WELLS FARGO

Weekly — January 17, 2025

Weekly Economic & Financial Commentary

United States: **Riding the Wave**

- The Consumer Price Index ended the year at 2.9% year-over-year, which is a minor improvement from its 3.1% rate in January 2024 and points to stalled progress on the road back to the Federal Reserve's 2% inflation target. We now look for only two 25 bps rate cuts in the second half of 2025 and expect the FOMC to hold at a target range of 3.75%-4.00% through 2026.
- Next week: Leading Economic Index (Wed.), Existing Home Sales (Fri.)

International: **China's Economy Finished 2024 on a Solid Note, but Challenges Remain**

- China's economy finished 2024 on a sturdy note, with policy support measures helping to boost activity late last year. Q4 GDP firmed more than expected to 5.4% year-over-year, while December activity data also showed an acceleration in retail sales and industrial output. We still expect 2025 to be a challenging year, however, with higher U.S. tariffs weighing on China's export sector and domestic growth unlikely to be sustained unless the government announces large-scale fiscal stimulus.
- Next week: Canada CPI (Tue.), Bank of Japan Policy Rate (Fri.), Eurozone PMIs (Fri.)

Interest Rate Watch: **FOMC Likely to Enter an Extended Pause in Its Recent Easing Cycle**

- We share the widely-held expectation that the FOMC will maintain its current target range of 4.25%-4.50% for the federal funds rate at its upcoming meeting on January 29. We also think the FOMC will keep rates on hold until the second half of the year before easing again.

Topic of the Week: **Beige Book Shows Moderate Expansion Across All Districts**

- The latest Beige Book revealed a picture of continued economic growth, with all 12 of the regional banks reporting a "slight" to "moderate" expansion in activity over the period. Employment across the Districts was resilient, and prices broadly rose. Tariffs clouded the economic outlook for many contacts.

Wells Fargo U.S. Economic Forecast

	Actual 2024				Forecast 2025				Actual	Forecast		
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2023	2024	2025	2026
Real Gross Domestic Product [1]	1.6	3.0	3.1	2.7	2.4	1.5	0.7	1.3	2.9	2.8	2.1	2.2
Personal Consumption	1.9	2.8	3.7	3.0	2.1	2.1	1.8	1.5	2.5	2.7	2.4	2.3
Consumer Price Index [2]	3.2	3.2	2.6	2.7	2.7	2.7	3.1	2.9	4.1	3.0	2.8	2.7
"Core" Consumer Price Index [2]	3.8	3.4	3.2	3.3	3.0	3.0	3.2	3.1	4.8	3.4	3.0	2.9
Quarter-End Interest Rates [3]												
Federal Funds Target Rate[4]	5.50	5.50	5.00	4.50	4.50	4.50	4.25	4.00	5.23	5.27	4.31	4.00
Conventional Mortgage Rate	6.82	6.92	6.18	6.72	7.10	6.90	6.65	6.50	6.80	6.72	6.79	6.50
10 Year Note	4.20	4.36	3.81	4.58	4.70	4.55	4.35	4.25	3.96	4.21	4.46	4.36

Forecast as of: January 16, 2025

[1] Compound Annual Growth Rate Quarter-over-Quarter

[2] Year-over-Year Percentage Change

[3] Quarterly Data - Period End; Annual Data - Annual Averages

[4] Upper Bound of the Federal Funds Target Range

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

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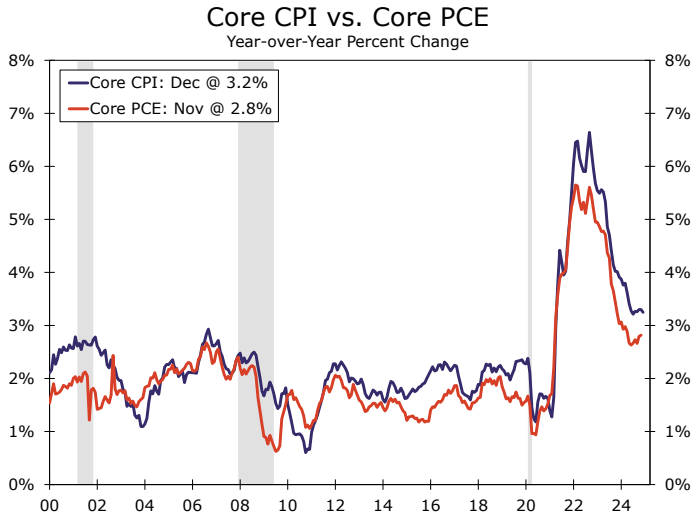
U.S. Review

