August 26, 2011

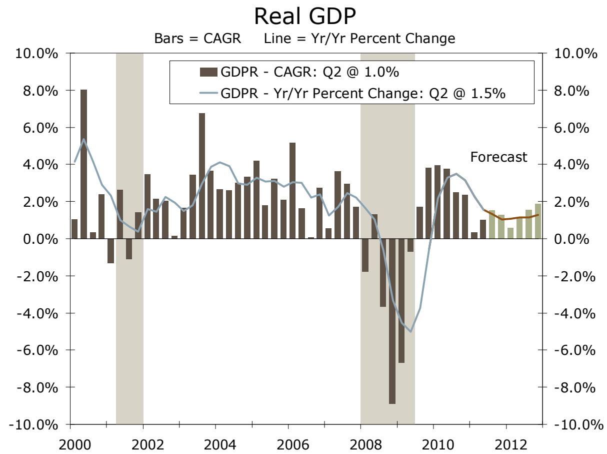
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

The Economy Continues to Grow at a Snail's Pace

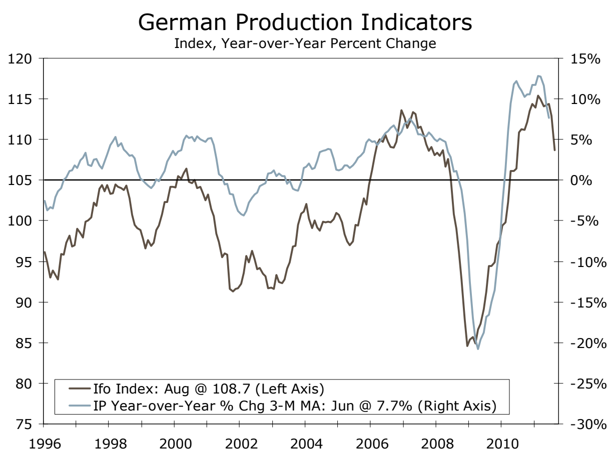
- Much of the economic data released during the week continued to show sluggish economic growth. Real GDP was revised down to a 1.0 percent pace in the second quarter from the initially reported 1.3 percent rate. While growth has slowed significantly, it is growth nonetheless.
- Durable goods orders rose a more-than-expected 4.0 percent in July, which was double the consensus. Non-defense capital goods excluding aircraft fell 1.5 percent on the month, which may suggest weaker growth in business investment in the coming quarter.



Global Review

Global Sentiment Weakens, Waiting for the Hard Data

- Global sentiment indicators point to deterioration in global economic growth in August, although we have few hard data points yet to hang our hat on, making a strong central bank reaction at this stage unlikely until more definitive indicators confirm the slowdown.
- The global wealth losses have been substantial, as equity markets have plunged. According to Bloomberg, global market capitalization has declined by $7.4 trillion since July 22. In the first three weeks post-Lehman Brothers failure in 2008, global equities only lost about $4.0 trillion.



Wells Fargo U.S. Economic Forecast

	Actual						Forecast		Actual			Forecast	
	2010				2011								
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2008	2009	2010	2011	2012
Real Gross Domestic Product [1]	3.9	3.8	2.5	2.3	0.4	1.0	1.5	1.3	-0.4	-3.6	3.0	1.5	1.2
Personal Consumption	2.7	2.9	2.6	3.6	2.1	0.4	1.6	1.3	-0.7	-2.0	2.0	2.1	1.3
Inflation Indicators [2]													
"Core" PCE Deflator	1.7	1.5	1.3	1.0	1.1	1.3	1.5	1.8	2.3	1.5	1.4	1.4	1.9
Consumer Price Index	2.4	1.8	1.2	1.2	2.2	3.3	3.5	3.5	3.8	-0.3	1.6	3.1	2.4
Industrial Production [1]	8.1	7.1	6.7	3.1	4.8	1.0	5.7	1.4	-3.3	-11.1	5.3	4.0	2.9
Corporate Profits Before Taxes [2]	46.7	41.5	27.4	18.2	8.8	8.3	6.5	6.4	-16.4	7.9	32.2	7.5	6.3
Trade Weighted Dollar Index[3]	76.1	78.8	73.6	73.2	70.6	69.4	68.5	69.5	74.3	77.7	75.6	69.5	71.9
Unemployment Rate	9.7	9.6	9.6	9.6	8.9	9.1	9.2	9.4	5.8	9.3	9.6	9.1	9.4
Housing Starts[4]	0.61	0.60	0.58	0.54	0.58	0.57	0.58	0.55	0.90	0.55	0.58	0.57	0.64
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	0.25
Conventional Mortgage Rate	4.97	4.74	4.35	4.71	4.84	4.51	3.80	3.70	6.04	5.04	4.69	4.21	3.98
10 Year Note	3.84	2.97	2.53	3.30	3.47	3.18	2.20	2.10	3.66	3.26	3.22	2.74	2.38

Forecast as of: August 26, 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

Searching for Clues of a Looming Downturn

Much of the economic data released during the week continued to show sluggish economic growth. In fact, real GDP was revised down to a 1.0 percent pace in the second quarter from the previously reported 1.3 percent rate. The pullback was largely in line with expectations, however. Consumer spending and business investment were revised higher, but the increase was offset by a downshift in inventories and net exports. Forward looking indicators for third quarter activity continue to point to slow economic growth, but growth nonetheless.

