

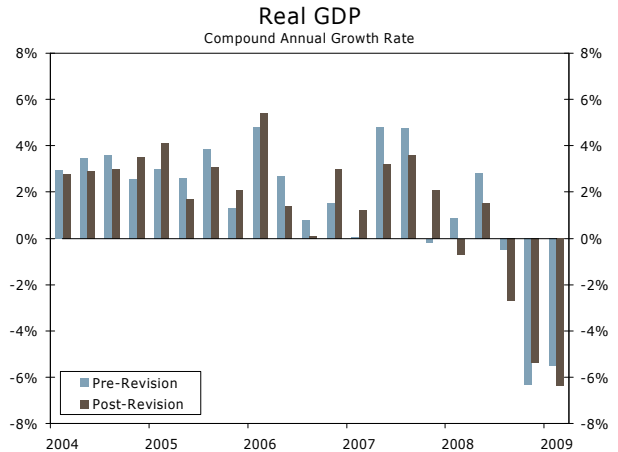
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

More Evidence That the Recession is Ending

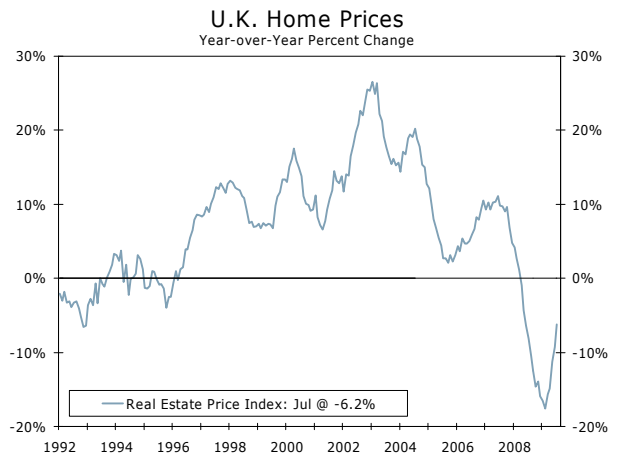
- Real GDP declined at a 1.0 percent annual rate and newly revised data for previous years show the recession was deeper than first reported.
- Inventories declined much more than expected during the second quarter, which should set the stage for a rebound in production. Real GDP should rise solidly in the third quarter, marking the end of the recession.
- Consumer Confidence fell in July and remains exceptionally low. Consumers remain concerned about job and income prospects, which will continue to weigh on spending.



Global Review

Gradual Improvement in Global Economy

- In the United Kingdom, where struggles in the housing market rivaled similar challenges in the States, there are signs of improvement as national home prices increased for the fourth time in five months. Across the channel, Euro-zone business confidence climbed for the fourth straight month but remains at low levels.
- In Asia, the recovery seems to be well underway as Japanese and South Korean industrial production both increased. The pace of recovery and run up in asset prices in China has the country's central bank considering ways to ease back the throttle.



	Wells Fargo U.S. Economic Forecast													
	Actual				Forecast				Actual				Forecast	
	2008		2009		2009		2010		2005	2006	2007	2008	2009	2010
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
Real Gross Domestic Product ¹	0.9	2.8	-0.5	-6.3	-5.5	-1.6	2.2	1.6	2.9	2.8	2.0	1.1	-2.4	1.7
Personal Consumption	0.9	1.2	-3.8	-4.3	1.4	-0.6	1.7	1.0	3.0	3.0	2.8	0.2	-0.7	1.3
Inflation Indicators ²														
"Core" PCE Deflator	2.2	2.3	2.3	1.9	1.8	1.8	1.3	1.2	2.1	2.3	2.2	2.2	1.5	1.0
Consumer Price Index	4.2	4.3	5.2	1.5	-0.2	-1.2	-2.6	-0.2	3.4	3.2	2.9	3.8	-1.0	1.0
Industrial Production ¹	0.2	-4.6	-9.0	-13.0	-19.0	-14.3	3.1	2.9	3.3	2.3	1.5	-2.2	-11.1	1.3
Corporate Profits Before Taxes ²	-1.5	-8.3	-9.2	-21.5	-17.6	-16.0	-12.0	-8.0	17.6	15.2	-1.6	-10.1	-13.7	5.8
Trade Weighted Dollar Index ³	70.3	71.0	76.1	79.4	83.2	77.2	82.6	85.0	86.0	81.5	73.3	79.4	85.0	85.0
Unemployment Rate	4.9	5.4	6.1	6.9	8.1	9.3	9.8	10.2	5.1	4.6	4.6	5.8	9.3	10.3
Housing Starts ⁴	1.06	1.02	0.87	0.66	0.53	0.49	0.52	0.55	2.07	1.81	1.34	0.90	0.52	0.70
Quarter-End Interest Rates														
Federal Funds Target Rate	2.25	2.00	2.00	0.25	0.25	0.25	0.25	0.25	4.25	5.25	4.25	0.25	0.25	0.50
Conventional Mortgage Rate	5.97	6.32	6.04	5.33	5.00	5.42	5.10	5.20	6.27	6.14	6.10	5.33	5.20	5.60
10 Year Note	3.45	3.99	3.85	2.25	2.71	3.53	3.50	3.60	4.39	4.71	4.04	2.25	3.60	4.00

