July 2, 2010

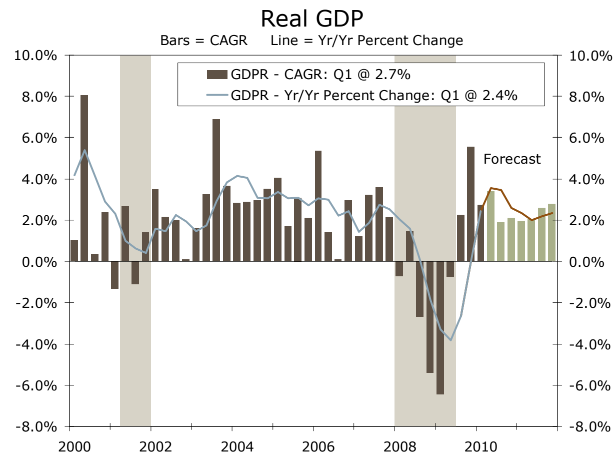
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

U.S. Economic Slowdown in Place: Still No Double Dip

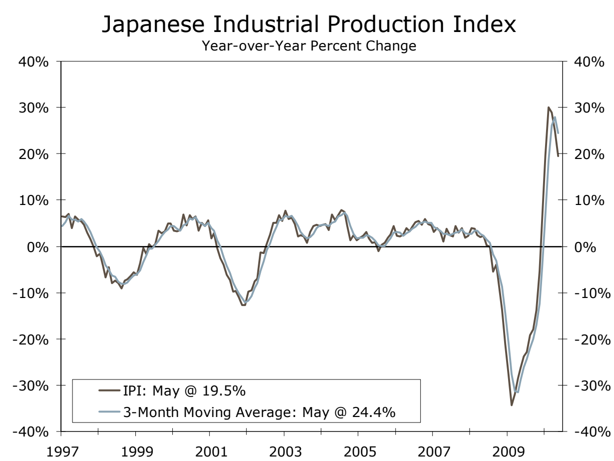
- With the release of the fourth quarter GDP numbers in January, we updated our outlook for 2010. Two themes were clear. First, growth was expected to slow post-stimulus in the second half. Second, unemployment rates were expected to remain high and job gains modest. This recovery pleases no one.
- Two themes were reinforced this week. First, the outlook differs from what many expected. Second, the economy is driven by both cyclical and structural forces. Growth continues but at a disappointing pace in ISM manufacturing, consumer spending and employment.



Global Review

Global Markets Feeling the Summer Heat

- This is shaping up to be anything but a calm and quiet summer for global financial markets. The recent G-20 meetings have intensified fears that policymakers will make mistakes, potentially throwing the global economic recovery off track.
- Driven primarily by domestic demand, Asia has been a strong leader of economic recovery. The pace of advance has been steady and robust since the second quarter of 2009. But recent economic data releases out of Asia point to a bumpier road ahead, just as doubts have arisen about the U.S. and European recoveries.



Inside

Wells Fargo U.S. Economic Forecast

	Actual 2009				Forecast 2010				Actual				Forecast	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2006	2007	2008	2009	2010	2011
Real Gross Domestic Product [1]	-6.4	-0.7	2.2	5.6	3.0	3.4	1.9	2.1	2.7	2.1	0.4	-2.4	3.0	2.2
Personal Consumption	0.6	-0.9	2.8	1.6	3.5	3.2	1.6	2.2	2.9	2.6	-0.2	-0.6	2.4	2.1
Inflation Indicators [2]														
"Core" PCE Deflator	1.7	1.6	1.3	1.5	1.4	1.2	1.2	1.2	2.3	2.4	2.4	1.5	1.3	1.6
Consumer Price Index	-0.2	-1.0	-1.6	1.5	2.4	1.9	1.0	0.7	3.2	2.9	3.8	-0.3	1.5	1.2
Industrial Production [1]	-19.0	-10.4	6.4	6.9	7.8	5.4	2.6	2.2	2.3	1.5	-2.2	-9.7	4.8	3.2
Corporate Profits Before Taxes [2]	-19.0	-12.6	-6.6	30.6	31.0	26.0	21.0	15.0	10.5	-4.1	-11.8	-3.8	22.7	7.2
Trade Weighted Dollar Index [3]	83.2	77.7	74.3	74.8	76.1	77.3	80.0	81.5	81.5	73.3	79.4	74.8	81.5	88.0
Unemployment Rate	8.2	9.3	9.6	10.0	9.7	9.8	10.0	10.0	4.6	4.6	5.8	9.3	9.9	9.6
Housing Starts [4]	0.53	0.54	0.59	0.56	0.62	0.59	0.56	0.62	1.81	1.34	0.90	0.55	0.60	0.84
Quarter-End Interest Rates														
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	5.25	4.25	0.25	0.25	0.25	2.00
Conventional Mortgage Rate	5.00	5.42	5.06	4.93	4.97	4.80	4.80	5.00	6.14	6.10	5.33	4.93	5.00	6.00
10 Year Note	2.71	3.53	3.31	3.85	3.84	3.20	3.20	3.40	4.71	4.04	2.25	3.85	3.40	4.40

Forecast as of: June 9, 2010
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change

U.S. Review

U.S. Economic Slowdown in Place: Still No Double Dip

Neither too hot (no boom) nor too cold (no double dip recession) appears to be the story for the second half of this year. But this is a recovery that pleases no one. Two themes in our outlook were reinforced by the data this week. First, certainly the pace of economic growth differs from what many had expected. Second, the pattern of the economy is driven by a mix of cyclical and structural forces that alters the behavior of the economy. For example, this week's ISM manufacturing release highlighted the slowdown thesis in the outlook. Production, employment and coincident components of the ISM index declined modestly in June suggesting that the economy has begun to slow.

