

Economics Group

Weekly Economic & Financial Commentary

U.S. Review

How Do We Differ from the Consensus?

- We see sustained economic growth but are more cautious on consumer spending and housing than the consensus. In part, this is the result of our more bearish view on unemployment. We believe there is a structural shift in labor demand. On the other hand we have been optimistic on the strength of capital spending.
- Even though we do not see inflation as a problem, we are above consensus in the interest rate outlook. Rising long-term Treasury rates are an issue of an imbalance between Treasury supply and foreign demand.

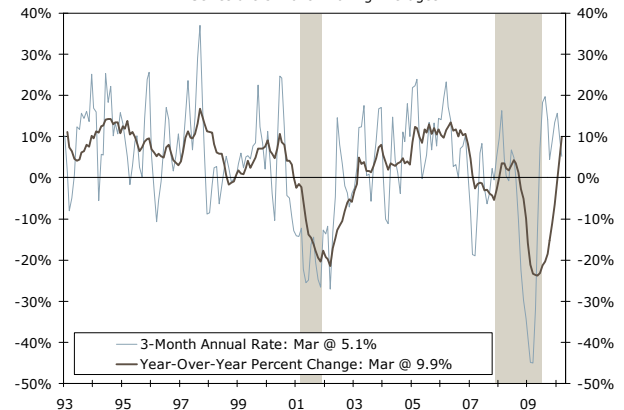
Global Review

U.K. Economy Continues to Limp Along

- Real GDP in the United Kingdom posted its second consecutive increase in the second quarter, but the pace of recovery remains very slow. Although some temporary factors helped to weigh on growth in the first quarter, the underlying pace of recovery can hardly be characterized as "robust" at present.
- CPI inflation is well above the Bank of England's target at present. Although inflation should recede in the months ahead, the elevated rate of inflation makes life difficult for Bank of England policymakers.

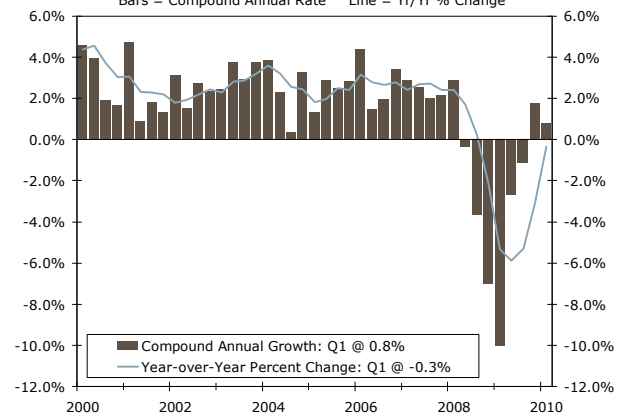
NonDefense Capital Goods Orders, Ex-Aircraft

Series are 3-Month Moving Averages



U.K. Real GDP

Bars = Compound Annual Rate Line = Yr/Yr % Change



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Wells Fargo U.S. Economic Forecast												
	Actual				Forecast				Actual			
	2009				2010				2006	2007	2008	2009
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2010	2011		
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
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
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
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
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
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
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
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
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
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
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
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

Forecast as of: April 7, 2010

¹ Compound Annual Growth Rate Quarter-over-Quarter² Year-over-Year Percentage Change

Together we'll go far



U.S. Review

How Are We Different...

How are we different—in our economic outlook, that is—from the consensus? Venturing into the financial jungle that is Wall Street, among the bulls and bears, lions and tigers, it is difficult to escape by successfully answering (or is it evading?) the most vexing question for economists—how do we differ from the consensus? On the most important point, we saw economic recovery coming and avoided the empty rhetoric of the double dip/L-shaped recovery, instead focusing on the importance of the inventory correction and both fiscal and monetary stimulus. At present the economy has self-sustaining growth with low inflation. By watching leading indicators, especially jobless claims and the ISM survey, our outlook remains one of positive growth.

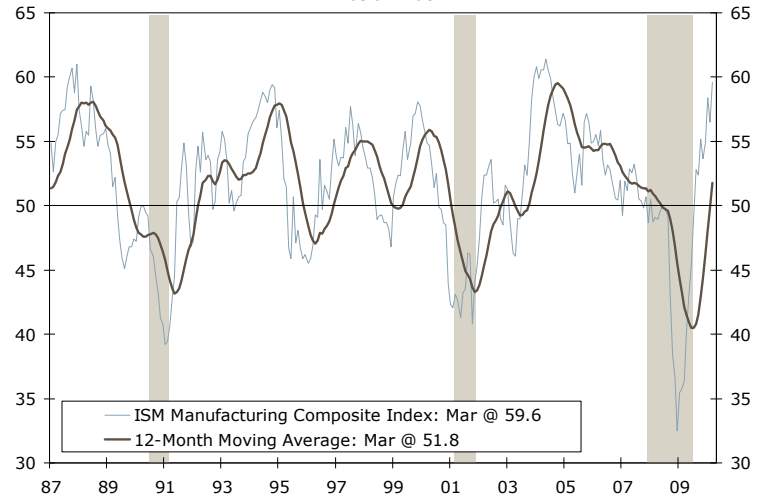
Within that growth outlook we have been more cautious on consumer spending than the consensus for both 2010 and the year ahead. Job growth and associated wage growth remain slow relative to trend. Consumer confidence is low. On the plus side equity prices are up, providing a boost through the wealth effect.

