November 5, 2010

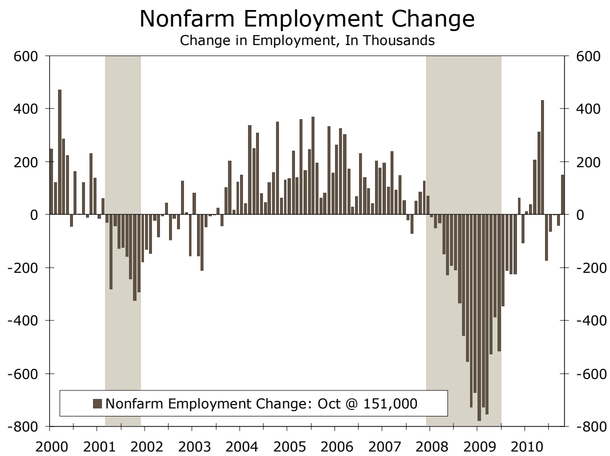
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Recovery Gaining Momentum?

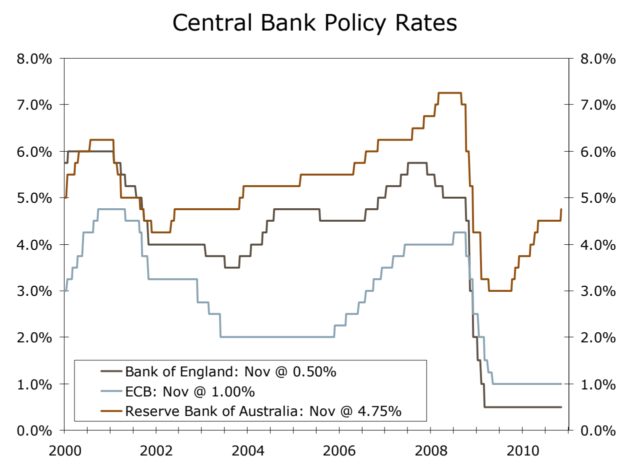
- For the last several months, we have been making the case for a slow recovery with no double-dip recession. Indicators this week support that view and may even suggest that the slack in this economy could be pulled taught at a slightly faster pace.
- Both of the main surveys from the ISM suggest the slowdown in growth may not be as bad as survey data have been suggesting in the last couple of months.
- With census adjustments behind us, the job market finally posted a month of growth in nonfarm payrolls.



Global Review

Foreign Central Banks in the News this Week

- Central banks in Australia and India continued their tightening cycles this week by hiking their main policy rates by 25 bps. In both countries, unacceptably high inflation or the risk that inflation rises to uncomfortable rates is a bigger concern than weak economic growth.
- Both the Bank of England and the European Central Bank kept their respective policy rates and quantitative easing (QE) programs unchanged this week. Although the ECB is likely to remain on hold, we think that planned fiscal consolidation in the United Kingdom next year will eventually lead to more QE by the BoE.



Inside

Wells Fargo U.S. Economic Forecast

	Actual			Forecast					Actual			Forecast		
	2010				2011				2007	2008	2009	2010	2011	2012
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
Real Gross Domestic Product [1]	3.7	1.7	2.0	1.5	1.9	2.3	2.2	2.5	1.9	0.0	-2.6	2.7	2.0	2.8
Personal Consumption	1.9	2.2	2.6	1.9	1.5	1.5	1.6	2.5	2.4	-0.3	-1.2	1.6	1.8	1.6
Inflation Indicators [2]														
"Core" PCE Deflator	1.8	1.5	1.3	1.0	0.9	1.0	1.1	1.2	2.9	2.3	1.5	1.4	1.0	1.4
Consumer Price Index	2.4	1.8	1.2	0.8	0.7	1.2	1.3	1.4	2.3	3.8	-0.3	1.6	1.2	1.7
Industrial Production [1]	7.1	7.0	4.8	1.2	2.0	3.2	4.2	5.5	81.3	-3.3	-9.3	5.4	3.2	5.2
Corporate Profits Before Taxes [2]	37.6	37.0	17.0	12.0	7.8	5.6	6.0	6.5	-6.2	-16.4	-0.4	24.9	6.5	6.9
Trade Weighted Dollar Index[3]	76.1	78.8	73.6	72.0	72.5	74.0	76.0	78.0	0.0	74.3	77.7	76.1	75.1	80.5
Unemployment Rate	9.7	9.7	9.6	9.8	10.0	9.8	9.7	9.5	1.3	5.8	9.3	9.7	9.7	9.0
Housing Starts[4]	0.62	0.60	0.59	0.62	0.64	0.72	0.81	0.89	16.09	0.90	0.55	0.61	0.77	1.04
Quarter-End Interest Rates [5]														
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	5.30	1.88	0.25	0.25	0.25	0.50
Conventional Mortgage Rate	4.97	4.74	4.35	4.20	4.80	5.00	5.20	5.60	4.48	6.04	5.04	4.73	5.15	5.60
10 Year Note	3.84	2.97	2.53	2.30	2.20	2.30	2.40	2.50	4.84	3.66	3.26	3.24	2.35	2.98

Forecast as of: November 5, 2010
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change
[3] Federal Reserve Major Currency Index, 1973=100 - Quarter End
[4] Millions of Units
[5] Annual Numbers Represent Averages

