June 11, 2010

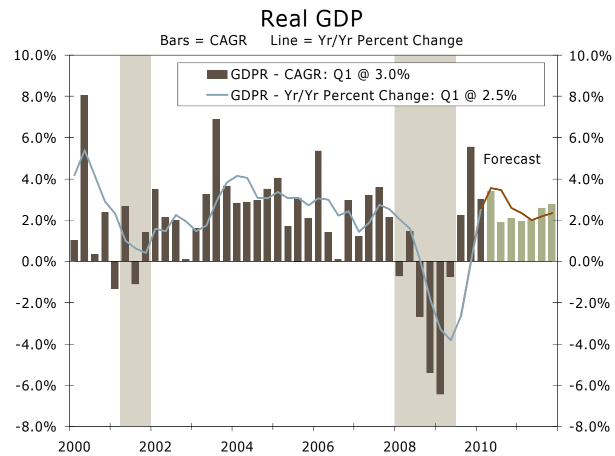
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

The Moderate Recovery Continues, but Is it Sustainable?

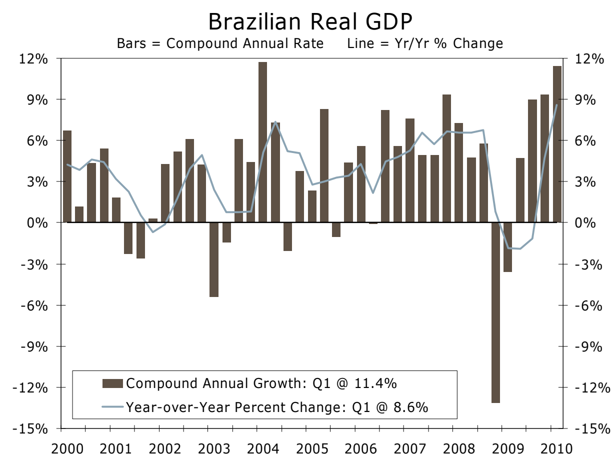
- In recent testimony, Fed Chairman Ben Bernanke reiterated that the economic recovery that is under way, will likely moderate in the second half of the year. This view is consistent with our forecast that real GDP will grow at around a 3.0 percent annual pace in 2010. While growth is expected to slow, the probability of a double-dip recession remains low.
- Retail sales fell a disappointing 1.2 percent in May, but much of the decline was in the more volatile components such as building materials, autos and gasoline. Core retail sales, however, grew 0.1 percent.



Global Review

Is Brazil Still the Country of the Future?

- Good policy decisions over the last several decades, political stability and very strong commodity prices are giving Brazil the chance to fulfill its promise.
- The economy grew at an 8.6 percent rate year on year during the first quarter, fueled by a very strong industrial sector.
- Investment in the Brazilian economy is expected to remain very strong during this decade as the country prepares to host the Soccer World Cup in 2014 and the Olympics in 2016.



Inside

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	3.0	3.4	1.9	2.1	2.7	2.1	0.4	-2.4	3.0	2.2
Personal Consumption	0.6	-0.9	2.8	1.6	3.5	3.2	1.6	2.2	2.9	2.6	-0.2	-0.6	2.4	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	1.9	1.0	0.7	3.2	2.9	3.8	-0.3	1.5	1.2
Industrial Production [1]	-19.0	-10.4	6.4	6.9	7.8	5.4	2.6	2.2	2.3	1.5	-2.2	-9.7	4.8	3.2
Corporate Profits Before Taxes [2]	-19.0	-12.6	-6.6	30.6	31.0	26.0	21.0	15.0	10.5	-4.1	-11.8	-3.8	22.7	7.2
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	9.8	10.0	10.0	4.6	4.6	5.8	9.3	9.9	9.6
Housing Starts [4]	0.53	0.54	0.59	0.56	0.62	0.59	0.56	0.62	1.81	1.34	0.90	0.55	0.60	0.84
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	2.00
Conventional Mortgage Rate	5.00	5.42	5.06	4.93	4.97	4.80	4.80	5.00	6.14	6.10	5.33	4.93	5.00	6.00
10 Year Note	2.71	3.53	3.31	3.85	3.84	3.20	3.20	3.40	4.71	4.04	2.25	3.85	3.40	4.40

Forecast as of: June 9, 2010
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change

U.S. Review

Recovery Continues, but at a Modest Pace

Fed Chairman Ben Bernanke's recent testimony to the U.S. House of Representatives contained no new surprises. He reiterated that "the recovery in economic activity that began in the second half of last year has continued at a moderate pace so far this year." He also cited momentum in consumer and capital spending, but highlighted restraints in housing activity, nonresidential construction outlays and state and local budgets. The Fed expects real GDP to grow at around a 3.5 percent annual pace in 2010 and at a somewhat faster pace next year.

Our recently published *Monthly Economic Forecast* is consistent with this view. We expect real GDP to grow at around a 3.0 percent annual pace in 2010, but our outlook for 2011 is far less optimistic than the Fed's. While economic growth will likely remain positive in 2011, weak job growth and high unemployment will likely hold down discretionary spending. We expect real GDP to grow at a mere 2.2 percent pace in 2011.

