WELLS FARGO

Weekly — April 14, 2023

Weekly Economic & Financial Commentary

United States: **Spring Break Is Over**

- On balance, this week's data show the U.S. economy is losing momentum, as the lagged effects of the FOMC's rapid pace of monetary policy tightening appear to be slowing growth as intended. In March, retail sales fell 1.0%, manufacturing production slipped 0.5% and the consumer price index rose a modest 0.1%.
- Next week: Housing Starts (Tue), Existing Home Sales (Thu), Leading Economic Index (Thu)

International: **Bank of Canada's Waiting Game Continues**

- The Bank of Canada (BoC) again held its policy rate steady at 4.50% at its monetary policy meeting this week. The central bank said growth in early 2023 will be stronger than previously forecast and that it remains prepared to tighten further if needed. At the same time, it expects past rate hikes will see growth slow as the year progresses and also expects inflation to slow quickly to around 3% by the middle of this year. Overall, we think the BoC remains comfortably on hold for now, with the main risk being that resilient economic trends see monetary easing beginning later than we currently expect.
- Next week: China GDP (Tue), U.K. CPI (Wed), Eurozone PMIs (Fri)

Interest Rate Watch: **FOMC on Path for 25 bps Rate Hike on May 3**

- With volatility in financial markets subsiding recently and with inflationary pressures remaining elevated, we look for the FOMC to hike rates by another 25 bps at its May 3 meeting. But we also think May 3 will mark the end of the tightening cycle that has been in place since last March.

Topic of the Week: **Nothing Is Certain in Life Except Death and Taxes**

- As millions of Americans have poured over their W-2s and 1099s in recent weeks, the culmination of the filing season will have important implications for the fiscal outlook, including the debt ceiling.

We have started a new podcast, "Ask Our Economists," where our economists answer questions that readers send in. If you would like to submit a question, please email us at askoureconomists@wellsfargo.com.

Wells Fargo U.S. Economic Forecast

	Actual 2022				Forecast 2023				Actual		Forecast	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2021	2022	2023	2024
Real Gross Domestic Product [1]	-1.6	-0.6	3.2	2.6	1.8	1.3	-0.9	-2.7	5.9	2.1	1.2	0.2
Personal Consumption	1.3	2.0	2.3	1.0	4.4	0.3	-0.2	-3.3	8.3	2.7	1.5	-0.1
Consumer Price Index [2]	8.0	8.6	8.3	7.1	5.8	4.1	3.2	2.7	4.7	8.0	3.9	2.5
"Core" Consumer Price Index [2]	6.3	6.0	6.3	6.0	5.6	5.2	4.5	4.0	3.6	6.1	4.8	2.9
Quarter-End Interest Rates [3]												
Federal Funds Target Rate[4]	0.50	1.75	3.25	4.50	5.00	5.25	5.25	4.75	0.25	2.02	5.06	2.88
Conventional Mortgage Rate	4.27	5.58	6.01	6.36	6.54	6.25	5.75	5.40	3.03	5.38	5.99	5.03
10 Year Note	2.32	2.98	3.83	3.88	3.48	3.50	3.15	2.90	1.45	2.95	3.26	2.83

Forecast as of: April 13, 2023 [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 Rate

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

Please see our full U.S. Economic Forecast.

