July 10, 2013

Economics Group

MONTHLY OUTLOOK

U.S. Overview	International Overview

An Improving But Still Less Optimistic View

With four years of economic recovery now in the books, we are seeing more pockets of improvement, which has led many economists to greatly increase their expectations for growth. We remain more cautious, with real GDP expected to rise just 1.7 percent in 2013 and 2.4 percent in 2014. The modest overall numbers are deceiving because we are starting from such a weak base. Fourth quarter-to-fourth quarter growth, which is the way the Fed issues its forecast, shows real GDP rising 1.9 percent in 2013 and 2.6 percent in 2014. Moreover, we see the sequestration process producing a much larger drag, particularly later this year. Fourth quarter-to-fourth quarter private-sector growth is expected to rise 3.4 percent this year and 3.8 percent in 2014.

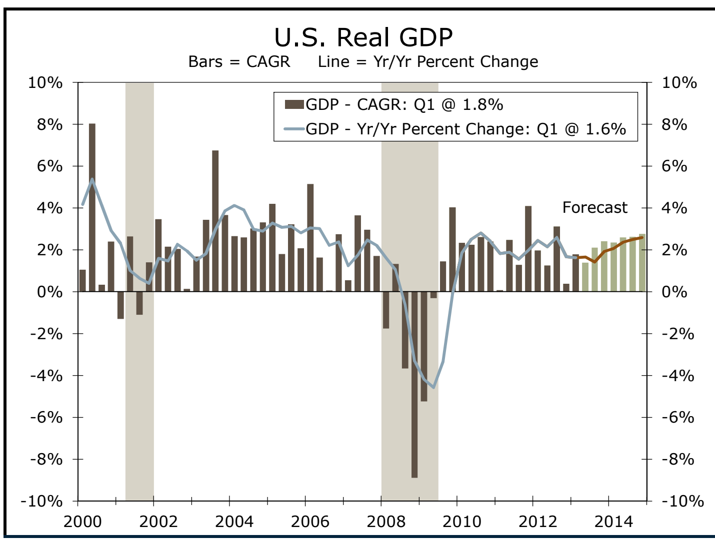
The split between a re-energizing private sector and further cutbacks in government spending partially explain how job growth has ramped up so much more than economic growth. Spending cuts by the federal government have had more of an effect on outlays and hours worked by federal employees and contractors than they have on employment. That being said, we do have some doubts about the quality of jobs being added in the private sector, which have been heavily weighted toward lower-paying industries, many of which predominantly employ part-time workers. Efforts to minimize the effect of the Affordable Care Act may have played a role in this hiring. If that is the case, we may see job growth slow later this year.

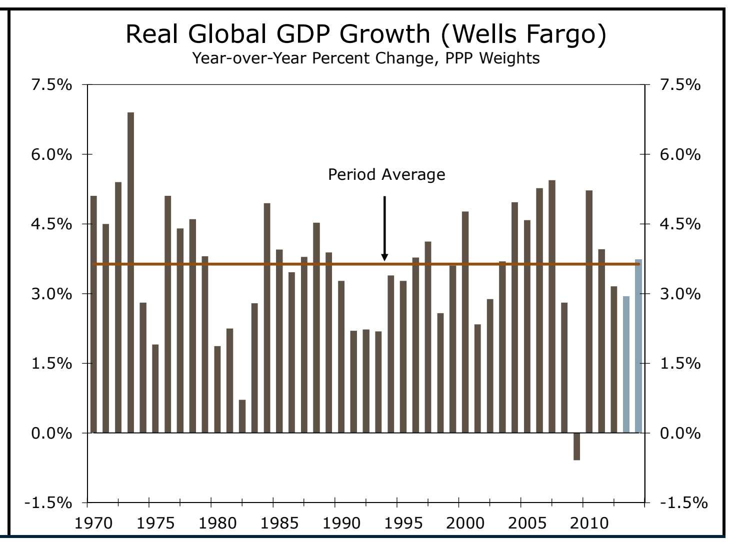
"Return to Normalcy" for the Global Economy?

