January 09, 2013

Economics Group

WELLS FARGO SECURITIES

MONTHLY OUTLOOK

U.S. Overview

Render Unto Caesar

The fiscal cliff was resolved in a way that created slightly less fiscal drag than we expected in our previous forecast. Tax rates were increased for families earning more than $450,000 and the payroll tax holiday on Social Security taxes was allowed to expire. The new taxes supporting the Affordable Care Act also took effect as planned. Federal funding for extended unemployment benefits was renewed, however, as was bonus depreciation on capital spending. There was a "permanent" fix to the Alternative Minimum Tax. The sequester was put off for a couple of months, and possibly made more difficult, as the changes in tax policy added $3.9 trillion to the CBO's 10-year deficit projects, a sum nearly equal to the amount that the unsuccessful Bowles-Simpson plan intended to cut.

With taxes rising less than earlier projected, estimates for consumer spending and business fixed investment have been increased ever so slightly. Consumer spending is now expected to rise at a 1.6 percent pace for all of 2013, up from 1.3 percent a month ago. Business fixed investment is expected to rise 0.9 percent this year, up from 0.5 percent in our last forecast.

The relative paltry gains in the private sector largely reflect the uncertainty surrounding the fiscal cliff, which caused economic activity to pull back at the tail end of 2012 and at the beginning of 2013. After a slow start, we expect the private sector to steadily build momentum over the course of the year, which will be needed to offset the drag from cuts in federal government outlays.

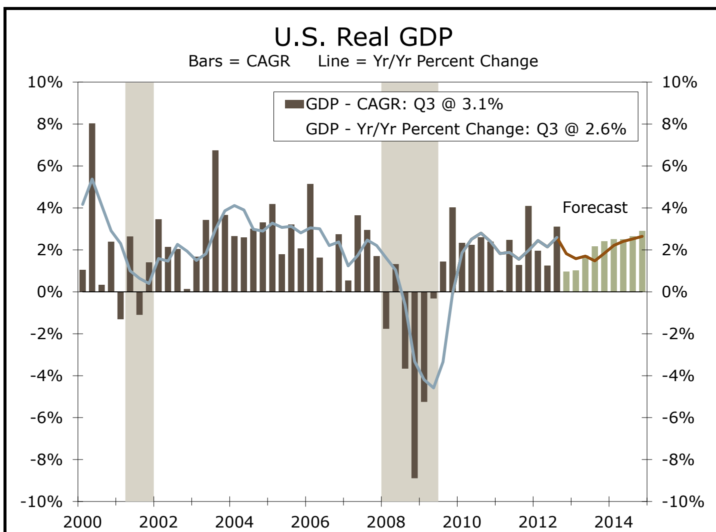
International Overview

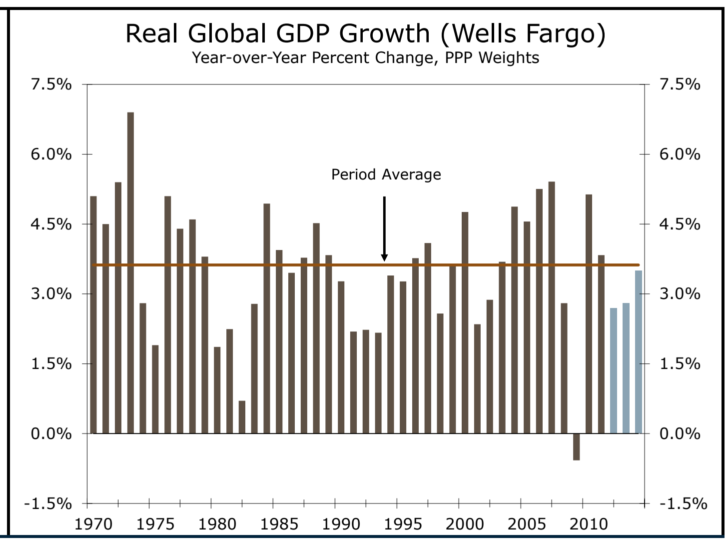
Global Growth Outlook Brightening a Bit

We continue to expect below-trend growth for the global economy this year, but for the first time in several months the outlook has brightened a bit, rather than deteriorating, as it has on trend for the past several months. That is not to say that we expect the global economy to take off, but 2013 will be a better year for growth than this past year and by 2014, we should see full-year growth that is more or less in line with the 3.6 percent growth rate that has been the average for the global economy since the IMF began collecting global GDP data in 1970.

