November 13, 2009

Economics Group

Weekly Economic & Financial Commentary

U.S. Review

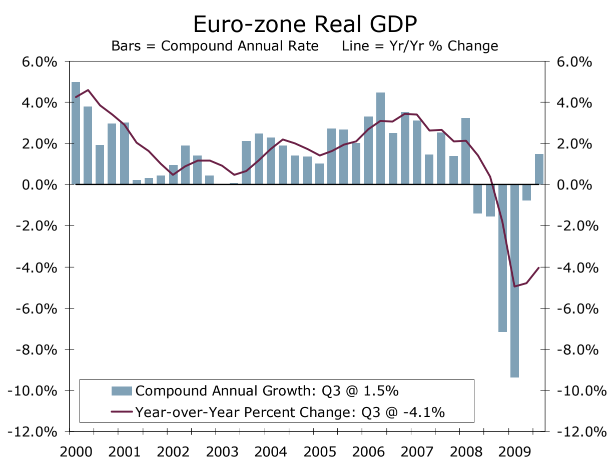
The Wages of Unemployment

- Both the composition and pace of the recovery raises core issues for any business strategy for the year ahead.
- Longer-term and high unemployment compounds the credit/workout risks for consumer and real estate debt.
- High unemployment keeps the Fed on hold and further distorts market pricing of risk both in the global carry trade and inflation premiums. Finally, high unemployment also creates political risk as policy makers introduce more programs that put a premium on quick band-aids and not long-term cures.

Global Review

Tentative Recovery Underway in the Euro-zone

- After contracting more than five percent on a peak-to-trough basis, real GDP in the Euro-zone rose 1.5 percent (annualized) on a sequential basis in the third quarter. However, it would be misleading to characterize the tentative recovery as truly self-sustaining yet because available evidence suggests that consumer spending remains weak.
- Germany, France and Italy all posted positive growth rates. However, real GDP in Spain, which is suffering from its burst housing bubble, continued to contract for the sixth consecutive 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	3.5	2.0	2.7	2.7	2.5	2.2	2.7	2.1	0.4	-2.5	2.4	2.4
Personal Consumption	0.6	-0.9	3.4	-1.2	0.9	1.2	1.3	1.3	2.9	2.6	-0.2	-0.7	0.8	1.4
Inflation Indicators [2]														
"Core" PCE Deflator	1.7	1.6	1.3	1.4	1.4	1.2	1.2	1.3	2.3	2.4	2.4	1.5	1.3	1.6
Consumer Price Index	-0.2	-0.9	-1.6	1.2	2.0	2.0	1.5	1.4	3.2	2.9	3.8	-0.4	1.8	2.0
Industrial Production [1]	-19.0	-10.3	5.2	6.1	2.3	3.1	2.8	4.2	2.3	1.5	-2.2	-9.9	2.8	4.1
Corporate Profits Before Taxes[2]	-19.0	-12.6	-10.5	20.0	22.0	16.0	10.0	8.5	10.5	-4.1	-11.8	-7.0	13.9	8.0
Trade Weighted Dollar Index[3]	83.2	77.7	74.3	73.5	76.1	78.6	81.0	81.8	81.5	73.3	79.4	73.5	81.8	82.8
Unemployment Rate	8.1	9.3	9.6	10.2	10.3	10.6	10.8	10.8	4.6	4.6	5.8	9.3	10.6	10.6
Housing Starts[4]	0.53	0.54	0.59	0.60	0.60	0.65	0.68	0.71	1.81	1.34	0.90	0.56	0.66	0.80
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	5.10	5.20	5.30	5.30	5.40	6.14	6.10	5.33	5.10	5.40	6.00
10 Year Note	2.71	3.53	3.31	3.50	3.60	3.60	3.60	3.70	4.71	4.04	2.25	3.50	3.70	4.40

Forecast as of: November 11, 2009
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change

Together we'll go far

U.S. Review

Unemployment Is High and Fed Funds Are Low, and You're Confused on Which Way to Go

Both the composition and pace of the recovery raises core issues for any business strategy for the year ahead. Straight line forecasting is out. A wide range of possibilities are in. Our November outlook reinforces the view that the pace of growth in 2010 will be below that of the first year of a typical economic recovery, and that the composition of growth will favor contributions from federal spending and inventory building with subpar performances from consumer spending and business investment.

Subpar growth, especially in the private sector (measured as private final domestic demand), will be below 2.5 percent for 2010 compared to the 3 percent plus expansion pace from 2003 to 2006. The unemployment rate, therefore, is likely to remain above 10 percent all year and monetary policy is likely to keep the federal funds rate low through the first half of the year at least. This outlook raises three risks for strategic thinking. First, longer-term and high unemployment compounds the credit/workout risks for consumer and real estate debt. Second, high unemployment will keep the Fed on hold and further distort market pricing of risk both in the global carry trade and inflation. Finally, high unemployment also creates political risk as policy makers introduce more programs that put a premium on quick band-aids and not long-term cures.

