March 18, 2011

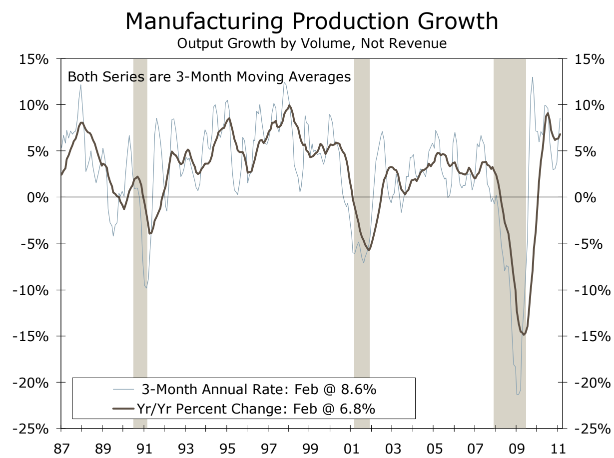
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Despite Headwinds, Expansion Continues

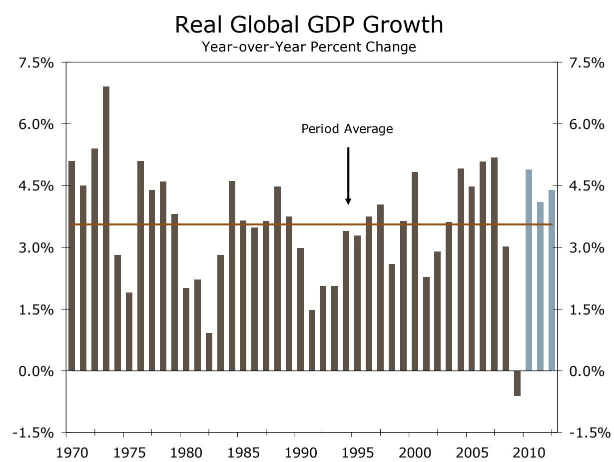
- The U.S. economy continues to generate solid economic growth. Manufacturing output increased for the eighth consecutive month and regional manufacturing surveys in New York and Philadelphia surged in February suggesting continued strength in the coming month.
- Weekly first-time unemployment claims fell by 16,000 to 385,000 in the week ending March 12. The four-week moving average also nudged lower to 386,250 which remains below the 400,000 threshold that has typically denoted labor market stability.



Global Review

Despite the Tragedy in Japan, Global Growth Continues

- The latest events in Japan have been devastating for that country in terms of loss of life and human suffering and our hearts and prayers are with the Japanese people. But the implications for the rest of the world are probably not as dire, as Japan had not been contributing that much to global growth before the earthquake.
- Our biggest concern with what is happening in Japan today is the reaction of the Japanese currency, which shot up to an all time high versus the U.S. dollar before the G7 decided to make a concerted effort to weaken the yen.



Wells Fargo U.S. Economic Forecast

	Actual 2010				Forecast 2011				Actual			Forecast	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2008	2009	2010	2011	2012
Real Gross Domestic Product [1]	3.7	1.7	2.6	2.8	2.7	2.4	2.7	3.0	0.0	-2.6	2.8	2.6	3.0
Personal Consumption	1.9	2.2	2.4	4.1	2.4	2.4	2.4	3.0	-0.3	-1.2	1.8	2.7	2.6
Inflation Indicators [2]													
"Core" PCE Deflator	1.8	1.5	1.2	0.8	0.8	0.9	1.0	1.3	2.3	1.5	1.3	1.0	1.4
Consumer Price Index	2.4	1.8	1.2	1.2	2.2	3.3	3.5	3.4	3.8	-0.3	1.6	3.1	2.6
Industrial Production [1]	7.1	7.2	6.2	3.0	5.5	3.8	4.1	3.9	-3.3	-9.3	5.7	4.6	3.9
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	8.9	8.7	8.5	8.4	5.8	9.3	9.6	8.6	8.2
Housing Starts [4]	0.62	0.60	0.59	0.53	0.55	0.58	0.64	0.70	0.90	0.55	0.59	0.62	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	0.75
Conventional Mortgage Rate	4.97	4.74	4.35	4.71	4.90	5.15	5.15	5.20	6.04	5.04	4.69	5.10	5.63
10 Year Note	3.84	2.97	2.53	3.30	3.60	3.75	3.75	3.80	3.66	3.26	3.22	3.73	4.13

Forecast as of: March 18, 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 Economic Expansion Is Still Underway

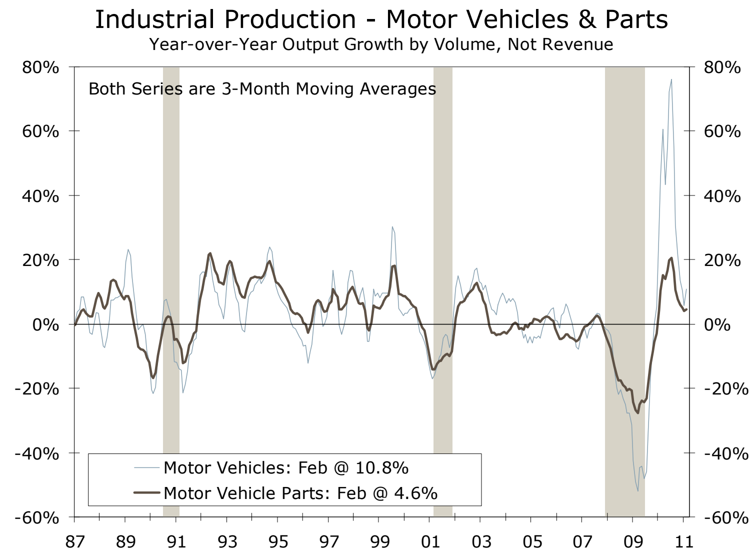
Despite uncertainty overseas and market volatility, economic indicators for the week continued to suggest economic expansion. Manufacturing output increased for the eighth consecutive month and regional manufacturing surveys in New York and Philadelphia surged in February suggesting continued strength in the coming month. Moreover, the initially reported decline in industrial production in January was revised to a gain of 0.3 percent.

