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# Economics and Finance in a Two-Percent Economy

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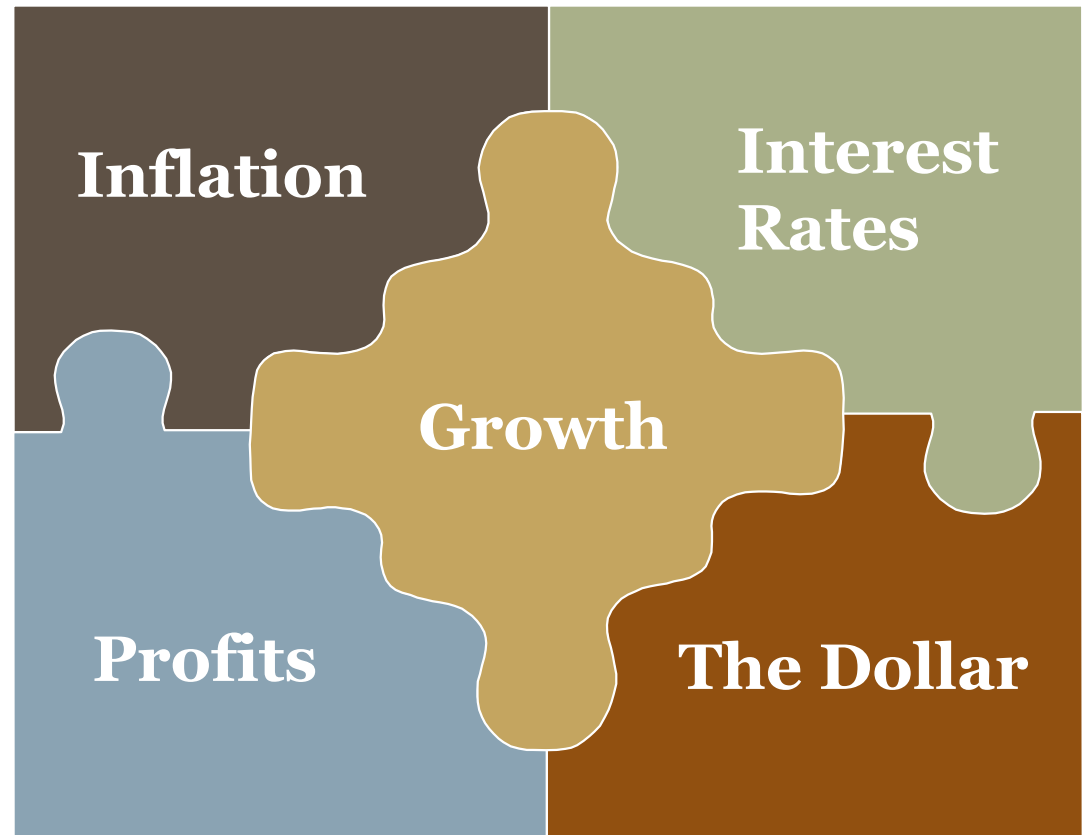
John E. Silvia, Chief Economist

