

Weekly — December 20, 2024

Weekly Economic & Financial Commentary

United States: **That's a Wrap**

- The outlook for 2025 is riddled with uncertainty, yet data released this week demonstrate a U.S. economy that retains momentum. Ascertaining what level of policy restraint achieves the careful balance of keeping inflation in check and easing stress on interest-rate sensitive sectors will dominate the monetary policy discussion come 2025.
- Next week:** ISM Manufacturing & Services (Jan 3, 7), Employment (Jan 10)

International: **Brazilian Real Responds to a Lack of Fiscal Credibility**

- The Brazilian real sold off sharply late last week on fiscal deficit worries, and the selloff continued into this week as markets lost more confidence in Brazil's ability to achieve its budget targets. These spending concerns drove Brazil's currency to a new low against the U.S. dollar this week.
- Next week:** Brazilian Policymakers (Mon-Fri), Mexico Inflation (Mon), Turkish Central Bank (Thu)

Interest Rate Watch: **FOMC Cuts Rates, but Pace of Easing Ahead Likely Will Slow**

- As widely expected, the Federal Open Market Committee (FOMC) cut the target range for the federal funds rate by 25 bps at its meeting this week. The FOMC has now cut its target range by 100 bps from its peak of 5.25%-5.50% through moves of 50 bps in September, 25 bps in November and 25 bps on Wednesday.

Credit Market Insights: **Household Net Worth Climbs in Q3 on Strong Equity Markets**

- Household net worth climbed \$4.77 trillion in the third quarter according to data released last week from the Federal Reserve. Net worth has now risen in four consecutive quarters and in seven of the last eight, with strong performance in corporate equities and mutual fund shares doing a lot of the heavy lifting.

Topic of the Week: **Will Federal Government Spending Be Slashed in 2025?**

- The outlays of the federal government totaled roughly \$6.8 trillion in the fiscal year that ended on September 30. With a new president and Congress taking control of Washington D.C. in January, focus has turned to whether significant spending cuts are on the horizon.

Please note that we will not publish a *Weekly Economic & Financial Commentary* on December 27 nor January 3, 2025. We will resume publication of this report on January 10. Happy holidays!

| Wells Fargo U.S. Economic Forecast | | | | | | | | | | | | |
|--|--------|------|------|------|----------|------|------|------|--------|----------|------|------|
| | Actual | | | | Forecast | | | | Actual | Forecast | | |
| | 2024 | | | | 2025 | | | | | 2023 | 2024 | 2025 |
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | | | | |
| Real Gross Domestic Product ¹ | 1.6 | 3.0 | 3.1 | 2.2 | 2.4 | 1.5 | 0.7 | 1.3 | 2.9 | 2.8 | 2.0 | 2.2 |
| Personal Consumption | 1.9 | 2.8 | 3.7 | 2.6 | 2.1 | 2.1 | 1.8 | 1.5 | 2.5 | 2.7 | 2.3 | 2.3 |
| Consumer Price Index ² | 3.2 | 3.2 | 2.6 | 2.7 | 2.6 | 2.6 | 2.9 | 2.8 | 4.1 | 2.9 | 2.7 | 2.7 |
| "Core" Consumer Price Index ² | 3.8 | 3.4 | 3.2 | 3.3 | 3.0 | 2.9 | 3.1 | 3.0 | 4.8 | 3.4 | 3.0 | 2.9 |
| Quarter-End Interest Rates ³ | | | | | | | | | | | | |
| Federal Funds Target Rate ⁴ | 5.50 | 5.50 | 5.00 | 4.50 | 4.25 | 4.00 | 3.75 | 3.75 | 5.23 | 5.13 | 3.94 | 3.75 |
| Conventional Mortgage Rate | 6.82 | 6.92 | 6.18 | 6.80 | 6.65 | 6.45 | 6.25 | 6.30 | 6.80 | 6.68 | 6.41 | 6.34 |
| 10 Year Note | 4.20 | 4.36 | 3.81 | 4.30 | 4.20 | 4.05 | 3.90 | 4.00 | 3.96 | 4.17 | 4.04 | 4.13 |

Forecast as of: December 12, 2024

¹ Compound Annual Growth Rate Quarter-over-Quarter² Year-over-Year Percentage Change³ Quarterly Data - Period End; Annual Data - Annual Averages⁴ Upper Bound of the Federal Funds Target Range

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

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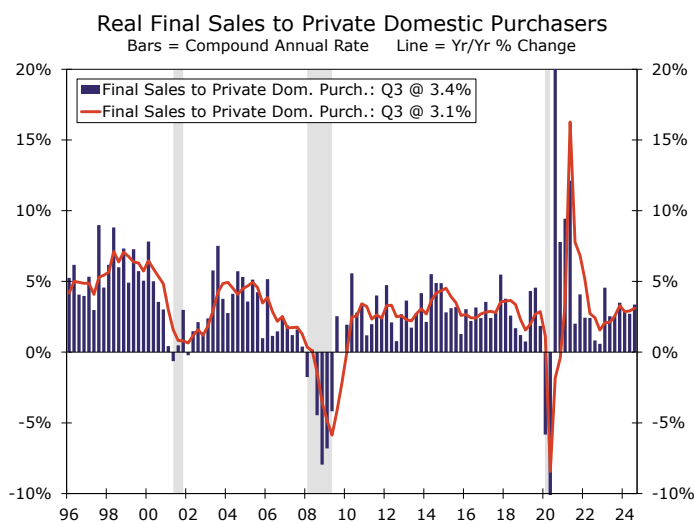
U.S. Review

