November 06, 2019

Economics Group

WELLS FARGO SECURITIES

Monthly Outlook

U.S. Overview

Recession Fears Diminish But Uncertainty Remains

Fears about an imminent recession have faded considerably now that the Federal Reserve has cut the federal funds rate three times and the yield curve is once again upward sloping. The Fed has shown that it will do what it takes to offset the headwinds from slower global economic growth and continued uncertainty around U.S. trade policy. While data from the manufacturing sector remain weak, the overall macro data have continued to come in slightly better than expected, with job growth remaining strong and real GDP expanding at a 1.9% pace during the third quarter. Moreover, revisions to previously reported data have mostly been to the upside.

We are maintaining a cautious forecast for the next few quarters. We still assume that the earlier announced 15% tariff on $156 billion of consumer goods will kick in on December 15. Though we acknowledge the possibility that the tariff hike might be delayed further or shelved altogether if a broader-than-expected "Phase I" deal is reached.

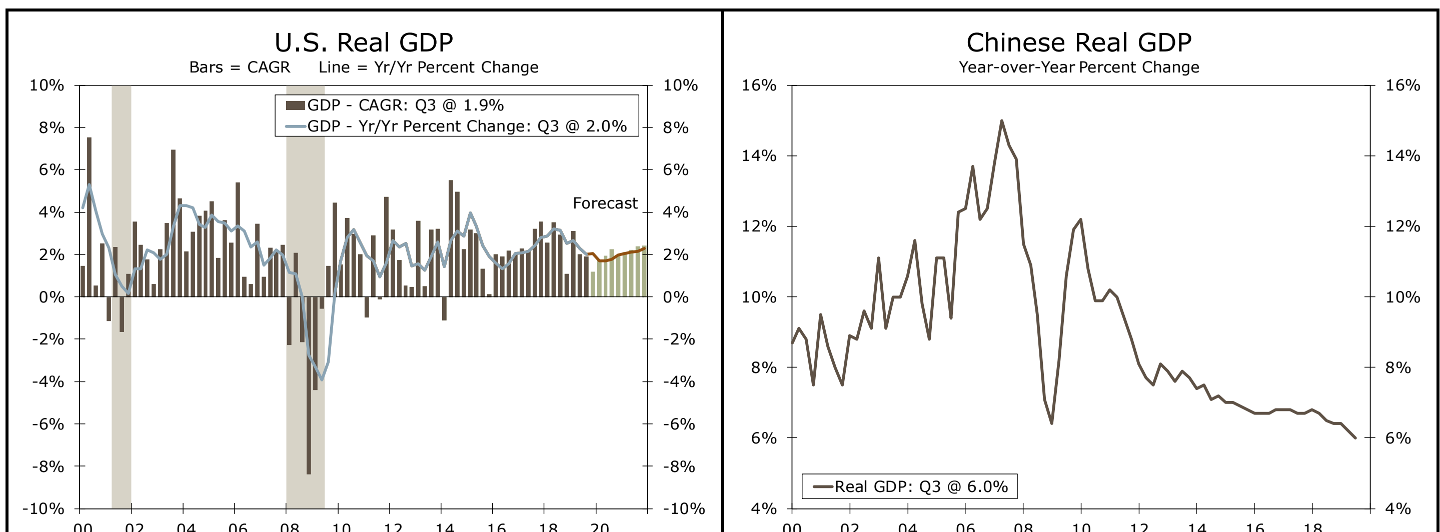
We are looking for exceptionally modest growth in Q4, with real GDP rising at just a 1.2% annual rate. Most of the weakness is due to declines in business investment but inventories are expected to decline further, slicing 0.6 percentage points off Q4 growth. On the bright side, homebuilding is gaining momentum and may produce some additional follow through into other areas of the economy. Even with the soft quarter, real GDP remains on track for a 2.3% calendar year gain.

