April 06, 2012

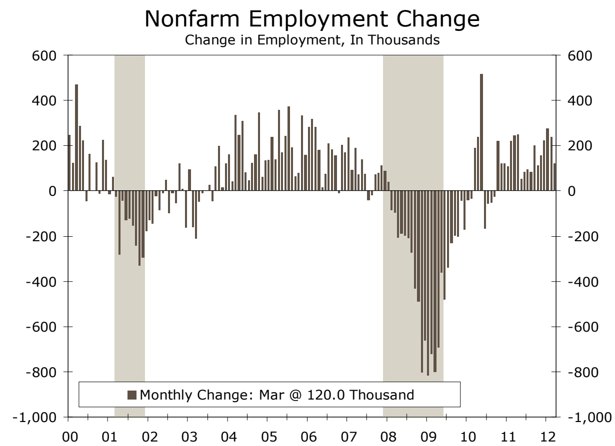
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Robust Manufacturing Recovery Remains Intact

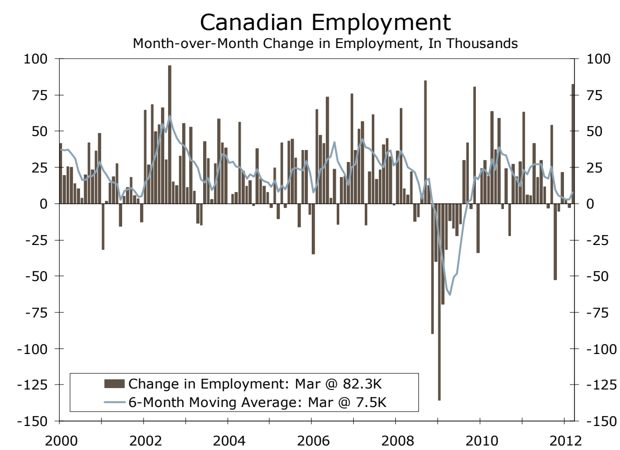
- March employment figures came in weaker than expected with nonfarm payrolls expanding by 120K added for the month. The unemployment rate fell to 8.2 percent as the labor force participation rate edged down slightly.
- The two ISM surveys came in mixed for the month of March with the ISM-manufacturing index posting a sizable improvement, while the ISM non-manufacturing index slipped slightly. The differences in growth between the manufacturing and service sectors were also reinforced in the employment data for March.



Global Review

Surveying the World Economy

- After six months of lackluster job growth, Canadian employers added 82.3K workers to payrolls in March. It was the largest monthly jump since before the financial crisis in 2008. While this series is notoriously volatile, the spike in hiring is welcome news and it pulled the unemployment rate to the lowest level in this cycle.
- This week's global review looks at various business surveys around the world to get a better sense of what purchasing managers and other plugged-in business professionals have to say about the growth outlook in their particular economy.



Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual			Forecast	
	2011				2012				2009	2010	2011	2012	2013
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product [1]	0.4	1.3	1.8	3.0	2.2	1.7	2.1	2.2	-3.6	3.0	1.7	2.1	2.2
Personal Consumption	2.1	0.7	1.7	3.0	2.9	1.4	1.4	1.4	-2.0	2.0	2.2	1.9	1.3
Inflation Indicators [2]													
PCE Deflator	1.8	2.5	2.9	2.7	2.3	2.1	2.0	2.1	0.6	1.8	2.5	2.1	2.0
Consumer Price Index	2.1	3.3	3.8	3.3	2.8	2.6	2.4	2.6	-0.3	1.6	3.1	2.6	2.3
Industrial Production [1]	4.4	1.2	5.6	4.3	4.8	3.2	3.0	2.2	-11.3	5.4	4.0	3.9	2.3
Corporate Profits Before Taxes [2]	8.8	8.5	7.5	7.0	6.2	6.0	6.3	6.4	9.1	32.2	7.9	6.2	6.5
Trade Weighted Dollar Index [3]	70.6	69.4	72.8	73.3	72.7	74.0	74.5	75.0	77.7	75.6	70.9	74.1	77.0
Unemployment Rate	9.0	9.0	9.1	8.7	8.3	8.4	8.6	8.5	9.3	9.6	9.0	8.4	8.3
Housing Starts [4]	0.58	0.57	0.62	0.67	0.69	0.71	0.72	0.71	0.55	0.58	0.61	0.71	0.82
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	0.25	0.25	0.25	0.25	0.25
Conventional Mortgage Rate	4.84	4.51	4.11	3.96	3.95	4.00	4.10	4.10	5.04	4.69	4.46	4.04	4.25
10 Year Note	3.47	3.18	1.92	1.89	2.23	2.30	2.40	2.50	3.26	3.22	2.78	2.36	2.73

Forecast as of: April 6, 2012
[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

