September 23, 2011

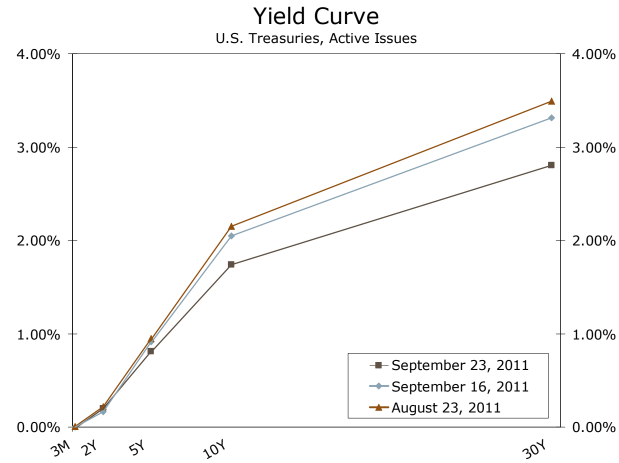
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Shake It Up, Benny, Now

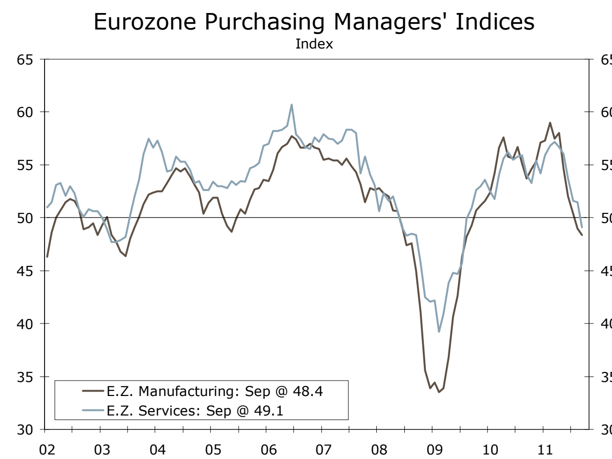
- Having already committed to maintaining a low Fed funds rate, policymakers are considering other options and trying out different dance steps to spur recovery. Will a reallocation of the Fed's holdings of Treasuries and more purchases of MBS spur recovery?
- Virulent selling on Wall Street seemed to have been sparked by concerns beyond slow growth in the U.S. economy. Domestic data, while somewhat underwhelming, was not too bad. A slip in housing starts was offset by a gain in permits, existing homes sales jumped, and jobless claims came down slightly.



Global Review

Eurozone Goes from Bad to Worse

- The economic news out of the Eurozone continues to deteriorate. For example, the "flash" purchasing managers' indices (PMIs) for September declined even further with the indices for the manufacturing and service sectors falling below the demarcation line separating expansion from contraction.
- Meanwhile, European policymakers are taking steps to address the European sovereign debt crisis, but they remain one step, at a minimum, behind the markets. Unless policymakers move decisively soon, we fear that the sovereign debt crisis will become even more virile.



Wells Fargo U.S. Economic Forecast

	Actual 2011 1Q	Actual 2011 2Q	Forecast 2011 3Q	Forecast 2011 4Q	Forecast 2012 1Q	Forecast 2012 2Q	Forecast 2012 3Q	Forecast 2012 4Q	Actual 2009	Actual 2010	Forecast 2011	Forecast 2012	Forecast 2013
Real Gross Domestic Product [1]	0.4	1.0	1.8	1.2	1.0	1.2	1.9	1.7	-3.6	3.0	1.6	1.3	1.7
Personal Consumption	2.1	0.4	1.8	1.2	1.3	1.3	1.4	1.4	-2.0	2.0	2.1	1.3	1.3
Inflation Indicators [2]													
"Core" PCE Deflator	1.1	1.3	1.6	2.0	2.1	2.0	1.9	1.8	1.5	1.4	1.5	1.9	1.7
Consumer Price Index	2.2	3.3	3.7	3.7	2.8	2.3	2.0	1.8	-0.3	1.6	3.2	2.2	2.0
Industrial Production [1]	4.8	0.5	4.9	1.5	2.3	3.2	3.7	3.7	-11.1	5.3	3.8	2.8	3.8
Corporate Profits Before Taxes [2]	8.8	8.3	6.5	6.4	6.2	6.0	6.4	6.6	7.9	32.2	7.5	6.3	7.1
Trade Weighted Dollar Index [3]	70.6	69.4	68.5	69.5	70.5	71.5	72.5	73.0	77.7	75.6	69.5	71.9	74.9
Unemployment Rate	8.9	9.1	9.1	9.4	9.5	9.5	9.5	9.4	9.3	9.6	9.1	9.5	9.2
Housing Starts [4]	0.58	0.57	0.58	0.55	0.57	0.62	0.67	0.70	0.55	0.58	0.57	0.64	0.86
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	3.90	3.70	3.70	3.80	4.00	4.10	5.04	4.69	4.24	3.90	4.28
10 Year Note	3.47	3.18	1.75	1.60	1.80	2.00	2.20	2.30	3.26	3.22	2.50	2.08	2.55

Forecast as of: September 23, 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

Together we'll go far

U.S. Review

Financial Markets Looking Beyond the U.S. Economy

In a week during which major equity indexes like the Dow Jones Industrial Average plunged to fresh 2011 lows, markets seem to be pricing in the risk of further deterioration with the sovereign debt situation in Europe and perhaps digesting the idea that global growth may be poised to slow. We discuss the challenges for Europe in the global review section in detail on page 4. With most market participants glued to the latest news from across the Atlantic, there was little in the way of developments in the U.S. economy this week to offer much in the way of distraction.

