Economics

Weekly — June 28, 2024

# Weekly Economic & Financial Commentary

United States: **It May Be Hot Outside, but Inflation Is Finally Cooling**

- According to the Federal Reserve's preferred gauge, core inflation cooled to its softest pace in more than three years in May against a backdrop of measured consumer spending and still-strong personal income. Elsewhere, the effect of higher rates remains evident in uninspiring data on capital investment and the housing market.
- Next week: Construction Spending (Mon.), ISM Manufacturing (Mon.), Employment (Fri.)

International: **Bird Food: Some Dovish Central Bank Rate Holds Amid Lighter Global Data Week**

- Although this week's central bank decision lineup was somewhat lighter than last week's, multiple institutions delivered updates to their monetary policy assessments. Sweden's Riksbank delivered a dovish policy rate hold. In Mexico, Banxico held rates steady at 11.00% and offered commentary consistent with our outlook for cautious central bank easing.
- Next week: China PMIs (Sun.), Japan Tankan Survey (Mon.), Eurozone CPI (Tue.)

Interest Rate Watch: **QT Gradually Putting Upward Pressure on Money Market Rates**

- The FOMC has left its main policy tool, the federal funds rate, unchanged for nearly a year as it awaits further progress on bringing inflation back down to 2%. However, the Federal Reserve continues to reduce the size of its balance sheet as part of its quantitative tightening (QT) program. Ongoing QT is gradually starting to put upward pressure on money market rates, such as the Secured Overnight Financing Rate (SOFR).

Credit Market Insights: **Strong Net Worth Gains Cloud Slowing Growth in Cash**

- Household net worth climbed to new highs across all wealth cohorts in Q1. Most of household wealth is tied up in relatively illiquid assets such as corporate equities and real estate. How are liquid "cash" assets holding up for households relative to pre-pandemic and over the past year?

Topic of the Week: **Yen Reaches Its Weakest Level Against the Greenback since 1986**

- This week, the yen reached its weakest intraday level against the greenback since 1986. The currency's dramatic slide over the past few years has spurred Japan's Ministry of Finance to intervene a couple of times. Will Japan continue to intervene, and how long can it do so?

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

**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 | 1.9 | 1.8 | 1.5 | 1.9 | 2.5 | 2.3 | 1.9 |
| Personal Consumption | 3.8 | 0.8 | 3.1 | 3.3 | 1.5 | 1.9 | 1.6 | 1.7 | 2.5 | 2.2 | 2.2 | 1.8 |
| Consumer Price Index [2] | 5.7 | 4.0 | 3.6 | 3.2 | 3.2 | 3.3 | 3.0 | 3.0 | 8.0 | 4.1 | 3.1 | 2.6 |
| "Core" Consumer Price Index [2] | 5.5 | 5.2 | 4.4 | 4.0 | 3.8 | 3.5 | 3.5 | 3.5 | 6.2 | 4.8 | 3.6 | 2.9 |
| 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 | 7.00 | 6.75 | 6.50 | 5.38 | 6.80 | 6.77 | 6.09 |
| 10 Year Note | 3.48 | 3.81 | 4.59 | 3.88 | 4.20 | 4.35 | 4.15 | 4.00 | 2.95 | 3.96 | 4.18 | 3.83 |

Forecast as of: June 14, 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.

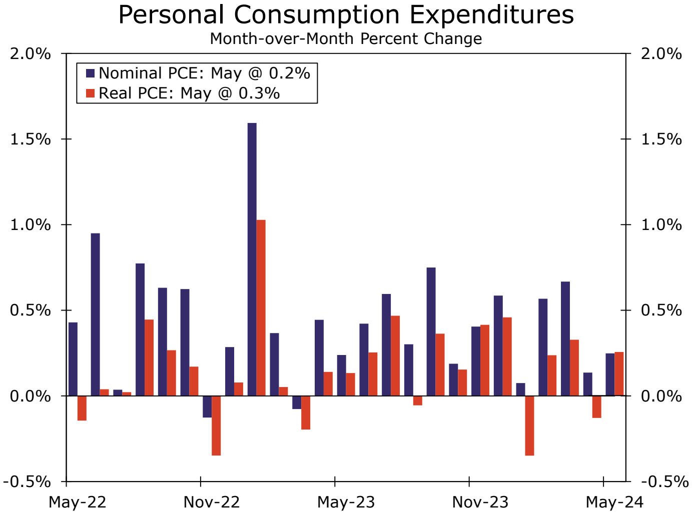
## U.S. Review

### It May Be Hot Outside, but Inflation Is Finally Cooling

The star of the show this week was the Bureau of Economic Analysis' monthly report on personal income and spending, which included updates to the Fed's preferred PCE inflation gauge. By and large, the data demonstrate a more measured consumer, with income growing at a strong clip and personal outlays growing more modestly. Personal spending was up 0.2% on a nominal basis, and real personal spending was up 0.3% on the month. Personal income was up 0.5% in May, tied for the second-highest monthly increase this year. Strong gains in income remain critical as paychecks have become the primary source of purchasing power for households.

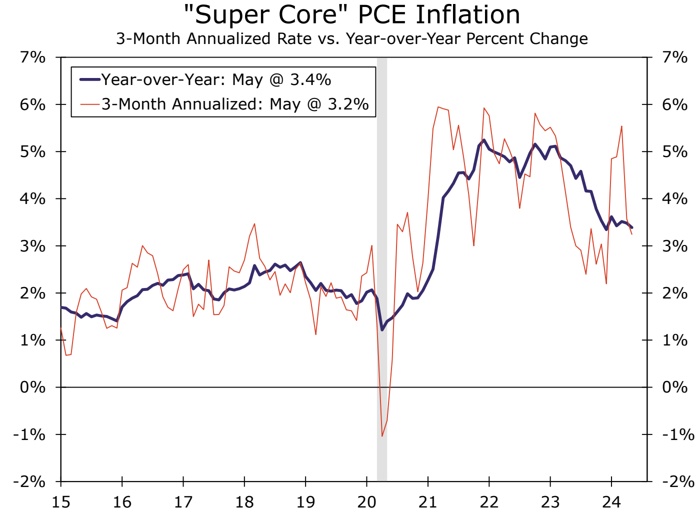
On the inflation front, moderating price level growth made for solid real income gains for consumers. Headline monthly PCE inflation was ever-so-slightly negative on an unrounded basis, and core PCE inflation grew a modest 0.1%. This brought the year-over-year rate for both measures down to 2.6%. That's the lowest rate of core inflation in over three years and just a tenth above the softest rate for headline inflation over the same period. Notably, core services less primary shelter inflation, otherwise known as "super core" inflation, abated to 3.2% on a three-month annualized basis. For the first time this year, the three-month annualized rate is now below the year-over-year rate of 3.4%, a positive development on the road to low and stable inflation, given the stubbornness of services inflation in recent months. The strong-yet-measured consumer in May data in tandem with welcome moderation in PCE inflation data proved to be a policymaker's dream. If inflation pressures continue to ease in accordance with our forecast, we still view the FOMC as on track to begin cutting the fed funds rate at its September meeting.

