June 15, 2012

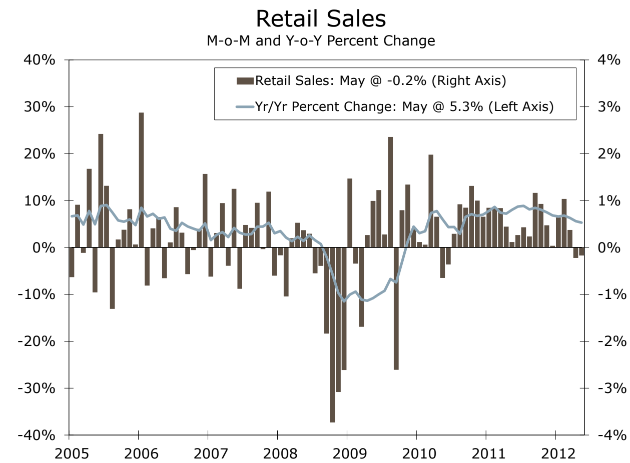
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Impediments to Additional Easing are Falling Away

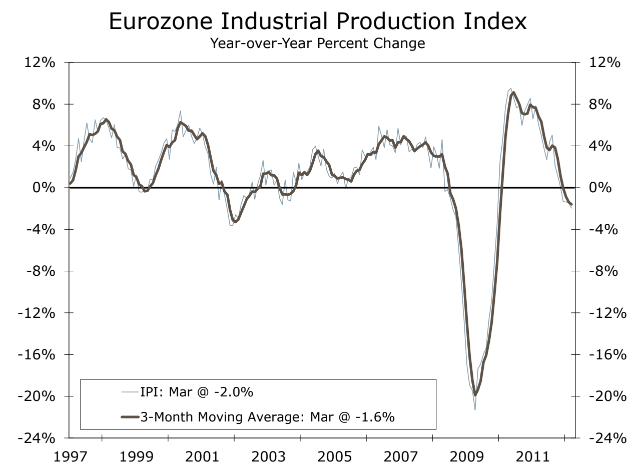
- There was little in terms of positive economic data this week. Consumer spending was disappointing and factory output was underwhelming. Continued deterioration in Europe dampened hopes for an export-led recovery.
- Both consumer prices and producer prices revealed only tepid price growth on a year-over-year basis, and the monthly change was negative. For consumer prices, this marked the first drop in prices in two years. This week's data bolster the case for additional Fed easing.



Global Review

Greek Election Weekend - Hold Your Breath

- All eyes are on Europe and Greece as the Greek election approaches. The stability in European equity markets this week suggests investors are putting more weight on the pro-bailout party holding power. However, Spanish and Italian bond yields, which have surged in recent days, suggest even a positive electoral outcome in Greece will not end the sovereign debt crisis in Europe.
- More rate cuts in China and evidence of better loan growth has raised expectations that China's growth could stabilize or reaccelerate before too long.



Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual			Forecast	
	2011				2012				2009	2010	2011	2012	2013
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product [1]	0.4	1.3	1.8	3.0	1.9	2.0	1.4	1.9	-3.6	3.0	1.7	2.0	1.8
Personal Consumption	2.1	0.7	1.7	3.0	2.7	2.2	1.7	1.7	-2.0	2.0	2.2	2.1	1.8
Inflation Indicators [2]													
PCE Deflator	1.8	2.5	2.9	2.7	2.3	1.8	1.4	1.2	0.6	1.8	2.5	1.7	1.1
Consumer Price Index	2.1	3.3	3.8	3.3	2.8	1.9	1.2	1.2	-0.3	1.6	3.1	1.8	1.6
Industrial Production [1]	4.4	1.2	5.6	5.1	5.6	3.1	2.4	2.2	-11.3	5.4	4.1	4.1	2.4
Corporate Profits Before Taxes [2]	8.8	8.5	7.5	7.0	6.5	6.0	5.8	5.4	9.1	32.2	7.9	5.9	5.5
Trade Weighted Dollar Index [3]	70.6	69.4	72.8	73.3	72.7	74.0	72.5	74.0	77.7	75.6	70.9	73.3	76.5
Unemployment Rate	9.0	9.0	9.1	8.7	8.3	8.2	8.3	8.2	9.3	9.6	9.0	8.2	8.0
Housing Starts [4]	0.58	0.57	0.61	0.68	0.71	0.73	0.76	0.75	0.55	0.59	0.61	0.74	0.85
Quarter-End Interest Rates [5]													
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Conventional Mortgage Rate	4.84	4.51	4.11	3.96	3.95	3.70	3.70	3.80	5.04	4.69	4.46	3.79	4.05
10 Year Note	3.47	3.18	1.92	1.89	2.23	1.65	1.65	1.80	3.26	3.22	2.78	1.83	2.05

Forecast as of: June 15, 2012
[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
[5] Annual Numbers Represent Averages

Inside

Together we'll go far

U.S. Review

Weakening Growth + Slower Inflation = Help From Fed?

Retail sales slipped 0.2 percent in May, and while this was in line with expectations, the gain reported previously for April was revised to a 0.2 percent decline. At first blush, the report seemed to be in-line with expectations, but underlying details of the report were substantially weaker. "Core" retail sales (ex-autos, gasoline and building materials) were flat in May, and gains for both March and April were revised down.

The only mitigating factor, in our view, is that, to some extent, the weakness in building materials in April and May can be attributed to the warmer spring, which pulled forward some seasonal spending and caused this category to jump in March. The report was not altogether negative. One bright spot was sales of motor vehicles and parts, which jumped 0.8 percent in May. The bottom-line, however, is that the report raises doubts about the ability of consumer spending to play a substantial role in supporting top-line economic growth. Particularly troubling is the downward revision to "core" retail sales in prior months.

