January 28, 2011

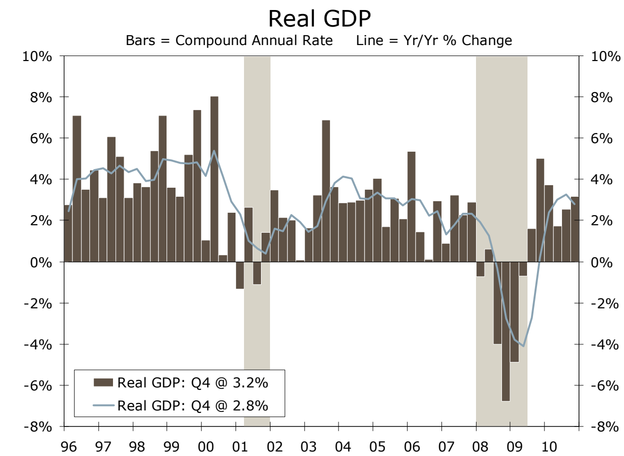
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Headline Real GDP Comes in Weaker than Expected

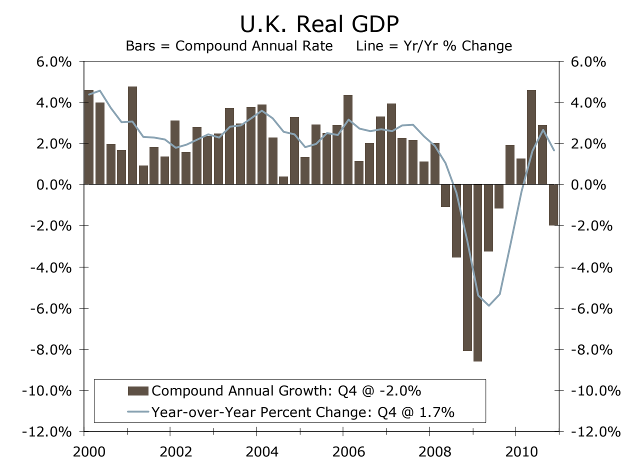
- Real GDP grew at a 3.2 percent annual pace in the fourth quarter, which was weaker than expected. The increase in output, however, pushed the level of GDP to $13.38 trillion slightly surpassing the peak of $13.36 trillion reached in late 2007. The disappointing headline figure was lowered by a significant pullback in inventories, which carved an eye-popping 3.7 percentage points off real GDP. Real final sales jumped 7.1 percent.
- Consumer confidence rose 7.3 points in January to 60.6, the fourth increase in five months and the highest level since May 2010.



Global Review

Big Miss on Q4 GDP Raises Doubts about U.K. Recovery

- Following four consecutive quarters of expansion, the U.K. economy contracted at a 2.0 percent annualized pace in the final quarter of 2010. The miss took markets by surprise and raises questions about the sustainability of the recovery in the United Kingdom.
- Minutes from the most recent Bank of England (BoE) meeting were also released this week. After keeping rates unchanged despite 12 consecutive months of inflation readings north of 3 percent, there appears to be growing dissent about the decision to leave rates unchanged. The ugly GDP print may buy the BoE some time.



Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual		Forecast		
	2010				2011				2008	2009	2010	2011	2012
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product [1]	3.7	1.7	2.6	3.2	3.9	3.8	3.6	2.8	0.0	-2.6	2.9	3.3	3.1
Personal Consumption	1.9	2.2	2.4	4.4	2.3	2.0	2.3	2.8	-0.3	-1.2	1.8	2.7	2.4
Inflation Indicators [2]													
"Core" PCE Deflator	1.8	1.5	1.2	0.8	0.8	0.8	1.0	1.3	2.3	1.5	1.3	1.0	1.6
Consumer Price Index	2.4	1.8	1.2	1.2	1.6	2.3	2.4	2.3	3.8	-0.3	1.6	2.2	2.5
Industrial Production [1]	7.1	7.2	6.5	2.4	5.1	3.7	3.7	3.7	-3.3	-9.3	5.7	4.4	4.2
Corporate Profits Before Taxes [2]	37.6	37.0	26.4	12.5	8.2	6.2	6.2	6.7	-16.4	-0.4	27.5	6.8	7.0
Trade Weighted Dollar Index [3]	76.1	78.8	73.6	73.2	72.5	73.0	74.0	75.0	74.3	77.7	75.6	73.6	78.0
Unemployment Rate	9.7	9.6	9.6	9.6	9.6	9.4	9.3	9.2	5.8	9.3	9.6	9.4	9.0
Housing Starts [4]	0.62	0.60	0.59	0.54	0.56	0.61	0.66	0.71	0.90	0.55	0.59	0.64	0.83
Quarter-End Interest Rates [5]													
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	1.88	0.25	0.25	0.25	0.50
Conventional Mortgage Rate	4.97	4.74	4.35	4.71	5.00	5.10	5.20	5.20	6.04	5.04	4.69	5.13	5.60
10 Year Note	3.84	2.97	2.53	3.30	3.40	3.50	3.60	3.70	3.66	3.26	3.22	3.55	4.08