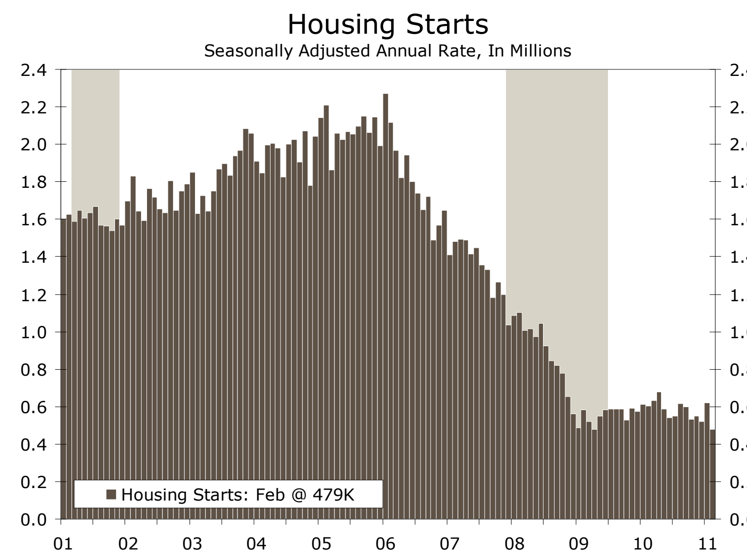
The strength in the factory sector is being led by robust growth in the auto sector. The production of motor vehicle and parts notched a third-straight monthly increase. When considered in the context of strong sales from manufacturers to auto dealers and the steady pace of retail auto sales, the auto sector as a whole is as healthy as it has been since the "Cash for Clunkers" incentive program. Although it is still too early to tell, some of the lost auto production in Japan could also help to boost domestic auto output. While headline industrial production slipped 0.1 percent in February, much of the decline was due to a drop in utility output. According to NOAA, for the Central and Southern United States, the second half of the month saw temperatures 15 degrees higher than normal, on average, while a warm spell brought spring-like weather early in the Southeast.

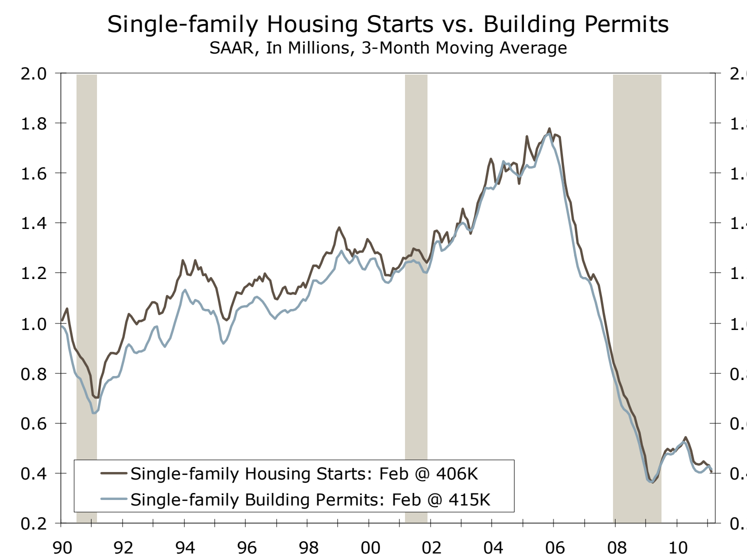
Another data point that is supportive of continued economic growth is initial jobless claims. Weekly first-time unemployment claims fell by 16,000 to 385,000 in the week ending March 12. The four-week moving average also nudged lower to 386,250 which remains below the 400,000 threshold that has typically denoted labor market stability.

Housing market indicators reported this week, however, continued to show weakness. Housing starts plunged 22.5 percent in February to a 479,000-unit pace, the second lowest level on record. Single-family starts fell 11.8 percent, confirming that the demand for new single-family homes remains exceptionally weak. While builder sentiment is finally improving after remaining unchanged for the past four months, prospective buyer traffic has shown little to no improvement. The oversupply of existing homes on the market and downward pressure on home prices due to foreclosures continue to give builders little incentive to significantly ramp up building activity.

Housing permits fell 8.2 percent to a 517,000-unit pace, which is the lowest level on record, but single-family permits are running above starts, which suggests we could see some modest improvement in coming months. While this is encouraging news, much of the gain will be because of the seasonal adjustment process. With starts at such depressed levels, any upward momentum could lead to exaggerated swings in the monthly data. This means the Spring home buying season will likely not be the beacon of hope that many are expecting. Consequently, we do not expect a genuine recovery in housing starts to occur until the pace of foreclosures slows significantly.





