August 12, 2020

Economics Group

MONTHLY OUTLOOK

U.S. Overview

A Riddle, Wrapped in a Mystery, Inside an Enigma

Winston Churchill's reply to questions about what Russia would do next are particularly relevant at this juncture of the recovery. Real GDP declined at its fastest pace on record during the second quarter, with output tumbling at a 32.9% annual rate. While a decline of that magnitude would normally stoke fear into the minds of forecasters, consumers and business owners, the drop seems like old news today, as it was widely anticipated and overshadowed by more recent data that show the economy has been on the mend since mid- to late-April. Furthermore, deconstructing GDP and matching that with the latest economic data suggest real GDP will rocket back in the current quarter.

The most stunning rebound has been consumer spending on goods, which has recovered its entire recession drop and is now about 5% ahead of its February pre-pandemic level. Goods purchases have been bolstered by the shift to working remotely, which has lifted demand for furniture, electronics and home accessories. Motor vehicle sales have also risen. With many factories closed in April and May, inventories have plunged. The inventory swing is boosting factory orders and driving rebounds in manufacturing and logistics now evident in the ISM surveys.

This summer's resurgence in virus cases led to a lull in most measures of consumer activity during July. While this quarter should certainly be stronger than the last, the fourth quarter remains a bit of a mystery. Q4 GDP growth will be dependent on continued declines in new COVID-19 cases and a rebound in consumer engagement in August and September.

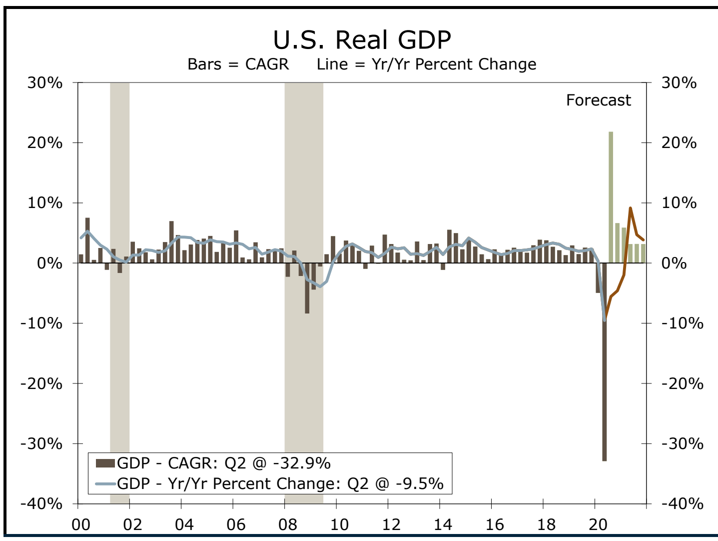
International Overview

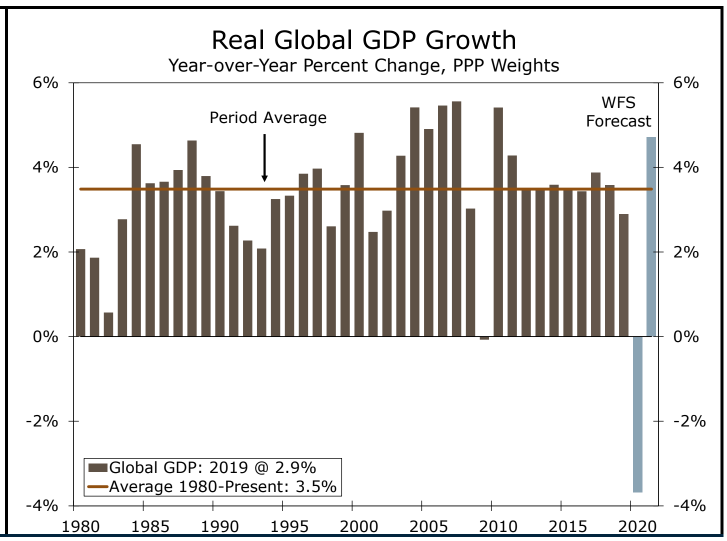
Global Growth Outlook Looking Mildly More Positive

The level of economic activity remains depressed in most major economies, but a gradual recovery continues to take hold. The rebound in the Eurozone has gathered momentum over the summer, and the Chinese economy looks increasingly likely to eke out modestly positive growth for 2020. In Canada, the story is similar, as data suggest the level of activity is depressed but the trend is headed in the right direction. Canada has recovered a bit more than half of the jobs it lost during March and April, compared to about 42% in the United States.

