

Monthly — May 11, 2023

U.S. Economic Outlook: May 2023

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The Trouble with Good News

- Recent data on consumer spending and the labor market have been better than expected, which ought to mean that a soft landing is more likely. Although we have pared back our expected decline in consumer spending, we maintain our call that recession is a more likely outcome than a soft landing.
- The trouble with good news these days is that each improvement in the labor market and consumer spending makes it more difficult for the Fed to get inflation under control. This implies tighter rather than more accommodative monetary policy.
- Yet, tight policy is already having a negative effect in other parts of the economy as the second-largest bank failure in U.S. history earlier this month demonstrates.
- After what we have characterized as a hawkish pause, we expect the Federal Reserve to keep rates higher-for-longer than market pricing currently anticipates. We think the Fed will hold off on cutting rates through year-end 2023 though we do expect monetary easing to get under way in earnest at the start of 2024.
- Ongoing stress in the financial sector is not the only threat to the outlook that worsens amid tight policy. Even if the debt ceiling is resolved without further incident, higher rates also make federal budget deficits more expensive to finance, a dynamic that implies that this debt ceiling fight won't be the last.
- As recessions go, the one we envision in our forecast is a comparatively mild one with a peak-to-trough decline of 1.0%, which is smaller than the 2.2% median decline across the past nine economic cycles.

Dark Clouds Gathering Despite Sunny Data

When it comes to the most important factors influencing the outlook for the economy these days, it is a crowded and not particularly cheerful field. Consider just the top three: the uncomfortable dichotomy between the FOMC and the market about where rates are headed, ongoing instability in the banking sector that culminated in another U.S. bank failure earlier this month and a looming deadline with the debt ceiling and little in the way of progress to avoid it.

Yet for all that, the Federal Reserve and other authorities have, for now at least, largely succeeded in preventing a repeat of the credit crisis of 2008, which has been the explicit premise of our forecast since March. Unlike those scary days 15 years ago, this time credit markets have avoided seizing and equities have not faced a broad selloff. On the contrary, access to credit may be less widely available but credit markets are still functioning, and equity markets are broadly higher since March lows.

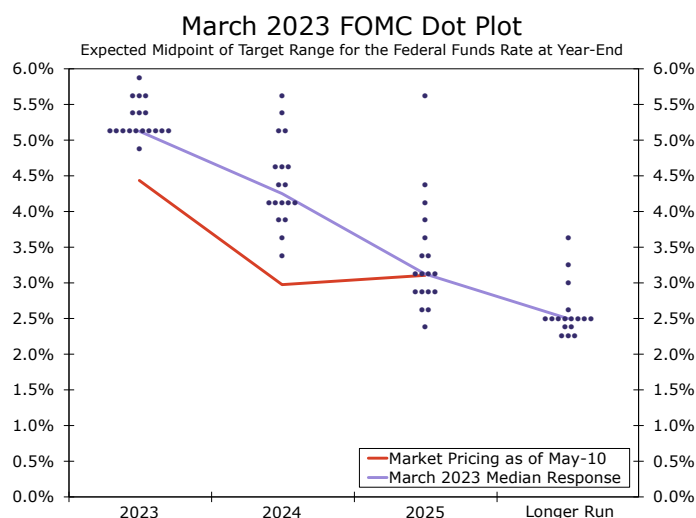
The titanic challenge for the FOMC is to administer just enough policy tightening to slow the jobs market and increase the cost of capital enough to take the swagger out of consumer spending and thus tame inflation without causing further collateral damage in the banking sector. To that end, the FOMC raised its target range for the fed funds rate by 25 bps in May, capping off a campaign that has hiked rates 500 bps since March 2022, the fastest pace of monetary tightening since the early 1980s.

The FOMC says rates are apt to remain higher for longer; the market disagrees. Market pricing may reflect concern about these other factors: the health of banking system and/or fallout from a disorderly handling of the debt ceiling. Lower rates could help ameliorate both and could thus explain why the futures market looks for a year-end fed funds rate of 4.32% as of this writing rather than the 5.00% or higher expected by 17 of 18 FOMC members, according to the March dot plot (Figure 1).

In ordinary times, we recalibrate our forecast on a monthly basis, considering the various ways the latest high frequency data inform our view on prospects for the coming quarters. Today, some clarity on these multiple threats such as the instability in the banking sector or a political standoff over the debt ceiling are just as critical as the economic data.

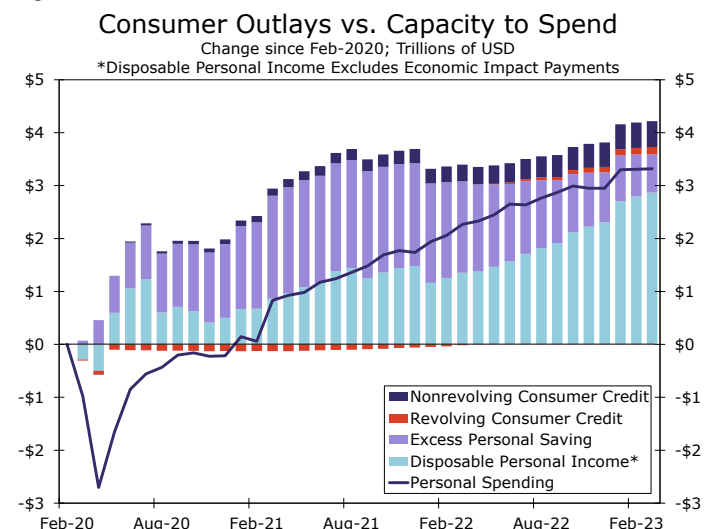
For months, we have maintained the explicit premise that systemic threat to the banking system will be avoided and that (eventually) the debt ceiling situation would be resolved. Even if those outcomes should come to pass exactly as we have described, it does not mean it will be smooth sailing. Even before the tumult in the financial sector took hold in March, lending standards were already tightening. It is also a fact that of the four largest bank failures in U.S. history, three have occurred in 2023. Even in the absence of additional fallout in the banking sector, the hair-whitening experience of the past three months will make access to credit both less accessible and less affordable. Meanwhile, even if a default in U.S. sovereign debt is avoided, last-minute grandstanding and dangerous games of chicken among lawmakers could add stress to already anxious financial markets.

Figure 1



Source: Federal Reserve Board and Wells Fargo Economics

Figure 2



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

Stop Hitting the Snooze Button on Recession

Our forecast says recession is coming. There was a time when we stood out with that call; it has become the consensus expectation. You can be forgiven if that warning does not instill the sort of apprehension that it once did. The next recession has become the most anticipated one in recent history even though it is taking longer to arrive than most forecasters thought, ourselves included. Having identified the pitfalls that may threaten the outlook, we return to the usual business of keeping tabs on the latest economic data, and on that score, things look decidedly upbeat. That is good for the economy, but it only delays what we consider to be the inevitable downturn that awaits.

The adjustments to our own forecast since last month price in a better-than-expected run of data for the labor market and the consumer in recent weeks and thus push out the timing of the downturn somewhat, while also paring back the expected decline in consumer spending in the out quarters. First quarter GDP numbers revealed that consumer spending accelerated to 3.7% at an annualized rate, the fastest in almost two years. Even as still-swollen savings accounts are drawn down and as credit could become more scarce, consumers are increasingly reliant on a paycheck as driver of spending ([Figure 2](#)).

Arguably the most consequential factor putting off the downturn is the resilience of the labor market. Despite several leading indicators pointing to lost momentum from a drop in job openings to a trend rise in the number of people on ongoing unemployment insurance, the monthly jobs numbers continue to come in strong. In April, the unemployment rate fell to match its 53-year low, while the latest data on employment costs and average hourly earnings show wage pressures cooling only gradually. With jobs still plentiful, employers are still paying up for talent resulting in nine straight months in which income growth has outpaced inflation. Real income gains are a more sustainable driver of spending than a drawing down of savings. But as long as spending remains robust, there is less incentive for firms to keep a lid on prices.

This is the other side of the FOMC's titanic challenge. Thanks to the strength of the jobs market and the staying power of the consumer, inflation has been slow to come down, but it is evident the monetary policy tightening already administered is too much for some parts of the banking sector. That is not to say there have been no signs of price moderation, there have, but the core CPI rose another 0.4% in April and the core rate of inflation remains stubbornly high. Core CPI inflation has registered annualized rates above 5% over both the past three months and the past 12 months. Still, core services inflation excluding primary shelter showed some tentative signs of slowing in April. Policymakers at the Fed will need to see more progress on that front before any move toward cutting rates.

Although April brought some cooling in travel services inflation, on trend, the sustained pressure on service prices reflects the composition of consumer spending, which has favored services over goods on trend for several months. After applying our inflation adjustment, real retail sales are now down in four of the past five months.

Amid this correction in goods spending, manufacturing activity has stalled. The ISM manufacturing index has been in contraction territory for six straight months. Small business plans to make new capital expenditures are also approaching pandemic lows, signaling decreased appetite to take on new projects ([Figure 4](#)). With conditions only growing less favorable, we anticipate equipment spending will be even weaker through this year than we had previously forecast.

