WELLS FARGO

Weekly — April 8, 2022

Weekly Economic & Financial Commentary

United States: **Minutes Put All Eyes on the Fed, but Economic Activity Remains Strong**

- In an otherwise calm week of data, Wednesday's release of the FOMC minutes stirred things up as they showed committee members agreeing that elevated inflation and the tight labor market warrant balance sheet reduction to start soon. The minutes also stressed that current economic indicators point to strong activity, which was affirmed by the robust domestic demand that drove the ISM services index higher in March and kept the February trade balance at a record deficit.
- Next week: CPI (Tuesday), Retail Sales (Thursday), Industrial Production (Friday)

International: **Commodity Price Spike Keeps Latam Inflation Elevated**

- In our view, one of the regions that is most at risk to elevated commodity prices is Latin America. This week, we received evidence that inflation is indeed moving higher as a result of the push higher in commodity prices. Furthermore, the Canadian economy continues to demonstrate a robust recovery from the COVID pandemic.
- Next week: India CPI (Tuesday), Bank of Canada (Wednesday), European Central Bank (Thursday)

Interest Rate Watch: **Balance Sheet Runoff Takes Shape**

- The minutes of the March FOMC meeting released this week signaled the committee is likely to begin balance sheet reduction in May. Monthly caps for Treasury and MBS runoff are likely to reach $60B and $35B, respectively, and be phased in over just three months. The expedited timeline helped the yield curve steepen.

Credit Market Insights: **Consumer Credit Expands in February**

- The Federal Reserve Board reported that consumer credit increased at an annualized rate of 11.3% in February, with revolving credit leading the way, increasing 20.7%.

Topic of the Week: **Last Week's Positive Russia and Ukraine Headlines Appear to Be a False Start**

- Toward the end of last week, headlines suggested the Russia-Ukraine conflict may have reached a turning point. While reports suggest the Russian military is indeed withdrawing from Kyiv, Russian troops seem to be reinforcing their positions in other areas of Ukraine in an effort to establish stronger control.

Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual		Forecast	
	2021				2022							
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2020	2021	2022	2023
Real Gross Domestic Product [1]	6.3	6.7	2.3	6.9	0.6	1.2	2.3	2.2	-3.4	5.7	2.8	2.1
Personal Consumption	11.4	12.0	2.0	2.5	3.0	0.1	1.9	1.7	-3.8	7.9	2.5	1.6
Consumer Price Index [2]	1.9	4.8	5.3	6.7	7.9	7.9	7.3	6.3	1.2	4.7	7.4	2.9
"Core" Consumer Price Index [2]	1.4	3.7	4.1	5.0	6.3	5.7	5.7	5.2	1.7	3.6	5.7	3.2
Quarter-End Interest Rates [3]												
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.50	1.50	2.00	2.50	0.50	0.25	1.63	3.19
Conventional Mortgage Rate	3.17	3.02	2.88	3.11	4.42	4.65	4.70	4.70	3.12	2.95	4.62	4.54
10 Year Note	1.74	1.45	1.52	1.52	2.32	2.60	2.70	2.75	0.89	1.45	2.59	2.70

Forecast as of: April 07, 2022

[1] Compound Annual Growth Rate Quarter-over-Quarter [2] Year-over-Year Percentage Change [3] Annual Numbers Represent Average

Source: U.S. Dept. of Commerce, U.S. Dept. of Labor, Federal Reserve Board and Wells Fargo Economics

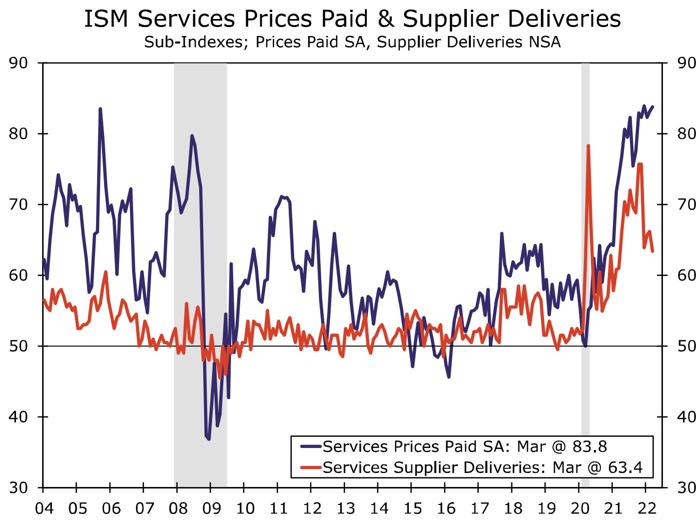
Please see our full U.S. Economic Forecast and our updated Consumer Dashboard and Pressure Gauge.

All estimates/forecasts are as of 4/8/2022 unless otherwise stated. 4/8/2022 13:21:45 EDT. **This report is available on Bloomberg WFRE**

