WELLS FARGO

Weekly — September 2, 2022

Weekly Economic & Financial Commentary

United States: **August Rush**

- Employers added 315K new names to their payrolls in August, but there were an additional 786K people looking for work. Amid such a rush into the labor market, the unemployment rate rose to 3.7%. More job seekers also lifted the participation rate to 62.4% and thus easing some tightness in the labor market even as payrolls expanded.
- Next week: ISM Services (Tue), Trade (Tue), Jobless Claims (Fri)

International: **Eurozone Inflation Sets New Record; Canada Chugs Along**

- Consumer price inflation in the Eurozone rose to an all-time high yet again in August. Headline CPI quickened to 9.1% year-over-year, while the core measure accelerated to 4.3%. Elsewhere, Canada's economy grew moderately in Q2, with GDP gaining 3.3% (annualized), boosted by solid household and business spending, high commodity prices and a resurgence of growth after COVID lockdowns were lifted.
- Next week: Reserve Bank of Australia (Tue), Bank of Canada (Wed), European Central Bank (Thu)

Interest Rate Watch: **Labor Market Report Complicates FOMC's Decision on September 21**

- The labor market report for August, which showed a rise in the unemployment rate and moderation in wage pressures, takes some heat off of the FOMC to hike rates by 75 bps on September 21. But CPI data for August, which will be released on September 13, will be crucial in determining how much the committee tightens later this month.

Credit Market Insights: **Mississippi Flooding Puts Munis and Infrastructure in the Spotlight**

- Record-breaking rainfall dropped more than a foot of rain across the state of Mississippi over the past week. As the water continues to recede, Jackson, the capital of Mississippi, has seen an ongoing issue with municipal water turn into a crisis as more than 180,000 residents are left without clean water for an indefinite period. We examine investment in infrastructure and municipal bonds.

Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual		Forecast	
	2021				2022				2020	2021	2022	2023
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Real Gross Domestic Product [1]	6.3	6.7	2.3	6.9	-1.6	-0.6	2.3	0.0	-3.4	5.7	1.7	-0.4
Personal Consumption	11.4	12.0	2.0	2.5	1.8	1.5	2.0	-0.6	-3.8	7.9	2.4	-0.1
Consumer Price Index [2]	1.9	4.8	5.3	6.7	8.0	8.6	8.2	7.2	1.2	4.7	8.0	3.5
"Core" Consumer Price Index [2]	1.4	3.7	4.1	5.0	6.3	6.0	6.2	6.1	1.7	3.6	6.2	4.2
Quarter-End Interest Rates [3]												
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.50	1.75	3.25	4.00	0.50	0.25	2.38	3.63
Conventional Mortgage Rate	3.17	3.02	2.88	3.11	4.42	5.81	5.20	5.25	3.12	2.95	5.17	4.83
10 Year Note	1.74	1.45	1.52	1.52	2.32	2.98	3.05	3.15	0.89	1.45	2.88	2.86

Forecast as of: August 11, 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

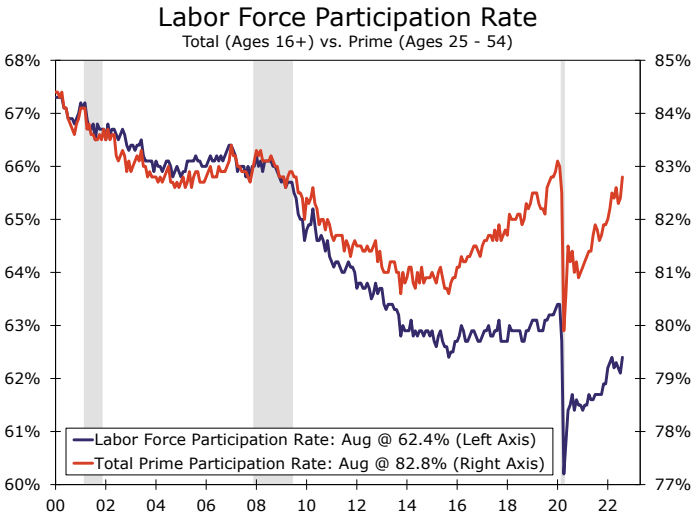
The Music Is All Around Us, All You Have to Do Is Listen

Employers added jobs at a decent, if more moderate pace of 315,000 in August as wage growth remained solid. The gain was roughly in line with expectations; the jump in the unemployment rate was not. The 3.7% jobless rate comes amid a pickup in the participation rate, which climbed to 62.4%, tied with the highest reading in the past two years. The mood music for the labor situation in August was set by the rush into the civilian labor force, which increased by more than three-quarters of a million people.