Together we'll go far

U.S. Review

Robust Manufacturing Recovery Remains Intact

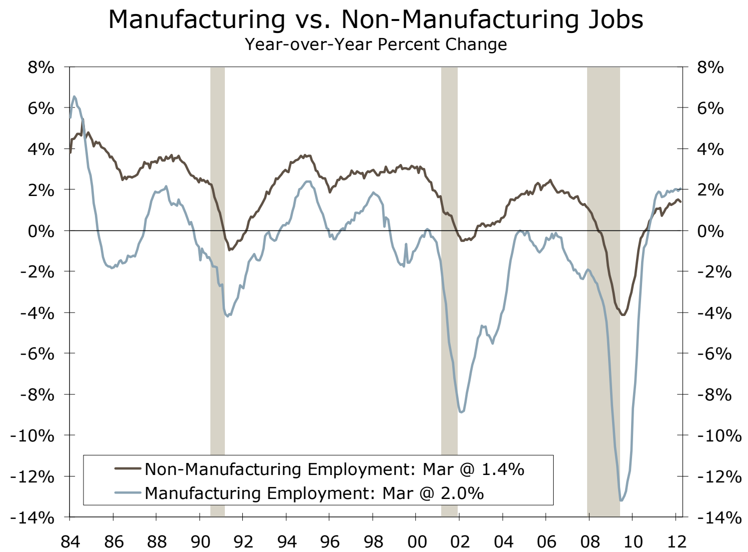
The economic news this week was dominated by the disappointing 120k gain in March nonfarm payrolls. The unemployment rate declined to 8.2 percent from 8.3 percent in February. In addition to the positive payroll report, data this week on the manufacturing sector continued to signal a robust pace of output. Both the factory orders report along with the ISM-manufacturing sentiment index continued to point to continued support for economic growth from the industrial sector of the economy. The February construction spending report came in a bit weaker than expected as nonresidential construction activity contracted for the month.

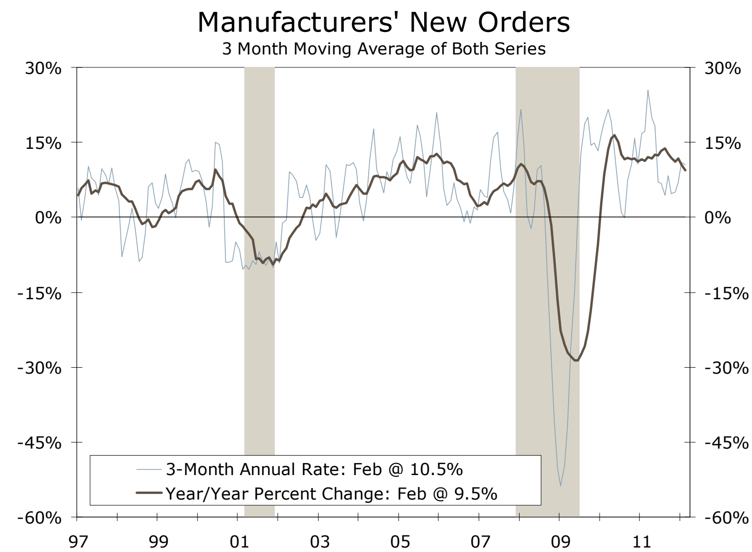
The March employment report indicated that 120k jobs were added, marking a pullback from above 200k levels observed over the past three months. The manufacturing sector continued to add jobs with payrolls increasing by 37K on the month. Construction industry employment remained weak, while service sector job growth softened with much smaller job gains in education and health and professional and business services. In light of the weaker-than-expected job gains in March along with a downshift in the pace of improvement in jobless claims, the labor market appears to be softening moving into the second quarter. Last week's claims data indicated that the four-week moving average continued to decline to around 362K, but more important, the strong downward momentum in unemployment claims has begun to soften. Thus, we continue to expect only modest job gains over the next two quarters.

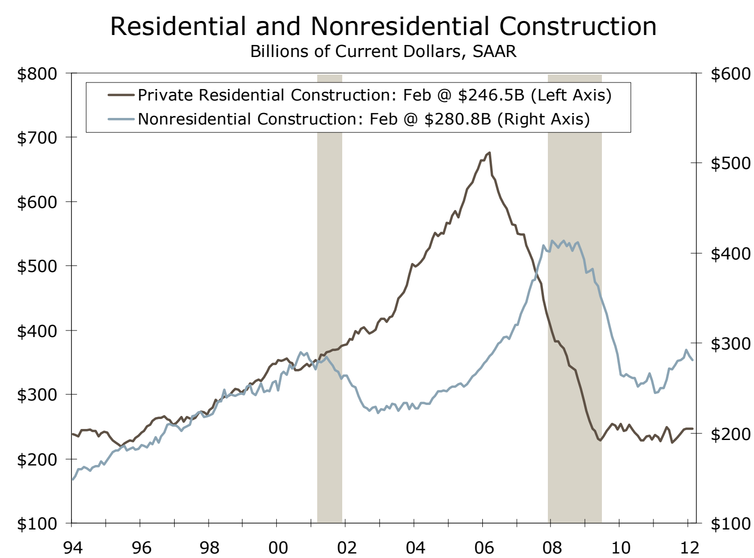
On the manufacturing front, factory orders for February bounced back after declining modestly in January. Nondefense capital goods orders excluding aircraft rebounded, rising 1.7 percent in February. Assuming capital goods orders do not slip significantly in March, equipment and software spending should remain a solid support to first-quarter GDP growth. The positive factory orders report comes on the heels of further positive news from the ISM manufacturing index, which rose to 53.4 from 52.4 in February. The index pointed to increasing production output going forward with the pace of new orders remaining positive but slowing slightly. The employment component of the index edged higher, signaling the willingness of manufacturers to expand payrolls.

The ISM non-manufacturing survey came in a bit weaker than expected, slowing to 56 from February's 57.3. The good news in the report was the jump in the employment component, which signaled a possible expansion of payrolls in the service sector. The Institute of Supply Management indicated a pickup in business activity for financial services and construction industry respondents, a sign that housing related services continue to firm.

