

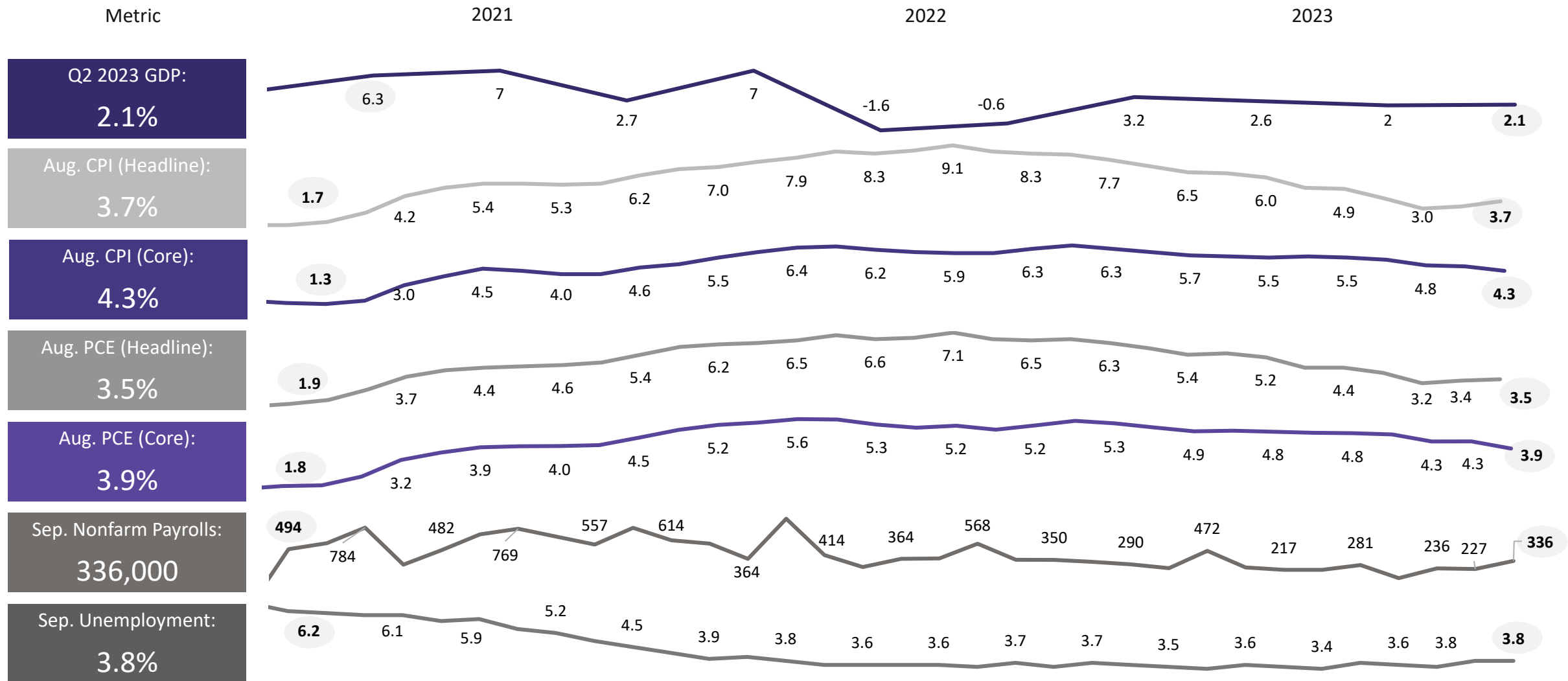
# Change on the Horizon

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November 2, 2023  
Vanessa McMichael, CTP, Director  
Head of Corporate and Public Entity Strategy



# Economic Snapshot: 2021 – 2023 Year-to-Date



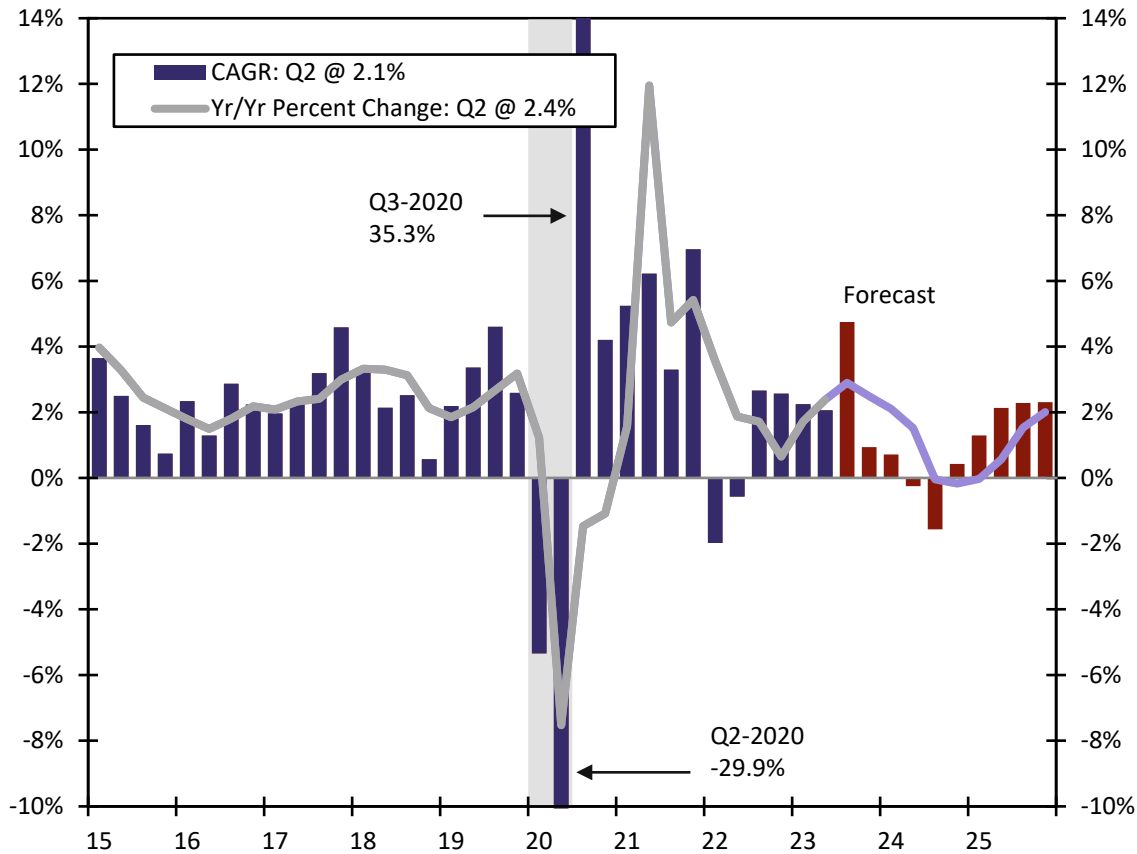
Source: Wells Fargo Corporate & Investment Banking, Bloomberg

Data as of 9/13/23

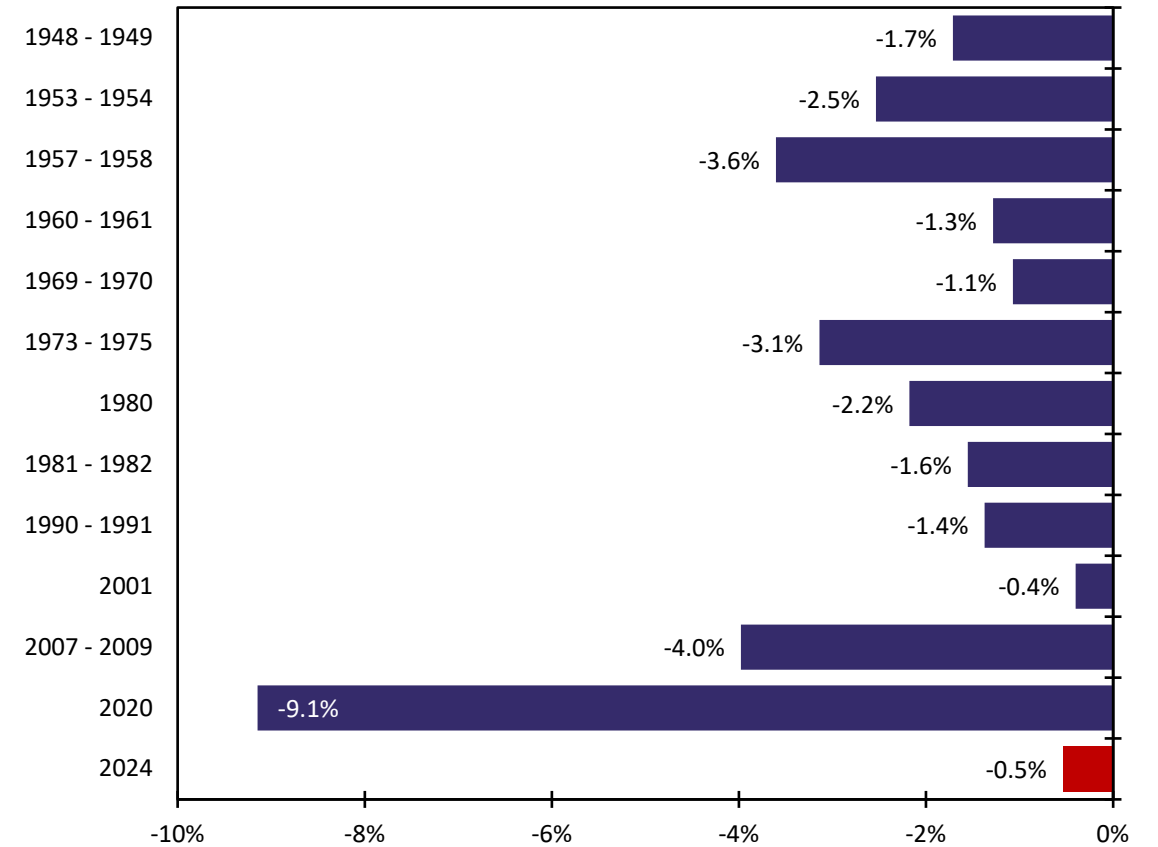
# Economic Activity | Gross Domestic Product

Growth is slowing across the globe with GDP data softening.

