WELLS FARGO

Weekly — March 4, 2022

Weekly Economic & Financial Commentary

United States: **The U.S. Economy Had Solid Momentum Ahead of Russia's Invasion**

- February's employment data showed the economy had strong momentum ahead of Russia's invasion of Ukraine and amid the Fed's shift to a more hawkish tone on monetary policy. Nonfarm employment surged by 678,000 jobs, and job growth over the prior two months was revised higher by 92,000 jobs. This week's factory orders and ISM manufacturing survey also pointed to strengthening momentum in the factory sector.
- Next week: Trade Balance (Tuesday), CPI (Thursday), U. of Mich. Consumer Sentiment (Friday)

International: **Bank of Canada Kicks Off Rate Hike Cycle**

- Canada's Q4 GDP came in stronger than expected in the fourth quarter, rising 6.7% quarter-over-quarter and setting the stage for the Bank of Canada's (BoC) monetary policy meeting. The central bank kicked off its rate hike cycle at its March monetary policy meeting with an initial, and widely expected, 25-bp policy rate increase to 0.50%.
- Next week: Brazil CPI (Tuesday), Mexico CPI (Wednesday), ECB Rate Decision (Thursday)

Interest Rate Watch: **Rates on a Roller Coaster Ride**

- Russia's invasion of Ukraine last week, followed by wide-ranging and severe sanctions placed on Russia by numerous Western countries, sent global bond yields into motion this week.

Credit Market Insights: **Russia-Ukraine War Increases Market Volatility**

- Russia's invasion of Ukraine has prompted sweeping financial and economic sanctions. S&P Global cut the Russian government's rating to junk, while Moody's has issued a junk warning. In reaction, credit default swaps on Russia's shorter-term government debt has risen to record levels.

Topic of the Week: **A Climb Down from Inflation Highs Resisted by Bread and Butter**

- Food commodities have been a strong driver of inflation over the past two years, and the CPI for food has risen at the strongest pace in nearly 40 years, tacking on one percentage point to the 7.5% year-over-year increase in headline CPI in January.

Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual		Forecast	
	2021				2022				2020	2021	2022	2023
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Real Gross Domestic Product [1]	6.3	6.7	2.3	7.0	2.1	2.7	3.7	3.6	-3.4	5.7	3.7	2.9
Personal Consumption	11.4	12.0	2.0	3.1	2.8	2.0	2.7	2.6	-3.8	7.9	3.1	2.3
Consumer Price Index [2]	1.9	4.8	5.3	6.7	7.6	6.7	5.9	4.7	1.2	4.7	6.2	2.6
"Core" Consumer Price Index [2]	1.4	3.7	4.1	5.0	6.3	5.6	5.4	4.9	1.7	3.6	5.5	2.9
Quarter-End Interest Rates [3]												
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.50	1.00	1.25	1.50	0.50	0.25	1.06	2.06
Conventional Mortgage Rate	3.08	2.98	2.87	3.10	3.80	3.90	3.95	4.00	3.12	2.95	3.91	4.13
10 Year Note	1.74	1.45	1.52	1.52	1.95	2.05	2.15	2.20	0.89	1.45	2.09	2.33

Forecast as of: February 25, 2022

[1] Compound Annual Growth Rate Quarter-over-Quarter [2] Year-over-Year Percentage Change [3] Annual Numbers Represent Average

Source: U.S. Dept. of Commerce, U.S. Dept. of Labor, Federal Reserve Board and Wells Fargo Economics

Please see our full U.S. Economic Forecast and our updated Consumer Dashboard and Pressure Gauge.

U.S. Review

Strong Momentum Will Help the Economy Weather Geopolitical Uncertainty

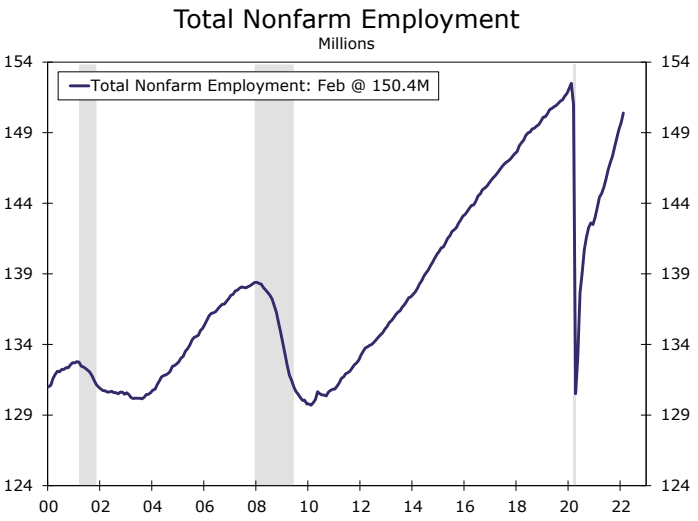
The war in Ukraine continues to overshadow economic news. Nevertheless, the latest data show the U.S. economy had strong momentum ahead of this crisis. Employers added a larger-than-expected 678,000 jobs in February, and job growth for the prior two months was revised higher by a total of 92,000 jobs. Job gains were extraordinarily broad-based in February, with more than three-quarters of the 256 industries surveyed adding jobs during the month. Some of the largest gains were in relatively lower-paying industries, such as restaurants, bars and hotels (151,200), retail trade (36,900), temporary staffing (35,500) and social assistance (30,700). The larger proportion of jobs added in lower-paying industries contributed to average hourly earnings (AHE) being unchanged in February; year-over-year AHE fell back down to 5.1%. The average workweek rose 0.1 hour to 34.7 hours, which, when combined with the surge in employment, pulled aggregate weekly hours up 0.8%.

