WELLS FARGO

Weekly — March 21, 2025

Weekly Economic & Financial Commentary

United States: **February Bounce More Likely a Head Fake**

- Retail sales, industrial production, existing home sales and housing starts all jumped in February, rebounding from the declines posted the month prior. On closer examination, however, the underlying data point to economic growth hitting a soft patch.
- Next week: New Home Sales (Tue.), Durable Goods (Wed.), Personal Income & Spending (Fri.)

International: **Active Week for Foreign Central Bank Announcements**

- It was a busy week for foreign central bank announcements. The Bank of England and Bank of Japan both held rates steady, though we see the former as still on course for a May rate cut, and the latter for a May rate hike. Sweden's central bank held rates steady, while the Swiss National Bank cut its policy rate by 25 bps, and in both cases, we view the easing cycle as likely finished. Brazil's central bank raised its Selic Rate 100 bps and signaled a slower pace of tightening going forward.
- Next week: Eurozone PMIs (Mon.), Norges Bank Policy Rate (Thu.), Banxico Policy Rate (Thu.)

Interest Rate Watch: **Increased Uncertainty Complicates the FOMC's Job**

- As widely expected, the FOMC kept its target range for the federal funds rate unchanged at its policy meeting this week. The post-meeting statement noted the obvious by stating "uncertainty around the economic outlook has increased."

Topic of the Week: **Thoughts on Germany's Fiscal Reform**

- A sea change in German fiscal policy is underfoot with a massive package of fiscal stimulus measures for defense and infrastructure expected to be signed into law today. At the core of the pro-growth policy is an adjustment to the country's famously strict borrowing rules and fiscal austerity paired with a renewed energy for German rearmament.

Wells Fargo U.S. Economic Forecast

	Actual 2024				Forecast 2025				Actual		Forecast	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2023	2024	2025	2026
Real Gross Domestic Product [1]	1.6	3.0	3.1	2.3	1.0	2.1	1.3	1.2	2.9	2.8	1.9	2.3
Personal Consumption	1.9	2.8	3.7	4.2	1.7	2.0	1.6	1.6	2.5	2.8	2.5	2.2
Consumer Price Index [2]	3.2	3.2	2.7	2.7	2.8	2.7	3.0	2.9	4.1	3.0	2.8	2.6
"Core" Consumer Price Index [2]	3.8	3.4	3.3	3.3	3.1	3.1	3.2	3.1	4.8	3.4	3.1	2.8
Quarter-End Interest Rates [3]												
Federal Funds Target Rate[4]	5.50	5.50	5.00	4.50	4.50	4.25	4.00	3.75	5.23	5.27	4.13	3.75
Conventional Mortgage Rate	6.82	6.92	6.18	6.72	6.70	6.55	6.45	6.40	6.80	6.72	6.53	6.46
10 Year Note	4.20	4.36	3.81	4.58	4.30	4.20	4.15	4.15	3.96	4.21	4.20	4.33

Forecast as of: March 13, 2025

[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

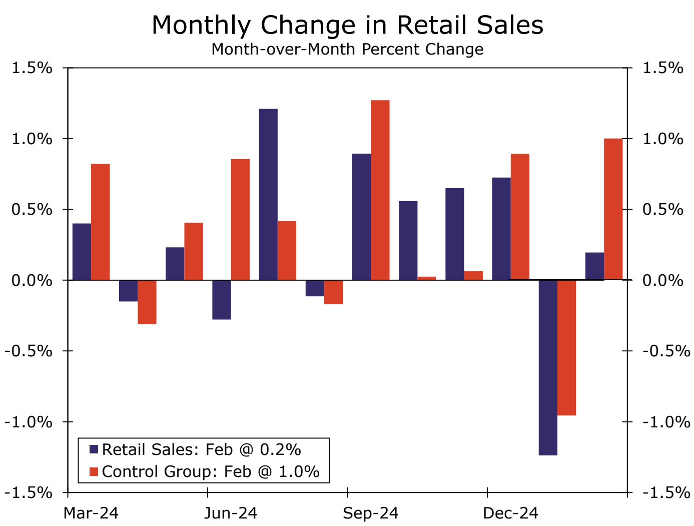
Submit a question to our "Ask Our Economists" podcast at askoureconomists@wellsfargo.com.

U.S. Review

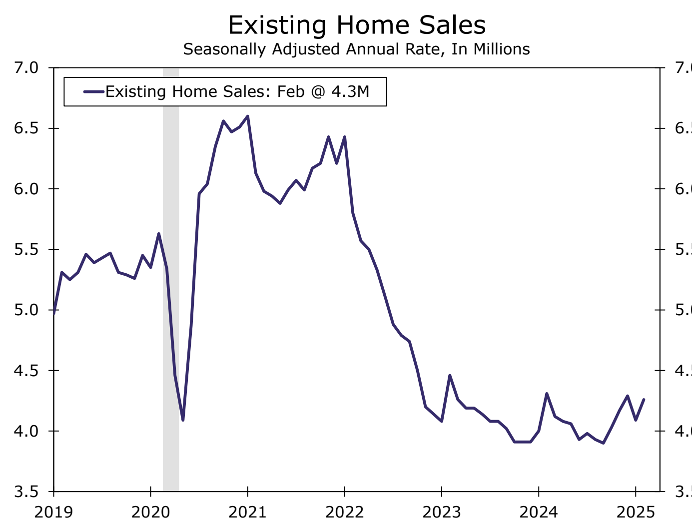
February Bounce More Likely a Head Fake

For the past few weeks, the market's attention has been focused squarely on the wide array of new economic policies being rolled out from the administration and their implications for the economy. While the potential effects of tariffs, immigration, federal spending cuts and other high-priority policies remained key considerations, the ball was back in the Federal Reserve's court this week. The March FOMC meeting concluded with only minor changes to monetary policy. Although the fed funds target rate was untouched, there were a few notable adjustments to the process of balance sheet runoff as well as the latest Summary of Economic Projections. For more on the meeting and our latest views on the future path of interest rates amid unusually elevated levels of policy uncertainty, please see the Interest Rate Watch.

