January 12, 2011

WELLS FARGO SECURITIES

Economics Group

MONTHLY OUTLOOK

U.S. Overview	International Overview

Improving in Fits and Starts

The optimism that swept through the financial markets late last year has been tapered a bit by the realization that job growth remains sluggish and housing is still years away from a meaningful recovery. The strong start to the holiday shopping season also appears to have given way toward the end of the season and a series of winter storms likely took an additional toll on consumer spending in early 2011. Exports and business fixed investment remain two notable bright spots and should help drive real GDP at a 3.4 percent pace in the fourth quarter.

Our latest forecast shows the economy maintaining a 3.0 percent pace over the next two years. Consumer spending is supported by stronger private-sector job growth and the 2 percent reduction in Social Security taxes. We did not adjust our forecast all that much in light of the tax cut, however, as it is temporary and will be offset by rising food and energy prices and higher mortgage rates. In addition, state and local governments are poised to make dramatic spending cuts and tax hikes, which will further offset any federal stimulus. Business fixed investment should remain strong early in the year and will benefit modestly from the tax compromise.

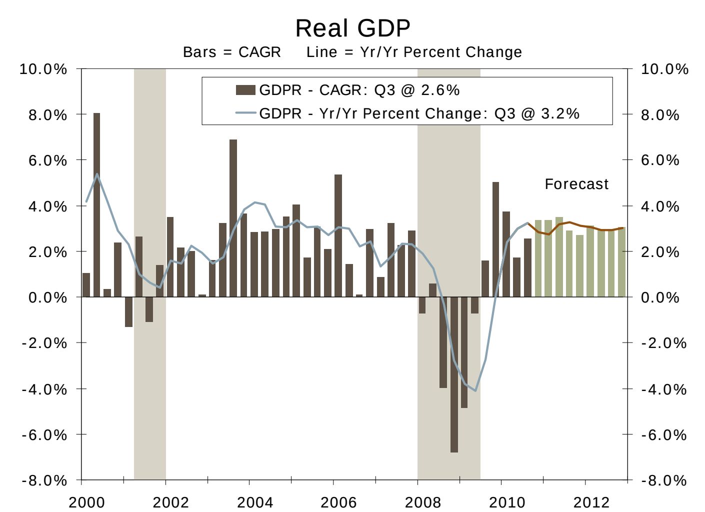
While 3.0 percent GDP growth sounds appealing, the pace will only make modest progress at reducing the unemployment rate. We see the jobless rate gradually edging lower over the forecast period and ending 2012 at around 8.8 percent. With unemployment remaining high, the Fed should remain on hold through mid-2012, even with rising inflation fears.

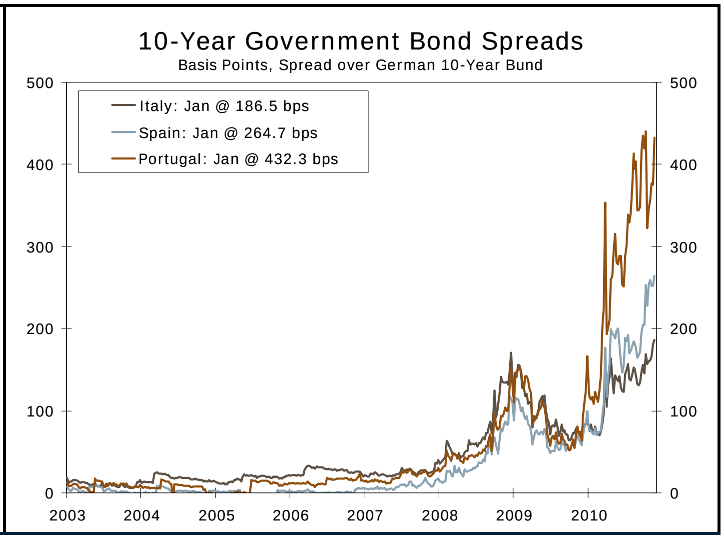
Global Outlook Reasonably Solid but Risks Remain

It appears that most economies posted solid growth rates in the fourth quarter, which gives the global economy good momentum entering the new year. Growth in the United States appears to have strengthened, and the Eurozone probably recorded a decent quarter as well. Growth in Asia, which slowed somewhat in the third quarter, looks like it stabilized at a strong rate in the fourth quarter. Our forecast calls for global GDP to expand roughly 4 percent this year, more or less in line with the long-run average.

