Economics

Weekly — January 24, 2025

Weekly Economic & Financial Commentary

United States: **Changing of the Guard**

- Considering a reasonably light domestic indicator schedule this week and the Fed's media blackout period ahead of next week's FOMC meeting, attention was understandably focused on the changing of the guard in Washington and the eagerly anticipated policy details from the new administration which will heavily influence the economic performance over the coming years.
- Next week: FOMC Statement (Wed.), GDP (Thu.), Personal Income and Spending (Fri.)

International: **Tariff Discussions Circulate During Trump's First Week**

- International economic data flow was relatively light this week. The majority of market participants' attention has been directed toward President Trump's first few days in office, especially pertaining to tariff discussions. Foreign central banks were not particularly active this week, but the Turkish central bank and Bank of Japan met to assess monetary policy.
- Next week: China PMIs (Mon.), Bank of Canada Policy Rate (Wed.), European Central Bank Policy Rate (Thu.)

Interest Rate Watch: **100 Basis Points Lower & 100 Basis Points Higher**

- No change in the fed funds rate is expected at next week's Fed meeting. We explore how a rise in longer-dated Treasury yields could provide a restrictive offset to the Fed's accommodative moves at the short end of the curve.

Credit Market Insights: **Credit Spread Slide**

- Credit spreads continued their fall last year, indicating an ongoing uptick in optimism toward the economy among market participants. While spreads have been performing better, investors still remain cautious.

Topic of the Week: **Impact of L.A. Wildfires on Shelter Inflation**

- The fires that have devastated Los Angeles have led to a frenzied search for rental properties in the area as residents whose homes have been lost or damaged seek new housing. The shock to the region's housing market will materially affect costs in L.A., but will the inflationary impact be felt more broadly in the national macroeconomy?

Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual	Forecast		
	2024				2025							
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2023	2024	2025	2026
Real Gross Domestic Product [1]	1.6	3.0	3.1	3.0	2.5	1.5	0.7	1.3	2.9	2.8	2.2	2.2
Personal Consumption	1.9	2.8	3.7	3.5	2.1	2.1	1.8	1.5	2.5	2.7	2.5	2.3
Consumer Price Index [2]	3.2	3.2	2.6	2.7	2.7	2.7	3.1	2.9	4.1	3.0	2.8	2.7
"Core" Consumer Price Index [2]	3.8	3.4	3.2	3.3	3.0	3.0	3.2	3.1	4.8	3.4	3.0	2.9
Quarter-End Interest Rates [3]												
Federal Funds Target Rate[4]	5.50	5.50	5.00	4.50	4.50	4.50	4.25	4.00	5.23	5.27	4.31	4.00
Conventional Mortgage Rate	6.82	6.92	6.18	6.72	7.10	6.90	6.65	6.50	6.80	6.72	6.79	6.50
10 Year Note	4.20	4.36	3.81	4.58	4.70	4.55	4.35	4.25	3.96	4.21	4.46	4.36

Forecast as of: January 16, 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

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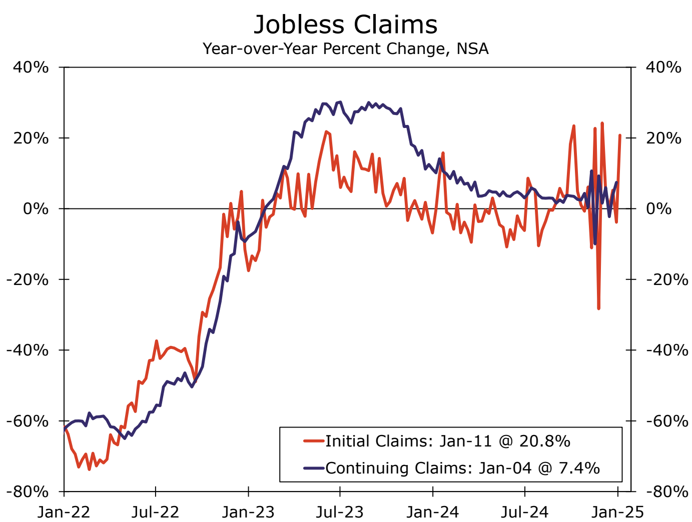
U.S. Review

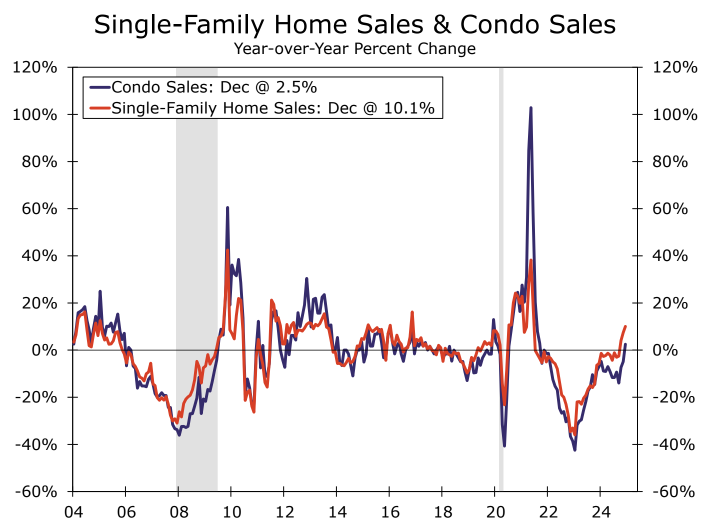
Changing of the Guard

Considering a reasonably light domestic indicator schedule this week and the Fed's media blackout period ahead of next week's FOMC meeting, attention was understandably focused on the changing of the guard in Washington and the eagerly anticipated policy details from the new administration which will heavily influence the economic performance over the coming years. On that point, President Trump signed a litany of executive orders and memorandums his first day in office spanning a number of areas, including immigration, energy, foreign policy and trade. On the energy front, President Trump declared a national energy emergency and signed executive orders that will, among other things, review burdens to energy development and end the freeze on the approval of new liquid natural gas export permit applications. Furthermore, President Trump made comments regarding his intentions to refill the Strategic Petroleum Reserve. While these actions are seen as bullish and an attempt to spark animal spirits in the sector, questions remain as to whether the desired surge in private sector investment and output will unfold if oil prices fall materially lower over the coming years.

