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Economics Group

Long-Run Forecast

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The Long Road Back to A Different Normal

Each generation seeks its truth, so do economic benchmarks. Our long-term outlook is consistent with the view that it will be several years before the fed funds rate will be back to its longer-run level.

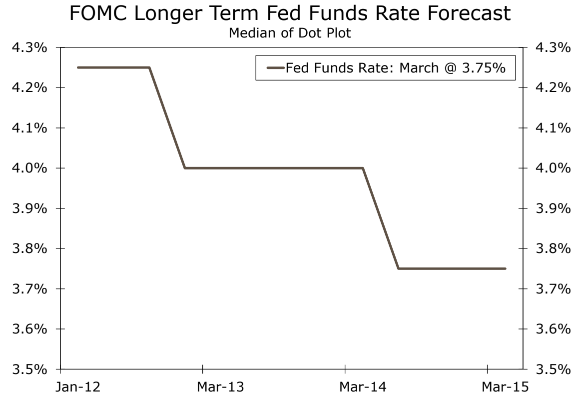
"The Future Ain't What It Used to Be"

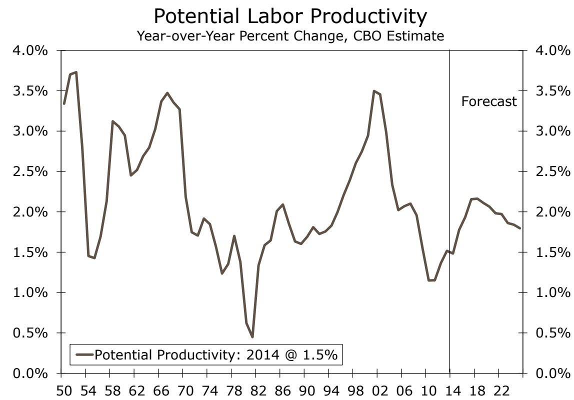
Just as with Federal Reserve officials, Yogi Berra's words tend to be incredibly insightful. Expectations for long-term economic growth and the interest rate environment over the long term have been consistently scaled back in recent years. One easy way to see this view is the Federal Reserve's expectations for the long-term federal funds rate, which is published four times a year as part of the forecast summary package following every other Federal Open Market Committee (FOMC) meeting. Expectations for the long-term federal funds rate have been steadily scaled back since the FOMC began regularly publishing forecasts for the fed funds rate in 2012. In the January 2012 forecast, just one FOMC participant put the long-run federal funds rate below 4 percent. The most recent report puts the central tendency of the FOMC's long-run federal funds rate forecasts at 3.75 percent (top chart), and more Fed participants had the long-run funds rate at 3.50 percent than at any other level.

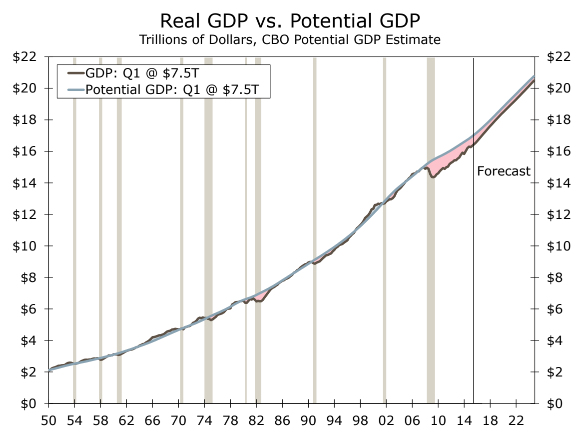
Reductions in the Fed's expectations for the long-run federal funds rate mirror the pullback in their expectations for long-term real GDP growth. Back in January 2012, the central tendency for the FOMC's long-run real GDP forecast was 2.3 to 2.6 percent. Today the central tendency is 2.0 to 2.3 percent. Long-run real GDP forecasts from the Congressional Budget Office and the Office of Management and Budget have also been steadily scaled back over this same time period. Expectations for long-run inflation, however, have remained firmly anchored at two percent.

