Economics

Weekly — September 30, 2022

Weekly Economic & Financial Commentary

United States: **Going to Take More to Break This Consumer**

- Incoming data indicate a slowing yet resilient economy. Recent strength makes it less likely in our view that a recession will start by the beginning of next year and also means more monetary tightening will be necessary to slow growth sufficiently to quell elevated inflation. We still forecast a modest recession next year, but now are expecting it to begin a bit later.
- Next week: ISM Manufacturing Index (Mon), ISM Services Index (Wed), Employment (Fri)

International: **Bank of England Intervenes to Calm Markets; Eurozone Inflation Hits Double Digits**

- After the U.K.'s mini budget fueled concerns about inflation, the BoE committed to temporarily buying unlimited long-dated gilts to soothe markets, and will make a full assessment at its next policy meeting on November 3, where we expect a 100 bps rate hike. In other news, Eurozone September CPI reached 10% year-over-year. With the natural gas supply relationship between Russia and Europe deteriorating, there are concerns that energy prices will climb even higher.
- Next week: Japan Tankan Survey (Mon), RBA Decision (Tue), RBNZ Decision (Wed)

Interest Rate Watch: **Update to Our Fed Funds Forecast**

- The continued resiliency of the U.S. economy and the FOMC's apparent willingness to do "whatever it takes" to rein in inflation has led us to upwardly revise our forecast. We now see the Committee taking its target range for the fed funds rate to 4.75%-5.00% by Q1-2023.

Credit Market Insights: **Five Trillion Down, Still 26 Trillion Up**

- The Fed's updated Distributional Financial Accounts indicated declining household wealth over Q2 of this year. Since its peak in the Q4-2021, household wealth is down over $5 trillion, from $141.9T to $135.8T, and all but a quarter trillion of this decline occurred in Q2. Even with the recent hit to wealth, household wealth is still almost 24% above pre-pandemic levels.

Topic of the Week: **Easy on the Gas: Germany Institutes Energy Price Cap**

- On Thursday, the German government announced plans to institute a $194B package aimed at curtailing crippling energy costs. This announcement came on the same day that Germany's September CPI report revealed inflation surging to a scorching hot 10.9% year-over-year.

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	2.7	1.1	0.4	-2.1	-1.8	-0.9	5.9	1.9	-0.1	0.9
Personal Consumption	1.3	2.0	0.6	0.9	0.5	-1.3	-1.8	-0.7	8.3	2.5	0.0	0.6
Consumer Price Index [2]	8.0	8.6	8.3	7.2	5.9	4.0	3.2	2.9	4.7	8.0	4.0	2.4
"Core" Consumer Price Index [2]	6.3	6.0	6.3	6.2	5.6	4.9	4.1	3.5	3.6	6.2	4.5	2.9
Quarter-End Interest Rates [3]												
Federal Funds Target Rate	0.50	1.75	3.25	4.50	5.00	5.00	5.00	4.50	0.25	2.50	4.88	3.00
Conventional Mortgage Rate	4.42	5.81	6.55	6.65	6.55	6.35	6.15	5.60	2.95	5.86	6.16	5.16
10 Year Note	2.32	2.98	3.95	4.05	4.05	3.90	3.75	3.25	1.45	3.33	3.74	2.95

Forecast as of: September 30, 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 note that we have updated our U.S. forecast as of today.

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

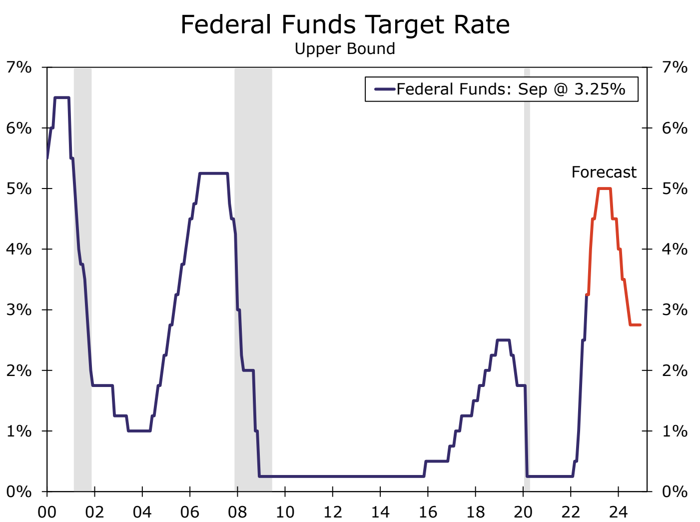
U.S. Review

Going to Take More to Break This Consumer

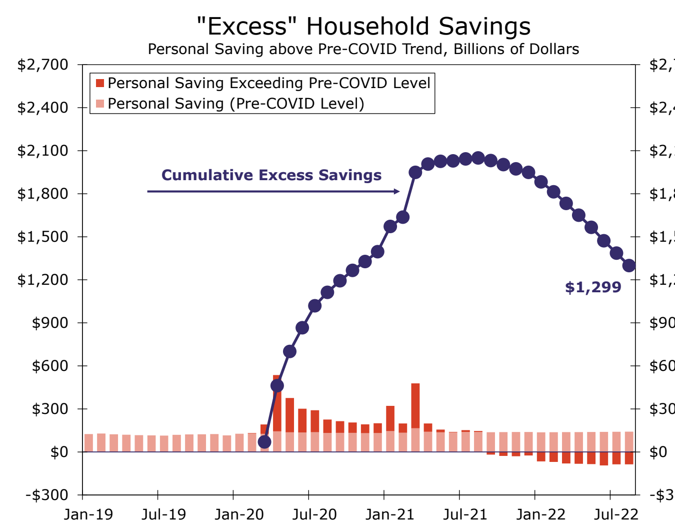
Incoming economic data demonstrate that while the economy is losing momentum, activity remains resilient. Consumer confidence rose to the highest level in six months in September, and stripping out some volatility in new orders for durable goods revealed stabilization in demand and strength in Q3 equipment spending. The third release of second-quarter GDP growth also included revisions that put the economy in a stronger position coming out of the pandemic-induced recession than previously thought. Consumer spending in particular has been unwavering, with real personal spending rising 0.1% in August.

