

# Economics Group

## Interest Rate Weekly

**John E. Silvia, Chief Economist**  
[john.silvia@wellsfargo.com](mailto:john.silvia@wellsfargo.com) • (704) 410-3275

### Financial Evolution: More Government, More Something Else

*Over the past 25 years, there has been an evolution of debt financing. There has been a remarkable gain in government debt, while non-bank loan finance has grown in importance for debt financing.*

#### Credit Market Debt: More Government

Public discussions of debt focus on households and businesses, yet another key aspect of this story is the growth of government debt, especially in the recent economic expansion (top graph). Over the past 25 years, nonfinancial corporate debt has only risen modestly as a share of GDP relative to household and government debt. Household and government debt grew significantly as a share of the nation's output over this period, although households have deleveraged somewhat since the Great Recession.

What makes this development so distinct, and a structural break from the past, is the lack of a true budget constraint on government finance, unlike the budget constraints on households and businesses. What has changed? Two factors have emerged as key to eliminating the governmental budget constraint. First, the emergence of a global capital market has increased the demand for U.S. sovereign debt as a benchmark asset for both public and private portfolios. Second, increased capital requirements and central bank policy have increased the demand for sovereign debt, especially U.S. debt, such that the increased supply of debt has been easily absorbed by increased demand, a reason that U.S. sovereign yields actually declined in the face of rapidly rising supply.

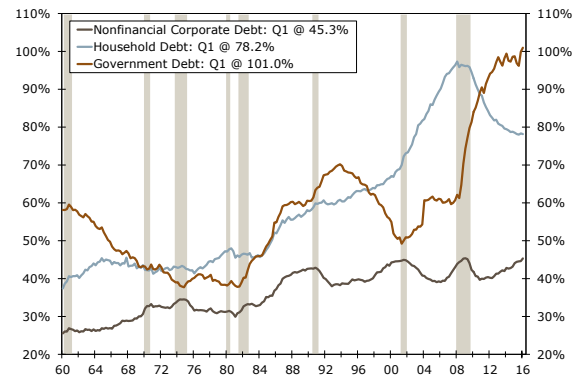
#### Squeeze the Balloon Here, Get Expansion Over There

Since the early 1980s, the share of credit supplied in the markets has evidenced a steady rise in the share of non-bank credit relative to bank credit (middle graph). This development signals the continued rise of non-bank credit allocation for nonfinancial corporations. Yet regulation has focused on banking as a terminal rather than a way station, a conduit of credit allocation. As a result, credit is still allocated but through a different set of pipes than traditional bank loans. Even post Dodd-Frank legislation, the squeeze on banks has and will likely continue to promote greater expansion in the non-bank sector.

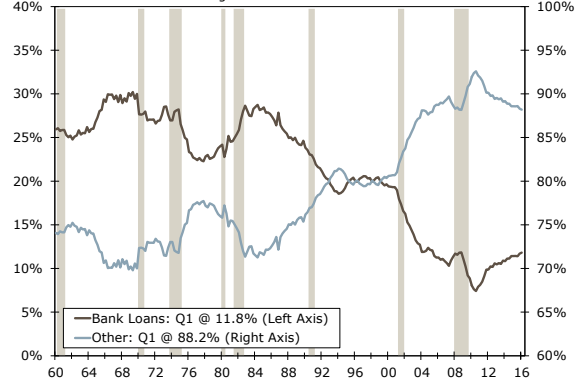
#### Non-Financial Finance: Increasing Diversification

Another development that is often overlooked is the diversification of finance. Since the early 1980s, bank loans as a share of debt financing have declined while the corporate bond market has increased its share. The globalization of capital markets over this time period has helped make capital markets deeper and more liquid. This in turn has likely been one reason, among others, that alternative means of debt financing, such as corporate bonds, have grown in popularity. In addition, since 2008 there has been a distinct slowdown in non-financial corporate finance via mortgages and commercial paper sources.

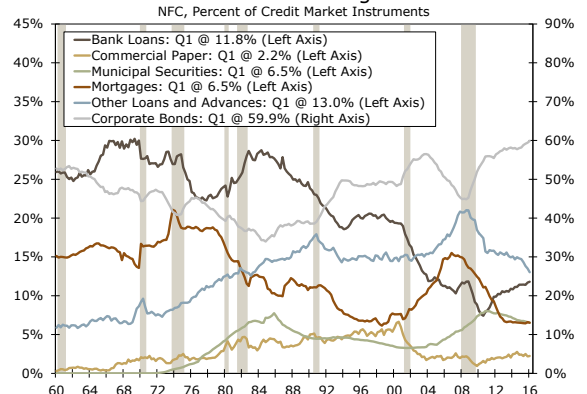
Credit Market Debt as a Share of GDP  
Total Sector Debt