International Overview

Major International Economies Still Slumping

Recent data from key international economies has offered investors little respite from concerns about slowing global growth. Chinese GDP growth softened further in Q3 to the slowest pace in decades, while Eurozone Q3 GDP data released last week showed the region's economy grew a paltry 0.2% (not annualized) during the quarter. October sentiment figures from China and the Eurozone suggest both economies may have lost further momentum going into Q4, hardly an encouraging sign. The European Central Bank (ECB) made no changes to monetary policy at its October meeting, the final meeting for Mario Draghi. However, we expect the central bank to cut rates an additional 10 bps at the December meeting, the first for newly appointed ECB President Christine Lagarde, as growth and inflation continue to languish in the Eurozone. Meanwhile, the Bank of Canada dropped a subtle hint that it could cut rates, and we expect it will ultimately deliver a 25 bp rate cut in December.

On the Brexit front, Prime Minister Boris Johnson turned matters back over to the people of the United Kingdom as he successfully put forth a bid to hold an early general election on December 12. Current polling suggests his Conservative Party will win a majority, allowing them to pass PM Johnson's recently negotiated Brexit deal and move on to longer-term trade talks with the European Union. Still, a lot can change in six weeks, and there is a significant risk that the election will merely result in more gridlock and dithering rather than a path forward to the next stages of the Brexit process.



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

Still No Recession, But Slower Growth in Second Half

Worries about an impending recession have diminished considerably since this summer, when the yield curve briefly inverted sending financial markets into a frenzy and sparking fears that this record-long business expansion was near its end. Most of the concern stems from the trade war with China, which has slowed global economic growth and led to a pullback in manufacturing orders and output. The Federal Reserve has been proactive, cutting the federal funds rate by a quarter percentage point three times this year and providing liquidity to the short-term funding markets by expanding its balance sheet with purchases of short-term Treasury Bills.

While the risk of recession have subsided, we are maintaining a cautious forecast for the current quarter. Following a 1.9% annualized growth rate in Q3, we see real GDP rising at a 1.2% pace in the current quarter. Much of the shortfall in headline GDP growth stems from a reduction in inventory building. Capital spending is also expected to slow as businesses cut back on equipment purchases and energy exploration moderates further. Trade is also likely to exert some additional drag on growth, as imports grow faster than exports.

Underlying demand is proving fairly resilient. Job growth remains solid, even in the face of cutbacks in capital spending, disruption in supply chains, Boeing problems with the 737 MAX and the recently settled strike at General Motors. Given that list of troubles, the latest employment data were a breath of fresh air. Employers added 128,000 jobs in October and job gains for the prior two months were revised higher by 95,000 jobs. The average gain for the past three months is a stellar 176,000 jobs. Moreover, the factory sector looks like it would have posted a slight gain in employment if not for the GM strike.

The resilience in factory sector employment is surprising to some, but should be reassuring to everyone. Even with the lack of visibility surrounding trade issues and global supply chains, most firms continue to cite a lack of skilled workers as one of their greatest immediate challenges. Now hiring billboards are a common site at factories across the country. Now, with inventories coming under control and at least a glimmer of hope on international trade, factory orders appear set to increase. The ISM manufacturing index rose 0.5 points to 48.3. The net share of firms reporting increased orders rose for the second month in a row, climbing 1.8 points to 49.1, while the export orders index jumped 9.4 points to 50.4–its largest one-month rise ever.