Above-consensus expectation for business equipment and software spending was also a good call and has followed patterns of earlier recoveries with the resulting outstanding performance of industrial stocks. This combination of strong capex—in light of the slow job gains—suggests changes in the production mix with more capital and less labor. In part, this new production mix has supported a rebound in profits. This is again a classical cyclical pattern that we have emphasized, and is consistent with efficiency and productivity gains that have been reported nationally.

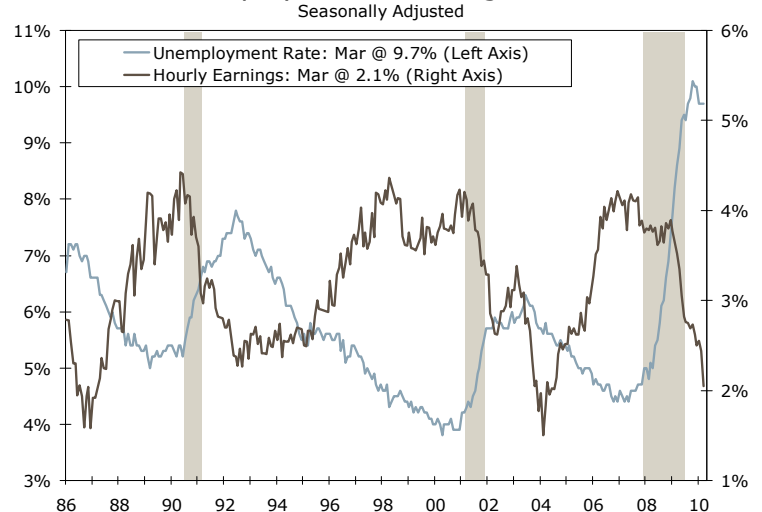
We have been and continue to be more bearish on unemployment. We believe there is a structural shift in labor demand toward higher educated, tech savvy workers. This matched with from construction (less housing) and the continued long-term decline in low and semi-skilled manufacturing jobs. In addition, the consumer retrenchment has incentivized many firms in the retail/wholesale sectors to emphasize efficiency over floor space. Job growth is essential to sustainable economic growth—and many of the jobs being filled today are not in the same areas as those lost (construction) and the workers filling new jobs are not the same that lost the old jobs. Frictional/structural unemployment remains an ongoing reality for the U.S. labor market.

We have been and remain cautious on the housing recovery. This reinforces the observation that the economic recovery has been very uneven by region. Hidden housing inventory differs by area as does the outlook for job/population growth. Home price rebounds reflect the reality of land constraints—rapid gains in San Francisco and Los Angeles—little improvement in the Central Valley. Next week we will write more on the risk associated with our outlook.

