

Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Despite Falling Energy Prices, Inflation Hangs in There

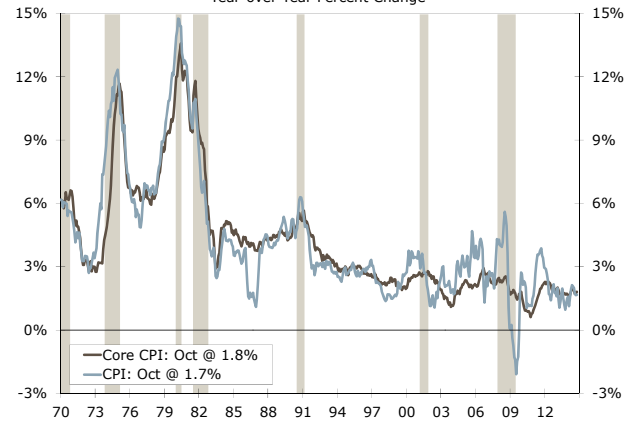
- Headline inflation continues to be held down by falling energy prices. Core prices, however, are inching up and look to be stable on a year-ago basis.
- Industrial production disappointed in October as it slipped 0.1 percent. Weakness was concentrated in the utilities and mining industries. Manufacturing output, which accounts for about three-fourths of industrial activity, rose 0.2 percent.
- The housing recovery continued to progress in October. Although starts fell slightly, permitting activity rose to a six-year high.

Global Review

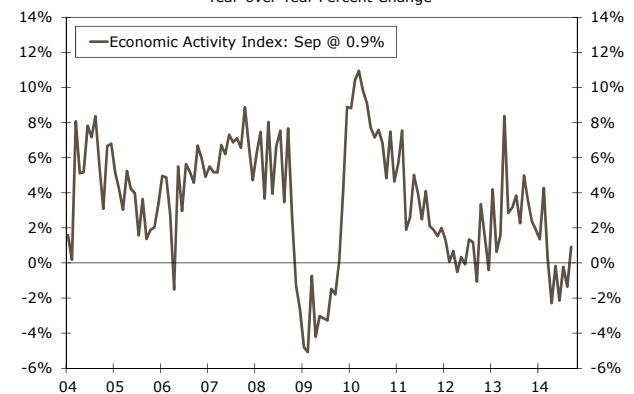
Has Latin America Hit the Bottom of this Cycle?

- The numbers coming out of Latin America are not great, and economic policy in the region could continue to prevent those economies from improving any time soon. However, there are some signs that the worst of this economic cycle affecting the region seems to be over, at least for now.
- The Latin American region is not booming and we are expecting growth to be limited. Furthermore, Argentina and Venezuela are expected to remain in recession into next year. However, we believe that the rest of the region may start to experience stronger growth, although the extent of that pick-up may be limited.

Headline CPI vs. "Core" CPI
Year-over-Year Percent Change



Brazilian Economic Activity Index
Year-over-Year Percent Change



Wells Fargo U.S. Economic Forecast													
	Actual				Forecast				Actual		Forecast		
	2014				2015				2012	2013	2014	2015	2016
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product ¹	-2.1	4.6	3.5	1.6	2.4	2.6	2.8	2.9	2.3	2.2	2.2	2.7	3.0
Personal Consumption	1.2	2.5	1.8	2.5	2.5	2.6	2.5	2.6	1.8	2.4	2.2	2.4	2.6
Inflation Indicators ²													
PCE Deflator	1.1	1.6	1.5	1.4	1.4	1.3	1.5	1.9	1.8	1.2	1.4	1.5	2.0
Consumer Price Index	1.4	2.1	1.8	1.5	1.5	1.3	1.6	2.2	2.1	1.5	1.7	1.7	2.4
Industrial Production ¹	3.9	5.5	3.2	5.9	5.0	4.9	4.9	4.9	3.8	2.9	4.1	5.0	4.2
Corporate Profits Before Taxes ²	-4.8	0.1	3.8	4.0	4.1	4.2	4.4	4.5	11.4	4.2	0.9	4.3	3.4
Trade Weighted Dollar Index ³	76.9	75.9	81.3	82.5	83.0	83.8	84.5	85.5	73.5	75.9	79.1	84.2	87.2
Unemployment Rate	6.7	6.2	6.1	5.8	5.7	5.6	5.5	5.4	8.1	7.4	6.2	5.6	5.2
Housing Starts ⁴	0.93	0.99	1.02	1.00	1.06	1.13	1.21	1.24	0.78	0.92	1.01	1.16	1.26
Quarter-End Interest Rates ⁵													
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	0.25	0.25	0.25	0.63	2.00
Conventional Mortgage Rate	4.34	4.16	4.16	4.26	4.31	4.44	4.46	4.62	3.66	3.98	4.23	4.46	5.32
10 Year Note	2.73	2.53	2.52	2.45	2.50	2.71	2.79	2.86	1.80	2.35	2.56	2.71	3.40

Forecast as of: November 12, 2014

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

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Together we'll go far



U.S. Review

Despite Falling Energy Prices, Inflation Hangs in There

Inflation has taken center-stage of late now that concerns are beginning to ease the state of the labor market. This week inflation data showed that while hardly robust, weaker price growth seems to primarily stem from falling energy prices. The PPI for final demand unexpectedly rose in October. The 0.2 percent gain, however, was overstated by a 1.5 percent rise in trade services, a new component of PPI that measures margins instead of selling prices. Excluding food, energy and trade services, prices ticked up 0.1 percent and are up 1.6 percent over the past year, just ahead of headline PPI. Meanwhile, the more reliable CPI showed consumer prices were unchanged over the month. Falling energy costs were offset by a rise in food and core services, which have been driving overall inflation higher over the past year. Although goods prices ex-food and energy were flat in October, the core index rose 0.2 percent on increasing shelter, transportation, medical, recreation and personal services. The upticks in the core measures of PPI and CPI last month allay fears of a broad softening inflation.

