# Economics

WELLS FARGO

Weekly — July 26, 2024

# Weekly Economic & Financial Commentary

United States: **Economic Resilience or Reticence?**

- The U.S. economy defied expectations in the second quarter, expanding at a 2.8% annualized pace. Despite the upside surprise, we still see enough softening in inflation and signs of stress to warrant a rate cut in September.
- Next week: ECI (Wed.), ISM Manuf. (Thu.), Employment (Fri.)

International: **Bank of Canada Doubles Down on Monetary Easing**

- The Bank of Canada (BoC) cut its policy rate 25 bps to 4.50% this week, following on from its initial rate cut in June. The accompanying statement was dovish in tone, suggesting that further rate cuts will be forthcoming in the months ahead. This week's sentiment surveys for July showed a strengthening in the U.K. manufacturing and services PMIs, but a moderate softening in the Eurozone PMIs.
- Next week: Eurozone CPI (Wed.), BoJ Policy Announcement (Thu.), BoE Policy Rate (Thu.)

Interest Rate Watch: **Wake Me Up When September Ends**

- The only change we expect out of next week's monetary policy meeting is for the FOMC to signal rate cuts are coming as early as its *next* meeting in September. Inflation progress resumed in Q2, and the labor market is softening—both developments position for Fed easing.

Credit Market Insights: **Small Businesses Are Feeling the Pinch**

- The NFIB Small Business Optimism Index remains lower than its historical average even at its highest level this year. With tight credit standards and high interest rate loans, we forecast some modest relief may only be from the Fed later this year.

Topic of the Week: **U.S. Presidential Election Update**

- The U.S presidential election took yet another historic turn this week, when President Biden announced that he will not seek re-election this November and subsequently endorsed Vice President Kamala Harris. While it is hard to say anything with certainty, it strikes us as likely a potential Harris administration, should it come to pass, would support many of the same economic policy positions of the current Biden administration.

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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 | 3.4 | 1.4 | 2.8 | 1.6 | 1.5 | 1.9 | 2.5 | 2.3 | 1.9 |
| Personal Consumption | 3.8 | 0.8 | 3.1 | 3.3 | 1.5 | 2.3 | 1.9 | 1.7 | 2.5 | 2.2 | 2.1 | 1.9 |
| Consumer Price Index [2] | 5.7 | 4.0 | 3.6 | 3.2 | 3.2 | 3.2 | 2.7 | 2.7 | 8.0 | 4.1 | 3.0 | 2.4 |
| "Core" Consumer Price Index [2] | 5.5 | 5.2 | 4.4 | 4.0 | 3.8 | 3.4 | 3.2 | 3.1 | 6.2 | 4.8 | 3.4 | 2.7 |
| Quarter-End Interest Rates [3] | | | | | | | | | | | | |
| Federal Funds Target Rate[4] | 5.00 | 5.25 | 5.50 | 5.50 | 5.50 | 5.50 | 5.25 | 5.00 | 2.02 | 5.23 | 5.31 | 4.38 |
| Conventional Mortgage Rate | 6.54 | 6.71 | 7.20 | 6.82 | 6.82 | 6.92 | 6.75 | 6.50 | 5.38 | 6.80 | 6.75 | 6.09 |
| 10 Year Note | 3.48 | 3.81 | 4.59 | 3.88 | 4.20 | 4.36 | 4.15 | 4.00 | 2.95 | 3.96 | 4.18 | 3.83 |

Forecast as of: July 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. Depart. of Commerce, U.S. Dept. of Labor, Federal Reserve Board and Wells Fargo Economics

Please see our full U.S. Economic Forecast.

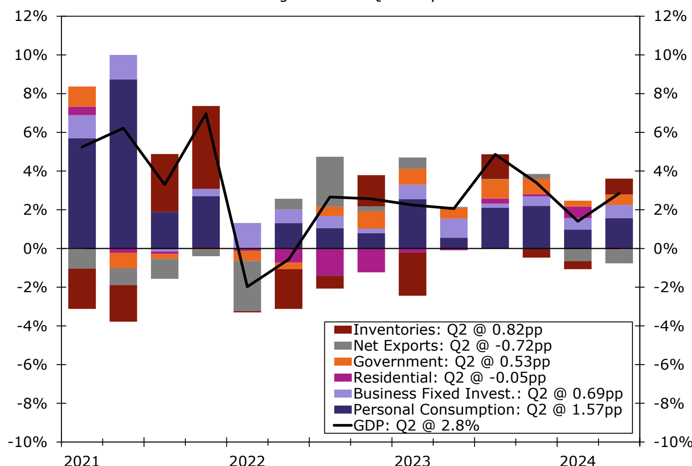
# U.S. Review

## Economic Resilience or Reticence?

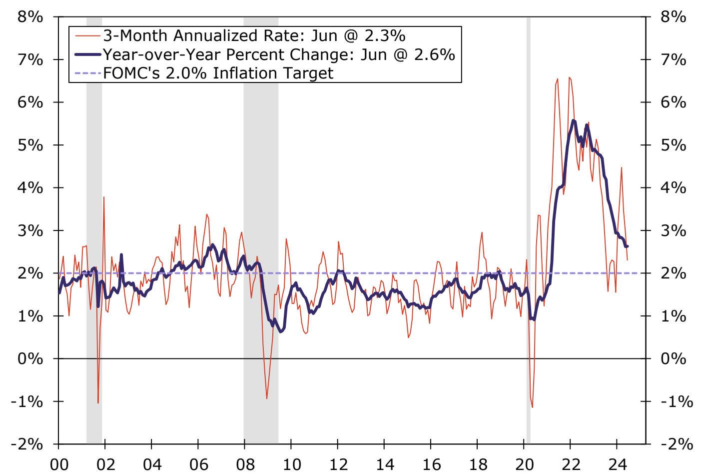
Economic growth defied expectations in the second quarter. Real GDP expanded at a 2.8% annualized rate, a sizable acceleration from 1.4% in Q1. Such a strong outturn can be a bit head-scratching when stacked up against the broader signs of economic deceleration that we have written about over the past few months. However, the underlying details revealed familiar signs of waning momentum. Aside from a boost from inventories, consumer spending and business equipment investment were the primary drivers of Q2's robust showing. Each of these was specifically propelled by sturdy spending on autos. Elsewhere, we saw a contraction in industrial equipment outlays and additional evidence that consumers are pivoting away from recreation in favor of essential purchases like housing and healthcare. Meanwhile, the lagged effects of monetary tightening pulled real estate investment into the red, causing outright declines in both residential and structures spending.

