Economics

Weekly — May 3, 2024

Weekly Economic & Financial Commentary

United States: **April Brings Signs of Cooling in Economic Growth**

- Q2 began on a softer note. Employment growth was sturdy in April, but the 175K jobs added was the smallest gain since October. The below-consensus gain was accompanied by an increase in the unemployment rate, which rose to 3.9%. Meanwhile, an unexpected acceleration in the Employment Cost Index was the latest indication that progress on inflation is plateauing. As such, the FOMC is likely to remain in a holding pattern in the months ahead.
- Next week: SLOOS (Mon.), Consumer Credit (Tue.), Consumer Sentiment (Fri.)

International: **Eurozone Growth Gradually Recovering, Eurozone Inflation Gradually Slowing**

- Eurozone Q1 GDP growth came in stronger than expected this week, and the April CPI showed further disinflation progress as the core CPI slowed to 2.7% year-over-year. Given an overall gradual economic recovery and ebbing inflation, we still see the European Central Bank as on course to deliver an initial 25 bps policy rate cut in June.
- Next week: Riksbank Policy Rate (Wed.), Bank of England Policy Rate (Thu.), Banxico Policy Rate (Thu.)

Interest Rate Watch: **Stalling in Inflation Leaves FOMC Stalling for Time**

- As universally expected, the FOMC voted unanimously to leave the target range for the federal funds rate unchanged at 5.25%-5.50% at its meeting this week. In our view, the statement and press conference suggested the Committee is not in any rush to cut rates.

Credit Market Insights: **Corporate Bonds Signal Optimism**

- The U.S. economy has shown remarkable resilience in the face of high interest rates. This has been reflected in the corporate bond market, which continues to signal optimism regarding future economic growth.

Topic of the Week: **Yen Falls to 34-Year Low, Prompting Possible BoJ Intervention**

- On Monday, the Japanese yen slid to a 34-year low against the dollar, prompting what appeared to be intervention by Japan's Ministry of Finance and central bank (BoJ) to support the beleaguered currency.

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Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual		Forecast	
	2023				2024							
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2022	2023	2024	2025
Real Gross Domestic Product [1]	2.2	2.1	4.9	3.4	1.6	1.9	1.6	1.5	1.9	2.5	2.6	2.0
Personal Consumption	3.8	0.8	3.1	3.3	2.5	2.1	1.6	1.7	2.5	2.2	2.3	1.8
Consumer Price Index [2]	5.7	4.0	3.6	3.2	3.2	3.5	3.2	3.2	8.0	4.1	3.3	2.4
"Core" Consumer Price Index [2]	5.5	5.2	4.4	4.0	3.8	3.6	3.6	3.4	6.2	4.8	3.6	2.8
Quarter-End Interest Rates [3]												
Federal Funds Target Rate[4]	5.00	5.25	5.50	5.50	5.50	5.50	5.25	5.00	2.02	5.23	5.31	4.38
Conventional Mortgage Rate	6.54	6.71	7.20	6.82	6.82	7.05	6.80	6.50	5.38	6.80	6.79	6.09
10 Year Note	3.48	3.81	4.59	3.88	4.20	4.40	4.20	4.00	2.95	3.96	4.20	3.83

Forecast as of: April 11, 2024 [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

Please see our full U.S. Economic Forecast.

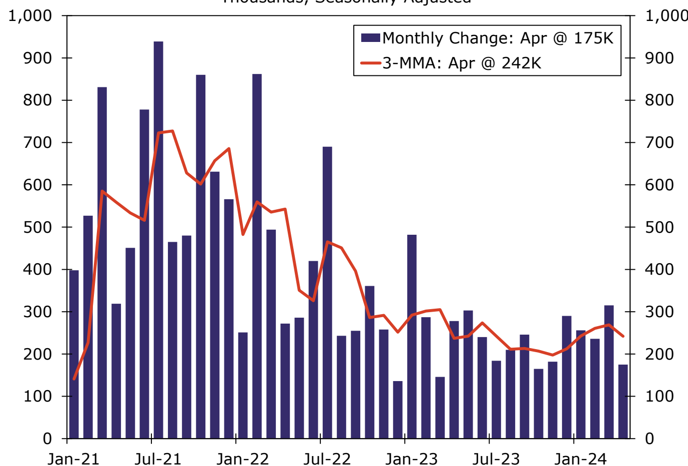
U.S. Review

April Brings Signs of Cooling in Economic Growth

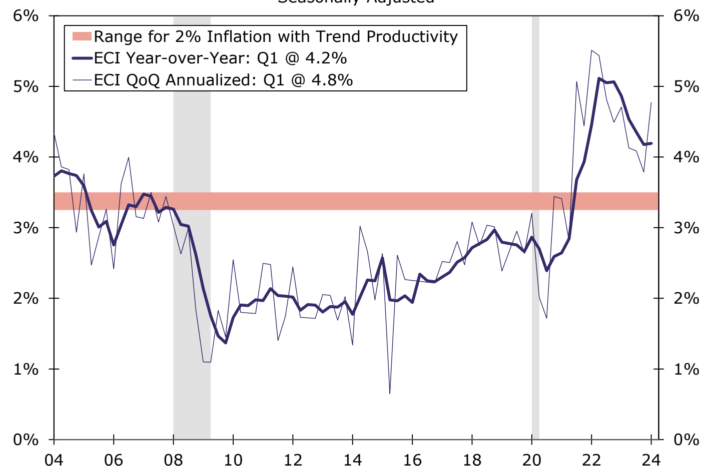
The economic data released this week showed a still-sturdy labor market and stubborn underlying inflation pressures, developments which lend further credence to our view that the Federal Reserve will continue to be patient in adjusting the federal funds target range. The flow of economic news was heavy this week, but the outcome of May's FOMC meeting took center stage. Although the Committee announced that it will dial back the pace of quantitative tightening (QT) starting in June, there were no changes to the federal funds target range. For more on the FOMC meeting, please see the Interest Rate Watch.

