July 6, 2012

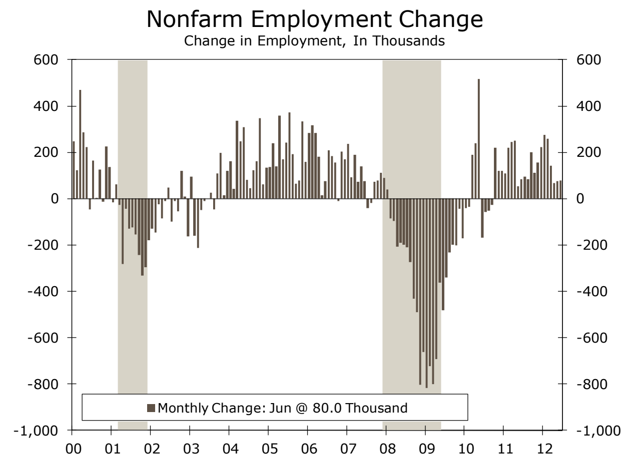
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Not Much to Cheer About

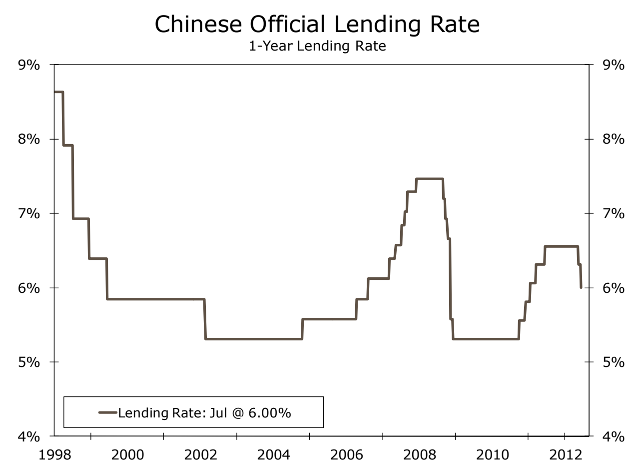
- Employment growth disappointed in June as only 80,000 jobs were created. The unemployment rate held at 8.2 percent, but the underemployment rate inched up to 14.9 percent. Average hourly earnings increased modestly.
- Both the ISM manufacturing and services indices declined in June. While new orders and production fell back, falling input costs should help support margins. Amid the weakness, employment held its ground.
- Factory orders rose in May but are trending at weak levels. Construction spending grew solidly in May.



Global Review

Further Monetary Easing by Foreign Central Banks

- The People's Bank of China cut its benchmark lending rate for the second time in four weeks. The move should help foster growth, at least on the margin, although it should be viewed in the context of the ongoing process to liberalize the Chinese financial system.
- The Bank of England maintained its main policy rate at 0.50 percent, but it chose to increase the size of its asset purchase program for the sixth time.
- The European Central Bank reduced its main policy rate to an all-time low of 0.75 percent.



Wells Fargo U.S. Economic Forecast

	Actual 2011				Forecast 2012				Actual			Forecast	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2009	2010	2011	2012	2013
Real Gross Domestic Product [1]	0.4	1.3	1.8	3.0	1.9	1.5	1.4	1.7	-3.6	3.0	1.7	1.9	1.6
Personal Consumption	2.1	0.7	1.7	3.0	2.5	1.9	1.6	1.7	-2.0	2.0	2.2	1.9	1.6
Inflation Indicators [2]													
PCE Deflator	1.8	2.5	2.9	2.7	2.3	1.7	1.2	1.1	0.6	1.8	2.5	1.6	1.1
Consumer Price Index	2.1	3.3	3.8	3.3	2.8	1.9	1.2	1.2	-0.3	1.6	3.1	1.8	1.6
Industrial Production [1]	4.4	1.2	5.6	5.1	5.6	3.1	2.4	2.2	-11.3	5.4	4.1	4.1	2.4
Corporate Profits Before Taxes [2]	8.8	8.5	7.5	7.0	5.5	6.0	5.8	5.4	9.1	32.2	7.9	5.7	5.5
Trade Weighted Dollar Index [3]	70.6	69.4	72.8	73.3	72.7	74.5	72.5	74.0	77.7	75.6	70.9	73.4	76.5
Unemployment Rate	9.0	9.0	9.1	8.7	8.3	8.2	8.4	8.3	9.3	9.6	9.0	8.3	8.1
Housing Starts [4]	0.58	0.57	0.61	0.68	0.71	0.73	0.76	0.75	0.55	0.59	0.61	0.74	0.85
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	3.68	3.70	3.80	5.04	4.69	4.46	3.78	4.05
10 Year Note	3.47	3.18	1.92	1.89	2.23	1.67	1.65	1.80	3.26	3.22	2.78	1.84	2.05