Although we saw a glimpse of it in the Q2 GDP release, this morning we received the full details describing consumer income and spending in the month of June. Real consumer spending rose 0.2% over the month. Although a step down from May's 0.4% upturn, spending on services is still too hot for comfort. Real services outlays in June advanced at the fastest pace in four months. As consumers pull back on credit usage, income growth remains the most significant factor sustaining spending. Real disposable personal income rose 0.1% in June, slower than May's 0.3% surge but still indicative of expanding purchasing power.

Yet, the Fed's preferred inflation gauge demonstrated additional incremental softening. The headline PCE deflator rose just 0.1% in June. Details were encouraging all around. Goods prices outright declined for the second straight month, while services prices did not show signs of acceleration. The core deflator remained sturdier at 0.2%, but June brought the second-lowest print this year. Core PCE is now running at a 2.3% three-month annualized rate, another step closer to that elusive 2.0%.




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




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

No matter how resilient the broader economy appears, cracks are still materializing across interest-rate sensitive sectors. The housing market is clearly caught in the crossfire. This week, we learned that both new and existing home sales softened in June. Elevated rate expectations amid the Fed's ongoing fight against inflation have kept mortgage rates close to 7.0% for most of the year, discouraging would-be buyers. Resales in June slid 5.4% to the slowest pace in six months, nearly retreating to the prior cycle low reached in October 2023. As inventories climb higher on the slower sales pace, weak demand has become a greater burden on the resale market than low supply. Existing home prices rose at a 4.1% annual rate in June, keeping buyers caught between rising prices and elevated mortgage rates.

Demand for new construction also appears to be losing steam. New home sales slipped a more modest 0.6% in June. That said, this print was weaker than expected and brought the pace of new home sales to its lowest point since last November. Despite increased use of incentives, builders report that buyer

traffic has waned as expectations for lower rates later this year keep buyers in wait-and-see mode. Developers have pulled back on single-family building in response, mirroring dips in buyer traffic and builder confidence. Plentiful new home inventories are also discouraging development. The count of new homes for sale rose for the third consecutive month in June, amounting to 9.3 months' supply at the current sales pace.

You wouldn't know it from Q2's equipment spending print, but the manufacturing sector continues to struggle in the weak demand environment. Durable goods orders plunged 6.6% in June, the sharpest monthly drop since 2020. Although June's downturn overstates recent weakness, it is indicative of the broader flatlining in manufacturing activity that has emerged against a backdrop of higher financing costs. Driving June's miss was a 130% collapse in nondefense aircraft orders. Orders excluding transportation actually posted a slight 0.5% improvement. Looking ahead, uncertainty around the election and its implications for interest deductibility and capital investment expensing will likely limit the scope for a manufacturing rebound heading into November.

In sum, we still see enough softening in inflation and signs of stress scattered through the economy to warrant a rate cut in September, despite the upside surprise to Q2 GDP.

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## U.S. Outlook

**Weekly Domestic Indicator Forecasts**

| Date | Indicator | Period | Consensus | Wells Fargo | Prior |
|---|---|---|---|---|---|
| 30-Jul | Consumer Confidence | Jul | 99.7 | 99.5 | 100.4 |
| 31-Jul | Employment Cost Index (QoQ) | Q2 | 1.0% | 1.0% | 1.2% |
| 31-Jul | FOMC Rate Decision (Upper Bound) | 31-Jul | 5.50% | 5.50% | 5.50% |
| 1-Aug | Nonfarm Productivity (QoQ) | Q2 | 1.6% | 2.8% | 0.2% |
| 1-Aug | Unit Labor Costs (QoQ) | Q2 | — | 1.8% | 4.0% |
| 1-Aug | ISM Manufacturing Index | Jul | 49.0 | 48.8 | 48.5 |
| 1-Aug | Construction Spending (MoM) | Jun | 0.2% | 0.2% | -0.1% |
| 1-Aug | Total Vehicle Sales | Jul | 16.20M | 16.20M | 15.29M |
| 2-Aug | Nonfarm Payrolls | Jul | 175K | 180K | 206K |
| 2-Aug | Unemployment Rate | Jul | 4.1% | 4.1% | 4.1% |
| 2-Aug | Average Hourly Earnings (MoM) | Jul | 0.3% | 0.3% | 0.3% |
| 2-Aug | Factory Orders (MoM) | Jun | 0.5% | -2.9% | -0.5% |