With little indication that households have lost their staying power, we have adjusted our forecast. The current resilience in economic activity does not dismiss an eventual recession, but it does make it less likely that a recession will start by the beginning of next year. Near-term strength also means more monetary tightening will likely be necessary to slow growth sufficiently enough to quell elevated inflation. As we detail in this week's *Interest Rate Watch*, we now project the FOMC to hike its federal funds rate by an additional 125 bps this year and another 50 bps at the start of next year, which would bring the target range of the federal funds rate to 4.75%-5.00% by March (chart).

Importantly, we still see the economy falling into a mild recession next year, but we now expect it to take place slightly later, beginning in the second rather than first quarter, as the lagged effects of monetary policy begin to bite more meaningfully into consumption and weigh on the ability of firms to hire. An important consideration is that the economic trade off for growth today is the potential for a worse hit to households later. Consumers have increasingly relied on their balance sheets to spend with wage gains not keeping pace with inflation. The longer that lasts, the larger the deterioration in household finances. For this reason, we are now looking for a slightly larger decline in real personal consumption expenditures in our latest projections with a peak-to-trough decline of 1.0% compared to 0.6% previously.



Source: Federal Reserve Board and Wells Fargo Economics



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

Digging a bit further into the personal income and spending numbers for August demonstrates continued consumer resilience. Despite inflation pushing higher, real spending rose 0.1%, boosted specifically by services consumption as consumers directed the largest share of their wallet to services since April 2020. Nominal spending only modestly outpaced income, which caused the personal saving rate to hold steady at 3.5%. The August personal income and spending report brought with it annual revisions that now indicate a much faster drawdown in excess savings and accompanying drop in the saving rate.

Prior to the August release, our estimate of cumulative outstanding excess saving, which aggregates actual saving accumulated during the pandemic above what would have been saved if the personal saving rate continued at its pre-pandemic trend, totaled $2.1 trillion. Revisions suggest almost double the drawdown rate over the past seven months, which now puts "excess" savings at $1.3 trillion in

August (chart). These data indicate slightly more deterioration in household finances than previously thought, and while consumers still have the ability to lean on their balance sheets in the near-term, consumer staying power looks shakier after these revisions. Even so, consumers have not yet let higher borrowing costs bite meaningfully into spending, and we expect it will be a few months before we see consumption buckle.

To date, higher rates have left the biggest mark on the housing market. The 30-year fixed mortgage rate shot higher this week, reaching 6.7% on Thursday, which marks the highest rate since 2000. Higher mortgage rates continue to have the expected effect on housing activity, and the jump higher in September will weigh on incoming sales. That said, the interest sensitivity of buyers is evident in the near-30% *jump* in new home sales for August. Lower rates at the end of July and into August helped temporarily spur activity and move buyers forward with a purchase, as did incentives from builders. While we view this as a temporary gain, it is evidence that despite the recent housing correction underlying home buying demand remains strong and worsening affordability is the major factor holding back prospective buyers. This may improve somewhat even in the face of higher rates if home prices continue to roll over. This week brought the first decline in home prices since March 2012, according to the S&P CoreLogic Case-Shiller Index. (Return to Summary)

U.S. Outlook

Weekly Domestic Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
3-Oct	ISM Manufacturing Index	Sep	52.4	52.0	52.8
3-Oct	Construction Spending (MoM)	Aug	-0.1%	-0.1%	-0.4%
5-Oct	Trade Balance	Aug	-$67.9B	-$68.2B	-$70.7B
5-Oct	ISM Services Index	Sep	56.5	55.9	56.9
7-Oct	Nonfarm Payrolls	Sep	250K	275K	315K
7-Oct	Unemployment Rate	Sep	3.7%	3.7%	3.7%
7-Oct	Average Hourly Earnings (MoM)	Sep	0.3%	0.4%	0.3%

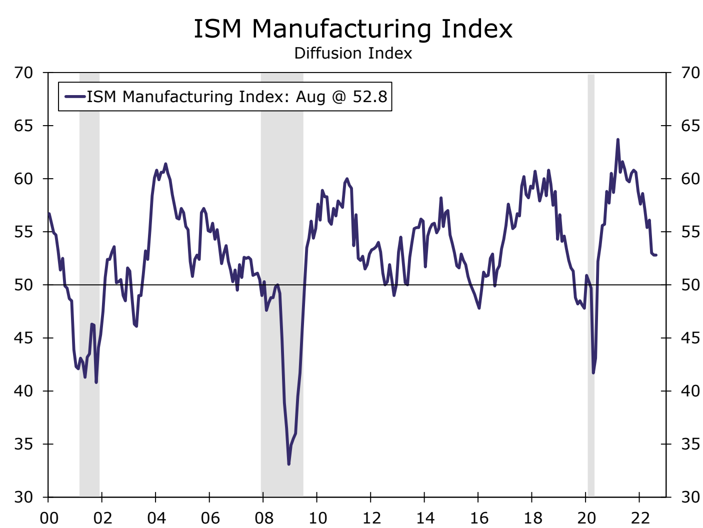
Forecast as of September 30, 2022

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

ISM Manufacturing Index • Monday

When recession fears are elevated, the ISM manufacturing index can garner extra attention for a couple of reasons. First, the ISM index for the factory sector is released at the beginning of every month, making it one of the most timely pieces of economic data. Second, the manufacturing sector is often more cyclical and prone to swings than its larger service sector counterpart.