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Forecast as of: July 8, 2009
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

Together we'll go far



U.S. Review

The Stage is Set for the Recovery to Begin

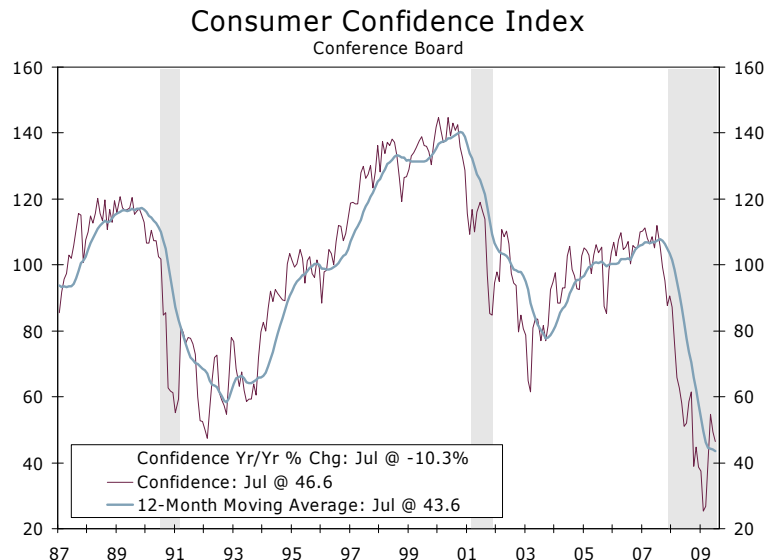
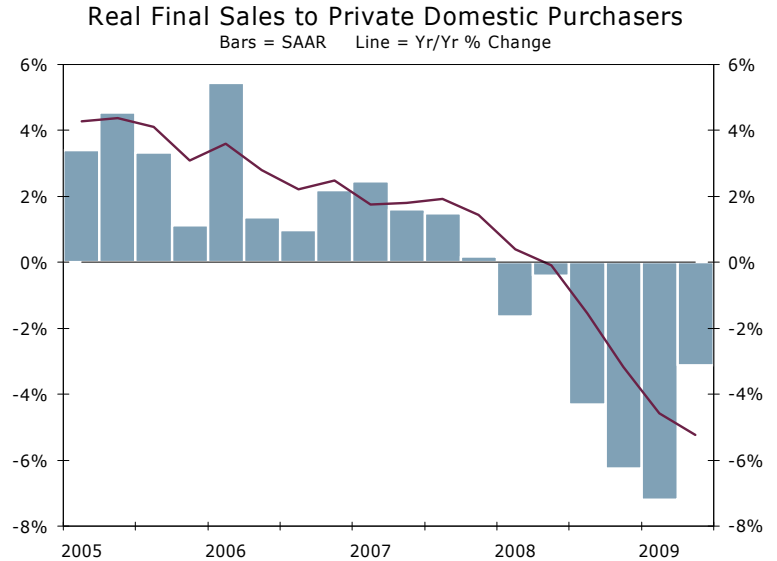
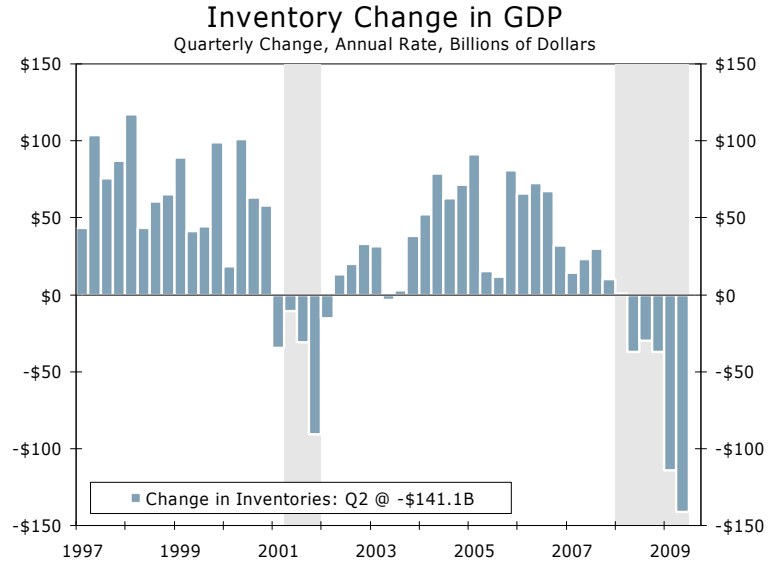
The latest batch of economic reports bolsters the case that the recession is coming to an end and the recovery is set to begin. Real GDP declined at just a 1.0 percent annual rate during the first quarter and most of that drop was due to a \$141 billion plunge in business inventories. Real final sales fell at only a 0.2 percent pace in the second quarter, compared to an average drop of a 3.9 percent during the three previous quarters. The sharp drop in inventories sets the stage for significant turnaround in real GDP. If inventories decline by an additional \$76 billion in the current quarter, then the slower rate of inventory drawdown would add 2.0 percentage points to real GDP. With a starting point like that, real GDP could post an eye-popping increase.

