December 21, 2012

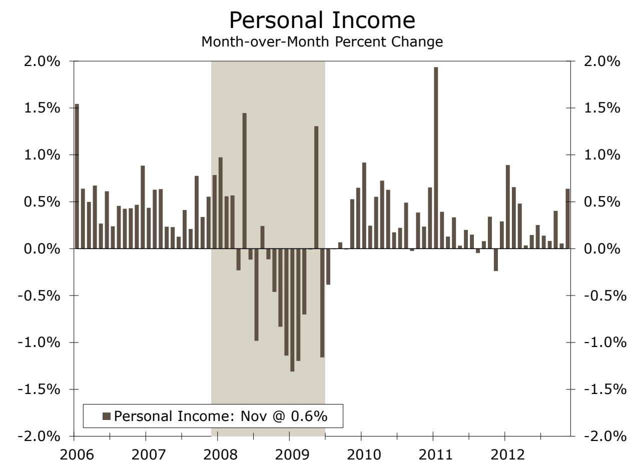
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Economic Growth Prospects Remain Suspect

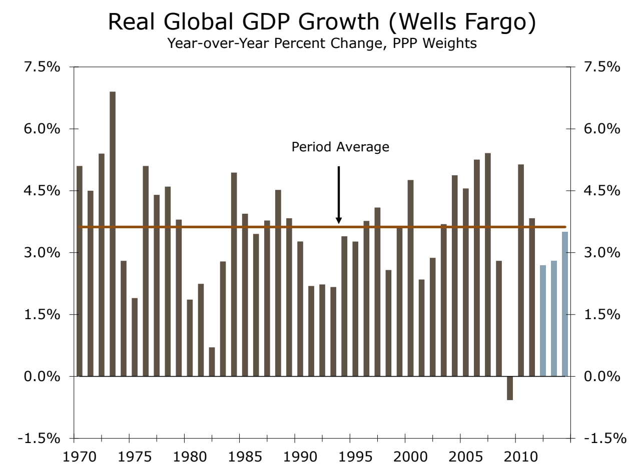
- Due to the holiday schedule, we will not publish a Weekly Economic & Financial Commentary next week.
- GDP growth for the third quarter was revised upward to 3.1 percent from the second estimate of 2.7 percent, with personal consumption, fixed investment, trade, and government consumption contributing to the upward revision.
- Personal income jumped 0.6 percent in November as personal spending increased 0.4 percent for the month.



Global Review

The World Is Not Ending

- The latest news about the European debt crisis has been a bit more encouraging than earlier in the year.
- S&P increased the ratings on Greece's debt from Selective Default to B-; however, the ratings agency noted that the change was due to the "strong determination" from the other Eurozone countries to keep the Eurozone intact rather than from an improvement in Greece's economy.
- Although the Chinese economy has slowed during the last several quarters, the market's expectations for a hard landing have been overstated.



Wells Fargo U.S. Economic Forecast

	Actual 2012 1Q	2Q	3Q	4Q	Forecast 2013 1Q	2Q	3Q	4Q	Actual 2010	2011	Forecast 2012	2013	2014
Real Gross Domestic Product [1]	2.0	1.3	3.1	0.7	0.7	1.8	1.9	2.3	2.4	1.8	2.2	1.5	2.4
Personal Consumption	2.4	1.5	1.6	1.6	1.1	1.3	1.3	1.5	1.8	2.5	1.8	1.4	1.6
Inflation Indicators [2]													
PCE Deflator	2.4	1.6	1.5	1.7	1.4	1.6	1.6	1.5	1.9	2.4	1.8	1.6	1.9
Consumer Price Index	2.8	1.9	1.7	1.9	1.7	2.0	2.0	1.9	1.6	3.1	2.1	1.9	2.1
Industrial Production [1]	5.9	2.4	0.3	-0.5	2.1	3.5	4.1	4.1	5.4	4.1	3.6	2.0	3.8
Corporate Profits Before Taxes [2]	10.3	6.7	7.5	5.0	4.8	5.2	5.4	5.8	26.8	7.3	7.3	5.3	6.5
Trade Weighted Dollar Index [3]	72.7	74.5	72.7	73.0	74.0	75.0	76.0	77.0	75.4	70.9	73.2	75.5	74.5
Unemployment Rate	8.3	8.2	8.1	7.8	7.7	7.8	7.8	7.8	9.6	9.0	8.1	7.8	7.6
Housing Starts [4]	0.71	0.74	0.77	0.87	0.90	0.96	1.02	1.08	0.59	0.61	0.78	0.99	1.17
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	0.25	0.25	0.25	0.25	0.25
Conventional Mortgage Rate	3.95	3.68	3.50	3.40	3.40	3.40	3.45	3.50	4.69	4.46	3.63	3.44	3.80
10 Year Note	2.23	1.67	1.65	1.75	1.70	1.75	1.85	1.90	3.22	2.78	1.83	1.80	2.28

Forecast as of: December 21, 2012
[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

Source: U.S. Department of Commerce, U.S. Department of Labor, Federal Reserve Board, IHS Global Insight, IMF and Wells Fargo Securities, LLC

Inside

U.S. Review

Ending the Year on a Softer Note

As the year winds down, data this week pointed toward soft economic growth in the fourth quarter of this year than in the previous quarter. Third quarter GDP growth was revised higher, likely setting us up for a much weaker fourth quarter. This view was reinforced with the release of the leading indicators this week, which signaled slower growth in the months ahead. In addition, durable goods orders showed that capital spending has yet to recover from its earlier year highs. Consumer spending remains modest, although income growth looked better in November. Indicators on the housing market reinforced our view that housing remains a bright spot. We continue to expect fourth quarter economic growth to come in slightly below 1 percent, with weakness continuing through the first quarter of 2013.