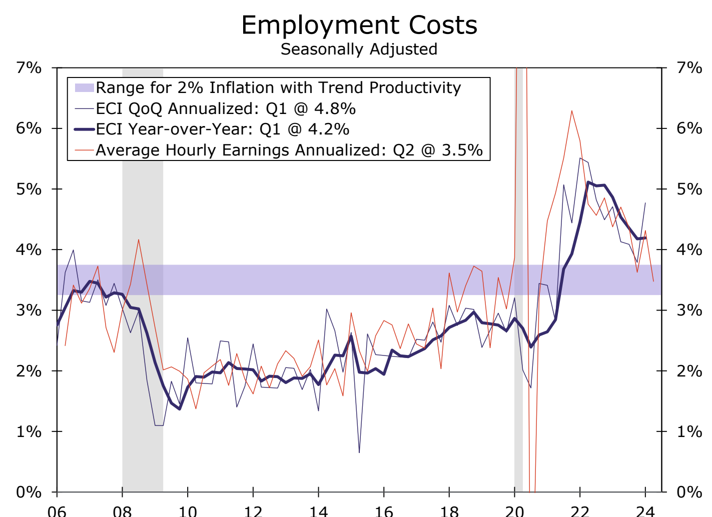
Forecast as of July 26, 2024

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

### Employment Cost Index • Wednesday

The 1.2% jump in the Employment Cost Index in Q1 piled on to other data at the start of the year that showed progress in lowering inflation had stalled out. Like other recent price data, however, we expect the ECI in the second quarter to suggest inflation pressures are indeed dissipating. Demand for labor has cooled over the past year, while the supply of labor has continued to expand. The more balanced state of the jobs market has already had a dampening effect on other measures of labor costs, including the year-over-year pace of average hourly earnings growth slowing below 4% in the second quarter for the first time since 2020. We look for the ECI to follow suit in Q2, rising 1.0% over the quarter and 4.1% over the past year.

While still elevated compared to the prior cycle's peak rate of 2.9%, the moderation should bring employment cost growth more in line with the pace needed to be consistent with the Fed's 2.0% inflation goal once accounting for productivity growth. Productivity growth, due Thursday, looks to have rebounded strongly in Q2 (+2.8%), which, through all the quarterly volatility, would put the average annualized rate of productivity growth this cycle at 1.6%.

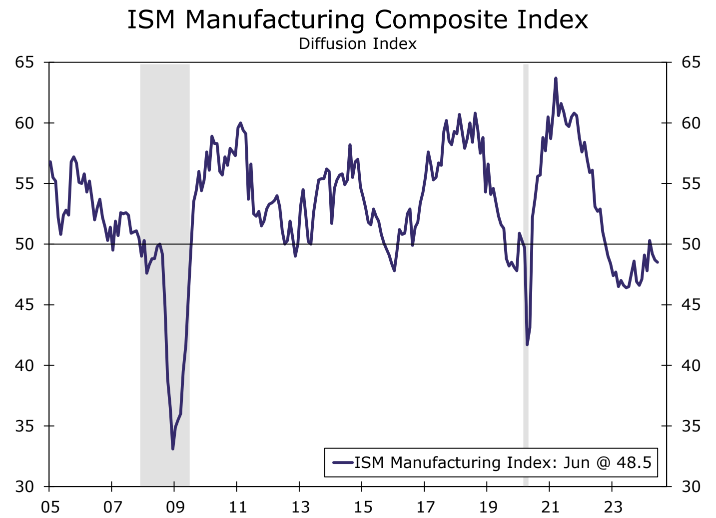


Source: U.S. Department of Labor and Wells Fargo Economics

## ISM Manufacturing • Thursday

High borrowing rates and the hangover from goods spending being pulled forward during the pandemic have continued to weigh on manufacturing activity. While the ISM manufacturing index has trended higher over the past year, it has struggled to return to expansion territory.

We expect the July ISM to show that factory activity continues to tread water. Regional Fed PMIs released thus far for July show activity continued to decline modestly on net during the month, while the sideways move of core capital goods orders the past few months suggests demand for manufactured items remains lackluster. The thinner order books at manufacturers are likely to keep hiring plans depressed but suggest price pressures from the goods sector continue to gradually abate. While ocean shipping costs have jumped since the spring, commodity prices have eased, which will be important to keeping the prices paid component in check for July.



Source: Institute for Supply Management and Wells Fargo Economics

## Employment • Friday

Another upside surprise to payrolls in the June employment report masked a more troubling message about the jobs market. While job growth remained north of 200K, gains over the prior two months were revised down substantially (-111K on net), and June's increase was overwhelmingly concentrated in the less cyclically sensitive sectors of government and healthcare. In the clearest sign the labor market is cooling, the unemployment rose to 4.1%, nearly half a point higher than at the start of the year.

The 180K increase to payrolls we expect in July would still be a respectable gain, but would underscore that, directionally, the jobs market is deteriorating. By a range of measures, including the unemployment rate, quit rate, level of temporary help workers and small business hiring plans, the labor market is not only softer than a year or two ago, but weaker compared to its pre-pandemic state.

Wage pressures have cooled as a result. We look for average hourly earnings to rise 0.3% in July, which would bring the year-over-year rate to more than a three-year low of 3.7%. The unemployment rate is likely to remain unchanged at 4.1%, which would bring it within a whisker of crossing the Sahm Rule threshold historically associated with the economy being in a recession.

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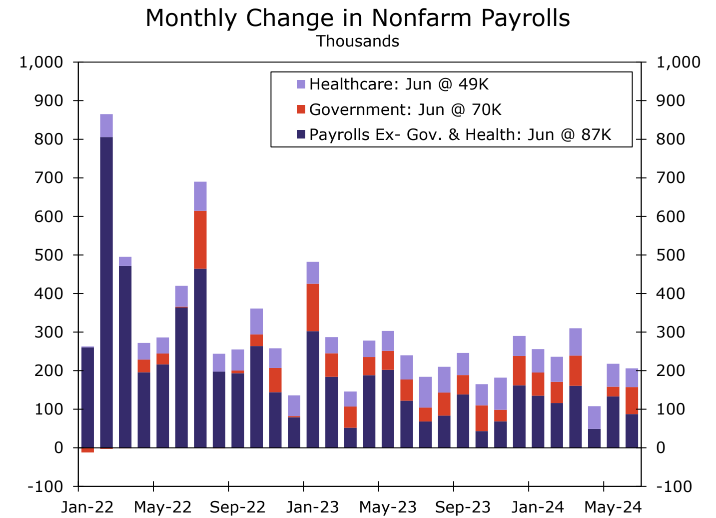


Source: U.S. Department of Labor and Wells Fargo Economics

## International Review

### Bank of Canada Doubles Down on Monetary Easing

The Bank of Canada (BoC) cut its policy rate 25 bps to 4.50% at this week's monetary policy announcement, matching the consensus forecast and following on from the initial rate cut delivered in June. Just as important as the interest rate reduction, the BoC offered dovish guidance that points to ongoing rate cuts in the months ahead. Among the comments from the Bank of Canada's announcement as well as Governor Macklem:

- The upside risks to CPI inflation need to be increasingly balanced against the risk that the economy and inflation could be weaker than expected. Indeed, as inflation gets closer to target "the downside risks are taking on increased weight in our monetary policy deliberations."
- Spare capacity in the economy has increased, and ongoing excess supply is lowering inflationary pressures.
- Household spending, including both consumer purchases and housing, has been weak. The softness in household spending was cited as a particular area of focus, with the BoC pointing to a larger share of incomes being allocated to debt servicing and with upcoming mortgage rate renewals also seen as a downside risk for consumer spending.
- The labor market has cooled significantly. While policymakers acknowledged elevated wage growth, it suggested a loosening labor market should see a moderation of pay increases over time.