Construction spending pulled back in February as a decline in nonresidential activity pulled down the headline number. Home improvements rose for the month after turning negative for the previous two months. Public construction spending remains relatively weak in light of ongoing local level budget pressures.





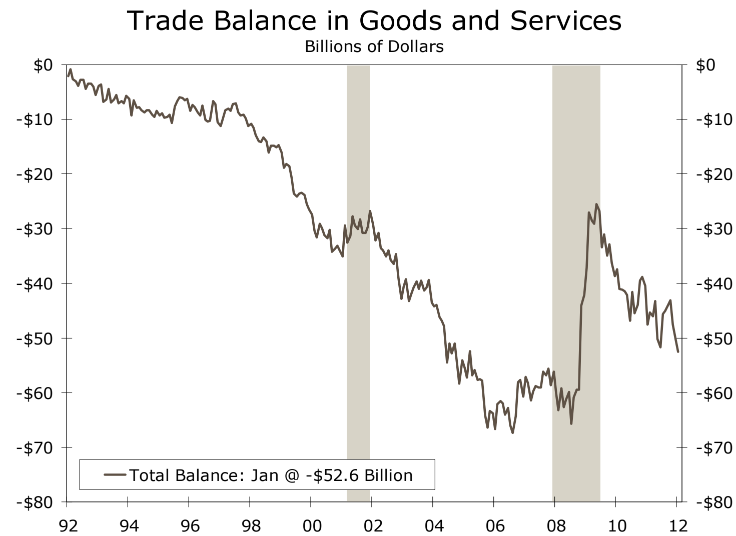


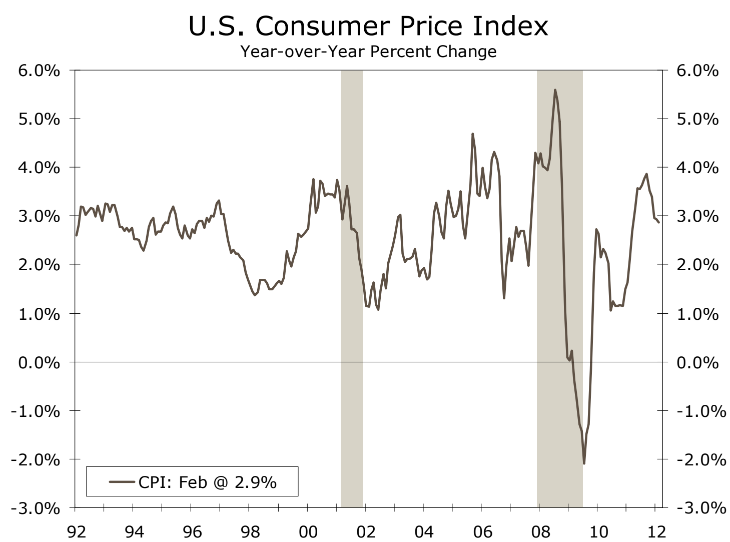
International Trade • Thursday

The trade deficit widened in January to $52.6 billion from $50.4 billion in December as imports rose 2.1 percent while exports rose only 1.4 percent. The jump in imports was led by a $2.4 billion surge in autos and parts imports, which was in line with the strong auto sales numbers we have seen recently. The gradual resumption of production of parts further up the supply chain following the Thailand floods has likely been a factor in stronger sales. Demand was also strong for fuel oil, but crude oil imports declined. Exports were driven by gains in computer accessories, civilian aircraft and semiconductors, while consumer goods exports saw broad weakness. We expect robust job growth to fuel strong import growth, while high oil prices will add to the import bill. Meanwhile, weakness in Europe and a slowdown in China will weigh on exports. This means trade will likely remain a drag on economic growth in the near to medium term.

Previous: -$52.6B **Wells Fargo: -$52.1B**

Consensus: -$52.0B





University of Michigan Sentiment • Friday

The University of Michigan Consumer Sentiment Index improved in March to 76.2, the highest since February 2011 and up from 75.3 in February. The current conditions index rose to 86.0 from 83.0, but the outlook index dipped to 69.8 from 70.3. Strong job growth, a rising stock market and a budding housing recovery are giving Americans more confidence on the sustainability of the recovery. However, consumers are becoming concerned about rising gas prices, which have jumped 23 percent since late December. Gas prices were the biggest factor in the rise in consumer prices in February, and with inflation outpacing hourly earnings growth for 12 months straight, we are concerned that eventually consumers could pull back their spending. However, consumers have chosen to continue spending while saving less of their income. If negative earnings growth doesn't curb spending, lower savings rates will eventually lead to some frugality.