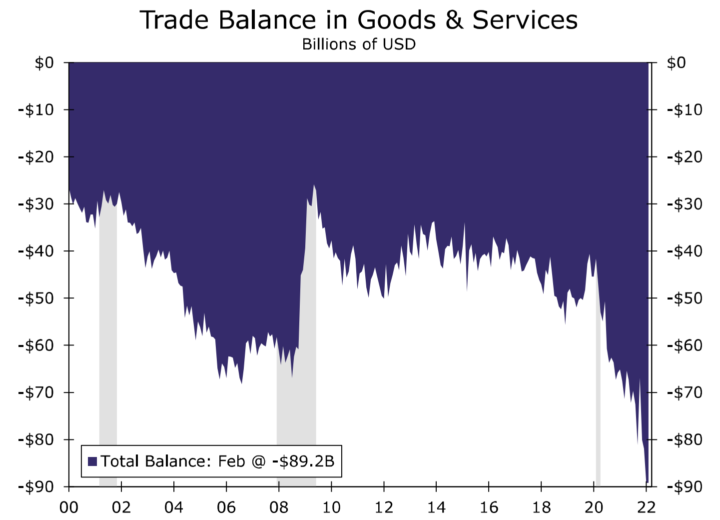
U.S. Review

Minutes Put All Eyes on the Fed, but Economic Activity Remains Strong

In an otherwise calm week of data, Wednesday's release of the FOMC minutes stirred things up. The comments showed committee members agreeing that elevated inflation and the tight labor market at present warrant balance sheet reduction to begin soon, perhaps as early as May, the details of which we discuss further in Interest Rate Watch. This acceleration of the balance sheet rolloff coincides with a hawkish change in tone when it comes to rate increases, as well, and puts all eyes on the March Consumer Price Index release next week, which we see rising to 8.4% over the year. This should give us a better idea of where prices sit as we finish the first quarter of the year.



Source: Institute for Supply Management and Wells Fargo Economics



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

While many changes are on the horizon, the FOMC minutes also stressed that current economic indicators continue to point to strong activity. One such sign was the modest increase in the ISM services index in March to 58.3. Even though this signals a service sector that is well in expansion territory (above 50 points), there is a bit of a gray cloud over the most recent movement considering the index was 10 points above its current state last November. 2022 was set to be the second leg of the comeback tour for the services sector, but just when inflation and supply chain issues looked to finally be seeing some relief, the Russia-Ukraine war is likely to exacerbate some of the outstanding issues. The supplier deliveries index edged down to 63.4 in March from 66.2 the previous month, but it still remains historically high, while the prices paid index jumped to its second-highest level on record at 83.8 (chart). The sentiment around the inventories index dropped a whopping 15 points is a sign that firms are feeling apprehensive about their ability to keep supplies up amid the ongoing conflict. The overwhelming theme in the comments section of the report was that everything was in short supply. However, in good news, the employment index gained a strong 5.5 points, which pushed employment back into expansion territory and gave some affirmation to the March employment report's healthy 431K-job addition. The uptick in the employment index also came as the overall business activity, new orders and backlogs indices all jumped higher in March, signaling that demand remains strong.

The trade balance holding at its record deficit also suggests that domestic demand is still ample (chart). The deficit only narrowed a mere $44M in February, marking the smallest movement since the beginning of 2020 in an era that has been defined by extreme volatility. The growing daylight between exports and imports is nothing new, as robust demand for goods in the United States and hampered production ability has led to a relatively consistent pattern of exports outpacing imports. February proved that trend is not yet over, as exports grew 1.8% over the month, while imports only grew 1.3%. The difference would have been more stark had it not been for the helping hand of a $1.9 billion gain in crude oil imports that made up nearly 60% of industrial supplies imports. Amid the Russia-Ukraine conflict, it is likely this line item will continue to see some increased demand in the near term. Although impressive in nominal terms, accounting for higher prices tells a different story as real exports looked more bleak in February, falling 0.8%. For the seventh consecutive quarter, net exports are looking to

be a drag on headline GDP and our latest forecast has it taking off a significant 2.0 percentage points from headline growth in Q1-2022. (Return to Summary)

U.S. Outlook

Weekly Domestic Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
12-Apr	CPI (MoM)	Mar	1.2%	1.1%	0.8%
12-Apr	CPI (YoY)	Mar	8.4%	8.4%	7.9%
12-Apr	Core CPI (MoM)	Mar	0.5%	0.5%	0.5%
12-Apr	Core CPI (YoY)	Mar	6.6%	6.6%	6.4%
14-Apr	Retail Sales (MoM)	Mar	0.6%	0.6%	0.3%
15-Apr	Industrial Production (MoM)	Mar	0.4%	0.5%	0.5%
15-Apr	Capacity Utilization	Mar	77.8%	77.8%	77.6%

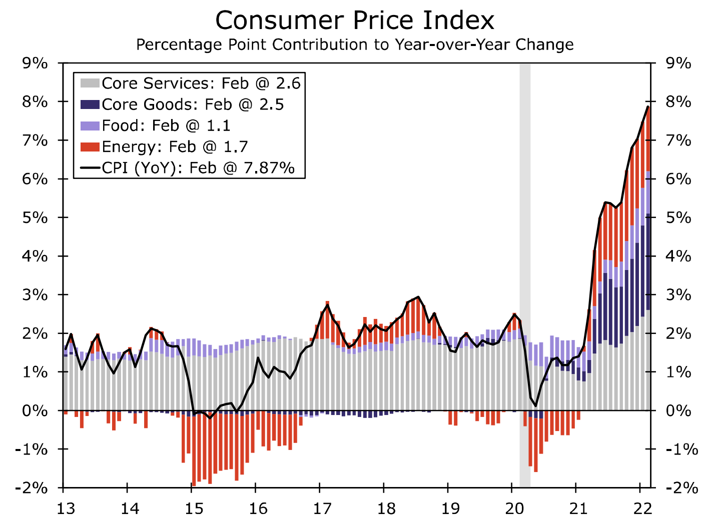
Forecast as of April 08, 2022

Source: Bloomberg Finance L.P. and Wells Fargo Economics

CPI • Tuesday

The Consumer Price Index (CPI) rose 0.8% in February, bringing the year-over-year rate to 7.9%—the highest in 40 years. The drivers of the headline gain came in as expected, with food, energy and core services prices picking up, while core goods prices moderated. All eyes have been on gasoline prices amid the invasion of Ukraine, which increased 6.6% in February. Consumers are not just feeling pain at the pump. Grocery prices advanced 1.4% over the month, while higher home prices and rents supported a solid gain in shelter inflation. In short, inflation pressure is broadening.

