

Economics Group

Interest Rate Weekly

John E. Silvia, Chief Economist

john.silvia@wellsfargo.com • (704) 410-3275

Michael A. Brown, Economist

michael.a.brown@wellsfargo.com • (704) 410-3278

Q2-2017 Net Treasury Issuance Forecast Update

With the passage of a funding bill for the remainder of the 2017 federal fiscal year, along with some initial data on April tax collections, we have revised our FY 2017 budget deficit forecast to \$600 billion.

Federal Deficit Forecast Revised Lower

Over the course of the past couple of weeks, we have received more clarity on the federal budget balance for the remainder of the current fiscal year (FY). On the revenue side of the equation, we have preliminary data on the important April tax collections for the 2016 filing season. On the spending side of the equation, the passage of an omnibus spending bill that keeps the federal government funded through September 30 allows us to update our expectations for federal spending this fiscal year. Finally, to a lesser extent, the expected long and drawn out debate over repealing and replacing the Affordable Care Act (ACA) also factored into us lowering our budget deficit numbers for the current fiscal year. On net, we revised our FY 2017 budget deficit down \$50 billion to \$600 billion. We have left our FY 2018 budget deficit of \$950 billion unchanged for now. Should the tax cut/reform debate become as contentious as the ACA repeal/replace effort, we would likely be inclined to trim at least some of the fiscal policy expansion currently baked into FY 2018. The next key piece of legislation we will watch closely will be the FY 2018 budget resolution, which will establish the top-line spending numbers and thus deficit targets for the next several years.

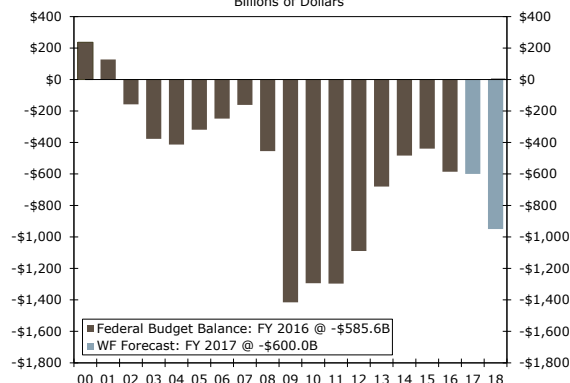
T-Bill Pay Down Expected Again in Q2

One of the stories playing out in the first quarter of this calendar year has been the required drawdown of the Treasury's cash balance related to the reestablishment of the debt ceiling, which resulted in a pay down of T-bills. As is typical in the second quarter of each year as tax collections surge, T-bills are paid down and total net Treasury issuance slows. We expect this trend to play out again this year in Q2 even with the T-bill pay down trend in Q1. The net result is that limited supply is likely to play a role limiting any increase in T-bill yields over the next quarter.

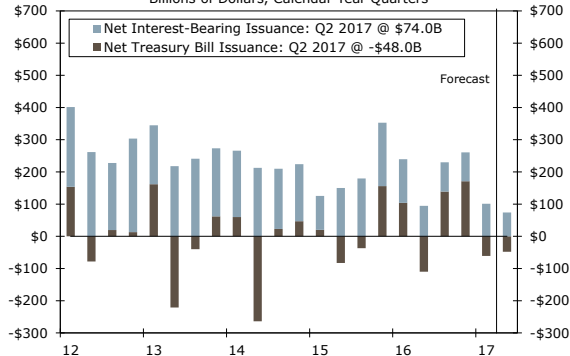
Net Treasury Issuance Expected to Pick Up in H2

With the slowdown in net Treasury issuance in both Q1 and Q2 of this year and only one more quarter left in the FY 2017 (calendar Q3), net Treasury issuance is poised for a rebound in the second half of the year. The debt ceiling will need to be lifted sometime this fall, likely in September, which should allow for greater net issuance. More important, the amount of federal spending relative to revenues is expected to jump in H2, resulting in an estimated \$290 billion net marketable borrowing need in the third quarter and \$369 billion in the fourth quarter of this year, assuming Congress and the Administration agree to roll back some, if not all, of the scheduled Budget Control Act cuts set to resume in October. We will provide more clarity around our FY 2018 budget deficit outlook once Congress agrees on a budget resolution for the year.

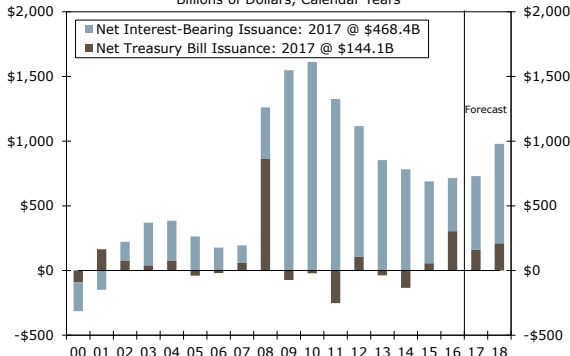
U.S. Federal Budget Balance
Billions of Dollars



Net Treasury Issuance Composition
Billions of Dollars, Calendar Year Quarters



Net Treasury Issuance Composition
Billions of Dollars, Calendar Years



Wells Fargo U.S. Interest Rate Forecast

	Actual				Forecast							
	2016				2017				2018			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Quarter End Interest Rates												
Federal Funds Target Rate	0.50	0.50	0.50	0.75	1.00	1.25	1.50	1.50	1.50	1.75	2.00	2.25
3 Month LIBOR	0.63	0.65	0.85	1.00	1.15	1.45	1.70	1.70	1.70	1.95	2.20	2.45
Prime Rate	3.50	3.50	3.50	3.75	4.00	4.25	4.50	4.50	4.50	4.75	5.00	5.25
Conventional Mortgage Rate	3.69	3.57	3.46	4.20	4.20	4.29	4.45	4.46	4.47	4.48	4.55	4.62
3 Month Bill	0.21	0.26	0.29	0.51	0.76	1.02	1.30	1.40	1.45	1.50	1.75	2.02
6 Month Bill	0.39	0.36	0.45	0.62	0.91	1.19	1.45	1.56	1.60	1.66	1.92	2.18
1 Year Bill	0.59	0.45	0.59	0.85	1.03	1.35	1.65	1.80	1.85	1.90	2.10	2.31
2 Year Note	0.73	0.58	0.77	1.20	1.27	1.55	1.90	2.00	2.05	2.11	2.26	2.41
5 Year Note	1.21	1.01	1.14	1.93	1.93	2.10	2.40	2.46	2.49	2.52	2.66	2.80
10 Year Note	1.78	1.49	1.60	2.45	2.40	2.55	2.72	2.75	2.76	2.78	2.86	2.94
30 Year Bond	2.61	2.30	2.32	3.06	3.02	3.18	3.44	3.54	3.56	3.58	3.67	3.76

Forecast as of: May 10, 2017

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

	2017	2018
Change in Real Gross Domestic Product		
Wells Fargo	2.2	2.7
FOMC	2.0 to 2.2	1.8 to 2.3
Unemployment Rate		
Wells Fargo	4.4	4.3
FOMC	4.5 to 4.6	4.3 to 4.6
PCE Inflation		
Wells Fargo	1.8	2.2
FOMC	1.8 to 2.0	1.9 to 2.0
"Core" PCE Deflator		
Wells Fargo	1.8	2.2
FOMC	1.8 to 1.9	1.9 to 2.0

Forecast as of: May 10, 2017

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: March 15, 2017

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	(212) 214-8543	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 Viloria, 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 Strategist	(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
E. Harry Pershing	Economic Analyst	(704) 410-3034	edward.h.pershing@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 © 2017 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