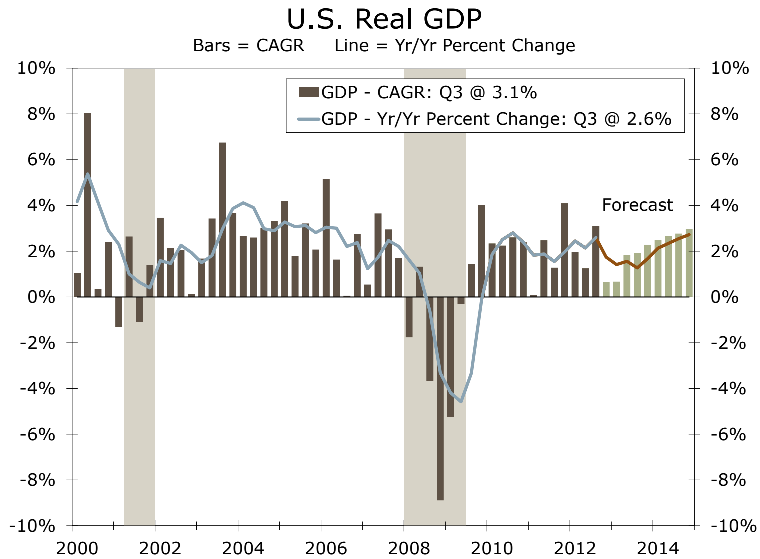
Third quarter GDP growth was revised higher to 3.1 percent from 2.7 percent. The upward revision was due to stronger contributions to growth from several areas including personal consumption, fixed investment, net exports and government consumption. However, the underlying strength of the economy as measured by final sales to private domestic purchasers was revised lower to 1.2 percent, which suggests that domestic growth fundamentals are downshifting in the second half of the year. In addition, the November leading economic indicators this week fell 0.2 percent, which also indicated slower growth in the months ahead.

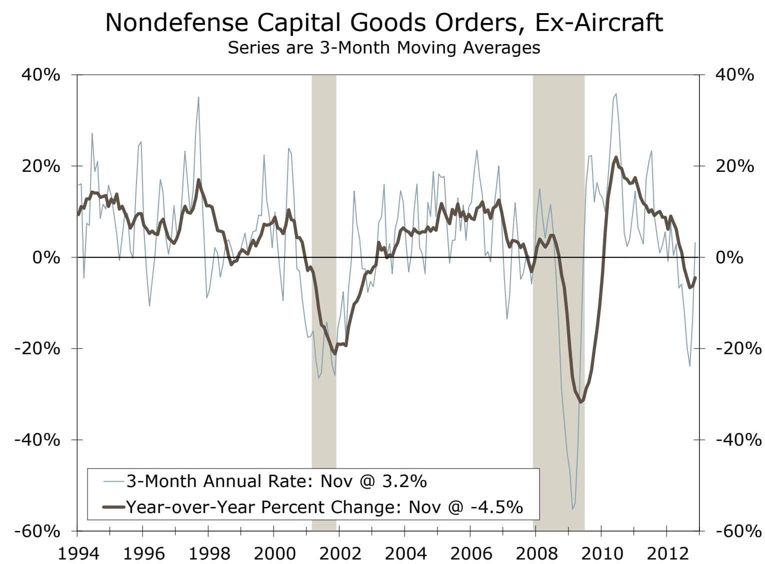
Durable goods orders rose a stronger-than-expected 0.7 percent in November. Compared to recent gains of this magnitude that were driven by the defense sector and civilian aircraft orders, November's strength was generally broad based. Nondefense capital goods orders ex-aircraft increased 2.7 percent, pushing the three-month average annualized rate positive for the first time in six months. That said, this key gauge of business spending remains below its high of the year, suggesting businesses are not quite ready to call the "all clear" on their near-term outlooks.

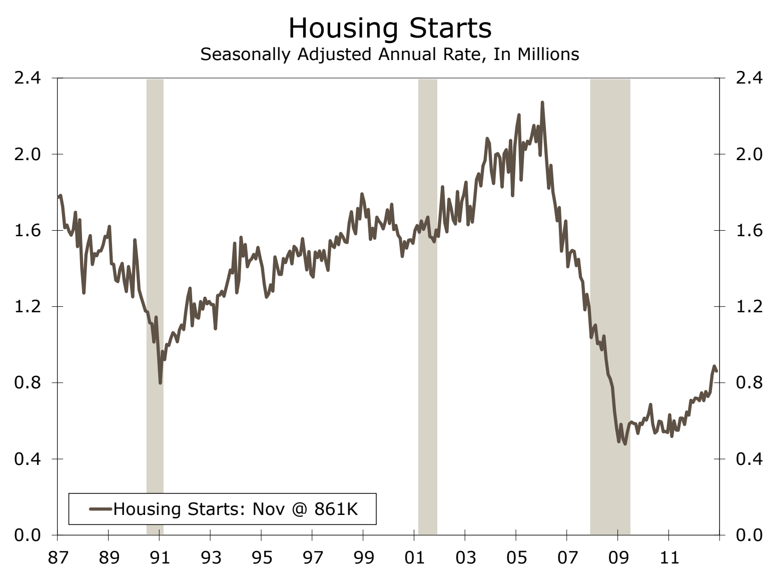
Personal income and spending data showed a decent rise in personal income and a modest pace of personal spending in November. Real disposable income rebounded in November, increasing 0.8 percent. Better income gains and moderate spending resulted in the savings rate rising to 3.6 percent.

Housing market data continued to reflect an ongoing housing market recovery. New housing starts slipped 3.0 percent in November to an 861,000 unit pace, but starts remained up 21.6 percent from last year's levels. New building permits rose a sharp 3.6 percent, suggesting more home building is in the pipeline.

