

Economics Group

Interest Rate Weekly

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Are Rates Finally Starting to Rise?

Over the past month, we have begun to see long-term interest rates gradually rise. The 10-year Treasury yield climbed to 2.16 percent from 1.98 percent this time last month, signaling the expected fed funds rate hike.

An Upward Migration in Rates, Impending Rate Hike

Our rate outlook this month maintains our call for the Federal Reserve to raise the fed funds target rate in June of this year. The 18 bps rise in yield on the 10-year Treasury security over the past month appears to be reflecting the reality of the impending rate hikes. Stronger economic data, particularly the impressive job growth numbers in recent months, have helped support the case for tighter Fed policy this summer. The rise in rates has not been isolated to the 10-year. The 5-year Treasury yield, which we feel better reflects economic fundamentals, climbed 12 bps over the past month. Shorter-term rates have started to edge higher but only slightly.

Global Growth Stability is Helping as Well

In addition, the announcement of the ECB's quantitative easing and rate cuts in China and India have helped provide needed confidence in the growth prospects for those countries. The likely result of these central bank moves has been a downshift in the capital inflows into U.S. Treasuries as a flight to quality. Given that early signs of growth are starting to emerge from the Eurozone, we believe that the rapid capital inflows that have characterized the past several months will begin to slow, allowing longer-term rates to better reflect anticipated movements in the fed funds rate.

Changes to Our Rate Outlook

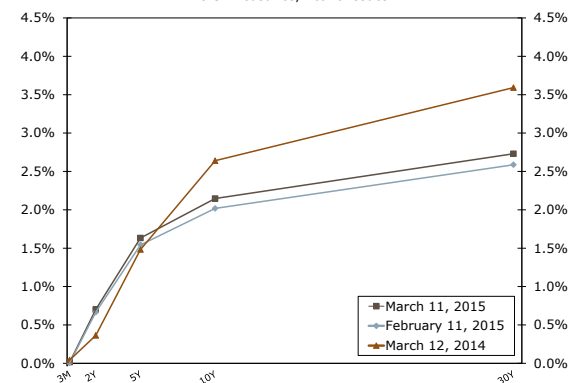
Since our forecast last month, we have increased our outlook for rates across the yield curve. We increased our rate outlook for the 3-month and 6-month bills by 6 bps by the end of 2015, mainly as a result of updated base effects, as these rates have drifted higher in recent weeks. Among the more pronounced changes in our rates forecast are at the longer end of the curve where, as we mentioned above, the rise in rates has been fairly dramatic over the past month. We now expect the 10-year Treasury yield to climb to 2.45 percent by the end of 2015 and 3.04 percent by the end of 2016. The 5-year Treasury yield should end this year just under 2 percent, while the 30-year Treasury rate should come in just north of 3.00 percent.

The main reason for the changes to our outlook are the base effects of the rate increases observed in recent weeks combined with signs that global growth may be beginning to stabilize, resulting in a reduction of the capital outflows from slower growth countries into the United States. With reduced capital flows into the U.S. Treasuries, longer-term rates have climbed higher and perhaps, at least for the time being, are becoming more in line with economic fundamentals. We continue to expect top-line GDP growth to average 2.7 percent this year and strengthen further in 2016 to 3.0 percent.

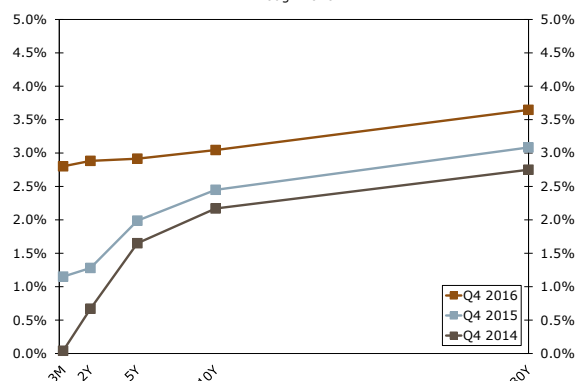
10-Year U.S. Treasury Yield



Yield Curve
U.S. Treasuries, Active Issues



Wells Fargo Rates Forecast
Through 2016



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	0.26	0.30	0.70	0.95	1.20	1.45	1.95	2.45	2.85
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	3.86	3.60	3.72	3.87	3.89	4.07	4.39	4.86	4.90
3 Month Bill	0.05	0.04	0.02	0.04	0.14	0.56	0.86	1.15	1.41	1.80	2.28	2.80
6 Month Bill	0.07	0.07	0.03	0.12	0.26	0.62	0.92	1.20	1.52	1.83	2.36	2.83
1 Year Bill	0.13	0.11	0.13	0.25	0.29	0.68	0.98	1.22	1.56	1.87	2.43	2.86
2 Year Note	0.44	0.47	0.58	0.67	0.71	0.89	1.08	1.28	1.74	2.05	2.47	2.88
5 Year Note	1.73	1.62	1.78	1.65	1.69	1.79	1.90	1.99	2.22	2.33	2.62	2.92
10 Year Note	2.73	2.53	2.52	2.17	2.20	2.36	2.40	2.45	2.51	2.76	2.88	3.04
30 Year Bond	3.56	3.34	3.21	2.75	2.80	2.91	2.98	3.08	3.17	3.35	3.57	3.65

Forecast as of: March 11, 2015

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

	<u>2014</u>	<u>2015</u>	<u>2016</u>
Change in Real Gross Domestic Product			
Wells Fargo	2.4	2.5	3.0
FOMC	2.3 to 2.4	2.6 to 3.0	2.5 to 3.0
Unemployment Rate			
Wells Fargo	5.7	5.2	4.8
FOMC	5.8	5.2 to 5.3	5.0 to 5.2
PCE Inflation			
Wells Fargo	1.1	0.9	2.1
FOMC	1.2 to 1.3	1.0 to 1.6	1.7 to 2.0

Forecast as of: March 11, 2015

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: December 17, 2014

Source: Federal Reserve Board and Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

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