January 15, 2010

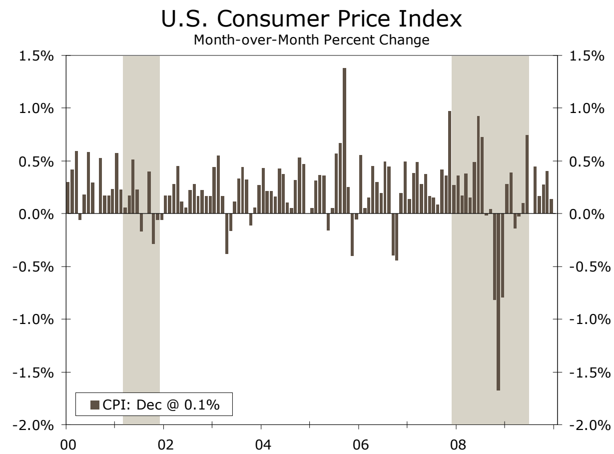
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

The Fourth Quarter Ended on a Weak Note

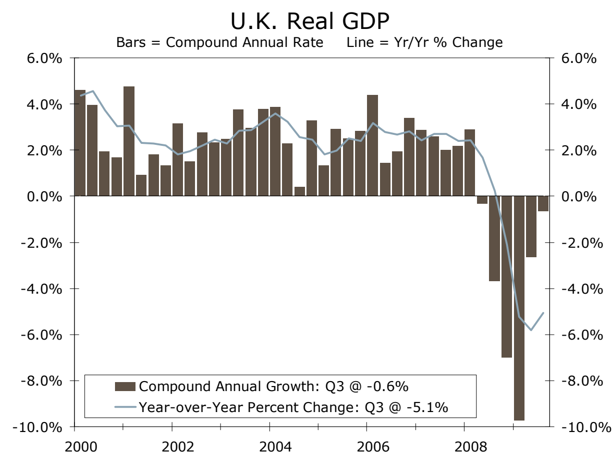
- We raised our estimate of fourth quarter real GDP growth to a 5.6 percent pace based on recent data on business inventories and international trade.
- December economic data continue to come in below expectations. Retail sales declined 0.2 percent and sales excluding motor vehicles fell 0.3 percent.
- The Fed's Beige Book and the National Federation of Independent Business survey showed conditions continuing to deteriorate across much of the country.
- Consumer prices rose 0.1 percent in December.



Global Review

The British Economy Appears to be Growing Again

- After enduring a horrific recession for six quarters it appears that real GDP growth in the United Kingdom turned positive again in the fourth quarter of 2009. Consumer spending appears to be leading the way in the recovery, but capital spending and exports may have strengthened as well.
- The Bank of England will probably want more insurance that the incipient recovery will morph into a lasting expansion before it begins to hike rates. In our view, the Bank will wait well into the second half of the year before beginning to raise rates.



Inside

Wells Fargo U.S. Economic Forecast

	Actual			Forecast					Actual			Forecast		
	2009				2010				2006	2007	2008	2009	2010	2011
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
Real Gross Domestic Product [1]	-6.4	-0.7	2.2	5.6	2.3	2.2	2.4	2.3	2.7	2.1	0.4	-2.4	2.7	2.5
Personal Consumption	0.6	-0.9	2.8	1.4	1.2	1.3	1.4	1.5	2.9	2.6	-0.2	-0.6	1.4	1.8
Inflation Indicators [2]														
"Core" PCE Deflator	1.7	1.6	1.3	1.4	1.3	1.1	1.2	1.3	2.3	2.4	2.4	1.5	1.2	1.6
Consumer Price Index	-0.2	-0.9	-1.6	1.5	2.7	2.7	2.2	1.8	3.2	2.9	3.8	-0.3	2.3	2.1
Industrial Production [1]	-19.0	-10.4	6.1	6.1	5.8	4.2	3.8	7.3	2.3	1.5	-2.2	-9.8	4.3	5.9
Corporate Profits Before Taxes[2]	-19.0	-12.6	-6.6	24.0	22.0	16.0	10.0	8.5	10.5	-4.1	-11.8	-5.1	13.8	8.0
Trade Weighted Dollar Index[3]	83.2	77.7	74.3	74.7	73.6	73.4	75.0	77.1	81.5	73.3	79.4	74.7	77.1	82.5
Unemployment Rate	8.2	9.3	9.6	10.0	10.2	10.2	10.5	10.5	4.6	4.6	5.8	9.3	10.4	10.1
Housing Starts[4]	0.53	0.54	0.59	0.56	0.60	0.65	0.68	0.71	1.81	1.34	0.90	0.55	0.66	0.80
Quarter-End Interest Rates														
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	5.25	4.25	0.25	0.25	0.50	3.25
Conventional Mortgage Rate	5.00	5.42	5.06	4.88	5.50	5.90	6.00	6.10	6.14	6.10	5.33	4.88	6.10	6.50
10 Year Note	2.71	3.53	3.31	3.85	3.80	4.00	4.20	4.40	4.71	4.04	2.25	3.85	4.40	4.90

Forecast as of: January 13, 2010
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change

U.S. Review

Caution Remains the Buzz Word

Businesses and consumers remain exceptionally cautious and will not likely be phased by a blowout real GDP number for the fourth quarter. We have recently raised our estimate for fourth quarter real GDP growth to a 5.6 percent annual rate. A substantial slowdown in the rate of inventory liquidations will account for the overwhelming majority of that gain. Final demand remains exceptionally weak and, while the worst of the layoffs appear to have passed, there is little sign hiring is set to pick up. Three major reports, the National Federation of Independent Businesses (NFIB) Small Business Optimism Index, the BLS Job Openings and Labor Turnover (JOLTS) report, and the Fed's Beige Book reiterated this point this past week.

