WELLS FARGO

Weekly — April 7, 2023

Weekly Economic & Financial Commentary

United States: **Labor Market is Strong but Loosening**

- Data this week broadly added evidence that the labor market is loosening. Employers added jobs at the slowest pace since 2020 in March, job openings fell and an upward trend in initial jobless claims has emerged. The weaker direction suggests the end of the Fed's tightening cycle may be in sight.
- Next week: CPI (Wed), Retail Sales (Fri), Industrial Production (Fri)

International: **Policy Divergence Down Under**

- The Reserve Bank of Australia (RBA) paused its rate hike cycle this week, holding its policy rate at 3.60%, citing the cumulative tightening to date, evidence that inflation has peaked and a cautious outlook for consumer spending. We expect the current policy rate to be the peak for this cycle and do not expect RBA easing until well into 2024. The Reserve Bank of New Zealand (RBNZ) was more hawkish, raising its policy rate 50 bps to 5.25%, saying that inflation is still too high and persistent. We expect some modest further tightening from the RBNZ, and we see a final 25 bps hike to 5.50% at the May monetary policy announcement.
- Next week: Bank of Canada Policy Rate (Wed), Australian Employment (Thu), U.K. GDP (Thu)

Credit Market Insights: **Households Foresee Higher Mortgage Rates**

- Last Tuesday, the Federal Reserve Bank of New York released the findings from its 2023 Survey of Consumer Expectations (SCE) Housing Survey. Despite lower mortgage rates in recent weeks, households anticipate financing costs to trend higher over the next year.

Topic of the Week: **OPEC+ Surprises With Production Cuts**

- The Organization of the Petroleum Exporting Countries (OPEC) surprised markets early this week by cutting production in an effort to boost oil prices after the latest selloff. The production cuts could lead to renewed inflationary pressures in the United States and other parts of the world.

We have started a new podcast, "Ask Our Economists", where our economists answer questions that readers send in. If you would like to submit a question, please email us at askoureconomists@wellsfargo.com.

Wells Fargo U.S. Economic Forecast

	Actual 2022				Forecast 2023				Actual		Forecast	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2021	2022	2023	2024
Real Gross Domestic Product [1]	-1.6	-0.6	3.2	2.6	0.7	1.2	-0.9	-2.6	5.9	2.1	1.0	0.3
Personal Consumption	1.3	2.0	2.3	1.0	2.8	0.8	-0.2	-3.2	8.3	2.8	1.3	-0.1
Consumer Price Index [2]	8.0	8.6	8.3	7.1	5.8	4.1	3.3	2.8	4.7	8.0	4.0	2.5
"Core" Consumer Price Index [2]	6.3	6.0	6.3	6.0	5.6	5.2	4.5	3.9	3.6	6.1	4.8	2.9
Quarter-End Interest Rates [3]												
Federal Funds Target Rate	0.50	1.75	3.25	4.50	5.00	5.25	5.25	4.75	0.25	2.02	5.06	2.88
Conventional Mortgage Rate	4.27	5.58	6.01	6.36	6.54	6.20	5.75	5.40	3.03	5.38	5.94	5.03
10 Year Note	2.32	2.98	3.83	3.88	3.48	3.50	3.15	2.90	1.45	2.95	3.29	2.83

Forecast as of: March 17, 2023
[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

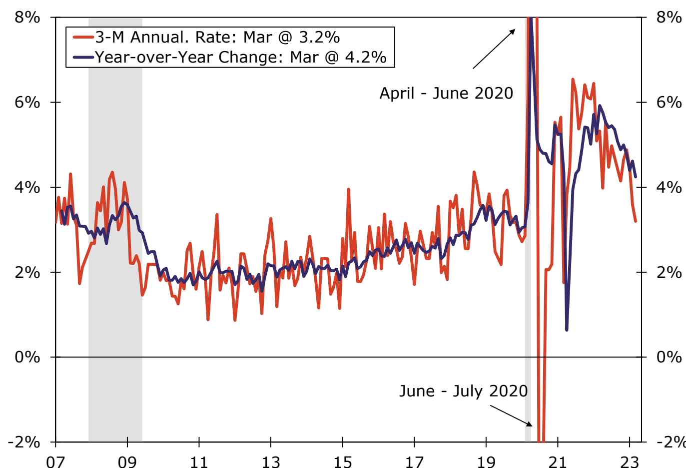
Please see our full U.S. Economic Forecast.

