April 2, 2010

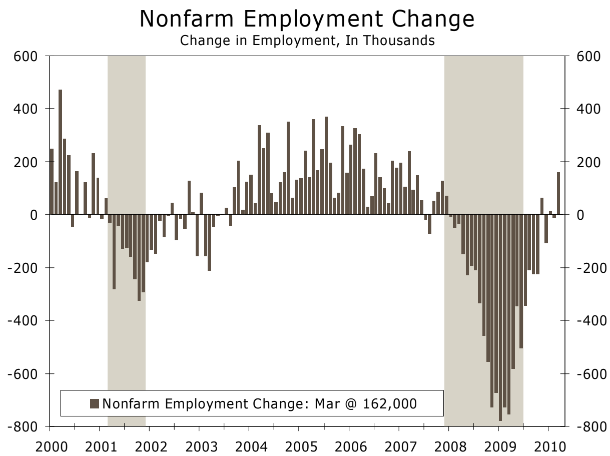
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Economic Recovery Continues, but is it Enough?

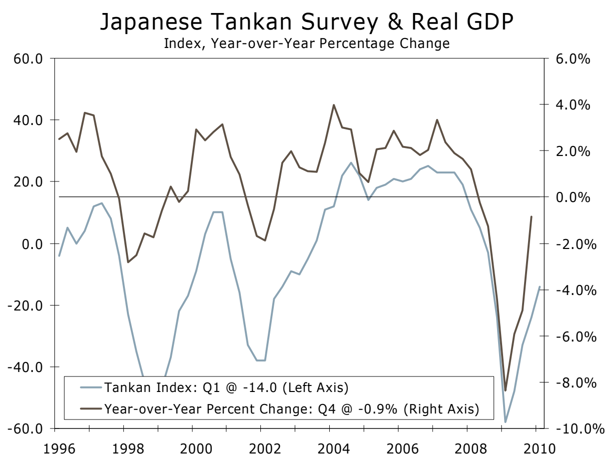
- Economic indicators this week suggested continued economic growth. Factory orders, the Institute for Supply Management manufacturing index and employment all suggest continued progress.
- Yet the pace of the recovery still presents several fundamental challenges. First, construction spending is disappointing and for a society that has put so much emphasis on housing, there is a disconnect between aspirations and reality. Second, the pace of growth will not likely solve the budget shortfalls in many states or at the national level.



Global Review

Signs of Continued Global Recovery in Q1

- The Tankan index of Japanese business sentiment, which is fairly correlated with GDP growth, rose further in the first quarter, and manufacturing PMIs across Asia were strong in March.
- Monthly GDP data suggest that the Canadian economy continued to expand at a strong pace in the first quarter.
- Manufacturing PMIs in Europe also rose further in March. However, strength in "soft" data has yet to translate into robust "hard" data in most European countries.

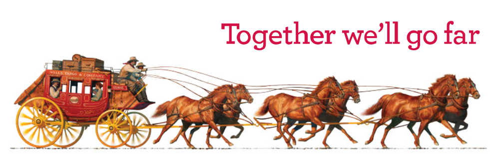


Wells Fargo U.S. Economic Forecast

	Actual 2009				Forecast 2010				Actual				Forecast	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2006	2007	2008	2009	2010	2011
Real Gross Domestic Product [1]	-6.4	-0.7	2.2	5.9	3.4	2.0	2.0	2.3	2.7	2.1	0.4	-2.4	2.9	2.5
Personal Consumption	0.6	-0.9	2.8	1.7	2.2	1.0	1.4	1.6	2.9	2.6	-0.2	-0.6	1.6	1.7
Inflation Indicators [2]														
"Core" PCE Deflator	1.7	1.6	1.3	1.5	1.4	1.2	1.2	1.2	2.3	2.4	2.4	1.5	1.3	1.7
Consumer Price Index	-0.2	-1.0	-1.6	1.5	2.5	2.4	1.9	1.6	3.2	2.9	3.8	-0.3	2.1	2.1
Industrial Production [1]	-19.0	-10.4	6.4	6.6	8.3	3.9	3.4	6.5	2.3	1.5	-2.2	-9.7	4.9	5.7
Corporate Profits Before Taxes [2]	-19.0	-12.6	-6.6	24.0	22.0	16.0	10.0	8.5	10.5	-4.1	-11.8	-5.1	13.8	8.0
Trade Weighted Dollar Index [3]	83.2	77.7	74.3	74.7	75.4	76.8	78.5	80.1	81.5	73.3	79.4	74.7	80.1	83.6
Unemployment Rate	8.2	9.3	9.6	10.0	9.7	9.8	10.1	10.0	4.6	4.6	5.8	9.3	9.9	9.6
Housing Starts [4]	0.53	0.54	0.59	0.56	0.59	0.64	0.67	0.70	1.81	1.34	0.90	0.55	0.65	0.76
Quarter-End Interest Rates														
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	5.25	4.25	0.25	0.25	0.50	3.25
Conventional Mortgage Rate	5.00	5.42	5.06	4.88	5.40	5.70	5.80	5.80	6.14	6.10	5.33	4.88	5.80	6.10
10 Year Note	2.71	3.53	3.31	3.85	3.70	3.80	4.00	4.10	4.71	4.04	2.25	3.85	4.10	4.50

Forecast as of: March 10, 2010
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change

Inside



U.S. Review

Economic Recovery Continues, but is it Enough?