While executive orders on trade tariffs were notably absent, President Trump initially alluded to the possibility of a 25% tariff on imports from Canada and Mexico starting as soon as February 1. Subsequent comments later in the week were less hawkish—considering 10% tariffs on imports from China—though highlight how much trade discussions remain in flux. Understandably, the administration is ironing out the details, including breadth, degree and implementation. As we have expressed in our economic outlook, our base case is for a 5% universal tariff alongside a 30% tariff on imports from China. For further insight, please read our report, Charting the Course: U.S. Trade in 12 Charts. Until clear guidance is given, the uncertainty about tariffs and the impact on the economic outlook remains high, particularly for firms evaluating existing supply chains and for those considering new investments. As we receive greater detail on new economic policies in the coming weeks—particularly those associated with trade—we will adjust our outlook accordingly.



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



Source: NAR and Wells Fargo Economics

As previously mentioned, the data calendar was relatively quiet this week. Initial jobless claims increased to a six-week high, rising to a seasonally adjusted level of 223K for the week ended January 18. The Southern California wildfires played a major role in the rise, increasing by 61K on a non-seasonally-adjusted basis. As the wildfires are ongoing, we would not be surprised to see initial claims continue to mount over the coming weeks. Continuing claims increased by 46K to 1,899K, marking the highest level since November 2021. Experiencing extended resilience, the labor market is seeing a dichotomy take shape, one that the Federal Reserve is undoubtedly monitoring as it evaluates monetary policy. On one hand, the historically low level of initial claims suggest the labor market is quite healthy. On the other hand, the relatively elevated level and rising trend of continuing claims suggest more concern, as unemployed workers are having a tougher time finding their next job.

On the housing front, existing home sales ended 2024 with strong momentum as resales posted their third consecutive gain in December, up 2.2% to a 4.24-million unit annualized pace. Last month's improvement was broad based with gains in single family and condos and co-ops resales. This helped bring total existing home sales 9.3% above the pace a year ago. While encouraging, total existing home sales remain 20% lower than the average pace in 2019. Lower mortgage rates have played a role in the slightly better affordability conditions seen in the second half of last year, though they are still prohibitive to most prospective homebuyers, as they currently hover around 7%. Home price appreciation is another headwind as demand continues to run ahead of supply. Inventories of homes on the market have come up from record lows, though the mortgage rate lock-in effect should keep supply relatively scarce and keep a ceiling on the overall pace of existing home sales.

While this week's data calendar was limited, the same cannot be said for the coming week. Updates to durable goods orders, consumer confidence, the first look at Q4-2024 GDP, the Employment Cost Index, personal income & spending and the PCE deflators will give market participants and policy watchers fresh insight into the health of the U.S. economy as 2024 came to a close and the momentum provided for early 2025. Moreover, Fed officials will gather for the first time this year. Given the ongoing resilience, the stickiness of inflation above target and the uncertainty new economic policies could potentially have on the outlook (see Interest Rate Watch), we expect no change in the fed funds rate.We currently project two rate cuts this year—September and December. (Return to Summary)

U.S. Outlook

Weekly Indicator Forecasts					
Domestic					
Date	Indicator	Period	Consensus	Wells Fargo	Prior
27-Jan	New Home Sales (SAAR)	Dec	670K	658K	664K
28-Jan	Durable Goods Orders (MoM)	Dec	0.8%	0.7%	-1.2%
28-Jan	Durables Ex Transportation (MoM)	Dec	0.4%	0.4%	-0.2%
28-Jan	Consumer Confidence	Jan	105.6	106.5	104.7
29-Jan	FOMC Rate Decision (Upper Bound)	29-Jan	4.50%	4.50%	4.50%
30-Jan	GDP Annualized (QoQ)	Q4	2.6%	3.0%	3.1%
30-Jan	Personal Consumption (QoQ)	Q4	3.1%	3.5%	3.7%
31-Jan	Employment Cost Index (QoQ)	Q4	1.0%	0.9%	0.8%
31-Jan	Personal Income (MoM)	Dec	0.4%	0.4%	0.3%
31-Jan	Personal Spending (MoM)	Dec	0.5%	0.7%	0.4%
31-Jan	PCE Deflator (MoM)	Dec	0.3%	0.3%	0.1%
31-Jan	PCE Deflator (YoY)	Dec	2.5%	2.6%	2.4%
31-Jan	Core PCE Deflator (MoM)	Dec	0.2%	0.2%	0.1%
31-Jan	Core PCE Deflator (YoY)	Dec	2.8%	2.8%	2.8%

