Economics

WELLS FARGO

Weekly — April 21, 2023

Weekly Economic & Financial Commentary

United States: A Downturn Is Still in the Cards

- Data released this week support our expectations for a recession in the second half of the year. The LEI continued to flash contraction as early signs of labor market weakening are starting to emerge. Meanwhile, a batch of housing data confirmed that a full-fledged housing market recovery is still far off.
- Next week: Durable Goods (Wed), GDP (Thu), Personal Income & Spending (Fri)

International: Global Growth Prospects Continue to Improve

- Early this week, China reported Q1-2023 GDP data, a widely anticipated data release. Q1 data offered markets an opportunity to gauge how China's economy performed after authorities lifted Zero-COVID policies around the end of last year. The key takeaway was that China's economy performed better than expected, growing 2.2% on a quarterly basis and 4.5% on a year-over-year basis.
- Next week: Central Bank of Turkey (Thu), Eurozone GDP (Fri), Bank of Japan (Fri)

Interest Rate Watch: Give Thought to the Pause

- The fastest pace of policy tightening since the early 1980s is winding down. Our forecast anticipates one more quarter-point rate hike at the upcoming FOMC meeting on May 3, after which we suspect the Fed will remain on hold until the fourth quarter. Had we not encountered a banking crisis, a few more rate increases might have been in the offing. However, the recent difficulties in the financial sector diminish the need for further hikes beyond May, in our view.

Credit Market Insights: Fed's Beige Book Brings Some Color to Recent Financial Turmoil

- On Wednesday, the latest edition of the Federal Reserve's Beige Book was released, covering the month of March and through early April. The previous Beige Book was published in early March but quickly became stale following the failures of Silicon Valley Bank and Signature Bank. The latest read covers the period following recent financial turmoil and the fallout it has caused.

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.

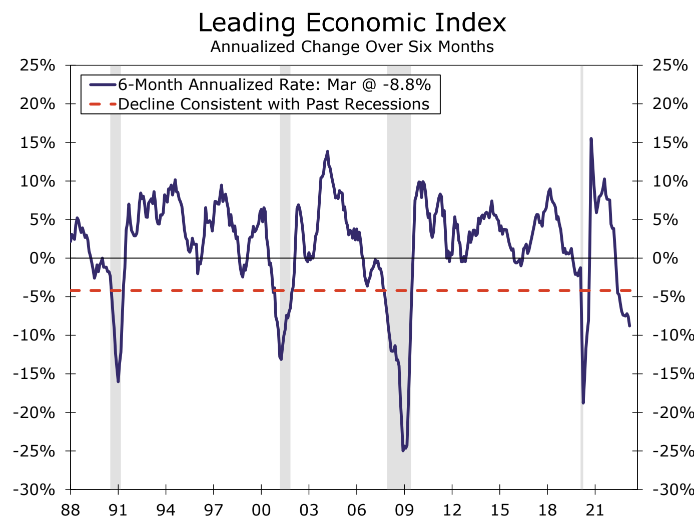
All estimates/forecasts are as of 4/21/2023 unless otherwise stated. 4/21/2023 11:02:16 EDT. **This report is available on Bloomberg WFRE**

U.S. Review

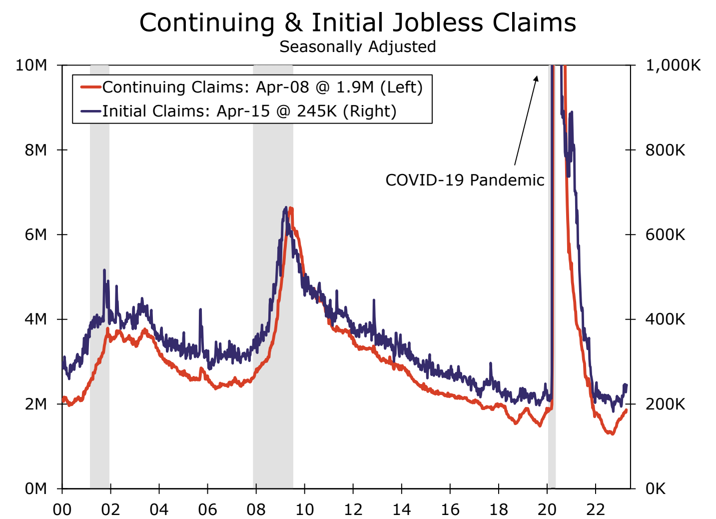
A Downturn Is Still in the Cards

The last couple of weeks revealed a core inflation reading that was too hot for comfort and a jobs report signifying still-tight labor markets. Market participants are now near certain that the FOMC will raise interest rates by another 25 bps at the May meeting. But as discussed further in Credit Market Insights, anecdotal evidence from the Fed's Beige Book indicates that credit conditions have tightened in recent weeks, which may give some FOMC members pause about the risk of over-tightening. We expect that the full effects of the Fed's interest rate hikes and tighter credit conditions will likely be realized later this year, setting the stage for weaker economic growth in the months ahead.