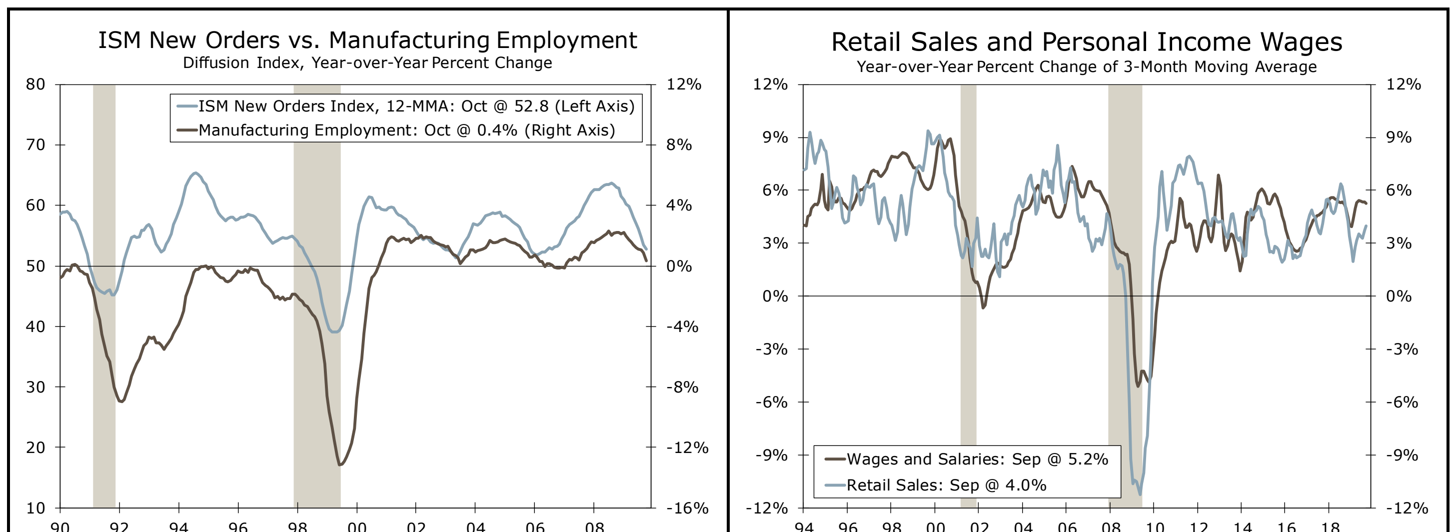
If the headwinds from the trade war truly subside, the economy could be headed for better days. Capital spending, which is where much of the weakness is centered today, tends to follow consumer spending and home building. Both look set to remain solid in coming quarters.

Households are in a relatively strong position today, with consumer confidence remaining near its high for this cycle and the saving rate currently running at 8.3%. Wages and salaries have risen at a 4.0% annual rate over the past three months and have risen 5.2% over the past year. Moreover, wages are rising fastest at the lower end of the income spectrum, where workers tend to spend a larger portion of their take-home pay.

Even with the improved fundamentals we are taking a cautious view in our outlook, looking for real personal consumption expenditures to rise at just a 2.0% pace in Q4. Our holiday retail sales forecast calls for sales to rise 5.0% from last year.

Another factor that could give consumer spending a boost is the recent pickup in home sales. Most of the improvement has been in new home sales, where builders have found ways to deliver homes priced for first time buyers. We look for new home sales to rise 7.0% this year and rise an additional 3.8% in 2020.

Given the recent improvement, doubts are surfacing as to whether the Fed will cut rates any further. We are sticking with our forecast for one more quarter-point cut in early 2020. One key variable to watch is wage growth, which Fed officials now appear to be looking to as a guide to determine whether they have met their full employment mandate.



Source: U.S. Department of Commerce, U.S. Department of Labor, Institute for Supply Management and Wells Fargo Securities

