November 19, 2010

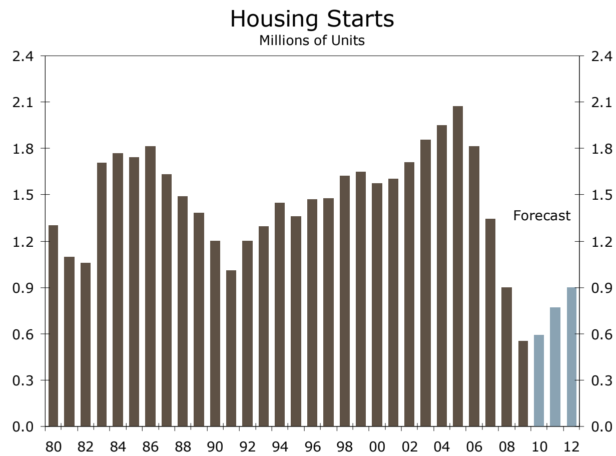
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

A Little News to Be Thankful For

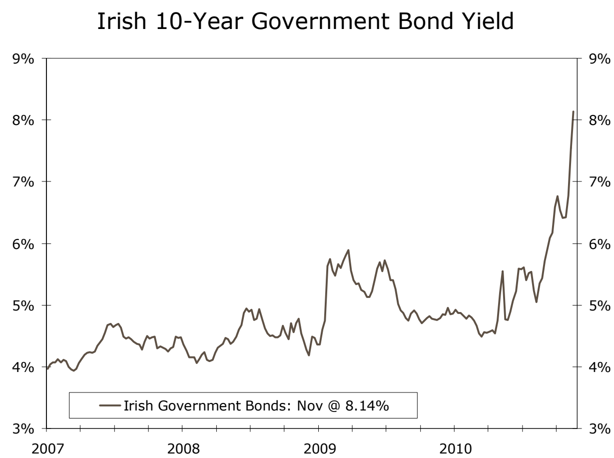
- Retail sales posted a huge 1.2 percent increase in October, fueled in large part by a suspicious 5.0 percent jump in motor vehicle sales.
- Inflation data remain mixed, with rising energy and industrial commodity prices pushing the headline numbers higher but weak domestic demand containing most measures of core inflation.
- Housing remains stuck in slow-growth mode, with starts plunging 11.7 percent in October and weekly mortgage applications for home purchases declining 5.0 percent.



Global Review

It's Ireland's Turn in the Crosshairs

- The Irish government bond market has imploded due to concerns that private sector creditors may need to take haircuts if Ireland (or any other European country) needs to restructure its debt.
- The fundamentals of the fiscal position of the Irish government are much stronger than Greece's at present. That said, the Irish banking system, which is being backstopped by the government, is essentially insolvent. It is likely that a rescue package for Ireland will soon be announced, but the Irish economy probably faces a few years of subpar growth.



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	2.0	2.5	2.3	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	1.1	1.1	1.8	1.9	1.9	2.3	3.8	-0.3	1.6	1.7	2.2
Industrial Production [1]	7.1	7.1	5.2	0.3	0.4	1.3	3.5	4.5	81.3	-3.3	-9.3	5.4	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	0.58	0.56	0.65	0.72	0.83	0.88	16.09	0.90	0.55	0.59	0.77	0.90
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	4.10	4.20	4.30	4.48	6.04	5.04	4.57	4.18	4.55
10 Year Note	3.84	2.97	2.53	2.60	2.50	2.60	2.70	2.80	4.84	3.66	3.26	2.99	2.65	3.05

Forecast as of: November 19, 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

Who's the Turkey?

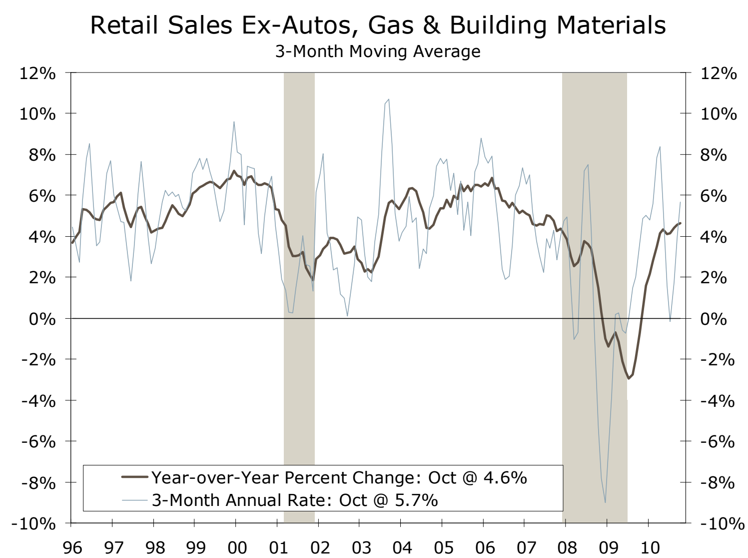
As Thanksgiving approaches we are faced with a dilemma as to who will be the turkey this year? Will it be Ben Bernanke, who has remained steadfast in his plans for implementing a second round of quantitative easing, even in the face of an unanticipated visceral negative reaction from policymakers overseas? Or will it be Sarah Palin and many other political and economic policy officials who have come out aggressively against the Fed's plans to expand its balance sheet by buying $600 billion more in Treasury bonds. The early returns showed surprising support for the Fed's critics, but recent numbers have swung the debate back in Bernanke's favor. "Core" inflation continues to decelerate, throwing cold water on near-term inflation concerns. Bernanke also delivered a well-thought-out and unwavering defense of the Fed's policy at the Sixth Annual European Central Bank Central Banking Conference in Frankfurt this morning.