The ISM manufacturing index is currently signaling a clear slowdown in the factor sector compared to a year ago. At 52.8, the August reading was the lowest since June 2020. That said, the August report was still somewhat encouraging. The index remained above the key 50 level separating expansion from outright contraction, while some key components such as current production and new orders actually increased last month. Perhaps even more important, the prices paid component fell to more than a two-year low, a sign of some easing in price pressures. Monetary policymakers at the Fed likely will be hoping for a similar print in next week's report: a cooling but still ongoing expansion paired with a slowing pace of price growth.

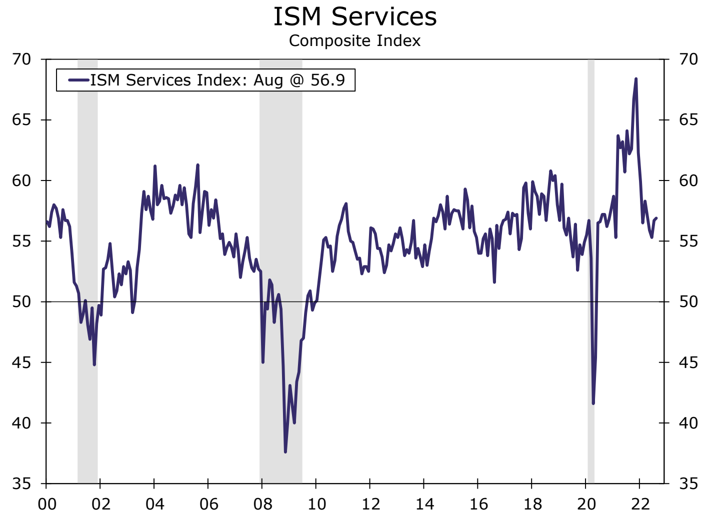


Source: Institute for Supply Management and Wells Fargo Economics

ISM Services Index • Wednesday

The service sector may be less cyclical than its manufacturing counterpart, but services account for a much larger share of the U.S. economy, and thus as its fortunes go so too does the economy as a whole. The ISM services index rose 0.2 points in August to 56.9, marking the fastest pace of expansion in the sector in four months. Most of the underlying components of the survey moved in the right direction and the headline index was buoyed by a pickup in business activity and new orders.

Prior to the 2001 and 2008-2009 recessions, the ISM services index showed clear signs of rolling over, eventually falling below the key 50 level that separates expansion from contraction. For now, the ISM services index suggests the U.S. economy is not yet in a recession, and the Bloomberg consensus is for a similarly strong reading of 56.5 for next week's release, which covers the month of September. That said, we doubt that persistently high inflation will be brought down without more of an economic slowdown, and a further slide in the index over the next few quarters seems likely as the rapid tightening of monetary policy catches up with the service sector.

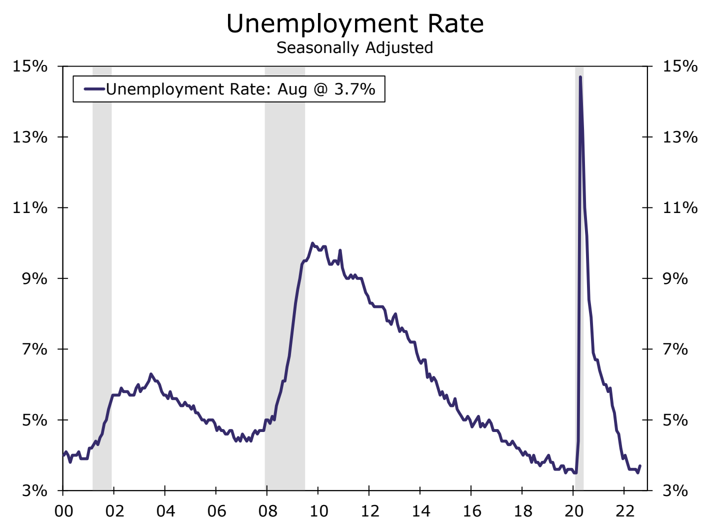


Source: Institute for Supply Management and Wells Fargo Economics

Employment Report • Friday

The U.S. labor market continues to be one of the strongest parts of the global economy. Nonfarm payrolls rose by 315K last month with industry gains once again widespread. This pace of job growth marks a downshift from the 402K average recorded in the prior three months, but it is nonetheless a robust gain in its own right. For context, nonfarm payrolls increased by an average of 167K per month in the 2010s. The unemployment rate rose to a six-month high of 3.7% in August, but it remains low by historical standards, and the increase was for "good" reasons. The labor force jumped by 786K, an even larger increase than the employment gain, signaling that not-working individuals began looking for work in droves in August.

