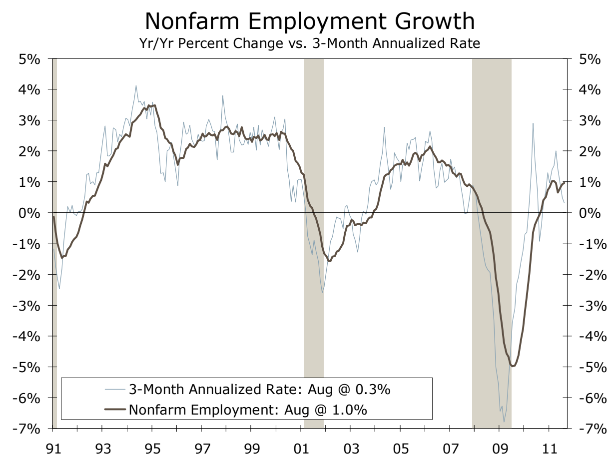
September 02, 2011

Economics Group

Weekly Economic & Financial Commentary

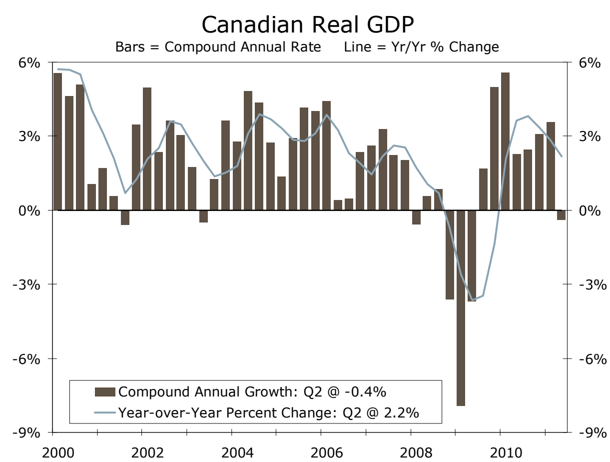
U.S. Review



Recession Fears Rise Again

- Today, markets received a gut-wrenching August payroll report, ratcheting up recession fears again. There were zero net nonfarm payroll jobs created in August with 58,000 fewer net jobs created during July and June. More troubling for people who still have jobs, average hourly earnings and weekly hours both contracted.
- Yet, the week started on a bright note, personal spending for July surprised on the upside, suggesting that economic growth was motoring ahead, when it was hit by the equity market declines and the shock to business and consumer confidence in August.

Global Review



Trade Pulls Canadian GDP Underwater in Q2

- The Canadian economy contracted at a 0.4 percent annualized rate in the second quarter. It was the first quarterly decline in two years.
- Surprisingly, total domestic demand grew at its fastest pace since Q1 2010. Trade was the culprit. Exports fell and imports jumped; the combination was enough to push overall output negative.
- This disappointing turnout has more to do with temporary factors influencing trade than it does anything fundamentally weak in the Canadian economy.

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]	3.9	3.8	2.5	2.3	0.4	1.0	1.8	1.2	-0.4	-3.6	3.0	1.6	1.2
Personal Consumption	2.7	2.9	2.6	3.6	2.1	0.4	2.0	1.2	-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	1.6	2.0	2.3	1.5	1.4	1.5	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	9.1	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

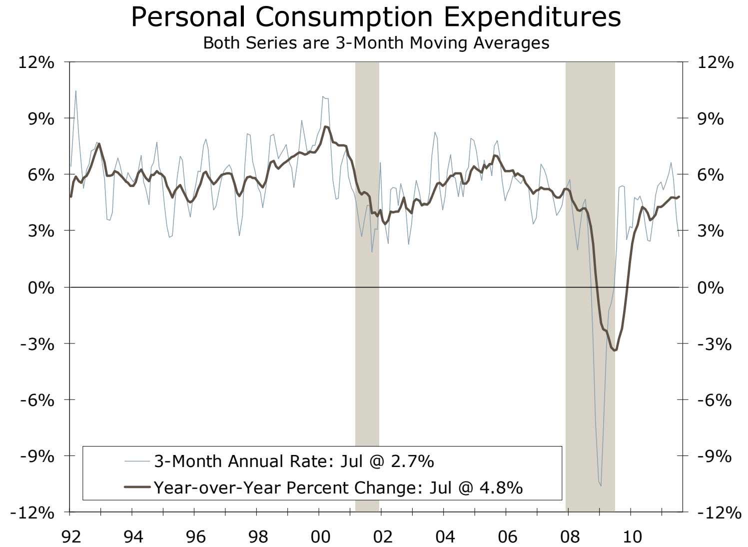
Forecast as of: September 2, 2011
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change
[3] Federal Reserve Major Currency Index, 1973=100 - Quarter End
[4] Millions of Units
[5] Annual Numbers Represent Averages

Inside

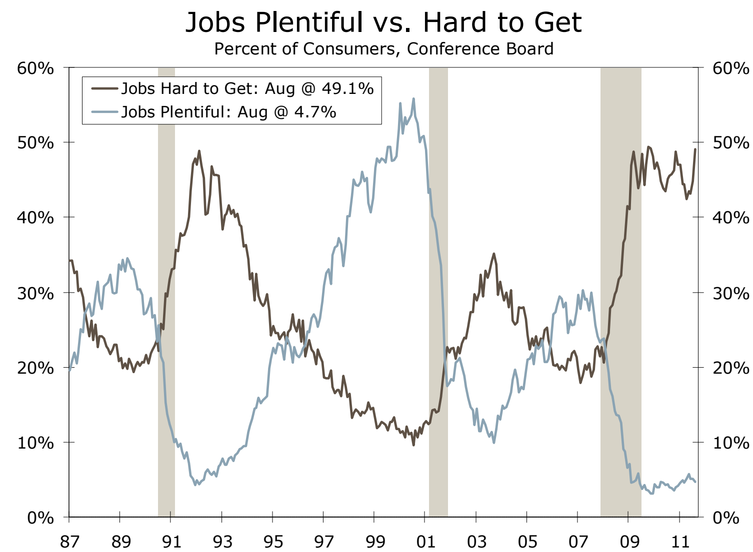
U.S. Review

Is the Glass Half Full or Half Empty?

