December 02, 2011

Economics Group

Weekly Economic & Financial Commentary

U.S. Review

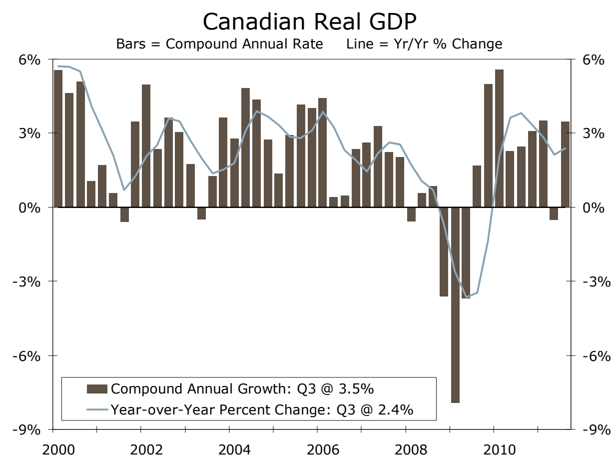
Moderate Improvement in Economic Data

- The November employment report showed a big drop in the unemployment rate. However, the overall pace of job growth remains constrained.
- Housing market data this week indicated that new home sales rose modestly in October, while home prices continued their downward trajectory.
- The latest read on manufacturing sentiment from the ISM-manufacturing survey indicated that output continued to expand at a moderate pace despite the ongoing European debt crisis.

Global Review

Central Banks Act: Untenably Strong Canadian Growth

- Offering some relief to strained interbank lending markets, the world's major central banks announced this week a coordinated plan that reduces the cost of borrowing between central banks. For a detailed analysis of this action, see our special report, *Coordinated Action by Major Central Banks* at WellsFargo.com/Economics.
- This week's global review will focus on Canada where the economy expanded at a 3.5 percent annualized rate in the third quarter. The outturn topping consensus expectations but an analysis of the underlying details is less encouraging.



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	2.0	3.1	1.7	1.8	1.9	2.0	-3.6	3.0	1.8	2.0	1.7
Personal Consumption	2.1	0.7	2.3	3.1	1.3	1.4	1.5	1.4	-2.0	2.0	2.3	1.6	1.3
Inflation Indicators [2]													
"Core" PCE Deflator	1.1	1.3	1.6	1.8	1.8	1.6	1.5	1.6	1.5	1.4	1.5	1.6	1.6
Consumer Price Index	2.2	3.3	3.8	3.5	2.6	2.0	1.7	1.8	-0.3	1.6	3.2	2.0	2.0
Industrial Production [1]	4.8	0.6	5.2	3.2	1.9	2.6	2.8	2.8	-11.1	5.3	4.0	2.8	2.0
Corporate Profits Before Taxes [2]	8.8	8.5	7.9	6.4	6.2	6.0	6.4	6.6	7.9	32.2	7.9	6.3	7.0
Trade Weighted Dollar Index [3]	70.6	69.4	72.8	74.0	75.0	76.0	76.5	77.0	77.7	75.6	71.7	76.1	78.6
Unemployment Rate	8.9	9.1	9.1	9.1	9.3	9.4	9.4	9.4	9.3	9.6	9.1	9.4	9.2
Housing Starts [4]	0.58	0.57	0.61	0.58	0.57	0.60	0.63	0.65	0.55	0.58	0.59	0.61	0.74
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	4.10	4.10	4.10	4.10	4.10	5.04	4.69	4.39	4.10	4.30
10 Year Note	3.47	3.18	1.92	2.10	2.20	2.20	2.30	2.40	3.26	3.22	2.67	2.28	2.60

Forecast as of: November 22, 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

Data Supports Stronger Growth in Q4

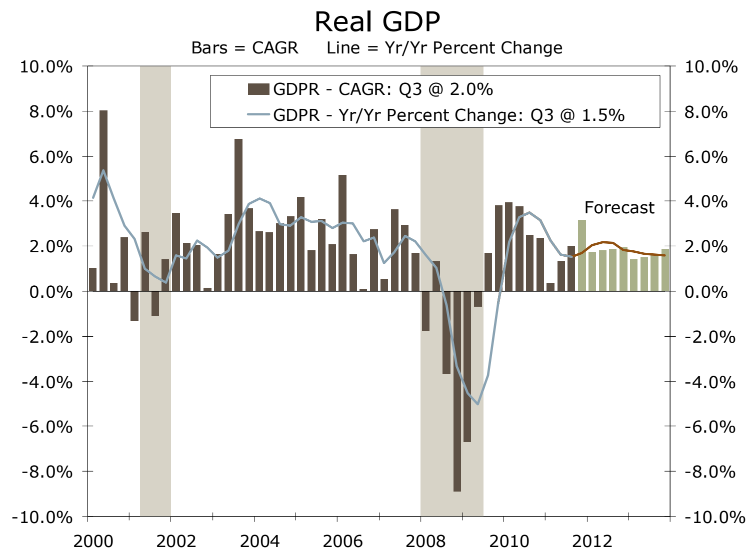
This week's data continued to reinforce our view for stronger fourth-quarter economic growth. The housing market data showed sales and new home construction have bottomed, while the ISM-Manufacturing Index signaled stronger manufacturing output. The big story of the week was the release of the November employment report that showed that 120,000 jobs were created for the month. We revised our forecast for the fourth quarter upward this week due to the revisions to third-quarter GDP last week and our increased consumer spending outlook based on early reports that holiday sales have been stronger than expected.