Looking ahead, we expect headline CPI to rise 1.1% in March (up 8.4% year-over-year). Excluding food and energy, which tend to be volatile on a month-to-month basis, we expect the core CPI to rise 0.5% (up 6.6% year-over-year). Oil prices have retreated in recent weeks and signs that vehicle prices are starting to ease has led us to pare back our near-term expectations. However, inflation's descent will remain painfully slow for consumers, businesses and policymakers alike. Services inflation, which includes housing, shows no signs of abating anytime soon.

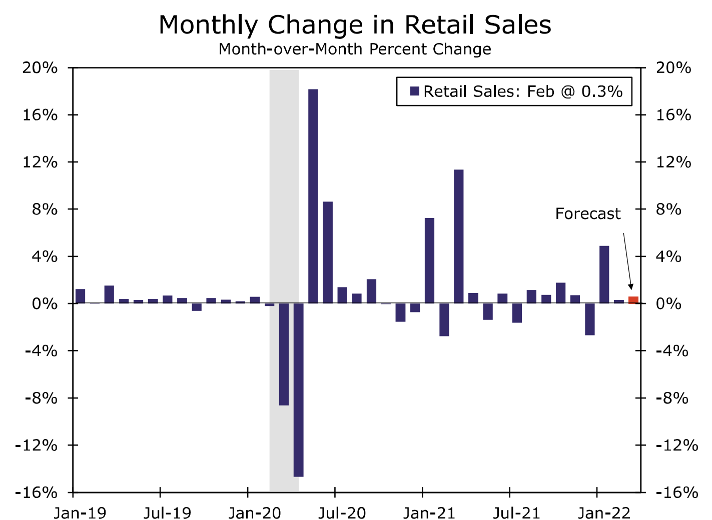


Source: U.S. Department of Labor and Wells Fargo Economics

Retail Sales • Thursday

Retail sales have had a resilient start to the year, at least at first glance. Sales increased 0.3% in February on the heels of a sharp upward revision to January's already-solid gain. Gasoline stations saw the highest monthly increase, while bars and restaurants followed with a 2.5% rise. On the flip side, consumers cut back on online spending and other discretionary goods, such as electronics and furniture. Since retail sales are reported nominally, meaning they are not adjusted for inflation, recent headline gains should be taken with a grain of salt.

The highest inflation in 40 years poses a significant headwind to sales. We expect retail sales to rise 0.6% in March, with much of the gain likely driven by higher prices. Excluding autos, we look for sales to rise 0.9%. To get a cleaner read on spending dynamics, we'll pay close attention to our real retail sales data. Higher prices for necessities, such as food and gas, mean consumers have fewer dollars left to spend at other retailers. With that in mind, we have downwardly revised our expectations for consumer spending this year, even as accumulated savings provide a bit of a buffer in the near term.

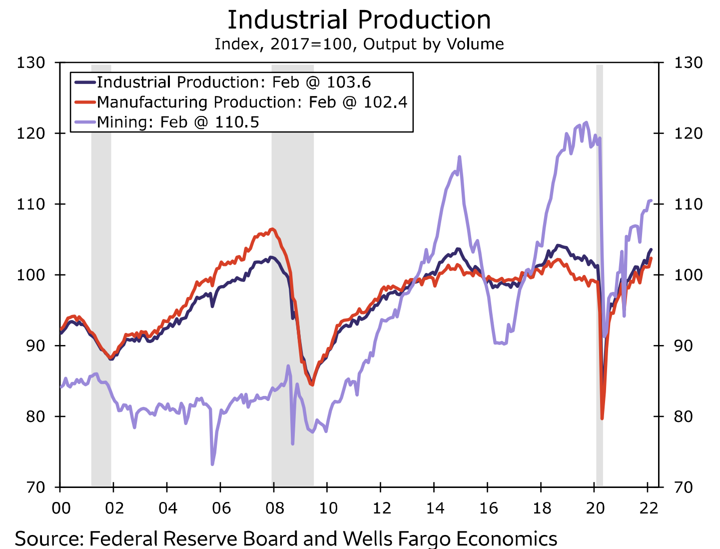


Source: U.S. Department of Commerce and Wells Fargo Economics

Industrial Production • Friday

Industrial production increased 0.5% in February, as incremental improvements in supply chains provided some room for manufacturers to work on backlogged orders. Manufacturing output rose 1.2%, the largest monthly increase since October 2021. Durable goods industries, such as primary & fabricated metals and nonmetallic mineral & wood products, posted gains of 2% or higher over the month, while every category within non-durable industries was either flat or increased.

In March, we forecast industrial production rose 0.5% and look for capacity utilization to inch up to 77.8%. Further supply chain disruptions from fresh lockdowns in China and the Russia-Ukraine war have the potential to unravel progress made on restoring smooth-functioning global supply chains. That said, we suspect manufacturers were able to continue to chip away at backlogged orders in March, while utilities production is likely due for another decline. Mining output has scope to edge up as well, as domestic oil producers were encouraged to ramp production following Russia's invasion of Ukraine. (Return to Summary)



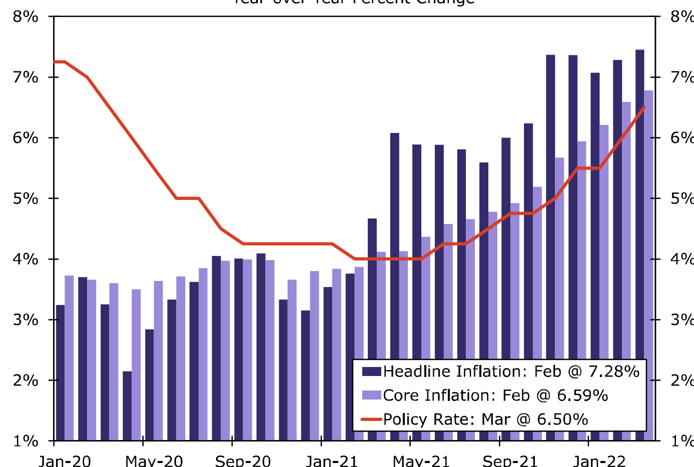
Source: Federal Reserve Board and Wells Fargo Economics