Credit and The Fed: Answers Must Come from Within

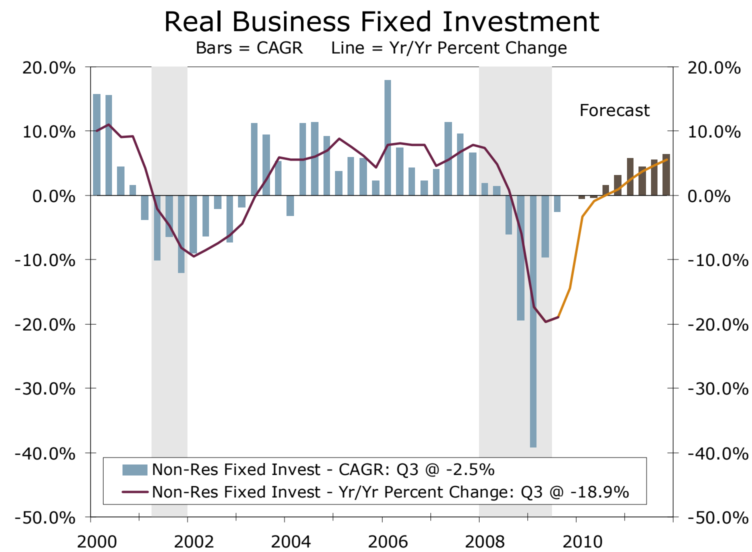
In recent weeks, mounting credit problems at the Federal Housing Agency have led to discussion of Treasury support and tighter lending standards at the Agency. Persistent credit problems are the result of persistent economic weakness—especially in job growth and thereby household income growth. Our November outlook highlights that high unemployment and weak real disposable income gains will persist in 2010 and thereby work against credit recovery.

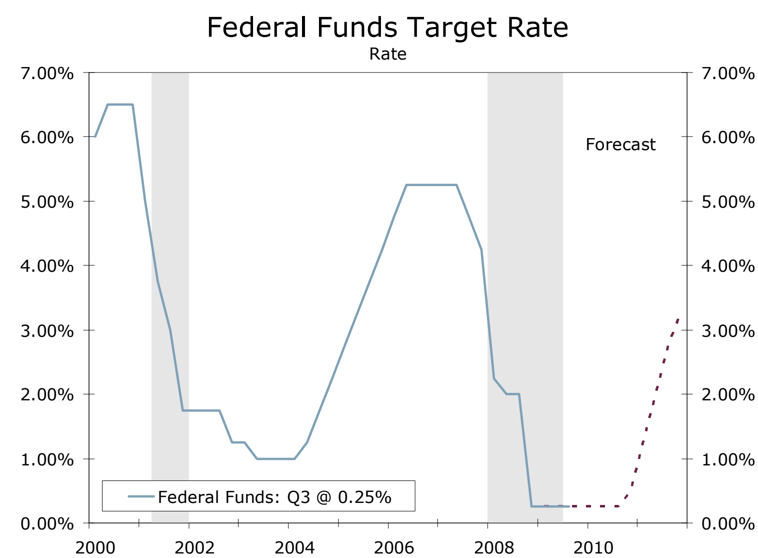
Second, the FOMC's latest statement emphasizes the weak economy and that the low interest rate policy will remain for a sustained period. For decision-makers this policy raises the risk that current market pricing on many assets, including Treasuries, MBS and ABS, are distorted. Moreover, concerns about a global carry trade leading to asset pricing distortions are happening on a broader scale.

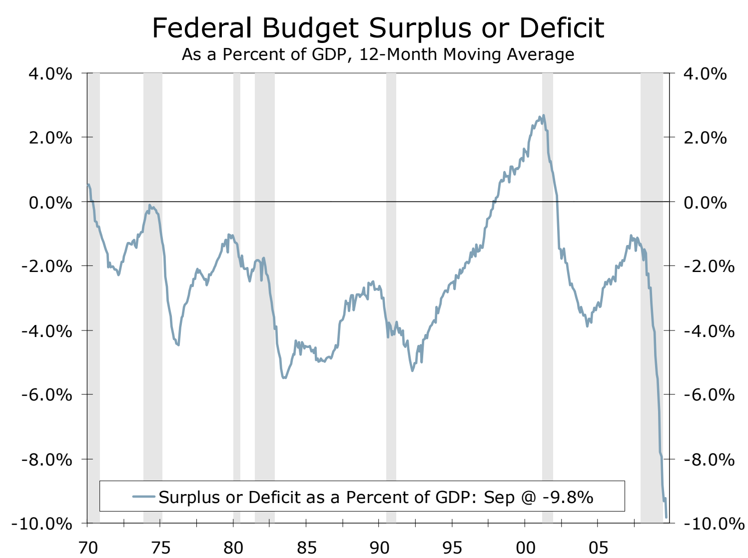
Political Risk: Nobody's Winning At this Kind of Game

Mid-term elections are coming in 2010 and the level of unemployment will be higher in November at election time than it was two years ago. Hope is not a strategy. Politicians who will seek to save their jobs will pursue quick fixes to get the unemployment rate down. This suggests a lot of targeted, make-work projects that will increase government spending and thereby larger fiscal deficits.

Our outlook is for a $1.4 trillion dollar federal deficit for 2010 and this will create further risks for decision-makers as long-term rates will become susceptible to political pressures on the Fed and the vagaries of foreign central bank support for the dollar. Volatility for both interest rates and the dollar opens the range of market outcomes that can produce uncertain performance in 2010.