July 2016

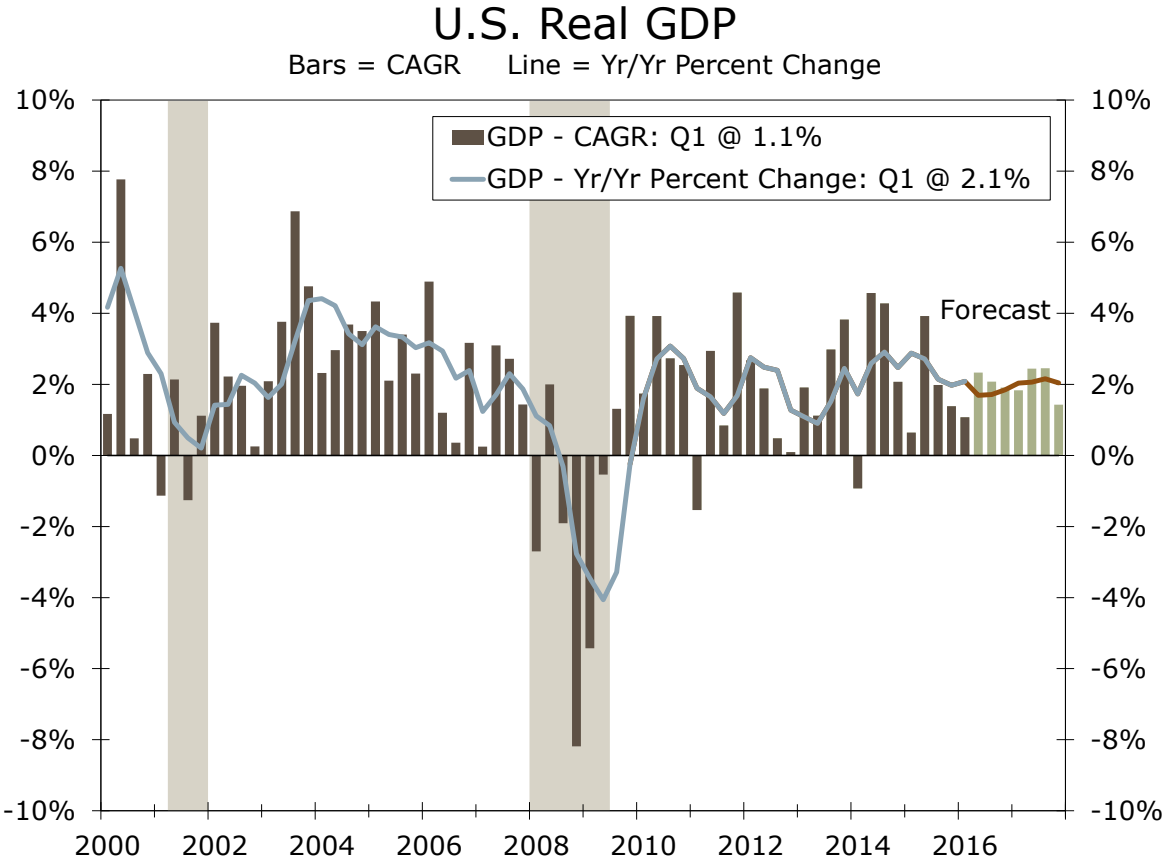
Together we'll go far



Five benchmarks for good  
decision making

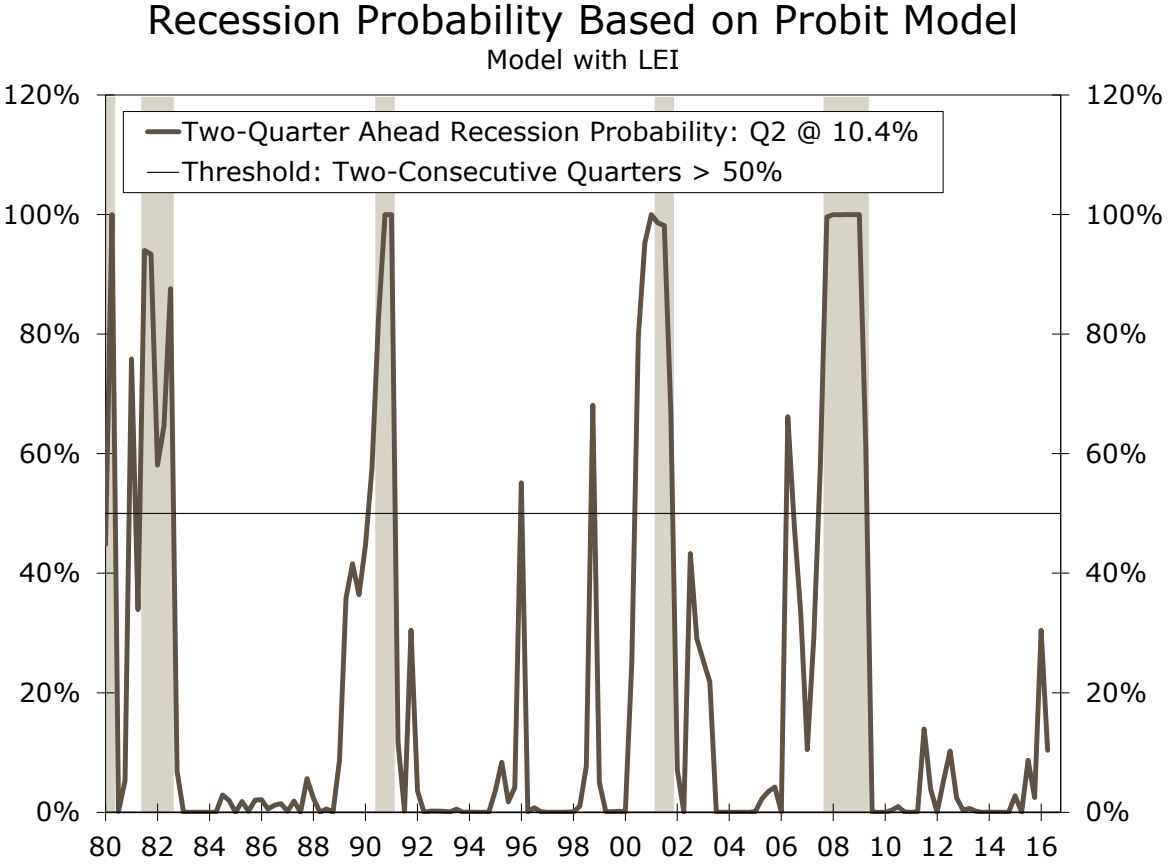


