Economics

WELLS FARGO

Weekly — March 22, 2024

Weekly Economic & Financial Commentary

United States: **Residential Tailwind Set to Continue as Monetary Policy Becomes Less Restrictive**

- This week's economic data indicate that the U.S. economy is still expanding at a solid pace with the housing sector continuing to provide a tailwind. During February, existing home sales and housing starts both topped expectations and rose at robust rates. Meanwhile, initial jobless claims have remained subdued so far in March.
- Next week: New Home Sales (Mon.), Durable Goods Orders (Tue.), Personal Income & Spending (Fri.)

International: **Bank of Japan Exits Negative Interest Rate Policy**

- In a historic—albeit well-anticipated—policy shift, the Bank of Japan (BoJ) formally ended its ultra-easy and nonconventional monetary policy stance this week, delivering the first BoJ interest rate hike since 2007. The outcome of Japan's spring wage talks appears to have been a particularly important factor behind the decision.
- Next week: Riksbank Policy Interest Rate (Wed.), Canada Monthly GDP (Thu.), Tokyo CPI (Fri.)

Interest Rate Watch: **Sitting, Waiting, Wishing**

- The FOMC left the target range on its federal funds rate unchanged and held the pace of balance sheet runoff (QT) constant at the conclusion of its March 20 meeting. Individual forecasts of FOMC participants for rates, growth and inflation this year strike a modestly hawkish tone.

Credit Market Insights: **Are American Consumers Learning to Live with Higher Rates?**

- This week, the New York Fed released its triannual Credit Access Survey. While the byline of its report, "Credit Application Rate Ticks Up; Rejection Rate Declines," suggests consumers and bankers are adjusting to the "higher for longer" world, the details reveal that the higher rate environment is dampening demand for current loans and expectations of future credit access.

Topic of the Week: **Building the Future**

- The high-tech manufacturing sector in the U.S. has been the fastest growing category within nonresidential construction in recent years. In a report published this week, we discuss how the construction boom in high-tech manufacturing may impact the U.S. economy.

Submit a question to our "Ask Our Economists" podcast at askoureconomists@wellsfargo.com.

Wells Fargo U.S. Economic Forecast

	Actual 2023				Forecast 2024				Actual		Forecast	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2022	2023	2024	2025
Real Gross Domestic Product [1]	2.2	2.1	4.9	3.5	2.4	1.3	1.3	1.4	1.9	2.5	2.5	1.8
Personal Consumption	3.8	0.8	3.1	3.2	2.4	1.5	1.1	1.4	2.5	2.2	2.2	1.7
Consumer Price Index [2]	5.7	4.0	3.6	3.2	3.2	3.2	3.0	2.9	8.0	4.1	3.1	2.4
"Core" Consumer Price Index [2]	5.5	5.2	4.4	4.0	3.8	3.5	3.5	3.3	6.2	4.8	3.5	2.7
Quarter-End Interest Rates [3]												
Federal Funds Target Rate[4]	5.00	5.25	5.50	5.50	5.50	5.25	4.75	4.50	2.02	5.23	5.00	3.88
Conventional Mortgage Rate	6.54	6.71	7.20	6.82	6.85	6.65	6.45	6.15	5.38	6.80	6.53	5.85
10 Year Note	3.48	3.81	4.59	3.88	4.05	3.90	3.80	3.70	2.95	3.96	3.86	3.61

Forecast as of: March 22, 2024 [1] Compound Annual Growth Rate Quarter-over-Quarter [2] Year-over-Year Percentage Change
[3] Quarterly Data - Period End; Annual Data - Annual Averages [4] Upper Bound of the Federal Funds Target Range

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.

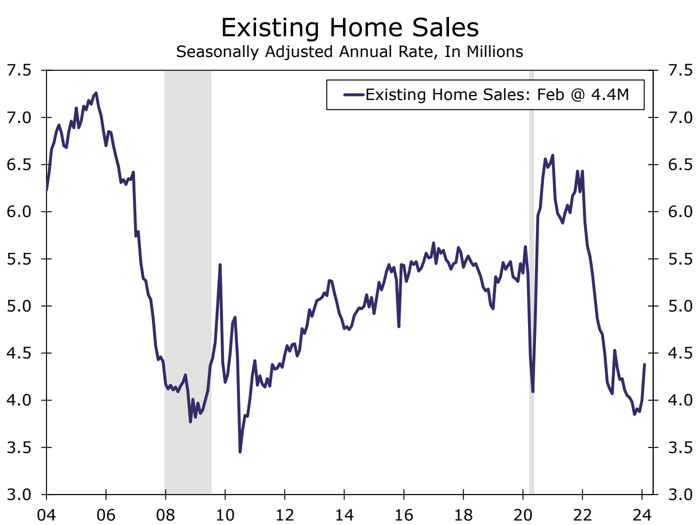
U.S. Review

Residential Tailwind Set to Continue as Monetary Policy Becomes Less Restrictive

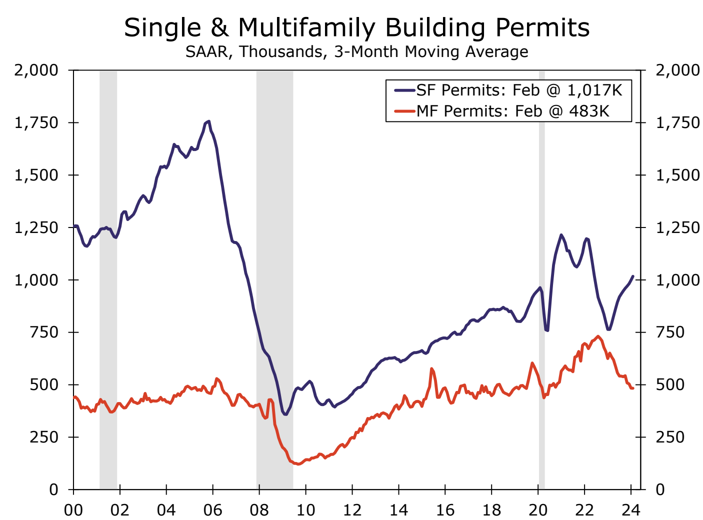
The FOMC decision took center stage this week amid an otherwise light economic calendar. As widely expected, the Federal Reserve did not make any major changes to the federal funds target rate or pace of balance sheet runoff. Wednesday's meeting was not entirely devoid of new information, however. In the press conference, Chair Powell seemed to downplay the relatively hot inflation prints so far this year and reaffirmed that less restrictive monetary policy is coming closer into view. The FOMC's latest Summary of Economic Projects also provided some noteworthy changes. For more details, please see the Interest Rate Watch section.