ISM Manufacturing Composite Index
Diffusion Index

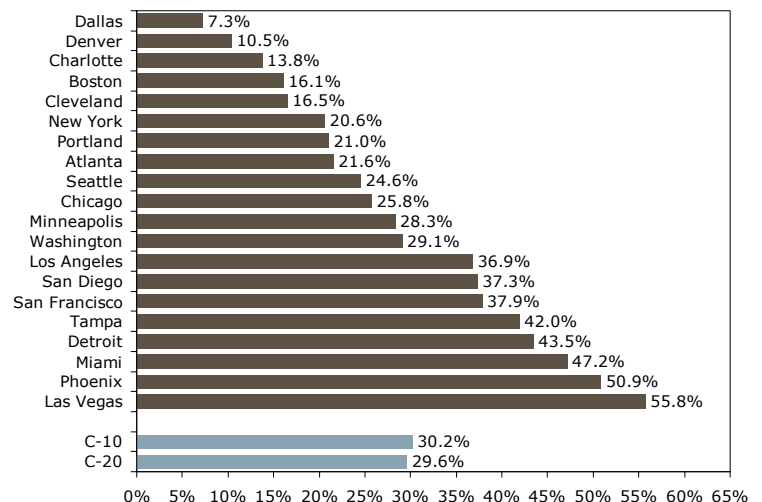


Unemployment and Wage Rates
Seasonally Adjusted



S&P Case-Shiller Home Prices

Percent Decline from Local Market Peak



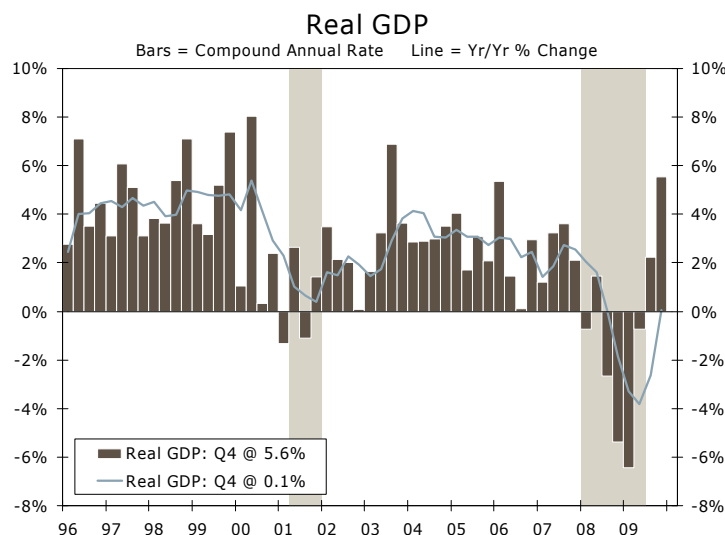
FOMC Decision • Tuesday

The FOMC is expected to hold the target fed funds rate unchanged in the 0 to 0.25 percent target range when it meets this week. Taking its cue from the most recent Beige Book report that showed a broadening of the economic expansion, the statement is likely to highlight that the U.S. economy continues to strengthen. Still the caveats that high unemployment, modest income growth, lower housing wealth and tight credit will constrain household spending will remain in place. The housing recovery is on shaky ground and non-residential construction continues to contract. The committee will likely conclude that conditions continue to warrant leaving rates “exceptionally low” for an “extended period.” Markets will be waiting to see if Kansas City President Hoenig remains the lone dissenter or if others join the opposition. Hoenig is concerned that the extended period language is leading to financial imbalances.

Previous: 0.25%

Wells Fargo: 0.25%

Consensus: 0.25%



Employment Cost Index • Friday

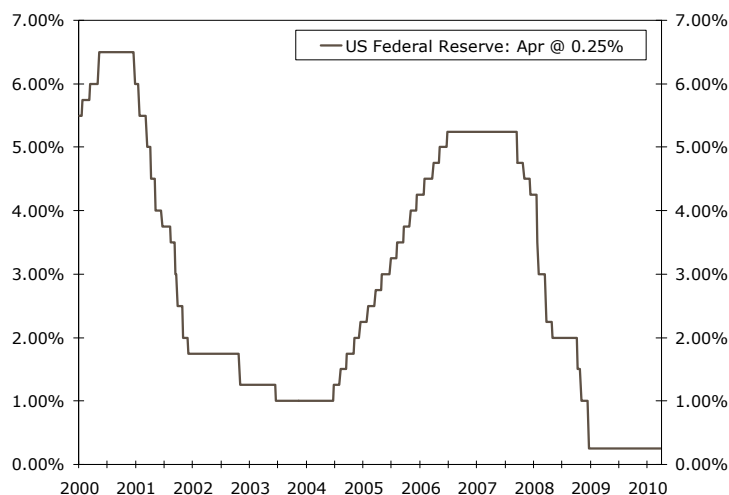
The Employment Cost Index is expected to rise at a modest 0.5 percent rate in the first quarter. This is slightly faster than the 0.3 percent gain in the first quarter of last year, which marked the smallest quarterly gain in this series since its inception in 1982. The quarterly gains have been subdued for more than a year now. The year-on-year increase stands at a new all-time low of 1.5 percent, where it has been since the third quarter of last year. A weak first quarter would keep the year-on-year rate near that all-time low. Wages and benefits are both expected to increase at a modest 0.5 percent pace in the first quarter. Benefit costs have been following wage growth lower over the past two years. Benefit costs grew in the 3.0 to 3.5 percent range in 2007, but now have also slumped to a tame 1.5 percent year-on-year growth rate in the fourth quarter of 2009.

Previous: 0.5%

Wells Fargo: 0.5%

Consensus: 0.5%

U.S. Federal Reserve Target Rate



Q1 GDP Advance • Friday

First quarter GDP is expected to advance 3.5 percent at an annual rate, slower than the 5.6 percent pace in the fourth quarter. Inventories should contribute less in the first quarter than they did in the fourth quarter when they added 3.8 percentage points to GDP growth. On a bright note, consumer spending is expected to accelerate around 2.8 percent, far stronger than the 1.6 percent growth rate in the fourth quarter. Fixed investment is likely to remain subdued, however, as equipment and software spending slows, and commercial construction continues to contract at a double-digit pace. Net exports are likely to be a small net drag in the first quarter as stronger consumer spending and rising energy prices push imports higher. The GDP chain price index is likely to accelerate a bit to a 1.4 percent growth rate, largely on rising energy and commodity prices, though still well within the Fed's tolerance level.

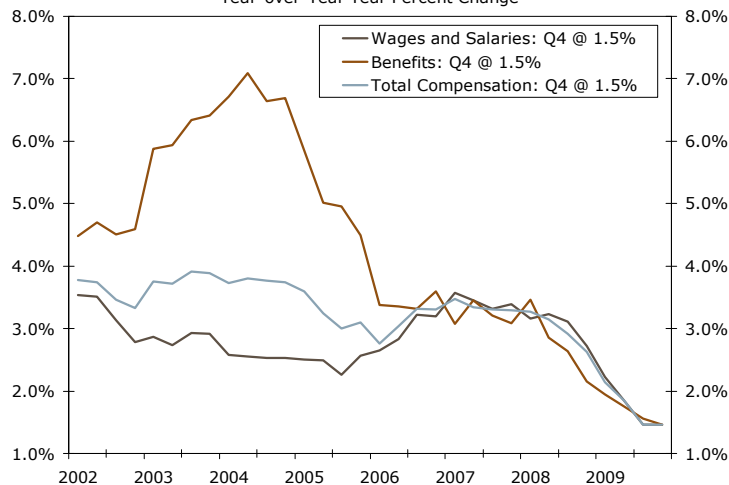
Previous: 5.6%

Wells Fargo: 3.5%

Consensus: 3.4%

Employment Cost Index

Year-over-Year Year Percent Change



Global Review

U.K. Economy Continues to Limp Along

Data released this week showed that the British economy expanded for the second consecutive quarter (see graph on front page). However, the 0.2 percent growth rate (0.8 percent at an annualized rate) that was registered in the first quarter can hardly be characterized as “robust.” Although the U.K. economy is technically in recovery, it may not feel like much of a recovery yet to most British consumers and businesses.