Higher interest rates have slowed activity in the housing market amid a near collapse in homebuilder sentiment, but the bottom has not completely fallen out. Higher mortgage rates do chip away at affordability, but the scarce inventory of homes available for sale has put a bit of a safety net under the housing market. In a sign that the initial reaction to rate hikes might have been a bit overdone, both builder sentiment and residential construction activity have both posted modest increases in recent months. A recession is still a recession and that is not good news for construction, but the lean inventories and the fact that the peak might already be in for mortgage rates suggests we are not due for a repeat of the collapse in homebuilding activity that followed the housing bubble.

An otherwise benign outlook for commercial real estate is still clouded by the question of office space. More than three years after office workers were first sent home during the pandemic, today's current occupancy rates point to an oversupply of office space. On that basis, our forecast reflects some moderation for structures investment. That said, other categories of commercial real estate such as industrial and warehouse space remain in demand with vacancy rates relatively low and rents steady.

On that basis, we look for some retrenchment in structures spending, but we suspect warnings of a total collapse due to a single category, even a large one like office space are perhaps a bit overdone.

To sum up, there are more reasons to suspect that recession is coming than there are to still believe in a soft landing. To be fair, on the basis of the economic data alone, the soft-landing scenario may appear more likely after a run of better-than-expected data for both the labor market and the consumer in recent weeks. The trouble is: This rosier outcome implies tighter rather than more accommodative monetary policy. Yet, tight policy is already having a negative effect in other parts of the economy as the second-largest bank failure in U.S. history earlier this month suggests. Even if the debt ceiling is resolved without further incident, higher rates also make federal budget deficits more expensive to finance, a dynamic that implies that this debt ceiling fight won't be the last. As recessions go, the one we envision in our forecast is a comparatively mild one with a peak-to-trough decline of 1.0%, which is smaller than the 2.2% median decline across the past nine economic cycles.

Figure 3

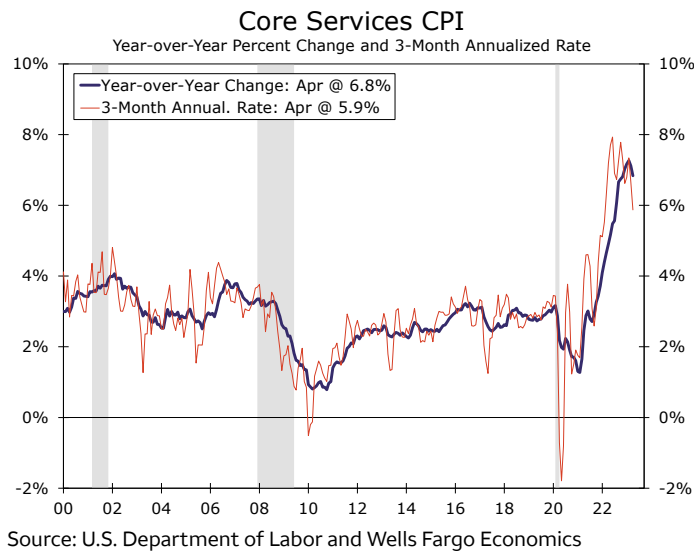
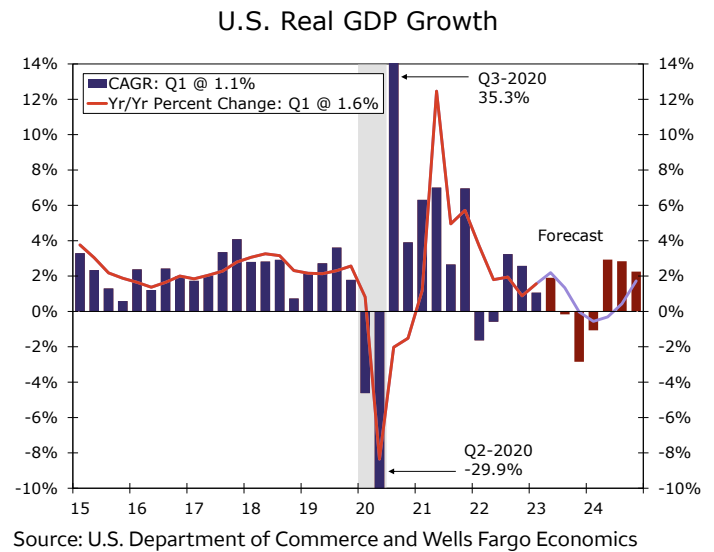


