June 09, 2020

Economics Group

WELLS FARGO SECURITIES

Monthly Outlook

U.S. Overview

More Pronounced Version of Similar Theme

Since this unprecedented pandemic took the world by storm, our theme has been for a sharp downturn in the first half of the year followed by a quick snapback in activity in Q3 and Q4 before the economy settles back into a trend-like pattern of growth in 2021. That theme still appears to be intact, although as the high frequency data come into focus, we have made more than just fine-tuning adjustments. What we present in this update is essentially a more pronounced version of our theme.

The contraction in Q2 GDP remains although we now see an annualized pace of decline 38% due to an even bigger drop in consumer spending than we had forecast previously. On the upside, we still see things turning sharply for the better for the economy in the third quarter with an upwardly revised growth rate of 24%.

Still, by the end of this year, the U.S. economy will be about 5% smaller than it was at the end of 2019, and even by the end of 2021 the level of real GDP will still be about 2.5% shy of the pre-recession peak. It's a V-shaped bottom, but a full recovery is at least another year and a half away; and that is predicated upon the reopening going smoothly without the virus making a comeback and necessitating another lockdown.

One key driver of the revisions is what is happening with household finances and what that means for consumer spending. We expect the rebound is business spending to be at least another six months or so away at this point, although some inventory rebuilding will boost growth in the second half.

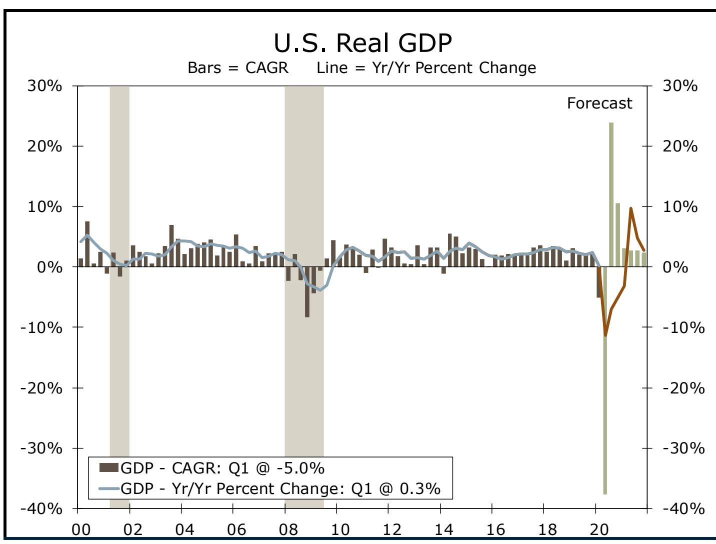
International Overview

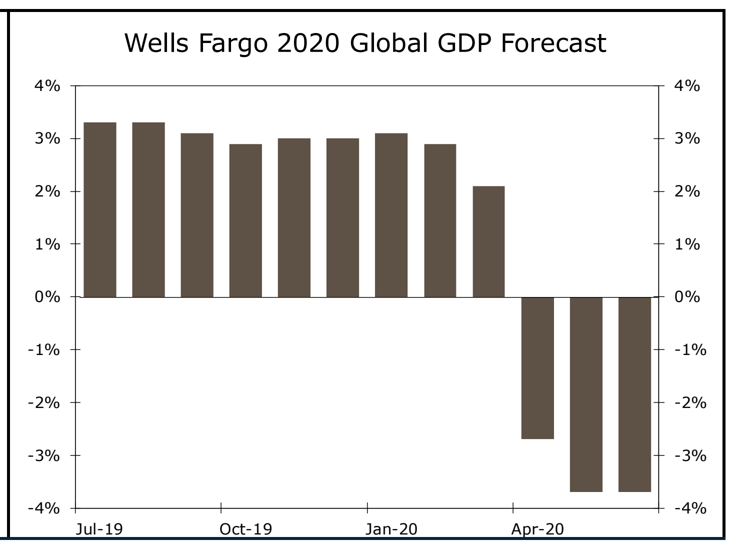
Global Economy Passing The Worst

Although the second quarter will almost certainly be another tough one for the global economy, there are nascent signs we may be passing the worst. Global manufacturing and services PMIs improved in May reflecting improved sentiment across several countries, while there were unexpected employment gains for some major economies. Given these developments, our 2020 outlook appears to be stabilizing. We expect the global economy to contract 3.7% in 2020, the first time since February we have not revised our 2020 growth outlook lower.

