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Economics Group

Special Commentary

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Forecast Update: Global Downturn Imminent

Executive Summary

In the forecast that we published on March 11, we looked for U.S. GDP to contract modestly in Q2-2020 before bouncing back in the second half of the year. We also projected that global GDP growth would slow to roughly 2% this year, which would mark the slowest pace of growth since the Great Recession. However, events over the past few days have made us reassess this outlook. Many economies are essentially locking down to combat the spread of the COVID-19 outbreak. Although these steps are necessary from a public health perspective, they likely will have significant economic consequences. We now project that the U.S. economy will fall into a sharp, albeit short-lived, recession in Q2-2020. Furthermore, we forecast that global GDP growth will fall to roughly 1% this year. Outside of 2009, when the global economy contracted modestly, our forecast for 2020 would mark the slowest pace for global GDP growth in nearly 40 years.

We now project that the U.S. economy will fall into recession in Q2-2020.

U.S. Economic Outlook

The U.S. economy has been hit in recent weeks by two negative shocks. First, the COVID-19 outbreak will affect the economy in a number of ways, which we will discuss in more detail subsequently. Second, the marked plunge in oil prices over the past month or so will also exert a slowing effect on the economy, at least in the near term. We now look for the economy to contract at an annualized pace in excess of 3% in Q2-2020 and by more than 2% in Q3 before returning to a positive growth trajectory at the end of the year (Figure 1 and Page 5). On a peak-to-trough basis, we project that real GDP will fall by 1.4% over the next two quarters, which would make it more or less an "average" recession. Fortunately, the economy built up few major imbalances (e.g., major housing bubble, an over-indebted household sector, leveraged bank balance sheets, etc.) during this expansion, so the economy should return to a positive trajectory once the growth-slowing effects of the two shocks dissipate.

Figure 1

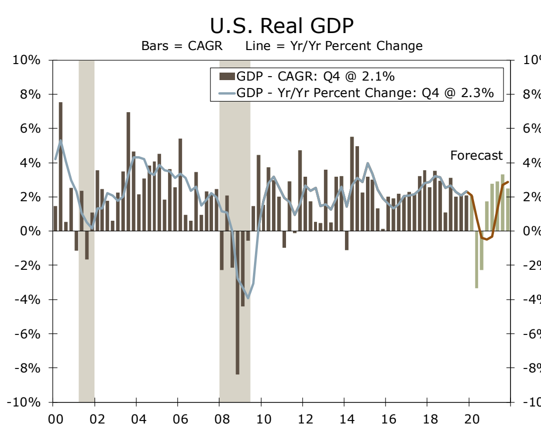
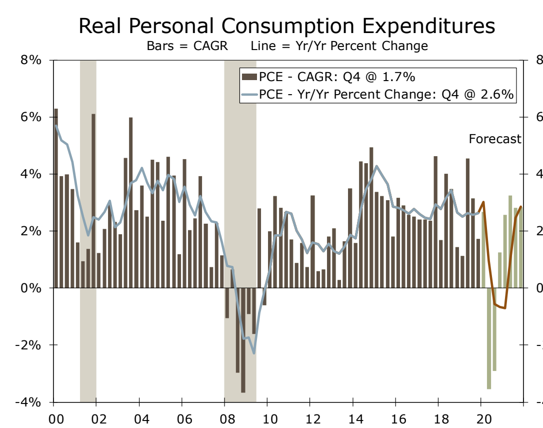


Figure 2



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

We look for consumer spending to weaken markedly.

There are a number of channels through which the COVID-19 pandemic will negatively affect the economy. First, weaker economic growth in the rest of the world (Figure 6 and Page 6) will depress American exports in coming months. Second, economic activity in industries such as air travel, hotels, restaurants, etc. is nosediving. Although some businesses in these industries may not reduce staff immediately, the income-destroying effects of reduced hours and lower gratuities, etc. will have multiplier effects on the rest of the economy. That is, workers who experience reduced income will begin to cut their levels of spending, which will then adversely affect other industries. We look for growth in real personal consumption expenditures, which accounts for roughly two-thirds of overall spending in the economy, to weaken markedly in the coming two quarters (Figure 2).