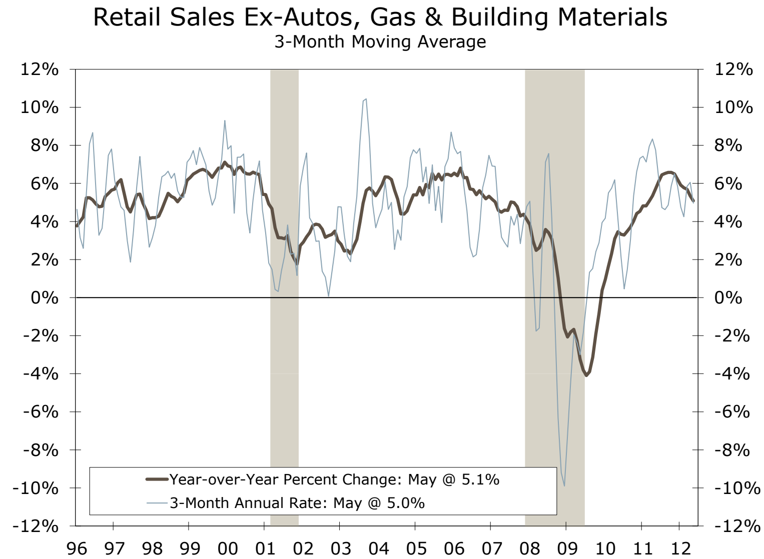
In a separate report this week, we learned that business inventories increased 0.4 percent in April, which was slightly more than expected. This suggests a second-quarter inventory build could offset some of the weakness in consumer spending. That said, if the stockpiling is unintended—as we suspect—then the boost to growth would be only temporary.

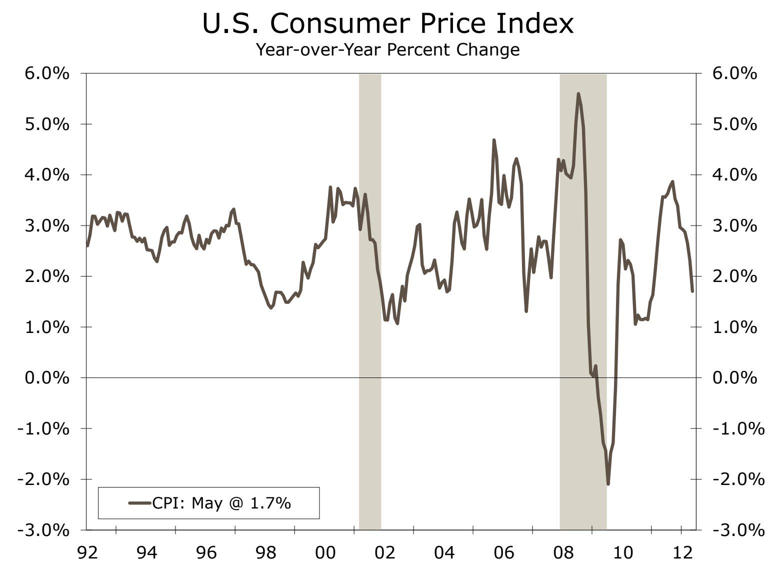
Energy prices dominated the price data this week. The May Producer Price Index (PPI) came down 1.0 percent during the month. The drop was larger than the consensus had expected, but energy prices plunged 4.3 percent, accounting for most of the decline. Food prices were also down 0.6 percent. Outside these volatile components, core PPI rose by 0.2 percent. On a year-over-year basis, core PPI is up 2.7 percent.

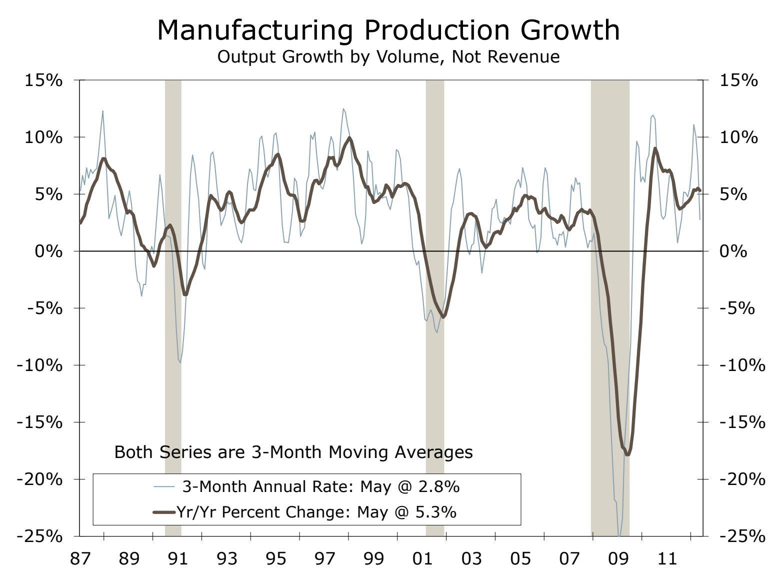
It was a similar story for consumer prices, as energy costs continued to push the overall consumer price index down, while the core index remained a shade above 2 percent on a year-over-year basis. The headline CPI decreased 0.3 percent in May, the first outright decline in consumer prices in two years.

Signs this week suggested the factory sector is losing momentum as well. The NY Fed's Empire State Manufacturing index dropped to 2.29 in June, the lowest level of the year and just barely in expansion territory. Overall industrial production decreased 0.1 percent in May. As with the disappointing retail sales numbers earlier in the week, downward revisions to previous data undermined assessments of the strength of the expansion that had been previously reported. Utilities and mining were both up modestly, but taken together, these sectors comprise less than a quarter of all industrial output. Manufacturing fell for the second time in three months, which should give reservation to those anticipating unhindered expansion in the factory sector.