The stabilization of growth has been assisted, at least in part, by an aggressive response from global policymakers. Europe has been a center of policy activity in recent weeks. On the fiscal front the European Commission proposed a region-wide €750 billion rescue fund, including €500 billion in grants and €250 billion in loans. While a final agreement may differ and is likely many months away, this is still a positive step. For monetary policy, the European Central Bank increased its Pandemic Emergency Purchase Program by €600 billion, while we expect the Bank of England to raise its asset purchase target a further £200 billion later this month.

As is often the case around turning points, the news is mixed. Our 2020 GDP forecast for China has improved and we expect growth of 1.2% this year. However, we have revised our 2020 GDP outlooks for the Eurozone and Canada lower, to declines of 8.9% and 7.4%, respectively.





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

Together we'll go far

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

Massive Savings Could Support Spending

Never before have Americans been asked to stay in their homes and avoid social interaction as they have these past few months. Among many other things, this behavioral shift has meant an outright inability for consumers to spend on various services from low cost experiences like a haircut or a trip to the movies to more significant outlays like air travel and medical procedures. Spending on services usually makes up more than 60% of consumer outlays and typically does not decline even in bad recessions; rather, the volatility is usually in spending on goods. The sudden and unprecedented stop in spending due to the lockdowns has already resulted in the largest drop in services spending on record (bottom left). But the income that would have been spent during that time has not vanished. It has largely gone into savings which can help underpin spending in the months and quarters ahead.

This forced savings dynamic is not the only factor at play in the recent build up in savings. Personal income in April increased by the most on record. This may sound completely at odds with the fact that more than 20 million people lost their job that month. Indeed, wages & salaries, which typically account for the bulk of personal income, fell dramatically in April but the decline was more than offset by the combination of “economic impact payments” and the extra $600 per week for unemployment benefits distributed by the federal government. The combination of regular, state-level unemployment benefits plus the extra $600 per week from the federal government has led to average wage replacement levels that exceed 100% in some states (bottom right).

Going forward, personal income will likely contract sharply in May. Unemployment benefits may be higher but economic impact payments will likely be much lower. Combine that with a further decline in wage & salary income and we would not be shocked to see one of the largest ever monthly declines in income. Still, this higher stock of savings should help make up for potential lost income throughout the forecast period, such that consumption growth can moderately outpace income growth over the next year.

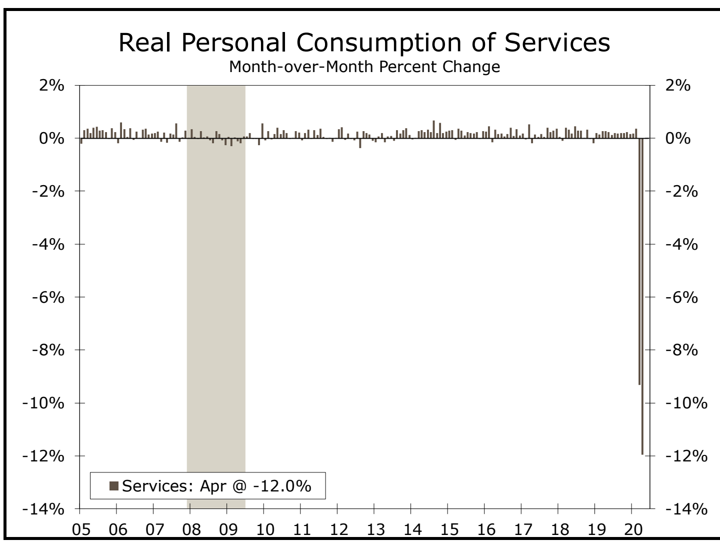
Our forecast of personal consumption expenditure (PCE) looks for spending in the second quarter to drop at an annualized rate of more than 40%. Outside of a lockdown, such a cratering in spending would defy any realistic expectation. The rebound in the third quarter is expected to be about the same growth rate but with a positive rather than a negative sign.

