June 09, 2010

WELLS FARGO SECURITIES

Economics Group

MONTHLY OUTLOOK

U.S. Overview	International Overview

Second-Half Slowdown or Something More Sinister?

Our forecast continues to incorporate a significant slowdown during the second half of the year. After likely expanding at a 3.4 percent pace during the current quarter, real GDP is expected to slow to a mere 2 percent pace during the second half of 2010. Conditions over the past month have reinforced our view. Indeed, the financial markets are providing a clear signal that there is danger ahead on the road to recovery. The tragic Gulf oil spill and still mounting European financial crisis add significant downside risk to the outlook.

The driving forces behind the slowdown continue to be the winding down of inventory restocking, which accounted for roughly half the rebound in economic growth over the past year, and the winding down of various stimulus programs, which have provided the bulk of the other half of the recovery. Final sales averaged just a 1.5 percent pace over the past three quarters. Unless demand picks up, real GDP growth will slide back to that pace once inventory rebuilding is completed.

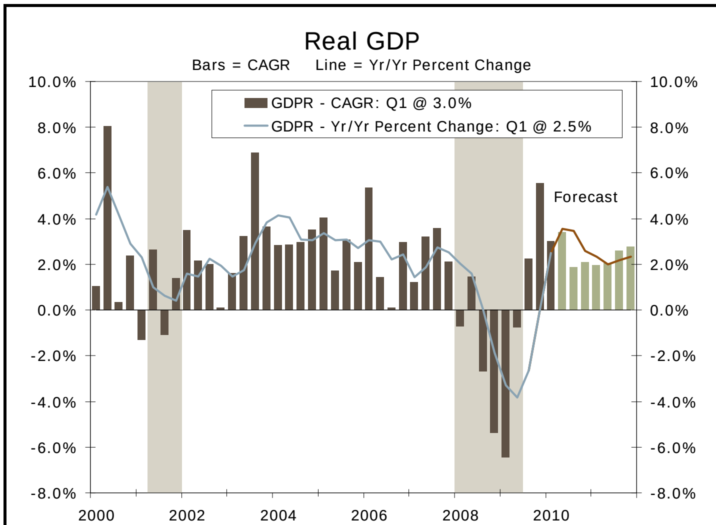
Demand appears more likely to ebb over the next few months than to accelerate. Many of the stimulus programs that propped up spending over the past year have either ended or are in the process of winding down. Moreover, the two unknowns that popped up over the past few weeks—the Gulf oil spill and European financial crisis—now look to be significant long-term drags on domestic economic activity. In this environment, inflation will be lower than previously thought and the Fed will keep policy on hold even longer.

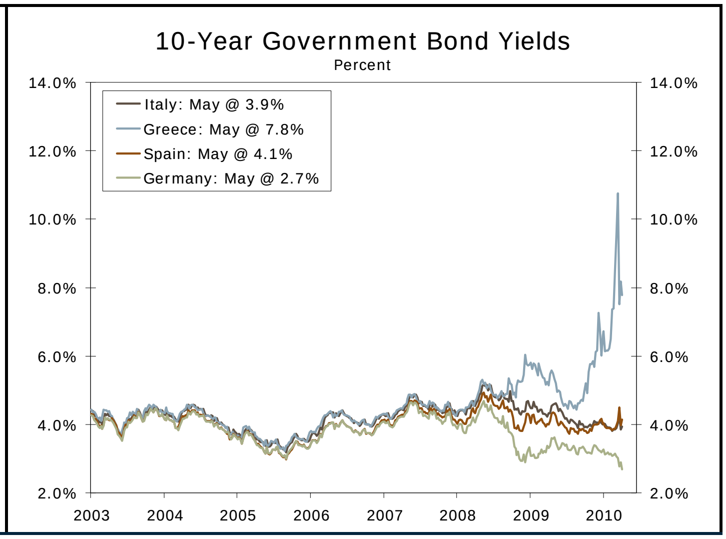
If Only It Weren't for Europe…

Most countries reported positive GDP growth in the first quarter, and recent monthly indicators suggest that global economic activity has continued to expand. Although China may be slowing from the super-charged pace of growth earlier this year, the Chinese economy still has plenty of momentum behind it. Moreover, recent monthly data from Japan, Korea and Taiwan indicate that the expansion in Asia, which began about a year ago, remains intact.