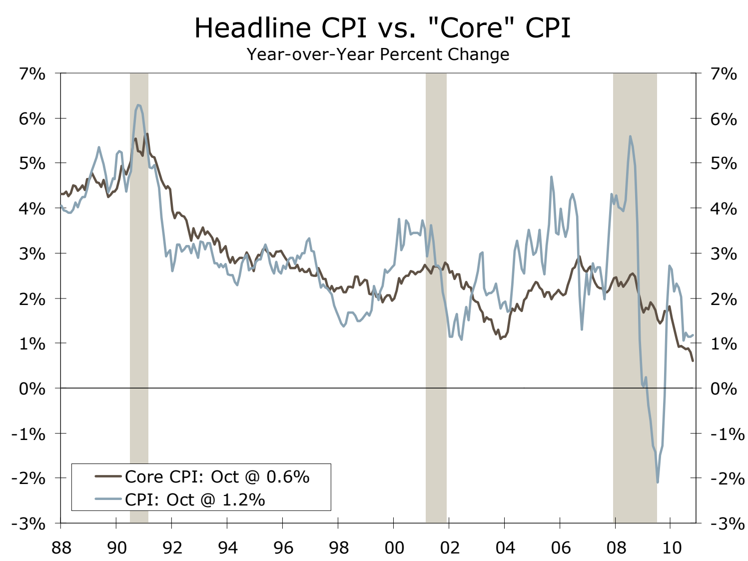
After spiking shortly after the Fed began buying Treasury securities, the yield on the Treasury's 10-year note appears to be settling just under three percent. If yields rise further in coming weeks, the markets will effectively be saying Bernanke is the turkey. If long-term interest rates fall back down toward their earlier lows, consistent with our forecast, the Fed's critics will be the turkey, at least for now.

This week's economic data tend to support the Fed's case that additional stimulus is needed. Real GDP appears to be growing at around a two percent pace, which is not strong enough to reduce the unemployment rate. "Core" inflation is running below the lower end of the Fed's comfort zone and is decelerating, with the year-to-year change at 0.6 percent, the lowest since the monthly series began in 1957. Higher commodities prices are affecting the headline number, but manufacturers and retailers are unable to pass those higher prices on to consumers. Moreover, fiscal policy remains unusually uncertain and is unlikely to promote economic growth in a major way in coming years and may actually turn into a slight drag on growth next year.

On the surface, this week's stronger retail sales data seem to suggest the Fed's move was not needed. Overall retail sales jumped 1.2 percent in October, with motor vehicle sales surging five percent. The rise in motor vehicle sales looks highly suspect. Sales actually declined slightly on a nonseasonally adjusted basis. We believe the sharp declines posted during the onset of the financial crisis and during the fall 2009, following the ending of the cash-for-clunkers program, have severely biased the seasonal factors. The net result should be a sharp drop in seasonally adjusted sales in November.

Excluding motor vehicles, retail sales rose 0.4 percent, which was in line with expectations. Core retail sales, which exclude autos, food, gasoline and building materials, rose just 0.2 percent. The retail sales data offer some encouragement going into the holiday season. We published our annual forecast for holiday sales this week and look for year-to-year gains of five percent.





Existing Home Sales • Tuesday

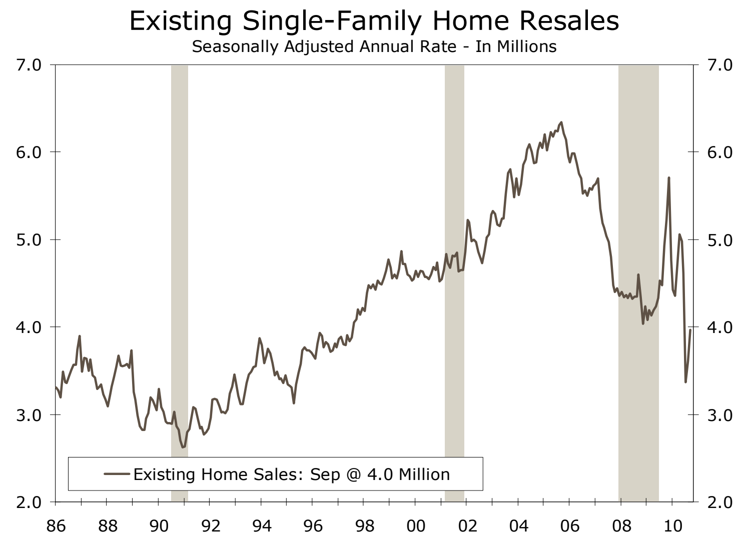
Existing home sales jumped 10 percent in August to a 4.53 million annual pace. While the increase was the largest on record in terms of percentage gain, the very slow pace of sales at present creates a very low base which makes large percentage swings an easy feat.