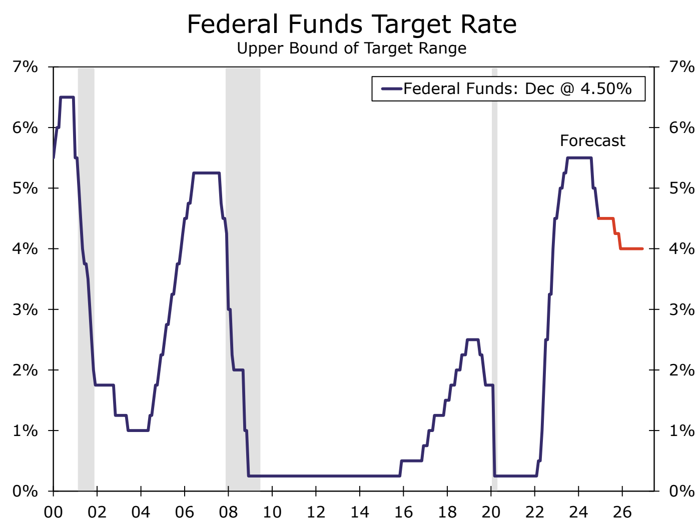
Forecast as of January 24, 2025

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

FOMC Statement • Wednesday

The FOMC has cut rates at each of its past three meetings since September, amounting to a cumulative reduction of 100 bps. The upper bound of the target range now sits at 4.50%; however, a pause in the easing cycle seems likely at next week's meeting and is widely expected by market participants. Economic growth has been strong entering 2025, and inflation has proved to be less cooperative than the FOMC would like. Comments from many policymakers at the Fed have highlighted the risks to further policy accommodation with PCE inflation still sitting at 2.4% year-over-year and core PCE inflation running at 2.8%. While the risks to the inflation side of the Fed's dual mandate have remained apparent, the risks to the employment mandate have subsided somewhat compared to a few months ago. The unemployment rate dropped a tenth to 4.1% in December, and nonfarm payroll growth has now been north of 200K in each of the past two months.

Looking forward, we expect the Fed to remain on hold for the first half of the year. We then look for two cuts of 25 bps each during the September and December meetings, with the FOMC holding its target range at 3.75%–4.00% throughout 2026.



Source: Federal Reserve Board and Wells Fargo Economics

GDP • Thursday

Real GDP growth expanded at a strong 3.1% annualized pace in Q3. Personal consumption expenditures were a major driver of growth, as they grew at a robust 3.7% clip in the quarter and contributed nearly 2.5 percentage points to the headline number. Business fixed investment also experienced solid growth of 2.1% annualized, which in conjunction with robust consumer spending leaves final demand across the economy in a very strong position. The only significant drags on growth in the third quarter were inventories and net exports, which together removed 0.6 percentage points from top-line growth, respectively.

We look for real GDP to continue its strong momentum and grow at a 3.0% annualized pace in Q4. Consumer spending was strong through the end of the year, as exhibited by solid retail sales data through December, and we forecast PCE to grow at a 3.5% annualized pace. Equipment investment was likely a weak spot, based on nondefense capital goods shipments data falling through the end of the year. We expect a modest rebound in residential investment after two quarters of consecutive declines and for the volatile net exports and inventory components to be a rather neutral force on top-line growth. Overall, we expect the Q4 data to show the economy continues to trek along at a healthy rate.

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

Personal Income and Spending • Friday

Personal spending grew 0.4% in November and, thanks to a softer inflation print, real spending was up a solid 0.3% during the month. The composition in November was especially interesting, as it showed households increasing goods spending at the fastest pace since January 2023, while services spending experienced its softest growth since August 2023. We suspect holiday sales were behind this pop in goods spending, as households prioritized goods over services when shopping for gifts. The increased demand for goods is, however, less than good news for policymakers who have seen inflation fall over the past year partly as a function of falling goods prices. With goods spending picking up, this source of deflationary pressure is drying up. Goods spending is also more directly exposed to cost pressure to the extent we see President Trump levy new tariffs. The upside for policymakers is that a moderating pace of services spending has the potential to finally ease some momentum in the services sector, where robust demand has kept core services inflation hot.

Retail sales data released earlier this month showed a stronger-than-anticipated pace of holiday sales among households last year. We forecast personal spending grew an impressive 0.7% in December and that personal income rose 0.4% on the month. Progress on the last mile of inflation looks to be slower going forward. We call for the headline PCE deflator to rise 0.3% on the month, bringing the year-over-year pace up two-tenths to 2.6%. In addition, we look for the core PCE deflator to be up 0.2% on the month, leaving the year-over-year rate at 2.8%.

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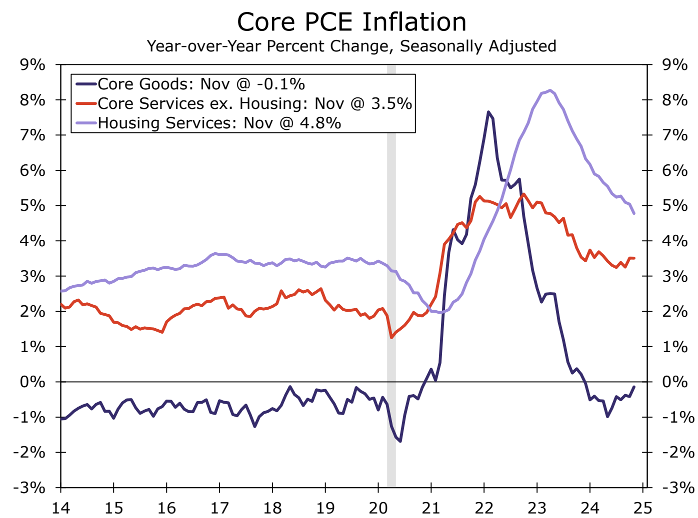


