. Soybean producers experienced a similar trend, with the value of production dropping to \$3.4 billion from \$4.4 billion in 2012.

Figure 9

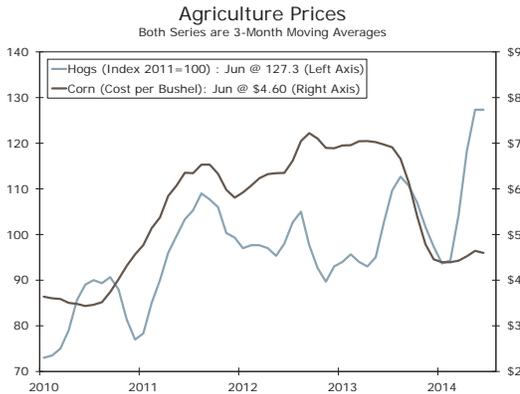
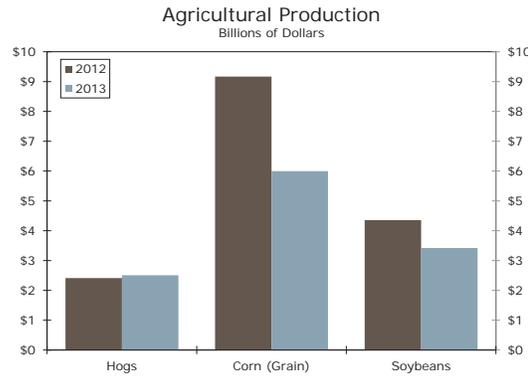


Figure 10



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

A survey of agricultural credit lenders indicates that things have not improved in 2014. Not a single lender reported rising farm incomes in the state and excess moisture is threatening yields of corn and soybeans. Acreage planted this year is higher than last, however. Farmers planted 8.5 million acres of corn across Minnesota in 2014, down about 1 percent from last year, but planted 7.5 million acres of soybeans, which was up some 800,000 acres from the prior year and the largest planting since 2003. Livestock producers, on the other hand, greatly benefit from lower prices of corn, which is often used in feed. Hog production increased in dollar terms in 2013, thanks to rising hog prices, which have remained elevated into 2014. The combination of low feed costs and higher hog prices this year has been a boon for those farmers.

Summary and Outlook

Minnesota’s economy has consistently outperformed the nation in recent years, in terms of output and employment growth. A preponderance of corporate headquarters, healthcare facilities, a large agricultural presence and a diversity of industries served as stabilizers in the downturn. An aging population, increased health insurance coverage and a massive expansion of the Mayo Clinic will drive gains in the health sector in the near and intermediate term. Increased infrastructure spending will also keep the economy moving in the right direction. After these one-time projects are completed, the stabilizers in the economy are likely to rein in long-term growth. A major medical campus, a large university, the state’s large agricultural sector and even corporate headquarters, particularly for retail companies, are unlikely to post huge employment gains in the long run. Technology and life sciences hold more promise. The state’s high proportion of college graduates should also aid such growth and encourage additional business investment. As these economic drivers take hold, home sales should gradually gain momentum and build on their recent recovery, boosting home equity and moving the housing sector closer to a self-reinforcing recovery.

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