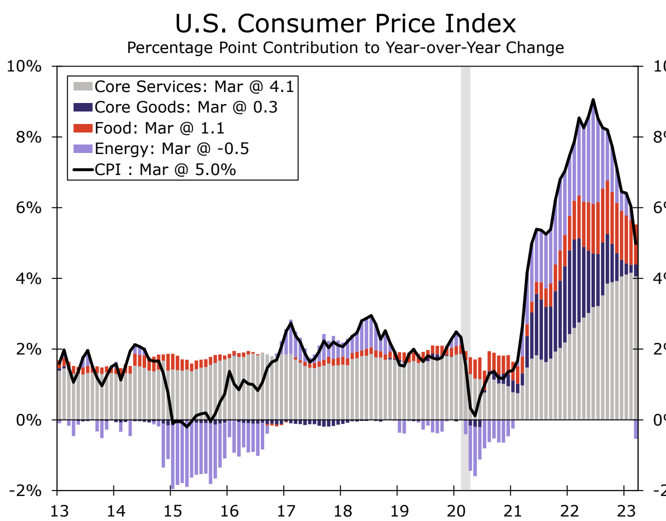
U.S. Review

Spring Break Is Over

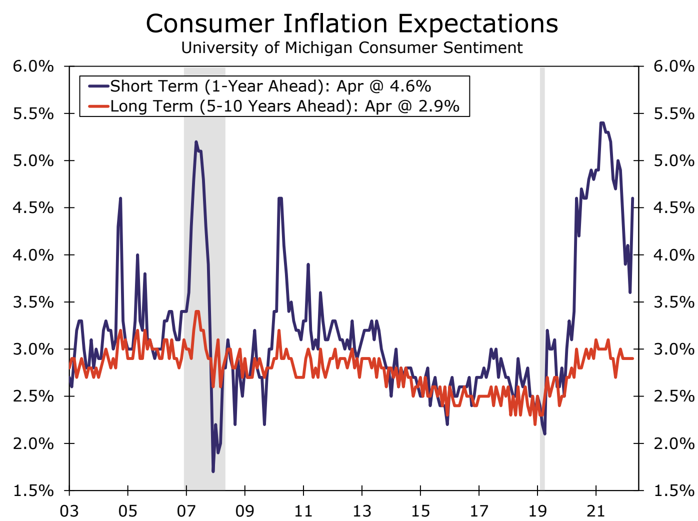
Economic data released this week add to mounting evidence that the U.S. economy is at an inflection point. Last week's employment report showed payroll growth, while still strong relative to its pre-pandemic run rate, cooling to the smallest gain in over two years. This week, attention turned to inflation. The consumer price index increased a modest 0.1% in March. Grocery prices slipped for the first time since late 2020 and energy posted its second-straight monthly decline. These components tend to be volatile on a month-to-month basis, however, and energy has scope to retrace its losses. Gas prices are currently up about 15 cents per gallon since the end of March.

Excluding food and energy, the core CPI rose 0.4% in March. Prices for core goods broke from their disinflation trend, rising 0.2% month-over-month, while core services rose a stronger 0.4%. Revenge travel is still humming, evidenced by notable increases in lodging away from home (2.7%) and airfares (4.0%). The underlying strength in core services, which accounts for roughly 60% of the overall CPI, suggests the path back down to 2% inflation will be bumpy. As discussed in more detail in the Interest Rate Watch, we look for one final 25 bps rate hike at the FOMC's May meeting.

The factory sector has acutely felt the effects of tighter monetary policy. Industrial production rose 0.4% in March, but the entire increase was driven by an 8.4% surge in utilities. Manufacturing and mining production each fell 0.5% over the month. The decline in manufacturing activity mirrors the ISM manufacturing index, which has been in contraction territory for five straight months and slid to its lowest level since 2020 in March.



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



Source: University of Michigan Wells Fargo Economics

Weakness in manufacturing appeared to stem mostly from the durable goods sector, which saw notable monthly declines in motor vehicles (-2.3%), electrical equipment (-1.7%) and furniture (-1.3%) production. Consumer demand for durable goods has materially softened, especially for these big-ticket items that often require financing. Retail sales declined for the second-straight month, falling 1.0% in March. Control group sales, which feeds into the Bureau of Economic Analysis' calculation of total personal consumption expenditures, fell a more modest 0.3%.

Consumer sentiment is hanging in there. The University of Michigan's headline index ticked to 63.5, up from 62.0 in March, as both the current and future conditions components inched up. Short-term inflation expectations (one-year ahead) unexpectedly jumped a full percentage point to 4.6%, but long-term expectations (5-10 years ahead) held steady at 2.9%, remaining within the range that many policymakers would consider well-anchored.

On balance, this week's data show the U.S. economy is losing momentum. The lagged effects of the FOMC's rapid pace of monetary policy tightening appear to be slowing growth as intended. As outlined in our latest *U.S. Economic Outlook*, we continue to look for the U.S. economy to fall into recession in the second half of this year. (Return to Summary)

U.S. Outlook

Weekly Domestic Indicator Forecasts					
Date	**Indicator**	**Period**	**Consensus**	**Wells Fargo**	**Prior**
18-Apr	Housing Starts (SAAR)	Mar	1400K	1417K	1450K
20-Apr	Existing Home Sales (SAAR)	Mar	4.50M	4.48M	4.58M
20-Apr	Leading Index (MoM)	Mar	-0.4%	-1.0%	-0.3%