That's a Wrap

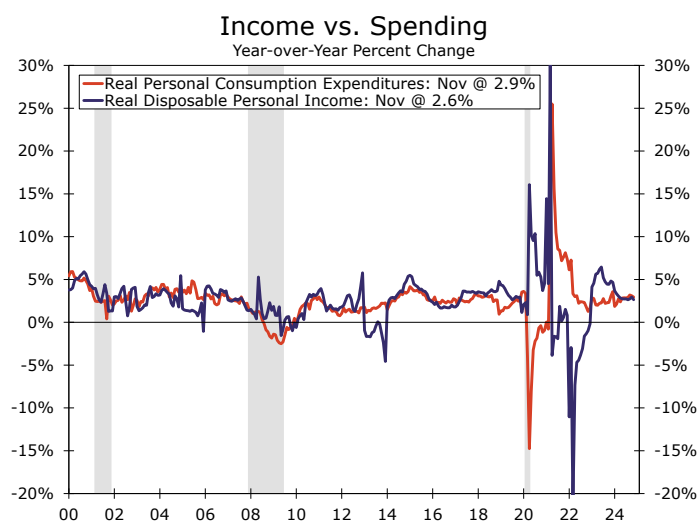
And what a whirlwind it has been. Recession forecasts unwound as consumer spending consistently surprised to the upside and propelled real GDP growth to above-trend paces. The strength in demand has hindered progress on disinflation, exemplified by the PCE deflator inching up a tenth to 2.4% year-over-year in November. While overall inflation remains above the Federal Reserve's 2% target, the FOMC has begun to dial back policy restriction to lend a helping hand to the decelerating labor market. The outlook for 2025 is riddled with uncertainty, yet the data released this week demonstrate a U.S. economy that retains momentum.

The third estimate of real GDP showed output expanding at a 3.1% annualized rate in Q3, up from an initially reported 2.8%. The upward revision stemmed from stronger growth in consumer spending and exports. Real final sales to private domestic purchasers (i.e., the sum of real personal consumption and business investment; a solid gauge for underlying demand) ticked up to 3.1% year-over-year, running ahead of its 2.9% average annual growth over the 2010–2019 economic expansion ([chart](#)). In short, final demand is solid.

Initial data for Q4 illustrate continued resilience. Retail sales rose 0.7% in November, beating expectations for the sixth consecutive month. Our measure of holiday sales—retail sales in November and December excluding auto dealers, gas stations and restaurants—is up 3.5% year-to-date, which is roughly in line with our forecast for a 3.3% annual gain. Separate data show total personal spending, which includes retail goods and services, was 5.5% higher on a year-over-year basis in November, up from 4.5% at the beginning of this year.



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



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

Real consumption growth has begun to outpace income in recent months, but income is still supportive of spending ([chart](#)). Income growth has cooled off as wage growth has ebbed with the deceleration in hiring demand. As discussed in the [U.S. Outlook](#), job growth has moderated considerably since January, which has eased the pressure on employers to hike compensation to attract and retain workers.

Cooling labor cost growth has quelled the labor market's inflationary impulse, but sustained consumption has helped to keep inflation sticky. The core PCE deflator has trended sideways in a tight annual range of 2.6-3.0% throughout 2024. The stalled progress underpinned the FOMC's hawkish signal this week—see the [Interest Rate Watch](#). While the Committee lowered the target range of the federal funds rate by 25 bps to 4.25-4.50%, Chair Powell signaled the FOMC may pause in the next meeting or two. Ascertaining what level of policy restraint achieves the careful balance of keeping inflation in check and easing stress on interest-rate sensitive sectors will dominate the monetary policy discussion come 2025. Until then, happy holidays and on your way out, check out [our favorite charts](#) of the year. ([Return to Summary](#))

U.S. Outlook

Weekly Indicator Forecasts

| Domestic | | | | | |
|----------|----------------------------------|--------|-----------|-------------|-------|
| Date | Indicator | Period | Consensus | Wells Fargo | Prior |
| 23-Dec | Consumer Confidence | Dec | 113 | 112.6 | 111.7 |
| 24-Dec | Durable Goods Orders (MoM) | Nov | -0.3% | -1.0% | 0.3% |
| 24-Dec | Durables Ex Transportation (MoM) | Nov | 0.3% | 0.3% | 0.2% |
| 24-Dec | New Home Sales (SAAR) | Nov | 665K | 657K | 610K |
| 2-Jan | Construction Spending (MoM) | Nov | 0.3% | 0.2% | 0.4% |
| 3-Jan | ISM Manufacturing Index | Dec | 48.5 | 48.6 | 48.4 |
| 3-Jan | Total Vehicle Sales | Dec | 16.5M | 16.5M | 16.5M |

Forecast as of December 20, 2024

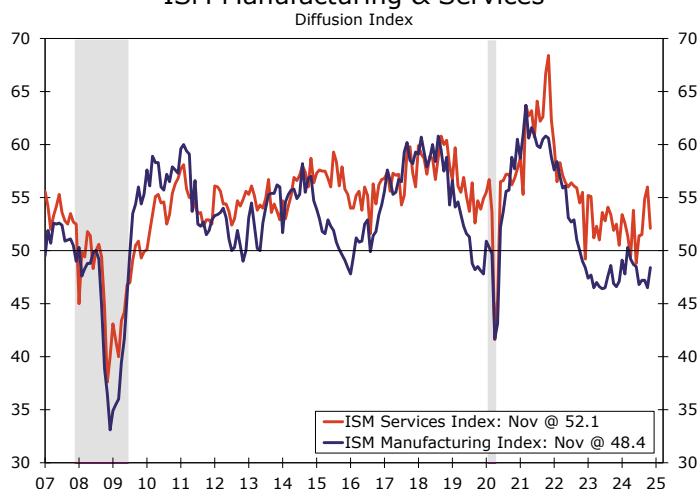
Source: Bloomberg Finance L.P. and Wells Fargo Economics

ISM Manufacturing & Services • January 3 & 7

The ISM Manufacturing Index has been flashing contraction in 25 of the past 26 months as the sector has done little more than tread water the past few years. We expect the ISM to do more of the same in December and look for the index to remain depressed. But better days are still ahead for the manufacturing sector, even if those days look a bit further out than previously expected. Ultimately, uncertainty over the Trump administration's policies, namely around tariffs, will likely keep purchasing managers on their toes and capex plans sidelined for much of next year. Contingency plans may spur a bout of activity as firms pull forward at least some inventory to offset the potential of initial tariff pressure later in the year, but a full recovery still feels a little ways out.

