September 24, 2010

Economics Group

Weekly Economic & Financial Commentary

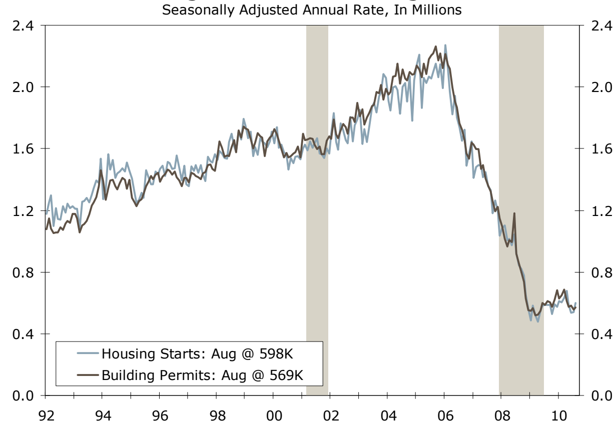
U.S. Review

Housing Data Bounces, FOMC Refocuses on Prices

- While we welcome the positive news in residential real estate this week, the percentage gains are made possible by the fact that these measures fell so very far during the recession. The best that can be said of this week's numbers is that markets seem to be finding a new equilibrium in the absence of the homebuyers' tax credit.
- The FOMC has signaled a renewed commitment to promoting price stability and may be laying the groundwork for further quantitative easing.

Housing Starts and Building Permits

Seasonally Adjusted Annual Rate, In Millions



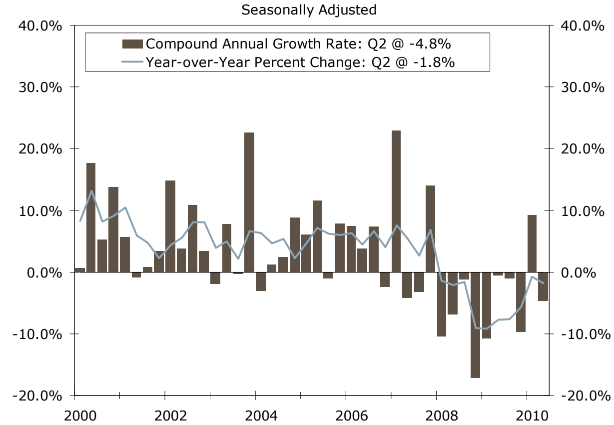
Global Review

Sovereign Debt Issues Resurface in the Eurozone

- Weaker-than-expected Irish GDP data and fears that bank restructuring will add further to the government's debt caused yields on Irish government bonds to rise to multiyear highs this week. Yields on Portuguese government debt also climbed higher, while yields on Greek government debt remained elevated.
- Recent data out of the euro area are consistent with slower, albeit still positive, GDP growth in the third quarter than the 3.9 percent annualized rate that was registered in the second quarter.

Irish Real GDP

Seasonally Adjusted



Inside

Wells Fargo U.S. Economic Forecast

	Actual						Forecast		Actual				Forecast	
	2009				2010				2006	2007	2008	2009	2010	2011
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
Real Gross Domestic Product [1]	-4.9	-0.7	1.6	5.0	3.7	1.6	1.6	2.3	2.7	1.9	0.0	-2.6	2.7	2.2
Personal Consumption	-0.5	-1.6	2.0	0.9	1.9	2.0	1.7	1.3	2.9	2.4	-0.3	-1.2	1.5	1.6
Inflation Indicators [2]														
"Core" PCE Deflator	1.6	1.5	1.3	1.7	1.8	1.5	1.3	1.0	2.3	2.4	2.3	1.5	1.4	1.1
Consumer Price Index	-0.2	-1.0	-1.6	1.5	2.4	1.8	1.1	0.6	3.2	2.9	3.8	-0.3	1.4	1.0
Industrial Production [1]	-17.6	-10.3	8.3	7.0	7.1	6.7	6.2	2.2	2.2	2.7	-3.3	-9.3	5.5	3.5
Corporate Profits Before Taxes[2]	-17.3	-11.4	-3.9	42.5	37.6	39.2	17.6	12.8	10.5	-6.1	-16.4	-0.4	25.8	6.8
Trade Weighted Dollar Index[3]	83.2	77.7	74.3	74.8	76.1	78.8	76.8	77.3	81.5	73.3	79.4	74.8	77.3	83.0
Unemployment Rate	8.2	9.3	9.6	10.0	9.7	9.7	9.6	9.9	4.6	4.6	5.8	9.3	9.7	9.6
Housing Starts[4]	0.53	0.54	0.59	0.56	0.62	0.60	0.55	0.60	1.81	1.34	0.90	0.55	0.59	0.81
Quarter-End Interest Rates														
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	5.25	4.25	0.25	0.25	0.25	0.31
Conventional Mortgage Rate	5.00	5.42	5.06	4.93	4.97	4.74	4.10	4.20	6.14	6.10	5.33	4.93	4.50	5.15
10 Year Note	2.71	3.53	3.31	3.85	3.84	2.97	2.50	2.60	4.71	4.04	2.25	3.85	2.98	2.98

Forecast as of: September 8, 2010

[1] Compound Annual Growth Rate Quarter-over-Quarter

[2] Year-over-Year Percentage Change

U.S. Review

Real Estate: The First Step in a Long Journey Back

Despite cheery headlines that pointed to the magnitude of the percentage gains in this week's housing data, the state of residential real estate market remains abysmal. Perhaps the most encouraging thing that can be said of this week's data is that the market seems to be improving on its own, driven by real market forces without the boost of the tax credits to artificially goose demand.

