WELLS FARGO

Weekly — November 10, 2022

Weekly Economic & Financial Commentary

United States: **October Prices Give Fed Ability to Slow Pace of Rate Hikes**

- Relief in October inflation gives the FOMC the ability to slow the pace of rate hikes ahead. But make no mistake, the Fed's job of taming inflation remains far from over. We still expect it to raise the federal funds rate 50 bps at its next policy meeting in December, and now look for the policy rate to reach a peak of 5.25% by March, 25 bps more than we previously forecast, due to near-term resilience in spending and labor market strength.
- Next week: Retail Sales (Wed), Industrial Prod. (Wed), Housing Starts/Existing Home Sales (Thu/Fri)

International: **Mixed Inflation Trends from Latin America**

- This week saw some mixed inflation trends from Latin America. Mexico's October CPI slowed to 8.41% year-over-year and energy prices slowed along with fruit and vegetables prices. However, the core CPI quickened further, and as a result, we fully expect the Bank of Mexico to raise its policy rate by 75 bps points this week. In Brazil, October inflation slowed further to 6.36% year-over-year, with lower taxes and gasoline prices as key drivers of the deceleration in recent months.
- Next week: Japan GDP (Tue), China Retail Sales & Industrial Output (Tue), U.K. CPI (Wed)

Credit Market Insights: **Consumer Credit Growth Steadies as Banks Tighten Lending Standards**

- Total consumer credit growth moderated in September, increasing by $25 billion in a step down from August's $30 billion gain. The Fed's quarterly Senior Loan Officer Opinion Survey, which generally covers the third quarter, found that banks have tightened their lending standards over the quarter and demand for most business and consumer loan types weakened.

Topic of the Week: **Election Day 2022**

- Election Day has come and gone in the United States, and although not every race has been determined, the broad contours of the election outcome have emerged. The most probable outcome appears to be a divided government, with Republicans controlling at least one chamber of Congress and the White House still safely in Democrats' hands.

Wells Fargo U.S. Economic Forecast

	Actual			Forecast					Actual	Forecast		
	2022				2023				2021	2022	2023	2024
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Real Gross Domestic Product [1]	-1.6	-0.6	2.6	1.1	0.7	0.1	-2.5	-3.2	5.9	1.9	0.1	-0.2
Personal Consumption	1.3	2.0	1.4	1.5	1.2	0.5	-1.7	-3.0	8.3	2.7	0.6	-0.5
Consumer Price Index [2]	8.0	8.6	8.3	7.4	6.0	4.2	3.4	3.1	4.7	8.1	4.1	2.7
"Core" Consumer Price Index [2]	6.3	6.0	6.3	6.1	5.5	4.7	3.8	3.3	3.6	6.2	4.3	2.9
Quarter-End Interest Rates [3]												
Federal Funds Target Rate	0.50	1.75	3.25	4.50	5.25	5.25	5.25	5.25	0.25	2.50	5.25	3.25
Conventional Mortgage Rate	4.42	5.81	6.70	6.95	7.00	6.80	6.50	5.80	2.95	5.97	6.53	5.10
10 Year Note	2.32	2.98	3.83	4.15	4.25	4.20	4.00	3.40	1.45	3.32	3.96	2.95

Forecast as of: November 10, 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 Pressure Gauge.

