

Economics Group

Weekly Economic & Financial Commentary

U.S. Review

A Sustainable, if Atypical, Recovery

- A recovery not led by a rebound in housing and consumer durable spending and accompanied by high unemployment? Such is the strange brew we appear to be making for this recovery.
- Moreover, markets and voters appear to be very wary of the degree of policy ease in the short-run and its implications for the long-run pace of economic growth and competitiveness in the U.S. economy. If this recovery is sustainable, it is very unlikely to be accompanied by the low level of interest rates and the high level of fiscal debts that have given it life.

Global Review

Canada: Economic Prosperity Brings Dollar Parity

- For the first time since July 2008, the Canadian dollar this week rose to parity with U.S. dollar in intraday trading. While this partly reflects the recent rise in oil prices, it is also a vote of confidence from currency markets in the Canadian economic recovery.
- The Ivey Purchasing Managers' Index jumped from 51.9 to 57.8 in March suggesting an even faster pace of expansion in Canada's factory sector than the recovery we have already seen.

Unemployment Rate
Seasonally Adjusted



Canadian Exchange Rate
CAD per USD



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	-6.4	-0.7	2.2	5.6	3.5	2.2	2.3	2.2	2.7	2.1	0.4	-2.4	3.0	2.5
Personal Consumption	0.6	-0.9	2.8	1.6	2.8	1.5	2.0	2.0	2.9	2.6	-0.2	-0.6	1.9	2.0
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	1.2	1.6
Consumer Price Index	-0.2	-1.0	-1.6	1.5	2.5	2.6	2.2	2.1	3.2	2.9	3.8	-0.3	2.3	2.4
Industrial Production ¹	-19.0	-10.4	6.4	6.6	6.5	3.4	3.4	6.5	2.3	1.5	-2.2	-9.7	4.4	5.7
Corporate Profits Before Taxes ²	-19.0	-12.6	-6.6	30.6	22.0	16.0	10.0	8.5	10.5	-4.1	-11.8	-3.8	13.7	8.0
Trade Weighted Dollar Index ³	83.2	77.7	74.3	74.8	76.1	75.5	77.5	79.4	81.5	73.3	79.4	74.8	79.4	83.6
Unemployment Rate	8.2	9.3	9.6	10.0	9.7	9.8	10.0	9.9	4.6	4.6	5.8	9.3	9.9	9.5
Housing Starts ⁴	0.53	0.54	0.59	0.56	0.60	0.64	0.67	0.71	1.81	1.34	0.90	0.55	0.65	0.82
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	4.93	4.97	6.10	6.00	6.00	6.14	6.10	5.33	4.93	6.00	6.30
10 Year Note	2.71	3.53	3.31	3.85	3.84	4.20	4.20	4.30	4.71	4.04	2.25	3.85	4.30	4.70

Forecast as of: April 7, 2010

¹ Compound Annual Growth Rate Quarter-over-Quarter

² Year-over-Year Percentage Change

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Together we'll go far



U.S. Review

A Recovery in Output But Not in Jobs

For this year and next we anticipate that overall economic growth will be a bit subpar compared to the long-run trend at 2.7 percent. Manufacturing output has rebounded and will continue to grow over the next two years, demonstrated by gains in industrial production of 9 percent and equipment and software spending of 17 percent. Yet two traditionally strong early cycle sectors, housing and consumer durables, remain below the pace of prior recoveries. To reemphasize our statement from the *Annual Outlook*, December, 2009, we continue to anticipate that both the pace and composition of the expansion will be very different than what we are used to or we may wish. The expected pace of job gains, 110,000 per month over the next two years, is not enough to reduce the unemployment rate below nine percent. Therefore the disconnect between the actual pace of this recovery and what voters expected continues to generate political tensions and, in effect, also prompt further policy change discussions.

Short-run Harmony, Long-run Dissonance

Yet, on the economic side, markets and voters appear to be very wary of the degree of policy ease in the short-run and its implications for the long-run pace of economic growth and competitiveness in the U.S. economy. If this recovery is sustainable, it is very unlikely to be accompanied by the low level of interest rates and the high level of fiscal debts that have given it life.

Both fiscal and monetary policies have been in harmony in supporting easy policy to promote growth—and growth we have. But over time, the Fed's intention is to keep inflation in check. On the fiscal side, the challenge is to maintain the delicate balance of providing enough policy support to maintain growth and yet not so much ease as to lead to increased skepticism about the longer-run credit rating of U.S. Treasury debt and the risk of debt monetization leading to inflation. As we have mentioned before, for fiscal policy, the party is over and bills are coming due.