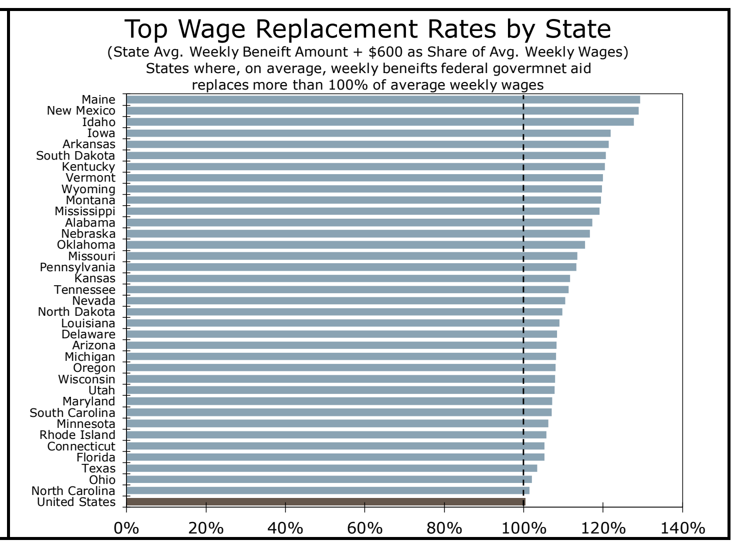
If all those numbers are right, the level of consumer spending after the surge in Q3 would still be about 7.5% lower than its peak in the fourth quarter of 2019. By the end of the year, PCE is still down about 5% from its peak and even by the end of 2021 it would still be down a little less than 3%. So the trajectory of spending is V-shaped, but it might be until the middle of 2022 before the right side of that V matched the left.

Elsewhere, we expect the rebound will be slower. Business fixed investment, for example, does not meaningfully improve until next year, although we expect equipment spending will turn positive in the fourth quarter of this year. Structures spending does not come back online until the second quarter of next year.

Businesses drew down inventories in the first quarter and we expect that to continue for the next couple of quarters. If that is right inventories would be a drag on growth in Q2, although all it would take is a slower pace of depletion for inventories to boost overall growth in the third quarter.

It may also be a longer wait before trade is a major positive influence on growth. Global trade has slowed amid lockdowns all over the world and it may take a while before growth in U.S exports is outpacing the growth in imports.