Trend growth at 1.5-2 percent in the year ahead. Consumer and housing lead, but exports will remain a drag.



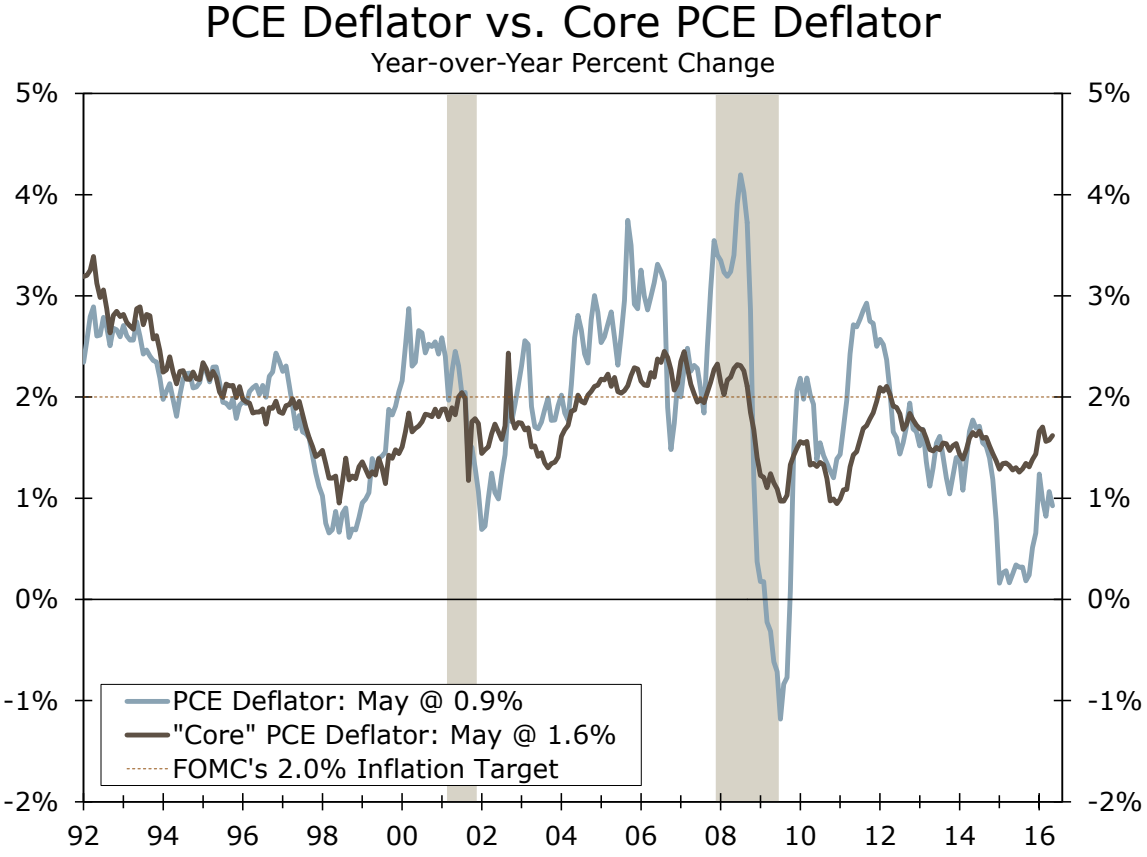
Source: U.S. Department of Commerce and Wells Fargo Securities

