December 16, 2019

Economics Group

Our Favorite Charts of 2019

Special commentary

In economics, it can be easy to get caught up in the details and overlook the economy of words. With that in mind, we present our favorite charts of the past year to illustrate some of the major trends of 2019.

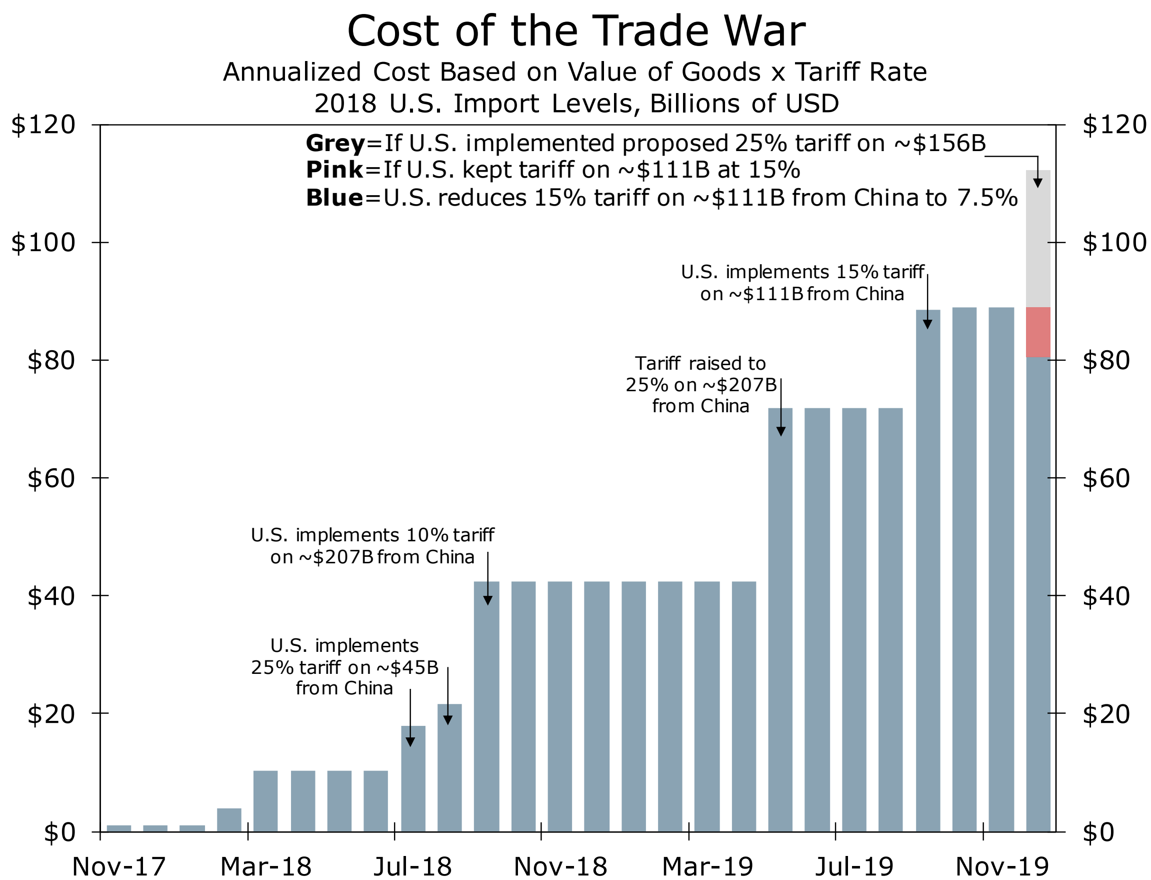
We want to thank you for subscribing to our commentary, and we wish you and your families the best in 2020.

This report is available at **wellsfargo.com/economics** and on Bloomberg at WFRE.

I Sought the Tariff

It's tough to stay current on the latest developments in the trade war. Regardless of the individual tranches and varying tariff rates, the cost of the trade war has risen. You have to go back to Smoot-Hawley in the 1930s to find a similar period of protectionism in the U.S. economy. This chart looks at the annualized cost of each escalation by multiplying the various tariff rates by the value of affected goods based on 2018 import levels.

For further reading, email us for a wide range of reports on the trade war.



Source: Office of the U.S. Trade Representative, U.S. Department of Commerce and Wells Fargo Securities

Chinese Exports Slow Amid Tariffs

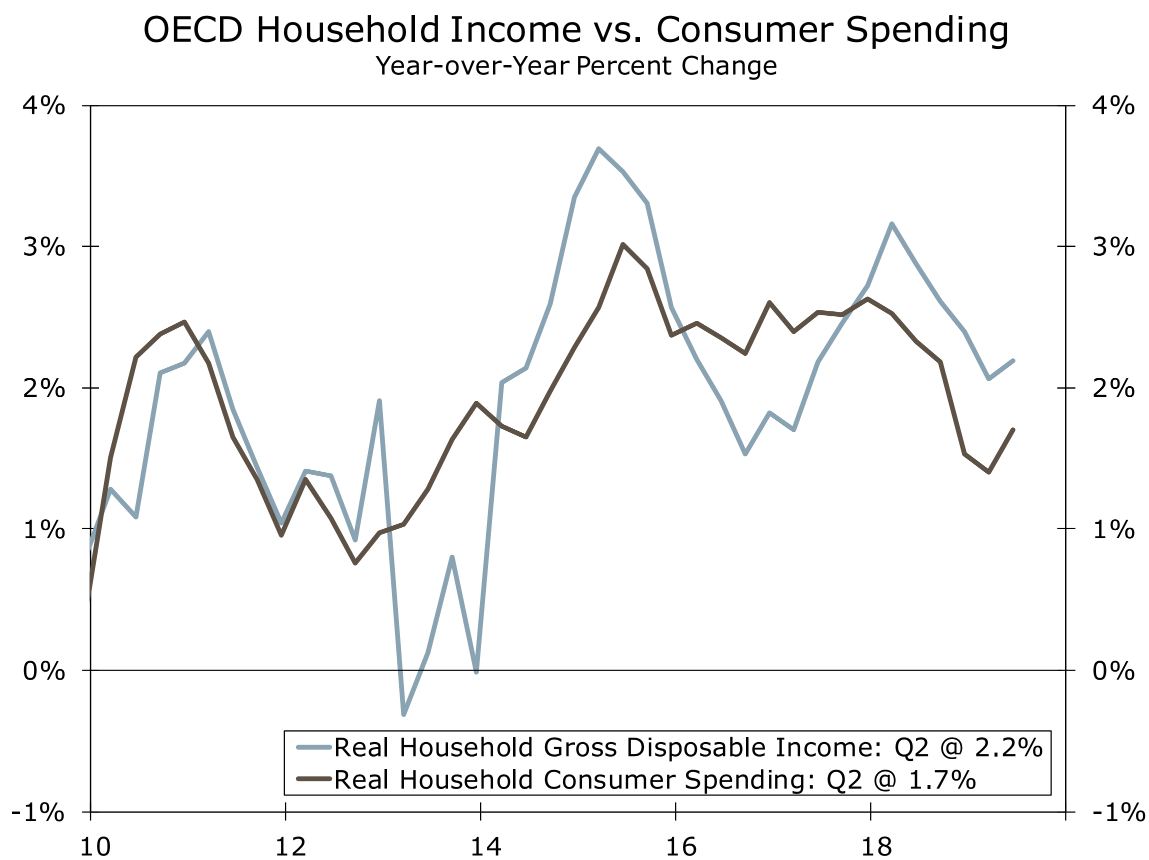
While it has been difficult to quantify the exact impact of tariffs on the Chinese economy, we can say with some level of certainty that trade tensions with the United States are having negative effects on China's economy. As trade tensions have escalated and intensified over the course of 2019, China's exports to the United States have turned negative, while exports to the rest of the world have slumped. Should trade tensions escalate from current levels, we would expect exports to the United States to contract even further, while any form of a trade deal that includes a roll back of existing tariffs, could see Chinese goods exports begin to recover.

