April 05, 2013

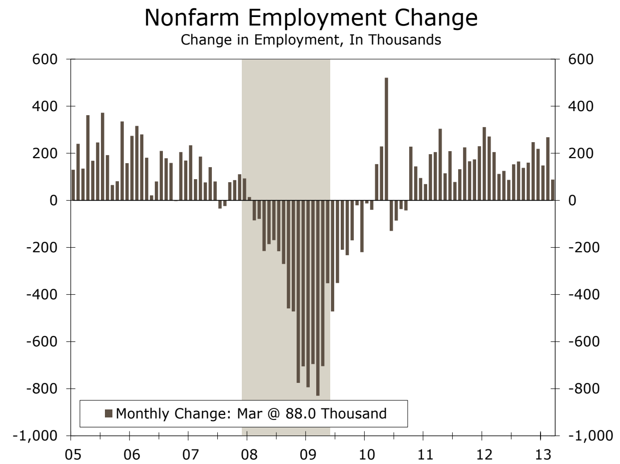
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Modest Job Growth—Still No Boom

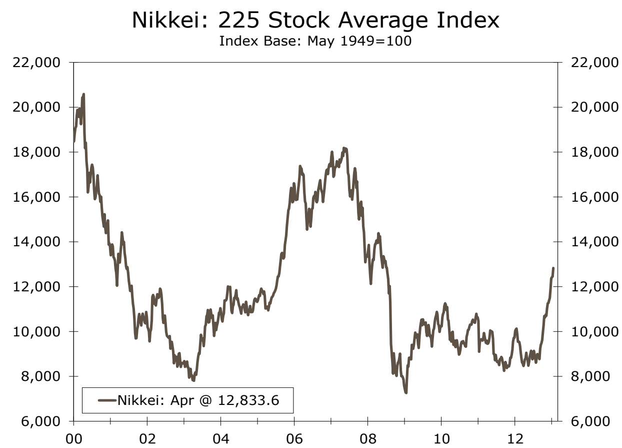
- Gains in employment, the ISM manufacturing index and factory orders reported this week support our view for modest economic growth for this year, but there is no sign that elevated first quarter gains will be sustained.
- The labor market added 88,000 nonfarm jobs in March, with improvement in services and construction sectors. We also saw continued improvement in hours worked but a slowdown in average hourly earnings. This report will support continued consumer spending gains and modest economic growth, but there is no suggestion that the boom some thought would begin this year is in place.



Global Review

Who Will Put The Biggest Q in QE?

- The Bank of Japan (BOJ) stole the show this week, with its dramatic increase in its asset purchase program. The BOJ has pledged to essentially double its monetary base over the next two years to boost economic growth.
- The Tankan report came out weaker than expected at -8, but that still marked an improvement from the prior month and indicates that large Japanese manufacturers are becoming slightly less pessimistic about the economic outlook.



Wells Fargo U.S. Economic Forecast

	Actual 2012				Forecast 2013				Actual			Forecast	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2010	2011	2012	2013	2014
Real Gross Domestic Product [1]	2.0	1.3	3.1	0.4	2.5	2.2	2.3	2.2	2.4	1.8	2.2	2.0	2.4
Personal Consumption	2.4	1.5	1.6	1.8	2.1	1.8	1.7	1.9	1.8	2.5	1.9	1.8	1.9
Inflation Indicators [2]													
PCE Deflator	2.4	1.6	1.5	1.6	1.3	1.6	1.6	1.6	1.9	2.4	1.8	1.5	1.9
Consumer Price Index	2.8	1.9	1.7	1.9	1.8	2.4	2.3	2.3	1.6	3.1	2.1	2.2	2.2
Industrial Production [1]	5.4	2.9	0.3	2.4	5.3	5.0	4.5	4.3	5.7	3.4	3.6	3.7	4.1
Corporate Profits Before Taxes [2]	10.3	6.7	7.5	3.1	4.8	5.2	5.3	5.7	26.8	7.3	6.8	5.3	6.4
Trade Weighted Dollar Index [3]	72.7	74.5	72.7	73.4	75.5	76.0	76.5	77.0	75.4	70.9	73.5	76.3	77.8
Unemployment Rate	8.3	8.2	8.0	7.8	7.7	7.6	7.5	7.4	9.6	8.9	8.1	7.6	7.2
Housing Starts [4]	0.71	0.74	0.77	0.90	0.92	0.96	1.02	1.08	0.59	0.61	0.78	0.95	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	3.35	3.47	3.70	3.80	3.90	4.69	4.46	3.66	3.72	4.30
10 Year Note	2.23	1.67	1.65	1.78	1.87	2.10	2.20	2.30	3.22	2.78	1.80	2.12	2.70

Forecast as of: March 29, 2013

[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 and Wells Fargo Securities, LLC

Inside

U.S. Review

Modest Growth Outlook, Despite Quarterly Volatility

Growth in 2013 is expected to come in at 2 percent-plus, which is remarkably close to the average gain over the prior three years. Yet, this sustained moderate growth view will sometimes lose its punch with the volatility in growth estimates in the past quarter of 2012 and the first quarter of this year. This week's data reinforce the view that growth remains positive but modest—neither the recession story of the initial estimate of the fourth quarter nor the boom story now appearing from some analysts.

ISM-Manufacturing: Growth not Boom

Sustained growth was the story of the March ISM (top graph) which came in at 51.3, above the break-even 50 level with expansionary signals from production, new orders and employment. In recent months the gain in new orders has been reassuring to our growth outlook. Twelve industries reported a gain in orders. Export orders, meanwhile, have risen for four straight months, suggesting that the problems for growth in the Euro area are serious but not enough to significantly hit the U.S. economy.