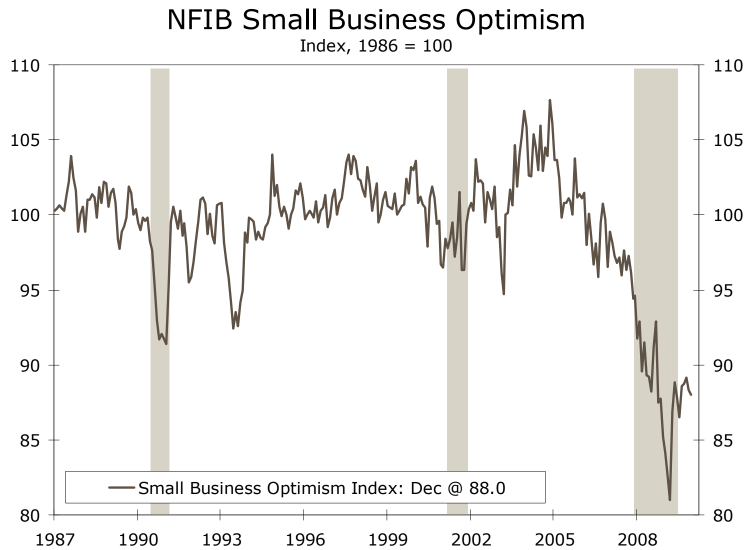
The NFIB Small Business Optimism Index fell 0.3 points to 88.0 in December. Plans to hire increased modestly but remain in negative territory, rising to -2 percent from -3 percent. In addition, fewer businesses said they were able to raise prices and fewer planned to boost inventories. The one positive aspect of the report is the number of firms stating they planned to boost capital spending rose slightly, climbing 2 points to 18 percent.

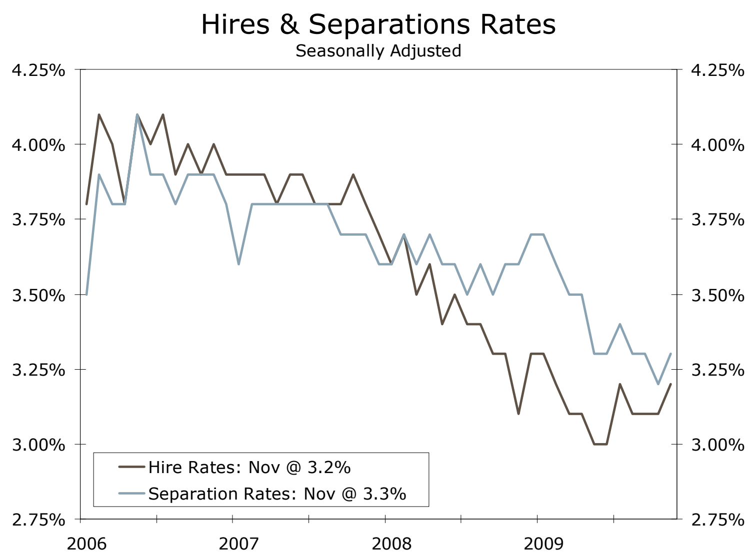
The lack of any clear sign that hiring is picking up is particularly discouraging following last Friday's weak employment report. Job openings in the November JOLTS report fell back to their series low of 1.8 percent. The number of hires and number of total separations both increased in November but total separations still outnumber hires, indicating employment declined on a net basis. There has been a slight improvement in hiring over the past five months. The number of people hired each month peaked in July 2006 and fell by 1.7 million by June of 2009. Hiring has since increased by 257,000 per month.

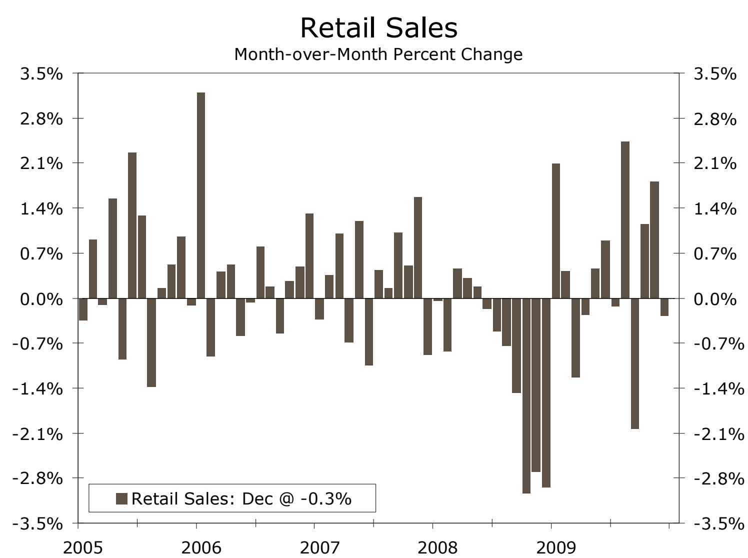
Total separations, which include quits, layoffs and retirements, rose in November but have generally been trending lower. The combination of fewer hires and fewer separations means that businesses are reducing their workforces more through quits and retirements today than by layoffs. The data also provided the missing link as to why the drop in weekly first-time unemployment claims has not translated into a net increase in nonfarm payrolls.

The Fed's Beige Book also noted weaker economic conditions and relatively few districts had anything positive to say about the employment outlook. Most districts said layoffs continued but most also noted there has been some reduction in the number and size of cutbacks and that more firms are opting for hiring freezes or reducing hours instead of making large-scale cuts.

The other major disappointment this week was November's retail sales report, which showed a 0.3 percent drop for December. Earlier reports had indicated that chain store sales were up for the month, so expectations for the Commerce Department's retail sales figures were high. The Commerce Department sales figures are adjusted for both seasonal and holiday day changes and this year's earlier Thanksgiving means that more holiday shopping took place in November and sales were thus pulled forward. On a net basis, holiday sales still show modest gains from last year.

