June 25, 2010

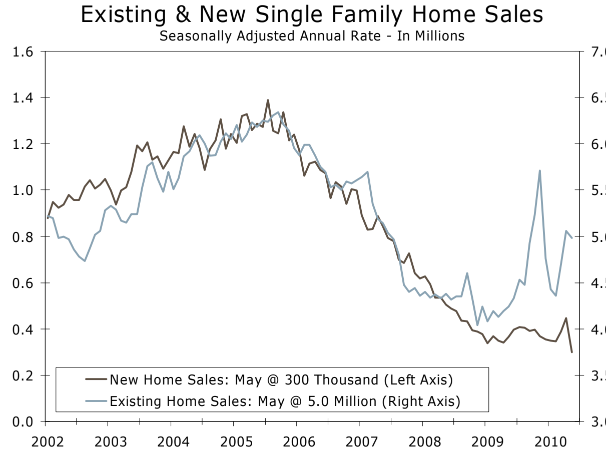
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Despite Disappointing Data, the Recovery Is Still On

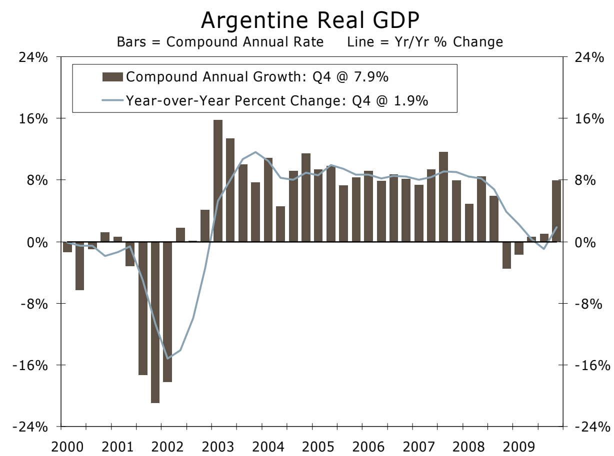
- Both existing and new home sales posted disappointing figures this week. Declines in sales for both were likely due potentially to the expiring homebuyers' tax credit.
- The third revision of first quarter GDP was also released this week with growth revised lower than the consensus had expected to a 2.7 percent annual pace. Final sales, which is a good gauge of underlying demand, was also revised lower to a 0.8 percent annual pace. While growth is slower than initially expected, it is growth, nonetheless.



Global Review

The Argentine Economy Recovers Strength.

- The economy grew at a year over year rate of 6.8 percent in the first quarter while posting a seasonally-adjusted growth rate of 3 percent compared to the last quarter of 2009.
- During the last year, the country has approved new trade regulations on food importation that are geared to defending domestic producers as the real exchange rate continues to appreciate.
- These new regulations are threatening price stability once again, while at the same time creating problems with important trading partners.



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

Inside

U.S. Review

Did Homebuyer Tax Incentives Build A House of Cards?

Housing market data released during the week were largely disappointing as figures were likely distorted due to the expiring homebuyers' tax credit. Existing home sales posted a surprising 2.2 percent decline in May while consensus estimates were looking for a gain of 6.1 percent. Economic forecasts took into consideration increases in pending home sales and mortgage applications, which indicated a boost in sales well in excess of a 6.0 million unit pace. According to the National Association of Realtors, roughly 180,000 homebuyers who signed contracts will likely not be able to close by the end of June due to delays in mortgage processing. If this is indeed the case, home sales in June will likely be elevated.

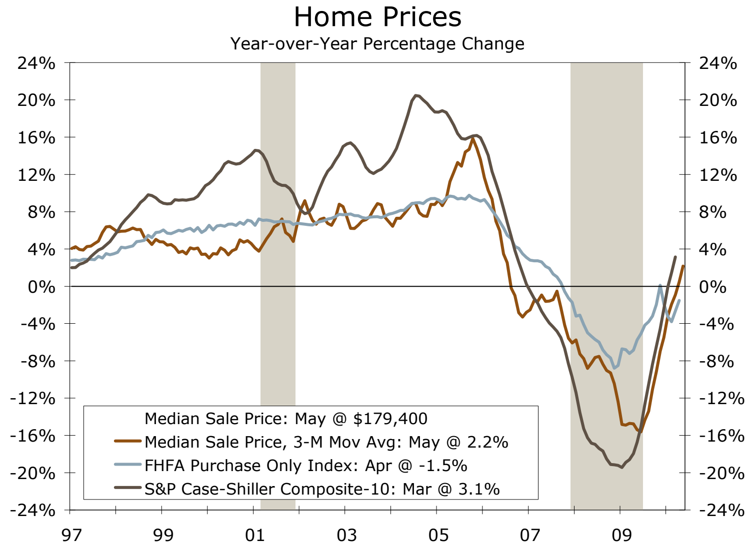
New home sales also fell in May, but while the retracement was expected, the 32.7 percent drop to a 300,000 unit pace, its lowest level on record, was unexpected. The sharp decline is likely due to homebuyers rushing to meet the April 30 contract signing deadline for the tax credit. The seasonal adjustment process also likely exaggerated the extent of the slowdown.