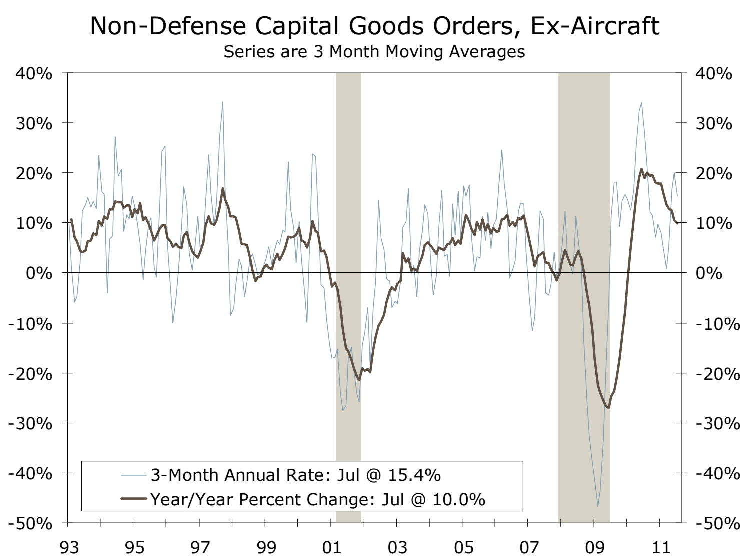
Fears of recession increased on Friday as the BLS reported that August nonfarm payrolls did not grow at all with net job losses reported in a number of important sectors such as retail trade, manufacturing, construction, information services, and government. The 48,000 jobs lost in the information sector were largely due to the Verizon strike, however, and are expected to bounce back in September. More troubling for the outlook on consumer spending was the decline in average hourly earnings and average weekly hours in August that will further squeeze consumer purchasing power. The unemployment rate held steady at 9.1 percent, however, as the household survey showed 331,000 more jobs in August and the labor force grew by a similar amount. We are still getting a fairly sharp differentiation between hard and soft data points. But since most of the hard data is prior to the August financial shock, it must be heavily discounted when trying to forecast the future.



Still, the unexpected strength in July personal spending along with other strong data from July, like industrial production, help to solidify projections of third quarter annualized GDP growth of around 1.6 percent. A disappointing growth rate to be sure, but still a ways away from contraction territory. Personal spending increased 0.8 percent in July from the month before and the annualized 3-month moving average continued to grow at steady 2.7 percent pace, although real consumer spending is having trouble keeping pace with accelerating inflation. The annualized 3-month moving average of real consumer spending held at July's low 0.4 percent pace as energy prices rebounded in July. But to achieve this modest pace of real spending, consumers had to eat into their savings, pushing personal savings rates down to 5.0 percent from 5.5 percent, as real disposable income fell 0.1 percent from July.



Moreover, the decline in "soft" sentiment indicators in August point to even weaker hard economic data ahead. August consumer confidence sank back to 44.5 from 59.2 in July, the lowest reading on this indicator since April 2009 when the economy was still mired in recession. This tempers the outlook for real consumer spending ahead. One of the most troubling indicators from this consumer confidence report was the perceived deterioration in labor market conditions. The spread between "jobs hard to get" and "jobs plentiful" jumped to the widest we have seen since last November, suggesting that the decline in consumer confidence cannot all be chalked up to equity market declines. The Dallas Fed manufacturing activity index for August also slipped to -11.4 from -2.0 prior. This is consistent with the weakness seen in other regional manufacturing indicators from the Empire State to the Philly Fed indexes. The Chicago PMI was surprisingly resilient, however, holding at 56.5 from 58.8 in July suggesting that manufacturers continue to expand in the Chicago region. A strong factory orders report for July and an expansionary ISM manufacturing reading of 50.6 in August further bolstered the case that the U.S. manufacturing expansion may still have some life left in it.