The unexpected strength in nonfarm payrolls is a nice offset to the deeply troubling news coming out of Ukraine. Nonfarm employment easily blew past consensus expectations, which were lowered following Thursday's weaker-than-expected ISM Services report. Not only was job growth one-and-a-half times stronger than expected in February, but data for the prior two months were revised up. One of the factors driving hiring is the broader reopening of the economy. Many of the nation's largest states, including California, New York and Illinois, remained in the federal government's expanded unemployment compensation program until it ended in September. Hiring in these large states has snapped back since then, which has provided a huge lift to overall nonfarm employment growth. The recovery in the labor force participation rate and employment-population ratio has also accelerated.

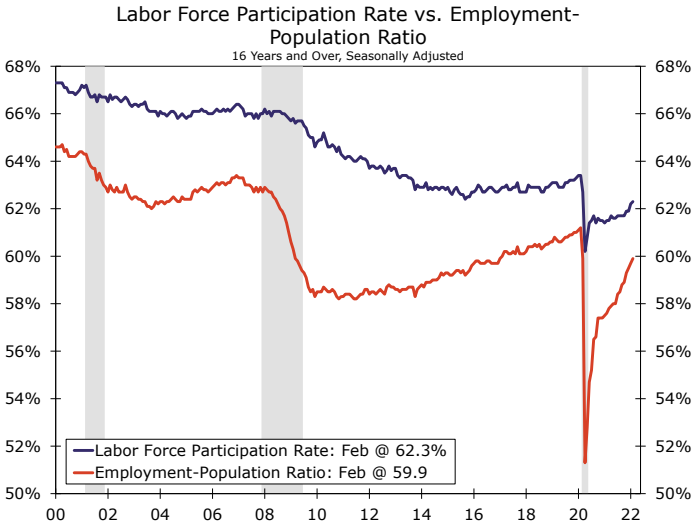
The composition of February's job gains was also more weighted toward lower-paying industries, which weighed on average hourly earnings. The surge in hiring at restaurants, bars and hotels likely reflects the broader reopening of the economy and diminishing concerns over COVID. OpenTable's seated dinner reservations data have recovered well beyond its pre-Omicron level. While hiring rose sharply in lower-paying industries, job gains were extraordinarily broad-based. Professional and business services added 95,000 jobs during the month, with roughly a third of that increase coming in professional and technical services. Construction added 60,000 jobs, with strong gains in both residential and commercial building. Manufacturers added 36,000 jobs in February, despite an 18,000-job drop in supply-constrained motor vehicles and parts. Mining added 9,000 jobs during the month, with most of the gain tied to increased energy exploration. The two components most tied to energy output—oil and gas extraction (2,400) and support activities for mining (6,100)—both added jobs solidly during the month.

The unemployment rate fell 0.2 percentage points to 3.8% in February, as the household measure of employment rose by 548,000, easily outpacing a 304,000-person rise in the civilian labor force. We expect the unemployment rate to continue to trend lower, but the pace of the decline should moderate. Both the labor force participation rate and employment-population ratio have increased substantially over the past few months, with the labor force participation rate rising 0.6 percentage points to 62.3% and the employment-population ratio rising 1.1 percentage points to 59.9%. The labor force participation rate for prime working age adults, those aged 25 to 54, has risen 0.6 percentage points over this time period to 82.2%. All threemark new highs for the pandemic period.

With many large employers planning to bring employees back to the office in March, we expect to see additional improvement in nonfarm employment and labor force growth. Nonfarm employment will benefit from further gains in leisure and hospitality jobs, as office-adjacent employment rebounds along with the return of office workers. The return of economic activity in the center cities should also further bolster labor force growth.



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



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

Manufacturing Has Strong Momentum

February's ISM manufacturing survey rose one point to 58.6, ending a string of three consecutive monthly drops. The report was fairly strong across the board. Output rose 0.7 points to 58.5. Production rose despite ongoing supply chain bottlenecks in the automotive industry. The supplier delivery index rose 1.5 points to 65.1, with 15 of the 18 industries surveyed reporting slower delivery times and the average production lead time rising by two days to 97 days. The new orders index rose 3.8 points to 61.7, which is the highest it has been since September 2021. The increase was corroborated by strong reports on factory orders for January. We expect manufacturing output and employment to strengthen this year as firms strive to rebuild inventories and build more resilient supply chains.

While it is too soon to see any impact from Russia's war with Ukraine in lagging indicators, we expect the invasion and growing fears of a more aggressive Russia to spur increased defense spending this year, with purchases from overseas providing a fairly quick bump to output. Higher energy prices should also support energy output and energy exports. A meaningful increase in energy output and distribution would require some regulatory relief. Higher gasoline prices will slow consumer spending this spring and summer. Consumers will still travel, however, as long as gasoline supplies are not negatively affected. (Return to Summary)

U.S. Outlook

Weekly Domestic Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
8-Mar	Trade Balance	Jan	-$87.1B	-$88.8B	-$80.7B
10-Mar	CPI (MoM)	Feb	0.8%	0.7%	0.6%
10-Mar	CPI (YoY)	Feb	7.9%	7.8%	7.5%
10-Mar	Core CPI (MoM)	Feb	0.5%	0.5%	0.6%
10-Mar	Core CPI (YoY)	Feb	6.4%	6.4%	6.0%
11-Mar	U. of Mich. Sentiment	Mar P	62.5	--	62.8