U.S. Review

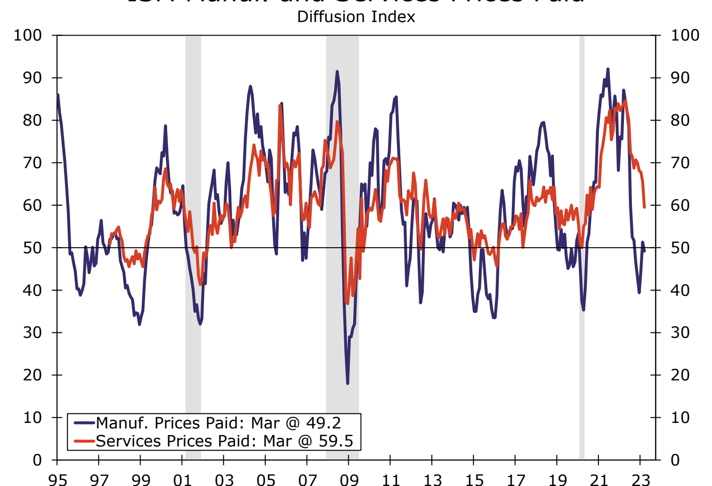
Labor Market is Strong but Loosening

This week's data broadly added to evidence that the labor market is loosening. The big release of the week was the nonfarm payrolls report on Friday morning, which showed employers added 236K net new jobs in March. This is still above the pre-pandemic run rate, but marks the lowest pace of job growth since late 2020 and is a marked move lower from the near 350K jobs added on average over the past three months. The unemployment rate ticked lower to 3.5% and labor force participation rose for the fourth straight month. Improved supply has helped soften the trend in earnings growth. Average hourly earnings are up just 3.2% at a three-month annualized rate, which is more consistent with the Fed's 2% inflation target (chart). This is very much what the Fed is looking for in terms of curing the labor market imbalance with more workers returning to the labor force.

Labor weakness was evident in other data as well. The March ISM reports showed a softening in hiring, consistent with layoffs in manufacturing and a slower pace of hiring in services. Job openings fell below 10 million, registering the lowest level since May 2021. The number of openings per unemployed worker also fell to 1.67. This remains above the 1.2 pre-pandemic ratio, but marks a 15-month low and is consistent with a topping out in labor demand—as is the fact that the lowest share of small businesses since May 2020 now plan to add workers in coming months. Finally, past revisions to initial jobless claims, which was one of the key data points stubbornly demonstrating strength, also now show a clear uptrend in recent months. All these data signal the labor market is weakening, albeit from a very strong starting point.



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



Source: Institute for Supply Management and Wells Fargo Economics

Beyond labor, there are growing signs of weakness elsewhere in the economy. Both ISM reports demonstrated economic slowdown last month. The ISM manufacturing index slid to its lowest level since 2020 and is consistent with a sector that has now been in correction for five straight months. Every sub-component was in contraction (below the breakeven 50) for the first time since 2009. At the same time, the services report called service sector resilience into question. The services index slid sharply to 51.2 from 55.1, but most major components remain consistent with expansion. This was not a great development for the services sector, but it's too soon to call off expansion, particularly in light of a solid gain in private service-providing industries employment in March (+196K).

The good news is that there are signs of slower activity bringing reprieve to prices. The prices paid components of both ISMs declined in March, though as shown in the nearby chart the gap between the two remains large, demonstrating how integral services prices are to returning inflation to the Fed's 2% target. At 59.5, service sector price pressure remains firm, but this is the first time it has slipped below 60 since late 2020. Overall it appears we have reached the point where a broadening group of indicators is suggesting the slowdown is in train and the end of the Fed's tightening cycle is in sight. (Return to Summary)

U.S. Outlook

Weekly Domestic Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
12-Apr	CPI (MoM)	Mar	0.2%	0.2%	0.4%
12-Apr	Core CPI (MoM)	Mar	0.4%	0.4%	0.5%
14-Apr	Retail Sales (MoM)	Mar	-0.5%	-0.3%	-0.4%
14-Apr	Retail Sales Less Autos (MoM)	Mar	-0.4%	-0.3%	-0.1%
14-Apr	Industrial Production (MoM)	Mar	0.3%	0.3%	0.0%

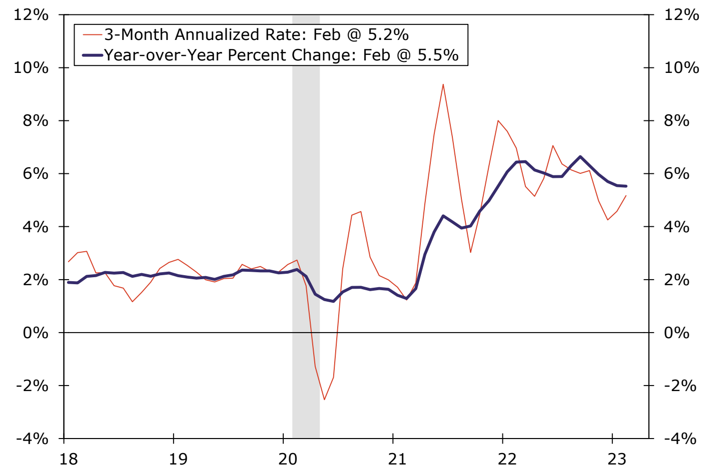
Forecast as of April 07, 2023

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

CPI • Wednesday

There were only a few positive developments in the February CPI data. Prices at the grocery store rose just 0.3%, the smallest increase since March 2021. Used auto prices continued to come back down to Earth and fell another 2.8% in the month. But beyond these pockets of improvement, core CPI inflation remained entrenched at uncomfortably high levels. With core CPI up 0.5% in February, it is rising at an annualized rate of more than 5% whether measured on a 1-month, 3-month or 12-month basis.

