September 18, 2009

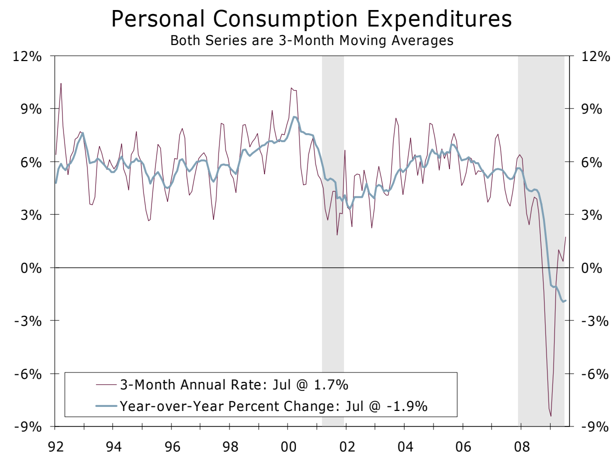
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Economics as Framework for Corporate Strategy in 2010

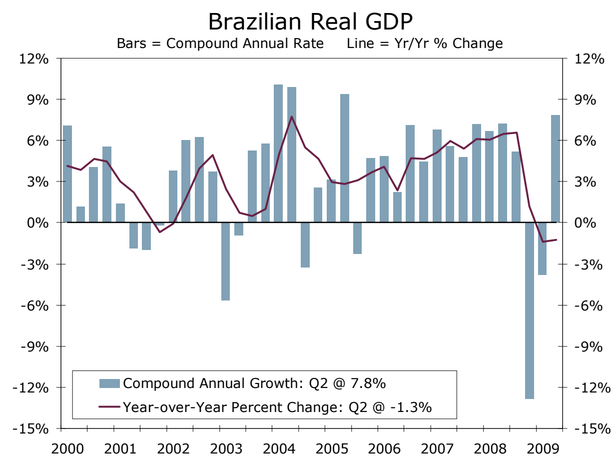
- Despite all the news we receive, there are four economic issues that must be addressed before a corporate strategy can be rationally formulated. For the real economy, the challenge is the post-recovery pace of consumer spending and housing.
- From the regional perspective, has the era of California/Florida dreaming come to an end?
- Finally, what are the Federal Reserve's and the Obama Administration's exit strategies for monetary and fiscal policy?



Global Review

The Roaring Brazilian Economy

- The Brazilian economy came roaring back during the second quarter of the year through an important expansion of monetary and fiscal policy that pushed domestic consumption higher. While the economy dropped on a year-earlier basis, it grew by 1.9 percent compared to the first quarter, seasonally adjusted.
- The central bank will have to keep a watchful eye on the price level. Right now foreign consumption (exports) is weak while domestic consumption is strong. If exports begin to grow the country will start to experience supply constraints that could put pressure on inflation.



Wells Fargo U.S. Economic Forecast

	Actual						Forecast		Actual			Forecast		
	2008				2009				2006	2007	2008	2009	2010	2011
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
Real Gross Domestic Product [1]	-0.7	1.5	-2.7	-5.4	-6.4	-1.0	3.7	2.5	2.7	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	2.9	2.7	-0.2	-0.9	0.7	1.5
Inflation Indicators [2]														
"Core" PCE Deflator	2.4	2.5	2.6	2.0	1.7	1.6	1.4	1.5	2.3	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	3.2	2.9	3.8	-0.6	1.3	2.0
Industrial Production [1]	0.2	-4.6	-9.0	-13.0	-19.1	-11.4	1.2	1.9	2.3	1.5	-2.2	-10.8	1.3	3.9
Corporate Profits Before Taxes [2]	-4.9	-12.0	-5.4	-25.1	-19.0	-10.9	-11.0	3.5	10.5	-4.1	-11.8	-10.1	7.8	9.8
Trade Weighted Dollar Index [3]	70.3	71.0	76.1	79.4	83.2	77.7	75.8	77.9	81.5	73.3	79.4	77.9	82.4	83.4
Unemployment Rate	4.9	5.4	6.1	6.9	8.1	9.3	9.6	10.0	4.6	4.6	5.8	9.2	10.1	9.3
Housing Starts [4]	1.06	1.02	0.87	0.66	0.53	0.54	0.59	0.64	1.81	1.34	0.90	0.58	0.79	0.95
Quarter-End Interest Rates														
Federal Funds Target Rate	2.25	2.00	2.00	0.25	0.25	0.25	0.25	0.25	5.25	4.25	0.25	0.25	1.50	3.50
Conventional Mortgage Rate	5.97	6.32	6.04	5.33	5.00	5.42	5.20	5.20	6.14	6.10	5.33	5.20	5.60	6.60
10 Year Note	3.45	3.99	3.85	2.25	2.71	3.53	3.50	3.60	4.71	4.04	2.25	3.60	4.00	5.00

Forecast as of: September 9, 2009
[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

Inside

U.S. Review

Corporate Strategy in an Era of Uncertainty

Since World War II, the pace and character of consumer spending has defined the U.S. economy. Going forward, will this all change and what are the implications? What about housing? Finally, has the era of California/Florida dreaming come to an end?

