June 04, 2010

Economics Group

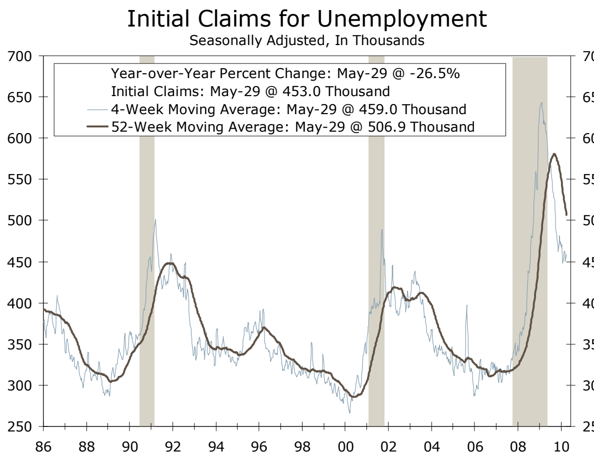
WELLS FARGO SECURITIES

Weekly Economic & Financial Commentary

U.S. Review

Decision-making in a Time of Economic Uncertainty

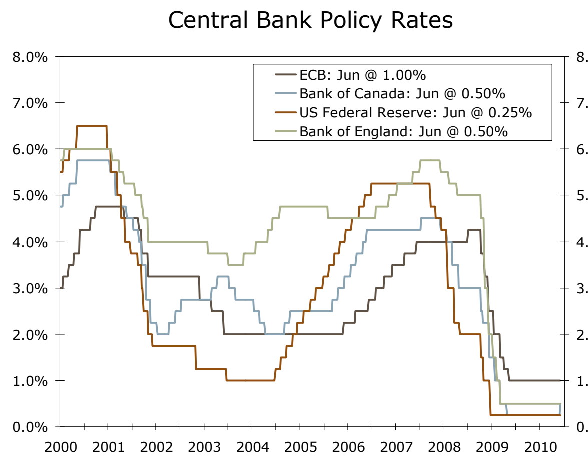
- Well, they never said decision-making would be easy. Recent data on employment, GDP, and personal income highlight the complexity of information, which is sometime contradictory and adds to the difficulty of decision-making now.
- Currently, the impact of short-run stimulus programs is ending while we remain uncertain about the sustainable path of growth going forward. One leading indicator, jobless claims, suggests that the sustainable pace of economic growth will be disappointing to many public officials hoping for a jump in public revenues and jobs.



Global Review

Canada Becomes First G7 Nation to Raise Rates

- The Bank of Canada (BoC) has become the first central bank from a G7 nation in this economic cycle to raise its key lending rate. The 25-bp increase brings the overnight rate to 0.50 percent. The move came in spite of mounting concern in the weeks preceding the announcement that the sovereign debt situation in Europe might cause the BoC to keep rates unchanged.
- Assuming the European debt crisis does not derail the global recovery, we still expect more hikes from the BoC this year as the swift pace of economic recovery in Canada progresses.



Wells Fargo U.S. Economic Forecast

	Actual 2009				Forecast 2010				Actual				Forecast	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2006	2007	2008	2009	2010	2011
Real Gross Domestic Product [1]	-6.4	-0.7	2.2	5.6	3.2	3.6	2.0	2.1	2.7	2.1	0.4	-2.4	3.1	2.5
Personal Consumption	0.6	-0.9	2.8	1.6	3.6	3.1	1.8	2.2	2.9	2.6	-0.2	-0.6	2.5	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	1.3	1.6
Consumer Price Index	-0.2	-1.0	-1.6	1.5	2.4	2.2	1.7	1.4	3.2	2.9	3.8	-0.3	1.9	1.8
Industrial Production [1]	-19.0	-10.4	6.4	6.9	7.8	4.2	4.2	4.9	2.3	1.5	-2.2	-9.7	4.9	4.7
Corporate Profits Before Taxes[2]	-19.0	-12.6	-6.6	30.6	22.0	15.0	20.0	-1.0	10.5	-4.1	-11.8	-3.8	13.4	6.0
Trade Weighted Dollar Index[3]	83.2	77.7	74.3	74.8	76.1	78.0	79.0	81.0	81.5	73.3	79.4	74.8	81.0	87.0
Unemployment Rate	8.2	9.3	9.6	10.0	9.7	9.9	10.0	10.0	4.6	4.6	5.8	9.3	9.9	9.5
Housing Starts[4]	0.53	0.54	0.59	0.56	0.62	0.64	0.67	0.71	1.81	1.34	0.90	0.55	0.66	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	2.75
Conventional Mortgage Rate	5.00	5.42	5.06	4.93	4.97	5.70	5.60	5.60	6.14	6.10	5.33	4.93	5.60	6.10
10 Year Note	2.71	3.53	3.31	3.85	3.84	3.80	3.80	3.90	4.71	4.04	2.25	3.85	3.90	4.50

Forecast as of: May 12, 2010
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change