News on existing home sales for November also reflected an improving housing market, with sales increasing a solid 5.9 percent to a 5.04 million unit pace, the highest since November of 2009. In addition to the strong sales numbers, inventories of existing homes continued to fall, while median prices rose 2.1 percent for the month. The housing market continues to outperform expectations, and we expect residential investment to add to growth over the next few quarters.







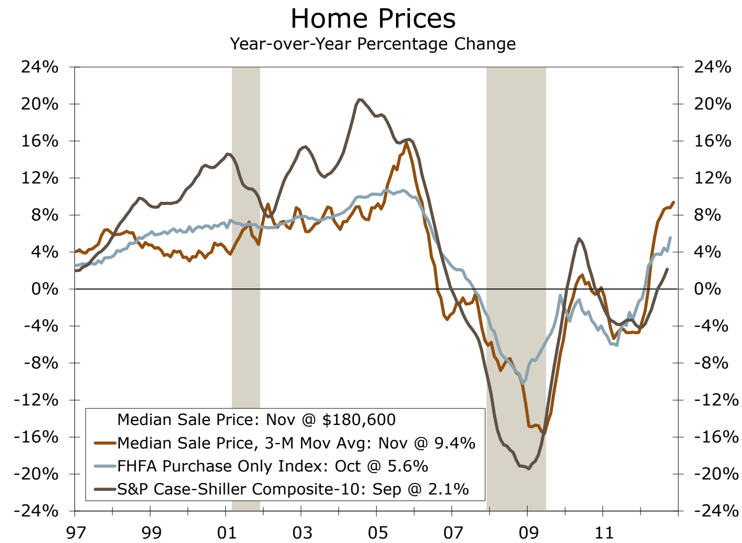
Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

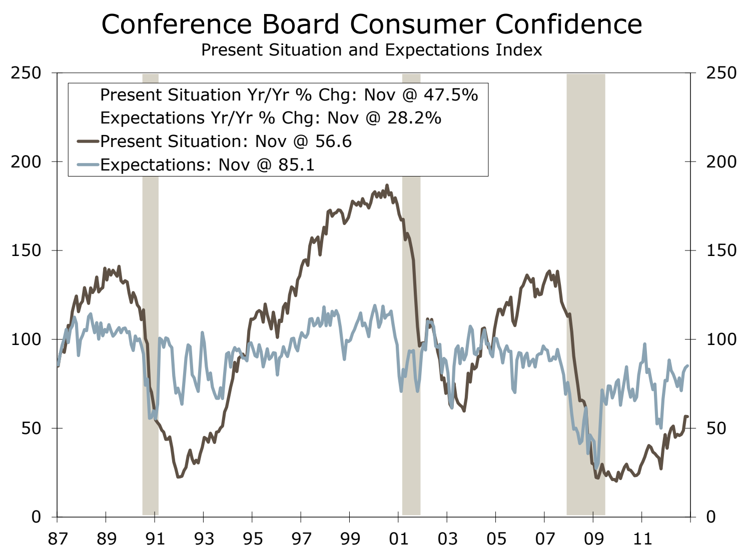
S&P/Case-Shiller Index • Wednesday

Home prices as measured by all of the major indices have improved consistently over the past year. We suspect that a "genuine" recovery in the housing sector has begun, and residential investment will likely continue to contribute to real GDP over the next few years. However, as we enter the seasonally slow months, volatility in prices is somewhat unavoidable, as sales retreat and foreclosures make up a larger portion of total sales. That said, the share of foreclosures has come down considerably, making up only 12 percent of total transactions. While home prices have clearly bottomed, the extent of the appreciation may be somewhat exaggerated. Constrained inventory and seasonal factors may be at play, but prices should increase modestly for the next few years. The S&P/Case-Shiller 20-City Composite Index shows Atlanta, Phoenix and San Diego posting double-digit gains over the past three months.

Previous: 3.0% (Year over Year)

Consensus: 4.0%





Consumer Confidence • Thursday

Following stronger labor market trends, the Conference Board's index of consumer confidence edged higher over the past three months, reaching its highest level since February 2008 in November at 73.7. Consumers appear to be more optimistic about future economic conditions, as employment growth has trended higher. Survey respondents asserting jobs are "plentiful" increased to 11.2 percent from 10.4 percent, while those claiming jobs are "hard to get" remained unchanged at 38.8 percent. While the trend in confidence is improving, short-term monthly volatility could pull the index lower as fiscal cliff uncertainty becomes top of mind. Indeed, business sentiment has been in the doldrums for some time, with poor sales and taxes as their largest concerns. We suspect households could follow the moribund sentiment, but with private sector jobs continuing to show improvement, confidence will likely continue its momentum.

