November 12, 2010

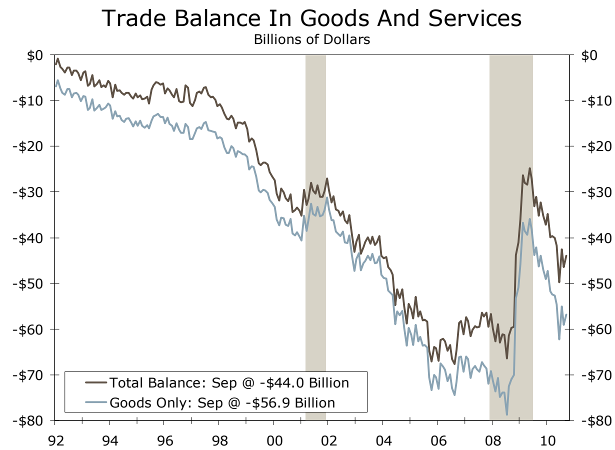
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Positive Economic News Makes QE3 Less Likely

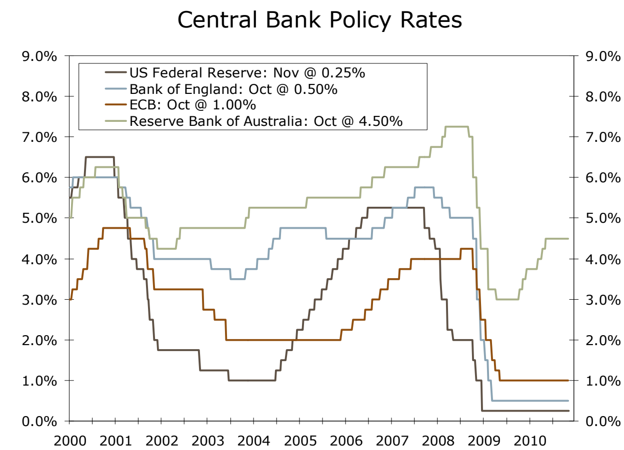
- This week had a relatively light schedule of economic reports, but nearly every report painted a more optimistic picture for the second half of the year.
- The U.S. trade deficit narrowed 5.5 percent to $44.0 billion in September. Exports rose 0.3 percent on the month, which is its highest level since August 2008 and imports fell 1.0 percent.
- Labor market indicators for the week were also positive. Weekly first-time unemployment claims fell by 24,000 to 435,000 in the week ending November 6, the second lowest level this year.



Global Review

What is Driving Decisions at Australia's Reserve Bank?

- On November 2, the Reserve Bank of Australia (RBA) raised its cash rate—its key target lending rate—another 25 basis points to 4.75 percent. The move brings the total amount of tightening in this cycle to 1.75 percent and extends the gap between the policy rate in Australia and other developed economies.
- The tightening in monetary policy has kept market watchers in Australia guessing in recent months because the hikes keep coming despite evidence of slackening private demand and slowing residential construction.



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	1.9	2.5	2.2	2.4	2.8	1.9	0.0	-2.6	2.7	2.3	3.0
Personal Consumption	1.9	2.2	2.6	2.2	1.9	1.9	1.9	2.8	2.4	-0.3	-1.2	1.7	2.1	2.0
Inflation Indicators [2]														
"Core" PCE Deflator	1.8	1.5	1.3	1.0	0.9	0.9	1.0	1.2	2.9	2.3	1.5	1.4	1.0	1.5
Consumer Price Index	2.4	1.8	1.2	0.9	1.0	1.6	1.7	1.9	2.3	3.8	-0.3	1.6	1.5	2.2
Industrial Production [1]	7.1	7.0	4.8	0.8	0.4	1.3	3.5	4.5	81.3	-3.3	-9.3	5.3	2.2	4.4
Corporate Profits Before Taxes [2]	37.6	37.0	17.0	12.5	8.0	6.0	6.0	6.5	-6.2	-16.4	-0.4	25.1	6.6	6.9
Trade Weighted Dollar Index[3]	76.1	78.8	73.6	70.0	70.0	71.0	72.0	73.0	0.0	74.3	77.7	74.6	71.5	76.3
Unemployment Rate	9.7	9.7	9.6	9.7	9.9	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	0.70	0.78	0.82	16.09	0.90	0.55	0.61	0.74	1.00
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	4.10	4.00	4.00	4.10	4.48	6.04	5.04	4.57	4.05	4.48
10 Year Note	3.84	2.97	2.53	2.40	2.30	2.40	2.50	2.60	4.84	3.66	3.26	2.94	2.45	2.98

Forecast as of: November 10, 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

Inside

U.S. Review

Finally, Light at the End of the Tunnel

This week had a relatively light schedule of economic reports, but nearly every report painted a more optimistic picture for the second half of the year. One clear sign that the economy continued to gain momentum was the recently released data on the trade balance. The U.S. trade deficit narrowed 5.5 percent to $44.0 billion in September. Exports rose 0.3 percent on the month, which is its highest level since August 2008 and imports fell 1.0 percent. Although much of the improvement in exports stemmed from a weaker dollar and aircraft orders, we think the trend is likely sustainable. With the second dose of quantitative easing we anticipate further downward pressure on the dollar, which should continue to lend support to exports in coming quarters.

Speaking of the trade outlook, the Bureau of Economic Analysis (BEA) assumed that the trade deficit would narrow only modestly in September when it made its initial estimate of third-quarter GDP growth. However, the actual outturn surpassed the BEA's pessimistic projection. As a result, the third-quarter GDP growth figure, which was originally reported as an annualized rate of 2.0 percent, could be revised up by roughly 0.2 percentage points if all other components of real GDP stay the same. We expect trade to support economic growth through the first half of 2011.