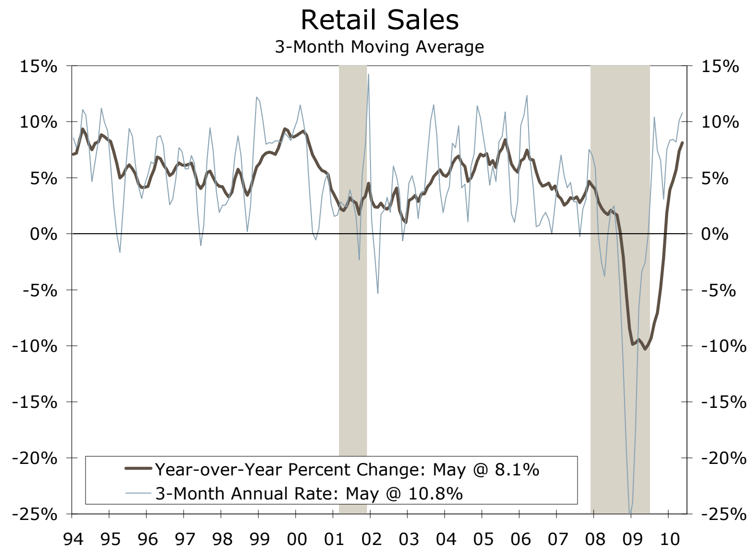
Economic indicators released during the week continue to suggest a moderate recovery is underway. While retail sales fell a disappointing 1.2 percent, the decline was concentrated in the more volatile components of the report. Building materials fell 9.3 percent on the month, but the drop largely reflected give back from stimulus induced appliance spending and from lower winter storm-related spending. Gasoline stations and motor vehicles also fell in May. Core retail sales, which exclude autos, gasoline and building materials rose 0.1 percent on the month and are up 3.5 percent from a year ago. The increase in core retail sales is more reflective of the underlying trend in consumer spending.

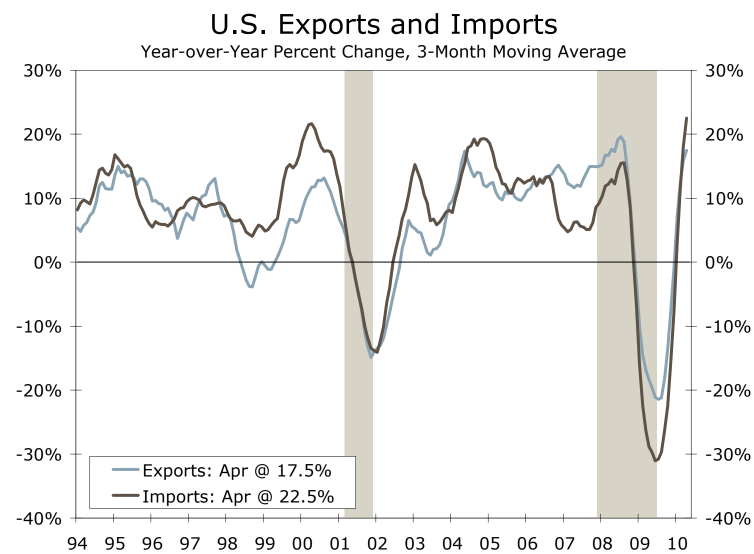
The nominal and real U.S. trade deficit for goods and services widened in April. Both exports and imports edged lower in April, but the declines are likely payback from the large increases in March. April's trade data suggest only a modest drag on growth in the second quarter.

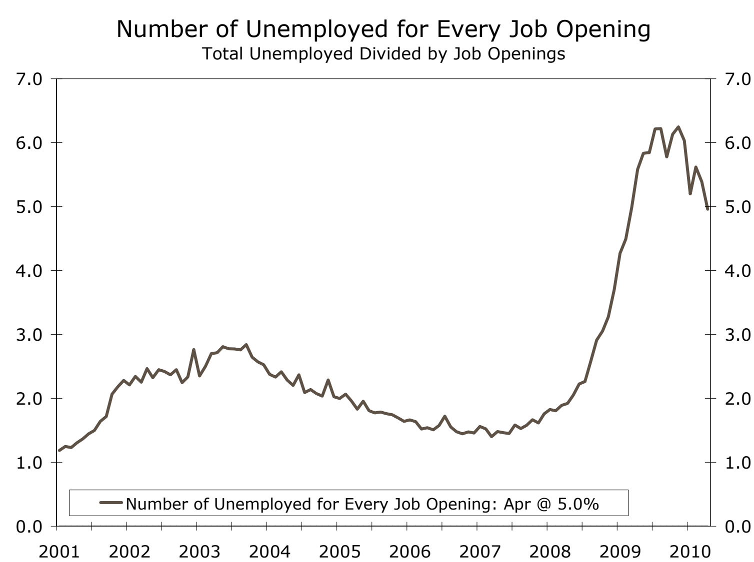
Labor market indicators for the week were mixed. Initial jobless claims remained stubbornly in the 450,000 range, falling by 3,000 to 456,000, from an upwardly revised 459,000. On a trend basis, the four-week moving average rose by 2,500, to 463,000.

The Job Openings and Labor Turnover Survey also showed improvement in the labor market with the number of job openings continuing to trend higher since the most recent trough of 2.3 million in July 2009. The number of job openings in April increased to 3.1 million with the ratio of unemployed to job openings consistent at 5.0 workers per job opening.

While employment growth excluding Census hiring was lackluster in May, the components beneath the surface such as temporary jobs and average hourly earnings increased suggesting private sector employment is positioned for an improvement. More important, according to the NFIB Small Business Optimism Survey, small business hiring was positive for the first time since September 2008. The biggest obstacle for small business hiring continues to be access to credit.