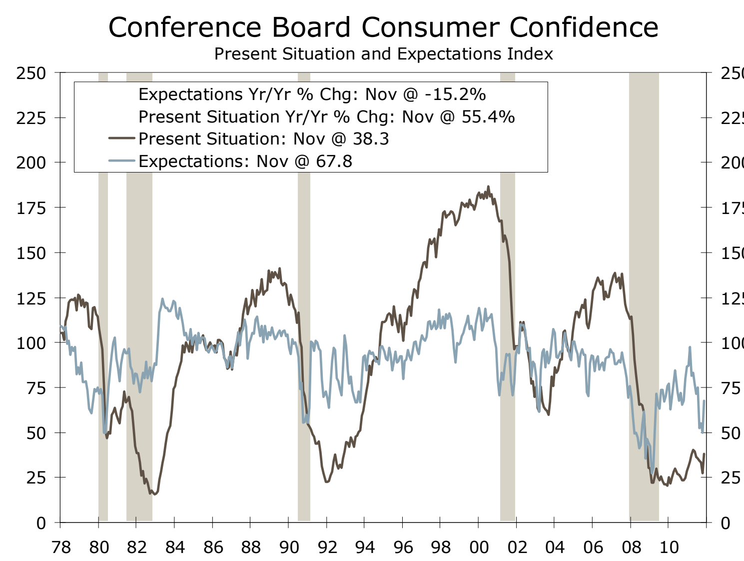
Housing market data this week indicated that new home sales rose modestly in October, while home prices continued their downward trajectory. New home sales rose 1.3 percent in October; however, net revisions to the past three months subtracted 15,000 units. The depressed level of new home sales is directly related to the ongoing home price declines. The S&P/Case-Shiller Home Price Index continued to decline in September, falling 3.9 percent from last year's levels. The declines in home prices continue to restrain new home construction as the lower-priced foreclosures and short-sale homes continue to pull demand away from new home construction.

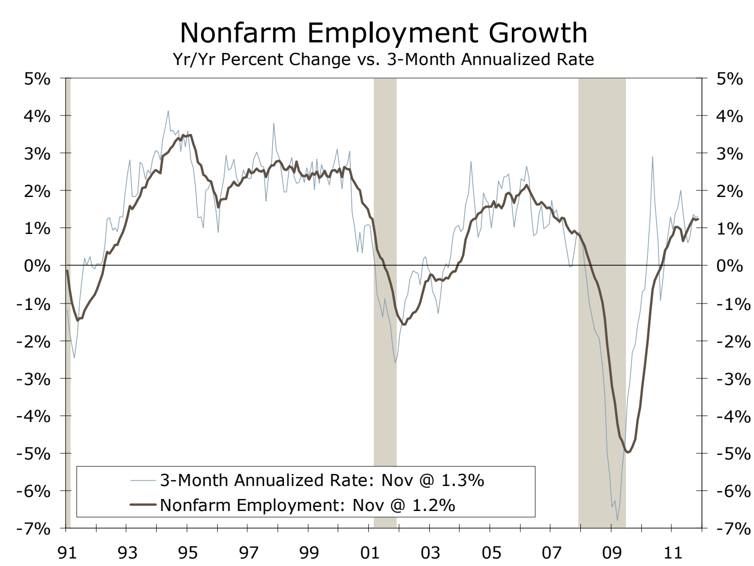
The latest read on manufacturing sentiment from the ISM-Manufacturing survey indicated that output continued to expand at a moderate pace despite the ongoing European debt crisis. The index rose to 52.7, up from 50.8 in October, which is the highest reading since June. The key components of the index, production and new orders, both improved for the month. The one weak spot was the employment component, which fell slightly. The employment measure remains in expansion territory but suggests that the pace of manufacturing payroll improvement will likely slow over the near term.

Consumer confidence this week came in stronger than expected rebounding 15.1 points on news that consumers were feeling better about both current economic conditions and future conditions. The boost to consumer confidence can also be seen in the strong start to the holiday shopping season. Another important finding of the report was that fewer individuals reported that jobs were difficult to get. This component of the index now stands at its lowest level since January 2009 and coincides with the downward trend in initial jobless claims that have been observed over the past few weeks.

The November employment report showed that the economy added 120,000 jobs and the unemployment rate declined to 8.6 percent. The fall in the unemployment rate was the result of a drop in the labor force participation rate and a sizable drop in the number of unemployed individuals. The government sector and construction sectors shed the most jobs on the month, while job gains were strongest in retail, temporary staffing, and leisure and hospitality. The report reinforced our view for a moderate pace of economic growth over the next few quarters.