Forecast as of: January 28, 2011

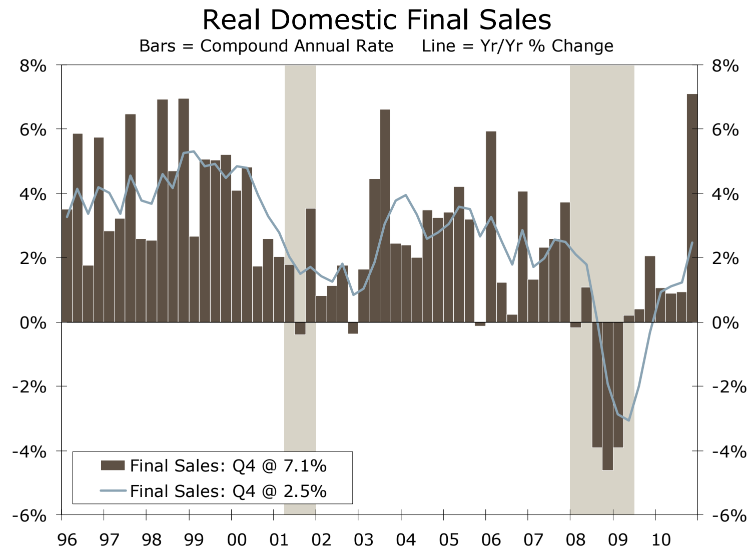
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change
[3] Federal Reserve Major Currency Index, 1973=100 - Quarter End
[4] Millions of Units
[5] Annual Numbers Represent Averages

Inside

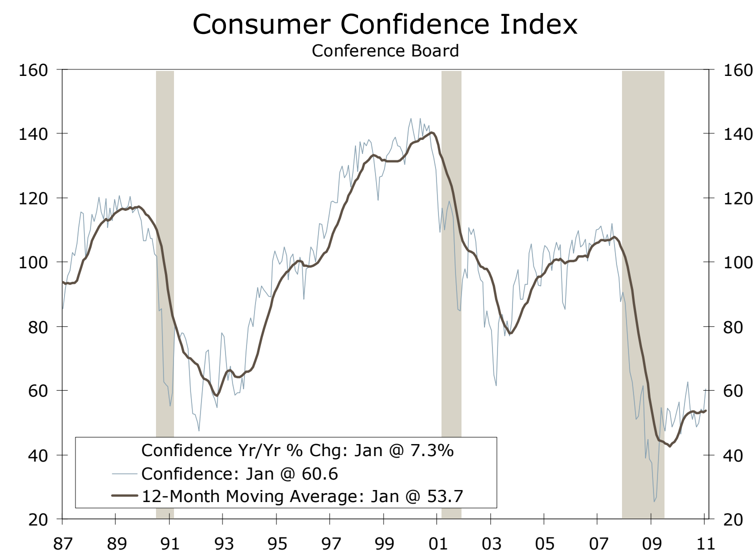
U.S. Review

The Stage Is Set for an Economic Expansion

Real GDP grew at a 3.2 percent annual pace in the fourth quarter, which pushed the level of output to $13.38 trillion, slightly surpassing the peak of $13.36 trillion reached in late 2007. While the headline was weaker than expected, the devil is in the details. The disappointing headline figure was depressed by a significant pullback in inventories, which shaved an eye-popping 3.7 percentage points off real GDP. Inventories are typically a wild card in forecasting and are notorious for delivering surprises. In contrast, consumer spending surged 4.4 percent, the strongest annualized rate of growth in nearly five years. Net exports also increased with exports far outpacing imports, which contributed another 3.44 percentage points to economic output. While headline real GDP and its underlying components are sending somewhat mixed messages, the true strength in the economy can be found in real final sales, which jumped by 7.1 percent.

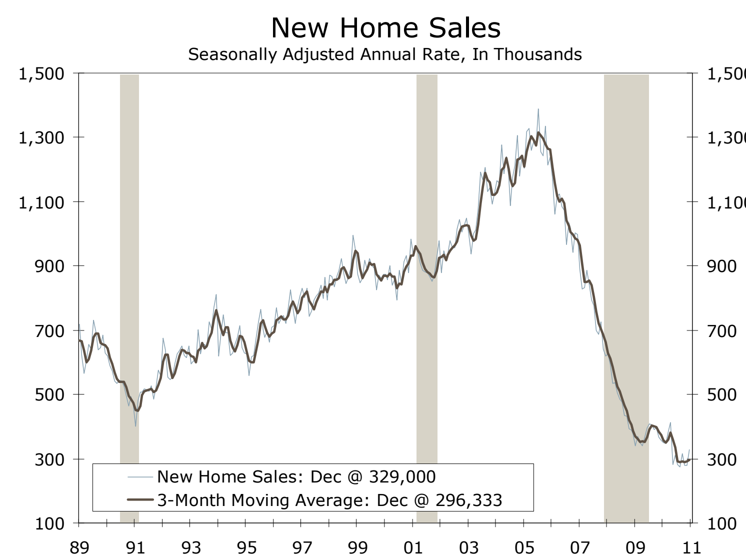


Consumers clearly sense the economy is improving. Consumer confidence rose 7.3 points in January to 60.6, the fourth increase in five months and the highest level since May 2010. All of the key components of the survey improved during the month, including the categories relating to the labor market. While confidence has increased, consumers remain guarded. The absolute level of consumer confidence remains exceptionally low. Moreover, consumers' assessment of current economic conditions is only marginally higher today at 31.0 than it was two years ago when it posted a 29.7 reading. The low level of confidence likely reflects the persistently high unemployment which has remained above 9.0 percent for the past 20 months.