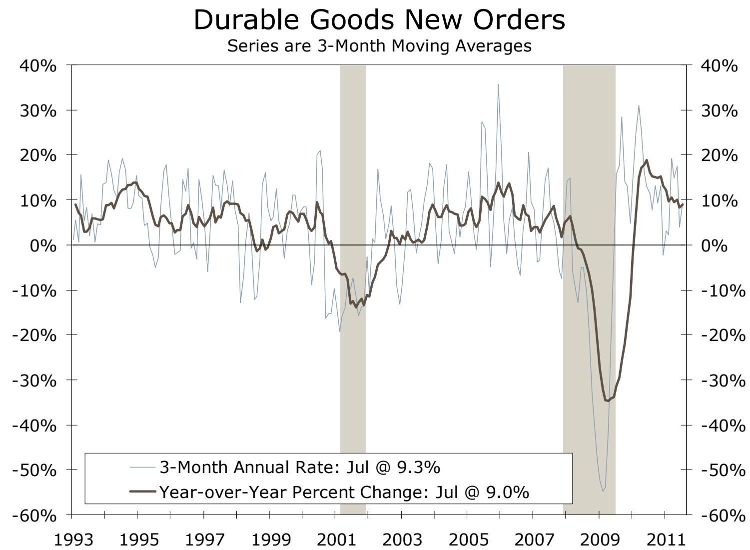
Durable goods orders rose a more-than-expected 4.0 percent in July, which was double the consensus. Previous months' data were also upwardly revised. Much of the gain was due to a sharp increase in nondefense aircraft and vehicles. While the headline brought cheer in an otherwise sea of gloomy economic releases, the details of the report are far less encouraging. In fact, non-defense capital goods excluding aircraft, which is used as a proxy for capital expenditures, fell 1.5 percent on the month. The retrenchment suggests that the solid gains in business investment that helped fuel the early stages of the recovery could begin to peter out, but a seasonal monthly glitch may be at play.

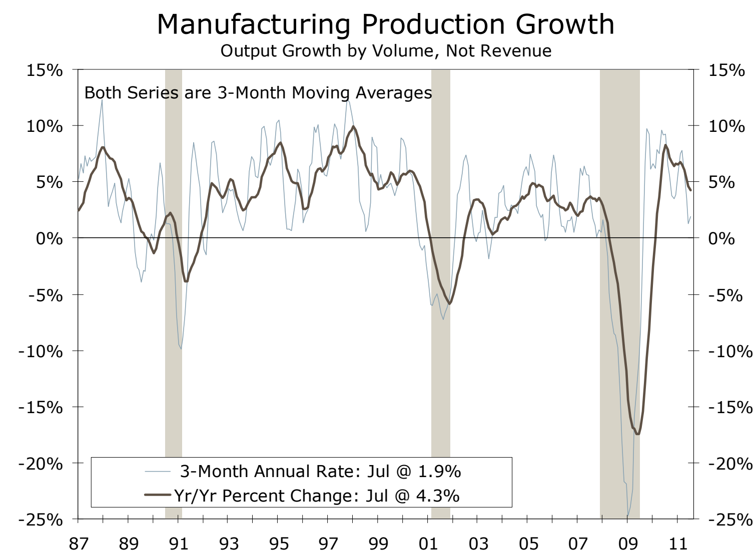
That said, in concert with other regional factory sector data, the Richmond Fed's manufacturing survey also pointed to looming weakness in manufacturing activity. The Richmond Fed's manufacturing survey fell to -10 in August, with new orders and shipments pulling the headline lower. In fact, the forward-looking new orders component has been down for three of the past four months. Across-the-board weakness in local factory indices suggests the upcoming ISM manufacturing survey and industrial production report could contract in August.

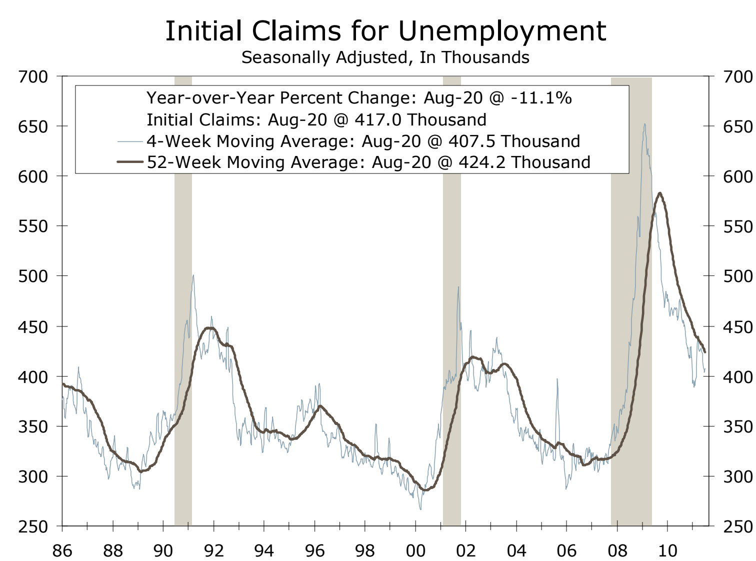
Industrial production has increased in the past three months largely due to solid gains in manufacturing, but we expect that momentum to stall in the coming month. Industrial production is a key indicator to watch, as it is one of the main measures the National Bureau of Economic Research uses in determining whether the economy has fallen into a recession.

Another important data point to watch is initial jobless claims. Jobless claims rose by 5,000 in the week ending Aug. 20 to 417,000, the second weekly increase. The previous weeks' data were revised up by 4,000 to 412,000. The Department of Labor, however, noted the increase was largely due to a labor dispute, which added a cumulative of 21,000 claims in the past two weeks. The four-week moving average also edged higher and is now 407,500.

Home sales also appear to be losing momentum. Sales fell 0.7 percent in July to a 298,000-unit pace, as builders continue to grapple with weak demand and competition from distressed sales. The gap between the median price of a new home and the median price of an existing home, which has now widened to a record $57,125 in July, remains another obstacle for builders.