U.S. Review

A Brightening Outlook for the U.S. Economy

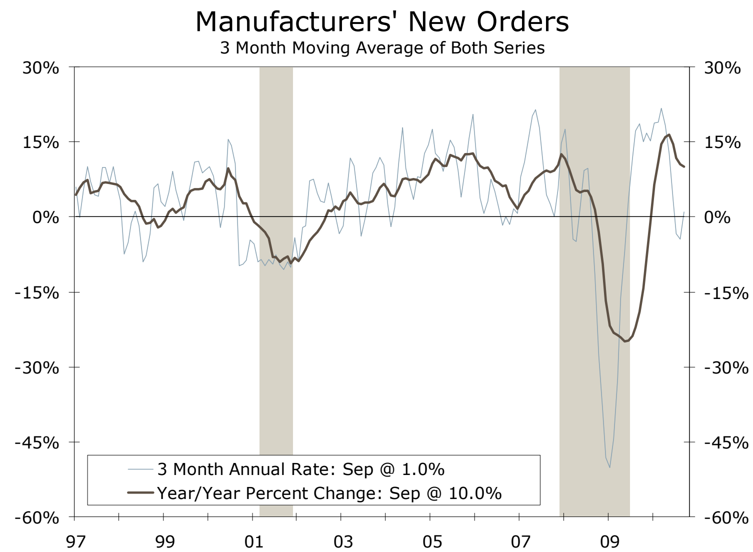
In a week that included an historic power shift in mid-term elections and maneuvering by the FOMC to inject $600 billion of cash into the financial system over the next several months, it was run-of-the-mill economic indicators that moved the markets. The elections were preceded by poll numbers that seemed to assure GOP control of the House, and Fed Chairman Bernanke had been telegraphing the FOMC's intent to engage in a second round of quantitative easing. So while these events were significant developments, financial markets had largely priced them in.

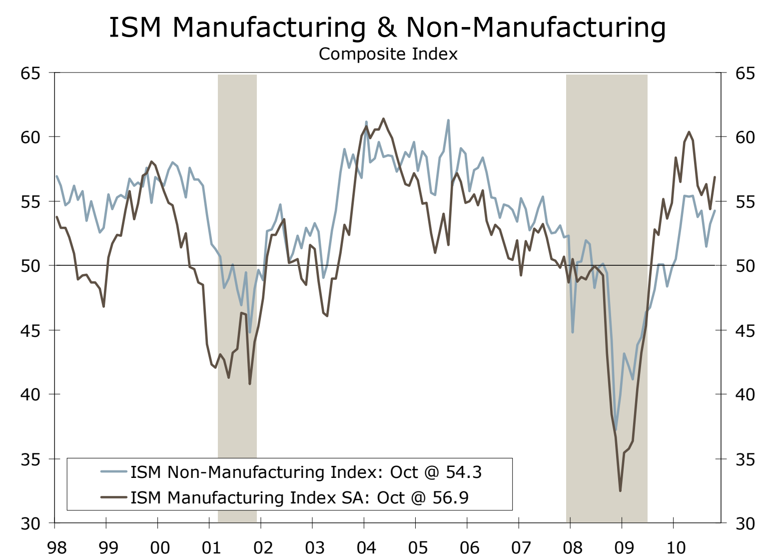
What markets had not priced in was an improvement in economic conditions. The manufacturing sector, which was the locomotive of growth in the early stages of this recovery, seemed to have lost momentum during the middle part of this year. Indeed orders at U.S. factories fell 1.8 percent in May, another 0.6 percent in June and did not show substantial improvement until September orders data, which were reported this week. Bookings increased 2.1 percent in the month, though the bulk of the gain came from a doubling in aircraft orders. Outside of the volatile transportation sector, orders gained a more modest 0.4 percent. That said, the outlook for the manufacturing sector brightened this week when the ISM manufacturing index for October came in much stronger than consensus estimates at 56.9. The new orders component and the employment measure both improved. The prices paid index climbed to 71.0, which raised eyebrows because in slow economic environment it can be difficult for businesses to raise prices to consumers. Higher input costs in this environment mean a drag on profitability. It appears that export orders are fueling industrial growth as the export orders component jumped six points to 60.5—tying the second largest monthly increase on record. On net, the ISM report was a welcome signal that the soft patch in manufacturing may be firming as we head into the fourth quarter.

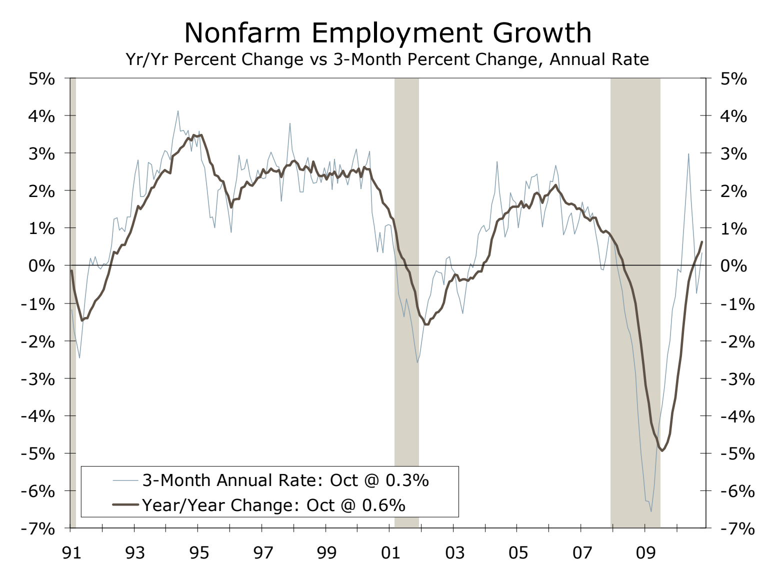
On the services side of the economy, survey numbers this week were also heartening. The ISM non-manufacturing index also posted a larger-than-expected gain, climbing to 54.3 in October. As with the manufacturing measure earlier in the week, the prices paid component increased, though it was a larger jump for the service sector, climbing from 60.1 to 68.3. The service sector also saw increases in orders and in the employment measure.