Early signs of labor market softening are one reason to believe that May's rate hike will be the last. Jobless claims ticked up to 245K this week. Although still lower than pre-COVID norms, this upside surprise cements a clear upward trend in layoffs since the start of the year. A 12-month slide in the Leading Economic Index (LEI) also supports our expectation that the economy will slip into recession in the second half of the year. The LEI dropped 1.2% in March, its sharpest monthly decline since the trough of the pandemic recession (April 2020). March's decline was widespread, reflecting a weakening manufacturing sector, souring consumer sentiment and a downshift in building permits.



Source: The Conference Board and Wells Fargo Economics



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

Meanwhile, a batch of housing data released this week confirms that a full-fledged housing market recovery is still far off. Existing home sales dipped 2.4% in March, stepping back the 13.8% jump in February. Buyers may have pounced on lower mortgage rates at the start of the year, but a recent upturn in mortgage rates will likely keep the housing market under pressure. Freddie Mac reported that the average 30-year fixed mortgage rate ended its five-week-long slide this week, bumping up to 6.39%. Higher frequency data from Mortgage News Daily suggest that rates jumped to 6.67% as of Thursday. The upturn in mortgage rates is a factor in keeping resale inventory low, as rising financing costs have discouraged homeowners from putting their houses on the market.

Residential construction has picked up as builders work to fill the gaps left by low existing home supply. Single-family housing starts rose 4.7% in March, the third upturn in four months. Single-family permits have similarly increased for two consecutive months. This improvement in single-family construction coincides with brightening builder optimism, reflected by steady advancements in the NAHB Housing Market Index. April marked the first month since September 2022 that surveyed builders expressed net positive perceptions of current single-family sales. It was also the first time since June 2022 that builders on net did not hold negative expectations of future sales traffic. Multifamily construction continues to advance at a robust clip, providing another potential alternative for affordability-crunched buyers amid low housing supply. Although multifamily starts and permits retracted in March, the 599K-unit pace of multifamily starts last month was stronger than the average annual pace registered in 2022. Furthermore, there is an astonishing number of multifamily units currently under construction. In March, this count rose to 958K, the highest level since 1973. (Return to Summary)

U.S. Outlook

Weekly Domestic Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
25-Apr	New Home Sales (SAAR)	Mar	632K	625K	640K
25-Apr	Consumer Confidence	Apr	104.1	103.7	104.2
26-Apr	Durable Goods Orders (MoM)	Mar	0.7%	0.5%	-1.0%
27-Apr	GDP Annualized (QoQ)	Q1 Adv	2.0%	1.8%	2.6%
27-Apr	Personal Consumption (QoQ)	Q1 Adv	4.0%	4.4%	1.0%
28-Apr	Personal Income (MoM)	Mar	0.2%	0.2%	0.3%
28-Apr	Personal Spending (MoM)	Mar	-0.1%	-0.2%	0.2%

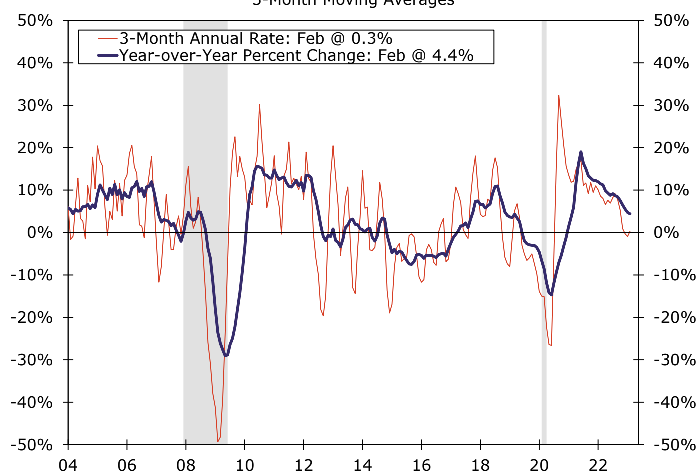
Forecast as of April 21, 2023

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

Durable Goods Orders • Wednesday

The goods sector of the economy appears to be going through correction as new demand slows amid increased economic uncertainty. Orders for core durable goods orders (excluding defense and aircraft) slipped 0.1% in February, marking the fourth decline in six months. Other industrial data have also been bleak. The ISM manufacturing index has signaled contraction for five consecutive months and manufacturing output has stalled. Conditions for new capital investment continue to grow less favorable and small business plans to make new capital expenditures have rolled over and are approaching new lows.