The IMF has been collecting data on global economic growth since 1970, and in all that time, global GDP contracted only one year: 2009. At roughly the halfway point of 2013, we are on track for the fourth year of expansion since that year of global recession in 2009. Although we are not quite there yet, the global economy is on a trajectory that would be sure to please Warren G. Harding, whose 1920 presidential campaign theme was "A Return to Normalcy." Our expectation is that full-year global growth will come in around 2.9 percent this year before picking up to 3.7 percent in 2014. If realized, that 3.7 percent figure for 2014 would be roughly in line with the long-term average for global growth which is 3.6 percent.

President Harding's theme was in reference to getting the country settled down after the disruptions from the First World War. So is the global economy really settled down after the disruptions from the global recession? This month we look at how the economic experiences have varied among the major developed and developing economies around the world.

In the early years of recovery after credit market disruptions roiled financial markets, emerging market economies with little in the way of fiscal budget imbalances generally outperformed. The inverse was also true as developed market countries whose governments were often highly levered faced bigger initial disruptions. But dynamics have shifted and the drivers of global growth are changing once again.





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

Together we'll go far

This report is available on wellsfargo.com/economics and on Bloomberg WFRE.

The Outlook Is Still a Bit of a Head Scratcher

We have clearly become more constructive on the economic outlook, but are maintaining our forecast for below trend growth. Although our forecast is considerably below the latest estimate from the Federal Open Market Committee and many other private forecasters, most of the difference is due to our less optimistic view on fiscal policy. We see the sequestration process continuing into next year, with little chance of a significant deal being struck. The effect from sequestration will be significantly greater in fiscal 2014 and is expected to exact an even greater toll on real GDP growth beginning in the fourth quarter of this year. Private final domestic demand, our preferred measure of economic activity, is expected to rise a robust 3.4 percent in 2013 and 3.8 percent in 2014. The split in these two broad economic gauges helps explain how job growth, motor vehicle sales and homebuilding can improve as much as they have, with GDP growth remaining so sluggish.

The strength in the private sector is being driven by the economy's traditionally most cyclical sectors, namely motor vehicles and homebuilding. Motor vehicle sales ramped up to a 15.9 million unit rate in June, the highest level seen since 2007. Much of the strength was in light trucks, which reflects strong demand for the agriculture, energy and construction sectors. Consumer demand is also coming back, thanks to stronger job and income growth. We see consumer spending gradually gaining momentum, as motor vehicle sales continue to ramp up and the housing recovery gains momentum.

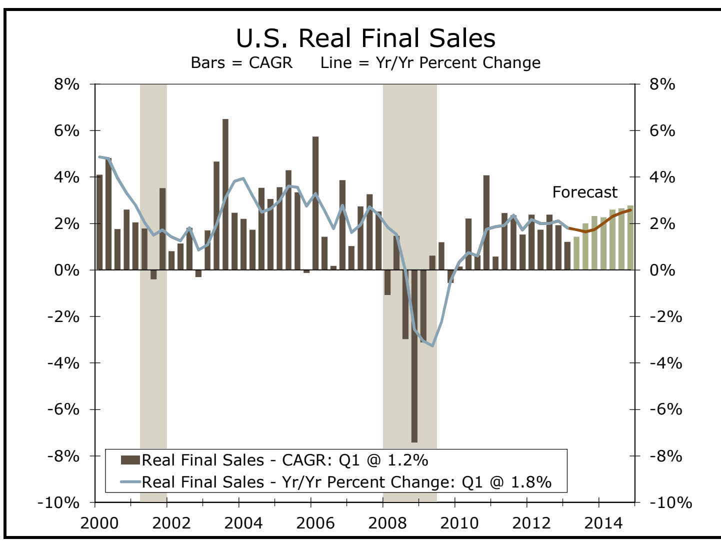
Residential construction has contributed 0.3 percentage points to economic growth over the past year, with most of the gain coming from apartment construction. Starts of single-family homes have taken longer to get back on track, even though inventories remain near all-time lows and buyer traffic is improving. Permits have been running ahead of starts, however, and we suspect that unusually wet spring weather in parts of the South has restrained starts. We are still looking for a 30 percent increase in single-family starts this year and expect overall housing starts to total 990,000 units in 2013. Starts should rise by an additional 20 percent next year.