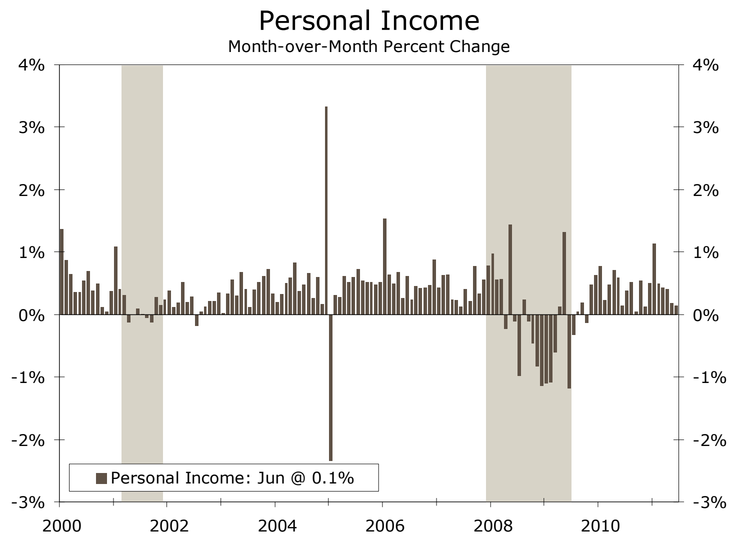


Personal Income • Monday

Personal income grew at a sluggish 0.1 percent pace in June, with an even more disappointing flat reading for wage and salary growth. Disposable income also rose a slight 0.1 percent. With higher gas and food prices observed in June, it is obvious that households are beginning to struggle. Personal incomes have been held back by the slow pace of job gains. With job growth picking up slightly in July, we expect that personal incomes rose 0.4 percent. However, without a sustained pace of improvement in the personal income situation, there will likely be further headwinds to personal consumption growth over the next few quarters. Growth in real personal consumption should average around 1.5 percent in the second half of this year. Given that our employment outlook has been reduced to an average of 62,000 jobs over the same time period it follows that personal income growth should continue to remain stagnant.

Previous: 0.1% **Wells Fargo: 0.4%**

Consensus: 0.3% (Month-over-Month)

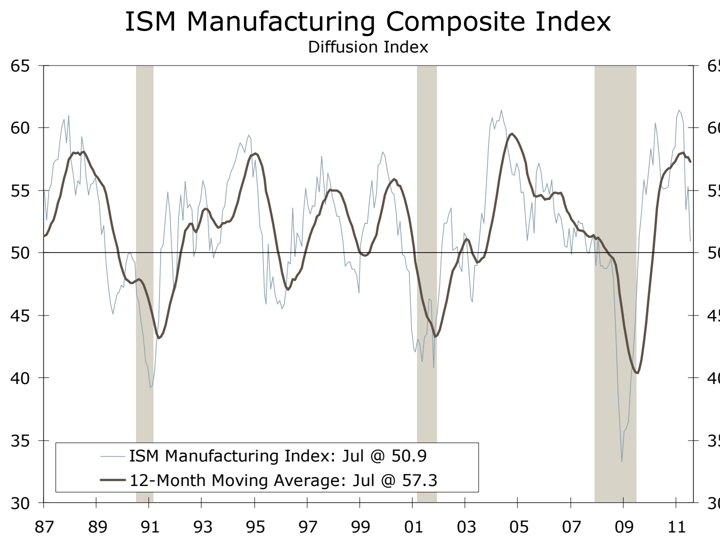


ISM Manufacturing • Thursday

Last month, the ISM manufacturing index pulled back to 50.9, just barely above the level marking expansionary territory. The most concerning aspect of the July report was the fact that the new orders component fell below the breakeven point, suggesting that there is less support for manufacturing production in the months ahead. We are expecting the manufacturing sector to continue to show signs of weakness on news of slower domestic demand and some pullback in global demand. It now appears that price pressures for producers are beginning to diminish, which should help profit margins in the current quarter. We expect that manufacturing will slide again in August, as firms scale back production to account for the slowing pace of demand. Given that orders for durable goods excluding transportation fell in July, we expect the ISM manufacturing index will decline to 49.1, thus slipping into contractionary territory.

Previous: 50.9 **Wells Fargo: 49.1**

Consensus: 48.5

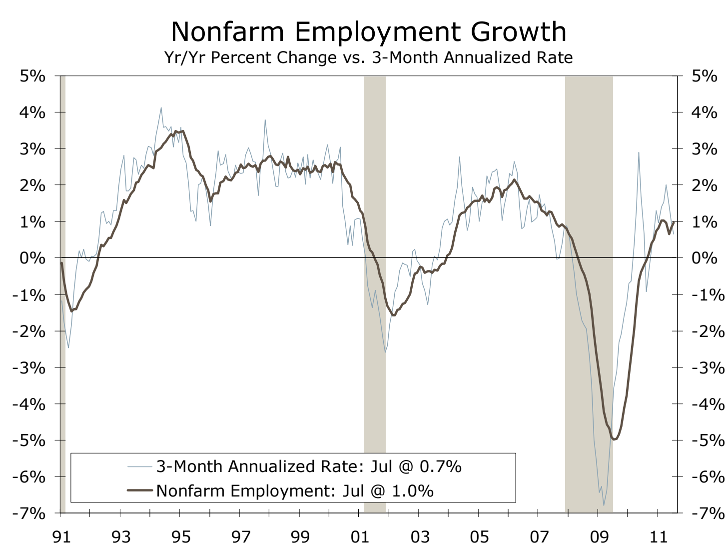


Employment • Friday

Nonfarm payrolls rose a higher-than-expected 117,000 in July. While payrolls improved in July, the pace of job creation remains anemic. Government payrolls have continued to fall, a trend we expect will continue for the next several months. The private sector continues to add jobs in several sectors including the professional and business service sector and the education and health services sector. Given that there are signs that the economy has slowed in August, we expect that job growth also downshifted. July's report also indicated that temporary staffing, a leading indicator of future hiring, was unchanged after falling in the past three months suggesting a slowdown in hiring activity in August. We expect payrolls will rise by a mere 30,000 and that the unemployment rate will remain unchanged at 9.1 percent. We still expect that the second half of the year will likely be plagued by weak economic and employment growth.