During the FOMC meeting press conference, Chair Powell pointed to softer consumer spending as a sign that overall economic growth is beginning to moderate. February's retail sales print provided additional evidence of such a slowdown. Top-line retail sales strengthened in February, with a notable gain in the control group measure that feeds into the personal consumption expenditures line of GDP. Beneath the headline, however, the details suggest that a weaker trend is starting to set in. The solid gain in control group sales followed a similarly sized drop the month prior, making growth for the year essentially a wash. What's more, January's sales figures were revised sharply lower, resulting in the worst month for total retail sales growth since 2021. At a high level, the household sector remains in good financial health, which helps assuage concerns that a collapse in spending is on the immediate horizon. That said, the two months of soft retail sales data so far this year indicate that growth is starting to downshift from a recently robust pace.



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



Source: NAR and Wells Fargo Economics

The housing data received this week offered another signal that growth is hitting a soft patch. Existing home sales bounced back from a dip in January; however, the overall pace of sales was down slightly relative to the same month a year ago and was anything but strong when lined up against historical norms. Similarly, housing starts bounced back from a weather-induced decline in February. Although starts increased across the board, building permits fell back during the month. Single-family permits have been more or less unchanged this year, coincident with weakening builder confidence and tepid mortgage application activity. The ongoing sluggishness evident on the single-family side mostly is owed to persistent affordability challenges for buyers, a topic we explored in depth in a report published this week. High ownership costs have been supportive of rental demand, which has helped stop the slide in multifamily development. But capital costs are still relatively elevated, and there is still a wave of new apartment supply hitting the market, making a significant liftoff in apartment construction unlikely.

Meanwhile, industrial production jumped in February. Headline industrial production rose 0.7% during the month, stronger than expected. Manufacturing production, lifted by auto sector output, posted the largest sequential gain in 12 months. That noted, a downward revision to production in January takes some shine off the upside surprise. Furthermore, auto-related gain could be owed to tariff front-running on the part of producers, making a sustained upturn in manufacturing activity difficult to imagine, given the mounting headwinds facing the sector. In addition to a still-high cost of capital, strong dollar and persistent industry-specific labor shortages, trade policy uncertainty stands to keep the factory sector on the defensive until visibility is improved on tariffs, supply chains and other policies relevant to producers. All told, the data this week generally showed that economic activity bounced in February. On closer examination, however, the improvement looks more like a head fake and signs of a growth slowdown are becoming increasingly evident. (Return to Summary)

U.S. Outlook

Weekly Indicator Forecasts

Domestic

Date	Indicator	Period	Consensus	Wells Fargo	Prior
25-Mar	New Home Sales (SAAR)	Feb	680K	678K	657K
25-Mar	Consumer Confidence	Mar	94.0	94.6	98.3
26-Mar	Durable Goods Orders (MoM)	Feb	-0.7%	-1.0%	3.2%
26-Mar	Durables Ex Transportation (MoM)	Feb	0.3%	0.2%	0.0%
27-Mar	GDP Annualized (QoQ)	Q4	2.4%	2.3%	2.3%
27-Mar	Personal Consumption (QoQ)	Q4	—	4.2%	4.2%
28-Mar	Personal Income (MoM)	Feb	0.4%	0.4%	0.9%
28-Mar	Personal Spending (MoM)	Feb	0.6%	0.6%	-0.2%
28-Mar	PCE Price Index (MoM)	Feb	0.3%	0.3%	0.3%
28-Mar	PCE Price Index (YoY)	Feb	2.5%	2.5%	2.5%
28-Mar	Core PCE Price Index (MoM)	Feb	0.3%	0.3%	0.3%
28-Mar	Core PCE Price Index (YoY)	Feb	2.7%	2.7%	2.6%

Forecast as of March 21, 2025

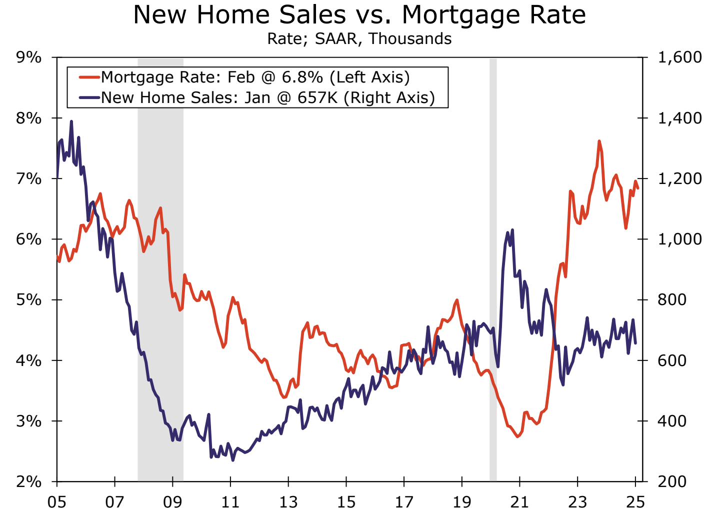
Source: Bloomberg Finance L.P. and Wells Fargo Economics

New Home Sales • Tuesday

When looking for a plush new home, so much depends on the weather. A number of would-be buyers found their house-hunting time was a wasted go in January amid particularly harsh winter weather and storms across the South. The 10.5% drop in new home sales in January also reflected concerns about financing costs as mortgage rates touched a six-month high in January at near 7.5%.