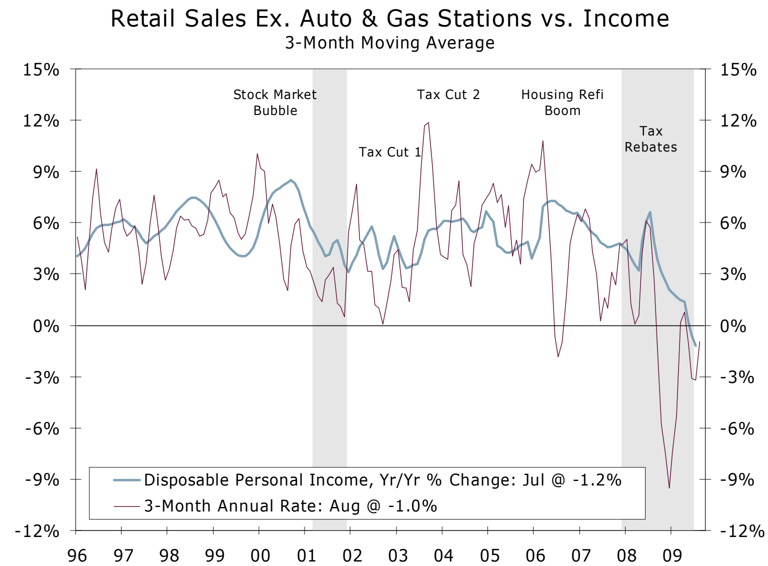
If the American consumer has truly changed her spots and become a greater saving, less credit-using, more bargain-hunting species, then what will be the character of this recovery and the longer-run pace of economic growth? With consumer spending approximately 70 percent of the economy, this issue is in the forefront of corporate strategy discussions as the annual review of corporate direction begins this time each year.

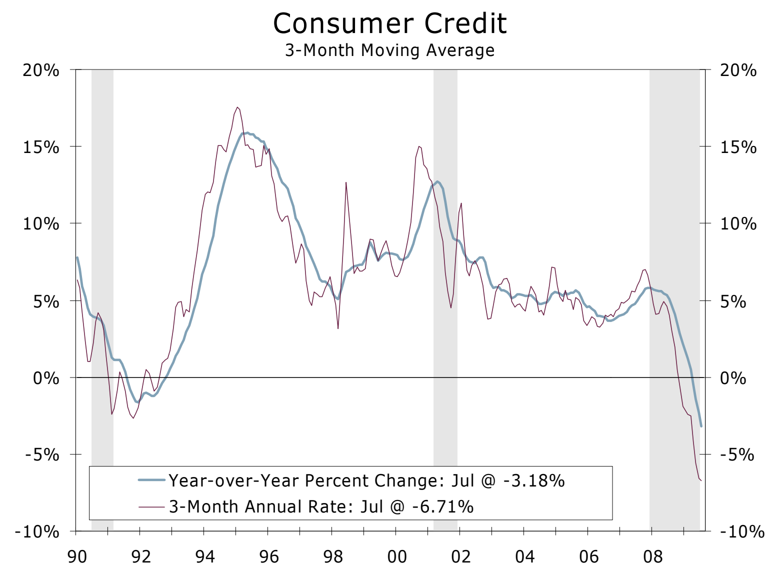
Historically, corporate strategy for the year ahead has been a fairly perfunctory straight-line projection based on recent business performance. However, both the cyclical and secular character of consumer spending and housing are likely to be far different in the year(s) ahead and so straight-line projections are likely to lead straight to corporate underperformance.

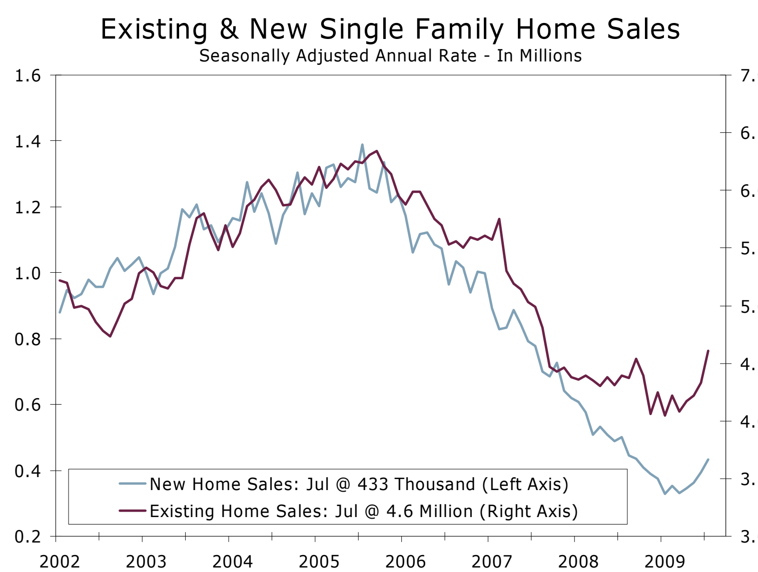
Consumer spending is and will continue to be hampered by income and credit constraints and low consumer confidence. The jobless recovery has already started—we will see three percent plus growth in the economy for the third quarter along with continued job losses. In addition, the average workweek remains low and wage growth very weak. Thus, income gains are modest at best for most workers and will likely remain so for 2010, a sharp contrast to traditional economic recoveries and straight-line forecasts of a rebound in many corporate plans. Meanwhile, consumer credit remains constrained and limited. Consumer and residential credit delinquencies have yet to turn around from the rising rate of the past two years. We remain cautious on recent improvement in the consumer confidence index, as the current conditions component has barely risen off its lows. Weekly first-time unemployment claims have clearly peaked, but the absolute level of claims remains relatively high, and the number of people exhausting their unemployment insurance and filing for extended benefits has surged.

Despite improvement in home sales and new construction, the question of the pace of housing construction if/when the Federal programs are removed remains. Historically, housing has helped lead the economy out of recession as sharply lower interest rates attracted buyers. Moreover, if household expectations for home price appreciation are permanently downshifted, and with the rise in sales and income taxes reducing disposable personal income, then the demand for both housing and remodeling will likely be permanently downshifted.

Dreams of endless summers in California and luxurious retirement in Florida now appear to be under a cloud of home price depreciation and wealth losses on retirement funds. In addition, the limits of congestion, water supply and high baseline housing costs are likely to change the patterns of in-migration. For corporate strategy making, the straight-line prosperity forecasts for both states are likely a relic of the past.