A number of factors play a role, but there is a common thread, areas that were a drag on global growth in the past year or so should be a modest boost to the global economy in the years ahead. The Eurozone economy, while not without its ongoing problems, is poised to emerge from recession and expand in 2013. In addition, after its awful run since 2009, Japan may finally be set to return to slow growth this year. Chinese economic growth is also showing signs of stabilizing even as economic growth in other parts of Asia, like South Korea, is accelerating. A faster growing Asian economy is a positive for resource rich economies elsewhere including Australia and Latin America.

Having said that, the problems in Europe are far from "fixed." As we pointed out in our *Annual Outlook*, fiscal policy in many European countries will continue to exert headwinds on economic growth in the euro area for the next few years.





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

Beware the Ides of March

The drama over the resolution of the fiscal cliff, which spilled over into the early part of 2013, appears to have caused economic activity to pull back a bit toward the end of 2012 and some of that weakness will likely spill over into the new year. Consumer confidence and small business confidence took a tumble during the latter part of 2012, and there appears to have been at least some carry through into spending and investment outlays. Housing is one notable exception. The NAHB/Wells Fargo Homebuilders' Index actually increased further in December and is now close to crossing back above the key 50 break-even level during the early part of 2013.

Any relief over the resolution of the fiscal cliff should be tempered by remembering how Julius Caesar shrugged off the warnings that his death would come not past the Ides of March. The agreement signed into law during the first week of January does not solve all the outstanding fiscal issues facing the economy in 2013. March will be a momentous month, with a trifecta of budget decisions due to be made, including dealing with the sequester on March 1, raising the debt ceiling around the middle of the month and passing a continuing resolution by March 27. Not only will these decisions involve making critical choices about spending but they also hold the prospect of further tax increases. President Obama himself noted in his Dec. 31 press briefing that "revenues have to be part of the equation in turning off the sequester."

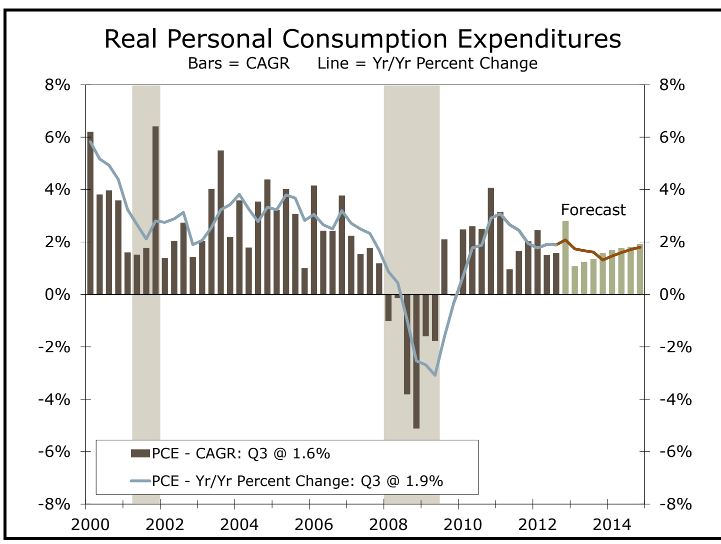
The prospect of further tax increases by the middle (the ides) of March will likely keep many business decisions on hold. Economic activity will clearly move forward, it just will not likely progress all that rapidly. A hospital, for example, would understandably be reluctant to commit to major capital purchases if reimbursements may be cut further. Small businesses will also remain cautious, if deductions could be scaled back further in a couple of months. When coupled with the smaller paychecks that all workers will see in early 2013 due to higher Social Security taxes, we see 2013 getting off to a fairly slow start.