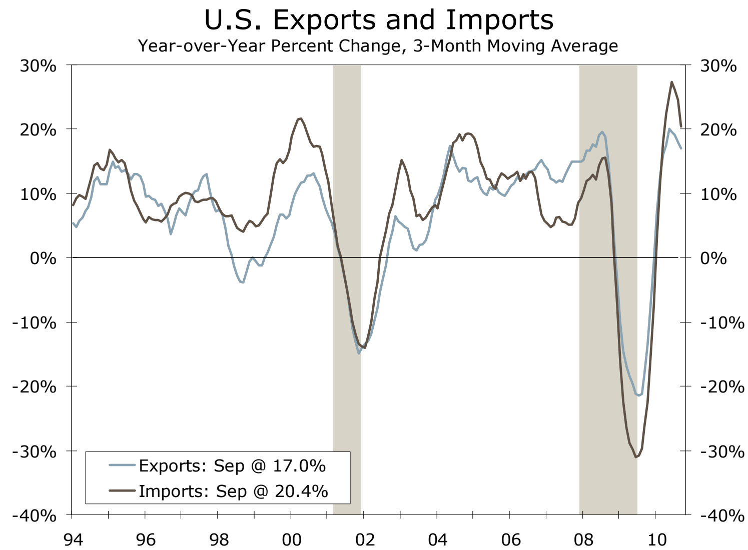
Labor market indicators for the week were also positive. Weekly first-time unemployment claims fell by 24,000 to 435,000 in the week ending November 6, the second lowest level this year. The four-week moving average, which is our preferred way of looking at this volatile series, fell to 446,500 which is the lowest level since the wake of the Lehman bankruptcy. Indeed, we project that the unemployment rate, which currently stands at 9.6 percent, will approach 10 percent by the first quarter of 2011, but we are seeing signs of stabilization in the labor market.

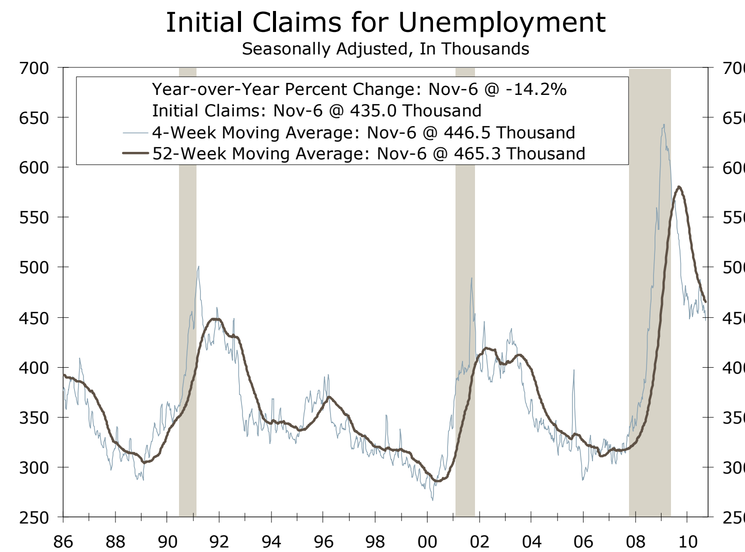
Another data point that is supportive of this claim is the Job Openings and Labor Turnover Survey. The hires and separation rate, which is the rate of hires and separations as a percentage of total nonfarm payrolls, remained unchanged from the previous month at 3.2 percent. The number of unemployed workers per job opening is now 5.0, which is well off of its high of 6.3 reached in November 2009. This suggests that, while hires still have not picked up significantly, separations have at least slowed, which is a step in the right direction.

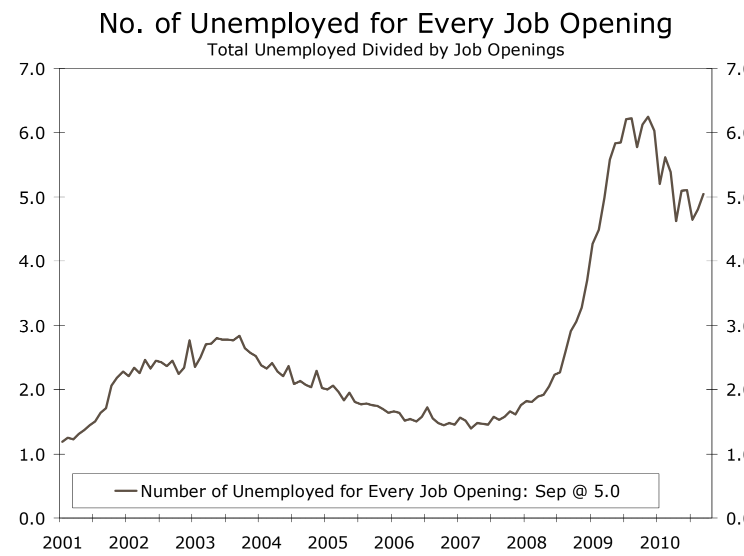
Many market watchers and policymakers suggest one of the main challenges for the labor market continues to be the sentiment of small business owners who hold back on hiring in uncertain times. This week, the Small Business Optimism Index showed a glimmer of hope. The index rose 3.0 percent in October, the third straight increase. Plans to hire also showed a gain.

Taken together, it appears that the fourth quarter has gotten off to a solid start. Our forecast calls for real GDP to rise at a 1.9 percent pace during the fourth quarter, which is roughly in line with the third quarter's growth.