The narrative has been brighter for the service sector. The ISM Services Index pulled back in November, but remains in expansionary territory. It's not a straight shot back to the Fed's target, and the last mile of disinflation is tougher to solve. The challenge confronting policymakers is how to slow growth in the service sector without completely extinguishing it and without keeping policy too restrictive for manufacturing and other rate-sensitive parts of the economy. The services ISM should remain in expansion in December amid somewhat steady demand, and we'll have a close eye on the prices paid component, which has proved sticky in recent months.

ISM Manufacturing & Services



Source: Institute for Supply Management and Wells Fargo Economics

Employment • January 10

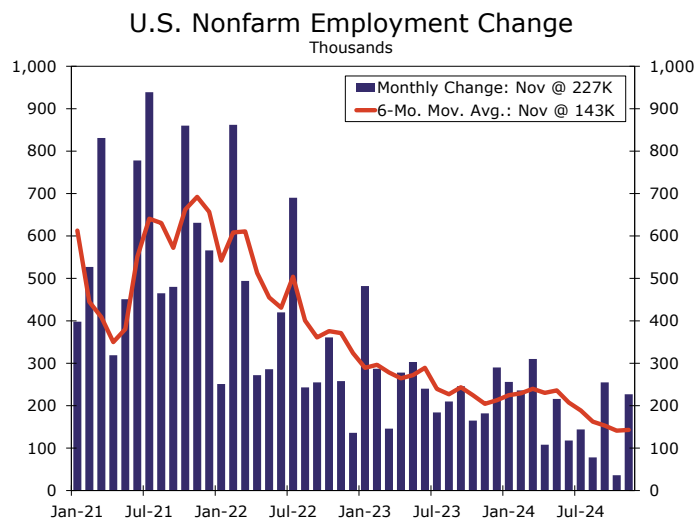
We won't get the December employment report until most of us are back in the full-swing of things on January 10. By that point, we'll likely have refined our forecast a bit on some newly-reported data, but as of now we expect payroll growth for December to revert to its recent trend. Bad weather and worker-strikes have caused volatility in the recent monthly hiring figures. For example, hiring received a boost in November as employers added 227K net new jobs during the month after adding just 36K jobs the month prior due to these one-off factors. In cutting through recent volatility, the job market has clearly moderated in the last year. Over the past six months, nonfarm payroll growth has averaged around 140K per month. At the start of the year that metric was running closer to 220K. The breadth of hiring has also narrowed with only a few industries being responsible for a bulk of hiring in recent months.

Virtually all labor data are consistent with moderation, but what has grown more clear since the summer months is that the deceleration in the labor market is non-linear. In other words, it's not a straight-shot lower. Hiring may be decelerating, but it's not collapsing. And while businesses aren't looking for as many workers as they were, they're not exactly laying off workers in droves either. The number of workers who filed an initial claim for unemployment insurance the week of December 14 (which is the survey week corresponding to the December nonfarm payroll report) fell and remains in line with recent levels. Worker participation has softened somewhat in recent months as the upward trend among prime-age workers (those age 25-54) is showing signs of leveling off in another indication of a cooling jobs market—something we'll be watching in the upcoming release.

This slow-but-steady descent in hiring is part of the recent shift in the Fed's tune at its December policy meeting. Chair Powell emphasized in the post-meeting press conference that the Committee does not feel it needs to see a further softening in the labor market in order to quell inflationary pressure. This is because despite the past two monthly pops in average hourly earnings, wage growth has continued to moderate by most measures and isn't exerting nearly as much pressure on consumer prices. To that end, we expect to see a more trend-like monthly gain in wage growth (~0.2%) in December. Further, as the broad economy continues to hold up and consumers keep spending, it's hard to imagine a broadening out in layoffs consistent with a recession-like pullback in growth. This is to say, the Fed still has some cover on the employment-side of its mandate to focus on stomping out recent stickiness in inflation by taking a slower approach to reducing policy.

We expect to see the pace of hiring move back in line with its recent run rate to end the year. As we think about how hiring is set to progress in the new year, we expect softer demand for new workers and slower growth in the labor supply to lead to a moderation in the pace of monthly net hiring to around 125K and for the unemployment rate to hover around 4.3% next year.

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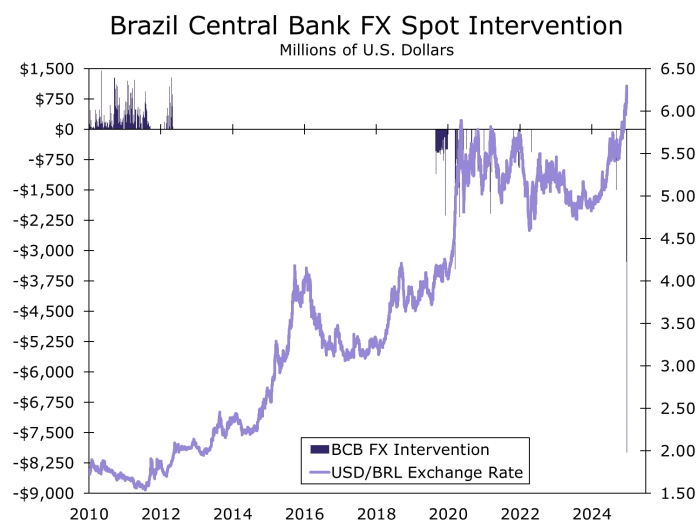
Source: U.S. Department of Labor and Wells Fargo Economics

