February 10, 2010

WELLS FARGO SECURITIES

Economics Group

Monthly Outlook

U.S. Overview	International Overview

Growth Is Not Nearly as Strong Beneath the Surface

Expectations for near-term growth have been ratcheted up, following the fourth quarter's robust 5.7 percent real GDP growth. While that number came in almost precisely in line with our forecast, we have raised our estimate for first quarter growth and slightly reduced our expectations for growth during the second and third quarters. The adjustments were necessary because inventories are correcting much more quickly than originally thought. Inventories added 3.4 percentage points to fourth quarter GDP growth and are expected to add another 1.2 percentage points to growth during the first quarter.

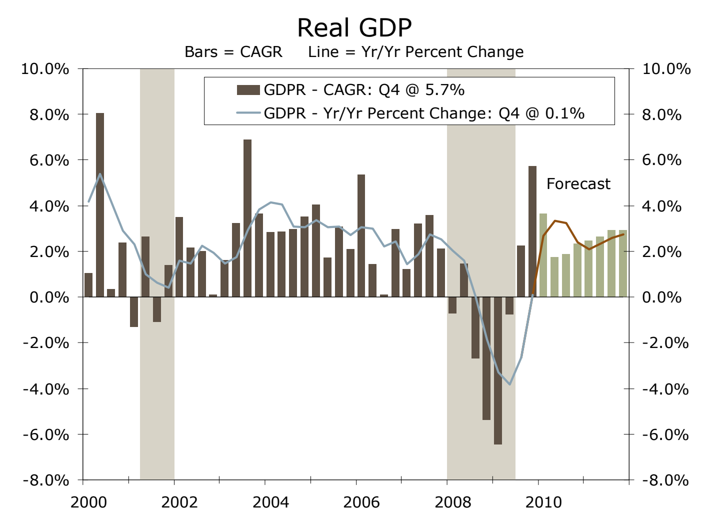
Consumer spending is also packing a little more punch. Real personal consumption expenditures ended the year well above their fourth quarter average. Spending looks set to rise at a 1.9 percent annual rate in the first quarter. Colder than usual temperatures are boosting utility usage and an early Easter should boost goods purchases in March. Toyota's huge recalls are expected to weigh on motor vehicle purchases during the quarter and might also add to inventories. Spending is expected to grow more modestly during the balance of the year.

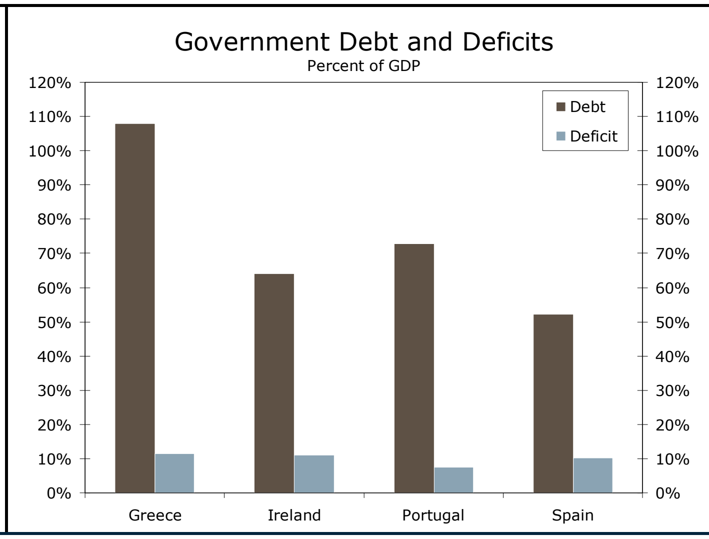
Business fixed investment modestly increased in the fourth quarter, with spending on computers and related equipment posting an astonishing rise. Much of that gain was in portable devices and equipment that drives the infrastructure supporting them. Residential investment pulled back toward the end of the year, reflecting a payback from the burst in starts tied to the first-time home buyers' tax credit.