Jobless claims ticked modestly higher this week as well. Taken together, the lousy economic data combined with weak inflation bolster the case for additional easing by the Federal Reserve.





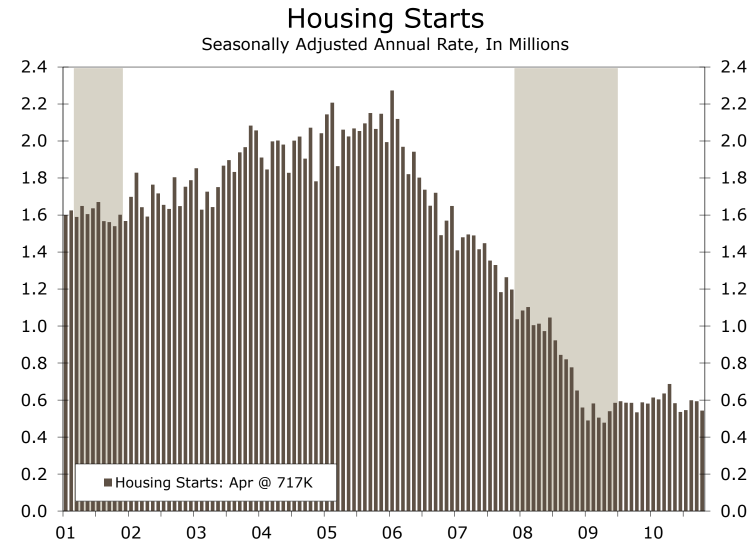


Housing Starts • Tuesday

Housing starts picked up in April, rising 2.6 percent after posting a decline in March of 2.6 percent. Single-family starts rose 2.3 percent, while the volatile multi-family component climbed 12.1 percent after rising 3.2 percent in April. On a regional basis, new home construction rose in the South and Midwest but fell in the Northeast and West. Building permits fell 7 percent in April, with single-family starts rising 1.9 percent while multi-family permits fell 20.8 percent for the month. Our expectation is that new housing starts will remain flat at around 715,000 in May. We continue to expect housing starts to expand through the end of the year, as builder confidence continues to improve and the gap between existing home prices and new home prices gradually erodes. We expect housing starts will return to a more normal level of approximately around 1.2 million new homes per year around 2015.

Previous: 717,000 **Wells Fargo: 715,000**

Consensus: 720,000

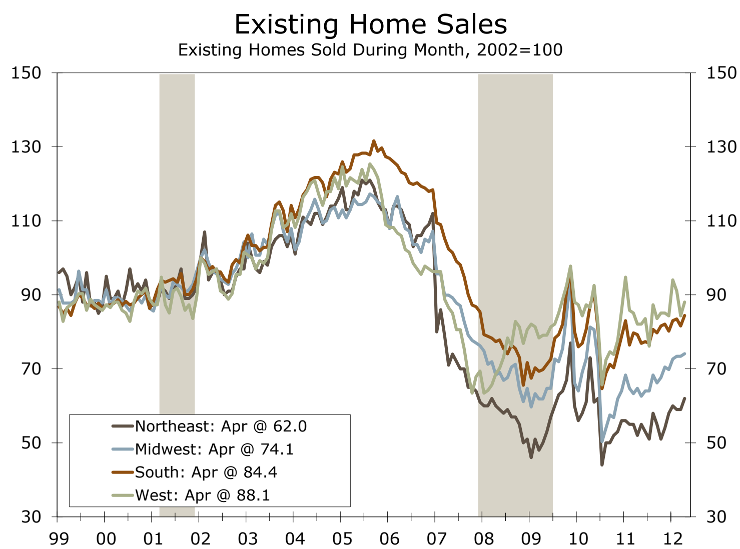


Existing Home Sales • Thursday

In April, existing home sales rebounded after two straight months of declines. Existing home sales rose 3.4 percent to a pace of 4.62 million units, the fastest pace of sales since May 2010. The pace of recovery remained robust in every major region of the country, with sales rising in all four regions. Existing home inventories continued to decline. Listing inventories are now 20.6 percent below year-ago levels, coupled with increased sales and dwindling supply. Also, some regions are facing a supply shortage of existing homes as some homeowners remove their homes from the market. The falling pace of inventories continues to point toward some stability returning to the housing market. We expect existing home sales remains flat in May at a 4.61 million unit pace. We believe existing home inventories will continue to fall, thus reducing the gap between new and existing home prices. These effects will help to move home prices higher over the next year.

Previous: 4.62 million **Wells Fargo: 4.61 million**

Consensus: 4.57 million

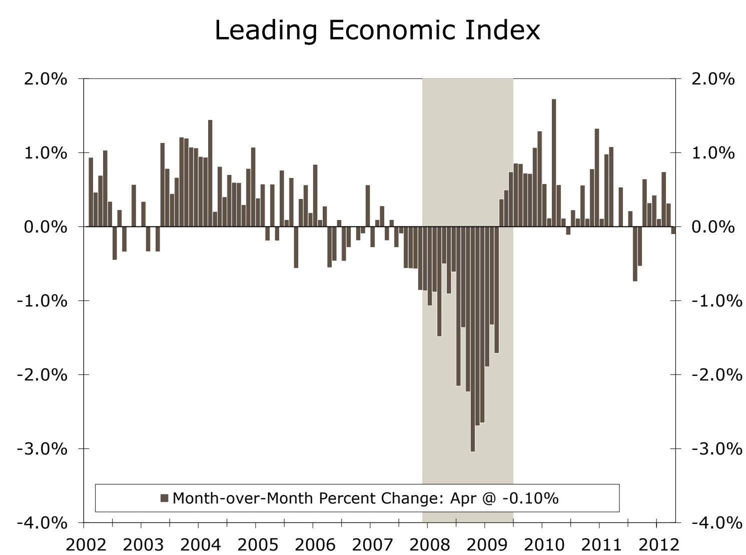


Leading Economic Indicators • Thursday

Leading Economic Indicators contracted in April, as the fall in building permits and rising jobless claims pulled the index into contraction territory for the first time in six months. The largest contributions to the index came from the yield spread and the ISM new orders component. The underlying trend in the LEI continued to point toward modest economic growth consistent with our current forecast for 2.0 percent headline GDP growth for this year. We expect the components of LEI to remain in modest growth territory but the headline index to come in flat in May. Positive contributions to the index should include initial jobless claims, the yield spread, and ISM new-orders. Stock prices and weekly hours will likely detract from the headline index. The May measure will continue to support the case for continued moderate economic growth for the near-term.