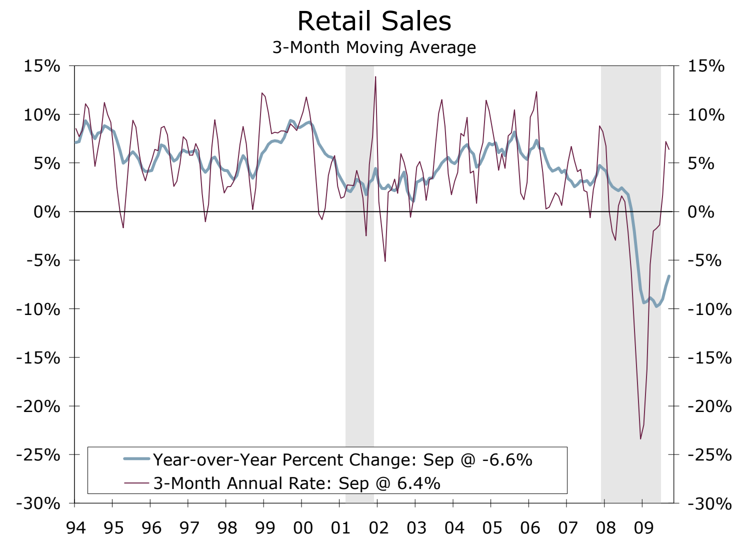


Retail Sales • Monday

Advanced retail sales fell 1.5 percent in September largely due to a 10.4 percent drop in motor vehicle sales as the cash-for-clunkers program ended in late August. Excluding auto dealers, sales rose 0.5 percent with furniture retailers posting the largest monthly sales gain since January 2007. Gasoline station sales also rose and will likely continue on an upward trend in October. Motor vehicle sales at dealerships should be another bright spot as manufacturer motor vehicle sales rose 13 percent in October to a 10.4 million unit annual pace. On a year-over-year basis, chain store sales rose 2.1 percent in October with discount stores and wholesale clubs continuing to be retailers of choice. With consumers deleveraging and still facing significant headwinds including a weak labor market, and declining wage and salary growth, we expect another dismal holiday shopping season.

Previous: -1.5% **Wells Fargo: 0.6%**

Consensus: 0.9%

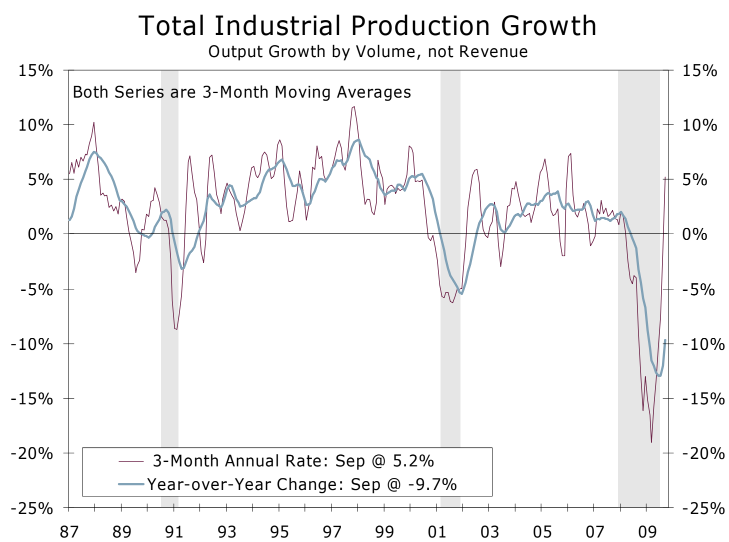


Industrial Production • Tuesday

Industrial production likely rose 0.5 percent in October, the fourth consecutive monthly increase. While the ISM manufacturing index fell modestly in September, the index remained above the demarcation line that separates expansion from contraction and continued to suggest manufacturing expansion. The headline ISM manufacturing index came in at 52.6 with new orders and production remaining in expansion territory. New orders are typically a leading indicator for industrial production and support expectations for a gain. Last month was the third coldest October on record and should result in an outsized utility output gain. Capacity utilization, which peaked in 2006 at 81.2 percent, will likely increase for the fourth consecutive month to 70.7 percent, but will remain near historic lows. The abundance of production capacity means pricing power will remain minimal.

Previous: 0.7% **Wells Fargo: 0.5%**

Consensus: 0.4%

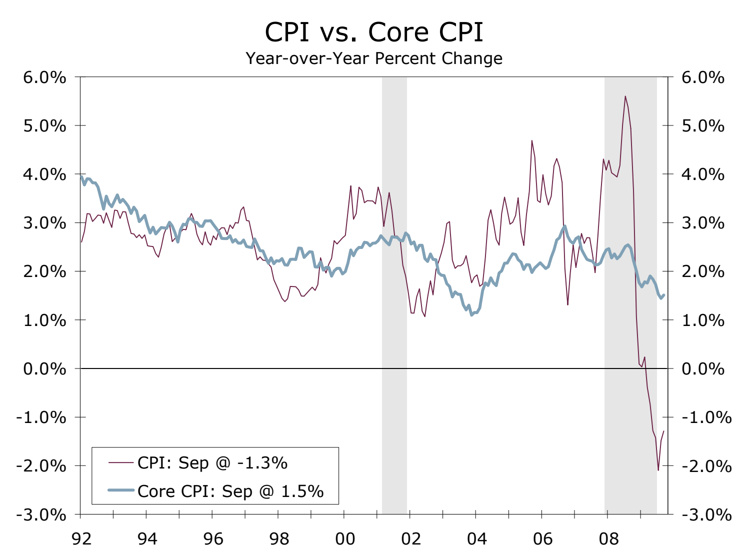


CPI • Wednesday

The headline Consumer Price Index (CPI) rose 0.2 percent in September due largely to a 1.0 percent increase in gasoline prices. "Core" CPI, which excludes food and energy, remained tame and also increased 0.2 percent with gains in lodging away from home, medical care, new vehicles, used car and trucks, tobacco and public transportation. Owners' equivalent rent fell 0.1 percent and is now down 1.3 percent from a year ago. With housing in obvious oversupply, rent and owners' equivalent rent should continue to moderate in October. While crude oil prices rose 9 percent in October, retail gas prices were little changed. Food prices should continue to moderate with prices at the grocery store remaining in negative territory. We expect a flat reading in the headline CPI and a modest 0.1 percent increase in the "core" CPI for the month of October.