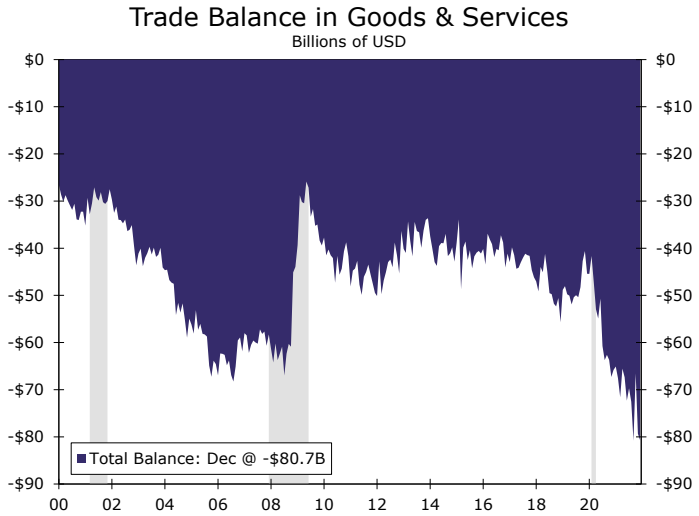
Forecast as of March 04, 2022

Source: Bloomberg Finance L.P. and Wells Fargo Economics

Trade Balance • Tuesday

After widening $1.4B in December, the U.S. trade balance essentially returned to where it stood three months prior (chart). The story for last year as a whole stayed relatively consistent as strong demand drove import growth higher, while exports were hampered by persistent supply issues. In the first month of 2022, we expect this trend spilled over and the trade balance widened to -$88.8B. Advanced goods trade data showed goods exports fell 1.8%, while imports rose 1.7% in January. While weakness in autos and consumer goods look to be primarily responsible for the softness in exports, imports saw broad-based strength. Considering the recent strength in inflation, we can expect that in real terms goods exports were even weaker than their nominal print.

Trade disruptions due to Russia-Ukraine are something we will be watching in the next few months, but despite mounting tensions in January, we will likely not see the full effects yet. In the past few days, there have been numerous headlines pertaining to the possible stoppage of Russian ships entering U.S. ports as well as statements from shipping companies that they will no longer plan to enter Russian ports. However, U.S. exports to Ukraine and Russia total only $2 billion and $6 billion, respectively, which is more or less meaningless in terms of the $24 trillion American economy. We estimated in a recent report that the value of American trade with Russia in 2019 was equivalent to a mere 0.1% of U.S. GDP. However, we will continue to monitor the effects as new information arises.

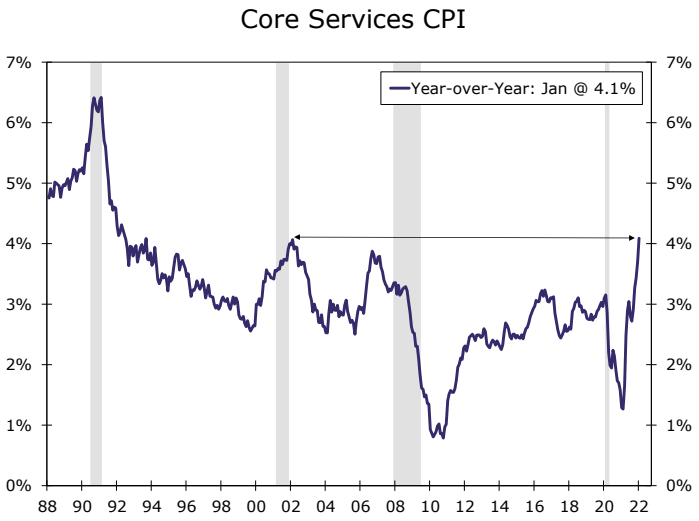


Source: U.S. Department of Commerce and Wells Fargo Economics

CPI • Thursday

We expect prices surged another 0.7% in February, which would move the year-over-year rate higher to 7.8%, a 40-year record. Rising shelter prices, one of the forces guiding January's 0.8% climb, will still be in play this month as lagging home price increases continue to be factored in. Owners equivalent rent (OER) increased another 0.4% last month. In addition, January witnessed upticks in other service sector prices such as airfare (+2.3%), food away from home (+0.7%) and personal care services (+1.2%). This helped core services inflation not only continue to broaden out but also rise to 4.1% year-over-year, its highest year-ago rate in 20 years (chart). However, as services inflation has gained steam, used cars, a poster child responsible for the beginning of inflation's ascent, may finally see prices cool off. Used cars and trucks prices were up "only" 1.5% last month after a 3.3% increase in December, and could see some additional relief in February.

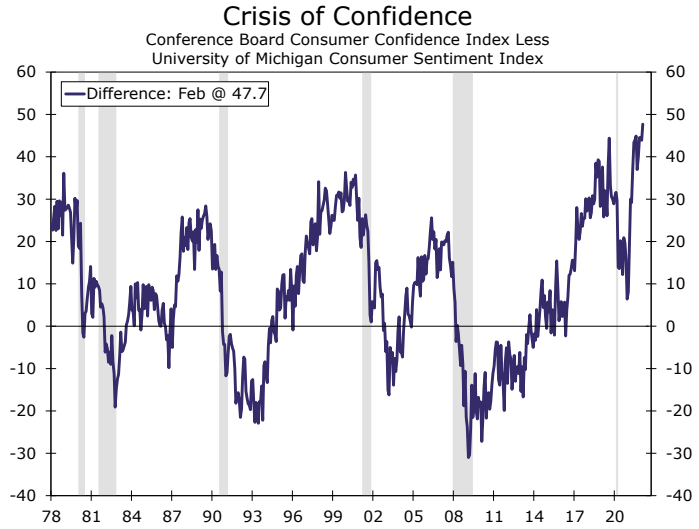
Energy was a guilty party in January's upside surprise. Electricity prices rose a whopping 4.2%, which pushed the energy index to 0.9% even with falling gas prices. In February, we are likely to see the energy line items climb higher as a result of Russia's invasion of Ukraine, which has only recently come on full display. Average gas prices started February under $3.40 a gallon and have since climbed to over $3.80. Peeling away the effects of food and energy prices, we see core CPI rising a still-strong 0.5% in February. We expect core inflation to see continued strength over the next few months, as it will take a much sharper slowdown in core goods inflation to balance out the increasing strength and breadth of services inflation.