New orders and supplier deliveries components of the ISM index declined suggesting slower growth going forward. Yet, the level of the overall index and its components hint slowdown, but not recession. All the major components are still in growth mode. Meanwhile, prices paid declined sharply suggesting less inflation pressure in the pipeline and no hurry at the Federal Reserve to raise rates. We do not expect any increase in the federal funds rate this year.

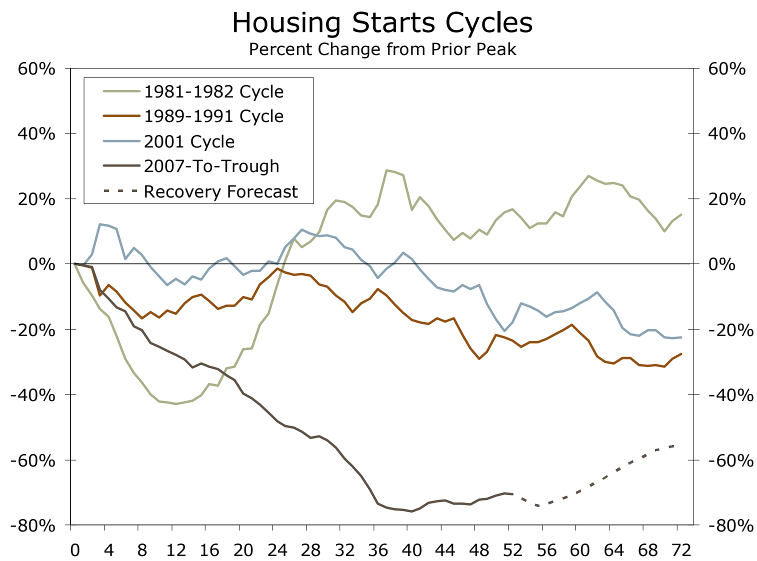
Meanwhile, employment and construction data released this week support the strange brew of cyclical and structural changes that are driving this recovery. Employment gains have been hampered by the uncertainty of future labor costs.

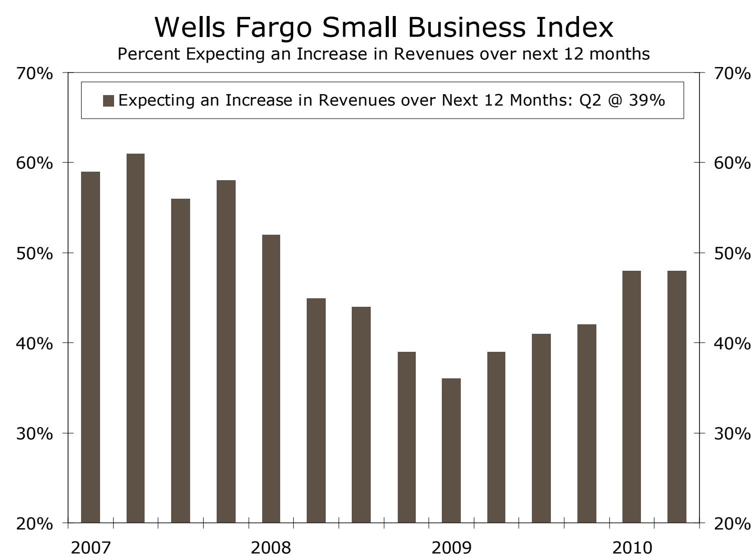
Private residential construction has improved in response to the cyclical stimulus of the first time home buyers' credit, but private non-residential construction is down more than 20 percent compared to a year-ago. Residential construction will add to second quarter GDP, but after the buyer credit expires we expect a slowdown. Our latest outlook still has private nonresidential construction declining for the rest of this year.

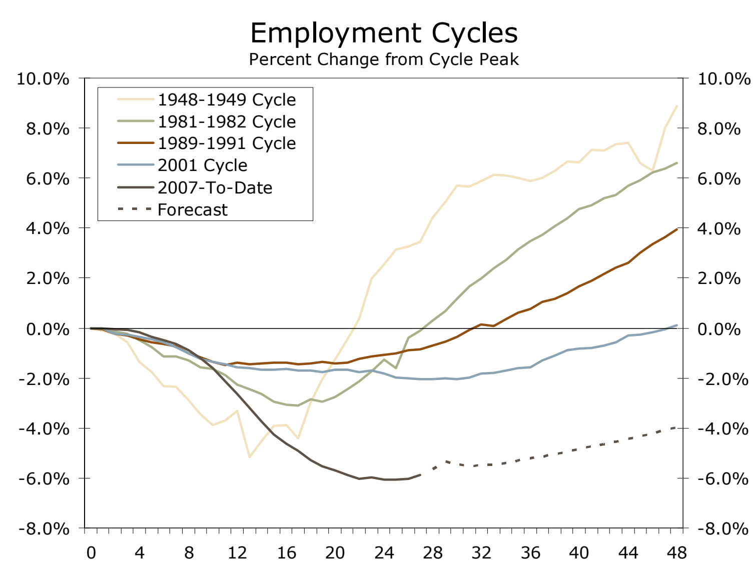
No Double Dip; Consumer Hangs in There

Along with business equipment spending the consumer remains the hope to keep the economy out of recession – although there is no boom here either. Over the last three months, real consumer spending is up 3.4 percent –not boom-like but enough to suggest that spending can continue going forward. One big positive has been the recent strength in wage and salary growth—up 4.4 percent over the last three months. Meanwhile, consumer price inflation remains very low. The core PCE deflator is up just 1.5 percent over the last three months and just 1.3 percent over the last year.

