

Economics Group

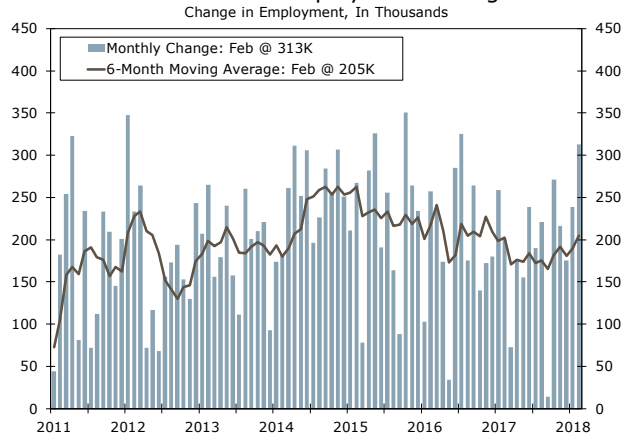
Weekly Economic & Financial Commentary

U.S. Review

February Hiring Heats Up, While Wages Cool Down

- Businesses added 313,000 new jobs in February and the unemployment rate was unchanged at 4.1 percent. Average hourly earnings growth slowed to 0.1 percent, but the trend remains upward.
- The ISM non-manufacturing index edged down in February, but remained well within expansion territory at 59.5.
- In January, the trade deficit widened by \$2.7 billion to reach the largest gap since October 2008. Lower exports of goods and services drove the increase, as imports were more or less flat over the month.

U.S. Nonfarm Employment Change

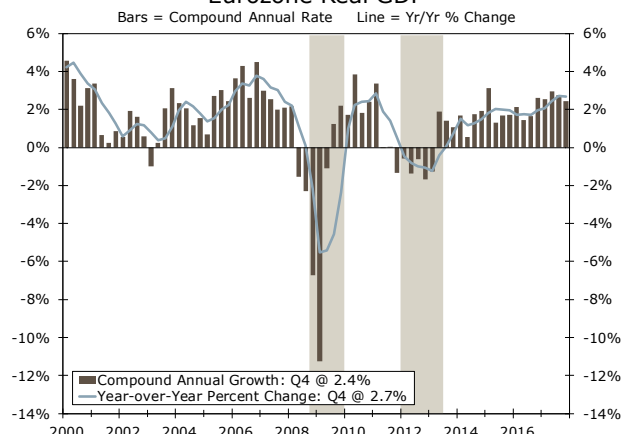


Global Review

Despite Speedbumps, Eurozone Expansion Continues

- Real GDP in the Eurozone grew 2.5 percent in 2017, the strongest annual growth rate since 2007. There are some signs that economic activity in the euro area has decelerated a bit thus far in 2018, but we look for the expansion to generally remain intact.
- The ECB apparently has confidence in the economic outlook. At its policy meeting this week, the Governing Council dropped a reference to expand its QE program again, if necessary. Although we look for the Council to “taper” its QE program further later this year, benign inflation means that the ECB is probably in no hurry to actually tighten policy.

Eurozone Real GDP



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Wells Fargo U.S. Economic Forecast													
	Actual 2017				Forecast 2018				Actual			Forecast	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2015	2016	2017	2018	2019
Real Gross Domestic Product ¹	1.2	3.1	3.2	2.5	2.0	2.8	2.9	2.7	2.9	1.5	2.3	2.6	2.8
Personal Consumption	1.9	3.3	2.2	3.8	2.2	2.5	2.5	2.5	3.6	2.7	2.7	2.7	2.6
Inflation Indicators ²													
PCE Deflator	2.0	1.6	1.5	1.7	1.8	2.2	2.3	2.1	0.3	1.2	1.7	2.1	2.0
Consumer Price Index	2.6	1.9	2.0	2.1	2.4	2.7	2.7	2.3	0.1	1.3	2.1	2.5	2.3
Industrial Production ¹	1.5	5.6	-1.2	8.3	2.4	3.0	2.6	2.4	-0.7	-1.2	2.0	3.4	2.5
Corporate Profits Before Taxes ²	3.3	6.3	5.3	3.8	3.4	3.2	3.1	3.1	-1.1	-2.1	4.7	3.2	2.9
Trade Weighted Dollar Index ³	94.0	90.5	88.1	87.5	84.5	83.3	82.0	80.8	91.0	91.5	91.1	82.6	78.0
Unemployment Rate	4.7	4.3	4.3	4.1	4.1	4.0	3.9	3.8	5.3	4.9	4.4	4.0	3.8
Housing Starts ⁴	1.24	1.17	1.17	1.26	1.30	1.30	1.31	1.32	1.11	1.17	1.20	1.31	1.37
Quarter-End Interest Rates ⁵													
Federal Funds Target Rate	1.00	1.25	1.25	1.50	1.75	2.00	2.25	2.25	0.27	0.52	1.13	2.06	2.63
Conventional Mortgage Rate	4.20	3.90	3.81	3.94	4.25	4.25	4.35	4.45	3.85	3.65	3.99	4.33	4.66
10 Year Note	2.40	2.31	2.33	2.40	2.80	2.85	2.95	3.05	2.14	1.84	2.33	2.91	3.26

Forecast as of: March 2, 2018
¹ Compound Annual Growth Rate Quarter-over-Quarter
² Year-over-Year Percentage Change
³ Federal Reserve Major Currency Index, 1973=100 - Quarter End
⁴ Millions of Units
⁵ Annual Numbers Represent Averages

Source: U.S. Department of Commerce, U.S. Department of Labor, Federal Reserve Board, IHS Global Insight and Wells Fargo Securities

Together we'll go far



U.S. Review

February Hiring Heats Up, While Wages Cool Down

Employment growth strengthened in February with businesses adding 313,000 new jobs. That pushed the three-month average up to 242,000 after job gains in December and January were also revised higher by a net of 54,000 jobs. Strength was widespread across industries, including gains of 50,000 in retail, 28,000 in financial services and 61,000 in construction, which likely benefited from a return to less severe winter weather.