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

University of Michigan Consumer Sentiment • Friday

Consumer sentiment, as measured by the University of Michigan, has had a bumpy start to the year, as the index has tumbled 7.8 points since the end of 2021. February's disappointing preliminary print was 61.7 and was revised up in the final to 62.8, but consensus estimates had expected sentiment to stay on par with January's 67.2 level. In March, preliminary estimates again are expecting little to no change in the index as right now only a -0.3pp drop is penciled in. But given the current inflationary environment as well as mounting concerns over the Russia-Ukraine invasion, much will be on consumers' minds in March. It has been difficult to gauge where consumer confidence stands recently as there have been mixed signals between the Conference Board's consumer confidence index, which has rather held up, and the fallout in Michigan's consumer sentiment index. The gap between the two has never been greater, and we expect that as long as inflation is hot and the labor market is tight this will be the case (chart). Next week's release of this more inflation-sensitive measure of consumers' opinions should offer some valuable insights as to which consumers are hurting due to higher prices and to what extent. February pointed to particularly pessimistic views within the lower income cohorts as well as a decline in buying plans. Purchase plans of vehicles and homes dropped, while that for major household items held steady. (Return to Summary)



Source: The Conference Board, Univ. of Michigan and Wells Fargo Economics

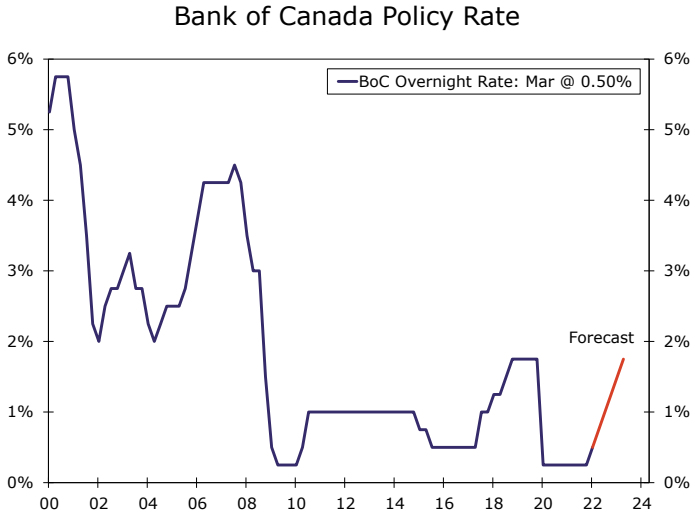
International Review

Bank of Canada Kicks Off Rate Hike Cycle

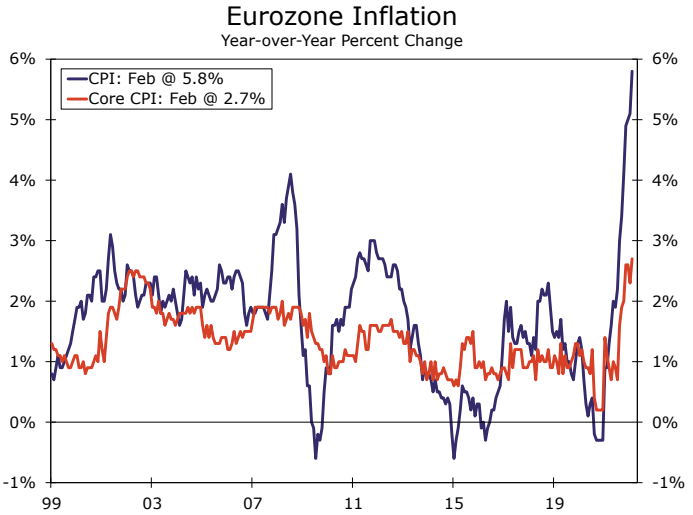
Canada's Q4 GDP came in stronger than expected, setting the stage for the Bank of Canada's (BoC) monetary policy meeting. GDP rose 6.7% in the fourth quarter on top of a solid 5.5% reading in the third quarter, while December GDP was unchanged month-over-month from November. Against this backdrop of sturdy economic growth, the BoC kicked off its rate hike cycle at its March monetary policy meeting with an initial, and widely expected, 25-bp policy rate increase to 0.50%. The central bank also said it is continuing to re-invest its bond holdings and will keep its "overall holdings of Government of Canada bonds on its balance sheet roughly constant until such time as it becomes appropriate to allow the size of its balance sheet to decline."

In addition to the policy rate increase, there were some hawkish elements in the central bank's accompanying statement. The BoC said fourth quarter and first quarter GDP growth were stronger than projected, price increases have become more pervasive and persistently elevated inflation is increasing the risk that longer-run inflation expectations could drift upward. It also expects interest rates will need to rise further.

Notably, the BoC acknowledged ongoing events in Ukraine, saying it was a major source of uncertainty, while also observing that prices for oil and other commodities have risen sharply. The central bank said the situation is fluid and that it is following events closely. Still, even acknowledging uncertainty from Ukraine, the BoC's announcement was hawkish enough to make clear that another 25-bp policy rate increase is likely at the April 13 meeting. Accordingly, we are adjusting our Bank of Canada policy rate outlook to include an additional 25-bp rate increase in April, to be followed by 25-bp rate increases at both the July and October meetings. By the end of this year, that would mean a further cumulative 75 bps of policy rate increases, which would lift the BoC interest rate to 1.25% from its current rate. While an even faster pace of tightening is conceivable, we are not inclined to make further adjustments at this time until there is further clarity surrounding the Russia-Ukraine situation. With this adjustment to our BoC policy outlook, we are broadly in line with the consensus forecast, but still somewhat more conservative than policy rate increases currently priced in by market participants.