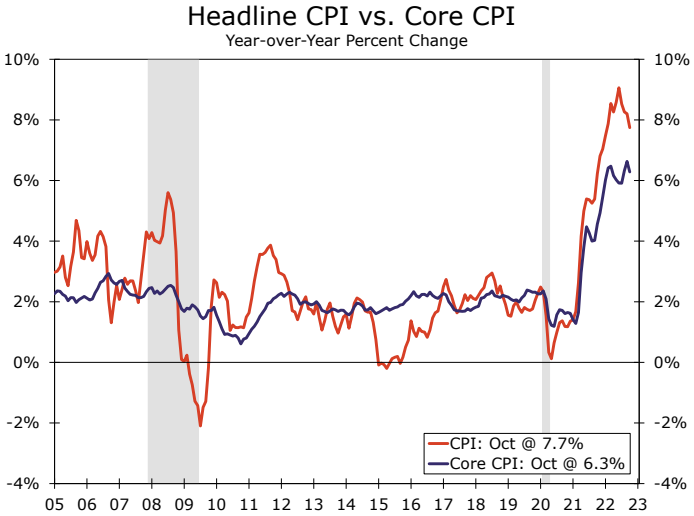
U.S. Review

October Prices Gives Fed Ability to Slow Pace of Rate Hikes

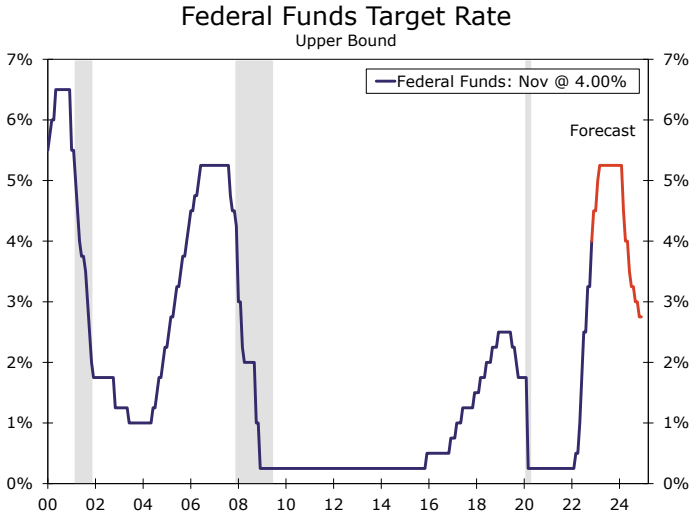
There was some clear relief in consumer inflation in October, which is a welcome development for households and policymakers alike. The headline consumer price index rose "just" 0.4% during the month, which was below the Bloomberg consensus expectation for a 0.6% gain and caused the year-ago pace to fall back to 7.7%, or the lowest annual rate of inflation in nine months (chart). Core prices also rose a more muted 0.3% during the month as core goods prices declined 0.4% amid an easing in supply chain constraints, which have boosted retail inventories. Core services prices rose 0.5% during the month, which is still quite fast compared to the pre-pandemic run rate but a bit softer than we anticipated.

Overall, October's moderation in inflation is welcome, but with the core CPI up at an annualized rate of 5.8% between July and October, there remains a long way to go before inflation returns to a rate the Fed will tolerate. The way back down to the Committee's 2% inflation goal will also likely be bumpy with services inflation particularly difficult to stomp out. The October CPI report reduced the likelihood of another 75 bps rate hike in December, but we expect policymakers to remain biased toward over-tightening rather than under-tightening for the foreseeable future.

The FOMC noted for the first time it will consider the cumulative degree of tightening and the lags inherent in monetary policy when deciding on future rate moves at its November policy meeting. Chair Powell also emphasized the Committee is not done tightening yet. We take this communication and the lower-than-expected gain in inflation as evidence that the Fed will continue to hike rates, but at a slower pace, and we forecast the FOMC will hike the federal funds rate by 50 bps at its next monetary policy meeting.



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



Source: Federal Reserve Board and Wells Fargo Economics

Still, as we detail in our latest monthly U.S. Economic Outlook, the uncanny staying power of the consumer and sustained tightness in the labor market suggest near-term resilience in activity and keeps the pressure on the Fed to do more. We now project the FOMC will raise rates by 50 bps in February before a 25 bps hike at its subsequent meeting in March. That would put the upper-end of the target rate at 5.25%, 25 bps higher than our previous forecast (chart). We expect the FOMC to hold rates there for the remainder of 2023 before it begins to guide rates lower in response to the recession, with initial rate cuts taking place at the start of 2024.

The outcome of the U.S. midterm elections held on Tuesday is still not determined, but it looks like the most probable outcome will be a divided government, which means it will be unlikely to see sweeping fiscal policy changes over the next two years. Please see this week's Topic of the Week section for more detail on the election.

(Return to Summary)

U.S. Outlook

Weekly Domestic Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
16-Nov	Retail Sales (MoM)	Oct	0.9%	1.0%	0.0%
16-Nov	Industrial Production (MoM)	Oct	0.0%	0.2%	0.4%
16-Nov	Capacity Utilization	Oct	80.4%	80.4%	80.3%
17-Nov	Housing Starts (SAAR)	Oct	1425K	1412K	1439K
18-Nov	Existing Home Sales (SAAR)	Oct	4.38M	4.31M	4.71M
18-Nov	Leading Index (MoM)	Oct	-0.4%	-0.5%	-0.4%