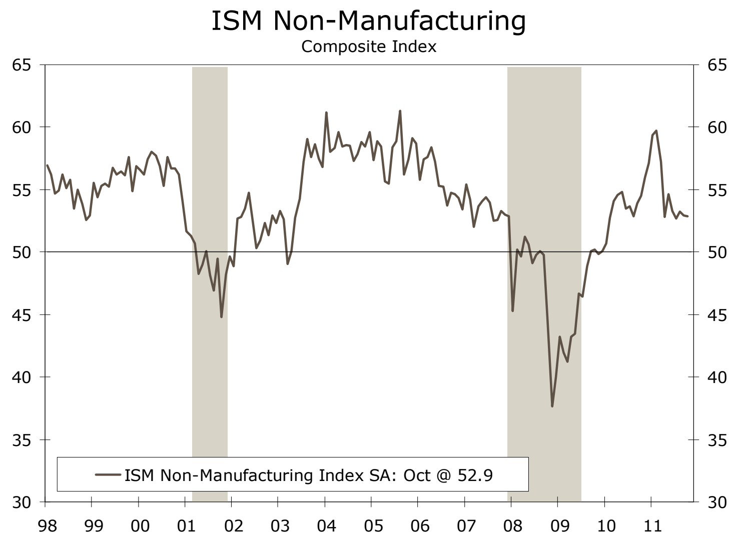


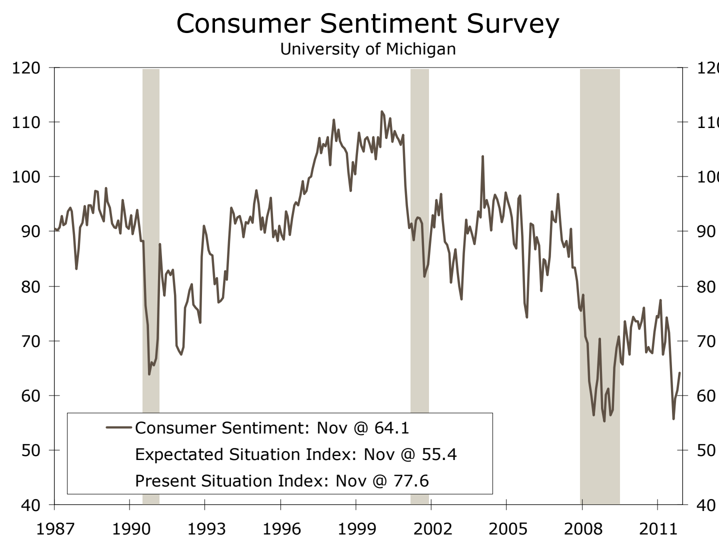
ISM Non-Manufacturing • Monday

The service sector continued to show growth in October with the ISM non-manufacturing index posting a reading of 52.9. While the headline remains in expansionary territory, it is well below its 59.7 cycle peak earlier this year. Moreover, the forward-looking new orders component fell 4.1 points in October, suggesting weak growth in the service sector in the coming months. Business activity also gave up ground, falling 3.3 points to 53.8. Indeed, the weak headline reading is consistent with our outlook for subpar economic growth. While eight industries reported growth, respondents to the survey continued to note concern about future business conditions. Much of the trepidation likely stems from headline risks largely driven by the Eurozone sovereign debt crisis and the stalemate in negotiations regarding the U.S. deficit. The employment component, however, bounced back into expansionary territory, suggesting further private sector job gains.

Previous: 52.9 **Wells Fargo: 53.4**

Consensus: 53.5





Michigan Sentiment • Friday

The Reuters/University of Michigan Survey of Consumers is expected to rise modestly in December but will remain well below its long-run average. Consumer confidence rose to 64.1 in November from 60.9 in October but remains below its year-ago level of 71.6. Current conditions edged higher for the fourth consecutive month, but expectations fell in November. Consumers' economic outlook continues to be tainted by stagnated economic growth in the United States and headline risks, including the debt ceiling debate and Eurozone sovereign debt crisis. Consumers' inflation expectations for one and five years ahead remained unchanged at 3.2 percent and 2.7 percent, respectively. With inflation expectations anchored, the Fed will continue to have the green light to pursue further unconventional approaches to monetary policy, including a third dose of quantitative easing, if conditions warrant.

Previous: 64.1

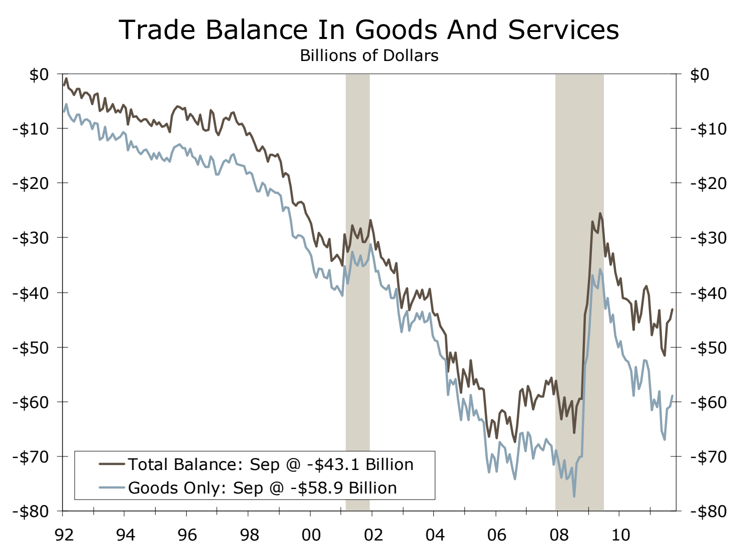
Consensus: 65.9

Trade Balance • Friday

The nominal trade deficit narrowed by $1.8 billion, to $43.1 billion, in September. Exports rose 1.4 percent with nearly broad-based gains, but nonmonetary gold was accountable for more than half of the increase. Exports have now risen in each of the past three months outpacing imports. Indeed, imports also increased, rising 0.3 percent, the second increase in three months. The gain in imports was led by autos, industrial supplies and materials and food. Moreover, the real goods trade deficit narrowed by $0.9 billion, to $45.4 billion. Recent trade data are now supportive of a small positive for Q4 real GDP as exports are likely to continue to outpace imports. The ISM manufacturing report for October is supportive of this claim as export orders remained in expansionary territory rising to 52.0 in November, while imports dropped to 49.0, remaining below the breakeven threshold for the second month.