Real GDP in Canada grew at its strongest rate in about 10 years in the first quarter, and we expect the Canadian economy to register another solid growth rate in the second quarter. The recovery in the United Kingdom has been sluggish to date, but growth seems to have strengthened in the second quarter. That said, the fiscal tightening that likely will take place later this year should exert some headwinds on the British economy for the foreseeable future.

Speaking of fiscal retrenchment, the recovery in the Euro-zone, which seems to have gathered a bit of steam in the second quarter, probably will remain fragile for some time. Indeed, our forecast calls for very sluggish growth in the overall euro area later this year and early next year, and the probability of a double-dip recession is not insignificant. If bank lending were to freeze up again, a la the autumn of 2008, the global economic outlook would darken considerably. Although not our central view, we are mindful of the downside risks to the global economy from renewed financial tension.





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

Together we'll go far

This report is available on wellsfargo.com/research and on Bloomberg WFEC

A Second-Half Slowdown Looks More Certain

While our forecast remains well below the consensus, we believe events over the past few weeks make a second-half slowdown more likely. The primary reasons we expect growth to slow are the winding down in inventory rebuilding and various stimulus programs. The Gulf oil spill and the European financial crisis add considerable downside risk. So far, the financial markets have been the chief transmission mechanism. In coming months, the direct economic effects will become evident.

One of the ways the crises are affecting the economy is through lower share prices. The S&P 500 has fallen nearly 13 percent since the Deepwater Horizon oil rig exploded and sank on April 20. Most of the drop occurred in May, as the debt crisis unfolded in Greece and spread to other parts of Europe. Lower stock prices remove one of the more covert sources of stimulus, the rebounding wealth effect.

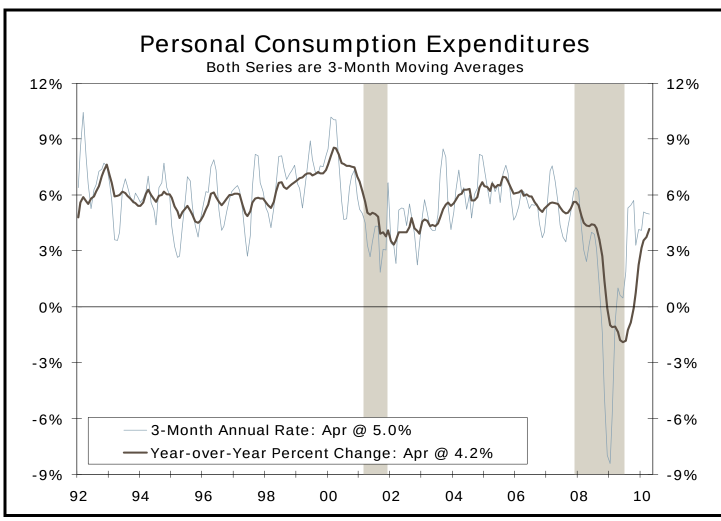
Consumer spending rose strongly during the first quarter, as higher stock prices and some stability in the housing sector made consumers somewhat more comfortable with their 401(k) and investment fund balances. Spending grew much faster than income, even though unemployment remained high and private sector hiring picked up ever so slowly. Much of the strength occurred at the end of the quarter, reflecting a sharp swing in weather conditions and an early Easter. Spending slowed in April and May but still looks like it will rise at a 3.2 percent pace during the second quarter. This time, however, the strength was at the start of the quarter, which means the third quarter will start in a bit of a hole. We look for consumer spending to rise just half as much in the third quarter before rebounding to a 2 percent pace later this year.