### U.S. Real GDP Growth



### Recession GDP Peak to Trough 2024 Recession Based on October Forecast

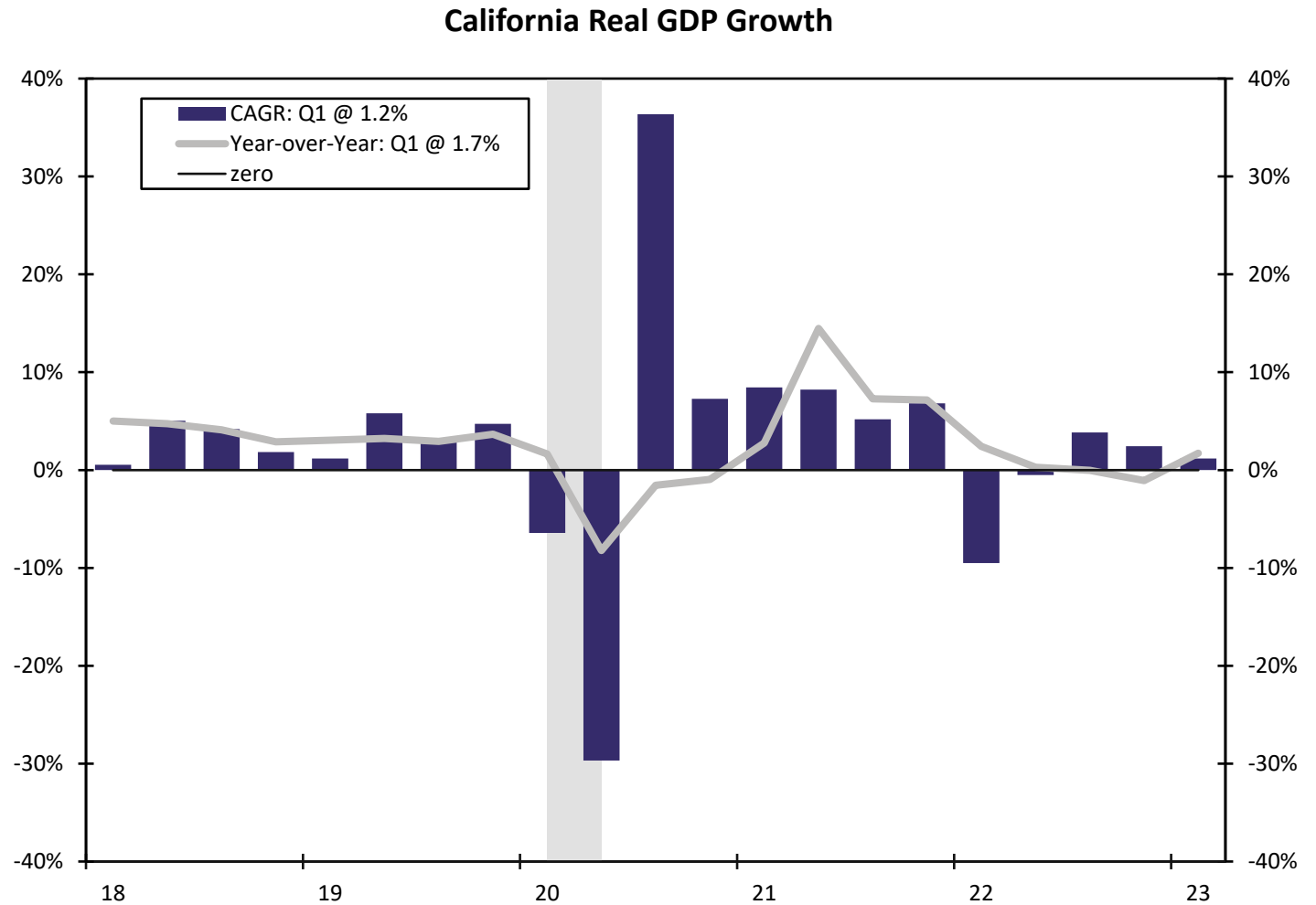


Source: Wells Fargo Corporate & Investment Banking, Wells Fargo Economics

Data as of 10/13/23

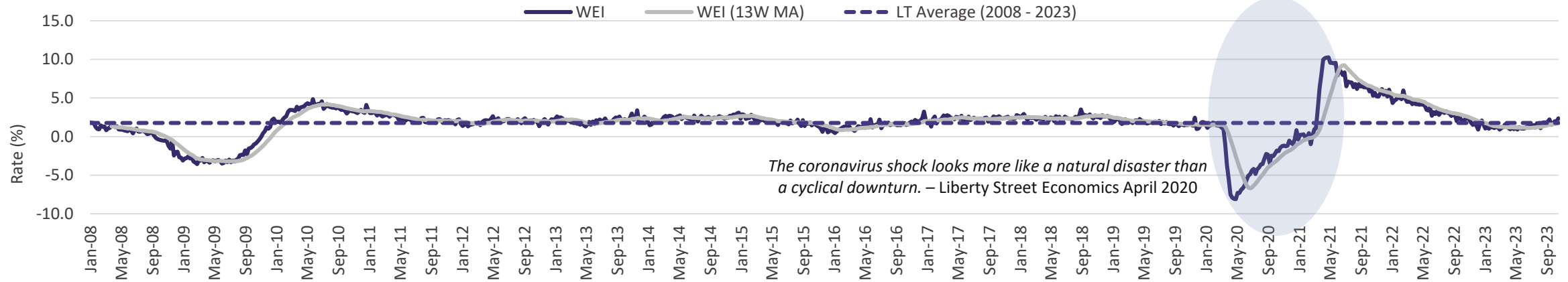
# Economic Activity | California: Real GDP

California has had positive GDP growth for the first three months of 2023. However, the pace of growth is more sustainable compared to rates of economic expansion in late 2020 and 2021.

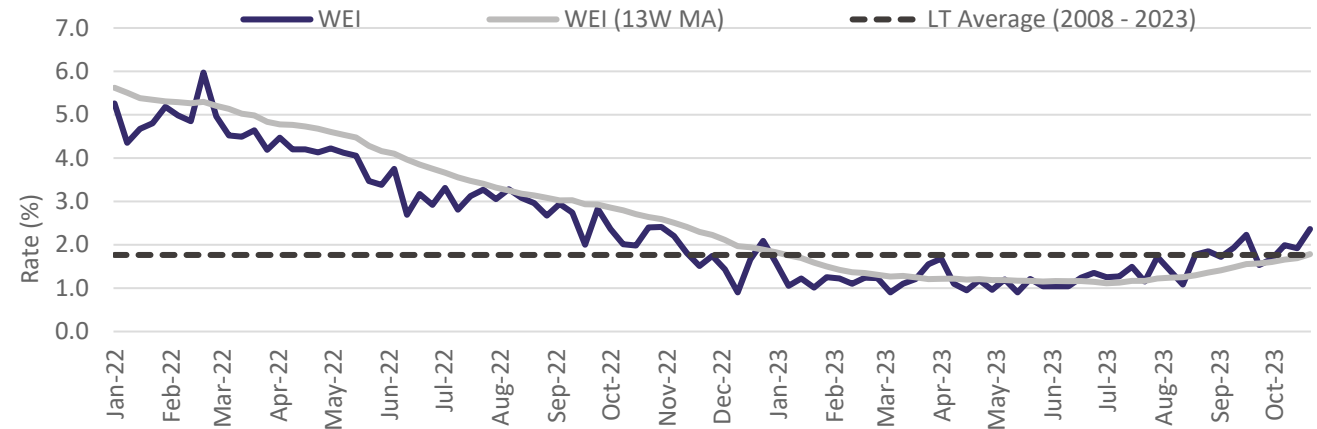


# Economic Activity | Fed Weekly Economic Index

Historical WEI



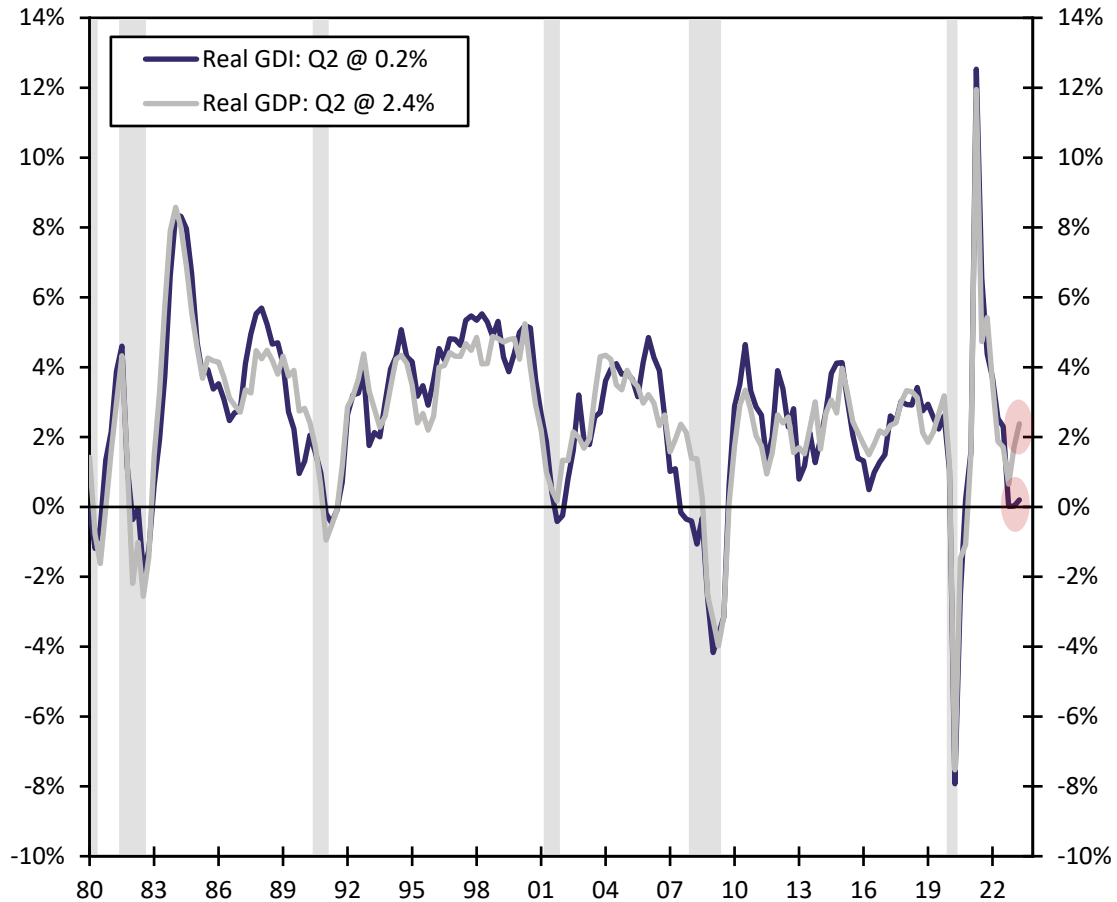
WEI January 2022- Present



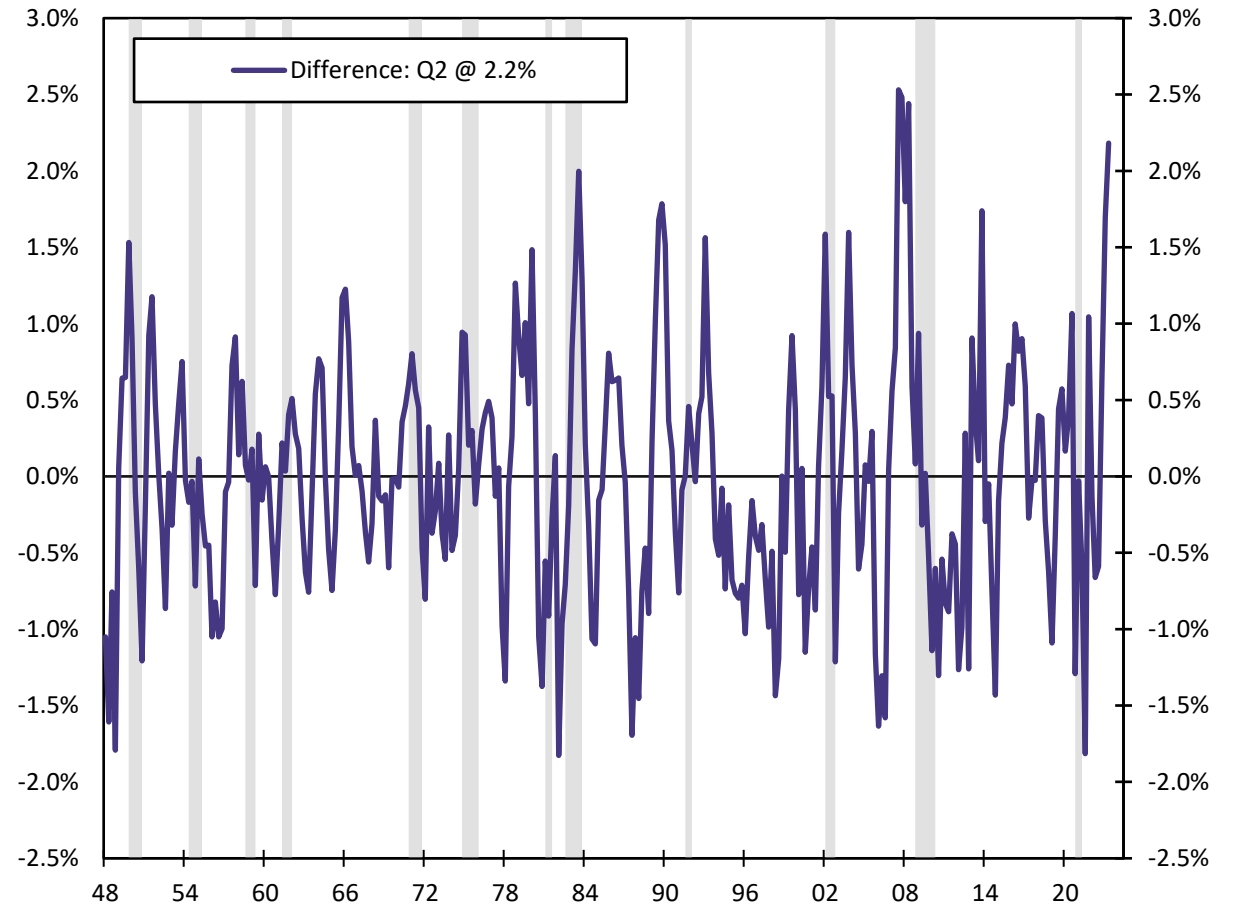
- The WEI measures economic activity in the U.S. based on 10 indicators.
- The index provides an analysis of consumer behavior, labor market and production.
- The WEI has been below the longer-term average for most of 2023.

