February 19, 2010

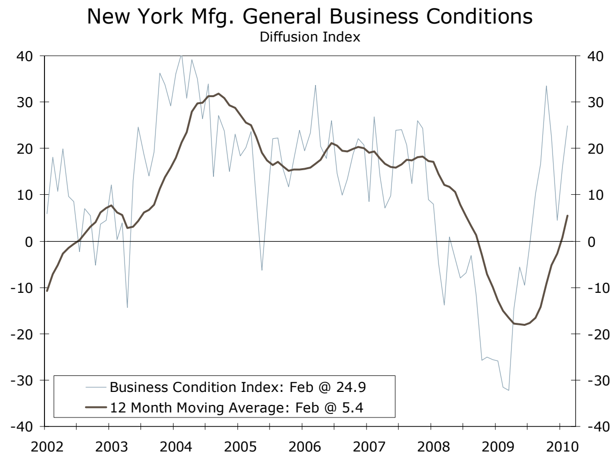
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

The Fed Moves to End its Extraordinary Policy Ease

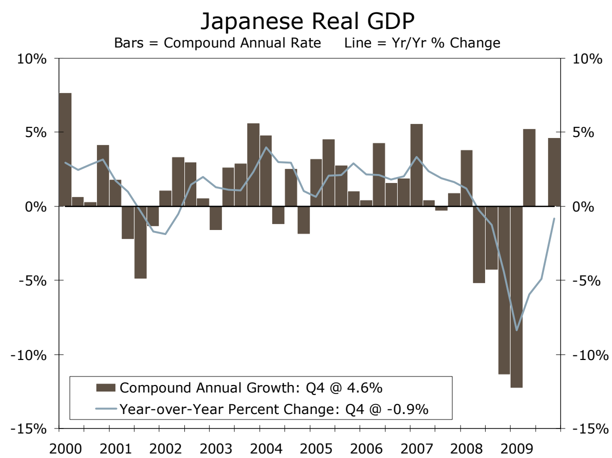
- Regional manufacturing surveys showed a stronger rebound in orders and production than had been expected. Industrial production also rose solidly.
- January's inflation data were mixed, with import prices and pipeline inflation up sharply and the Consumer Price Index rising slightly less than expected.
- The Federal Reserve raised the discount rate by a quarter percentage point late Thursday afternoon.



Global Review

Japan's Q4 Growth Shows Recovery Has Staying Power

- Japan's GDP rebounded at a stronger-than-expected 4.6 percent annualized pace in the fourth quarter, reducing fears of a relapse back into recession.
- Exports led the gains in Q4, as expected, but the real surprise was the healthy follow-through from Japanese consumers and non-residential fixed investment, which revealed that a more-balanced expansion is currently underway.
- Japan's GDP fell 5.0 percent in 2009 and is expected to advance 2.6 percent in 2010.



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]	-6.4	-0.7	2.2	5.7	3.7	1.7	1.9	2.3	2.7	2.1	0.4	-2.4	2.9	2.4
Personal Consumption	0.6	-0.9	2.8	2.0	1.9	0.8	1.3	1.5	2.9	2.6	-0.2	-0.6	1.6	1.7
Inflation Indicators [2]														
"Core" PCE Deflator	1.7	1.6	1.3	1.4	1.3	1.2	1.2	1.3	2.3	2.4	2.4	1.5	1.2	1.7
Consumer Price Index	-0.2	-0.9	-1.6	1.5	2.6	2.6	2.1	1.7	3.2	2.9	3.8	-0.3	2.2	2.1
Industrial Production [1]	-19.0	-10.4	6.9	7.0	6.8	3.9	3.4	6.5	2.3	1.5	-2.2	-9.7	4.7	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	74.0	74.9	76.0	78.5	81.5	73.3	79.4	74.7	78.5	82.3
Unemployment Rate	8.2	9.3	9.6	10.0	9.8	9.9	10.2	10.1	4.6	4.6	5.8	9.3	10.0	9.7
Housing Starts[4]	0.53	0.54	0.59	0.55	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: February 10, 2010
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change

U.S. Review

When Ben Bernanke Talks, People Listen

Sometimes Ben Bernanke does not even have to speak. Just one week after the Fed Chairman released his testimony, in which he stated that "'before long" the Fed would raise the discount rate and return it to the spread over the federal funds that existed before the crisis, the Fed acted. We now know the meaning of "before long," at least as it relates to Fed policy.

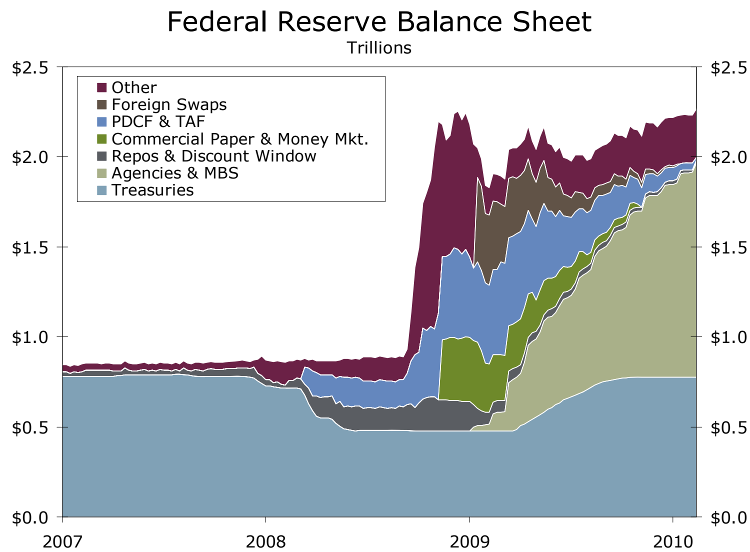
Our initial read from the Fed's move is that it intends to stay very close to the script Ben Bernanke laid out to reverse the extraordinary actions it put in place to fight the financial crisis. Those actions contributed to an enormous expansion of the Fed's balance sheet and heightened concerns about whether the Fed could adequately contain or reverse this extraordinary stimulus without putting the recovery at risk or creating an environment, in which inflation might accelerate.