Previous: -0.1% (Month-over-Month) **Wells Fargo: 0.0%**

Consensus: 0.1%



Global Review

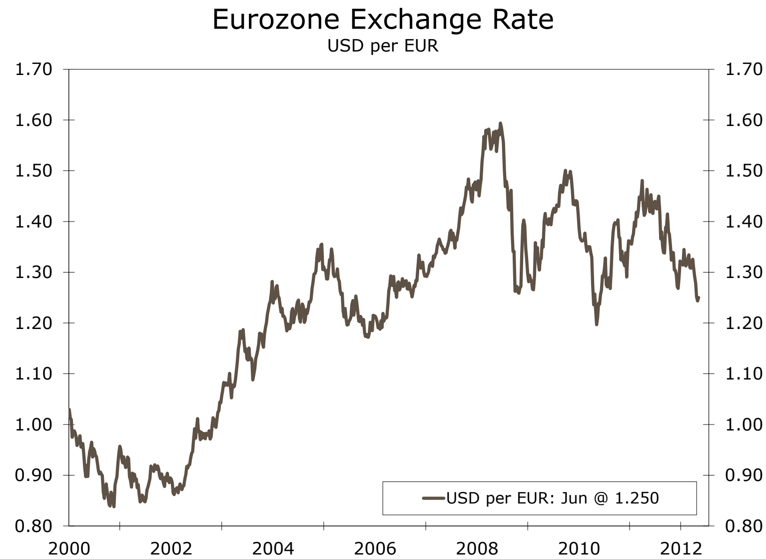
Sovereign Bond Stresses Re-emerge in Europe

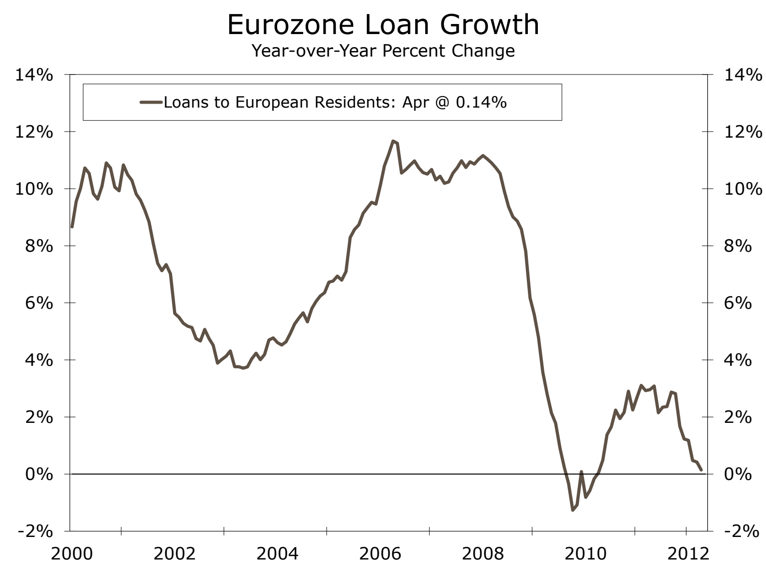
All is not well in Europe. The most visible sign of risk aversion and financial contagion in Europe is the recent spike in sovereign bond yields. Spanish 10-year bond yields briefly traded above 7.0 percent this week, up about 100 basis points since June 7. In the past, sustained bond yields above 7.0 percent have triggered international bailouts of other Eurozone countries. Moody's downgraded Spanish debt by three notches this week to Baa3, just one notch away from non-investment grade, citing the stresses on the government budget balance from the 100 billion euro bank bailout and deepening recession in Spain. Moody's also put Spain on a negative ratings watch over the next three months, which could push Spain's bond rating below investment grade, likely triggering another avalanche of Spanish bond selling as many institutional funds are forced to hold only investment-grade bonds in their portfolios.

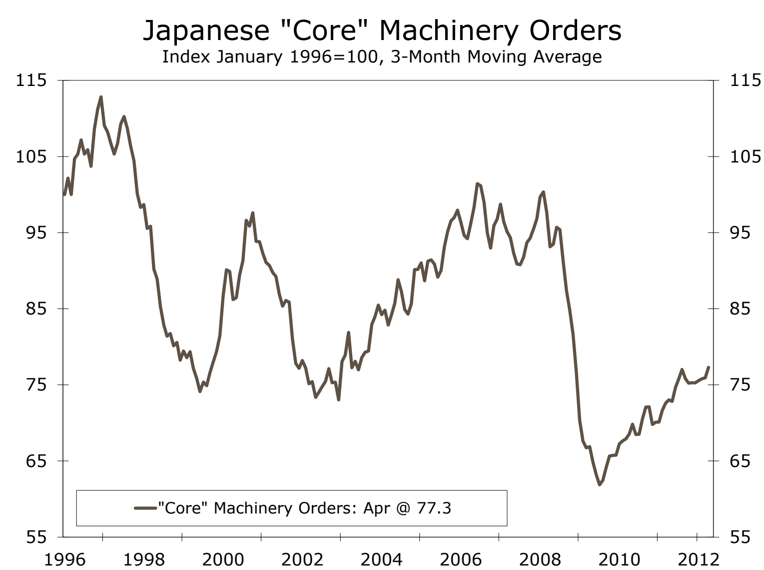
With spreading financial contagion from Greece already visible in Spain and Italy, it seems likely that Greek voters will think twice before electing a party that wants to turn away from the rest of Europe and the euro. The second Greek parliamentary election is seen as a referendum on Greek membership in the Eurozone and the survival of the euro itself. As of this writing, it appears that the New Democracy-PASOK coalition may win by a slim margin, perhaps providing some short-term relief for the euro, European equity and bond markets post-election. However, we believe the honeymoon will be short-lived as Europe's fundamental sovereign debt problems only continue to worsen. The next hurdle is the G-20 meetings next week in Mexico, at which investors will be looking for more unity about how Europe should move forward. Leading up the meeting, Angela Merkel said quick fixes are counter-productive, effectively ruling out euro-bonds. This puts Germany at odds with France's Hollande, who has advocated for euro-bonds as a potential solution.