The Federal Reserve can afford patience thanks to a resilient labor market. During April, total nonfarm payrolls rose by 175,000 net jobs, continuing a string of solid monthly payroll additions. There have been a few signs that labor market conditions are cooling a bit. The monthly payroll gain was a bit softer than consensus expectations and amounted to the lowest net increase since October 2023. The unemployment rate also ticked up slightly, rising to 3.9% from 3.8% in March. The moderation in the labor market arrives amid a cooling trend in demand for workers. Earlier this week, the Job Openings and Labor Turnover Survey (JOLTS) showed a decrease in the rate of job openings, hiring and quits, which presages further easing in employment growth in the months ahead. What's more, April's drop in consumer confidence to the lowest level since July 2022 was partly prompted by mounting labor market concerns, with consumers reporting that jobs are becoming harder to find. That said, initial jobless claims and continuing claims have both remained low over the past few weeks, which suggests that layoffs are not accelerating and those that need a job are finding one relatively quickly. All told, some further cooling appears in order, but a material deterioration in labor market conditions does not appear imminent.

The major reason that the FOMC is not in any hurry to begin a rate-cutting cycle is that progress on reducing price pressures appears to have plateaued. On the heels of last week's warm PCE deflator reading, a batch of indicators measuring labor costs came in on the hot side of expectations this week, showing that underlying inflation pressures are still percolating. The Employment Cost Index (ECI), which is the Fed's preferred measure of labor costs, rose 1.2% on a quarter-over-quarter basis and 4.2% on a yearly basis in Q1, both stronger than consensus expectations. Separately reported, unit labor costs accelerated at a 4.7% annualized pace in the same period, a gain which accompanied a tepid quarterly improvement in productivity growth. Encouragingly, average hourly earnings, which were published in the April employment report, were weaker than anticipated and rose just 0.2% during the month. Although labor costs are still running at a toasty pace that is not consistent with 2% inflation, April's easing in average hourly earnings is a reassuring sign that softer labor market conditions will lead to more moderate labor cost pressures in the coming months.



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



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

That said, stalled progress on inflation was also evident in the April ISM manufacturing and services reports. The ISM manufacturing headline index slipped to a reading of 49.2 during April, falling back into contraction territory and providing a reminder that the factory sector remains constrained by higher interest rates. However, the prices-paid index jumped more than five points to the highest level since 2022. The rise in manufacturing prices paid reflects the recent uptick in commodity prices and offers more evidence that, moving forward, goods prices are not likely to be the same disinflationary force as they were last year.

Similarly, a leap in the ISM services prices-paid index during April points to continued stickiness in service sector inflation, even as activity looks to be downshifting. Similar to its manufacturing counterpart, the headline ISM services index faltered in April and dropped below the 50-demarcation line indicating contraction for the first time since December 2022. The business activity, new orders and employment sub-indexes all fell back during the month. Over the past several years, services activity has been seemingly unmoved by higher interest rates thanks to strong household finances and pent-up demand from the pandemic. One month of data does not make a trend, but April's decline in the ISM services index suggests that services activity may be starting to feel the effects of tighter monetary policy.

Elsewhere, higher interest rates are clearly restricting construction activity. Total construction spending declined 0.2% in March, the second drop in three months. Overall construction spending has gotten off to a slow start in 2024, and on balance, total spending declined in the first quarter. Residential spending weakened in March with pullbacks across both single-family and multifamily segments. Meanwhile, nonresidential spending edged up slightly, but that was fueled by spending on the public side, particularly for infrastructure projects. Private nonresidential spending fell for a third straight month as developers remain constrained by weak demand for commercial real estate, higher interest rates and tighter lending standards. A downdraft in nonresidential project starts for these types of construction and a pullback in architecture firm billings suggests a drop in private nonresidential activity is ahead in the near term.

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U.S. Outlook

Weekly Domestic Indicator Forecasts					
Date	**Indicator**	**Period**	**Consensus**	**Wells Fargo**	**Prior**
7-May	Consumer Credit	Mar	$15B	—	$14.1B
10-May	Consumer Sentiment	May	76.2	—	77.2

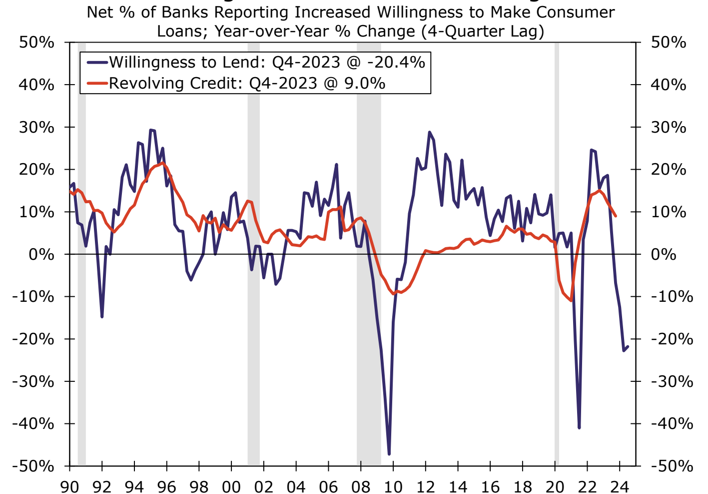
Forecast as of May 03, 2024

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

Senior Loan Officer Opinion Survey • Monday

The Federal Reserve Board will release the Q1-24 update to its Senior Loan Officer Opinion Survey on Monday, providing a glimpse at lending conditions through the early months of the year. In the Q4-23 release, respondents reported tighter standards and weaker demand for both commercial & industrial and commercial real estate loans. Loans to households, including HELOCs, credit cards and auto loans, similarly experienced tighter lending standards and weaker demand. As banks' willingness to lend to consumers has nosedived, year-over-year growth in revolving consumer credit has rolled over.