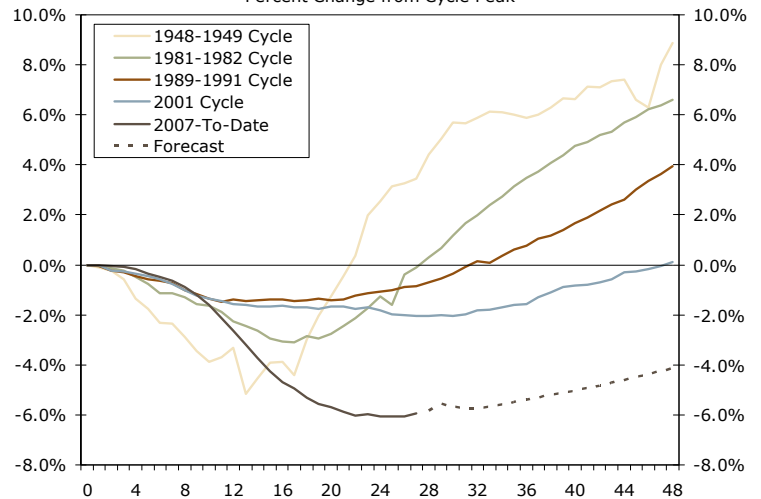
Non-market Prices: The Cost of Normalization

In recent weeks we have witnessed a rise in mortgage and Treasury rates as markets have begun the difficult process of returning to open-market pricing independent of the artificial support of Federal Reserve's buying in both markets. Our outlook has both short-run and long-run interest rates rising despite nine percent-plus unemployment and under-two percent inflation. Moreover, as outlined in the *Interest Rate Watch*, page 6, President Hoenig of the Kansas City Fed is already gearing up for higher short-term interest rates in an effort to head-off the inflation bandits at the pass.

Mortgage rates are rising while many homeowners see flat prices and rising foreclosures. Unemployment rates are high and yet both monetary and fiscal policies are gearing up for moves to tighten policy. The structural excesses of too many houses and too many goods relative to demand persist as many low-skilled and semi-skilled workers see very little in their future. Indeed a very strange brew for this very atypical economic recovery.

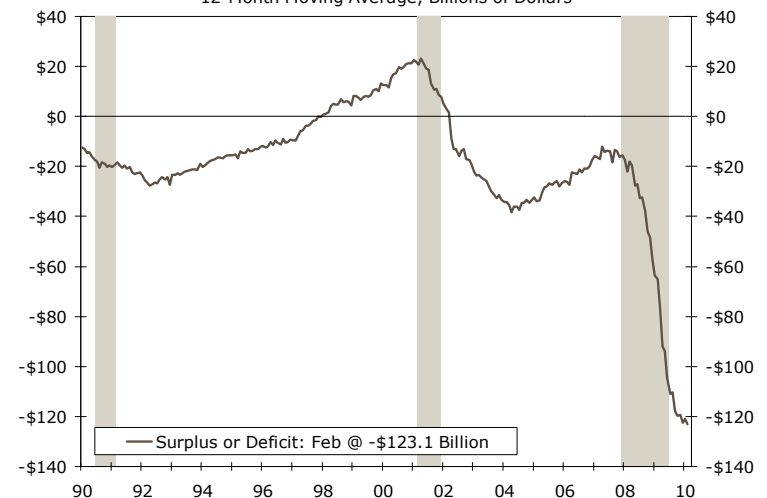
Employment Cycles

Percent Change from Cycle Peak



Federal Budget Surplus or Deficit

12-Month Moving Average, Billions of Dollars



10-Year Treasury Yield

Percent



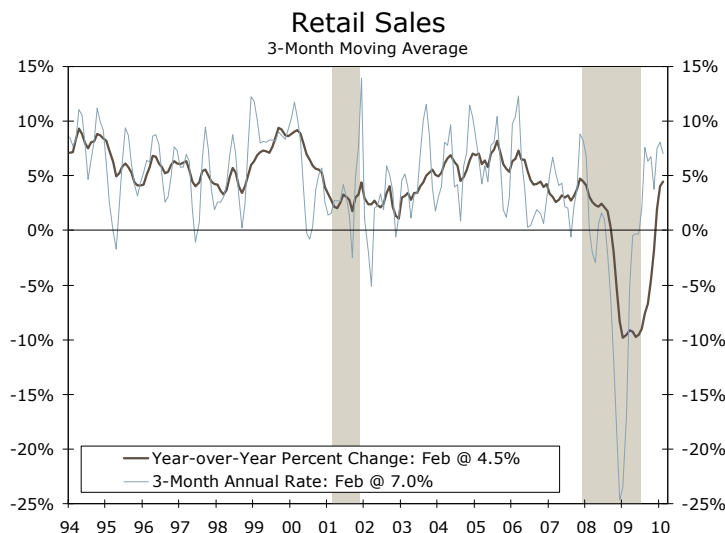
Consumer Price Index • Wednesday

There was no sign of accelerating inflation in the February CPI data. March CPI is expected to increase 0.3 percent, while the core index, stripping out food and energy prices, will likely advance 0.1 percent. Energy prices, normally a volatile component, should add to inflation as should food prices. Core inflation continues to be held down by the important shelter component. Apparel has also been holding down inflation recently, while medical care inflation has been advancing of late. The Fed noted in the FOMC minutes released last week that core inflation has declined sharply in recent months. Core CPI inflation, now 1.3 percent higher than a year ago, is at the low end of the Fed's informal target zone, suggesting little need for the Fed to swiftly remove monetary accommodation to address inflation concerns.

