June 24, 2011

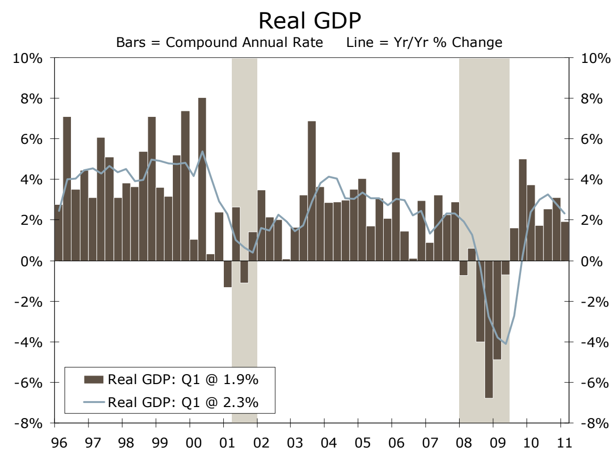
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Weak Economic Numbers and Political Impasse

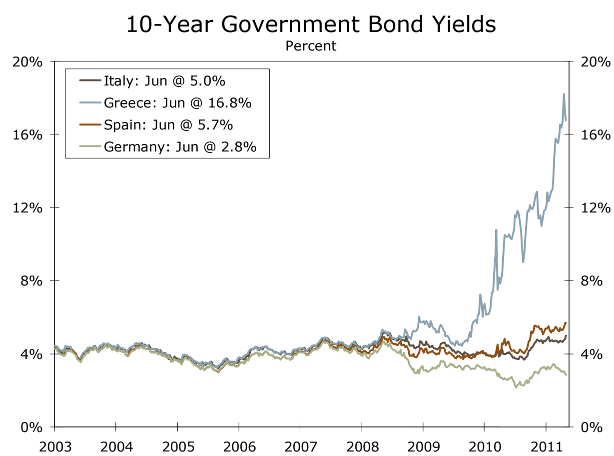
- First-quarter GDP was revised up to 1.9 percent growth versus a previously reported 1.8 percent. On the negative side, both the GDP price deflator and the core PCE deflator were revised up.
- Meanwhile, the political arena remained at an impasse, where Republicans are standing put on the issue of the debt ceiling and Democrats are still asking for increases in taxes. The two parties have been negotiating for more than three months on the issue, and it seems they are going nowhere.



Global Review

Greece Averts Disaster, For Now

- Prime Minister Papandreou narrowly survived a no-confidence vote in the Greek Parliament this week, while France and Germany moved closer to agreement on the terms of further lending to the Hellenic Republic.
- Attention now turns to the vote in the Greek Parliament on further austerity measures that will be held next week. Even if the legislation passes, we probably have not heard the last of the sovereign debt crisis among highly indebted European countries.



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	3.1	1.9	2.0	2.7	3.0	0.0	-2.6	2.9	2.4	2.5
Personal Consumption	1.9	2.2	2.4	4.0	2.2	2.1	1.8	3.0	-0.3	-1.2	1.7	2.5	2.1
Inflation Indicators [2]													
"Core" PCE Deflator	1.8	1.5	1.2	0.8	0.9	1.1	1.6	2.1	2.3	1.5	1.3	1.4	2.2
Consumer Price Index	2.4	1.8	1.2	1.2	2.2	3.5	3.7	4.0	3.8	-0.3	1.6	3.3	3.0
Industrial Production [1]	8.1	7.1	6.7	3.1	4.2	1.8	6.8	3.0	-3.3	-11.1	5.3	4.3	3.8
Corporate Profits Before Taxes [2]	37.6	37.0	26.4	18.3	10.2	6.2	6.0	6.2	-16.4	-0.4	29.2	7.1	7.0
Trade Weighted Dollar Index [3]	76.1	78.8	73.6	73.2	70.6	69.0	69.5	71.0	74.3	77.7	75.6	70.0	75.3
Unemployment Rate	9.7	9.6	9.6	9.6	8.9	9.1	8.9	8.8	5.8	9.3	9.6	8.9	8.5
Housing Starts [4]	0.61	0.60	0.58	0.54	0.58	0.56	0.61	0.66	0.90	0.55	0.58	0.60	0.76
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	0.69
Conventional Mortgage Rate	4.97	4.74	4.35	4.71	4.84	4.50	4.70	4.90	6.04	5.04	4.69	4.74	5.33
10 Year Note	3.84	2.97	2.53	3.30	3.47	2.90	3.10	3.30	3.66	3.26	3.22	3.19	3.73

Forecast as of: June 24, 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

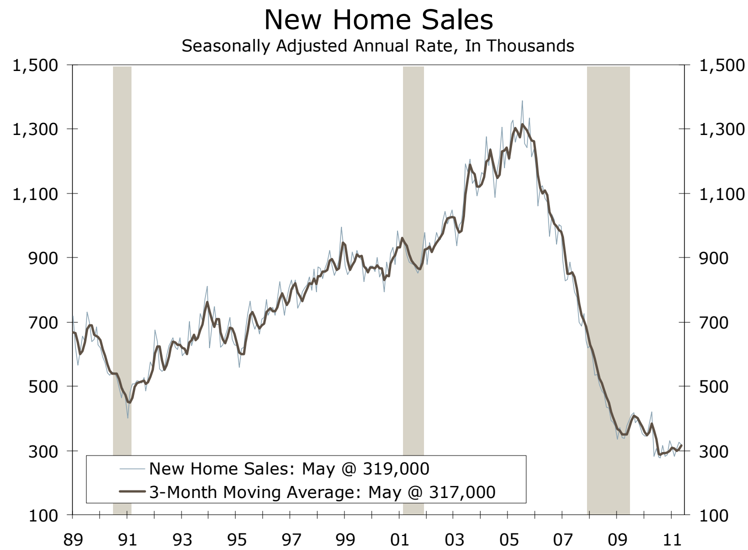
Mixed Data Confirms U.S. Economic Weakness