Previous: 0.2% **Wells Fargo: 0.0%**

Consensus: 0.2%



Global Review

Positive Growth Returns to the Euro-zone

Preliminary data show that real GDP in the Euro-zone rose 0.4 percent (1.5 percent at an annualized rate) in the third quarter relative to the second quarter (see graph on front page). Although the outturn was a bit weaker than the market consensus forecast had anticipated, the positive growth rate was not much of a surprise. The previously reported 2.2 percent increase in industrial production that occurred in the third quarter suggested that overall GDP growth had turned positive as well.

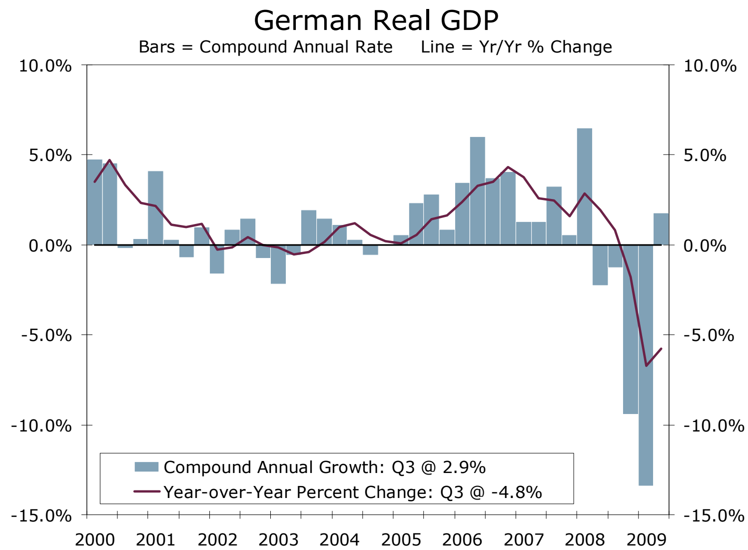
A breakdown of the GDP data into its underlying demand components for the entire euro area will not be available for a few weeks, but monthly indicators suggest that recovery is not yet truly self-sustaining. Inventories fell sharply in the second quarter, so some of the bounce-back in real GDP in the third quarter likely reflects less rapid inventory liquidation. An inventory cycle can help to lift growth for a quarter or two. For the recovery to become truly self-sustaining, however, final sales would need to rise. And on that score, the jury is still out.

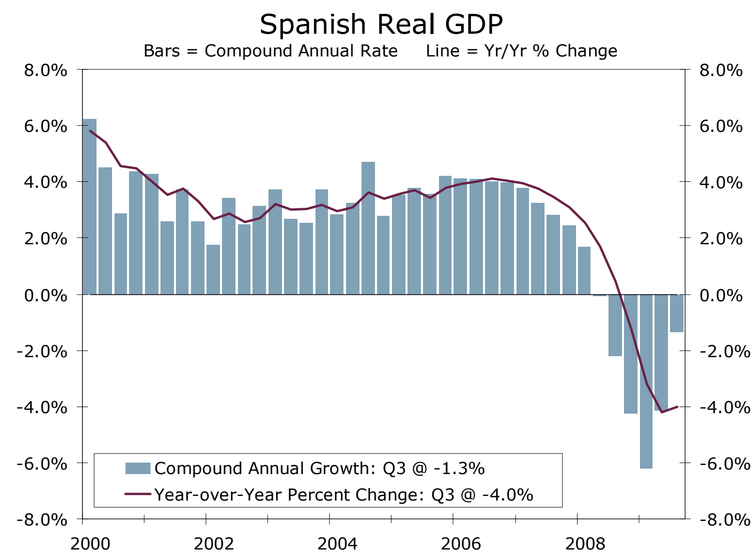
The good news is that monthly data through August indicate that exports likely rebounded in the third quarter. The recoveries that are starting to take hold in some of the Euro-zone's trading partners are showing up as stronger exports. However, imports appear to have remained depressed in the third quarter, which reflects the underlying weakness of domestic demand.

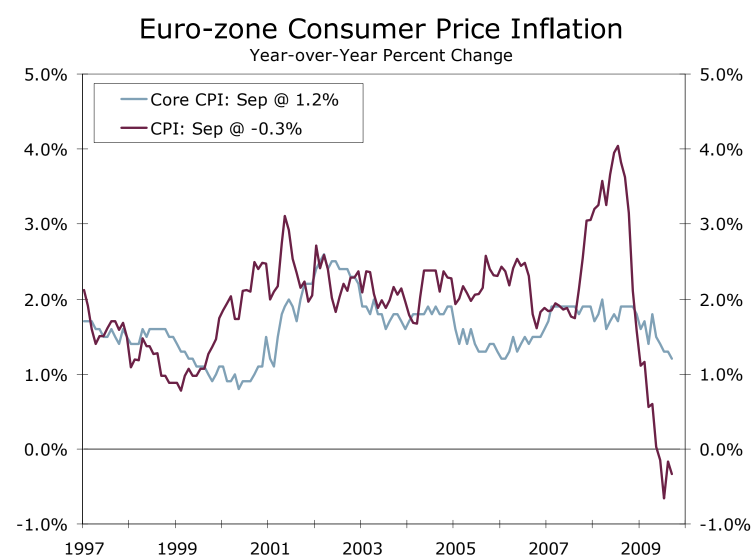
Real personal consumption expenditures edged up in the second quarter, but the result was flattered by "cash for clunkers" programs in some large countries in the Euro-zone. Moreover, monthly retail sales data indicate that the underlying pace of consumer spending remained weak in the third quarter. "Hard" data from France, the only major Euro-zone economy to have provided a breakdown of the GDP data, showed that real consumer spending grew only 0.2 percent on a sequential basis. Although they have not yet provided details, German statistical authorities indicated that personal consumption expenditures in that country were weak in the third quarter.