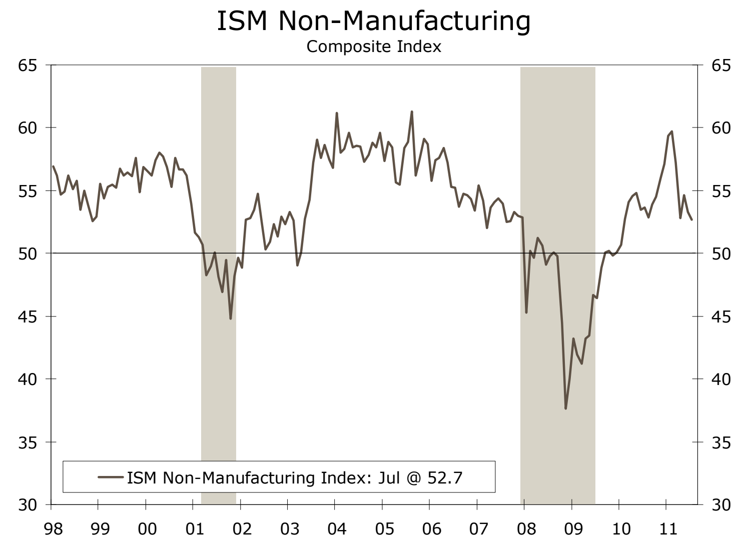
ISM Non-Manufacturing • Tuesday

The ISM non-manufacturing index is going to be released after Labor Day and depending on whether it comes in higher or lower than 50 it will set the stage for a relatively normal or volatile week in the markets. We already got a surprise last week when the ISM manufacturing index remained above 50 and another of these readings for the non-manufacturing index will be good news.

However, the risks are high as August was affected by the debt ceiling debate as well as by S&P's downgrade of the U.S. government risk rating. This political fight and downgrade has the potential to bring the index below 50, not because the economy was doing too badly, but because the sentiment regarding the future path of the U.S. economy was severely affected by the events in early August. The service sector is the largest component of the U.S. economy so a bad reading for this index could jolt the markets as we come back from resting during the long weekend.

Previous: 52.7 **Wells Fargo: 50.1**

Consensus: 51.0



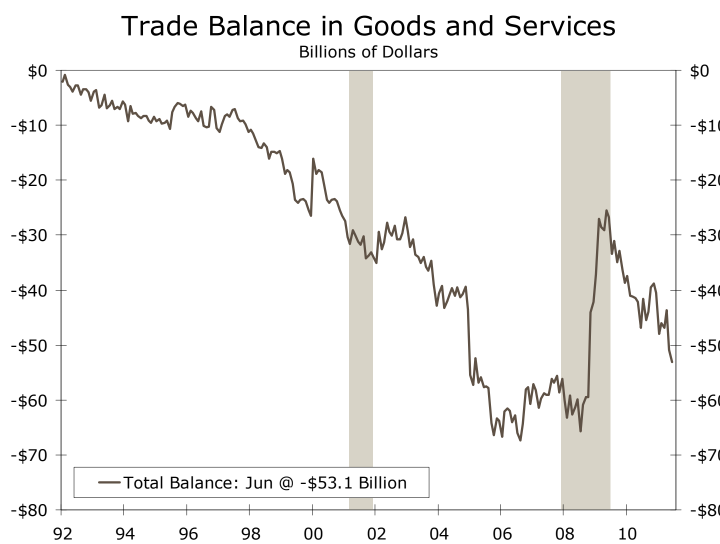
Trade Balance • Thursday

Exports of capital goods, with the exception of civilian aircraft and telecom equipment, were weak in June, contributing to a large trade deficit during the month. However, it was the drop in industrial supplies that contributed the most to the drop in exports and imports in June.

For July, we are expecting the trade deficit to come in higher than in June even as we expect exports and imports of goods and services to have recovered compared to the decline seen in June. However, the reason for the larger deficit will be a larger recovery on the import side of the equation. One of the reasons for this bounce in imports is a recovery in auto and auto parts, as the Japanese supply disruptions produced after the earthquake and the tsunami start to disappear. Furthermore, we will also see some more upward pressure from petroleum prices compared to the weakness in the month of June.

Previous: -$53.1B **Wells Fargo: -$55.0B**

Consensus: -$50.5B



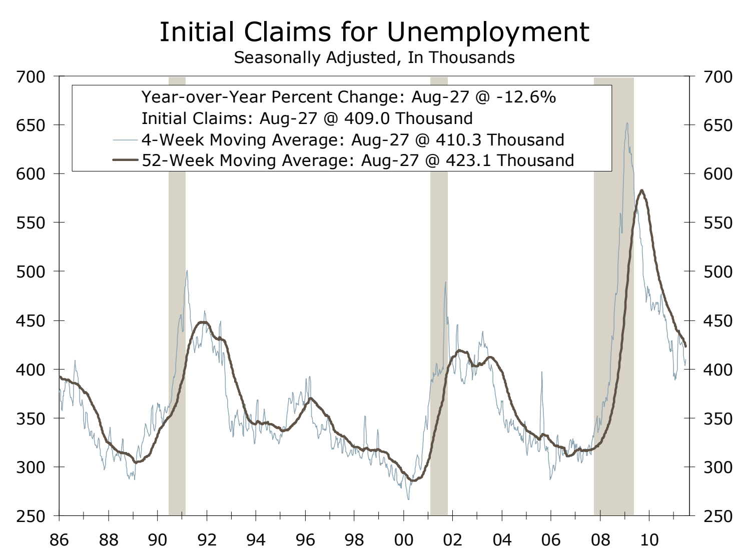
Initial Jobless Claims • Thursday

The weakness in U.S. economic activity seems to have put a floor on initial jobless claims as they have hovered around 400,000 since early this year when they briefly explored the top of the 300,000 handle but came roaring back to 420,000 during the second quarter of the year. Markets are anxiously expecting the crossover to 300,000 because they know that a steady decline below the 400,000 level would mean that the labor market is finally improving.

However, considering the current conditions of the U.S. economy and the recent data on different sectors, especially on the recent release of several PMIs, the probability of this actually happening is very low. Thus, expect no surprises on the initial jobless claim number next week, as the U.S. labor market continues to suffer from the limitations imposed by the weak housing and home construction markets.