While we expect to see a pick up in private sector job growth in 2011, it will still not be sufficient enough to bring the unemployment rate down significantly. In fact, the latest snapshot of the labor market posted a disappointing increase for the week ended Jan. 22 with claims rising by 51,000, to 454,000. The closely watched four-week moving average and continuing claims also increased. While the U.S. Labor Department noted distortions due to weather, even excluding these factors, the elevated level still does not suggest a significant pick up in employment.

New home sales were also released this week. Sales rose 17.5 percent in December but also continue to rise from historically low levels. While the gain in new home sales is promising, builder sentiment has been essentially unchanged over the past four months, suggesting little to no change in the coming months. Builders remain reluctant to increase inventories as they continue to face tough competition from foreclosures, which limit price flexibility. Moreover, credit conditions remain tight, also likely curtailing applications. Recently released data on mortgage applications provided a sobering reminder of the weak housing sector. Mortgage applications for purchase fell 8.7 percent, the fourth consecutive weekly drop. Declines in mortgage applications suggest housing activity will likely remain weak until the backlog of foreclosures and short sales is cleared.

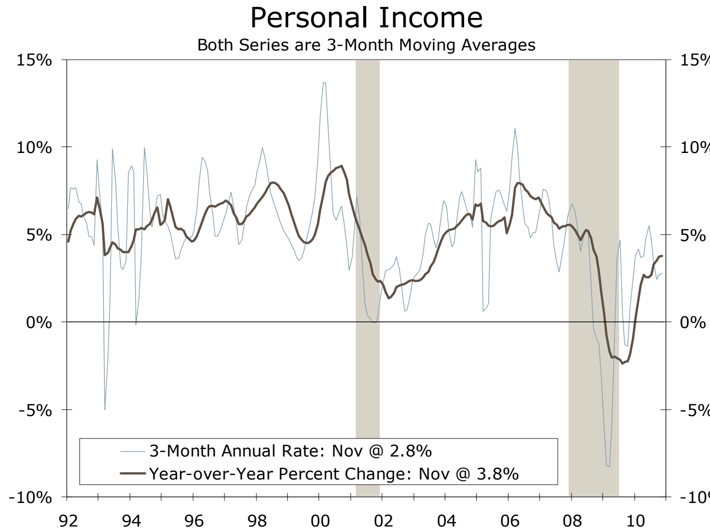


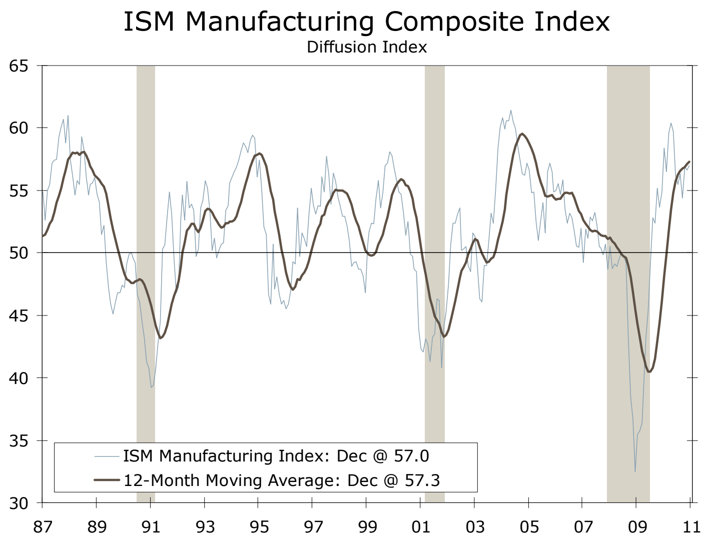
Personal Income • Monday

November personal income rose 0.3 percent; the slight upward trend in personal income was due to some marginal improvement in the labor market. Interestingly, the saving rate continued to decline in November, suggesting that consumer spending likely picked up in the last few months of 2010. Wages and salaries in the service sector continued to increase, while goods-producing and manufacturing payrolls continued to decline. We anticipate that December's personal income likely remained unchanged at 0.3 percent due to slower job growth toward the end of the year. Our 2011 forecast indicates a year-over-year 8.2 percent increase in nominal personal income, boosted in large part by the two percent reduction in Social Security taxes from the tax compromise passed last month.

Previous: 0.3% **Wells Fargo: 0.3%**

Consensus: 0.4%





ISM Manufacturing Index • Tuesday

The December ISM manufacturing index at 57.0 continued to indicate growth in the manufacturing sector. Several components of the index improved last month, including production, new orders and order backlogs. The prices paid component rose to 72.5, indicating some upward price pressure on raw materials due to the recent rise in commodity prices. Eleven of the 18 manufacturing industries reported growth in December. Consistent with our view for continued economic growth through equipment and software spending, gains were observed in fabricated metals along with machinery, computer and electronic products. We anticipate that the January ISM manufacturing index continued to improve to 59.0. Manufacturing output should continue to expand over the next year as demand begins to slowly rebound.