International Review

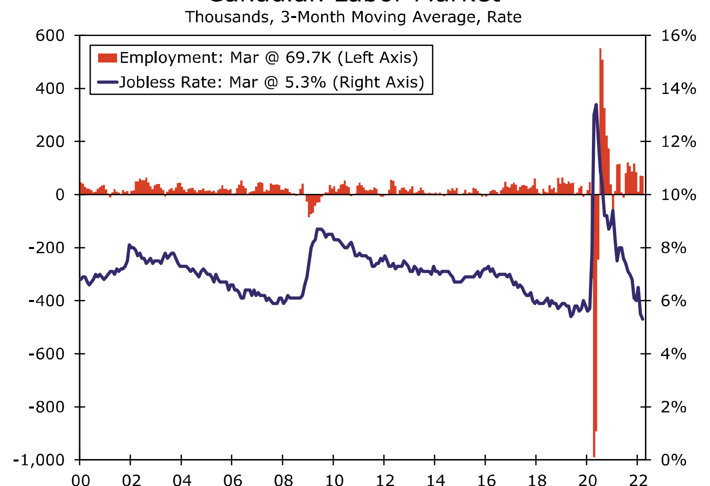
Commodity Price Spike Keeps Latam Inflation Elevated

We have discussed at length the impacts of the Russia-Ukraine crisis on global economic growth and inflation. We have noted the economic deceleration in Russia and Ukraine will be negligible on the global economy, while trade linkages to each country are also not significant. However, both countries carry more weight as both are major commodity exporters and have a sizable influence over commodity markets around the world. Disrupted Russian supply and elevated demand have pushed oil and natural gas prices significantly higher, while interrupted production from Ukraine has pushed prices up for many agriculture products. It's the commodity price shock that worries us most, particularly from an inflation perspective. We highlighted how countries that consume and import a sizable amount of energy are at risk of a sharp push higher in prices, while countries that also have a high percentage of energy and food prices in their respective inflation baskets could also see an inflation spike. In our view, one of the regions that is most at risk is Latin America. This week, we received evidence that inflation is indeed moving higher as a result of the push higher in commodity prices.

This week, inflation in Mexico not only rose, but rose above consensus expectations. To that point, the consensus forecast was looking for headline CPI to rise to 7.38% year-over-year. Actual data indicate headline CPI rose to 7.45% year-over-year in March, while the same higher-than-expected inflation dynamics occurred as it relates to core inflation as well. We can point to the rise in commodity prices as rationale for the elevated inflation print. In our view, persistently high inflation should keep the Central Bank of Mexico in tightening mode going forward. Above elevated inflation will likely be the primary driver of tighter monetary policy; however, with the Fed likely to turn more hawkish in May, Banxico will likely opt to match hikes with the Fed. Brazil inflation also rose quite sharply in March as a result of commodity prices. In that sense, Brazil CPI rose 11.3% year-over-year in March, up from 10.5% a month earlier. In the short term, we expect inflationary pressures in Brazil to persist as commodity prices stay high; however, we do expect CPI to trend lower over the second half of the year as the cumulative effects of aggressive monetary tightening take shape. Despite elevated inflation, we expect the Brazilian Central Bank (BCB) to end its tightening cycle in May after one last 100-bp rate hike.



Source: Bloomberg Finance L.P. and Wells Fargo Economics



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Canada's Economy Keeps Creating Jobs

The Canadian economy continues to demonstrate a robust recovery from the COVID pandemic. The recent spike in oil prices is also providing a tailwind to the economy. GDP data have been strong lately, and to complement these solid growth figures, Canada's labor market has been on fire. March data reinforce this trend as the economy created a net 72.5K jobs over the course of the month, largely in line with consensus expectations. While the economy lost 20K part-time jobs in March, growth in full-time positions more than made up for the decline. In March, Canada's economy created close to 93K full-time jobs, a welcome sight for the overall health of the economy. Strong job creation also pushed Canada's unemployment rate down to 5.3%, the lowest jobless rate since the early 1970s, with the

participation rate solidly above 65%. In our view, strong jobs data for the month of March should keep the Bank of Canada committed to tightening monetary policy.

A sound labor market, strong economic activity and elevated inflation is certainly a recipe for interest rate hikes. Come next week, we expect Bank of Canada policymakers to continue lifting interest rates and are likely to cite the overall strength of the economy as justification for tighter policy. We also expect the BoC statement to refer to a closing output gap, which should also provide policymakers with rationale to keep raising interest rates. Given the Fed is likely to pick up the pace of interest rate hikes in the near future, there is certainly a possibility the Bank of Canada opts to raise policy rates 50 bps at its next meeting. Consensus forecasts believe the Canadian economy is strong enough to handle a 50-bp hike, while financial markets are priced for around 45 bps of tightening next week. Given our view for a 25-bp hike, the Canadian dollar could weaken in the immediate aftermath of the decision. (Return to Summary)

International Outlook

Weekly International Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
12-Apr	India CPI (YoY)	Mar	6.38%	--	6.07%
13-Apr	Bank of Canada Rate Decision	13-Apr	1.00%	0.75%	0.50%
14-Apr	European Central Bank Rate Decision	14-Apr	-0.50%	-0.50%	-0.50%