# Economic Activity | Widening Gap Between GDP & GDI

**Real GDP & Real GDI**  
Year-over-Year Percent Change



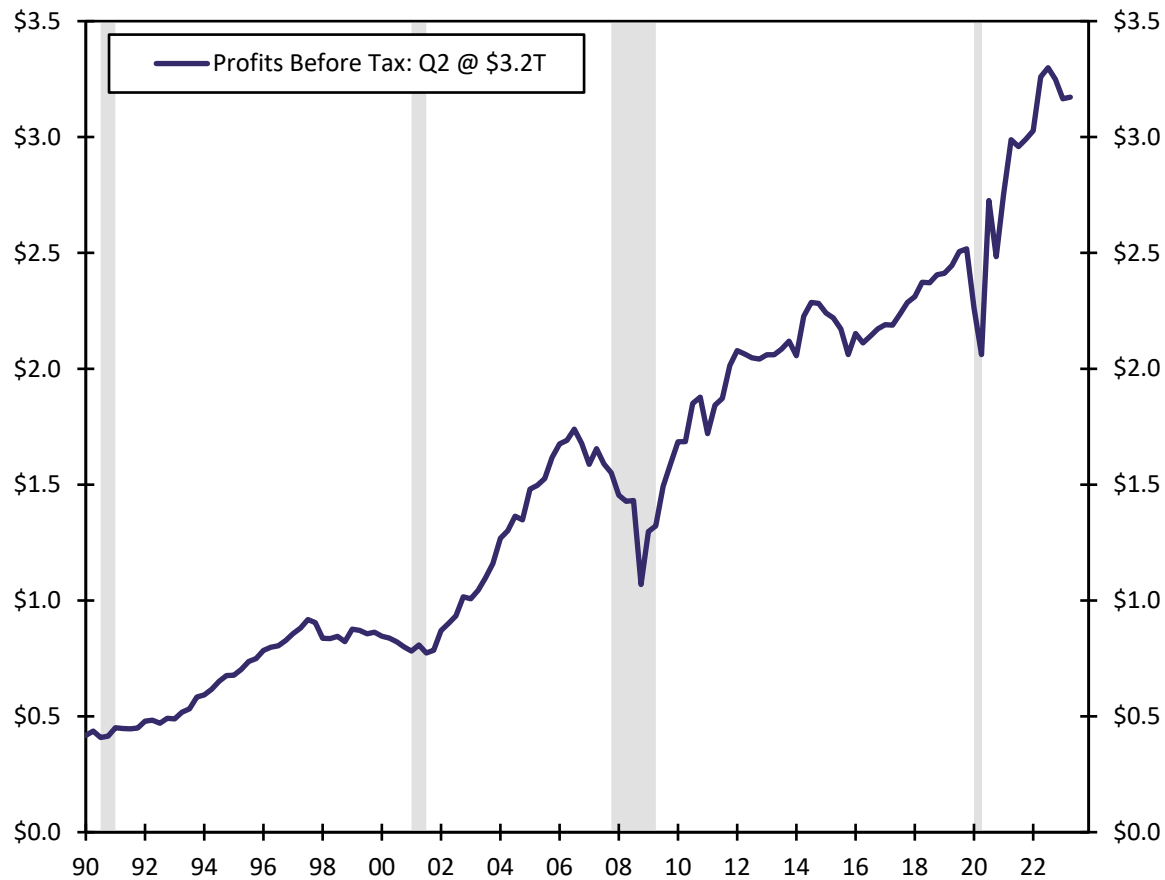
**Expenditure-Income Gap**  
Real GDP Year-ago Rate Less Real GDI Year-ago Rate



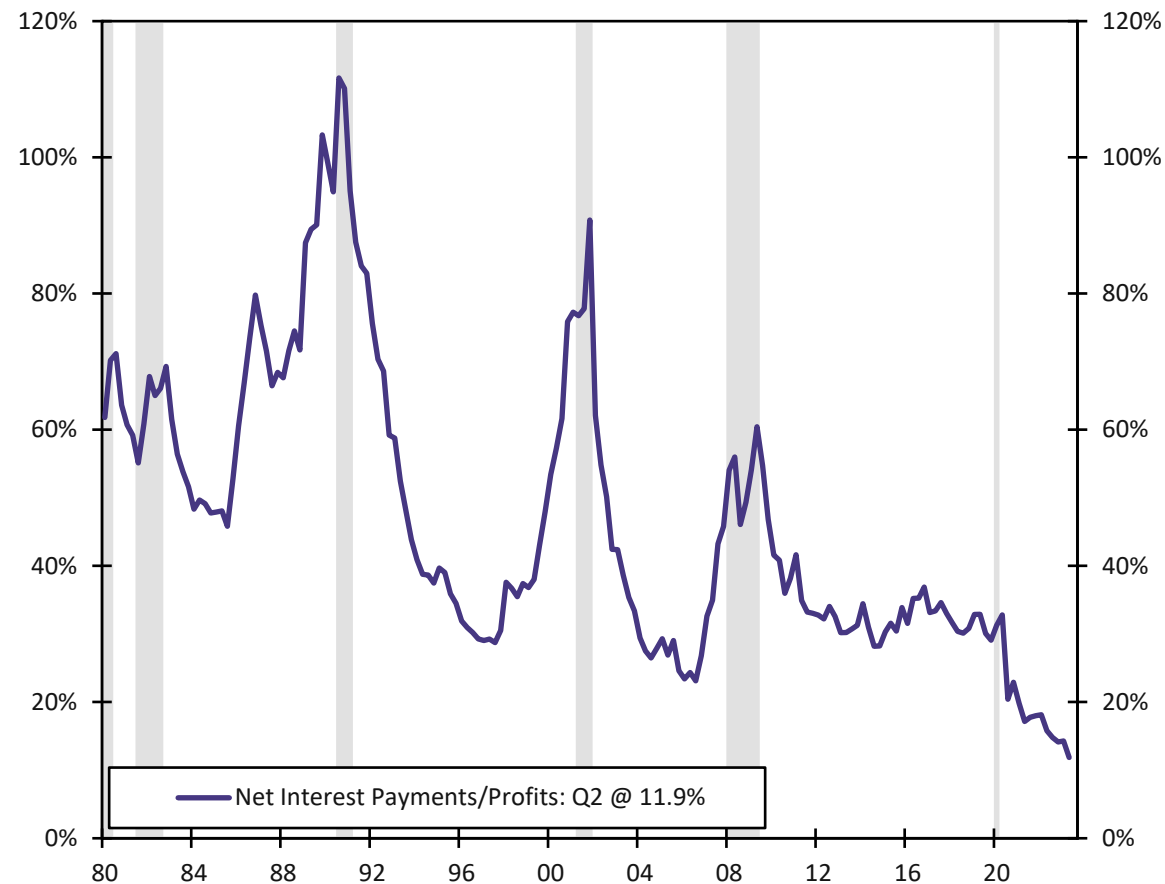
Source: U.S. Department of Commerce and Wells Fargo Economics