Better Economic Data Out of Asia

Despite all the gloom in Europe, the financial news and economic data out of China and Japan this week were welcome rays of sunshine. China cut deposit and lending rates last week, which surprised the markets, bolstering expectations that China's policymakers will pivot quickly to support Chinese economic growth. Even more encouraging, the People's Bank of China announced Chinese loan growth reaccelerated in May, as the government prodded banks to open the spigot wider on credit expansion. This has raised expectations that China may be able to reignite stronger domestic demand in the months ahead. Japan saw machinery orders jump 5.4 percent in April, a much-needed reminder that Japan's economic recovery continues to strengthen in the face of a deteriorating global environment. Japan's first-quarter GDP came in well above expectations at 4.7 percent on an annualized basis, causing us to revise our forecast for Japanese growth higher to 2.4 percent for 2012. Japan's economic resilience has its limits, however, and if financial contagion once again ricochets around the world, Japan's economy would surely succumb to the pressure.



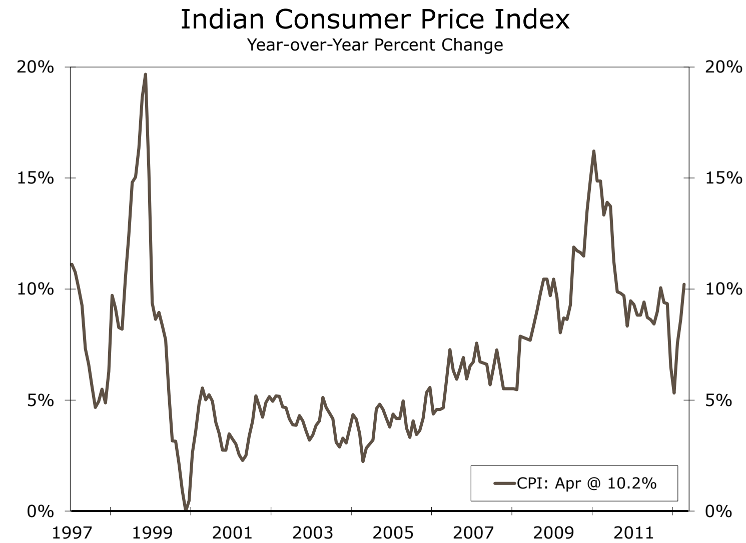




India CPI • Monday

After falling from about 10.0 percent year over year in September to 5.3 percent in January, Indian consumer price inflation has jumped back up over 10.0 percent again as of April. The main culprit is soaring food prices, the result of not enough supply coming to market. In turn, higher prices are stifling consumer spending, which rose 6.1 percent year over year in the first quarter, down slightly from the fourth quarter but well off the pace of a couple years ago. With inflation slowing markedly in many of the world's largest economies, central banks are being afforded more leeway with monetary policy. Unfortunately, this is not the case with India. The Reserve Bank of India did cut interest rates by 50 basis points in April to support the slowing economy, but with consumer inflation ramping up again, the central bank may be limited in its ability to stoke growth with further rate cuts. The wobbling of a pillar of recent global strength adds downside risk to global growth.

Previous: 10.4% (Year-over-Year) Wells Fargo: 10.4%

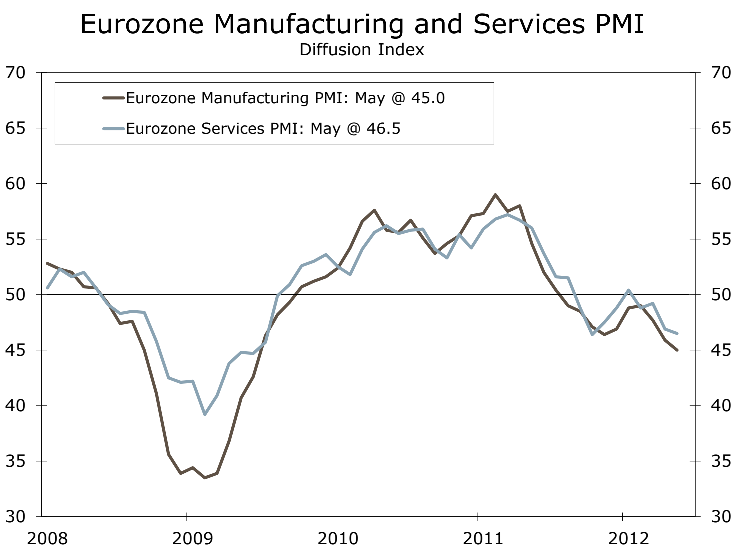


Eurozone PMIs • Thursday

The services and manufacturing industries in the Eurozone both contracted at a faster pace in May. The composite index fell from 46.7 in April to 46.0 in May, the lowest since June 2009. The services index fell from 46.9 to 46.7, the lowest since October. Meanwhile, the manufacturing index fell from 45.9 to 45.0, also the lowest since June 2009. With unemployment at a record high, consumer confidence in the tank, consumer spending still falling and industrial production in decline, it is quite possible we could see even faster contraction in both services and manufacturing in June. With Spain's banks tottering before the recent bank bailout and the Greek election on everyone's mind, uncertainty and fear have gripped the currency bloc, restraining spending and production. Still, even with all the concern about the euro possibly breaking up, manufacturing and services are in better shape than back in the depths of the financial crisis in 2009, at least for now.

