

Economics Group

Weekly Economic & Financial Commentary

U.S. Review

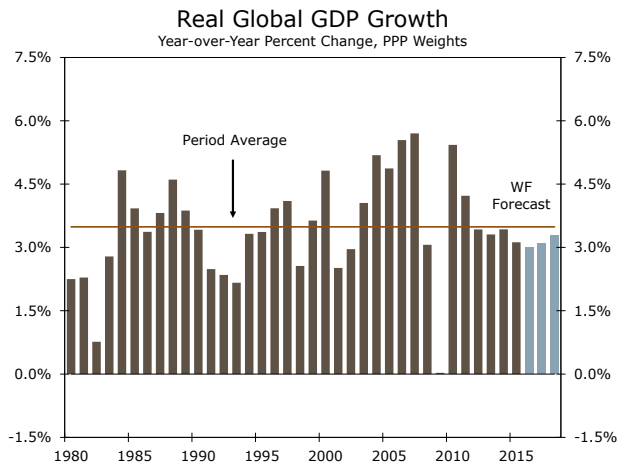
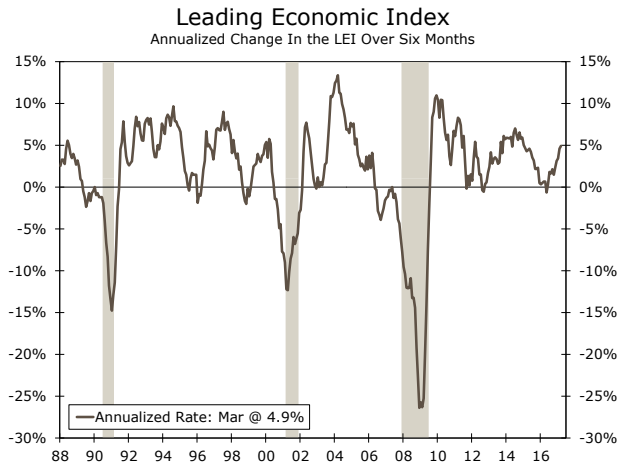
The Expansion Plods Along in a Quiet Data Week

- Housing market data were generally mixed this week, with builder confidence and housing starts declining while existing home sales rose.
- Despite a healthy 0.5 percent increase in industrial production in March, the devil was in the details. The largest surge in utilities output on record masked a decline in manufacturing production.
- The Leading Economic Index (LEI) posted another broad-based gain in March. Our recession forecasting model, which heavily incorporates the LEI, shows a very small chance of a recession in the next six months.

Global Review

It's Official: The Global Economy Is Improving

- The latest IMF global forecast just confirmed what we have been observing for almost half a year: that the global economy was on the mend and that we expect an improvement in economic growth across the world. The IMF's forecast for this year is now 3.5 percent versus 3.1 percent for 2016.
- The Chinese economy grew at a 6.9 percent rate in the first quarter of the year, year over year, a tad higher than what markets were expecting and is the third consecutive improvement in a similar number of quarters.



Wells Fargo U.S. Economic Forecast													
	Actual 2016				Forecast 2017				Actual			Forecast	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2014	2015	2016	2017	2018
Real Gross Domestic Product ¹	0.8	1.4	3.5	2.1	0.8	2.9	2.6	2.3	2.4	2.6	1.6	2.1	2.5
Personal Consumption	1.6	4.3	3.0	3.5	1.1	2.7	2.5	2.4	2.9	3.2	2.7	2.5	2.7
Inflation Indicators ²													
PCE Deflator	0.9	1.0	1.0	1.4	2.0	1.9	2.0	2.0	1.5	0.3	1.1	2.0	2.2
Consumer Price Index	1.1	1.1	1.1	1.8	2.7	2.4	2.5	2.4	1.6	0.1	1.3	2.5	2.4
Industrial Production ¹	-1.3	-0.7	0.8	0.8	2.2	3.2	2.4	2.4	3.1	-0.7	-1.2	1.8	2.4
Corporate Profits Before Taxes ²	-6.6	-4.3	2.1	9.3	3.8	3.6	3.2	3.1	5.9	-3.0	-0.1	3.4	2.9
Trade Weighted Dollar Index ³	89.8	90.6	90.0	95.8	94.0	96.3	97.0	99.3	78.4	91.1	91.6	96.6	97.4
Unemployment Rate	4.9	4.9	4.9	4.7	4.7	4.6	4.6	4.5	6.2	5.3	4.9	4.6	4.5
Housing Starts ⁴	1.15	1.16	1.14	1.25	1.26	1.24	1.26	1.27	1.00	1.11	1.17	1.26	1.35
Quarter-End Interest Rates ⁵													
Federal Funds Target Rate	0.50	0.50	0.50	0.75	1.00	1.25	1.50	1.50	0.25	0.27	0.52	1.31	1.88
Conventional Mortgage Rate	3.69	3.57	3.46	4.20	4.20	4.29	4.45	4.46	4.17	3.85	3.65	4.35	4.53
10 Year Note	1.78	1.49	1.60	2.45	2.40	2.55	2.72	2.75	2.54	2.14	1.84	2.61	2.84

Forecast as of: April 12, 2017
¹ Compound Annual Growth Rate Quarter-over-Quarter
² Year-over-Year Percentage Change
³ Federal Reserve Major Currency Index, 1973=100 - Quarter End
⁴ Millions of Units
⁵ Annual Numbers Represent Averages

Source: U.S. Department of Commerce, U.S. Department of Labor, Federal Reserve Board, IHS Global Insight, The Conference Board and Wells Fargo Securities