Figure 4



U.S. Forecast Table

| Wells Fargo U.S. Economic Forecast | | | | | | | | | | | | | | | | | | | | |
|--|---------|---------|---------|---------|---------|---------|---------|---------|----------|---------|---------|---------|---------|---------|---------|---------|---------|---------|----------|---------|
| | Actual | | | | | | | | Forecast | | | | | | | | Actual | | Forecast | |
| | 2021 | | | | 2022 | | | | 2023 | | | | 2024 | | | | 2021 | 2022 | 2023 | 2024 |
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | | | | |
| Real Gross Domestic Product (a) | 6.3 | 7.0 | 2.7 | 7.0 | -1.6 | -0.6 | 3.2 | 2.6 | 1.1 | 1.9 | -0.2 | -2.8 | -1.1 | 2.9 | 2.8 | 2.3 | 5.9 | 2.1 | 1.3 | 0.3 |
| Personal Consumption | 10.8 | 12.1 | 3.0 | 3.1 | 1.3 | 2.0 | 2.3 | 1.0 | 3.7 | 1.0 | -0.2 | -1.5 | -0.7 | 2.5 | 2.4 | 2.6 | 8.3 | 2.7 | 1.6 | 0.5 |
| Business Fixed Investment | 8.9 | 9.9 | 0.6 | 1.1 | 7.9 | 0.1 | 6.2 | 4.0 | 0.7 | 1.5 | -1.9 | -6.5 | -5.3 | -0.5 | 2.0 | 3.3 | 6.4 | 3.9 | 1.3 | -2.4 |
| Equipment | 6.1 | 14.0 | -2.2 | 1.6 | 11.4 | -2.0 | 10.6 | -3.5 | -7.3 | -1.6 | -4.1 | -10.8 | -8.0 | 0.4 | 3.5 | 4.1 | 10.3 | 4.3 | -2.9 | -4.0 |
| Intellectual Property Products | 15.6 | 12.6 | 7.4 | 8.1 | 10.8 | 8.9 | 6.8 | 6.2 | 3.8 | 4.1 | 0.7 | -2.5 | -2.0 | 1.5 | 3.7 | 5.5 | 9.7 | 8.8 | 4.2 | 0.4 |
| Structures | 1.9 | -2.5 | -6.7 | -12.7 | -4.3 | -12.7 | -3.6 | 15.8 | 11.2 | 2.8 | -3.1 | -5.8 | -7.5 | -8.5 | -6.8 | -5.3 | -6.4 | -6.6 | 3.9 | -6.0 |
| Residential Investment | 11.6 | -4.9 | -5.8 | -1.1 | -3.1 | -17.8 | -27.1 | -25.1 | -4.2 | -3.5 | -3.2 | -2.9 | -2.6 | 1.9 | 3.1 | 4.8 | 10.7 | -10.6 | -12.4 | -0.8 |
| Government Purchases | 6.5 | -3.0 | -0.2 | -1.0 | -2.3 | -1.6 | 3.7 | 3.8 | 4.7 | 1.5 | 1.4 | 1.3 | 1.0 | 1.0 | 0.9 | 0.8 | 0.6 | -0.6 | 2.8 | 1.1 |
| Net Exports | -1164.5 | -1203.9 | -1267.5 | -1297.6 | -1488.7 | -1430.5 | -1268.8 | -1238.6 | -1235.8 | -1224.9 | -1215.3 | -1184.0 | -1148.0 | -1138.3 | -1180.2 | -1199.4 | -1233.4 | -1356.7 | -1215.0 | -1166.5 |
| Pct. Point Contribution to GDP | -1.0 | -0.6 | -1.1 | -0.2 | -3.1 | 1.2 | 2.9 | 0.4 | 0.1 | 0.2 | 0.2 | 0.6 | 0.7 | 0.2 | -0.8 | -0.4 | -1.7 | -0.6 | 0.7 | 0.2 |
| Inventory Change | -83.0 | -143.6 | -48.6 | 197.6 | 214.5 | 110.2 | 38.7 | 136.5 | -1.6 | 28.3 | 22.7 | -56.7 | -85.0 | -45.3 | 25.5 | 28.3 | -19.4 | 125.0 | -1.8 | -19.1 |
| Pct. Point Contribution to GDP | -2.5 | -0.8 | 2.0 | 5.0 | 0.2 | -1.9 | -1.2 | 1.5 | -2.3 | 0.6 | -0.1 | -1.6 | -0.6 | 0.8 | 1.4 | 0.1 | 0.2 | 0.7 | -0.6 | -0.1 |
| Nominal GDP (a) | 11.7 | 13.8 | 9.0 | 14.3 | 6.6 | 8.5 | 7.7 | 6.6 | 5.1 | 4.3 | 1.9 | -1.0 | 1.0 | 5.2 | 5.6 | 5.2 | 10.7 | 9.2 | 5.0 | 2.5 |
| Real Final Sales | 9.2 | 7.9 | 0.7 | 1.9 | -1.8 | 1.3 | 4.5 | 1.1 | 3.4 | 1.3 | -0.1 | -1.3 | -0.5 | 2.1 | 1.4 | 2.2 | 5.7 | 1.3 | 2.1 | 0.5 |
| Retail Sales (b) | 13.8 | 30.7 | 13.7 | 15.9 | 13.0 | 9.2 | 10.0 | 7.0 | 4.9 | 2.5 | 0.7 | -1.0 | -2.3 | -2.8 | -1.2 | 0.7 | 18.2 | 9.7 | 1.8 | -1.4 |
| Inflation Indicators (b) | | | | | | | | | | | | | | | | | | | | |
| PCE Deflator | 1.9 | 4.0 | 4.5 | 5.7 | 6.4 | 6.6 | 6.3 | 5.7 | 4.9 | 3.6 | 3.1 | 2.6 | 2.1 | 2.1 | 2.2 | 2.4 | 4.0 | 6.3 | 3.5 | 2.2 |
| "Core" PCE Deflator | 1.7 | 3.5 | 3.9 | 4.7 | 5.3 | 5.0 | 4.9 | 4.8 | 4.7 | 4.4 | 4.0 | 3.6 | 2.9 | 2.6 | 2.4 | 2.4 | 3.5 | 5.0 | 4.2 | 2.6 |
| Consumer Price Index | 1.9 | 4.8 | 5.3 | 6.8 | 8.0 | 8.6 | 8.3 | 7.1 | 5.8 | 4.0 | 3.2 | 2.7 | 2.4 | 2.3 | 2.6 | 2.8 | 4.7 | 8.0 | 3.9 | 2.5 |
| "Core" Consumer Price Index | 1.5 | 3.7 | 4.0 | 5.0 | 6.3 | 6.0 | 6.3 | 6.0 | 5.6 | 5.2 | 4.6 | 4.2 | 3.7 | 3.2 | 2.9 | 2.8 | 3.6 | 6.1 | 4.9 | 3.1 |
| Producer Price Index (Final Demand) | 2.9 | 6.9 | 8.4 | 9.7 | 10.8 | 11.0 | 8.9 | 7.4 | 4.5 | 2.0 | 1.8 | 1.4 | 1.5 | 1.8 | 2.0 | 2.3 | 7.0 | 9.5 | 2.4 | 1.9 |
| Employment Cost Index | 2.6 | 2.9 | 3.7 | 4.0 | 4.5 | 5.1 | 5.0 | 5.1 | 4.8 | 4.6 | 4.4 | 4.3 | 4.0 | 3.8 | 3.6 | 3.5 | 3.3 | 4.9 | 4.5 | 3.7 |
| Real Disposable Income (a) | 52.3 | -28.7 | -4.6 | -4.9 | -10.6 | -2.3 | 3.2 | 5.0 | 8.0 | 1.5 | 1.0 | 0.0 | 0.7 | 2.2 | 2.0 | 2.9 | 1.9 | -6.1 | 3.5 | 1.2 |
| Nominal Personal Income (a) | 55.2 | -19.7 | 1.7 | 3.0 | 3.0 | 4.9 | 7.5 | 7.5 | 5.1 | 3.4 | 2.5 | 1.3 | 2.2 | 3.7 | 4.1 | 5.2 | 7.4 | 2.4 | 4.9 | 2.8 |
| Industrial Production (a) | 1.4 | 6.5 | 3.2 | 4.2 | 3.7 | 4.1 | 2.1 | -2.5 | 0.2 | -2.6 | -7.1 | -9.2 | -5.8 | -0.1 | 1.2 | 1.3 | 4.4 | 3.4 | -1.9 | -4.1 |
| Capacity Utilization | 75.5 | 77.2 | 78.2 | 79.2 | 80.0 | 80.6 | 80.8 | 79.9 | 79.6 | 79.0 | 77.6 | 75.8 | 74.7 | 74.7 | 74.9 | 75.2 | 77.6 | 80.3 | 78.0 | 74.9 |
| Corporate Profits Before Taxes (b) | 16.1 | 39.2 | 15.3 | 22.3 | 10.9 | 7.7 | 5.5 | 2.6 | 0.5 | -4.5 | -6.0 | -10.0 | -4.0 | 0.0 | 3.0 | 10.0 | 22.6 | 6.6 | -5.0 | 2.1 |
| Corporate Profits After Taxes | 13.8 | 37.5 | 14.0 | 20.7 | 6.1 | 5.0 | 3.5 | 1.6 | 2.4 | -4.1 | -6.5 | -9.4 | -4.0 | -0.1 | 3.1 | 10.0 | 20.9 | 4.0 | -4.5 | 2.1 |
| Federal Budget Balance (c) | -1133 | -532 | -538 | -378 | -291 | 153 | -860 | -421 | -679 | -130 | -270 | -470 | -622 | -135 | -373 | -497 | -2776 | -1375 | -1500 | -1600 |
| Trade Weighted Dollar Index (d) | 104.2 | 102.7 | 105.3 | 108.2 | 109.6 | 114.7 | 121.4 | 116.6 | 116.2 | 114.3 | 114.0 | 112.5 | 110.8 | 109.3 | 107.8 | 106.5 | 104.5 | 115.1 | 114.2 | 108.6 |
| Nonfarm Payroll Change (e) | 618 | 487 | 663 | 655 | 561 | 329 | 423 | 284 | 295 | 191 | 67 | -108 | -250 | -8 | 92 | 142 | 606 | 399 | 111 | -6 |
| Unemployment Rate | 6.2 | 5.9 | 5.1 | 4.2 | 3.8 | 3.6 | 3.6 | 3.6 | 3.5 | 3.5 | 3.7 | 4.1 | 4.7 | 4.7 | 4.6 | 4.3 | 5.4 | 3.6 | 3.7 | 4.6 |
| Housing Starts (f) | 1.58 | 1.59 | 1.57 | 1.68 | 1.72 | 1.65 | 1.45 | 1.40 | 1.40 | 1.35 | 1.24 | 1.15 | 1.12 | 1.26 | 1.40 | 1.42 | 1.60 | 1.55 | 1.29 | 1.30 |
| Light Vehicle Sales (g) | 16.7 | 16.7 | 13.3 | 13.0 | 14.1 | 13.3 | 13.4 | 14.3 | 15.2 | 15.3 | 14.6 | 13.9 | 14.7 | 15.7 | 16.3 | 16.6 | 14.9 | 13.8 | 14.7 | 15.8 |
| Crude Oil - Brent - Front Contract (h) | 60.9 | 68.6 | 72.5 | 79.0 | 95.7 | 109.8 | 95.5 | 87.9 | 81.9 | 83.0 | 78.8 | 71.2 | 70.8 | 77.5 | 79.5 | 80.2 | 70.3 | 97.2 | 78.7 | 77.0 |
| Quarter-End Interest Rates (i) | | | | | | | | | | | | | | | | | | | | |
| Federal Funds Target Rate (j) | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 | 1.75 | 3.25 | 4.50 | 5.00 | 5.25 | 5.25 | 5.25 | 4.25 | 3.25 | 2.75 | 2.75 | 0.25 | 2.02 | 5.19 | 3.25 |
| Secured Overnight Financing Rate | 0.01 | 0.05 | 0.05 | 0.05 | 0.29 | 1.50 | 2.98 | 4.30 | 4.87 | 5.05 | 5.05 | 5.05 | 4.10 | 3.10 | 2.60 | 2.60 | 0.04 | 1.64 | 5.01 | 3.10 |
| 3 Month LIBOR* | 0.19 | 0.15 | 0.13 | 0.21 | 0.96 | 2.29 | 3.75 | 4.77 | 5.19 | 5.30 | - | - | - | - | - | - | 0.16 | 2.41 | 5.25 | - |
| Prime Rate | 3.25 | 3.25 | 3.25 | 3.25 | 3.50 | 4.75 | 6.25 | 7.50 | 8.00 | 8.25 | 8.25 | 8.25 | 7.25 | 6.25 | 5.75 | 5.75 | 3.25 | 5.02 | 8.19 | 6.25 |
| Conventional Mortgage Rate | 3.14 | 3.04 | 2.98 | 3.21 | 4.27 | 5.58 | 6.01 | 6.36 | 6.54 | 6.30 | 5.90 | 5.55 | 5.50 | 5.25 | 5.00 | 4.85 | 3.03 | 5.38 | 6.07 | 5.15 |
| 3 Month Bill | 0.03 | 0.05 | 0.04 | 0.06 | 0.52 | 1.72 | 3.33 | 4.42 | 4.85 | 5.05 | 5.05 | 4.80 | 3.80 | 2.80 | 2.60 | 2.60 | 0.04 | 2.09 | 4.94 | 2.95 |
| 6 Month Bill | 0.05 | 0.06 | 0.05 | 0.19 | 1.06 | 2.51 | 3.92 | 4.76 | 4.94 | 5.05 | 5.00 | 4.30 | 3.30 | 2.75 | 2.65 | 2.65 | 0.06 | 2.51 | 4.82 | 2.84 |
| 1 Year Bill | 0.07 | 0.07 | 0.09 | 0.39 | 1.63 | 2.80 | 4.05 | 4.73 | 4.64 | 4.80 | 4.25 | 3.35 | 2.85 | 2.75 | 2.70 | 2.70 | 0.10 | 2.80 | 4.26 | 2.75 |
| 2 Year Note | 0.16 | 0.25 | 0.28 | 0.73 | 2.28 | 2.92 | 4.22 | 4.41 | 4.06 | 4.05 | 3.70 | 3.15 | 2.90 | 2.80 | 2.75 | 2.75 | 0.27 | 2.99 | 3.74 | 2.80 |
| 5 Year Note | 0.92 | 0.87 | 0.98 | 1.26 | 2.42 | 3.01 | 4.06 | 3.99 | 3.60 | 3.55 | 3.30 | 3.05 | 2.90 | 2.85 | 2.80 | 2.85 | 0.86 | 3.00 | 3.38 | 2.85 |
| 10 Year Note | 1.74 | 1.45 | 1.52 | 1.52 | 2.32 | 2.98 | 3.83 | 3.88 | 3.48 | 3.50 | 3.25 | 3.00 | 2.95 | 2.90 | 2.85 | 2.90 | 1.45 | 2.95 | 3.31 | 2.90 |
| 30 Year Bond | 2.41 | 2.06 | 2.08 | 1.90 | 2.44 | 3.14 | 3.79 | 3.97 | 3.67 | 3.80 | 3.60 | 3.45 | 3.40 | 3.35 | 3.30 | 3.35 | 2.06 | 3.11 | 3.63 | 3.35 |