However, the extremely tight labor market is keeping wage growth above what is consistent with the Fed's 2% inflation target. To achieve a soft landing, the Federal Reserve needs labor demand to cool *enough* that wages decelerate but not *so much* that the economy is tipped into a nasty recession. In the near term, we look for another solid 275K increase in nonfarm payrolls in next week's employment report. Another sizable increase in labor force participation would be a welcome development for Fed officials as they attempt the high wire act of bringing labor supply and demand into a healthy balance. (Return to Summary)



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

International Review

Bank of England Intervenes to Calm Markets, Eurozone Inflation Hits Double Digits

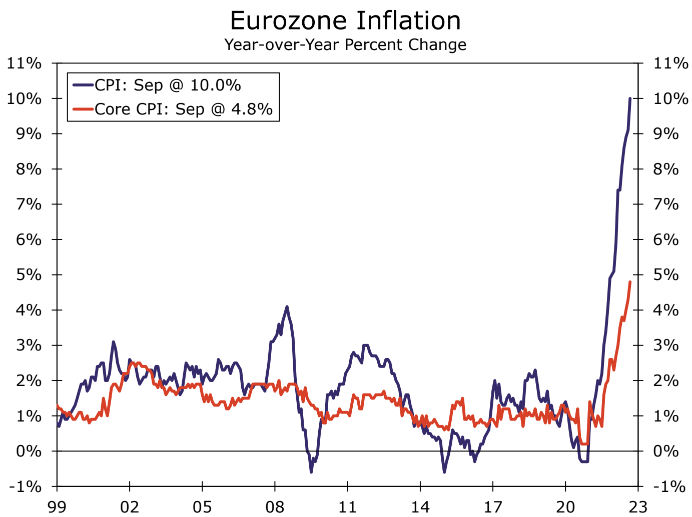
The U.K.'s mini budget fiscal stimulus plan sent markets into a frenzy this week. To provide some context, the U.K. government announced series of tax cuts and regulatory reforms that will cost £161 billion over the next five years, fueling concerns about sprawling inflation. The market's subsequent reaction was pronounced, with the pound reaching a record low, and U.K. short-term interest rates and bond yields moving sharply higher upon the news.

In response, Bank of England (BoE) Governor Bailey said the central bank is closely monitoring market developments and won't hesitate to change rates by as much as needed to ensure inflation returns to the 2% target sustainably over the medium term. He said that the BoE Monetary Policy Committee will make a full assessment at its next scheduled meeting on November 3, rather than delivering an inter-meeting emergency hike. Given this news, we now expect the Bank of England to hike its policy rate by a larger 100 bps at its next meeting in November. Still, we believe this larger rate hike will prove to be a one-off. As the U.K. economic slowdown crystallizes and inflation peaks, we expect the BoE to revert to a 50 bps increase in December and deliver a final 25 bps rate increase at its first meeting in 2023, which would see the policy rate peak at 4.00%.

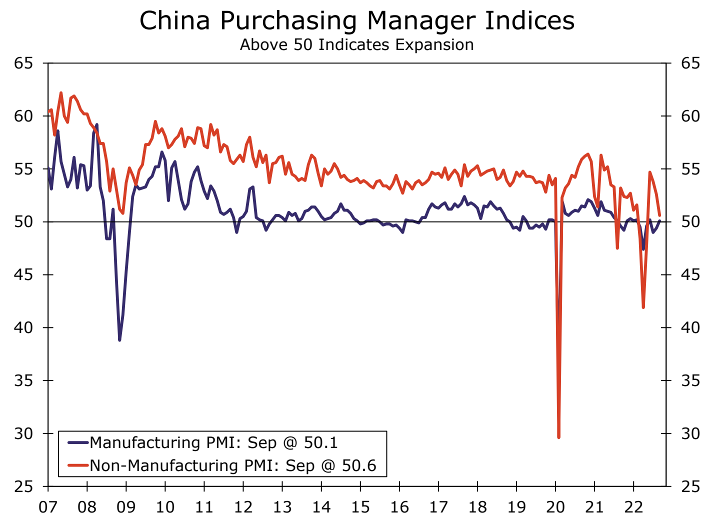
Later in the week, the BoE also committed to temporarily buying an unlimited amount of long-dated government bonds (gilts) to soothe markets and prevent an unwarranted tightening of financing conditions. The statement said the central bank would conduct gilt purchases at "whatever scale is necessary" to restore orderly market conditions. Meanwhile, the BoE will delay its original plan to sell gilts to the end of October.

In other G10 news, the Eurozone's September CPI data release showed inflation surging more than expected. Headline CPI accelerated to 10% year-over-year, driven by food and energy prices yet again. With the natural gas supply relationship between Russia and Europe deteriorating, there are concerns that energy prices will climb even higher in the coming months. Meanwhile, core inflation also rose to a higher-than-expected 4.8%, showing that underlying price pressures are getting more intense.

Against this backdrop of stubbornly high inflation, we now forecast a faster pace of ECB rate hikes—75 bps in November, 50 bps in December, and a final 50 bps in February—bringing the Deposit Rate to 2.50%, a higher peak than previously expected. This is consistent with recent comments from ECB policymakers arguing for a more hawkish approach. ECB policymaker Schnabel said the central bank would need to continue raising interest rates despite the risk of a downturn, while other policymakers have suggested policy rates remain below neutral. Finally, ECB President Lagarde, in more balanced comments, said the outlook is darkening, but inflation remains far too high and risks to inflation are primarily to the upside.



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



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

Zero-COVID & Property Sector Turmoil Do Little to Boost Sentiment in China

In emerging markets, China PMI surveys provided a glimpse into how sentiment for the manufacturing and service sectors fared in September. The data showed slight improvement for the manufacturing side, but a stumble for the non-manufacturing sector. Specifically, the manufacturing PMI ticked up to 50.1, while the non-manufacturing PMI slumped to 50.6, the first decline in three months.

Developments in China have had a material impact on the global economic outlook this year. China's economy has stumbled over “zero-COVID” policies as well as turmoil in the real estate sector. While confirmed cases have receded and the latest lockdowns in Chengdu have been lifted, the government has not budged on its commitment toward implementing large-scale mobility restrictions to combat any uptick in COVID cases. Given the uncertainty around the path of the virus, the possibility of another round of nationwide lockdowns will continue to hover over the Chinese economy and likely weigh on sentiment in the country.

