July 30, 2010

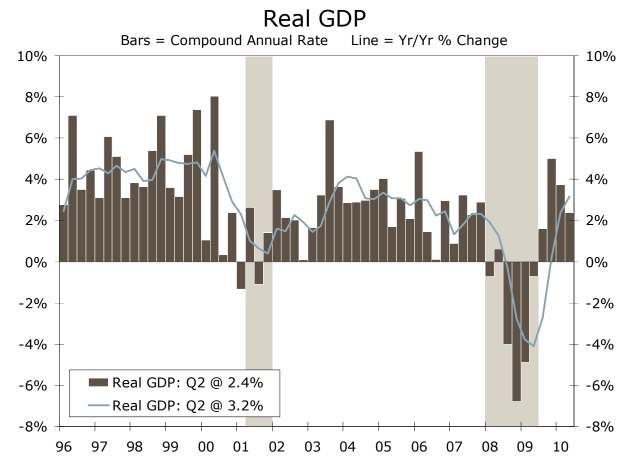
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

The Second Quarter Ended on a Soft Note

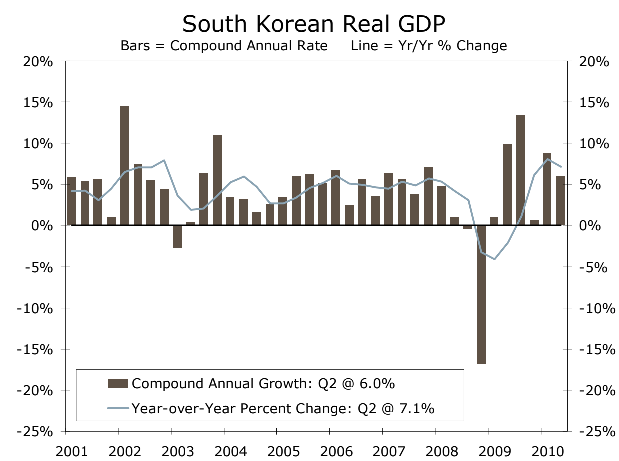
- Real GDP grew at a 2.4 percent annual rate during the second quarter, but recent data suggest the period ended on a weak note and point to a slower second half of 2010.
- New home sales rose in June, but downward revisions to April and May data show an even larger pullback following the end of homebuyer tax incentives.
- Advance orders for durable goods fell in June, and regional surveys show industrial activity losing steam.
- Consumer confidence fell in July, despite generally good news on corporate earnings and rising share prices.



Global Review

Global Economy More Resilient Than You Think

- South Korea released second-quarter GDP earlier this week, and while growth slowed from the first quarter, the pace of activity continued to surprise analysts. The South Korean economy is still humming along at a rapid clip.
- The economic data out of Europe also brightened significantly, reducing market fears of a double-dip in Europe and easing some of the strains in the European bond market, as concerns about the sovereign debt crisis faded into the background.



Wells Fargo U.S. Economic Forecast

	Actual 2009 1Q	2Q	3Q	4Q	Forecast 2010 1Q	2Q	3Q	4Q	Actual 2006	2007	2008	2009	Forecast 2010	2011
Real Gross Domestic Product [1]	-6.4	-0.7	2.2	5.6	2.7	3.2	1.6	2.2	2.7	2.1	0.4	-2.4	2.9	2.3
Personal Consumption	0.6	-0.9	2.8	1.6	3.0	3.0	1.5	2.2	2.9	2.7	-0.2	-0.6	2.2	2.1
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	2.4	1.8	0.9	0.6	3.2	2.9	3.8	-0.3	1.4	1.2
Industrial Production [1]	-17.6	-10.3	8.3	7.0	6.9	7.5	3.9	2.2	2.2	2.7	-3.3	-9.3	5.3	3.4
Corporate Profits Before Taxes[2]	-19.0	-12.6	-6.6	30.6	34.0	25.0	20.0	14.0	10.5	-4.1	-11.8	-3.8	22.6	7.1
Trade Weighted Dollar Index[3]	83.2	77.7	74.3	74.8	76.1	77.3	80.0	81.5	81.5	73.3	79.4	74.8	81.5	88.0
Unemployment Rate	8.2	9.3	9.6	10.0	9.7	9.7	9.8	9.8	4.6	4.6	5.8	9.3	9.7	9.6
Housing Starts[4]	0.53	0.54	0.59	0.56	0.62	0.60	0.52	0.60	1.81	1.34	0.90	0.55	0.58	0.85
Quarter-End Interest Rates														
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	5.25	4.25	0.25	0.25	0.25	1.00
Conventional Mortgage Rate	5.00	5.42	5.06	4.93	4.97	4.58	4.50	4.70	6.14	6.10	5.33	4.93	4.70	5.60
10 Year Note	2.71	3.53	3.31	3.85	3.84	2.97	3.00	3.20	4.71	4.04	2.25	3.85	3.20	4.00

Forecast as of: July 7, 2010
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change

Inside

U.S. Review

More Evidence Of A Second Half Slowdown

Real GDP grew at a 2.4 percent annual rate during the second quarter. While the gain was slightly higher than the reduced market expectations, most of the strength occurred earlier in the quarter and the revisions to previously published data show the recession was deeper than first reported and the recovery in private final demand has been much weaker.