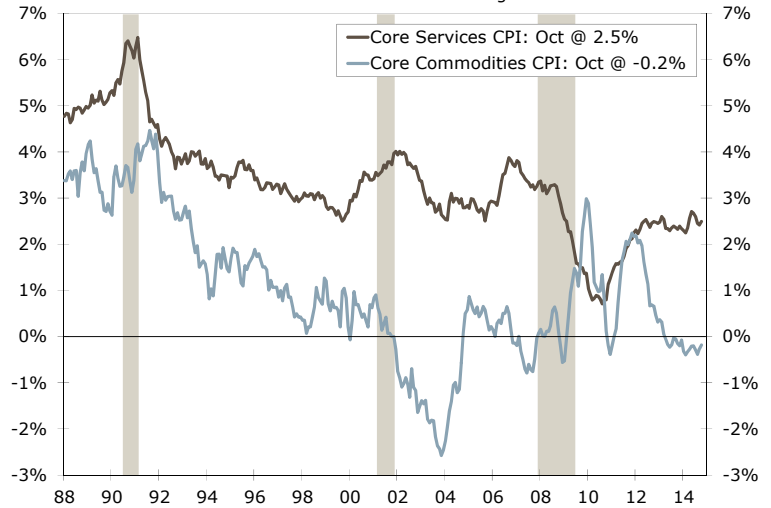
U.S. Factory Sector Shaking Off Global Slowdown

The manufacturing sector would likely be the first place where the effects of slower global growth would creep into the U.S. economy, but, thus far, the factory sector has held up in the face of headwinds. Industrial production slipped 0.1 percent in October, but the drop was attributable to falling utilities output and lower mining production. Manufacturing production rose 0.2 percent. Gains were broad based outside of motor vehicles production, which has been distorted in recent months due to changes in the timing of seasonal shutdowns. Over the past year, manufacturing production has advanced a respectable 3.7 percent. Gains look set to continue, with the first of the November regional purchasing managers' indices strengthening. The New York Fed's Empire index rose four points and the Philadelphia Fed's manufacturing index surged to a 21-year high. While the separately derived headline in the Philly Fed survey can sometimes look unsupported by sub-indices, details also broadly strengthened and the forward-looking new orders index rose to a 27-year high.

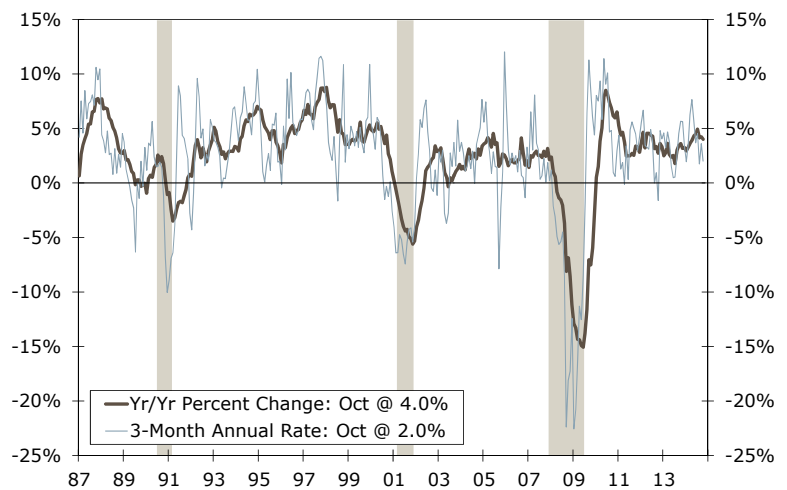
Housing Continues to Slowly Recover

After a disappointing first half of the year, the housing sector's recovery is back on track, albeit the slow track. Existing home sales rose more than expected in October and are now back above year-ago levels. The median price slipped heading into the quieter part of the selling season, but is up 5.5 percent from a year earlier. Housing construction also appears to be picking up. Although starts fell 2.8 percent in October, the drop stemmed from the volatile multifamily component. Single-family starts increased 4.2 percent and are now up 15.4 percent over the past year. Momentum for new construction looks favorable heading into the final months of the year. The NAHB/Wells Fargo Housing Market Index rose more than expected in November to 58. Present and future sales improved alongside prospective buyers' traffic.

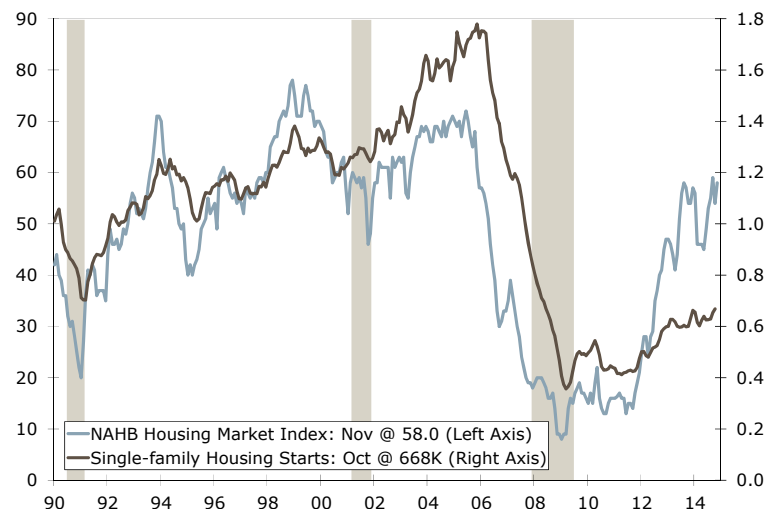
Core Commodities vs. Core Services
Year-over-Year Percent Change



