April 22, 2011

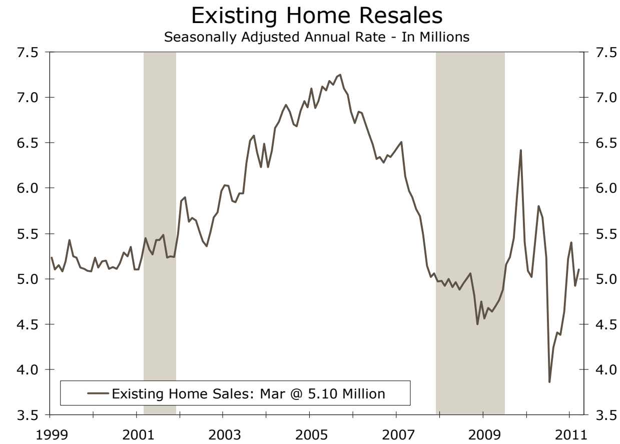
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Housing Activity Still on the Road to Recovery

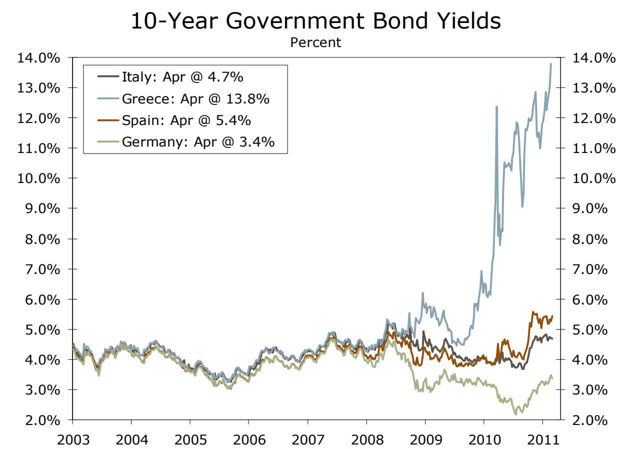
- Better-than-expected first quarter earnings helped push the Dow Jones Industrial Average to its highest level in over three years. The upbeat earnings announcements overshadowed somewhat lackluster housing market data released during the week.
- Sales of existing homes rose to a 5.1 million-unit pace in March, but distressed transactions accounted for 40 percent of overall sales. Investors accounted for 22 percent of sales and all-cash buyers rose to a record 35 percent. The increasing entrance of investors and all-cash buyers is a sign a bottom in home prices is near.



Global Review

Sovereign CDS and Yield Spreads Widen in Europe

- Greek and Portugal yield spreads climbed to record levels this week and the cost of insuring these bonds against default increased to all-time highs. Fears of a debt restructuring have fueled the recent increases.
- In contrast to the financial concerns swirling in sovereign debt circles, European manufacturing surveys released for April suggest that manufacturing activity in Germany, France, and the EMU continues to expand at a solid pace, though clouds appear to be forming on the horizon, suggesting that manufacturing growth could be peaking.



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	3.1	1.8	2.0	2.9	2.9	0.0	-2.6	2.9	2.4	2.8
Personal Consumption	1.9	2.2	2.4	4.0	2.2	1.9	2.1	2.9	-0.3	-1.2	1.7	2.5	2.3
Inflation Indicators [2]													
"Core" PCE Deflator	1.8	1.5	1.2	0.8	0.9	1.0	1.3	1.7	2.3	1.5	1.3	1.2	1.8
Consumer Price Index	2.4	1.8	1.2	1.2	2.2	3.4	3.7	3.9	3.8	-0.3	1.6	3.3	3.3
Industrial Production [1]	8.1	7.1	6.7	3.2	6.0	4.4	4.1	3.9	-3.3	-11.1	5.3	5.0	4.0
Corporate Profits Before Taxes [2]	37.6	37.0	26.4	18.3	8.2	6.2	6.2	6.7	-16.4	-0.4	29.2	6.8	7.0
Trade Weighted Dollar Index [3]	76.1	78.8	73.6	73.2	70.6	71.0	72.0	73.0	74.3	77.7	75.6	71.6	75.5
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	1.19
Conventional Mortgage Rate	4.97	4.74	4.35	4.71	4.84	5.20	5.25	5.30	6.04	5.04	4.69	5.15	5.70
10 Year Note	3.84	2.97	2.53	3.30	3.47	3.70	3.75	3.80	3.66	3.26	3.22	3.68	4.23