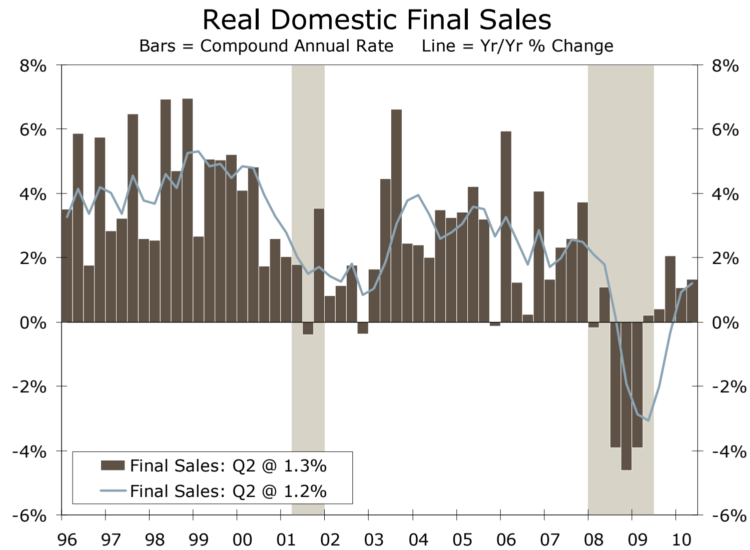
There is a growing debate about whether the economy will need more fiscal and monetary stimulus during the second half of the year. The argument for stimulus got a boost from a paper released by Mark Zandi and Alan Blinder that shows the extraordinary efforts taken by the Treasury, Federal Reserve and the Congress that helped to stave off a much more dire economic outcome than what actually transpired. Altogether, around $4 trillion in fiscal and monetary stimulus was thrown at the economy. While this spending may have averted a deeper recession, or even depression, it has not done much to promote economic growth over the past year. With most of the spending now behind us, the debate is shifting to whether policymakers should do more of what has already been tried, do less or do something different.

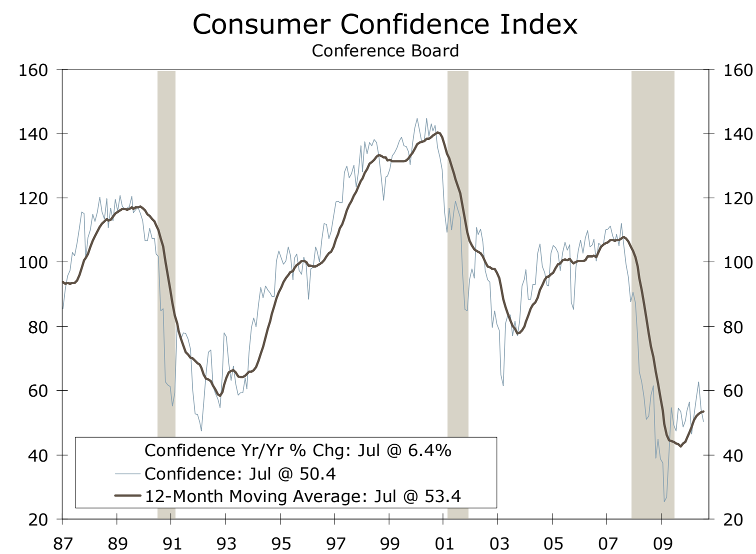
Consumers clearly sense something is missing in this economic recovery. The Consumer Confidence Index has fallen for two months in a row and remains extraordinarily low at 50.2. Most of the drop in the Index has been in the expectations component, which has fallen 18 points in the past two months. Consumers are still deeply concerned about employment and income prospects. The share of households reporting that jobs are hard to get rose 2.3 points to 45.8, while the percentage that believe jobs are plentiful remains near its all-time low at just 4.3. The expectations for employment and income both weakened in July, with consumers expecting fewer jobs to be created over the next six months and more consumers expecting income to fall or remain stagnant.

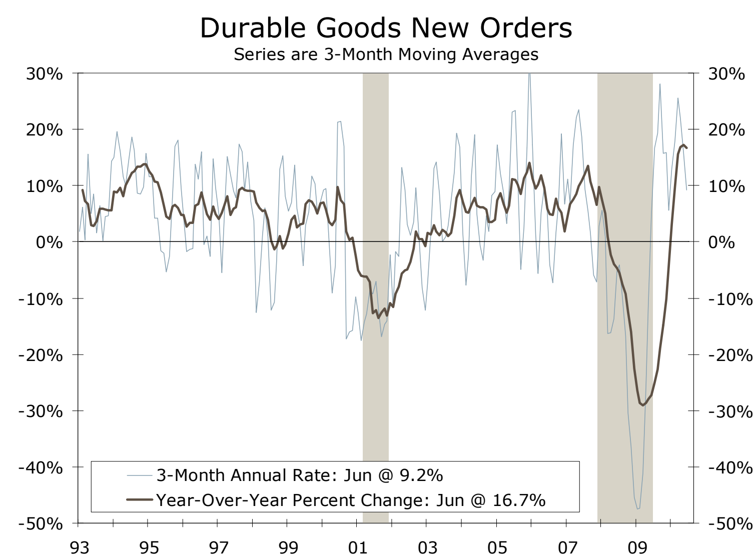
The latest snapshot of the labor market posted a modest improvement during the past week, with first-time claims for unemployment insurance falling 11,000 to 457,000. Unfortunately, that level of jobless claims is inconsistent with the monthly gains in nonfarm employment. Next week's employment report will again post a decline, as temporary Census jobs fall out of the data. We expect nonfarm payrolls to dip by 45,000 in July. The jobless rate may increase 0.1 percentage point.

New home sales rose 23.6 percent in June, but data for May and April were revised substantially lower. The huge percentage increase garnered headlines but does not mark a turn in new home sales. Builders generally reported a sharper pullback in demand and have weaker production pipelines than they believed they would have once the homebuyer tax credits expired.