Forecast as of: May 11, 2023

Notes: (a) Compound Annual Growth Rate Quarter-over-Quarter

(b) Year-over-Year Percentage Change

(c) Quarterly Sum - Billions USD; Annual Data Represents Fiscal Year

(d) Federal Reserve Advanced Foreign Economies Index, 2006=100 - Quarter End

(e) Average Monthly Change

(f) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Houses Started

(g) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold

(h) Quarterly Average of Daily Close

(i) Quarterly Data - Period End; Annual Data - Annual Averages

(j) Upper Bound of the Federal Funds Target Rate

*3 Month LIBOR will no longer be published after June 30, 2023

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

Changes to U.S. Forecast

| Changes to the Wells Fargo U.S. Economic Forecast | | | | | | | | | | | | | | | | | | | | |
|---|--------|-------|-------|-------|------|------|------|-------|----------|---------|-------|--------|--------|--------|--------|-------|--------|------|----------|---------|
| | Actual | | | | | | | | Forecast | | | | | | | | Actual | | Forecast | |
| | 2021 | | | | 2022 | | | | 2023 | | | | 2024 | | | | 2021 | 2022 | 2023 | 2024 |
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | | | | |
| Real Gross Domestic Product (a) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -0.71 | 0.65 | 0.78 | -0.15 | -0.07 | -0.26 | 0.73 | -0.14 | 0.00 | 0.00 | 0.03 | 0.13 |
| Personal Consumption | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -0.75 | 0.67 | 0.03 | 1.81 | 0.45 | 0.08 | 0.30 | 0.40 | 0.00 | 0.00 | 0.06 | 0.59 |
| Business Fixed Investment | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -1.04 | -0.19 | 1.13 | -1.30 | -1.30 | -0.37 | -0.05 | -0.05 | 0.00 | 0.00 | -0.24 | -0.53 |
| Equipment | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -4.12 | -1.39 | -0.03 | -2.36 | -1.72 | 0.00 | 0.02 | 0.02 | 0.00 | 0.00 | -1.48 | -1.01 |
| Intellectual Property Products | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -2.77 | 0.37 | 2.53 | -0.74 | -1.37 | -0.76 | 0.00 | 0.00 | 0.00 | 0.00 | -0.34 | -0.29 |
| Structures | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 8.57 | 1.60 | 0.40 | -0.05 | 0.00 | 0.00 | -0.05 | -0.05 | 0.00 | 0.00 | 2.41 | 0.12 |
| Residential Investment | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 3.32 | 0.80 | 0.30 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.94 | 0.09 |
| Government Purchases | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 1.70 | -0.05 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.41 | 0.00 |
| Net Exports | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 13.2 | 18.3 | 12.3 | 1.7 | 1.0 | 3.3 | -36.7 | -55.4 | 0.0 | 0.0 | 11.4 | -21.9 |
| Pct. Point Contribution to GDP | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.32 | 0.10 | -0.12 | -0.21 | -0.01 | 0.05 | -0.79 | -0.37 | 0.00 | 0.00 | 0.06 | -0.16 |
| Inventory Change | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | -53.6 | -49.6 | -13.7 | -67.1 | -76.2 | -92.1 | -26.5 | -28.8 | 0.0 | 0.0 | -46.0 | -55.9 |
| Pct. Point Contribution to GDP | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -0.59 | 0.08 | 0.70 | -1.04 | -0.18 | -0.32 | 1.30 | -0.05 | 0.00 | 0.00 | -0.23 | -0.05 |
| Nominal GDP | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -0.71 | 0.54 | 0.94 | 0.10 | 0.15 | -0.47 | 0.88 | 0.15 | 0.00 | 0.00 | 0.06 | 0.24 |
| Real Final Sales | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -0.06 | 0.57 | 0.07 | 0.89 | 0.11 | 0.06 | -0.57 | -0.09 | 0.00 | 0.00 | 0.19 | 0.25 |
| Retail Sales (b) | -1.26 | -1.99 | -1.50 | -1.73 | 0.41 | 0.80 | 0.59 | 0.25 | -0.68 | 1.05 | 1.82 | 2.34 | 3.08 | 0.89 | 0.51 | -0.02 | -1.60 | 0.51 | 1.15 | 1.15 |
| Inflation Indicators (b) | | | | | | | | | | | | | | | | | | | | |
| PCE Deflator | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.04 | 0.01 | 0.04 | 0.11 | 0.12 | 0.11 | 0.10 | 0.11 | 0.00 | 0.00 | 0.05 | 0.11 |
| "Core" PCE Deflator | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.05 | 0.08 | 0.16 | 0.24 | 0.24 | 0.26 | 0.22 | 0.18 | 0.00 | 0.00 | 0.14 | 0.23 |
| Consumer Price Index | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -0.05 | -0.04 | 0.03 | 0.09 | 0.01 | 0.02 | 0.03 | 0.00 | 0.00 | -0.02 | 0.04 |
| "Core" Consumer Price Index | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.05 | 0.12 | 0.20 | 0.28 | 0.25 | 0.19 | 0.13 | 0.00 | 0.00 | 0.09 | 0.21 |
| Producer Price Index (Final Demand) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.07 | 0.14 | 0.15 | 0.17 | 0.11 | 0.03 | 0.02 | 0.00 | 0.00 | 0.00 | 0.02 | 0.14 | 0.01 |
| Employment Cost Index | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.21 | 0.46 | 0.69 | 0.69 | 0.57 | 0.46 | 0.35 | 0.26 | 0.00 | 0.00 | 0.52 | 0.41 |
| Real Disposable Income (a) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.28 | 1.01 | 0.55 | -0.33 | -0.07 | 0.64 | -0.42 | -0.08 | 0.00 | 0.00 | 0.31 | 0.11 |
| Nominal Personal Income (a) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.25 | 0.64 | 0.78 | -0.01 | 0.23 | 0.52 | -0.23 | 0.28 | 0.00 | 0.00 | 0.28 | 0.28 |
| Industrial Production (a) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -0.06 | 2.32 | 0.49 | -1.88 | -1.47 | -0.76 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.32 | -0.70 |
| Capacity Utilization | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -0.01 | 0.42 | 0.45 | 0.06 | -0.24 | -0.38 | -0.38 | -0.38 | -0.38 | 0.00 | 0.00 | 0.17 | -0.38 |
| Corporate Profits Before Taxes (b) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -0.50 | -0.50 | 0.00 | -2.00 | -2.00 | 0.00 | 0.00 | 2.00 | 0.00 | 0.00 | -0.75 | -0.06 |
| Corporate Profits After Taxes | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -0.51 | -0.50 | 0.00 | -1.56 | -2.00 | 0.00 | 0.00 | 2.00 | 0.00 | 0.00 | -0.64 | -0.06 |
| Federal Budget Balance (c) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -1.94 | -154.02 | 55.96 | -23.77 | -24.33 | -27.87 | -24.02 | 0.38 | 0.00 | 0.00 | -100.00 | -100.00 |
| Trade Weighted Dollar Index (d) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -0.75 | 0.50 | 0.50 | 0.25 | 0.25 | 0.25 | 0.50 | 0.00 | 0.00 | 0.06 | 0.31 |
| Nonfarm Payroll Change (e) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -49.67 | 46.00 | 28.33 | 33.33 | -16.67 | 58.33 | 0.00 | -8.33 | 0.00 | 0.00 | 14.50 | 8.33 |
| Unemployment Rate | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -0.09 | -0.18 | -0.41 | -0.33 | -0.34 | -0.12 | -0.25 | 0.00 | 0.00 | -0.17 | -0.26 |
| Housing Starts (f) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.02 | 0.05 | 0.05 | 0.05 | 0.03 | 0.03 | 0.03 | 0.03 | 0.00 | 0.00 | 0.04 | 0.03 |
| Light Vehicle Sales (g) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -0.05 | 0.54 | 0.60 | 0.30 | 0.33 | 0.33 | 0.00 | 0.00 | 0.00 | 0.00 | 0.35 | 0.17 |
| Crude Oil - Brent - Front Contract (h) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -3.18 | -0.83 | -0.50 | -0.50 | -1.50 | -1.50 | -1.17 | 0.00 | 0.00 | -1.13 | -1.17 |
| Quarter-End Interest Rates (i) | | | | | | | | | | | | | | | | | | | | |
| Federal Funds Target Rate (j) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.50 | 0.50 | 0.50 | 0.25 | 0.25 | 0.00 | 0.00 | 0.13 | 0.38 |
| Secured Overnight Financing Rate | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.50 | 0.50 | 0.50 | 0.25 | 0.25 | 0.00 | 0.00 | 0.13 | 0.38 |
| 3 Month LIBOR* | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | - | - | - | - | - | - | 0.00 | 0.00 | 0.00 | - |
| Prime Rate | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.50 | 0.50 | 0.50 | 0.25 | 0.25 | 0.00 | 0.00 | 0.13 | 0.38 |
| Conventional Mortgage Rate | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.05 | 0.15 | 0.15 | 0.15 | 0.15 | 0.10 | 0.10 | 0.00 | 0.00 | 0.09 | 0.13 |
| 3 Month Bill | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.10 | 0.35 | 0.35 | 0.35 | 0.25 | 0.25 | 0.00 | 0.00 | 0.11 | 0.30 |
| 6 Month Bill | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.25 | 0.45 | 0.35 | 0.30 | 0.25 | 0.25 | 0.00 | 0.00 | 0.18 | 0.29 |
| 1 Year Bill | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.10 | 0.15 | 0.25 | 0.20 | 0.25 | 0.25 | 0.20 | 0.00 | 0.00 | 0.13 | 0.23 |
| 2 Year Note | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.20 | 0.25 | 0.25 | 0.25 | 0.20 | 0.10 | 0.00 | 0.00 | 0.11 | 0.20 |
| 5 Year Note | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -0.05 | 0.15 | 0.20 | 0.15 | 0.15 | 0.10 | 0.05 | 0.00 | 0.00 | 0.08 | 0.11 |
| 10 Year Note | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.10 | 0.10 | 0.10 | 0.10 | 0.05 | 0.05 | 0.00 | 0.00 | 0.05 | 0.08 |
| 30 Year Bond | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.10 | 0.15 | 0.10 | 0.10 | 0.10 | 0.05 | 0.05 | 0.00 | 0.00 | 0.09 | 0.07 |