The probability of recession in the next six months is very low, according to our model



Source: Wells Fargo Securities

Inflation remains historically low, but we expect to see a pickup in coming quarters – average less than 2% since 1991

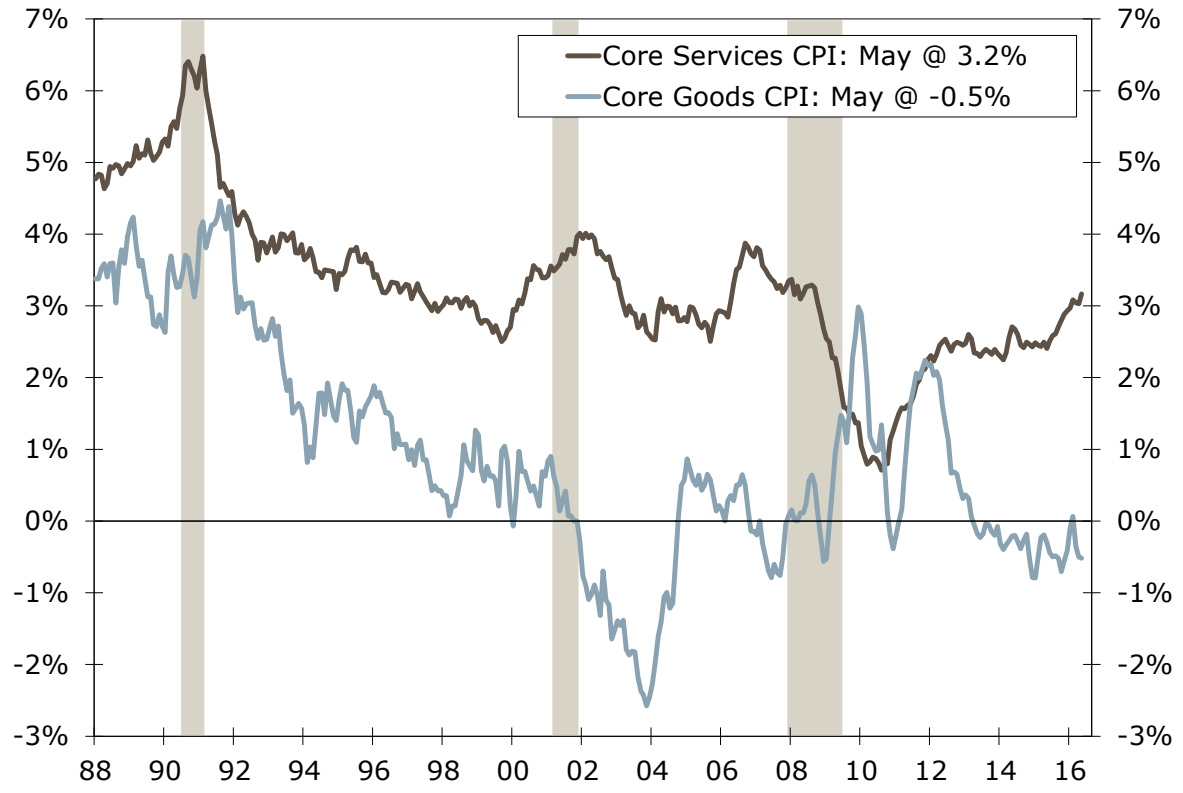


Source: U.S. Department of Commerce and Wells Fargo Securities

Inflation for services has been much firmer than for commodities

## Core Goods vs. Core Services CPI

Year-over-Year Percent Change

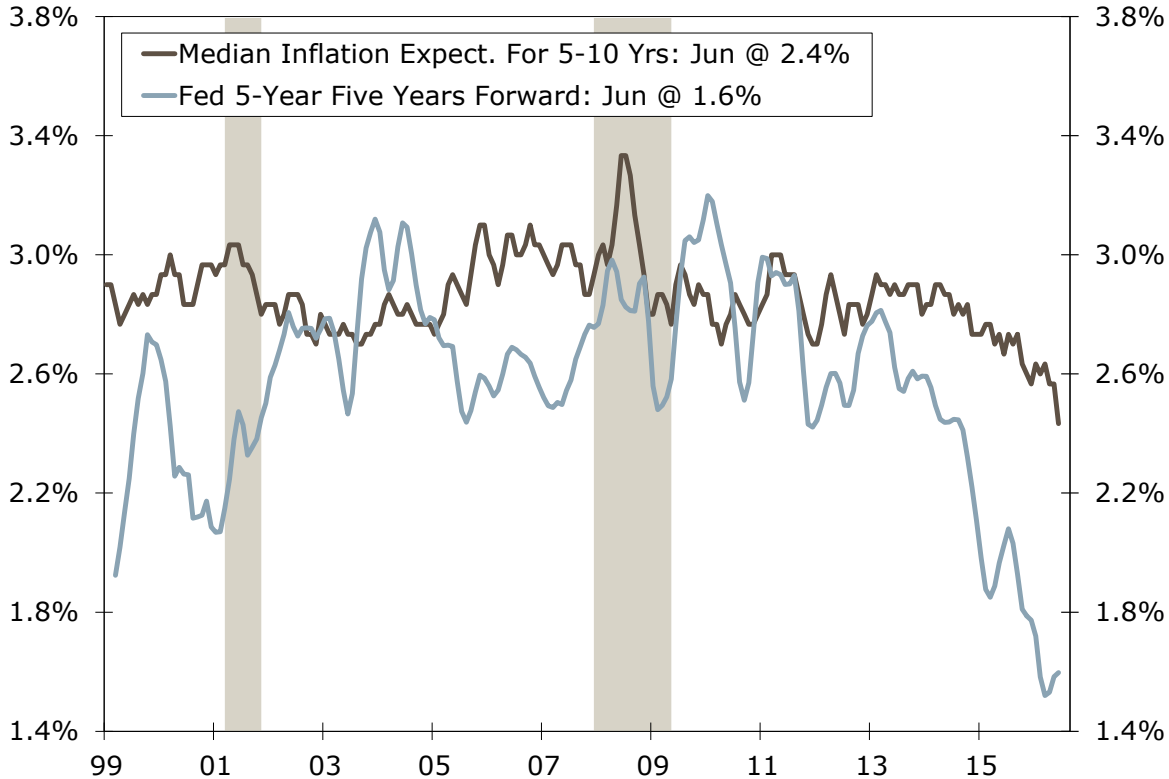


Source: U.S. Department of Labor and Wells Fargo Securities

Long-term inflation expectations have fallen alongside oil, keeping some FOMC members worried about the future path of inflation

## Med. Inflation Expectations 5 to 10-Years Ahead

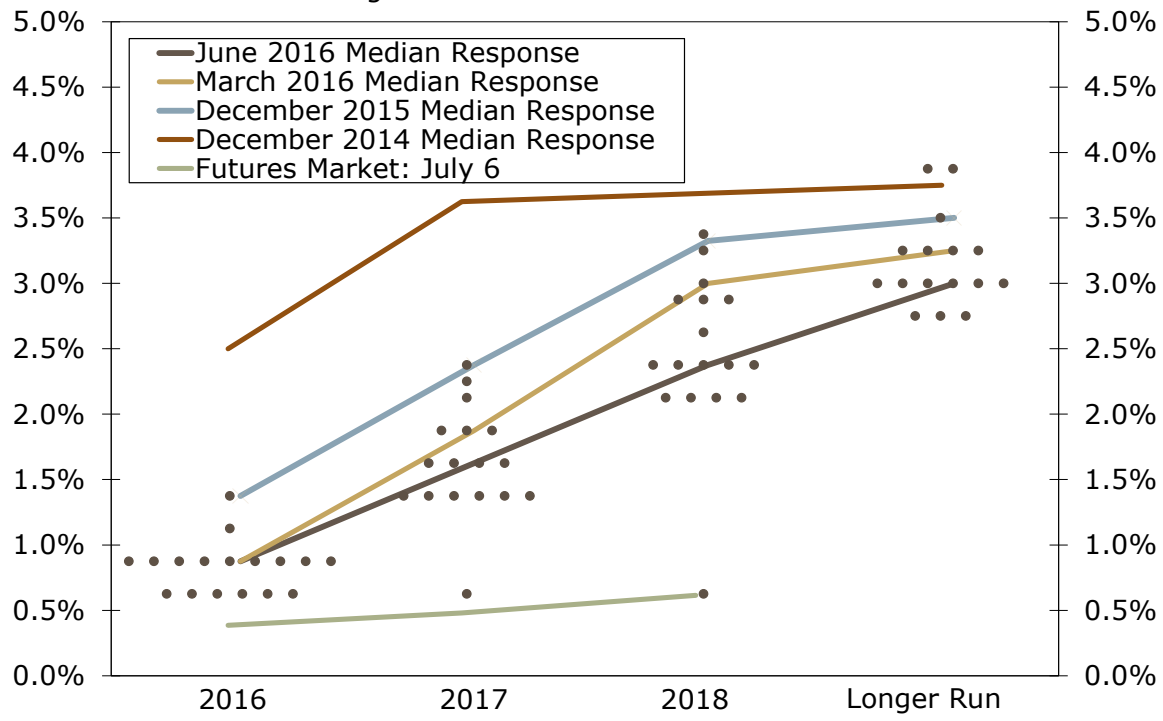
U. of Mich. Consumer Sentiment, Breakeven Rate of Inflation, 3-MMA



Source: Federal Reserve Board, Bloomberg LP and Wells Fargo Securities

Normalization is underway, but there remains wide variation between the market and Fed officials themselves about the appropriate path of the fed funds rate

