

Economics Group

Special Commentary

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Forecast Update: When the Facts Change, We Change Our Minds

Two developments have occurred recently that have caused us to make some modest adjustments to the forecasts we released just last week. First, we had been assuming since the summer that the 15% tariffs the U.S. government had been threatening to levy on Chinese imports would go into effect as scheduled on December 15. Readers could clearly have questioned the validity of this assumption, but given the political nature of the decision, into which we had few insights, we thought it was the most reasonable assumption we could have made at the time.

But the facts have changed, and so too must our assumptions. American and Chinese negotiators reached an agreement in principle on December 13 that averted the imposition of the tariffs. As noted in a [recent report](#), precise details on the agreement remain sparse, but it seems that we need to make some adjustments to our forecast. Before doing so, we should first outline our new assumptions regarding trade policy going forward. Simply, we assume that the United States will refrain from levying any additional tariffs, but we also assume that existing tariffs will not be reduced further, at least not through 2020.

Tariffs did not take effect on December 15, as we had assumed.

Figure 1

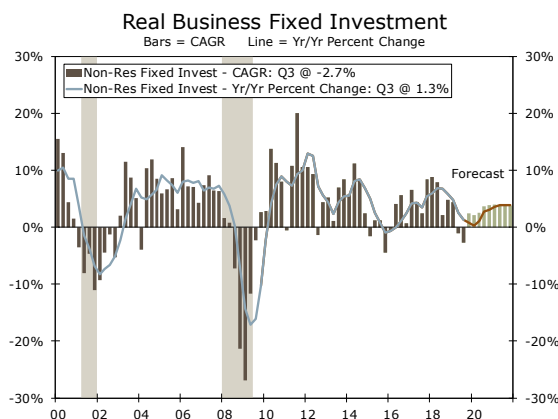
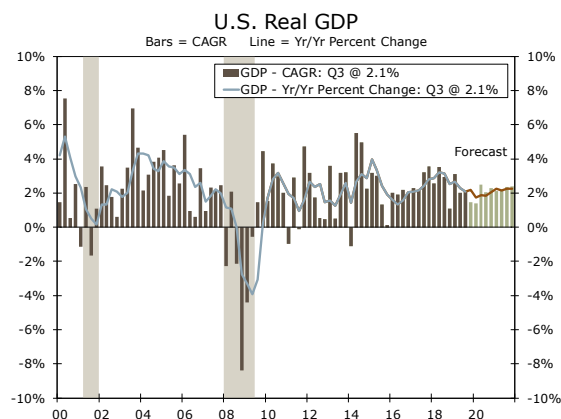


Figure 2



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

Because tariffs on mostly consumer goods were not imposed on December 15, we have edged down our consumer price inflation forecasts by 0.1 percentage point in 2020. If inflation were significantly lower, then growth in real personal consumption expenditures (PCE) should be stronger than in our previous forecast due to stronger growth in real income. But a decline in inflation of only 0.1 percentage point is more or less meaningless so we kept our real PCE forecast for next year essentially unchanged. However, we have lifted our forecast for growth in real business fixed investment (BFI) spending to 1.8% in 2020 from 1.5% previously. That said, our BFI forecast is still rather tepid (Figure 1). In our view, uncertainty related to trade policy will continue to exert some headwinds on BFI growth through next year.

We have bumped up our BFI growth forecast.



The suspension of 737 MAX production will impart a near-term hit to GDP growth.

We have also made some modest changes to our foreign economic forecast. Specifically, we have raised our real GDP growth forecast for China to 5.9% in both 2020 and 2021. Previously, we had forecasted that Chinese real GDP would grow 5.8% next year and 5.6% in 2021.

Everything else equal, the recent developments on the trade policy front would raise our forecast for real GDP growth in the United States by 0.2 percentage points in Q1-2020 to 1.5% (Figure 2). But everything else is not equal. The second development that affects U.S. GDP growth is Boeing's announcement on December 16 that it will suspend production of its 737 MAX airplane. As we noted in [recent report](#), Boeing had been producing 42 aircraft per month and we had been assuming that this production schedule would remain in effect for the foreseeable future. Because the aircraft were being produced but not shipped, they showed up as an inventory build in the GDP accounts. With production now suspended, inventory accumulation will weaken, which we calculate will shave roughly 0.5 percentage points from overall GDP growth in Q1-2020 (Figure 3). In other words, we have reduced our forecast for Q1 GDP growth from 1.7%, which is the forecast we released last week to 1.4% at present.