Factory Orders: Support for Capex

For February, factory orders were reported up 3.0 percent. Over the past three months, non-defense capital goods, excluding aircraft (a leading indicator), have risen 10.1 percent at an annual rate while shipments, a direct input to GDP calculations, were reported up 5.3 percent. Meanwhile, the inventory-to-shipments ratio edged lower suggesting that inventories are under control.

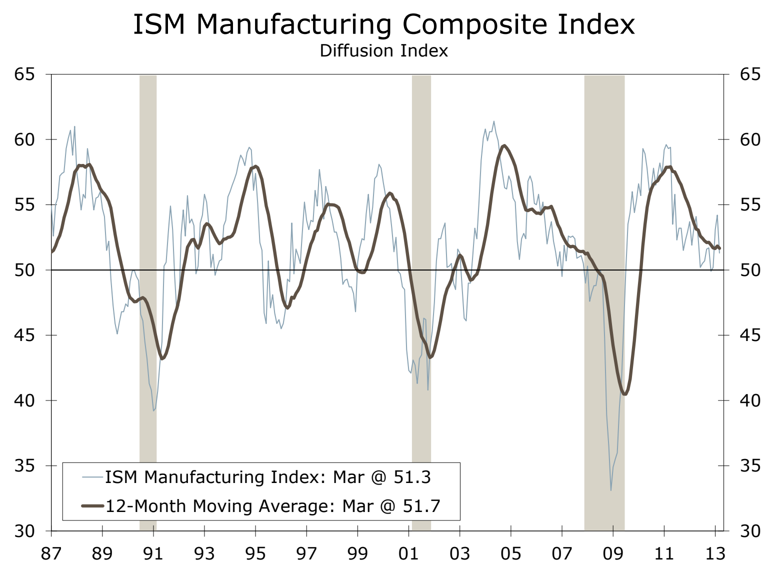
As the year progresses the outlook for business spending will be dependent on the ability of Congress to give the business community some long-term clarity on tax policy. In the NFIB's February report, the top concern was "taxes." Fiscal policy uncertainty is one hurdle for capex in 2013.

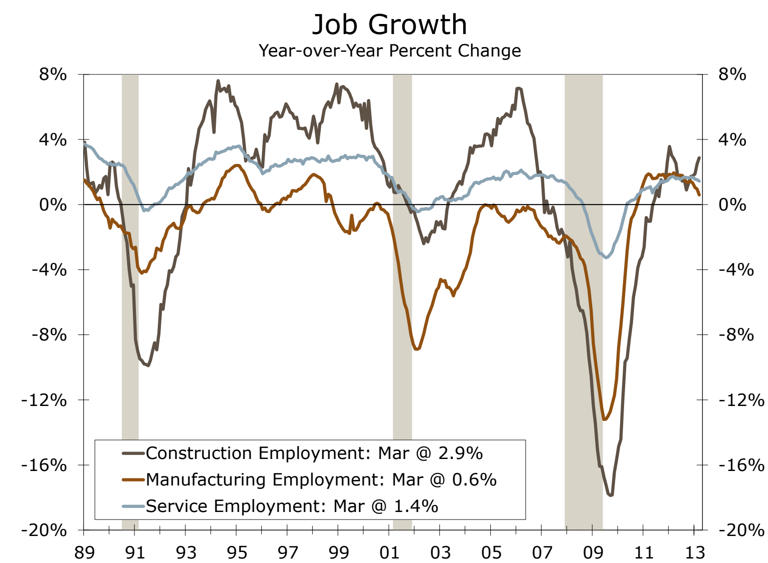
Continued Job Gains: A Plus for Consumer Income and Growth

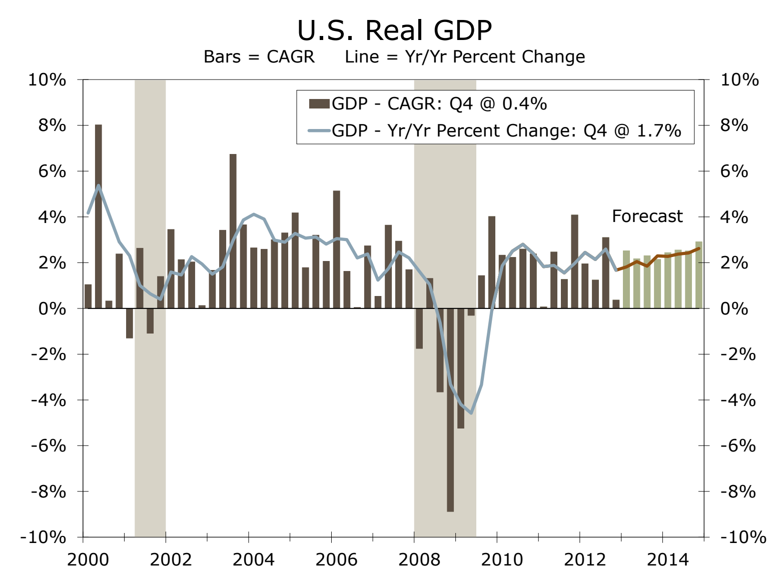
Nonfarm employment increased by 88,000 jobs in March and averaged 168,000 during the past three months. Both January and February's job gains were revised upward suggesting that March may also be revised upward as well. Gains were evident across most key sectors including construction and business services. Private sector job growth averaged 171,000 over the past three months. The bottom line is that from an employment perspective, the first three months of job numbers support the case for sustained, moderate growth going forward.