Manufacturing activity appears to be cooling off. Advance orders for durable goods fell 1.0 percent in May, following a revised 0.8 percent drop the prior month. Several regional surveys noted that the rebound in manufacturing activity is losing momentum. Output is still rising, but the rate of improvement has slowed.





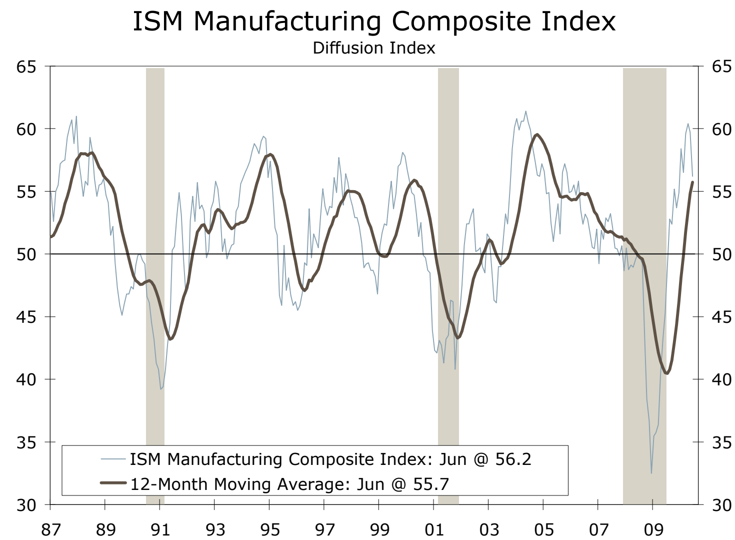


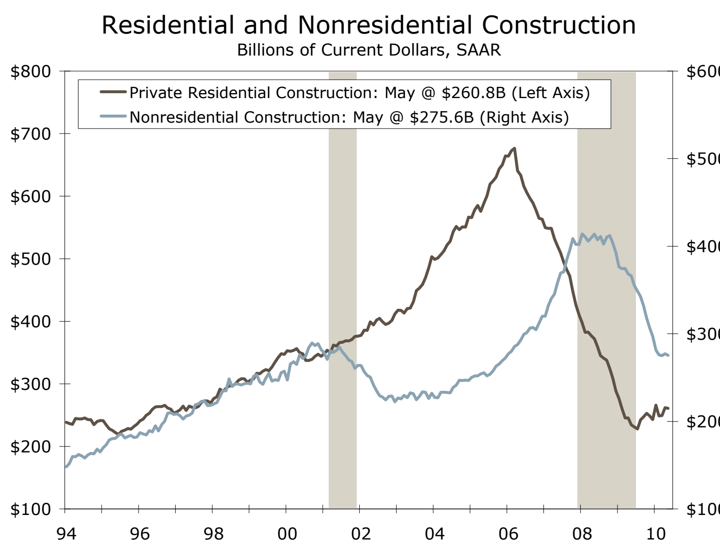
ISM Manufacturing • Monday

The Institute for Supply Management's (ISM) headline manufacturing index remained in expansionary territory in June, but fell for the second consecutive month. The 4.2 point drop from its April peak of 60.4 reflects the ending of the inventory cycle as manufacturers bring inventories in line with sales. The forward-looking new orders index remained above the threshold of 50, but fell 7.2 points to 58.5, the largest monthly drop since September 2008. Retracement in the regional manufacturing surveys in July further reflect the slowdown in the factory sector. Moreover, if the last two inventory cycles provide any insight, ISM could fall below 50 by year-end. Moderation in ISM is consistent with our expectation of slower industrial production in the second half of the year.

Previous: 56.2 **Wells Fargo: 55.0**

Consensus: 54.2





Construction Spending • Monday

Construction spending fell 0.2 percent in May with declines concentrated in multifamily and home improvements. Single-family outlays, however, increased 0.8 percent on the month, the fourth consecutive monthly gain. With the expiration of the homebuyers' tax credit, single-family construction spending should fall in June. The payback will likely pull the headline down 1.4 percent in June. Private nonresidential construction spending was down 24.8 percent from year-ago levels in May with declines concentrated in manufacturing, commercial, office and lodging. We expect declines in nonresidential outlays to persist through year-end, which will continue to subtract from GDP.

Previous: -0.2% **Wells Fargo: -1.4%**

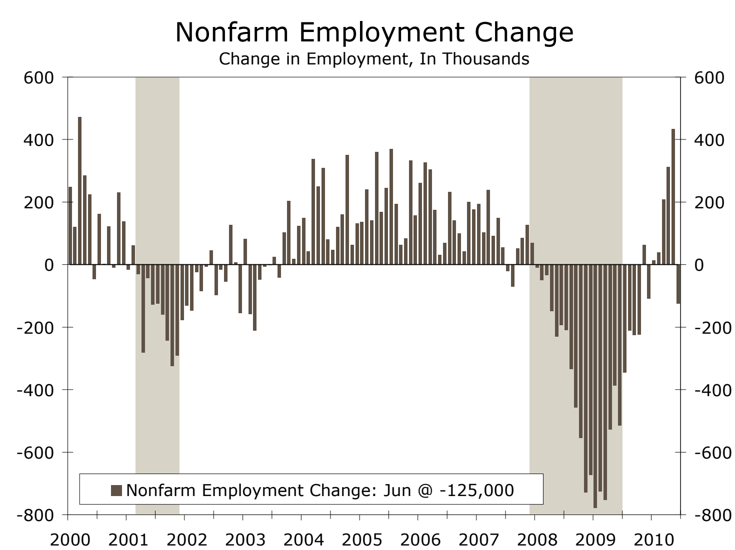
Consensus: -0.5%

Employment • Friday

The pace of the economic recovery continues to rely on private-sector employment growth. Since January, the private sector added only 593,000 jobs. Some market participants point to weak job creation in the small business sector as the major drag on job growth. According to data released by ADP, small firms, which are defined as companies that employ 1–49 workers, represent about 45 percent of the level of employment, but accounted for only 16 percent of the increase in employment over the past five months. Small firms will likely remain reluctant to hire as credit continues to be hard to obtain. Initial jobless claims have now fallen in three of the last four weeks, but remain stubbornly around 450,000. The elevated level of claims suggests employment will likely remain weak.

