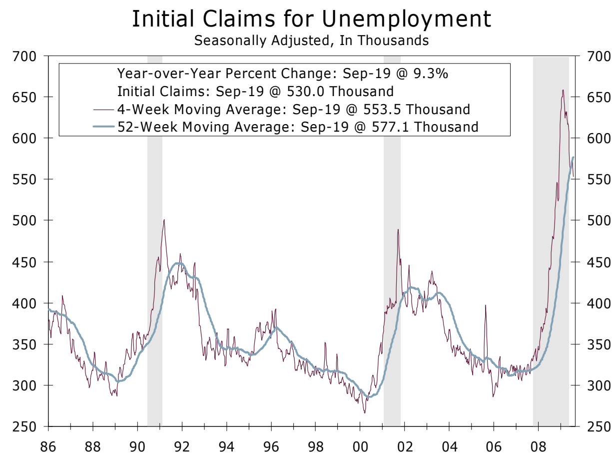
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

A Huge Week for Policy Announcements

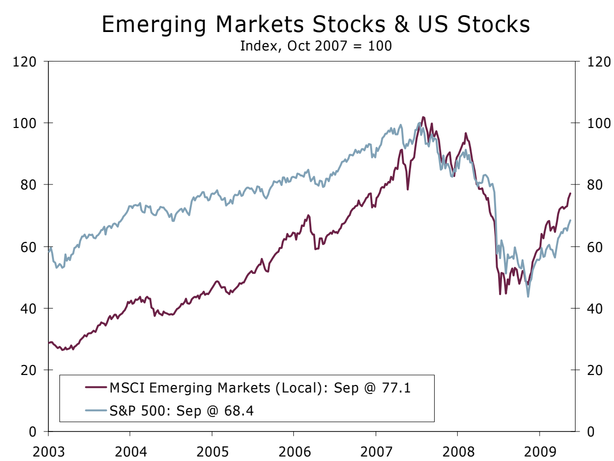
- The U.N. General Assembly, G-20 and FOMC meeting overshadowed this week's economic news. Stimulus efforts remain in place but some programs are approaching expiration and plans were announced for an orderly winding down of the Fed's quantitative easing.
- This week's key economic news included reports on new and existing home sales. New home sales rose 0.7 percent, whereas existing home sales fell 2.7 percent.
- Weekly first-time unemployment claims fell more than expected, dropping 21,000 to 530,000.



Global Review

G-20 Summit: Coordinated Policies Ahead?

- When the leaders of the G-20 countries gathered in London in April, the global economy was in its worst recession in decades. As they met in Pittsburgh this week, a tentative global recovery appears to be taking hold.
- Promises of continued macroeconomic stimulation may be difficult to achieve in practice. Although many advanced economies will probably need accommodative policies for some time, many developing economies will most likely need to withdraw some stimulus in the months ahead to ward off another inflationary outbreak.



Inside

Wells Fargo U.S. Economic Forecast

	Actual 2008 1Q	2Q	3Q	4Q	2009 1Q	2Q	Forecast 3Q	4Q	Actual 2006	2007	2008	Forecast 2009	2010	2011
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

U.S. Review

The Leading Economic Index may Hold Some Key Clues

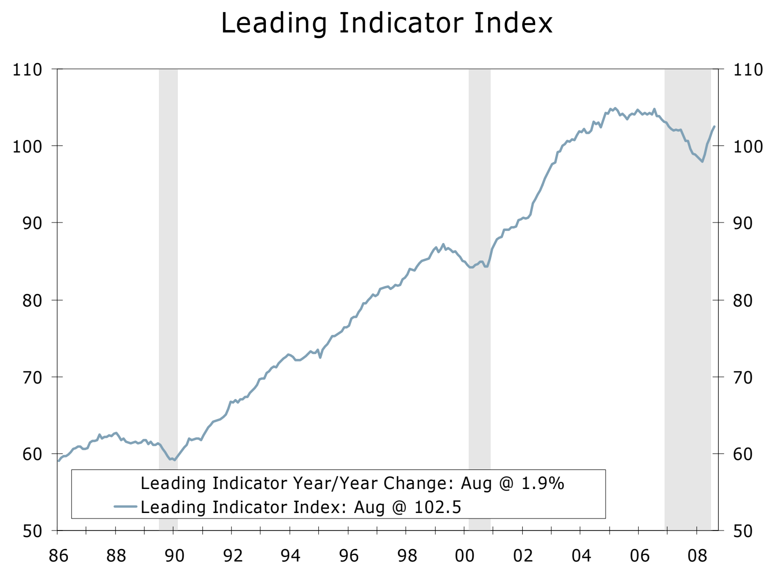
The Leading Economic Index may be giving us some key clues on the answer to the often asked question about what the letter shape of the economic recovery will most closely resemble (V, W, U or L). The LEI fell for 20 consecutive months following its peak in July 2007, which marked its longest downtrend since the deep recession of the early to mid-1970s. The LEI bottomed in March and has risen for five consecutive months. The increase would be consistent with the recession ending this summer. If this proves to be correct, the downtrend in the LEI would be roughly consistent with the length of the recession. Moreover, the LEI would have provided a five-month lead on the start of the recession and four-month lead on the start of the recovery.

