

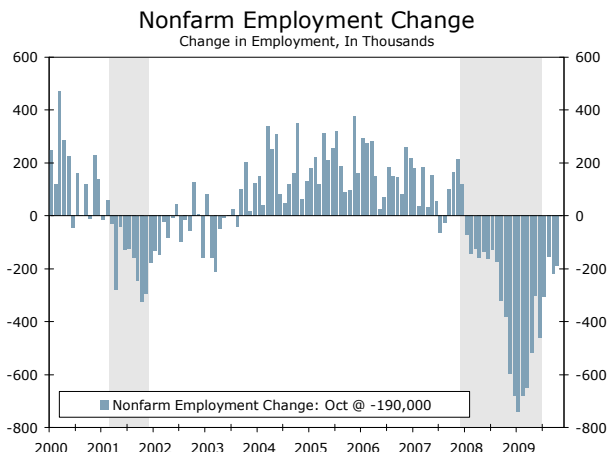
# Economics Group

## Weekly Economic & Financial Commentary

### U.S. Review

#### Almost Everything Is Improving Except Hiring

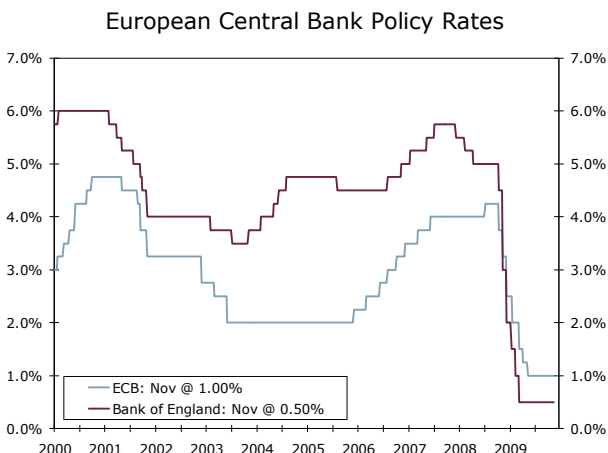
- Nonfarm employment fell by 190,000 jobs in October, with declines as broad based as in recent months. The unemployment rate rose to 10.2 percent.
- The ISM manufacturing index rose 3.1 points to 55.7 in October, led by a 7.6 jump in the production component. The employment index rose above 50 for the first time in 14 months.
- Productivity surged during the third quarter, with rebounding manufacturing output and broad based cutbacks in the service sector accounting for most of the increase.



### Global Review

#### European Central Banks Remain Accommodative

- The Bank of England's Monetary Policy Committee (MPC) announced this week that it will continue its program of bond purchases, but the pace of those purchases will be dialed back somewhat. The MPC decided to keep its main policy rate at 50 basis points, as was widely expected.
- Across the English Channel, the European Central Bank (ECB) also opted to keep its key policy rate at 1 percent. ECB President Trichet said that the recovery is taking shape in-line with the bank's expectations, and the current rate level is "appropriate."



Wells Fargo U.S. Economic Forecast														
	Actual				Forecast				Actual			Forecast		
	2008		2009		2009		2010		2006	2007	2008	2009	2010	2011
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
Real Gross Domestic Product <sup>1</sup>	-0.7	1.5	-2.7	-5.4	-6.4	-0.7	3.7	2.8	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	2.9	2.6	-0.2	-0.8	1.0	1.4
Inflation Indicators <sup>2</sup>														
"Core" PCE Deflator	2.4	2.5	2.6	2.0	1.7	1.6	1.3	1.4	2.3	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	3.2	2.9	3.8	-0.4	1.6	2.0
Industrial Production <sup>1</sup>	0.2	-4.6	-9.0	-13.0	-19.0	-10.5	3.2	1.7	2.3	1.5	-2.2	-10.4	1.6	3.9
Corporate Profits Before Taxes <sup>2</sup>	-4.9	-12.0	-5.4	-25.1	-19.0	-12.6	-11.0	3.5	10.5	-4.1	-11.8	-10.6	7.8	9.8
Trade Weighted Dollar Index <sup>3</sup>	70.3	71.0	76.1	79.4	83.2	77.7	74.7	76.0	81.5	73.3	79.4	76.0	81.8	85.3
Unemployment Rate	4.9	5.4	6.1	6.9	8.1	9.3	9.6	10.0	4.6	4.6	5.8	9.2	10.4	9.9
Housing Starts <sup>4</sup>	1.06	1.02	0.87	0.66	0.53	0.54	0.60	0.60	1.81	1.34	0.90	0.57	0.66	0.80
Quarter-End Interest Rates														
Federal Funds Target Rate	2.25	2.00	2.00	0.25	0.25	0.25	0.25	0.25	5.25	4.25	0.25	0.25	1.25	3.25
Conventional Mortgage Rate	5.97	6.32	6.04	5.33	5.00	5.42	5.19	5.00	6.14	6.10	5.33	5.00	5.50	6.00
10 Year Note	3.45	3.99	3.85	2.25	2.71	3.53	3.31	3.40	4.71	4.04	2.25	3.40	3.80	4.40

Forecast as of: October 7, 2009  
<sup>1</sup> Compound Annual Growth Rate Quarter-over-Quarter  
<sup>2</sup> Year-over-Year Percentage Change  
<sup>3</sup> Federal Reserve Major Currency Index, 1973=100 - Quarter End  
<sup>4</sup> Millions of Units

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Together we'll go far



**U.S. Review**

**Almost Everything Is Improving Except Hiring**

This week's busy schedule of economic reports brought mostly good news, even if it did end on a somewhat disappointing note. Several of the more leading indicators of economic growth posted strong gains, suggesting that the recovery process is well underway. We still suspect that the second quarter shutdown and third quarter restart of motor vehicle output is responsible for much of the swing in economic activity. The near doubling in motor vehicle production casts a broad shadow over the entire economy and is lifting orders and production in a number of industries.