Previous: -125K **Wells Fargo: -45K**

Consensus: -60K



Global Review

Slower Global Growth, Not Another Great Recession

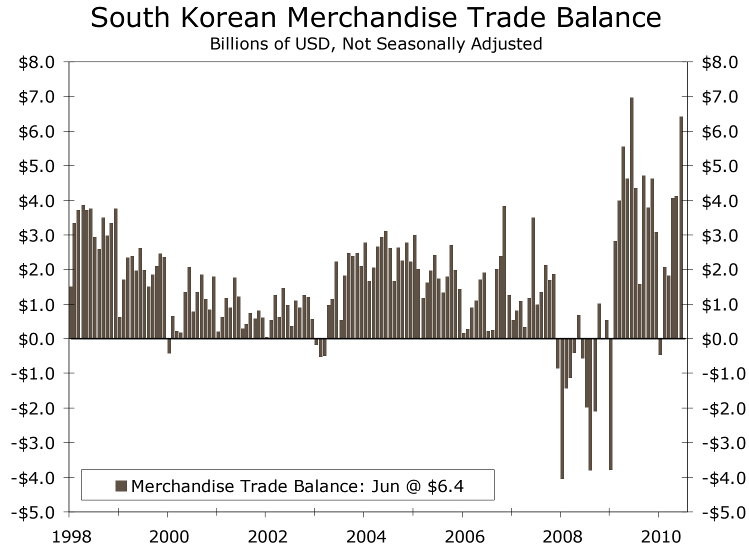
Market fears about a double-dip global recession, or a Great Recession Part II, faded a little further into the background this week as economic data from South Korea and Continental Europe built upon the good second-quarter GDP data out of the United Kingdom early in the month. Some slowing of global growth is expected in the second half of 2010 and into 2011, but there is nothing in the numbers so far to suggest the global economy is headed for a train wreck.

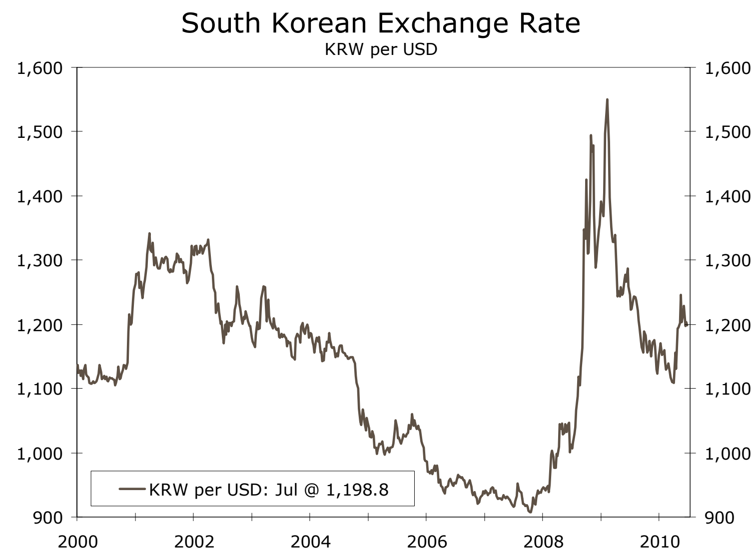
In Asia, South Korea was one of the first countries, after China, to report second-quarter GDP. The data revealed an economy that continues to hum along at a respectable pace. South Korean GDP expanded another 1.5 percent from the first quarter of 2010 and is 7.2 percent above a year ago. The numbers easily beat analysts' consensus expectations and the central banks own forecasts. South Korea's economy has seen strong growth now for six consecutive quarters. Growth has been reignited on a solid foundation of record low interest rates, government stimulus spending and robust export growth. The concerns had grown about the durability of growth as the Korean Central Bank begins to raise borrowing costs and government stimulus programs begin to unwind.

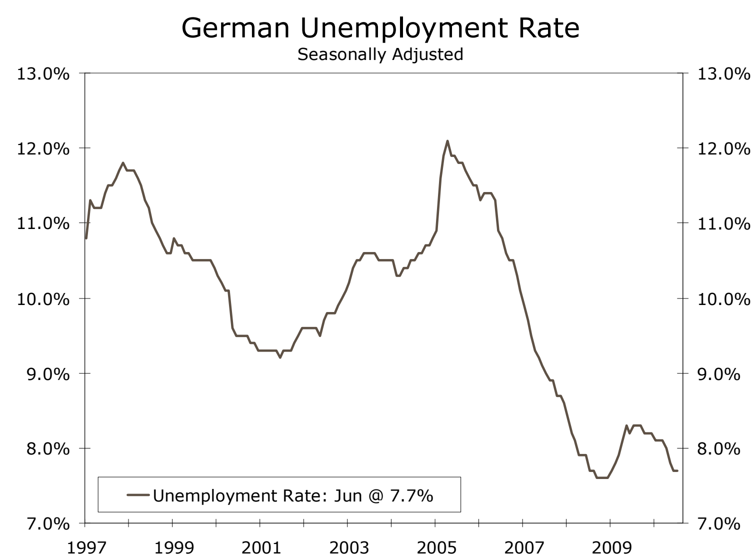
South Korean manufacturing, exports, consumer and capital spending all posted increases from the first quarter. Exports of goods increased 7.1 percent over the quarter led by shipments of automobiles, semiconductors and machinery. On a weaker note, South Korea's construction sector contracted 0.8 percent from the first quarter, and services and government spending slowed sharply, rising just 0.2 and 0.1 percent, respectively.