In contrast to earlier economic recoveries, there is no consumer boom. This week's consumer confidence survey provides some clues. Consumer confidence, measured by the Conference Board survey, declined sharply in June. Job growth, or the lack of it, remains a core economic and political issue. The jobs hard to get index rose while jobs plentiful fell. Meanwhile consumer intentions to buy an auto fell sharply, suggesting reduced consumer spending on durable goods ahead. Confidence fell across a number of regions and was not driven exclusively by attitudes of consumers near the Gulf of Mexico.





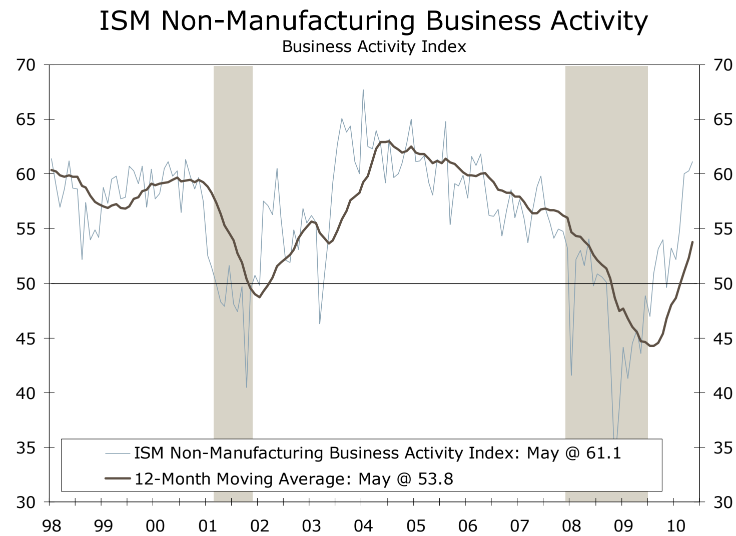


ISM Non-Manufacturing • Tuesday

ISM non-manufacturing remained unchanged in the last three months, but is well in expansionary territory at 55.4 in May. The business activity sub-index has increased in each of the past four months. Consistent with gains in private sector employment, the employment sub-index reached expansionary territory for the first time since the recession started in December 2007. While new orders continue to be expansionary at 57.1, we should see pullback in coming months as economic growth slows due to the draw-down in inventories and fading of stimulus. Consequently, we expect the headline composite index to drop modestly to 55.2.

Previous: 55.4 **Wells Fargo: 55.2**

Consensus: 55.0

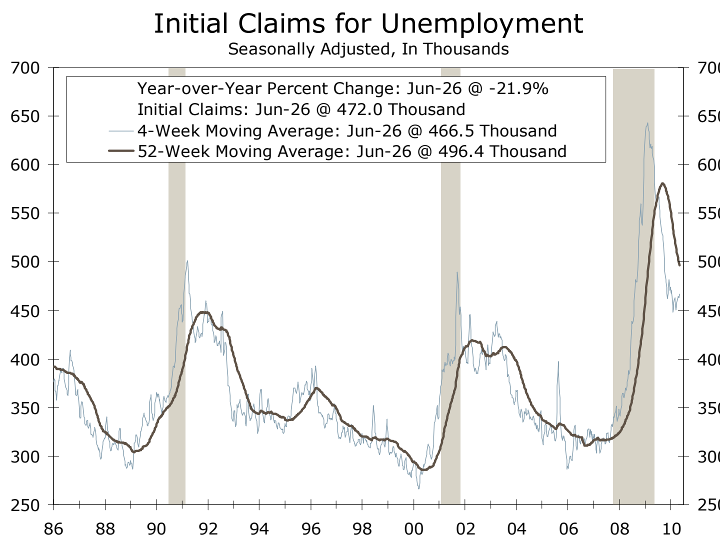


Initial Jobless Claims • Thursday

Initial jobless claims rose by 13,000 for the week ended June 26 to 472,000, remaining stubbornly above levels that would suggest sustainable employment growth. On a trend basis, the four-week moving average increased to 466,500. Claims have been trending around in the 450,000-480,000 range for months now, but we would like to see them slip back around the 350,000-400,000 level that has historically reflected a stronger labor market during an economic expansion. Recent increases in claims data, however, likely reflect the roll off of Census workers. Sluggish economic growth of around a 2.0 percent annual pace in the second half of the year and the re-entrance of discouraged workers back into the workforce will likely put upward pressure on the unemployment rate in coming months. We expect the unemployment rate to rise to 10.0 percent by year end.