We expect durable goods orders remained under pressure in March. While we forecast total durable goods orders rose around 0.5%, that is likely due to a rise in aircraft orders, specifically based on orders data from Boeing during the month. Excluding transportation, orders look to have contracted around 0.1%. We'll also be paying close attention to the nondefense capital goods *shipments* data, which feeds into the BEA's calculation for equipment spending for the last read on Q1 investment ahead of Thursday's GDP report.

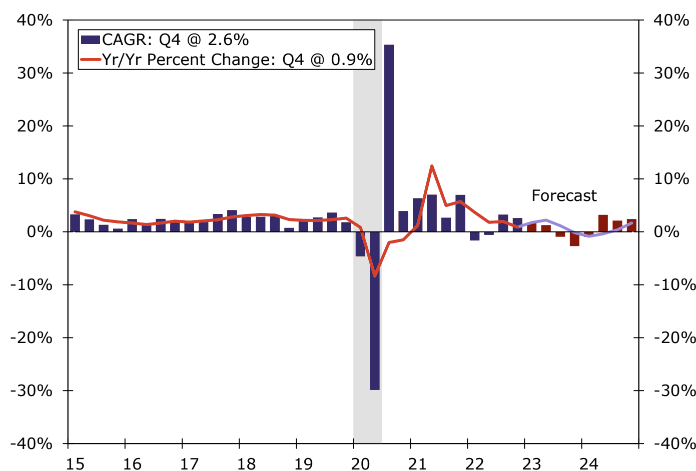


Source: U.S. Department of Commerce and Wells Fargo Economics

Q1 GDP Growth • Thursday

A strong start to the year positioned the economy to grow at a solid clip during the first quarter, and when data print on Thursday, we expect to see real GDP expanded at a 1.8% annualized pace in Q1. Growth was likely specifically lifted by a jump in consumer spending, as real personal consumption expenditures jumped 1.5% in the month of January alone. Even as growth began to moderate over the course of the first quarter, strong activity in January positioned for a solid outturn in overall output.

We expect signs of weakness elsewhere in the report, however, with a second consecutive quarterly contraction in equipment spending amid a flagging manufacturing sector. Residential investment spending also remained under pressure during the first quarter as elevated mortgage rates amid still-high home values eroded affordability. As the year progresses, we anticipate a gradual slowdown in activity to unfold amid the lagged effects of tighter monetary policy. We still forecast the U.S. economy to slip into a mild recession in the second half of the year as tighter policy crimps demand and firms begin to lay off workers.



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

Personal Income & Spending • Friday

Consumers continue to demonstrate an underlying level of resiliency in terms of spending. But after a strong start to the year, consumer spending looks to have lost momentum over the course of the first quarter. Real personal spending slipped in February, and we look for further contraction in March. Specifically, we expect real personal spending declined 0.2% last month. Retail sales slid 1.0% in March and point to weak goods spending during the month. There's less indication of how services activity fared in March. Spending at restaurants from the retail release suggests only modest growth, though continued gains in prices of leisure activities like hotels and airfare demonstrate continued demand for services.

In terms of income, slower inflation continues to give way to solid growth in real disposable income. For March, we look for only a modest gain, but that comes after eight consecutive months of growth in real income, which we continue to see as a near-term tailwind for spending. Even as credit has grown more expensive and potentially becomes more challenging to come by, households continue to have capacity to spend.