Forecast as of: July 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

U.S. Review

Not Much to Cheer About

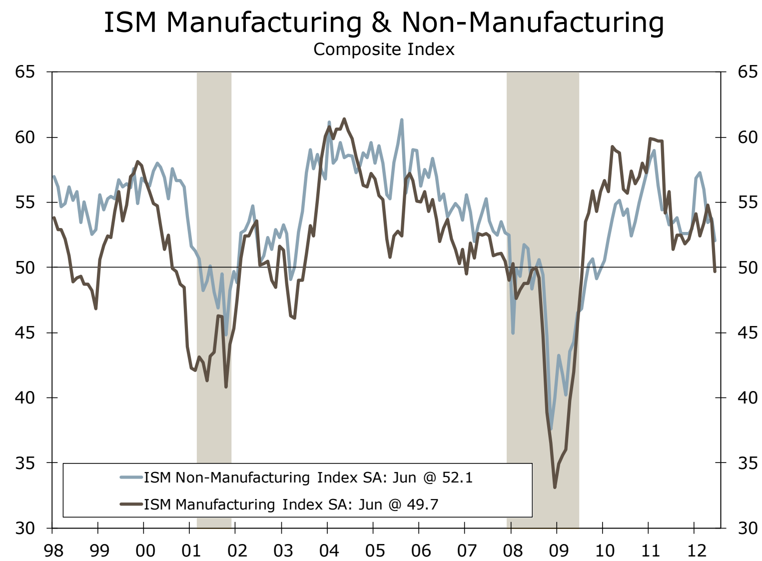
Employment growth disappointed in June, as only 80,000 jobs were created, much less than the 100,000 consensus forecast. The private sector added 84,000 jobs, while the public sector shed 4,000 positions. The biggest disappointment was arguably in education and healthcare services, which only created 2,000 jobs in June, the least in almost two years. Retailers cut 5,000 jobs, in line with weak sales during the month. The unemployment rate held steady at 8.2 percent, but the underemployment rate edged up to 14.9 percent. Still, average hourly earnings rose by the most in several months. Thus, while the economy continues to add jobs, the pace of hiring is quite anemic at this stage of the recovery.

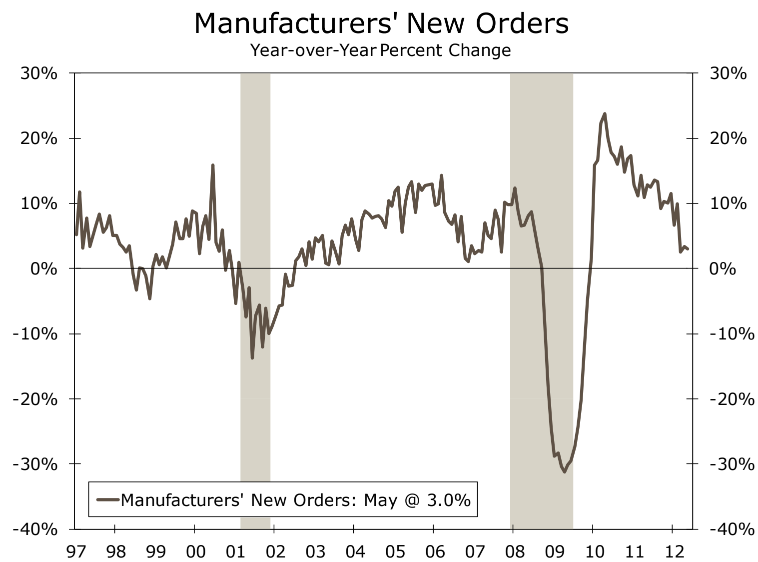
The pullback in both the ISM manufacturing and services indices in June was consistent with the labor market's recent downshift. The manufacturing index fell from 53.5 in May to 49.7 in June, the lowest in nearly three years, which means manufacturing is now in contraction. The production and new orders indices were also the lowest since early 2009, with the new orders index slipping into contraction. The new orders component is considered a forward-looking indicator, so the contraction in new orders portends weaker production ahead. The good news is that the employment index held fairly steady, while the prices paid index fell to the lowest since April 2009.

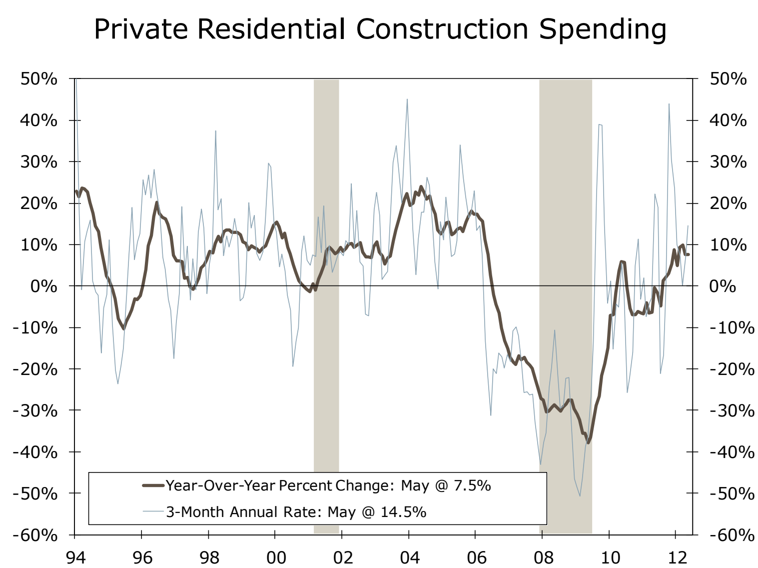
The services index fell in June to 52.1, the lowest since January 2010, from 53.7 in May. The new orders component fell from 55.5 to 53.3, the lowest since October, showing orders are still growing but at a slower rate. New export orders are in worse shape, falling into contraction for the first time since last July amid the ongoing debt crisis in Europe and slowing growth in China. As with manufacturing, the prices paid index was the lowest since mid-2009, giving service providers a break on costs. In addition, the employment index edged up, a bit at odds with the payroll report that showed a near halving in staff additions.