Total Industrial Production Growth
Output Growth by Volume



Builder Confidence & Single-Family Starts
Diffusion Index; Starts SAAR In Millions, 3-MMA



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

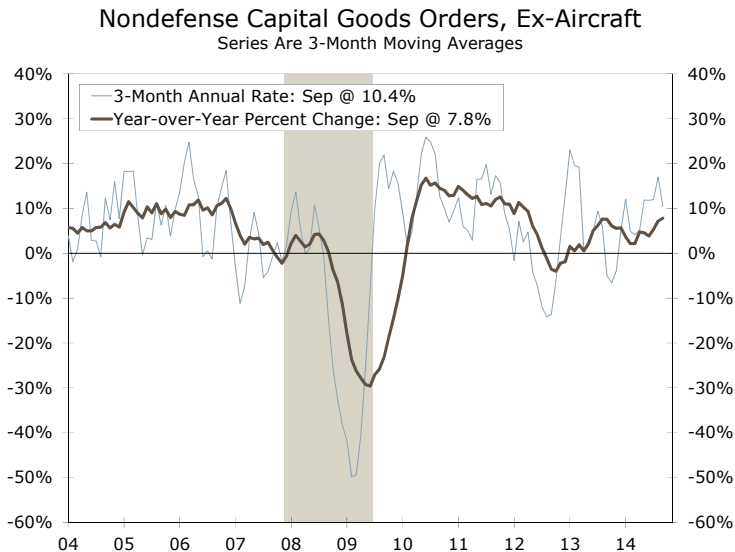
Consumer Confidence • Tuesday

Consumer confidence jumped to 94.5 in October, the highest level since 2007. While the present situation and future expectations components improved, future expectations posted the largest improvement. The continued improvement in labor market conditions, particularly an unemployment rate below 6 percent, boosted consumers' outlook for future job growth. Consumers also reported that their expectations for business conditions and income growth rose for the month. The sizable jump in confidence even in light of financial market volatility and the Ebola scare sets the tone for consumer spending as we enter the holiday shopping season. Our expectation is that consumer confidence rose again in November to 98.6 from October's level. With continued gains in consumer confidence, we remain optimistic about consumer spending growth in Q4.

Previous: 94.5

Wells Fargo: 98.6

Consensus: 96.0



Personal Income & Spending • Wednesday

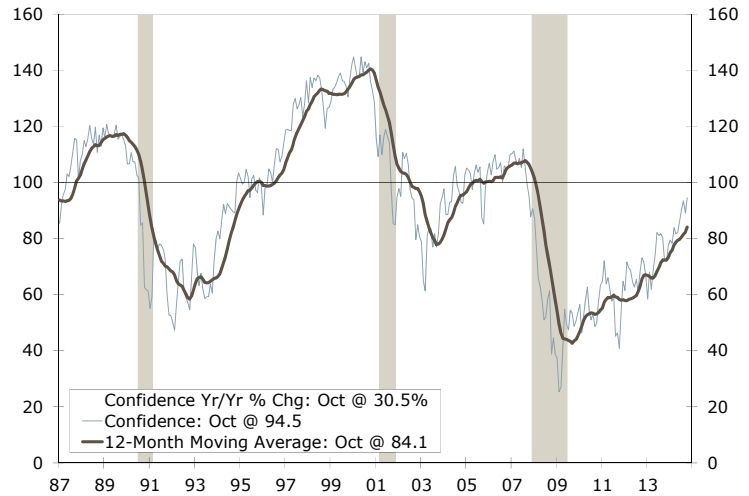
Personal income rose 0.2 percent in September driven higher by a 0.2 percent increase in wages and salaries. Disposable income growth rose a slight 0.1 percent for the month; however, after adjusting for inflation, real disposable income growth was flat for the month. Real personal spending declined 0.2 percent for the month to a 1.8 percent three-month annualized rate. Inflation, as measured by the PCE deflator, remained modest, rising 1.4 percent on a year-over-year basis. October will mark the first reading of consumer spending in Q4. We expect that personal income will post a 0.4 percent increase for October and personal spending likely rose 0.4 percent. The solid retail sales report for October provides some evidence that consumer spending in Q4 should remain healthy. Our expectation is that real consumer spending will rise 2.5 percent in Q4 as lower oil prices help support real spending activity.

Previous: 0.2% (PI)

Wells Fargo: 0.4%

Consensus: 0.4%

Consumer Confidence Index
Conference Board



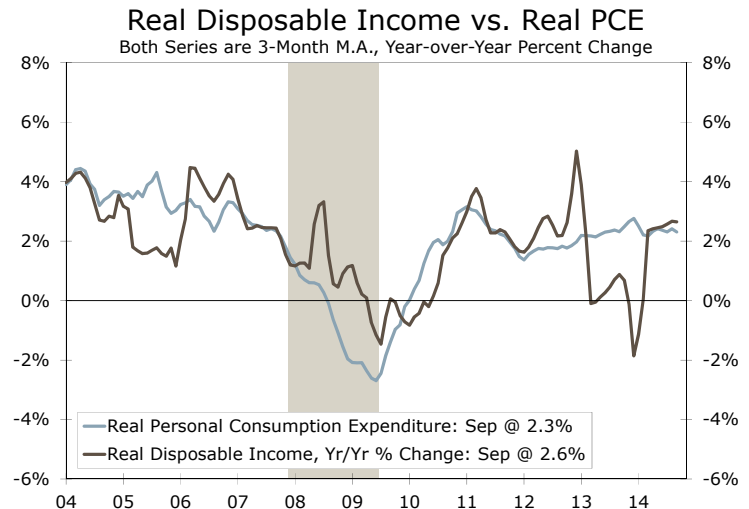
Durable Goods Orders • Wednesday

Durable goods orders fell 1.1 percent in September as a sharp pullback in the transportation component pulled the headline reading lower. Nondefense capital goods orders excluding aircraft posted a 1.7 percent decline for the month, which indicated that the pullback was more widespread than just transportation goods. Outside of transportation, declines in orders occurred for computers and electronics and machinery goods. Shipments of core capital goods remain fairly robust, rising 0.5 percent for the month, taking the three-month moving average up to 11.1 percent. Our expectation is that durable goods orders will likely pull back again in October, declining 0.1 percent for the month. Excluding transportation goods, we estimate that orders rose 0.4 percent. With two months of weakness in durable goods orders, some downside risks to equipment spending in Q4 have emerged.