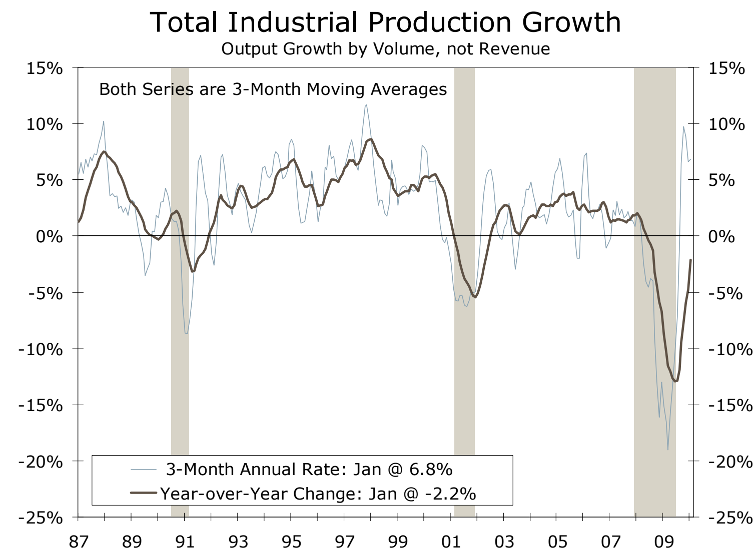
Bernanke noted that returning the discount rate back to its normal relationship to the federal funds rate should not be seen as a tightening move but rather a return to a more normal monetary policy. Maybe that is why the Fed chose to announce its move along with the regular weekly release of the monetary aggregates, whose influence the Fed has also traditionally downplayed. Specifically the Fed noted its policy actions were "not expected to lead to tighter financial conditions for households or businesses and do not signal any change in the outlook for the economy or monetary policy." Monetary policy is still extremely easy, with the federal funds rate close to zero. All that has changed is that the era of extremely cheap money is beginning to end.

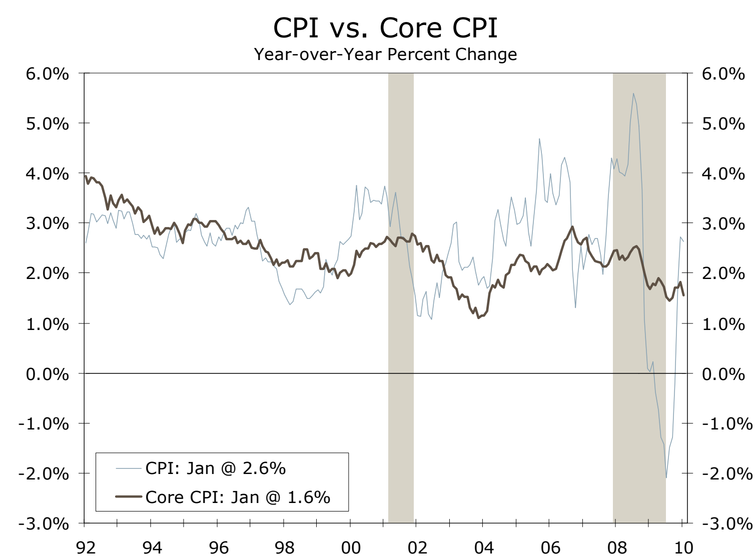
There was a pretty full set of economic reports released this week, including a number of reports on the manufacturing sector. Most of the regional manufacturing surveys, including the New York Fed's Empire Manufacturing Survey and the Philadelphia Fed survey, came in stronger than expected. The Empire Survey rose nearly nine points to 24.9. The employment component rose for the second month in a row and is now solidly positive at 5.56. Manufacturers also seem to have a better handle on inventories.

Industrial production rose 0.9 percent in January, with solid gains across most categories. Output in the manufacturing sector rose 1.0 percent, with output of consumer goods and business equipment rising solidly. Production of IT equipment remains a notable bright spot, with production climbing 1.7 percent. Utility output, which surged in December, rose a much more moderate 0.7 percent in January. February's cold temperatures should send output even higher in next month's report.

The inflation data were clearly mixed. Import prices continue to rebound off last year's sharp declines. The overall index jumped 1.4 percent in January, while prices excluding petroleum rose 0.6 percent. The Producer Price Index also registered a larger-than-expected gain, climbing 1.4 percent. The Consumer Price Index was much tamer, however, rising just 0.2 percent overall and falling 0.1 percent after excluding food and energy items. Sharply lower prices for hotels and lodging accounted for the smaller-than-expected overall rise and most of the drop in the core.