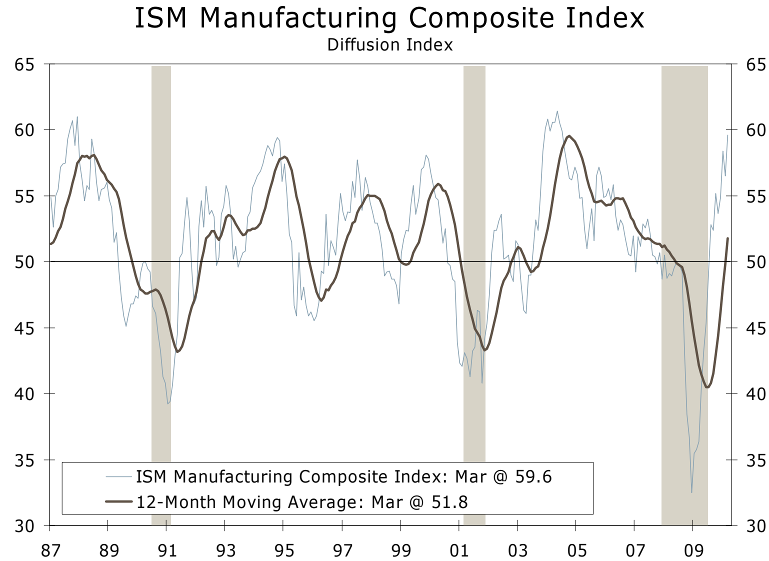
Three important economic indicators this week suggested continued economic growth. Factory orders, the Institute for Supply Management Index and employment all suggested continued progress on the economic front. Factory orders increased 0.6 percent in February and the gain reported for January was revised higher. Factory orders have gained in 10 of the past 11 months and are now more than a third of the way back to where they were at their peak in July 2008. Specifically, new orders for non-defense capital goods ex-aircraft are up nine percent (annualized) over the last three months, consistent with our expectations for 8 percent or more gains in real equipment & software spending for this year.

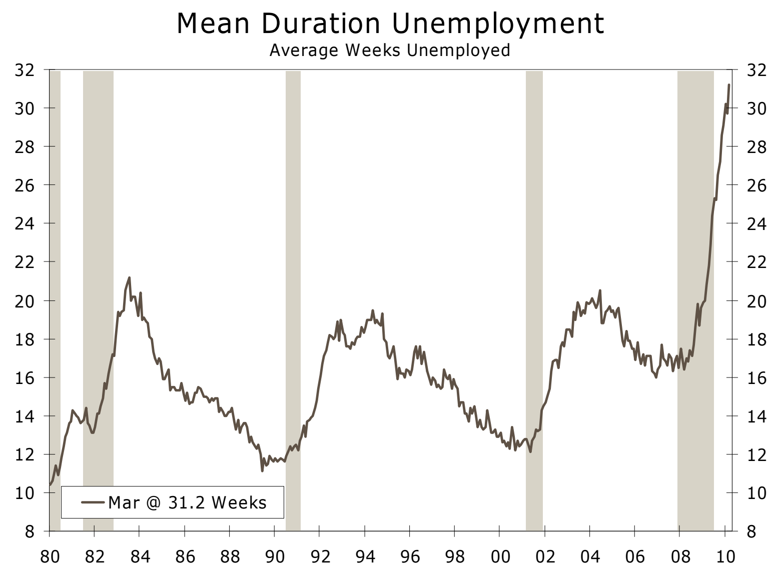
Meanwhile, the Institute for Supply Management manufacturing index rose to 59.6 and is consistent with a continued recovery rather than a double-dip recession. Orders, employment and production all suggest a positive growth outlook. Finally, employment rose in March and private sector employment has risen for the past three months. The breadth of the employment gains was also positive in March. There were gains in manufacturing and services with improvement in such cyclical areas as retail trade, leisure & hospitality and temporary help. One downside for jobs is that the mean duration of unemployment remains very high and suggests persistent structural unemployment. With that come concerns about consumer and housing credit.

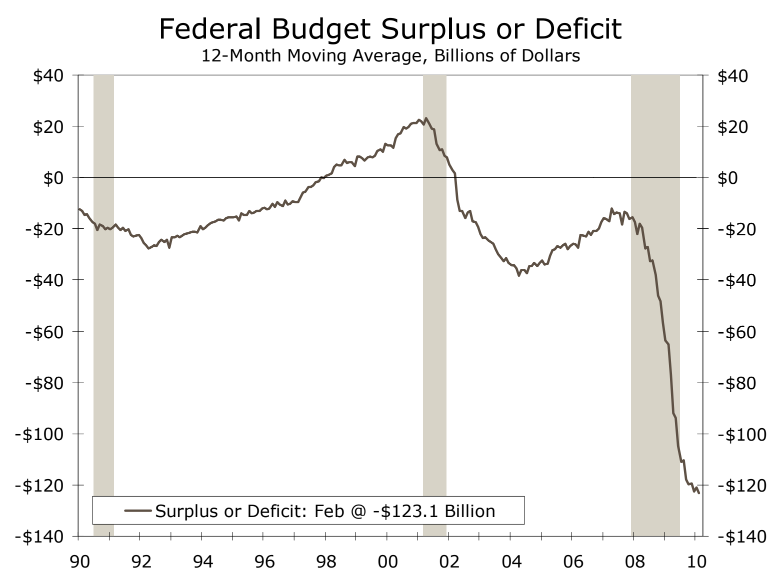
Yet, the pace of the recovery still represents several fundamental challenges. Moderate economic growth alone does not solve several secular imbalances in the economy. First, construction spending is disappointing and for a society that has put so much emphasis on housing, there is a disconnect between aspirations and reality. Our expectation is that housing purchases will not rebound at a pace that will make many speculative housing starts economically viable. Second, the pace of growth will not solve the budget shortfalls in many states or at the national level. Political promises have outpaced the ability of the economy to deliver. For several years entitlement spending has outpaced the tax base that supports it. Finally, the longer-term budget deficits and our dependence on foreign capital to support them creates a delicate balance of supply and demand that is currently being tested by questions raised about the U.S. commitment to long-term deficit control.