Personal Consumption Expenditures




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

"Super Core" PCE Inflation




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

Elsewhere in the economy, data were mixed this week. Durable goods orders surprised to the upside in May, as new orders rose 0.1%. The unexpected strength came from nondefense aircraft orders falling 'only' 2.8%, in contrast to relatively weak orders data from Boeing released earlier in the month. Motor vehicle orders were up on the month, offsetting some weakness from nondefense aircraft. Despite the upside surprise, the report was consistent with a challenged demand environment for durable goods and demonstrates that the manufacturing sector remains under pressure. Core capital goods orders, a key measure of demand in the sector, slipped 0.6%, now down 0.2% year-over-year. Production activity fared no better, with durable goods shipments falling 0.3% in May. Core capital goods shipments, which flow into the calculations for equipment spending in the GDP accounts, declined 1.5% and suggest some downside risk to our forecast for 5.1% annualized growth in equipment spending in Q2.

Final revisions to Q1 GDP data were in line with expectations, rising a tenth to 1.4% annualized growth. Despite the on-consensus outturn, there was plenty of movement under the surface. Personal consumption was revised lower to 1.5%, down from an initially reported 2.5% annualized gain in the advance estimate. Downward revisions to both goods and services consumption contributed to the drop. Upward revisions to net exports, investment and government spending offset the slower growth in personal consumption.

The housing market has been constrained thus far through the first half of the year, with May housing data continuing the downbeat mood. New home sales fell 11.3% in May to a 619K-unit pace. Higher mortgage rates, an incremental lift in inventory of existing homes and moderating economic growth have led to a softening in the new homes market. Still, upward revisions to data from earlier in the year take some of the sting out of this month's number, revealing the new homes market to be more resilient than previously thought. Pending home sales also declined in May, falling 2.1% on the month. On a year-over-year basis, pending home sales are now down 6.6%, extending the streak of negative year-over-year growth to 30 consecutive months. Separately released data showed the S&P Case-Shiller National Home Price Index rose 0.3% in April and is now up 6.3% over the past year. Home price growth has been moderating in recent months, with month-over-month growth having softened in each of the past three months.

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## U.S. Outlook

**Weekly Domestic Indicator Forecasts**

| Date | Indicator | Period | Consensus | Wells Fargo | Prior |
|---|---|---|---|---|---|
| 1-Jul | ISM Manufacturing Index | Jun | 49.2 | 48.8 | 48.7 |
| 1-Jul | Construction Spending (MoM) | May | 0.3% | 0.3% | -0.1% |
| 2-Jul | Total Vehicle Sales | Jun | 15.85M | 16.00M | 15.90M |
| 3-Jul | Trade Balance | May | -$76.0B | -$76.5B | -$74.6B |
| 3-Jul | Factory Orders (MoM) | May | 0.3% | 0.5% | 0.7% |
| 3-Jul | ISM Services Index | Jun | 52.7 | 52.2 | 53.8 |
| 5-Jul | Nonfarm Payrolls | Jun | 185K | 200K | 272K |
| 5-Jul | Unemployment Rate | Jun | 4.0% | 3.9% | 4.0% |
| 5-Jul | Average Hourly Earnings (MoM) | Jun | 0.3% | 0.3% | 0.4% |

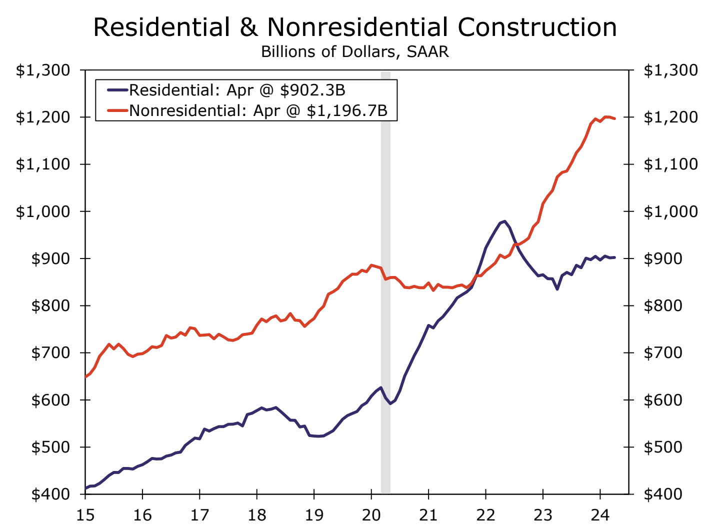
Forecast as of June 28, 2024

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

### Construction Spending • Monday

Construction spending has been surprisingly resilient to higher interest rates. Construction outlays dipped 0.1% in April but were up 10.0% on a year-to-date basis. A boom in manufacturing facility construction and uptrend in single-family homebuilding have been bright spots in an otherwise dim environment for builders. Infrastructure outlays have also picked up as funds from the Infrastructure Investment and Jobs Act (IIJA) begin to be doled out. We expect the tailwinds supporting these segments to outweigh weakness in commercial and multifamily construction in May, and we anticipate a 0.3% increase in overall construction outlays.