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Together we'll go far



U.S. Review

The Expansion Plods Along in a Quiet Data Week

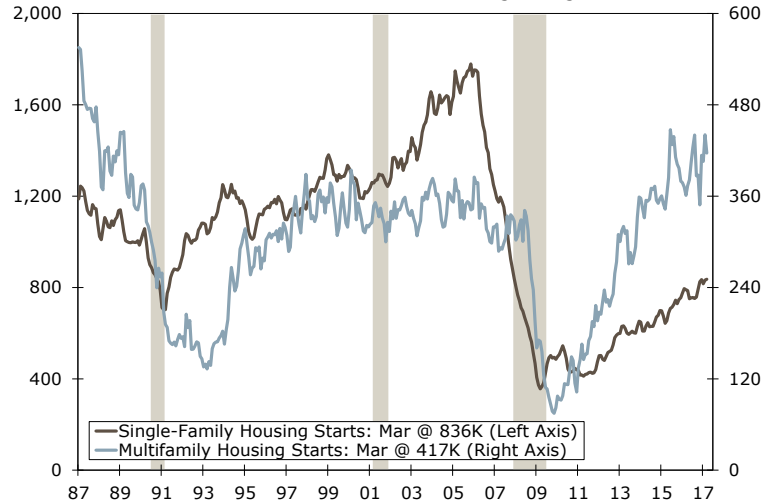
Housing market data released this week were generally mixed but continued to improve on trend. The NAHB/Wells Fargo Housing Market Index fell three points in April from its cycle-high in March. Despite the pullback, confidence remains relatively high; the present sales index has trended above 70 for five consecutive months, signaling strong demand for new homes. Housing starts also dipped, falling 6.8 percent in March, but this decline came on the heels of an unusually strong February reading that was likely boosted by unseasonably warm weather. On balance, the spring construction season got off to a strong start to the year, as starts are up 8.1 percent through the first three months of the year compared to 2016. Further evidence of strength in the housing market could be seen in the existing home sales data released on April 21, which topped expectations. Sales at home improvement stores have also been solid of late and should boost residential construction's contribution to GDP growth in Q1.

The industrial production data for March suggested the factory sector's recovery took a breather last month. On the surface, the strong 0.5 percent gain in industrial production suggests a continued acceleration in activity. However, the largest surge in utilities output on record played an outsized role in the gain. After the second-warmest February on record led to a 5.8 percent decline utilities production, temperatures in the lower 48 returned to more seasonal norms in March. At about 11 percent of the total index, utilities alone boosted the headline by 0.9 percentage points.

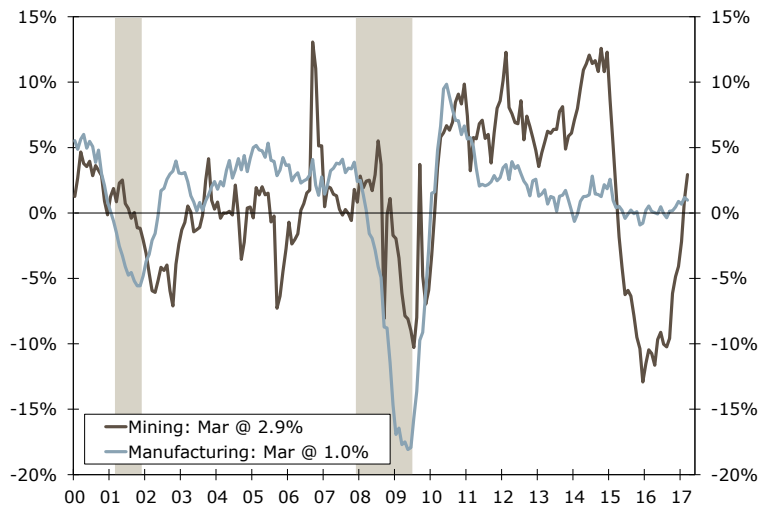
Outside of utilities, mining production rose 0.1 percent over the month, with output for oil and gas extraction leading the way with a nearly 8 percent gain. Although far from recovered, the mining sector is headed in the right direction after the steep decline that began in late 2014 (middle chart). Manufacturing output, which comprises about three-fourths of the total index, fell 0.4 percent. Weak auto sales and rising inventories led producers to pullback on motor vehicle and parts production, which declined 3 percent. While the latest data suggest some cooling, we still look for manufacturing output to expand in the coming months. A pause in the dollar's appreciation, more stable commodity prices and a brightening global outlook all bode well for continued improvement in the factory sector.

The Leading Economic Index (LEI) notched a healthy 0.4 percent gain in March. Strong new orders in the ISM Manufacturing Index, robust consumer confidence, rising building permits and additional equity market gains boosted the index and point to steady economic growth ahead. Our primary recession forecasting model uses the LEI as a main component. As illustrated in the bottom chart, the probability of a recession in the next six months has fallen from the brief spike that occurred in early 2016. When the advance release for Q1 real GDP growth comes out next week, we anticipate a soft but positive reading, followed by a pick-up in growth in the subsequent quarter. Thus, for now at least, the economic expansion continues to plod along.

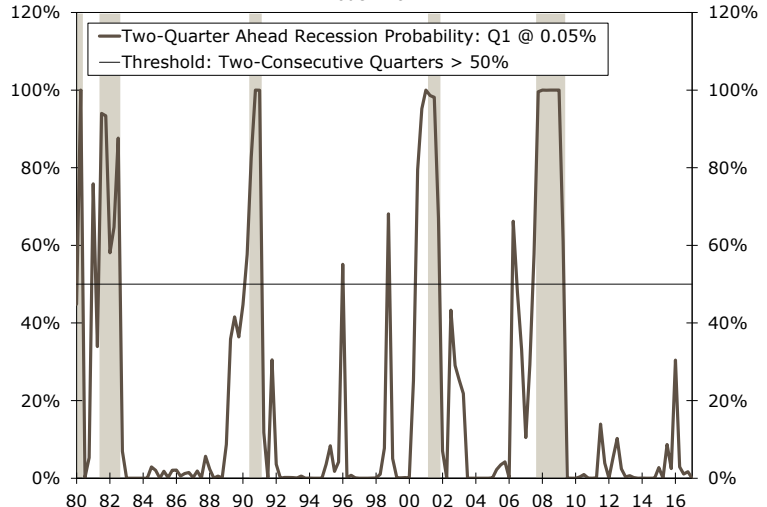
Single & Multifamily Housing Starts
SAAR, In Thousands, 3-Month Moving Average