Previous: 117K **Wells Fargo: 30K**

Consensus: 95K



Global Review

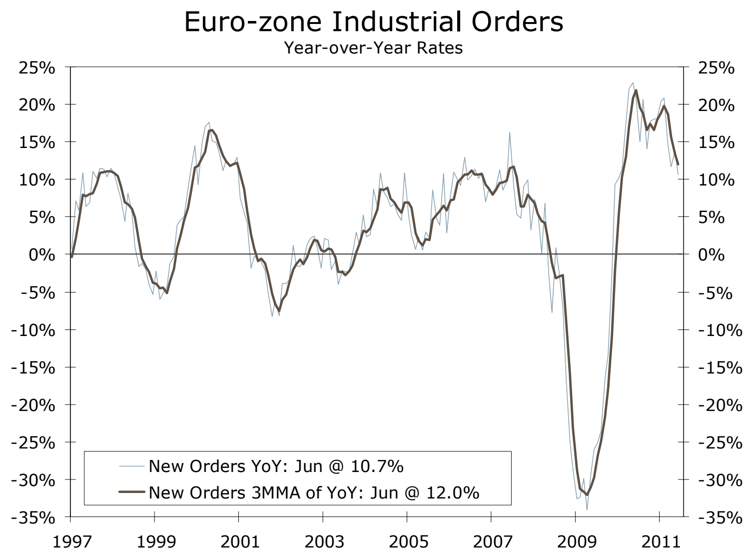
Global Confidence Cracks, Will the Economy Be Next?

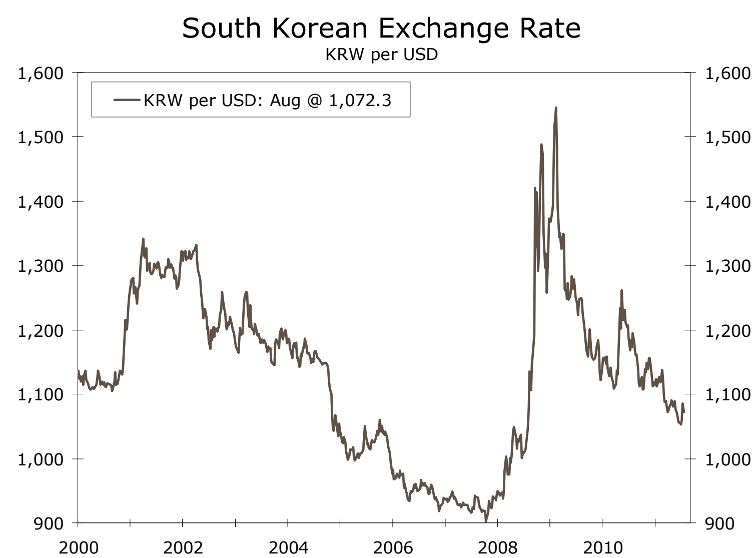
A slew of August manufacturing and consumer sentiment indicators were released in Europe this week with most pointing toward economic deterioration. Reuter's manufacturing and service PMI indexes for the Eurozone both slipped in August. The Eurozone manufacturing PMI actually fell below 50.0, the dividing line between manufacturing expansion and contraction for this diffusion index. Germany's services PMI for August dropped to 50.4 in August from 52.9 in July, very close to the demarcation line between expansion and contraction. These declines in sentiment out of the Eurozone were confirmed by several other widely followed sentiment measures. The German Ifo business climate index fell more than expected in August to 108.7. The Ifo expectations component plunged nearly 5 points to 100.1, while the current assessment fell 3.3 points to 118.1. The souring mood in manufacturing and services businesses in Europe was also shared by European consumers. The Eurozone's flash consumer confidence measure for August fell to -16.6 from -11.2 the month before. Although a bit lagged, the Eurozone industrial orders index for June fell -0.7 percent, providing some hard data support that Europe's manufacturing activity is set to decelerate in the third quarter.

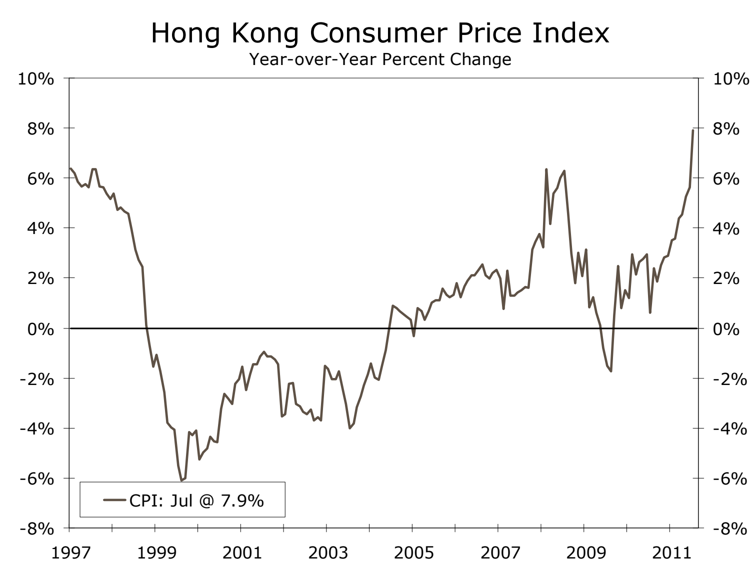
How Sick Is Asia?