Forecast as of: May 11, 2023

Notes: (a) Compound Annual Growth Rate Quarter-over-Quarter

(b) Year-over-Year Percentage Change

(c) Quarterly Sum - Billions USD; Annual Data Represents Fiscal Year

(d) Federal Reserve Advanced Foreign Economies Index, 2006=100 - Quarter End

(e) Average Monthly Change

(f) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Houses Started

(g) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold

(h) Quarterly Average of Daily Close

(i) Quarterly Data - Period End; Annual Data - Annual Averages

(j) Upper Bound of the Federal Funds Target Rate

*3 Month LIBOR will no longer be published after June 30, 2023

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

Personal Consumption Expenditures

- We have pared the peak-to-trough decline in overall personal consumption expenditures to 0.6%. If realized, that would make the coming dip in overall consumer spending roughly half the average decline of 1.1% in downturns going back to 1960.
- We expect the fallout to be most evident in the decline in durable goods outlays, where spending was pulled forward over the past couple of years. Also, since durable goods are often financed, higher interest rates means steeper financing costs, which should also weigh on this category.
- Credit is apt to become more dear in the coming months, but there is still more than \$700 billion in excess household savings, and real personal income growth continues to drive consumer capacity to spend. We expect this to limit any serious slowing in services outlays.

There is some gas left in the tank to rely on excess savings, but it is becoming less of a driver of spending and households may grow less inclined to tap the rainy day fund as uncertainty grows. The labor market remains exceptionally tight, though there are signs slack is beginning to materialize with job openings rolling over and layoff announcements surfacing. The outcome depends on the income. Job security and prospects matter much more for today's consumer than rising interest rates and persistent inflation. If we see further deterioration in the labor market, then spending likely will come under pressure as the year progresses.

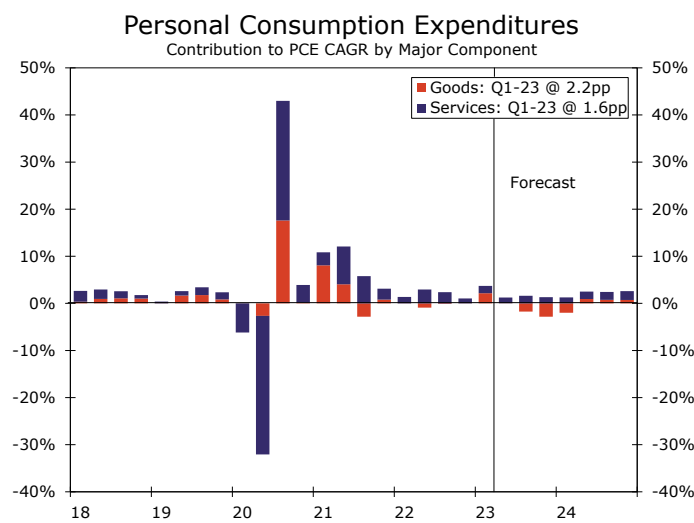
Investment: Equipment, Intellectual Property Products and Inventories

- Amid increased recession risk, less favorable financing and diminished interest in new investment, we now have a slightly larger decline in equipment spending than in our April forecast.
- The fact that manufacturers are not overproducing going into this downturn implies a bigger draw-down of inventories, which we now have penciled in for the fourth quarter of this year and the first half of next year. A rebuilding of those inventories helps lead the way out of the recession in the second half of 2024.

The ISM manufacturing index has signaled contraction for six consecutive months and manufacturing output has stalled. Conditions for new capital investment continue to grow less favorable, and small business plans to make new capital expenditures have rolled over and are approaching new lows. We continue to anticipate a further tightening in banks' lending standards to take hold, which will further weigh on new investment.

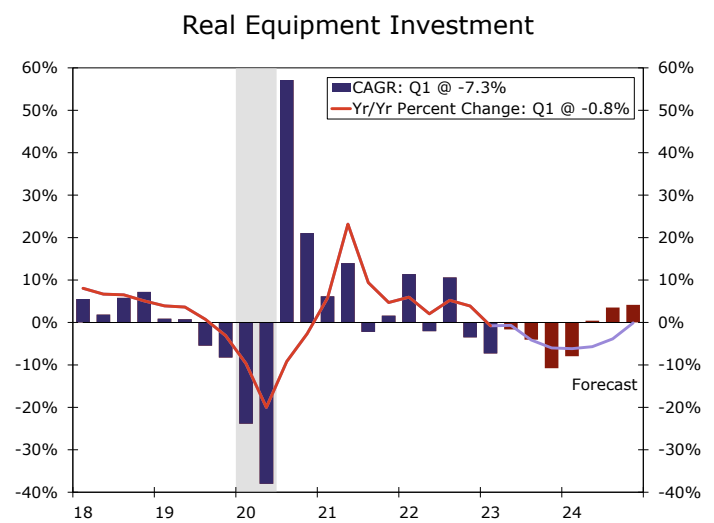
Supply chains may not be fully healed, but with the supplier deliveries component of the ISM in contraction for a seventh straight month in April, it is hard to make the case that kinks in the supply chain are to blame for today's factory sector weakness.

Figure 5



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

Figure 6



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

Investment: Residential

- We have taken up our near-term forecast for residential investment after a stronger-than-expected first quarter. We still expect residential investment to drag on headline growth over the next four quarters; however, we now expect slightly milder declines.

The housing market continues to exhibit signs of stabilization. Single-family housing starts surpassed expectations in both February and March as low resale inventory has nudged prospective buyers toward new construction. New home sales in March rose to the fastest sales pace since March 2022. Meanwhile, apartment and condo development continues to advance at a robust clip. Although multifamily permits pulled back in March, the number of multifamily units under construction is currently at its highest count since the early 1970s.

That said, a full housing market recovery is still far off. Although an improvement, the pace of new home sales in March was still running 19% below the most recent peak reached in December 2021. Furthermore, home improvement outlays have been trending down since July 2022. While buyers seem to have grown more accustomed to the higher mortgage rate environment, our expectations for a recession on top of still-elevated mortgage rates will likely keep the housing market under pressure.

Investment: Nonresidential Structures

- Stronger-than-expected growth during Q1 encouraged us to slightly boost our near-term outlook for structures spending. However, we still expect tighter credit conditions to weigh on structures investment throughout the forecast horizon.