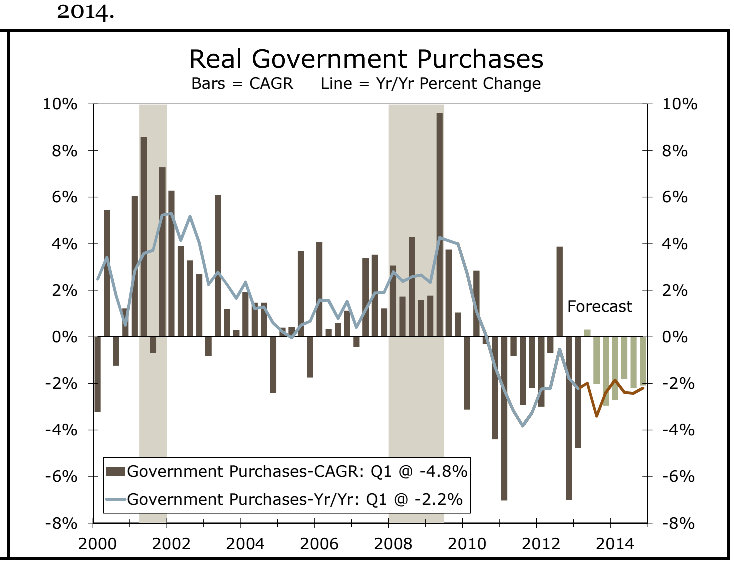
Business fixed investment is also taking longer to find its footing. Businesses remain reluctant to commit to major capital projects given all the uncertainty surround public policy. Moreover, many firms do not need additional capacity at this time and will need to see further gains in sales and earnings before boosting capital spending. There are some exceptions. Orders for domestic aircraft have surged this year and Boeing and Airbus are boosting production capacity at multiple facilities in the United States. The energy and technology sectors are also expanding. But even with these bright spots, business fixed investment is expected to grow just 3.6 percent in 2013 and 5.0 percent in 2014.

Government spending has been a weak spot for the economy for quite some time and is expected to remain a drag going forward. The source of the weakness has shifted, however, from cutbacks at the state and local level to cuts in federal outlays. The source of the cuts makes a difference. State and local governments tended to slash jobs, which was one of the only options available to them once tax receipts plummeted. By contrast, reductions in federal outlays are leading to fewer job cuts and, instead, restraining hours and earnings. Federal purchases of goods and services are also being reduced.

The restraint in government spending and improvement in the private sector have helped improve government finances. State and local governments have seen a surge in tax receipts as job and income growth has ramped up and tax increases have taken hold. With expenses having been trimmed during the lean years, many states are boosting outlays again, which will help offset the drag from greater cutbacks in federal outlays.

We have raised our long-term interest rate forecast to incorporate the most recent reassessment of Fed policy. The Fed is expected to begin to taper its security purchases later this year and fully wind down its purchase program by fall 2014.