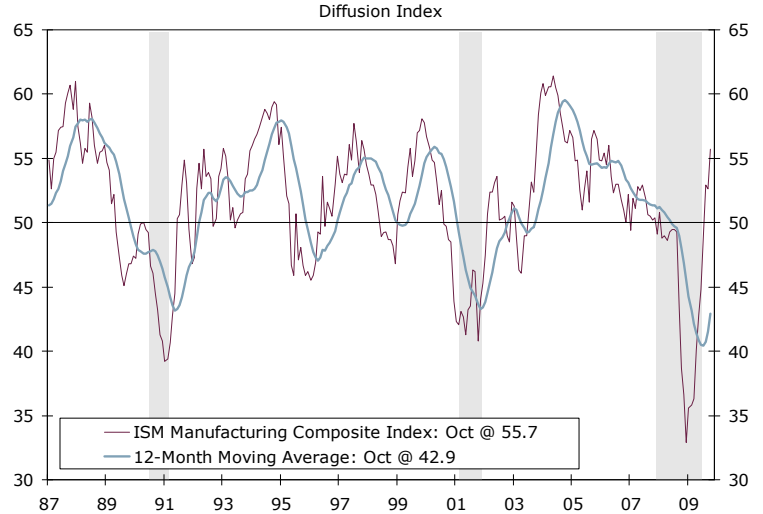
October's 3.1 point rise in the ISM manufacturing index started the week on a positive note. The ISM manufacturing index is one of the best ways to measure swings in the factory sector, which typically produces the cyclical impulse for the broader economy. Most of the increase was in the production series, which surged 7.6 points. The biggest surprise, however, was the 6.9 point increase in the employment component, which brought that series above 55 for the first time in 14 months. The more leading components of the index, inventories and new orders, were mixed. Inventories and customer inventories remain low but the new orders series dropped during the month, suggesting that future ISM numbers may not be as robust.

Motor vehicle sales rebounded solidly in October, with sales coming in at a 10.4 million unit pace. Sales had plummeted to a 9.2 million unit pace in September, reflecting the abrupt end to the cash-for-clunkers program. Averaging the two months sales might provide a better indication of the underlying sales pace, putting it at around 9.8 million units.

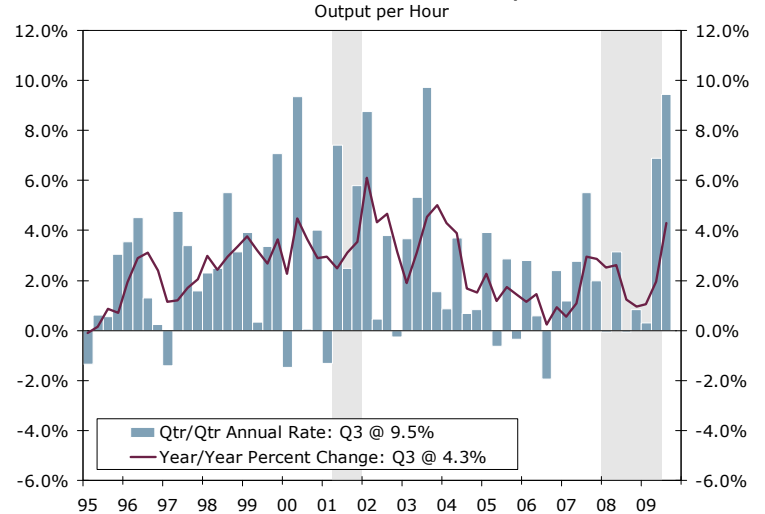
Third quarter productivity numbers came in stronger than expected. Nonfarm productivity surged at a 9.5 percent annual rate and productivity figures for the second quarter were revised modestly higher. The improvement reflects a rebound in production and incessant cost cutting. Output rose at a 4.0 percent annual rate during the third quarter and hours worked plunged at a 5.0 percent pace. Over the past year output has fallen 3.5 percent and employee hours have fallen even more, 7.5 percent. Productivity surged by an even stronger 13.6 percent pace in the factory sector. Most of that increase was in the auto sector, which helped boost productivity in the durable goods sector at a 21.2 percent pace. The stronger productivity numbers suggest a pick up in hiring is not that far off.

Nonfarm payrolls fell by 190K jobs in October, and the unemployment rate surged to 10.2 percent, despite continued shrinkage of the labor force. However, improvements in the average workweek in manufacturing and overtime suggest a turn in the cyclical forces on employment. In addition, the index of hours worked is close to a bottom and this is consistent with gains in total output. These improvements are solid signals that there is a modest recovery—but not a boom—in place. We expect hiring to turn positive on sustained basis sometime in the next six to nine months, which would be an earlier turnaround for employment than in either of the past two recoveries.

