

# Economics Group

## MONTHLY OUTLOOK

### U.S. Overview

#### U.S. Economic Growth Appears To Be Positive Again

Real GDP data that are scheduled for release at the end of this month should show that output nosedived at an extraordinary rate of roughly 35% (annualized) in the second quarter. But recent monthly data suggest that the economy hit bottom in May, and that GDP should bounce robustly in the third quarter. That said, we have dialed back our growth forecast for Q3 due to the recent acceleration in COVID-19 cases that have led some states to hit pause on the re-opening process or to implement some modest new restrictions.

Our forecast for the rest of the year is predicated on the assumption that a generalized lockdown of the economy, such as which occurred in March and April, does not reoccur. We also assume that the eventual development of an effective vaccine will allow economic life to gradually return to some semblance of “normal” next year. But we readily acknowledge that a generalized re-imposition of restrictions represents a downside risk to our forecast.

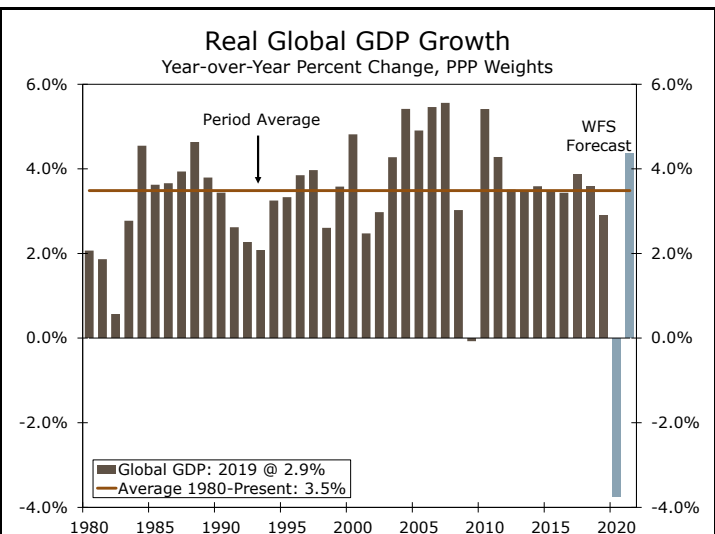
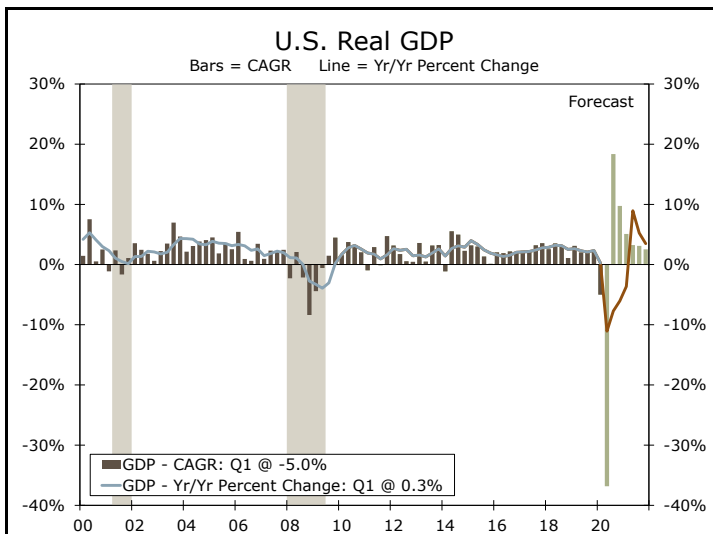
It likely will take a few years before the economy bounces back to the level that prevailed before the pandemic struck. In that regard, we look for the unemployment rate, which had been as low as 3.5% in February, to recede to only 8% by the end of this year and to 6% by the end of 2021. An elevated rate of unemployment and benign inflation should keep the Fed on hold through at least the end of next year. Consequently, long-term interest rates should also remain depressed for the foreseeable future.