Unfortunately, not all economies are on the upswing. Mexico's economy remains in a difficult place as the country grapples with its still-robust spread of COVID-19. With few signs of a meaningful fiscal stimulus on the way, the country may not see as much of a rebound in economic growth in H2-2020.

At a more macro level, our thematic expectations for the global economy over the next 12 months largely remain intact. The negative output gaps in most economies are large, and it will be a long slog before they are fully closed. But, some of the worst case economic scenarios envisioned back in March and April have been avoided thus far, fought off by historic monetary and fiscal policy responses. If the economic recovery can continue over the next couple of quarters, we believe steady progress on the public health front can help keep the economic momentum going into 2021. But, the unpredictability and potential severity of COVID-19 outbreaks around the world still remain a risk to our forecast.





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

More Questions than Answers as We Head into Fall

With the big decline in second quarter real GDP growth now behind us, attention is even more keenly focused on where the economy is headed. The second quarter started off feebly, with real economic activity coming to a sudden stop, as policies were put in place to slow the spread of the virus. Businesses either shut down entirely or adjusted their work environment so that work could be done remotely. The impact on the economy was substantial and widespread, with activity plummeting in March and April. The bulk of the impact was in consumer spending, which plunged at a 34.6% annualized rate, with a majority of the weakness in outlays for services, reflecting less spending for health care, entertainment and personal services. A recovery began to take hold in May and June, and activity ended Q2 at a much higher level than it averaged during the quarter.

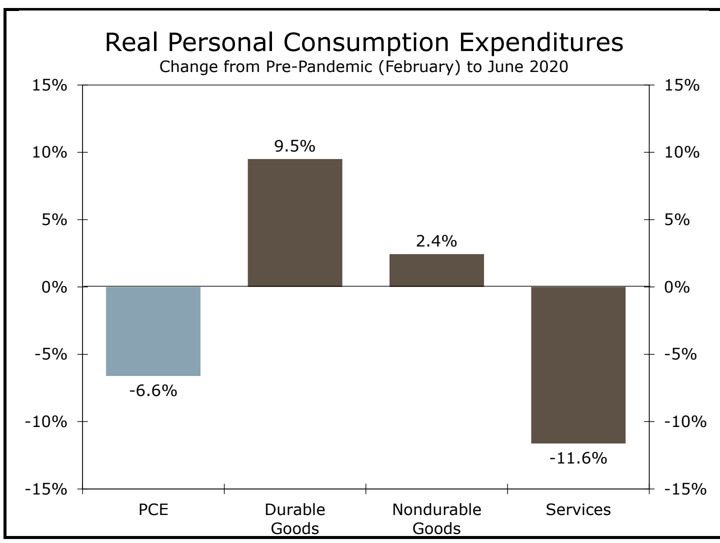
How the economy ended the quarter is an important element in determining how strong economic growth will be in the current quarter and the dynamic will also prove instructive in determining what is likely to happen later this year. Consumer spending, which accounts for roughly two-thirds of GDP, ended the second quarter 6.1% ahead of its average for the quarter. This means consumer spending will rise solidly in the current quarter, even if it does not rise at all in July, August or September. While we do not expect that to happen, many of the high frequency data slowed in July, as consumers and businesses pulled back from activities requiring social contact, following a rise in COVID-19 cases. That resurgence appears to have topped out and measures of restaurant dining, consumer engagement and travel have all improved. We look for consumer spending to rise at a 30% annualized rate in the current quarter, with most of the bounce back coming from goods purchases.