Most individual economies posted positive growth rates in Q3. Among the major economies, Germany led the pack with a 0.7 percent increase (top chart). The Italian economy expanded 0.6 percent, and output in France grew 0.3 percent. However, real GDP in Spain, which is suffering from the hangover of its burst housing bubble, fell 0.3 percent, the sixth consecutive quarter in which the economy contracted (middle chart).

The return of positive growth probably has been greeted by relief within the ECB's headquarters in Frankfurt. However, we do not look for imminent tightening just because real GDP rose in the third quarter. As indicated above, it would be a stretch to characterize the tentative recovery in the euro area as truly self-sustaining yet. In addition, the ECB does not need to quickly hike rates due to benign inflation (bottom chart). Therefore, we think the ECB will remain on hold until the Euro-zone economy is further out of the woods. In that regard, we do not expect the ECB to tighten policy until the second half of next year.







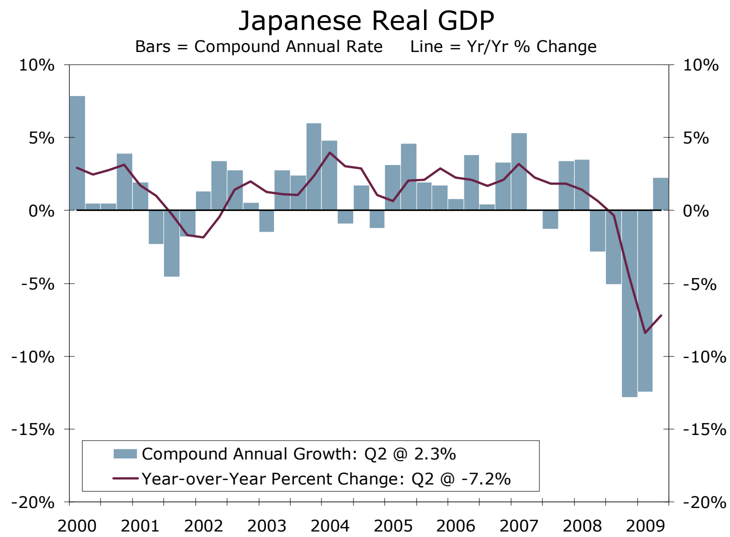
Japanese GDP • Monday

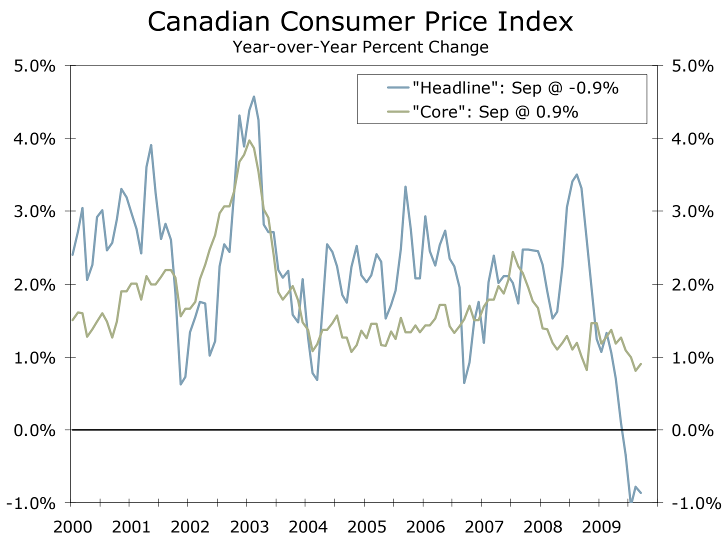
After plunging more than eight percent, Japanese real GDP grew at a decent clip in the second quarter and monthly data suggest that the economy expanded further in the third quarter. Industrial production surged at an annualized rate of 32 percent in the third quarter relative to the second quarter. A turnaround in de-stocking and strong export growth, especially to other Asian economies, appears to be partly responsible for the jump in IP.

It will be interesting to see how much final domestic demand grew during the third quarter. Personal consumption expenditures rose 3.0 percent in the second quarter, but questions about the sustainability of consumer spending are rampant due to the high unemployment rate. With the domestic economy weak, it is inconceivable that the BoJ would hike rates at its policy meeting on Friday.

Previous: 2.3% (annualized rate) Wells Fargo: 1.7%

Consensus: 3.0%





Canadian CPI • Wednesday

Canada's inflation rate dropped below zero for the first time this decade earlier this year. The drop in the headline number was driven primarily by the year-over-year comparisons with the summer of 2008 when oil and other commodity prices soared to record highs. Core inflation has been much steadier, alleviating immediate concerns of deflation. The Bank of Canada endeavors to promote growth while keeping inflation between one and three percent per annum. We expect headline inflation to normalize in coming months, but a slow recovery and a strong Canadian dollar should keep inflation from rising too quickly. This should give the central bank cover to keep rates low well into 2010.

Also out next week in Canada: September data for manufacturing sales on Monday and wholesale sales on Thursday, both are expected to post modest gains after big drops in August.