Cyclical Recovery Still Leaves Structural Imbalances

Both public and private decision-makers are left with the reality that a cyclical economic recovery still leaves us with longer-run structural imbalances—many of which have been growing since the 1960s. Economic growth appears insufficient to generate the income needed to meet all the entitlement promises. The latest Congressional Budget Office report on Social Security emphasizes this point. For the private sector, the ability to generate jobs and earnings are being challenged in an economy with slower top-line sales and greater consumer caution. We may be out of the woods but it is still a long journey to Mordor.

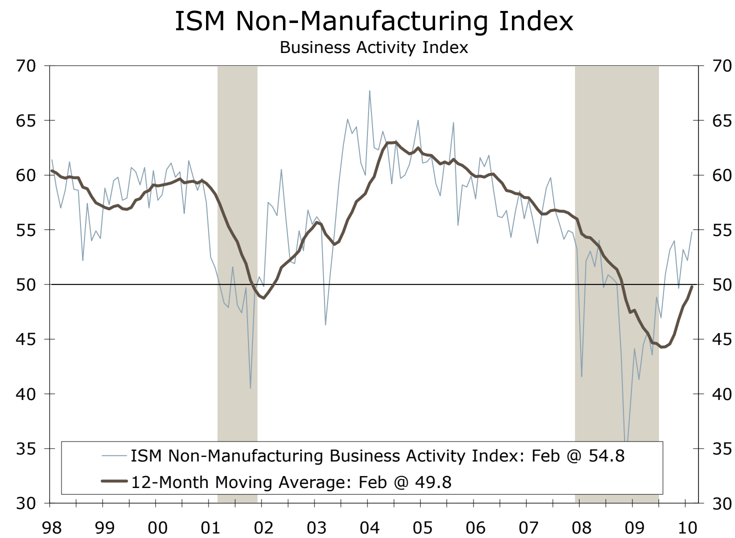






ISM Non-Manufacturing • Monday

The ISM Non-Manufacturing Index remained in expansionary territory for the second consecutive month in February increasing by 2.5 points to 53.0. With the exception of employment, all components of the composite index (business activity, new orders and supplier deliveries) contributed to the increase. The recent strength in service sector business activity is consistent with our view that an economic recovery is underway. The forward looking new orders index has been in expansionary territory for seven consecutive months and suggests continued strength in the service sector in the near future. The employment index rose 4.0 points to 48.6, the highest level since April 2008. The employment index will likely push into expansionary territory in March, which is consistent with underlying strength in private sector jobs.

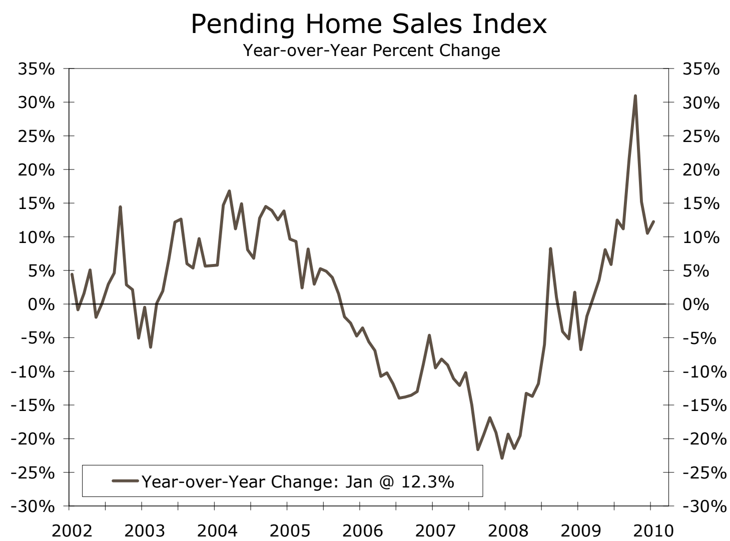


Previous: 53.0 **Wells Fargo: 53.5**

Consensus: 54.0

Pending Home Sales • Monday

Pending home sales have fallen two out of three months with declines likely due to the weather and a payback from the jump in sales that occurred before the initial expiration of the first-time homebuyer tax credit (initially scheduled to end November 30th). While the extension and modification of the tax credit has yet to spur sales, we expect to see a boost in the months leading up to the second expiration (extended to April 30th for contracts to be signed). All four regions of the country saw declines in January with the West seeing the largest decline. We expect the index to continue to wane in February. The decline in mortgage applications in February supports the notion that pending sales will likely remain weak.