Although thin, the stream of incoming data received in recent days indicates that the U.S. economy is still expanding at a solid pace with the housing sector continuing to provide a tailwind. Residential fixed investment—which is a component of total GDP and mostly includes spending on new housing construction, brokers commissions from home sales and home improvements—declined sharply in 2022 and the first half of 2023 as the Fed tightened monetary policy and interest rates shot higher. More recently, however, a turnaround has become apparent. Residential investment rose solidly during the second half of 2023 and, if this week's slew of housing data are any guide, should expand further in the coming quarters.

Lower mortgage rates are poised to further boost the residential sector this year. Since peaking around 8% last October, the average 30-year mortgage rate has receded and averaged 6.7% so far this year. Even this slight decline in financing costs looks like it was enough to have pulled affordability-crunched buyers off the sidelines. After rising solidly in January, existing home sales topped expectations and surged 9.5% during February. Although still relatively slow, last month's 4.38 million-unit pace marks the strongest pace in a year. The recent plateau in mortgage applications for purchase suggests that home sales may not move at quite the same pace in the coming months. During the week ended March 15, mortgage purchase applications fell slightly and, on balance, have moved more or less sideways so far in 2024. That noted, resales should continue to improve over the longer run as easier monetary policy brings about a gradual decline in mortgage rates.



Source: NAR and Wells Fargo Economics



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

An improving resales trend should translate to growth in brokers commissions, especially as low supply continues to exert upward pressure on home prices. However, strengthening single-family construction is likely to continue as the primary force behind expanding residential investment. On balance, total housing starts have been essentially flat over the first two months of the year, as February's surge in overall starts made up for a sharp weather-induced drop in January. The number of residential groundbreakings moving sideways is largely a result of an ongoing downdraft in multifamily construction, which has offset gains from single-family projects. Multifamily development, which comprises a smaller share of investment, is downshifting in the wake of softening apartment market conditions and tighter construction lending. By contrast, single-family starts have steadily trended higher over the past year. Single-family permits have taken a similar upward trajectory, with permits climbing again during February. The gain in permits suggests that home builders are planning to scale up production in light of improving economic growth prospects, the increased ability to offset higher interest rates with pricing incentive and higher confidence that adverse affordability and availability in the resale market will translate to stronger sales in the future.

February's rise in single-family permits was one factor behind the recent upturn in the Leading Economic Index (LEI). The LEI advanced 0.1% in February, the first monthly gain in nearly two years. ISM manufacturing new orders, consumer expectations and the interest rate spread continued to weigh on the headline index. On the plus side, the average weekly hours component provided a substantial lift, while stock prices continued to gain over the month. Another contributor to the upswing was initial jobless claims. During the week ended March 16, jobless claims fell to 210K from 212K the week prior. Overall, applications for unemployment insurance remain subdued, or as Chair Powell put it at the FOMC press conference on Wednesday, "very, very low." All told, the low level of claims indicates that the labor market is still holding up quite well, which only bolsters our expectation for the turnaround in the residential sector to continue as a tailwind for economic growth throughout in 2024.

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U.S. Outlook

Weekly Domestic Indicator Forecasts

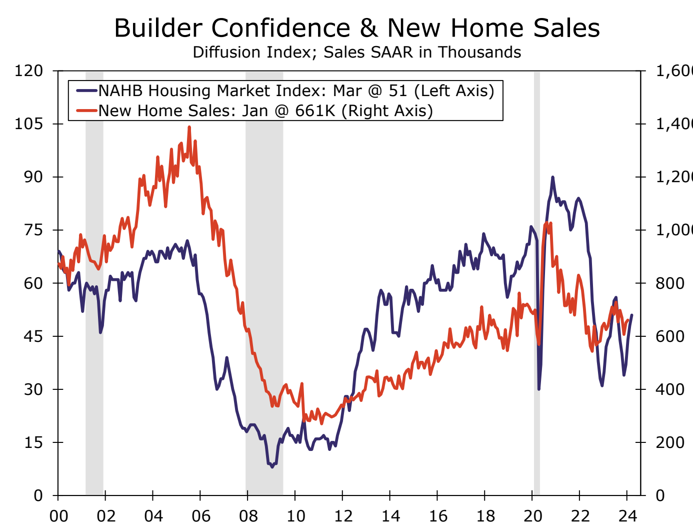
Date	Indicator	Period	Consensus	Wells Fargo	Prior
25-Mar	New Home Sales (SAAR)	Feb	675K	686K	661K
26-Mar	Durable Goods Orders (MoM)	Feb	1.4%	1.2%	-6.2%
26-Mar	Durables Ex Transportation (MoM)	Feb	0.3%	0.4%	-0.4%
26-Mar	Consumer Confidence	Mar	107.0	108.0	106.7
28-Mar	GDP Annualized (QoQ)	Q4	3.2%	3.5%	3.2%
28-Mar	Personal Consumption (QoQ)	Q4	—	3.2%	3.0%
29-Mar	Personal Income (MoM)	Feb	0.4%	0.4%	1.0%
29-Mar	Personal Spending (MoM)	Feb	0.5%	0.5%	0.2%
29-Mar	PCE Deflator (MoM)	Feb	0.4%	0.4%	0.3%
29-Mar	PCE Deflator (YoY)	Feb	2.5%	2.5%	2.4%
29-Mar	Core PCE Deflator (MoM)	Feb	0.3%	0.3%	0.4%
29-Mar	Core PCE Deflator (YoY)	Feb	2.8%	2.8%	2.8%