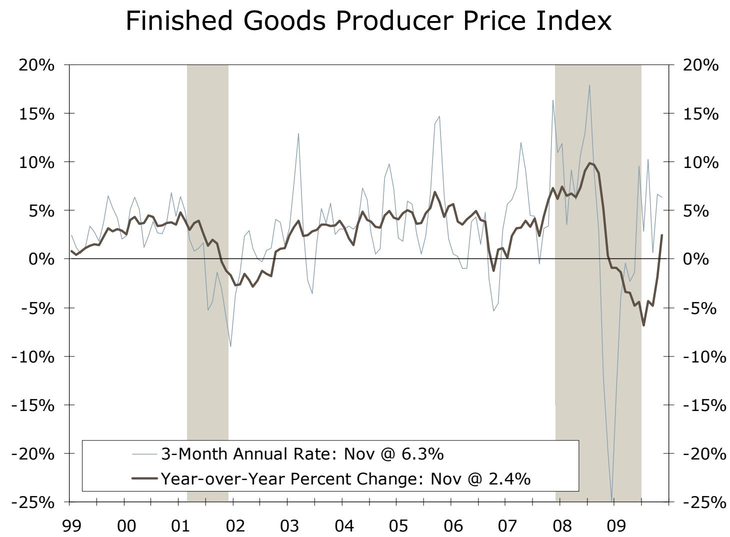






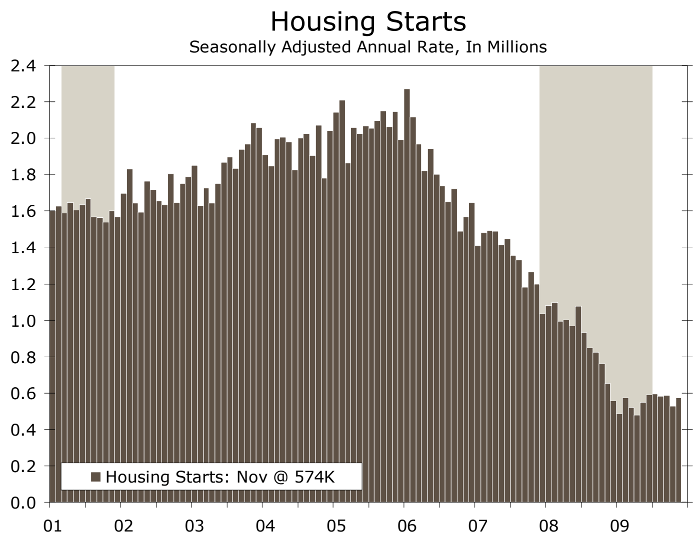
Producer Price Index • Wednesday

The Producer Price Index (PPI) for total finished goods rose 1.8 percent in November driven by an out-sized gain in wholesale gasoline prices. Gasoline prices accounted for nearly three-fourths of the headline increase in November, but gave up ground in December. Core finished goods prices rose in November due to an increase in light truck prices, which tend to be volatile on a monthly basis. They will likely retrace some of this gain. Consequently, we expect headline PPI to fall 0.3 percent in December and core finished goods prices to be flat. Measures of economic slack like capacity utilization and unemployment continue to suggest inflationary pressures will remain benign. As such, the Fed will continue to have the flexibility to keep short-term interest rates low.



Previous: 1.8% **Wells Fargo: -0.3%**

Consensus: 0.0%



Housing Starts • Wednesday

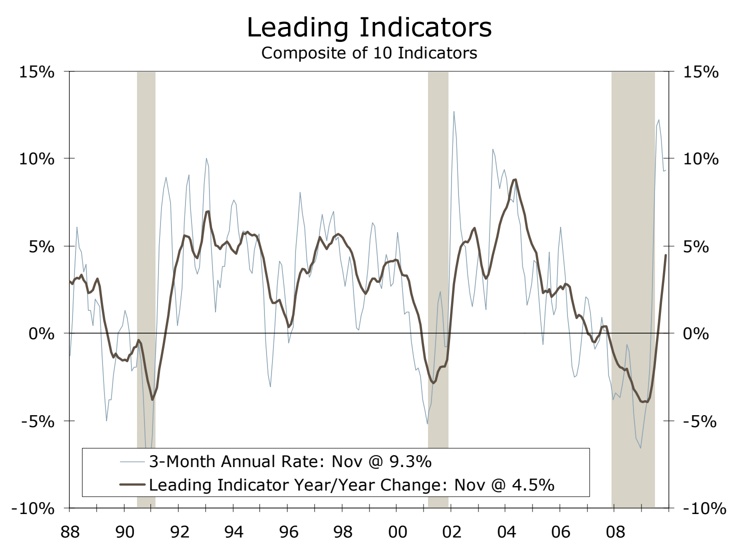
Housing starts rose to 574,000 in November an 8.9 percent increase from the previous month. Single-family permits are running ahead of starts, which suggest starts are sustainable at current levels. We continue to remain cautious, however, as housing starts have stagnated in recent months. Expected buyer traffic has stalled and mortgage loan applications for home purchases are showing a downward trend. Moreover, record high rental vacancy rates will likely continue to keep residential construction constrained. Our 2010 outlook is for just 660,000 housing starts—not the 1.3 million of 2007. Household income growth remains modest and credit standards remain tight. Household expectations for home prices and the state of the market remain very subdued.

Previous: 574K **Wells Fargo: 550K**

Consensus: 575K

Leading Economic Indicator • Thursday

Leading indicators increased 0.9 percent in November and are up more than 9 percent over the past six months. These are very good signals for continued economic recovery. Positive contributors in December will likely be driven by improvement in jobless claims, consumer confidence and supplier deliveries. On the financial side there have been gains in stock prices, the money supply and interest rate spreads. These broad-based improvements suggest continued growth. However, leading indicators do not tell us the pace of this improvement. We expect growth of more than 5 percent in the fourth quarter with gains led by inventories, trade, federal and consumer spending. But after the inventory adjustment, which may continue in the first quarter, the pace of growth will be subpar with final demand rising at a very modest pace.