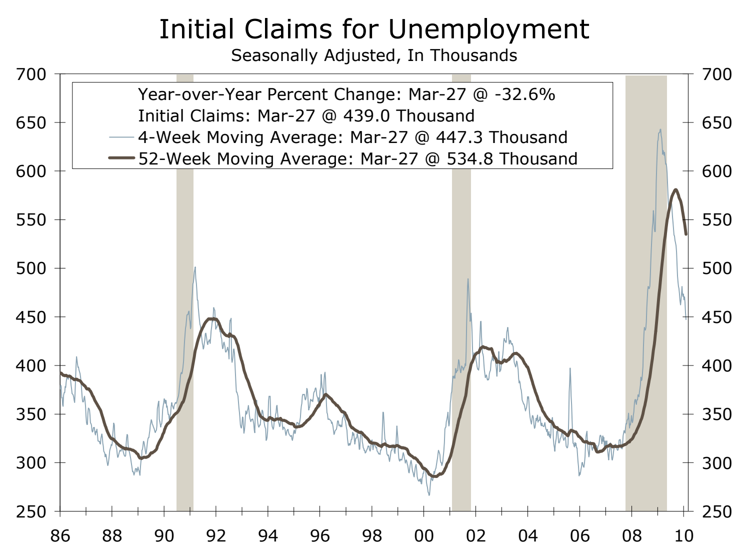


Previous: -7.6%

Consensus: -1.0%

Initial Jobless Claims • Thursday

Initial jobless claims for the week ending March 27th fell by 6,000 to 439,000, the second consecutive weekly decline. On a trend basis, the four-week moving average edged lower to 447,250. Consistent with our view that labor market conditions are stabilizing, we expect claims to continue to decline in coming weeks (especially with improving weather conditions in most parts of the country). While claims are moving in the right direction, the level is still too high to be consistent with sustained underlying strength in payroll growth. We expect temporary census hiring will likely help boost payrolls through May. Thereafter, we should see a retracement in temporary and government employment from June through September. By the fourth quarter, the effects of the census should be behind us and payroll gains should reflect underlying strength in the private sector.



Previous: 439K

Consensus: 433K

Global Review

Signs That Global Growth Strengthened Further in Q1

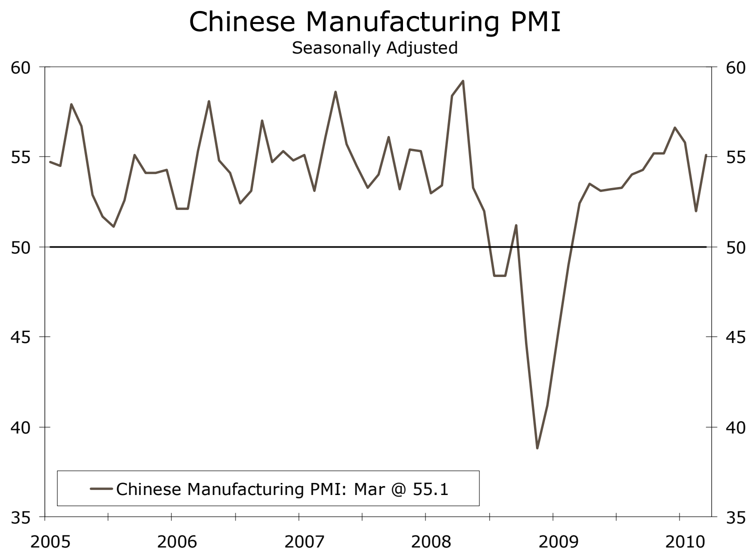
Data released this week suggest that the global economic recovery, which has been in place over the past few quarters, strengthened further in the first quarter of this year. In Japan, the Tankan index of business sentiment, which is fairly correlated with real GDP growth, rose to its highest level since the near collapse of the global financial system in the autumn of 2008 (see graph on first page). Sentiment among large manufacturers, who tend to be exporters, was the strongest among different sectors. However, the increase in sentiment was broad-based among both manufacturers and non-manufacturers, suggesting that domestic demand also strengthened in the first quarter.

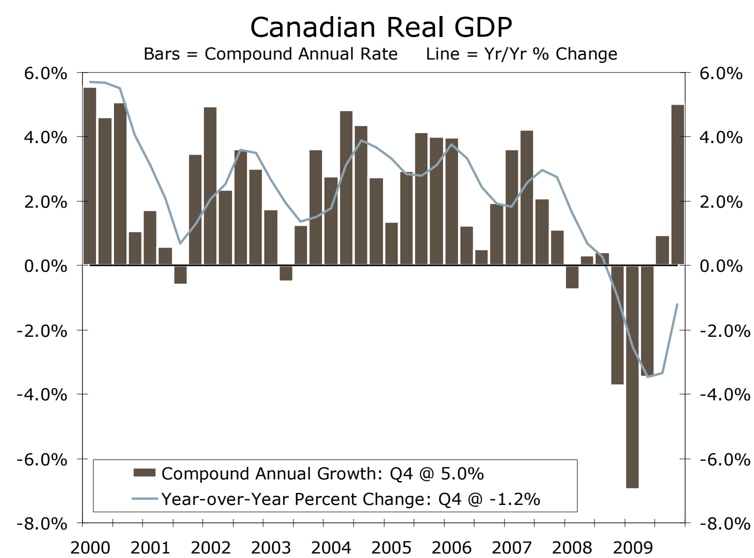
Speaking of Japanese exports, survey evidence indicates that growth in some of Japan's major trading partners in Asia remained strong in the first quarter. The manufacturing PMI in China rebounded in March after a brief dip during the previous month, suggesting that growth in Chinese industrial production remained strong (top chart). In India and Taiwan, manufacturing PMIs remained well within expansion territory in March.

