September 09, 2009

Economics Group

MONTHLY OUTLOOK

U.S. Overview	International Overview

The Recovery Will Take Time to Build Momentum

Forecasts for economic growth during the second half of this year and 2010 have been steadily ratcheted up as most of the monthly economic indicators have come in better than expected. We have raised our own estimate modestly. We now see real GDP rising at a 3.7 percent annual rate, which is 0.3 percentage points higher than one month ago. Estimates for real GDP growth during the fourth quarter and 2010 are essentially the same as they were one month ago, and our first look at 2011 calls for real GDP to rise 2.5 percent.

The long string of real GDP gains seems a bit odd coming just as the unemployment rate approaches 10 percent. Much of the near-term improvement comes from a narrowing of the trade deficit and a smaller inventory drawdown. Inventories are "only" expected to decline by $100.0 billion in the current quarter, less than the prior quarter's $159.2 billion plunge. The smaller decline will add 1.8 percentage points to third-quarter growth and 1.7 percentage points to the fourth-quarter numbers.

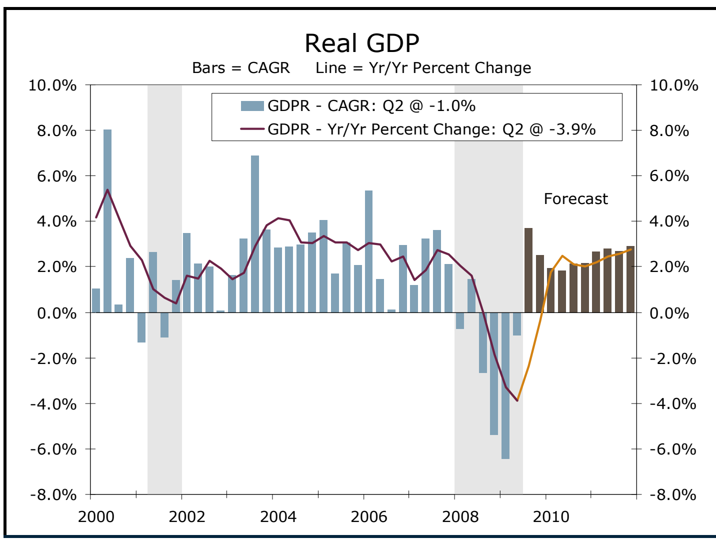
There is also some real improvement taking place. Stronger economic growth overseas is boosting demand for exports, helping further narrow the trade deficit. Fiscal stimulus dollars are also flowing a little more freely. Federal government spending is expected to average a 6.0 percent pace for the next three quarters, helping offset continued weakness of state & local government and the private sector.

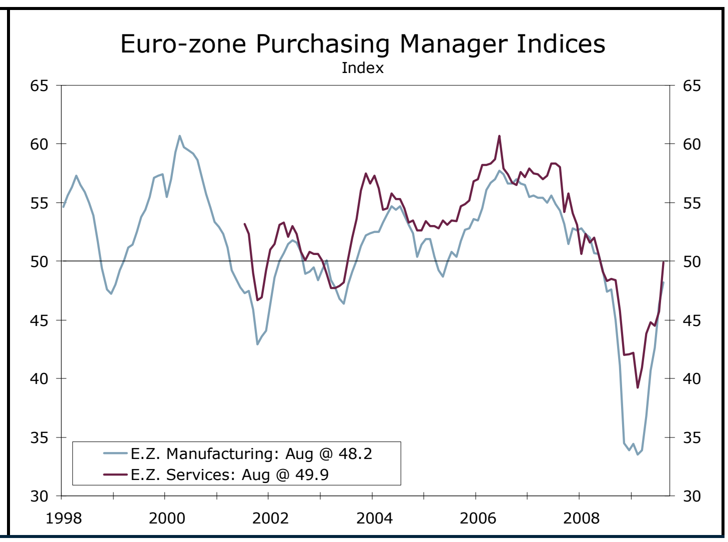
Has the Global Economy Turned the Corner?