Will February bring a rebound for new home sales? The weather was milder and mortgage rates trended lower, breaking below 7% by month's end. We learned this week that existing home sales rebounded in February after a tough January. We suspect new home sales indeed picked up in February. When that number prints on Tuesday, we suspect the annualized rate of new home sales will rise to 678K.

New Home Sales vs. Mortgage Rate



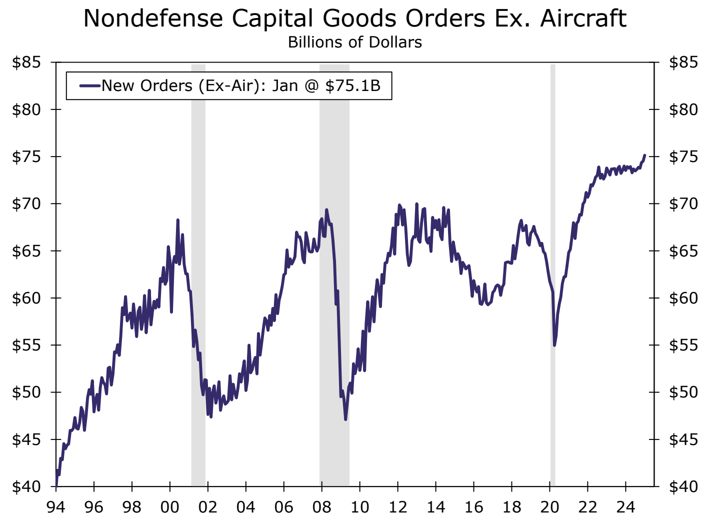
Source: U.S. Department of Commerce, Freddie Mac and Wells Fargo Economics

Durable Goods Orders • Wednesday

Leaving on a southern train, a massive surge of industrial supplies headed into the United States from Canada in January. The surge in industrial supply imports was the largest monthly increase on record, enough to pull some estimates for first quarter GDP growth into negative territory. Durable goods orders in January also shot higher, rising 3.2% during the month, the third largest such gain in three years.

For a manufacturing sector beset by more bad news than good in the past few years, purchasing managers wonder if this is promises of what seemed to be, or a genuine uptick in activity? The regional PMIs from various Federal Reserve banks show no interstate love from purchasing managers despite the imports and orders surge in January. February PMI readings from New York, Texas, Richmond and Kansas City were all in contraction territory. This suggests the pulling forward of materials and products to get ahead of tariffs.

That said, core capital goods orders have shown some signs of life more recently, suggesting a more sustained, albeit slower, rebound in activity. It's hard to see conditions overly supportive of a broad and *sustained* recovery in capex spending amid elevated uncertainty and still-high rates.On that basis, we see a 1.0% giveback in headline durables orders for February when that report comes out on Wednesday.



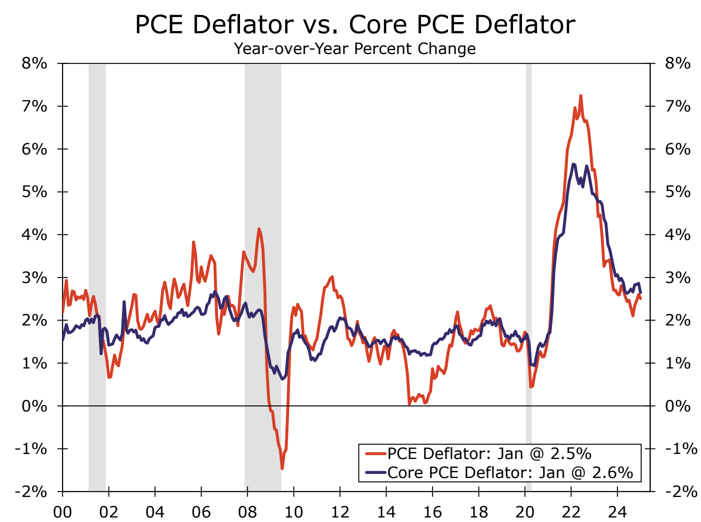
Source: U.S. Department of Commerce and Wells Fargo Economics

Personal Income and Spending • Friday

What they said was real, as recent data suggest consumers were nimble in getting ahead of potential tariffs. While consumer optimism surveys are not always the best leading indication of actual spending, households have mentioned worries around inflation and a potential pull-forward in buying plans of major durables ahead of tariff threats. We saw a surge in spending at the end of last year, which reversed at the start of this one.

We ultimately expect to see some stabilization in February spending. Retail sales rose a modest 0.2% during the month and came with downward revisions to January, but the control group measure, which acts as a good proxy for broader goods spending, rebounded a stronger 1%. Restaurants spending slipped, but we expect to see a steady gain in broader services consumption. We ultimately forecast broader inflation-adjusted real spending to rise 0.3% in February.

While purchasing power may be half of what it used to be, income growth is still supportive of spending. After a Social Security cost-of-living-adjustment influenced a pop in spending in January, we look for a still strong, but more modest, 0.4% gain in personal income, which should again be driven by solid wage growth. Inflation remains the big hurdle for consumers, and we forecast some sticky price pressures in the February data, which should keep the headline deflator at 2.5% and nudge the core deflator up a tenth to 2.7%.