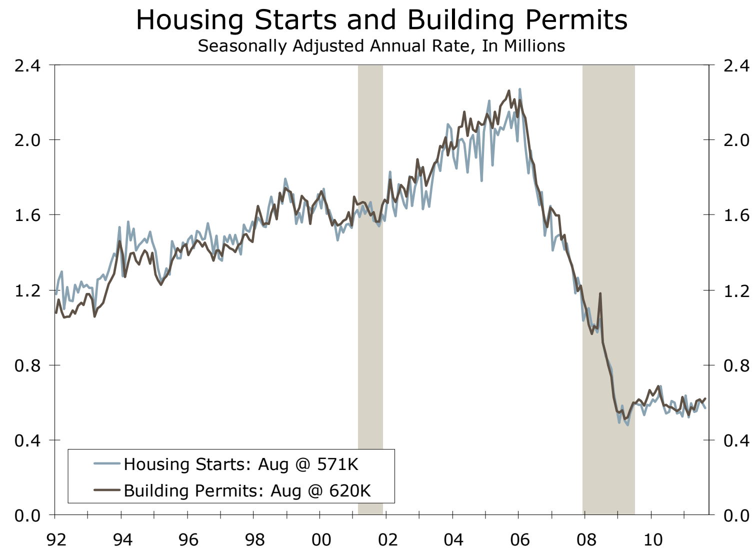
Most indicators this week came in roughly in line with expectations. Even the Fed's announcement of its latest plan to spur recovery was (by and large) just what Chairman Bernanke has been outlining in his speeches and public appearances for several weeks. This week, economic news in the United States offered a picture of a slow-growth economy that is not substantively different from what we have discussed for the better part of the past year.

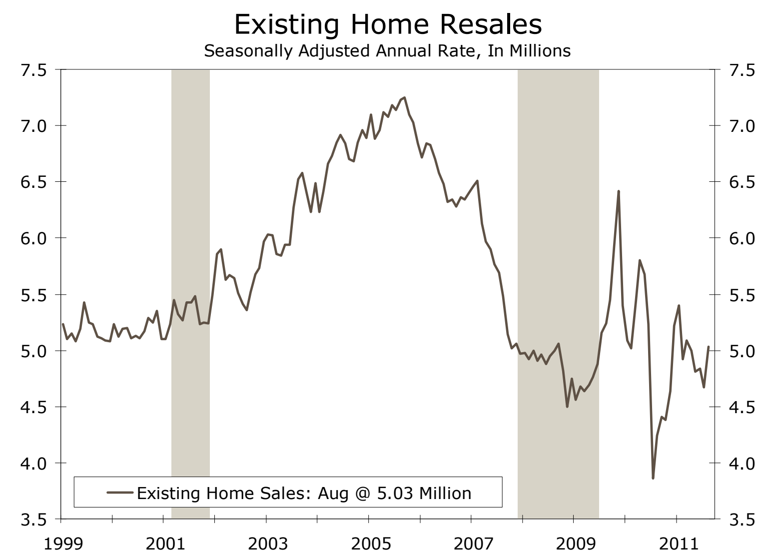
Housing starts disappointed on the headline with a 5.0 percent drop that brought the annualized rate of new residential construction activity to a 571,000-unit pace. The drop was primarily due to a decline in multi-family construction, although single-family activity slowed as well. The silver lining on this report was that the number of permits for new residential projects picked up for the third time in four months. While the housing market remains under pressure, there are other indications of modest improvement. We learned this week that existing homes sales climbed 7.7 percent in August lifting the annualized rate of sales to more than 5 million units for the first time since April. This was a welcome positive after months of disappointing sales figures, and all four regions of the country reported increased sales. However, cash-only and distressed properties still comprise a fairly substantial share of purchases.

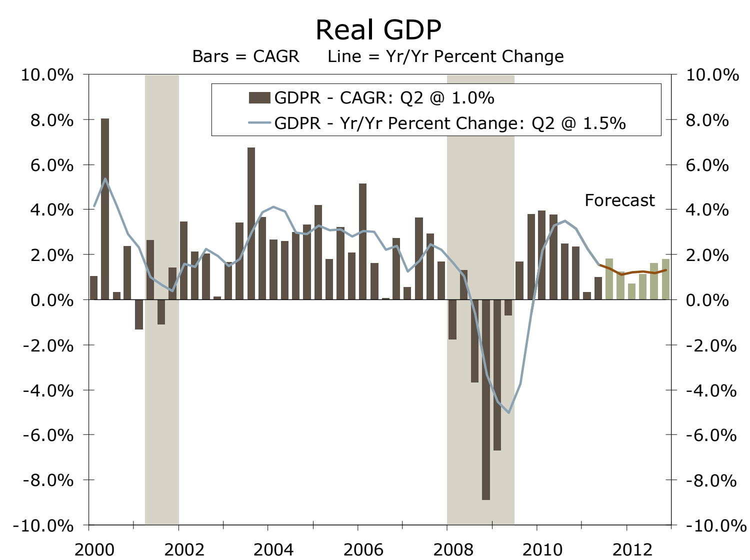
Fed Lays Out Its Latest Plan to Spark Growth

Having already committed to maintaining a low Fed funds rate, and facing political pressure not to expand the Fed's balance sheet, policymakers are considering other options and trying out different dance steps to spur recovery. Between now and June 2012, the Fed intends to augment its already accommodative monetary policy by selling short-term Treasury assets already in the Fed's portfolio and using the proceeds to purchase longer-dated Treasuries. The total dollar amount is pegged at $400 billion and has already resulted in a flattening of the yield curve (see chart on page 1). Additionally, the Fed announced that starting in October it will reinvest maturing agency debt into agency mortgage-backed securities in the secondary market. The Fed seems to be aiming both barrels at the housing market as these twin measures should drive down the cost of financing as well as increase mortgage origination activity.