Looking ahead, the outlook for lending standards appears to be less than sanguine. On the household front, delinquencies have been on the rise for several quarters. The most recent release of the New York Fed's Household Debt and Credit report showed transitions into early delinquency rising for mortgages and HELOCs and even rising enough to surpass pre-pandemic norms for credit card loans and auto loans. With the Fed holding rates steady, a pickup in demand for credit does not appear to be on the horizon. Furthermore, banks have reported widening interest rate spreads over the cost of funds for consumer loans, further contributing to a rise in the cost of borrowing. These costs have risen dramatically over the past two years, and uncertainty over when, and even whether, the Fed will cut its target for the fed funds rate this year could leave many would-be borrowers on the sidelines awaiting a firmer outlook on the path of rates.

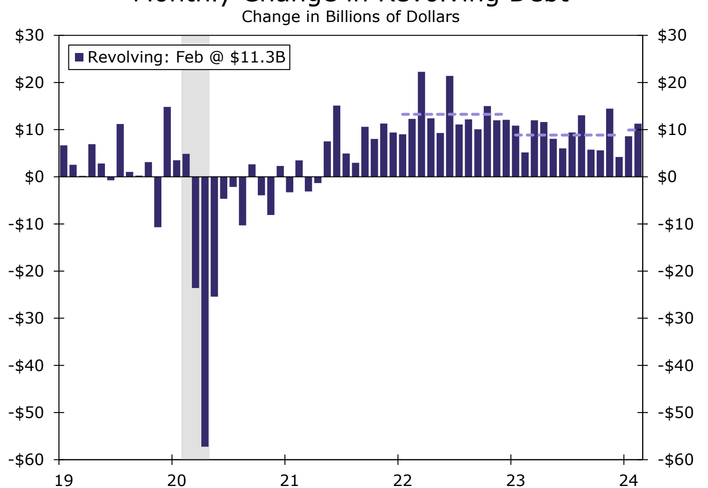


Source: Federal Reserve Board and Wells Fargo Economics

Consumer Credit • Tuesday

Consumer credit grew $14.1B in February. Through the first two months of the year, consumer credit has increased $31.8B, which is already high enough to surpass the growth seen in each of the last two quarters of 2023 and to notch the largest quarterly increase since Q2-23. Revolving credit—primarily composed of credit card debt—has done most of the heavy lifting here, as non-revolving credit—primarily composed of installment debt such as auto and student loans—has felt pressure.

While consumer credit outstanding has expanded solidly over the past few years, consumers have reduced the amount they have been drawing on revolving credit lines each month. The monthly average increase in revolving credit balances was $13.3B throughout 2022, and it decreased to a monthly average increase of $8.9B in 2023. Year-to-date, the monthly average increase so far in 2024 has hovered around $9.9B, although this should be taken with a grain of salt, given there are only two months of data available this year. Indeed, consumers seemingly both do not need to and do not want to draw on credit at the same pace they did in 2022 when inflation was rampant and real disposable income growth was negative. Moreover, interest rates on consumer credit



Source: Federal Reserve Board and Wells Fargo Economics

loans have soared since 2022, making the cost of borrowing rise and giving consumers reason to avoid it if possible. We expect consumer credit to continue to increase at a similarly modest pace to that of recent months, as we view income as the most consequential driver of household spending growth in the coming months.

Consumer Sentiment • Friday

Consumer sentiment has started the year with a string of strong prints and has yet to drop below an index level of 76. This is a marked improvement from where sentiment stood in 2023, when it only cracked above 70 for a single month, even dropping as low as 59. A sizable gap between weakness in the more inflation-focused consumer sentiment measure from the University of Michigan and strength in the more labor market-focused consumer confidence measure from The Conference Board persisted between 2021 and 2023. The two indices usually track close together, but a remarkably strong labor market and decades-high inflation put pressure on consumers' pocketbooks and drove a wedge between the two indices. However, recent data have shown a gradual softening in the labor market beginning to materialize, in addition to inflation data that, until recently, had been making progress in coming down.

The narrowing of the gap between the two indices is likely due in large part to a reversal in the trends of the underlying employment and inflation data that initially drove the wedge. A key component in the continued rebound of the inflation-focused consumer sentiment measure is consumer inflation expectations remaining well-anchored. In April, year-ahead inflation expectations rose to 3.2%, while expectations 5-10 years out hit 3.0%. Despite hitting the highest level in five months, long-term expectations are still consistent with its recent range and will be considered "anchored" by the Fed. Even so, if inflation data continue to come in sticky, the risk remains that consumers could begin to shift their expectations higher and put a damper on the thus-far strong sentiment readings in 2024. Looking to May, consensus expectations are for consumer sentiment to decline modestly to 76.2.

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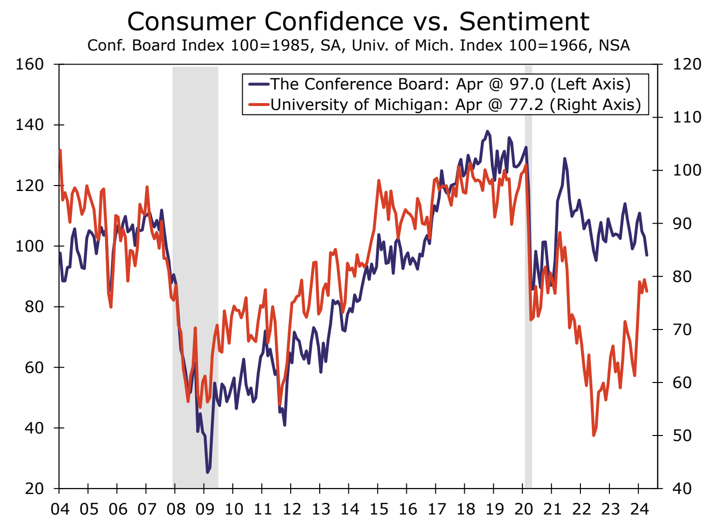


