May 08, 2019

Economics Group

Monthly Outlook

U.S. Overview

The U.S. Economy Continues to Hang In There

U.S. real GDP grew at a strong annualized pace of 3.2% in Q1-2019, which stood in marked contrast to the widespread discussion early in the quarter about a looming recession. However, the overall GDP growth rate was flattered by a sizeable build in inventories and what was likely only a temporary decline in imports. Real final sales to private domestic purchasers, a gauge of underlying U.S. demand, increased just 1.3%—the slowest pace in nearly six years.

That said, the economy is hardly falling apart. Consumer spending entered the second quarter with strong momentum, and solid income gains should continue to support solid growth in personal consumption expenditures. Construction spending appears to be stabilizing, and public sector spending will continue to impart stimulus to the economy over the next few quarters. Although growth in capital spending is generally lackluster at present and net exports and inventories may exert some headwinds on the overall rate of GDP growth in coming quarters, we look for the economic expansion to remain intact for the foreseeable future.

Despite the 50-year low in the unemployment rate, inflation remains quiescent, which should keep the Fed on hold. Many market participants look for the FOMC to cut rates by the end of the year, but we believe there is a fairly high bar for a rate cut. In our view, growth would need to slow meaningfully and/or inflation would need to recede further to induce the committee to ease policy.

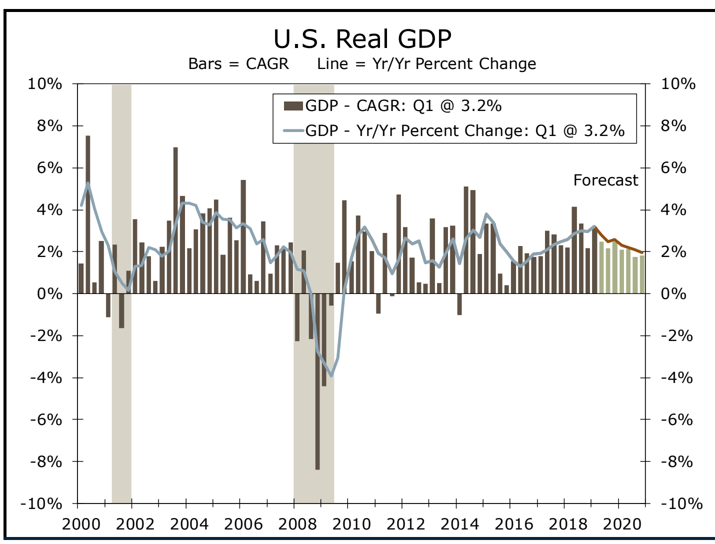
International Overview

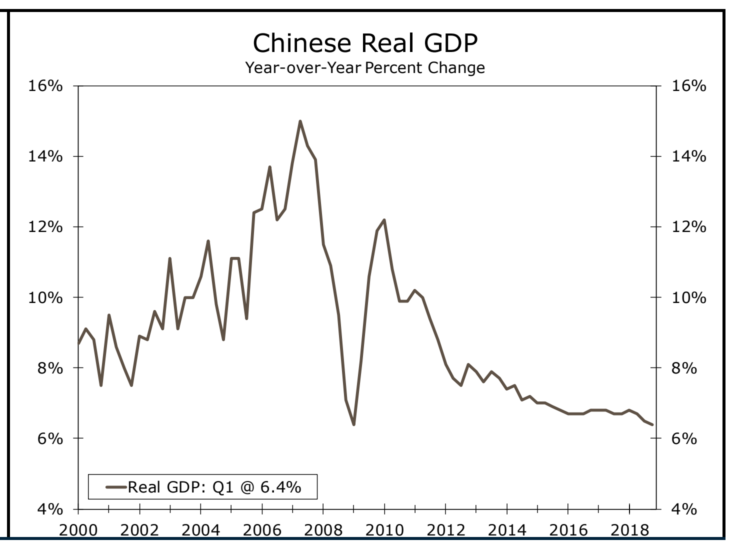
Can We Call the "All Clear" for the Global Economy?

Economic data released over the past month from major international economies have been more encouraging. Q1 GDP growth topped expectations in China and in the Eurozone, and monthly activity indicators for those two economies have also been stronger of late.