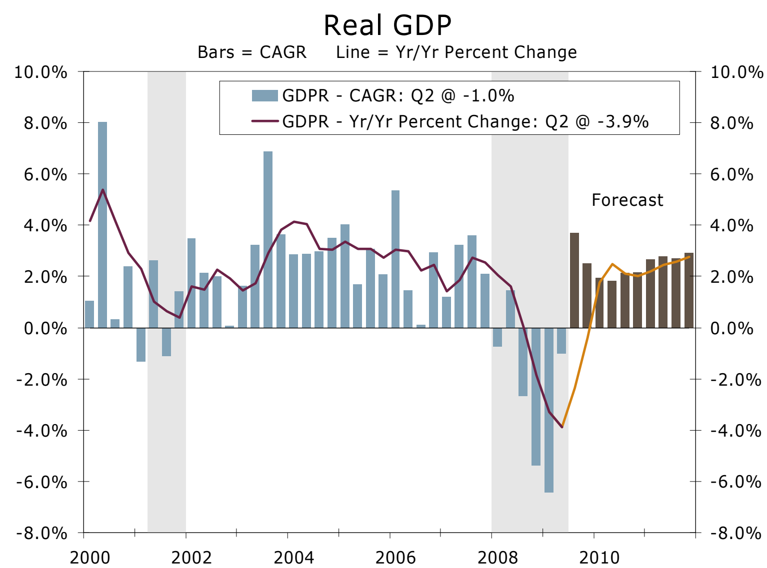
Discussions about the usefulness of the LEI usually focus on its accuracy at predicting turning points in the business cycle. The LEI has given a number of false signals of recessions in the past but has a slightly better record at predicting recoveries. The strength and breadth of the rebound in the LEI may also provide us with some indication about the shape of the recovery. The LEI came storming back in April and May, rising 1.0 percent in April and 1.3 percent in May. Seven of the 10 indicators increased in both months, with the stock market, interest rate spread and consumer expectations leading the way.

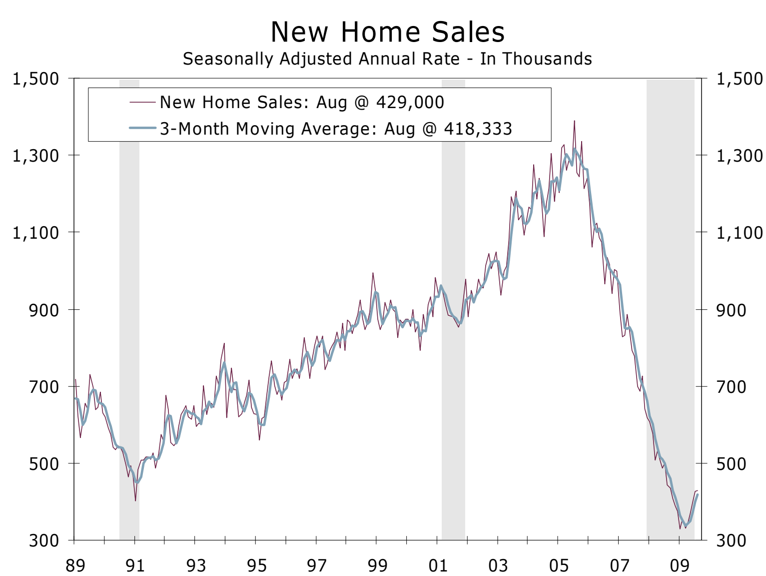
The pace of improvement in the LEI has lessened somewhat in recent months, rising 0.8 percent in June, 0.9 percent in July and 0.6 percent in August. Not only has the pace of improvement slowed but the breadth of improvement has also narrowed. Only six of the 10 components of the LEI rose in August, and much more of this past month's increase came from the financial components, such as the stock market and interest rates spread, rather than the purely economic components, such as the average workweek and factory orders.

The letup in the pace of improvement of the LEI may lend some support to those looking for a W-shaped recovery. After a strong start, growth will likely to settle back down a bit. And that trend will likely be reinforced by the ending and winding down of key stimulus programs like the $8000 tax credit for first-time homebuyers and the Fed's purchases of asset-backed securities and Treasury bonds. Just because we have a W, however, does not mean the second downward leg will result in a decline in GDP. Our current forecast has real GDP rebounding at a 3.7 percent pace this quarter, followed by 2.5 percent growth in the fourth quarter and 2.0 percent growth in the first quarter of next year. The LEI numbers are consistent with this outlook.

Most of this week's other key economic reports were also consistent with at least some modest improvement in the broader economy. Sales of new homes rose 0.7 percent in August, following a downwardly-revised 6.5 percent gain in July. New home sales have risen for five consecutive months and appear to benefitting from the $8000 tax credit for first-time homebuyers. The benefit from that program now appears to be waning. Sales of existing homes fell 2.7 percent in August.