Previous: -$43.1B **Wells Fargo: -$43.5B**

Consensus: -$43.1B



Global Review

Canadian GDP Growth Rate May Be Difficult to Sustain

In many ways the stronger-than-expected 3.5 percent growth rate in the Canadian economy in the third quarter reflects a reversal of some of the dynamics that held growth back in the prior quarter.

Weak exports exerted the biggest drag in the second quarter, but a turnaround in this component resulted in the largest positive contribution (4.2 percentage points) of any component in the third quarter.

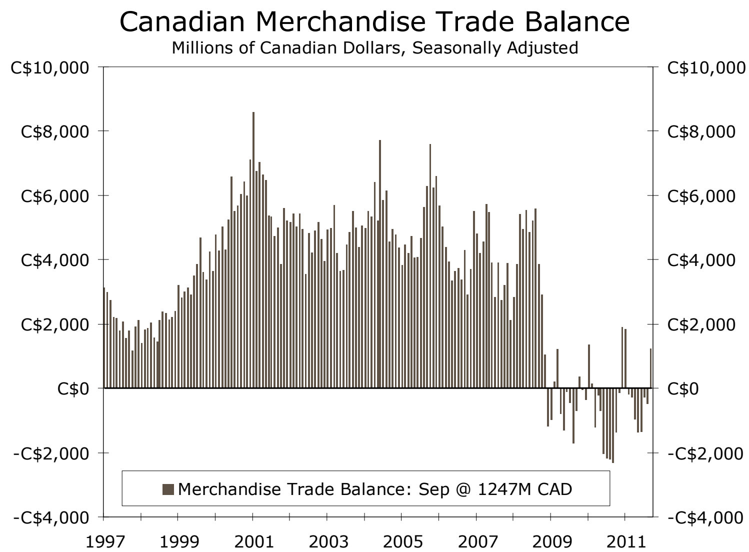
After the disappointing print for second-quarter growth, we observed at the time that weak exports were holding back what was otherwise rather strong domestic demand. That dynamic has also shifted somewhat in this report of third-quarter growth. Softer domestic demand is now getting some help from exports. Indeed, final domestic demand slowed to just a 1.0 percent annual rate in the third quarter from a 3.1 percent rate in the second.

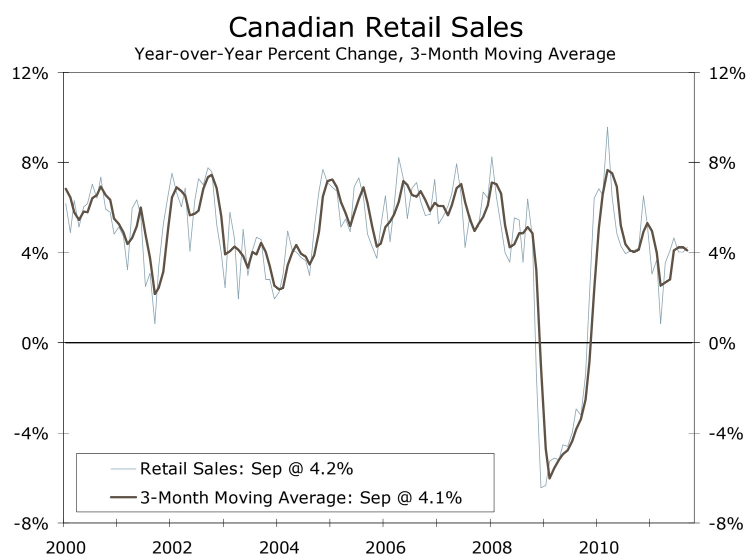
Part of the reason for slower domestic demand is a slower pace of spending from the Canadian consumer. That is not to say that Canadian consumers are going into hiding. As the nearby chart shows, retails sales are up more that 4 percent from year-ago levels. But, the pace of spending growth is indeed slowing. Private consumption growth slowed to 1.2 percent in the third quarter from a 2.1 percent pace in the prior quarter.

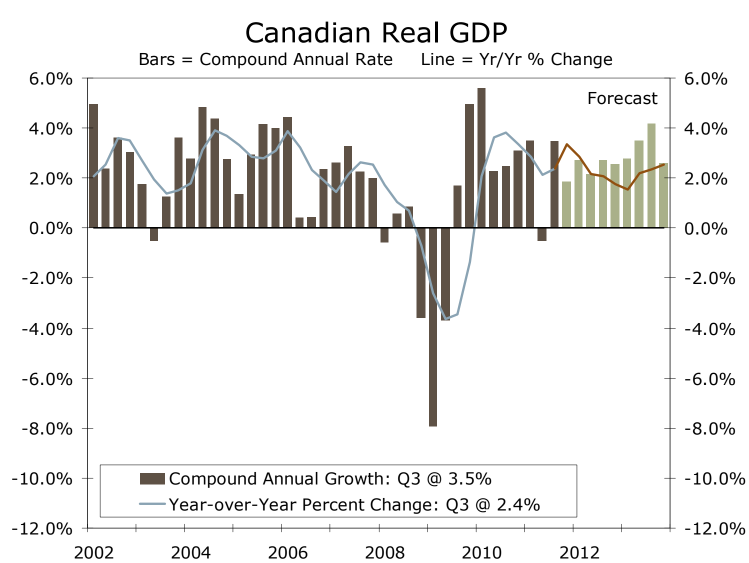
The consumer sector is not the only sector losing steam. Business fixed investment spending slowed to at mere 0.5 percent pace in the third quarter. That is a major change from the blistering 7.8 percent pace witnessed in the second quarter. This was not a complete shock, given the deterioration in business sentiment we have seen in the Ivey survey throughout the quarter. Another way that deterioration in sentiment was reflected in the GDP report was the 2.7 percentage point drag from business inventories—the largest drag of any component.