Source: The Conference Board, University of Michigan and Wells Fargo Economics

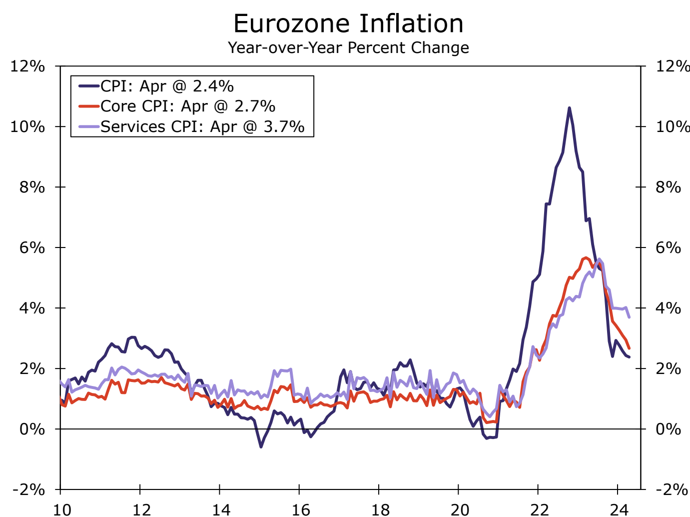
International Review

Eurozone Growth Gradually Recovering, Eurozone Inflation Gradually Slowing

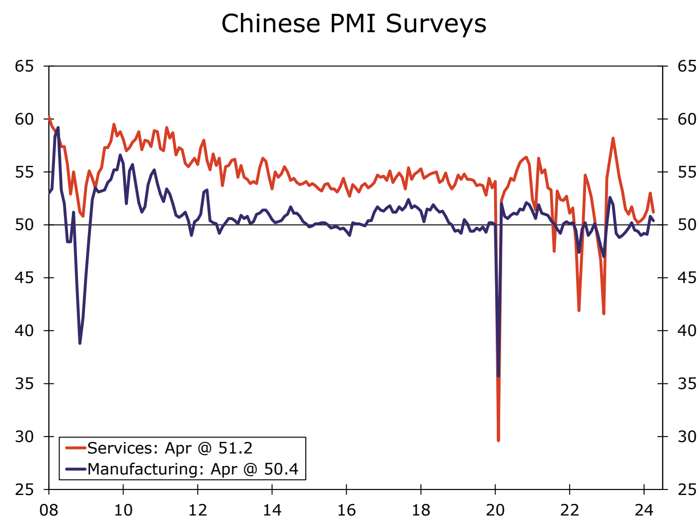
This week saw the release of key Eurozone economic data, which we anticipate will see the European Central Bank (ECB) adopt an initially gradual pace of rate cuts as it embarks on its monetary easing cycle. Eurozone Q1 GDP surprised to the upside with growth of 0.3% quarter-over-quarter and 0.4% year-over-year. The rise in first quarter GDP comes after two straight sequential declines in Q3 and Q4 of last year, and confirms the improvement seen in the region's sentiment surveys—most notably in the Eurozone services PMI—in recent months. The gain in Eurozone Q1 GDP was widespread, even if the strength of the rebound varied across the region's major economies. German and French GDP both rose in Q1, albeit by a modest 0.2% quarter-over-quarter. Italy's GDP increased by a slightly stronger 0.3%, and Spain's GDP rose by a solid 0.7%. Looking ahead, we expect Eurozone recovery to gather some momentum as the year progresses. Receding inflation is contributing to firmer growth in real household incomes, which should be supportive of consumer spending and overall economic activity.

On the price front, the Eurozone April CPI was mixed, but consistent with some further overall lessening in inflationary pressures. The headline CPI rose 2.4% year-over-year, matching the consensus forecast as well as the increase seen in March. Core inflation slowed in April, though by a bit less than expected, to 2.7%. On a more favorable note, services inflation slowed to 3.7% after having been stuck at 4.0% over the past several months. While acknowledging that the inflation news was favorable overall, underlying inflation still appears to be trending modestly above the ECB's 2% inflation target for the time being. We note, for example, the CPI excluding food and energy has risen at a 2.7% annualized pace over the past six months. Against that backdrop, and also given the rebound in Q1 GDP, we believe the European Central Bank will take an initially cautious approach toward lowering policy interest rates. We still expect the ECB to cut its Deposit Rate by 25 bps to 3.75% at its June meeting, a move that has been widely signaled by ECB policymakers. We expect the ECB to hold its Deposit Rate steady at its July meeting, however, before resuming with another 25 bps rate cut at its September announcement.

In Canada, the February GDP report pointed to a slowing in economic momentum during the first quarter. February GDP rose 0.2% month-over-month, slightly below the consensus forecast for a 0.3% gain. Services activity increased by 0.2%, while industrial output ticked up by a smaller 0.1%. With the January GDP increase also revised lower and Statistics Canada's advance estimate for a flat GDP outcome in March, Canada's economy appears to be on track for growth of around 2.5% quarter-over-quarter annualized in the first quarter. Given moderate growth and improving inflation, we still lean toward the Bank of Canada delivering an initial 25 bps policy rate cut at its June monetary policy meeting. Finally, the Norges Bank—Norway's central bank—held its Deposit Rate at 4.50% at its monetary policy meeting this week. The accompanying announcement noted that, overall, inflation is slowing but still above target and economic growth is low, though it has firmed slightly recently. High wage growth and a weaker krone were cited as upside risks to inflation. Looking ahead, Norges Bank states that tight monetary policy might be needed for somewhat longer than previously envisaged. In our view, while higher wage growth and a weaker currency mean there is some risk of Norges Bank rate cuts getting pushed back, we still expect the central bank to begin lowering rates at some point during Q3-2024, given some progress on inflation and a modest pace of economic recovery.



