March 12, 2010

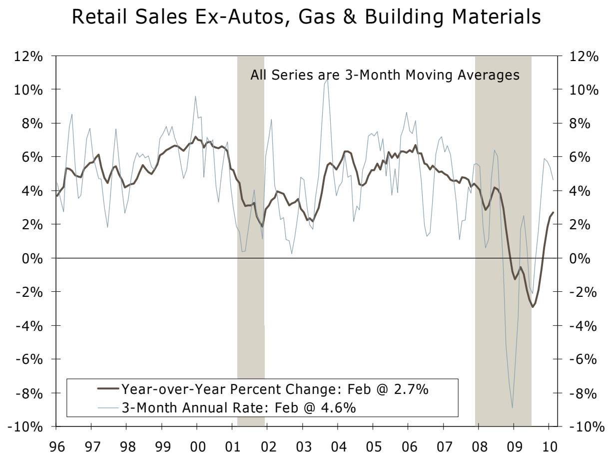
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Upbeat, Downbeat or Simply No Rhythm

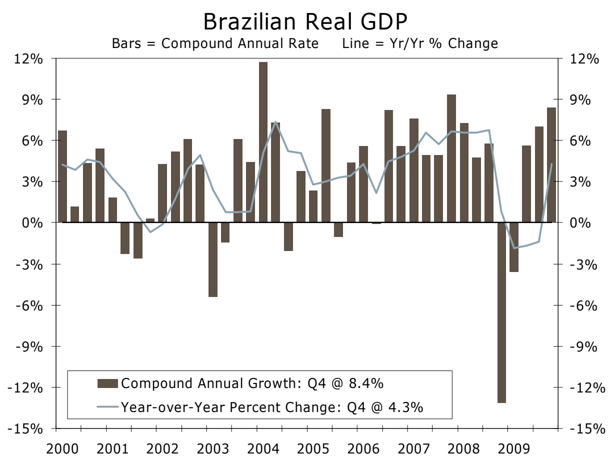
- Economic news continues to come in mixed, with positive reports on retail sales and the trade deficit being offset by disappointing reports on small business optimism and unemployment claims.
- Revised employment data for states show larger job losses during the recession and cast some doubt on January's drop in the national unemployment rate.
- Stronger retail sales and declines in imports led to surprising drops in inventories at retailer and wholesalers in January. Inventories rose slightly at manufacturers, however.



Global Review

Brazilian Economy Surges on Domestic Consumption

- The Brazilian economy surged during the last quarter of 2009 on the back of personal consumption expenditures and government expenditures. Given the faster-than-expected rate of recovery, we will likely raise our forecast for 2010 GDP growth.
- For the full year, the economy slipped 0.2 percent in real terms during 2009 after growing 5.1 percent in 2008.
- Our primary concern in Brazil going forward is inflation.



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	5.9	3.4	2.0	2.0	2.3	2.7	2.1	0.4	-2.4	2.9	2.5
Personal Consumption	0.6	-0.9	2.8	1.7	2.2	1.0	1.4	1.6	2.9	2.6	-0.2	-0.6	1.6	1.7
Inflation Indicators [2]														
"Core" PCE Deflator	1.7	1.6	1.3	1.5	1.4	1.2	1.2	1.2	2.3	2.4	2.4	1.5	1.3	1.7
Consumer Price Index	-0.2	-1.0	-1.6	1.5	2.5	2.4	1.9	1.6	3.2	2.9	3.8	-0.3	2.1	2.1
Industrial Production [1]	-19.0	-10.4	6.4	6.6	8.3	3.9	3.4	6.5	2.3	1.5	-2.2	-9.7	4.9	5.7
Corporate Profits Before Taxes [2]	-19.0	-12.6	-6.6	24.0	22.0	16.0	10.0	8.5	10.5	-4.1	-11.8	-5.1	13.8	8.0
Trade Weighted Dollar Index [3]	83.2	77.7	74.3	74.7	75.4	76.8	78.5	80.1	81.5	73.3	79.4	74.7	80.1	83.6
Unemployment Rate	8.2	9.3	9.6	10.0	9.7	9.8	10.1	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	0.59	0.64	0.67	0.70	1.81	1.34	0.90	0.55	0.65	0.76
Quarter-End Interest Rates														
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	5.25	4.25	0.25	0.25	0.50	3.25
Conventional Mortgage Rate	5.00	5.42	5.06	4.88	5.40	5.70	5.80	5.80	6.14	6.10	5.33	4.88	5.80	6.10
10 Year Note	2.71	3.53	3.31	3.85	3.70	3.80	4.00	4.10	4.71	4.04	2.25	3.85	4.10	4.50

Forecast as of: March 10, 2010
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change

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U.S. Review

Still on Pace for a Modest Economic Recovery

February's retail sales report was easily the best economic news released this week. Overall sales rose 0.3 percent during February, with strong gains reported across nearly every major category. Sales excluding gasoline, building material and automotive dealers, which is a category that tends to track the personal consumption data, rose 0.9 percent in February, following a 0.6 percent gain in January. The strong back-to-back gains suggest consumer spending will rise at a 2.2 percent pace or better during the first quarter, which is in line with our forecast, published earlier this week.