Inside

U.S. Review

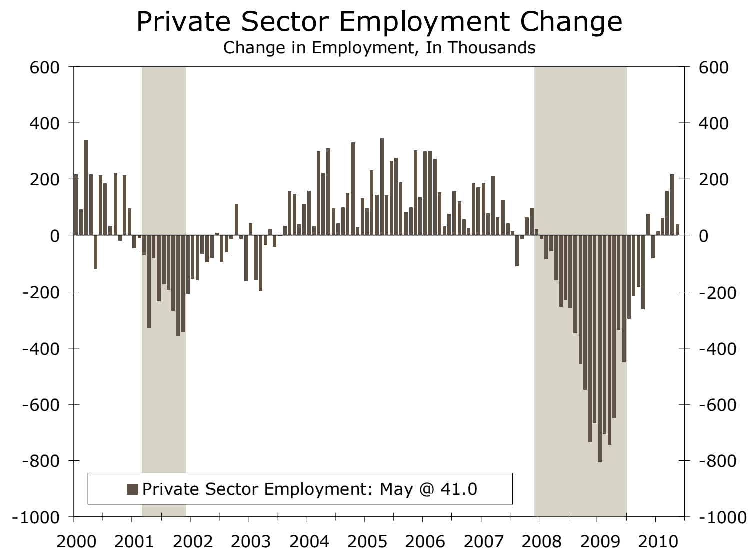
Decision-making in a Time of Economic Uncertainty

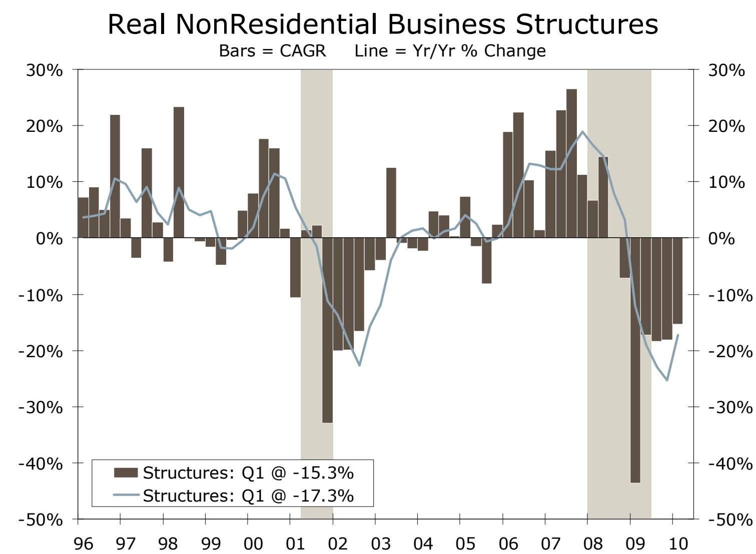
Recent data on employment, GDP, and personal income highlight the complexity of information, which is sometimes contradictory and adds to the difficulty of decision-making. Employment rose just 41,000 ex-Census with gains across sectors. The pace of gains satisfies very few. Hiring is just barely enough to technically sustain the recovery but not fast enough to catch up with what a more typical recovery would see. Moreover, the pace of job gains is not sufficient enough to generate the income and tax receipts household and policymakers need or have come to expect.

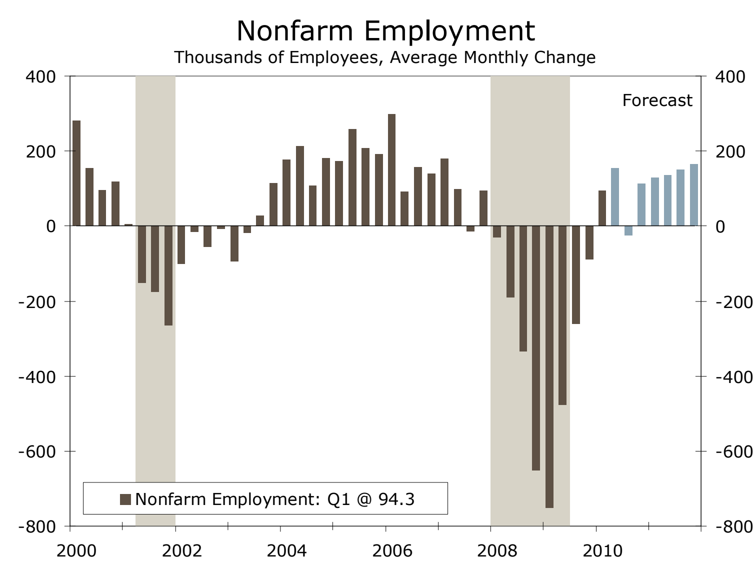
First quarter GDP came in at 3.0 percent, a trend-like number, but real final sales came in only at 1.4 percent. The underlying demand in the economy remains subpar relative to the typical recovery. Therefore, the crunch for decision-makers is that there is a recovery but it remains disappointing relative to expectations and, therefore, disappointing relative to financial market expectations that were discounted in equity and bond market prices. Within the GDP accounts, personal consumption spending and equipment spending appear to be holding their own. The problems appear in the residential and commercial real estate sectors as well as state & local government spending. Hence, the recovery is both below average and different in character relative to earlier recoveries. These aspects add to the challenge of decision-making for the second half of the year, when we expect growth to remain subpar.

Personal income rose modestly in April and is up 3.4 percent over the past three months. Yet real disposable income is up just 2.2 percent over the past three months compared to 3 percent plus at this stage in the prior two recoveries. Once again there is a sense that we have a recovery but less than what many had hoped. Such modest income growth also suggests that the first quarter consumption gains of 3.5 percent are simply not sustainable in the year ahead. Currently, the impact of short-run stimulus programs is ending and we remain uncertain about the sustainable path of growth going forward. Our bias is that growth downshifts in the second half of this year. One leading indicator, jobless claims, suggests that the sustainable pace of economic growth will be disappointing to many public officials hoping for a jump in public revenues and jobs. Jobless claims remain in the 450,000 plus range and have not improved very much over the past three months. In recent weeks the persistent problems of limited credit availability and job gains suggest that we remain uncertain about the pace of sustainable growth for the next six quarters. Our outlook remains below the Blue Chip consensus on GDP growth and we retain an above-average unemployment rate.