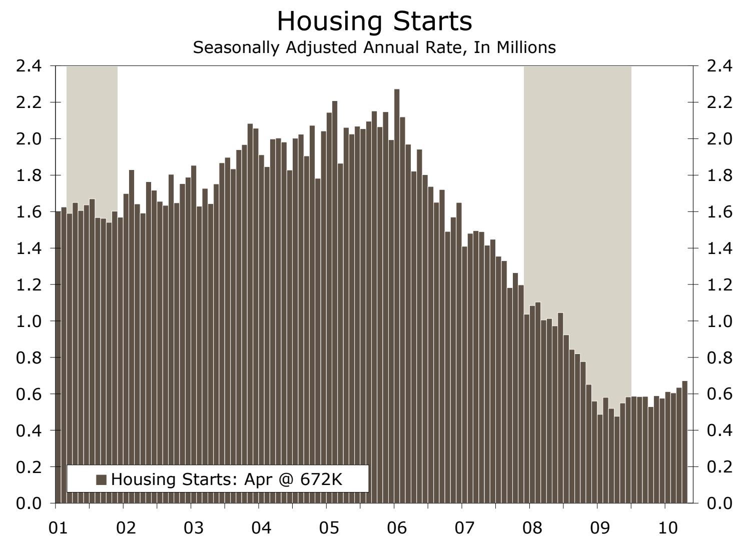


Housing Starts • Wednesday

We expect housing starts to fall roughly 8 percent in May to a 620,000 unit pace. The projected decline would be the largest monthly drop since late 2009 when the homebuyers' tax credit was initially scheduled to expire. Moreover, the combination of the expiration of the tax credit and the start of the peak homebuying season will likely exaggerate seasonally adjusted declines. We expect the downward trend in starts to persist as the oversupply of housing curtails homebuilding and demand wanes. Building permits fell 11.5 percent in April suggesting further weakness. Mortgage applications for purchase are now down 49 percent from their April peak and the rate of delinquencies and foreclosures continue to rise. Consequently, housing starts should pull back in the second and third quarters, but begin to pick up some momentum later in the year.

Previous: 672,000 **Wells Fargo: 620,000**

Consensus: 650,000

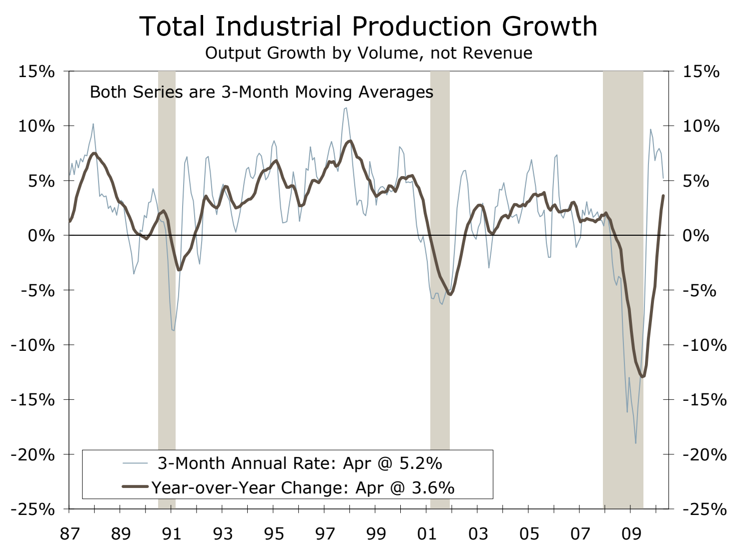


Industrial Production • Wednesday

Industrial production likely rose 0.7 percent in May, the third consecutive monthly increase. While the ISM manufacturing index fell modestly in May, the headline index remained solidly in expansion territory at 59.7. The forward looking new orders index was unchanged at 65.7 and suggests continued strength in the manufacturing sector in coming months. The manufacturing workweek rose to 41.5 hours, the highest reading since July 2000. Capacity utilization, which peaked in 2006 at 81.2 percent, will likely increase for the fourth consecutive month to 74.5 percent, but will remain near historical lows. The abundance of production capacity means pricing power will remain minimal.

Previous: 0.8% **Wells Fargo: 0.7%**

Consensus: 0.9%

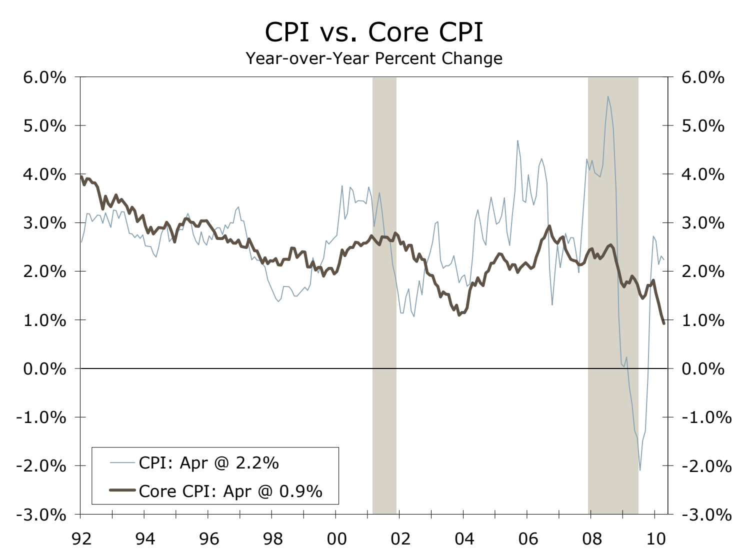


Consumer Price Index • Thursday

The Consumer Price Index (CPI) fell 0.1 percent in April, the first decline in more than a year. Much of the decline was due to a 2.4 percent pullback in the gasoline index. Core CPI, which excludes food and energy prices, remained flat on the month, pulling the year-over-year rate to a 44-year low at just 0.9 percent. We expect consumer prices to fall for the second consecutive month in May again led lower by energy prices. While housing rental indexes have exerted some downward pressure on core prices in recent months, disinflation is evident in other core prices. Goods prices continue to rise faster than service prices, but the pace is slowing. Core goods prices are being pulled up by stronger global economic growth, whereas weak domestic demand continues to restrain core services prices. Substantial slack in the economy should continue to put downward pressure on core consumer prices.