### International Overview

#### Global Recovery Underway, but a Bit Uneven

There continues to be significant uncertainty around the pace of the global economic recovery. Activity and sentiment data suggest the worst of the COVID-19 led slowdown may be over; however, we believe certain countries may be on track to rebound faster than others. In that context, we forecast a less severe Q2 contraction in the Eurozone as retail sales data as well as manufacturing and services PMIs signal a quicker recovery could be underway. In addition, we expect a sharper bounce back in Q3 and now forecast a 7.7% annual contraction, revised up from an 8.9% contraction a month ago. On the other hand, we forecast a sharper downturn in Japan. Despite a large fiscal stimulus program, consumer spending activity has not picked up as retail sales data are still underwhelming and signal a slower than expected recovery. Part of the issue in Japan is the higher consumption tax; however, even compared to the prior tax hike in 2014, consumer spending is extremely subdued.

The recovery is also expected to be uneven in the emerging markets, and Mexico is one country we are particularly worried about. We revised our GDP forecast for this year lower again as the virus continues to spread and the government defers fiscal stimulus efforts. Our forecasts remain steady in China and India, although risks are tilted towards slower growth, especially in India as the country struggles to contain the spread of the virus. Despite some adjustments, our global GDP forecast remains relatively stable as we made only a slight downward revision and forecast a 3.8% annual contraction this year.



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



**U.S. Economic Growth Appears To Be Positive Again**

Real GDP data that are scheduled to print on July 30 likely will show that the U.S. economy contracted at an extraordinary rate in the second quarter. Specifically, we estimate that real GDP plunged at an annualized rate in excess of 35% in Q2 (see chart on front page). This unprecedented rate of decline masks some important monthly dynamics, however. Economic activity went into free fall in April as many states implemented shelter-in-place restrictions. For example, retail sales nosedived roughly 15%, industrial production tumbled nearly 13% and nonfarm employment plunged by approximately 21 million. Economic activity subsequently bounced in May as many states eased restrictions, and this rebound appears to have carried over into June. Therefore, it appears that the economy entered the third quarter with significant momentum, albeit from a low base.

But the recent acceleration in COVID-19 cases has led many states to hit pause on the re-opening process or to implement some modest new restrictions. Although we project that real GDP will grow at a very strong rate in Q3-2020—roughly 18% at an annualized rate—we have dialed back our forecast from the 24% rate that we projected a month ago due to the steps that many states have implemented in recent weeks to slow the process of re-opening.

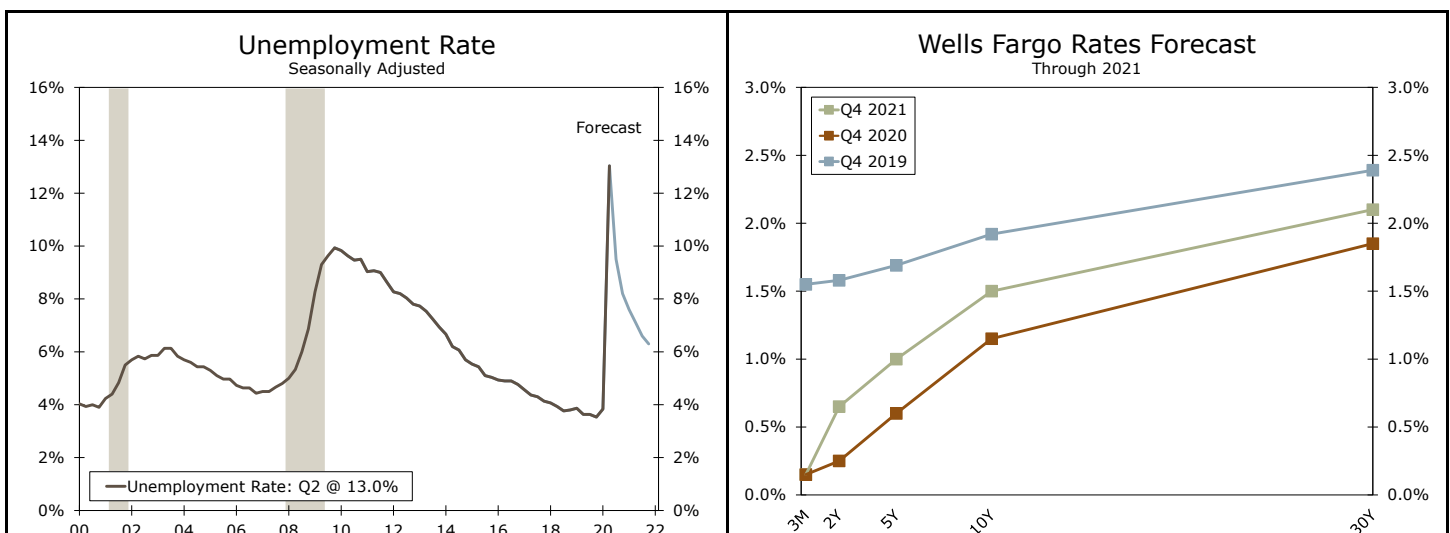
Our forecast in the coming quarters is predicated on the assumption that a generalized lockdown of the economy, such as which occurred in March and April, does not reoccur. There may be localized setbacks, but in our view governors in many states will be under significant pressure from their constituents not to re-impose generalized shelter-in-place restrictions. We readily acknowledge that a generalized re-imposition of restrictions represents a downside risk to our forecast.

