May 08, 2015

Economics Group

Weekly Economic & Financial Commentary

U.S. Review

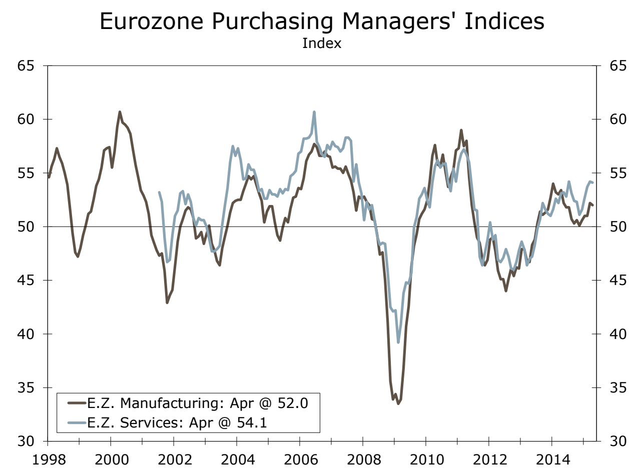
A Softer Bounce Back in the Second Quarter

- Nonfarm payrolls rose 223,000 in April, with the unemployment rate falling to 5.4 percent. The continued moderation in the pace of job growth suggests that second quarter economic growth may not see the same sharp turn around observed last year.
- International trade data for March showed a large increase in the trade deficit, which will likely pull the first quarter GDP reading into negative territory.
- Factory orders data remained mixed, suggesting only a moderate pace of business investment in the second quarter.

Global Review

Foreign Economic Growth Remains Mixed

- Recently released data show that the modest cyclical upswing that appears to be underway in the euro area may be gathering a bit more steam. Real GDP in the Eurozone likely grew at a modest pace in the first quarter, and positive momentum looks to have continued into Q2.
- The central bank in Australia cut rates again this week due to its outlook of continued slow economic growth down under. The Bank of Canada probably will not be cutting rates soon, but signs of sluggish growth north of the U.S. borders will preclude any rate hikes in the foreseeable future.



Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual			Forecast	
	2014				2015				2012	2013	2014	2015	2016
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product [1]	-2.1	4.6	5.0	2.2	0.2	2.0	2.9	2.9	2.3	2.2	2.4	2.3	2.8
Personal Consumption	1.2	2.5	3.2	4.4	1.9	2.8	3.0	3.0	1.8	2.4	2.5	3.0	2.8
Inflation Indicators [2]													
PCE Deflator	1.1	1.6	1.5	1.1	0.3	0.2	0.3	0.9	1.8	1.2	1.3	0.4	2.0
Consumer Price Index	1.4	2.1	1.8	1.2	-0.1	-0.1	0.2	1.0	2.1	1.5	1.6	0.2	2.4
Industrial Production [1]	3.9	5.7	4.1	4.6	-1.0	1.6	3.5	3.1	3.8	2.9	4.2	2.4	3.3
Corporate Profits Before Taxes [2]	-4.8	0.1	1.4	-0.2	4.8	5.0	4.9	4.7	11.4	4.2	-0.8	4.8	4.2
Trade Weighted Dollar Index [3]	76.9	75.9	81.3	85.1	92.1	92.8	94.0	95.3	73.5	75.9	78.5	93.5	98.3
Unemployment Rate	6.6	6.2	6.1	5.7	5.6	5.4	5.3	5.2	8.1	7.4	6.2	5.4	5.0
Housing Starts [4]	0.93	0.99	1.03	1.06	0.97	1.13	1.21	1.24	0.78	0.92	1.00	1.12	1.22
Quarter-End Interest Rates [5]													
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	0.25	0.25	0.25	0.44	1.56
Conventional Mortgage Rate	4.34	4.16	4.16	3.86	3.77	3.95	4.15	4.23	3.66	3.98	4.17	4.03	4.51
10 Year Note	2.73	2.53	2.52	2.17	1.94	2.19	2.35	2.41	1.80	2.35	2.54	2.22	2.66

Forecast as of: May 1, 2015
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change
[3] Federal Reserve Major Currency Index, 1973=100 - Quarter End
[4] Millions of Units
[5] Annual Numbers Represent Averages

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

Inside

Together we'll go far

U.S. Review

A Softer Bounce Back in the Second Quarter

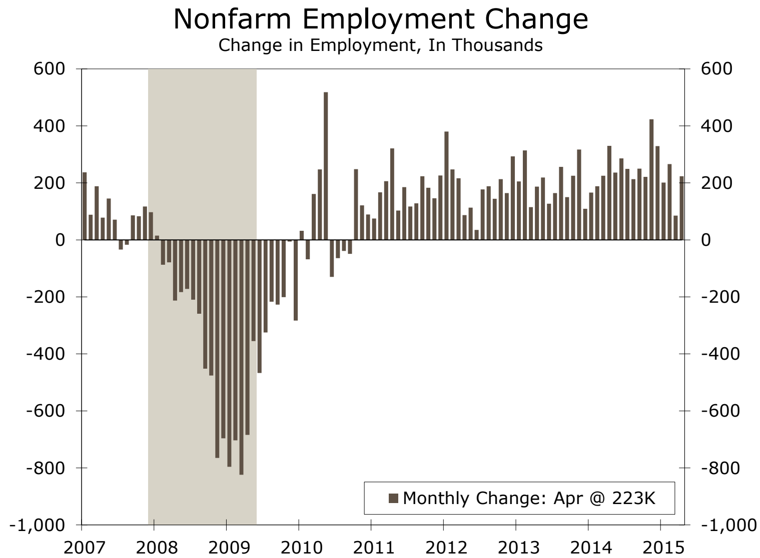
The first major data release in the second quarter, the April nonfarm payrolls report, showed that job growth returned back above a 200,000 per month pace. Taken together with other recent data, it now appears that the second quarter growth outlook is better than the first quarter, but headwinds to growth will likely remain. Furthermore, data from this week's international trade report for March showed that the trade deficit widened far more than the Bureau of Economic Analysis (BEA) estimated for the first quarter. We expect that the trade data by itself will likely shave around 0.5 percentage points from the already sluggish 0.2 percent growth for Q1. Unfortunately, it does not appear that second quarter GDP growth will rebound at the same rate observed in the second quarter of last year.