Figure 3

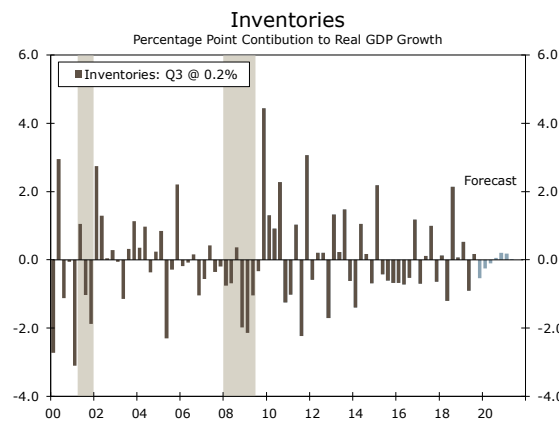
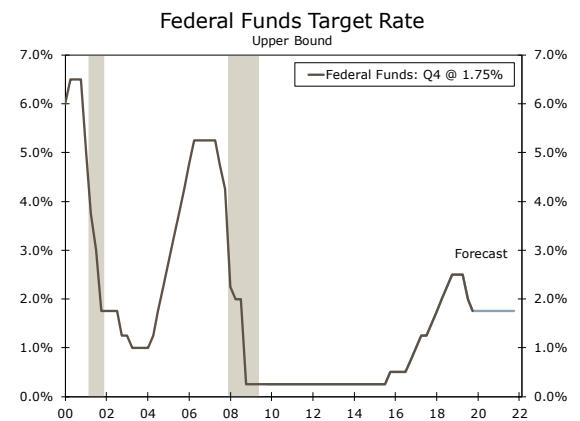


Figure 4



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

We have also made an adjustment to our forecast for U.S. monetary policy. Specifically, we had looked for the Federal Open Market Committee (FOMC) to reduce its target range for the fed funds rate another 25 bps in the first quarter. In our view, financial markets were not priced for an imposition of tariffs on December 15. If the tariffs would have taken effect as scheduled, then we think that stock markets would have weakened and credit spreads would have widened. We believe the FOMC would have wanted to offset this tightening in financial market conditions, at least in part, by another rate cut.

We no longer look for the FOMC to cut rates in early 2020.

But with a ratcheting up of trade tensions averted, financial market conditions have not tightened. Furthermore, Fed officials have indicated that they likely will keep policy unchanged unless there is a "material" change in their outlook. Because our own forecast is very similar to the [FOMC's outlook](#), we now think that the committee will not cut rates early in 2020 as we had been previously projecting. With GDP growing more or less at its long-run potential rate and with inflation not moving meaningfully above the FOMC's 2% target, we continue to forecast that the committee will keep rates on hold through the end of 2021. In our view, the FOMC would tighten policy only if GDP growth turned out to be materially stronger and/or inflation significantly higher than our forecasts. We believe there is a fairly low probability that these conditions will be met.