Sovereign Debt Concerns in Southern Europe

In response to market concerns over its indebtedness, the Greek government has proposed an ambitious fiscal adjustment plan over the next few years. In order to help stabilize the government's debt-to-GDP ratio, however, nominal GDP growth in Greece needs to rebound. But the common currency that Greece shares with the other members of the euro area precludes strong export growth via real exchange rate depreciation, which will hamper its ability to achieve strong growth in nominal GDP. In our view, there is a significant probability that Greece will need financial support from the European Union (EU) and/or the IMF to help the government smooth out its fiscal adjustment. The fiscal situations in both Portugal and Spain are not as dire as they are in the Hellenic Republic, but these two countries may also need financial support if investors remain spooked.

The fiscal adjustment that will need to take place in Southern Europe will restrain economic growth in those countries over the next few years. Although these Mediterranean countries are not the largest economies in the euro area, they accounted for more than their share of overall GDP growth in the Euro-zone during the last expansion. Therefore, we expect that economic growth in the overall euro area likely will be sluggish as well for the foreseeable future. In our view, the combination of slow economic growth and benign inflation will lead the European Central Bank to keep its policy rate at 1.00 percent, where it has been maintained since last May, until early next year.





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

Is it Time to Take the Training Wheels Off?

We expect real GDP to rise at a 3.7 percent annual rate during the current quarter. Business inventories are expected to move back into positive territory for the first time in two years, adding 1.2 percentage points to first quarter growth. Final demand is growing much more modestly. Real final sales are expected to rise at a 2.0 percent annual rate, marking the fourth consecutive quarterly increase. The three prior gains in final sales have also been exceptionally modest, however, and much of the increase that has occurred results from some sort of temporary fiscal or monetary stimulus. Once those programs end, growth will likely pull back a notch.

Solid gains in first quarter real GDP almost seem guaranteed. Real personal consumption expenditures ended the year well above their fourth quarter average and outlays would rise at around a 1 percent annual rate even if spending were flat in every month of the quarter. Spending is also getting a boost from increased utility usage resulting from this year's unusually harsh winter. Spending on goods should also rise solidly, although we are concerned the huge recall by Toyota will cut into motor vehicle sales for the quarter. Easter falls on the first Sunday in April, which means most of the related shopping will occur in March, making some amends.

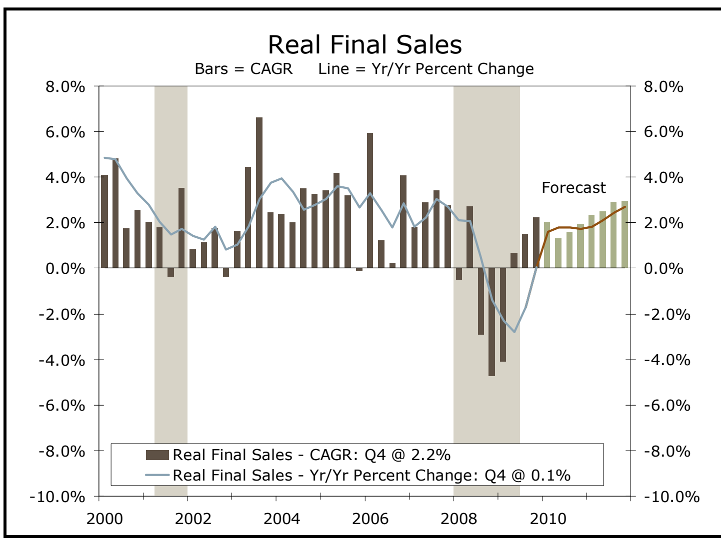
The early Easter means sales will be weaker during the second quarter and consumers may also need to scale back discretionary purchases so they can catch up with their power bills. Fortunately, we expect nonfarm employment to move back into positive territory this spring, providing a boost to wages & salaries and consumer confidence.