Source: Bloomberg LP and Wells Fargo Securities

Resilient Consumer is a Global Story

The U.S. consumer been a source of stability this year, but less widely reported is the fact that employment and wage growth in many international economies have also fared rather well.

For the most part, household income growth has outpaced the growth in consumer spending in recent years. As a result, while some risks and headwinds remain for the global economy, the resilience of the consumer and services sectors should mean slow growth rather than recession.

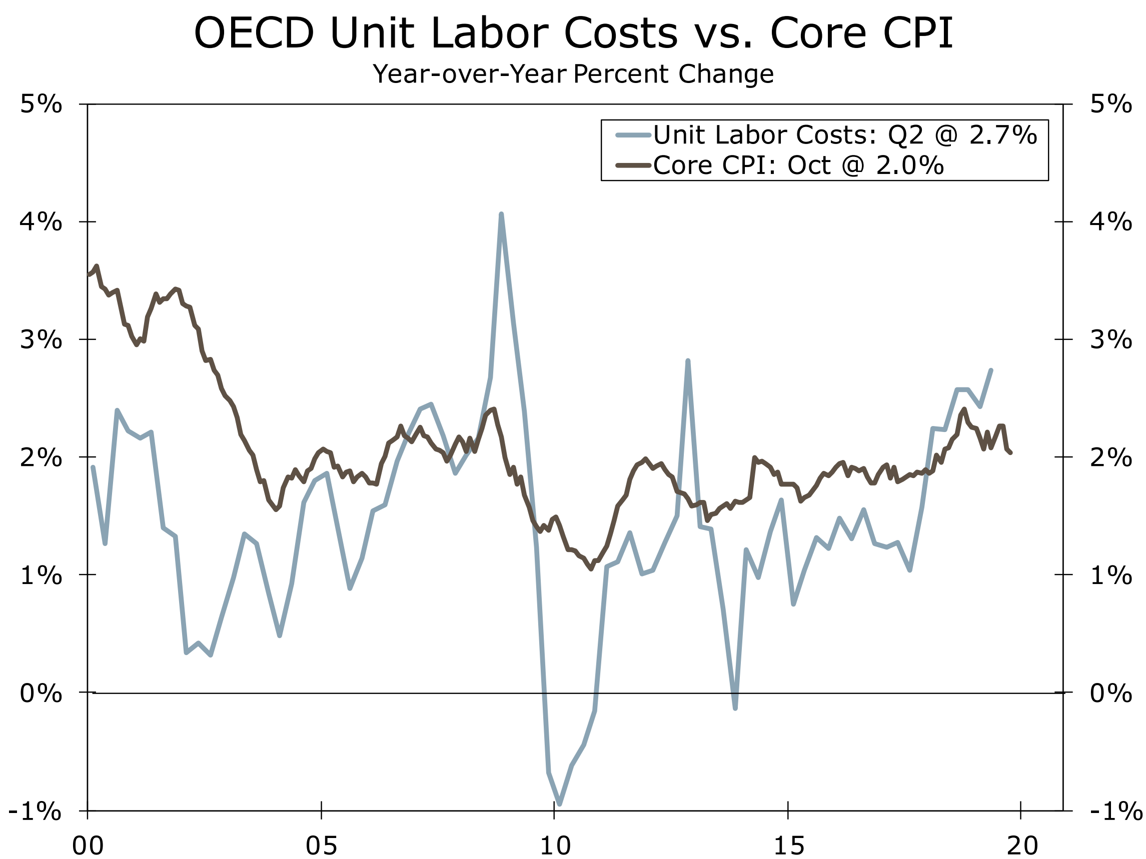


Source: Datastream, OECD and Wells Fargo Securities

Household Gain, Business Pain?

Another important sectoral theme during 2019 has been the apparent global transition of incomes from the corporate sector to the household sector globally. Rising employment and wages have helped the household sector, but they have also been a factor behind falling corporate incomes and a squeeze on corporate profits.

In OECD economies, growth in unit labor costs has outpaced the rise in core consumer prices—a suggestion that business costs are outpacing selling prices. If margin pressures continue to restrain business profitability, keep a close eye on employment and business investment trends in 2020, as those indicators serve as a harbinger of a business-led economic slowdown.



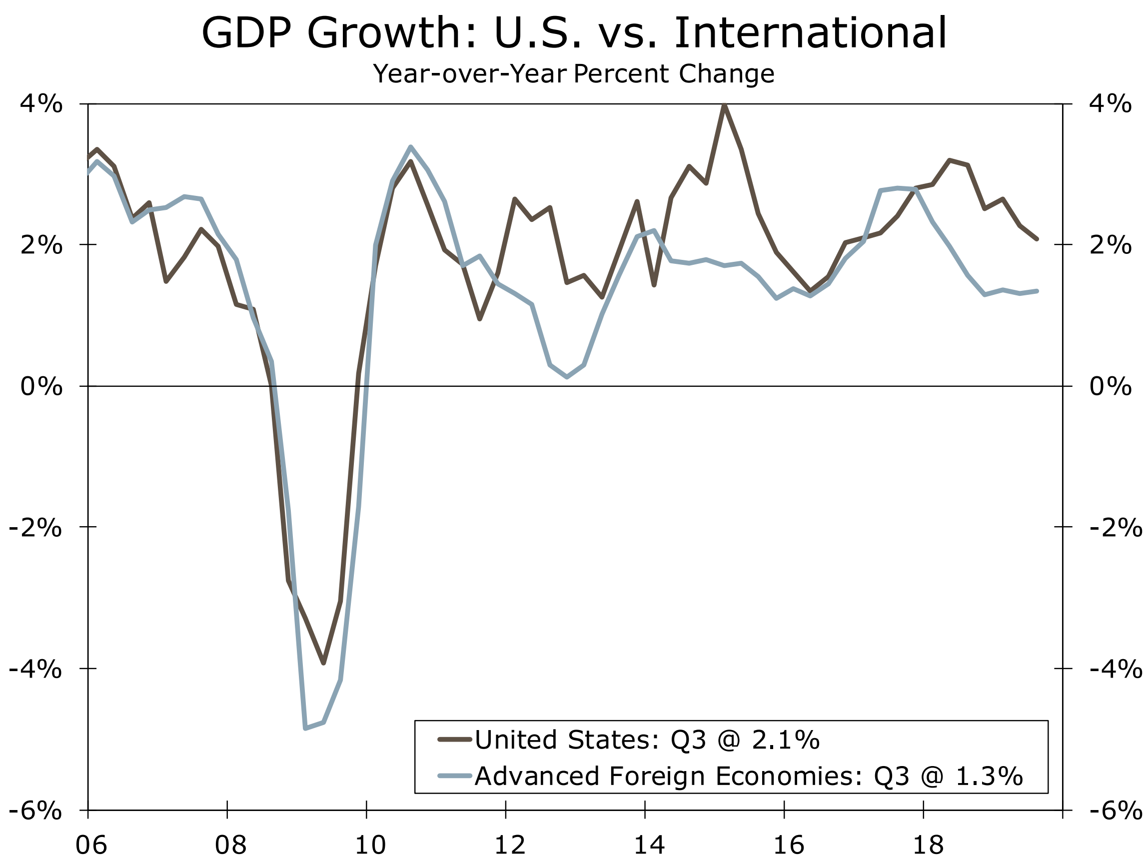
Source: Datastream, OECD and Wells Fargo Securities

U.S. Outperformance Waning

This year has been notable for a lessening in the outperformance of the U.S. economy relative to international economies—not because international economic trends have improved, but rather because international growth has remained slow but steady, while U.S. GDP growth has gradually slowed in recent quarters.