The existing home sales market is still adjusting to the post-tax economic fundamentals. Inventory levels remain quite high. The present level of inventories suggests there is enough supply of existing homes to match more than ten months of buying given the slower pace of sales. That is only slightly down from the highest levels seen during the recession.

The question we hear most on existing home sales has to do with when prices will come back in line. We would not expect to see sustainable price growth until the massive oversupply of inventory is depleted.

Previous: 4.53M **Wells Fargo: 4.2M**

Consensus: 4.48M



Durable Goods Orders • Wednesday

Durable goods orders for September came in stronger than expected, but the headline number was boosted by a jump in aircraft orders. Ex-aircraft, orders fell 0.2 percent signaling a slower pace of business spending.

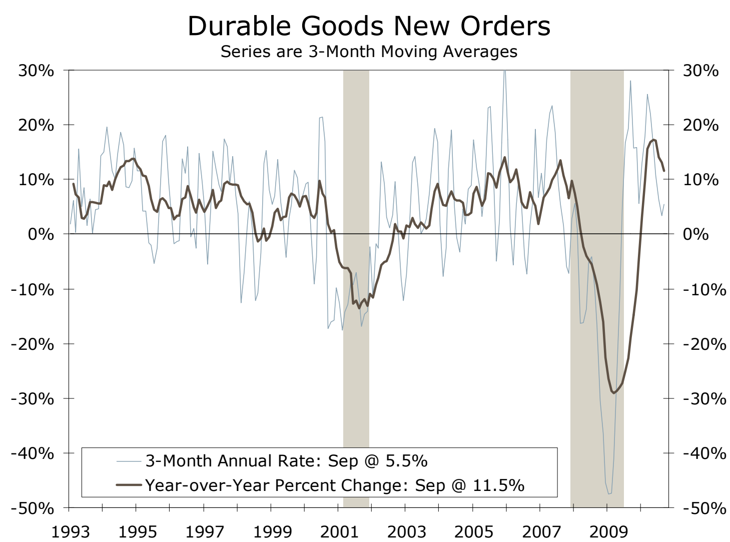
That said, the ISM manufacturing index for October jumped to 56.9—a number that would be consistent with strong factory sector growth. Additionally, the new orders component of the ISM report (which tends to lead durables and factory orders) surged to 58.9.

Regional PMI readings have been somewhat mixed with weakness in the Empire Index (NY) offset by strong numbers in the Philadelphia Fed Index.

After having led the way out of recession, the recovery in industrial growth still has some legs.

Previous: 3.5% **Wells Fargo: -0.5%**

Consensus: 0.1%



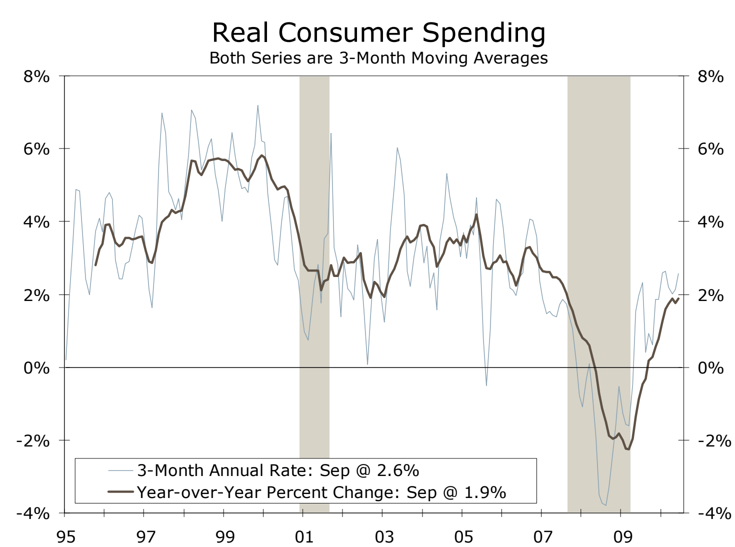
Personal Income and Spending • Wed.

Personal income in September slipped 0.1 percent in September, though the modest drop had to do with a reduction in benefits payments to the unemployed following a big catch-up payment the month prior. Outside transfer payments, income was flat in September, but is modestly positive compared to depressed levels last year.

Spending picked up 0.2 percent in September marking the 12th consecutive monthly pick-up in consumer outlays. We would expect to see modest payroll growth to continue in coming months. While spending will be positive as well, it may not keep pace with income gains as consumers will likely increase savings to repair balance sheets damaged during the recession.

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

Consensus: 0.5% (spending)



Global Review

It's Ireland's Turn in the Crosshairs

In "normal" times, very few investors care much about developments in Irish financial markets. However, the meltdown in the Irish bond market moved to center-stage over the past few weeks (see chart on front page). What is going on in Ireland?