Source: Datastream and Wells Fargo Economics



Source: Datastream and Wells Fargo Economics

In emerging markets, China's April PMIs hinted at a potential slowing in economic growth after a strong start to the year. The official manufacturing PMI slipped to 50.4 in April from 50.8 in March, though within the details we note divergent trends as the output component rose to 52.9, while the new orders component fell to 51.1. The official non-manufacturing PMI also declined to 51.2 in April from 53.0 in March, with the details showing a drop in the new orders component to 46.3 and the business activity expectations component to 57.2. Separately, the April Caixin manufacturing PMI was somewhat more encouraging, rising to 51.4. Still, the fall in the official PMIs in April combined with the slowdown seen in March retail sales and industrial output suggest a slowing in growth momentum following the strong gain reported for China's Q1 GDP.

Mexico released first quarter GDP growth data this week, which were mixed and modest. Mexico's Q1 GDP rose 0.2% quarter-over-quarter, slightly more than expected, but slowed more than forecast to 1.6% year-over-year. Service sector activity rose 0.7% quarter-over-quarter, while industrial output fell 0.4% quarter-over-quarter. Finally, Colombia's central bank lowered its policy rate by 50 bps to 11.75% at this week's announcement, and said inflation would need to slow further for the central bank to speed up the pace of rate cuts. Our base case is for similar 50 bps rate cuts at upcoming meetings, rather than accelerated easing.

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International Outlook

Weekly International Indicator Forecasts					
Date	**Indicator**	**Period**	**Consensus**	**Wells Fargo**	**Prior**
8-May	Riksbank Policy Rate	8-May	3.75%	3.75%	4.00%
9-May	Bank of England Policy Rate	9-May	5.25%	5.25%	5.25%
9-May	Banxico Policy Rate	9-May	–	11.00%	11.00%

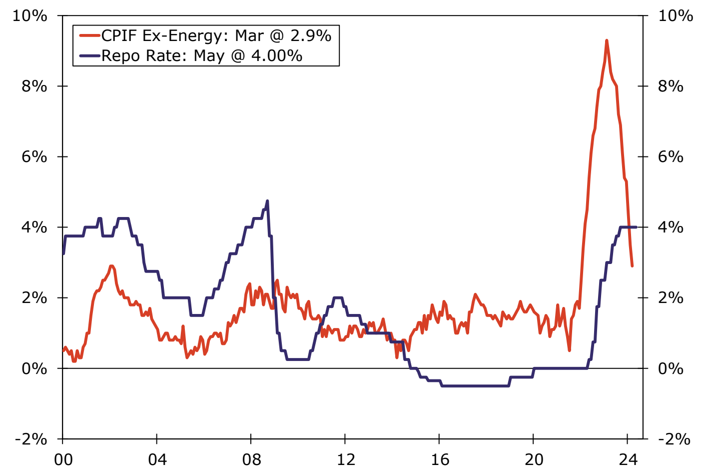
Forecast as of May 03, 2024

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

Riksbank Policy Rate • Wednesday

The Riksbank, Sweden's central bank, announces its monetary policy decision next week, at which we expect an initial 25 bps policy rate cut to 3.75%. When holding rates steady in March, the Riksbank said that inflationary pressures were lessening but still remained somewhat elevated. The central bank also said that if inflation prospects remained favorable, the policy rate could be lowered in May or June, with about a 50% chance of an initial rate cut coming at either of those meetings.

Over the past month, inflation has slowed further and by more than expected, with March CPIF ex-energy inflation slowing to 2.9% year-over-year. Growth has also remained weak, with the Q1 GDP indicator falling 0.1% quarter-over-quarter and the jobless rate rising in March. Meanwhile, comments from Sweden's central bank policymakers have remained dovish overall, and the strong signals from the European Central Bank that it will lower interest rates in June could also help Sweden's central bank lean toward an earlier rather than later move. To be sure, the softness in the krona in recent weeks could give policymakers some pause for thought, and represents a risk to early easing. But considering still-softening inflation, still-weak growth and dovish overall comments from Sweden's central bank policymakers, we believe the Riksbank will deliver a 25 bps rate cut at its announcement next week.

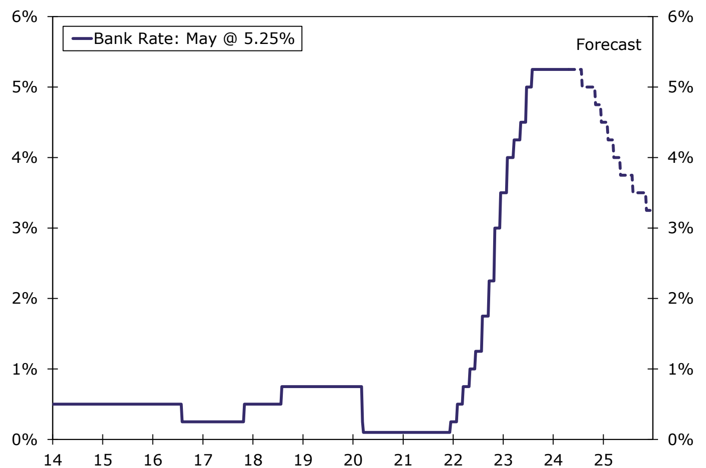


Source: Bloomberg Finance L.P. and Wells Fargo Economics

Bank of England Policy Rate • Thursday

The Bank of England (BoE) announces its monetary policy decision next week, for which our forecast and the consensus forecast is for the central bank to hold its policy rate steady at 5.25%. The accompanying statement and updated economic forecasts will, however, be closely scrutinized for any clues on when the BoE might begin easing. Some key policymakers have offered dovish comments recently, with Governor Bailey saying inflation dynamics in Europe were different from the U.S., and deputy governor Ramsden noting there were downside risks to the BoE's inflation forecast. Those comments are in contrast to recent data, however, which saw CPI inflation surprise to the upside in March, and wage growth and GDP growth firmer than expected in February.