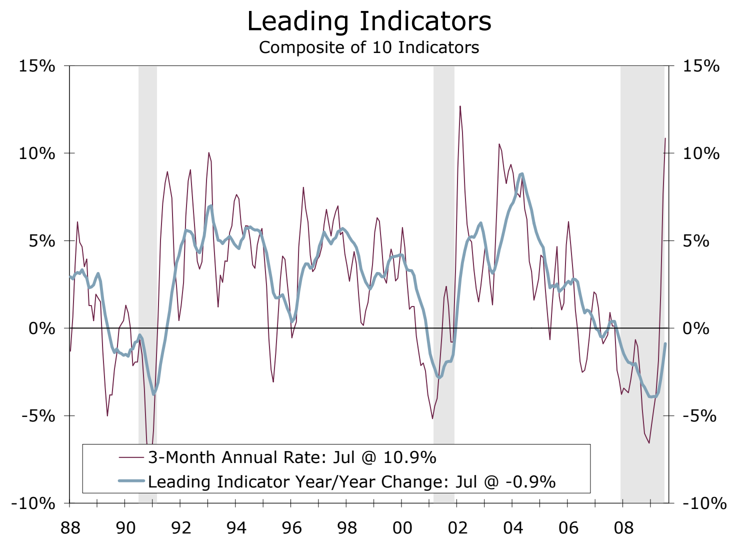


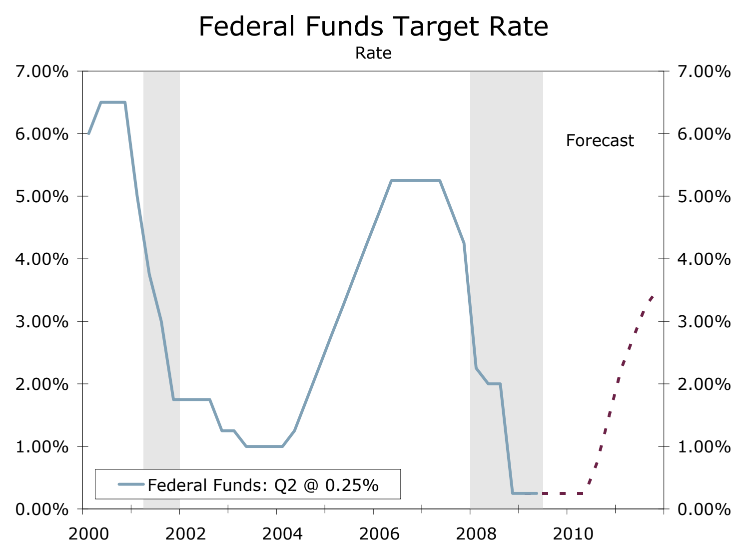
Leading Economic Index • Monday

The Leading Economic Index (LEI) rose 0.6 percent in July, the fourth consecutive monthly increase. Most of the rise in the index was due to an increase in the interest rate spread and decline in jobless claims. We expect seven of the ten indicators to contribute to an increase in the LEI in August. The ISM index for supplier deliveries rose for the fifth consecutive month to 57.1 in July suggesting a rise in demand for manufactured goods. The positive yield curve, stock prices, housing permits, consumer expectations and orders for capital goods will also likely contribute positively. The average workweek should be flat while the real money supply, initial claims and orders for consumer goods will likely detract from the index. The continued increases in LEI are consistent with our forecast that the economy will begin to grow in the third quarter.

Previous: 0.6% **Wells Fargo: 0.7%**

Consensus: 0.7%





FOMC Rate Decision • Wednesday

The Federal Reserve is expected to remain on hold through the first half of next year as core inflation, as measured by the personal consumption expenditures deflator, will likely remain below the Fed's perceived two percent rate. Historically, the Fed has not raised the funds rate until after the unemployment rate has peaked. We expect the unemployment rate to peak in early to mid-2010 reaching above 10 percent. Once rate hikes begin, the Federal Reserve will likely continue to increase the funds rate until it exceeds the core rate of inflation. Long-term Treasury rates, however, will likely trend upward as the Fed executes its exit strategy. With core inflation remaining below the two percent target, the Fed has free reign to focus on providing liquidity to assist with the economic recovery and the improvement of bank balance sheets in the near term.

Previous: 0.25% **Wells Fargo: 0.25%**

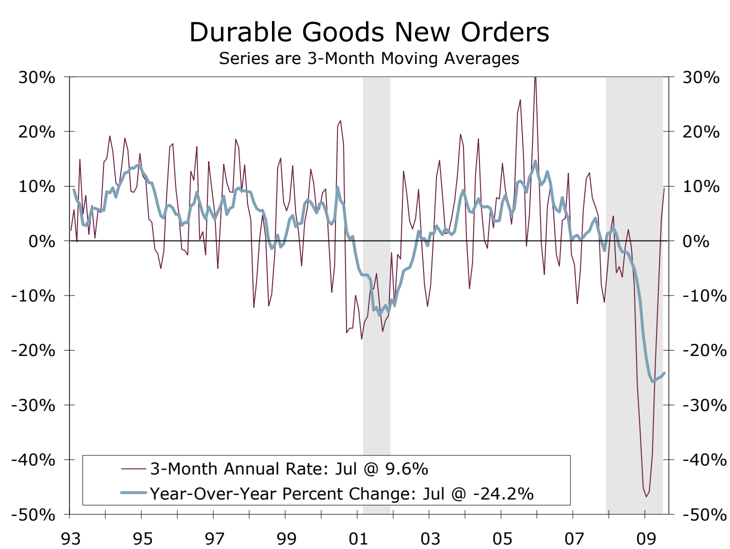
Consensus: 0.25%

Durable Goods • Friday

New orders for durable goods spiked 4.9 percent in July, the largest increase in two years. The headline number was driven by a vault of 107.2 percent in nondefense aircraft orders. Aircraft orders tend to be volatile, however, and are trending downward with the year-over-year number down 22.4 percent. The volatility in nondefense aircraft sets the stage for a pay-back in August. The recent gain in industrial production due to a jump in motor vehicle production suggests a similar spike in new durable goods orders in August. We do not expect the gains from new orders for vehicles and parts, however, will be enough to offset the pay back from the spike in nondefense aircraft. Moreover, while cash-for-clunkers should provide positive momentum in August, the gains will likely be unsustainable. Domestic demand is being restrained by continued job losses, sluggish wage and salary growth and a massive loss of wealth.