Wells Fargo U.S. Economic Forecast

	Actual							Forecast									Actual	Forecast		
	2018				2019				2020				2021				2018	2019	2020	2021
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Real Gross Domestic Product (a)	2.6	3.5	2.9	1.1	3.1	2.0	1.9	1.2	1.7	1.9	2.2	1.9	2.1	2.2	2.4	2.4	2.9	2.3	1.8	2.2
Personal Consumption	1.7	4.0	3.5	1.4	1.1	4.6	2.9	2.0	2.0	2.0	1.9	1.9	1.8	2.1	2.2	2.2	3.0	2.6	2.2	1.9
Business Fixed Investment	8.8	7.9	2.1	4.8	4.4	-1.0	-3.0	3.4	2.6	1.8	3.5	3.5	4.0	3.9	3.9	3.8	6.4	2.4	1.8	3.7
Equipment	6.6	3.4	2.9	7.4	-0.1	0.8	-3.8	-0.1	0.9	-0.5	2.1	2.1	3.4	3.4	3.2	3.0	6.8	1.5	0.1	2.7
Intellectual Property Products	9.7	11.9	4.1	11.7	10.8	3.6	6.6	6.1	4.9	4.2	5.7	6.0	5.9	5.5	5.6	5.7	7.4	8.0	5.3	5.7
Structures	12.1	11.0	-2.1	-9.0	4.0	-11.1	-15.3	0.5	2.5	3.0	2.5	2.0	1.8	1.9	2.0	2.1	4.1	-4.5	-1.2	2.1
Residential Construction	-5.3	-3.7	-4.0	-4.7	-1.0	-3.0	5.1	4.5	3.5	4.0	4.0	4.0	4.0	4.5	4.5	4.0	-1.5	-1.6	3.7	4.2
Government Purchases	1.9	2.6	2.1	-0.4	2.9	4.8	2.0	0.4	0.7	1.4	1.1	0.8	0.8	0.8	0.7	0.7	1.7	2.2	1.2	0.9
Net Exports	-884.2	-850.5	-962.4	-983.0	-944.0	-980.7	-986.4	-992.7	-992.3	-991.3	-1001.2	-1018.2	-1026.2	-1032.7	-1030.4	-1029.4	-920.0	-975.9	-1000.8	-1029.6
Pct. Point Contribution to GDP	0.0	0.7	-2.1	-0.4	0.7	-0.7	-0.1	-0.1	0.0	0.0	-0.2	-0.3	-0.2	-0.1	0.0	0.0	-0.4	-0.3	-0.1	-0.1
Inventory Change	40.5	-28.0	87.2	93.0	116.0	69.4	69.0	42.0	30.0	25.0	40.0	50.0	59.0	60.0	60.0	60.0	48.1	74.1	36.3	59.8
Pct. Point Contribution to GDP	0.1	-1.2	2.1	0.1	0.5	-0.9	-0.1	-0.6	-0.3	-0.1	0.3	0.2	0.2	0.0	0.0	0.0	0.1	0.1	-0.2	0.1
Nominal GDP (a)	5.0	7.1	4.8	2.9	3.9	4.7	3.5	2.9	4.2	4.1	4.1	3.8	4.2	4.1	4.2	4.1	5.4	4.0	3.9	4.1
Real Final Sales	2.4	4.8	0.8	1.0	2.6	3.0	2.0	2.1	2.0	2.1	1.9	1.7	1.9	2.2	2.4	2.4	2.8	2.2	2.1	2.0
Retail Sales (b)	4.7	5.7	5.5	3.4	2.8	3.4	4.0	4.2	4.2	3.1	2.7	2.9	3.0	3.1	2.9	3.0	4.8	3.6	3.2	3.0
Inflation Indicators (b)																				
PCE Deflator	1.9	2.3	2.2	1.9	1.4	1.4	1.4	1.5	2.0	1.9	2.0	2.1	2.0	1.9	1.9	1.8	2.1	1.4	2.0	1.9
"Core" PCE Deflator	1.8	2.0	2.0	1.9	1.6	1.6	1.7	1.7	2.0	2.2	2.1	2.1	2.0	1.9	1.8	1.8	2.0	1.6	2.1	1.9
Consumer Price Index	2.2	2.7	2.6	2.2	1.6	1.8	1.8	1.8	2.2	2.0	2.1	2.3	2.2	2.2	2.2	2.1	2.4	1.7	2.2	2.2
"Core" Consumer Price Index	1.9	2.2	2.2	2.2	2.1	2.1	2.3	2.3	2.4	2.5	2.3	2.3	2.1	2.1	2.0	2.1	2.1	2.2	2.4	2.1
Producer Price Index (Final Demand)	2.8	3.0	3.1	2.8	1.9	2.1	1.6	1.1	1.8	1.5	2.0	2.4	2.3	2.2	2.2	2.2	2.9	1.7	1.9	2.2
Employment Cost Index	2.7	2.8	2.8	2.9	2.8	2.7	2.8	2.8	2.9	3.0	3.0	3.0	3.1	3.1	3.1	3.1	2.8	2.8	3.0	3.1
Real Disposable Income (b)	3.9	3.9	4.1	3.9	3.3	3.2	3.2	2.9	2.3	3.1	2.4	2.1	2.0	1.5	2.0	2.2	4.0	3.1	2.5	1.9
Nominal Personal Income (b)	5.6	5.8	5.9	4.9	4.6	4.9	4.7	4.6	4.3	4.9	4.4	4.2	4.1	3.5	3.9	4.1	5.6	4.7	4.4	3.9