Although our base-case scenario for the global economy in 2011 is fairly sanguine, there are some significant downside risks that need to be kept firmly in mind. First, the sovereign debt crisis in Europe continues to fester. Although the EU/IMF rescue fund is more than large enough to support Portugal, a bailout of Spain, should one be needed, would stress the fund. In a worst-case scenario in which the Spanish and/or Italian government need to restructure debt, the European banking system would be forced to take capital losses. Credit markets in Europe could lock up again as they did in autumn of 2008, which clearly would reverberate back onto U.S. financial markets.

Second, sharp increases in commodity and food prices have caused inflation rates in many developing economies to rise. Central banks in these economies may feel compelled to tighten more aggressively, which would raise the risk of markedly slower economic growth.





Source: U.S. Department of Commerce, IHS Global Insight and Wells Fargo Securities, LLC

The Recovery Begins to Take Shape

The U.S. economy appears to have successfully navigated the adjustment from a recovery driven primarily from economic stimulus and inventory rebuilding to one driven by private domestic demand and rising exports. Solid gains in holiday spending and 12 consecutive months of modest job gains have bolstered confidence which should support private demand in 2011. Moreover, questions about what would happen to tax rates and the preferential tax rates on dividends and capital gains were answered late last year, with a broad compromise that also provided a temporary two percentage point reduction in the employee portion of Social Security payroll taxes.

Economic forecasts were ratcheted up immediately following reports that a tax deal had been reached. We did not adjust our numbers up as much as many other forecasters, however, because we still see many challenges ahead and do not think the tax compromise was as big a game changer as has been hyped. The only additional stimulus is the reduction in Social Security payroll taxes. But that cut will also lead to an immediate larger Social Security deficit. The prospect of increased Treasury borrowing pushed long-term interest rates sharply higher following the announcement of the tax deal, which has already cut mortgage refinancing applications and will make it even more difficult for home sales to recover.

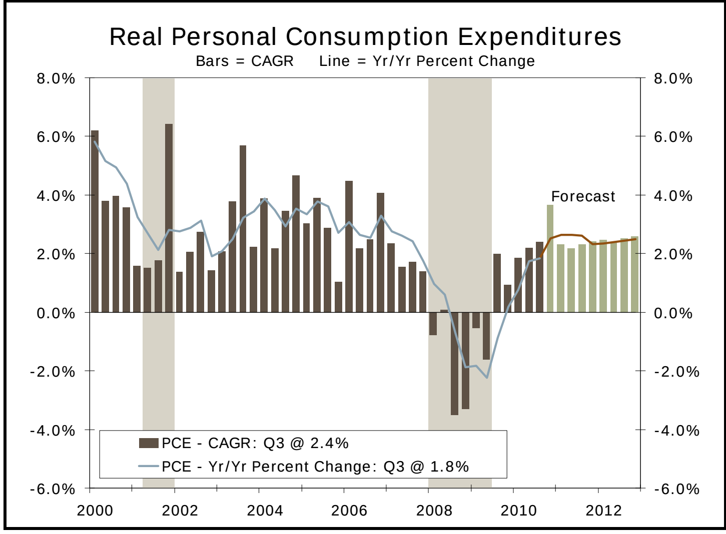
One of the immediate challenges for the economy in 2011 will be significantly tighter state and local budgets. Federal aid to states and municipalities will begin to taper off this spring, and November's election results suggest that governments are unlikely to seek additional funds from the federal government, which is unlikely to provide it even if they ask. Spending is set for dramatic cuts across the country and states and municipalities are likely to hike taxes significantly.