Previous: 73.7 **Wells Fargo: 70.7**

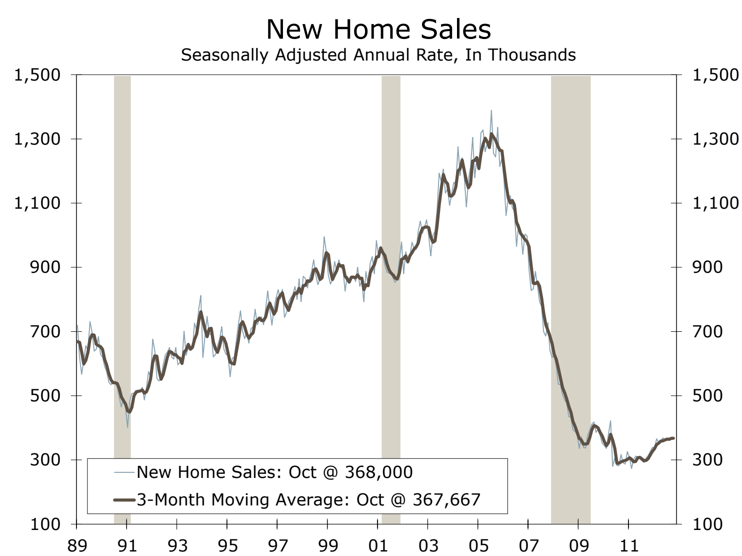
Consensus: 70.0

New Home Sales • Thursday

New home sales have held in a tight range over the past six months, averaging a 366,000 unit pace, but are expected to break above the current pace in November, reaching a 377,000 unit pace. We suspect that while some of the impact from Hurricane Sandy could appear in the November release, sales activity in the Northeast comprises only around 6 percent of overall sales, while the South and West account for about 80 percent. Indeed, homebuilders report that backlog and net orders are up in these regions on a year-ago basis. Sentiment is also rising among homebuilders and is quickly approaching the breakeven threshold at which more builders see housing conditions as "good" than "poor." Much of the optimism among homebuilders is due to improving demand and a lessening of competition from foreclosures. The premium paid for a new home versus an existing home, while still fairly wide, has narrowed a bit.

Previous: 368,000 **Wells Fargo: 377,000**

Consensus: 379,000



Source: S&P, FHFA, U.S. Department of Commerce, Conference Board and Wells Fargo Securities, LLC

Global Review

The World Is Not Ending

Even if the Y2K issue was highly overblown, firms at least had alternatives to try to minimize the potential effects of it. In fact, the preparations produced such a large pre-emptive increase in investment in the quarters before the year 2000 that many have blamed the 2001 recession in the United States to those preparations.

Today, firms have not been preparing for the end of the world, even if some say that the Mayan calendar predicted it. What the world has been preparing for has been for a collapse of the Eurozone. Although the region has been close to this occurrence over the last several years, the latest news from the Eurozone region is a bit more encouraging. In fact, the latest news from the Eurozone sovereign debt crisis is that S&P increased the ratings on Greece's debt from Selective Default to B- after the country said it was planning to buy back some of its debt.

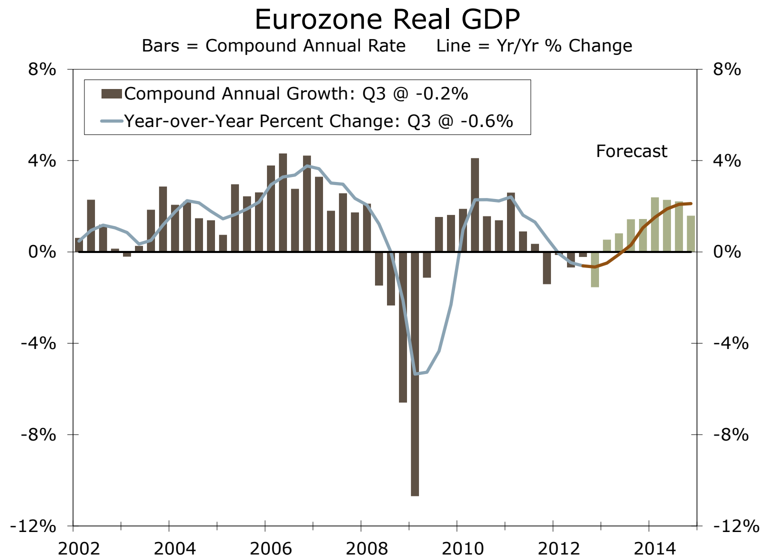
Of course, not all is rosy for the Eurozone and for Greece in particular. S&P also said that the change in rating was due to the "strong determination" from the other Eurozone countries to keep the Eurozone intact, rather than due to an improvement in Greece's economy. However, even if the news was not as positive as many seem to have implied, it is the best news coming out of the Eurozone for some time and should help the region in buying more time to produce an economic turnaround that will, potentially, benefit Greece's economy.

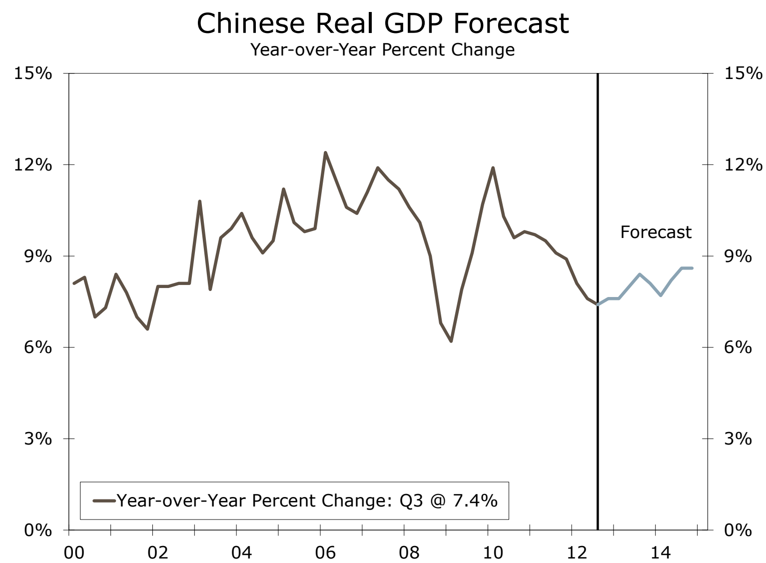
On a negative note, it seems that all the talk regarding the U.S. fiscal cliff, as well as the relative improvement in the Eurozone, has pushed the euro higher, which negatively affects any prospects for recovery for the Greek economy if it stays within the Eurozone.