Riding the Wave

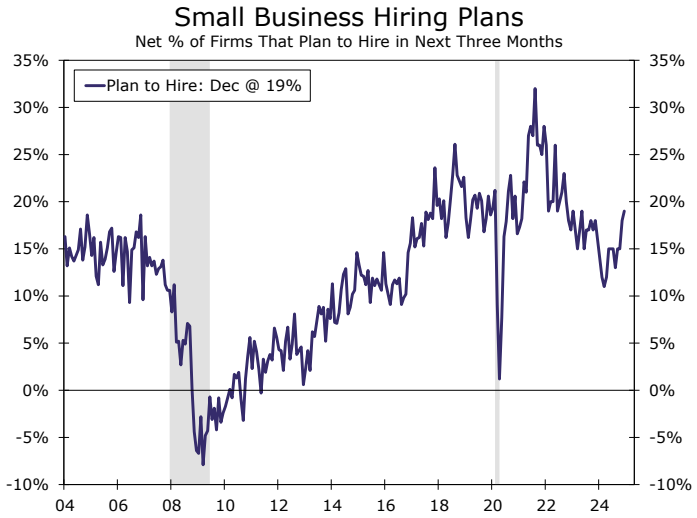
Data released this week continue to demonstrate the U.S. economy's resilience. Holiday sales closed 2024 stronger than expected, small business optimism has rallied back to pre-pandemic levels and home builders have signaled greater confidence in the traffic of prospective buyers. The steady demand impulse has kept some pressure on inflation. The Consumer Price Index ended the year at 2.9% year-over-year, which is a minor improvement from its 3.1% rate in January 2024 and points to stalled progress on the road back to the Federal Reserve's 2% inflation target.

On a monthly basis, the headline CPI rose 0.4% in December on the wings of higher gasoline and food prices. Firm price growth in these essential items has strained lower-income households in particular. Excluding food and energy, the core CPI rose a tamer 0.2%. Vehicle prices continued to rise, but at a slower rate than in November, while prices for the remainder of core goods fell or were essentially flat over the month. Core services inflation remained solid as housing costs (owners' equivalent rent and primary rent) reverted to their recent trend after slowing sharply in November.

The CPI details, along with December's Producer Price Index, suggest the core PCE deflator rose 0.2% in the final month of 2024. If realized, that increase would leave the year-over-year change at 2.8%, down just three-tenths from where it started the year (chart). With the Federal Reserve's preferred gauge of inflation also showing stalled progress, and considering the potential inflationary impulse of policy changes from the incoming administration, the risks to the FOMC's price stability mandate have risen in recent months.



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



Source: NFIB and Wells Fargo Economics

Meantime, the risks surrounding the maximum employment side of the mandate have subsided. Initial claims for unemployment insurance remain historically low. Nonfarm payroll growth surprised to the upside in December, and the unemployment rate unexpectedly fell to 4.1%. The net share of small businesses planning to hire in the next three months rose to 19% in December, which is the highest reading in nearly two years (chart). We suspect the FOMC will feel comfortable maintaining a more restrictive stance of monetary policy this year, given the recent string of solid jobs data. As discussed in the Interest Rate Watch, we now look for only two 25 bps rate cuts in the second half of 2025 and expect the FOMC to hold at a target range of 3.75%-4.00% through 2026.

The labor market's stabilization has supported wage growth, which has underpinned robust consumer spending. Retail sales rose 0.4% in December on the heels of upward revisions to the prior month's gain. Holiday sales, which we define as total retail sales in November and December excluding sales at auto dealers, gasoline stations and restaurants, rose 4.1% in 2024. All told, the 2024 holiday shopping season beat expectations and was stronger than 2023. As long as consumers remain employed and earn income, they likely will continue to spend. (Return to Summary)

U.S. Outlook

Weekly Indicator Forecasts

Domestic

Date	Indicator	Period	Consensus	Wells Fargo	Prior
22-Jan	Leading Index (MoM)	Dec	-0.1%	-0.1%	0.3%
24-Jan	Existing Home Sales (SAAR)	Dec	4.20M	4.16M	4.15M