Mining vs. Manufacturing Production
Year-over-Year Percent Change



Recession Probability Based on Probit Model
Model with LEI



Source: U.S. Department of Commerce, Federal Reserve Board and Wells Fargo Securities

New Home Sales • Tuesday

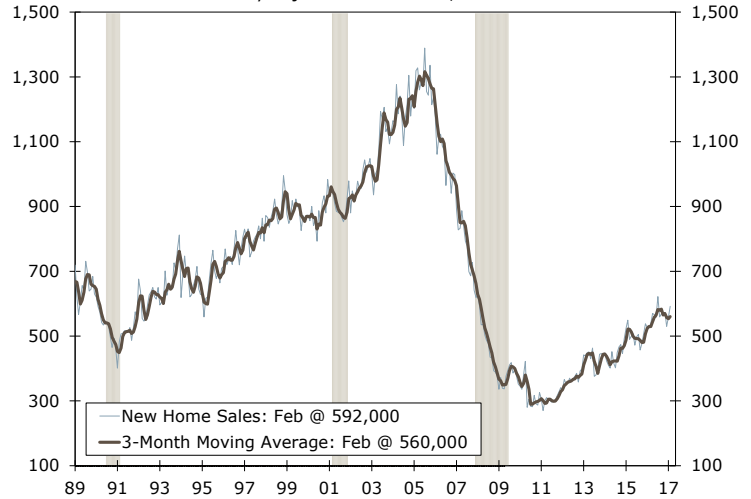
New home sales rose for the second straight month in February as milder-than-usual weather helped pull activity forward, with the level reaching a seven-month high. Despite the still-elevated level of builder sentiment, sales activity is expected to cool in March as the return to more typical winter weather conditions likely stalled activity. Moreover, since new home sales are registered when the contract is signed, light foot traffic during the seasonally-slow period of the year likely impeded activity. Median home prices fell relative to the previous year in February, while mean prices posted a double-digit gain. Indeed, the gap between the level of median and mean prices was the widest on record as activity was concentrated at the high end of the market. In fact, sales for homes more than \$400,000 rose more than 23 percent year over year, while homes priced below the threshold increased just 3 percent. Builders have now turned their sights to lower-priced homes.

Previous: 592K

Wells Fargo: 578K

Consensus: 588K

New Home Sales
Seasonally Adjusted Annual Rate, In Thousands



Durable Goods • Thursday

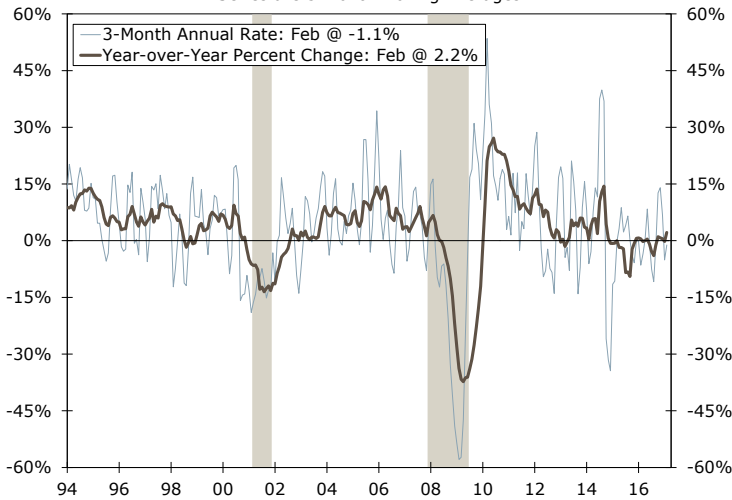
Following two straight monthly declines in November and December, orders for durable goods rebounded in January and February. However, much of the headline increase was concentrated in the volatile nondefense aircraft component, which still reflects the surge in orders booked in December. That said, Boeing booked 147 orders (mostly lower priced 737s) in March, which should further lift the headline reading. Similar to the December spike in civilian aircraft orders, we would not be surprised to see headline activity increase over the course of a couple of months. In contrast to strong aircraft orders, vehicle orders will likely be weak. The expected pullback in vehicle orders is consistent with elevated inventories and lackluster production, retail and unit sales. Excluding transportation, the three-month annual rate posted a strong reading in February, suggesting upside risks in the coming months.