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	0.4	1.8	1.4	2.1	2.4	2.3	2.6	2.6	2.8	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	1.8	2.6	1.9	2.1	2.4	2.5	2.5	2.6	2.6	1.8	2.5	1.9	2.1	2.4
Business Fixed Investment	-1.3	14.5	19.0	9.5	7.5	3.6	-1.8	13.1	0.4	1.5	3.8	6.1	3.9	5.6	6.3	6.8	0.7	8.6	8.0	3.6	5.0
Equipment and Software	11.1	7.8	18.3	8.8	5.4	4.8	-2.6	11.8	4.1	1.5	3.9	5.3	5.1	5.8	6.1	6.6	8.9	11.0	6.9	4.2	5.1
Structures	-28.2	35.2	20.7	11.5	12.9	0.6	0.0	16.7	-8.3	0.0	3.5	9.0	0.0	5.0	7.0	7.5	-15.6	2.7	10.8	1.7	4.4
Residential Construction	-1.4	4.2	1.4	12.0	20.6	8.4	13.6	17.5	14.0	14.0	15.5	16.5	17.0	18.0	18.0	18.5	-3.7	-1.4	12.1	14.6	17.0
Government Purchases	-7.0	-0.8	-2.9	-2.2	-3.0	-0.7	3.9	-7.0	-4.8	0.3	-2.0	-3.0	-2.7	-1.8	-2.2	-2.1	0.6	-3.1	-1.7	-2.5	-2.2
Net Exports	-416.6	-399.6	-397.9	-418.0	-415.5	-407.4	-395.2	-384.7	-387.7	-406.3	-407.0	-408.4	-407.6	-410.2	-413.4	-418.0	-419.7	-408.0	-400.7	-402.3	-412.3
Pct. Point Contribution to GDP	0.0	0.5	0.0	-0.6	0.1	0.2	0.4	0.3	-0.1	-0.5	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.5	0.1	0.1	0.0	-0.1
Inventory Change	30.3	27.5	-4.3	70.5	56.9	41.4	60.3	13.3	36.7	42.0	45.5	49.0	52.0	52.5	52.0	52.0	50.9	31.0	43.0	43.3	52.1
Pct. Point Contribution to GDP	-0.5	0.0	-1.1	2.5	-0.4	-0.5	0.7	-1.5	0.6	0.2	0.1	0.1	0.1	0.0	0.0	0.0	1.5	-0.2	0.1	0.0	0.1
Nominal GDP	2.2	5.2	4.3	4.2	4.2	2.8	5.9	1.4	3.1	2.8	3.6	4.1	4.1	4.4	4.6	4.8	3.8	4.0	4.0	3.1	4.1
Real Final Sales	0.6	2.4	2.4	1.5	2.4	1.7	2.4	1.9	1.2	1.4	2.0	2.3	2.3	2.6	2.6	2.8	0.9	2.0	2.1	1.7	2.3
Retail Sales (b)	7.5	7.6	8.1	7.0	6.6	4.9	5.0	4.7	4.0	4.5	4.2	3.9	4.1	4.8	5.3	5.6	5.5	7.5	5.3	4.1	4.9
Inflation Indicators (b)																					
PCE Deflator	1.8	2.6	2.8	2.5	2.4	1.6	1.5	1.6	1.2	0.9	1.0	1.2	1.5	2.1	2.1	2.0	1.9	2.4	1.8	1.1	1.9
Consumer Price Index	2.1	3.4	3.7	3.3	2.8	1.9	1.7	1.9	1.7	1.3	1.3	1.4	1.8	2.4	2.5	2.3	1.6	3.1	2.1	1.4	2.3
"Core" Consumer Price Index	1.1	1.5	1.9	2.2	2.2	2.3	2.0	1.9	1.9	1.7	1.8	1.9	1.9	2.1	2.1	2.1	1.0	1.7	2.1	1.8	2.1
Producer Price Index	4.8	6.7	7.0	5.5	3.4	1.1	1.6	1.7	1.4	1.5	0.9	1.2	1.8	3.0	2.9	2.8	4.2	6.0	1.9	1.3	2.6
Employment Cost Index	2.0	2.2	2.0	2.0	1.9	1.7	1.9	1.9	1.9	1.9	2.0	2.0	2.2	2.2	2.2	2.3	1.3	2.6	1.9	1.9	2.2
Real Disposable Income (a)	4.4	-1.5	-1.3	-0.2	3.7	2.2	0.7	8.9	-8.6	4.4	3.0	3.1	3.0	3.1	3.2	3.3	1.8	1.3	1.7	0.9	3.2
Nominal Personal Income (b)	6.3	5.3	4.7	4.1	2.9	3.0	3.3	5.7	2.8	3.2	3.5	2.1	4.3	3.9	3.9	3.4	3.8	5.1	3.7	2.9	3.9