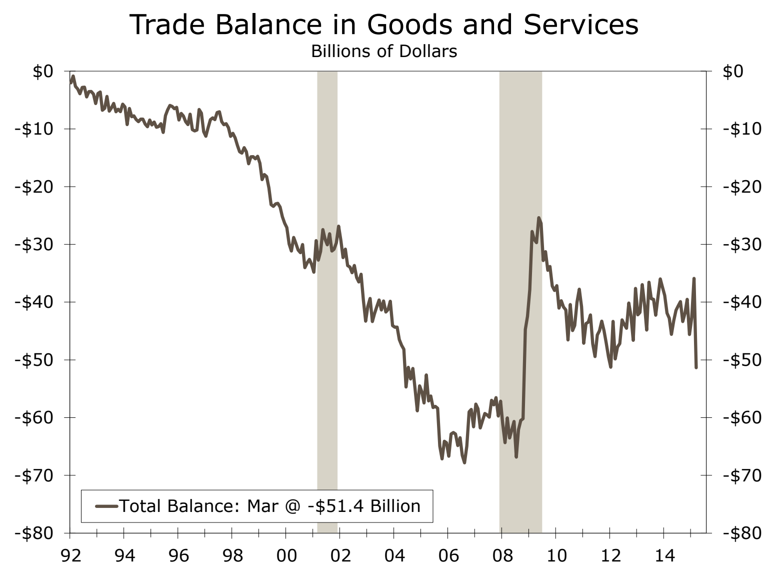
Nonfarm payroll data for April showed that 223,000 jobs were added for the month, with the unemployment rate falling to 5.4 percent. Among the key sectors adding jobs were construction, professional services, and education and health care services. Average hourly earnings rose 0.1 percent for the month. The downward revision to March's nonfarm number was a bit disappointing, with just 85,000 jobs added for the month. That said, the bounce-back in job growth in April is consistent with our views of a slightly stronger pace of economic growth as income growth prospects for the remainder of this year improve.

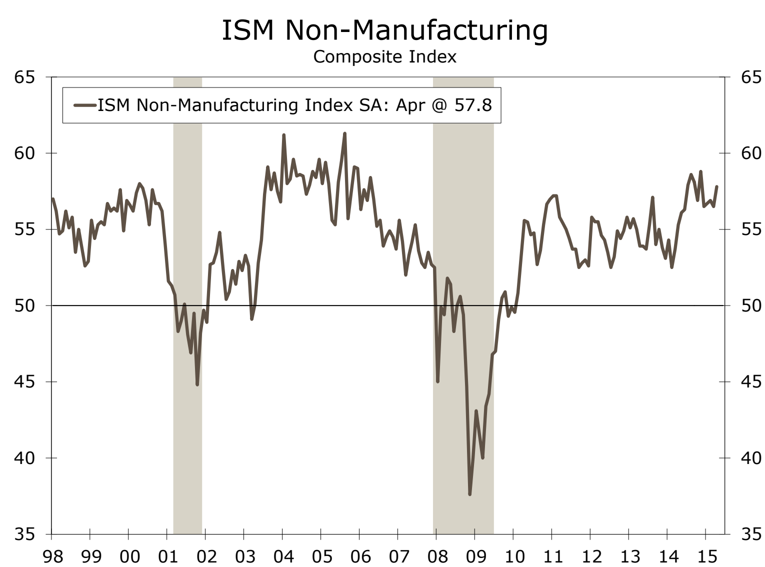
International trade data showed that imports surged, while exports only rose slightly, resulting in the largest monthly swing in the trade deficit on record. The surge in imports was mostly the by-product of the end of work stoppages related to West Coast port disruptions, while export growth remained restrained by slow global growth conditions. Going forward, we expect trade to continue to subtract from headline GDP growth as slow global growth conditions and a strong U.S. dollar weigh on export growth while domestic demand supports stronger import growth.

March factory orders data suggested that there would likely be little revision to equipment investment in the first quarter. The higher headline reading was supported by automobile and defense orders. Core capital goods shipments continued their slide in March, consistent with the nearly flat reading for equipment spending in Q1. The more forward looking new orders component, which is down 8.3 percent on a three-month annualized basis, suggests that challenges remain for equipment spending and the manufacturing sector as a whole in the second quarter.

One side of the economy that continues to show signs of expansion is the service sector. The Institute for Supply Management's (ISM) non-manufacturing index for April rose to 57.8 from March's 56.5 reading. The business activity component of the index rose to the highest reading since November and the jump in the new orders component suggests that there remains some forward momentum behind economic activity.