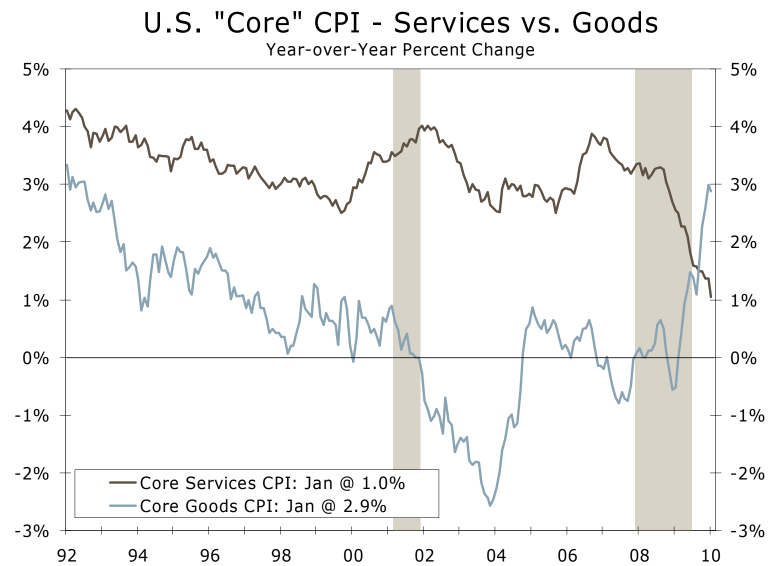
One complicating factor in the retail sales figures is that retailers have done a really good job at bringing inventories in line with sales and are discounting much less than they did in prior years. As a result, the better numbers reported for January and February may not reflect as much volume as they first appear. The lack of discounting is also apparent in the Consumer Price Index, which has shown larger price gains for core good prices. Prices for core goods are currently up 2.9 percent over the past year, which is their largest gain since the early 1990s.

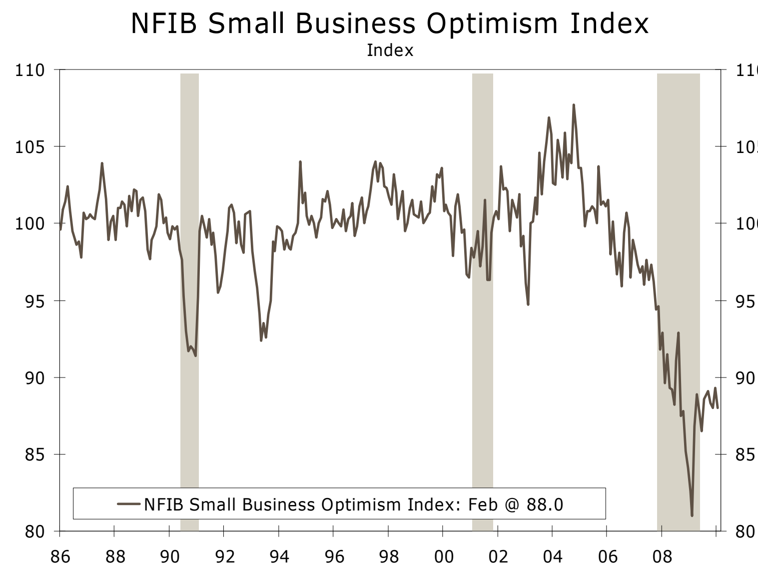
One of the more disappointing reports released this week was the Small Business Optimism survey conducted by the National Federation of Independent Business. The survey fell 1.3 points in February and showed little to no improvement in most of its key components. Small businesses remain pessimistic about the near-term economic outlook and relatively few feel that it is a good time to expand their operations or hire additional staff.

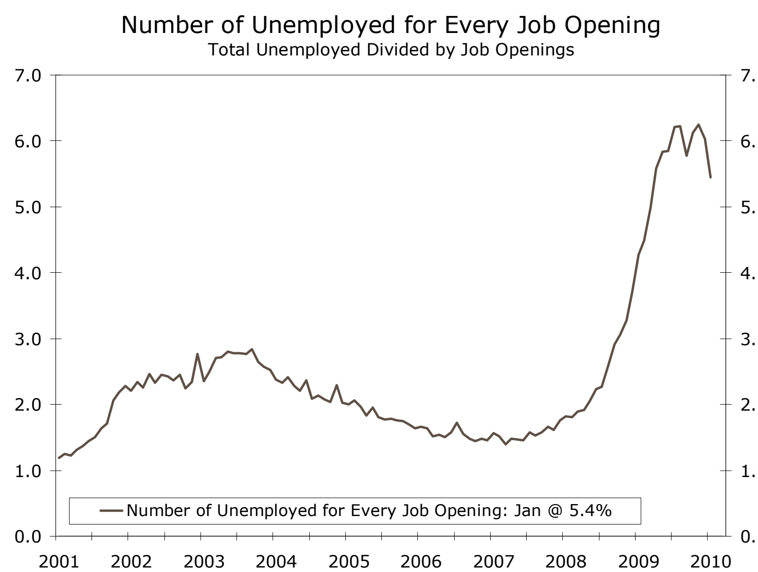
The lack of improvement in small business optimism does not come as much of a surprise to those that follow the sector. Small businesses are often firms that are usually privately owned and the owners are intricately involved in the operations of their business. The owners likely hired the vast majority of the workers they currently employ, work side by side with them, and many had to let some of their workers go over the past couple of years. Most owners also have a great deal of the personal net worth invested in their business and are understandably cautious about putting their life's work at risk. To further complicate matters, credit is harder to get for many firms, particularly those tied to the housing sector.

There were three key reports on the labor market this past week. One was slightly positive, while the other two pointed to continued trouble. The Job Openings and Labor Turnover Survey reported a sizable increase in job openings during January, with the job openings rate rising to 2.1 percent. The increase brings the number of job openings to 2.7 million. The ratio of unemployed to job openings fell a record 0.6 during the month to 5.5 workers per job opening.