There are also potential supply-side effects from the outbreak. That is, some American industries may not be able to source inputs from suppliers located in countries that are in a state of lockdown. A lack of inputs could cause production in these industries to grind to a halt, with negative consequences for the rest of the economy. On a more positive note, it appears that many industries have ample inputs in stock, so they should be able to ride out supply disruptions that prove to be short-lived.

The nosedive in oil prices will also have adverse effects on the economy, at least in the near term. The plunge in oil prices in 2014-2016 caused investment in the energy sector to dry up (Figure 3), and we expect another down-leg in overall business fixed investment (BFI) spending in coming quarters. The pullback that we expect in consumer spending and the uncertainty that pervades the economy now are certainly not conducive for a positive BFI outlook.

Figure 3

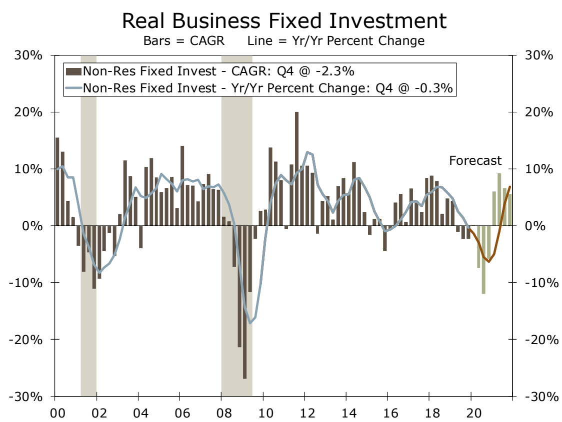
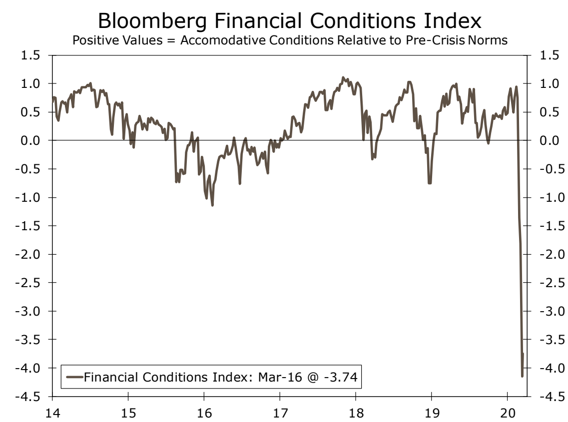


Figure 4



Source: U.S. Department of Commerce, Bloomberg LP and Wells Fargo Securities

Furthermore, financial conditions have tightened considerably over the past few weeks (Figure 4). The stock market has gone into virtual freefall, and corporate bond spreads have widened markedly. This tightness in capital markets likely will lead commercial banks to tighten lending standards to businesses and consumers in the weeks and months ahead. Tighter credit will also exert headwinds on economic growth in the near term.

The Fed is trying to cushion the economy as much as possible via rate cuts and other forms of accommodation.

In an effort to cushion the economy from these shocks, the Federal Reserve has slashed the target range for the fed fund rate 150 bps since early March, returning the target range to only 0.00% to 0.25%, where it was maintained from December 2008 until December 2015. The FOMC has also reduced its discount rate to an all-time low of 0.25%, and it has re-instated its quantitative easing program via renewed purchase of Treasury and mortgage-backed securities. Furthermore, we believe that the Fed will keep rates on hold through at least the end of 2021, even if the economy enters a recovery phase later this year, as we project. With the unemployment rate breeching 5% early next year and with inflation remaining quiescent, we do not believe that the FOMC will feel compelled to tighten monetary policy anytime soon. The fiscal policy response of the federal government, which is still evolving, can potentially cushion some of the blow. We stand ready to make refinements to our forecast if the government should open up the fiscal taps even further, which we believe will eventually be necessary.