Nevertheless, the unemployment rate was unchanged at 4.1 percent amid the largest monthly increase in the labor force since 2003. The labor force participation rate rose 0.3 points to 63.0, which puts it back at the top end of the past two year's range.

Average hourly earnings were up 0.1 percent (0.149 percent before rounding), barely missing expectations for a 0.2 percent increase. February average hourly earnings were up 2.6 percent from a year ago compared to 2.5 percent in 2017.

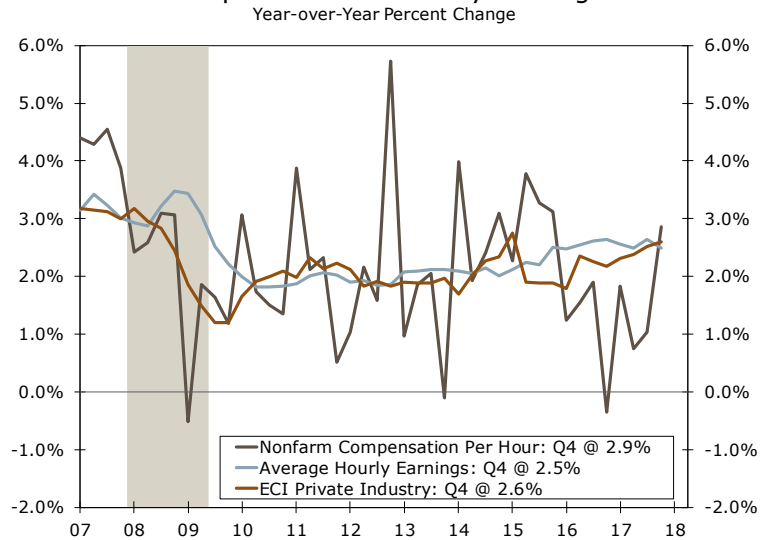
Other data released this week point to labor compensation trending higher. The updated look at fourth quarter productivity and costs showed hourly compensation increasing at a 2.4 percent annualized pace in the fourth quarter compared to an earlier estimate of 1.8 percent. That puts compensation per hour up 2.9 percent over the past year and makes it look more consistent with the increase in average hourly earnings over the same period.

Moving beyond the labor market, the ISM non-manufacturing index suggests that the economy continues to expand at a solid clip. The index edged down 0.4 points to a still-strong 59.5 after setting a cycle high in January. Current activity edged up and a 12-year high in new orders suggest near-term momentum remains positive.

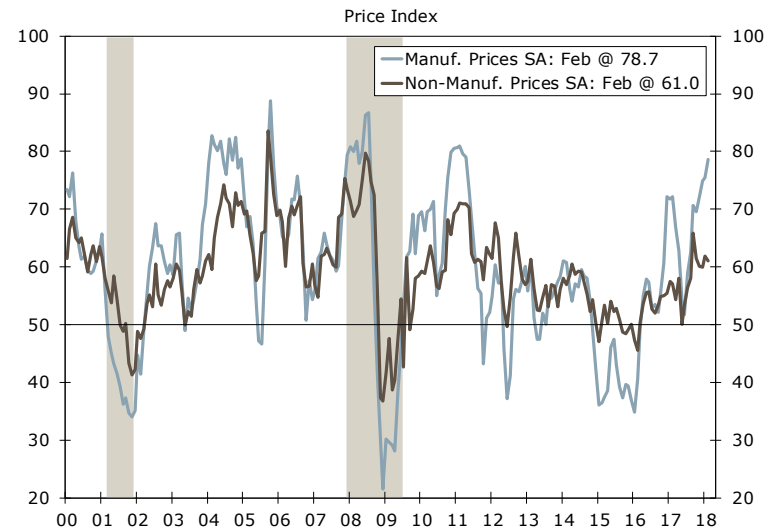
Higher input costs may be becoming more of a concern for businesses, however. The prices paid component of the ISM non-manufacturing survey ticked down almost a point but, at 61, still indicates input costs rising at nearly the fastest pace in a number of years. Cost concerns were more ubiquitous in the comments section. Respondents ranging from construction and mining to health care and hospitality specifically mentioned higher prices. Although more impactful for the manufacturing sector, where input prices are rising more dramatically, recent tariff plans could intensify cost pressures. We discuss tariffs' impact on price inflation further on page 7 in our Topic of the Week.

The proposed tariffs have been fueled in part by the Trump administration's concerns over the trade deficit. The most recent monthly trade print is unlikely to allay their concerns. In January, the trade deficit widened by \$2.7 billion to reach the largest gap since October 2008. Lower exports of goods and services drove the increase as imports were more or less flat over the month. The drop in exports was driven by some of the more volatile categories like aircraft and petroleum products. We expect exports to recover in the coming months due to solid growth in the rest of the world and a weaker dollar. However, imports should also rise amid strong domestic demand, keeping trade as a drag on real GDP growth over the next few quarters.