Source: Bloomberg Finance L.P. and Wells Fargo Economics



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Eurozone Inflation Soars while Australian Growth Rebounds Amid Patient RBA

Elsewhere in the G10, the latest CPI readings from the Eurozone showed that inflation pressures are still very much present. In fact, Eurozone CPI inflation accelerated to an all-time high in February, quickening more than expected to 5.8% year-over-year, up from 5.1% in January. While base effects are at play here, the main driver of inflation remains energy prices, which are up 31.7% year-over-year. Furthermore, the conflict in Russia-Ukraine adds even more fuel to concerns about rising price pressures, as the global cost of fuel and commodities has driven inflation higher. Stripping out more volatile components like food and energy, core inflation still quickened to a record high 2.7%. We will continue to monitor incoming data to see if there is any effect from the Russia/Ukraine

situation, which may cause a further economic slowdown going forward. In addition to concerns about inflation, retail sales data released this week indicated that the consumer sector's rebound has yet to significantly pick up pace after a COVID-related slowdown in December. January retail sales increased 0.2% month-over-month, missing consensus expectations for a 1.5% rise, but are now up 7.8% year-over-year.

Down under, despite similar concerns about elevated inflation, the Reserve Bank of Australia (RBA) struck a patient tone at its March monetary policy meeting, leaving its policy interest rate unchanged at 0.10%. The central bank reiterated it will not raise rates until underlying inflation is "sustainably within its 2%-3% target range," which it believes is too early to conclude. In Q4, headline inflation surprised to the upside, accelerating to 3.5% year-over-year. More important, underlying price pressures measured by trimmed mean inflation (2.6%) and weighted median inflation (2.7%) also quickened more than expected and are higher than the midpoint of the 2%-3% target band. Notably, the central bank added commentary on the Russia-Ukraine situation, indicating that the conflict is a "major new source of uncertainty," as inflation has increased sharply in many countries due to spikes in energy and commodity prices as well as supply chain disruptions. In addition to elevated price pressures, Australia's economy saw a strong rebound in the final quarter of 2021. GDP grew 3.5% quarter-over-quarter in Q4 and is now up 4.2% year-over-year. Growth was driven primarily by resurgent household spending after pandemic lockdowns sent economic growth into negative territory in Q3. Given the solid rebound in the Australian economy, we see potential for underlying inflation to quicken further in the coming quarters as well. Against this backdrop, we expect the RBA's initial 15-bp rate hike to 0.25% to occur in November of this year. We also forecast an additional 100 bps of rate hikes over the course of 2023, which would take the Cash Rate to 1.25% by the end of 2023. (Return to Summary)

International Outlook

Weekly International Indicator Forecasts

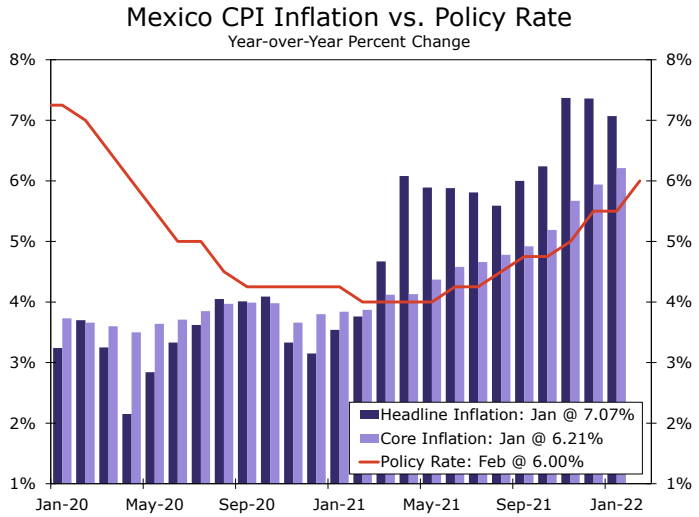
Date	Indicator	Period	Consensus	Wells Fargo	Prior
9-Mar	Mexico CPI (YoY)	Feb	--	7.22%	7.07%
10-Mar	ECB Deposit Rate	10-Mar	-0.50%	-0.50%	-0.50%
11-Mar	Brazil CPI (YoY)	Feb	10.46%	--	10.38%

Forecast as of March 04, 2022

Source: Bloomberg Finance L.P. and Wells Fargo Economics

Mexico CPI • Wednesday

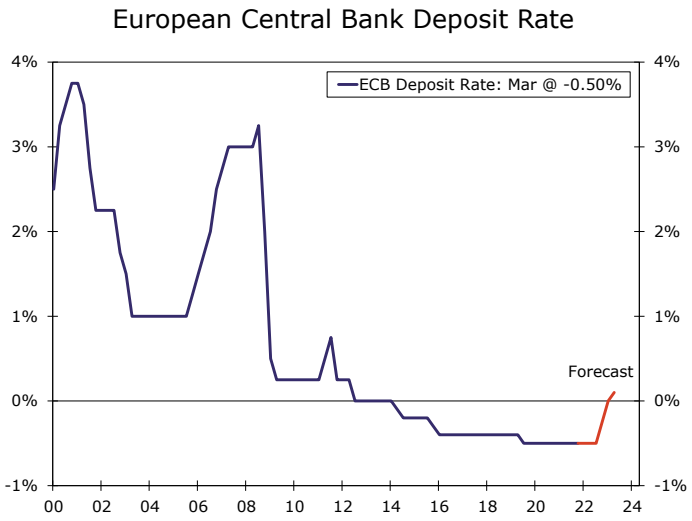
In the emerging markets, Mexico's February CPI figures are due for release next week. Similar to the Eurozone, Mexico has also seen price pressures intensify, and CPI data are expected to show that inflation has not yet begun to slow there either. Overall, the economy has struggled to gain momentum, and inflation remains well above the central bank's 3% target. In January, the headline CPI rose 7.07% year-over-year, while core inflation climbed to 6.21%, the highest reading in 20 years. Goods inflation was up 7.9% year-over-year, while services inflation was only slightly more contained at 4.4%. Against a backdrop of above-target inflation, Banxico raised policy rates 50 bps to 6.00% at its February meeting. The central bank's projections see core inflation peaking at 6.4% in Q1-2022, while it expects headline inflation to be 6.9% in the same quarter. Furthermore, Banxico sees inflation slowing to 4% by the end of 2022 and suspects it will not be back within its target range until Q4-2023. For February, we expect Mexico's headline CPI inflation to accelerate further and remain elevated at 7.22%.