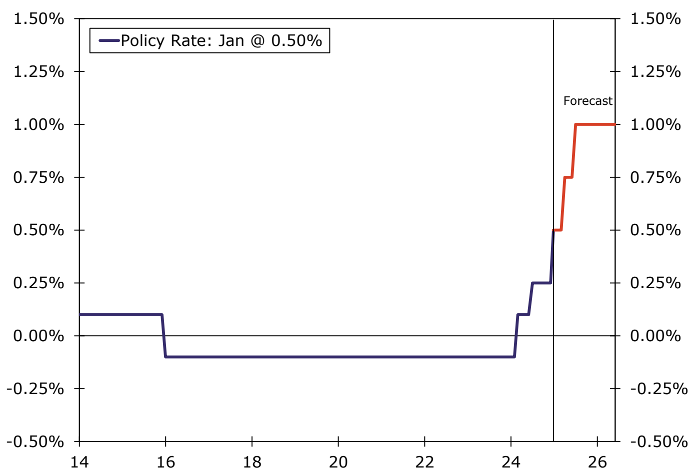
Source: U.S. Department of Commerce and Wells Fargo Economics

International Review

Tariff Discussions Circulate During Trump's First Week

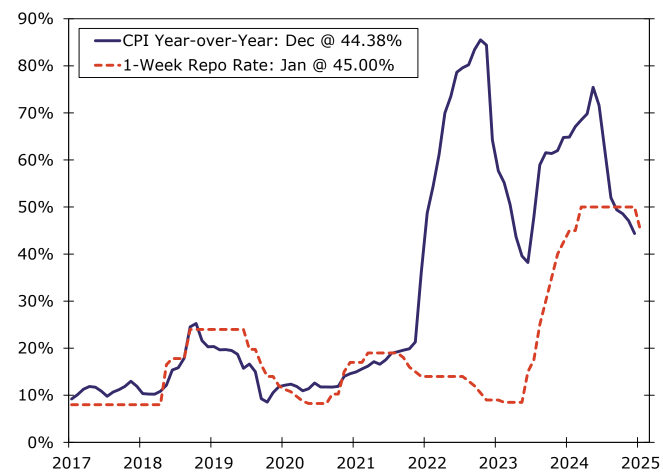
International economic data flow was relatively light this week. Even if data were released, the majority of market participants' attention likely would have been directed toward President Trump's first few days in office as well as his speech at Davos. President Trump's recent actions and public pronouncements are very much in line with his campaign proposals. Tariffs seem to still be on their way—with Trump singling out the EU, Canada and Mexico—this week, but less so China. Related to Canada and Mexico, Trump mentioned that 25% tariffs could be imposed on the two countries on February 1 due to the perceived cross-border flow of undocumented migrants and illegal narcotics coming into the United States from both countries. Trump also mentioned a possible 10% tariff on China under similar pretenses. As we highlighted in a note this week, tariffs on Canada and Mexico can do particular damage to each economy due to strong trade linkages with the United States. In Canada, goods exports represent a sizable portion of Canadian economic output, while goods exports to the U.S. are more meaningful in Mexico. In the case of Canada, the economy is diversified enough where crisis conditions will likely not materialize, and the Bank of Canada has room to cut interest rates more aggressively to offset the economic impact of tariffs. Mexico, on the other hand, has limited options. Potential currency depreciation and renewed inflationary pressures limit how much easing Banxico can deliver, while a wide fiscal deficit and rising debt burdens are constraints on the fiscal side. Without policy space to fight back against tariffs, Mexico's economy is very likely to slip into recession. Bi-weekly inflation data released this week suggest Banxico may deliver a 50 bps cut at its meeting in February, although we have our doubts it will be enough to stave off a tariff-induced recession.

Bank of Japan Policy Rate



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

Turkey Policy Rate vs. CPI Inflation



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

Foreign central banks were not particularly active this week, although two institutions did meet to assess monetary policy. First, Turkey's central bank cut policy rates by another 250 bps, the second sizable rate cut in as many meetings. Inflation is on a downward trajectory and the lira stable, offering policy space for the Turkish central bank to deliver easing. However, large rate cuts raise the risk of currency depreciation, especially if rate cuts are influenced by President Erdogan. For now, Erdogan has been supportive of the transition back to economic orthodoxy, although recent rhetoric suggests Erdogan may prefer more aggressive easing in the future. Should markets feel the independence of the central bank is being eroded again, another significant lira selloff could materialize and the progress Turkey has made on its reform agenda could be lost. For now, we believe the lira will only gradually depreciate, but we are paying particular attention to government commentary and any potential meddling in central bank affairs. As far as policy rate decisions, policymakers are likely to continue along their current path well into 2025. With disinflation likely to continue amid tighter fiscal policy, monetary policy settings are likely to become less restrictive.

Perhaps of more significance, the Bank of Japan (BoJ) delivered a 25 bps rate hike at its January meeting. This week's monetary tightening brought the BoJ policy rate to 0.50%, a level last seen in late 2008. This rate hike was mostly expected and priced by financial markets, but is yet another signal that

BoJ policymakers are increasingly comfortable moving away from ultra-accommodative monetary policy settings. While growth is still lackluster, CPI inflation has trended higher over the past few years. Higher inflation, sparked by higher wages, has been the impetus for multiple rounds of recent BoJ tightening. To that point on inflation, Japan also revealed that local policymakers expect inflation to pick up pace going forward as they adjusted their inflation forecasts notably higher. Supporting the BoJ's view on inflation were CPI ex-fresh food data that showed prices firmed to 3.0% year-over-year. With inflation seemingly at more sustainable levels and the BoJ firmly in tightening mode, we expect policymakers to deliver additional tightening going forward. For now, we expect at least one more 25 bps hike around the middle of this year, although risks are also squarely tilted toward even more aggressive tightening.