Wells Fargo U.S. Economic Forecast																				
	Actual								Forecast								Actual		Forecast	
	2018				2019				2020				2021				2018	2019	2020	2021
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Real Gross Domestic Product (a)	2.6	3.5	2.9	1.1	3.1	2.0	2.1	1.5	1.4	2.5	2.1	2.3	2.1	2.2	2.4	2.4	2.9	2.3	1.9	2.2
Personal Consumption	1.7	4.0	3.5	1.4	1.1	4.6	2.9	2.1	2.1	2.0	1.9	1.9	1.8	2.1	2.2	2.2	3.0	2.6	2.3	2.0
Business Fixed Investment	8.8	7.9	2.1	4.8	4.4	-1.0	-2.7	2.5	2.2	2.6	3.7	3.8	4.0	3.9	3.9	3.8	6.4	2.3	1.8	3.8
Equipment	6.6	3.4	2.9	7.4	-0.1	0.8	-3.8	1.1	1.4	1.5	2.6	2.9	3.4	3.4	3.2	3.0	6.8	1.6	0.9	3.0
Intellectual Property Products	9.7	11.9	4.1	11.7	10.8	3.6	5.1	6.2	5.1	4.4	5.7	6.0	5.9	5.5	5.6	5.7	7.4	7.8	5.2	5.7
Structures	12.1	11.0	-2.1	-9.0	4.0	-11.1	-12.0	-6.5	-1.5	1.5	2.5	2.0	1.8	1.9	2.0	2.1	4.1	-4.5	-3.2	2.0
Residential Investment	-5.3	-3.7	-4.0	-4.7	-1.0	-3.0	5.1	4.5	4.3	4.5	4.5	4.3	4.0	4.0	3.8	3.5	-1.5	-1.6	4.0	4.1
Government Purchases	1.9	2.6	2.1	-0.4	2.9	4.8	1.6	0.5	1.1	1.1	1.0	0.8	0.8	0.8	0.7	0.7	1.7	2.2	1.2	0.9
Net Exports	-884.2	-850.5	-962.4	-983.0	-944.0	-980.7	-988.3	-983.3	-982.3	-981.2	-989.3	-992.7	-1000.4	-1006.7	-1004.3	-1003.2	-920.0	-974.1	-986.4	-1003.6
Pct. Point Contribution to GDP	0.0	0.7	-2.1	-0.4	0.7	-0.7	-0.1	0.1	0.0	0.0	-0.2	-0.1	-0.2	-0.1	0.0	0.0	-0.4	-0.3	-0.1	-0.1
Inventory Change	40.5	-28.0	87.2	93.0	116.0	69.4	79.8	54.0	20.0	37.0	40.0	50.0	59.0	60.0	60.0	60.0	48.1	79.8	36.8	59.8
Pct. Point Contribution to GDP	0.1	-1.2	2.1	0.1	0.5	-0.9	0.2	-0.5	-0.7	0.4	0.1	0.2	0.2	0.0	0.0	0.0	0.1	0.2	-0.2	0.1
Nominal GDP (a)	5.0	7.1	4.8	2.9	3.9	4.7	3.8	3.2	3.6	4.4	4.0	4.2	4.2	4.1	4.1	4.1	5.4	4.1	3.8	4.2
Real Final Sales	2.4	4.8	0.8	1.0	2.6	3.0	2.0	2.3	2.1	2.1	2.0	2.1	1.9	2.2	2.4	2.4	2.8	2.2	2.2	2.1
Retail Sales (b)	4.7	5.7	5.5	3.4	2.8	3.4	4.0	4.1	4.2	3.0	2.7	2.9	3.0	3.1	2.9	3.0	4.8	3.6	3.2	3.0
Inflation Indicators (b)																				
PCE Deflator	1.9	2.3	2.2	1.9	1.4	1.4	1.4	1.5	1.9	1.8	1.9	1.9	1.9	1.9	1.9	1.8	2.1	1.4	1.9	1.9
"Core" PCE Deflator	1.8	2.0	2.0	1.9	1.6	1.6	1.7	1.6	1.8	1.9	1.8	1.8	1.8	1.7	1.8	1.8	2.0	1.6	1.8	1.8
Consumer Price Index	2.2	2.7	2.6	2.2	1.6	1.8	1.8	2.0	2.4	2.1	2.2	2.2	2.2	2.2	2.2	2.1	2.4	1.8	2.2	2.2
"Core" Consumer Price Index	1.9	2.2	2.2	2.2	2.1	2.1	2.3	2.3	2.3	2.3	2.1	2.0	2.0	2.0	2.0	2.1	2.1	2.2	2.2	2.0
Producer Price Index (Final Demand)	2.8	3.0	3.1	2.8	1.9	2.0	1.6	1.2	1.8	1.5	2.0	2.3	2.3	2.2	2.2	2.2	2.9	1.7	1.9	2.2
Employment Cost Index	2.7	2.8	2.8	2.9	2.8	2.7	2.8	2.8	2.9	3.0	3.0	3.0	3.1	3.1	3.1	3.1	2.8	2.8	3.0	3.1
Real Disposable Income (b)	3.9	3.9	4.1	3.9	3.3	3.0	2.9	2.4	1.9	3.0	2.3	2.2	2.1	1.5	2.0	2.2	4.0	2.9	2.3	1.9
Nominal Personal Income (b)	5.6	5.8	5.9	4.9	4.6	4.7	4.4	4.2	3.8	4.6	4.2	4.2	4.1	3.5	3.9	4.1	5.6	4.5	4.2	3.9