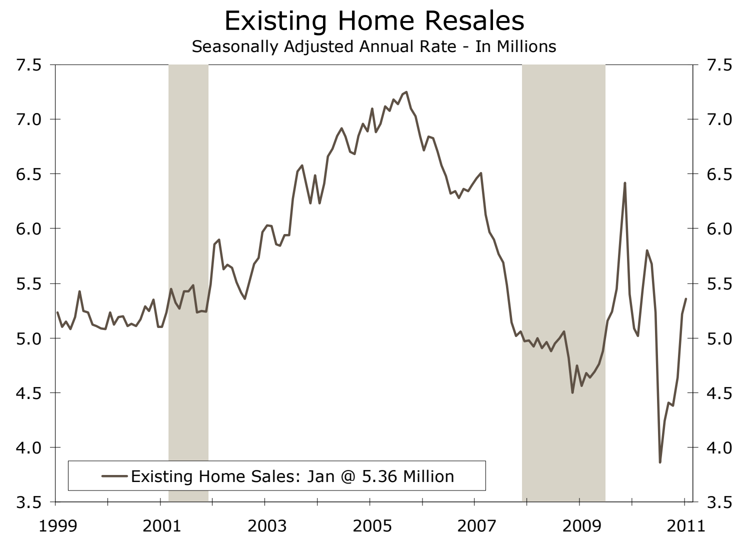


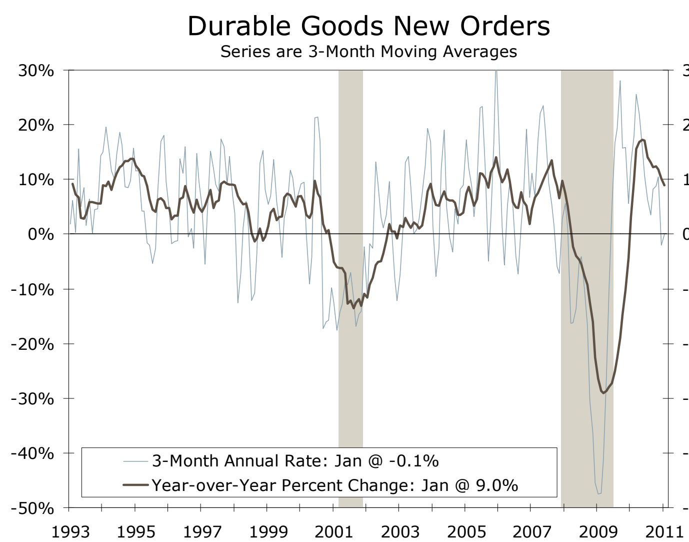
Existing Home Sales • Monday

Existing home sales rose 2.7 percent in January to 5.36 million, the highest level in eight months. Sales gains were driven by distressed transactions which accounted for 37 percent of total sales. Another trend that has become apparent is the number of all cash transactions which increased 32 percent while investors accounted for 23 percent of sales. The high level of existing home inventories continues to weigh on the housing market. Single-family inventories fell 2.6 in January indicating a positive trend for the housing market. As employment and income growth picks up existing home sales should continue to increase. At the current pace of sales, it would take 7.5 months to clear the inventory of existing single-family homes. With the months supply numbers beginning to edge downward, there will likely be some positive momentum for existing housing starts in the later part of this year.

Previous: 5.36M **Wells Fargo: 5.00M**

Consensus: 5.12M





Durable Goods Orders • Thursday

January durable goods orders remained positive, increasing 2.7 percent for the month and in line with the consensus forecast. However, the data was likely distorted from some seasonal adjustment issues along with poor winter that led to the shutdown of some facilities. Orders for electrical equipment were off 4.9 percent, computer orders declined 6.8 percent and machinery orders fell 13.0 percent. Orders for non-defense capital goods also fell 6.9 percent in January, which is the first decline in two months. Even in light of these somewhat disappointing numbers, the underlying trend in orders is still positive. We expect manufacturing output will continue to improve. Our expectation is that durable goods orders rose 1.3 percent in February due to stronger orders for the month. Our 2011 forecast for industrial production remains strong as manufacturers continue to increase production to meet increasing domestic and global demand.

Previous: 3.2% **Wells Fargo: 1.3%**

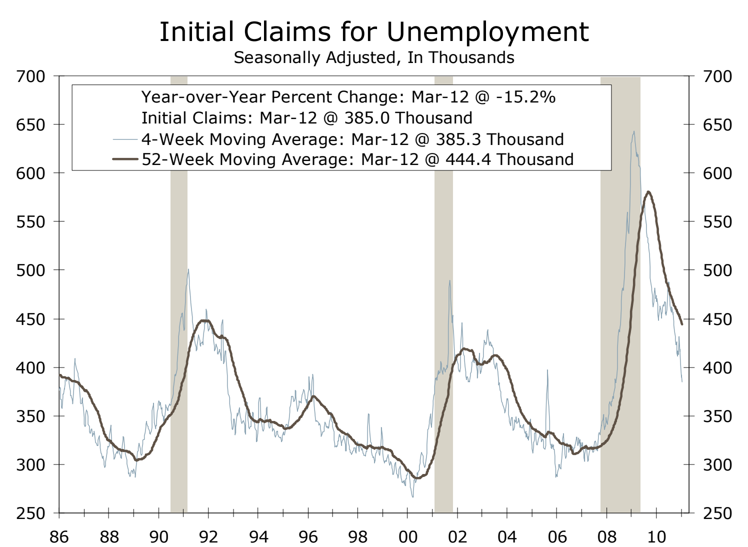
Consensus: 1.1%

Initial Jobless Claims • Thursday

Initial jobless claims fell again this week to 385K, a decrease of 16K from the previous week. The trend, as measured by the four-week moving average continued to move downward, which is a positive sign for employment growth over the next few months. With the release of this week's claims data, initial jobless claims are now 15.2 percent lower than this time last year. Employment gains in February increased by 192,000 and included an upward revision to January's employment number. We are beginning to see more widespread job gains which would be a good sign for stability in employment growth. Our forecast indicates that employment growth should continue to pickup with gains averaging 162,500 per month. In aggregate we believe an increase of around 2.0 million jobs will be created this year and an additional 2.2 million jobs in 2012.