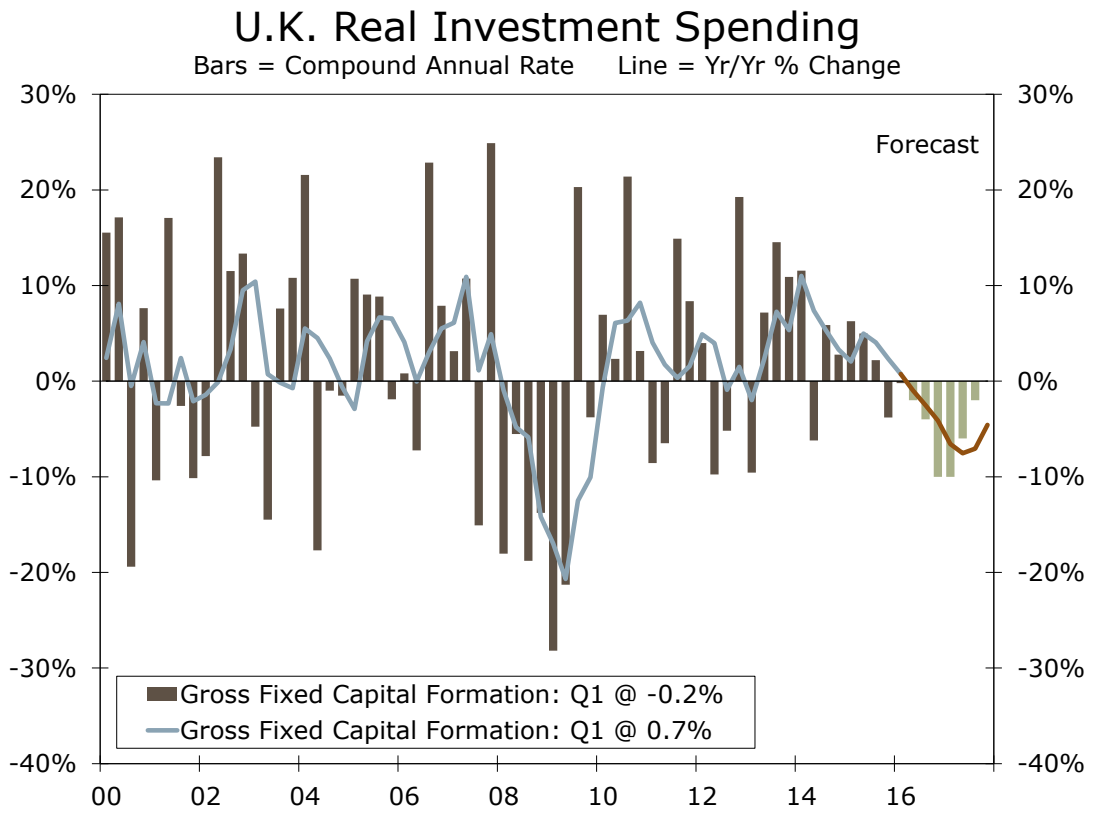
Appropriate Pace of Policy Firming  
Target Federal Funds Rate at Year-End



Source: Federal Reserve Board, Bloomberg LP and Wells Fargo Securities

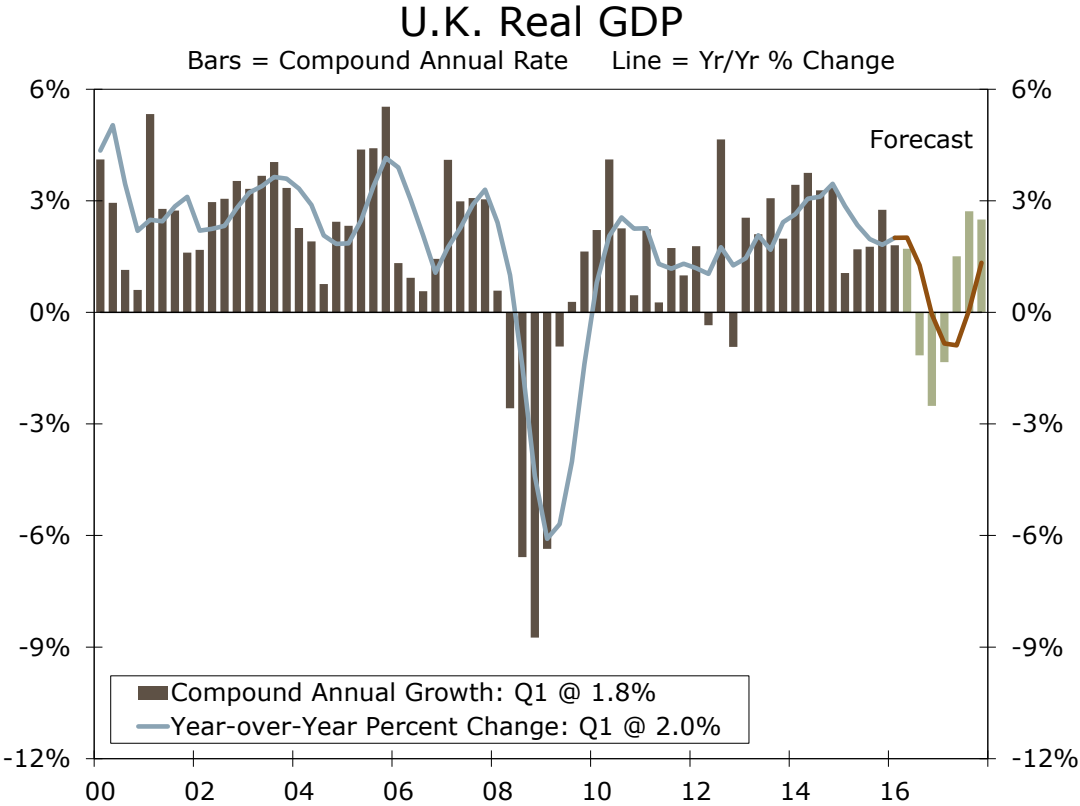


Uncertainty related to the ultimate relationship between the UK and the EU will likely depress investment spending in the UK