Factory orders rose 0.7 percent in May from the prior month. It was good to see nondefense capital goods orders, excluding aircraft, were up 2.1 percent. However, the three-month annualized rate of growth for such orders fell to -6.9 percent, the weakest since May 2009. In addition, year-ago changes in overall orders are hovering around levels not seen since the end of 2009. This suggests business investment continues to lose momentum and will not provide as much support for the economy as it did coming out of the recession as global growth slows and tax incentives fade. Furthermore, inventories fell for the second straight month, suggesting inventories will likely be a drag on second quarter economic growth.

This week we also got a look at construction spending, which rose 0.9 percent in May from the prior month and was up 7.0 percent from a year ago. The increase came from private spending, driven by a 3.0 percent rise in residential construction. While the rebound in housing is supporting private construction spending, tight budgets continue to weigh on state and local government construction spending, which fell for the fifth straight month.





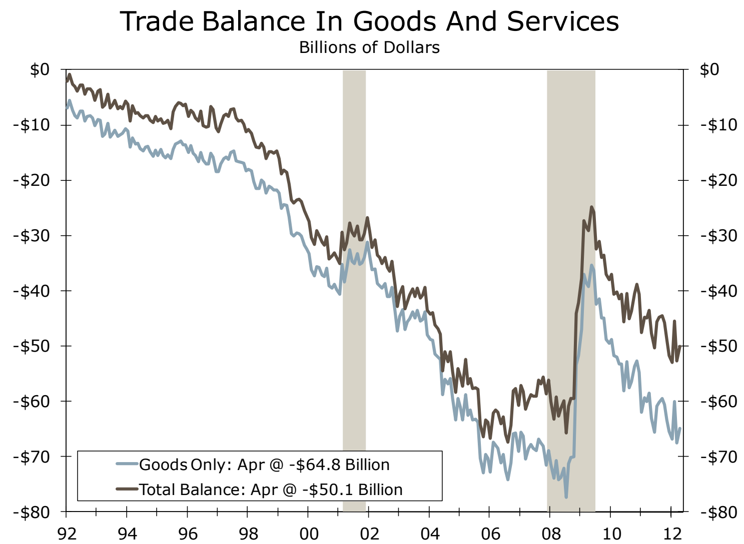


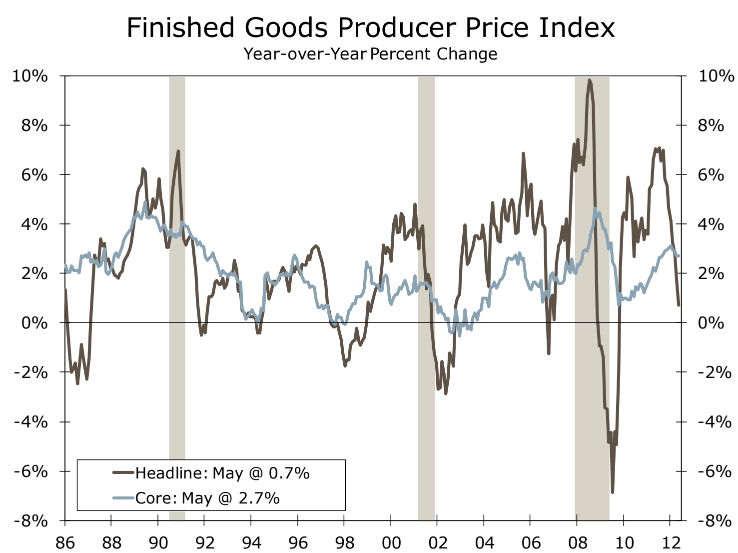
Trade Balance • Wednesday

The nominal trade deficit narrowed in April to -$50.1 billion from -$52.6 in March as the pace of decline in imports fell more than exports. Much of the pullback in imports can be attributed to a drop in capital goods, but declines were fairly broad based. Exports also retraced in April, with capital goods and industrial supplies also showing weakness. May's trade deficit will have implications on economic growth in the second quarter and the trade component in national and regional manufacturing surveys' for May and June suggest trade may be a slight drag on growth. That said, with the slowdown in global economic activity and tepid consumer demand, we do not expect trade to make a major contribution to real GDP for the foreseeable future.

Previous: -$50.1 billion **Wells Fargo: -$48.7 billion**

Consensus: -$48.5 billion





Producer Price Index • Friday

Largely reflecting lower food and energy prices, wholesale prices fell 1.0 percent in May, the largest monthly decline in nearly three years. Energy prices fell 4.3 percent and food prices are down 0.6 percent on the month. The monthly drop in energy prices was the biggest since March 2009, and was largely due to a significant drop in gasoline prices. Liquefied petroleum and natural gas prices also fell. Core prices rose modestly, however due to higher pharmaceutical prices. With producers finally getting a much needed reprieve following the oil price spike early last year, consumers should continue to have a little breathing room as savings get passed down. Prices further back in the pipeline corroborate the pullback in final goods prices, which could be sustained in the coming months. The prices of raw materials have declined along with the slowdown in global economic growth and are now down 4.1 percent on a year-ago basis.