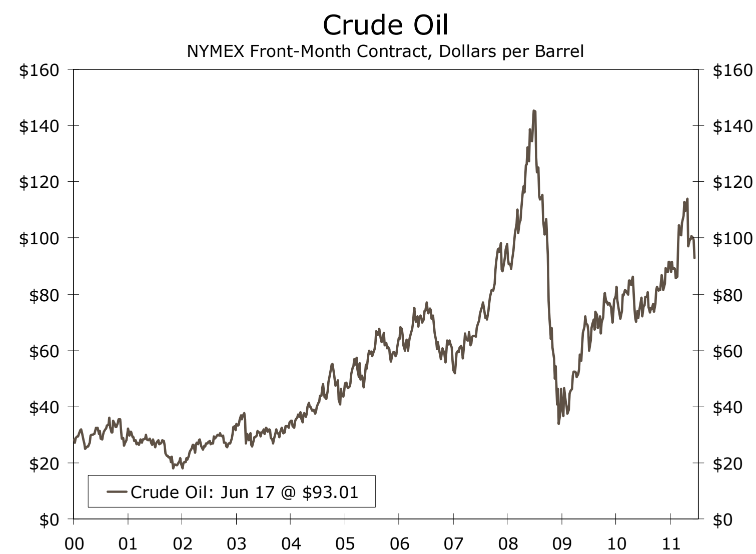
Whenever we talk about the U.S. economy, we always say that it is, if not the most, one of the most efficient economies in the world. We could even apply the saying, "the only constant is change itself." However, this does not seem to translate into other sectors of the country, where time does not seem to move and things stay the same day-in and day-out. We saw examples of this behavior again in the political arena, where Republicans are standing put on the issue of the debt ceiling. Democrats are still asking for tax increases and Republicans are replying that their mandate is no new taxes. The two parties, negotiating for more than three months on the issue, seem to be at an impasse. Hopefully, there is light at the end of the tunnel, as was the case the last time we were at this juncture, when the potential closing of the U.S. government earlier in the year ended with an agreement reached as the bell rang.

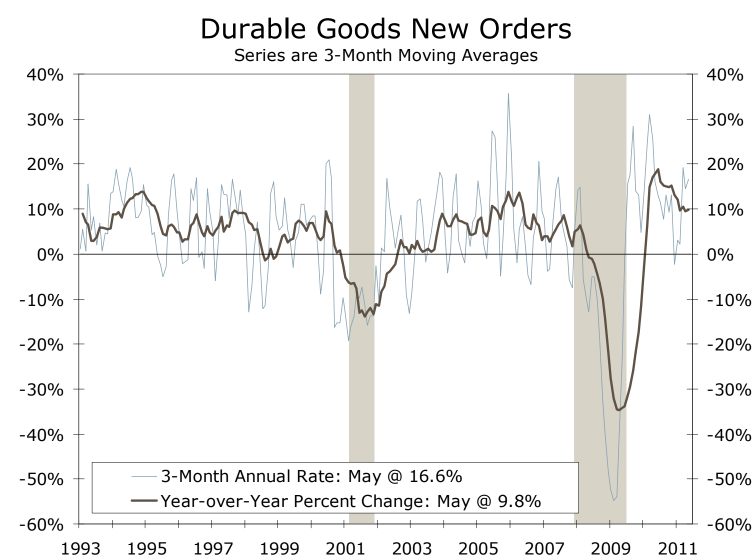
We again received some weak numbers on the housing market, with new home sales dropping 2.1 percent in May and new home inventories breaking another record low at only 166,000 units. This should be good news for the housing market as inventories are at an all-time low. While one piece of the housing puzzle may have been found, a self-sustaining recovery in new home sales and construction is still a long way off.

Oil prices continued to drop this week, and this is great news for the summer driving season and the American consumer. However, we still don't understand the reason why the U.S. government agreed to release 30 million barrels of petroleum from the Strategic Oil Reserves while other countries--represented by the International Energy Agency (IEA)—agreed to release 30 million more to, according to them, relieve the world's supply of oil due to the problems with supply from Libya. However, oil prices were already dropping before the decision to release these reserves. The release of reserves is expected to be made at a rate of 2 million barrels per day for 30 days. We are doubtful as to whether this will have any long lasting effect on the price of oil just because 60 million is not even one day's worth of world oil consumption (or only about 0.2 percent yearly oil consumption), which is closer to 88 million barrels per day.

Late in the week we got the revision to first-quarter GDP and durable goods orders. Both data points were relatively good, with real GDP growing at a 1.9 percent annual rate. On the negative side, the GDP price deflator and the core PCE deflator were revised up to 2.0 percent from 1.9 percent and to 1.6 percent from 1.4 percent, respectively. Personal consumption, on the other hand, was unchanged at 2.2 percent. Meanwhile, durable goods orders came at 1.9 percent vs. the consensus estimate of only 1.5 percent. A rebound in commercial aircraft orders was responsible for much of the gain. Excluding transportation equipment, orders were below consensus at 0.6 percent vs. an expected 0.9 percent. Nevertheless, this positive number on orders was probably just a rebound from the relatively strong 2.7 percent drop the previous month. Overall, the data still point to a weak economy during the second quarter.