Looking further ahead, both residential and nonresidential construction spending are poised to soften. Persistently elevated mortgage rates have weighed on buyer traffic and homebuilder confidence, bringing the pace of single-family housing permits in May to its lowest level in 10 months. Construction starts have also plummeted for office, retail and industrial projects amid high financing costs and a soft demand environment. Although multifamily demand is sturdier, we expect apartment outlays to continue to weaken as high vacancy rates discourage new development.

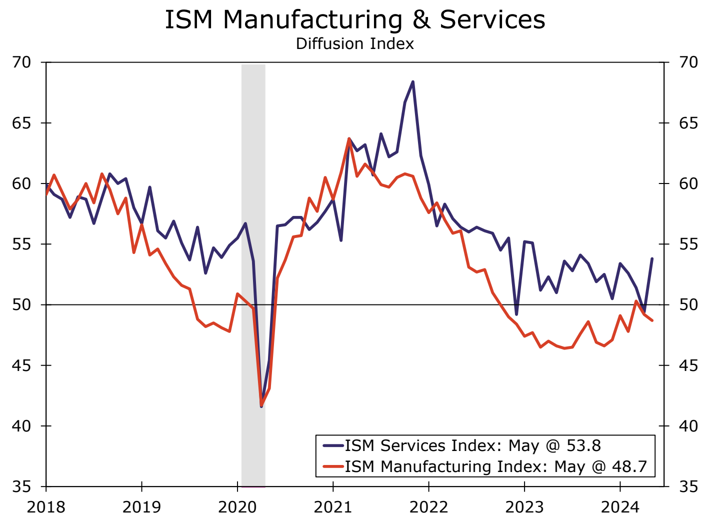



Source: U.S. Department of Commerce and Wells Fargo Economics

### ISM Manufacturing & Services • Monday & Wednesday

Manufacturing is not out of the woods. After briefly entering expansionary territory (above 50.0) earlier this year, the ISM Manufacturing Index dropped to 48.7 in May, the second sequential decline and the second-lowest reading so far in 2024. The production index technically indicated expansion with a reading of 50.2; however, new orders sank to their lowest level in a year. A weak outturn for durable goods orders in May suggests that demand remains tepid. We suspect that economic uncertainty, tight credit conditions and elevated borrowing costs will continue to constrain capex spending and industrial production, at least until the path of monetary policy comes into clearer view. We expect the ISM Manufacturing Index to post another contractionary reading of 48.8 in June.

Meanwhile, seemingly unshakable consumer demand for services continues to propel the services industry. The ISM Services Index reached 53.8 in May, marking the highest monthly jump in 16 months. Even as consumers lean into non-discretionary purchases like housing and healthcare, services spending continues to grow at a remarkable rate. Real personal consumption expenditures on services has only slipped in three of the past 30 months. Unfortunately, formidable services demand is working against the Fed's goal of price stability. Fourteen industries reported higher input costs in May, while none reported a decrease in prices paid. We estimate the ISM Services Index to dip back slightly in June but remain firmly in expansion, estimating a print of 52.2.

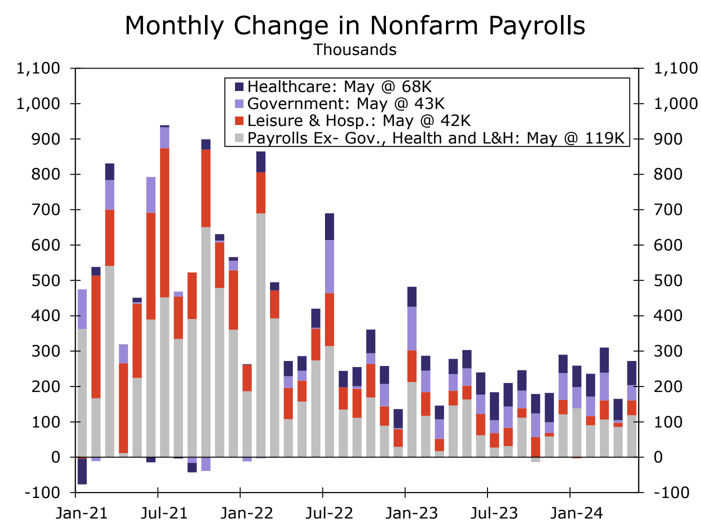


Source: Institute for Supply Management and Wells Fargo Economics

### Employment • Friday

Hiring has yet to meaningfully lose steam. Nonfarm payrolls rose by 272K in May, nearly 100K more than expected by forecasters. While robust job gains have coincided with general economic resilience to the Fed's tightening cycle, strong headline prints in recent months mask some broader signs of labor market cooling. The ongoing slip in job openings and deteriorating perceptions of job availability suggest that labor demand is not what it once was a year or two ago. Additional weakening is evident in the unemployment rate creeping up to 4.0% in May, the highest reading since January 2022, and rising continuing claims for unemployment. Household employment, once adjusted to match the scope of nonfarm payrolls, has *fallen* in three of the past five months.

Digging deeper, two-thirds of nonfarm payroll gains over the past year have stemmed from only three industries: government and healthcare, which are less cyclically sensitive, and leisure & hospitality, which is still trying to find its footing after the pandemic. These sectors are likely to remain significant contributors in the short term, but fading tailwinds are apt to reduce overall job growth in the months ahead. We expect 200K payrolls were added on net in June. Meanwhile, we estimate that the unemployment fell back to 3.9% and average hourly earnings advanced 0.3% over the month.