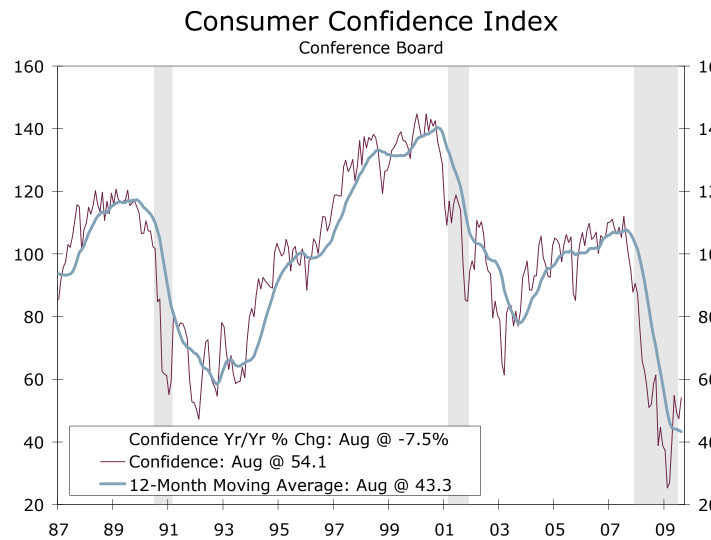


Consumer Confidence • Tuesday

Consumer confidence rose 6.7 points to 54.1 in August, marking the first rise since May. Most of the improvement was in expectations which rose to the highest level since the financial crisis intensified last fall. With various economic indicators suggesting the economy is in recovery and the recent gains in the stock market, we expect consumer confidence will likely rise for the second consecutive month, once again led by expectations. Consumers' assessment of current economic conditions, however, remains near cycle lows. Consumers' ongoing concerns about current conditions reflect their worries about the labor market. Layoffs appear to have topped out but hiring has not yet begun to improve. During the past two recoveries, the current conditions component did not improve significantly until nonfarm employment began to increase. This means consumer confidence and spending will likely remain constrained well into early 2010, making for another difficult holiday shopping season.

Previous: 54.1 **Wells Fargo: 55.5**

Consensus: 57.0

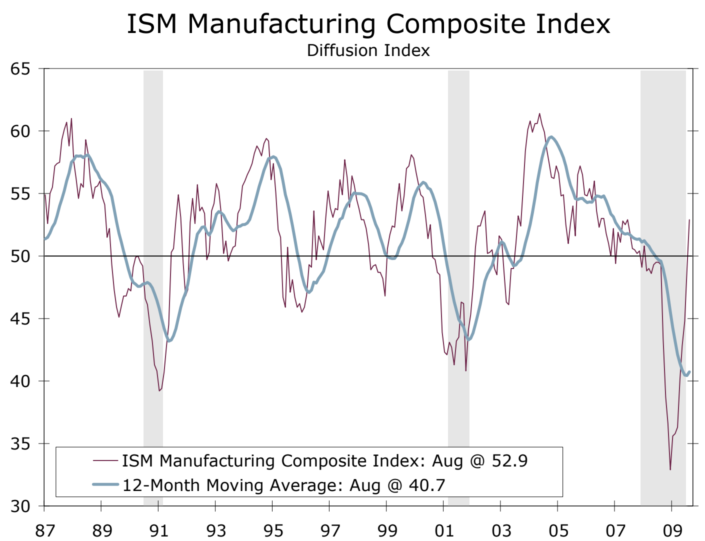


ISM Manufacturing • Thursday

The Institute for Supply Management's headline manufacturing index rose for the eighth consecutive month in August, reaching 52.9 which is consistent with expansion in the manufacturing sector. The consecutive gains and level of the headline number are consistent with an economy in recovery. The forward-looking new orders index has risen five out of six months and has increased in 13 industries suggesting broad based stabilization in orders. With inventory levels still lean, the spread between the new orders and the inventories indices is the widest since August 1975 and suggests further gains in production are likely to meet consumer demand. Prices paid, however, rose for the sixth consecutive month due to gains in metals like steel, aluminum and copper. Forward contracts for these metals remained elevated in September suggesting some continued price pressure for businesses.

