October 07, 2009

Economics Group

WELLS FARGO SECURITIES

MONTHLY OUTLOOK

U.S. Overview	International Overview

U.S. Overview

"The Recovery Will Be Agonizingly Slow"

So it indeed has been. As this short quote from the Executive Summary of our 2009 *Annual Outlook* (published in December 2008) neatly summarized, the economic recovery faces a number of secular challenges that will alter the pace and composition of growth. For many decision-makers, the outlook for 2010 suggests continued change and adjustment to an altered reality of more government/less private sector contributions to growth, greater caution/less leverage for consumer spending, greater prudence/less speculation in lending and the importance of exports in moving the U.S. economy.

Even though our outlook for continued growth in the overall economy would suggest a normal cycle, the underlying forces in this economy are anything but normal. Much of the near-term gain in growth reflects federal, not private spending; foreign buying via exports, not domestic spending and production to rebuild inventories, not for new final sales. These odd characteristics of our growth in the short term give rise to questions about the sustainability of the recovery over time.

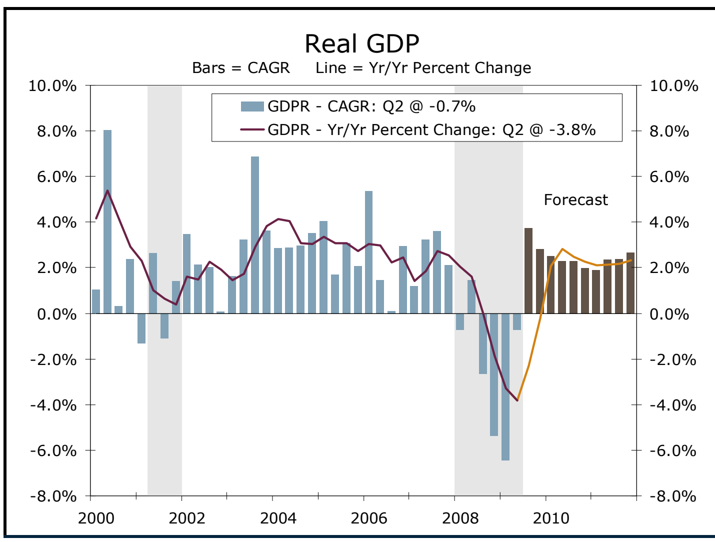
Finally, our outlook is framed, as it has been for two years, by the character of America's evolving credit cycle. This credit cycle will not be a repeat of the past. We are still searching for that new balance in private and public leverage. We have not yet defined the limits of federal fiscal and monetary support. We are unsure of continued foreign purchases of U.S. securities and what price foreign investors might be willing to pay.

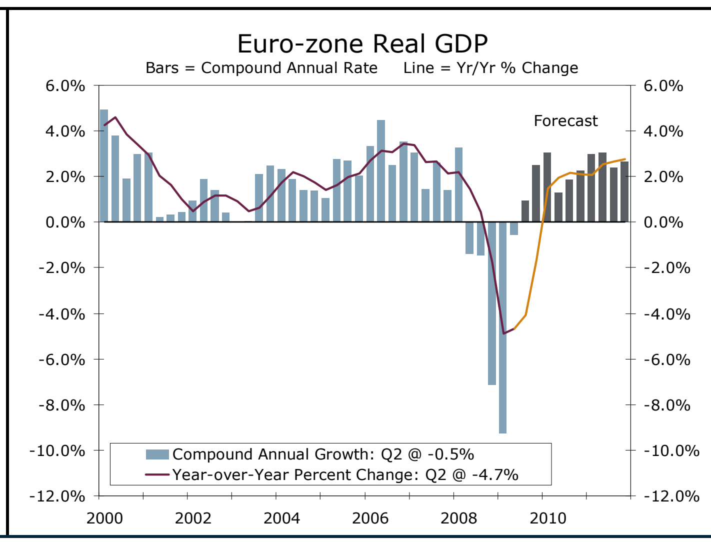
International Overview

Is Coordinated Policy Easing Still Appropriate?

Leaders of the G-20 countries recently agreed to "avoid any premature withdrawal of stimulus" in order to secure a "durable recovery." Policy stimulus may be appropriate for many advanced economies, which probably will experience sluggish upturns due to further deleveraging, and we expect that most major central banks will maintain their respective policy rates at extremely low levels through much of next year. However, bona fide recoveries appear to be taking hold in many parts of the developing world, and it is no longer apparent that continued policy accommodation remains in the best long-run economic interests of many of these countries.