International Review

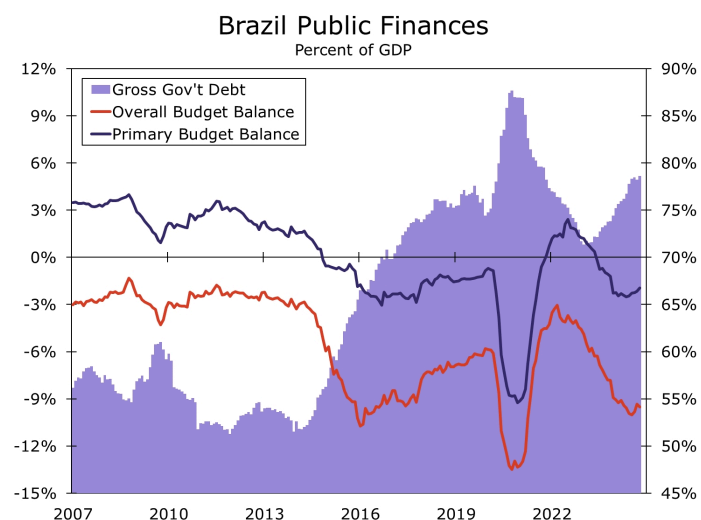
Brazilian Real Responds to a Lack of Fiscal Credibility

Fiscal responsibility in Brazil has been elusive for most of President Lula's administration, and while Brazil has been able to muddle along without major repercussions, local financial markets finally gave in. To that point, the Brazilian real sold off sharply late last week on fiscal deficit worries, and the selloff continued into this week as markets lost more confidence in Brazil's ability to achieve its budget targets. These spending concerns drove Brazil's currency to a new low against the U.S. dollar this week, and while persistent and aggressive central bank FX intervention helped the currency pair losses by Friday, Brazil's currency has settled into a new range. We flagged the possibility of Brazil's markets coming under pressure in August and raised a sharper degree of concern in early November. Underlying our pessimistic outlook was our view that Brazil was entering a period of fiscal dominance. Essentially, a scenario where fiscal spending overpowers the economy and leaves monetary policy all but ineffective. No matter how high the Brazilian Central Bank raised interest rates, we felt the Brazilian currency would be at risk as fiscal dominance took hold. Given the sharp currency selloff this week, we feel more comfortable saying the fiscal dominance scenario has largely unfolded. Fiscal dominance has been a risk in Brazil for decades; however, more often than not, Brazil has been able to pull back from the brink (i.e. full-blown "currency crisis" or sovereign default). While the probability of sovereign default has risen, we believe default is an unlikely outcome. Even a currency crisis à la Argentina or Turkey is unlikely as Brazil has adequate FX reserves, a healthy real interest rate margin as well as an independent central bank with credible monetary policymakers in office.

With that said, we believe the long-term outlook for the Brazilian real is still fraught with challenges. Fiscal dominance is not something that FX intervention cures, and in order to fundamentally restore confidence, the Lula administration will need to deliver a somewhat sizable fiscal adjustment. We have our doubts Lula and his cabinet have the appetite to deliver that fiscal adjustment, especially with presidential and congressional elections around the corner in 2026. Lula's Workers' Party and parties with a left-leaning political agenda performed very poorly in mid-term elections earlier this year. With Lula's approval ratings slipping, and possibly slipping further after the latest currency selloff, Lula may revert to even looser fiscal policy as a means to support his re-election campaign. At least that is our working assumption going forward. The same blueprint that made Lula one of the most popular politicians in Brazil for decades is likely to be deployed once again, which can keep depreciation pressures on the real going forward given the lack of fiscal discipline associated with that political strategy. The chunky FX depreciations from this week may not be the norm going forward, although we believe the Brazilian real will continue to set new lows against the dollar. At the beginning of November we forecast the USD/BRL exchange rate to hit BRL7.00 by early 2026, we reinforced that forecast in our 2025 Outlook, and retain that forecast for the Brazilian real at the current juncture.



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



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

In addition to actions taken from the Brazilian Central Bank, peer emerging market institutions met over the course of this week. FX intervention was a theme that came out of most meetings, with

central banks across EM Asia and EMEA deploying FX reserves to stabilize local currencies. While emerging Asia and most EMEA economies are not experiencing fiscal challenges the way Brazil is, policymakers are responding to an environment of broad U.S. dollar strength that could complicate local efforts to tame inflation. FX intervention was used by Bank Indonesia on multiple occasions this week, while the Philippine central bank and Hungary's central bank also intervened. In our view, FX intervention can be useful in times of market stress; however, intervening in FX markets has diminishing returns over time, not to mention that central banks only have a finite supply of hard currency at their disposal. Depleting, or even drawing down FX reserves below adequate levels, can lead markets to speculate against certain currencies, in turn leading to further depreciation. Point being, FX intervention has limitations, and central banks should operate prudently when deploying hard currency reserves. Also, rather than spend FX reserves, central banks could revert to tighter monetary policy as a way to defend their respective currencies. Trade-off's exist with higher interest rates as well, but tighter monetary policy could be the more impactful and sustainable currency defense mechanism.