The strong GDP growth numbers suggest that further interest rate hikes from the Bank of Korea can be expected this year. The Bank of Korea also reported this week that South Korea's current account surplus reached a one-year high of $5.04 billion in June. The won has been rallying on the stronger economic news, prompting the central bank to intervene in the currency market to temper the strengthening currency.

The economic data out of Europe over the past two weeks has been almost unanimously positive, surprising the markets, which had been bracing for signs that the sovereign debt crisis would still be negatively impacting European growth. Some of the highlights, European manufacturing and service PMIs for July, exceeded expectations and revealed robust expansion. European industrial orders jumped a much stronger-than-expected 3.8 percent in May. German consumer confidence improved in August, suggesting that the sovereign debt crisis has not irreparably damaged German consumer spending growth. While Germany's labor market continued to show improvement, German unemployment fell 20,ooo in July and the unemployment rate slipped to 7.6 percent from 7.7 percent in June. Taken together, these data have raised expectations for European Union second-quarter GDP growth and helped to ease concerns about the economic fallout from the sovereign debt crisis.







U.K. PMIs • Monday - Wednesday

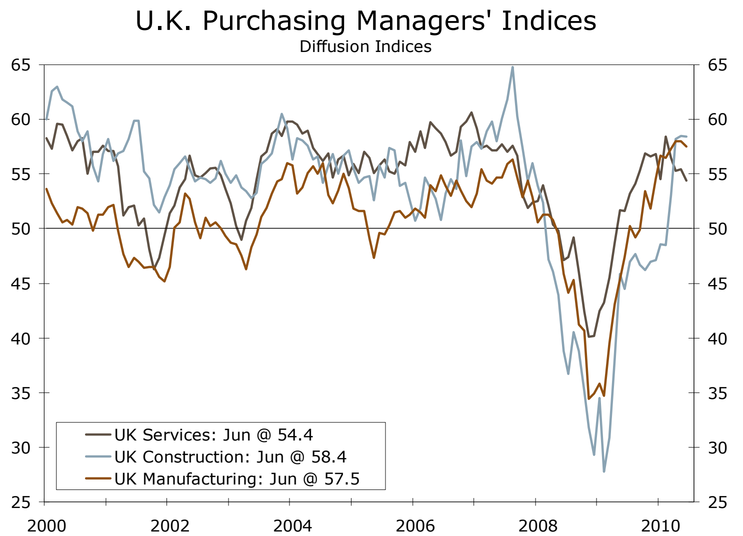
The U.K. economy has posted three straight quarterly gains in GDP as it gradually continues to recover from the recession. While growth jumped in the second quarter, we suspect the sequential growth rate in the second quarter will likely be the high-water mark for the next several quarters and the expansion will slow somewhat as fiscal tightening and deficit reduction programs sap economic growth in the coming quarters.

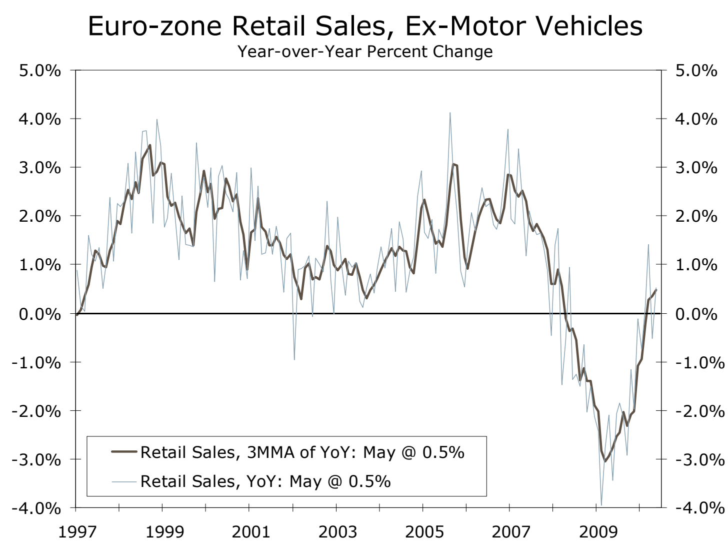
Still, consumer spending has shown signs of strength in recent months with retail sales adding 1.0 percent in May, a larger increase than had been expected and the second straight increase.

The various purchasing managers' indexes (PMI) have all been in expansion territory in recent month. No major changes are expected when PMI data become available in the first half of the week.

Previous: 57.5 (Mfg.) 58.4 (Const.) 54.4 (Services)

Consensus: 57.0 (Mfg.) N/A (Const.) 54.8 (Services)





Eurozone Retail Sales • Wednesday

After plunging in late 2008/early 2009 retail sales in the Eurozone have essentially been going sideways since the spring of 2009. In fact, over the past 12 months, retail sales have been up six times and down six times. June retail sales data will print on Wednesday, but we do not expect this sideways trend to change until consumers begin to have confidence that the sovereign debt crisis is no longer a concern, and that could be several quarters.