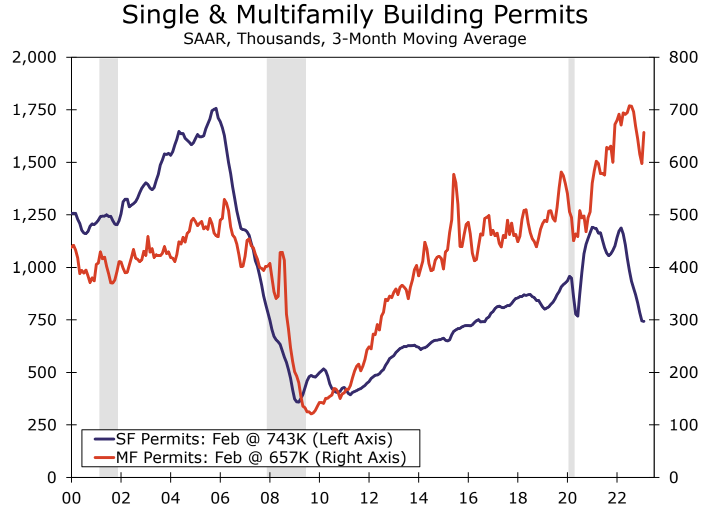
Forecast as of April 14, 2023

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

Housing Starts • Tuesday

New residential construction ended a five-month streak of declines and jumped 9.8% to a 1.45 million-unit pace during February. The improvement was broad-based, although mostly driven by a surge in multifamily construction. Building permits also rose in February, with notable increases in both single-family and multifamily permits.

The strength experienced in February is unlikely to persist. Multifamily construction tends to be highly volatile on a monthly basis, and rising apartment vacancies and the elevated count of rental units already under construction lead us to believe that some payback is in the offing. The recent stabilization in single-family permits is a potential green shoot that returning buyers are translating to an increase in single-family construction. That said, new home inventories remain highly elevated, which means a sustained recovery is likely still off in the distance. Overall, we expect total housing starts slowed to a 1.417 million-unit pace in March.

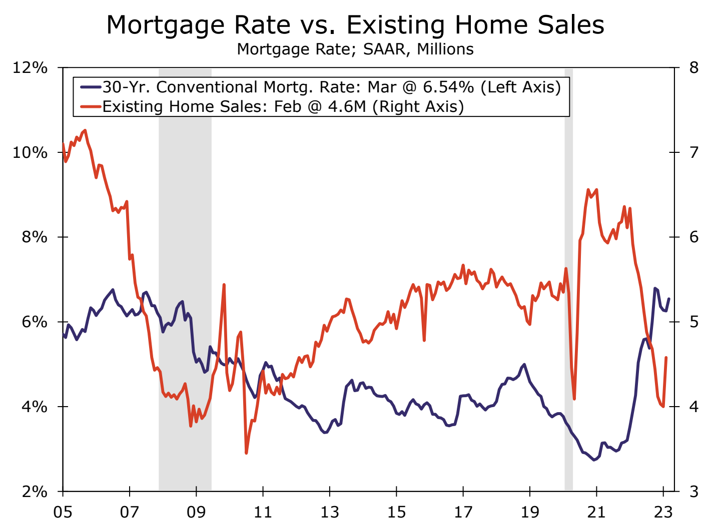


Source: U.S. Department of Commerce and Wells Fargo Economics

Existing Home Sales • Thursday

Existing home sales surged 14.5% in February to a 4.58 million-unit pace, the largest month-over-month increase since December 2015, excluding the pandemic era. The surprising gain arrived as inventories of homes for sale remained remarkably low. While home price appreciation has eased considerably from the torrid pace experienced in 2021, the ongoing supply and demand mismatch has prevented a full-on collapse. During February, the median existing home prices rose on a not-seasonally adjusted monthly basis for the first time since mid-2022.

We anticipate existing home sales slipped to a 4.48 million-unit pace in March. One factor that drove February's surprising jump in resales was lower mortgage rates. More recently, however, mortgage rates have trended higher. The 30-year mortgage rate averaged 6.1% at the start of February and shot up to 6.7% in the second week of March. Mortgage rates have trended slightly lower since, but the sharp uptick in financing costs likely weighed on the pace of home sales for the month of March.



Source: National Association of Realtors, Freddie Mac and Wells Fargo Economics

Leading Economic Index • Thursday

The Leading Economic Index (LEI) declined 0.3% in February, the 11th-consecutive monthly drop. The trend down in the LEI over the past year is a clear warning sign that economic growth is nearing an inflection point. Consumer expectations, building permits and ISM new orders have been the largest drags on the top-line index since the LEI began to turn down, although many of the underlying components have also weighed on the index throughout the year.

The LEI looks to have declined again during March, and we forecast a 1% drop in the headline index. Tighter financial conditions as a result of banking sector volatility experienced throughout the month likely weighed on the overall LEI. Furthermore, consumer expectations dipped during March, according to the University of Michigan. New orders in both the ISM manufacturing and services indices also weakened during the month and building permits likely gave back some of the strength registered during February.