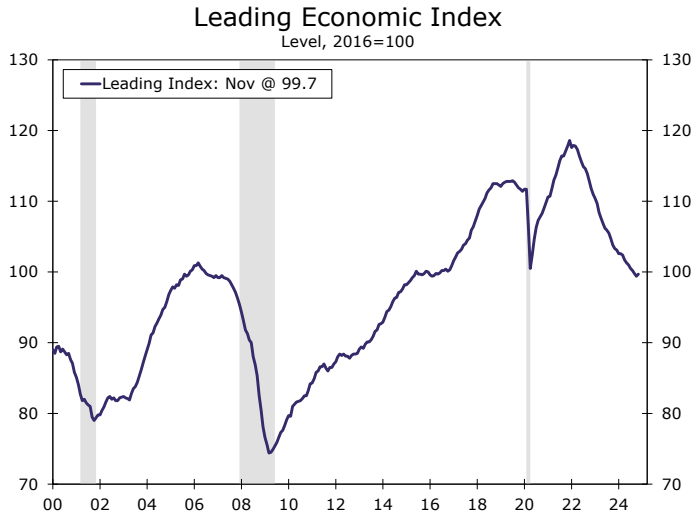
Forecast as of January 17, 2025

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

Leading Index • Wednesday

The Leading Index surprised to the upside and rose 0.3% during November. The monthly gain mostly was the result of gains in building permits, stock prices, average workweek and a decline in jobless claims. Although November's upturn was an encouraging sign that economic growth is still running at a sturdy pace, the predictive power of the top-line index has lost luster this cycle. Aside from a flat month in early 2024 and November's positive reading, the LEI has steadily declined since 2022 without a material contraction in overall economic output.

What's more, the recent upturn does not appear to be an inflection point for the LEI. Although ISM new orders increased and jobless claims continued to show improvement during the month, building permits—which have been a recent area of support—pulled back slightly in December. Equity markets were volatile in December, with many major stock indices ending the month lower than where they began. All told, we anticipate that the top-line LEI declined 0.1% during December.



Source: The Conference Board and Wells Fargo Economics

Existing Home Sales • Friday

Existing home sales continue to run a sluggish pace as affordability and availability constraints limit activity. While weak, resales are no longer declining sharply, and the 4.8% gain in sales during November is a sign the pace of activity is starting to pick up. That said, the recent upturn largely looks owed to the easing in mortgage rates in the second half of last year. Consequently, we suspect existing home sales improved modestly during December. Although still working from low levels, pending home sales and mortgage applications rose a bit in November, indicating a slightly stronger pace of home-buying at the end of 2024.

Recently, however, mortgage rates have ticked back up and are now hovering near 7%. As we write in the Interest Rate Watch, a more cautious approach to monetary easing will likely keep mortgage rates elevated relative to recent norms. Elevated financing costs will also limit new supply and exert upward pressure on prices, keeping buyer affordability unfavorable. As such, activity in the housing sector looks set to remain tepid in the years ahead.

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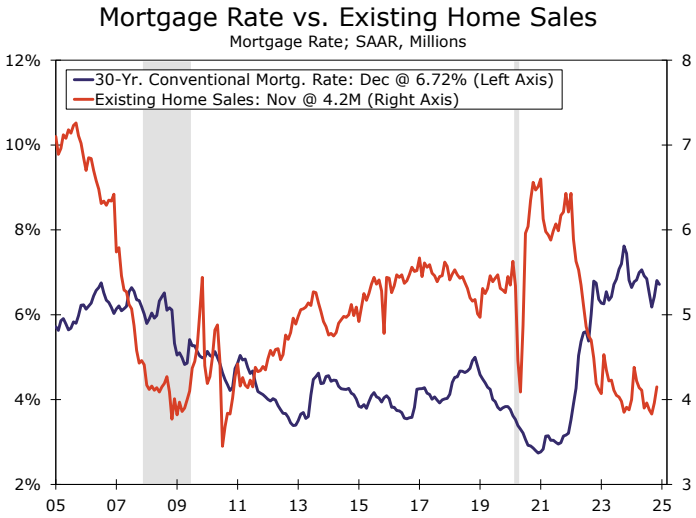


Source: NAR, Freddie Mac and Wells Fargo Economics

International Review

China's Economy Finished 2024 on a Sturdy Note, but Challenges Remain

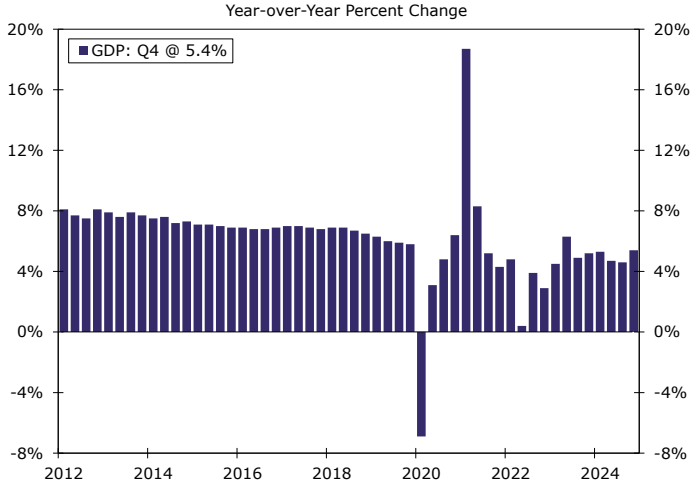
China's released a wide range of data this week, revealing the economy finished 2024 on a sturdy note. Helped by lower interest rates and other liquidity actions, along with modest fiscal stimulus and property support measures, China's fourth quarter growth surprised to the upside. Q4 GDP rose 1.6% quarter-over-quarter, which was broadly as expected, though upward revisions to prior quarters still made that a solid result. More notable, annual GDP growth firmed more than expected to 5.4%, allowing the government to reach its full-year 2024 economic growth target of 5%.