Previous: 0.9% **Wells Fargo: 0.7%**

Consensus: 0.7%

Global Review

The British Economy Appears to be Growing Again

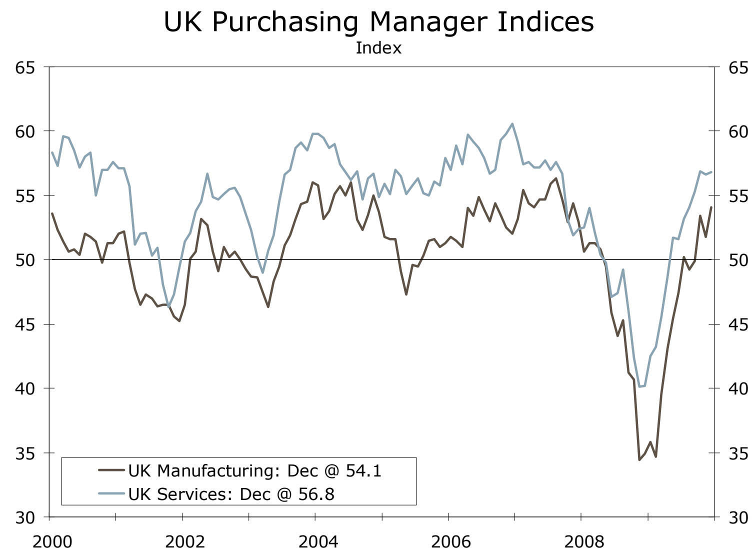
The United Kingdom recently endured its deepest recession in decades. Between the first quarter of 2008 and the third quarter of 2009 British real GDP plunged 6 percent (graph on front page). Although most major economies posted positive growth rates in the third quarter, the British economy continued to contract. However, according to the National Institute of Economic and Social Research (NIESR) the U.K. economy expanded 0.3 percent on a sequential basis in the fourth quarter. (Official GDP data will not be released until January 26.)

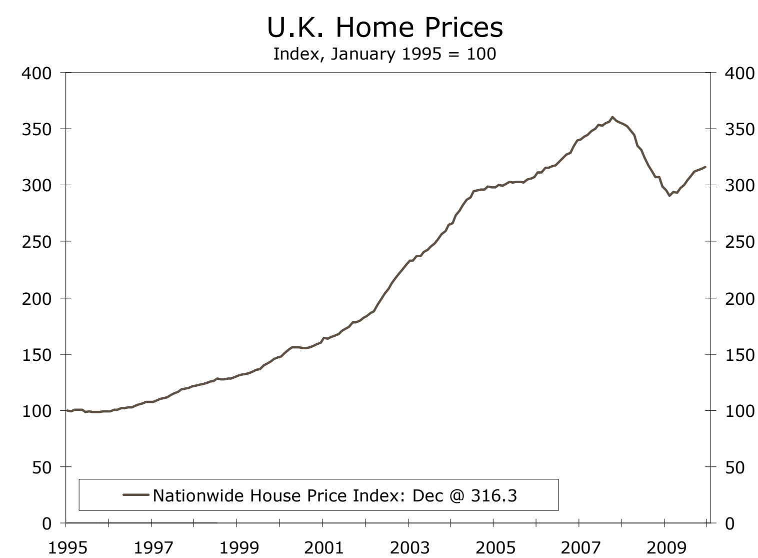
If indeed the British economy is growing again, then from where is the recovery emanating? Consumers certainly appear to be playing a role. As discussed on page 5 of this report, the consensus forecast anticipates that next week's retail sales report will show that the volume of retail spending rose 1.3 percent in December relative to the previous month. If this forecast is realized, then real retail sales will have increased about 1 percent in the fourth quarter on a sequential basis. News this week that same store sales were up 4.2 percent (year-over-year) in December lends credence to expectations for fairly sizeable gains in the volume of retail sales during the month. In addition, the service sector PMI has been well into expansion territory over the past few months, suggesting that consumer purchases of services were also strong in the fourth quarter (top chart).

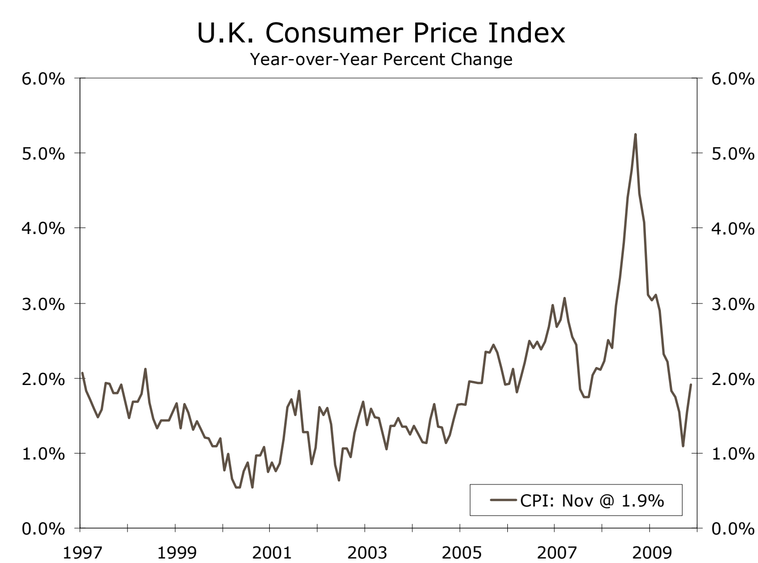
Stronger consumer spending may reflect recent stabilization in the labor market. Although the unemployment rate remains at a 12-year high of 7.9 percent, the ranks of the jobless have stopped rising, at least for now. Consumer confidence remains generally depressed, but it is well off the lows plumbed in early 2009. The recent rise in house prices may also be helping to underpin consumer sentiment and spending (middle chart).