Structures investment remained strong to start the year. Real structures investment rose at an 11.2% annualized rate in Q1, down a bit from the 15.8% gain in the previous quarter. The upturn in the nonresidential category was partially driven by strong gains in manufacturing project spending. Through March, manufacturing project spending is up 62.3% year-over-year and largely reflects the build out of electric vehicle production supply chains as well as new semiconductor manufacturing facilities.

Real estate lending conditions have tightened rapidly in recent months, however. The Fed's Q1 Senior Loan Officer Opinion Survey found conditions generally have tightened faster for CRE lending compared to other business and consumer segments. Tight credit conditions and a looming economic downturn are both factors that will likely weigh heavily on new investment over the next few years.

Figure 7

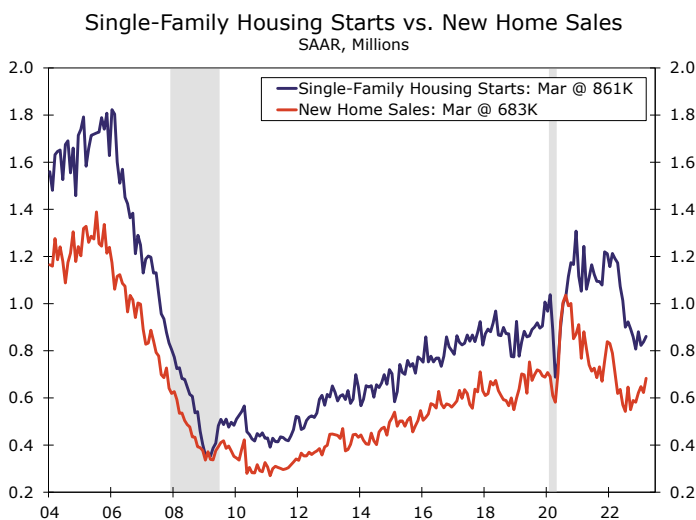
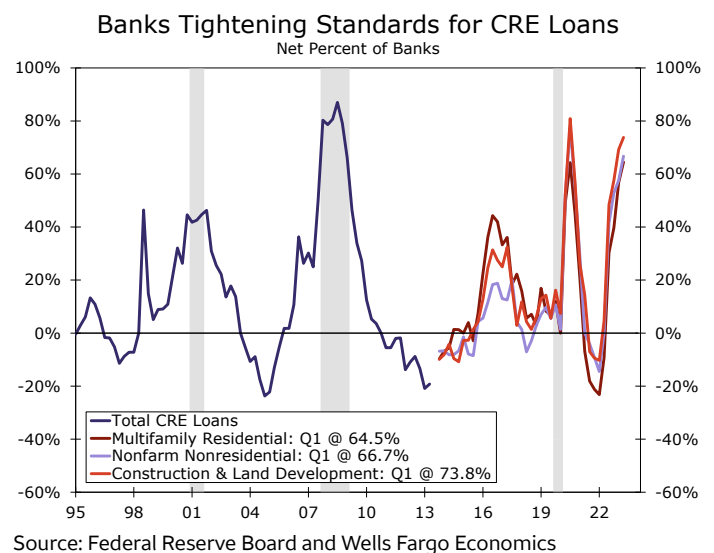


Figure 8



Labor Market

- Employment continued to plow ahead in April, but momentum in hiring has begun to slow with deteriorating demand for workers pointing to a further downshift ahead.
- Amid our expectations of a more mild downturn in activity along with the jobs market's recent fortitude, we look for the unemployment rate to now peak a little under 5% in the first half of 2024.

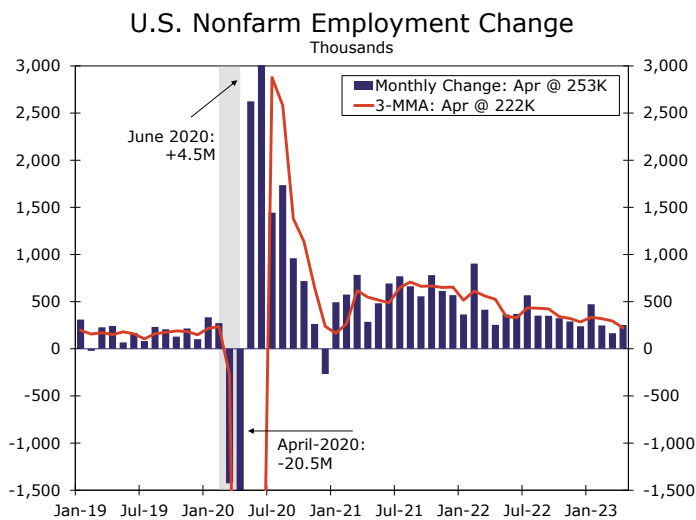
Despite strengthening labor supply growth and softening demand for workers in recent months, the labor market remains extraordinarily tight. In April, the unemployment rate fell to match its 53-year low, while the latest data on employment costs and average hourly earnings show wage pressures cooling only gradually. Payroll growth may have surprised to the upside again in April, but substantial downward revisions to February and March show hiring continues to lose momentum. We look for further slowing ahead as declines in job openings, hiring plans and employment of temporary workers point to the dampening effects of tighter monetary policy starting to feed through to the jobs market. But the more modest downturn in activity we now expect, along with the jobs market's greater resilience to date, leads us to expect a somewhat lower peak in unemployment and a more drawn-out process in getting labor costs in check.

Inflation

- Softening demand and easing supply constraints for physical inputs and labor are reducing upward pressure on price growth, but inflation remains stubbornly high.
- We suspect inflation will be slower to recede than in our prior forecast, with the core PCE deflator still up 3.6% on a year-ago basis in Q4.

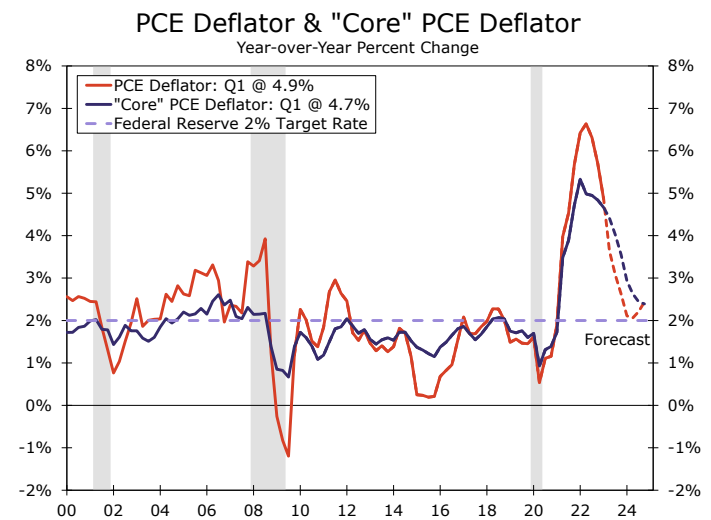
Returning inflation to a pace remotely close to the Fed's long-run target remains slow-going. The latest core CPI showed only incremental signs of core inflation easing in a meaningful way, with prices ex-food and energy rising 5.5% in April and at a 5.1% annualized pace over the past three months. Downward pressure on inflation continues to gather, even as it has been slow to manifest in the CPI and PCE deflator. Commodity prices have fallen from last year's highs, supply chains continue to normalize and softer housing market conditions over the past year should more consistently filter through to measured inflation. However, with the jobs market and real consumer spending holding up a bit better than anticipated, pricing power is likely to as well. We have raised our inflation outlook as a result, and now look for core PCE to be up 3.6% year-over-year in the fourth quarter of this year and 2.4% by the fourth quarter of 2024.

Figure 9



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

Figure 10



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

Fiscal Policy

- Our FY 2023 federal budget deficit forecast has widened modestly from \$1.4 trillion to \$1.5 trillion. Similarly, our FY 2024 federal budget deficit forecast has widened from \$1.5 trillion to \$1.6 trillion.
- An increase in the debt ceiling that buys a few months' time for more negotiations seems like the most likely outcome at this point in time, but the outlook is highly uncertain.

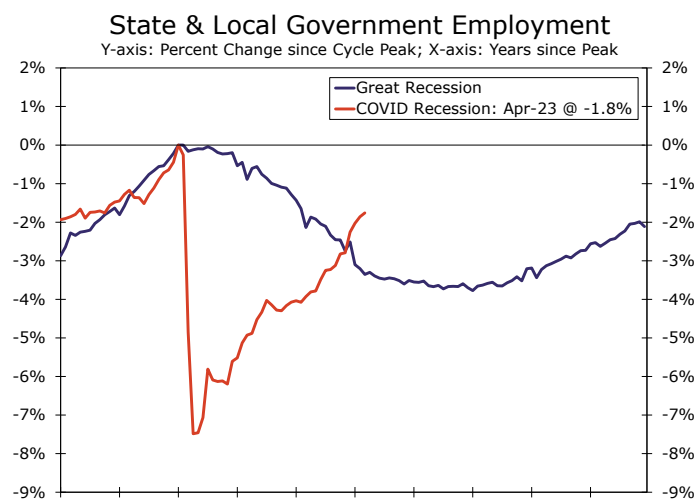
In [a letter](#) to Speaker of the House Kevin McCarthy dated May 1, Secretary Yellen said that Treasury's "best estimate is that we will be unable to continue to satisfy all of the government's obligations by early June." Secretary Yellen noted that the estimate is based on currently available data, and the actual date that Treasury exhausts extraordinary measures could be "a number of weeks later" than this estimate. It has become increasingly clear that Treasury's breathing room under the debt ceiling will be very tight in the first couple of weeks of June, and whether Treasury can remain solvent until an infusion of tax revenue on June 15 is an open question. Our federal budget deficit forecast has gone from \$1.4 trillion to \$1.5 trillion for this fiscal year amid a somewhat weaker near-term fiscal outlook. Despite the ongoing troubles in federal fiscal policy, one recent public sector bright spot has been an acceleration in state and local government hiring. State and local government employment has climbed by 207K since the end of last year and, despite a slow start, is recovering much faster from the pandemic than was the case in the wake of the 2008 financial crisis.