Previous: 1.8%

Wells Fargo: 1.1%

Consensus: 1.5%

Durable Goods New Orders
Series are 3-Month Moving Averages



First Quarter GDP • Friday

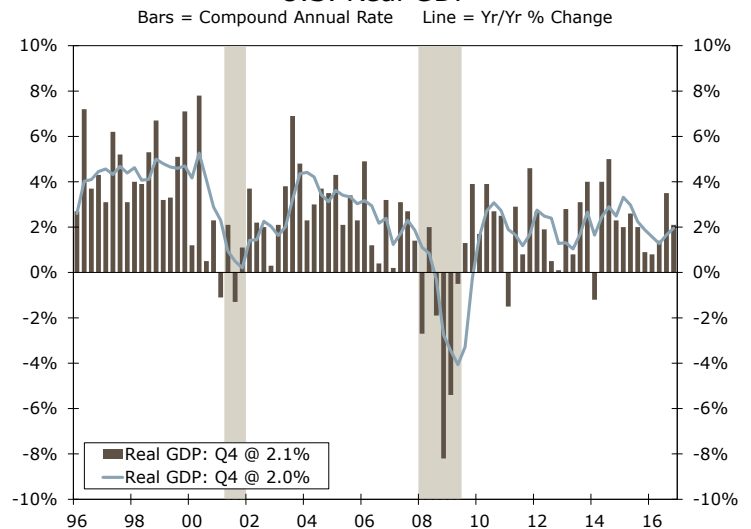
Consistent with the last three first quarter advanced readings, real GDP is expected to register a sub-trend pace of growth. Much of the slower pace will be concentrated in consumer spending due largely to one-off factors like milder-than-usual weather in January and February, which cut utility use and tax refund delays. That said, control-group sales, which exclude food, autos, building materials and gasoline sales, rose at a 4.1 percent three-month annual rate in March suggesting still-solid underlying growth. International trade will also pull the headline lower as the earlier timing of the Chinese New Year led to a surge in imports in January. We also expect state and local government purchases to post a weak reading. On a positive note, business fixed investment should advance as the drag from the earlier collapse in oil prices continues to dissipate. Indeed, nondefense capital goods excluding aircraft shipments rose at an 8.8 percent three-month annual pace in February.

Previous: 2.1%

Wells Fargo: 0.8%

Consensus: 1.2%

U.S. Real GDP



Source: U.S. Department of Commerce, NAHB and Wells Fargo Securities

Global Review

It's Official: The Global Economy Is Improving

The latest IMF global forecast just confirmed what we have been observing for almost half a year: that the global economy was on the mend and that we expect an improvement in economic growth across the world. The IMF's forecast for this year is now 3.5 percent versus 3.1 percent for 2016.

Of course, this new growth spurt will likely not be similar to the ones we had during the first decade and a half of this century, but it will nevertheless help to lift almost all boats across the globe. Some of the first signs of this recovery have been evident for some time, and while there are still many, many threats that could jeopardize the current growth spurt, we remain confident that the global economy is on the right path.

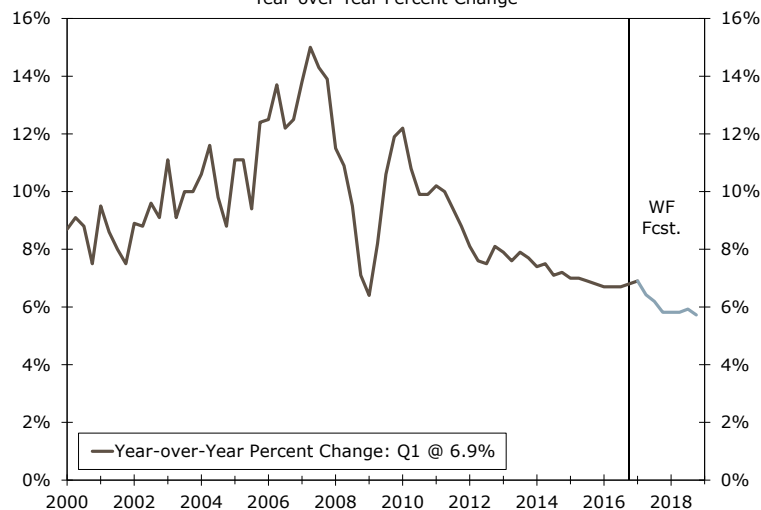
Again, and even against lots of negative talk regarding trade, especially in the United States, trade is what is actually leading the growth charge across the global economy. And China, while not acting as the behemoth that helped drive growth across the globe during the first decade and a half of this century, is showing that it can still contribute its share to the effort. Case in point was the release of first quarter GDP, which showed an economy growing at a slightly higher clip than what markets were expecting, up 6.9 percent versus market expectations of 6.8 percent. Not much different but it is the third slight improvement in growth in a similar number of quarters.

In our international section last week, we mentioned the strong performance by Chinese trade in March as well as the slight improvement in international reserves during the first quarter of the year and indicated that these were encouraging signs of economic growth solidifying across the world.

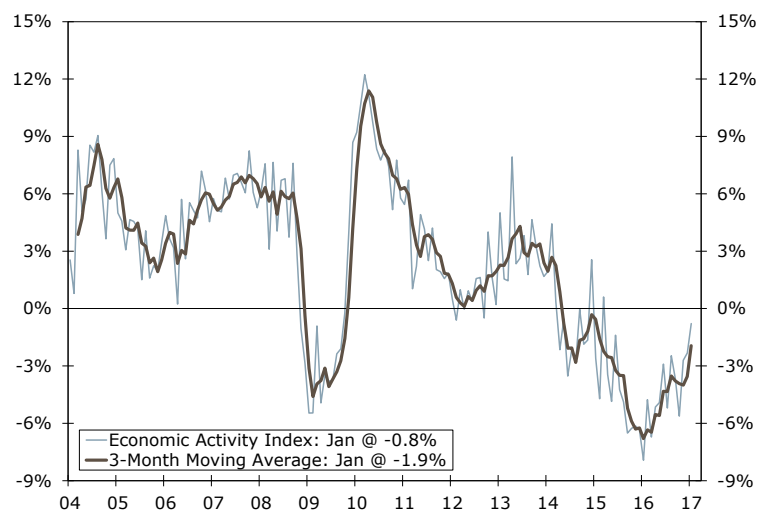
Even Brazil seems to have been doing better lately. The Brazilian monthly economic activity index in February posted the strongest month-over-month print, up 1.3 percent, since July 2014 when it grew 1.5 percent. On a year-earlier basis, the economy was still down 0.7 percent, but markets were expecting a decline of 2.3 percent. This release followed the central bank's decision last week to decrease the Selic, benchmark interest rate 100 bps, from 12.25 percent to 11.25 percent, while indicating that it would continue to lower interest rates aggressively during the next several months due to the strong disinflationary path for Brazilian inflation and inflationary expectations. Still, the political corruption situation in Brazil is a potential threat to the recovery in economic activity this year, but the fact that the economy is coming from such a low base will keep the good news coming and will help deliver low but positive growth in 2017.