Outlook: Continued Moderate Growth and Low Inflation

This week's data reinforce our view that economic growth will be sustained, but that after a stronger first quarter, the pace of growth will return to the 2.0 percent to 2.5 percent pace in the last three quarters of this year that we have witnessed for the last three years. Job gains and the improving stock market and home prices will support better consumer spending in 2013 relative to the past year. Inflation remains modest compared to the Fed's target and so continued quantitative easing will be the theme for the rest of the year in terms of monetary policy.



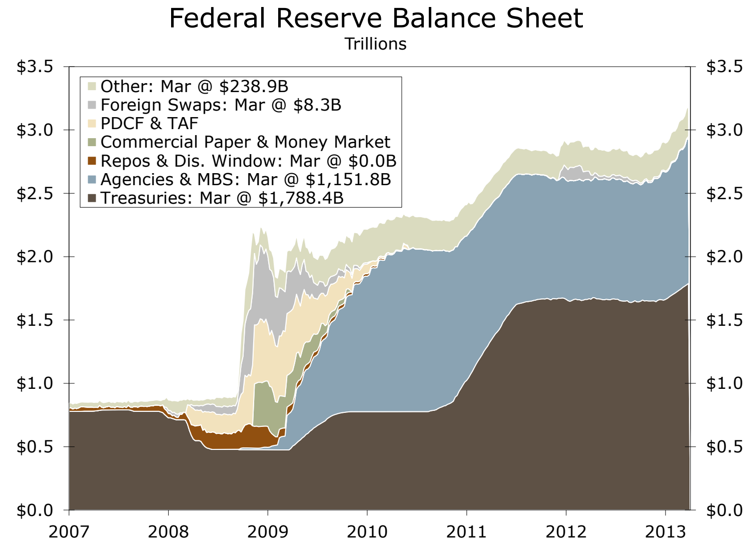


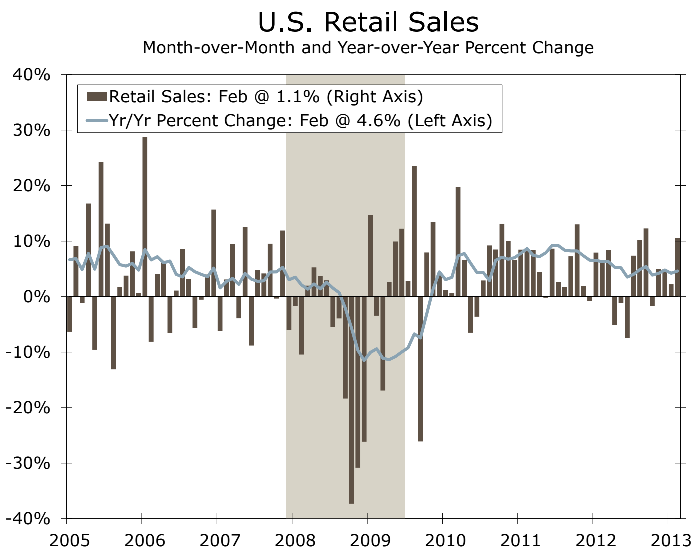


Source: ISM, U.S. Department of Commerce and Wells Fargo Securities, LLC

FOMC Minutes • Wednesday

The Fed will release the minutes from the March 19-20 FOMC meeting on Wednesday. Although there were no policy changes announced at the meeting, discussion appears to be heating up over when to end, or at least begin to taper, the Fed's latest round of asset purchases. In the March statement, the Committee "decided to" continue asset purchases, instead of saying that they "will" continue purchases. Although a subtle change, it is likely not without reason. We expect the latest minutes to suggest a growing preference for tapering purchases later this year among members. Since the March meeting, Chairman Bernanke and Vice Chair Yellen have both publicly indicated that they are willing to vary the pace of asset purchases as changes in the economy develop. In addition, the minutes could shed light on what criteria the FOMC may use when deciding to reduce purchases, which would add some clarity to the timing of reductions.





Retail Sales • Friday

Despite a drop in disposable income since the start of the year, consumers have not been shying away from spending as much as feared. Retail sales rose more than expected in February, increasing 1.1 percent. Higher gasoline prices were one factor driving sales up over the month. Outside of gasoline, motor vehicles and building materials, sales rose 0.4 percent.

We expect sales to have increased more moderately in March. While consumers have not gone into hiding since higher payroll taxes took effect, they do appear somewhat cautious in their discretionary spending. Sales at eating and drinking establishments have fallen in each of the past two months, while consumer confidence tumbled in March. The February boost to sales stemming from higher gas prices is set to fade as gas prices were little changed over the month. Moreover, a pullback in auto sales to dealers in March suggests weaker sales at the retail level.