Debt Financing - Bank Loans to NFC  
Percentage of Credit Market Instruments



Debt Financing



## Wells Fargo U.S. Interest Rate Forecast

	Actual								Forecast			
	2015				2016				2017			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Quarter End Interest Rates												
Federal Funds Target Rate	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25
3 Month LIBOR	0.27	0.28	0.33	0.61	0.63	0.65	0.70	0.95	0.95	1.20	1.20	1.45
Prime Rate	3.25	3.25	3.25	3.50	3.50	3.50	3.50	3.75	3.75	4.00	4.00	4.25
Conventional Mortgage Rate	3.77	3.98	3.89	3.96	3.69	3.57	3.46	3.53	3.57	3.60	3.64	3.67
3 Month Bill	0.03	0.01	0.00	0.16	0.21	0.26	0.28	0.47	0.55	0.77	0.82	1.01
6 Month Bill	0.14	0.11	0.08	0.49	0.39	0.36	0.39	0.58	0.65	0.87	0.92	1.11
1 Year Bill	0.26	0.28	0.33	0.65	0.59	0.45	0.48	0.67	0.73	0.94	0.99	1.20
2 Year Note	0.56	0.64	0.64	1.06	0.73	0.58	0.66	0.83	0.92	1.13	1.22	1.35
5 Year Note	1.37	1.63	1.37	1.76	1.21	1.01	1.02	1.15	1.19	1.33	1.39	1.48
10 Year Note	1.94	2.35	2.06	2.27	1.78	1.49	1.41	1.50	1.55	1.60	1.66	1.71
30 Year Bond	2.54	3.11	2.87	3.01	2.61	2.30	2.09	2.13	2.17	2.24	2.28	2.31

Forecast as of: July 13, 2016

## Wells Fargo U.S. Economic Forecast and FOMC Central Tendency Projections

	<u>2016</u>	<u>2017</u>
<b>Change in Real Gross Domestic Product</b>		
Wells Fargo	1.8	2.0
FOMC	1.9 to 2.0	1.9 to 2.2
<b>Unemployment Rate</b>		
Wells Fargo	4.7	4.5
FOMC	4.6 to 4.8	4.5 to 4.7
<b>PCE Inflation</b>		
Wells Fargo	1.5	2.1
FOMC	1.3 to 1.7	1.7 to 2.0
<b>"Core" PCE Deflator</b>		
Wells Fargo	1.7	1.7
FOMC	1.6 to 1.8	1.7 to 2.0

Forecast as of: July 13, 2016

NOTE: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation is the percentage rate of change in the price index for personal consumption expenditures (PCE). Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated.

Fed Data as of: June 15, 2016

Source: IHS Global Insight, Bloomberg LP, Federal Reserve Board and Wells Fargo Securities

## Wells Fargo Securities Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloría, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Jamie Feik	Economist	(704) 410-3291	jamie.feik@wellsfargo.com
Erik Nelson	Currency Analyst	(212) 214-5652	erik.f.nelson@wellsfargo.com
Misa Batcheller	Economic Analyst	(704) 410-3060	misa.n.batcheller@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
Julianne Causey	Economic Analyst	(704) 410-3281	julianne.causey@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

Wells Fargo Securities Economics Group publications are produced by Wells Fargo Securities, LLC, a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes these publications directly and through subsidiaries including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Advisors, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC, is registered with the Commodities Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. Wells Fargo Bank, N.A. is registered with the Commodities Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC, and Wells Fargo Bank, N.A. are generally engaged in the trading of futures and derivative products, any of which may be discussed within this publication. Wells Fargo Securities, LLC does not compensate its research analysts based on specific investment banking transactions. Wells Fargo Securities, LLC's research analysts receive compensation that is based upon and impacted by the overall profitability and revenue of the firm which includes, but is not limited to investment banking revenue. The information and opinions herein are for general information use only. Wells Fargo Securities, LLC does not guarantee their accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company © 2016 Wells Fargo Securities, LLC.

### Important Information for Non-U.S. Recipients

For recipients in the EEA, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority. The content of this report has been approved by WFSIL a regulated person under the Act. For purposes of the U.K. Financial Conduct Authority's rules, this report constitutes impartial investment research. WFSIL does not deal with retail clients as defined in the Markets in Financial Instruments Directive 2007. The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. This report is not intended for, and should not be relied upon by, retail clients. This document and any other materials accompanying this document (collectively, the "Materials") are provided for general informational purposes only.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE

WELLS  
FARGO

SECURITIES