The details of the GDP print show strength in both the services and manufacturing sectors, a trend that was also borne out by monthly activity figures. December retail sales firmed a bit more than expected to 3.7% year-over-year and services production firmed to 6.5%, while industrial output also surprised to the upside, quickening to 6.2%. This week's figures also showed the property sector continues to face a difficult environment, as home prices fell again in December, while full-year 2024 property investment fell 10.6%.

Despite finishing last year on a positive note, 2025 is likely to prove to be another challenging year for China's economy. We expect higher U.S. tariffs on imports from China, weighing on China's export sector, which was a key growth driver during the latter part of last year. In addition, unless or until the government announces large-scale fiscal stimulus aimed at supporting the consumer sector, we doubt retail and services activity will be able to keep growing at its recent pace. Against this backdrop, we still expect China's GDP growth to slow this year from the 5% pace seen in 2024.

Chinese Economic Growth

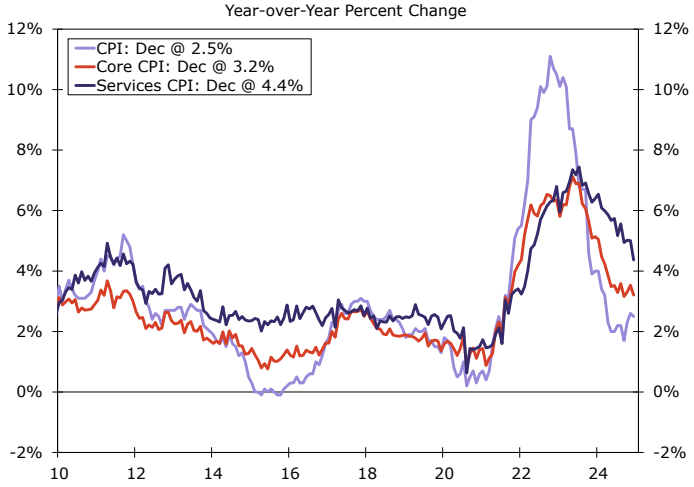
Year-over-Year Percent Change



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

U.K. Consumer Prices

Year-over-Year Percent Change



Source: Datastream and Wells Fargo Economics

This week's data from the United Kingdom saw good news on the inflation front and mildly disappointing news on the growth front. The December CPI surprised to the downside, as headline inflation eased to 2.5% year-over-year and core inflation slowed more than expected to 3.2%. Perhaps the most notable development, however, was the sharp slowdown in services inflation, an area where price pressures have proved especially persistent. The services CPI rose 4.4%, well below the consensus forecast of 4.8% and the November increase of 5.0%. With respect to economic activity, November GDP rose 0.1% month-over-month, a bit less than the consensus forecast for a 0.2% gain but still a return to growth after the modest declines registered in September and October. Services activity rose by 0.1%, but industrial output unexpectedly fell by 0.4%. The favorable inflation news combined with the slight growth disappointment, in our view, solidifies the case for a 25 bps rate cut from the Bank of England at its February monetary policy announcement. Longer term, this week's decline in U.K. bond yields and the prospect of lower central bank policy rates might also provide the government improved flexibility to pursue a growth-supportive fiscal policy as well.

Down under, Australia's economy rounded out 2024 with another solid labor market report. December employment rose by 56,300, much more than the 15,000 gain expected by economists, while the unemployment rate edged only slightly higher to 4.0%, in line with the consensus forecast. The

underlying details of the employment increase were mixed. The job increase was led entirely by part-time employment, which rose by 80,000, while full-time employment fell by 23,700. That said, aggregate hours worked—admittedly a more volatile data series—also rose 0.5% month-over-month. For now, with the labor market sturdy enough and domestic inflation elevated enough, we lean toward the Reserve Bank of Australia (RBA) holding its policy rate at 4.35% at its February meeting. That said, Australia's Q4 CPI remains a key data point ahead of that announcement, and a significant downside surprise in core inflation in particular could still potentially shift the RBA toward lowering interest rates next month.