Previous: 385K

Consensus: 383K



Global Review

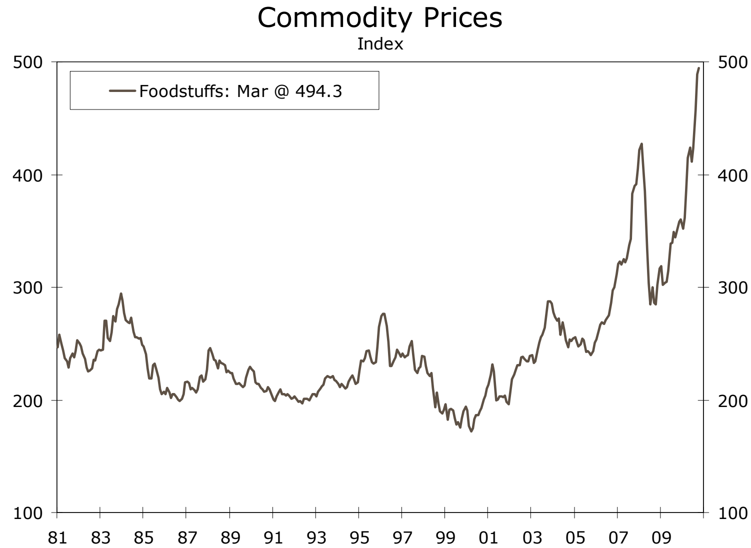
Despite the Tragedy in Japan, Global Growth Continues

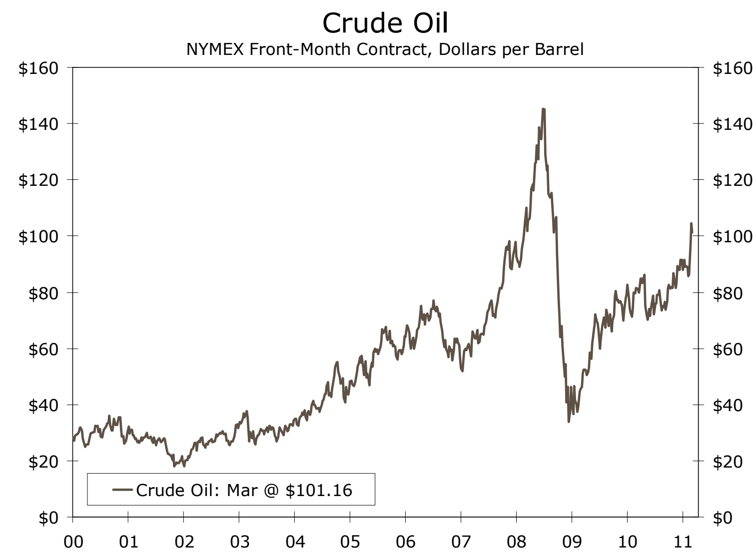
The latest events in Japan have been devastating for that country in terms of loss of life and human suffering and our hearts and prayers are with the Japanese people at this crucial crossroads. However, the implications for the rest of the world are probably not as dire, as Japan had not been contributing that much to global growth before the earthquake and tsunami hit. However, while the short-run implications of the Japanese disaster will put some downward pressure on growth, the Japanese recovery from the disaster will have a larger impact on global economic performance. Some analysts are even suggesting that this may be the event that will finally take the Japanese economy off of a depression that has already lasted more than two decades, as the Japanese administration puts out a fiscal policy package to reconstruct the affected parts of the country.

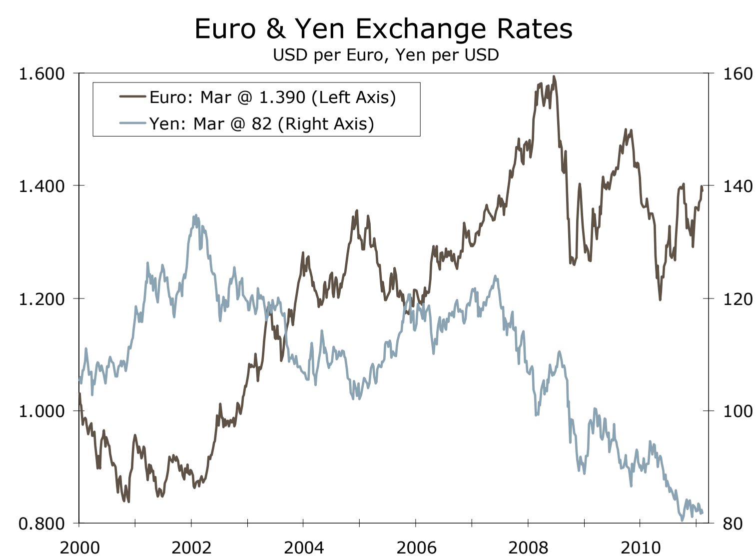
The global growth story is still intact even though parts of the world, especially the Middle East and North Africa, are still immersed in a crisis with unknown potential consequences for their regions and for the rest of the world. As we said before, the global growth story remains intact even though growth has slowed down somewhat compared to last year's rates. The so called BRIC economies (Brazil, Russia, India, and China) are still growing and are still driving growth across the world, contributing to the pressure on commodity prices.