Source: Bloomberg Finance L.P. and Wells Fargo Economics

ECB Monetary Policy Decision • Thursday

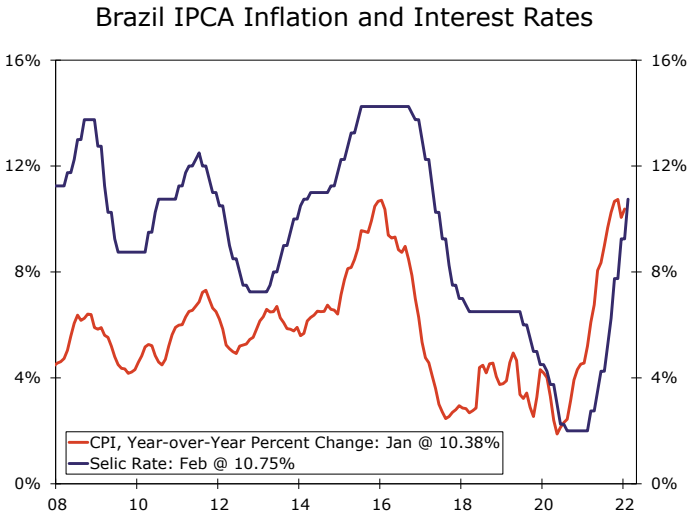
Market participants will be watching the European Central Bank's (ECB) March monetary policy meeting for insight into its future policy path. In the context of subdued growth and persistent inflation, we saw the ECB adopt a more hawkish tone at its February meeting, laying the foundation for a move to less accommodative policy in the months and quarters ahead. ECB President Lagarde expressed that inflation risks are tilted to the upside, and unlike at previous meetings, she did not rule out a rate hike in 2022. Thus, we expect the central bank to begin tightening monetary policy this year, even as the Ukraine crisis poses downside risks to growth and upside risks to inflation. At the March meeting, we expect the ECB to keep its Deposit Rate unchanged at -0.50% but also indicate an accelerated tapering of bond purchases. More specifically, we anticipate the ECB will conduct asset purchases at a monthly pace of €40B per month in Q2-2022 before slowing to €20B per month in Q3-2022. We also expect the ECB to signal that it intends to end its asset purchases in September 2022 and reiterate that it expects net asset purchases to end shortly before it starts raising key ECB interest rates. We expect the ECB to acknowledge Ukraine uncertainty and signal that it is prepared to recalibrate its monetary policy stance if needed. Overall, we still see the ECB on track for an initial 25-bp Deposit Rate increase this December. (Return to Summary)



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Brazil CPI • Friday

Similar to Mexico, Brazil has been experiencing high inflation, and we expect February's data to show that price pressures remain intact despite the Brazilian Central Bank's (BCB) aggressive monetary tightening efforts. January CPI figures showed inflation ticking higher to 10.38% year-over-year, well above the BCB's target of 3.5% +/- 1.5% for 2022, and only slightly below its November 2021 peak of 10.74%. Inflation in Brazil has been driven by price increases in transportation, housing and household goods, which have all been influenced by higher commodity prices. In response to this elevated inflation, the BCB raised its Selic Rate 150 bps to 10.75% at its February monetary policy meeting. So far, the central bank has raised rates by 875 bps since the beginning of the pandemic but has failed to significantly alleviate inflation, while the country also fell into technical recession. Seeing as the BCB signaled the pace of rate hikes is likely to slow going forward, we believe the central bank could be getting closer to the end of its tightening cycle. Overall, consensus expectations are for Brazil's February CPI inflation to remain elevated and tick up to 10.46% year-over-year.



Source: Bloomberg Financial L.P. and Wells Fargo Economics

Interest Rate Watch

Rates on a Roller Coaster Ride

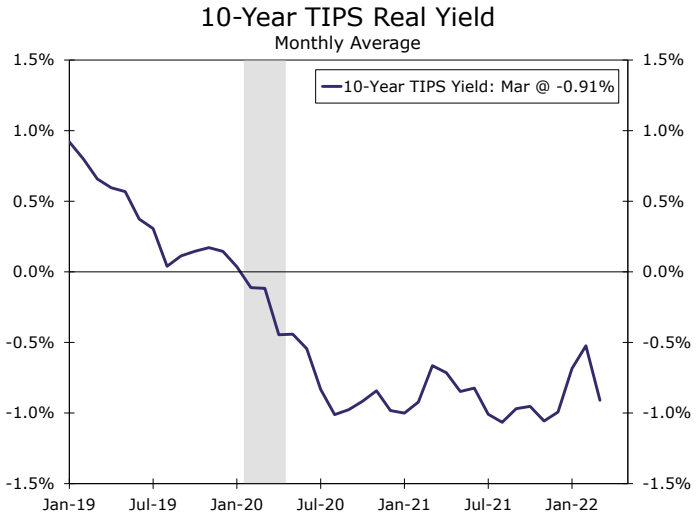
Russia's invasion of Ukraine last week, followed by wide-ranging and severe sanctions placed on Russia by numerous Western countries, sent global bond yields into motion this week. The 10-year Treasury yield plunged from 1.96% on Friday, February 25 to 1.73% by Tuesday, March 1. The two-year Treasury yield saw a similar move as investors rushed to safer assets and reassessed the Federal Reserve's tightening plans in light of geopolitical developments. On Wednesday, yields surged higher, with the 10-year yield climbing 15 bps on the day to 1.88%. By Friday morning, yields were again touching the week's lows, with the 10-year Treasury yield around 1.74%.