In part, our outlook for subpar growth reflects our expectation that job growth will be disappointing compared to prior recoveries and therefore personal income and eventually consumption will be disappointing. Moreover, persistently high unemployment suggests the labor market is seeing lots more structural unemployment compared to earlier recoveries. Slower growth is also associated with continued low inflation and steady interest rates. Yet, despite these low mortgage rates we do not see a jump in housing starts and therefore see a subpar recovery.





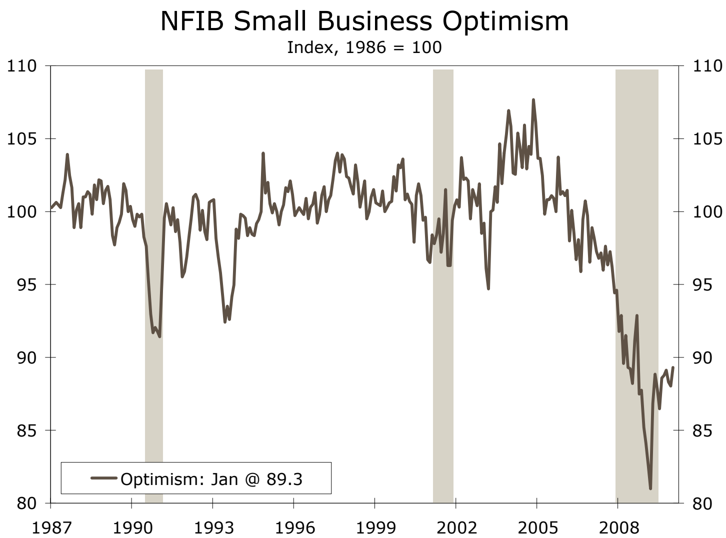


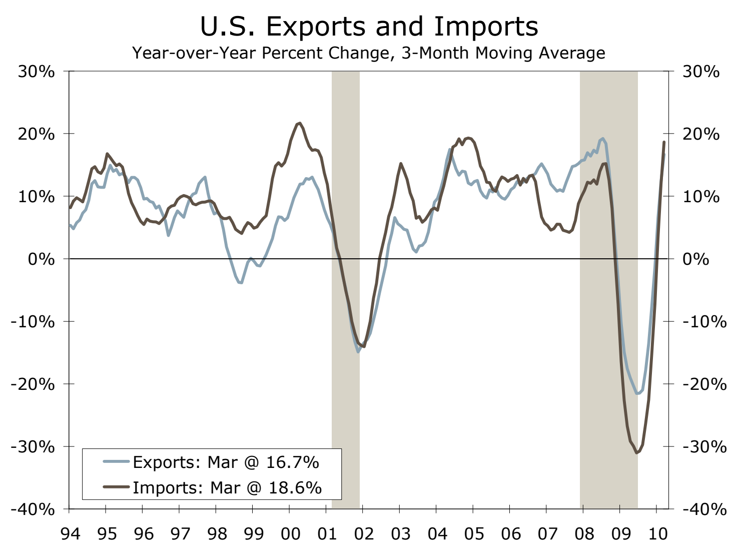
NFIB Small Business Optimism • Tuesday

While the NFIB Small Business Optimism index (NFIB index) is not closely followed, the health of small businesses remains important to the pace and sustainability of the economic recovery. The NFIB Index rose 4.4 percent in April to 90.6 percent, the largest increase in seven years. Plans to hire increased modestly but remain in negative territory, rising to -1 percent from -2 percent. The slow pace of job creation is consistent with employment numbers reported by ADP, which shows payroll gains for small businesses continue to lag medium and large businesses. Much of the lag in small business hiring continues to be related to weak credit conditions. While the percentage of firms expecting credit conditions to get better rose slightly, it remains at historical lows at -15 percent.

Previous: 90.6

Consensus: N/A





Trade Balance • Thursday

The nominal U.S. trade deficit for goods and services widened slightly in March to $40.4 billion with broad-based increases in exports and imports. Both increases reflect the economic recovery that is occurring in the U.S. and the global economy. U.S. exports continued to rise in March, increasing 3.2 percent on the month. Exports of industrial goods were up $2.0 billion and capital goods rose $500 million. Imports also rebounded strongly in March rising 3.1 percent.

We expect the trade balance to continue its trajectory in April and widen for the third consecutive month to -$41.7 billion.