Previous: 52.9 **Wells Fargo: 54.5**

Consensus: 54.0

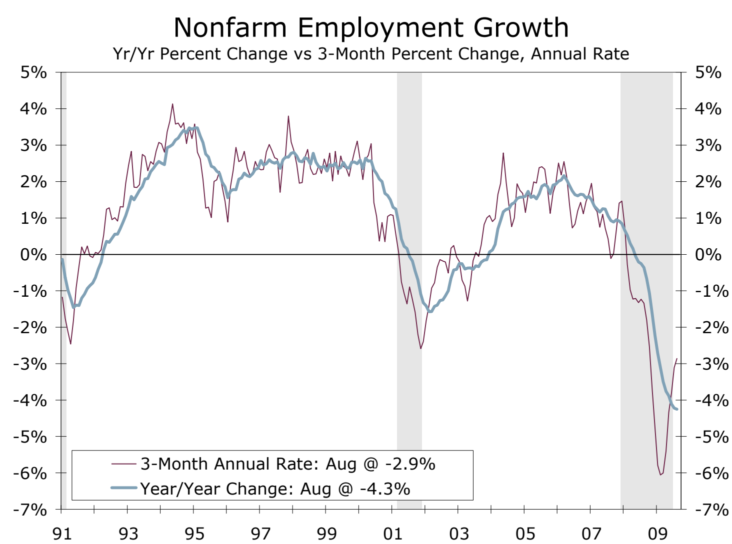


Employment • Friday

Nonfarm employment fell by 216,000 jobs in August, producing a net loss of 6.9 million jobs since the recession began. The pace of declines has moderated significantly with job losses peaking in the first quarter of 2009 at around 691,000. Employment losses continue to be exceptionally broad based with the biggest declines still in manufacturing and construction. The four-week moving average for initial jobless claims fell for the third consecutive week, suggesting further moderation in job losses in September. While seasonal distortions and exhaustion of benefits may still be at play, the trajectory remains downward. We expect nonfarm employment likely dropped by 205,000 jobs with the unemployment rate reaching 9.8 percent in August. Nonfarm employment will likely continue to decline into early 2010 and the unemployment rate will not likely top out until early to the middle of next year.

Previous: -216,000 **Wells Fargo: -205,000**

Consensus: -189,000



Global Review

What a Difference Five Months Make

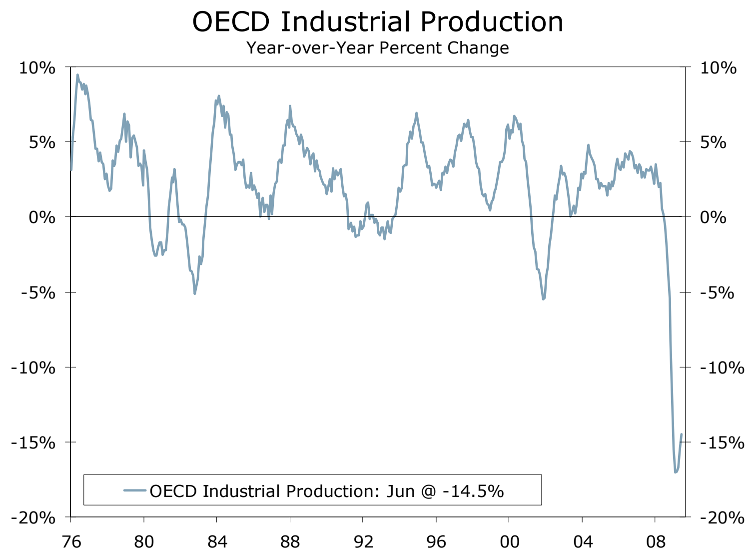
When the leaders of the G-20 countries gathered in London in early April, the global economy was in the midst of its worst recession in decades. As they met in Pittsburgh this week, the outlook had certainly improved. Stock markets worldwide have rallied since their March lows as signs of global recovery have become more widespread (see graph on front page).

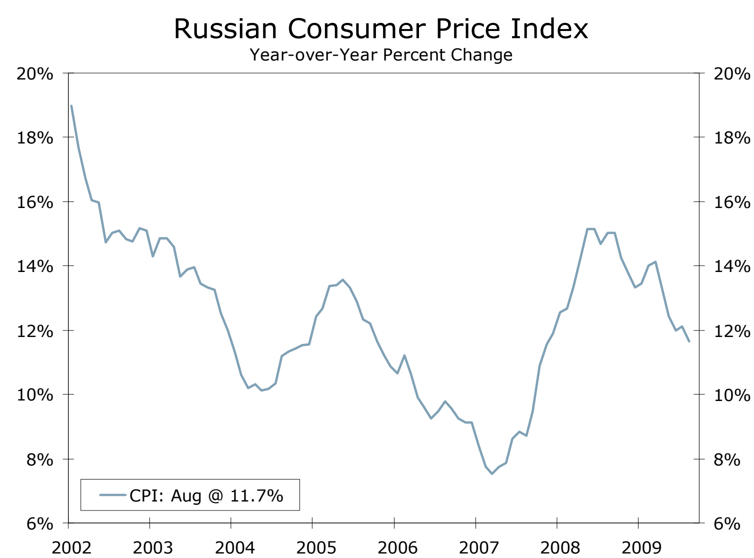
Should credit for the incipient global recovery go to the summit meeting held in London in April? Probably not. Most G-20 countries implemented expansionary monetary and fiscal policies late last year and early this year, and these policies have helped to stabilize the global economy. In that regard, the leaders deserve credit for the policies their countries undertook individually. However, the decisions that the G-20 leaders made as a group in London in early April likely have had little effect, at least so far, on the global economy.

President Obama, who hosted the summit meeting this week, was keen to get his counterparts to agree not to withdraw macroeconomic stimulus until a global recovery is truly self-sustaining. Although the communiqué, which had not yet been released as of this writing, likely will make some reference to ensuring recovery, it will be interesting to see what individual countries do in the months ahead. Now that priorities may be starting to diverge, continued coordination may be more difficult to achieve.