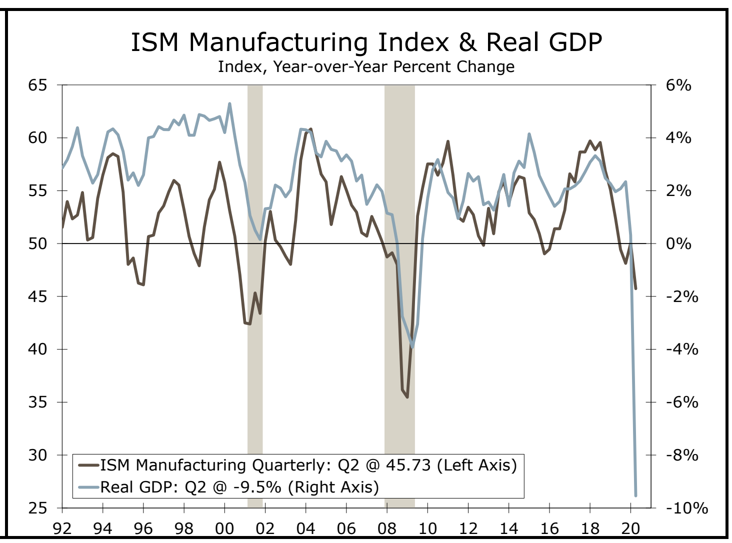
The lull in many of the high frequency data series we saw during July and the apparent rebound we are seeing now, after COVID-19 cases appear to have topped out in much of the Sun Belt, suggest economic activity might again end the quarter at a much stronger pace than its average for Q3 as a whole—setting the stage for solid Q4 growth as well. There are still plenty of questions about the fourth quarter, however. How will the restart of the school year affect the spread of COVID-19 and what will happen when the flu season kicks in after Thanksgiving? There are also some potential upside surprises, with a handful of vaccines now in stage three testing. We slightly reduced our Q4 GDP forecast to a 6.6% annualized rate. The base, or the level of Q3 growth, is also much stronger, however.

The rebound in consumer goods purchases is good news for the factory sector, which has already seen a rise in orders and a rebound in output. The ISM manufacturing index has risen for three months in a row. The production and new orders indices have both increased solidly and are now back in the low 60s. Sales of motor vehicles have been surprisingly strong, as consumers continue to shun mass transit and ride sharing. Capital spending has also increased, possibly reflecting needs to alter the workplace to incorporate more social distancing but also likely helped by an earlier and stronger recovery in orders.

Homebuilding is another part of the economy enjoying a strong rebound. Demand for homes is being bolstered by lower mortgage rates, more favorable demographic trends and a desire for more living space, as people are spending more time at home. Employment in financial, business, professional and technical services has also shown a great deal of resiliency. The housing market is not problem free, however. The surge in job losses earlier this year has led to a rise in late or missed rent and mortgage payments. Delinquencies will likely rise even further if some sort of deal cannot be worked out to extend supplemental unemployment benefits.

Failure to reach a deal on more stimulus would have wide ranging impact on the economy. Income has held up remarkably well given the plunge in nonfarm payrolls, thanks in large part to the timely and well-targeted stimulus efforts. An abrupt end to that stimulus would put recent economic gains at risk.