Looking into 2021, we expect that the eventual development of an effective vaccine will allow economic life to gradually return to some semblance of “normal.” That said, it likely will take a few years before the economy bounces back to the level that

prevailed before the pandemic struck. In that regard, we forecast the level of GDP (*i.e.*, the size of the economy) in Q4-2021 will still be roughly 3% percent below its Q4-2019 peak.

As noted previously, nonfarm payrolls swooned by roughly 21 million in April as many workers were laid off due to business closures. Payrolls rebounded by a cumulative 7.5 million in May and June, and the unemployment rate, which spiked to 14.7% in April, has subsequently receded to 11.1%. But with the process of re-opening being delayed, employment growth likely will slow significantly in coming months. We look for the unemployment rate to fall to about 8% by the end of this year and to 6% or so by the end of 2021 (bottom left). Our forecast implies that payrolls at the end of next year will still be more than seven million smaller than they were in February. An effective vaccine that is developed more quickly than we anticipate could lead to some faster job growth later this year and early next year. That said, a return to the 3.5% unemployment rate that prevailed in February 2020 likely will not happen anytime soon.

With an elevated rate of unemployment and with inflation benign—we look for the rate of PCE inflation to remain well-below the Fed’s target of 2% throughout the end of next year—we forecast that the Fed will keep rates on hold for the foreseeable future. Some analysts look for the Federal Open Market Committee (FOMC) to cut rates into negative territory, an outlook we do not share. But we look for the FOMC to keep its target range for the fed funds rate at 0.00% to 0.25% through at least the end of next year. Consequently, we forecast that long-term interest rates will also remain extraordinarily low (bottom right). As of this writing, the yield on the 10-year Treasury security is approximately 0.66%, and we look for it to creep higher in coming months to end the year modestly above 1.00%. We forecast that this trend rise in the 10-year rate will continue in 2021. Nevertheless, if the 10-year rate ends next year at roughly 1.50%, it would still be about 50 bps lower than it was at the end of 2019.