Will it work? Our view is that the Fed's actions may help on the margin, but we do not expect a significantly stimulative effect on the economy as a whole. We continue to expect subpar, painfully slow growth for the rest of this year and into 2012.





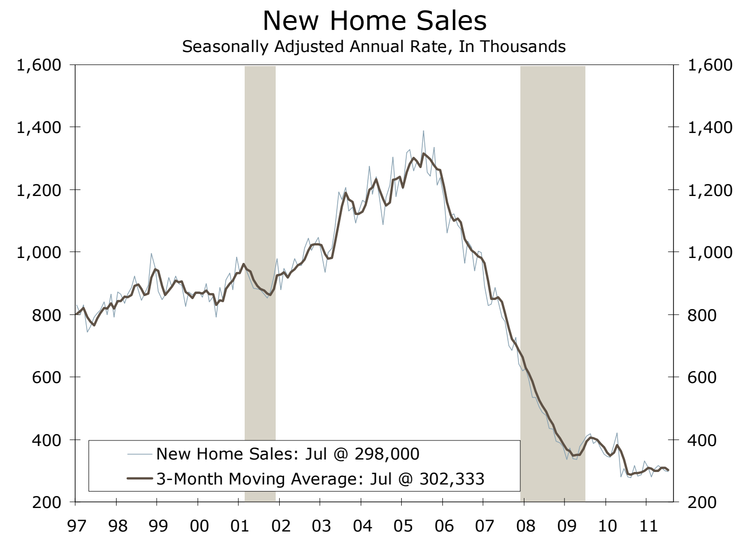


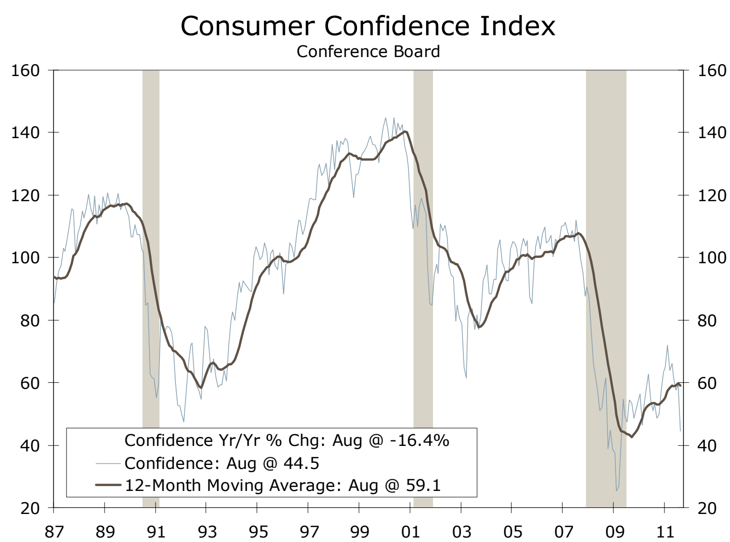
New Home Sales • Monday

New home sales are expected to remain anemic in August at around 295,000 units on an annualized basis. New home sales have been slowing since April, but remain slightly above the August 2010 low of 278,000 units. New home sales have never really recovered from the hangover of the first-time homebuyers' tax credit. According to the Wells Fargo/NAHB housing market index, new home sales could slow further in the months ahead, as homebuilder optimism has hit its lowest level since June, and is only modestly higher than the lows in this cycle. More homebuilders reported slowing sales and sales expectations in August, as well as weakening buyer traffic, as financial market volatility and economic uncertainty have ramped-up. Despite record-low 30-year mortgage rates, there is little sign that potential homebuyers are getting ready to buy a home. Mortgage purchase applications continue to trend lower and the pending home sales index is treading water.

Previous: 298K **Wells Fargo: 293K**

Consensus: 295K





Consumer Confidence • Tuesday

All eyes are on the U.S. consumer, as the sustainability of the economic recovery largely hangs on their willingness and ability to continue to spend. The Conference Board's consumer confidence index took a scary plunge in August to 44.5 from a 59.2 reading for July, spooking markets that the plunge in equities and the slowdown in job creation could cause consumers to once again tighten their financial belts and hold back on their spending. Declines in consumer expectations have led the drop in consumer confidence, although the present situation index has also deteriorated in recent months. Consumer confidence has been on a down trend since April as the European sovereign debt crisis, rising food and energy prices, and supply disruptions from the Japanese earthquake hit the U.S. economy. Since August, stock prices have stabilized and policymakers have turned more dovish, perhaps lifting consumers' gloom a bit in September.