All economic forecasts are subject to uncertainty. But we want to stress that the economic outlook is more uncertain than usual at present. The path that the U.S. economy takes in coming months will depend in large part on how the COVID-19 outbreak evolves, which is highly uncertain. If American authorities manage to get the outbreak under control in coming weeks, then real GDP may not decline as much as we fear. On the other hand, if the outbreak continues to accelerate well into the second quarter, then the contraction in U.S. real GDP could be even deeper than we currently project.

Global Economic Outlook

Not only are we looking for recession in the United States, but we think that many foreign economies will suffer downturns this year as well. Let's start with China where the COVID-19 pandemic originated. The Chinese economy likely has contracted meaningfully on a sequential basis in the first quarter due to the state of near lockdown that many parts of the country experienced. But China is returning to work, and economic activity should accelerate over the next few quarters. Still, the 3% growth rate that we forecast for 2020 (Page 6) would be the slowest rate of Chinese GDP growth in at least 40 years.

We also expect many foreign economies will suffer downturns this year.

The outbreak is dealing a body blow to most European countries as well. The Eurozone economy was already on shaky footing coming into the year, and the pandemic will undoubtedly push the common currency area into an outright downturn. As shown in Figure 5, we forecast that real GDP in the Eurozone will slump in the first three quarters of 2020. If our forecast of a 1.0% contraction in 2020 real GDP in the euro area proves to be correct, it would be roughly equivalent to the downturn that the common currency area experienced in 2012 during the height of the European sovereign debt crisis. We look for the U.K. economy to contract 0.6% in 2020, the weakest year for the British economy since the Great Recession.

Like the Eurozone, the Japanese economy entered 2020 on a weak note with real GDP in Japan nose-diving at an annualized rate in excess of 7% in Q4-2019. The consumption tax hike and a typhoon, which both hit in October, dealt a one-two punch to the economy. In that regard, the COVID-19 outbreak has hit the Japanese economy at a particularly ill-suited time. We look for real GDP in Japan to tumble nearly 2% in 2020, the worst year for the Japanese economy since 2009.

In North America, we look the Canadian economy to follow its U.S. counterpart lower for the next two quarters, with a peak-to-trough contraction in Canada of roughly a similar magnitude to that in the United States. The Mexican economy, which was already contracting before the COVID-19 outbreak hit the global economy, likely will slump even further. Globally, we see real GDP growing roughly 1% in 2020 (Figure 6). Although not as weak as 2009, our forecasted global GDP growth rate for 2020 would be significantly weaker than the global slowdown of the early 1990s, which is considered to be a period of global recession.

Globally, we see real GDP growing roughly 1% in 2020.

Figure 5

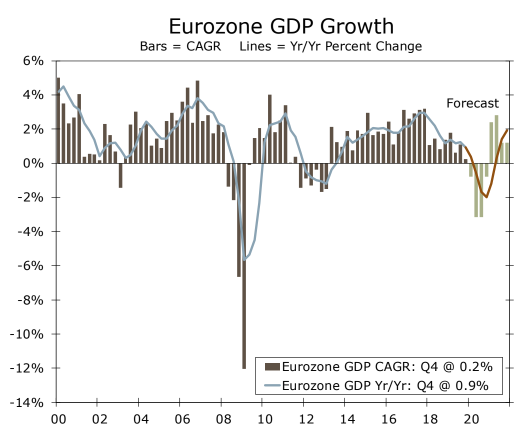
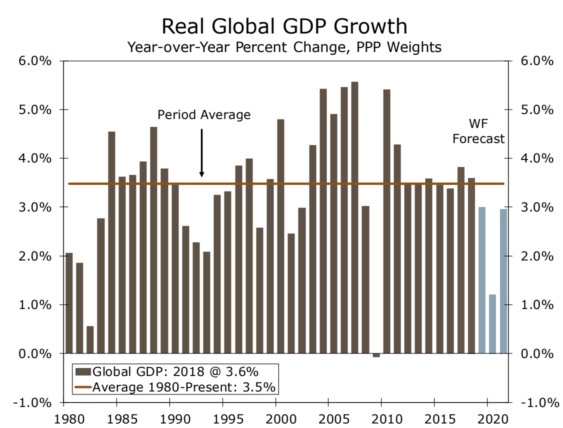