Previous: -1.1%

Wells Fargo: -0.1%

Consensus: -0.6% (Month-over-Month)



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

Global Review

Has Latin America Hit the Bottom of this Cycle?

The numbers coming out of Latin America are not great, and economic policy in the region could continue to prevent those economies from improving any time soon. However, there are some signs that the worst of this economic cycle affecting the region seems to be over, at least for now. For starters, the largest economy of the region, Brazil, posted its first positive year-over-year rate in six months for its monthly economic activity index in September, up 0.9 percent compared to a decline of 1.35 percent in August. On a month-over-month basis, the 0.4 percent improvement in September was the third-consecutive positive reading, which is also a good sign. Granted, this improvement could be related to the “political cycle” as the deterioration in the Brazilian government’s fiscal accounts has shown. Thus, the improvement could fizzle in the coming months.

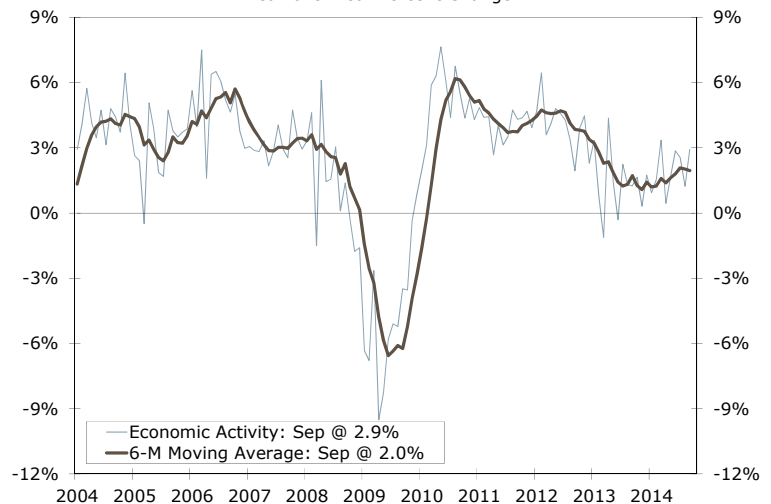
However, better news is not only limited to the Brazilian economy. Although the Mexican economy is not doing great, economic growth has not deteriorated and is expected to improve in the coming quarters. In Chile, although the month-over-month economic activity index fell 0.2 percent in September, the year-over-year rate improved to 1.5 percent, compared to just 0.3 percent in August. Colombia’s vehicle sales, exports, retail sales and industrial production all rose in September, which should keep the economy relatively strong going into the last quarter of the year. Meanwhile, the Peruvian economy, the other bright spot in the region for the past several years, saw a marked improvement on its monthly GDP index, which grew 2.7 percent in September on a year-over-year basis. This is compared to a 1.3 percent rate in both August and July, which was already a vast improvement compared to the 0.3 percent rate recorded in June. The bottom line is that economic activity is starting to gain steam.

The Latin American region is not booming and we are expecting growth to be limited. Furthermore, Argentina and Venezuela are expected to remain in recession into next year. However, we believe that the rest of the region may start to experience stronger growth, although the extent of that pick-up may be limited.

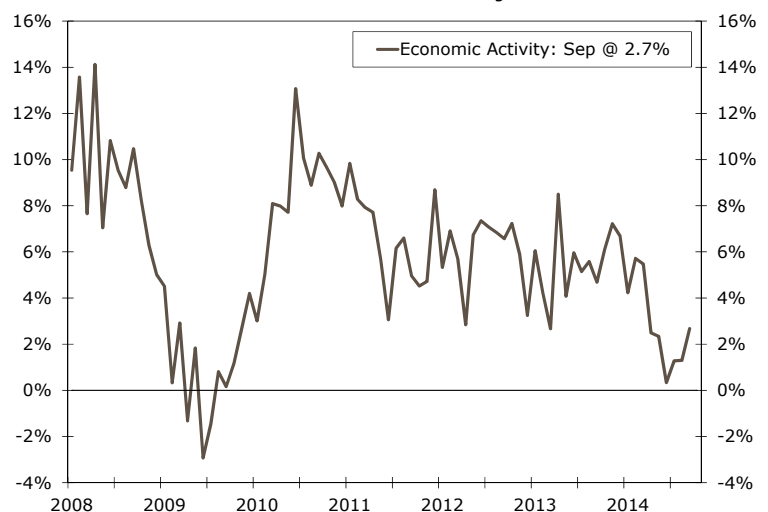
Japanese Economy Struggles to Grow Again

The week started on a down note as Japan reported a new bump in the road for Abenomics, with the economy slumping into recession once again. However, much of the weakness in economic activity was a draw-down of inventories, which should improve the prospects for the next several quarters. Furthermore, the call for a snap election of the parliament, which is a risky move for Prime Minister Abe, if successful, could give him the necessary reassurance to push forward with his reform process, but especially with the structural reforms. With this result, the expected increase in the sales tax next year is off the economic policy table and markets will have to concentrate on the results of the election to gauge how much more Abe can do to push forward with structural reforms. For the global economy, the fact that the Japanese economy represents about 4 percent of global GDP may help to put the Japanese economy’s struggles in perspective.