Previous: 0.0%

Wells Fargo: 0.3%

Consensus: 0.1%



Industrial Production • Thursday

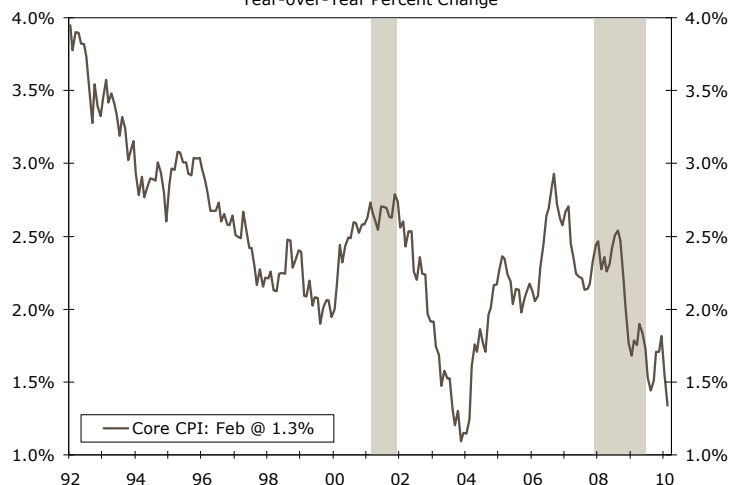
Industrial production data are expected to show that production continued to advance in March at a solid pace. Vehicle production will not be a big contributor this month as car and truck production largely remained flat on the month. Even so, the March ISM figure jumped to 59.6 from 56.5, the highest reading from this index since July 2004, suggesting a big monthly gain in total industrial production. Both manufacturing hours worked and mining hours worked jumped in the March employment report, supporting this forecast for a solid gain in industrial production. The utility component could be a bit of a drag as the warmer spring weather unwinds the weather-boosted levels of the past three months. Industrial production growth at around a six to seven percentage point pace on an annualized basis shows the manufacturing recovery remains on a solid and sustainable footing.

Previous: 0.1%

Wells Fargo: 0.8%

Consensus: 0.6%

U.S. "Core" Consumer Price Index
Year-over-Year Percent Change



Retail Sales • Wednesday

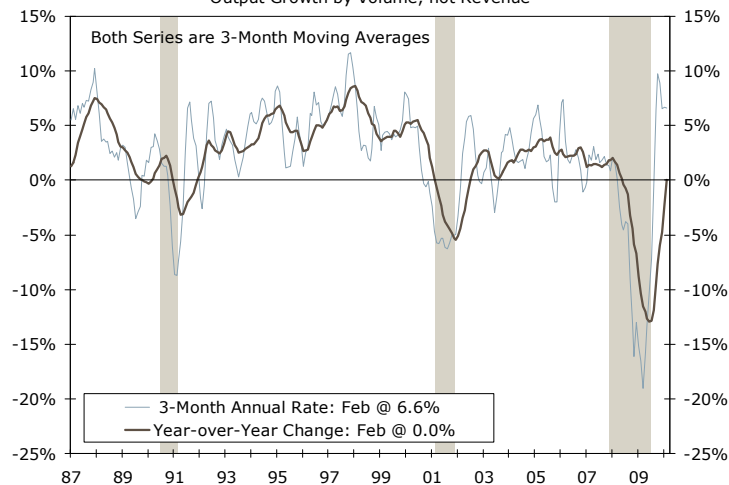
Retail sales were likely robust in March, rising 1.8 percent from February. We expect auto sales to be a big reason why. Unit vehicle sales jumped 15.0 percent in March, implying a large contribution from the auto component. Ex-auto retail sales should still rise a respectable 1.4 percent. Same-store chain-store sales continue to post solid gains, supporting our March ex-auto forecast. A number of temporary factors appear to have supported spending in recent months. Federal tax refunds are running ahead of last year's rates by about 11 percent, providing a boost in spending power. Pent-up demand is playing a role in spending on technology, computers and clothing. Moreover, consumers appear to be using their savings to drive this spending binge. The personal saving rate has dropped to around 3.0 percent from 6.5 percent a year ago, as income growth has not kept pace with spending.

Previous: 0.3%

Wells Fargo: 1.8%

Consensus: 1.0%

Total Industrial Production Growth
Output Growth by Volume, not Revenue



Global Review

Maybe the Canadian Economy Should get a Gold Medal

While many parts of the Canadian economy are recovering well, there are still areas that face significant headwinds. The total value of building permits slipped another 0.5 percent in February after falling 4.7 percent in the prior month. Most of the weakness was in multiple unit dwellings—historically a volatile component. Permit activity peaked in May 2007, then gradually weakened for a year or so before collapsing in the wake of the financial crisis in the autumn of 2008, eventually bottoming in February 2009. Since then, permits have recovered substantially. The current level is roughly 20 percent lower than that peak level, but also more than 56 percent higher than the trough in permit activity a year ago. A collapse in residential construction activity does not seem likely, but we would not be shocked to see homebuilders pause to catch their breath after such a swift recovery.