Previous: 472K

Consensus: 460K

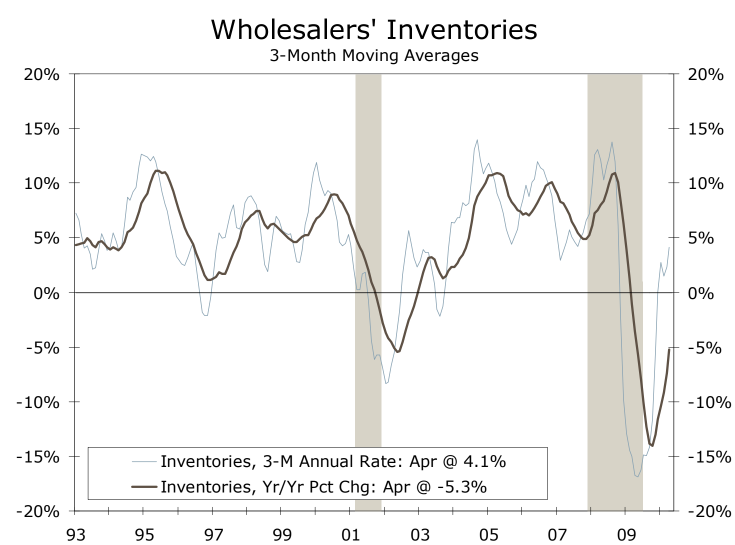


Wholesale Inventories • Friday

In response to increased sales, U.S. wholesalers restocked inventories at a fairly consistent pace in recent months. In April, wholesale inventories rose 0.4 percent, the fourth consecutive monthly gain. On a year-over-year basis, however, inventories are down 3.2 percent, but the pace of decline is slowing. Much of the increase in inventories thus far has been concentrated in computers, now up 16.3 percent over the past year and is consistent with the robust pace of equipment and software spending. Sales grew 0.7 percent in April which pulled the inventory-to-sales ratio down to its lowest level on record. Inventory rebuilding has been one of the major drivers of economic growth in the first half of the year and has contributed as much as 3.8 percentage points to real GDP. The pace of gains, however, is unsustainable, and we expect only a modest contribution from inventories in coming quarters.

Previous: 0.4%

Consensus: 0.4%



Global Review

Can We Take Global Growth For Granted?

While few analysts are predicting a double-dip global recession, perhaps investors have gotten a little too complacent that the march to global prosperity is preordained and that the path there will always be a pleasant upward stroll.

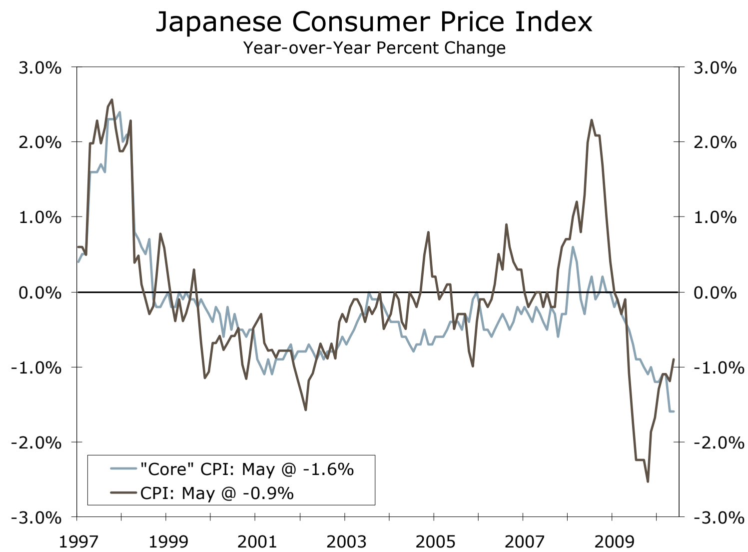
Just as markets have become unsettled by the sovereign debt problems in Europe, the recent G-20 meetings did not provide any panacea for what ails global markets. Indeed, the G-20 meetings only served to highlight the danger that policy mistakes and disagreements are nearly assured during a global and financial shock of this magnitude. Is fiscal austerity or more government spending the path to prosperity?

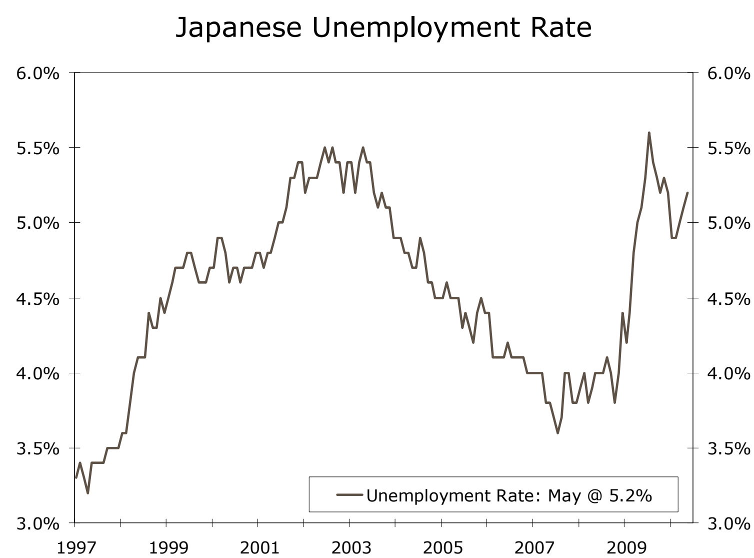
The G-20's answer was "it depends" on the country. This is an unsatisfactory answer at best. It certainly suggests that there is no-longer a coordinated global response to the economic problems still facing the world, perhaps a big negative for global growth ahead, depending on one's view of the world. Indeed the economic and fiscal policies of the United States vis-à-vis most other advanced economies, are largely at odds with each other. Such policy confusion threatens the strength and sustainability of global recovery crafted out of coordinated government intervention. The market's reaction since the meeting certainly is consistent with this thesis.