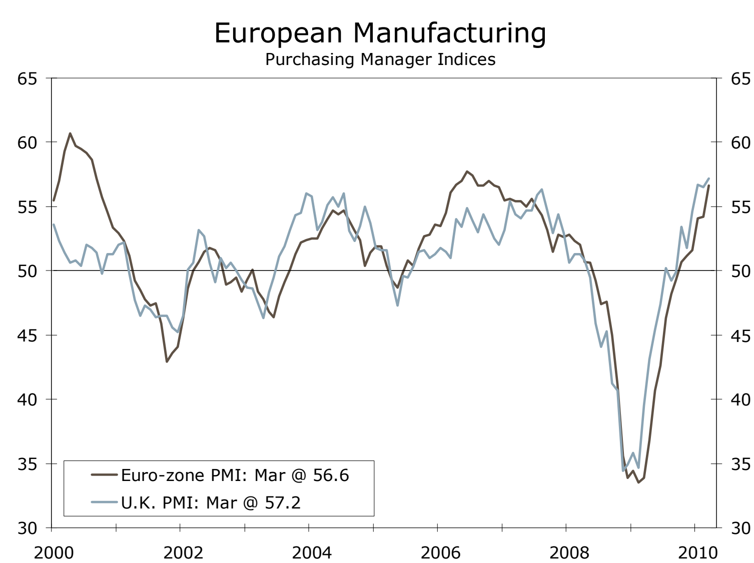
A marked upturn got underway in Canada in the second half of 2009, and real GDP data for January indicate that the economy is on pace to register another strong quarter of growth in the first quarter (middle chart). In January, real GDP rose 0.6 percent relative to the previous month, which follows the 0.5 percent increase that was chalked up in December. Even if the economy stagnated in February and March, which we do not expect, real GDP in the first quarter will have risen at an annualized rate of about 5 percent. Although exports clearly have played an important role in the Canadian recovery, indicators of domestic demand have been strong as well recently. For example, retail sales in January were up 0.7 percent relative to the previous month, and employment in February stood 0.4 percent above its year-ago level. (By way of comparison, U.S. employment in February was down 2.5 percent on a year-over-year basis.)

Among the major regions of the global economy, recovery thus far has been strongest in Asia and weakest in Europe. However, the manufacturing PMIs for the euro-zone and the United Kingdom strengthened further in March (bottom chart). The PMI in the former jumped to a 40-month high and the index in the latter rose to its highest level since 1994. Service sector PMIs for March will not print until next week, but European and British indices are expected to remain well within expansion territory where they have resided since last summer.

Unfortunately, the apparent strength in the PMIs has not translated into strong economic growth, at least not yet. Real GDP in the United Kingdom rose only 0.4 percent (not annualized) in the fourth quarter, and it was essentially flat in the euro-zone. Although British consumer spending has rebounded somewhat, continental European consumers have no pulse at present. And we fear that the fiscal consolidation that is underway in some of the euro-zone's former high-flying economies (e.g., Greece, Ireland and Spain) will keep growth in the overall euro area weak for some time.







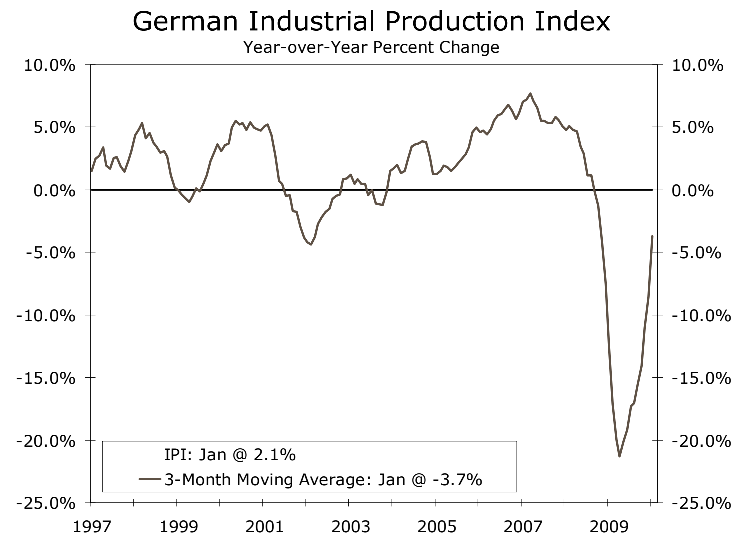
German Industrial Production • Thursday

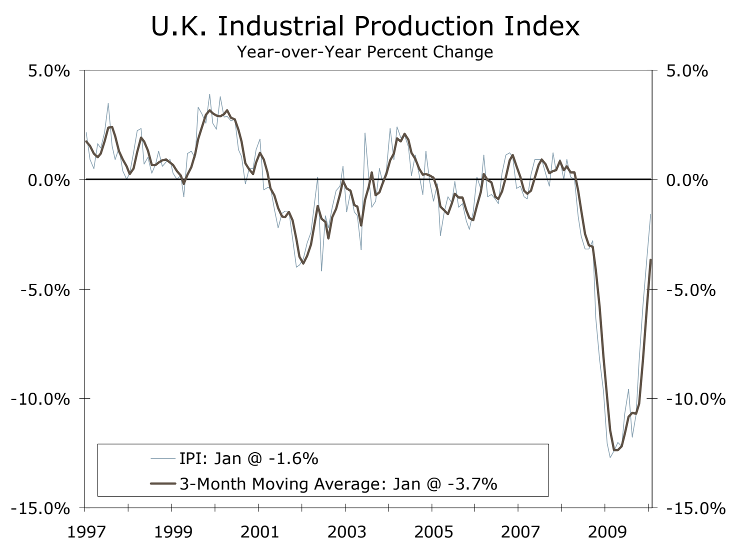
The year-over-year rate of decline in German industrial production (IP) has slowed significantly over recent months due, at least in part, to base effects. German IP has risen 8 percent from its low last April, but remains 17 percent below its peak in early 2008. However, recent increases in survey data (e.g., the Ifo index and the PMI) suggest that German IP rose further in February. Germany also releases data on February factory orders and French IP data will print next week as well.