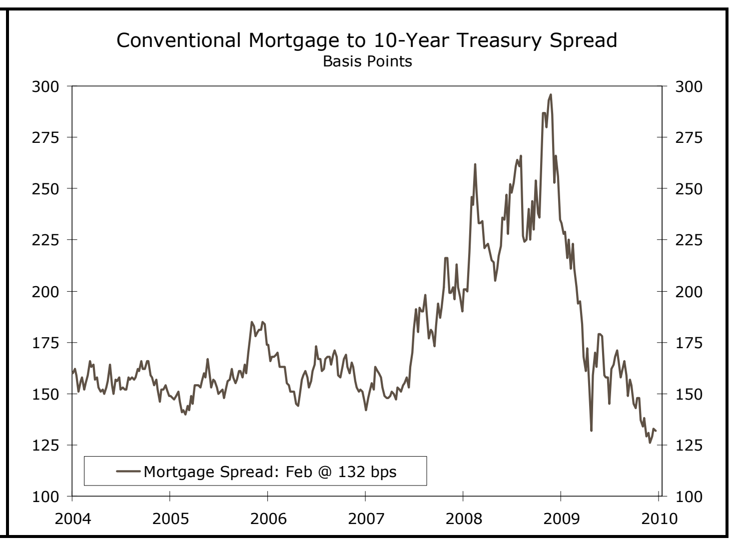
Residential construction outlays are expected to decline during the first quarter, reflecting a payback from what was supposed to be the end of the first-time homebuyers' tax credit. The initial plan was for the credit to expire at the end of November and that led to a mini surge in homebuilding last fall and existing home sales in October and November. Housing starts pulled back after the program was due to end late last year and existing home sales plummeted in December. Construction spending tends to lag starts by about a quarter, so the fourth quarter's drop in starts, along with the harsh winter weather, should lead to a small drop in outlays during the first quarter.

We expect another surge in housing starts and sales leading up to the revised end of the home-buyer tax credit. The numbers should be less impressive this time, however, as the end of the program coincides with the start of the key spring home buying season. As a result, the seasonal adjustment process will not exaggerate the impact like it did last fall.

An even larger question is what will happen to mortgage rates and home sales once the Fed stops adding to its holdings of mortgage backed securities. The Fed's MBS purchase program, which began early last year, caused the spread between 30-year conventional mortgages and the 10-year Treasury note to tighten a little more than a quarter percentage point below its historic average. Once the program ends on March 31, we expect the spread to overshoot the other way for at least a short time, which means mortgage rates should rise about a half a percentage point from their current level by this spring. The net result will be a slower recovery in residential construction than many had hoped for.

While the Fed apparently feels confident enough to take the training wheels off monetary policy, we do not expect them do much more than stand back and watch for now. We see the federal funds rate remaining unchanged until after the mid-term congressional elections. The administration is likely even more cautious and may urge some sort of stimulus this year, mostly aimed at jobs programs and aid to state and local governments.





Source: U.S. Department of Commerce, Freddie Mac, Federal Reserve Board and Wells Fargo Securities, LLC