Donut is off the Bat, Job Market Gets a Base Hit

Speaking of employment, after four straight monthly declines, employers added 151,000 net new employees to nonfarm payrolls during the month. Private sector employers have been adding jobs since March, but layoffs related to temporary census workers, as well as state and local jobs, have been weighing on the job market recently. With census layoffs over for the most part, payrolls are set to rise modestly in the months ahead. While the gain in October is certainly welcome news, job growth of roughly 150K per month is only adequate to keep the unemployment rate from rising. It will take numbers of at least this magnitude to bring down the jobless rate, which we think could take several months.





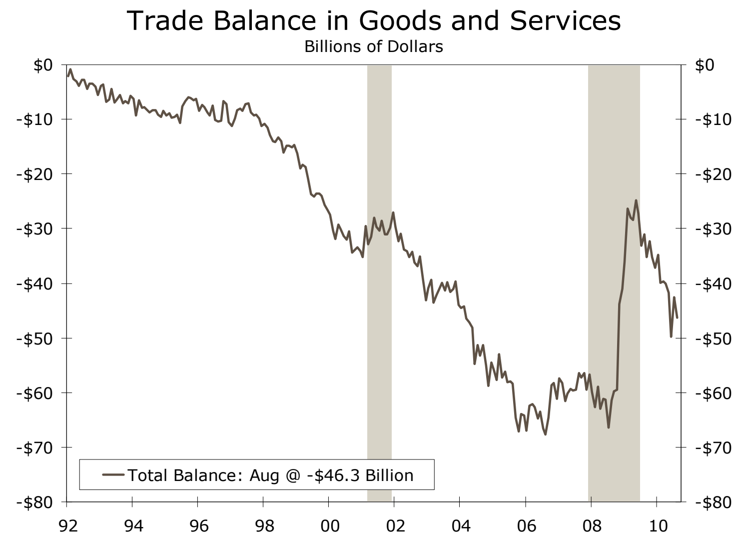


Trade Balance • Wednesday

The trade deficit widened in August to $46.3 billion. Export growth slowed to just 0.2 percent month-over-month as civilian aircraft orders plunged following a surge in July. Higher soybean prices drove a big jump in exports of foods, feeds and beverages. Imports rose 2.1 percent on the month. Semiconductor imports jumped as companies continued to invest in computers and equipment to bolster productivity. Imports of toys and games rose as consumers took advantage of discounts and tax holidays. Soybean prices continued to rise in September, so food exports could see another large increase. Civilian aircraft exports likely bounced back. On the import side, semiconductor imports likely remained strong, but consumer goods imports may have weakened based on weaker-than-expected consumer spending in September. Initial estimates show trade subtracted 2.0 percentage points from Q3 GDP.

Previous: -$46.3B **Wells Fargo: -$44.1B**

Consensus: -$45.0B

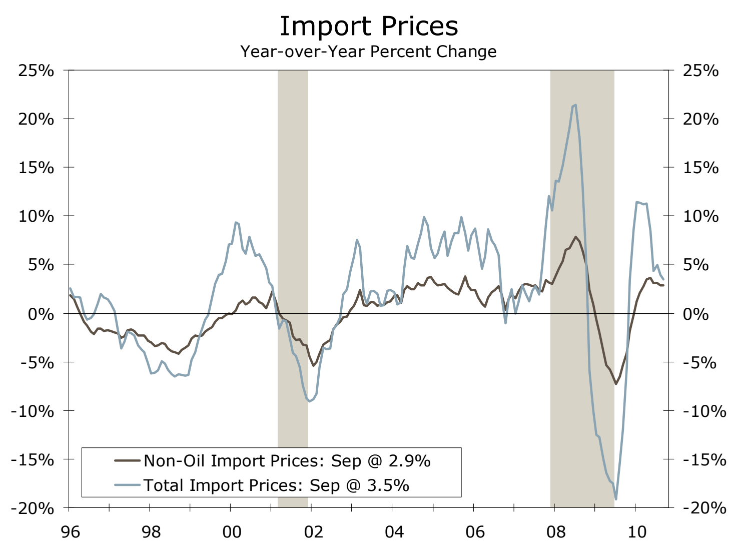


Import Prices • Wednesday

Import prices fell 0.3 percent month-over-month in September. Lower prices for petroleum led the decline, while industrial supplies prices also fell noticeably. Excluding petroleum, prices rose. The dollar declined further in October, which could factor into higher import prices for October. Oil prices averaged in the low $80s per barrel in October compared to the mid $70s in September, so this increase in petroleum prices should help to boost overall import prices. Based on continued increases in metals prices in October, we are likely to see more increases in imported metals prices for the month. If weakness in consumer spending in September carried over to October, we could see a pullback in prices for consumer goods imports, although the weaker dollar could somewhat offset this. So far, the weaker dollar has really only affected commodities prices, but sooner or later dollar weakness will likely lift overall prices.