Previous: -0.1% **Wells Fargo: -0.1%**

Consensus: -0.2%



Global Review

Is Brazil Still the Country of the Future?

A famous joke about Brazil says that it is the country of the future, and that it will always be, because the future is never here. However, things are changing. Good policy decisions over the last several decades, political stability and very strong commodity prices are giving Brazil the chance to fulfill its promise.

Almost a decade ago, an analyst coined the BRIC acronym, which stands for Brazil, Russia, India and China, as the new economic axis for the world economy. And today more than ever, Brazil is earning its reputation as a leading country in this highly heterogeneous grouping of countries.

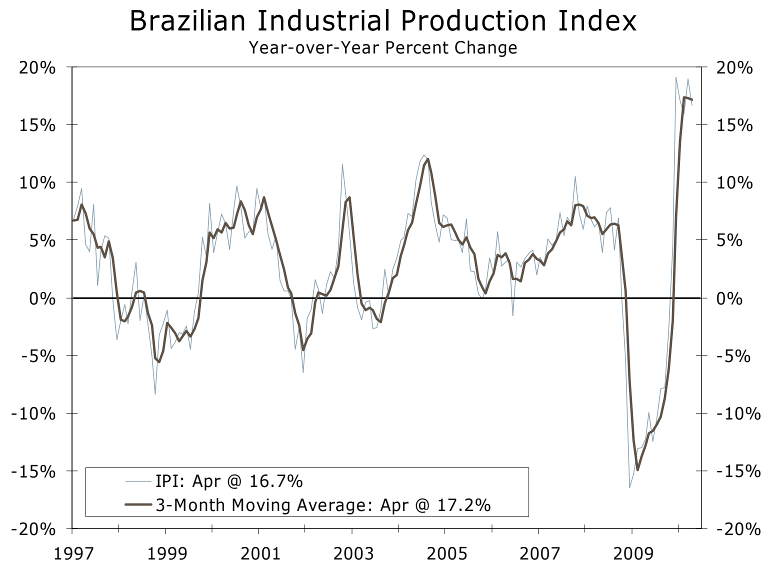
The Brazilian economy posted the highest growth of its gross domestic product since the introduction of the Plan Real, in the mid-1990s. The economy grew at a 9.0 percent rate year-on-year during the first quarter, motorized by a very strong industrial sector. Industrial GDP increased by 14.6 percent with the manufacturing sector rising by 17.2 percent, as the financial crisis and the drop in demand from the world abated and the administration engineered an important expansion in government expenditures while the central bank expanded monetary policy to cushion the effects of the global meltdown.

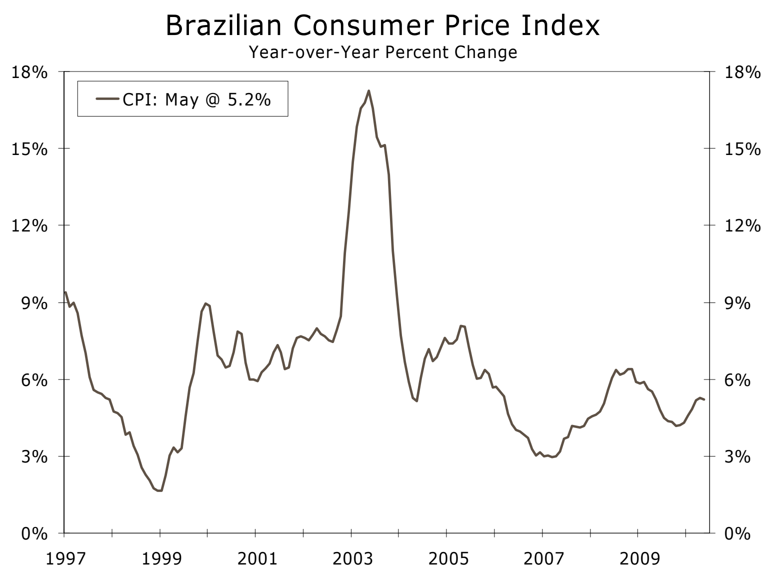
But this growth is not sustainable if investment does not grow strongly over the next several years as it grew during the first quarter. Gross investment increased by 30 percent during this period and will remain one of the keys to the country's success.