After rising 0.4% in February, we look for the CPI to moderate to a 0.2% gain in March. With the initial surge in oil/gasoline prices stemming from Russia's invasion of Ukraine a full year behind us, CPI when measured on a year-over-year basis should fall to 5.1% in March from 6.0% in February. However, another elevated reading in the core CPI is likely to indicate that the recent trend in inflation is little improved. Excluding food and energy, we look for the CPI to rise 0.4% and remain close to 5% on a three-month annualized basis. A further slowdown in core inflation is likely coming as the year progresses, but we doubt it will be evident in next week's CPI release.

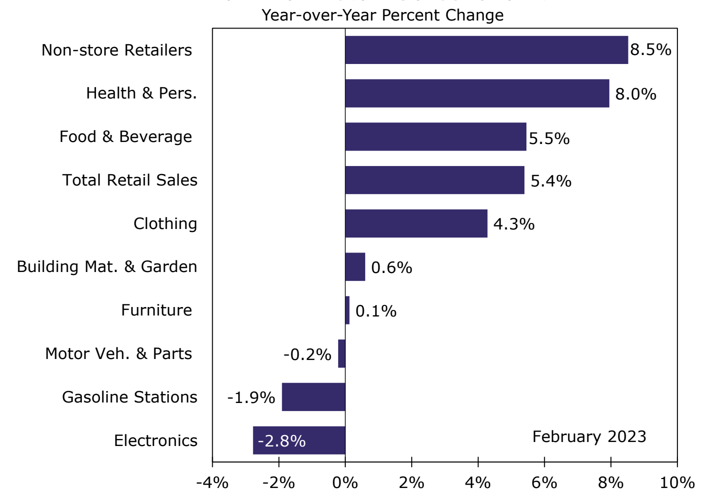


Source: U.S. Department of Labor and Wells Fargo Economics

Retail Sales • Friday

Retail sales exploded to start the year, rising 3.2% in January (a stunning 46.3% annualized rate). Some payback in the subsequent months seemed all but assured, and sure enough, retail sales dropped 0.4% in February. We suspect retail sales posted a similar decline in March. If realized, softness in next week's report can be interpreted as some continued normalization in sales following January's outsized surge.

The strength in January retail sales paired with continued solid growth in services consumption signals that real consumer spending grew at a solid clip in the first quarter of the year despite some giveback in February and March. That said, the outlook past Q1 is murky. After a curiously strong January, the consumer is evidently losing some momentum amid rate hikes, tightening credit and a softening labor market. We think household consumption growth has a bit longer to run before it eventually rolls over later this year as part of a broader U.S. recession.



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

Industrial Production • Friday

Industrial production rose a modest 0.1% in February. A 0.5% boost from utilities output was largely offset by a 0.6% contraction in mining production. Manufacturing output, which comprises nearly 75% of industrial output, also grew 0.1%. The slowdown in the manufacturing sector is evident in the output data. Total output in the factory sector is down about 1% over the past year. Furthermore, the catch-up in the supply-constrained motor vehicle sector is flattering the headline numbers. Motor vehicle and parts production is up 10.8% over the past year. Excluding this sector, manufacturing output is down nearly 2% over the past year.

The separate ISM manufacturing report for March was a dud, which bodes poorly for industrial production growth. Not only was the headline index at its lowest since 2020, every sub-component was below the breakeven 50 for the first time since 2009. All but two (production and customer inventories) were lower versus the prior month. We expect total industrial production to rise modestly in next week's report, but on trend we expect output to fall further into contraction in the months to come.

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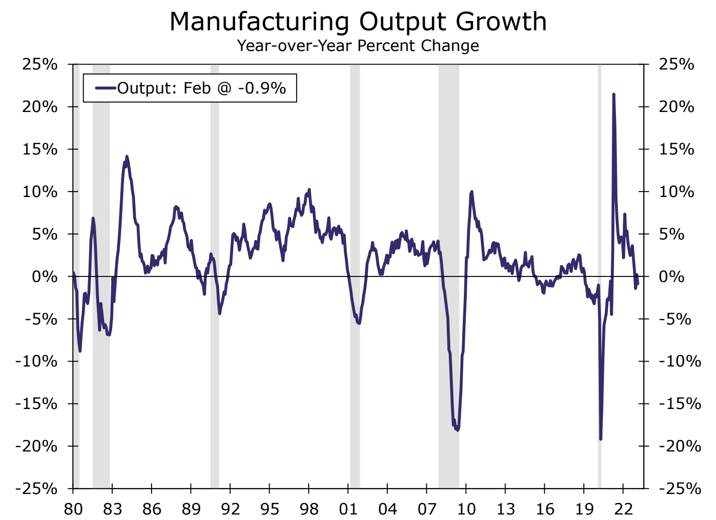


