May 21, 2010

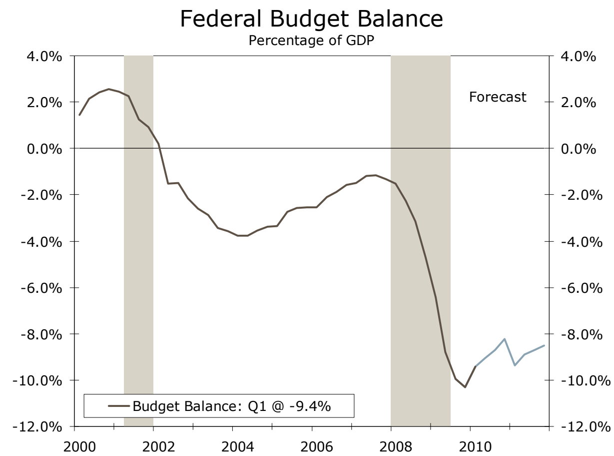
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

"He Was Never the Same"

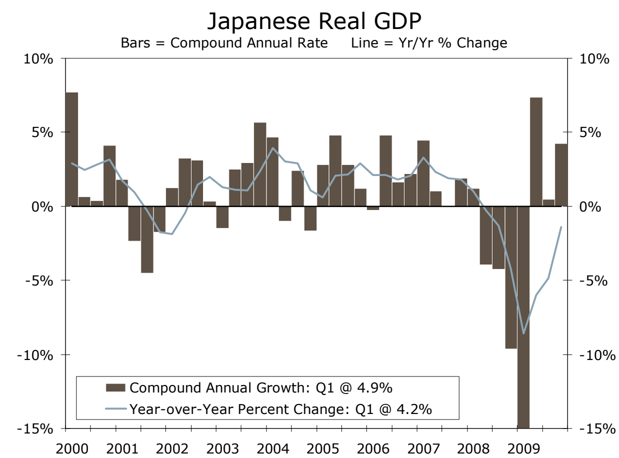
- In sports, this refrain often accompanies the attempted recovery of an athlete after a serious injury. Today, we can say much the same for the U.S. and European economies.
- Moderate growth and low inflation remain the hallmarks of the outlook in the post-stimulus era. Yes, we have growth, but the pace of gains remains short of the political promises. Moreover, moderate recovery and limited private-sector job gains suggest continued large public-sector deficits and a continued need to restructure all levels of government—both here and abroad.



Global Review

Asian Economic Data Remains Strong

- While the markets remain fixated on Europe and the euro, it was heartening to see some good economic data out of Asia this week.
- Japan reported first-quarter GDP growth of 4.9 percent at a seasonally adjusted annualized rate. Singapore's large provisional first-quarter gain was revised up to 38.6 percent from the fourth quarter at an annualized rate, while Taiwan grew 11.3 percent. Clearly, Asia was very strong in the first quarter.



Inside

Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual				Forecast	
	2009				2010				2006	2007	2008	2009	2010	2011
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
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

U.S. Review

"He Was Never the Same"

In sports, this refrain often accompanies the attempted recovery of an athlete after a serious injury. Today, we can say much the same for the U.S. and European economies.

"*We sense the convergence process to a new economic equilibrium has been more difficult than policymakers estimate. Job growth has been non-existent. Credit growth has been restrained and the recovery in housing far less significant than expected. Still inflation remains subdued as unemployment limits the acceleration in wages and unit labor costs.*"

(Annual Outlook, Dec. 9, 2009, for 2010).

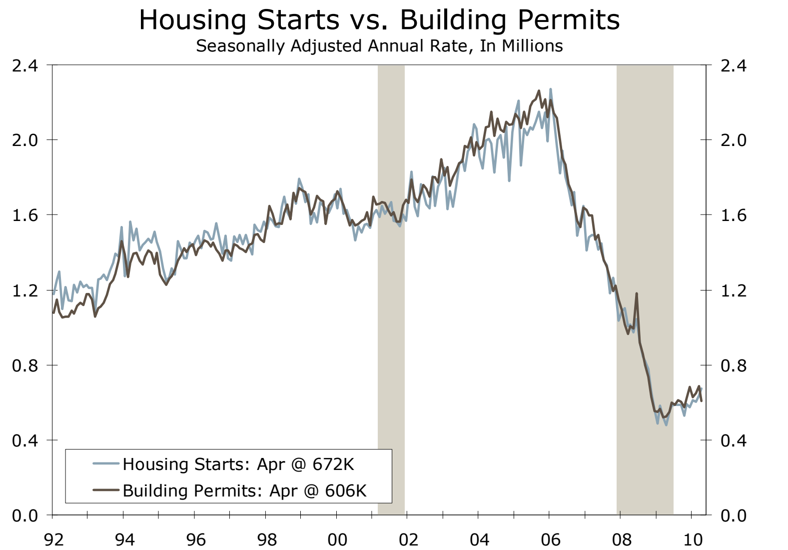
This week's data highlight the change in the U.S. recovery that confirms our suspicions back in December. Housing starts jumped 5.8 percent in April as homebuyers and builders rushed to get contracts signed prior to the April 30 deadline of the homebuyer credit. Yet, building permits fell, thereby suggesting that the rebound in housing will fall short of prior business cycles. Why? For one, consumer confidence numbers indicate that plans to buy a home dropped to the second-lowest level in more than 25 years. Why? Our view is that home values remain uncertain, and there has been a shift in the way households view a home, from an investment opportunity to a shelter. The investment premium in housing is gone. Second, household income growth remains limited once the impact of transfer payments is removed. The Leading Economic Index fell in April. This was the first decline in 12 months. While such a drop is not a signal for panic, it does suggest that forward momentum in the economy may be more modest. There are two components of the leading indicators we find troubling. Building permits fell sharply, which suggests a drop-off in residential construction post-first-time homebuyer credit. This brings into question the sustainability of the housing recovery and its new equilibrium pace of housing starts. Our outlook is for 670,000–710,000 in the fourth quarter. Also, the rise in jobless claims suggests to us that private-sector job growth will remain subpar.