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International Outlook

Weekly International Indicator Forecasts

Date	Indicator	Period	Consensus	Wells Fargo	Prior
27-Jan	China Manufacturing PMI	Jan	50.1	—	50.1
27-Jan	China Services PMI	Jan	52.2	—	52.2
29-Jan	Bank of Canada Policy Rate	29-Jan	3.00%	3.00%	3.25%
30-Jan	European Central Bank Deposit Rate	30-Jan	2.75%	2.75%	3.00%

Forecast as of January 24, 2025

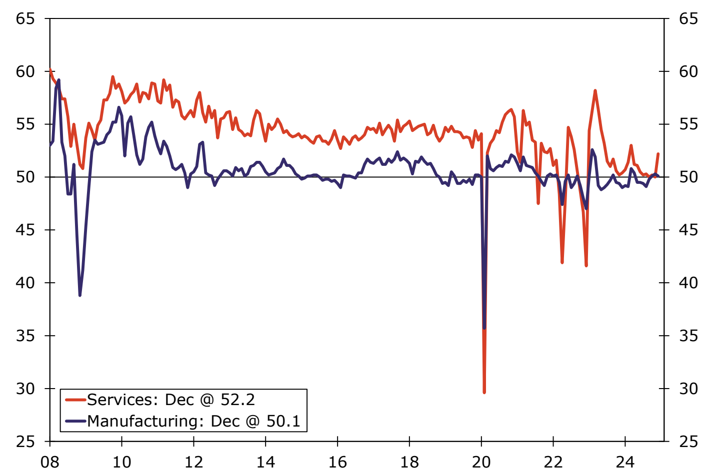
Source: Bloomberg Finance L.P and Wells Fargo Economics

China PMIs • Monday

China's official manufacturing and service sector PMIs for January, due for release next week, will provide insight into the state of the economy during the early part of this year. Chinese growth received a boost during Q4, with GDP rising 5.4% year-over-year. Monetary stimulus, in the form of lower benchmark interest rates and a reduction in the central bank's Reserve Requirement Ratio, was supportive of activity late last year, while property support measures also likely helped at the margin. However, stronger exports were also an important driver of growth. That could reflect some front-loading of shipments, given the threat of higher tariffs from the U.S., suggesting the jump in Chinese growth could be transitory in nature.

For January, the consensus forecast is for China's PMIs to hold broadly steady. The manufacturing PMI is expected to remain unchanged at 50.1, while the services PMI is expected to ease slightly to 52.2. Overall, this would suggest the boost in activity seen in Q4 has persisted into the early part of this year. However, in the absence of large-scale fiscal stimulus (so far), we doubt growth in the service sector will maintain its recent pace, while we also expect export growth to soften over time. Overall, we expect China's GDP growth to slow during 2025 and, indeed, see the risks for the January PMI readings as tilted to the downside.

Chinese PMI Surveys



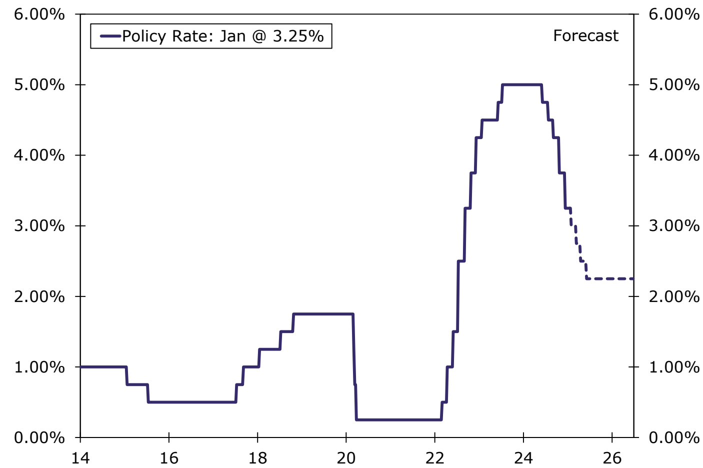
Source: Datastream and Wells Fargo Economics

Bank of Canada Policy Rate • Wednesday

The Bank of Canada (BoC) announces its latest monetary policy decision next week. We, along with the consensus, expect the BoC to ease monetary policy further, though we also expect a smaller 25 bps reduction in the policy rate, compared to the 50 bps cuts seen at the two most recent meetings. In our view, a couple of factors point to more gradual easing from the central bank. First, given the cumulative easing, so far the policy rate is at the top of the perceived 2.25%-3.25% neutral range, and thus monetary policy is no longer in a "clearly" restrictive territory. Recent activity and survey data have also been somewhat firmer, including a December employment jump of 90.9K and improving business confidence and sales expectations as reflected in the central bank's Q4 Business Outlook Survey.

On the flip side, however, the unemployment rate remains elevated at 6.7%, suggesting the economy remains in excess supply, while the threat of higher tariffs from the U.S. brings renewed downside risks to the growth outlook. Meanwhile, wage growth is slowing and the December CPI was relatively benign, with headline inflation at 1.8% year-over-year, and core inflation moderately above the 2% inflation target. Against this backdrop, we expect the Bank of Canada to continue its easing cycle with a 25 bps policy rate cut at next week's announcement.