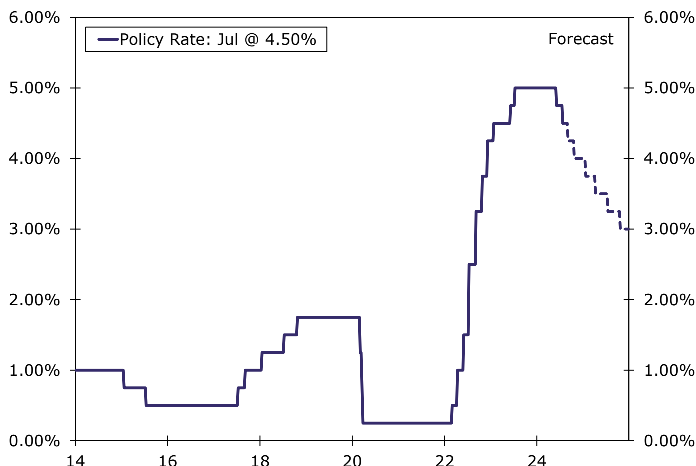
These dovish overall comments were reinforced by the BoC's updated economic projections in which the central bank lowered its near-term GDP growth forecasts and projected headline and core inflation to return to the 2% inflation target by the second half of next year. Overall, we view this week's announcement as fully consistent with further 25 bps rate cuts at the September and October monetary policy meetings, which would take the central bank's policy rate to 4.00%. While our base case is currently for the Bank of Canada to pause in December, should economic growth, as well as wages and inflation, remain especially subdued, the risks are tilted in the direction of the BoC cutting interest rates at its December meeting as well.

It was also a relatively active week in the policy front in China, with a reduction in several key benchmark interest rates. Following underwhelming Q2 GDP growth of 0.7% quarter-over-quarter, this week's moves included

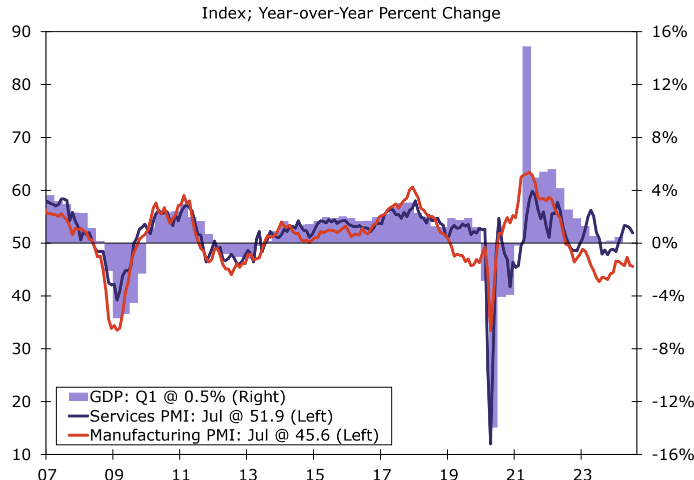
- A 10 bps reduction in the seven-day reverse repo rate to 1.70%, aimed at easing pressure in the bond market.
- Unexpected reductions in the loan prime rates. The one-year loan prime rate was reduced by 10 bps to 3.35%, while the five-year loan prime rate, a reference for mortgages, was reduced by 10 bps to 3.85%.
- A 10 bps reduction to the overnight, seven-day and one-month standing lending facility rates.
- A 20 bps reduction in the one-year medium-term lending facility rate to 2.30%, the largest cut to that benchmark rate since April 2020.

While the interest rate moves are helpful at the margin, in the absence of significant fiscal stimulus, we doubt they will be enough to drive a turnaround in consumer and domestic demand and broader economic growth. Our forecast remains for gradual overall deceleration in the Chinese economy, with our forecast for GDP growth of 4.8% in 2024 and 4.5% in 2025.

Finally, in Turkey, the central bank held its one-week repo rate at 50% this week, as expected. The central bank said it was focusing its attention on a build-up of lira liquidity and said it would maintain a tight monetary policy stance until it sees a lasting slowdown in monthly price increases. Services inflation, inflation expectations, geopolitical risks and food prices were also cited as factors keeping inflationary pressures alive. Given the hawkish leaning announcement, rate cuts are not on the immediate horizon, suggesting that monetary easing could be delayed until 2025.



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



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

The July PMI surveys for the Eurozone and United Kingdom pointed to mixed economic trends across Europe early in the third quarter. The Eurozone PMI surveys unexpectedly softened, with the manufacturing index easing to 45.6, the services index falling to 51.9 and the composite or economy-wide index dropping to 50.1. The results are consistent with the European Central Bank's view that GDP growth could slow from its first quarter pace and that growth risks are potentially tilted to the downside. In terms of the region's largest economies, Germany's manufacturing and services PMIs both fell in July. In France, the manufacturing PMI declined but the services PMI improved—the latter perhaps reflecting some relief following the French elections, and perhaps also getting a boost ahead of the Paris Olympics.