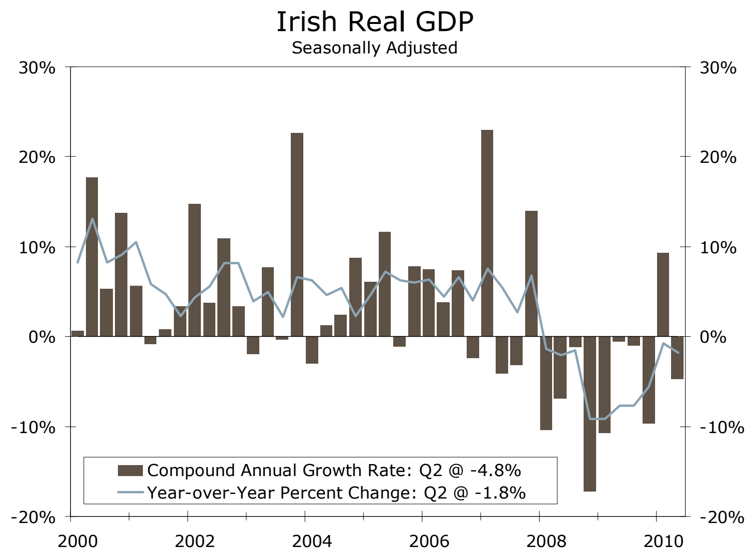
Ireland experienced a massive housing bubble between 1996 and 2006 as housing starts tripled and house prices rose fourfold. When the inevitable crash came, Ireland was rocked. Real GDP in the Emerald Isle has declined more than 13 percent since the end of 2007 (top chart). The shriveling of the tax base in conjunction with the government's support of the nation's troubled banking system caused the government deficit to widen dramatically. Although Greece was at the center of the sovereign debt crisis earlier this spring, Irish bond yields also rose due to concerns about the deteriorating fiscal condition of the government.

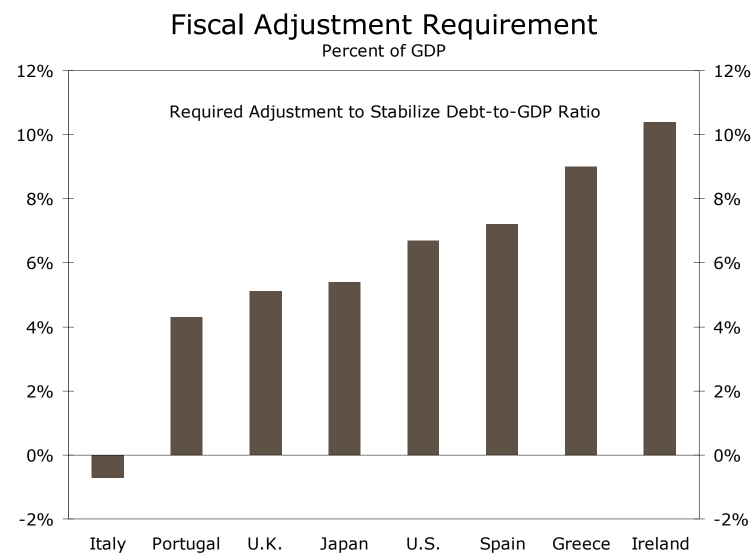
In early May the European Union and the IMF ponied-up a war chest of €750 billion that could be used in the event that an EU government would not be able to raise funds in private credit markets. The European sovereign debt crisis subsequently moved offstage. However, yields on Irish government bonds never fully retreated. If Irish taxpayers were on the hook for the nation's banking sector, then the deteriorating fundamentals among the banks led investors to reason that the government's liabilities would be even larger than originally expected.

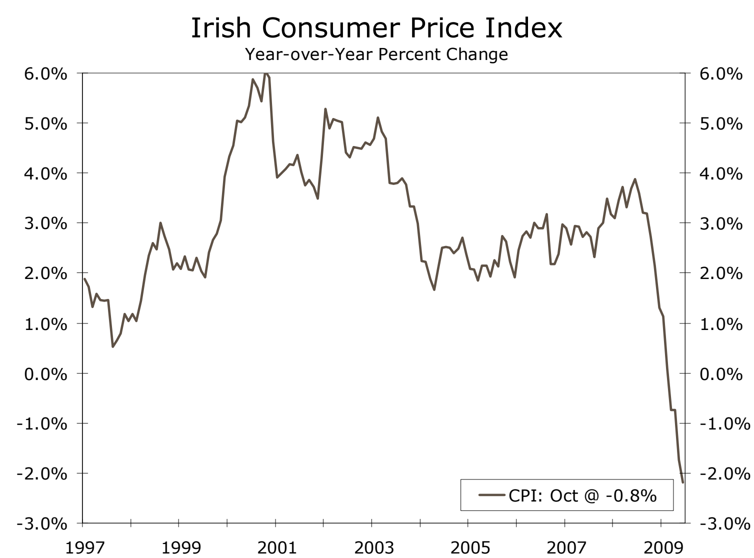
The sovereign debt crisis started to move back to center stage again about a month ago with Ireland cast as the protagonist. The catalyst for the renewed attention on sovereign debt was Germany's insistence that private sector creditors need to be involved in any sovereign debt restructuring. Bond investors had originally understood that they would be made whole by the €750 billion rescue package in the event of a restructuring. However, if the rules of the game were changing to involve private sector haircuts, then investors decided they wanted nothing to do with Irish government bonds.

Unlike Greece, which was on the verge of illiquidity this spring, the Irish government has enough cash on hand to fund operations through mid-2011. Moreover, the debt-to-GDP ratio of the Irish government, which currently is around 80 percent, is more sustainable than the 130 percent ratio in Greece. Although Ireland's fiscal deficit mushroomed to more than 30 percent of GDP this year, it should drop back to "only" nine percent in 2011 as the one-off support for the banking sector rolls off. In some sense, the Irish government does not need to be "bailed out."