Figure 6



Source: IHS Markit, International Monetary Fund and Wells Fargo Securities

As in the United States, monetary policymakers in other major economies are starting to respond aggressively to the deterioration in the economic outlook. On March 11, the Bank of England (BOE) cut its main policy rate 50 bps, returning its Bank Rate to its all-time low of 0.25%. The Bank of Canada (BoC) has slashed rates 100 bps since early March, and we look for the BoC to return its main policy rate to its all-time low of 0.25% in short order. At that point, policy rates at most of the world's major central banks will be close to 0%. In some cases, policy rates are negative already.

We expect that foreign central banks will look for ways to provide even more accommodation.

Looking ahead, we expect that foreign central banks will look for ways to provide even more accommodation, to the extent that they can. The European Central Bank (ECB) recently upped the size of its asset purchase program, and ramped up its programs to incentivize commercial banks to lend more to the private sector. We believe that the ECB could potentially cut its deposit rate, which already sits at -0.50%, a bit further into negative territory, and it may consider even more asset purchases. We do not believe that the BOE will cut its main policy rate into negative territory, but we do expect that it will eventually increase the size of its asset purchase program, which has remained unchanged at £445 billion—£435 billion of government bonds and £10 billion of commercial debt—since August 2016. Ultimately, however, any meaningful economic stimulus in most major foreign economies will need to come from fiscal authorities rather than central banks. On that score, we will wait and see what steps governments may announce in coming weeks and months.