Previous: -1.0% (Month over Month) **Wells Fargo: -0.4%**

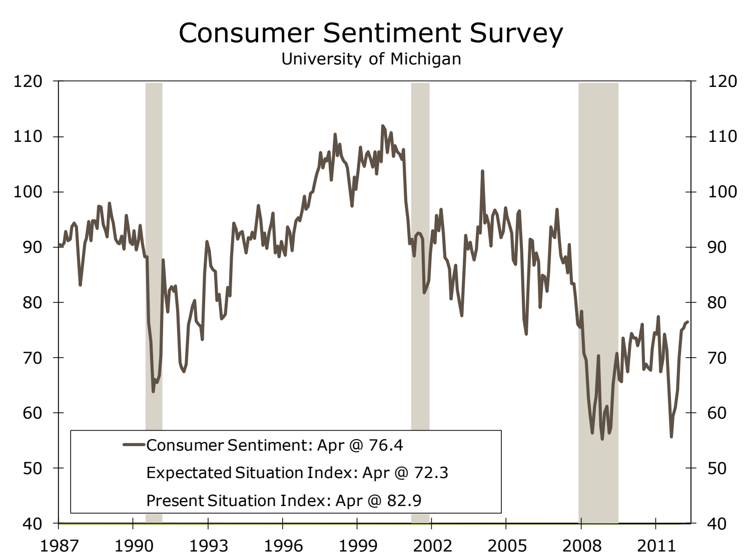
Consensus: -0.4%

University of Michigan Confidence • Friday

Reflecting the ongoing slowdown in global economic activity and equity market volatility, consumer sentiment fell from 79.3 in May to 73.2 in June. Consumers' assessment of current economic conditions and outlook both fell on the month. The below-trend level in consumer sentiment is evident in modest consumer spending growth as consumers continue to unwind the unprecedented levels of debt racked up during the boom years. With the debt-to-income ratio still above 100 percent, we will likely not see a genuine pick up in consumer spending for some time. One positive note in the report, however, is inflation expectations. Inflation expectations appear to be well anchored as the outlook one year and five years ahead remain in a fairly tight range. Well anchored inflation expectations and a declining rate of inflation will continue to give the Fed the green light to pursue further accommodative measures if needed.

Previous: 73.2

Consensus: 73.5



Global Review

Further Monetary Easing by Foreign Central Banks

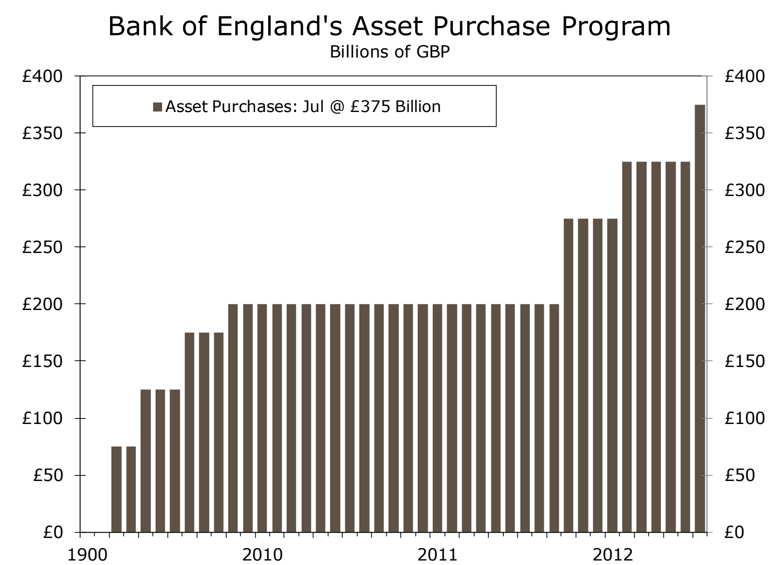
Highlighting the fragile nature of the global expansion at present, a number of major foreign central banks eased policy this week. The People's Bank of China (PBoC) reduced its benchmark 12-month lending rate by 31 bps to 6.00 percent, the second rate cut in four weeks (see chart on front page). The PBoC also announced that banks could price loans up to 30 percent below this benchmark (i.e., 180 bps below 6.00 percent). Previously, the maximum had been 20 percent.

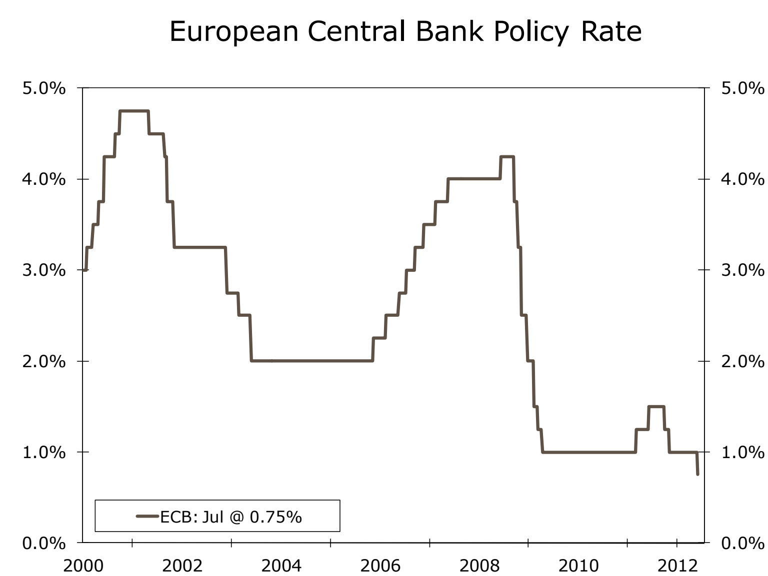
Chinese financial markets are extremely regulated, at least by western standards, and guidance by the PBoC to banks about the amount of lending they should be doing is arguably more important in terms of Chinese monetary policy than interest rates. In that regard, loan growth has stabilized in recent months (top chart). To the extent that interest rates are "too high" in China, the cut in the benchmark rate will benefit consumers and businesses and stimulate growth, at least on the margin. The move should also be viewed in the context of the ongoing process, which has been underway for a few years and still has years to run, to liberalize the Chinese financial system.