Previous: 44.5 **Wells Fargo: 46.7**

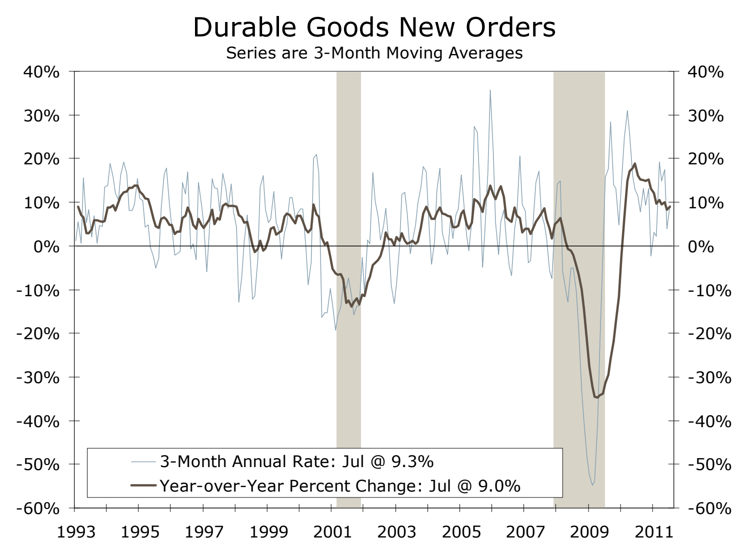
Consensus: 46.5

Durable Goods Orders • Wednesday

Regional and national manufacturing surveys have weakened markedly over the past few months, with many now in outright contraction. Weakness has also been widely evident in the new orders subcomponent of these indicators, perhaps foreshadowing an impending decline in durable goods orders. Yet so far, the hard durable goods orders reports through July have remained buoyant, as strong vehicle and aircraft orders have largely offset declines in defense orders. Some of this order strength is coming from long delayed orders for commercial aircraft from companies like American Airlines and Delta, while the strength in vehicle orders is largely a temporary unwinding from supply disruptions that affected the auto sector's supply chains. For August, we expect the underlying weakness in manufacturing and final demand to become more obvious as durable orders decline 0.9 percent from July.

Previous: 4.0% **Wells Fargo: -0.9%**

Consensus: -0.4% (Month-over-Month)



Global Review

Eurozone Goes From Bad to Worse

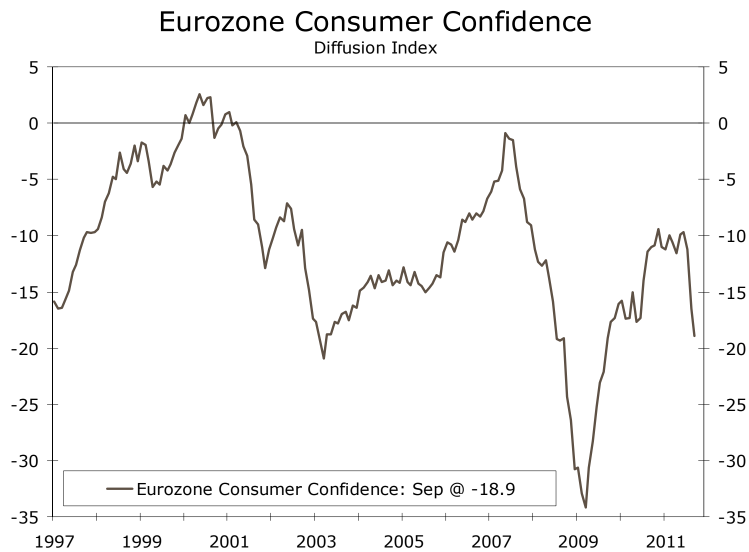
The economic news out of the Eurozone continues to deteriorate. For example, the "flash" purchasing managers' indices (PMIs) for September declined even further with the indices for the manufacturing and service sectors falling below the demarcation line separating expansion from contraction (see chart on page 1). Given all the negative news and financial market volatility out of Europe recently, it should come as little surprise that consumer confidence slumped further in September (top chart).

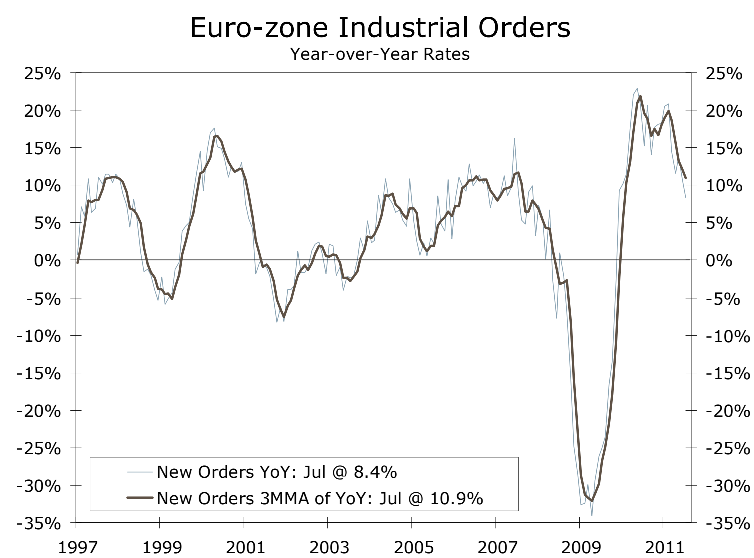
Although "hard" data lag the "soft" indices on business and consumer sentiment by a month or two, these data have also been downbeat. Factory orders in the Eurozone were up more than 8 percent on a year-over-year basis in July, but they are falling quite rapidly on a sequential basis. Indeed, the level of orders in July stood more than 3 percent below its recent peak in May. Given the drop in the manufacturing PMI in recent months, orders are likely to have declined further in August and September. The overall euro area probably eked out a positive GDP growth rate in the third quarter, but the declines in the PMIs are not a good omen for the fourth quarter. In other words, the Eurozone is very close to recession again, if it has not already slipped into one.