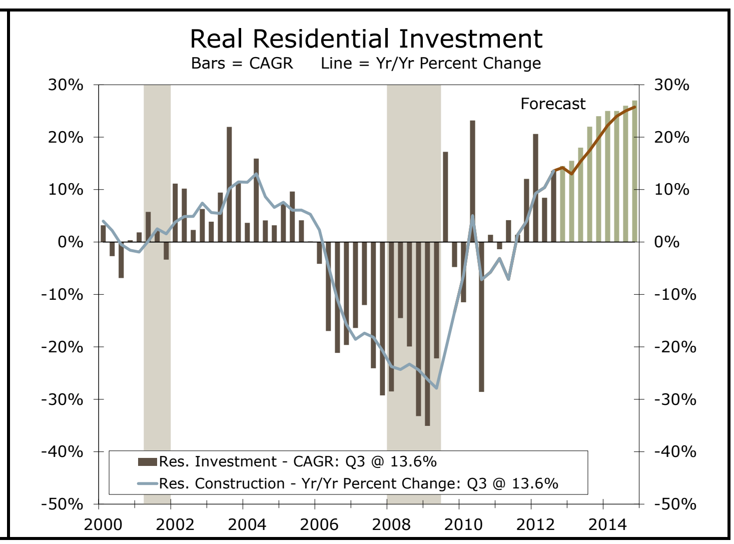
Consumer spending is expected to rise at a 1.1 percent pace in the first quarter, while business fixed investment is expected to decline at a 1.0 percent pace. Overall growth should remain positive thanks to the continued recovery in residential construction and a narrowing in the trade deficit. Real GDP is expected to grow at a 1.0 percent pace in the first quarter, matching what we believe growth was in the prior quarter.

The weak ending to 2012 and slow start to 2013 explains why we are projecting such slow real GDP in 2013, following a 2.2 percent gain in 2012. Economic growth is expected to gain momentum over the course of the year, as households and businesses adjust to the new fiscal framework and residential construction steadily improves. Even though real GDP is expected to rise just 1.7 percent in 2013, the first quarter is the only period where growth is expected to be below that figure.

Residential construction remains the economy's bright spot. Single-family housing starts are expected to rise 27 percent this year and multi-family starts should rise near 30 percent. The rebound in single-family construction comes from severely depressed levels and will provide only a modest direct boost to overall growth. Homebuilding has considerable knock-on effects, however, and gains in single-family starts will clearly help retailers, financial services, building products manufacturers and commercial development.

With economic growth off to a slow start in 2013, the Federal Reserve will keep policy on hold for the foreseeable future. The recent debate about whether the Fed is getting set to end its mortgage-purchase program makes for interesting theater but is unlikely to produce meaningful results during the first half of 2013 and we would be surprised if the program ends before next fall. The Fed would like to see a self-reinforcing recovery take hold in the housing market before they pull support out from under the mortgage market.