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International Outlook

Weekly International Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
21-Jan	Canada CPI (YoY)	Dec	1.8%	—	1.9%
24-Jan	Bank of Japan Policy Rate	24-Jan	0.50%	0.50%	0.25%
24-Jan	Eurozone Manufacturing PMI	Jan	45.5	—	45.1
24-Jan	Eurozone Services PMI	Jan	51.5	—	51.6

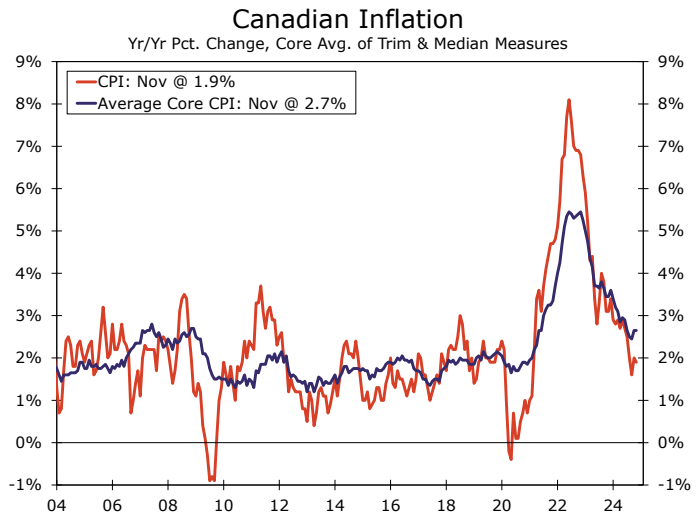
Forecast as of January 17, 2025

Source: Bloomberg Finance L.P and Wells Fargo Economics

Canada CPI • Tuesday

Canada's December inflation report, due for release next week, is a key input for Bank of Canada (BoC) policymakers ahead of their next monetary policy decision in late January. The past year has seen significant progress on the disinflation front such that November headline inflation, at 1.9% year-over-year, was actually slightly below the BoC's 2% inflation target. Underlying inflation pressures have also eased, albeit more gradually, with average core inflation at 2.7%. Still, given rising unemployment and some signs of softening in economic activity, the central bank has lowered its policy rate by 175 bps so far, including 50 bps rate cuts at both the October and December meetings.

We expect the BoC to lower its policy rate a further 25 bps at this month's meeting. That said, a strong December jobs report that saw employment rise by 90,900 and the jobless rate tick lower has at least raised the possibility of a pause. The consensus forecast is, however, for a benign December CPI outcome, with headline inflation expected to show a modest slowing to 1.8%, and core and services inflation also likely to ease slightly. As long as underlying inflation shows a modest decelerating trend in December, we expect the Bank of Canada to cut interest rates later this month.

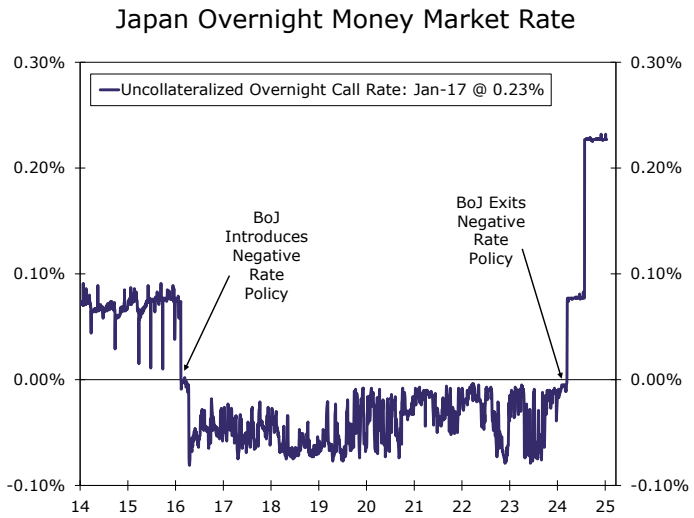


Source: Bloomberg Finance L.P. and Wells Fargo Economics

Bank of Japan Policy Rate • Friday

The Bank of Japan (BoJ) announces its latest monetary policy decision on Friday next week, a meeting at which we (and consensus) expect the central bank to take the next step along its policy normalization path. The BoJ raised interest rates twice last year, in March and July. However, central bank policy has since been on hold for several months. That, in part, has reflected market volatility, including large swings in the yen following the July rate increase, as well as a more unsettled local political environment as the ruling coalition lost its majority in lower house elections late last year. The BoJ's December policy announcement was also less hawkish than expected, with Governor Ueda citing the need for more information on wage increases to support a decision to hike rates further, and not offering a clear signal on the timing of a further rate increase.

We still view the fundamental case for further monetary policy normalization as intact, with economic growth relatively solid and core inflation elevated above 2%. Moreover, in our view, recent developments suggest an increased chance of a January rate increase. November labor cash earnings rose 3.0% year-over-year, pointing to firmer wage trends, while media reports suggest the BoJ could also raise its underlying inflation forecast in January and is actively considering a rate increase. Against this backdrop, we expect the BoJ to deliver a 25 bps rate increase next week, which would take its policy rate to 0.50%.