In fact, the growth spread between the United States and some advanced foreign economies (Eurozone, Canadian, Japan, United Kingdom, Switzerland, Sweden and Australia) in Q3-2019 was at its narrowest since Q2-2018.

This dynamic may have been a factor for the greenback in 2019 after it enjoyed strong gains last year amidst clear outperformance in U.S. growth. However, to the extent that U.S. growth becomes less exceptional, it could lead to some modest U.S. dollar weakness.



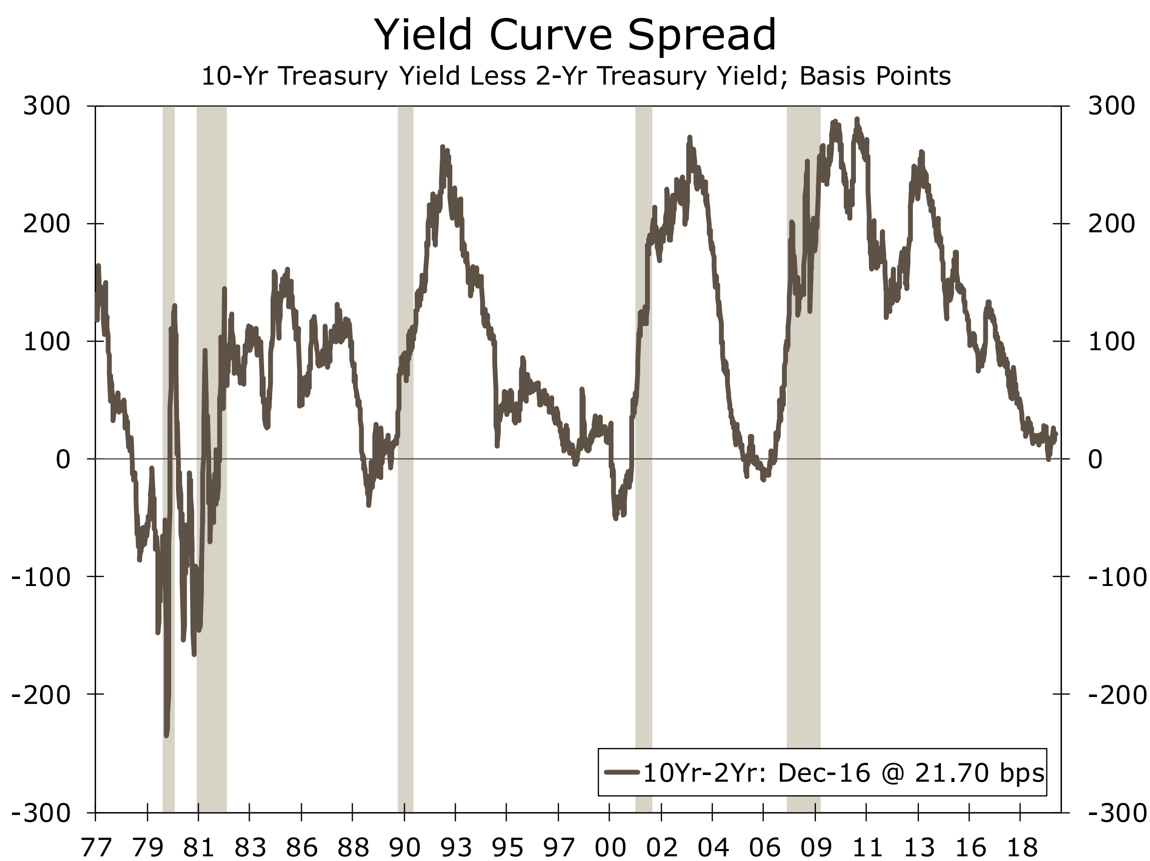
Source: Datastream, Federal Reserve Board and Wells Fargo Securities

If You Were Directly Above Him, How Could You See Him?

Because I was inverted. Financial market participants were on high alert for recession in the summer when the yield curve inverted. An inversion of the yield curve has been a fairly reliable indicator of looming recession in the past, but we cautioned at the time not to over-react.

In our view, the curve would need to invert further and for a more extended period of time to be really concerning. Also, Fed purchases of Treasury securities may have made the yield curve a less reliable predictor of recession than it has been historically.

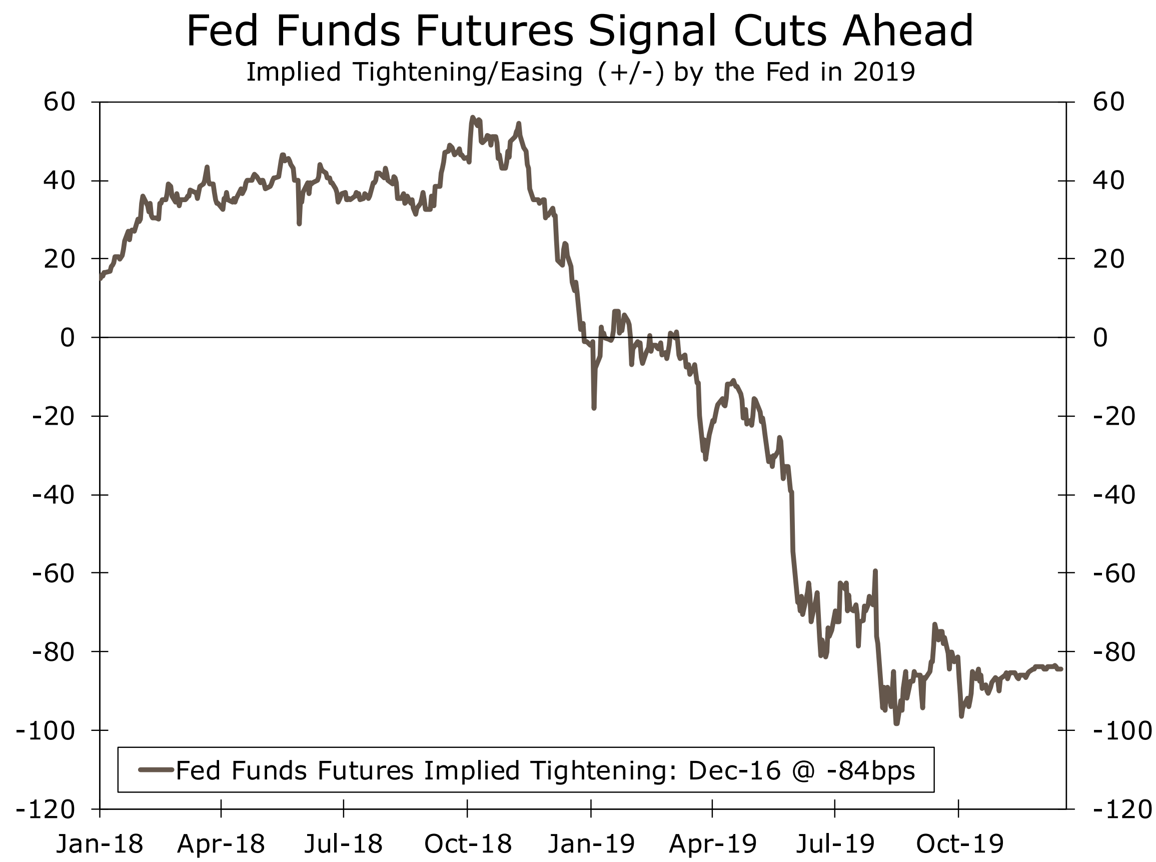
For further reading, see "The Yield Curve: Is Recession Coming?" (August 14, 2019)