Previous: 76.2

Consensus: 76.5

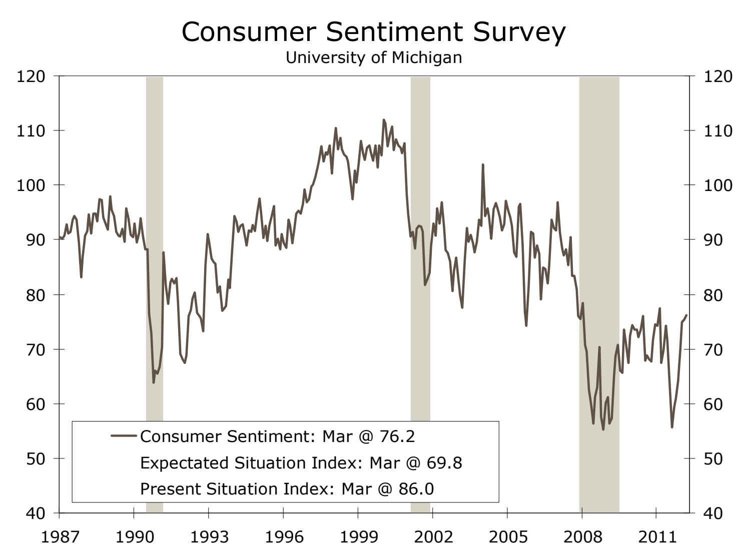
Consumer Prices • Friday

Consumer prices rose 0.4 percent in February, the biggest gain in 10 months, and were up 2.9 percent from a year ago. Core prices rose just 0.1 percent and were up 2.2 percent year over year. Nearly all of the increase in prices in February was due to a 6.0 percent jump in the price of gasoline. Meanwhile, falling cotton prices helped to push apparel prices lower.

While annual growth in overall prices has edged down, core inflation remains near the top of the recent range. The Federal Reserve believes the jump in oil and gas prices is only temporary and that prices will eventually moderate later this year. As such, there is little concern about inflation at the present time, even with core inflation elevated. Still, stronger job growth and further escalation of the situation with Iran pose upside risks to inflation. But even stronger job growth may not be much of a concern with hourly earnings growth the lowest in decades.

Previous: 0.4% (Month-over-Month) **Wells Fargo: 0.4%**

Consensus: 0.3%



Global Review

Survey Says…

While the first quarter is now in the rearview mirror, it will still be several weeks before we have first-quarter economic numbers with which to measure the progress of various countries across the global economy.

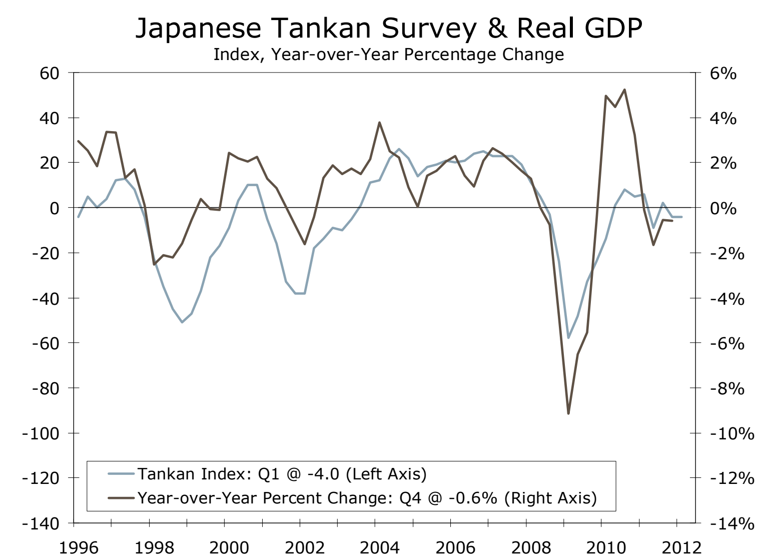
To get an early indication of how things are shaping up, we can look to survey data. While each of these surveys has different questions and scoring methodologies, the concept is generally the same. The group conducting the survey approaches a key person within a business, typically the purchasing manager (PMI stands for purchasing managers index) and asks a series of questions usually about orders, inventories, shipments and employment. Survey results are often presented as a diffusion index, typically "50" is the line of demarcation that marks the distinction between expansion and contraction in economic activity, but the delineation can also be drawn at zero.

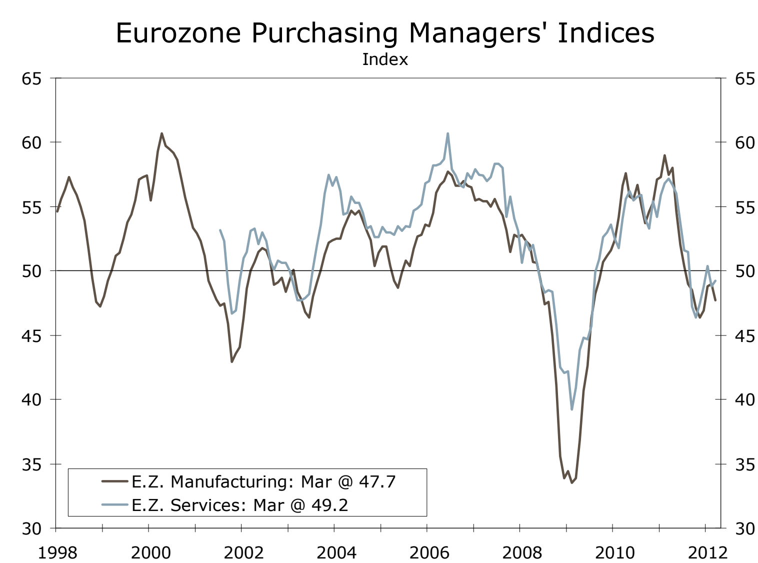
China got the ball rolling late last week and earlier this week when the manufacturing PMI and the nonmanufacturing PMI for March hit the wire. Both of these official PMI measures from China's National Bureau of Statistics showed improvement with both moving further into expansion territory, somewhat alleviating concerns of slowing growth in the world's second largest economy. Separately, a private survey of business sentiment, the HSBC PMI, slipped from 49.6 to 48.3, which seemed to undermine the official number and warn of potential slowing in output. To square the difference between the two, it helps to keep in mind that the HSBC measure tends to be more reflective of smaller, private businesses that focus on exports, while the official measure tends to capture big, state-owned enterprise. The message here may well be that domestic growth in China is outpacing foreign demand from global growth.