Source: U.S. Department of Commerce, Institute of Supply Management 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)	3.8	2.7	2.1	1.3	2.9	1.5	2.6	2.4	-5.0	-32.9	21.8	6.6	5.9	3.2	3.2	3.2	3.0	2.2	-4.9	3.8
Personal Consumption	2.0	3.2	2.7	1.6	1.8	3.7	2.7	1.6	-6.9	-34.6	29.8	7.8	3.9	3.8	3.7	3.4	2.7	2.4	-5.0	4.4
Business Fixed Investment	12.2	6.2	2.6	5.0	4.2	0.0	1.9	-0.3	-6.7	-27.0	2.2	1.1	2.4	3.9	5.0	5.5	6.9	2.9	-6.8	0.7
Equipment	10.1	2.4	6.1	9.6	2.0	-3.8	-1.7	-1.7	-15.2	-37.7	16.1	5.3	3.5	4.1	4.4	5.3	8.0	2.1	-10.8	2.3
Intellectual Property Products	8.8	12.3	4.4	12.1	4.5	4.1	5.3	4.6	2.4	-7.2	-0.6	0.5	3.7	4.8	6.9	6.7	7.8	6.4	0.9	2.6
Structures	21.6	5.0	-5.9	-12.6	8.2	1.6	3.6	-5.3	-3.7	-34.9	-19.0	-7.5	-3.0	1.5	2.5	3.0	3.7	-0.6	-11.6	-6.8
Residential Investment	-3.3	-1.7	-5.4	-5.2	-1.7	-2.1	4.6	5.8	19.0	-38.7	22.0	9.0	7.0	6.5	7.0	7.0	-0.6	-1.7	-0.2	5.2
Government Purchases	1.5	2.9	2.5	-0.9	2.5	5.0	2.1	2.4	1.3	2.7	-4.3	0.8	-1.2	-0.8	-0.4	0.0	1.8	2.3	1.3	-0.7
Net Exports	-833.0	-820.2	-920.3	-937.3	-907.4	-951.4	-950.2	-861.5	-788.0	-780.7	-857.2	-929.2	-944.3	-938.2	-938.3	-938.0	-877.7	-917.6	-838.8	-939.7
Pct. Point Contribution to GDP	0.3	0.3	-1.8	-0.3	0.6	-0.8	0.0	1.5	1.1	0.7	-1.8	-1.6	-0.3	0.1	0.0	0.0	-0.3	-0.2	0.4	-0.6
Inventory Change	47.3	-4.9	79.1	92.3	101.7	49.4	44.0	-1.1	-80.9	-315.5	-150.0	-50.0	90.0	80.0	70.0	60.0	53.4	48.5	-149.1	75.0
Pct. Point Contribution to GDP	0.4	-0.9	1.6	0.2	0.2	-1.0	-0.1	-0.8	-1.3	-4.0	3.9	2.2	3.1	-0.2	-0.2	-0.2	0.2	0.0	-1.0	1.2
Nominal GDP (a)	6.2	6.3	3.8	3.3	4.0	4.1	4.0	3.9	-3.4	-34.3	25.2	7.8	6.9	4.5	5.0	4.9	5.5	4.0	-3.9	5.0
Real Final Sales	3.4	3.7	0.5	1.1	2.7	2.5	2.7	3.2	-3.6	-29.3	18.5	4.3	2.7	3.4	3.4	3.4	2.8	2.2	-3.8	2.7
Retail Sales (b)	4.4	5.3	5.0	3.0	2.7	3.4	4.0	4.0	1.2	-8.1	3.8	7.9	13.5	24.7	10.2	6.5	4.4	3.5	1.2	13.3
Inflation Indicators (b)																				
PCE Deflator	2.0	2.3	2.3	2.0	1.4	1.5	1.5	1.5	1.7	0.6	0.9	0.7	0.7	1.5	1.3	1.4	2.1	1.5	1.0	1.2
"Core" PCE Deflator	1.8	2.1	2.1	2.0	1.7	1.7	1.8	1.6	1.8	0.9	0.9	0.8	0.9	1.5	1.4	1.6	2.0	1.7	1.1	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	0.8	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	1.3	1.0	0.8	0.8	1.6	1.7	1.8	2.1	2.2	1.3	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	-0.8	-0.5	-0.2	0.5	2.4	2.6	2.5	2.9	1.7	-0.1	2.0
Employment Cost Index	2.7	2.8	2.8	2.9	2.8	2.7	2.8	2.7	2.8	2.7	2.3	2.0	1.6	1.5	1.7	1.8	2.8	2.7	2.4	1.7