Source: U.S. Dept. of Labor, U.S. Dept. of Commerce, Institute for Supply Management and Wells Fargo Securities, LLC

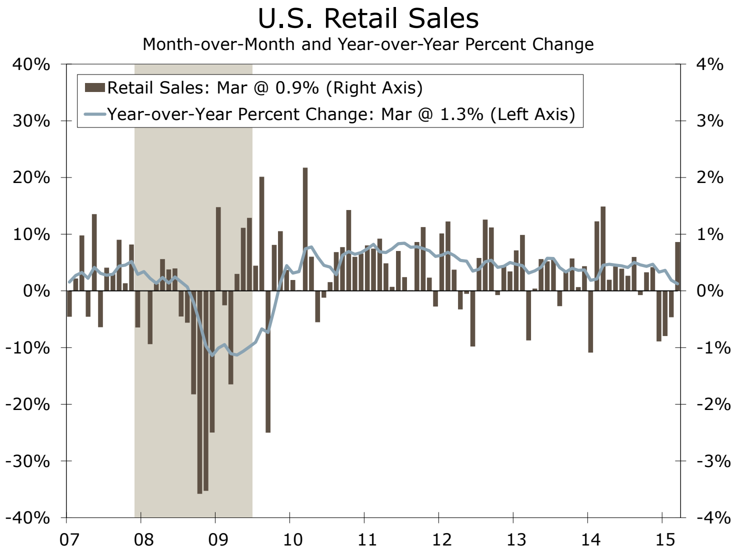
Retail Sales • Wednesday

Retail sales continued their string of disappointing prints in March. Although sales jumped 0.9 percent, the increase was less than markets were expecting after months of sales being held down by severe winter weather in some parts of the country and the price-related declines of sales at gasoline stations. Moreover, core sales came in lower than expected on top of a downward revision to February's figures.

Retail sales likely continued to recover in April, but at a more moderate pace. Additional spending at gasoline stations following another rise in gas prices over the month should lift the headline. Meanwhile, auto sales look to have fallen over the month, with only a 16.5 million unit annualized rate of sales compared to 17.1 million pace in March. We expect sales excluding autos to have increased 0.2 percent, as income growth from job gains and savings from still-low gasoline prices support consumer spending more broadly.

Previous: 0.9% **Wells Fargo: 0.0%**

Consensus: 0.2% (Month-over-Month)



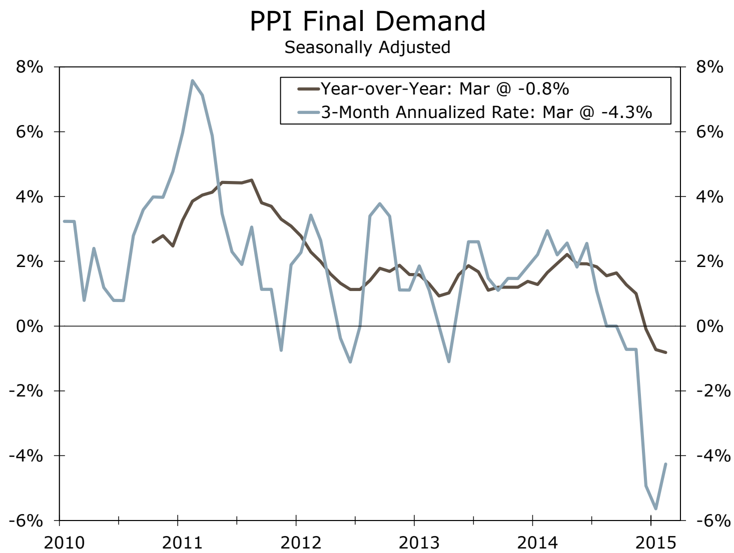
Producer Price Index • Thursday

The trend in inflation is beginning to show signs of turning around. After falling for four straight months, the producer price index (PPI) for final demand rose 0.2 percent in March. The increase was driven by a rebound in energy prices as well as pickup in core goods and services.

The PPI for final demand likely nudged up again in April. Another rise in oil and gasoline prices over the month should help lead the index 0.1 percent higher. Excluding energy, goods inflation likely remains modest as prices for processed and unprocessed non-energy inputs have fallen for four straight months. Prices for core services—which exclude trade, transportation and warehousing—have also picked up over the past two months and should support further gains in the PPI over the next few months.

Previous: 0.2% **Wells Fargo: 0.1%**

Consensus: 0.1% (Month-over-Month)



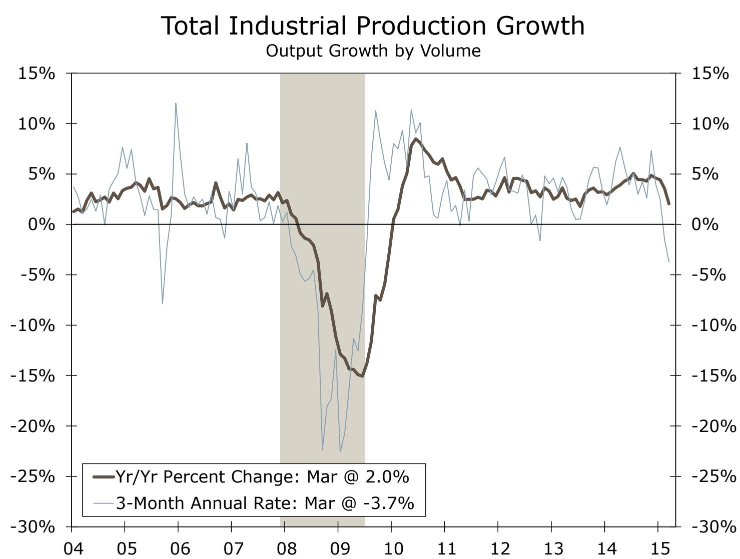
Industrial Production • Friday

Activity in the industrial sector has sputtered in recent months. The collapse in oil prices, supply chain disruptions due to the West Coast port strike and the stronger value of the dollar have all been factors in industrial production's 1.0 percent slide since November. Although March's 0.6 percent drop was largely due to weather, details continued to suggest that the manufacturing and mining industries are still under pressure.

We expect activity remained subdued in April. The ISM manufacturing index was unchanged in April and suggests activity is increasing only modestly, while aggregate hours worked rebounded only partially from declines in the past two months. Mining output likely declined for a fourth-straight month on another pullback in drilling activity. Utilities should have little effect on the headline this month given that average temperatures across the country were only slightly above normal.

