

Weekly — November 18, 2022

Weekly Economic & Financial Commentary

United States: Even with Encouraging Inflation Developments, Economic Resilience Continues to Challenge the Fed

- In line with last week's CPI performance, the headline PPI increased 0.2% sequentially, two-tenths below expectations. The resiliency of the U.S. consumer was also on display, as total retail sales increased a stronger-than-expected 1.3% in October, boosted, in part, by a 1.3% jump in motor vehicles & parts and a 4.1% rise at gasoline stations. Weakness continued in the housing market, which is clearly in recession.
- Next week: Durable Goods Orders (Wed), New Home Sales (Wed)

International: What's Going On with Global Inflation?

- This week, October CPI data were released for the U.K., Canada and Japan, highlighting diverging paths for inflation in each economy. In the U.K., headline CPI inflation rose to 11.1% year-over-year, with the electricity, gas and other fuels category up nearly 90% compared to last year. Meanwhile, headline inflation in Canada has receded from a recent peak, coming in at 6.9%, but underlying price pressures continue to intensify. Last, Japan's inflation is much more contained compared to the U.K. and Canada, although prices are elevated by recent historical standards. Headline inflation quickened to 3.7% in October.
- Next week: Australia PMIs (Wed), Eurozone PMIs (Wed), U.K. PMIs (Wed)

Interest Rate Watch: Yield Curve Inversion Deepens

- Various points of the Treasury yield curve have inverted this year amid the Federal Reserve's aggressive policy tightening cycle. The spread between the yield on the two-year Treasury and the 10-year Treasury notes first turned negative in the spring and has become even more inverted in recent months, reaching a new low of -68 bps at the close on Thursday of this week.

Topic of the Week: The Economics of the 2022 World Cup

- What is expected to be the most viewed sporting event in world history is back, as 32 nations compete in Qatar starting on Sunday for the 2022 FIFA World Cup. We take a look at the economics of Qatar as well as our own predictions for the tournament.

Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual	Forecast			
	2022				2023				2021	2022	2023	2024	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product ¹	-1.6	-0.6	2.6	1.1	0.7	0.1	-2.5	-3.2	5.9	1.9	0.1	-0.2	
Personal Consumption	1.3	2.0	1.4	1.5	1.2	0.5	-1.7	-3.0	8.3	2.7	0.6	-0.5	
Consumer Price Index ²	8.0	8.6	8.3	7.4	6.0	4.2	3.4	3.1	4.7	8.1	4.1	2.7	
"Core" Consumer Price Index ²	6.3	6.0	6.3	6.1	5.5	4.7	3.8	3.3	3.6	6.2	4.3	2.9	
Quarter-End Interest Rates ³													
Federal Funds Target Rate	0.50	1.75	3.25	4.50	5.25	5.25	5.25	5.25	0.25	2.50	5.25	3.25	
Conventional Mortgage Rate	4.42	5.81	6.70	6.95	7.00	6.80	6.50	5.80	2.95	5.97	6.53	5.10	
10 Year Note	2.32	2.98	3.83	4.15	4.25	4.20	4.00	3.40	1.45	3.32	3.96	2.95	

Forecast as of: November 10, 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 [Pressure Gauge](#).

We will hold our 2023 Annual Economic Outlook on December 8th. Please see our [event link](#) for registration details.

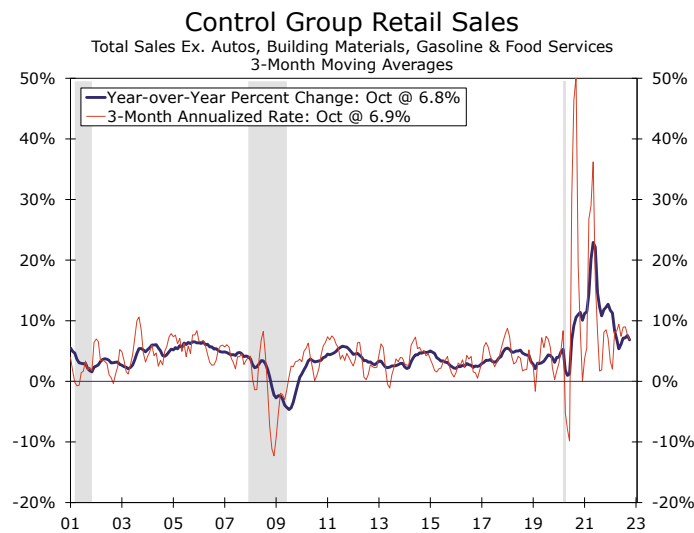
U.S. Review

Even with Encouraging Inflation Developments, Economic Resilience Continues to Challenge the Fed

On balance, this week's indicator performance came in slightly better than expected, supporting economic resilience so far through the fourth quarter even as the headwinds of elevated inflation, tightening monetary policy and heightened uncertainty about the outlook remain firmly intact. While supportive to the sustainability of the economic expansion, the stronger-than-expected performance makes the Fed's job of taming inflation that much more difficult.