Monetary Policy & Interest Rates

- Our forecasted peak for the federal funds target range remains unchanged at 5.00%-5.25%. However, we have pushed back the timing of the first fed funds rate cut from Q4-2023 to Q1-2024.
- Our forecast for the 10-year Treasury yield at year-end 2023 is 3.00%.

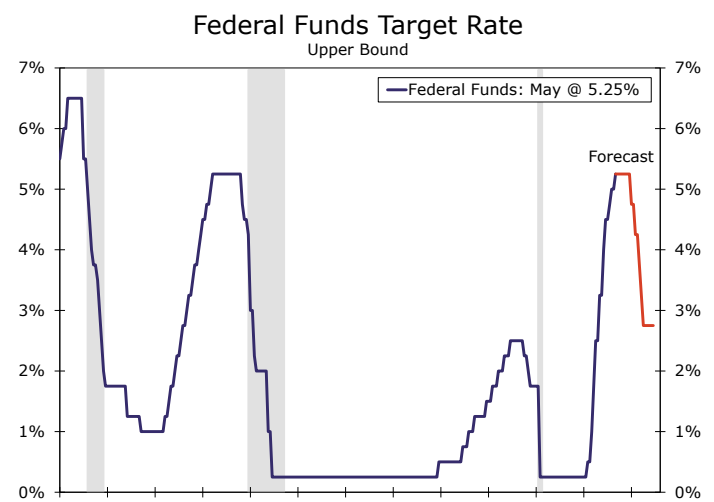
Since our previous *Monthly Economic Outlook* on April 13, Treasury yields have bounced around but on trend have been generally unchanged. Similarly, although we have made some tweaks to our expected path for the federal funds rate through 2024, our latest interest rate forecast did not have major modifications relative to our April forecast. Over the next few months, we expect Treasury yields across the curve to remain roughly near current levels as the economic expansion continues and Federal Reserve rate cuts remain a ways off. But as the year progresses, we expect a weakening economy and slowing inflation to bring monetary policy easing in 2024 more clearly into focus. We look for the first rate cut to occur at the January 2024 FOMC meeting, with more easing to follow at subsequent FOMC meetings. This in turn should lead Treasury yields to head lower later this year and into 2024.

Figure 11



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

Figure 12



Source: Federal Reserve Board and Wells Fargo Economics

Net Exports

- We look for the trade balance to be a neutral-to-positive force on Q2 real GDP growth.

We have lifted our forecasts for exports and imports since our previous monthly update. Exports are higher on the improvement in the global growth backdrop, while imports are boosted based on our expectations for stronger consumer spending. Trade flows continue to be noisy month-to-month, but the deficit has broadly narrowed on trend since early 2022 and should continue to narrow over the course of the year amid our expectations for the U.S. economy to slip into a mild recession, while the global economy avoids one.

International Developments & The U.S. Dollar

- This month has seen a further—and significant—improvement in the global outlook, as we have revised our global GDP growth forecast for 2023 to 2.5% from 2.2% a month ago. Improved outlooks for China, the Eurozone, the United Kingdom and Mexico contributed to the firmer growth forecast.
- Persistent underlying inflation pressures, combined with a delay in Fed easing, means we also now forecast later easing from some foreign central banks. We now expect the Bank of Canada, Bank of England and Bank of Mexico to begin easing monetary policy in early 2024, compared to our previous forecast for rate cuts from those central banks to begin in late 2023.
- With a shift in the Federal Reserve policy outlook, we also forecast a slower pace of U.S. dollar depreciation over the medium-term. We now do not expect the trade-weighted dollar to begin a significant or sustained period of depreciation until Q4 this year as market participants begin to focus on Fed easing from early next year.
- For further reading on the global economy, please see our most recent [International Economic Outlook](#).

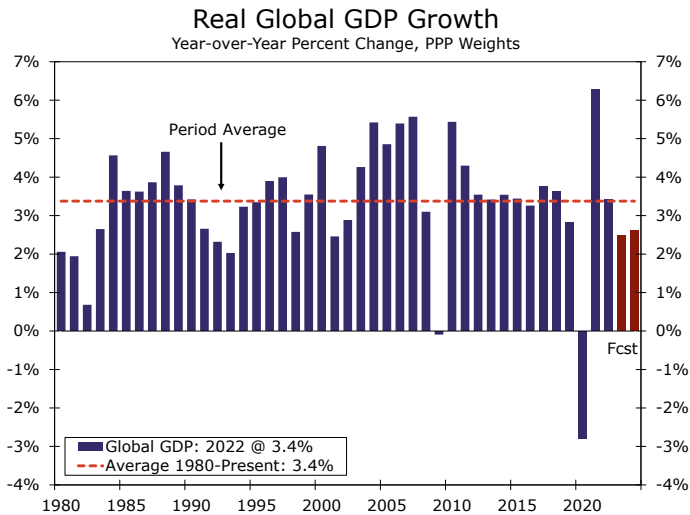
This month has seen a further—and significant improvement—in the global outlook, as we have revised our global GDP growth forecast for 2023 to 2.5% from 2.2% a month ago. Some of that improvement stems from the ongoing resilience of the U.S. economy, but there have also been notable improvements for some foreign economies. In particular, China's economy showed strong momentum with a large GDP gain in Q1, while confidence surveys and other high frequency indicators suggest that momentum has continued, prompting us to lift our China growth forecast for this year to 6.0%. In the Eurozone, lower energy prices, which have helped put household finances on a more favorable trajectory, mean we no longer expect a recession for the region. Lower energy prices and improving confidence surveys also suggest a more constructive outlook for the U.K., although we still expect a mild recession for the British economy this year. Finally, the resilience so far in the United States has also translated into a steady start for growth in 2023 for both Canada and Mexico, contributing to a constructive outlook over the past couple of months for those countries.

Alongside an improving growth outlook, inflation is also slowing, but only at a gradual pace. For March, headline CPI for the OECD countries decelerated further to 7.7% year-over-year. However, core CPI inflation eased only slightly to 7.2% and has not slowed much from the peak seen late last year. With only a gradual deceleration of inflation, and the Federal Reserve now expected to delay monetary easing until early next year, we also think some foreign central banks could now hike their policy rates further, or delay rate cuts until 2024. Among the changes we have made over the past month, we now forecast a higher peak policy rate for the Reserve Bank of Australia of 4.35% after a surprise rate increase in early May. For Canada and Mexico, strong economic linkages to the United States means the delay in Fed rate cuts to 2024 has translated into delayed rate cuts in Canada and Mexico until early next year as well. We also expect the Bank of England to delay monetary easing until next year. Although U.K. economic linkages are not as strong, the fact that U.K. inflation is slowing only very gradually and growth has shown some resilience will likely make Bank of England policymakers very wary about any premature easing of monetary policy. Meanwhile, although the monetary policy outlook for some other key central banks such as the European Central Bank are unchanged, we note that in many instances we had not expected monetary easing to begin until 2024 in any case.

With a shift in the Federal Reserve policy outlook, we also forecast a slower pace of U.S. dollar depreciation over the medium term. In the near term, we still do not anticipate a period of significant U.S. dollar strength, given that our base case is for no further Fed rate hikes. However, given delayed

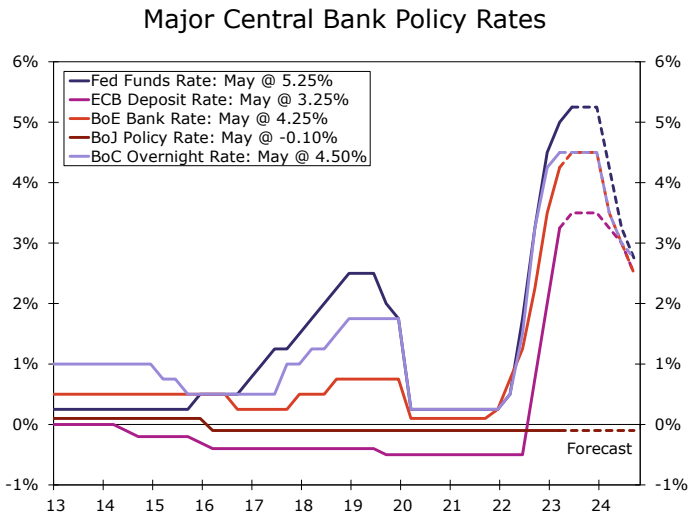
Fed easing, which in some cases is matched by delayed easing internationally, we do anticipate a slower pace of U.S. dollar decline. We now do not expect the trade-weighted dollar to begin a significant or sustained period of depreciation until Q4 this year as market participants begin to focus on Fed easing from early next year. Altogether, we forecast the trade-weighted dollar against the currencies of the advanced foreign economies to decline just 1.5% over the rest of 2023, but see a larger decline of a bit more than 5% during 2024.