Going forward, we suspect the pace of economic growth in Canada will ultimately fall victim to slower growth in the United States, ongoing uncertainty in Europe and slower-than-expected growth in emerging markets. With slower growth in the rest of the world, export growth will not be able to offset softening domestic demand. The number of full-time employees on Canadian payrolls is slightly down on net since June, which does not bode well for a near-term increase in consumer fundamentals. Consequently, we look for full-year economic growth in 2012 of between 2 percent and 2.5 percent.

The headline rate of inflation, presently at 2.9 percent, is narrowly within the bounds of the Bank of Canada's (BoC) target range. The core rate of inflation, however, is more subdued at just 1.5 percent on a year-over-year basis. This somewhat benign rate of inflation combined with tepid economic growth likely means that the BoC will most likely remain on hold throughout 2012. If world leaders are able to successfully deal with the sovereign debt crisis in Europe, we think that the Canadian expansion will eventually pick up speed and the BoC might begin tightening again in 2013.







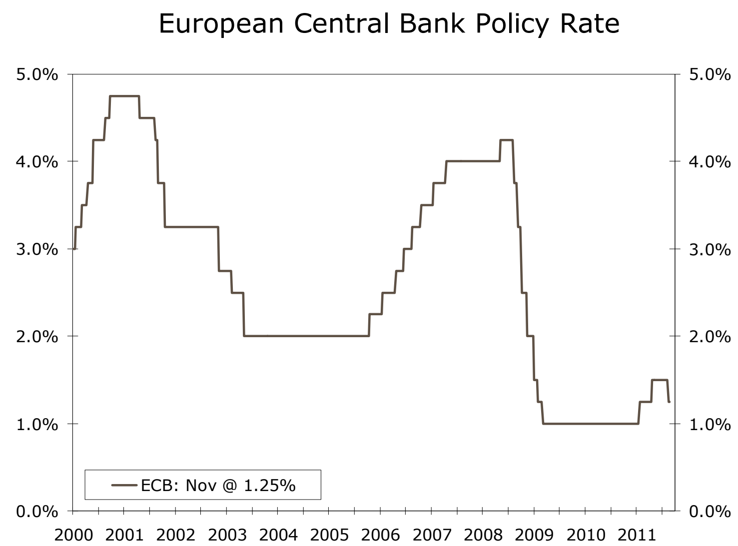
ECB Policy Rate • Thursday

The European Central Bank (ECB) holds its monthly policy meeting on Thursday, and there is widespread expectation, which we share, that the ECB will cut rates by 25 bps again. (It reduced its main policy rate to 1.25 percent from 1.50 percent at its November meeting.) There are increasingly signs that the Eurozone is slipping into recession, which gives the ECB room to cut rates again. The ECB may also announce further liquidity-providing measures for the region's banks that are finding it increasingly difficult to obtain financing.

"Hard" economic data for Germany, the largest economy in the Eurozone, will also be released next week. Factory orders and industrial production both slumped badly in September, and investors will be keen to see whether this weakness continued in October.

Previous: 1.25% **Wells Fargo: 1.00%**

Consensus: 1.00%



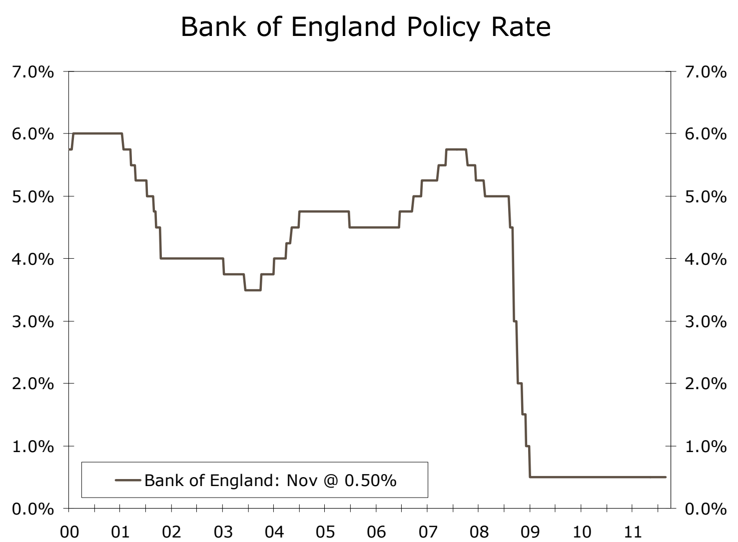
Bank of England Policy Rate • Thursday

Like the ECB, the Bank of England (BoE) holds its monthly policy meeting on Thursday. Unlike the ECB, however, there is little expectation of a rate change by the BoE, which has kept its main policy rate steady at 0.50 percent since March 2009. That does not necessarily mean that policy will remain unchanged. At its October policy meeting, the BoE surprised most analysts when it increased the size of its asset purchase program to £275 billion from £200 billion. Although we look for the BoE to eventually increase the size of the program to £350 billion, we think that decision will come in another month or two rather than at the current meeting.