Previous: 58.5 **Wells Fargo: 59.0**

Consensus: 57.9

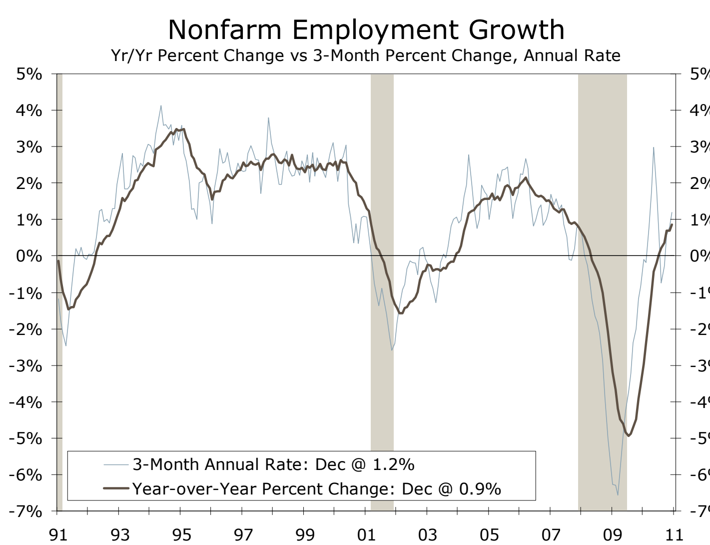
Employment Report • Friday

Nonfarm payrolls in December increased modestly by 103,000, led by employment gains across several sectors. Job gains continued in the service sector, including retail, business services, education and healthcare and leisure. Manufacturing employment grew by 10,000 as the average workweek remained around 34.3 hours.

The unemployment rate in December fell to 9.4 percent. The reason for the decline was not due to an increase in the rate of job creation, but rather to a substantial drop in the labor force. The labor force has been declining since the end of the 2001 recession; however, last month's drop was a significant departure from the long-term trend. We anticipate the unemployment rate continuing to rise over the next few months as the labor force participation rate increases greater than the pace of new hiring. The number of new jobs created in December likely increased by 175K.

Previous: 103K **Wells Fargo: 175K**

Consensus: 135K



Global Review

Does the Decline in U.K. GDP Signal a Double Dip?

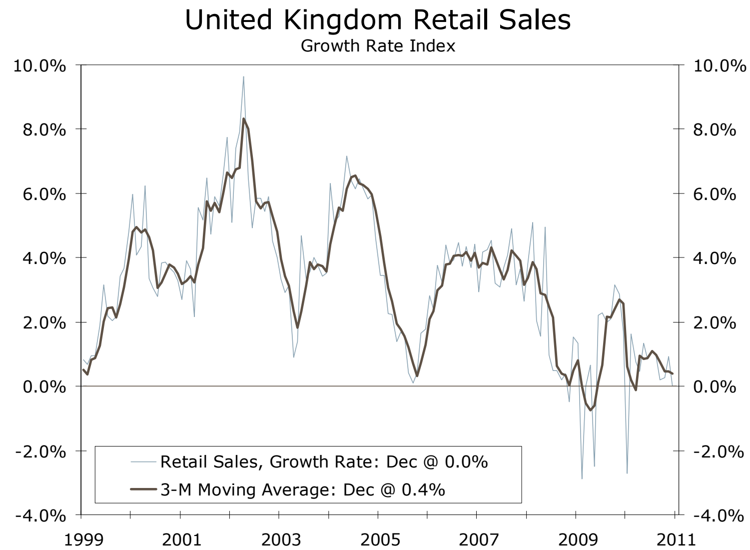
After contracting 6.4 percent on a peak-to-trough basis in the global recession, the U.K. economy was able to string together four consecutive quarters of economic growth and seemed to be firmly on the road to recovery going into this week's first estimate of fourth-quarter GDP growth. The consensus expectation was that the economy expanded 0.5 percent in the quarter. Markets were rather startled when the Office of National Statistics (ONS) reported the economy actually lost ground in the final quarter of the year. The first look from the ONS reported a decline of 0.5 percent, a number that was a full percentage point off the consensus estimate, and translates to an annualized pace of decline of 2.0 percent. Is this huge miss a sign that the recovery is over and the United Kingdom is headed for a double-dip recession?

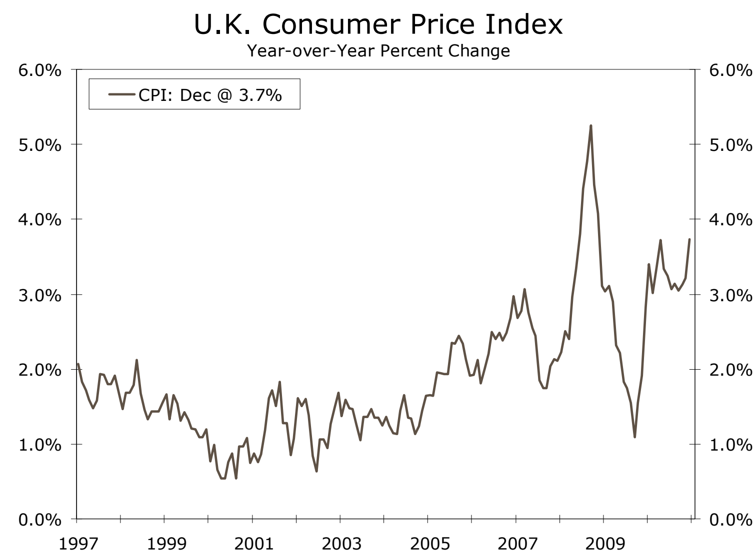
Not necessarily. Exceptional weather conditions blanketed much of the United Kingdom in heavy snow in December, disrupting economic activity—particularly construction work, which fell 3.3 percent in the quarter. But the impact of the snow likely had adverse effects in other sectors where weather can play a significant role. Mining and quarrying, for example, contracted 2.5 percent. Service industries also declined 0.5 percent with drops in predictable areas, such as transportation and catering, where activities would be hampered by several feet of snow.