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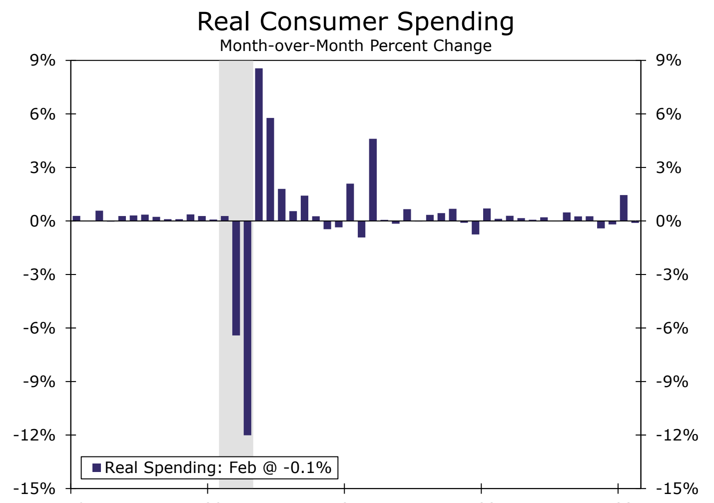
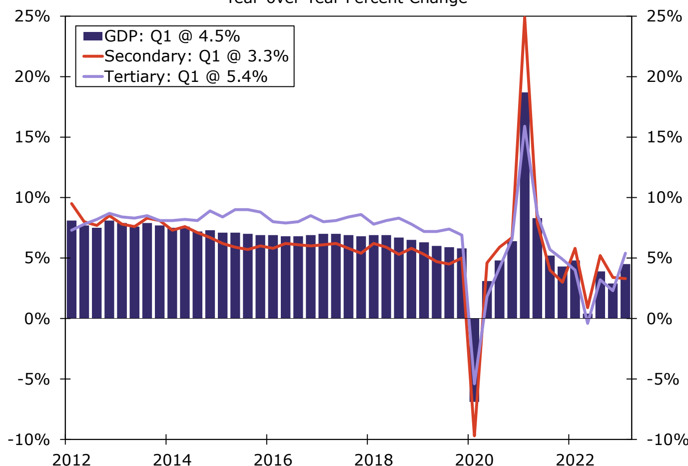


Source: U.S. Department of Commerece and Wells Fargo Economics

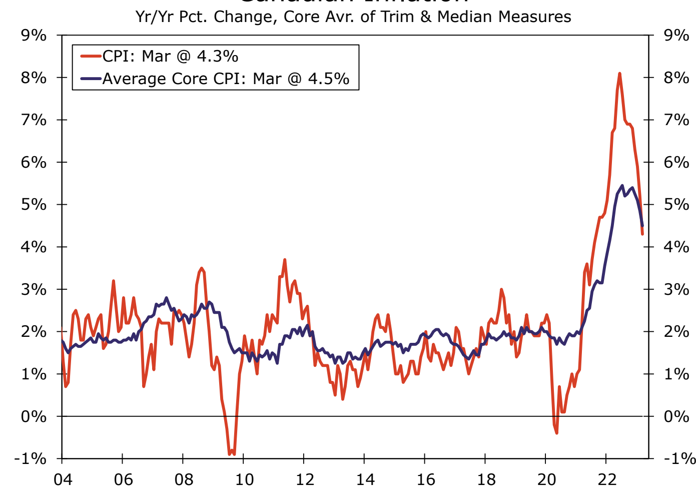
International Review

Global Growth Prospects Continue to Improve

Early this week, China reported Q1-2023 GDP data, a widely anticipated data release. Q1 data offered markets an opportunity to gauge how China's economy performed after authorities lifted Zero-COVID policies around the end of last year. The key takeaway was that China's economy performed better than expected, growing 2.2% on a quarterly basis and 4.5% on a year-over-year basis. Q4-2022 data were also revised higher to show a more robust expansion at the end of last year. With the economy growing more than we forecast over the first three months of this year, upside risks are forming to our already above-consensus annual GDP growth forecast. Right now, we forecast China's economy to grow 5.5% in 2023; however, Q1 outperformance, along with a property sector that is showing tentative signs of stabilizing and still strong consumer activity, could result in a revised growth outlook of closer to 6% when we update our forecast. Given the sheer size and influence of China's economy, upward revisions to China's growth outlook can have positive implications around the world and boost our global GDP forecast. We have made consistent upward revisions to our global growth forecast this year, and with China's economic rebound still intact, another global GDP growth revision could be forthcoming. In addition to China, the economic outlook for the Eurozone continues to improve. This week, sentiment data showed the Eurozone services sector pushed further into expansion territory with a firmer April Purchasing Manager Index. According to PMI data, sentiment within the manufacturing sector slowed; however, we see rationale for the Eurozone economy being able to avoid recession this year. Revisions to our Eurozone growth outlook would also boost the growth prospects for the global economy.



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



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

Bank of Canada Easing Delayed?