Forecast as of March 22, 2024

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

New Home Sales • Monday

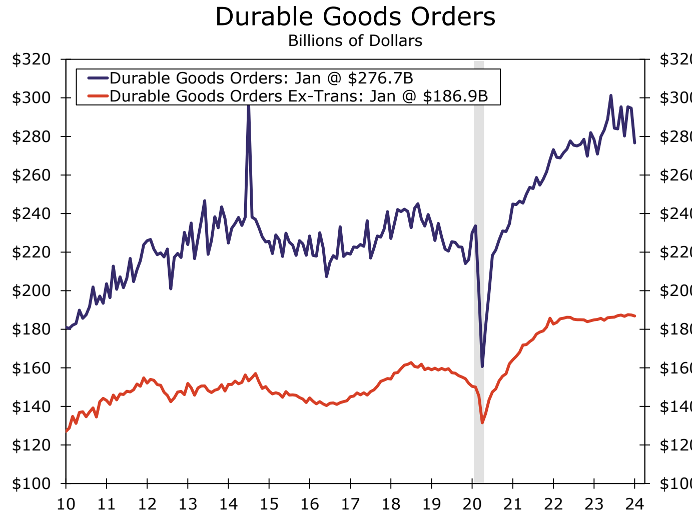
In contrast to the resale market, sales of new homes strengthened last year. Plentiful inventory and builder concessions have supported the solid pace of sales. This year, lower borrowing costs amid monetary policy easing from the Federal Reserve will likely be a tailwind to the housing market; see our latest housing outlook for more detail. Home builders appear aligned with that view—the NAHB's Housing Market Index shows builders' assessments of present sales, future sales and traffic of prospective buyers improving in the first three months of 2024. The average 30-year fixed mortgage rate hovered around 6.6% through January and the first half of February, which was more than a full percentage point below the highs reached in October. Relatively low rates spurred a rebound in mortgage purchase applications in January, suggesting home sales rose in February. Indeed, existing home sales popped 9.5% over the month, and we suspect new home sales rose 3.8% to a 686K-unit annual sales pace.



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

Durable Goods Orders • Tuesday

Over the past year, business equipment spending has been weak and consumer demand has pivoted away from durable goods. These dynamics have weighed on the factory sector. Yet similar to the housing market, production appears poised for growth this year as borrowing costs eventually ease. In January, orders of durable goods contracted 6.2%, but most of that decline can be attributed to nondefense aircraft orders. Aircraft sales data from Boeing show net new orders modestly picking up in February after plummeting to zero in January. The rebound will likely boost total durable goods orders, which we forecast rose 1.2% in February. Excluding transportation goods, we look for a more modest 0.4% increase. Longer term, business capital expenditures may meaningfully ramp up in the coming years as recent investment in U.S. manufacturing facilities begins to translate to increased production; see Topic of the Week for more detail.



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

Personal Income & Spending • Friday

After a blockbuster year for consumer spending, households may finally be hitting the brakes. Real consumer spending slipped 0.1% in January, which was corroborated by a 1.1% contraction in retail sales over the month. On the income side, real personal disposable income was flat. The lackluster outturn was in part driven by a strong gain in prices. The core PCE deflator rose 0.4% in January, which was the largest increase in a year.

Looking ahead, we forecast personal income rose 0.4% on a nominal basis in February and personal spending increased 0.5%. These are strong prints in an absolute sense, but given our expectation that the core PCE deflator rose 0.3%, the inflation-adjusted outcomes will likely be consistent with a more moderate pace of consumer spending growth than in recent years. As discussed in our latest U.S. Economic Outlook, the pullback in spending at the beginning of the year led us to downwardly revise our Q1 real personal consumption expenditures forecast to a 2.4% annualized rate of growth, down from 2.9% previously.

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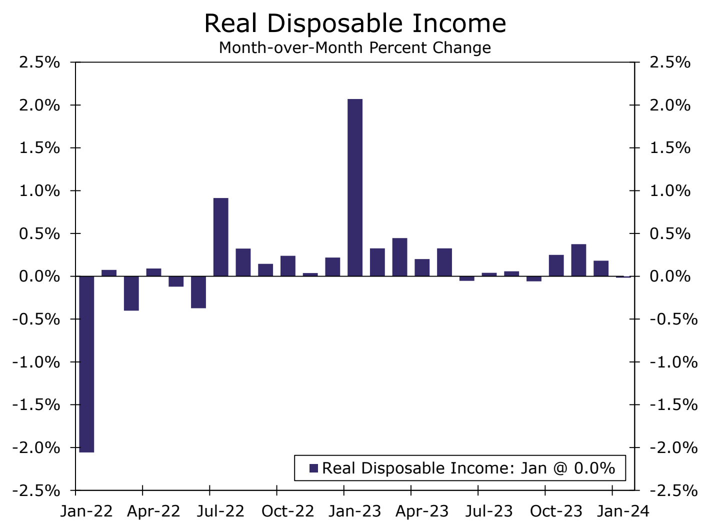


Source: U.S. Department of Commerce and Wells Fargo Economics

International Review

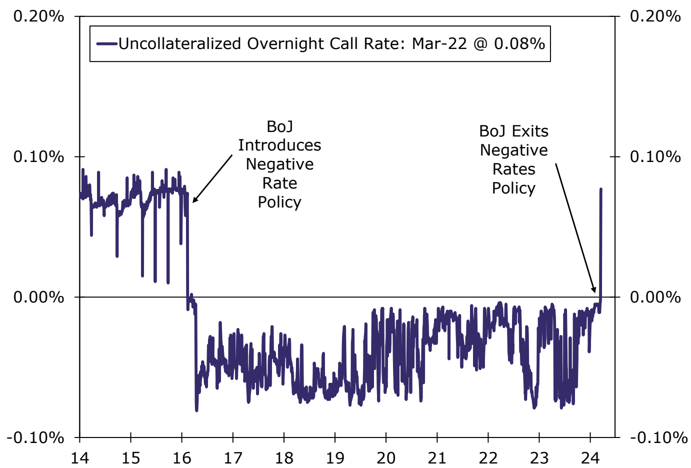
Bank of Japan Exits Negative Interest Rate Policy