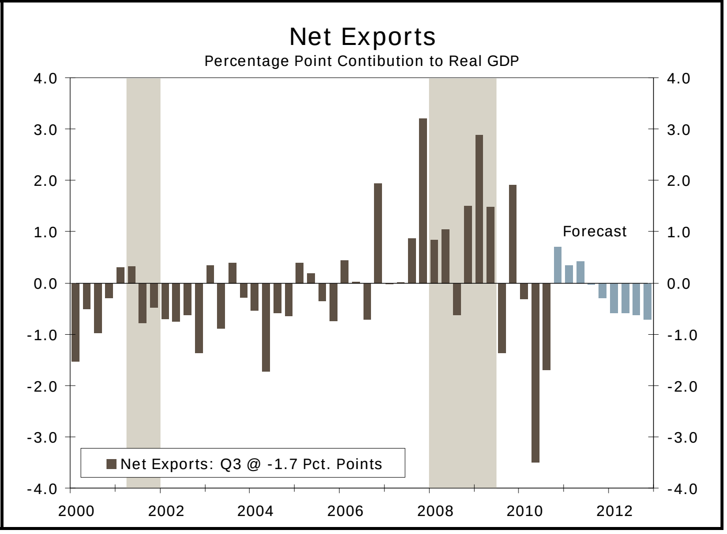
Rising food and energy prices present another near-term challenge. Disappointing harvests around the world have led to sharply higher prices for key agricultural commodities. Food prices may rise as much as 5 percent this year. Oil prices also appear to be headed higher, reflecting tight supplies and rising demand. We have revised up our forecast for oil prices for the next two years and see prices averaging around $92 a barrel this year and ending 2012 at $95 a barrel. Higher food and energy prices are expected to drive the headline CPI up 2.0 percent in 2011. Core inflation is also expected to rise slightly faster, climbing 1.2 percent in 2011 and 1.6 percent in 2012.

Rising inflation means we have likely already seen the lows for interest rates in this cycle. We may see long-term rates temporarily drift lower during the early part of the year, however, as some of the enthusiasm about last year's strong numbers begins to wear off. Rates should rise over the course of the year, however, even with the Fed fully committed to completing its $600 billion in Treasury purchases. The Fed is expected to remain on hold until the unemployment rate falls below 9 percent, which we believe will not occur until the middle of 2012 or later.

Rising interest rates will make it even more difficult for housing to recover. We have scaled back our expectations for home sales and housing starts, reflecting ongoing concerns about foreclosures and tougher appraisals and underwriting standards. That said, housing starts are expected to rise 15 percent in 2011. Part of that rebound reflects a stronger apartment market. Single-family starts will rise somewhat less.

Given the constraints we have outlined, 3 percent growth looks pretty good, particularly with housing stuck in low gear. Business fixed investment and net exports will provide a strong contribution to growth over the next few quarters. With so much growth coming from capital-intensive areas, job growth will remain relatively modest. We have nonfarm employment gradually ramping up over the forecast period, rising 160,000 per month in 2011 and 175,000 per month in 2012.