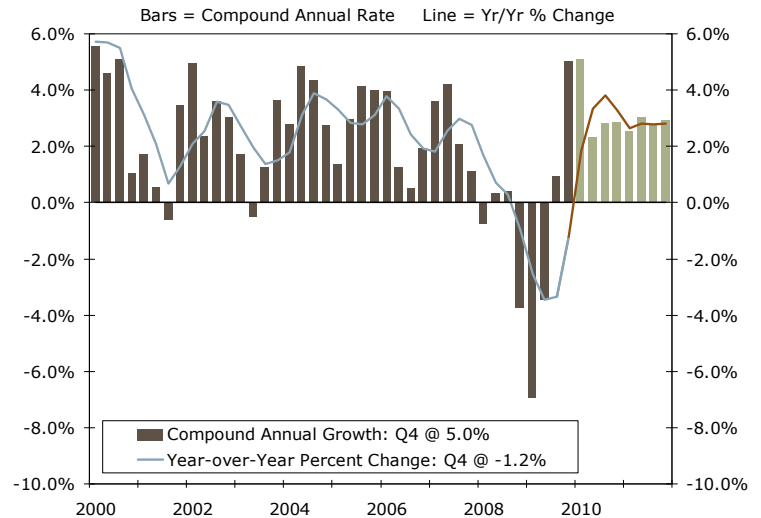
Data released last week revealed that the Canadian economy bested analysts' forecast again with monthly GDP data that showed the economy grew another 0.6 percent in January. Coming on the heels of a fourth-quarter GDP reading that showed the fastest pace of quarterly growth since 2000, this strong start sets a brisk pace for growth in 2010. We expect to see another strong number for GDP for the first quarter in Canada, probably north of 5 percent, and we recently increased our full-year growth forecast for Canada to 3.1 percent.

Like other areas in the Canadian economy, the factory sector is on an upswing. There was some concern that the pace of recovery was leveling off when industrial production was flat in February after increasing in each of the three prior months. New data this week about business sentiment moved those concerns to the back burner. The Ivey Purchasing Managers' Index jumped 5.9 points to 57.8—the largest monthly increase since June of last year.

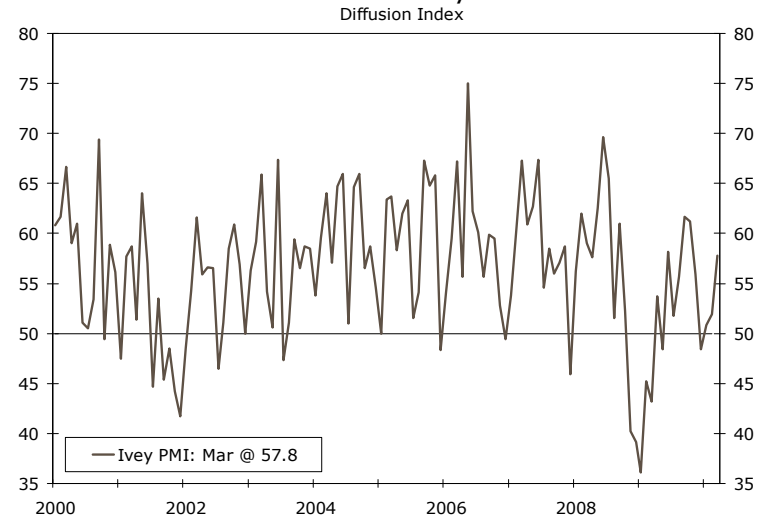
Canada has long been dependant on robust export growth to fuel expansion in the broader economy. While that remains true, domestic demand in Canada is playing a bigger role in this cycle, contributing to a recovery that has broadly exceeded expectations. Retailers in Canada have enjoyed sales growth in five of the past six months. Part of the strength can be attributed to government incentives like the temporary tax credit on home renovations. But consumer spending strength has also been underpinned by a recovering labor market. Monthly swings in employment are common, so it takes a few months of data to get a sense of the true direction of the job market. However, since bottoming in July, Canadian payrolls have expanded 1 percent. Should this improving employment trend continue, we could see a recovery in consumer spending that could be self-sustaining, even after government incentives expire.

Bank of Canada's (BoC) governor Mark Carney recently went out of his way to make the point that even though the BoC intended to leave lending rates unchanged until mid-2010, the "commitment is expressly conditional on the outlook for inflation." This raised concerns that the BoC might begin tightening monetary policy sooner than expected.