Previous: -$40.4B **Wells Fargo: -$41.7B**

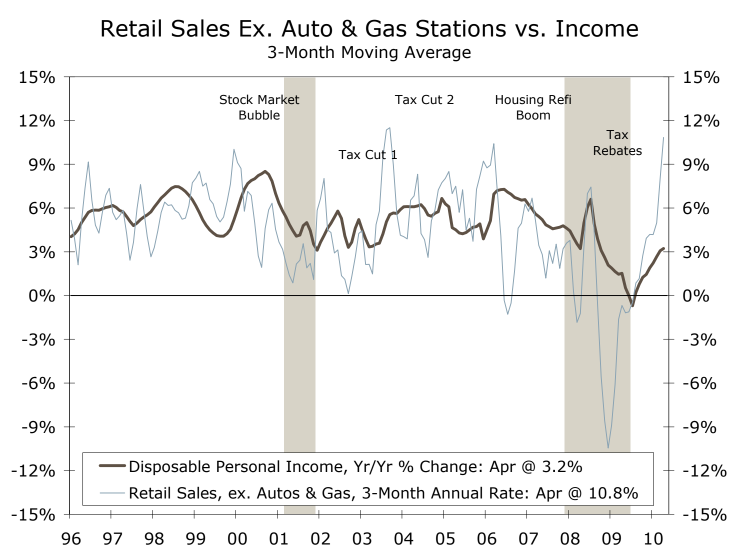
Consensus: -$41.0B

Retail Sales • Friday

Retail sales grew 0.4 percent in April due largely to the third consecutive increase in building materials, which grew 6.9 percent on the month. The boost to retail sales likely overstates the underlying trend in sales, however. Core retail sales, which excludes autos, gasoline and building material sales, fell 0.2 percent. On a year-ago basis, core retail sales is up 4.4 percent, but the pace is slowing. With the pace in core sales moderating, consumer spending is expected to lose momentum in coming quarters. Tax refunds helped bolster spending earlier this year and are unlikely to provide as much lift as we head into summer. Moreover, the burst of spending during the first quarter outpaced disposable income, cutting the saving rate back to just 3.1 percent. We expect spending to more closely track after-tax income going forward, allowing for a gradual recovery in the saving rate.

Previous: 0.4% **Wells Fargo: 0.2%**

Consensus: 0.2%



Global Review

After Raising Rates, Bank of Canada Stands on Guard

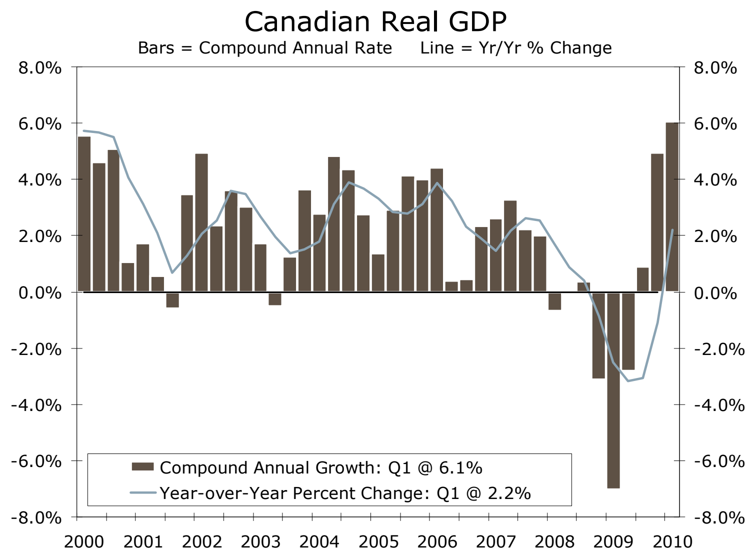
In April, when the Bank of Canada (BoC) first removed its conditional commitment to keep rates unchanged until the second quarter of 2010, most market watchers viewed a rate increase at the June 1 meeting to be very likely. But as the ongoing turmoil in the European sovereign debt market grabbed headlines in May, the probability of a June hike seemed to be falling. Before the rate decision was announced the last new piece of economic news was the GDP report, which showed the economy grew at a 6.1 percent pace in the first quarter. Gains were led by increases in consumer spending and manufacturing. It was the fastest pace of growth in Canada since the 1990s, and it increased the pressure on the BoC to increase rates.

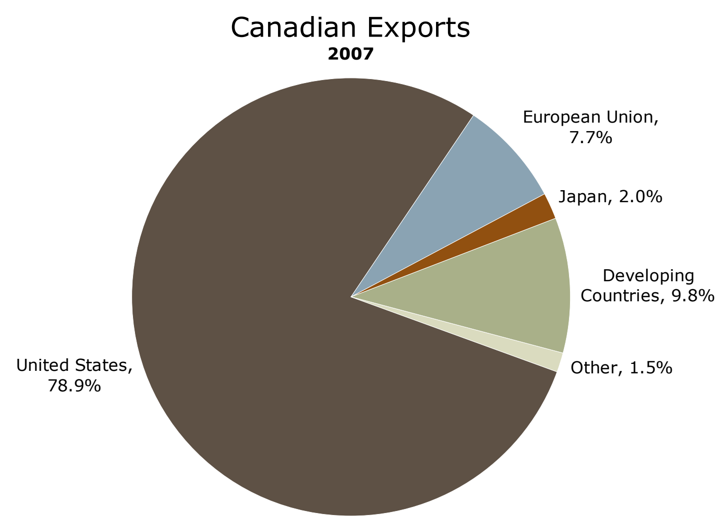
The BoC had to balance the need to stabilize fast-paced economic growth at home against the risk of financial market disruptions in Europe. While the BoC did in fact raise rates, the accompanying official statement acknowledged the fact that the global recovery is shaking out differently across the world's major foreign economies. When the BoC sizes up the global economy it sees "strong momentum in emerging market economies, some consolidation of the recovery in the United States, Japan and other industrialized economies, and the possibility of renewed weakness in Europe."