Source: Bloomberg LP and Wells Fargo Securities

Expect the Unexpected

In the first couple weeks of October 2018, fed funds futures implied that markets were priced for roughly two 25 bps rate hikes by the FOMC in 2019. Slightly more than one year later, this has swung to a realized reduction in the fed funds rate of 75 bps, a 125 bps swing in 14 months.



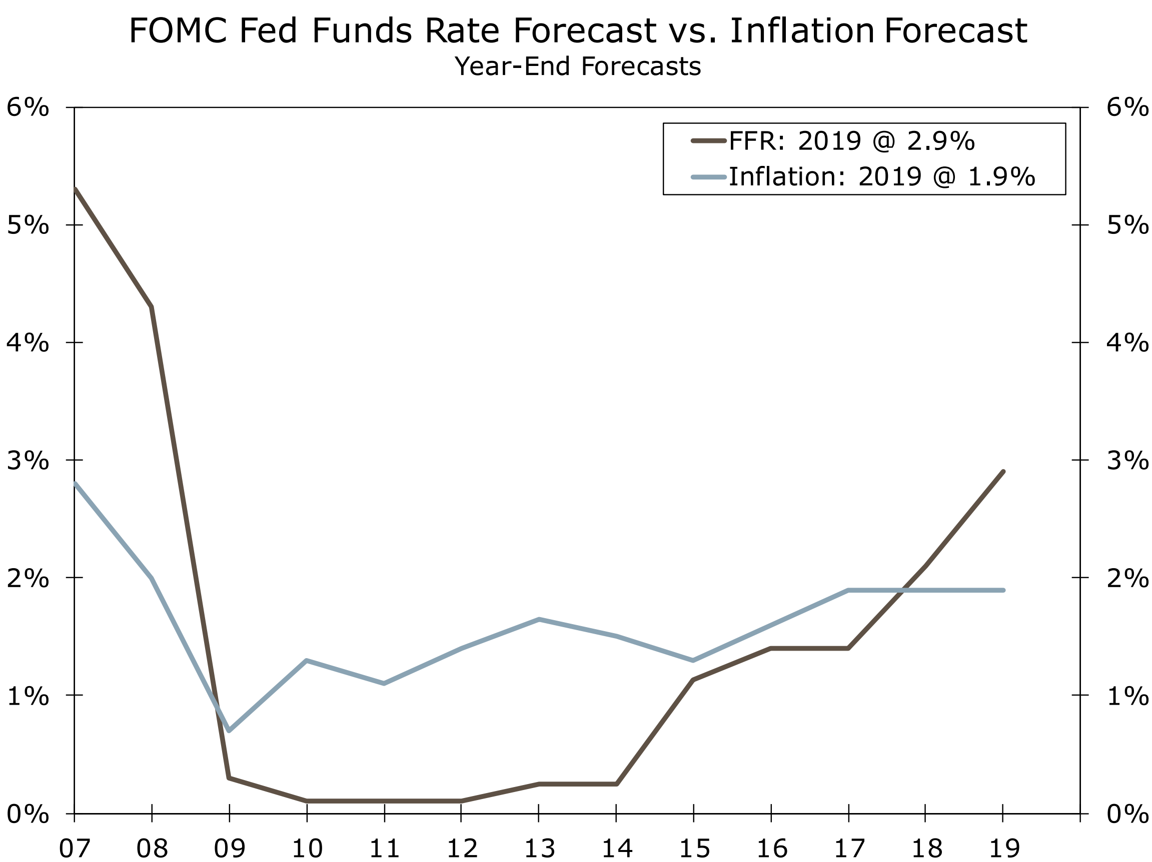
Source: Bloomberg LP and Wells Fargo Securities

Fall Into the Gap

We examined the gap between the FOMC's federal funds rate forecasts and its economic data projections, to analyze whether its December 2018 rate hike was overly restrictive and inconsistent with its forecasts. A wider gap between GDP growth/inflation and the fed funds forecasts is typically associated with an accommodative policy, while a narrow gap suggests policy normalization.

In 2018, the gap turned negative for the first time in the post-Great Recession era, as the fed funds rate was forecast to increase to a higher rate than GDP growth and inflation. With GDP growth trending downward and inflation flat, and below the Fed's 2% target, the negative gap suggested forecast inconsistency.

For further reading, see "Was the Fed's Rate Hike in December a 'Policy Mistake'?" (July 31, 2019)