Real Disposable Income (b)	3.6	3.4	3.6	3.7	3.2	2.1	1.8	1.6	1.4	11.5	3.3	-0.1	0.1	-8.2	-0.8	2.7	3.6	2.2	4.0	-1.7
Nominal Personal Income (b)	5.5	5.5	5.5	4.8	4.7	4.1	3.5	3.5	3.2	10.1	3.2	-0.3	-0.3	-6.2	0.5	4.2	5.3	3.9	4.0	-0.6
Industrial Production (a)	2.3	4.6	5.2	3.9	-1.9	-2.3	1.1	0.4	-6.8	-42.6	33.5	4.6	3.5	5.0	5.7	3.6	3.9	0.9	-7.8	3.6
Capacity Utilization	77.9	78.5	79.1	79.4	78.6	77.8	77.6	77.2	75.8	66.0	70.9	71.7	72.3	73.1	74.1	74.8	78.7	77.8	71.1	73.6
Corporate Profits Before Taxes (b)	6.9	5.8	5.7	5.9	-1.1	1.7	-0.5	1.3	-6.7	-18.0	-11.0	-5.0	6.0	20.0	12.0	3.0	6.1	0.3	-10.2	9.9
Corporate Profits After Taxes	11.4	9.2	8.6	5.8	-3.3	0.5	-0.3	1.3	-5.7	-17.5	-11.4	-4.2	5.6	19.7	12.2	2.9	8.7	-0.4	-9.7	9.7
Federal Budget Balance (c)	-375	-7	-172	-319	-372	-56	-237	-357	-387	-2001	-656	-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	109.8	112.7	110.3	106.5	105.5	104.5	103.8	103.3	103.3	106.4	110.1	108.8	103.7
Nonfarm Payroll Change (e)	234	211	153	172	139	159	203	210	-303	-4424	921	500	300	240	210	200	193	178	-826	238
Unemployment Rate	4.1	3.9	3.8	3.8	3.9	3.6	3.6	3.5	3.8	13.0	9.6	8.3	7.5	7.1	6.6	6.3	3.9	3.7	8.7	6.9
Housing Starts (f)	1.31	1.26	1.24	1.18	1.20	1.26	1.29	1.43	1.48	1.04	1.25	1.30	1.32	1.29	1.28	1.27	1.25	1.29	1.27	1.29
Light Vehicle Sales (g)	17.1	17.2	17.0	17.5	16.9	17.0	17.0	16.8	15.0	11.3	14.2	14.3	14.9	15.5	16.1	16.4	17.2	17.0	13.7	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	34.7	43.0	44.0	46.0	48.0	46.0	50.0	71.5	63.6	43.2	47.5
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	0.25	0.25	0.25	0.25	0.25	0.25	2.31	2.33	0.56	0.25
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	2.75	2.80	2.85	2.95	3.00	3.05	4.54	3.94	3.04	2.96
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	0.15	0.15	0.15	0.15	1.97	2.11	0.14	0.15
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	0.15	0.15	0.20	0.20	2.14	2.11	0.16	0.18
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	0.15	0.20	0.20	0.25	0.30	2.33	2.05	0.16	0.24
2 Year Note	2.27	2.52	2.81	2.48	2.27	1.75	1.63	1.58	0.23	0.16	0.15	0.20	0.25	0.35	0.40	0.50	2.53	1.97	0.19	0.38
5 Year Note	2.56	2.73	2.94	2.51	2.23	1.76	1.55	1.69	0.37	0.29	0.35	0.50	0.65	0.75	0.85	0.90	2.75	1.95	0.38	0.79
10 Year Note	2.74	2.85	3.05	2.69	2.41	2.00	1.68	1.92	0.70	0.66	0.70	0.90	1.05	1.20	1.30	1.35	2.91	2.14	0.74	1.23
30 Year Bond	2.97	2.98	3.19	3.02	2.81	2.52	2.12	2.39	1.35	1.41	1.40	1.60	1.80	2.00	2.10	2.15	3.11	2.58	1.44	2.01