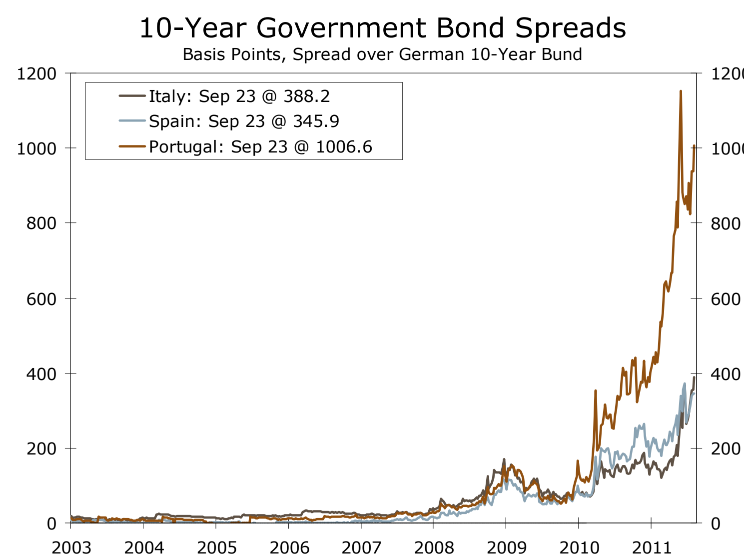
Meanwhile, European policymakers are taking steps to address the European sovereign debt crisis, but they remain one step, at a minimum, behind the markets. This week, the Greek cabinet announced further austerity measures, which include a reduction in the tax-free threshold for income and some reduction in the public sector pension. The measures were meant to induce the International Monetary Fund (IMF) to release the next tranche of Greece's loan. Without the next tranche, the Greek government will run out of cash by the middle of October. However, the IMF may demand that parliament approves the measures before it releases the next tranche of the loan.

In Germany, the budget committee of the Bundestag backed proposed changes to the European rescue fund, the so-called European Financial Stability Facility (EFSF). The change increases the effective firepower of the EFSF. However, Europe is hardly out of the woods even if, as is expected, the full Bundestag approves the measure next week. At one time, the €440 billion EFSF was seen as sufficient to handle Europe's debt woes. Indeed, the EFSF is large enough to provide support to Greece, Ireland and Portugal. However, it is too small to provide meaningful support to the government of Spain, which owes creditors more than €800 billion, not to mention Italy (€2.1 trillion).

What needs to be done to extinguish the sovereign debt crisis? In our view, more support needs to be offered to the highly indebted countries either through an enhanced EFSF or joint guarantees on government debt (i.e., so-called Eurobonds). Otherwise, some governments could default, which would entail significant writedowns among European banks. Unless European policymakers move decisively soon, we fear that the sovereign debt crisis will become even more virile.





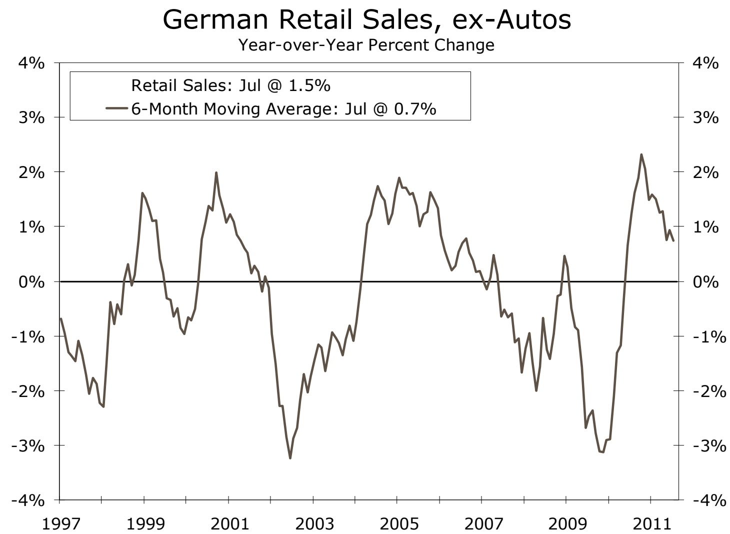


Germany Retail Sales • Friday

Real German retail sales were unchanged in July following a 4.5 percent jump in June. Sales were down 1.6 percent from a year ago, the second straight decline. Despite the lowest unemployment rate in two decades, retail sales have been lackluster for most of this year, primarily due to a lull in auto sales, which fell for four straight months in the aftermath of the Japan disasters before rebounding in July. Excluding autos, sales have been trending down for months as the global economy has slowed and consumer confidence has waned. Private consumption actually declined in the second quarter for the first time since the fourth quarter of 2009, contributing to the weakest quarterly economic growth since the first quarter of 2009. With export growth slowing as its Eurozone neighbors implement austerity measures to reduce deficits, personal spending has failed to take up the slack. We expect the plunge in consumer confidence in August likely caused retail sales to weaken as well.

Previous: 0.3%

Consensus: -0.5% (Month-over-Month)

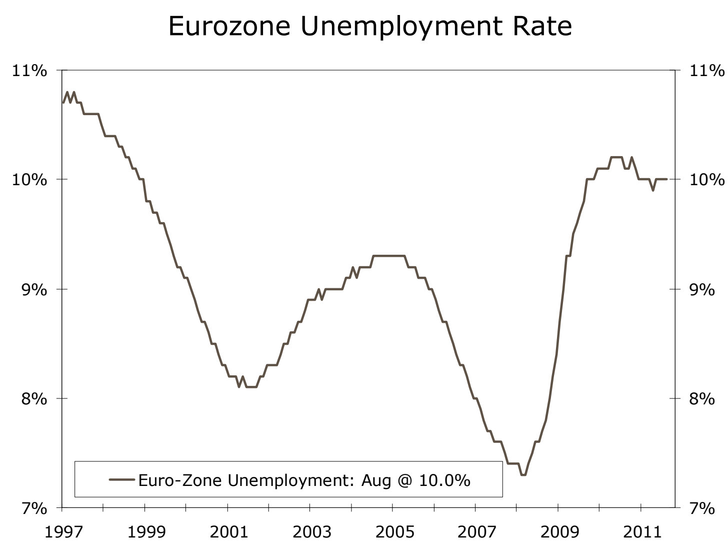


Eurozone Unemployment • Friday

The unemployment rate in the Eurozone held steady at 10.0 percent in July, and has seen little change since the beginning of the year. It was down slightly from 10.2 percent a year ago. Thus, it appears on the surface that the debt crisis is having little effect on the region's labor markets. However, as one would expect, there are vast differences among the member countries. Of the countries with the most serious debt concerns, Greece's unemployment rate has risen the most over the past year (+3.3 percentage points), followed by Spain (+0.9), Ireland (+0.8) and Portugal (+0.2), while Italy has seen a decline (-0.3). On the other hand, the biggest declines have come in Estonia (-3.3), Lithuania (-2.7) and Hungary (-1.5). The region's economic engine, Germany, has seen a decline of 0.9 percentage points. With unemployment in double digits in four of the five heavily indebted countries, their inability to withstand further austerity measures is a major risk to global growth.