Wells Fargo U.S. Economic Forecast

	Actual								Forecast								Actual			Forecast	
	2008				2009				2010				2011				2007	2008	2009	2010	2011
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product (a)	-0.7	1.5	-2.7	-5.4	-6.4	-0.7	2.2	5.7	3.7	1.7	1.9	2.3	2.5	2.7	2.9	2.9	2.1	0.4	-2.4	2.9	2.4
Personal Consumption	-0.6	0.1	-3.5	-3.1	0.6	-0.9	2.8	2.0	1.9	0.8	1.3	1.5	1.8	1.9	2.0	2.1	2.6	-0.2	-0.6	1.6	1.7
Business Fixed Investment	1.9	1.4	-6.1	-19.4	-39.2	-9.6	-5.9	2.9	3.6	1.2	3.3	6.0	7.5	6.6	7.1	7.0	6.2	1.6	-17.9	1.0	6.0
Equipment and Software	-0.5	-5.0	-9.4	-25.9	-36.4	-4.9	1.5	13.3	8.2	6.2	7.0	9.5	9.7	7.8	7.9	7.6	2.6	-2.6	-16.9	7.0	8.4
Structures	6.8	14.5	-0.1	-7.2	-43.6	-17.3	-18.4	-15.4	-13.0	-11.0	-6.5	-3.5	1.5	3.0	4.5	5.0	14.9	10.3	-19.7	-12.8	-0.5
Residential Construction	-28.2	-15.8	-15.9	-23.2	-38.2	-23.2	18.9	5.7	-2.0	5.8	8.5	9.0	9.0	8.5	10.0	10.0	-18.5	-22.9	-20.4	3.7	8.8
Government Purchases	2.6	3.6	4.8	1.2	-2.6	6.7	2.7	-0.2	2.5	1.6	2.7	1.5	1.2	1.2	1.8	1.0	1.7	3.1	1.9	2.1	1.5
Net Exports	-550.9	-476.0	-479.2	-470.9	-386.5	-330.4	-357.4	-341.1	-346.8	-340.9	-354.6	-361.0	-364.6	-363.7	-358.7	-349.9	-647.7	-494.3	-353.9	-350.8	-359.2
Pct. Point Contribution to GDP	0.4	2.4	-0.1	0.5	2.6	1.7	-0.8	0.5	-0.2	0.2	-0.4	-0.2	-0.1	0.0	0.1	0.3	0.6	1.2	1.1	0.0	-0.1
Inventory Change	0.6	-37.1	-29.7	-37.4	-113.9	-160.2	-139.2	-33.5	7.0	20.5	28.5	40.8	45.2	50.0	50.0	50.0	19.5	-25.9	-111.7	24.2	48.8
Pct. Point Contribution to GDP	-0.2	-1.3	0.3	-0.6	-2.4	-1.4	0.7	3.4	1.2	0.4	0.2	0.4	0.1	0.1	0.0	0.0	-0.3	-0.3	-0.6	1.0	0.2
Nominal GDP	1.0	3.5	1.4	-5.4	-4.6	-0.8	2.6	6.4	4.6	2.9	3.1	3.9	4.2	4.5	4.9	5.0	5.1	2.6	-1.3	3.8	4.1
Real Final Sales	-0.5	2.7	-2.9	-4.7	-4.1	0.7	1.5	2.2	2.0	1.3	1.6	2.0	2.4	2.5	2.9	2.9	2.5	0.8	-1.7	1.7	2.3
Retail Sales (b)	2.6	2.4	0.3	-8.4	-8.9	-9.5	-6.7	1.9	3.8	4.7	4.2	3.9	4.3	4.8	4.8	4.9	3.3	-0.8	-6.0	4.1	4.7
Inflation Indicators (b)																					
"Core" PCE Deflator	2.4	2.5	2.6	2.0	1.7	1.6	1.3	1.4	1.3	1.2	1.2	1.3	1.5	1.6	1.7	1.8	2.4	2.4	1.5	1.2	1.7
Consumer Price Index	4.2	4.3	5.2	1.5	-0.2	-0.9	-1.6	1.5	2.6	2.6	2.1	1.7	1.7	2.0	2.2	2.4	2.9	3.8	-0.3	2.2	2.1
"Core" Consumer Price Index	2.4	2.3	2.5	2.0	1.7	1.8	1.5	1.7	1.6	1.2	1.1	1.0	1.1	1.2	1.4	1.6	2.3	2.3	1.7	1.2	1.3
Producer Price Index	7.2	7.6	9.5	1.4	-2.2	-4.0	-5.2	1.8	4.4	4.5	3.8	2.5	2.2	2.2	2.4	2.4	3.9	6.4	-2.4	3.8	2.3
Employment Cost Index	3.3	3.1	2.9	2.6	2.1	1.8	1.5	1.5	1.9	1.6	1.6	1.7	1.8	1.7	1.7	1.8	3.4	3.0	1.7	1.2	1.7
Real Disposable Income (a)	-2.4	9.8	-8.5	3.4	0.2	6.2	-1.4	2.1	1.3	1.5	1.8	2.0	2.2	2.4	2.6	2.7	2.2	0.5	1.3	1.5	2.2
Nominal Personal Income (b)	3.7	4.0	2.9	1.1	-1.6	-2.0	-1.7	-0.2	2.8	2.8	3.5	3.6	4.0	4.1	4.1	4.3	5.6	2.9	-1.4	3.2	4.1
Industrial Production (a)	0.2	-4.6	-9.0	-13.0	-19.0	-10.4	6.9	7.0	6.8	3.9	3.4	6.5	6.4	6.1	6.0	5.0	1.5	-2.2	-9.7	4.7	5.7