Data on the service sector PMI in November, which will be released on Monday, and industrial production in October, which is on the docket on Wednesday, will give investors some insights into the present state of the British economy.

Previous: 0.50% **Wells Fargo: 0.50%**

Consensus:0.50%



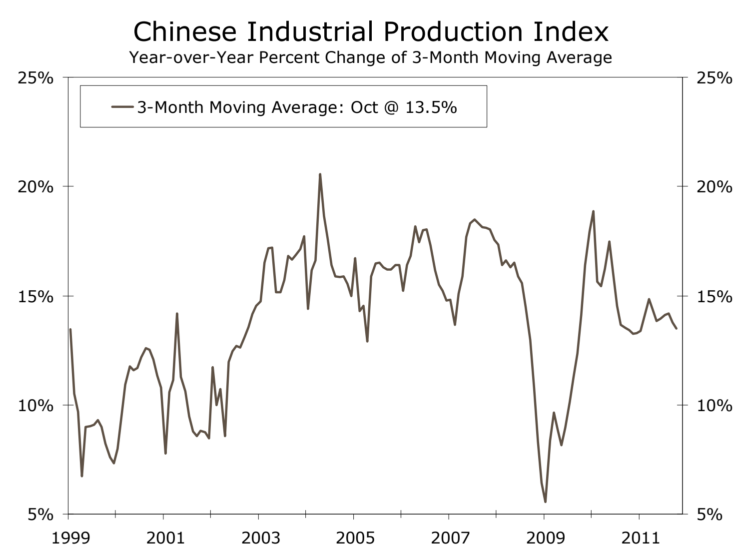
Chinese Industrial Production • Friday

The rate of economic growth in China has slowed over the course of the year due in part to deceleration in exports, which reflects slower global growth, and policy tightening at home. Data on the docket next week, which include industrial production and retail sales, are expected to show that the Chinese economy slowed further in November.

Inflation data will also print at the end of next week. CPI inflation shot up to more than 6 percent earlier this year as food prices rose sharply. However, the overall rate of CPI inflation has receded over the past few months, and the market consensus forecast expects a marked step-down from 5.5 percent in October to 4.5 percent in November. This decline in inflationary pressures in China is advantageous, because it give authorities scope to ease policy in the coming months if global growth slows too sharply.

Previous: 13.2%

Consensus: 12.6% (Year over Year)



Interest Rate Watch

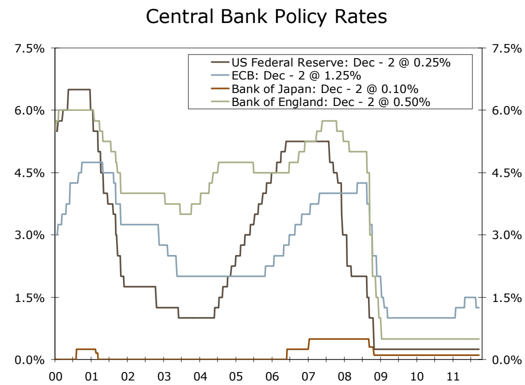
LIBOR Appears to be Stabilizing

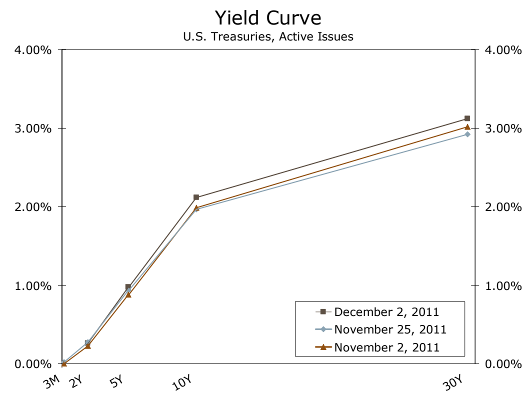
On Wednesday, major central banks announced actions that are intended to stop the rise in LIBOR rates that have been under way over the past few months. By making it cheaper for other central banks to borrow dollars from the Federal Reserve, the action is designed to reduce the demand for dollars in the interbank funding market, thereby arresting the upward climb in rates. (For further reading, see *Coordinated Action by Major Central Banks*, which is posted on our website.) So far, the action appears to have had its desired effects. U.S. dollar LIBOR rates have been steady to slightly lower over the past two days. LIBOR rates should continue to drift lower in coming weeks as some European banks go directly to the ECB for dollar funding.

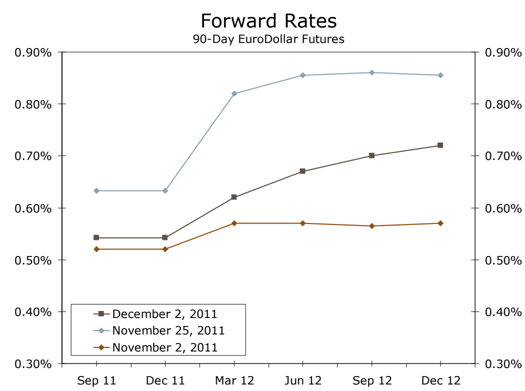
Although the central banks' action does not "solve" the European debt crisis, borrowing costs for heavily indebted European countries have receded over the past few days. The yield on the 10-year Italian government bond is down about 70 bps since its highs earlier this week, and the comparable yield in Spain has dropped more than 100 bps. If yields in Italy remain at current rates, it will be difficult for the Italian government to stabilize the debt to GDP. However, yields could certainly fall back into sustainable territory in the weeks ahead if the Italian government enacts economic reform measures and EU leaders devise a plan to more adequately address the crisis. Some of these measures could be announced as soon as next week's E.U. summit meeting.