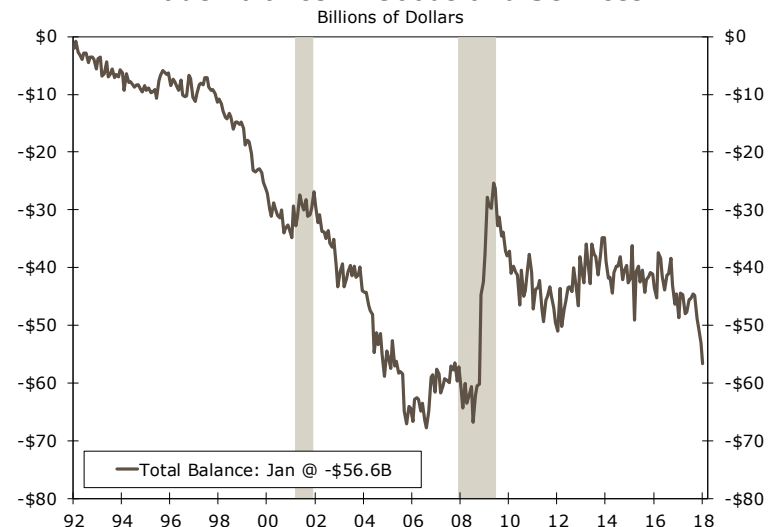
Compensation vs. Hourly Earnings



ISM Manuf. and Non-Manuf. Prices



Trade Balance in Goods and Services



Source: U.S. Department of Labor, U.S. Department of Commerce, Institute for Supply Management and Wells Fargo Securities

CPI • Tuesday

The recent pickup in inflation pressure was underscored by a larger-than-expected 0.5 percent gain in the CPI during January. Headline prices have increased 2.1 percent over the year, as higher energy prices provided a lift both on the month and on the year.

Core inflation gains were notable in January, notching a 0.3 percent rise during the month on higher prices for goods, particularly used vehicles and apparel, and services prices which were boosted by medical and insurance costs. Core CPI year-over-year growth held steady at 1.8 percent in January, but its 2.9 percent three-month annualized rate suggests the trend is strengthening more recently.

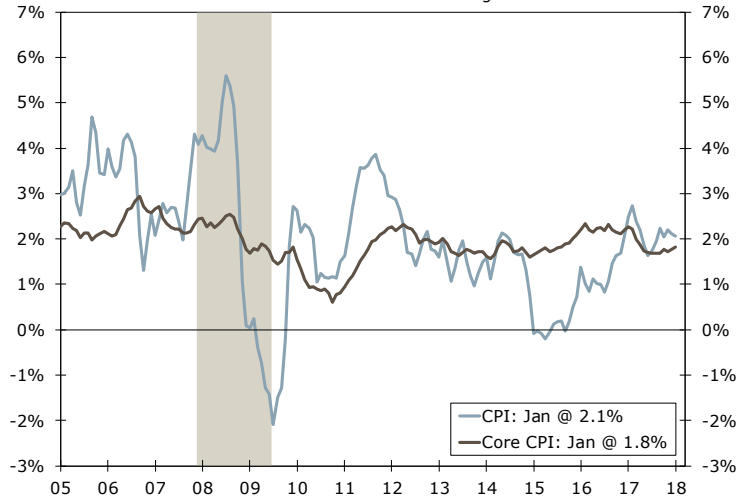
The Fed will be encouraged that the inflation readings have firmed as expected, and is likely to proceed with plans to tighten monetary policy.

Previous: 0.5%

Wells Fargo: 0.1%

Consensus: 0.2% (Month-over-Month)

Headline CPI vs. Core CPI
Year-over-Year Percent Change



Retail Sales • Wednesday

January’s 0.3 percent decline in headline retail sales was a surprise, and downward revisions to past months’ control group sales made it more disappointing. Even with higher gasoline prices, sales ex-auto were down 0.2 percent in January. Motor vehicles sales posted the largest decline in January, but there were also broad based month-to-month losses in other categories. We expect seasonal adjustment issues were more to blame than an actual slowing in consumer purchases from December to January. Compared to January 2017, nominal retail sales were up solidly, with nonstore retailers and gasoline stations posting the largest sales growth over the year.

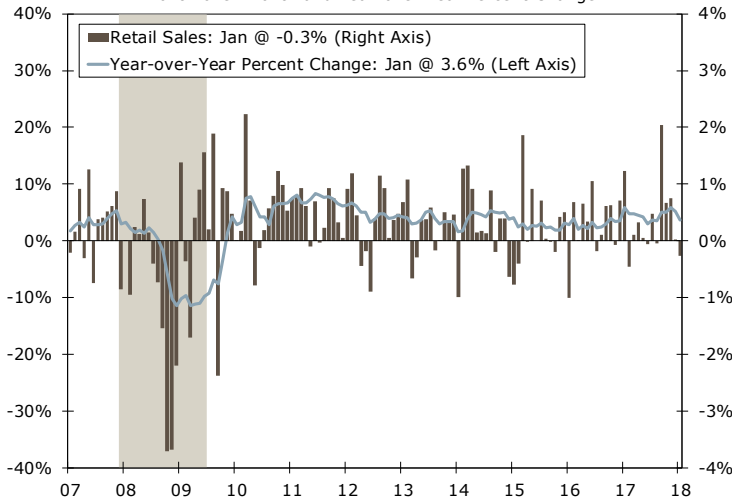
February’s showing should be stronger, and it will be interesting to see what impact, if any, the new tax withholding schedules that took effect in February had for retailers. We will also be watching for the impact that rising inflation may have on spending in coming months.

Previous: -0.3%

Wells Fargo: 0.3%

Consensus: 0.3% (Month-over-Month)

U.S. Retail Sales
Month-over-Month and Year-over-Year Percent Change



Housing Starts • Friday

Homebuilding got off to a solid start this year, as housing starts rose 9.7 percent to a 1.33-million unit pace in January. These data can be volatile in winter months, but the January ramp-up is still a reassuring sign that the stage is set for a strong spring season for the housing market.

Multifamily starts were particularly strong, rising 23.7 percent in January. Single-family starts rose 3.7 percent. The Northeast saw the largest percentage gain even with severe weather early in the month, though weather likely held back building in the Midwest. The South and West are seeing solid rises in both multifamily and single-family building, thanks to continued population and job gains. Overall momentum should continue strengthening as the year progresses, though labor shortages and higher materials costs could exert some downward pressure, particularly in the West where building is already expensive.