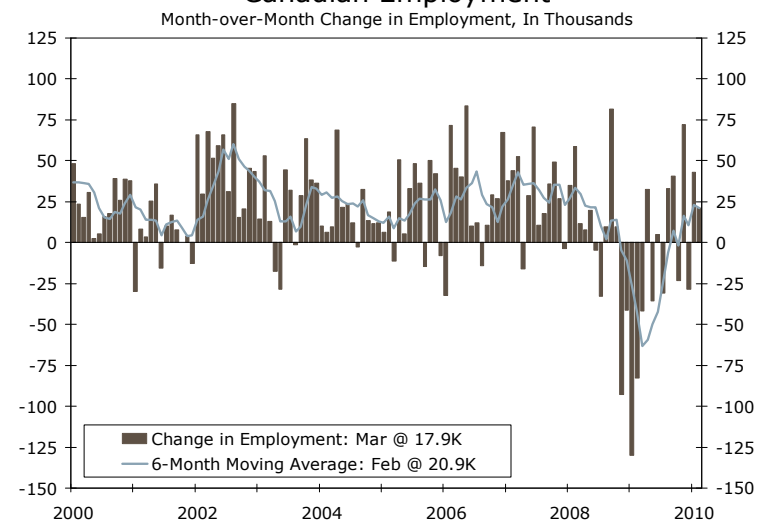
Canadian Real GDP



Canadian Ivey PMI



Canadian Employment



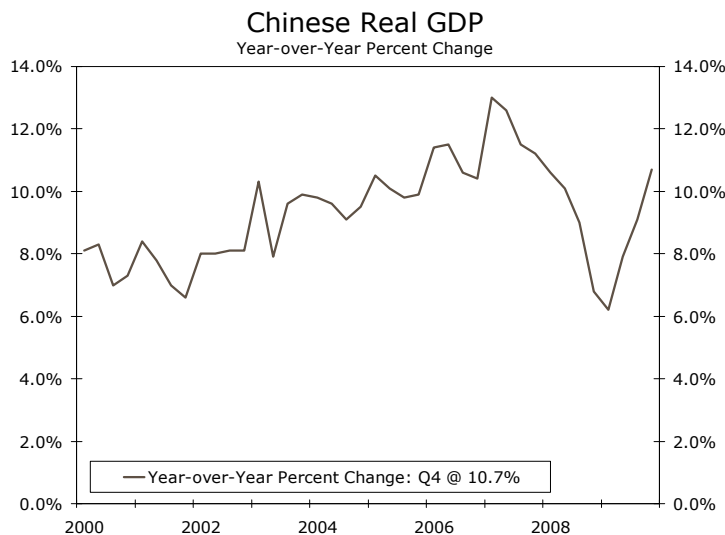
Euro-zone IP • Wednesday

Despite the 1.8 percent increase in industrial production (IP) that occurred in the October-December period, real GDP growth in the euro-zone was flat in the fourth quarter. If, however, stronger IP eventually shows up as positive GDP growth, then the 1.5 percent increase in IP in January is good news for the overall economy. Moreover, the subsequent rise in the manufacturing PMI to a four-year high suggests that IP has strengthened further in recent months. "Hard" data on euro-zone IP in February are slated for release on Wednesday.

The "flash" estimate showed that CPI inflation jumped to a 15-month high of 1.5 percent in March, so the final estimate, which will print on Friday, should not be much of a surprise. However, investors will be very interested in the March estimate of core CPI inflation, which stood at 0.8 percent in February.

Previous: 1.5% (month-on-month change)

Consensus: 0.1%



Canadian Manufacturing Sales • Friday

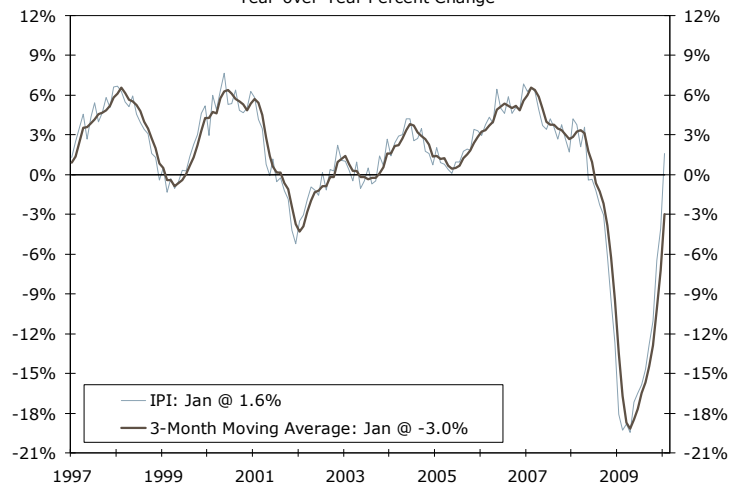
Factory sales in Canada have increased in each of the last five months and in January rose more than expected to the highest level since November 2008. Part of the strength in Canadian manufacturing sales comes from rising exports for manufacturers as global trade recovers. The strength of the Canadian dollar may eventually impede robust export growth as a strong Canadian dollar makes Canadian manufactured goods more expensive to foreign consumers. We will get a look at February sales for factories and auto-makers on Friday. The consensus is looking for another modest gain in manufacturing sales and a larger increase in auto sales.

Housing starts data are also due out next week and we expect to see the improving trend in residential construction to hold, though the pace of growth may slow from here.