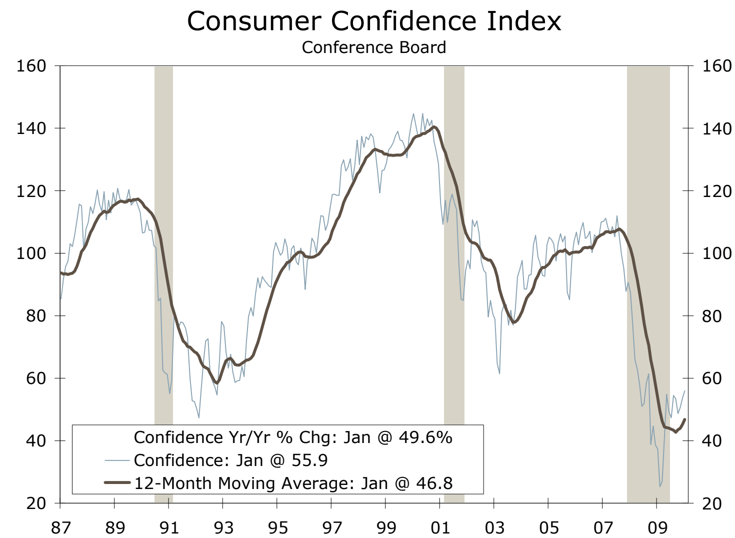


Consumer Confidence • Tuesday

Consumer confidence rose 2.3 points to 55.9 in January, its highest level in nearly a year and a half. Both the present situation and expectations series increased, while the labor market differential improved slightly. With various economic indicators suggesting the economy is in recovery, we expect consumer confidence will likely rise for the third consecutive month. Consumers' assessment of current economic conditions rose 4.8 points but remains near cycle lows. Consumers' ongoing concerns about current conditions reflect worries about the labor market. Layoffs appear to have topped out, but hiring remains sluggish. During the past two recoveries, the current conditions component did not improve significantly until nonfarm employment began to increase. Accordingly, we expect consumer confidence and spending will likely remain constrained through early 2010.

Previous: 55.9 **Wells Fargo: 57.0**

Consensus: 54.8

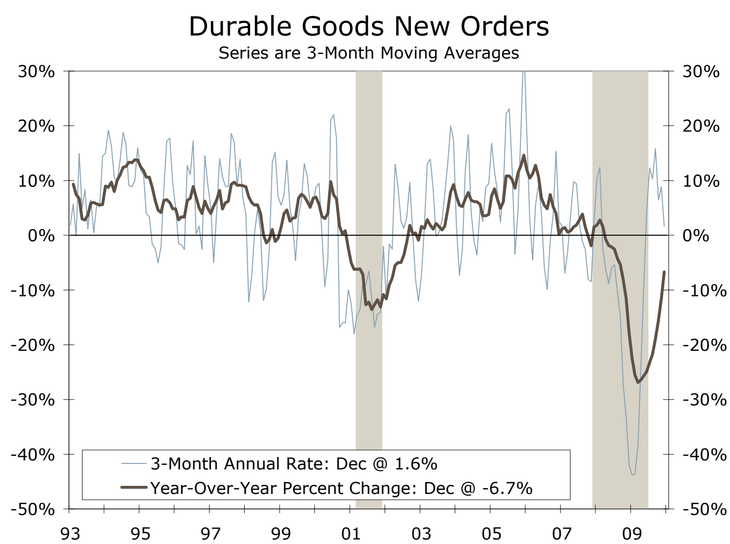


Durable Goods Orders • Thursday

New orders for durable goods rose 0.3 percent in December, but were restrained by a decline in nondefense aircraft orders. While the headline tends to be extremely volatile on a month-to-month basis, the three-month annual rate of new nondefense capital goods orders, excluding aircraft, is a better gauge of manufacturing activity. That figure has remained positive for seven consecutive months and increased at a 10.7 percent annual rate in December. Recent gains in industrial production and the ISM Manufacturing Index also suggest a similar trend for new orders in January. On a year-ago basis, industrial production had the largest gain in nearly two years with manufacturing up 1.7 percent. Moreover, the ISM Manufacturing Index also rose with the forward-looking new orders index at a level last seen five years ago. Consequently, we expect new orders rose 1.1 percent in January. New orders excluding transportation should see a gain of 0.9 percent.

Previous: 0.3% **Wells Fargo: 1.1%**

Consensus: 1.4%

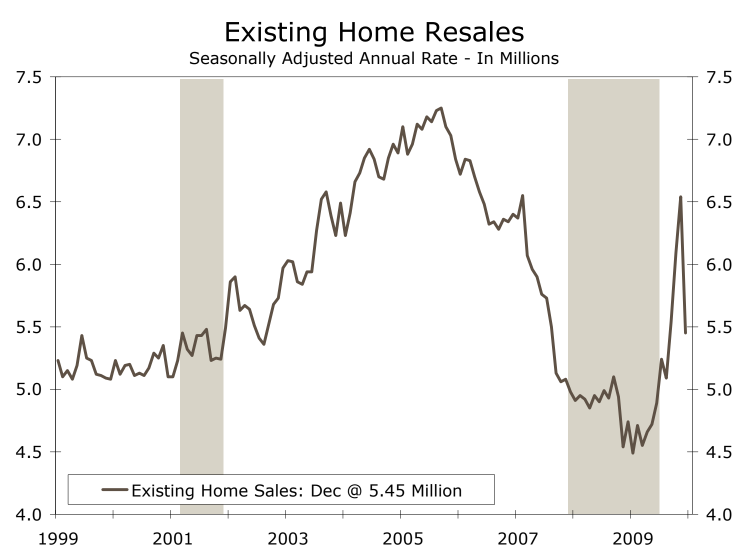


Existing Home Sales • Friday

Sales of existing homes fell 16.7 percent in December to a 5.4 million unit annual rate. Existing home sales likely fell due to the originally anticipated end to the first time homebuyers' tax credit. While the tax credit was extended and expanded, it may be another month or two before closings catch up with activity. Moreover, uncertainty concerning the expiration of the Federal Reserve's mortgage-backed security purchase program and potential for higher mortgage rates will likely help sales in coming months, but the pace will not be sustainable. With distressed sales still representing a little less than a third of existing home sales, we are not out of the woods yet. We expect sales will decline 3.7 percent to a 5.2 million unit annual rate.