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

Wells Fargo U.S. Economic Forecast

	Actual							Forecast									Actual		Forecast		
	2011				2012				2013				2014				2010	2011	2012	2013	2014
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product (a)	0.1	2.5	1.3	4.1	2.0	1.3	3.1	1.0	1.0	1.7	2.2	2.4	2.5	2.5	2.7	2.9	2.4	1.8	2.2	1.7	2.4
Personal Consumption	3.1	1.0	1.7	2.0	2.4	1.5	1.6	2.8	1.1	1.2	1.4	1.6	1.7	1.8	1.8	1.9	1.8	2.5	1.9	1.6	1.6
Business Fixed Investment	-1.3	14.5	19.0	9.5	7.5	3.6	-1.8	0.6	-1.0	2.4	3.1	3.9	4.4	4.8	5.0	5.3	0.7	8.6	7.2	0.9	4.2
Equipment and Software	11.1	7.8	18.3	8.8	5.4	4.8	-2.6	0.5	-1.0	2.3	2.8	3.5	4.1	4.6	4.6	5.0	8.9	11.0	6.2	0.8	3.9
Structures	-28.2	35.2	20.7	11.5	12.9	0.6	0.0	1.0	-1.0	3.0	4.0	5.0	5.5	5.8	6.0	6.2	-15.6	2.7	9.8	1.3	5.2
Residential Construction	-1.4	4.2	1.4	12.0	20.6	8.4	13.6	14.5	15.5	18.0	22.0	24.0	25.0	25.0	26.0	27.0	-3.7	-1.4	11.9	16.5	24.3
Government Purchases	-7.0	-0.8	-2.9	-2.2	-3.0	-0.7	3.9	0.5	-0.8	-0.7	-0.7	-0.7	-0.6	-0.5	-0.4	-0.3	0.6	-3.1	-1.2	0.0	-0.6
Net Exports	-416.6	-399.6	-397.9	-418.0	-415.5	-407.4	-395.2	-422.9	-412.7	-397.9	-383.1	-372.0	-364.3	-363.5	-363.0	-360.1	-419.7	-408.0	-410.3	-391.4	-362.7
Pct. Point Contribution to GDP	0.0	0.5	0.0	-0.6	0.1	0.2	0.4	-0.8	0.3	0.4	0.4	0.3	0.2	0.0	0.0	0.1	-0.5	0.1	0.0	0.1	0.2
Inventory Change	30.3	27.5	-4.3	70.5	56.9	41.4	60.3	57.0	50.5	44.0	42.5	42.5	41.5	41.5	42.0	42.0	50.9	31.0	53.9	44.9	41.8
Pct. Point Contribution to GDP	-0.5	0.0	-1.1	2.5	-0.4	-0.5	0.7	-0.1	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	1.5	-0.2	0.2	-0.1	0.0
Nominal GDP	2.2	5.2	4.3	4.2	4.2	2.8	5.9	2.9	2.9	3.8	4.1	4.5	4.7	4.7	4.9	5.2	3.8	4.0	4.1	3.7	4.6
Real Final Sales	0.6	2.4	2.4	1.5	2.4	1.7	2.4	1.5	1.2	1.9	2.2	2.4	2.6	2.5	2.6	2.9	0.9	2.0	2.0	1.8	2.5
Retail Sales (b)	7.9	8.1	8.6	7.5	6.6	4.7	4.8	3.8	2.7	3.9	3.9	4.2	4.9	5.4	5.5	5.7	5.5	8.0	4.9	3.7	5.4
Inflation Indicators (b)																					
PCE Deflator	1.8	2.6	2.8	2.5	2.4	1.6	1.5	1.5	1.1	1.3	1.3	1.4	1.7	1.8	1.9	2.0	1.9	2.4	1.7	1.3	1.9
Consumer Price Index	2.1	3.3	3.8	3.3	2.8	1.9	1.7	1.9	1.7	2.0	1.9	1.9	2.1	2.1	2.1	2.2	1.6	3.1	2.1	1.8	2.1
"Core" Consumer Price Index	1.1	1.5	1.9	2.2	2.2	2.3	2.0	2.0	1.9	1.7	1.8	1.9	2.0	2.0	2.1	2.1	1.0	1.7	2.1	1.8	2.0
Producer Price Index	4.8	6.6	7.0	5.5	3.5	1.1	1.6	1.8	1.7	3.2	2.3	2.2	2.5	2.6	2.7	2.7	4.2	6.0	2.0	2.3	2.6
Employment Cost Index	2.0	2.2	2.0	2.0	1.9	1.7	2.0	2.0	2.1	2.0	2.0	2.0	2.2	2.1	2.0	2.1	1.3	2.6	1.9	2.0	2.1
Real Disposable Income (a)	4.4	-1.5	-1.3	-0.2	3.7	2.2	0.5	2.0	-1.9	1.7	2.0	2.0	2.1	2.2	2.3	2.3	1.8	1.3	1.2	0.8	2.1
Nominal Personal Income (b)	6.3	5.3	4.7	4.1	2.9	3.0	3.3	3.8	2.2	2.2	2.5	2.7	3.5	3.5	3.5	3.3	3.8	5.1	3.2	2.4	3.4