Previous: -0.6% **Wells Fargo: -0.1%**

Consensus: 0.0% (Month-over-Month)



Source: U.S. Dept. of Commerce, U.S. Dept. of Labor, Federal Reserve Board and Wells Fargo Securities, LLC

Global Review

Foreign Economic Growth Remains Mixed

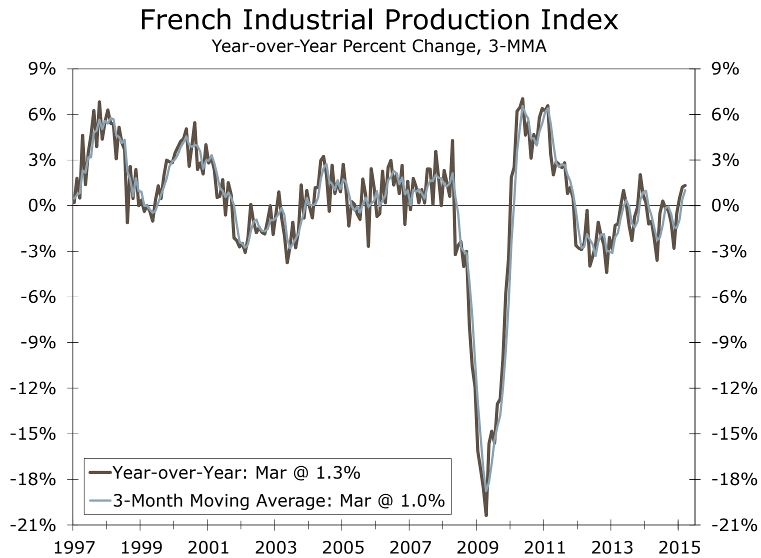
Recently released data show that the modest cyclical upswing that appears to be underway in the Eurozone may be gathering a bit more steam. French industrial production (IP) edged lower in March, but it was the first monthly decline since November. Strength in the previous three months translated into a 1.4 percent (not annualized) rise in IP in Q1 relative to the previous quarter, the strongest quarterly increase in four years. On a year-over-year basis, French IP growth also moved into positive territory in the first quarter (top chart).

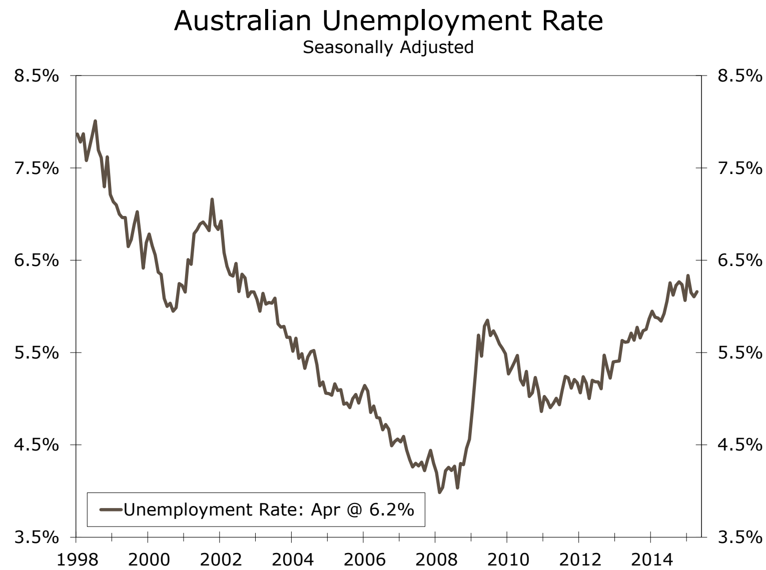
Italian and German IP growth rates were not nearly as impressive—they rose 0.4 percent and 0.5 percent, respectively, on a sequential basis in Q1—but they were strong enough to essentially guarantee that IP growth in the overall euro area was positive in the first quarter. Moreover, the manufacturing and service sector PMIs both remained well above the demarcation line separating expansion from contraction in April, suggesting that positive momentum has continued into the second quarter (see graph on front page).

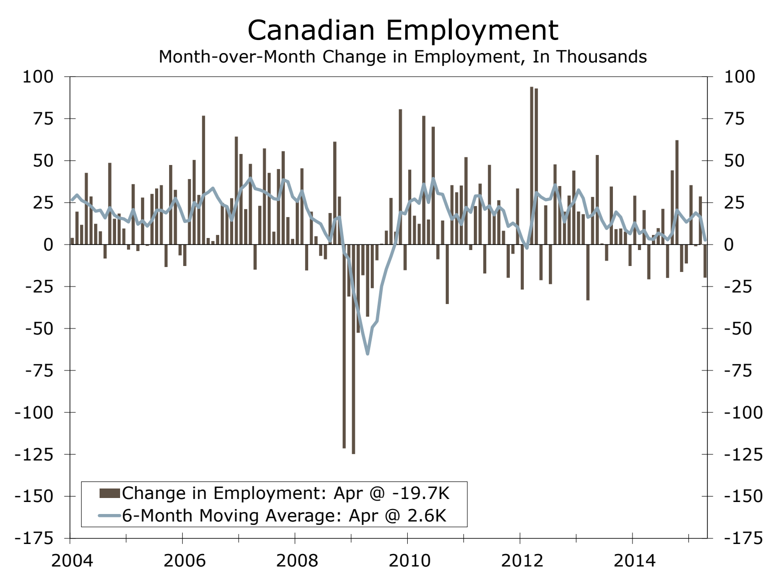
Whereas growth in Europe appears to be strengthening, at least at the margin, economic growth in Australia has been, and likely will continue to be, lackluster. In response to the tepid economic outlook, the Reserve Bank of Australia (RBA) cut is main policy rate by 25 bps this week, the second time since early December that the RBA has eased policy.