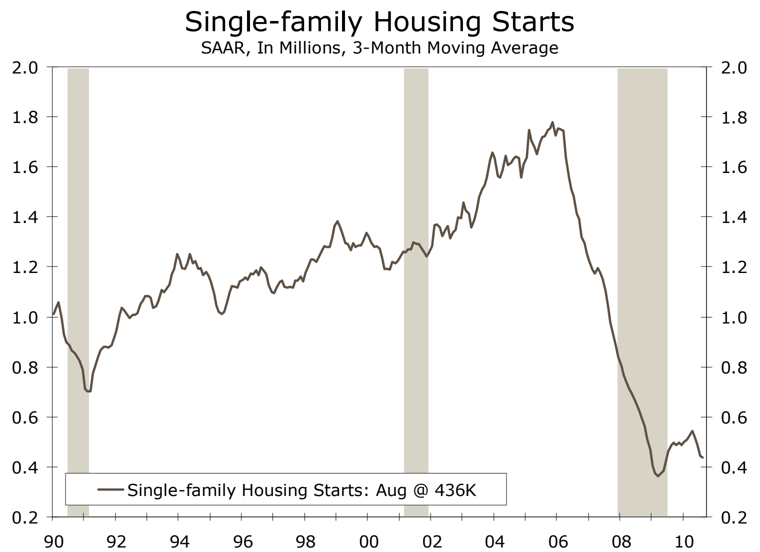
The 10.6 percent "jump" in housing starts was certainly a better number than the consensus had been expecting. While we welcome the news, most of the strength was in multifamily construction, and we still think a recovery in single-family residential construction activity is a long way off. Builders are presently breaking ground on 598,000 new homes per year—a far cry from the more than 2 million unit pace throughout most of 2005. But, that was at the peak of the bubble, if we looked instead at the average pace of starts between 1995 and 2005, we find that builders averaged about 1.7 million new projects annually. To get back to the 1.7 million pace we witnessed in the late 1990s and early 2000s, we'd need to match the 57,000-unit growth we had in August every month for almost two years.

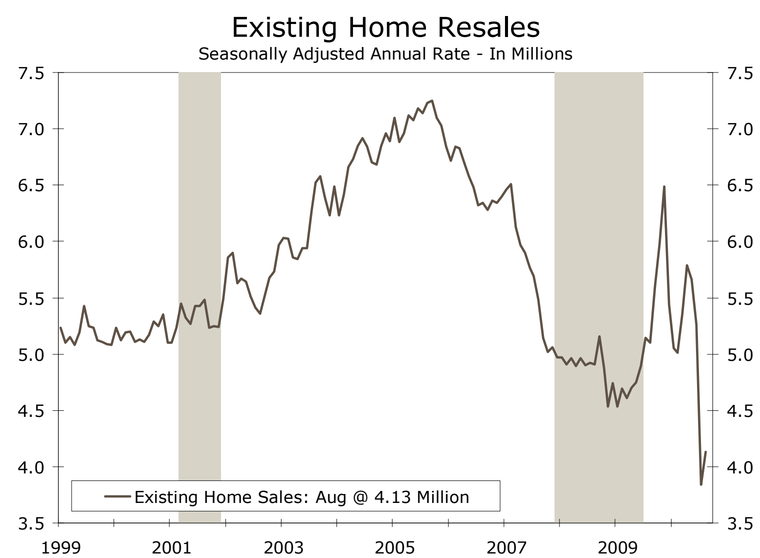
Existing home sales similarly enjoyed a bounce this week, posting a 7.6 percent monthly increase in the number of homes sold. However, as with the bounce in starts, this percentage gain off such a low base is not super impressive. But again, it is encouraging that the market seems to be finding a new equilibrium in the absence of tax credits. As we recently stated in our housing chartbook, no significant improvement in sales or construction is expected to take place until the spring home-buying season. By then, the economy should have put up a fairly lengthy string of modest private-sector job gains, which should bolster confidence and household formations.

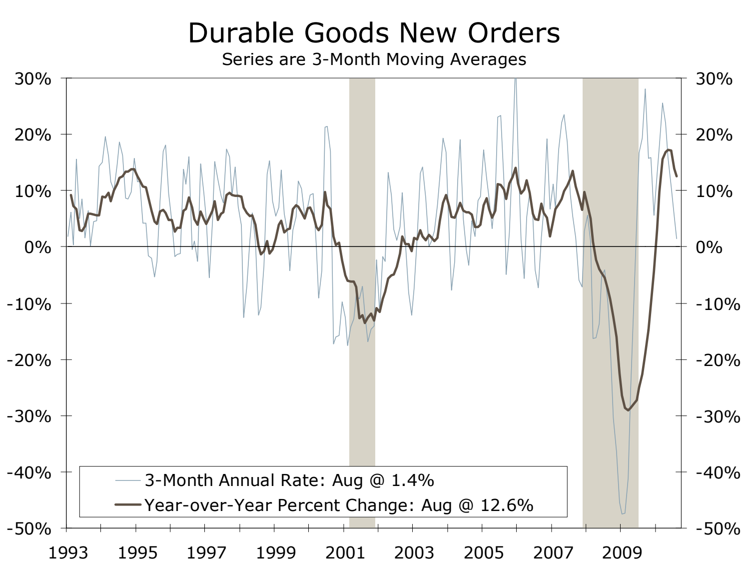
Durable goods orders for August came in weaker than markets were expecting falling 1.3 percent on the month, but most of the decline was concentrated in the volatile transport sector. Ex-transports, durable orders were up two percent. Nondefense capital goods orders, ex-aircraft, recovered some lost ground rising 4.1 percent. The takeaway from the durable goods report is that even though the inventory rebuilding has run its course, demand in manufacturing is still with us. We look for business spending to be supportive of GDP growth into next year.