As widely expected, the Bank of England also eased policy. However, rather than cut rates further—the Monetary Policy Committee (MPC) has maintained its main policy rate at 0.50 percent since March 2009—the MPC chose to increase the size of its asset purchase program to £375 billion from £325 billion (middle chart). The level of real GDP in the United Kingdom has been essentially flat on balance for nearly two years, and data slated for release at the end of the month are likely to show that the economy contracted further in Q2-2012.

Could the MPC ease policy further? Perhaps, but probably not in the near term. The MPC said this latest round of asset purchases will take four months to complete, and the "Funding for Lending Scheme," which was announced a few weeks ago in conjunction with HM Treasury, is still not completely off the ground yet. In our view, the MPC will wait until it has some indications on the efficacy of the latest policy moves before easing further. However, a turn for the worse in the ongoing saga of the European sovereign debt crisis could force the MPC's hand much sooner than it would like.

The European Central Bank (ECB) also eased policy this week, taking its main policy rate to an all-time low of 0.75 percent (bottom chart). As in the United Kingdom, it appears real GDP in the Eurozone likely contracted in the second quarter and, as ECB President Draghi acknowledged, "the risks surrounding the economic outlook for the euro area continue to be on the downside." The ECB decided at this time not to restart its Securities Market Program, by which it had purchased Spanish and Italian government bonds, nor to undertake another long-term refinancing operation (LTRO) for banks in the euro area. However, with government bond yields in Italy and Spain remaining elevated, further support from the ECB appears likely at some point in the not-too-distant future.



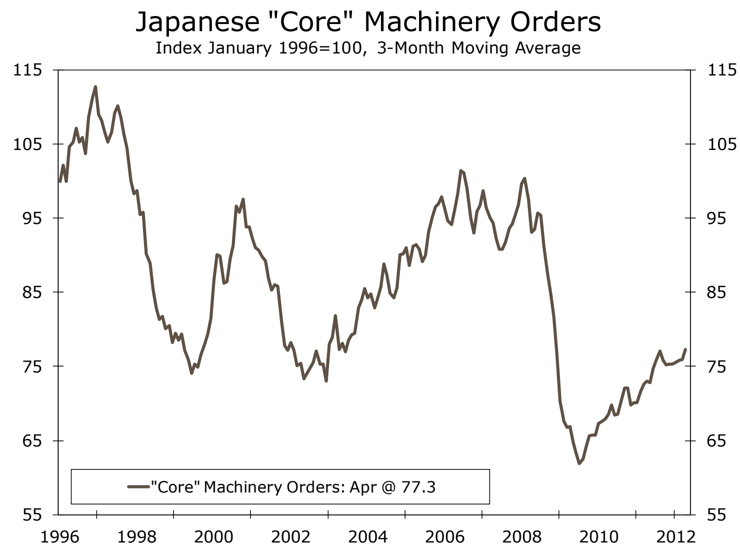


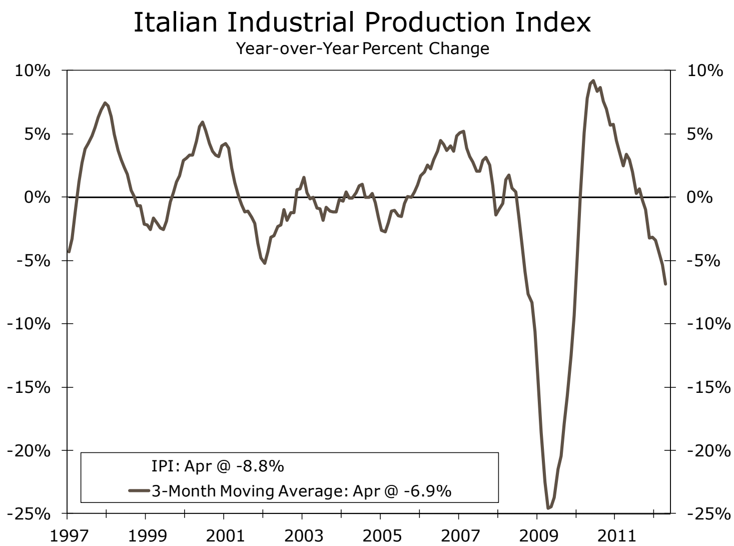
Japan Machinery Orders • Monday

Japan core machinery orders, excluding shipbuilding and utilities, jumped 5.7 percent in April from March, a sign of solid capital spending plans. This pushed the three-month annualized growth rate in core machinery orders in Japan to a robust 9.5 percent from a 3.5 percent pace in March. Analysts will be looking for signs of weakness in the May machinery orders report. A rising yen and slowing global growth are threatening Japan's export recovery, and could dampen Japanese firms' enthusiasm for reinvesting in their businesses. Non-manufacturing companies lead the way in machinery orders in April, increasing them 5.7 percent on the month. Manufacturing firms also increased their orders 3.4 percent in April. Public machinery orders slipped 5.0 percent in April, bucking the more positive private sector trend on the month. Public machinery orders are nearly 42 percent higher than a year ago.