Further ECB Easing Likely

As discussed on page 5, we look for the ECB to ease further at its policy meeting on Dec 8. A 25-bp rate cut seems to us to be the most likely outcome of the meeting, but there is an outside chance that the ECB could deliver a 50-bp cut. Moreover, the ECB is likely to adopt more liquidity providing measures in the form of extended maturities for euro financing. We forecast that the ECB will reduce its policy rate, which currently stands at 1.25 percent, to 0.50 percent by the end of the first quarter of 2012.







Credit Market Insights

Top Concern for Lenders Is Housing

Last week, the Federal Reserve reported that all loan categories saw a decline in delinquency rates in the third quarter on both a quarter-ago and year-ago basis. Even the beleaguered residential real estate sector saw a decline following two consecutive quarterly increases. Despite the improvements, there is a wide disparity between categories in terms of rates of improvement. Relative to their respective peaks, the biggest improvement in basis points has come from credit card delinquency rates, which are down 330 bps from the peak, while the smallest decline has come from non-credit card delinquency rates, which are down just 90 bps from the peak. In percentage terms, the biggest decline has come from C&I loan delinquency rates, which are down 58 percent from the peak, while the smallest decline has come from residential real estate loan delinquency rates, which are down just 9 percent from the peak. Since credit card delinquency rates peaked a year earlier than residential real estate loan delinquency rates, it stands to reason that improvement in residential real estate loan delinquency rates would be a bit behind that of credit card delinquency rates. In addition, residential real estate loans have the highest delinquency rate (10.2 percent) and account for the greatest share of bad debt of any category (39 percent versus just 9 percent for credit cards). Thus, housing remains the top domestic credit quality concern for lenders.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.00%	3.98%	4.00%	4.27%
15-Yr Fixed	3.30%	3.30%	3.31%	3.72%
5/1 ARM	2.90%	2.91%	2.96%	3.47%
1-Yr ARM	2.78%	2.79%	2.88%	3.40%
MBA Applications				
Composite	576.4	652.5	665.6	608.8
Purchase	192.1	193.6	174.8	207.2
Refinance	2,834.5	3,344.7	3,539.3	2,974.4

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

Topic of the Week

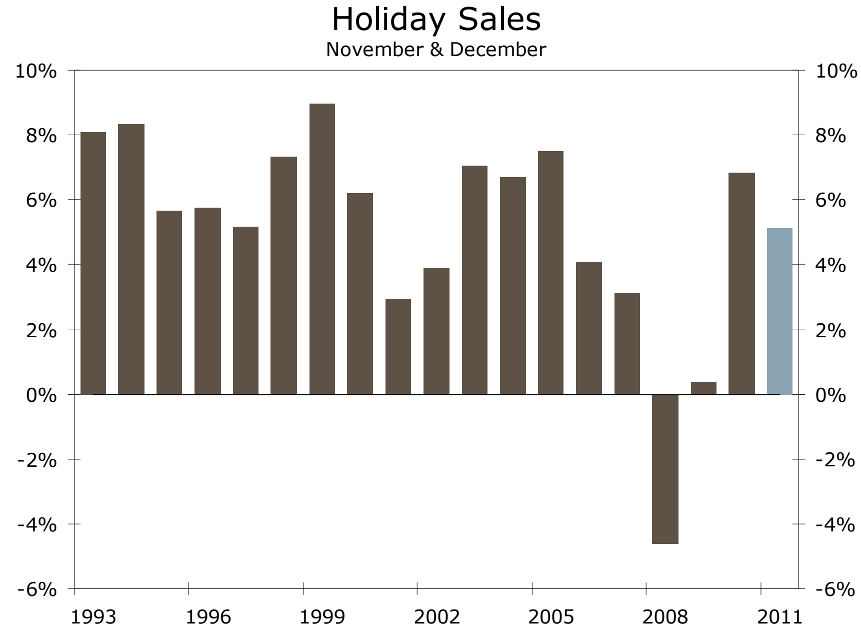
Santa Somehow Always Finds a Way

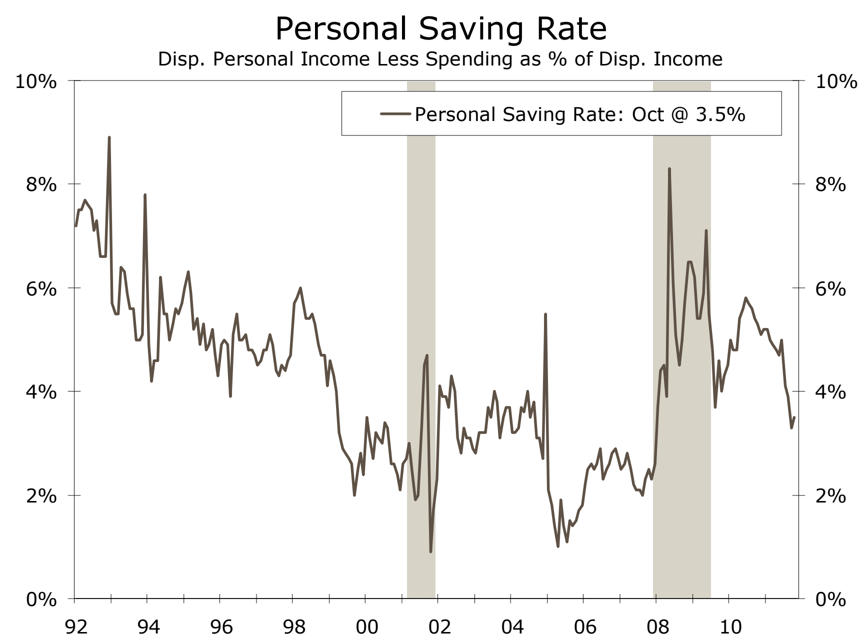
The holiday shopping season got off to a solid start on Black Friday, with sales on this important day totaling an estimated $11.4 billion, according to ShopperTrak. We expect total sales for the 2011 holiday shopping season to increase 5.2 percent over 2010 sales. This year-over-year measure is down slightly from 2010, when holiday shopping sales increased 6.8 percent over 2009 levels. Holiday sales this year will likely be concentrated in gift cards, high-end and designer clothing, consumer electronics, including tablet computers and smartphones, and video games and consoles. The early arrival of winter weather will also likely help sales by prompting more purchases of coats, scarves, sweaters and gloves.