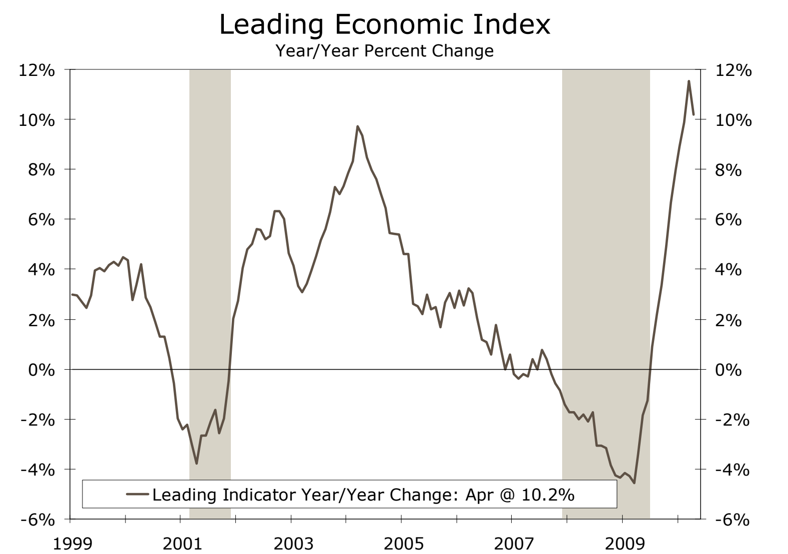
Inflation: Benign Pressures

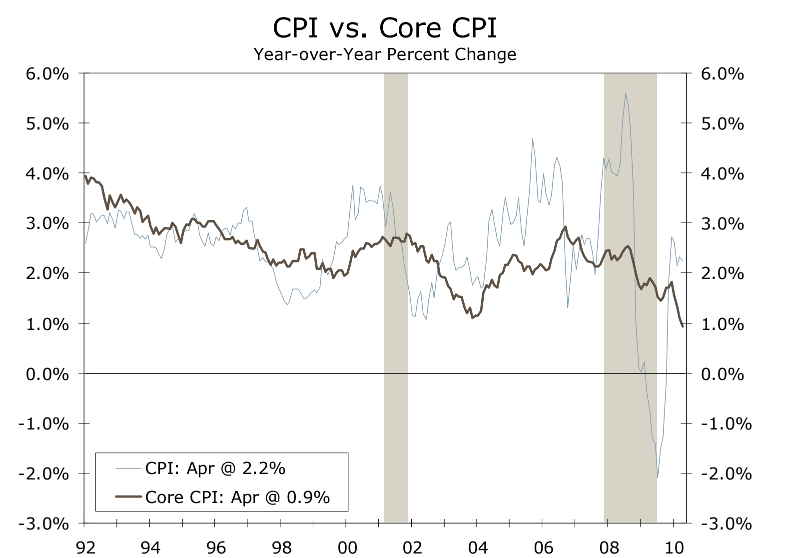
Both the producer price and consumer price indices suggest that low inflation remains the hallmark of the outlook in the post-stimulus era. Producer prices for finished goods are flat over the past three months. Yet, core intermediate goods are up 5.6 percent compared to a year ago. Rising commodity prices continue to put upward pressure due to improving global demand. Yet, there appears to be little follow-through to consumer prices. Core CPI is up just 0.9 percent compared to a year ago. This is consistent with our low inflation outlook for this year and further supports the case for little Fed action for now.

Never the Same: Market Globalization and New Realities

Production, financial capital and labor markets have become truly globalized, setting up interdependence between countries that has been emphasized with a vengeance with the Greek problem and the fallout for the euro. The closed U.S. economy of the 1950s is long gone—time to deal with globalization today.