Wells Fargo U.S. Economic Forecast

	Actual								Forecast								Actual		Forecast	
	2018				2019				2020				2021				2018	2019	2020	2021
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Real Gross Domestic Product (a)	2.6	3.5	2.9	1.1	3.1	2.0	2.1	2.1	2.1	-3.3	-2.3	1.8	2.8	2.9	3.3	2.5	2.9	2.3	0.5	1.6
Personal Consumption	1.7	4.0	3.5	1.4	1.1	4.6	3.1	1.7	2.7	-3.5	-2.9	1.2	2.6	3.2	2.8	2.8	3.0	2.6	0.7	1.4
Business Fixed Investment	8.8	7.9	2.1	4.8	4.4	-1.0	-2.3	-2.3	0.2	-7.4	-11.9	-5.8	6.0	9.2	6.7	5.7	6.4	2.1	-4.0	1.1
Equipment	6.6	3.4	2.9	7.4	-0.1	0.8	-3.8	-4.4	-3.7	-11.1	-20.4	-9.4	10.8	14.2	8.4	6.3	6.8	1.3	-7.5	0.9
Intellectual Property Products	9.7	11.9	4.1	11.7	10.8	3.6	4.7	4.0	4.2	-2.5	-3.7	-2.0	4.7	7.4	6.9	6.7	7.4	7.6	1.5	2.8
Structures	12.1	11.0	-2.1	-9.0	4.0	-11.1	-9.9	-8.1	-3.5	-8.0	-6.0	-4.5	-2.0	1.5	2.0	2.0	4.1	-4.3	-6.9	-2.0
Residential Investment	-5.3	-3.7	-4.0	-4.7	-1.0	-3.0	4.6	6.2	12.5	-3.5	-2.0	3.5	4.0	4.5	4.5	4.5	-1.5	-1.5	3.8	2.8
Government Purchases	1.9	2.6	2.1	-0.4	2.9	4.8	1.7	2.6	2.2	2.6	3.2	3.3	2.3	0.9	-0.2	-0.3	1.7	2.3	2.6	1.9
Net Exports	-884.2	-850.5	-962.4	-983.0	-944.0	-980.7	-990.1	-899.6	-873.0	-843.7	-815.1	-838.4	-920.4	-981.9	-975.3	-982.6	-920.0	-953.6	-842.5	-965.1
Pct. Point Contribution to GDP	0.0	0.7	-2.1	-0.4	0.7	-0.7	-0.1	1.5	0.6	0.6	0.6	-0.5	-1.7	-1.3	0.1	-0.1	-0.4	-0.2	0.6	-0.6
Inventory Change	40.5	-28.0	87.2	93.0	116.0	69.4	69.4	13.0	-40.0	-75.0	-55.0	15.0	80.0	100.0	110.0	100.0	48.1	67.0	-38.8	97.5
Pct. Point Contribution to GDP	0.1	-1.2	2.1	0.1	0.5	-0.9	0.0	-1.0	-1.1	-0.7	0.4	1.5	1.4	0.4	0.2	-0.2	0.1	0.1	-0.6	0.7
Nominal GDP (a)	5.0	7.1	4.8	2.9	3.9	4.7	3.8	3.5	3.1	-3.4	-0.4	3.8	5.2	5.3	5.3	4.2	5.4	4.1	1.7	3.6
Real Final Sales	2.4	4.8	0.8	1.0	2.6	3.0	2.1	3.1	3.7	-2.6	-2.7	0.3	1.4	2.5	3.1	2.7	2.8	2.2	1.1	0.9
Retail Sales (b)	4.7	5.7	5.5	3.5	2.8	3.4	4.0	4.0	4.3	0.5	-1.8	-2.3	-2.1	1.3	3.9	5.4	4.8	3.5	0.1	2.1
Inflation Indicators (b)																				
PCE Deflator	1.9	2.3	2.2	1.9	1.4	1.4	1.4	1.4	1.6	0.9	1.0	1.2	1.5	2.1	2.1	2.0	2.1	1.4	1.2	2.0
"Core" PCE Deflator	1.8	2.0	2.0	1.9	1.6	1.6	1.7	1.6	1.7	1.5	1.4	1.5	1.5	1.7	1.7	1.7	2.0	1.6	1.5	1.6
Consumer Price Index	2.2	2.7	2.7	2.2	1.6	1.8	1.8	2.0	2.2	1.4	1.5	1.5	1.8	2.5	2.6	2.5	2.4	1.8	1.7	2.3
"Core" Consumer Price Index	1.9	2.2	2.3	2.2	2.1	2.1	2.3	2.3	2.3	2.2	2.0	1.9	1.9	1.9	1.9	2.0	2.1	2.2	2.1	1.9
Producer Price Index (Final Demand)	2.8	3.0	3.1	2.8	1.9	2.0	1.6	1.1	1.3	0.4	0.8	1.2	1.8	2.6	2.7	2.7	2.9	1.7	0.9	2.4
Employment Cost Index	2.7	2.8	2.8	2.9	2.8	2.7	2.8	2.7	2.7	2.7	2.6	2.5	2.3	2.1	2.1	2.2	2.8	2.7	2.6	2.2
Real Disposable Income (b)	3.9	3.9	4.1	3.9	3.3	3.0	2.7	2.4	2.4	2.5	0.9	0.2	-0.8	-0.9	0.7	1.5	4.0	2.9	1.5	0.1
Nominal Personal Income (b)	5.6	5.8	5.9	4.9	4.6	4.7	4.2	4.1	3.9	3.3	2.1	1.6	0.8	1.3	2.8	3.6	5.6	4.4	2.7	2.1