While real GDP appears poised to pop up in the third quarter it may not be the best measure of underlying demand in the economy. We have pointed out repeatedly that the GDP figures have been distorted by the unwinding of the nation's record trade deficit and massive drawdown in business inventories. Final demand has been much weaker than the headline GDP figures, particularly in the private sector. Final sales to domestic purchasers fell at a 1.5 percent pace in the second quarter, reflecting a 1.2 percent drop in consumer outlays and an 8.9 percent decline in business fixed investment. Residential construction plummeted at a 29.3 percent pace. Those declines were offset by a 5.6 percent pick up in government spending. Final demand in the private sector declined at a 3.1 percent pace.

While a recovery in real GDP seems all but certain in the current quarter, a sustainable economic recovery will require an improvement in final demand in the private sector. There are some encouraging signs on this front. The cash for clunkers program, where owners of older motor vehicles who meet certain income requirements can qualify for a government incentive to trade-in for a new fuel-efficient vehicle, has been more successful than expected. The program has reportedly run out of funding just one week into the program, as many dealers apparently pre-qualified buyers for the program and had a backlog of sales ready to be booked. The success of the program shows that there is some pent up demand for major purchases. Unfortunately, it is unclear how this program will be extended and how much of the current sales are merely being pulled forward a few months.

Home sales and new home construction also appear to be reviving. Sales of both new and existing homes have improved for the past three months and starts of new single-family homes have risen for four months in a row. Housing prices have also perked up, although we believe part of that improvement is due to a decline in foreclosed homes coming to the market.

We continue to believe private sector final demand will be slow to recover. The latest consumer confidence figures show consumers remain very concerned about their employment and income prospects, which will keep a tight rein on discretionary purchases. With private demand weak, any inventory led rebound in GDP will have only limited staying power.



ISM Manufacturing • Monday

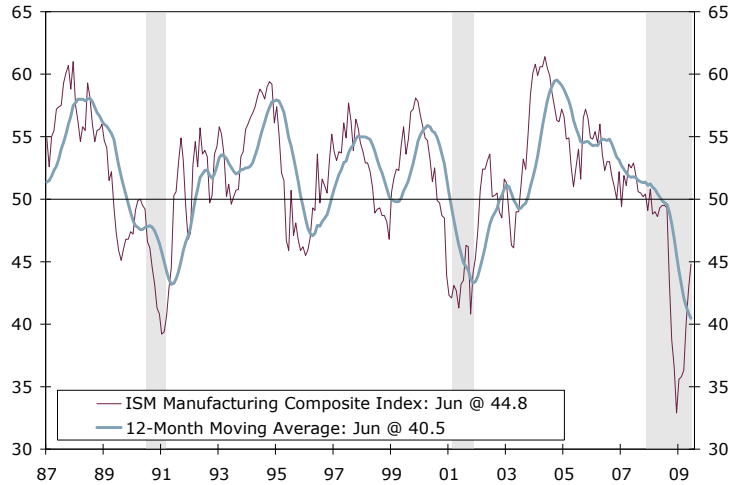
The Institute for Supply Management's headline manufacturing index rose to a nine-month high in June reflecting the prolonged contraction in the manufacturing sector is staged for recovery. Increased auto production should help to buoy the headline index. The consecutive gains toward the expansion/contraction threshold of 50 are consistent with the end of previous recessions. The forward-looking new orders index rose three out of four months, breaking 50 in May which suggests stabilization in orders. Additionally, several regional purchasing managers' indices have shown continued improvement in July. The employment index will likely register a modest gain with manufacturing activity beginning to bounce off recessionary lows. Prices paid in June moved up to 50 likely due to the spike in crude oil prices, but the recent decline should help to lower manufacturer input costs.

Previous: 44.8

Wells Fargo: 46.1

Consensus: 46.5

ISM Manufacturing Composite Index
Diffusion Index



Vehicle Sales • Monday

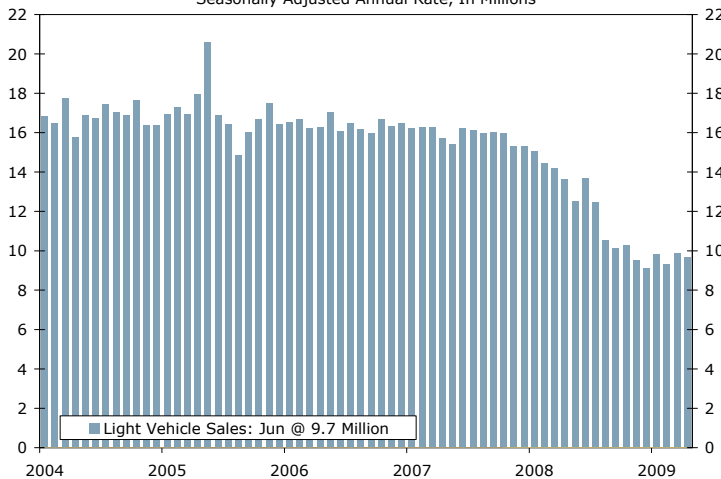
Motor vehicle sales should ramp up from recent lows of around a 9.6 million unit pace in the first half of the year to more than a 10 million unit pace by the end of this year. Motor vehicle sales have plunged roughly 47 percent from their 20.6 million unit peak pace reached in 2005. Manufacturers are slated to ramp up production again in coming quarters. The swing in motor vehicle output will cause inventories to fall much less in the third quarter. Inventories will likely add around two percentage points to real GDP growth during the quarter. The cash-for-clunkers program will likely provide a slight boost to vehicle sales. While the program took effect on July 1st, rules were not published until July 24th and funding was used up in less than a week. We believe motor vehicle sales will jump to an 11.6 million unit rate for the month of July.