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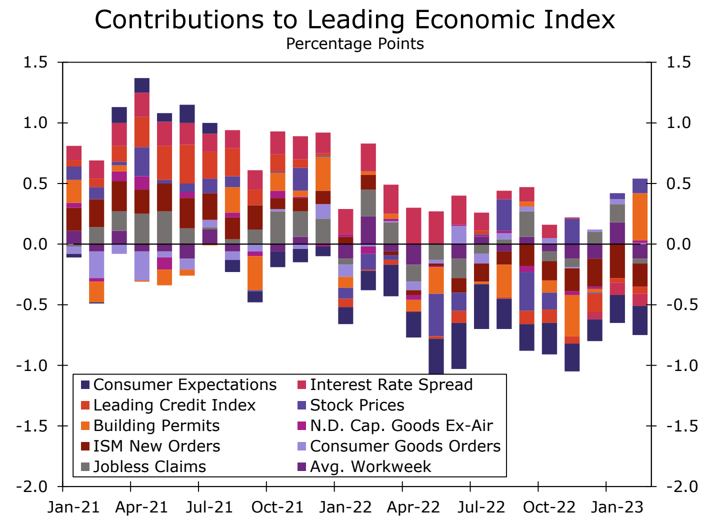


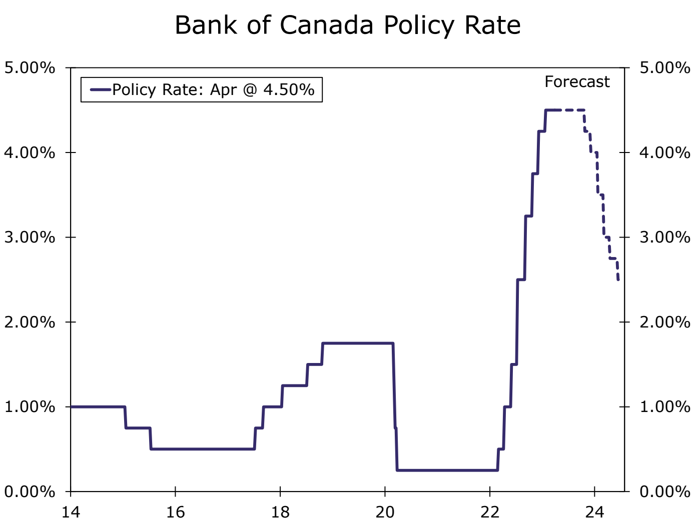
Source: The Conference Board and Wells Fargo Economics

International Review

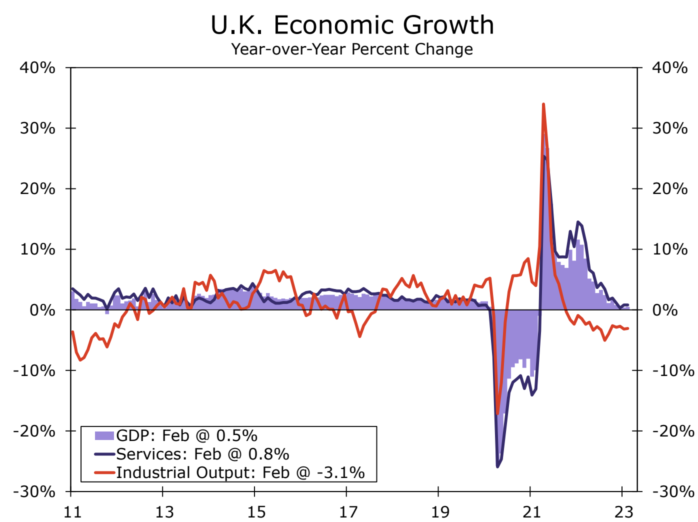
Bank of Canada's Waiting Game Continues

The Bank of Canada (BoC) held its monetary policy meeting this week and for the second meeting in a row, held its policy rate steady at 4.50%. Regarding the economic outlook, the BoC said it expects Q1 GDP growth to be stronger than previously forecast, reflecting solid consumption growth and a bounce in exports. Still, the economy is expected to soften through the remainder of 2023, as higher interest rates restrain the consumer sector, while softening foreign demand restrains exports and business investment. Against this backdrop, the central bank forecasts moderate GDP growth of 1.4% this year and 1.3% in 2024, and sees the economy moving into excess supply in the second half of this year. Regarding inflation, the BoC expects CPI inflation to slow quickly to 3% around the middle of this year, but then decline more gradually to 2% by the end of 2024.