However, outside support can be used to recapitalize the nation's insolvent banking sector. Moreover, EU leaders have an interest in putting out the Irish fire due to the collateral damage it has inflicted in the Greek, Portuguese, and Spanish bond markets. We expect some sort of rescue package will eventually be reached for Ireland (as of this writing nothing official has been announced). Nevertheless, it will be years before Irish GDP regains its precrisis peak due, at least in part, to the massive fiscal consolidation that the country needs to undergo over the next few years.







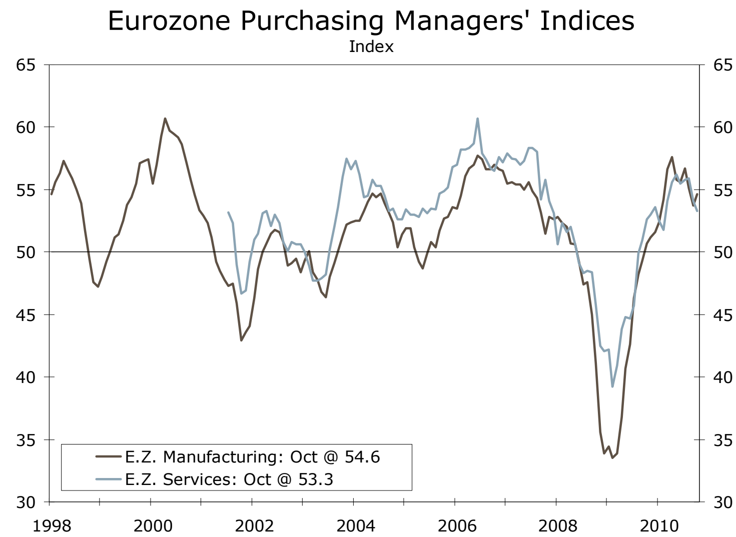
Eurozone PMI's • Tuesday

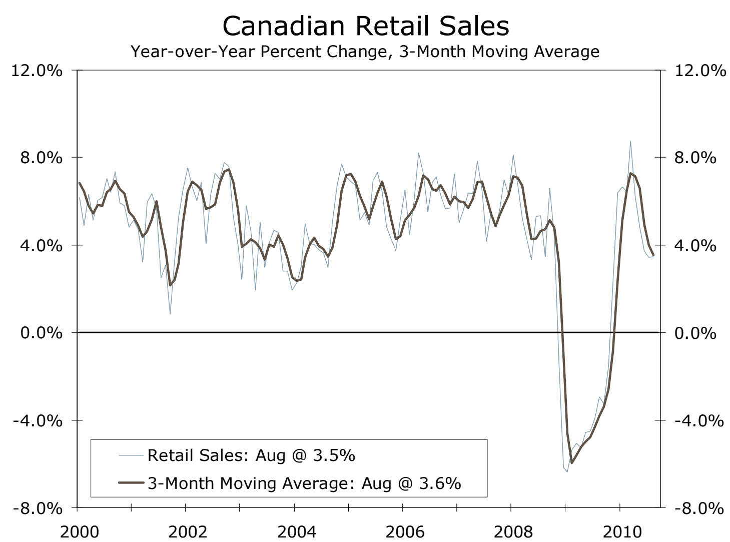
The decline in the Eurozone purchasing managers' indices between the second and third quarters correctly signaled the deceleration in economic activity that occurred in the euro area. That said, both indices remain above the demarcation line that separates expansion from contraction. Investors will be interested in the change, if any, that occurred in the indices in November.

Germany, which was widely referred to as "the sickman of Europe" for much of the past decade, has enjoyed some of the strongest growth rates among Eurozone countries in the current recovery. The Ifo index of German business sentiment, which is highly correlated with growth in German industrial production, rose to a three-year high in October. Continued strength in the Ifo index—data for November will print on Wednesday—would suggest that the German expansion remained solid in the fourth quarter.

Current Manufacturing PMI: 54.6 Consensus: 54.4

Current Services PMI: 53.3 Consensus: 53.2





Canadian Retail Sales • Tuesday

Growth in Canadian consumer spending has been solid this year. Indeed, the year-over-year growth rate in overall retail sales was 3.5 percent in September. Another increase in retail sales in October would suggest that the recovery in Canada, which has been in place for the past year, probably remained intact in the fourth quarter.

Data on CPI inflation in October will also print on Tuesday. The overall CPI inflation rate is currently 1.9 percent, well within the Bank of Canada's target range of one percent to three percent, and the core rate of inflation is only 1.5 percent. Unless CPI inflation were to take off suddenly, which we do not expect, the Bank, which has hiked rates by 75 bps since early June, likely will remain on hold for the next few months.