Previous: 5.4M **Wells Fargo: 5.2M**

Consensus: 5.5M



Global Review

Japan's Recovery Still Blossoming

It appears Japan's recovery is somewhat stronger and more balanced than what the consensus was expecting (assuming Japan's fourth quarter GDP figures don't get revised lower over the next few months). GDP jumped 4.6 percent at an annualized rate in Q4, though Q3 GDP growth was cut to 0.0 percent from 1.3 percent annualized, and for the year, the economy contracted 5.0 percent, the worst annual downturn since World War II. The fourth quarter rate of growth nearly matched the second quarter's 5.2 percent gain, reducing apprehension that Japan's economy is in eminent danger of slipping back into recession.

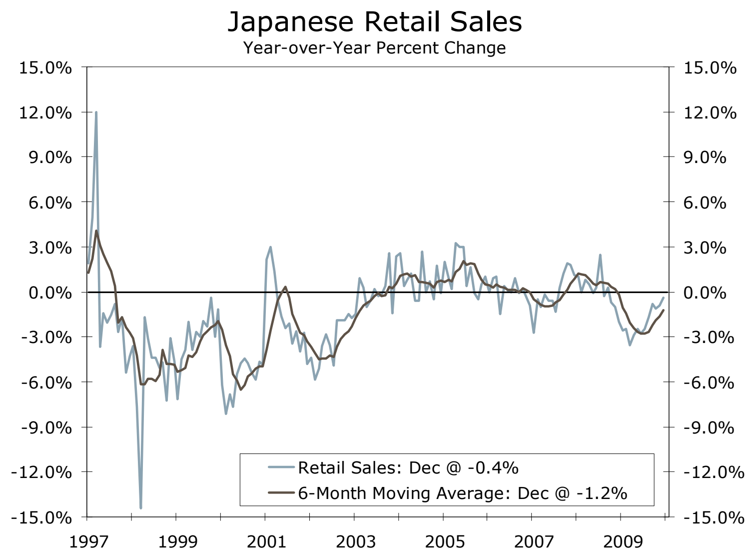
Despite fears that rampant deflation would cause Japanese consumers to retrench and hold off on purchases, government incentives seem to have been effective in enticing consumers to spend. Household consumption rose 2.8 percent at an annualized rate in the fourth quarter, adding nearly as much to GDP growth as Japan's net exports. A more stable labor market and rising consumer confidence in 2010 should keep consumer spending growing on a modest, but sustainable, path.

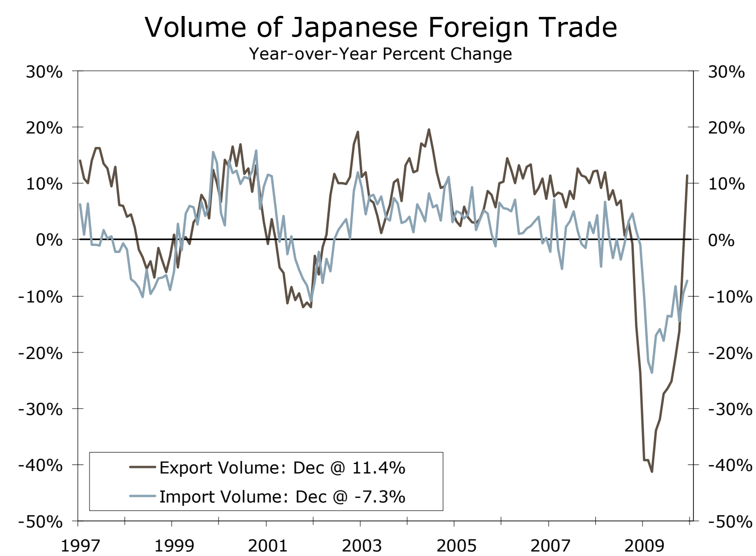
Exports were strong in the fourth quarter, rising at a 21.7 percent annualized pace. Demand from China and the United States for Japanese exports has been robust coming out of the recession. A manufacturing-, technology-, and business-spending-led recovery in the United States will be an important driver of Japanese exports going forward.