FOMC Refocuses on Promoting Price Stability

In a move that surprised no one, the Fed announced earlier this week its decision to leave rates on hold. However there were some changes in the accompanying statement that gave markets a few new sentences to parse and consider the implicit message from the FOMC. The key line that attracted the most such deliberation had to do with the inflation outlook. "Inflation is likely to remain subdued for some time" and the Fed is "prepared to provide additional accommodation if needed...to return inflation, over time, to levels consistent with its mandate." Some interpret this shift as laying the foundation for further quantitative easing.







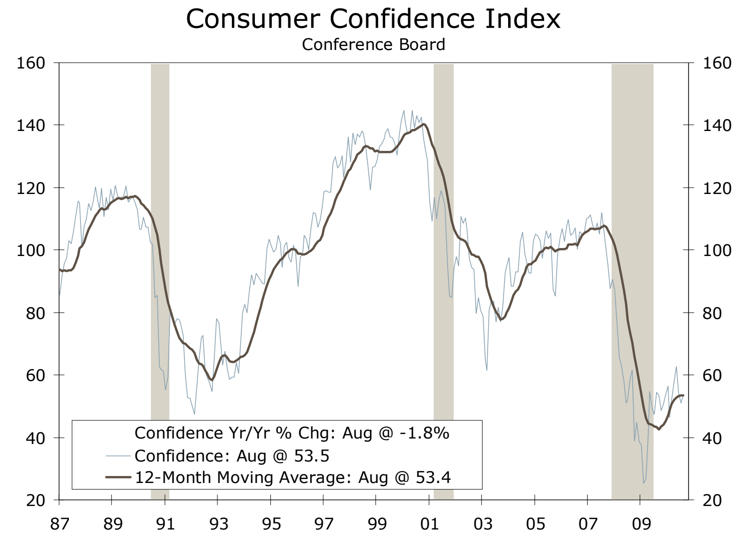
Consumer Confidence • Tuesday

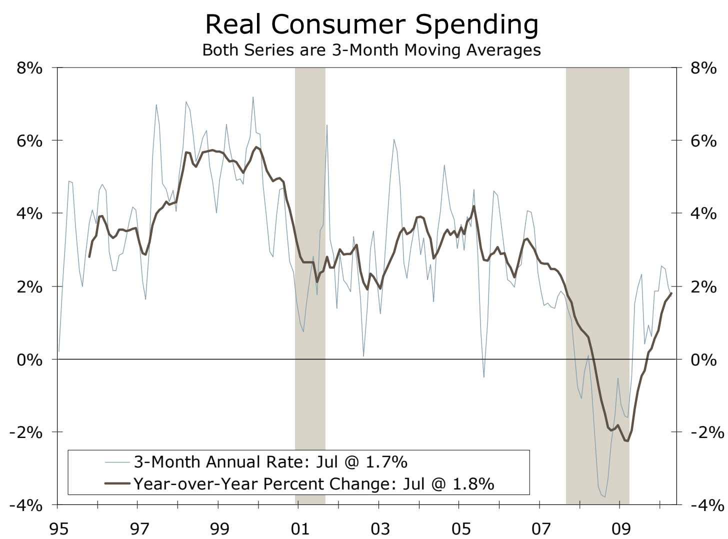
The Conference Board's measure of consumer confidence is due out on Tuesday. In August, confidence climbed to 53.5 from 51.0. Although the number was better than the consensus had been expecting, a reading in the mid-50s is hardly anything to applaud. In the last recession, confidence never dipped below 60. The August increase was primarily attributable to a rise in the expectations index; current conditions actually slipped.

Speaking of confidence, the University of Michigan will revise its estimate of September consumer sentiment on Friday. The initial reading showed sentiment falling to a fresh one-year low as consumers fret about whether Congress would extend the Bush tax cuts. But, with equity markets up roughly eight percent in August and gasoline prices slightly lower than in August, an upward revision may be in the cards.

Previous: 53.5 **Wells Fargo: 52.4**

Consensus: 52.3





Personal Income and Spending • Friday

Personal incomes increased 0.2 percent in July, but spending was a bit stronger than expected, rising 0.4 percent. This is a decent start for consumer spending in the third quarter. With spending growing faster than income, the saving rate nudged down to 5.9 percent, from 6.2 percent in June. We do not expect this trend to continue for long as consumers will need to pay down debts and come to terms with the hit they have taken to their own stored wealth. Indeed recent data from the Federal Reserve about consumer finances revealed that net worth deteriorated in the second quarter. We expect nominal personal income to grow at a 3–4 percent pace over the next year or so, with spending growth plodding along at about half that pace. More immediate, we suspect personal income picked up 0.2 percent in August, with an increase of the same magnitude in spending.

Previous: 0.4% **Wells Fargo: 0.2%**

Consensus: 0.3% (spending, M-o-M)