In a historic—albeit well-anticipated—policy shift, the Bank of Japan (BoJ) formally ended its ultra-easy and nonconventional monetary policy stance at this week's monetary policy announcement. The central bank said its negative interest rate and yield curve control policies had fulfilled their roles, and notably, this week's announcement included the first interest rate increase from the Bank of Japan since 2007. Among the key elements of the decision, the BoJ announced:

- **An End to Negative Interest Rate Policy.** The BoJ said guiding the short-term interest rate would be a primary policy tool and that it will "encourage the uncollateralized overnight call rate to remain at around 0 to 0.1 percent." This new approach represents both a change in the targeted interest rate and a streamlining of the short-term interest rate system that had existed under the negative interest rate policy. That said, we view this week's move as effectively similar to a 10 bps rate increase. The BoJ noted that the overnight call rate had traded in a range of -0.10% to 0.00% before this week's announcement, whereas going forward it is now expected to trade in a range of 0.00% to 0.10%.
- **An End to Yield Curve Control.** The BoJ also formally ended its Yield Curve Control policy, although that arguably had little effect in practice. The upper bound for 10-year Japanese Government Bond (JGB) yields had already evolved from a "hard cap" to a "reference point" in terms of the BoJ's bond-buying operations, and in any case, 10-year yields have recently been well below that upper bound. The Bank of Japan did say it will continue its JGB purchases at broadly the same pace as previously, which it noted is currently around 6 trillion yen per month. It said that in the case of a rapid rise in long-term interest rates it would respond nimbly by, for example, increasing the amount of JGB purchases, conducting fixed rate JGB purchase operations or utilizing other Funds-Supplying operations.
- **A Cessation to Other Asset Purchases.** The Bank of Japan said it will discontinue, with immediate effect, purchases of exchange-traded funds and Japan real estate investment trusts. The BoJ said it will gradually reduce its purchases of commercial paper and corporate bonds, and will discontinue the purchases in about one year.

In terms of making this week's policy shift, the BoJ signaled it was becoming more confident on the inflation outlook. The BoJ said a virtuous cycle between wages and prices was solidifying and that the achievement of the 2% price stability target in a sustainable and stable manner was coming into sight. The outcome of Japan's spring wage talks appears to have been a particularly important factor behind the BoJ's decision. The latest tally of wage increases from Rengo—Japan's largest labor union federation—saw Japan's labor unions secure an average wage increase of 5.25% for fiscal year 2024, well above the 3.58% gain secured for fiscal year 2023, and the largest increase since the early 1990s. Modestly firmer labor earnings data and GDP data in recent weeks may have contributed to this week's decision at the margin. While there was no indication the BoJ is embarking on a prolonged monetary tightening cycle, we do believe one further rate increase this year is more likely than not. As long as economic figures show continuing growth in Japan's GDP, a firming in labor cash earnings as the wage increases agreed to at the spring wage talks take effect and CPI inflation remaining elevated above 2% for the time being, we suspect the Bank of Japan will eventually be comfortable hiking interest rates further. Accordingly, we now see an additional rate hike at the central bank's October meeting, where we expect the BoJ to lift the target range for the uncollateralized overnight call rate by 10 bps, to a range of 0.10% to 0.20%.

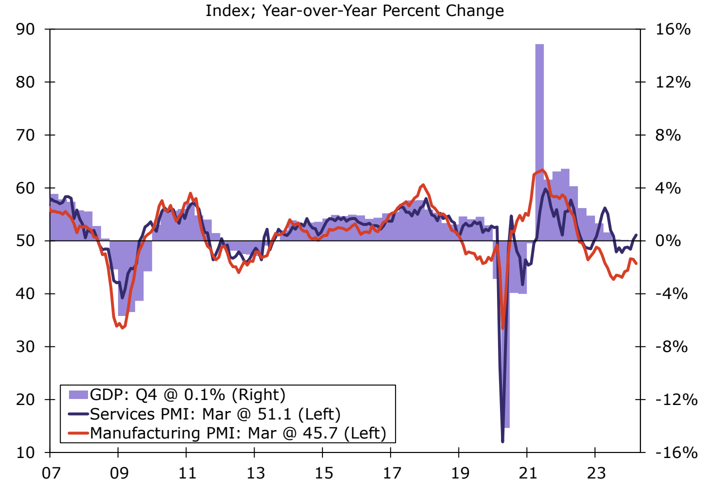
Japan Overnight Money Market Rate



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

Eurozone PMI Indices vs. GDP Growth

Index; Year-over-Year Percent Change



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

In addition to the Bank of Japan, there were several other policy announcements this week from international central banks. The most notable of these was from the Swiss National Bank (SNB), which surprised markets with a 25 bps policy rate cut to 1.50%. The SNB also sharply lowered its CPI forecast and sees inflation settling a little above 1% over the medium to longer term. The central bank also said it will adjust monetary policy again if necessary to ensure inflation remains in a range consistent with price stability, which makes another SNB rate cut in June sound quite likely. The Bank of England (BoE) held its policy rate steady at 5.25%, but the accompanying statement and details were relatively dovish in tone. With two policymakers dropping their vote for a hike, there was an 8-1 vote to hold rates steady this week, with the one dissent being in favor of easing. Even though Governor Bailey said we're "not yet at the point" to cut rates, the BoE did say the "restrictive stance of monetary policy is weighing on activity in the real economy, is leading to a looser labor market and is bearing down on inflationary pressures." The central bank also said policy could remain restrictive even if rates were lowered. We view the announcement as consistent with an initial 25 bps BoE rate cut in June, although an earlier move in May cannot be completely ruled out.