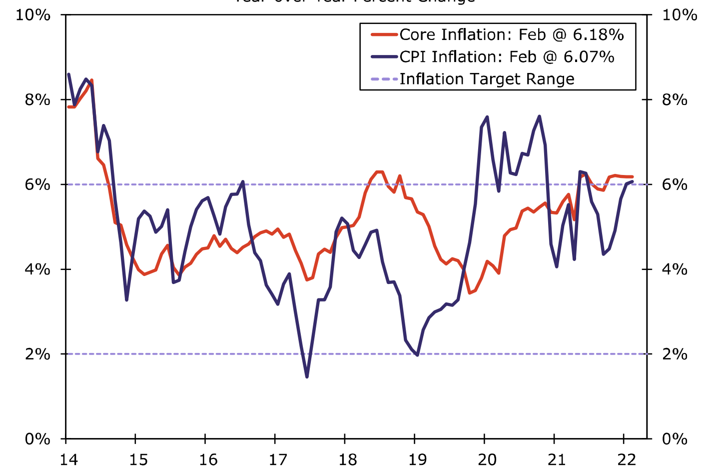
Forecast as of April 08, 2022

Source: Bloomberg Finance L.P. and Wells Fargo Economics

India CPI • Tuesday

The recent spike in commodity prices is likely to push inflation in India higher in the coming months. Next week, we'll get a sense of the magnitude of the local inflation shock as March CPI data are released. India is one of the largest commodity importers in the world, and energy and food prices make up a sizable portion of the country's inflation basket. Given oil prices are up around 30% this year and agriculture prices are up significantly, we expect headline inflation to continue to trend above the Reserve Bank of India's (RBI) target range going forward.

This week, RBI policymakers opted to keep interest rates on hold; however, they did signal inflationary pressures are starting to build. In our view, the RBI will begin to prioritize inflationary pressures rather than growth in the coming meetings. In that sense, we believe the RBI will start its tightening cycle in Q2 of this year as inflation moves higher and persists above the upper bound of the RBI's inflation target range. Tighter Fed monetary policy could also give RBI policymakers justification to continue its tightening cycle throughout the remainder of 2022. We look for the RBI to tighten monetary policy in Q3 as well as Q4 and possibly into 2023.

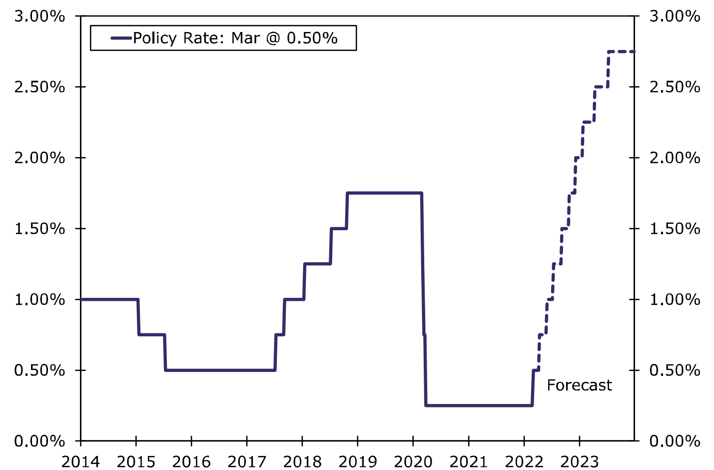


Source: Bloomberg Finance L.P. and Wells Fargo Economics

Bank of Canada • Wednesday

Just recently, the Bank of Canada (BoC) kicked off its tightening cycle with a 25-bp rate hike. Alongside the rate hike in March, BoC policymaker commentary shifted in a more hawkish direction. Recent economic data have supported that shift, most notably a strong labor market and above-target inflation. In our view, hawkish commentary combined with sound economic fundamentals should result in the Bank of Canada lifting interest rates at a more aggressive pace than we previously expected.

Next week, we expect BoC policymakers to continue tightening monetary policy and look for another 25-bp rate hike. We do wish, however, to acknowledge that risks around our forecast are tilted toward even more aggressive tightening. With the Fed signaling a 50-bp rate hike is likely to come in May, BoC policymakers may choose to match the Fed and hike 50 bps themselves. For now, we are sticking to a 25-bp hike next week, and by the end of this year, we expect policy rates in Canada to reach 2.00%. We also expect the tightening cycle to continue in 2023 as well. By the end of next year, we forecast BoC policymakers will lift rates to 2.75%.

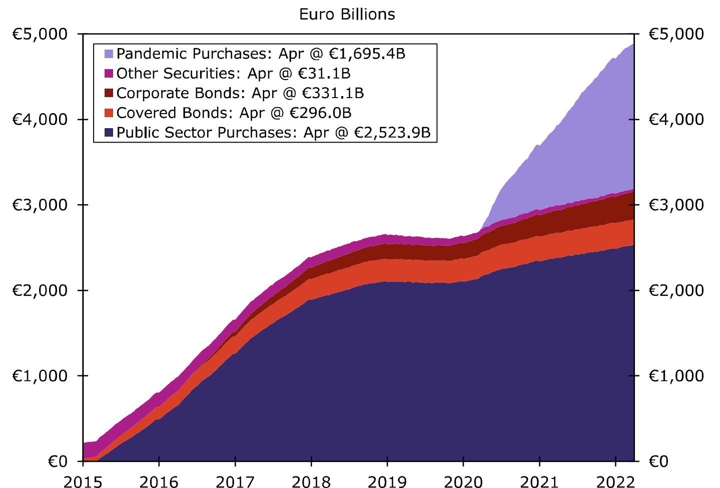


Source: Bloomberg Finance L.P. and Wells Fargo Economics

European Central Bank • Thursday

The Eurozone economy has had a tough start to 2022. A surge in COVID cases and uncertainties tied to the Russia-Ukraine conflict have weighed on overall activity. Consumer excess savings and spending power also seem to be softer now than previously, which we believe can further contribute to a slowdown in activity. Against this backdrop, we recently lowered our Eurozone GDP forecast and now expect the economy to grow only modestly over 3% this year.

