March 15, 2017

WELLS FARGO SECURITIES

Economics Group

Monthly Outlook

U.S. Overview

Growth Suffers From Another Cold Snap

This year's late winter East Coast blizzard serves as a reminder of how weather and other factors have had an uncanny ability to make the first quarter the weakest quarter in four of the seven full years of economic recovery we have had so far. This year's first quarter also looks like it could be the weakest of the year, with our current estimate showing real GDP growing at just a 1.1 percent annual rate during Q1. While the weather played a role in suppressing growth this year, it was not so much from the late winter blizzard as it was from the milder weather earlier, which cut utility use. The widening trade deficit also looks to have subtracted 0.5 percentage points off growth in the quarter and government spending declined.

While 2017 has gotten off to a slow start, we are still looking real GDP to rise 2.1 percent this year, following a 1.6 percent gain in 2016. Consumer spending is being supported by strong job and income growth. Consumer confidence has also held on to much of the gains posted following the presidential election. In addition, the earlier firming in oil prices has led to a rebound in oil exploration and production. Homebuilding also appears to be gaining momentum, particularly in the South and West.

Even with just 2.1 percent real GDP growth, we expect the unemployment rate to inch lower and look for inflation to continue to firm. Economic growth should remain strong enough for the Federal Reserve to hike the federal funds rate two more times, with the next hike likely coming in June.

International Overview

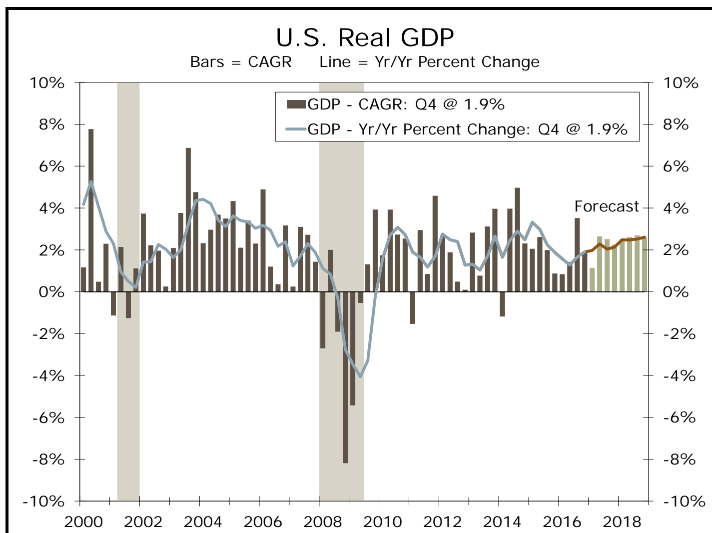
Modest Firming in Global Outlook

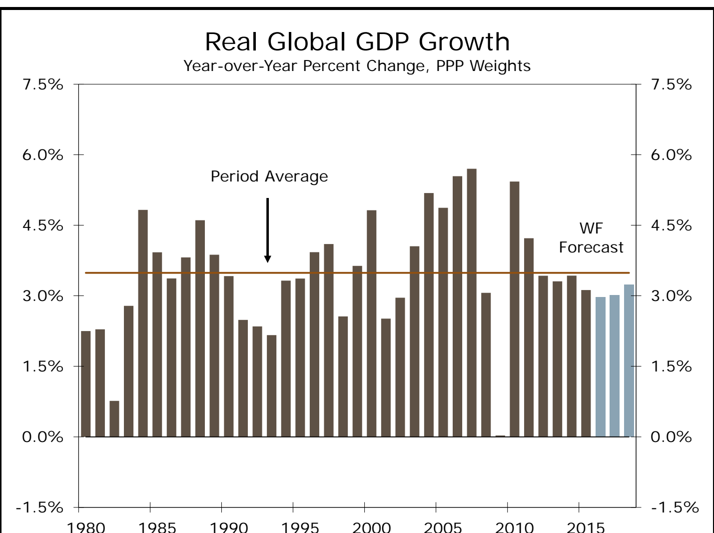
Prospects for the global economy have brightened somewhat since our February update and that is reflected in the tenth of a percentage point upward nudge we have made to our estimates for global GDP growth for this year (now 3.1 percent) and next (now 3.3 percent). Our estimate for 2016 global GDP growth remains unchanged at 3.0 percent. Official global GDP figures for 2016 will become available from the IMF in its June World Economic Outlook publication. If our numbers prove accurate, 2016 will mark the slowest year for global growth in the post-2009 period.