So far this year in Latin America, high commodity prices are still supporting relatively strong growth. Furthermore, as the U.S. economy continues to recover, the region will likely export more goods to the U.S. market while U.S. consumers will consume more goods imported from this region, helped by a weak dollar. From a trade perspective, the Pacific Rim countries are probably going to be the hardest hit economies, as exports to Japan are a very important component of their total exports. Meanwhile, petroleum prices are doing its share to slow down growth across Europe even though the German economy is still showing no signs of slowing down that economy. However, the European region has problems of its own and those problems could come to haunt the region without any help from other countries.

Probably the biggest concern with what is happening in Japan today is the reaction of the Japanese currency, which shot up to an all-time high versus the U.S. dollar before the Group of 7 (G7) decided to make a concerted effort to weaken the yen. The sudden appreciation was a market reaction to expectations regarding a large repatriation of capital flows to Japan. This poses a threat to capital flows across the world as the Japanese reconstruction efforts suck up monies that were invested in other countries. This has the potential to increase interest rates across the world and hurt those countries that were receiving these flows before the disaster. Furthermore, the Japanese have been large buyers of U.S. Treasuries and this could put some added pressure on U.S. Treasury yields in the future. If the Japanese currency remains at such an appreciated level it will be difficult for Japan to recover through increases in exports.





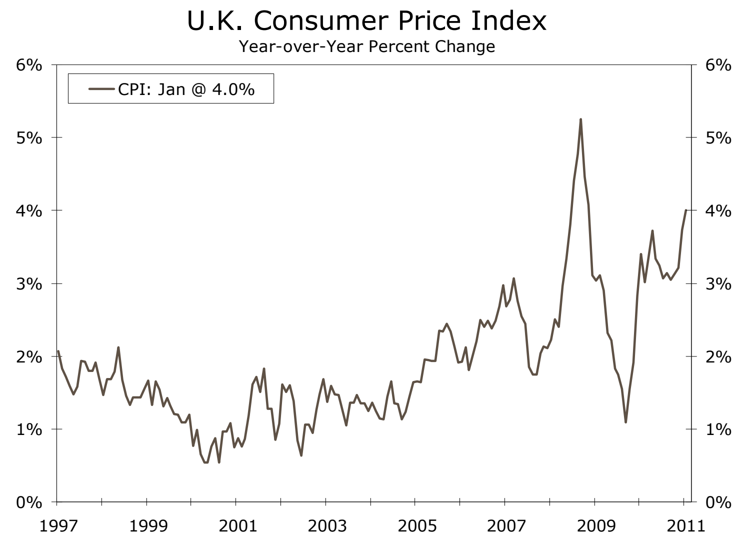


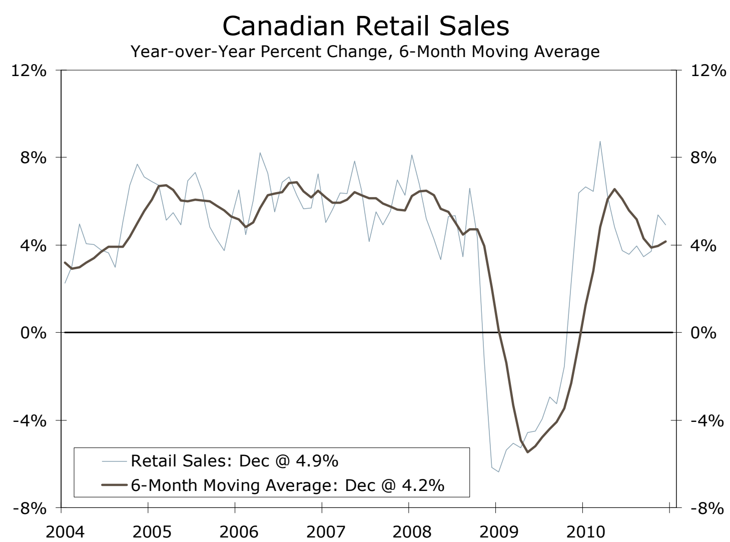
United Kingdom CPI • Tuesday

Despite its mandate to maintain price stability, the Bank of England (BoE) has been content to let inflation remain north of the maximum limit of 3 percent for the better part of the last year without tightening monetary policy. In his fifth consecutive letter to the Chancellor of the Exchequer, BoE Governor Mervyn King discussed a "great deal of uncertainty" about the inflation outlook. (U.K. law requires a letter from the governor to the chancellor whenever the inflation target is breached). January CPI inflation revealed a 4.0 percent increase in prices on a year-over-year basis, which may reflect the January increase in the VAT tax. Still, with crude oil prices and gasoline costs on the rise, inflation pressures could build in coming months. If they do, the growing dissent on the BoE's monetary policy committee could mean a tightening in UK monetary policy.