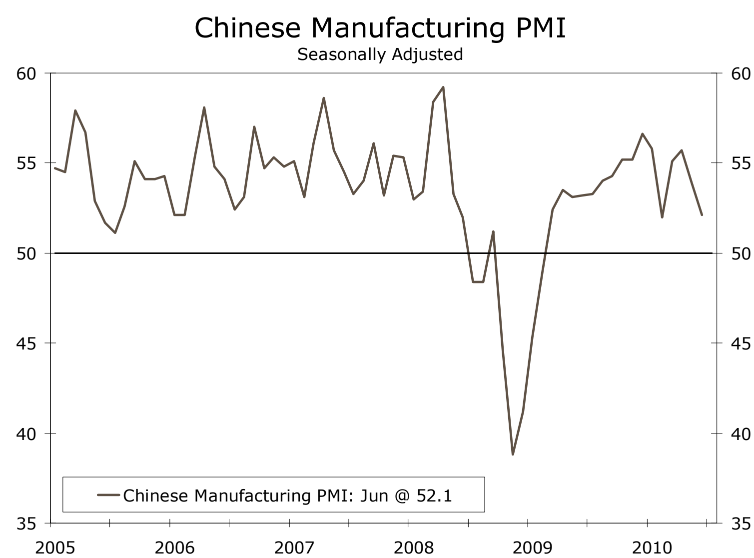
On the other hand, the status quo is also untenable. If Europe does nothing to tighten its belt, the euro will surely continue to weaken. A weaker euro would allow Europe to run large trade surpluses with the U.S. as Asia has done for decades. This large and growing trade deficit in the United States would only increase the pressure on the Administration and the Fed to spend and monetize our way out of this quagmire. A weaker dollar and higher inflation would soon emerge, wiping away any illusion of long-term prosperity. Thus, neither path provides a pleasant stroll back to prosperity, which is why the markets are so volatile these days.

As if on queue, the economic data out of Asia, which has been consistently beating expectations for more than a year, has suddenly gotten a bit more mixed. Notably, Japan's economic recovery appears to be slowing. Japan's jobless rate hit a five month high in May, while wages, industrial production, and retail spending all fell. With lingering deflation still well entrenched and Prime Minister Naoto Kan's administration considering raising the national sales tax from the current 5 percent to 10 percent, there are growing fears that Japanese domestic demand is not strong enough to withstand such a dual assault on consumers. The Japanese still keenly remember the fate of Prime Minister Ryutaro Hashimoto, who in 1997 raised taxes when he thought the economy had regained some of its strength only to see the recovery soon fall back into contraction.

China saw a rare setback this week as well. The Conference Board corrected its April Leading Economic Indicator for China's economy. It turns out the leading indicator increased only 0.3 percent compared to the initially reported gain of 1.7 percent.







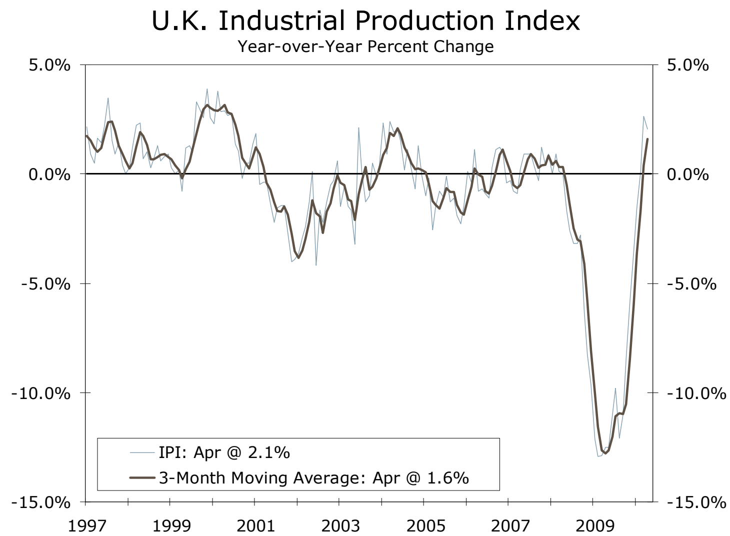
U.K. Industrial Production • Thursday

Although the pace of U.K. GDP growth slowed slightly in the first quarter, it appears the economy expanded at a faster rate in the second quarter. It is becoming increasingly clear that the business sector is spending again as well. First quarter business investment increased 7.8 percent, an upward revision from the previously reported gain of 6.0 percent. April's manufacturing PMI data released this week show that the factory sector is still expanding. That is a good sign for industrial production data due out on Thursday. Output has swung back after dropping off significantly during the recession.

The Bank of England (BoE) meets on Thursday, and no rate adjustments are expected. Although the minutes of the meeting will not be released for two weeks, investors will be very interested to see if there was any sentiment to hike rates.

Previous: 2.1% (Year-over-year)

Consensus: N/A



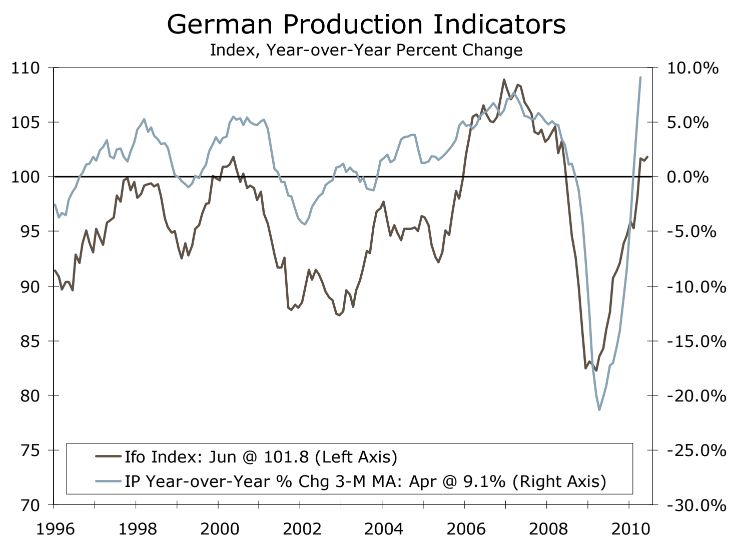
German Industrial Production • Thursday

The Ifo index of German business sentiment bottomed in mid-2009. The V-shaped bottom since that time signaled the eventual recovery in German industrial production (IP). The Ifo index edged a bit lower in May, before rebounding in June. Although the index is still at a level that is consistent with positive IP growth, the slowing pace of recovery in the Ifo may mean production will decelerate a bit in the months ahead. The manufacturing and service sector PMIs for the broader Euro-zone have also largely been going sideways for the last few months, and we would not be surprised to see factory output begin to stagnate as well.