In the wake of the biggest financial disruption since the Great Depression, retailers have had to improvise and adapt, as cash-strapped consumers spend their dollars much more cautiously than they did during the previous expansion. Retailers will likely compete with discounts and fire-sale deals this year, but not to the extent witnessed in 2008 and 2009. Therefore, bargain hunters may have a tougher time finding jaw-dropping markdowns this year, as retailers will be keeping a sharper eye on profit margins.

We do not expect the relatively strong holiday shopping season and November's solid consumer confidence reading to translate into stronger consumption gains in 2012. Consumption growth has been consistently running ahead of income growth, meaning that consumers have been saving less to finance their purchases of goods and services. Indeed, the saving rate has fallen from 5.0 percent in June to 3.5 percent as of October. This trend, however, will not likely continue; either income growth needs to pick up at a faster pace or consumption will slow in the first half of 2012.

For more information about our holiday sales forecast, see *Giddy-Up Jingle Horse: Holiday Sales Preview*, which is available on our website.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 12/2/2011	1 Week Ago	1 Year Ago
3-Month T-Bill	0.00	0.02	0.15
3-Month LIBOR	0.53	0.52	0.30
1-Year Treasury	0.11	0.11	0.25
2-Year Treasury	0.26	0.27	0.54
5-Year Treasury	0.97	0.93	1.67
10-Year Treasury	2.09	1.96	2.99
30-Year Treasury	3.07	2.92	4.25
Bond Buyer Index	4.12	4.07	4.65

Foreign Exchange Rates

	Friday 12/2/2011	1 Week Ago	1 Year Ago
Euro ($/€)	1.341	1.324	1.321
British Pound ($/£)	1.562	1.544	1.560
British Pound (£/€)	0.859	0.857	0.847
Japanese Yen (¥/$)	77.950	77.730	83.820
Canadian Dollar (C$/$)	1.016	1.047	1.003
Swiss Franc (CHF/$)	0.920	0.930	0.993
Australian Dollar (US$/A$)	1.025	0.971	0.977
Mexican Peso (MXN/$)	13.544	14.231	12.327
Chinese Yuan (CNY/$)	6.360	6.379	6.661
Indian Rupee (INR/$)	51.206	52.255	45.294
Brazilian Real (BRL/$)	1.793	1.892	1.696
U.S. Dollar Index	78.467	79.686	80.303

Foreign Interest Rates

	Friday 12/2/2011	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.40	1.42	0.97
3-Month Sterling LIBOR	1.04	1.03	0.74
3-Month Canadian LIBOR	1.33	1.29	1.23
3-Month Yen LIBOR	0.20	0.20	0.18
2-Year German	0.30	0.46	0.86
2-Year U.K.	0.38	0.46	1.02
2-Year Canadian	0.92	0.94	1.68
2-Year Japanese	0.14	0.14	0.19
10-Year German	2.14	2.26	2.82
10-Year U.K.	2.30	2.29	3.40
10-Year Canadian	2.16	2.09	3.20
10-Year Japanese	1.04	1.03	1.21

Commodity Prices

	Friday 12/2/2011	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	100.58	96.77	88.00
Gold ($/Ounce)	1748.98	1683.53	1385.18
Hot-Rolled Steel ($/S.Ton)	705.00	630.00	565.00
Copper (¢/Pound)	356.35	326.80	397.70
Soybeans ($/Bushel)	11.16	11.03	12.68
Natural Gas ($/MMBTU)	3.61	3.54	4.34
Nickel ($/Metric Ton)	16,721	17,077	23,507
CRB Spot Inds.	527.00	523.25	556.40

Next Week's Economic Calendar

	Monday 5	Tuesday 6	Wednesday 7	Thursday 8	Friday 9
U.S. Data	**ISM Non-Mfg.** October 52.9 November 53.4 **Factory Orders** September 0.3% October -0.2%		**Consumer Credit** September $7.386B	**Wholesale Inventories** September -0.1%	**Trade Balance** September -43.1B October -$43.5B
Global Data		**Mexico** **Consumer Prices (YoY)** Previous (Oct) 3.20%		**Eurozone** **ECB Policy Rate** Previous (Nov) 1.25% **U.K.** **BoE Policy Rate** Previous (2009) 0.5%	**China** **IP (YoY)** Previous (Oct) 13.2%

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

Wells Fargo Securities, LLC Economics Group

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