Forecast as of: August 12, 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

Global Growth Outlook Looking Mildly More Positive

The level of economic activity remains depressed in most major economies, but a gradual recovery continues to take hold. Through the first six months of the year, the average level of Eurozone real retail sales is down “only” 4.2% following strong growth in May and June. In July, the Eurozone PMIs for manufacturing and services rose 4.4 and 6.4 points, respectively, to 51.8 and 54.7. With both indices now firmly in expansionary territory, the pace of economic recovery in the Eurozone appears to be gathering momentum. Europe, in comparison with the United States, has benefitted from relatively low rates of COVID-19 spread over the past couple of months. New case growth remain relatively low, although there has been an uptick in recent weeks that bears close watching (bottom left chart).

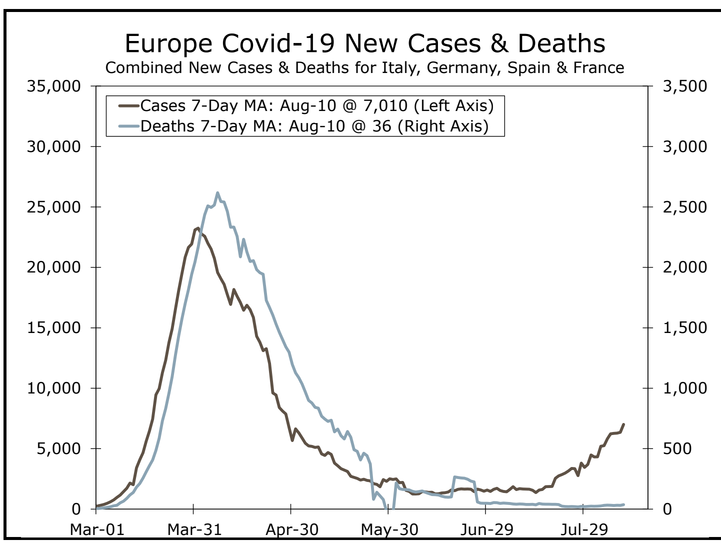
Further adding to optimism about the European economic recovery and the euro was the EU-wide agreement to finance a €750 billion recovery fund. The deal calls for €390 billion in grants and €360 billion in loans over the next few years, focused primarily on countries most negatively affected by the pandemic. The expected economic impact from this €750 billion is significant though not decisive. As important, in our view, is the signal sent by such an unprecedented degree of fiscal integration in Europe. On net, a downward revision to Eurozone real GDP growth in 2020 has been more than offset by upward revisions to our expectations for economic growth in 2021.

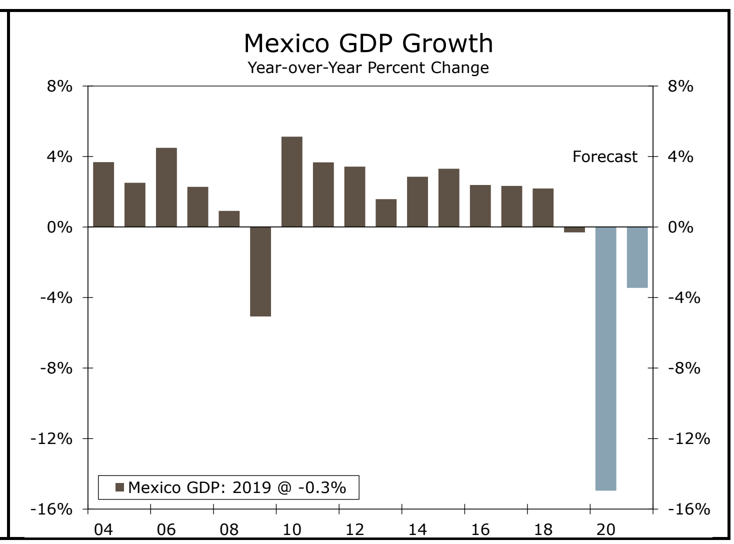
In China, the world’s second-largest economy, there has been an element of “no news is good news” over the past month. Data on retail sales and industrial production signal that the Chinese economy continues to gradually pull itself out of the deep hole in which it found itself to start the year. It is looking increasingly likely that the Chinese economy will manage to eke out positive real GDP growth of 1%-2% in 2020, a soft reading by Chinese standards but impressive given the state of the global economy.