In terms of the factors that are driving our slightly improved growth outlook, it is rather broadly based with upward revisions in the outlook for two advanced economies: Japan and Canada, and for three developing economies: India, Brazil and Mexico (in the case of Mexico, we have pared back our forecast decline in GDP).

We upgraded our outlook for Japan based on a better Q4-2016 outturn in GDP growth than we had been expecting. In addition, the Tankan survey of large manufacturers in Japan rose to 10.0 in the latest print, up from 6.0 where it had been for three prior quarters and another survey, the Nikkei manufacturing PMI for Japan rose to 53.3 in February, its highest level since 2014.

The Canadian economy also performed well in Q4 2016, as the annualized rate of real GDP growth came in at 2.6 percent, versus the expected 2.0 percent.





Source: U.S. Department of Commerce, International Monetary Fund and Wells Fargo Securities

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

Hard to Break the 2 Percent Habit

This year does not look like it will be the year that real GDP growth breaks out of the 2 percent range that it has averaged since the recession ended nearly eight years ago. We look for real GDP to grow just 2.1 percent this year, which is a slight improvement from last year but less than was hoped for earlier this year. Overall growth is being held back by many of the same forces that have restrained growth over the past few years, namely precariously tight state and local government budgets and a widening trade deficit. Private final demand is holding up better and we expect it to grow 2.5 percent this year, following a 2.1 percent rise in 2016.

While growth has been underwhelming, it has been sufficient enough to reduce the unemployment rate below 5 percent and bring the economy back to a point where the Federal Reserve feels comfortable returning monetary policy to some sense of normalcy. We look for the Federal Reserve to hike the federal funds rate three times by a total of 75 bps this year and look for three more 25 bps hikes in 2018.

The return of a more normal monetary policy is complicated by the extraordinary lengths the Federal Reserve went to ward off the Great Recession and engender a sustainable recovery. Not only were short-term interest rates slashed to near zero, but the Fed also greatly expanded its balance sheet and provided enhanced forward guidance about future policy moves. Unwinding these policy moves will take a great deal of time and will have to be carefully choreographed.

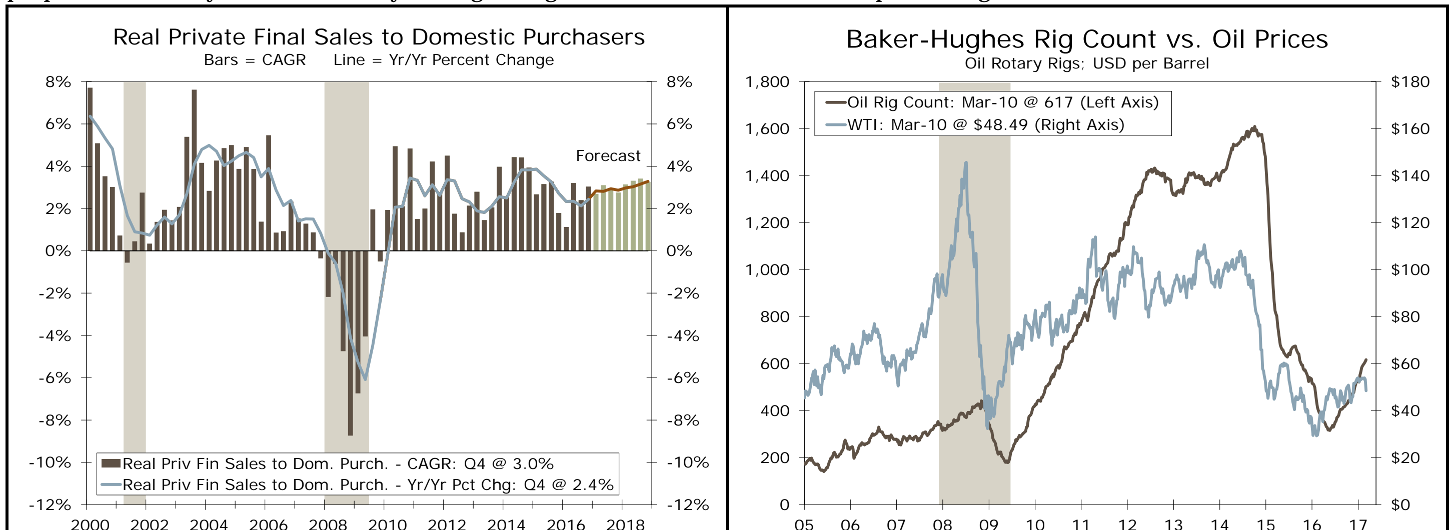
Another complication is the Trump administration would like to overhaul the Affordable Care Act, pass a major tax cut and increase spending on defense and infrastructure. The prospect of so much fiscal stimulus coming at a time when the economy is close to full employment sent bond yields soaring. More recently, the financial markets appear to be adjusting their expectations as to how quickly and how many of Trump's proposals are likely to make its way through congress, which has at least temporarily slowed the run-up in the stock market and capped the rise in long-term interest rates.