Previous: 1,326K

Wells Fargo: 1,283K

Consensus: 1,291K

Housing Starts
Seasonally Adjusted Annual Rate, In Millions



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

Global Review

Despite Speedbumps, Eurozone Expansion Continues

Data released this week confirmed that real GDP in the Eurozone grew at an annualized rate of 2.4 percent on a sequential basis in Q4-2017 (see graph on front page). The new information in the data release—preliminary data printed at the end of January—was the breakdown of the GDP data into its underlying demand components.

The good news is that all domestic spending components (i.e., consumer spending, investment spending and government spending) continued to expand in Q4. The bad news is that sequential growth in domestic demand was sluggish, rising only 1.5 percent on an annualized basis. Strength in exports relative to imports—the former rose nearly 8 percent while the latter grew only 4.4 percent—boosted the overall rate of real GDP growth in the fourth quarter.

The data from January that are now starting to trickle in suggest that economic activity may be decelerating a bit in early 2018. For example, retail sales in the overall euro area edged down 0.1 percent in January, which follows the 1.0 percent decline that was registered in December. Factory orders in Germany tumbled 3.9 percent in January, completely reversing December's 3.0 percent gain. Industrial production (IP) in Germany declined 0.1 percent in January, while IP in France fell 2.0 percent. That said, the year-over-year growth rates in factory orders and IP in Germany remained robust in January (top chart).

Does this mean that the expansion in the euro area is stalling? Probably not. For starters, sequential growth rates can be volatile. As the year-over-year strength in German factory orders and IP show, underlying growth momentum appears to be solid at present. In addition, the manufacturing and service sector PMIs remained at high levels through February, although both indices have edged a bit lower in recent months (middle chart). Moreover, macroeconomic policy in the Eurozone is still accommodative at least for now, and bank credit is accelerating.

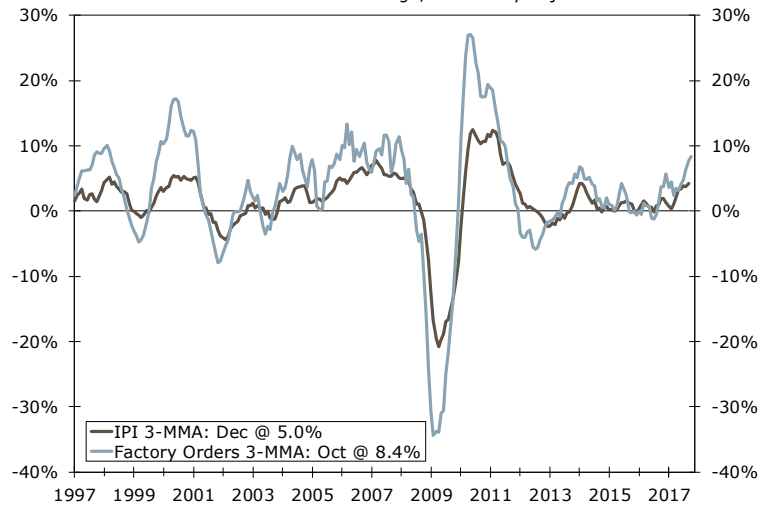
Real GDP in the Eurozone grew 2.5 percent in 2017, which was the strongest annual growth rate since 2007. We look for some deceleration this year, but we expect that the expansion in the Eurozone will generally remain intact.

The European Central Bank (ECB) is showing increased confidence in the economic outlook. Until this week, the Governing Council had been saying that it could increase the size or duration of its quantitative easing (QE) program, if necessary. At its policy meeting on March 8 the Council dropped this reference to increasing its QE program. In our view, the ECB is signaling that it intends to “taper” its QE program further later this year.

That said, the Governing Council appears to be in no hurry to tighten policy. (“Tapering” just dials back further accommodation.) The policy statement this week noted that “measures of underlying inflation remain subdued and have yet to show convincing signs of a sustained upward trend” (bottom chart). Indeed, we continue to believe that the Council will refrain from hiking rates until well into 2019.