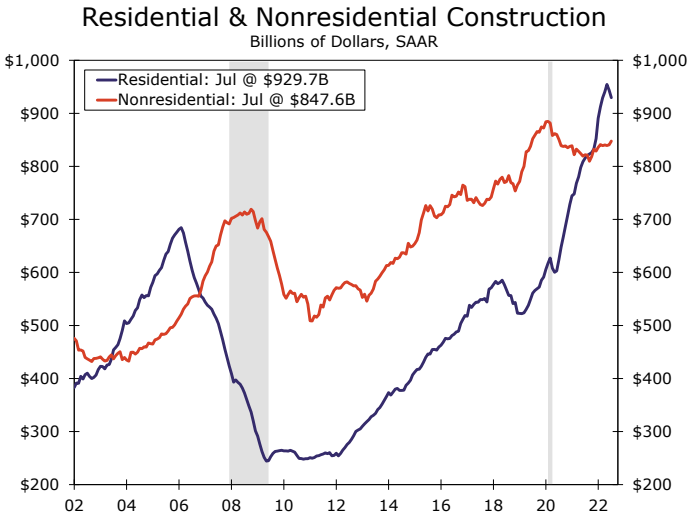
With the Fed laser-focused on inflation, the August CPI will offer the last major piece of the 50 bps vs. 75 bps puzzle. But we do not see anything in the August employment report to alter the general path ahead. See Interest Rate Watch for further details.

Lower gas prices put some pep back in consumers' step. Consumer confidence rose to 103.2 in August, up from 95.3 in July. A near 10-point jump in expectations flattered the headline gain. Some relief on the inflation front came as welcome news against the backdrop of sluggish real disposable income growth. Perceptions of the jobs market were more mixed in August. The share of consumers reporting jobs as "plentiful" slid for the fifth consecutive month to 48%, while the share reporting jobs as "hard to get" fell one percentage point to 11.4%.

It is not quite a contradiction, but it is interesting how the confidence survey points to a potential inflection point in the jobs market, while hard data like the August jobs report are still strong. Job openings increased to 11.2 million in July, coming off the heels of an upward revision to the prior month. Job separations fell, primarily driven by a declining number of quits, while layoffs were little changed. Initial jobless claims for unemployment insurance, which had been rising for much of the spring, have edged lower in recent weeks. Furthermore, the ISM manufacturing survey's employment measure rose 4.3 points to 54.2 in August, pulling the component back into expansionary territory. For now, the labor market is not yet cooling in response to higher interest rates.



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



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

To find a place where the effect of the Fed's rate hikes are visible, look to the housing market. The S&P Case-Shiller National Home Price Index (HPI) rose 0.3% in June, a big step down from its 1.7% average monthly rise over the first five months of this year. Even with June's slight moderation, the National HPI is up a sky-high 18% over the year. Leading up to this year, home prices were rising at a ripping pace amid strong demand and limited inventory. The stunning rise has left home prices well-above the prior cycle's peak. Taken together with rising mortgage rates, housing affordability has significantly eroded, sapping buyer demand and spurring sellers to start discounting this summer.

The deceleration in home buying has prompted home builders to tap the brakes on construction. Residential construction spending declined for the second straight month, falling 1.5% in July. The decrease was broad-based, with single-family (-4.0%) and multifamily (-0.6%) outlays declining

over the month. Meanwhile, nonresidential construction spending rose 0.8% in July for the second consecutive month. Most private nonresidential sectors saw spending increase during the month, with continued strength in manufacturing-related construction outlays (up 19.3% year-over-year) being a notable standout. (Return to Summary)

U.S. Outlook

Weekly Domestic Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
6-Sep	ISM Services Index	Aug	55.2	55.8	56.7
7-Sep	Trade Balance	Jul	-$70.1B	-$70.2B	-$79.6B