We still look for Trump to get most of his proposals through Congress this year and in early 2018. The magnitude of these changes may be slightly less than originally hoped but should still provide a potent boost to real disposable income in 2018 and also lift business fixed investment. The economy will be less affected in 2017, particularly after getting off to another slow start in the first quarter, when we expect real GDP to rise at just a 1.1 percent annual rate.

The slow start to 2017 is due to some familiar forces. Unusually mild winter weather reduced demand for heating along much of the East Coast, leading to a rare decline in real personal consumption expenditures in January, at least as initially reported. Consumer spending was also held back by a rebound in gasoline prices and higher healthcare insurance costs. Tax refunds have also lagged. Spending should strengthen going forward, as job and income growth remain solid and the unemployment rate has continued to trend lower. We look for consumer spending to rise 2.7 percent both this year and next.

International trade is also weighing on Q1 growth. The early timing of the Chinese New Year led to a surge in imports in January that all but assures trade will be a huge drag on growth for the quarter. With final demand growing solidly, trade will also likely subtract from growth in subsequent quarters, which again makes it tough to break away from 2 percent growth.

One area where growth has been looking up has been business fixed investment. The earlier rebound in oil prices to the $50/barrel range has led to resurgence in the energy patch. Unfortunately, increased energy production has added further to bloated inventories and pulled prices lower more recently. The $50 a barrel level likely reflects the sweet spot of U.S. oil production but the $40 a barrel level likely reflects a key breaking point. If prices fall below that level we will likely see the run-up in the rig count stall or even reverse.