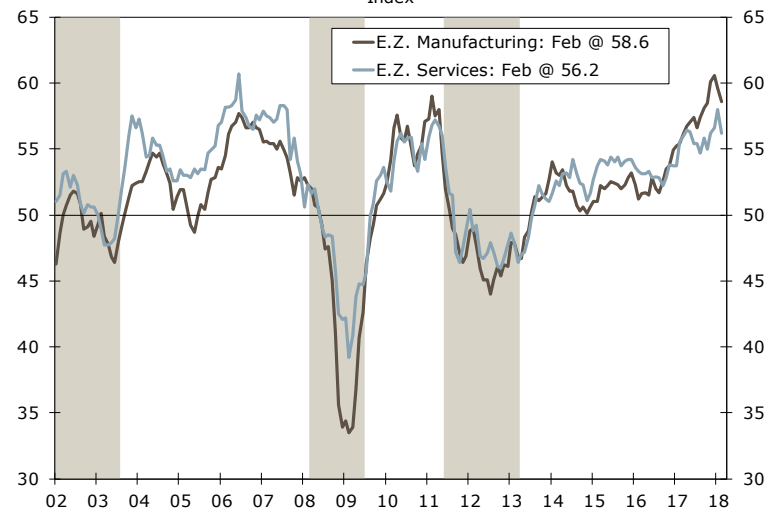
German Industrial Production Index

Year-over-Year Percent Change, Seasonally Adjusted



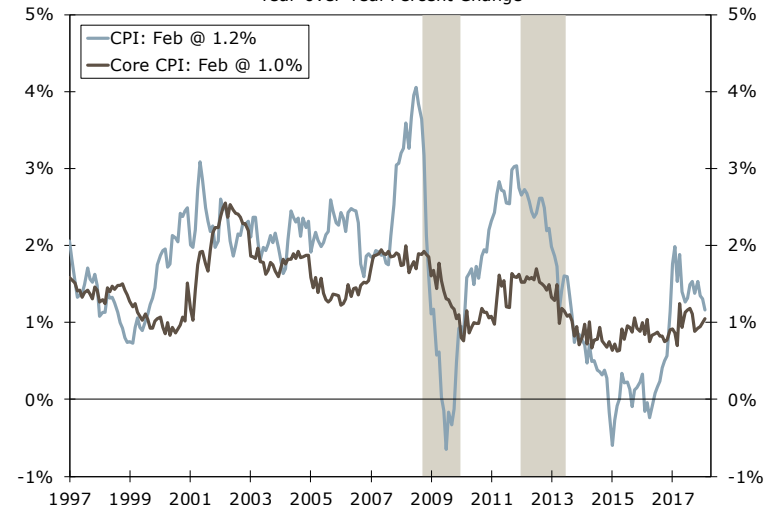
Eurozone Purchasing Managers' Indices

Index



Eurozone Consumer Price Inflation

Year-over-Year Percent Change



Source: IHS Markit, Bloomberg LP and Wells Fargo Securities

India Consumer Price Index • Monday

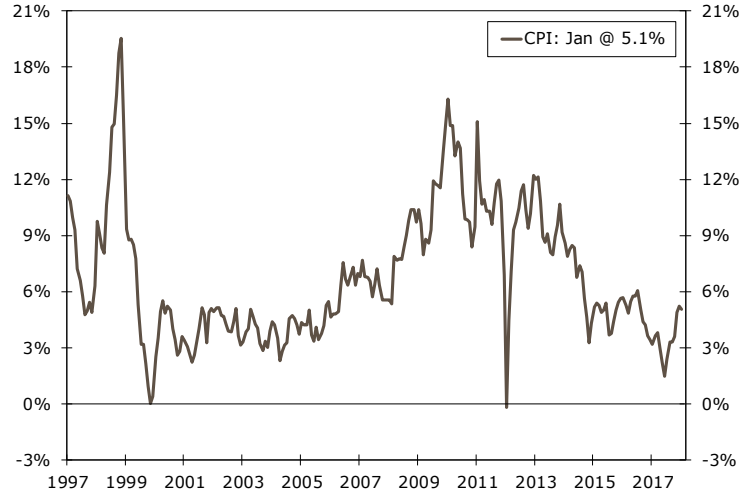
A perfect storm of demonetization, rupee appreciation, falling food prices and slowing economic growth pushed Indian inflation below 2 percent by mid-2017. Sluggish growth and inflation led the Reserve Bank of India (RBI) to cut its repo rate 200 bps since 2015. However, inflation has since moved closer to the RBI’s 4 percent target (with a +/- target band of 2 percentage points). Food prices account for nearly half the weight of the Indian CPI, and a turnaround in food price growth has propelled the index higher. The food and beverage component of the Indian CPI was up 4.6 percent in January, a marked pickup from 1.2 percent deflation as recently as last June.

The inflation pressures have extended beyond food, as both fuel and shelter prices have accelerated since last summer. The RBI is likely to proceed with caution as disruptions from structural reforms echo through the economy, but a sustained acceleration in prices in the coming months could force the RBI’s hand.

Previous: 5.07%

Consensus: 4.74% (Year-over-Year)

Indian Consumer Price Index
Year-over-Year Percent Change



China Retail Sales • Tuesday

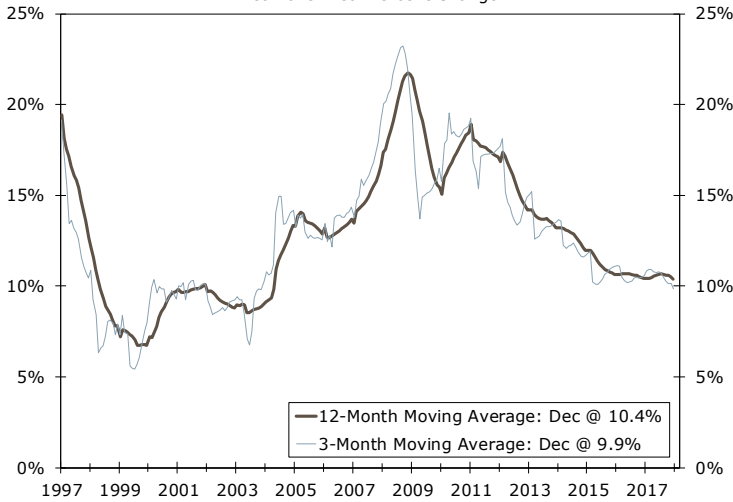
As China’s economy has developed, policymakers have strived to rebalance economic growth away from its heavy reliance on investment spending and towards a more consumption-oriented model. To that end, retail sales growth held up fairly well in China last year. Retail sales grew 10.2 percent in 2017 compared to 10.4 percent in 2016. A challenge to sustaining this growth in future years will be unfavorable demographics—the working-age population has already peaked and is expected to decline by nearly 2 percent between 2015 and 2025. Chinese industrial production data also print next Wednesday, with markets eyeing whether Chinese manufacturers can sustain the momentum achieved in 2017.

Because of the Chinese New Year, next week’s retail sales/industrial production data will encompass both January and February, adding a bit more weight than usual to these typically monthly prints.