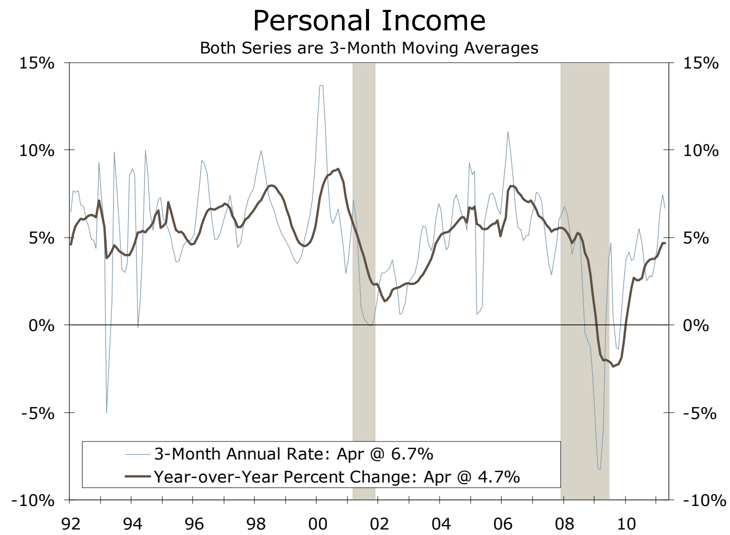


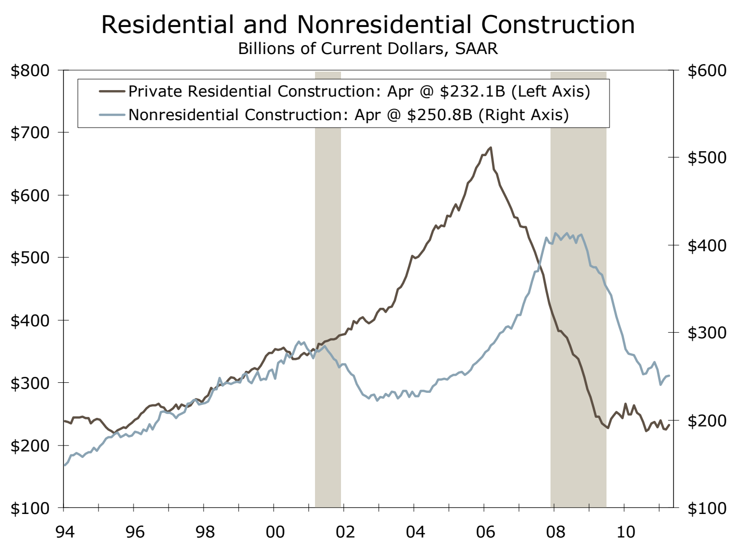
Personal Income • Monday

Personal income rose 0.4 percent in April due to strong gains in salaries and wages along with nonfarm proprietors' income. While the gains in personal income were strong, higher food and gas prices eroded much of the gain. After accounting for the pickup in inflation, real personal income rose a slight 0.1 percent. With the slowdown in real incomes, consumers are cutting back on spending and dipping into savings. Real personal consumption expenditures rose just 0.1 percent in both of the past two months as households struggled to deal with the higher prices of food and energy. Even with only marginal job gains in May, we expect that personal income still grew at a moderate pace due to stronger wage and salary growth trends. We expect a 0.4 percent increase in personal income for the month. Stronger job gains in the second half of the year should continue to support higher wage and salary growth figures in the third and fourth quarters.

Previous: 0.4% **Wells Fargo: 0.4%**

Consensus: 0.4% (Month-over-Month)





Construction Spending • Friday

Construction spending rose in April for the second straight month. The 0.4 percent increase in April was largely concentrated in residential construction, which increased 3.1 percent. Nonresidential construction fell 0.8 percent for the month due to a 2 percent drop in public nonresidential construction combined with a modest 0.5 percent increase in private nonresidential construction. Home improvement activity increased for the month with a 7.6 percent increase. Public nonresidential construction will continue to weigh on construction spending as all levels of government cutback on expenditures over the next couple of years. Our outlook continues to signal somewhat stronger construction spending in the second half of the year as home building activity slowly begins to pick back up. Nonresidential construction, however, should remain sluggish as lending for new construction projects remains subdued.

Previous: 0.4% **Wells Fargo: -0.7%**

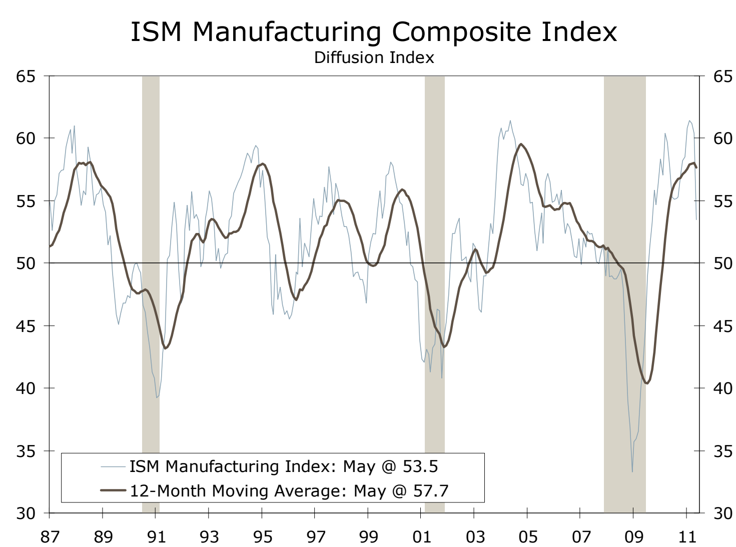
Consensus: 0.0% (Month-over-Month)

ISM Manufacturing • Friday

The ISM Manufacturing Index moderated for the third straight month in May at 53.5 suggesting a downshift in the pace of manufacturing output. Furthermore, declines in new orders and supplier deliveries indicate that there may be further slowdowns in the pace of output over the next couple of months. In addition, the upswing in input prices remains a concern. The price index remains elevated with 15 of 18 sectors reporting higher prices paid which may begin to squeeze corporate profit margins. The effects from the Japanese supply chain disruptions, for the most part, are now behind us. However, some pullback in manufacturing is expected in June as automakers move their model year factory changeovers forward to June instead of the usual month of July. The effect should be a pullback in June production and a modest boost to July's manufacturing output numbers.