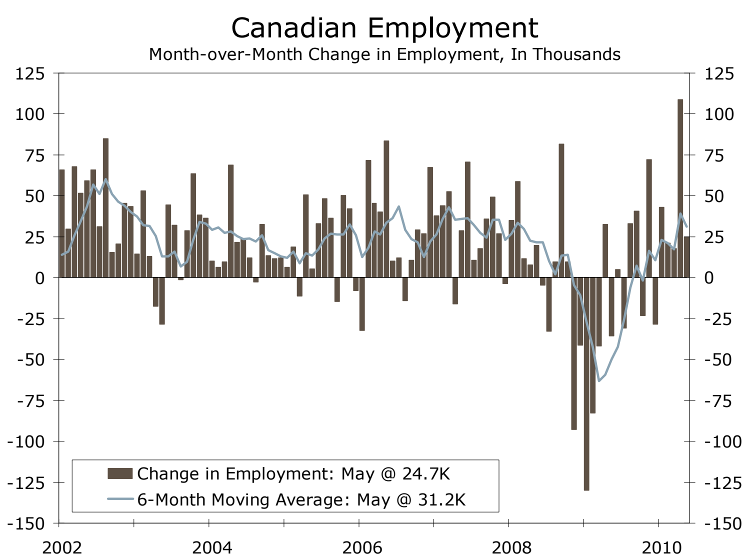
The problems in Europe certainly bear some consideration on the part of the BoC, but the fact of the matter is that the Canadian economy can continue to grow even if European economies stagnate. Less than 8 percent of Canadian exports are bound for European Union economies. The BoC acknowledged this disconnect, observing that "spillover into Canada from events in Europe has been limited to a modest fall in commodity prices and some tightening of financial conditions." Still, the financial crisis taught us just how interconnected the global financial system can be. If debt problems in Europe spawned a larger logjam in global credit markets, clearly Canada and most other economies would have reason to worry.

Going forward, any further tightening by the BoC "would have to be weighed carefully against domestic and global economic developments." The next scheduled meeting is set for July 20, and we would not be surprised to see the bank pause at that meeting, especially if world financial markets are still preoccupied with sovereign debt issues in Europe. But if the Canadian economic recovery remains on track, it would not be long before the Bank has to consider its mandate to keep inflation in check. For now, pricing pressures remain benign and barring a big jump in inflation, the BoC has cover to sit on hold in July.

Recent strength in consumer spending has been made possible by a recovery in the labor market that broadly exceeded expectations so far this year. The most recent jobs report was no exception as payrolls grew by another 24,700 jobs—higher than the 15,000 that was expected. Since bottoming in July 2009, the number of workers with a full time job has increased more than 300,000, which is more than half of the jobs lost in the recession. With the job market halfway back to pre-recession levels, overall consumer spending cannot be far behind.







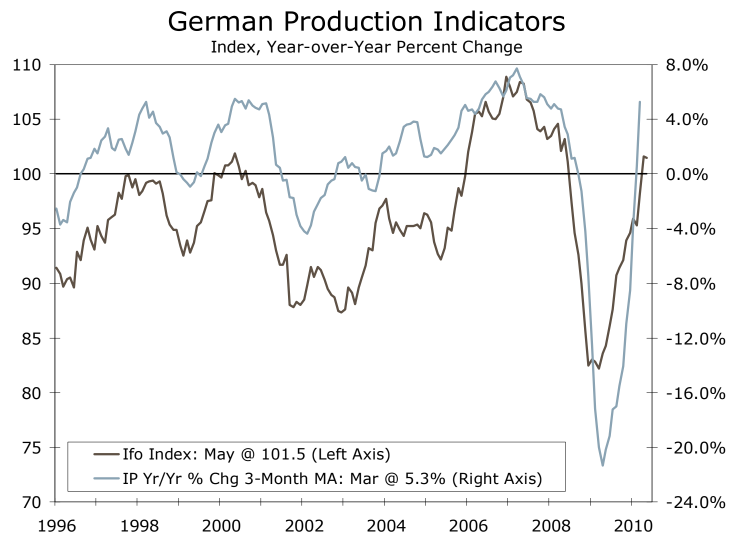
German Industrial Production • Tuesday

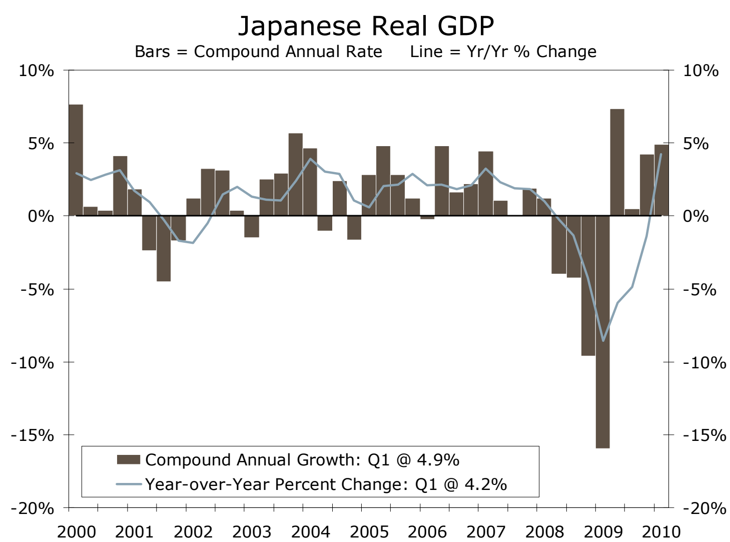
After contracting 6.7 percent on a peak-to-trough basis, the German economy is clearly on the rebound as the economy has gradually expanded in each of the past four quarters. Other signs of economic recovery are evident as well, like the recent better-than-expected unemployment figures, which show the ranks of the county's unemployed are falling faster than most analysts expected. Recent increases in year-over-year industrial production (IP) are partly a result of favorable comparisons to depressed levels a year ago. IP tends to track pretty closely with the Ifo index—a measure of business sentiment. After recovering sharply after the recession, the Ifo has leveled off in recent months. Will gains in IP begin to taper off as well? We will get an answer when IP for April is reported on June 8.