While the economic outlook suggests the Bank of Canada appears relatively comfortable holding rates steady, there were a couple of mildly hawkish elements in the statement. The BOC said it "continues to assess whether monetary policy is sufficiently restrictive to relieve price pressures and remains prepared to raise the policy rate further if needed." The central bank also pointed to persistent wage and services inflation as risks to the outlook. We doubt Canadian growth will prove so strong or inflation so persistent for the Bank of Canada to raise rates further. Rather, we think the main risk would be more gradual easing from the Bank of Canada if growth or inflation does not slow as quickly as we currently anticipate. Our base case is for BoC easing to begin in Q4-2023 with policy rate cuts totaling 50 bps, though the risk is that those rate cuts get pushed back to 2024. Indeed, BoC Governor Macklem said at the post meeting press conference that rate cuts this year don't look like the most likely scenario.



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



Source: Datastream and Wells Fargo Economics

Another central bank we believe is probably on hold is the Reserve Bank of Australia (RBA), which held its policy rate at 3.60% in April. A strong March employment report this week has arguably revived discussion of a possible May rate hike. March employment gained by 53,000, almost as large as the 64,600 seen in February. The details were also firm, as full time employment rose by 72,000, while part-time employment fell by 19,200. Finally, the unemployment rate remained steady in March at 3.5%. Still, the Q1 CPI remains an important release ahead of the RBA's May monetary policy meeting, and monthly releases point to slower inflation during the first quarter. For now, therefore, we expect the RBA to hold rates steady again in May, but further strong job reports could potentially increase the chances of RBA resuming its monetary tightening later in the year.

One central bank we do expect to raise interest rates further at their next monetary policy meeting is the Bank of England, even with a mildly subdued February GDP reading. U.K. GDP growth was flat for the month, slightly less than the 0.1% month-over-month gain forecast by the consensus, although an upward revision to January GDP provided an offset. Services activity dipped 0.1%, again after an upwardly revised January gain. Services was weighed down by strike activity by teachers and civil servants, with education output, for example, down 1.7%. In contrast, consumer facing services rose

0.4%. Finally, February industrial output fell 0.2%, on top of a January decline. So far, the average level of GDP for the January-February period is 0.1% above its Q4 average, keeping the economy on course for another quarter of growth in Q1. Against that backdrop, unless the March CPI surprises sharply to the downside, we would expect the Bank of England to hike rates further in May.

Finally, the latest CPI figures from Brazil this week saw inflation slow further and by more than expected, as the March CPI rose 4.65% year-over-year. Food and beverages, household goods and clothing have been among that areas that have driven the ongoing slowing of inflation over the past several months. In contrast to the downside CPI surprise, January retail sales rose 3.8% month-over-month, more than expected and more than reversing the December decline. Overall, we think slower inflation will allow Brazil's Central Bank to begin lowering interest rates in Q3 this year, although we think rate cuts will be more gradual than implied by current market pricing.

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International Outlook

Weekly International Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
18-Apr	China GDP (QoQ)	Q1	2.1%	--	0.0%
18-Apr	China GDP (YoY)	Q1	3.9%	--	2.9%
19-Apr	U.K. CPI (YoY)	Mar	9.8%	9.8%	10.4%
21-Apr	Eurozone Manufacturing PMI	Apr	48.0	--	47.3
21-Apr	Eurozone Services PMI	Apr	54.5	--	55.0

Forecast as of April 14, 2023

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

China GDP • Tuesday

China's Q1 GDP report, due for release next week, should provide confirmation of a rebound in growth following the reopening of China's economy from late last year as Zero-COVID restrictions were lifted. More timely monthly economic figures have already pointed to an improvement in activity, most notably the gains reported in the PMI surveys. The official services PMI rose to 58.2, which was the highest reading since mid-2011. Meanwhile, although the manufacturing PMI eased to 51.9, it remained comfortably in expansion territory.

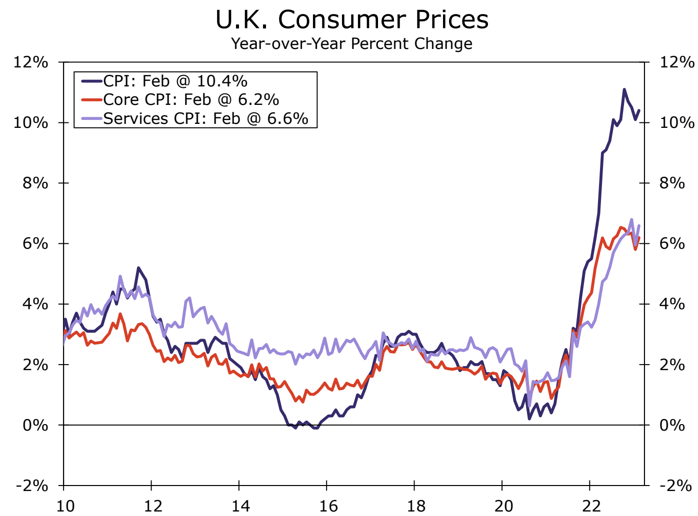
Reflecting this improvement, the consensus forecast is for China's Q1 GDP to rise 2.1% quarter-over-quarter, which would be a sharp improvement from the flat outcome seen in Q4. That would also see GDP growth firm to 3.9% year-over-year, from 2.9% in Q4. Monthly activity data also slated for next week should also show the first quarter ended with a fair degree of momentum. The consensus forecast is for March retail sales to rise to 8.0% year-over-year, while the consensus forecast is for industrial output to firm to 4.7%.