However, it may be a bit too early to call the "all clear" for the global economy. For one, the sudden re-emergence of concerns about U.S.-China trade tensions highlights the ever-looming risk of geopolitical uncertainty. Moreover, sentiment surveys from the Eurozone and China paint a picture of still-tepid confidence, and it may be some time before these economies display more concrete signs of stabilization. In the United Kingdom, Q1 GDP data are scheduled for release on May 10 and are shaping up to be quite strong, but largely as a result of temporary Brexit stockpiling, suggesting some payback in Q2.

With the global economic outlook still somewhat fragile, most central banks seem to be comfortably on hold. The Bank of Canada (BoC) removed its explicit rate hike bias at its April meeting, and as a result, **we no longer expect any BoC rate hikes this year**. Meanwhile, the Bank of England (BoE) suggested rates may have to rise faster than markets currently expect, but it cut its inflation forecast, and in any event we doubt the BoE will hike rates again at least until next year given lingering Brexit uncertainty. With interest rates on hold at low levels in most major economies, the global economy appears to have some breathing room to regain its footing.





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

Together we'll go far

This report is available on wellsfargo.com/economics and on Bloomberg WFRE.

The U.S. Economy Continues to Hang In There

Growth held up better than expected in the first quarter, with the economy expanding at a 3.2% annualized pace. That marked a pickup from Q4 and contrasted with ubiquitous discussion early in the quarter about a looming recession. Fears about deteriorating growth, however, were not fully unfounded. Headline GDP growth was flattered by a sizeable build in inventories and what was likely only a temporary decline in imports. Real final sales to private domestic purchasers, a gauge of underlying U.S. demand, increased just 1.3%—the slowest pace in nearly six years. Although the trend in overall GDP growth is not as strong as 3%, it is not as weak as 1% either. We expect GDP to expand about 2.5% in Q2 (chart on front page).

Stronger consumer spending in the second quarter is likely to underscore that growth remains intact. With some distance from the stock market's sell-off at the tail end of 2018 and a final resolution to the government shutdown, household spending roared back in March (left chart). The solid momentum heading into the second quarter and healthy fundamentals point to personal consumption increasing nearly 3% in Q2.

Continued tightening in the labor market also bodes well for consumer spending. Employers added 263,000 new jobs in April, while the unemployment rate fell to a 50-year low of 3.6%. After pausing at a 3.2% year-over-year growth rate in April, we expect average hourly earnings growth to resume its upward trend, and, in conjunction with further payroll gains, to see nominal income growth continue to run a little over 4%.

The domestic demand picture should also improve with the federal government shutdown fully behind us. We currently anticipate government spending to increase at a 3.7% annualized pace in Q2. If realized, that would be the fastest pace of the expansion and add half a point to topline GDP growth. The strength in part reflects a bounce-back following the shutdown, but also the higher level of government spending from last year's budget deal still stimulating the economy.

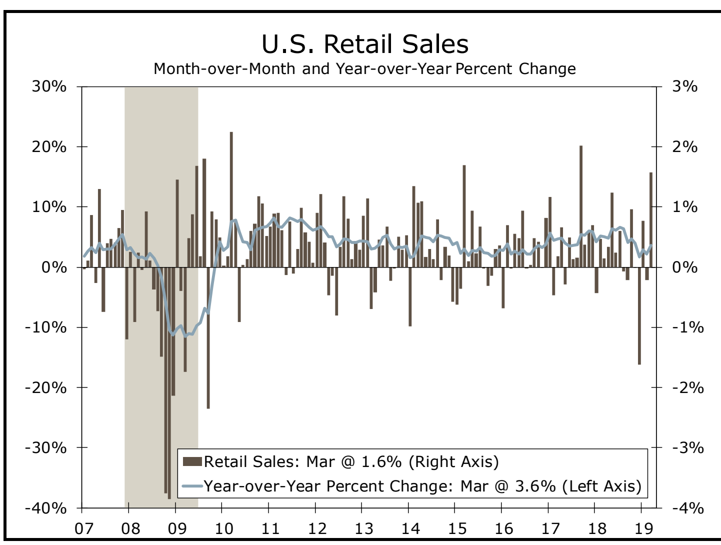
Construction spending also appears to be stabilizing. Higher oil prices in recent months have supported a rebound in energy-related structural investment. Residential construction spending has shown less momentum to date, but the drop in mortgage rates since last autumn, slower price appreciation and continued income gains have arrested the slide in affordability and spurred a modest rebound in new and existing home sales. We look for a modest rise in housing starts in coming months.