Previous: 10.0%

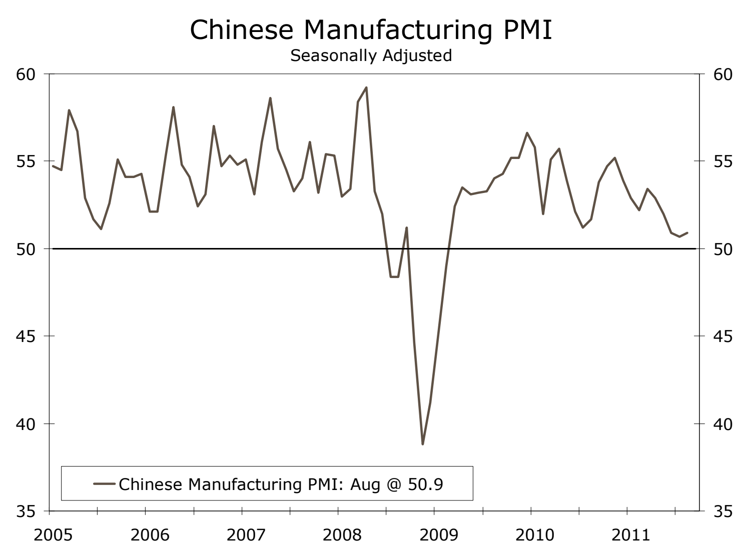
Consensus: 10.0%



China Manufacturing PMI • Friday

China's manufacturing PMI rose slightly to 50.9 in August from a 29-month low of 50.7 in July. Output rose slightly from a two-and-a-half-year low and new orders remained unchanged. Meanwhile, new export orders fell into contraction territory for the first time since April 2009, while order backlogs have contracted for four months straight. Slowing growth in the United States and Europe has constrained demand for China's exports. At the same time, the central bank has raised interest rates five times since last October in an effort to cool rising inflation, which was 6.2 percent year-over-year in August. The central bank has also raised reserve requirements to record levels to slow domestic demand. These measures to slow the domestic economy, combined with flagging external demand and high raw material costs, are squeezing profits at some of the nation's top manufacturers. We expect little change in the PMI, but outright contraction is certainly a possibility.

Previous: 50.9



Interest Rate Watch

"Operation Twist" Gets Under Way

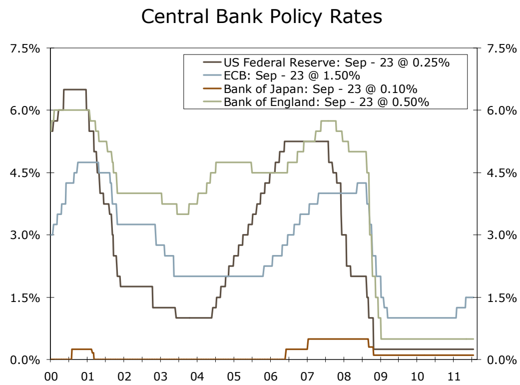
As many analysts had expected, the Fed embarked upon "Operation Twist" this week. By June 30, 2012, the Fed will purchase $400 billion worth of U.S. Treasury securities, with maturities of six to 30 years, and it will sell an equal amount of securities that mature in three years or less. The Fed's intent is to bring down long-term interest rates, with the goal of spurring more borrowing. In that regard, yields at the long end of the Treasury curve (seven to 30 years) have dropped 10 bps-40 bps.

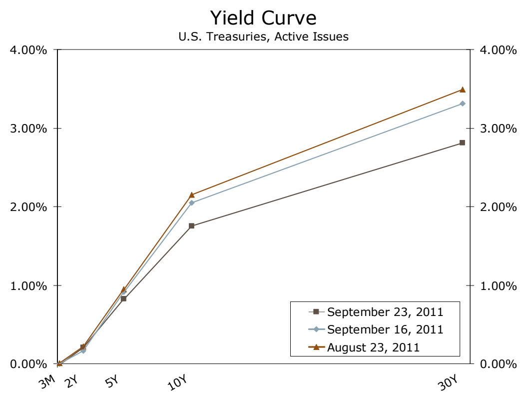
In our view, however, the problem with the economy is not that long-term interest rates are too high. Rather, the problem is that credit remains very tight and many homeowners are "underwater," preventing them from refinancing at attractive rates. Therefore, we do not believe that "Operation Twist" will be the silver bullet that is needed to solve all the economy's problems.

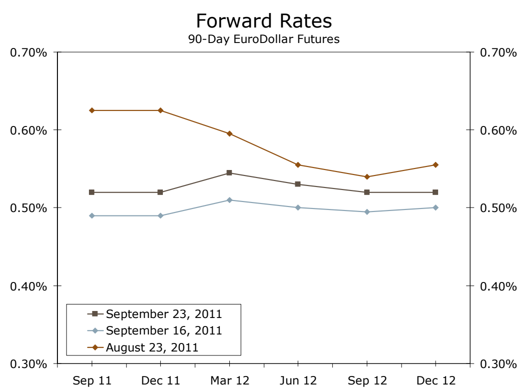
We do not mean to criticize the Fed for its actions. The Fed long ago ran out of conventional "ammunition." That is, the FOMC cut the fed funds rate to essentially zero percent in December 2008, the level where the fed funds rate remains today. If the Fed could cut its main policy rate even further, it clearly would. However, the lower bound of zero percent is preventing the Fed from undertaking further conventional stimulus. The Fed is in uncharted territory at present, and it is doing all it can to help the struggling economy get back on its feet via unconventional policy actions.