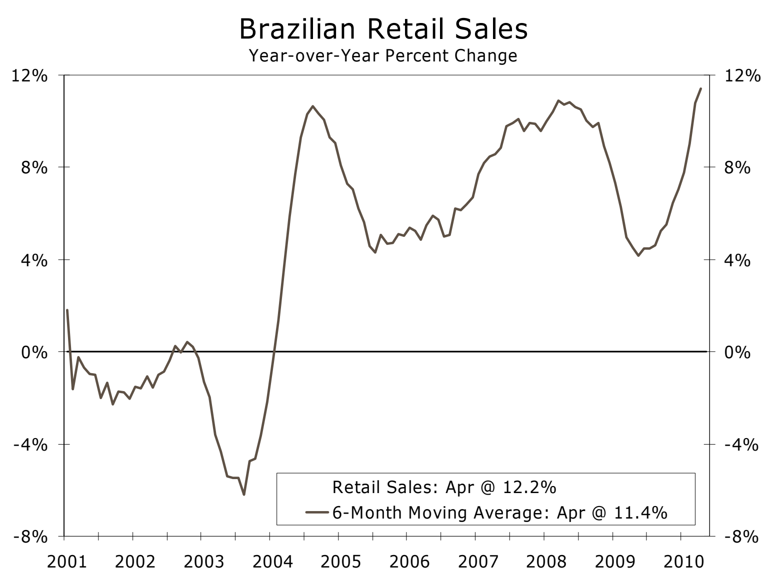
Investment in the Brazilian economy is expected to remain very strong during this decade as the country prepares to host the Soccer World Cup in 2014 and the Olympics in 2016. Infrastructure investment will be the driving force as the economy continues to modernize. Thus, for the first time in its history, Brazil may finally become the country of today, rather than being touted as the country of the future.

While investment in Brazil has been very strong and has helped the country keep price pressures limited, the central bank has again put itself behind the curve in terms of interest rates, perhaps pressured by the administration's interest to delay the inevitable due to the upcoming presidential elections.

However, the institution made an about-face and has finally taken action, and this was the reason why the central bank increased the Selic benchmark interest rate by 75 basis points, from 9.50 percent to 10.25 percent during this week's meeting of the COPOM, the monetary policy committee meeting. For this reason, the central bank will have to fight inflationary pressures during the rest of the year while at the same time avoiding a severe slowdown in economic activity that may affect the course of the presidential elections. On the positive side, the bank has indicated that the European crisis has yet to make a dent on Brazilian economic activity, and this is great news for the Brazilian industrial sector. However, the Brazilian economy, especially the auto sector, is highly dependent on European demand, so it is still not clear how this crisis will ultimately affect Brazil's performance.







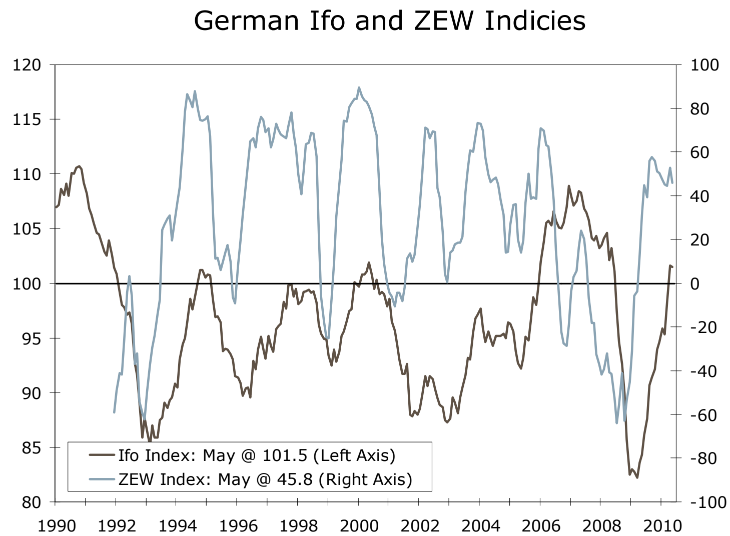
German Econ. Sentiment (ZEW) • Tuesday

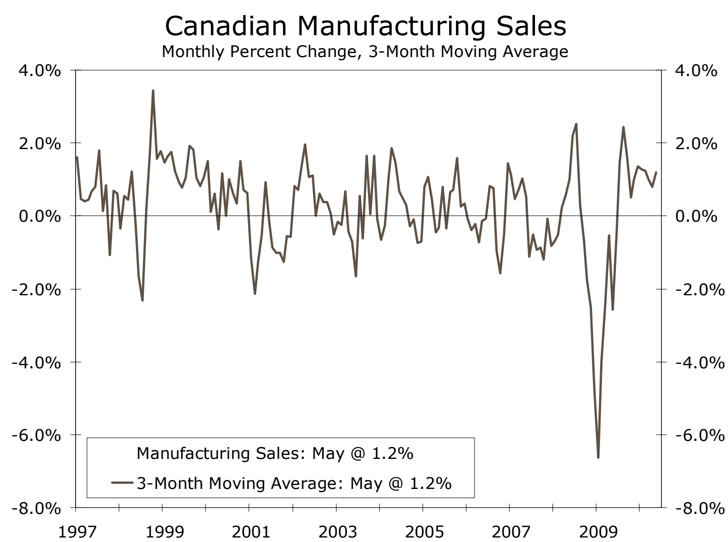
While lingering concerns about the European sovereign debt situation continue to cast a pall over the Euro-zone, recently released data on the state of the German economy show that it remains in an upswing, though the pace of recovery may slow in the months ahead. German industrial production increased another 0.9 percent in April following a jump of 4.3 percent in March. Will the German economy continue to expand, despite concerns about its neighbor's debts? One clue will be the ZEW index due out on Tuesday, June 15. The market expects a modest weakening.

A measure of the health of the broader Euro-zone economy comes out this week when April industrial production (IP) data for the Euro-zone become available. IP increased 1.5 percent in March and analysts look for another, perhaps more modest gain when that number hits the wire on Monday, June 14.

Previous: 45.8

Consensus: 42.0





Canadian Manufacturing Sales • Tuesday

Canadian manufacturing sales turned positive in September of last year and have not given up ground in the six months since. In fact, the pace of shipments for manufactured goods has drawn down inventories, bringing the inventory-to-sales ratio down to 1.32 in March—the lowest level since September 2008. The Ivey purchasing managers' index climbed to 62.7 in May—the highest level of business sentiment since July 2008. This brightening mood among purchasing managers suggests another increase in factory sales may be in the cards for June.