Forecast as of: April 15, 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

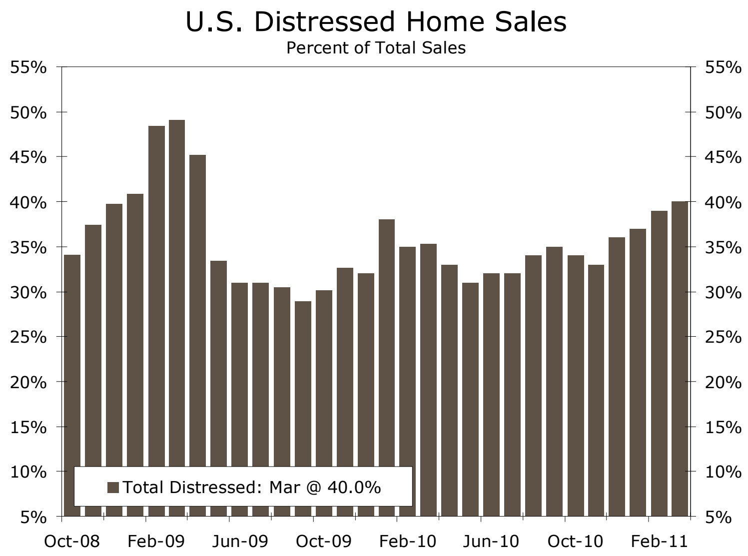
Home Sweet Rental Home

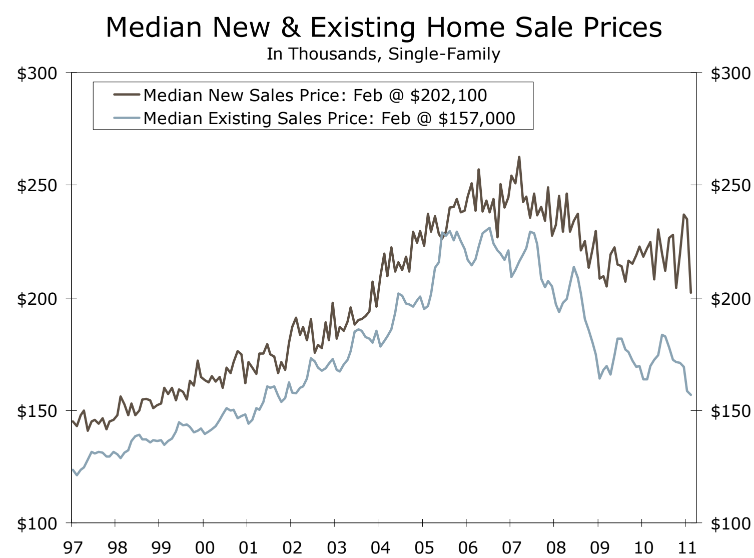
Better-than-expected first quarter earnings helped push the Dow Jones Industrial Average to its highest level in over three years. The upbeat earnings announcements overshadowed somewhat lackluster economic data released during the week. Housing indicators, in particular, continued to show that while housing activity is making some modest improvement, any recovery will be long and arduous. Indeed, being on the road to recovery is not the same as being in a recovery. Sales of existing homes rose 3.7 percent in March to a 5.1 million-unit pace, but distressed transactions accounted for 40 percent of overall sales. With foreclosures and short sales accounting for an increasing share of sales, prices will remain under pressure in the coming months.

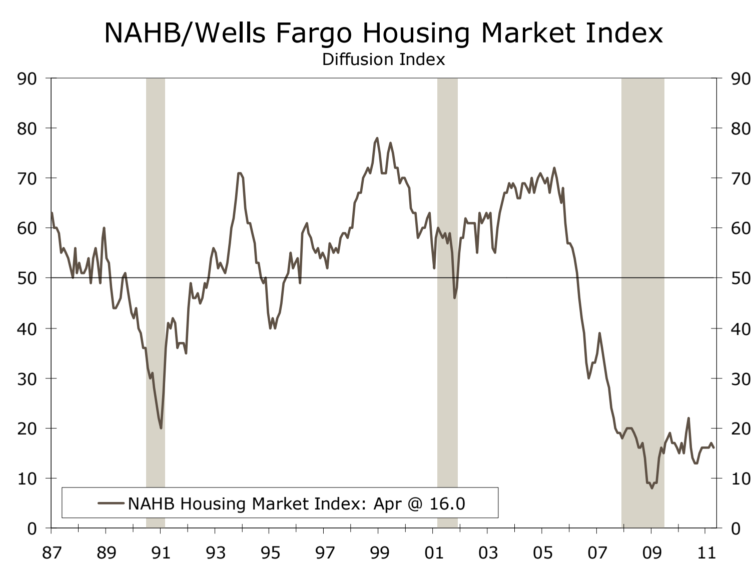
In fact, home prices are expected to continue to decline over the next six to eight months, eventually bringing the peak-to-trough decline in the median price and S&P/Case-Shiller Home Price Index to around 38 percent. The steady decline in existing home prices has significantly widened the gap between the median price of a new home versus existing home. New homes typically sell for about 12 percent above existing homes, but that premium is closer to 30 percent today, which is effectively relegating many builders to the sidelines. With foreclosed properties creating a competitive headwind for homebuilders, builder sentiment as reported by the National Association of Homebuilders/Wells Fargo Home Price Index posted a decline in April, which left the index virtually unchanged for the last six months. With builder sentiment at such depressed levels, expectations for future single-family sales fell to the lowest level in six months in April.

Housing starts were also released during the week. Housing starts rose 7.2 percent in March to a 549,000 unit pace, but much of the increase likely reflects payback from the pullback in February due to harsh weather conditions in the first half of the month. The downward pressure on home prices gives builders little incentive to ramp up single-family construction activity in any meaningful way. While single-family starts remain at depressed levels, multifamily construction continues to trend upward. The demand for rental apartments has been strong over the past year, and a large number of single-family home sales are now coming from investors intending to turn homes into rental properties. According to the National Association of Realtors, investors accounted for 22 percent of existing home sales and all-cash buyers increased to a new record of 35 percent. The increasing entrance of investors and all-cash buyers into the housing market is a sign that a bottom in housing prices is near.

Despite many of the challenges in the housing market, we expect a modest rise in starts in 2011. We project starts to increase to a 620,000-unit pace in 2011, which is a modest increase of 5.9 percent from 2010. The increase will stem from improvements in the rest of economy, particularly stronger job and income growth, improved household formation and increased housing affordability.