The European Central Bank also meets on Thursday, and while rate adjustments are likely off the table, markets will watch for statements about funding in the wake of this week's expiration of the one-year lending facility.

Previous: 13.3% (Year-over-year)

Consensus: N/A



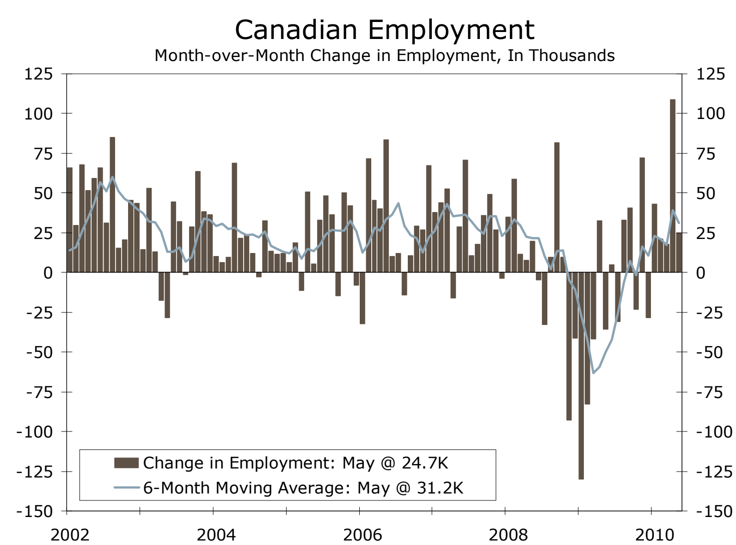
Canadian Jobs Report • Friday

Canadian economic growth continues to outpace growth in most of the developed economies in the world, and the country is the only G7 economy to begin raising rates. That said, Canada is coming off a decidedly poor week for economic news. Retail sales data for the month of April came in much weaker than expected, declining 2.0 percent on the month. The news hit the wire Tuesday morning and by the end of the day, the Canadian dollar had depreciated 2.0 percent against the U.S. dollar. GDP data for the month of April were also disappointing coming in essentially flat, despite expectations for an eighth consecutive monthly gain.

The job market recovery in Canada has also outpaced other developed economies. In fact Canadian employers have added to payrolls every month so far this year. Will that continue in June? We will find out when the jobs report is released on Friday.

Previous: 24.7K

Consensus: N/A



Interest Rate Watch

Non-Market Prices and Risk

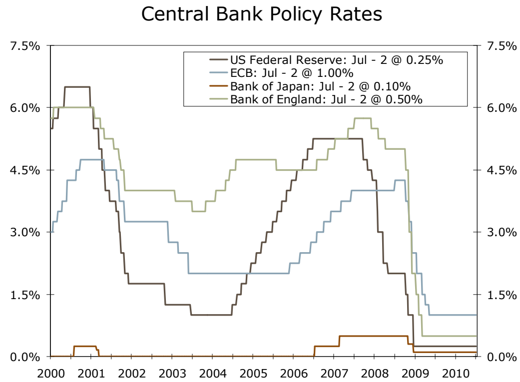
For some time now we have witnessed the cost of mis-priced assets, especially in residential real estate. Going forward, the problem we expect to see is that both the excess supply of housing and labor is putting a damper on prices. For some time, forecasters have interpreted a rebound in economic activity over the last six months as a true economic recovery. Instead, much of the rebound has reflected the impact of subsidies to the economy either directly through Federal spending or indirectly through the cash-for-clunkers-type programs and credit allocation by the Federal Reserve.

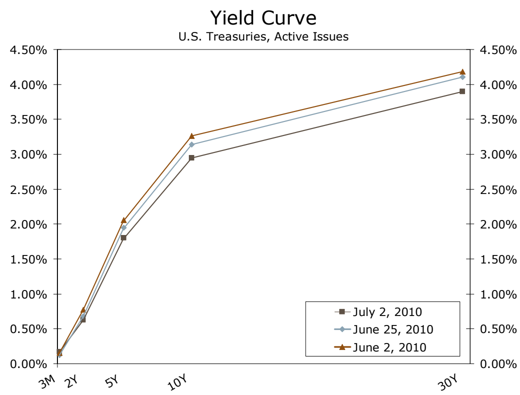
The excess supply of housing, housing-related goods, as well as autos, has remained because sellers have persisted in believing that their real assets, often bought with subprime-driven financing, really was worth more in a world in which credit and risk for mortgage lending had been repriced. New buyers cannot get the old subprime terms yet and, therefore, cannot justify paying subprime-induced housing prices. Federal tax credits intended to stabilize the housing market in the short run were but a stop-gap measure that gave false hope of a rebound in construction.