Previous: 10.2% (Year-to-Date)

Consensus: 10.0% (Year-to-Date)

Chinese Retail Sales
Year-over-Year Percent Change



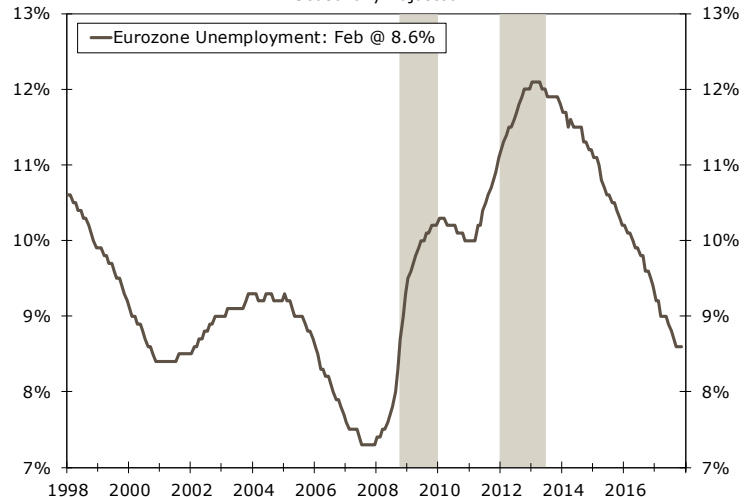
Eurozone Employment • Wednesday

Data on employment in the Eurozone in Q4-2017 will be released next Wednesday. Employment growth was a solid 1.7 percent year over year in Q3, helping to bring the unemployment rate down to post-Great Recession lows. Spain, Portugal, Italy and Sweden outpaced the Eurozone’s quarterly average employment growth, while Greece and France were among the laggards. However, the quarterly weakness in Greece came on the heels of two strong quarters: the year-over-year employment growth was 2.0 percent in Q3.

Continued strength in employment growth across Europe would help European Central Bank policymakers reaffirm that it should end its bond-buying program by the end of this year. Our forecast looks for real GDP growth in the Eurozone to exceed long-term potential growth in the next two years, which should help drive the unemployment rate in the euro area even lower.

Previous: 0.4% (Quarter-over-Quarter)

Eurozone Unemployment Rate
Seasonally Adjusted



Source: IHS Markit, Bloomberg LP and Wells Fargo Securities

Interest Rate Watch

Things fall apart

Over the past six months, the framework for an economic outlook based upon the prior five year history of economic performance has fallen apart. As illustrated in the top graph, over the past three months, core CPI has risen 2.9 percent, intimating that the year-over-year core CPI and overall CPI will rise. In addition, we anticipate the PCE deflator will rise steadily to approach, then exceed the FOMC's 2 percent target (precisely 2.2 percent) in the second quarter of 2018 and remain at about that pace in Q3.

In addition, despite the rise in the funds rate and short-term interest rates in the U.S., the trade-weighted dollar has continued to decline contrary to many analyst expectations.

Finally, recent Treasury auctions have been disappointing while projected Treasury financing over the next few years has shifted upward.

Center Cannot Hold

As a result, market interest rates and expectations of future interest rates (middle graph) have moved upward away from the pattern of the past five years and interest rates have broken from the range of the past five years.

Fundamentals are, well, fundamental. The four forces of higher growth expectations, higher inflation expectations, weaker dollar and increased future federal deficit estimates all support the case that interest rates will rise in the period ahead and will not return to the center of economic expectations of the past.

Ride the Lightning

What to do? Our outlook remains for higher market interest rates ahead. We are particularly concerned about the conflict of the FOMC's intent to reduce their balance sheet (bottom graph) in the face of rising CBO estimates of federal financing needs. Once again, the center cannot hold at the current interest rate/dollar/growth combination.

We are not assured that plans of a simultaneous reduction of the balance sheet and increases in the funds rate are consistent with growth at a 2.5 percent plus pace.

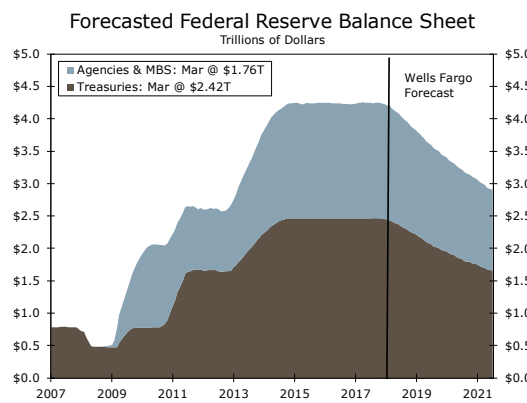
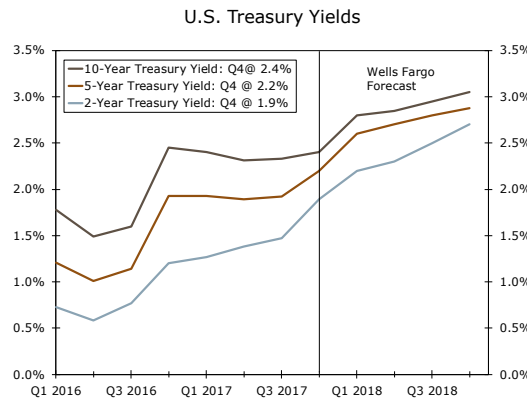
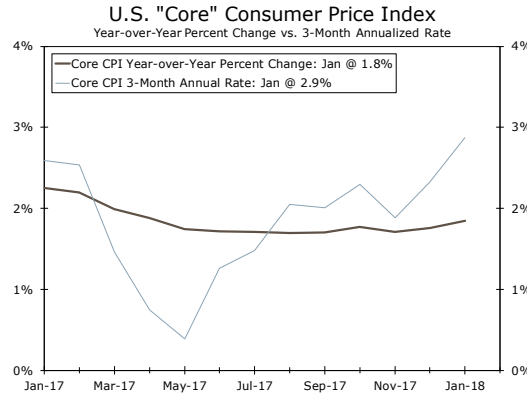
Credit Market Insights

Beige Book Corroborates Hard Data

Amid several credit market reports released by the Federal Reserve this week, the March Beige Book detailed generally positive credit conditions across the 12 Federal Reserve districts. The majority of districts reported unchanged or modestly stronger loan demand to start the year, and noted an optimistic outlook for lending activity and credit quality in the next six months. Some districts also described a modest decline in delinquency rates across various loan types.