Capacity Utilization	80.1	78.9	76.9	74.2	70.4	68.7	70.1	71.5	72.0	72.5	73.0	74.3	75.3	76.2	76.9	77.4	80.6	77.6	70.2	72.9	76.4
Corporate Profits Before Taxes (b)	-4.9	-12.0	-5.4	-25.1	-19.0	-12.6	-6.6	24.0	22.0	16.0	10.0	8.5	8.0	7.5	8.0	8.5	-4.1	-11.8	-5.1	13.8	8.0
Corporate Profits After Taxes	6.6	-3.7	4.8	-15.8	-19.7	-15.3	-9.7	34.0	32.0	20.0	15.0	9.0	8.5	9.0	10.5	11.0	-4.0	-2.0	-4.6	18.2	9.8
Federal Budget Balance (c)	-205.9	26.9	-168.9	-332.5	-448.9	-304.9	-330.8	-388.5	-589.9	-176.2	-255.4	-316.5	-502.5	-193.5	-252.5	-300.0	-161.5	-454.8	-1417.1	-1410.0	-1265.0
Current Account Balance (d)	-179.3	-187.7	-184.2	-154.9	-104.5	-98.0	-108.0	-120.0	-130.0	-135.0	-140.0	-140.0	-145.0	-145.0	-150.0	-150.0	-726.6	-706.1	-430.5	-545.0	-590.0
Trade Weighted Dollar Index (e)	70.3	71.0	76.1	79.4	83.2	77.7	74.3	74.7	74.0	74.9	76.0	78.5	80.0	81.0	81.7	82.3	73.3	79.4	74.7	78.5	82.3
Nonfarm Payroll Change (f)	-31	-191	-334	-652	-753	-478	-260	-103	40	80	-30	110	130	135	150	165	90	-302	-398	50	145
Unemployment Rate	5.0	5.3	6.0	7.0	8.2	9.3	9.6	10.0	9.8	9.9	10.2	10.1	10.0	9.8	9.6	9.4	4.6	5.8	9.3	10.0	9.7
Housing Starts (g)	1.06	1.02	0.87	0.66	0.53	0.54	0.59	0.55	0.59	0.64	0.67	0.70	0.71	0.73	0.76	0.82	1.34	0.90	0.55	0.65	0.76
Light Vehicle Sales (h)	15.2	14.1	12.9	10.5	9.5	9.6	11.5	10.8	10.9	11.0	11.0	11.3	11.6	11.9	12.2	12.5	16.1	13.2	10.3	11.1	12.1
Crude Oil - WTI - Front Contract (i)	97.90	123.98	117.98	58.74	43.08	59.62	68.30	76.19	78.00	82.00	80.00	80.00	82.00	84.00	87.00	90.00	72.31	99.65	61.80	80.00	85.75
Quarter-End Interest Rates																					
Federal Funds Target Rate	2.25	2.00	2.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	1.25	2.00	2.75	3.25	4.25	0.25	0.25	0.50	3.25
3 Month LIBOR	2.69	2.78	4.05	1.43	1.19	0.60	0.29	0.25	0.30	0.35	0.55	0.80	1.50	2.35	3.10	3.60	4.70	1.43	0.25	0.80	3.60
Prime Rate	5.25	5.00	5.00	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.50	4.25	5.00	5.75	6.25	7.25	3.25	3.25	3.50	6.25
Conventional Mortgage Rate	5.97	6.32	6.04	5.33	5.00	5.42	5.06	4.88	5.40	5.70	5.80	5.80	5.80	5.90	6.00	6.10	6.10	5.33	4.88	5.80	6.10
3 Month Bill	1.38	1.90	0.92	0.11	0.21	0.19	0.14	0.06	0.10	0.10	0.30	0.55	1.25	2.10	2.85	3.35	3.36	0.11	0.06	0.55	3.35
2 Year Note	1.62	2.63	2.00	0.76	0.81	1.11	0.95	1.14	1.00	1.20	1.50	1.70	1.90	2.50	3.10	3.60	3.05	0.76	1.14	1.70	3.60
5 Year Note	2.46	3.34	2.98	1.55	1.67	2.54	2.31	2.69	2.40	2.60	2.80	2.90	3.00	3.10	3.25	3.75	3.45	1.55	2.69	2.90	3.75
10 Year Note	3.45	3.99	3.85	2.25	2.71	3.53	3.31	3.85	3.70	3.80	4.00	4.10	4.20	4.30	4.40	4.50	4.04	2.25	3.85	4.10	4.50
30 Year Bond	4.30	4.53	4.31	2.69	3.56	4.32	4.03	4.63	4.60	4.70	4.80	4.90	5.00	5.10	5.20	5.30	4.45	2.69	4.63	4.90	5.30