Industrial Production (a)	2.3	4.6	5.2	3.9	-1.9	-2.2	1.2	0.2	1.1	0.7	1.3	2.0	1.2	1.8	1.9	1.3	3.9	0.9	0.8	1.5
Capacity Utilization	77.9	78.5	79.1	79.4	78.6	77.8	77.6	77.2	76.8	77.1	77.5	78.0	78.3	78.6	78.9	79.2	78.7	77.8	77.3	78.8
Corporate Profits Before Taxes (b)	2.9	2.4	4.2	4.2	-2.2	1.3	0.5	3.2	3.8	1.9	2.8	0.6	1.5	2.8	3.0	2.5	3.4	0.7	2.3	2.5
Corporate Profits After Taxes	10.3	8.3	11.3	10.1	-2.9	1.3	0.6	2.8	3.6	1.8	2.8	0.6	1.5	2.7	2.9	2.4	10.0	0.4	2.2	2.4
Federal Budget Balance (c)	-375	-7	-172	-319	-372	-56	-237	-316	-428	-63	-244	-331	-448	-66	-255	-359	-779	-984	-1050	-1100
Trade Weighted Dollar Index (d)	103.1	107.3	107.6	110.1	109.8	109.7	111.0	110.0	109.5	109.0	108.0	107.3	106.0	105.5	105.0	104.5	106.4	110.1	108.4	105.3
Nonfarm Payroll Change (e)	228	243	189	233	174	152	188	143	170	395	-115	0	100	105	110	110	223	164	113	106
Unemployment Rate	4.1	3.9	3.8	3.8	3.9	3.6	3.6	3.6	3.6	3.5	3.6	3.7	3.7	3.7	3.7	3.7	3.9	3.7	3.6	3.7
Housing Starts (f)	1.32	1.26	1.23	1.19	1.21	1.26	1.28	1.28	1.26	1.27	1.27	1.28	1.28	1.28	1.28	1.28	1.25	1.26	1.29	1.30
Light Vehicle Sales (g)	17.1	17.3	17.0	17.4	16.8	17.0	17.0	16.7	16.5	16.4	16.4	16.4	16.4	16.4	16.4	16.4	17.2	16.9	16.4	16.4
Crude Oil - Brent - Front Contract (h)	66.9	74.6	75.8	68.6	63.8	67.6	61.5	58.0	56.0	57.0	59.0	59.0	59.0	59.0	59.0	59.0	71.5	62.7	57.8	59.0
Quarter-End Interest Rates (i)																				
Federal Funds Target Rate	1.75	2.00	2.25	2.50	2.50	2.50	2.00	1.75	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.96	2.19	1.50	1.50
3 Month LIBOR	2.31	2.34	2.40	2.81	2.60	2.32	2.09	1.80	1.60	1.60	1.60	1.60	1.65	1.60	1.60	1.60	2.31	2.20	1.60	1.61
Prime Rate	4.75	5.00	5.25	5.50	5.50	5.50	5.00	4.75	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.96	5.19	4.50	4.50
Conventional Mortgage Rate	4.44	4.57	4.63	4.64	4.28	3.80	3.61	3.55	3.50	3.55	3.65	3.75	3.80	3.90	3.95	4.00	4.54	3.81	3.61	3.91
3 Month Bill	1.73	1.93	2.19	2.45	2.40	2.12	1.88	1.55	1.40	1.40	1.40	1.40	1.45	1.40	1.40	1.40	1.97	1.99	1.40	1.41
6 Month Bill	1.93	2.11	2.36	2.56	2.44	2.09	1.83	1.55	1.45	1.45	1.45	1.45	1.50	1.45	1.45	1.45	2.14	1.98	1.45	1.46
1 Year Bill	2.09	2.33	2.59	2.63	2.40	1.92	1.75	1.55	1.50	1.55	1.55	1.60	1.60	1.60	1.65	1.65	2.33	1.91	1.55	1.63
2 Year Note	2.27	2.52	2.81	2.48	2.27	1.75	1.63	1.60	1.60	1.65	1.65	1.70	1.75	1.75	1.80	1.80	2.53	1.81	1.65	1.78
5 Year Note	2.56	2.73	2.94	2.51	2.23	1.76	1.55	1.55	1.60	1.70	1.75	1.80	1.90	1.95	2.00	2.00	2.75	1.77	1.71	1.96
10 Year Note	2.74	2.85	3.05	2.69	2.41	2.00	1.68	1.70	1.75	1.85	1.95	2.05	2.10	2.20	2.25	2.30	2.91	1.95	1.90	2.21
30 Year Bond	2.97	2.98	3.19	3.02	2.81	2.52	2.12	2.20	2.30	2.45	2.55	2.65	2.75	2.80	2.85	2.90	3.11	2.41	2.49	2.83