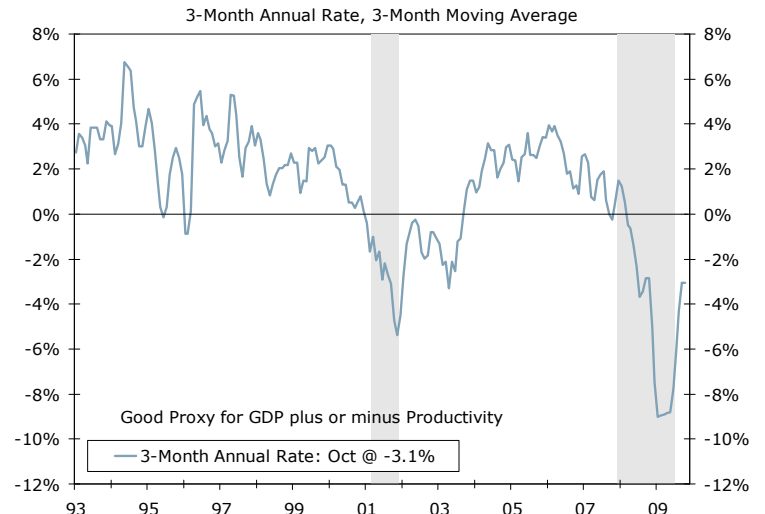
ISM Manufacturing Composite Index



Nonfarm Productivity



Index of Hours Worked



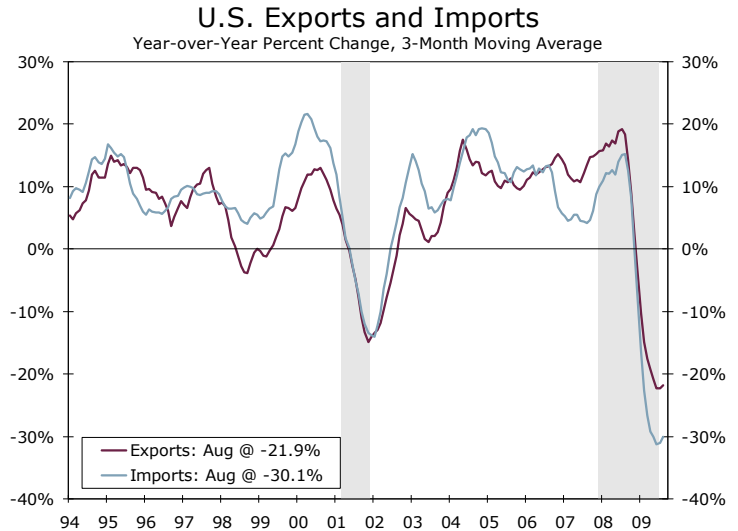
**U.S. Trade Balance • Friday**

Third quarter GDP showed a modest widening in the U.S. trade deficit to \$348.3 billion from \$330.4 billion, as both exports and imports rose at a double digit annualized rate on recovering demand. The trade balance subtracted a little more than a half a percentage point from GDP growth in the quarter, after adding 1.7 percentage points in Q2 and 2.6 percentage points in Q1. The September trade balance figure released on Friday will help fine-tune this estimate. We expect the trade deficit to widen to -\$32.4B for the month of September as imports rebound from a modest 0.6 percent decline in August. Investors will be looking for continued signs the global recovery in the report and the weaker dollar is having a noticeable impact on the ability to sell U.S. products abroad. The government has noted that the recovery will be inordinately reliant on this growth driver as U.S. consumer demand remains soft.

**Previous: -\$30.7B**

**Wells Fargo: -\$32.4B**

**Consensus: -\$31.0B**



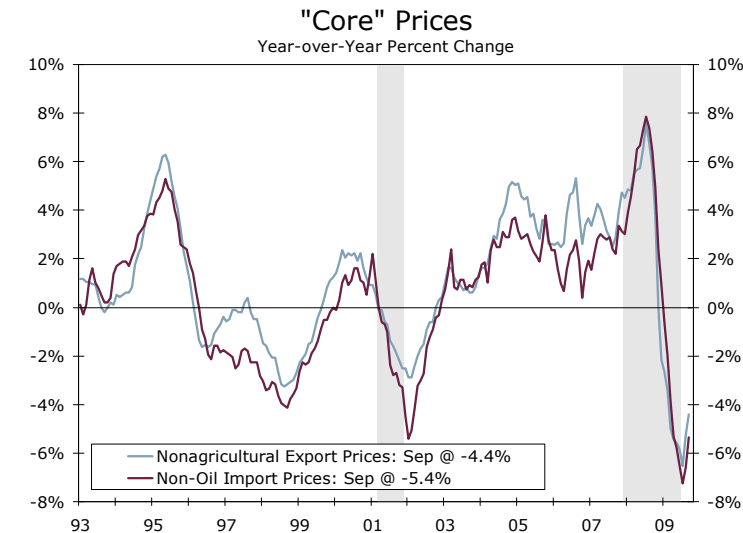
**Import Prices • Friday**

Import prices likely jumped 1.6 percent in October, primarily due to large increases in imported oil prices. Excluding volatile oil prices, the import price index will likely rise a more modest 0.2 percent. Trade prices fell rapidly during the last five months of 2008, and began forming a trough in the first quarter of 2009. More recently, import prices have begun rising as oil prices have more than doubled from their low, and a weaker dollar begins to have an impact on foreign producers' ability to discount U.S.-bound merchandise. Still, given the drop in consumer demand in the U.S., import prices are expected to remain 5.0 percent below year-ago levels. Export prices are also likely to also rise in October, reversing a September decline as foreign demand continues to recover, though the gains should prove more modest. Deflation is now rapidly dissipating, at least from a trade perspective.