Previous: Manufacturing: 45.1 Services: 46.7

Consensus: Manufacturing: 44.8 Services: 46.4

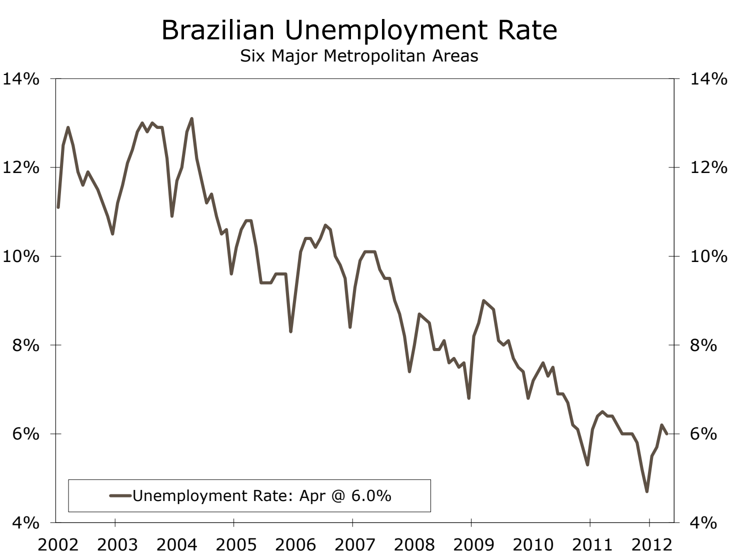


Brazil Unemployment Rate • Thursday

Brazil's unemployment rate was 6.0 percent in April, the lowest on record for that month. Record low unemployment, combined with rising wages and strong credit growth, helped to buoy consumer spending in the first quarter, which rebounded to 2.5 percent year over year from 2.2 percent in the fourth quarter. The support from consumers comes at a critical time, as the economy has slowed despite reduced taxes, increased credit subsidies for businesses and several interest rate cuts over the past year. GDP growth slowed to 0.8 percent year over year in the first quarter, a far cry from the 9.0 percent growth seen two years ago. The main factor behind the swift slowdown has been a large drop in investment, which fell 2.1 percent in the first quarter after rising nearly 30.0 percent two years ago. The good news is that inflation has cooled to 5.0 percent year over year as of May from 7.3 percent in September. This leaves room for more interest rate cuts, unlike in India.

Previous: 6.0%

Consensus: 6.0%



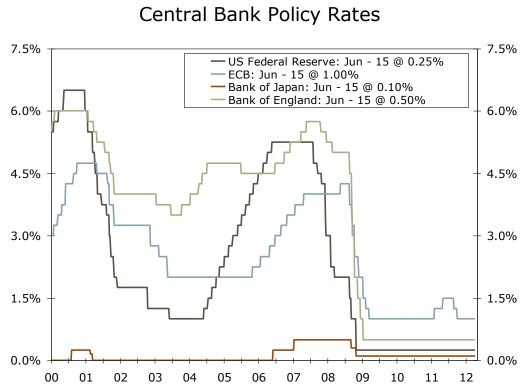
Interest Rate Watch

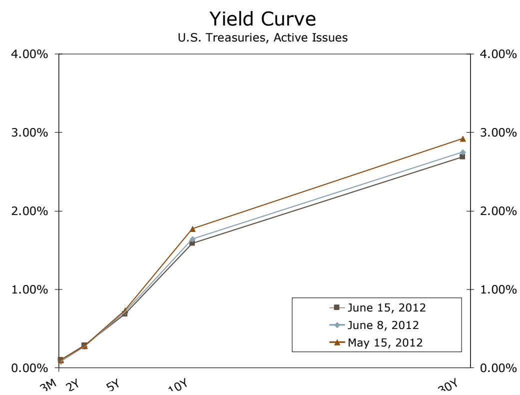
All Hands On Deck

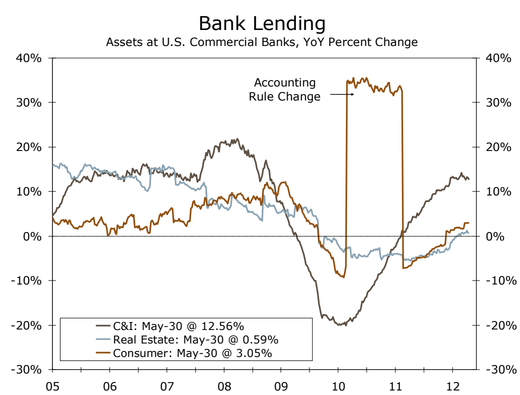
The heightened uncertainty surrounding this weekend's election in Greece and the likelihood that the uncertainty will carry over into the next week, as a coalition government is attempted to be put together, has put the world's central banks on a heightened sense of alert. Rumors have been bandied about that some sort of coordinated intervention will be put in place to minimize the impact of any liquidity squeeze that emanates from the crisis. The increased expectations of further policy action and flight to safety trade brought the 10-year Treasury yield back below 1.60 percent on Friday morning and have pushed U.S. equity prices higher.