The first piece of encouraging news this week was the lower-than-expected gain in producer prices. In line with last week's CPI performance, the headline PPI increased 0.2% sequentially, two-tenths below expectations. The more moderate pace of price gains cooled the year-over-year rate for the fourth straight month, dropping 0.5 percentage points to a still elevated 8.0%. October's headline increase reflected a 0.6% rise in final demand goods prices (about 60% of this increase can be traced to a 5.7% gain in gasoline) as final demand services prices slipped 0.1%, marking the first monthly drop since November 2020. While showing prices are beginning to head in the right direction, inflation is still running at an unacceptably high pace for the Fed. Yet another similar, downward trending performance from the November CPI report next month may provide enough evidence for the Fed to pull back on the pace of rate hikes as it seeks to bring down inflation markedly.

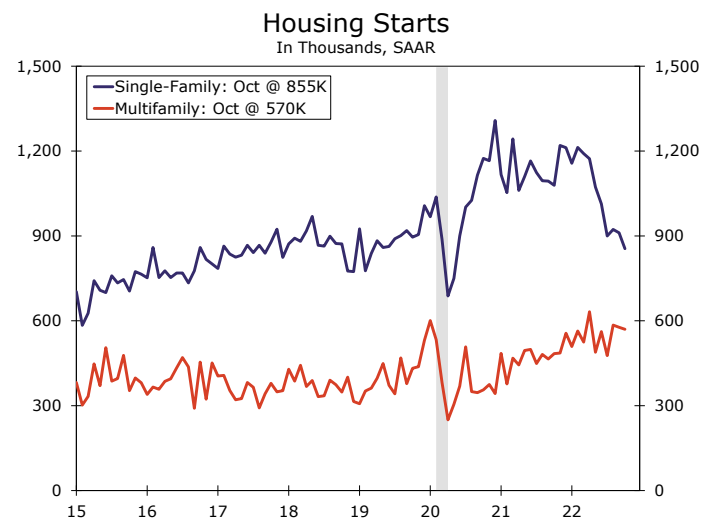
Highlighting the resiliency of the U.S. consumer, total retail sales increased a stronger-than-expected 1.3% in October, boosted, in part, by a 1.3% jump in motor vehicles & parts and a 4.1% rise at gasoline stations. Excluding the aforementioned and building materials and food, control group sales—which feed into the personal consumption expenditures component of GDP—increased by a strong 0.7% last month, on top of upward revisions to September and August. It is clear consumers are willing to run down savings and accumulate credit card debt in order to maintain their current pace of spending. The strong start to the current quarter suggests upside risk to our 6% year-over-year holiday shopping spending call and, in turn, Q4 consumer spending and GDP growth. Indeed, the Atlanta Fed GDPNow model currently projects Q4 U.S. real GDP growth at a 4.2% annualized rate.



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

In contrast to the aforementioned consumer resilience, industrial production slipped 0.1% in October as a muted rise in manufacturing was more than offset by declines in utility and mining output. There are growing signs of deterioration in the manufacturing sector, which is of little surprise given the weak global backdrop, rising interest rates, strong U.S. dollar and downturn in business and regional manufacturing surveys.

Weakness also extended to the housing market, which is clearly in recession. Total housing starts fell another 4.2% in October, bringing the annualized level to 1.425 million units. The fall in housing starts continues to be concentrated in the single-family sector where starts fell to the lowest rate since May 2020. Forward-looking building permits suggest little relief is in sight, with single-family permits also



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

dropping to the lowest level since the early months of the pandemic. Moreover, the NAHB Housing Market Index fell for the 11th straight month, dropping to its lowest level since April 2020. The current sales, future sales and traffic of prospective buyers' components all decreased and are running at very lows levels, which highlights the degree of homebuyer retreat the market is now seeing.