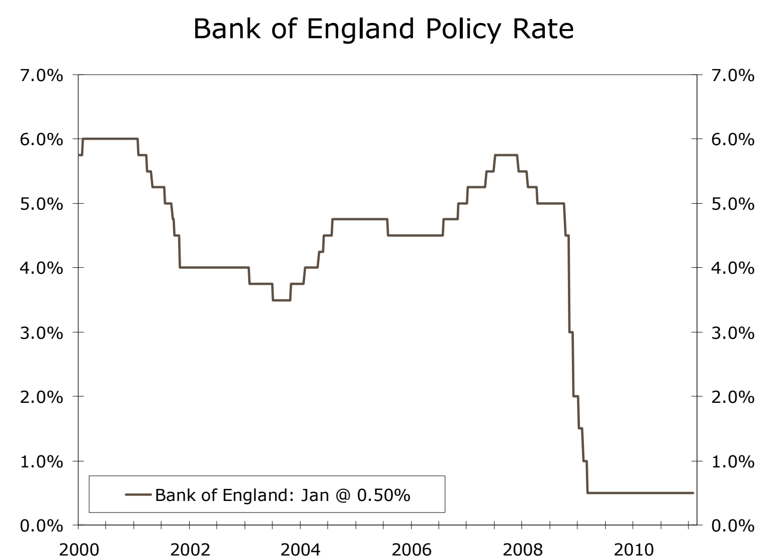
That said, the announcement came with a proviso that is troubling to anyone who wants to blame the snow for all the U.K.'s economic problems. The ONS suggested that even after accounting for the impact of the storms in December, growth was likely flat. So, while the big drop in GDP may not suggest a double-dip is imminent, it does raise some concerns about the sustainability of the U.K. recovery. One area that has shown a weakening trend is consumer spending. Retail sales have lost ground in three of the past five months. This softness in consumer demand is even more troubling when considering that some sales were presumably brought forward in recent months in anticipation of a higher VAT that went into effect in January.

As the implementation of various austerity measures weigh on activity in 2011, economic growth in the United Kingdom faces an uphill battle to sustain the recovery.

It has not been an easy time for the Bank of England's (BoE) Monetary Policy Committee (MPC). Charged with targeting an inflation rate of two percent, the MPC has turned a blind eye as year-over-year inflation remained north of three percent for all of 2010. The January increase in the VAT should keep inflation elevated into early 2011. Further out, slow growth should cause inflation to recede, which has kept the BoE from risking snuffing out the recovery by engaging in any tightening measures. However, in the minutes of the last BoE meeting released this week, we learned that a second member has voted in favor of a 25 bps hike in the key lending rate. The weak fourth-quarter GDP numbers probably buy the Bank some time, allowing it to keep rates low until inflation begins to come closer to target.







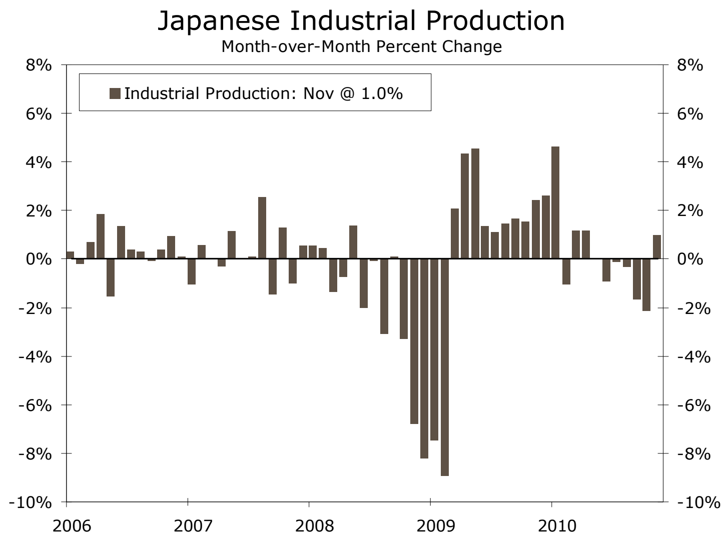
Japanese Industrial Production • Monday

After bouncing sharply in 2009, industrial production (IP) in Japan flattened in 2010. Indeed, IP contracted for five consecutive months in mid-2010 as the inventory swing came to an end. However, it appears that Japanese producers are starting to ramp up production again. IP rose 1.0 percent in November relative to the previous month, and the statistical agency that compiles the series projected that IP rose strongly in December. "Hard" data on IP that are to be released on Monday will show how accurate this projection is.

The IP data should be the highlight of the week, but data on housing starts and construction in December and vehicles sales in January will give investors further insights into the present state of the Japanese economy.

