Economics

WELLS FARGO

Weekly — February 2, 2024

# Weekly Economic & Financial Commentary

United States: **A March Rate Cut Bites the Dust**

- It was a busy week for economic data, but Friday's employment report stole the show. Nonfarm payrolls rose 353K in January, almost double the consensus expectation. While we suspect the Federal Reserve will put more weight on the Employment Cost Index's soft reading on labor cost growth in Q4, the pickup in average hourly earnings and overall strength in hiring suggest the odds of a rate cut in March are quickly fading.
- Next week: ISM Services (Mon.), Trade Balance (Wed.), Consumer Credit (Wed.)

International: **Eurozone Inflation Slows as Growth Remains at a Standstill**

- Eurozone GDP was flat in Q4, while CPI inflation eased slightly further in January. As long as growth remains weak and inflation trends keep improving, we believe the European Central Bank could cut its policy rate as early as April. This week also saw monetary policy announcements from several other foreign central banks, which saw rate cuts delivered in Brazil, Chile, Colombia and Hungary and rates held steady in the United Kingdom and Sweden.
- Next week: RBA Policy Rate (Tue.), Japan Labor Cash Earnings (Tue.), Banxico Policy Rate (Thu.)

Interest Rate Watch: **FOMC Removes "Bias" to Tighten**

- As universally expected, the FOMC decided to make no changes to its monetary policy stance, keeping the fed funds target range at 5.25%-5.50% and maintaining the current pace of quantitative tightening. Importantly, the Committee removed its implicit "bias" to tighten policy further in its post-meeting statement.

Topic of the Week: **China's Property Crisis Grows Ever Grander**

- On Monday, a Hong Kong court ordered the liquidation of Evergrande, China's second-largest property developer, marking the most significant blow yet to China's struggling real estate sector. China's real estate crisis has intensified over the past couple of years, but challenges for the sector have been evident for some time.

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**Wells Fargo U.S. Economic Forecast**

| | Actual 2023 | | | | Forecast 2024 | | | | Actual | | Forecast | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | 2022 | 2023 | 2024 | 2025 |
| Real Gross Domestic Product [1] | 2.2 | 2.1 | 4.9 | 3.3 | 1.4 | 1.1 | 0.5 | 1.0 | 1.9 | 2.4 | 1.7 | 1.7 |
| Personal Consumption | 3.8 | 0.8 | 3.1 | 2.8 | 1.0 | 0.5 | 0.5 | 1.1 | 2.5 | 2.2 | 1.3 | 1.4 |
| Consumer Price Index [2] | 5.8 | 4.1 | 3.6 | 3.2 | 2.9 | 2.8 | 2.4 | 2.3 | 8.0 | 4.1 | 2.6 | 2.3 |
| "Core" Consumer Price Index [2] | 5.6 | 5.2 | 4.4 | 4.0 | 3.6 | 3.2 | 3.0 | 2.7 | 6.1 | 4.8 | 3.1 | 2.4 |
| Quarter-End Interest Rates [3] | | | | | | | | | | | | |
| Federal Funds Target Rate[4] | 5.00 | 5.25 | 5.50 | 5.50 | 5.50 | 5.00 | 4.50 | 4.25 | 2.02 | 5.23 | 4.81 | 3.63 |
| Conventional Mortgage Rate | 6.54 | 6.71 | 7.20 | 6.82 | 6.80 | 6.60 | 6.35 | 6.05 | 5.38 | 6.80 | 6.45 | 5.76 |
| 10 Year Note | 3.48 | 3.81 | 4.59 | 3.88 | 4.00 | 3.85 | 3.70 | 3.60 | 2.95 | 3.96 | 3.79 | 3.51 |

Forecast as of: January 12, 2024 [1] Compound Annual Growth Rate Quarter-over-Quarter [2] Year-over-Year Percentage Change
[3] Quarterly Data - Period End; Annual Data - Annual Averages [4] Upper Bound of the Federal Funds Target Range

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

Please see our full U.S. Economic Forecast.