Previous: 4.9% **Wells Fargo: -0.5%**

Consensus: 0.1%



Global Review

Brazilian Economy: Thank Active Economic Policies

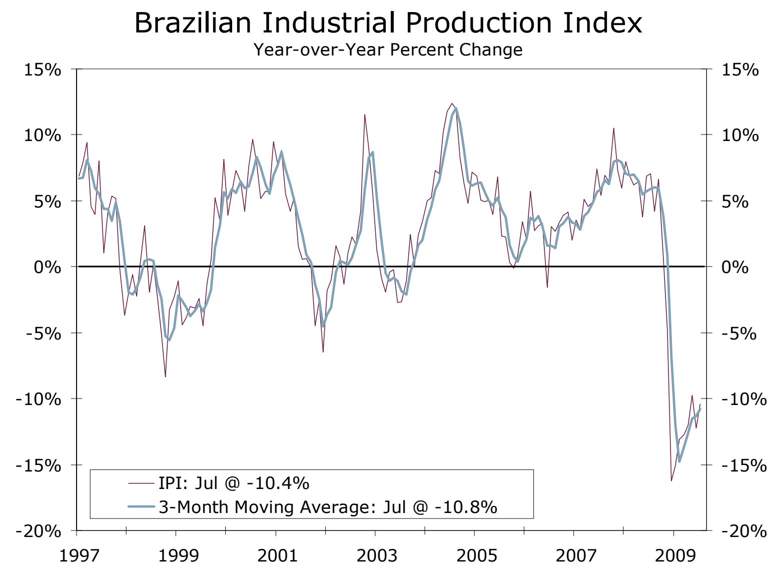
When the worldwide financial crisis hit last year, the Brazilian economy was riding high as the fairly recent decision to transform the country into a major world exporter was yielding impressive results. The Chinese were buying everything the Brazilians could produce, from raw materials to manufactured goods, while the Europeans were buying diesel-powered motors. The result was the Brazilian economy was able to grow at a 5.1 percent rate in 2008. Growth would have been stronger except that the performance during the fourth quarter was very weak.

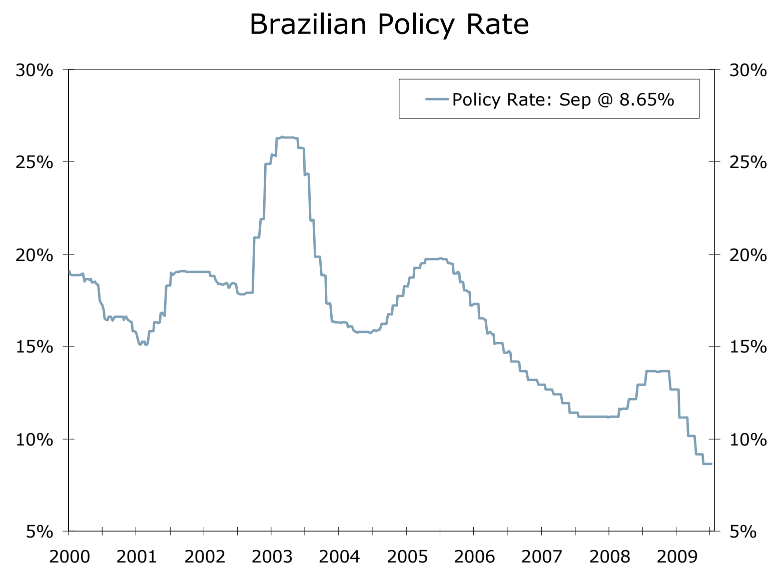
Then the financial crisis hit, affecting trade through two sources: lack of credit and a worldwide collapse in demand. The severity of the decline in the auto manufacturing sector was impressive due to the fact that while the Brazilian auto sector produces diesel motors for European consumption, Brazilian laws prohibits diesel-powered cars for its internal market, a policy that was born out of the development of sugar cane ethanol as an alternative fuel. Thus, not only were the Europeans not buying, but firms could not redirect that production to the domestic market.

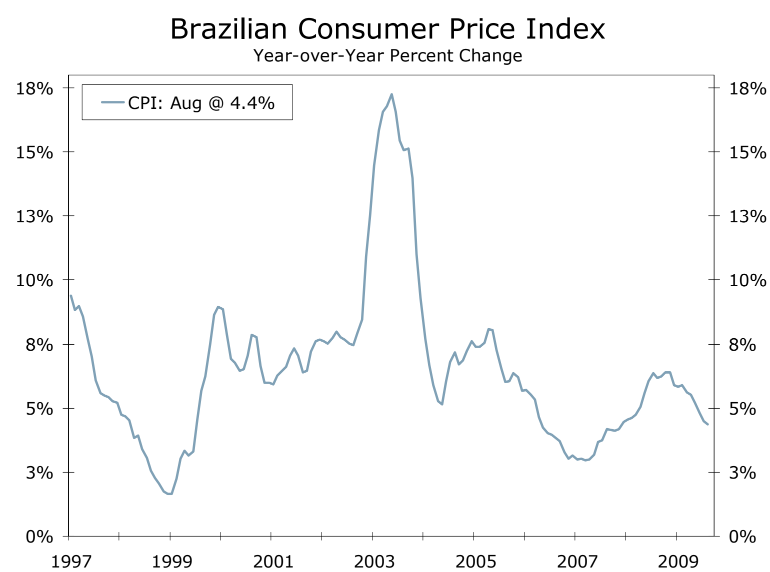
The collapse in external demand pushed the da Silva administration to come up with plan B: rely more on the domestic consumer market until the rest of the world recovers. Thus, the administration went back to the drawing board and designed fiscal programs to increase domestic consumption that seem to have worked reasonably well, at least temporarily. At the same time, the Brazilian central bank took notice and produced an impressive about-face in terms of monetary policy, helped by the collapse in commodity prices. In fact, the central bank increased the benchmark interest rate by 75 basis points, from 13.0 percent to 13.75 percent in September 2008 (just as the crisis was hitting the world economy) and kept it there until December of that year. However, by January, it had recognized the problems in the economy and started to lower interest rates, taking the benchmark Selic rate from 13.75 percent in December 2008 to 8.75 percent today.