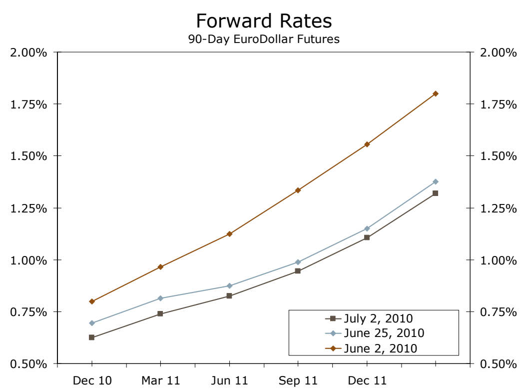
Similarly, Federal workers and stimulus-induced hires have accounted for much of the improvement in jobs, and do not reflect the viability of the private economy.

Unfortunately, monetary policy has added to the confusion on market signals. Monetary policy has generated an excess supply of credit to mop up the excess supply of goods. This excess credit supply is reflected in very low nominal interest rates which are viewed as unsustainable over time.

Finally, the growth of the real stock of government debt has exceeded the gains in the economy in the short run. Over time, the excess supply of federal debt is likely to be met with diminished demand from abroad. In the short run we have run up spending and debt to buy a recovery that will be paid for in the future at a much higher price than today's non-market determined interest rates.







Consumer Credit Insights

ABS Issuance Continues to Slow

Issuance of asset-backed securities (ABS) slowed to $7.1 billion in June, the lowest total since February 2009. The 3-month moving average fell to $8.5 billion, down 60 percent from the peak of $21.4 billion in July 2009. Over the past few months, credit card ABS issuance has held fairly steady at low levels, while auto ABS issuance has trended lower. Student loan ABS issuance had been trending slightly higher but saw a notable drop in June. There has only been one month in the past 19 where there was any issuance of home equity ABS, and that was January 2010 for a mere $200 million, compared to $20-$30 billion a month during the boom.

Compared to a year ago, total issuance YTD is down 27 percent, with credit card issuance down 80 percent, auto issuance up 31 percent, student loan issuance down 18 percent and issuance for other loans down 44 percent. If 2010 ABS issuance is to meet last year's paltry total, issuance in the second half will need to be more than double that of the first half. However, even with the cash-for-clunkers (CFC) program in place, issuance in 2H09 was only 30 percent higher than 1H09. The absence of the CFC program, the slowing of the economy and the recent downward trend of ABS issuance suggests 2H10 will be hard pressed to match the activity of 2H09. We expect consumer spending to slow in the months ahead based on fundamentals, and this analysis of ABS issuance lends further credence to our outlook.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.58%	4.69%	4.79%	5.32%
15-Yr Fixed	4.04%	4.13%	4.20%	4.77%
5/1 ARM	3.79%	3.84%	3.94%	4.88%
1-Yr ARM	3.80%	3.77%	3.95%	4.94%
MBA Applications				
Composite	675.9	621.2	639.0	444.8
Purchase	172.1	177.9	178.0	267.7
Refinance	3,613.1	3,208.5	3,336.9	1,482.2

Source: Freddie Mac, Mortgage Bankers Association and Wells Fargo Securities, LLC