Source: Federal Reserve Board and Wells Fargo Economics

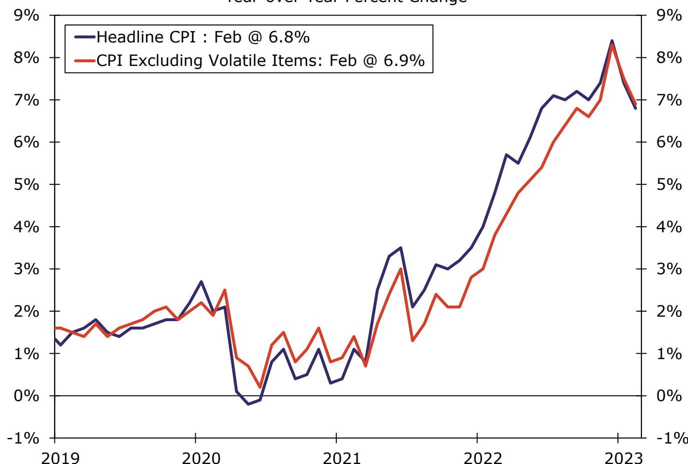
International Review

Policy Divergence Down Under

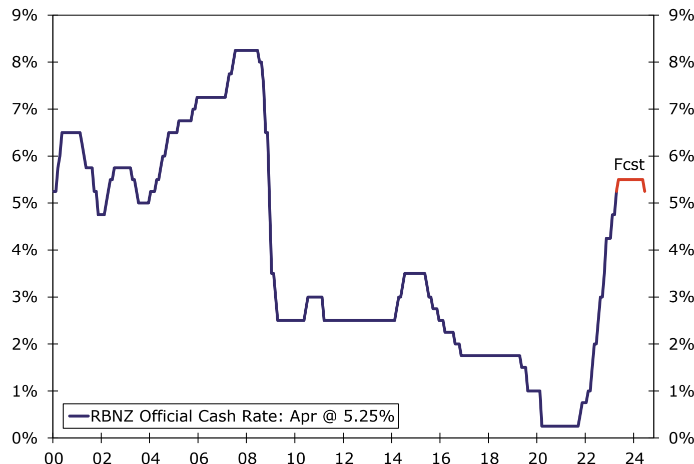
This week saw a couple of notable monetary policy meetings from Australia and New Zealand, with the respective central banks taking contrasting approaches in their policy deliberations and announcements. The Reserve Bank of Australia (RBA) paused its rate hike cycle, keeping its policy rate at 3.60%. Among the factors encouraging the RBA to hold rates steady, the central bank noted that higher interest rates, cost-of-living pressures and a decline in housing prices is leading to a substantial slowing in household spending. The RBA also highlighted a cumulative 350 bps of tightening over the past year, and that given monetary policy operates with a lag, the full effect of this substantial increase in interest rates is yet to be felt. And finally there is also evidence Australian inflation has peaked, especially given the slowing in the monthly CPI reading in early 2023. The RBA said it expects inflation to slow to around 3% by mid-2025.

On a slightly more hawkish note, the RBA said the labor market remains very tight and that wage growth is firming. The RBA said it remains alert to the risk of a wage-price spiral, and seeks to guard against higher inflation expectations becoming entrenched. In subsequent comments, RBA Governor Lowe offered comments both for and against further monetary tightening. He said "the decision to hold rates steady this month does not imply that interest rate increases are over" but also said the RBA "is prepared to have a slightly slower return of inflation to target than some other central banks." With the RBA having softened its policy guidance to some extent, saying "some further tightening of monetary policy may well be needed to ensure that inflation returns to target," we believe the bar is somewhat higher for the Reserve Bank of Australia to resume rate hikes. That is not a bar we expect to be met. Instead, we expect the current policy rate of 3.60% will be the peak for this cycle, while we do not expect the Reserve Bank of Australia to begin easing monetary policy until well into 2024.

The Reserve Bank of New Zealand (RBNZ) adopted a more hawkish approach, delivering a larger-than-forecast 50 bps increase in its Official Cash Rate, to 5.25%. In raising interest rates more than expected, the RBNZ said inflation is still too high and persistent, and that employment is beyond its maximum sustainable level. The central bank also said recent weather events add some upside risk to the near-term inflation outlook. While the central bank anticipated slower growth through 2023, they also viewed this slowdown in spending as necessary to return inflation to target over the medium-term. Against this backdrop we expect some modest further tightening from the RBNZ, and we see a final 25 bps rate hike to 5.50% at the May monetary policy announcement.