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International Outlook

Weekly International Indicator Forecasts

| Date | Indicator | Period | Consensus | Wells Fargo | Prior |
|--------|----------------------------------|--------|-----------|-------------|--------|
| 23-Dec | Mexico Bi-Weekly CPI | 15-Dec | 0.36% | — | -0.12% |
| 23-Dec | Mexico Bi-Weekly CPI (YoY) | 15-Dec | 4.37% | — | 4.55% |
| 26-Dec | Turkish Central Bank Policy Rate | 26-Dec | 48.50% | — | 50.00% |

Forecast as of December 20, 2024

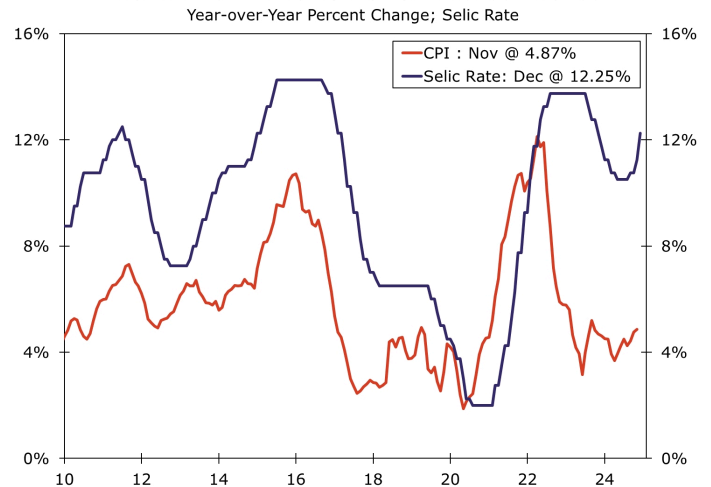
Source: Bloomberg Finance L.P. and Wells Fargo Economics

Brazilian Policymakers • Monday-Friday

While the Brazilian Central Bank does not have a meeting scheduled and the holiday season could introduce scheduling challenges for other policymakers, we will keep an eye out for commentary from local officials addressing the recent volatility in financial markets. Now that the Brazilian real has recovered some losses, we doubt an emergency BCB rate hike will materialize, but would not be surprised if Campos Neto or Galipolo offered comments to reassure markets of financial stability. Also, we would not be totally surprised if President Lula spoke. Following health complications and financial market volatility, Lula may take an opportunity to update Brazil and market participants on his health and offer guidance of budget matters.

As mentioned above, we have our doubts that volatility in Brazil is over. Near-term, the currency may find its footing, but longer-term we would not be surprised to see a repeat of recent volatility. Brazil's fiscal issues are deeply engrained, and fiscal adjustment is necessary. Any signs that fiscal responsibility will not be achieved or pursued would be the catalyst for another bout of volatility.

Brazil IPCA Inflation and Interest Rates



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

Mexico Bi-Weekly Inflation • Monday

Banxico policymakers eased monetary policy this week, opting for a 25 bps rate cut as core inflation has trended lower. Guidance from Mexico's central bank lead markets to believe that, at a minimum, policymakers will continue easing at the 25 bps pace; however, Banxico's statement suggested an increase in the pace of rate reductions could materialize if core inflation continued to trend lower. Next week's bi-weekly inflation print could be a key input into whether Banxico indeed picks up the pace of easing in 2025.

Core inflation is top of mind for Banxico members, and financial markets will be particularly interested if mid-month core inflation ticks lower. A further softening in core inflation, alongside further currency stability, could make Banxico policymakers comfortable enough to deliver 50 bps of easing in the new year. We note, however, the risks that more rapid easing could bring. The Fed is shifting less accommodative, which if Banxico does ease quicker, would result in less favorable interest rate differentials. Also, Mexico is struggling with fiscal discipline as well. A combination of poor public finance management and less attractive rate differentials could weigh on the peso over the longer-term.

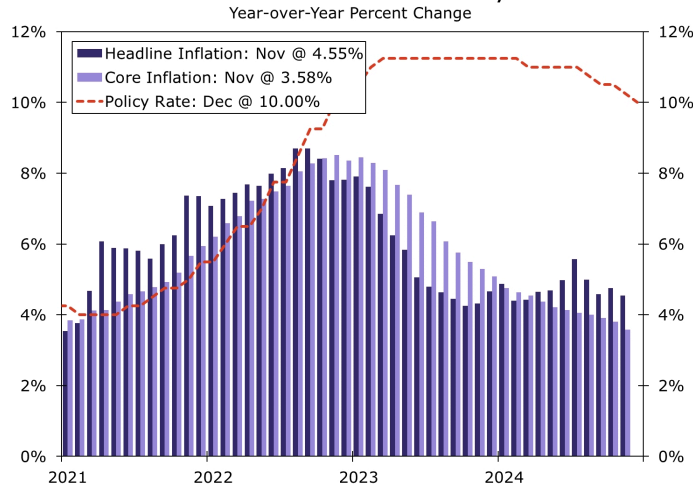
Turkish Central Bank • Thursday

Following presidential elections last year, Turkey's central bank has operated with a newfound degree of independence and orthodoxy. Interest rates have come up significantly and have been held at levels restrictive enough to put inflation on a downward trajectory. Next week, Turkey's monetary authority will meet to assess if monetary policy needs to shift in a more accommodative direction now that inflation trends have improved. Consensus economists believe Turkey's central bank will indeed deliver a rate cut; however, we tend to believe policymakers will operate with more caution and keep interest rates steady next week.

Inflation trends have improved, although recent inflation prints have shown rapid disinflation from here will be somewhat challenging. Also, with the Fed leaning in a less dovish direction this week, Turkish policymakers may see a need to keep policy rates steady in December. When rate cuts are indeed delivered, policymakers are likely to cut in size. 100-200 bps reductions are likely, and that pace of easing is likely to be maintained for most of 2025. Easing of that magnitude raises the possibility of another one-off Turkish lira depreciation, and while we expect the lira to depreciate in 2025, as of now, we think another large selloff can be avoided as markets appreciate Turkey's overall reform story.