Source: IHS Global Insight and Wells Fargo Securities

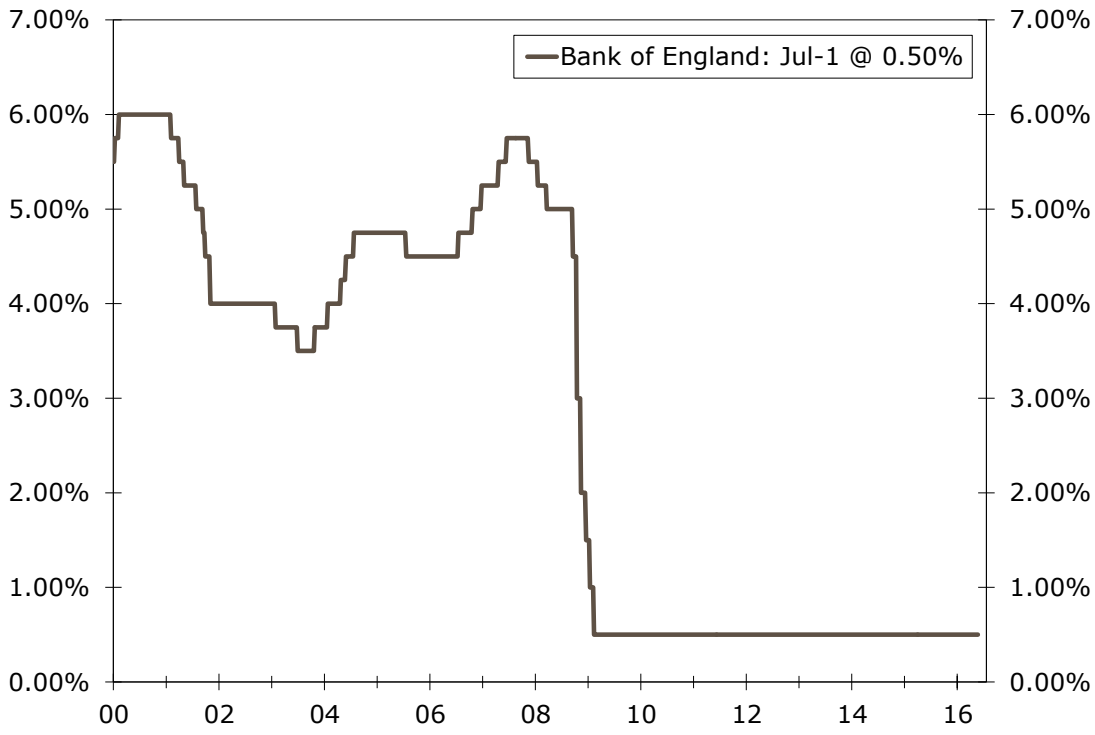
In our view, further contraction in investment will lead to a modest U.K. recession later this year and into early 2017



Source: IHS Global Insight and Wells Fargo Securities

If, as we expect, the British economy is headed for a modest recession, then the BoE will likely cut further