The better unemployment rate data for January, which saw the nation's jobless rate fall 0.3 percentage points to 9.7 percent, may have overstated the pace of recovery. Newly revised state data show the unemployment rate moving in the other direction, with increases reported in January for every major Census region.





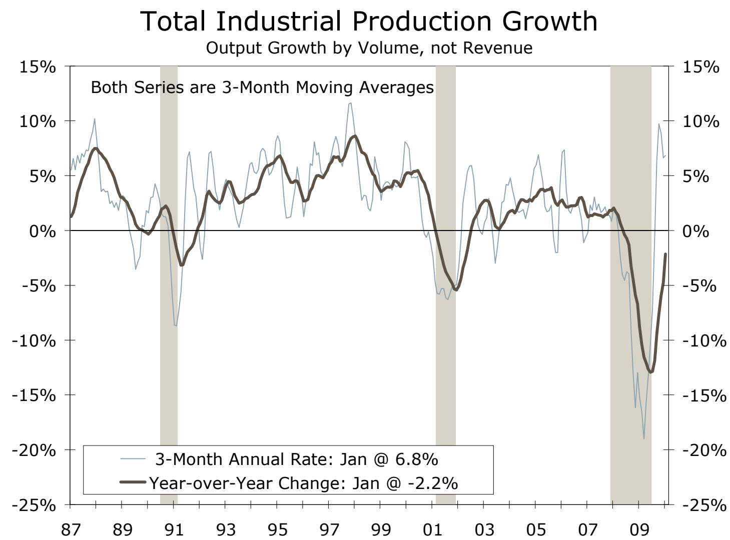


Industrial Production • Monday

Industrial production rose 0.9 percent in January, the seventh consecutive monthly increase. The string of gains dating back to July is consistent with our view that the recession likely ended in June. Both manufacturing and utility output contributed to the gain. Cold weather will likely continue to boost utility output in February. The headline ISM manufacturing index came in at 56.5 in February with new orders and production still solidly in expansionary territory. With inventory levels still relatively lean, the difference between new orders and inventories suggest further gains in production are likely in coming months. Capacity utilization, which peaked in 2006 at 81.2 percent, will likely continue its gradual upward trajectory, but is rising from very depressed levels. Consequently, pricing power will remain minimal.

Previous: 0.9% **Wells Fargo: 0.2%**

Consensus: 0.0%

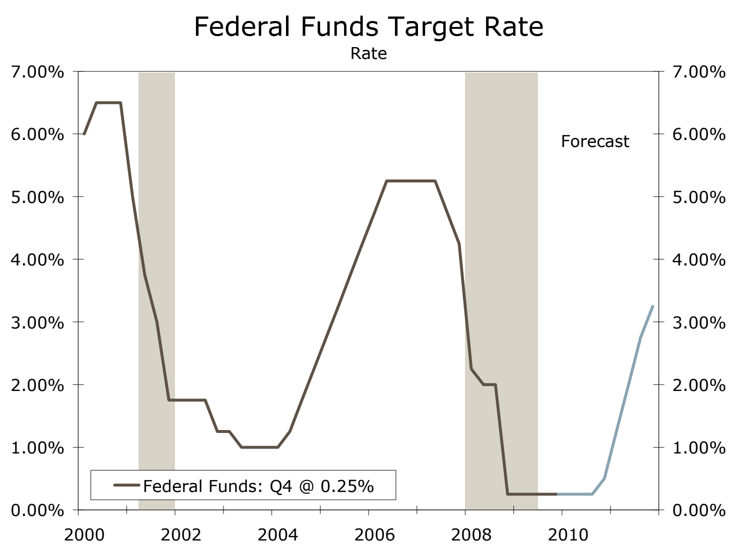


FOMC • Tuesday

The Federal Reserve is expected to keep its federal funds target rate at its current level at the March meeting. Economic conditions including "low rates of resource utilization, subdued inflation trends, and stable inflation expectations" that have continued to warrant "exceptionally low levels of the federal funds rate for an extended period" are still in place. Our outlook continues to suggest that resource utilization should remain low through the end of 2010 with the unemployment rate peaking at around 10.1 percent. Moreover, the fed has historically not raised rates while the unemployment rate is rising. Further, inflation trends as measured by the core PCE deflator remain well within the Fed's comfort zone at 1.4 percent year over year. Finally, one measure of inflation expectations, the TIPS spread, is a little more than 2 percent, suggesting inflation expectations are contained.