(please see our November *Monthly Economic Outlook*)





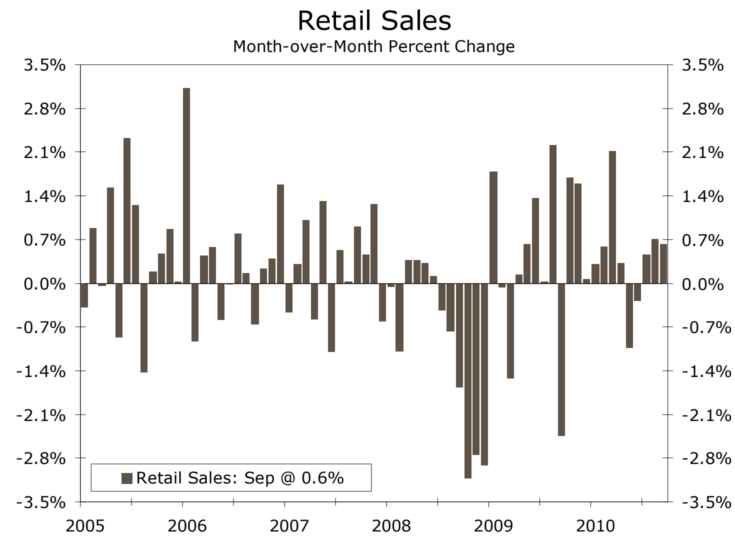


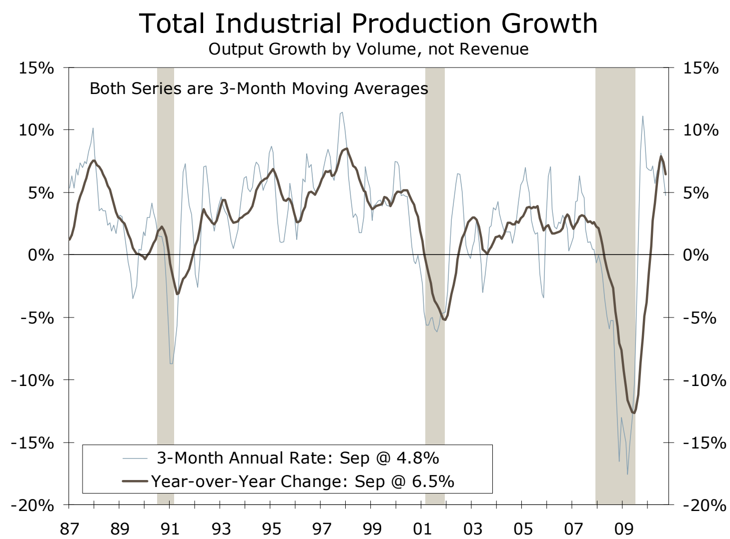
Retail Sales • Monday

September retail sales increased 0.6 percent, the third straight monthly increase. Motor vehicle & parts sales rose 1.6 percent and building materials increased 1.5 percent from August to September. Sales at electronic stores were up 1.5 percent, the largest increase since February. In addition, core retail sales, which excludes autos, gas and building materials increased 0.4 percent month-over-month. With the pickup in the reported number of vehicle sales in October, we should see a continued improvement in retail sales for the month. As a result, our expectation is that the headline retail sales for October increased 0.6 percent. If we continue to see improvement in retail sales numbers, it may signal stronger contributions to fourth quarter GDP growth from personal consumption expenditures.

Previous: 0.6% **Wells Fargo: 0.6%**

Consensus: 0.7% (Month-over-Month)





Industrial Production • Tuesday

Industrial production numbers for September declined an unexpected 0.2 percent, which was the first monthly decline since the end of the recession in June 2009. Declines were observed in several market groups. The only positive contributions were seen in home electronics, business equipment and energy. When the October industrial production number is released on Tuesday, we anticipate that production continued to grow by 0.4 percent for the month. The stronger-than-expected number observed in the ISM Manufacturing Index combined with a slight increase in average weekly hours for manufacturing supports our view that we will likely see a moderate uptick in industrial production. Going forward, our forecast indicates a moderate rate of growth around 0.8 percent in industrial production for the fourth quarter.

Previous: -0.2% **Wells Fargo: 0.4%**

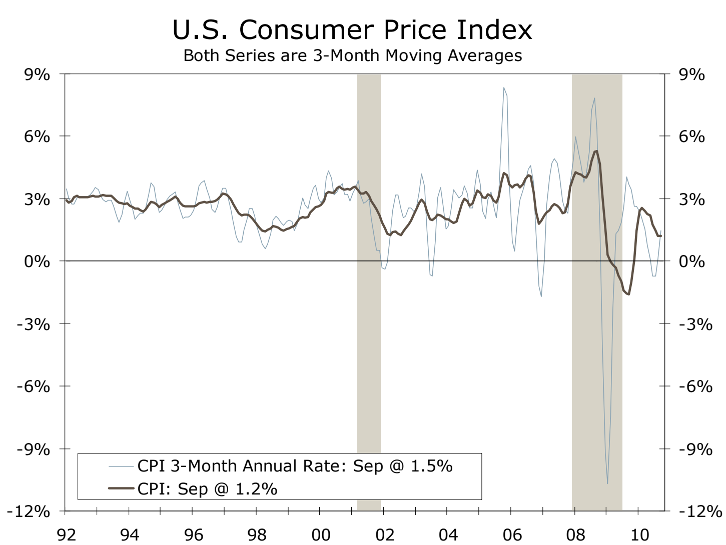
Consensus: 0.3% (Month-over-Month)