Previous: 409K

Consensus: 410K



Global Review

Trade Pushes Canadian GDP Negative

The Canadian economy contracted at an annualized rate of 0.4 percent in the second quarter. The consensus expectation was for no change in economic output during the quarter, so the actual outturn was a disappointment. The Canadian economy has been one of the quickest developed economies to recover from the global recession. So does this drop in GDP signal cracks in the foundation of the Canadian economy or raise concerns about a recession in that economy?

A look at the underlying details of this report suggest that a number of one-off factors are to blame for a significant drag in net exports which is offsetting a strong positive contribution from domestic demand. When looking at net exports, both sides of the equation moved against growth. Imports increased at a 10 percent annualized rate as consumer spending picked up in the quarter and retail sales figures bounced back from a rough start in the spring. Exports dropped off at an 8.3 percent annualized rate in the second quarter. But the weakness here is attributable to temporary factors like slower auto exports due to supply chain concerns and weaker energy exports which is partly explained by wildfires in Alberta. The total drag on headline growth attributable to trade was a whopping 7.2 percentage points.

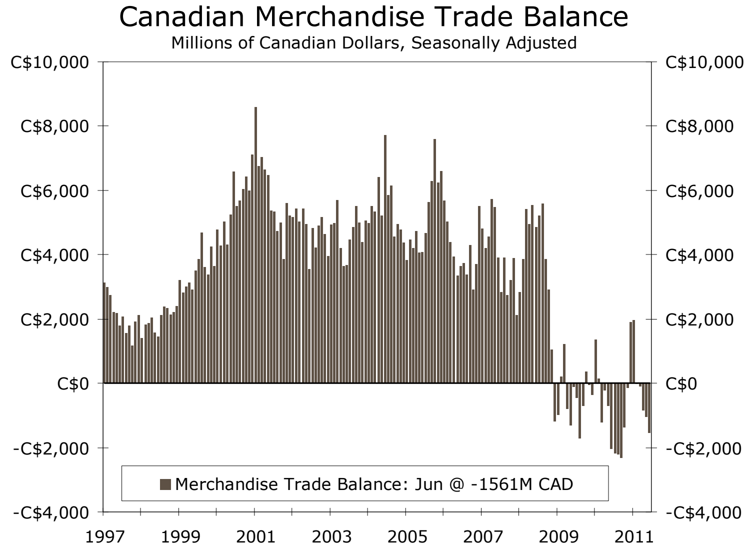
The drag from trade was enough to swamp a 6.2 percentage point contribution from total domestic demand. In addition to the gains in consumer spending, business fixed investment picked up at an 8.1 percent annualized rate and government spending posted a surprise increase after a flat first quarter. Inventories are growing and perhaps growing a bit too fast. The 19.2 percent annualized growth rate for inventories marks the fastest pace of quarterly growth we have seen thus far in the recovery. Ordinarily this might signal unintended inventory building, a worrying signal for future output. But in the context of the Japan-related supply disruptions, Canadian businesses probably deserve a pass for now, but we would not expect this pace of inventory growth to continue.

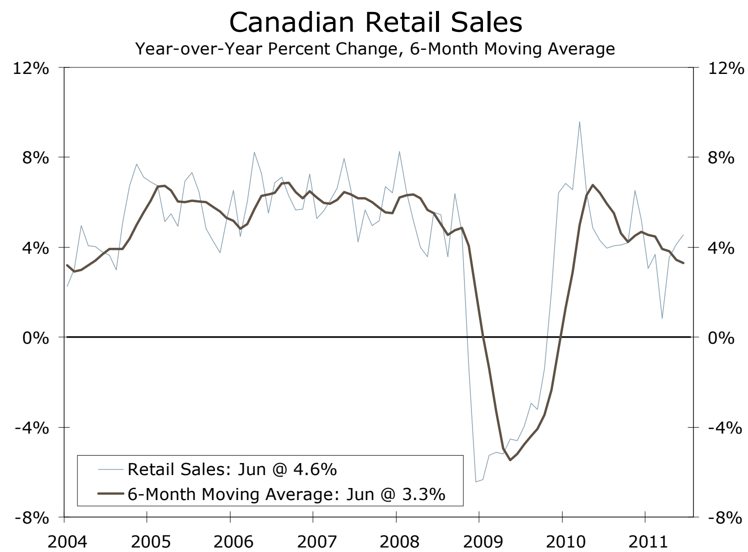
Return to Expansion Seems Likely

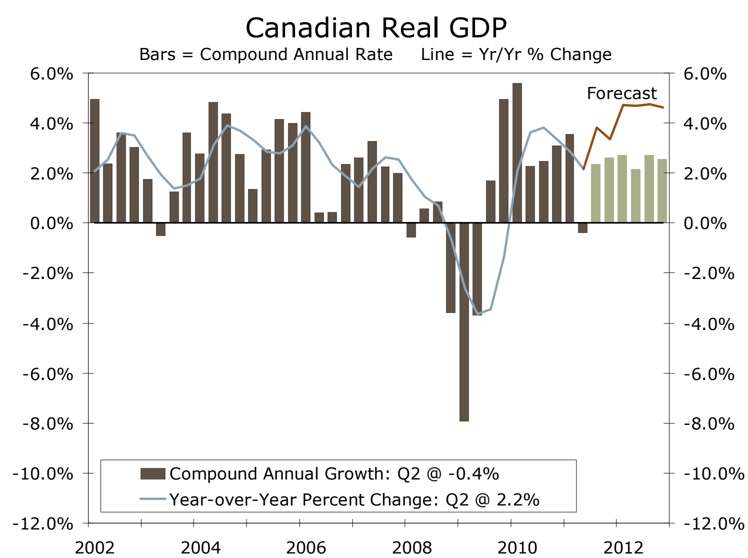
Going forward, we look for renewed economic expansion in Canada. In the near term, the greatest risk to the Canadian outlook is a double-dip recession in the United States, Canada's primary export market. But even as recession fears have risen in recent weeks, some key trends in Canada have improved as well.