Following five consecutive quarters of contraction, it appears that real GDP growth in the euro area is turning positive again. However, there are a few important countries in the Euro-zone in which consumers became highly geared over the past few years. Therefore, growth in the overall euro area could be held back somewhat over the next year or so as these consumers delever. With inflation benign and the sustainability of the recovery still in question, the European Central Bank will likely refrain from tightening policy.

The British economy, which plunged into its deepest recession in decades, is also exhibiting incipient signs of recovery. Like their counterparts in some continental economies, British consumers levered up earlier this decade. Therefore, it seems that a period of consumer retrenchment is in store. In our view, the Bank of England will also be on hold well into next year.

If there is a region of the world where recovery has clearly taken hold already, it would be Asia. China is leading, but most other Asian economies have also posted positive rates of GDP growth, at least on a sequential basis. Asian central banks likely will be the first institutions to hike rates, but policy tightening probably won't get under way in the region until sometime next year. Inflation is benign in most Asian economies, and the outlook for many western economies, which are important trading partners for the region, remains uncertain.





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

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

The Economy Still Faces Significant Headwinds

The recent moderation in the rate of job losses along with a host of upbeat reports has raised hopes the recovery might turn out to be stronger than expected. As much as we would like to join that camp, we believe the economy still faces significant headwinds that will make it difficult to sustain the relatively robust gains we are likely to see over the next couple of quarters. Much of the improvement merely reflects a bounce back in motor vehicle production and a reduction in the rate of inventory liquidations. Federal stimulus programs, including aid to state & local governments, the cash-for-clunkers program and the $8,000 tax credit for first-time homebuyers, are also helping drive activity in the near term.

Private final domestic demand, or "core" GDP, remains exceptionally weak. "Core" GDP is expected to grow at just a 0.5 percent pace over the next year. The weakness in private demand means overall growth will decelerate once the inventory drawdown is complete and stimulus programs end.

While we are forecasting a substantial deceleration in overall growth, we do not expect a double dip. Overall growth is expected to remain in positive territory throughout the forecast period thanks mostly to continued narrowing in the trade deficit and increases in federal government outlays. Private domestic demand should gradually build momentum, but there are a number of hurdles that need to be overcome before robust growth returns to the private sector.

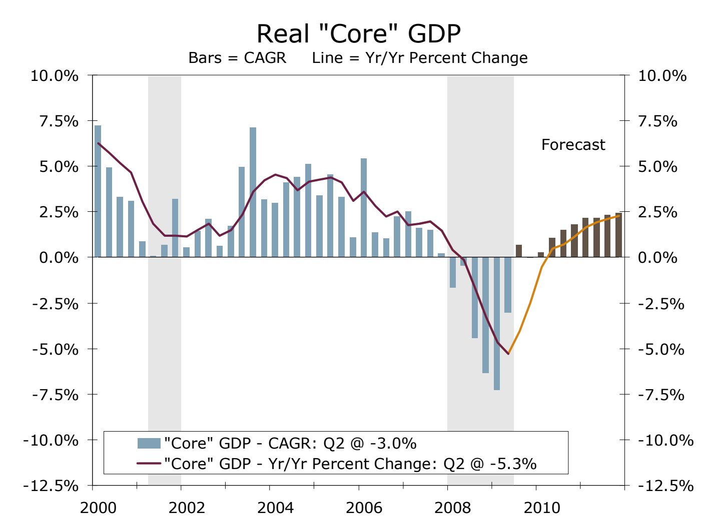
Consumer spending got a temporary boost during the third quarter from the cash-for-clunkers program, which helped boost motor vehicle sales to around an 11.6 million unit rate for the third quarter, up from a 9.6 million unit pace in the prior quarter. The gain in new vehicle sales did not carry over into spending for other items. Spending for nondurable goods likely declined during the quarter, and outlays for services likely posted only a modest increase. Consumers are only willing to spend if they are presented with a bargain.