Forecast as of: November 06, 2019

Notes: (a) Compound Annual Growth Rate Quarter-over-Quarter
(b) Year-over-Year Percentage Change
(c) Quarterly Sum - Billions USD; Annual Data Represents Fiscal Yr.
(d) Federal Reserve Advanced Foreign Economies Index, 2006=100 - Quarter End
(e) Average Monthly Change
(f) Millions of Units - Annual Data - Not Seasonally Adjusted
(g) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold
(h) Quarterly Average of Daily Close
(i) Annual Numbers Represent Averages

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

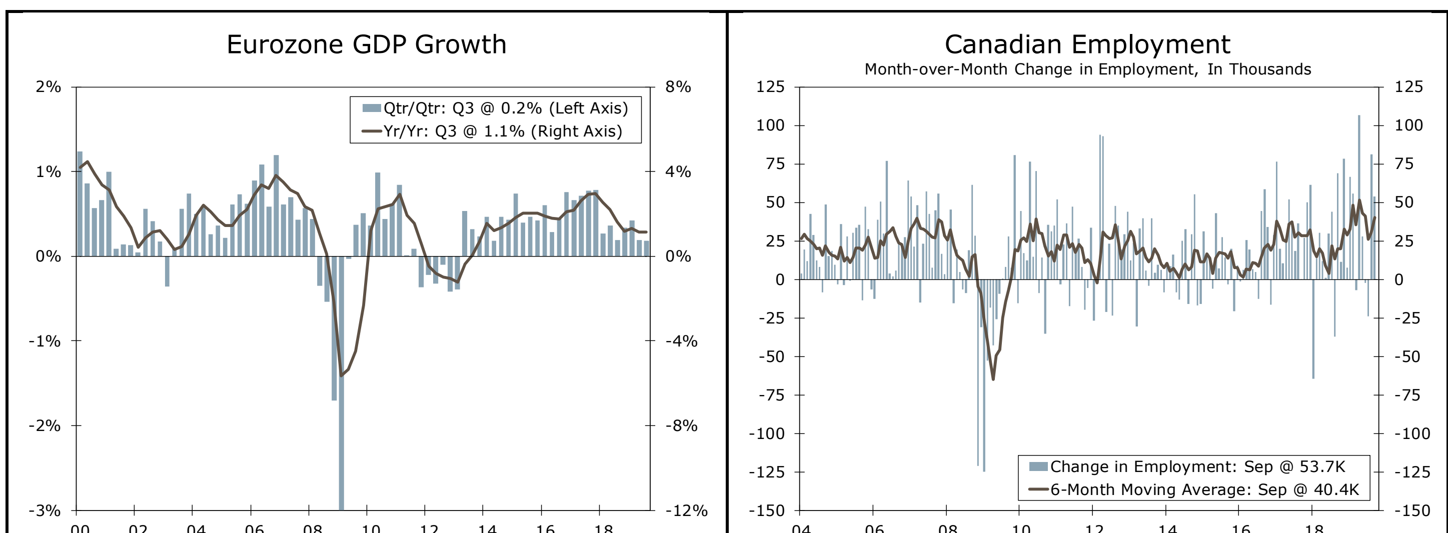
Not Much Respite from Global Growth Concerns