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

(Return to Summary)

International Review

Active Week for Foreign Central Bank Announcements

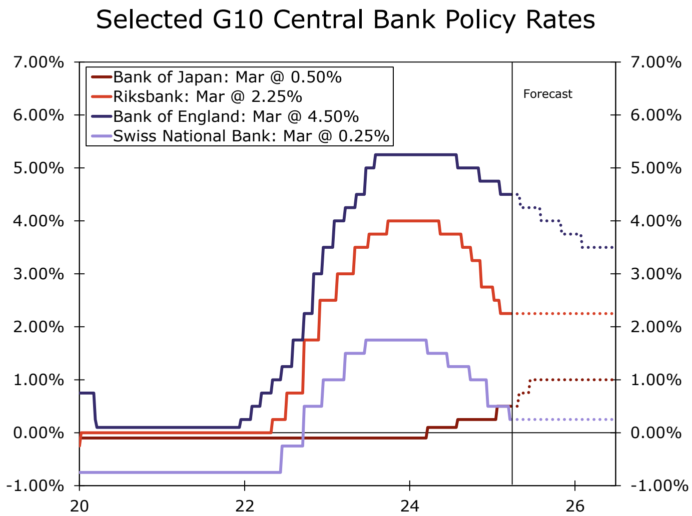
The Bank of England (BoE) was among several foreign central banks to announce their latest monetary policy assessment this week. BoE policymakers voted 8-1 to hold the policy rate steady at 4.50%. In holding rates steady, the central bank noted that global trade policy uncertainty has intensified, but that growth has been slightly stronger than expected and that domestic wage and price pressures are moderating, but remain somewhat elevated. Against this backdrop, the BoE said "a gradual and careful approach to the further withdrawal of monetary policy restraint is appropriate." While the BoE did not offer precise guidance, we see today's announcement as consistent with our view for the next 25 bps rate cut to come at the May meeting, which would take the policy rate to 4.25%.

The Bank of Japan (BoJ) held monetary policy steady at this week's announcement, and although the central bank was not overtly hawkish, it kept the door open for a possible May rate hike, in our view. Among the comments from the BoJ statement and Governor Ueda's press conference, the central bank said the virtuous cycle between wages & prices and incomes & spending is intensifying and that growth above potential is likely as these cycles intensify. Ueda noted the "somewhat" strong results of the spring wage talks and did not push back against the recent rise in longer-term bond yields. On the dovish side, the BoJ introduced trade policies of overseas countries as a new uncertainty and said FX developments are more likely to affect prices than in the past. With the BoJ's announcement leaning hawkish, as long as financial markets are relatively calm through April, we still lean toward a 25 bps BoJ rate hike in early May.

Sweden's central bank, the Riksbank, held its policy rate steady at 2.25% at this week's announcement and signaled that its monetary easing cycle has likely finished. While noting uncertainty from global factors, it said CPIF inflation has been higher than expected on elevated food prices and due to technical factors, but should recede next year. It described the Swedish economy as in a gradual recovery phase. This was also reflected in the Riksbank's updated economic projections. CPIF inflation is forecast at 2.5% for 2025 (2.0% previously), while inflation forecasts are unchanged for 2026 and 2027. Meanwhile, there were only minor changes to the GDP outlook compared to the December projections. With the outlook for the Swedish economy broadly intact, the projected rate path also points to Sweden's policy rate remaining on hold at 2.25%. Considering some improvement in medium-term Eurozone growth prospects as well as our less-dovish European Central Bank monetary policy view, we concur with the Riksbank's assessment, and no longer expect the Riksbank to lower it policy interest rate in May.

The Swiss National Bank (SNB) cut its policy rate 25 bps to 0.25%, at what may well be the last policy rate reduction of the current cycle. The SNB noted low inflationary pressures and downside risks to inflation, projecting CPI inflation at just 0.4% for 2025, 0.8% for 2026 and 0.8% for 2027. While the central bank said the outlook for Switzerland is more uncertain, it sees GDP growth of around 1.0%-1.5% for this year, and around 1.5% for 2026. In a press conference following the announcement, SNB President Schlegel said the monetary policy stance was now appropriate, and that there was now a lower probability for further easing. That's consistent with our own view of the SNB's policy rate remaining on hold at 0.25% for the foreseeable future.

Another central bank that adjusted monetary policy this week was Brazil's Central Bank, which delivered a third straight 100 bps rate hike, taking its Selic Rate to 14.25%. However, the central bank also hinted at smaller rate increases ahead, saying that given the continuation of an adverse scenario for inflation convergence toward target, heightened uncertainty and monetary policy lags, it anticipates an adjustment of a lower magnitude at the next meeting. Still-elevated inflation and upside risks to the inflation outlook along with a slippage in fiscal discipline are key factors supporting the case for further tightening, although a nascent slowdown in activity growth is a contributing factor behind the guidance for slower tightening. We expect a slower pace of rate hikes at the meetings ahead, with a peak in the Selic Rate of 15.25% by around midyear. Finally, in an unscheduled move in response to local political and financial market uncertainty, Turkey's central bank also made a modest adjustment to its monetary policy settings this week, raising its overnight lending rate by 200 bps to 46%.



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

Source: Datastream and Wells Fargo Economics

The Bank of Canada did not make any monetary policy announcement this week, although we believe Canada's February CPI offered meaningful insight into the central bank's likely decision at its next scheduled announcement on April 16. Headline inflation quickened much more than expected to 2.6% year-over-year, an acceleration that was driven by the end of a temporary sales tax holiday. There was also evidence of persistence in broader price pressures, however. The average of the core inflation measures (median-CPI and trimmed-CPI)—which are affected far less by any tax changes—also quickened moderately to 2.9% year-over-year in February, from 2.7% in January. Indeed, core inflation has advanced at a 3.3% annualized pace over the past six months, a metric that has been on a steady upward path since the middle of last year. Unless there is a sharp and severe downturn in Canadian economic activity, we would expect the central bank to hold its policy rate steady at its April monetary policy announcement.