# Economic Activity | Where is the GDP/GDI gap Coming from?

**Corporate Profits**  
USD Trillions, SAAR

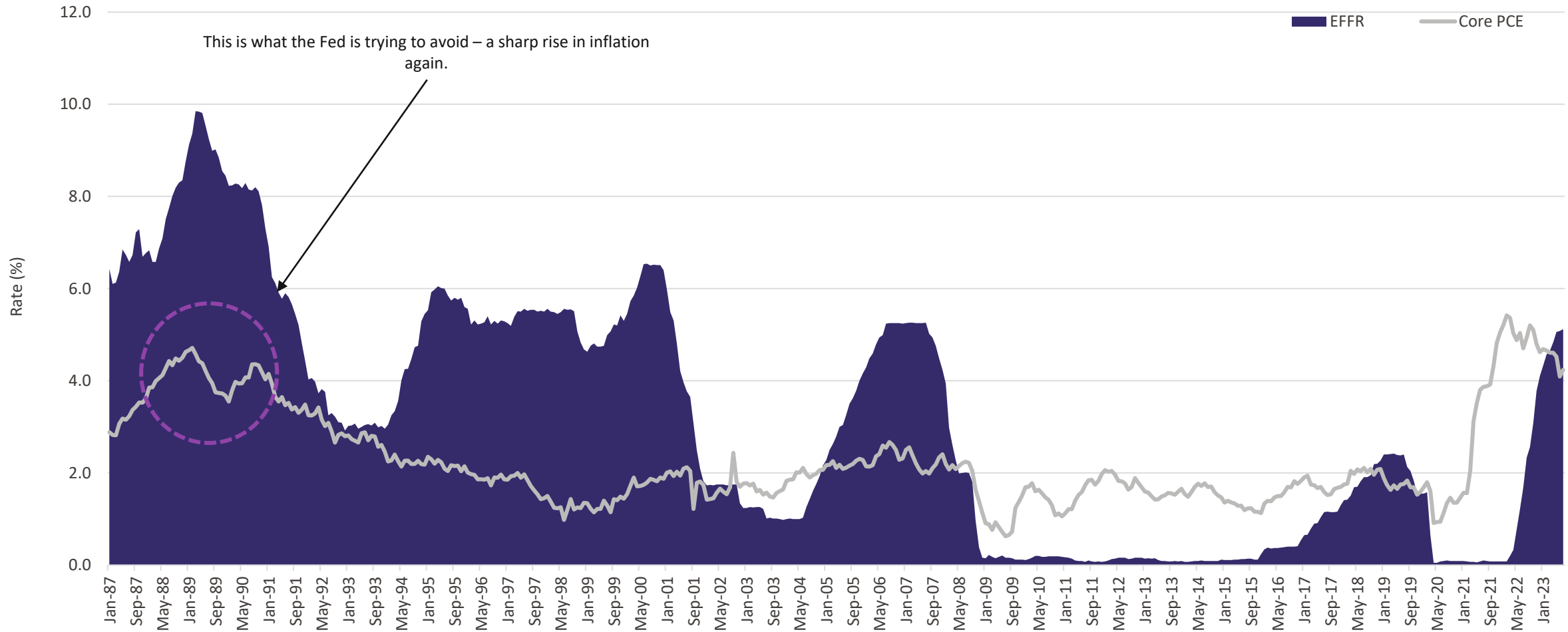


**Nonfinancial Corporate Interest Burden**  
Net Interest Payments as a Share of After-Tax Profits



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

# Prior Tightening Cycle Lessons have Driven the Current Cycle Fed Reaction



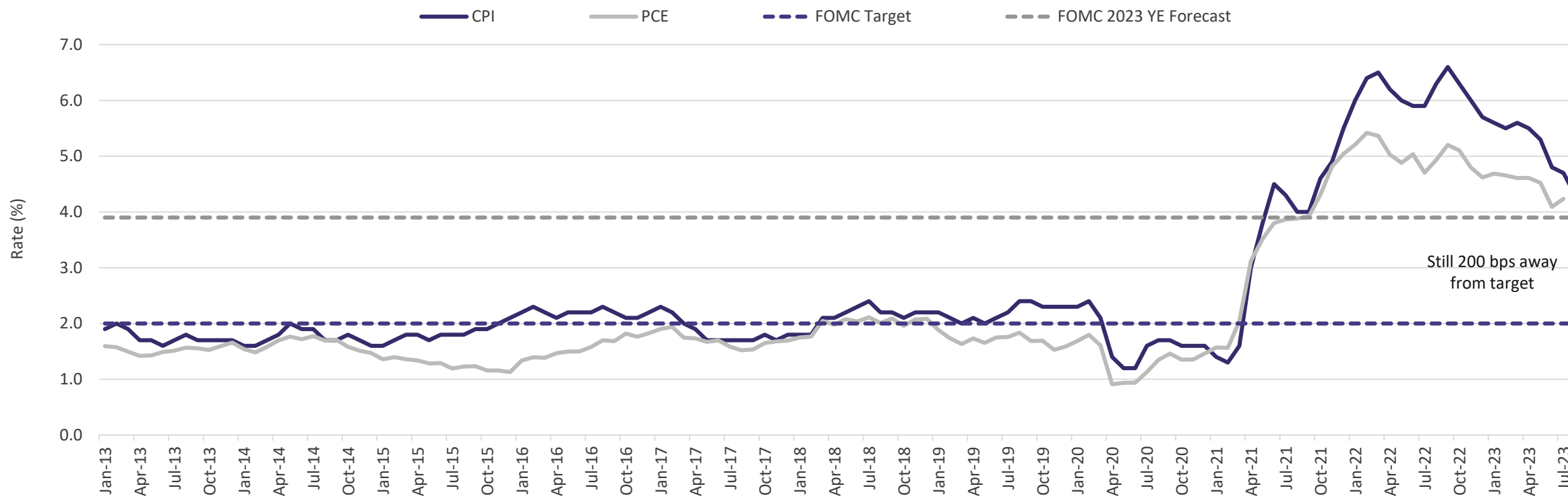
Source: Wells Fargo Corporate & Investment Banking, Bloomberg

Data as of 7/31/23



# Inflation | CPI & PCE

While progress has been made towards the FOMC's inflation forecast this year, current price levels still remain more than 200 basis points wider than target.

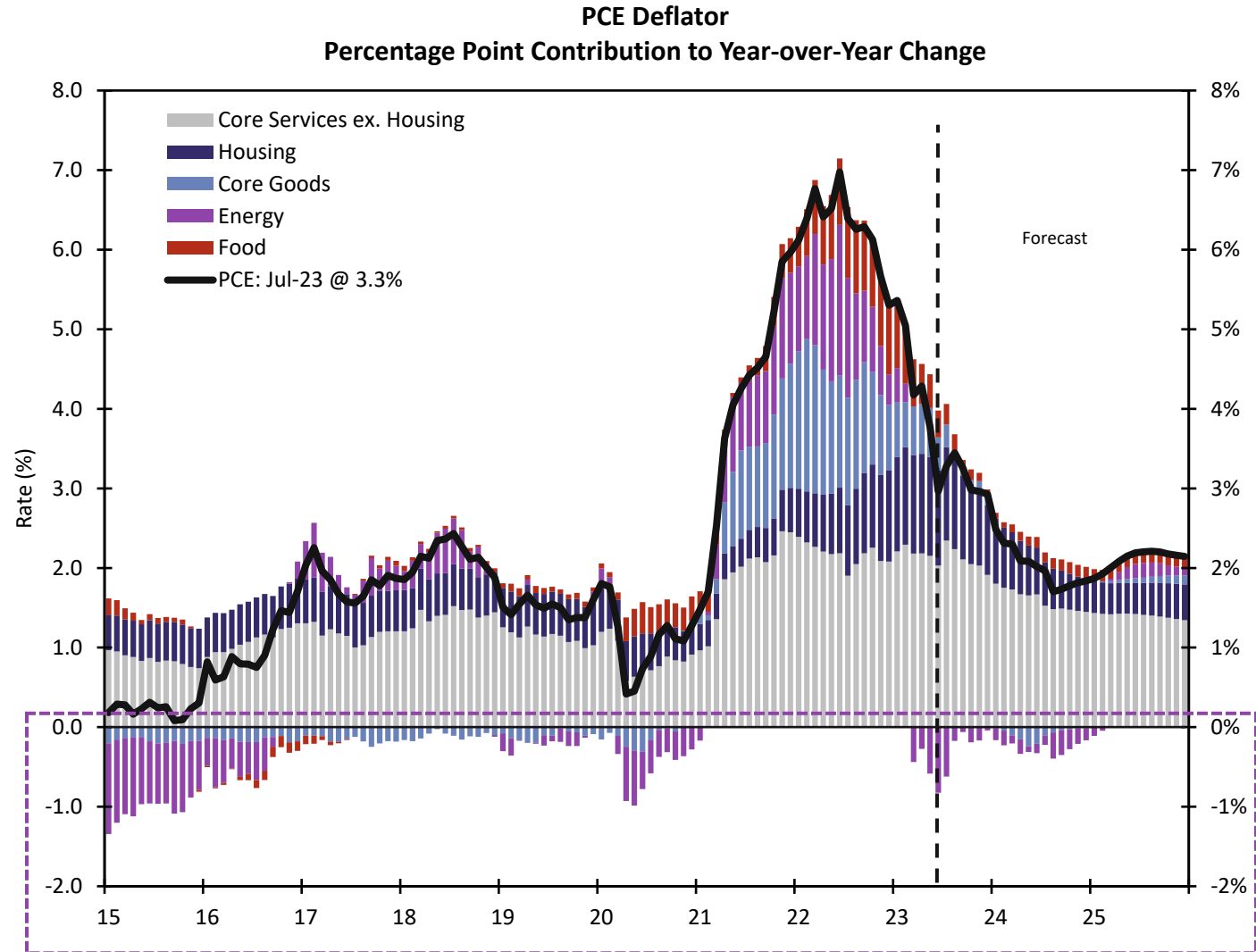


Source: Wells Fargo Corporate & Investment Banking, Federal Reserve, Bloomberg

Data as of 8/31/23

# Fed's Preferred Inflation Measure | Underlying Components

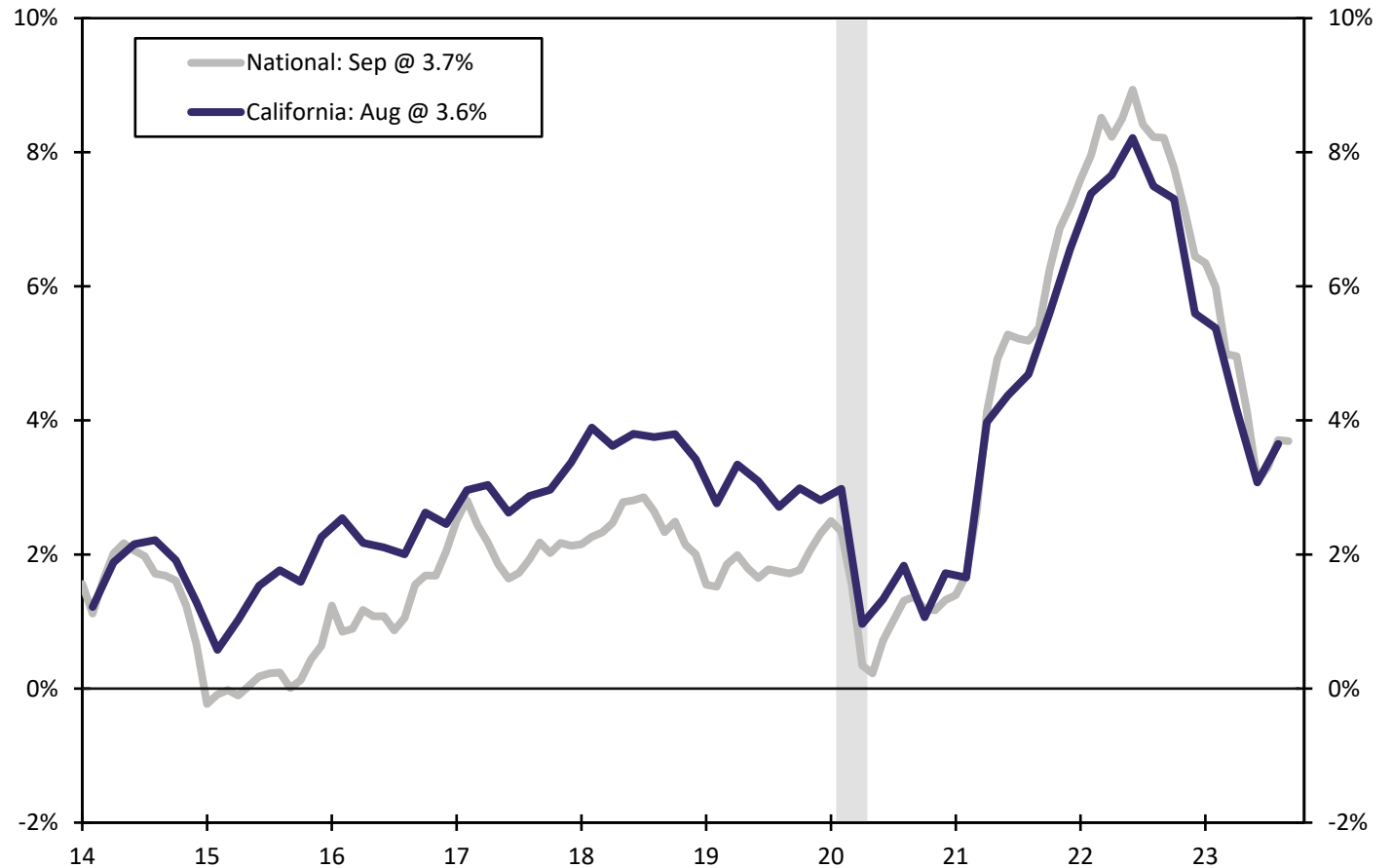
Although prices have cooled across a variety of segments, prices continue to be fueled by services.



# Inflation | California

California's consumer price index inflation has tracked in line with or below the national average through 2022 and 2023.

**California CPI Inflation Rates**  
Year-over-Year Percent Change, SA

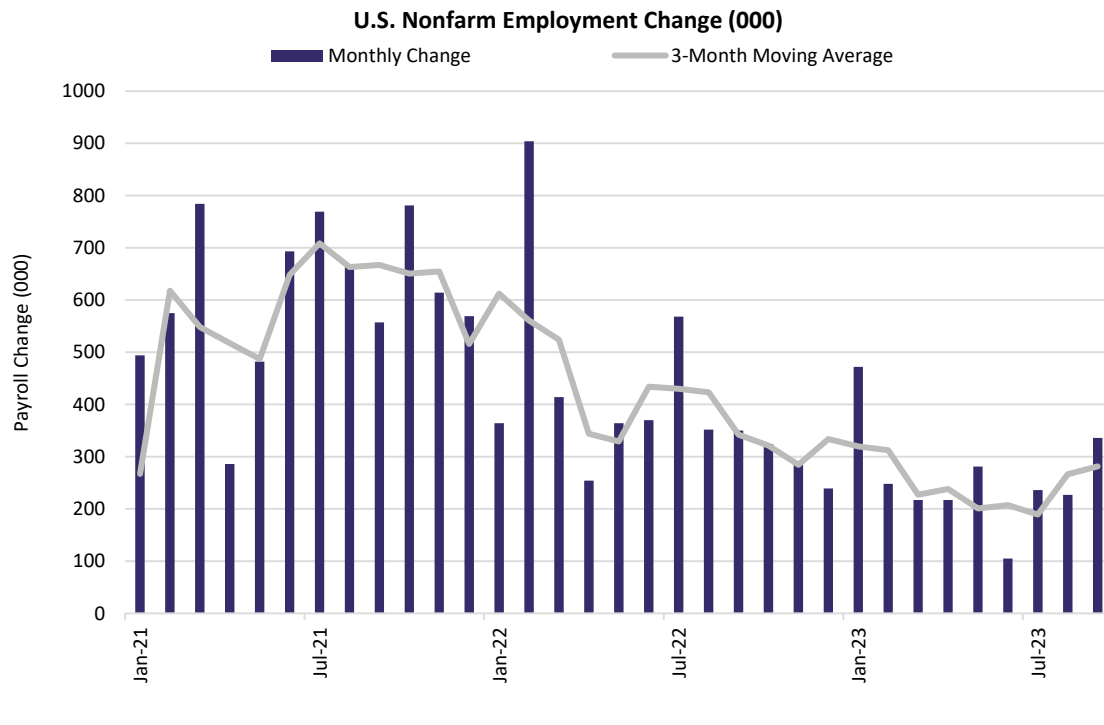


Source: U.S. Department of Labor and Wells Fargo Economics

# Labor Market | U.S. Nonfarm Payrolls

Nonfarm payrolls were unsustainably high for nearly a year and half.