Previous: -0.3% **Wells Fargo: 1.6%**

Consensus: 1.1%

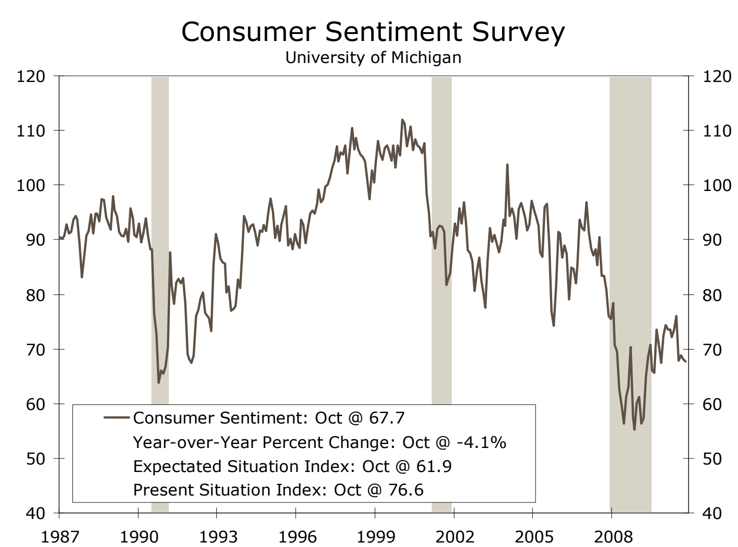


Michigan Consumer Sentiment • Friday

The University of Michigan Consumer Sentiment Index slid to 67.7 in October, the lowest level since November 2009, from 68.2 in September. This is far below the average of 89 for the five years before the recession. Consumer confidence remains subdued amid myriad problems in the economy, including high unemployment, tight credit and the seemingly never-ending foreclosure situation. Coupled with uncertainty regarding taxes and health care, consumers are probably more confused than anything. Yet, actions speak louder than words, as consumer spending rose 2.6 percent in the third quarter and added 1.8 percentage points to GDP, both better than in the second quarter. Built-up savings and deep discounts likely supported spending. The uncertainty over the election will likely now give way to uncertainty over what Congress will actually be able to accomplish.

Previous: 67.7

Consensus: 69.0



Global Review

Foreign Central Banks in the News this Week

The FOMC may have taken center-stage on Wednesday, but some foreign central banks held high-profile policy meetings as well this week. In Australia, the Reserve Bank of Australia (RBA) surprised most analysts when it hiked its policy rate again by 25 bps. In the past 12 months the RBA has tightened by 175 bps (see graph on front page).

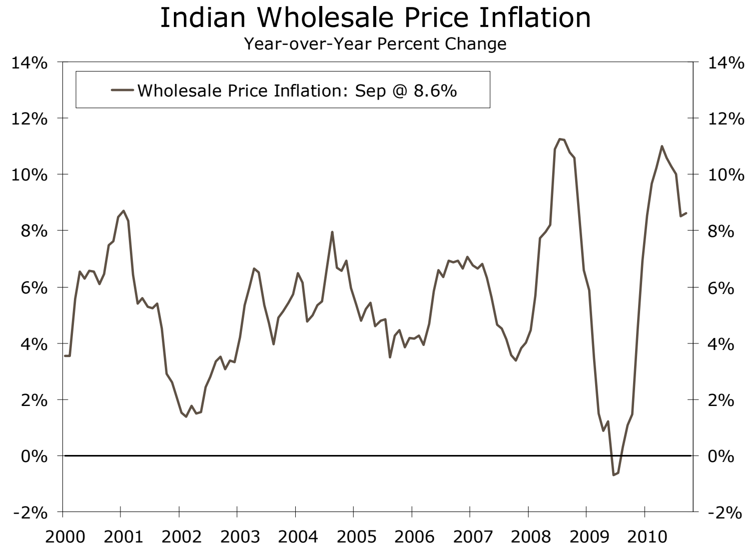
Unlike the Federal Reserve, the RBA does not have to deal with a sluggish economy at present. Not only was the recession Down Under relatively shallow—real GDP in Australia contracted only 0.7 percent versus the 4.1 percent downturn experienced in the United States—but the economy is expanding solidly again. With the unemployment rate at only 5.1 percent at present, inflation could become an issue if growth remains strong. Therefore, the RBA decided that another rate hike was in order.

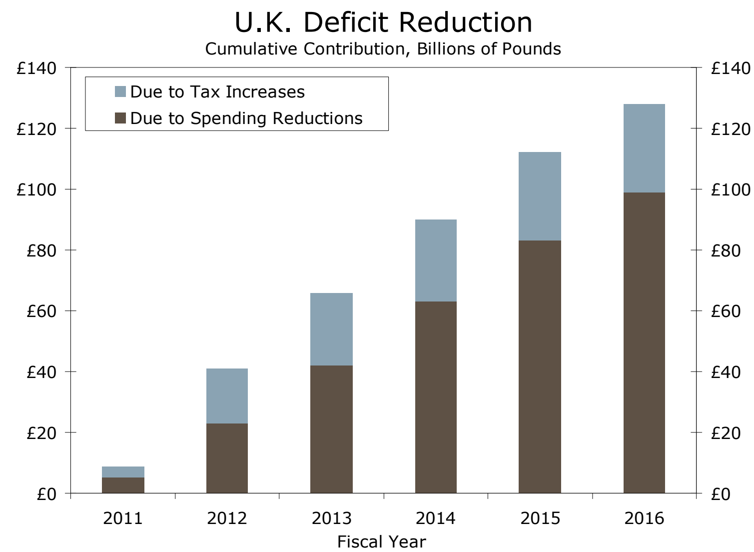
The Reserve Bank of India (RBI) this week announced its sixth 25-bp rate hike since March 2010. One of the reasons that the FOMC gave for increasing the size of its quantitative easing (QE) program this week was that inflation in the United States probably will remain below the Fed's implicit target for some time. In contrast, the RBI specifically pointed to high inflation as a reason for tightening policy (top chart). Further rate hikes in India seem likely.