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

U.K. CPI • Wednesday

The U.K. March CPI is scheduled for release next week, which could be a key data point heading into the Bank of England's May monetary policy decision. U.K. consumer price inflation has receded from the peak of 11.1% year-over-year last October, led by slowing energy inflation as oil and natural gas prices have fallen, and the government's energy support measures have limited the prices faced by U.K consumers and business. That downtrend was interrupted in February, however, as headline inflation ticked up to 10.4% and core CPI inflation ticked up to 6.2%. However, some of that upside surprise was accounted for by higher clothing and footwear prices, which tend to be volatile, and slower underlying inflation and wage trends are expected to prevail over time.

Most interest in the March CPI, therefore, will be in whether the downtrend of inflation re-asserts itself. The consensus forecast is for some slowing of inflation, with the headline CPI seen rising 9.8% and core CPI inflation also expected to slow to 6.0%. Despite the forecast slowing, with inflation readings still elevated we believe such an outcome would be sufficient for the Bank of England to raise its policy rate 25 bps to 4.50% at its May monetary policy announcement, and think it would take a significant downside CPI surprise for the Bank of England to pause. While the CPI should be the most consequential U.K. data next week, there will also be other releases to watch out for. The U.K. April manufacturing PMI is forecast to rise to 48.5 and the services PMI should remain steady at 52.9, while March retail sales are forecast to drop by 0.5% month-over-month.

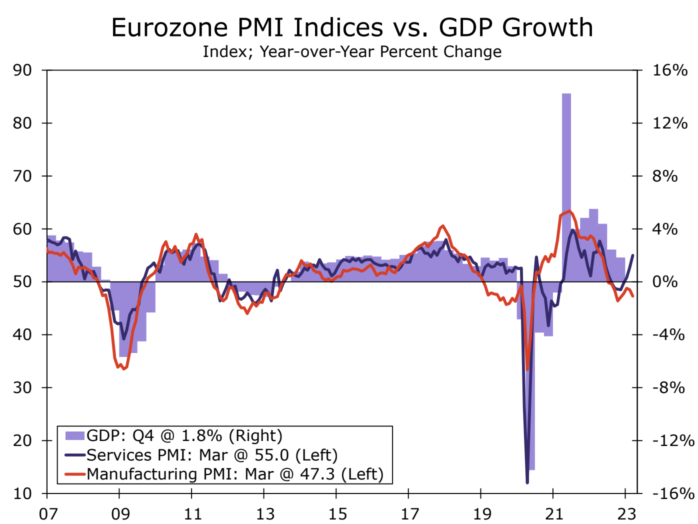


Source: Datastream and Wells Fargo Economics

Eurozone PMIs • Friday

A notable theme in early 2023 has been an evolving—and improving—outlook for the Eurozone, as lower energy prices have contributed to slower headline inflation. That has led to an improving outlook for Eurozone consumer in particular, and corporate sector to a lesser extent. So far, the Eurozone has avoided economic contraction, as Q4 GDP came in flat for the quarter on a sequential basis. In the early months of 2023, the services PMI in particular has jumped higher, reaching 55.0 in March, the highest reading since May last year. In contrast, the manufacturing PMI slipped to 47.3 in March to be only slightly above the lows seen in late 2022. Nonetheless, with composite (or economy-wide) PMI above the breakeven 50 level for each month in the first quarter of this year, it's possible for the Eurozone to avoid GDP contraction in Q1-2023.

Regardless of how Q1 Eurozone activity ultimately plays out, there is keen interest in whether the apparent resilience around the turn of the year will persist later into 2023, especially given the ongoing tightening of monetary policy from the European Central Bank. In that context, the April PMI indices will provide an early read on the economy for the second quarter, and perhaps hint at some easing in growth. The consensus forecast is for the services PMI to ease to 54.5, while the manufacturing PMI is expected to rise to 48.0. Taken together, those readings would be broadly similar to March and still at levels historically consistent with modestly positive economic growth.