Consider the OECD countries, the 30 most advanced economies in the world. Although industrial production has come up off the bottom, the upturn so far has been rather muted (see top chart). Many of these countries went on a credit binge during the past few years, and growth in the quarters ahead will likely prove to be frustratingly slow as banks and consumers in these countries continue to delever. For them, continued macroeconomic stimulus is probably necessary. On the other hand, many developing economies are well on their way to self-sustaining economic recoveries. For example, Chinese industrial production growth has trended higher since the beginning of the year (middle chart). Most developing economies outside of Eastern Europe were not overly leveraged coming into the crisis, and they have been able to recover fairly quickly. For them, it is not as readily apparent that continued stimulus is needed.

CPI inflation rates in most developing economies have declined in recent months, but deflation is generally not much of a concern in the developing world at present (see Russian CPI in bottom chart). As economic growth strengthens, inflationary pressures may start to rise again in many emerging economies. Indeed, we project that CPI inflation rates in most of the developing countries that we follow will pick up somewhat over the course of the next year or so. Will these governments really want to continue stimulating their economies if inflation is becoming a problem again? When inflation starts to rise, will governments of developing countries stand by the promises made in Pittsburgh or will they start to tighten policies? Our bet would be that they follow the latter course of action.





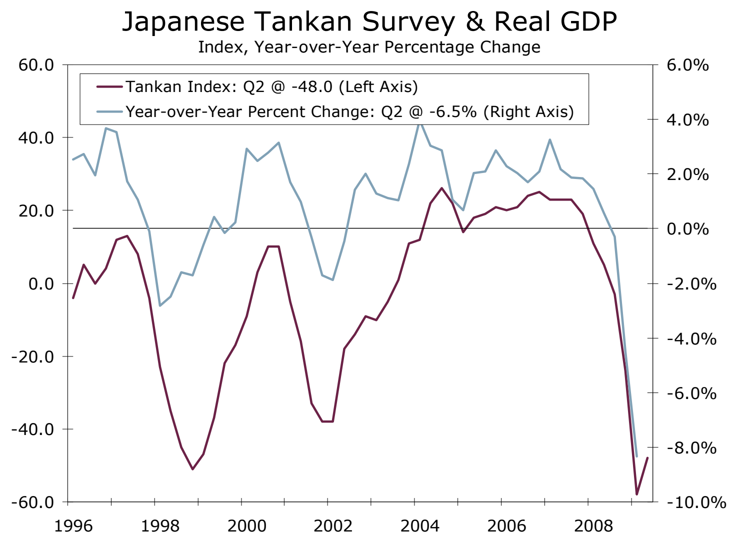
Japanese Tankan Index • Wednesday

The quarterly Tankan index of Japanese business sentiment, which is highly correlated with real GDP growth in Japan, plunged earlier this year to its lowest level on record. At the time, the Japanese economy was in its deepest recession since the end of World War II. However, the Tankan index improved somewhat in July, which is consistent with positive growth, at least on a sequential basis, that the Japanese economy achieved during the second quarter. The consensus forecast anticipates a sizeable rise in the index when the data are released on Thursday.

Other data releases on the docket next week, including consumer prices (Tuesday) industrial production (Wednesday) and retail sales (Thursday) will give investors further insights into the current state of the Japanese economy.

Previous: -48.0

Consensus: -34.0

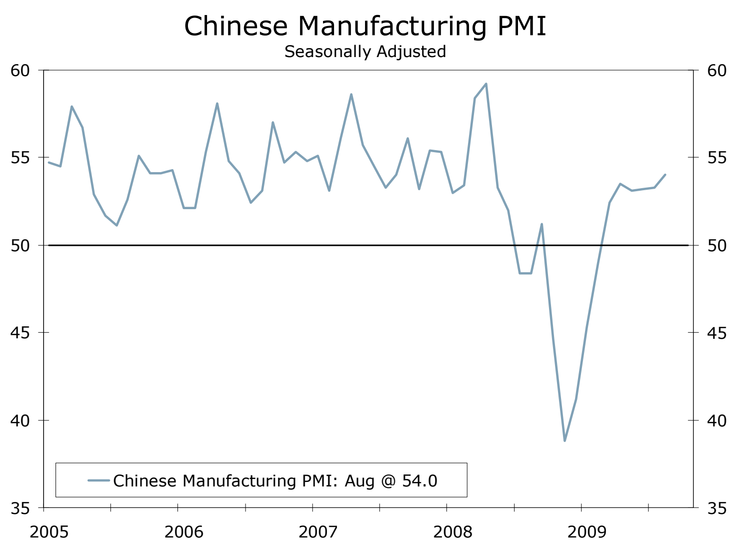


Chinese Manufacturing PMI • Thursday

Manufacturing activity in China tanked late last year as global trade collapsed, but the recent rebound in trade has contributed to the rise in industrial production since the beginning of the year. In addition, the stimulus that the Chinese government has applied to the economy this year is also helping the economy. The manufacturing PMI has risen in eight out of the last nine months, and most market participants look for another increase when the September number prints on Thursday. Even if the number is not as strong as the consensus forecast anticipates, the year-over-year growth rate of overall GDP likely will rise in the third quarter from the 7.9 percent rate that was registered in the second quarter.