Topic of the Week

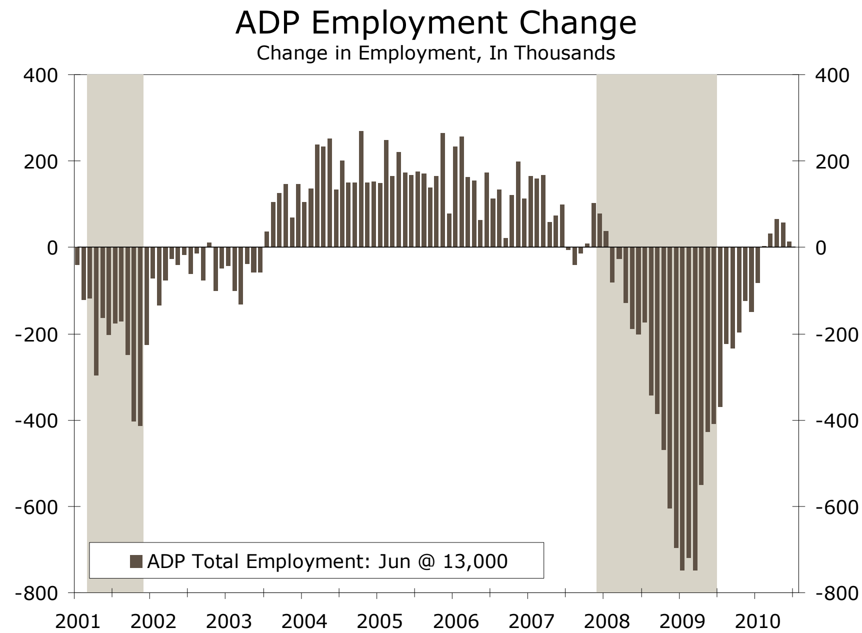
Sluggish Growth in Private Sector Jobs

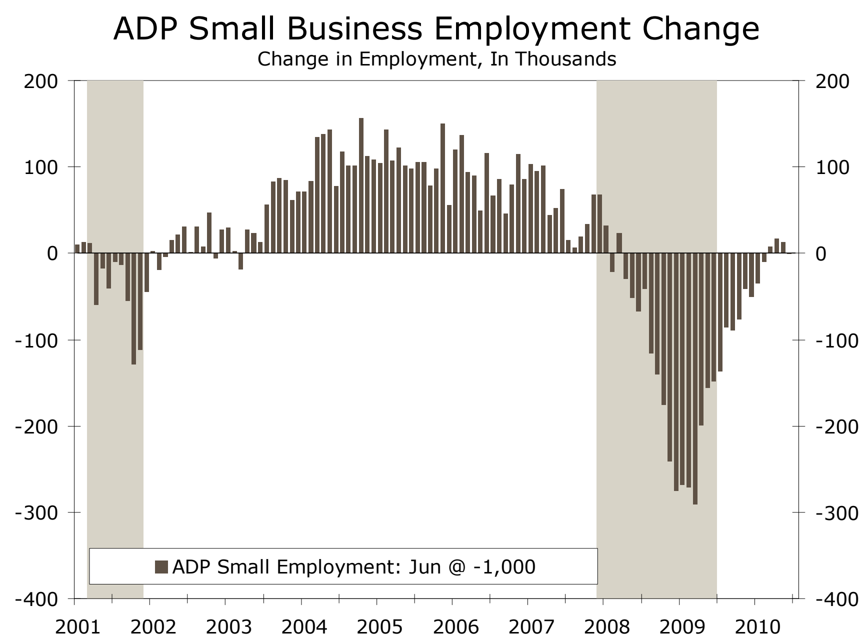
The non-farm payroll report is considered the most important monthly report because it contains a wealth of information about the current economy. However, there is a less noticed report, the ADP employment report, which contains some interesting information about the labor market. Specifically, it breaks down private sector employment by firm size. This week we received the ADP employment report, which showed that private sector employment has risen by 170,000 jobs over the past five months.

Small firms, defined as those that employ 1 to 49 workers, represent about 45 percent of private sector jobs, but they have accounted for only 16 percent of the increase in ADP employment over the past five months. Accounting for almost half of private sector jobs, it is vital that we see significant job creation from small firms. After three months of positive job growth, their payrolls decreased by 1,000 in June. Medium sized firms (50-499 workers) represent 39 percent of the level of employment, but 71 percent of the total increase since February. Large firms (more than 500 workers) represent 16 percent of the level of employment and 13 percent of the change over the past five months.

Looking at the previous economic recovery, one sees an entirely different picture. By the ADP measure, employment bottomed in June 2003 and it rose by 483,000 over the next five months. Small firms accounted for 77 percent of the growth in total ADP employment, with medium and small firms registering 32 percent and -9 percent, respectively.

There are two takeaways from this analysis. First, the recovery in private sector employment is much slower in this upturn than in the previous economic recovery. Secondly, if small firms continue to struggle, it will be difficult to register strong growth rates in private sector employment.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 7/2/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.17	0.13	0.16
3-Month LIBOR	0.53	0.53	0.58
1-Year Treasury	0.03	0.13	0.15
2-Year Treasury	0.64	0.65	0.98
5-Year Treasury	1.82	1.90	2.42
10-Year Treasury	2.96	3.11	3.49
30-Year Treasury	3.92	4.06	4.32
Bond Buyer Index	4.38	4.40	4.81

Foreign Exchange Rates

	Friday 7/2/2010	1 Week Ago	1 Year Ago
Euro ($/€)	1.260	1.237	1.400
British Pound ($/£)	1.519	1.506	1.639
British Pound (£/€)	0.829	0.821	0.854
Japanese Yen (¥/$)	87.800	89.230	95.940
Canadian Dollar (C$/$)	1.061	1.036	1.163
Swiss Franc (CHF/$)	1.064	1.093	1.084
Australian Dollar (US$/A$)	0.847	0.874	0.794
Mexican Peso (MXN/$)	13.070	12.649	13.249
Chinese Yuan (CNY/$)	6.772	6.792	6.831
Indian Rupee (INR/$)	46.786	46.290	47.950
Brazilian Real (BRL/$)	1.775	1.780	1.956
U.S. Dollar Index	84.283	85.313	80.151

Foreign Interest Rates

	Friday 7/2/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.73	0.67	1.06
3-Month Sterling LIBOR	0.73	0.73	1.16
3-Month Canadian LIBOR	0.84	0.83	0.60
3-Month Yen LIBOR	0.25	0.25	0.45
2-Year German	0.68	0.57	1.23
2-Year U.K.	0.78	0.73	1.29
2-Year Canadian	1.42	1.58	1.17
2-Year Japanese	0.15	0.16	0.28
10-Year German	2.60	2.61	3.33
10-Year U.K.	3.35	3.38	3.74
10-Year Canadian	3.09	3.22	3.35
10-Year Japanese	1.10	1.15	1.36

Commodity Prices

	Friday 7/2/2010	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	72.72	78.86	66.73
Gold ($/Ounce)	1207.05	1255.60	929.80
Hot-Rolled Steel ($/S.Ton)	625.00	625.00	335.00
Copper (¢/Pound)	292.30	309.30	229.00
Soybeans ($/Bushel)	9.51	9.51	12.63
Natural Gas ($/MMBTU)	4.82	4.86	3.62
Nickel ($/Metric Ton)	18,935	19,327	16,416
CRB Spot Inds.	473.39	482.80	406.63

Next Week's Economic Calendar

	Monday 5	Tuesday 6	Wednesday 7	Thursday 8	Friday 9
U.S. Data		**ISM Non-Mfg** May 55.4 June 55.2 (W)		**Consumer Credit** April $1.0B May $0.0B (C)	**Wholesale Inventories** April 0.4% May 0.5% (C)
Global Data	**U.K.** **PMI Services** Previous (May) 55.4 **Euro-zone** **Retail Sales (MoM)** Previous (April) -1.2%		**Germany** **Factory Orders (MoM)** Previous (April) 2.8% **Canada** **Ivey PMI** Previous (May) 62.7	**Japan** **Machine Orders (MoM)** Previous (April) 4.0% **U.K.** **IP (MoM)** Previous (April) -0.4%	**Canada** **Employment Change** Previous (May) 24.7K

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

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