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

Wells Fargo U.S. Economic Forecast

	Actual							Forecast									Actual		Forecast		
	2009				2010				2011				2012				2008	2009	2010	2011	2012
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product (a)	-4.9	-0.7	1.6	5.0	3.7	1.7	2.6	3.4	3.4	3.5	2.9	2.7	3.1	3.0	3.0	3.1	0.0	-2.6	2.9	3.1	3.0
Personal Consumption	-0.5	-1.6	2.0	0.9	1.9	2.2	2.4	3.7	2.3	2.2	2.3	2.4	2.5	2.4	2.5	2.6	-0.3	-1.2	1.7	2.6	2.4
Business Fixed Investment	-35.2	-7.5	-1.7	-1.4	7.8	17.2	10.0	15.6	14.5	11.7	11.2	11.6	15.9	12.4	11.9	12.2	0.3	-17.1	6.2	13.2	12.9
Equipment and Software	-31.6	0.2	4.2	14.6	20.5	24.8	15.4	11.6	19.5	14.7	13.4	13.6	18.7	14.0	13.1	13.1	-2.4	-15.3	15.5	15.7	14.9
Structures	-41.0	-20.2	-12.4	-29.2	-17.8	-0.5	-3.6	-5.0	-2.0	1.0	3.0	4.0	5.0	6.0	7.0	8.0	5.9	-20.4	-14.3	-1.1	4.9
Residential Construction	-36.2	-19.7	10.6	-0.8	-12.3	25.6	-27.3	1.5	-6.0	12.0	10.0	8.0	8.0	9.0	11.0	12.5	-24.0	-22.9	-3.1	0.0	9.3
Government Purchases	-3.0	6.2	1.6	-1.4	-1.6	3.9	3.9	2.2	0.9	0.7	0.1	-0.3	-0.1	0.7	0.7	0.9	2.8	1.6	1.3	1.5	0.3
Net Exports	-389.2	-342.0	-390.8	-330.1	-338.4	-449.0	-505.0	-481.7	-470.2	-455.9	-457.2	-467.5	-487.7	-508.2	-530.3	-555.4	-504.1	-363.0	-443.5	-462.7	-520.4
Pct. Point Contribution to GDP	2.9	1.5	-1.4	1.9	-0.3	-3.5	-1.7	0.7	0.3	0.4	0.0	-0.3	-0.6	-0.6	-0.6	-0.7	1.1	1.1	-0.6	-0.1	-0.4
Inventory Change	-125.8	-161.8	-128.2	-36.7	44.1	68.8	121.4	80.0	75.0	70.0	64.0	60.0	61.0	64.0	65.0	65.0	-37.6	-113.1	78.6	67.3	63.8
Pct. Point Contribution to GDP	-1.1	-1.0	1.1	2.8	2.6	0.8	1.6	-1.2	-0.1	-0.1	-0.2	-0.1	0.0	0.1	0.0	0.0	-0.5	-0.6	1.5	-0.1	0.0
Nominal GDP	-3.9	-0.4	2.3	4.7	4.8	3.7	4.6	4.5	4.6	4.8	4.1	4.0	4.6	4.5	4.6	4.8	2.2	-1.7	3.9	4.5	4.4
Real Final Sales	-3.9	0.2	0.4	2.1	1.1	0.9	0.9	5.1	3.5	3.7	3.1	2.8	3.1	2.9	3.0	3.1	0.5	-2.1	1.3	3.3	3.0
Retail Sales (b)	-9.4	-9.9	-7.0	1.6	5.7	6.9	5.8	7.6	6.2	5.9	6.1	4.1	4.1	4.4	5.0	4.9	-1.0	-6.3	6.5	5.6	4.6
Inflation Indicators (b)																					
"Core" PCE Deflator	1.6	1.5	1.3	1.7	1.8	1.5	1.2	0.8	0.8	0.8	1.0	1.3	1.4	1.5	1.6	1.7	2.3	1.5	1.3	1.0	1.6
Consumer Price Index	-0.2	-1.0	-1.6	1.5	2.4	1.8	1.2	1.2	1.4	2.1	2.2	2.2	2.2	2.3	2.6	2.8	3.8	-0.3	1.6	2.0	2.5
"Core" Consumer Price Index	1.7	1.8	1.5	1.7	1.3	1.0	0.9	0.6	1.0	1.1	1.2	1.4	1.5	1.6	1.7	1.8	2.3	1.7	1.0	1.2	1.6
Producer Price Index	-2.2	-4.1	-5.2	1.5	5.1	4.3	3.7	3.9	3.1	3.9	5.0	4.4	3.6	3.8	3.3	2.9	6.4	-2.5	4.2	4.1	3.4
Employment Cost Index	2.1	1.8	1.5	1.5	1.7	1.8	1.9	1.5	1.9	1.5	1.5	1.6	2.2	1.8	1.7	1.8	3.0	1.7	1.3	1.6	1.9
Real Disposable Income (a)	0.4	5.9	-4.4	0.0	1.3	5.6	0.9	0.8	4.0	3.5	3.3	3.0	-2.0	1.8	2.4	2.7	1.7	0.6	1.3	2.9	1.5
Nominal Personal Income (b)	-1.7	-2.1	-2.3	-0.9	2.1	2.6	3.5	3.7	8.4	8.3	8.3	8.0	3.1	2.4	2.4	2.4	4.0	-1.7	3.0	8.2	2.6