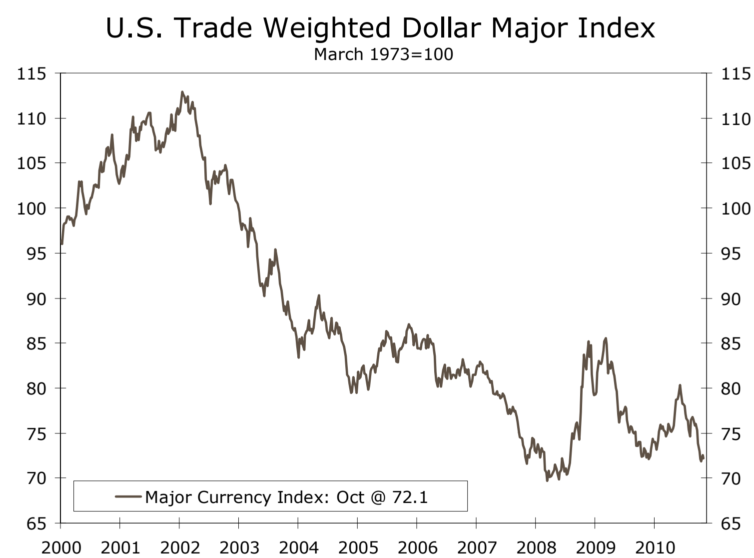
Few investors expected the European Central Bank (ECB) to follow the Fed's lead in expanding its own QE program, and ECB policymakers had no surprises up their sleeves. Not only did the ECB maintain its policy rate at 1.00 percent and make no changes to its relatively modest QE program, but its press statement sounded a bit hawkish. Although we do not look for the ECB to hike rates anytime soon, the economic outlook in the Eurozone would need to deteriorate significantly before the ECB would even fathom an increase in the size of its QE program. Any QE by the ECB, should it even occur, appears to be months away.

The Bank of England held its policy rate steady at 0.50 percent and maintained the size of its QE program at £200 billion. The likelihood that the Monetary Policy Committee (MPC) would increase the size of its QE program at this week's meeting dwindled when third quarter real GDP gr0wth printed significantly stronger than expected last week. As we argued in a recent special report, however, we look for British economic growth to slow next year as fiscal consolidation gets under way. (See "Outlook for U.K. Growth Amid Budget Cutting," which is posted on our Web site.) Therefore, we believe there is a better-than-even chance that the MPC eventually increases the size of its QE program, probably early next year.

The dollar has depreciated over the past few weeks versus many currencies on the expectation that the Fed would increase the size of its QE program (bottom chart). With few other central banks willing to follow the Fed's lead at this time, it seems that further dollar depreciation is in store in the near term. (For further reading, see "QE2 Sails, Dollar Sinks?", which is posted at www.wellsfargo.com/com/research/foreign_exchange.)







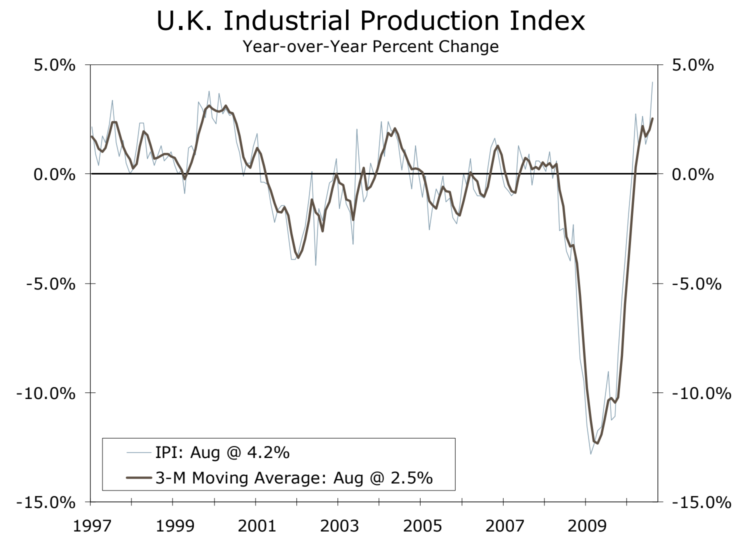
U.K. Industrial Production • Tuesday

Following its deep downturn in 2008-2009, industrial production (IP) in the United Kingdom is growing again. That said, IP remains more than 10 percent below its peak in early 2008. The purchasing managers' index for the manufacturing sector remains above the demarcation line that separates expansion from contraction, suggesting that the trend increase in IP remains intact. Indeed, the consensus forecast anticipates that IP rose again in September.