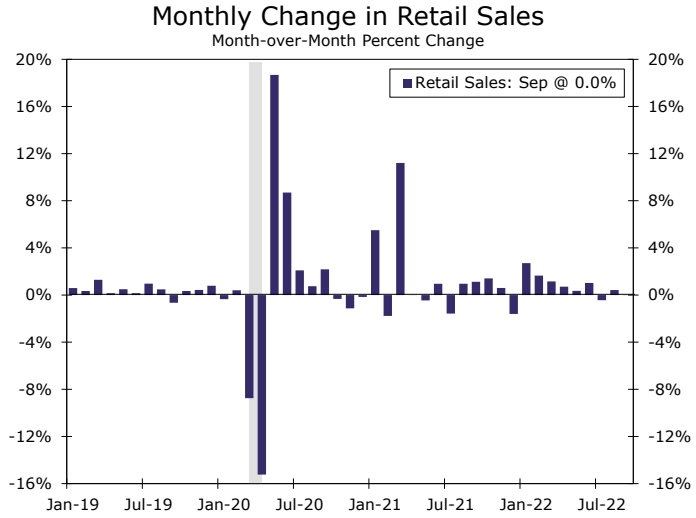
Forecast as of November 10, 2022

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

Retail Sales • Wednesday

Retail sales were flat in September, coming off of an upwardly-revised 0.4% increase in August. A 1.4% decline at gasoline stations and a 0.4% slip at auto & parts dealers weighed on total sales, offsetting rises at department stores and e-commerce retailers. Adjusting for inflation, we estimate real retail sales rose 0.3% in September and sit about 8.5% higher than its pre-pandemic level. In short, consumers continue to spend despite elevated inflation.

Several retailers pulled forward orders to avoid potential snags in the supply chain heading into this holiday season. Consumer spending, while still strong, has gradually slowed at the same time. In view of the moderation in demand, some retailers started to move inventory in October with early holiday sales, which may boost total sales growth in next week's report. Beyond holiday-related spending, gas prices started to creep back up last month, suggesting nominal sales at gasoline stations will boost the headline figure. We forecast that retail sales increased 1.0% in October, which translates to about a 0.5% real gain.

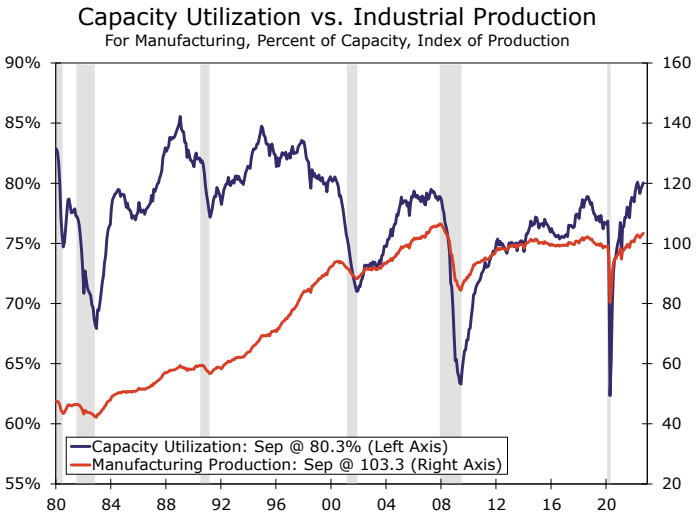


Source: U.S. Department of Commerce and Wells Fargo Economics

Industrial Production • Wednesday

Industrial production regained footing in September, rising 0.4% off of a 0.1% decline the prior month. Manufacturing (0.4%) and mining (0.6%) rose over the month, while utilities declined 0.3%. Strength in manufacturing was broad-based, with producers across the durable and nondurable sectors posting monthly gains. Meanwhile, capacity utilization rose to 80.3%, the highest level since 2008. September's utilization rate marks the fifth above-80% reading this year—an impressive feat, given the 76% average over the past 15 years.

Looking ahead, we anticipate that steady consumer demand for goods, durable goods in particular, will support manufacturing in the final stretch of this year. Supply constraints are easing, which should allow producers to chip away at still-elevated backlogs as well. In the mining sector, crude oil production modestly slowed last month, which may weigh on the overall index. We expect industrial production to increase 0.2% in October, and we look for capacity utilization to inch up to a fresh cycle high of 80.4%.



Source: Federal Reserve Board and Wells Fargo Economics

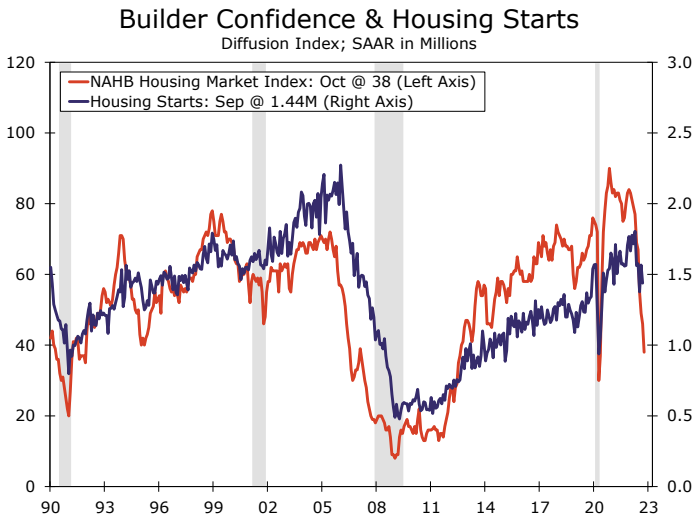
Housing Starts & Existing Home Sales • Thursday & Friday

The housing market has buckled under the weight of higher mortgage rates. Elevated home prices, combined with skyrocketing financing costs, have crippled buyer demand. Residential construction has moderated in response, evident in the trend decline in housing starts this year. Starts plummeted 8.1% month-over-month to a 1.439 million-unit annual pace in September. Weakness was broad-based, with single-family (-4.7%) and multifamily (-13.2%) starts declining. We suspect housing starts continued to slow in October and look for a 1.412 million-unit pace.