Previous: 0.25% **Wells Fargo: 0.25%**

Consensus: 0.25%

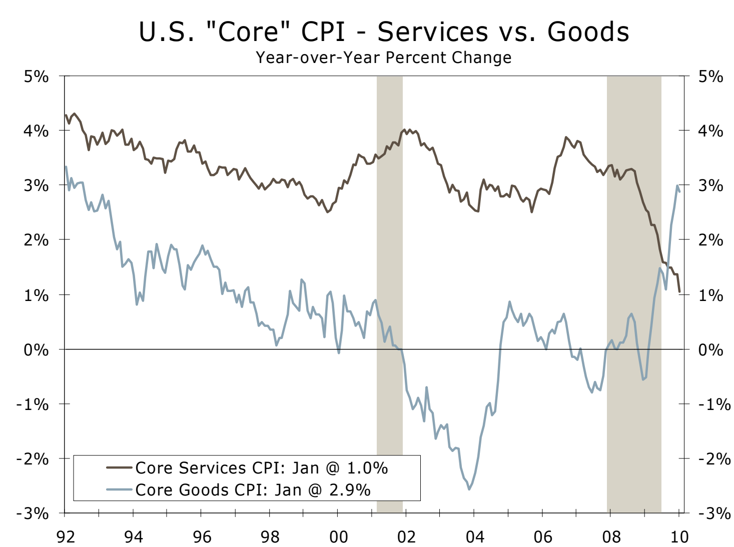


CPI • Thursday

The Consumer Price Index (CPI) rose 0.2 percent in January. The overall CPI is now up 2.6 percent year to year, while the core CPI is up just 1.6 percent. With housing in obvious oversupply, rent and owners' equivalent rent should continue to moderate in coming months keeping core consumer prices relatively tame. Goods prices, however, are continuing to rise faster than services prices. Goods prices were up 2.9 percent over the past year in January, the largest increase since the early 1990s. Core goods prices are being pulled up by stronger global economic growth, while weak domestic demand continues to restrain core services prices. Higher retail gasoline prices will likely also push the headline higher. We expect headline CPI to increase 2.3 percent year-over-year in February and core CPI will likely register a modest increase of 1.4 percent.

Previous: 2.6% (Year-over-Year) **Wells Fargo: 2.3%**

Consensus: 2.3%



Global Review

Brazilian Economy Surges on Domestic Consumption

The Brazilian economy expanded substantially during the last quarter of 2009 on the back of personal consumption and government expenditures. Personal consumption expenditures jumped 7.7 percent during the fourth quarter of the year compared to the same period a year earlier, while government consumption posted a 4.9 percent growth rate over the same period. The growth in private and public consumption was largely engineered by the administration through very specific fiscal programs as well as a very accommodative monetary policy by the Brazilian central bank.

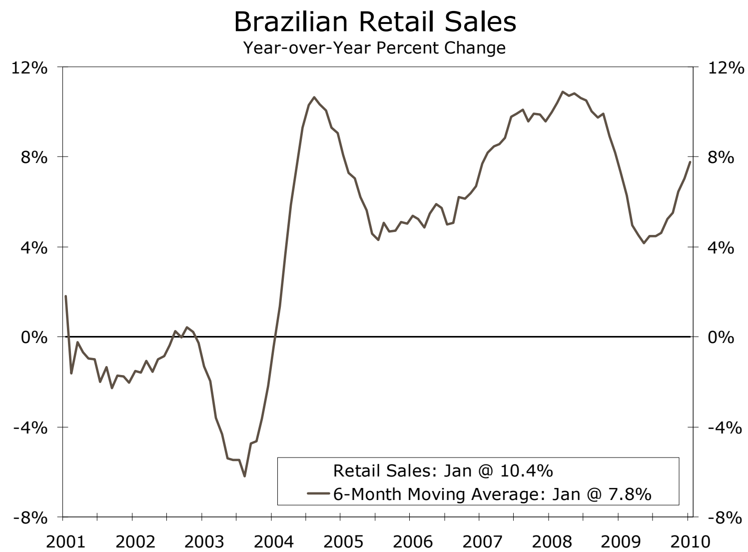
The economy dropped 0.2 percent in real terms during 2009 after growing 5.1 percent during 2008. It is clear that the Lula administration had to put some type of domestic package together during the year because exports remained very weak even as the world economy recovered. Exports of goods and services dropped by 4.5 percent year over year in the last quarter of 2009 and by 10.2 percent during the whole of 2009 after a decrease of just 0.7 percent during 2008.

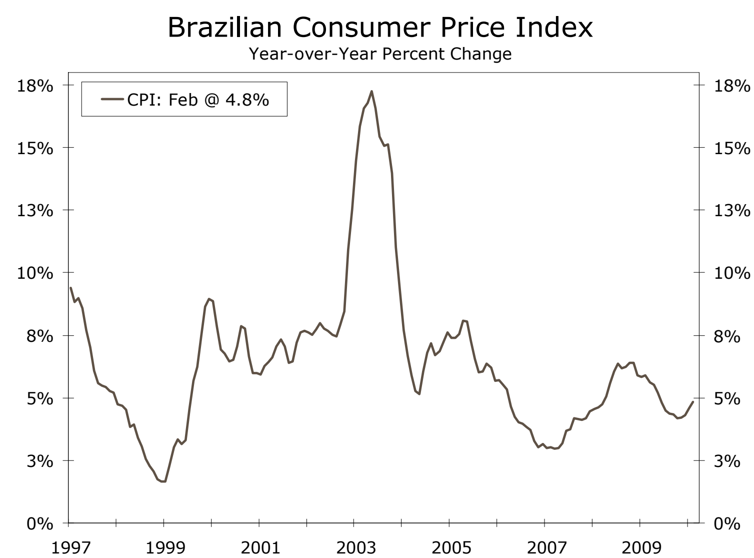
After three miserable quarters for gross fixed investment, there was a welcome turnaround in the fourth quarter. This is an important dynamic because fixed investment spending is going to provide some sustainability to the current recovery, especially as the external sector comes back. Gross fixed investment grew by 3.6 percent during the fourth quarter of the year compared to the same quarter a year earlier but dropped by 9.8 percent for the whole of 2009 compared to the previous year.