Previous: 0.5%

Consensus: 0.8% (month-over-month change)

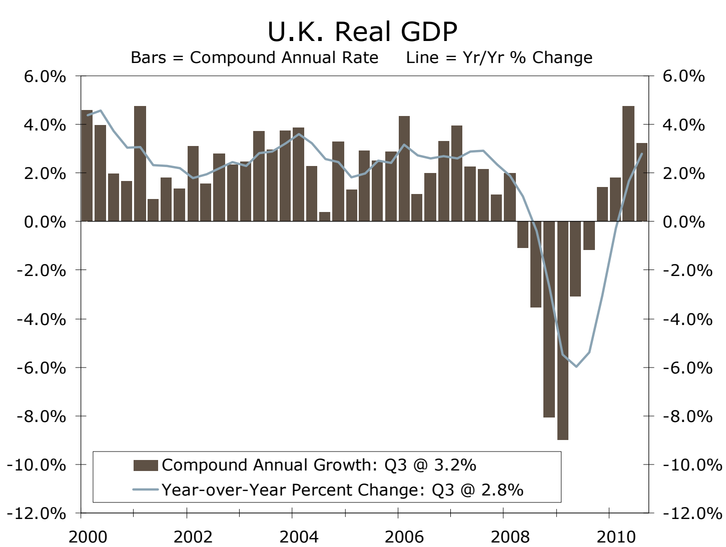
U.K. GDP • Wednesday

Preliminary data released a few weeks ago showed that British real GDP in the third quarter rose 0.8 percent (3.2 percent annualized) relative to the previous quarter. Revised data, which are slated for release on Wednesday, will provide the first breakdown of GDP into its underlying demand-side components. After a sizable inventory swing in the second quarter—stock building contributed 1.5 percentage points to the 4.7 percent growth rate that was achieved in the quarter—investors will be interested to see how much inventories added to growth in the third quarter.

Retail spending in the United Kingdom has held up reasonably well this year. Data released this week showed that the volume of retail sales (excluding petrol) rose 0.3 percent in October relative to the previous month. Survey data that are slated for release on Thursday will offer insights into the state of retail spending in November.

Previous: 0.8%

Consensus: 0.8% (sequential rate, not annualized)



Interest Rate Watch

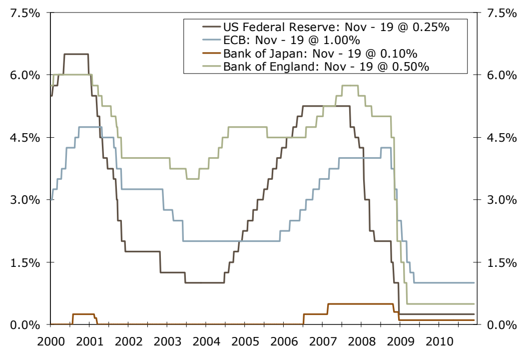
Will Anybody Follow the Fed?

The Fed obviously made headlines two weeks ago when it embarked on its second round of quantitative easing (QE). Other than the Bank of Japan, which announced its own asset-buying program in early October, are any major central banks about the follow the Fed's lead with more QE?

The most likely candidate would seem to be the Bank of England (BoE), because it has a large QE program already in place and it tends to be "activist" in terms of policy changes. However, developments this week reduce the probability that the BoE would engage in another round of QE in the near term. Most importantly, the CPI inflation rate for October came in at 3.2 percent. Not only was the outturn higher than most analysts had expected, but it is also significantly above the BoE's mandated target of two percent. The minutes of the BoE's policy meeting earlier this month showed that only one out of nine members of the Monetary Policy Committee (MPC) voted to increase the size of the QE program. Most MPC members indicated that they would prefer to await further developments before embarking on another round of QE. At a minimum, it would seem that CPI inflation needs to be moving back toward its target before a majority of MPC members would contemplate further QE.

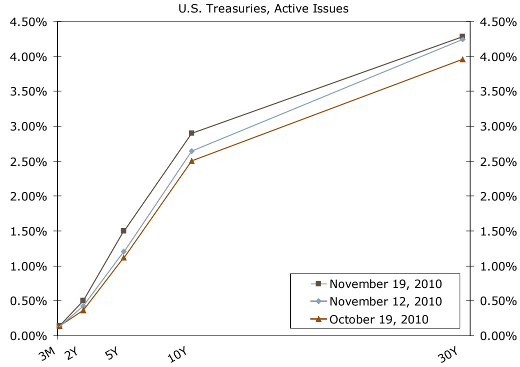
The European Central Bank (ECB) authorized a small QE program in May 2009 but, in our view, the likelihood of a follow-up round is very small. For starters, the ECB is focused almost exclusively on inflation. With the overall CPI inflation rate at 1.9 percent and the core rate of inflation at 1.1 percent, the ECB does not seem to be concerned with deflation at this point. In addition, the ECB has been encouraged by signs that economic growth remains positive thus far in the fourth quarter. Moreover, it seems unlikely that the inflation-phobic ECB would entertain a major program of QE that could, at least in theory, lead to significantly higher inflation down the line. A return to recession seems to be necessary before the ECB would undertake further QE.