Previous: 53.5 **Wells Fargo: 52.4**

Consensus: 51.5



Global Review

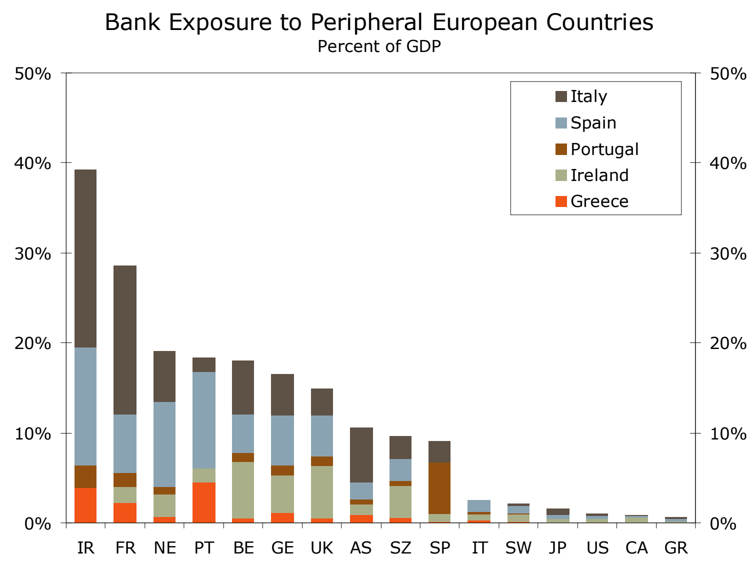
Greece Averts Disaster, For Now

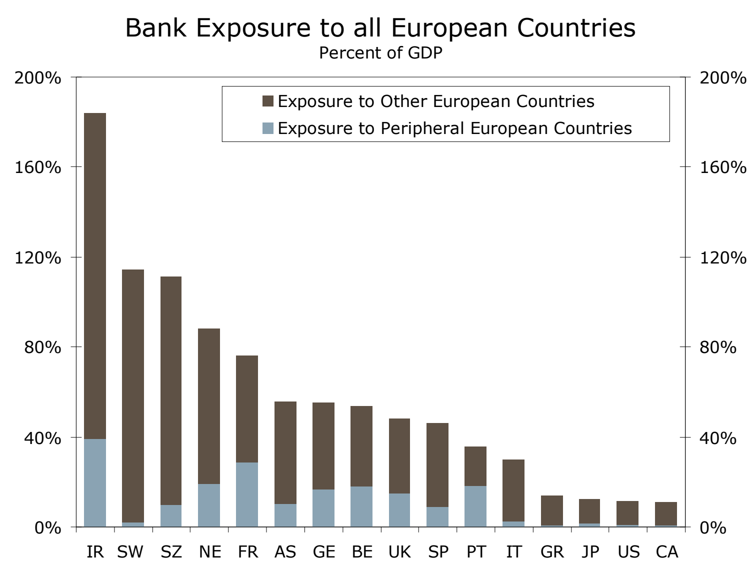
The ongoing sovereign debt crisis in Europe has been center-stage yet again over the past few weeks. When assembling Greece's €110 billion bailout package in May 2010, authorities believed at the time that the Hellenic Republic would be able to access private credit markets again in 2012. However, with yields on Greek government bonds rising into the stratosphere (see graph on front page), investors seem to have a different notion of Greece's solvency than do the European Union and the International Monetary Fund. Because a return to private credit markets in 2012 now seems far-fetched, Greece needs to go hat-in-hand to other EU countries and the IMF for more money to keep it from defaulting over the next few years.

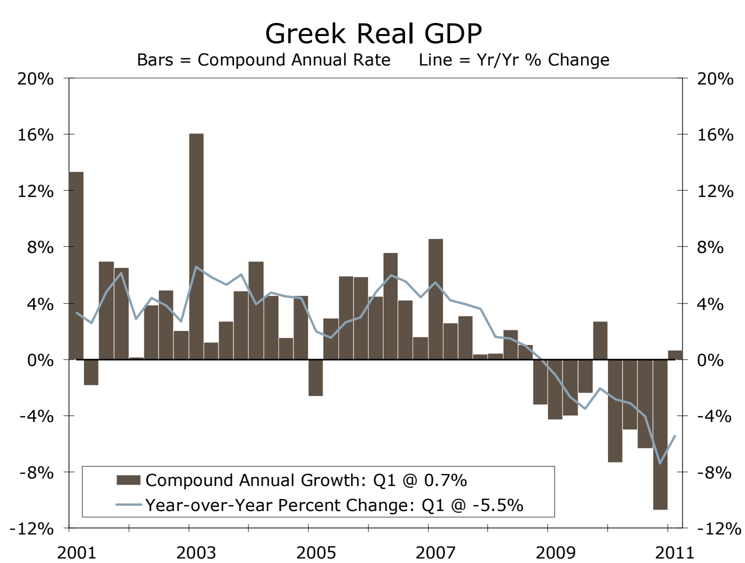
There have been two subplots to the unfolding Greek tragedy competing for investor attention. First, European countries have differed in their proposed "solutions" to the crisis. Germany and a few other nations have been demanding that private creditors should essentially be forced to lengthen the maturities on Greek debt. France and the ECB, fearing contagion spreading to other highly indebted countries, have insisted that any "reprofiling" of debt should be strictly voluntary. (Why creditors would willingly lengthen the maturities of Greek debt in the absence of some kind of incentive is unclear.) With France and Germany at loggerheads there was a very real possibility that European countries would not pony up more money for the Hellenic Republic. However, Germany has softened its stance recently by agreeing that private sector involvement could be on a voluntary basis. Therefore, the subplot of Greece not receiving more money due to bickering among EU countries does not seem to be relevant anymore.