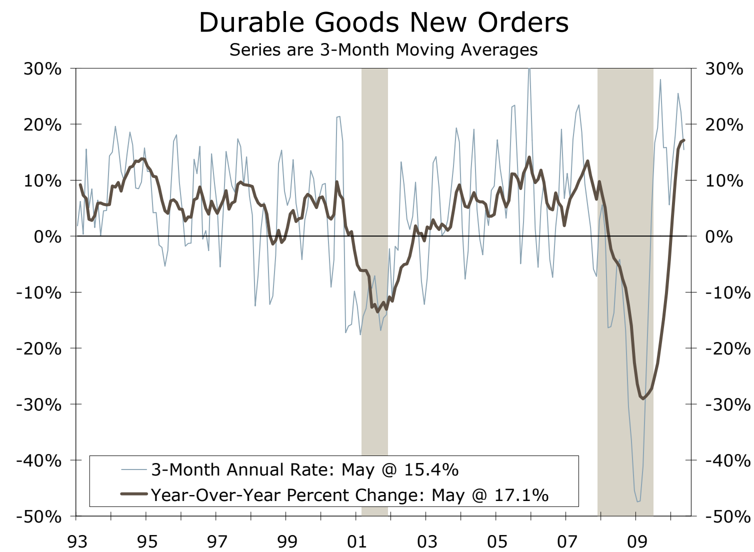
Home price data released by the Federal Housing Finance Agency, however, were far more promising. Home prices rose 0.8 percent in April, its second consecutive monthly gain. The increase was likely driven by a rise in sales volume, once again fueled by the tax credit. A similar pattern of two consecutive increases occurred in October and November when the initial tax credit was scheduled to expire. As the effect of the tax credit fades, we remain cautious on the housing outlook. We expect home prices will likely come under pressure as delinquencies and foreclosures continue to increase.

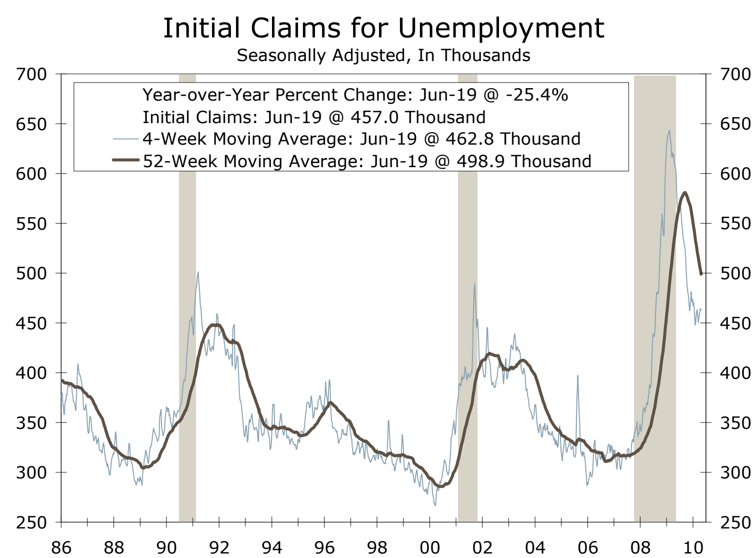
Durable goods orders were also released this week. The headline decline of 1.1 percent was driven by nondefense aircraft bookings which fell 29.6 percent in May following a 215.7 percent surge in April. The retracement was expected, but the underlying components of the report are far more sanguine than the headline suggests. On a three-month annualized basis, the forward looking non-defense capital goods orders, excluding aircraft, jumped 28.7 percent suggesting further gains in business equipment spending in coming months.

Also this week, initial jobless claims remained stubbornly in the 450,000 range, falling by 19,000 to 457,000, from an upwardly revised 476,000. On a trend basis, the four-week moving average fell by 1,500, to 462,750. The expiration of extended benefits, which were available only through June 2, will likely begin to put some upward pressure on the unemployment rate as many workers reenter the workforce.

The third look at first quarter GDP was revised lower than the consensus had expected to a 2.7 percent annual rate. Personal consumption was a lot weaker than initially reported and final sales was revised down to a 0.8 percent annual rate. While final sales is moving at a snails pace, economic growth still remains positive and the modest recovery is still underway.