In Japan, the Tankan index, which was in contraction territory in the fourth quarter at -4 (zero separates expansion from growth in this survey), came in unchanged, despite the expectation for a slower pace of contraction. The Japanese economy contracted at a 0.7 percent clip in the fourth quarter. Industrial production slipped 1.3 percent in January, before rebounding 1.5 percent in February. The miss here in the survey suggests business spending still faces headwinds.

The Eurozone PMIs show that service sector sentiment is at the cusp of moving out of contraction, while the manufacturing measure at 47.7 tells us that conviction in a manufacturing-led recovery is fleeting. This is consistent with our call for a second consecutive quarter of economic contraction in for the Eurozone in the first quarter. That said, it is worth noting that the German services PMI came in at a better-than-expected 52.1, a testament to that nation's resilience to the slowdown elsewhere in Europe.

Finally, we return to North America where both ISM measures still signal expansion for the United States (for more on that see our U.S. Review section on page 2). In Canada, the Ivey PMI at 63.5 is in line with our forecast for continued economic expansion in Canada, supported by steady growth in business spending.





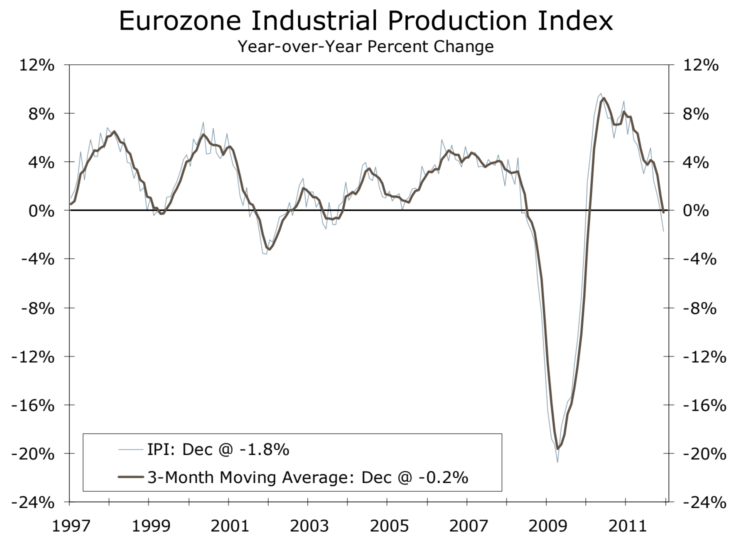
Eurozone Industrial Production • Thursday

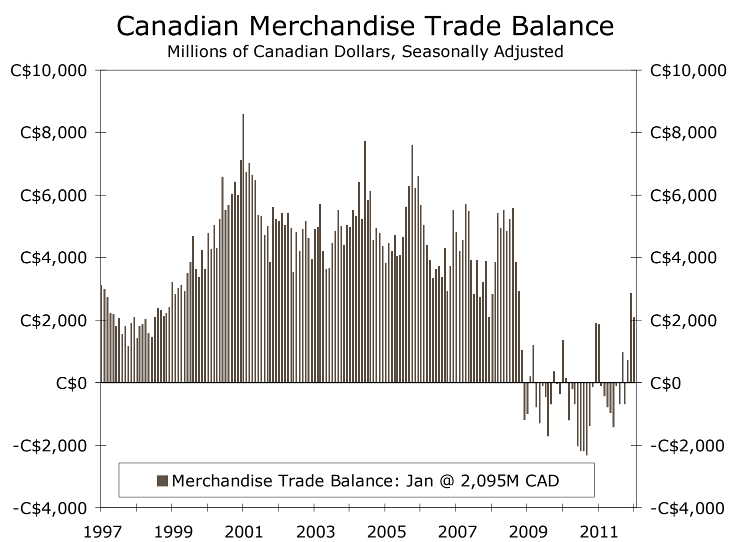
The manufacturing PMI in the Eurozone has been in contraction territory since August, and "hard" data generally corroborate the story the PMI has been telling. Industrial production (IP) in the euro area has declined in three out of the past five months. Although IP rose 0.2 percent in January relative to the previous month, the 14 percent increase in energy output, which likely reflects the colder-than-usual weather in Europe this winter, pushed up overall IP. The IP data for February, which will print on Thursday, will help analysts sharpen their GDP estimates for the first quarter.

The ECB also releases its Monthly Bulletin on Thursday. After cutting rates by 50 bps late last year, the ECB has been on hold so far in 2012. The Monthly Bulletin may provide some insights into the ECB's current thinking, and it may give some clues about the direction of monetary policy in the coming months.

Previous: 0.2% (Month-over-Month)

Consensus: -0.3%





Canadian Trade Balance • Thursday

During the global expansion of 2003-2007, Canada enjoyed very large trade surpluses. Although the country in December posted its largest trade surplus since 2008, the black ink in the current account is significantly less today than it was just a few years ago. Indeed, the narrowing of the trade surplus has been a drag on overall GDP growth over the past two years. In that regard, the recent appreciation of the Canadian dollar may be a cause for concern north of the border. Trade data for February print on Thursday.