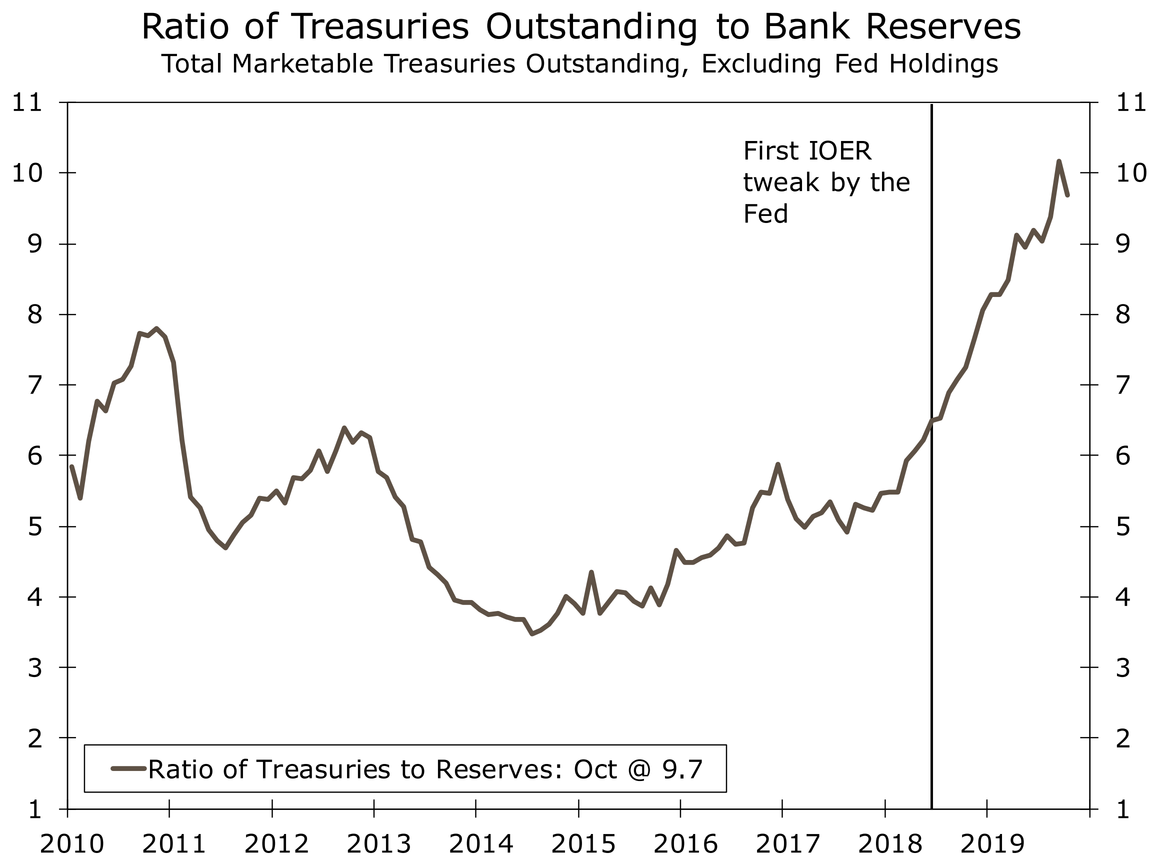


Source: Federal Reserve Board and Wells Fargo Securities

Repo Running Wild

The combination of increased Treasury security collateral and declining cash balances steadily put upward pressure on secured funding rates, culminating in the spike in money market rates on September 17, 2019. Since then, the Federal Reserve has largely gotten the problem under control through repurchase agreements and purchases of Treasury bills. That said, questions remain about whether it has solved the problem longer-term, and the issue is likely to remain relevant to financial market participants in 2020.

For further reading, see our special report "Repo Running Wild: A Deeper Dive."
(September 27, 2019)



Source: Federal Reserve System, U.S. Department of the Treasury and Wells Fargo Securities

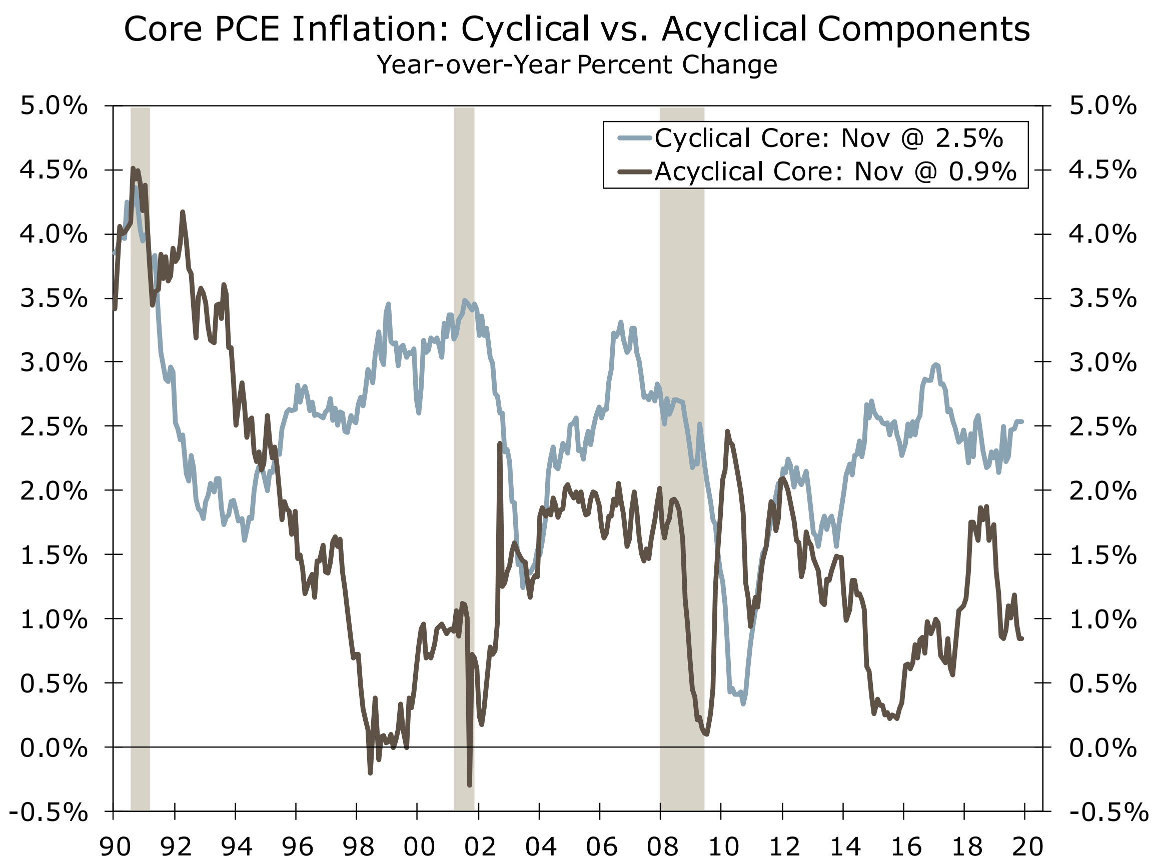
How Do You Get Through to a Slacker?

The ongoing shortfall in inflation from the Fed's 2% target was a contributing factor to the FOMC's decision to cut interest rates earlier this year.

More accommodative policy should help to spur inflation in cyclically sensitive areas, but the bulk of inflation's shortfall has been concentrated in "acyclical" categories, where price changes in prior decades have shown no significant link to slack in the economy.

Just because an inflation category was dominated by industry-specific factors in the past does not guarantee it is wholly immune to cyclical influences. However, with inflation for the acyclical categories running well-below 2%, ***rate cuts are unlikely to solve inflation's persistent shortfall on their own***.

For further reading, see "Will "Insurance" Cuts Solve Inflation's Shortfall?" (June 14, 2019)