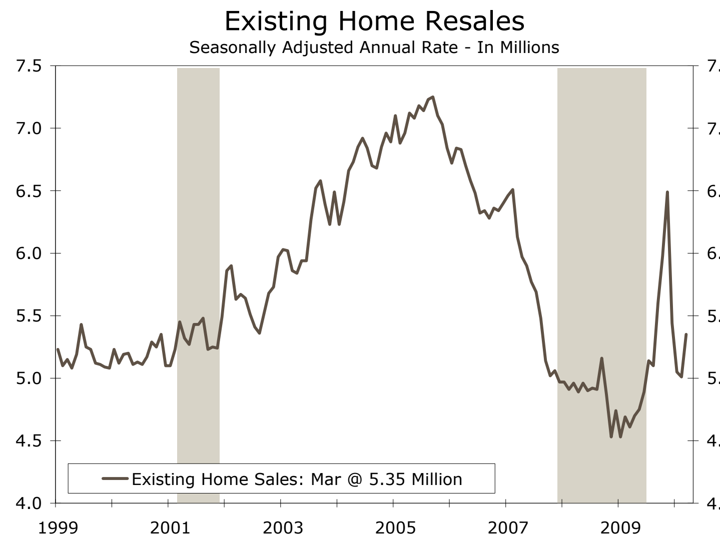


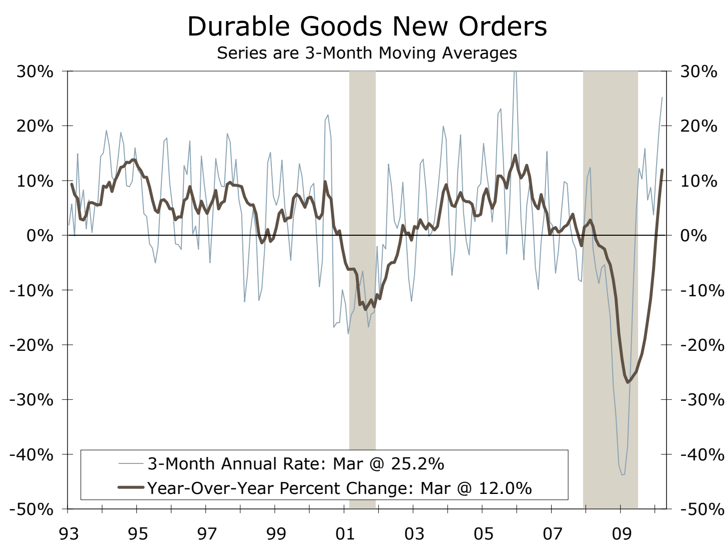
Existing Home Sales • Monday

Existing home sales increased 6.8 percent to a 5.35 million unit pace in March, likely boosted by the homebuyer tax credit and better weather conditions. March's monthly increase was the highest since November 2009, which was the initial expiration date of the stimulus program. With the tax credit scheduled to expire in late June (contracts signed by April), homebuyers will continue to pull purchases forward. Moreover, mortgage applications for home purchase continued to increase in April, and mortgage rates are again at record lows. Consequently, we expect existing home sales will increase 2.8 percent in April to a 5.5 million unit pace. The excess supply of homes and the increasing rate of delinquencies and foreclosed properties, however, suggest a bumpy road ahead for home sales once the tax credit expires.

Previous: 5.35M **Wells Fargo: 5.50M**

Consensus: 5.60M





Durable Goods • Wednesday

Advance orders for durable goods fell 1.3 percent in March, driven by a 67 percent drop in nondefense aircraft orders. The forward-looking series on nondefense capital goods (excluding aircraft) orders is now up 5.1 percent on a three-month annualized basis, suggesting further gains in business equipment spending. Reflecting improving global demand and domestic inventory restocking, both the ISM Manufacturing Index and industrial production also suggest continued positive momentum for the manufacturing industry. Moreover, defense orders will likely help boost the headline in April. Hence, we expect durable goods orders to increase 1.6 percent in April. On a trend basis, shipments of core capital goods suggest capital spending could make another positive contribution to economic growth in the coming quarter.

Previous: -1.3% **Wells Fargo: 1.6%**

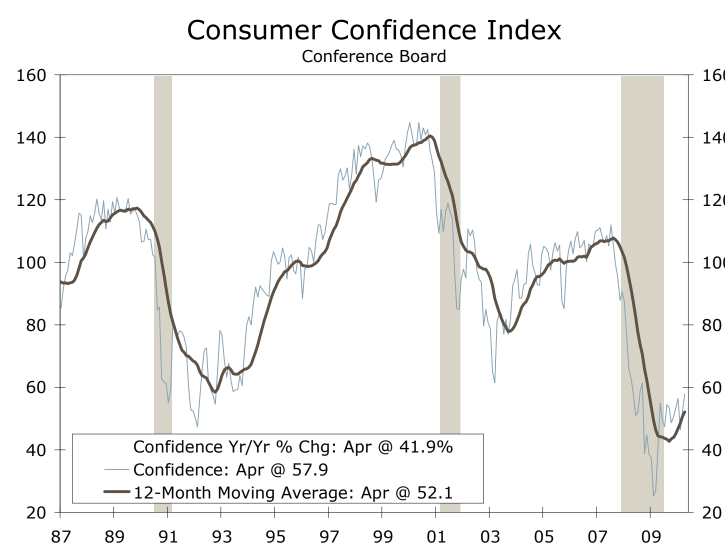
Consensus: 1.3%

Consumer Confidence • Friday

Consumer confidence is expected to increase for the third consecutive month in May to 58.6. The improvement in consumer confidence is likely due to continued strength in the labor market. Nonfarm payrolls posted a sizable gain of 290,000 jobs in April, the fourth straight monthly increase. While the unemployment rate rose to 9.9 percent, the labor force increased by 805,000 job seekers likely due to the reentrance of marginally attached workers. The increase in consumer confidence has also helped to fuel consumer spending. Core retail sales, which excludes autos, gasoline and building materials, is now up 9 percent on a three-month annualized basis. With spending currently outpacing income growth and the impending wind-down of Census hiring, the current pace in consumer confidence will likely be unsustainable.