Having declined eight of the past 10 months, the Leading Economic Index (LEI) reminds us choppy waters are likely ahead for the U.S. economy in 2023. Led by lower consumer expectations and unemployment insurance claims, the LEI continued its descent in October, dropping 0.8% to its lowest level since May 2021. At -0.7%, the six-month average of the LEI remains below the -0.4% threshold we have found is consistent with a coming recession. While near-term resiliency in consumer spending and business investment look to support overall growth in the current quarter, we continue to anticipate economic momentum to slow going forward, with the U.S. economy entering recession in the second half of 2023 (for more information, please see our latest [U.S. Economic Outlook](#)).

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U.S. Outlook

Weekly Domestic Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
23-Nov	Durable Goods Orders (MoM)	Oct	0.5%	0.4%	0.4%
23-Nov	Durables Ex. Transportation (MoM)	Oct	0.1%	0.1%	-0.5%
23-Nov	New Home Sales (SAAR)	Oct	575K	581K	603K

Forecast as of November 18, 2022

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

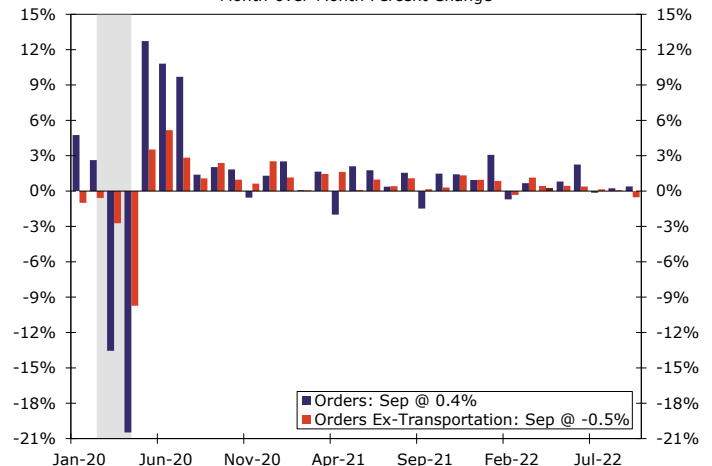
Durable Goods Orders • Wednesday

The industrial sector is losing momentum. Durable goods orders increased 0.4% in September, but the details of the report suggest new demand is fading. Capital goods orders excluding defense and aircraft, a leading indicator for business investment spending, slipped 0.7% in September. A streak of moderating monthly gains preceded the decline and suggests the pipeline of new demand is starting to dry up. Separately-reported data from the ISM manufacturing survey support that notion, with the new orders component in contraction territory for four of the past five months.

We suspect durable goods orders increased 0.4% in October. Orders for Boeing aircraft picked up last month, which may help to lift the transportation category. Excluding transportation, we look for orders to rise just 0.1%. While capital demand is showing signs of fading, consumer spending on goods has been resilient. Real personal spending on durable products is trending well above its pre-pandemic level, and orders for durable consumer goods have maintained an upward trajectory this year, even after adjusting for the run-up in producer prices. We suspect this category will help support production in the final stretch of the year.

Durable Goods New Orders

Month-over-Month Percent Change



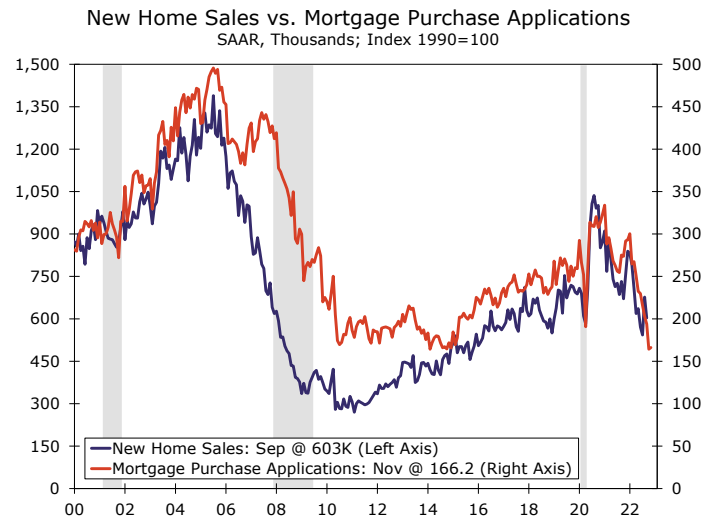
Source: U.S. Department of Commerce and Wells Fargo Economics

New Home Sales • Wednesday

Skyrocketing mortgage rates have significantly eroded housing affordability this year, pushing many potential buyers to the sidelines. Sales of new homes slid nearly 11% to a 603K-unit annual pace during September. Year-to-date, sales were down 14.3%. On the supply side, home builders have contended with faltering demand amid still-elevated building material and labor costs. New home inventories rose to 462K units in September, up 23% over the year. Separately-released residential construction data show single-family home completions dropping 8% in October. The drop-off in completions is a possible sign that home builders are beginning to cancel new home projects.