Motor vehicle sales will also be reported in Canada this week. Auto sales slipped 4.2 percent in March and another decline is expected for April.

Previous: 1.2% (Month-over-Month)

Consensus: 0.5%

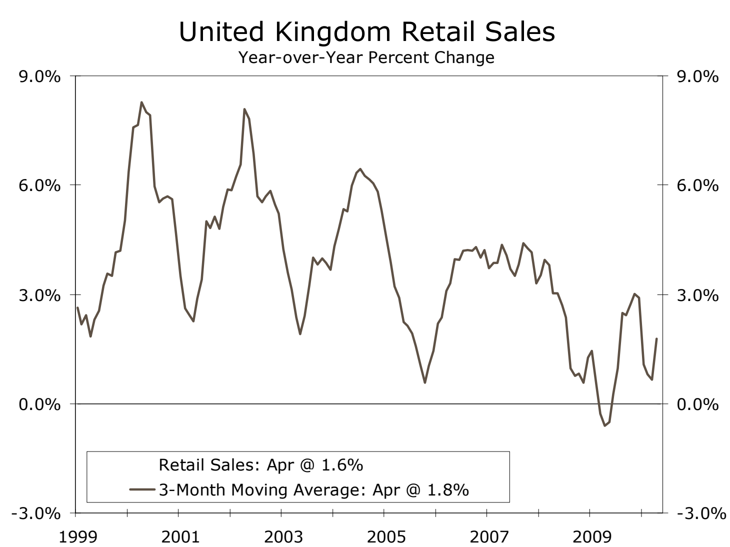
U.K. Retail Sales • Thursday

While U.K. economic growth has turned modestly positive in the last couple of quarters, the sequential growth rate has yet to grow faster than 2 percent (annualized). Private consumption was essentially flat in the first quarter, perhaps reflecting the additional burden of the Value Added Tax (VAT) on consumer activity. We will get a sense of how private consumption is shaping up in the second quarter when retail sales data for the month of May are reported on Thursday, June 17. After a monthly increase of 0.3 percent in April, analysts expect another modest increase in May.

CPI inflation is well above the Bank of England's (BoE) target of 2 percent, though prices have been nudged higher in recent months by the VAT increase. The May reading of CPI inflation is also due out next week. While this will likely show prices increased more than 3 percent, we expect inflation to trend lower later this year.

Previous: 0.3% (Month-over-Month)

Consensus: 0.1%



Interest Rate Watch

European Central Banks on Hold

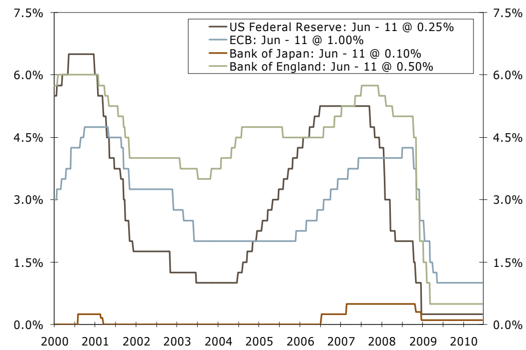
The Bank of England and the European Central Bank held regularly scheduled policy meetings this week and, as universally expected, both banks maintained their policy rates at 0.50 percent and 1.00 percent, respectively. We think we will be able to write the preceding sentence repeatedly for months to come.

Recent economic data suggest that British GDP growth has probably strengthened from the lackluster 1.2 percent annualized rate that was registered in the first quarter. However, the United Kingdom has a frightening budget deficit—estimated at roughly 11 percent of GDP this year, so belt tightening is priority No. 1 of the newly elected government. Tighter fiscal policy over the next few years will likely exert headwinds on British economic growth, which should keep the Bank of England on hold well into next year.

A similar theme is prevalent across the English Channel on the continent. Greece announced this week that GDP declined at an annualized rate of 4 percent in the first quarter, the sixth consecutive quarter of contraction, and with draconian austerity measures in place in the Hellenic Republic, further declines in GDP seem likely. Greece accounts for less than 3 percent of the Euro-zone's GDP, but other countries, including Germany, will be taking the axe to government budgets over the next few years. With economic growth in Europe already rather weak, it is difficult to envision a strong recovery taking hold in the euro area in the foreseeable future. Indeed, the risk of a double-dip recession in the Euro-zone is not insignificant. In our view, the ECB is also on hold well into next year.

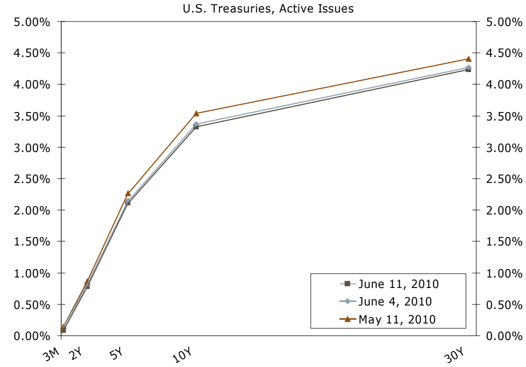
This week, the currency strategy group published its monthly report, in which it envisages further depreciation of the euro vis-à-vis the dollar in the quarters ahead. One of the reasons for the group's bearish view of the euro is the lackluster growth outlook for the Euro-zone. Although the euro certainly could strengthen somewhat in the near term, a trend decline in the value of the common currency seems likely.