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

Wells Fargo Securities U.S. Economic Forecast

	Actual									Forecast							Actual		Forecast	
	2018				2019				2020				2021							
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2018	2019	2020	2021
Real Gross Domestic Product (a)	2.6	3.5	2.9	1.1	3.1	2.0	2.1	2.1	-5.0	-37.6	23.9	10.6	3.1	2.7	2.7	2.4	2.9	2.3	-5.8	3.3
Personal Consumption	1.7	4.0	3.5	1.4	1.1	4.6	3.1	1.8	-6.8	-43.7	39.6	10.6	3.0	2.7	2.7	2.5	3.0	2.6	-6.4	4.1
Business Fixed Investment	8.8	7.9	2.1	4.8	4.4	-1.0	-2.3	-2.4	-7.9	-28.1	-9.3	3.2	3.0	5.2	4.9	4.9	6.4	2.1	-9.5	-0.2
Equipment	6.6	3.4	2.9	7.4	-0.1	0.8	-3.8	-4.3	-16.6	-33.4	-10.8	15.1	4.6	4.6	4.0	4.0	6.8	1.3	-12.9	1.3
Intellectual Property Products	9.7	11.9	4.1	11.7	10.8	3.6	4.7	2.8	1.0	-12.2	-2.8	-4.4	3.7	7.4	6.9	6.7	7.4	7.5	-1.5	1.5
Structures	12.1	11.0	-2.1	-9.0	4.0	-11.1	-9.9	-7.2	-3.9	-45.0	-19.0	-7.5	-3.0	1.5	2.5	3.0	4.1	-4.3	-16.8	-7.9
Residential Investment	-5.3	-3.7	-4.0	-4.7	-1.0	-3.0	4.6	6.5	18.5	-35.0	6.0	2.0	3.0	5.0	6.0	6.5	-1.5	-1.5	-1.3	1.1
Government Purchases	1.9	2.6	2.1	-0.4	2.9	4.8	1.7	2.5	0.8	-7.3	-1.6	2.6	1.5	0.7	0.2	0.0	1.7	2.3	-0.3	0.3
Net Exports	-884.2	-850.5	-962.4	-983.0	-944.0	-980.7	-990.1	-900.7	-816.0	-805.2	-848.7	-857.0	-861.3	-865.6	-862.3	-860.9	-920.0	-953.9	-831.7	-862.5
Pct. Point Contribution to GDP	0.0	0.7	-2.1	-0.4	0.7	-0.7	-0.1	1.5	1.3	0.2	-1.0	-0.2	-0.1	-0.1	0.1	0.0	-0.4	-0.2	0.6	-0.2
Inventory Change	40.5	-28.0	87.2	93.0	116.0	69.4	69.4	13.1	-67.2	-80.0	-40.0	60.0	75.0	75.0	70.0	60.0	48.1	67.0	-31.8	70.0
Pct. Point Contribution to GDP	0.1	-1.2	2.1	0.1	0.5	-0.9	0.0	-1.0	-1.4	-0.3	1.0	2.3	0.3	0.0	-0.1	-0.2	0.1	0.1	-0.5	0.6
Nominal GDP (a)	5.0	7.1	4.8	2.9	3.9	4.7	3.8	3.5	-3.5	-39.2	25.7	11.8	4.9	4.6	4.3	3.9	5.4	4.1	-5.0	4.7
Real Final Sales	2.4	4.8	0.8	1.0	2.6	3.0	2.1	3.1	-3.6	-36.8	22.7	8.2	2.8	2.7	2.8	2.6	2.8	2.2	-5.2	2.8
Retail Sales (b)	4.4	5.3	5.0	3.0	2.7	3.5	4.0	4.0	1.2	-17.7	-10.5	-6.4	-1.5	20.7	10.9	6.5	4.4	3.6	-8.4	8.6
Inflation Indicators (b)																				
PCE Deflator	1.9	2.3	2.2	1.9	1.4	1.4	1.4	1.4	1.6	0.5	0.5	0.4	0.5	1.5	1.6	1.6	2.1	1.4	0.7	1.3
"Core" PCE Deflator	1.8	2.0	2.0	1.9	1.6	1.6	1.7	1.6	1.7	0.8	0.6	0.5	0.6	1.4	1.6	1.7	2.0	1.6	0.9	1.3
Consumer Price Index	2.2	2.7	2.7	2.2	1.6	1.8	1.8	2.0	2.1	0.4	0.3	0.3	0.5	1.8	1.8	1.6	2.4	1.8	0.8	1.4
"Core" Consumer Price Index	1.9	2.2	2.3	2.2	2.1	2.1	2.3	2.3	2.2	1.3	0.9	0.8	0.8	1.7	1.8	1.9	2.1	2.2	1.3	1.6
Producer Price Index (Final Demand)	2.8	3.0	3.1	2.8	1.9	2.0	1.6	1.1	1.3	-0.9	-0.5	-0.1	0.5	2.6	2.6	2.5	2.9	1.7	0.0	2.0
Employment Cost Index	2.7	2.8	2.8	2.9	2.8	2.7	2.8	2.7	2.8	2.4	2.0	1.8	1.5	1.8	2.0	2.1	2.8	2.7	2.2	1.8
Real Disposable Income (b)	3.9	3.9	4.1	3.9	3.3	3.0	2.7	2.6	1.7	5.3	-2.1	-1.7	-1.2	-4.3	3.1	3.0	4.0	2.9	0.8	0.1