Previous: 4.0% **Wells Fargo: 3.8%**

Consensus: 4.2% (Year-over-Year)





Canadian Retail Sales • Tuesday

December retail sales in Canada were broadly disappointing, down 0.2 percent in the month, led lower by a 2.8 percent decline in sales at auto dealers. Still, fourth quarter consumer spending grew at a 4.9 percent annualized pace in Canada, and we suspect the consumer will add to spending in the first quarter of 2011 as well. An early indication of spending will be reported when January retail sales data are released on Tuesday of next week. After December's disappointing turnout, we would not be surprised to see sales increase in January. Canadian businesses added another 15.1K workers to their payrolls in February. While that was slightly less than the consensus had been expecting, it is still strong enough that labor market dynamics can be supportive of consumer spending growth.

Previous: -0.2%

Consensus: 0.1% (Month-over-Month)

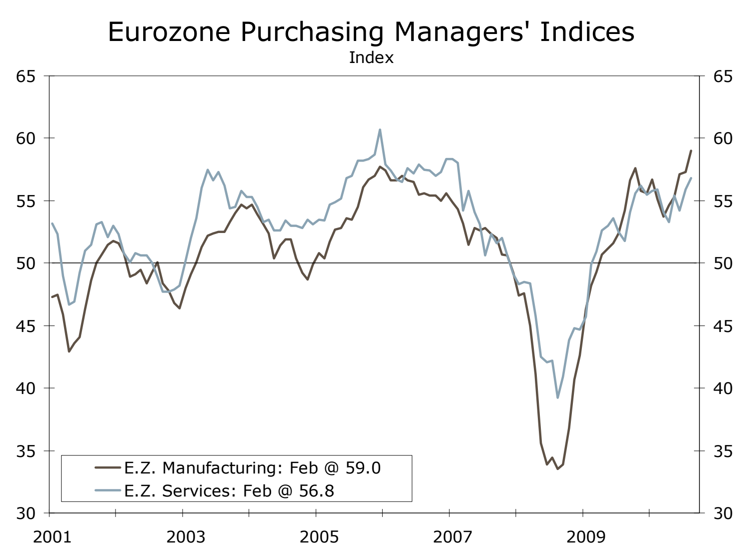
Eurozone PMIs • Thursday

Despite ongoing challenges from the sovereign debt situation, the recovery in the Eurozone seems to be intact, even if it is somewhat inconsistent across the various member countries.

Like the Bank of England, the European Central Bank (ECB) appears to be getting closer to its first rate hike as inflation seems to be on the rise. It will make the job a bit easier for the ECB if it seems that growth will continue in the first quarter. Various purchasing managers' surveys released on Thursday will give the Bank and market watchers in Europe a sense of the strength of the recovery. Manufacturing and services PMIs for March are reported on Thursday. Both measures are firmly in expansion territory, suggesting that despite the Eurozone's challenges, at least business sentiment is positive.

Previous: 59.0

Consensus: 58.2 (Manufacturing)



Interest Rate Watch

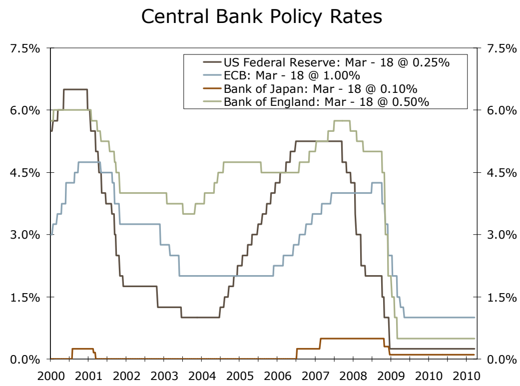
Japan and Fed Policy

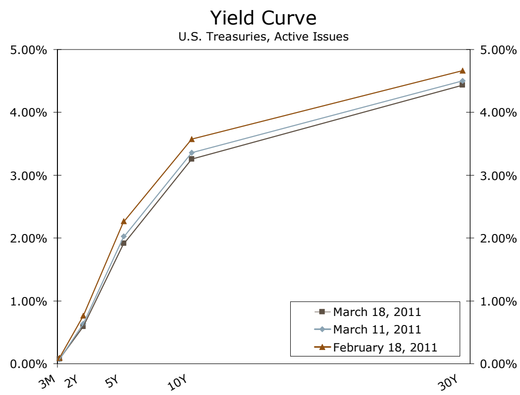
Do the unfolding events in Japan have any implications for U.S. monetary policy? The FOMC held a regularly scheduled meeting this week, but Japan was not mentioned in the brief statement that was released at the conclusion of the meeting. However, more detailed minutes of the meeting will be released in a few weeks, and we would be surprised if the subject of Japan did not arise at all during the discussion among FOMC members.

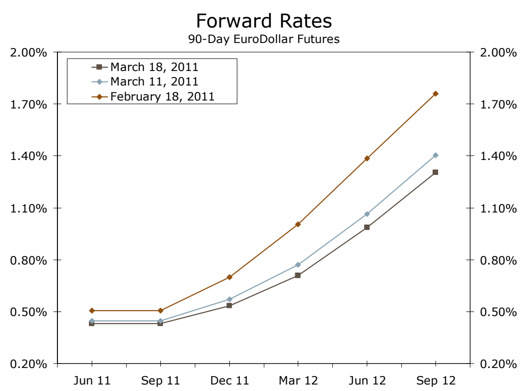
Prior to the Japanese earthquake there was very little chance that the Fed was planning to hike rates in the near term. In our view, recent events in Japan reduced that probability even further. Although a cottage industry that attempts to quantify the effects of the Japanese disasters has sprung up—and we make our own assessments on page 4—nobody really knows what impact Japan will ultimately have on the global economy. In such an environment, it is probably prudent for policymakers to wait for more information before deciding what to do next.