Industrial Production (a)	4.4	1.2	5.6	5.1	5.9	2.4	0.3	-0.5	2.1	3.5	4.1	4.1	3.5	3.8	4.1	4.1	5.4	4.1	3.6	2.0	3.8
Capacity Utilization	76.2	76.3	77.1	77.9	78.7	78.9	78.6	78.3	78.8	79.1	79.4	79.5	79.6	79.8	80.0	80.2	73.7	76.8	78.6	79.2	79.9
Corporate Profits Before Taxes (b)	4.6	10.8	4.7	9.2	10.3	6.7	7.5	5.0	4.8	5.2	5.4	5.8	6.2	6.4	6.6	6.8	26.8	7.3	7.3	5.3	6.5
Corporate Profits After Taxes	2.1	11.0	7.8	14.5	9.2	4.4	3.2	3.7	4.0	4.5	4.7	5.1	5.5	5.7	5.9	6.1	23.9	8.9	5.0	4.6	5.8
Federal Budget Balance (c)	-460.5	-141.1	-326.3	-321.7	-457.2	-125.3	-185.0	-392.1	-252.9	-175.0	-240.0	-205.0	-260.0	-195.0	-240.0	-205.0	-1294.2	-1296.8	-1089.2	-1060.0	-900.0
Current Account Balance (d)	-120.0	-119.1	-108.2	-118.7	-133.6	-118.1	-107.5	-110.0	-115.0	-120.0	-120.0	-125.0	-125.0	-120.0	-115.0	-110.0	-442.0	-465.9	-469.2	-480.0	-470.0
Trade Weighted Dollar Index (e)	70.5	69.2	72.8	73.3	72.7	74.5	72.7	73.3	74.0	75.0	76.0	77.0	76.0	75.0	74.0	73.0	75.4	70.9	73.5	75.5	74.5
Nonfarm Payroll Change (f)	192.0	129.7	127.7	164.0	225.7	66.7	168.3	151.0	120.0	130.0	145.0	150.0	155.0	160.0	165.0	170.0	85.6	153.3	152.9	136.3	162.5
Unemployment Rate	9.0	9.0	9.0	8.7	8.3	8.2	8.0	7.8	7.7	7.8	7.8	7.8	7.7	7.7	7.6	7.5	9.6	8.9	8.1	7.8	7.6
Housing Starts (g)	0.58	0.57	0.61	0.68	0.71	0.74	0.77	0.87	0.90	0.96	1.02	1.08	1.12	1.15	1.20	1.23	0.59	0.61	0.78	0.99	1.17
Light Vehicle Sales (h)	12.7	12.2	12.6	13.5	14.1	14.1	14.5	15.1	14.4	14.5	14.8	15.0	15.2	15.3	15.4	15.5	11.6	12.7	14.4	14.7	15.4
Crude Oil - Brent - Front Contract (i)	105.21	116.88	111.79	108.43	118.12	108.68	109.03	109.56	108.00	109.33	111.33	112.67	115.00	117.00	119.00	121.00	80.47	110.58	111.35	110.3	118.0
Quarter-End Interest Rates (j)																					
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	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3 Month LIBOR	0.30	0.25	0.37	0.58	0.47	0.46	0.36	0.31	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.34	0.34	0.43	0.30	0.30
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Conventional Mortgage Rate	4.84	4.51	4.11	3.96	3.95	3.68	3.50	3.35	3.40	3.40	3.45	3.50	3.60	3.70	3.90	4.00	4.69	4.46	3.68	3.44	3.80
3 Month Bill	0.09	0.03	0.02	0.02	0.07	0.09	0.10	0.05	0.10	0.15	0.20	0.30	0.30	0.35	0.40	0.40	0.14	0.05	0.09	0.19	0.36
2 Year Note	0.80	0.45	0.25	0.25	0.33	0.33	0.23	0.25	0.25	0.30	0.40	0.50	0.60	0.80	1.00	1.10	0.70	0.45	0.28	0.36	0.88
5 Year Note	2.24	1.76	0.96	0.83	1.04	0.72	0.62	0.72	0.70	0.85	0.90	1.00	1.10	1.30	1.50	1.70	1.93	1.52	0.76	0.86	1.40
10 Year Note	3.47	3.18	1.92	1.89	2.23	1.67	1.65	1.78	1.80	1.90	2.00	2.10	2.20	2.40	2.60	2.80	3.22	2.78	1.80	1.95	2.50
30 Year Bond	4.51	4.38	2.90	2.89	3.35	2.76	2.82	2.95	2.85	2.90	2.90	3.00	3.10	3.30	3.50	3.70	4.25	3.91	2.92	2.91	3.40