Previous: 2.4%

Consensus: 0.9%

Euro-zone Industrial Production Index
Year-over-Year Percent Change



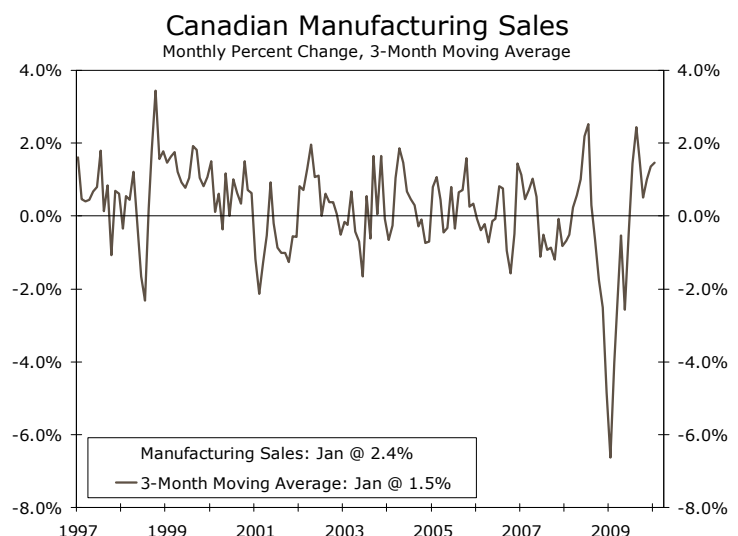
Chinese GDP Growth • Thursday

The Chinese economy rebounded over the course of 2009 to record a year-over-year growth rate of 10.7 percent in the fourth quarter. The consensus anticipates that growth strengthened even further in the first quarter, although the number will be flattered by the low base in the first quarter of last year. That said, there is clear evidence to suggest that economic activity in China remained very strong in the first quarter of 2010.

March data on the money supply, retail spending and industrial production will also print next week. Perhaps of most interest to investors will be CPI data for March that are also on the docket. There is some concern that the Chinese economy will eventually overheat, and the CPI data will shed some light on the severity of inflationary pressures within China at present.

Previous: 10.7%

Consensus: 11.6%



Interest Rate Watch

Hoenig "Sometime Soon"

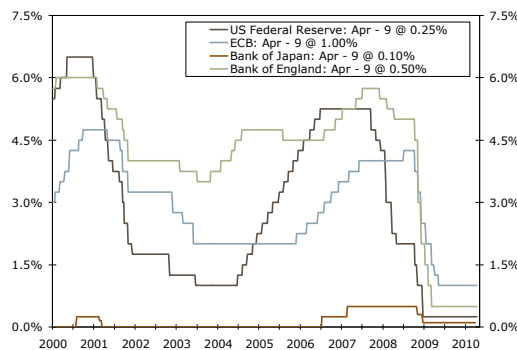
In a speech this week in Santa Fe, Thomas Hoenig suggested that the Fed should consider starting to raise the federal funds rate sometime soon to about one percent. This is more aggressive than we had anticipated. Our latest *Monthly*, out earlier this week, cited our expectation that the funds rate would rise to 50 basis points in the fourth quarter and 1.25 percent in the first quarter of next year. Inflation does not appear to be the driving force. We expect that the Fed's benchmark core PCE deflator will hover between roughly 1.2 percent and 1.5 percent over the next four quarters.

Instead, Hoenig appears to be more concerned that low interest rates over an extended period could lead to a buildup of financial imbalances and increase risks to economic stability in the longer term. To us, this appears to be an argument that the Fed is certainly trying to avoid any repeat of the questioned policy of the last decade during which interest rates stayed low for a long period and may have led to many consumers using cheap money at the short end of the curve to speculate on real estate. In addition, the very steep yield curve may be leading investors to play the yield curve to generate trading profits and thereby reinforce Hoenig's concerns about asset bubbles.

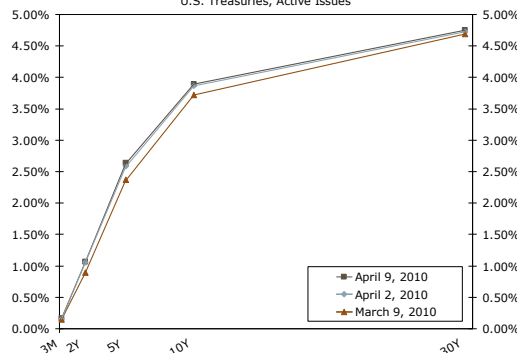
Exit Strategy: Risks

As we have discussed previously, the Fed's exit strategy contains considerable risks to both the expected path as well as the execution. A simple exit strategy appears increasingly difficult. On the political side, increases in interest rates, no matter how small, will make the housing recovery more difficult (see Consumer Credit column in the next column). On the economic side, it will be very difficult to control market reaction once investors feel the Fed will start to normalize yields. Certainly the current 25 basis points funds rate is too low to be considered neutral but a one percent funds rate is also likely too low. Therefore, financial markets are likely to move faster and farther than the Fed or other policymakers desire.

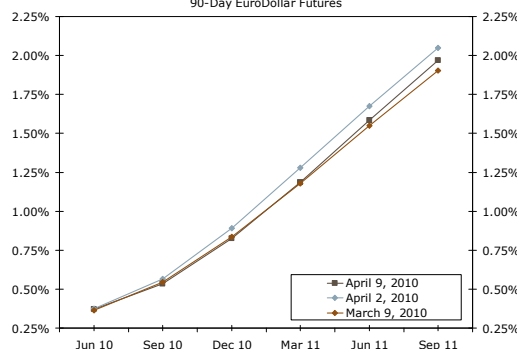
Central Bank Policy Rates



Yield Curve
U.S. Treasuries, Active Issues



Forward Rates
90-Day EuroDollar Futures



Consumer Credit Insights

Caution From the Latest News

Two pieces of new data on the consumer suggest caution from our viewpoint on the strength of the consumer rebound and the credit quality of consumer credit. First, consumer credit fell \$11.5B in February after a solid gain in January. Both revolving and non-revolving components of credit fell. The January gain was the first in more than a year and suggested some positive news for the consumer. Therefore, February's release was very disappointing. Consumer fundamentals still suggest caution as unemployment rates remain high, housing price improvements are very uneven and real income gains are very modest. Moreover, there is some commentary that the decline in consumer credit may be more a matter of simply writing off bad debts rather than households actually paying down debt.