March CPI data confirmed the disinflation trend in Canada is still underway. This week, year-over-year headline inflation fell to 4.3%, down from over 5% in February. While slipping oil prices drove headline inflation lower, core inflation also trended lower, providing additional evidence that underlying price pressures in Canada are softening. But while inflation is retreating, economic activity across the economy has been more resilient than we expected. To that point, we have, for some time, been anticipating a slowdown in Canada's economy in 2023, given an accumulation of headwinds through late last year. While we still believe that slowdown will be forthcoming, the economy has proved surprisingly resilient at the beginning of 2023. Perhaps the most notable area of strength over the past several months has been the Canadian labor market. Employment rose by 34,700 in March, reflecting an 18,800 gain in full-time jobs and a 15,900 gain in part-time jobs. The March increase comes after a run of solid job gains, such that the monthly employment increase has averaged 61,800 over the past six months. The unemployment rate remained low in March at 5.0%, although hourly wage growth for permanent employees did ease a little to 5.2% year-over-year.

To be clear, we don't think Canada's economy has been strong enough to prompt further Bank of Canada (BoC) rate hikes. However, depending on how quickly (or not) any growth slowdown transpires,

it is possible that BoC easing begins later than our current forecast for initial rate cuts starting in Q4-2023. For the time being, we are sticking with our call for easing to start around the end of this year; however, recent BoC policymaker commentary also suggest the central bank may be leaning toward keeping rates on hold longer. To that point, in the Bank of Canada's April monetary policy announcement the statement noted that the BoC "continues to assess whether monetary policy is sufficiently restrictive to relieve price pressures and remains prepared to raise the policy rate further if needed to return inflation to the 2% target." With respect to the CPI outlook, the BoC said that it expects inflation to fall quickly to around 3% in the middle of this year, but "getting inflation the rest of the way back to 2% could prove to be more difficult because inflation expectations are coming down slowly, service price inflation and wage growth remain elevated, and corporate pricing behaviour has yet to normalize." In his post meeting press conference and subsequent comments, BoC Governor Macklem also said policy rate cuts this year do not look like the most likely scenario, and that it is too early for the central bank to consider rate cuts. And finally, when we visited the IMF for the Spring Meetings, Macklem reinforced that policy rate cuts are not on the horizon, given the current state of economic conditions in Canada.

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International Outlook

Weekly International Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
27-Apr	Central Bank of Turkey Repo Rate	27-Apr	8.50%	--	8.50%
28-Apr	Eurozone GDP QoQ	Q1 A	0.2%	--	0.0%
28-Apr	Eurozone GDP YoY	Q1 A	1.4%	--	1.8%
28-Apr	Bank of Japan Policy Rate	28-Apr	-0.10%	-0.10%	-0.10%

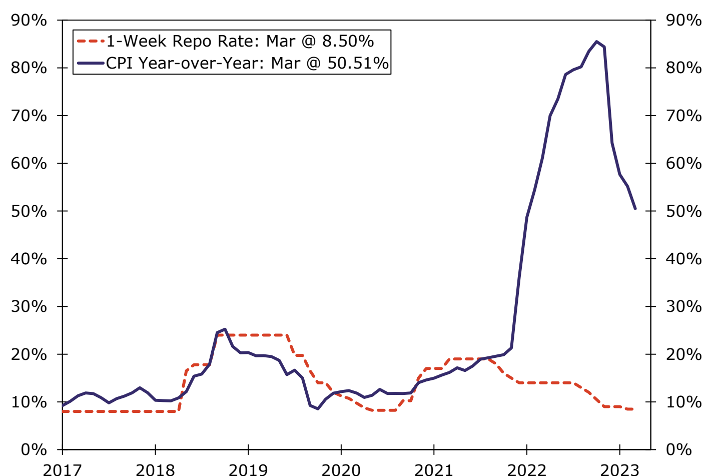
Forecast as of April 21, 2023

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

Central Bank of Turkey • Thursday

When we comment on the Central Bank of Turkey, we typically do so to highlight the unorthodox approach to monetary policy the institution takes. For years, the central bank has lowered interest rates in an effort to contain inflation, in contrast to modern economic theory of raising interest rates to quell price pressures. Next week, consensus expects no change in interest rates despite inflation significantly higher than the central bank's target. But, with Turkish elections around the corner in May, President Erdogan may look to rally support for re-election by further easing monetary policy.

Turkish elections could have significant implications for Turkey's central bank going forward. In the event President Erdogan wins re-election, which is our base case scenario, we would expect an unorthodox monetary policy framework and little independence to persist. However, in a regime change scenario, the central bank could retrieve independence and a more orthodox direction for policy could follow. In our view, a regime change scenario could result in a sharp rally for the Turkish lira, reversing a trend that has taken the lira to all-time lows against the U.S. dollar.