The ECB also meets next week. With the core rate of CPI inflation only 0.9 percent in June and weak economic growth likely causing the core rate to trend lower in the months ahead, we think the ECB has the cover to keep monetary policy accommodative. While no change in the target rate is expected, analysts will watch for any hints that ECB President Trichet gives about the future course of policy in his post-meeting press conference.

Previous: 0.5% (Year-over-year)

Consensus: 0.1%

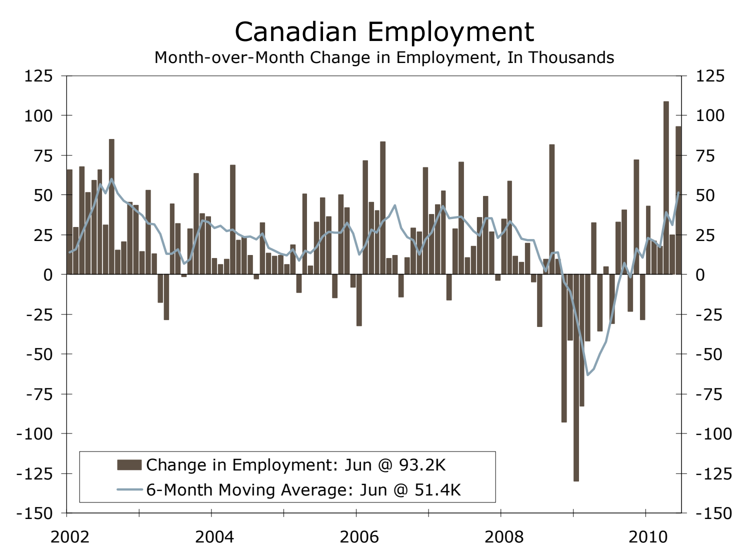
Canadian Net Employment Change • Friday

With two hikes in the overnight lending rate already implemented, Canada is the only G7 economy to have already begun monetary policy tightening. While Canada is leading the economic recovery among developed countries, its economy is not without its troubles. Retail sales data for the months of April and May came in much weaker than expected, declining 2.2 percent in April and another 0.2 percent in May. GDP data for the month of April were also disappointing, coming in essentially flat despite expectations for an eighth consecutive monthly gain.

The job market in Canada remains a bright spot as employers have added to payrolls every month so far this year, including a 93,200 print in June, which has restored the labor market to within spitting distance of pre-recession highs. We will find out if jobs grew again in July when the jobs report is released on Friday.

Previous: 93.2K

Consensus: 10K



Interest Rate Watch

Japanese-Style Deflation?

Federal Reserve Bank of St. Louis President James Bullard noted that the threat of Japanese-style deflation in the U.S. has increased and that the Federal Reserve needs to make its battle strategy clear to the financial markets. The strategy to combat deflation would be another large dose of quantitative easing, not simply extending the extended period language on short-term interest rates. We view the risk of a Japanese-style deflation as low but still high enough for the Fed's concern.

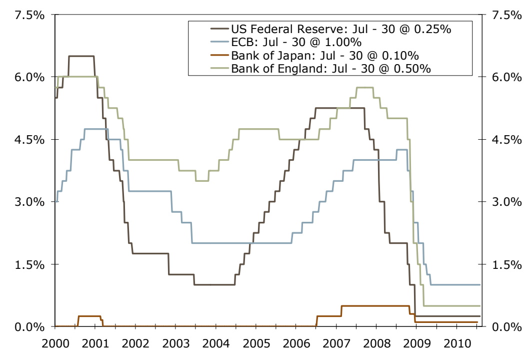
We track a large number of inflation indicators and virtually all them are pointing to reduced inflationary pressures during the second half of this year. The Consumer Price Index has declined during each of the past three months and will likely end the year up between zero and 0.5 percent. The core CPI will likely rise less than 1 percent in 2010. These low inflation numbers are the result of weak final demand, an excess supply of housing and excellent weather, which is leading to abundant harvests and low food prices.

Inflation numbers this low leave little margin for error. If economic growth falters or there is some exogenous shock to the economy, persistent and troublesome deflation could become reality.

The likelihood of much lower inflation and risks of deflation are a big reason the Treasury's two-year note is yielding less than 0.7 percent and the 10-year note is constantly flirting with sub 4 percent yields. The low inflation numbers are also apparent in the share prices of grocery store chains and food products companies, which are seeing intense price pressures as consumers continually seek ways to cut their food budgets.

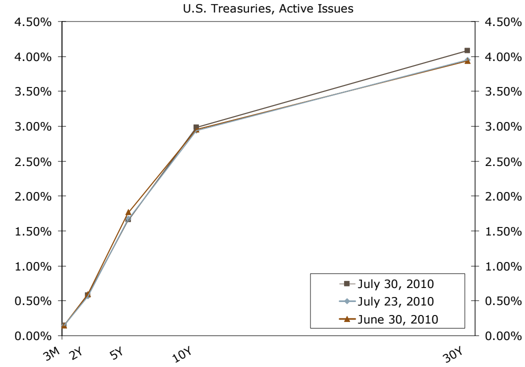
As low as the inflation numbers are, we do not believe troublesome deflation will actually materialize. Apartment rents are already rising, and we expect them to put pressure on the housing components of the CPI in 2011. Inflation will remain low, however, and this will continue to keep businesses in a cost-cutting mode, making it difficult for the recovery to gain momentum.