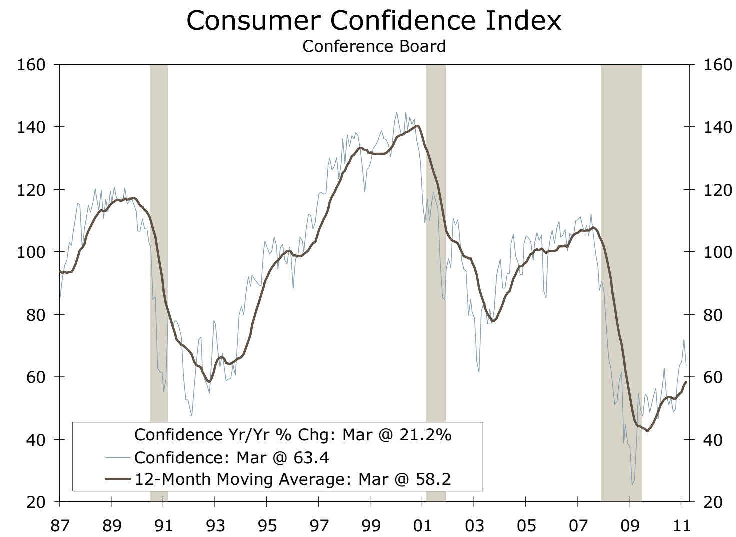


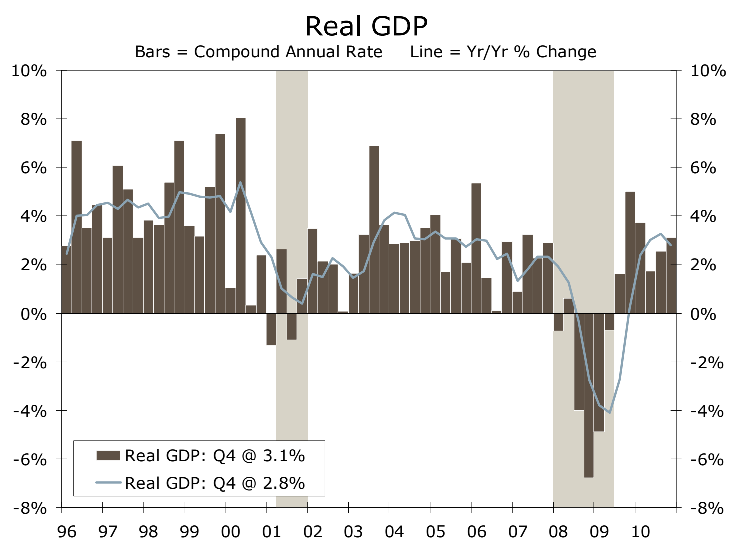
Consumer Confidence • Wednesday

Consumer confidence fell in March to 63.4 from 72.0 in February, the lowest level since December. The rise in gasoline prices along with unsettling news from abroad led the index lower for the month. Another important factor that drives the index is the current labor market conditions, which showed some improvement. The labor differential (jobs plentiful minus hard to get) represented the second best assessment of the job market in the last few years. Auto sales have been relatively strong lately compared to other forms of consumer spending; however, the release showed that plans to buy an automobile fell for the month, suggesting that auto sales may slow in the near future. We anticipate that consumer confidence will gradually improve as job growth becomes more widespread. We expect that the consumer confidence index rose to 64.5 in April as an improved job outlook and a month of positive S&P market returns helped to boost consumers' confidence.

Previous: 63.4 **Wells Fargo: 64.5**

Consensus: 64.5





Gross Domestic Product • Thursday

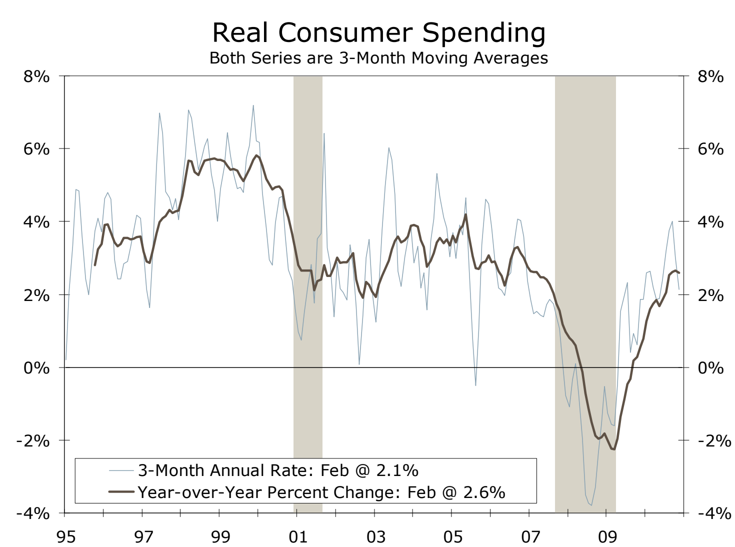
Gross domestic product rose 3.1 percent in the fourth quarter of last year, boosted in part by stronger-than-expected consumer spending. The government sector subtracted from GDP growth in the fourth quarter due to the continued budget pressures faced by state and local governments. Inventories also subtracted from GDP growth in the last quarter as stocks were depleted due to higher consumer expenditures. Going forward, we expect that both government expenditures and inventories will only marginally add to GDP growth, with the bulk of economic growth stemming from business fixed investment and a moderate contribution from the consumer sector. The economy likely grew 1.8 percent in the first quarter, slightly softer than the 3.1 percent annualized rate in Q4. Growth should begin to pickup in the later part of the year as job growth takes hold. We expect GDP growth of around 2.4 percent for the current year, rising to 2.8 percent for 2012.