Previous: 57.9 **Wells Fargo: 58.6**

Consensus: 59.0



Global Review

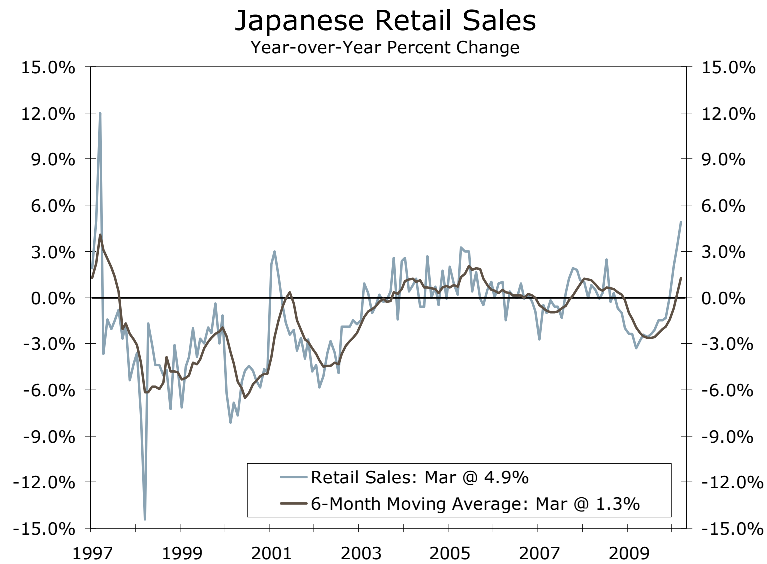
Can Contagion Kill The Global Recovery?

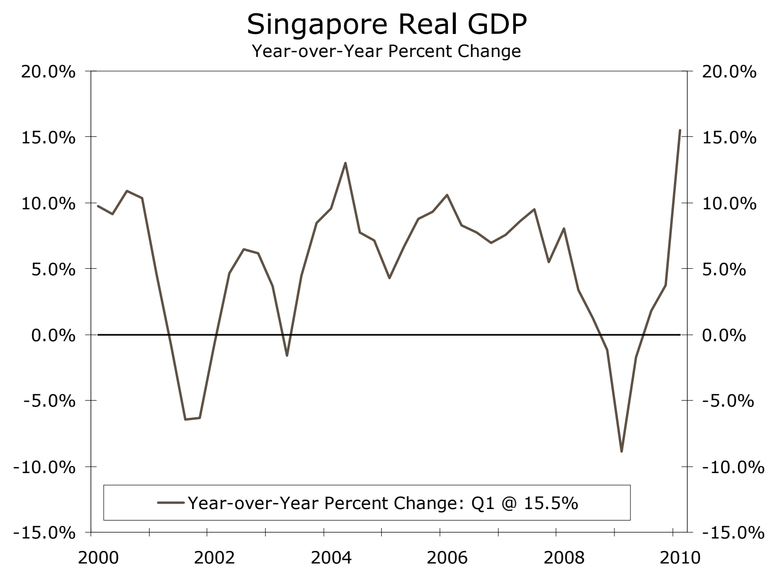
The latest data out of Asia shows that the global economy came roaring out of the gate at the beginning of the year. We currently anticipate global economic growth of around 4.6 percent this year and 4.1 percent in 2011. Despite fears of a collapse of the euro, or a double-dip recession in Europe, it would likely take another severe financial contagion, a refreeze of credit and bond markets, to derail the global recovery at this point. Even a rapidly depreciating euro, by itself, is an unlikely catalyst.

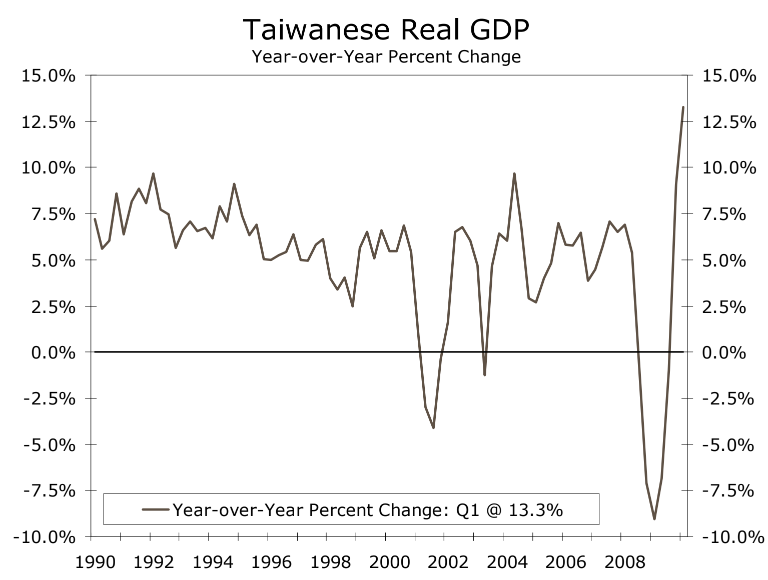
As if to underscore this point, the GDP data out of Japan for the first quarter revealed another solid increase in quarterly GDP growth, though the media spun it as a disappointment, given the consensus was for slightly stronger gains. Japan's economic growth accelerated from the fourth quarter of last year and has now put together four consecutive quarters of positive GDP growth. Japan's economic activity remains heavily weighted toward capital investment and exports. Capital investment rose at a 4.2 percent seasonally adjusted annualized rate in the first quarter, while exports jumped 30.5 percent on a seasonally adjusted annualized basis. Still, concerns about deflation remain front and center. The GDP deflator has contracted 3.0 percent from a year ago, and the Japanese consumer remains hesitant to spend. Consumer spending rose at a 1.3 percent annualized pace in the first quarter, quite a bit slower than the rates of consumer spending growth we saw over the past three quarters. Still, we don't see Japan slipping back into recession, and growth this year is on track to exceed consensus expectations by a wide margin. Japan GDP growth may well accelerate to around 3.4 percent this year, before cooling back down to 1.8 percent in 2011.