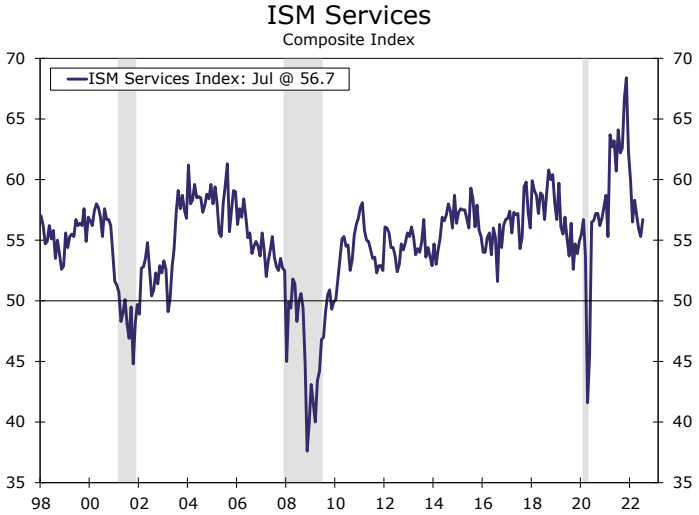
Forecast as of September 02, 2022

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

ISM Services • Tuesday

The manufacturing ISM released earlier this week came in better than expectations, with orders and employment both climbing back into expansion territory and the prices-paid measure falling to a more than two-year low. On Tuesday of next week, financial markets will absorb the latest ISM survey data for the service sector.

Among many crosscurrents in the economy at present, the outlook for services spending is an important one and, like other sectors these days, is muddied with contradiction. July's ISM services report came at 56.7; higher than all 60 forecasts submitted to Bloomberg. While the overall report indicated solid activity in the sector, some selected industry comments from purchasing managers did point to a weakening economic environment and coming headwinds for sales. Growing fears of recession are likely weighing on optimism to some extent. The August ISM services report may benefit from falling gas prices, which leaves more money for consumers to spend in the service sector.



Source: Institute for Supply Management and Wells Fargo Economics

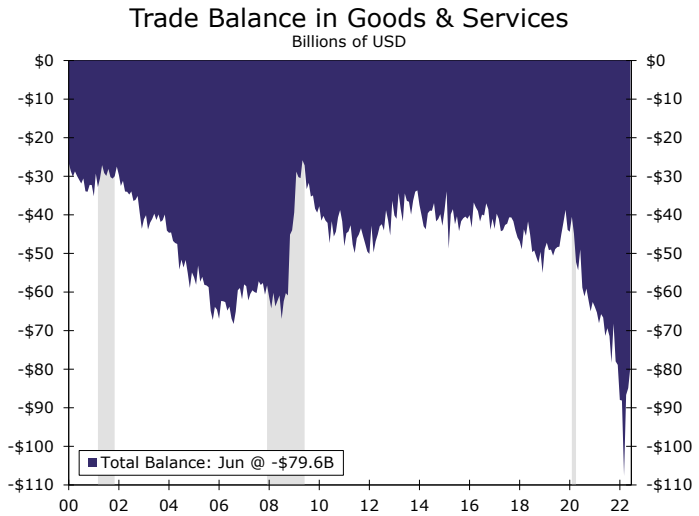
Trade Balance • Wednesday

For the better part of the past two years, the trade balance has stretched wider and has weighed on GDP growth. Strong domestic spending ratcheted up demand for imported goods, and the U.S. economy generally outpaced many other parts of the world where slower growth weighed on exports. That dynamic started moving in the other direction in the second quarter.

Slower domestic demand has begun to weigh on import growth just as export growth is ramping up. In fact, exports advanced for the fifth consecutive month in June. The United States is supplying more commodities to Europe as the Russia-Ukraine war continues

As Europe deals with issues securing the supply of natural gas specifically, the United States has been supplying more. According to the Energy Information Association, “During the first four months of 2022, the United States exported 74% of its liquefied natural gas (LNG) to Europe, compared with an annual average of 34% last year.”

July trade figures print on Wednesday. The advance trade report points to a continued narrowing.



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

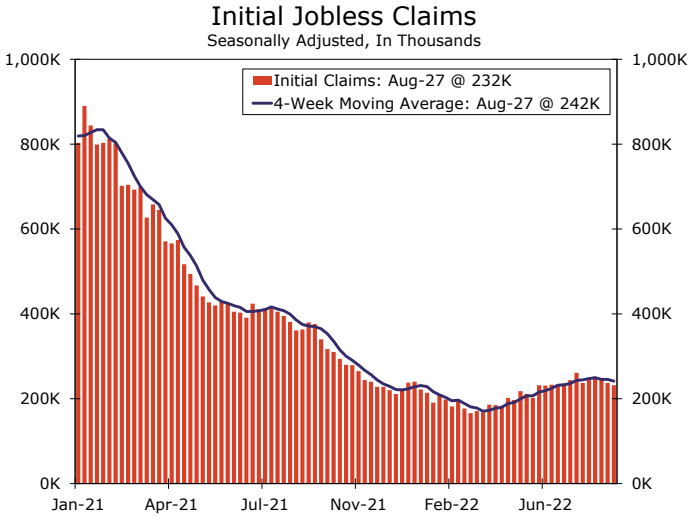
Jobless Claims • Thursday

The best argument that the U.S. economy is not presently in recession is the strength of the labor market. While it is true that jobless claims are historically low, they are often at a low immediately prior to a recession.