Not only does it appear that personal consumption expenditures posted solid gains in the fourth quarter, but business fixed investment spending may also have edged higher as production of capital goods rose about 3 percent in the October-November period relative to the previous quarter. However, some of this production may have been sent overseas as the volume of exports was up nearly 5 percent in the first two months of the fourth quarter. Either way, the increase in the production of capital goods would be additive to British GDP in the fourth quarter.

The Bank of England has maintained its policy rate at the unprecedented level of 0.50 percent for ten consecutive months. Does the apparent increase in British GDP in the fourth quarter portend a near-term tightening of monetary policy? Probably not, because a self-sustaining recovery is not yet assured. The Monetary Policy Committee (MPC) will probably want more insurance that the incipient recovery will morph into a lasting expansion before it begins to hike rates. Although the CPI inflation rate is currently near the MPC's 2 percent target, policymakers project that the overall rate of CPI inflation will recede in coming months as energy prices flatten. In our view, the MPC will be on hold well into the second half of the year.







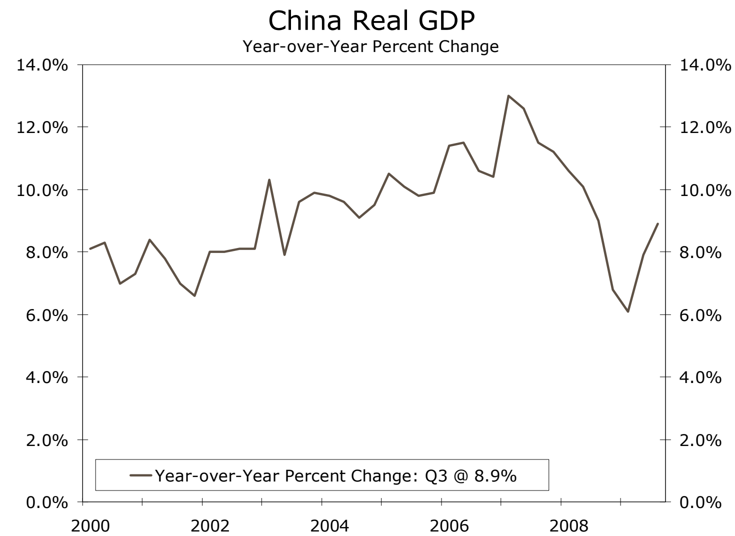
Chinese Real GDP • Thursday

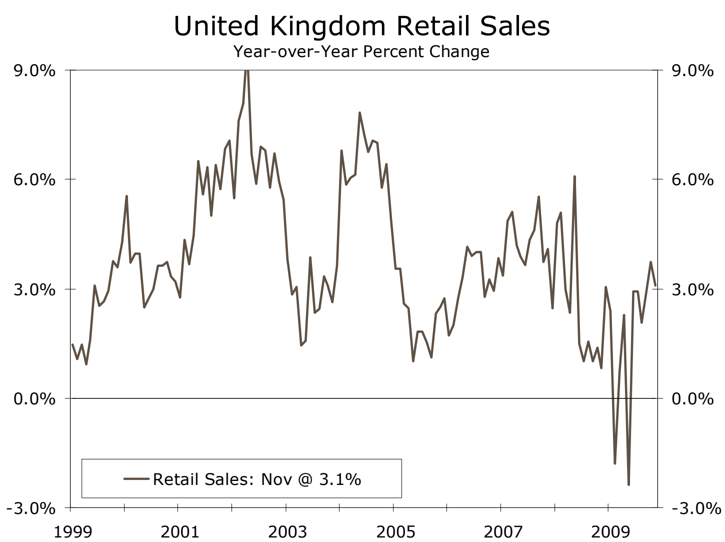
Chinese real GDP growth slowed to a 10-year low early in 2009, but the economy has subsequently accelerated due to the effects of expansionary monetary and fiscal policies. The year-over-year rate of real GDP growth picked up to nearly 9 percent in the third quarter of last year, and the consensus forecast anticipates that growth exceeded 10 percent in the fourth quarter. Monthly data show that growth in industrial production shot up from 12 percent in the third quarter to nearly 18 percent in the October-November period.

Although the GDP data will be the highlight of the Chinese data calendar, there are a few important monthly indicators for December on the docket including industrial production, retail sales, CPI inflation and fixed asset investment.

Previous: 8.9% (year-over-year) Wells Fargo: 11.1%

Consensus: 10.5%





U.K. Retail Sales • Friday

Despite the worst recession in decades, retail spending in the United Kingdom has held up fairly well over the past year (see discussion on page 4). Indeed, the volume of retail sales has been trending steadily higher since early 2009, and the consensus forecast looks for a sizeable rebound in December following the 0.3 percent decline in November relative the previous month.

Other indicators on the docket next week will also be watched closely. Inflation data for December print on Tuesday. Wednesday sees the release of labor market data as well as the minutes of the Bank of England's policy meeting that was held on January 7. Although the MPC did not change rates at the meeting, the minutes may give investors some insights into the stance of British monetary policy in the months ahead.