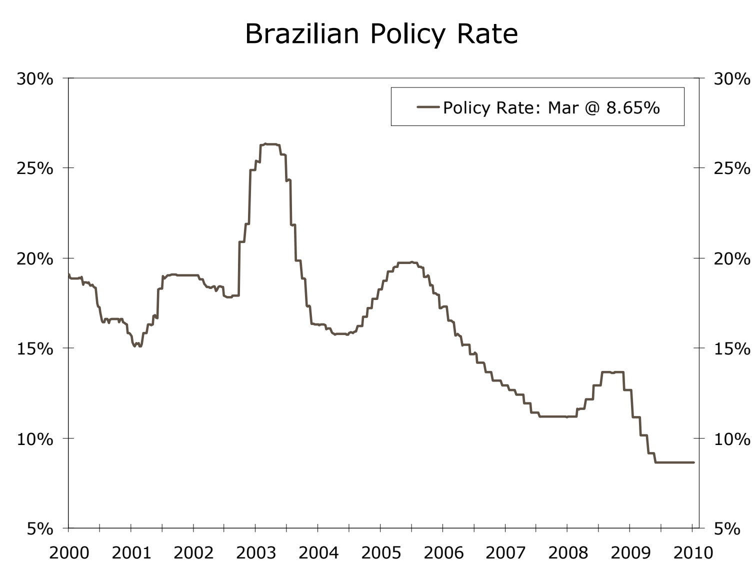
Our main concern going forward is Brazilian inflation. The Lula administration will have to scale down government programs put in place during the last two years if it does not want to suffer another bout of accelerating inflation, especially during an election year, which is normally a very difficult time for inflation expectations.

Even though the country has advanced considerably in terms of productive infrastructure, it still needs to invest more to reduce productive bottlenecks that occur once the economy is growing at a fast pace. Thus, gross fixed investment will have to keep advancing at a much faster pace than it is today to help relieve some of the pressure on the supply side of the economy.

Given the faster-than-expected rate of recovery, we will likely raise our forecast for 2010 GDP growth. That said, there are still some risks attached to this forecast, and the fundamental risk is renewed inflationary pressures. We have already seen the first signs that inflation is coming back, and if domestic consumption continues to remain as strong as it is today, then the problems will worsen as the external sector continues to recover. Thus, the central bank will have to move sooner rather than later, and this could slow down growth during the second half of the year. For this reason, our forecast is likely to remain below the consensus forecast of almost 6 percent for 2010.







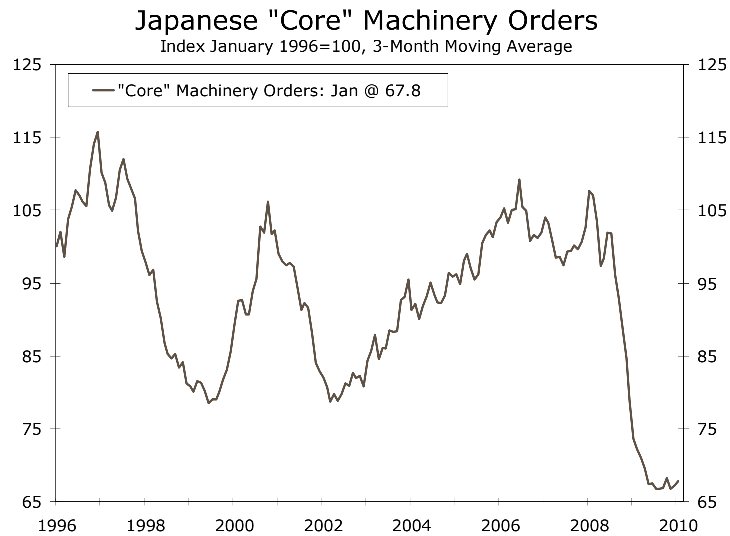
Japanese Machine Tool Orders • Monday

The Japanese economy surprised markets by posting a very strong 4.6 percent rate of growth during the last quarter of 2009. Early indications point to a very strong number for Japanese machine tool orders next week, which could point to relatively strong growth during the first quarter of this year.

However, these expectations will have to deal with the blow coming from the automobile industry where Toyota has continued to face production slowdowns and stoppages as well as reputation hits that have severely affected the company's performance. Thus, while the economy seems to be on the mend, it is still too early to gauge how serious Toyota's problems will be for the overall economy. So far, the news coming form Japan seems to point to a somewhat negligible effect, but we will not be surprised if this changes during the next several months.

Previous: 67.8

Consensus: N/A



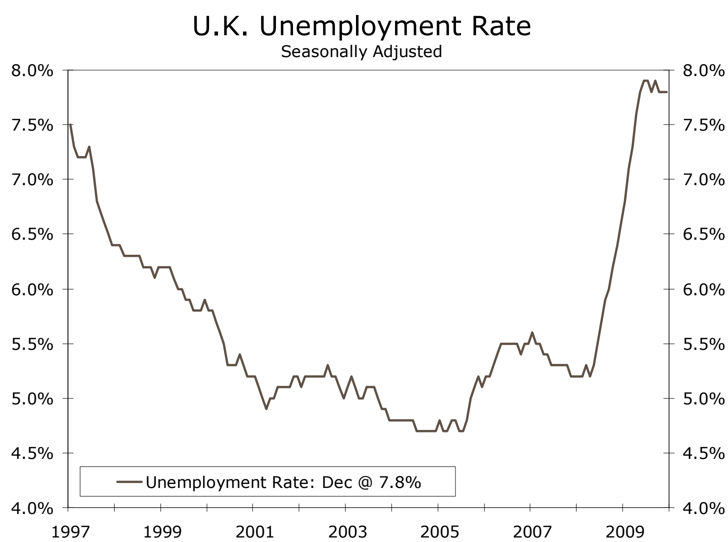
U.K. Unemployment Rate • Wednesday

While the U.K.'s unemployment rate remained at 7.8 percent during the last quarter of 2009, there is plenty of evidence that the employment situation has continued to deteriorate during the first quarter of this year. Production measures like the industrial production index have remained in negative territory even as other countries' indices have rebounded strongly during the last several months.