- The job market has cooled, with the hottest numbers *mostly* behind us.
- June – August nonfarm payrolls resulted in the lowest level of new jobs added since 2022, but then September surprised to the upside. .



Source: Wells Fargo Corporate & Investment Banking, Bureau of Economic Analysis

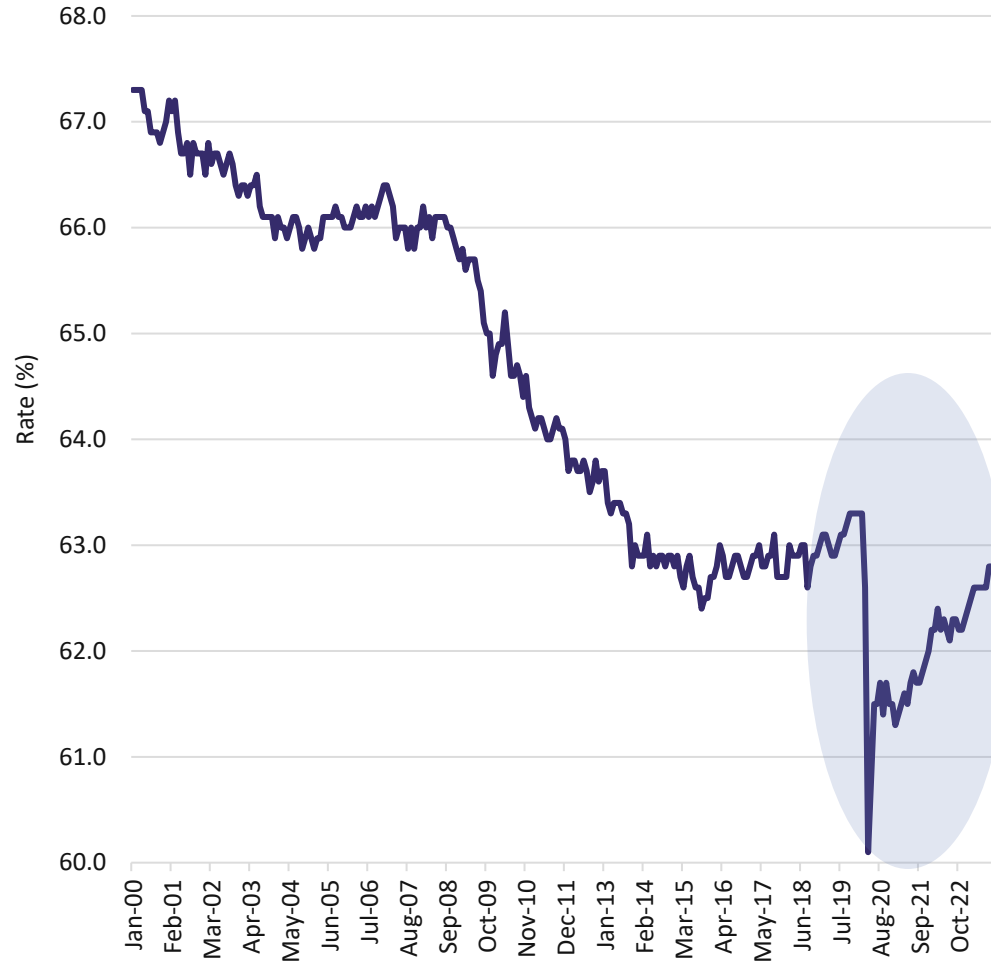
Month	Nonfarm Payrolls Change (000)
Jan-22	364
Feb-22	904
Mar-22	414
Apr-22	254
May-22	364
Jun-22	370
Jul-22	568
Aug-22	352
Sep-22	350
Oct-22	324
Nov-22	290
Dec-22	239
Jan-23	472
Feb-23	248
Mar-23	217
Apr-23	217
May-23	281
Jun-23	105
Jul-23	236
Aug-23	227
Sep-23	336

Legend: Highest releases (Purple), Lowest releases (Dark Blue)