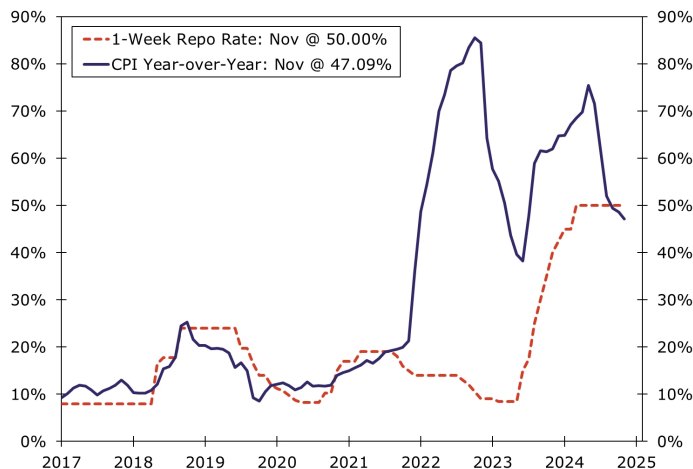
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Mexico CPI Inflation vs. Policy Rate



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

Turkey Policy Rate vs. CPI Inflation



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

Interest Rate Watch

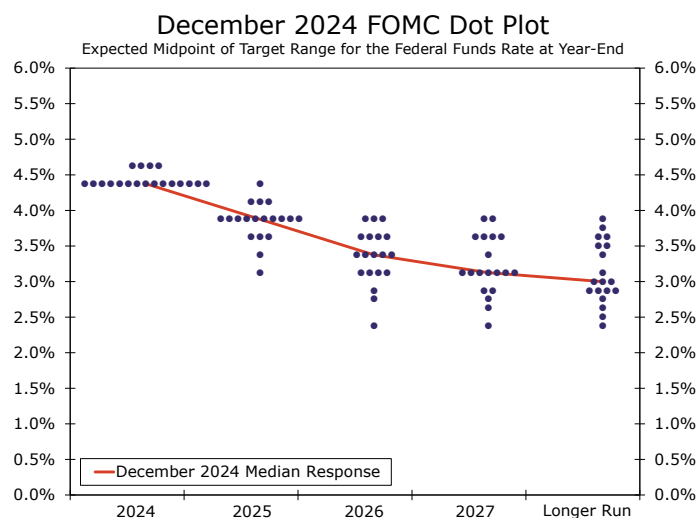
FOMC Cuts Rates, but Pace of Easing Ahead Likely Will Slow

As widely expected, the Federal Open Market Committee (FOMC) cut the target range for the federal funds rate by 25 bps at its meeting this week. The FOMC has now cut its target range by 100 bps from its peak of 5.25%-5.50% through moves of 50 bps in September, 25 bps in November and 25 bps on Wednesday. Though December's cut was not a surprise, we would characterize the decision as a "hawkish" rate cut. For starters, there was a lone dissent from member Beth Hammack, who voted to keep rates on hold. Chair Powell also noted in his post-meeting press conference that the decision was a "closer call" to cut rates by 25 bps than it was in November. Lastly, the Committee made a notable change to its post-meeting statement. In the statement released after the November meeting, the Committee wrote: "In considering additional adjustments to the target range for the federal funds rate..." This clause implied that the FOMC thought last month that it would continue to ease policy in coming months. That clause was changed to the following in Wednesday's statement: "In considering the *extent and timing* (emphasis ours) of additional adjustments to the target range for the federal funds rate..." This rewording of the clause implies to us that the FOMC may now pause in the next meeting or two to ascertain how much additional policy easing may be appropriate.

The FOMC also released its quarterly Summary of Economic Projections (SEP) on Wednesday. As we projected in our recent [Flashlight report](#), the median forecast for real GDP growth in 2025 was revised a touch higher, the unemployment rate forecast for the end of next year edged down from 4.4% in the September SEP to 4.3% in Wednesday's projections, while the core PCE inflation rate for 2025 was pushed up from 2.2% to 2.5%. Accordingly, the median dot in the so-called "dot plot" rose by 50 bps for 2025 to a target range of 3.75%-4.00%. That said, the dots for next year are widely dispersed. The most dovish Committee member thinks that 125 bps of additional easing would be appropriate next year, while the most hawkish member sees no additional rate cuts from today's level. This dispersion may reflect uncertainty surrounding the policy agenda that the incoming Trump administration may pursue in 2025, particularly regarding implications for inflation. The range of forecasts for core PCE inflation widened meaningfully from a range of 2.1%-2.5% in September to 2.1%-3.2% at Wednesday's meeting. Some FOMC members may be assuming that tariff hikes, should they go into effect, will raise inflation next year. (See the [report](#) we wrote in July for further discussion of the macroeconomic effects of tariffs).

In sum, this week's FOMC meeting leads us to believe that, barring some dramatic unexpected development, the Committee likely will keep rates on hold at its next meeting on January 29. However, we believe the FOMC will continue to ease policy next year, albeit at a slower pace than over the past few months. Chair Powell seemed to support this expectation when he noted in his presser that the stance of monetary policy is "significantly closer to neutral" than it was previously, but that policy is "still meaningfully restrictive."

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Source: Federal Reserve Board and Wells Fargo Economics

Credit Market Insights

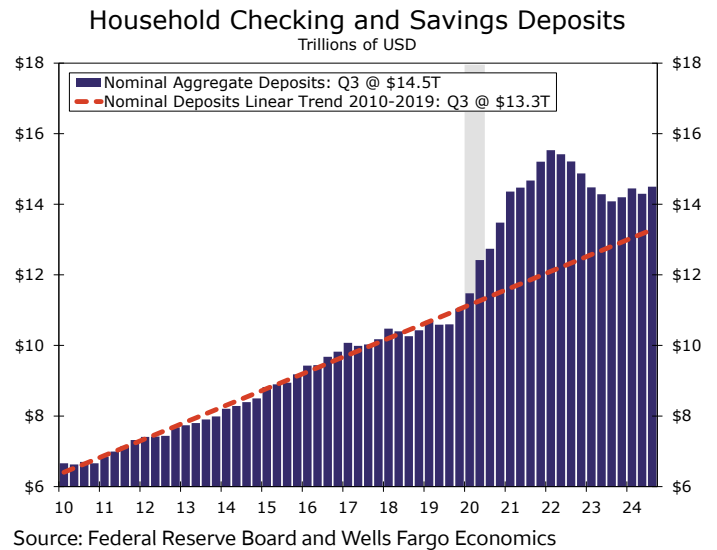
Household Net Worth Climbs in Q3 on Strong Equity Markets