Previous: 3.1% **Wells Fargo: 1.8%**

Consensus: 1.8% (Annualized)

Personal Spending • Friday

Consumer spending picked up in February, increasing 0.7 percent for the month. While this appears to be a good sign for consumer spending, most of the increase was due to higher energy prices, which rose 35.6 percent on a 3-month annualized basis. After accounting for higher prices, real spending increased a modest 0.3 percent. This translates to a 2.1 percent annualized rate, far below the 4.0 percent pace observed in the fourth quarter of last year. The savings rate slipped in February to 5.8 percent from 6.1 percent in January. We expect it will take some time for consumers to strike a new balance between their spending and level of saving, suggesting that we may not have seen the end of consumer deleveraging quite yet. We expect that personal spending continued to improve in March, rising 0.3 percent for the month.



Previous: 0.7% **Wells Fargo: 0.3%**

Consensus: 0.5% (Month-over-Month)

Global Review

Debt Restructuring Pressure Builds In Europe

Greek government debt is under the most selling pressure these days as investors see an increased probability of default over the next five years. As of this writing, Greek 10-year government bond yields were at 14.719 percent, approximately 11.46 percentage points above comparable German bonds. The Greek 2-year note was trading at 22.2 percent, a full 20.45 percentage points above the German 2-year note. This was the fourth consecutive day that Greek 2-year yields hit new record highs. The cost of insuring Greek sovereign bonds jumped to 1422 basis points, according to Bloomberg London 5-year credit default swaps. These swap prices signal more than a 68 percent chance of a Greek debt default within five years.

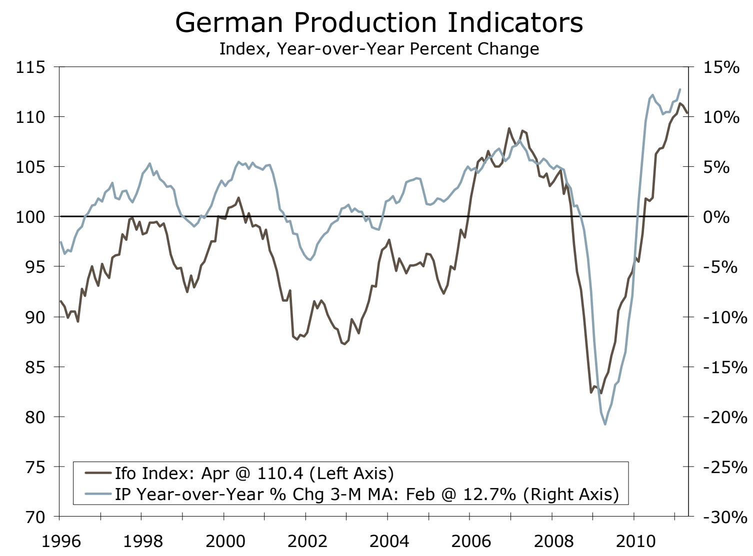
Bond yields, yield spreads, and CDS prices are also rising rapidly for Portugal and Ireland. Two-year Portugal debt yields are at 11.18, while Irish 2-year government yields are trading at 10.79. Portugal relented earlier this month to an international bailout package despite previous denials that they needed one. The debt markets appear to be just as skeptical about the Greek government's ability to avoid a debt restructuring, despite the government statements to the contrary.

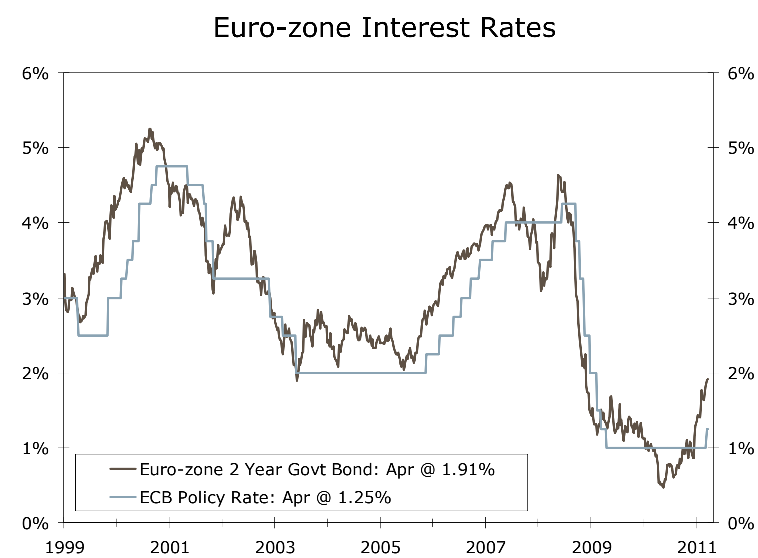
For now, at least, the debt markets appear to be keeping the sovereign debt panic contained just to these three countries. Spain and Italian debt is performing quite a bit better, though these markets are under some pressure as well. The Spanish 2-year note yield is at 3.46 percent, while the Italian 2-year is holding at around 3.05 percent.

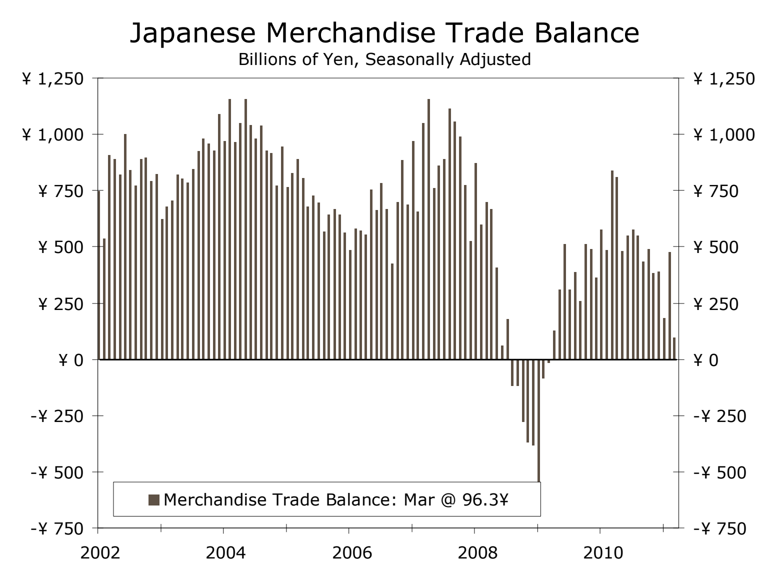
Europe Manufacturing Solid, But Clouds Appear