Central Bank Policy Rates



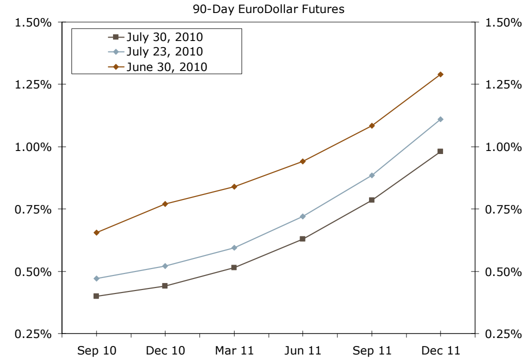
Yield Curve

U.S. Treasuries, Active Issues



Forward Rates

90-Day EuroDollar Futures



Consumer Credit Insights

New Lows for Mortgage Rates

Mortgage rates have fallen to 4.54 percent, the lowest since Freddie Mac began reporting 30-year fixed-rate mortgage rates in the 1970s. Rates now stand roughly 2 percentage points below the peak before the recession and another 60 bps below rates in April of this year. Better credit scores and higher down payments can bring rates even lower—but only for the most qualified and well-positioned buyers.

The oversupplied housing market is still searching for price stability, making home purchasing exceed the risk tolerance of many consumers (hence the large impact of homebuyer incentives). Accordingly, mortgage applications for refinancing have increased 98 percent on the year, while mortgage applications for purchase have fallen about 19 percent. Treasury yields have fallen over the past few months as investors have sought a haven from volatile equity performance and sovereign debt concerns in Europe, and mortgage rates have followed, with an average spread of 150 basis points off of 10-year Treasury notes, a trend we expect to hold for the remainder of 2010. As the recovery continues and investor fear diminishes, we expect bond yields and mortgage rates to gradually increase. For the well-positioned consumer, this summer is likely to be the best opportunity to finance a home for some time. Unfortunately, however, many consumers, given the dismal labor market and their overleveraged state, will be unable to act.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.54%	4.56%	4.58%	5.25%
15-Yr Fixed	4.00%	4.03%	4.04%	4.69%
5/1 ARM	3.76%	3.79%	3.79%	4.75%
1-Yr ARM	3.64%	3.70%	3.80%	4.80%
MBA Applications				
Composite	720.6	753.5	675.9	495.4
Purchase	172.3	168.9	172.1	262.0
Refinance	3,918.1	4,161.9	3,613.1	1,862.1

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

Topic of the Week

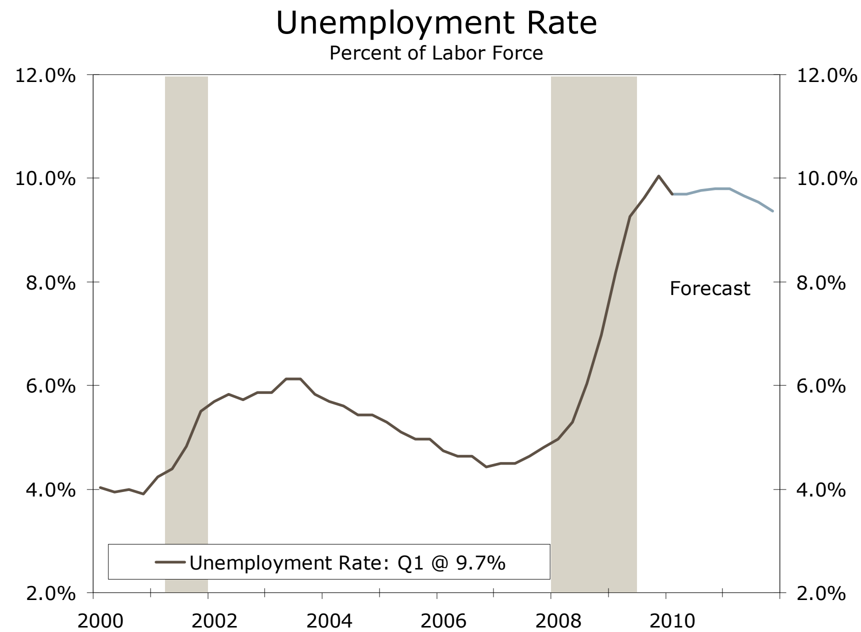
America's (Un)Employment Experience

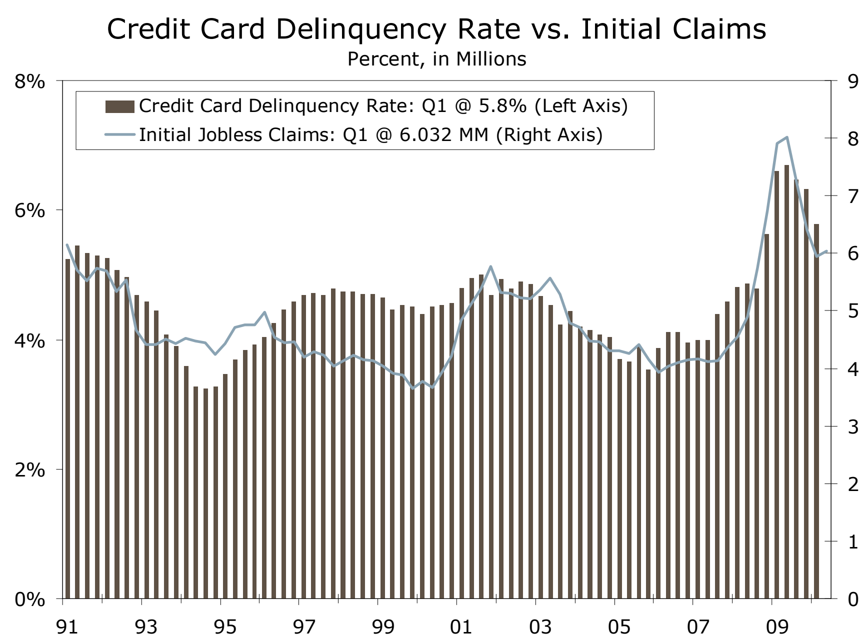
The nation has a well-publicized and politicized unemployment problem. With nearly 10 percent of the labor force unable to find work, the headlines and party lines would suggest that employers are not comfortable increasing their workforce under the shadow of slow top-line revenue expectations. Yet, behind this macro story are the micro dynamics of the labor market today, a host of undercover factors that create an uneven employment experience.