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

Eurozone PMIs • Friday

The release next week of Eurozone PMI surveys for January will provide early insight into the state of the region's economy in early 2025. Eurozone economic indicators were mixed, if unimpressive overall, toward the end of last year. On the more positive side, Q3 GDP growth rose 0.4% quarter-over-quarter, including a 0.7% gain in consumer spending. Sentiment surveys for more recent months have been mixed. The December manufacturing PMI slipped a touch to 45.1, while the services PMI rebounded to 51.6, recovering all of its November decline. Even so, the composite (or economy-wide) PMI printed at 49.6 in December, a level broadly consistent with a stagnating Eurozone economy.

For January, the consensus forecast is for the manufacturing PMI to rise to 45.5, an outcome that would still be solidly in contraction territory. The services PMI is expected to ease only slightly to 51.5. That said, political uncertainty in Germany and France, the region's two largest economies, and concern surrounding possible U.S. tariffs are factors that could potentially weigh on sentiment, suggesting some downside risk to the consensus forecast. Our outlook sees Eurozone GDP growth of just 0.9% in 2025, although given still subdued overall sentiment, the Eurozone recovery could be even more modest than that growth forecast. Against that backdrop and even with lingering inflation pressures, we expect 25 bps rate cuts from the European Central Bank at every meeting through June, and a final policy rate cut in September.

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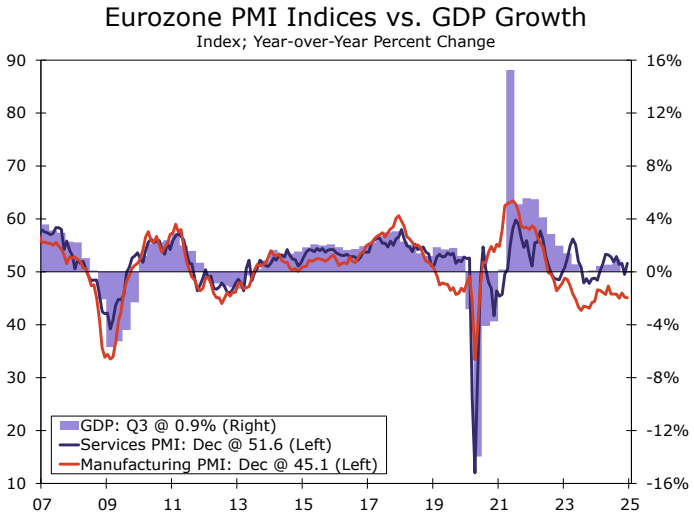


Source: Datastream, Bloomberg Finance L.P. and Wells Fargo Economics

Interest Rate Watch

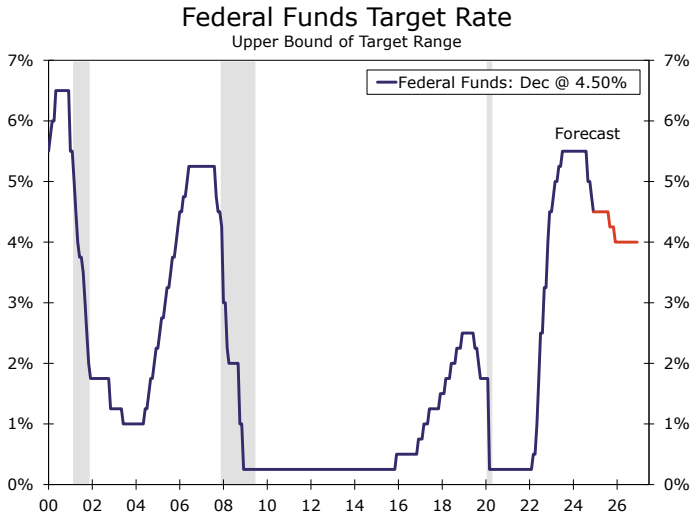
FOMC Likely to Enter an Extended Pause in Its Recent Easing Cycle

The Federal Open Market Committee (FOMC) reduced its target range for the federal funds rate by 100 bps between September and December (chart). The FOMC next meets on January 29, and we share the universal expectation that the Committee will decide on that day to keep the target range unchanged at 4.25%-4.50%. As we outlined in our recent U.S. Economic Outlook, there are a few reasons why we expect the FOMC to remain on hold at its next meeting. First, the U.S. economy entered the new year with a fair amount of momentum. We estimate that real GDP grew an annualized rate of 2.7% in Q4-2024 relative to the previous quarter, while recently released data show payroll growth averaged 170K jobs per month in the fourth quarter.