Industrial Production (a)	2.3	4.6	5.2	3.9	-1.9	-2.3	1.2	-0.6	-3.9	1.6	1.7	2.1	1.2	1.8	1.9	1.3	3.9	0.8	-0.5	1.7
Capacity Utilization	77.9	78.5	79.1	79.4	78.6	77.8	77.6	77.1	76.4	76.7	77.0	77.4	78.0	78.4	78.9	79.2	78.7	77.8	76.9	78.6
Corporate Profits Before Taxes (b)	2.9	2.4	4.2	4.2	-2.2	1.3	-0.8	2.6	3.0	0.8	3.2	2.2	1.4	3.2	2.5	1.0	3.4	0.2	2.3	2.0
Corporate Profits After Taxes	10.3	8.3	11.3	10.1	-2.9	1.3	0.4	2.2	2.9	0.7	2.0	2.1	1.3	3.1	2.4	0.9	10.0	0.2	1.9	1.9
Federal Budget Balance (c)	-375	-7	-172	-319	-372	-56	-237	-367	-411	-46	-227	-331	-448	-66	-255	-359	-779	-984	-1050	-1100
Trade Weighted Dollar Index (d)	103.1	107.3	107.6	110.1	109.8	109.7	111.0	108.8	107.8	106.8	106.0	105.0	104.3	103.5	103.0	102.5	106.4	109.8	106.4	103.3
Nonfarm Payroll Change (e)	228	243	189	233	174	152	193	184	180	405	-105	10	115	110	110	110	223	176	123	111
Unemployment Rate	4.1	3.9	3.8	3.8	3.9	3.6	3.6	3.6	3.6	3.5	3.6	3.6	3.7	3.7	3.7	3.7	3.9	3.7	3.6	3.7
Housing Starts (f)	1.32	1.26	1.23	1.19	1.21	1.26	1.28	1.30	1.29	1.29	1.29	1.29	1.30	1.30	1.32	1.32	1.25	1.26	1.29	1.31
Light Vehicle Sales (g)	17.1	17.3	17.0	17.4	16.8	17.0	17.0	16.8	16.5	16.4	16.4	16.4	16.4	16.4	16.4	16.4	17.2	16.9	16.4	16.4
Crude Oil - Brent - Front Contract (h)	66.9	74.6	75.8	68.6	63.8	67.6	61.5	61.5	60.0	60.0	59.0	59.0	59.0	59.0	59.0	59.0	71.5	63.6	59.5	59.0
Quarter-End Interest Rates (i)																				
Federal Funds Target Rate	1.75	2.00	2.25	2.50	2.50	2.50	2.00	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.96	2.19	1.75	1.75
3 Month LIBOR	2.31	2.34	2.40	2.81	2.60	2.32	2.09	1.85	1.80	1.80	1.80	1.80	1.85	1.85	1.85	1.85	2.31	2.21	1.80	1.85
Prime Rate	4.75	5.00	5.25	5.50	5.50	5.50	5.00	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.96	5.19	4.75	4.75
Conventional Mortgage Rate	4.44	4.57	4.63	4.64	4.28	3.80	3.61	3.75	3.85	3.85	3.85	3.90	3.95	4.00	4.05	4.10	4.54	3.86	3.86	4.03
3 Month Bill	1.73	1.93	2.19	2.45	2.40	2.12	1.88	1.55	1.60	1.60	1.60	1.60	1.65	1.65	1.65	1.65	1.97	1.99	1.60	1.65
6 Month Bill	1.93	2.11	2.36	2.56	2.44	2.09	1.83	1.55	1.60	1.60	1.60	1.65	1.65	1.70	1.70	1.70	2.14	1.98	1.61	1.69
1 Year Bill	2.09	2.33	2.59	2.63	2.40	1.92	1.75	1.50	1.60	1.65	1.65	1.70	1.70	1.75	1.80	1.85	2.33	1.89	1.65	1.78
2 Year Note	2.27	2.52	2.81	2.48	2.27	1.75	1.63	1.65	1.75	1.80	1.80	1.85	1.90	1.90	1.95	2.00	2.53	1.83	1.80	1.94
5 Year Note	2.56	2.73	2.94	2.51	2.23	1.76	1.55	1.70	1.85	1.90	1.90	1.95	2.00	2.05	2.10	2.15	2.75	1.81	1.90	2.08
10 Year Note	2.74	2.85	3.05	2.69	2.41	2.00	1.68	1.90	2.10	2.15	2.15	2.20	2.25	2.30	2.35	2.40	2.91	2.00	2.15	2.33
30 Year Bond	2.97	2.98	3.19	3.02	2.81	2.52	2.12	2.30	2.50	2.55	2.60	2.70	2.75	2.80	2.85	2.90	3.11	2.44	2.59	2.83