The slowdown in China has weakened demand for many of Australia's commodities, thereby leading to cutbacks in the country's mining sector. The RBA noted that "weakness in business capital expenditure in both the mining and non-mining sectors over the coming year" likely will exert restraint on private demand. The RBA went on to say that the economy likely will be "operating with a degree of spare capacity for some time yet." Indeed, the unemployment rate in Australia has trended higher for the past three years and shows little signs yet of reversing course (middle chart). Although most analysts believe that the RBA is now done cutting rates, there is essentially universal agreement that it won't be tightening policy anytime soon.

Production of commodities is also important to the Canadian economy, and there appear to be some signs of slowing growth in Canada as well. Employment in Canada fell by 19,700 in April, although the entire decline was attributable to a big drop in the number of part-time employees. The 46,900 rise in full-time employment in April was very strong. Because the monthly changes tend to be so volatile, we prefer to look at the six-month moving average of the monthly changes to get a sense of the underlying trend in employment growth. In that regard, non-farm payrolls have risen only 2,600 per month on average over the past six months (bottom chart). With core CPI inflation near the Bank of Canada's 2 percent inflation target at present, policymakers probably do not feel compelled to cut rates at this time. However, the Bank appears to be in no hurry to raise rates either due to signs of sluggish economic growth.







Source: IHS Global Insight and Wells Fargo Securities, LLC

U.K. Industrial Production • Tuesday

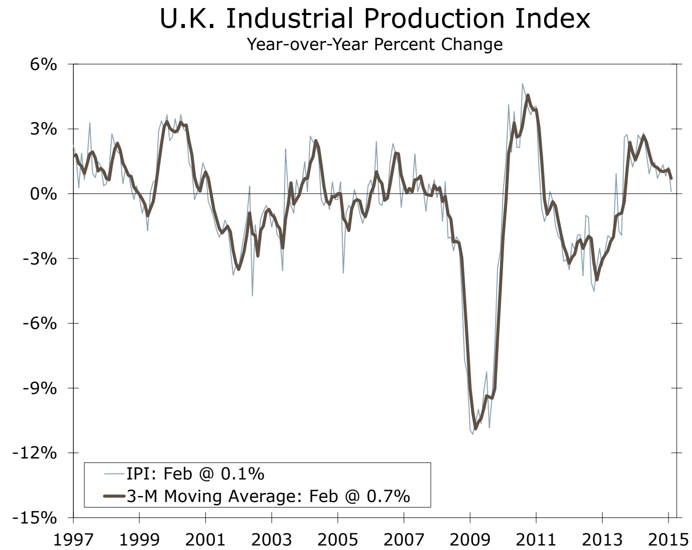
As recently as autumn of last year, official comments from Bank of England Governor Mark Carney and members of the Bank's Monetary Policy Committee were steering financial market expectations in the direction of rate hikes early in 2015.

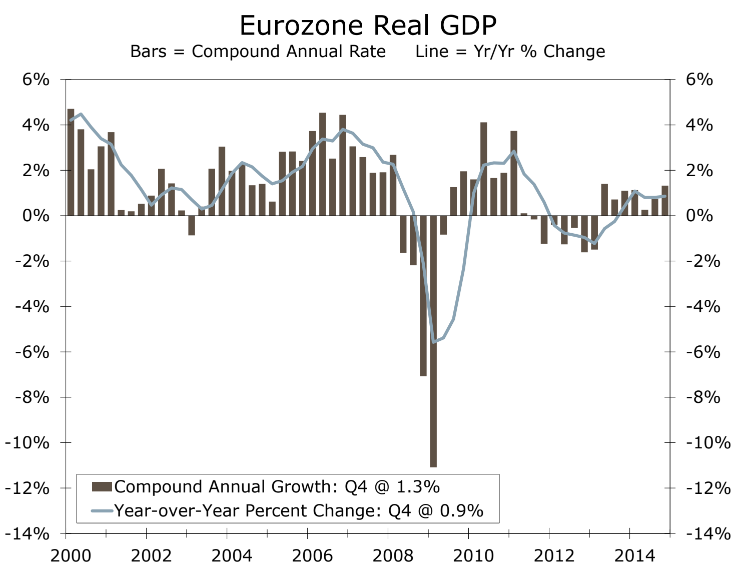
However, with the marked decline in CPI inflation in the second half of 2014 and indications that robust growth in the U.K. economy had slowed (first quarter GDP was disappointing), the timing of eventual rate hikes continues to be pushed back.

In this week's Topic of the Week on page 7, we discuss the implications of this week's U.K. elections. Next week brings fresh data on output from the Tuesday release of industrial production figures for March. On the following day (Wednesday) financial markets will get an indication of labor market health when the March unemployment rate is released.

Previous: 0.1% (Year-over-Year)

Consensus: 0.0%





Eurozone GDP • Wednesday

Most of the attention directed to the Eurozone economy in recent months has been focused either on the Greek political situation and the possibility of Greek default or on the European Central Bank's move to finally implement quantitative easing after years of hand-wringing.

Throughout this period of uncertainty and volatility, we have maintained our view that the economy in the Eurozone would weather the volatility and continue to expand. In recent months, purchasing managers' surveys have continued to rise, indicating a pick-up in activity.

On Wednesday of next week, the first quarter GDP number will hit the wire. Our sense is that the Eurozone economy, supported by a pick-up in bank lending and a weaker euro, will post a growth rate of 0.5 percent (not annualized) for the period.