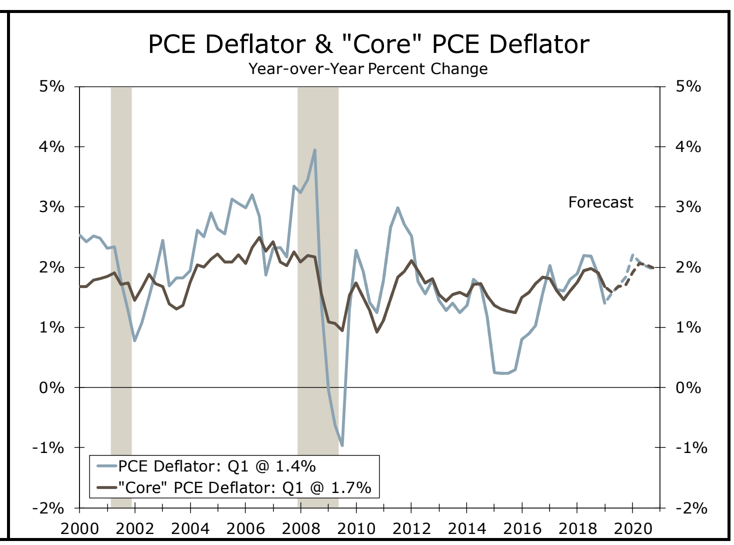
While domestic demand is expected to improve from the first quarter, pockets of weakness are likely to persist. After virtually stalling in Q1, equipment spending is expected to remain lackluster. Capital goods orders posted a solid gain in March, but purchasing managers' indices, like the ISM manufacturing index, indicate factory activity continues to struggle. Sluggish economic growth in many of America's major trading partners and modest dollar appreciation over the past year or so likely will exert some headwinds on export growth in coming quarters. We also look for some inventory unwind in the next two quarters following stock-building in Q1-2019, some of which was likely unintended.

Fed in Wait-and-See Mode

Despite the 50-year low in the unemployment rate, inflation remains quiescent. Indeed, the core PCE deflator, which the Federal Reserve views as the best indicator of the underlying rate of consumer price inflation, slipped to an 18-month low of 1.6% in March (right chart). The weakness in core inflation is likely overstated by a few special factors, but the Fed's continued struggle to meet its 2% inflation goal on a sustained basis likely will keep the FOMC on hold for the foreseeable future.

Many market participants look for the FOMC to cut rates by the end of the year, but we believe there is a fairly high bar for a rate cut. In our view, growth would need to slow meaningfully and/or inflation would need to recede further to induce the committee to ease policy.