Jobless claims have moved up since the spring, with the four-week average of initial filings increasing by 71K since its early April low. The climb has been sharper than the lead-up to prior recessions, at which point payrolls traditionally begin to decline outright. However, the upward trend in claims since the spring comes against what's been a particularly hard stretch for seasonal factors to accurately capture regular shifts in activity.

The trend in seasonally adjusted initial claims has edged lower in recent weeks, matching the sideways moves in layoffs as reported by the JOLTS data. The labor market may be in great shape now; jobless claims are a great leading indicator to watch to get a sense of how long it will stay that way.

(Return to Summary)



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

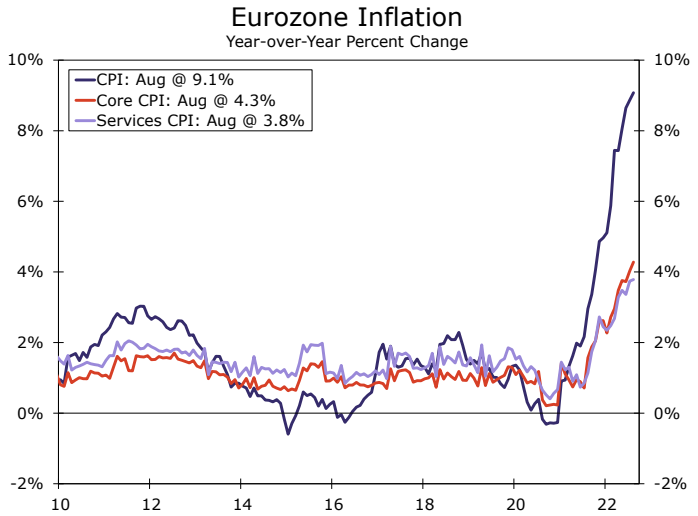
International Review

Eurozone Inflation Sets New Record; Canada Chugs Along

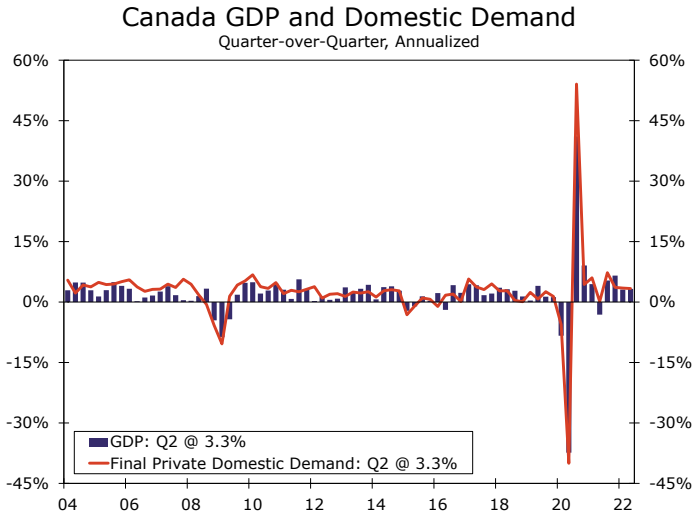
Consumer price inflation in the Eurozone rose to an all-time high yet again in August. Headline CPI quickened to 9.1% year-over-year, while the core measure accelerated to 4.3%. Diving into the details, energy prices are indeed still elevated, up 38% over the year, and a jump in August food prices (+10.6%) also boosted the headline reading.

A closer look at Germany, the Eurozone's largest economy, offers a hint as to where inflation might head next. Germany's headline inflation rose to an 8.8% year-over-year rate, driven by, of course, food and energy prices. Although gas and diesel prices in Germany softened in August, price gains are still expected in the coming months, as the temporary relief to consumers via lowered tax rates on natural gas expired at the end of August. As this aid ends amid surging energy prices, it is probable that inflation will accelerate further in the coming months. We expect that Eurozone inflation will average 7.7% this year. At the moment, persistently elevated inflation is placing additional pressure on the European Central Bank to tighten monetary policy more than previously expected (more on that below).