The German Ifo survey for April slipped to 110.4 from 111.1 in March. The current assessment balance increased to a new high for this cycle of 116.3 from 115.8 in March, though the future expectations balance fell to 104.7 from 106.5 the previous month. The ECB's recent decision to raise its benchmark interest rate has caused the euro to strengthen over the past month, putting more competitive price and margin pressures on the country's manufacturing exporters. Other pressures from rising oil prices, conflict in the Middle East, supply disruptions with Japan and concerns about German bank exposure to a Greek restructuring certainly could be playing a role in the reduction in future manufacturing expectations as well. It is still too early to tell if this is the start of a larger growth slowdown in manufacturing or just a plateauing in activity in an overall solid economic environment. In defense of the continued growth story, Reuters PMI manufacturing indices for Germany, France, and the EMU all strengthened in April, consistent with a manufacturing expansion that remains on a solid foundation for now.

Japan released March's trade balance report that revealed a 2.2 percent year-on-year contraction in Japanese exports. From February, Japan's exports fell 7.7 percent as the earthquake's impact surfaced. This was well below consensus expectations. Meanwhile imports surged at an 11.9 percent year-on-year pace. Net exports will be a large drag on Japan's growth near-term.







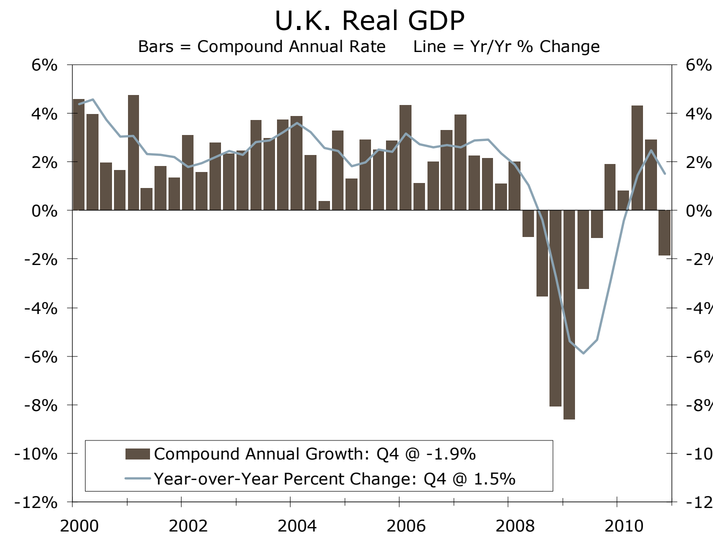
U.K. GDP • Wednesday

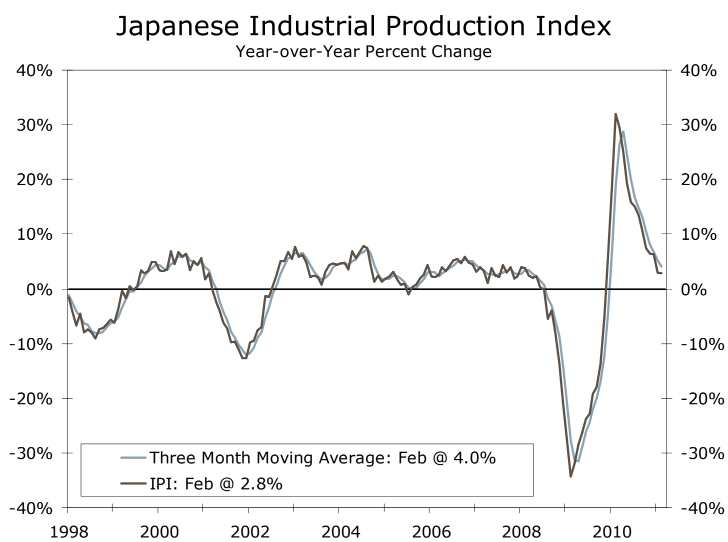
Real GDP contracted 0.5 percent (not annualized) in the fourth quarter relative to the previous quarter. Although unusually harsh winter conditions in December may have helped to depress overall GDP, British statistical authorities estimate that growth would have been roughly flat in the absence of the weather effects. In other words, the British economy ended 2010 on a soft note. The first look at growth in the first quarter will be released on Wednesday. Monthly data suggest that the overall rate of GDP growth turned positive again in the first quarter, although the pace of growth was probably not very strong.

The GDP data will be an important input into the next policy meeting at the Bank of England on May 5. If, as we expect, the economy expanded at only a modest pace in the first quarter, then the Monetary Policy Committee likely will keep its benchmark policy rate unchanged at 0.50 percent.

Previous: -0.5% **Wells Fargo: 0.4%**

Consensus: 0.5 (Not Annualized)





Japanese Industrial Production • Thursday

There has been very little "hard" data yet to gauge what effects the March 11 earthquake and tsunami had on the economy. However, a slew of March data that are slated for release next week will give analysts some insights into the extent of the economic fallout. One of the most important indicators will be industrial production, which is on the docket on Thursday. The consensus forecast anticipates an eye-popping double-digit decline in industrial production in March.