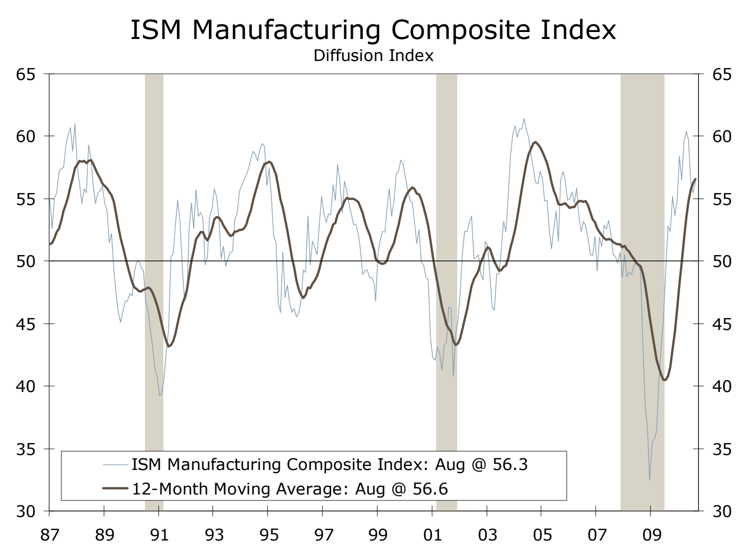
ISM Manufacturing Index • Friday

After the manufacturing sector rebounded in the wake of the recession, the pace of growth slowed substantially this summer, which dampened expectations for a decent sentiment number for the ISM. Yet in August, the headline number for ISM came in at 56.3—considerably stronger than markets had been expecting. The underlying data in the survey were mixed. New orders fell further to 53.1, but that was more than offset by rebounds in the production, employment and inventories indexes.

Since then, it appears that business sentiment has deteriorated again as the N.Y. Fed's Empire Index showed a slower pace of growth and the Philadelphia Fed Index declined for the second month in a row. ISM in September may weaken but should remain in expansion territory. That kind of a reading would be consistent with our outlook for slow growth in the remaining months of 2010.

Previous: 56.3 **Wells Fargo: 55.0**

Consensus: 54.5



Global Review

Sovereign Debt Concerns Resurface in Euro Area

Ireland announced this week that real GDP contracted at an annualized rate of 4.8 percent in the second quarter relative to the previous quarter (see graph on front page). Not only was the outturn significantly weaker than the modest expansion the consensus forecast had anticipated, but it cast some doubt on the notion that the Irish economy is emerging from its very deep recession. Irish real GDP is currently 13 percent smaller than it was at its peak in the fourth quarter of 2007.

Ireland does not have much direct impact on the Eurozone economy, because it accounts for only two percent of GDP in the overall euro area. However, it has an outsized effect on European debt markets, because it is one of the countries that have had sovereign debt issues this year. Moreover, there are concerns that the tab for the restructuring of Anglo-Irish Bank, which has already cost €33 billion (20 percent of Irish GDP), could rise even further. These concerns have led to anxieties about the future solvency of the Irish government. The debt-to-GDP ratio of the Irish government, which was less than 30 percent before the crisis, is on a path to balloon to more than 100 percent.

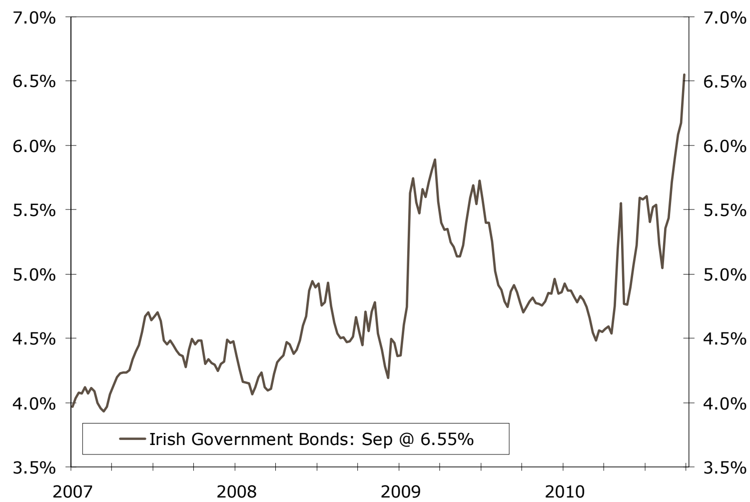
Yields on Irish government debt have shot up over the past two weeks. For example, the yield on the 10-year government bond closed the week near 6.50 percent, the highest yield since Ireland joined the European Monetary Union in 1999 (top chart). Concerns about Portugal's fiscal outlook have caused investors to dump Portuguese government bonds recently, and yields on Greek government bonds remain elevated. Developments this week fit with our long-standing thesis that investor concerns over European sovereign debt issues will be a chronic issue rather than a one-time event (see "European Union Moves to Put Out Greek Fire," May 10, 2010.)

Further Evidence of Slowing in the Eurozone

Recent economic data generally show that real GDP growth in the euro area has slowed in the third quarter from the 3.9 percent annualized rate that was achieved in the second quarter. The Eurozone manufacturing PMI, which averaged 56.3 in the second quarter, declined to 53.6 in September, and the service PMI has also moved lower in recent months (middle chart). Both indices remain above the demarcation line that generally separates expansion from contraction, but the declines in both indices are consistent with slower economic growth in the third quarter than in the second quarter.

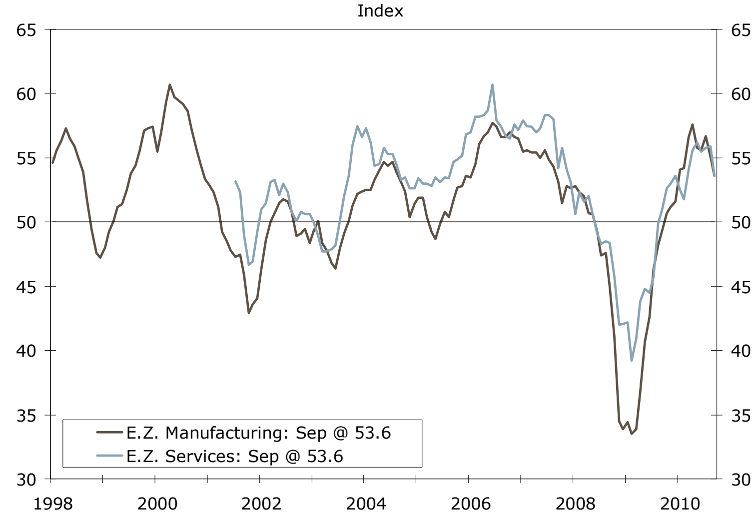
Recent data out of Germany, the largest economy in the euro area, have been mixed. Although the manufacturing PMI fell to an eight-month low in September, the Ifo index of German business sentiment, which is highly correlated with growth in German industrial production, remained at an elevated level (bottom chart). On balance, we take the recent economic data as indicating that the growth momentum in Germany has slowed somewhat from the breakneck pace of earlier this year. Real GDP shot up 2.2 percent (not annualized) in the second quarter, the fastest rate of sequential growth since reunification. (The sharp increase in Q2 notwithstanding, the level of German real GDP remains 2.7 percent below its Q1 2008 peak.) Industrial production was very strong, rising nearly five percent during the quarter. However, IP was flat in July, meaning that another outsized gain in GDP is unlikely in the third quarter.