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

Wells Fargo U.S. Economic Forecast

	Actual								Forecast								Actual			Forecast	
	2015				2016				2017				2018				2014	2015	2016	2017	2018
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product (a)	2.0	2.6	2.0	0.9	0.8	1.4	3.5	1.9	1.1	2.6	2.5	2.3	2.5	2.6	2.7	2.6	2.4	2.6	1.6	2.1	2.5
Personal Consumption	2.4	2.9	2.7	2.3	1.6	4.3	3.0	3.0	2.2	2.7	2.4	2.2	2.7	2.9	3.0	2.9	2.9	3.2	2.7	2.7	2.7
Business Fixed Investment	1.3	1.6	3.9	-3.3	-3.4	1.0	1.4	1.3	5.2	4.4	4.4	4.7	4.4	4.9	4.8	4.6	6.0	2.1	-0.5	3.5	4.6
Equipment	9.3	-0.3	9.1	-2.6	-9.5	-2.9	-4.5	1.9	6.6	4.2	3.9	4.3	3.8	4.3	4.2	3.7	5.4	3.5	-2.9	2.7	4.1
Intellectual Property Products	0.8	8.0	2.1	4.5	3.8	9.0	3.2	4.5	3.7	4.5	4.7	5.0	5.1	4.8	4.7	4.5	3.9	4.8	4.9	4.5	4.8
Structures	-12.3	-2.7	-4.3	-15.2	0.1	-2.1	12.0	-4.5	4.7	4.9	5.2	5.5	6.0	6.3	6.5	6.7	10.3	-4.4	-3.0	3.5	5.6
Residential Construction	13.4	14.8	12.6	11.5	7.8	-7.8	-4.1	9.6	9.2	6.7	6.5	6.3	5.8	5.6	5.4	5.4	3.5	11.7	4.9	5.4	5.9
Government Purchases	2.6	3.2	1.9	1.0	1.6	-1.7	0.8	0.3	-0.6	1.5	1.4	1.5	1.8	1.8	1.5	1.5	-0.9	1.8	0.8	0.4	1.6
Net Exports	-521.2	-524.9	-547.1	-566.6	-566.3	-558.5	-522.2	-599.6	-621.4	-636.9	-651.4	-667.4	-688.8	-712.7	-735.4	-756.3	-425.7	-540.0	-561.7	-644.3	-723.3
Pct. Point Contribution to GDP	-1.7	-0.1	-0.5	-0.5	0.0	0.2	0.9	-1.7	-0.5	-0.4	-0.3	-0.4	-0.5	-0.6	-0.5	-0.5	-0.1	-0.7	-0.1	-0.5	-0.5
Inventory Change	114.4	93.8	70.9	56.9	40.7	-9.5	7.1	46.2	41.0	45.0	50.0	50.0	50.0	50.0	50.0	50.0	57.7	84.0	21.1	46.5	50.0
Pct. Point Contribution to GDP	1.0	-0.5	-0.6	-0.4	-0.4	-1.2	0.5	0.9	-0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	-0.1	0.2	-0.4	0.2	0.0
Nominal GDP (a)	2.1	4.9	3.2	1.8	1.3	3.7	5.0	3.9	3.9	4.4	4.5	4.4	4.9	5.0	5.1	5.4	4.2	3.7	2.9	4.2	4.8
Real Final Sales	1.0	3.2	2.6	1.2	1.3	2.6	3.0	0.9	1.7	2.6	2.4	2.3	2.5	2.6	2.7	2.6	2.5	2.4	2.0	2.0	2.5
Retail Sales (b)	2.9	2.0	2.3	2.0	2.5	2.7	2.6	4.2	5.9	5.2	5.3	4.5	4.3	4.8	5.3	5.8	4.1	2.3	3.0	5.2	5.1
Inflation Indicators (b)																					
PCE Deflator	0.3	0.3	0.3	0.4	0.9	1.0	1.0	1.4	2.0	1.9	2.1	2.1	2.0	2.2	2.3	2.4	1.5	0.3	1.1	2.0	2.2
"Core" PCE Deflator	1.4	1.4	1.3	1.4	1.6	1.6	1.7	1.7	1.7	1.8	1.8	2.0	2.0	2.1	2.2	2.2	1.6	1.4	1.7	1.8	2.1
Consumer Price Index	-0.1	0.0	0.1	0.4	1.1	1.1	1.1	1.8	2.7	2.6	2.8	2.7	2.4	2.6	2.6	2.6	1.6	0.1	1.3	2.7	2.6
"Core" Consumer Price Index	1.7	1.8	1.8	2.0	2.2	2.2	2.2	2.2	2.3	2.3	2.4	2.5	2.4	2.5	2.6	2.6	1.7	1.8	2.2	2.4	2.5
Producer Price Index (Final Demand)	-0.5	-0.8	-0.9	-1.3	0.0	0.1	0.2	1.3	2.2	2.3	2.7	2.7	2.2	2.2	2.2	2.2	1.6	-0.9	0.4	2.5	2.2
Employment Cost Index	2.6	2.0	2.0	2.0	1.9	2.3	2.3	2.2	2.5	2.6	2.8	2.9	2.9	2.9	3.0	3.0	2.1	2.1	2.2	2.7	3.0
Real Disposable Income (a)	2.0	3.9	3.3	3.0	2.1	2.9	2.9	2.0	2.1	2.3	2.2	2.0	3.4	3.5	3.5	3.4	3.5	3.5	2.8	2.3	3.0
Nominal Personal Income (b)	4.8	4.6	4.2	3.9	3.6	3.4	3.6	3.7	4.3	4.1	4.0	3.9	4.2	4.6	4.7	4.9	5.2	4.4	3.6	4.1	4.6