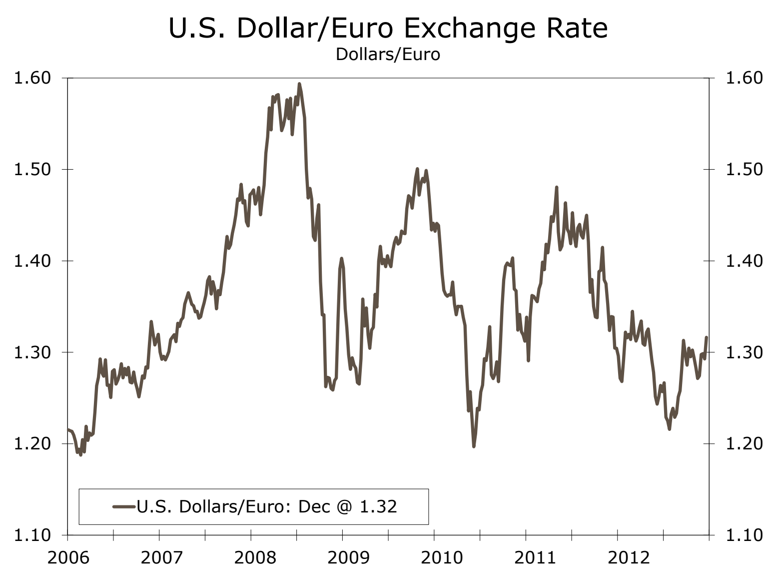
Meanwhile, it is clear that while the Chinese economy has slowed during the last several quarters, the market's expectation for a hard landing seems to have been overstated. Furthermore, recent commentaries by party officials tend to point to a more balanced growth path for the Chinese economy, which includes a more inward-oriented and/or domestic consumer-oriented path of economic development going forward. Although there may be challenges in implementing a new growth model, Chinese economic growth should be more sustainable if implemented properly. The improvement of the Chinese economy must also include an improvement in income redistribution within the country.

Thus, not only is the world not coming to an end today, but the prospects for the world economy seem to have become a bit more promising over the last several months. Of course, not all is clear going forward, as many risks are still latent and other issues could resurface. However, we believe that, as the most immediate uncertainties are removed from the horizon, the prospects for the world economy will continue to improve.

Although 2013 comes with risks attached, an improvement compared to the last several years is possible.







Source: IHS Global Insight, Bloomberg LP and Wells Fargo Securities, LLC

Japanese IP • Thursday, Dec. 27

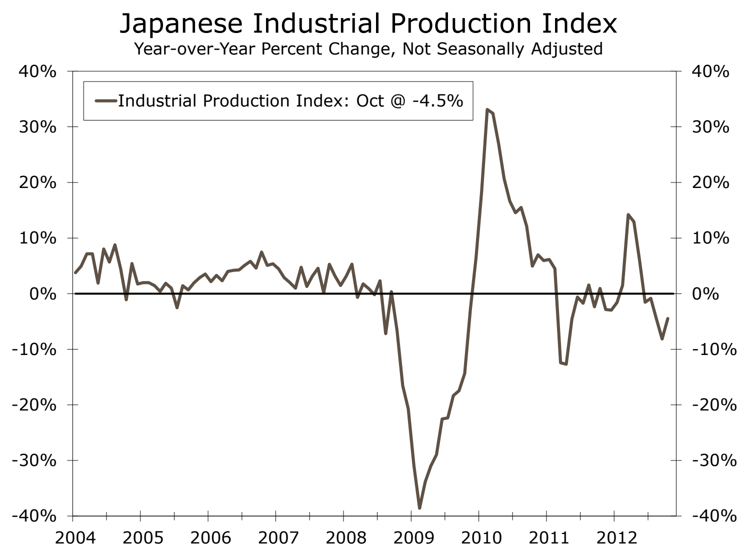
After falling all three months in the third quarter, industrial production in Japan bounced back a bit in October, increasing 1.6 percent on a month-over-month basis. Even with this bounce in October, output is 4.5 percent lower than it was at the same time a year earlier.

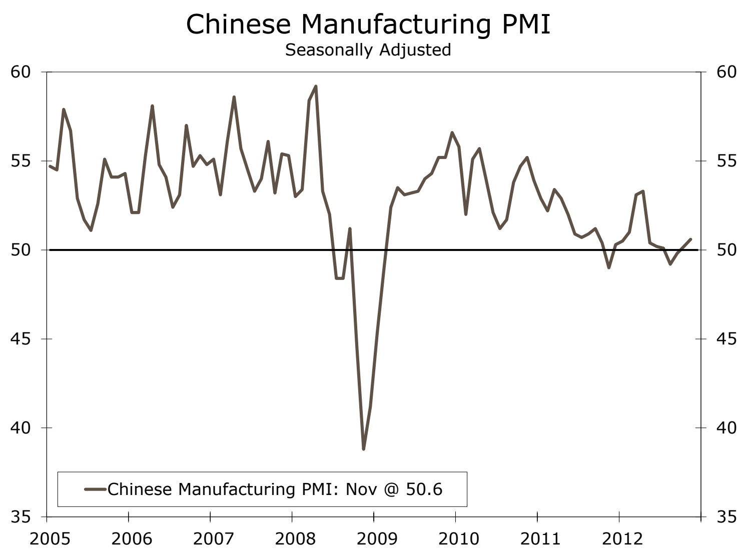
Business confidence does not seem supportive of a significant improvement. The Tankan survey of large manufacturers fell in the fourth quarter of 2012 to its lowest level since the global recession damped sentiment in the first quarter of 2010.

On Thursday, Dec. 27, industrial production figures will offer hard data on output for the month of November.

Previous: -4.5% (Year over Year)

Consensus: -4.6%





Chinese PMI • Monday, Dec. 31

In the third quarter, the annual growth rate for the Chinese economy as a whole slowed to just 7.4 percent, the slowest year-over-year growth rate since the first quarter of 2009.

Although the disappointing figures raised doubts about China's role as the engine of growth in the emerging market world, there are some signals that the outlook in China is brightening a bit.