The natural disasters closed an unknown number of retail establishments so retail sales probably took a noticeable hit in March. Data will be released on Wednesday. Data on the unemployment rate, construction orders, housing starts and the CPI will give analysts further insights into the economic effects of the natural disasters.

Previous: 1.8%

Consensus: -10.6% (Month-over-Month)

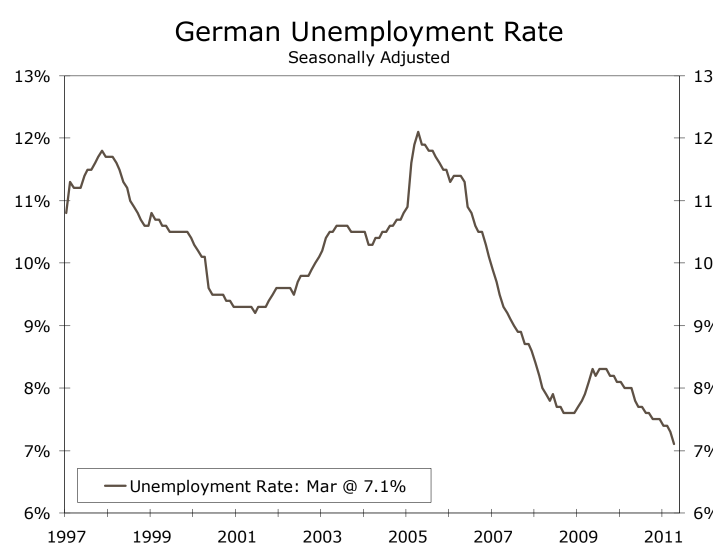
German Unemployment • Thursday

The German economy is pacing growth in the euro area, and the sharp bounce-back in the economy is leading to a recovery in the labor market. The ranks of the jobless have declined by 500,000 people since the summer of 2009, which has caused the unemployment rate to drop to a 20-year low of 7.1 percent. The consensus forecast anticipates that the rate dropped to 7.0 percent in April. Retail sales data for March, which will be released on Friday, will shed further light on the current state of the German economy.

The "flash" estimate of the overall CPI inflation rate in April in the euro area will also be released on Friday. Consumer prices rose 2.6 percent in March, the highest year-over-year inflation rate in nearly three years. An upside surprise in the overall inflation rate could cause the ECB to raise rates again at its next policy meeting on May 5.

Previous: 7.1%

Consensus: 7.0%



Interest Rate Watch

Fed: Same Policy—New Show

Policy is unlikely to change as we expect that the Federal Open Market Committee (FOMC) will complete QEII, not engage in QEIII, will maintain the target range for the federal funds rate at 0 to 25 basis points and that conditions will "warrant exceptionally low levels for the federal funds rate for an extended period."

For now, the economic fundamentals do support the FOMC's view as economic growth remains moderate, unemployment "remains elevated" and while "measures of underlying inflation continue to be somewhat low."

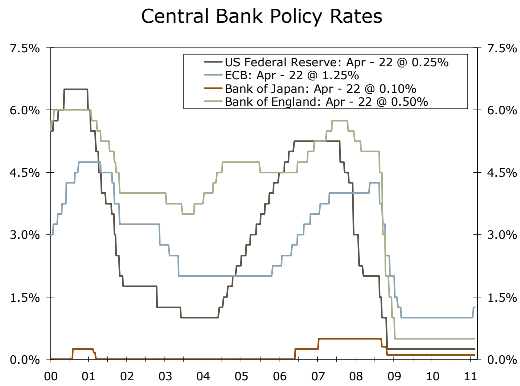
For economic growth, we expect that real GDP will be reported at 1.8 percent for the first quarter with gains in consumer and business equipment spending while residential investment and trade will subtract from growth. For the year we estimate a growth pace of 2.4 percent which will deliver a modest decline in the unemployment rate from 8.8 percent today to 8.4 percent by the end of the year.

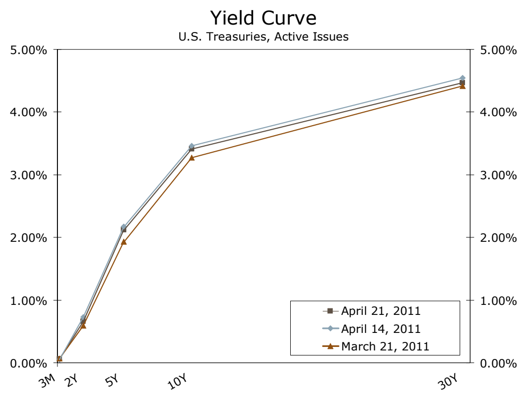
We are not as complacent as the FOMC on inflation. The impacts of food and energy price increases have not been and are not likely to become "transitory" as cited by the FOMC. Over the last six months, both the overall and core measures of inflation have drifted upward while the five-year five-year ahead TIPS measure of inflation has drifted upward from 2.0 to 2.65 and thereby suggests that inflation expectations have moved upward. The rise in the TIPS breakevens should be a concern to some members of the FOMC as well as private investors.

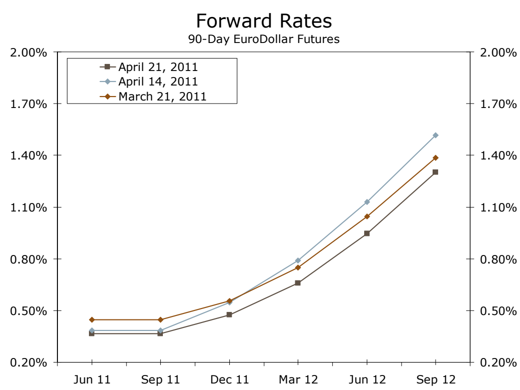
Dual Mandate Proscribes the Options

With the FOMC's dual mandate in hand, we expect that the unemployment rate will remain a strong counterweight against any early move in policy. The Fed will complete its purchase program for $600 billion of Treasury debt yet we also anticipate that there will be no follow-up program given our current economic outlook.