Despite a softer growth outlook, Eurozone headline inflation has moved sharply higher. Core inflation has also trended higher but to a lesser extent as it does not include volatile price components such as energy and food. But, even with core inflation slightly more modest, we still expect ECB policymakers to respond to elevated headline inflation. In that sense, we do not expect interest rate settings to change meaningfully next week but do expect ECB policymakers to taper asset purchases; however, we do now expect the ECB to lift interest rates 25 bps at the September 2022 meeting. We also expect steady interest rate hikes over the remainder of this year as well as into 2023. (Return to Summary)

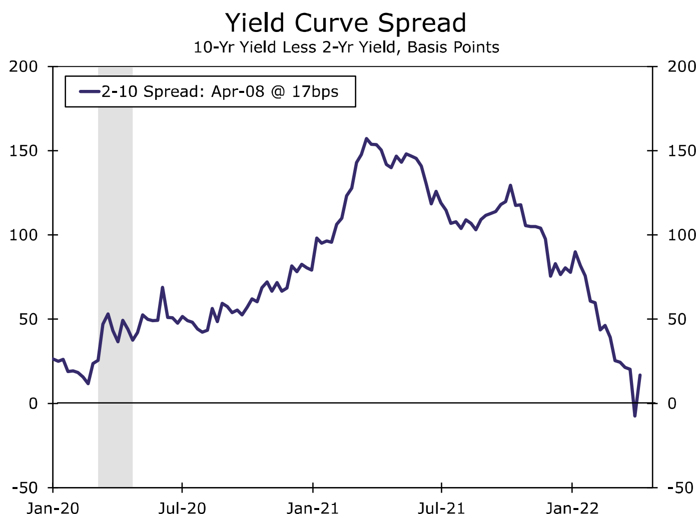


Source: Bloomberg Finance L.P. and Wells Fargo Economics

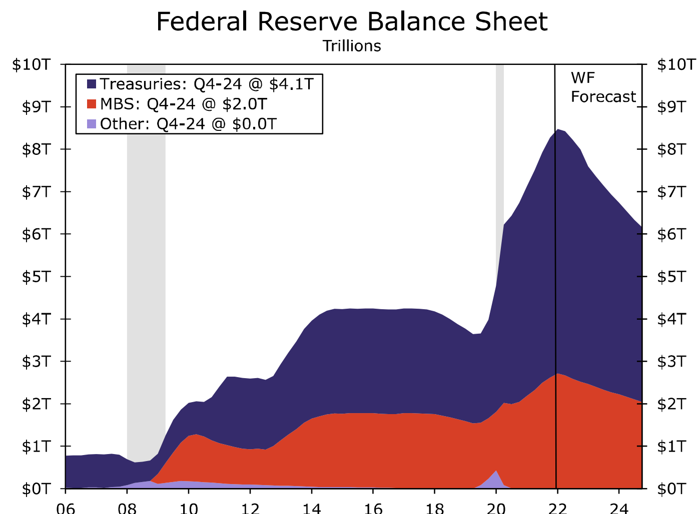
Interest Rate Watch

Balance Sheet Runoff Takes Shape

FOMC Chair Powell hinted in the March 16 post-meeting press conference that the meeting's minutes would hold important clues on the Fed's plans to reduce its balance sheet, i.e. begin quantitative tightening (QT). The minutes delivered, providing details around the speed and composition in which securities are likely to roll off the Fed's nearly $9T balance sheet. Participants "generally agreed" on monthly caps of $60B and $35B for maturing Treasury and mortgage-backed securities (MBS), respectively, which together would be nearly twice the amount of the 2017-2019 experience. Another way in which the Fed will expedite the removal of accommodation will be with a shorter phase-in period; rather than taking a full year to reach planned caps, the Fed looks set to reach them in just three months. With more certainty that the Fed will embark on a faster wind-down this cycle, the yield curve generally steepened, notably with the 2s/10s spread turning positive (chart).



Source: Bloomberg Finance L.P. and Wells Fargo Economics



Source: Federal Reserve Board and Wells Fargo Economics

All told, we expect the FOMC to begin balance sheet runoff in May. We expect Treasury caps to start at $40B per month, rise to $50B in June and finally $60B in July. MBS caps are likely to start at $25B and reach $35B in July. Although for all intents and purposes, MBS runoff is uncapped as the amount maturing securities each month is unlikely to reach such a high level in a rising rate environment. With the FOMC preferring to hold primarily Treasury securities over the longer run, participants signaled sales of MBS would be on the table once balance sheet reduction was "well underway."

By our estimates, the Fed's balance sheet would shrink by about $950B this year. How much pressure would this put on financial conditions, the channel through which monetary policy flows through to the economy? In the March press conference, Powell said the shrinkage of the balance sheet "might be the equivalent of another rate increase." But he did not seem to have a lot of conviction in this estimate, which underscores the risk to the economy of such rapid removal of accommodation.

The accelerated pace of balance sheet runoff coincides with the FOMC running full-steam ahead in raising the fed funds rate. The meeting minutes showed that "many" FOMC members were on board with "one or more 50 bps increases" at upcoming meetings. Our baseline expectation, discussed in our April *U.S. Economic Outlook*, is for the FOMC to hike by 50 bps at both the May and June meetings. Markets appear braced for such a move, pricing in about a 90% chance of a 50-bp hike in May and an 85% chance of a subsequent 50-bp hike in June. Over the next 12 months, we expect the Fed to raise the fed funds rate by 250 bps, which would be the largest one-year increase since 1994, before ultimately taking it to a range of 3.00%-3.25% in the second quarter of next year.