In the U.K., Prime Minister Theresa May surprised markets with a call for early elections, a strategy that analysts expect to give her administration more power in the negotiations with the European Union on the terms of the U.K. exit from that union. Meanwhile, in Turkey, President Recep Tayyip Erdogan won a contested referendum to reform the country's constitution that many say will enhance his presidential powers and are calling it the beginnings of a dictatorship.

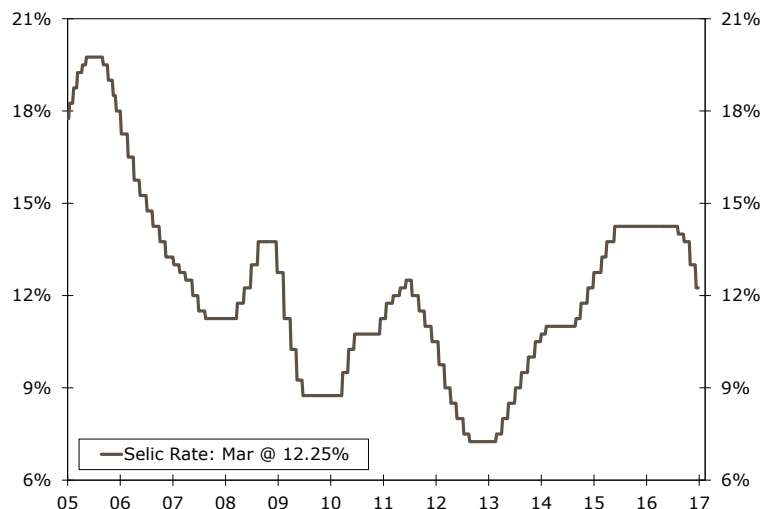
Chinese Real GDP Forecast
Year-over-Year Percent Change



Brazilian Economic Activity Index
Year-over-Year Percent Change



Brazilian Central Bank Policy Rate
Percent



Source: IHS Global Insight, Bloomberg LP and Wells Fargo Securities

ECB Policy Meeting • Thursday

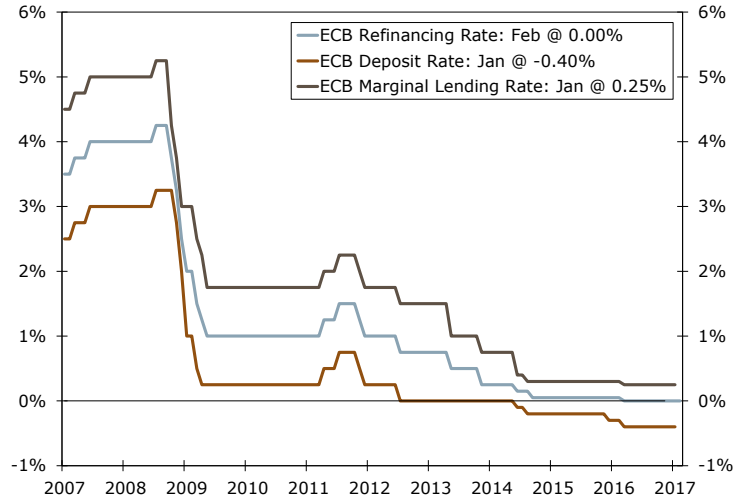
The European Central Bank (ECB) holds a regularly scheduled policy meeting on Thursday, and there is very little chance that the Governing Council will change its three main policy rates. Some analysts look for the Governing Council to announce some changes to its quantitative easing program that would take effect in coming months. Although we suspect that the ECB will eventually begin to “taper” its monthly bond purchases, we do not believe that it is quite ready to announce such a step at this policy meeting.

There is also a fair amount of European economic data on the docket next week. In Germany, the Ifo index of business confidence in April is to print on Monday, while retail spending data for March could be released on Friday. The initial estimate of French GDP growth in the first quarter is on the docket on Friday as well. Italian data on business and consumer confidence are slated for release on Friday.

Previous Refi Rate: 0.00% Wells Fargo: 0.00%

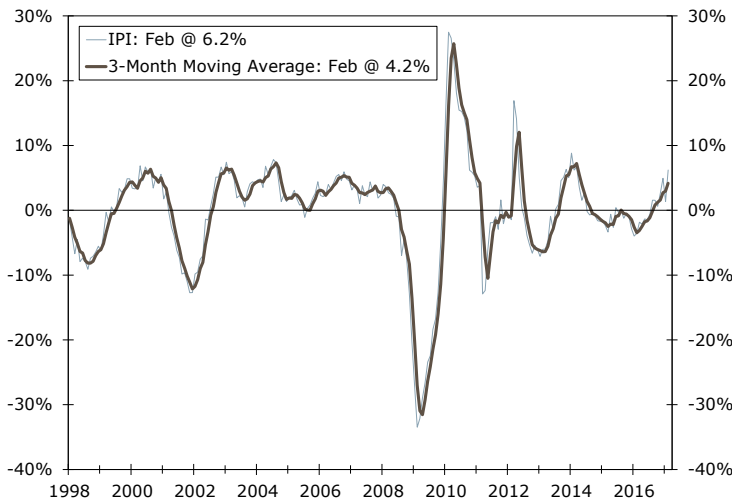
Consensus: 0.00%

ECB Policy Rates



Japanese Industrial Production Index

Year-over-Year Percent Change, Seasonally Adjusted



Japan Industrial Production • Friday

The usual end-of-month data barrage in Japan is expected to occur next week, and the data for March should help analysts firm up their GDP growth estimates for the first quarter. The initial official estimate of Q1 GDP growth is to be released by the Japanese government on May 18.