Previous: 9.7M

Wells Fargo: 11.6M

Consensus: 9.9M

Light Vehicle Sales
Seasonally Adjusted Annual Rate, In Millions



Employment • Friday

Nonfarm employment has fallen 4.7 percent since the recession began, producing a net loss of 6.4 million jobs. The largest losses continue to be in manufacturing and construction. The services sector is also being hit, particularly in financial services, retail trade and temporary staffing companies. While recent swings in unemployment claims are distorted by the unusual timing of auto plant shutdowns, there is little doubt that layoffs have peaked. Continuing claims have declined in recent weeks but some of the drop is due to job seekers exhausting their unemployment insurance. Nonfarm employment is likely to continue declining into early 2010 and the unemployment rate will not likely top out until the middle of next year. We foresee a temporary pause, however, in the unemployment rate climb this month given the aforementioned seasonal adjustment issues with the early auto plant closings.

Previous: -467K

Wells Fargo: -245K

Consensus: -345K

Nonfarm Employment Growth
Yr/Yr Percent Change vs 3-Month Percent Change, Annual Rate



Global Review

Slow Recovery in Europe, but Picking up Steam in Asia

The fourth increase in U.K. home prices is certainly welcome news for the battered housing sector in the United Kingdom. While house prices are now actually in positive territory on a year-to-date basis, they remain off roughly 15 percent from their high water mark set in late 2006. Mortgage financing activity is another cloud with a silver lining in U.K. residential real estate. Mortgage approvals jumped to a 14-month high of 47.6K in June. Good improvement to be sure, but past periods suggest mortgage approvals need to be north of roughly 70K to be consistent with periods of steadily rising home prices.

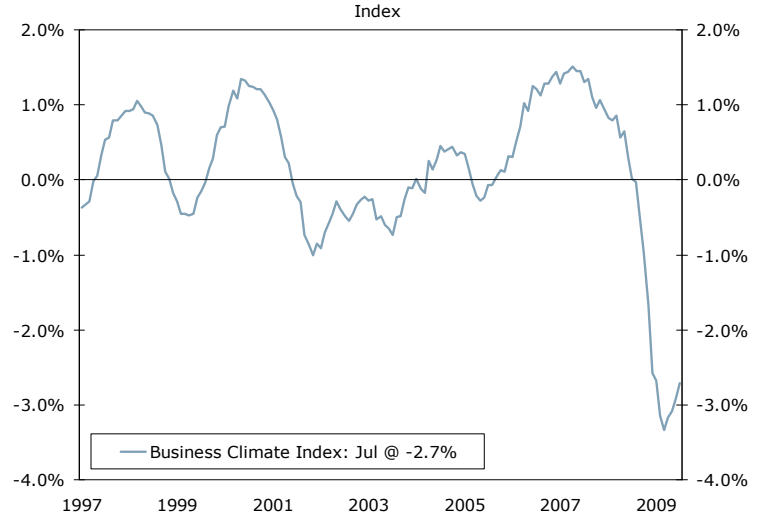
In the Euro-zone this week, economic developments also were reflective of an economy that is pulling itself out of recession, but there is little evidence that would suggest things will come roaring back. Business confidence posted its fourth increase in as many months. It is reassuring that confidence is up from the lows seen earlier this year, but confidence remains well-below levels seen during the last decade. Capacity utilization in the Euro-zone slipped to an all-time low of 69.5 percent. Given the recent improvements in sentiment and signs of recovering global trade, this may mark the bottom for capacity utilization. The recent slack in the system has contributed to climbing unemployment rates across Europe in recent months. Germany, the largest of the euro-zone economies, has been no exception to the challenges in labor markets. But German market watchers were relieved to see that the unemployment rate remained unchanged in July despite expectations for another increase.

In Asia, signs of recovery have been less restrained in recent weeks. Even in Japan where the export-driven economy is facing its most difficult period since the aftermath of the Second World War, there are signs of a robust turnaround. Industrial production climbed for the fourth consecutive month and is now up 16.6 percent from its cycle low in February. Real household spending in Japan picked up in June and remains positive on year-over-year basis, but the gain was less than the consensus had expected. Ongoing challenges in the Japanese labor market seem to be restraining the pace of recovery. Data released this week reflect those struggles as the jobless rate jumped to 5.4 in June.