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

Wells Fargo U.S. Economic Forecast

	Actual								Forecast								Actual		Forecast	
	2017				2018				2019				2020				2017	2018	2019	2020
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Real Gross Domestic Product (a)	1.8	3.0	2.8	2.3	2.2	4.2	3.4	2.2	3.2	2.5	2.2	2.5	2.1	2.1	1.8	1.8	2.2	2.9	2.8	2.1
Personal Consumption	1.8	2.9	2.2	3.9	0.5	3.8	3.5	2.5	1.2	2.9	2.4	2.4	1.9	2.0	1.8	1.9	2.5	2.6	2.4	2.1
Business Fixed Investment	9.6	7.3	3.4	4.8	11.5	8.7	2.5	5.4	2.7	4.0	3.1	3.4	3.9	3.6	2.9	2.8	5.3	6.9	3.9	3.5
Equipment	9.1	9.7	9.8	9.9	8.5	4.6	3.4	6.6	0.2	1.2	1.4	1.8	3.1	2.6	2.1	2.0	6.1	7.4	2.5	2.2
Intellectual Property Products	8.0	6.6	1.7	0.7	14.1	10.5	5.6	10.7	8.6	7.8	4.7	4.6	4.7	4.6	3.7	3.5	4.6	7.5	7.8	4.7
Structures	12.8	3.8	-5.7	1.3	13.9	14.5	-3.4	-3.9	-0.8	2.5	4.5	5.0	4.5	4.0	3.5	3.5	4.6	5.0	0.8	4.2
Residential Construction	11.1	-5.5	-0.5	11.1	-3.4	-1.3	-3.6	-4.7	-2.8	2.0	2.0	1.5	1.5	1.5	1.0	1.0	3.3	-0.3	-1.4	1.5
Government Purchases	-0.8	0.0	-1.0	2.4	1.5	2.5	2.6	-0.4	2.4	3.7	1.6	1.0	0.7	0.7	0.4	0.3	-0.1	1.5	1.9	1.0
Net Exports	-845.5	-844.1	-845.9	-899.2	-902.4	-841.0	-949.7	-955.7	-899.3	-918.3	-898.0	-911.1	-903.5	-901.8	-904.5	-903.6	-858.7	-912.2	-906.7	-903.3
Pct. Point Contribution to GDP	-0.1	0.1	0.0	-0.9	0.0	1.2	-2.0	-0.1	1.0	-0.4	0.4	-0.3	0.2	0.0	-0.1	0.0	-0.4	-0.3	0.0	0.0
Inventory Change	-2.4	11.9	64.4	16.1	30.3	-36.8	89.8	96.8	128.4	104.0	71.3	87.3	80.0	80.0	80.0	80.0	22.5	45.0	97.8	80.0
Pct. Point Contribution to GDP	-0.8	0.2	1.0	-0.9	0.3	-1.2	2.3	0.1	0.7	-0.5	-0.7	0.3	-0.2	0.0	0.0	0.0	0.0	0.1	0.3	-0.1
Nominal GDP (a)	3.9	4.2	4.8	5.1	4.3	7.6	4.9	4.1	3.8	5.2	4.3	4.6	4.3	4.3	3.6	3.7	4.2	5.2	4.6	4.3
Real Final Sales	2.6	2.8	1.8	3.2	1.9	5.4	1.0	2.1	2.5	3.3	2.9	2.1	2.3	2.1	1.8	1.8	2.2	2.7	2.6	2.3
Retail Sales (b)	4.9	4.1	4.3	5.7	4.8	5.7	5.7	3.4	2.9	3.0	3.0	4.0	4.9	4.4	4.4	3.8	4.7	4.9	3.2	4.4
Inflation Indicators (b)																				
PCE Deflator	2.0	1.6	1.6	1.8	1.9	2.2	2.2	1.9	1.4	1.6	1.7	1.8	2.2	2.1	2.0	2.0	1.8	2.0	1.6	2.1
"Core" PCE Deflator	1.8	1.6	1.5	1.6	1.7	1.9	2.0	1.9	1.7	1.6	1.7	1.7	1.9	2.1	2.0	2.0	1.6	1.9	1.7	2.0
Consumer Price Index	2.5	1.9	2.0	2.1	2.2	2.7	2.6	2.2	1.6	2.0	2.0	2.2	2.6	2.3	2.2	2.2	2.1	2.4	2.0	2.3
"Core" Consumer Price Index	2.1	1.8	1.7	1.8	1.9	2.2	2.2	2.2	2.1	2.1	2.2	2.1	2.2	2.1	2.2	2.1	1.8	2.1	2.1	2.1
Producer Price Index (Final Demand)	2.0	2.2	2.4	2.7	2.8	3.0	3.1	2.8	2.0	1.9	1.9	1.8	2.4	2.3	2.3	2.2	2.3	2.9	1.9	2.3
Employment Cost Index	2.4	2.4	2.5	2.6	2.7	2.8	2.8	2.9	2.8	3.0	3.0	3.1	3.2	3.2	3.3	3.3	2.5	2.8	3.0	3.2
Real Disposable Income (a)	4.5	2.2	2.2	2.3	4.4	1.8	2.6	4.3	2.4	3.3	3.1	3.0	2.9	2.8	2.7	2.5	2.6	2.9	3.0	2.9
Nominal Personal Income (b)	4.1	4.3	4.5	4.6	4.3	4.5	4.5	4.6	4.1	4.2	4.2	4.0	4.1	4.2	3.9	3.6	4.4	4.5	4.1	4.0