Consider Brazil, for example. Although the Brazilian inflation rate has trended lower since the end of last year, we project that it will begin to rise again in mid-2010 as growth strengthens and commodity prices trend higher. With budding inflationary pressures, continued policy accommodation would not be appropriate. The Reserve Bank of Australia recently surprised most investors by hiking its main policy rate by 25 bps, and central banks in many developing countries will likely begin their own tightening cycles early next year as well. We do not mean to imply that developing countries will slam on the brakes, thereby threatening to derail the incipient global recovery. Inflation is generally benign at present, and there is no need for excessive tightening. However, policy will need to become less accommodative in many developing countries or inflation could become a major problem again.





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

Recovery—The Initial Push

Real final sales, our measure of underlying demand, remains subpar in the outlook with a gain of just more than one percent in the second half of this year and 1.4 percent in 2010 compared to 2.5 percent in 2007. This weakness primarily reflects subpar consumer spending of just 1.0 percent for next year.

Currently, federal spending, net exports and inventory rebuilding have provided the initial push into recovery for the economy. Fiscal stimulus dollars continue to flow freely and we estimate that federal spending will grow 2.8 percent on average during the last half of this year and 2.6 percent next year. Net exports are expected to add to growth by just less than half a percent after adding one percent during the past two years. Finally, inventory rebuilding will add nearly two percent to growth in the second half of this year and roughly one percent next year.

Real Final Demand, Headwinds Limit Sustainability

As evidenced by recent data on jobs, orders and vehicle sales, once the stimulus runs its course, we are left searching for the sustainable growth at a pace typical of the V-shaped recoveries of the past. We find none. September's employment report highlighted the underlying weakness in household's earned income as jobs fell, hours worked declined and earnings growth continued to slow. Our view is that the American consumer is unlikely to reassert her usual role as spender of last resort and instead move forward at a more deliberate pace given the headwinds of wealth rebuilding, more limited credit, as well as the aging of the baby boomers. We postulate a household saving rate of eight percent over the next two years.

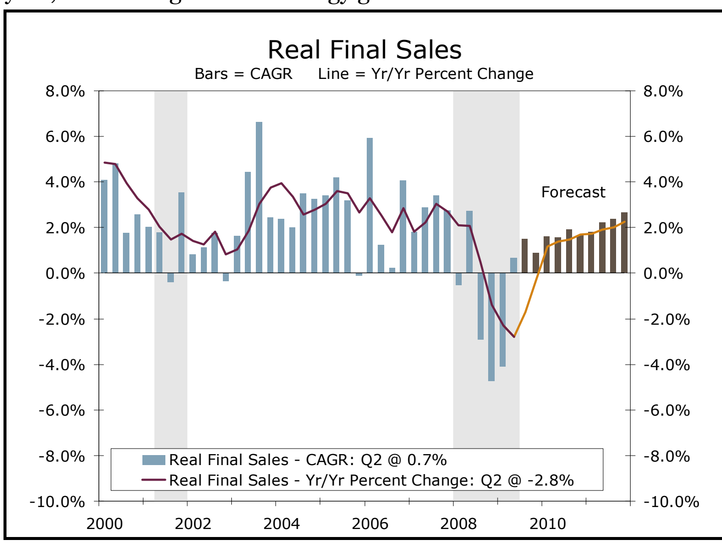
Factory orders slipped in August with the biggest weakness in transportation orders. The recovery in business equipment investment is expected to start in the fourth quarter of this year, with strength in technology goods.