**Previous: 0.1%**

**Wells Fargo: 1.6%**

**Consensus: 1.0%**

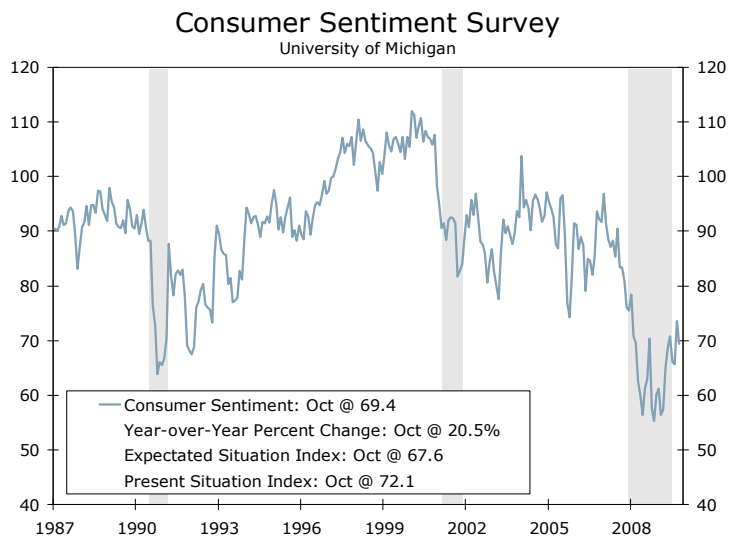


**Michigan Sentiment • Friday**

Consumer sentiment slumped in October to 70.6 as labor market weakness and slowing income growth weighed heavily on consumers' minds. September's sentiment reading at 73.5 marked the highest level since January 2008. But even with October's decline, consumer sentiment remains well above the November 2008 low of 55.3. Recent weakness has been led by the expectations component, while the current component has continued to improve at a gradual pace. Stock market declines over the past two weeks may also weigh on preliminary November sentiment as the S&P 500 dropped about 5.0 percent from recent highs before rebounding yesterday. The rebound in consumer confidence, so far, is somewhat disappointing after such a steep recession, suggesting that consumer spending growth will remain weaker than usual, sapping the vigor out of this economic recovery.

**Previous: 70.6**

**Consensus: 71.0**



## Global Review

### London Fog Lifting

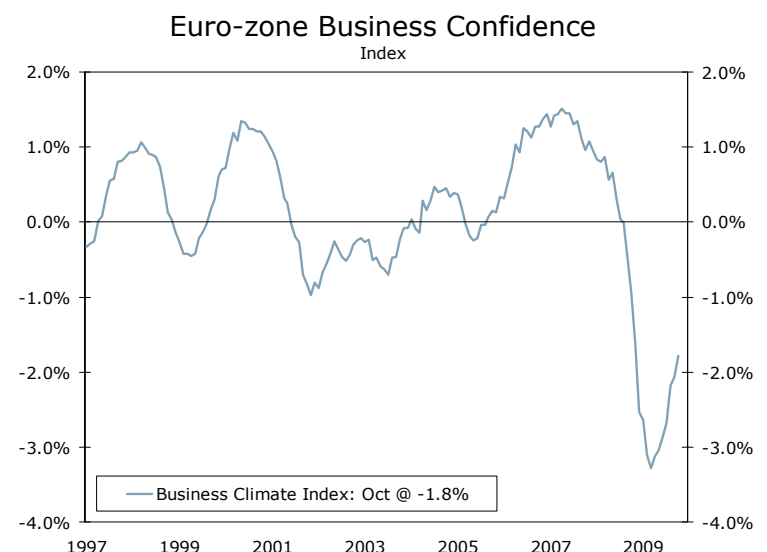
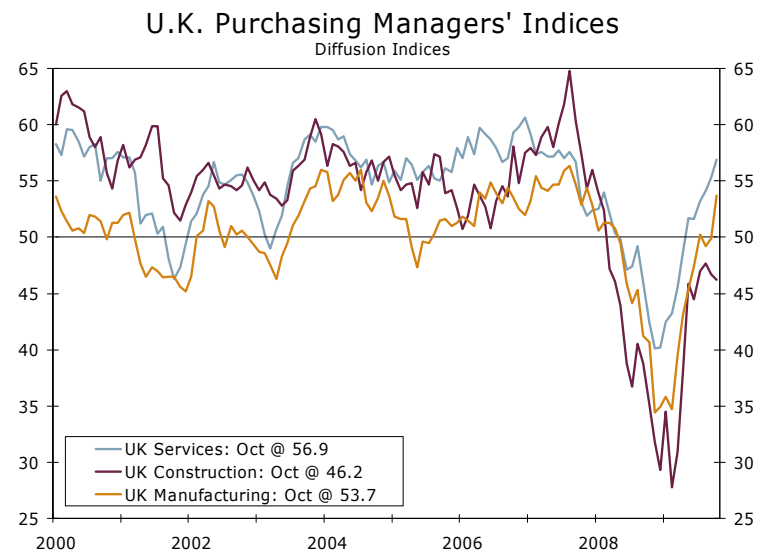
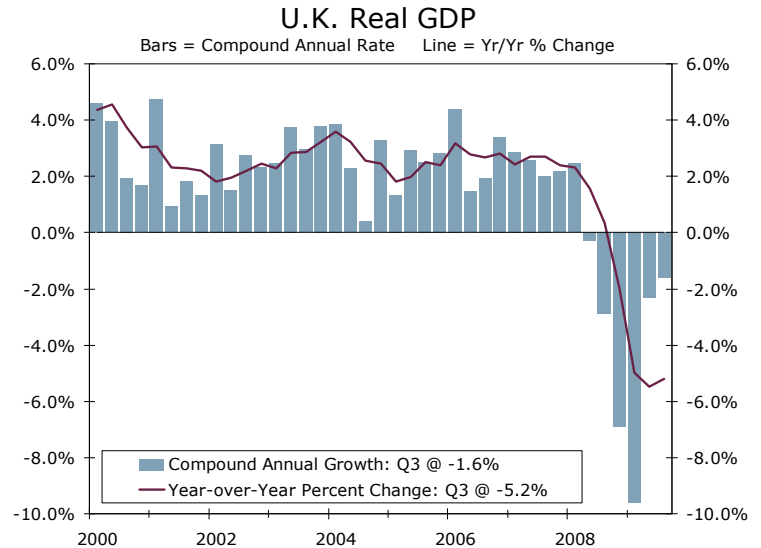
The rate decision from the Bank of England (BoE) was widely expected but slowing the pace of bond purchases took some by surprise. The BoE's asset purchase program was extended to £200B (\$332B USD); the consensus was looking for £225B.