Steady policy will not be the big story. The focus will be how Chairman Bernanke will handle himself and questions from sometimes hostile journalists this week.







Credit Market Insights

ABS Market Still Dead in the Water

The market for asset-backed securities (ABS) remains in the doldrums and issuance continues to trend lower. Following the brief mini-boom in the first half of 2009, the three-month moving average of ABS issuance has dropped from $20.7 billion in July 2009 to just $9.9 billion in March 2011. Issuance year to date through March was $29.8 billion, 8.6 percent below the same period a year ago and on pace for a full-year decline of 6.2 percent from 2010 levels. As credit card debt continues to contract, credit card ABS issuance has slowed to a crawl, with the three-month moving average below $1.0 billion since last August compared to upwards of $8.0 billion at the peak. Home equity ABS is virtually extinct, as only $2.2 billion has been issued since January 2008 compared to $20-30 billion per month during the boom. Strong auto demand has led to a rebound in auto ABS recently, but even here year-to-date issuance through March was down 23.0 percent from last year. There has been a large increase in student loans outstanding lately, but the ABS market is not seeing a whole lot of issuance here either. The three-month moving average of student loan ABS issuance was just $1.3 billion in March and year-t0-date issuance was down about 25 percent from 2010. Weak lending has given the overall ABS market little in the way of supply, while demand for ABS remains lackluster amid regulatory uncertainty and lingering fears about associated risks.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.80%	4.91%	4.81%	5.08%
15-Yr Fixed	4.02%	4.13%	4.04%	4.39%
5/1 ARM	3.61%	3.78%	3.62%	4.10%
1-Yr ARM	3.16%	3.25%	3.21%	4.05%
MBA Applications				
Composite	467.5	444.0	524.4	550.5
Purchase	210.8	191.7	191.7	240.1
Refinance	1,975.2	1,923.9	2,471.2	2,371.0

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

Topic of the Week

Fiscal Profile: "Meaningfully Weaker"

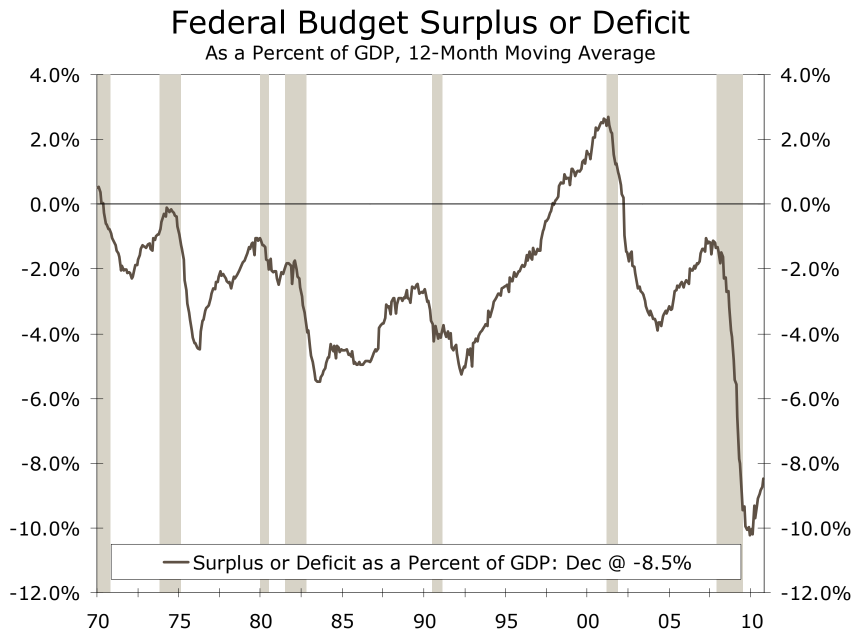
In 1933, a first-term President decided to default on the U.S. sovereign debt. A weak domestic economy would not produce the revenues needed to pay off bondholders in gold coin as specified by the bond covenants. The President opted to depreciate the currency by going off the gold standard, thus nullifying the right of creditors to be paid in gold. For global investors and decision makers, S&P's revised outlook this week for AAA sovereign debt for the U.S. from stable to negative reflected the reality that the current federal deficit situation and political situation are untenable. We agree.