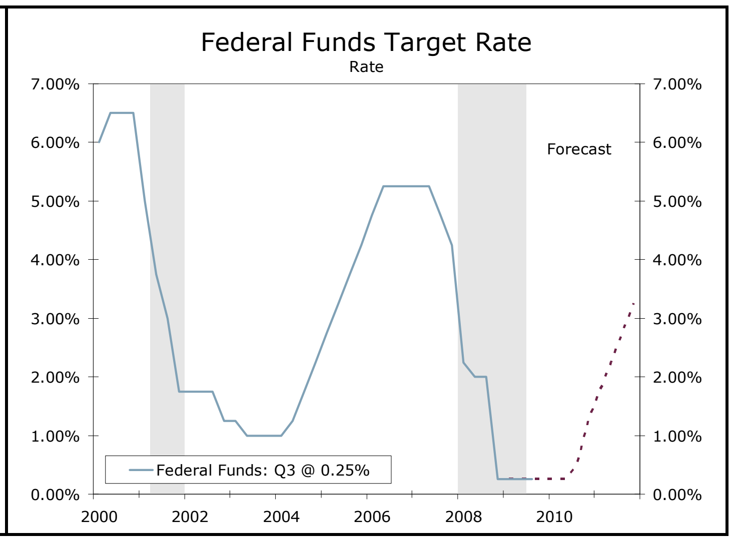
Light vehicle sales dropped sharply to only a 6.8 million rate in September compared to 10.2 million in August with the Cash for Clunkers program. This suggests that the sustainable pace of household spending, post-stimulus is far less than the optimists in the V-shaped recovery camp hope for. This increases our caution on estimates of final demand when other stimulus measures, such as aid to state and local governments and the $8,000 tax credit for first-time homebuyers expire.

While we are forecasting a substantial deceleration in overall growth, we do not expect a double dip. Overall growth is expected to remain in positive territory throughout the forecast period thanks mostly to continued narrowing in the trade deficit and increases in federal government outlays. Private domestic demand should gradually build momentum, but there are a number of hurdles that need to be overcome before robust growth returns to the private sector.

Recent data indicate that delinquency rates are surging for prime and subprime mortgages. What evidence do we have that attitudes have changed? From the Senior Loan Officer Survey, we note that the net percentage of banks tightening standards on C&I loans to large and medium sized firms remains in the range associated with prior recessions. For consumer loans the net percent tightening remains higher than the last recession. Prudence appears to be evident on both the demand and supply side of the credit markets.

Unfortunately we are only now entering the exit period for monetary policy from its support for Treasuries and by next March from mortgage-backed and asset-backed securities. This will be a test for the economy, the financial markets, the Fed and the Obama administration as well. How well will the economy adjust back to freely traded markets and how well will policymakers, both domestic and foreign, accept the markets' judgment? We await new data.