Consumer Price Index • Wednesday

The Consumer Price Index for September came in at 0.1 percent. Most of the slight increases in the headline CPI in September are attributed to a 0.3 percent increase in food prices and a 1.6 percent increase in gasoline prices. The core CPI, which excludes food and energy, has been flat for the past two months. Continued price declines in housing, education, communication, recreation and apparel all helped to keep the overall rate of inflation minimal last month. Last week, the depressed CPI numbers led the Federal Reserve Open Market Committee to implement another round of quantitative easing. The Fed's fear of deflation combined with sluggish employment growth resulted in the additional quantitative easing of $600 billion. This move on the part of the Fed is intended to put upward pressure on the rate of inflation and ignite stronger economic growth.

Previous: 0.1% **Wells Fargo: 0.3%**

Consensus: 0.3% (Month-over-Month)



Global Review

The Reserve Bank Looks Beyond Australia

The Australian economy was a rare example of a developed economy to have sidestepped a recession during the global slowdown in 2008 and 2009. The country's central bank, the Reserve Bank of Australia (RBA), has been at the forefront of major central banks that have raised key target lending rates. Since its first hike in September 2009, the RBA has taken its cash rate to 4.75 percent from 3.00 percent. The most recent hike took most market watchers by surprise. Earlier in the cycle, the fast pace of expansion in Australia seemed to justify the RBA's rate hikes. Indeed, markets seemed to anticipate the moves after a spate of strong readings from various indicators of economic growth, particularly signs of growth in domestic demand.

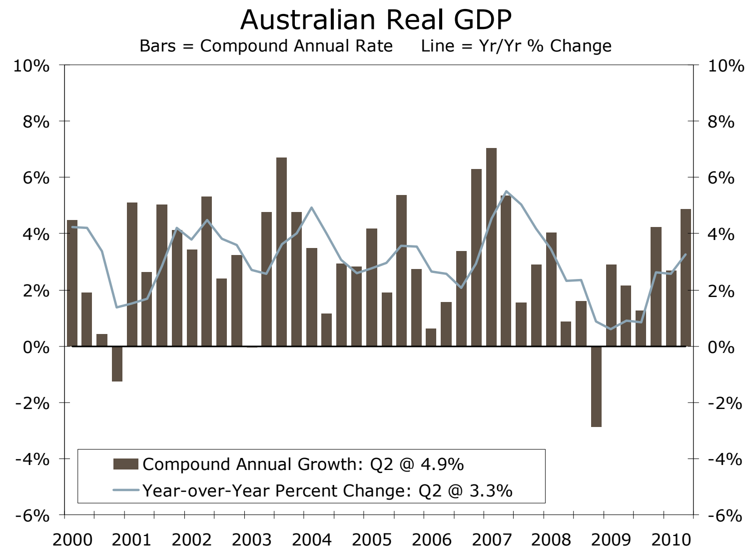
More recently, however, the RBA has kept analysts guessing as to its next move by continuing to hike even when the economic data seemed to signal a slower pace of expansion in the domestic economy. The RBA appears to be looking out across the Banda and South China Seas when making its monetary policy decisions. In its official statement accompanying the most recent rate increase on November 2, the RBA cited improvement in the Chinese growth outlook and a firming in commodity prices as justification for the move to tighten policy further. The statement acknowledged the softness in recent Australian data, noting "a degree of caution in private spending behavior" and subdued credit growth, but these considerations seem to take a backseat to developments in China and commodity price moves.