Irish 10-Year Government Bond Yield



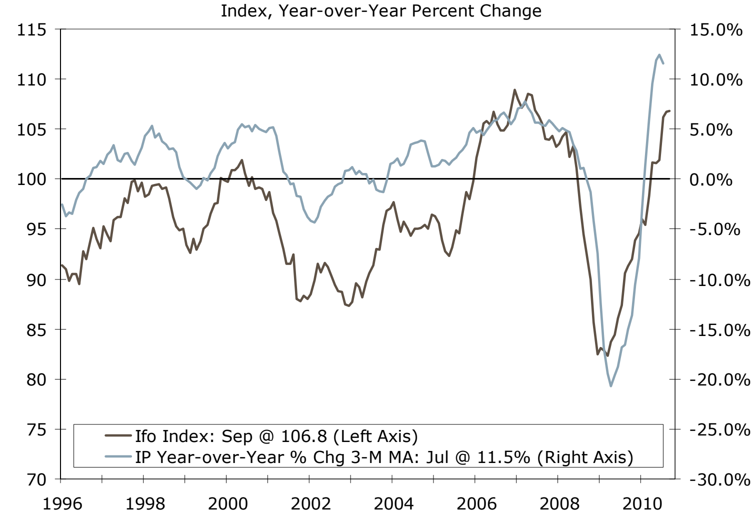
Eurozone Purchasing Managers' Indices

Index



German Production Indicators

Index, Year-over-Year Percent Change



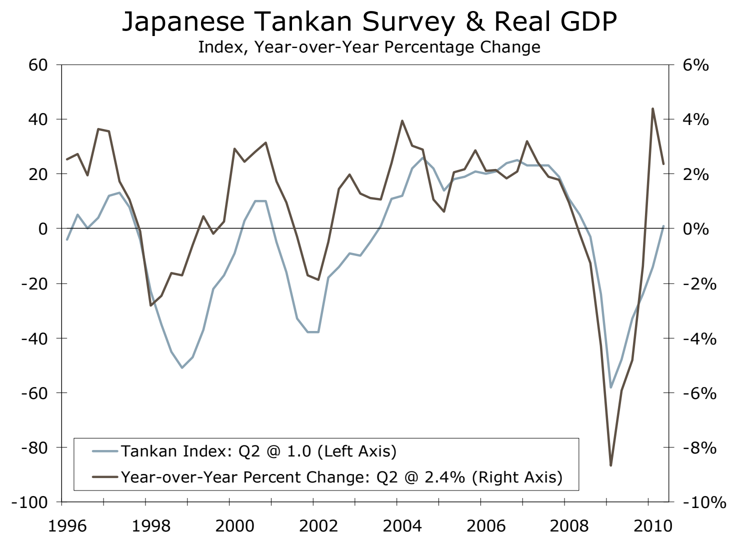
Japanese Tankan Index • Wednesday

The quarterly Tankan survey is one of the most widely watched indicators in Japan because it contains a plethora of data about the Japanese economy. Moreover, the "headline" diffusion index, which measures business sentiment among large manufacturers, is fairly correlated with Japanese GDP growth. If, as is expected, the "headline" index increases in the third quarter, some of the fears of a double-dip recession in Japan may be relieved.

There are also a number of "hard" data releases on the docket next week. Outside of the Tankan, the most widely watched release likely will be industrial production data for August, which print on Thursday. After expanding rapidly in late 2009/early 2010, IP has declined for two consecutive months. Analysts look for the streak to be broken with a fairly hefty increase in August. Retail sales data for August are also on the docket on Thursday.

Previous: 1

Consensus: 7



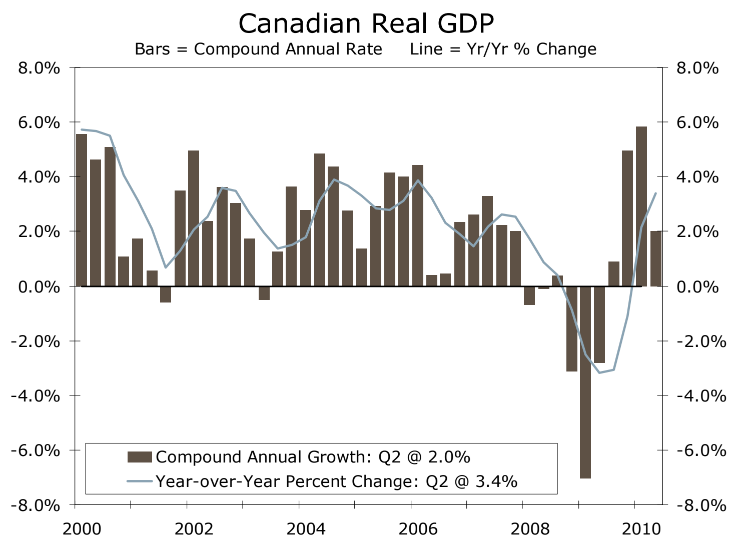
Canadian GDP • Thursday

Canada is the only major country to release GDP data on a monthly basis, and output data for July are on the docket on Thursday. After growing rapidly in Q4 2009 and Q1 2010, Canadian GDP growth slowed in the second quarter to an annualized growth rate of only 2.0 percent. True, robust growth in imports, which reflects strong growth in domestic demand, helped to depress the overall GDP growth rate. That said, the 0.1 percent decline in retail sales in July suggests that growth in domestic demand may have decelerated in the third quarter. If the consensus forecast of a 0.1 percent decline in GDP in July is realized, then sluggish growth in Canada in the third quarter would be likely.