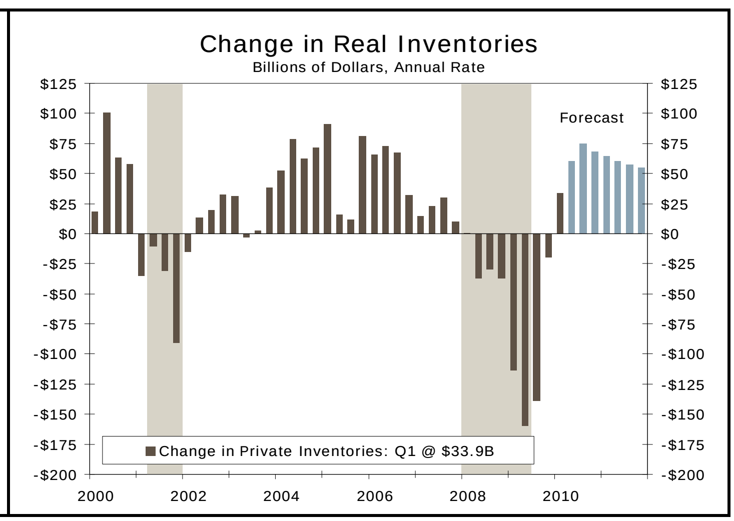
Business fixed investment has been one of the lone true bright spots in the outlook. Spending for mobile internet technologies, including smart phones, tablet computers and handheld communication devices, has fueled strong growth in supporting industries. Alternative energy projects have been another bright spot. Core investment spending has been slower to recover but has benefitted somewhat from the rebound in production to replenish inventories.

With events still unfolding, it is difficult to make a complete account of the direct impacts of the Gulf oil spill and European financial crisis. One thing is certain, both events increase uncertainty. Whenever uncertainty increases, the required rate of return on any investment rises. This means there is less investment and hiring than there would be otherwise. We are also beginning to see some direct job loss along the Gulf. Some of these losses appear to be permanent. While there have been some offsets in hiring to clean the beaches, many more jobs will be lost in energy exploration, tourism and fishing.

Another byproduct of the European debt crisis is that many borrowing decisions now need to be rethought. Credit spreads have widened, even on high grade debt. Heavily indebted governments now need to think about what their tipping point is and what level of borrowing will give lenders pause. One of the immediate results is a renewed round of fiscal austerity in the most heavily indebted European countries. Larger economies are also feeling the heat, however. Our forecast continues to have public outlays growing very modestly, reflecting cuts at the state and local level and more modest efforts at fiscal stimulus by the federal government. Business inventories are now projected to rise much more sharply in the current quarter and third quarter of 2010. Some of this build up will likely be unintentional, resulting in some pull back in the recent strength in industrial output.

We have also reduced our inflation forecast, reflecting slower global economic growth and lower commodity prices. The combination of lower inflation and high unemployment means the Fed will likely remain on hold a little longer. We have tentatively pushed the first rate hike into next spring.