Certain characteristics of the labor force are having a greater effect than ever before on employment status. First, the spread between women's and men's rates of unemployment has never been higher. The difference in unemployment rates for those with less education versus those with more is also increasingly problematic. Lastly, different age cohorts are experiencing the labor market very differently, with older generations delaying retirement, while teenage participation in the labor force has declined. These systemic trends have implications for the economy well beyond employment.

The diversity of the labor market experience reflects a variety of factors that cannot be changed in the short run through fiscal stimulus. Thus, the labor market will not recover quickly. Job creation provides the income needed to support consumer spending, which has been limited of late. Current income is more important than ever as consumer credit has retraced significantly; consumers are reluctant to take on debt they are not confident they can pay off. On the supply side, banks have been hurt by credit delinquencies and are working to rebuild their balance sheets. Long-term loans may not make sense if one cannot assume income and steady employment. Given the weakened and evolving state of the labor market, a new thought process in lending may be necessary when we compare the labor market evolution to credit quality in the years ahead.

For further insight, see *America's (Un)Employment Experience: Diversity in the Details* on our Web site.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 7/30/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.14	0.15	0.18
3-Month LIBOR	0.45	0.49	0.48
1-Year Treasury	0.32	0.31	0.56
2-Year Treasury	0.55	0.58	1.17
5-Year Treasury	1.63	1.73	2.63
10-Year Treasury	2.95	2.99	3.61
30-Year Treasury	4.05	4.01	4.41
Bond Buyer Index	4.21	4.26	4.69

Foreign Exchange Rates

	Friday 7/30/2010	1 Week Ago	1 Year Ago
Euro ($/€)	1.303	1.291	1.408
British Pound ($/£)	1.560	1.543	1.649
British Pound (£/€)	0.835	0.837	0.853
Japanese Yen (¥/$)	86.440	87.460	95.560
Canadian Dollar (C$/$)	1.033	1.036	1.083
Swiss Franc (CHF/$)	1.039	1.054	1.088
Australian Dollar (US$/A$)	0.899	0.896	0.826
Mexican Peso (MXN/$)	12.725	12.732	13.265
Chinese Yuan (CNY/$)	6.775	6.780	6.832
Indian Rupee (INR/$)	46.408	46.945	48.368
Brazilian Real (BRL/$)	1.760	1.774	1.883
U.S. Dollar Index	81.738	82.464	79.285

Foreign Interest Rates

	Friday 7/30/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.83	0.82	0.87
3-Month Sterling LIBOR	0.75	0.74	0.89
3-Month Canadian LIBOR	0.99	0.94	0.60
3-Month Yen LIBOR	0.24	0.24	0.41
2-Year German	0.81	0.75	1.34
2-Year U.K.	0.77	0.87	1.34
2-Year Canadian	1.49	1.59	1.47
2-Year Japanese	0.16	0.15	0.28
10-Year German	2.69	2.71	3.43
10-Year U.K.	3.34	3.44	3.95
10-Year Canadian	3.14	3.23	3.56
10-Year Japanese	1.07	1.08	1.40

Commodity Prices

	Friday 7/30/2010	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	77.90	78.98	66.94
Gold ($/Ounce)	1173.15	1189.20	934.40
Hot-Rolled Steel ($/S.Ton)	565.00	565.00	455.00
Copper (¢/Pound)	325.65	318.50	255.70
Soybeans ($/Bushel)	10.17	10.19	10.53
Natural Gas ($/MMBTU)	4.87	4.58	3.74
Nickel ($/Metric Ton)	20,606	20,182	16,201
CRB Spot Inds.	484.93	475.02	425.38

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	2	3	4	5	6
U.S. Data	**ISM Manufacturing** June 56.2 July 55.0 (W) **Construction Spending** May -0.2% June -1.4% (W)	**Personal Income** May 0.4% June 0.2% (W) **Personal Spending** May 0.2% June 0.1% (W) **Factory Orders** May -1.4% June -0.5% (W)	**ISM Non-Mfg** June 53.8 July 53.1 (W)		**Nonfarm Payrolls** June -125K July -45K (W) **Unemployment Rate** June 9.5% July 9.5% (W)
Global Data	**UK** **PMI Manufacturing** Previous (Jun) 57.5	**UK** **PMI Construction** Previous (Jun) 58.4 **Euro-zone** **PPI (YoY)** Previous (May) 3.1%	**UK** **PMI Services** Previous (Jun) 54.4 **Euro-zone** **Retail Sales (MoM)** Previous (May) 0.1%	**Germany** **Factory Orders (MoM)** Previous (May) -0.5% **Euro-zone** **ECB Announces Rates** Previous 1.00%	**UK** **Industrail Prod. (MoM)** Previous (May) 0.7% **Canada** **Net Change in Employ.** Previous (Jun) 93.2K

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

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