Previous: -0.3% (month-on-month change)

Consensus: 1.3%

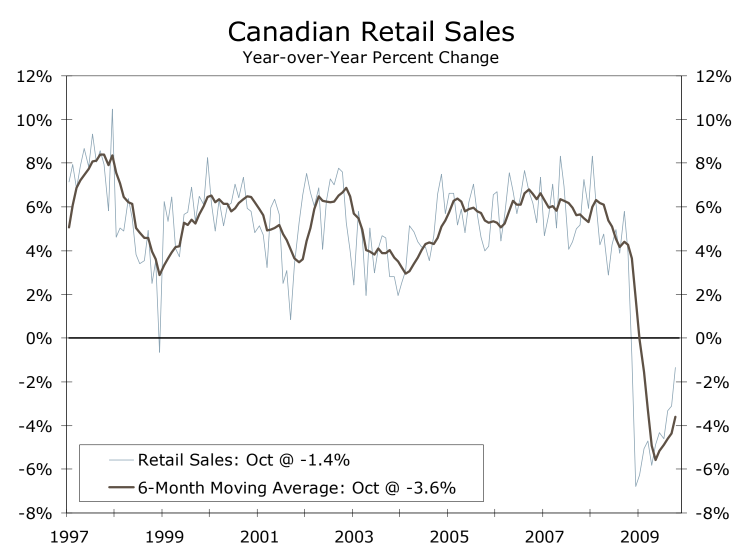
Canadian Retail Sales • Friday

The Canadian economic recovery has gotten some help from robust spending on the part of Canadian consumers. Third quarter GDP reported at a 3.1 percent annualized gain in consumer spending. Recent developments in the labor market may be helping. Despite some back and forth in the monthly jobs data, the Canadian economy added a net 33.3K jobs in the fourth quarter of 2009. Next Friday, market-watchers in Canada will get a sense of whether or not Canadian shoppers hit the stores during the holiday season as November retail sales data become available.

Also next week the Bank of Canada (BoC) will announce its decision about the key policy rate. The BoC has previously signaled that it would keep the target rate at its current level of 0.25 percent until the second quarter of 2010. Analysts will watch for the bank's latest assessment on the recovery.

Previous: 0.8%

Consensus: -0.2%



Interest Rate Watch

The Dawn of Another Conundrum

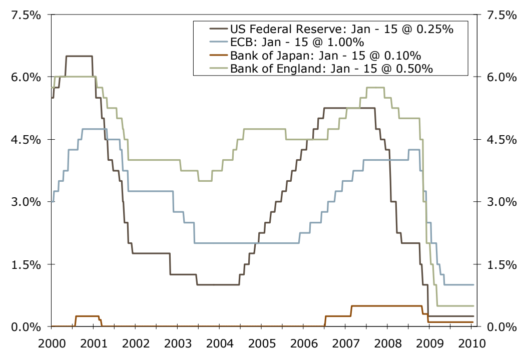
Treasury yields retreated slightly this past week as weaker economic news, including last Friday's employment number and December's weak retail sales report, have caused investors to scale back their expectations for economic recovery. Growth is still expected to strengthen over the coming year, which should boost private credit demand. Treasury yields are also being lifted by expectations federal borrowing needs will remain exceptionally large, with the 2010 federal budget deficit expected to be around $1.4 trillion. On the plus side, core inflation is expected to moderate, with our current forecast calling for the year-to-year change in the core CPI to decelerate to 1.1 percent by year end.

Bond yields remain relatively high compared to inflation and consensus inflation expectations. Apparently, there is a reluctance to fully embrace the improving core inflation figures. Some of that skepticism is justified. Much of this year's expected improvement in core inflation will likely result from moderating housing costs, which are imputed from rent data. Measures of market-driven price changes are not likely to be as bond market friendly. Moreover, with global demand reviving, core inflation is likely to accelerate earlier than in past recoveries.

The Federal Reserve also remains conflicted. Ben Bernanke and other members of the FOMC have made no secret of their intention to end the Fed's quantitative easing program. Most of the lending facilities will expire early this year and the Mortgage Backed Securities (MBS) purchase program is expected to wind down at the end of March. Ending the Fed's unconventional easing measures is an essential precondition for any subsequent tightening. The Fed cannot start tightening policy until its stops easing.

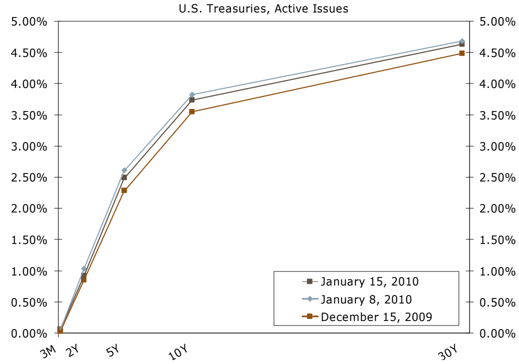
The switch from easing to tightening will not be instantaneous. The Fed will need to review the economy's performance in the absence of quantitative easing and there is some discussion that MBS purchases will continue beyond March 31. The uncertainty contributed to the earlier run up in Treasury yields and mortgage rates.

Central Bank Policy Rates



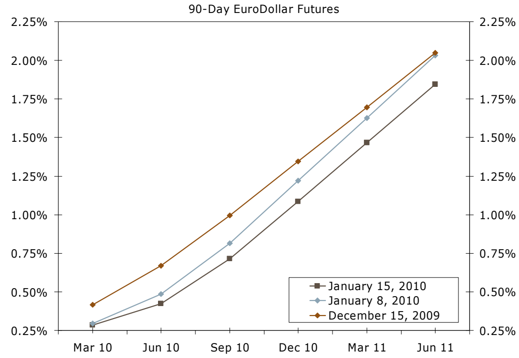
Yield Curve

U.S. Treasuries, Active Issues



Forward Rates

90-Day EuroDollar Futures



Consumer Credit Insights

De-Levering Continues at Full Tilt

Despite solid retail sales in November consumers slashed their credit usage by another record amount. Revolving credit outstanding declined by more than $13 billion in November alone and is down nearly $90 billion over the past year. While we expect the economy grew strongly in the fourth quarter on the back of a massive swing in inventories, consumers cannot be counted upon to use their credit cards to propel the economy forward at the same pace into 2010. We expect that most consumers will remain more cautious in their use of credit over the medium-term as the lessons of the past decade are fresh in their minds. At the same time consumers are likely to continue adding to their savings at the fastest past since before the housing boom.