Previous: -0.9% Wells Fargo: 0.1%

Consensus: 0.2%

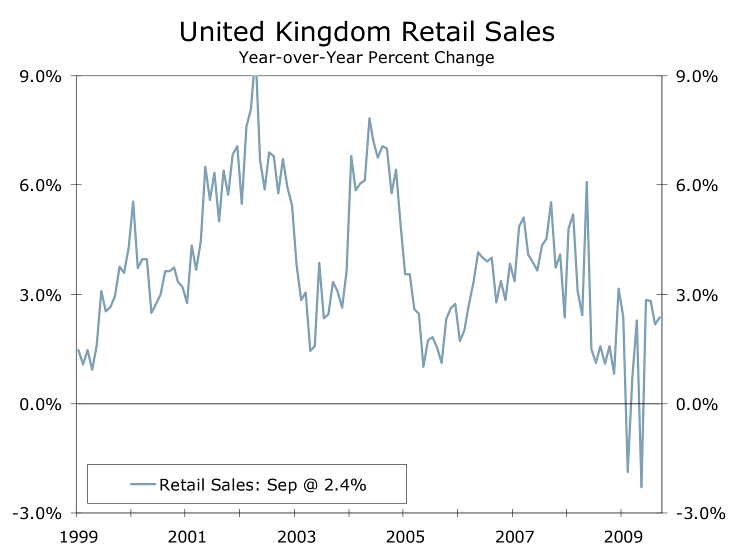
British Retail Sales • Thursday

Although the U.K. economy has tanked over the past year or so, British retail spending has held up fairly well. The volume of retail sales rose at a year-over-year rate of 2.4 percent in September, and the consensus forecast anticipates that growth strengthen further in October. Data on retail spending will print on Thursday.

CPI inflation data for October are slated for release earlier in the week (Tuesday). The overall rate of CPI inflation has dropped from more than 5 percent to only 1.1 percent over the past year. However, the period of disinflation appears to be coming to an end. We are in line with the consensus forecast in anticipating an increase in the year-over-year inflation rate to 1.4 percent in October. The minutes of the Bank of England's policy meeting, which will print on Wednesday, will give investors some insights into the Bank's current thinking about the economy.

Previous: 0.0% (month-on-month change)

Consensus: 0.5%



Interest Rate Watch

Outlook Dictates Rate Expectations

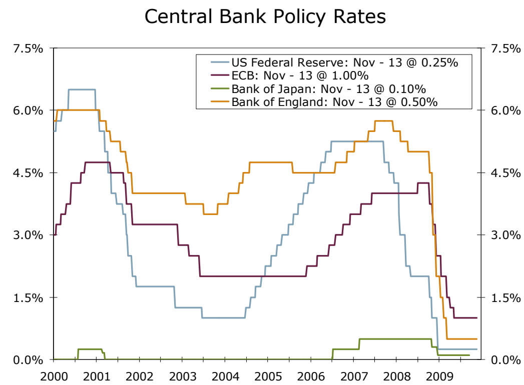
Our latest monthly outlook suggests no change in short rates for the next six months and only a slight increase in yield for the benchmark 10-year Treasury rate. For the time being the risks remain on the upside, however, for long rates as volatility around expectations on the dollar and Federal deficits suggest a continued cautious position on Treasuries.

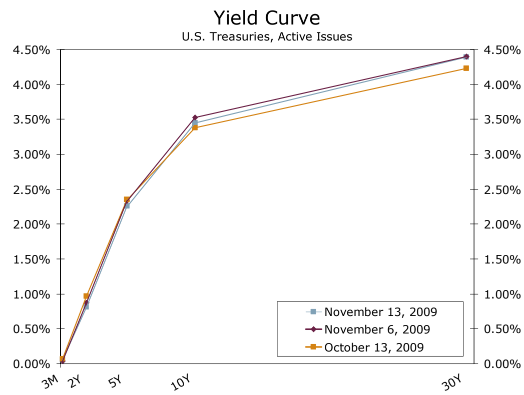
Fundamentals, not wishful thinking, dictate the path of interest rates. In our annual outlook, dated December 10, 2008 we did have a modest economic recovery in the second half of 2009 accompanied with continued low inflation Therefore, our outlook then, as it is now, is that the Federal funds rate would be unchanged.

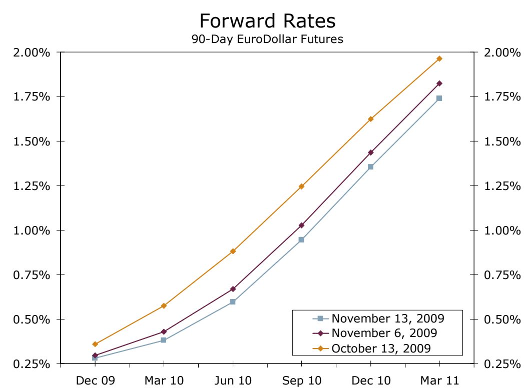
Risk and volatility are more likely the province for longer-term Treasury rates. Here, our story is a complex mixture of economic fundamentals, policy actions and the ephemeral character of foreign investor interest—no linear projection here!

Economics alone would suggest a slight upward bias to Treasury rates for two reasons. First, on the demand side, investor interest suggests more risk-taking and therefore a move into corporate bonds, equities and real investment and away from Treasury debt. Meanwhile, on the supply side, Treasury issuance will continue and that increased supply, with decreased demand, suggests an upward bias in interest rates. Given the continued low inflation we expect a modest upswing, not a rapid rise, in rates.

Volatility is a risk because both the Federal Reserve and the Obama administration will have to reveal/implement an exit strategy from stimulus. Stimulus cannot represent a permanent state of affairs. We have three guideposts on rates. First, how will the Treasury market react to the end of Fed buying? Second, how will markets react to the administration's budget message in February? Finally, how will foreign investors react to recent dollar weakness, large fiscal deficits, and interplay of politics and economics in an election year—all this brings volatility to the markets and a busy workload for the economics department.