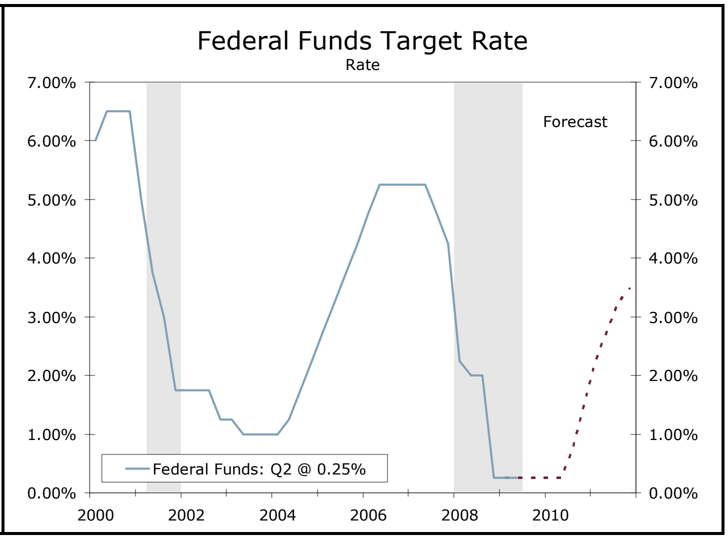
We are expecting a modest payback from the cash-for-clunkers program and look for sales to slip back below a 10 million unit annual rate later this year. Spending for other goods and services will also likely remain exceptionally modest, reflecting a 5.0 percent drop in wages and salaries over the past year and continuing concerns about job security. Personal income is holding up better than that, thanks to government transfer payments. Even when income turns back up, spending will likely continue to lag. Consumers are still deleveraging and trying to rebuild savings. As a result, spending will likely lag behind real after-tax income for the next several quarters.

Residential construction is finally showing some positive signs. Single-family housing starts have risen in each of the past five months, which should push real outlays for residential construction back into positive territory during the third quarter. Home sales and construction have been helped out a good bit by the $8,000 tax credit for first-time homebuyers. Once the tax credit program ends, the rebound in new home sales and construction may level back out.

Even if first-time homebuyer tax credits are extended, there is not much immediate upside for the housing market. Delinquency rates are surging for both prime and subprime mortgages. As a result, underwriting will remain exceptionally tight, while sales and new construction will remain near historic lows.

The Federal Reserve is expected to keep short-term interest rates near current levels until it feels confident that there is little risk of the economy sliding back into recession. Once it feels the coast is clear, the pace of interest rate hikes will likely be surprisingly fast until they bring the Federal Funds rate back in line with the core inflation rate. This means we should see a 1.50 percent Federal Funds rate by the end of 2010.