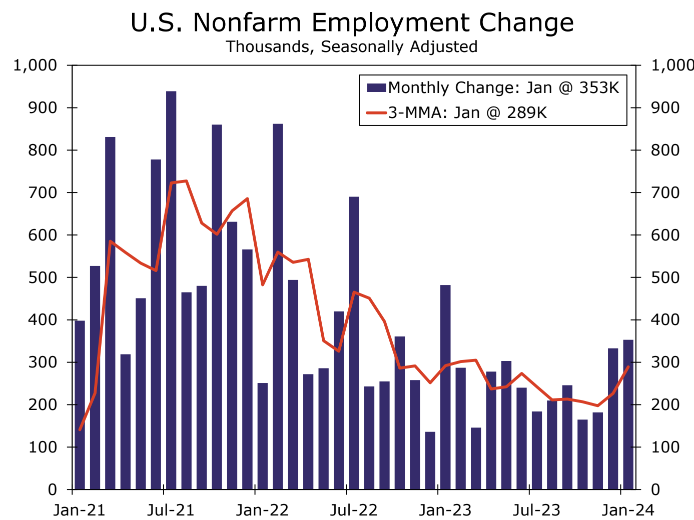
# U.S. Review

## A March Rate Cut Bites the Dust

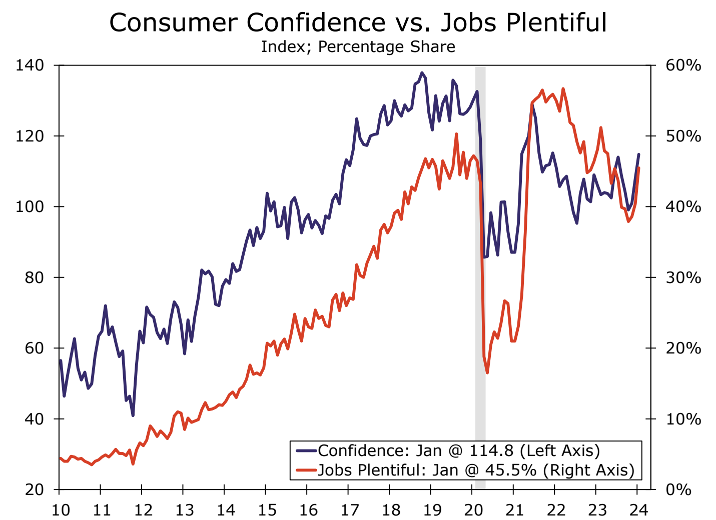
It was a busy week for economic data, but Friday's employment report stole the show. Nonfarm payrolls rose 353K in January, almost double the consensus expectation. Hefty upward revisions to the prior two months of data also show a stronger pace of hiring during the fourth quarter than previously reported (chart). Throughout 2023, employment increased at an average of 255K per month, which marks a deceleration from 2022, but is a stronger pace of payroll expansion relative to 2019.

Employment growth has come up against a tight supply of workers. The unemployment rate held steady at 3.7% for the third month in a row, and the labor force participation rate was flat at 62.5%. Average hourly earnings growth posted a stronger-than-expected 0.6% increase over the month, bringing the year-ago change up 0.2 percentage points to 4.5%. The outturn comes in contrast to the Q4 Employment Cost Index (ECI), which signaled the labor market's inflationary impulse is easing as compensation costs posted their smallest increase in two years. We suspect the Federal Reserve will put more weight on the ECI's reading, but the pickup in average hourly earnings and overall strength in hiring suggests the odds of a rate cut in March are quickly fading; see Interest Rate Watch for more detail.

Separately released data from the Job Openings and Labor Turnover Survey show labor demand and supply coming into better balance. Over the course of 2023, the job vacancy rate fell one percentage point to 5.4% in December, while the layoff rate was essentially flat at 1.0% and the quits rate softened to 2.2%. The easing in job availabilities amid low employee churn suggests that employers are holding onto their existing workers.




Source: U.S. Department of Labor and Wells Fargo Economics




Source: The Conference Board and Wells Fargo Economics

Despite the trend moderation in job vacancies, consumers' perceptions of the jobs market have materially improved in recent months. The share of consumers who rated jobs as "plentiful" rose 5.1 percentage points to 45.5% in January, while the share of consumers who rated jobs as "hard to get" fell 3.3 percentage points to 9.8%. All told, consumers feel fairly confident about their job prospects, which led the headline Consumer Confidence Index to a two-year high of 114.8 in January (chart).

While confidence has turned a corner amid labor market optimism, consumers' home buying plans continue to soften. The share of consumers that plan to buy a home within the next six months fell to 4.7% in January—the lowest since the summer of 2022. The mix of elevated borrowing costs and high home prices have crimped affordability. The average 30-year fixed mortgage rate has hovered around 6.6% over the past few weeks. Although that is down from a near 8% peak in October, mortgage rates are roughly three percentage points above the average that prevailed in 2019. At the same time, home prices are on the rise. The S&P CoreLogic Case-Shiller National Home Price Index rose 0.2% in November, bringing the year-over-year rate up to 5.1%.

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## U.S. Outlook

| Weekly Domestic Indicator Forecasts | | | | | |
|---|---|---|---|---|---|
| **Date** | **Indicator** | **Period** | **Consensus** | **Wells Fargo** | **Prior** |
| 5-Feb | ISM Services Index | Jan | 52.0 | 52.7 | 50.5 |
| 7-Feb | Trade Balance | Dec | -$62.2B | -$62.4B | -$63.2B |
| 7-Feb | Consumer Credit | Dec | $16.5B | — | $23.8B |

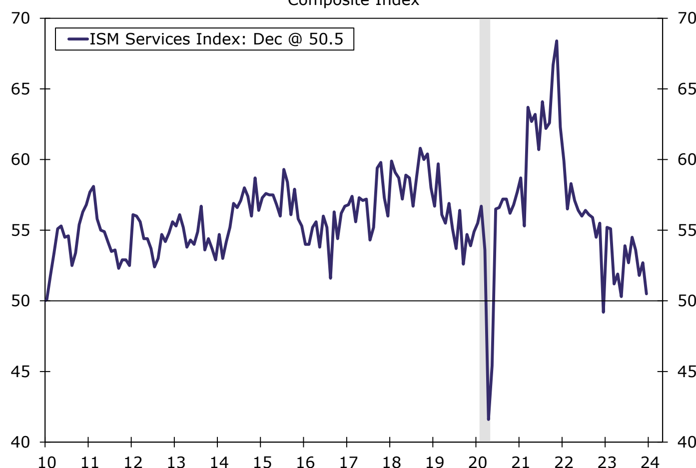
Forecast as of February 02, 2024

Source: Bloomberg Finance L.P. and Wells Fargo Economics

### ISM Services • Monday

The ISM services index declined two points to 50.5 in December, which brought the index to its lowest level of 2023. The main driver of the decline was a precipitous 7.4-point plunge in the employment component, bringing it to 43.3, or the lowest level outside the pandemic since 2009. Friday's employment report revealed payrolls in the private service-providing sector rose 289K in January, indicating the employment component of the ISM services index is in prime position to bounce back next week.