Looking ahead, we forecast new home sales to fall to a 581,000-unit annual pace in October. According to Freddie Mac, the fixed rate on a 30-year mortgage averaged 6.9% last month, a 0.7 ppt increase from September. Mortgage demand fell in response, which was evident in the mortgage applications for home purchase index declining by roughly 15% last month.

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Source: U.S. Department of Commerce, Mortgage Bankers Association and Wells Fargo Economics

International Review

What's Going On with Global Inflation?

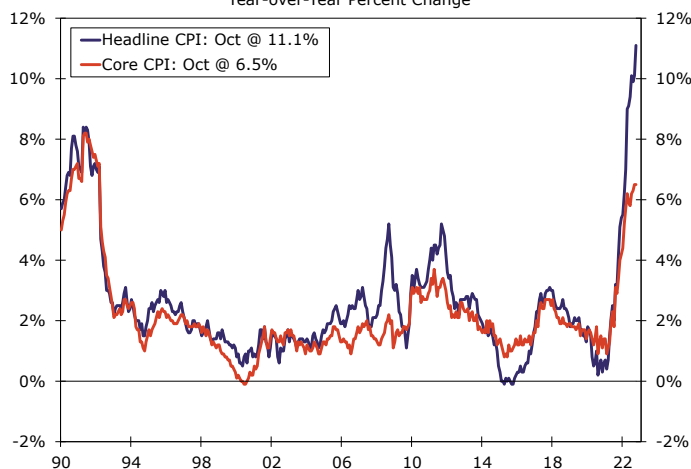
This week, CPI data were released for the United Kingdom, Canada and Japan, highlighting diverging paths for inflation in the global economy.

In the U.K., inflation soared even higher. The headline CPI accelerated to 11.1% year-over-year in October, a 42-year high. The number came in above both consensus economist estimates, as well as the Bank of England's (BoE) forecast for a peak of 10.9%, which should set the scene for continued monetary tightening at the central bank's next policy meeting in December. We expect the BoE to deliver a 50 bps rate hike to 3.50% in December, and one last 25 bps rate hike in February to a terminal rate of 3.75%. We think the BoE will keep rates steady for the majority of 2023, but begin cutting rates in Q4-2023, as the economy will likely have been in recession. Taking a close look at the details of the CPI report, it is no surprise energy costs were a large driver of price increases. Indeed, the electricity, gas and other fuels category was up nearly 90% year-over-year in October. Meanwhile, core inflation (excluding energy, food, alcohol and tobacco) remained unchanged from September at 6.5% year-over-year, but nevertheless is stubbornly elevated. With energy costs to households and firms expected to rise again in April 2023 when the government's energy price guarantee is adjusted, the path to lower inflation remains long.

While inflation in the U.K. continues its upward climb, headline inflation in Canada has come down from a recent peak, but remained stuck at a 6.9% year-over-year rate in October (unchanged from September). The main drivers of Canadian inflation appear to be food (10.1%), transportation (9.5%) and shelter (6.9%). Within the shelter category, the water, fuel and electricity line item is up "only" 12% year-over-year, piling in comparison to energy price rises in the U.K. and Eurozone. While the headline rate of inflation remained the same from September to October, underlying prices accelerated. The average of trim and median inflation, two measures of core inflation tracked closely by the Bank of Canada (BoC), quickened to 5.1% year-over-year, showing that even though headline inflation may have peaked, underlying price pressures remain persistent. This elevated inflation should provide a backdrop for the BoC to continue monetary tightening at its next policy meeting in December. BoC Governor Macklem has signaled that policy rates still need to rise further, but acknowledged that the tightening cycle is close to the end. We expect the central bank to deliver two more 25 bps rate hikes in December and January, with a terminal rate of 4.25%.