Source: U.S. Department of Commerce 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	5.6	3.0	3.4	1.9	2.1	2.0	2.1	2.6	2.8	2.1	0.4	-2.4	3.0	2.2
Personal Consumption	-0.6	0.1	-3.5	-3.1	0.6	-0.9	2.8	1.6	3.5	3.2	1.6	2.2	1.8	1.9	2.2	2.4	2.6	-0.2	-0.6	2.4	2.1
Business Fixed Investment	1.9	1.4	-6.1	-19.4	-39.2	-9.6	-5.9	5.3	3.1	6.5	6.1	7.8	9.3	8.7	9.5	9.9	6.2	1.6	-17.8	2.8	8.4
Equipment and Software	-0.5	-5.0	-9.4	-25.9	-36.4	-4.9	1.5	19.0	12.7	11.0	10.0	11.3	12.1	10.6	11.1	11.4	2.6	-2.6	-16.6	10.5	11.2
Structures	6.8	14.5	-0.1	-7.2	-43.6	-17.3	-18.4	-18.0	-15.3	-6.6	-4.5	-2.0	1.0	3.0	4.5	5.0	14.9	10.3	-19.8	-12.8	0.3
Residential Construction	-28.2	-15.8	-15.9	-23.2	-38.2	-23.2	18.9	3.7	-10.7	9.2	-6.2	3.0	3.5	7.6	8.0	8.0	-18.5	-22.9	-20.5	-0.6	4.1
Government Purchases	2.6	3.6	4.8	1.2	-2.6	6.7	2.7	-1.3	-1.9	-0.4	1.2	0.6	0.8	0.9	1.4	1.3	1.7	3.1	1.8	0.1	0.9
Net Exports	-550.9	-476.0	-479.2	-470.9	-386.5	-330.4	-357.4	-348.0	-368.3	-390.0	-400.7	-421.5	-421.5	-434.8	-446.7	-458.6	-647.7	-494.3	-355.6	-391.9	-440.4
Pct. Point Contribution to GDP	0.4	2.4	-0.1	0.5	2.6	1.7	-0.8	0.3	-0.6	-0.7	-0.3	-0.2	-0.4	-0.4	-0.3	-0.3	0.6	1.2	1.0	-0.3	-0.4
Inventory Change	0.6	-37.1	-29.7	-37.4	-113.9	-160.2	-139.2	-19.7	33.9	60.0	75.0	68.0	65.0	60.0	57.5	55.0	19.5	-25.9	-108.3	59.2	59.4
Pct. Point Contribution to GDP	-0.2	-1.3	0.3	-0.6	-2.4	-1.4	0.7	3.8	1.6	0.8	0.4	-0.2	-0.1	-0.1	-0.1	-0.1	-0.3	-0.3	-0.6	1.3	0.0
Nominal GDP	1.0	3.5	1.4	-5.4	-4.6	-0.8	2.6	6.1	4.1	4.8	3.3	3.3	3.2	3.5	4.1	4.4	5.1	2.6	-1.3	4.0	3.6
Real Final Sales	-0.5	2.7	-2.9	-4.7	-4.1	0.7	1.5	1.7	1.4	2.2	1.4	2.3	2.1	2.2	2.7	2.8	2.5	0.8	-1.7	1.6	2.2
Retail Sales (b)	2.3	2.1	0.2	-8.5	-9.4	-9.9	-7.1	1.9	5.4	7.6	6.6	5.9	5.1	4.0	4.2	4.3	3.3	-1.0	-6.3	6.4	4.4
Inflation Indicators (b)																					
"Core" PCE Deflator	2.4	2.5	2.6	2.0	1.7	1.6	1.3	1.5	1.4	1.2	1.2	1.2	1.5	1.6	1.7	1.8	2.4	2.4	1.5	1.3	1.6
Consumer Price Index	4.2	4.3	5.3	1.6	-0.2	-1.0	-1.6	1.5	2.4	1.9	1.0	0.7	0.6	1.1	1.5	1.7	2.9	3.8	-0.3	1.5	1.2
"Core" Consumer Price Index	2.4	2.3	2.5	2.0	1.7	1.8	1.5	1.7	1.3	0.9	0.7	0.6	0.9	1.0	1.3	1.4	2.3	2.3	1.7	0.9	1.1
Producer Price Index	7.2	7.7	9.4	1.4	-2.2	-4.1	-5.2	1.6	5.3	4.7	3.8	2.6	0.9	1.7	3.1	3.7	3.9	6.4	-2.5	4.1	2.4
Employment Cost Index	3.3	3.1	2.9	2.6	2.1	1.8	1.5	1.5	1.7	1.5	1.5	1.6	1.7	1.6	1.6	1.7	3.4	3.0	1.7	1.6	1.7
Real Disposable Income (a)	-2.4	9.8	-8.5	3.4	0.2	6.2	-3.6	0.0	1.9	4.4	1.9	2.6	-0.8	3.4	2.8	3.0	2.2	0.5	0.8	1.6	2.0
Nominal Personal Income (b)	3.7	4.0	2.9	1.1	-1.6	-2.0	-2.3	-1.1	2.2	2.2	3.3	3.5	3.5	3.6	3.9	4.2	5.6	2.9	-1.7	2.8	3.8
Industrial Production (a)	0.2	-4.6	-9.0	-13.0	-19.0	-10.4	6.4	6.9	7.8	5.4	2.6	2.2	2.0	3.6	4.8	4.9	1.5	-2.2	-9.7	4.8	3.2