To get the money, however, the EU and the IMF have been demanding that Greece implement more austerity measures and privatize some public companies. Enter the second subplot of Greek politics. There is a toxic brew of weak economic growth, reform fatigue, and resentment of foreigners (especially Germans) that has made more austerity measures politically unpopular in Greece. The drama was heightened this week when Prime Minister Papandreou barely survived a no-confidence vote in the Greek Parliament.

The next act will feature a vote on further austerity measures next week. Although Papandreou received unanimous support from his Socialist colleagues in this week's no-confidence vote, unqualified support of the austerity program is not guaranteed. If the vote fails, the IMF will probably withhold the next €12 billion tranche of Greece initial bailout funds. In that event, Greece would likely default on its debt and the financial markets would become volatile as investors would fret about contagion to other highly indebted European countries. If the austerity measures pass, volatility may die down for some time. However, it has been our thesis since early last year that the European sovereign debt crisis would have a slow burning fuse. Although Greece may dodge another bullet next week, every weaker-than-expected data release or higher-than-expected deficit number will cause investors to wonder what the end game is.







Japanese IP • Wednesday

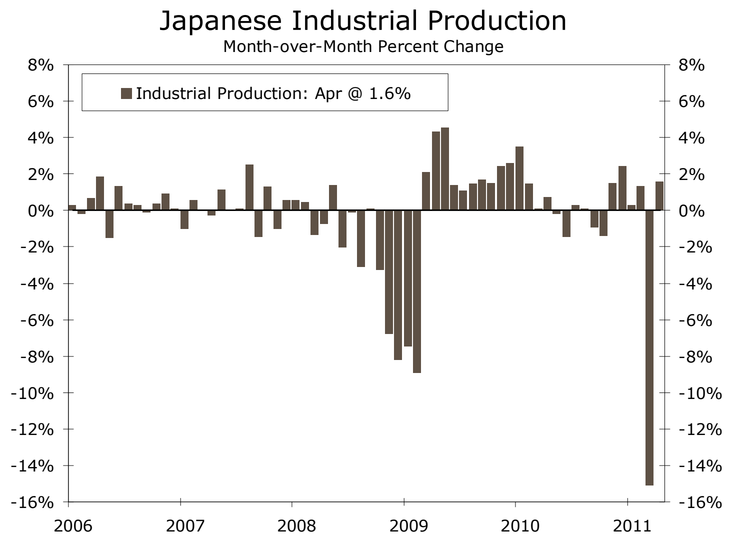
The earthquake in Japan destroyed factories, disrupted supply chains and cut off power across large areas critical to factory output. Not surprisingly, Japanese industrial production plunged more than 15 percent in March.

There was a slight bounce-back in April as power was restored to undamaged Japanese factories and output began the long recovery process. In coming months, we would expect output to continue to recover further as factories come back online and as supply chain delays get sorted out. May industrial production numbers will hit the wire on Tuesday of next week and will likely show another increase from a low base.

Eventually, the pent-up demand for specific Japanese-made goods will likely spark a snap-back in output that should boost Japanese economic growth in the second half of the year.

Previous: 1.6%

Consensus: 5.5% (Month-over-Month)

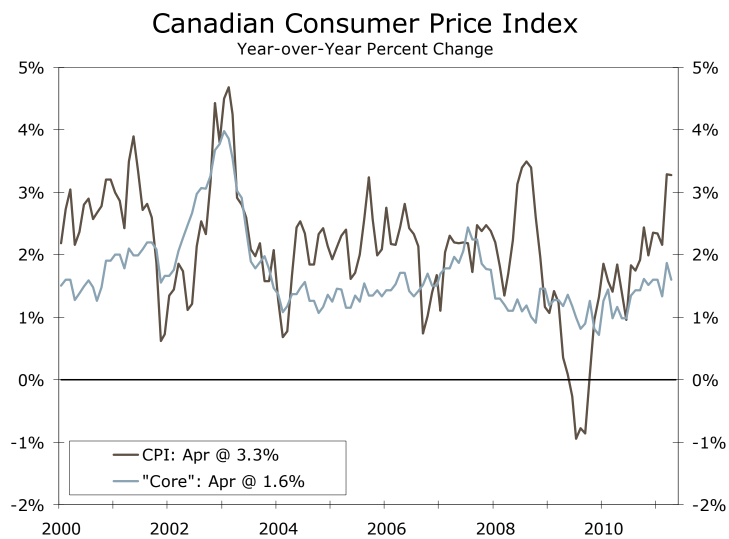


Canadian CPI • Wednesday

The Bank of Canada (BoC) has a mandate to promote price stability, specifically to achieve an inflation target of between 1 percent and 3 percent. The BoC already raised its overnight rate earlier in this cycle. Subsequently, the pace of growth in Canada has slowed and the outlook for the U.S. economy (Canada's primary trading partner) has deteriorated as well. Unfortunately for Canadian policymakers, this outlook deterioration came just as inflation was heating up. The pressure on the BoC eased somewhat when April CPI inflation data revealed that consumer prices were not rising as fast as many had feared. CPI inflation may well come in above 3 percent in the next few months due to low base effects from last year. But as inflation slows, it takes some pressure off the BoC to hike rates in a slow growth environment. May CPI data prints on Wednesday of next week.