Global economic activity has accelerated a bit in recent months, which has helped to boost Japanese exports and Japanese industrial production (IP). Indeed, Japanese IP is currently growing at its strongest rate since 2014. March data on retail spending, the labor market and CPI inflation will print as well next week. The Bank of Japan (BoJ) also holds a policy meeting next week. But with the current rate of CPI inflation barely above zero percent at present, there is little chance that the BoJ will dial back its degree of monetary accommodation anytime soon, let alone next week.

Previous: 3.2% (Month-over-Month)

Consensus: -0.8%

U.K. GDP Growth • Friday

Real GDP growth in the United Kingdom has held up better in the wake of last June’s Brexit referendum, better than most analysts, ourselves included, had expected. That said, recent monthly data suggest that the economy decelerated in the first quarter. The rise in inflation in recent months has eroded growth in real income, which has weighed on consumer spending. In that regard, real retail sales in the first quarter fell 1.6 percent on a sequential basis. However, positive growth in the consumption of services likely means that overall consumer spending growth probably continued to grow in the first quarter.

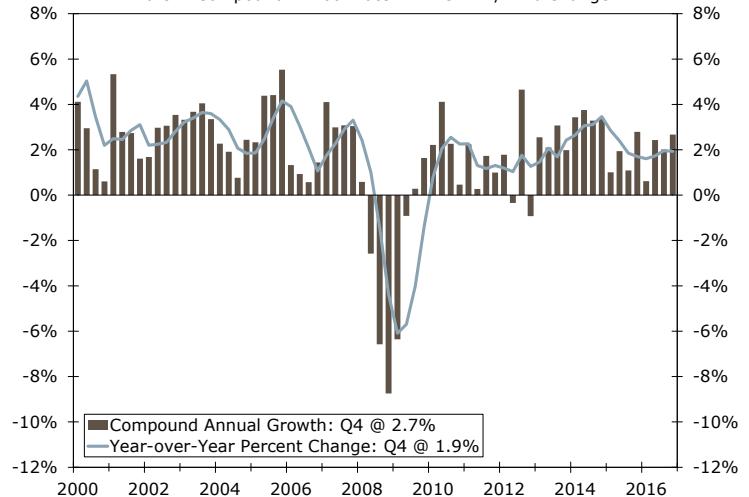
Survey data that are collected from retailers, which are slated for release on Thursday, will give analysts some insights into the state of British consumer spending in April. House price data for April may also print at the end of the week.

Previous: 0.7% (not annualized) Wells Fargo: 0.5%

Consensus: 0.4%

U.K. Real GDP

Bars = Compound Annual Rate Line = Yr/Yr % Change



Source: IHS Global Insight, Bloomberg LP and Wells Fargo Securities

Interest Rate Watch

Rate Expectations Slip

Benchmark Treasury yields have trended lower since the FOMC’s March meeting, while markets have pared back expectations for further rate increases this year.

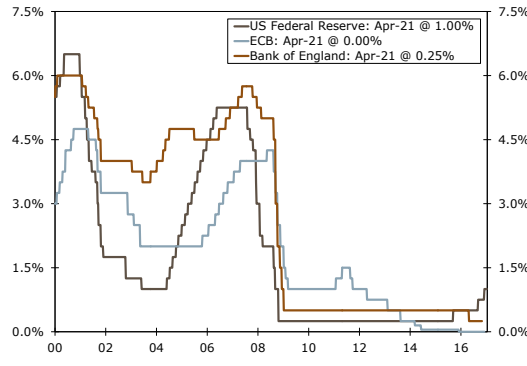
The lower benchmark rates have followed softer readings of the economic data in recent weeks. First quarter GDP estimates, including our own, continue to track below one percent, while the March payrolls number and downward revisions point to a slowdown in hiring.

While the weak first quarter GDP estimate and March payroll print look to be more noise than signal in our view, more recent data on inflation have likely trimmed market expectations for rate increases since last week. Core CPI unexpectedly fell in March. The decline was mostly due to an unusually large drop in wireless telephone services that is unlikely to be repeated, but it resets the base for inflation and points to a more protracted return to the Fed’s target. We expect the year-over-year pace of core PCE inflation to slow to 1.6 percent in March from 1.8 percent in February.

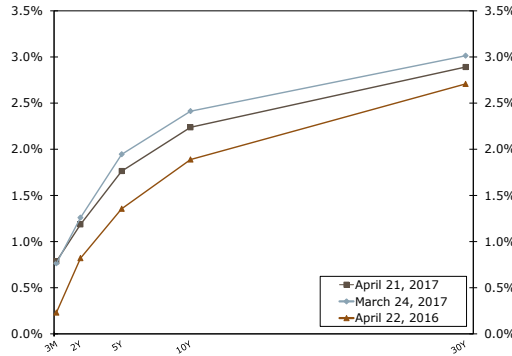
In addition to the latest inflation data hinting that the Fed has a bit more time on its side before raising rates, last week’s comments from President Trump may also be weighing on rate expectations. Noting that he likes low rates (rather than critiquing the low-rate environment on the campaign trail), the FOMC looks less likely to suddenly turn hawkish regardless of who is at the helm next February.

Markets continue to put the odds of the FOMC raising rates again in June above 50/50. While expectations fell as low as 40 percent early this week, they have since rebounded back to around 60 percent. A stronger-than-expected reading on the index of leading economic indicators and reiteration from a number of Fed officials this week that multiple more rate hikes remain appropriate despite other soft data looks to have helped the turnaround. Still, markets are pricing in only about one more rate hike this year, suggesting FOMC members have more communicating to do before June if a rate hike remains in the offing this quarter.