Previous: 54.0

Consensus: 54.8



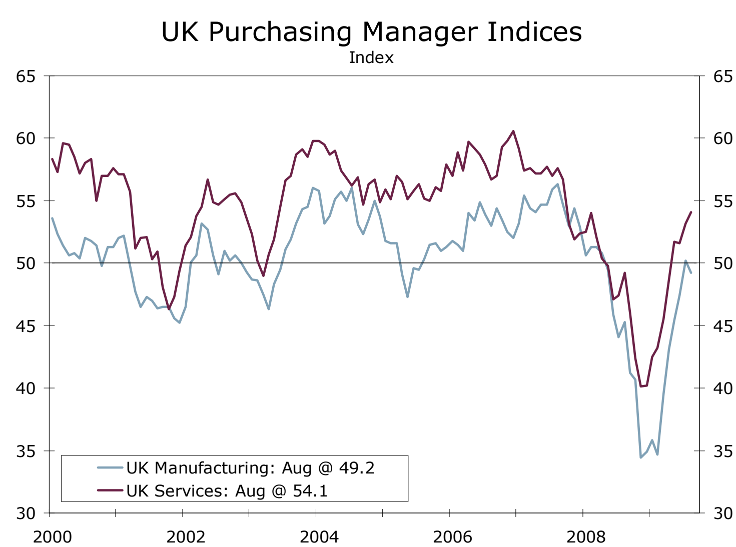
British Manufacturing PMI • Thursday

The U.K. manufacturing PMI plunged late last year/early this year to its lowest level since records began. However, the index has been trending higher since spring, and the consensus forecast looks for it to return above the demarcation line that separates expansion from contraction in September.

There is also a slew of housing market data on the docket next week. Mortgage approvals have trended higher since last November, and most market participants expect that the trend continued in August. House prices have also risen over the past few months, and the consensus forecast looks for another increase when the Nationwide House Price Index for September prints next week. Consumer confidence data are also slated for release on Tuesday.

Previous: 49.7

Consensus: 50.3



Interest Rate Watch

FOMC: Setting Up for the Exit

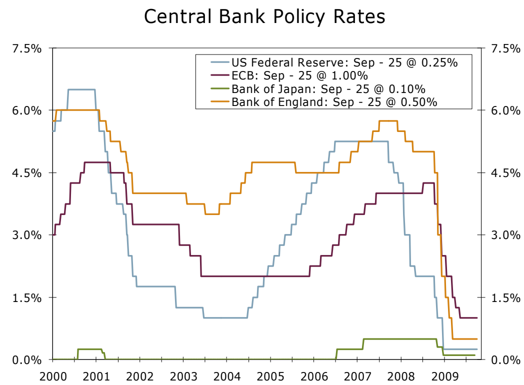
The press release for this week's Federal Open Market Committee (FOMC) meeting suggested that the FOMC "continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period of time," and yet also will complete its purchases of Treasuries by the end of October. This would suggest that the yield curve will be biased towards steepening as reduced Fed buying and continued Treasury issuance will raise interest rates—particularly given recent weakness in the dollar. Moreover, the FOMC sees "that economic activity has picked up" and this should reduce the flight-to-safety trade. Another factor favoring a steeper yield curve.

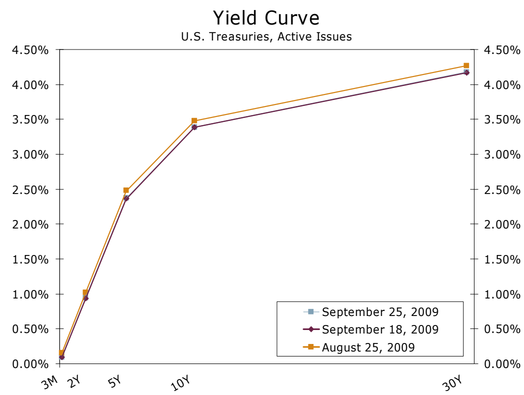
Our outlook remains for an unchanged federal funds rate through mid-2010 and we believe the FOMC statement is consistent with that. In addition, we have a modest rise in the benchmark 10-year Treasury rate and, again, believe the FOMC's policy guidance is also consistent with that outlook.

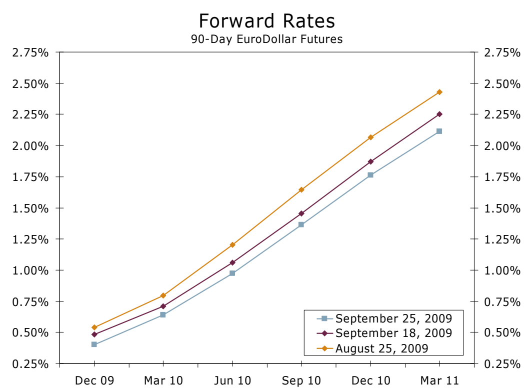
What Are the Risks?