Previous: 3.3% **Wells Fargo: 3.6%**

Consensus: 3.3% (Year-over-Year)

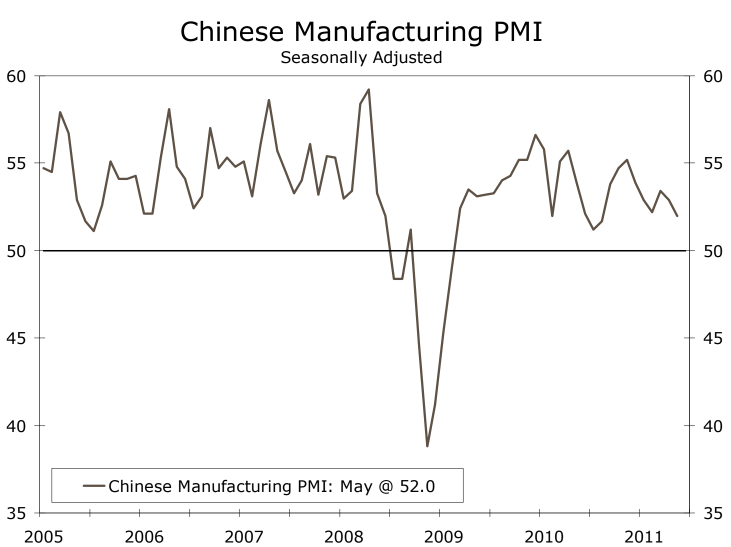


Chinese PMI • Friday

The rapid pace of economic growth over the past few years in China has contributed to growing inflation in that economy. To be sure, a fair amount of the rise in Chinese consumer prices can be attributed to higher food prices, but core CPI is picking up in China as well. In an effort to rein in economic growth and thereby stymie the run up in consumer prices, the Chinese government has begun to tighten monetary policy and raise reserve requirements for the country's banks. These measures are having the desired effect. The year-over-year rate of industrial production growth has slowed for three straight months. To get a better sense of where Chinese factory output is headed from here, we look to the manufacturing PMI—a key gauge of business sentiment. After two straight monthly declines, the consensus expectation is for a third monthly drop when the reading for June prints on Friday.

Previous: 52.0

Consensus: 51.5



Interest Rate Watch

FOMC Update: Growth Downgrade

Expectations for short-term rates have become even more solidified at current low levels, and, therefore, the likelihood of any upward move in the funds rate has become minimal.

Central tendency forecasts by the FOMC for real GDP growth for 2011 and 2012 were downgraded in the June projections compared to April's. As a result, unemployment rate expectations were raised for both years as well.

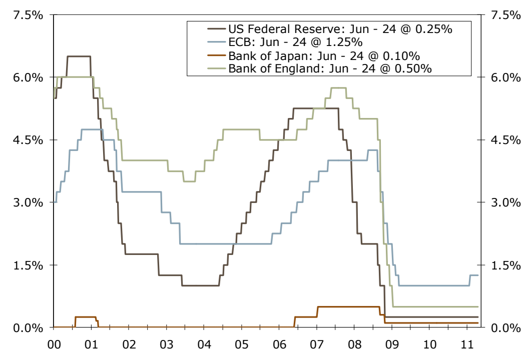
For a central bank with a dual mandate, slower growth and higher unemployment is a combination in favor of no moves toward policy restraint.

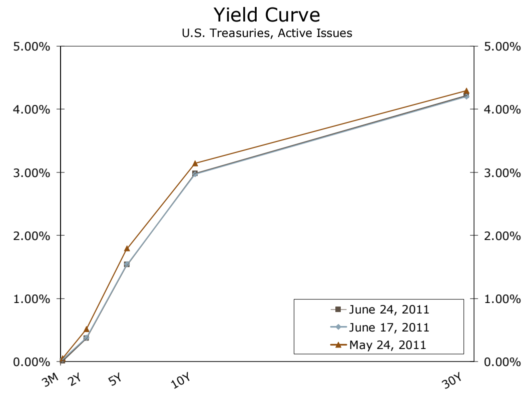
Yet, inflation projections for the inflation benchmark, core PCE inflation, were raised in both years as well. At least to this observer, this suggests some of the recent inflation increase is not transitory. Higher inflation projections suggest that a central bank with a dual mandate is not in any position to ease further by pursuing a third asset purchase program.

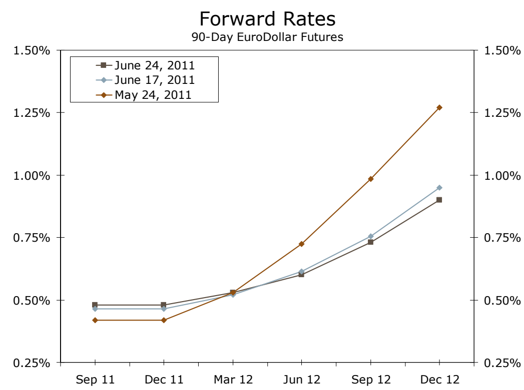
Long-Term Rates and the Yield Curve

In contrast to the FOMC's control over short-term interest rates, longer-term rates reflect the market's expectations for longer term growth and inflation as well as federal debt issuance and the euro experience. The FOMC's longer-run real GDP growth projection at 2.5 percent to 2.8 percent is lower than many analysts would have projected for trend growth in the economy. This would bias long rates downward. Second, the FOMC's longer-run projection of PCE inflation is 1.7 percent to 2.0 percent, and, if attained, would also suggest that long rates would remain lower on average than in the past.