Taking a step back, the manufacturing and services sectors were on different paths throughout 2023. The ISM manufacturing index has been in contraction since late 2022, while the services index hasn't registered a reading below 50 since a brief one-month decline in December 2022. In contrast to the beleaguered manufacturing sector, the service sector is brimming with activity. The six-month moving averages for the business activity and new orders components sit at 56.5 and 54.7, respectively, with both comfortably in expansionary territory. The downside of strong activity has been that services prices have been slow to cool. The prices paid component averaged 58.2 over the past six months, and it has not dipped below 50 since 2017. Indeed, core services inflation has been slower to improve relative to core goods, and we anticipate services prices to remain firm in the coming year. Next week, we look for the headline ISM services index to come in at 52.7, demonstrating continued strength in the services sector.

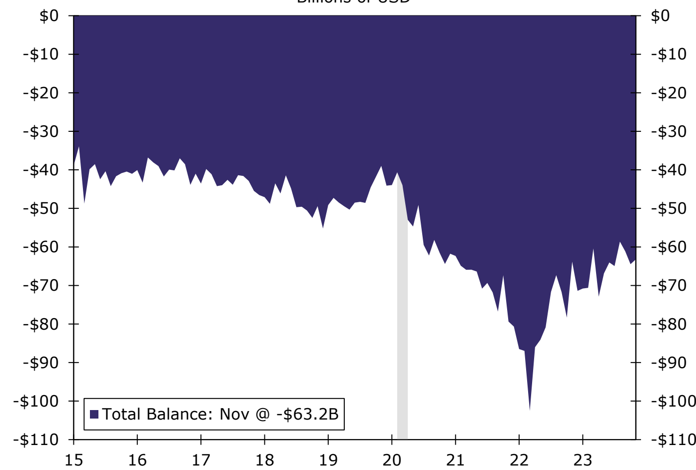


Source: Institute for Supply Management and Wells Fargo Economics

### Trade Balance • Wednesday

The international trade balance narrowed modestly in November, driven by a larger drop in imports than exports. International trade flows were generally weak in November due to the goods sector specifically. Both goods imports and exports declined on the month, falling 2.3% and 3.2%, respectively. Consumers goods imports and exports were particularly weak.

Looking ahead to December, the advance goods trade balance data released last week showed the merchandise goods trade balance narrowed $0.9B in December. Goods exports jumped 2.5% ($4.1B) on the month to $169.8B on a seasonally-adjusted basis, driven by a large increase in industrial goods exports that partially offset last month's decline in that category. Imports of goods rose a more tepid 1.3% ($3.2B) to $258.3B, driven by an increase in consumer goods specifically, also partially offsetting the previous month's declines. Demand for consumer goods imports was strong in December, as the holiday sales season was in full swing. For December's total trade balance, we look for the deficit to modestly narrow to -$62.4B.



Source: U.S. Department of Commerce and Wells Fargo Economics

## Consumer Credit • Wednesday

Household borrowing rose for the third straight month in November as consumers continued to reach for their credit cards. Total consumer credit outstanding rose $23.8 billion and surpassed $5 trillion for the first time ever. The main driver of this increase was revolving consumer credit, which accounted for $19.1 billion of the overall increase. Nonrevolving debt also contributed to the headline increase in November, though it was a more muted $4.6 billion gain and in line with the pace of increases in the prior two months.

Consumer credit is poised for another strong increase in December. Data released thus far indicate consumers continued to spend at a strong clip through December. Holiday sales increased 3.7% year-over-year on a non-seasonally adjusted basis, and this was no doubt in part financed through consumers reaching for their credit cards. In addition to the consumer credit release next Wednesday, the New York Fed will also be releasing its Q4-2023 Household Debt and Credit survey next Tuesday. This release will provide a more in-depth look at how the household debt situation evolved during the fourth quarter, including an update on household delinquencies.

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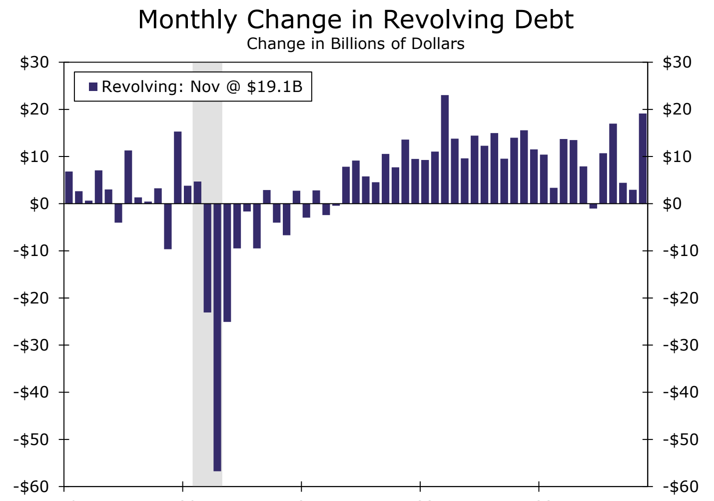


