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Economics Group

Interest Rate Weekly

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The Fed is Tracking Improving Labor Market Conditions

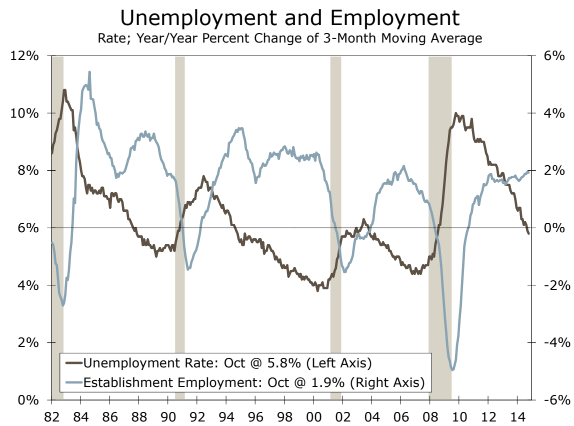
Employment conditions continue to improve in ways that should keep the Fed on pace to begin raising short term interest rates around the middle of 2015. The jobless rate could easily be less than 5.5 percent by May.

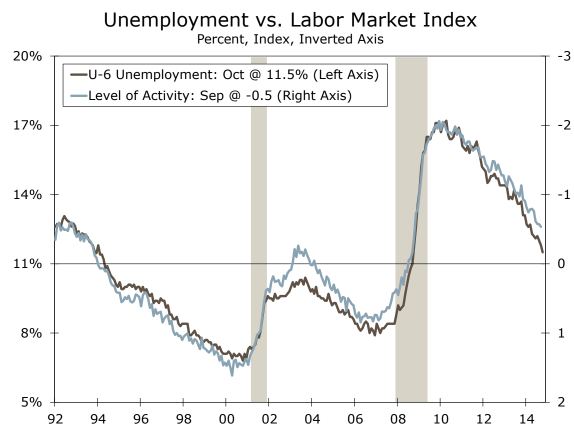
The Labor Market Seems to be Catching Up With the Economy

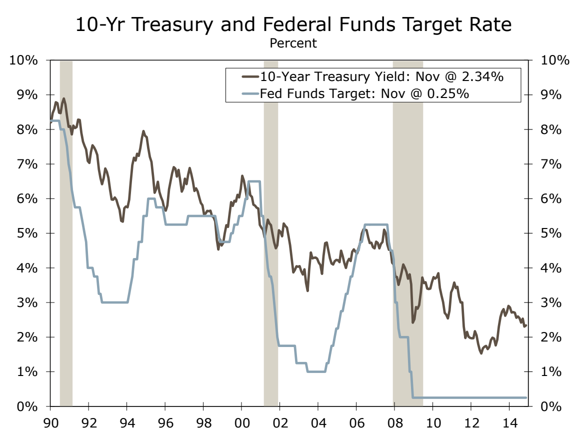
Strong job growth had been the missing ingredient for most of this economic recovery. While the unemployment rate has come down steadily, concerns about declining labor force participation and the large number of involuntary part-time workers have caused the Fed to develop a whole host of new labor market indicators. More recently, both traditional and nontraditional measures of the labor market have shown notable improvements. Nonfarm employment has risen by 200,000 or more jobs during each of the past nine months and the unemployment rate fell to 5.8 percent in October. Even that number, however, was rounded up, suggesting that the jobless rate will likely track a bit lower than the Fed's most recent outlook.

The unemployment rate is not the measure of labor market health that it used to be. Much of the drop in the unemployment rate has been made possible by the continued slide in the labor force participation rate, which is partly being driven by the aging of the population. The large proportion of the workforce working part-time also gives less credence to what otherwise would be a fairly respectable unemployment rate. It is because of these concerns that the Fed developed its own encompassing measure of the labor market, the Labor Market Conditions Index. The Fed's index incorporates 19 labor market indicators that cover virtually all aspects of the labor market. While the creation of the index is noteworthy, its end result shows a similar trend to the U-6 measure of the unemployment rate, which includes measures of involuntary part-time employment and discouraged workers. The U-6 measure of the unemployment rate has improved considerably over the past year but remains relatively high at 11.5 percent. The last time the U-6 rate fell to this level from a higher level was at the start of 1994. The Fed subsequently began to raise the fed funds rate, which had remained at 3 percent for more than two years, and continued to increase the fed funds rate by 300 basis points to 6 percent.

Of course the Fed is not just concerned about where the economy is right now but also where they believe it is headed. The U.S. economy is coming off a much deeper recession today than it was in the early 1990s and the global economic foundation seems much less sturdy. Deflation is a real concern in Europe, and falling commodity prices may lead to some short-term weakness in the U.S. before lower gasoline prices get a chance to stimulate consumer spending. We still see the Fed on track to raise the federal funds rate in June, when the unemployment rate may very well be below the CBO's 5.5 percent estimate of full employment. The pace of interest rate hikes may be slower, however, and rates may not ultimately rise as much as previously thought.







Source: U.S. Department of Labor, Kansas City Fed, IHS Global Insight and Wells Fargo Securities, LLC

Wells Fargo U.S. Interest Rate Forecast

	Actual				Forecast							
	2014				2015				2016			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Quarter End Interest Rates												
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.25	1.75	2.25	2.75
3 Month LIBOR	0.23	0.23	0.24	0.24	0.38	0.75	1.00	1.25	1.50	2.00	2.50	3.00
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.50	3.75	4.00	4.25	4.75	5.25	5.75
Conventional Mortgage Rate	4.34	4.16	4.16	4.26	4.31	4.44	4.46	4.62	4.84	5.07	5.47	5.91
3 Month Bill	0.05	0.04	0.02	0.08	0.20	0.54	0.78	1.02	1.28	1.77	2.28	2.79
6 Month Bill	0.07	0.07	0.03	0.09	0.24	0.58	0.80	1.03	1.29	1.80	2.30	2.80
1 Year Bill	0.13	0.11	0.13	0.10	0.25	0.59	0.83	1.08	1.33	1.84	2.32	2.82
2 Year Note	0.44	0.47	0.58	0.53	0.66	0.98	1.18	1.39	1.61	2.09	2.57	3.06
5 Year Note	1.73	1.62	1.78	1.68	1.71	1.93	2.00	2.06	2.15	2.50	2.86	3.25
10 Year Note	2.73	2.53	2.52	2.45	2.50	2.71	2.79	2.86	2.96	3.32	3.57	3.75
30 Year Bond	3.56	3.34	3.21	3.31	3.39	3.57	3.60	3.66	3.74	3.95	4.05	4.20

Forecast as of: November 12, 2014

Wells Fargo U.S. Economic Forecast and FOMC Central Tendency Projections

	2014	2015	2016
Change in Real Gross Domestic Product			
Wells Fargo	1.8	2.6	2.9
FOMC	2.0 to 2.2	2.6 to 3.0	2.6 to 2.9
Unemployment Rate			
Wells Fargo	5.8	5.4	5.1
FOMC	5.9 to 6.0	5.4 to 5.6	5.1 to 5.4
PCE Inflation			
Wells Fargo	1.4	1.8	2.0
FOMC	1.5 to 1.7	1.6 to 1.9	1.8 to 2.0

Forecast as of: November 12, 2014

NOTE: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation is the percentage rate of change in the price index for personal consumption expenditures (PCE). Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated.

Fed Data as of: September 17, 2014

Source: IHS Global Insight, Federal Reserve Board and Wells Fargo Securities, LLC

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