Unsurprisingly, home builder sentiment has soured. The NAHB/Wells Fargo Housing Market Index (HMI) has declined for 10 straight months, falling eight points to 38 in October. The present sales gauge slid into contraction territory last month, while the traffic of prospective buyers component fell to 25, or its lowest since the initial pandemic lockdown in spring 2020. We will get another look at builder sentiment Wednesday with the HMI's November report.

The HMI's assessment of weaker demand mirrors the precipitous fall in existing home sales. Sales of existing homes have declined for eight straight months, falling to a 4.71 million-unit annual pace in September. Relative to January, September's sales pace is down 27%. Mortgage applications for home purchases fell around 15% in October, setting up for another decline in next week's existing home sales report. We forecast overall sales fell to a 4.31 million-unit annual pace.

(Return to Summary)

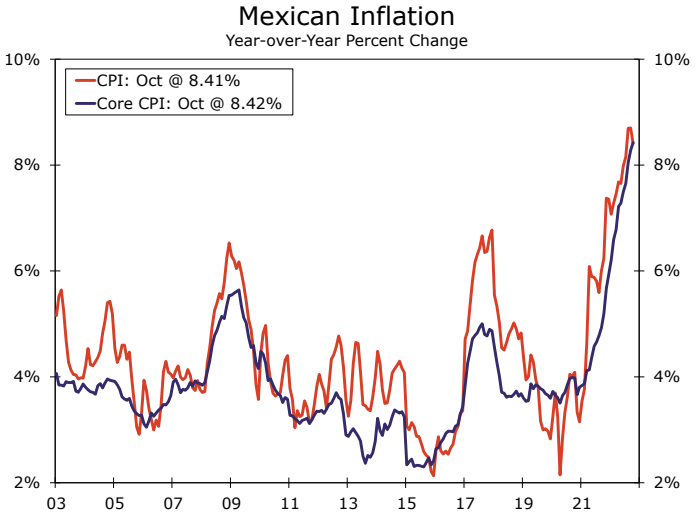


Source: NAHB, U.S. Department of Commerce and Wells Fargo Economics

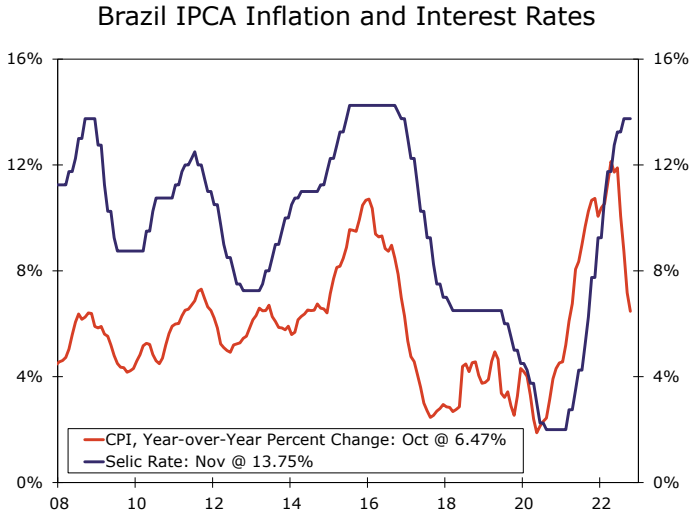
International Review

Mixed Inflation Trends from Latin America

This week saw some mixed inflation news from Latin America. Mexico's October CPI inflation was a slight downside surprise, though remains elevated and well above the central bank's target range. Headline inflation slowed to 8.41% year-over-year from 8.70% in September, although core CPI inflation quickened further, to 8.42% in October from 8.28% in September. With respect to overall inflation, a slowing in energy price gains to 3.10% and fruit and vegetable prices to 12.63% drove the deceleration. In contrast and in terms of core price pressures, services inflation was broadly steady at 5.30%, while core food and beverage prices quickened to 13.95%. Despite the slight downside surprise, inflationary pressures remain reasonably persistent and the October outcome is in our view unlikely to significantly alter the path for Mexican monetary policy. In this context, we fully expect the Bank of Mexico to raise its policy interest rate by 75 bps to 10.00% at this week's monetary policy meeting.