As we move through 2010 we expect that interest rates will trend higher and consumer rates are likely to be affected as well. Most notably the Fed's plan to end purchases of MBS at the end of the first quarter should put upward pressure on mortgage rates even as we expect treasuries to be moving higher. The Fed has artificially compressed the spread between the 30-year conventional mortgage and its traditional benchmark the 10-year Treasury. When the Fed stops soaking up MBS issuance the spread is likely to widen considerably. As a result, we expect mortgage rates to climb back above 6 percent by the middle of the year. This may constrain origination activity.

Mortgage Data

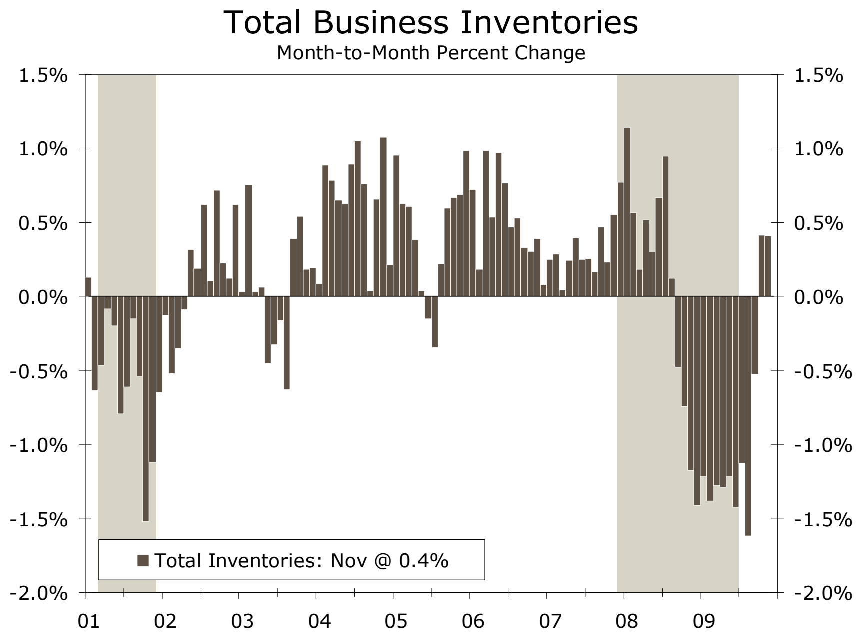
	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	5.06%	5.09%	4.94%	4.96%
15-Yr Fixed	4.45%	4.50%	4.38%	4.65%
5/1 ARM	4.32%	4.44%	4.37%	5.25%
1-Yr ARM	4.39%	4.31%	4.34%	4.89%
MBA Applications				
Composite	528.1	462.2	667.3	1,324.8
Purchase	213.7	212.1	241.2	295.8
Refinance	2,407.2	1,976.9	3,214.0	7,414.1

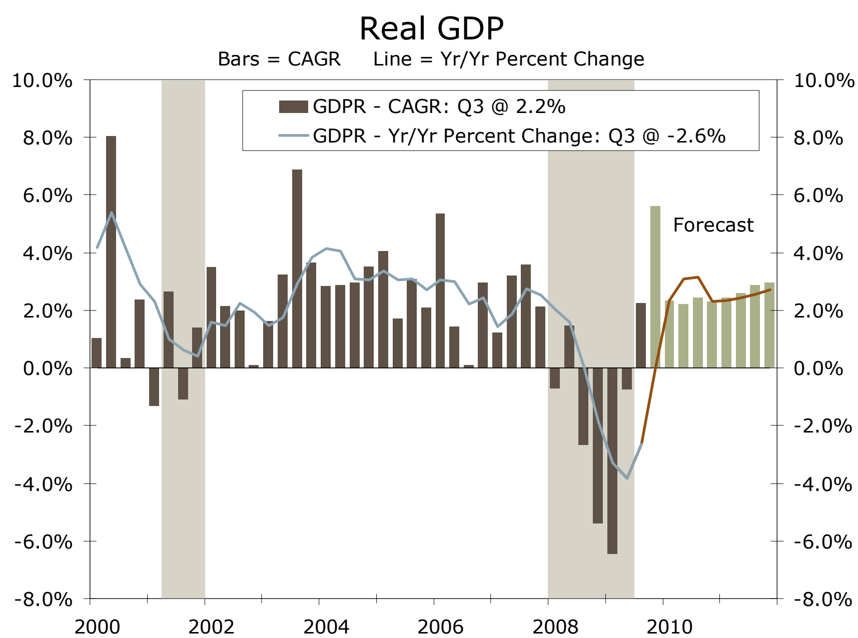
Source: Freddie Mac, Mortgage Bankers Association and Wells Fargo Securities, LLC

Topic of the Week

Inventories Add to Q4 Growth

This week markets received inventory data through November 2009 for the manufacturing, wholesale and retail sectors. After 13 months of inventory drawdowns, we have seen two consecutive monthly gains. This is enough to convince us that the changing tide of the inventory cycle is indeed upon us and the gains were not simply a one-month blip. Inventories are still down more than 12 percent down on a year-over-year basis, which shows that we are in the very early and tentative phase of inventory building. A change in the direction of the inventory cycle is a necessary and important step in most economic recoveries. Inventory changes can have enormous effects on GDP calculations and are often the largest swing variable at turning points in the cycle. After having sliced growth in the first half of the year inventory investment is poised to provide some payback with an impressive positive contribution to the Q4 data which will be released at the end of this month. While the inventory cycle appears to be turning across sectors, wholesalers and manufacturers are definitely leading the way. The data for these sectors show that the two months of inventory gains were driven largely by increases in the value of farm/food products such as grain, dairy and meat as well as petroleum products. The drawback of relying on the monthly measures of inventories is that they do not account for price changes, meaning that the same quantity of inventory from one month to the next will be of higher or lower value depending on movements in the price of the goods in inventory. Real GDP inventory data accounts for price changes, so inflation and price fluctuations are stripped out. Unfortunately, food and energy prices tend to be particularly volatile, so the extent to which price has driven inventory increases in the monthly data remains to be seen. In the retail sector we have seen just one month of inventory building (September) in recent months. However, because of the way that inventory investment adds to GDP even a slowing in the pace of inventory liquidation contributes to growth. We do not yet have a complete picture for fourth quarter inventories, but with the benefit of two months of data, we expect inventories will add 3.7 percentage points to fourth quarter real GDP.