Previous: 1.1% **Wells Fargo: 0.1%**

Consensus: 0.0% (Month-over-Month)

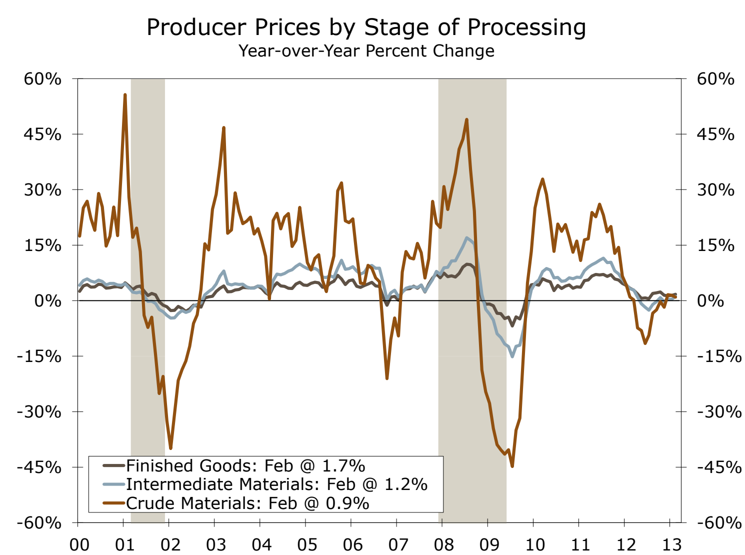
Producer Price Index • Friday

Sluggish demand in the economy has led to only moderate inflation at the wholesale level over the past year. In February, the producer price index was up 1.7 percent from a year earlier, even after rising 0.7 percent over the month. The pickup in producer prices in February was largely due to higher energy prices. Excluding energy commodities, prices slipped 0.1 percent on the heels of a 0.5 percent decline in food prices.

Price pressures for finished goods at the wholesale level are expected to have eased in March. Energy prices pulled back over the month, and price pressures further back in the pipeline remain contained. Over the past year, prices for intermediate and crude goods have increased 1.2 percent and 0.9 percent, respectively. Core prices will likely rise a tick, however, as the economy continues to expand.

Previous: 0.7% **Wells Fargo: -0.3%**

Consensus: -0.1% (Month-over-Month)



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

Global Review

Who Will Wind Up Putting The Biggest Q Into QE?

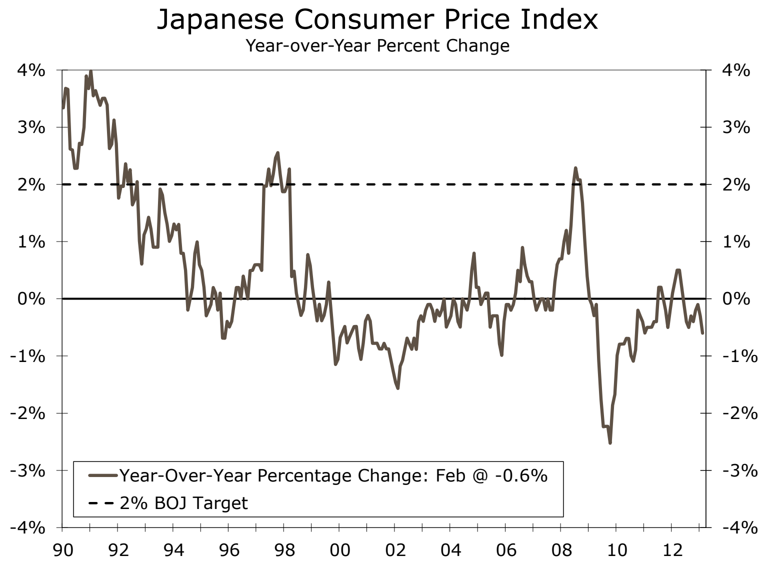
Global economic growth continues to be weighed down by weak final demand in developed countries and partially successful efforts at boosting domestic demand in many emerging economies. Concerns about property speculation in China have also raised questions about what lengths that nation will go to boost demand. The weakness in global economic growth is one of the reasons commodity prices have weakened and those falling prices have rekindled concerns about deflation, as well as raised doubts about growth prospects in commodity-producing nations.

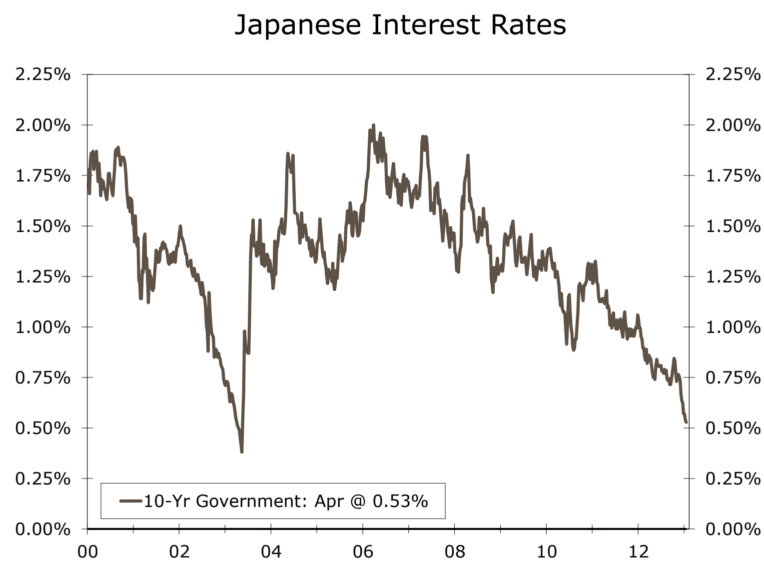
Amid this backdrop, the Fed's quantitative easing (QE) program looks like a sure-fire winner. Japan in particular is keen to implement the Fed's strategy, and the BOJ appears to have borrowed one of Bernanke's helicopters this past week. On Thursday, the BOJ announced it would introduce its own massive "quantitative and qualitative monetary easing." One of the goals is to reflate the Japanese economy to a 2 percent inflation target. The BOJ aims to meet its target with aggressive asset purchases that will double the nation's monetary base over the next two years, including dramatically increasing its purchases of Japanese government bonds (JGBs) and exchange-traded funds (ETFs) that track the Nikkei 225. In addition, the BOJ will buy more Japanese real estate investment trusts (J-REITs) and extend the maturity of its bond portfolio. In short, the BOJ is taking the Fed's QE model and, in an ironic twist of history, enhancing it. Maybe Kuroda will win the Deming Prize.