Central Bank Policy Rates



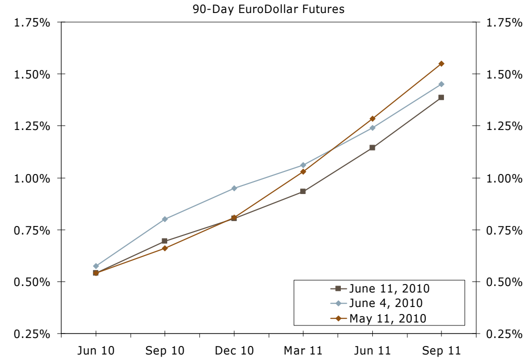
Yield Curve

U.S. Treasuries, Active Issues



Forward Rates

90-Day EuroDollar Futures



Consumer Credit Insights

The Consumer Credit Mystery

Consumer credit outstanding at commercial banks continues to shrink. This might suggest that consumers are focusing on paying off their loans. However, there is another significant factor at work: charge-offs. The change in consumer credit equals new loans less loan repayments less net charge-offs. Rearranging the equation, we get the change in consumer credit plus net charge-offs equals new loans less loan repayments. In this way, we can tell whether net lending activity (new loans less loan repayments) is positive or negative. Consumer credit has contracted for the last four quarters. However, if we take into account the surge in net charge-offs, we see that net lending activity has actually been positive in the last three quarters, albeit much weaker than during the boom years. Unfortunately, with the data available, we can only tell whether net lending activity is positive or negative; we cannot tell the actual levels of new loans or loan repayments. Thus, we cannot say for certain whether loan repayments or charge-offs are having a greater impact. However, with lending standards still tight and loan demand still weak, we can assume that new lending remains tepid. As net lending activity is positive, loan repayments must be even less than new loans. Low loan repayments make sense as delinquency rates remain high and job growth weak. All of this suggests that charge-offs are likely having a greater impact than loan repayments on the contraction in credit.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.72%	4.79%	4.93%	5.59%
15-Yr Fixed	4.17%	4.20%	4.30%	5.06%
5/1 ARM	3.92%	3.94%	3.95%	5.17%
1-Yr ARM	3.91%	3.95%	4.02%	5.04%
MBA Applications				
Composite	560.9	639.0	578.1	611.0
Purchase	167.8	178.0	263.6	270.7
Refinance	2,859.5	3,336.9	2,430.8	2,605.7

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

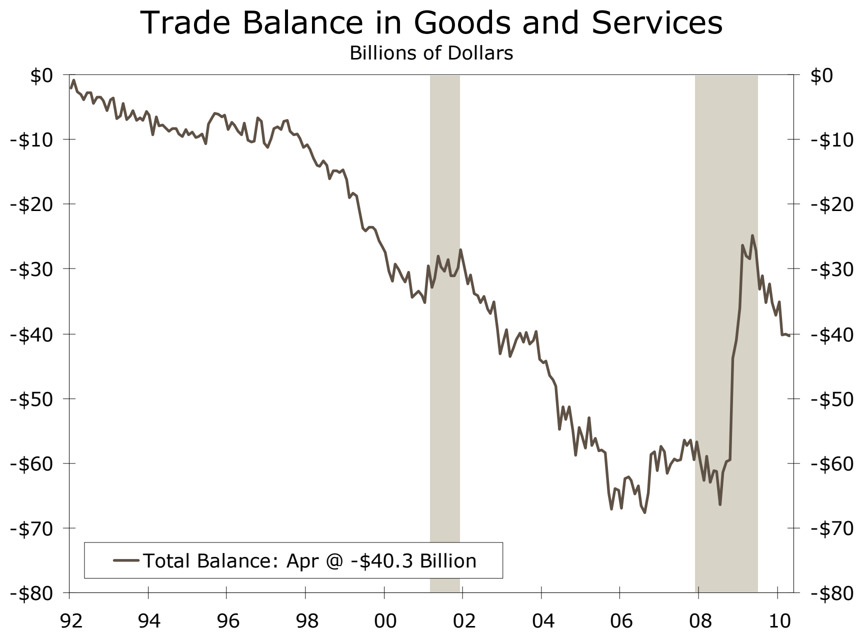
Topic of the Week

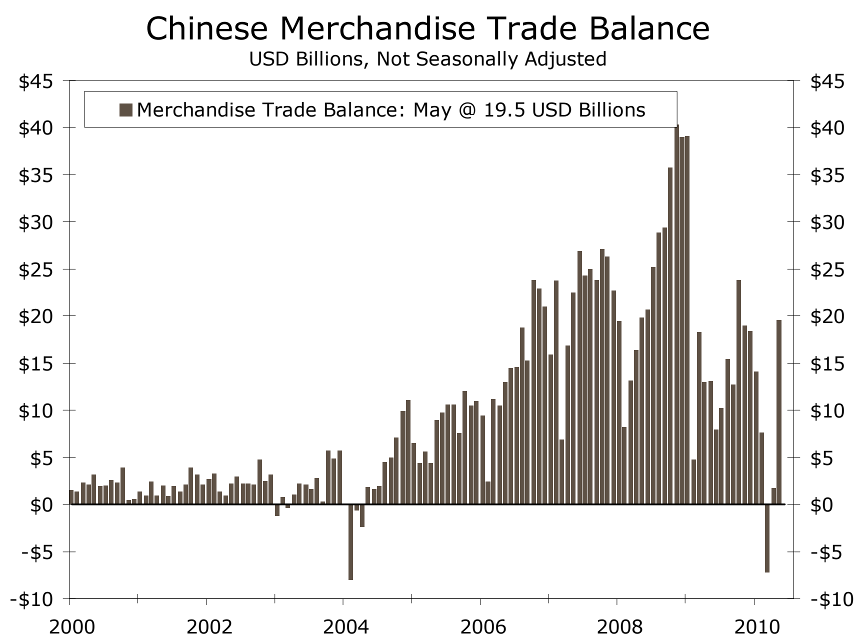
More China Bashing Ahead?