Nominal Personal Income (b)	5.6	5.8	5.9	4.9	4.6	4.7	4.2	4.2	3.2	4.2	-2.4	-2.1	-1.4	-2.4	4.7	4.7	5.6	4.4	0.7	1.3
Industrial Production (a)	2.3	4.6	5.2	3.9	-1.9	-2.3	1.1	0.4	-7.1	-46.8	-12.2	-5.1	3.0	6.3	5.7	3.6	3.9	0.9	-14.1	-4.0
Capacity Utilization	77.9	78.5	79.1	79.4	78.6	77.8	77.6	77.2	75.6	63.3	70.4	71.1	71.4	72.5	73.5	74.2	78.7	77.8	70.1	72.9
Corporate Profits Before Taxes (b)	2.9	2.4	4.2	4.2	-2.2	1.3	-1.2	2.2	-8.5	-15.0	-12.0	-2.0	6.0	15.0	14.0	5.0	3.4	0.0	-9.3	9.8
Corporate Profits After Taxes	10.3	8.3	11.3	10.1	-2.9	1.3	-0.3	2.2	-8.6	-14.3	-11.9	-1.5	7.3	16.3	15.3	6.2	10.0	0.1	-9.0	11.1
Federal Budget Balance (c)	-375	-7	-172	-319	-372	-56	-237	-357	-387	-1777	-879	-541	-658	-328	-472	-383	-779	-984	-3400	-2000
Trade Weighted Dollar Index (d)	103.1	107.3	107.6	110.1	109.8	109.7	111.0	109.9	112.7	110.3	111.3	109.8	108.3	107.0	106.8	106.8	106.4	110.1	111.0	107.2
Nonfarm Payroll Change (e)	234	211	153	172	139	159	203	210	-303	-5059	2000	550	280	240	225	215	193	178	-703	240
Unemployment Rate	4.1	3.9	3.8	3.8	3.9	3.6	3.6	3.5	3.8	13.4	9.9	7.7	6.9	6.4	6.2	6.1	3.9	3.7	8.7	6.4
Housing Starts (f)	1.31	1.26	1.24	1.18	1.20	1.26	1.29	1.43	1.49	0.96	1.18	1.22	1.22	1.23	1.24	1.24	1.25	1.29	1.21	1.23
Light Vehicle Sales (g)	17.1	17.3	17.0	17.4	16.8	17.0	17.0	16.7	15.0	11.0	12.0	12.8	14.2	15.9	16.3	16.5	17.2	16.9	12.7	15.7
Crude Oil - Brent - Front Contract (h)	66.9	74.6	75.8	68.6	63.8	67.6	61.5	61.7	51.0	32.0	33.0	37.0	42.0	48.0	46.0	50.0	71.5	63.6	38.3	46.5
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	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	1.96	2.25	0.25	0.25
3 Month LIBOR	2.31	2.34	2.40	2.81	2.60	2.32	2.09	1.91	1.45	0.30	0.30	0.30	0.35	0.30	0.30	0.30	2.31	2.33	0.59	0.31
Prime Rate	4.75	5.00	5.25	5.50	5.50	5.50	5.00	4.75	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	4.96	5.25	3.25	3.25
Conventional Mortgage Rate	4.44	4.57	4.63	4.64	4.28	3.80	3.61	3.72	3.45	3.00	2.95	2.95	3.00	3.00	3.10	3.20	4.54	3.94	3.09	3.08
3 Month Bill	1.73	1.93	2.19	2.45	2.40	2.12	1.88	1.55	0.11	0.15	0.15	0.15	0.20	0.15	0.15	0.15	1.97	2.11	0.14	0.16
6 Month Bill	1.93	2.11	2.36	2.56	2.44	2.09	1.83	1.60	0.15	0.15	0.15	0.15	0.20	0.15	0.20	0.20	2.14	2.11	0.15	0.19
1 Year Bill	2.09	2.33	2.59	2.63	2.40	1.92	1.75	1.59	0.17	0.20	0.20	0.20	0.20	0.25	0.25	0.30	2.33	2.05	0.19	0.25
2 Year Note	2.27	2.52	2.81	2.48	2.27	1.75	1.63	1.58	0.23	0.20	0.20	0.25	0.30	0.40	0.50	0.65	2.53	1.97	0.22	0.46
5 Year Note	2.56	2.73	2.94	2.51	2.23	1.76	1.55	1.69	0.37	0.50	0.60	0.65	0.75	0.85	0.95	1.00	2.75	1.95	0.53	0.89
10 Year Note	2.74	2.85	3.05	2.69	2.41	2.00	1.68	1.92	0.70	0.90	1.05	1.15	1.25	1.30	1.40	1.50	2.91	2.14	0.95	1.36
30 Year Bond	2.97	2.98	3.19	3.02	2.81	2.52	2.12	2.39	1.35	1.65	1.80	1.85	1.90	1.95	2.05	2.10	3.11	2.58	1.66	2.00