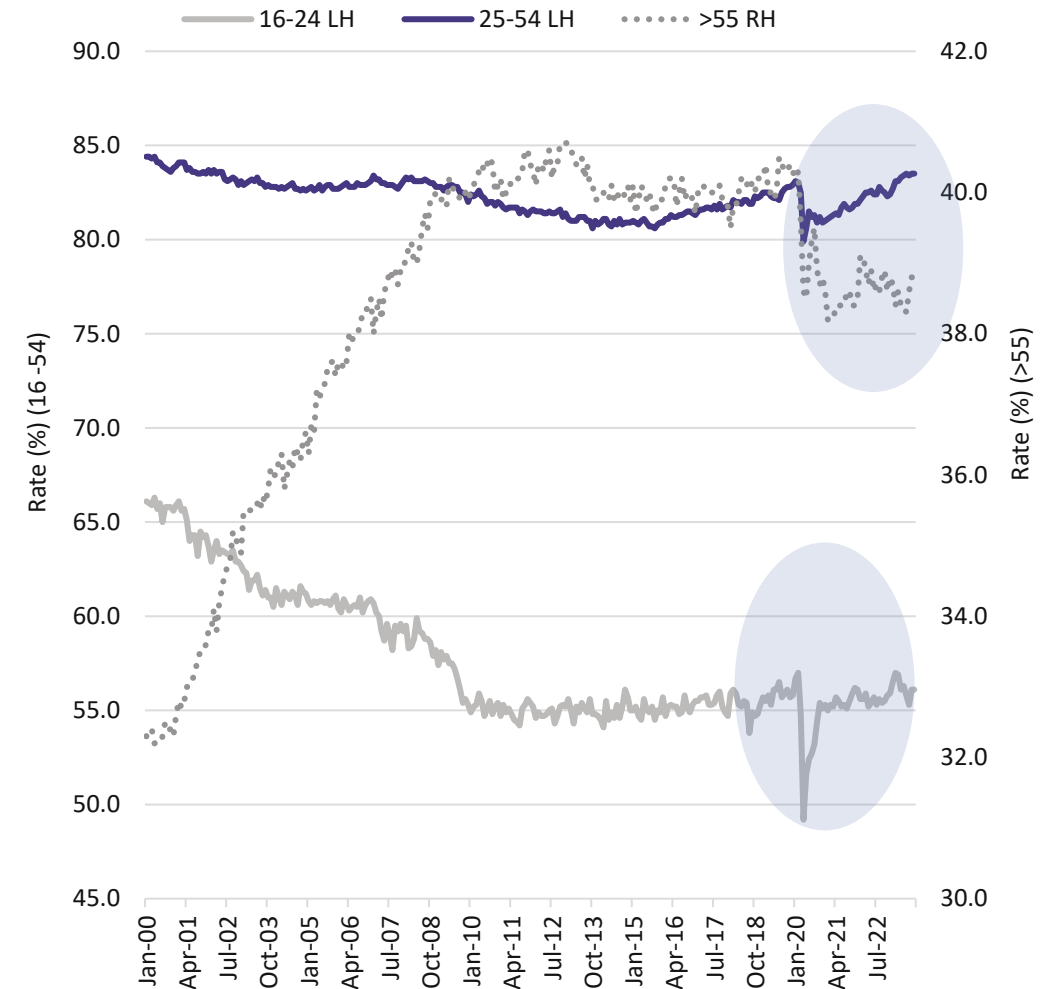
Data as of 10/6/23

# Labor Market | Labor Force Participation Rate

Total Participation Rate



Participation Rate by Age Group

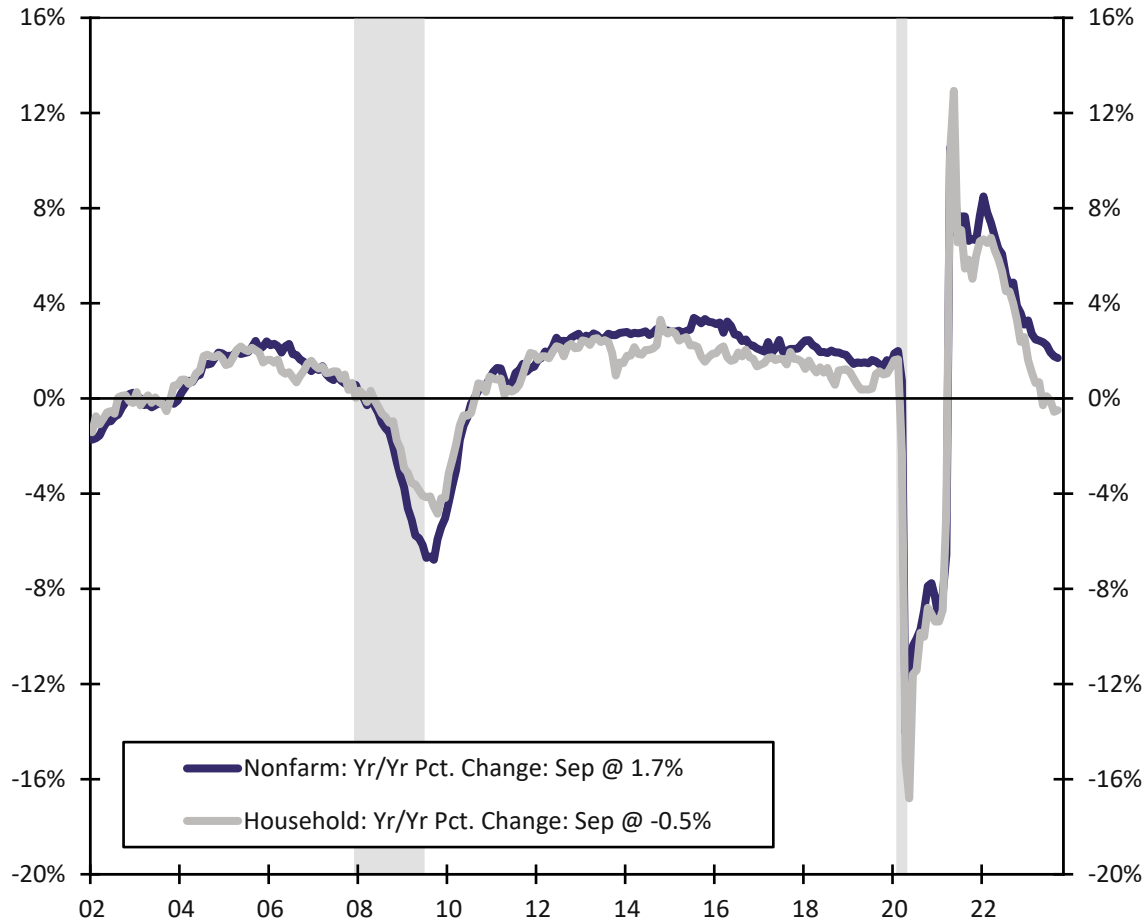


Source: Wells Fargo Corporate & Investment Banking, Bloomberg

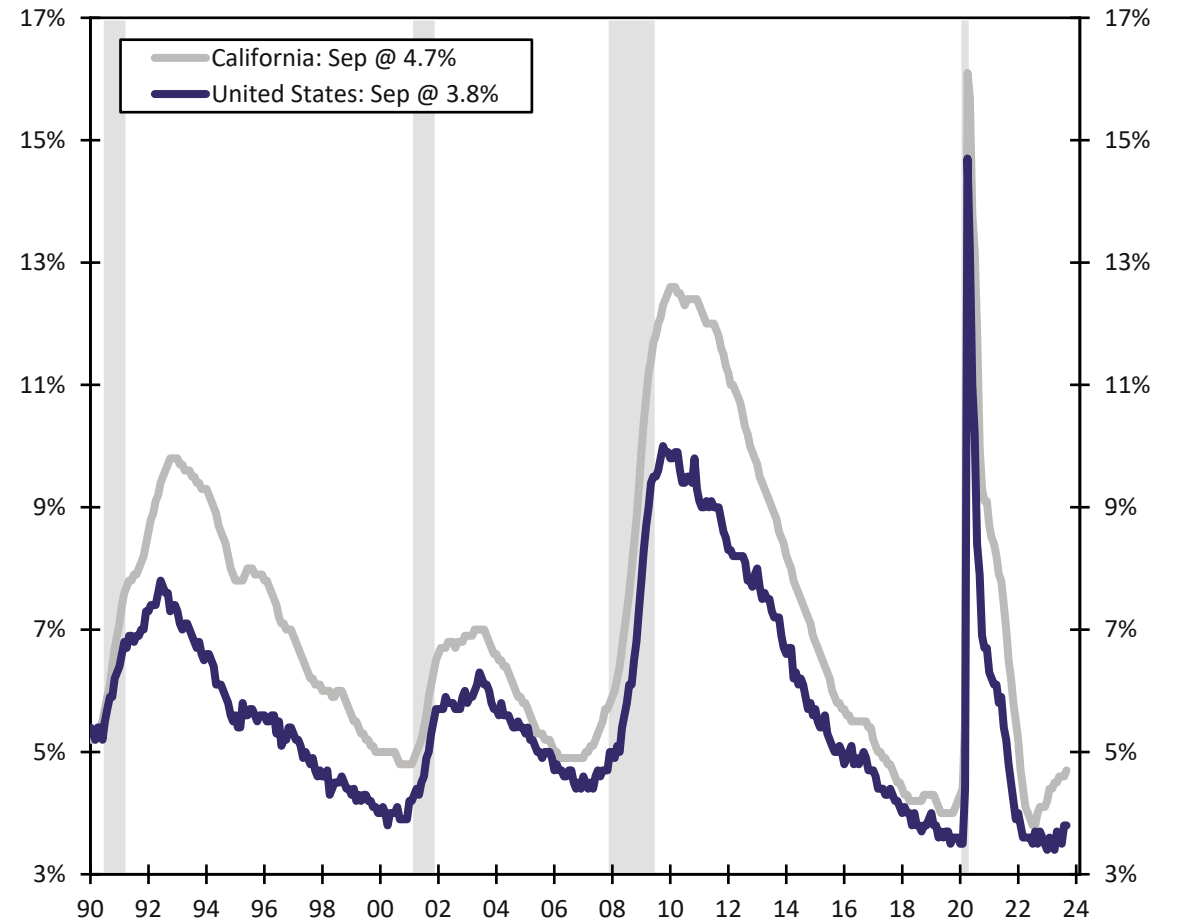
Data as of 10/26/23

# Labor Market | California

## California Employment Growth



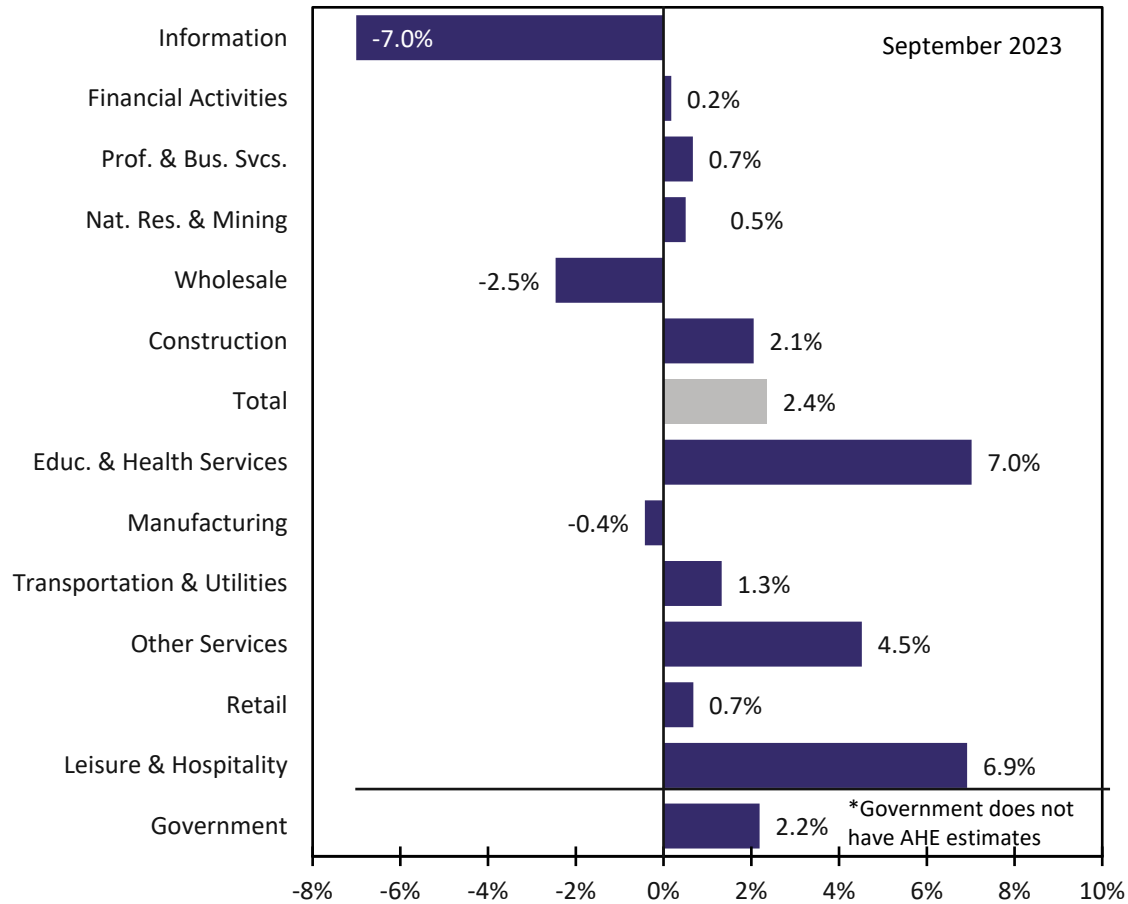
## California vs. U.S. Unemployment Rate Seasonally Adjusted



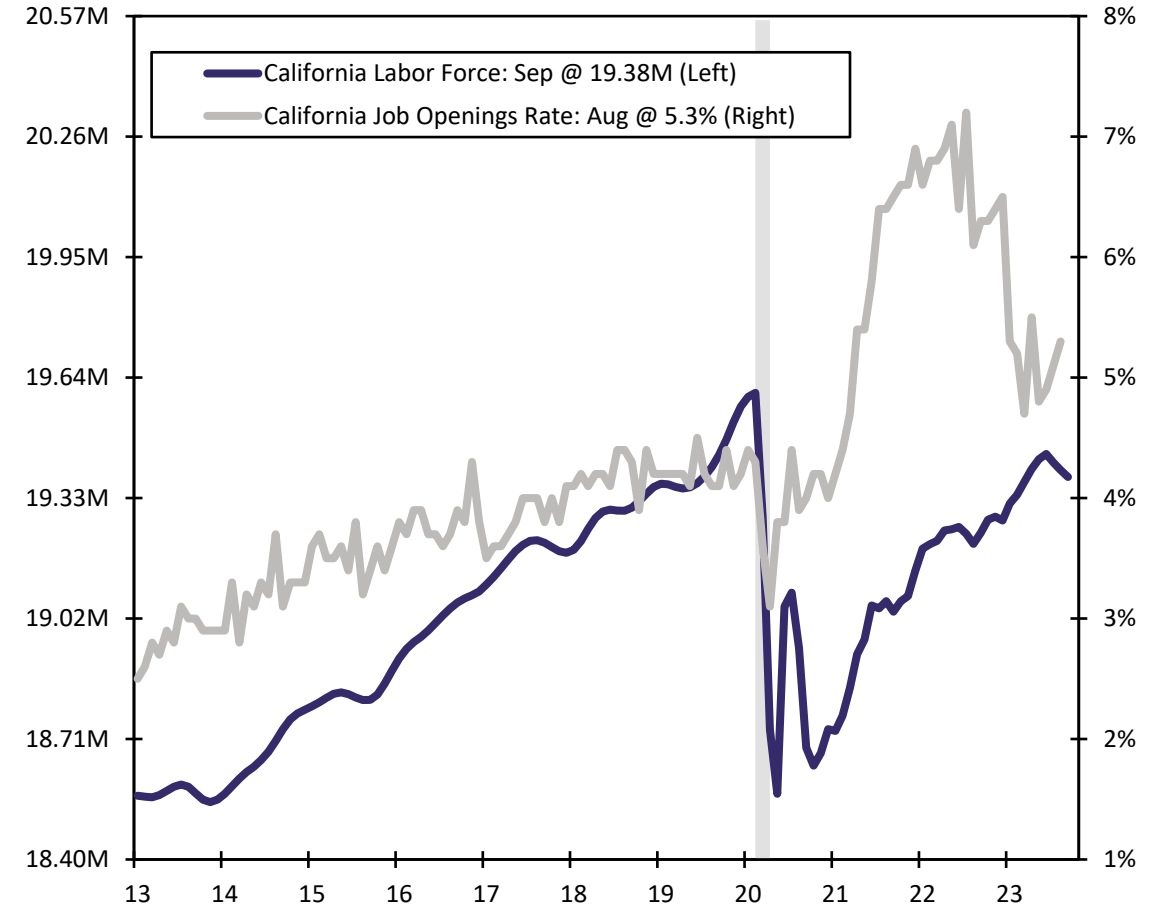
Source: U.S. Department of Labor and Wells Fargo Economics

# Labor Market | California

California Job Growth - Past Year  
Year-over-Year Percent Change, Ranked by Average Hourly Earnings