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

Wells Fargo Securities 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	2.1	2.1	-5.0	-36.8	18.4	9.7	5.1	3.2	3.1	2.5	2.9	2.3	-6.1	3.3
Personal Consumption	1.7	4.0	3.5	1.4	1.1	4.6	3.1	1.8	-6.8	-37.0	24.8	9.4	4.0	3.8	3.6	2.8	3.0	2.6	-5.8	3.9
Business Fixed Investment	8.8	7.9	2.1	4.8	4.4	-1.0	-2.3	-2.4	-6.4	-31.5	-9.3	3.1	2.9	5.2	4.9	4.9	6.4	2.1	-10.0	-0.6
Equipment	6.6	3.4	2.9	7.4	-0.1	0.8	-3.8	-4.3	-16.6	-39.1	-10.8	15.0	4.6	4.6	4.0	4.0	6.8	1.3	-14.3	0.6
Intellectual Property Products	9.7	11.9	4.1	11.7	10.8	3.6	4.7	2.8	1.3	-13.7	-2.8	-4.4	3.7	7.4	6.9	6.7	7.4	7.5	-1.7	1.4
Structures	12.1	11.0	-2.1	-9.0	4.0	-11.1	-9.9	-7.2	2.6	-45.0	-19.0	-7.5	-3.0	1.5	2.5	3.0	4.1	-4.3	-15.4	-7.9
Residential Investment	-5.3	-3.7	-4.0	-4.7	-1.0	-3.0	4.6	6.5	18.2	-35.0	6.0	2.0	3.0	5.0	6.0	6.5	-1.5	-1.5	-1.4	1.1
Government Purchases	1.9	2.6	2.1	-0.4	2.9	4.8	1.7	2.5	1.1	-7.7	-2.8	3.8	1.8	0.4	-0.4	-0.6	1.7	2.3	-0.4	0.3
Net Exports	-884.2	-850.5	-962.4	-983.0	-944.0	-980.7	-990.1	-900.7	-816.6	-879.4	-926.4	-936.8	-943.2	-949.0	-947.3	-947.5	-920.0	-953.9	-889.8	-946.7
Pct. Point Contribution to GDP	0.0	0.7	-2.1	-0.4	0.7	-0.7	-0.1	1.5	1.3	-1.3	-1.1	-0.2	-0.1	-0.1	0.0	0.0	-0.4	-0.2	0.3	-0.3
Inventory Change	40.5	-28.0	87.2	93.0	116.0	69.4	69.4	13.1	-74.8	-250.0	-70.0	20.0	90.0	80.0	70.0	60.0	48.1	67.0	-93.7	75.0
Pct. Point Contribution to GDP	0.1	-1.2	2.1	0.1	0.5	-0.9	0.0	-1.0	-1.6	-3.6	4.3	2.1	1.6	-0.2	-0.2	-0.2	0.1	0.1	-0.8	0.9
Nominal GDP (a)	5.0	7.1	4.8	2.9	3.9	4.7	3.8	3.5	-3.4	-38.2	20.6	10.8	6.1	4.6	5.0	4.2	5.4	4.1	-5.3	4.4
Real Final Sales	2.4	4.8	0.8	1.0	2.6	3.0	2.1	3.1	-3.5	-33.5	13.4	7.5	3.5	3.5	3.3	2.8	2.8	2.2	-5.3	2.4
Retail Sales (b)	4.4	5.3	5.0	3.0	2.7	3.5	4.0	4.0	1.2	-9.6	1.5	6.2	11.6	24.6	10.9	6.5	4.4	3.5	-0.2	13.0
Inflation Indicators (b)																				
PCE Deflator	1.9	2.3	2.2	1.9	1.4	1.4	1.4	1.4	1.6	0.6	0.7	0.5	0.5	1.3	1.2	1.4	2.1	1.4	0.8	1.1
"Core" PCE Deflator	1.8	2.0	2.0	1.9	1.6	1.6	1.7	1.6	1.7	1.0	1.1	0.9	1.0	1.6	1.4	1.6	2.0	1.6	1.2	1.4
Consumer Price Index	2.2	2.7	2.7	2.2	1.6	1.8	1.8	2.0	2.1	0.5	0.9	0.6	0.6	1.8	1.3	1.6	2.4	1.8	1.0	1.3
"Core" Consumer Price Index	1.9	2.2	2.3	2.2	2.1	2.1	2.3	2.3	2.2	1.4	1.2	1.0	1.0	1.7	1.6	1.8	2.1	2.2	1.5	1.5
Producer Price Index (Final Demand)	2.8	3.0	3.1	2.8	1.9	2.0	1.6	1.1	1.3	-0.7	0.0	0.3	1.0	2.8	2.6	2.5	2.9	1.7	0.2	2.2