In the United Kingdom, the July PMI readings were more encouraging overall. The manufacturing PMI rose to 51.8— the highest reading since July 2022—with the details showing an increase in the new orders component to 52.0. The services PMI also rose to 52.4, with the new business component jumping to 55.3. The rise in the July PMIs adds to evidence of improving economic momentum coming off the back of monthly GDP figures that suggest solid growth in the second quarter. Against this backdrop, we recently raised our 2024 U.K. GDP forecast to 1.0%. Given signs of stronger growth, and with wages and underlying inflation decelerating only gradually, next week's Bank of England rate decision looks likely to be a close call. While our base case is for the Bank of England to lower interest rates next week, we acknowledge there is also a decent chance that an initial rate cut could be delayed until the central bank's September monetary policy meeting.

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## International Outlook

**Weekly International Indicator Forecasts**

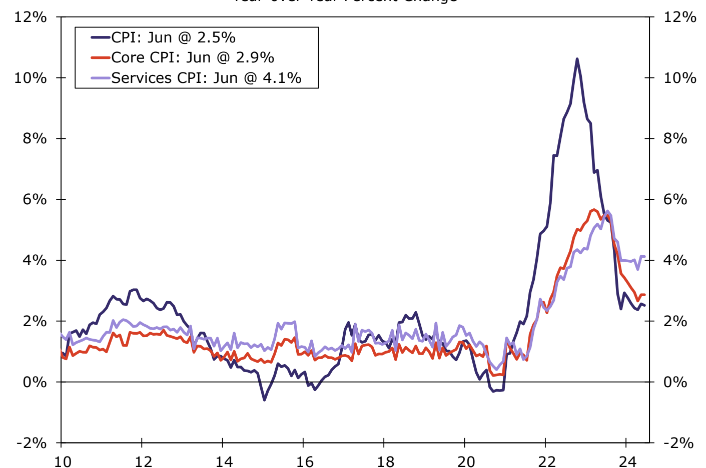
| Date | Indicator | Period | Consensus | Wells Fargo | Prior |
|---|---|---|---|---|---|
| 31-Jul | Eurozone CPI (YoY) | Jul | 2.4% | – | 2.5% |
| 31-Jul | Bank of Japan Policy Rate | 31-Jul | 0.10% | 0.10% | 0.10% |
| 1-Aug | Bank of England Policy Rate | 1-Aug | 5.00% | 5.00% | 5.25% |

Forecast as of July 26, 2024

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

### Eurozone CPI • Wednesday

Next week's July Eurozone CPI will offer the latest reading on inflationary pressures across the region as the European Central Bank contemplates whether to lower its policy rate further at its September meeting. While headline inflation has slowed dramatically from its peak, it has moved broadly sideways since early this year. That is a pattern that likely continued in July, with consensus forecast for the headline CPI to ease only slightly to 2.4% year-over-year.

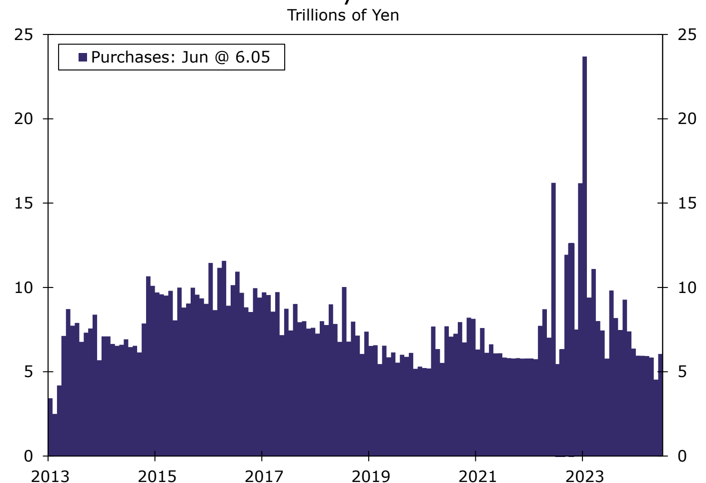


Source: Datastream and Wells Fargo Economics

Core inflation is also forecast to slow modestly to 2.8%, while, helped in part by base effects, services inflation could slow more noticeably. However, even with the slight year-over-year deceleration, when measured on a shorter three- or six-month basis, the annualized rate of core inflation will likely still be elevated above 3%, and annualized rate of services inflation likely still elevated above 4%. Thus while the July CPI will keep the possibility of a September rate cut alive, we doubt it will be decisive. We suspect European Central Bank policymakers will also want to see some moderation in Q2 wage growth, and another tame CPI reading in August, to be fully comfortable in delivering further monetary easing in September.

### Bank of Japan Policy Announcement • Wednesday

The Bank of Japan (BoJ) announces its policy decision next week, with markets focused on whether—and what—steps the central bank will take along its monetary policy normalization path. Recent economic figures have been mixed, suggesting a still uneven economic expansion. Q1 GDP growth was revised to show a larger than previously reported decline, but looking ahead, the details of the Q2 Tankan survey were more encouraging for growth prospects. In May, regular earnings for Japanese workers rose 2.5% year-over-year, the biggest increase since 1993, as the increases at this year's spring wage talks start to get reflected in pay checks. The June core CPI firmed slightly to 2.6% year-over-year but was still a downside surprise.



Source: Datastream and Wells Fargo Economics

Against a backdrop of mixed activity and sentiment data, and a modest acceleration in wages and prices, we believe the BoJ will hold off on a rate hike this month. We expect the central bank to maintain the target range for its policy rate at 0% to 0.1% at next week's meeting. As previously signaled, we do expect the BoJ to provide a detailed plan for a reduction in the pace of its bond purchases over time. Our base case is for the BoJ to reduce the pace of its bond purchases in 1 trillion yen increments. We expect confirmation of a slower ~5 trillion yen pace of bond purchases through the remainder of Q3-2024. We then see a slowing to an ~4 trillion yen pace in Q4-2024, an ~3 trillion yen pace in Q1-2025 and an ~2 trillion yen pace from Q2-2025 forward. Finally, the Bank

of Japan will provide updated growth and inflation forecast. Any significant increase in the medium-term inflation forecasts could portend further rate hikes to come. We forecast the next BoJ rate hike to come in October, by 15 bps to a range of 0.15% to 0.25%.