Source: Datastream and Wells Fargo Economics



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

Elsewhere, this week saw some mixed economic figures from Canada. The March labor market report was solid, as employment rose 34,700 reflecting an 18,800 gain in full-time jobs and a 15,900 gain in part-time jobs. The unemployment rate held steady at 5.0%, although hourly wage growth for permanent employees did ease slightly to 5.2% year-over-year. In contrast, the Bank of Canada's (BoC) Q1 Business Outlook Survey was more downbeat. The BoC's business outlook indicator fell to -1.1 in the first quarter, the first negative reading since Q3-2020, and although the future sales balance

improved to -18, it remained in negative territory for the fifth quarter in a row. While the Canadian economy appears to have started 2023 on a reasonably solid note, we expect activity to soften as the year progresses.

In emerging markets, the Reserve Bank of India (RBI) surprised market participants by holding its policy rate steady at 6.50%, in contrast to the consensus forecast for a 25 bps increase to 6.75%. Although the central bank held rates steady, the announcement still had hawkish undertones. Even as policymakers voted 6-0 to keep rates steady this month, they also voted 5-1 in favor of keeping the monetary policy stance tilted toward removing accommodation. In addition, the accompanying statement and comments from RBI Governor Das focused on elevated inflation, in particular core inflation. Das also noted the April decision was a pause, not a pivot, and the central bank stands ready to act further if needed to bring inflation under control. Still, following the pause and despite the continued tightening bias, unless there is an upside inflation shock we believe the current policy rate of 6.50% may mark the peak for this cycle. Elsewhere, Mexico's March CPI slowed slightly more than expected to 6.85% year-over-year, thanks in part to slower energy and food price inflation. Core CPI inflation also slowed, albeit less markedly and slightly above the consensus forecast, to 8.09%. At its most recent announcement the Bank of Mexico slowed the pace of tightening to a 25 bps rate hike to 11.25%, but also said resistant underlying price pressures could make the case for additional monetary efforts. Despite the slowing in Mexican inflation in March, we still anticipate a final 25 bps hike to 11.50% from the Bank of Mexico at its May monetary policy meeting.

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International Outlook

Weekly International Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
12-Apr	Bank of Canada Policy Rate	4-Apr	4.50%	4.50%	4.50%
13-Apr	Australia Employment	Mar	20.0K	--	64.6K
13-Apr	Australia Unemployment Rate	Mar	3.6%	--	3.5%
13-Apr	U.K. GDP (MoM)	Feb	0.1%	--	0.3%

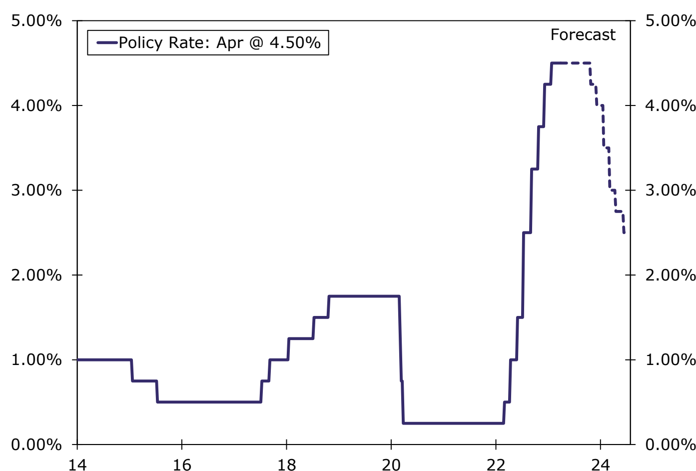
Forecast as of April 06, 2023

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

Bank of Canada Policy Rate • Wednesday

The Bank of Canada (BoC) holds its next monetary policy meeting Wednesday, a meeting at which we expect the central bank to hold its policy rate steady at 4.50% for the second meeting in a row. The BoC moved to a neutral stance earlier this year, given some signs of slower inflation and moderate growth, and as it assessed the effects of its previous monetary tightening.

Since that time, activity indicators have been somewhat mixed. There have been hints of strength, including a 0.5% month-over-month rise in January GDP, and an average employment gain of 68,800 per month during the first quarter. On the flip side, the drop in the BoC's business outlook indicator to -1.1 in Q1 still points to softer growth ahead, while the three-month annualized rate of core inflation for the BoC's preferred measures have slowed to a 3-4% range. That is, core inflation is still running above the central bank's inflation target but is well down from the highs seen last year. Against this backdrop, we do not expect the Bank of Canada to raise rates further, but nor do we expect the central bank will be in any rush to lower its policy rate either. For now, we see Bank of Canada monetary policy as comfortably on hold at the April monetary policy meeting.