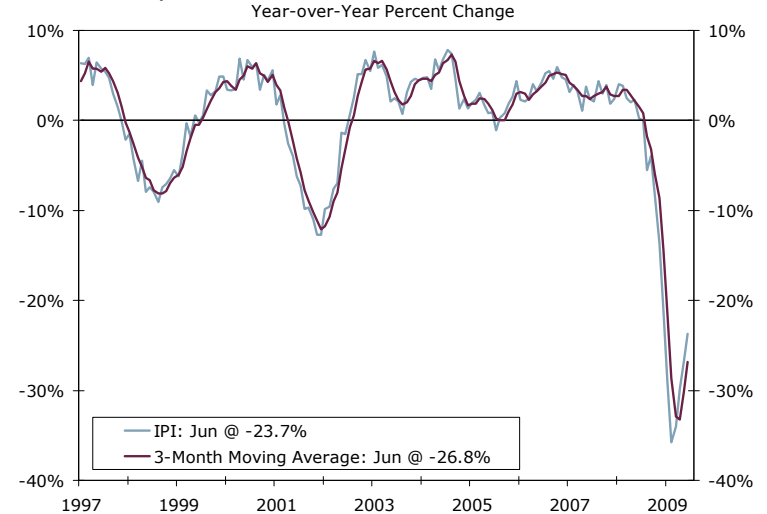
Across the Sea of Japan, South Korean industrial production notched another month of better-than-expected improvement in the latest sign of strength for the Korean economy. This marked the sixth straight month of gains for industrial production and provides further confirmation that global trade is making a comeback. The outlook for domestic demand in South Korea is also improving as data released this week showed improvement in sentiment for both businesses as well as consumers.

We also received further evidence this week that the recovery in the Chinese economy remains in gear. The latest reading of the MNI China Business Sentiment survey rose to 57.4 in July from 56.7 last month. The pace of recovery in China is so robust that the People's Bank of China, the country's central bank, signaled it may soon take measures to slow the run-up in asset prices.

Euro-zone Business Confidence



Japanese Industrial Production Index



South Korean Industrial Production Index



U.K. PMIs • Monday - Wednesday

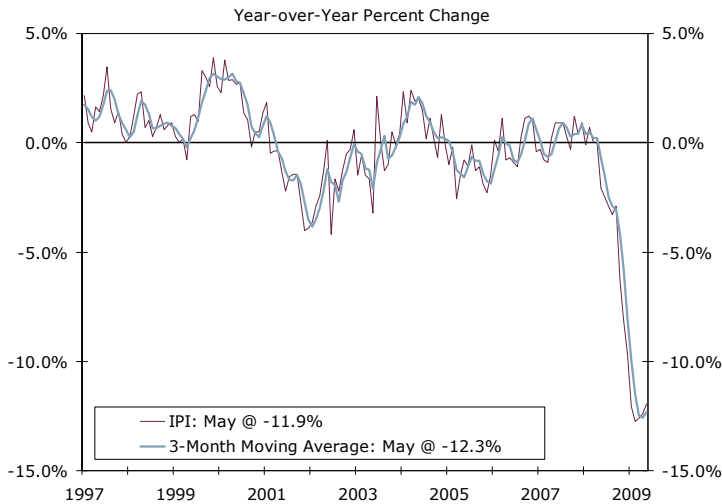
Recent improvements in the U.K. housing market have lifted hopes among consumers that worst may be over for this recession. We will get a sense of the extent to which businesses are seeing improvement when the various purchasing managers' indexes (PMIs) are reported next week.

Real GDP in the United Kingdom contracted at an annualized rate of 5.6 percent in the second quarter, the sharpest rate of contraction since 1979. But PMIs have recovered in recent months. Manufacturing PMI and Construction PMI are released Monday and Tuesday of next week. Both are expected to show modest improvement, but will likely remain below 50. Finally on Wednesday, the services PMI prints, and markets will watch to see if the series remains over 50.

Previous: Mfg. 47.0, Construction 44.5, Services 51.6

Consensus: Mfg. 47.8, Construction 45.0, Services 51.8

U.K. Industrial Production Index



German Industrial Production • Friday

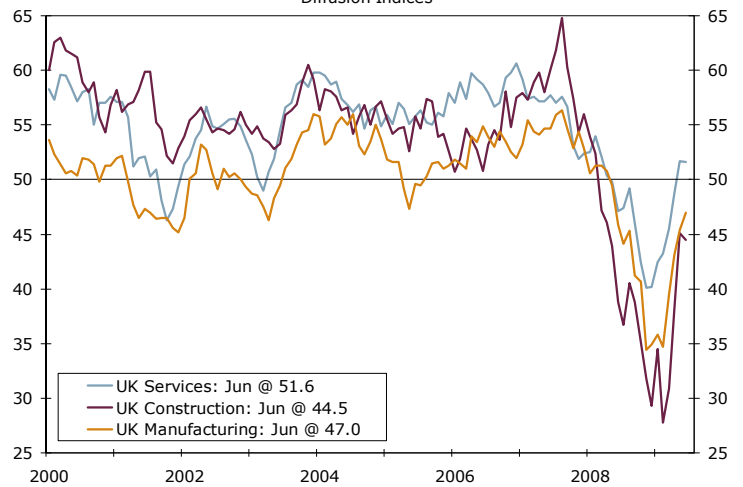
German industrial production (IP) fell off a cliff between last fall and this spring, but seems to have bounced more recently. The Ifo index of German business sentiment has risen somewhat from its record low in March. Combined with increases in German IP in two of the last three months, we may have already hit bottom. We will get a better read on that when data for German industrial production in June prints on Friday.