Industrial Production (a)	2.4	5.6	-0.8	7.5	2.3	4.6	5.2	4.0	-0.3	0.3	1.6	2.2	0.5	0.7	0.7	0.1	2.3	4.0	2.0	1.0
Capacity Utilization	75.5	76.5	76.3	77.6	77.9	78.5	79.1	79.5	79.0	78.8	78.9	79.1	79.0	79.1	79.0	78.9	76.5	78.7	78.9	79.0
Corporate Profits Before Taxes (b)	3.0	3.6	2.8	3.3	5.9	7.3	10.4	7.4	7.4	6.2	3.7	5.7	3.5	1.5	-0.5	-2.0	3.2	7.8	5.7	0.6
Corporate Profits After Taxes	6.0	6.2	6.4	7.3	15.1	15.8	19.6	14.3	6.4	6.0	3.5	5.5	3.4	1.4	-0.8	-2.3	6.5	16.2	5.3	0.4
Federal Budget Balance (c)	-317	4	-143	-225	-375	-7	-172	-319	-372	-63	-221	-301	-449	-66	-233	-315	-666	-779	-975	-1050
Trade Weighted Dollar Index (d)	112.9	109.7	104.1	106.1	103.1	107.3	107.6	110.1	109.8	109.0	108.8	107.8	106.5	105.8	104.5	103.3	108.9	106.4	108.8	105.0
Nonfarm Payroll Change (e)	173	190	136	218	228	243	189	233	186	201	170	160	150	140	100	90	179	223	179	120
Unemployment Rate	4.6	4.4	4.3	4.1	4.1	3.9	3.8	3.8	3.9	3.7	3.7	3.6	3.5	3.5	3.6	3.6	4.4	3.9	3.7	3.6
Housing Starts (f)	1.23	1.17	1.17	1.26	1.32	1.26	1.23	1.19	1.19	1.26	1.27	1.28	1.28	1.29	1.30	1.30	1.20	1.25	1.27	1.29
Light Vehicle Sales (g)	17.1	16.8	17.1	17.6	17.1	17.2	16.9	17.5	16.8	16.6	16.7	16.6	16.6	16.5	16.4	16.3	17.1	17.2	16.7	16.5
Crude Oil - Brent - Front Contract (h)	54.6	50.8	52.2	61.4	66.9	74.6	75.8	68.6	63.8	70.0	68.0	68.0	68.0	67.0	66.0	65.0	54.7	71.5	67.4	66.5
Quarter-End Interest Rates (i)																				
Federal Funds Target Rate	1.00	1.25	1.25	1.50	1.75	2.00	2.25	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.25	1.13	1.96	2.50	2.44
3 Month LIBOR	1.15	1.30	1.33	1.69	2.31	2.34	2.40	2.81	2.60	2.65	2.65	2.65	2.65	2.65	2.65	2.40	1.26	2.31	2.64	2.59
Prime Rate	4.00	4.25	4.25	4.50	4.75	5.00	5.25	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.25	4.13	4.96	5.50	5.44
Conventional Mortgage Rate	4.20	3.90	3.81	3.94	4.44	4.57	4.63	4.64	4.28	4.20	4.25	4.30	4.35	4.30	4.25	4.15	3.99	4.54	4.26	4.26
3 Month Bill	0.76	1.03	1.06	1.39	1.73	1.93	2.19	2.45	2.40	2.40	2.40	2.40	2.40	2.40	2.35	2.15	0.95	1.97	2.40	2.33
6 Month Bill	0.91	1.14	1.20	1.53	1.93	2.11	2.36	2.56	2.44	2.45	2.45	2.45	2.45	2.40	2.35	2.15	1.07	2.14	2.45	2.34
1 Year Bill	1.03	1.24	1.31	1.76	2.09	2.33	2.59	2.63	2.40	2.50	2.50	2.45	2.45	2.40	2.30	2.10	1.20	2.33	2.46	2.31
2 Year Note	1.27	1.38	1.47	1.89	2.27	2.52	2.81	2.48	2.27	2.45	2.45	2.40	2.40	2.30	2.20	2.05	1.40	2.53	2.39	2.24
5 Year Note	1.93	1.89	1.92	2.20	2.56	2.73	2.94	2.51	2.23	2.45	2.50	2.50	2.45	2.35	2.30	2.20	1.91	2.75	2.42	2.33
10 Year Note	2.40	2.31	2.33	2.40	2.74	2.85	3.05	2.69	2.41	2.60	2.65	2.70	2.75	2.70	2.65	2.55	2.33	2.91	2.59	2.66
30 Year Bond	3.02	2.84	2.86	2.74	2.97	2.98	3.19	3.02	2.81	2.95	3.00	3.05	3.10	3.10	3.05	3.00	2.89	3.11	2.95	3.06