U.S. economic growth is also supportive of lower interest rates. This week's data on retail sales and industrial production were clearly disappointing. Data for core retail sales were revised lower for March and April and personal consumption expenditures now look like they will rise less than they did in the first quarter. The factory sector also looks weaker, with manufacturing output outside of the automotive sector falling in two of the past three months. Finally, the inflation data came in below expectations, with a much larger 1.0 percent drop in the PPI and a 0.3 percent drop in the CPI. Core inflation has proved a bit more resilient, however, with pipeline inflationary pressures remaining positive and the core CPI rising 0.2 percent.

Taken together, the more immediate concerns about the still intensifying financial crisis in Europe and its likely impact on the U.S. more than outweigh any concerns about lingering strength in the major core inflation measures. Global commodity prices have weakened and with labor markets softening, as evidenced by the rising weekly jobless claims data, inflationary pressures should continue to subside. However, the current level of interest rates is only justified by the heightened uncertainty emanating from Europe. If stability was to return to Europe and risks subsided a bit, the yield on the 10-year Treasury would likely quickly return to around 2 percent.







Credit Market Insights

Uneven Growth in Credit

Data from the Fed's Flow of Funds Report showed that credit continued to expand in the first quarter. Total credit market borrowing in the economy expanded at an annualized rate of 2.5 percent, roughly on pace with the fourth quarter. Growth across sectors was uneven, however, as different segments of the economy have healed more quickly than others following the past recession. With the financial position of the business sector fairly healthy, businesses took advantage of low interest rates and increased credit market borrowing at a 4.4 percent annualized rate. Corporate debt liabilities and loans from depository institutions drove the bulk of the increase, while borrowing for commercial mortgages declined further in the first quarter. Borrowing by the federal government also expanded in the first quarter, rising at an annualized rate of 16.1 percent through Treasury securities.

Borrowing in the household sector, on the other hand, declined by $53 billion in the first quarter and has now contracted for four consecutive years. Home mortgage borrowing has led the decline as credit standards in this sector remain tight, while consumer credit borrowing and loans from depository institutions saw strong growth in the first quarter. State and local governments reduced borrowing at an annualized rate of 1 percent over the quarter as governments continued to restructure their finances amid lower revenues.

Credit Market Data

Mortgage Rates	Current	Week Ago	4 Weeks Ago	Year Ago
30-Yr Fixed	3.71%	3.67%	3.79%	4.50%
15-Yr Fixed	2.98%	2.94%	3.04%	3.67%
5/1 ARM	2.80%	2.84%	2.83%	3.27%
1-Yr ARM	2.78%	2.79%	2.78%	2.97%
Bank Lending	**Current Assets (Billions)**	**1-Week Change (SAAR)**	**4-Week Change (SAAR)**	**Year-Ago Change**
Commercial & Industrial	$1,425.7	7.75%	11.03%	12.56%
Revolving Home Equity	$540.1	-2.56%	-5.12%	-4.46%
Residential Mortgages	$1,567.4	-10.37%	-5.62%	5.64%
Commerical Real Estate	$1,416.6	4.64%	-2.02%	-2.59%
Consumer	$1,117.0	42.37%	7.89%	3.05%