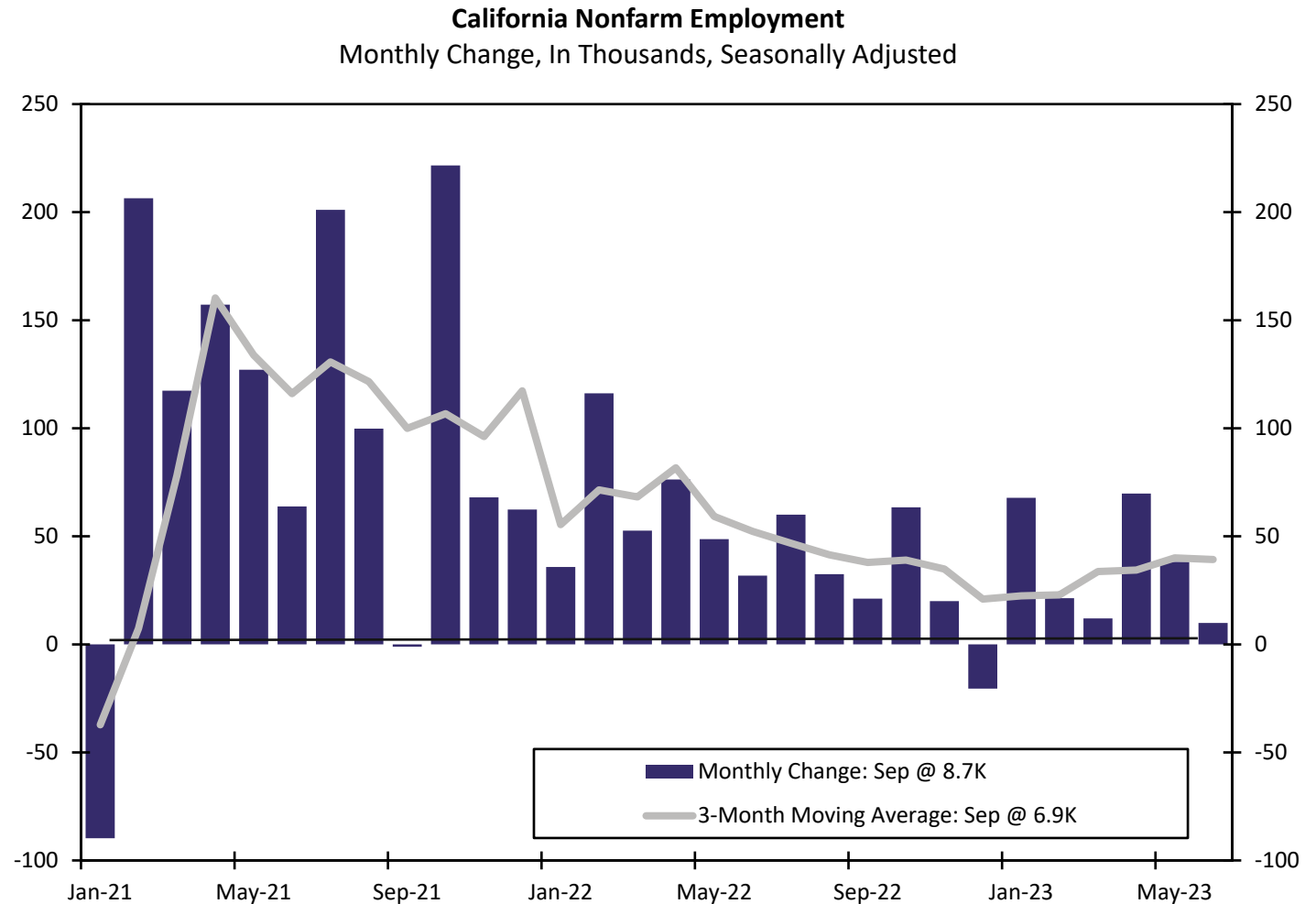


California Labor Force and Job Openings  
In Millions, Job Openings Rate



# Labor Market | California

California's nonfarm employment has trended upwards throughout 2023, but is increasing at a decreasing rate. The job market is positive but not as hot as it used to be.



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



# R-Word

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One of the biggest risks to the U.S. economic outlook is Federal Reserve policy.

Wells Fargo's Economic Team expects a mild recession at some point in 2024.

## Probit Method

Suggests a recession within next year is likely.

- Based on Leading Economic Index, S&P 500 and employment component of ISM manufacturing index.
- Probit estimates the probability of a recession at 52% at the end of Q2 (slightly lower than 55% at the end of Q1, but has been above 50% for the past 5 quarters).
- Historically – when Probit probability climbs above 50%, a recession begins within the next four quarters.

## 10-Year/1-Year Treasury Curve

Suggests a recession is on the horizon.

- The inversion in this part of the yield curve has predicted the past 10 recessions, with an average lead time of 12 months.
- This threshold was crossed in July 2022.

## 10-Year/Federal funds rate

Accommodative Fed policy pivot is nearing.

- In a rising rate environment, when the Fed's policy rate crosses the lowest 10-year yield in that cycle, a policy pivot is likely over the next 18-months.
- This threshold was crossed in March 2022.

# Hawkishness Index

March 2023

“We are not done yet...”

“I am committed to lowering inflation to our 2 percent target....”

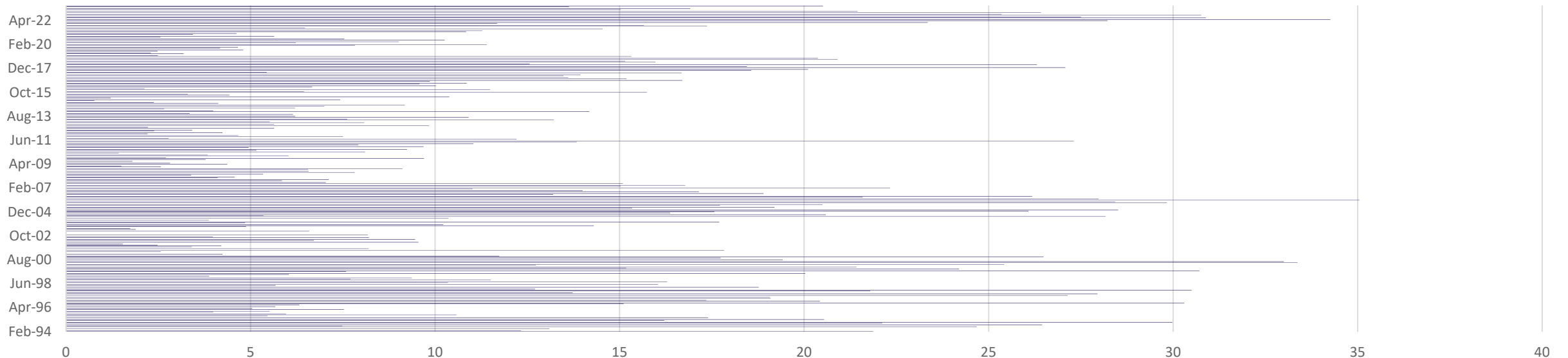
“The risk of not tightening enough is far greater than over tightening...”

Today

“We can be patient...”

“committed to lowering inflation to our 2 percent target....”

“The risk of not tightening enough and over tightening is more balanced...”



Source: Wells Fargo Corporate & Investment Banking, Bloomberg

Data as of 8/30/23

# Recent Fed Speak | Alternate Voters

Raphael Bostic, Atlanta Fed

“I am not in a hurry to raise, but I am not in a hurry to reduce either.”

“If we reduce too soon, or send signals that we are not resolved, we won’t get to 2% — and we have to get to 2%. That’s non-negotiable.”

October 3<sup>rd</sup>, 2023

Mary Daly, San Francisco Fed

“If we continue to see a cooling labor market and inflation heading back to our target, we can hold interest rates steady and let the effects of policy continue to work.”

October 5<sup>th</sup>, 2023

Thomas Barkin, Richmond Fed

“The path forward depends on whether we can convince ourselves inflationary pressures are behind us or whether we see them persistent. And I’ll be watching the labor market closely for those signals.”

October 5<sup>th</sup>, 2023

Loretta Mester, Cleveland Fed

“If the economy looks the way it did at the next meeting similar to the way it looked at our recent meeting, I would do the further rate increase.”

October 3<sup>rd</sup>, 2023

## Recent Comments

Dovish

Hawkish

# Recent Fed Speak FOMC Voters

Michael Barr, Board of Governors

“I think it is likely that we’ll need to keep rates up for some time in order to get inflation down to 2%. I’m confident that we’ll get there.”

October 2<sup>nd</sup> , 2023

Austan Goolsbee, Chicago Fed

Fed should not assume traditional link between inflation and unemployment: “Believing too strongly in the inevitability of a large trade-off between inflation and unemployment comes with the serious risk of a near-term policy error.”

October 5<sup>th</sup>, 2023

Neel Kashkari, Minneapolis Fed

“If the economy is fundamentally much stronger than we realized, on the margin that would tell me rates probably have to go a little bit higher and then be held higher for longer to cool things off.”

September 25<sup>th</sup>, 2023

Michelle Bowman, Board of Governors

“I continue to expect that further rate hikes will likely be needed to return inflation to 2% in a timely way,”