Forecast as of: May 8, 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 - Quarte
(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

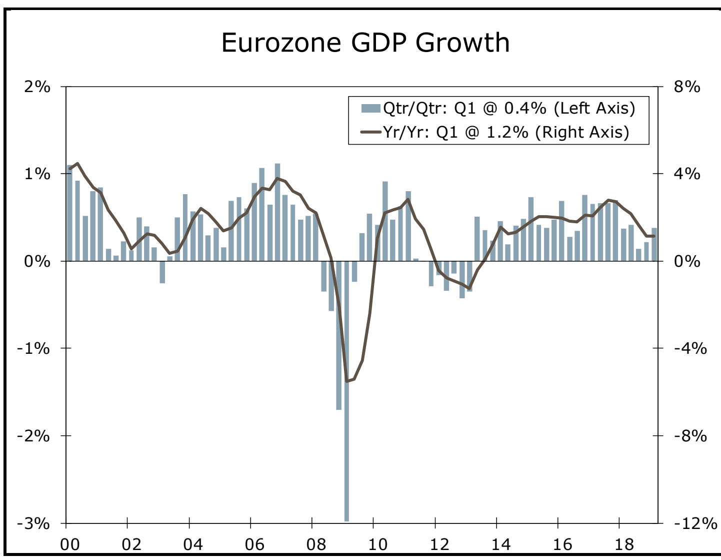
More Global Green Shoots, But Not Yet in Bloom

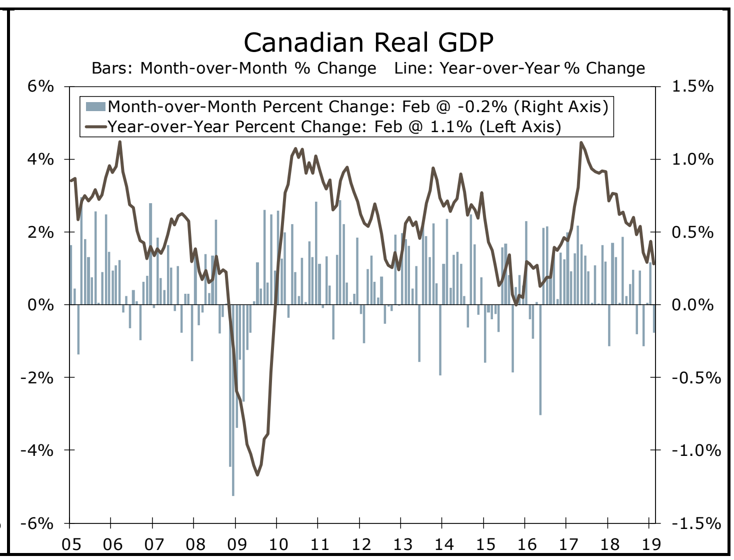
More encouraging economic signs continue to emerge from major international economies. Chinese growth and activity data were perhaps the most notable example, as they pointed to some stabilization in the domestic economy. Q1 GDP data were stronger than expected as year-over-year growth remained at 6.4%. Higher frequency monthly activity indicators, such as retail sales and industrial output, were also surprisingly robust in March, suggesting the Chinese economy carried some momentum into Q2. Perhaps in response to the improving domestic economic outlook, Chinese authorities hinted in late April that they could dial back the degree of stimulus that they are providing to the economy. To be sure, Chinese policymakers are unlikely to turn the policy taps off completely—indeed, earlier this week, the central bank announced that it would cut the reserve requirement ratio (RRR) for small and mid-sized banks, a day after new threats from U.S. President Trump to raise tariffs on imported Chinese goods. Going forward, the question in our view is not whether Chinese authorities will continue to ease policy but rather to what extent they will do so. Of course, it will also be important to monitor to what extent any further stimulus leads to more stable or stronger economic activity. For now, we still look for a slowdown in growth over the course of the year, with a **full-year Chinese GDP forecast of just 6.2% for 2019**, but we will continue to calibrate that forecast as needed depending on how policy evolves.