Industrial Production (a)	-17.6	-10.3	8.3	7.0	7.1	7.2	5.9	1.1	3.5	3.7	3.7	3.7	4.5	4.4	4.9	4.6	-3.3	-9.3	5.5	3.6	4.2
Capacity Utilization	70.5	68.5	69.9	71.1	72.5	73.9	75.0	75.1	75.3	75.7	76.1	76.5	76.9	77.3	77.8	78.2	77.9	70.0	74.1	75.9	77.5
Corporate Profits Before Taxes (b)	-17.3	-11.4	-3.9	42.5	37.6	37.0	26.4	12.5	8.2	6.2	6.2	6.7	6.8	7.0	7.2	7.1	-16.4	-0.4	27.5	6.8	7.0
Corporate Profits After Taxes	-10.1	-3.1	0.4	41.9	27.0	26.5	16.2	10.7	6.2	5.7	6.2	7.7	8.2	8.5	8.6	8.5	-10.4	5.1	19.6	6.5	8.5
Federal Budget Balance (c)	-448.9	-304.9	-329.4	-388.1	-328.9	-287.0	-290.2	-380.8	-360.0	-173.0	-220.0	-280.0	-290.0	-125.0	-225.0	-230.0	-454.8	-1415.7	-1294.2	-1133.8	-920.0
Current Account Balance (d)	-95.6	-84.4	-97.5	-100.9	-109.2	-123.2	-127.2	-110.0	-125.0	-135.0	-150.0	-160.0	-175.0	-180.0	-190.0	-200.0	-668.9	-378.4	-469.6	-570.0	-745.0
Trade Weighted Dollar Index (e)	83.2	77.7	74.3	74.8	76.1	78.8	73.6	73.2	72.5	73.0	74.0	75.0	76.0	77.0	79.0	80.0	74.3	77.7	75.6	73.6	78.0
Nonfarm Payroll Change (f)	-752.7	-476.7	-261.0	-89.7	87.0	190.0	-30.3	128.0	150.0	156.7	165.0	170.0	170.0	175.0	175.0	180.0	-301.9	-395.0	93.7	160.4	175.0
Unemployment Rate	8.2	9.3	9.7	10.0	9.7	9.6	9.6	9.6	9.6	9.4	9.3	9.2	9.1	9.0	8.9	8.8	5.8	9.3	9.6	9.4	9.0
Housing Starts (g)	0.53	0.54	0.59	0.56	0.62	0.60	0.59	0.55	0.59	0.65	0.70	0.75	0.79	0.82	0.86	0.89	0.90	0.55	0.59	0.68	0.84
Light Vehicle Sales (h)	9.6	9.7	11.6	10.8	11.0	11.3	11.6	12.3	12.7	12.8	13.0	13.1	13.3	13.4	13.6	13.9	13.2	10.4	11.5	12.9	13.6
Crude Oil - WTI - Front Contract (i)	43.08	59.62	68.30	76.19	78.72	78.03	76.20	85.17	90.00	92.67	92.00	92.00	93.00	93.00	94.00	95.00	99.65	61.80	79.53	91.67	93.75
Quarter-End Interest Rates (j)																					
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	1.00	1.88	0.25	0.25	0.25	0.50
3 Month LIBOR	1.19	0.60	0.29	0.25	0.29	0.53	0.29	0.30	0.30	0.30	0.35	0.40	0.40	0.50	0.65	1.20	2.93	0.69	0.34	0.34	0.69
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.50	4.00	4.88	3.25	3.25	3.25	3.50
Conventional Mortgage Rate	5.00	5.42	5.06	4.93	4.97	4.74	4.35	4.71	4.90	5.00	5.20	5.20	5.30	5.50	5.70	5.70	6.04	5.04	4.69	5.08	5.55
3 Month Bill	0.21	0.19	0.14	0.06	0.16	0.18	0.16	0.12	0.15	0.20	0.25	0.30	0.40	0.60	0.80	1.40	1.40	0.15	0.14	0.23	0.80
2 Year Note	0.81	1.11	0.95	1.14	1.02	0.61	0.42	0.61	0.70	0.80	1.00	1.20	1.40	1.60	1.80	2.00	2.01	0.96	0.70	0.93	1.70
5 Year Note	1.67	2.54	2.31	2.69	2.55	1.79	1.27	2.01	1.80	2.00	2.10	2.20	2.30	2.60	2.80	3.00	2.80	2.20	1.93	2.03	2.68
10 Year Note	2.71	3.53	3.31	3.85	3.84	2.97	2.53	3.30	3.30	3.40	3.60	3.70	3.80	4.00	4.10	4.20	3.66	3.26	3.22	3.50	4.03
30 Year Bond	3.56	4.32	4.03	4.63	4.72	3.91	3.69	4.34	4.40	4.50	4.50	4.70	4.70	4.80	4.90	5.00	4.28	4.08	4.25	4.53	4.85