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

Wells Fargo U.S. Economic Forecast

	Actual						Forecast										Actual		Forecast		
	2008				2009				2010				2011				2007	2008	2009	2010	2011
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product (a)	-0.7	1.5	-2.7	-5.4	-6.4	-0.7	3.7	2.8	2.5	2.3	2.3	2.0	1.9	2.3	2.4	2.7	2.1	0.4	-2.4	2.4	2.2
Personal Consumption	-0.6	0.1	-3.5	-3.1	0.6	-0.9	2.3	0.0	1.0	1.2	1.3	1.4	1.4	1.4	1.5	1.5	2.6	-0.2	-0.8	1.0	1.4
Business Fixed Investment	1.9	1.4	-6.1	-19.4	-39.2	-9.6	-5.8	-2.1	-0.9	-0.6	1.3	2.7	4.5	4.5	5.3	6.1	6.2	1.6	-18.1	-1.8	3.6
Equipment and Software	-0.5	-5.0	-9.4	-25.9	-36.4	-4.9	-1.8	3.2	4.8	3.8	4.6	5.0	5.8	5.4	5.9	6.4	2.6	-2.6	-17.7	2.8	5.4
Structures	6.8	14.5	-0.1	-7.2	-43.6	-17.3	-15.0	-13.5	-13.5	-11.0	-7.0	-3.5	1.0	2.0	3.5	5.0	14.9	10.3	-19.2	-12.2	-1.0
Residential Construction	-28.2	-15.8	-15.9	-23.2	-38.2	-23.2	7.0	3.5	2.0	3.5	4.0	5.0	5.5	6.0	6.5	7.0	-18.5	-22.9	-21.5	1.8	5.4
Government Purchases	2.6	3.6	4.8	1.2	-2.6	6.7	3.2	2.6	1.9	1.6	3.2	2.3	1.8	1.6	1.6	1.6	1.7	3.1	2.2	2.6	2.0
Net Exports	-550.9	-476.0	-479.2	-470.9	-386.5	-330.4	-323.6	-309.0	-291.3	-279.1	-275.0	-280.1	-283.2	-271.9	-260.5	-242.7	-647.7	-494.3	-337.4	-281.4	-264.6
Pct. Point Contribution to GDP	0.4	2.4	-0.1	0.5	2.6	1.7	0.2	0.4	0.5	0.4	0.1	-0.2	-0.1	0.3	0.3	0.5	0.6	1.2	1.2	0.4	0.1
Inventory Change	0.6	-37.1	-29.7	-37.4	-113.9	-160.2	-107.1	-45.0	-15.0	7.5	20.0	31.0	34.0	38.0	39.0	40.0	19.5	-25.9	-106.6	10.9	37.8
Pct. Point Contribution to GDP	-0.2	-1.3	0.3	-0.6	-2.4	-1.4	1.7	1.9	0.9	0.7	0.4	0.3	0.1	0.1	0.0	0.0	-0.3	-0.3	-0.6	0.9	0.2
Nominal GDP	1.0	3.5	1.4	-5.4	-4.6	-0.8	4.1	3.5	3.4	3.3	3.6	3.6	3.7	4.3	4.4	4.8	5.1	2.6	-1.2	3.3	3.9
Real Final Sales	-0.5	2.7	-2.9	-4.7	-4.1	0.7	1.5	0.9	1.6	1.6	1.9	1.7	1.8	2.2	2.4	2.7	2.5	0.8	-1.8	1.4	2.0
Retail Sales (b)	2.6	2.4	0.3	-8.0	-8.9	-9.5	-6.3	1.1	3.3	4.2	3.2	3.8	4.5	4.8	4.9	5.0	3.3	-0.7	-6.0	3.7	4.8
Inflation Indicators (b)																					
"Core" PCE Deflator	2.4	2.5	2.6	2.0	1.7	1.6	1.3	1.4	1.4	1.2	1.2	1.3	1.4	1.5	1.6	1.7	2.4	2.4	1.5	1.2	1.6
Consumer Price Index	4.2	4.3	5.2	1.5	-0.2	-0.9	-1.5	0.9	1.8	1.8	1.3	1.4	1.7	1.9	2.1	2.2	2.9	3.8	-0.4	1.6	2.0
"Core" Consumer Price Index	2.4	2.3	2.5	2.0	1.7	1.8	1.5	1.5	1.4	1.1	1.1	1.3	1.5	1.6	1.7	1.8	2.3	2.3	1.6	1.2	1.7
Producer Price Index	7.2	7.6	9.5	1.4	-2.2	-4.1	-4.9	1.2	3.3	3.4	2.3	1.9	2.1	2.2	2.4	2.4	3.9	6.4	-2.5	2.7	2.3
Employment Cost Index	3.3	3.1	2.9	2.6	2.1	1.8	1.7	1.6	1.9	1.6	1.6	1.7	2.0	1.9	1.8	1.8	3.4	3.0	1.8	1.7	1.9
Real Disposable Income (a)	-2.4	9.8	-8.5	3.4	0.2	3.8	-1.4	1.3	1.2	1.4	1.7	1.9	1.9	2.0	2.1	2.2	2.2	0.5	0.8	1.2	1.9
Nominal Personal Income (b)	3.7	4.0	2.9	1.1	-1.6	-2.6	-2.8	-2.7	0.0	0.7	1.9	3.5	4.1	4.2	4.1	3.8	5.6	2.9	-2.4	1.5	4.1