Such speed on both the fed funds rate and the balance sheet brings with it risk. In the most recent tightening cycle, when the fed funds rate rose 225 bps over four years, the FOMC had the benefit of time to assess the impact of its policy changes on the economy. The current circumstances of roughly 8% consumer price inflation, 3.6% unemployment and still very easy policy provide no such luxury. The Fed will need to feel its way through the data to determine the impact of sharp QT alongside a quickly

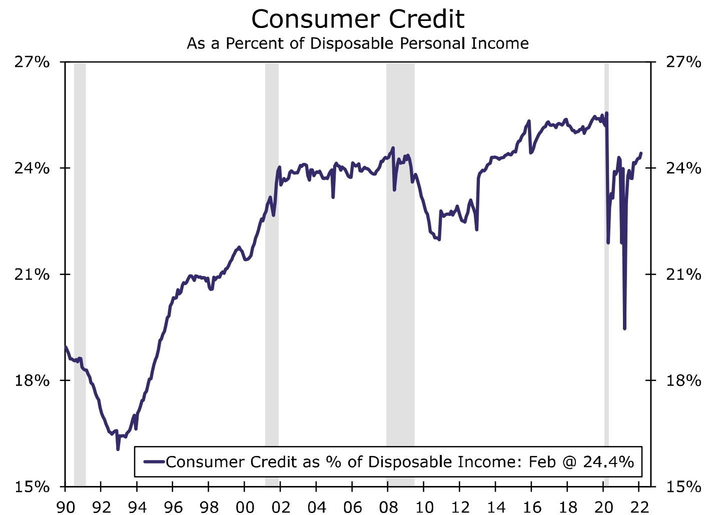
rising fed funds rate. However, given the lagged effects of monetary policy on the economy, the Fed runs the risk of not seeing tighter policy until it is too late. (Return to Summary)

Credit Market Insights

Consumer Credit Expands in February

The Federal Reserve Board reported that consumer credit increased at an annualized rate of 11.3% in February, with revolving credit leading the way increasing 20.7%. This increase in credit outstanding grew even as anticipation of tighter monetary policy has forced shorter-term interest rates upwards, as 48-month new car loan rates grew 32 bps to 4.90% and 24-month personal loan rates also grew 32 bps to 9.41% since Q4-2021. At the same time, rates on 60-month car loans fell 12 bps to 4.55%.

Consumer credit outstanding has reached a new high of $4.45T, as major creditors holdings expanded broadly, with the exception of nonfinancial businesses, nonprofits and the federal government. Even as the level of consumer credit has reached a new high, consumers are in better shape than they were during the past business cycle, as consumer credit as a percentage of disposable income has yet to recover to its pre-COVID level (chart). With a deleveraging of household balance sheets in 2020 and the boost to disposable income provided by growing wages and fiscal stimulus, consumers still have room to expand their consumption credit even as higher rates may affect credit decisions at the margin. Household savings have expanded over the pandemic, and while January and February have seen some reduction of these "excess" savings, equivalent to about $40B, we estimate there is still about $2.3T in "excess" savings for consumers to draw upon. We expect real personal consumption expenditures to continue to expand this year, with services spending gaining more wallet share and recovering above its pre-COVID level in Q2-2022. As fiscal support has largely ceased and inflation eats into real income gains, households may tap lines of credit to fund spending. Finally, the announcement of yet another extension of the federal student loan memorandum through August and the Department of Education's provision to bring those in default to good standing will provide relief for the Americans who currently hold an estimated $1.7T in federal student loans. (Return to Summary)



Source: Federal Reserve Board, U.S. Department of Commerce and Wells Fargo Economics

Topic of the Week

Last Week's Positive Russia and Ukraine Headlines Appear to Be a False Start

Toward the end of last week, headlines suggested the Russia-Ukraine conflict may have reached a turning point. Media reports put forward that Russian troops could be pulling out of Kyiv and scaling back military operations in key cities across northern Ukraine. These reports were substantiated by Russian officials confirming operations would recede and that a troop withdrawal out of Kyiv and Cherniv would be imminent. According to those same Russian officials, the change in tactics were aimed at reducing hostilities and deescalating tensions, while also working on finding a way toward a peace agreement or some type of ceasefire. A meeting between Ukrainian President Zelensky and Russian President Putin was also floated as a possibility by both Ukrainian and Russian negotiators. These developments took place on March 29, and while only slightly more than a week ago, the situation has evolved considerably since then. In our view, the positive developments we saw last week seem to be a false start.

While reports suggest the Russian military is indeed withdrawing from Kyiv, Russian troops seem to be consolidating in the Donbass region and reinforcing their positions in the Donetsk and Luhansk in an effort to establish stronger control over eastern and southeastern Ukraine. Russian shelling of the city of Kharkiv also continued, with little evidence the assault on the northeast city is easing. And finally, footage over this past weekend revealed possible war crimes in Bucha, a city in Kyiv Oblast, which is a province in northern Ukraine, but does not include the capital city of Kyiv. Media reports allege Ukrainian civilians, not military, were targeted in an attack on Bucha, leading President

Biden and Western allied governments to announce new sanctions against Russia, and for European governments to strongly consider halting Russian energy imports.

The U.S. Treasury also took action against Russia, disallowing United States financial institutions to process Russian sovereign debt payments. While Russia has maintained its willingness to pay interest and principal payments up to now, sanctions restricting U.S. banks from processing bond payments likely increases the probability of Russia defaulting on its obligations. To that point, just this week Russia tried to make coupon payments on dollar-denominated debt; however, U.S. banks were blocked from processing transfers to bondholders.