The weak employment situation is clear when looking at the unemployment claimant count. This measure, which shows those workers seeking unemployment insurance, increased by 23,500 in January to 1.64 million, the highest level in 13 years, and was up by 381,800 compared to January of last year. Thus, while the U.K. economy is recovering from the recession, the pace of this recovery is still very weak.

Previous: 7.8%

Consensus: 7.9%



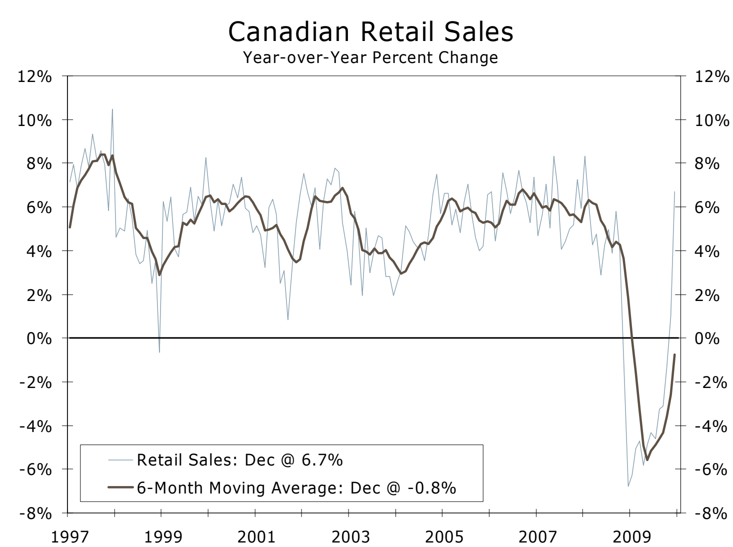
Canadian Retail Sales • Friday

The rebound in Canadian economic activity has been significant, and next week's retail sales activity could confirm the recovery in domestic demand, which was also prey to the global economic downturn during the last two years. Retail sales in December of 2009 posted a very strong growth of 6.7 percent, and we should expect that trend continued during the first month of 2010 as the economic recovery gained momentum.

Meanwhile, commodity prices have increased considerably over the last several months, and this is giving the external sector and the economy as a whole some more ammunition to continue its current expansion. Petroleum prices are once again on the way up, and this is very good news for the Canadian petroleum sector and for domestic consumption.

Previous: 0.4% (Month-over-Month)

Consensus: 0.5%



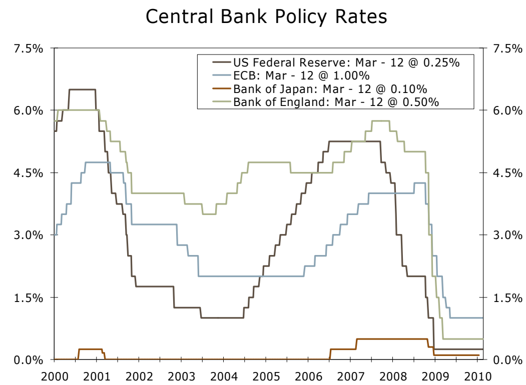
Interest Rate Watch

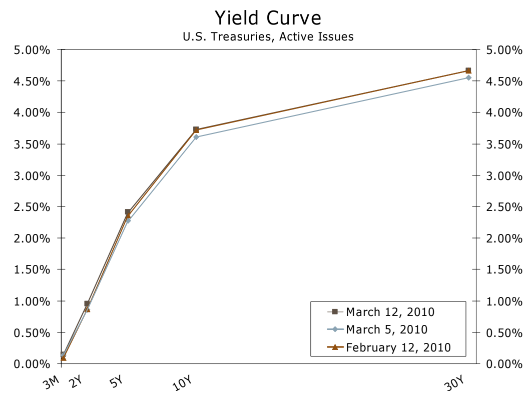
Fed Exit Strategy

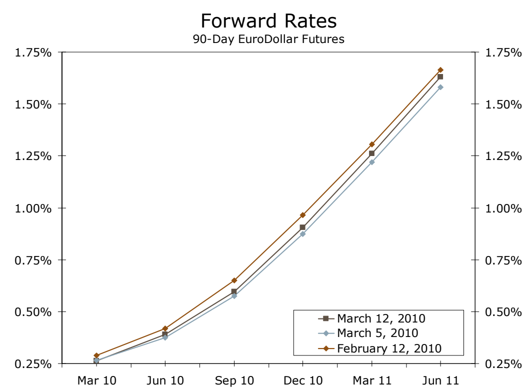
We are skeptical. This perfect strategy sounds too much like the British invasion of Gallipoli. Seldom have we had so much policy easing in so many new and untried ways, and now we are looking at getting out with no problems?

Effective communication is the way we have heard it expressed but already we have the Treasury SPF program announcement with some confusion about what is the purpose of this rebuild of the program from $5B to $200B over the next two months. The Fed's announcement of the discount rate hike did catch many observers by surprise. Certainly we do not expect the Fed to have a perfect plan that will be laid out so that everyone will know exactly what to expect at all times and we have already seen two examples where actions that entail credit markets effects have not been perfectly anticipated. Why would we expect future actions to be perfectly anticipated? Instead our expectation is for short-term rates to be more volatile and drift upward over the next six months. There is uncertainty about the commitment of the Fed to drop further intervention in the mortgage backed security (MBS) market. Without the continuation of the Fed's significant buying over the last six months our expectation is that mortgage rates will drift up as growth and inflation expectations rise with the economic recovery while the Fed drops out as a major buyer of MBS. Much uncertainty remains among investors that the Fed can remain out of the mortgage market due to the political pressures to support the economy and housing. Yet any Fed return to intervention in the MBS market would suggest that the Fed's balance sheet is not going to be reduced and that growth, not inflation, is the goal. In this case the Fed's inflation-targeting credentials will be tarnished—especially in an election year.