Household net worth climbed \$4.77 trillion in the third quarter according to data released last week from the Federal Reserve. Net worth has now risen in four consecutive quarters and in seven of the last eight. The trend in recent quarters has been positive, with net worth hitting a fresh all-time high of \$168.8 trillion. Household net worth is now an astounding 44% higher than it was prior to the onset of the pandemic. Net worth had surged during 2020 and 2021 in the wake of stimulus and a strong rebound in equity prices that ensued after the onset of the pandemic. The decline in stock prices in 2022 and an increase in home mortgage liabilities dragged net worth lower throughout the year, before it began to climb again with the support of rising stock prices.

The biggest driver of the increase in household net worth was large increases in the value of corporate equities and mutual fund shares, which added \$3.81 trillion, or nearly 80% of the total gain in the third quarter. Debt securities and the other assets contributed \$557 million and \$59 million, respectively. The only category that was down on the quarter was real estate, which subtracted \$195 million. Further, household liquidity remained in a good place, with household checking and savings balances sitting at \$14.5 trillion in the third quarter. This leaves household liquidity \$1.2 trillion above where it would be expected to be based on its 2010–2019 trend. Even as liquidity is elevated compared to pre-pandemic, cash as-a-share of total assets has fallen to the lowest level since 2008. While we don't expect liquidity is still a driving force behind spending, these reserves speak to the still-healthy financial position of households.

Looking ahead, the Federal Reserve will be releasing the Q3-2024 Distributional Financial Accounts within the next month. This important release will provide a more in-depth look at how the aggregate gains in household net worth were distributed across the income and wealth spectrum, in addition to providing more detail on how assets and liabilities evolved over the quarter. This release will be an important pulse check for households. We expect vulnerabilities may be mounting for lower wealth and income cohorts.

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Topic of the Week

Will Federal Government Spending Be Slashed in 2025?

The outlays of the federal government, which were less than \$2 trillion at the turn of the 21st century, totaled roughly \$6.8 trillion in the fiscal year (FY) that ended on September 30. The size of the U.S. economy also has grown significantly over that period, but even so the federal spending-to-GDP ratio is roughly six percentage points higher today than in 2000. With a new president and Congress taking control of Washington D.C. in January, focus has turned to whether significant spending cuts are on the horizon.

In our view, meaningful reductions in federal outlays are simply hard to come by given political promises and realities. Of the \$6.8 trillion spent in FY 2024, \$950 billion went just to financing the public debt. We consider these outlays untouchable since reduction would necessitate Treasury to default, which likely would lead to another global financial crisis. To reduce interest costs, policymakers first will need to reduce the deficit (i.e., curtail spending growth or generate additional tax revenues).

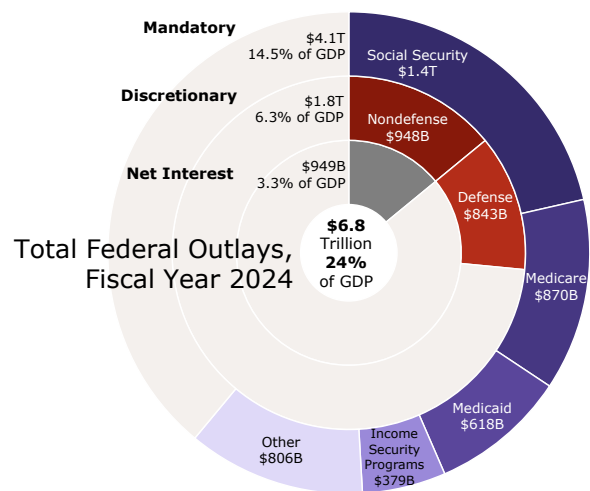
Roughly \$4.1 trillion of outlays last fiscal year fell into the “mandatory” spending category, meaning that the spending is determined by permanent laws and eligibility rules and occurs largely on “autopilot” each year. For example, Social Security, Medicare and Medicaid payments are determined by the number of people eligible (e.g, by age or income) to participate in the programs. Just these three programs accounted for ~40% of total spending in FY 2024. Pressures from powerful voting blocs—like senior citizens—make taking an ax to these popular programs difficult, and spending on these programs will likely continue to climb in the years ahead amid an aging population and rising health care costs. Other mandatory spending programs, such as those for veterans benefits or retirement benefits for federal employees and former members of the military, may be equally hard to reduce.

That leaves the roughly \$1.8 trillion worth of discretionary spending that the federal government undertook in FY 2024. Half of this was spent on national defense. Defense spending amounted to 3.0% of GDP in FY 2024, more or less a 50-year low. Heightened geopolitical tensions and a push to rebuild the defense industrial base stand out as upward pressures to defense spending in the near term. The nondefense discretionary side of the budget encompasses many operations and services that would jump to mind when thinking of government activities, such as air traffic control, NASA, FEMA, the IRS, etc. Like defense discretionary spending, nondefense discretionary spending as-a-share of GDP is near the lows of the past 50 years, suggesting sizable cuts may be hard to come by.

Of course, this is not to say that budget cuts are impossible or that they cannot be done. There are plenty of [ideas](#) and [options](#) from nonpartisan sources for reducing the federal budget deficit. Increasing efforts to combat fraud could be a particularly palatable avenue—intentional efforts to defraud the federal government and misuse taxpayer dollars clearly are not popular regardless of one's political views. That said, reducing fraudulent payments to zero would not be nearly enough to single-handedly put the federal government on a fiscally sustainable path. That would require making tradeoffs, and it is up to elected officials to make those decisions.