Relative to last Thursday, the day before the earthquake struck, market expectations about near-term Fed policy are little changed. However, whereas the market had looked for approximately 100 bps of Fed tightening by the end of 2012, it currently anticipates a bit less than that now.

Unless the crisis suddenly spirals out of control, thereby dealing a long-term effect on the Japanese economy, we doubt that the disasters will have any lasting effect on Fed policy. Natural disasters like earthquakes tend to have only a temporary impact on the affected economy. Economic activity in Japan will be reduced in the near term, but rebuilding should lead to stronger activity in subsequent quarters. Likewise, U.S. exports to Japan, which account for only 5 percent of total American exports, will be weakened in the near term, but they should rebound in subsequent quarters. As we note in the Topic of the Week, the effect on the United States should be marginal and temporary. Therefore, Fed policy should be little changed.







Credit Market Insights

Home Prices and Charge-offs

Now that home prices have started to drop again after the tax-credit-induced run-up, the question is how far will they fall? The answer has far-reaching implications for both homeowners and banks. The further home prices fall, the more homeowners will be underwater, which would likely lead to more foreclosures and more charge-offs by banks. Residential charge-offs had been trending lower since the Q409 peak but turned higher again in Q410 as home prices dipped. This is not good news, and it shows that banks still face tremendous challenges in the housing market. More recent news only adds to the gloomy outlook. Despite a decline in mortgage rates, applications to purchase a home fell 4.0 percent in the latest week and have remained weak ever since mortgage rates rose above 4.5 percent in December. Although home sales have risen recently, more homes are being purchased by investors with cash, which generally results in a lower price due to greater financing reliability and less paperwork. In another sign of weakness, housing starts plunged in February to the lowest since April 2009 and building permits fell to a record low. Although housing affordability is at a record high and mortgage rates remain extremely low, lackluster job growth and tight lending standards have restrained demand. With all these signs of weakness in the housing market, it would be wise for banks to be very conservative with their bad-debt provisions.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.76%	4.88%	5.00%	4.96%
15-Yr Fixed	3.97%	4.15%	4.27%	4.33%
5/1 ARM	3.57%	3.73%	3.87%	4.09%
1-Yr ARM	3.17%	3.21%	3.39%	4.12%
MBA Applications				
Composite	510.7	514.2	420.4	620.9
Purchase	186.6	194.4	175.1	221.5
Refinance	2,406.3	2,383.7	1,848.6	2,955.9

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

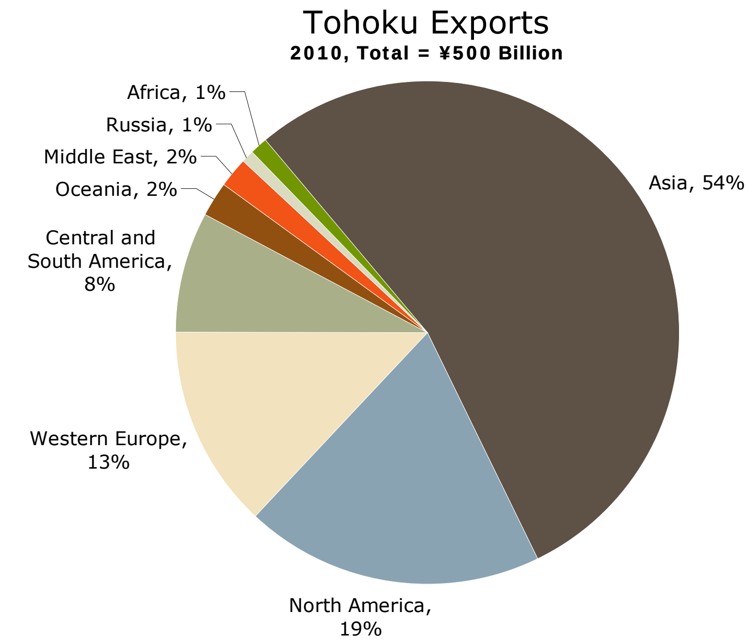
Topic of the Week

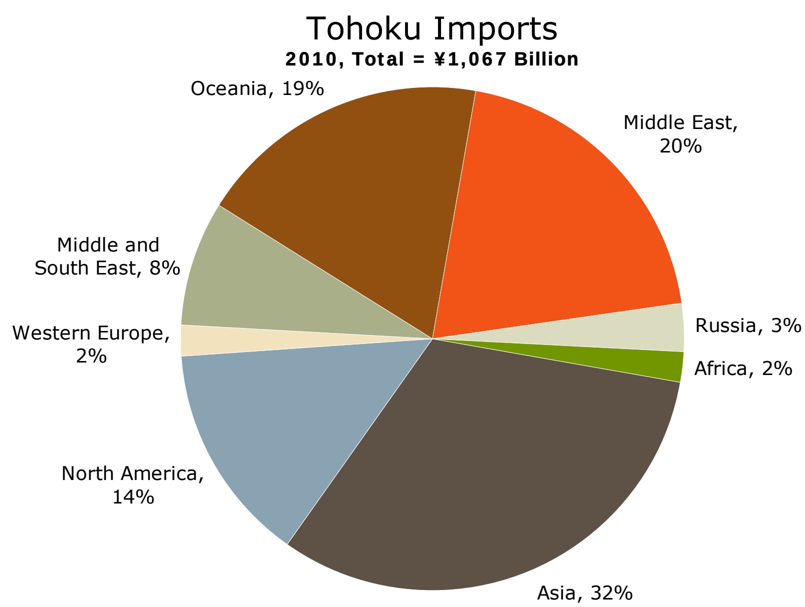
The Crisis in Japan and the United States