Source: Bloomberg Finance L.P. and Wells Fargo Economics

In an effort to stay current on debt obligations, the Russian government made interest payments in rubles rather than U.S. dollars. Since the start of the conflict, and before the U.S. Treasury-imposed sanctions, credit rating agencies warned paying dollar-denominated debt with rubles would be considered a sovereign default. Should rating agencies and regulators determine a "credit event" has occurred, according to Russia's sovereign bond covenants, the government would enter a 30-day grace period where debts could still be paid in U.S. dollars and Russia would avoid technical default.

Should Russia enter the 30-day grace period and not fulfill its dollar-denominated obligations during that time, the likelihood of Russia being in default would be very high. In the coming months, Russia will have to make multiple dollar-denominated payments to bondholders. While the payments are not particularly large, the same logistical and operational challenges could result in Russia again paying dollar-denominated debts in rubles. Additional bonds entering the grace period are also at risk of being defaulted on. Russia will have to make $70M worth of interest payments in May and close to $400M of coupon payments in June. September's obligations are more burdensome, as the government will have to make total payments of around $800M (~$370M of interest payments as well as pay off a sinkable bond worth ~$425M).

While the likelihood of a sovereign default has likely risen, the ruble's fortunes have turned and have become more positive. Over the past month, the ruble has recovered all of its recent decline in value in offshore markets and is back to pre-conflict levels against the U.S. dollar. Once 45% weaker against the greenback, the currency is now down just around 9% through the beginning of April. As of the first week of April, the USD/RUB exchange rate sits at RUB83.95, a staggering recovery from the weak point of RUB114.25 in mid-March. In our view, the ruble's rebound is a product of counter-sanctions and policies put in place designed to support the currency. These policies include strict capital controls, mandating Russian companies to sell hard currency, forcing "hostile" countries to purchase Russian energy in rubles, aggressive monetary tightening, as well as Russia's sovereign wealth funds purchasing up to $10B in ruble-denominated assets.

While the majority of these counter-sanctions are likely not sustainable over the long term and will inflict damage on Russia's economy, an argument can be made that counter-sanctions are achieving their intended goal. The ruble has stabilized, and in our view, as long as counter-sanctions remain in place, we believe the ruble can gradually strengthen going forward. Even in the event that Russia is declared as in default on its sovereign bonds, we believe the ruble can continue to strengthen as a default will likely not result in capital controls or any other counter-sanctions to be lifted. In fact, a default could incentivize Russian officials to keep these policies in place for longer, as a default would likely result in a sudden stop of capital flows toward Russia. While the ruble has strengthened back to pre-invasion levels and already hit our medium-term targets, we believe the currency can continue to strengthen going forward. (Return to Summary)

Market Data • Mid-Day Friday

U.S. Interest Rates

	Friday 4/8/2022	1 Week Ago	1 Year Ago
SOFR	0.30	0.29	0.01
3-Month LIBOR	0.99	0.96	0.19
3-Month T-Bill	0.68	0.51	0.01
1-Year Treasury	1.62	1.56	0.02
2-Year Treasury	2.50	2.46	0.15
5-Year Treasury	2.74	2.56	0.84
10-Year Treasury	2.70	2.38	1.62
30-Year Treasury	2.73	2.43	2.31
Bond Buyer Index	3.48	2.73	2.30

Foreign Exchange Rates

	Friday 4/8/2022	1 Week Ago	1 Year Ago
Euro ($/€)	1.087	1.104	1.191
British Pound ($/£)	1.303	1.311	1.374
British Pound (£/€)	0.834	0.842	0.867
Japanese Yen (¥/$)	124.300	122.520	109.260
Canadian Dollar (C$/$)	1.258	1.252	1.256
Swiss Franc (CHF/$)	0.933	0.926	0.925
Australian Dollar (US$/A$)	0.746	0.750	0.765
Mexican Peso (MXN/$)	20.091	19.854	20.096
Chinese Yuan (CNY/$)	6.365	6.363	6.551
Indian Rupee (INR/$)	75.905	75.786	74.583
Brazilian Real (BRL/$)	4.748	4.659	5.572
U.S. Dollar Index	99.843	98.632	92.059

Source: Bloomberg Finance L.P. and Wells Fargo Economics

Foreign Interest Rates

	Friday 4/8/2022	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	-0.58	-0.59	-0.57
3-Month Sterling LIBOR	1.06	1.04	0.08
3-Month Canada Banker's Acceptance	1.40	1.26	0.44
3-Month Yen LIBOR	0.00	0.00	-0.07
2-Year German	0.05	-0.07	-0.71
2-Year U.K.	1.48	1.37	0.05
2-Year Canadian	2.43	2.35	0.23
2-Year Japanese	-0.08	-0.03	-0.13
10-Year German	0.71	0.56	-0.34
10-Year U.K.	1.75	1.61	0.75
10-Year Canadian	2.62	2.43	1.46
10-Year Japanese	0.23	0.23	0.10

Commodity Prices

	Friday 4/8/2022	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	96.84	99.27	59.60
Brent Crude ($/Barrel)	101.27	104.39	63.20
Gold ($/Ounce)	1942.50	1925.68	1755.84
Hot-Rolled Steel ($/S.Ton)	1510.00	1540.00	1350.00
Copper (¢/Pound)	472.70	468.85	409.45
Soybeans ($/Bushel)	16.43	15.80	14.16
Natural Gas ($/MMBTU)	6.35	5.72	2.52
Nickel ($/Metric Ton)	33,700	32,093	16,589
CRB Spot Inds.	682.30	684.18	564.88

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