Source: Datastream and Wells Fargo Economics



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

In Brazil, the October CPI saw another substantial deceleration in annual pace of inflation. To be sure, October did see a monthly increase in the CPI of 0.59% month-over-month, after three months of outright declines. On a year-over-year basis however, the CPI slowed further in October to 6.47%. Lower taxes and cuts to gasoline prices in particular have contributed to the slowing in annual inflation, as transportation prices slowed to just 1.55% year-over-year in October. A slowing in prices for food and beverages (11.21%), housing (1.14%) and household goods (10.55%) has also contributed to the deceleration in annual inflation in recent months.

Slowing inflation, along with fiscal stimulus in the form of increasing cash payments to low-income households, probably contributed to the gain in Brazil's retail sales for September. Sales surprised to the upside, rising by 1.1% month-over-month and firming to 3.2% year-over-year. The increase in September sales was led by fuel, food & beverages, and books & magazines. Still, the solid retail sales outcome is unlikely to have any immediate implication for Brazilian monetary policy, with the central bank having clearly signaled an end to its tightening cycle after lifting its Selic rate to 13.75% in recent months.

Speaking of retail sales, the Eurozone also saw a decent gain in sales for September. Eurozone retail sales rose 0.4% month-over-month, matching the consensus forecast, while sales for prior months were revised modestly higher. For the region's largest economies September sales rose in Germany (0.9%), France (0.2%) and Spain (0.2%), but dipped in Italy (-0.1%). Even with the September increase, Eurozone retail sales fell 0.7% quarter-over-quarter for Q3 overall. Given still elevated inflation and weak consumer confidence, we believe retail sales (and broader consumer spending) could also fall in Q4.

(Return to Summary)

International Outlook

Weekly International Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
15-Nov	Japan GDP (QoQ, SAAR)	Q3	1.2%	1.2%	3.5%
15-Nov	China Retail Sales (YoY)	Oct	0.7%	--	2.5%
15-Nov	China Industrial Output (YoY)	Oct	5.2%	--	6.3%
16-Nov	United Kingdom CPI (YoY)	Oct	--	10.9%	10.1%

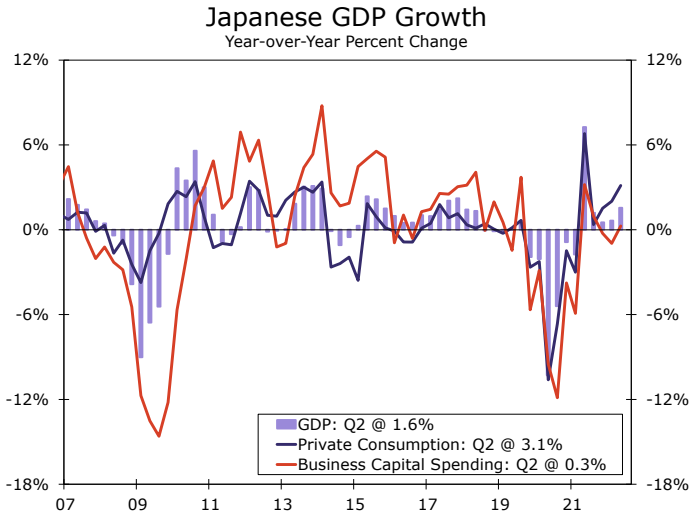
Forecast as of November 10, 2022

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

Japan GDP • Tuesday

Japan has experienced uneven growth as the country has rebounded from the pandemic, and that pattern will likely continue when Q3 GDP figures are released next week. During the second quarter, Japan enjoyed GDP growth of 3.5% quarter-over-quarter annualized, as both consumer spending and investment spending registered solid increase. In recent months however, the economy's momentum appears to have waned. Higher prices for commodities and a moderate increase in Japanese inflation have weighed on consumers' purchasing power, while confidence surveys such as the Purchasing Managers Indices or the Economy Watchers Survey have softened.

As a result, Japan is expected to report slower economic growth for Q3. Third quarter GDP growth is forecast to slow to 1.2% quarter-over-quarter annualized, reflecting a sharp slowdown in consumer spending even as investment spending is expected to continue rising at a steady clip. Against this relatively subdued economic backdrop, the Bank of Japan appears unlikely to adjust its monetary policy stance for the time being, while the government is also pursuing another fiscal stimulus package to help consumers deal with higher living costs, while also supporting growth in the quarters ahead.