Otherwise, the Canadian economic calendar is fairly light. That said, a house price index would give investors some insights into the current state of the Canadian housing market.

Previous: 0.2%

Consensus: -0.1% (M-o-M)



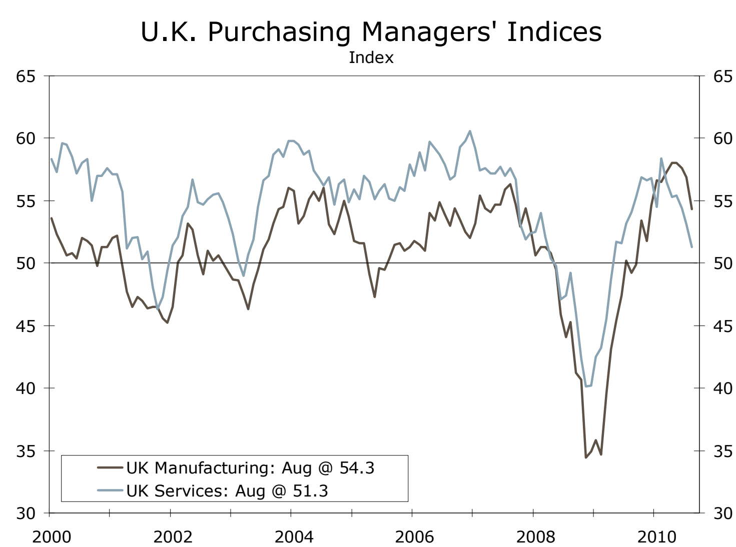
U.K. Manufacturing PMI • Friday

Real GDP in the United Kingdom grew at an annualized rate of 4.9 percent in the second quarter, the strongest sequential growth rate in about nine years. However, available indicators suggest that growth has slowed sharply in the third quarter. For example, the manufacturing PMI, which peaked at 58.0 in May, has declined to 54.3 through August. The index is still in expansion territory, but its decline recently suggests that growth in the manufacturing sector has slowed. Meanwhile, the service sector PMI has dropped to 51.3, still in expansion territory, but the weakest reading since spring 2009. Investors will be very interested to see what the September PMIs say about the economy.

Other releases of note during the week include data on consumer credit, the money supply and survey data on retail spending in September.

Previous: 54.3

Consensus: 53.8



Interest Rate Watch

More Fed Action Looks Imminent

While the Federal Reserve did not specifically state it is about to embark on another round of massive securities purchases, the financial markets drew that conclusion from the policy statement released after this week's FOMC meeting. We continue to believe the timing for a second quantitative easing would most likely be after the midterm elections and probably around the Thanksgiving holiday.

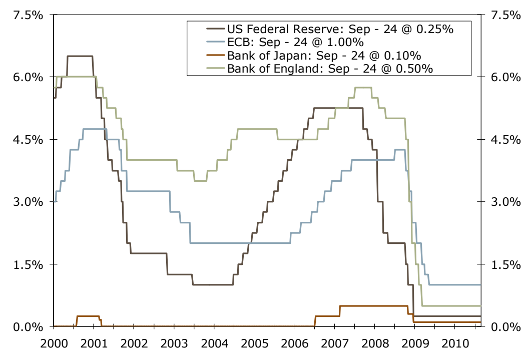
Support for a second round of quantitative easing can be found from what the Fed said and what it did not say. The policy statement began very much like the previous one, noting household spending is being restrained "by high unemployment, modest income growth, lower housing wealth, and tight credit." The language essentially ignored the recently improved tone of economic reports, which made for a little more bearish read.

The Fed also significantly strengthened its language on inflation, or the apparent lack thereof. The policy statement noted that measures of underlying inflation were running "at levels somewhat below those the Committee judges" are "most consistent" with what is needed to promote "maximum employment and price stability." The stronger statement, and equal billing given to labor market conditions and price stability, suggests more Fed action is needed and likely. In short, the Fed has now come clean and proclaimed the obvious, unemployment is too high and core inflation is too low.

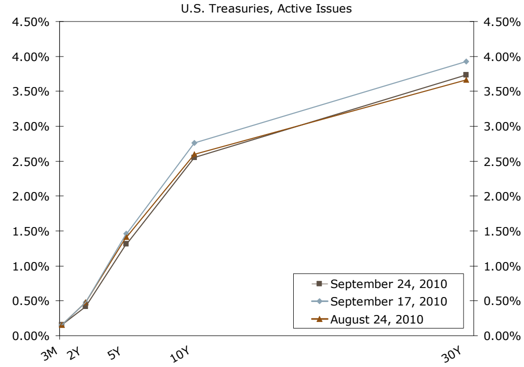
With prospects of an additional round of Fed easing increasing, commodity prices have soared. Gold prices surged above $1,300 an ounce and prices for agricultural commodities, including corn and cotton, have soared on reports that yields have been a little less than hoped for.