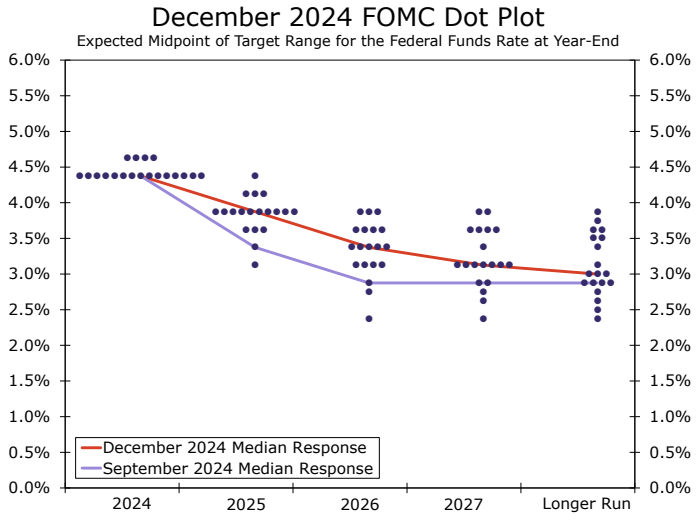
Second, we estimate that the year-over-year change in the core PCE deflator, which most Fed officials believe is the best measure of the underlying pace of consumer price inflation, edged up from 2.6% in June to 2.8% in December. The solid pace of economic activity and modest uptick in the rate of inflation call into question for us and other market participants the need for additional monetary accommodation, at least at this time.

Third, Federal Reserve policymakers themselves seem to have significantly re-assessed the degree of additional policy easing that is appropriate this year. The so-called "dot plot" that was released at the conclusion of the September FOMC meeting showed that the median Committee member thought that a target range for the federal funds rate of 3.25%-3.50% would be appropriate at the end of 2025. The most recent dot plot, which was released after the December FOMC meeting, showed that the median dot had shifted up by 50 bps (chart).

Looking further ahead, we believe that, barring some unforeseen economic calamity, the FOMC will keep rates on hold through the first half of the year. Inflation continues to recede toward the Fed's goal of 2%, but at a painfully slow pace. We have penciled in a 25 bps rate cut at the September FOMC meeting and a similar-sized reduction in December (chart). We, then, look for the FOMC to keep its target range for the federal funds rate unchanged at 3.75%-4.00% throughout 2026.



Source: Federal Reserve Board and Wells Fargo Economics



Source: Federal Reserve Board and Wells Fargo Economics

That said, the outlook for U.S. monetary policy is clouded at present by the yet-to-be-determined policy choices, especially those related to tariffs, of the incoming Trump administration. Meaningful tariff increases on America's trading partners, should they be imposed, could lead to a modest rise in inflation this year. Higher inflation would erode growth in real income and weigh on growth in real consumer expenditures. The growth-slowing effects of tariffs could be exacerbated if foreign countries levy retaliatory tariffs on U.S. exports. The FOMC's response to any tariff-related effects on the U.S. economy will depend on how Committee members judge the risks to the achievement of their dual mandate (i.e., price stability and full employment). In short, the uncertainty at present that

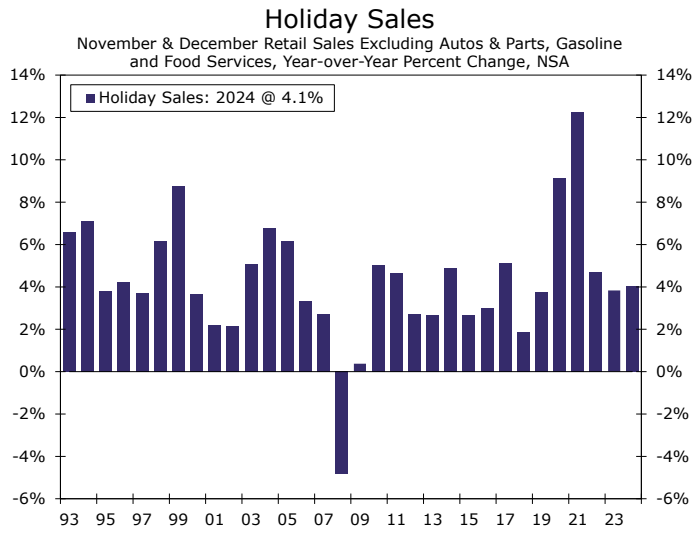
is related to the economic policy choices of the incoming administration imparts uncertainty onto the outlook for Fed policy. (Return to Summary)

Topic of the Week

Beige Book Shows Moderate Expansion Across All Districts

The latest Beige Book, which covers November through December, revealed a picture of continued economic growth, with all 12 of the regional banks reporting a "slight" to "moderate" expansion in activity over the period. Employment across the Districts was resilient, with six Districts reporting an uptick in hiring and six reporting no change. On an industry level, the healthcare and construction sectors continued to see job growth, while employment in the manufacturing sector remained unchanged. In addition, several employer contacts noted trouble finding and hiring skilled workers. Prices across the Districts also broadly increased, with both selling prices and input prices rising. Contacts noted worry that tariffs might contribute to higher prices throughout the new year. Overall, there was more optimism than pessimism in the outlook for 2025, but uncertainty about the immigration and tariff policy outlook left many with worries about downside risk to economic growth over the course of the year.