Consumer Credit Insights

Mortgage Applications: Complex Signal of Consumer Behavior

Mortgage applications are frequently used as a barometer of consumer intentions on housing. While generally instructive, this applications index reflects a complex mix of several influences and so the top-line results are sometimes misleading.

In the spring of 2005 the conventional mortgage purchase index peaked and then rapidly collapsed at the end of 2007. This pattern is consistent with what you would expect if applications followed purely economic influences. Yet since the end of November 2007 we have also witnessed a rise in the government sponsored (Federal Housing Agency, FHA) purchase index. Therefore, there is a substitution effect going on between conventional and government financing.

Within the government category we are also witnessing a regulatory impact. The FHA is losing money as its delinquencies have been rising. Therefore the FHA is likely to seek aid from the Treasury as well as tighten up its standards. Tighter standards are likely to lead to a decline in applications even though the economy is improving.

Applications are also split between purchases and refinancing. The refinancing index tends to be very volatile but has been rising since June of this year. This pattern would reflect the current low 30-year mortgage rates relative to the steady rise we have seen since June in the one-year adjustable mortgage rates. Facing higher short rates, homeowners are driven to refinancing into longer mortgages even though markets expect no Fed move soon.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.91%	4.98%	4.92%	6.14%
15-Yr Fixed	4.36%	4.40%	4.37%	5.81%
5/1 ARM	4.29%	4.35%	4.38%	5.98%
1-Yr ARM	4.46%	4.47%	4.60%	5.33%
MBA Applications				
Composite	627.5	608.3	742.9	425.0
Purchase	220.9	250.3	290.9	284.4
Refinance	2,998.2	2,693.7	3,374.6	1,248.4

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

Topic of the Week

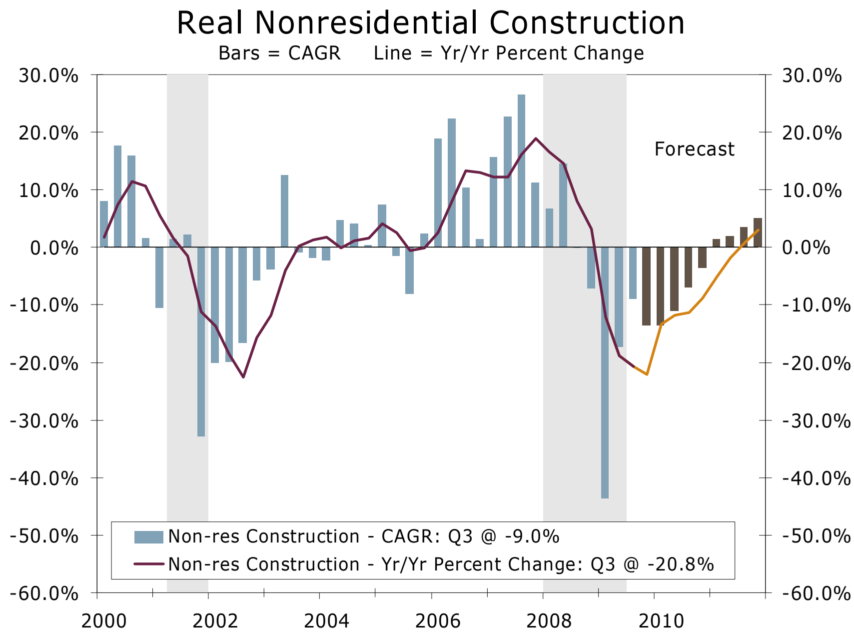
The Commercial Real Estate Centipede Loses Another Shoe

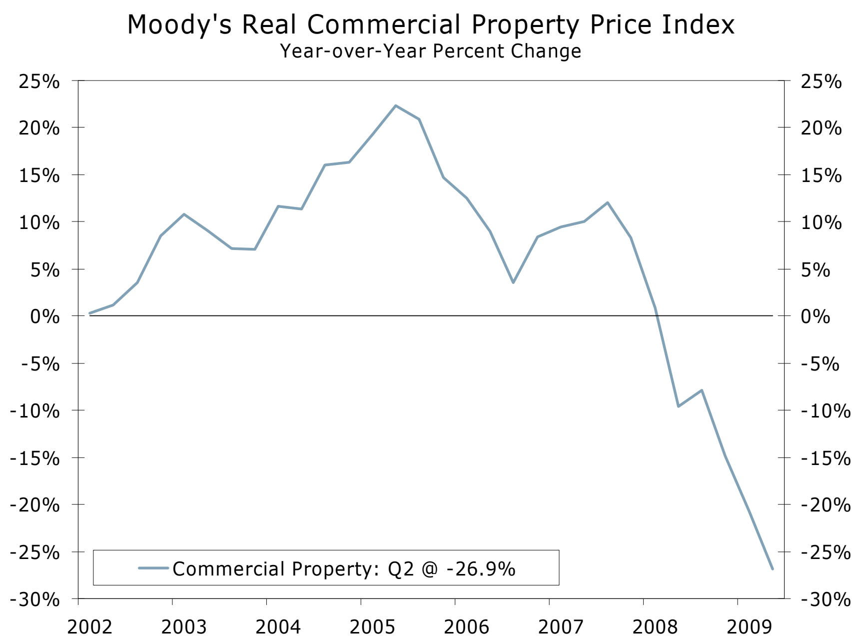
Hardly a day goes by without some mention that another shoe is about to drop on the economy as the rising tide of defaults and foreclosures of commercial properties overwhelms the financial system. Such talk is understandable given the circumstances and the nearness of the collapse of the residential market. There is still plenty of bad news stoking fears, both real and imagined. Property values are declining. Credit is hard to obtain. Numerous high-profile commercial real estate bankruptcies such as General Growth Properties, Extended Stay Hotels and Capmark remind us of just how perilous the real estate industry is today.