Canadian consumers have contributed to the recovery thus far, but all that spending has resulted in a lot of debt for Canadian households. That burden might hold back spending somewhat, but the job market in Canada remains on sound footing. That should be supportive of wage and income growth which should ultimately help offset reluctance to spend based on leverage concerns. Business spending should remain supportive as well.

Government spending will eventually shift to a modest drag as spending decisions will likely be made in the context of getting back to budget surplus.







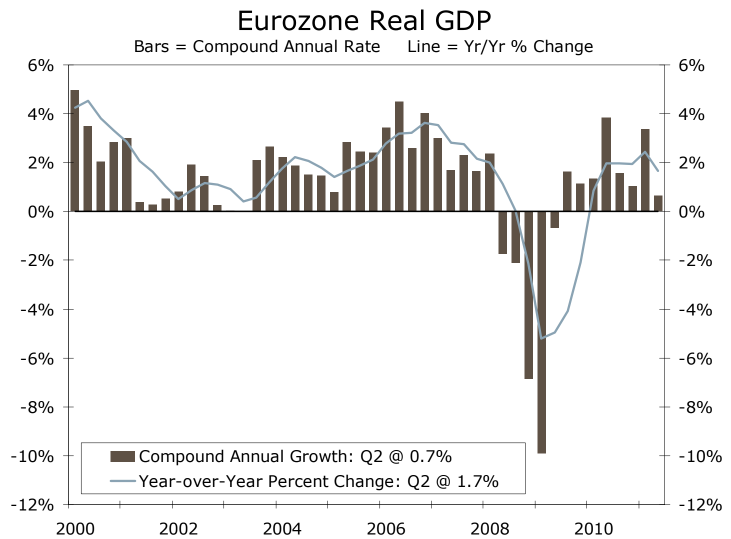
Eurozone GDP • Tuesday

According to the "flash" estimate released a few weeks ago, real GDP in the Eurozone rose at an annualized rate of only 0.7 percent in the second quarter relative to the preceding quarter. There will likely be no major revisions to the overall GDP growth rate, but the data release is important because it will contain the first look at the breakdown of the GDP data into its underlying components. Therefore, analysts will get a better sense of what momentum, if any, the Eurozone economy had coming into the third quarter.

The ECB holds its regularly scheduled monthly policy meeting on Thursday, and few analysts look for the ECB to change its refi rate from its current setting of 1.50 percent. However, investors will listen closely to President Trichet's press conference for clues about the direction of policy in the months ahead. July data on German factory orders (Tuesday) and industrial production (Wednesday) will also draw investor attention.

Previous: 0.2% **Wells Fargo: 0.2%**

Consensus: 0.2% (Quarter-over-Quarter)



Chinese Industrial Production • Friday

Like most other economies, China has seen its growth rate in industrial production (IP) slow over the course of the year. That said, Chinese IP is still growing at a year-over-year rate of roughly 14 percent. Data that are slated for release on Friday will show how Chinese IP held up in August.

Continued strong growth in Chinese retail spending is one of the reasons why growth in Chinese IP has remained solid. Indeed, the year-over-year growth rate in retail sales has been clipping along around 17 percent for most of the year. Data on August sales, which are slated for release on Friday as well, will show how Chinese consumers are faring. The consensus forecast anticipates only a slight slowing in the growth rate of retail spending in August. CPI data for August also print on Friday, and most analysts expect (hope for?) a modest decline in the year-over-year rate of CPI inflation.

Previous: 14.0%

Consensus: 13.7% (Year-over-Year)

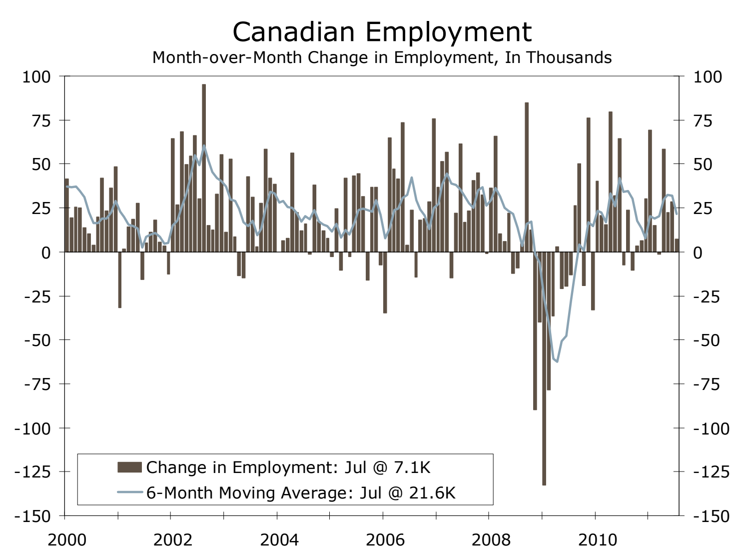
Canadian Employment • Friday

The labor market in Canada has been much stronger than its counterpart south of the border. Indeed, the level of Canadian employment has already risen more than 1 percent above its pre-downturn peak. In contrast, nonfarm payrolls in the United States remain nearly 5 percent below their January 2008 high. Data that will print on Friday will give analysts insights into the state of the Canadian labor market in August.