Our outlook is that both short and long-term interest rates will rise this year as the economy continues to recover. However the rise in rates will limit the gains in housing and consumer durable purchases this year. Rebalancing the consumer balance sheet does require less spending.







Consumer Credit Insights

Rebalancing the U.S. Consumer

One of the key drivers for the pace of the recovery will be the actions of the U.S. consumer. If the consumer does shift toward higher savings and paying down credit/debt obligations we will see a slower pace of growth in the short run. Yet if the consumer returns to old ways then leverage will drive spending again.

This week's Flow of Funds data from the Fed suggested that households are downshifting on debt and raising that saving rate. Household total liabilities (debt) fell for the fifth straight quarter. Liabilities declined for both home mortgages and consumer credit. Meanwhile, the personal saving rate came in at four percent and is off the sub-two percent range that characterized the 2005-2008 period.

On the asset side, homeowners' equity as a share of household real estate has begun to recover and we expect this recovery will continue for several years. Household net worth also continues to recover although it remains beneath the 2007 peak.

Our outlook is for consumer spending growth to remain subpar in 2010 and 2011 compared to the 2004-2007 period. Both housing starts and light vehicle sales will therefore remain significantly below the pace of that same period. With more modest consumer spending comes more modest economic growth and thereby continued stress on state and local sales tax revenues.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.95%	4.97%	4.97%	5.03%
15-Yr Fixed	4.32%	4.33%	4.34%	4.64%
5/1 ARM	4.05%	4.11%	4.19%	4.99%
1-Yr ARM	4.22%	4.27%	4.33%	4.80%
MBA Applications				
Composite	633.1	629.9	613.1	723.4
Purchase	226.8	214.5	221.2	253.3
Refinance	3,007.2	3,054.3	2,893.9	3,470.7

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

Topic of the Week

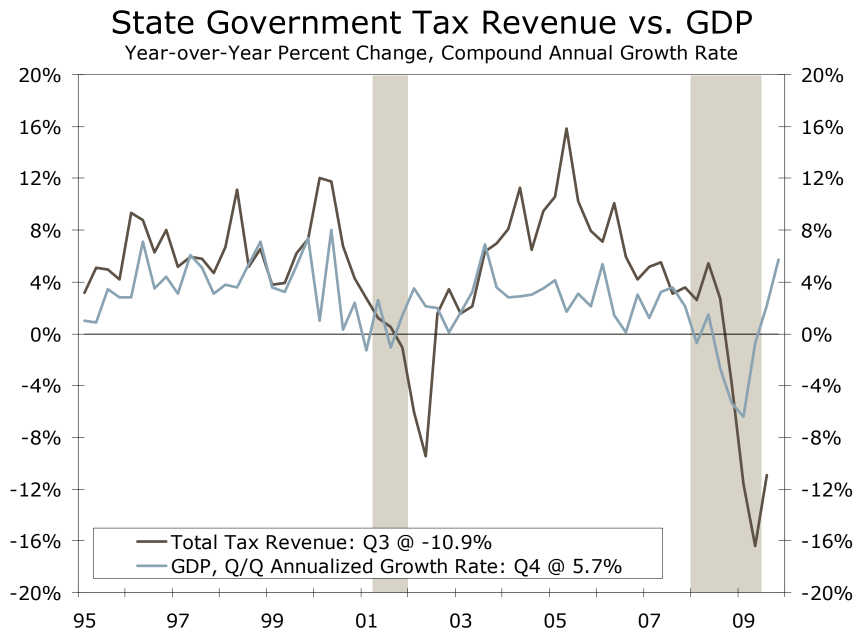
State Finances Face a Tough Road Ahead

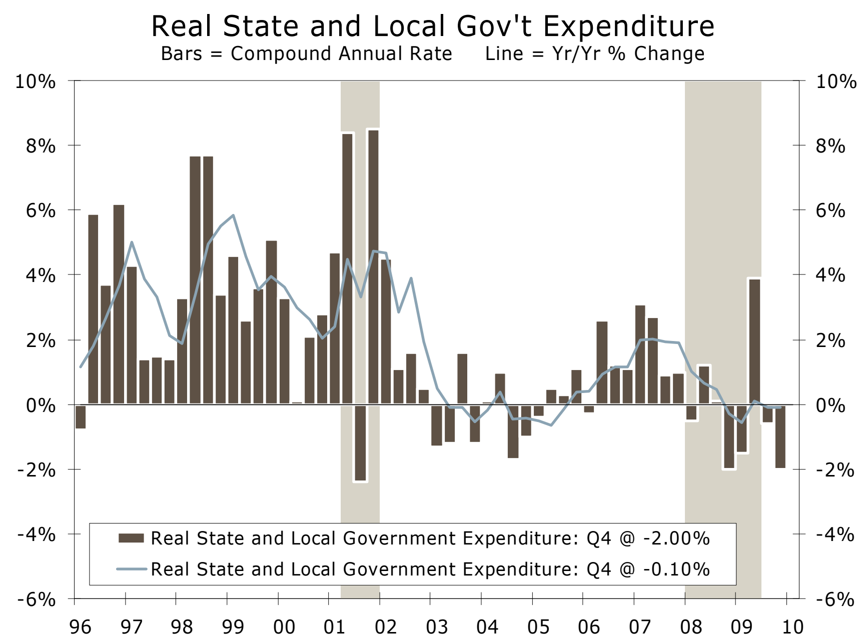
Even with the recovery finally taking hold, the outlook for state finances remains bleak. The exceptionally weak labor market, with high and unusually long-term unemployment, continues to restrain personal income tax receipts, while falling home prices and disappointing retail sales are hitting property and sales tax collections. State lawmakers already closed a cumulative budget gap of $158.5 billion earlier in fiscal year 2010, but new gaps have emerged as revenues have failed to keep pace with spending. Midyear budget gaps bring the total shortfall for fiscal 2010 to $196.2 billion.