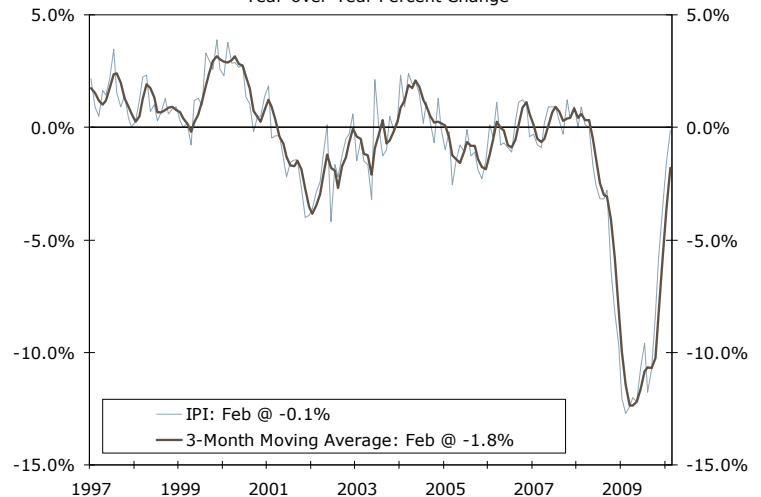
The good news is that industrial activity appears to be rebounding. Industrial production (IP) rose 0.7 percent, the strongest quarterly rise in four years (top chart). Businesses have been liquidating inventories since the end of 2008, and some of the increase in IP in the first quarter may reflect a swing in the inventory cycle. (A breakdown of real GDP in the first quarter into its underlying demand components will not be available for a few more weeks.)

The bad news, however, is that other sectors of the economy struggled in the first quarter due, at least in part, to some temporary factors. The harsh winter may help to explain the 0.7 percent contraction in the construction sector in the first quarter. The service sector, which accounts for roughly three quarters of the U.K. economy, expanded only 0.2 percent. In that regard, the increase in the value-added tax that took effect on January 1 appears to have weighed on consumer spending. Indeed, the volume of retail sales rose 1.2 percent in the fourth quarter of 2009—before the increase in the VAT took effect, but spending fell back 0.6 percent in the first quarter (middle chart).

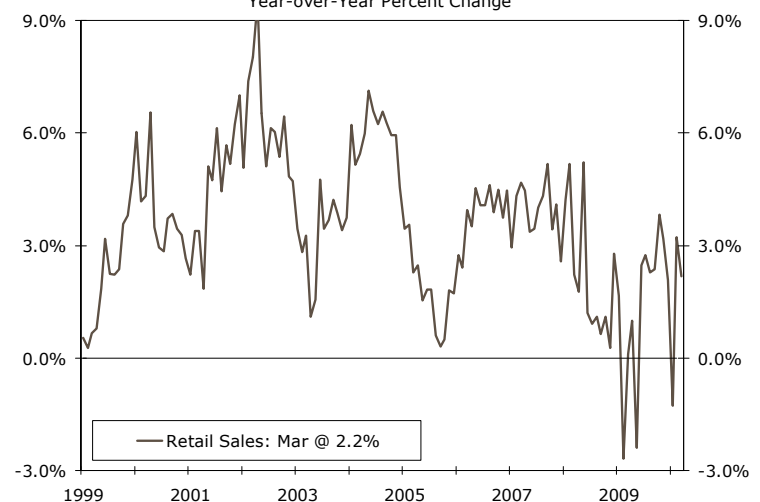
Although the tepid growth rate in the first quarter could be revised modestly higher, the bottom line is that the U.K. economy recovery is not very strong at present. Looking forward, overall economic growth likely will strengthen over the next quarter or two as the temporary factors that depressed activity fade. Growth in consumer spending should be positive in the second quarter, and survey data suggest that industrial production has continued to expand thus far as well. However, the sluggish upturn in the Euro-zone, to which Great Britain sends about 60 percent of its exports, likely will preclude a rapid expansion in exports, and necessary fiscal tightening after the May 6 general election may exert a headwind on growth as well.

With a sluggish economy, one would expect CPI inflation to be quite low. However, the overall inflation rate bounced up from 3.0 percent in February to 3.4 percent in March, which is well above the Bank of England's target of 2 percent. Some of the increase in inflation over the past few months can be explained by the increase in the VAT and the depreciation of sterling that has helped to lift import prices. These effects should fade in the months ahead, which will allow inflation to retreat again. However, the fact that inflation is more than a full percentage point above target is an embarrassment to the Bank. Although we do not look for the Bank to tighten policy anytime soon, the above-target inflation rate probably will preclude further easing steps for the foreseeable future.