This week's data from China suggested economic activity held up quite well in the early months of 2025. For the first two months of the year—a January-February period used to smooth out fluctuations related to the variable timing of the Lunar New Year holiday—retail sales rose 4.0% year-over-year. That was slightly stronger than the consensus forecast for a 3.8% gain, and also firmer than the 3.7% year-over-year gain seen in December. China's industrial output rose 5.9% year-over-year for the January-February period, above the 5.3% gain forecast by the consensus, though slightly below the 6.2% gain registered in December. The investment spending details were mixed as fixed asset investment rose 4.1% year-over-year in the January-February period, more than expected, but property investment fell 9.8% during the same period, which was a larger-than-expected decline. We still expect a moderation in Chinese economic growth. That said, given the relatively solid start to the year, and with policymakers recently hinting at more fiscal stimulus and support—including steps to boost incomes and consumption—the risks are tilted toward a more gradual Chinese slowdown than previously anticipated.

(Return to Summary)

International Outlook

Weekly International Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
24-Mar	Eurozone Manufacturing PMI	Mar	48.2	—	47.6
24-Mar	Eurozone Services PMI	Mar	51.1	—	50.6
27-Mar	Norges Bank Policy Rate	27-Mar	4.50%	4.25%	4.50%
27-Mar	Banxico Policy Rate	27-Mar	9.00%	9.00%	9.50%

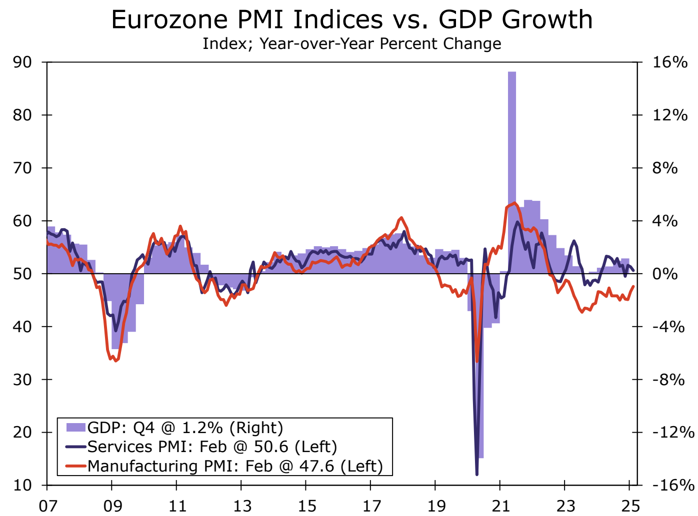
Forecast as of March 21, 2025

Source: Bloomberg Finance L.P and Wells Fargo Economics

Eurozone PMIs • Monday

Next week, the March Eurozone PMIs will be released, offering market participants insight into how the region's economy has performed as of late, and also providing hints at its near-term prospects.

The story of Eurozone economic data has been somewhat mixed lately. Fourth quarter GDP growth figures were recently revised upward, an encouraging sign, though at the same time, escalating trade tensions between the United States and Eurozone pose risks to the outlook. U.S. tariffs on steel and aluminum imports went into effect last week, and the European Union has announced retaliatory tariffs on a set of U.S. goods imports to start in April. In another relevant economic development, fiscal policy in Germany has also made headlines lately, with news surrounding a set of fiscally expansionary measures.These measures—which were passed by the lower house earlier this week and upper house today—could bring about an expansionary impulse to the Eurozone's largest economy, which has sputtered in recent quarters. Overall, we see tariff policy and fiscal policy as having the potential to negatively or positively affect Eurozone economic growth, respectively. The timing of how these developments filter into economic sentiment and activity data may vary. The tariff impact may be more near term, while the potential growth-boosting affects of the fiscal policy changes may not start to really seep into GDP growth figures until 2026.As such, we forecast the PMIs from March as well as in the coming months to show a somewhat modest story for the Eurozone economy. While the consensus forecast is for the March manufacturing PMI to tick up to 48.2, this level is still below the 50 line that separates expansion from contraction. Consensus economists also see the services PMI ticking up to 51.1, and we would note this level is consistent with an only-modest pace of economic growth (chart).

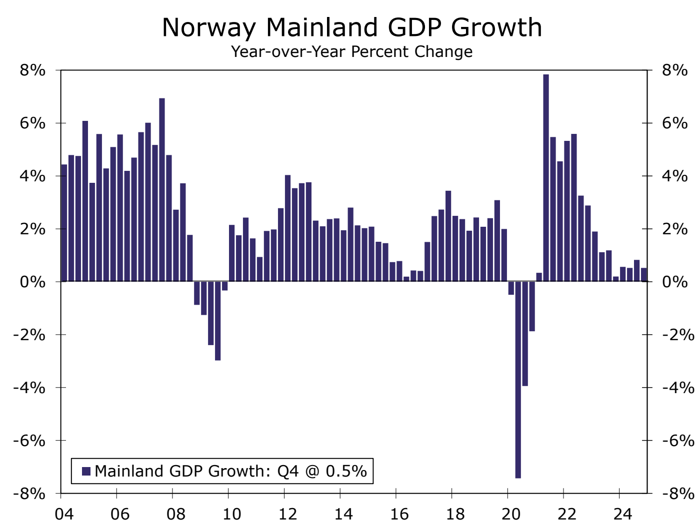


Source: Datastream, Bloomberg Finance L.P. and Wells Fargo Economics

Norges Bank Policy Rate • Thursday

Norges Bank meets next week, at which time we expect policymakers to lower the deposit rate by 25 bps to 4.25%, which would initiate an easing cycle. Of the G10 central banks that are in easing mode (that is, excluding the Bank of Japan), Norges Bank is the last to the "rate cut" party.