Singapore's first-quarter GDP growth saw a significant upward revision this week to 38.6 percent annualized quarterly growth from an advanced estimate of 32.1 percent. By industry, Singapore's manufacturing sector grew at a stunning 157.6 percent rate in the first quarter. The wholesale/retail sector wasn't all that far behind, increasing at a 57.5 percent annualized pace in Q1. The only weak areas to be found were in transportation and storage, which declined at a 3.2 percent annualized pace, and information and communication, which eked out only modest 0.8 percent annualized growth in the first quarter.

Adding further heft to the Asian growth story this week, Taiwan's first-quarter GDP jumped 13.27 percent from a year ago, and was up 11.3 percent at an annualized quarterly rate. Solid gains were made across the board, though manufacturing clearly lead the way, jumping 41.0 percent from a year ago. Taiwan's growth is also on track to easily surpass the government's latest projection of 6.1 percent growth in 2010, despite the latest turmoil in financial markets surrounding the Eurozone. Even though Asian growth will be hard pressed to surpass its robust first-quarter performance in the quarters ahead, a strong start to the year will almost ensure that Asian growth in 2010 will surpass the market's expectations when the year began. Asia will provide a solid foundation for sustained global growth.





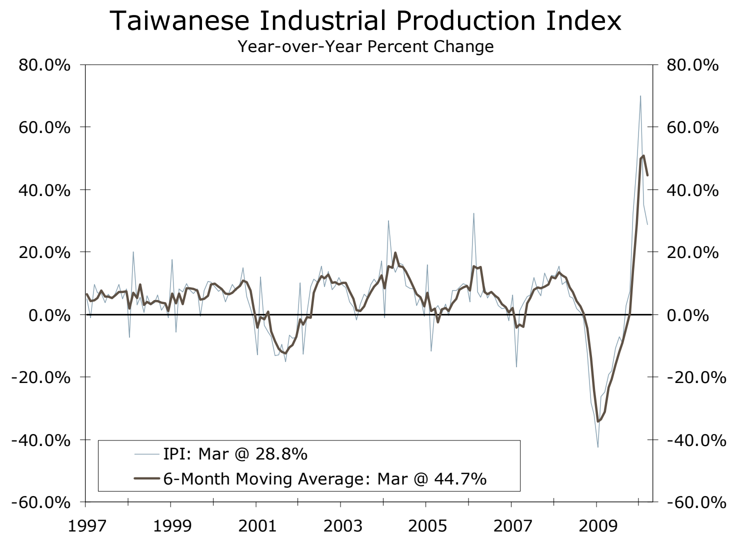


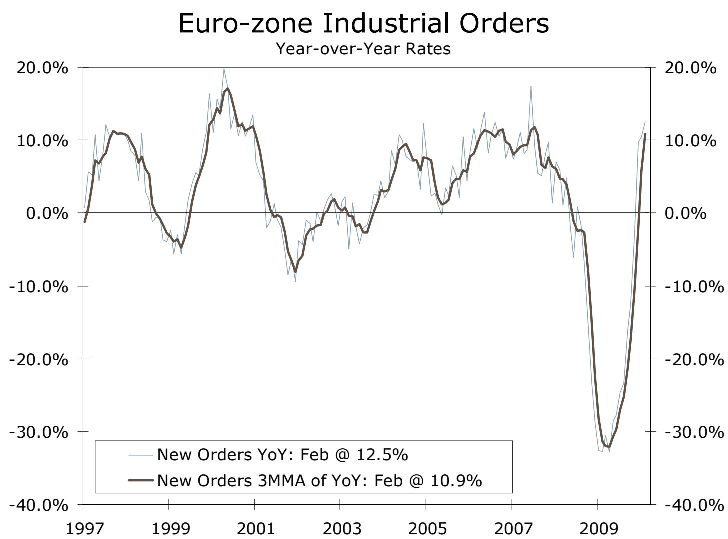
Taiwan Industrial Production • Monday

Taiwan's March industrial production grew 39.2 percent year-over-year, seasonally adjusted. Investors will be looking to see if April industrial production shows any signs of slowing, given the modest deceleration in the Chinese PMI index and attempts by policymakers to cool down overheating sectors. Exports have been driving the advance in industrial production this year in Taiwan. Taiwan exports are running 50 percent above year-ago levels. Areas of strength include electronic components and computers and telecom. Industrial production in these key Taiwanese sectors is up 77.3 percent and 46.8 percent, respectively. While a strong rebound in U.S. demand is a welcome development for Taiwanese industry, Taiwan's manufacturing fate will be increasingly driven by demand from its largest and fastest growing neighbor, The People's Republic of China.

Previous: 39.2% Y-o-Y **Wells Fargo: 31.0% Y-o-Y**

Consensus: 29.0% Y-o-Y





European Industrial Orders • Tuesday

Focus on European economic data will be intense as the markets look for signs of broader economic impact from the sovereign debt crisis sweeping the European Union. Eurozone industrial orders have been perking up of late. February manufacturing orders rose 1.7 percent after a 2.0 percent decline in January. February orders are now running ahead of last year's pace by 12.2 percent. Order gains have been broad-based, showing continued improvement across a wide range of industries and sectors. Gains in recent months have been particularly strong for intermediate, capital and durable consumer goods, confirming the economic recovery in the Eurozone remained on track through February. Nondurable consumer goods orders continue to lag, however. Domestic consumption remains sluggish as the unemployment rate in the Eurozone continues to nudge higher.