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

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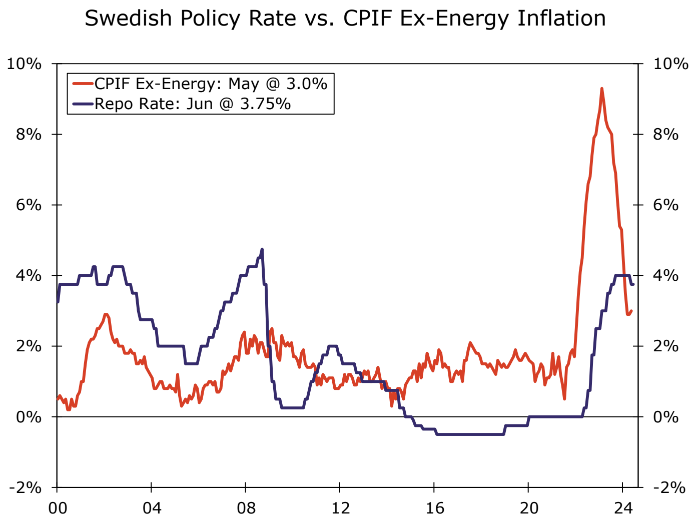
# International Review

## Bird Food: Some Dovish Central Bank Rate Holds Amid Lighter Global Data Week

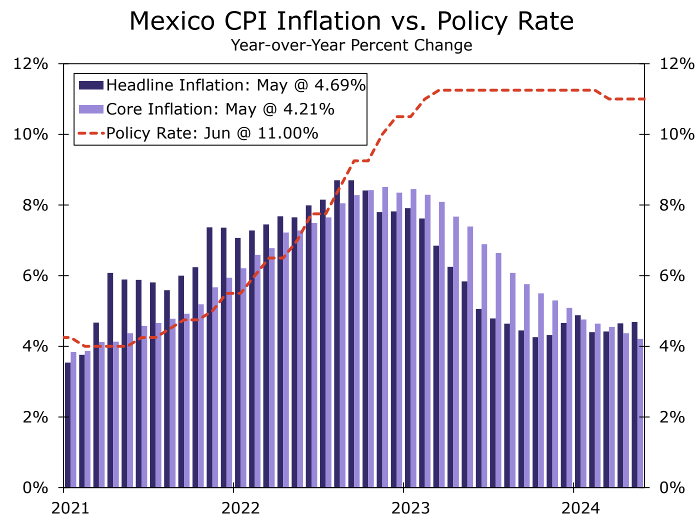
Although this week's central bank decision lineup was somewhat lighter than last week's slate, multiple institutions in both advanced and emerging economies delivered updates to their monetary policy assessments over the past several days. To start, the Riksbank, Sweden's central bank, delivered a dovish policy rate hold at 3.75%. In its accompanying announcement, policymakers noted that if the inflation outlook remains well-anchored, "the policy rate can be cut two or three times during the second half of the year," a dovish shift since their May meeting where the central bank only signaled two further rate cuts in 2024. In other notable developments, the Riksbank lowered its CPIF inflation forecasts for 2024 to 2026, core CPIF inflation forecasts for 2024 and 2025, and forecasts for the policy rate through Q2-2026. In its assessment of Swedish economic conditions, policymakers highlighted the fact that inflation has continued to return closer to the 2% target, and that inflation expectations are signaling a return to on-target inflation over the longer term. Officials also noted that they expect wage growth to slow down from Q2-2024 onward, and for economic growth to slowly recover in the second half of this year and beyond. We believe that policymakers, in consideration of encouraging inflation progress, economic growth that is only gradually recovering, and only moderate wage growth, will opt to deliver three rate cuts this year. We maintain our forecast for the central bank to deliver 25 bps rate reductions at its August, November and December meetings for an end-2024 policy rate of 3.00%.

Banxico, Mexico's central bank, also delivered a dovish policy rate hold this week at 11.00%. Four out of five policymakers voted for the rate hold, with one calling for a 25 bps cut. In the policy announcement, Banxico's Governing Board noted that although Mexico's financial markets have been volatile—with higher government bond yields and a weaker Mexican peso—they have become more well-behaved recently. Policymakers also noted that the inflationary effects of a weaker local currency are partly offset by the effects of softer economic activity. Overall, Banxico officials do not appear to be excessively concerned by recent local financial market developments in the context of their inflation and monetary policy outlook. Policymakers highlighted the continued easing in core inflation, and reaffirmed their forecasts for headline and core inflation to return to the 3% target by year-end 2025. Risks to the inflation outlook do remain biased to the upside, according to the board, meaning that it will continue to conduct monetary policy "prudently," but the board also referred to the possibility of further monetary policy easing, given the inflationary environment. We see Banxico proceeding with monetary easing at a cautious pace for now, keeping the policy rate on hold at 11.00% through Q3 before lowering it by 25 bps in Q4.

In other global central bank news, the Philippine central bank held rates steady at 6.50%, Turkey's central bank held its one-week repo rate at 50.00% and the Czech central bank cut rates by more than expected, to 4.75%, but signaled a cautious stance toward further rate reductions.




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




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

In other economic data this week, Canada's inflation figures from May showed a surprise acceleration in price pressures. Thanks largely to higher services prices, headline CPI inflation picked up to 2.9% year-over-year against expectations for a further slowing. The average of core measures of inflation followed the same pattern, coming in at 2.9%. Services inflation sped up to 4.6% year-over-year. This marked an interruption to four months of consecutive easing in underlying price pressures, and we believe this development will keep Bank of Canada (BoC) policymakers on the sidelines next month with a rate pause. Beyond that, we expect underlying inflation to return to an overall slowing trend as 2024 progresses, and look for the BoC to deliver an additional 75 bps of rate cuts through the end of this year. Canada was not the only advanced economy that saw an uptick in inflation in May; in Australia, headline CPI inflation accelerated by more than expected to 4.0% year-over-year. Headline monthly inflation has now sped up for three consecutive months. Services inflation also came in hot in May, speeding up to 4.8%. We view these data as consistent with our outlook for the Reserve Bank of Australia to hold rates steady at 4.35% all of 2024 in order to tamp down persistent inflation.