Industrial Production (a)	2.6	1.0	5.0	4.7	5.4	2.9	0.3	2.5	4.1	0.2	2.9	4.5	4.3	4.3	4.4	4.3	5.7	3.4	3.6	2.4	3.9
Capacity Utilization	76.1	76.1	76.7	77.1	77.6	77.7	77.4	77.5	78.0	78.0	79.2	79.6	79.7	79.8	80.0	80.2	74.0	76.5	77.6	78.7	79.9
Corporate Profits Before Taxes (b)	4.6	10.8	4.7	9.2	10.3	6.7	7.5	3.1	4.5	5.2	5.3	5.7	6.1	6.3	6.5	6.7	26.8	7.3	6.8	5.2	6.4
Corporate Profits After Taxes	2.1	11.0	7.8	14.5	9.2	4.4	3.2	-1.1	7.0	4.5	4.6	5.1	5.5	5.7	5.9	6.0	23.9	8.9	3.7	5.3	5.8
Federal Budget Balance (c)	-460.5	-141.1	-326.3	-321.7	-457.2	-125.3	-185.0	-293.3	-307.2	-65.8	-183.7	-190.0	-190.0	-155.0	-205.0	-200.0	-1294.2	-1296.8	-1089.2	-850.0	-750.0
Current Account Balance (d)	-116.6	-118.9	-105.6	-116.6	-120.8	-110.5	-106.7	-102.3	-106.1	-110.0	-115.0	-120.0	-120.0	-125.0	-125.0	-130.0	-449.5	-457.7	-440.4	-451.1	-500.0
Trade Weighted Dollar Index (e)	70.5	69.2	72.8	73.3	72.7	74.5	72.7	73.4	76.2	77.5	79.0	79.8	80.3	81.0	81.3	81.3	75.4	70.9	73.5	78.1	80.9
Nonfarm Payroll Change (f)	156.7	209.3	145.0	190.0	262.3	108.0	152.0	208.7	207.3	196.3	190.0	200.0	200.0	200.0	200.0	210.0	85.2	175.3	182.8	198.4	202.5
Unemployment Rate	9.0	9.0	9.0	8.7	8.3	8.2	8.0	7.8	7.7	7.6	7.5	7.4	7.3	7.3	7.2	7.2	9.6	8.9	8.1	7.6	7.3
Housing Starts (g)	0.58	0.57	0.62	0.67	0.71	0.74	0.78	0.90	0.96	0.92	1.02	1.04	1.09	1.15	1.20	1.23	0.59	0.61	0.78	0.99	1.18
Light Vehicle Sales (h)	12.7	12.2	12.6	13.5	14.1	14.1	14.5	15.0	15.3	15.3	15.5	15.5	15.7	15.9	16.2	16.4	11.6	12.7	14.4	15.4	16.0
Crude Oil - Brent - Front Contract (i)	105.21	116.88	111.79	108.43	118.12	108.68	109.03	109.56	112.23	103.28	105.00	106.00	105.00	107.00	109.00	111.00	80.47	110.58	111.35	106.6	108.0
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	0.28	0.27	0.25	0.25	0.25	0.25	0.30	0.30	0.34	0.34	0.43	0.26	0.28
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	3.57	4.07	4.50	4.60	4.80	4.90	5.00	5.10	4.69	4.46	3.66	4.19	4.95
3 Month Bill	0.09	0.03	0.02	0.02	0.07	0.09	0.10	0.05	0.07	0.04	0.10	0.15	0.20	0.20	0.20	0.20	0.14	0.05	0.09	0.09	0.20
2 Year Note	0.80	0.45	0.25	0.25	0.33	0.33	0.23	0.25	0.25	0.36	0.40	0.60	0.80	0.90	1.10	1.30	0.70	0.45	0.28	0.40	1.03
5 Year Note	2.24	1.76	0.96	0.83	1.04	0.72	0.62	0.72	0.77	1.41	1.50	1.60	1.80	1.90	2.20	2.40	1.93	1.52	0.76	1.32	2.08
10 Year Note	3.47	3.18	1.92	1.89	2.23	1.67	1.65	1.78	1.87	2.52	2.60	2.70	2.90	3.00	3.20	3.40	3.22	2.78	1.80	2.42	3.13
30 Year Bond	4.51	4.38	2.90	2.89	3.35	2.76	2.82	2.95	3.10	3.52	3.60	3.70	3.80	3.90	4.10	4.30	4.25	3.91	2.92	3.48	4.03