Another international economy that has shown some improving economic data recently is the Eurozone. Q1 GDP data were stronger than expected as output rose 0.4% (not annualized) on a sequential basis. Digging into the data by country, Italy's economy grew 0.2% during the quarter, officially emerging from recession, while the French and Spanish economies grew 0.3% and 0.7%, respectively. Despite the stronger-than-expected growth figures for Q1, the ECB does not appear convinced that the Eurozone economy is about to surge any time soon, as reports indicate several officials doubt that a growth recovery is coming in H2-2019. We largely share that sentiment, **as we expect the Eurozone economy to grow just 1.1% in full-year 2019,** matching the official ECB forecast.

Meanwhile, most signs point to a strong Q1 GDP reading for the U.K. economy (released May 10), but most of that strength appears to be the result of inventory building among producers ahead of the original March 29 Brexit deadline (which has now been extended to October 31). That stockpiling activity reduces the need for future production, and as the built-up inventories are drawn down, topline GDP growth should slow in Q2 after a robust Q1 figure. That is not to say the U.K. economy is going to fall off a cliff, as consumer spending has been solid in recent months amid accelerating wages and slowing inflation. However, **our forecast for U.K. GDP growth in 2019 is relatively underwhelming at just 1.3%.**

The good news for the global economy is that monetary policy is still relatively accommodative in most major economies, and is likely to remain so for the foreseeable future. The ECB reiterated at its April meeting that rates would be on hold at least until next year, while the Bank of Canada (BoC) dropped its explicit rate hike bias at its April meeting. That dovish shift from the BoC comes after Canada's GDP unexpectedly fell 0.1% on a sequential basis in February. With economic data in Canada subdued and the central bank no longer signaling a rate hike bias, **we now do not think the next BoC rate hike will come until Q1 2020.** One of the few major global central banks that has been a bit more hawkish in its signaling is the Bank of England (BoE), which signaled at its May meeting that interest rates may have to rise more than markets were currently expecting. However, the BoE also cut its inflation forecasts, and in the end markets appeared unconvinced of the BoE's message as interest rate futures ended up largely unchanged after the policy announcement. At the end of the day, it appears the global monetary policy backdrop is likely to remain rather accommodative for the time being, which bodes well for a global economy that still appears to be finding its footing.





Source: IHS Markit and Wells Fargo Securities

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP			CPI		
	2018	2019	2020	2018	2019	2020
Global (PPP Weights)	3.6%	3.4%	3.3%	3.6%	3.4%	3.6%
Advanced Economies[1]	2.2%	2.1%	1.8%	2.0%	1.7%	2.0%
United States	2.9%	2.8%	2.1%	2.4%	2.0%	2.3%
Eurozone	1.8%	1.1%	1.4%	1.8%	1.3%	1.5%
United Kingdom	1.4%	1.3%	1.4%	2.5%	2.0%	2.0%
Japan	0.8%	0.7%	0.4%	1.0%	1.0%	1.5%
Canada	1.8%	1.7%	1.6%	2.3%	1.8%	2.0%
Developing Economies[1]	4.5%	4.3%	4.3%	4.8%	4.5%	4.6%
China	6.6%	6.2%	6.0%	2.1%	2.2%	2.3%
India	7.3%	6.9%	7.1%	3.9%	3.8%	4.5%
Mexico	2.0%	1.6%	1.5%	4.9%	4.1%	3.8%

Forecast as of: May 8, 2019

[1]Aggregated Using PPP Weights

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	Central Bank Key Policy Rate						10-Year Bond					
	2019			2020			2019			2020		
	Q2	Q3	Q4	Q1	Q2	Q3	Q2	Q3	Q4	Q1	Q2	Q3
U.S.	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.60%	2.65%	2.70%	2.75%	2.70%	2.65%
Japan	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%	0.04%	0.08%	0.10%	0.13%	0.16%	0.16%
Eurozone[1]	-0.40%	-0.40%	-0.40%	-0.20%	-0.20%	0.00%	0.15%	0.25%	0.35%	0.45%	0.55%	0.65%
U.K.	0.75%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.30%	1.60%	1.70%	1.75%	1.85%
Canada	1.75%	1.75%	1.75%	2.00%	2.00%	2.00%	1.85%	1.90%	2.00%	2.05%	2.05%	2.00%

Forecast as of: May 8, 2019

[1] 10-year German Government Bond Yield

Source: International Monetary Fund and Wells Fargo Securities

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