The European Central Bank holds its monthly policy meeting next week, and there is very little chance of a change in rates at the meeting. Rather, investors will look to the press conference for clues about ECB policy going forward. Due to the sluggish nature of the euro-zone recovery to date (see page 4), we believe that the ECB will keep rates on hold throughout the rest of the year.

Previous: 0.6% (month-on-month change)

Consensus: 0.7%





British Industrial Production• Thursday

As in Germany, the year-over-year rate of decline in British IP has flattened out in recent months. Unlike Germany, however, there has been very little bounce in British industry thus far. British IP is up only 2 percent from its low, and it remains 14 percent below its peak in early 2008. As discussed on page 4, the manufacturing PMI has risen sharply in recent months, so "hard" data should, sooner or later, start to firm as well. Indeed, the consensus forecast looks for a modest rise in IP in February. In addition, a widely followed index of monthly GDP is also slated for release next week.

Like the ECB, there is very little chance that the Bank of England will change rates at its own policy meeting next week. In our view, the upturn in Britain is not quite as tepid as the euro-zone recovery, and we look for a BoE rate hike by the end of 2010.

Previous: -0.4% (month-on-month change)

Consensus: 0.5%

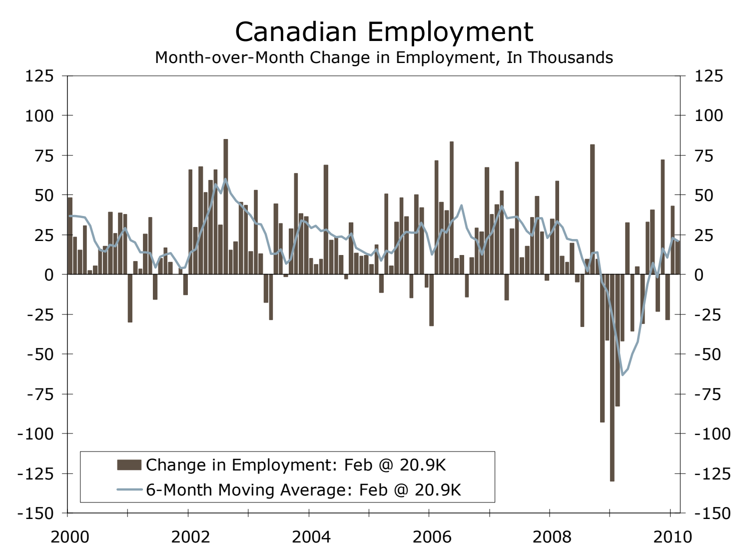
Canadian Employment Report • Friday

Despite the occasional month of contraction, Canadian payrolls have been growing on trend since midsummer 2009. The gain in payrolls reported for February was driven by an increase in manufacturing jobs. Consensus expectations for March payrolls look for an even larger increase. Still, the employment component of the forward-looking Ivey purchasing managers' index recently slipped to its lowest level since February 2009, suggesting the pace of the recovery in the labor market might slow somewhat in coming months.

Speaking of the Ivey index, we get our next look at that survey on Wednesday of next week. The overall index has been above 50 for eight of the last nine months. However the employment series has been below 50, signaling contraction, for the last several months. An improvement here could lift expectations for future jobs reports.

Previous: 20.9 K

Consensus: 25.0 K



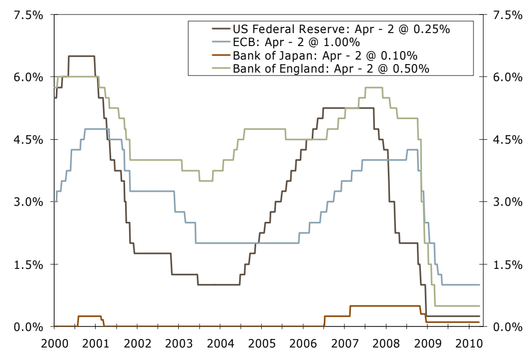
Interest Rate Watch

Canary in the Coal Mine

As expressed by Alan Greenspan, rising Treasury interest rates are the canary in the coal mine suggesting danger in the outlook for interest rates. In our December annual outlook for 2010 we posited a pattern of rising interest rates on the benchmark 5- and 10-year Treasury notes. In rebalancing the U.S. economy, we anticipated that both fiscal and monetary policy would have a significant influence on the pattern of interest rates this year. In recent weeks the pattern of fiscal policy has turned negative. First, recent estimates of the future fiscal integrity of Social Security have suggested that the system's revenues would fall short of spending this year—much sooner than many anticipated. Second, the budget estimates for the healthcare plan do not appear credible to the markets. Future Medicare cuts are unlikely. While mandates have been raised and entitlements broadened, there is likely no reasonable method to pay for these.

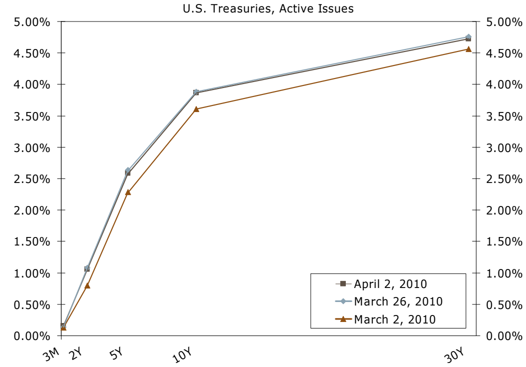
Meanwhile for monetary policy, questions have arisen about the ease and extent of the Fed's exit strategy. Both the composition and the size of the Fed's balance sheet represent significant issues to the marketplace. Also the Fed's real commitment to reducing the balance sheet has been in question as several members of the Federal Open Market Committee suggested that the Fed could reenter the market for mortgage-backed securities if problems arose. With the recovery in the first quarter and expectations for further growth, the flight to safety trade that favored U.S. Treasury debt became less attractive. Bond issuance for both high grade and high yield has grown sharply over the last three months. Equity markets have improved. Therefore, the opportunity costs have risen for continued investing in Treasury debt. For the rest of this year our view is that interest rates will continue to rise. We see that investor demand will decline as more attractive alternatives become available. Our concern is that the interplay of policy risks and diminished domestic and foreign demand may create more upside risks to the interest rate outlook than earlier anticipated.