The Reserve Bank of Australia held its policy rate at 4.35% and removed any explicit reference to possible further tightening. However, the central bank also said it is not ruling anything in or out, and that it will be some time before inflation is sustainably within the target range, suggesting it will be at least several months before Australia's central bank begins lowering interest rates. The Norges Bank held its policy rate at 4.50%, while its accompanying statement was balanced in tone. The projected policy rate path in the updated economic forecast was broadly unchanged from its prior forecast, and envisages the policy rate remaining at its current level until the autumn before moving lower. The risks around that policy rate outlook are balanced, as the Norges Bank did not rule out a further rate hike, or an earlier rate cut.

With respect to emerging market central banks, Brazil's Central Bank (BCB) continued its easing cycle with another 50 bps cut in the Selic rate to 10.75%. The central bank did however adjust its guidance in a hawkish direction, saying there is uncertainty and that more flexibility is needed on the path for interest rates. The BCB signaled a similarly sized reduction in rates only at the next meeting, meaning the possibility of smaller 25 bps reductions could come into play from midyear onwards. Mexico's central bank, Banxico, delivered an initial 25 bps policy rate reduction at this week's meeting, lowering its policy rate to 11.00%. Banxico policymakers offered limited guidance saying that future decisions "will take into account the progress in the inflation outlook", leaving open the possibility that it might pause at some meetings this year. Finally, Turkey's central bank surprised markets, raising its policy interest rate by 500 bps to 50.00%, in contrast to the consensus expectation for the policy rate to remain unchanged.

In terms of economic data, this week's release of March manufacturing and service sector PMIs from several countries pointed to a gradual firming in growth during early 2024. The Eurozone services PMI rose further into expansion territory to 51.1, offsetting a decline in the manufacturing PMI and suggesting a gradual Eurozone economic upswing is under way. Although the U.K. services

PMI dipped to 53.4, it remains comfortably in expansion territory, and the U.K. manufacturing PMI improved. Japan's services and manufacturing PMIs both improved, to 54.9 and 48.2, respectively, while in Australia an increase in the services PMI more than offset a decline in the manufacturing PMI. Meanwhile, with respect to price developments, February inflation slowed in Canada and the United Kingdom, but quickened in Japan. In Canada, the average core CPI slowed to 3.2% year-over-year, and in the United Kingdom, the core CPI slowed to 4.5%, while in Japan, the core CPI firmed to 2.8%.

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International Outlook

Weekly International Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
27-Mar	Riksbank Policy Rate	27-Mar	4.00%	4.00%	4.00%
28-Mar	Canada Monthly GDP (MoM)	Jan	0.4%	--	0.0%
29-Mar	Tokyo CPI (YoY)	Mar	2.5%	--	2.5%

Forecast as of March 22, 2024

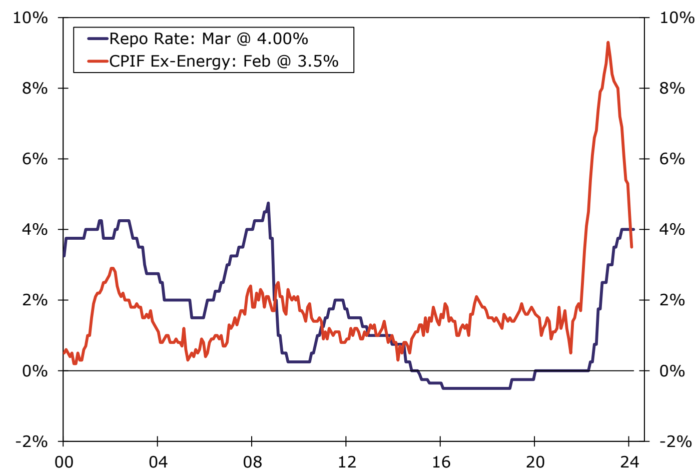
Source: Bloomberg LP and Wells Fargo Securities

Riksbank Policy Interest Rate • Wednesday

Sweden's central bank, the Riksbank, announces its monetary policy decision on Wednesday of next week. The Riksbank is widely expected to hold its policy rate steady at 4.00%; however, the accompanying announcement will be closely scrutinized for any hints that a near-term rate cut could be forthcoming. Updated economic forecasts will also accompany the central bank's decision.

The Riksbank's most recent announcement in early February was broadly dovish in tone. The central bank said that previous monetary tightening had contributed to lower inflationary pressures. While saying that restrictive monetary policy was still needed for now, it signaled that slow growth and markedly slower inflation meant the policy rate could be lowered sooner than indicated in its previous forecast. Indeed, the central bank did not rule out a policy rate cut during the first half of this year. Since then, growth indicators have been mixed: Q4 GDP unexpectedly dipped 0.1% quarter-over-quarter, but the January GDP indicator rose 0.9% month-over-month. More important, however, price pressures have eased further, with February CPIF-ex energy inflation slowing to just 3.5% year-over-year. While our base case is for an initial 25 bps rate cut at the Riksbank's June meeting, a particularly dovish announcement, or sharp downgrade to GDP growth and CPI inflation forecasts, could prompt us to bring forward our expected timing for initial Riksbank easing to the May monetary policy meeting.

Swedish Policy Rate vs. CPIF Ex-Energy Inflation

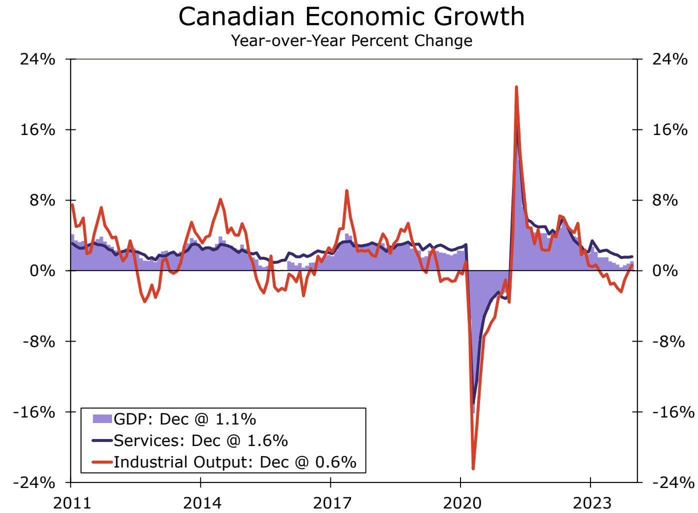


Source: Bloomberg Finance L.P. and Wells Fargo Economics

Canada Monthly GDP • Thursday

Canada's January GDP due next week should provide insight into the state of the economy in early 2024, as well as potential clues into the timing of an initial rate cut from the Bank of Canada. While Canada's economy grew overall in Q4 2023, it did lose some momentum in December as GDP was flat on the month. Services activity was also unchanged in December, while industrial output fell 0.4% month-over-month.