German CPI on June 10 will likely show prices remain benign.

Previous: 8.6% (Year over year)

Consensus: 12.4%





Japanese Real GDP • Thursday

The Japanese economy shrank more than 8 percent between 2007 and 2009, but growth has returned to the island nation as the economy expanded for four consecutive quarters. Real GDP data for the first quarter were somewhat weaker than expected, but still posted a respectable growth rate of nearly 5 percent. The latest revision to first quarter GDP data will become available on June 10. Early indicators of growth in the second quarter are somewhat mixed. The April jobless rate climbed to 5.1 percent and housing starts data were disappointing, but retail trade picked up a bit in April, despite expectations for further declines. We will get a sense of how the recovery is shaping up in the factory sector when Japanese machine orders are reported on June 9. Orders remain nearly 40 percent off their 2008 peak, but an improvement here might signal a recovery in business spending.

Previous: 4.9%

Consensus: 4.2%

Chinese Industrial Production • Friday

The Chinese economy dodged the global recession largely unscathed. As the global recovery has taken shape, it appears the Chinese economy is firing on all cylinders once again. In fact the torrid pace of growth is stoking concerns about inflation and the government is directing banks to slow down the pace of credit creation. By most measures the Chinese economy is slated to continue growing, but manufacturing PMI has slipped twice in the past four months, suggesting the pace of growth may slow somewhat. On June 11, Chinese industrial production data for April will give a sense of how the manufacturing sector is shaping up at the start of the second quarter. On the same day both PPI and CPI inflation data for May might shed some light on how prices are reacting to the government's plan to slow the fast pace of lending growth.

Previous: 17.8% (Year over year)

Consensus: 17.3%

Interest Rate Watch

Higher Short Rates, Lower Long Rates – What Gives?

In recent weeks we have seen both volatile and unexpected moves in market rates. Underlying such moves are the forces of changes in risk perceptions as well as the fundamentals of growth and inflation expectations. In capital markets it is the expected result that is the surprise outcome. The unexpected is often the norm.

At the Short End: Credit Risk

Recent LIBOR rates have risen despite little change in central bank administered rates. The issue is changed perceptions of credit risk—particularly the quality of private bank balance sheets. The issue is not liquidity, the lack of short-term funds, but credit quality and the adequacy of capital.

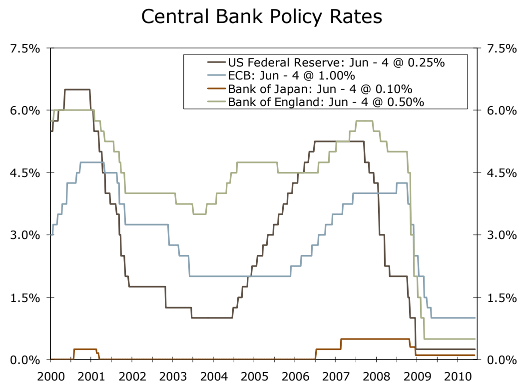
At the Long End: Default Risk

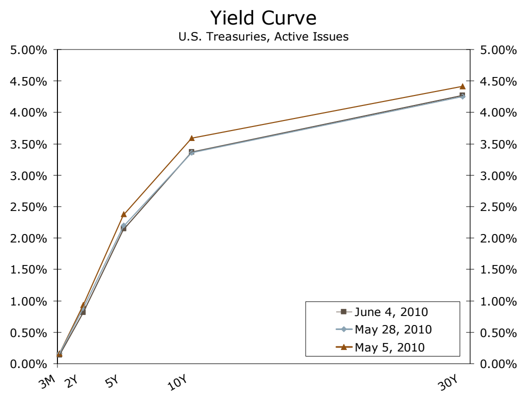
In recent weeks, 10-year Treasury rates have declined sharply. This has happened despite perceptions of rising sovereign debt burdens in the United States as well as abroad. Investing is a matter of relative performance and so even if the U.S. deficit position looks bad that of the European countries looks worse. The U.S. financing issue appears to be several years away. The European problem is here today. The United States in a way, is the least unsafe.

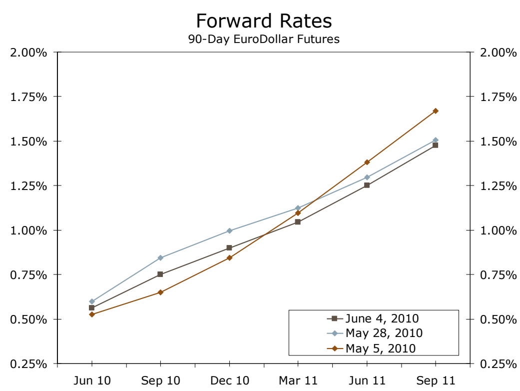
Of course, recent U.S. data on inflation and growth have been below expectations for many investors and the probability of any Fed increase in interest rates has declined. Therefore there are other reasons for lower Treasury yields beyond just the fight to safety in favor of Treasuries. Yet, the sense is that lower Treasury rates are a negative signal on expected growth and the sustainability of the European debt load in a subpar European recovery.