Arguably, the FOMC could authorize another round of quantitative easing (QE). However, the efficacy of further QE is unknown, and the policy is seen as controversial, certainly outside of the Fed and arguably within the Fed as well. Only if inflation recedes significantly over the next few months and/or the economy appears to be rolling back into recession do we think that a critical mass of Fed policymakers will support another round of QE.

For further reading see "Operation Twist Gets Underway", which is posted on our website.







Credit Market Insights

Credit Market Borrowing Picks Up

Total credit outstanding continued to increase in the nonfinancial sector during the second quarter, according to the Fed's Flow of Funds report. Credit market borrowing rose at a $1.1 trillion annualized rate, or 3.0 percent. Federal government borrowing was the largest driver, rising at a $826 billion annualized rate. Nonfinancial business also posted a sizable increase, as corporate bond issuance picked up and bank loans continued to increase. Offsetting the rise, however, was a decline in commercial mortgage debt, which has been declining at nonfinancial businesses since 2009. Also reducing borrowing over the quarter were state and local governments. Municipal securities fell for the second consecutive quarter as both short-term and long-term liabilities fell, although the pace of decline moderated from the first quarter to a 3.2 percent annualized rate.

In the household sector, borrowing declined for the 12th straight quarter. The bulk of the reduction stemmed from home mortgages, which continue to decline under tough financing criteria and relatively high rates of cash buyers. Total home mortgage debt now stands at its lowest level since the height of the housing boom in 2006. Consumer credit, on the other hand, rose in the second quarter and is now 1.5 percent higher than a year earlier. Much of this is being driven by an increase in nonrevolving debt, rather than revolving sources.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.09%	4.09%	4.22%	5.08%
15-Yr Fixed	3.29%	3.30%	3.44%	4.39%
5/1 ARM	3.02%	2.99%	3.07%	4.10%
1-Yr ARM	2.82%	2.81%	2.93%	4.05%
MBA Applications				
Composite	702.7	638.7	699.1	790.6
Purchase	172.2	170.8	157.9	177.6
Refinance	3,813.2	3,361.0	3,850.6	4,357.4

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

Topic of the Week

Credit Markets Show Signs of Improvement

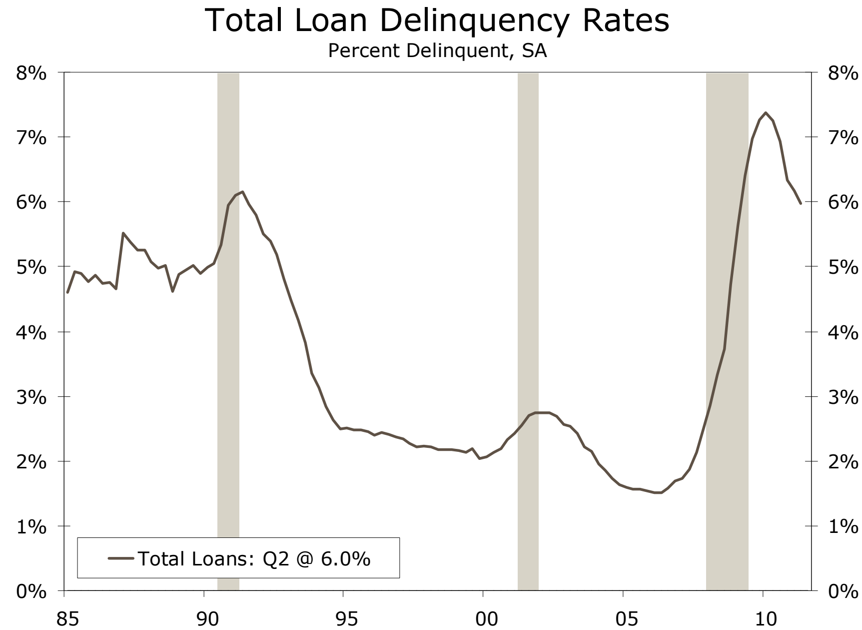
Despite renewed deterioration in delinquency rates on residential mortgages, credit markets continue to show signs of improvement. The overall loan delinquency rate fell to 6.0 percent in the second quarter, marking the fifth straight decline, although still well above prerecession levels. Credit card delinquency rates have plummeted since the end of the recession to just 3.6 percent, only slightly above the low of 3.5 percent in the fourth quarter of 2005 before the housing bubble burst.