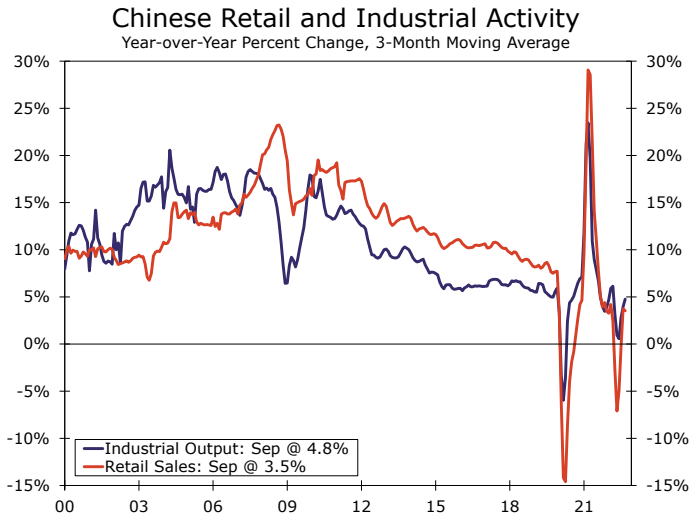


Source: Datastream and Wells Fargo Economics

China Retail Sales and Industrial Output • Tuesday

Chinese activity data for October are also due next week, and are likely to also show some loss of momentum. China's economy has sputtered in recent months and there has been some increase in COVID cases prompting authorities to reimpose lockdowns in some port cities and around schools. Those restrictions continue to weigh on activity and saw confidence surveys soften during October as the manufacturing PMI dropped to 49.2 and the services PMI fell to 48.7.

That softening in sentiment is expected to be confirmed by a similar softening in activity data for October. Most notably, growth in retail sales is forecast to slow to just 0.7% year-over-year, while growth in industrial output is seen slowing to 5.2% year-over-year. So far, there have been no clear indications authorities will move away from their COVID-Zero policy, while challenges in the real estate sector also remain a headwind for growth. Against this backdrop, we expect China's economic recovery to remain tentative and underwhelming through the balance of 2022 and into 2023.



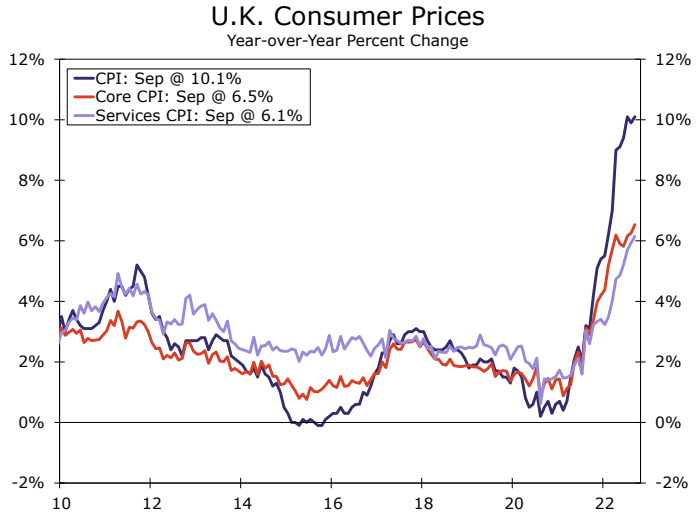
Source: Datastream and Wells Fargo Economics

United Kingdom CPI • Wednesday

U.K. inflation has accelerated sharply during 2022 as higher natural gas prices have contributed to higher energy costs for households, a trend that should continue with the release of the October CPI next week. While the government has announced an energy price cap for all households for a period of at least six months starting from October, higher wholesale energy prices will nonetheless still be at least partly passed on to consumers. As a result, we look for another jump in electricity and gas prices, and see the October CPI rising 1.8% month-over-month and rising to 10.9% year-over-year. The latter would represent the fastest pace of CPI inflation for multiple decades. Broader price pressures will likely remain steady however, and we anticipate the increase in the October core CPI will be similar to the 6.5% year-over-year gain seen in September.

As the energy price cap becomes more binding, the Bank of England expects CPI inflation to remain through the rest of Q4, before easing from early 2023. The elevated rates of inflation will probably see the Bank of England raise its policy rate further at upcoming meetings. However, with the U.K. likely already in sharp recession, easing of inflation could be enough to curtail central bank rate hikes, and we see a peak in the U.K. policy rate of 3.75% by early 2023.

(Return to Summary)



Source: Datastream and Wells Fargo Economics

Credit Market Insights

Consumer Credit Growth Steadies as Banks Tighten Lending Standards

Total consumer credit growth moderated in September, increasing by $25 billion in a step down from August's $30 billion gain. The increase was primarily driven by non-revolving credit, which grew by $16.7B, while revolving credit tacked on an additional $8.3B. Growth in revolving credit, which is primarily composed of credit cards, moderated over the month, rising just 8.7% compared to August's 18.1% gain. Nonrevolving credit, which is mostly composed of auto and student loans and is typically less volatile month to month, rose 5.7%, up from 4.5% the prior month.