**Bank of England Policy Rate • Thursday**

The Bank of England's (BoE) latest monetary announcement is due next week, with split views among market participants on whether the BoE will deliver an initial rate cut at its early August meeting. To be sure, comments from some BoE policymakers have leaned more dovish in recent weeks. For example, in the BoE's June policy announcement the central bank in part explained away the persistence of services inflation as due to regulated or index-linked prices, or volatile components. The BoE also said that as part of its August forecast round, it would consider how incoming information affects the assessment that risks from inflation persistence are receding.

Given the apparent inclination of U.K. central bank policymakers to begin moving to a less restrictive monetary policy stance, we expect an initial 25 bps policy rate cut to 5.00% next week, even as recent economic data have not been entirely cooperative. May GDP rose 0.4% month-over-month, more than expected and keeping the economy on track for another solid quarter of growth in Q2. Services inflation held steady at 5.7% year-over-year in June, although wage growth did slow moderately in the three months to May, including regular pay for private sector workers. Still, while we lean toward the BoE beginning its rate cut cycle next week, we acknowledge that lingering inflation concerns mean there is a risk of BoE easing being delayed further, to the central bank's September announcement.

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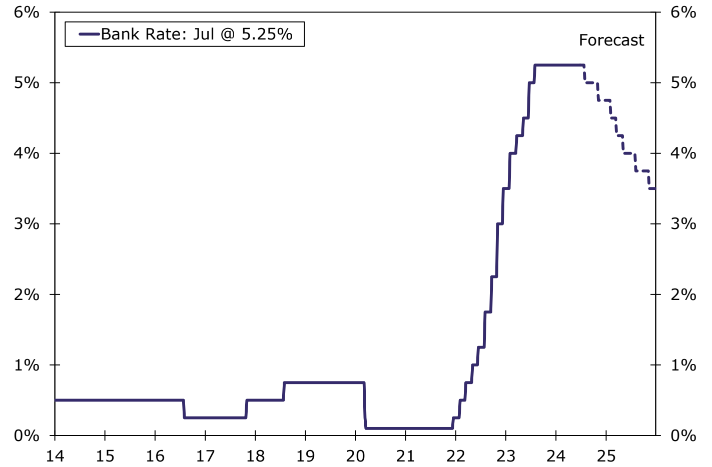


Source: Bloomberg Finance L.P. and Wells Fargo Economics

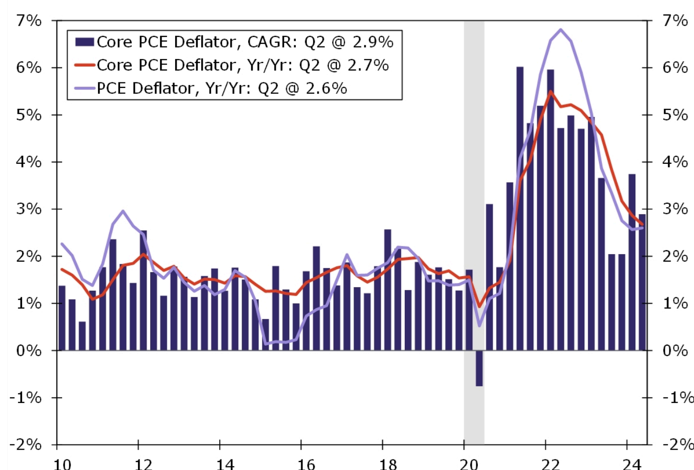
## Interest Rate Watch

### Wake Me Up When September Ends

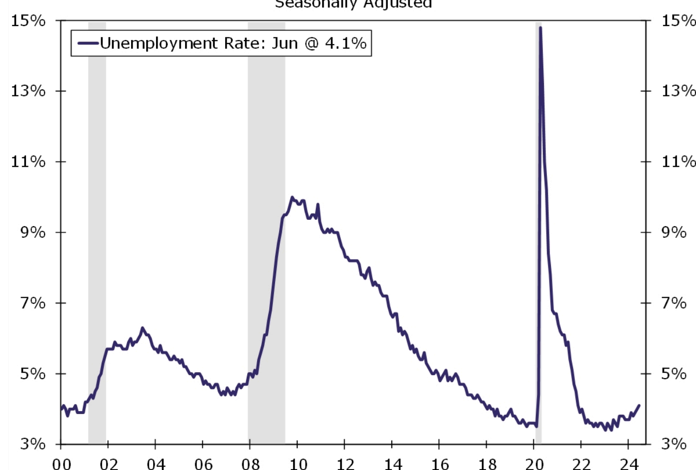
The Federal Open Market Committee (FOMC) meets next week to evaluate the state of monetary policy. We don't expect any policy changes to be announced at next week's meeting, but we do expect the Committee to signal rate cuts are coming as early as its next meeting in September. The FOMC will likely note that it has seen material improvement on inflation in recent months, but that it is also attentive to labor market risks.

Let's start with inflation. As we had anticipated, the Q1 bounce in consumer inflation looks to be nothing more than a bump in the road. The core PCE deflator decelerated to a 2.7% annualized rate in Q2 after accelerating to 3.7% in Q1. At the same time, the year-ago pace of inflation continued to drift lower, with core reaching its lowest rate since the first quarter of 2021 (chart). The job might not be done on inflation, but the year-ago rate has been falling for two years, and we're now closer to target.

This brings us to the labor market. Employers are still adding jobs at a sturdy pace, but nearly all other labor market data have moderated. Job growth has narrowed with government and healthcare accounting for a majority of recent monthly gains, the ratio of open jobs to unemployed workers is again consistent with pre-pandemic levels and business are continuing to lay off temporary workers. Perhaps most concerning is that the unemployment rate has drifted up by a worrying degree (chart).