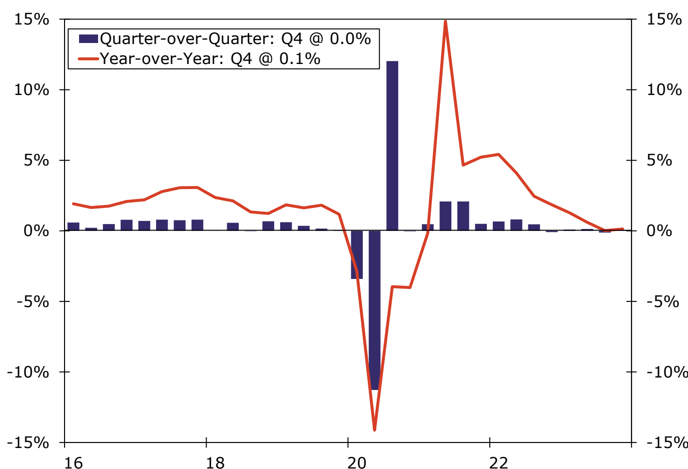

Source: Federal Reserve Board and Wells Fargo Economics

## International Review

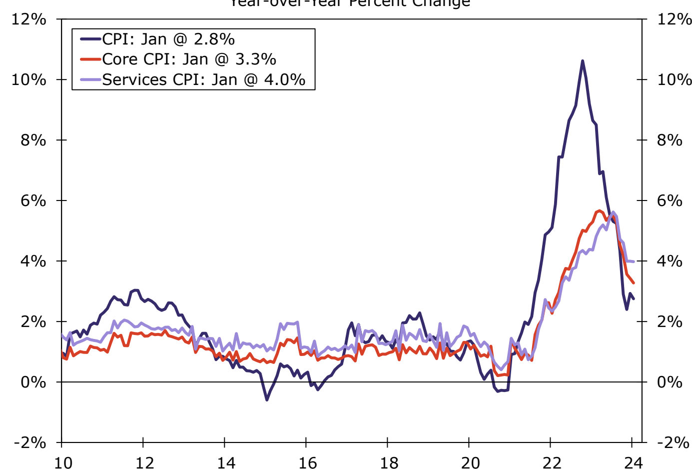
### Eurozone Inflation Slows as Growth Remains at a Standstill

This week's Eurozone data offered some key insights into the state of the region's economy, with potential implications for the path of European Central Bank (ECB) monetary policy in the months ahead. The Eurozone economy underwhelmed in Q4, with GDP unchanged quarter-over-quarter. However, while far from impressive, the outcome was actually slightly better than the 0.1% quarter-over-quarter decline forecast by consensus economists. It also meant that, for now, the Eurozone avoided a technical recession—two consecutive quarters of negative GDP growth—during the second half of last year. With respect to the region's largest economies, German GDP shrank 0.3% quarter-over-quarter, French GDP was unchanged, Italy's GDP rose 0.2% and Spain's GDP rose by a more solid 0.6%. Even though the Eurozone has avoided recession, it has stuttered in recent quarters, and as a result, Eurozone Q4 GDP was up just 0.1% year-over-year.

Looking ahead, sentiment surveys remain at subdued levels, and both employment and real household income are growing at only a modestly positive pace. As a result, we do not expect a quick rebound in the Eurozone economy and forecast GDP growth of 0.7% for 2024, only slightly stronger than the 0.5% gain seen in 2023.



Source: Datastream and Wells Fargo Economics



Source: Datastream and Wells Fargo Economics

In this week's other key Eurozone release, the January CPI showed a deceleration in both headline and core inflation. January headline inflation eased to 2.8% year-over-year and core inflation eased to 3.3%, although services inflation was steady at 4.0%. While the deceleration was a bit less than expected, it did keep the overall disinflation trend intact. In fact, when measured on a three-month annualized basis, services and core CPI inflation already appear to be running at a pace broadly consistent with the ECB's 2% inflation target. As long as economic growth remains weak and underlying inflation ebbs further, we think the ECB will feel comfortable enough to begin lowering its policy interest rate with a 25 bps cut to 3.75% at its April monetary policy announcement. That said, we acknowledge the risks are tilted toward a later initial rate cut, at the ECB's June meeting.

The Bank of England (BoE) made its first monetary policy announcement of 2024 this week, holding its policy rate steady at 5.25%, as widely expected. There were mixed developments in the BoE's accompanying guidance, although overall its announcement was perhaps less dovish than expected. On the dovish side, the BoE did remove any reference to the potential for further tightening, with Governor Bailey adding that the central bank has taken away the upside bias on rates, and the question is now how long interest rates must stay on hold. However, that was offset by a hawkish message from the central bank's updated inflation forecasts, which suggested the monetary easing implied by market pricing might be slightly on the aggressive side. Based on the market-implied interest rate path, lower energy inflation initially sees U.K. inflation falling quickly to the 2% target in Q2-2024, but then rebounding and remaining above the inflation target for an extended period until Q2-2026. That's a longer period than policymakers would ideally prefer, in our view. BoE policymakers also appear to be split on the outlook for interest rates, with this week's meeting seeing one policymaker vote to

lower interest rates, six vote to hold rates steady and two vote for a rate hike. Against this backdrop, we remain comfortable with our outlook that an initial Bank of England rate cut will not come until the June monetary policy announcement.

In Sweden, this week's monetary policy announcement from the Riksbank was perhaps more dovish than expected. The Riksbank held its repo rate at 4.00%, but added that previous monetary tightening has contributed to lower inflationary pressures. While saying that restrictive monetary policy is still needed for now, the Riksbank said the economy has slowed down and inflation has fallen significantly. As a result, the Riksbank said its policy rate can be lowered sooner than indicated in its previous forecast from November. Indeed, the central bank said that if inflation prospects remain favorable, a policy rate cut during the first half of this year cannot be ruled out. Separately, and somewhat in contrast to other dovish details, the Riksbank decided to increase the pace of its bond sales to 6.5B krona per month (from 5B krona per month previously) as it shrinks the size of its balance sheet. Altogether, the dovish announcement keeps us comfortable with our existing outlook for Riksbank policy, which envisages an initial 25 bps rate cut coming during Q2-2024, most likely in June, but possibly in May.