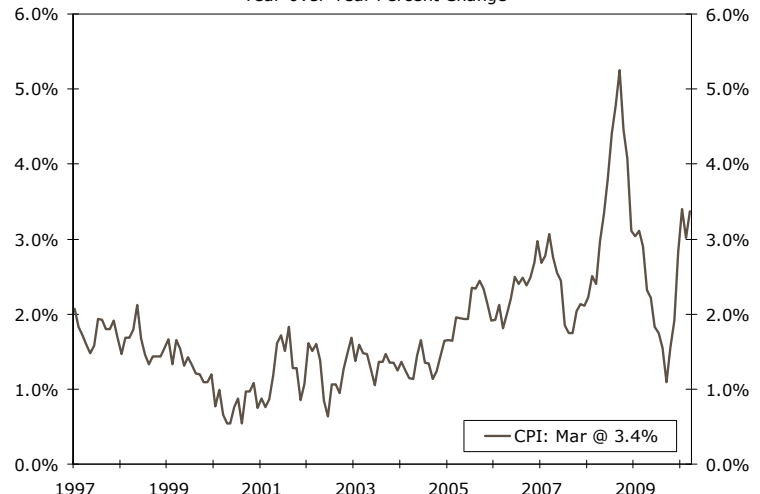
U.K. Industrial Production Index
Year-over-Year Percent Change



United Kingdom Retail Sales
Year-over-Year Percent Change



U.K. Consumer Price Index
Year-over-Year Percent Change



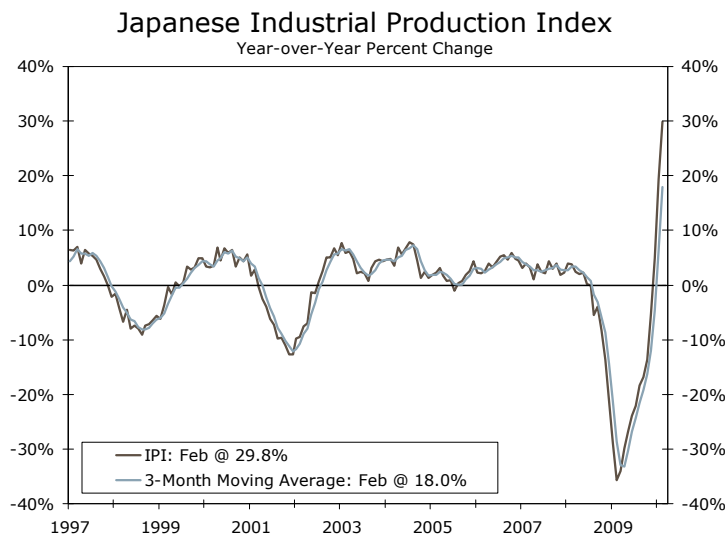
Australian CPI Inflation • Wednesday

Earlier this month the Reserve Bank of Australia (RBA) raised the benchmark overnight cash rate to 4.25 percent—the fifth increase since the RBA began raising rates last fall.

The Australian economy was among the few developed economies in the world to escape the global financial crisis without falling into recession, and the swift rate of recovery there is stoking concerns about inflation and putting the pressure on the RBA to keep their foot on the brakes with more rate hikes. Since the last meeting of the RBA, data released on employment showed that the growing Australian economy created another 19,600 jobs. With the unemployment rate now at a low 5.3 percent, there is some risk of labor shortages, which can push earnings higher and further stoke inflation worries. On Wednesday, CPI data for Q1 will give market-watchers a better sense of the inflation situation in Australia.

Previous: 2.1% (Year-over-year)

Consensus: N/A



Euro-zone CPI Inflation • Friday

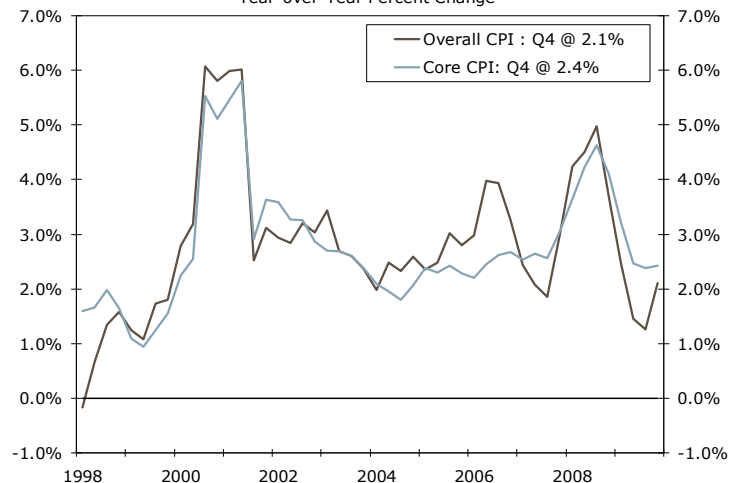
The European Central Bank (ECB) has one mandate, “price stability”, which it defines as an inflation rate that is “below, but close to, 2 percent over the medium term.” By that definition, prices are currently “stable” in the Euro-zone because the overall CPI inflation is only 1.5 percent at present and the core inflation rate is 1.0 percent. Moreover, growth in the M3 money supply, which is an important variable for the ECB, is currently flat. In other words, there are few inflationary pressures in the Euro-zone at present, which we expect will be reinforced by the “flash” estimate of CPI inflation in April.

Other data highlights in the euro area next week include M3 money supply data for March and indices of consumer and business confidence.