As for China's property sector, August marked the 12th consecutive month that home prices have declined on a month-over-month basis, matching the length of the downturn seen in 2014-2015. While the decline in home prices has not been as sharp as the drop in 2014-2015, we would fully expect the decline in housing prices to extend in 2023, making the current slump in house prices one of the longest on record. In addition, development projects remain stalled across the country as firms struggle to generate cash flow and are experiencing liquidity issues. In response, many Chinese consumers are still participating in a “mortgage strike,” refusing to pay for homes that have yet to be delivered or even homes that fail to meet a certain standard.

COVID containment policy and real estate sector problems have resulted in the Chinese economy coming under pressure. Our current forecast of 3% growth for 2022 is a below consensus view, with risks tilted to the downside.

For further reading on global developments, please see our latest International Economic Outlook. (Return to Summary)

International Outlook

Weekly International Indicator Forecasts					
Date	**Indicator**	**Period**	**Consensus**	**Wells Fargo**	**Prior**
3-Oct	Tankan Large Mfg Index	Q3	11	--	9
3-Oct	Tankan Large Non-Mfg Index	Q3	13	--	13
4-Oct	RBA Cash Rate Target	4-Oct	2.85%	2.60%	2.35%
5-Oct	RBNZ Official Cash Rate	5-Oct	3.50%	3.50%	3.00%

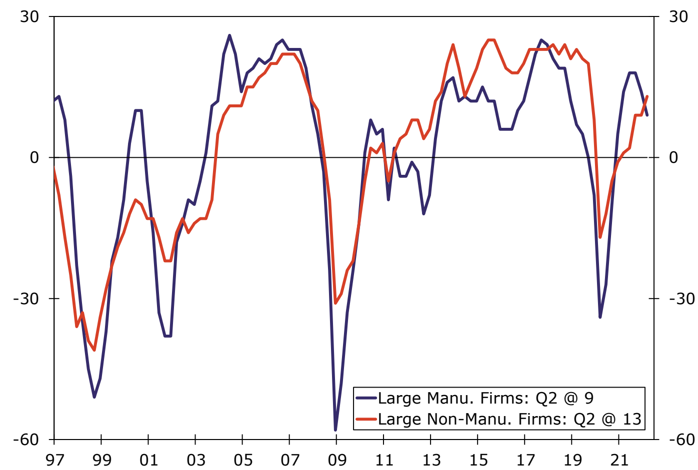
Forecast as of September 30, 2022

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

Japan Tankan Survey • Monday

Next week's Bank of Japan (BoJ) Tankan survey will provide early insight into how Japan's economy fared during the third quarter of this year. Growth trends have been moderate so far in 2022, but key measures from the Q3 Tankan survey should show some resilience in sentiment. The consensus forecast is for the large manufacturers' diffusion index to improve two points to +11, while the large non-manufacturers' diffusion index is expected to remain steady at +13.

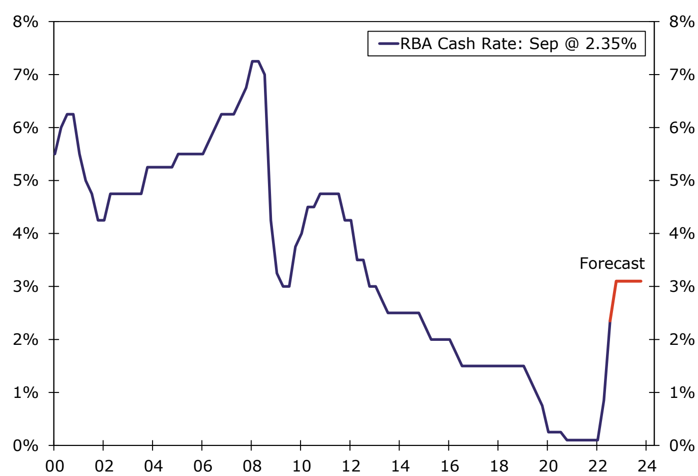
Against a backdrop of only moderate growth and slowing global economic activity, the Bank of Japan remains comfortable with its easy monetary policy stance, and expressed it will not hike rates for the time being. As such, we do not expect any shift in the Bank of Japan's key policy parameters—the policy rate and the 10-year government bond yield target—for the foreseeable future. BoJ President Kuroda has said that current monetary easing will help support the economy and help prevent a downturn, and that the central bank won't hesitate to add to easing if needed.



Source: Datastream and Wells Fargo Economics

Reserve Bank of Australia • Tuesday

The Reserve Bank of Australia (RBA) holds its October monetary policy meeting next week. We expect the central bank to deliver a 25 bps hike, bringing the Cash Rate to 2.60%. In September, the RBA raised its Cash Rate by 50 bps to 2.35% and signaled that further rate hikes would be needed to bring inflation back to target, repeating that policy is not on a pre-set path. In our view, the announcement had a less hawkish tone than prior announcements. The RBA dropped previous wording that rate hikes were a further step in the normalization of monetary conditions, which could indicate that the central bank believes monetary policy is close to neutral, and any further moves could be seen as moving toward restrictive territory. In another less hawkish comment, the RBA said the path for bringing inflation back to target while keeping the economy on an even keel is "narrow" and "clouded in uncertainty." This cautious tone leads us to believe the RBA will move in smaller magnitude rate hikes going forward. More specifically, after a 25 bps hike at its October meeting, we expect two more 25 bps hikes in November and December, bringing the Cash Rate to 3.10%.