Capacity Utilization	80.1	78.9	76.9	74.2	70.4	68.7	70.0	71.4	73.0	73.9	73.9	73.8	73.7	73.9	74.2	74.4	80.6	77.6	70.1	73.7	74.1
Corporate Profits Before Taxes (b)	-4.9	-12.0	-5.4	-25.1	-19.0	-12.6	-6.6	30.6	31.0	26.0	21.0	15.0	9.0	6.0	6.5	7.5	-4.1	-11.8	-3.8	22.7	7.2
Corporate Profits After Taxes	6.6	-3.7	4.8	-15.8	-19.7	-15.3	-9.7	22.8	23.8	18.0	16.0	12.0	6.0	7.5	8.0	8.5	-4.0	-2.0	-6.9	17.1	7.5
Federal Budget Balance (c)	-205.9	26.9	-168.9	-332.5	-448.9	-304.9	-329.4	-388.1	-328.9	-293.0	-305.0	-386.0	-425.0	-202.0	-230.0	-274.0	-161.5	-454.8	-1415.7	-1315.0	-1243.0
Current Account Balance (d)	-179.3	-187.7	-184.2	-154.9	-104.2	-97.7	-102.3	-115.6	-125.0	-132.0	-135.0	-140.0	-150.0	-155.0	-165.0	-170.0	-726.6	-706.1	-419.9	-532.0	-640.0
Trade Weighted Dollar Index (e)	70.3	71.0	76.1	79.4	83.2	77.7	74.3	74.8	76.1	77.3	80.0	81.5	83.0	84.5	86.0	88.0	73.3	79.4	74.8	81.5	88.0
Nonfarm Payroll Change (f)	-31	-191	-334	-652	-753	-477	-261	-90	94	187	0	107	127	135	150	162	90	-302	-395	97	143
Unemployment Rate	5.0	5.3	6.0	7.0	8.2	9.3	9.6	10.0	9.7	9.8	10.0	10.0	9.8	9.7	9.5	9.4	4.6	5.8	9.3	9.9	9.6
Housing Starts (g)	1.06	1.02	0.87	0.66	0.53	0.54	0.59	0.56	0.62	0.59	0.56	0.62	0.71	0.80	0.89	0.94	1.34	0.90	0.55	0.60	0.84
Light Vehicle Sales (h)	15.2	14.1	12.9	10.5	9.5	9.6	11.5	10.8	11.0	11.3	11.3	11.7	11.7	12.2	12.4	12.6	16.1	13.2	10.3	11.3	12.2
Crude Oil - WTI - Front Contract (i)	98.25	125.41	119.02	56.20	43.77	60.13	68.39	75.45	78.19	79.08	77.67	80.00	83.00	86.00	89.00	92.00	72.66	99.72	61.94	78.73	87.50
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	0.25	0.25	0.50	1.50	2.00	4.25	0.25	0.25	0.25	2.00
3 Month LIBOR	2.69	2.78	4.05	1.43	1.19	0.60	0.29	0.25	0.29	0.55	0.60	0.60	0.60	0.65	1.70	2.15	4.70	1.43	0.25	0.60	2.15
Prime Rate	5.25	5.00	5.00	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.50	4.50	5.00	7.25	3.25	3.25	3.25	5.00
Conventional Mortgage Rate	5.97	6.32	6.04	5.33	5.00	5.42	5.06	4.93	4.97	4.80	4.80	5.00	5.10	5.40	5.70	6.00	6.10	5.33	4.93	5.00	6.00
3 Month Bill	1.38	1.90	0.92	0.11	0.21	0.19	0.14	0.06	0.16	0.14	0.18	0.20	0.20	0.45	1.40	1.80	3.36	0.11	0.06	0.20	1.80
2 Year Note	1.62	2.63	2.00	0.76	0.81	1.11	0.95	1.14	1.02	0.90	1.00	1.10	1.20	1.50	2.30	2.60	3.05	0.76	1.14	1.10	2.60
5 Year Note	2.46	3.34	2.98	1.55	1.67	2.54	2.31	2.69	2.55	2.10	2.20	2.20	2.30	2.60	3.30	3.60	3.45	1.55	2.69	2.20	3.60
10 Year Note	3.45	3.99	3.85	2.25	2.71	3.53	3.31	3.85	3.84	3.20	3.20	3.40	3.50	3.80	4.10	4.40	4.04	2.25	3.85	3.40	4.40
30 Year Bond	4.30	4.53	4.31	2.69	3.56	4.32	4.03	4.63	4.72	3.90	4.10	4.20	4.30	4.50	4.70	5.00	4.45	2.69	4.63	4.20	5.00