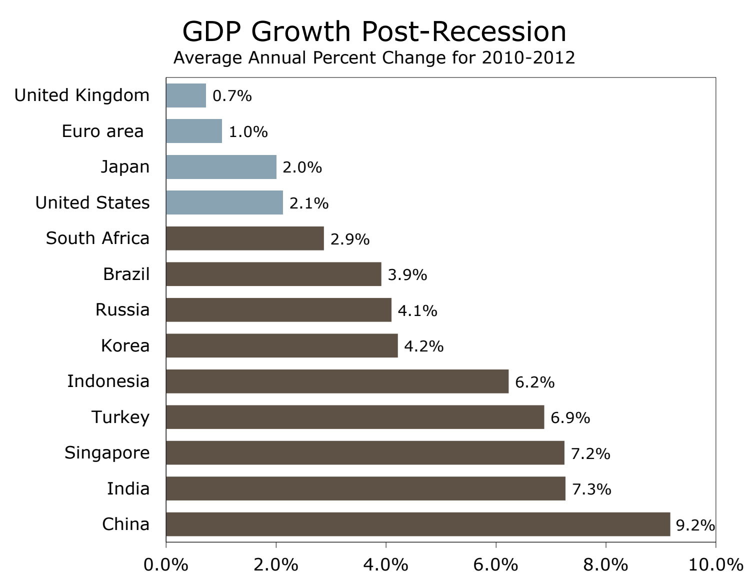
The European Central Bank (ECB) remains somewhat more cautious but is still doing what it can to keep up with the Bernankes and Kurodas of the world. So far that means a bit more dovish talk, such as the renewed doubts by ECB president Mario Draghi about the strength of the much anticipated second half eurozone recovery. Draghi also pledged to keep monetary policy accommodative as long as needed.

Interest rates on JGBs dropped sharply following the BOJs announcement and the yen weakened against the dollar but less so against the euro. That was a winning combination for Japanese share prices and on the surface looks to be an effective tool to jumpstart the Japanese economy. Surfaces can be deceiving, however, particularly if you are looking long term. Our currency strategist sees the dovish bias of the Japanese and Eurozone central banks weighing on their respective currencies.

Competitive currency devaluations are no way to boost competitiveness. Sustainable gains in competitiveness can only be achieved by boosting long-term productivity growth, which requires investment in human and physical capital. As large as the Japanese, European and American monetary stimulus programs are, they are in no way a cure for what ails their respective economies. QE is nothing more than a pain reliever, and a temporary one at that. What developed countries need are growth-oriented fiscal policies that encourage private and public investment. Without that, we fear the developed world is bound to develop an unhealthy addiction to pain relievers, if they have not already done so.







Source: IHS Global Insight, IMF and Wells Fargo Securities, LLC

Germany Industrial Production • Monday

The week will start early with the release of Germany's industrial production index for February. Markets expect the number to rise 0.3 percent versus the previous month and 0.9 percent lower versus a year earlier. Both numbers, if confirmed, will be an improvement compared to the January numbers when the release disappointed with a 0.0 percent and -1.3 percent, respectively.

A weaker number for the standard-bearer of the Eurozone will be another disappointment as the region tries to overcome a still-difficult sovereign debt environment for its periphery countries, with Cyprus being the latest drop on a very convoluted financial environment. On the positive side, factory orders for February were relatively strong, coming in at 2.3 percent from a market expectation of 1.1 percent and a revised drop of 1.6 percent in the previous year.

Previous: -1.3%

Consensus: -0.9% (Year-over-Year)

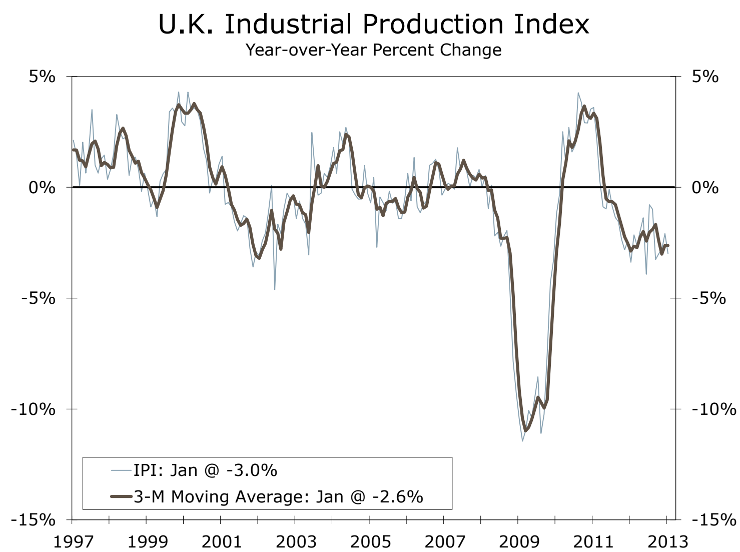
U.K. Industrial Production • Tuesday

The United Kingdom is also releasing industrial production on Tuesday and the markets are expecting an improvement from the very disappointing drop of 1.2 percent in January. This time around, markets are expecting industrial production to increase 0.4 percent in February with manufacturing production also posting a 0.4 percent increase.