Some of the same trends appear to be taking shape in Asia as well. A consumer sentiment measure for South Korea fell to 99.0 in August from 102 in July, a five-month low. South Korea's stock market has been one of the hardest hit during the recent financial turmoil. The Kospi index has dropped 18.6 percent over the past month, dampening consumer confidence. South Korea is also one of the most vulnerable Asian economies to a global economic slowdown. South Korea's merchandise exports comprise more than 45 percent of GDP. The South Korean won has been one of the faster appreciating currencies against the dollar in Asia, making South Korea's export engine even more vulnerable. The Korean won has gained 3.5 percent against the U.S. dollar year-to-date just behind the Indonesian rupiah and Singapore dollar. Over the past month, however, the currency has slipped 2.9 percent against the dollar as the economic picture has darkened.

Yet price pressures have yet to subside in some parts of the region. Hong Kong's inflation problems worsened in July. Hong Kong consumer inflation jumped to 7.9 percent in July from 5.6 percent. Much of the jump was due to a housing subsidy distortion. Excluding the housing subsidy effect, Hong Kong inflation would have increased to 5.8 percent. Still, the headline is an attention grabber and could affect consumer and business behavior going forward. The Hong Kong dollar's peg to the U.S. dollar means that Hong Kong must effectively import the Fed's loose monetary policy stoking inflation pressures. China's HSBC Flash manufacturing PMI figures were a bit better in August, improving to 49.8 from 49.3 in July, although this manufacturing index for China has been in contraction territory for two consecutive months.







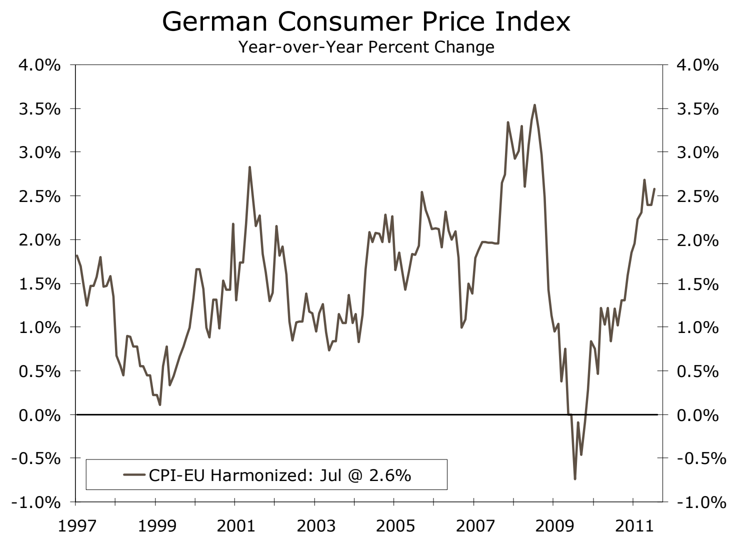
Germany CPI • Monday

The coming week is full of reports coming out of Germany, reports that could make or break the mood of the markets regarding the staying power of the German economy and of the Eurozone. The week starts with the preliminary CPI, with markets expecting a 0.1 percent drop in consumer prices month-over-month compared to a 0.4 percent increase during the previous month. Then, on Wednesday, we get retail sales and the rate of unemployment, with markets expecting a poor showing of a 1.5 percent drop in retail sales for July compared to a revised 4.5 percent increase in the previous month, while the rate of unemployment should remain at 7 percent in August.

On Thursday, the final GDP number for the second quarter of the year is released with markets expecting a 2.8 percent increase year-over-year and a 0.1 percent increase (not annualized) compared to the first quarter.

Previous: 2.6%

Consensus: 2.5% (Year-over-Year)



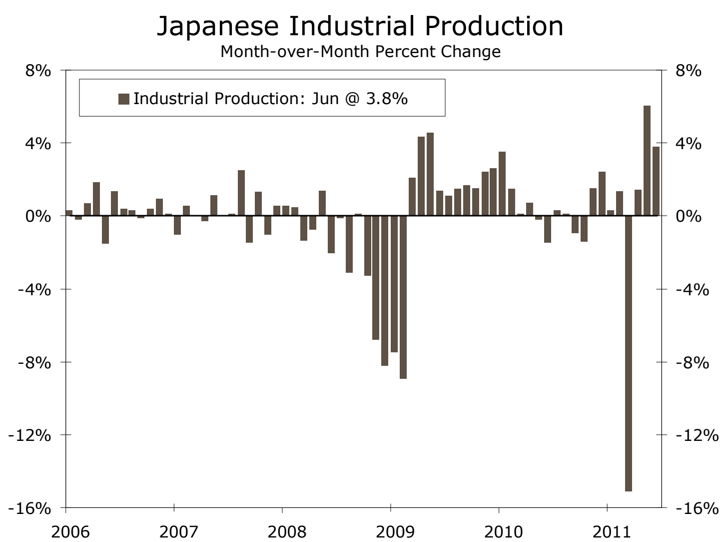
Japan Industrial Production • Tuesday

Japan also has a slew of data releases during the coming week, with industrial production for July expected to come in at 1.4 percent month over month but still down by 1.9 percent on a year-over-year basis. On the same day, we have the release of the Markit/JMMA Manufacturing PMI for August, which will give a more timely view of the current state of the Japanese manufacturing sector. A better-than-expected number could be good news for the Japanese economy as well as for the rest of the world, as it will indicate that world demand is not as weak as recent numbers have indicated. However, we do not put a large probability on this outcome and expect the PMI to reflect the weakening trend that we have observed in PMIs across the world.