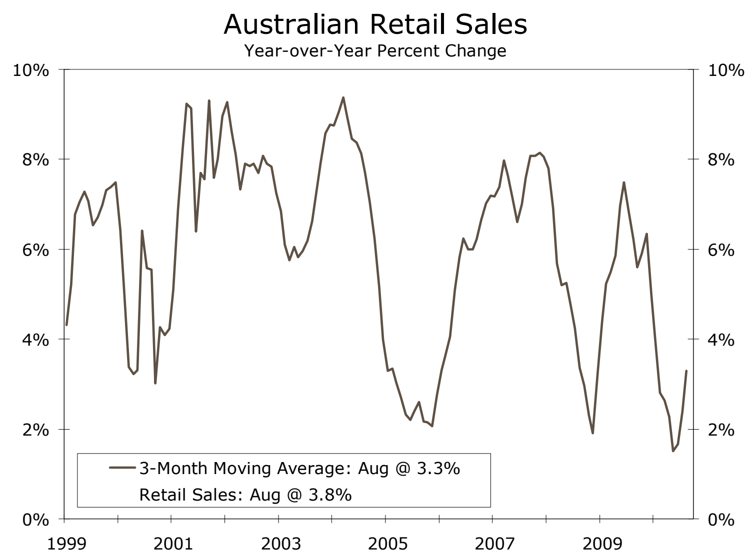
Australian Economic Numbers a Mixed Bag

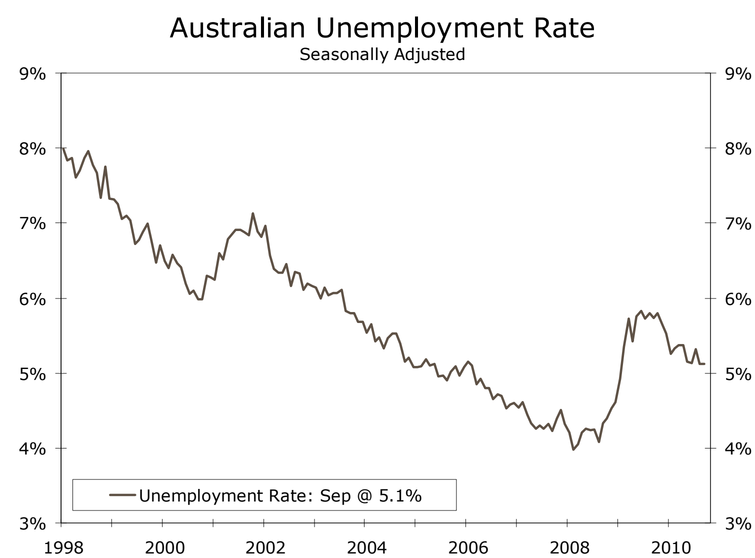
In terms of recent economic data, the picture is somewhat mixed. Since the RBA's last meeting, we have learned that building approvals fell 6.6 percent in September. That marked the sixth straight monthly decline and the largest drop since April.

The turnout in September retail sales was somewhat more heartening as sales rose 0.3 percent in the month. While the gain was somewhat less than the 0.5 percent increase that had been expected, August sales were upwardly revised to a 1.0 percent gain from the more modest 0.8 percent increase first reported. The largest gains in retail sales were driven by a 2.5 percent jump in apparel, which offset a smaller decline in purchases at cafés and restaurants.

After payrolls in Australia surged 55,800 in September, most analysts expected a more modest gain in October. The actual number showed a better-than-expected 29,700 gain in jobs, even as September's increase was revised a bit higher. Most surprising, however, was that the unemployment rate jumped to 5.4 percent from 5.1 percent in September. The explanation for the increase is a jump in the labor force which lifted the participation rate in Australia to a record high. On net, the October jobs report is consistent with a steady employment picture for Australia. That said, the higher unemployment rate and the run up in the value of the Aussie dollar suggests that the RBA will sit out the last meeting of the year—barring any news that suggests faster-than-expected economic growth in China, that is.







UK Unemployment Rate • Wednesday

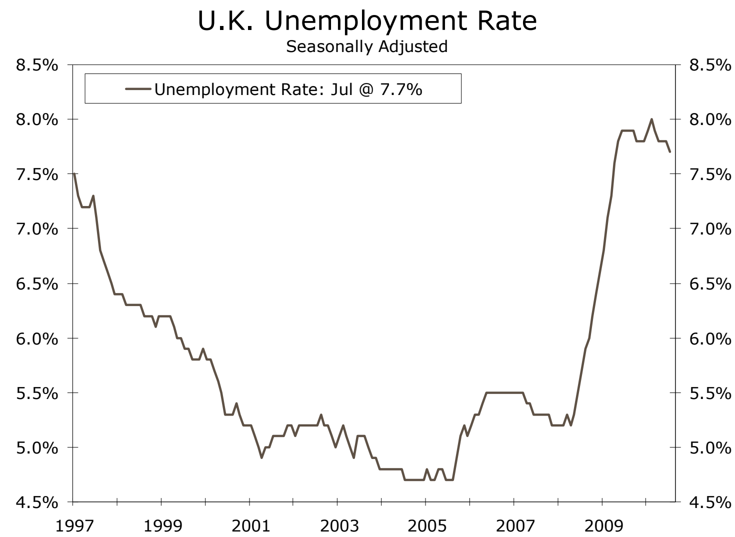
We expect the U.K. unemployment rate to remain stable at 7.7 percent for the month of September, but with a downward bias as economic news has been a bit more encouraging than what markets originally expected.

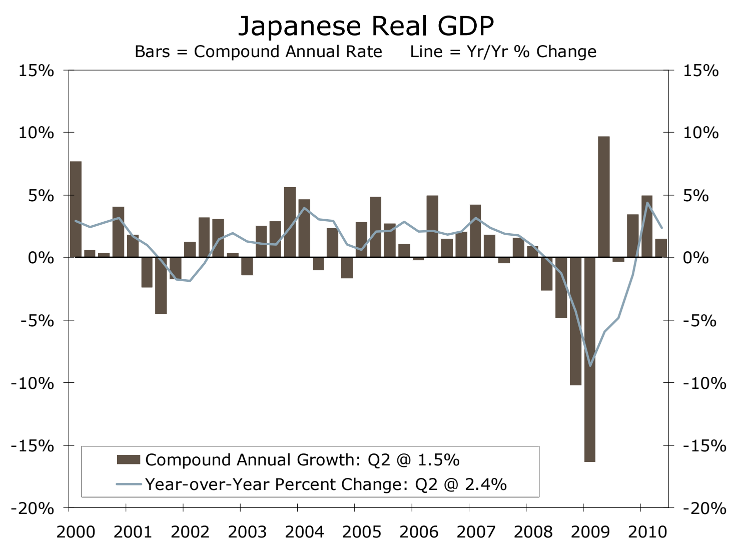
Next week is a very busy week for economic data in the U.K. with CPI, retail prices, weekly earnings, retail sales, and housing prices scheduled to be released during the week. Overall, we expect economic news in the U.K. to continue to surprise markets on the upside even if these indices do not move much compared to the preceding month.

Another interesting bit of information to be released will be the minutes of the Bank of England (BoE) in which markets will probably be able to assess the potential for the BoE to follow its American counterpart with another round of quantitative easing.