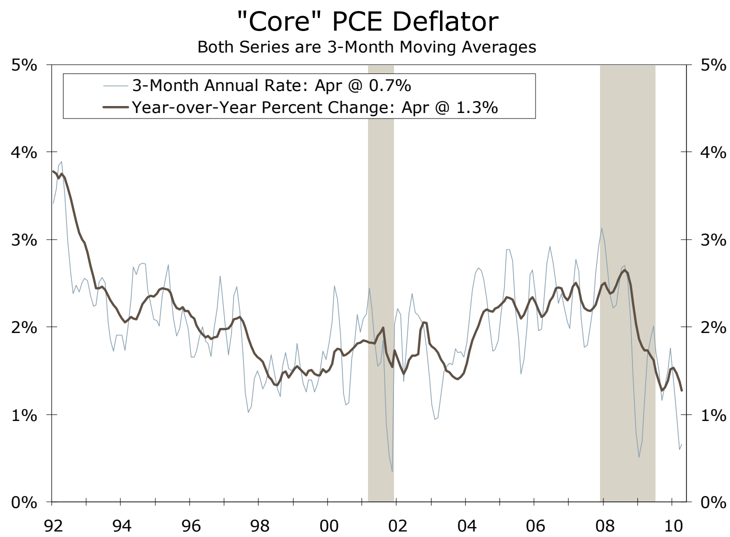


PCE Deflator • Monday

Concern that consumer inflation is becoming too low is again surfacing in the market. The 10-year Treasury yield is now trading around 3.12 percent, its lowest level since May 15, 2009. Market indications of inflation expectations have been trending lower as well. The 10-year Treasury/TIPS spread has narrowed by nearly half a percentage point since the end of April. We expect consumer inflation to remain uncomfortably low for awhile longer. In its statement this week, the FOMC noted that underlying inflation has trended lower in recent months and that resource slack is expected to restrain cost pressures and keep long-term inflation expectations stable. The PCE deflator is expected to moderate to 1.8 percent from a year ago in May from 2.0 percent in April. After stripping out volatile food and energy costs, the core PCE deflator is expected to hold steady at a modest 1.2 percent from a year ago.

Previous: 0.0% **Wells Fargo: 0.1%**

Consensus: 0.1%

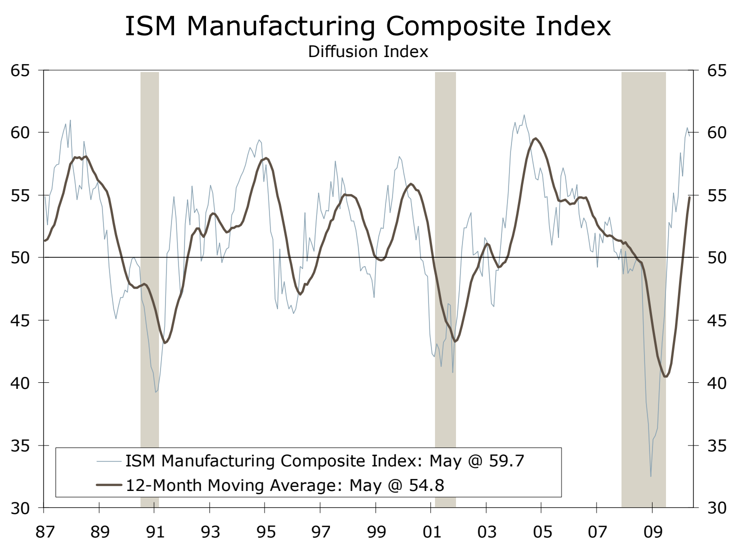


ISM Manufacturing • Thursday

The ISM manufacturing index for June is expected to moderate from very robust levels in May. The April ISM manufacturing reading of 60.0 was the strongest so far for this recovery and a decline in June would mark the second consecutive month of modest declines. Even so, the manufacturing index at current levels indicates that U.S. manufacturing continues to expand at a healthy pace. We see little danger that manufacturing will soon fall into contraction. U.S. inventories remain on the lean side, giving ample support to manufacturing production, even if final demand starts to slowdown. Regional manufacturing surveys have been mixed, increasing the uncertainty around the forecast for this month. The Philly Fed survey was weaker than expected, possibly indicating a temporary move back into contraction, while the New York Fed survey indicated accelerating manufacturing activity.