Previous: 1.5% (year-over-year rate) Wells Fargo: 1.5%

Consensus: 1.5%

Australian Consumer Price Index
Year-over-Year Percent Change



Japanese Industrial Production • Friday

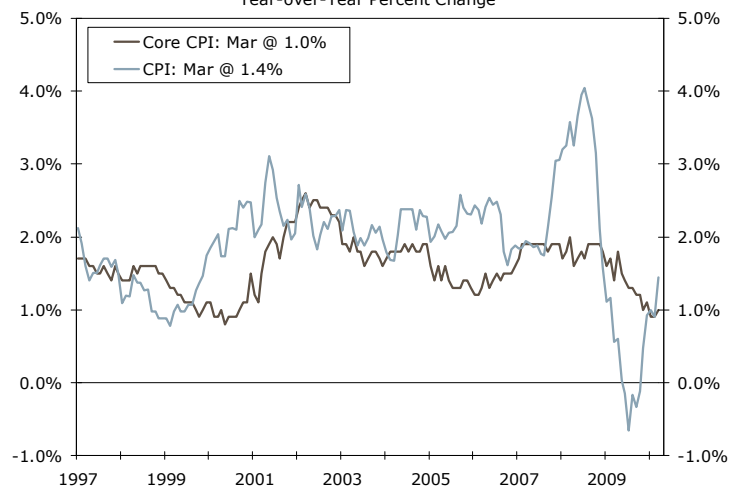
The last week of every month usually brings a barrage of Japanese economic data including industrial production (IP), retail spending, CPI inflation and the unemployment rate. On a year-over-year basis, growth in industrial production has been off the charts recently. However, the apparent surge in IP reflects, at least in part, the collapse that occurred early last year. Although IP is up about 30 percent from its low, it remains 15 percent below its previous peak. The consensus forecast anticipates that IP in March regained the modest decline it experienced during the previous month.

Retail spending has started off the year on a strong note, at least by Japanese standards, so it will be interesting to see whether sales in March remained solid. CPI data are expected to show that Japan remains mired in a mild case of deflation. Therefore, the Bank of Japan likely will keep policy unchanged for the foreseeable future.

Previous: -0.7% (month-on-month change)

Consensus: 0.7%

Euro-zone Consumer Price Inflation
Year-over-Year Percent Change



Interest Rate Watch

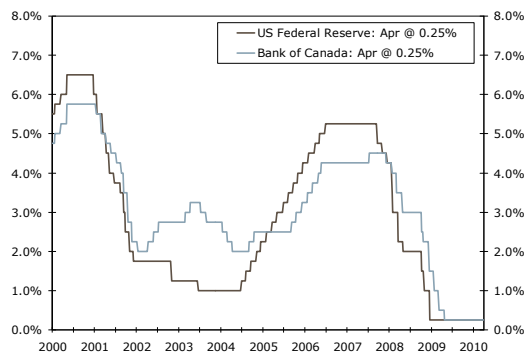
Does BoC Have Relevance for Fed?

The Bank of Canada (BoC) surprised investors at the conclusion of its regularly scheduled policy meeting on Tuesday. As widely expected, the BoC kept its policy rate unchanged at only 0.25 percent, where it has been maintained for the past 12 months. However, the BoC removed its commitment to keep the policy rate unchanged until the end of the second quarter of 2010. With only one more meeting scheduled between now and the end of the second quarter, the BoC is in effect signaling that it intends to hike rates on June 1. Does the BoC's intention to hike rates mean that the Fed is about to embark on the same course?

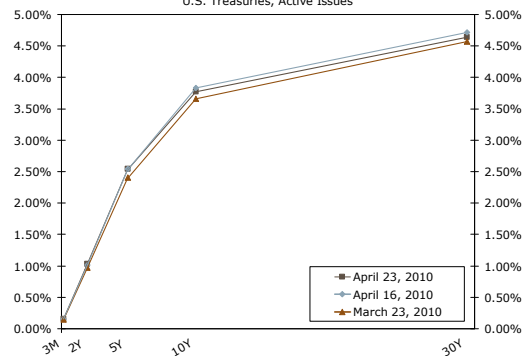
Not really, because Canada and the United States are at slightly different points in their respective economic cycles. Canada experienced a painful recession, but it was not quite as deep as in the United States. Canada's unemployment rate rose only 2-½ percentage points versus 5-½ percentage points in America. In its statement the BoC said "the need for such extraordinary policy is now passing, and it is appropriate to begin to lessen the degree of monetary stimulus." Otherwise, inflation could undershoot the Bank's target of 2 percent if the Canadian economy continues to rebound rapidly.

Although there is a high degree of correlation between the BoC's policy rate and the fed funds target rate, the two policy rates have not moved in lockstep nor necessarily in the same direction in the short term (top chart). Policymakers in different countries obviously talk to each other, but only rarely do they coordinate policies explicitly. The Fed will hike rates only if it is appropriate for the U.S. economy, not because some other central bank is tightening policy. If the U.S. economy continues to post above trend growth rates, then the Fed may begin to tighten policy before most investors expect. However, we believe growth will slow somewhat over the next few quarters as the temporary boost from the inventory cycle fades. Therefore, we remain comfortable in our view, at least for now, that the Fed will be on hold until late this year.

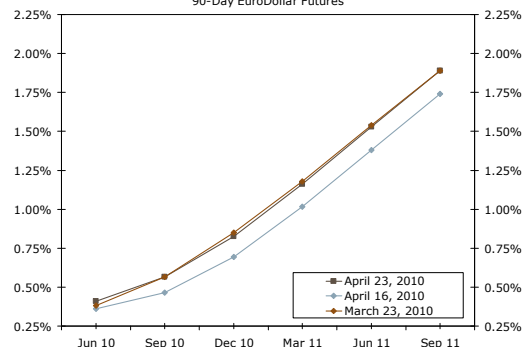
Central Bank Policy Rates



Yield Curve
U.S. Treasuries, Active Issues



Forward Rates
90-Day EuroDollar Futures



Consumer Credit Insights

What Is Fueling the Consumer?