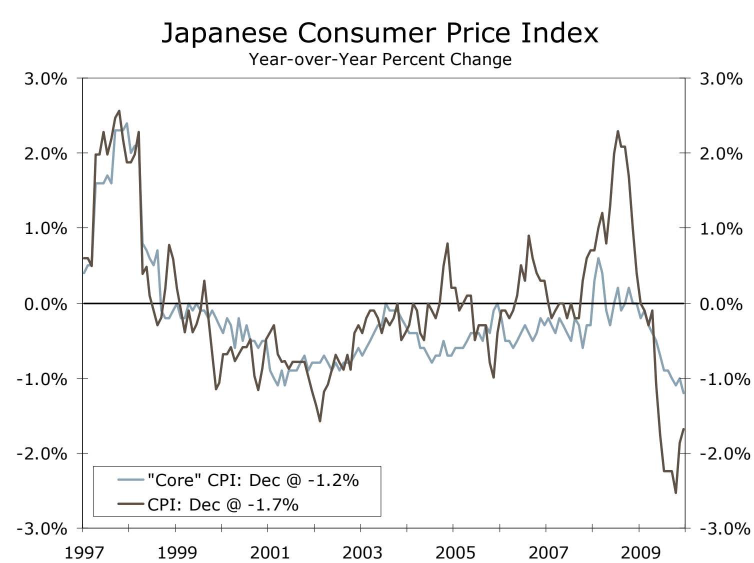
Non-residential fixed investment also rose at a healthy 4.0 percent annualized pace, an encouraging break from the past seven quarters when business investment declined significantly, and a sign that Japan's economic recovery is broadening out and moving away from mere export expansion. Residential construction still declined at a 12.8 percent annualized pace, but that was a smaller decline than in the third quarter.

Government consumption increased 3.3 percent on an annualized basis, while politically unpopular public works decreased at a 6.4 percent annualized pace. Inventory accumulation contributed marginally to growth, showing that the private inventory cycle is finally becoming a positive for the GDP data.

Still growth at the fourth quarter pace doesn't appear sustainable in 2010. Deflation is still well entrenched in Japan. The GDP deflator slipped to -3.0 percent from a year ago in Q4, though the consumption deflator improved a bit to -2.7 percent in Q4 from -2.9 percent year on year in Q3. Deflation is still a large threat to the sustainability of spending growth longer-term, especially as the government begins to scale back fiscal stimulus. Japanese fiscal debt problems dwarf those of the United States with a debt-to-GDP ratio approaching 200 percent. We expect no move this year by the Bank of Japan to raise interest rates in the face of this lingering deflation threat. This somewhat stronger GDP print in Q4 raises our 2010 GDP growth estimate to 2.6 percent from 2.1 percent. This forecast is still well above the consensus, which anticipates growth of less than 2.0 percent for 2010.







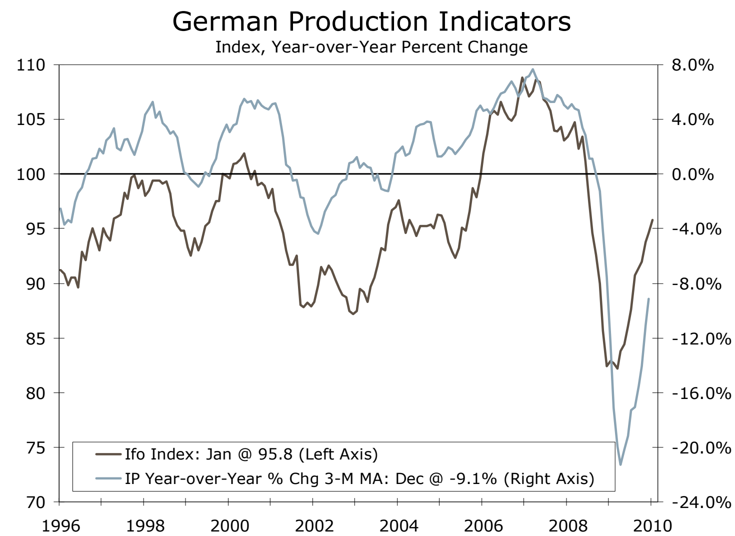
German Ifo Index • Tuesday

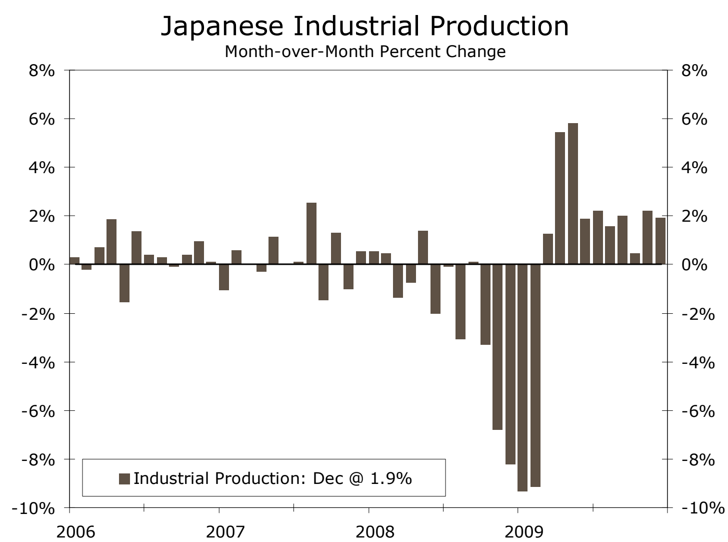
The Ifo index of German business sentiment is widely followed because it is closely correlated with industrial production. The index has now risen for ten consecutive months, and the consensus forecast expects another increase in February. Similarly positive, the "flash" estimate for the purchasing managers index, which is a separate survey, rose to a 32-month high this month.

Revised GDP data for the fourth quarter will be released on Wednesday. The initial estimate, which showed no growth in Q4 when it was released last week, did not contain a breakdown of GDP into its underlying demand components. The breakdown will be available next week, and it should help analysts understand whether the growth pause in the fourth quarter is just temporary or whether it reflects underlying weakness in the economy that will be manifested in the quarters ahead.