Previous: 7.7%

Consensus: 7.7%





Japanese GDP • Monday

Japan is going to release its third quarter GDP number on Monday and markets are expecting a relatively strong reading of 2.5 percent growth (annualized rate) compared to 1.5 percent growth for the preceding quarter. On a quarter-over-quarter basis, GDP is expected to have increased by 0.6 percent. However, this acceleration of growth is not doing much for Japanese inflation as the GDP deflator is expected to show a 1.5 percent decrease on a year-over-year basis.

Thus, while the economy is expected to have improved a bit compared to the second quarter of the year, the improvement is going to remain short of what a solid recovery in economic activity should be.

Previous: 1.5% **Wells Fargo: 0.5%**

Consensus: 2.5% (Annualized)

Euro zone CPI • Tuesday

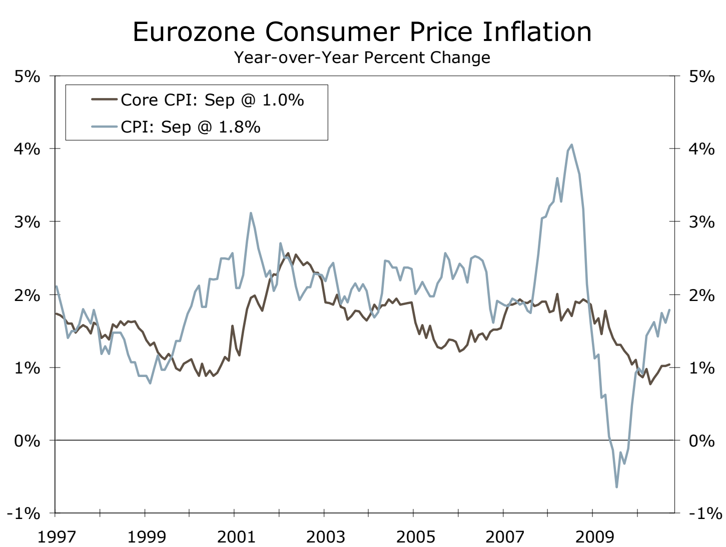
Euro zone consumer prices are expected to have grown by 0.3 percent during October to a 1.9 percent year-over-year rate. If this is the case, then this will mark the third consecutive year-over-year increase in Euro zone inflation and could be one of the reasons why the European Central Bank (ECB) remains concerned about introducing further monetary easing in the region.

Even the strong appreciation of the euro has not been able counteract the increase in energy prices during the past several months. Thus, inflation has continued to accelerate from a low of 0.9 percent in February of this year.

We should not expect any further move by the ECB on quantitative easing after the move earlier this year to bail out Greece and other Euro zone countries that could not access financing to pay their own debts.

Previous: 1.8% **Wells Fargo: 1.9%**

Consensus: 1.9% (Year-over-Year)



Interest Rate Watch

Pricing Assets in a Mixed Market

Free markets are characterized by price discovery by buyers and sellers. Each of these buyers and sellers act in their own interest to maximize their personal or financial benefit. Moreover, the basic premise in financial markets is that there is a risk-free rate with a rate of return with zero risk, including default risk. In practice, asset pricing is often based upon the Treasury yield curve, but here is where our problems begin.

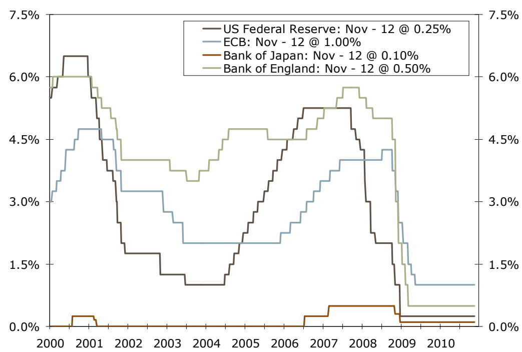
First, while we can be fairly sure that at least in the short-run the Treasury instrument is default free, it is assuredly not free of interest rate, inflation or currency risk in an environment in which the central bank explicitly wants a higher inflation rate. Quantitative easing, whatever its merits are on increasing short-run economic growth, is an increase in the supply of dollars relative to existing demand and thereby has led to a decline in the value of the dollar. There is exchange rate risk for foreign investors. There is also inflation risk for domestic investors since any move by the central bank to allow higher inflation can never be guaranteed to stop precisely at two percent.

Domination by Non-Market Buyers

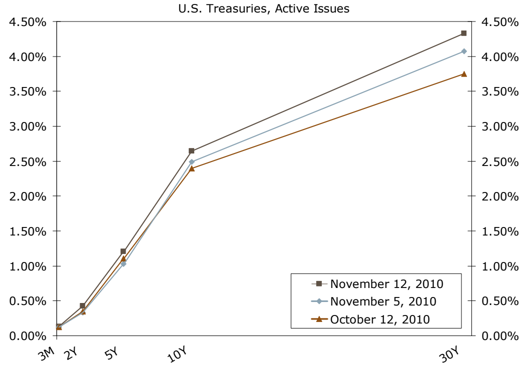
Second, the three largest buyers in the Treasury market—Japan, China and the Federal Reserve—are not market buyers. These are three institutions that do not mark to market, do not report to the SEC or to shareholders or to investors. Therefore, it is not possible to assume with all candor that the current set of Treasury yields represent anything like a market interest rate.

What we see on the screen is a set of phony interest rates driven by three non-market buyers, and of course a U.S. Treasury which is a non-market supplier of bonds. These are the rates that serve as the bench-mark rates for pricing assets? As decision-makers, entrepreneurs and investors alike, the current set of printed interest rates on the screen are not freely determined market rates and certainly in today's environment are far from the risk-free rates implied in our pricing models.