Central Bank Policy Rates



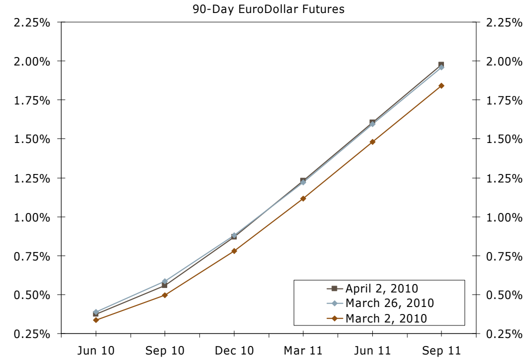
Yield Curve

U.S. Treasuries, Active Issues



Forward Rates

90-Day EuroDollar Futures



Consumer Credit Insights

Mortgage Rates Still Low…for Now

The Fed's mortgage-backed securities (MBS) and agency debt purchase programs have helped to keep mortgage rates low for the past year. Even though 10-year Treasury yields have rebounded by about 180 basis points from the December 2008 lows, 30-year conventional fixed mortgage rates have actually declined slightly. The average spread between 30-year fixed mortgage rates and 10-year Treasury yields over the last 15 years has been about 160 basis points, about 40 basis points higher than the current spread, which is still near the lowest in decades. The Fed's mortgage purchase program however, came to an end this week on schedule and we have already seen some response in the MBS markets where securities declined in value and yields rose on Thursday. Buyers are likely on the sidelines waiting to see how the Fed's exit affects markets in the coming days. In addition, with signs that the housing market is continuing to struggle and unemployment remaining high, investors are still concerned about mortgage defaults. This will continue to exert upward pressure on rates. Higher mortgage rates will add another headwind, or at least takeaway a tailwind, from a housing market that continues to struggle. In the coming months the housing market is also likely to lose the other major stimulus it has received with the first-time homebuyer tax credit scheduled to expire. The combination will likely hold down sales activity through the summer months.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	5.08%	4.99%	4.97%	4.78%
15-Yr Fixed	4.39%	4.34%	4.33%	4.52%
5/1 ARM	4.10%	4.14%	4.11%	4.92%
1-Yr ARM	4.05%	4.20%	4.27%	4.75%
MBA Applications				
Composite	602.8	595.0	629.9	1,194.4
Purchase	243.0	227.5	214.5	268.0
Refinance	2,707.8	2,744.7	3,054.3	6,600.1