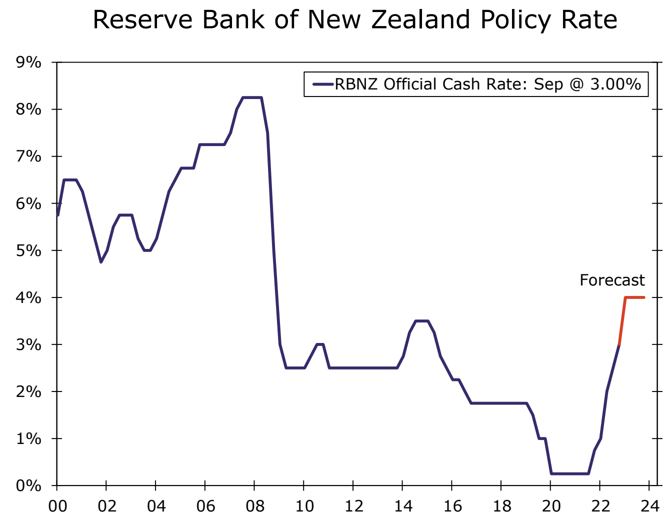


Source: Bloomberg Finance L.P. and Wells Fargo Economics

Reserve Bank of New Zealand • Wednesday

The Reserve Bank of New Zealand (RBNZ) also holds its October monetary policy decision next week. We expect the central bank to hike rates by 50 bps to 3.50%. In August, the RBNZ delivered a 50 bps rate hike to 3.00% and signaled that it was not done yet, as core CPI inflation is still too elevated and labor market slack remains scarce.

Looking back, the RBNZ was one of the first major central banks to ramp up monetary tightening. Indeed, RBNZ Governor Orr recently said that the tightening cycle is very mature, but it still has some work to do with regard to policy rates. Updated forecasts show the RBNZ expects the policy rate to peak at 4.1% in Q2-2023 before declining in 2024. As for inflation, the RBNZ upwardly revised its inflation forecasts and expects CPI inflation to begin to fall to 5.8% by the end of 2022 and 3.8% by the end of 2023, only returning to the target midpoint by mid-2024. Seeing as the RBNZ now expects inflation to remain elevated for longer, we expect additional rate hikes in the months to come until we are closer to the 4% range. (Return to Summary)



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

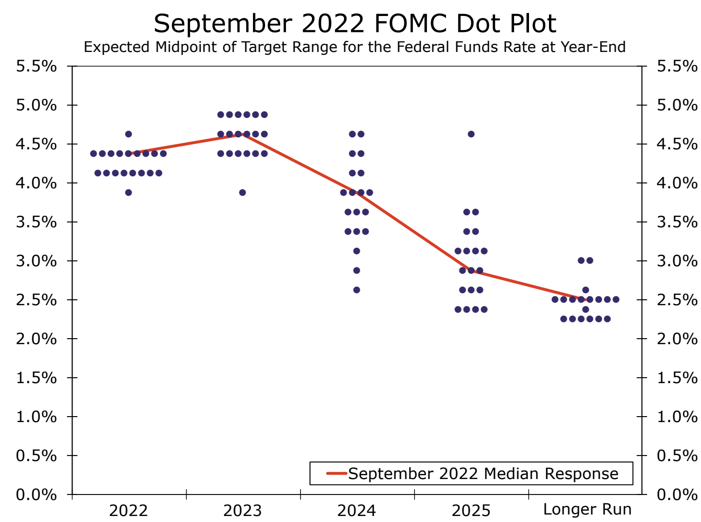
Interest Rate Watch

Update to Our Fed Funds Forecast

Skyrocketing inflation has caused the Federal Open Market Committee (FOMC) to tighten monetary policy significantly this year. Specifically, the FOMC has raised its target range for the federal funds rate by 300 bps since March, the fastest pace of rate hikes in more than 40 years. We had looked for the Committee to hike rates by another 100 bps by early next year, but recent developments have led us to believe that even more tightening lies ahead. We now forecast the FOMC will raise rates by another 175 bps before it is finished tightening policy.

The update to our forecast reflects, at least in part, the apparent resiliency of the U.S. economy in recent weeks. Nonfarm payrolls rose by 315K in August, well above the average monthly increase of roughly 190K that the economy generated during the long expansion of 2010-2019. Tightness in the labor market has pushed wages significantly higher, with average hourly earnings up more than 5% over the past year. Not only have sizable wage gains helped to sustain consumer spending, but they are not consistent with an inflation rate of 2%, which is the Fed's target rate.

Our updated forecast for the fed funds rate also reflects the Fed's apparent willingness to do "whatever it takes" to rein in inflation. As expressed by Fed Chair Jerome Powell in his August 26 speech in Jackson Hole, "the FOMC's overarching focus right now is to bring inflation back down to our 2 percent goal." This commitment was visibly expressed in the "dot plot" (chart). The vast majority of FOMC members see the target range for the fed funds rate ending the year at either 4.00%-4.25% or 4.25%-4.50%. In short, the vast majority of policymakers envision either 100 bps or 125 bps of rate hikes over the final two policy meetings of 2022. Furthermore, most Committee members envision even more tightening in 2023.



Source: Federal Reserve Board and Wells Fargo Economics

The FOMC's most recent thinking and increased resolve to wring out inflation compelled us to change our fed funds rate outlook. We now look for the Committee to raise rates by 75 bps at the November 2 meeting and by another 50 bps at the December 14 meeting, which would take the range for the federal funds rate to 4.25%-4.50% by mid-December. But with the core rate of PCE inflation also up 4.5% in December by our estimates, the real federal funds rate (i.e., the nominal fed funds rate deflated by the rate of core PCE inflation) would still not be positive. In our view, the FOMC would need to get the real fed funds rate into positive territory to slow the economy sufficiently to bring inflation convincingly back toward 2%. This movement into positive territory occurs early in 2023 as the FOMC continues to tighten policy—we look for 25 bps rate hikes at the meetings on February 1 and March 22—and as inflation slowly recedes. We look for the real fed funds rate to climb to about 1% in the second quarter, which we estimate would be restrictive enough to push the economy into recession by midyear.