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

Wells Fargo U.S. Economic Forecast

	Actual						Forecast										Actual		Forecast		
	2008				2009				2010				2011								
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2007	2008	2009	2010	2011
Real Gross Domestic Product (a)	-0.7	1.5	-2.7	-5.4	-6.4	-1.0	3.7	2.5	2.0	1.8	2.1	2.2	2.7	2.8	2.7	2.9	2.1	0.4	-2.5	2.1	2.5
Personal Consumption	-0.6	0.1	-3.5	-3.1	0.6	-1.0	1.7	0.0	0.3	1.1	1.3	1.4	1.6	1.6	1.7	1.7	2.7	-0.2	-0.9	0.7	1.5
Business Fixed Investment	1.9	1.4	-6.1	-19.4	-39.2	-10.9	-6.5	-2.2	-0.4	0.0	2.2	3.8	5.9	4.8	5.9	6.6	6.2	1.6	-18.4	-1.6	4.5
Equipment and Software	-0.5	-5.0	-9.4	-25.9	-36.4	-8.4	-4.8	2.6	6.0	4.0	5.9	6.3	7.8	5.9	6.7	7.2	2.6	-2.6	-18.7	2.6	6.5
Structures	6.8	14.5	-0.1	-7.2	-43.6	-15.1	-10.0	-12.0	-14.0	-9.0	-6.5	-2.5	1.0	2.0	3.5	5.0	14.9	10.3	-18.1	-10.7	-0.6
Residential Construction	-28.2	-15.8	-15.9	-23.2	-38.2	-22.8	1.5	7.5	4.0	4.5	5.0	5.0	5.5	6.0	6.5	7.0	-18.5	-22.9	-21.8	2.7	5.6
Government Purchases	2.6	3.6	4.8	1.2	-2.6	6.4	3.2	2.6	1.9	1.6	3.2	1.9	1.6	1.6	1.6	1.6	1.7	3.1	2.1	2.6	1.9
Net Exports	-550.9	-476.0	-479.2	-470.9	-386.5	-331.8	-310.4	-300.5	-287.5	-288.9	-293.2	-290.7	-278.1	-258.8	-244.0	-224.8	-647.7	-494.3	-332.3	-290.1	-251.4
Pct. Point Contribution to GDP	0.4	2.4	-0.1	0.5	2.6	1.6	0.7	0.3	0.4	0.0	-0.1	0.1	0.4	0.6	0.4	0.6	0.6	1.2	1.2	0.3	0.3
Inventory Change	0.6	-37.1	-29.7	-37.4	-113.9	-159.2	-100.0	-45.0	-15.0	7.5	20.2	28.2	34.2	38.2	39.2	40.2	19.5	-25.9	-104.5	10.2	38.0
Pct. Point Contribution to GDP	-0.2	-1.3	0.3	-0.6	-2.4	-1.4	1.8	1.7	0.9	0.7	0.4	0.2	0.2	0.1	0.0	0.0	-0.3	-0.3	-0.6	0.9	0.2
Nominal GDP	1.0	3.5	1.4	-5.4	-4.6	-1.0	4.3	3.3	2.9	2.9	3.5	3.8	4.5	4.7	4.8	5.1	5.1	2.6	-1.3	3.0	4.3
Real Final Sales	-0.5	2.7	-2.9	-4.7	-4.1	0.4	1.3	0.8	1.0	1.1	1.8	1.9	2.5	2.7	2.7	2.9	2.5	0.8	-1.9	1.1	2.3
Retail Sales (b)	2.6	2.4	0.4	-8.0	-8.9	-9.6	-6.7	0.9	3.1	4.2	3.6	4.0	4.7	4.8	4.9	5.0	3.3	-0.7	-6.2	3.7	4.9
Inflation Indicators (b)																					
"Core" PCE Deflator	2.4	2.5	2.6	2.0	1.7	1.6	1.4	1.5	1.5	1.3	1.2	1.3	1.5	1.6	1.7	1.8	2.4	2.4	1.6	1.3	1.6
Consumer Price Index	4.2	4.3	5.2	1.5	-0.2	-0.9	-1.8	0.5	1.4	1.4	1.1	1.4	1.7	1.9	2.1	2.2	2.9	3.8	-0.6	1.3	2.0
"Core" Consumer Price Index	2.4	2.3	2.5	2.0	1.7	1.8	1.6	1.6	1.5	1.2	1.2	1.3	1.5	1.6	1.7	1.8	2.3	2.3	1.7	1.3	1.7
Producer Price Index	7.2	7.6	9.5	1.4	-2.2	-4.2	-5.8	-0.1	1.9	2.1	1.9	1.9	2.1	2.2	2.4	2.4	3.9	6.4	-3.1	1.9	2.3
Employment Cost Index	3.3	3.1	2.9	2.6	2.1	1.8	1.7	1.6	1.9	1.6	1.6	1.7	2.0	1.9	1.8	1.8	3.4	3.0	1.8	1.7	1.9
Real Disposable Income (a)	-2.4	9.8	-8.5	3.4	0.2	3.8	-1.4	1.4	1.2	1.5	1.8	2.1	2.3	2.5	2.5	2.5	2.2	0.5	0.9	1.2	2.2
Nominal Personal Income (b)	3.7	4.0	2.9	1.1	-1.6	-2.5	-2.5	-4.0	-1.3	-0.8	0.3	3.5	4.1	4.2	4.1	3.8	5.6	2.9	-2.6	0.4	4.1