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

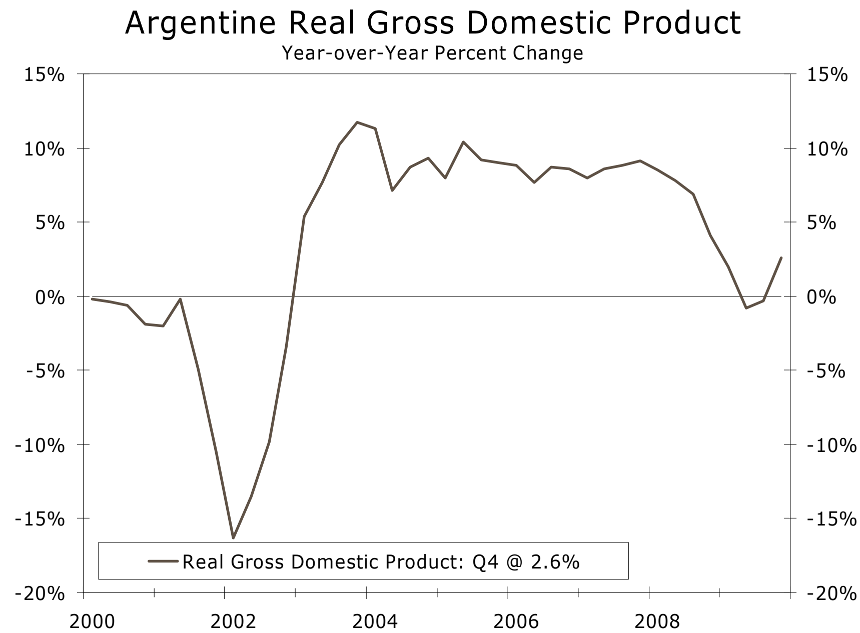
Topic of the Week

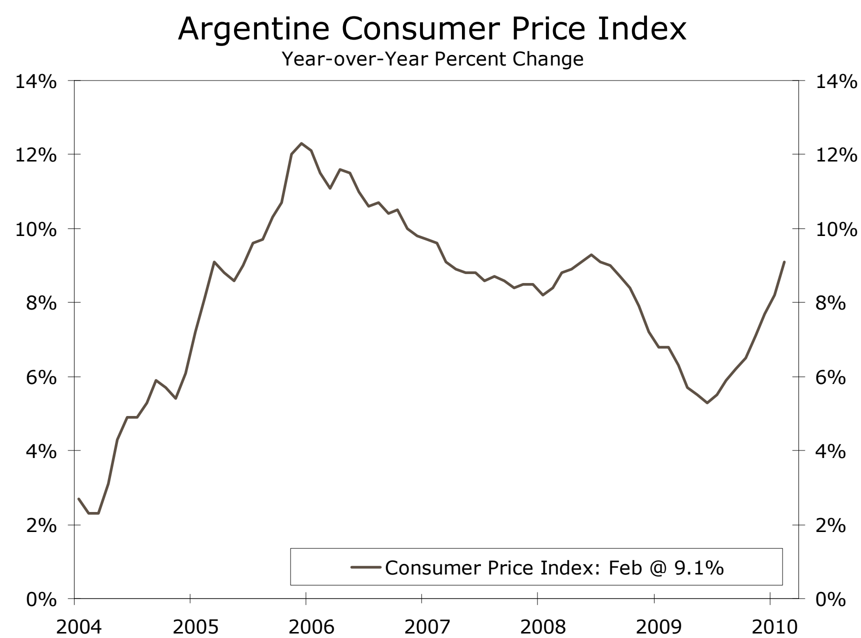
Does Another Debt Crisis Await Argentina?

Argentina has been in the news once again as investors are worried that Argentina may default on its external debt. This speculation is a repeat of what happened during 2008 and 2009, and it seems to be more related to internal political fights than to the current condition of government finances, though government finances have continued to deteriorate. Argentina is still negotiating with holdout bondholders from the 2005 restructuring of its defaulted external debt. Argentina's access to international financing markets has been closed since the default in 2001, and some investors holding about $20 billion in defaulted debt did not accept the debt renegotiation in 2005.

While we do not expect Argentina to default during the next several years, the seeds of a potential default are being planted today. First, the administration is using stocks to pay for what it owes instead of relying on its cash flow. Second, the government is tampering with inflation numbers to pay less in interest on some part of its current debt. Third, government expenditures are growing too fast for fiscal sustainability, especially if the economy does not make a strong recovery.

The administration has been moving to make a final offer to the 2005 holdouts from the 2001 debt default. According to the Argentine minister of economics, Amado Boudou, the holdouts should expect no more than 35 cents on the dollar. If the holdouts accept this offer from the government, the country will be able to access the international capital markets once again, and will likely be able to find financing rates close to the single digits, much better than today's rates of 15 to 20 percent. However, if the government runs into trouble obtaining financing in the short- to medium-run, then we should expect a higher inflation tax, devaluation and more confiscatory measures against different productive sectors of the economy. The outcome of these measures will determine how close or how far away another debt default may be.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 4/2/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.16	0.13	0.21
3-Month LIBOR	0.29	0.29	1.18
1-Year Treasury	0.41	0.43	0.40
2-Year Treasury	1.10	1.04	0.88
5-Year Treasury	2.67	2.59	1.75
10-Year Treasury	3.94	3.85	2.77
30-Year Treasury	4.80	4.75	3.60
Bond Buyer Index	4.44	4.44	4.92

Foreign Exchange Rates

	Friday 4/2/2010	1 Week Ago	1 Year Ago
Euro ($/€)	1.348	1.341	1.346
British Pound ($/£)	1.519	1.490	1.473
British Pound (£/€)	0.887	0.900	0.914
Japanese Yen (¥/$)	94.650	92.520	99.520
Canadian Dollar (C$/$)	1.011	1.027	1.238
Swiss Franc (CHF/$)	1.064	1.065	1.134
Australian Dollar (US$/A$)	0.919	0.904	0.715
Mexican Peso (MXN/$)	12.296	12.496	13.752
Chinese Yuan (CNY/$)	6.826	6.827	6.835
Indian Rupee (INR/$)	44.918	45.595	50.730
Brazilian Real (BRL/$)	1.765	1.819	2.274
U.S. Dollar Index	81.279	81.676	84.446

Foreign Interest Rates

	Friday 4/2/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.58	0.58	1.49
3-Month Sterling LIBOR	0.65	0.65	1.63
3-Month Canadian LIBOR	0.41	0.41	1.00
3-Month Yen LIBOR	0.24	0.24	0.60
2-Year German	0.96	1.00	1.41
2-Year U.K.	1.15	1.20	1.35
2-Year Canadian	1.73	1.70	1.12
2-Year Japanese	0.18	0.17	0.41
10-Year German	3.08	3.15	3.16
10-Year U.K.	3.92	4.04	3.37
10-Year Canadian	3.56	3.55	2.86
10-Year Japanese	1.36	1.39	1.38

Commodity Prices

	Friday 4/2/2010	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	84.87	80.53	48.39
Gold ($/Ounce)	1120.05	1107.50	904.05
Hot-Rolled Steel ($/S.Ton)	615.00	615.00	450.00
Copper (¢/Pound)	357.70	337.10	184.55
Soybeans ($/Bushel)	9.27	9.30	9.45
Natural Gas ($/MMBTU)	4.09	3.98	3.69
Nickel ($/Metric Ton)	25,011	22,806	10,005
CRB Spot Inds.	505.56	501.12	339.52

Next Week's Economic Calendar

	Monday 5	Tuesday 6	Wednesday 7	Thursday 8	Friday 9
U.S. Data	**ISM Non-Man.** February 53.0 March 53.5 (W)	**Minutes of FOMC**	**Consumer Credit** January $5.0B February $1.4B (C)		**Wholesale Inventories** January -0.1% February 0.4% (C)
Global Data			**Euro-zone** **PMI Services** Previous (Feb) 53.7 **UK** **PMI Services** Previous (Feb) 58.4	**Germany** **Industrial Prod. (MoM)** Previous (Jan) 0.6% **UK** **Mfg Production (MoM)** Previous (Jan) -0.9%	**Canada** **Net Chg Employment** Previous (Feb) 20.9K

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

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