Although economic data have been somewhat mixed since the Norges Bank's latest monetary policy announcement in late January, we believe that easing at the March meeting will ultimately come to fruition due to some softness in the activity data as well as previous central bank policymaker signals. Retail sales improved in January, and the February inflation data were a noticeable upside surprise, driven by food and electricity. But at the same time, industrial production dropped off in January, and recently released GDP data showed that the country's mainland economy contracted by 0.4% quarter-over-quarter, almost entirely reversing the previous quarter's gain. As for signaling by Norges Bank policymakers, in the central bank's January monetary policy announcement, Governor Ida Wolden Bache said that "the policy rate will likely be reduced in March." Signaling of an initial March rate cut was also present in the December announcement. Overall, even though recent inflation data surprised to the upside, other economic data have been mixed, with some softness seen, in particular, in economic growth. And pairing this with signaling from Norges Bank policymakers, we maintain our view for the Norges Bank to initiate its easing cycle with a 25 bps rate cut next week. This meeting will also come



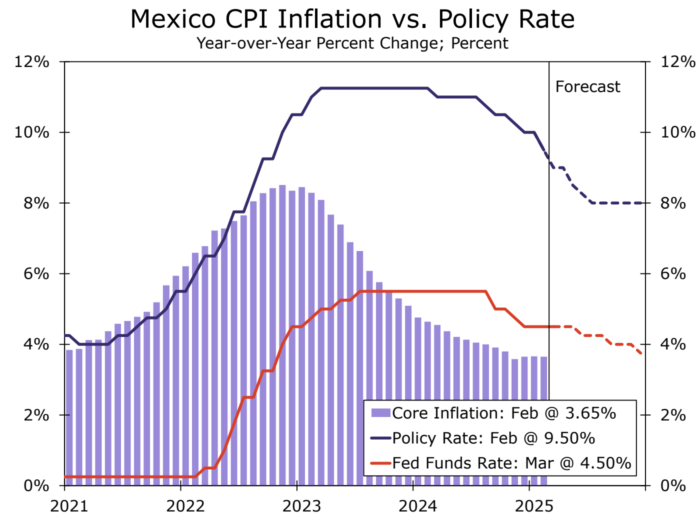
Source: Datastream and Wells Fargo Economics with an updated set of economic projections, and we believe that if policymakers remain somewhat concerned about the recent upside inflation surprise, these projections could possibly include a forecast for a slower pace of easing, as well as less overall easing, than before.

Banxico Policy Rate • Thursday

When Banxico policymakers meet next week, we forecast them to deliver a 50 bps policy rate cut to 9.00%. This view is shared by a consensus of economists as well. If realized, this would mark the second consecutive move of this magnitude. There are a variety of reasons that we see a 50 bps rate reduction next week, and another move of the same magnitude in May.

We see three main reasons for Banxico policymakers to opt for a 50 bps rate cut move next week. First, inflation has continued to generally come down closer to the central bank's 3% target over the past several months. Next, given escalations in the U.S.-Mexico trade tensions sparked by recently-implemented U.S. tariffs on Mexico, we are becoming more pessimistic about the prospects for the Mexican economy this year. We have maintained our forecast for the Mexican economy to fall into recession this year. In addition, we recently further downgraded our forecast for 2025 Mexico GDP growth to 0.1%, teetering on the brink of negative growth for this year as a whole. Last, we note that the Mexican peso has been reasonably stable on balance against the dollar this year, trending broadly sideways before strengthening somewhat in the past week or so. Due to this combination of factors, we see Banxico policymakers feeling comfortable delivering somewhat more aggressive easing this meeting and next, and then shifting to a 25 bps rate cut pace thereafter. We see the policy rate reaching a low of 8.00% by the third quarter of this year.

(Return to Summary)



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

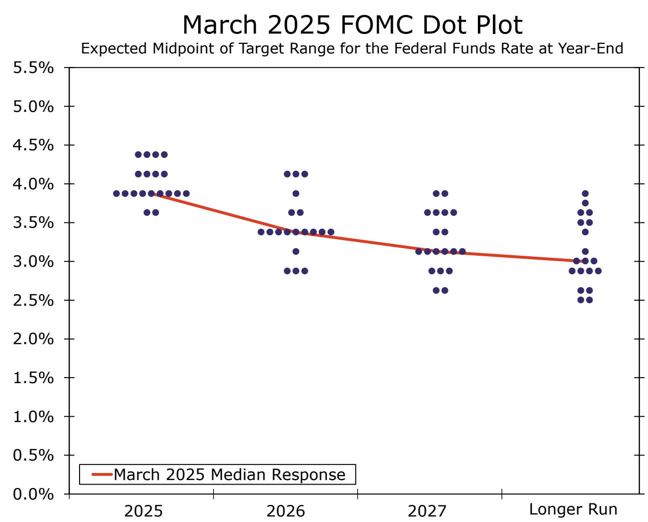
Interest Rate Watch

Increased Uncertainty Complicates the FOMC's Job

The Federal Open Market Committee (FOMC) held a policy meeting this week and, as widely expected, decided to keep its target range for the federal funds rate unchanged at 4.25%-4.50%, the second consecutive meeting at which the Committee remained on hold. The post-meeting statement that the FOMC released was little changed relative to the previous statement following the Jan. 29 meeting. In that regard, the FOMC continued to characterize the current pace of economic activity as "solid," while continuing to note that inflation "remains somewhat elevated." But in a notable change, the Committee stated that "uncertainty around the economic outlook *has increased* (emphasis ours)." Previously, the FOMC simply said that "the economic outlook is uncertain." In our view, the new terminology is an apparent reference to the uncertain outlook for U.S. trade policy and the effects it may have on the economy.