U.K. Consumer Prices

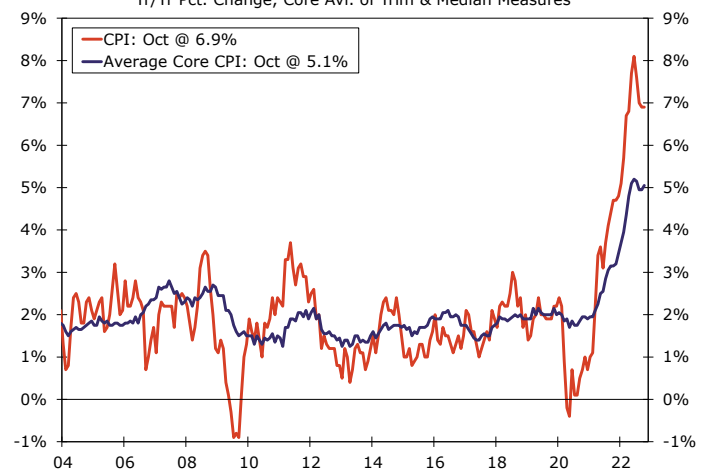
Year-over-Year Percent Change



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

Canadian Inflation

Yr/Yr Pct. Change, Core Avr. of Trim & Median Measures



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

In comparison to the U.K. and Canada, Japan's inflation is much more contained, although local inflation is elevated by recent historical standards. National headline CPI inflation quickened to 3.7% year-over-year in October. Meanwhile, core inflation (excluding fresh food) accelerated to 3.6%. This measure of underlying inflation has been above the Bank of Japan's (BoJ) target of 2% for seven months now. After the data release, BoJ Governor Kuroda said the recent acceleration in inflation is significant and prices could rise further. However, the BoJ expects price growth to fall back below 2%

next fiscal year, which means raising rates is not appropriate for the time being. Kuroda reiterated that 3% wage growth is necessary in order to achieve sustainable 2% overall inflation.

Higher local inflation has been boosted by a weaker yen in recent months. As of this writing, the yen has rebounded from 32-year lows; however, the effect of a weaker currency was still reflected in the Q3 GDP report. While the consensus expected the economy to expand in the third quarter, Japan's economy unexpectedly contracted by 1.2% quarter-over-quarter (annualized), as weakness in the currency led to higher import costs and a drop in net exports. Within the details of the GDP report, housing investment was also a drag on growth, but private consumption and business spending were both supportive of growth. The Japanese government's proposed stimulus package should help support the economy in the coming quarters and absorb some of the higher energy costs for households and firms. The reopening of borders to tourism should also be a plus. All told, with an eye toward supporting economic growth, we still expect the Bank of Japan to retain its easy monetary policy stance for the foreseeable future.

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International Outlook

Weekly International Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
23-Nov	Australia Manufacturing PMI	Nov	--	--	52.7
23-Nov	Australia Services PMI	Nov	--	--	49.3
23-Nov	Eurozone Manufacturing PMI	Nov	46.0	--	46.4
23-Nov	Eurozone Services PMI	Nov	48.0	--	48.6
23-Nov	UK Manufacturing PMI	Nov	45.8	--	46.2
23-Nov	UK Services PMI	Nov	48.0	--	48.8

Forecast as of November 18, 2022

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

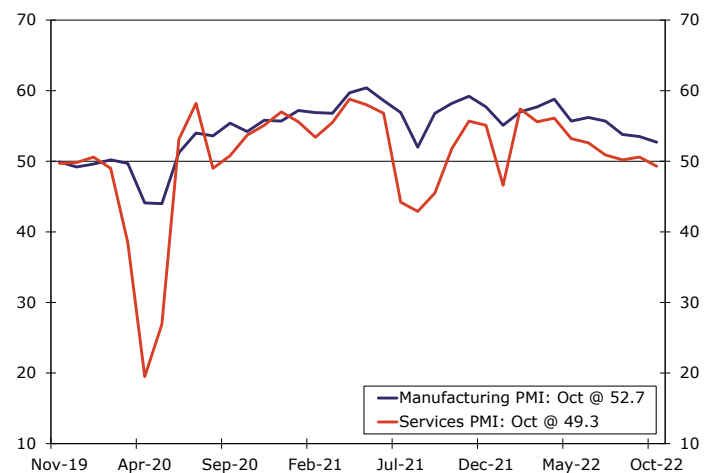
Australia PMIs • Wednesday

Next week will be a busy one for the Purchasing Managers' Index (PMI) indicator. These monthly surveys provide a timely read on sentiment and growth trends at manufacturing and services firms, taking into account factors like production, employment and prices.