Forecast as of: February 10, 2010

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

Source: Wells Fargo Securities, LLC

Grim Fiscal Outlook in Southern Europe

Financial markets have been buffeted recently by concerns about the fiscal situation in some countries in the Euro-zone. Attention has focused most acutely on Greece because it has the most precarious fiscal position (see graph on front page). However, investors are also nervous about the respective fiscal outlooks in Ireland, Portugal and Spain. (For a more in-depth report, see "The Long Road Ahead for Greece (and Others,)" which is posted on our website.)

The Greek government has proposed a very ambitious plan to reduce its deficit to about 3 percent of GDP in two years, but there is an inconsistency in the government's blueprint. That is, nominal GDP growth needs to be fairly strong to help stabilize the debt-to-GDP ratio. However, a sharp fiscal contraction, which is also needed to stabilize the situation, weighs on GDP growth, everything else equal. How can the government bring about the necessary fiscal adjustment while at the same time supporting nominal GDP growth?

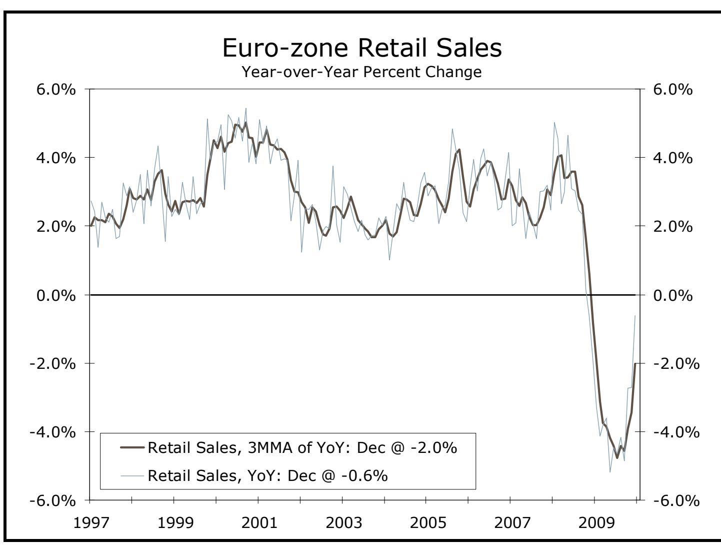
This inconsistency would not be so glaring if Greece could rely on strong export growth to prop up the economy as it tightens fiscal policy. For example, both the Finnish and Swedish economies were able to bounce back from their banking crises in the early 1990s via strong export growth that was aided by significant depreciation of their currencies. However, the majority of Greece's exports go to the other member countries of the Euro-zone with which the Hellenic republic shares a common currency. Without strong export growth in Greece, how will the economy grow as fiscal policy is tightened?

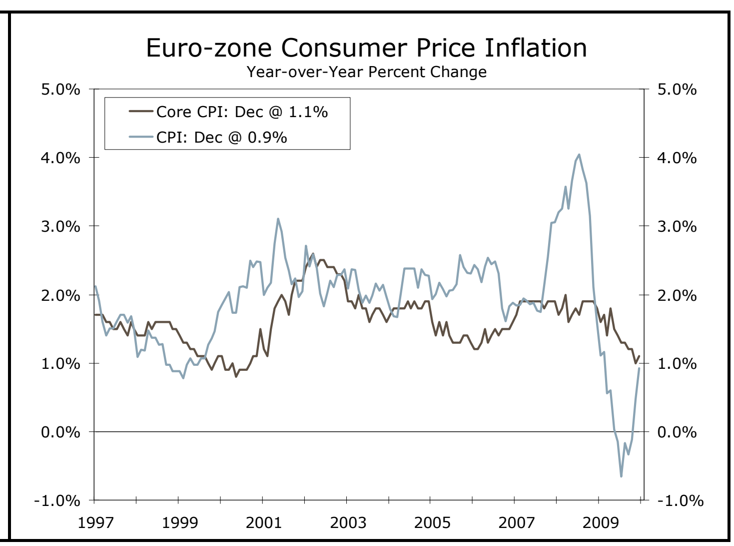
In our view, there is a significant probability that Greece will need financial support from the European Union and/or the IMF to help the government smooth out its fiscal adjustment. Indeed, EU officials have recently discussed a possible deal for Greece. The debt dynamics for Portugal and Spain are not quite as challenging as they are for Greece, but financial assistance packages may also need to be assembled for the governments of the Iberian countries if investors become spooked enough that they refuse to buy the debt.