Like the United States, housing starts in Canada weakened significantly in the wake of the global financial crisis. Unlike the United States, however, starts in Canada have subsequently rebounded strongly. The data on housing starts in March that are slated for release on Wednesday will give analysts more insights into the current state of the Canadian housing market.

Previous: C$2.1 billion

Consensus: C$2.3billion

Chinese GDP Growth • Friday

Because growth remains lackluster in many advanced economies, economic data coming out of China, the world's second-largest economy, receive intense investor scrutiny. Therefore, the GDP growth rate for the first quarter, which is on the docket on Friday, will be a major highlight for the week. The year-over-year rate of real GDP growth in China has slowed over the past two years, and our below-consensus estimate projects that it slipped below 8 percent in the first quarter for the first time since 2009.

Although the GDP data will receive the most attention, there are a number of monthly data releases for March, including international trade, industrial production, retail sales and CPI inflation that are also on the docket next week. The March data will give analysts some sense of the momentum with which the Chinese economy entered the second quarter.

Previous: 8.9% (Year-over-Year) **Wells Fargo: 7.8%**

Consensus: 8.4%

Interest Rate Watch

Renormalization of Rates

For some time, we have argued that the current benchmark Treasury rates were arbitrarily low given the aims of U.S. monetary policy, the flight-to-safety trade tie to the European sovereign debt situation and cautious expectations on economic growth. In recent weeks, all three factors have moved our way and rates are at a more normal level, but low, compared to our expectations on growth, inflation and monetary policy.

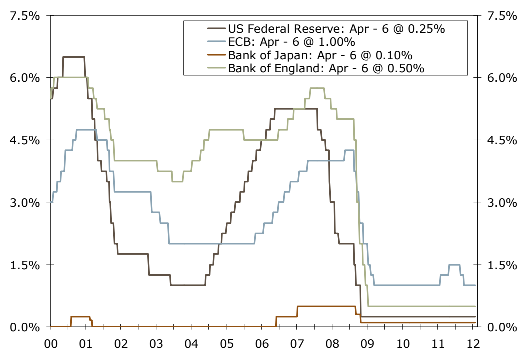
Growth in the U.S. economy is coming in at the sustained, moderate pace we had expected, and thereby, the market consensus has diminished the fat-tail risk of recession/double dip. Moreover, with employment gains averaging 200,000 over the past three months, the economic expansion looks and is more durable and will be better able to stand up to the European slowdown. Meanwhile, the downside of the European outlook has also faded as a moderate recession, not depression, appears to us to be the most likely outcome. As a result, the great flight-to-safety trade is dwindling and therefore, is the marginal demand for Treasury debt.

No QE3? No Surprise Here

Further monetary policy ease has not been the base case here, and so, this week's change in market sentiment away from the QE3 fits our view of the world. Our view has been that growth of 2.0 percent to 2.5 percent with a modest decline in unemployment is consistent with the economic fundamentals and therefore did not require further monetary policy ease. In fact, further ease would only further distort the pricing of financial assets, the dollar and increase the probability of higher inflation than currently discounted in the marketplace.

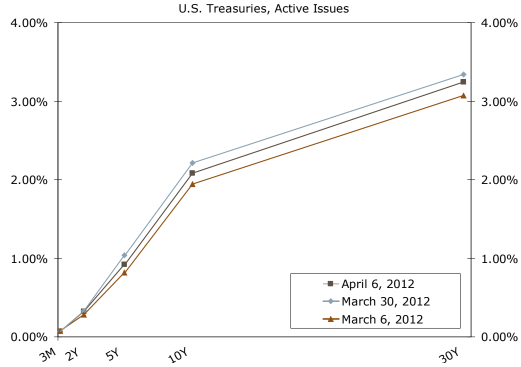
We have believed that the recent benchmark interest rates were too low to reflect an accurate gauge of market risk assessments and provide a thoughtful basis for a benchmark "risk-free" rate to price non-Treasury financial instruments. While March's weaker employment figures have pulled interest rates down again, we are holding to our view that rates will gradually increase over the balance of the year.

Central Bank Policy Rates



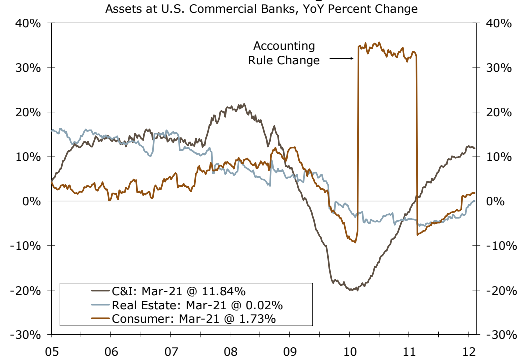
Yield Curve

U.S. Treasuries, Active Issues



Bank Lending

Assets at U.S. Commercial Banks, YoY Percent Change



Credit Market Insights

Drop in Residential Delinquencies

Recently released data from Lender Processing Services (LPS) show further improvement in loan performance in the residential mortgage market. In February, LPS reports that 7.57 percent of mortgages across the country were 30 or more days past due (but not in foreclosure), down from 7.97 percent in January and from 8.80 percent in February 2011. The LPS delinquency rate peaked in January 2010, at 10.97 percent.