All these measures, fiscal and monetary, plus the stabilization of the international markets, have allowed the Brazilian economy to grow by 1.9 percent during the second quarter of the year compared to the first quarter, while dropping by only 1.2 percent compared to the second quarter of last year. Thus, monetary and fiscal policies have done the trick, at least temporarily, as domestic consumption was strong in the second quarter of the year, increasing by 2.1 percent on a quarter-0ver-quarter basis after posting a 0.6 percent growth rate during the first quarter.

With the international market stabilizing and growing again, foreign consumption will start competing with domestic consumption and could start creating problems for prices. This has always been the Brazilian economy's Achilles heel due to lack of infrastructure to support both foreign and domestic consumption, that is, supply constraints. But this problem will probably be something for next year. Right now, inflationary pressures are reassuring, and the central bank will stay put for the time being and probably into early next year.







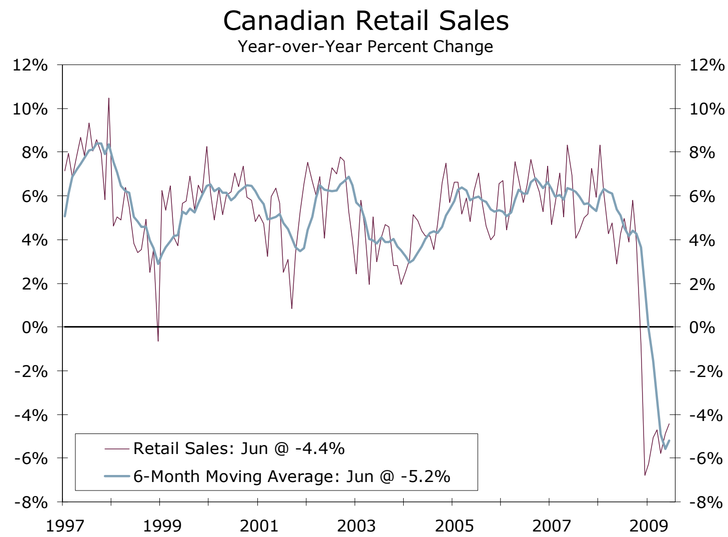
Canadian Retail Sales • Tuesday

On a year-over-year basis, growth in Canadian retail spending has been negative all year. Some of the weakness in overall retail sales reflects the collapse in gasoline prices last year and the sharp downturn in auto sales. However, other forms of retail spending have also weakened as job losses have caused Canadian consumers to become more cautious.

That said, retail spending is starting to grow again on a sequential basis, and the consensus forecast anticipates that overall spending rose 1.0 percent in July due in part to strong auto sales that were driven by Canada's version of cash-for-clunkers. Excluding autos, the consensus forecast expects that retail spending was flat in July. The sharp downturn in retail sales has come to an end, but a strong upturn has not yet taken hold either.

Previous: 1.0% (month-on-month change)

Consensus: 0.5%



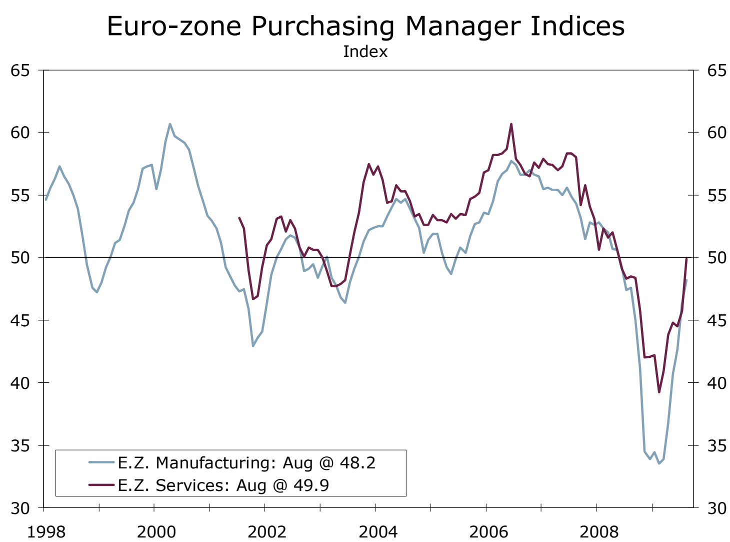
Euro-zone PMIs •Wednesday

Judging by the behavior of the purchasing manager indices, economic activity in the Euro-zone appears to be leveling out after falling sharply late last year and earlier this year. If the consensus forecast is realized, the service sector PMI will rise in September above the demarcation line that separates expansion from contraction, and the manufacturing PMI will approach 50.

Hard data on factory orders in the Euro-zone in July will print on Wednesday as well. Orders increased sharply in June—up 2.5 percent relative to the previous month—and the consensus looks for another marked rise in July. Although industrial production has yet to turn up, the recent rise in orders makes an increase in IP only a matter of time.