While many of the challenges facing commercial real estate are well known, there are also important differences with previous real estate crunches. One of the most notable differences is that real estate is not nearly as overbuilt as it was in the late 1980s and early 1990s. Commercial development did not really get going until the last two years of the economic expansion and significant office development was largely confined to a handful of markets. Retail development and industrial construction were more widespread, with the housing boom fueling explosive gains in consumer spending and an import boom.

Various measures of commercial property values show prices topped out in late 2007, right about the time the capital markets froze. Prices are currently down a cumulative 34 percent from that peak across all property types. We expect further price declines over the next 18 months, as sales of distressed properties increase. The largest drops will continue to be in areas where housing weakened the most, including Florida, southern California, Arizona, Nevada and Georgia. Office buildings and shopping centers remain exceptionally vulnerable as employment is still falling and discretionary consumer spending remains weak.

Visit our website for the full report.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 11/13/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.06	0.04	0.18
3-Month LIBOR	0.27	0.27	2.15
1-Year Treasury	0.32	0.38	0.78
2-Year Treasury	0.82	0.84	1.23
5-Year Treasury	2.26	2.29	2.42
10-Year Treasury	3.43	3.50	3.85
30-Year Treasury	4.36	4.40	4.36
Bond Buyer Index	4.40	4.41	5.14

Foreign Exchange Rates

	Friday 11/13/2009	1 Week Ago	1 Year Ago
Euro ($/€)	1.485	1.485	1.277
British Pound ($/₤)	1.665	1.661	1.484
British Pound (₤/€)	0.892	0.894	0.861
Japanese Yen (¥/$)	89.750	89.876	97.683
Canadian Dollar (C$/$)	1.052	1.075	1.212
Swiss Franc (CHF/$)	1.017	1.017	1.187
Australian Dollar (US$/A$)	0.928	0.919	0.666
Mexican Peso (MXN/$)	13.155	13.410	12.923
Chinese Yuan (CNY/$)	6.826	6.827	6.830
Indian Rupee (INR/$)	46.343	46.815	49.293
Brazilian Real (BRL/$)	1.738	1.720	2.331
U.S. Dollar Index	75.483	75.741	86.938

Foreign Interest Rates

	Friday 11/13/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.67	0.68	4.23
3-Month Sterling LIBOR	0.61	0.61	4.20
3-Month Canadian LIBOR	0.50	0.50	3.10
3-Month Yen LIBOR	0.31	0.32	0.90
2-Year German	1.21	1.28	2.27
2-Year U.K.	1.32	0.83	2.28
2-Year Canadian	1.41	1.42	1.91
2-Year Japanese	0.26	0.28	0.58
10-Year German	3.37	3.36	3.64
10-Year U.K.	3.78	3.89	4.09
10-Year Canadian	3.51	3.54	3.74
10-Year Japanese	1.35	1.45	1.50

Commodity Prices

	Friday 11/13/2009	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	76.08	77.43	58.24
Gold ($/Ounce)	1104.83	1095.10	736.50
Hot-Rolled Steel ($/S.Ton)	485.00	485.00	770.00
Copper (¢/Pound)	293.30	294.55	161.50
Soybeans ($/Bushel)	9.60	9.84	8.59
Natural Gas ($/MMBTU)	4.36	4.60	6.32
Nickel ($/Metric Ton)	16,130	17,699	10,359
CRB Spot Inds.	452.55	441.49	353.08

Next Week's Economic Calendar

	Monday 16	Tuesday 17	Wednesday 18	Thursday 19	Friday 20
U.S. Data	**Retail Sales** September -1.5% October 0.6% (W) **Retail Sales Less Autos** September 0.5% October 0.3% (W) **Business Inventories** August -1.5% September -0.7% (W)	**PPI** September -0.6% October 0.0% (W) **Industrial Production** September 0.7% October 0.5% (W) **Capacity Utilization** September 70.5% October 70.7% (W)	**CPI** September 0.2% October 0.0% (W) **Core CPI** September 0.2% October 0.1% (W) **Housing Starts** September 590K October 610K (W)	**Leading Indicators** September 1.0% October 0.5% (W)	
Global Data	**Canada** **Manufacturing Sales** Previous (Aug) -2.1% **Japan** **GDP Annualized** Previous (2Q) 2.3%	**UK** **CPI (YoY)** Previous (Sep) 1.1%	**Canada** **CPI (YoY)** Previous (Sep) -0.9%	**UK** **Retail Sales (MoM)** Previous (Aug) 0.0%	

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@wachovia.com
John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wachovia.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wachovia.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wachovia.com
Scott Anderson, Ph.D.	Senior Economist	(612) 667-9281	scott.a.anderson@wellsfargo.com
Eugenio Aleman, Ph.D.	Senior Economist	(612) 667- 0168	eugenio.j.aleman@wellsfargo.com
Sam Bullard	Economist	(704) 383-7372	sam.bullard@wachovia.com
Anika Khan	Economist	(704) 715-0575	anika.khan@wachovia.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wachovia.com
Adam G. York	Economist	(704) 715-9660	adam.york@wachovia.com
Ed Kashmarek	Economist	(612) 667-0479	ed.kashmarek@wellsfargo.com
Tim Quinlan	Economic Analyst	(704) 374-4407	tim.quinlan@wachovia.com
Kim Whelan	Economic Analyst	(704) 715-8457	kim.whelan@wachovia.com
Yasmine Kamaruddin	Economic Analyst	(704) 374-2992	yasmine.kamaruddin@wachovia.com