Finally, on the positive side, euro problems make the dollar and U.S. Treasury issues attractive for risk-averse investors. In our annual forecast last December, we had projected that the benchmark 10-year rate would end this year at 3.2 percent, and that outlook remains reasonable. However, the one major uncertainty is the longer-run federal deficit forecast—that remains a wildcard.







Credit Market Insights

Higher Used Vehicle Prices Aid ABS

Auto loan asset-backed securities (ABS) issuance has been leading the way in the ABS market over the past couple of years. Auto loan ABS issuance has not only grown the most, but it has accounted for the lion's share of ABS issuance in most months during this time. In addition, the sector has seen improved recovery rates. According to Standard & Poor's, the recovery rate for prime auto loan ABS from 2000-2008 was 42.7 percent but improved to 53.4 percent for 2009-2010. One reason recovery rates have improved is because used vehicle values have improved markedly. The Manheim Used Vehicle Value Index reached a record 127.8 in May, up 5.6 percent from a year ago and up 30 percent from the December 2008 trough. Over the past couple of years, used vehicle values have been buoyed by low inventories after many manufacturers ceased leasing programs during the recession, which has led to fewer lease returns. Inventories have also remained low due to owners keeping their vehicles longer. Recently, used car values have been further boosted by the dearth of new inventories coming onto the market in the wake of the Japanese earthquake and tsunami. Furthermore, while used vehicles generally have lower fuel efficiency, high gas prices and tepid job growth have forced some consumers to buy a used vehicle instead of a new one. Finally, tighter lending standards have lowered default rates, helping to minimize auto loan ABS losses.

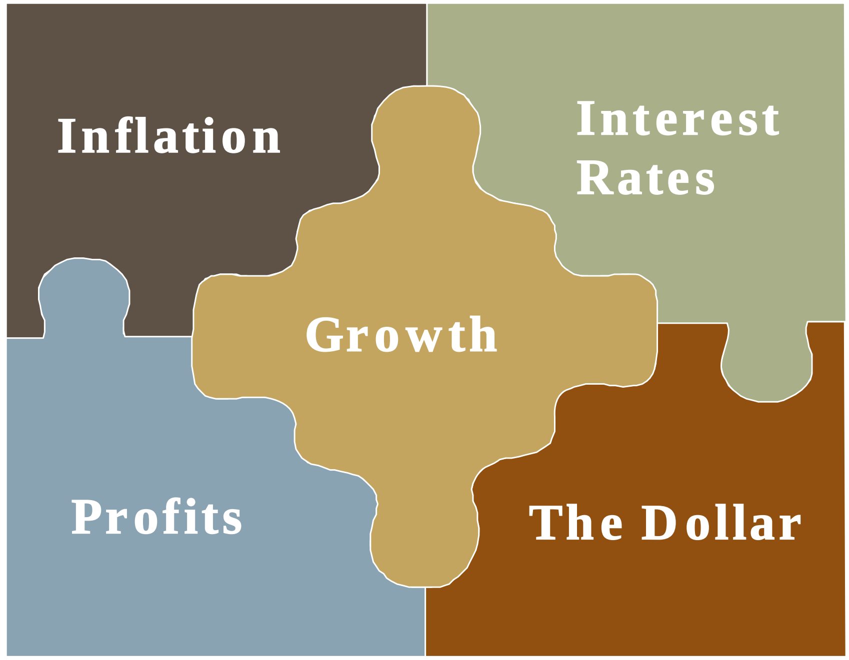
Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.50%	4.50%	4.60%	5.08%
15-Yr Fixed	3.69%	3.67%	3.78%	4.39%
5/1 ARM	3.25%	3.27%	3.41%	4.10%
1-Yr ARM	2.99%	2.97%	3.11%	4.05%
MBA Applications				
Composite	549.9	584.6	540.8	621.2
Purchase	185.8	191.1	191.4	177.9
Refinance	2,675.2	2,883.7	2,591.7	3,208.5

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

Topic of the Week

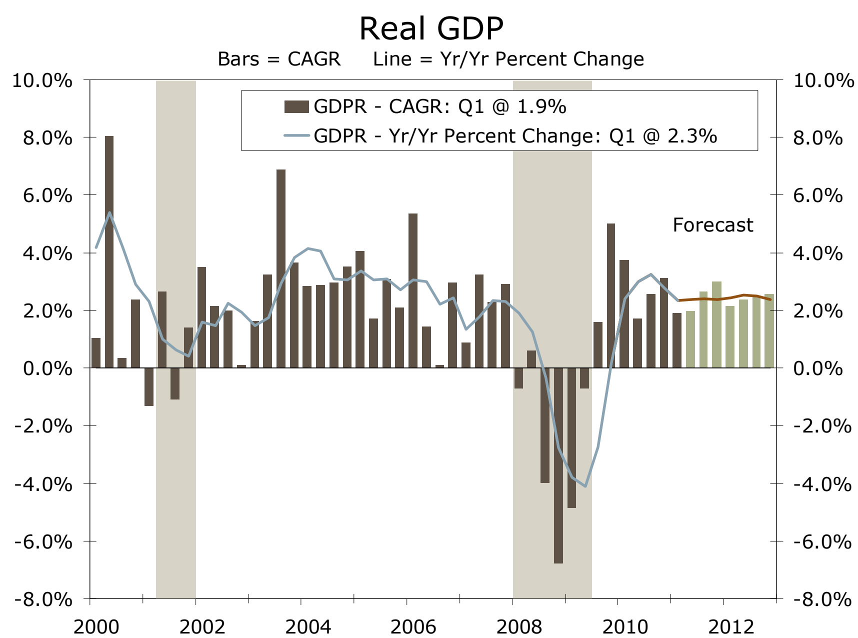
An Economic Framework for Financial Services



For the financial services sector, the economic and regulatory changes have been momentous over the past four years. Looking at our five economic fundamentals—growth, inflation, interest rates, corporate profits and the dollar—we see a familiar cyclical pattern to the data. However, there are also hints of a more ominous altering of select long-term trends that would suggest decision-makers in financial services must alter their view on how the economy affects their business.