Australia's October PMIs lost some steam, with the services PMI falling into contraction territory (less than 50) for the first time since January. Meanwhile, sentiment among manufacturing firms remains largely intact. Even though the manufacturing PMI has ticked down in recent months, it has remained above 50 since 2020. Overall, while we do not forecast a recession for Australia, a slowdown in growth may be approaching. This is supported by recent data showing dwindling consumer confidence, as well as a deteriorating assessment of business conditions and confidence by local firms.

Despite downside risks to growth, the labor market remains resilient, with a 32,200 employment gain driven by a surge in full-time jobs in October, and a solid 1% quarter-over-quarter rise in wages in Q3. Meanwhile, inflation at 7.3% year-over-year reinforces our expectation for the Reserve Bank of Australia to deliver another 25 bps rate hike in December.

Australia PMIs



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

Eurozone PMIs • Wednesday

Recessionary fears are running high in the Eurozone against a backdrop of soaring energy prices, European Central Bank (ECB) monetary tightening and a dimming global outlook. November PMIs released next Wednesday are expected to show another decline in optimism toward the economy, with the consensus expecting the manufacturing and services readings to decline to 46 and 48, respectively.

In the past few months, both the manufacturing and services PMIs have fallen further into contraction territory, signaling that sentiment in these sectors is worsening. With Eurozone inflation reaching 10.6% year-over-year in October, it is no surprise that confidence in the economy has dwindled. In the Eurozone in particular, high energy prices as a result of the Russia-Ukraine war have been a major point of pain. This was especially apparent in October PMI survey data from energy-intensive industries, including manufacturing firms, that reported steep losses in output. To make matters worse, demand for heating and energy will likely rise as temperatures drop throughout the winter season, a sign that it is unlikely these price pressures will abate anytime soon.

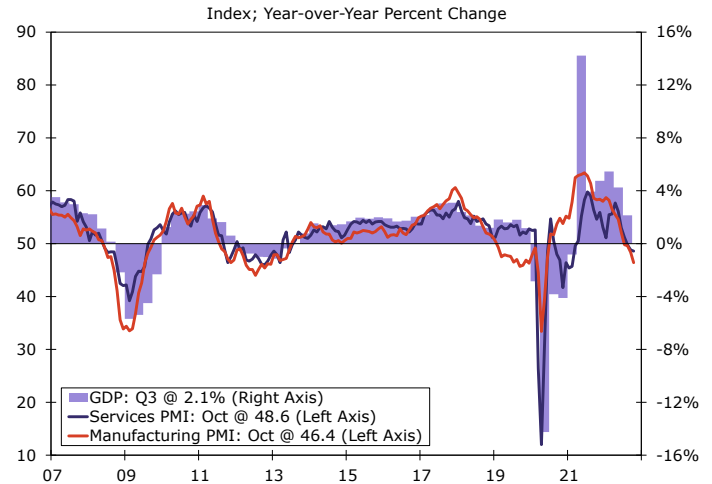
U.K. PMIs • Wednesday

A similar story is unfolding in the United Kingdom. U.K. CPI inflation reached 11.1% year-over-year in November, and the negative effect on sentiment will likely be reflected in the November PMIs released next week. More specifically, consensus expectations are for the manufacturing and services PMI to dip to 45.8 and 48, respectively.

To provide some context, in October the PMI surveys showed that average prices charged by private firms rose, while business expectations for activity in the year-ahead index registered the largest decline since March 2020. Furthermore, political uncertainties, rising interest rates and persistently high inflation weighed on optimism for both sectors. While some political uncertainties have been resolved, high inflation and rising interest rates remain prevalent in the U.K. economy, which we believe is already in recession. In addition, the government's recent fiscal policy plan that includes increased taxes for oil and gas companies as well as high-income earners also serves as a downside risk to growth. Plus, with energy bills expected to rise after the government's energy price guarantee is adjusted in April 2023, sentiment is likely to further deteriorate against a backdrop of stubbornly high inflation.