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## International Outlook

**Weekly International Indicator Forecasts**

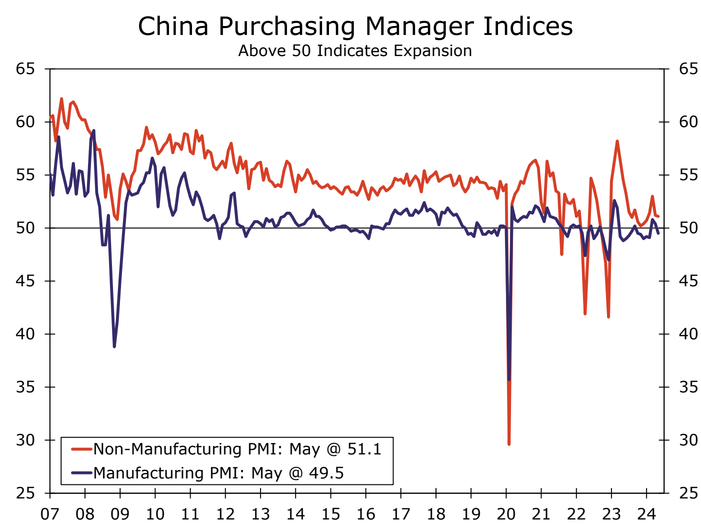
| Date | Indicator | Period | Consensus | Wells Fargo | Prior |
|---|---|---|---|---|---|
| 30-Jun | China Manufacturing PMI | Jun | 49.5 | – | 49.5 |
| 30-Jun | China Nonmanufacturing PMI | Jun | 51.0 | – | 51.1 |
| 1-Jul | Japan Tankan Large Mfg Index | Q2 | 11 | – | 11 |
| 1-Jul | Japan Tankan Large Non-Mfg Index | Q2 | 33 | – | 34 |
| 2-Jul | Eurozone CPI (YoY) | Jun | 2.5% | – | 2.6% |

Forecast as of June 28, 2024

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

### China PMIs • Sunday

China's official June PMI figures coming out next week will provide timely insight into the state of the economy. Economic data from China as of late have been generally mixed. While the economy expanded 5.3% year-over-year in the first quarter, it appears that this momentum may not be carrying through beyond the start of the year. To that point, retail sales activity has been somewhat modest and the latest industrial production data from May were a meaningful downside surprise. Also in May, both the manufacturing and non-manufacturing PMI figures declined for the second-straight month, though the non-manufacturing index managed to stay above the 50 "breakeven" level, reaffirming the mixed nature of recent Chinese economic data. Consensus economists expect the manufacturing PMI held steady in June at 49.5 and the non-manufacturing PMI ticked down slightly to 51.0.



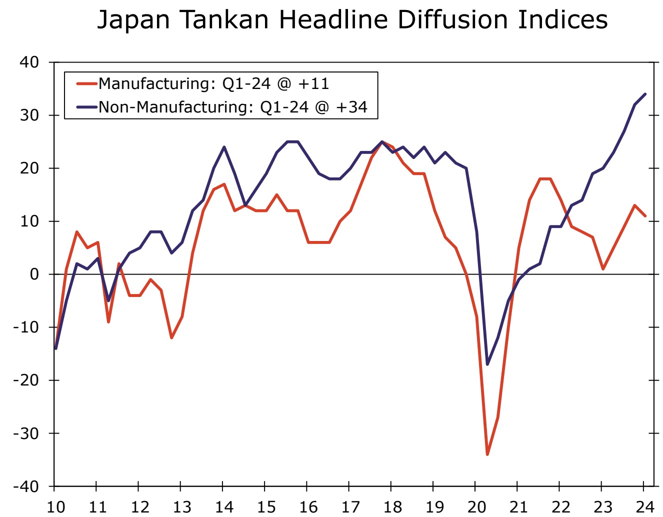

Source: Bloomberg Finance L.P. and Wells Fargo Economics

If economic activity and sentiment data continue to be mildly subdued in China, this would be consistent with our view for the country's economy to slow down in the medium to longer term. We believe structural challenges and geopolitical tensions will limit the extent to which the Chinese economy can expand in the coming years. After likely achieving this year's official GDP growth target of around 5%, we see the economy slowing to a 4.3% growth pace in 2025.

### Japan Tankan Survey • Monday

Next week, Japan's Q2 Tankan Survey—a closely watched measure of business sentiment—will provide market participants with a timely reading of Japanese economic conditions. Consensus economists expect the survey results to hold broadly steady, which would be mildly encouraging for the Japanese economic outlook. The consensus forecast is for the Large Manufacturing Index to hold steady at 11, and the Large Non-Manufacturing Index to tick down slightly to 33 from 34 previously, which would still be a historically elevated level. Market participants will likely be most sensitive to an upside surprise in the context of the Bank of Japan's (BoJ) monetary policy normalization efforts. Another closely watched aspect of the quarterly Tankan report are firms' capital investment plans for the current fiscal year, which began in April. In Q1, firms expected to grow their spending by 4.0% over the fiscal year, and consensus economists expect firms to upwardly revise their plans to 13.8% spending growth for the year.

If the consensus forecasts are realized, this would generally be consistent with our view that the Japanese economy can continue to gradually recover over 2024 and into 2025, as faster wage growth contributes to improving income dynamics for households and supports overall economic growth. That said, we believe the Bank of Japan (BoJ) will take a gradual approach to monetary policy normalization alongside a gradual improvement in economic trends. As such, we look for the BoJ to hike its policy rate in October 2024 and again in April 2025. For more information on our BoJ outlook, please see our recent report.

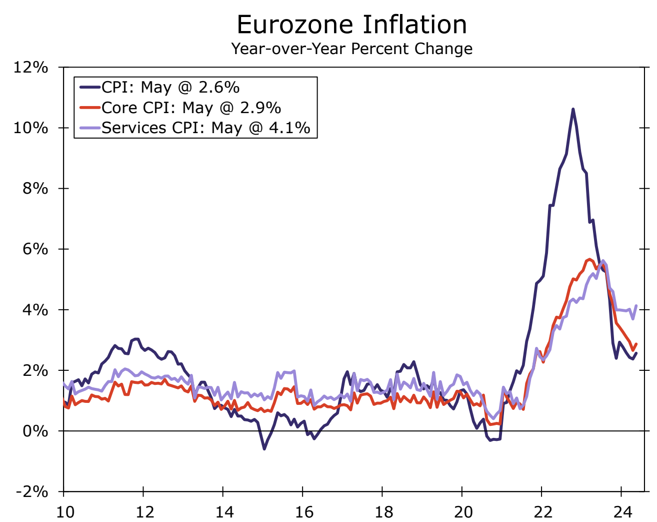



Source: Bloomberg Finance L.P. and Wells Fargo Economics

### Eurozone CPI • Tuesday

Eurozone CPI inflation figures for June coming out next week will provide market participants with further insight into the potential future path for European Central Bank (ECB) monetary policy. Consensus economists expect headline CPI inflation to ease slightly to 2.5% year-over-year, and for core inflation to tick down modestly to 2.8%.