Central Bank Policy Rates



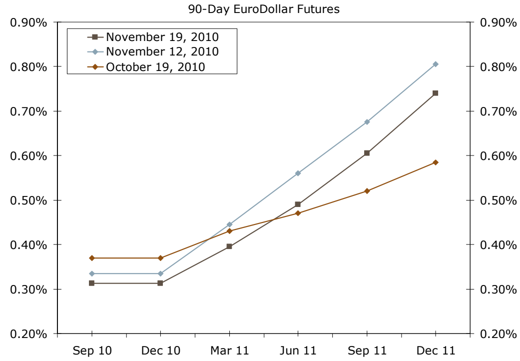
Yield Curve

U.S. Treasuries, Active Issues



Forward Rates

90-Day EuroDollar Futures



Credit Market Insights

Mortgage Rates Jump, Apps Plunge

Mortgage applications plunged 14.4 percent in the latest week, the biggest decline since the week of December 25, 2009. The drop was driven primarily by a 16.5 percent plunge in refinancing applications, while purchase applications fell 5.0 percent. The decline in applications came as the average 30-year fixed mortgage rate in the survey jumped to 4.46 percent from 4.28 percent the week before, following the upward trend seen in the 10-year Treasury yield during the same period. Long-term yields have been marching higher recently as investors have become more worried about inflation due to the dollar's decline amid further Fed easing. The Fed has stated that QE2 was designed to lower long-term rates while stoking a bit of inflation to escape the grips of possible deflation. But this is like trying to run forward and backward at the same time; you can't have it both ways. Therefore, regardless of how many billions of Treasuries the Fed buys, if it leads to a weaker dollar and accelerating inflation, we are going to have higher interest rates and probably higher mortgage rates.

Meanwhile, small banks, which comprise the vast majority of all banks in the U.S., continued to tighten standards on prime mortgage loans in the third quarter. If the Fed is not successful in lowering mortgage rates, and rates actually rise while credit conditions remain tight, the housing market will be in for quite an unwelcome shock.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.39%	4.17%	4.21%	4.83%
15-Yr Fixed	3.76%	3.57%	3.64%	4.32%
5/1 ARM	3.40%	3.25%	3.45%	4.25%
1-Yr ARM	3.26%	3.26%	3.45%	4.35%
MBA Applications				
Composite	713.6	833.3	803.4	629.1
Purchase	179.2	188.7	169.7	203.6
Refinance	3,831.0	4,587.7	4,491.1	3,115.1

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

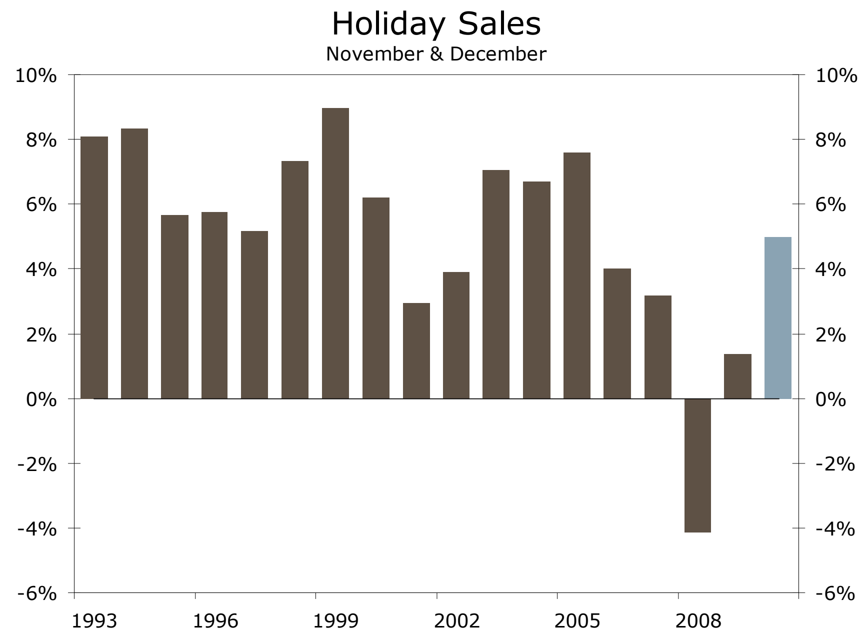
Topic of the Week

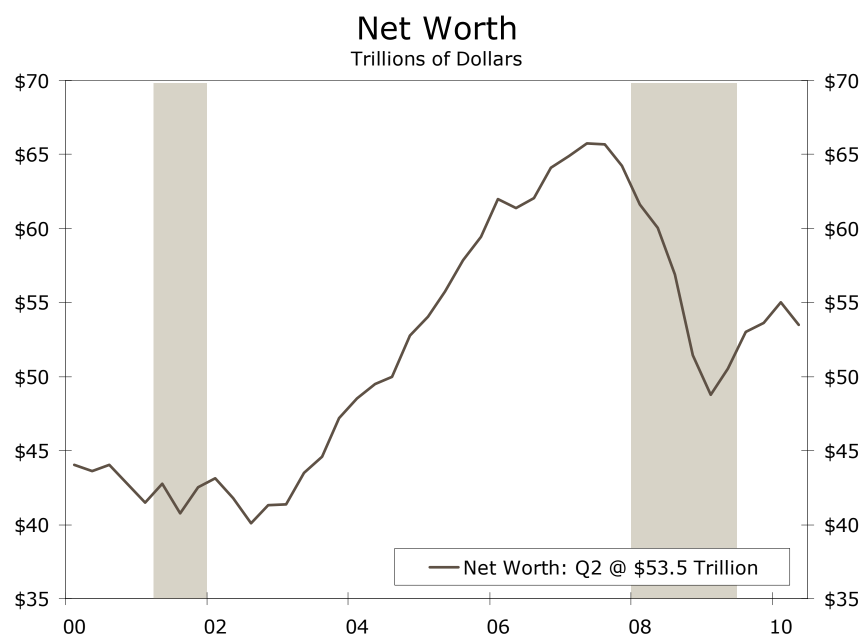
Retailers Can Expect a Happy Holiday

Roughly a year and a half into the recovery, economic growth has yet to gain the sort of substantial momentum that makes a recovery self-sustaining. With the unemployment rate at 9.6 percent and ongoing struggles in the housing market, you might do a double-take when you see that we are forecasting a 5.0 percent year-over-year increase in holiday sales. If realized, it would be the biggest annual increase in holiday sales since 2005.