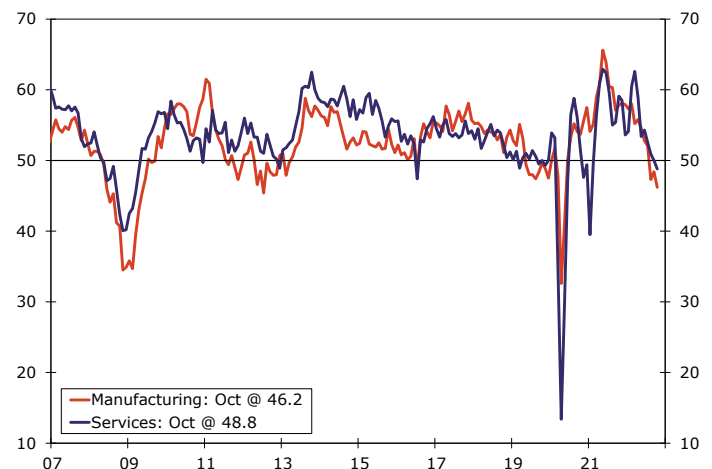
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Eurozone PMI Indices vs. GDP Growth



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

United Kingdom PMIs



Source: Datastream and Wells Fargo Economics

Interest Rate Watch

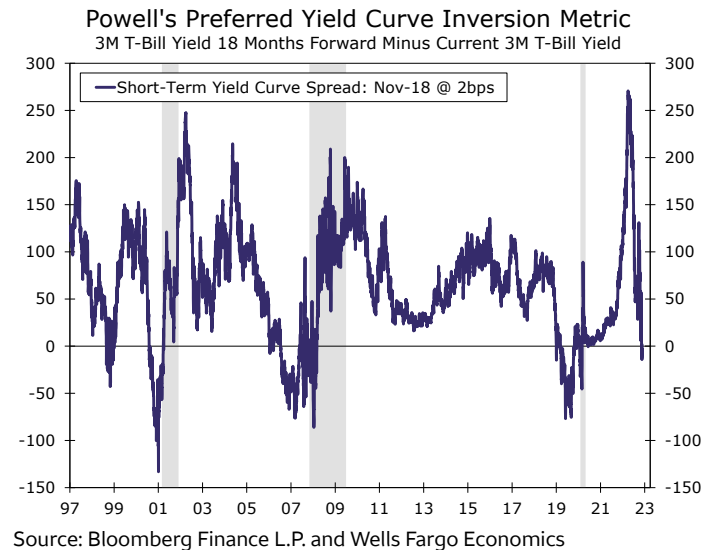
Yield Curve Inversion Deepens

Various points of the Treasury yield curve have inverted this year amid the Federal Reserve's aggressive policy tightening cycle. The spread between the yield on the two-year Treasury and the 10-year Treasury notes first turned negative in the spring and has become even more inverted in recent months, reaching a new low of -68 bps at the close on Wednesday of this week. Earlier in the year, Chair Powell cited a different segment of the yield curve that focuses on shorter maturities as the best empirical yield curve measure for future economic performance. That metric, which was sharply positive earlier in the year, has steadily flattened this year and turned slightly negative in recent days ([chart](#)).

Investors sometimes worry about inverted yield curves because of what they may signal about the future of the economy. If yields on shorter-term securities are above those of longer-term securities, it suggests that markets anticipate that interest rates will start falling at some point down the road. Another way to think about this is that if the FOMC hikes rates in the near term but starts cutting them over the medium term, it hints that somewhere over that horizon the economy might weaken enough that a policy easing cycle is warranted.

Our economic forecast is in line with a yield curve that is signaling turbulent times ahead. We expect the FOMC to keep hiking rates through March of next year, followed by an extended pause that leaves the federal funds rate slightly above 5%. As the lagged effect of this tight monetary policy hits the economy, we expect a mild recession starting around the middle of next year. But once inflation has moved closer to 2%, we expect rate *cuts* to come back into view. Accordingly, we look for the yield curve to start steepening late in 2023 and throughout 2024.

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Topic of the Week

The Economics of the 2022 World Cup

What is expected to be the most viewed sporting event in world history is back. Thirty-two nations will compete in Qatar starting on Sunday for the FIFA World Cup. Last time around, the 2018 World Cup in Russia was viewed by over three-and-a-half billion people, nearly half of the world's population. FIFA believes that number may reach 5 billion this year, reaching nearly two-thirds of the world's population. The choice of Qatar as host is fraught with [controversy](#), but it is a significant historical milestone. In the 92-year history of the cup, Qatar is the first Middle Eastern nation to host, and the first Asian nation since the joint South Korea-Japan 2002 World Cup.