Forecast as of: July 10, 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, IHS Global Insight and Wells Fargo Securities, LLC

Many Developed Economies Still Have a Way to Go

The global economy remains on track to post its fourth consecutive year of expansion in 2013, and we expect the rate of global growth in 2014 to be fairly close to the long-term average of 3.9 percent. But in the years that have passed since the global recession of 2009, the major economies of the world have had very different experiences.

The Unites States, for example, returned to pre-recession levels of output in the first quarter of 2012 and has been in expansion ever since. As we discuss in the U.S. Outlook section of this report, we expect the slow-growth recovery at home to continue this year before picking up steam in 2014. Canada was the first G-7 economy to fully recover from the recession, and we forecast the expansion there to continue throughout our forecast period. However some of the largest developed economies of the world still have a long way to go before returning to pre-recession levels of real GDP. Some of the most glaring examples of these struggling economies are the United Kingdom (still off 3.9 percent from its pre-recession high), the Eurozone (down 3.3 percent) and Japan (off 1.2 percent).

However, there are indications of healing in these big global economies. The United Kingdom's economy has expanded in two out of the past three quarters, and early indications suggest to us that expansion continued into the second quarter.

The Japanese economy, through its wholesale adoption of expansionary monetary and fiscal policy is experiencing something of a renaissance with first quarter GDP growth coming in at a 4.1 percent annualized rate of growth. Although we have some doubts about the long-term sustainability of stimulus-fueled growth, the near-term prospect remain bright for Japan. We expect full-year GDP growth for Japan to come in at 2.0 percent this year and closer to 2.4 percent in 2014.

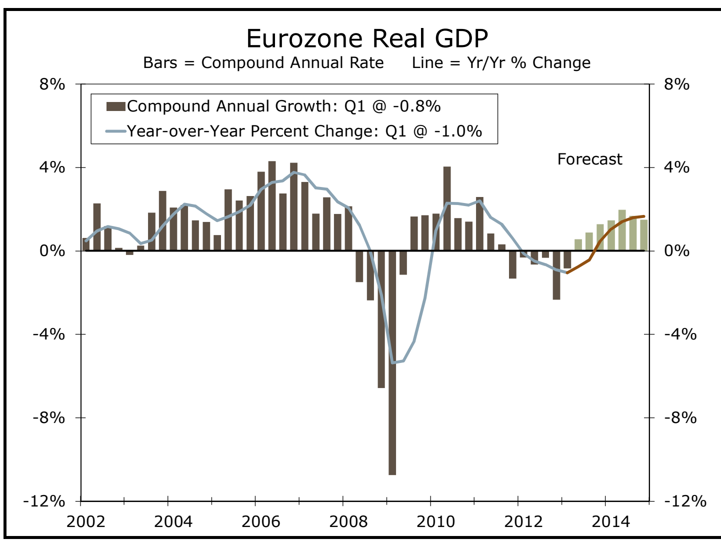
A return to growth in the Eurozone has been more elusive, although the level of German GDP now exceeds its pre-recession level. The German economy, for example, is 1.3 percent larger today than it was at its 2008 peak. We look for the broader Eurozone economy to return to growth mode in the second half of the year. But even with positive GDP numbers, the Eurozone economy is a long way from being "fixed." Sovereign debt worries and fiscal budget imbalances will serve as a governor on the pace of growth in the Eurozone for the foreseeable future.

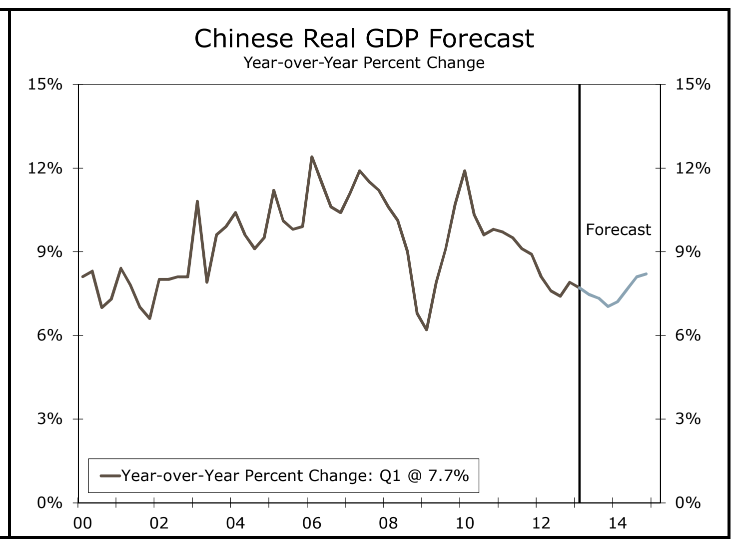
So What Does This Mean for Emerging Markets?