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




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

The Fed has a dual mandate from Congress: to promote maximum employment and stable prices. A sturdy labor market had allowed the Fed to focus on getting inflation closer to target in recent years, but as inflation nears the mark, labor market moderation is gaining greater importance in calibrating policy. Said differently, the FOMC's reaction function is moving back into balance between its two mandates.

Even as the Fed has held rates steady over the past year, there has been a passive tightening in monetary policy; as inflation has receded the *real* fed funds rate has crept higher. With recent data ensuring inflation progress has resumed and further softening in the labor market materializing, we suspect the Fed is getting ready to loosen policy. We don't think a consensus yet exists among FOMC members to cut rates at next week's meeting, but we expect the Committee to signal rate cuts are coming. Wake me up when these rate cuts finally begin.

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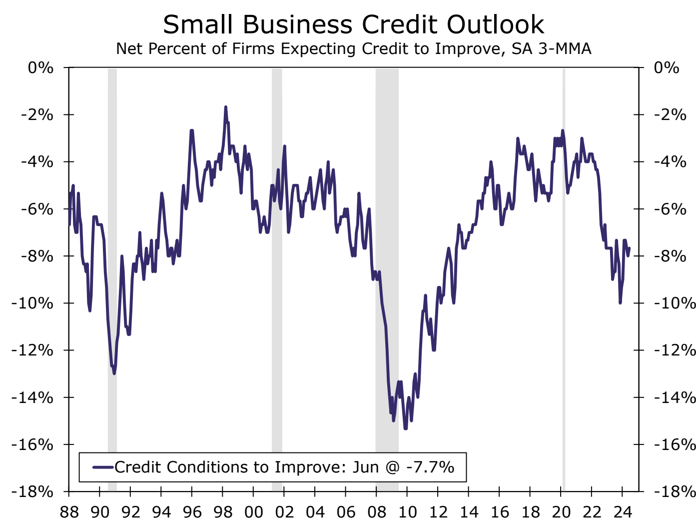
## Credit Market Insights

### Small Businesses Are Feeling the Pinch

While small business optimism has improved in recent months, the NFIB Small Business Optimism Index remains well below its historical average. The lackluster outlook is underpinned by a tight monetary policy backdrop. In 2022, the Federal Reserve undertook its most aggressive rate hiking cycle since the late 1980s to mitigate an upswing in prices. Credit standards tightened along with the rise in borrowing costs, as banks worried about businesses' credit quality amid surging costs and an uncertain future.

Prohibitive interest rates and tighter lending standards have crimped loan availability. The NFIB's loan availability index has been on a steady decline since the pandemic. It currently sits at a net percent of -7%, which means more small businesses reported that it was harder to get a loan in June compared to three months ago than those reporting it was easier. The lack of loan availability is consistent with a sustained weakness in credit quality. The applicant credit quality index of the Kansas City Fed's Small Business Lending Survey improved recently to a net -11% in Q1, yet the *overall* trend in reported credit quality among small businesses is a clear aberration from the positive levels in early 2022.

As the fed funds rate rose to its current peak of 5.25%–5.50%, the interest rate on short-term business loans has similarly followed. The upward climb has firms averaging interest rate payments of a near-modern-high of 9.5% as of June. Suffice to say that small businesses are not only burdened by these tight credit conditions but also by increased pessimism on the activity outlook. Sales have been deterred by inflationary pressures and have worsened expectations for credit conditions: Right before the pandemic, the net percentage of firms expecting credit conditions to improve was historically elevated—today, it stands at nearly four times below that level (chart).



Source: NFIB and Wells Fargo Economics

With tight credit standards, *new* small business lending has faltered. The Kansas City Fed notes that lending rates took yet another consecutive hit with a decline of just over 6% in Q1 of this year. Similarly, in comparison to Q1-2023, total new loans decreased by 6.7%, including a 9.7% decrease in new credit lines, primarily driven by a fall in lending from both large and midsized banks. While concerning, the lending weakness likely stems from soft demand. The Kansas City Fed's loan demand diffusion index has also tapered for eight consecutive quarters with a net -12% of banks reporting weaker loan demand in Q1.

Overall, while these measures emphasize breadth over depth and may overstate credit weakness, it is evident that small businesses have weathered the storm of persistent inflation and the accompanying *higher-for-longer* rates for yet another quarter. Some modest relief may be on the horizon, however. We forecast two 25 bps rate cuts from the Fed later this year, which would lower short-term interest rates and alleviate some pressures off small businesses.

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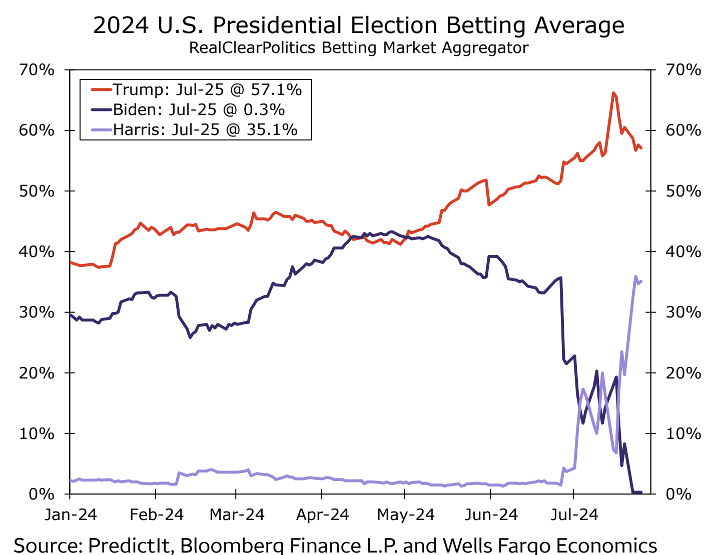
# Topic of the Week

## U.S. Presidential Election Update

The U.S presidential election took yet another historic turn this week, when President Biden announced on Sunday that he will not seek re-election this November. Following his announcement, he went on to endorse Vice President Kamala Harris for the Democratic Party nomination. As we wrote in a note earlier this week, the situation is still a new development, and we would caution against making strong conclusions about the path ahead.