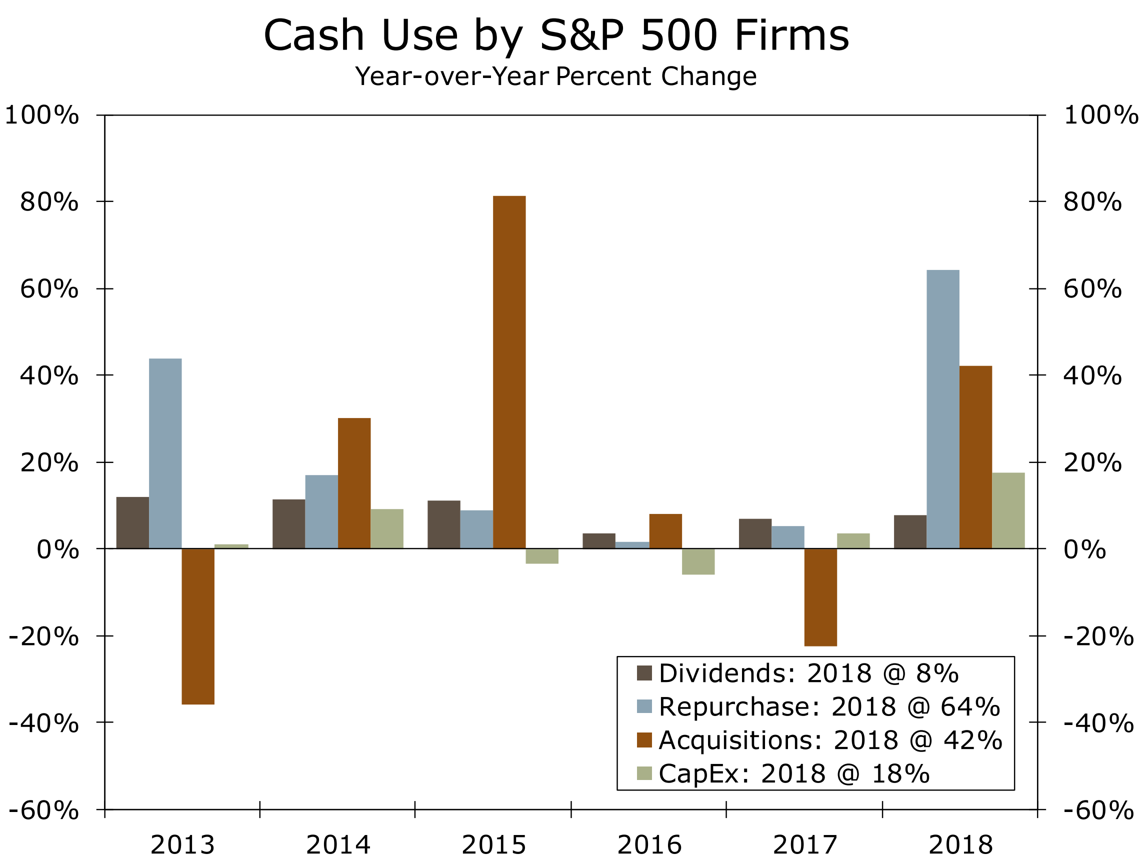
Source: U.S. Department of Commerce and Wells Fargo Securities

Capex Takes a Backseat to M&A & Buybacks

The tax cuts boosted corporate profits and allowed repatriation of profits previously held overseas. So what did businesses do with the windfall of cash? They did increase capital expenditures, but they increased M&A activity more than twice as much and increased share buybacks three times as much.

A business is entitled to whatever it wants with its own money, but only Capex spending can meaningfully lift potential GDP growth.

For further reading, see "Down, Not Out: Late Cycle Business Spending" (August 14, 2019)



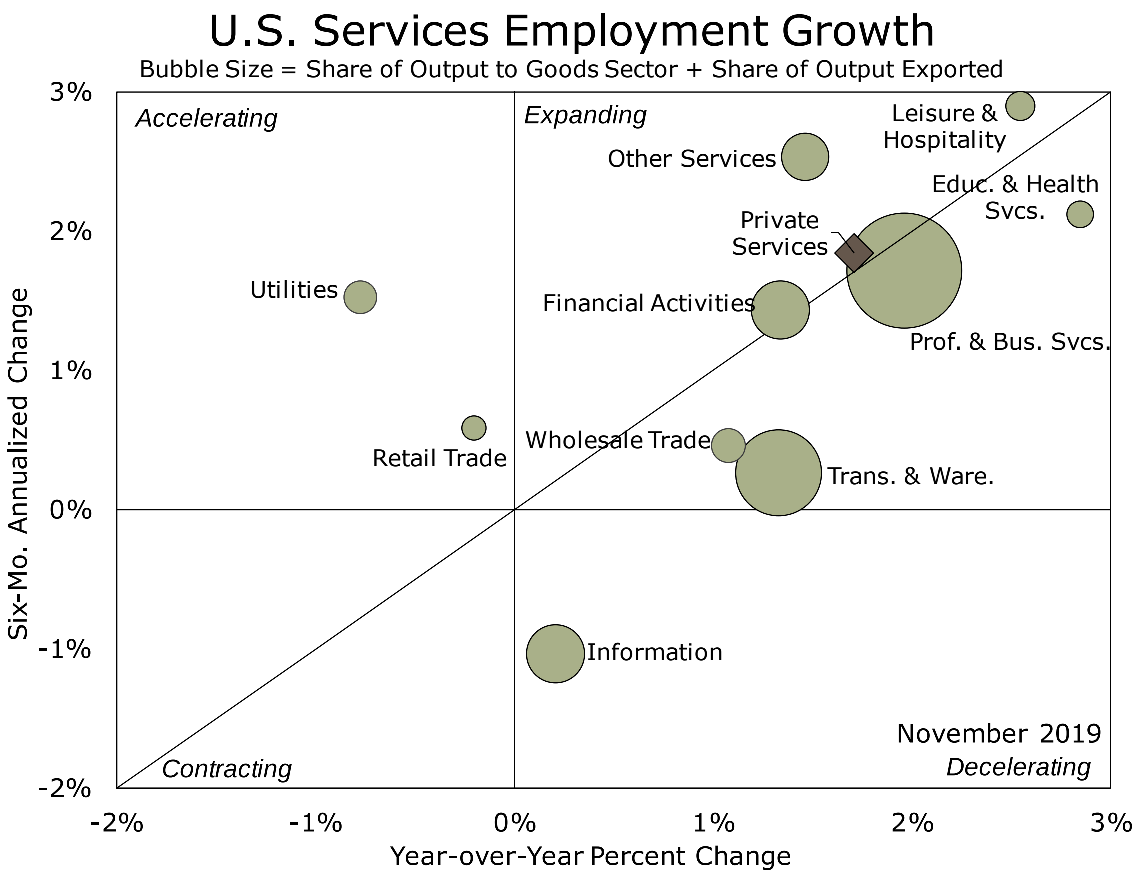
Source: IHS Markit and Wells Fargo Securities

No Disruption in Service

Overall growth in the United States has been resilient despite a notable slowdown in the goods sector thanks to the economy's large service sector. Hiring here is holding up, but where would spillovers from the goods sector show up first?

Based on exports and output derived from the goods sector, the professional & business services, transportation & warehousing, information and finance industries bear the most exposure. Hiring in these industries has slowed only modestly, suggesting limited spillovers and risks to the expansion at present, but it warrants close monitoring.

For further reading, see "[How Exposed Are Services to Goods Sector Weakness?]" (November 05, 2019)