On Monday, we have the release of the retail trade number for July and markets are expecting a 1.3 year-over-year percent increase compared to a revised 1.2 percent for the previous month.

Previous: 3.8%

Consensus: 1.4% (Month-over-Month)



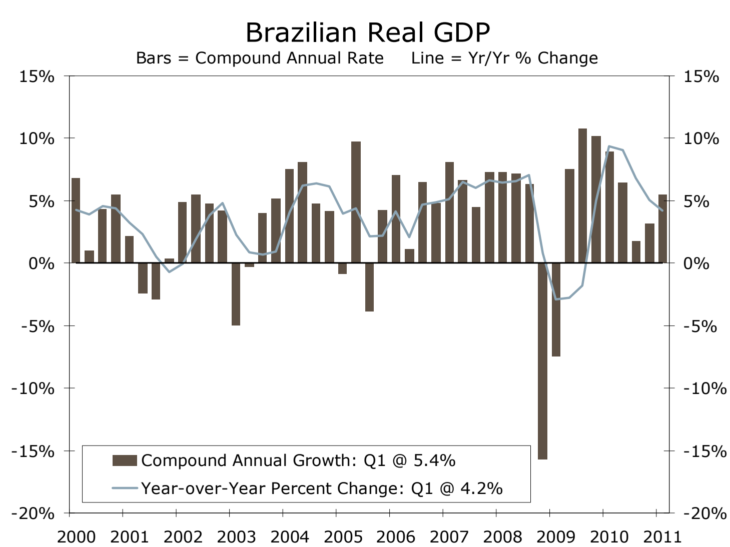
Brazil GDP • Friday

Brazil will release its second quarter GDP number on Friday, and the result is anxiously expected by markets as they want to have an idea of how much the economy has weakened. The key to this will rest on the differences in investment versus domestic consumption. On the one hand, investment continues to surge in the country, while the Brazilian central bank has been tightening monetary policy to contain domestic consumption.

We should see a large negative contribution from imports to GDP reflecting the strong appreciation of the Brazilian currency as well as a further deterioration in the current account deficit, with an increase in the service deficit and deterioration in the trade surplus. Markets are expecting GDP growth for the second quarter to come in at 2.9 percent year-over-year and at 0.8 percent on a seasonally adjusted basis compared to the previous quarter. We, on the other hand, are a bit more optimistic and expect 3.3 percent growth.

Previous: 4.2% **Wells Fargo: 3.3%**

Consensus: 2.9% (Year-over-Year)



Interest Rate Watch

All Options Are on the Table

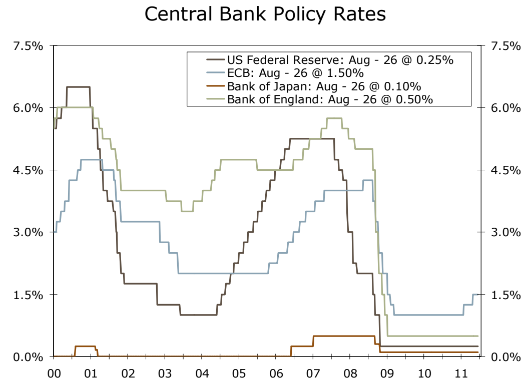
Ben Bernanke's much anticipated Jackson Hole speech outlined the options remaining for the Federal Reserve. Earlier hopes that history would repeat itself and Bernanke would set the table for another round of quantitative easing subsided earlier in the week. The three dissents by Federal Reserve Bank presidents at the Aug. 9 FOMC meeting and more recent statements by Tom Hoenig and other Fed presidents that downplay the risks of recession are a sure sign that the Fed will move cautiously.

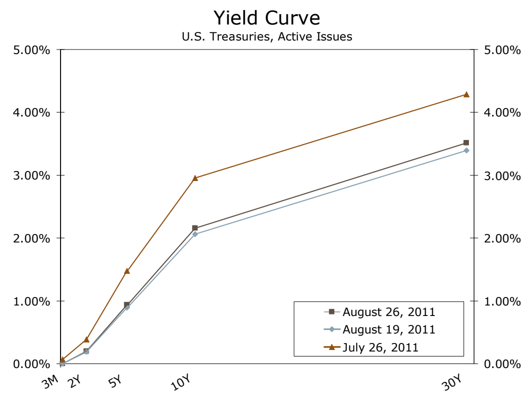
By the time Bernanke got around to speaking on Friday, the financial markets had already lowered their expectations for any new policy initiatives. The economy is in a different place today than it was a year ago. Back then, Bernanke cited the risk of deflation as justification for further expanding the Fed's balance sheet. Today, the core CPI is up twice as much on a year-to-year basis than it was a year ago, although the economy looks a little shakier. Moreover, fiscal policy is in a tougher spot. Uncertainty is the big enemy today, and the less the Fed says about any bold new policy initiatives the better.

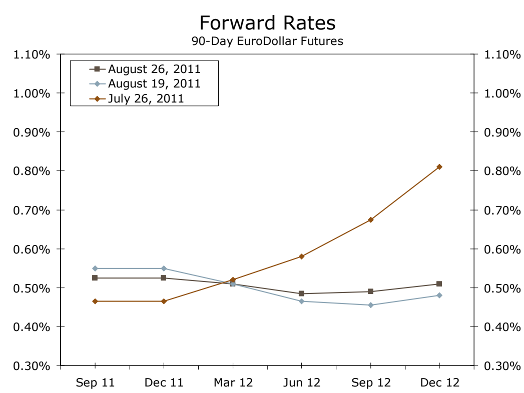
Amidst this background, Bernanke chose to use his Jackson Hole speech to explain why the recovery was taking so long to take hold and to reduce expectations for future growth. He noted that the recovery would be long and arduous and that we might face a few setbacks along the way. Our read is that Bernanke was implying that the Fed has achieved about all that it can reasonably hope to and that there is no magic switch that it can pull that will push the economy past the structural problems we currently face.