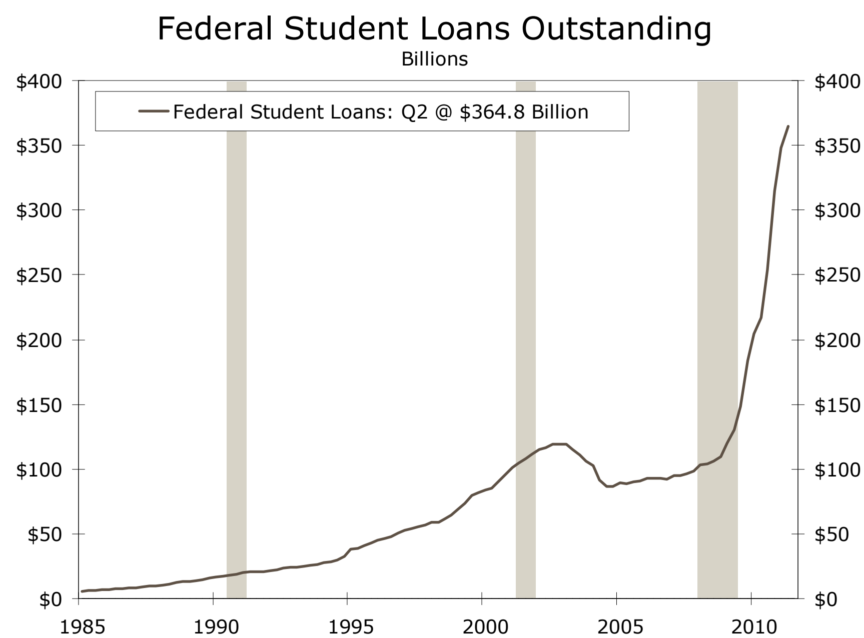
Consumer credit outstanding at all financial institutions has expanded for 10 straight months. However, the $36.0 billion increase in the second quarter from a year ago was driven primarily by the $147.5 billion surge in federal student loans. Therefore, the rise in consumer credit has been a result of higher costs and higher demand for education, rather than an increased capacity to borrow and spend on goods and other services.

While federally held student loans have soared over the past year, total loans outstanding at commercial banks have declined. The willingness to lend for consumer loans remained robust in the second quarter, falling only slightly to 26.9 percent from 28.8 percent in the first quarter, a six-year high. Despite the strong trend in willingness to lend and an increased demand for consumer loans, loan growth remains absent. This imbalance suggests that, along with a weak labor market and continued household deleveraging, consumer lending has been suppressed by the mismatch between the credit quality banks will accept and the credit quality of borrowers seeking a loan.

While we have seen improvements in the credit quality and general financial condition of businesses and households, it will be awhile before credit quality returns to a level of normalcy as the economy continues to struggle with weak labor and housing markets.

For more information, please see our recent report, *Credit Quality Monitor: September 2011*, available at www.wellsfargo.com/economics.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 9/23/2011	1 Week Ago	1 Year Ago
3-Month T-Bill	-0.01	0.00	0.15
3-Month LIBOR	0.36	0.35	0.29
1-Year Treasury	0.11	0.11	0.25
2-Year Treasury	0.20	0.17	0.42
5-Year Treasury	0.80	0.91	1.31
10-Year Treasury	1.73	2.05	2.55
30-Year Treasury	2.80	3.31	3.73
Bond Buyer Index	3.85	4.07	3.83

Foreign Exchange Rates

	Friday 9/23/2011	1 Week Ago	1 Year Ago
Euro ($/€)	1.349	1.380	1.331
British Pound ($/£)	1.545	1.579	1.568
British Pound (£/€)	0.873	0.874	0.849
Japanese Yen (¥/$)	76.170	76.790	84.380
Canadian Dollar (C$/$)	1.027	0.978	1.034
Swiss Franc (CHF/$)	0.905	0.876	0.986
Australian Dollar (US$/A$)	0.979	1.036	0.949
Mexican Peso (MXN/$)	13.860	13.046	12.657
Chinese Yuan (CNY/$)	6.388	6.384	6.689
Indian Rupee (INR/$)	49.434	47.268	45.658
Brazilian Real (BRL/$)	1.880	1.733	1.723
U.S. Dollar Index	78.278	76.599	80.010

Foreign Interest Rates

	Friday 9/23/2011	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.49	1.48	0.82
3-Month Sterling LIBOR	0.93	0.92	0.73
3-Month Canadian LIBOR	1.18	1.18	1.24
3-Month Yen LIBOR	0.19	0.19	0.22
2-Year German	0.34	0.51	0.70
2-Year U.K.	0.53	0.54	0.64
2-Year Canadian	0.83	1.04	1.41
2-Year Japanese	0.13	0.14	0.14
10-Year German	1.68	1.86	2.29
10-Year U.K.	2.32	2.48	2.95
10-Year Canadian	2.02	2.29	2.83
10-Year Japanese	0.99	1.00	1.04

Commodity Prices

	Friday 9/23/2011	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	84.30	87.96	75.18
Gold ($/Ounce)	1686.45	1811.88	1292.45
Hot-Rolled Steel ($/S.Ton)	698.00	695.00	585.00
Copper (¢/Pound)	336.30	392.00	358.50
Soybeans ($/Bushel)	12.41	13.19	10.59
Natural Gas ($/MMBTU)	3.72	3.81	4.02
Nickel ($/Metric Ton)	18,855	21,785	22,567
CRB Spot Inds.	547.90	568.53	521.71

Next Week's Economic Calendar

	Monday 26	Tuesday 27	Wednesday 28	Thursday 29	Friday 30
U.S. Data	**New Home Sales** July 298K August 293K (W)	**Consumer Confidence** August 44.5 September 46.7 (W)	**Durable Goods Orders** July 4.1% August -0.9% (W)	**Pending Home Sales** July -1.3% August -2.1% (C) **GDP** Q2-S 1.0% Q2-T 1.1% (W)	**Personal Income** July 0.3% August 0.1% (W) **Personal Spending** July 0.8% August 0.1% (W)
Global Data	**Germany** **IFO-Business Climate** Previous (Aug) 108.7		**Japan** **Retail Trade (YoY)** Previous (Jul) 0.6%	**Japan** **CPI (YoY)** Previous (Jul) 0.2% **Japan** **IP (MoM)** Previous (Jul) 0.4%	**Eurozone** **Unemployment Rate** Previous (Jul) 10.0% **China** **Manuf. PMI** Previous (Aug) 50.9

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
Kaylyn Swankoski	Economic Analyst	(704) 715-0526	kaylyn.swankoski@wellsfargo.com

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