## China's Economy Firms Modestly in Early 2024

China's official January manufacturing and service sector PMIs suggested the economy started 2024 on a modestly firmer note. The January manufacturing PMI rose to 49.2 (from 49.0 in December), slightly less than the consensus forecast for an increase to 49.3. The output component rose to 51.3, the highest level since September. However, the increase in the new orders component was more moderate, to 49.0, suggesting the improvement in manufacturing activity might not be sustained for an extended period. The January services PMI rose to 50.7 (from 50.4 in December), a bit more than the consensus forecast for an increase to 50.6. The new orders component edged up to 47.6, although the business activity expectations component slipped to 59.7. While some policy measures—such as a reduction in the People's Bank of China's Reserve Requirement Ratio, and the broadening access for property developers to commercial loans—could temporarily support growth, China's economy continues to face challenges. Given a declining and aging population, a still sluggish property sector, and geopolitical tensions, we expect growth to slow as the year progresses, and forecast GDP growth of 4.7% for full-year 2024.

It was also an active week for central banks across emerging economies. Brazil's Central Bank maintained the pace of its monetary easing, lowering its Selic Rate by 50 bps to 11.25%. The central bank said it sees a gradual disinflation process, and that it considered the current pace of easing as "appropriate to keep the necessary contractionary monetary policy for the disinflationary process." The central bank kept its inflation forecasts unchanged, and signaled that it anticipates further rate reductions of the same magnitude at upcoming meetings. In Chile, the central bank stepped up the pace of its rate cuts, lowering its policy rate by 100 bps to 7.25%. The central bank noted that inflation slowed more than expected in December, and that global inflation continues to ease. The central bank reiterated that the timing and magnitude of future moves will depend on new data, but with one policymaker voting for an even larger easing, it appears an accelerated pace of rate cuts could continue at upcoming meetings.

In Colombia, the central bank lowered its overnight lending rate less than expected, by 25 bps to 12.75%, compared to the consensus forecast for a 50 bps reduction. Central bank governor Villar said policymakers cut interest rates "in a cautious way to control the risks that a more accelerated reduction will lead to a situation in which the process has to be slowed down or even eventually reversed," and also observed that the increase in the minimum wage was above expectations. Still, there does appear to be potential for larger reductions going forward. While five policymakers voted for the 25 bps cut, two policymakers voted in favor of a larger 50 bps move. Finally, Hungary's central bank cut its policy rate at this week's meeting, but by a less-than-expected 75 bps to 10.00%. While receding inflation meant the central bank entertained thoughts of a larger 100 bps rate reduction, recent weakness in the forint ultimately saw policymakers maintain its 75 bps rate cut pace. Central bank policymakers indicated they will again consider both 100 bps and 75 bps moves next month.

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## International Outlook

| Weekly International Indicator Forecasts | | | | | |
|---|---|---|---|---|---|
| **Date** | **Indicator** | **Period** | **Consensus** | **Wells Fargo** | **Prior** |
| 6-Feb | Australia Policy Rate | 6-Feb | 4.35% | 4.35% | 4.35% |
| 6-Feb | Japan Labor Cash Earnings (YoY) | Dec | 1.3% | – | 0.7% |
| 8-Feb | Mexico Policy Rate | 8-Feb | 11.25% | 11.25% | 11.25% |

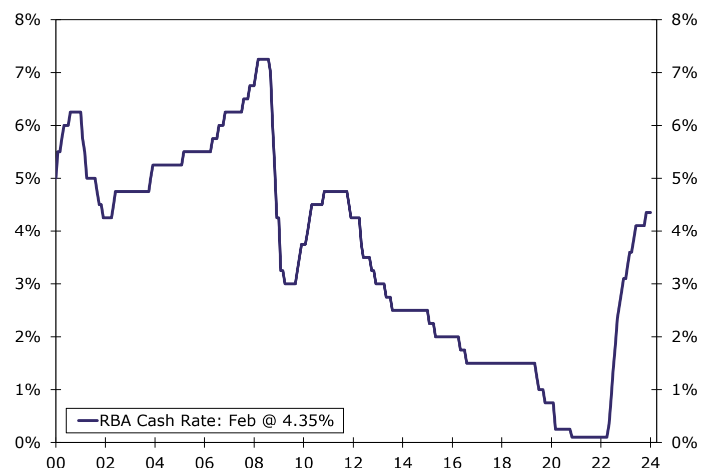
Forecast as of February 02, 2024

Source: Bloomberg Finance L.P. and Wells Fargo Economics

### Reserve Bank of Australia Policy Rate • Tuesday

When the Reserve Bank of Australia (RBA) meets next week, we suspect policymakers will opt to hold rates steady at 4.35% for a second consecutive meeting.

Although the RBA's December announcement left the door open for further rate hikes, our view is that the RBA's tightening cycle is over. This view stems from a variety of factors. For one, inflation has slowed meaningfully since late 2022, which was the year-over-year peak for headline and core measures. Wage growth is also not expected to accelerate much further in the months ahead. In addition, there are signs that higher interest rates are starting to crimp economic activity: Output growth has been below trend, and household consumption has shown weakness. Economic data released since the RBA's last meeting has been broadly consistent with these trends, with the unemployment rate edging higher in recent months, and Q4 headline and core inflation posting larger-than-expected declines. While the recent reworking of upcoming tax cuts will favor lower income earners and could offer some support to growth, we doubt that this will be particularly inflationary. All in all, these dynamics lead us to believe that the RBA is done hiking rates, although we do not think rate cuts are coming just yet. For now, inflation and wage growth are likely at levels still too high to be consistent with the 2%-3% inflation target. As a result, we expect the RBA to stay on hold next week and do not forecast an initial rate cut until Q3 of this year.