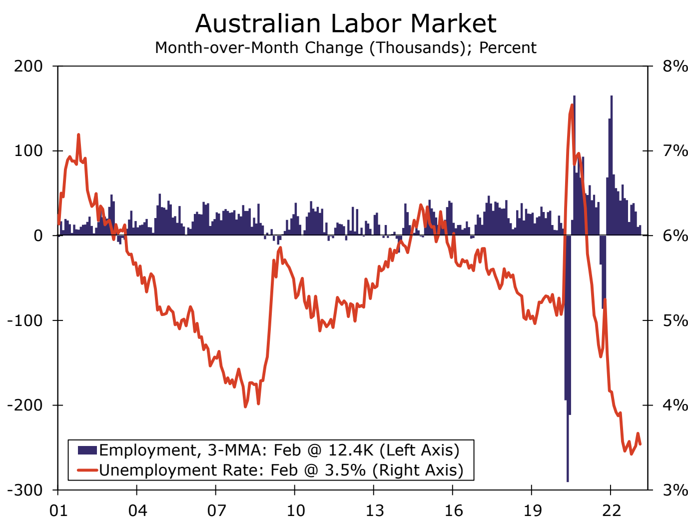


Source: Bloomberg Finance L.P. and Wells Fargo Economics

Australian Employment • Thursday

Next week's Australian employment report for March should provide a timely insight into the state of the economy in early 2023. Australian activity has been subdued around the turn of the year—Q4 GDP rose a moderate 0.5% quarter-over-quarter, while the manufacturing and service sector PMIs were both in contraction territory in the latest reading for March. That subdued activity has also been reflected in the labor market, with employment declining in both December and January before jumping by 64,600 in February.

We do expect Australian growth to improve as the year progresses, especially as a reopening of China's economy (which is the largest export destination for Australia) sees a rebound in activity for that key trading partner. Against this backdrop, the consensus forecast is for a trend-like employment gain of 20,000 for March, while the unemployment rate is forecast to tick higher to 3.6%. Given the Reserve Bank of Australia's pause in monetary tightening against a backdrop of gradually slowing inflation, we believe a gradual improvement in Australian activity as 2023 progresses should keep the Australian central bank comfortably on hold for an extended period.

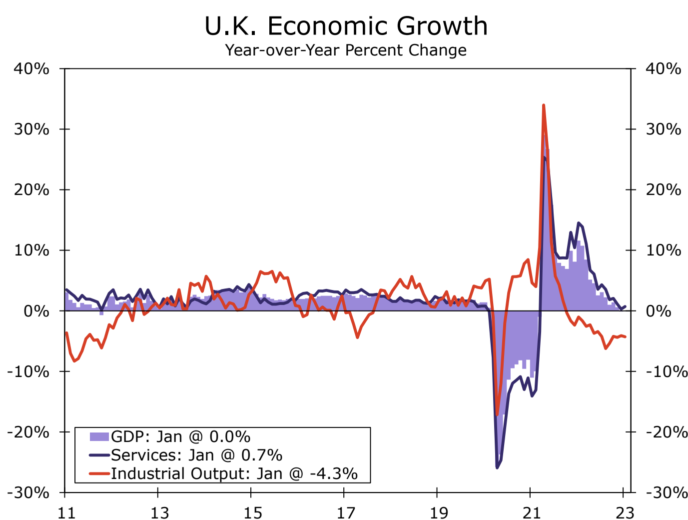


Source: Datastream and Wells Fargo Economics

U.K. GDP • Thursday

The U.K. economy has shown some resilience in early 2023 as energy prices have fallen sharply from last year's highs, and next week's February GDP figures will be keenly watched to see if that solid start to the year has continued. January saw GDP rise 0.3% month-over-month, driven by a 0.5% gain in service sector activity. Some one-off factors appeared to boost the service sector gains, notably a rise in the education sector as school attendance returned, and an increase in entertainment as Premier League Football resumed. That said, early indications are that firmer activity continued into February, with retail sales rising for the month and the services PMI remaining above the breakeven 50 level.

Against this backdrop, the consensus forecast is for February GDP to edge up a further 0.1% month-over-month. That gain is expected to reflect a rise in industrial output, which is forecast to gain by 0.2%, while services activity is expected to be flat. In terms of monetary policy, a moderate gain in February in line with the consensus forecast could support the case for another 25 bps policy rate increase from the Bank of England. That is particularly the case given U.K. inflation which, although on a slowing overall trend, remains elevated and surprised to the upside in the most recent month.



Source: Datastream and Wells Fargo Economics

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Credit Market Insights

Households Foresee Higher Mortgage Rates

Recently, the Federal Reserve Bank of New York released the findings from its 2023 Survey of Consumer Expectations (SCE) Housing Survey. This year's survey found a strong pullback in home price growth expectations. Households expected home price appreciation to amount to just 2.6% on a year-over-year basis, down from 7.0% a year earlier. Rent growth expectations followed a similar path, decreasing to 8.2% over the next 12 months, down from 11.5% in the 2022 survey.

Despite lower mortgage rates in recent weeks, households anticipate financing costs to trend higher. Households now expect the average 30-year fixed mortgage rate to rise to 8.4% one year from now and 8.8% in three years (chart). One-year ahead expectations are up from 6.7% a year ago and 5.2% two years ago. One-year expectations are also running well above their five-year pre-pandemic average of 6.2%. Despite expectations for higher rates, households are still uncertain about the path of rates and see about a 49% chance that rates will actually fall over the next 12 months.