Figure 13



Source: International Monetary Fund and Wells Fargo Economics

Figure 14



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

Wells Fargo International Economic Forecast

| | GDP | | | | CPI | | | |
|-----------------------------------|------|------|-------|------|-------|------|------|------|
| | 2021 | 2022 | 2023 | 2024 | 2021 | 2022 | 2023 | 2024 |
| Global (PPP Weights) | 6.3% | 3.4% | 2.5% | 2.5% | 4.7% | 8.7% | 5.0% | 3.8% |
| Advanced Economies ¹ | 5.4% | 2.7% | 1.2% | 1.3% | 3.1% | 7.3% | 4.7% | 2.5% |
| United States | 5.9% | 2.1% | 1.3% | 0.3% | 4.7% | 8.0% | 3.9% | 2.5% |
| Eurozone | 5.4% | 3.5% | 0.7% | 1.6% | 2.6% | 8.4% | 5.6% | 2.5% |
| United Kingdom | 7.6% | 4.1% | 0.0% | 1.3% | 2.6% | 9.1% | 7.1% | 2.5% |
| Japan | 2.1% | 1.0% | 0.9% | 1.5% | -0.2% | 2.5% | 2.1% | 1.2% |
| Canada | 5.0% | 3.4% | 1.0% | 1.5% | 3.4% | 6.8% | 3.5% | 2.2% |
| Switzerland | 4.2% | 2.1% | 0.3% | 1.7% | 0.6% | 2.8% | 2.4% | 2.0% |
| Australia | 5.2% | 3.7% | 1.5% | 1.8% | 2.8% | 6.6% | 5.6% | 3.2% |
| New Zealand | 6.1% | 2.4% | 1.5% | 1.5% | 3.9% | 7.2% | 5.5% | 3.0% |
| Sweden | 5.4% | 2.7% | -0.4% | 1.7% | 2.7% | 8.3% | 7.5% | 2.5% |
| Norway | 3.9% | 3.8% | 1.1% | 0.8% | 3.5% | 5.8% | 4.6% | 2.6% |
| Developing Economies ¹ | 6.9% | 4.0% | 3.5% | 3.5% | 5.9% | 9.8% | 5.2% | 4.7% |
| China | 8.5% | 3.0% | 6.0% | 4.9% | 0.9% | 2.0% | 2.0% | 2.2% |
| India | 9.1% | 6.7% | 5.7% | 6.7% | 5.5% | 6.7% | 5.3% | 5.0% |
| Mexico | 4.7% | 3.1% | 1.9% | 1.5% | 5.7% | 7.9% | 5.6% | 3.9% |
| Brazil | 5.0% | 3.0% | 0.6% | 1.9% | 8.3% | 9.0% | 5.5% | 4.0% |

Forecast as of: May 11, 2023

¹Aggregated Using PPP Weights

Source: International Monetary Fund and Wells Fargo Economics

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

| | Central Bank Key Policy Rate | | | | | | |
|-----------------------|------------------------------|--------|--------|--------|--------|--------|--------|
| | 2023 | | | | 2024 | | |
| | Current | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 |
| United States | 5.25% | 5.25% | 5.25% | 5.25% | 4.25% | 3.25% | 2.75% |
| Eurozone ¹ | 3.25% | 3.50% | 3.50% | 3.50% | 3.25% | 3.00% | 2.50% |
| United Kingdom | 4.25% | 4.50% | 4.50% | 4.50% | 3.50% | 3.00% | 2.50% |
| Japan | -0.10% | -0.10% | -0.10% | -0.10% | -0.10% | -0.10% | -0.10% |
| Canada | 4.50% | 4.50% | 4.50% | 4.50% | 3.50% | 3.00% | 2.75% |
| Switzerland | 1.50% | 1.75% | 1.75% | 1.75% | 1.50% | 1.25% | 1.00% |
| Australia | 3.85% | 4.10% | 4.35% | 4.35% | 4.35% | 4.10% | 3.85% |
| New Zealand | 5.25% | 5.50% | 5.50% | 5.50% | 5.50% | 5.25% | 4.75% |
| Sweden | 3.50% | 3.25% | 3.25% | 3.25% | 3.25% | 3.00% | 2.75% |
| Norway | 3.25% | 3.50% | 3.50% | 3.50% | 3.25% | 3.00% | 2.75% |
| China ³ | 10.75% | 10.75% | 10.75% | 10.75% | 10.50% | 10.50% | 10.50% |
| India | 6.50% | 6.50% | 6.50% | 6.25% | 6.00% | 5.50% | 5.00% |
| Mexico | 11.25% | 11.50% | 11.50% | 11.50% | 10.50% | 9.50% | 9.00% |
| Brazil | 13.75% | 13.75% | 13.25% | 12.25% | 11.25% | 10.25% | 9.25% |
| | 2-Year Note | | | | | | |
| | 2023 | | | | 2024 | | |
| | Current | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 |
| United States | 3.93% | 4.05% | 3.70% | 3.15% | 2.90% | 2.80% | 2.75% |
| Eurozone ² | 2.57% | 2.80% | 2.75% | 2.65% | 2.55% | 2.35% | 2.25% |
| United Kingdom | 3.82% | 3.80% | 3.65% | 3.30% | 2.90% | 2.70% | 2.50% |
| Japan | -0.03% | 0.00% | 0.00% | 0.05% | 0.05% | 0.10% | 0.10% |
| Canada | 3.75% | 3.75% | 3.45% | 3.10% | 2.85% | 2.75% | 2.65% |
| | 10-Year Note | | | | | | |
| | 2023 | | | | 2024 | | |
| | Current | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 |
| United States | 3.45% | 3.50% | 3.25% | 3.00% | 2.95% | 2.90% | 2.85% |
| Eurozone ² | 2.29% | 2.40% | 2.45% | 2.40% | 2.35% | 2.25% | 2.20% |
| United Kingdom | 3.80% | 3.80% | 3.60% | 3.25% | 2.85% | 2.70% | 2.55% |
| Japan | 0.43% | 0.45% | 0.50% | 0.75% | 0.70% | 0.65% | 0.65% |
| Canada | 2.92% | 2.95% | 2.90% | 2.80% | 2.70% | 2.65% | 2.65% |

Forecast as of: May 11, 2023

¹ ECB Deposit Rate ² German Government Bond Yield ³ Reserve Requirement Ratio Major Banks

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

This Month's Economic Calendar

| Monday | Tuesday | Wednesday | Thursday | Friday |
|---|--|--|---|---|
| May 8 | 9 | 10 | 11 | 12 |
| | NFIB Small Business Optimism April 89.0 Williams* Speaks (New York) | CPI (MoM) April 0.4% China CPI (YoY) April 0.7% | PPI Final Demand (MoM) March -0.6% Bank of England Rate Decision Previous 4.25% Waller* Speaks (Governor) Kashkari* Speaks (Minneapolis) | Consumer Sentiment April 63.5 United Kingdom GDP (QoQ) Q4 2022 0.1% Bullard & Jefferson* (St. Louis, Governor) |
| 15 | 16 | 17 | 18 | 19 |
| Bostic Speaks (Atlanta) Kashkari* Speaks (Minneapolis) | Retail Sales (MoM) March -1.0% Industrial Production (MoM) March 0.4% Japan GDP (QoQ) Q4 2022 0.0% Mester* Speaks (Governor) | Housing Starts (SAAR) March 1,420K | Existing Home Sales (SAAR) March 4.44M Japan Natl CPI (YoY) March 3.2% Bank of Mexico Rate Decision Previous 11.25% | Williams* Speaks (New York) Powell* Speaks (Fed Chair) |
| 22 | 23 | 24 | 25 | 26 |
| Bullard Speaks (St. Louis) | New Home Sales (SAAR) March 683K Reserve Bank of New Zealand Rate Decision Previous 5.25% | UK CPI (YoY) March 10.1% | | Personal Income & Spending (MoM) March 0.3%; 0.0% (Income; Spending) Durable Goods Orders (MoM) March 3.2% |
| | | <i>FOMC Meeting Minutes</i> | | |
| 29 | 30 | 31 | June 1 | 2 |
| Memorial Day [U.S. Markets Closed] | Consumer Confidence April 101.3 | JOLTS Job Openings March 9.59M Canada GDP (QoQ Annualized) Q4 2022 0.0% Beige Book Released | ISM Manufacturing April 47.1 Eurozone CPI (YoY) April 7.0% | Nonfarm Payrolls April 253K |

Note: (W) = Wells Fargo Estimate, (C) = Consensus Estimate, * = voting FOMC member in 2023, **Purple** = Market Moving Releases

Source: Bloomberg Finance L.P., Federal Reserve System, U.S. Department of Labor, U.S. Department of Commerce, Institute for Supply Management, Conference Board and Wells Fargo Economics

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