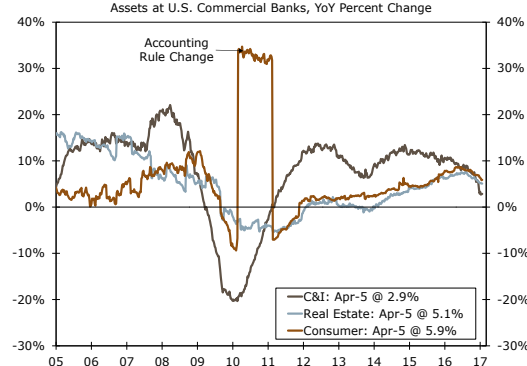
Central Bank Policy Rates



Yield Curve U.S. Treasuries, Active Issues



Bank Lending



Source: Federal Reserve, IHS Global Insight, Bloomberg LP and Wells Fargo Securities

Credit Market Insights

Beige Book: All Districts See Growth

The underlining tone of the Federal Reserve’s recently released *Beige Book* was one of growth. All 12 Federal Reserve districts reported an increase in overall economic activity with growth in employment, wages and prices. But like with most things, the devil is in the details.

Across the nation, districts reported at least a moderate increase in employment between mid-February and the end of March along with wage growth. However, the tighter labor market is leading to an increase in businesses having trouble filling lower-skilled and higher-skilled positions in addition to higher labor costs and employee retention difficulties. That said, as businesses increase their workforce, we could see a pickup in wages.

In addition to modest wage growth, overall inflation rose modestly in most districts. Districts noted selling prices rising “only slightly” since the previous report. Higher prices weighed on consumers’ non-auto retail spending, while warmer weather kept energy prices low. The warmer weather also pulled the home building season forward, which should increase inventory. Moreover, districts saw an increase in lending activity at financial institutions and credit quality remained strong.

The anecdotal information provided by the Fed banks indicates that despite March’s slower employment growth, decline in inflation and adverse weather conditions, much of the nation continued to grow at a modest-to-moderate pace.

Credit Market Data

Mortgage Rates	Current	Week Ago	4 Weeks Ago	Year Ago
	30-Yr Fixed	3.97%	4.08%	4.14%
15-Yr Fixed	3.23%	3.34%	3.39%	2.85%
5/1 ARM	3.10%	3.18%	3.18%	2.81%

Bank Lending	Current Assets (Billions)	1-Week Change (SAAR)	4-Week Change (SAAR)	Year-Ago Change
	Commercial & Industrial	\$2,093.4	22.47%	9.83%
Revolving Home Equity	\$396.2	-4.57%	-6.23%	-7.36%
Residential Mortgages	\$1,746.9	-5.74%	1.46%	4.12%
Commercial Real Estate	\$2,003.5	-2.17%	4.93%	8.86%
Consumer	\$1,366.1	6.95%	0.07%	5.89%

Source: Freddie Mac, Federal Reserve Board and Wells Fargo Securities

Topic of the Week

Fiscal Challenges Facing Policymakers

With the release of the Congressional Budget Office’s (CBO) latest Long-Term Budget Outlook, the ongoing fiscal policy story of increasing federal deficits and a large and growing stock of federal debt continues.

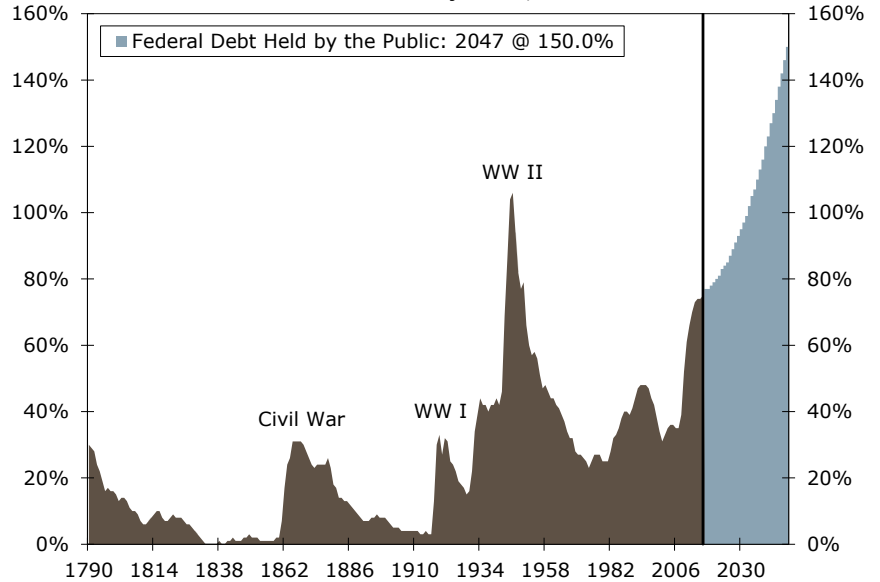
The CBO projects that deficits are expected to rise from 2.9 percent of GDP today to 9.8 percent of GDP by 2047 if current law remains unchanged. The result of these increasing deficits is the debt-to-GDP ratio rising from 77 percent today to 150 percent of GDP by 2047 (top chart). The three largest categories of spending contributing to annual deficits are Social Security, Medicare and interest on government debt. In fact, by 2047, under current law, federal spending for people age 65 or older who receive benefits from Social Security, Medicare and Medicaid would account for about half of all federal noninterest spending, compared with roughly two-fifths today.

The CBO also presented various alternative scenarios, including one with \$2 trillion in additional deficit spending and or/tax cuts over the next 10 years, very roughly the size of our current forecast for tax cuts. With a cumulative increase in the federal budget deficit over the next 10 years of \$2 trillion, excluding interest and macroeconomic feedback effects, the net result would be an increase in federal debt to 202 percent of GDP by 2047 compared to 150 percent in the CBO’s baseline estimates (bottom chart).