Previous: 95.8

Consensus: 96.2





Japanese Industrial Production • Friday

Japanese industrial production tanked in late 2008/early 2009, but it has grown for 10 consecutive months, and most analysts look for another increase when the January data print on Friday. Although the level of IP remains about 20 percent below its peak of early 2008, it has risen 30 percent from its nadir last year. Strong growth in exports has helped to boost IP over the past few months.

Industrial production is arguably the highlight, but the usual slew of monthly Japanese data releases will also print next week. Most analysts look for some bounce-back in retail sales in January following the 1.2 percent decline the previous month. CPI data will show that the Japanese economy remained in a mild case of deflation in January, although the rate of decline probably slowed somewhat. Data on international trade and housing starts in January are also on the docket next week.

Previous: 1.9% (month-on-month change)

Consensus: 1.0%

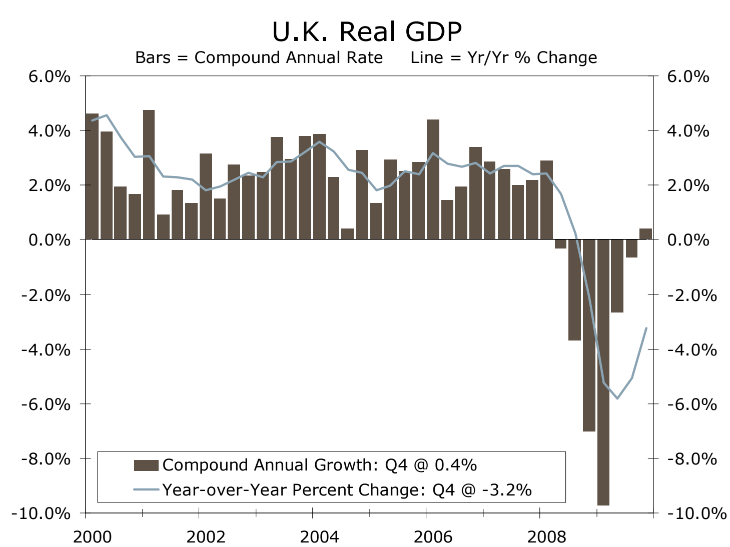
U.K. GDP • Friday

Real GDP in the United Kingdom fell 6 percent between its peak in the first quarter of 2008 and its trough in the third quarter of last year. The recession may have come to an end, but preliminary data show that the economy barely expanded in the fourth quarter as real GDP edged up at an annualized rate of only 0.4 percent.

The preliminary release a few weeks ago did not contain a breakdown of the real GDP data into its underlying demand components. This breakdown will become available next week, and it should help analysts pinpoint which sectors of the economy are expanding at present and which sectors continue to experience weakness. A widely watched series on house prices will also be released next week.

Previous: 0.1% (not annualized) **Wells Fargo: 0.1%**

Consensus: 0.2%



Interest Rate Watch

Discount Rate: Normalization Begins

Yesterday the Fed raised the discount rate citing "continued improvement in financial market conditions." Meanwhile the industrial production and leading economic index releases suggest the economy is continuing its recovery. We maintain our monetary policy call from our 2010 annual outlook that the Fed will begin to tighten policy this year and will increase the funds rate by the fourth quarter.

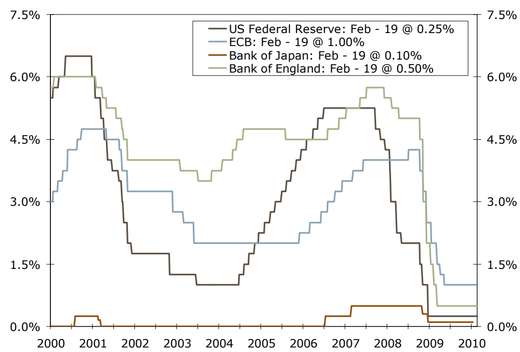
Signals of improved financial market conditions are emanating from the Senior Loan Officer Survey as well, as increased issuance of high-grade debt and leveraged loans. From the Senior Loan Officer Survey we see that the "net percentage of banks tightening standards" in the first quarter actually fell to a -5 percent, meaning that more banks were easing, not tightening, credit. The net percent of banks increasing spreads declined to 9 percent compared to 100 percent during last year. TED spreads have returned to pre-Lehman levels.

Economic Signals: Recovery

Two important indicators, industrial production and the leading economic index, suggest continued economic growth. Industrial production registered its seventh straight increase with gains in durable (computers and autos) and nondurable manufacturing. These data suggest the economic recovery began in the second quarter of 2009. Meanwhile, the leading economic index rose for the tenth straight month with improvement in vendor performance (delays rising in deliveries), stock prices and consumer expectations. Jobless claims were a negative, and that is consistent with the lag in jobs relative to the economic recovery.

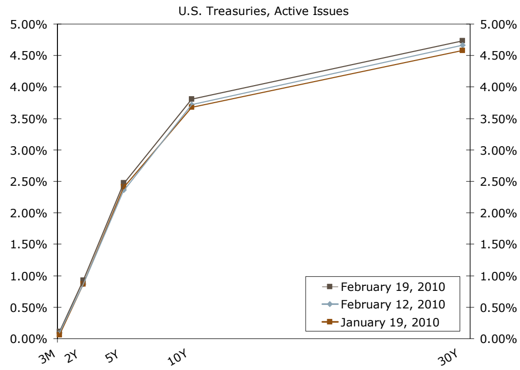
Inflation remains tame at present, so our view is that the Fed will continue to move to normalize the position of monetary policy, but until the inflation data suggest otherwise, there will be no sustained increase in policy tightening. Over the next few months we will see a sequence of moves that will clarify the outlook for rates and financial markets.