Forecast as of: June 09, 2020

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

Some Light at the End of the Economic Tunnel

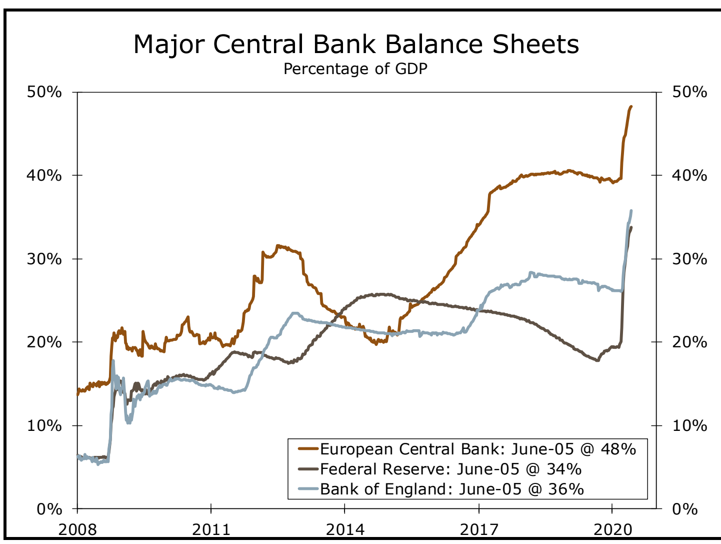
The second quarter is set to be another tough one for the global economy, and will confirm the second recession for the G20 group of economies since 1998. The only other back-to-back G20 GDP declines occurred in Q4-2008 and Q1-2009 and saw a cumulative GDP fall of roughly 3%. We expect the contraction to be much deeper during this episode.

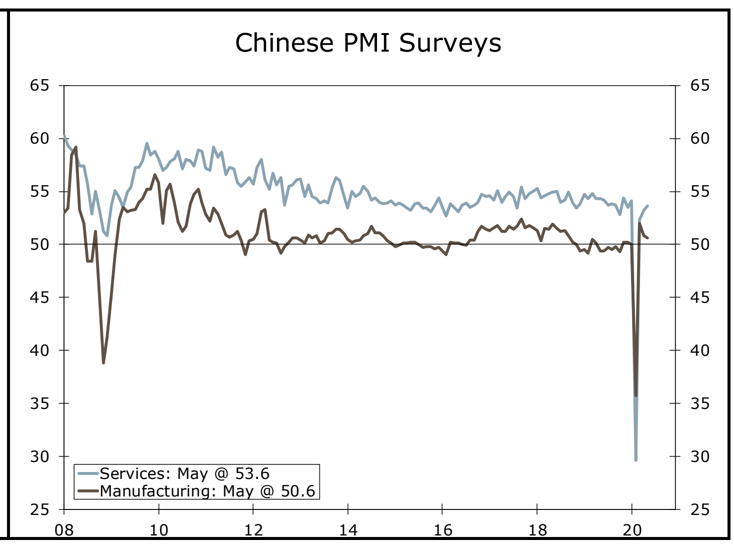
Despite the current challenges, there are nascent signs the global economy is past the worst. Confidence surveys improved for several major economies in May, leading the global manufacturing and services PMIs to rise to 42.4 and 35.2, respectively. In addition, there were some unexpected employment gains for some major countries in May. These signs of potential stabilization in the global economy are also reflected in our growth outlook. We expect the global economy to contract 3.7% in 2020, the first time since February we have not revised our 2020 outlook lower.

The stabilization of growth has been assisted by an aggressive response by global policymakers. In recent weeks Europe has been a center of policy activity. On the fiscal front the European Commission proposed a region wide €750 billion rescue fund, including €500 billion in grants and €250 billion in loans. With further negotiations needed, a final agreement may differ and is likely still many months away, but this still represents a positive step. On the monetary policy front, the European Central Bank increased its Pandemic Emergency Purchase Program another €600 billion to €1350 billion and extended the program through until June 2021. Later this month, we expect the Bank of England will raise its asset purchase target a further £200 billion. With the U.K. economy expected to fall sharply in Q2 and the central bank looking to maintain supportive monetary policy during the early and tentative stages of the U.K. recovery, we expect the Bank of England will extend its asset purchases through Q3. While the data flow is becoming more hopeful, as is often the case around turning points, the news is not uniformly positive or negative. In terms of our stabilizing 2020 global growth outlook, much of that stems from what appears to be a robust rebound in China. Manufacturing and services PMIs have recovered above the breakeven 50 level and activity data have also improved. We now expect Chinese Q2 GDP to recoup most of its Q1 decline, while for full-year 2020 we also expect positive growth of 1.2%.