Economic data from key international economies have generally been subdued over the past month. In China, Q3 real GDP growth surprised to the downside, rising 6% year-over-year, or the slowest pace of growth in decades. Higher frequency data suggest the slowdown is fairly widespread, with growth in retail sales and industrial output continuing to slow, while October sentiment data suggest the economy may be losing further momentum going into Q4. Indeed, the official manufacturing PMI slipped to 49.3, while the services PMI dropped to 52.8, the lowest reading since 2016.

Eurozone GDP data for Q3 were also soft as real GDP rose just 0.2% quarter-over-quarter, not annualized. The industrial sector was the main source of weakness in the region, although services output was also likely subdued during the quarter. Sentiment figures for October suggest the prospects for Q4 are not much better. Indeed, the services PMI edged only slightly higher to 51.8, or just marginally above 50, while the manufacturing PMI remained at 45.7, deep in contraction territory.

Against this backdrop of continued underperformance in the Eurozone economy, we expect the European Central Bank (ECB) to cut rates another 10 bps in December. We recognize this diverges from the consensus expectation of no change in policy. It will be newly appointed ECB President Christine Lagarde's first meeting, and one can reasonably challenge the idea that she will make a splash in her debut given the apparent dissent against easing at the September ECB announcement. However, financial conditions have tightened, not eased, since the ECB eased policy in September, and given growth and inflation numbers remain weak, we would expect a majority of ECB policymakers to favor another 10 bp interest rate cut at the December announcement. We also expect the Bank of Canada (BoC) to cut rates in December. The BoC held rates steady last week but said the resilience of the Canadian economy will continue to be tested by global uncertainty. BoC Governor Poloz also noted that the central bank considered a possible "insurance" rate cut at the meeting, but ultimately decided against it. Recent data from Canada suggest the economy has been reasonably resilient, but still generally soft. Real GDP growth slowed to 1.3% on a y/y basis in August, due to weaker retail sales. While the labor market has been red-hot in recent months, we expect it to cool in the months ahead. In the end, we think the BoC will cut rates 25 bps at its December meeting, electing this time around to provide the Canadian economy with some "insurance," but for now we do not expect any further BoC rate cuts beyond that.