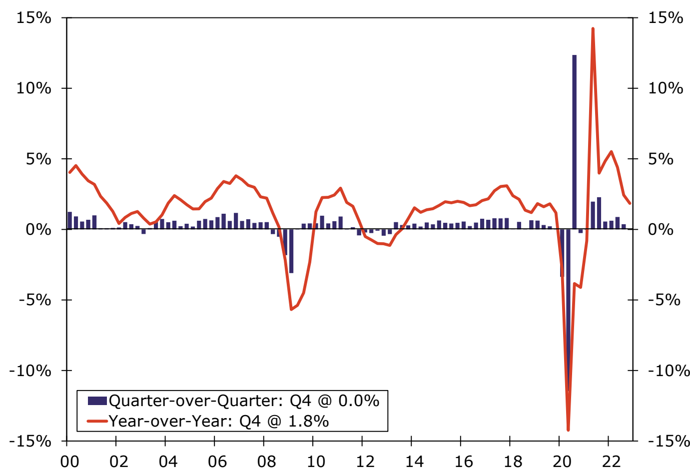


Source: Bloomberg Finance L.P. and Wells Fargo Economics

Eurozone GDP • Friday

We have noted the economic resilience of the Eurozone for some time. As a reminder, the Eurozone avoided an energy crisis with an especially warm winter relieving upward pressure on oil and natural gas prices following Russia's invasion of Ukraine. Lower energy prices improved household finances and allowed for more consumer spending across the economy. In addition, inflation was able to trend lower, allowing real incomes to rise and also support broader consumer spending. We forecast the Eurozone to enter recession; however, with economic activity resilient and improving, the Eurozone may be able to avoid recessionary conditions.

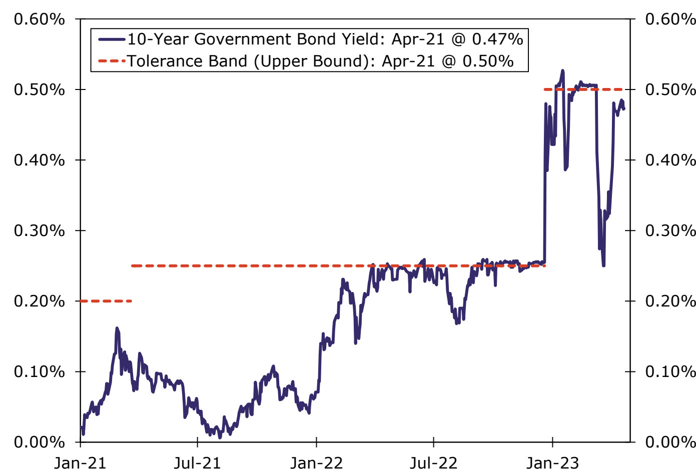
April Purchasing Manager Indices paint a bit of a mixed picture of the Eurozone economy, one where the services sector continues to improve, while the manufacturing industry is more sluggish. Labor markets are still tight and the unemployment rate across the region is also relatively low despite aggressive ECB tightening. This combination, along with improving household finances, means the Eurozone may be able to eek out expansion when Q1 GDP data are released next week.



Bank of Japan • Friday

Following a tweak in monetary policy settings at the end of last year, expectations for further adjustments from the Bank of Japan (BoJ) have gathered momentum. While we believe additional tweaks are possible in the future, next week may be too early for another adjustment. In that sense, we do not expect the BoJ to exit negative interest rates nor adjust its yield curve control policy next week.

With new BoJ Governor Ueda set to lead his first meeting next week, we have our doubts Ueda will look to alter monetary policy settings right away. In fact, Ueda has communicated that accommodative monetary policy is the correct stance for the time being. Growth prospects are rather subdued and inflation, while historically elevated, is expected to trend lower in the coming months and quarters providing support to Ueda's statements. Over time, we do believe policy changes at the BoJ may be appropriate, especially if inflation remains more persistent than expected. To that point, we believe further tweaks could be made in October as Ueda settles in and inflation trends are more developed.