In Canada, the story is similar, as incoming data suggest the level of activity is depressed but the trend is headed in the right direction. Canada has recovered a bit more than half of the jobs it lost during March and April, compared to about 42% in the United States. New deaths from COVID-19 have been averaging in the single digits per day over the past month in Canada. Combined with some stability in oil prices and substantial fiscal stimulus from the Canadian government, the backdrop for economic growth in Canada is relatively encouraging.

Unfortunately, not all economies are on the upswing. Mexico’s economy remains in a difficult place as the country grapples with its still-robust spread of COVID-19. With few signs of a meaningful fiscal stimulus on the way, the country may not see as much of a rebound in economic growth in H2-2020 (bottom right chart). We have long maintained that countries with the fiscal capacity, capital markets access and political will to float their economies through COVID-19 would have a major leg up, and Mexico’s experience thus far is a prime example of how a country without these ingredients may struggle when dealing with the economic fallout from the virus. Accordingly, our latest forecast has downgraded real GDP growth for Mexico for both 2020 and 2021.

At a more macro level, our thematic expectations for the global economy over the next 12 months largely remain intact. The negative output gaps in most economies are large, and it will be a long slog before they are fully closed. But, some of the worst case economic scenarios envisioned back in March and April have been avoided thus far, fought off by historic monetary and fiscal policy responses. If the economic recovery can continue over the next couple of quarters, we believe steady progress on the public health front can help keep the upward economic momentum going into 2021. But, the unpredictability and potential severity of COVID-19 outbreaks around the world still remain a risk to our forecast.





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%	-3.7%	4.7%	3.6%	3.4%	3.1%	2.9%
Advanced Economies[1]	2.2%	1.9%	-6.1%	3.8%	2.0%	1.6%	0.8%	1.2%
United States	3.0%	2.2%	-4.9%	3.8%	2.4%	1.8%	1.0%	1.3%
Eurozone	1.9%	1.3%	-8.3%	4.0%	1.8%	1.2%	0.5%	1.2%
United Kingdom	1.3%	1.5%	-10.1%	5.9%	2.5%	1.8%	0.8%	1.4%
Japan	0.3%	0.7%	-5.5%	1.0%	1.0%	0.5%	0.0%	0.2%
Canada	2.0%	1.7%	-6.6%	3.8%	2.3%	1.9%	0.6%	1.7%
Developing Economies[1]	4.5%	3.6%	-2.0%	5.3%	4.8%	4.8%	4.7%	4.1%
China	6.7%	6.1%	1.6%	9.5%	2.1%	2.9%	2.7%	1.8%
India	6.8%	4.9%	-1.6%	3.6%	3.9%	3.7%	5.0%	3.6%
Mexico	2.2%	-0.3%	-15.0%	-3.4%	4.9%	3.6%	3.2%	3.5%

Forecast as of: August 12, 2020

[1]Aggregated Using PPP Weights

Wells Fargo 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[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			
	Q3	Q4	Q1	Q2	Q3	Q4
United States	0.15%	0.20%	0.25%	0.35%	0.40%	0.50%
Eurozone[2]	-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	0.30%	0.35%	0.40%	0.45%	0.55%	0.70%

10-Year Note	2020		2021			
	Q3	Q4	Q1	Q2	Q3	Q4
United States	0.70%	0.90%	1.05%	1.20%	1.30%	1.35%
Eurozone[2]	-0.40%	-0.25%	-0.15%	-0.05%	0.05%	0.10%
United Kingdom	0.25%	0.45%	0.55%	0.60%	0.65%	0.70%
Japan	0.05%	0.10%	0.10%	0.10%	0.15%	0.15%
Canada	0.60%	0.80%	0.90%	1.00%	1.05%	1.15%

Forecast as of: August 12, 2020

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

Source: International Monetary Fund and Wells Fargo Securities

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