Previous: 59.7 **Wells Fargo: 56.9**

Consensus: 59.0

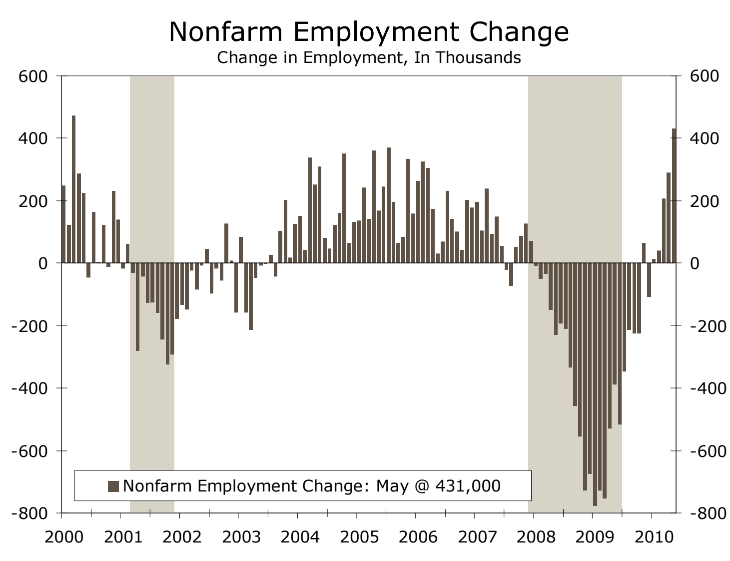


Payroll Employment • Friday

The most important release for the week will be the June payroll report. The consensus expectation is that net non-farm payrolls will contract by more than 100K jobs in June, driven primarily by lost temporary Census worker positions. Below the surface of the headline number, expectations are that private payrolls will show modest improvement, rising by 113K compared to the anemic 41K gain in May. Still, the loss of net jobs in the month should be enough to keep the U.S. unemployment at 9.7 percent. U.S. unemployment has been hovering just below 10 percent for much of the year, and we expect little or no improvement over the coming months. Initial jobless claims have remained stubbornly high. In contrast, aggregate hours worked and aggregate income gains have been more promising, suggesting the labor market may be a bit healthier than the headline job gains imply.

Previous: 431 K **Wells Fargo: -100 K**

Consensus: -105 K



Global Review

The Argentinean Economy Recovers Strength

After posting a 0.9 percent growth rate during 2009, which was affected by the worldwide recession, the Argentine economy rebounded during the first quarter of the year, according to the INDEC, the country's statistical institute. The economy in the first quarter grew at a year-over-year rate of 6.8 percent, up from a growth rate of 2.6 percent during the last quarter of last year. Meanwhile, the quarter-on-quarter seasonally-adjusted growth during the first quarter was a very strong three percent.

Private consumption expenditures came back very strongly after a very poor performance during 2009. Private consumption grew by only 0.5 percent during all of 2009, but it grew by 7.3 percent during the first quarter of the year. Meanwhile, government consumption expenditures remained very strong, posting a growth rate of 8.4 percent year on year after growing by 7.2 percent during all of 2009.

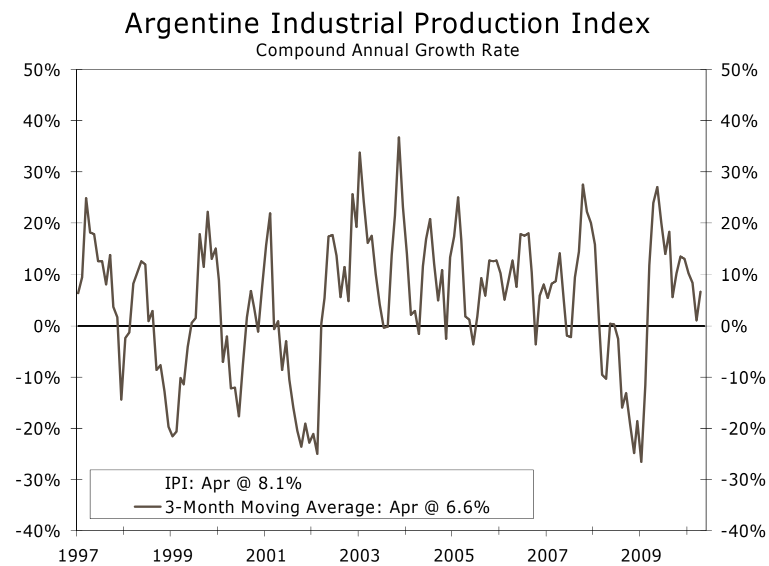
Thus, the Argentine government not only has not pulled back from the economy, but it seems that it has expanded its participation in the economy. At the same time, imports of goods and services surged by 30.1 percent during the quarter while exports of goods and services disappointed with a very weak 4.2 percent gain after falling by 6.4 percent during 2009.

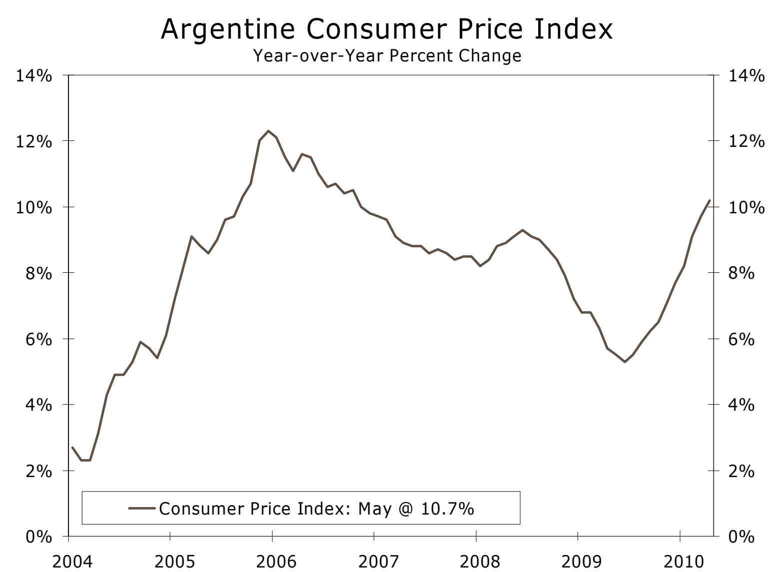
A large part of this growth was directly related to the strong performance of the Brazilian economy to which Argentina's economy is highly linked. However, ties with the Euro-zone are also strong, and the recent events in that region could affect the export sector's performance during the rest of the year.