Looking beyond the economic data, political and trade uncertainty have not necessarily worsened since last month, but the uncertainty around Brexit and U.S.-China trade talks has hardly abated. U.K. Prime Minister Boris Johnson's bid to ratify a Brexit withdrawal deal was blocked by the opposition. Hoping to break the deadlock, the United Kingdom is now scheduled to hold a snap general election on December 12. Our baseline expectation, consistent with current polling, is that the U.K. Conservative Party will win a majority of seats in parliament, allowing them to ratify the Brexit deal that PM Johnson negotiated with the European Union a few weeks ago. That would be a relatively positive scenario for the U.K. economy and financial markets in the near term, but importantly this would not mark the end of the Brexit process. Instead, ratifying Johnson's withdrawal agreement would merely unlock the next phase of negotiations: a discussion of the future E.U.-U.K. relationship, including longer-term trade talks. Moreover, the risk of further gridlock is considerable at this point, as Boris Johnson could fall short of a majority in the upcoming elections. Suddenly the U.K. could end up back in the same place it was just a few weeks ago—staring down an imminent Brexit deadline, unable to agree on a path forward.



Source: Datastream, IHS Markit and Wells Fargo Securities

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP				CPI			
	2018	2019	2020	2021	2018	2019	2020	2021
Global (PPP Weights)	3.6%	3.0%	3.0%	3.2%	3.6%	3.3%	3.4%	3.4%
Advanced Economies[1]	2.3%	1.9%	1.6%	2.0%	2.0%	1.5%	1.9%	1.9%
United States	2.9%	2.3%	1.8%	2.2%	2.4%	1.7%	2.2%	2.2%
Eurozone	1.9%	1.1%	1.0%	1.4%	1.8%	1.2%	1.3%	1.5%
United Kingdom	1.4%	1.3%	1.1%	1.5%	2.5%	1.9%	1.8%	2.0%
Japan	0.8%	1.0%	0.4%	1.1%	1.0%	0.5%	1.2%	1.0%
Canada	1.9%	1.6%	1.7%	1.8%	2.3%	1.9%	2.0%	2.0%
Developing Economies[1]	4.5%	3.8%	4.0%	4.1%	4.8%	4.5%	4.6%	4.4%
China	6.6%	6.1%	5.8%	5.6%	2.1%	2.6%	2.6%	2.2%
India	7.4%	5.5%	6.6%	6.7%	3.9%	3.2%	3.8%	4.0%
Mexico	2.0%	0.2%	1.1%	1.8%	4.9%	3.6%	3.6%	3.5%

Forecast as of: November 06, 2019

[1]Aggregated Using PPP Weights

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	Central Bank Key Policy Rate					
	2019	2020				2021
	Q4	Q1	Q2	Q3	Q4	Q1
United States	1.75%	1.50%	1.50%	1.50%	1.50%	1.50%
Eurozone[1]	-0.60%	-0.60%	-0.60%	-0.60%	-0.60%	-0.60%
United Kingdom	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%
Japan	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%
Canada	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%
	2-Year Note					
	2019	2020				2021
	Q4	Q1	Q2	Q3	Q4	Q1
United States	1.60%	1.60%	1.65%	1.65%	1.70%	1.75%
Eurozone[2]	-0.75%	-0.70%	-0.60%	-0.50%	-0.40%	-0.30%
United Kingdom	0.45%	0.60%	0.75%	0.80%	0.90%	0.95%
Japan	-0.25%	-0.20%	-0.15%	-0.15%	-0.10%	-0.05%
Canada	1.45%	1.50%	1.55%	1.60%	1.65%	1.65%
	10-Year Note					
	2019	2020				2021
	Q4	Q1	Q2	Q3	Q4	Q1
United States	1.70%	1.75%	1.85%	1.95%	2.05%	2.10%
Eurozone[2]	-0.50%	-0.45%	-0.30%	-0.20%	-0.05%	0.05%
United Kingdom	0.60%	0.85%	1.05%	1.15%	1.20%	1.25%
Japan	-0.15%	-0.10%	-0.05%	0.00%	0.05%	0.05%
Canada	1.35%	1.45%	1.55%	1.60%	1.70%	1.75%

Forecast as of: November 06, 2019

[1] ECB Deposit Rate [2] German Government Bond Yield

Source: International Monetary Fund and Wells Fargo Securities

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