Chinese industrial production figures returned to a double-digit growth rate in November, posting a year-over-year growth rate of 10.1 percent. It was the first time the annual pace of growth in production exceeded 10 percent since March.

Will this factory sector improvement continue? We will get a sense of that on Monday, Dec. 31, when a December PMI reading is due out.

Previous: 50.6

Consensus: 51.0

Canadian Payrolls • Friday, Jan. 4

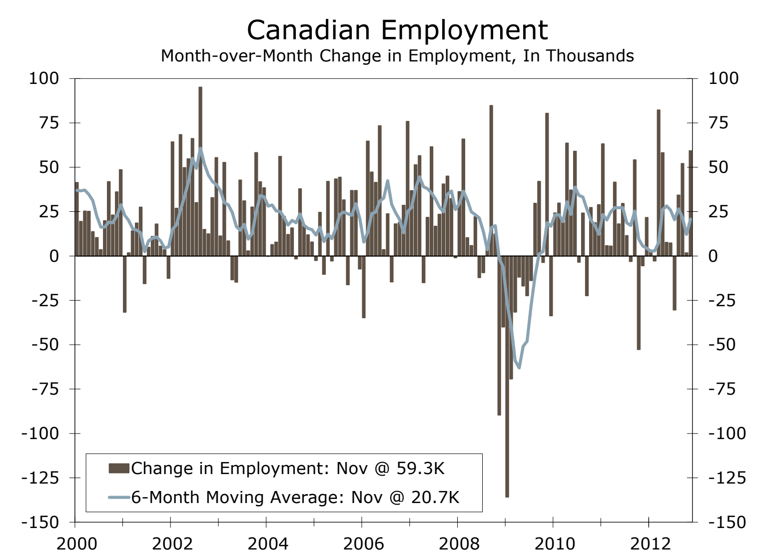
A much larger-than-expected jump in Canadian employment in November resulted in a 0.2 percentage point drop in the unemployment rate to 7.2 percent.

After a run of economic data that was generally disappointing in the preceding weeks, the jobs report was welcome news. Underlying details were positive as well. Of the 59,000 jobs that were created, more than 55,000 were full time jobs. A number of different sectors added to payrolls, though manufacturing shed nearly 20,000 jobs in the month.

Looking forward, it does not seem as though this pace will be sustainable. That said, we look for gradual improvement in the labor market and slightly below-trend growth in Canada in 2013.

Previous: 59,300

Consensus: 5,000



Source: IHS Global Insight, Bloomberg LP and Wells Fargo Securities, LLC

Interest Rate Watch

Political Volatility in a Small Range

Fiscal cliff discussions have been the primary driver of yield volatility in recent weeks but, quite frankly, there is little to play for, given the current outlook for the fundamentals of growth, inflation and monetary policy.

Growth in 2013 is expected to remain in the 2 percent range as it has been for the past three years and, therefore, the benchmark unemployment rate is expected to remain between 7 percent and 8 percent all year. As for inflation, our annual outlook is for the PCE deflator to remain below the 2 percent old inflation threshold and far below the new 2.5 percent tripwire for a Fed reevaluation of the current policy of monetary policy accommodation.

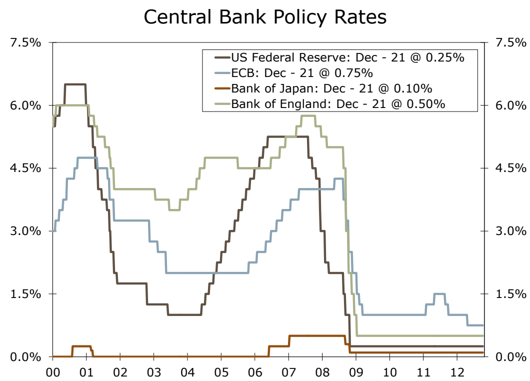
Europe's economic and financial troubles will continue to weigh on global economic activity in 2013 and should put a further bid into Treasury rates, as overall Eurozone and Japanese growth are expected to be below one percent in 2013. In addition, both the central banks of Europe and Japan appear to be committed to further policy easing in 2013.

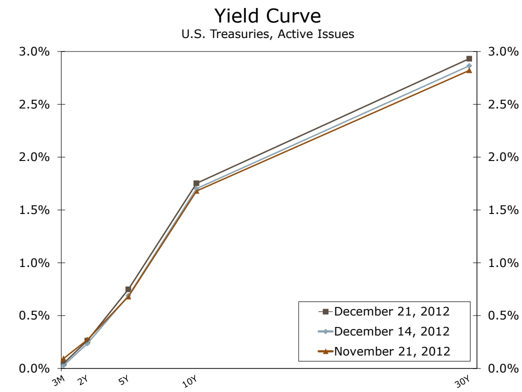
Credit Markets and the Search for Yield

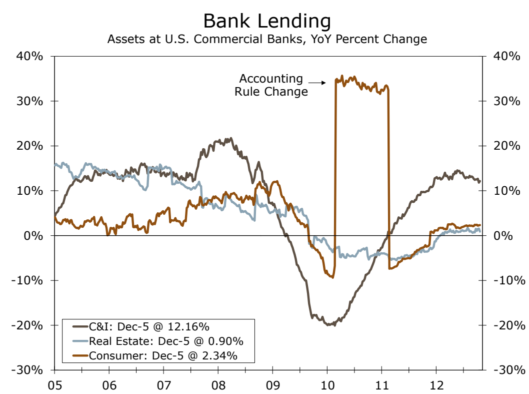
For all this central bank largesse, the primary beneficiaries remain households and corporate credits with solid balance sheets that can finance their activities at low interest rates. This financing has certainly helped the housing, auto and business investment markets during the past two years.