It is clear that current policies in Europe are not working and if weak news persists, we may see some change in the conversation regarding future policy measures. We already saw that the Bank of England stayed put in terms of interest rates during the monetary policy meeting this week and did not follow the lead of the Bank of Japan regarding its asset purchases decision. However, if the situation does not improve in the near future the probability for further intervention could increase.

Previous: -2.9%

Consensus: -2.8% (Year-over-Year)



Mexico Industrial Production • Thursday

Mexico releases its own industrial production index for February on Thursday and this release is probably going to reveal a great deal regarding the strength of the Mexican economy at the beginning of the year. The country experienced a strong slowdown in economic activity in the fourth quarter of last year. Industrial production decreased 1.2 percent year over year in December 2012 to rebound somewhat in January by printing a growth rate of 1.7 percent.

Thus, a strong positive number for industrial production in February will probably dispel speculation that the economy has entered a weaker growth environment in 2013. If the index does not improve versus January then we will probably see Mexican economic forecasts for this year starting to scale back from the high 3 plus percent to the low 3 percent range. Mexico needs a strong U.S. economy in order to sustain a strong domestic performance, especially from its auto manufacturing sector.

Previous: 1.7%

Consensus: 0.2% (Year-over-Year)

Source: IHS Global Insight and Wells Fargo Securities, LLC

Interest Rate Watch

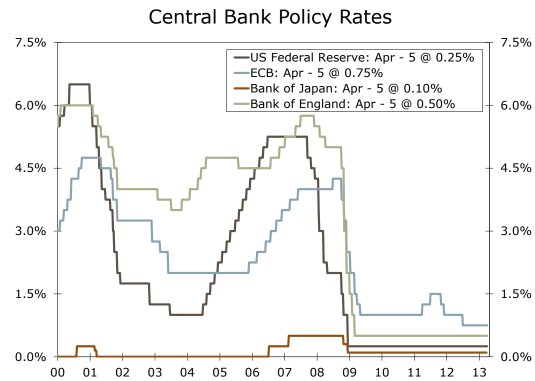
Setting Benchmarks for the Turn

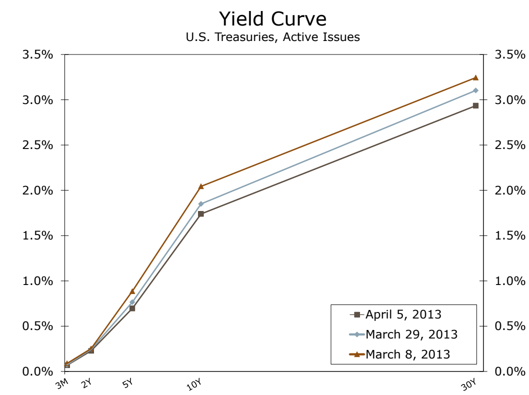
For some time, bond markets have traded in a very narrow range, yet we suspect that at some point changes in the outlook for inflation and interest rates will come to the fore. To anticipate, let us consider some indicators that would signal the change in the markets. A change in inflation expectations would be our first choice for a change in market sentiment. The 10-year implied inflation expectations from the TIPS yield have drifted up since the beginning of the economic expansion but as of yet, have not moved into new territory. Another measure of inflation expectations, 5-year TIPS, demonstrates that since 2010 there is a steady, but very modest, rise in inflation expectations. The five-year measure of inflation expectations is at 2.29 percent, and the five-year forward rate is 2.85 percent. So far inflation expectations are rising but not at the pace that would likely prompt any change in monetary policy. At current levels, however, these inflation expectations measures are at the peak of the recent range and therefore any additional rise would be a signal to us that inflation expectations are no longer well anchored.

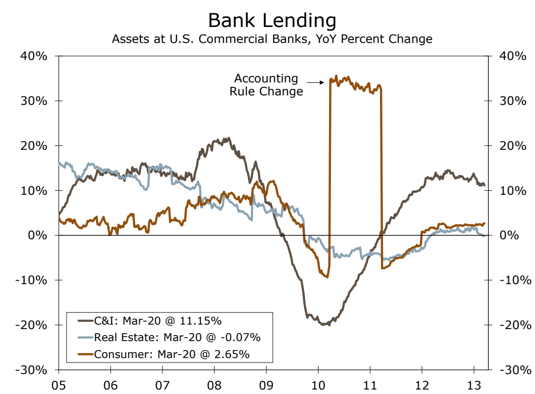
Japanese Purchases and the Capital Losses issue

As for benchmark Treasury issues, foreign holdings are one-half of Treasury debt outstanding. China and Japan dominate foreign holdings. Meanwhile, Federal Reserve purchases constitute the majority of new purchases. Our second benchmark is a signal that the current new monetary policy of Japan will mean a decline in Treasury purchases by the Japanese.

For many investors, the news that may turn the market will be the reporting of returns on bond portfolios for even just a small move upward in rates. If ten-year Treasury rates hit 3 percent by the end of 2014, today's Treasury buyer will suffer capital losses. When reported, these losses may trigger the turn. The turn can come at any time since current market interest rates are out of line with history.