Analysts had expected the BoE to increase the size of its quantitative easing program because "hard" economic data from the United Kingdom in recent weeks have generally been weaker than expected. U.K. GDP data that were released just a few weeks ago show that the British economy contracted for the sixth consecutive quarter. The BoE's Monetary Policy Committee (MPC) is keenly aware of the challenges that still confront the U.K. economy, but it is also keeping an eye on current developments that are more encouraging. Indeed, in its official press release the MPC observed that while growth contracted in the third quarter, "indicators of spending and confidence...suggest that a pickup in economic activity may soon be evident." U.K. purchasing managers' indices (PMIs) attest to the resurgence in confidence. The construction PMI has recovered on trend, but has yet to break through the 50 line that separates contraction from growth. The services and the manufacturing PMIs, however, are well-north of 50 and firmly in expansion territory.

With inflation under control and the U.K. economy still in the early stages of recovery, the Bank's MPC has cover to maintain an accommodative policy stance, at least with respect to keeping rates where they are for now. That said, with the outlook improving, we suspect the BoE will not increase the size of its asset purchase program any further.

### European Renaissance

In the Euro-zone, economic recovery appears to be on track as well. Industrial production (IP) in the Euro-zone increased 1.1 percent in the month of August. There has not been a larger month-over-month jump in IP since May 2006. As we saw in the U.K. purchasing managers' data, both the manufacturing and services PMIs in the Euro-zone have recently broken into expansion territory. Euro-zone business confidence has improved for seven straight months, and other regional measures of confidence like the ZEW survey also show economic sentiment improving across Europe. While the Euro-zone economy contracted mildly in the second quarter, we expect growth to return in the third quarter. In the context of this story of recovery, it comes as little surprise that the ECB opted to leave its target rate at 1 percent. After signaling that the ECB has little intention of raising rates by calling the current rate level "appropriate," the ECB President Trichet said the Bank would monitor inflation along with the overall economy as it considers future decisions. He also hinted that the ECB would consider scaling back some of its lending to banks. We don't expect any significant moves from the ECB in the near future. As the recovery picks up steam and we move into the second half of 2010, the ECB will start to normalize monetary policy eventually culminating in a decision to slowly raise its main policy rate.



## U.K. Unemployment Rate • Wednesday

The unemployment rate in the United Kingdom has taken off over the past year. It currently stands at 7.9 percent, the highest rate in 13 years. Although the economy is showing signs of stabilization, there are few indications yet of an increase in hiring activity. It appears the jobless rate will continue to climb in the foreseeable future. The consensus expectation is that the jobless rate climbed to 8.0 percent in September; the number prints on Wednesday.

Also on Wednesday, we can expect the publication of the Bank of England's quarterly Inflation Report. With U.K. CPI currently at 1.1 percent, inflation is at the low boundary of the Bank's target range of 1 to 3 percent. As the recovery gets under way, we suspect inflation will gradually rise, particularly in the second half of next year. The report will lend perspective on the Bank of England's assessment of the situation.

**Previous: 7.9%**

**Consensus: 8.0%**



## Euro-zone GDP • Friday

Industrial production (IP) in the Euro-zone has stabilized over the past few months, but it remains depressed relative to the level of a year ago. As discussed in the Global Review section of this report, the manufacturing purchasing managers' index points in the direction of stronger production. Does strong survey data necessarily translate into stronger IP data? We will find out when IP is released on Thursday.

The next day European bourses will get a first look at economic growth in the Euro-zone when GDP data are published. The Euro-zone economy contracted in the second quarter, but it was the slowest pace of contraction in this cycle. We suspect growth likely turned positive in the third quarter as it has in other major economies as a broader global recovery begins to take hold.