The soft data from the most recent Beige Book largely confirms the hard data seen in this week's consumer credit report. Consumer credit expanded a solid \$13.9 billion in January, even with relatively flat revolving credit growth, which is largely comprised of credit card loans. Beige Book respondents noted that consumers likely paid down credit card bills following the holiday shopping season. Nonrevolving credit subsequently drove the expansion, up about 5 percent in January, year over year.

While overall consumer credit remains solid, increasing short-term interest rates on various loan types detailed by Beige Book respondents is a key area to watch over the coming months. Indeed, credit card interest rates have increased over the course of 2017, now at 13.2 percent in Q4. We forecast three hikes in the federal funds rate this year, likely pushing interest rates on consumer loans higher. However, in the near-term, solid loan quality and lower delinquency rates will likely support continued health in the credit market.



Source: IHS Markit, Bloomberg LP, Federal Reserve Board, U.S. Department of Labor and Wells Fargo Securities

Credit Market Data

Mortgage Rates	Current	Week Ago	4 Weeks Ago	Year Ago
	30-Yr Fixed	4.46%	4.43%	4.38%
15-Yr Fixed	3.94%	3.90%	3.84%	3.42%
5/1 ARM	3.63%	3.62%	3.63%	3.23%

Bank Lending	Current Assets (Billions)	1-Week Change (SAAR)	4-Week Change (SAAR)	Year-Ago Change
	Commercial & Industrial	\$2,134.4	16.06%	6.13%
Revolving Home Equity	\$372.3	-12.92%	-9.45%	-7.09%
Residential Mortgages	\$1,831.6	24.62%	1.70%	4.54%
Commercial Real Estate	\$2,090.1	-0.72%	3.05%	4.97%
Consumer	\$1,436.8	-0.43%	5.70%	5.33%

Source: Freddie Mac, Federal Reserve Board and Wells Fargo Securities

Topic of the Week

Limited Pass-Through of Tariffs to CPI

On March 8, President Trump imposed tariffs of 25 percent on steel imports and 10 percent on aluminum imports, with Canada and Mexico excluded for now and the possibility to extend exemptions to other countries. Prices for some products may rise as a result, but we suspect that the effect on overall consumer price index (CPI) inflation will be modest at best.

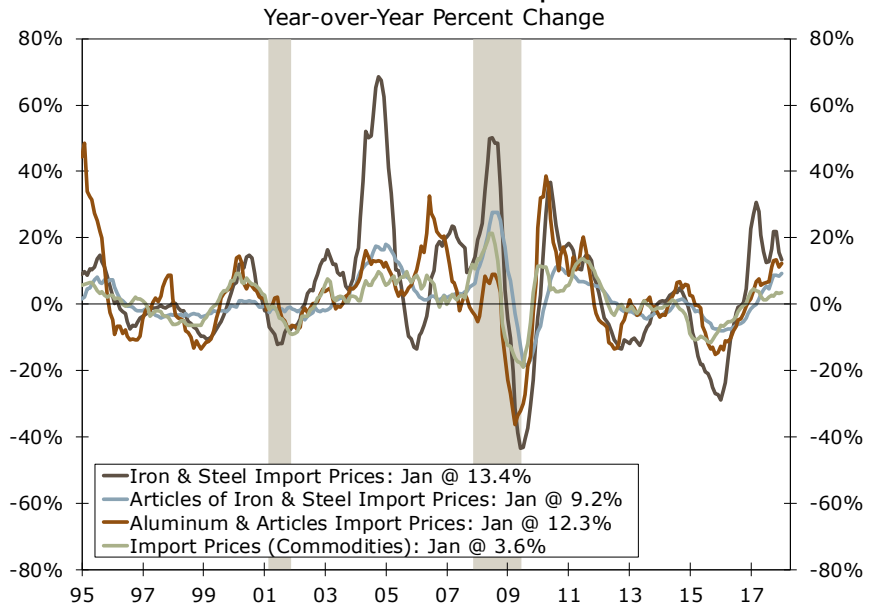
The combined share of steel and aluminum imports hovers below 4 percent of total U.S. merchandise imports, which limits the effect on overall prices (top chart). If steel and aluminum import prices increased by the full amount of the recently-proposed tariffs, this could add about 79 basis points to year-over-year import price inflation. Domestic producers could also raise prices as tariffs ease competitive pressure.

The ultimate pass-through to consumer price inflation, however, tends to be small after steel and aluminum get incorporated into finished products. Although there are positive correlations between producer prices for steel and aluminum and the CPI, the relationship is weaker than it is between import and producer prices. This is not surprising given that nearly two-thirds of CPI consists of services, where the largest input cost is labor.

That is not to say some industries will not see significantly higher costs. A look at the detailed input-output tables for the United States reveals which industries bear the greatest exposure to higher steel and aluminum costs (bottom chart). Still, the pass-through to consumers should be fairly small. Even in the industries that use steel and aluminum most intensively, those metals account for less than 40 percent of costs. In addition, firms may absorb some of the costs via tighter margins rather than adjusting prices fully.