Previous: 1.7% **Wells Fargo: 1.5%**

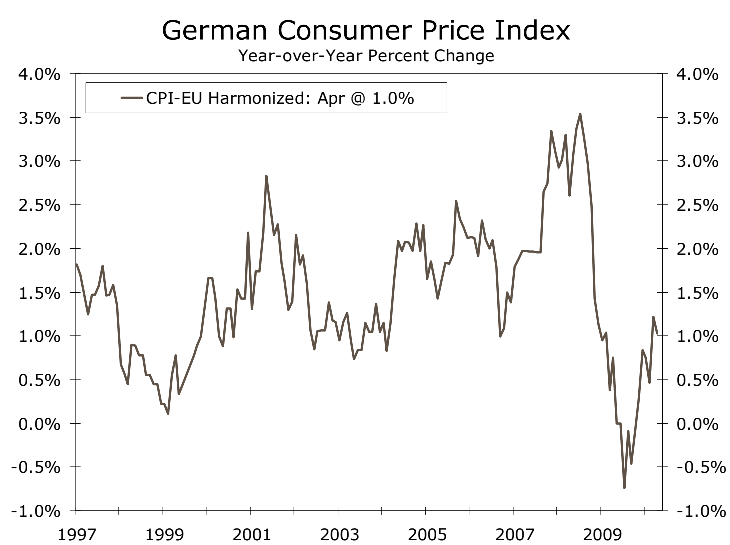
Consensus: 2.5%

German CPI • Thursday

Germany's consumer price index is expected to rise 0.1 percent for May, pushing the year-over-year rate of consumer inflation in Germany to 1.2 percent from 1.0 percent in April. April consumer inflation unexpectedly decelerated, though the trend is higher as cost pressures increase and the euro declines. We expect to see renewed acceleration in May. German food prices are rising again after holding down inflation last year. Moreover, import price inflation is running well ahead of consumer prices. March import prices rose 1.7 percent in Germany and rose 5.0 percent from a year ago. This import inflation data have been running much stronger than anticipated and threaten to put further upward pressure on consumer prices. Oil price inflation will be the big wildcard. It will be a tug-of-war between falling oil prices in dollars and a falling euro against the dollar.

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

Consensus: 0.1%



Interest Rate Watch

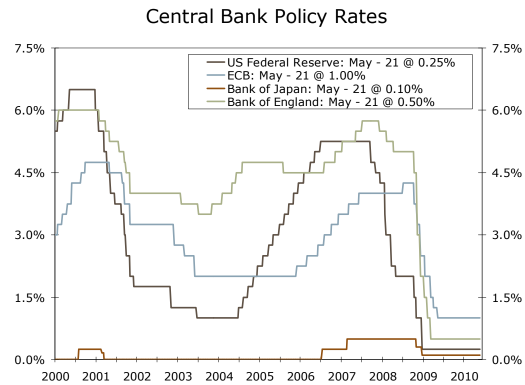
Capital Preservation Trumps Seeking Returns

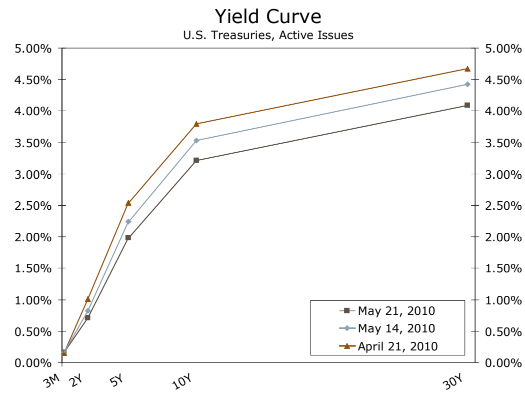
Heavy inflows into U.S. dollar-denominated financial assets, as evidenced in the Treasury's TIC data, suggest that capital preservation was the driving factor affecting yields in recent months.

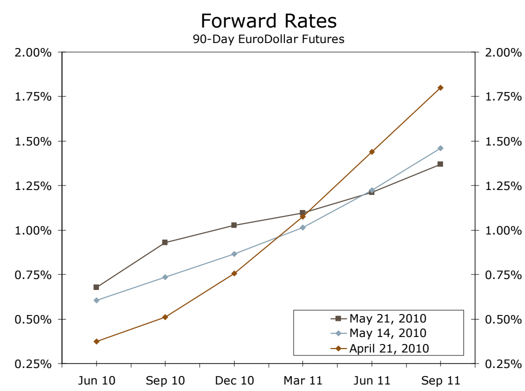
Foreign investors purchased more than $100 billion in Treasury securities in March. Moreover, March evidenced the second-largest inflow of total U.S. financial assets by foreigners in more than eight years. Default/restructure risk avoidance is the driving factor as investors drop euro debt in favor of dollar debt. Despite all our problems here in the United States, investing remains a game of relative returns and right now getting a return of capital trumps any focus on returns on capital. Our outlook anticipates that 10-year Treasury rates will remain below 4 percent at the end of this year.

Two pieces of economic data this week support the case for continued low Treasury rates this year. Consumer prices fell in April and are up 2.2 percent year-over-year, while the core CPI is up just 0.9 percent compared to a year ago. Slack in the economy, especially evident in the weakness in housing and hotel prices, suggests continued price weakness. This news has two implications. First, low inflation will likely keep the Fed on hold at least until the fourth quarter of this year. We anticipate that the earliest Fed move on the funds rate could be November—this has been our view since our Annual Outlook released last December. Second, the low CPI data suggest continued moderate inflation expectations and thereby a limited upside in the yield curve.