Forecast as of: January 12, 2011

Notes: (a) Compound Annual Growth Rate Quarter-over-Quarter
(b) Year-over-Year Percentage Change
(c) Quarterly Sum - Billions USD; Annual Data Represents Fiscal Yr.
(d) Quarterly Sum - Billions USD
(e) Federal Reserve Major Currency Index, 1973=100 - Quarter End
(f) Average Monthly Change
(g) Millions of Units
(h) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold
(i) Quarterly Average of Daily Close
(j) Annual Numbers Represent Averages

Global Outlook Reasonably Solid but Risks Remain

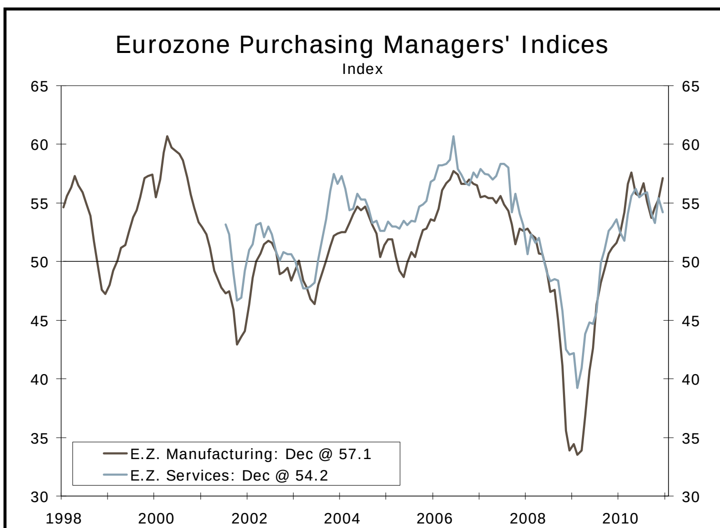
Recent evidence suggests that the global economy is entering the new year on a reasonably solid footing. For starters, growth in the United States, the largest economy in the world, looks to have strengthened in the fourth quarter. In addition, economic growth in the euro area—the 17 countries that make up the Eurozone collectively comprise the second-largest economy in the world—appears to have held up as well, albeit not as strong as U.S. GDP growth. Industrial production in the euro area rose 0.6 percent in October relative to the preceding month, and the position of the manufacturing PMI in November and December, which remained above the demarcation line separating expansion from contraction, suggests that production rose further at the end of the year (bottom left chart).

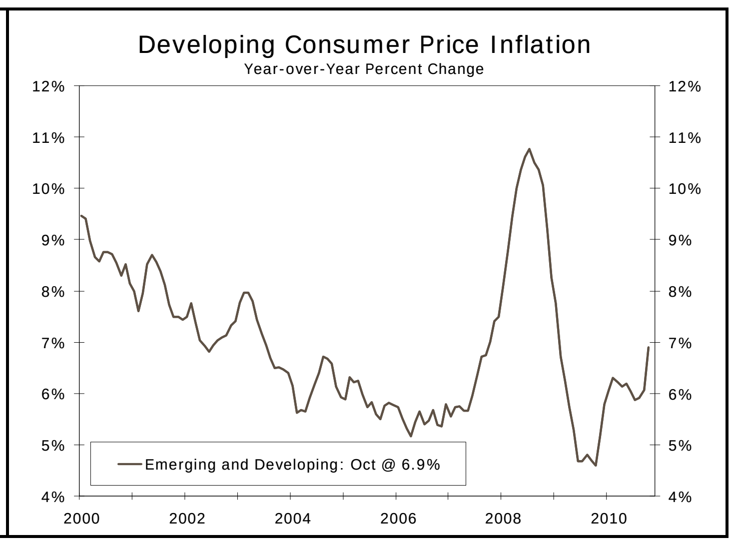
After slowing in midyear, economic growth in most Asian economies appears to have stabilized at a rather high rate in the final quarter of 2010. For example, Chinese industrial production (IP) rose at a year-over-year rate of 13.2 percent in the October-November period, little changed from the 13.5 percent growth rate posted in the third quarter, and Korean IP grew about 9 percent. Japanese IP likely contracted on a sequential basis in the fourth quarter, but producers expect a strong January. IP growth in Brazil, Latin America's largest economy, looks to have turned positive again in the fourth quarter following a modest decline in the preceding three- month period.