China's rise over the past decade has been fueled to some extent by exporting goods to the United Stated and Europe among other places. As growth has cooled in these developed economies, China has been transitioning to a more domestic-demand driven economy. We look for the year-over-year rate of growth in China to come in around the 7 to 8 percent range over the next year and a half. Although this is certainly slower than the torrid double-digit growth achieved a few years ago, it is more sustainable, especially given the shifting drivers of Chinese economic growth.

The relatively slower pace of Chinese economic growth has knock-on effect throughout the rest of the developing world. Many Latin American countries which provide some of the raw materials to support China's growth have seen slower growth in recent years. Brazil's economy is still suffering through a period of weak growth and high inflation. We forecast full-year GDP growth in Brazil of 2.1 percent this year before picking up to 2.4 percent in 2014. That is a far cry from the more than 6 percent growth rate seen in the 2007—2008 period.

The bottom line for the global outlook is that we see full-year global growth of 2.9 percent this year before picking up to 3.7 percent in 2014.





Source: IHS Global Insight, Bloomberg LP 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)	3.2%	2.9%	3.7%	3.9%	3.9%	4.2%
Global (Market Exchange Rates)	2.5%	1.9%	2.2%	n/a	n/a	n/a
Advanced Economies[1]	1.2%	1.1%	2.1%	2.0%	1.3%	1.9%
United States	2.2%	1.7%	2.4%	2.1%	1.4%	2.3%
Eurozone	-0.5%	-0.5%	1.4%	2.5%	1.5%	1.7%
United Kingdom	0.2%	1.1%	2.2%	2.8%	2.5%	2.2%
Japan	1.9%	2.0%	2.4%	0.0%	0.1%	1.5%
Korea	2.0%	2.3%	3.5%	2.2%	1.4%	2.9%
Canada	1.7%	1.7%	2.3%	1.5%	1.0%	1.8%
Developing Economies[1]	5.1%	4.7%	5.3%	5.9%	6.6%	6.4%
China	7.7%	7.4%	7.8%	2.7%	2.5%	2.7%
India	5.0%	5.5%	6.2%	9.7%	9.6%	8.7%
Mexico	3.9%	2.0%	3.1%	4.1%	4.5%	5.1%
Brazil	0.9%	2.1%	2.4%	5.4%	6.5%	5.8%
Russia	3.4%	2.6%	3.5%	5.1%	6.7%	5.7%

Forecast as of: July 10, 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			
	Q3	Q4	Q1	Q2	Q3	Q4	Q3	Q4	Q1	Q2	Q3	Q4
U.S.	0.25%	0.25%	0.25%	0.25%	0.30%	0.30%	2.60%	2.70%	2.90%	3.00%	3.20%	3.40%
Japan	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.85%	0.90%	1.00%	1.05%	1.10%	1.20%
Euroland*	0.10%	0.10%	0.10%	0.10%	0.15%	0.20%	1.65%	1.75%	1.90%	2.00%	2.15%	2.30%
U.K.	0.50%	0.50%	0.50%	0.55%	0.55%	0.60%	2.30%	2.50%	2.80%	3.00%	3.20%	3.25%
Canada	1.15%	1.25%	1.40%	1.50%	1.75%	2.00%	2.40%	2.75%	3.00%	3.20%	3.30%	3.40%

Forecast as of: July 10, 2013

*10-year German Government Bond Yield

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

Wells Fargo Securities, LLC Economics Group

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