The consensus forecast is that GDP growth resumed at the beginning of 2024, with January GDP expected to rise 0.4% month-over-month, an outcome that would be in line with Statistics Canada's advance estimate for a 0.4% gain. Such an increase would likely see GDP growth on track to exceed the Bank of Canada's subdued GDP growth forecast for Q1-2024. In contrast, Canada's February CPI pointed to easing price pressures, as both headline and core inflation slowed more than expected. In that context, even if Canadian GDP show decent growth in January in line with the consensus forecast, we still think the Bank of Canada would remain on course to deliver an initial 25 bps rate cut at its June monetary policy announcement.

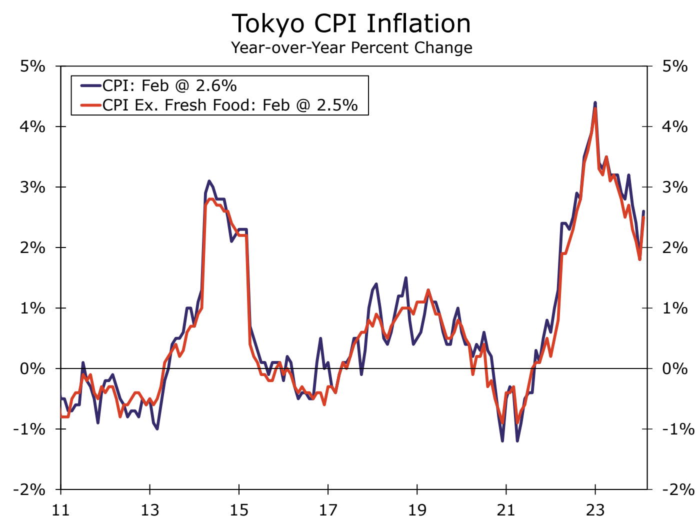


Source: Datastream and Wells Fargo Economics

Tokyo CPI • Friday

Following this week's historic rate hike from the Bank of Japan, the first since 2007, next week's data from Japan may offer some insight into whether the case could build for eventual further monetary tightening. Among the most significant of those data will be the March Tokyo CPI, which will offer early insight into whether inflation above the central bank's 2% inflation target will persist for the time being. Tokyo inflation jumped in February as the effect of government energy subsidies—that had lowered costs for households—waned. For March, the consensus forecast is for Tokyo inflation to remain broadly steady after the February jump, with headline inflation forecast at 2.5% year-over-year, and core inflation forecast at 2.4%.

In addition to the Tokyo CPI, there are some other notable Japanese data releases next week. Japan's February retail sales are forecast to rise 0.6% month-over-month after a modest gain in January, while February industrial output should rise 1.3%, partly reversing its larger January fall. Should Japan's economic growth continue and inflation stay elevated over the next several months, we think the Bank of Japan could be comfortable enough to hike interest rates again by late this year.



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

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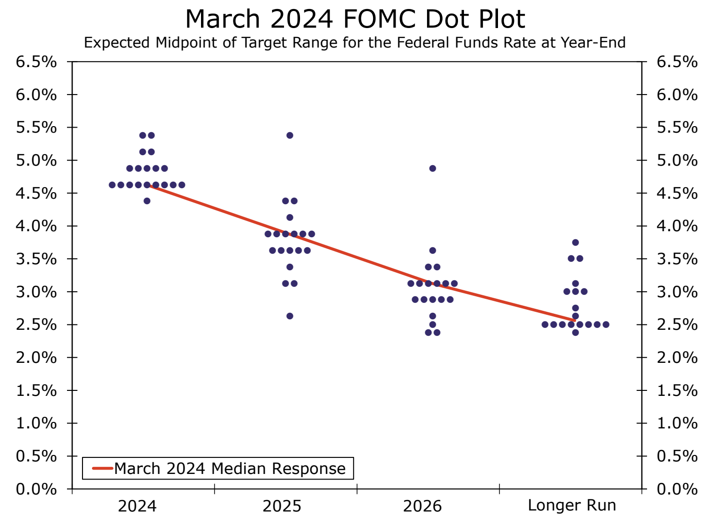
Interest Rate Watch

Sitting, Waiting, Wishing

As widely anticipated, the Federal Open Market Committee (FOMC) made no change to policy at the conclusion of its March 20 policy meeting. It left the target range on its federal funds rate unchanged and held the pace of balance sheet runoff—commonly referred to as quantitative tightening (QT)—constant. The largest development was in the Fed's updated *Summary of Economic Projections (SEP),* which revealed a slightly higher expected path of interest rates as well as stronger growth and inflation this year. These results suggest the Fed's outlook is incrementally more hawkish, but overall we'd say this was a fairly neutral outcome in the context of higher-than-expected data to start the year.

The updated "dot plot" which tallies the individual forecasts of FOMC participants signals all but two of the committee members expect to start cutting rates this year, with the median participant still projecting 75 bps of easing by year-end 2024 (chart). While this median projection was unchanged from the December SEP, the distribution of dots shifted modestly higher. The median dots for 2025 and 2026 also rose by 25 bps each, consistent with 75 bps of easing in 2025 and another 75 bps of cuts in 2026. There was also a modest uptick in the committee's expectations for yields in the long run, with the median estimate rising to 2.6%, marking the first time the median is above 2.5% since March 2019.