Leading indicators, the second indicator this week, suggested more moderate growth ahead as the stimulus wears off and the inventory adjustment is completed. Leading indicators fell in April, and this was the first decline in 12 months. The drop in building permits was particularly worrying, because it suggests that even after the stimulus spent on housing the housing recovery is disappointing. Bottom line, rates remain lower and are likely to remain low this year.







Consumer Credit Insights

The Housing Credit Crisis Drags On

The percentage of homeowners either late on payments or in foreclosure at the end of the quarter slid to a non-seasonally adjusted 14.0 percent in Q1 2010, down from the record high of 15.0 percent in Q4 2009, which was double anything seen in the past 30 years. While the delinquency rate fell, it was due primarily to seasonality, and was still higher than a year earlier. Meanwhile, the foreclosure rate, which is far less seasonal in nature, rose further and was also higher than a year ago. Thus, the decline in the combined rate of delinquencies and foreclosures was mostly due to the seasonal nature of delinquencies, while the foreclosure situation continued to worsen. This suggests that we have a long way to go before we exit the woods of the housing credit crisis.

The Fed's efforts to grease the wheels of the mortgage market had a clear impact, bringing mortgage rates lower. This, in combination with the homebuyer tax credit, helped to stabilize home prices. The expansion and extension of the tax credit may help in the interim, but it only serves to steal sales from the future, while delaying the much-needed return to market equilibrium for sales and prices. Indeed, this week we saw a steep 27 percent decline in mortgage applications for purchases, while building permits plunged 11.5 percent in April, suggesting the housing market may be entering a renewed period of weakness. This will weigh on consumer spending.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.84%	4.93%	5.07%	4.82%
15-Yr Fixed	4.24%	4.30%	4.39%	4.50%
5/1 ARM	3.91%	3.95%	4.03%	4.79%
1-Yr ARM	4.00%	4.02%	4.22%	4.82%
MBA Applications				
Composite	569.2	578.1	550.5	915.9
Purchase	192.1	263.6	240.1	254.0
Refinance	2,783.0	2,430.8	2,371.0	4,794.4

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

Topic of the Week

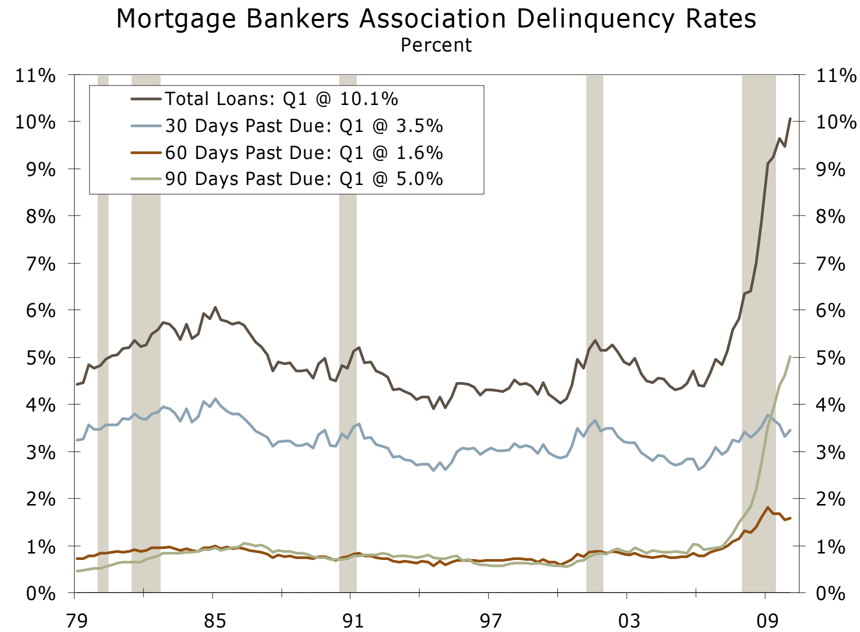
Delinquencies and Foreclosures Increase

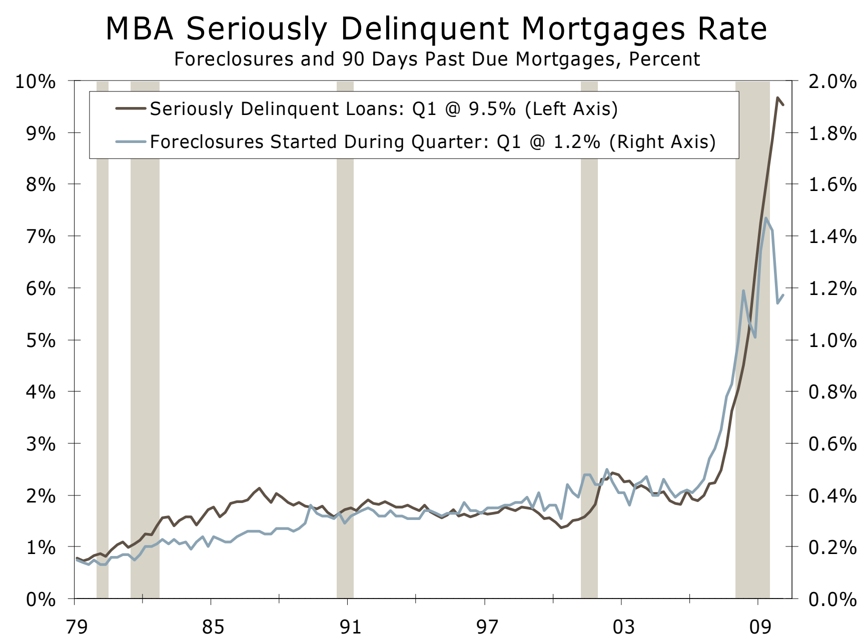
Mortgage delinquency rates continued to rise in the first quarter and reached a record high of 10.06 percent, which is close to a percentage point higher than a year ago. The overall mortgage delinquency rate has nearly doubled since mid-2007. The rise in the mortgage delinquency rate comes as a damper to many who expect the recovery to pass through to the housing sector.