In sum, solid economic growth in most countries in the fourth quarter indicates that the global economy entered 2011 with a fair amount of momentum. Looking forward, we expect the global economy to grow roughly 4 percent this year, which represents some modest deceleration compared to the 5 percent rate that looks to have been achieved in 2010. That said, the global expansion appears to be entering a more self-sustaining phase as domestic demand is starting to strengthen in many economies. Although our base-case scenario for the global outlook is fairly upbeat, we acknowledge that there are significant downside risks to the global economy that need to be kept firmly in mind.

First, the European sovereign debt crisis continues to fester. The crisis is no longer front-page news in the financial press at present, but the continued increase in yields on Portuguese, Spanish and Italian government bonds relative to their German counterparts indicates that investors remain hesitant to finance further deficits of these governments (see chart on front page). Although the financing facility put together by the European Union and the International Monetary Fund could easily provide a bailout package for Portugal, a rescue of Spain would probably exhaust the facility. In a worst-case scenario in which the governments of Spain and/or Italy would need to restructure their debt, the European banking system, which has significant exposure to European sovereign debt, would be forced to take capital losses. Credit markets in Europe could lock up again as they did in the autumn of 2008, which clearly would reverberate back onto U.S. financial markets.

The second downside risk that needs to be kept in mind is the rising rate of CPI inflation in many developing countries (bottom right chart). Central banks in many developing economies have hiked rates recently, but they have not slammed on the policy brakes because, so far, the rise in inflation largely reflects increases in food and commodity prices. If, however, inflation becomes more entrenched, central banks in these economies may feel compelled to tighten more aggressively. In that event, the risk of renewed downturns in economic activity in those countries would begin to increase. With growth in many advanced economies still sluggish, renewed slumps in the developing world would weigh heavily on global GDP growth.





Source: Bloomberg LP, IHS Global Insight and Wells Fargo Securities, LLC

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP			CPI		
	2010	2011	2012	2010	2011	2012
Global (PPP weights)	4.9%	4.1%	4.4%	4.2%	4.7%	4.4%
Global (Market Exchange Rates)	3.8%	2.9%	3.2%	n/a	n/a	n/a
Advanced Economies[1]	2.9%	2.4%	2.7%	1.4%	2.0%	2.0%
United States	2.9%	3.1%	3.0%	1.6%	2.0%	2.5%
Eurozone	1.7%	1.5%	2.2%	1.6%	2.3%	2.0%
United Kingdom	1.7%	1.9%	2.2%	3.2%	2.9%	1.9%
Japan	4.4%	1.3%	1.6%	-0.7%	-0.3%	-0.2%
Korea	6.4%	4.0%	4.2%	3.0%	3.5%	3.0%
Canada	2.9%	2.7%	3.1%	1.8%	2.2%	2.1%
Developing Economies[1]	7.4%	6.1%	6.4%	7.7%	7.9%	7.2%
China	10.3%	9.0%	9.2%	3.3%	4.6%	3.3%
India	8.6%	7.5%	8.0%	12.3%	7.7%	7.1%
Mexico	5.3%	4.1%	3.8%	4.2%	5.1%	5.6%
Brazil	7.7%	5.0%	5.7%	5.0%	5.9%	5.6%
Russia	4.2%	4.0%	4.5%	6.9%	9.7%	9.3%

Forecast as of: January 12, 2011

[1]Aggregated Using PPP Weights

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	3-Month LIBOR						10-Year Bond					
	2011				2012		2011				2012	
	Q1	Q2	Q3	Q4	Q1	Q2	Q1	Q2	Q3	Q4	Q1	Q2
U.S.	0.30%	0.30%	0.35%	0.40%	0.40%	0.50%	3.30%	3.40%	3.60%	3.70%	3.80%	4.00%
Japan	0.20%	0.20%	0.20%	0.20%	0.25%	0.25%	1.17%	1.19%	1.20%	1.22%	1.25%	1.30%
Euroland	1.10%	1.15%	1.15%	1.40%	2.25%	2.75%	2.80%	2.85%	3.00%	3.50%	3.90%	4.10%
U.K.	0.75%	0.75%	0.80%	1.00%	1.75%	2.50%	3.30%	3.40%	3.50%	3.90%	4.20%	4.50%
Canada	1.20%	1.25%	2.00%	2.75%	3.25%	3.75%	3.10%	3.20%	3.60%	3.80%	4.00%	4.25%

Forecast as of: January 12, 2011

Wells Fargo Securities, LLC Economics Group

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