We believe that, thanks to persistence in services and wage inflation in the Eurozone, the ECB will proceed with its already-begun easing cycle at a cautious pace. Services inflation popped to 4.1% year-over-year in May and wage growth remains elevated at around 5%. ECB policymakers will likely be wary of moving forward with rate cuts too quickly, in our view. We expect the central bank to pause at its July meeting before delivering just two more rate cuts in 2024 in September and December. If next week's data on price pressures for June surprise to the upside, this could increase the risks that the September rate cut in our current forecast is pushed back to October.




Source: Datastream and Wells Fargo Economics

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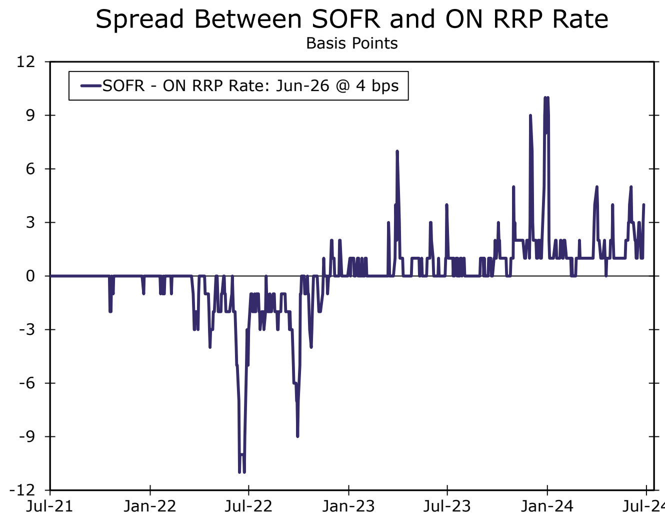
## Interest Rate Watch

### QT Gradually Putting Upward Pressure on Money Market Rates

The FOMC has left its main policy tool, the federal funds rate, unchanged for nearly a year as it awaits further progress on bringing inflation back down to 2%. However, the Federal Reserve continues to reduce the size of its balance sheet as part of its quantitative tightening (QT) program. The Federal Reserve's security holdings peaked at roughly $8.5 trillion in early 2022 as policymakers concluded their enormous bond buying spree that began in March 2020. Starting in June 2022, the Fed began shrinking its security holdings, and those holdings have declined to $6.8 trillion today, a $1.7 trillion reduction from the peak. Furthermore, QT is still ongoing at roughly a $45 billion per month pace.

QT can impact intermediate- and longer-term interest rates as the Fed's reduced security holdings must be absorbed by private investors. An increase in bond supply will put downward pressure on prices and upward pressure on yields, all else equal. However, QT also impacts very short-term interest rates. A decline in the asset side of the Fed's balance sheet (predominantly Treasury securities and mortgage-backed securities) must be matched by a commensurate decline on the liability side of the central bank's balance sheet. Most of the Fed's liability decline has been from reverse repurchase agreements and bank reserves, two sources of overnight liquidity in the financial system. As additional collateral is pumped into the system and liquidity is drained out, this can put upward pressure on money market rates over time.



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

For much of the pandemic quantitative easing (QE) era, the Secured Overnight Financing Rate (SOFR) was in line or even below the rate the Federal Reserve paid on overnight reverse repurchase agreements. This signaled that the supply of overnight loanable funds was abundant and well in excess of demand for such funds. However, more recently, SOFR has begun to print above the RRP rate, particularly around month-end and quarter-end when balance sheet pressures can be most acute (chart).

For now, this upward drift in SOFR and other money market rates has been relatively modest and is a sign that the abundant liquidity from the pandemic is dissipating. That said, the Federal Reserve does not want bank reserves to become so scarce it creates undesirable strains in the financial system. In September 2019, SOFR spiked more than 300 bps in what was a clear sign that the Federal Reserve's QT program had gone too far.

Our base case forecast assumes that the current QT episode will last through Q1-2025, at which point the Federal Reserve will have moved from an "abundant" to merely an "ample" reserve environment. Policymakers will be watching SOFR and a wide array of other indicators for signs that QT should run longer or wrap up sooner, and this week's quarter-end will provide one more small piece of the puzzle.

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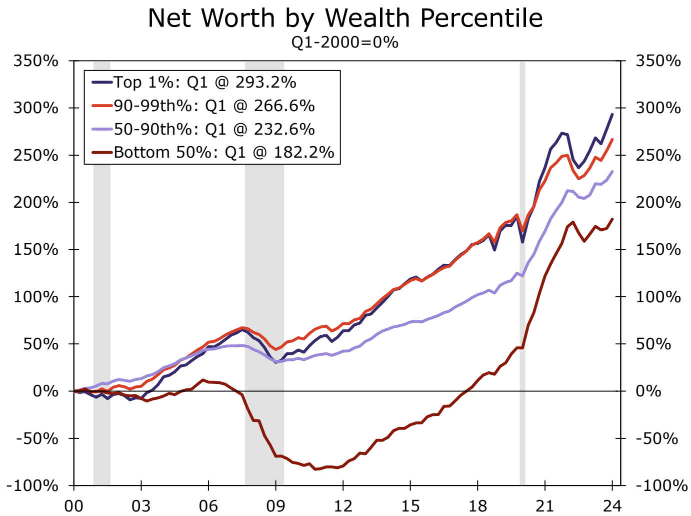
## Credit Market Insights