Elsewhere in the G10, Canada's economy grew moderately in Q2. In the second quarter, GDP gained 3.3% (annualized), boosted by solid household and business spending, high commodity prices and a resurgence of growth after COVID lockdowns were lifted. While growth in Canada has been more resilient compared to other major economies like the United States, Eurozone and United Kingdom, cracks may be starting to show against a backdrop of high inflation and aggressive rate hikes from the Bank of Canada. In particular, recent monthly GDP readings have been less than spectacular. A preliminary flash estimate indicates the economy contracted 0.1% in July, after a small increase in June and a flat reading in May. While we expect growth to average 3.5% this year, we expect the economy to slow significantly in 2023, with no outright recession forecast but growth averaging only 0.9%.



Source: Datastream and Wells Fargo Economics



Source: Datastream and Wells Fargo Economics

Warning Signs Flash for China's Economy

As the growth outlook dims, recent survey data show that sentiment surrounding China's economy is softening. In August, China's composite PMI fell to 51.7. The manufacturing reading ticked up only slightly to 49.4 but remained in contractionary territory. At the same time, the services PMI fell for the second month in a row to 52.6. China's continued commitment to its COVID Zero policy has been a major drag on sentiment in the manufacturing and services sectors. Just recently, it was announced that the city of Chengdu would be locked down due to a rise in COVID cases—this is the first major city to be put back in lockdown since Shanghai's two-month stint in April. In addition, increased restrictions in tech hub Shenzhen increase the risk for an even larger drag on economic activity for factory and services activity. Further restrictions that limit mobility and economic activity continue to act as a headwind for Chinese growth.

Overall, the Chinese economy looks to be struggling to gather momentum, and growth looks like it is trending lower against a backdrop of a slumping real estate sector, as well as the aforementioned COVID Zero policy. While we are not specifically calling for a "hard landing" scenario, we believe the Chinese economy is set to grow only 3.0% in 2022. (Return to Summary)

International Outlook

Weekly International Indicator Forecasts

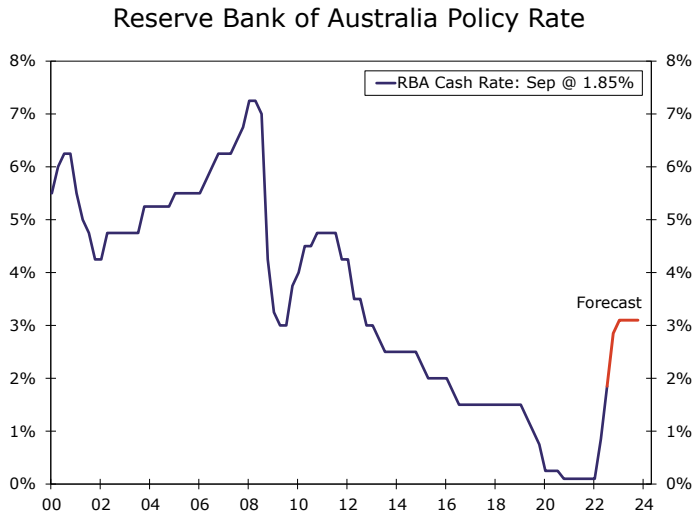
Date	Indicator	Period	Consensus	Wells Fargo	Prior
6-Sep	RBA Rate Decision	6-Sep	2.35%	2.10%	1.85%
7-Sep	BoC Rate Decision	7-Sep	3.25%	3.25%	2.50%
8-Sep	ECB Rate Decision	8-Sep	0.75%	0.50%	0.00%