Forecast as of: June 9, 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

Other than Europe, Global Economy Is Doing Well

Most countries reported positive GDP growth in the first quarter, and available monthly indicators suggest that global economic activity has continued to expand in the second quarter. Start with Asia where Chinese industrial production (IP) grew about 18 percent on a year-ago basis in April (bottom left). Although the outturn represents a slowdown from the 19.6 percent rate that was registered in the first quarter—and the decline in the PMI in May suggests that growth slowed a bit further in May—the double-digit growth rate in IP suggests that the Chinese economy still has plenty of momentum behind it. Moreover, IP increased on a sequential basis in April relative to the previous month in Japan, Korea and Taiwan. The bottom line is that economic growth in Asia remains solid, if not a bit slower than in the first quarter.

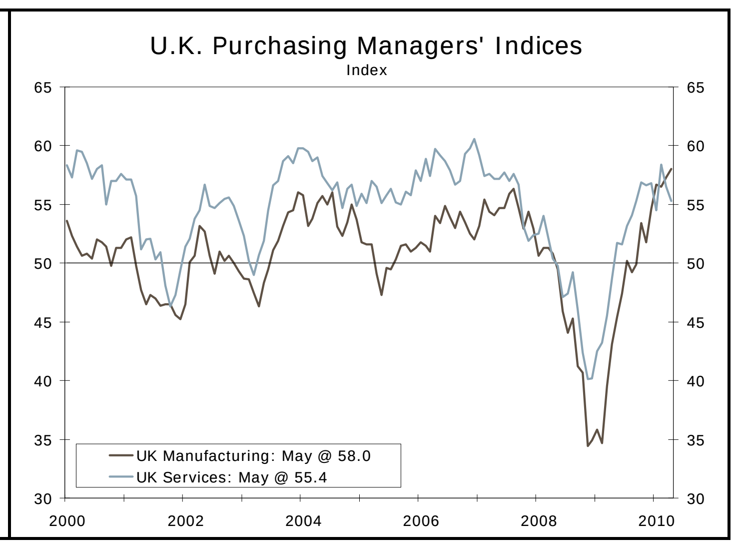
Moving to Canada, there are not many data points yet about how the economy is performing in the second quarter, but the few we have suggest that economic activity has continued to expand at a solid rate. For example, Canadian payrolls in May were up 0.8 percent relative to the end of the first quarter. Real GDP shot up at an annualized rate of 6.1 percent in the first quarter, the strongest sequential growth rate in about 10 years, and we project that the Canadian economy has continued to expand at a solid clip in the second quarter.