The short-term delinquency rate, which refers to 30 days past due, rose mildly in the first quarter, but is showing some tentative signs of leveling off. As employment data have improved modestly and layoffs have slowed, more people are feeling more secure about their jobs. However, the labor market has to improve further for the short-term delinquency rate to trend downward.

Foreclosures started in the first quarter marginally rose to 1.17 percent. After having peaked at 1.47 percent in the first quarter of last year, the foreclosure rate has come down markedly, even if the number still remains about four times above the historical average. The percentage of mortgages that are seriously delinquent, which refers to mortgages which are 90 days past due or in foreclosure, remain elevated at 9.5 percent. There has been a growing disconnect between seriously delinquent mortgages and foreclosures, largely because banks have been keeping loans from being foreclosed upon until they received clarification from the Housing Affordability Modification Program (HAMP). We expect foreclosures to rise as banks move forward with foreclosures temporarily put on hold.

The rise in delinquencies and foreclosures show that the winding down of the housing bubble still has quite a ways to go. The recovery in housing will be slow and arduous, and while the worst is likely over we do not expect strength in the housing market until next year or 2012.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 5/21/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.15	0.15	0.18
3-Month LIBOR	0.50	0.45	0.66
1-Year Treasury	0.14	0.22	0.10
2-Year Treasury	0.71	0.78	0.86
5-Year Treasury	1.95	2.16	2.14
10-Year Treasury	3.17	3.45	3.36
30-Year Treasury	4.07	4.34	4.31
Bond Buyer Index	4.27	4.32	4.44

Foreign Exchange Rates

	Friday 5/21/2010	1 Week Ago	1 Year Ago
Euro ($/€)	1.256	1.236	1.389
British Pound ($/£)	1.441	1.454	1.584
British Pound (£/€)	0.872	0.850	0.877
Japanese Yen (¥/$)	89.770	92.470	94.410
Canadian Dollar (C$/$)	1.065	1.036	1.137
Swiss Franc (CHF/$)	1.148	1.134	1.094
Australian Dollar (US$/A$)	0.827	0.886	0.778
Mexican Peso (MXN/$)	13.131	12.590	13.111
Chinese Yuan (CNY/$)	6.828	6.827	6.825
Indian Rupee (INR/$)	46.924	45.205	47.388
Brazilian Real (BRL/$)	1.882	1.799	2.031
U.S. Dollar Index	85.612	86.095	80.558

Foreign Interest Rates

	Friday 5/21/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.64	0.63	1.25
3-Month Sterling LIBOR	0.70	0.70	1.30
3-Month Canadian LIBOR	0.57	0.54	0.73
3-Month Yen LIBOR	0.25	0.25	0.53
2-Year German	0.51	0.56	1.28
2-Year U.K.	0.85	0.93	1.05
2-Year Canadian	1.60	1.83	1.15
2-Year Japanese	0.16	0.17	0.37
10-Year German	2.66	2.86	3.37
10-Year U.K.	3.52	3.75	3.67
10-Year Canadian	3.30	3.43	3.26
10-Year Japanese	1.25	1.31	1.44

Commodity Prices

	Friday 5/21/2010	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	69.76	71.61	61.05
Gold ($/Ounce)	1183.08	1233.18	953.80
Hot-Rolled Steel ($/S.Ton)	645.00	645.00	375.00
Copper (¢/Pound)	302.90	312.30	205.40
Soybeans ($/Bushel)	9.34	9.50	11.75
Natural Gas ($/MMBTU)	4.10	4.31	3.60
Nickel ($/Metric Ton)	21,128	22,701	12,591
CRB Spot Inds.	481.74	492.12	384.03

Next Week's Economic Calendar

	Monday 24	Tuesday 25	Wednesday 26	Thursday 27	Friday 28
U.S. Data	**Existing Home Sales** March 5.35M April 5.50M (W)	**Consumer Confidence** April 57.9 May 58.6 (W)	**Durable Goods Orders** March -1.2% April 1.6% (W) **Durables Ex Tranp.** March 3.7% April 0.3% (W) **New Home Sales** March 411K April 425K (W)	**GDP (QoQ)** 1Q: Advance 3.2% 1Q: 2nd 3.6% (W)	**Personal Income** March 0.3% April 0.4% (W) **Personal Spending** March 0.6% April 0.4% (W) **PCE Deflator** March 2.0% April 1.9% (W)
Global Data		**UK** **GDP (QoQ)** Previous (4Q) 0.2%	**Japan** **BoJ Meeting Minutes** **Canada** **Home Price Index** Previous (Mar) 9.9%	**Germany** **CPI (YoY)** Previous (Feb) 1.0%	**Japan** **CPI (YoY)** Previous (Mar) -1.1%

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

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