Previous: 1.0% (Month-over-Month)

Consensus: 2.8%



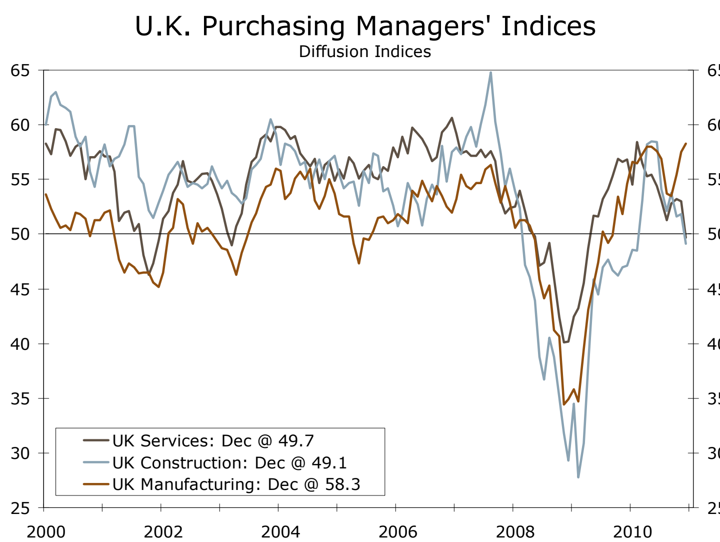
U.K. PMIs • Tuesday

As noted on page 4, the British economy unexpectedly contracted in the fourth quarter due, at least in part, to unseasonably harsh weather in December. That said, the behavior of the service and construction sector PMIs, which both breeched the demarcation line that separates expansion from contraction in December, was an indicator that the economy ended the year on a weak note. Alarm bells about the health of the British economy would undoubtedly sound if the PMIs remain below "50" in January.

There will also be some updates on the present state of the British housing market with the Halifax index of house prices in January slated for release next week. Data on the number of mortgage approvals and overall mortgage credit extended will also print next week.

Previous Manufacturing PMI: 58.3 **Consensus: 57.9**

Previous Services PMI: 49.7 **Consensus: 51.0**



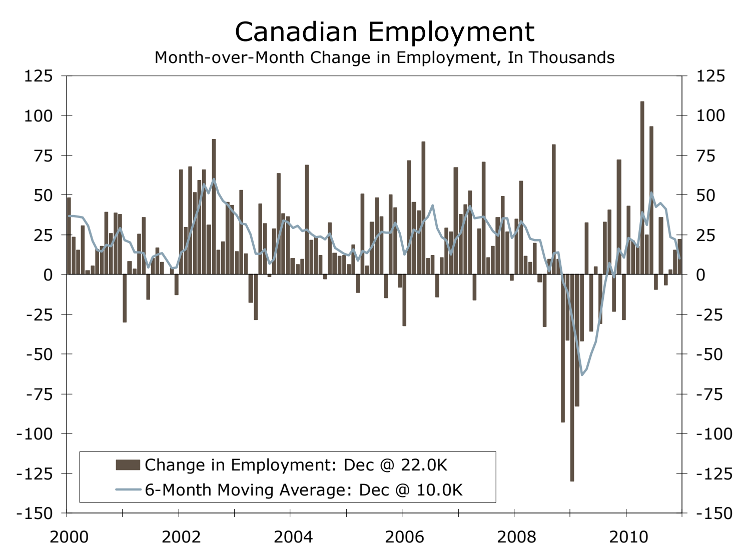
Canadian Employment • Friday

The downturn in Canada was less severe than the U.S. recession, and the labor market north of the border has bounced back much faster. Indeed, employment in Canada has already surpassed its pre-downturn peak. (In contrast, nonfarm payrolls in the United States remain 5 percent below their December 2007 high). The unemployment rate in Canada, which peaked at 8.9 percent in August 2009, has subsequently receded to 7.6 percent. Canadian labor market data for January are to be released on Friday.

GDP data for November will print on Monday. If, as the consensus forecast anticipates, GDP rose only 0.2 percent in November, then the Canadian economy would be on pace to register a quarterly annualized growth rate that falls short of 2 percent for the second consecutive quarter.

Previous: 22K

Consensus: 22.3K



Interest Rate Watch

FOMC Stays the Course

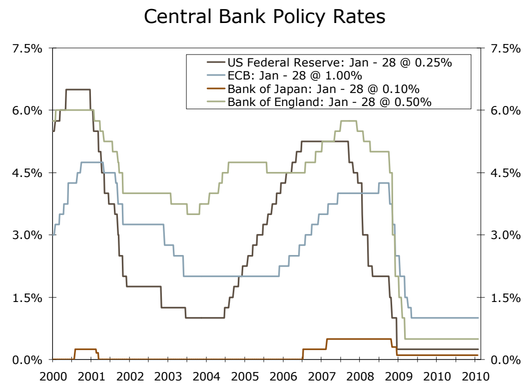
The result of this week's meeting of the Federal Open Market Committee was not a surprise to many. The committee will continue to keep rates in the target range of 0 to ¼ percent for "an extended period of time." The FOMC also continues to see economic growth that is not sufficiently high enough to bring greater improvement to the labor market. It also reported a continual downward trend in inflation and does not perceive the rise in commodity prices as a sign of future upward inflation pressure. The committee pointed to the fact that inflation expectations have remained stable. Our forecast continues to indicate inflation, measured by the core PCE deflator, will remain below 1.6 percent over the next two years.