Industrial Production (a)	0.2	-4.6	-9.0	-13.0	-19.0	-10.5	3.2	1.7	2.0	2.3	3.0	4.1	4.5	4.3	3.9	3.7	1.5	-2.2	-10.4	1.6	3.9
Capacity Utilization	80.1	78.9	76.9	74.2	70.4	68.6	69.4	69.6	69.7	69.8	69.8	70.1	70.5	70.9	71.3	71.5	80.6	77.6	69.5	69.9	71.0
Corporate Profits Before Taxes (b)	-4.9	-12.0	-5.4	-25.1	-19.0	-12.6	-11.0	3.5	5.0	7.0	9.5	9.5	9.5	9.5	10.0	10.0	-4.1	-11.8	-10.6	7.8	9.8
Corporate Profits After Taxes	6.6	-3.7	4.8	-15.8	-19.7	-15.3	-9.0	3.0	5.0	8.5	11.0	11.5	11.5	11.5	11.5	11.5	-4.0	-2.0	-10.9	9.1	11.5
Federal Budget Balance (c)	-205.9	26.9	-168.9	-332.5	-448.9	-304.9	-373.7	-375.3	-595.8	-229.5	-284.4	-275.2	-436.9	-168.3	-219.6	-180.0	-161.5	-454.8	-1460.0	-1485.0	-1100.0
Current Account Balance (d)	-179.3	-187.7	-184.2	-154.9	-104.5	-98.8	-100.0	-105.0	-100.0	-100.0	-105.0	-105.0	-110.0	-110.0	-110.0	-110.0	-726.6	-706.1	-408.2	-410.0	-440.0
Trade Weighted Dollar Index (e)	70.3	71.0	76.1	79.4	83.2	77.7	74.7	76.0	78.1	79.2	80.7	81.8	83.7	84.3	85.0	85.3	73.3	79.4	76.0	81.8	85.3
Nonfarm Payroll Change (f)	-113	-153	-208	-553	-691	-428	-256	-225	-150	-75	40	105	130	130	140	150	96	-257	-400	-20	138
Unemployment Rate	4.9	5.4	6.1	6.9	8.1	9.3	9.6	10.0	10.3	10.5	10.5	10.4	10.2	10.0	9.8	9.7	4.6	5.8	9.2	10.4	9.9
Housing Starts (g)	1.06	1.02	0.87	0.66	0.53	0.54	0.60	0.60	0.60	0.65	0.68	0.71	0.74	0.77	0.82	0.88	1.34	0.90	0.57	0.66	0.80
Light Vehicle Sales (h)	15.2	14.1	12.9	10.5	9.5	9.6	11.5	9.6	9.9	10.2	10.5	10.8	11.1	11.4	11.7	12.0	16.1	13.2	10.0	10.4	11.6
Crude Oil - WTI - Front Contract (i)	97.90	123.98	117.98	58.74	43.08	59.62	68.30	68.00	69.00	71.00	72.00	73.00	74.00	75.00	75.00	76.00	72.31	99.65	59.75	71.25	75.00
Quarter-End Interest Rates																					
Federal Funds Target Rate	2.25	2.00	2.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	1.25	1.75	2.25	2.75	3.25	4.25	0.25	0.25	1.25	3.25
3 Month LIBOR	2.69	2.78	4.05	1.43	1.19	0.60	0.29	0.30	0.35	0.40	0.60	1.40	1.90	2.40	2.90	3.40	4.70	1.43	0.30	1.40	3.40
Prime Rate	5.25	5.00	5.00	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.50	4.25	4.75	5.25	5.75	6.25	7.25	3.25	3.25	4.25	6.25
Conventional Mortgage Rate	5.97	6.32	6.04	5.33	5.00	5.42	5.19	5.00	5.10	5.30	5.40	5.50	5.50	5.60	5.80	6.00	6.10	5.33	5.00	5.50	6.00
3 Month Bill	1.38	1.90	0.92	0.11	0.21	0.19	0.14	0.20	0.25	0.25	0.50	1.25	1.70	2.20	2.70	3.20	3.36	0.11	0.20	1.25	3.20
2 Year Note	1.62	2.63	2.00	0.76	0.81	1.11	0.95	1.10	1.20	1.30	1.40	1.70	1.90	2.30	2.80	3.40	3.05	0.76	1.10	1.70	3.40
5 Year Note	2.46	3.34	2.98	1.55	1.67	2.54	2.31	2.40	2.50	2.60	2.70	2.80	2.90	3.10	3.30	3.50	3.45	1.55	2.40	2.80	3.50
10 Year Note	3.45	3.99	3.85	2.25	2.71	3.53	3.31	3.40	3.50	3.60	3.70	3.80	3.90	4.00	4.20	4.40	4.04	2.25	3.40	3.80	4.40
30 Year Bond	4.30	4.53	4.31	2.69	3.56	4.32	4.03	4.10	4.20	4.30	4.40	4.50	4.60	4.70	4.80	5.00	4.45	2.69	4.10	4.50	5.00