Four times each year, the Federal Reserve releases the Summary of Economic Projections (SEP), which contains summary statistics of the macroeconomic forecasts of the individual FOMC members. Relative to the most recent SEP, which was released in December, the median GDP growth forecast for 2025 was pared back to 1.7% from 2.1%, while the median forecast for core PCE inflation rose to 2.8% from 2.5%. The median forecast for the unemployment rate at the end of 2025 ticked up to 4.4% from 4.3% in the most recent SEP. We do not know what assumptions regarding trade policy individual FOMC members are making when they formulate their forecasts. However, the decline in the GDP growth forecast, the increase in the jobless rate forecast and the rise in the inflation forecast imply that many Fed policymakers are assuming the Trump administration will levy tariffs on America's trading partners this year, at least in part.

A higher unemployment rate in conjunction with higher inflation present a conundrum for the FOMC. On one hand, the FOMC would want to respond to the rise in the jobless rate with more accommodative monetary policy. On the other hand, however, the Committee would want to respond to higher inflation with more restrictive policy. The so-called "dot plot," which shows the assessment of each individual FOMC member regarding the appropriate stance of monetary policy, did not change much relative to the December dot plot. The median forecaster continues to think that 50 bps of rate cuts this year would be appropriate (chart). That said, four FOMC members believe that it would not be appropriate to cut rates at all this year.



Source: Federal Reserve Board and Wells Fargo Economics

Our interpretation of the dot plot is that the uncertainty related to trade policy is more or less freezing the FOMC in place right now. In our view, the outlook for monetary policy this year will be more dependent than usual on incoming data. Tariff increases, to the extent they come to pass, should only cause a temporary rise in inflation. The potential rise in the unemployment rate, however, could be more long-lasting if monetary policy remains restrictive.

We have a more dovish view at present of monetary policy in coming months than the collective FOMC. Specifically, we forecast the Committee will ultimately reduce rates by 75 bps by the end of the year. If, as we forecast, the rise in inflation proves to be temporary, then we believe the FOMC will begin to place more weight on the "full employment" objective of its dual mandate and cut rates. That said, the behavior of inflation expectations will be important in determining the Committee's reaction in coming months. A rise in inflation expectations can become self-fulfilling in terms of realized inflation. If tariff increases cause inflation expectations to rise, then the FOMC could very well decide to maintain a restrictive policy stance. But if inflation expectations remain well-contained, then we believe the FOMC will react to rising unemployment with more accommodative policy. We, like the FOMC, will be glued to the incoming data flow in the coming months to divine the outlook for monetary policy.

(Return to Summary)

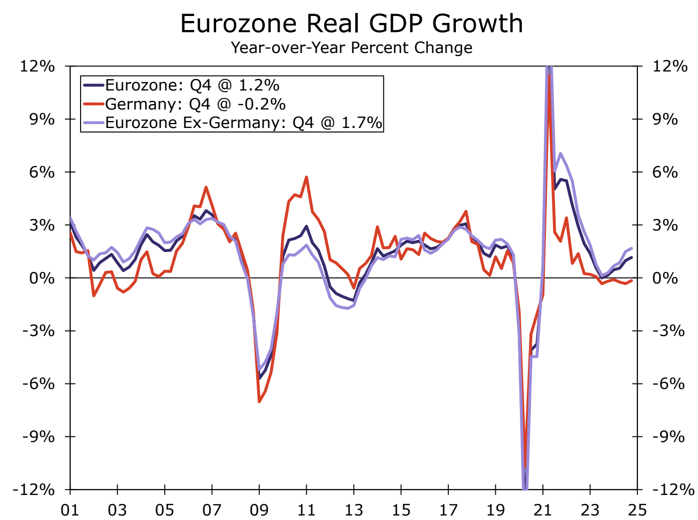
Topic of the Week

Thoughts on Germany's Fiscal Reform

A sea change in German fiscal policy is occurring. A massive package of fiscal stimulus measures for defense and infrastructure—passed by Germany's lower house of parliament earlier this week and the upper house today—is expected to be signed into law by President Steinmeier later today. At the core of the pro-growth policy is an adjustment to the country's famously strict borrowing rules and fiscal austerity paired with a renewed energy for German rearmament.

The fiscal package comes after years of a stagnant and often stumbling German economy, but the spending deal has gained immediacy due primarily to two developments. For one, the results from the late-February elections left only a handful of weeks for the lame duck parliament to push through constitutional changes requiring a two-thirds majority before the party composition shifts. Furthermore, President Trump's rhetoric on possible lessening in American security support for Europe and Putin's foot-dragging on Ukraine cease-fire negotiations have added urgency to the current situation.

The landmark package consists of three principal pillars. First, the bill will exempt defense spending (in excess of 1% of GDP) from the constitutional borrowing restriction known as the “debt brake”—a federal spending law that currently allows for a maximum structural budget deficit of just 0.35% of GDP. With the policy change, outlays for defense above 1% of GDP will not be subject to any sort of fiscal limitation, meaning the federal government can borrow unrestricted to finance defense spending. This reform has potential for large-scale implications for both defense and nondefense spending. Germany reportedly spent ~€90B on defense in 2024, meeting NATO's target of 2% of GDP, through a combination of its regular budget, the use of special off-budget funds and some additional expenses. To the extent an exemption from the debt brake over and above 1% of GDP then frees up ~€45B of spending that previously "took up room" in the deficit, the extra headspace could potentially be used for *additional*, nondefense-related expenditures, while still adhering to the 0.35% debt brake.