Bank of Canada Policy Rate



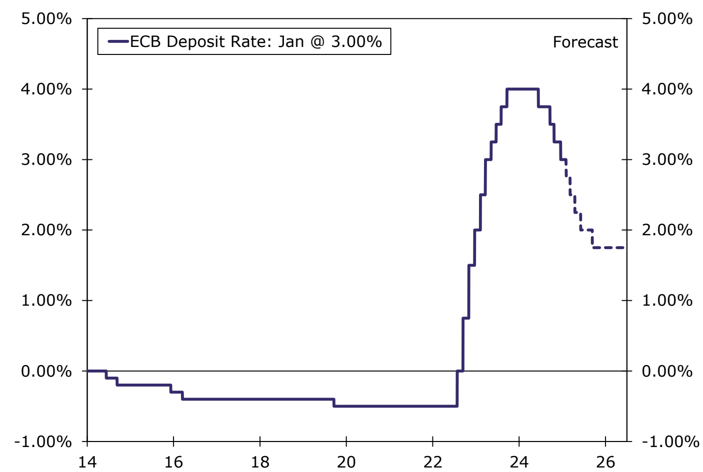
Source: Bloomberg Finance L.P. and Wells Fargo Economics

European Central Bank Policy Rate • Thursday

The European Central Bank (ECB) announces its monetary policy decision next week, at which we expect the central bank to continue with its measured approach to monetary easing. We, along with the consensus, expect the ECB to lower its Deposit Rate another 25 bps to 2.75%. Supporting the case for a further rate cut next week, several ECB policymakers have highlighted the sluggish growth dynamic of the Eurozone region and suggested inflation remains on course to reach to the 2% target later in 2025. Against that backdrop, policymakers have indicated market expectations that the ECB will lower interest rates at upcoming meetings appear plausible and reasonable. Growth risks that are arguably to the downside and a policy rate that is still above a neutral level are also arguments for further monetary easing.

That said, we do expect the ECB will continue to lower interest rates at a gradual pace. The December CPI revealed lingering price pressures, with headline inflation at 2.4% year-over-year and services inflation at 4.0%, while wage growth remains elevated. We expect the ECB to reduce its policy rate by 25 bps next week and, as long as Eurozone growth remains subdued and inflation slows as we forecast, expect the ECB to follow up with 25 bps rate reductions at its March, April, June and September meetings, for a terminal policy rate of 1.75% at the end of 2025.

ECB Deposit Rate



Source: Datastream and Wells Fargo Economics

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Interest Rate Watch

100 Basis Points Lower & 100 Basis Points Higher

When the Federal Reserve concludes the two-day meeting of its Open Market Committee (FOMC) on Wednesday of next week, we expect policymakers to maintain the target range for the federal funds rate at 4.25%-4.50%.

The case for lower interest rates is less urgent today than it was in the autumn of last year when the labor market was showing signs of lost momentum and inflation was trending lower. Neither of those dynamics have done a complete about-face, but the economy enters 2025 with renewed momentum, and progress on inflation has stalled. Both of these dynamics were evident in the ISM's survey of purchasing managers in the service sector. These businesses report that activity snapped back into action in December. Most sub-components notched gains, but, tremblingly for the FOMC, none rivaled the 6.2-point jump in the prices paid-component, which signaled the broadest increase in service sector costs since February 2023.

From that September meeting when the FOMC first lowered rates as part of a cumulative 100 bps easing, the yield on the 10-year Treasury has climbed 102 bps. The return of a positive slope to the yield curve is welcome, but a rise in longer-dated interest rates signals inflation expectations are creeping higher.

Next week brings the December reading for the Fed's preferred inflation gauge, the core PCE deflator. By that measure, core inflation was 2.8% in November and our forecast is for that measure to stay put at 2.8% in next week's report for December. That report drops after the FOMC meeting, so the FOMC will be forecasting as well, but it is clear that inflation is still above the 2.0% target. Take that alongside the renewed labor market momentum evident in the more than a quarter million jobs added in December and there is no rush at all to lower rates now.

We suspect that the ascent in the 10-year Treasury yield could restrict activity, and a question for next week's Fed meeting is: Do Powell and other members of the FOMC see higher longer-dated rates as being restrictive as well? If so, the upshot would be dovish to the outlook for fed funds because whether policymakers view higher long-term rates as helpful in bringing inflation down or disruptive in restoring momentum to the labor market, it argues for lower short-term rates.

Financial markets are trying to gauge the degree to which Trump policy proposals—tariffs in particular—could affect the outlook for inflation and Fed policy. We do not look for much explicit guidance in this regard in the official statement, but it will no doubt be a topic that comes up in the press conference.

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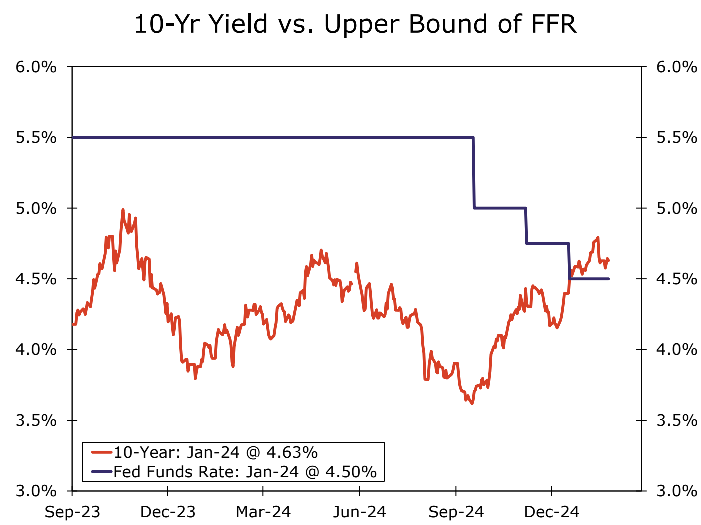