Current Manufacturing PMI: 48.2 **Consensus: 49.8**

Current Services PMI: 49.9 **Consensus: 50.4**



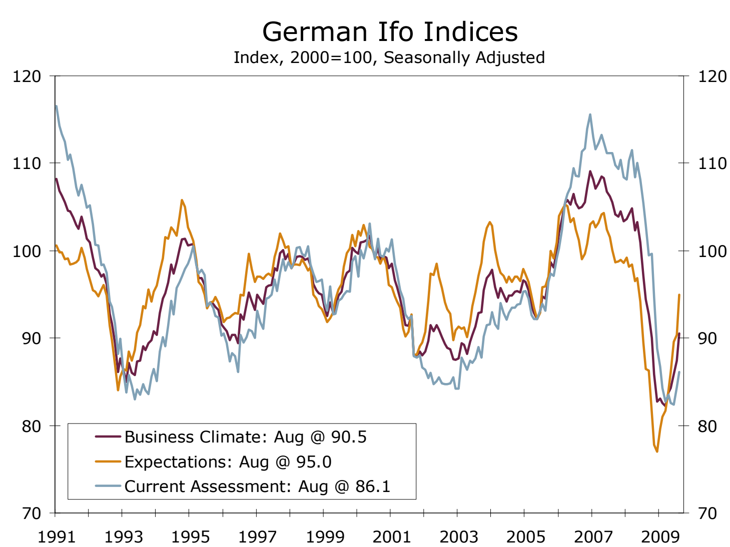
German Ifo Index • Thursday

The Ifo index of German business sentiment is widely followed because it is highly correlated with growth in German industrial production. Since bottoming in March, the index has risen sharply. Although most of the increase has occurred because of the expectations component, the current assessment component is off its lows as well. That is, German businesses report that current business is still quite soft, but they expect it to improve in the future. The consensus forecast looks for a marked increase in the current assessment component in September.

Italy reports retail spending data for July on Friday. Retail sales have been very weak this year. Indeed, sales in June were down nearly one percent relative to the same month last year. However, the consensus looks for a modest increase in retail sales of 0.2 percent in July relative to the previous month.

Previous: 90.5

Consensus: 92.0



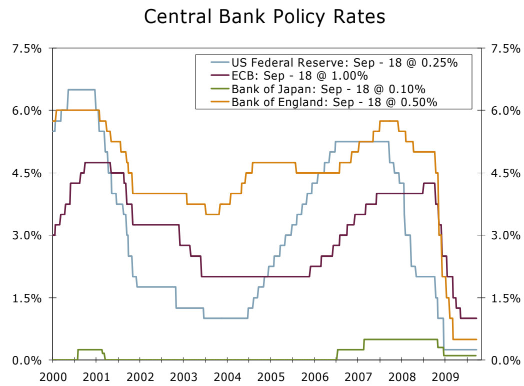
Interest Rate Watch

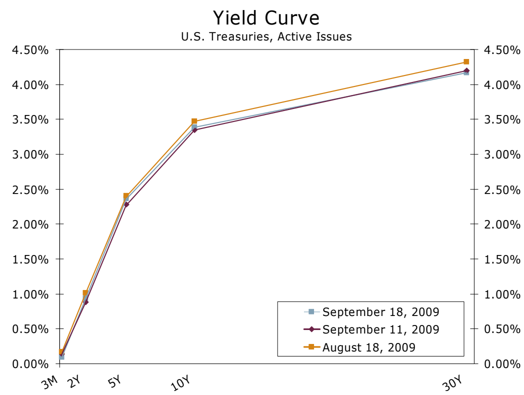
Sure There Is an Exit Strategy—Will They Use It? At What Cost?

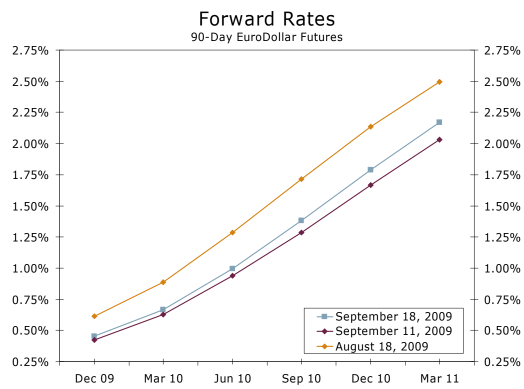
Exit strategies are not free. There are significant costs to executing and not executing the exit strategies that the Fed and the Obama Administration profess that they will implement. For corporate strategy makers these two paths, and their possible combinations, make decision-making difficult for next year—no straight-line projections here. Moreover, we will not have to wait very long to find out how and when these strategies are put into place.

For monetary policy, the Fed has already indicated that it will gradually cease its Treasury security buying. However, with the recent weakness in the dollar, diminished Treasury buying, along with continued Treasury supply due to federal deficits, the trend is likely upward on benchmark Treasury rates. Will that be politically acceptable in a period of subpar economic growth and continued high unemployment? Even more to the political heart of the matter, will the Fed exit its purchases of mortgage–backed securities? Currently, Fed buying is the 800 pound gorilla in the market and reduced buying suggests rising interest rates in a housing market that remains subpar by many political standards—ditto here for asset-backed securities which provide support to other forms of consumer spending.

Fiscal policy is even less likely to be restrained in a midterm election year. The Obama administration must release its budget in February and there is likely to be a sustained period of large budget deficits. The incentives of a subpar economy and perceived domestic spending needs will likely dictate continued spending despite already large deficits. While over the longer run lower deficits are likely to be projected the issues in 2010 will be the combination of reduced Fed buying and continued Treasury issuance in an atmosphere of potentially weaker dollar and rising inflation. While for decision-makers the most likely case is for an effective exit strategy there remains a significant risk that global capital and currency markets will react negatively to any perceived hesitation.