Furthermore, Argentina's trade sector and government policies are facing a tough time as China has banned its purchase of Argentine soybean oil because of complains that the oil has traces of chemical substances. However, it seems that the real reason has been retaliation for Argentina's trade barriers on Chinese exports to the country. Argentina exports approximately $2 billion in soybean oil per year, which represents almost one fourth of the country's production of that product. Thus, this is one of the reasons why exports have performed so poorly during the first quarter of the year. Problems within the external sector don't end here. Argentina has also had issues with Brazil and hasbeen using several barriers to prevent Brazilian production from reaching the country.

During the last year, the country has approved new trade regulations on food importation that are geared to defending domestic producers as the real exchange rate continues to appreciate. At the same time, domestic producers of these goods are taking advantage of these measures to regain pricing power lost due to competition from foreign producers, and thus consumer prices are, once again, accelerating.

Thus, while the economy has rebounded from the slowdown in 2009, policy decisions by the Argentinean government are threatening price stability once again while at the same time creating problems with important trading partners.



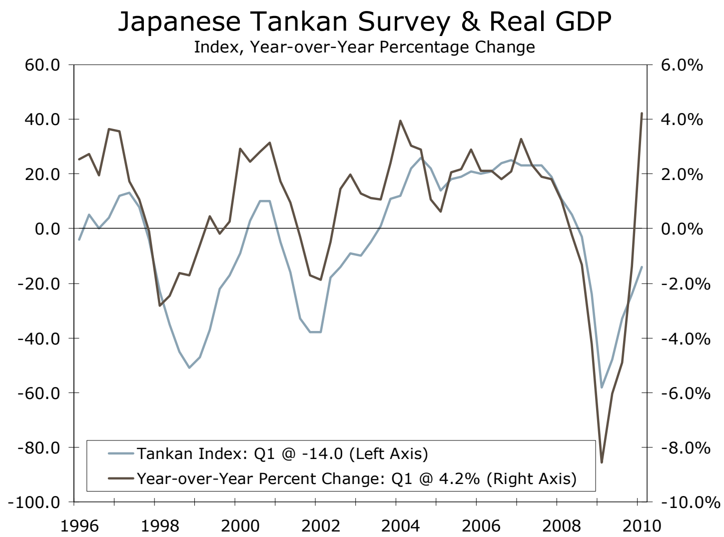


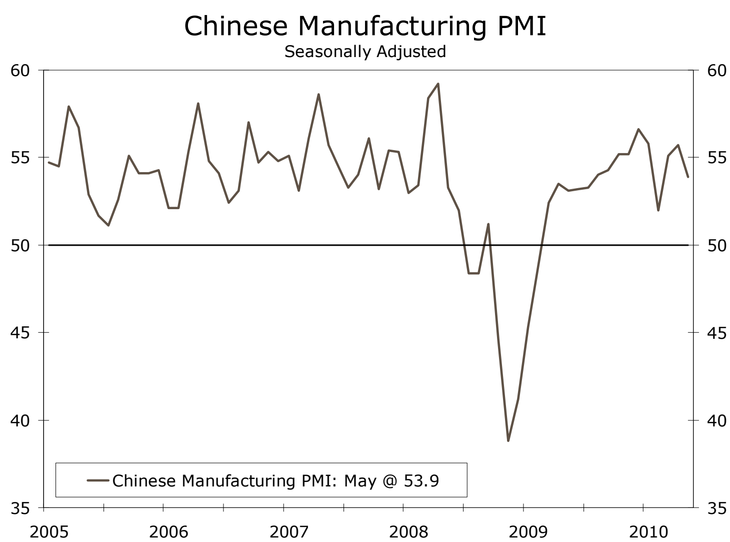
Japanese Tankan Index • Thursday

The Japanese economy was able to post solid growth in the first quarter thanks to increased exports as global growth fueled demand for goods made in Japan. Unfortunately, exports out of Japan have slipped recently, falling in each of the past three months as demand from foreign economies has cooled. This weakening trend in exports has many market watchers in Japan wondering where the Japanese economy will go from here. The Japanese Tankan survey is a widely followed measure of business sentiment and tends to track pretty closely with GDP data as the nearby chart shows. The consensus is expecting a dip in the second quarter reading but a smaller decline than the first quarter. Japanese industrial production for May is also due out on Wednesday. No change in output is expected following a 1.3 percent increase in April.

Previous: -14.0

Consensus: -3.0





Chinese Manufacturing PMI • Thursday

Chinese officials recently made headlines with a formal announcement to gradually allow their currency to strengthen against the U.S. dollar. Overnight, the yuan strengthened 0.4 percent vis-à-vis the greenback, its biggest daily move since the one-step revaluation of two percent in July 2005.

The Chinese government has been taking measures to gradually reign in the fast-growing economy, including efforts to slow lending growth. Data released earlier this month confirmed that inflation in China is growing at the fastest pace in 19 months.