Forecast as of: December 18, 2019

Notes: (a) Compound Annual Growth Rate Quarter-over-Quarter

(b) Year-over-Year Percentage Change

(c) Quarterly Sum - Billions USD; Annual Data Represents Fiscal Yr.

(d) Federal Reserve Advanced Foreign Economies Index, 2006=100 - Quarter End

(e) Average Monthly Change

(f) Millions of Units - Annual Data - Not Seasonally Adjusted

(g) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold

(h) Quarterly Average of Daily Close

(i) Annual Numbers Represent Averages

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

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP				CPI			
	2018	2019	2020	2021	2018	2019	2020	2021
Global (PPP Weights)	3.6%	3.0%	3.0%	3.3%	3.6%	3.4%	3.6%	3.4%
Advanced Economies ¹	2.3%	1.9%	1.6%	2.0%	2.0%	1.5%	1.9%	1.9%
United States	2.9%	2.3%	1.9%	2.2%	2.4%	1.8%	2.2%	2.2%
Eurozone	1.9%	1.2%	1.0%	1.4%	1.8%	1.2%	1.3%	1.5%
United Kingdom	1.4%	1.3%	1.1%	1.6%	2.5%	1.8%	1.8%	2.0%
Japan	0.3%	1.1%	0.4%	1.0%	1.0%	0.5%	1.2%	1.0%
Canada	2.0%	1.6%	1.6%	1.7%	2.3%	1.9%	1.9%	2.0%
Developing Economies ¹	4.5%	3.7%	4.1%	4.2%	4.8%	4.7%	4.8%	4.4%
China	6.6%	6.1%	5.9%	5.9%	2.1%	2.8%	3.0%	2.1%
India	7.4%	5.2%	6.3%	6.7%	3.9%	3.5%	4.1%	3.9%
Mexico	2.1%	0.1%	1.1%	1.8%	4.9%	3.6%	3.6%	3.5%

Forecast as of: December 18, 2019

¹Aggregated Using PPP Weights

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	Central Bank Key Policy Rate					
	2019	2020				2021
	Q4	Q1	Q2	Q3	Q4	Q1
United States	1.75%	1.75%	1.75%	1.75%	1.75%	1.75%
Eurozone ¹	-0.50%	-0.60%	-0.60%	-0.60%	-0.60%	-0.60%
United Kingdom	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%
Japan	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%
Canada	1.75%	1.75%	1.75%	1.75%	1.75%	1.75%
	2-Year Note					
	2019	2020				2021
	Q4	Q1	Q2	Q3	Q4	Q1
United States	1.65%	1.75%	1.80%	1.80%	1.85%	1.90%
Eurozone ²	-0.65%	-0.70%	-0.65%	-0.60%	-0.55%	-0.45%
United Kingdom	0.55%	0.65%	0.75%	0.80%	0.90%	0.95%
Japan	-0.10%	-0.05%	-0.05%	0.00%	0.00%	0.05%
Canada	1.70%	1.70%	1.75%	1.75%	1.80%	1.85%
	10-Year Note					
	2019	2020				2021
	Q4	Q1	Q2	Q3	Q4	Q1
United States	1.90%	2.10%	2.15%	2.15%	2.20%	2.25%
Eurozone ²	-0.35%	-0.40%	-0.35%	-0.25%	-0.15%	0.00%
United Kingdom	0.75%	0.90%	1.00%	1.05%	1.05%	1.10%
Japan	0.00%	0.05%	0.05%	0.10%	0.10%	0.15%
Canada	1.65%	1.70%	1.75%	1.80%	1.85%	1.90%

Forecast as of: December 18, 2019

¹ ECB Deposit Rate ² German Government Bond Yield

Source: International Monetary Fund and Wells Fargo Securities

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