In the days since the initial announcement, Vice President Harris has reportedly secured support from enough delegates to claim the party's official nomination next month. In addition, a large number of prominent members of the Democratic Party have officially endorsed Harris for the nomination, including former President Barack Obama, Senate Majority Leader Chuck Schumer and House Minority Leader Hakeem Jefferies. Prediction markets peg the probability that Vice President Harris secures the nomination at roughly 90%.

There is limited public polling data available about a direct matchup between Harris and Trump. The data that are available show the race roughly in the ballpark of the Biden vs. Trump matchup. That said, we suspect it may take some time for public polls to effectively capture public sentiment on the new matchup in the race, given that Harris is a brand-new candidate for the office of the president and the Democratic National Convention, and selection of a vice presidential candidate for the ticket likely are still a few weeks away. Presently, prediction markets place the probability of another Trump presidency at just below 60%, while they place that of a Harris presidency at about 35% (chart).



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

It is hard to say with any certainty the exact policies a Harris administration, should it come to pass, would pursue. However, it strikes us as likely that such an administration would support many of the economic policies supported by the Biden administration, including continued efforts at student loan forgiveness, protecting and expanding the Affordable Care Act and protecting and expanding the Inflation Reduction Act. In either case, we will be watching closely for any updates on Harris' views on the upcoming expiration of the 2017 Tax Cuts and Jobs Act, which will be one of the largest economic policy questions that the next administration and next Congress will have to negotiate. With just over 100 days to election day, Harris will be making a concentrated pitch to the American people. Even on such a constrained timeline, it is still hard to say exactly how the race will look come November. The lack of modern historical precedent leaves a wide range of possible electoral outcomes on the table, and we will be sure to keep readers updated as the outlook unfolds.

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# Market Data • Mid-Day Friday

## U.S. Interest Rates

| | Friday 7/26/2024 | 1 Week Ago | 1 Year Ago |
|---|---|---|---|
| SOFR | 5.35 | 5.34 | 5.06 |
| Effective Fed Funds Rate | 5.33 | 5.33 | 5.08 |
| 3-Month T-Bill | 5.29 | 5.33 | 5.40 |
| 1-Year Treasury | 4.68 | 4.73 | 5.19 |
| 2-Year Treasury | 4.39 | 4.51 | 4.85 |
| 5-Year Treasury | 4.09 | 4.17 | 4.12 |
| 10-Year Treasury | 4.21 | 4.24 | 3.87 |
| 30-Year Treasury | 4.46 | 4.45 | 3.93 |
| Bond Buyer Index | 3.94 | 3.92 | 3.60 |

## Foreign Exchange Rates

| | Friday 7/26/2024 | 1 Week Ago | 1 Year Ago |
|---|---|---|---|
| Euro ($/€) | 1.086 | 1.088 | 1.109 |
| British Pound ($/£) | 1.286 | 1.291 | 1.294 |
| British Pound (£/€) | 0.844 | 0.843 | 0.857 |
| Japanese Yen (¥/$) | 153.810 | 157.480 | 140.240 |
| Canadian Dollar (C$/$) | 1.384 | 1.373 | 1.321 |
| Swiss Franc (CHF/$) | 0.883 | 0.889 | 0.861 |
| Australian Dollar (US$/A$) | 0.656 | 0.669 | 0.676 |
| Mexican Peso (MXN/$) | 18.395 | 18.048 | 16.842 |
| Chinese Yuan (CNY/$) | 7.248 | 7.270 | 7.143 |
| Indian Rupee (INR/$) | 83.728 | 83.660 | 81.995 |
| Brazilian Real (BRL/$) | 5.654 | 5.598 | 4.738 |
| U.S. Dollar Index | 104.308 | 104.396 | 100.887 |

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

## Foreign Interest Rates

| | Friday 7/26/2024 | 1 Week Ago | 1 Year Ago |
|---|---|---|---|
| 3-Month German Govt Bill Yield | 3.36 | 3.39 | 3.46 |
| 3-Month U.K. Govt Bill Yield | 5.18 | 5.18 | 3.89 |
| 3-Month Canadian Govt Bill Yield | 4.42 | 4.46 | 5.03 |
| 3-Month Japanese Govt Bill Yield | 0.06 | 0.02 | -0.09 |
| 2-Year German Note Yield | 2.62 | 2.78 | 3.13 |
| 2-Year U.K. Note Yield | 3.92 | 4.00 | 5.03 |
| 2-Year Canadian Note Yield | 3.60 | 3.73 | 4.68 |
| 2-Year Japanese Note Yield | 0.40 | 0.35 | -0.04 |
| 10-Year German Bond Yield | 2.41 | 2.47 | 2.49 |
| 10-Year U.K. Bond Yield | 4.10 | 4.12 | 4.28 |
| 10-Year Canadian Bond Yield | 3.33 | 3.40 | 3.48 |
| 10-Year Japanese Bond Yield | 1.07 | 1.04 | 0.46 |

## Commodity Prices

| | Friday 7/26/2024 | 1 Week Ago | 1 Year Ago |
|---|---|---|---|
| WTI Crude ($/Barrel) | 76.72 | 80.13 | 78.78 |
| Brent Crude ($/Barrel) | 80.71 | 82.63 | 82.92 |
| Gold ($/Ounce) | 2385.24 | 2400.83 | 1972.07 |
| Hot-Rolled Steel ($/S.Ton) | 664.00 | 657.00 | 835.00 |
| Copper (¢/Pound) | 410.40 | 421.90 | 389.05 |
| Soybeans ($/Bushel) | 11.36 | 11.47 | 15.26 |
| Natural Gas ($/MMBTU) | 2.03 | 2.13 | 2.67 |
| Nickel ($/Metric Ton) | 15,503 | 16,150 | 22,201 |
| CRB Spot Inds. | 542.66 | 555.62 | 562.20 |

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