The bond market has largely priced in the Fed's latest actions, with the 10-year Treasury trading between 2.00 and 2.30 percent. The spread between mortgages and the 10-year Treasury has widened.

Short-term rates remain close to zero. The ongoing concerns about the European financial system continue to put pressure on T-Bills, with the 3-month T-Bill hovering right around zero.







Credit Market Insights

Good and Bad in MBA Delinquencies

The Mortgage Bankers Association's quarterly delinquency survey had some good news and some bad news. The bad news was that the overall delinquency rate climbed to 8.44 percent in the second quarter from 8.32 percent in the first quarter. This was the second straight quarterly increase in delinquency rates, suggesting a housing market rebound is nowhere in sight years after its epic collapse. Worse yet, every category saw an increase in delinquency rates. Regardless of whether mortgages are prime, subprime, fixed rate or adjustable rate, homeowners are finding it more difficult to make the monthly payments. Another daunting sign was that the non-seasonally adjusted subprime fixed-foreclosure inventory rate reached a new cyclical high. Also worrisome was an increase in the share of newly delinquent loans (30-59 days) to 3.46 percent from 3.36 percent, as the job market deteriorated in the second quarter.

There was some good news in the report. The share of loans delinquent 90 days or more fell to 3.61 percent from 3.62 percent. Since the foreclosure start rate also fell to 1.01 percent, this suggests more loans 90 days past due are being modified rather than going into foreclosure. Still, the rise in newly delinquent loans suggests the housing market could be turning for the worse again, even with mortgage rates at record lows. Further deterioration in mortgage credit quality would be a bitter pill for an economy already on life support.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.22%	4.15%	4.55%	5.08%
15-Yr Fixed	3.44%	3.36%	3.66%	4.39%
5/1 ARM	3.07%	3.08%	3.25%	4.10%
1-Yr ARM	2.93%	2.86%	2.95%	4.05%
MBA Applications				
Composite	699.1	716.4	528.0	870.3
Purchase	157.9	167.5	176.7	170.5
Refinance	3,850.6	3,915.5	2,578.8	4,944.7

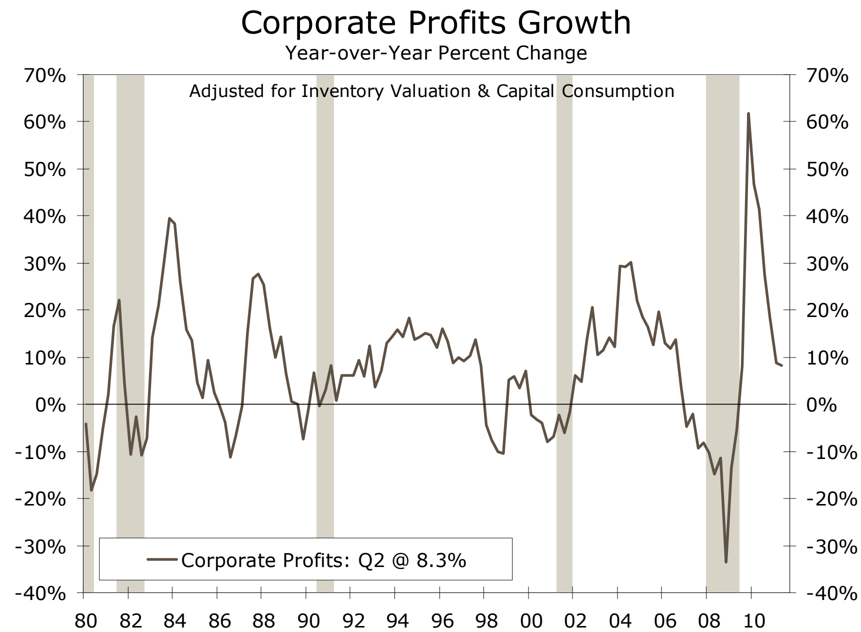
Source: Freddie Mac, Mortgage Bankers Association and Wells Fargo Securities, LLC