Forecast as of September 02, 2022

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

Reserve Bank of Australia Rate Decision • Tuesday

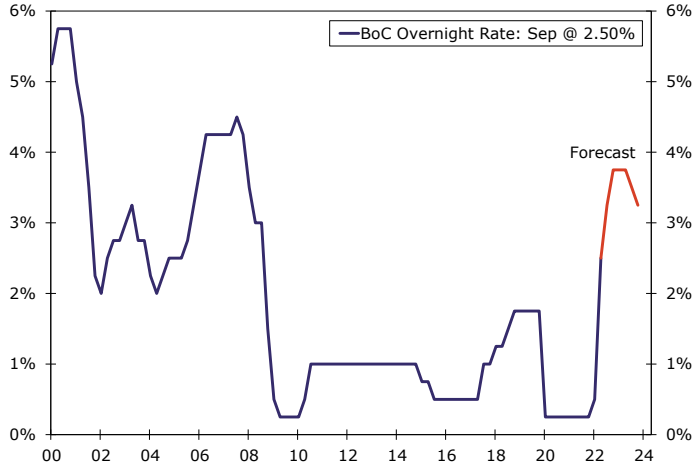
It's a busy week ahead for central banks. The Reserve Bank of Australia (RBA) will kick things off on Tuesday with its September monetary policy meeting, where we expect it to deliver a 25 bps rate hike. In August, the central bank raised its Cash Rate by 50 bps to 1.85% and signaled that further rate hikes will be needed to bring inflation back toward target over time. A few important changes in language from that announcement lead us to believe the RBA will revert to smaller hikes going forward. Notably, the central bank indicated that while further normalization of policy is expected in the months ahead, it also noted that policy is “not on a pre-set path.” The RBA also dropped references to “extraordinary monetary support” that had appeared in previous announcements, suggesting it now sees itself a bit further along the monetary tightening path, and perhaps does not need to move at an accelerated 50 bps pace anymore. Given these changes, we believe that the RBA will be more flexible moving forward with regard to the size and timing of future rate hikes. We now expect 25 bps rate hikes at the RBA's meetings in September, October, November, December and February, which would see the Cash Rate peak at 3.10% early next year.



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

Bank of Canada Rate Decision • Wednesday

The Bank of Canada (BoC) will also have its September monetary policy meeting on Wednesday. The BoC has embarked on one of the more aggressive tightening cycles among the G10 countries, and there are some hints the effects of tighter monetary policy might be starting to cool inflation down. Headline inflation in Canada decelerated to a 7.6% year-over-year pace in July, driven by falling commodity prices. However, the average of three core inflation measures ticked up to 5.3%, indicating that underlying price pressures still remain elevated for now. In a hawkish op-ed following the inflation release, Governor Macklem said that despite the possibility of a peak in prices, inflation will likely remain too high for some time, which will require front-loading rate hikes now to avoid a sharper slowdown down the road. After a jumbo 100 bps rate hike in July, we expect the BoC to deliver a 75 bps hike to 3.25% at its September meeting. We think the BoC will slow down the pace of its hikes beyond September, only taking the policy rate to 3.75% by the end of Q4-2022, although we see the risks as remaining tilted to a higher peak. We will be particularly interested in guidance on future policy from the BoC, especially against a backdrop of slowing growth and still-elevated inflation.

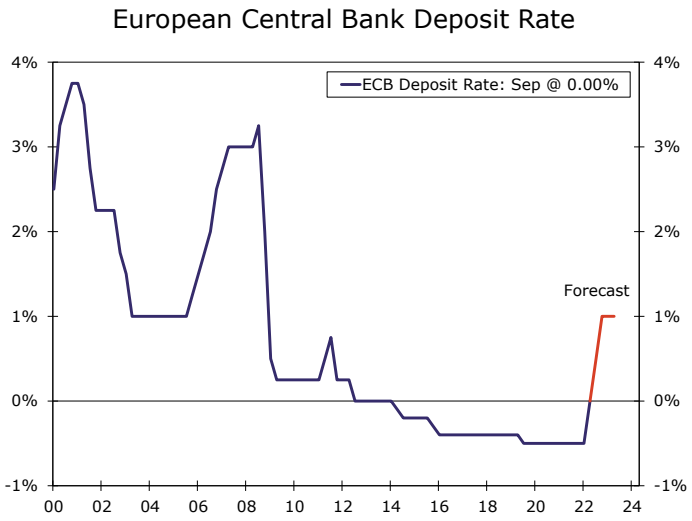


Source: Bloomberg Finance L.P. and Wells Fargo Economics

European Central Bank Rate Decision • Thursday

Last but certainly not least, the European Central Bank (ECB) will announce its policy rate decision on Thursday. In contrast with Canada, the Eurozone has not enjoyed the benefits of lower commodity prices. As such, CPI inflation hit a new record high in August, at 9.1% year-over-year. With this new record CPI print, we expect the ECB to continue raising rates to combat inflation. We anticipate the ECB will deliver a 50 bps rate hike at its September meeting, although we clearly acknowledge the risk of a 75 bps hike. Recently, executive board member Isabel Schnabel made a series of hawkish comments that argued central banks should tighten monetary policy even at the risk of lower growth and higher unemployment, since the greater danger is inflation becoming entrenched.