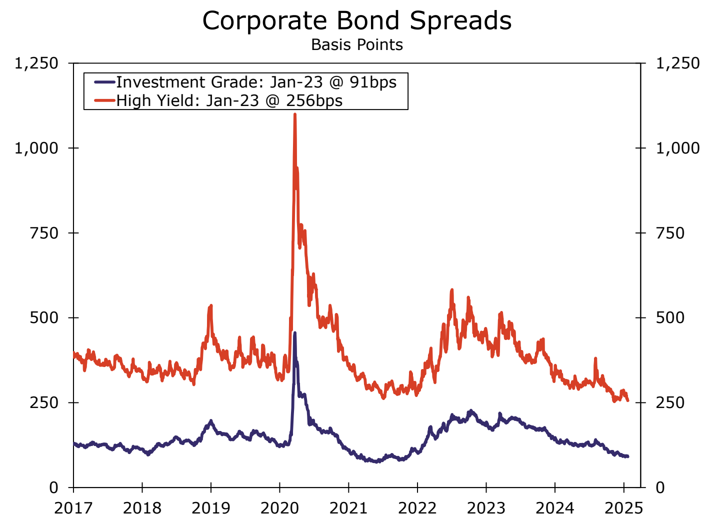
Source: Bloomberg Finance L.P. and Wells Fargo Economics

Credit Market Insights

Credit Spread Slide

Corporate bond spreads, or credit spreads, are the difference between the yield on a corporate bond and a Treasury security with the same maturity period. Essentially, this metric measures the extra yield, or *extra risk*, needed to hold corporate bonds instead of a *safer* Treasury security. Credit spreads indicate how market participants price current risk in the market and their relative understandings of optimism for the U.S. economy and its future.

At the start of last year, spreads were priced at 144 bps for investment-grade (IG) bonds and 333 bps for high yield (HY) bonds. At the time, there was a large degree of uncertainty, and if the Fed could achieve a soft landing was very much in question. The Federal Open Market Committee had just hiked rates at the fastest pace in four decades, lifting the federal funds rate to a level not seen in over 20 years. However, as the year progressed, optimism continued to increase. Concerns over a looming recession faded and inflation eased. While there was some month-to-month volatility in the labor market, the unemployment rate and layoffs largely remained in check. As a result, the market grew more optimistic by the end of 2024, as demonstrated by the slide in credit spreads (chart). At the start of 2025, credit spreads were at 94 bps and 282 bps for IG and HY bonds, respectively. That puts both IG and HY spreads near a four-year low and signals not only short-term optimism but confidence in the resilience of the U.S. economy among investors.



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

Despite the optimism that has rung in the new year, some concerns remain at large. Market participants are still watching economic data closely, and concerns over the nature of some economic policies, namely tariffs, remain in view. Furthermore, as the Fed tangos with maintaining strong employment and fighting sticky inflation, credit spreads are a key gauge on how market optimism progresses. (Return to Summary)

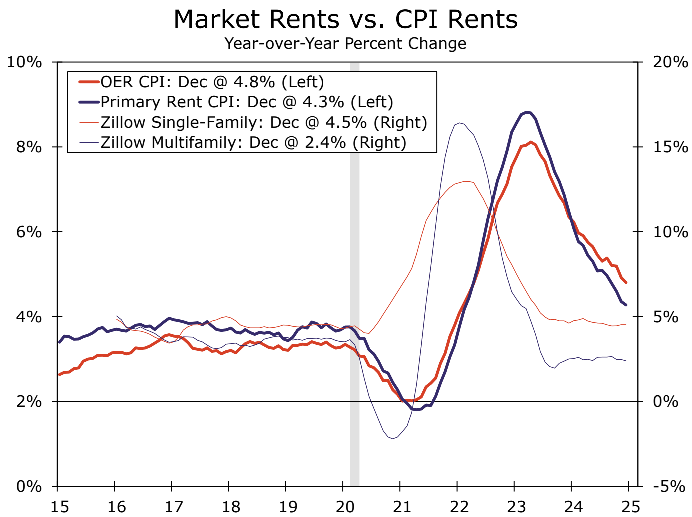
Topic of the Week

Impact of L.A. Wildfires on Shelter Inflation

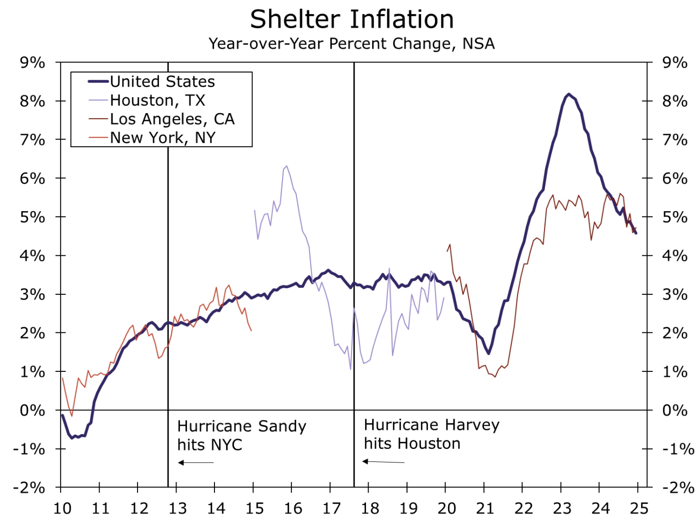
The Palisades and Eaton fires that have devastated Los Angeles have led to a frenzied search for short-term and long-term rental properties in the area as residents whose homes have been lost or damaged seek new housing. The shock to the region's housing market will materially affect costs in L.A., but will the inflationary impact be felt more broadly in the national macroeconomy?