The other item of interest to investors will be the Bank of England's quarterly Inflation Report, in which the Bank presents its two-year forecasts of GDP growth and CPI inflation. Although the Monetary Policy Committee refrained from increasing the size of its asset-purchase program this week, another round of quantitative easing could eventually be in store if the Bank marks down its growth and/or inflation forecasts.

Previous: 0.3%

Consensus: 0.4% (month-over-month)



Chinese Industrial Production • Thursday

Next week sees the usual mid-month barrage of Chinese economic data. One of the most closely watched indicators will be data on industrial production in October, which are slated for release on Thursday. The manufacturing PMI trended lower through August, but it has subsequently risen again, suggesting that production is stabilizing. Indeed, the consensus forecast anticipates that the year-over-year rate of IP growth edged higher in October.

Industrial production is not the only indicator of note next week. Trade data for October will likely show how export and import growth are faring. Growth in retail sales has been steady all year around 18 percent, a rate that is expected to have been maintained last month. The outlook for further tightening by the central bank will be determined, at least in part, by CPI data for October that are scheduled to be released on Thursday.

Previous: 13.3%

Consensus: 13.5% (year-over-year)

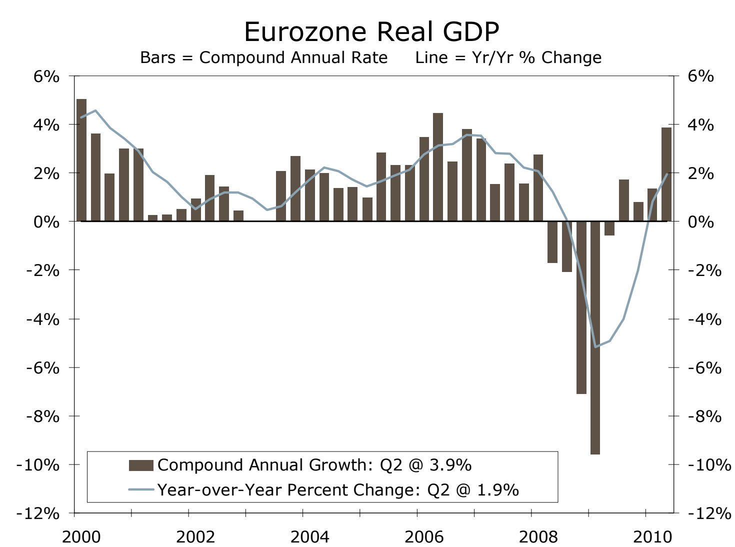
Eurozone GDP Growth • Friday

On a peak-to-trough basis, real GDP in the euro area dropped more than 5 percent between Q1-2008 and Q2-2009, which is deeper than the 4 percent downturn that the United States suffered. However, the Eurozone economy is growing again, and real GDP grew at an annualized rate of 3.9 percent in the second quarter of this year. That said, available monthly indicators suggest that growth slowed in third quarter. Official data will print on Friday.

Moreover, the pace of growth varies across individual countries in the Eurozone. Germany posted its strongest rate of growth since re-unification in the second quarter, while the Irish and Greek economies continued to contract. Many countries release their own GDP data on Friday, so it will be interesting to see if the uneven pace of the expansion among individual Eurozone economies continued into the third quarter.

Previous: 1.0% **Wells Fargo: 0.5%**

Consensus: 0.5% (not annualized)



Interest Rate Watch

Fed Easing, Tax Cuts: Growth and Rising Interest Rates.

Hitting the Daily Double is exciting, especially when that suggests economic growth going forward. This week the FOMC announced a policy of quantitative easing while the Obama administration suggested it might compromise on extending the Bush tax cuts for everyone. Both these policies are pro-growth.

Short-Run

For now the liquidity effect of quantitative easing will support the case for continued low short-term interest rates. The economic outlook is for continued modest economic growth and low inflation. Our outlook is consistent with the Fed's view of modest growth of two percent over the next two quarters and core inflation, measured by the core PCE deflator of one percent plus over the same period. Therefore our outlook was, and remains, for a steady fed funds rate and a 10-year benchmark rate of 2.5 percent plus over the same period.

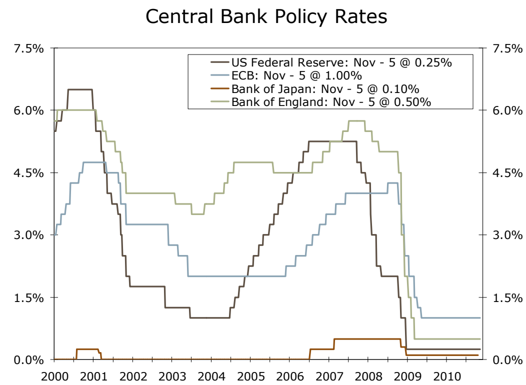
Quantitative easing should keep the short-rates low and maintain lower long-term rates as well.