Three risks, each of such cunning device, to the interest outlook are the dollar, the fiscal policy exit strategy and the interplay of domestic policy and global investors. Dollar weakness in recent weeks has brought currency risk into the outlook for rates. As we have seen in many other countries, currency depreciation, and more specifically, expected currency depreciation, can lead to rapid interest rate increases in countries that run large fiscal deficits that are externally financed to a significant extent, such as the U.S. That brings us to our fiscal exit strategy. By February, the current administration will present its annual budget projections for the years ahead and the bond and currency markets will vote on the reasonableness of these budget numbers. Global investors will also have their say and, we suspect the Chinese will lead the chorus.

For investors the risks remain, in our view, on the upside for interest rates as the dollar weakness may be reinforced with investor disappointment with the fiscal exit strategy. Without inflation, soaring interest rates are not likely but rising rates are.







Consumer Credit Insights

FOMC Withdrawal From MBS

Even while the economy begins to show signs of recovery, the financial markets will begin to discover the true price of consumer credit especially in the mortgage market. For some time, the Federal Reserve has been injecting liquidity into the market and thereby keeping interest rates on Treasury and mortgage-backed securities below what they would be otherwise. This week the FOMC indicated that the desk at the New York Fed would gradually begin to reduce its purchases of agency mortgage-backed securities to "promote a smooth transition in markets."

While such a strategy objective is admirable, we need to be careful that private market interest rates may not react as smoothly as the best laid plans of men. Moreover, higher mortgage rates, whatever their magnitude, may engender a slowdown in home sales and that, in turn, could raise political concerns.

The interplay of public policy and private markets, with the overlay of politics, may generate market prices that would be out of the expected path of precise policy models. In an environment with job losses and weak income gains, there is not much cushion for the average consumer to absorb higher interest rates. As a benchmark rate, Treasury rates may also rise in the face of reduced Fed purchases and continued federal bond issuance and thereby give rise to higher consumer rates across the board.

Our outlook remains for subpar consumer spending, especially on durable goods, as the real interest rate on credit is still extremely high in the face of very low inflation. Exits are never easy.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	5.04%	5.04%	5.14%	6.09%
15-Yr Fixed	4.46%	4.47%	4.58%	5.77%
5/1 ARM	4.51%	4.51%	4.67%	6.02%
1-Yr ARM	4.52%	4.58%	4.69%	5.16%
MBA Applications				
Composite	668.5	592.8	566.4	591.4
Purchase	288.3	272.9	280.4	342.2
Refinance	2,881.5	2,454.5	2,233.5	2,043.4

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

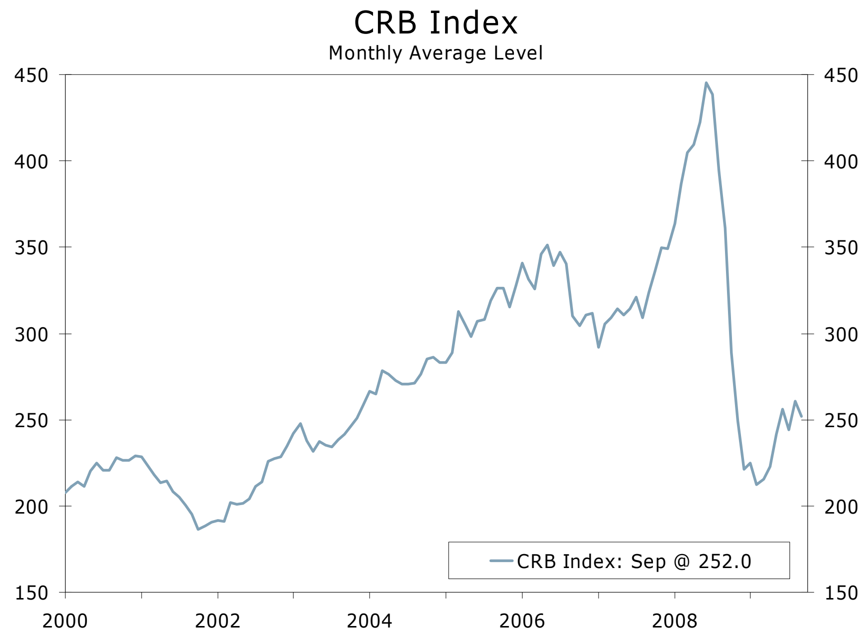
Topic of the Week

Commodity Markets Reflect Global Recovery

The CRB index, a widely followed index of commodity futures prices, has experienced dramatic swings over the past 18 months that somewhat echo the swooning of the global economy during the same period. Oil and other commodities hit their peak in July 2008, when the global economy was humming. By the dark days of March 2009 when economic activity around the world seemed to be falling off a cliff, the CRB index bottomed. From peak to trough the decline was 57.7 percent.

As discussed in the global review section of this report, the prospects for a global recovery have brightened considerably in recent months. Since early March, the CRB index has climbed more than 25 percent, and on a year-to-date (YTD) basis, the index has climbed nearly 10 percent.