**Previous: -0.8% (CAGR)**

**Consensus: 2.0%**

U.K. Unemployment Rate  
Seasonally Adjusted



## Chinese Industrial Production • Wed.

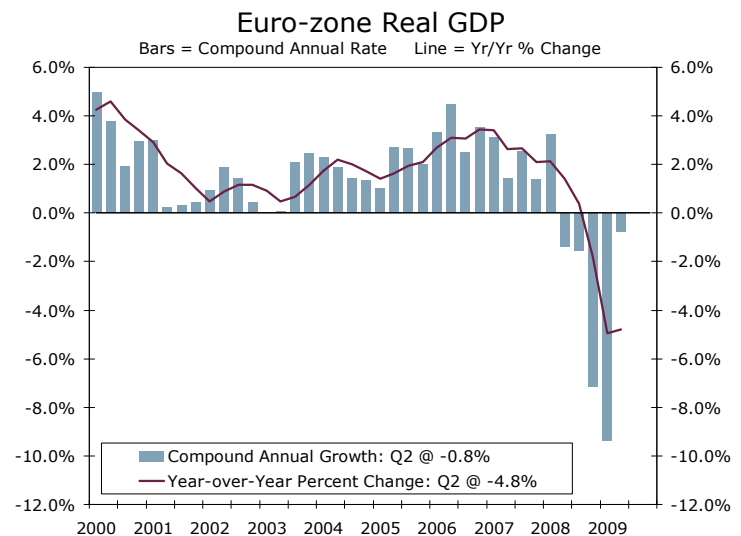
Chinese economic growth strengthened from 7.9 percent in the second quarter to 8.9 percent in the third quarter, due in part to fiscal stimulus.

Monthly industrial production and retail sales data can be a good harbinger of Chinese GDP growth. The year-over-year rate of industrial production growth is expected to rise to more than 15 percent from 13.9 percent in September. Retail sales growth likely maintained its fast pace of year-over-year growth north of 15 percent. Both of those numbers print on Wednesday.

Consumer prices are down on a year-over-year basis, but the rate of contraction likely slowed between September and August. Markets will know for sure when Chinese CPI data are also released on Wednesday.

**Previous: 13.9% (Year-over-Year)**

**Consensus: 15.5%**



**Interest Rate Watch**

**FOMC Anchors Short Rates**

This week's statement from the Federal Open Market Committee (FOMC) reinforced market expectations that the federal funds rate, and thereby short-term market rates, will remain low for the rest of this year and at least into the first half of next year. Two fundamentals are driving these expectations: slow growth and low inflation. Our outlook remains for no change in the federal funds target range until third quarter 2010 at the earliest.

**“Economic activity...weak for a while”**

From the FOMC release we read that the Fed considers household spending to be constrained and businesses are still cutting back on fixed investment and staffing. Our outlook remains for below-trend (3 percent) growth for the next four quarters. Yes, this is a recovery, but the pace of recovery does not appear to be quick enough to pick up the slack in the economy to generate conditions anywhere near full employment. Our expectation is that the unemployment rate will remain above 9 percent through the first half of next year.

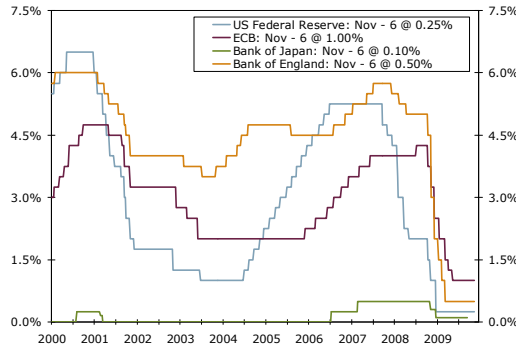
**“Inflation...subdued for some time”**

At great lengths, the FOMC goes on to inform us that with “substantial resource slack ...and with longer-term inflation expectations stable, inflation will remain subdued for some time.” Economic slack appears to be the driving factor here. This model for inflation is based upon what is commonly called a Phillips curve approach which argues that trends in unemployment are associated with trends in the opposite direction for wages—and thereby inflation. For now, the consensus view is that the slack (high unemployment rate) in the economy dictates that the FOMC is far from raising interest rates anytime soon.

**Problem for Decision-makers: Are We Repeating Old Mistakes?**

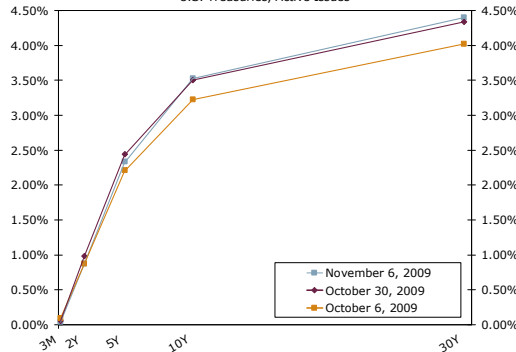
Low, stable interest rates driven by central bank policy has been blamed for some of the excesses of the 1990s. When interest rates are low and are expected to stay there for an “extended” period of time, then investors/speculators finance investment activities at a very low apparent cost of capital and thereby take on too many risks. Caution is warranted here.