More broadly, while we currently forecast a peak of 1.00% by the end of 2022, we believe our longer-term policy rate forecast's risks are also tilted to upside. At the September meeting, we will be particularly interested in comments and clues from President Lagarde about the potential future path of monetary policy, as well as updated GDP and CPI forecasts from the central bank. (Return to Summary)



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

Interest Rate Watch

Labor Market Report Complicates FOMC's Decision on September 21

In his speech in Jackson Hole, WY on August 26, Federal Reserve Chair Jerome Powell forcefully stated that the FOMC's "overarching focus right now is to bring inflation back down to our 2 percent goal." According to Powell, the elevated rate of inflation at present stems, at least in part, from the strong state of the economy, including the labor market. The Fed chair noted that "the labor market is particularly strong, but it is clearly out of balance, with demand for workers substantially exceeding the supply of available workers."

In that regard, the employment report for August, which was released today, had mixed messages. On one hand, nonfarm payrolls rose by a solid 315K in August. So the demand for workers clearly remains strong. But the labor force increased by 786K individuals, which pushed the labor force participation rate up to 62.4% from 62.1%. So the supply of workers increased in August. Moreover, average hourly earnings rose only 0.3% during the month. Viewed in isolation, the labor market report may lead some, if not most, FOMC members to conclude that a rate hike of only 50 bps at the September 21 policy meeting is warranted rather than a larger 75 bps increase. Markets pared back the probability of a 75 bps rate hike on September 21 in the immediate aftermath of the August labor market data.

But Powell said in his Jackson Hole speech that "our decision at the September meeting will depend on the totality of the incoming data." There is another crucial piece of data to be released ahead of September 21 that will help to determine the size of the rate hike the committee makes on that day. Namely, CPI data for August are slated to print on Tuesday, September 13. The decline in gasoline prices—the retail price of gasoline has dropped by more than $1 per gallon since mid-June—should offer some relief on the overall rate of CPI inflation. But the sequential increase in "core" prices, which exclude food and energy, has averaged 0.5% per month so far this year. Another sizable increase in core prices in August, should it occur, could convince the FOMC that another 75 bps rate increase is warranted on September 21. In sum, rates are headed still higher on September 21. Incoming data over the next few weeks will help to determine the magnitude. (Return to Summary)

Credit Market Insights

Mississippi Flooding Puts Munis and Infrastructure in the Spotlight

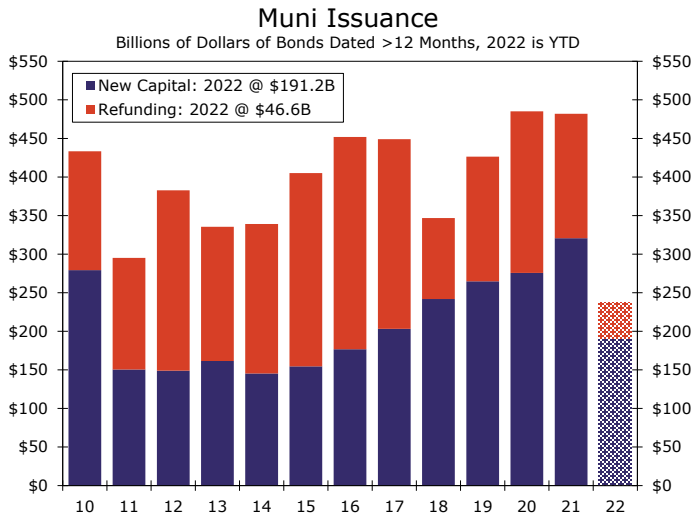
Record-breaking rainfall dropped more than a foot of rain across the state of Mississippi over the past week, putting strains on infrastructure and resulting in the loss of multiple lives. As the water continues to recede, Jackson, the capital of Mississippi, has seen an ongoing issue with municipal water turn into a crisis as more than 180,000 residents are left without clean water for an indefinite period.

Jackson sits on the west bank of the Pearl River, and even before the flooding compromised its main water treatment plant, the city was having major issues with funding and maintaining its water infrastructure. Before the flooding, Jackson was already on a boil water notice for water filtering and water pressure issues. Its main treatment plant was already running on backup pumps. While the city had recently begun to work on its water infrastructure after American Rescue Plan Act funds were distributed, the investment is not complete.