Mexican Economic Activity Index
Year-over-Year Percent Change

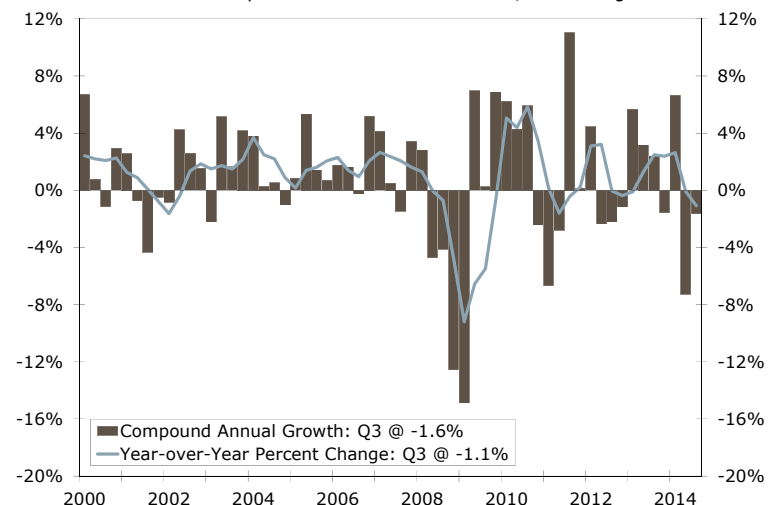


Peru Economic Activity Index
Year-over-Year Percent Change



Japanese Real GDP

Bars = Compound Annual Rate Line = Yr/Yr % Change



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

Japan CPI • Friday

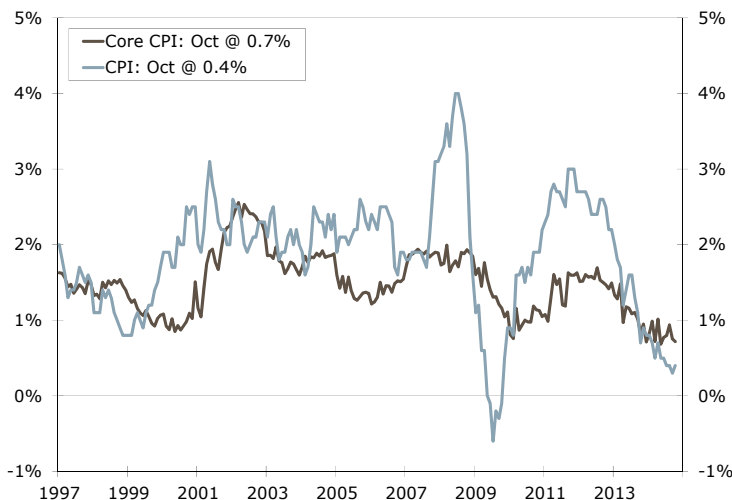
The Bank of Japan's (BoJ) expansionary monetary policy known as Quantitative and Qualitative Easing (QQE) is geared toward guiding Japanese CPI inflation toward a target of 2.0 percent. On the last day of October, the BoJ kicked the QQE into higher gear by lifting the annualized rate of monetary base expansion to ¥80 trillion from a range of ¥60 trillion-¥70 trillion previously. News of the faster pace of easing came prior to the release of Japan's disappointing Q3 GDP figures. So the rationale for the maneuver is not immediately clear, although to some extent it can be seen as a way to try to make the hard won gains in creating CPI inflation more permanent, as the short-term effects of the April consumption tax hike begin to fade. CPI numbers for October hit the wire on Friday of next week.

Previous: 3.2% (Year-over-Year) Wells Fargo: 3.0%

Consensus: 3.0%

Eurozone Consumer Price Inflation

Year-over-Year Percent Change



Canadian GDP • Friday

Monthly GDP figures for the Canadian economy in July and August were not particularly strong with gains of just 0.1 percent in each of those two months. On Friday of next week, financial markets will get the first look at September GDP numbers as well as overall GDP growth for Q3.

Second-quarter GDP growth was driven primarily by consumer spending, but given the stretched balance sheets of the Canadian consumer we do not expect consumer outlays to continue to be a major growth driver. Retail sales fell in July and August. The Bank of Canada has been talking about a rotation to exports and business spending. Stronger growth in the United States and high readings from the Ivey PMI suggest that might be possible. We will find out when Canadian GDP prints on Friday morning.

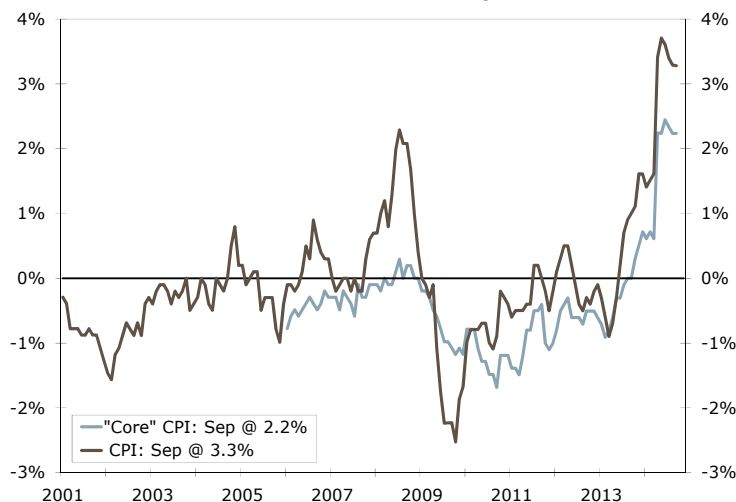
Previous: 3.6% (CAGR)

Wells Fargo: 2.0%

Consensus: 2.1%

Japanese Consumer Price Index

Year-over-Year Percent Change



Eurozone CPI • Friday

Since 2011, the year-over-year rate of CPI inflation has been trending lower and since October 2013, it has been below 1 percent—well below the ECB's target of 2 percent.