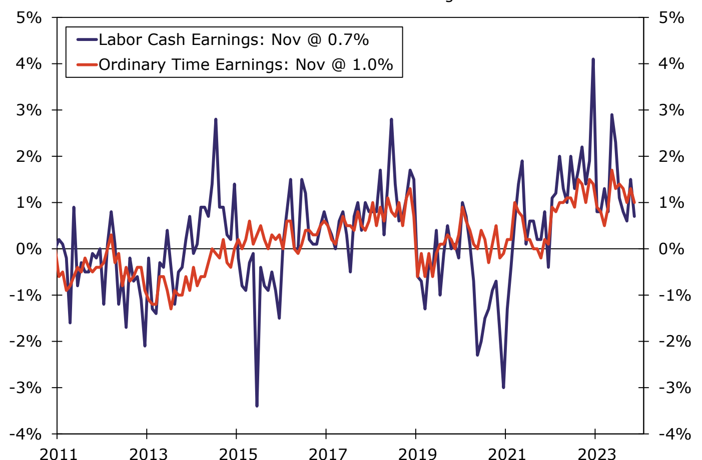


Source: Bloomberg Finance L.P. and Wells Fargo Economics

### Japan Labor Cash Earnings • Tuesday

Next week sees the release of December labor earnings data from Japan. This economic indicator has gained increased prominence over recent months due to repeated comments from the Bank of Japan (BoJ) that, in order to sustainably achieve the 2% inflation target in the medium term, a "virtuous cycle" between rising wages and prices must take hold. Wage negotiations are currently taking place in Japan between labor unions and firms, and there is a widespread view that these negotiations will deliver higher wage hikes this year than last. Rengo—an umbrella group for trade unions in Japan—has publicly stated that they will be targeting a 5% increase in wages; for context, last year's average wage increase for firms of all sizes was about 3.6%. While we anticipate modestly underwhelming outcomes for wage growth in the near term (the consensus forecast is for December labor cash earning to rise 1.3% year-over-year), wage growth should firm later in 2024 following the outcome of the wage talks.

There have been increased signals lately that policy normalization is coming soon. After the BoJ policy meeting last week, Governor Kazuo Ueda made several comments that sent the strongest signal yet that policy change is on the horizon, noting optimism



Source: Bloomberg Finance L.P. and Wells Fargo Economics

toward the spring wage talks as well as the ability to reach the bank's economic projections for inflation. The BoJ lifted its forecast for fiscal 2025 core inflation to 1.8%, from 1.7%. The Summary of Opinions from the monetary policy meeting amplified this general tone, with members seeming to feel encouraged that favorable wage dynamics will take hold and that the 2% inflation target is increasingly coming into view. We view these developments as consistent with our view that the BoJ will deem it appropriate to deliver a 10 bps rate hike at its April meeting.

**Banxico Policy Rate • Thursday**

Next week, Mexico's central bank, Banxico, will deliver its first monetary policy decision of this year. We forecast the Overnight Rate to be held at 11.25%, with an initial 25 bps cut not forecast to come until March.

There are several reasons we think that next week is too soon for Banxico to ease monetary policy. Headline and core inflation are both still elevated, and the central bank has highlighted concerns about services inflation, which also remains high. In addition, in the latest monetary policy statement from December, Banxico policymakers noted a potential for upside risks to inflation. Against that backdrop, we think next week is too early for a rate decrease, but a cut could become a more plausible option by the time of the March meeting. Inflation is still high, but decelerating on trend. That is reflected in the forecast for the January CPI, which sees headline inflation firming to 4.88% year-over-year but core inflation slowing to 4.72%.

Finally, market participants will also be keenly focused on any potential changes to the central bank's policy guidance. In recent announcements, Banixco has softened its language to saying interest rates should be held elevated "for some time" from its prior guidance of "for an extended period." Any further changes in that language would be noteworthy, as would any changes in the central bank's CPI inflation forecast, which currently projects CPI inflation returning to the 3% target by Q2-2025.

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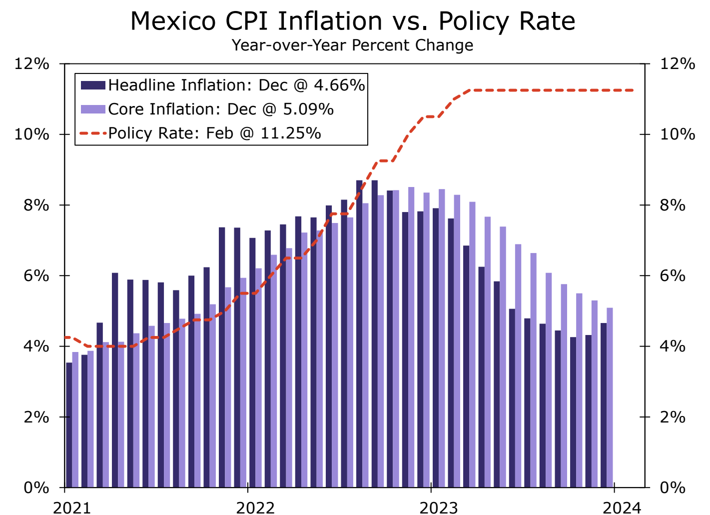