Forecast as of: October 7, 2009

Notes:
(a) Compound Annual Growth Rate Quarter-over-Quarter
(b) Year-over-Year Percentage Change
(c) Quarterly Sum - Billions USD; Annual Data Represents Fiscal Yr.
(d) Quarterly Sum - Billions USD
(e) Federal Reserve Major Currency Index, 1973=100 - Quarter End
(f) Average Monthly Change
(g) Millions of Units
(h) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold
(i) Quarterly Average of Daily Close

Policy Priorities Beginning to Shift in Some Countries

When the global economy fell off a cliff last autumn, governments in most major economies were quick to enact stimulus programs, both monetary and fiscal, to prevent a total worldwide collapse in economic activity. Their efforts largely succeeded. Although the global economy has suffered its deepest recession in decades, a catastrophe (i.e., another Great Depression) was averted. Indeed, recent monthly indicators suggest that a tentative global recovery is starting to take hold.

The leaders of the G-20 nations met recently in Pittsburgh and congratulated themselves on a job well done. They also pledged to "avoid any premature withdrawal of stimulus" in order to secure a "durable recovery." It will be interesting to see whether that commitment actually remains in place in the quarters ahead. When the global economy is teetering at the precipice, it is relatively easy to get leaders to agree that stimulus is needed. Now that the immediate crisis has passed and policy priorities are starting to diverge somewhat, achieving consensus may be more difficult.

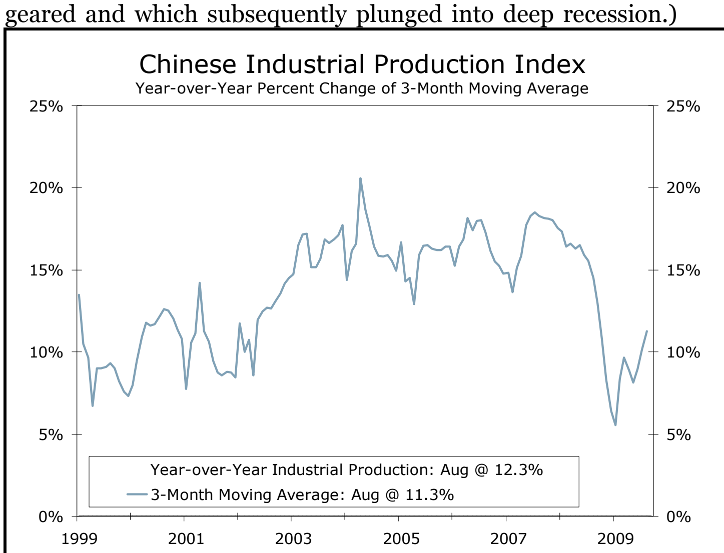
The group of countries most likely to require continued macroeconomic stimulus is the western economies. Financial systems in many western economies became very leveraged earlier this decade, and economic growth could continue to be held back by continued deleveraging. Although the worst is probably over for the Euro-zone, we project that real GDP growth in continental Europe will remain lackluster throughout most of next year (see the chart on the front page). Both the U.S. and U.K. economies will likely grow at a sluggish pace next year also. If stimulus is withdrawn prematurely, these economies could conceivably roll back into recession. (A "double dip" recession is not our forecast, however.)

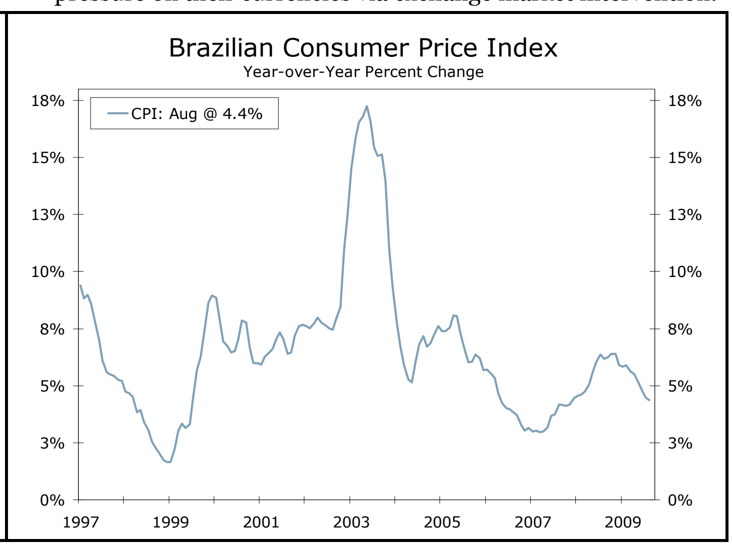
In contrast, bona fide recoveries appear to be underway in many developing economies. (The major exception to this statement would be Eastern Europe, which was very highly geared and which subsequently plunged into deep recession.) For example, Chinese industrial production has returned to double-digit growth rates recently (see below). Although the emerging world surely would experience a renewed slowdown if a number of major economies were to slide back into recession, continued stimulus may no longer be appropriate for many developing economies. Addressing inflation could become a policy priority again for some of these countries.