Industrial Production (a)	0.2	-4.6	-9.0	-13.0	-19.1	-11.4	1.2	1.9	2.0	2.3	3.0	4.1	4.5	4.3	3.9	3.7	1.5	-2.2	-10.8	1.3	3.9
Capacity Utilization	80.1	78.9	76.9	74.2	70.4	68.5	69.0	68.9	68.4	68.1	68.3	69.3	70.2	71.0	71.7	75.3	80.6	77.6	69.2	68.5	72.1
Corporate Profits Before Taxes (b)	-4.9	-12.0	-5.4	-25.1	-19.0	-10.9	-11.0	3.5	5.0	7.0	9.5	9.5	9.5	9.5	10.0	10.0	-4.1	-11.8	-10.1	7.8	9.8
Corporate Profits After Taxes	6.6	-3.7	4.8	-15.8	-19.7	-13.5	-9.0	3.0	5.0	8.5	11.0	11.5	11.5	11.5	11.5	11.5	-4.0	-2.0	-10.5	9.1	11.5
Federal Budget Balance (c)	-205.9	26.9	-168.9	-332.5	-448.9	-304.9	-513.7	-375.3	-595.8	-229.5	-284.4	-275.2	-436.9	-168.3	-219.6	-180.0	-161.5	-454.8	-1600.0	-1485.0	-1100.0
Current Account Balance (d)	-179.3	-187.7	-184.2	-154.9	-101.5	-95.0	-110.0	-115.0	-120.0	-115.0	-110.0	-105.0	-100.0	-90.0	-85.0	-80.0	-726.6	-706.1	-421.5	-450.0	-355.0
Trade Weighted Dollar Index (e)	70.3	71.0	76.1	79.4	83.2	77.7	75.8	77.9	79.5	80.8	81.8	82.4	82.4	82.6	83.0	83.4	73.3	79.4	77.9	82.4	83.4
Nonfarm Payroll Change (f)	-113	-153	-208	-553	-691	-428	-250	-210	-80	60	140	160	167	173	180	185	96	-257	-395	70	176
Unemployment Rate	4.9	5.4	6.1	6.9	8.1	9.3	9.6	10.0	10.2	10.2	10.1	9.9	9.8	9.5	9.2	8.8	4.6	5.8	9.2	10.1	9.3
Housing Starts (g)	1.06	1.02	0.87	0.66	0.53	0.54	0.59	0.64	0.70	0.78	0.82	0.85	0.88	0.94	0.97	1.00	1.34	0.90	0.58	0.79	0.95
Light Vehicle Sales (h)	15.2	14.1	12.9	10.5	9.5	9.6	11.6	9.9	10.2	10.6	11.2	11.8	12.3	12.5	12.7	12.8	16.1	13.2	10.1	11.0	12.6
Crude Oil - WTI - Front Contract (i)	97.90	123.98	117.98	58.74	43.08	59.62	69.14	70.00	70.00	72.00	75.00	75.00	77.00	78.50	80.00	82.00	72.31	99.65	60.46	73.00	79.38
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	0.75	1.50	2.25	2.75	3.25	3.50	4.25	0.25	0.25	1.50	3.50
3 Month LIBOR	2.69	2.78	4.05	1.43	1.19	0.60	0.20	0.25	0.35	0.60	1.10	1.75	2.50	3.00	3.50	3.75	4.70	1.43	0.25	1.75	3.75
Prime Rate	5.25	5.00	5.00	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.75	4.50	5.25	5.75	6.25	6.50	7.25	3.25	3.25	4.50	6.50
Conventional Mortgage Rate	5.97	6.32	6.04	5.33	5.00	5.42	5.20	5.20	5.30	5.40	5.50	5.60	5.80	6.10	6.30	6.60	6.10	5.33	5.20	5.60	6.60
3 Month Bill	1.38	1.90	0.92	0.11	0.21	0.19	0.20	0.20	0.30	0.40	0.90	1.50	2.25	2.75	3.25	3.50	3.36	0.11	0.20	1.50	3.50
2 Year Note	1.62	2.63	2.00	0.76	0.81	1.11	1.00	1.10	1.20	1.30	1.70	2.00	2.50	3.10	3.50	3.70	3.05	0.76	1.10	2.00	3.70
5 Year Note	2.46	3.34	2.98	1.55	1.67	2.54	2.50	2.60	2.70	2.80	2.90	3.00	3.20	3.50	3.70	4.00	3.45	1.55	2.60	3.00	4.00
10 Year Note	3.45	3.99	3.85	2.25	2.71	3.53	3.50	3.60	3.70	3.80	3.90	4.00	4.20	4.50	4.70	5.00	4.04	2.25	3.60	4.00	5.00
30 Year Bond	4.30	4.53	4.31	2.69	3.56	4.32	4.30	4.40	4.50	4.60	4.70	4.80	4.90	5.10	5.30	5.60	4.45	2.69	4.40	4.80	5.60