Factory orders lead industrial production, and orders in Germany stabilized this spring before jumping 4.4 percent in May. Data on factory orders for June will be released on Thursday and further gains could signal that the worst is over for the German manufacturing sector.

Previous: -17.9% (year-over-year)

Consensus: -17.5%

U.K. Purchasing Managers' Indices



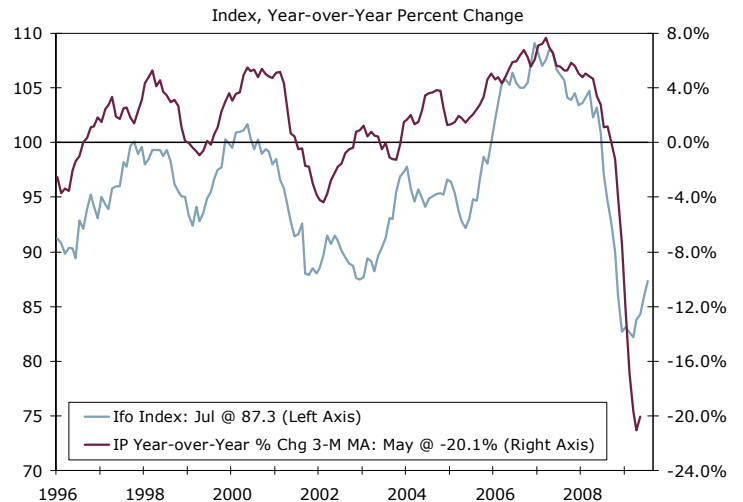
U.K. Industrial Production • Wednesday

Industrial production (IP) in the United Kingdom was hammered late last year and early this year as the global economy fell into a deep recession. There was hope in April when IP edged up a tenth of a percent, the first monthly increase since February 2008. But then things deteriorated further in May falling 0.6 percent. There has been steady improvement in the U.K. manufacturing PMI in recent months, but the June reading was still below 50 which suggests to us a slowing in the pace of decline in IP, but little in the way of actual growth. The June number for IP will be released on Wednesday.

Previous: -0.6% (month-over month)

Consensus: 0.0%

German Production Indicators



Interest Rate Watch

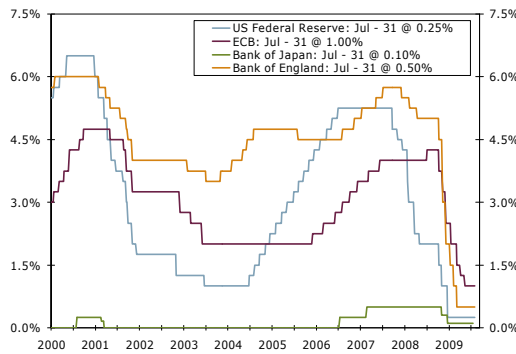
Fundamentals and Fed Policy

In Chairman Bernanke’s mid-year review, he emphasized stabilization in the economy and subdued inflation. Since the Chairman’s last report in February, credit markets have improved as issuance of financial instruments has increased and spreads have narrowed. Fed actions appear to have been successful in supplying liquidity at the short-end of the yield curve while banks have raised capital.

However, going forward, the strength and breadth of the recovery remain open questions. Our outlook remains for far below-trend economic growth with modest inflation. The challenge for investors is how to discount current market pricing. This week, we saw the results of both the two and five year Treasury auctions disappoint as demand was weak relative to the supply. Yields rose, consistent with our outlook for higher interest rates on Treasuries due to the policy contradictions we have outlined earlier. Fiscal and monetary stimulus is aimed at promoting economic growth and lowering risk premiums. Yet, those lower risk premiums also suggest a move in investors’ allocations away from the flight-to-safety trade that favors Treasuries and toward credit products. Unfortunately, the supply of Treasuries does not diminish even as investor demand moves away. A successful anti-recession policy contradicts the attempt to keep interest rates low.

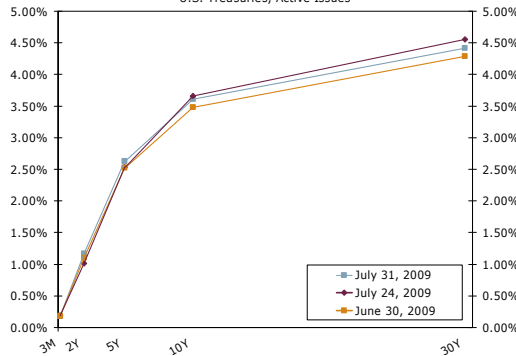
Moreover, recent testimony and a Wall Street Journal editorial by Chairman Bernanke emphasize the Fed’s commitment to reduce liquidity and exit the current easy monetary stance, which presents challenges to investors. First, any Fed exit strategy will alter the relative returns for all instruments the Fed attempts to sell, especially for longer maturity assets such as Treasuries, mortgage- and asset-backed securities. Second, the timing of the Fed’s exit is likely to coincide with a modest economic recovery and less deflationary pressures. In this case the upward pressure on yields will likely be amplified. The issue is not whether the Fed has an exit strategy but whether they implement it and be willing to accept the political criticism.