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

Credit Market Insights

Consumer Delinquencies Continued to Fall in the Fourth Quarter

Data on consumer finances continue to paint a picture of a healthier, or at least more conservative, American consumer. Data released this week from the American Bankers Association reported that many categories of consumer loan delinquencies continued to decline in the fourth quarter of 2012. On a quarterly basis, delinquencies on bank-issued credit cards fell to its lowest level since 1994 to 2.47 percent. In the Q4 2011 the credit card delinquency rate was 3.17 percent. Other loan categories making noticeable progress are personal loans, with the delinquency rate falling to 2.14 percent in Q3 to 2.08 percent in Q4, and property improvement loans, which fell to 0.83 percent from 0.89 percent in Q3.

The American Bankers Association's data corroborates with last month's Flow of Funds data out of the Federal Reserve, which showed a continued reduction in household liabilities and the household debt-service ratio hitting all-time lows. Despite consistent improvement in the economy, uncertainty over fiscal policy and the overall strength of the recovery remains. Consumers have worked hard to obtain a more sustainable debt burden following the recession, and will likely maintain their conservative spending habits for some time. Banks are also doing their part in limiting delinquencies. While remaining willing to lend, underwriting standards remain historically tight.

Credit Market Data

Mortgage Rates	Current	Week Ago	4 Weeks Ago	Year Ago
30-Yr Fixed	3.54%	3.57%	3.52%	3.98%
15-Yr Fixed	2.74%	2.76%	2.76%	3.21%
5/1 ARM	2.65%	2.68%	2.63%	2.86%
1-Yr ARM	2.63%	2.62%	2.63%	2.78%
Bank Lending	**Current Assets (Billions)**	**1-Week Change (SAAR)**	**4-Week Change (SAAR)**	**Year-Ago Change**
Commercial & Industrial	$1,535.5	-5.81%	5.20%	11.15%
Revolving Home Equity	$504.4	-9.66%	-10.04%	-7.73%
Residential Mortgages	$1,614.3	9.47%	0.94%	2.71%
Commerical Real Estate	$1,419.6	-1.09%	0.09%	-0.20%
Consumer	$1,121.5	-4.15%	6.69%	2.65%

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

Topic of the Week

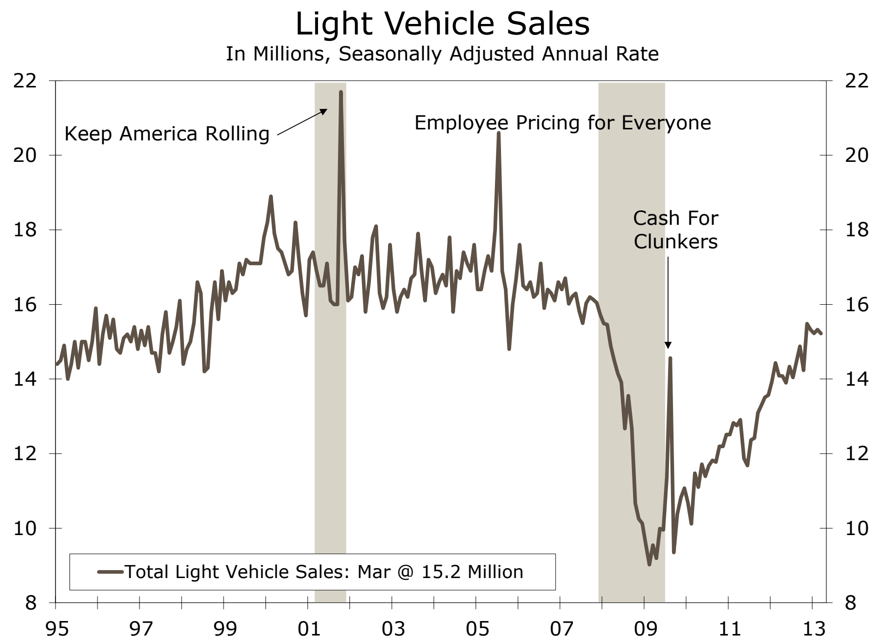
What is Driving Auto Sales Higher?

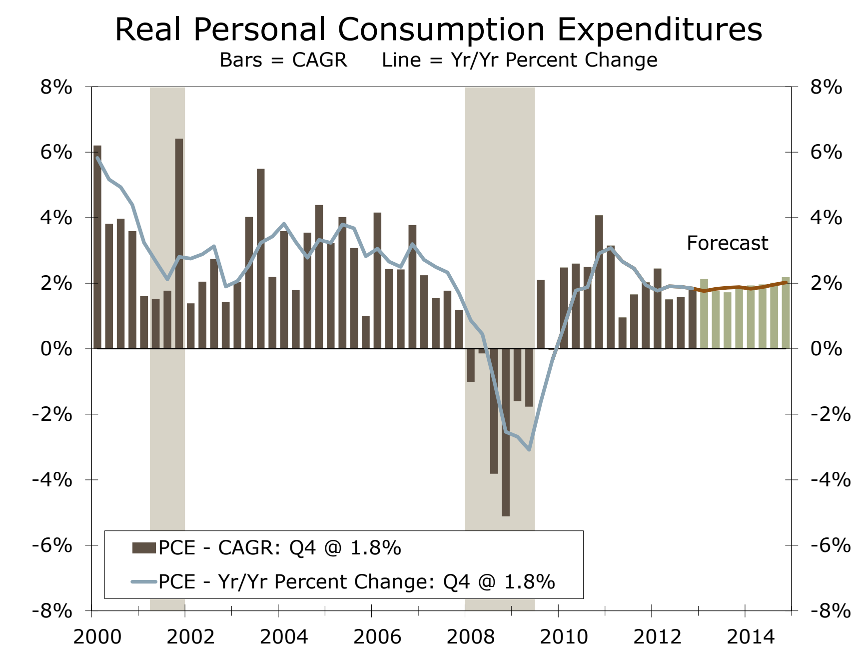
One aspect of consumer spending that has continued to outperform expectations has been automobile spending. Prior to the recession, the average level of auto sales hovered around 16.7 million units. Following a brief sharp jump in sales due to the cash for clunkers program in 2009, sales have climbed from a low of 9.02 million units to a 15.3 million unit pace over the last three months (top graph). The steady pace of improvement can be attributed to several economic factors, but primarily changing credit conditions along with an aging car fleet have helped to drive auto sales higher.