Second, the Mortgage Bankers Association's release on purchase and refinance indices revealed a sharp decline in the refi index which is consistent with the rise in mortgage rates in recent weeks. This suggests that consumer credit demand is very sensitive to rising mortgage rates and that the recent rise in rates, which we believe will continue for a while, suggests a weaker housing recovery than many have penciled in for the second quarter. Early April mortgage rates are up 23 basis points for both 15-year FRM and one-year ARM mortgages. Housing credit remains very sensitive to rising rates as consumers appear wary of the future.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	5.21%	5.08%	4.95%	4.87%
15-Yr Fixed	4.52%	4.39%	4.32%	4.54%
5/1 ARM	4.25%	4.10%	4.05%	4.93%
1-Yr ARM	4.14%	4.05%	4.22%	4.83%
MBA Applications				
Composite	536.3	602.8	633.1	1,250.6
Purchase	243.6	243.0	226.8	297.7
Refinance	2,250.6	2,707.8	3,007.2	6,813.5

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

Topic of the Week

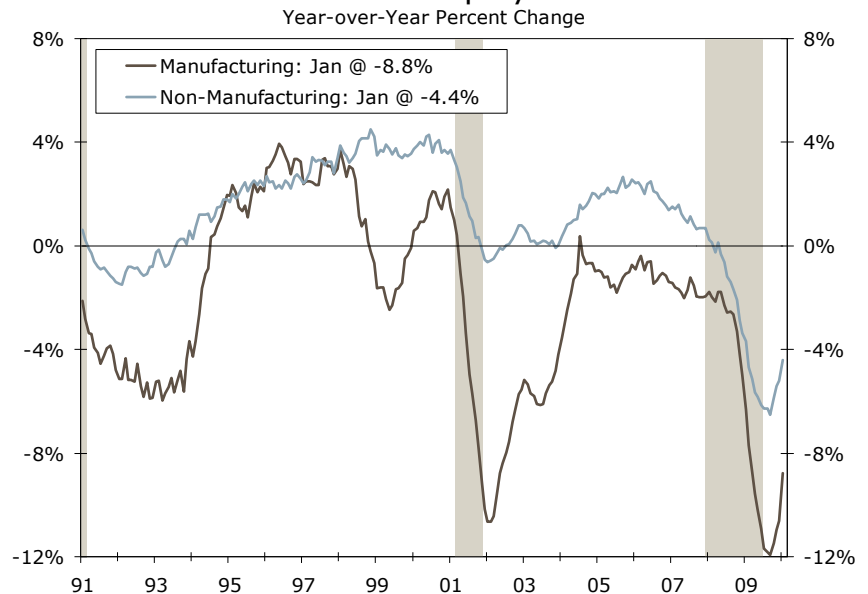
California's Budget Mess

Last year California worked to close a \$60 billion shortfall. The state even resorted to issuing IOUs for the second time since the Great Depression when it nearly ran out of cash. But the state's budget problems are still far from over. California must now confront an additional budget gap of nearly \$20 billion for the 2010-2011 budget cycle. Through the first seven months of the 2009-10 fiscal year, tax revenues have fallen short of disbursements by \$12.2 billion, and the state's cash balance is even worse, a remarkable deficit of \$24.1 billion, thanks to a \$11.9 billion dollar deficit carried over from the 2008-09 fiscal year. The state has \$28.7 billion in borrowable reserves, but has \$24.1 billion in outstanding loans, leaving net borrowable reserves at a paltry \$4.6 billion. State spending is already down 12.1 percent from a year ago, and government job losses are mounting. Local government job cuts have totaled 47,000 jobs, or 3 percent of the workforce over the last two fiscal years, while state job cuts have totaled about 1.5 percent of the workforce.

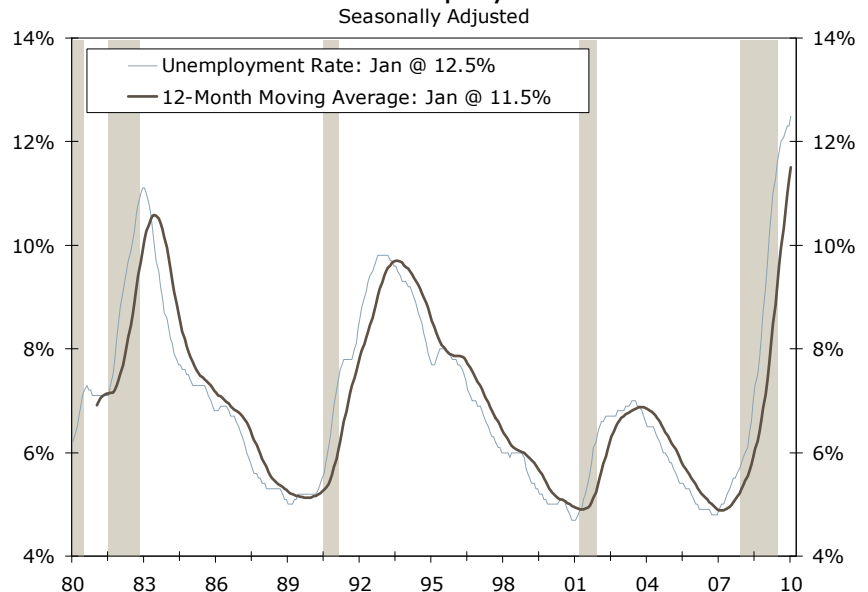
California already has the lowest debt rating of any U.S. state, and 39 states are struggling with shortfalls this fiscal year. The state is begging for more Federal funds to forestall yet another round of spending cuts. Governor Schwarzenegger has already unveiled a plan to balance the budget largely with spending cuts, but the Democratic-controlled state legislature has sharply criticized it.