Despite the dovish tilt from some policymakers, we believe the BoE will be hesitant to send a clear easing signal just yet. At its most recent announcement in March, the BoE said it would "keep under review for how long Bank Rate should be maintained at its current level." Unless there is a shift from that guidance to a clear and distinct easing bias (which is not our base case) or the BoE were to forecast CPI to remain sharply and sustainably below 2% over the medium term (also not our base case), our expectation for Bank of England monetary policy would continue to lean toward an initial



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

rate cut coming at the August meeting, rather than an earlier June move.

Banxico Policy Rate • Thursday

Banxico, the central bank of Mexico, is scheduled to announce its monetary policy decision next week, with market participants keenly focused on whether it will continue the monetary easing cycle it began at its March meeting. Banxico lowered its policy rate by 25 bps to 11.00% in March, but was cautious with respect to its forward guidance. The central bank said the persistence of core inflation remains a risk and indeed that inflation risks are biased to the upside. It also said that at its next monetary policy meetings, it will make its decisions depending on available information, leaving open the possibility that it could revert to a monetary policy pause.

Since then, the inflation news has been slightly mixed as March CPI inflation ticked up to 4.42% year-over-year, while core inflation slowed to 4.55%. Importantly, however, services inflation remains elevated, edging up to 5.37%. Meanwhile, stubborn U.S. inflation has seen the expected timing for Fed easing pushed back over the past several weeks. That has seen the Mexican peso show vulnerability at times to U.S. and other external developments. Considering still-elevated domestic inflation, an initial Fed rate cut that is likely still several months away, and some sensitivity to the possibility of a weaker Mexican currency, we believe Banxico policymakers will opt to hold their policy rate steady at 11.00% next week.

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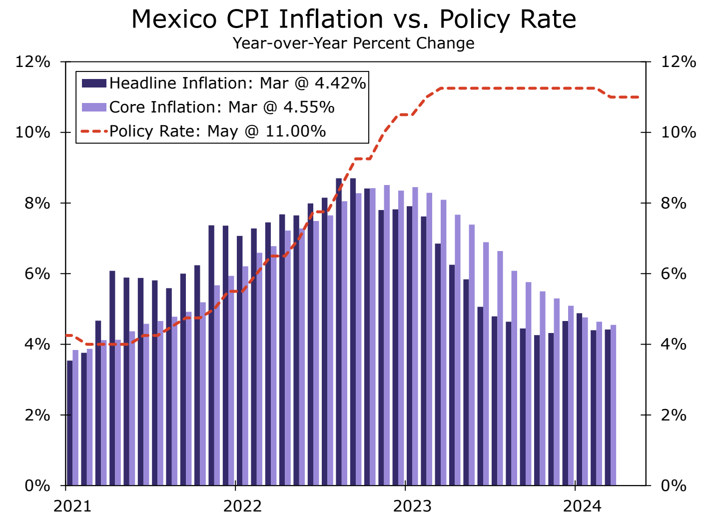

Source: Bloomberg Finance L.P. and Wells Fargo Economics

Interest Rate Watch

Stalling in Inflation Leaves FOMC Stalling for Time

As universally expected, the Federal Open Market Committee (FOMC) voted unanimously to leave the target range for the federal funds rate unchanged at 5.25%-5.50% at its meeting this week. The Committee did not release a Summary of Economic Projections, which is customary for its April/May meeting. Therefore, market participants needed to infer the FOMC's intentions from the post-meeting statement and from Chair Powell's press conference. In our view, the commentary suggested that the Committee is not in any rush to cut rates, a message that was presaged by numerous Fed officials in the weeks leading up to the meeting.

The FOMC continues to have an upbeat assessment of the economy. The post-meeting statement noted that "economic activity has continued to expand at a solid pace," that "job gains have remained strong" and that "the unemployment rate has remained low." Furthermore, the Committee continues to acknowledge that "inflation has eased over the past year," although the statement noted for the first time that "there has been a lack of further progress toward the Committee's 2 percent inflation objective."

The year-over-year rate of core PCE inflation, which the FOMC considers to be the best measure of the underlying rate of consumer price inflation, has receded from more than 5% in 2022 to 2.8% in March. However, core PCE prices have shot up at an annualized rate of 4.4% over the past three months. To paraphrase recent Fed speakers, the FOMC will need greater "confidence" that inflation is returning to 2% on a sustained basis before it feels comfortable cutting its target range for the federal funds rate. In our view, the Committee will not have that confidence until the Sept. 18 FOMC meeting, at the earliest.

In Chair Powell's press conference, he noted that it likely will take longer than originally thought to get that confidence. Notably, he backed off any reference to the potential timing of a rate reduction in his prepared remarks, no longer stating that "it will likely be appropriate to begin dialing back policy restraint at some point this year." Yet, he also noted that he believes it is "unlikely" that the FOMC will need to hike again and that current policy settings remain restrictive. On balance, the recent data appear to have pushed the FOMC away from the precipice of rate cuts but still very comfortable with a wait-and-see approach.