Consumer Credit Insights

Consumer Credit: Secular Change Alters the Cyclical Recovery

Besides housing, nowhere is the pace and character of the recovery more uncertain than it is for consumer credit. What is the future for the many forms of consumer credit and, more to the point, the future of credit to consumers with less-than-stellar credit? Since World War II, credit access has broadened to a wide range of income and wealth strata in our society. Unfortunately, recent experience suggests that credit availability has probably been stretched too far. The issue before us is how much that credit will be limited and what the impact on consumer spending and society in general will be.

Higher rates of consumer saving appear to be certain. However, the transition from easy credit/low saving to tighter credit/higher saving will be anything but easy. We have an infrastructure of retail stores built on the premise of easy credit. Much of retail and construction employment in recent years reflects an easy credit environment. Credit lending and earnings also have been built upon this easy credit world. Moving to less credit also suggests that the decrease in credit availability will be particularly pronounced for middle and lower income groups where credit was often the means of making it between paychecks. How credit is allocated going forward will mean significant differences in the economic outlook for corporate strategists.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	5.04%	5.07%	5.12%	5.78%
15-Yr Fixed	4.47%	4.50%	4.56%	5.35%
5/1 ARM	4.51%	4.51%	4.57%	5.67%
1-Yr ARM	4.58%	4.64%	4.69%	5.03%
MBA Applications				
Composite	592.8	648.3	527.0	661.7
Purchase	272.9	304.1	277.7	380.4
Refinance	2,454.5	2,651.2	1,982.5	2,300.0

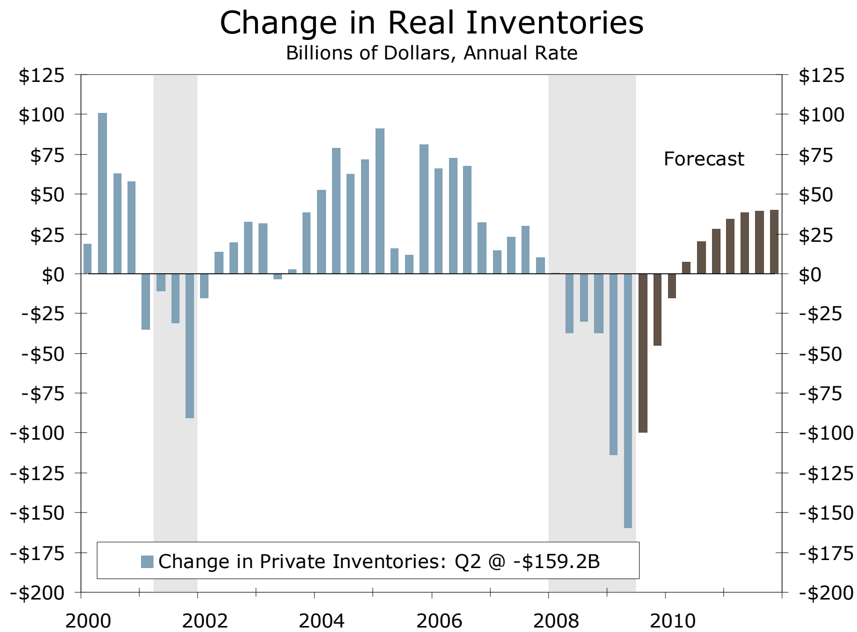
Source: Freddie Mac, Mortgage Bankers Association and Wells Fargo Securities, LLC

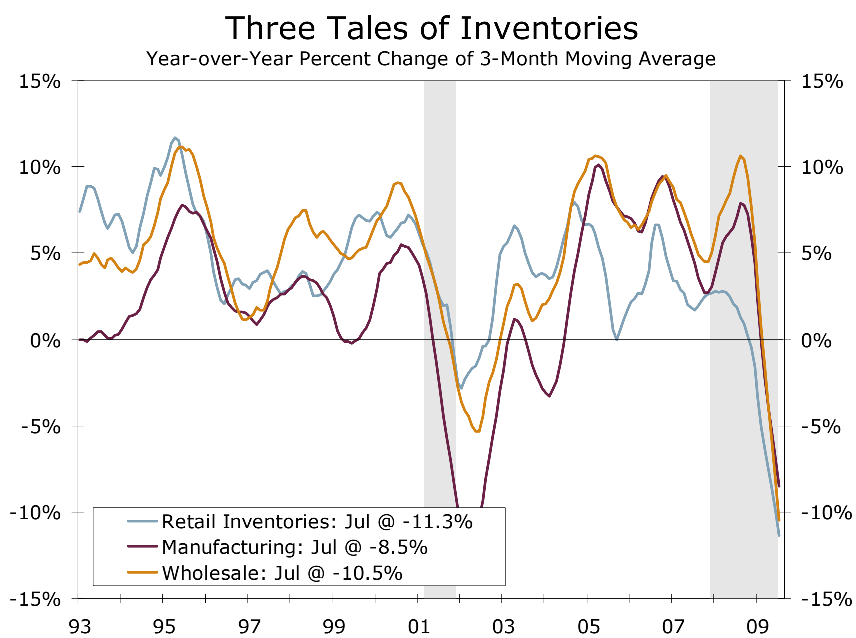
Topic of the Week

Growth Effects of Inventory Investment

The economic forecast that our group released last week looks for the strongest growth number since the first quarter of 2005. However, we do not expect the expansionary environment normally associated with such a strong GDP figure. Instead, as is often the case when emerging from recession, the growth figure relies heavily on a change in inventory investment for support. A 1.8 percentage point contribution to GDP comes from a slowing in the pace of inventory drawdown, from $159.2 billion in Q2 to about $100 billion in Q3. Beyond the effect on the calculation of GDP, leaner inventories are a boon for the economy and set the stage for future growth, allowing other sectors to become supportive of GDP. Low levels of inventory allow manufacturers, wholesalers and retailers to boost new orders, which will support a desperately awaited bounce back in output. Increases in industrial production will add viability to the current recovery, despite starting from very low levels.