Industrial Production (a)	2.3	4.6	5.2	3.9	-1.9	-2.3	1.1	0.1	-1.4	-6.1	-7.7	-0.4	4.3	3.9	3.2	3.0	3.9	0.8	-2.5	0.9
Capacity Utilization	77.9	78.5	79.1	79.4	78.6	77.8	77.6	77.2	76.7	75.6	74.1	74.0	74.8	75.5	76.1	76.6	78.7	77.8	75.1	75.7
Corporate Profits Before Taxes (b)	2.9	2.4	4.2	4.2	-2.2	1.3	-1.2	-3.0	3.0	-10.0	-6.0	1.0	2.5	8.0	9.0	6.0	3.4	-1.3	-3.1	6.3
Corporate Profits After Taxes	10.3	8.3	11.3	10.1	-2.9	1.3	-0.3	-2.6	3.8	-9.2	-6.0	1.1	2.6	8.1	9.1	6.0	10.0	-1.1	-2.7	6.4
Federal Budget Balance (c)	-375	-7	-172	-319	-372	-56	-237	-357	-483	-121	-290	-377	-494	-125	-304	-393	-779	-984	-1250	-1300
Trade Weighted Dollar Index (d)	103.1	107.3	107.6	110.1	109.8	109.7	111.0	109.9	111.8	112.5	112.5	111.5	110.3	109.3	108.8	108.8	106.4	110.1	112.1	109.3
Nonfarm Payroll Change (e)	234	211	153	172	139	159	203	210	222	-185	-360	-275	0	175	200	225	193	178	-150	150
Unemployment Rate	4.1	3.9	3.8	3.8	3.9	3.6	3.6	3.5	3.6	4.0	4.6	5.3	5.2	5.0	4.9	4.6	3.9	3.7	4.4	4.9
Housing Starts (f)	1.32	1.26	1.23	1.19	1.21	1.26	1.28	1.45	1.38	1.30	1.30	1.30	1.33	1.33	1.33	1.34	1.25	1.29	1.32	1.33
Light Vehicle Sales (g)	17.1	17.3	17.0	17.4	16.8	17.0	17.0	16.7	16.7	16.1	15.3	15.7	16.0	16.2	16.4	16.6	17.2	16.9	15.9	16.3
Crude Oil - Brent - Front Contract (h)	66.9	74.6	75.8	68.6	63.8	67.6	61.5	61.7	52.0	34.0	39.0	44.0	44.0	44.0	44.0	44.0	71.5	63.6	42.3	44.0
Quarter-End Interest Rates (i)																				
Federal Funds Target Rate	1.75	2.00	2.25	2.50	2.50	2.50	2.00	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	1.96	2.25	0.25	0.25
3 Month LIBOR	2.31	2.34	2.40	2.81	2.60	2.32	2.09	1.91	0.60	0.45	0.35	0.35	0.45	0.35	0.35	0.40	2.31	2.33	0.44	0.39
Prime Rate	4.75	5.00	5.25	5.50	5.50	5.50	5.00	4.75	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	4.96	5.25	3.25	3.25
Conventional Mortgage Rate	4.44	4.57	4.63	4.64	4.28	3.80	3.61	3.72	3.10	2.80	2.80	2.85	2.90	2.95	3.05	3.10	4.54	3.94	2.89	3.00
3 Month Bill	1.73	1.93	2.19	2.45	2.40	2.12	1.88	1.55	0.15	0.15	0.15	0.15	0.20	0.15	0.15	0.20	1.97	2.11	0.15	0.18
6 Month Bill	1.93	2.11	2.36	2.56	2.44	2.09	1.83	1.60	0.15	0.15	0.15	0.15	0.20	0.20	0.25	0.35	2.14	2.11	0.15	0.25
1 Year Bill	2.09	2.33	2.59	2.63	2.40	1.92	1.75	1.59	0.20	0.25	0.25	0.25	0.30	0.35	0.45	0.55	2.33	2.05	0.24	0.41
2 Year Note	2.27	2.52	2.81	2.48	2.27	1.75	1.63	1.58	0.30	0.35	0.40	0.50	0.65	0.75	0.85	0.95	2.53	1.97	0.39	0.80
5 Year Note	2.56	2.73	2.94	2.51	2.23	1.76	1.55	1.69	0.55	0.65	0.75	0.80	0.90	0.95	1.05	1.10	2.75	1.95	0.69	1.00
10 Year Note	2.74	2.85	3.05	2.69	2.41	2.00	1.68	1.92	0.75	0.90	1.05	1.15	1.20	1.25	1.35	1.40	2.91	2.14	0.96	1.30
30 Year Bond	2.97	2.98	3.19	3.02	2.81	2.52	2.12	2.39	1.45	1.60	1.75	1.80	1.85	1.90	1.95	2.00	3.11	2.58	1.65	1.93