Previous: 0.3% **Wells Fargo: 0.5%**

Consensus: 0.4% (Quarter-over-Quarter, Not Annualized)

Chinese Industrial Production • Thursday

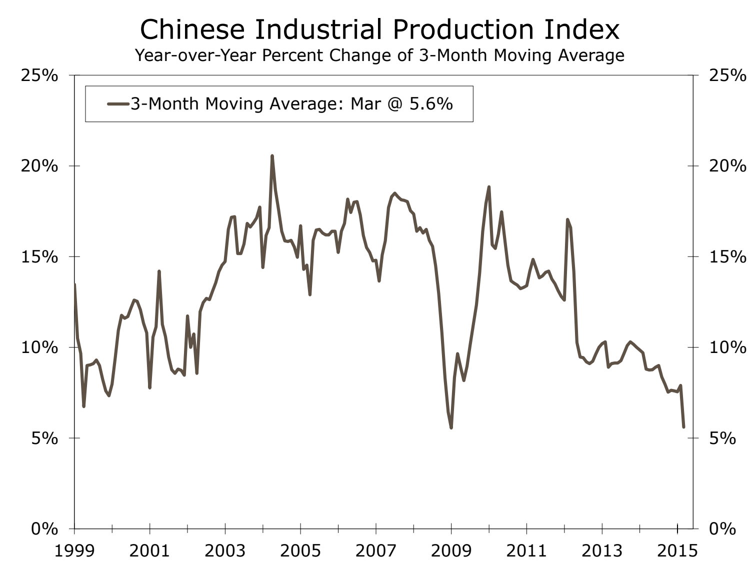
The Chinese economy has been experiencing some growing pains in recent months. On the upside, foreign interest in the Chinese-backed Asian Infrastructure Investment Bank lifts China's clout in the region. That said, the yuan is not yet widely held outside of China and thus is not an active international currency in practice, but its prospects in that regard are improving.

The world's second largest single-country economy is in the process of transitioning from a lending-fueled splurge on investment spending to one that derives more of its growth from domestic spending. First quarter GDP growth showed the year-over-year rate slowed to 7.0 percent, the weakest rate since 2009.

Next week, we will get an early look at second quarter output in China when April industrial production figures become available on Thursday.

Previous: 5.6% (Year-over-Year)

Consensus: 6.0%



Source: IHS Global Insight and Wells Fargo Securities, LLC

Interest Rate Watch

Deciphering the Back-Up in Rates

After a nearly uninterrupted year-long decline, the yield on the German Bund has finally turned around in recent weeks. The yield 10-year U.S. Treasuries has also backed up recently, causing a reversal of some of the yield curve flattening that has characterized the market over the past year or so (top chart).

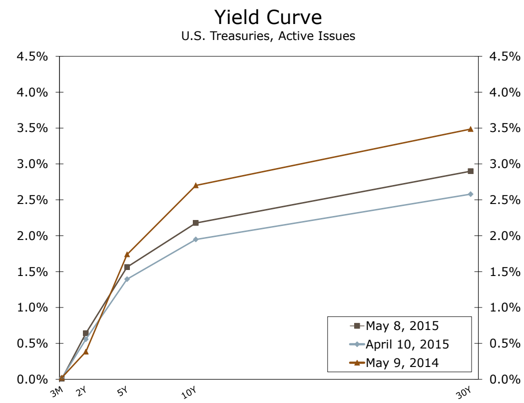
The uptick in the trend for longer-term U.S. Treasury rates in recent months is consistent with inflation looking to be on firmer footing. Much of the firming in inflation recently can be attributed to the rebound in oil and gasoline prices, which has also helped to quell some of the broader uncertainty in financial markets and perhaps reduced flows to Treasuries as a safe haven. In addition, the upward trend may signal expectations for a fed funds rate hike later this year.

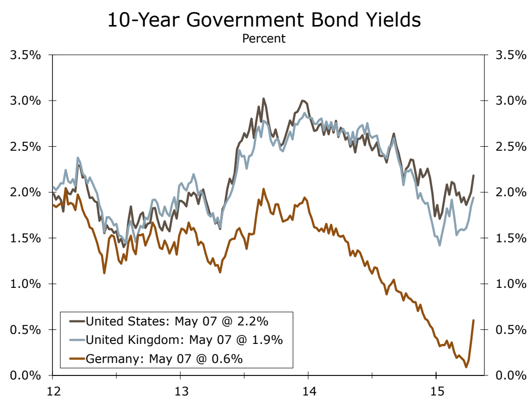
Looking to Europe, the inflation outlook is also showing signs of firming. Indeed, Eurozone CPI inflation is no longer in negative territory, and general inflation expectations in the currency union have trended higher over the past few months. However, while the inflation outlook has also improved in the Eurozone, the coexistence of the rise in German yields (middle graph) may also reflect the move away from the safe-haven play as the Greek situation appears to be less extreme in its risk of contagion.

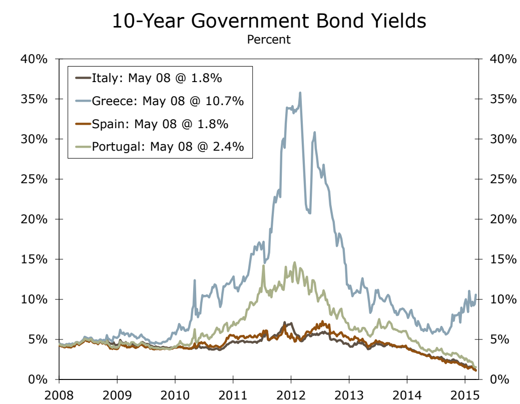
Greece: The Counter Case

In contrast to the global pattern of yield movements since late last year, there is the case of Greece (bottom graph). While Greek rates have risen, there has been no such commensurate increase in Spanish, Italian or Portuguese yields. Compare this to the situation a few years ago, when fears of Greek contagion were more widespread and yields in Portugal spiked.