Source: Federal Reserve Board and Wells Fargo Economics

The slightly higher rate outlook comes with more upbeat projections for economic growth and stickier inflation this year. The median projection for real GDP growth in 2024 is now 2.1% (up from 1.4% in December), and core PCE inflation is 2.6% (up from 2.4%). These changes likely reflect the stronger growth and price pressure we've seen at the start of the year. While the Fed reaffirmed its ongoing pace of balance sheet runoff (QT), Chair Powell stated it is the committee's view that it would be appropriate to slow the pace of asset runoff "fairly soon" in the post-meeting press conference.

Overall, the updated estimates reflect an FOMC that believes inflation is on the path back to its 2% target, but that it is likely to be achieved slightly later than previously expected. The timing and degree of Fed easing continues to depend on how inflation and the labor market evolve in the coming months. We'll get three months of inflation and employment data ahead of the June 12 meeting, the first at which we anticipate the committee will cut the range of its federal funds target.

Summary of Our Fed Expectations:

- *Federal Funds Rate (FFR)*: We continue to expect the committee to first ease policy by 25 bps at its June 12 meeting, and for a cumulative reduction of 100 bps this year. The risks to this forecast are presently skewed toward later (first cut at its July 31 meeting), or potentially proceeding at a slower pace (every other meeting resulting in less total FFR reduction this year).
- *Quantitative Tightening (QT)*: We now expect the FOMC to announce a plan to slow the pace of QT at its May meeting (up from June). We continue to look for runoff caps for Treasury securities to be reduced to monthly caps of $30 billion (from $60 billion currently), while mortgage-backed securities caps are dropped to $20 billion ($35 billion currently), with this slower pace of runoff continuing until roughly year-end 2024.

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Credit Market Insights

Are American Consumers Learning to Live with Higher Rates?

This week, the Federal Reserve Bank of New York released the latest data from its triannual Credit Access Survey. The byline of its report, "Credit Application Rate Ticks Up; Rejection Rate Declines," suggests that American consumers and bankers are adjusting to the "higher for longer" world. Even as the fed funds rate remains at its likely peak of this cycle, consumers appear to be learning to live with the reality of higher interest rates, and creditors are easing standards. However, in the details of the survey, it becomes clear that the sustained higher rate environment is dampening demand for current loans as well as expectations of future credit access.

According to the latest data, 43.4% of respondents had applied for any kind of credit in the 12 months ended February 2024. The reading, which is the highest application rate in over a year, largely reflects the uptick in mortgage loan applications during the period, rather than broad-based strength. As mortgage rates fell from their October highs, the mortgage loan application rate increased from 4.3% in October 2023 to 5.6% in the latest survey.

Applications for credit cards dipped slightly in the latest survey, but the rate remains in line with its pre-pandemic average and has increased roughly 4.5 percentage points from this time last year. That said, the extent to which credit card applications reflect a stomach for the highest credit card interest rates in over 30 years is up for debate. If many consumers use credit cards as if they were debit cards—paying them off each month—then the interest rate is of little importance.

Applications for auto loans (9.8%) fell to a record low in the February survey (the survey began in October 2013), as did the application rate for mortgage refinances (0.9%). For auto loans, the application rate fell among all major credit score and age groups. The pullback in many types of loan applications corroborates the glimmer of consumer restraint exhibited at the start of this year as consumers dialed back real spending, while reprioritizing non-discretionary outlays.

Looking forward, households are at last showing signs of being more reserved. At 22.9%, the share of survey respondents who answered that they are likely to apply for one or more sources of credit in the next year is at its lowest since summer of 2018. Overall, the application rate for all types of credit may be returning to a more normal level after the throes of uncertainty from earlier this cycle, but the headline improvement masks disparity in the details and a growing expectation to limit consumption financed via credit.

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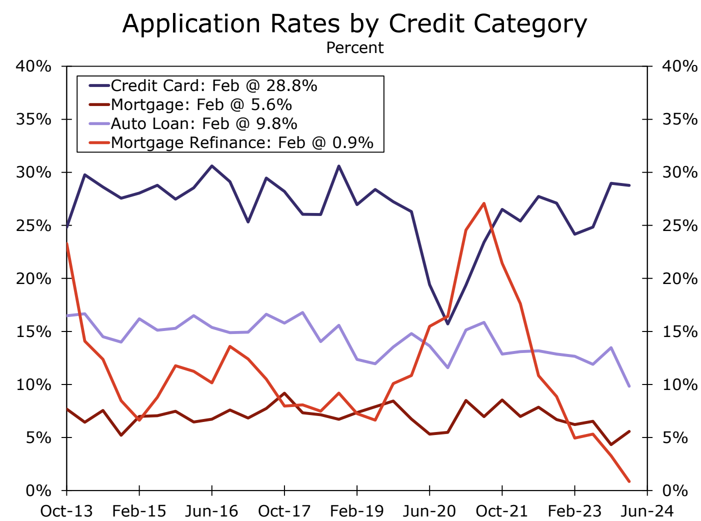


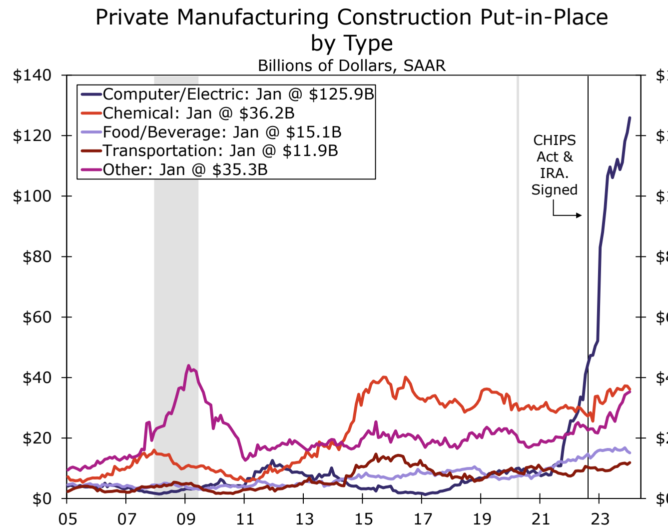
Source: Federal Reserve Bank of New York and Wells Fargo Economics

Topic of the Week

Building the Future

The high-tech manufacturing sector in the United States has been the fastest growing category within nonresidential construction in recent years and is already producing 1.5 times the amount it produced in 2017. In a report published this week, we discuss how the construction boom in high-tech manufacturing may impact the U.S. economy. While we do not anticipate a major onshoring of jobs, we expect to see the onshoring of technical capabilities. This has the potential to contribute to a rise in productivity, which may offset structural labor force challenges stemming from an aging demographic. While there are many risks present in our economic outlook, the high-tech building boom is emerging as a key bright spot.