Earlier in the week (i.e., Wednesday), the Bank of Canada holds a policy meeting. After raising its main policy rate by 75 bps between June and September 2010, the bank has subsequently been on hold. Given recent signs of weak growth and moderating inflation—see page 4 for an overview of recent economic developments in Canada—few analysts, ourselves included, expect the Bank to hike rates on Wednesday. Analysts will dissect the subsequent policy statement for clues about the future direction of Canadian rates.

Previous: 7.1K

Consensus: 31.0K



Interest Rate Watch

Understanding the Split

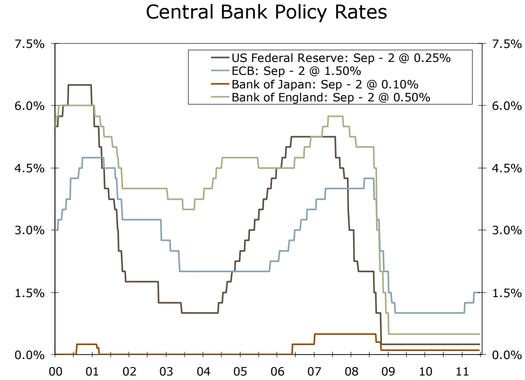
This morning's employment report immediately raised the question as to whether QE3 was back on the table. We do not think it is.

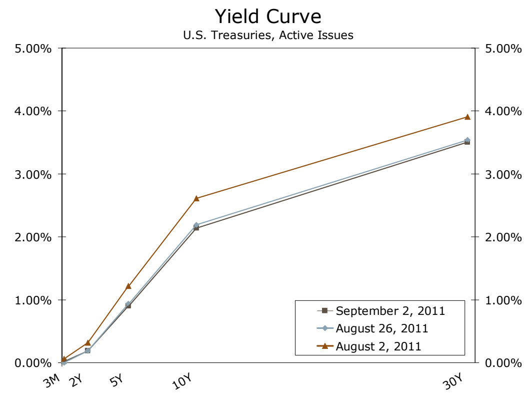
The Aug. 9 FOMC meeting minutes provide some keen insight into how much the Fed's thinking has changed over the past month and also helps explain the rare three dissents. Two members, FRB of Minneapolis President Narayana Kocherlakota and FRB of Philadelphia President Charles Plosser thought the move was unnecessary, set a dangerous precedent, and locked in the Fed's policy. The other, FRB of Dallas President Richard Fisher, thought the move only added to the heightened uncertainty already present.

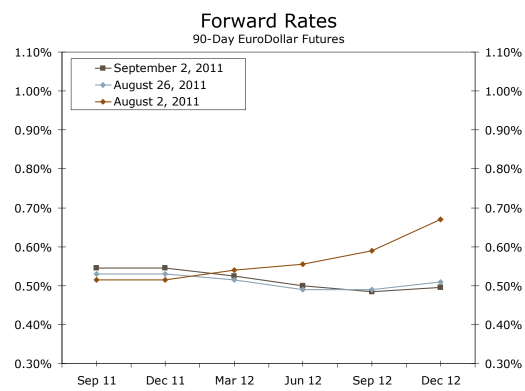
There was apparently more agreement on the Fed's economic forecast, which was dramatically reduced following the downward revision to first half GDP growth, recent intensification of the European sovereign debt crisis and tense federal debt ceiling negotiations. The Fed also raised their forecast for inflation for the second half of the year.

With expectations for growth reduced and the financial markets on edge, the FOMC reviewed a host of policy options and ultimately decided to harden the policy statement by explicitly stating the Fed's intention to keep the federal funds rate at exceptionally low levels through at least mid-2013. The move temporarily helped drive the yield on the 10-year Treasury down to 2 percent, a level that it has gotten close to again in the wake of this morning's disappointing employment report.

The Fed has changed its September meeting from one day to two days to further reassess its forecast and policy options. There is a great deal of speculation the Fed will opt to revive the 1960s-era Operation Twist policy of selling short-term securities and buying more longer-term securities in an effort to either push long-term interest rates lower or keep them there for a longer period of time. Such a move is likely at some point but may not actually occur until the deficit reduction committee concludes in November.







Credit Market Insights

Most Delinquency Rates Improving

Loan delinquency rates largely improved in the second quarter. The overall delinquency rate fell to 6.0 percent, the fifth straight decline. Still, this is only slightly lower than the peak of 6.2 percent seen in the 1990-1991 recession and much higher than the peak of 2.8 percent in the 2001 recession. Thus, while we appear to be going in the right direction, it could take years to get back to prerecession levels of delinquency rates.

There has been a significant decline in credit card delinquency rates since the end of the recession. After peaking at 6.8 percent in the second quarter of 2009, the credit card delinquency rate has plummeted to just 3.6 percent as of the second quarter of 2011, only slightly above the low of 3.5 percent in the fourth quarter of 2005, just before the housing bubble burst. Vigilance by consumers in paying down their card balances to avoid having their accounts closed, further charge-offs of bad debt from banks and tighter lending standards have all been factors in the huge decline in credit card delinquency rates.