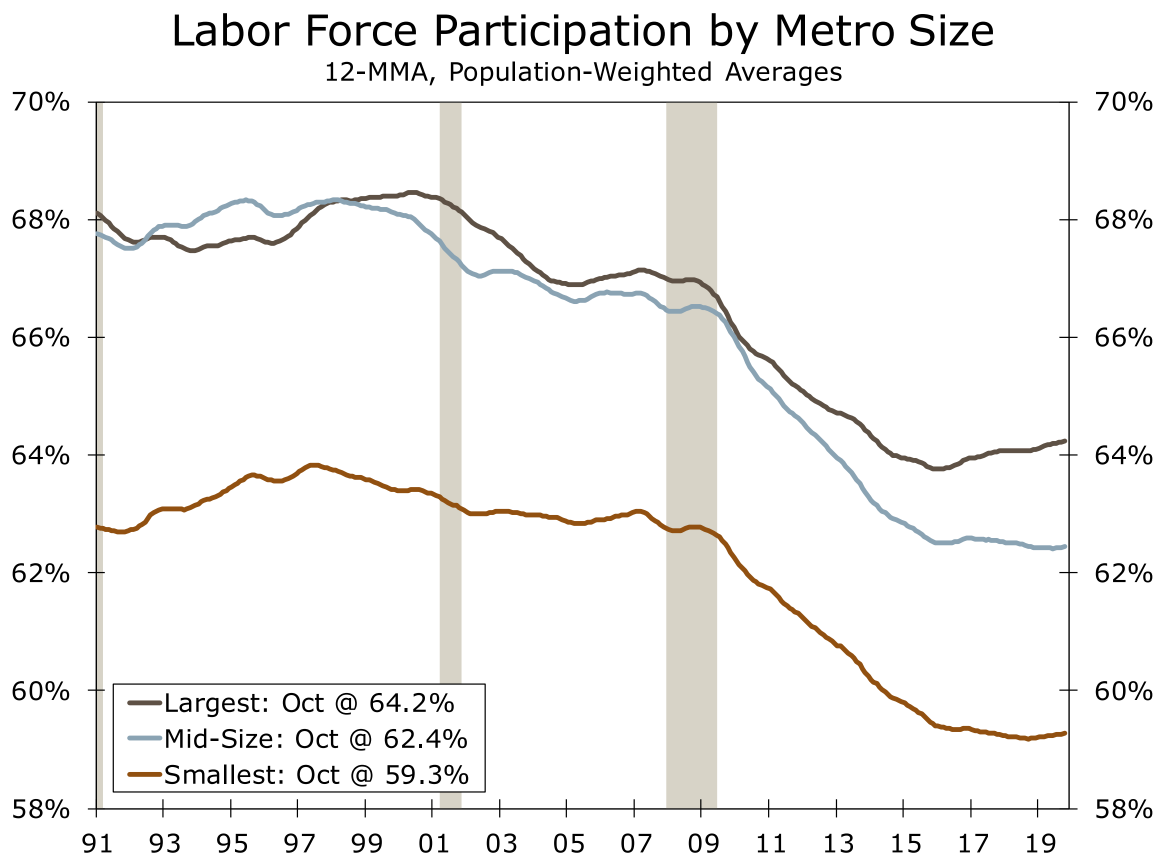
Source: U.S. Department of Commerce, U.S. Department of Labor and Wells Fargo Securities

Where Have You Been

Low labor force participation has been a glaring example that, despite a nearly 50-year low in the unemployment rate, the U.S. jobs market is not what it once was. Participation trends, moreover, have varied between different segments of the workforce. They have also varied on a geographic basis, making "place" another consideration in the outlook for the U.S. labor market.

Labor force participation in the largest third of the nation's metro areas—based on population size—has been climbing in recent years, while participation has continued to edge lower in mid-size and small metros.

For further reading, see "[Diverging Fortunes: Labor Force Participation Trends in Large and Small Metro Areas]" (July 12, 2019)

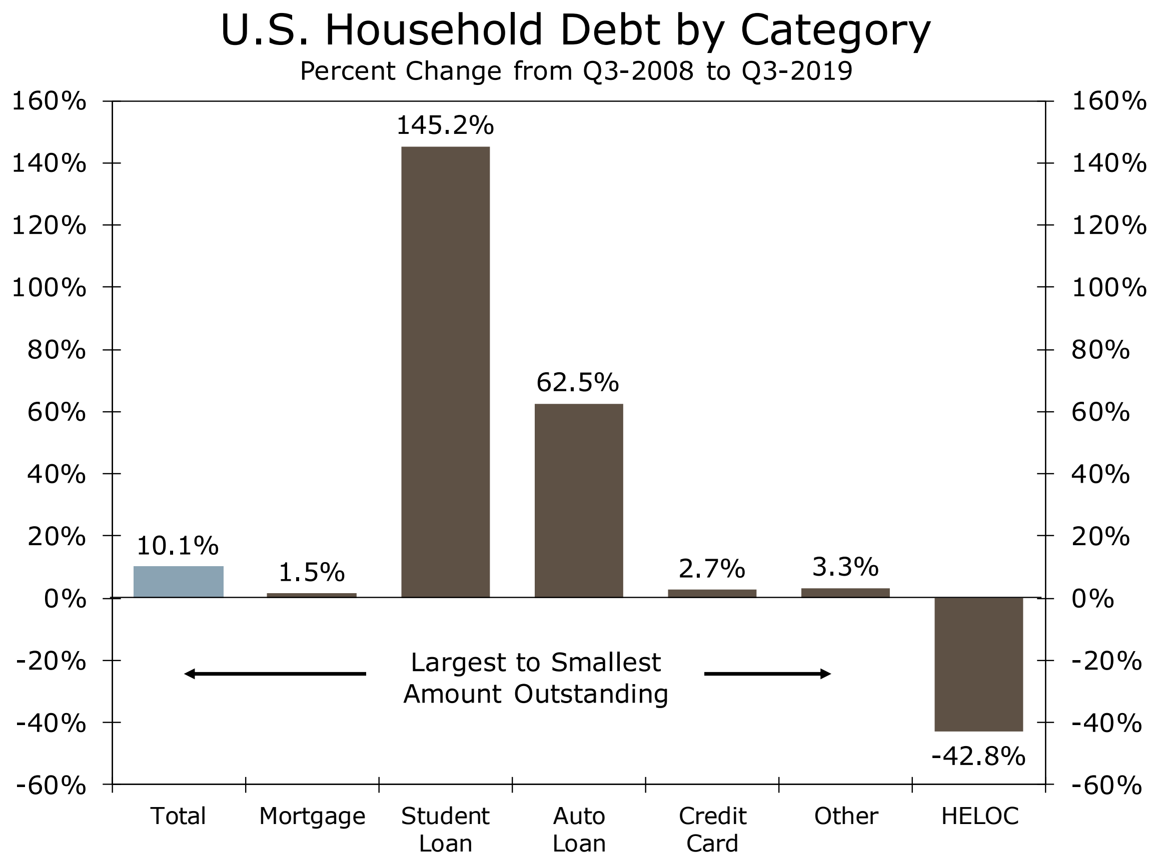


Source: U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities

Shifting Composition of Household Debt

Almost all of the growth in household debt in this cycle has come from just two categories: auto loans and student loans. Outstanding student loan debt stood at $1.50 trillion in the third quarter, and is now the second largest category of household debt after mortgages. Of student debt, a 10.9% share was 90+ days delinquent or in default in the third quarter. The burden of student loans is a factor in our measured outlook for consumer spending.