Forecast as of: January 9, 2013

Notes: (a) Compound Annual Growth Rate Quarter-over-Quarter
(b) Year-over-Year Percentage Change
(c) Quarterly Sum - Billions USD; Annual Data Represents Fiscal Yr.
(d) Quarterly Sum - Billions USD
(e) Federal Reserve Major Currency Index, 1973=100 - Quarter End
(f) Average Monthly Change
(g) Millions of Units
(h) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold
(i) Quarterly Average of Daily Close
(j) Annual Numbers Represent Averages

Source: U.S. Department of Commerce, U.S. Department of Labor, Federal Reserve Board, Bloomberg LP and Wells Fargo Securities, LLC

Eurozone to Be Less of a Drag on the Global Economy

While we do expect the broader Eurozone to return to positive economic growth in 2013, it bears noting that many of the highly indebted southern European economies will remain in recession. In fact, the IMF forecasts that these economies will experience another year of negative real GDP growth in 2013. Regrettably, these highly indebted economies have few options in terms of stimulating economic growth. Monetary policy is determined by the European Central Bank (ECB), a body that is primarily concerned with price stability. Even if the ECB wanted to boost growth across the Eurozone, with its primary lending rate presently set at 0.75 percent, rates cannot go much lower.

Fiscal easing is not a realistic policy option either, given the strapped fiscal budgets that already exist for these countries. That leaves only one option for now and that is to continue to engage in fiscal consolidation with consequently negative implications for GDP growth. The bottom line is that it could take a number of years for real GDP to return to pre-crisis levels in many of the highly indebted European economies. In other parts of the Eurozone, the outlook is more positive. Germany for example, has already crested above pre-recession levels of economic output and growth there should lift overall economic growth in the Eurozone later this year. The Eurozone should be a slight positive boost to global growth in 2013 instead of the drag that it was on global growth last year.

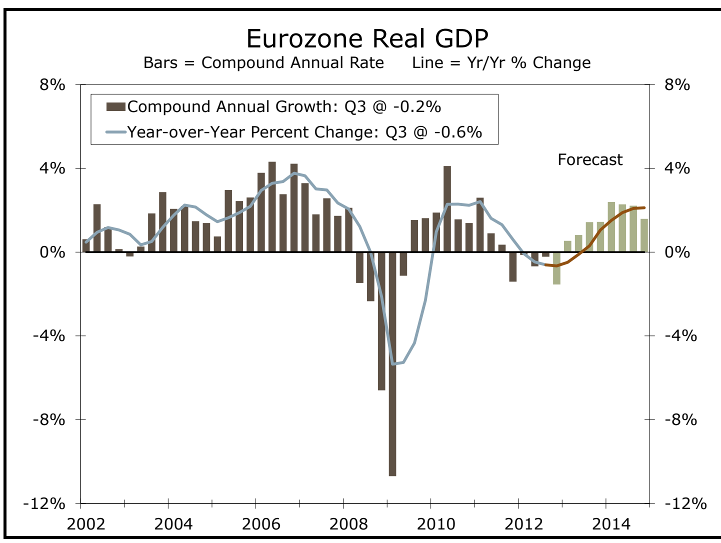
Asia Poised to Pick Up as Well

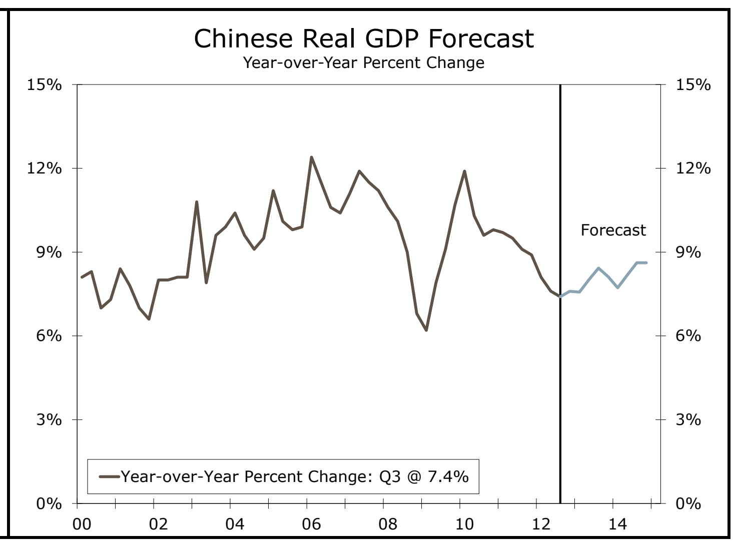
The Japanese economy has been under tremendous pressure the past several years. Just as the island nation was struggling to get back on its feet after the global slowdown of 2009 the Tohoku earthquake and tsunami struck in March 2010. Beyond the tragic loss of life, the tsunami disrupted supply chains around the world and pushed the vulnerable Japanese economy back into recession. Factories were rebuilt and supply disruptions cleared. Then just as the economy was beginning to heal, the situation in Europe began to deteriorate. At the same time Sino-Japanese diplomatic relations became strained and exports to China slowed. Economic activity slowed in six of the past nine quarters in Japan. Having said that, we think Japan's economy probably bottomed out in the fourth quarter of 2012. The newly installed Prime Minister Shinzo Abe was elected on a platform of fiscal policy stimulus. Abe also will be making a new appointment to replace the governor of the Bank of Japan, and it stands to reason that he would fill the post with a like-minded individual. The combination of stimulative monetary and fiscal policy should help the Japanese economy return to slow growth this year. As with the Eurozone, we are likely looking at a situation with Japan where the economy is no longer a drag on global growth as it was in 2012. Even the weak 0.4 percent growth we have penciled in for 2013 growth in Japan would be better than an economy still in recession.