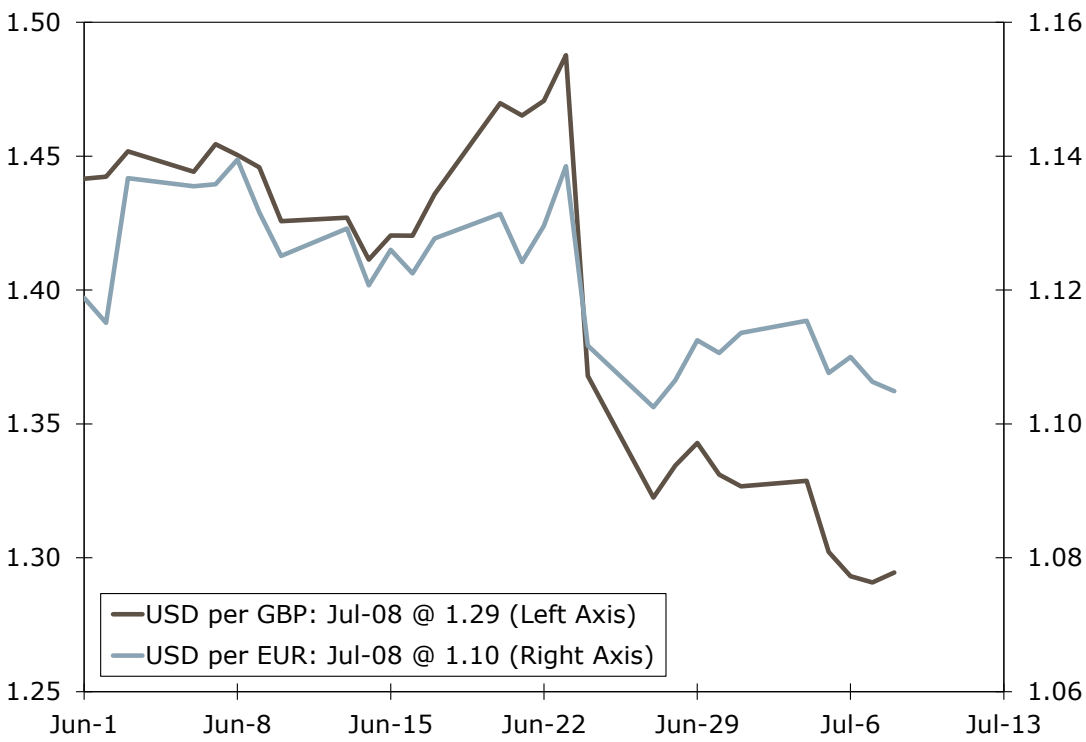
Bank of England Policy Rate



Source: Bloomberg LP and Wells Fargo Securities

The pound has depreciated since the Brexit vote

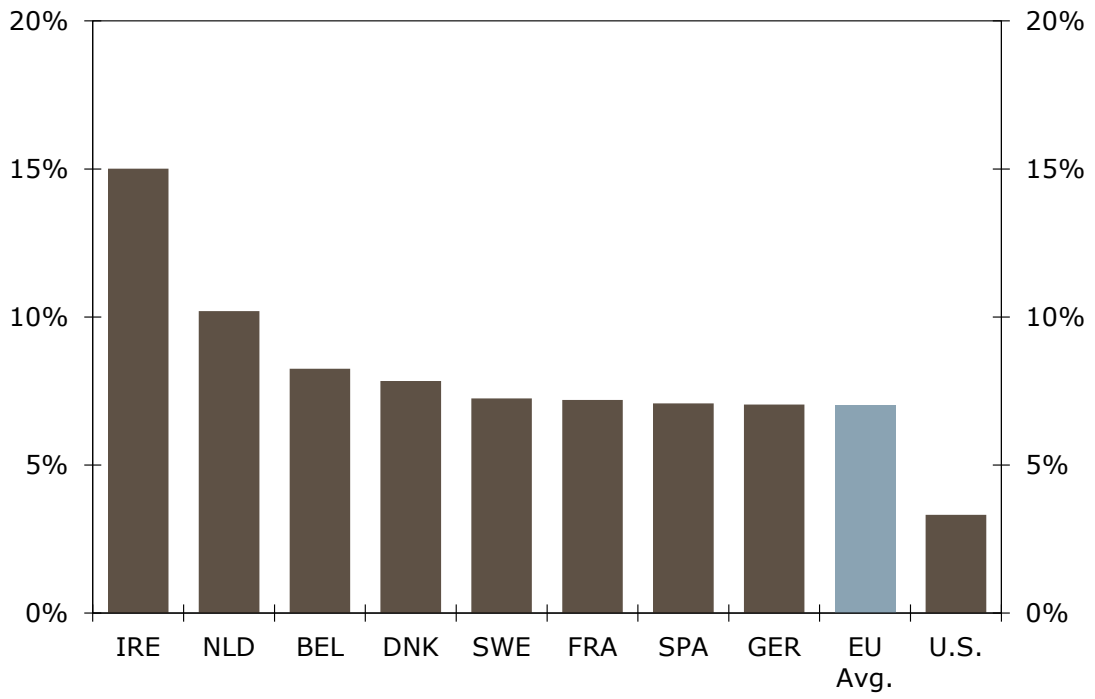
U.K. and Euro Exchange Rates



Source: Bloomberg LP and Wells Fargo Securities

The UK accounted for less than 4 percent of American exports of goods in 2015, which is equivalent to only 0.4 percent of U.S. GDP

Exports to the United Kingdom  
As a Percent of Total Exports, 2014

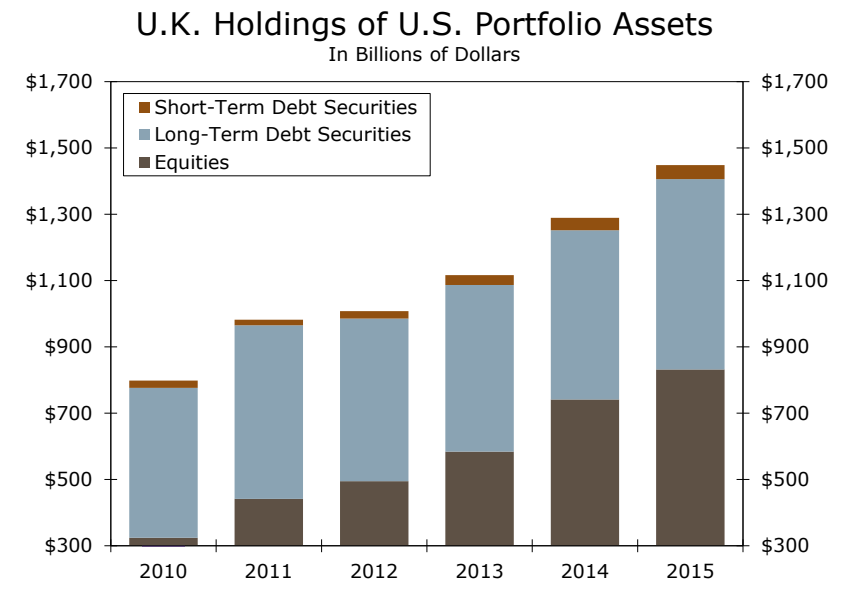
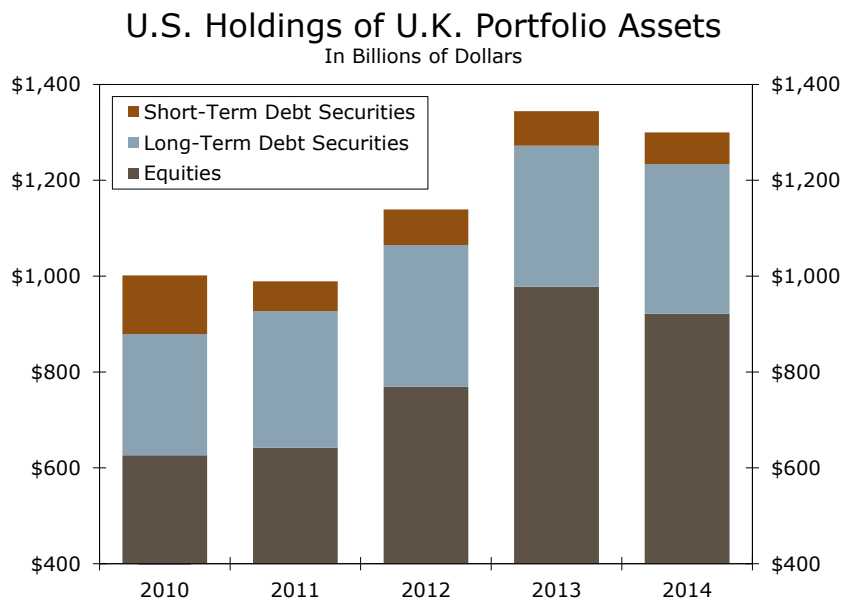


Source: IHS Global Insight and Wells Fargo Securities

Americans own \$1.3 trillion worth of British securities, most of which are equities. That said, total household balance sheets in the U.S. have \$70 trillion worth of financial assets.