While the overall economic recovery has been mixed, the recent resilience of the consumer and the rebound in real retail sales growth the last few months has been stronger than expected. With unemployment still near 10 percent, foreclosures still rampant, credit still extremely tight and real wages stagnant, what is driving this improvement in consumer spending?

A number of factors combined to bolster consumer spending, even as the broader economy continues to struggle. The housing market is stabilizing as prices, starts and sales rebounded, thanks primarily to the homebuyer tax credit. It remains to be seen whether or not the recovery in residential real estate will continue after the rebate expires in June. The stock market has rallied roughly 70 percent since the March 2009 lows, lifting the wealth effect. While the unemployment rate remains high, there are early signs that the labor market may finally be entering the early stages of recovery. We are a long way from the kind of payroll growth that would generally be associated with robust income growth and increased consumer spending, but it is a relative improvement from where we were a year ago.

Individual tax refunds are running ahead of year-ago levels, which is padding consumer's wallets. Finally, statistics aside, perhaps after a long winter, warmer weather is drawing consumers out of the house and into the stores.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	5.07%	5.07%	4.99%	4.80%
15-Yr Fixed	4.39%	4.40%	4.34%	4.48%
5/1 ARM	4.03%	4.08%	4.14%	4.85%
1-Yr ARM	4.22%	4.13%	4.20%	4.82%
MBA Applications				
Composite	550.5	484.6	595.0	1,172.2
Purchase	240.1	218.0	227.5	253.0
Refinance	2,371.0	2,047.1	2,744.7	6,540.7

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

Topic of the Week

Tax Credit Finally Takes Hold Again

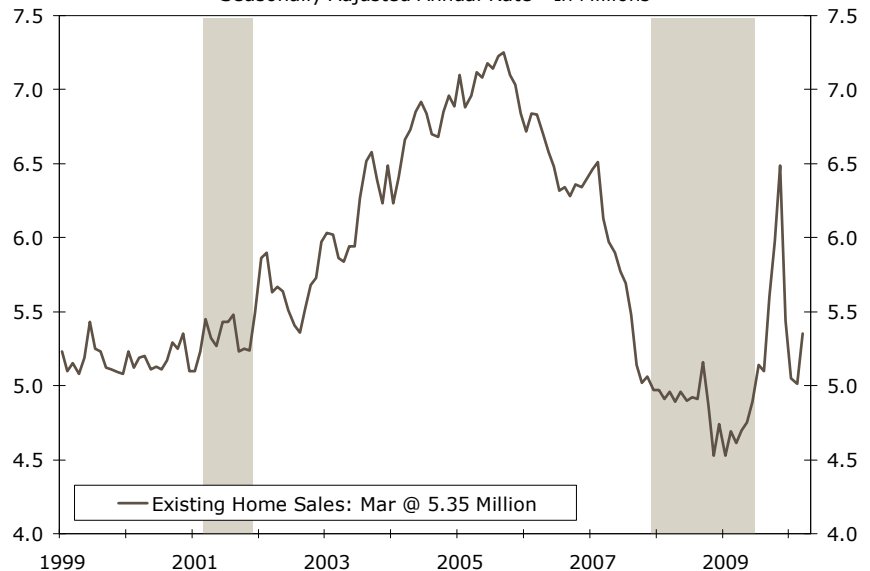
The extension and expansion of the first-time homebuyer tax credit finally started to push activity higher in March. We saw a solid gain in existing home sales and a startling jump in new home sales this week as well. However, we still have some concerns about the ex-stimulus pace of growth in housing.

From the start, the housing recovery has been on a very shaky foundation of tax incentives, artificially low mortgage rates and unprecedented assistance to struggling homeowners. None of these programs are sustainable. The real problems with the housing market center around three fairly simple concepts. First, home sales were too strong during the boom years, and demand was effectively pulled forward. Second, credit underwriting has tightened considerably, effectively shutting out many potential buyers. And third, the deep recession, which sent the unemployment rate up to 10 percent, led to a sharp reduction in household formations and fundamentally reduced the demand for housing. The painful truth is that there is no quick fix to any of these problems, and the recovery in housing is likely to be longer and more arduous than many expect.