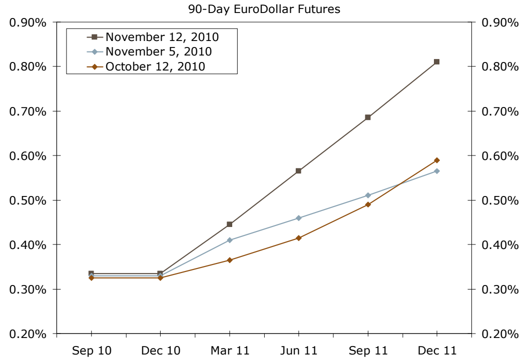
Central Bank Policy Rates



Yield Curve
U.S. Treasuries, Active Issues



Forward Rates
90-Day EuroDollar Futures



Credit Market Insights

Lending Terms Differ by Bank Size

The October Senior Loan Officer Opinion Survey on Bank Lending Practices showed that a net 20.0 percent of banks were more willing to lend for consumer loans in the third quarter, slightly less than the 22.6 percent in the second quarter. While increased willingness to lend is good news, terms and conditions continued to tighten in many cases. Just like last quarter, though, there were differences between large banks (more than $20 billion in assets) and small banks. For credit card loans, both large and small banks continued to tighten credit limits. However, while loan spreads over cost of funds for large banks were basically unchanged, small banks increased spreads. Large banks eased required minimum payments, but small banks tightened. Required minimum credit scores were also eased at large banks, but were unchanged at small banks. The story was similar for non-credit card loans, although both large and small banks decreased spreads. Demand for consumer loans was stronger at large banks and weaker at small banks. Thus, it is clear that lending terms are improving at large banks, but small banks are still tightening. It is, therefore, interesting to see that it is the small banks that have increased business credit lines, while large banks have reduced them. Yet, for many businesses, lack of demand for their products, not access to credit, is the main problem. Unfortunately, demand for their products will likely remain weak until job growth improves.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.96%	4.95%	4.93%	4.98%
15-Yr Fixed	4.33%	4.32%	4.33%	4.61%
5/1 ARM	4.09%	4.05%	4.12%	4.98%
1-Yr ARM	4.12%	4.22%	4.23%	4.91%
MBA Applications				
Composite	620.9	633.1	600.5	876.9
Purchase	221.5	226.8	212.3	257.1
Refinance	2,955.9	3,007.2	2,860.1	4,497.6

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

Topic of the Week

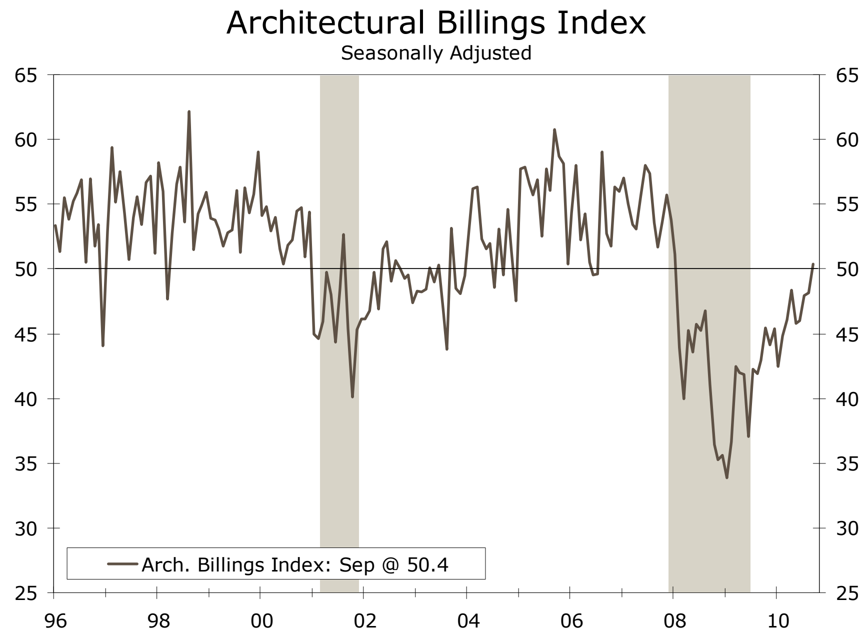
Commercial Real Estate: Set for Improvement

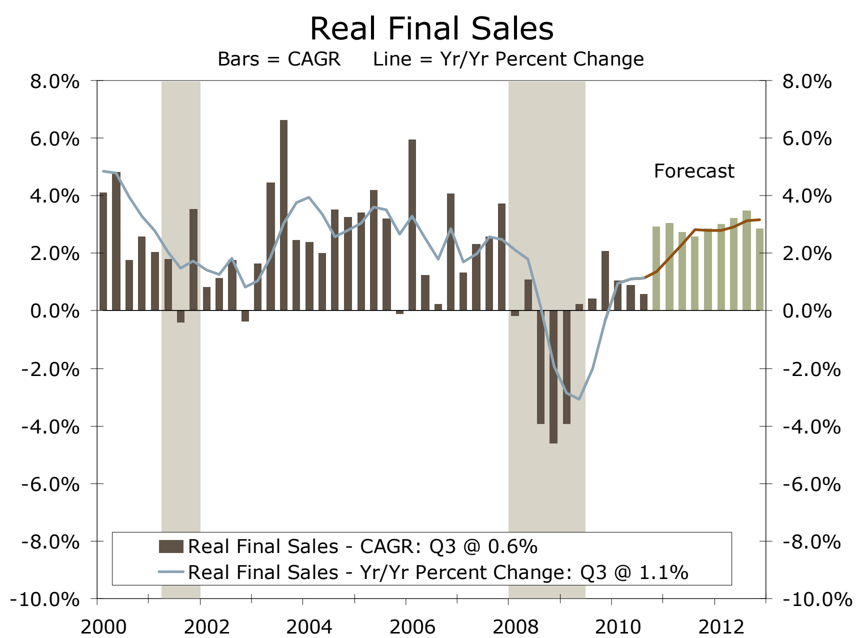
Demand for commercial real estate continues to show surprising resiliency in the face of this frustratingly sluggish economic recovery. The improvement in operating fundamentals has occurred more quickly than would have been expected given the modest recovery in employment seen so far in this recovery. Leasing has picked up, rents are rising or stabilizing and sales have increased. Moreover, demand for high quality properties in choice locations remains exceptionally strong, which has helped pull prices higher for non-distressed deals.