Employment Cost Index	2.7	2.8	2.8	2.9	2.8	2.7	2.8	2.7	2.8	2.5	2.0	1.8	1.5	1.8	2.1	2.2	2.8	2.7	2.3	1.9
Real Disposable Income (b)	3.9	3.9	4.1	3.9	3.3	3.0	2.7	2.6	1.7	9.1	1.4	1.0	1.7	-5.0	2.4	3.0	4.0	2.9	3.3	0.4
Nominal Personal Income (b)	5.6	5.8	5.9	4.9	4.6	4.7	4.2	4.2	3.2	7.9	1.4	0.8	1.4	-3.0	3.7	4.5	5.6	4.4	3.3	1.6
Industrial Production (a)	2.3	4.6	5.2	3.9	-1.9	-2.3	1.1	0.4	-6.9	-44.9	15.0	5.5	3.5	6.3	5.7	3.6	3.9	0.9	-10.1	1.8
Capacity Utilization	77.9	78.5	79.1	79.4	78.6	77.8	77.6	77.2	75.6	64.9	68.0	70.7	71.4	72.5	73.5	74.2	78.7	77.8	69.8	72.9
Corporate Profits Before Taxes (b)	2.9	2.4	4.2	4.2	-2.2	1.3	-1.2	2.2	-6.9	-15.0	-12.0	-2.0	6.0	15.0	14.0	5.0	3.4	0.0	-9.0	9.8
Corporate Profits After Taxes	10.3	8.3	11.3	10.1	-2.9	1.3	-0.3	2.2	-6.6	-14.3	-11.9	-1.5	7.3	16.3	15.3	6.2	10.0	0.1	-8.6	11.0
Federal Budget Balance (c)	-375	-7	-172	-319	-372	-56	-237	-357	-387	-1665	-991	-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	110.6	109.2	108.2	107.3	106.7	106.6	106.4	110.1	110.7	107.2
Nonfarm Payroll Change (e)	234	211	153	172	139	159	203	210	-303	-4429	1100	500	280	240	210	200	193	178	-783	233
Unemployment Rate	4.1	3.9	3.8	3.8	3.9	3.6	3.6	3.5	3.8	13.0	9.5	8.2	7.6	7.1	6.6	6.3	3.9	3.7	8.6	6.9
Housing Starts (f)	1.31	1.26	1.24	1.18	1.20	1.26	1.29	1.43	1.48	0.97	1.14	1.21	1.22	1.23	1.24	1.24	1.25	1.29	1.20	1.23
Light Vehicle Sales (g)	17.1	17.3	17.0	17.4	16.8	17.0	17.0	16.7	15.0	11.4	13.1	13.6	14.2	15.9	16.3	16.5	17.2	16.9	13.3	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	34.7	36.0	38.0	42.0	48.0	46.0	50.0	71.5	63.6	39.9	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	3.16	3.00	3.00	3.05	3.05	3.10	3.20	4.54	3.94	3.15	3.10
3 Month Bill	1.73	1.93	2.19	2.45	2.40	2.12	1.88	1.55	0.11	0.16	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	0.18	0.15	0.15	0.20	0.15	0.20	0.20	2.14	2.11	0.16	0.19
1 Year Bill	2.09	2.33	2.59	2.63	2.40	1.92	1.75	1.59	0.17	0.16	0.15	0.20	0.20	0.25	0.25	0.30	2.33	2.05	0.17	0.25
2 Year Note	2.27	2.52	2.81	2.48	2.27	1.75	1.63	1.58	0.23	0.16	0.20	0.25	0.30	0.40	0.50	0.65	2.53	1.97	0.21	0.46
5 Year Note	2.56	2.73	2.94	2.51	2.23	1.76	1.55	1.69	0.37	0.29	0.50	0.60	0.75	0.85	0.95	1.00	2.75	1.95	0.44	0.89
10 Year Note	2.74	2.85	3.05	2.69	2.41	2.00	1.68	1.92	0.70	0.66	1.00	1.15	1.25	1.30	1.40	1.50	2.91	2.14	0.88	1.36
30 Year Bond	2.97	2.98	3.19	3.02	2.81	2.52	2.12	2.39	1.35	1.41	1.75	1.85	1.90	1.95	2.05	2.10	3.11	2.58	1.59	2.00