Forecast as of: September 9, 2009

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

Europe Not Completely out of the Woods Yet

The purchasing managers' indices (PMIs) in the Euro-zone collapsed late last year, but both manufacturing and service sector PMIs have recently returned to the demarcation line that separates expansion from contraction (see graph on front page). Therefore, it appears that real GDP growth in the Euro-zone is about to turn positive again following five consecutive quarters of contraction. Does this mean that there is nothing but blue skies ahead for the euro area?

Although the worst is probably over, we believe that the economic skies above the Euro-zone will remain partly cloudy for some time. As we wrote recently, there are a few economies, namely Greece, the Netherlands, Portugal and Spain, in which consumers are fairly indebted. (See "Will Debt Restrain Euro-zone Consumer Spending?", which is posted on our Website.) In our view, lackluster growth in consumer spending in these economies will help to restrain real GDP growth in the overall euro area well into next year. This point was reinforced by the recent release of Euro-zone GDP data for the second quarter as real consumer spending in Spain plunged nearly six percent relative to the same period last year (left chart).

Consumer prices in the Euro-zone were down 0.2 percent on a year-over-year basis in August. Although the collapse in oil prices over the past year overstates the drop in underlying inflationary pressures, inflation is just not much of an issue at present. (The "core" rate of inflation fell to only 1.3 percent in July, the lowest rate in four years.) The combination of a sluggish recovery and benign inflation should keep the European Central Bank on hold well into next year.

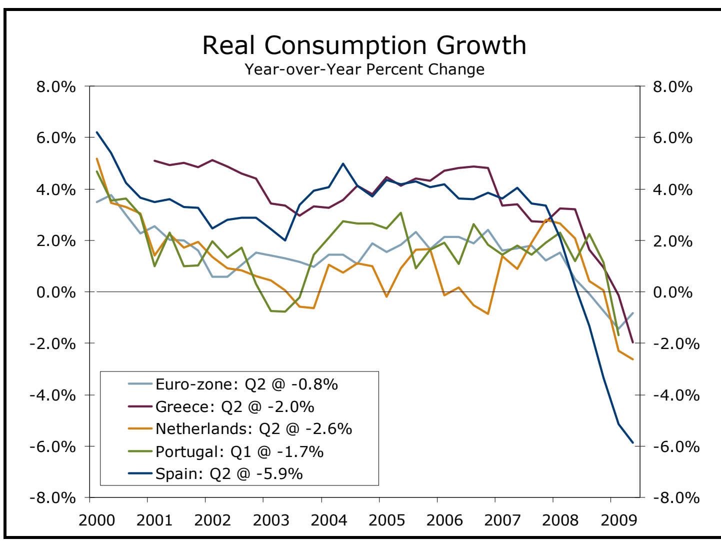
Positive economic growth in the United Kingdom appears to be imminent as well, following that economy's five-quarter slide. Like the Euro-zone, British PMIs are nearing the break-even demarcation line. Like their counterparts in some continental economies, British consumers became highly geared earlier this decade, and a period of consumer retrenchment appears likely. Therefore, the Bank of England probably will keep its benchmark policy rate, which currently stands at only 0.50 percent, unchanged for a considerable period of time.