Consumer credit conditions have become more favorable over the past year as higher loan terms, looser credit standards and lower interest rates have helped to fuel demand. Ongoing low interest rates in the automotive market are nothing new. The industry strategy of lower rates to stimulate auto sales has more or less been in place since the September 11, 2001 attacks. Experian Automotive reported that the average loan term for new vehicles rose to a new high of 65 months in the fourth quarter of 2012. The higher loan terms along with the current low interest rate environment has increased consumer accessibility as average monthly loan payments have declined.

Another key factor helping to support stronger auto sales is the aging of the existing cars on the road, which has prompted more consumers to purchase newer vehicles with better gas mileage than older models. The average age of vehicles on the road climbed to 11 years in 2012 indicating that replacement demand has played some role in boosting auto sales, a trend we expect to continue in the months ahead.

This year we expect light vehicle sales to reach a 15.5 million-unit pace. We continue to expect retail sales over the next few months will continue to reflect the strength in the auto and parts dealer sales. The robust pace of auto sales should help to support consumer spending in the 2 percent range this year.





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

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 4/5/2013	1 Week Ago	1 Year Ago
3-Month T-Bill	0.07	0.07	0.07
3-Month LIBOR	0.28	0.28	0.47
1-Year Treasury	0.14	0.16	0.21
2-Year Treasury	0.23	0.24	0.34
5-Year Treasury	0.69	0.76	1.01
10-Year Treasury	1.74	1.85	2.18
30-Year Treasury	2.93	3.10	3.33
Bond Buyer Index	3.96	3.99	4.08

Foreign Exchange Rates

	Friday 4/5/2013	1 Week Ago	1 Year Ago
Euro ($/€)	1.293	1.282	1.307
British Pound ($/₤)	1.523	1.520	1.583
British Pound (₤/€)	0.849	0.844	0.825
Japanese Yen (¥/$)	96.220	94.220	82.370
Canadian Dollar (C$/$)	1.014	1.017	0.993
Swiss Franc (CHF/$)	0.940	0.949	0.920
Australian Dollar (US$/A$)	1.041	1.042	1.030
Mexican Peso (MXN/$)	12.319	12.331	12.873
Chinese Yuan (CNY/$)	6.206	6.210	6.314
Indian Rupee (INR/$)	54.813	54.280	51.105
Brazilian Real (BRL/$)	2.016	2.022	1.823
U.S. Dollar Index	82.723	82.996	80.076

Foreign Interest Rates

	Friday 4/5/2013	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.13	0.13	0.67
3-Month Sterling LIBOR	0.51	0.51	1.02
3-Month Canadian LIBOR	1.18	1.18	1.36
3-Month Yen LIBOR	0.16	0.16	0.20
2-Year German	0.02	-0.02	0.14
2-Year U.K.	0.20	0.20	0.42
2-Year Canadian	0.99	1.00	1.25
2-Year Japanese	0.09	0.05	0.12
10-Year German	1.23	1.29	1.74
10-Year U.K.	1.68	1.77	2.16
10-Year Canadian	1.77	1.87	2.12
10-Year Japanese	0.53	0.55	1.00

Commodity Prices

	Friday 4/5/2013	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	92.97	97.23	103.31
Gold ($/Ounce)	1555.97	1598.75	1631.23
Hot-Rolled Steel ($/S.Ton)	613.00	615.00	695.00
Copper (¢/Pound)	334.35	340.20	379.55
Soybeans ($/Bushel)	13.77	14.14	14.14
Natural Gas ($/MMBTU)	3.94	4.02	2.09
Nickel ($/Metric Ton)	16,026	16,709	17,785
CRB Spot Inds.	536.88	539.22	538.07

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	8	9	10	11	12
U.S. Data		**Wholesale Inventories** January 1.2% February 0.5% (C)	**Monthly Budget** February March	**Import Price Index** February 1.1% March -0.5% (W)	**PPI** February 0.7% March -0.3% (W) **Retail Sales** February 1.1% March 0.1% (W) **Business Inventories** January 1.0% February 0.4% (W)
Global Data	**Germany** **IP (YoY)** Previous (Jan) -1.3% **China** **CPI (YoY)** Previous (Feb) 3.2%	**U.K.** **IP (MoM)** Previous (Jan) -1.2% **Canada** **Housing Starts** Previous (Feb) 178K	**Japan** **Machine Orders (MoM)** Previous (Jan) -13.1% **China** **Trade Balance** Previous (Feb) $15.23B	**Mexico** **IP (YoY)** Previous (Jan) 1.7% **Brazil** **Retail Sales (MoM)** Previous (Feb) 0.6%	

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

Source: Bloomberg LP and Wells Fargo Securities, LLC

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