Improvements in housing starts, home prices and home sales have borne out our expectations from the 2012 outlook. Besides low interest rates, the housing market has benefitted from the Fed's purchase of MBS securities. Securitization of auto loans has been a pleasant support for auto sales as well. So far, the demand for credit for housing and autos has had no measurable impact on moving interest rates upward.

Finally, the high-grade and high-yield bond markets have also benefitted from continued economic growth and the Fed's commitment to keep rates low longer. The challenge here will not be rates, but ensuring quality.







Source: IHS Global Insight, Bloomberg LP and Wells Fargo Securities, LLC

Credit Market Insights

Student Loans Continue to Rise

Consumer credit posted yet another monthly rise, coming in at $14.2 billion in October. Nonrevolving credit drove this monthly gain, with a large contribution from student loans. Total consumer loans owned by the federal government and Sallie Mae (mainly student loans) increased by $13.8 billion in September, followed by a $7.0 billion increase in October. Steep increases are expected in these months, as colleges are beginning their fall semesters. Key contributors to the increases in student debt come mainly from higher education costs and more students going to school, or returning to school, in order to avoid the weak labor market.

When looking at the Q3 Household Debt and Credit report, student loans increased by $42.0 billion in the quarter. This large surge is unfortunately made up of $19 billion in defaulted student loans. Moreover, the seriously delinquent student loans (90+ days) rate increased to 11.0 percent from 8.9 percent. This comes from the 59.0 percent of students who borrow for undergraduate-level education, coming out of school with a cumulative debt per person just shy of $22,000.

With a weak job market, students with higher education have to take employment where they can find it, even if they are over-qualified. Until an improvement in the job market is seen, it will be difficult for young adults to boost consumption, with large student debt burdens looming.

Credit Market Data

Mortgage Rates	Current	Week Ago	4 Weeks Ago	Year Ago
30-Yr Fixed	3.37%	3.32%	3.31%	3.91%
15-Yr Fixed	2.65%	2.66%	2.63%	3.21%
5/1 ARM	2.71%	2.70%	2.74%	2.85%
1-Yr ARM	2.52%	2.53%	2.56%	2.77%
Bank Lending	**Current Assets (Billions)**	**1-Week Change (SAAR)**	**4-Week Change (SAAR)**	**Year-Ago Change**
Commercial & Industrial	$1,484.2	43.34%	1.37%	12.16%
Revolving Home Equity	$516.7	-12.52%	-7.55%	-5.93%
Residential Mortgages	$1,585.8	-52.73%	-24.12%	3.98%
Commerical Real Estate	$1,420.1	10.47%	5.77%	0.23%
Consumer	$1,115.4	-3.21%	3.55%	2.34%

Source: Freddie Mac, Federal Reserve Board and Wells Fargo Securities, LLC

Topic of the Week

Hu Wouldn't Want to Own Treasuries?

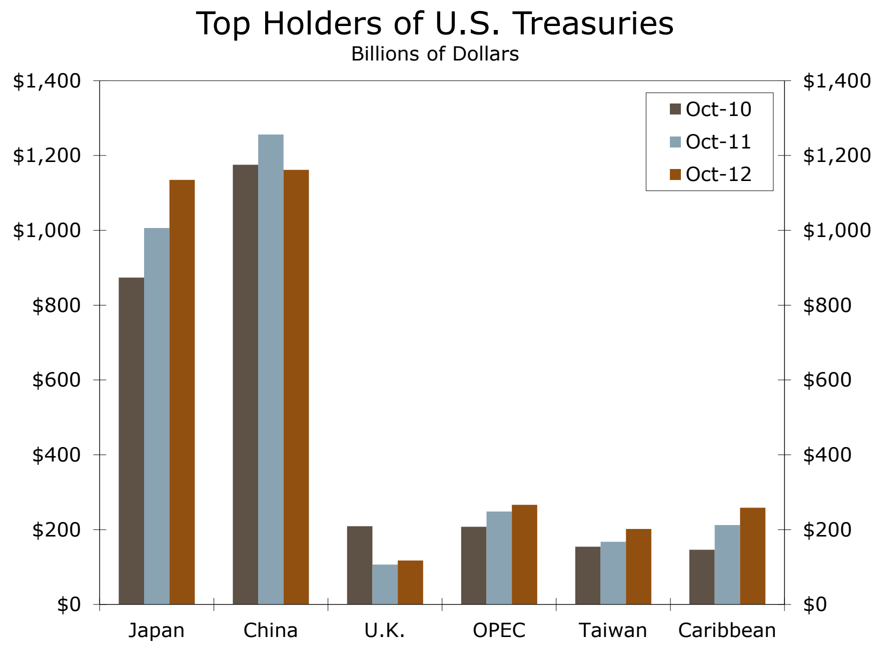
Foreign purchases of U.S. financial assets picked up just $1.3 billion in October, well short of consensus expectations. It appears the flight-to-quality trade is fading. The sum of all cross-border financial activity was a net monthly outflow of $56.7 billion.