Central Bank Policy Rates



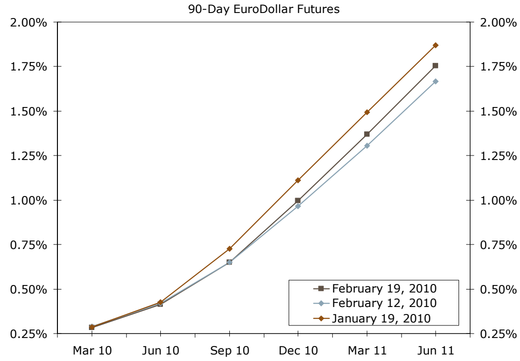
Yield Curve

U.S. Treasuries, Active Issues



Forward Rates

90-Day EuroDollar Futures



Consumer Credit Insights

Jobs Lag the Recovery, Credit too

Continued weakness in the job market brings continued delinquencies and charge-offs. In addition, rising saving rates and consumer deleveraging are both setting the stage for a more modest trajectory of consumer borrowing relative to earlier economic recoveries. Progress in the labor markets has been evident in recent months. Private sector jobs are up ex-construction, and there have been gains in the average workweek and temporary help categories. Yet the absolute loss in jobs and the continued high unemployment rate puts stress on households. The long duration of unemployment suggests that households that continue to struggle paying bills will increasingly fall even further behind in the months ahead.

Meanwhile, saving rates have moved up since April 2008. For December, the saving rate came in at 4.8 percent and our expectation is that the saving rate will come in at 5 percent plus in the years ahead. A higher saving rate means that the pace of consumer spending (and credit demand) will take a haircut and be lower than in the prior recoveries. In part, many households nearing retirement will attempt to make up for recent wealth losses. Meanwhile, many younger households will save in anticipation of higher taxes and lower real benefits from public retirement programs. The dynamics of household credit usage are changing and with them the pace and character of growth.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.93%	4.97%	4.99%	5.04%
15-Yr Fixed	4.33%	4.34%	4.40%	4.68%
5/1 ARM	4.12%	4.19%	4.27%	5.04%
1-Yr ARM	4.23%	4.33%	4.32%	4.80%
MBA Applications				
Composite	600.5	613.1	575.9	875.3
Purchase	212.3	221.2	223.0	257.3
Refinance	2,860.1	2,893.9	2,663.8	4,472.9

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

Topic of the Week

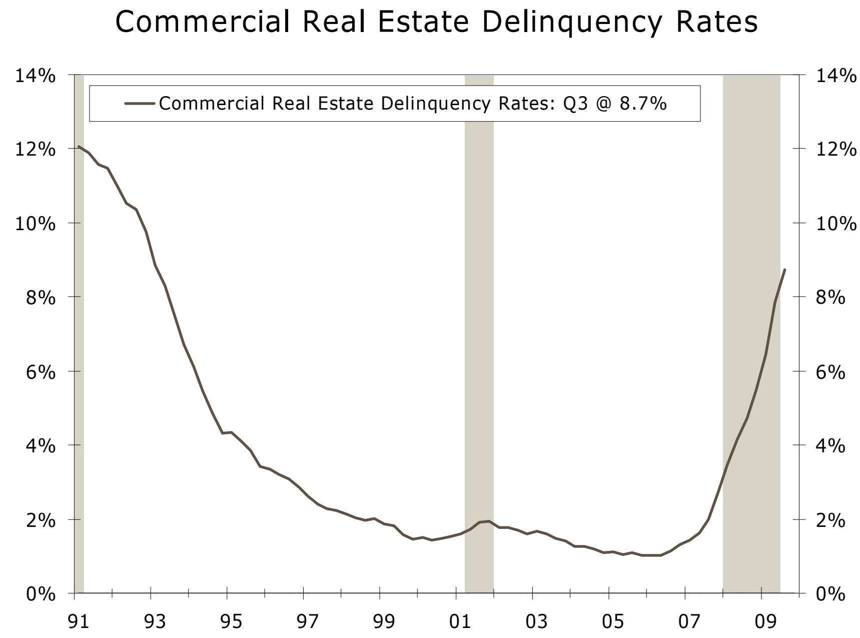
Dust Hasn't Settled for Commercial Real Estate