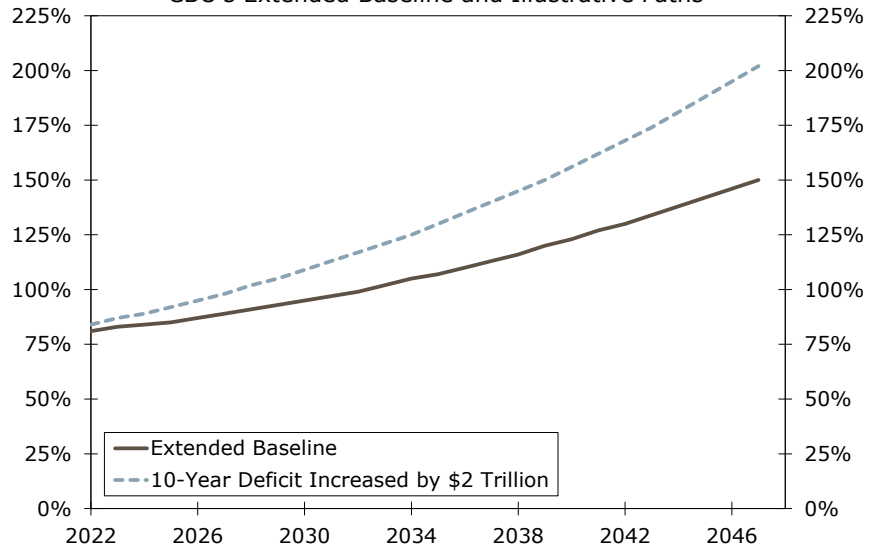
Against this backdrop, Congress and the new administration have ambitious plans to provide fiscal stimulus in the form of tax cuts and perhaps greater federal spending on defense and infrastructure projects. The unchecked costs of some programs in the years ahead create a very challenging environment for this generation of fiscal policymakers and private markets as well.

For further reading, see our report “2017 Long-Term Budget Outlook: Fiscal Challenges Facing Policymakers” available on our website.

U.S. Debt Held by the Public
CBO Extended Baseline Projections, Percent of GDP



Fed. Budget Deficit: Alternative Assumptions
CBO's Extended Baseline and Illustrative Paths



Source: Congressional Budget Office and Wells Fargo Securities

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 4/21/2017	1 Week Ago	1 Year Ago
3-Month T-Bill	0.78	0.80	0.23
3-Month LIBOR	1.15	1.16	0.64
1-Year Treasury	1.13	1.13	0.54
2-Year Treasury	1.18	1.21	0.81
5-Year Treasury	1.76	1.77	1.33
10-Year Treasury	2.24	2.24	1.86
30-Year Treasury	2.89	2.89	2.68
Bond Buyer Index	3.71	3.77	3.28

Foreign Exchange Rates

	Friday 4/21/2017	1 Week Ago	1 Year Ago
Euro (\$/€)	1.070	1.062	1.129
British Pound (\$/£)	1.278	1.252	1.432
British Pound (£/€)	0.838	0.848	0.788
Japanese Yen (¥/\$)	109.140	108.640	109.460
Canadian Dollar (C\$/\\$)	1.346	1.333	1.274
Swiss Franc (CHF/\\$)	0.998	1.006	0.975
Australian Dollar (US\$/A\\$)	0.753	0.758	0.774
Mexican Peso (MXN/\\$)	18.817	18.521	17.470
Chinese Yuan (CNY/\\$)	6.886	6.885	6.482
Indian Rupee (INR/\\$)	64.611	64.411	66.394
Brazilian Real (BRL/\\$)	3.148	3.147	3.529
U.S. Dollar Index	99.899	100.560	94.599

Source: Bloomberg LP and Wells Fargo Securities

Foreign Interest Rates

	Friday 4/21/2017	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	-0.36	-0.36	-0.27
3-Month Sterling LIBOR	0.34	0.34	0.59
3-Month Canada Banker's Acceptance	0.93	0.94	0.92
3-Month Yen LIBOR	0.01	0.01	-0.03
2-Year German	-0.80	-0.86	-0.49
2-Year U.K.	0.11	0.11	0.51
2-Year Canadian	0.73	0.73	0.64
2-Year Japanese	-0.22	-0.23	-0.26
10-Year German	0.24	0.19	0.24
10-Year U.K.	1.04	1.04	1.59
10-Year Canadian	1.48	1.49	1.45
10-Year Japanese	0.02	0.01	-0.11

Commodity Prices

	Friday 4/21/2017	1 Week Ago	1 Year Ago
WTI Crude (\\$/Barrel)	50.62	53.18	43.18
Gold (\\$/Ounce)	1283.78	1285.69	1248.06
Hot-Rolled Steel (\\$/S.Ton)	650.00	655.00	486.00
Copper (¢/Pound)	254.45	257.05	225.10
Soybeans (\\$/Bushel)	9.19	9.30	10.04
Natural Gas (\\$/MMBTU)	3.17	3.23	2.07
Nickel (\\$/Metric Ton)	9,435	9,783	9,296
CRB Spot Inds.	501.87	503.31	455.95

Next Week's Economic Calendar

	Monday 24	Tuesday 25	Wednesday 26	Thursday 27	Friday 28	
U.S. Data		New Home Sales February 592K March 578K (W)		Durable Goods Orders February 1.8% March 1.1% (W)	GDP Q4 2.1% Q1 0.8% (W)	
		Consumer Confidence March 125.6 April 122 (W)				
	Global Data	Germany IFO Business Climate Index Previous (March) 112.3	Brazil Current Account Balance Previous (February) -\$935 Million	France Consumer Confidence Previous (March) 100	Eurozone ECB Policy Meeting Previous Refi Rate: 0.0%	Japan Industrial Production (MoM) Previous (February) 3.2%
				South Korea GDP (QoQ) Previous (Q4) -0.5%		United Kingdom GDP Growth Previous (Q4) 0.7%

Note: (W) = Wells Fargo Estimate (C) = Consensus Estimate

Source: Bloomberg LP and Wells Fargo Securities

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