Two data releases, which came out on opposite sides of the world this week, suggest that a subject that has lain dormant for a year or two could start to heat up again. The first observation was the $40.3 billion trade deficit the United States incurred in April, the largest monthly trade gap in more than a year. The second data point was the 48 percent year-over-year increase in Chinese exports that contributed to the $19.5 billion trade surplus in May. U.S.-Sino trade tensions may soon be on the front burner again.

The U.S. bilateral trade deficit with China shrank from $268 billion in 2008 to $227 billion in 2009. The deep U.S. recession caused the dollar value of American imports from China to decline by 12 percent while U.S. exports to China held steady. Now that the American economy is in recovery mode, imports are starting to grow again. In the first four months of 2010, U.S. imports from China were up 14 percent relative to the same period last year and the bilateral trade deficit is beginning to widen again.

Treasury Secretary Geithner encountered congressional frustration this week over the U.S. trade deficit with China. Never mind that a country's current account balance is determined by deep underlying macroeconomic factors. Specifically, the current account deficit reflects the shortfall of national savings relative to domestic investment. America runs a trade deficit because it saves "too little" while China racks up trade surpluses because it saves "too much." Although there is not much that U.S. policymakers can do to encourage lower savings in China, they could implement policies that would increase the low national savings rate in the United States if they believe the current account deficit is a problem. However, it probably is more difficult to build political support for policies that arguably would involve some pain than it is to point fingers at other countries. Look for the rhetoric about the U.S.-Sino trade deficit to escalate in the months ahead.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 6/11/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.08	0.12	0.17
3-Month LIBOR	0.54	0.54	0.63
1-Year Treasury	0.22	0.26	0.47
2-Year Treasury	0.74	0.73	1.32
5-Year Treasury	2.04	1.98	2.85
10-Year Treasury	3.25	3.20	3.85
30-Year Treasury	4.17	4.13	4.70
Bond Buyer Index	4.37	4.28	4.86

Foreign Exchange Rates

	Friday 6/11/2010	1 Week Ago	1 Year Ago
Euro ($/€)	1.209	1.197	1.411
British Pound ($/£)	1.456	1.445	1.659
British Pound (£/€)	0.830	0.828	0.850
Japanese Yen (¥/$)	91.290	91.900	97.630
Canadian Dollar (C$/$)	1.037	1.063	1.102
Swiss Franc (CHF/$)	1.149	1.162	1.070
Australian Dollar (US$/A$)	0.844	0.823	0.819
Mexican Peso (MXN/$)	12.725	12.956	13.380
Chinese Yuan (CNY/$)	6.833	6.829	6.837
Indian Rupee (INR/$)	46.845	46.845	47.613
Brazilian Real (BRL/$)	1.813	1.865	1.924
U.S. Dollar Index	87.332	88.233	79.410

Foreign Interest Rates

	Friday 6/11/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.65	0.64	1.27
3-Month Sterling LIBOR	0.73	0.73	1.25
3-Month Canadian LIBOR	0.79	0.76	0.65
3-Month Yen LIBOR	0.24	0.24	0.49
2-Year German	0.47	0.48	1.73
2-Year U.K.	0.83	0.85	1.53
2-Year Canadian	1.81	1.63	1.42
2-Year Japanese	0.16	0.16	0.38
10-Year German	2.57	2.58	3.70
10-Year U.K.	3.50	3.51	4.02
10-Year Canadian	3.38	3.29	3.54
10-Year Japanese	1.24	1.28	1.56

Commodity Prices

	Friday 6/11/2010	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	73.84	71.51	72.68
Gold ($/Ounce)	1227.47	1219.90	953.95
Hot-Rolled Steel ($/S.Ton)	645.00	645.00	335.00
Copper (¢/Pound)	290.85	281.25	243.80
Soybeans ($/Bushel)	9.30	9.48	12.50
Natural Gas ($/MMBTU)	4.71	4.80	3.93
Nickel ($/Metric Ton)	18,885	18,600	14,832
CRB Spot Inds.	473.68	473.25	408.11

Next Week's Economic Calendar

	Monday 14	Tuesday 15	Wednesday 16	Thursday 17	Friday 18
U.S. Data		**Import Price** April 0.9% May -1.7% (W)	**PPI** April -0.1% May -0.3% (W) **Housing Starts** April 672K May 620K (W) **Industrial Production** April 0.8% May 0.7% (W)	**CPI** April -0.1% May -0.1% (W) **Current Account** Q4 -$115.6B Q1 -$125.0B (W) **Leading Indicators** April -0.1% May 0.6% (W)	
Global Data	**Euro-zone** **Industrial Prod. (MoM)** Previous (Mar) 1.5% **Canada** **Motor Vehicle Sales** Previous (Mar) -4.2%	**Germany** **ZEW Survey (Econ.)** Previous (May) 45.8 **UK** **CPI (YoY)** Previous (Apr) 3.7%	**Euro-zone** **CPI (MoM)** Previous (Apr) 1.5%	**UK** **Retail Sales Ex Auto** Previous (Apr) 0.1%	**Germany** **PPI (YoY)** Previous (Apr) 0.6%

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

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