The Fed's survey was conducted in February, which happened to coincide with a lull in mortgage rates. The average 30-year fixed rate averaged 6.3% during the month (chart), a five-month low. The modest drop in mortgage rates appears to have been a factor in driving a turnaround in mortgage applications for purchase and existing home sales. Even with mortgage rates hovering near the highest level in 15 years, the expectation that rates could move even higher perhaps has made some homebuyers more willing to deal with the current elevated rate environment.

Despite the gloomy outlook for mortgage rates, the SCE survey also found that a majority of households still think investing in a home is worthwhile. Roughly 68% of respondents still believe buying property in their own zip code is a good investment. This share has fallen from about 72% in the 2022 survey and 74% in 2021, but is still above the five-year pre-pandemic average of about 64%.

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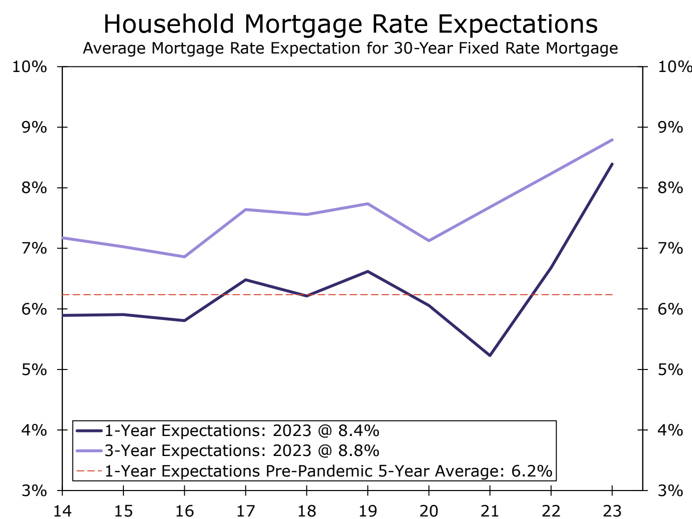
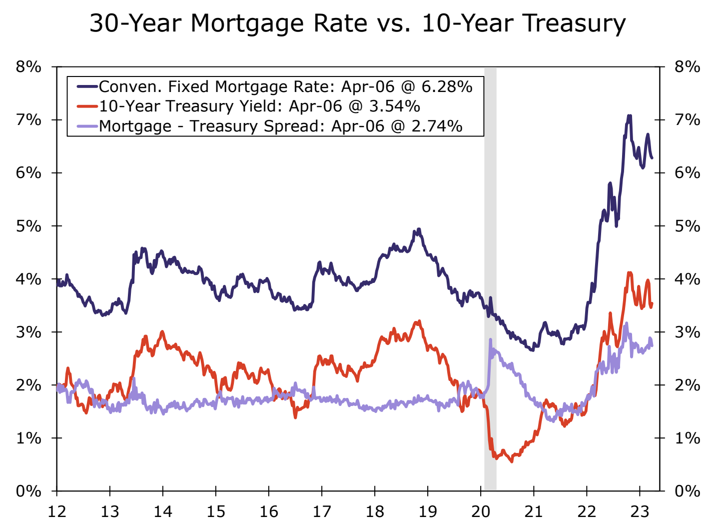


Source: Federal Reserve Bank of New York and Wells Fargo Economics



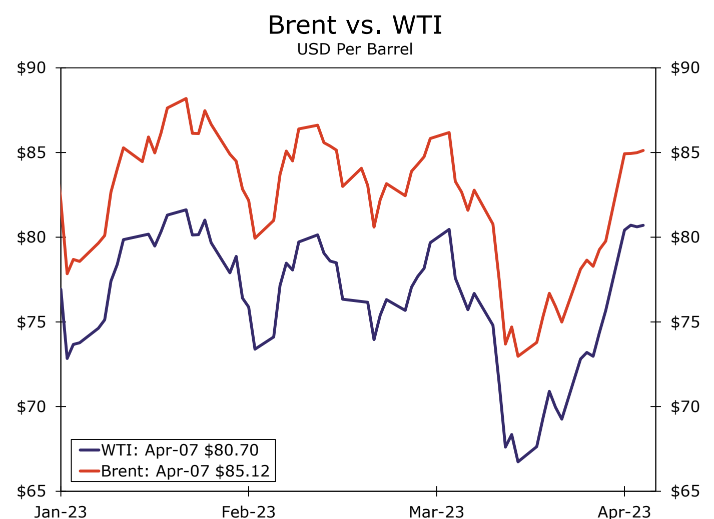
Source: Freddie Mac, Bloomberg Finance L.P. and Wells Fargo Economics