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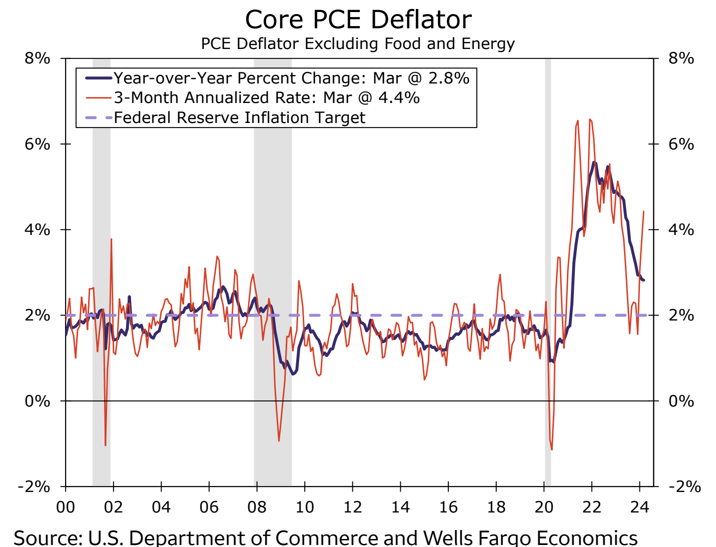


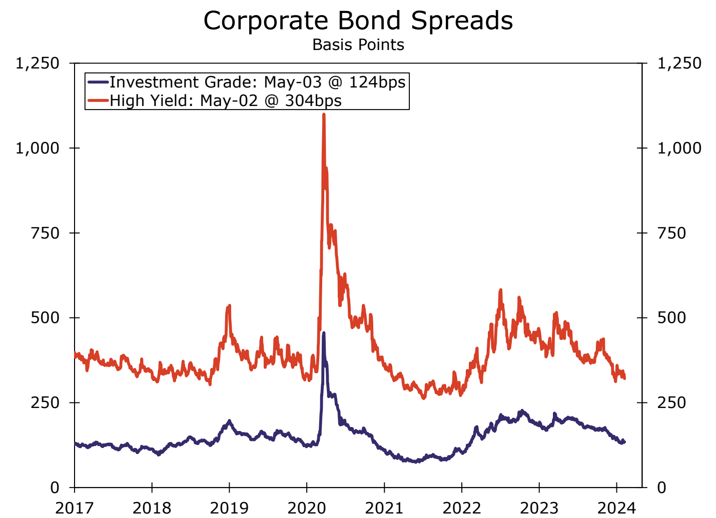
Source: U.S. Department of Commerce and Wells Fargo Economics

Credit Market Insights

Corporate Bonds Signal Optimism

The U.S. economy has shown remarkable resilience in the face of high interest rates. This has been reflected in the corporate bond market, which continues to signal optimism regarding future economic growth. Investors often watch corporate bond spreads to monitor the health of the economy. When economic conditions are uncertain, investors will flee to the safety of U.S. Treasuries at the expense of corporate bonds. As a result, prices of U.S. Treasury securities will rise and yields will fall, while corporate bond prices will fall and yields will rise: the widening of the spreads reflects investor concern and is thus a solid indicator of economic health. So far this year, spreads have been tight, pointing to investor optimism about future economic growth.

In 2024, the spread on high-yield (HY) and investment-grade (IG) corporate bonds averaged 317 bps and 132 bps, respectively. In comparison, HY spreads averaged 790 bps and IG spreads 300 bps in March and April 2020 at the start of the pandemic. Before COVID, the 2015-2019 averages were 438 bps and 151 bps, respectively. In addition, the VIX index, which measures stock market volatility, has remained close to or below its 2015-2019 average of 15.2 in 2024, indicating that investors feel less uncertain about the outlook of the stock market. Overall, the data suggest that market participants remain optimistic about the health of the economy.



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

Recent economic data point to a still-strong economy. April's employment report saw payrolls increasing 175K over the month, showing a still-tight but cooling labor market. The unemployment rate remains near historic lows at 3.9%, and inflation data have stalled on the descent back to 2%. Real final sales to domestic private purchasers rose at a 3.1% annualized rate in Q1, signaling a still-healthy and growing economy. Additionally, consumers continue to spend, especially in the service sector, which rose in Q1 at a rate seldom seen in the past 20 years.

As a result, the Federal Open Market Committee (FOMC) has remained on hold at a federal funds rate of 5.25%-5.50% since July of last year. As discussed in Interest Rate Watch, the FOMC continues to have an upbeat assessment of the economy and needs greater "confidence" that inflation is returning to 2% on a sustained basis before it feels comfortable cutting its target range. We do not anticipate the FOMC gaining this confidence until its Sept. 18 meeting at the earliest. Overall, should we continue to get strong economic data prints, corporate bond spreads are likely to remain tight and continue to signal optimism.

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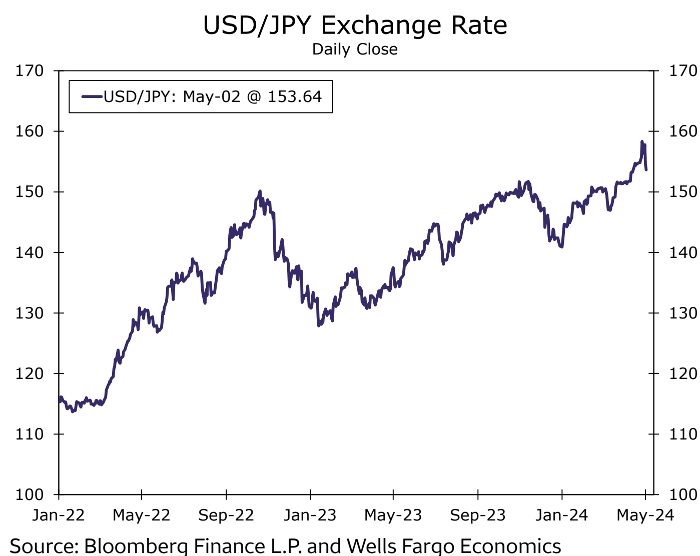
Topic of the Week

Yen Falls to 34-Year Low, Prompting Possible BoJ Intervention

On Monday, the Japanese yen slid to a 34-year low against the dollar, prompting what appeared to be intervention by Japan's Ministry of Finance and central bank (BoJ) to support the beleaguered currency. The USD/JPY exchange rate briefly breached JPY160.00 before rebounding and now sits at JPY152.8 as of this writing. The Ministry of Finance has yet to officially acknowledged the intervention, keeping with tradition of staying tight-lipped on the subject of FX market interventions. Japan's top currency minister, Masato Kanda, was purposefully vague in his comments, stating "I have nothing to say now on whether we intervened in the foreign currency market," and "we will disclose intervention data at the end of this month." That said, the Ministry of Finance has consistently stated its readiness to intervene on behalf of the yen, and BoJ Governor Ueda had telegraphed back in April that an intervention was possible if yen weakness became "too big to ignore".