Just across the Sea of Japan, the South Korean manufacturing sector seems to be on a different trajectory. After having weakened on trend the past two years, industrial production in Korea increased 2.3 percent in November; the third straight sequential increase. The Korean consumer continues to support the economy as well, with retail sales rising in the fourth quarter and domestic auto sales surging to 429,000 units, just shy of the record 433,000 set in June 2011.

Fourth-quarter GDP figures for China are not yet available, but we know that the year-over-year rate of industrial production rose in October and November. We also learned recently that the non-manufacturing PMI improved to 56.1 in December, which suggests that Chinese business confidence is firming.

Taken together, smaller drags from Europe and Japan, firming growth elsewhere in Asia combined with slow and steady economic growth in the United States underpins our forecast for continued growth in Australia, Canada and Latin America.





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

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP			CPI		
	2012	2013	2014	2012	2013	2014
Global (PPP weights)	2.7%	2.8%	3.7%	4.2%	4.1%	4.1%
Global (Market Exchange Rates)	1.5%	1.5%	2.4%	n/a	n/a	n/a
Advanced Economies[1]	1.3%	1.1%	2.4%	2.1%	1.8%	1.8%
United States	2.2%	1.4%	2.5%	2.2%	2.3%	2.1%
Eurozone	-0.5%	0.2%	1.9%	2.5%	1.8%	1.9%
United Kingdom	0.0%	1.1%	2.0%	2.8%	2.3%	2.0%
Japan	2.0%	0.4%	2.4%	0.0%	-0.3%	0.1%
Korea	2.2%	3.0%	4.2%	2.2%	2.0%	2.4%
Canada	2.0%	1.7%	2.7%	1.6%	1.6%	0.9%
Developing Economies[1]	4.4%	4.8%	5.3%	6.7%	6.8%	6.9%
China	7.7%	8.0%	8.3%	2.6%	2.8%	3.2%
India	5.4%	6.2%	6.5%	9.2%	8.0%	8.3%
Mexico	3.7%	2.9%	3.9%	4.2%	4.5%	4.6%
Brazil	0.9%	2.5%	3.5%	5.4%	6.3%	6.1%
Russia	3.5%	3.1%	3.7%	5.1%	6.2%	5.5%

Forecast as of: January 9, 2013

[1]Aggregated Using PPP Weights

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	3-Month LIBOR						10-Year Bond					
	2013				2014		2013				2014	
	Q1	Q2	Q3	Q4	Q1	Q2	Q1	Q2	Q3	Q4	Q1	Q2
U.S.	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	1.65%	1.75%	1.85%	1.90%	2.00%	2.10%
Japan	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.85%	0.90%	0.95%	1.05%	1.10%	1.15%
Euroland*	0.15%	0.15%	0.20%	0.30%	0.40%	0.50%	1.50%	1.70%	1.85%	2.10%	2.40%	2.70%
U.K.	0.50%	0.50%	0.50%	0.50%	0.60%	0.70%	2.15%	2.25%	2.40%	2.60%	2.80%	3.20%
Canada	1.25%	1.25%	1.25%	1.45%	1.50%	1.70%	2.00%	2.20%	2.40%	2.80%	3.20%	3.30%

Forecast as of: January 9, 2013

*10-year German Government Bond Yield

Source: IHS Global Insight and Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

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