In contrast, we have cut our growth outlook for some other major economies. Even as Eurozone confidence surveys begin to improve, a cumulative 21.5% decline in retail sales during March and April, as well as a large decline is service sector output more broadly for March, means that the Eurozone recovery is off a very low base. We expect Eurozone GDP to contract 8.9% in 2020, more than the 8% decline we forecast a month ago. Another notable downward revision is our outlook for Canada's economy, where we expect GDP to fall 7.4% in 2020.

A less than uniform recovery is also likely across emerging markets, reflecting the evolution of COVID-19 in various parts of the world. Whereas COVID-19 hit China's economy hard and early, in recent weeks COVID-19 case numbers have picked up markedly in several other emerging economies, including Brazil and Russia in particular, along with India and a range of Latin American countries. We forecast a large contraction in Mexico's economy in 2020 and a smaller fall in India, while as a region, we anticipate any economic recovery in Latin America will lag other parts of the world. Finally the signs of economic hope appears to be reducing support for safe haven currencies like the U.S. dollar and Japanese yen, and we now expect commodity-sensitive and emerging currencies to strengthen earlier, and by more than we previously anticipated.





Source: Datastream 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%	2.9%	-3.7%	4.4%	3.6%	3.4%	3.0%	3.0%
Advanced Economies[1]	2.2%	1.9%	-6.6%	3.0%	2.0%	1.6%	0.5%	1.3%
United States	2.9%	2.3%	-5.8%	3.3%	2.4%	1.8%	0.8%	1.4%
Eurozone	1.9%	1.2%	-8.9%	2.7%	1.8%	1.2%	0.3%	1.2%
United Kingdom	1.3%	1.4%	-7.6%	4.3%	2.5%	1.8%	0.8%	1.4%
Japan	0.3%	0.7%	-5.8%	-0.2%	1.0%	0.5%	0.0%	0.2%
Canada	2.0%	1.7%	-7.4%	3.5%	2.3%	1.9%	0.4%	1.5%
Developing Economies[1]	4.5%	3.7%	-1.8%	5.4%	4.8%	4.8%	4.7%	4.1%
China	6.7%	6.1%	1.2%	9.5%	2.1%	2.9%	2.7%	1.8%
India	6.8%	4.9%	-1.6%	3.6%	3.9%	3.7%	4.7%	3.6%
Mexico	2.2%	-0.3%	-8.3%	-1.3%	4.9%	3.6%	2.8%	3.2%

Forecast as of: June 09, 2020

[1]Aggregated Using PPP Weights

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	Central Bank Key Policy Rate					
	2020			2021		
	Q2	Q3	Q4	Q1	Q2	Q3
United States	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
Eurozone[1]	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%
United Kingdom	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
Japan	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%
Canada	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
	2-Year Note					
	2020			2021		
	Q2	Q3	Q4	Q1	Q2	Q3
United States	0.20%	0.20%	0.25%	0.30%	0.40%	0.50%
Eurozone[2]	-0.60%	-0.55%	-0.50%	-0.40%	-0.30%	-0.15%
United Kingdom	0.05%	0.15%	0.25%	0.35%	0.45%	0.55%
Japan	-0.15%	-0.15%	-0.10%	0.00%	0.05%	0.05%
Canada	0.40%	0.40%	0.45%	0.45%	0.50%	0.60%
	10-Year Note					
	2020			2021		
	Q2	Q3	Q4	Q1	Q2	Q3
United States	0.90%	1.05%	1.15%	1.25%	1.30%	1.40%
Eurozone[2]	-0.30%	-0.20%	-0.10%	0.00%	0.10%	0.20%
United Kingdom	0.35%	0.50%	0.65%	0.70%	0.75%	0.80%
Japan	0.00%	0.05%	0.10%	0.10%	0.15%	0.15%
Canada	0.75%	0.85%	0.95%	1.00%	1.05%	1.10%

Forecast as of: June 09, 2020

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

Source: International Monetary Fund and Wells Fargo Securities

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