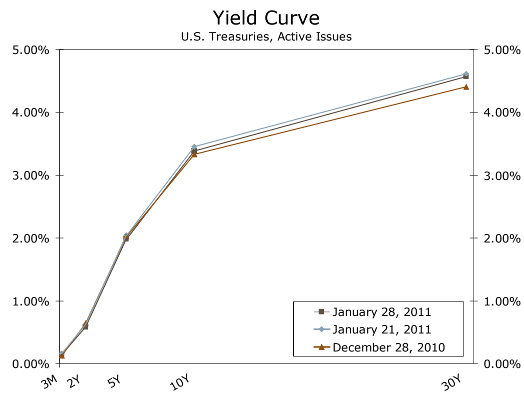
QE2 Continues

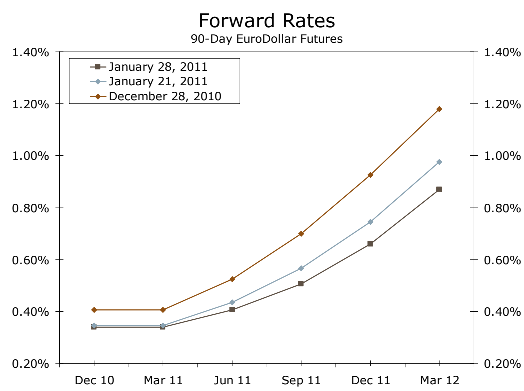
Citing the continued high unemployment rate, the FOMC also elected to continue the second round of quantitative easing (QE2), which began back in November 2010. The committee signaled its intent to complete the purchase of $600 billion in long-term Treasury securities through the second quarter of 2011. We anticipate that the FOMC will complete the entire QE2 stimulus through the spring of this year. Thus, short-term rates will remain low over the near term, while long-term rates will likely remain relatively stable. We still believe that rates will gradually begin to rise and increase more rapidly toward the second half of 2012.

Rates Face Some Upside Risks

In addition to the FOMC meeting, the Congressional Budget Office this week released its long-term budget projections for the U.S. budget deficit. According to its report, the U.S. deficit will likely reach $1.5 trillion in the current fiscal year. Looking at the longer-term budget picture, the U.S. deficit as a share of GDP is expected to decline, but will remain between 3.0 to 3.5 percent of GDP by the middle of this decade. This continued deficit spending along with the need to finance it will be one factor that will put some upward pressure on rates over the next few years.







Credit Market Insights

Savings Still Supporting Spending

While outstanding loans at commercial banks have started to rebound in some categories, such as C&I loans and residential real estate loans, consumer loans outstanding continue to shrink. Consumer loan balances were down 16.3 percent from the peak in February 2009, having been on a steady decline since that time. Still, consumer spending has been holding up recently, growing 3.8 percent in November, the strongest year-over-year growth rate since May. Personal income growth has also been strong, up 3.4 percent year-over-year in November. Consumption has been growing faster than income recently, leading to a decline in the saving rate from 6.3 percent in June to 5.3 percent in November. While savings have fallen to $614 billion from $720 billion a few months ago, savings are still nearly four times higher than they were at the dawn of the recession. Thus, even as consumer loans outstanding continue to shrink, consumer spending has rebounded, fueled by built-up savings. With savings still quite high, we can expect decent consumer spending in the near-to-medium-term despite the contraction in consumer credit. Furthermore, this shows that, at least for the time being, the continued decline in consumer credit should not be viewed as a negative for the economy. As debts get paid down or charged off, in due time the economy will be in much better shape for the next round of sustained economic growth.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.80%	4.74%	4.86%	4.98%
15-Yr Fixed	4.09%	4.05%	4.20%	4.39%
5/1 ARM	3.70%	3.69%	3.77%	4.25%
1-Yr ARM	3.26%	3.25%	3.26%	4.29%
MBA Applications				
Composite	441.8	507.0	461.3	513.0
Purchase	172.3	188.8	201.4	215.6
Refinance	2,025.2	2,390.7	2,036.9	2,260.4

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

Topic of the Week

State of the Union: The President's Export Goal

Tuesday night's speech marked the one-year anniversary of the president's goal to double the nation's exports in five years. The goal is an ambitious one. In fact, the nation's exports have only doubled once in a five-year period, circa 1945, fueled by the resumption of international trade following World War II and the beginning of the Marshall Plan to rebuild Europe.

So with one year under his belt and only four more to go, how is the president doing? To date, right on target. The November trade numbers put year-to-date total exports up 16.7 percent in nominal value terms over the same period in 2009. If exports continue to grow at this pace for four more years, U.S. exports will more than double by 2014. However, nominal value terms reflect the rate of inflation, which, once accounted for, dampens the rate of growth by almost two percentage points. In real terms, exports have grown 14.9 percent year-to-date since 2009—a performance that is still sufficient to double exports if repeated for four more years. Politicians are likely to focus on value terms since they tend to overstate the growth rate, while economists will be watching the deflated real export numbers to gauge the progress of the president's goal. Fortunately for President Obama (and the United States), he is in good shape by either measure at the moment.

Although year one was successful, the sustainability of this rate of growth in exports is another question altogether. The growth rate cited by the Trade Administration is based on the 2009 level of exports, most likely the president's benchmark as well, but 2009 witnessed a precipitous drop in exports as the international economy felt the full effects of the recession. In contrast, 2008 set an all-time high in exports. The growth we have seen in exports over the past year reflects part of a rapid recovery in exports as they approach levels seen in 2008. We are on pace to match pre-recession export levels in the next two years, but it is unclear whether the momentum of the recovery can carry into a potential future expansion.

