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Economics Group

Interest Rate Weekly

John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 410-3275
Mark Vitner, Senior Economist
mark.vitner@wellsfargo.com • (704) 410-3277
Michael A. Brown, Economist
michael.a.brown@wellsfargo.com • (704) 410-3278

Consumers Expect to Borrow More

Applications for consumer credit have declined slightly over the past year. Expectations for new mortgages and auto loans, however, have increased. Is this because of rising interest rates or higher expected income?

Rejection Rates Fall

Consumers have been marginally less likely to apply for credit from a year ago according to data from the Federal Reserve Bank of New York. The application rate for all types of credit, which is the share of respondents who applied for credit, fell from 43.2 percent a year ago to 40.0 percent earlier this year. Mortgage refinancing and credit card applications led the decline. Applications for auto loans declined slightly over the past year, but applications for new mortgages increased over the year.

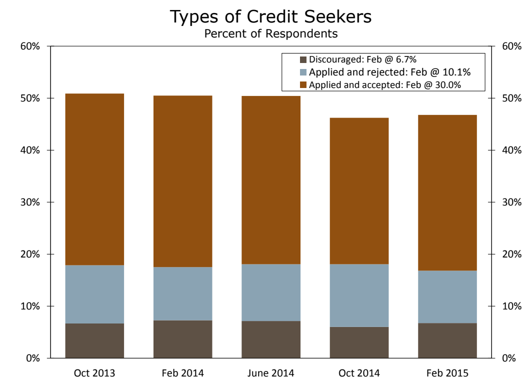
One notable change in the February survey results was the drop in rejection rates. The percentage of applicants who were rejected from one or more sources shrunk from 30.0 percent in October 2014 to 25.2 percent in February 2015. This decline was mainly coming from applicants with higher credit scores. Applicants with credit scores above 680 reported that they had better experiences obtaining credit in February, while the rejection rate for borrowers with credit scores lower than 680 increased to start the year. That said, all categories of borrowers saw their rejection rates decline from a year ago. In addition, the share of discouraged credit seekers, those who believed they wouldn't be approved despite their need for credit, dropped over the year, but ticked up to 6.7 percent to begin 2015.

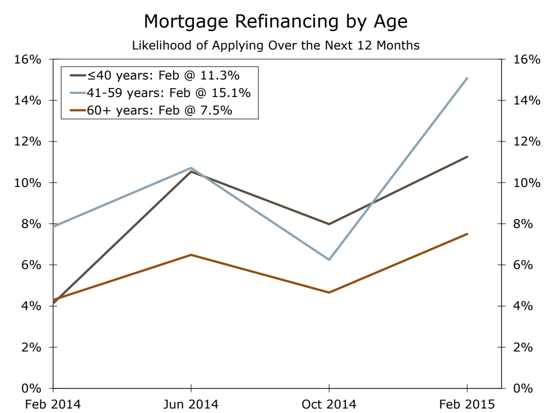
Likelihood of Applying for Credit on the Rise

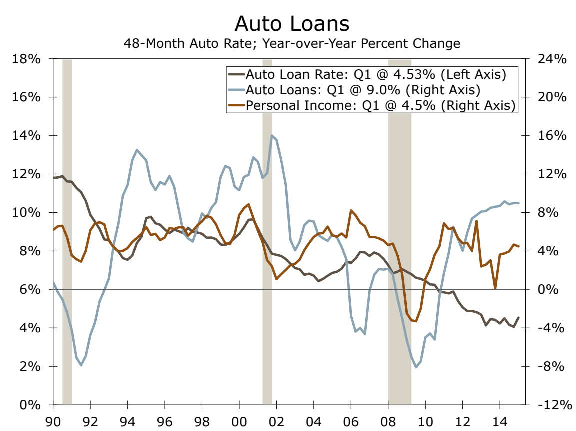
Turning toward consumers' expectations, the average likelihood of applying for credit over the next 12 months rose for each type of credit included in the survey. In particular, the share of respondents who expected to apply to refinance their mortgage over the next 12 months doubled from 6 percent in October 2014 to 12 percent in February 2015. This increase was mainly driven by the middle-aged group (ages 41 to 50), whose expectation of applying to refinance their mortgage jumped from 6 percent to 15 percent (middle chart).

The likelihood of applying for auto loans in the next 12 months rose in February's survey as well. Compared to a year ago, the share of respondents who expected to apply for an auto loan increased three percentage points from 8.6 percent to 11.6 percent. This may reflect consumers pulling demand forward amid expected increases in interest rates, likely providing a transitory boost, or an improved economic outlook, indicating stronger fundamentals. Historically, it is unclear which effect has dominated.

Once the Fed begins to raise the federal funds rate we expect long-term interest rates to move upward gradually as short-term rates rise. Expectations of rising interest rates later this year have already encouraged people to go ahead and take advantage of today's low interest rates, as the prospect of applying for one or more sources of credit rose from a year ago.







Source: Federal Reserve System, U.S. Department of Commerce, 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	0.25	0.50	0.75	1.00	1.25	1.75	2.25
3 Month LIBOR	0.23	0.23	0.24	0.26	0.27	0.28	0.70	0.95	1.20	1.45	1.95	2.45
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.50	3.75	4.00	4.25	4.75	5.25
Conventional Mortgage Rate	4.34	4.16	4.16	3.86	3.77	3.98	4.15	4.23	4.28	4.37	4.63	4.75
3 Month Bill	0.05	0.04	0.02	0.04	0.03	0.01	0.13	0.55	0.86	1.15	1.43	1.82
6 Month Bill	0.07	0.07	0.03	0.12	0.14	0.11	0.27	0.63	0.91	1.22	1.52	1.85
1 Year Bill	0.13	0.11	0.13	0.25	0.26	0.28	0.69	0.99	1.24	1.57	1.89	2.27
2 Year Note	0.44	0.47	0.58	0.67	0.56	0.64	0.86	1.08	1.27	1.72	2.04	2.48
5 Year Note	1.73	1.62	1.78	1.65	1.37	1.63	1.78	1.89	2.01	2.20	2.32	2.61
10 Year Note	2.73	2.53	2.52	2.17	1.94	2.35	2.41	2.49	2.55	2.66	2.80	2.91
30 Year Bond	3.56	3.34	3.21	2.75	2.54	3.11	3.18	3.22	3.27	3.34	3.55	3.72

Forecast as of: July 8, 2015

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

	2015	2016	2017
Change in Real Gross Domestic Product			
Wells Fargo	2.1	2.9	N/A
FOMC	1.8 to 2.0	2.4 to 2.7	2.1 to 2.5
Unemployment Rate			
Wells Fargo	5.2	4.8	N/A
FOMC	5.2 to 5.3	4.9 to 5.1	4.9 to 5.1
PCE Inflation			
Wells Fargo	1.0	2.0	N/A
FOMC	0.6 to 0.8	1.6 to 1.9	1.9 to 2.0

Forecast as of: July 8, 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: June 17, 2015

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

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Michael T. Wolf	Economist	(704) 410-3286	michael.t.wolf@wellsfargo.com
Erik Nelson	Economic Analyst	(704) 410-3267	erik.f.nelson@wellsfargo.com
Alex Moehring	Economic Analyst	(704) 410-3247	alex.v.moehring@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Cyndi Burris	Senior Admin. Assistant	(704) 410-3272	cyndi.burris@wellsfargo.com