Take Brazil, for example. The overall rate of CPI inflation in Brazil has trended lower since the end of 2008, and it likely will drift lower over the next few months. However, we project that it will begin to pick up again by mid-2010 as Brazilian economic growth strengthens and as commodity prices continue to grind higher. Will Brazilian authorities continue to sanction further stimulus if inflation threatens to head higher? Probably not. Some analysts look for the Brazilian central bank to hike rates early next year, and central banks in some other large developing countries probably will follow suit as well.

As recently shown by Australia, an advanced economy that is also a G-20 member, rate hikes in some countries could begin fairly soon. The Reserve Rank of Australia surprised most investors on October 6 when it lifted its main policy rate by 25 basis points. The Australian economy escaped relatively unscathed from last autumn's global financial crisis, and recoveries in many of the country's major trading partners in Asia will continue to boost the country's exports.

We do not mean to imply that developing countries will slam on the brakes, thereby threatening to derail the incipient global recovery. Inflation is generally benign at present, and there is no need for excessive tightening. Very low interest rates may no longer be appropriate in many parts of the developing world, and central banks in these countries likely will begin to withdraw excess stimulus well in order to ensure that inflation does not become a major problem again. As rates rise, central banks in these countries likely will resist some of the upward pressure on their currencies via exchange market intervention.





Source: IHS Global Insight and Wells Fargo Securities, LLC

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP			CPI		
	2009	2010	2011	2009	2010	2011
Global (PPP weights)	-0.9%	3.7%	3.9%	2.7%	3.6%	3.9%
Global (Market Exchange Rates)	-2.1%	2.5%	2.7%	n/a	n/a	n/a
Advanced Economies[1]	-3.4%	2.3%	2.4%	-0.3%	1.1%	1.8%
United States	-2.4%	2.4%	2.2%	-0.4%	1.6%	2.0%
Eurozone	-3.8%	1.9%	2.5%	0.3%	1.1%	1.7%
United Kingdom	-4.4%	1.9%	2.4%	2.2%	2.3%	1.8%
Japan	-5.9%	1.8%	1.6%	-1.3%	-0.7%	0.5%
Korea	-1.0%	3.9%	3.5%	2.7%	2.8%	2.9%
Canada	-2.5%	2.1%	2.7%	0.2%	1.6%	1.9%
Developing Economies[1]	2.2%	5.3%	5.7%	6.4%	6.4%	6.4%
China	8.4%	8.8%	9.0%	-0.8%	1.3%	2.0%
India	5.8%	7.0%	8.0%	10.9%	9.4%	6.8%
Mexico	-7.0%	2.2%	2.5%	5.3%	3.6%	3.9%
Brazil	0.2%	3.5%	3.6%	4.9%	4.9%	5.1%
Russia	-8.0%	2.4%	3.0%	12.1%	8.1%	9.2%

Forecast as of: October 7, 2009

[1]Aggregated Using PPP Weights

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	3-Month LIBOR							10-Year Bond						
	2009	2010				2011		2009	2010				2011	
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q4	Q1	Q2	Q3	Q4	Q1	Q2
U.S.	0.30%	0.35%	0.40%	0.60%	1.40%	1.90%	2.40%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%
Japan	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.35%	1.30%	1.30%	1.35%	1.45%	1.55%	1.65%	1.80%
Euroland	0.70%	0.70%	1.00%	1.40%	2.00%	2.75%	3.20%	3.25%	3.30%	3.60%	3.90%	4.25%	4.40%	4.45%
U.K.	0.60%	0.60%	0.65%	0.90%	1.45%	2.20%	3.20%	3.50%	3.60%	3.90%	4.20%	4.50%	4.60%	4.70%
Canada	0.50%	0.50%	0.60%	1.00%	2.00%	3.00%	3.75%	3.30%	3.40%	3.60%	4.00%	4.30%	4.40%	4.45%

Forecast as of: October 7, 2009

Wells Fargo Securities, LLC Economics Group

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