### U.S. Holdings

### U.K. Holdings



Note: This includes private and public institutions  
Source: IHS Global Insight and Wells Fargo Securities

“Breakaways”

Anglo-Saxon Trade

- Singapore
- United States
- South Korea
- Bangladesh
- India
- Canada

## Growth

- **Continued moderate growth led by domestic consumer and housing**
- 

## Inflation

- **Rising, but is the pace slow enough to delay Fed move?**
- 

## Interest Rates

- **Rising short rates, but flat long rates as capital flows favor the U.S.**
- 

## Dollar

- **Stronger dollar as rates and growth favor U.S.**
- 

## Profits

- **A late cycle slowdown**



## Wells Fargo U.S. Economic Forecast

	Actual				Forecast								Actual			Forecast	
	2015				2016				2017				2013	2014	2015	2016	2017
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product <sup>1</sup>	0.6	3.9	2.0	1.4	1.1	2.3	2.1	1.9	1.8	2.4	2.5	1.4	1.5	2.4	2.4	1.8	2.1
Personal Consumption	1.8	3.6	3.0	2.4	1.5	4.3	2.7	2.0	2.3	3.2	3.1	1.9	1.7	2.7	3.1	2.7	2.7
Business Fixed Investment	1.6	4.1	2.6	-2.1	-4.5	1.1	0.6	3.4	3.1	2.9	2.8	2.5	3.0	6.2	2.8	-0.5	2.6
Equipment	2.3	0.3	9.9	-2.1	-8.7	1.6	-1.0	3.5	3.0	2.7	2.2	1.7	3.2	5.8	3.1	-1.1	2.2
Intellectual Property Products	7.4	8.3	-0.8	-0.1	4.4	4.2	4.8	5.3	4.9	4.8	4.8	4.7	3.8	5.2	5.7	3.2	4.9
Structures	-7.4	6.2	-7.2	-5.1	-7.9	-5.0	-2.5	0.0	0.5	0.5	1.0	1.0	1.6	8.1	-1.5	-4.8	-0.2
Residential Construction	10.1	9.4	8.2	10.1	15.6	0.0	9.0	8.5	8.5	8.5	8.0	8.0	9.5	1.8	8.9	8.9	7.9
Government Purchases	-0.1	2.6	1.8	0.1	1.3	-0.3	1.8	1.7	1.2	1.0	1.0	0.9	-2.9	-0.6	0.7	1.0	1.2
Net Exports <sup>2</sup>	-1.9	0.2	-0.3	-0.1	0.1	0.1	-0.7	-0.6	-0.6	-0.6	-0.6	-0.5	0.2	-0.2	-0.6	-0.1	-0.6
Inventories <sup>2</sup>	0.9	0.0	-0.7	-0.2	-0.2	-0.4	0.2	0.1	0.0	-0.1	0.0	-0.1	0.0	0.0	0.2	-0.2	0.0
Nonfarm Payroll Change <sup>3</sup>	190	251	192	282	196	147	175	170	165	160	155	150	193	251	229	172	158
Unemployment Rate	5.6	5.4	5.2	5.0	4.9	4.9	4.8	4.7	4.7	4.6	4.6	4.5	7.4	6.2	5.3	4.8	4.6
Consumer Price Index <sup>4</sup>	-0.1	0.0	0.1	0.4	1.1	1.1	1.3	1.7	2.4	2.3	2.3	2.3	1.5	1.6	0.1	1.3	2.3
Quarter-End Interest Rates <sup>5</sup>																	
Federal Funds Target Rate	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	0.25	0.25	0.27	0.56	1.00
Conventional Mortgage Rate	3.77	3.98	3.89	3.96	3.69	3.57	3.46	3.53	3.57	3.60	3.64	3.67	3.98	4.17	3.85	3.56	3.62
2 Year Note	0.56	0.64	0.64	1.06	0.73	0.58	0.66	0.83	0.92	1.13	1.22	1.35	0.31	0.46	0.69	0.70	1.16
10 Year Note	1.94	2.35	2.06	2.27	1.78	1.49	1.41	1.50	1.55	1.60	1.66	1.71	2.35	2.54	2.14	1.55	1.63

Forecast as of: July 13, 2016

<sup>1</sup> Compound Annual Growth Rate Quarter-over-Quarter

<sup>2</sup> Percentage Point Contribution to GDP

<sup>3</sup> Average Monthly Change

<sup>4</sup> Year-over-Year Percentage Change

<sup>5</sup> Annual Numbers Represent Averages

Source: U.S. Department of Commerce, U.S. Department of Labor, Federal Reserve Board, Freddie Mac and Wells Fargo Securities

# Appendix

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## Recent Special Commentary

Date	Title	Authors
<b>U.S. Macro</b>		
June-30	Job Quality and the Missing Middle	House & Batcheller
June-30	Brexit and the U.S. Economy	Vitner
June-24	Brexit—Now What?	Bryson
June-23	Can labor force participation ever recover?	House
June-08	Where's the Rebound in Inflation Expectations?	House
<b>U.S. Regional</b>		
June-23	California mid-year economic update: June 2016	Vitner & Batcheller
June-22	State GDP Q4: Output continues to grow as headwinds come and go	Vitner & Feik
June-22	Healthcare, technology and construction drive incomes in Q1	Vitner
June-17	Florida Employment Conditions: May 2016	Vitner, Feik & Batcheller
June-17	North Carolina Employment Conditions: May 2016	Vitner, Feik & Batcheller
<b>Global Economy</b>		
June-28	Korea and Global Trade Dynamics	Quinlan
June-21	Chilean economy struggles in early 2016	Alemán
June-09	Global Chartbook: June 2016	Alemán, House & Nelson
June-01	Disappointing Swiss GDP Growth in Q1-2016	Bryson
June-01	Indian GDP Growth Bests Expectations in Q1-2016	Bryson
<b>Interest Rates/Credit Market</b>		
July-06	Argentina Sets the GDP Record Straight	Alemán
July-06	Go Your Own Way: Policy with Imperfect Information	Silvia
July-01	U.K. Recession Post-Brexit Referendum?	Bryson
June-28	The Referendum & the Reckoning: Rates Implications of Brexit	Silvia
June-22	Profits, Corporate Financing and Capital Investment	Silvia & Moehring
<b>Real Estate</b>		
July-06	International Home Buying: 2016	Vitner, Khan & Batcheller
June-28	Brexit Vote Could Pump More Dollars into U.S. CRE	Khan
June-01	Housing Chartbook: June 2016	Vitner, Khan & Batcheller
May-20	Commercial Real Estate Chartbook: Q1	Khan & Causey
April-29	Is the Housing Market Finally Becoming Unstuck?	Vitner, Khan & Batcheller

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