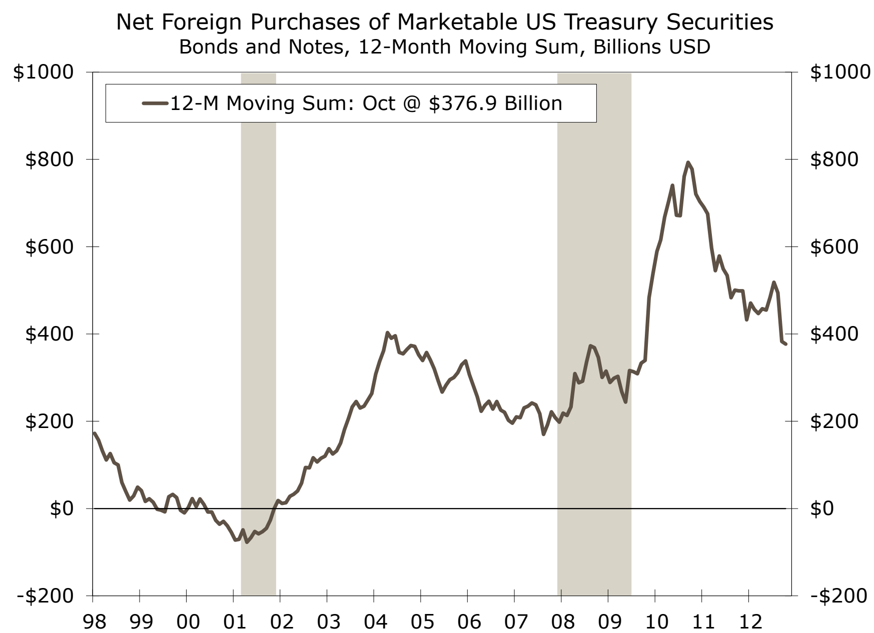
One interesting dynamic in the details of the report is that Japan nearly displaced China as the top foreign holder of U.S. Treasuries. As the top chart to the right shows, China has been slowly paring back its Treasury holdings, even as Japan continues to buy more.

Chinese Treasury purchases did outpace Japanese acquisitions in the most recent month however. China purchased a net $7.9 billion in Treasuries in October to lift its total holdings to $1.162 trillion. Japan added just $5.2 billion to its Treasury portfolio to lift the total value of Japanese-held Treasuries to $1.135 trillion.

The diminished foreign appetite for U.S. government bonds is as weak as it has been in years. To some extent, this shows growing risk appetite, or at least it is an indication of less fear in financial markets. Even though purchases have been trending lower for the past two-and-a-half years, the present rate of $376.9 billion/year is higher than it was for the majority of the previous economic expansion between 2002 and 2008. The notion that foreigners are rushing to unload Treasuries on a wholesale basis is overblown, in our view.

That said, it bears noting the divergence between the Chinese and just about every other foreign buyer. China was a net seller of Treasuries over the past year, while Japan, the United Kingdom, OPEC countries, Taiwan and Caribbean countries were all net buyers. The Chinese government may be attempting to diversify some of its foreign exchange reserves, which total more than $3 trillion. Earlier this month, Chinese state oil company Cnooc offered to buy Nexen, a Calgary-based oil-sands producer and offshore explorer. Rather than putting more eggs into the Treasury basket, China is choosing to own the rights to raw materials.





Source: U.S. Department of the Treasury, Bloomberg LP and Wells Fargo Securities, LLC

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 12/21/2012	1 Week Ago	1 Year Ago
3-Month T-Bill	0.05	0.03	0.00
3-Month LIBOR	0.31	0.31	0.57
1-Year Treasury	0.22	0.20	0.11
2-Year Treasury	0.26	0.23	0.27
5-Year Treasury	0.75	0.69	0.92
10-Year Treasury	1.75	1.70	1.97
30-Year Treasury	2.93	2.86	3.00
Bond Buyer Index	3.64	3.44	3.92

Foreign Exchange Rates

	Friday 12/21/2012	1 Week Ago	1 Year Ago
Euro ($/€)	1.318	1.316	1.305
British Pound ($/₤)	1.620	1.617	1.568
British Pound (₤/€)	0.813	0.814	0.832
Japanese Yen (¥/$)	84.200	83.520	78.060
Canadian Dollar (C$/$)	0.994	0.986	1.027
Swiss Franc (CHF/$)	0.916	0.918	0.936
Australian Dollar (US$/A$	1.042	1.057	1.010
Mexican Peso (MXN/$)	12.868	12.742	13.827
Chinese Yuan (CNY/$)	6.230	6.246	6.339
Indian Rupee (INR/$)	55.069	54.485	52.485
Brazilian Real (BRL/$)	2.075	2.086	1.860
U.S. Dollar Index	79.554	79.580	80.022

Foreign Interest Rates

	Friday 12/21/2012	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.12	0.12	1.35
3-Month Sterling LIBOR	0.52	0.52	1.07
3-Month Canadian LIBOR	1.24	1.23	1.35
3-Month Yen LIBOR	0.18	0.18	0.20
2-Year German	-0.01	-0.04	0.23
2-Year U.K.	0.34	0.33	0.38
2-Year Canadian	1.11	1.13	0.90
2-Year Japanese	0.10	0.10	0.14
10-Year German	1.38	1.35	1.93
10-Year U.K.	1.89	1.86	2.07
10-Year Canadian	1.81	1.79	1.96
10-Year Japanese	0.77	0.74	0.98

Commodity Prices

	Friday 12/21/2012	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	88.51	86.73	98.67
Gold ($/Ounce)	1657.95	1696.10	1615.23
Hot-Rolled Steel ($/S.Ton)	642.00	643.00	#N/A
Copper (¢/Pound)	353.30	366.50	338.90
Soybeans ($/Bushel)	14.15	14.83	11.32
Natural Gas ($/MMBTU)	3.45	3.31	3.16
Nickel ($/Metric Ton)	17,502	17,636	18,840
CRB Spot Inds.	528.01	525.53	514.55

Next Week's Economic Calendar

	Monday 24	Tuesday 25	Wednesday 26	Thursday 27	Friday 28
U.S. Data			**S&P/Case-Shiller 20-City** September 3.00% October 4.00% (C)	**Consumer Confidence** November 73.7 December 70.7 (W) **New Home Sales** October 368K November 377K (W)	**Pending Home Sales** October 5.2% November 1.2% (C)
Global Data				**Japan** **CPI (YoY)** Previous (Oct) -0.4% **Japan** **IP (YoY)** Previous (Oct) -4.5%	**France** **GDP (QoQ)** Previous (3Q) 0.2%

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

Source: Bloomberg LP and Wells Fargo Securities, LLC

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