Central Bank Policy Rates



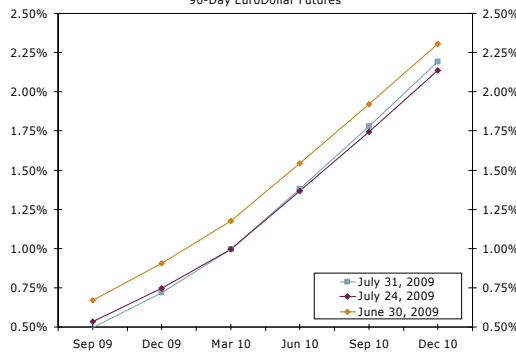
Yield Curve

U.S. Treasuries, Active Issues



Forward Rates

90-Day EuroDollar Futures



Consumer Credit Insights

Improving Credit Outlook for Consumers

On March 3rd the Federal Reserve and Treasury announced the launch of TALF. This program aimed to support the consumer credit market—particularly asset-backed securities for autos, credit cards and student loans. Liquid AAA ABS spreads have declined from over 500 basis points (bps) earlier this year to just 140 bps today. Five-year AAA Home Equity spreads have declined 500 bps. However, there are clearly “haves” and “have nots” in the credit world. Home equity spreads for BBB issues have declined only 200 bps and remain above pre-Lehman levels.

While the signs of economic recovery may be tenuous, credit improvements have been clear only for TALF eligible issues. New issue volume for auto and equipment ABS has been solid, but can such market improvements continue when TALF expires? Moreover, the latest Senior Loan Officer Survey showed a further tightening of standards and terms on consumer loans.

Consumer fundamentals have not improved as quickly as consumer credit, and employment losses are expected to continue. Personal income gains in the second quarter reflected Federal programs while earned income has been declining due to job and hour cuts. Delinquency rates rose in the first half of 2009. Household bankruptcy rates continue their upward trend. TALF, not consumer fundamentals, appears to justify credit market improvements—but for how long?

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	5.25%	5.20%	5.32%	6.52%
15-Yr Fixed	4.69%	4.68%	4.77%	6.07%
5/1 ARM	4.75%	4.74%	4.88%	6.07%
1-Yr ARM	4.80%	4.77%	4.94%	5.27%
MBA Applications				
Composite	495.4	528.9	444.8	420.8
Purchase	262.0	262.1	267.7	309.5
Refinance	1,862.1	2,089.7	1,482.2	1,074.4

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

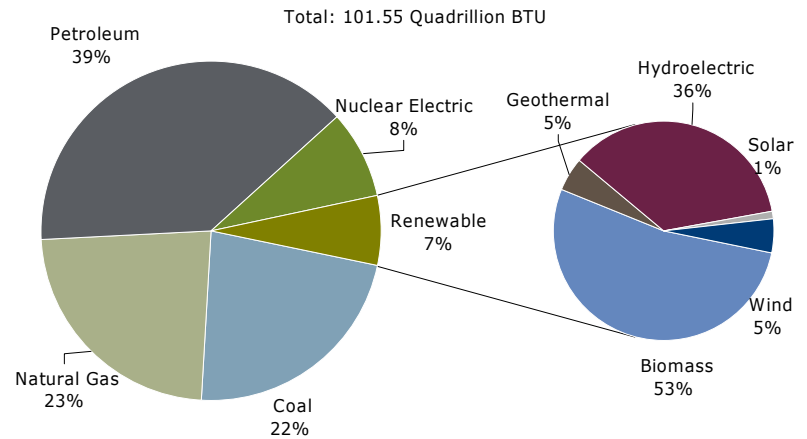
Topic of the Week

Energy Policy Requires Tradeoffs

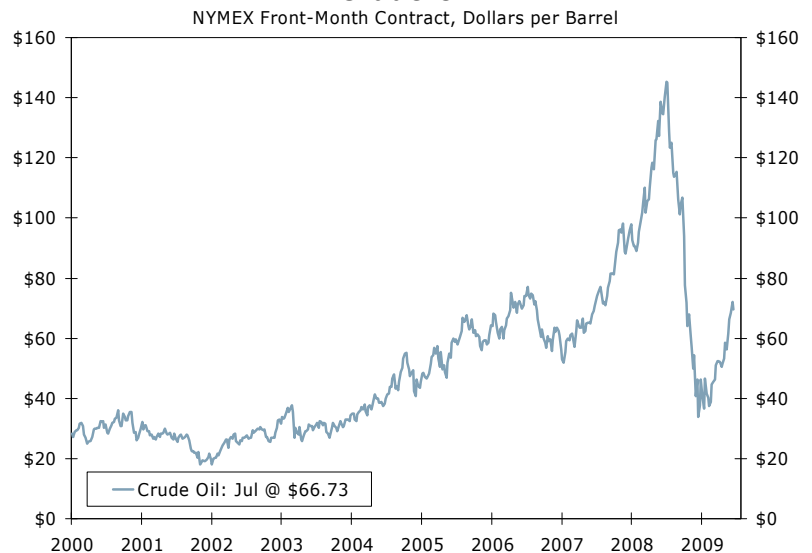
About thirty years ago, President Carter called the energy crisis of the 1970s the "moral equivalent of war." Since Carter's presidency succeeding administrations have tried, perhaps with a bit less fanfare than war, to enhance the energy security of the country. With petroleum imports still setting record highs, the ultimate success of those attempts has to be questioned. Last summer we experienced the detrimental effects of high oil prices, and though prices have since come down, we expect a continued upward trend as world demand, especially in non-OECD nations, increases. Not only do we want less dependence on foreign sources of energy but we also want a cleaner greener future, which adds an additional complication to energy policy.