With nearly one in ten Americans out of work and an even larger proportion not working as much as they would like, there is still a large number of people cutting back or potentially eliminating holiday spending altogether this year. However, since the previous holiday season, the unemployment rate has come down about half a percentage point and more than 1.1 million new private sector jobs have been created. Personal income growth has also been on the upswing for much of the past year. The labor market is far from strong, but the employment picture is better than it was last year.

A common proxy for income growth multiplies average hourly earnings and total hours worked, and that measure shows a 2.3 percent pickup over last year. Similarly, the wages and salaries component of the personal income, which has tended to be more tightly correlated with consumer spending, shows solid gains over the past year. These gains may be modest by historical standards, but workers who have remained on the job for the past year have more income and are generally more upbeat than they were one year ago. In past two years, spending was held back by a significant drop-off in net worth. It will take years to return to the lofty levels reached in 2007, as we do not expect home values to recover quickly. However, the recent run-up in equity markets has helped fuel a recovery in net worth, which has recouped roughly $5 trillion since bottoming in the first quarter of 2009. That is not to suggest that the wealth effect is strongly positive, but it may mean that consumers will be less reticent to spend this holiday season.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 11/19/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.13	0.12	0.01
3-Month LIBOR	0.28	0.28	0.27
1-Year Treasury	0.20	0.18	0.25
2-Year Treasury	0.50	0.50	0.70
5-Year Treasury	1.52	1.36	2.15
10-Year Treasury	2.90	2.79	3.34
30-Year Treasury	4.26	4.28	4.28
Bond Buyer Index	4.72	4.24	4.35

Foreign Exchange Rates

	Friday 11/19/2010	1 Week Ago	1 Year Ago
Euro ($/€)	1.367	1.369	1.493
British Pound ($/£)	1.598	1.611	1.667
British Pound (£/€)	0.856	0.850	0.895
Japanese Yen (¥/$)	83.440	82.530	88.970
Canadian Dollar (C$/$)	1.022	1.012	1.064
Swiss Franc (CHF/$)	0.996	0.981	1.013
Australian Dollar (US$/A$)	0.983	0.985	0.919
Mexican Peso (MXN/$)	12.300	12.343	13.058
Chinese Yuan (CNY/$)	6.639	6.638	6.828
Indian Rupee (INR/$)	45.290	44.830	46.694
Brazilian Real (BRL/$)	1.717	1.722	1.727
U.S. Dollar Index	78.574	78.082	75.293

Foreign Interest Rates

	Friday 11/19/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.98	0.99	0.68
3-Month Sterling LIBOR	0.74	0.74	0.61
3-Month Canadian LIBOR	1.20	1.20	0.50
3-Month Yen LIBOR	0.20	0.19	0.31
2-Year German	1.11	1.02	1.30
2-Year U.K.	1.11	1.06	1.26
2-Year Canadian	1.64	1.58	1.27
2-Year Japanese	0.17	0.15	0.24
10-Year German	2.71	2.51	3.27
10-Year U.K.	3.41	3.20	3.66
10-Year Canadian	3.13	3.02	3.39
10-Year Japanese	1.07	1.00	1.31

Commodity Prices

	Friday 11/19/2010	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	81.37	84.88	77.46
Gold ($/Ounce)	1345.78	1368.75	1144.60
Hot-Rolled Steel ($/S.Ton)	530.00	540.00	520.00
Copper (¢/Pound)	380.35	388.85	307.80
Soybeans ($/Bushel)	12.25	12.87	10.00
Natural Gas ($/MMBTU)	4.07	3.80	4.34
Nickel ($/Metric Ton)	21,788	23,930	17,091
CRB Spot Inds.	551.35	562.77	458.38

Next Week's Economic Calendar

	Monday 22	Tuesday 23	Wednesday 24	Thursday 25	Friday 26
U.S. Data		**GDP** 3Q (1st) 2.0% 3Q (2nd) 2.2% (W) **Existing Home Sales** September 4.53M October 4.20M (W)	**Personal Income** September -0.1% October 0.4% (W) **Durable Goods Orders** September 3.5% October -0.5% (W) **New Homes Sales** September 307K October 320K (W)	**Market Closed**	**No Weekly Document**
Global Data		**Canada** **Retail Sales (MoM)** Previous (Aug) 0.5% **Euro-zone** **PMI Manufacturing** Previous (Oct) 54.6	**UK** **GDP (QoQ)** Previous (2Q) 0.8% **Germany** **IFO- Business Climate** Previous (Oct) 107.6		**Japan** **CPI (YoY)** Previous (Sep) -0.6%

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

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