Subscription Info

Wells Fargo's *Weekly Economic & Financial Commentary* is distributed to subscribers each Friday afternoon by e-mail.

To subscribe please visit: www.wachovia.com/economicsemail

The *Weekly Economic & Financial Commentary* is available via the Internet at www.wachovia.com/economics

Via The Bloomberg Professional Service at WFEC.

And for those with permission at www.wellsfargo.com/research

Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 1/15/2010	1 Week Ago	1 Year Ago
3-Month T-Bill	0.04	0.04	0.10
3-Month LIBOR	0.25	0.25	1.09
1-Year Treasury	0.28	0.35	0.32
2-Year Treasury	0.88	0.98	0.71
5-Year Treasury	2.42	2.59	1.36
10-Year Treasury	3.67	3.83	2.21
30-Year Treasury	4.57	4.72	2.87
Bond Buyer Index	4.31	4.31	4.80

Foreign Exchange Rates

	Friday 1/15/2010	1 Week Ago	1 Year Ago
Euro ($/€)	1.437	1.441	1.312
British Pound ($/₤)	1.629	1.602	1.463
British Pound (₤/€)	0.883	0.899	0.896
Japanese Yen (¥/$)	90.848	92.656	89.840
Canadian Dollar (C$/$)	1.029	1.030	1.253
Swiss Franc (CHF/$)	1.026	1.024	1.125
Australian Dollar (US$/A$)	0.924	0.925	0.663
Mexican Peso (MXN/$)	12.683	12.697	13.949
Chinese Yuan (CNY/$)	6.827	6.828	6.837
Indian Rupee (INR/$)	45.775	45.771	49.017
Brazilian Real (BRL/$)	1.767	1.726	2.354
U.S. Dollar Index	77.174	77.471	84.440

Foreign Interest Rates

	Friday 1/15/2010	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.63	0.65	2.50
3-Month Sterling LIBOR	0.61	0.61	2.27
3-Month Canadian LIBOR	0.45	0.46	1.65
3-Month Yen LIBOR	0.26	0.27	0.73
2-Year German	1.13	1.24	1.53
2-Year U.K.	1.23	1.27	1.55
2-Year Canadian	1.30	1.31	0.96
2-Year Japanese	0.17	0.17	0.38
10-Year German	3.27	3.39	2.89
10-Year U.K.	3.95	4.06	3.14
10-Year Canadian	3.50	3.60	2.59
10-Year Japanese	1.33	1.35	1.22

Commodity Prices

	Friday 1/15/2010	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	78.74	82.75	35.40
Gold ($/Ounce)	1128.18	1138.25	817.80
Hot-Rolled Steel ($/S.Ton)	505.00	505.00	475.00
Copper (¢/Pound)	336.40	338.80	143.85
Soybeans ($/Bushel)	9.64	10.01	9.58
Natural Gas ($/MMBTU)	5.68	5.75	4.84
Nickel ($/Metric Ton)	18,228	18,386	10,765
CRB Spot Inds.	496.69	494.10	340.10

Next Week's Economic Calendar

	Monday 18	Tuesday 19	Wednesday 20	Thursday 21	Friday 22
U.S. Data		**Net TIC Flows** October $20.7B November $30.0B (C)	**PPI** November 1.8% December -0.3% (W) **Core PPI** November 0.5% December 0.0% (W) **Housing Starts** November 574K December 550K (W)	**Leading Indicators** November 0.9% December 0.7% (W) **Philadelphia Fed BOS** December 22.5 January 18.0 (C)	
Global Data		**UK** **CPI (YoY)** Previous (Nov) 1.9% **Canada** **Bank of Canada Rate** Previous 0.25%	**Canada** **CPI (YoY)** Previous (Nov) 1.0%	**China** **Real GDP (YoY)** Previous (3Q) 8.9% **China** **Industrial Prod. (YoY)** Previous (Nov) 19.2%	**UK** **Retail Sales (MoM)** Previous (Nov) -0.3% **Canada** **Retail Sales (MoM)** Previous (Oct) 0.8%

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

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research & Economics	(704) 715-8437 (212) 214-5070	diane.schumaker@wachovia.com
John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wachovia.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wachovia.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wachovia.com
Scott Anderson, Ph.D.	Senior Economist	(612) 667-9281	scott.a.anderson@wellsfargo.com
Eugenio Aleman, Ph.D.	Senior Economist	(612) 667-0168	eugenio.j.aleman@wellsfargo.com
Sam Bullard	Economist	(704) 383-7372	sam.bullard@wachovia.com
Anika Khan	Economist	(704) 715-0575	anika.khan@wachovia.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wachovia.com
Adam G. York	Economist	(704) 715-9660	adam.york@wachovia.com
Ed Kashmarek	Economist	(612) 667-0479	ed.kashmarek@wellsfargo.com
Tim Quinlan	Economic Analyst	(704) 374-4407	tim.quinlan@wachovia.com
Kim Whelan	Economic Analyst	(704) 715-8457	kim.whelan@wachovia.com
Yasmine Kamaruddin	Economic Analyst	(704) 374-2992	yasmine.kamaruddin@wachovia.com

WELLS FARGO SECURITIES