Now to take a step back, municipal utilities are typically funded by two types of bonds, general obligation and revenue bonds. General obligation bonds are bonds that are credit extended by the issuing authority, usually state or local government, and are paid for by revenues they collect. Revenue bonds are backed by the revenues collected by the specific recipient of the bonds, specifically the water and sewer system. Water and sewer fees collected by the system are used to pay off these debts. In this case, the city of Jackson government has issued both in recent years.

Recent rains have exacerbated the issues the city is facing, leading to a new appeal to the state and federal governments for assistance. The state of Mississippi is set to receive $75M for clean water this year due to the Bipartisan Infrastructure Act, and some of it will likely go to Jackson as it divides up the grant for needs across the state. Overall, the Bipartisan Infrastructure Act involves more than $1T in spending with significant allotments for water infrastructure and waterways. These funds may provide the cash necessary to make repairs and stabilize water and sewer systems to restore the confidence of creditors and fund future expansions or upgrades of its infrastructure.

Even where natural disasters are not affecting utilities, the population of the United States continues to grow and urban development can strain the abilities of water and sewer systems built when the population was smaller. If federal grants do not provide enough money to ensure that state and local governments and other government entities like utilities are able to make capital expenditures, then they will need to turn to bond issuance to fund it. New capital and refunding (think refinancing) have seen a significant boost over the past two years. While refunding is on pace to fall in 2022 in a higher interest rate environment, borrowing for new capital spending is on pace to grow to $327B this year. (Return to Summary)



Source: SIFMA and Wells Fargo Economics

Market Data • Mid-Day Friday

U.S. Interest Rates

	Friday 9/2/2022	1 Week Ago	1 Year Ago
SOFR	2.29	2.28	0.05
3-Month LIBOR	3.14	3.04	0.12
3-Month T-Bill	2.88	2.82	0.04
1-Year Treasury	3.33	3.12	0.04
2-Year Treasury	3.43	3.40	0.21
5-Year Treasury	3.32	3.21	0.76
10-Year Treasury	3.22	3.04	1.28
30-Year Treasury	3.37	3.19	1.90
Bond Buyer Index	3.64	3.59	2.14

Foreign Exchange Rates

	Friday 9/2/2022	1 Week Ago	1 Year Ago
Euro ($/€)	1.003	0.997	1.188
British Pound ($/£)	1.158	1.174	1.383
British Pound (£/€)	0.866	0.849	0.858
Japanese Yen (¥/$)	140.080	137.640	109.940
Canadian Dollar (C$/$)	1.309	1.303	1.255
Swiss Franc (CHF/$)	0.980	0.966	0.914
Australian Dollar (US$/A$)	0.685	0.690	0.740
Mexican Peso (MXN/$)	19.942	20.041	19.961
Chinese Yuan (CNY/$)	6.900	6.872	6.457
Indian Rupee (INR/$)	79.799	79.871	73.068
Brazilian Real (BRL/$)	5.180	5.064	5.185
U.S. Dollar Index	108.974	108.803	92.225

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

Foreign Interest Rates

	Friday 9/2/2022	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	-0.58	-0.59	-0.57
3-Month Sterling LIBOR	2.58	2.40	0.07
3-Month Canada Banker's Acceptance	3.87	3.72	0.45
3-Month Yen LIBOR	-0.02	-0.02	-0.09
2-Year German	1.10	0.99	-0.72
2-Year U.K.	3.13	2.82	0.19
2-Year Canadian	3.58	3.54	0.40
2-Year Japanese	-0.08	-0.08	-0.13
10-Year German	1.52	1.39	-0.39
10-Year U.K.	2.91	2.60	0.68
10-Year Canadian	3.11	3.02	1.16
10-Year Japanese	0.24	0.22	0.04

Commodity Prices

	Friday 9/2/2022	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	88.11	93.06	69.99
Brent Crude ($/Barrel)	94.06	100.99	73.03
Gold ($/Ounce)	1714.52	1738.14	1809.66
Hot-Rolled Steel ($/S.Ton)	781.00	794.00	1943.00
Copper (¢/Pound)	345.55	369.70	429.00
Soybeans ($/Bushel)	15.05	15.44	13.00
Natural Gas ($/MMBTU)	8.74	9.30	4.64
Nickel ($/Metric Ton)	20,249	21,263	19,395
CRB Spot Inds.	592.21	608.91	617.80

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