Data on the state of inventories and sales in previous months are an early indication of what the actual effect on growth will be in the third quarter. July data showed that sales grew more quickly for wholesalers, more slowly for manufacturers and actually decreased for retailers. Despite the variation in sales, inventories declined at a 1.0 percent pace, relatively slower across all sectors, gradually bringing inventories closer into alignment with the weak demand environment. The pace of the drawdown did not slow as much as expected, meaning that businesses are continuing to work off excess inventory with gusto. If stocks are reduced more quickly over the entire quarter than initially anticipated, then some of the contribution to GDP will be pushed from Q3 to Q4—the inventory swing is a question of when as opposed to if. The only August data we have thus far are on retail sales, which were surprisingly strong, and could foretell further strong inventory reductions when those data are reported in several weeks.





Subscription Info

Wells Fargo's *Weekly Economic & Financial Commentary* is distributed to subscribers each Friday afternoon by e-mail.

To subscribe please visit: www.wachovia.com/economicsemail

The *Weekly Economic & Financial Commentary* is available via the Internet at www.wachovia.com/economics

Via The Bloomberg Professional Service at WFEC.

And for those with permission at www.wellsfargo.com/research

Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 9/18/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.09	0.13	0.07
3-Month LIBOR	0.29	0.30	3.20
1-Year Treasury	0.45	0.30	1.27
2-Year Treasury	0.96	0.90	1.70
5-Year Treasury	2.40	2.30	2.63
10-Year Treasury	3.41	3.35	3.54
30-Year Treasury	4.19	4.18	4.19
Bond Buyer Index	4.20	4.33	5.03

Foreign Exchange Rates

	Friday 9/18/2009	1 Week Ago	1 Year Ago
Euro ($/€)	1.471	1.457	1.435
British Pound ($/£)	1.634	1.666	1.818
British Pound (£/€)	0.900	0.875	0.789
Japanese Yen (¥/$)	91.230	90.710	105.440
Canadian Dollar (C$/$)	1.067	1.077	1.061
Swiss Franc (CHF/$)	1.030	1.038	1.105
Australian Dollar (US$/A$)	0.870	0.863	0.805
Mexican Peso (MXN/$)	13.224	13.337	10.747
Chinese Yuan (CNY/$)	6.828	6.829	6.839
Indian Rupee (INR/$)	48.142	48.485	46.490
Brazilian Real (BRL/$)	1.803	1.831	1.897
U.S. Dollar Index	76.414	76.608	78.019

Foreign Interest Rates

	Friday 9/18/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.71	0.73	5.00
3-Month Sterling LIBOR	0.58	0.63	5.98
3-Month Canadian LIBOR	0.50	0.50	3.78
3-Month Yen LIBOR	0.35	0.36	0.90
2-Year German	1.29	1.20	3.67
2-Year U.K.	0.83	0.88	4.15
2-Year Canadian	1.28	1.20	2.60
2-Year Japanese	0.23	0.22	0.76
10-Year German	3.37	3.24	4.04
10-Year U.K.	3.74	3.61	4.42
10-Year Canadian	3.38	3.32	3.51
10-Year Japanese	1.35	1.31	1.50

Commodity Prices

	Friday 9/18/2009	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	71.96	69.29	97.88
Gold ($/Ounce)	1014.78	1005.20	850.84
Hot-Rolled Steel ($/S.Ton)	555.00	555.00	940.00
Copper (¢/Pound)	283.05	282.75	309.55
Soybeans ($/Bushel)	9.46	9.56	10.67
Natural Gas ($/MMBTU)	3.51	2.96	7.62
Nickel ($/Metric Ton)	17,493	17,160	16,870
CRB Spot Inds.	439.72	453.60	448.66

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	21	22	23	24	25
U.S. Data	**Leading Indicators** July 0.6% August 0.7% (W)		**FOMC Rate Decision** Previous 0.25% Expected 0.25% (W)	**Existing Home Sales** July 5.24M August 5.3M (W)	**Durable Goods Orders** July 5.1% August -0.5% (W) **Durables Ex Transp.** July 1.1% August 0.5% (W) **New Home Sales** July 433K August 440K (W)
Global Data		**Canada** **Retail Sales (MoM)** Previous (Jun) 1.0%	**Euro-zone** **PMI Manufacturing** Previous (Aug) 48.2 **Euro-zone** **PMI Services** Previous (Aug) 49.9	**Germany** **IFO-Business Climate** Previous (Aug) 90.5	

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

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research & Economics	(704) 715-8437 (212) 214-5070	diane.schumaker@wachovia.com
John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wachovia.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wachovia.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wachovia.com
Scott Anderson, Ph.D.	Senior Economist	(612) 667-9281	scott.a.anderson@wellsfargo.com
Eugenio Aleman, Ph.D.	Senior Economist	(612) 667- 0168	eugenio.j.aleman@wellsfargo.com
Sam Bullard	Economist	(704) 383-7372	sam.bullard@wachovia.com
Anika Khan	Economist	(704) 715-0575	anika.khan@wachovia.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wachovia.com
Adam G. York	Economist	(704) 715-9660	adam.york@wachovia.com
Ed Kashmarek	Economist	(612) 667-0479	ed.kashmarek@wellsfargo.com
Tim Quinlan	Economic Analyst	(704) 374-4407	tim.quinlan@wachovia.com
Kim Whelan	Economic Analyst	(704) 715-8457	kim.whelan@wachovia.com
Yasmine Kamaruddin	Economic Analyst	(704) 374-2992	yasmine.kamaruddin@wachovia.com