Forecast as of: March 16, 2020

Notes: (a) Compound Annual Growth Rate Quarter-over-Quarter
(b) Year-over-Year Percentage Change
(c) Quarterly Sum - Billions USD; Annual Data Represents Fiscal Yr.
(d) Federal Reserve Advanced Foreign Economies Index, 2006=100 - Quarter End
(e) Average Monthly Change
(f) Millions of Units - Annual Data - Not Seasonally Adjusted
(g) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold
(h) Quarterly Average of Daily Close
(i) Annual Numbers Represent Averages

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

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP				CPI			
	2018	2019	2020	2021	2018	2019	2020	2021
Global (PPP Weights)	3.6%	3.0%	1.2%	3.0%	3.6%	3.4%	3.0%	3.2%
Advanced Economies[1]	2.2%	1.9%	-0.1%	1.4%	2.0%	1.6%	1.0%	1.9%
United States	2.9%	2.3%	0.5%	1.6%	2.4%	1.8%	1.7%	2.3%
Eurozone	1.9%	1.2%	-1.0%	0.6%	1.8%	1.2%	0.4%	1.4%
United Kingdom	1.3%	1.4%	-0.6%	0.7%	2.5%	1.8%	1.0%	2.0%
Japan	0.3%	0.7%	-1.8%	1.1%	1.0%	0.5%	-0.2%	1.0%
Canada	2.0%	1.6%	-0.3%	0.8%	2.3%	1.9%	0.6%	2.0%
Developing Economies[1]	4.5%	3.8%	2.1%	4.1%	4.8%	4.8%	4.3%	4.2%
China	6.7%	6.1%	3.0%	6.2%	2.1%	2.9%	2.2%	1.7%
India	6.7%	5.3%	4.9%	5.6%	3.9%	3.7%	4.5%	4.0%
Mexico	2.1%	-0.1%	-0.4%	1.1%	4.9%	3.6%	3.3%	3.2%

Forecast as of: March 16, 2020

[1]Aggregated Using PPP Weights

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	Central Bank Key Policy Rate					
	2020				2021	
	Q1	Q2	Q3	Q4	Q1	Q2
United States	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
Eurozone[1]	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%
United Kingdom	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
Japan	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%
Canada	0.75%	0.25%	0.25%	0.25%	0.25%	0.25%
	2-Year Note					
	2020				2021	
	Q1	Q2	Q3	Q4	Q1	Q2
United States	0.30%	0.35%	0.40%	0.50%	0.65%	0.75%
Eurozone[2]	-0.90%	-0.90%	-0.85%	-0.80%	-0.70%	-0.60%
United Kingdom	0.15%	0.15%	0.20%	0.30%	0.40%	0.50%
Japan	-0.25%	-0.20%	-0.15%	-0.10%	0.00%	0.05%
Canada	0.45%	0.50%	0.55%	0.60%	0.75%	0.90%
	10-Year Note					
	2020				2021	
	Q1	Q2	Q3	Q4	Q1	Q2
United States	0.75%	0.90%	1.05%	1.15%	1.20%	1.25%
Eurozone[2]	-0.70%	-0.70%	-0.60%	-0.50%	-0.40%	-0.30%
United Kingdom	0.25%	0.30%	0.40%	0.55%	0.60%	0.65%
Japan	-0.10%	-0.10%	-0.05%	0.00%	0.05%	0.10%
Canada	0.65%	0.75%	0.85%	1.00%	1.10%	1.20%

Forecast as of: March 16, 2020

[1] ECB Deposit Rate [2] German Government Bond Yield

Source: International Monetary Fund and Wells Fargo Securities

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