The factory sector is growing very quickly as well. Industrial production grew 16.5 percent in May from a year earlier. On Thursday, Chinese manufacturing PMI will hit the wire and should provide some insight about the future direction of output. A number above 50 is consistent with expansion.

Previous: 53.9

Consensus: 53.3

U.K. PMIs • Thursday-Friday

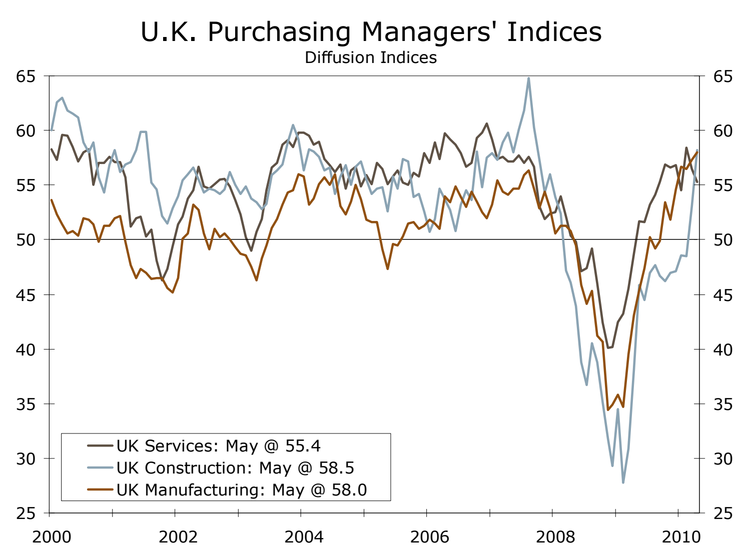
The U.K. economy has posted back-to-back quarterly gains in GDP as it gradually digs out from the recession. Although the pace of growth slowed slightly in the first quarter, it appears the economy is on track to expand at a faster rate in the current quarter.

Growth will likely be supported by strength in consumer spending, which has shown signs of strength in recent months. Indeed, retail sales gained 0.6 percent in May, a larger increase than had been expected. Recent improvements in the labor market have brought the unemployment rate back below eight percent, which should be supportive of future spending increases.

The various purchasing managers' indexes (PMI) were all in expansion territory for the month of May and April PMI data start rolling in on Thursday. No major swings are expected—consistent with expectations for ongoing recovery in the second quarter.

Previous: 58.0 (Manufacturing) 58.5 (Construction)

Consensus: 57.5 (Manufacturing) 58.5 (Construction)



Interest Rate Watch

Fed Sets Tone for the Outlook

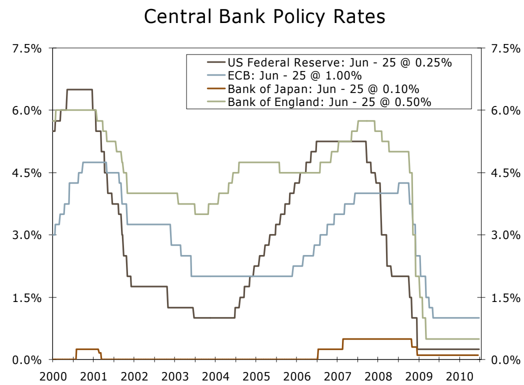
This week's press release from the Federal Open Market Committee meeting (FOMC) of June 23 suggests "that the economic recovery is proceeding and that the labor market is improving gradually...inflation is likely to be subdued for some time."

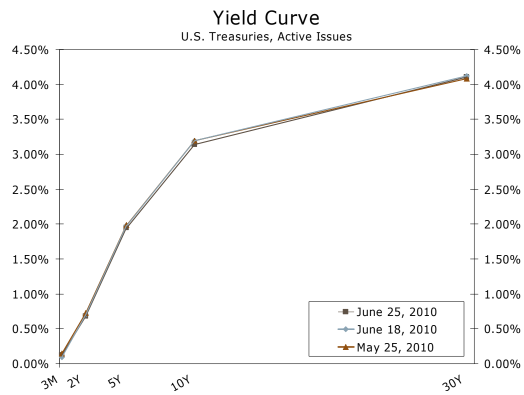
Given this overview, our expectation is that the FOMC will leave the Fed funds rate unchanged for a while and also not attempt to alter the level or composition of its balance sheet through the rest of this year.

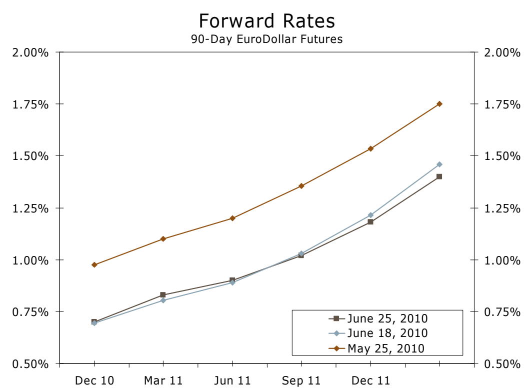
In contrast to the prior FOMC statement of April 28, the economy no longer "continued to strengthen." We agree. Our outlook is for real GDP growth to slow in the second half of this year to a two percent pace from a three percent-plus rate in the first half with slower consumer sector spending the main drag. We do see the labor market improving, but the pace is very slow and the short-run stimulus programs such as the first-time home buyers' tax credit are fading away. Housing and commercial real estate remain weak—the FOMC cites "housing starts remain at a depressed level."