We expect growth over 2011 and 2012 to be sustained, but at a pace below what is typically associated with a post-WWII expansion among structural shifts in the housing and labor markets. Slower growth alone forces financial service firms to reevaluate their top-line growth expectations. Inflation, our second fundamental, is drifting higher both in measured indexes and expectations. While modest, low nominal yields do not compensate for the increase—there is no need for Jimmy Carter-era inflation to generate capital losses. Modest inflation suggests higher long-term interest rates in the future, but low interest rates in the current environment are supporting opportunistic financing for corporate debt issuance. Looking at corporate profits, the strength of profit gains this cycle is linked more to the global opportunities available to many large companies and less to the subpar pace of the U.S. recovery. There are many opportunities abroad for those firms willing to explore the global territory. For the dollar, a steady erosion in its value since 2003 suggests a redistribution of spending power in favor of exporters and away from importers, and remember the United States is, on balance, a nation of net importers.

The net result of these shifts in our five economic fundamentals has led to a more globally focused corporate environment and financial services sector. Companies will need to restructure their operations and balance sheets to adjust to these long-term changes in the economy. For our full report, please visit www.wellsfargo.com/economics.



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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 6/24/2011	1 Week Ago	1 Year Ago
3-Month T-Bill	0.01	0.03	0.12
3-Month LIBOR	0.25	0.25	0.54
1-Year Treasury	0.12	0.14	0.11
2-Year Treasury	0.35	0.37	0.68
5-Year Treasury	1.44	1.53	1.95
10-Year Treasury	2.90	2.94	3.14
30-Year Treasury	4.17	4.21	4.10
Bond Buyer Index	4.46	4.49	4.40

Foreign Exchange Rates

	Friday 6/24/2011	1 Week Ago	1 Year Ago
Euro ($/€)	1.417	1.431	1.233
British Pound ($/£)	1.598	1.619	1.494
British Pound (£/€)	0.887	0.884	0.826
Japanese Yen (¥/$)	80.360	80.050	89.610
Canadian Dollar (C$/$)	0.984	0.979	1.043
Swiss Franc (CHF/$)	0.838	0.848	1.103
Australian Dollar (US$/A$)	1.052	1.062	0.867
Mexican Peso (MXN/$)	11.882	11.902	12.733
Chinese Yuan (CNY/$)	6.474	6.476	6.800
Indian Rupee (INR/$)	44.995	44.866	46.486
Brazilian Real (BRL/$)	1.595	1.598	1.784
U.S. Dollar Index	75.603	74.988	85.733

Foreign Interest Rates

	Friday 6/24/2011	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.47	1.45	0.67
3-Month Sterling LIBOR	0.83	0.83	0.73
3-Month Canadian LIBOR	1.17	1.18	0.83
3-Month Yen LIBOR	0.20	0.20	0.25
2-Year German	1.36	1.51	0.54
2-Year U.K.	0.71	0.77	0.73
2-Year Canadian	1.43	1.50	1.58
2-Year Japanese	0.16	0.18	0.16
10-Year German	2.84	2.96	2.60
10-Year U.K.	3.15	3.20	3.39
10-Year Canadian	2.89	2.95	3.22
10-Year Japanese	1.11	1.12	1.15

Commodity Prices

	Friday 6/24/2011	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	91.03	93.01	76.51
Gold ($/Ounce)	1508.40	1539.45	1243.45
Hot-Rolled Steel ($/S.Ton)	750.00	748.00	655.00
Copper (¢/Pound)	411.75	410.30	300.30
Soybeans ($/Bushel)	13.28	13.61	9.53
Natural Gas ($/MMBTU)	4.23	4.33	4.75
Nickel ($/Metric Ton)	22,099	21,568	19,202
CRB Spot Inds.	595.56	602.80	479.04

Next Week's Economic Calendar

	Monday 27	Tuesday 28	Wednesday 29	Thursday 30	Friday 1
U.S. Data	**Personal Income** April 0.4% May 0.4% (W) **Personal Spending** April 0.4% May 0.1% (W) **PCE Deflator** April 2.2% May 2.5% (W)	**Consumer Conf.** May 60.8 June 59.3 (W)			**ISM Manufacturing** May 53.5 June 52.4 (W) **Construction Spending** April 0.4% May -0.7% (W) **Total Vehicle Sales** May 11.76M June 12.2M (W)
Global Data		**Japan** **Retail Sales (MoM)** Previous (Apr) 4.1%	**Japan** **IP (MoM)** Previous (Apr) 1.6% **Canada** **CPI (YoY)** Previous (Apr) 3.3%	**Eurozone** **CPI (YoY)** Previous (May) 2.7% **China** **PMI Manufacturing** Previous (Apr) 52.0	**U.K.** **PMI Manufacturing** Previous (May) 52.1 **Brazil** **IP (YoY)** Previous (Apr) -1.3%

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

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