Previous: 5.7% (Month over Month)

Consensus: -2.6%





Italy Industrial Production • Tuesday

Industrial production data for the Eurozone will be released next week and markets will be looking for more signs of softening in the industrial production measures. Italy is now on the frontlines of the Eurozone sovereign debt crisis, and more evidence the economic contraction is worsening could further damage Italy's cost of borrowing. Italy's industrial production fell 1.9 percent in April and is now 9.2 percent below year-ago levels. If Italy's Markit manufacturing PMI is any guide, investors will need to brace themselves for more disappointment in May and June. Italy's manufacturing PMI has been in a downtrend since March, when it already stood in contraction territory at 47.9. The June PMI released earlier this week sank further to 44.6 from 44.8 in May. On a brighter note, labor market conditions in Italy seem to have stabilized in May, with unemployment in Italy slipping to 10.1 percent from 10.2 in April.

Previous: -1.9% (Month over Month)

Consensus: -0.6%

China Q2 GDP • Thursday

China has been an important driver of commodity prices and global growth over the past several years, so investors will be parsing the initial release of China's second-quarter GDP data very carefully to see if China is achieving the soft landing it wants, or if the downturn in growth is taking on a life of its own. The consensus view is China's GDP growth year-on-year for the second quarter will slip below the important 8.0 percent threshold China has sought to maintain in the past. In the first quarter, China's GDP growth had already slowed to 8.1 percent from the first quarter of 2011. This is a sharp slowdown from the nearly 10.0 percent GDP growth China achieved in the first half of 2011 and 2010. China had been working to slow its economic growth to cool inflation pressures and property bubbles that were brewing in many Chinese cities, but now authorities are looking to prop up growth and loosen lending standards to support the economy.

Previous: 8.1% (Year over Year)

Consensus: 7.9%

Interest Rate Watch

Coordinated Easing?

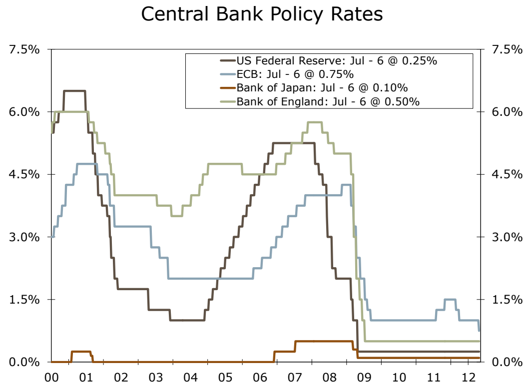
As discussed in the Global Review on page four, three major central banks (the People's Bank of China, the Bank of England and the ECB) eased monetary policy this week. Were these moves "coordinated"? If so, do these moves raise the probability the Fed will also ease at the next FOMC meeting on August 1?

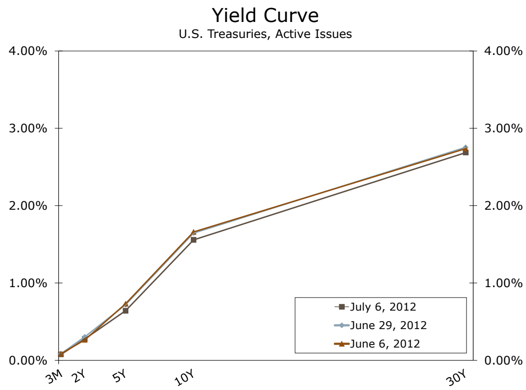
If "coordination" means policymakers from the three central banks agreed among themselves ahead of the individual meetings to ease policy, then the moves were probably not coordinated. Central bankers routinely communicate, but policy actions that are truly coordinated usually happen only in exceptional circumstances. For example, at the height of the financial crisis in October 2008, major central banks jointly announced reductions in policy rates. When strains in financial markets intensified in 2010 and again in 2011 due to the European sovereign debt crisis, the Fed, in conjunction with other central banks, announced the extension of swap lines that were meant to increase dollar liquidity.

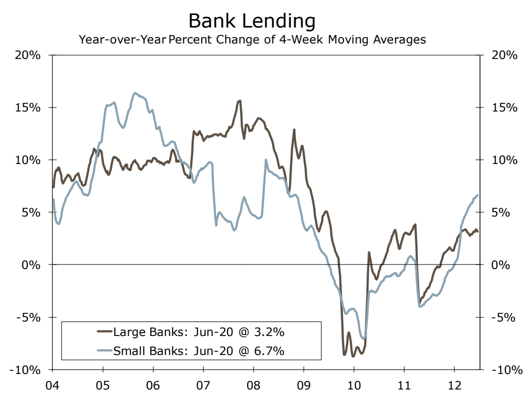
Although there may not have been overt coordination among foreign central bankers this week, each central bank responded to the economic environment in a similar fashion. In other words, there is a global slowdown underway that makes monetary easing in each country the appropriate policy response.

The fact that the PBoC, the BoE and the ECB each eased policy this week does not necessarily mean the Fed will follow suit at its next FOMC meeting by announcing the commencement of QE3. We doubt the Fed is part of a secret cabal of central bankers agreeing to ease policy simultaneously.

The Fed will set monetary policy that is appropriate for the U.S. economy. In that regard, this morning's disappointing news that the economy created only 80,000 jobs in June raises the probability that the Fed will consider additional policy action. However, further policy easing is by no means guaranteed at this point. Data over the coming weeks will be watched closely by the FOMC.