The economy is likely to go through a bit of a rough patch in coming weeks, with the unemployment rate likely rising and the ISM report falling back near the key 50 breakeven level. When that happens, bond yields will likely retest their recent lows and a second quantitative easing will look even more imminent.

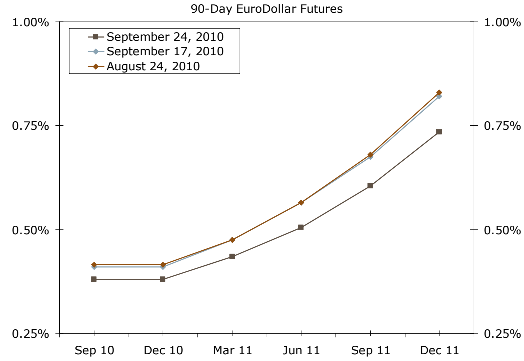
Central Bank Policy Rates



Yield Curve
U.S. Treasuries, Active Issues



Forward Rates
90-Day EuroDollar Futures



Consumer Credit Insights

ABS Demand Strong, Supply Weak

A recent study by Moody's Analytics shows that while the average savings rate of the bottom 95 percent of consumers has risen over the past couple of years, that of the top 5 percent of income earners has plunged from 26 percent in 2008 to minus 7 percent as of the first quarter of 2010. The study also showed that spending by the top 5 percent of income earners now accounts for 37 percent of all consumer outlays, the highest in 20 years. These figures suggest that the bulk of the growth in consumer spending over the past year has come from the very top of the socioeconomic pyramid. Along with charge-offs and high unemployment, this may be another reason why consumer credit continues to contract; those who are currently driving consumer spending simply do not need a loan to finance their purchases.

This is borne out in the asset-backed securities (ABS) market, which remains nearly nonexistent. Year-to-date issuance of ABS through August was only $81.3 billion, on pace for a yearly total of $121.9 billion. That is a 90 percent decline from peak issuance in 2006. However, despite record-low interest rates, yield spreads on ABS are the lowest since before the credit crunch. This suggests demand for ABS is high amid a dearth of securitized loans. Rising savings rates for the majority of consumers, and the lack of need for a loan for the rest, suggests ABS supply will likely remain anemic for some time. But when issuance rebounds, demand will be there.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.37%	4.37%	4.36%	5.04%
15-Yr Fixed	3.82%	3.82%	3.86%	4.46%
5/1 ARM	3.54%	3.55%	3.56%	4.51%
1-Yr ARM	3.46%	3.40%	3.52%	4.52%
MBA Applications				
Composite	790.6	801.5	870.3	668.5
Purchase	177.6	183.7	170.5	288.3
Refinance	4,357.4	4,396.1	4,944.7	2,881.5

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

Topic of the Week

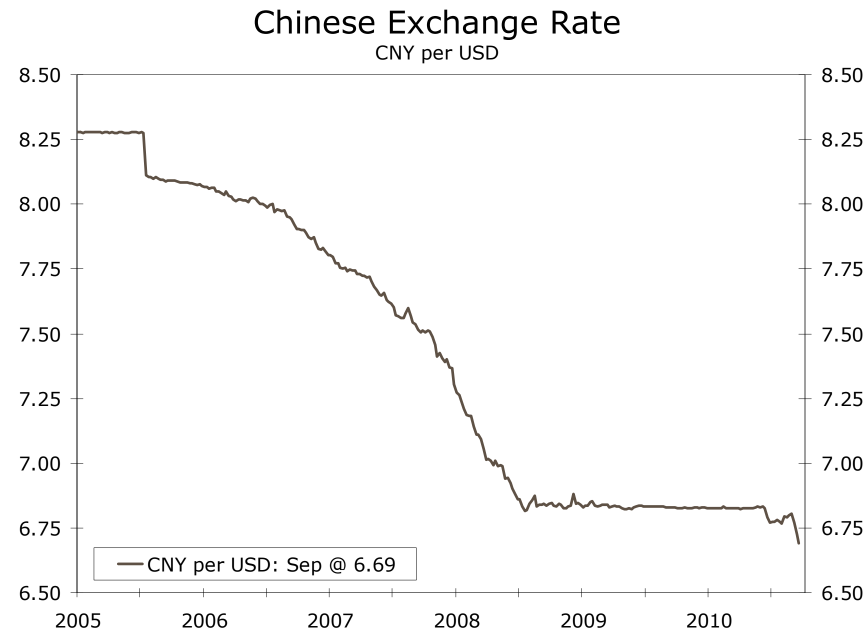
Malaysian Central Bank Buys Chinese Bonds

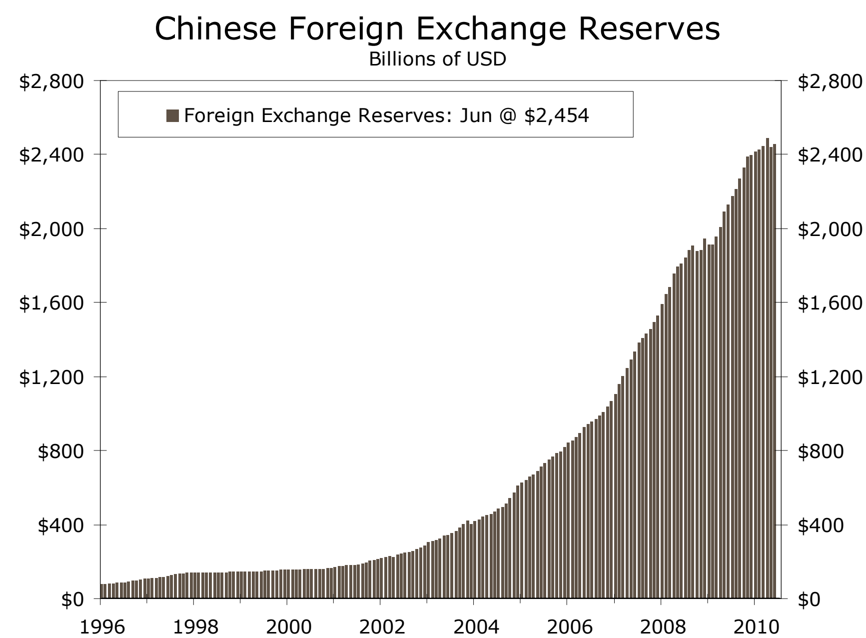
Eyebrows were raised earlier this week when it was announced that Bank Negara Malaysia, the central bank of Malaysia, bought Chinese government bonds. Few details were announced, but the news was interesting, because it represents another small step in the efforts of the Chinese government to slowly make the renminbi an international currency, like the dollar or the euro.