Once again, this influence reflects the dynamic nature of financial markets. While the Greek issues once appeared to influence other Southern European yields, fears of spillover effects from the Greek debt situation seem to have generally subsided. Markets evolve over time as the factors that influence markets evolve.







Source: IHS Global Insight, Bloomberg LP and Wells Fargo Securities, LLC

Credit Market Insights

Mortgage Market Improving

Mortgage delinquencies continued to decline in the first quarter according to the Mortgage Bankers' Association (MBA) National Delinquency Survey. The delinquency rate declined to 5.5 percent in the first quarter, the lowest level since 2007. The delinquency rate decreased for both prime and subprime loans, falling to 3.2 percent and 17.6 percent, respectively. An improving labor market, rising home prices and increasing home sales were cited as reasons for the increase.

The states with the largest share of loans in foreclosure continue to be judicial states. Recall that the judicial foreclosure process takes much longer than the non-judicial process, explaining why these states have taken longer to recover. New Jersey, New York and Florida round-out the top three, and all have rates significantly above the national rate.

Recently released data from the Senior Loan Officer Opinion Survey showed that, on balance, banks continued to ease standards for the fourth consecutive quarter. The release also noted stronger demand for residential mortgages. Improving loan performance may have lead banks to ease lending standards. We must keep in mind, however, that delinquencies still remain elevated by historical standards. In addition, delinquency rates typically follow a very cyclical pattern.

Credit Market Data

Mortgage Rates	Current	Week Ago	4 Weeks Ago	Year Ago
30-Yr Fixed	3.80%	3.68%	3.67%	4.21%
15-Yr Fixed	3.02%	2.94%	2.94%	3.32%
5/1 ARM	2.90%	2.85%	2.88%	3.05%
1-Yr ARM	2.46%	2.49%	2.46%	2.43%
Bank Lending	**Current Assets (Billions)**	**1-Week Change (SAAR)**	**4-Week Change (SAAR)**	**Year-Ago Change**
Commercial & Industrial	$1,859.1	6.04%	9.87%	12.32%
Revolving Home Equity	$452.6	0.17%	-1.56%	-3.15%
Residential Mortgages	$1,600.3	28.70%	-1.12%	1.68%
Commerical Real Estate	$1,657.6	7.76%	5.09%	8.10%
Consumer	$1,212.3	6.03%	11.46%	4.52%

Source: Freddie Mac, Federal Reserve Board and Wells Fargo Securities, LLC

Topic of the Week

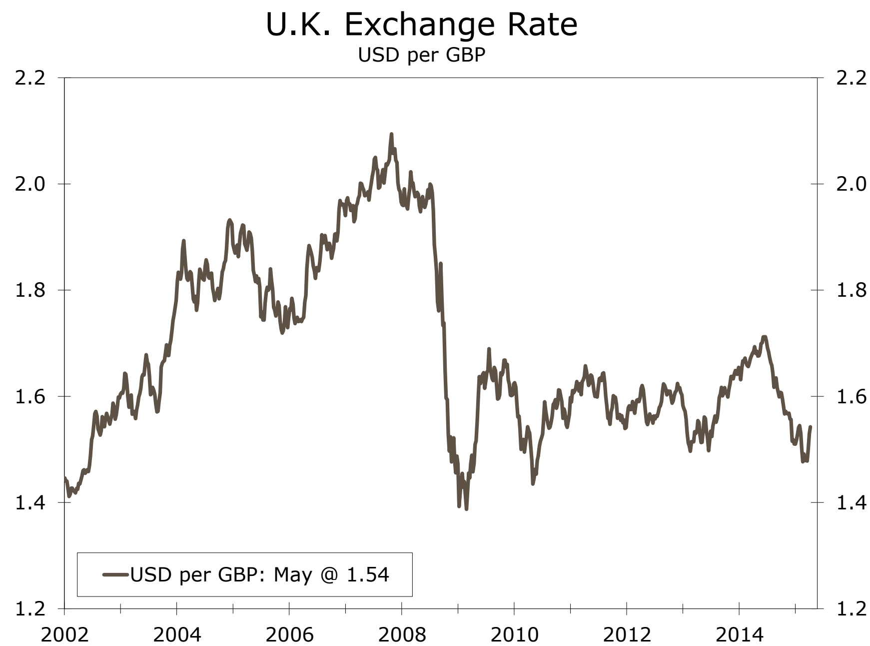
Cameron Wins Surprising Victory

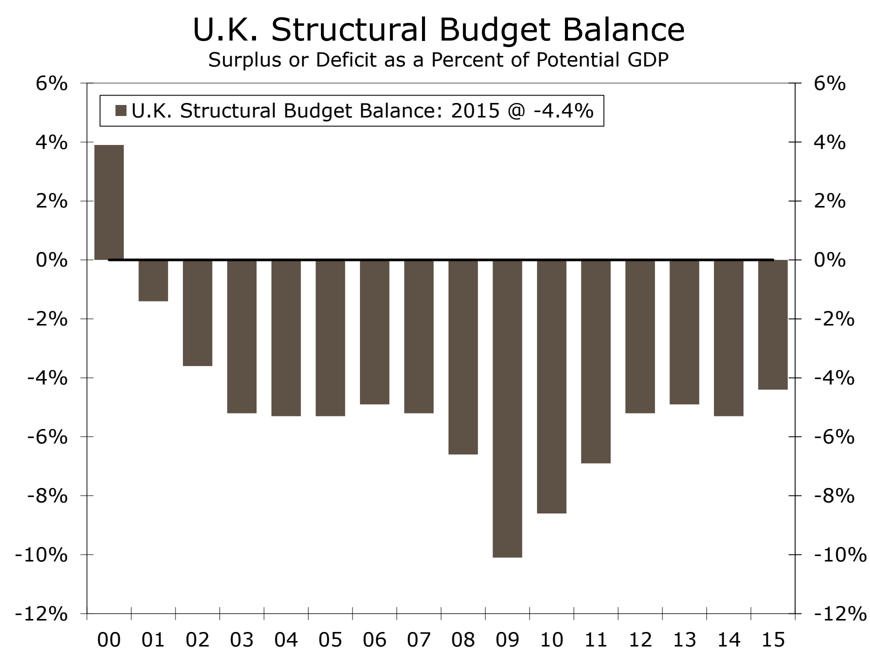
Following yesterday's voting in the United Kingdom, Prime Minister David Cameron will retain his residence at 10 Downing Street. Moreover, the Tories will be able to rule by themselves, rather than remain in coalition with the Liberal Democrats in Parliament. The British pound and the FTSE 100 stock index have moved higher in the immediate aftermath of the election as near-term political uncertainty has been reduced. Opinion polls had suggested that the election would be much closer than it actually was.