Forecast as of: July 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

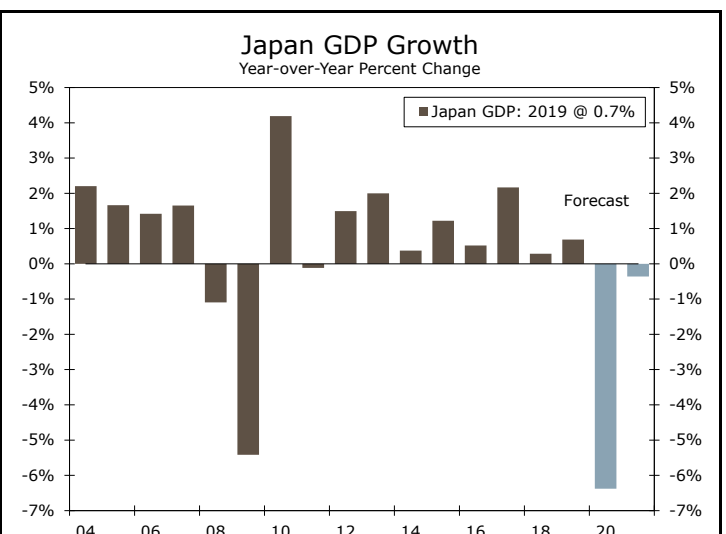
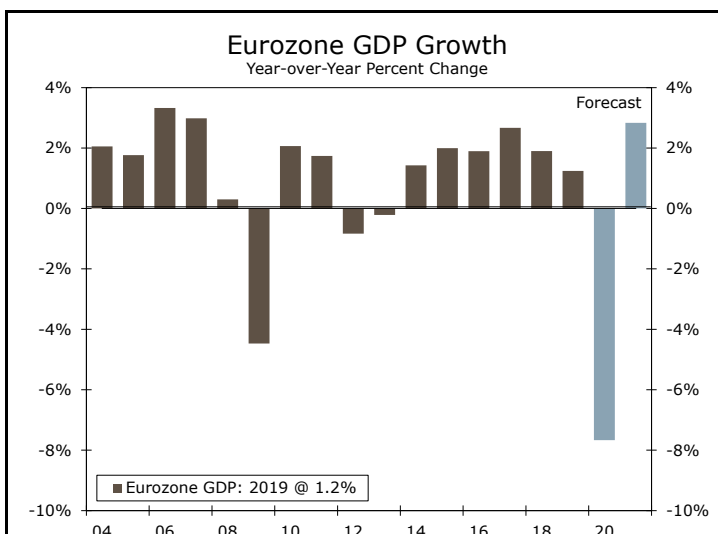
**The Uneven Global Recovery is Likely Underway**

We have held our global GDP forecast relatively steady, with only a minor downward revision as we expect a larger U.S. decline. In our view, we believe the worst of the COVID-19 slowdown is behind us and the global economy is on the gradual road to recovery. Activity and sentiment data across the G10 and in emerging markets have started to confirm these beliefs and we have seen a nice rebound in consumer spending data, PMIs and employment figures over the past few months. With that said, the Q2 contractions will likely be severe as lockdown measures are likely to take their toll on the global economy. We will not know how bad the declines will be for a few more weeks; however, we are becoming more confident that the global economic recovery will begin in Q3 and most economies will experience a sharp GDP rebound in the third quarter and for the recovery to persist into Q4.

While we expect a broad recovery in Q3, the strength of the rebound may be a bit uneven as some countries seem better positioned to combat the effects of the virus. To that point, we have become more optimistic on the economic prospects for the Eurozone. Some of the consumer driven data appears to be improving faster than initially expected as May retail sales beat consensus forecasts by a relatively wide margin, increasing 17.8% month-over-month against expectations for just a 15.0% gain. In addition, both the manufacturing and services PMIs firmed above expectations in June, and while still-below the key 50 level, we are encouraged that sentiment data continues to improve. As a result, we expect the Q2 contraction to be less severe and for the Q3 rebound to be more pronounced, and now forecast a 7.7% contraction in the Eurozone economy this year, up from about an 8.5% decline in last month's forecast (bottom left). Risks around this forecast are balanced as of now; however, we believe progress could be made towards additional fiscal spending, which, if implemented, could support the Eurozone economy even further and help in the recovery.