In order to reduce its dependence on foreign sources of energy, especially petroleum, the country could turn to greater use of coal and natural gas; the United States has ample reserves of the former. However, burning coal produces significant CO₂ emissions, and increased usage would conflict with the goal of developing a more environmentally friendly and sustainable source of energy. Renewable sources of energy could resolve this dilemma, but non-carbon energy sources (e.g., nuclear and renewables) account for only 15 percent of the country's energy consumption, a percentage that has held steady over the past decade. A meaningful switch to non-carbon energy is simply not realistic in the near future. The federal government currently spends about \$17 billion annually on energy subsidies, and greater subsidization of renewables could bring closer the day when the country's energy supply was mostly green and largely produced at home. However, the large budget deficit of the federal government means that the country faces painful choices among other spending priorities like healthcare and defense. If we spend more on energy subsidies, do we spend less on other priorities, do we tax more, or do we let the budget deficit swell even further? To use an old cliché that is popular among economists, there is no free lunch.

Energy Consumption in the Nation's Energy Supply
2007



Crude Oil



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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 7/31/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.18	0.18	1.66
3-Month LIBOR	0.48	0.50	2.79
1-Year Treasury	0.57	0.41	2.30
2-Year Treasury	1.11	0.99	2.51
5-Year Treasury	2.52	2.53	3.24
10-Year Treasury	3.50	3.66	3.95
30-Year Treasury	4.33	4.54	4.57
Bond Buyer Index	4.69	4.69	4.74

Foreign Exchange Rates

	Friday 7/31/2009	1 Week Ago	1 Year Ago
Euro (\$/€)	1.426	1.420	1.560
British Pound (\$/£)	1.670	1.643	1.984
British Pound (£/€)	0.854	0.865	0.787
Japanese Yen (¥/\$)	94.748	94.793	107.915
Canadian Dollar (C\$/\\$)	1.078	1.087	1.025
Swiss Franc (CHF/\\$)	1.068	1.072	1.047
Australian Dollar (US\$/A\\$)	0.833	0.817	0.942
Mexican Peso (MXN/\\$)	13.216	13.202	10.037
Chinese Yuan (CNY/\\$)	6.832	6.832	6.832
Indian Rupee (INR/\\$)	47.935	48.227	42.570
Brazilian Real (BRL/\\$)	1.863	1.896	1.565
U.S. Dollar Index	78.293	78.749	73.227

Foreign Interest Rates

	Friday 7/31/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.86	0.90	4.96
3-Month Sterling LIBOR	0.89	0.92	5.78
3-Month Canadian LIBOR	0.60	0.60	3.34
3-Month Yen LIBOR	0.41	0.42	0.90
2-Year German	1.26	1.32	4.26
2-Year U.K.	1.23	1.33	4.80
2-Year Canadian	1.42	1.33	2.94
2-Year Japanese	0.29	0.28	0.79
10-Year German	3.30	3.48	4.36
10-Year U.K.	3.80	3.96	4.81
10-Year Canadian	3.46	3.55	3.70
10-Year Japanese	1.42	1.38	1.54

Commodity Prices

	Friday 7/31/2009	1 Week Ago	1 Year Ago
WTI Crude (\\$/Barrel)	68.17	68.05	124.08
Gold (\\$/Ounce)	954.33	951.35	914.07
Hot-Rolled Steel (\\$/S.Ton)	455.00	455.00	1125.00
Copper (\\$/Pound)	261.65	251.70	371.65
Soybeans (\\$/Bushel)	11.23	10.43	13.98
Natural Gas (\\$/MMBTU)	3.60	3.70	9.12
Nickel (\\$/Metric Ton)	17,164	16,326	18,625
CRB Spot Inds.	426.70	423.88	488.52

Next Week's Economic Calendar

	Monday 3	Tuesday 4	Wednesday 5	Thursday 6	Friday 7
U.S. Data	ISM Manufacturing Index June 44.8 July 46.1 (W)	Personal Income May 1.4% June -0.5% (W)	ISM Non-Manufacturing June 47.0 July 47.5 (W)		Nonfarm Payrolls June -467K July -245K (W)
	Total Vehicle Sales June 9.7M July 11.6M (W)	Personal Spending May 0.3% June 0.3% (W)	Factory Orders May 1.2% June -1.5% (W)		Unemployment Rate June 9.5% July 9.5% (W)
	Construction Spending May -0.9% June -0.7% (W)	PCE Deflator May 0.1% June 0.6% (W)			
Global Data	Germany Retail Sales (MoM) Previous (May) -1.3%	South Korea CPI (YoY) Previous (Jun) 2.0%	UK Indus. Production (YoY) Previous (May) -11.9%	Euro-zone ECB Announces Rates Previous 1.00%	Germany Indus. Production (YoY) Previous (May) -17.9%
		Euro-zone PPI (YoY) Previous (May) -5.8%			

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

Wells Fargo Securities, LLC Economics Group

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