Declining delinquencies in the residential mortgage market is welcome news and a sign that the housing market continues to improve. But there is still a long way to go. The LPS delinquency rate remained in the 4 percent to 5 percent range prior to the housing bust. Moreover, delinquency rates for FHA-insured loans continue to rise. According to data from the Department of Housing and Urban Development, the serious delinquency rate for FHA-insured single-family loans rose to 9.59 percent in Q1 2012 from 8.70 percent in Q4 2011. In Q1 2011, this rate stood at 8.78 percent. The highest delinquency rates for FHA-insured loans continue to be found in loans originated in 2007. Of all the FHA-insured single-family loans originated in 2007, nearly 26 percent are seriously delinquent.

Foreclosure starts will likely pick up in the coming months, which will lower delinquency rates further and help to clear out the large backlog of vacant homes weighing on the market.

Credit Market Data

Mortgage Rates	Current	Week Ago	4 Weeks Ago	Year Ago
30-Yr Fixed	3.98%	3.99%	3.88%	4.87%
15-Yr Fixed	3.21%	3.23%	3.13%	4.10%
5/1 ARM	2.86%	2.90%	2.81%	3.72%
1-Yr ARM	2.78%	2.78%	2.73%	3.22%
Bank Lending	**Current Assets (Billions)**	**1-Week Change (SAAR)**	**4-Week Change (SAAR)**	**Year-Ago Change**
Commercial & Industrial	$1,382.3	13.37%	10.89%	11.84%
Revolving Home Equity	$545.5	-8.65%	-9.02%	-4.56%
Residential Mortgages	$1,567.0	-8.64%	11.54%	4.80%
Commerical Real Estate	$1,421.8	-8.20%	-2.79%	-3.07%
Consumer	$1,091.5	-7.51%	2.34%	1.73%

Source: Freddie Mac, Federal Reserve Board and Wells Fargo Securities, LLC

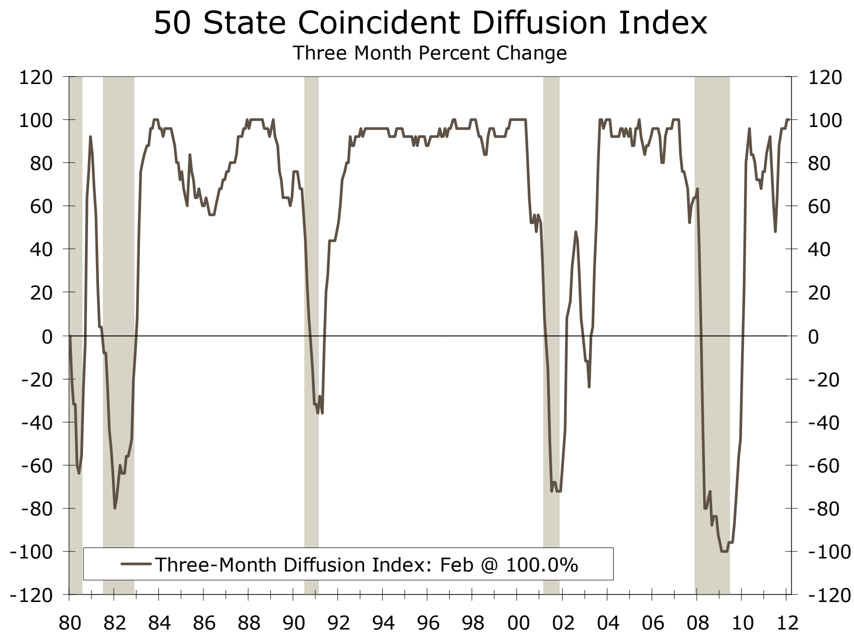
Topic of the Week

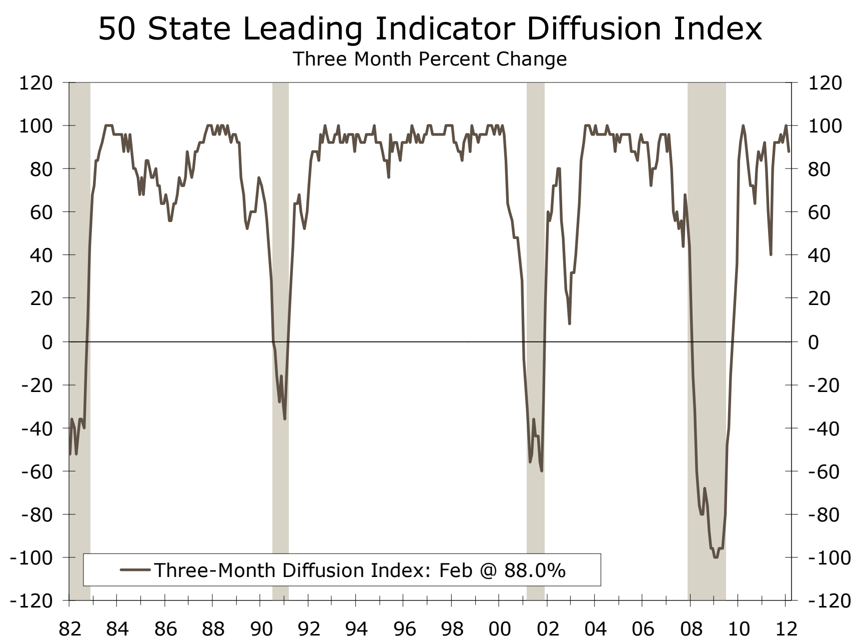
Regional Data Points To A Mid-Year Slowdown

Aggregate U.S. macroeconomic data has continued to strengthen over the last several weeks, pointing towards a stronger than expected first quarter. The question that remains to be answered is whether the current pace of growth will persist through the end of the year. Our current forecast view is that the middle of the year will be characterized by somewhat slower GDP growth as the pace of hiring moderates and uncertainty around the future political landscape increases.