Downward revisions have also been made, and one country in particular where we made a downgrade is Japan. Despite a large fiscal stimulus package, consumer activity has not picked up as we had expected. COVID-19 is likely keeping some Japanese consumers on the sidelines for now; however, we believe the increase to the nation's consumption tax is playing a large role in downbeat activity data as well. Comparing the 2014 consumption tax increase to the most recent hike, consumer spending has slowed much quicker and has stayed at subdued levels as the COVID-19 outbreak gained momentum. We now expect the Japanese economy to contract 6.4% this year, which represents a modest downward revision from last month. Slight downward adjustments have also been made in Canada and the United Kingdom, although these revisions are a product of larger-than-forecasted contractions in Q1, and we still expect strong Q3 rebounds in each country.

We believe the recovery will be uneven across the emerging markets as well. The one bright spot is China, which continues to see data stabilize and in some cases even continue to improve. We maintain our view for the Chinese economy to expand a little over 1%, although acknowledge risks may be tilted to the downside as localized COVID-19 outbreaks could result in further lockdown measures. The outlook for Mexico, however, has turned darker. Activity and sentiment data remains bleak and will likely weigh on the economy throughout the year as the AMLO administration continues to exercise fiscal austerity and not pursue any meaningful spending packages. The Central Bank of Mexico is likely to continue easing monetary policy, although lower policy rates will not be enough to offset the economic impact of the virus. As a result, we have downgraded our GDP forecast for Mexico around a full percentage point and now expect the Mexican economy to contract 9.4% in 2020, with risks by about this forecast also tilted towards a deeper contraction.



Source: Bloomberg LP 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%	-3.8%	4.4%	3.6%	3.4%	3.1%	2.9%
Advanced Economies <sup>1</sup>	2.2%	1.9%	-6.5%	3.0%	2.0%	1.6%	0.7%	1.2%
United States	2.9%	2.3%	-6.1%	3.3%	2.4%	1.8%	1.0%	1.3%
Eurozone	1.9%	1.2%	-7.7%	2.8%	1.8%	1.2%	0.5%	1.2%
United Kingdom	1.3%	1.5%	-9.0%	4.1%	2.5%	1.8%	0.7%	1.3%
Japan	0.3%	0.7%	-6.4%	-0.4%	1.0%	0.5%	-0.1%	0.1%
Canada	2.0%	1.7%	-7.8%	3.3%	2.3%	1.9%	0.4%	1.4%
Developing Economies <sup>1</sup>	4.5%	3.7%	-1.8%	5.3%	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%	-9.4%	-1.7%	4.9%	3.6%	3.0%	3.3%

Forecast as of: July 09, 2020

<sup>1</sup>Aggregated Using PPP Weights

## Wells Fargo Securities International Interest Rate Forecast

(End of Quarter Rates)

	Central Bank Key Policy Rate					
	2020		2021			
	Q3	Q4	Q1	Q2	Q3	Q4
United States	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
Eurozone <sup>1</sup>	-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			
	Q3	Q4	Q1	Q2	Q3	Q4
United States	0.20%	0.25%	0.30%	0.40%	0.50%	0.65%
Eurozone <sup>2</sup>	-0.60%	-0.55%	-0.45%	-0.35%	-0.25%	-0.15%
United Kingdom	0.05%	0.10%	0.20%	0.30%	0.40%	0.60%
Japan	-0.15%	-0.10%	-0.05%	0.00%	0.05%	0.05%
Canada	0.35%	0.40%	0.40%	0.45%	0.55%	0.70%
	10-Year Note					
	2020		2021			
	Q3	Q4	Q1	Q2	Q3	Q4
United States	1.00%	1.15%	1.25%	1.30%	1.40%	1.50%
Eurozone <sup>2</sup>	-0.25%	-0.15%	-0.05%	0.05%	0.15%	0.20%
United Kingdom	0.40%	0.60%	0.65%	0.70%	0.75%	0.80%
Japan	0.05%	0.10%	0.10%	0.10%	0.15%	0.15%
Canada	0.75%	0.90%	0.95%	1.00%	1.05%	1.15%

Forecast as of: July 09, 2020

<sup>1</sup> ECB Deposit Rate <sup>2</sup> German Government Bond Yield

Source: International Monetary Fund and Wells Fargo Securities

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