Note, that we use the words "small" and "slowly" in the preceding sentence. It is unlikely that Chinese authorities will take the necessary steps overnight to make the renminbi a truly convertible currency. To do so would require unfettered access to China's capital markets as well as freedom for capital to flow out of China. Both are tightly controlled at present. Chinese economic policies tend to be changed in a glacial rather than in a dramatic fashion and, in our view, it will be years before capital can flow freely in and out of China.

Regardless of the size, purchases of Chinese government bonds by foreigners help to strengthen the currency. In that regard, the renminbi has appreciated almost 2 percent against the greenback since early September, which is a slow rate of change when measured against monthly movements in the dollars/euro exchange rate, but rather quickly in terms of recent Chinese standards.

The quickened pace of appreciation this month is probably a gambit intended to deflect some criticism of China's currency policies in the U.S. Congress. That said, currency appreciation is also consistent with long-run Chinese policy objectives. Chinese leaders recognize that their economy is unbalanced in the sense that consumer expenditures account for less than 40 percent of GDP. (The comparable ratio in most advanced economies ranges between 60 and 70 percent.) Currency appreciation helps to lift purchasing power, which is supportive of stronger growth in consumer spending. Although we look for further renminbi appreciation in the months ahead, we believe the pace will remain frustrating slow for many U.S. policymakers.





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.wellsfargo.com/research

Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 9/24/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.15	0.15	0.09
3-Month LIBOR	0.29	0.29	0.28
1-Year Treasury	0.25	0.28	0.45
2-Year Treasury	0.43	0.46	0.94
5-Year Treasury	1.35	1.43	2.37
10-Year Treasury	2.60	2.74	3.38
30-Year Treasury	3.78	3.90	4.17
Bond Buyer Index	3.83	3.89	4.04

Foreign Exchange Rates

	Friday 9/24/2010	1 Week Ago	1 Year Ago
Euro ($/€)	1.347	1.305	1.467
British Pound ($/£)	1.580	1.563	1.606
British Pound (£/€)	0.852	0.835	0.913
Japanese Yen (¥/$)	84.230	85.860	91.270
Canadian Dollar (C$/$)	1.026	1.033	1.089
Swiss Franc (CHF/$)	0.983	1.010	1.030
Australian Dollar (US$/A$)	0.959	0.936	0.865
Mexican Peso (MXN/$)	12.542	12.799	13.506
Chinese Yuan (CNY/$)	6.690	6.725	6.827
Indian Rupee (INR/$)	45.255	45.840	47.973
Brazilian Real (BRL/$)	1.714	1.721	1.800
U.S. Dollar Index	79.380	81.398	76.900

Foreign Interest Rates

	Friday 9/24/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.82	0.83	0.70
3-Month Sterling LIBOR	0.73	0.73	0.56
3-Month Canadian LIBOR	1.24	1.24	0.50
3-Month Yen LIBOR	0.22	0.22	0.35
2-Year German	0.73	0.77	1.20
2-Year U.K.	0.69	0.72	0.78
2-Year Canadian	1.46	1.48	1.28
2-Year Japanese	0.14	0.14	0.23
10-Year German	2.34	2.43	3.31
10-Year U.K.	3.05	3.13	3.69
10-Year Canadian	2.86	2.93	3.40
10-Year Japanese	1.01	1.05	1.33

Commodity Prices

	Friday 9/24/2010	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	76.44	73.66	65.89
Gold ($/Ounce)	1296.65	1274.30	994.10
Hot-Rolled Steel ($/S.Ton)	535.00	545.00	555.00
Copper (¢/Pound)	362.60	351.35	269.95
Soybeans ($/Bushel)	10.66	10.11	9.13
Natural Gas ($/MMBTU)	3.91	4.02	3.95
Nickel ($/Metric Ton)	22,766	23,257	17,796
CRB Spot Inds.	522.56	520.49	432.85

Next Week's Economic Calendar

	Monday 27	Tuesday 28	Wednesday 29	Thursday 30	Friday 1
U.S. Data		**Consumer Confidence** August 53.5 September 52.4 (W)		**GDP** 2Q 2nd 1.6% 2Q 3rd 1.5% (W)	**ISM Manufacturing** August 56.3 September 55.0 (W) **Personal Income** July 0.2% August 0.2% (W) **Personal Spending** July 0.2% August 0.2% (W)
Global Data			**Japan** **Lge Manufacturers** Previous (2Q) 1.0	**Canada** **GDP (MoM)** Previous (Jun) 0.2%	**UK** **PMI Manufacturing** Previous (Aug) 54.3 **China** **PMI Manufacturing** Previous (Aug) 51.7

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	(612) 667-0168	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

WELLS FARGO SECURITIES