Data this week on the current condition of state economies from the Philadelphia Fed indicated that economic conditions have continued to improve and according to the 50 state composite indexes (top graph), economic growth conditions are on par with the pace of growth observed before the onset of the recession. The 100 percent reading on the index coincides with all fifty states reporting better economic conditions than the previous month. Thus each region of the country appears to be positivity contributing to growth.

One of the regional tools we use to guide our thinking during the forecasting process is a composite index constructed by our group of state leading indices. Like the coincident index, this measure aggregates state specific leading economic variables with current economic conditions to produce a six-month ahead forecast for each state's coincident indicator. The bottom graph highlights how the index provides a leading signal before economic growth slows. The index also successfully forecasted the dramatic slowdown in the US economy in the fall of last year. While the index currently remains firmly in positive growth territory, the pace of overall growth across the nation is expected to slow over the next several months. One reason for the pullback in state index values may be due to differences in the pace of initial jobless claim declines around the country. While only one factor influencing our thinking, the leading index does provide evidence that the pace of economic growth is likely to slow in the months ahead.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 4/6/2012	1 Week Ago	1 Year Ago
3-Month T-Bill	0.07	0.07	0.06
3-Month LIBOR	0.47	0.47	0.29
1-Year Treasury	0.21	0.21	0.25
2-Year Treasury	0.32	0.33	0.83
5-Year Treasury	0.92	1.04	2.31
10-Year Treasury	2.08	2.21	3.55
30-Year Treasury	3.25	3.34	4.59
Bond Buyer Index	4.08	4.02	5.04

Foreign Exchange Rates

	Friday 4/6/2012	1 Week Ago	1 Year Ago
Euro ($/€)	1.310	1.334	1.433
British Pound ($/₤)	1.588	1.601	1.633
British Pound (₤/€)	0.825	0.833	0.877
Japanese Yen (¥/$)	81.490	82.870	85.490
Canadian Dollar (C$/$)	0.997	0.999	0.961
Swiss Franc (CHF/$)	0.917	0.903	0.919
Australian Dollar (US$/A$)	1.031	1.035	1.044
Mexican Peso (MXN/$)	13.050	12.811	11.806
Chinese Yuan (CNY/$)	6.306	6.299	6.544
Indian Rupee (INR/$)	51.105	50.785	44.585
Brazilian Real (BRL/$)	1.823	1.821	1.610
U.S. Dollar Index	79.866	79.004	75.514

Foreign Interest Rates

	Friday 4/6/2012	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.67	0.69	1.21
3-Month Sterling LIBOR	1.02	1.03	0.82
3-Month Canadian LIBOR	1.36	1.36	1.20
3-Month Yen LIBOR	0.20	0.20	0.20
2-Year German	0.14	0.21	1.84
2-Year U.K.	0.42	0.44	1.44
2-Year Canadian	1.25	1.18	1.87
2-Year Japanese	0.12	0.12	0.22
10-Year German	1.74	1.81	3.39
10-Year U.K.	2.16	2.20	3.77
10-Year Canadian	2.13	2.11	3.42
10-Year Japanese	0.99	0.99	1.30

Commodity Prices

	Friday 4/6/2012	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	103.31	102.78	108.34
Gold ($/Ounce)	1640.25	1668.35	1459.70
Hot-Rolled Steel ($/S.Ton)	690.00	695.00	857.00
Copper (¢/Pound)	379.55	379.65	426.45
Soybeans ($/Bushel)	14.28	13.51	13.56
Natural Gas ($/MMBTU)	2.09	2.15	4.23
Nickel ($/Metric Ton)	18,336	17,078	25,381
CRB Spot Inds.	537.52	539.22	628.30

Next Week's Economic Calendar

	Monday 9	Tuesday 10	Wednesday 11	Thursday 12	Friday 13
U.S. Data		**Wholesale Inventories** January 0.4% February 0.5% (C)	**Import Price Index** February 0.4% March 0.8% (W) **Monthly Budget** February -$231.683B March -$203.0B (C) **Fed's Beige Book**	**Trade Balance** January -$52.6B February -$52.1B (W) **PPI (MoM)** February 0.4% March 0.5% (W) **Core PPI (MoM)** February 0.2% March 0.2% (W)	**CPI (MoM)** February 0.4% March 0.4% (W) **Core CPI (MoM)** February 0.1% March 0.2% (W) **U. of Mich. Confidence** March 76.2 April 76.5 (C)
Global Data		**Japan** **Machine Tool Orders** Previous (Feb) -8.6% **Germany** **Trade Balance** Previous (Jan) 13.1B		**Eurozone** **IP (MoM)** Previous (Jan) 0.2% **Canada** **Trade Balance** Previous (Jan) 2.10B	**China** **Real GDP (YoY)** Previous (4Q) 8.9%

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

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