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

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Interest Rate Watch

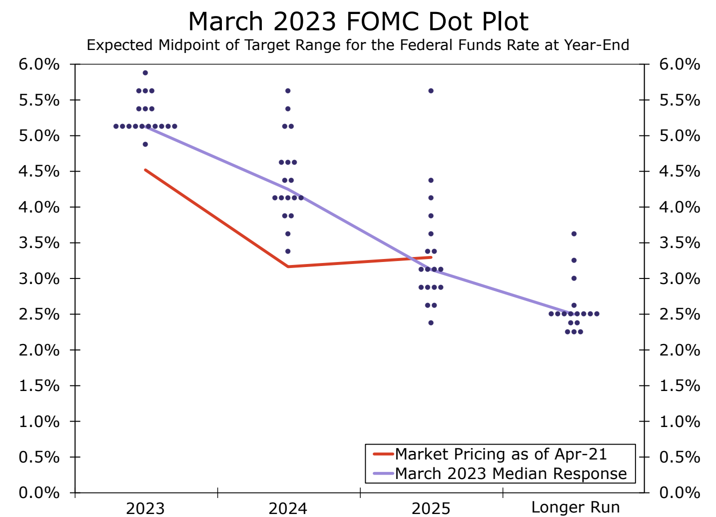
Give Thought to the Pause

The fastest pace of policy tightening since the early 1980s is winding down. Our forecast anticipates one more quarter-point rate hike at the upcoming FOMC meeting on May 3 after which we suspect the Fed will remain on hold until the fourth quarter. Had we not encountered a banking crisis, a few more rate increases might have been in the offing. The recent difficulties in the financial sector, however, and the associated strain on the financial system diminish the need for further hikes beyond May, in our view.

The statement from the Federal Reserve's March meeting also recognized the end of this tightening cycle is fast approaching. It pivoted from earlier language suggesting that "ongoing increases" in the fed funds rate would be needed to quell inflation to a more milquetoast assessment that "some additional policy firming may be appropriate." Translation: almost done with rate hikes. In any cycle, financial markets try to anticipate the terminal fed funds rate, or the rate at which the fed pauses in its tightening cycle, and what the duration of that plataea in rates will be. Getting that right is arguably the most compelling puzzle in the rates landscape in 2023.

So, the more gripping question these days has less to do with the specifics of the FOMC's next meeting and more to do with when policymakers will eventually take back some rate hikes. When you look at the dot plot from the March meeting, among 18 current members of the FOMC, 17 of them have the fed funds rate at 5.00% or higher at year-end; one brave committee member has fed funds between 5.75%-6.00%.

In other words, the dot plot is saying "higher for longer" but markets are not convinced. The implied rate based on fed funds futures trading is hovering near 4.50%. Our own forecast splits the uprights with a year-end target of 4.75% for the fed funds rate. Our view is informed by the premise that recession takes hold in the second half of the year and the associated slowing in the labor market combined with a trend decline in the inflation rate compels policymakers to adopt a less restrictive policy regime. We suspect that will be just getting underway by the fourth quarter of this year before the FOMC gets serious about cutting rates significantly next year. Between now and then, every available indicator dealing with prices or jobs will be parsed over for clues. There was not a ton of new data on that score this week, other than a report showing the number of people remaining on unemployment insurance jumped to 1,865K in the week of April 8. That is higher than it has been at any point since 2021. Further cracks in the foundation of the labor market later this year might give policymakers more thought to the duration of the pause in interest rates.



Source: Federal Reserve Board and Wells Fargo Economics

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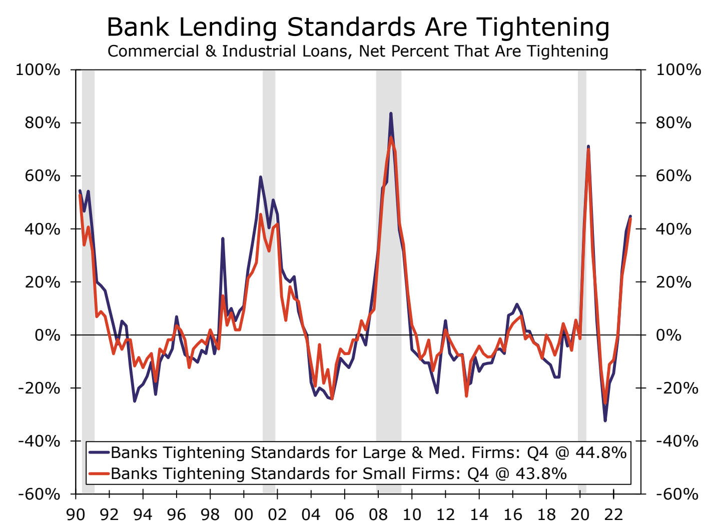
Credit Market Insights

Fed's Beige Book Brings Some Color to Recent Financial Turmoil

On Wednesday, the latest edition of the Federal Reserve's Beige Book was released, covering the month of March and through early April. The previous Beige Book was published in early March but quickly became stale following the failures of Silicon Valley Bank and Signature Bank. The latest read covers the period following recent financial turmoil and the fallout it has caused.