Commercial real estate delinquency rates also saw further improvement in the second quarter, coming in at 7.1 percent. In contrast, the rebound in residential loan delinquency rates, which have risen for two straight quarters despite programs to help homeowners, is a disturbing sign. This does not bode well for housing-related employment or the broader economy.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.22%	4.22%	4.39%	5.08%
15-Yr Fixed	3.39%	3.44%	3.54%	4.39%
5/1 ARM	2.96%	3.07%	3.18%	4.10%
1-Yr ARM	2.89%	2.93%	3.02%	4.05%
MBA Applications				
Composite	631.7	699.1	565.3	893.8
Purchase	159.3	157.9	185.8	173.6
Refinance	3,381.7	3,850.6	2,780.5	5,085.3

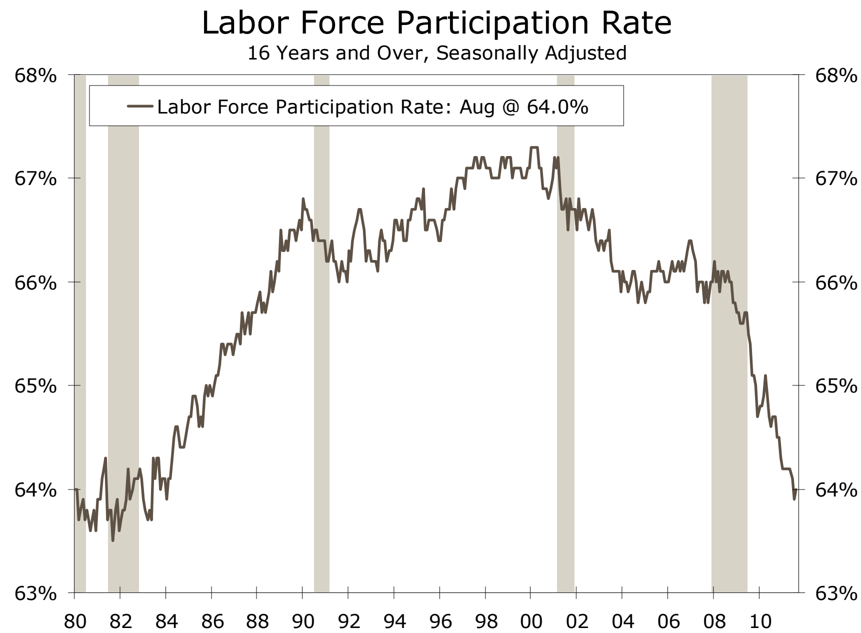
Source: Freddie Mac, Mortgage Bankers Association and Wells Fargo Securities, LLC

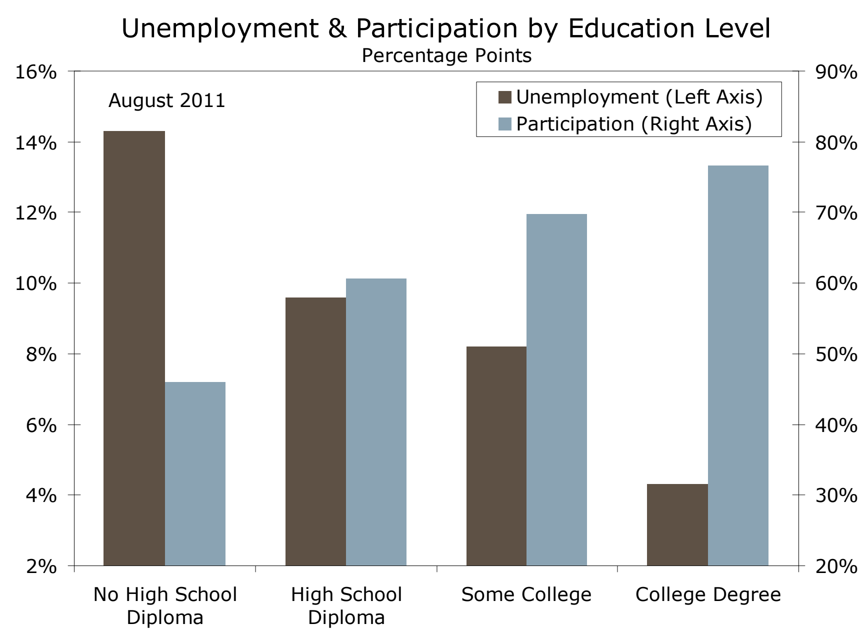
Topic of the Week

A Long Road Ahead for the Unemployment Rate

Today's employment report confirmed that the modest job gains throughout this year are not enough to alleviate unemployment in any meaningful way. Unemployment remains stubbornly high at 9.1 percent, but the underlying details show even further weakness. While unemployment has edged down over the past year, the labor force has also declined as fewer people search for jobs. This has driven the labor force participation rate down to nearly 30-year lows. The labor force represents the supply side of the labor market equation and is often associated with the potential growth of an economy. A long-run decline in the rate of growth and the participation rate of the labor force could have far reaching consequences such as lower output and consumption, as well as a reduction in future tax revenues that fund public entitlements. While we expect workers to gradually return to the labor force when the employment picture brightens, it is unlikely that the participation rate will rebound substantially as the skills of many labor-force leavers do not match the needs of jobs being created.