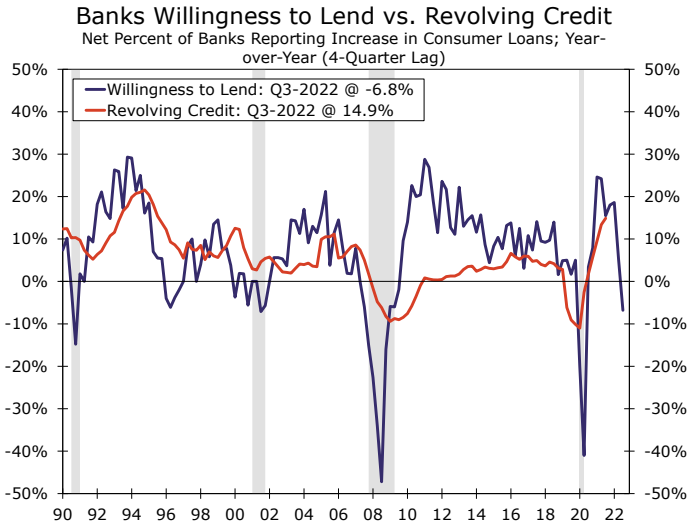
September's consumer credit report was accompanied by the Fed's quarterly Senior Loan Officer Opinion Survey (SLOOS), which generally covers the third quarter. The survey found that banks have tightened their lending standards over the quarter, and demand for most business and consumer loan types weakened. Bank's willingness to lend for consumer installment loans slipped to a net -6.8% in Q3 from 5.2%. This is the first negative reading since the Q2-2020 survey conducted following the start of the pandemic, and only the second time this measure has slipped negative outside a recession in data going back to the early 1990s. Banks largely tightened standards for all consumer loan types. A net 18% of banks reported tightening credit card standards, a net 2% tightened auto loan standards and a net 13% tightened standards for other consumer loans. Lending standards for commercial & industrial (C&I) loans have tightened the most since the start of the pandemic.

Bank tightening in Q3 was largely driven by recession concerns. The Q3 SLOOS included special questions covering the likelihood and expected severity of a recession within the next 12 months. Most banks surveyed assigned a probability between 40 and 80 percent that a recession would occur within the next year. Foreign banks had a similar recession probability outlook. Most banks surveyed expect that if a recession were to occur, it would be a mild or moderate downturn, a sentiment that is in line with our own recession call. Were a recession to occur, 80% of banks expect to further tighten lending standards going forward.

Even as banks tightened standards for household lending in Q3, most banks reported an uptick in demand for credit cards. This further supports that households are increasingly leaning on credit to consume amid elevated inflation. Reported demand for auto loans fell for the second straight quarter as financing costs have become increasingly prohibitive for potential car buyers and consumer demand was largely pulled forward during the pandemic in this segment.

A record share of banks reported declining demand for residential mortgages, a move that comes as no surprise as mortgage rates have risen at record pace this year, recently topping 7% for the first time in 20 years. On the business side, a greater share of banks reported weakening demand for CRE loans. A more modest share reported weaker demand for C&I loans from large and middle-market firms with a larger drop in demand from smaller firms.

The SLOOS also included new questions regarding FICO score approvals for credit card and auto loan applications. Banks reported tightening lending standards for applicants with FICO scores between 620 and 680 since the beginning of the year. On the flip side, banks have kept lending standards largely unchanged for applicants with FICO scores north of 720.



Source: Federal Reserve Board and Wells Fargo Economics

Looking ahead, banks' willingness to lend can provide some insight into changes in revolving consumer credit down the road. Historically, banks' willingness to lend leads movements in revolving credit by about four quarters (chart), and this suggests some coming weakness in revolving credit growth over the next 12 months. This too is in line with our expectation that consumers continue to rely on their balance sheets in the near term to consume, but that it becomes more challenging for them to do so the longer inflation persists and the higher rates go.

(Return to Summary)

Topic of the Week

Election Day 2022

Election Day has come and gone in the United States, and although not every race has been determined, the broad contours of the election outcome have emerged. Republicans appear to be headed for a small majority in the House of Representatives, a shift from Democrats' small majority in the current Congress. In the Senate, a few key races have not yet been called, and the Georgia Senate race is headed to a runoff election to be held on December 6. Depending on how the other uncalled Senate races in Arizona and Nevada shake out, Georgia's runoff election could again determine which party holds a narrow majority in the Senate.

The most probable outcome appears to be divided government, with Republicans controlling at least one chamber of Congress and the White House still safely in Democrats' hands. Under this scenario, sweeping fiscal policy changes seem unlikely over the next two years, absent a crisis like the one that occurred in 2020. We do not intend to make any major changes to our forecasts for GDP growth, inflation or the federal funds rate as a result of the election. Instead, status quo and political gridlock strike us as the most likely outcomes, with the possibility for some government shutdown/debt ceiling theatrics over the next two years.