The drop in long-run growth expectations is tied to both cyclical and structural factors. The unusual depth of the Great Recession led to significant labor market distortions that have produced a lasting drag on labor force growth. Productivity growth (middle chart) has also slowed in a meaningful way, as the deep recession has slowed capital formation. While conditions have improved slightly over the past few years, there is no quick way to reverse the slowdown in both labor force and productivity growth.

Long-run economic forecasts do not typically incorporate the business cycle. Our long-run forecast builds on our May GDP forecast, which runs through the fourth quarter of 2016. We feel that the potential growth rate of the economy has decreased. That said, economic growth from 2015 to 2018 is expected to be above its long-run trend, leading to a reduction in the output gap (red area in bottom chart). Our forecast is consistent with the view that the federal funds rate will not return to its normal, long-run level for at least several years. We have the federal funds rate coming back to 3.50 percent near the end of the decade. Long-term interest rates are also expected to rise gradually, although there will undoubtedly be a great deal of volatility along the way. Moreover, the yield curve is expected to flatten considerably, as short-term interest rates rise more than long-term rates.







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

Wells Fargo U.S. Economic Long-Term Forecast

	Actual			Forecast							
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022-2026
Real Gross Domestic Product (a)	2.3	2.2	2.4	2.2	2.9	2.8	2.6	2.4	2.2	2.2	2.2
Blue Chip Consensus	N/A	N/A	N/A	2.5	2.8	2.6	2.5	2.4	2.4	2.4	2.3
CBO Forecast	N/A	N/A	N/A	2.8	3.0	2.7	2.2	2.1	2.2	2.2	2.1
Nominal GDP	4.2	3.7	3.9	3.3	4.9	5.0	5.0	4.7	4.4	4.3	4.2
Inflation Indicators (a)											
GDP Deflator	1.8	1.5	1.5	1.1	2.0	2.3	2.4	2.3	2.2	2.1	2.0
Consumer Price Index	2.1	1.5	1.6	0.1	2.2	2.5	2.6	2.5	2.4	2.3	2.1
Unemployment Rate	8.1	7.4	6.2	5.4	5.0	4.8	4.4	4.2	4.0	4.2	4.8
Quarter-End Interest Rates (b)											
Federal Funds Target Rate	0.25	0.25	0.25	0.44	1.56	2.50	2.90	3.30	3.50	3.40	3.30
3 Month LIBOR	0.43	0.27	0.23	0.56	1.76	2.60	3.00	3.40	3.60	3.50	3.40
Prime Rate	3.25	3.25	3.25	3.44	4.56	5.50	5.90	6.30	6.50	6.40	6.30
Conventional Mortgage Rate	3.66	3.98	4.17	4.05	4.51	5.30	5.50	5.70	5.90	5.80	5.70
3 Month Bill	0.09	0.06	0.03	0.39	1.67	2.60	3.00	3.30	3.50	3.40	3.30
6 Month Bill	0.13	0.09	0.06	0.49	1.73	2.70	3.10	3.40	3.60	3.50	3.40
1 Year Bill	0.17	0.13	0.12	0.56	1.78	2.80	3.20	3.50	3.70	3.60	3.50
2 Year Note	0.28	0.31	0.46	0.80	1.86	3.00	3.40	3.70	3.90	3.80	3.70
5 Year Note	0.76	1.17	1.64	1.68	2.27	3.40	3.80	4.00	4.20	4.10	4.00
10 Year Note	1.80	2.35	2.54	2.24	2.66	3.70	4.00	4.20	4.40	4.30	4.20
Blue Chip Consensus	N/A	N/A	N/A	2.20	3.00	3.70	4.20	4.40	4.60	4.60	4.50
CBO Forecast	N/A	N/A	N/A	2.80	3.40	3.90	4.20	4.50	4.60	4.60	4.60
30 Year Bond	2.92	3.45	3.34	2.93	3.42	4.00	4.30	4.40	4.60	4.50	4.40

Forecast through 2016 as of May 22, 2015
Long-term finanical forecast as of June 01, 2015 as submitted to Blue Chip
There are no assumptions of recessions in long-term forecasts
Notes: (a) Year-over-Year Percent Change
(b) Annual Averages

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