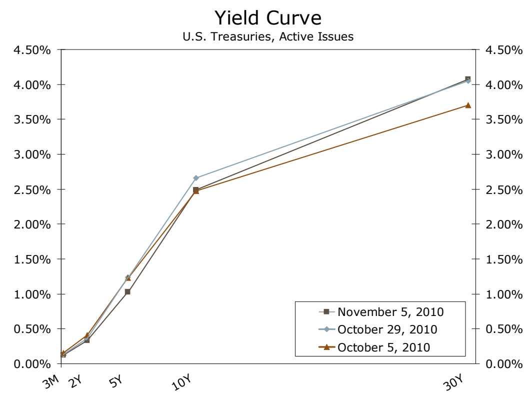
Risks over Time

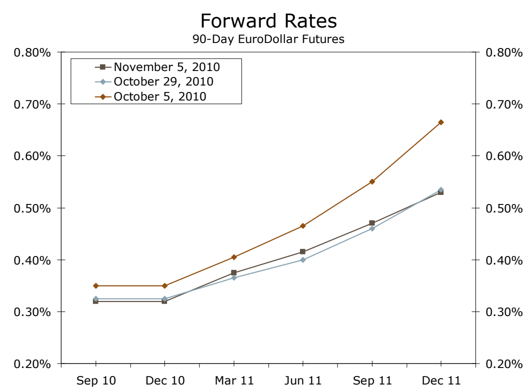
Given the level of rates today, all the risks are on the upside. We would caution against the complacency expressed in the view that rates will remain low for a long time.

Markets are forward-looking, and therefore the explicit goals of both fiscal and monetary policy for growth and higher inflation suggest that rates will rise. Moreover, dollar devaluation suggests that foreign investors will require a risk premium in interest rates to compensate them for the risk of further currency depreciation. In addition, despite the election results, Congress will have great difficulties cutting federal spending and therefore our expectation is that large federal deficits will still need to be financed.

Complacency on rates cost many their careers in the 1970s, 1980s and 1994-95. Complacency is not an investment strategy.







Credit Market Insights

Overblown Municipal Bond Concerns

Recently there has been concern expressed about increased risks associated with municipal bonds primarily due to declines in state and local tax revenue. State finances around the country are indeed fragile, but at this stage in the recovery, some cyclical weakness is expected. While some concerns are overstated there is some merit to increased concern due to weak fundamental factors, mainly tax revenues collections.

State-level tax revenues increased by 4.9 percent in the second quarter of 2010 led by gains in sales tax revenue. Much of the recent revenue increases are likely due to temporary state tax increases. Outside of the gains in sales taxes, corporate income taxes declined 19.8 percent and individual income tax collections fell 0.2 percent during the second quarter of this year. These declines along with state budget gaps indicate likely continued weakness in state budgets for the near future. Property tax revenues will also become a point of concern over the next 12 months. In most states property tax collections lag a year or two. With continued declines in real estate valuations local governments that rely primarily on property tax receipts may face further declines in revenues.

These aggregated trends are not representative of all state and municipal governments. However, widespread stability in the fundamental factors of the municipal bond market will likely be a ways off.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.24%	4.23%	4.27%	4.98%
15-Yr Fixed	3.63%	3.66%	3.72%	4.40%
5/1 ARM	3.39%	3.41%	3.47%	4.35%
1-Yr ARM	3.26%	3.30%	3.40%	4.47%
MBA Applications				
Composite	787.3	828.9	782.6	608.3
Purchase	178.9	176.4	198.7	250.3
Refinance	4,328.8	4,626.1	4,180.8	2,693.7

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

Topic of the Week

Brazil: The Workers' Party (PT) Retains the Presidency, As Expected

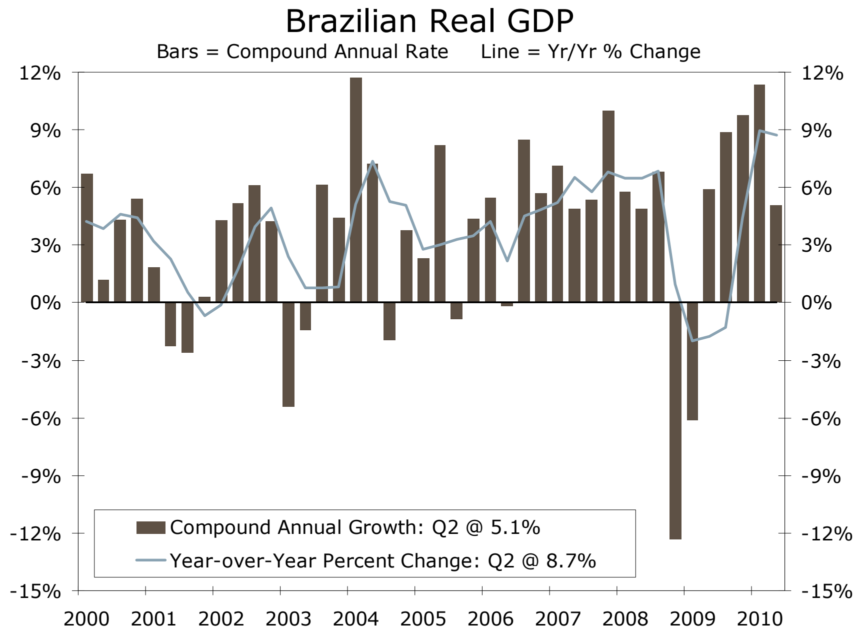
As expected, Luiz Inácio "Lula" da Silva, the current president of Brazil, delivered the presidency to his chosen successor, Dilma Rousseff, during a second round voting process. But before wining by a large margin, 56 percent to 44 percent for Jose Serra from the PSDB, Dilma Rousseff had to tone down her radical views on some issues, especially on abortion rights, after religious groups started to second guess their potential support to the front runner.