In any event, fiscal policies in Greece, Portugal and Spain will need to be tightened over the next few years. Although these countries are not the largest economies in the euro area, they added more than their share to overall growth in the Euro-zone during the last expansion. That is, Greece, Portugal and Spain make up less than 15 percent of the overall Euro-zone economy, but accounted for 20 percent of overall GDP growth in the euro area during the last expansion. If, as we believe, these countries are destined for a few years of sluggish growth due to fiscal tightening, then GDP growth in the overall euro area likely will be restrained for the next year or two as well.

Growth in real spending in the Euro-zone is starting to flatten out, at least on a year-over-year basis, largely because the collapse late in 2008 is starting to drop out of the calculation (bottom chart). However, there has been very little growth on a sequential basis, and real spending remains about 5 percent below its May 2008 peak. Growth in real consumer spending likely will remain sluggish throughout most of this year.

In addition, there are few inflationary pressures in the Euro-zone at present. The year-over-year rate of overall CPI inflation has bounced higher over the past few months as energy prices have rebounded from their collapse last year. However, the core rate of CPI inflation, which reflects underlying demand conditions, has trended down to a nine-year low and further disinflation seems likely (bottom chart). Slow economic growth and benign inflation is a recipe for the European Central Bank to maintain its policy rate at its historic low of only 1.00 percent for the foreseeable future.





Source: IHS Global Insight and Wells Fargo Securities, LLC

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP			CPI		
	2009	2010	2011	2009	2010	2011
Global (PPP weights)	-0.7%	4.1%	4.1%	2.8%	4.2%	4.2%
Global (Market Exchange Rates)	-1.9%	2.9%	2.9%	n/a	n/a	n/a
Advanced Economies[1]	-3.3%	2.4%	2.5%	-0.3%	1.5%	1.7%
United States	-2.4%	2.9%	2.4%	-0.3%	2.2%	2.1%
Eurozone	-3.9%	1.4%	2.3%	0.3%	1.0%	1.3%
United Kingdom	-4.8%	1.3%	2.5%	2.2%	2.9%	2.1%
Japan	-5.2%	2.1%	1.6%	-1.3%	-0.6%	0.5%
Korea	0.1%	5.0%	3.6%	2.8%	2.7%	2.9%
Canada	-2.5%	2.3%	2.8%	0.3%	1.9%	1.9%
Developing Economies[1]	2.5%	6.1%	6.0%	6.5%	7.4%	7.1%
China	8.5%	9.5%	9.0%	-0.7%	2.8%	3.2%
India	7.2%	8.5%	8.0%	11.4%	11.9%	8.0%
Mexico	-6.9%	3.4%	3.5%	5.3%	4.1%	4.3%
Brazil	-0.9%	3.5%	3.9%	4.9%	5.0%	5.0%
Russia	-7.3%	3.1%	4.1%	11.8%	6.8%	9.0%

Forecast as of: February 10, 2010

[1]Aggregated Using PPP Weights

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	3-Month LIBOR						10-Year Bond					
	2010				2011		2010				2011	
	Q1	Q2	Q3	Q4	Q1	Q2	Q1	Q2	Q3	Q4	Q1	Q2
U.S.	0.30%	0.35%	0.55%	0.80%	1.50%	2.35%	3.70%	3.80%	4.00%	4.10%	4.20%	4.30%
Japan	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	1.30%	1.35%	1.45%	1.55%	1.60%	1.70%
Euroland	0.55%	0.60%	0.80%	1.00%	1.40%	2.25%	3.20%	3.40%	3.75%	4.00%	4.20%	4.30%
U.K.	0.65%	0.65%	0.75%	1.00%	1.75%	2.75%	3.90%	4.20%	4.50%	4.60%	4.70%	4.75%
Canada	0.40%	0.40%	0.50%	1.00%	2.00%	3.00%	3.40%	3.60%	3.90%	4.10%	4.30%	4.40%

Forecast as of: February 10, 2010

Source: Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

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