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

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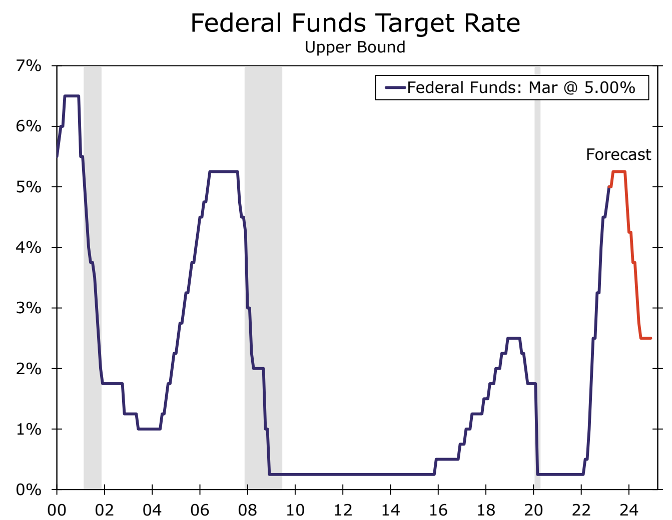
Interest Rate Watch

FOMC on Path For 25 bps Rate Hike on May 3

The minutes of the March 22 FOMC meeting, which were released this week, shed some light on the current thinking at the nation's central bank. Financial market volatility was elevated in the wake of Silicon Valley Bank's failure when the FOMC met on March 22. Accordingly, "several" FOMC members thought "it would be appropriate to hold the target range steady at this meeting" to give them "more time to assess the financial and economic effects of recent banking-sector developments." But these members also noted that the steps that authorities had taken had helped to "calm conditions in the banking sector and lessen the near-term risks to economic activity and inflation." On the other hand, "some participants noted that given persistently high inflation and the strength of the recent economic data, they would have considered a 50 basis point increase in the target range to have been appropriate at this meeting in the absence of the recent developments in the banking sector." But "due to the potential for banking-sector developments to tighten financial conditions and to weigh on economic activity and inflation, they judged it prudent to increase the target range by a smaller increment at this meeting." In the event, the decision to raise rates by 25 bps was unanimously supported by all 11 voting members of the FOMC.

Economic data that have been released since March 22 generally support the case for further tightening. The employment report for March, which was published on Good Friday, showed that nonfarm payrolls rose by 236K during the month, while the unemployment rate ticked down to 3.5% from 3.6% in February. In short, the labor market generally remains tight, which could lead to further upward pressure on wages that could slow the return of inflation to a rate that is acceptable to Fed policymakers. As discussed in more detail in the U.S. Review section, the core rate of CPI inflation edged up to 5.6% (year-over-year) from 5.5% in February, well above the FOMC's target of 2%.

In our view, the combination of falling volatility in financial markets and elevated inflationary pressures will induce the FOMC to raise rates by another 25 bps on May 3. If realized, the FOMC will have raised its target range for the fed funds rate by 500 bps in 14 months, the fastest pace of monetary tightening since the early 1980s. But we think the May 3 rate hike, if it indeed occurs, will be the last increase in the target range during this tightening cycle.



Source: Federal Reserve Board and Wells Fargo Economics

We look for the committee to pause at the June 14 meeting. If, as we expect, incoming data are pointing in the direction of further economic deceleration, then we think most FOMC members will determine a pause in the tightening cycle is warranted to assess how the economy is evolving. Although we expect the economy to begin contracting in the third quarter of this year—see our most recent *U.S. Economic Outlook* for more details—we believe the committee will initially refrain from easing policy to ensure that inflation is headed back to 2%. But as the economy continues to deteriorate and as policymakers become reasonably confident that inflation is on a path back to 2%, we look for the FOMC to begin cutting rates. Specifically, we forecast that the FOMC will reduce its target range for the federal funds rate by 275 bps between Q4-2023 and Q3-2024. In our view, the combination of receding inflation, which will help to support growth in real income, and monetary policy easing will lead to an economic recovery starting in mid-2024.

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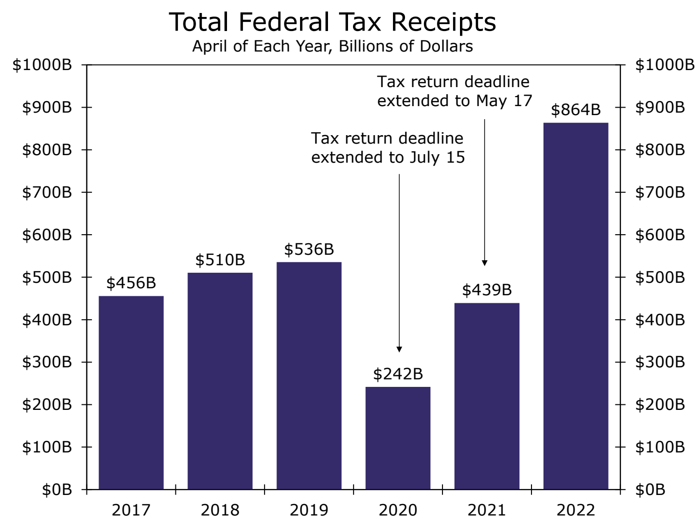
Topic of the Week

Nothing Is Certain in Life Except Death and Taxes

Next Tuesday, April 18, is the annual deadline for filing individual income taxes in the United States. As millions of Americans have poured over their W-2s and 1099s in recent weeks, the culmination of the filing season will have important implications for the fiscal outlook, including the debt ceiling.