Qatar's unique position as the first Middle Eastern host of the World Cup represents years of work in fiscal management and construction. For reference, Qatar is only 4,473 square miles large, smaller than Connecticut. In order to accommodate FIFA hosting regulations and an expected 1.5 million tourists, Qatar has spent an estimated \$220B, equivalent to almost one full year of GDP. No other host country has spent anywhere near this much, either in nominal terms or as a fraction of GDP.

The costs associated with hosting the World Cup mean that host nations typically do not break even, despite the tourism receipts. However, Qatar is in what is possibly the best fiscal situation of all host nations dating back to 1986. With a relatively low debt burden and a high fiscal surplus, Qatar has been able to undertake a massive amount of construction without accumulating an unwieldy amount of debt. As a major international exporter of both oil and natural gas, Qatar has certainly benefited from the rising price of these commodities this year, and will likely be a bigger player on the world stage due to these resources. Successfully organizing the World Cup could be the first step of attracting international capital for both expanding current resource extraction and diversifying the economy of Qatar.

In case you are wondering our pick for the World Cup winner, our international economist Brendan McKenna believes that Brazil will ultimately hoist the cup on Dec. 18. For more information on both the economics surrounding the World Cup and Brendan's picks, please see our [special report](#).



Source: FIFA and Wells Fargo Economics

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Market Data • Mid-Day Friday

U.S. Interest Rates

	Friday 11/18/2022	1 Week Ago	1 Year Ago
SOFR	3.80	3.78	0.05
3-Month LIBOR	4.68	4.65	0.16
3-Month T-Bill	4.23	4.16	0.05
1-Year Treasury	4.49	4.38	0.11
2-Year Treasury	4.47	4.33	0.50
5-Year Treasury	3.98	3.94	1.22
10-Year Treasury	3.81	3.81	1.59
30-Year Treasury	3.92	4.02	1.97
Bond Buyer Index	3.75	4.02	2.13

Foreign Exchange Rates

	Friday 11/18/2022	1 Week Ago	1 Year Ago
Euro (\$/€)	1.036	1.035	1.137
British Pound (\$/£)	1.192	1.183	1.349
British Pound (£/€)	0.869	0.875	0.842
Japanese Yen (¥/\$)	139.950	138.810	114.260
Canadian Dollar (C\$/ \$)	1.338	1.328	1.260
Swiss Franc (CHF/\$)	0.951	0.942	0.926
Australian Dollar (US\$/A\$)	0.668	0.670	0.728
Mexican Peso (MXN/\$)	19.496	19.503	20.778
Chinese Yuan (CNY/\$)	7.120	7.097	6.386
Indian Rupee (INR/\$)	81.704	80.823	74.238
Brazilian Real (BRL/\$)	5.364	5.326	5.566
U.S. Dollar Index	106.585	106.292	95.544

Foreign Interest Rates

	Friday 11/18/2022	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	-0.58	-0.59	-0.57
3-Month Sterling LIBOR	3.55	3.47	0.11
3-Month Canada Banker's Acceptance	4.67	4.63	0.49
3-Month Yen LIBOR	-0.04	-0.03	-0.09
2-Year German	2.10	2.21	-0.75
2-Year U.K.	3.19	3.17	0.54
2-Year Canadian	3.94	3.83	0.98
2-Year Japanese	-0.03	-0.06	-0.12
10-Year German	2.02	2.16	-0.28
10-Year U.K.	3.24	3.36	0.93
10-Year Canadian	3.12	3.15	1.70
10-Year Japanese	0.25	0.24	0.08

Commodity Prices

	Friday 11/18/2022	1 Week Ago	1 Year Ago
WTI Crude (\$/Barrel)	79.32	88.96	79.01
Brent Crude (\$/Barrel)	87.25	95.99	81.24
Gold (\$/Ounce)	1755.98	1771.24	1858.94
Hot-Rolled Steel (\$/S.Ton)	660.00	662.00	1798.00
Copper (¢/Pound)	366.50	391.35	430.45
Soybeans (\$/Bushel)	14.15	14.26	12.75
Natural Gas (\$/MMBTU)	6.38	5.88	4.90
Nickel (\$/Metric Ton)	24,929	25,853	19,439
CRB Spot Inds.	568.59	563.44	646.95

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

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