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Economics Group

Interest Rate Weekly

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Q2-2017 Net Treasury Issuance Forecast Update

With the passage of a funding bill for the remainder of the 2017 federal fiscal year, along with some initial data on April tax collections, we have revised our FY 2017 budget deficit forecast to $600 billion.

Federal Deficit Forecast Revised Lower

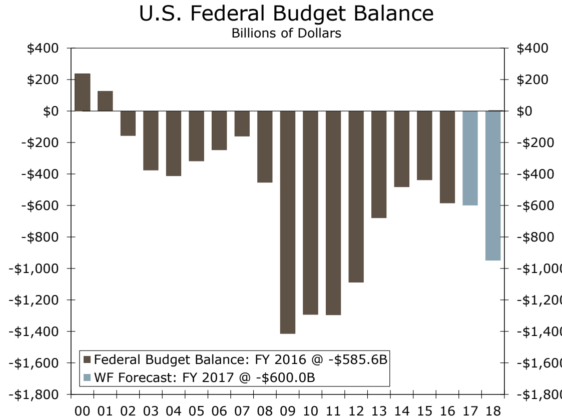
Over the course of the past couple of weeks, we have received more clarity on the federal budget balance for the remainder of the current fiscal year (FY). On the revenue side of the equation, we have preliminary data on the important April tax collections for the 2016 filing season. On the spending side of the equation, the passage of an omnibus spending bill that keeps the federal government funded through September 30 allows us to update our expectations for federal spending this fiscal year. Finally, to a lesser extent, the expected long and drawn out debate over repealing and replacing the Affordable Care Act (ACA) also factored into us lowering our budget deficit numbers for the current fiscal year. On net, we revised our FY 2017 budget deficit down $50 billion to $600 billion. We have left our FY 2018 budget deficit of $950 billion unchanged for now. Should the tax cut/reform debate become as contentious as the ACA repeal/replace effort, we would likely be inclined to trim at least some of the fiscal policy expansion currently baked into FY 2018. The next key piece of legislation we will watch closely will be the FY 2018 budget resolution, which will establish the top-line spending numbers and thus deficit targets for the next several years.

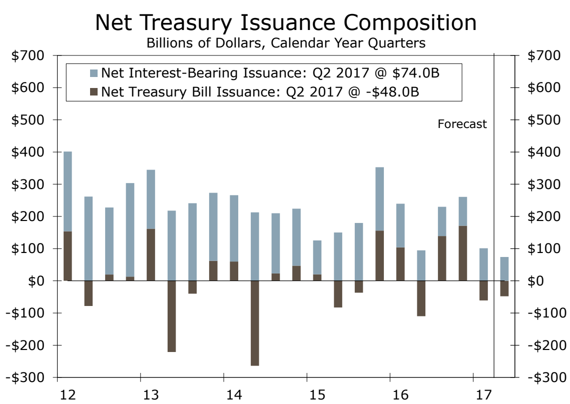
T-Bill Pay Down Expected Again in Q2

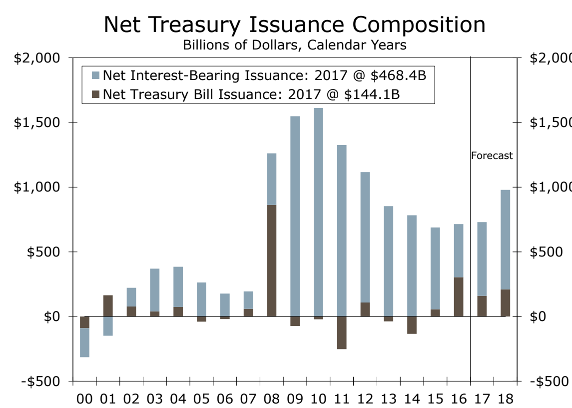
One of the stories playing out in the first quarter of this calendar year has been the required drawdown of the Treasury's cash balance related to the reestablishment of the debt ceiling, which resulted in a pay down of T-bills. As is typical in the second quarter of each year as tax collections surge, T-bills are paid down and total net Treasury issuance slows. We expect this trend to play out again this year in Q2 even with the T-bill pay down trend in Q1. The net result is that limited supply is likely to play a role limiting any increase in T-bill yields over the next quarter.

Net Treasury Issuance Expected to Pick Up in H2

With the slowdown in net Treasury issuance in both Q1 and Q2 of this year and only one more quarter left in the FY 2017 (calendar Q3), net Treasury issuance is poised for a rebound in the second half of the year. The debt ceiling will need to be lifted sometime this fall, likely in September, which should allow for greater net issuance. More important, the amount of federal spending relative to revenues is expected to jump in H2, resulting in an estimated $290 billion net marketable borrowing need in the third quarter and $369 billion in the fourth quarter of this year, assuming Congress and the Administration agree to roll back some, if not all, of the scheduled Budget Control Act cuts set to resume in October. We will provide more clarity around our FY 2018 budget deficit outlook once Congress agrees on a budget resolution for the year.







Source: U.S. Department of the Treasury and Wells Fargo Securities

Wells Fargo U.S. Interest Rate Forecast

	Actual				Forecast							
	2016				2017				2018			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Quarter End Interest Rates												
Federal Funds Target Rate	0.50	0.50	0.50	0.75	1.00	1.25	1.50	1.50	1.50	1.75	2.00	2.25
3 Month LIBOR	0.63	0.65	0.85	1.00	1.15	1.45	1.70	1.70	1.70	1.95	2.20	2.45
Prime Rate	3.50	3.50	3.50	3.75	4.00	4.25	4.50	4.50	4.50	4.75	5.00	5.25
Conventional Mortgage Rate	3.69	3.57	3.46	4.20	4.20	4.29	4.45	4.46	4.47	4.48	4.55	4.62
3 Month Bill	0.21	0.26	0.29	0.51	0.76	1.02	1.30	1.40	1.45	1.50	1.75	2.02
6 Month Bill	0.39	0.36	0.45	0.62	0.91	1.19	1.45	1.56	1.60	1.66	1.92	2.18
1 Year Bill	0.59	0.45	0.59	0.85	1.03	1.35	1.65	1.80	1.85	1.90	2.10	2.31
2 Year Note	0.73	0.58	0.77	1.20	1.27	1.55	1.90	2.00	2.05	2.11	2.26	2.41
5 Year Note	1.21	1.01	1.14	1.93	1.93	2.10	2.40	2.46	2.49	2.52	2.66	2.80
10 Year Note	1.78	1.49	1.60	2.45	2.40	2.55	2.72	2.75	2.76	2.78	2.86	2.94
30 Year Bond	2.61	2.30	2.32	3.06	3.02	3.18	3.44	3.54	3.56	3.58	3.67	3.76

Forecast as of: May 10, 2017

Wells Fargo U.S. Economic Forecast and FOMC Central Tendency Projections

	2017	2018
Change in Real Gross Domestic Product		
Wells Fargo	2.2	2.7
FOMC	2.0 to 2.2	1.8 to 2.3
Unemployment Rate		
Wells Fargo	4.4	4.3
FOMC	4.5 to 4.6	4.3 to 4.6
PCE Inflation		
Wells Fargo	1.8	2.2
FOMC	1.8 to 2.0	1.9 to 2.0
"Core" PCE Deflator		
Wells Fargo	1.8	2.2
FOMC	1.8 to 1.9	1.9 to 2.0

Forecast as of: May 10, 2017

NOTE: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation is the percentage rate of change in the price index for personal consumption expenditures (PCE). Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated.

Fed Data as of: March 15, 2017

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

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