Financial Conditions

According to the FOMC, "Financial conditions have become less supportive of economic growth on balance, largely reflecting developments abroad." We are talking about Greece, sovereign debt and the euro/trade movements. Indeed, the nature of global capital markets has again reasserted its influence on domestic monetary policy. With questions on the quality of sovereign debt in Europe, investors have sought refuge in U.S. Treasuries and thereby driven up the value of the dollar. Along with these movements we have seen a decline in private corporate finance in both high grade and high yield issuance in the U.S. and abroad as investors have increased their risk aversion. Meanwhile, the stronger dollar has raised doubts about trade competitiveness and the reduced dollar value of profits earned in euros. This has hit the equity markets and thereby raised the cost of equity finance. Indeed, financial opportunity is reduced in both the equity and bond markets.







Consumer Credit Insights

Personal Disposable Income Rising

At the outset of the recession, total household debt as a percent of disposable income had risen to 136.4 percent. Recently released data show that through the first quarter of this year, that ratio has come down to 125.9 percent. Nearly $500 billion in household debt has gone away. While consumers have taken measures to fix their balance sheets, unfortunately part of the improvement has to do with substantial charge-offs as lenders accept that some of those debts will never be repaid. Still, over the same time period, disposable income (PDI) has risen by a similar magnitude.

So what has been driving this increase in PDI? Since Q1 2008, while government wages and salaries increased only modestly, private wages and salaries have actually fallen more than $300 billion. Investment income has also dropped as personal income receipts on interest have fallen more than $60 billion.

The primary source of the increase in PDI over the past two years is government transfer payments, which have risen roughly $450 billion since January 2008. Social benefits for old age, survivors, disability and health insurance have risen by $162 billion, "other" transfers have risen by $194 billion and unemployment insurance payouts increased $94.6 billion.

Meanwhile, tax payments have plunged by almost a third as millions of jobs were lost. So the improvement in debt-to-GDP ratios does not exactly reflect a healthy economy.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.69%	4.75%	4.78%	5.42%
15-Yr Fixed	4.13%	4.20%	4.21%	4.87%
5/1 ARM	0.00%	3.89%	3.97%	4.99%
1-Yr ARM	3.77%	3.82%	3.95%	4.93%
MBA Applications				
Composite	621.2	659.9	633.5	548.2
Purchase	177.9	180.0	185.7	280.3
Refinance	3,208.5	3,461.5	3,257.4	2,116.3

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

Topic of the Week

China Reintroduces Currency Flexibility

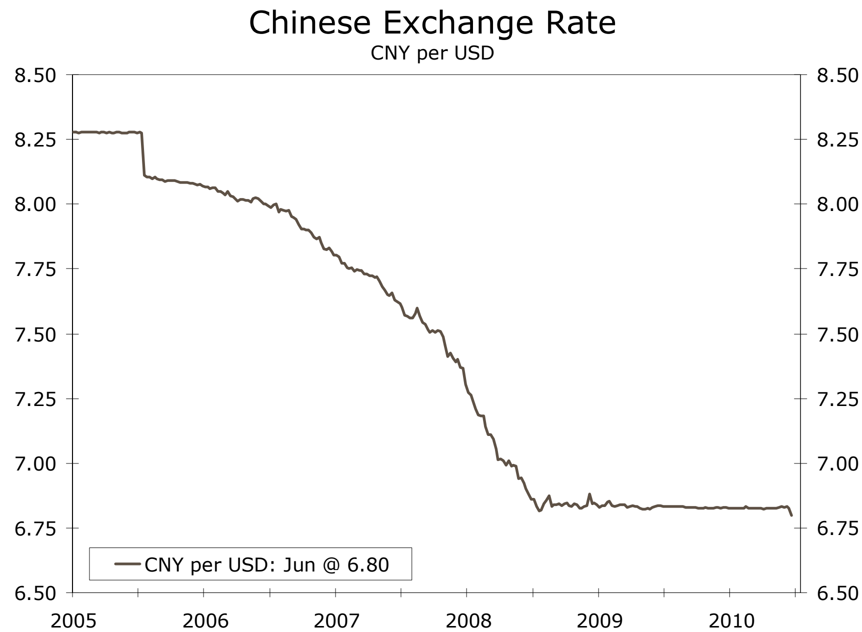
Chinese officials recently announced their intention to permit some flexibility in the heavily managed renminbi/dollar exchange rate. Why is China making the move at this time?