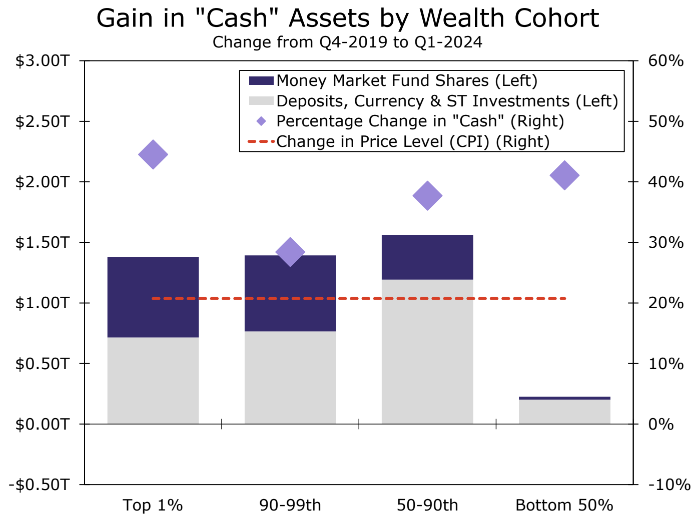
### Strong Net Worth Gains Cloud Slowing Growth in Cash

Household net worth climbed to new highs across all wealth cohorts in the first quarter (chart). After stimulus payments, a sharp rebound in equity prices post-lockdown and swelling real estate equity all boosted net worth over 2020 and 2021, growth in wealth stalled in late 2022. However, the renewed rise in stock prices and further appreciation in home prices have continued to support asset growth into the first quarter of 2024. Even the lowest bracket's net worth has now surpassed its initial post-COVID peak from Q2-2022.

While the strength in household net worth supports consumer spending via a wealth effect (i.e., consumers feel richer and accordingly increase their outlays), much of household wealth is tied up in relatively illiquid assets that cannot be easily drawn down to finance consumption. For the highest wealth brackets, a little less than half of their assets tends to be locked away in corporate equities & mutual fund shares, which are disproportionately kept in retirement accounts. The next largest share of assets—making up roughly a fifth—for the top 1% is held in private businesses. For the lowest wealth cohort, nearly half of assets are in real estate. Growth in these relatively illiquid holdings over the past year have driven net worth increases. That said, liquid "cash" assets, though comprising a small portion of each group's wealth profile, have also risen since the pandemic, supporting consumer spending.




Source: Federal Reserve Board and Wells Fargo Economics




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

Compared to Q4-2019, all wealth brackets have seen a rise in cash assets, with the top 1% seeing the largest increase with a 45% gain (chart). The bottom cohort has seen a jump almost as high in percentage terms, with assets held in money market fund shares and in deposits, currency & short-term investments up 41% since the eve of the pandemic. Notably, all cohorts have witnessed their cash assets outpace the cumulative 21% inflation over the same time period.

That said, while liquid spending power as measured by "cash" assets is up more than inflation compared to pre-pandemic, momentum in cash growth has faded over the past year or so. From Q1-2023 to Q1-2024, total cash assets for all cohorts grew 2.0%, with the lowest wealth bracket's cash assets *down* 1.0% during the period. At the same time, total CPI inflation rose 3.5%. All in all, household balance sheets may be holding up to the cumulative rise in inflation and multiple years of high interest rates, but spending power is eroding — especially at the lower end of the wealth spectrum, where cash assets have declined on a year-ago basis for the past six quarters. The difference between the relative financial position of households when compared to pre-pandemic versus the recent worsening trend may be contributing to the cognitive dissonance evident in consumer confidence that is stuck in a rut.

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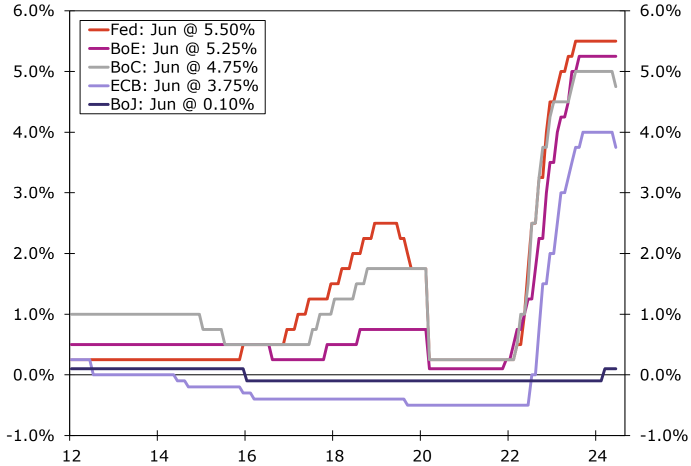
## Topic of the Week

### Yen Reaches Its Weakest Level Against the Greenback since 1986

The past few years have been characterized by divergence among global economies. Robust growth in the United States, along with persistent inflation, led the Federal Reserve to hike its policy rate more aggressively than other major central banks (chart). More recently, the Fed's "higher for longer" policy stance has maintained interest rate differentials that in turn have sustained the dollar's strength against a variety of currencies, particularly the Japanese yen.

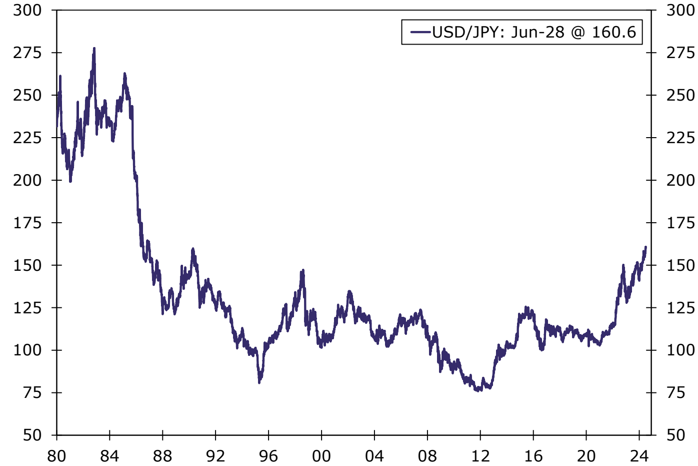
This week, the dollar-yen exchange rate breached 160 for only the third time in the past few decades, and the yen reached its weakest intraday level against the greenback since 1986. This has stirred memories of the 1985 Plaza Accord when finance ministers of the G5 (West Germany, France, the United Kingdom, the United States and Japan) met in the iconic Plaza Hotel in New York City to coordinate foreign exchange intervention to bring down the value of the dollar. The concerted effort was largely successful, as evidenced by the trend decline in the dollar index, which shed 40% of its value by the end of the decade. Partners in the G7, the successor of the G5, have broadly agreed that such interventions should be seldom used today. While not strictly permissible, unilateral interventions amid heightened currency market volatility have not been met with serious pushback.