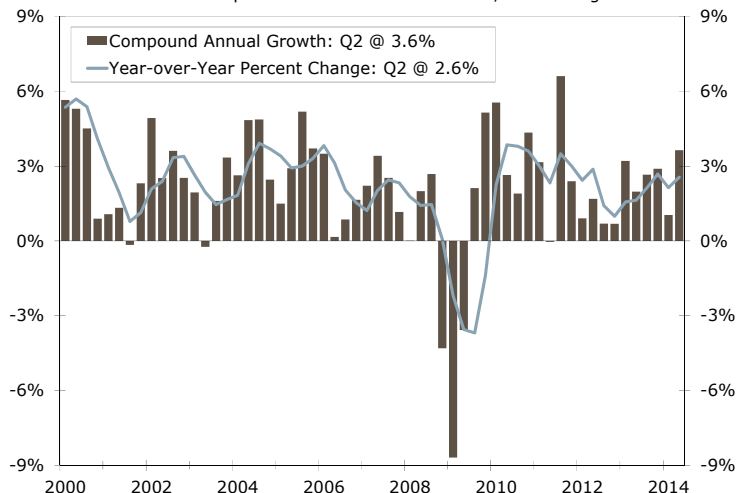
A lack of robust bank lending has been cited as one reason for the slack in consumer prices, and the ECB has struggled with getting banks to lend in Europe. The latest policy initiative (the TLTRO) involves preferred borrowing rates from the ECB for European banks that can demonstrate they are growing their loan portfolio. The first iteration of this program was in September and so far the take-up rate by banks has not been enough to move the needle much on inflation. The year-over-year rate of CPI inflation was just 0.4 percent in October. The first estimate of November CPI hits the wire on Friday.

Previous: 0.4% (Year-over-Year) Wells Fargo: 0.3%

Consensus: 0.3%

Canadian Real GDP

Bars = Compound Annual Rate Line = Yr/Yr % Change



Source: IHS Global Insight and Wells Fargo Securities, LLC

Interest Rate Watch

FOMC October Minutes—Concern about Lower Inflation Expectations

One message that came through from the FOMC's minutes of the Oct. 28-29 meeting is a greater concern about a downward shift in inflation expectations. Moreover, the FOMC found the use of the phrase "considerable time" to be an advantage. At the time of the meeting, the FOMC saw a limited global impact on the U.S. economy—but that was before the surprise negative GDP report from Japan. Net, we expect that some analysts will drop their expectations of a March Fed funds increase. We are sticking with June 2015 for the first move and retain the view that the FOMC will raise rates more gradually than projected by the end of 2015.

From our reading of the minutes, the most significant shift was the elevation of lower inflation expectations, as a benchmark for decision making. At this point, the Fed's bias appears to be that inflation expectations five years ahead had declined over the intermeeting period (top graph).

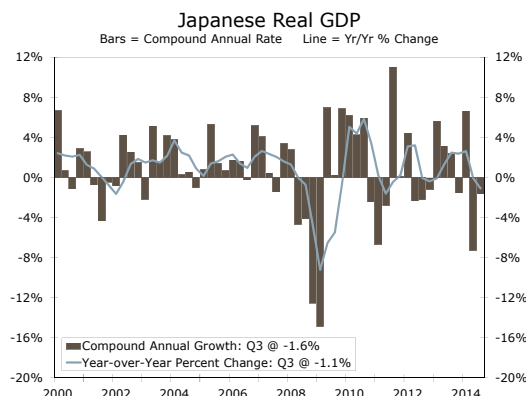
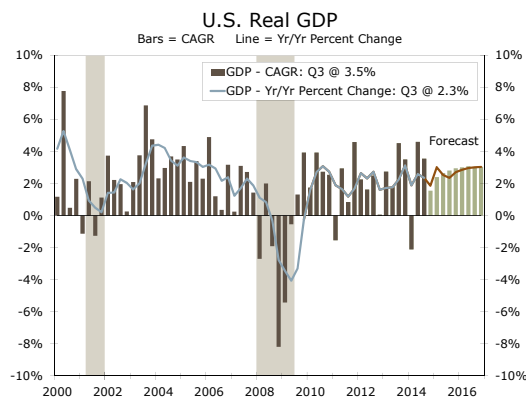
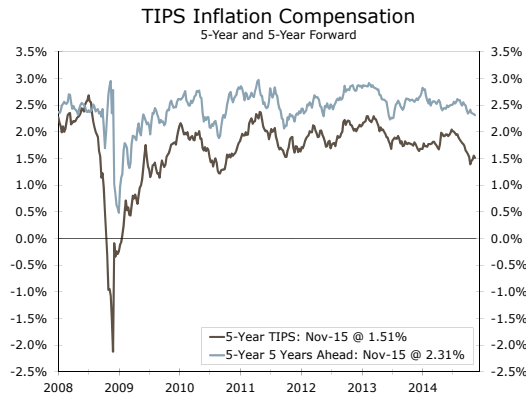
"Most participants anticipated that inflation was likely to edge lower in the near term, reflecting the decline in oil and other commodity prices and lower import prices." If this drop in current prices becomes imbedded into long-term inflation expectations then the FOMC will likely postpone any rate increase.

"Considerable Time" Remains

At this point, "most meeting participants viewed the information received over the intermeeting period as suggesting that economic activity continued to expand at a moderate pace (middle graph)." We agree. The pace of economic growth and the lower unemployment rate do not appear to be the critical element in altering FOMC policy—that remains the outlook for inflation.