For further reading, see "Shifting Burdens of Household Debt" (March 19, 2019)



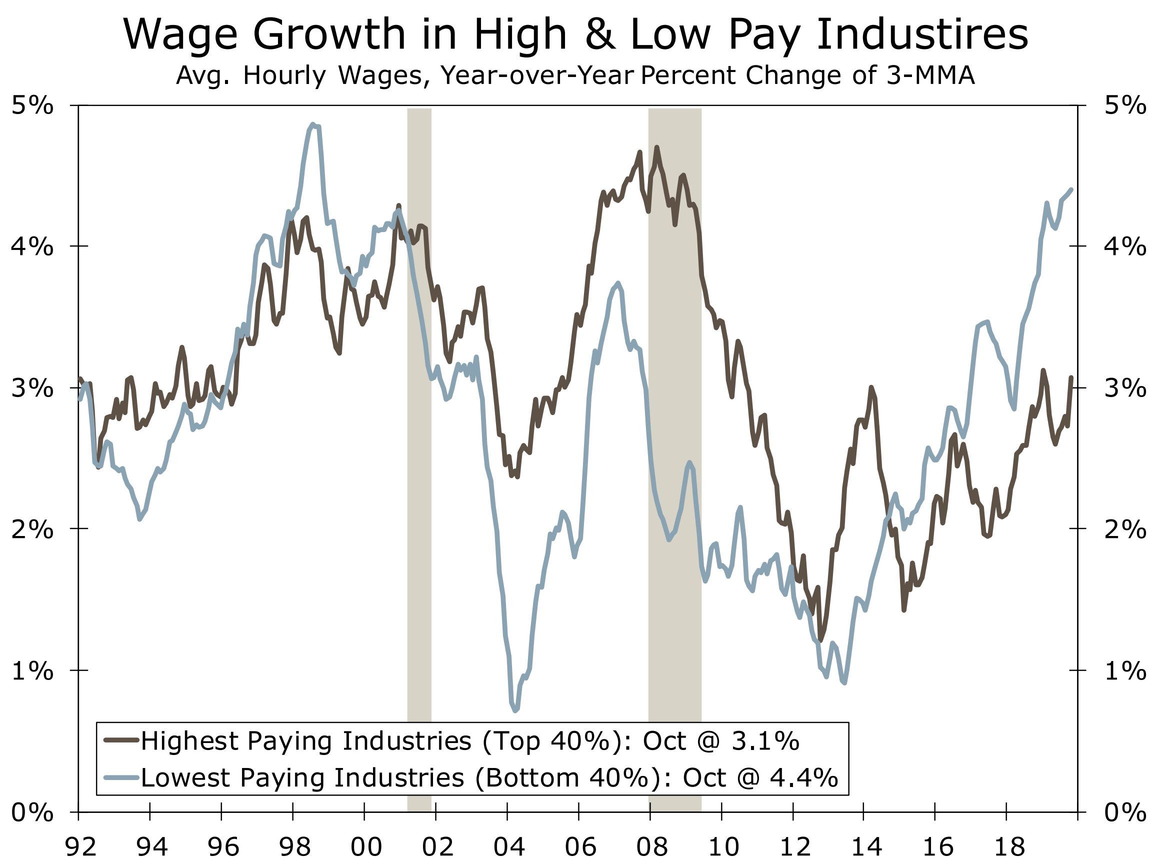
Source: IHS Markit and Wells Fargo Securities

Lower is Higher

In a reversal of trends that have been in place for decades, workers in lower-paying industries have seen wages that have been outpacing higher-paying industries. Since lower-income households tend to have a higher marginal propensity to consume, the gains here should be supportive of consumer spending.

The recent progress, however, has not fully unwound the damage done by the last recession and suggests that there may be more benefits from supportive monetary policy to come for the workers who have struggled the most over the past decade.

For further reading, see, "[Who Is Benefiting Most from a Tight Labor Market?]" (December 02, 2019)

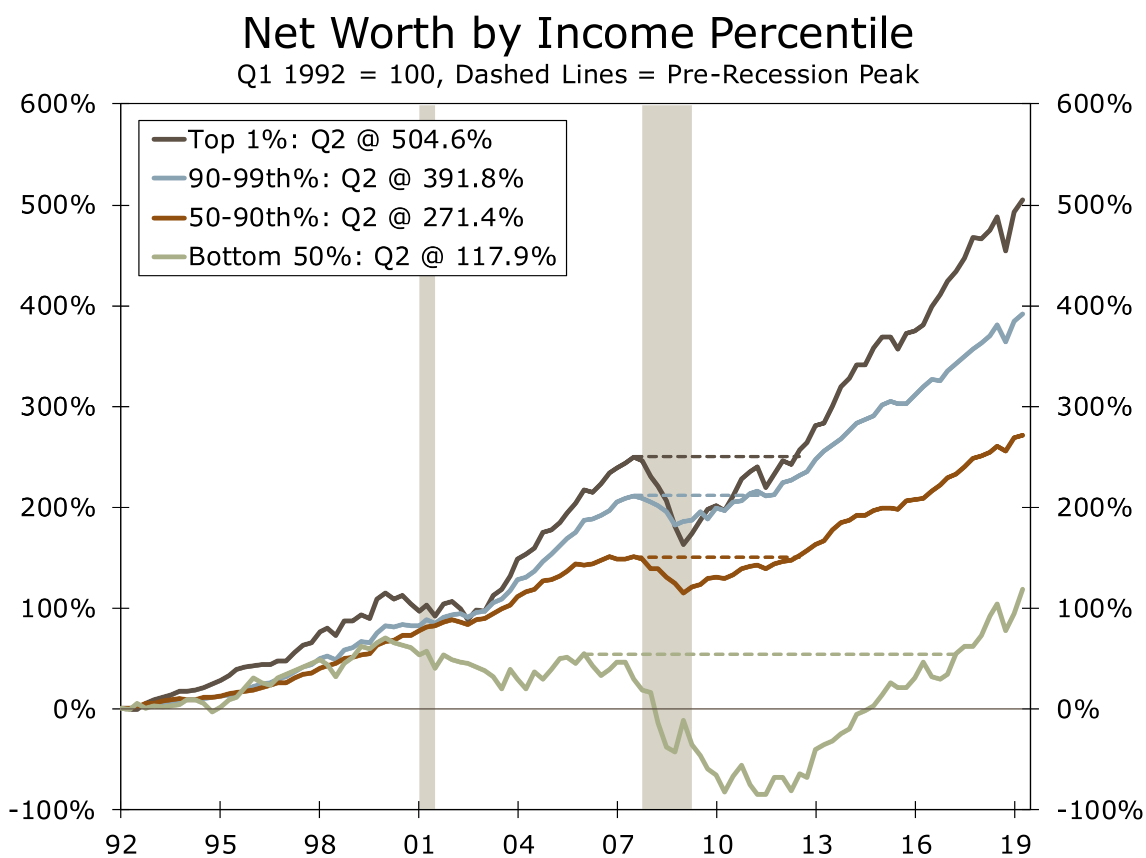


Source: U.S. Department of Labor and Wells Fargo Securities

Know Your Worth

Stronger job and wage growth over the past few years have benefitted household balance sheets. The bottom 50% of households tend to spend a higher share of their earnings, making it difficult to build wealth. It was not until 2017, or eight years into the current expansion, that the bottom 50% of U.S. households' net worth surpassed its pre-recession peak.

The improvement in net worth across the income spectrum not only grants an increasing share of households a sturdier financial cushion when the next downturn strikes, but will likely act as a tailwind to consumer spending in the next year or so.



Source: Federal Reserve Board and Wells Fargo Securities

Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Acting Chief Economist	704-410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	704-410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Macro Strategist	212-214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	704-410-6542	charles.dougherty@wellsfargo.com
Erik Nelson	Macro Strategist	212-214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economist	212-214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	Macro Strategist	212-214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economic Analyst	704-410-1681	shannon.seery@wellsfargo.com
Matthew Honnold	Economic Analyst	704-410-3059	matthew.honnold@wellsfargo.com
Jen Licis	Economic Analyst	704-410-1309	jennifer.licis@wellsfargo.com
Hop Mathews	Economic Analyst	704-383-5312	hop.mathews@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	coren.burton@wellsfargo.com