Directionally, the wildfires create an additional headwind to further lowering inflation. According to CoreLogic, approximately 20,000 properties lie within the perimeters of the Palisades and Eaton fires. The resulting influx of rental demand exacerbates an already tight housing market; only 5.0% of L.A. multifamily units were vacant in Q3 compared to 7.9% nationally. As prices adjust to reflect an even more supply-constrained market, rental increases will slowly be incorporated into the national Consumer Price Index (CPI) measure of shelter inflation. The L.A. metro makes up roughly 6% of units in the CPI shelter sample—second only to the New York City metro, which is 8% of the housing sample.

That said, we expect the impact to be drawn out over the course of years, not months, and do not expect it to leave an obvious mark on the path of U.S. shelter inflation ahead. Monthly readings do stand to be more volatile as units seeing new rents jump move in and out of the monthly sample. Still, this volatility is a story that may play out over years, not just the next few readings. Individual rental units are only sampled once every six months, so even if rent for a new lease rose sharply as soon as February, that might not get picked up in the data until July. Moreover, as we've seen with the lag between CPI shelter and measures of "spot" rent growth this cycle (chart), changes in market conditions can take years to show up in the CPI data due to the CPI also measuring changes in rent for existing tenants, which usually adjust more slowly than rents for new tenants. The near-term change in market conditions on rental growth is also likely to be blunted by California law limiting price increases in the wake of a state of emergency.



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



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

Even with upward pressure on L.A. area rents and added month-to-month volatility in the national shelter prints, evidence from previous disasters, such as Hurricane Sandy in New York and Hurricane Harvey in Houston, suggests city-specific housing shocks have difficulty moving the needle on national shelter inflation figures (chart). The un-obvious effect of the disasters in these metros is likely tied in part to the BLS capping weights of specific units, which can mitigate the effect of individual units experiencing a significant change in price.

Ultimately, we will likely push up our forecasts for primary rent and owners' equivalent rent slightly over our forecast horizon through 2026, but the recent devastation is not expected to alter the overall trajectory of shelter inflation ahead. We continue to look for the year-over-year rate of primary shelter inflation to slow through the first half of this year and then level off at a pace that remains slightly above its pre-COVID pace due to housing shortages more broadly across the United States. (Return to Summary)

Market Data • Mid-Day Friday

U.S. Interest Rates

	Friday 1/24/2025	1 Week Ago	1 Year Ago
SOFR	4.35	4.29	5.31
Effective Fed Funds Rate	4.33	4.33	5.33
3-Month T-Bill	4.30	4.30	5.36
1-Year Treasury	4.23	4.23	4.66
2-Year Treasury	4.25	4.28	4.38
5-Year Treasury	4.42	4.43	4.09
10-Year Treasury	4.62	4.63	4.18
30-Year Treasury	4.86	4.86	4.41
Bond Buyer Index	4.19	4.28	3.43

Foreign Exchange Rates

	Friday 1/24/2025	1 Week Ago	1 Year Ago
Euro ($/€)	1.051	1.027	1.089
British Pound ($/₤)	1.249	1.217	1.273
British Pound (₤/€)	0.842	0.844	0.855
Japanese Yen (¥/$)	155.760	156.300	147.510
Canadian Dollar (C$/$)	1.433	1.448	1.352
Swiss Franc (CHF/$)	0.905	0.915	0.863
Australian Dollar (US$/A$)	0.632	0.619	0.658
Mexican Peso (MXN/$)	20.234	20.786	17.225
Chinese Yuan (CNY/$)	7.241	7.325	7.158
Indian Rupee (INR/$)	86.205	86.613	83.134
Brazilian Real (BRL/$)	5.879	6.080	4.933
U.S. Dollar Index	107.292	108.957	103.236

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

Foreign Interest Rates

	Friday 1/24/2025	1 Week Ago	1 Year Ago
3-Month German Govt Bill Yield	2.53	2.56	3.76
3-Month U.K. Govt Bill Yield	4.59	4.62	5.23
3-Month Canadian Govt Bill Yield	3.02	3.05	5.02
3-Month Japanese Govt Bill Yield	0.35	0.36	-0.18
2-Year German Note Yield	2.29	2.23	2.71
2-Year U.K. Note Yield	4.33	4.38	4.42
2-Year Canadian Note Yield	2.94	2.93	4.03
2-Year Japanese Note Yield	0.72	0.69	0.07
10-Year German Bond Yield	2.58	2.54	2.34
10-Year U.K. Bond Yield	4.64	4.66	4.01
10-Year Canadian Bond Yield	3.30	3.30	3.50
10-Year Japanese Bond Yield	1.23	1.20	0.72

Commodity Prices

	Friday 1/24/2025	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	74.55	78.68	75.09
Brent Crude ($/Barrel)	78.41	80.79	80.04
Gold ($/Ounce)	2774.28	2703.25	2013.89
Hot-Rolled Steel ($/S.Ton)	688.00	699.00	1070.00
Copper (¢/Pound)	433.05	444.10	388.60
Soybeans ($/Bushel)	10.60	10.34	12.42
Natural Gas ($/MMBTU)	3.87	4.26	2.64
Nickel ($/Metric Ton)	15,461	15,755	16,070
CRB Spot Inds.	546.52	548.96	543.08

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