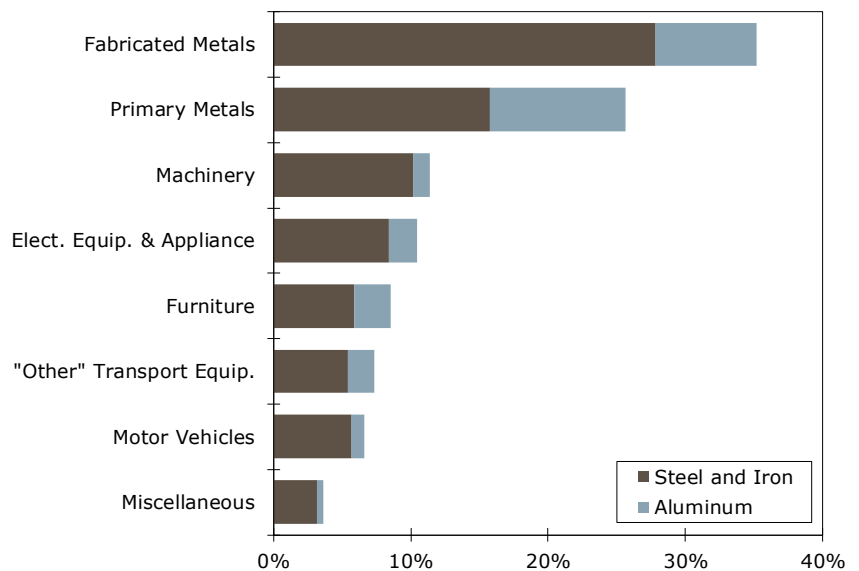
We suspect that CPI inflation would rise only modestly as a result of the currently-proposed tariffs, assuming no trade war ensues. This would likely not be enough to change the Fed's path of rate hikes. For more, see ["Steel Your Nerves: Effects of Tariffs on U.S. Inflation."](#)

Steel and Aluminum Import Prices



Aluminum and Steel Inputs

Manufacturing Industries, % of Total Intermediate Inputs



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

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 3/9/2018	1 Week Ago	1 Year Ago
1-Month LIBOR	1.74	1.69	0.86
3-Month LIBOR	2.07	2.02	1.11
3-Month T-Bill	1.66	1.64	0.73
1-Year Treasury	2.00	2.05	1.00
2-Year Treasury	2.28	2.24	1.37
5-Year Treasury	2.67	2.63	2.14
10-Year Treasury	2.91	2.86	2.61
30-Year Treasury	3.17	3.14	3.19
Bond Buyer Index	3.88	3.85	4.02

Foreign Exchange Rates

	Friday 3/9/2018	1 Week Ago	1 Year Ago
Euro (\$/€)	1.232	1.232	1.058
British Pound (\$/£)	1.387	1.380	1.217
British Pound (£/€)	0.888	0.893	0.870
Japanese Yen (¥/\$)	106.980	105.750	114.950
Canadian Dollar (C\$/\\$)	1.284	1.288	1.351
Swiss Franc (CHF/\\$)	0.950	0.937	1.012
Australian Dollar (US\$/A\\$)	0.784	0.776	0.751
Mexican Peso (MXN/\\$)	18.558	18.823	19.838
Chinese Yuan (CNY/\\$)	6.334	6.345	6.911
Indian Rupee (INR/\\$)	65.165	65.165	66.715
Brazilian Real (BRL/\\$)	3.244	3.253	3.193
U.S. Dollar Index	90.075	89.935	101.850

Source: Bloomberg LP and Wells Fargo Securities

Foreign Interest Rates

	Friday 3/9/2018	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	-0.38	-0.38	-0.36
3-Month Sterling LIBOR	0.60	0.58	0.35
3-Month Canada Banker's Acceptance	1.68	1.68	0.94
3-Month Yen LIBOR	-0.05	-0.06	-0.01
2-Year German	-0.56	-0.55	-0.85
2-Year U.K.	0.84	0.78	0.11
2-Year Canadian	1.82	1.77	0.83
2-Year Japanese	-0.15	-0.16	-0.26
10-Year German	0.65	0.65	0.43
10-Year U.K.	1.50	1.47	1.23
10-Year Canadian	2.26	2.20	1.81
10-Year Japanese	0.05	0.07	0.10

Commodity Prices

	Friday 3/9/2018	1 Week Ago	1 Year Ago
WTI Crude (\\$/Barrel)	61.05	61.25	49.28
Brent Crude (\\$/Barrel)	64.59	64.37	52.19
Gold (\\$/Ounce)	1320.98	1322.75	1201.17
Hot-Rolled Steel (\\$/S.Ton)	820.00	840.00	622.00
Copper (\\$/Pound)	310.85	310.10	257.00
Soybeans (\\$/Bushel)	10.29	10.33	10.01
Natural Gas (\\$/MMBTU)	2.74	2.70	2.97
Nickel (\\$/Metric Ton)	13,214	13,412	10,142
CRB Spot Inds.	529.14	525.76	503.64

Next Week's Economic Calendar

	Monday 12	Tuesday 13	Wednesday 14	Thursday 15	Friday 16
U.S. Data	Federal Budget	CPI (MoM)	PPI (MoM)	Import Prices (MoM)	Housing Starts
	January -\$192B	January 0.5%	January 0.4%	January 1.0%	January 1,326K
	February -\$216B (W)	February 0.1% (W)	February 0.1% (W)	February 0.4% (W)	February 1,283K (W)
Global Data		Mexico	Eurozone	Canada	
		Industrial Production (MoM)	Employment (QoQ)	Existing Home Sales (MoM)	
		December 0.9%	Q3 0.4%	January -14.5%	
		New Zealand			
		GDP (YoY)			
		Q3 2.7%			

Note: (W) = Wells Fargo Estimate (C) = Consensus Estimate

Source: Bloomberg LP and Wells Fargo Securities

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