Credit Products: Less Issuance as Credit Risk Avoidance?

Both high-grade and high-yield issuance have declined in recent weeks. Investor interest has waned as evidenced by the drop in mutual fund inflows to high-yield funds during the period. Here, the downshift to economic expectations has driven investors away from risk.







Consumer Credit Insights

Housing Payback on the Way

If there was any doubt about whether we would see payback from the homebuyers' tax credit, that doubt has been all but erased over the past few weeks, as mortgage applications for purchasing a home have plunged. After surging to 291.3 on April 30 from 196.8 on February 19, the Mortgage Bankers Association's purchase index has since dropped 39 percent to 178.0 for the week of May 28. That is the lowest reading since the week of April 11, 1997, and comes despite a 30-bp drop in mortgage rates since April 30. However, the drop in mortgage rates has led to another round of refinancing as that index has jumped 58 percent since April 30 and is up 41 percent from a year ago. But while the first three weeks of May saw double-digit increases in the refinance index, the pace slowed considerably to just a 2.4 percent increase for the week of May 28, suggesting the economy may get less support from refinancing going forward.

Meanwhile, after a mini-burst in early spring, consumer loans outstanding have dipped again over the past few weeks and are still 5.8 percent below year-ago levels. Home equity loans outstanding continue to shrink as well and are down 3.2 percent from a year ago. These readings take into account the adjustment due to off-balance sheet loans being brought back onto bank balance sheets in accordance with new FASB regulations. Now that the sugar high from the homebuyers' tax credit has passed, it's time to get back to reality.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.79%	4.78%	5.00%	5.29%
15-Yr Fixed	4.20%	4.21%	4.36%	4.79%
5/1 ARM	3.94%	3.97%	3.97%	4.85%
1-Yr ARM	3.95%	3.95%	4.07%	4.81%
MBA Applications				
Composite	639.0	633.5	556.2	658.7
Purchase	178.0	185.7	291.3	267.7
Refinance	3,336.9	3,257.4	2,117.3	2,953.6

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

Topic of the Week

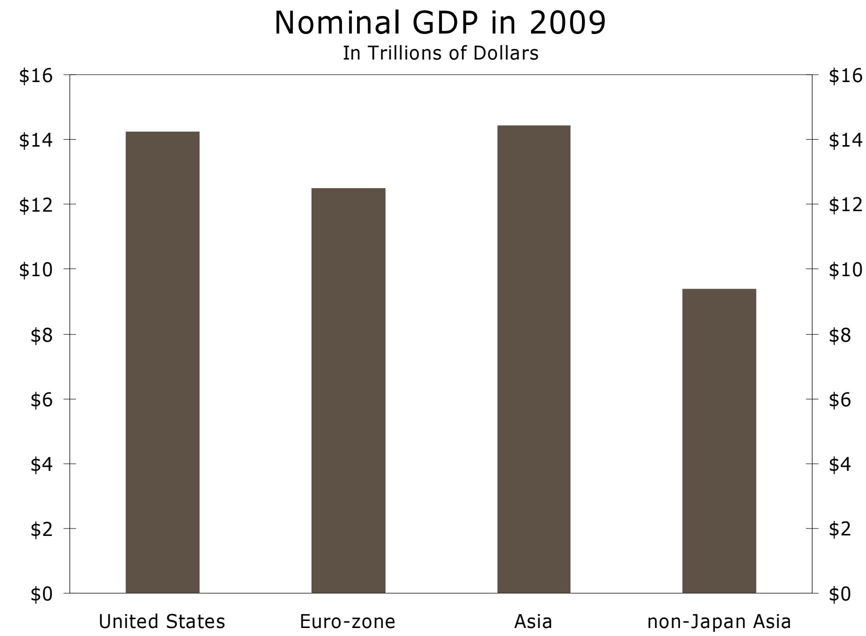
Will Europe Pull Down Asia?

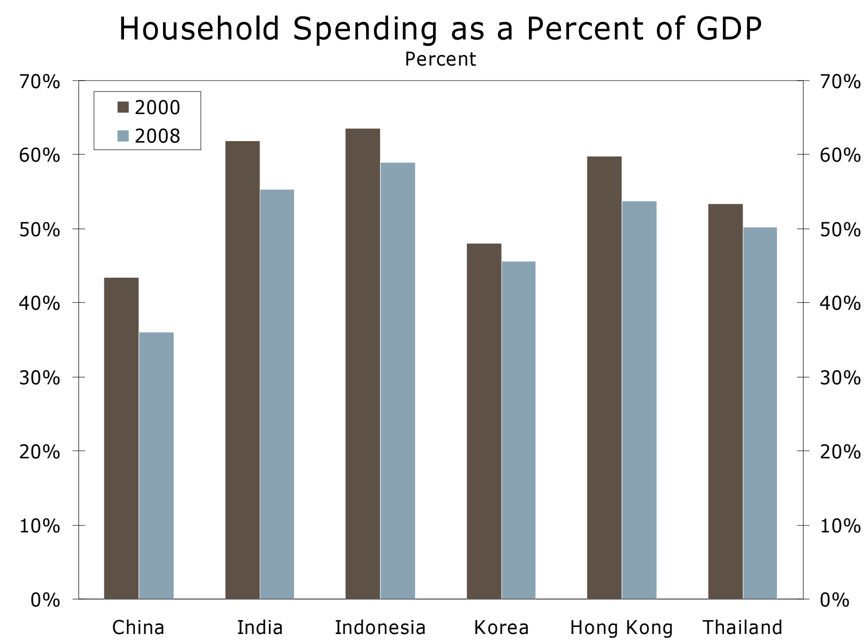
Volatility has crept back into financial markets due to concerns that the sovereign debt crisis in the Euro-zone may lead to another recession there. At a minimum, fiscal tightening over the next few years will create powerful headwinds on growth in many individual economies in the Euro-zone. If another downturn occurs in the euro area, would it pull Asia under as well? What about the global economy?