Beyond legislative changes, Republicans recapturing the Senate would have implications for key nominations made by President Biden. That said, the implications for the makeup of the FOMC likely would be limited. Among the Board of Governors, there are no current openings, and only Governor Lisa Cook's term expires over the next two years. As a result, Chair Powell and company should remain in the driver's seat in their fight against inflation.

Even if the 2022 midterm elections do not prove to be a game changer for financial markets, attention will turn to the 2024 presidential election in short order. Potential presidential candidates could begin announcing their intention to run soon, and the 2024 presidential election will occur right before a slew of scheduled economic policy changes, such as the expiration of big parts of the Tax Cuts and Jobs Act and the end of Chair Powell and Vice Chair Brainard's terms. Thus, even with monetary policy stealing the spotlight of late, we suspect prospective federal legislative action will re-emerge into the spotlight later in 2023.

2022 Midterm Election Results			
	Republicans	Democrats	TBD
House	208	185	42
Senate	49	48*	3

*Includes 2 Independents who caucus with Democrats

Source: The Associated Press and Wells Fargo Economics

(Return to Summary)

Market Data • Mid-Day Thursday

U.S. Interest Rates

	Thursday 11/10/2022	1 Week Ago	1 Year Ago
SOFR	3.78	3.05	0.05
3-Month LIBOR	4.63	4.51	0.15
3-Month T-Bill	4.12	4.13	0.04
1-Year Treasury	4.58	4.52	0.10
2-Year Treasury	4.33	4.71	0.51
5-Year Treasury	3.95	4.37	1.22
10-Year Treasury	3.85	4.15	1.55
30-Year Treasury	4.12	4.18	1.90
Bond Buyer Index	4.06	4.16	2.10

Foreign Exchange Rates

	Thursday 11/10/2022	1 Week Ago	1 Year Ago
Euro ($/€)	1.017	0.975	1.148
British Pound ($/£)	1.167	1.116	1.341
British Pound (£/€)	0.871	0.874	0.856
Japanese Yen (¥/$)	141.960	148.260	113.910
Canadian Dollar (C$/$)	1.338	1.375	1.249
Swiss Franc (CHF/$)	0.968	1.013	0.918
Australian Dollar (US$/A$)	0.658	0.629	0.733
Mexican Peso (MXN/$)	19.399	19.648	20.638
Chinese Yuan (CNY/$)	7.187	7.302	6.389
Indian Rupee (INR/$)	81.806	82.891	74.384
Brazilian Real (BRL/$)	5.332	5.116	5.498
U.S. Dollar Index	108.276	112.930	94.850

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

Foreign Interest Rates

	Thursday 11/10/2022	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	-0.58	-0.59	-0.57
3-Month Sterling LIBOR	3.47	3.36	0.11
3-Month Canada Banker's Acceptance	4.64	4.58	0.49
3-Month Yen LIBOR	-0.03	-0.03	-0.09
2-Year German	2.08	2.09	-0.70
2-Year U.K.	3.10	3.10	0.58
2-Year Canadian	3.83	4.06	1.00
2-Year Japanese	-0.05	-0.04	-0.11
10-Year German	2.01	2.25	-0.25
10-Year U.K.	3.29	3.52	0.93
10-Year Canadian	3.14	3.41	1.68
10-Year Japanese	0.25	0.25	0.06

Commodity Prices

	Thursday 11/10/2022	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	87.21	88.17	81.34
Brent Crude ($/Barrel)	94.19	94.67	82.64
Gold ($/Ounce)	1748.74	1629.49	1849.60
Hot-Rolled Steel ($/S.Ton)	634.00	649.00	1674.00
Copper (¢/Pound)	377.45	342.70	432.30
Soybeans ($/Bushel)	14.55	14.47	12.05
Natural Gas ($/MMBTU)	6.13	5.98	4.88
Nickel ($/Metric Ton)	24,595	24,063	19,502
CRB Spot Inds.	562.35	553.27	652.27

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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Shannon Seery	Economist	332-204-0693	Shannon.Seery@wellsfargo.com
Nicole Cervi	Economic Analyst	704-410-3059	Nicole.Cervi@wellsfargo.com
Jessica Guo	Economic Analyst	212-214-1063	Jessica.Guo@wellsfargo.com
Karl Vesely	Economic Analyst	704-410-2911	Karl.Vesely@wellsfargo.com
Patrick Barley	Economic Analyst	704-410-1232	Patrick.Barley@wellsfargo.com
Jeremiah Kohl	Economic Analyst	704-410-1437	Jeremiah.J.Kohl@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

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