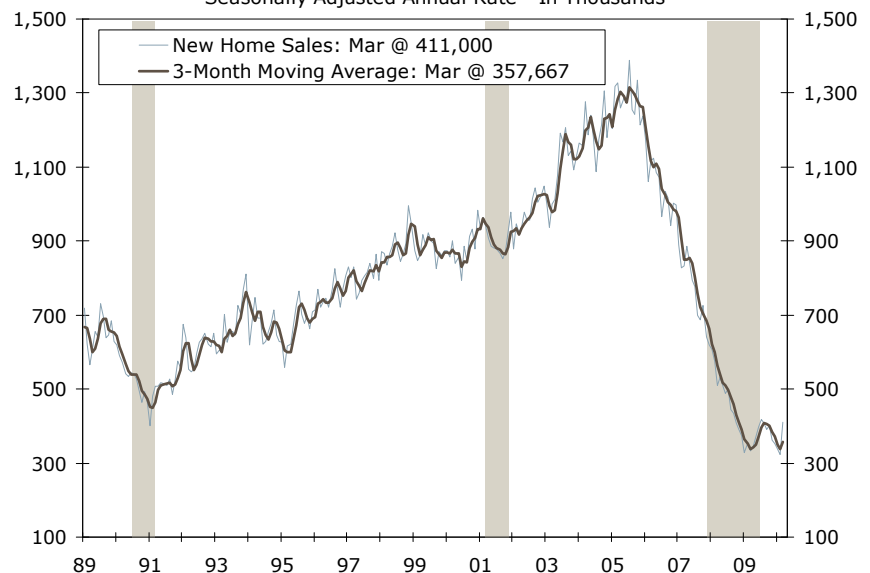
While none of this should come as a surprise to anyone associated with the housing industry, we have been struck by some of the more upbeat forecasts for home sales and new home construction we have seen in recent months. Many of these forecasts appear to be built around the signs of stability that appear to be returning to some of the nation's more troubled hot spots. In many of these areas, home sales have risen, inventories of new and existing homes for sale have decreased, and prices have increased. This improvement, however, has come about amid unprecedented support of the housing market, including various efforts to forestall foreclosures and numerous programs to provide subsidized mortgages.

For further details please see our latest *Housing Chartbook*, which is available on our website.

Existing Home Resales
Seasonally Adjusted Annual Rate - In Millions



New Home Sales
Seasonally Adjusted Annual Rate - In Thousands



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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 4/23/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.15	0.15	0.10
3-Month LIBOR	0.32	0.31	1.09
1-Year Treasury	0.39	0.37	0.42
2-Year Treasury	1.05	0.95	0.92
5-Year Treasury	2.58	2.47	1.88
10-Year Treasury	3.81	3.76	2.92
30-Year Treasury	4.65	4.67	3.79
Bond Buyer Index	4.37	4.43	4.57

Foreign Exchange Rates

	Friday 4/23/2010	1 Week Ago	1 Year Ago
Euro (\$/€)	1.336	1.350	1.314
British Pound (\$/£)	1.536	1.536	1.472
British Pound (£/€)	0.870	0.879	0.893
Japanese Yen (¥/\$)	94.150	92.170	97.960
Canadian Dollar (C\$/¥)	1.003	1.013	1.223
Swiss Franc (CHF/\$)	1.074	1.061	1.151
Australian Dollar (US\$/A\$)	0.922	0.924	0.715
Mexican Peso (MXN/\$)	12.193	12.276	13.180
Chinese Yuan (CNY/\$)	6.827	6.826	6.830
Indian Rupee (INR/\$)	44.436	44.330	49.930
Brazilian Real (BRL/\$)	1.766	1.758	2.205
U.S. Dollar Index	81.446	80.824	85.517

Foreign Interest Rates

	Friday 4/23/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.59	0.58	1.40
3-Month Sterling LIBOR	0.66	0.65	1.49
3-Month Canadian LIBOR	0.51	0.43	0.90
3-Month Yen LIBOR	0.24	0.24	0.56
2-Year German	0.90	0.89	1.45
2-Year U.K.	1.30	1.13	1.29
2-Year Canadian	1.99	1.88	0.99
2-Year Japanese	0.17	0.17	0.41
10-Year German	3.06	3.08	3.22
10-Year U.K.	4.05	3.98	3.52
10-Year Canadian	3.68	3.68	3.00
10-Year Japanese	1.32	1.35	1.44

Commodity Prices

	Friday 4/23/2010	1 Week Ago	1 Year Ago
WTI Crude (\$/Barrel)	84.52	83.24	49.62
Gold (\$/Ounce)	1154.30	1137.40	904.30
Hot-Rolled Steel (\$/S.Ton)	645.00	615.00	400.00
Copper (¢/Pound)	349.75	351.15	201.30
Soybeans (\$/Bushel)	9.89	9.69	10.36
Natural Gas (\$/MMBTU)	4.18	4.04	3.41
Nickel (\$/Metric Ton)	27,035	27,165	11,458
CRB Spot Inds.	513.28	512.90	358.08

Next Week's Economic Calendar

	Monday 26	Tuesday 27	Wednesday 28	Thursday 29	Friday 30
U.S. Data		Consumer Confidence	FOMC Rate Decision		GDP
		March 5 2.5	Previous 0.25 %		4 Q 5.6 %
		April 5 4.9 (W)	Expected 0.25 % (W)		1 Q 3.5 % (W)
					Employment Cost
					4 Q 0.5 %
					1 Q 0.5 % (W)
Global Data			Australia	Germany	Eurozone
			CPI (YoY)	Unemployment Rate	CPI (YoY)
			Previous (4 Q) 2.1 %	Previous (Mar) 8.0 %	Previous (Mar) 1.4 %
			Japan		Japan
			Retail Trade (MoM)		Industrial Prod.
			Previous (Feb) 0.9 %		Previous (Feb) -0.7 %

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	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
Adam G. York	Economist	(704) 715-9660	adam.york@wellsfargo.com
Ed Kashmarek	Economist	(612) 667-0479	ed.kashmarek@wellsfargo.com
Tim Quinlan	Economist	(704) 374-4407	tim.quinlan@wellsfargo.com
Kim Whelan	Economic Analyst	(704) 715-8457	kim.whelan@wellsfargo.com
Yasmine Kamaruddin	Economic Analyst	(704) 374-2992	yasmine.kamaruddin@wellsfargo.com

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