The Bank of Japan's account activity seemingly confirmed FX intervention. Although we will not know the exact extent of FX intervention until the finance ministry publishes its monthly activity report at the end of May, money market data from the BoJ signaled that liquidity reductions worth tens of billions of dollars occurred on both Monday and Wednesday of this week. Further obfuscating the details is the start of Golden Week, the week-long series of public holidays in Japan during which financial markets in Tokyo are closed, resulting in thin trading of the yen.

The move comes less than two years since the previous intervention to strengthen the yen which commenced in September 2022 when the yen breached JPY145. The yen would ultimately weaken to nearly JPY152 before further intervention in October 2022 reversed the downturn. Japan ultimately spent around $59 billion of FX reserves to prop up the yen in 2022. Monday's slump followed last Friday's BoJ meeting at which it elected to hold interest rates at near zero. Governor Ueda's comments were interpreted as dovish in nature, indicating there was little concern over inflationary pressures tied to the weakening yen and that a near-term monetary policy adjustment is unlikely.



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

In the short term, we do not expect FX intervention to result in a significant yen rebound, but more of a temporary Band-Aid for Japan's currency. A sustained yen rebound would require a considerable change in monetary policy settings from both the Fed and BoJ, adjustments that we do not believe are in the cards in the very near term. Over time, we anticipate a more sustained recovery against the U.S. dollar, a view that is underpinned by a worsening of U.S. economic trends, Fed easing and lower U.S. bond yields, and one more BoJ rate hike toward the end of this year. The prospect of higher-for-longer interest rate policy from the Fed has been the driver of yen weakness so far this year, and the yen is roughly 8% weaker year-to-date against the greenback as of this writing. Meaning, Fed cuts and BoJ tightening should contribute to a reversal of the yen's fortunes around the end of 2024.

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Market Data • Mid-Day Friday

U.S. Interest Rates

	Friday 5/3/2024	1 Week Ago	1 Year Ago
SOFR	5.31	5.31	4.81
Effective Fed Funds Rate	5.33	5.33	4.83
3-Month T-Bill	5.39	5.39	5.18
1-Year Treasury	5.21	5.27	4.44
2-Year Treasury	4.80	4.99	3.80
5-Year Treasury	4.49	4.69	3.30
10-Year Treasury	4.51	4.66	3.34
30-Year Treasury	4.67	4.78	3.68
Bond Buyer Index	4.07	4.07	3.53

Foreign Exchange Rates

	Friday 5/3/2024	1 Week Ago	1 Year Ago
Euro ($/€)	1.077	1.069	1.106
British Pound ($/£)	1.255	1.249	1.256
British Pound (£/€)	0.858	0.856	0.880
Japanese Yen (¥/$)	152.770	158.330	134.710
Canadian Dollar (C$/$)	1.368	1.367	1.362
Swiss Franc (CHF/$)	0.905	0.914	0.884
Australian Dollar (US$/A$)	0.661	0.653	0.667
Mexican Peso (MXN/$)	17.013	17.162	17.928
Chinese Yuan (CNY/$)	7.241	7.245	6.913
Indian Rupee (INR/$)	83.430	83.350	81.830
Brazilian Real (BRL/$)	5.070	5.117	4.995
U.S. Dollar Index	105.024	105.938	101.343

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

Foreign Interest Rates

	Friday 5/3/2024	1 Week Ago	1 Year Ago
3-Month German Govt Bill Yield	3.62	3.61	2.74
3-Month U.K. Govt Bill Yield	5.23	5.24	3.89
3-Month Canadian Govt Bill Yield	4.92	4.93	4.43
3-Month Japanese Govt Bill Yield	0.04	0.04	-0.18
2-Year German Note Yield	2.92	2.99	2.64
2-Year U.K. Note Yield	4.36	4.48	3.77
2-Year Canadian Note Yield	4.17	4.32	3.55
2-Year Japanese Note Yield	0.29	0.29	-0.04
10-Year German Bond Yield	2.50	2.58	2.25
10-Year U.K. Bond Yield	4.22	4.32	3.70
10-Year Canadian Bond Yield	3.65	3.82	2.76
10-Year Japanese Bond Yield	0.90	0.89	0.42

Commodity Prices

	Friday 5/3/2024	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	78.47	83.85	68.60
Brent Crude ($/Barrel)	83.29	89.50	72.33
Gold ($/Ounce)	2298.31	2229.87	2038.97
Hot-Rolled Steel ($/S.Ton)	813.00	821.00	1105.00
Copper (¢/Pound)	456.70	456.40	383.15
Soybeans ($/Bushel)	11.98	11.67	14.33
Natural Gas ($/MMBTU)	2.15	1.61	2.17
Nickel ($/Metric Ton)	18,465	18,994	24,950
CRB Spot Inds.	551.59	557.87	559.11

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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Patrick Barley	Economic Analyst	704-410-1232	Patrick.Barley@wellsfargo.com
Jeremiah Kohl	Economic Analyst	212-214-1164	Jeremiah.J.Kohl@wellsfargo.com
Aubrey George	Economic Analyst	704-410-2911	Aubrey.B.George@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Anna Stein	Economic Analyst	212-214-1063	Anna.H.Stein@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

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