In this commentary, we focus more on the dynamic economies of China, Hong Kong, India, Indonesia, Korea, Taiwan and Thailand, which we aggregate as non-Japan Asia (NJA). GDP in NJA is about 25 percent less than the Euro-zone and the euro area accounts for about a third of NJA exports. The region is clearly more dependent on exports than other western economies. At first glance, it appears that a downturn in the Euro-zone would not be good news for Asia. However, high export-to-GDP ratios across Asia tend to overstate the export dependence of the region. Although the region is clearly more dependent on exports than are most western economies, the percentage of total value added for which manufacturing exports account is much smaller than gross export-to-GDP ratios. Moreover, domestic demand has been growing rapidly in Asia, and that should continue for the foreseeable future. In addition, we believe most Asian governments have the financial wherewithal to turn to fiscal stimulus again should the need arise.

We conclude that a garden-variety recession in the Euro-zone would certainly slow growth in Asia, but it probably would not pull the region, let alone the global economy, under again. If, however, banks continue to eye one another wearily and another financial crisis comes to pass à la the aftermath of the Lehman Brothers bankruptcy, then the outlook for Asia, as well as for the entire global economy, could darken considerably.

Please visit out website for the full report: *Will Europe Pull Down Asia?*





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 6/4/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.12	0.16	0.14
3-Month LIBOR	0.54	0.54	0.63
1-Year Treasury	0.26	0.17	0.23
2-Year Treasury	0.74	0.77	0.95
5-Year Treasury	2.02	2.09	2.59
10-Year Treasury	3.26	3.29	3.71
30-Year Treasury	4.19	4.21	4.58
Bond Buyer Index	4.28	4.28	4.71

Foreign Exchange Rates

	Friday 6/4/2010	1 Week Ago	1 Year Ago
Euro ($/€)	1.205	1.227	1.418
British Pound ($/£)	1.457	1.446	1.618
British Pound (£/€)	0.827	0.849	0.877
Japanese Yen (¥/$)	92.130	91.060	96.580
Canadian Dollar (C$/$)	1.049	1.055	1.097
Swiss Franc (CHF/$)	1.157	1.159	1.069
Australian Dollar (US$/A$)	0.832	0.847	0.802
Mexican Peso (MXN/$)	12.842	12.960	13.196
Chinese Yuan (CNY/$)	6.829	6.832	6.834
Indian Rupee (INR/$)	46.845	46.355	47.195
Brazilian Real (BRL/$)	1.838	1.817	1.938
U.S. Dollar Index	87.714	86.185	79.414

Foreign Interest Rates

	Friday 6/4/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.64	0.63	1.26
3-Month Sterling LIBOR	0.73	0.71	1.27
3-Month Canadian LIBOR	0.76	0.58	0.67
3-Month Yen LIBOR	0.24	0.25	0.51
2-Year German	0.48	0.52	1.52
2-Year U.K.	0.85	0.90	1.22
2-Year Canadian	1.70	1.74	1.17
2-Year Japanese	0.16	0.17	0.36
10-Year German	2.59	2.68	3.64
10-Year U.K.	3.53	3.61	3.85
10-Year Canadian	3.33	3.31	3.40
10-Year Japanese	1.28	1.26	1.51

Commodity Prices

	Friday 6/4/2010	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	73.15	74.55	68.81
Gold ($/Ounce)	1204.35	1214.38	980.25
Hot-Rolled Steel ($/S.Ton)	645.00	645.00	375.00
Copper (¢/Pound)	285.70	315.15	230.15
Soybeans ($/Bushel)	9.48	9.28	11.86
Natural Gas ($/MMBTU)	4.70	4.29	3.81
Nickel ($/Metric Ton)	18,600	21,038	14,126
CRB Spot Inds.	474.24	480.35	397.92

Next Week's Economic Calendar

	Monday 7	Tuesday 8	Wednesday 9	Thursday 10	Friday 11
U.S. Data	**Consumer Credit** March $2.0B April -$1.0B (C)		**Wholesale Inventories** March 0.4% April 0.7% (C)	**Trade Balance** March -$40.4B April -$41.7B (W)	**Retail Sales** April 0.4% May 0.2% (W) **Retail Sales Less Autos** April 0.4% May 0.3% (W) **Business Inventories** March 0.4% April 0.6% (W)
Global Data		**Germany** **Industrial Production** Previous (Mar) 8.6% **Canada** **Housing Starts** Previous (Apr) 200.7K	**Japan** **Machine Orders (MoM)** Previous (Mar) 5.4%	**Germany** **CPI (YoY)** Previous (Apr) 1.2% **Japan** **GDP (QoQ)** Previous (1Q)A 1.2%	**UK** **Industrial Prod. (YoY)** Previous (Mar) 2.0% **China** **Industrial Prod. (YoY)** Previous (Apr) 17.8%

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

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