First, the policy move dovetails with the current economic needs of China. The major risk to the Chinese economy has shifted from insufficient economic growth to inflation that could potentially be higher than desired. Second, the move should soften some of the political criticism of China's exchange rate policy at this weekend's G-20 summit meeting in Toronto.

In reality, do not look for runaway appreciation of the Chinese currency. Officials would prefer to move in a very deliberate fashion to minimize the probability of negative shocks to the economy. Indeed, the currency strategy team expects the renminbi to appreciate about two percent against the dollar in six months and eight percent in eighteen months.

We continue to forecast that Chinese GDP will grow in excess of 10 percent in 2010 before slowing to about nine percent next year. In our view, the modest amount of renminbi appreciation that we expect over the next eighteen months will not have a significant negative effect on the Chinese economy. Due to its very high saving rate, we believe that China will continue to rack up current account surpluses over the next few years. This currency move should have very little impact on the U.S. current account, which we forecast will remain in deficit for the foreseeable future. In other words, a major re-balancing of the global economy, whereby the U.S. current account deficit and the Chinese current account surplus both move toward balance, does not seem likely due solely to this currency move.

For further insights see *China Reintroduces Currency Flexibility* on our website.



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Market Data ♦ Mid-Day Friday

U.S. Interest Rates	Friday 6/25/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.12	0.09	0.17
3-Month LIBOR	0.53	0.54	0.60
1-Year Treasury	0.13	0.16	0.26
2-Year Treasury	0.66	0.71	1.13
5-Year Treasury	1.93	2.01	2.58
10-Year Treasury	3.13	3.22	3.54
30-Year Treasury	4.09	4.14	4.33
Bond Buyer Index	4.40	4.40	4.79

Foreign Exchange Rates	Friday 6/25/2010	1 Week Ago	1 Year Ago
Euro ($/€)	1.230	1.239	1.399
British Pound ($/£)	1.493	1.482	1.637
British Pound (£/€)	0.823	0.836	0.855
Japanese Yen (¥/$)	89.490	90.710	95.950
Canadian Dollar (C$/$)	1.040	1.022	1.155
Swiss Franc (CHF/$)	1.101	1.109	1.094
Australian Dollar (US$/A$)	0.865	0.872	0.803
Mexican Peso (MXN/$)	12.704	12.549	13.218
Chinese Yuan (CNY/$)	6.792	6.826	6.835
Indian Rupee (INR/$)	46.290	46.174	48.608
Brazilian Real (BRL/$)	1.781	1.772	1.943
U.S. Dollar Index	85.846	85.699	80.403

Foreign Interest Rates	Friday 6/25/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.67	0.66	1.14
3-Month Sterling LIBOR	0.73	0.73	1.20
3-Month Canadian LIBOR	0.83	0.81	0.60
3-Month Yen LIBOR	0.25	0.24	0.47
2-Year German	0.56	0.58	1.32
2-Year U.K.	0.74	0.88	1.15
2-Year Canadian	1.56	1.74	1.24
2-Year Japanese	0.16	0.16	0.32
10-Year German	2.61	2.73	3.43
10-Year U.K.	3.39	3.54	3.71
10-Year Canadian	3.22	3.33	3.42
10-Year Japanese	1.15	1.21	1.39

Commodity Prices	Friday 6/25/2010	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	76.52	77.18	70.23
Gold ($/Ounce)	1250.65	1256.80	939.25
Hot-Rolled Steel ($/S.Ton)	625.00	625.00	335.00
Copper (¢/Pound)	297.00	288.10	230.00
Soybeans ($/Bushel)	9.51	9.47	11.89
Natural Gas ($/MMBTU)	4.78	5.00	3.84
Nickel ($/Metric Ton)	19,327	19,731	15,409
CRB Spot Inds.	480.45	477.13	399.02

Next Week's Economic Calendar

	Monday 28	Tuesday 29	Wednesday 30	Thursday 1	Friday 2
U.S. Data	**Personal Income** April 0.4% May 0.3% (W) **Personal Spending** April 0.0% May 0.0% (W) **PCE Deflator** April 2.0% May 1.8% (W)	**Consumer Confidence** May 63.3 June 63.0 (W)		**ISM Manufacturing** May 59.7 June 56.9 (W) **Construction Spending** April 2.7% May -0.9% (W) **Total Vehicle Sales** May 11.64M June 11.40M (W)	**Nonfarm Payrolls** May 431K June -100K (W) **Unemployment Rate** May 9.7% June 9.7% (W) **Factory Orders** April 1.2% May -0.1% (W)
Global Data	**Germany** **CPI (MoM)** Previous (May) 0.1%	**Japan** **Industrial Prod. (YoY)** Previous (Apr) 25.9%	**Germany** **Unemployment Rate** Previous (May) 7.7%	**Japan** **Tankan Mfg Index** Previous (1Q) -14 **China** **PMI Manufacturing** Previous (May) 53.9	**Euro-zone** **PPI (YoY)** Previous (Apr) 2.8% **UK** **PMI Construction** Previous (May) 58.5

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

Wells Fargo Securities, LLC Economics Group

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