Source: Bloomberg Finance L.P. and Wells Fargo Economics

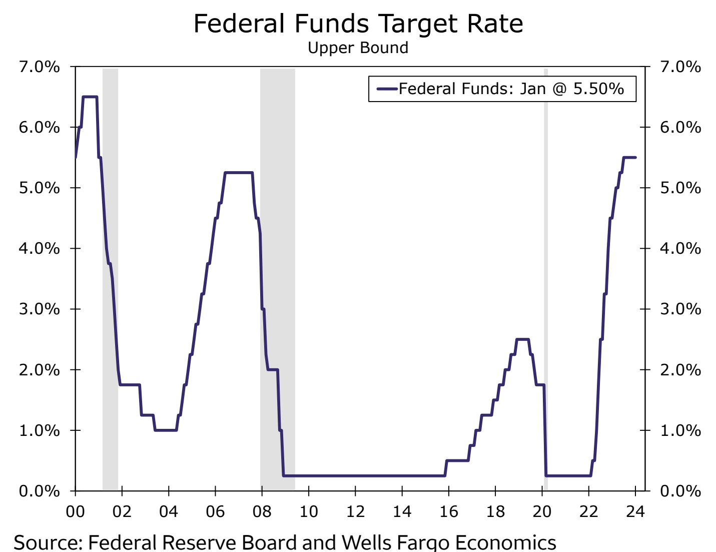
## Interest Rate Watch

### FOMC Removes "Bias" to Tighten

As universally expected, the voting members of the Federal Open Market Committee (FOMC) decided unanimously at its meeting this Wednesday to make no changes to the federal funds rate. After hiking rates by 525 bps between March 2022 and July 2023, the Committee has subsequently maintained its target range for the fed funds rate at 5.25%–5.50%.

In an important development, the Committee removed its implicit "bias" to tighten policy further in its post-meeting statement. Since last autumn, the statements noted that the Committee would take into account a range of information when "determining the extent of additional policy firming that may be appropriate to return inflation to 2 percent over time." This sentence was tweaked in December to: "in determining the extent of *any* additional policy firming that may be appropriate..." (emphasis ours). This week's statement instead noted "the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks" when "considering any adjustments to the target range for the federal funds rate." This communicates a more balanced approach toward the next move for the fed funds rate. Chair Powell's post-meeting press conference re-affirmed that the tightening cycle is likely over. Powell stated, "we believe that our policy rate is likely at its peak for this tightening cycle."

This communication has led markets and analysts alike to speculate about the timing of the first rate cut. We are not yet convinced the conditions will be in place to induce the FOMC to cut rates at its next meeting on March 20. This week's statement pointed out that "the Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent." The Fed's preferred inflation measure, the core PCE deflator, has risen at an annualized rate of only 1.9% over the past six months. That said, it is still up 2.9% over the past 12 months, and inflation has been much higher than that over much of the past three years. Our sense is that the FOMC wants to see a few more months of acceptable inflation data before it feels comfortable beginning the easing process.



Source: Federal Reserve Board and Wells Fargo Economics

The FOMC will get only one more reading on PCE inflation before its next policy meeting on March 20. We are not entirely convinced that just one more data point will give the FOMC "greater confidence" that inflation is moving back toward 2% on a sustainable basis. A rate cut in March is not out of the question, but the Committee would probably need to see soft inflation data, in conjunction with weak data on economic activity, to cut rates in March.

We look for the FOMC to first cut rates by 25 bps at its meeting on May 1. The FOMC will receive three more PCE prints between now and May 1. The 1.5% annualized rate of change in the core PCE deflator over the past three months indicates that the year-over-year rate of core PCE inflation will recede further in coming months. In the meantime, the economy's recent solid performance suggests no imminent need to ease. For further reading, please see our full report here.

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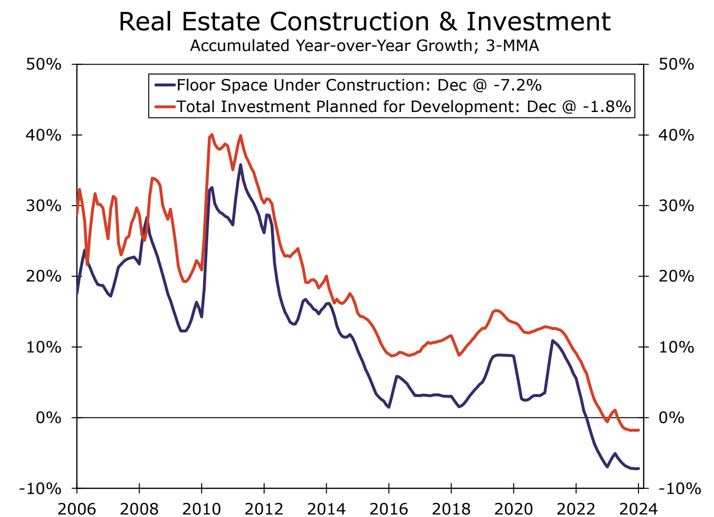
## Topic of the Week

### China's Property Crisis Grows Ever Grander

On Monday, a Hong Kong court ordered the liquidation of Evergrande, China's second-largest property developer, marking the most significant blow yet to China's struggling real estate sector. China's real estate crisis has intensified over the past couple of years, but challenges for the sector have been evident for some time. Following the 2008 global financial crisis, Chinese authorities relied on debt-fueled infrastructure spending to achieve and sustain economic growth. While the initiative was successful in stimulating growth, a secondary effect was that Chinese property developers, and the broader non-financial corporate sector, became heavily overleveraged.

As China's economic growth decelerated and cost of living rose, real estate purchases—a key investment vehicle for middle- and upper-income families—slowed. As a result, property developers have struggled to generate the cash necessary to service the debt they took on following the global financial crisis. This indebtedness has fueled some high profile property developer defaults and deteriorating confidence toward the industry. Indeed, Evergrande defaulted on its debt in December 2021, and since then, dozens of other large local developers have defaulted on their debts.