Real GDP growth in the United Kingdom, which printed at only 1.2 percent in the first quarter, looks to have strengthened in the second quarter. Industrial production came into the quarter with strong momentum due to the 1.9 percent rise in March relative to the previous month, the largest monthly increase since the economy exited from recession in 2002. Moreover, the manufacturing PMI, which rose to its highest level in April and May in about 10 years, suggests that production in the factory sector continued to expand in the second quarter (bottom right). We estimate that real GDP will grow roughly 3 percent at an annualized rate in the second quarter, which would be the strongest outturn since the economy tumbled into recession in early 2008. However, the overall pace of recovery likely will remain sluggish into next year due to the headwinds of fiscal tightening that is slated to begin later this year.

Even growth in continental Europe appears to have strengthened recently. As with the United Kingdom, industrial production in the euro area entered the second quarter with strong momentum, and the behavior of the manufacturing PMI and some “hard” data suggest that factory output has continued to expand. For example, German factory orders, which shot up 5.1 percent in March relative to the previous month, rose another 2.8 percent in April.

However, there are storm clouds gathering on the Euro-zone’s economic horizon in the form of the sovereign debt crisis. Some countries, namely, Greece, Ireland, Portugal and Spain face significant fiscal retrenchment in the years ahead. Germany and Italy have also announced some budget cutting plans for next year as well, although they are not as draconian as the measures announced in the crisis countries. At a minimum, tighter fiscal policies in many countries will exert a powerful drag on growth for the foreseeable future. Our outlook calls for very sluggish growth later this year through early next year, but no outright recession. That said, the risk of a double-dip recession in the Euro-zone is not insignificant.

There is a chance, however, that the storm clouds on the horizon could be the leading edge of a powerful hurricane. Banks have become a bit leery of lending to each other lately due to concerns about sovereign debt exposure. Although the current tension in interbank funding markets is nowhere near the strains that prevailed after Lehman Brothers’ collapse, the global economic outlook would darken considerably should banks curtail lending to each other again.



Source: Bloomberg LP, 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%	4.6%	3.9%	2.8%	4.1%	3.9%
Global (Market Exchange Rates)	-2.0%	3.4%	2.7%	n/a	n/a	n/a
Advanced Economies[1]	-3.4%	2.5%	2.0%	-0.3%	1.3%	1.0%
United States	-2.4%	3.0%	2.2%	-0.3%	1.5%	1.2%
Eurozone	-4.1%	0.9%	1.1%	0.3%	1.4%	0.9%
United Kingdom	-4.9%	1.2%	2.1%	2.2%	3.1%	1.9%
Japan	-5.2%	3.3%	1.6%	-1.3%	-0.8%	0.0%
Korea	0.2%	6.1%	3.7%	2.8%	2.8%	3.0%
Canada	-2.5%	3.6%	3.0%	0.3%	2.0%	2.3%
Developing Economies[1]	2.5%	7.0%	6.2%	6.5%	7.5%	7.3%
China	8.5%	10.5%	9.0%	-0.7%	2.9%	3.6%
India	7.4%	8.5%	7.5%	11.4%	11.8%	7.8%
Mexico	-6.5%	4.2%	3.6%	5.3%	5.4%	5.4%
Brazil	-0.2%	5.9%	6.0%	4.9%	5.5%	6.5%
Russia	-8.3%	3.7%	4.1%	11.8%	6.2%	7.6%

Forecast as of: June 9, 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		
	Q2	Q3	Q4	Q1	Q2	Q3	Q2	Q3	Q4	Q1	Q2	Q3
U.S.	0.40%	0.40%	0.65%	1.40%	2.15%	2.65%	3.80%	3.80%	3.90%	4.00%	4.20%	4.30%
Japan	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	1.35%	1.35%	1.35%	1.45%	1.50%	1.60%
Euroland	0.65%	0.65%	0.80%	1.00%	1.40%	2.25%	2.45%	2.80%	3.00%	3.20%	3.40%	3.60%
U.K.	0.75%	0.75%	0.80%	0.80%	1.25%	2.00%	3.40%	3.70%	4.00%	4.20%	4.30%	4.40%
Canada	0.80%	1.00%	1.75%	2.75%	3.20%	3.50%	3.25%	3.50%	4.00%	4.10%	4.25%	4.30%

Forecast as of: June 9, 2010

Source: Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

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