Topic of the Week

OPEC+ Surprises With Production Cuts

The Organization of the Petroleum Exporting Countries (OPEC) surprised markets early this week by cutting production in an effort to boost oil prices after the latest selloff. Leading into the April meeting, OPEC provided little in the way of signals that production cuts were being pondered. Countries such as Saudi Arabia commented that while the banking sector issues were concerning and oil prices were responding to negative sentiment, the impact on supply and demand dynamics is yet to be known. For markets, these comments were enough to believe the cartel would keep production steady in April and possibly beyond, or at least until a more noticeable impact was determined. However, in a surprise move, OPEC opted to lower production by 1.1 million barrels per day, led by Saudi Arabia cutting its own production by 500,000 barrels per day. In addition to Saudi Arabia, OPEC member nations such as Iraq, the United Arab Emirates and Kuwait all participated in the voluntary production cuts. Russia, a non-OPEC member, followed through on a previously signaled 500,000 bpd cut, while also deciding to extend these production cuts through the end of this year. All in, a little over 1.6 million barrels of oil per day will be pulled out of the market as a result of this week's decisions.

Given production cuts were a surprise, oil prices jumped early in the week. The immediate reaction was an 8% pop in the price of Brent crude and WTI, while natural gas and other energy commodity also prices spiked. Over the course of the week, oil prices maintained these gains and all but wiped out year-to-date losses. While production cuts can support prices in the short-term, the longer-term direction of crude and WTI prices can be determined by multiple factors. Supply and demand will play the primary role, and while OPEC+ seems willing to limit supply, fears of global recession could weigh on the demand side of the equation. Also, OPEC+ nations are now producing well below capacity. Low production could limit the cartel's ability or willingness to trim production further if supply starts to outweigh demand again. In addition, global financial markets remain volatile, and if sentiment deteriorates again similarly to what unfolded in response to banking sector challenges, oil prices could head lower.



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

In the meantime, OPEC+ production cuts could lead to renewed inflationary pressures in the United States and other parts of the world. In March, a slump in oil prices likely led to a sharp softening in headline inflation for most countries. However, with oil and energy prices now higher in April, headline inflation could rise sharply when April data are released. For central banks looking to end their tightening cycles, this week could present new challenges to pausing on interest rate hikes or even initiating easing cycles. In our view, central banks are likely to stick to the script and not overreact. But, if inflation expectations climb and price formations deteriorate as a result, "higher for longer" could be back on the table for many central banks.

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Market Data • Mid-Day Friday

U.S. Interest Rates

	Friday 4/7/2023	1 Week Ago	1 Year Ago
SOFR	4.81	4.83	0.30
3-Month LIBOR	5.20	5.18	0.99
3-Month T-Bill	4.82	4.69	0.67
1-Year Treasury	4.20	4.35	1.63
2-Year Treasury	3.96	4.03	2.46
5-Year Treasury	3.48	3.57	2.71
10-Year Treasury	3.39	3.47	2.66
30-Year Treasury	3.60	3.65	2.68
Bond Buyer Index	3.36	3.50	2.87

Foreign Exchange Rates

	Friday 4/7/2023	1 Week Ago	1 Year Ago
Euro ($/€)	1.091	1.084	1.088
British Pound ($/₤)	1.242	1.234	1.308
British Pound (₤/€)	0.878	0.879	0.832
Japanese Yen (¥/$)	132.060	132.860	123.950
Canadian Dollar (C$/$)	1.351	1.352	1.259
Swiss Franc (CHF/$)	0.905	0.915	0.934
Australian Dollar (US$/A$)	0.667	0.669	0.748
Mexican Peso (MXN/$)	18.131	18.046	20.141
Chinese Yuan (CNY/$)	6.870	6.874	6.360
Indian Rupee (INR/$)	81.898	82.338	75.760
Brazilian Real (BRL/$)	5.058	5.095	4.716
U.S. Dollar Index	102.017	102.506	99.751

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

Foreign Interest Rates

	Friday 4/7/2023	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	-0.58	-0.59	-0.57
3-Month Sterling LIBOR	4.44	4.41	1.06
3-Month Canada Banker's Acceptance	5.05	5.03	1.38
3-Month Yen LIBOR	-0.03	-0.03	-0.08
2-Year German	2.55	2.75	-0.04
2-Year U.K.	3.37	3.46	1.46
2-Year Canadian	3.62	3.76	2.35
2-Year Japanese	-0.05	-0.06	-0.04
10-Year German	2.18	2.37	0.65
10-Year U.K.	3.43	3.52	1.70
10-Year Canadian	2.79	2.94	2.52
10-Year Japanese	0.47	0.35	0.23

Commodity Prices

	Friday 4/7/2023	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	80.70	74.37	96.23
Brent Crude ($/Barrel)	85.12	79.27	101.07
Gold ($/Ounce)	2007.91	1980.37	1925.35
Hot-Rolled Steel ($/S.Ton)	1166.00	1165.00	1516.00
Copper (¢/Pound)	401.55	409.15	473.80
Soybeans ($/Bushel)	14.95	15.13	16.17
Natural Gas ($/MMBTU)	2.01	2.10	6.03
Nickel ($/Metric Ton)	22,657	23,007	33,469
CRB Spot Inds.	560.63	563.51	684.11

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