Central Bank Policy Rates



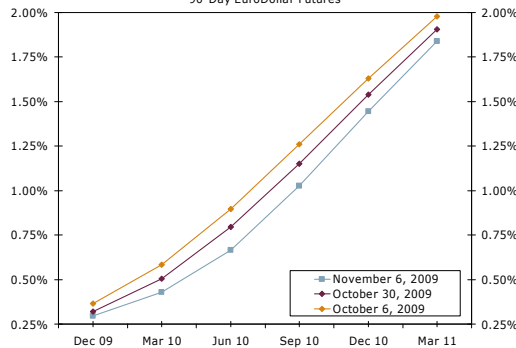
Yield Curve

U.S. Treasuries, Active Issues



Forward Rates

90-Day EuroDollar Futures



**Consumer Credit Insights**

**Jobs Will Extend Consumer Struggle**

Job losses and rising unemployment suggest continued consumer struggles with modest spending gains, rising delinquencies and continued structural job challenges for many local areas. The employment report for October revealed continued high unemployment in production and construction sectors. In contrast, there were signs that employment opportunities were improving in education/health as well as business services. For households and regional economies, skills and employment characteristics do not adjust as quickly as for the national economy. Therefore, households whose skills are in production and construction sectors and communities whose employment base is over weight in those sectors will suffer from above average delinquency and credit problems. In the U.S. recent experience has shown that delinquencies/foreclosures are very concentrated in a small set of states—given the employment data this will likely persist for the next 12 months. Corrections in the residential and commercial real estate sectors and the associated high level of the unemployment rate suggest that households who are currently unemployed will likely be unemployed for some time. Therefore, their credit experience will continue to suffer. There is no “V” shaped recovery for the economy or for credit quality. Modest economic recovery is associated with a gradual recovery in consumer credit quality.

**Mortgage Data**

	Current	Week Ago	4 Weeks Ago	Year Ago
<b>Mortgage Rates</b>				
30-Yr Fixed	4.98%	5.03%	4.87%	6.20%
15-Yr Fixed	4.40%	4.46%	4.33%	5.88%
5/1 ARM	4.35%	4.42%	4.35%	6.19%
1-Yr ARM	4.47%	4.57%	4.53%	5.25%
<b>MBA Applications</b>				
Composite	608.3	562.3	756.3	379.9
Purchase	250.3	254.9	306.1	260.9
Refinance	2,693.7	2,352.5	3,377.1	1,075.4

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

## Topic of the Week

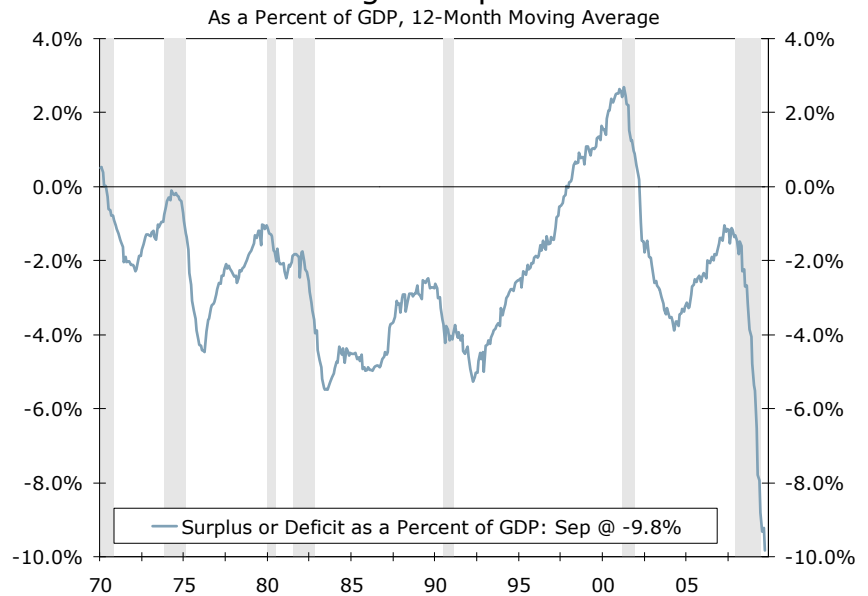
### Did the Nation Overdose on Debt?

Fiscal year 2009 for the United States government drew to a close on Sept. 30, when the closing bell sounded to the sour tune of a \$1.417 trillion deficit. The stock of debt held by the public, as a percentage of gross domestic product (GDP) has never been as high during peacetime. Wartime spikes in debt levels were temporary, however. In contrast, the current path of indebtedness shows a permanent venture into economically unfavorable territory. As a result, some of the financial flexibility of a lower debt load is lost. The United States benefits from high global demand for dollar-denominated assets, especially in turbulent economic environments when the safety trade is in play. Yields on 10-year Treasury notes remain low, implying that there is still a market for additional U.S. debt. While the nation is certainly not in the worst position relative to the rest of the world, its fiscal position does not leave room for complacency and free spending, especially given its dependence on capital inflows. The foremost holders (and primary market buyers) of Treasury securities are foreign investors, public and private, who held nearly 50 percent of Treasury securities outstanding in Q2 2009.