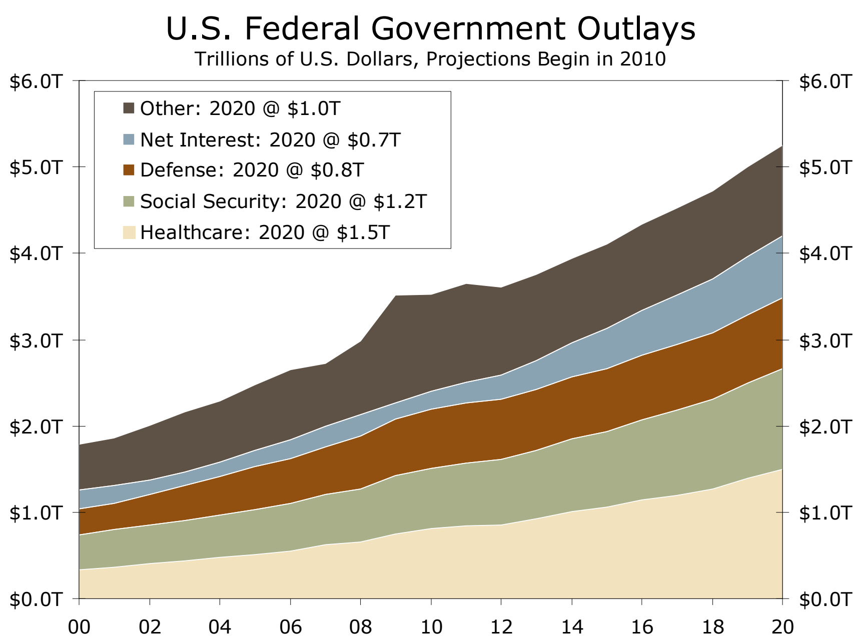
Time Inconsistency

For the last 40 years, at the state and federal government levels, political promises of entitlement benefits were made to public workers, Medicaid and Medicare as well as Social Security recipients. Over time these benefits were enhanced by subsequent political promises. Yet, making good on these promises were left to a later generation of political office holders. There is a time inconsistency between the time that promises are made and the day for delivery. It has been far too easy for political leaders to make promises without funding them—from over-indexed Social Security payments to underfunded Medicare drug benefit programs.

Patterns of Debt Devaluation

Three options are likely to be pursued in devaluing the federal debt. First, inflation will erode the real value of benefits over time. Second, taxation and tighter eligibility standards for entitlement programs will lower the real after-tax benefit of entitlement promises—this is especially apparent to voters under 40 years old. This option has been the back-door approach of recent tax "reform" measures and will likely continue in the future. Finally, steady dollar depreciation, already evident in recent years, is likely to continue in the future such that the real value of debt repayments to foreign creditors will be significantly diminished over time. S&P identified that the current fiscal and political positions are untenable. They are right.





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Market Data ♦ Thursday

U.S. Interest Rates

	Thursday 4/21/2011	1 Week Ago	1 Year Ago
3-Month T-Bill	0.05	0.07	0.15
3-Month LIBOR	0.27	0.28	0.31
1-Year Treasury	0.21	0.22	0.37
2-Year Treasury	0.66	0.77	0.99
5-Year Treasury	2.11	2.23	2.49
10-Year Treasury	3.40	3.50	3.74
30-Year Treasury	4.47	4.55	4.62
Bond Buyer Index	5.06	5.04	4.43

Foreign Exchange Rates

	Thursday 4/21/2011	1 Week Ago	1 Year Ago
Euro ($/€)	1.455	1.443	1.330
British Pound ($/£)	1.651	1.633	1.538
British Pound (£/€)	0.881	0.884	0.864
Japanese Yen (¥/$)	81.830	83.130	93.490
Canadian Dollar (C$/$)	0.953	0.959	1.000
Swiss Franc (CHF/$)	0.886	0.892	1.078
Australian Dollar (US$/A$	1.074	1.057	0.928
Mexican Peso (MXN/$)	11.613	11.663	12.210
Chinese Yuan (CNY/$)	6.522	6.531	6.828
Indian Rupee (INR/$)	44.368	44.505	44.555
Brazilian Real (BRL/$)	1.566	1.587	1.751
U.S. Dollar Index	74.106	74.685	81.161

Foreign Interest Rates

	Thursday 4/21/2011	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.32	1.28	0.58
3-Month Sterling LIBOR	0.82	0.82	0.66
3-Month Canadian LIBOR	1.20	1.20	0.50
3-Month Yen LIBOR	0.20	0.20	0.24
2-Year German	1.76	1.87	0.88
2-Year U.K.	1.12	1.24	1.20
2-Year Canadian	1.81	1.82	2.05
2-Year Japanese	0.21	0.21	0.17
10-Year German	3.26	3.43	3.08
10-Year U.K.	3.53	3.69	4.02
10-Year Canadian	3.29	3.37	3.72
10-Year Japanese	1.24	1.30	1.34

Commodity Prices

	Thursday 4/21/2011	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	112.29	108.11	83.68
Gold ($/Ounce)	1505.13	1486.70	1141.50
Hot-Rolled Steel ($/S.Ton	858.00	850.00	685.00
Copper (¢/Pound)	439.80	427.95	353.30
Soybeans ($/Bushel)	13.44	13.16	9.69
Natural Gas ($/MMBTU)	4.41	4.21	3.96
Nickel ($/Metric Ton)	26,380	26,252	27,227
CRB Spot Inds.	627.03	635.37	513.43

Next Week's Economic Calendar

	Monday 25	Tuesday 26	Wednesday 27	Thursday 28	Friday 29
U.S. Data	**New Home Sales** February 250K March 287K (W)	**Consumer Confid.** March 63.4 April 64.5 (W)	**FOMC Rate Decision** Previous 0.25% Expected 0.25% (W) **Durable Goods** February -0.6% March 1.7% (W) **Durable Ex Transp.** February -0.3% March 1.9% (W)	**GDP** 4Q 3.1% 1Q 1.8% (W)	**Personal Income** February 0.3% March 0.2% (W) **Personal Income** February 0.7% March 0.3% (W) **Employment Cost** 4Q 0.4% 1Q 0.5% (W)
Global Data		**Japan** **Retail Sales (MoM)** Previous (Feb) 0.8%	**U.K.** **GDP (QoQ)** Previous (Q4) -0.5% **Japan** **IP (MoM)** Previous (Feb) 1.8%	**Germany** **Unemployment Rate** Previous (Mar) 7.1%	**Eurozone** **CPI (YoY)** Previous (Mar) 2.6% **Germany** **Retail Sales (MoM)** Previous (Feb) -0.4%

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

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