While the CRB index has swung quite a bit over the period, the prices of some individual commodities have experienced an even wilder ride. Industrial production in developing economies such as that of China has picked up steam in recent months. The faster pace of recovery in the world's developing economies is part of what is driving price increases for many hard commodities like copper, nickel and silver, all of which are up more than 40 percent YTD. Not all of the price changes in commodities are attributable to a recovering global economy. Sugar, for example, has spiked more than 80 percent YTD. However, the sugar high has more to do with a drought in India and the heaviest rain season in 20 years in Brazil (the world's largest sugar producer). The rainfall postpones harvesting and diminishes yields. Corn prices soared in 2008 based on the speculation for a massive increase in demand for ethanol. That demand never quite materialized as the price of gasoline came back down to earth. Since that time, the price of corn has been halved and other agricultural commodities that soared in 2008 like corn, wheat and lean hogs are down more than 16 percent YTD. These declines offset the recovery-driven gains in hard commodities.



Performance of CRB Components

	Year to Date
Copper	95.8%
Sugar	82.8%
Gasoline	60.7%
Nickel	46.5%
Crude Oil	48.0%
Silver	42.3%
Orange Juice	32.6%
Cotton	30.4%
Aluminium	20.0%
Heating Oil	19.4%
Coffee	14.0%
Cocoa	15.7%
Gold	11.9%
Live Cattle	1.9%
Soybeans	-4.8%
Corn	-17.9%
Wheat	-17.9%
Lean Hogs	-17.9%
Natural Gas	-29.3%
CRB Index	**9.0%**

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 9/25/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.09	0.08	0.75
3-Month LIBOR	0.28	0.29	3.77
1-Year Treasury	0.44	0.45	1.58
2-Year Treasury	0.98	0.99	2.16
5-Year Treasury	2.41	2.45	3.04
10-Year Treasury	3.39	3.46	3.85
30-Year Treasury	4.17	4.22	4.41
Bond Buyer Index	4.04	4.20	5.23

Foreign Exchange Rates

	Friday 9/25/2009	1 Week Ago	1 Year Ago
Euro ($/€)	1.470	1.471	1.461
British Pound ($/£)	1.598	1.627	1.837
British Pound (£/€)	0.919	0.904	0.795
Japanese Yen (¥/$)	90.128	91.291	106.560
Canadian Dollar (C$/$)	1.091	1.069	1.035
Swiss Franc (CHF/$)	1.028	1.030	1.091
Australian Dollar (US$/A$)	0.865	0.867	0.835
Mexican Peso (MXN/$)	13.496	13.276	10.713
Chinese Yuan (CNY/$)	6.829	6.828	6.817
Indian Rupee (INR/$)	47.986	48.142	46.205
Brazilian Real (BRL/$)	1.796	1.808	1.821
U.S. Dollar Index	76.654	76.425	76.994

Foreign Interest Rates

	Friday 9/25/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.70	0.71	5.11
3-Month Sterling LIBOR	0.55	0.58	6.28
3-Month Canadian LIBOR	0.50	0.50	4.10
3-Month Yen LIBOR	0.35	0.35	0.92
2-Year German	1.23	1.29	3.85
2-Year U.K.	0.75	0.84	4.34
2-Year Canadian	1.29	1.29	2.88
2-Year Japanese	0.22	0.22	0.81
10-Year German	3.28	3.38	4.23
10-Year U.K.	3.64	3.74	4.62
10-Year Canadian	3.40	3.40	3.69
10-Year Japanese	1.32	1.32	1.49

Commodity Prices

	Friday 9/25/2009	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	66.41	72.04	108.02
Gold ($/Ounce)	990.65	1007.60	877.90
Hot-Rolled Steel ($/S.Ton)	555.00	555.00	940.00
Copper (¢/Pound)	269.75	277.10	314.55
Soybeans ($/Bushel)	9.12	9.46	11.20
Natural Gas ($/MMBTU)	3.91	3.78	7.72
Nickel ($/Metric Ton)	17,011	17,493	16,993
CRB Spot Inds.	432.85	439.72	448.35

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	28	29	30	1	2
U.S. Data		**Consumer Confidence** August 54.1 September 55.5 (W)	**GDP** 2Q (P) -1.0% 2Q (F) -1.1% (W)	**Personal Income** July 0.0% August 0.5% (W) **Personal Spending** July 0.2% August 0.8% (W) **ISM Manufacturing** August 52.9 September 54.5 (W)	**Nonfarm Payrolls** August -216K September -205K (W) **Unemployment Rate** August 9.7% September 9.8% (W) **Factory Orders** July 1.3% August -1.0% (W)
Global Data		**Japan** **CPI (YoY)** Previous (Jul) -2.2%	**Japan** **Indus. Prod. (MoM)** Previous (Jul) 2.1% **Canada** **GDP (MoM)** Previous (Jun) 0.1%	**Japan** **Lge Manufrs. Index** Previous (2Q) -48 **China** **PMI Manufacturing** Previous (Aug) 54.0	

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

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