And this is a good signal in that it gave a chance for Dilma to show whether she was as pragmatic as her predecessor, Lula da Silva. Of course, anything could happen now that she has won the presidency, but our guess is that she will be very careful not to compromise her ability to succeed, especially because the political alliance that took her to power is very heterogeneous.

According to her own explanation she wants to get rid of poverty in Brazil during her presidency without increasing the fiscal deficit of the country. While ending poverty is a very noble objective, the comment is basically geared towards her followers, who are the poorest of the poor in the country. However, fulfilling this promise will, of course, be impossible. Nevertheless, she will have to come clean on her second promise, which was keeping the budget under tabs.

But if Dilma believed that her experience during the presidential campaign was difficult, the truth is that managing the Brazilian political system and the Brazilian economy will likely be much more difficult than wining the presidency, especially because she probably won't have the daily advice of Lula da Silva.

Thus, while we believe that the Brazilian economy is going to continue to outperform those of other Latin American countries, the road will not be without some bumps and bruises, and Dilma will have to learn on the job and very fast if she expects to be successful at the helms of the up-and-coming Brazil.



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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 11/5/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.11	0.11	0.03
3-Month LIBOR	0.29	0.29	0.28
1-Year Treasury	0.14	0.14	0.38
2-Year Treasury	0.34	0.34	0.87
5-Year Treasury	1.06	1.17	2.33
10-Year Treasury	2.50	2.60	3.52
30-Year Treasury	4.10	3.98	4.40
Bond Buyer Index	4.02	3.96	4.41

Foreign Exchange Rates

	Friday 11/5/2010	1 Week Ago	1 Year Ago
Euro ($/€)	1.408	1.395	1.487
British Pound ($/₤)	1.624	1.604	1.658
British Pound (₤/€)	0.867	0.869	0.897
Japanese Yen (¥/$)	81.110	80.400	90.710
Canadian Dollar (C$/$)	1.001	1.019	1.065
Swiss Franc (CHF/$)	0.961	0.982	1.016
Australian Dollar (US$/A$)	1.016	0.984	0.910
Mexican Peso (MXN/$)	12.200	12.345	13.279
Chinese Yuan (CNY/$)	6.657	6.671	6.828
Indian Rupee (INR/$)	44.211	44.524	47.061
Brazilian Real (BRL/$)	1.679	1.699	1.717
U.S. Dollar Index	76.337	77.266	75.741

Foreign Interest Rates

	Friday 11/5/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.99	0.99	0.68
3-Month Sterling LIBOR	0.74	0.74	0.60
3-Month Canadian LIBOR	1.21	1.22	0.50
3-Month Yen LIBOR	0.20	0.20	0.32
2-Year German	0.91	0.99	1.30
2-Year U.K.	0.66	0.68	0.89
2-Year Canadian	1.45	1.41	1.42
2-Year Japanese	0.14	0.14	0.28
10-Year German	2.39	2.52	3.35
10-Year U.K.	2.97	3.08	3.85
10-Year Canadian	2.83	2.81	3.54
10-Year Japanese	0.94	0.92	1.45

Commodity Prices

	Friday 11/5/2010	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	86.64	81.43	79.62
Gold ($/Ounce)	1392.18	1359.40	1090.30
Hot-Rolled Steel ($/S.Ton)	505.00	505.00	485.00
Copper (¢/Pound)	396.50	373.20	295.05
Soybeans ($/Bushel)	12.34	11.83	9.84
Natural Gas ($/MMBTU)	3.93	4.04	4.78
Nickel ($/Metric Ton)	24,434	23,029	17,840
CRB Spot Inds.	557.41	544.71	443.53

Next Week's Economic Calendar

	Monday 8	Tuesday 9	Wednesday 10	Thursday 11	Friday 12
U.S. Data		**Wholesale Inventories** August 0.8% September 0.6% (C)	**Trade Balance** August -$46.3B September -$44.1B (W) **Import Price** September -0.3% October 1.6% (W)		**U of Mich Confidence** October 67.7 November (P) 69.0 (C)
Global Data		**UK** **Industrial Prod. (MoM)** Previous (Aug) 0.3%	**Canada** **Trade Balance (CAD)** Previous (Aug) -1.3B **China** **Trade Balance (USD)** Previous (Sep) $16.88B	**China** **CPI (YoY)** Previous (Sep) 3.6% **China** **Industrial Prod. (YoY)** Previous (Sep) 13.3%	**Euro-zone** **GDP (QoQ)** Previous (2Q) 1.0%

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

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research & Economics	(704) 715-8437 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wellsfargo.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wellsfargo.com
Scott Anderson, Ph.D.	Senior Economist	(612) 667-9281	scott.a.anderson@wellsfargo.com
Eugenio Aleman, Ph.D.	Senior Economist	(704) 715-0134	eugenio.j.aleman@wellsfargo.com
Sam Bullard	Senior Economist	(704) 383-7372	sam.bullard@wellsfargo.com
Anika Khan	Economist	(704) 715-0575	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wellsfargo.com
Ed Kashmarek	Economist	(612) 667-0479	ed.kashmarek@wellsfargo.com
Tim Quinlan	Economist	(704) 374-4407	tim.quinlan@wellsfargo.com
Michael A. Brown	Economist	(704) 715-0569	michael.brown4@wellsfargo.com
Tyler Kruse	Economic Analyst	(704) 715-1030	tyler.kruse@wellsfargo.com

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