Revenues are expected to decline further as state tax collections traditionally lag trends in the overall economic recovery. In the previous recession, tax revenues lagged nearly a year following the end of the recession. The extended drag on revenues is due to the weak labor market, which weighs on personal income, consumption and corporate profits growth. State tax revenues were down nearly 11 percent on a sequential basis in the third quarter and are 33 percent below the peak reached in the second quarter of 2008. Preliminary figures for the fourth quarter from The Nelson A. Rockefeller Institute of Government showed continued weakness with total tax revenues declining 4.1 percent. Declines have moderated, however, reflecting fewer layoffs, a slight increase in hours worked, and a slightly better-than-expected holiday shopping season.

Many states have already projected huge budget gaps for fiscal 2011 with estimates of $103.5 billion. Provisions in the proposed federal budget for fiscal 2011, however, will likely not be enough to offset growing budget concerns. With many states having already scaled back many nonessential services and boosted taxes and user fees, there are few easy alternatives left. The drag from state and local government will continue to be a drag on GDP growth, further slowing an already modest economic recovery.

Please visit our website for the full report.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 3/12/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.15	0.14	0.19
3-Month LIBOR	0.26	0.25	1.32
1-Year Treasury	0.42	0.35	0.71
2-Year Treasury	0.96	0.89	1.00
5-Year Treasury	2.44	2.34	1.90
10-Year Treasury	3.74	3.68	2.85
30-Year Treasury	4.67	4.64	3.61
Bond Buyer Index	4.33	4.34	5.03

Foreign Exchange Rates

	Friday 3/12/2010	1 Week Ago	1 Year Ago
Euro ($/€)	1.373	1.363	1.291
British Pound ($/£)	1.513	1.514	1.394
British Pound (£/€)	0.907	0.900	0.926
Japanese Yen (¥/$)	90.940	90.280	97.720
Canadian Dollar (C$/$)	1.018	1.029	1.278
Swiss Franc (CHF/$)	1.062	1.074	1.185
Australian Dollar (US$/A$)	0.915	0.908	0.655
Mexican Peso (MXN/$)	12.555	12.631	14.721
Chinese Yuan (CNY/$)	6.826	6.826	6.839
Indian Rupee (INR/$)	45.445	45.615	51.860
Brazilian Real (BRL/$)	1.765	1.778	2.296
U.S. Dollar Index	79.966	80.432	87.660

Foreign Interest Rates

	Friday 3/12/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.59	0.60	1.65
3-Month Sterling LIBOR	0.64	0.64	1.87
3-Month Canadian LIBOR	0.40	0.40	1.05
3-Month Yen LIBOR	0.25	0.25	0.62
2-Year German	1.06	1.00	1.30
2-Year U.K.	1.23	1.12	1.37
2-Year Canadian	1.60	1.52	0.99
2-Year Japanese	0.15	0.15	0.42
10-Year German	3.20	3.16	3.01
10-Year U.K.	4.12	4.06	2.95
10-Year Canadian	3.54	3.47	2.92
10-Year Japanese	1.35	1.32	1.32

Commodity Prices

	Friday 3/12/2010	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	82.68	81.50	47.03
Gold ($/Ounce)	1106.72	1134.65	926.63
Hot-Rolled Steel ($/S.Ton)	575.00	575.00	465.00
Copper (¢/Pound)	337.05	340.25	161.75
Soybeans ($/Bushel)	9.15	9.22	8.67
Natural Gas ($/MMBTU)	4.45	4.59	3.99
Nickel ($/Metric Ton)	21,222	22,220	9,719
CRB Spot Inds.	500.06	490.31	330.16

Next Week's Economic Calendar

	Monday 15	Tuesday 16	Wednesday 17	Thursday 18	Friday 19
U.S. Data	**Industrial Production** January 0.9% February 0.2% (W) **Capacity Utilization** January 72.6% February 72.6% (W)	**Housing Starts** January 591K February 580K (W) **FOMC Rate Decision** Previous 0.25% Expected 0.25% (W) **Import Price Index** January 1.4% February 0.1% (W)	**PPI** January 1.4% February -0.3% (W) **Core PPI** January 0.3% February 0.0% (W)	**CPI** January 0.2% February 0.1% (W) **Current Account** 3Q -$108.0B 4Q -$120.0B (W) **Leading Indicators** January 0.3% February 0.1% (W)	
Global Data	**Japan** **Machine Orders (MoM)** Previous (Jan) 0.9%	**Germany** **ZEW Survey** Previous (Feb) -54.8 **Euro-zone** **CPI (YoY)** Previous (Jan) 0.9%	**UK** **Unemployment Rate** Previous (Dec) 7.8%	**Euro-zone** **Trade Balance** Previous (Dec) 4.4B	**Germany** **PPI (YoY)** Previous (Jan) -3.4% **Canada** **Retail Sales (MoM)** Previous (Dec) 0.4%

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

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