Nonresidential construction is showing signs of bottoming and the early signs of a pick up are in place. We are beginning to see an increase in inquiries to commercial realty firms and improvement in the Architectural Billings Index. One area we believe is primed for a turnaround is the factory sector, which is attracting a high volume of domestic and international investment. During the second half of the year, we have witnessed the announcement of various major construction projects, including Intel's announcement to spend between $6 billion and $8 billion to build a new microchip factory in Oregon and Nucor's decision to invest $750 million in St. James Parish, LA to build a direct reduced iron facility. In addition, dollars also continue to flow into the automotive sector, particularly from overseas companies, which have been building assembly and parts plants throughout the South.

We have recently raised our forecast and now expect slightly stronger job and income growth over the next two years. Final demand for goods and services should consistently strengthen over the next two years, which should lead to increased demand for commercial real estate. The improvement in operating fundamentals achieved this year provides a better idea of where rents will settle, which should better enable investors and lenders to properly value properties so they can be sold, refinanced or redeveloped.

(please see our Q3 *Commercial Real Estate Chartbook*)





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 11/12/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.12	0.11	0.05
3-Month LIBOR	0.28	0.29	0.27
1-Year Treasury	0.18	0.13	0.32
2-Year Treasury	0.50	0.37	0.81
5-Year Treasury	1.37	1.09	2.25
10-Year Treasury	2.76	2.53	3.44
30-Year Treasury	4.26	4.12	4.39
Bond Buyer Index	4.24	4.02	4.40

Foreign Exchange Rates

	Friday 11/12/2010	1 Week Ago	1 Year Ago
Euro ($/€)	1.368	1.403	1.485
British Pound ($/£)	1.616	1.618	1.658
British Pound (£/€)	0.847	0.867	0.896
Japanese Yen (¥/$)	82.650	81.260	90.370
Canadian Dollar (C$/$)	1.010	1.000	1.056
Swiss Franc (CHF/$)	0.979	0.962	1.018
Australian Dollar (US$/A$)	0.988	1.016	0.924
Mexican Peso (MXN/$)	12.283	12.202	13.204
Chinese Yuan (CNY/$)	6.638	6.657	6.827
Indian Rupee (INR/$)	44.830	44.215	46.650
Brazilian Real (BRL/$)	1.722	1.680	1.736
U.S. Dollar Index	78.047	75.882	75.596

Foreign Interest Rates

	Friday 11/12/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.99	0.99	0.67
3-Month Sterling LIBOR	0.74	0.74	0.61
3-Month Canadian LIBOR	1.20	1.21	0.50
3-Month Yen LIBOR	0.19	0.20	0.32
2-Year German	1.04	0.92	1.21
2-Year U.K.	1.05	0.66	1.29
2-Year Canadian	1.60	1.41	1.40
2-Year Japanese	0.15	0.14	0.26
10-Year German	2.52	2.42	3.36
10-Year U.K.	3.20	2.98	3.78
10-Year Canadian	3.03	2.81	3.51
10-Year Japanese	1.00	0.94	1.38

Commodity Prices

	Friday 11/12/2010	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	85.23	86.85	76.94
Gold ($/Ounce)	1366.40	1393.65	1103.80
Hot-Rolled Steel ($/S.Ton)	505.00	505.00	485.00
Copper (¢/Pound)	392.65	394.40	294.35
Soybeans ($/Bushel)	13.07	12.03	9.42
Natural Gas ($/MMBTU)	3.84	3.94	4.37
Nickel ($/Metric Ton)	23,930	24,434	16,786
CRB Spot Inds.	568.38	552.70	452.55

Next Week's Economic Calendar

	Monday 15	Tuesday 16	Wednesday 17	Thursday 18	Friday 19
U.S. Data	**Retail Sales** September 0.6% October 0.6% (W) **Retail Sales Less Autos** September 0.4% October 0.2% (W) **Business Inventories** August 0.6% September 0.7% (W)	**PPI** September 0.4% October 0.7% (W) **Industrial Production** September -0.2% October 0.4% (W) **Capacity Utilization** September 74.7% October 75.0% (W)	**CPI** September 0.1% October 0.3% (W) **Core CPI** September 0.0% October 0.1% (W) **Housing Starts** September 610K October 586K (W)	**LEI** September 0.3% October 0.7% (W)	
Global Data	**Japan** **GDP (QoQ)** Previous (2Q) 1.5%	**UK** **CPI (YoY)** Previous (Sep) 3.1% **Euro-zone** **CPI (YoY)** Previous (Sep) 1.8%	**UK** **Unemployment Rate** Previous (Aug) 7.7%		**Germany** **Producer Prices (YoY)** Previous (Sep) 3.9%

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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