As we noted in our most recent monthly *U.S. Economic Outlook*, the FOMC has been quick to cut rates at the first signs of trouble during the past few cycles. However, we believe the Committee will be slower to ease policy during this cycle to ensure that inflation is indeed moving unmistakably back toward the Fed's target of 2%. But with the economy likely in recession next year, the unemployment rate rising and inflation receding considerably, we look for the FOMC to reverse course in the fourth quarter of 2023. Specifically, we look for the Committee to cut rates by 50 bps in Q4-2023 with another 175 bps of easing by Q3-2024. Without rate cuts, the real fed funds rate would rise further, which would not be warranted in recession, as inflation continues to recede. (Return to Summary)

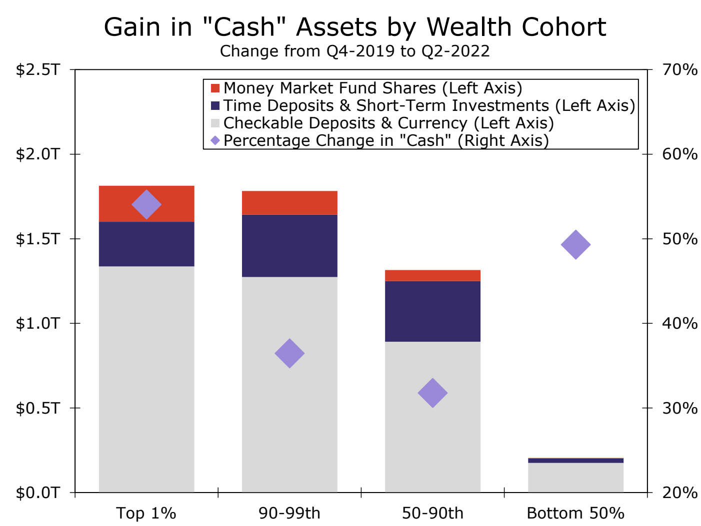
Credit Market Insights

Five Trillion Down, Still 26 Trillion Up

The Federal Reserve's updated Distributional Financial Accounts indicated declining household wealth over the second quarter of this year. Since its peak in the last quarter of 2021, household wealth is down over $5 trillion, from $141.9T to $135.8T, and all but a quarter trillion of this decline occurred in the second quarter. Large declines in equity prices and rising bond yields have driven the value of investment assets down, leading to sharp declines in brokerage accounts as well as defined contribution investment plans. Reducing the net fall in investment assets, home equity rose by $1.2T over the quarter, as a $1.5T increase in real estate wealth outgained the $0.3T increase in mortgage liabilities. As of July, home prices are still up a resounding 15.8% year-over-year, according to the Case-Shiller National Home Price Index, though they are off their peak from a few months ago. Though eroding affordability and rising rates are now leading to a slowdown, home prices were holding up and contributing to wealth for existing homeowners. Sky-high home prices have, however, added to affordability concerns, and mortgage payments as a percent of income are now back at highs hit in 2006. We may see a decline in real estate wealth in coming quarters if home prices continue to decline, though the massive run-up in prices over the past two years continues to augment the wealth of most homeowners who purchased their homes prior to 2020.

Even with the recent hit to wealth, household wealth is still almost 24% above pre-pandemic levels. Household balance sheets are still bolstered compared to their pre-pandemic position, "Cash" assets are up 40% overall and this 'cash-cushion' in part helps explain recent consumer resilience. There is still room for consumer spending to run, as cash savings and elevated home equity bolster the ability of consumers across the wealth spectrum to spend. Cash assets of the bottom half of the population by wealth are 49% higher compared to the end of 2019, while the top 1% have seen a 54% gain, indicating a consistent rise in cash since the end of 2019. Overall, the top 10% of incomes account for more than 40% of personal spending, but these broad gains in cash assets broadly strengthen consumer spending.

Consumer spending remains strong, as evidenced by real personal spending rising 0.1% in August. With extra savings and significantly higher wealth, households are still able to spend even with persistent inflation headwinds. We forecast that personal consumption growth remains positive through the end of this year, as nominal disposable incomes continue to grow at a rapid pace and the pace at which real income gains are eroded by inflation slows down. However, as savings and accumulated wealth move farther away from their COVID-era peaks, we see significant headwinds to personal consumption in 2023. (Return to Summary)