Credit Market Insights

Different Sizes, Similar Stories

Lending at banks continued to climb during the second quarter. Total lending through June 20 climbed $63 billion since the end of the first quarter and is up 5 percent from a year-ago. The recovery in lending has been supported by both small and large domestic banks, with loans over the last year having risen at each type of institution. While variations in the rate of credit expansion persist, the patterns of credit growth remain similar between large and small banks. Commercial and industrial loans have posted the strongest recovery in credit, led by lending at large banks. Large banks—defined as the 25 largest banking institutions by asset size—have expanded C&I lending by 16 percent over the last year versus 11 percent at small banks. While this expansion in credit is viewed as a positive sign for businesses in terms of demand and borrowing ability, the consumer credit story remains mixed. First mortgage residential real estate lending has expanded at large and small institutions, but has been propped up by a historically low rate environment and multiple government refinance programs. In contrast, both large and small banks continue to reduce their exposure to the real estate market through tighter standards in home equity lending. While businesses have broadly de-leveraged and repaired their financial positions since the financial crisis, consumer finances remain tenuous, which will limit the expansion in consumer credit at institutions of all sizes.

Credit Market Data

Mortgage Rates	Current	Week Ago	4 Weeks Ago	Year Ago
30-Yr Fixed	3.62%	3.66%	3.67%	4.60%
15-Yr Fixed	2.89%	2.94%	2.94%	3.75%
5/1 ARM	2.79%	2.79%	2.84%	3.30%
1-Yr ARM	2.68%	2.74%	2.79%	3.01%

Bank Lending	Current Assets (Billions)	1-Week Change (SAAR)	4-Week Change (SAAR)	Year-Ago Change
Commercial & Industrial	$1,435.3	22.76%	20.08%	14.21%
Revolving Home Equity	$538.1	-7.50%	-5.82%	-4.57%
Residential Mortgages	$1,561.3	13.64%	-6.52%	4.88%
Commerical Real Estate	$1,413.9	-3.13%	-1.60%	-2.35%
Consumer	$1,109.2	-18.26%	0.70%	2.33%

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

Topic of the Week

The Housing Recovery Builds Momentum

Even with the overall economy slowing, the budding recovery in the housing market appears to be gradually gaining momentum. New construction during the first five months of the year has benefitted from modest gains in employment, increased household formations and resurgent demand for apartments.

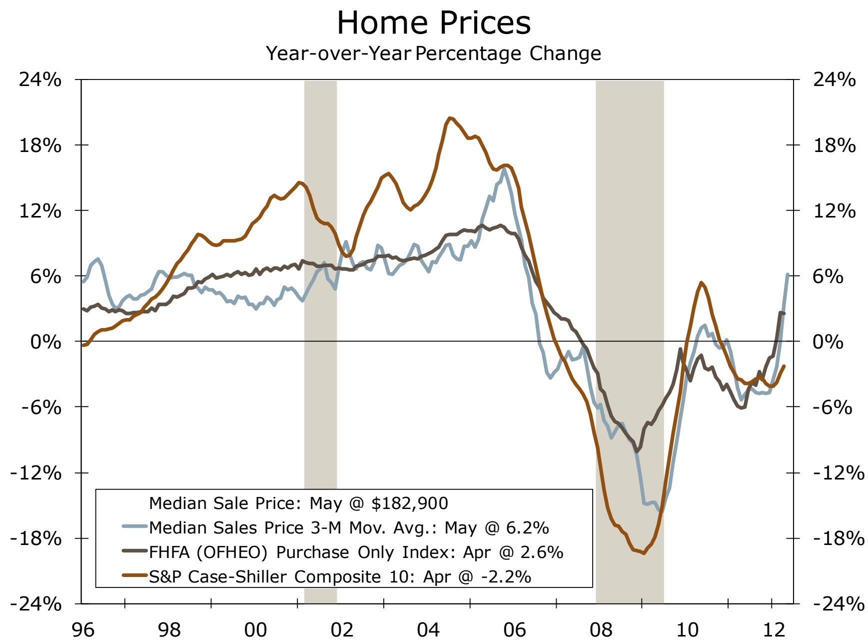
With demand up, new home construction has increased. Through May, single-family starts are 20.4 percent ahead of the year-ago pace, while multi-family starts are up 44.6 percent. Milder-than-usual weather bolstered construction during the seasonally slow winter months, providing builders more inventory to sell this spring. New home sales are a solid 18.2 percent ahead of the year-ago pace through the first five months of 2012.