"Limited Global Impact"

Well, that was before the Japanese reported a second-consecutive quarter of negative GDP (bottom graph). This development now calls for further BoJ policy easing and a weaker yen versus the dollar. In this case, the FOMC is less likely to raise the funds rate in the near term until the dust settles.



Source: U.S. Dept. of Commerce, IHS Global Insight, Bloomberg LP and Wells Fargo Securities, LLC

Credit Market Insights

Credit Is Playing Hard to Get

Recent data from the Mortgage Bankers Association indicates that lending standards for mortgages have tightened over the past month. The Mortgage Credit Availability Index (MCAI) declined 2.5 percent on a month-over-month basis to 113.2 in October. This index was benchmarked at 100 in March 2012, indicating that over the past two and a half years mortgage lending has eased 13.2 percent.

The MCAI can be broken into two subcomponents—conventional mortgages and government loan programs. While the government MCAI declined only one percent in October to 246, the conventional mortgage MCAI declined 5 percent to 80.9. While both series have improved over the past few years, lending standards for government-sponsored programs remain substantially easier than for conventional mortgages.

Demand for mortgages still appears to be strengthening, however, as mortgage applications rose in the first two weeks of November and remain at their highest level since June. Continued improvement in the labor market should drive this trend.

Despite tighter lending standards, the housing sector still appears to be improving at a modest pace. Existing home sales rose on the month while prior data were upwardly revised. The headline reading for housing starts fell; however, the entire drop was in the multifamily sector. Excluding the multifamily sector, single-family housing starts rose 4.2 percent for the month.

Credit Market Data

Mortgage Rates

	Current	Week Ago	4 Weeks Ago	Year Ago
30-Yr Fixed	3.99%	4.01%	3.98%	4.22%
15-Yr Fixed	3.17%	3.20%	3.13%	3.27%
5/1 ARM	3.01%	3.02%	2.94%	2.95%
1-Yr ARM	2.44%	2.43%	2.43%	2.61%

Bank Lending

	Current Assets (Billions)	1-Week Change (SAAR)	4-Week Change (SAAR)	Year-Ago Change
Commercial & Industrial	\$1,743.7	-7.77%	4.92%	12.23%
Revolving Home Equity	\$459.5	-2.49%	-0.31%	-3.92%
Residential Mortgages	\$1,563.2	-22.86%	-5.25%	0.47%
Commercial Real Estate	\$1,581.6	-1.66%	4.07%	6.66%
Consumer	\$1,195.3	5.66%	6.07%	3.79%

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

Topic of the Week

2014 Holiday Sales Outlook

Better economic news has characterized the consumer landscape in recent months. The unemployment rate declined to 5.8 percent in October, and consumer confidence rose to 94.5, up from just 72.4 a year earlier (top chart). Furthermore, a sharp decline in gasoline prices has freed up more disposable income for households, which is likely to be a boon for consumer spending in the coming holiday season.

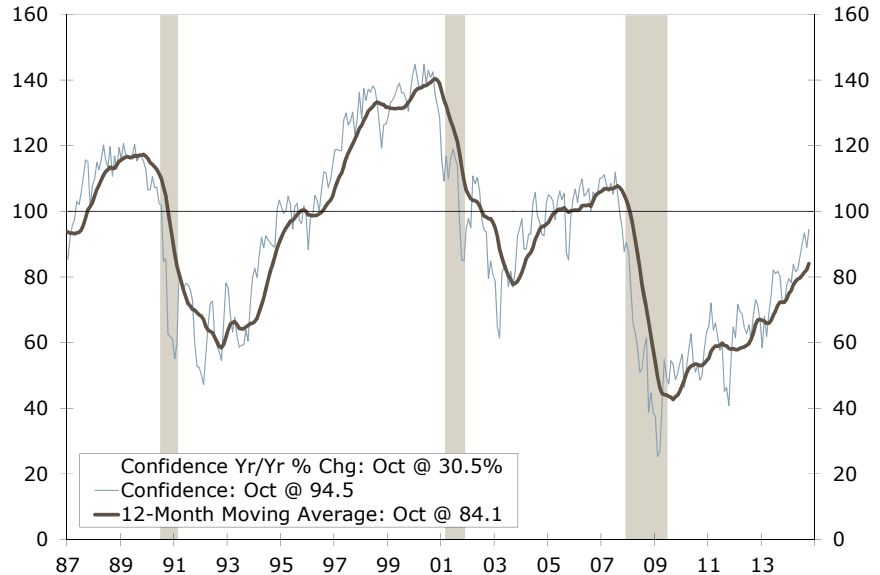
Our expectation is that holiday sales, defined as retail sales less sales of autos, sales at gas stations and restaurant sales in November and December, will rise 3.9 percent over last year's levels, slightly below the National Retail Federation's (NRF) projected 4.1 percent increase (bottom chart). This would mark a stronger rate of growth than the 3.3 percent year-ago pace registered last holiday season. In addition to the more robust pace of holiday sales, spending per person also looks like it will be stronger this year. According to the NRF's holiday spending survey, the average holiday shopper is expected to spend \$804.42 this year compared with \$767.42 last year, an increase of 4.8 percent. Consumer confidence was one of the key factors weighing on consumer spending growth last year, as fiscal policy added a great deal of uncertainty to consumers' outlook. This year, however, robust job growth, lower gasoline prices, and higher equity prices have turned consumer confidence into a key tailwind for our holiday sales outlook.

While sales growth should be slightly stronger this year over last year, consumer spending will likely remain restrained, consistent with prior years following the recession. Consumer personal income growth over the past year has modestly improved and revolving consumer credit has shown decent growth, but both remained constrained. We expect real consumer spending growth of around 2.5 percent on a sequential basis in the next few quarters.