Source: Federal Reserve Board and Wells Fargo Economics

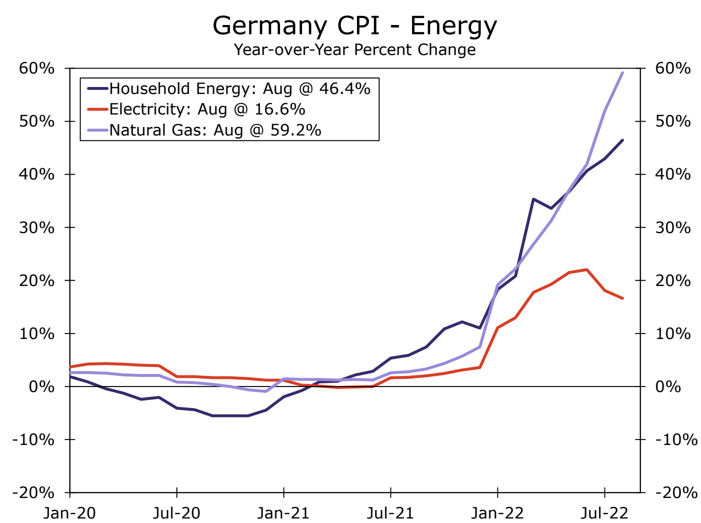
Topic of the Week

Easy on the Gas: Germany Institutes Energy Price Cap

On Thursday, the German government announced plans to institute a $194B package aimed at curtailing crippling energy costs. The package consists of both a reduction in the sales tax on natural gas to 7% from 19% and a cap on the price of electricity for consumers and certain businesses. This announcement came on the same day that Germany's September CPI report revealed the year-over-year growth in price level for the country to be a scorching hot 10.9%, the highest inflation for the country in the Euro era. If the headline number was not stark enough, the devil was in the details for German household energy prices. The August data revealed that prices for natural gas are up a whopping 59.2% year-over-year, with the broader household energy category coming in not far behind at 46.4% on the year. While electricity prices are up *only* 16.6% on the year, it is of little relief to German households to know that it is a slight decline from highs earlier in 2022.

Details of the energy package that policymakers describe as a "defensive shield" are not complete and will be fully announced next month. The reduction in sales tax and price cap are planned to last through spring 2024. They are also directing strategic energy to ween their country off of Russian energy dependence, including promoting construction of additional LNG terminals and advancing efforts to transition to renewable energy. In addition, it was announced that two nuclear plants in the southern region of the country previously slated to be decommissioned will continue operating until at least spring 2023. The traditionally fiscally austere government will take advantage of a suspension on constitutional debt limits to finance the package with new borrowing. Even with all of these measures included in the package, Germany may be forced to implement emergency gas rationing if the situation worsens. German households are in for a period of belt tightening on their energy consumption. The outlook for German households and current macro-environment are supportive of our view that the Eurozone is likely to slip into a recession in 2023.

With winter on the horizon, policymakers in Germany have quite a daunting situation facing them. The announced price cap and reduction in sales tax may help to address the spiraling energy prices, but they will probably not be able to reverse the adverse effect of Russia shutting down the Nord Stream pipelines. There is little hope of natural gas flows resuming through the pipelines anytime soon as a series of substantial leaks in them have led to natural gas bubbling up in the Baltic Sea. The damage to this critical infrastructure means even in the unlikely event that the Russia-Ukraine conflict is resolved in the near future, the pipelines' efficacy as a reliable source of energy will be uncertain. The shutoff of this pipeline is already having deleterious effects to German households, as evidenced by this week's CPI report. The situation is not just confined to Germany, however, and is likely to have significant spillover effects across the EU more broadly. As we have detailed in a previous report, the EU is particularly vulnerable to energy shocks, as Russia is its largest source of imports for natural gas. The U.S., a net exporter of LNG, has ramped up exports to the EU year to date, though this is unlikely to deliver the bloc from its energy price woes. To put it lightly, the zeitgeist of 2022 has not been a pleasant one thus far for Germany or the EU as a whole. (Return to Summary)



Source: Germany Federal Statistical Office and Wells Fargo Economics

Market Data • Mid-Day Friday

U.S. Interest Rates

	Friday 9/30/2022	1 Week Ago	1 Year Ago
SOFR	2.96	2.99	0.05
3-Month LIBOR	3.74	3.64	0.13
3-Month T-Bill	3.30	3.18	0.03
1-Year Treasury	4.06	3.99	0.07
2-Year Treasury	4.15	4.20	0.28
5-Year Treasury	3.96	3.98	0.96
10-Year Treasury	3.73	3.68	1.49
30-Year Treasury	3.70	3.61	2.04
Bond Buyer Index	4.02	3.89	2.26

Foreign Exchange Rates

	Friday 9/30/2022	1 Week Ago	1 Year Ago
Euro ($/€)	0.979	0.969	1.158
British Pound ($/£)	1.115	1.086	1.347
British Pound (£/€)	0.879	0.893	0.859
Japanese Yen (¥/$)	144.690	143.310	111.290
Canadian Dollar (C$/$)	1.373	1.359	1.268
Swiss Franc (CHF/$)	0.982	0.982	0.932
Australian Dollar (US$/A$)	0.644	0.653	0.723
Mexican Peso (MXN/$)	20.090	20.208	20.640
Chinese Yuan (CNY/$)	7.116	7.128	6.445
Indian Rupee (INR/$)	81.349	80.991	74.239
Brazilian Real (BRL/$)	5.401	5.262	5.443
U.S. Dollar Index	112.045	113.192	94.230

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

Foreign Interest Rates

	Friday 9/30/2022	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	-0.58	-0.59	-0.57
3-Month Sterling LIBOR	3.60	2.91	0.08
3-Month Canada Banker's Acceptance	4.20	4.13	0.45
3-Month Yen LIBOR	-0.02	-0.02	-0.08
2-Year German	1.76	1.92	-0.69
2-Year U.K.	4.24	3.96	0.41
2-Year Canadian	3.79	3.78	0.53
2-Year Japanese	-0.05	-0.07	-0.12
10-Year German	2.11	2.02	-0.20
10-Year U.K.	4.09	3.83	1.02
10-Year Canadian	3.17	3.12	1.51
10-Year Japanese	0.24	0.24	0.07

Commodity Prices

	Friday 9/30/2022	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	80.48	78.74	75.03
Brent Crude ($/Barrel)	88.23	86.15	78.52
Gold ($/Ounce)	1672.17	1643.94	1756.95
Hot-Rolled Steel ($/S.Ton)	772.00	802.00	1900.00
Copper (¢/Pound)	345.25	337.15	408.90
Soybeans ($/Bushel)	14.33	14.31	12.64
Natural Gas ($/MMBTU)	7.00	6.83	5.87
Nickel ($/Metric Ton)	22,250	24,482	18,358
CRB Spot Inds.	567.71	578.49	625.40

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