Industrial Production (a)	-1.9	-2.7	1.5	-3.3	-1.7	-0.8	1.7	0.4	1.3	2.8	2.3	2.4	2.4	2.2	2.3	2.1	2.9	0.3	-0.9	1.5	2.4
Capacity Utilization	77.7	76.6	76.6	75.8	75.4	75.2	75.5	75.4	75.4	76.0	76.6	76.9	77.3	77.7	78.0	78.2	78.2	76.7	75.4	76.2	77.8
Corporate Profits Before Taxes (b)	7.5	-2.8	-4.5	-11.2	-6.6	-4.3	2.1	2.6	2.7	2.6	2.4	2.4	2.4	2.4	2.4	2.3	5.9	-3.0	-1.7	2.5	2.4
Corporate Profits After Taxes	7.9	-2.9	-6.0	-18.3	-6.5	-5.8	0.6	2.3	2.0	1.8	1.8	1.8	3.3	3.2	3.2	3.2	3.5	-5.3	-2.5	1.8	3.2
Federal Budget Balance (c)	-263	123	-123	-214	-245	60	-186	-208	-131	-90	-221	-250	-265	-160	-275	-250	-484	-439	-586	-650	-950
Current Account Balance (d)	-114.5	-111.9	-123.1	-113.4	-131.8	-118.3	-113.0	-128.0	-135.0	-145.0	-150.0	-155.0	-160.0	-170.0	-175.0	-180.0	-392.1	-463.0	-491.1	-585.0	-685.0
Trade Weighted Dollar Index (e)	92.1	90.0	92.3	94.5	89.8	90.6	90.0	95.8	96.0	97.3	98.8	100.3	101.3	101.3	100.3	99.3	78.4	91.1	91.6	98.1	100.5
Nonfarm Payroll Change (f)	186	271	170	277	196	164	239	148	213	160	155	150	150	145	145	140	250	226	187	169	145
Unemployment Rate	5.5	5.4	5.1	5.0	4.9	4.9	4.9	4.7	4.7	4.7	4.6	4.6	4.5	4.5	4.4	4.4	6.2	5.3	4.9	4.7	4.5
Housing Starts (g)	0.99	1.16	1.16	1.13	1.15	1.16	1.14	1.25	1.25	1.24	1.26	1.27	1.29	1.32	1.33	1.34	1.00	1.11	1.17	1.25	1.33
Light Vehicle Sales (h)	16.9	17.2	17.7	17.9	17.3	17.1	17.5	18.0	17.4	17.2	17.0	16.9	16.9	16.9	16.9	16.8	16.5	17.4	17.5	17.1	16.9
Crude Oil - Brent - Front Contract (i)	55.6	63.9	51.6	45.0	35.2	47.0	47.0	51.0	54.0	58.0	59.0	57.0	58.0	60.0	61.0	58.0	99.5	54.0	45.1	57.0	59.3
Quarter-End Interest Rates (j)																					
Federal Funds Target Rate	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.25	1.50	1.50	1.75	2.00	2.25	0.25	0.27	0.52	1.25	1.88
3 Month LIBOR	0.27	0.28	0.33	0.61	0.63	0.65	0.85	1.00	1.30	1.50	1.50	1.75	1.75	2.00	2.25	2.50	0.23	0.32	0.74	1.51	2.13
Prime Rate	3.25	3.25	3.25	3.50	3.50	3.50	3.50	3.75	4.00	4.25	4.25	4.50	4.50	4.75	5.00	5.25	3.25	3.27	3.52	4.25	4.88
Conventional Mortgage Rate	3.77	3.98	3.89	3.96	3.69	3.57	3.46	4.20	4.30	4.36	4.41	4.44	4.46	4.48	4.55	4.62	4.17	3.85	3.65	4.38	4.53
3 Month Bill	0.03	0.01	0.00	0.16	0.21	0.26	0.29	0.51	0.76	1.02	1.10	1.30	1.40	1.50	1.76	2.02	0.03	0.05	0.32	1.05	1.67
6 Month Bill	0.14	0.11	0.08	0.49	0.39	0.36	0.45	0.62	0.88	1.12	1.20	1.40	1.51	1.61	1.87	2.13	0.06	0.17	0.46	1.15	1.78
1 Year Bill	0.26	0.28	0.33	0.65	0.59	0.45	0.59	0.85	1.02	1.38	1.46	1.66	1.75	1.84	2.05	2.26	0.12	0.32	0.61	1.38	1.98
2 Year Note	0.56	0.64	0.64	1.06	0.73	0.58	0.77	1.20	1.34	1.66	1.75	1.93	2.02	2.11	2.26	2.41	0.46	0.69	0.83	1.67	2.20
5 Year Note	1.37	1.63	1.37	1.76	1.21	1.01	1.14	1.93	2.08	2.21	2.29	2.40	2.46	2.52	2.66	2.80	1.64	1.53	1.33	2.25	2.61
10 Year Note	1.94	2.35	2.06	2.27	1.78	1.49	1.60	2.45	2.55	2.62	2.68	2.72	2.75	2.78	2.86	2.94	2.54	2.14	1.84	2.64	2.83
30 Year Bond	2.54	3.11	2.87	3.01	2.61	2.30	2.32	3.06	3.18	3.34	3.40	3.49	3.54	3.58	3.67	3.76	3.34	2.84	2.59	3.35	3.64