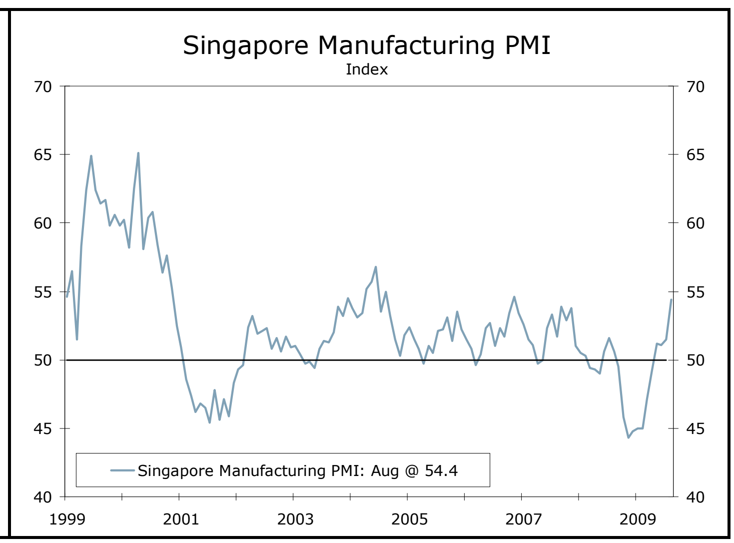
Bona-Fide Signs of Recovery in Asia

If there is a region of the world where recovery has clearly taken hold already, it would be Asia. Yes, most Asian economies experienced significantly slower growth, if not outright contraction, late last year and earlier this year when global trade imploded. However, the financial systems of most Asian economies were not leveraged to the same extent as their western counterparts, so they were not hammered as badly during the global credit crunch. In addition, most Asian governments were quick to implement fiscal stimulus programs, which have contributed to the pick-up in economic activity this year.

The region is being led by China, where the year-over-year GDP growth rate has risen from 6.1 percent in the first quarter to 7.9 percent in the second quarter. However, even the most open economies in the region, which were dealt a body blow by the implosion of global trade, have bounced back. The manufacturing PMI in Singapore has returned to "normal" territory (right chart). In Taiwan, industrial production has climbed more than 60 percent from its low in January.

At some point, Asian central banks will begin to tighten policy again. However, inflation is benign across the region, so policy tightening is not imminent. Moreover, Asian central banks will probably want some clarity on the sustainability of the incipient recoveries in western economies before hiking rates. We are looking for higher rates in Asia next year.





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)	-0.9%	3.6%	4.1%	2.4%	3.2%	3.9%
Global (Market Exchange Rates)	-2.2%	2.4%	2.9%	n/a	n/a	n/a
Advanced Economies[1]	-3.4%	2.2%	2.6%	-0.5%	0.9%	1.8%
United States	-2.5%	2.1%	2.5%	-0.6%	1.3%	2.0%
Eurozone	-3.9%	1.9%	2.6%	0.2%	1.0%	1.9%
United Kingdom	-4.1%	2.1%	2.6%	2.0%	1.6%	1.7%
Japan	-5.7%	1.6%	1.6%	-1.4%	-0.8%	0.5%
Korea	-1.0%	3.9%	3.0%	2.7%	2.6%	2.9%
Canada	-2.3%	2.6%	3.1%	0.1%	1.5%	1.9%
Developing Economies[1]	2.1%	5.3%	5.8%	6.0%	5.9%	6.3%
China	8.4%	8.8%	9.0%	-0.9%	1.0%	2.0%
India	5.8%	7.0%	8.0%	8.7%	6.8%	6.1%
Mexico	-7.2%	2.2%	2.5%	5.3%	3.7%	3.9%
Brazil	-0.7%	3.5%	3.6%	4.9%	4.7%	4.8%
Russia	-7.7%	2.6%	3.6%	12.3%	8.9%	9.8%

Forecast as of: September 9, 2009

[1]Aggregated Using PPP Weights

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	3-Month LIBOR						10-Year Bond					
	2009		2010				2009		2010			
	Q3	Q4	Q1	Q2	Q3	Q4	Q3	Q4	Q1	Q2	Q3	Q4
U.S.	0.20%	0.25%	0.35%	0.60%	1.10%	1.75%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%
Japan	0.35%	0.30%	0.30%	0.30%	0.30%	0.30%	1.50%	1.45%	1.45%	1.50%	1.60%	1.65%
Euroland	0.75%	0.65%	0.60%	0.70%	1.00%	1.50%	3.40%	3.60%	3.90%	4.10%	4.40%	4.50%
U.K.	0.60%	0.60%	0.60%	0.65%	0.90%	1.45%	3.75%	4.00%	4.25%	4.50%	4.70%	4.80%
Canada	0.50%	0.45%	0.45%	0.50%	1.00%	2.00%	3.50%	3.75%	4.15%	4.55%	4.70%	4.75%

Forecast as of: September 9, 2009

Source: Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

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