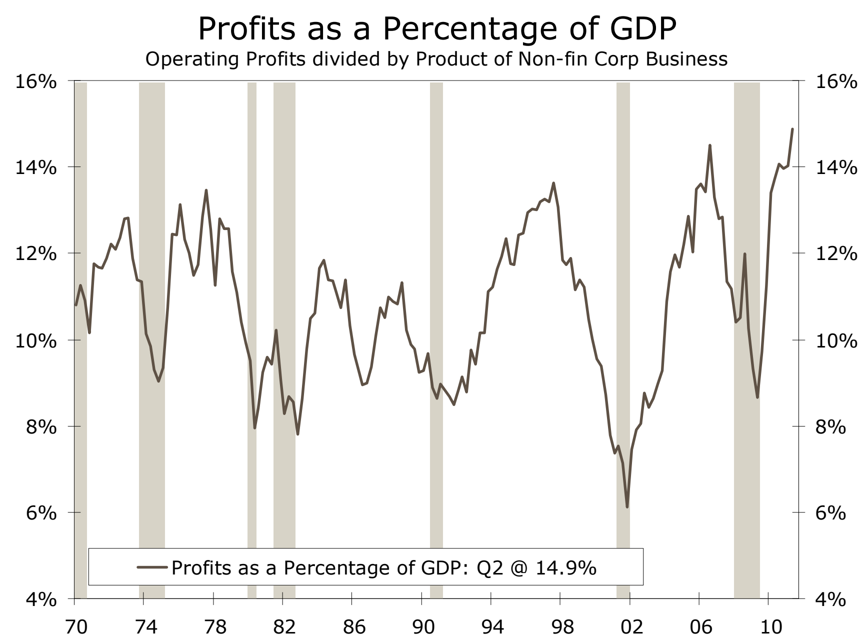
Topic of the Week

Corporate Profits Remain Strong in Q2

Along with the release of the second estimate of second quarter economic growth, we received an update on the profitability of America's corporations in the second quarter. Profits rose 8.3 percent, supported by nonfinancial institutions which posted a 14.2 percent rise in profits, which offset the decline in financial industry profits of 7.4 percent. One of the main reasons for such robust corporate earnings in a weak economic growth environment can be traced back to the cutbacks in operating costs that took place coming out of the recession. Firms were left with light labor forces and lower fixed costs. As demand slowly picked up, these firms were in a position to take advantage of technologies that increased production without a large increase in costs. We can see this trend reflected in the substantial contributions to GDP growth from business fixed investment. Another reason for the recent growth in corporate profits can be tied to the global nature of today's firms. Domestic corporations that are global in nature have been able to generate revenues from international markets, particularly emerging markets, which have helped boost domestic revenues.

The strong profit growth in the first half of the year has left some to wonder if the current pace of profit growth will continue. There are now signs that global growth is beginning to slow, while domestic demand for business equipment is starting to wane. Thus, the existing supports to profit growth are beginning to subside. From a growth-expectations perspective, we can see that corporate profits have remained in excess of 14 percent of GDP over the past few quarters. Now that growth expectations have been reduced for the second half of the year and even slower growth is expected in 2012, there are clearly some downside risks to profit growth going forward. A pullback in both domestic and global demand will likely have the effect of squeezing margins. We expect that profits over the next few quarters will begin to moderate, in line with the slow pace of the economic recovery.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates	Friday 8/26/2011	1 Week Ago	1 Year Ago
3-Month T-Bill	-0.01	0.00	0.15
3-Month LIBOR	0.32	0.30	0.30
1-Year Treasury	0.11	0.10	0.26
2-Year Treasury	0.20	0.19	0.52
5-Year Treasury	0.94	0.90	1.37
10-Year Treasury	2.19	2.06	2.48
30-Year Treasury	3.56	3.39	3.51
Bond Buyer Index	4.09	3.83	3.88

Foreign Exchange Rates	Friday 8/26/2011	1 Week Ago	1 Year Ago
Euro ($/€)	1.436	1.440	1.272
British Pound ($/£)	1.623	1.647	1.553
British Pound (£/€)	0.885	0.874	0.819
Japanese Yen (¥/$)	76.860	76.550	84.450
Canadian Dollar (C$/$)	0.989	0.990	1.058
Swiss Franc (CHF/$)	0.811	0.785	1.024
Australian Dollar (US$/A$)	1.053	1.041	0.886
Mexican Peso (MXN/$)	12.526	12.298	13.069
Chinese Yuan (CNY/$)	6.388	6.392	6.800
Indian Rupee (INR/$)	46.155	45.748	46.849
Brazilian Real (BRL/$)	1.612	1.600	1.762
U.S. Dollar Index	74.336	74.009	82.934

Foreign Interest Rates	Friday 8/26/2011	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.48	1.48	0.83
3-Month Sterling LIBOR	0.88	0.87	0.72
3-Month Canadian LIBOR	1.14	1.13	1.01
3-Month Yen LIBOR	0.19	0.19	0.23
2-Year German	0.63	0.65	0.61
2-Year U.K.	0.59	0.60	0.65
2-Year Canadian	1.00	0.87	1.25
2-Year Japanese	0.14	0.14	0.13
10-Year German	2.14	2.11	2.16
10-Year U.K.	2.48	2.39	2.89
10-Year Canadian	2.39	2.30	2.80
10-Year Japanese	1.04	0.99	0.95

Commodity Prices	Friday 8/26/2011	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	84.30	82.26	73.36
Gold ($/Ounce)	1779.88	1852.10	1237.60
Hot-Rolled Steel ($/S.Ton)	665.00	665.00	605.00
Copper (¢/Pound)	406.45	398.25	330.55
Soybeans ($/Bushel)	13.82	13.56	9.89
Natural Gas ($/MMBTU)	3.94	3.94	3.82
Nickel ($/Metric Ton)	20,812	21,260	20,031
CRB Spot Inds.	565.52	570.12	500.51

Next Week's Economic Calendar

	Monday 29	Tuesday 30	Wednesday 31	Thursday 1	Friday 2
U.S. Data	**Personal Income** June 0.1% July 0.4% (W) **Personal Spending** June -0.2% July 0.3% (W) **Core PCE Deflator** June 0.1% July 0.2% (W)	**Consumer Confidence** July 59.5 August 49.8 (W)	**Factory Orders** June -0.8% July 2.1% (W)	**ISM Manufacturing** July 50.9 August 49.1 (W) **Construction Spending** June 0.2% July 0.2% (W) **Total Vehicle Sales** July 12.2M August 12.0M (W)	**Nonfarm Payrolls** July 117K August 30K **Unemployment Rate** July 9.1% August 9.1% (W)
Global Data	**Germany** **CPI (YoY)** Previous (Jul) 2.4%	**Japan** **IP (MoM)** Previous (Jun) 3.8%	**Eurozone** **CPI (YoY)** Previous (Jul) 2.5% **Canada** **GDP (CAGR)** Previous (Q1) 3.9%		**Brazil** **GDP (YoY)** Previous (Q1) 4.2% **Eurozone** **PPI (YoY)** Previous (Jun) 5.9%

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

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