Forecast as of: March 15, 2017

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) Quarterly Sum - Billions USD
(e) Federal Reserve Major Currency Index, 1973=100 - Quarter End
(f) Average Monthly Change
(g) Millions of Units - Annual Data - Not Seasonally Adjusted
(h) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold
(i) Quarterly Average of Daily Close
(j) Annual Numbers Represent Averages

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

Modest Firming in Global Outlook

We remain somewhat cautious on Canada, given the elevated consumer debt levels and a housing market that is overheating in some areas, in our view.

That said, Canada has fared better since oil prices have stabilized and while crude prices remain volatile, our baseline expectation is for oil prices to grind gradually higher throughout the forecast period. Still, given the high debt levels and uncertainty about oil prices, the Bank of Canada is in no rush to raise rates.

A wholesale re-write of NAFTA, while not completely out of the question, is not likely, in our view, and Canada probably has less to lose in any renegotiation of North American trade given the fact that Canadian workers do not offer the same cost savings to employers as Mexico does. We still forecast a decline in Mexican GDP next year, but the decline got smaller in the latest forecast revision.

The forecast for Brazil is a shade less dire as well with a tenth of a percentage point increase in the growth outlook for 2017, which is still just 0.7 percent.

India has the fastest expected growth rate for all the economies for which we forecast, and we are bumping up our numbers for 2017 growth slightly. There are some encouraging signs that the de-monetization disruption is beginning to wane. Strong population growth and robust investment spending should underpin Indian economic growth in the years ahead.

Central Banks in Neutral with a Foot on the Clutch

In Europe, our forecast is for the slow growth expansion to continue and gain momentum. Some measures of economic firming in the Eurozone (like the PMIs that are presently showing the fastest pace of expansion in six years) have some traders placing bets that the European Central Bank (ECB) will follow the lead of the Fed and eventually raise rates. In fact, based on futures contracts, the implied probability of an ECB rate hike climbs above 50 percent in less than a year's time.

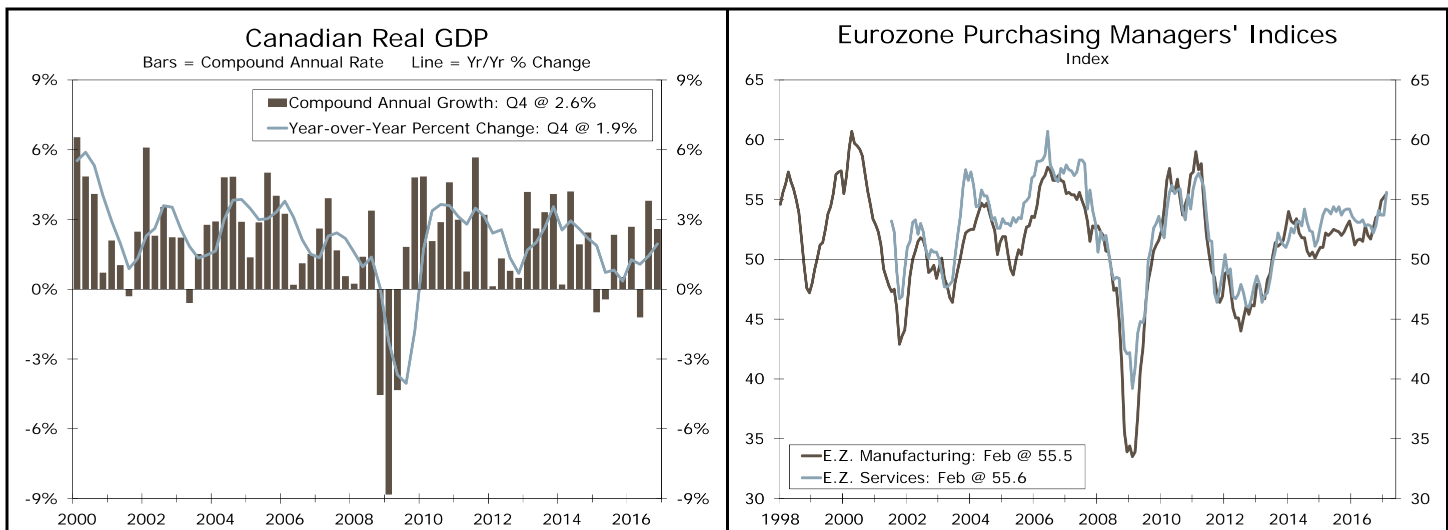
At its December policy meeting, the ECB announced it would dial back the pace of its monthly asset purchases to €60 billion from €80 billion effective next month. But the ECP affirmed that the program would remain in place at least through year-end and that key interest rates would remain low for an extended period and "well past the horizon" of the QE purchases.