To some extent, the volatility is not surprising, given the significant economic uncertainty at the moment. Teasing out the impact to Treasury yields and interest rates more broadly from the Russia-Ukraine conflict is challenging. On the one hand, surging commodity prices and new challenges for global supply chains suggest that additional inflationary pressures will soon emerge. All else equal, higher realized and expected inflation should be associated with higher interest rates. On the other hand, high inflation due to rising commodity prices will eat into consumers' purchasing power and likely slow U.S. economic growth. Slower economic growth could put downward pressure on real (i.e., inflation-adjusted) interest rates, as would a more cautious Federal Reserve.

On the surface, the 10-year U.S. Treasury yield is down about 20 bps over the past week. Beneath the surface, however, there have been even bigger moves. 10-year Treasury breakevens, which are a measure of the market's expected inflation over the next decade, have jumped about 15 bps over the past week. Subsequently, real interest rates, or the nominal interest rate minus expected inflation, have plungedroughly 35 bps and are near the levels that prevailed at the beginning of the year (chart to the right).

This dynamic is an important one. As long as moves in breakevens are partially or even fully offset by moves in real yields, nominal Treasury yields will remain range bound. Numerous factors could change that relationship, such as changes to the economic growth outlook, changes in investor preferences and changes in the FOMC's reaction function. That said, steadily declining real interest rates have been a facet of the U.S. economy for several decades now. And for the time being at least, investors seem willing to purchase Treasury securities at relatively low nominal yields despite sky-high realized and expected inflation.

(Return to Summary)



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Credit Market Insights

Russia-Ukraine War Increases Market Volatility

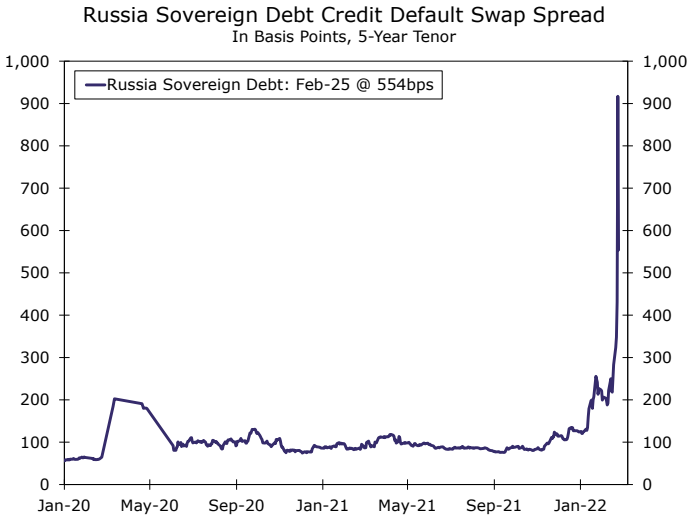
Russia's invasion of Ukraine has prompted sweeping financial and economic sanctions. For example, some of the country's largest banks have been barred from SWIFT, a messaging system that internationally-active commercial banks use to send and receive payment instructions. The United States and European Union imposed another significant sanction this week, banning certain transaction activities with Russia's banking system. The Central Bank of Russia, which built up a reserve of approximately $630 billion prior to the invasion of Ukraine, is now unable to access the majority of its reserves. The sanctions also impede Russia's ability to intervene in currency markets in an effort to support the ruble, which has plummeted against the U.S. dollar.

The falling ruble and the growing list of sanctions has rattled Russia's credit market. The Central Bank of Russia more than doubled its policy rate to 20% in response to the ruble's sharp depreciation, and yields have risen significantly on Russian government bonds. S&P Global cut the Russian government's rating to junk, while Moody's has issued a junk warning. Credit default swaps on Russia's shorter-term government debt have risen to record levels in reaction, with liquidity insufficiently low to chart the volatile spread past February 25th (see chart). Volatility has spilled over into the U.S. corporate bond market, with the spread on the benchmark index for North American investment-grade credit default swaps trading at 73 bps on March 4, which remains elevated relative to its average this year. As the spread widens when credit risk increases, the rise likely signals that investors are wary of the potential financial implications of the war.

That said, U.S. financial exposure to Russia appears to be rather limited. Russia's total external debt, which comprises the obligations that the household, business and public sectors owe to all foreign creditors, totaled nearly $500 billion at the end of the third quarter of last year. Most of this debt (about $350 billion) was denominated in foreign currencies, such as U.S. dollars and euros. The sharp depreciation of the ruble will make servicing these foreign currency-denominated debts more difficult, leading to a rise in Russia's default risk.

A detailed breakdown of the nationality of Russia's foreign creditors is not readily available, but the data suggest that much of the country's external debt is likely held by countries in Western Europe. Data from the U.S. Treasury Department show that Americans held only $17 billion worth of Russian debt securities at the end of 2020 (latest available data), which is trivial when viewed in the context of the $105 trillion worth of financial assets that American households held at year-end 2020.

While Russia's invasion of Ukraine has certainly caused higher financial market volatility, the overall effect on the U.S. financial system should be fairly minimal. For more information, please see "Who Has Economic and Financial Exposure to Russia?" and "Russia Economic Forecasts and Ruble Update". (Return to Summary)