The tradeoffs and complexity of reaching consensus on budget-related issues were on full display this week as what looked to be a drama-free stop-gap bill to avert a government shutdown has turned into a down-to-the-wire budget showdown. As we go to print, the situation has yet to have been resolved. Unless a continuing resolution (CR) is passed to temporarily fund the government, any unfunded federal agencies will discontinue non-essential functions starting at midnight tonight. We do not expect the shutdown—if it comes to pass—to be prolonged, but an extended shutdown is a possibility.

[\(Return to Summary\)](#)



Source: Congressional Budget Office and Wells Fargo Economics
Based on CBO preliminary estimates when possible, otherwise from June projections and Wells Fargo Economics calculations.

Market Data • Mid-Day Friday

| U.S. Interest Rates | | | |
|--------------------------|----------------------|---------------|---------------|
| | Friday 12/20/2024 | 1 Week Ago | 1 Year Ago |
| SOFR | 4.30 | 4.62 | 5.31 |
| Effective Fed Funds Rate | 4.33 | 4.58 | 5.33 |
| 3-Month T-Bill | 4.33 | 4.32 | 5.38 |
| 1-Year Treasury | 4.33 | 4.29 | 4.54 |
| 2-Year Treasury | 4.30 | 4.24 | 4.33 |
| 5-Year Treasury | 4.36 | 4.25 | 3.84 |
| 10-Year Treasury | 4.51 | 4.40 | 3.85 |
| 30-Year Treasury | 4.70 | 4.60 | 3.99 |
| Bond Buyer Index | 4.10 | 4.01 | 3.37 |

| Foreign Exchange Rates | | | |
|------------------------------|----------------------|---------------|---------------|
| | Friday 12/20/2024 | 1 Week Ago | 1 Year Ago |
| Euro (\$/€) | 1.041 | 1.050 | 1.094 |
| British Pound (\$/£) | 1.257 | 1.262 | 1.264 |
| British Pound (£/€) | 0.828 | 0.832 | 0.866 |
| Japanese Yen (¥/\$) | 156.360 | 153.650 | 143.570 |
| Canadian Dollar (C\$/)\$) | 1.437 | 1.423 | 1.337 |
| Swiss Franc (CHF/\$) | 0.894 | 0.893 | 0.863 |
| Australian Dollar (US\$/A\$) | 0.625 | 0.636 | 0.673 |
| Mexican Peso (MXN/\$) | 20.098 | 20.126 | 17.146 |
| Chinese Yuan (CNY/\$) | 7.296 | 7.274 | 7.139 |
| Indian Rupee (INR/\$) | 85.021 | 84.796 | 83.180 |
| Brazilian Real (BRL/\$) | 6.084 | 6.056 | 4.915 |
| U.S. Dollar Index | 107.876 | 107.003 | 102.408 |

| Foreign Interest Rates | | | |
|----------------------------------|----------------------|---------------|---------------|
| | Friday 12/20/2024 | 1 Week Ago | 1 Year Ago |
| 3-Month German Govt Bill Yield | 2.48 | 2.19 | 3.60 |
| 3-Month U.K. Govt Bill Yield | 4.72 | 4.71 | 5.23 |
| 3-Month Canadian Govt Bill Yield | 3.12 | 3.15 | 5.04 |
| 3-Month Japanese Govt Bill Yield | 0.13 | 0.15 | -0.19 |
| 2-Year German Note Yield | 2.03 | 2.07 | 2.47 |
| 2-Year U.K. Note Yield | 4.37 | 4.31 | 4.12 |
| 2-Year Canadian Note Yield | 3.05 | 3.02 | 3.90 |
| 2-Year Japanese Note Yield | 0.58 | 0.57 | 0.05 |
| 10-Year German Bond Yield | 2.29 | 2.26 | 1.97 |
| 10-Year U.K. Bond Yield | 4.52 | 4.41 | 3.53 |
| 10-Year Canadian Bond Yield | 3.28 | 3.18 | 3.06 |
| 10-Year Japanese Bond Yield | 1.06 | 1.04 | 0.56 |

| Commodity Prices | | | |
|-----------------------------|----------------------|---------------|---------------|
| | Friday 12/20/2024 | 1 Week Ago | 1 Year Ago |
| WTI Crude (\$/Barrel) | 69.34 | 71.29 | 74.22 |
| Brent Crude (\$/Barrel) | 72.82 | 74.49 | 79.70 |
| Gold (\$/Ounce) | 2623.94 | 2648.23 | 2031.39 |
| Hot-Rolled Steel (\$/S.Ton) | 678.00 | 675.00 | 1074.00 |
| Copper (¢/Pound) | 403.95 | 414.90 | 390.15 |
| Soybeans (\$/Bushel) | 9.68 | 9.93 | 13.00 |
| Natural Gas (\$/MMBTU) | 3.64 | 3.28 | 2.45 |
| Nickel (\$/Metric Ton) | 14,883 | 15,941 | 16,517 |
| CRB Spot Inds. | 539.84 | 545.85 | 542.10 |

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

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| | | | |
|----------------------|--------------------------|--------------|-------------------------------------|
| 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 |
| Jeremiah Kohl | Economic Analyst | 212-214-1164 | Jeremiah.J.Kohl@wellsfargo.com |
| Aubrey Woessner | Economic Analyst | 704-410-2911 | Aubrey.B.Woessner@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 |
| Ali Hajibeigi | Economic Analyst | 212-214-8253 | Ali.Hajibeigi@wellsfargo.com |
| Coren Miller | Administrative Assistant | 704-410-6010 | Coren.Miller@wellsfargo.com |

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