U.K. economic policy really will not change much. The government has been making progress, if only slowly, in reducing the structural budget deficit and Cameron has pledged to continue that policy in coming years. With the government's economic policy unchanged, the outlook for Bank of England monetary policy likely will not be altered to any great extent.

However, there are some longer-term risks to keep in mind. The Scottish National Party (SNP) swept the parliamentary seats allocated to Scotland, so the question of Scottish independence, which many observers thought was settled by last September's referendum vote in Scotland, may come back on the agenda. There are some politicians who want greater political powers devolved to England. (The sovereign state of the United Kingdom is a federation of four countries: England, Scotland, Wales and Northern Ireland.) In an extreme scenario, the United Kingdom could eventually split apart.

Cameron also pledged that, if returned to power, he would hold a referendum by 2017 on U.K. membership in the European Union (EU). There is, at best, lukewarm support for the EU in the United Kingdom, and it is impossible to predict what British voters would decide in any referendum. A British exit from the European Union, should it occur, could jeopardize the status of London as Europe's financial capital. Many businesses will now likely start to make contingency plans for a potential British exit from the EU.





Source: IHS Global Insight, OECD and Wells Fargo Securities, LLC

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 5/8/2015	1 Week Ago	1 Year Ago
3-Month T-Bill	0.00	0.00	0.03
3-Month LIBOR	0.28	0.28	0.22
1-Year Treasury	0.19	0.18	0.12
2-Year Treasury	0.56	0.60	0.39
5-Year Treasury	1.47	1.50	1.63
10-Year Treasury	2.11	2.11	2.62
30-Year Treasury	2.86	2.83	3.43
Bond Buyer Index	3.74	3.62	4.31

Foreign Exchange Rates

	Friday 5/8/2015	1 Week Ago	1 Year Ago
Euro ($/€)	1.123	1.120	1.384
British Pound ($/£)	1.545	1.515	1.693
British Pound (£/€)	0.727	0.739	0.817
Japanese Yen (¥/$)	119.750	120.150	101.660
Canadian Dollar (C$/$)	1.209	1.216	1.083
Swiss Franc (CHF/$)	0.929	0.932	0.880
Australian Dollar (US$/A$)	0.791	0.785	0.938
Mexican Peso (MXN/$)	15.119	15.542	12.947
Chinese Yuan (CNY/$)	6.209	6.203	6.228
Indian Rupee (INR/$)	63.938	63.423	60.060
Brazilian Real (BRL/$)	2.985	3.015	2.215
U.S. Dollar Index	94.655	95.297	79.361

Foreign Interest Rates

	Friday 5/8/2015	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	-0.02	-0.01	0.31
3-Month Sterling LIBOR	0.57	0.57	0.53
3-Month Canada Banker's Acceptance	1.00	1.00	1.27
3-Month Yen LIBOR	0.10	0.10	0.14
2-Year German	-0.21	-0.22	0.12
2-Year U.K.	0.52	0.55	0.72
2-Year Canadian	0.66	0.71	1.07
2-Year Japanese	0.02	0.01	0.09
10-Year German	0.55	0.37	1.45
10-Year U.K.	1.88	1.84	2.64
10-Year Canadian	1.68	1.66	2.37
10-Year Japanese	0.42	0.36	0.61

Commodity Prices

	Friday 5/8/2015	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	59.44	59.15	100.26
Gold ($/Ounce)	1188.17	1178.59	1289.30
Hot-Rolled Steel ($/S.Ton)	445.00	462.00	684.00
Copper (¢/Pound)	292.75	293.15	308.25
Soybeans ($/Bushel)	9.75	9.69	14.61
Natural Gas ($/MMBTU)	2.87	2.78	4.57
Nickel ($/Metric Ton)	14,099	13,391	18,625
CRB Spot Inds.	474.52	472.10	542.98

Source: Bloomberg LP and Wells Fargo Securities, LLC

Next Week's Economic Calendar

	Monday 11	Tuesday 12	Wednesday 13	Thursday 14	Friday 15
U.S. Data		**NFIB Small Business Optimism** March 95.2 April 96.0 (C) **JOLTS** February 5133	**Retail Sales (MoM)** March 0.9% April 0.0% (W) **Import Price Index (MoM)** March -0.3% April 0.3% (W)	**PPI Final Demand (MoM)** March 0.2% April 0.1% (W)	**Industrial Production** March -0.6% April -0.1% (W) **TIC** February $9.8B
Global Data			**Eurozone** **GDP (YoY)** Previous (Q4) 0.9% **China** **Industrial Production (YoY)** Previous (March) 5.6%	**Japan** **PPI (YoY)** Previous (March) 0.7%	**Russia** **GDP (YoY)** Previous (Q4) 0.4%

Note: (W) = Wells Fargo Estimate (C) = Consensus Estimate

Source: Bloomberg LP and Wells Fargo Securities, LLC

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