The general discrepancy in skills demanded by employers can be seen when looking at the education levels of the unemployed. Unemployment for workers with a college education stands at 4.3 percent compared to 9.6 percent for those with only a high school degree. Moreover, the unemployment rate for college degree holders stands only 2.2 percentage points higher from when the recession began, whereas the unemployment rate for workers without a high school diploma is 6.6 percentage points higher. Participation rates by education are also highly uneven, with less-educated workers less likely to participate in the labor force. The road ahead for many of the unemployed remains arduous as employers increasingly value skills that can help them compete in a more knowledge-based economy. We expect the unemployment rate to move slightly higher through the remainder of the year and remain above 9 percent in 2012.





Subscription Info

Wells Fargo's *Weekly Economic & Financial Commentary* is distributed to subscribers each Friday afternoon by e-mail.

To subscribe please visit: www.wellsfargo.com/economicsemail

The *Weekly Economic & Financial Commentary* is available via the Internet at www.wellsfargo.com/economics

Via The Bloomberg Professional Service at WFEC.

And for those with permission at www.wellsfargoresearch.com

Market Data ♦ Mid-Day Friday

U.S. Interest Rates	Friday 9/2/2011	1 Week Ago	1 Year Ago
3-Month T-Bill	0.01	-0.01	0.13
3-Month LIBOR	0.33	0.32	0.29
1-Year Treasury	0.12	0.11	0.23
2-Year Treasury	0.18	0.19	0.49
5-Year Treasury	0.90	0.94	1.42
10-Year Treasury	2.14	2.19	2.62
30-Year Treasury	3.50	3.54	3.71
Bond Buyer Index	4.14	4.09	3.86

Foreign Exchange Rates	Friday 9/2/2011	1 Week Ago	1 Year Ago
Euro ($/€)	1.426	1.450	1.283
British Pound ($/£)	1.622	1.637	1.540
British Pound (£/€)	0.879	0.886	0.833
Japanese Yen (¥/$)	76.800	76.640	84.280
Canadian Dollar (C$/$)	0.978	0.981	1.052
Swiss Franc (CHF/$)	0.780	0.806	1.013
Australian Dollar (US$/A$)	1.070	1.057	0.911
Mexican Peso (MXN/$)	12.324	12.455	13.033
Chinese Yuan (CNY/$)	6.382	6.388	6.808
Indian Rupee (INR/$)	45.788	46.155	46.713
Brazilian Real (BRL/$)	1.620	1.609	1.746
U.S. Dollar Index	74.457	73.814	82.463

Foreign Interest Rates	Friday 9/2/2011	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.48	1.48	0.83
3-Month Sterling LIBOR	0.89	0.88	0.73
3-Month Canadian LIBOR	1.16	1.14	1.03
3-Month Yen LIBOR	0.19	0.19	0.23
2-Year German	0.57	0.65	0.62
2-Year U.K.	0.57	0.57	0.72
2-Year Canadian	1.00	1.00	1.28
2-Year Japanese	0.15	0.14	0.13
10-Year German	2.08	2.16	2.28
10-Year U.K.	2.51	2.46	2.96
10-Year Canadian	2.39	2.40	2.87
10-Year Japanese	1.03	1.04	1.12

Commodity Prices	Friday 9/2/2011	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	84.30	85.37	75.02
Gold ($/Ounce)	1859.75	1827.95	1250.95
Hot-Rolled Steel ($/S.Ton)	695.00	665.00	595.00
Copper (¢/Pound)	410.30	409.90	348.80
Soybeans ($/Bushel)	14.07	13.82	9.81
Natural Gas ($/MMBTU)	4.03	3.93	3.75
Nickel ($/Metric Ton)	21,708	20,788	20,996
CRB Spot Inds.	571.74	565.85	506.79

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	5	6	7	8	9
U.S. Data		**ISM Non-Manufact.** July 52.7 August 50.1 (W)		**International Trade** June -$53.1B July -$55.0B (W) **Consumer Credit** June $15.532B July $6.000B (C)	
Global Data	**Eurozone** **Retail Sales (MoM)** Previous (Jun) 0.7%	**Eurozone** **GDP (MoM)** Previous (Q1) 0.2%	**UK** **IP (MoM)** Previous (Jun) 0.0% **Japan** **Machine Orders (MoM)** Previous (Jun) 17.9%	**Mexico** **CPI (YoY)** Previous (Jul) 3.55%	**China** **IP (YoY)** Previous (Jul) 14.0% **Canada** **Employment Change** Previous (Jul) 7.1K

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

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research & Economics	(704) 715-8437 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wellsfargo.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wellsfargo.com
Scott Anderson, Ph.D.	Senior Economist	(612) 667-9281	scott.a.anderson@wellsfargo.com
Eugenio Aleman, Ph.D.	Senior Economist	(704) 715-0314	eugenio.j.aleman@wellsfargo.com
Sam Bullard	Senior Economist	(704) 383-7372	sam.bullard@wellsfargo.com
Anika Khan	Economist	(704) 715-0575	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wellsfargo.com
Ed Kashmarek	Economist	(612) 667-0479	ed.kashmarek@wellsfargo.com
Tim Quinlan	Economist	(704) 374-4407	tim.quinlan@wellsfargo.com
Michael A. Brown	Economist	(704) 715-0569	michael.a.brown@wellsfargo.com
Tyler B. Kruse	Economic Analyst	(704) 715-1030	tyler.kruse@wellsfargo.com
Joe Seydl	Economic Analyst	(704) 715-1488	joseph.seydl@wellsfargo.com
Sarah Watt	Economic Analyst	(704) 374-7142	sarah.watt@wellsfargo.com

WELLS FARGO SECURITIES