Manufacturing activity has stalled amid the fastest pace of monetary tightening in over 40 years. This is unsurprising, given the after-effects of the pandemic on the economy, including softening domestic demand for goods amid a rebuild in inventories and high costs of financing new capital investment. Though manufacturing activity has stalled, manufacturing *construction* has not, with spending on private manufacturing construction more than double what it was three years ago. Though these data are nominal, they still speak to an unmatched boom in spending on manufacturing facilities.



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

The surge in manufacturing construction spending can largely be explained by one key sector: computer, electronic & electrical manufacturing. Outlays in this sector have increased by nearly $120 billion since 2021, and spending today tops total manufacturing construction prior to the pandemic by about $48 billion. Such rapid growth can be partially explained by a push to rethink far-flung supply chains through both public investment and private initiative. The CHIPS Act, passed in 2022, allocated funds for domestic production by specifically setting aside financial incentives for investment in facilities and equipment in the U.S. semiconductor space. A realignment of supply chains is also likely supporting the push to produce key inputs domestically (chart).

While the domestic computer and electrical manufacturing sector is relatively small today, production in selected high-technology industries is already showing signs of outsized growth. This is also seen in orders activity for computers & electronic products in particular, which have risen for six straight months. Production in these industries will likely benefit from the uptick in demand as factories come online.

Computer products and electrical equipment are also key inputs for an array of domestic industries, alongside semiconductors. As seen during the pandemic, a disruption to a small share of inputs can have a dramatic effect on production. Today, the economy relies largely on foreign economies for some key inputs like semiconductors, but the uptick in domestic supply will help diminish reliance on foreign production. In addition, manufacturers' inventory build is currently concentrated in inputs rather than finished manufactured goods. This points to scope for hyper-charged growth in production, particularly if it occurs alongside an easing in monetary policy and a lower cost of capital.

As the Fed begins to ease policy in the second half of the year, we anticipate a modest recovery in capex investment generally. But a medium- to longer-term support factor will likely come from this recent manufacturing construction boom, which looks set to be transformative for those who rely on key inputs, like semiconductors. There are sure to be knock-on effects from this surge in development as well. Specifically, a more readily available supply of chips will likely contribute to a rise in automation generally, which may contribute to a rise in productivity and offset structural labor force challenges stemming from an aging demographic. The manufacturing construction boom is therefore a bright spot in our economic outlook. For more information, please see our special report.

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Market Data • Mid-Day Friday

U.S. Interest Rates

	Friday 3/22/2024	1 Week Ago	1 Year Ago
SOFR	5.31	5.31	4.55
Effective Fed Funds Rate	5.33	5.33	4.58
3-Month T-Bill	5.37	5.37	4.66
1-Year Treasury	5.07	5.09	4.40
2-Year Treasury	4.59	4.73	3.94
5-Year Treasury	4.20	4.33	3.51
10-Year Treasury	4.22	4.31	3.43
30-Year Treasury	4.39	4.43	3.65
Bond Buyer Index	3.55	3.52	3.57

Foreign Exchange Rates

	Friday 3/22/2024	1 Week Ago	1 Year Ago
Euro ($/€)	1.082	1.089	1.086
British Pound ($/£)	1.260	1.274	1.227
British Pound (£/€)	0.859	0.855	0.885
Japanese Yen (¥/$)	151.300	149.040	131.440
Canadian Dollar (C$/$)	1.360	1.354	1.373
Swiss Franc (CHF/$)	0.899	0.884	0.917
Australian Dollar (US$/A$)	0.652	0.656	0.669
Mexican Peso (MXN/$)	16.726	16.714	18.609
Chinese Yuan (CNY/$)	7.229	7.197	6.870
Indian Rupee (INR/$)	83.425	82.890	82.666
Brazilian Real (BRL/$)	4.989	4.996	5.239
U.S. Dollar Index	104.324	103.432	102.346

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

Foreign Interest Rates

	Friday 3/22/2024	1 Week Ago	1 Year Ago
3-Month German Govt Bill Yield	3.63	3.71	2.55
3-Month U.K. Govt Bill Yield	5.22	5.26	3.89
3-Month Canadian Govt Bill Yield	4.95	4.94	4.37
3-Month Japanese Govt Bill Yield	0.00	-0.02	-0.26
2-Year German Note Yield	2.83	2.95	2.71
2-Year U.K. Note Yield	4.13	4.33	3.49
2-Year Canadian Note Yield	4.11	4.26	3.51
2-Year Japanese Note Yield	0.20	0.19	-0.05
10-Year German Bond Yield	2.33	2.44	2.33
10-Year U.K. Bond Yield	3.93	4.10	3.45
10-Year Canadian Bond Yield	3.45	3.54	2.73
10-Year Japanese Bond Yield	0.74	0.79	0.33

Commodity Prices

	Friday 3/22/2024	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	80.85	81.04	70.90
Brent Crude ($/Barrel)	85.60	85.34	76.69
Gold ($/Ounce)	2168.86	2155.90	1970.11
Hot-Rolled Steel ($/S.Ton)	794.00	792.00	1058.00
Copper (¢/Pound)	399.35	411.25	406.85
Soybeans ($/Bushel)	12.12	11.98	14.80
Natural Gas ($/MMBTU)	1.67	1.66	2.17
Nickel ($/Metric Ton)	17,337	17,866	22,259
CRB Spot Inds.	545.63	548.56	556.20

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