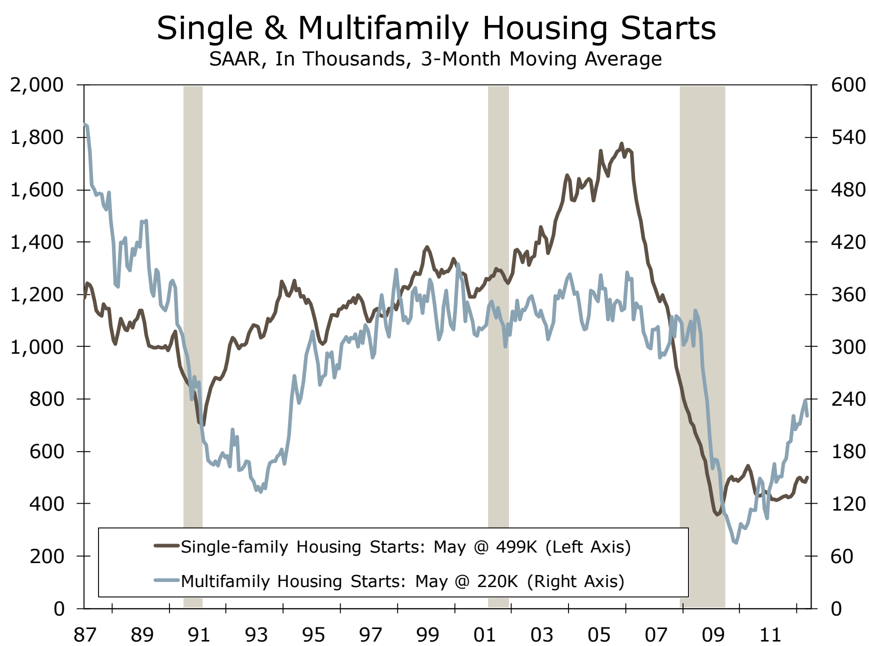
Furthermore, home prices have firmed up. The S&P/Case-Shiller 20-City Home Price Index rose 0.7 percent in April, as prices have now increased for three consecutive months and are up at a 6.2 percent annual rate over this period. In addition, prices rose in 17 of the 20 markets covered by the S&P/Case-Shiller index in April, and no markets hit new lows.

Looking past monthly volatility, we see demand gradually improving. Affordability remains at or near all-time highs, and recent gains in existing home sales are beginning to entice more trade-up buyers back to the market. However, home sales will continue to be hindered by sluggish growth in household formations and would-be buyers choosing to rent rather than buy.

Despite all of the positive data this year, we continue to stress the need to keep the recent improvements in perspective. Even with the recent gains, new home sales and residential construction remain shadows of their former selves. The tiny foundation from which the housing recovery is beginning means that even large percentage gains in housing starts will make only a modest contribution to real GDP growth.

Our report, Housing Data Wrap-Up: June 2012, can be found on our website.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 7/6/2012	1 Week Ago	1 Year Ago
3-Month T-Bill	0.07	0.08	0.01
3-Month LIBOR	0.46	0.46	0.25
1-Year Treasury	0.10	0.13	0.14
2-Year Treasury	0.27	0.30	0.42
5-Year Treasury	0.64	0.72	1.66
10-Year Treasury	1.56	1.64	3.11
30-Year Treasury	2.69	2.75	4.36
Bond Buyer Index	3.94	3.95	4.65

Foreign Exchange Rates

	Friday 7/6/2012	1 Week Ago	1 Year Ago
Euro ($/€)	1.235	1.267	1.432
British Pound ($/₤)	1.552	1.571	1.600
British Pound (₤/€)	0.795	0.806	0.895
Japanese Yen (¥/$)	79.640	79.790	80.910
Canadian Dollar (C$/$)	1.018	1.017	0.965
Swiss Franc (CHF/$)	0.973	0.949	0.839
Australian Dollar (US$/A$)	1.023	1.024	1.070
Mexican Peso (MXN/$)	13.485	13.361	11.627
Chinese Yuan (CNY/$)	6.365	6.354	6.467
Indian Rupee (INR/$)	55.455	55.638	44.490
Brazilian Real (BRL/$)	2.032	2.009	1.569
U.S. Dollar Index	82.937	81.627	75.122

Foreign Interest Rates

	Friday 7/6/2012	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.45	0.56	1.52
3-Month Sterling LIBOR	0.87	0.90	0.83
3-Month Canadian LIBOR	1.31	1.31	1.18
3-Month Yen LIBOR	0.20	0.20	0.20
2-Year German	-0.01	0.12	1.58
2-Year U.K.	0.21	0.28	0.79
2-Year Canadian	1.00	1.03	1.54
2-Year Japanese	0.11	0.11	0.17
10-Year German	1.33	1.58	2.93
10-Year U.K.	1.63	1.73	3.25
10-Year Canadian	1.69	1.74	3.04
10-Year Japanese	0.80	0.84	1.18

Commodity Prices

	Friday 7/6/2012	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	85.29	77.69	96.65
Gold ($/Ounce)	1594.80	1597.40	1528.90
Hot-Rolled Steel ($/S.Ton)	605.00	600.00	722.00
Copper (¢/Pound)	345.00	332.60	432.65
Soybeans ($/Bushel)	16.07	14.61	13.43
Natural Gas ($/MMBTU)	2.97	2.72	4.22
Nickel ($/Metric Ton)	16,667	16,174	23,269
CRB Spot Inds.	506.59	499.45	600.57

Next Week's Economic Calendar

	Monday 9	Tuesday 10	Wednesday 11	Thursday 12	Friday 13
U.S. Data	**Consumer Credit** April $6.515B May $8.500B (C)		**Trade Balance** April -$50.1B May -$48.7B (W) **Wholesale Invent.** April 0.6% May 0.3% (C) **FOMC Minutes**	**Import Price Index** May -1.0% June -1.9% (W) **Budget Statement** May -$124.636B	**PPI (MoM)** May -1.0% June -0.4% (W) **U. of M. Confidence** June 73.2 July 73.5 (C)
Global Data	**Japan** **Machine Orders** Previous (Apr) 5.7%	**Italy** **IP (YoY)** Previous (Apr) -9.2% **China** **Trade Balance** Previous (May) $18.7B	**Japan** **Machine Tool Orders** Previous (May) -3.0%	**Eurozone** **IP (YoY)** Pervious (Apr) -2.5% **China** **Real GDP (YoY)** Previous (1Q) 8.1%	

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

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