Major Central Bank Policy Rates




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

Dollar-Yen Exchange Rate




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

Indeed, the yen's dramatic slide has spurred Japan's Ministry of Finance to intervene. The Bank of Japan bought 2.8 trillion yen in September 2022, 6.3 trillion yen in October 2022 and 9.8 trillion yen in April-May 2024. The operations resulted in sharp appreciations, but each reprieve was short-lived (chart). Historically, foreign exchange interventions aimed at changing the direction of a given exchange rate have had limited success *unless* fundamental economic conditions change, or there is coordination among other major central banks, such as what occurred with the Plaza Accord. In short, the Ministry of Finance's interventions thus far have not stymied the weakening trend in the yen.

So, will Japan continue to intervene and how long can it do so? On Thursday of this week, Japanese Finance Minister Shunichi Suzuki told reporters the ministry will "take necessary action as needed." In U.S. dollar terms, the BoJ has roughly $1.1 trillion worth of FX reserves to deploy at present. The last intervention equated to about $62 billion, which implies the BoJ could technically intervene 17 more times in similar scale before it depletes its reserves.

While we would not rule out further intervention, we doubt the Ministry of Finance will significantly run down Japan's FX reserves, especially with potential help on the way in terms of monetary policy. In its latest policy announcement, the BoJ expressed some optimism on the economic outlook. It pointed to firming inflation and wage growth as reasons to normalize policy after providing ultra-easy support over the past few decades. We anticipate output growth to gradually strengthen in the coming quarters, which will pave the way for two more BoJ policy rate increases (15 bps in October and 25 bps in April 2025). Over the same timeframe, we suspect U.S. real GDP growth will downshift and look for the FOMC to ease 50 bps this year and 100 bps in 2025. The narrowing yield differential should allow the yen to modestly strengthen against the dollar in the coming quarters, even in the absence of foreign exchange intervention.

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## Market Data • Mid-Day Friday

### U.S. Interest Rates

| | Friday 6/28/2024 | 1 Week Ago | 1 Year Ago |
|---|---|---|---|
| SOFR | 5.34 | 5.32 | 5.05 |
| Effective Fed Funds Rate | 5.33 | 5.33 | 5.07 |
| 3-Month T-Bill | 5.35 | 5.36 | 5.32 |
| 1-Year Treasury | 5.02 | 5.02 | 5.12 |
| 2-Year Treasury | 4.71 | 4.73 | 4.71 |
| 5-Year Treasury | 4.33 | 4.27 | 3.97 |
| 10-Year Treasury | 4.34 | 4.26 | 3.71 |
| 30-Year Treasury | 4.49 | 4.40 | 3.81 |
| Bond Buyer Index | 3.93 | 3.90 | 3.65 |

### Foreign Exchange Rates

| | Friday 6/28/2024 | 1 Week Ago | 1 Year Ago |
|---|---|---|---|
| Euro ($/€) | 1.072 | 1.069 | 1.091 |
| British Pound ($/₤) | 1.264 | 1.265 | 1.264 |
| British Pound (₤/€) | 0.848 | 0.846 | 0.864 |
| Japanese Yen (¥/$) | 160.820 | 159.800 | 144.480 |
| Canadian Dollar (C$/$) | 1.369 | 1.369 | 1.326 |
| Swiss Franc (CHF/$) | 0.899 | 0.894 | 0.897 |
| Australian Dollar (US$/A$) | 0.667 | 0.664 | 0.660 |
| Mexican Peso (MXN/$) | 18.221 | 18.113 | 17.093 |
| Chinese Yuan (CNY/$) | 7.267 | 7.261 | 7.239 |
| Indian Rupee (INR/$) | 83.391 | 83.540 | 82.058 |
| Brazilian Real (BRL/$) | 5.559 | 5.432 | 4.850 |
| U.S. Dollar Index | 105.866 | 105.796 | 102.905 |

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

### Foreign Interest Rates

| | Friday 6/28/2024 | 1 Week Ago | 1 Year Ago |
|---|---|---|---|
| 3-Month German Govt Bill Yield | 3.32 | 3.35 | 3.32 |
| 3-Month U.K. Govt Bill Yield | 5.23 | 5.22 | 3.89 |
| 3-Month Canadian Govt Bill Yield | 4.64 | 4.63 | 4.90 |
| 3-Month Japanese Govt Bill Yield | 0.03 | 0.02 | -0.10 |
| 2-Year German Note Yield | 2.83 | 2.79 | 3.10 |
| 2-Year U.K. Note Yield | 4.22 | 4.17 | 5.15 |
| 2-Year Canadian Note Yield | 3.99 | 3.90 | 4.53 |
| 2-Year Japanese Note Yield | 0.37 | 0.31 | -0.07 |
| 10-Year German Bond Yield | 2.50 | 2.41 | 2.32 |
| 10-Year U.K. Bond Yield | 4.17 | 4.08 | 4.32 |
| 10-Year Canadian Bond Yield | 3.50 | 3.35 | 3.22 |
| 10-Year Japanese Bond Yield | 1.06 | 0.98 | 0.39 |

### Commodity Prices

| | Friday 6/28/2024 | 1 Week Ago | 1 Year Ago |
|---|---|---|---|
| WTI Crude ($/Barrel) | 81.59 | 80.73 | 69.56 |
| Brent Crude ($/Barrel) | 86.47 | 85.24 | 74.03 |
| Gold ($/Ounce) | 2330.21 | 2321.98 | 1907.32 |
| Hot-Rolled Steel ($/S.Ton) | 669.00 | 721.00 | 894.00 |
| Copper (¢/Pound) | 438.40 | 444.20 | 372.25 |
| Soybeans ($/Bushel) | 11.60 | 11.68 | 14.83 |
| Natural Gas ($/MMBTU) | 2.63 | 2.71 | 2.60 |
| Nickel ($/Metric Ton) | 16,844 | 17,164 | 20,581 |
| CRB Spot Inds. | 555.75 | 553.99 | 548.31 |

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