The epicenter of the recent earthquake in Japan was 130 km of the coast of northeast Japan, near the port city of Sendai in the Miyagi prefecture. The main areas damaged by both the earthquake and the resulting tsunamis were located along the eastern coast of the Tohoku region. This area is far removed from the principal manufacturing regions of Japan further south on the island of Honshu. Nevertheless, the city of Sendai, the largest, most important port along the northeastern coast, was decimated by the tsunami. Although Sendai is important in the Tohoku region of Japan, the port is not one of Japan's principal ports and more than half of its exports are rubber-related goods. In addition, the Tohoku region is a net importer of goods and relies heavily on imported fuels. The Tohoku region's principal trading partner is Asia, with the United States accounting for less than 20 percent of total trade.

Supply chain issues caused by direct damage will be concentrated upstream from finished production and are likely to have limited effects on the U.S. economy, but rolling blackouts across the country will slow down production in regions with stronger trading ties to U.S. consumers. In addition, the bulk of industrial capacity in the three most heavily damaged prefectures is located far from the coastal areas hardest hit by the tsunami.

The diversion of resources from normal production to rebuilding efforts will constrain production for export, which could potentially raise the price of Japanese exports to the United States. As more energy, material and manpower are dedicated to the reconstruction of devastated coastal areas, we could see a constriction in the availability of some primary goods and upstream manufactured goods produced in the affected areas. In terms of trade with the United States, the economic impact of the natural disasters should be limited and transitory. For more information, please see our most recent report entitled "Gauging the Impact of the Natural and Nuclear Disaster."





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 3/18/2011	1 Week Ago	1 Year Ago
3-Month T-Bill	0.06	0.07	0.15
3-Month LIBOR	0.31	0.31	0.27
1-Year Treasury	0.25	0.23	0.37
2-Year Treasury	0.58	0.64	0.96
5-Year Treasury	1.93	2.06	2.42
10-Year Treasury	3.27	3.40	3.68
30-Year Treasury	4.44	4.55	4.59
Bond Buyer Index	4.86	4.91	4.32

Foreign Exchange Rates

	Friday 3/18/2011	1 Week Ago	1 Year Ago
Euro ($/€)	1.413	1.390	1.361
British Pound ($/£)	1.617	1.608	1.524
British Pound (£/€)	0.874	0.865	0.893
Japanese Yen (¥/$)	81.080	81.840	90.390
Canadian Dollar (C$/$)	0.985	0.973	1.014
Swiss Franc (CHF/$)	0.905	0.930	1.058
Australian Dollar (US$/A$)	0.994	1.014	0.921
Mexican Peso (MXN/$)	12.051	11.908	12.523
Chinese Yuan (CNY/$)	6.570	6.575	6.826
Indian Rupee (INR/$)	45.126	45.243	45.454
Brazilian Real (BRL/$)	1.673	1.665	1.792
U.S. Dollar Index	75.847	76.776	80.225

Foreign Interest Rates

	Friday 3/18/2011	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.12	1.13	0.59
3-Month Sterling LIBOR	0.81	0.81	0.65
3-Month Canadian LIBOR	1.20	1.22	0.40
3-Month Yen LIBOR	0.20	0.19	0.24
2-Year German	1.61	1.65	0.99
2-Year U.K.	1.20	1.29	1.24
2-Year Canadian	1.61	1.75	1.56
2-Year Japanese	0.22	0.22	0.15
10-Year German	3.18	3.21	3.13
10-Year U.K.	3.52	3.55	3.98
10-Year Canadian	3.17	3.28	3.45
10-Year Japanese	1.22	1.26	1.37

Commodity Prices

	Friday 3/18/2011	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	101.27	101.16	82.20
Gold ($/Ounce)	1420.48	1417.45	1127.35
Hot-Rolled Steel ($/S.Ton)	875.00	870.00	645.00
Copper (¢/Pound)	432.90	419.50	338.75
Soybeans ($/Bushel)	13.12	13.30	9.44
Natural Gas ($/MMBTU)	4.12	3.89	4.09
Nickel ($/Metric Ton)	25,924	26,020	22,210
CRB Spot Inds.	606.08	619.06	500.08

Next Week's Economic Calendar

	Monday 21	Tuesday 22	Wednesday 23	Thursday 24	Friday 25
U.S. Data	**Existing Home Sales** January 5.36M February 5.00M (W)		**New Home Sales** January 284K February 285K (W)	**Durable Goods Orders** January 3.2% February 1.3% (W) **Durables Ex Tranp.** January -3.0% February 1.8% (W)	**GDP** 4Q (2nd) 2.8% 4Q (3rd) 2.9% (W)
Global Data		**U.K.** **CPI (YoY)** Previous (Jan) 4.0% **Canada** **Reatail Sales (MoM)** Previous (Dec) -0.2%	**Mexico** **Retail Sales (YoY)** Previous (Dec) 2.6%	**Eurozone** **PMI (Manufacturing)** Previous (Feb) 59.0 **Japan** **CPI (YoY)** Previous (Jan) 0.0%	**U.K.** **Retail Sales (MoM)** Previous (Jan) 1.9% **Germany** **Ifo Current Assessment** Previous (Feb) 114.7

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

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