In a typical year, 15%-20% of the government's annual tax revenue is collected in April, which makes it a crucial month for the fiscal outlook. Last year saw a big spike in April tax receipts to $864B, nearly double April 2021's total and well-above a typical year pre-pandemic. This increase in revenue was in part attributable to the strong economic recovery, as well as high capital gains tax revenues as a result of 2021's robust asset price appreciation. This fiscal year, federal revenues have been about flat compared to last year. In the fiscal year to date (October 2022–March 2023), revenues are currently 3% lower than what they were in the fiscal year to date in March 2022.



Source: U.S. Department of the Treasury and Wells Fargo Economics

The trend in federal revenue growth has important implications for the debt ceiling. Since the federal government is running a budget deficit ($1.1 trillion thus far this fiscal year), the U.S. Treasury needs to issue debt to finance the gap between revenues and outlays. The federal government hit the debt ceiling in January, and since then, the Treasury has been employing "extraordinary measures" to remain solvent. However, sooner or later these accounting maneuvers will be exhausted. The exact date on which the Treasury will be unable to meet all of its obligations on time and in full is uncertain. Our base case is that the "X date" falls in early August, but the tax revenues collected on the other side of the upcoming filing deadline will be a key determinant of this forecast.

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Market Data • Mid-Day Friday

U.S. Interest Rates	Friday 4/14/2023	1 Week Ago	1 Year Ago
SOFR	4.80	4.81	0.29
3-Month LIBOR	5.26	5.20	1.04
3-Month T-Bill	5.01	4.75	0.75
1-Year Treasury	4.31	4.20	1.50
2-Year Treasury	4.11	3.98	2.45
5-Year Treasury	3.61	3.50	2.79
10-Year Treasury	3.53	3.39	2.83
30-Year Treasury	3.75	3.61	2.91
Bond Buyer Index	3.32	3.36	2.87

Foreign Exchange Rates	Friday 4/14/2023	1 Week Ago	1 Year Ago
Euro ($/€)	1.098	1.091	1.083
British Pound ($/£)	1.242	1.242	1.307
British Pound (£/€)	0.884	0.878	0.828
Japanese Yen (¥/$)	133.760	132.160	125.880
Canadian Dollar (C$/$)	1.338	1.351	1.260
Swiss Franc (CHF/$)	0.896	0.905	0.942
Australian Dollar (US$/A$)	0.670	0.667	0.742
Mexican Peso (MXN/$)	18.056	18.138	19.970
Chinese Yuan (CNY/$)	6.871	6.868	6.378
Indian Rupee (INR/$)	81.855	81.898	76.180
Brazilian Real (BRL/$)	4.939	5.058	4.701
U.S. Dollar Index	101.692	101.822	100.321

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

Foreign Interest Rates	Friday 4/14/2023	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	-0.58	-0.59	-0.57
3-Month Sterling LIBOR	4.48	4.44	1.11
3-Month Canada Banker's Acceptance	5.05	5.05	1.50
3-Month Yen LIBOR	-0.03	-0.03	-0.08
2-Year German	2.88	2.55	0.05
2-Year U.K.	3.62	3.37	1.56
2-Year Canadian	3.85	3.62	2.42
2-Year Japanese	-0.04	-0.05	-0.06
10-Year German	2.44	2.18	0.84
10-Year U.K.	3.67	3.43	1.89
10-Year Canadian	3.07	2.79	2.76
10-Year Japanese	0.48	0.47	0.23

Commodity Prices	Friday 4/14/2023	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	82.67	80.70	106.95
Brent Crude ($/Barrel)	86.43	85.12	111.70
Gold ($/Ounce)	1995.44	#N/A N/A	1973.71
Hot-Rolled Steel ($/S.Ton)	1175.00	1166.00	1479.00
Copper (¢/Pound)	410.15	401.55	472.35
Soybeans ($/Bushel)	15.09	14.95	16.74
Natural Gas ($/MMBTU)	2.07	2.01	7.30
Nickel ($/Metric Ton)	23,549	22,910	32,947
CRB Spot Inds.	559.38	560.63	685.50

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