Overall economic activity was little changed from the prior survey. Of the 12 Fed districts, nine reported that economic activity was relatively flat and three reported moderate growth. Growth outlooks were subdued across 10 of the districts and worsened in the San Francisco and Dallas districts. Easing price pressures were evident across most districts as input inflation cooled in March. Although the labor market is losing steam, hiring is still moving along at a healthy pace, and firms have benefited from improved employee retention. Wage growth has moderated somewhat but is still running higher than the FOMC is comfortable with.

One of the more anticipated and timely aspects of the survey is its report on how credit conditions have evolved since the collapse of SVB and Signature Bank. Every Fed district reported tightening lending standards and/or some sort of decline in loan volumes, but the overall impact of the recent financial turmoil has been modest across most districts. Actions taken by the Federal Reserve, Treasury Department and FDIC following the collapse of these regional banks appear to have stabilized financial markets.



Source: Federal Reserve Board and Wells Fargo Economics

The San Francisco district is the notable exception. The San Francisco district, the former home of SVB, reported that "lending activity fell significantly in recent weeks amid higher interest rates and elevated uncertainty in the banking sector." The San Francisco Fed went on to report that despite ample liquidity, lending standards tightened considerably and projects across sectors have been delayed or canceled due to the sudden rise in financing costs.

We will get more data on how banks have adjusted lending standards from the Fed's upcoming Q1 Senior Loan Officer Opinion Survey, which is set to release later in April or early May. Although the Beige Book brought with it some mounting financial concerns, the still resilient read on the economy and bank activity supports our view that the FOMC will raise its policy rate a further 25 bps to a 5.00%-5.25% range at its May 3 meeting.

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Market Data • Mid-Day Friday

U.S. Interest Rates

	Friday 4/21/2023	1 Week Ago	1 Year Ago
SOFR	4.80	4.80	0.27
3-Month LIBOR	5.26	5.25	1.10
3-Month T-Bill	5.06	4.99	0.79
1-Year Treasury	4.46	4.31	1.66
2-Year Treasury	4.18	4.10	2.68
5-Year Treasury	3.65	3.61	2.97
10-Year Treasury	3.56	3.51	2.91
30-Year Treasury	3.77	3.73	2.93
Bond Buyer Index	3.56	3.32	3.19

Foreign Exchange Rates

	Friday 4/21/2023	1 Week Ago	1 Year Ago
Euro ($/€)	1.097	1.099	1.083
British Pound ($/£)	1.241	1.241	1.303
British Pound (£/€)	0.884	0.886	0.832
Japanese Yen (¥/$)	134.320	133.790	128.380
Canadian Dollar (C$/$)	1.353	1.337	1.258
Swiss Franc (CHF/$)	0.893	0.894	0.953
Australian Dollar (US$/A$)	0.670	0.671	0.737
Mexican Peso (MXN/$)	17.992	18.016	20.173
Chinese Yuan (CNY/$)	6.890	6.869	6.451
Indian Rupee (INR/$)	82.098	81.855	76.159
Brazilian Real (BRL/$)	5.049	4.928	4.622
U.S. Dollar Index	101.885	101.552	100.578

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

Foreign Interest Rates

	Friday 4/21/2023	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	-0.58	-0.59	-0.57
3-Month Sterling LIBOR	4.60	4.48	1.16
3-Month Canada Banker's Acceptance	5.05	5.05	1.59
3-Month Yen LIBOR	-0.03	-0.03	-0.08
2-Year German	2.92	2.88	0.20
2-Year U.K.	3.75	3.62	1.75
2-Year Canadian	3.75	3.82	2.64
2-Year Japanese	-0.04	-0.04	-0.05
10-Year German	2.48	2.44	0.95
10-Year U.K.	3.76	3.67	2.01
10-Year Canadian	2.97	3.04	2.89
10-Year Japanese	0.47	0.48	0.25

Commodity Prices

	Friday 4/21/2023	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	77.89	82.52	103.79
Brent Crude ($/Barrel)	81.61	86.31	108.33
Gold ($/Ounce)	1983.23	2004.17	1951.62
Hot-Rolled Steel ($/S.Ton)	1087.00	1117.00	1430.00
Copper (¢/Pound)	399.55	410.65	470.40
Soybeans ($/Bushel)	14.98	15.08	17.24
Natural Gas ($/MMBTU)	2.25	2.11	6.96
Nickel ($/Metric Ton)	24,923	23,549	33,464
CRB Spot Inds.	560.42	559.38	684.32

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