September 22<sup>nd</sup>, 2023

## Recent Comments

Dovish

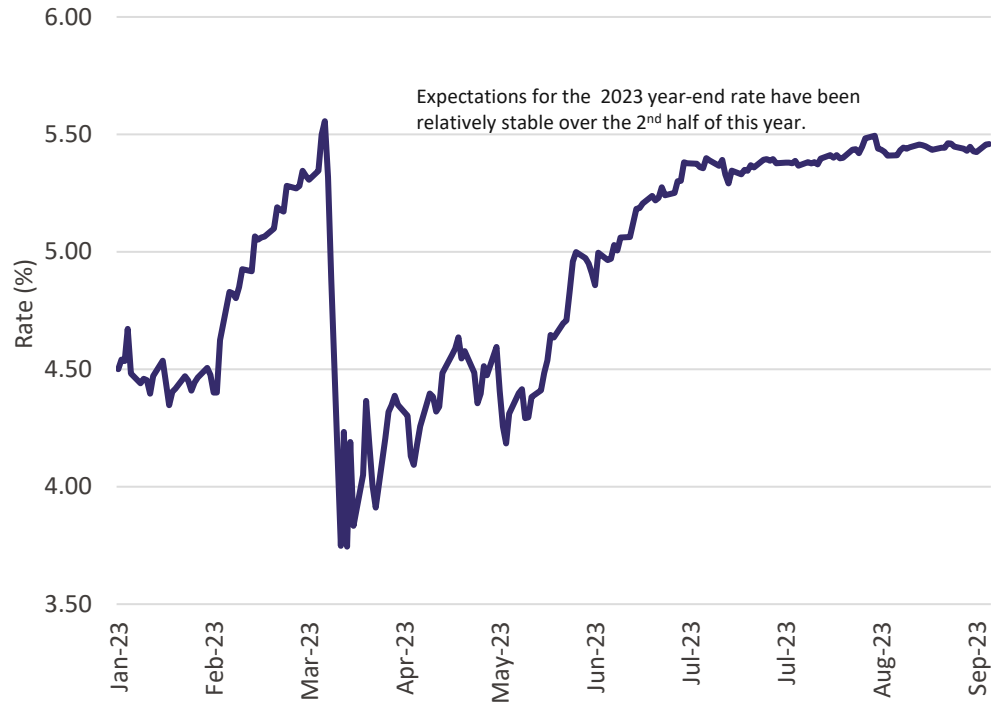
Hawkish



# Rates Outlook

## Bloomberg Market Implied Probabilities

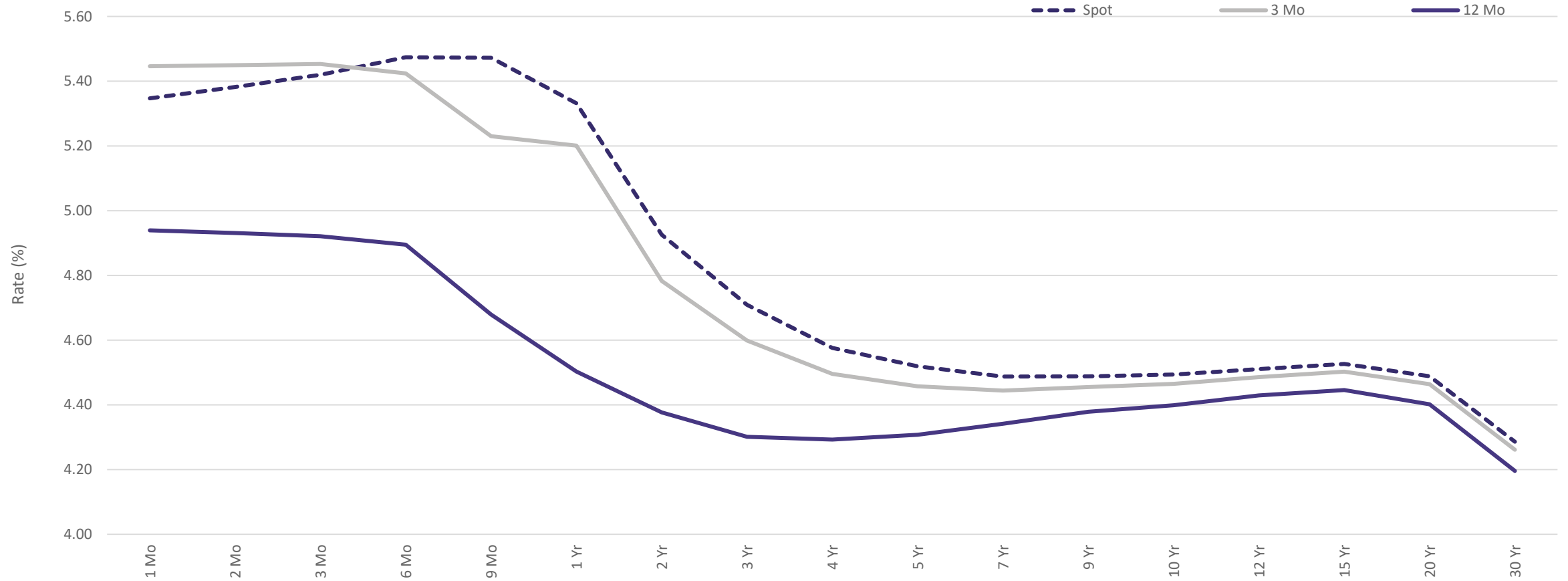
### December 2023 FOMC Meeting



### December 2024 FOMC Meeting



# U.S. Treasury Curve



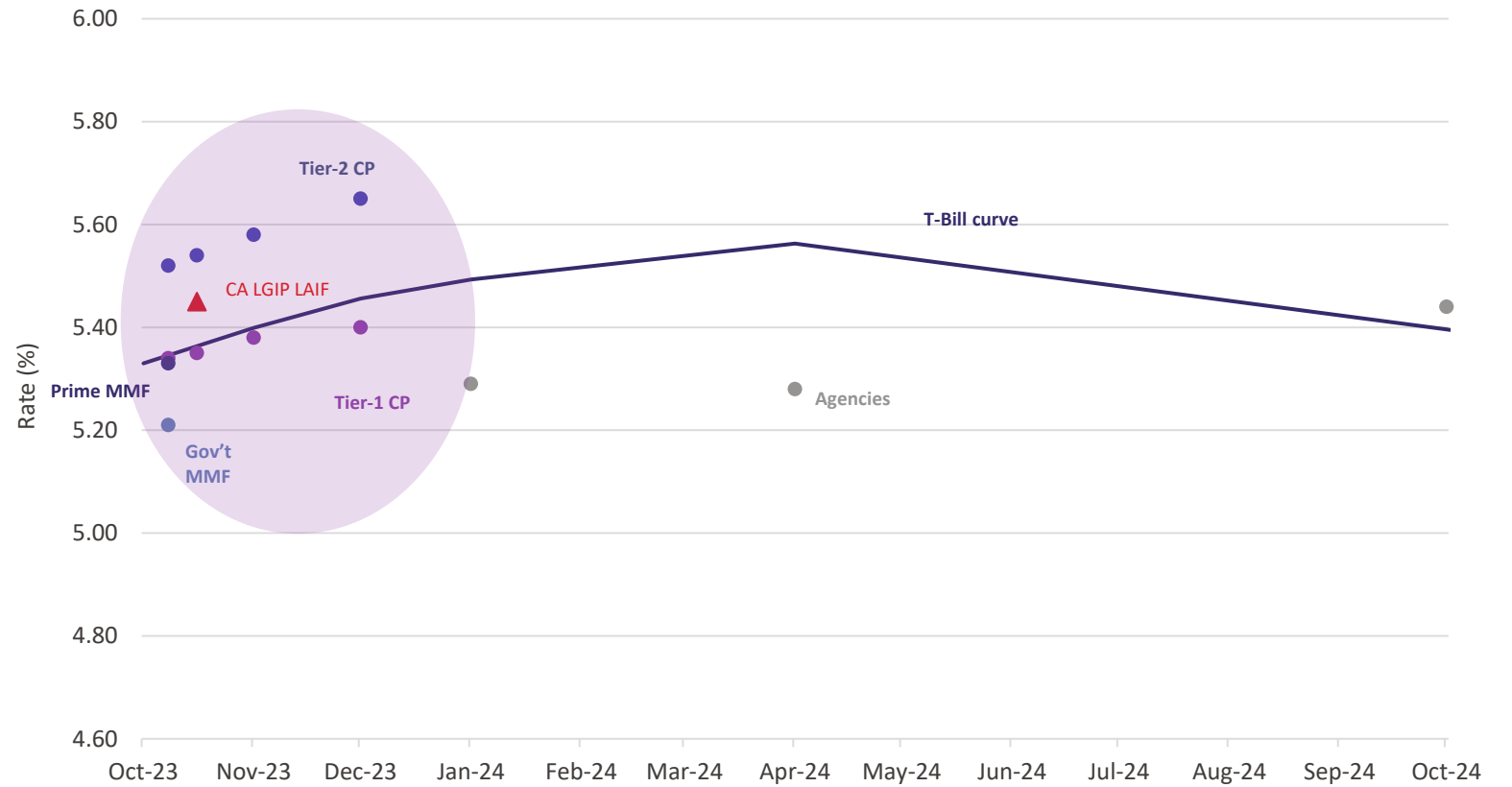
Source: Wells Fargo Corporate & Investment Banking, Bloomberg

Data as of 10/9/23

# Value is on the Front End

Cash and cash equivalent alternatives on the front-end (maturity of less than 90 days) offer the most value (yield).

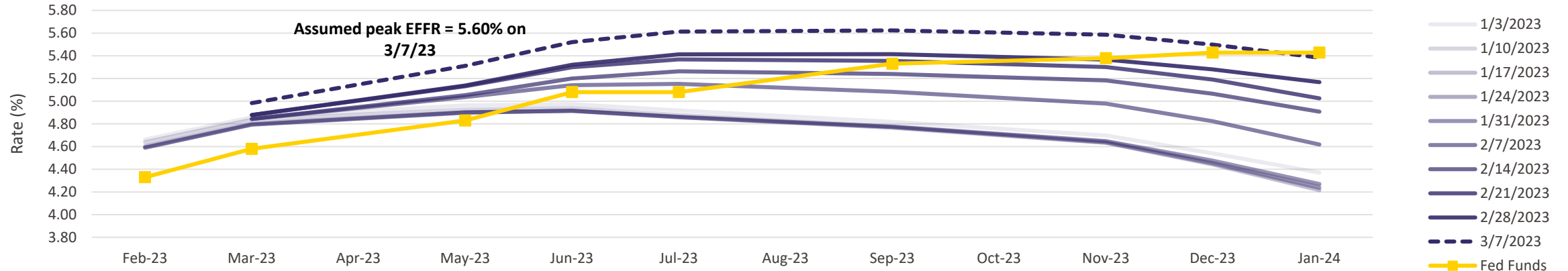
Alternatives Versus the Treasury Bill Curve (less than one year)



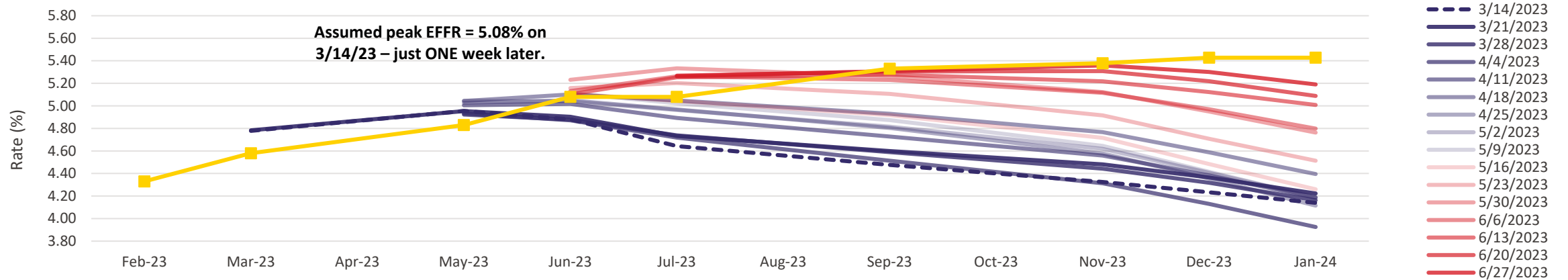


# ... But Things can Change...

## EFFR Expectations | January – March 7<sup>th</sup>, 2023



## EFFR Expectations | March 14<sup>th</sup> – June 28<sup>th</sup>

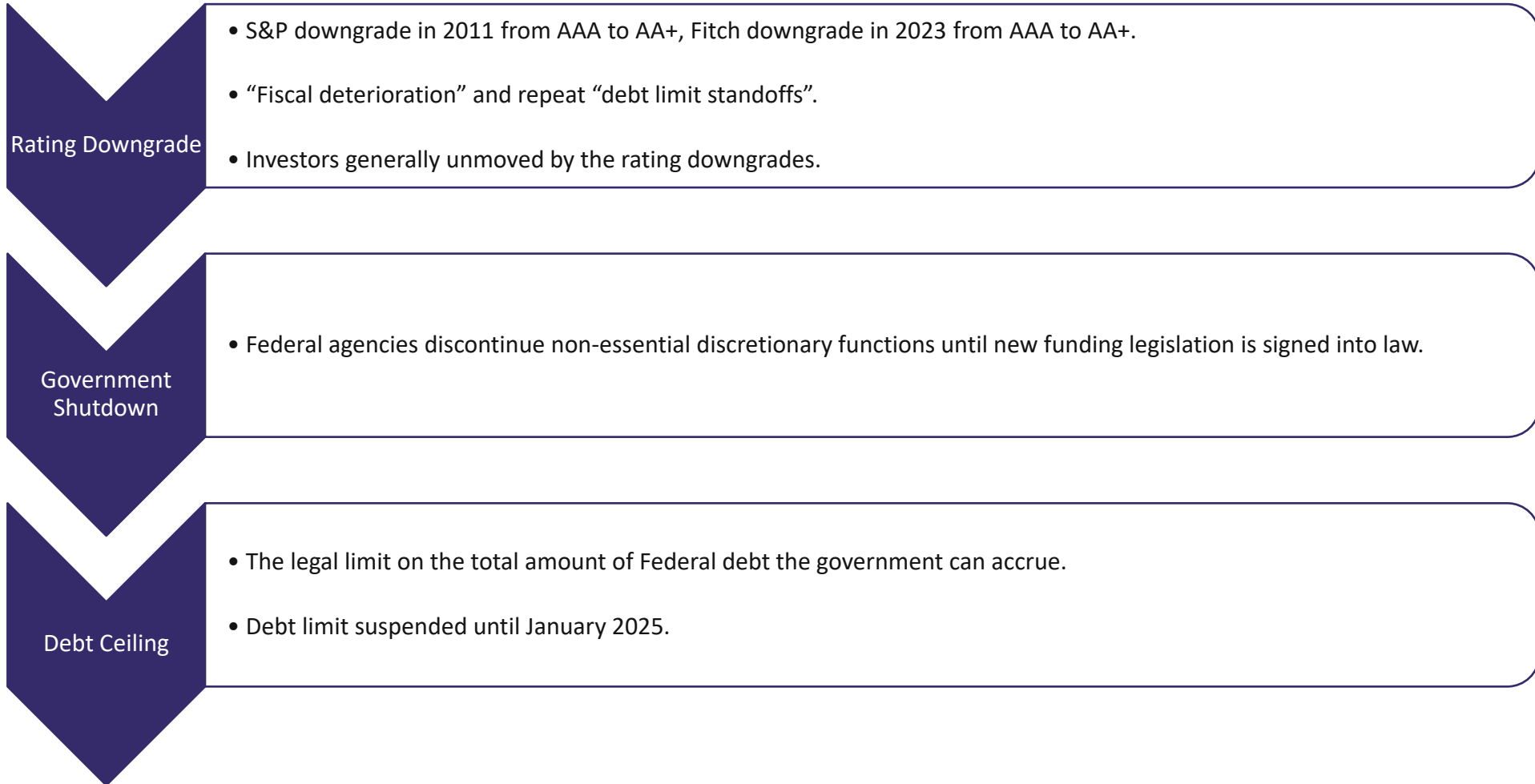


Source: Wells Fargo Corporate & Investment Banking, Bloomberg

Data as of 9/12/23

# U.S. Treasury

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# Conclusion

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- The consumer is fueling the continued U.S. economic expansion and “soft landing” prospects.
- The biggest risk to the economic outlook right now is Fed policy.
- Although rates are going to decline in the near-term, the pace is uncertain.

Thank you!

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