Source: Eurostat and Wells Fargo Economics

Second, the bill allocates €500B over the next 12 years to an "off-budget" infrastructure fund. This fund earmarks money for specific expenditures for which the federal government can finance via issuing debt without being subject to the debt brake. The fiscal stimulus from this fund—roughly €42B per year if spread evenly—should begin boosting Germany's economy within the next few quarters, whereas the impulse from defense spending is more likely to play out later in 2026 and 2027, given the time needed for large projects to be implemented.

Finally, the 16 states that comprise Germany are currently required to run balanced budgets, and the spending package that was enacted today will now allow individual states to run deficits of up to 0.35% of GDP. This could allow for an additional ~€15B in state-led fiscal stimulus per year.

All together, the package could be a momentous change for the German economy, and ultimately (though to a lesser extent) the broader Eurozone economy. We think the bill could amount to roughly €100B in additional nondefense expenditures per year, taking into account the portion of the deficit that could be freed up, state spending and the off-budget infrastructure fund. For context, this translates to 2.3% of GDP, which would be equivalent to an extra annual $680B in federal outlays if the U.S. were to enact a similarly-sized stimulus. Theoretically, the additional outlays on defense spending are unlimited, making ~€100B the lower bound for the stimulus, and it is conceivable the impact from the measures comes closer to 3.3% of GDP by 2027 as defense spending ramps up.

With the additional fiscal support in the Eurozone's largest economy, we have increased our forecast for Eurozone GDP growth in 2026 to 1.4% (up from 1.2% previously). Fiscal spending efforts have already boosted the euro relative to the U.S. dollar, and we believe upside risks to our euro forecast are starting to mount. The stronger momentum and higher yields will mean that the European

Central Bank can afford to shift a tad less dovish, in our view, and we have reduced our expectation for further ECB cuts from three this year to two. Tariffs, of course, remain a headwind to Europe, but the repositioning to domestic demand- and defense-driven growth as opposed to an export-driven model are changing the outlook.

(Return to Summary)

Market Data • Mid-Day Friday

U.S. Interest Rates

	Friday 3/21/2025	1 Week Ago	1 Year Ago
SOFR	4.29	4.30	5.31
Effective Fed Funds Rate	4.33	4.33	5.33
3-Month T-Bill	4.29	4.29	5.38
1-Year Treasury	3.95	3.93	5.10
2-Year Treasury	3.93	4.02	4.64
5-Year Treasury	3.99	4.09	4.25
10-Year Treasury	4.24	4.31	4.27
30-Year Treasury	4.58	4.62	4.43
Bond Buyer Index	4.30	4.29	3.55

Foreign Exchange Rates

	Friday 3/21/2025	1 Week Ago	1 Year Ago
Euro ($/€)	1.083	1.088	1.086
British Pound ($/₤)	1.294	1.294	1.266
British Pound (₤/€)	0.837	0.841	0.858
Japanese Yen (¥/$)	148.840	148.640	151.620
Canadian Dollar (C$/$)	1.434	1.437	1.353
Swiss Franc (CHF/$)	0.882	0.885	0.898
Australian Dollar (US$/A$)	0.628	0.632	0.657
Mexican Peso (MXN/$)	20.210	19.932	16.740
Chinese Yuan (CNY/$)	7.251	7.237	7.200
Indian Rupee (INR/$)	85.973	87.008	83.154
Brazilian Real (BRL/$)	5.731	5.742	4.979
U.S. Dollar Index	103.999	103.718	104.007

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

Foreign Interest Rates

	Friday 3/21/2025	1 Week Ago	1 Year Ago
3-Month German Govt Bill Yield	2.12	2.16	3.67
3-Month U.K. Govt Bill Yield	4.45	4.42	5.25
3-Month Canadian Govt Bill Yield	2.64	2.64	4.95
3-Month Japanese Govt Bill Yield	0.31	0.32	0.00
2-Year German Note Yield	2.14	2.19	2.88
2-Year U.K. Note Yield	4.26	4.18	4.18
2-Year Canadian Note Yield	2.51	2.57	4.17
2-Year Japanese Note Yield	0.85	0.84	0.19
10-Year German Bond Yield	2.77	2.88	2.41
10-Year U.K. Bond Yield	4.70	4.67	4.00
10-Year Canadian Bond Yield	3.00	3.07	3.52
10-Year Japanese Bond Yield	1.52	1.52	0.74

Commodity Prices

	Friday 3/21/2025	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	68.18	67.18	81.07
Brent Crude ($/Barrel)	72.00	70.58	85.78
Gold ($/Ounce)	3014.54	2984.16	2181.33
Hot-Rolled Steel ($/S.Ton)	937.00	939.00	794.00
Copper (¢/Pound)	501.70	486.95	404.65
Soybeans ($/Bushel)	10.13	10.11	12.13
Natural Gas ($/MMBTU)	4.00	4.10	1.68
Nickel ($/Metric Ton)	16,060	16,289	17,290
CRB Spot Inds.	571.54	573.48	544.18

Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

Via The Bloomberg Professional Services at WFRE

Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Jeremiah Kohl	Economic Analyst	212-214-1164	Jeremiah.J.Kohl@wellsfargo.com
Aubrey Woessner	Economic Analyst	704-410-2911	Aubrey.B.Woessner@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Anna Stein	Economic Analyst	212-214-1063	Anna.H.Stein@wellsfargo.com
Ali Hajibeigi	Economic Analyst	212-214-8253	Ali.Hajibeigi@wellsfargo.com
Coren Miller	Administrative Assistant	704-410-6010	Coren.Miller@wellsfargo.com

Required Disclosures