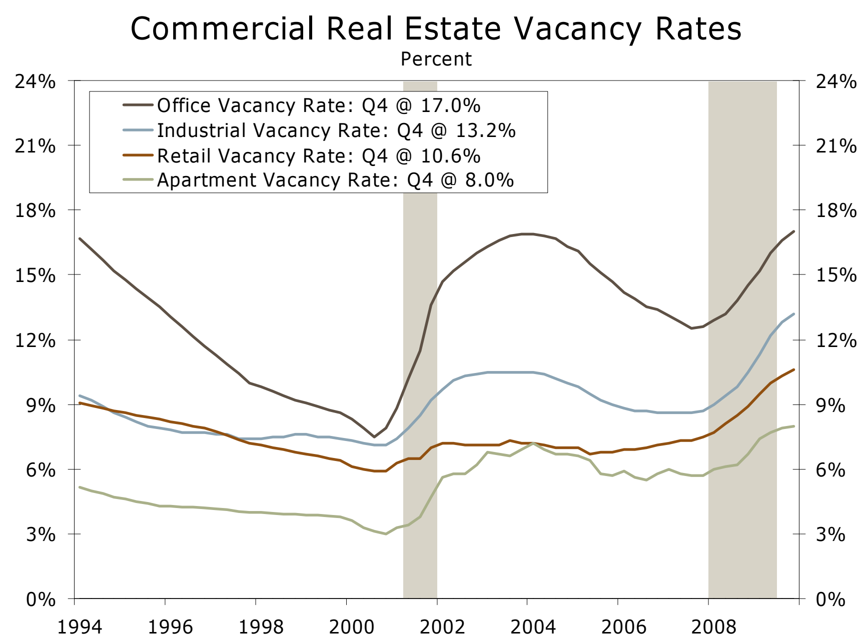
Despite robust economic growth in the second half of last year and a more upbeat assessment for economic activity during the first part of 2010, the outlook for commercial real estate has not materially improved. Credit quality is still deteriorating as delinquencies and defaults increase. Operating fundamentals continue to decline. Vacancy rates across all property types have either already risen to record highs or appear set to do so. Lending standards remain exceptionally tight, and there has been little progress at clearing up properties with maturing loans in the next few years, many of which are underwater or have seen loan-to-value (LTV) ratios skyrocket to levels that are difficult to refinance.

This list of problems is nothing new. There has been a persistent chatter about the impending dislocations that will unfold when large numbers of borrowers are unable to refinance commercial real estate loans coming due over the next two to three years. Many of these loans were made at the height of the real estate bubble, between 2005 and mid-2007, when valuations were stretched to the maximum. Economic conditions have proven to be much more difficult than the operating assumptions many of these projects expected, which means occupancy rates and rents never reached the levels needed to adequately service debt payments. As a result, values have tumbled, and many properties are now worth less than the balance due on their loans.

Given the uncertainty surrounding what awaits the financial markets, investors and lenders are more likely to treat any glimmer of light as an approaching freight train rather than the light at the end of the tunnel. We expect vacancy rates, operating fundamentals and prices to deteriorate in coming months and look for sales to gradually increase as investors become more comfortable and accustomed to the new economic and regulatory environment.

Please visit our website for the *Commercial Real Estate Chartbook*.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 2/19/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.09	0.09	0.30
3-Month LIBOR	0.25	0.25	1.25
1-Year Treasury	0.43	0.33	0.61
2-Year Treasury	0.90	0.83	0.98
5-Year Treasury	2.46	2.33	1.87
10-Year Treasury	3.80	3.69	2.85
30-Year Treasury	4.74	4.65	3.67
Bond Buyer Index	4.38	4.34	4.89

Foreign Exchange Rates

	Friday 2/19/2010	1 Week Ago	1 Year Ago
Euro ($/€)	1.353	1.363	1.267
British Pound ($/£)	1.540	1.570	1.429
British Pound (£/€)	0.878	0.868	0.887
Japanese Yen (¥/$)	91.720	89.960	94.200
Canadian Dollar (C$/$)	1.050	1.050	1.258
Swiss Franc (CHF/$)	1.084	1.075	1.174
Australian Dollar (US$/A$)	0.893	0.888	0.644
Mexican Peso (MXN/$)	12.843	12.941	14.762
Chinese Yuan (CNY/$)	6.833	6.834	6.838
Indian Rupee (INR/$)	46.306	46.500	49.623
Brazilian Real (BRL/$)	1.815	1.854	2.374
U.S. Dollar Index	81.068	79.994	87.439

Foreign Interest Rates

	Friday 2/19/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.61	0.60	1.89
3-Month Sterling LIBOR	0.64	0.64	2.07
3-Month Canadian LIBOR	0.41	0.41	1.45
3-Month Yen LIBOR	0.25	0.25	0.63
2-Year German	1.09	0.98	1.37
2-Year U.K.	1.18	1.17	1.49
2-Year Canadian	1.39	1.38	1.26
2-Year Japanese	0.16	0.17	0.39
10-Year German	3.28	3.19	3.08
10-Year U.K.	4.17	4.04	3.51
10-Year Canadian	3.50	3.47	2.90
10-Year Japanese	1.34	1.34	1.27

Commodity Prices

	Friday 2/19/2010	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	78.79	75.28	39.48
Gold ($/Ounce)	1112.98	1093.38	974.65
Hot-Rolled Steel ($/S.Ton)	545.00	545.00	475.00
Copper (¢/Pound)	326.30	312.95	146.80
Soybeans ($/Bushel)	9.36	9.20	8.83
Natural Gas ($/MMBTU)	5.08	5.40	4.08
Nickel ($/Metric Ton)	20,375	18,377	9,622
CRB Spot Inds.	481.92	471.49	336.17

Next Week's Economic Calendar

	Monday 22	Tuesday 23	Wednesday 24	Thursday 25	Friday 26
U.S. Data		**Consumer Confidence** January 55.9 February 57.0 (W)	**New Home Sales** December 342K January 350K (W)	**Durable Goods Orders** December 1.0% January 1.1% (W) **Durables Ex Transp.** December 1.4% January 0.9% (W)	**GDP** 4Q (1st) 5.7% 4Q (2nd) 5.6% (W) **Existing Home Sales** December 5.45M January 5.20M (W)
Global Data		**Germany** **IFO - Business Climate** Previous (Jan) 95.8	**Germany** **GDP (Not Annualized)** Previous (3Q) 0.7%		**UK** **GDP (Not Annualized)** Previous (3Q) -0.2% **Japan** **Industrial Prod. (MoM)** Previous (Dec) 1.9%

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

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