Subscription Info

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

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

The *Weekly Economic & Financial Commentary* is available via the Internet at www.wellsfargo.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 1/28/2011	1 Week Ago	1 Year Ago
3-Month T-Bill	0.14	0.15	0.07
3-Month LIBOR	0.30	0.30	0.25
1-Year Treasury	0.19	0.27	0.34
2-Year Treasury	0.59	0.61	0.86
5-Year Treasury	1.98	2.01	2.39
10-Year Treasury	3.38	3.40	3.63
30-Year Treasury	4.56	4.57	4.55
Bond Buyer Index	5.25	5.41	4.39

Foreign Exchange Rates

	Friday 1/28/2011	1 Week Ago	1 Year Ago
Euro ($/€)	1.363	1.362	1.397
British Pound ($/£)	1.584	1.600	1.614
British Pound (£/€)	0.861	0.851	0.866
Japanese Yen (¥/$)	82.290	82.570	89.920
Canadian Dollar (C$/$)	0.999	0.993	1.066
Swiss Franc (CHF/$)	0.944	0.958	1.052
Australian Dollar (US$/A$)	0.994	0.990	0.895
Mexican Peso (MXN/$)	12.122	12.064	13.066
Chinese Yuan (CNY/$)	6.586	6.587	6.827
Indian Rupee (INR/$)	45.756	45.620	46.359
Brazilian Real (BRL/$)	1.682	1.678	1.872
U.S. Dollar Index	78.042	78.213	78.904

Foreign Interest Rates

	Friday 1/28/2011	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.01	0.96	0.61
3-Month Sterling LIBOR	0.78	0.78	0.62
3-Month Canadian LIBOR	1.22	1.24	0.45
3-Month Yen LIBOR	0.19	0.19	0.25
2-Year German	1.40	1.29	1.12
2-Year U.K.	1.28	1.34	1.28
2-Year Canadian	1.70	1.73	1.19
2-Year Japanese	0.21	0.19	0.16
10-Year German	3.17	3.18	3.20
10-Year U.K.	3.67	3.70	3.94
10-Year Canadian	3.27	3.33	3.33
10-Year Japanese	1.22	1.22	1.32

Commodity Prices

	Friday 1/28/2011	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	87.02	89.11	73.64
Gold ($/Ounce)	1326.98	1342.68	1087.10
Hot-Rolled Steel ($/S.Ton)	765.00	724.00	570.00
Copper (¢/Pound)	437.85	430.00	309.00
Soybeans ($/Bushel)	13.75	13.85	9.12
Natural Gas ($/MMBTU)	4.32	4.74	5.14
Nickel ($/Metric Ton)	26,463	25,744	18,117
CRB Spot Inds.	603.57	594.76	490.35

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	31	1	2	3	4
U.S. Data	**Personal Income** November 0.3% December 0.3% (W)	**ISM Manufacturing** December 58.5 January 59.0 (W)		**ISM Non-mfg** December 57.1 January 57.0 (W)	**Nonfarm Payrolls** December 103K January 175K (W)
	Personal Spending November 0.4% December 0.6% (W)	**Construction Spending** November 0.4% December -0.8% (W)		**Nonfarm Productivity** 3Q 2.3% 4Q 2.2% (W)	**Unemployment Rate** December 9.4% January 9.5% (W)
	PCE Deflator November 1.0% December 1.3% (W)	**Total Vehicle Sales** December 12.53M January 12.50M (W)		**Factory Orders** November 0.4% December -1.1% (W)	
Global Data	**Japan** **Industrial Prod. (MoM)** Previous (Nov) 1.0%	**U.K.** **PMI (Man)** Previous (Dec) 58.3	**U.K.** **PMI (Con)** Previous (Dec) 49.1	**U.K.** **PMI (Serv)** Previous (Dec) 49.7	**Canada** **Ivey (PMI)** Previous (Dec) 50.0
	China **PMI (Man)** Previous (Dec) 53.9	**Brazil** **PMI (Man)** Previous (Dec) 52.4	**Eurozone** **PPI (MoM)** Previous (Nov) 0.3%		**Canada** **Employment** Previous (Dec) 22K

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@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wellsfargo.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wellsfargo.com
Scott Anderson, Ph.D.	Senior Economist	(612) 667-9281	scott.a.anderson@wellsfargo.com
Eugenio Aleman, Ph.D.	Senior Economist	(704) 715-0314	eugenio.j.aleman@wellsfargo.com
Sam Bullard	Senior Economist	(704) 383-7372	sam.bullard@wellsfargo.com
Anika Khan	Economist	(704) 715-0575	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wellsfargo.com
Ed Kashmarek	Economist	(612) 667-0479	ed.kashmarek@wellsfargo.com
Tim Quinlan	Economist	(704) 374-4407	tim.quinlan@wellsfargo.com
Michael Brown	Economist	(704) 715-0569	michael.brown4@wellsfargo.com
Tyler B. Kruse	Economic Analyst	(704) 715-1030	tyler.kruse@wellsfargo.com
Joe Seydl	Economic Analyst	(704) 715-1488	joseph.seydl@wellsfargo.com
Sarah Watt	Economic Analyst	(704) 374-7142	sarah.watt@wellsfargo.com

WELLS FARGO SECURITIES