Source: Bloomberg Finance L.P. and Wells Fargo Economics

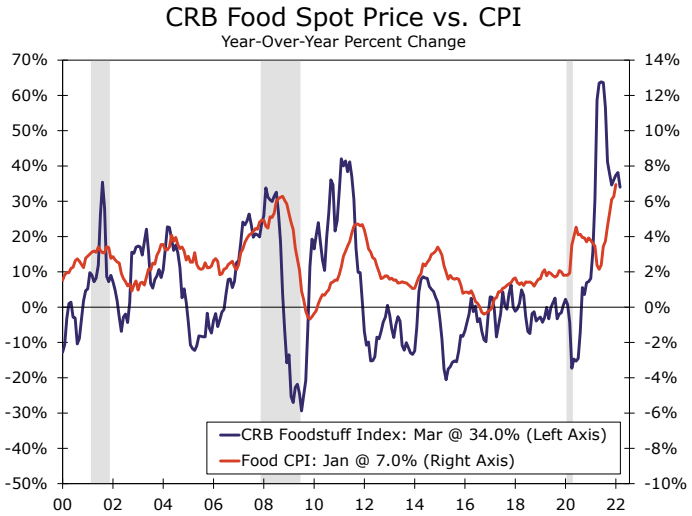
Topic of the Week

A Climb Down from Inflation Highs Resisted by Bread and Butter

Risk to the global supply of oil has risen considerably in the past 10 days. Russia alone accounts for approximately 10% of global oil production, and since the invasion of Ukraine, price increases in global oil futures have steadily risen. This only strengthens growth in oil prices, which have been increasing since the spring of 2020, when oil demand experienced fallout due to the onset of the pandemic in the Americas and Europe. However, the rise in energy prices are just one, albeit large, aspect of the inflation story that arises from recent volatility. The implications for food commodities are an important reason why inflation is likely to have a much slower descent from its peaks this spring.

Food commodities have been a strong driver of inflation over the past two years, and the CPI for food has risen at the strongest pace in nearly 40 years, tacking on one percentage point to the 7.5% year-over-year increase in headline CPI in January. At the start of February, the Commodities Research Bureau (CRB) Foodstuffs Spot Price Index sat just 1.2% below its record high set in 2011. However, these are only set to rise further in the wake of the ongoing conflict.

Much like energy, the nations involved in the war in Ukraine are significant producers and exporters of agricultural commodities. Russia, Belarus and Ukraine produce 27.9% of the world's wheat exports, 15.7% of the world's corn exports and 20.9% of the world's chemicals used in fertilizer. The potential for supply disruption in agricultural markets, through war or economic sanctions, threatens to drive food costs up even further. The rising cost of food is not an issue limited to food price increases, as it incites cost increases across sectors. We have mapped out how higher commodity prices—in the case of food alone as well as the combination of food and oil—have the power to reduce GDP growth, increase headline and core inflation and even raise the unemployment rate, due to economic sensitivity to these prices.



Source: Commodities Research Bureau, U.S. Department of Labor and Wells Fargo Economics

Food is a significant part of the consumption basket that forms the CPI index, and unlike some other notable fast-rising inflation categories like automobiles, one cannot substitute away from food. Consumers may be able to keep driving an older car and forgo vacationing due to higher prices, but everyone feels the impact of higher prices at the grocery stores. Ultimately, a rise in the price of food commodities is less impactful to overall inflation than a rise in the price of oil, due to oil's use as an input across the economy, but consumers will be very sensitive to these changes all the same. (Return to Summary)

For more information please see our recent special report for the broader impact of the Russia/Ukraine conflict on the U.S. economy.

Market Data • Mid-Day Friday

U.S. Interest Rates

	Friday 3/4/2022	1 Week Ago	1 Year Ago
SOFR	0.05	0.05	0.04
3-Month LIBOR	0.58	0.51	0.19
3-Month T-Bill	0.29	0.29	0.03
1-Year Treasury	1.15	1.15	0.04
2-Year Treasury	1.45	1.57	0.14
5-Year Treasury	1.60	1.87	0.79
10-Year Treasury	1.70	1.96	1.56
30-Year Treasury	2.13	2.27	2.32
Bond Buyer Index	2.53	2.51	2.44

Foreign Exchange Rates

	Friday 3/4/2022	1 Week Ago	1 Year Ago
Euro ($/€)	1.092	1.127	1.197
British Pound ($/£)	1.322	1.341	1.390
British Pound (£/€)	0.826	0.840	0.861
Japanese Yen (¥/$)	114.810	115.550	107.980
Canadian Dollar (C$/$)	1.277	1.271	1.267
Swiss Franc (CHF/$)	0.919	0.925	0.929
Australian Dollar (US$/A$)	0.734	0.723	0.773
Mexican Peso (MXN/$)	20.956	20.346	21.126
Chinese Yuan (CNY/$)	6.320	6.318	6.470
Indian Rupee (INR/$)	76.168	75.293	72.835
Brazilian Real (BRL/$)	5.087	5.152	5.669
U.S. Dollar Index	98.667	96.615	91.631

Source: Bloomberg Finance L.P. and Wells Fargo Economics

Foreign Interest Rates

	Friday 3/4/2022	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	-0.58	-0.59	-0.57
3-Month Sterling LIBOR	0.95	0.86	0.07
3-Month Canada Banker's Acceptance	1.00	0.93	0.44
3-Month Yen LIBOR	-0.01	-0.01	-0.08
2-Year German	-0.75	-0.38	-0.69
2-Year U.K.	1.06	1.21	0.08
2-Year Canadian	1.40	1.54	0.29
2-Year Japanese	-0.03	-0.02	-0.12
10-Year German	-0.09	0.23	-0.31
10-Year U.K.	1.20	1.46	0.73
10-Year Canadian	1.66	1.90	1.50
10-Year Japanese	0.16	0.21	0.13

Commodity Prices

	Friday 3/4/2022	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	112.65	91.59	63.83
Brent Crude ($/Barrel)	114.89	97.93	66.74
Gold ($/Ounce)	1959.94	1889.34	1697.52
Hot-Rolled Steel ($/S.Ton)	1150.00	1010.00	1268.00
Copper (¢/Pound)	487.70	447.20	399.10
Soybeans ($/Bushel)	16.61	15.74	14.10
Natural Gas ($/MMBTU)	4.94	4.47	2.75
Nickel ($/Metric Ton)	27,582	25,233	17,369
CRB Spot Inds.	660.71	653.11	554.42

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