One area for optimism from the report was the better-than-expected holiday sales experienced in the retail sectors of many Districts. The Districts of New York, Cleveland, St. Louis and Minneapolis all specifically noted holiday sales activity surpassing expectations, a trend in line with national holiday sales figures that came in stronger than expected in this week's retail sales report (chart). The New York Fed noted that consumers in the Second District "continued to seek value and responded strongly to discounts during the holiday season" while also noting that higher-end items sold well over the period. Another contact for the Cleveland Fed remarked that consumers in the Fourth District were willing to spend more during this holiday sales season than in years prior.



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

Contacts across many Districts noted uncertainty about the outlook with the prospect of tariffs on the horizon. Specifically, manufacturers across the Districts reported stockpiling inventories in anticipation of tariffs. However, some manufacturers noted some difficulty in stockpiling due to limited shipping capacity arising from disruptions in the Red Sea. The Philadelphia Fed noted that inflation expectations were rising in the Third District, due in part to contacts beginning to factor tariffs into their outlook.

The effects of Hurricane Helene were still being felt, with much of the impact concentrated in the Fifth District, particularly Western North Carolina. The Richmond Fed noted that activity in this region was much softer than usual due to the aftermath of the hurricane. The real estate markets in these areas were just starting to pick back up, with the Asheville area starting to show signs of activity. Vacancies in the industrial, retail and office sectors dropped as displaced businesses worked to reopen and government agencies mobilized into the area. On balance across the Districts, economic growth continues to be strong and consumers continue to spend. Though there is downside risk in the near term, we look for better balance moving forward.

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Market Data • Mid-Day Friday

U.S. Interest Rates

	Friday 1/17/2025	1 Week Ago	1 Year Ago
SOFR	4.29	4.30	5.32
Effective Fed Funds Rate	4.33	4.33	5.33
3-Month T-Bill	4.30	4.32	5.37
1-Year Treasury	4.23	4.22	4.39
2-Year Treasury	4.27	4.38	4.36
5-Year Treasury	4.41	4.57	4.03
10-Year Treasury	4.61	4.76	4.10
30-Year Treasury	4.84	4.95	4.31
Bond Buyer Index	4.28	4.16	3.39

Foreign Exchange Rates

	Friday 1/17/2025	1 Week Ago	1 Year Ago
Euro ($/€)	1.029	1.024	1.088
British Pound ($/£)	1.219	1.221	1.268
British Pound (£/€)	0.844	0.839	0.858
Japanese Yen (¥/$)	156.190	157.730	148.160
Canadian Dollar (C$/$)	1.441	1.442	1.351
Swiss Franc (CHF/$)	0.914	0.916	0.864
Australian Dollar (US$/A$)	0.622	0.615	0.655
Mexican Peso (MXN/$)	20.707	20.716	17.197
Chinese Yuan (CNY/$)	7.325	7.333	7.196
Indian Rupee (INR/$)	86.613	85.974	83.136
Brazilian Real (BRL/$)	6.037	6.108	4.931
U.S. Dollar Index	109.206	109.650	103.450

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

Foreign Interest Rates

	Friday 1/17/2025	1 Week Ago	1 Year Ago
3-Month German Govt Bill Yield	2.56	2.60	3.79
3-Month U.K. Govt Bill Yield	4.61	4.68	5.22
3-Month Canadian Govt Bill Yield	3.05	3.12	5.03
3-Month Japanese Govt Bill Yield	0.36	0.24	-0.23
2-Year German Note Yield	2.23	2.28	2.70
2-Year U.K. Note Yield	4.36	4.54	4.38
2-Year Canadian Note Yield	2.95	3.07	4.05
2-Year Japanese Note Yield	0.69	0.65	0.03
10-Year German Bond Yield	2.53	2.60	2.32
10-Year U.K. Bond Yield	4.65	4.84	3.99
10-Year Canadian Bond Yield	3.32	3.44	3.45
10-Year Japanese Bond Yield	1.20	1.20	0.62

Commodity Prices

	Friday 1/17/2025	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	77.93	76.57	72.56
Brent Crude ($/Barrel)	80.67	79.76	77.88
Gold ($/Ounce)	2716.55	2689.76	2006.25
Hot-Rolled Steel ($/S.Ton)	696.00	702.00	1073.00
Copper (¢/Pound)	436.50	430.40	373.30
Soybeans ($/Bushel)	10.19	10.24	12.30
Natural Gas ($/MMBTU)	3.99	3.99	2.87
Nickel ($/Metric Ton)	15,755	15,272	15,901
CRB Spot Inds.	548.96	545.67	538.68

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