The costs of running these state deficits are growing by the day. The cost of debt service in the state is running 4.5 percent above last year. Moreover, the cost to insure California's debt with credit default swaps is higher now than in many developing countries. While we still expect the probability of default in California is very low, it cannot be ruled out. The most likely outcome is that California GO bond investors continue to worry that California's bonds could move from investment grade toward "junk" status.

California Employment



California Unemployment Rate



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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 4/9/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.15	0.16	0.18
3-Month LIBOR	0.30	0.29	1.13
1-Year Treasury	0.42	0.39	0.45
2-Year Treasury	1.08	1.10	0.95
5-Year Treasury	2.67	2.67	1.89
10-Year Treasury	3.91	3.94	2.92
30-Year Treasury	4.77	4.81	3.75
Bond Buyer Index	4.45	4.44	4.92

Foreign Exchange Rates

	Friday 4/9/2010	1 Week Ago	1 Year Ago
Euro (\$/€)	1.345	1.350	1.317
British Pound (\$/£)	1.535	1.521	1.468
British Pound (£/€)	0.876	0.888	0.897
Japanese Yen (¥/\$)	93.440	94.610	100.420
Canadian Dollar (C\$/¥)	1.005	1.011	1.224
Swiss Franc (CHF/\$)	1.069	1.061	1.156
Australian Dollar (US\$/A\$)	0.932	0.919	0.719
Mexican Peso (MXN/\$)	12.204	12.303	13.089
Chinese Yuan (CNY/\$)	6.824	6.826	6.835
Indian Rupee (INR/\$)	44.294	44.918	50.040
Brazilian Real (BRL/\$)	1.775	1.765	2.171
U.S. Dollar Index	81.188	80.776	85.786

Foreign Interest Rates

	Friday 4/9/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.58	0.58	1.43
3-Month Sterling LIBOR	0.65	0.65	1.56
3-Month Canadian LIBOR	0.42	0.41	1.00
3-Month Yen LIBOR	0.24	0.24	0.57
2-Year German	0.96	0.96	1.38
2-Year U.K.	1.16	1.16	1.36
2-Year Canadian	1.84	1.73	1.13
2-Year Japanese	0.17	0.18	0.47
10-Year German	3.16	3.09	3.26
10-Year U.K.	4.03	3.94	3.29
10-Year Canadian	3.67	3.56	2.94
10-Year Japanese	1.39	1.36	1.48

Commodity Prices

	Friday 4/9/2010	1 Week Ago	1 Year Ago
WTI Crude (\$/Barrel)	85.25	84.87	52.24
Gold (\$/Ounce)	1158.93	1119.80	879.35
Hot-Rolled Steel (\$/S.Ton)	615.00	615.00	410.00
Copper (¢/Pound)	358.40	357.70	207.05
Soybeans (\$/Bushel)	9.32	9.26	9.99
Natural Gas (\$/MMBTU)	4.02	4.09	3.61
Nickel (\$/Metric Ton)	24,668	24,319	10,874
CRB Spot Inds.	507.27	503.61	349.88

Next Week's Economic Calendar

	Monday 12	Tuesday 13	Wednesday 14	Thursday 15	Friday 16
U.S. Data	Monthly Budget	Trade Balance	CPI	Industrial Production	Housing Starts
	February -\$191.6B	January -\$37.3B	February 0.0%	February 0.1%	February 575K
	March -\$105.0B (C)	February -\$39.0B (W)	March 0.3% (W)	March 0.8% (W)	March 606K (W)
		Import Price Index	Retail Sales	Capacity Utilization	
		February -0.3%	February 0.3%	February 72.7%	
Global Data		March 1.1% (W)	March 1.8% (W)	March 73.3% (W)	
			Business Inventories		
			January 0.0%		
			February 0.3% (W)		
		Canada	Euro-zone	China	Canada
		International Trade	Industrial Prod. (MoM)	Real GDP (YoY)	Manufacturing Sales
		Previous (Jan) 0.8B	Previous (Jan) 1.5%	Previous (4Q) 10.7%	Previous (Jan) 2.4%
				China	Euro-zone
				CPI (YoY)	CPI (YoY)
				Previous (Feb) 2.7%	Previous (Feb) 0.9%

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

Wells Fargo Securities, LLC Economics Group

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