That might have squelched any further bets on rate increases, except that in the Q&A session following the prepared statement, ECB President Draghi was directly asked about raising rates before QE ended and his response was ambiguous. By any reckoning, we do not expect the ECB to raise rates anytime in 2017 and will keep a watchful eye on inflation in Europe to inform our thinking on the ECB's next move.

In the United Kingdom, CPI inflation of 1.7 percent is near the Bank of England's (BoE) 2.0 percent target. As of this report, the Monetary Policy Committee is in session with a decision expected after we have published. However, we do not expect any major change at this meeting.

For now, the BoE's official neutral outlook on interest rates is consistent with our own view that it will remain on hold for now, particularly given the uncertainty surrounding Brexit and its implications for the U.K. economy.

After depressed oil and commodity prices held down global inflation, the outlook for global inflation shows gradual firming in each of the next two years as reflected in our updated global CPI forecast of 3.4 percent for 2017 and 3.7 percent in 2018. Although the central banks of the major foreign economies are not likely to be tightening policy anytime soon, the synchronous easing that took place in the past couple of years has likely run its course, at least for the time being.



Source: IHS Global Insight and Wells Fargo Securities

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP			CPI		
	2016	2017	2018	2016	2017	2018
Global (PPP Weights)	3.0%	3.1%	3.3%	3.1%	3.5%	3.7%
Global (Market Exchange Rates)	2.7%	2.9%	3.1%	3.1%	3.5%	3.7%
Advanced Economies[1]	1.8%	2.0%	2.3%	0.7%	2.2%	2.1%
United States	1.6%	2.1%	2.5%	1.3%	2.7%	2.6%
Eurozone	1.7%	1.8%	2.0%	0.2%	1.7%	1.8%
United Kingdom	1.8%	1.8%	1.8%	0.7%	2.3%	2.2%
Japan	1.0%	1.1%	0.9%	-0.1%	0.6%	0.9%
Korea	2.7%	2.5%	2.6%	1.0%	2.1%	1.7%
Canada	1.4%	2.1%	1.9%	1.4%	1.8%	2.0%
Developing Economies[1]	4.2%	4.1%	4.3%	5.5%	4.8%	5.3%
China	6.7%	6.3%	5.8%	2.0%	1.5%	2.0%
India[2]	7.8%	7.0%	7.0%	5.0%	4.1%	5.5%
Mexico	2.3%	-1.0%	1.6%	2.8%	6.6%	6.1%
Brazil	-3.6%	0.7%	2.7%	8.7%	4.9%	5.5%
Russia	-0.2%	1.4%	2.1%	7.1%	4.4%	4.5%

Forecast as of: March 15, 2017

[1]Aggregated Using PPP Weights [2]Forecasts Refer to Fiscal Year

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	3-Month LIBOR						10-Year Bond					
	2017				2018		2017				2018	
	Q1	Q2	Q3	Q4	Q1	Q2	Q1	Q2	Q3	Q4	Q1	Q2
U.S.	1.30%	1.50%	1.50%	1.75%	1.75%	2.00%	2.55%	2.62%	2.68%	2.72%	2.75%	2.78%
Japan	-0.02%	-0.02%	-0.02%	-0.02%	0.00%	-0.08%	0.05%	0.05%	0.07%	0.10%	0.12%	0.15%
Euroland[1]	-0.35%	-0.35%	-0.32%	-0.30%	-0.25%	-0.10%	0.40%	0.45%	0.55%	0.65%	0.85%	1.05%
U.K.	0.35%	0.35%	0.35%	0.40%	0.45%	0.60%	1.30%	1.40%	1.60%	1.75%	1.90%	2.10%
Canada[2]	0.95%	0.95%	0.95%	1.15%	1.15%	1.40%	1.80%	1.90%	2.00%	2.10%	2.25%	2.30%

Forecast as of: March 15, 2017

[1] 10-year German Government Bc[2] 3-Month Canada Bankers' Acceptances

Source: Wells Fargo Securities

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