For further reading, see our report *2014 Holiday Sales Outlook*, available on our website.

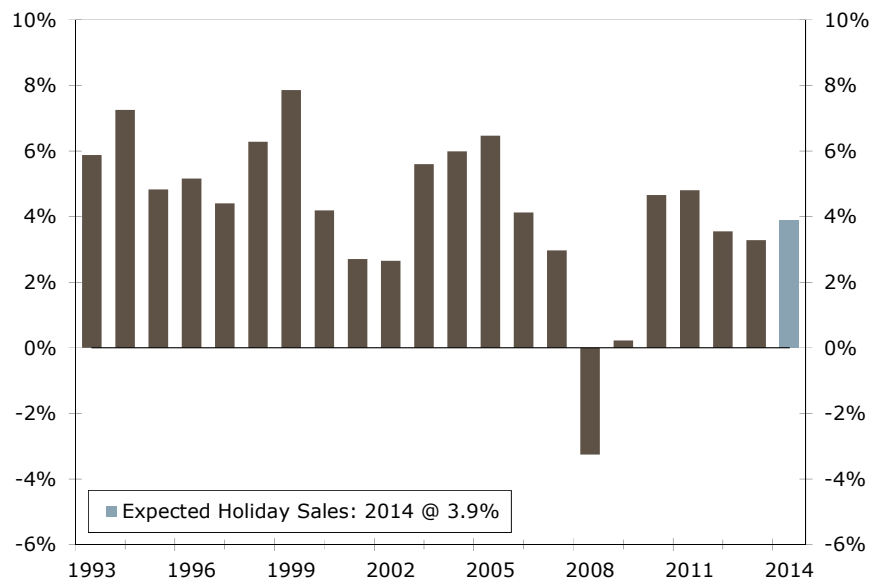
Consumer Confidence Index

Conference Board



Wells Fargo Holiday Sales Forecast

Year-over-Year Percent Change for November & December



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

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 11/21/2014	1 Week Ago	1 Year Ago
3-Month T-Bill	0.00	0.01	0.07
3-Month LIBOR	0.23	0.23	0.24
1-Year Treasury	0.16	0.17	0.12
2-Year Treasury	0.51	0.51	0.27
5-Year Treasury	1.62	1.61	1.36
10-Year Treasury	2.32	2.32	2.78
30-Year Treasury	3.04	3.05	3.89
Bond Buyer Index	3.93	3.98	4.60

Foreign Exchange Rates

	Friday 11/21/2014	1 Week Ago	1 Year Ago
Euro (\$/€)	1.243	1.253	1.348
British Pound (\$/£)	1.566	1.567	1.620
British Pound (£/€)	0.794	0.799	0.832
Japanese Yen (¥/\$)	117.790	116.290	101.160
Canadian Dollar (C\$/ \$)	1.124	1.129	1.052
Swiss Franc (CHF/\$)	0.967	0.959	0.913
Australian Dollar (US\$/A\$)	0.870	0.875	0.923
Mexican Peso (MXN/\$)	13.608	13.535	13.028
Chinese Yuan (CNY/\$)	6.125	6.130	6.093
Indian Rupee (INR/\$)	61.775	61.721	62.940
Brazilian Real (BRL/\$)	2.535	2.602	2.305
U.S. Dollar Index	88.158	87.525	81.073

Source: Bloomberg LP and Wells Fargo Securities, LLC

Foreign Interest Rates

	Friday 11/21/2014	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.06	0.06	0.17
3-Month Sterling LIBOR	0.56	0.56	0.52
3-Month Canada Banker's Acceptance	1.28	1.28	1.28
3-Month Yen LIBOR	0.10	0.11	0.14
2-Year German	-0.04	-0.04	0.10
2-Year U.K.	0.54	0.57	0.45
2-Year Canadian	1.07	1.01	1.11
2-Year Japanese	0.01	0.01	0.09
10-Year German	0.77	0.79	1.74
10-Year U.K.	2.05	2.12	2.82
10-Year Canadian	2.02	2.03	2.62
10-Year Japanese	0.46	0.48	0.63

Commodity Prices

	Friday 11/21/2014	1 Week Ago	1 Year Ago
WTI Crude (\$/Barrel)	76.27	75.82	95.44
Gold (\$/Ounce)	1203.87	1188.75	1243.08
Hot-Rolled Steel (\$/S.Ton)	634.00	632.00	668.00
Copper (¢/Pound)	306.10	304.65	319.15
Soybeans (\$/Bushel)	10.11	10.49	12.81
Natural Gas (\$/MMBTU)	4.32	4.02	3.70
Nickel (\$/Metric Ton)	16,306	15,342	13,460
CRB Spot Inds.	502.93	506.21	519.45

Next Week's Economic Calendar

	Monday 24	Tuesday 25	Wednesday 26	Thursday 27	Friday 28
U.S. Data		GDP (QoQ) Second Revision	Durable Goods Orders		
		3 Q 3.5 %	September -1.3 %		
		3 Q (Second Revision) 3.1 % (W)	October -0.1 % (W)		
		Consumer Confidence Index	Personal Income & Spending		
		October 94.5	September 0.2 % & -0.2 %		
		November 98.6 (W)	October 0.4 % & 0.4 % (W)		
Global Data			United Kingdom	Germany	Japan
			GDP (QoQ)	Unemployment Rate	CPI (YoY)
			Previous (2 Q) 0.7 %	Previous (October) 6.7 %	Previous (September) 3.2 %
					Eurozone
					CPI (YoY)
					Previous (October) 0.4 %

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

Source: Bloomberg LP and Wells Fargo Securities, LLC

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