The impact to China's real estate sector has been extremely pronounced. Although construction and investment growth in real estate have been slowing for more than a decade, the ongoing crisis has sparked a further drop off in these categories (chart). About 30% of China's economic growth comes from real estate and related activities, leaving China susceptible to a wider crisis if the industry continues to weaken. Not only are banks heavily exposed as the financiers of real estate projects, but Chinese households also have a significant portion of their wealth associated with real estate.



Source: Bloomberg Finance L.P. and Wells Fargo Economics

As covered in the International Review, we believe that China's real estate crisis paired with other systematic risks will weigh on growth in 2024. That said, although a greater contagion would have damaging effects on the global economy as well as global financial markets, foreign exposure to China's debt is limited, and G10 economies should be insulated from a downturn. Ripple effects would be felt more intensely across emerging markets, with the economies and markets of South Korea, South Africa, Chile, Singapore and Thailand being the most exposed.

Our base case scenario for China does not include a large-scale crisis unfolding, even with the collapse of Evergrande. Rather, we believe China will pursue accommodative fiscal and monetary policy to support the economy over the next few years. However, more accommodative policy will, in our view, do little to change the direction of China's economy or alter underlying trends. It is also possible authorities could further pause their deleveraging campaign as long as the local real estate sector remains under pressure, although we have our doubts that deploying fiscal resources toward property development will yield more than only marginal benefits.

(Return to Summary)

# Market Data • Mid-Day Friday

## U.S. Interest Rates

| | Friday 2/2/2024 | 1 Week Ago | 1 Year Ago |
|---|---|---|---|
| SOFR | 5.32 | 5.32 | 4.31 |
| Effective Fed Funds Rate | 5.33 | 5.33 | 4.33 |
| 3-Month T-Bill | 5.37 | 5.35 | 4.61 |
| 1-Year Treasury | 4.58 | 4.63 | 4.56 |
| 2-Year Treasury | 4.38 | 4.35 | 4.10 |
| 5-Year Treasury | 4.00 | 4.04 | 3.49 |
| 10-Year Treasury | 4.04 | 4.14 | 3.39 |
| 30-Year Treasury | 4.24 | 4.37 | 3.54 |
| Bond Buyer Index | 3.34 | 3.43 | 3.51 |

## Foreign Exchange Rates

| | Friday 2/2/2024 | 1 Week Ago | 1 Year Ago |
|---|---|---|---|
| Euro ($/€) | 1.079 | 1.085 | 1.091 |
| British Pound ($/£) | 1.264 | 1.270 | 1.223 |
| British Pound (£/€) | 0.854 | 0.854 | 0.892 |
| Japanese Yen (¥/$) | 148.380 | 148.150 | 128.680 |
| Canadian Dollar (C$/$) | 1.345 | 1.345 | 1.332 |
| Swiss Franc (CHF/$) | 0.867 | 0.864 | 0.913 |
| Australian Dollar (US$/A$) | 0.651 | 0.658 | 0.708 |
| Mexican Peso (MXN/$) | 17.135 | 17.162 | 18.671 |
| Chinese Yuan (CNY/$) | 7.193 | 7.177 | 6.731 |
| Indian Rupee (INR/$) | 82.925 | 83.116 | 82.183 |
| Brazilian Real (BRL/$) | 4.968 | 4.911 | 5.044 |
| U.S. Dollar Index | 103.909 | 103.433 | 101.750 |

Source: Bloomberg Finance L.P. and Wells Fargo Economics

## Foreign Interest Rates

| | Friday 2/2/2024 | 1 Week Ago | 1 Year Ago |
|---|---|---|---|
| 3-Month German Govt Bill Yield | 3.70 | 3.73 | 2.17 |
| 3-Month U.K. Govt Bill Yield | 5.21 | 5.22 | 3.89 |
| 3-Month Canadian Govt Bill Yield | 4.99 | 5.02 | 4.43 |
| 3-Month Japanese Govt Bill Yield | -0.15 | -0.17 | -0.18 |
| 2-Year German Note Yield | 2.56 | 2.63 | 2.50 |
| 2-Year U.K. Note Yield | 4.42 | 4.35 | 3.20 |
| 2-Year Canadian Note Yield | 4.07 | 4.06 | 3.66 |
| 2-Year Japanese Note Yield | 0.09 | 0.05 | -0.02 |
| 10-Year German Bond Yield | 2.23 | 2.30 | 2.08 |
| 10-Year U.K. Bond Yield | 3.91 | 3.96 | 3.01 |
| 10-Year Canadian Bond Yield | 3.40 | 3.52 | 2.83 |
| 10-Year Japanese Bond Yield | 0.67 | 0.72 | 0.50 |

## Commodity Prices

| | Friday 2/2/2024 | 1 Week Ago | 1 Year Ago |
|---|---|---|---|
| WTI Crude ($/Barrel) | 72.15 | 78.01 | 75.88 |
| Brent Crude ($/Barrel) | 77.23 | 83.55 | 82.17 |
| Gold ($/Ounce) | 2034.47 | 2018.52 | 1912.72 |
| Hot-Rolled Steel ($/S.Ton) | 967.00 | 1077.00 | 795.00 |
| Copper (¢/Pound) | 382.65 | 385.20 | 409.10 |
| Soybeans ($/Bushel) | 12.06 | 12.12 | 14.85 |
| Natural Gas ($/MMBTU) | 2.09 | 2.71 | 2.46 |
| Nickel ($/Metric Ton) | 15,984 | 16,469 | 29,092 |
| CRB Spot Inds. | 541.48 | 546.47 | 580.03 |

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