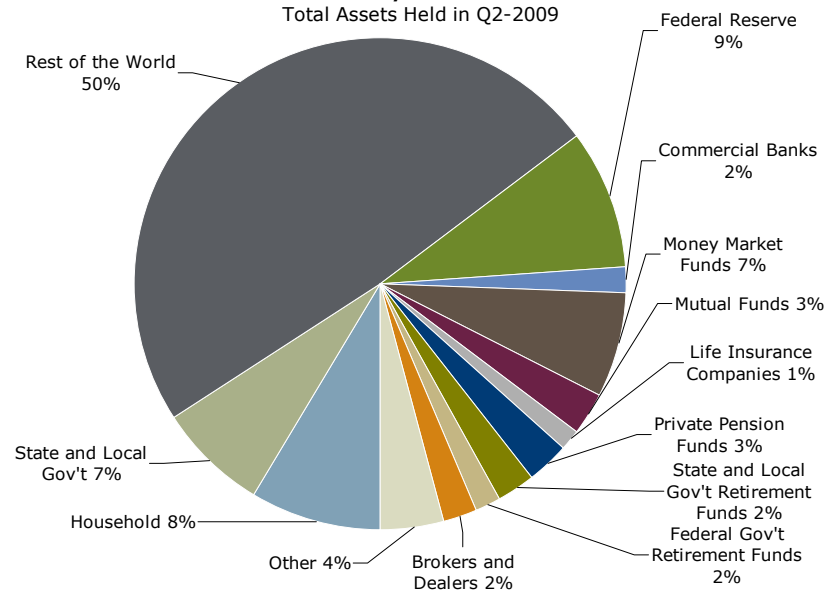
Despite the diminishing effects of short-term deficit drivers, the recession and the financial crisis, a quick bounce back to sustainability is off the table. Underlying the cyclical deficit story is the more meaningful long-run factor of entitlements, and a recession serves to accelerate the severity and immediacy of the problem. The primary federal entitlement programs, Medicare and Social Security, already pose serious threats to fiscal sustainability. It is clear that the nation faces difficult choices about the extent of debt servicing responsibility it is willing (and able) to take on and the extent to which it wishes to pass on the debt burden to future generations. Policymakers who evade the responsibility in the present merely postpone the day of reckoning.

Please visit our website for the complete report.

### Federal Budget Surplus or Deficit



### Treasury Securities



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## Market Data ♦ Mid-Day Friday

## U.S. Interest Rates

	Friday 11/6/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.04	0.04	0.30
3-Month LIBOR	0.27	0.28	2.39
1-Year Treasury	0.36	0.46	0.95
2-Year Treasury	0.85	0.89	1.28
5-Year Treasury	2.30	2.31	2.46
10-Year Treasury	3.50	3.38	3.69
30-Year Treasury	4.41	4.23	4.20
Bond Buyer Index	4.41	4.39	5.24

## Foreign Exchange Rates

	Friday 11/6/2009	1 Week Ago	1 Year Ago
Euro (\$/€)	1.485	1.472	1.272
British Pound (\$/£)	1.659	1.645	1.563
British Pound (£/€)	0.895	0.894	0.814
Japanese Yen (¥/\$)	89.836	90.090	97.750
Canadian Dollar (C\$/\\$)	1.071	1.085	1.198
Swiss Franc (CHF/\\$)	1.017	1.026	1.178
Australian Dollar (US\$/A\\$)	0.918	0.900	0.666
Mexican Peso (MXN/\\$)	13.371	13.198	13.047
Chinese Yuan (CNY/\\$)	6.827	6.827	6.825
Indian Rupee (INR/\\$)	46.815	46.975	47.687
Brazilian Real (BRL/\\$)	1.718	1.761	2.218
U.S. Dollar Index	75.765	76.300	85.893

## Foreign Interest Rates

	Friday 11/6/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.68	0.67	4.60
3-Month Sterling LIBOR	0.61	0.59	5.56
3-Month Canadian LIBOR	0.50	0.50	3.10
3-Month Yen LIBOR	0.32	0.33	0.89
2-Year German	1.27	1.29	2.43
2-Year U.K.	0.82	0.86	2.54
2-Year Canadian	1.40	1.39	1.91
2-Year Japanese	0.28	0.27	0.55
10-Year German	3.37	3.23	3.70
10-Year U.K.	3.88	3.62	4.33
10-Year Canadian	3.51	3.42	3.74
10-Year Japanese	1.45	1.41	1.50

## Commodity Prices

	Friday 11/6/2009	1 Week Ago	1 Year Ago
WTI Crude (\\$/Barrel)	77.23	77.00	60.77
Gold (\\$/Ounce)	1095.38	1045.40	732.85
Hot-Rolled Steel (\\$/S.Ton)	485.00	485.00	790.00
Copper (\\$/Pound)	295.05	294.75	172.25
Soybeans (\\$/Bushel)	9.55	9.78	8.68
Natural Gas (\\$/MMBTU)	4.57	5.05	6.98
Nickel (\\$/Metric Ton)	17,699	18,620	12,128
CRB Spot Inds.	445.62	438.48	363.29

## Next Week's Economic Calendar

	Monday 9	Tuesday 10	Wednesday 11	Thursday 12	Friday 13
U.S. Data				Monthly Budget Statement September -\$155.5B October -\$150.0B (W)	Trade Balance August -\$30.7B September -\$32.4B (W) Import Price Index September 0.1% October 1.6% (W)
Global Data	Canada Housing Starts Previous (Sep) 149.3K	UK Trade Balance Non-EU Previous (Aug) -3.05B (GBP)	UK Unemployment Rate Previous (Aug) 7.9%	Euro-zone Industrial Prod. (YoY) Previous (Aug) -15.4%	Euro-zone GDP (QoQ) Previous (2Q) -0.2%
	Germany Industrial Prod. (YoY) Previous (Aug) -16.8%	Germany Econ. Sentiment Previous (Oct) 56.0	China Industrial Prod. (YoY) Previous (Sep) 13.9%		Germany GDP (QoQ) Previous (2Q) 0.3%
Note: (W) = Wells Fargo Estimate (c) = Consensus Estimate					

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