Source: Freddie Mac, Federal Reserve Board and Wells Fargo Securities, LLC

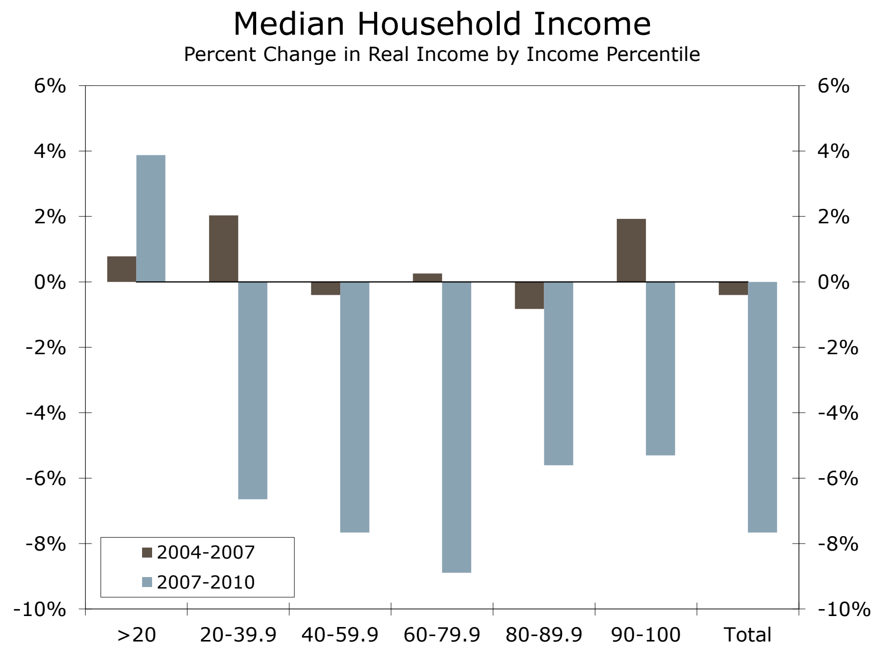
Topic of the Week

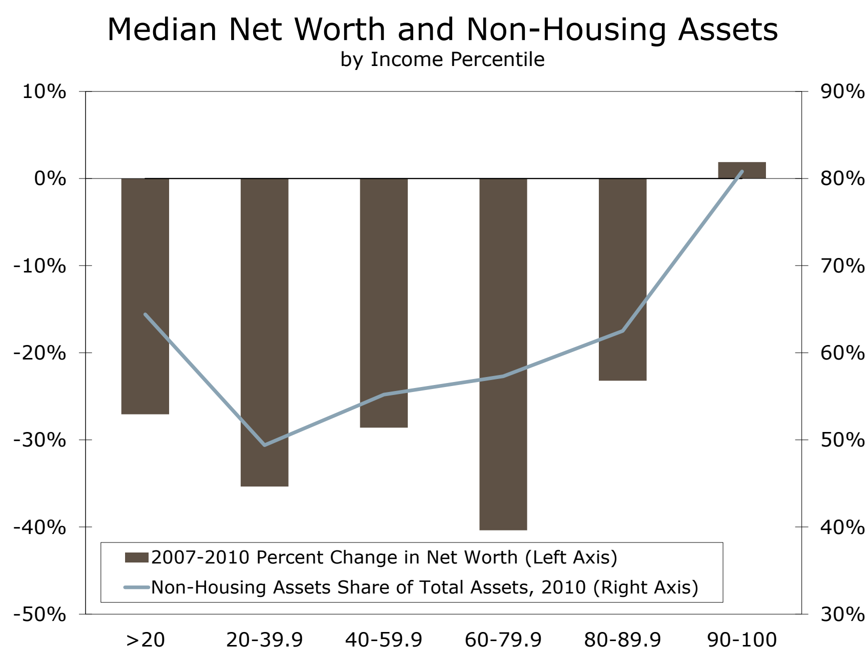
The 2010 Survey of Consumer Finances

While a multitude of data have shown how consumers were affected by the past recession, the data have primarily described aggregate conditions when there has been great variation between households. To provide insight into how households of varying characteristics fared following the past recession, the Federal Reserve released its triennial Survey of Consumer Finances (SCF) this week, covering the year 2010.

Data from the survey showed a widespread decline in median real income of households between 2007 and 2010, whereas real income growth had been relatively flat between previous surveys (top chart). However, the decline in 2010 was uneven across income percentiles, with the lowest quintile seeing an increase over the period ($500). Median incomes also increased for retirees and nonworking families, as these groups were less reliant on the labor market for income. By education, median real income rose only for households headed by an individual without a high school degree, although income for this group was less than one-third the median income for college graduates.

Looking at household balance sheets, the SCF showed substantial declines in net worth between 2007 and 2010. Median net worth declined by 38.8 percent as asset values fell and liabilities were little changed. Not surprisingly, housing played a significant role in the decline. The median net worth of homeowners fell 29.1 percent over the period compared to a decline of 5.6 percent for renters. While declines were fairly broad based across income groups, the lowest and highest quintiles saw a less severe decline, with the top 10 percent of earners actually seeing an increase in net worth. As the lowest and highest income households have fewer assets tied to housing, the balance sheets of these groups have tended to fare better since the housing bust (bottom chart). While more recent data on the aggregate position of household balance sheets show improvement in the sector, the SCF reminds us that the past recession hit household finances unevenly.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 6/15/2012	1 Week Ago	1 Year Ago
3-Month T-Bill	0.09	0.08	0.05
3-Month LIBOR	0.47	0.47	0.25
1-Year Treasury	0.12	0.09	0.19
2-Year Treasury	0.28	0.27	0.38
5-Year Treasury	0.67	0.71	1.55
10-Year Treasury	1.57	1.64	2.97
30-Year Treasury	2.67	2.75	4.20
Bond Buyer Index	3.95	3.92	4.49

Foreign Exchange Rates

	Friday 6/15/2012	1 Week Ago	1 Year Ago
Euro ($/€)	1.264	1.252	1.418
British Pound ($/£)	1.565	1.547	1.619
British Pound (£/€)	0.807	0.809	0.876
Japanese Yen (¥/$)	78.660	79.490	80.960
Canadian Dollar (C$/$)	1.023	1.027	0.979
Swiss Franc (CHF/$)	0.950	0.960	0.853
Australian Dollar (US$/A$)	1.006	0.992	1.058
Mexican Peso (MXN/$)	13.912	13.921	11.915
Chinese Yuan (CNY/$)	6.365	6.370	6.482
Indian Rupee (INR/$)	55.496	55.455	44.773
Brazilian Real (BRL/$)	2.042	2.024	1.600
U.S. Dollar Index	81.672	82.511	75.601

Foreign Interest Rates

	Friday 6/15/2012	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.57	0.58	1.43
3-Month Sterling LIBOR	0.95	0.99	0.82
3-Month Canadian LIBOR	1.30	1.31	1.20
3-Month Yen LIBOR	0.20	0.20	0.20
2-Year German	0.07	0.04	1.50
2-Year U.K.	0.22	0.24	0.78
2-Year Canadian	0.97	1.04	1.42
2-Year Japanese	0.10	0.10	0.18
10-Year German	1.45	1.33	2.95
10-Year U.K.	1.67	1.63	3.24
10-Year Canadian	1.73	1.81	2.95
10-Year Japanese	0.85	0.86	1.17

Commodity Prices

	Friday 6/15/2012	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	84.14	84.10	94.81
Gold ($/Ounce)	1627.22	1593.45	1530.88
Hot-Rolled Steel ($/S.Ton)	620.00	628.00	748.00
Copper (¢/Pound)	339.55	328.50	412.20
Soybeans ($/Bushel)	13.81	14.23	13.78
Natural Gas ($/MMBTU)	2.48	2.30	4.58
Nickel ($/Metric Ton)	16,579	16,525	22,283
CRB Spot Inds.	515.97	513.94	606.77

Next Week's Economic Calendar

	Monday 18	Tuesday 19	Wednesday 20	Thursday 21	Friday 22
U.S. Data		**Housing Starts** April 717K May 715K (W) **Building Permits** April 723K May 730K (C)	**FOMC Rate Decision** May 0.25% June 0.25% (W)	**Existing Home Sales** April 4.62M May 4.61M (W) **Home Price Index** March 1.8% April 0.4% (C) **LEI** April -0.1% May 0.0% (W)	
Global Data	**India** **CPI (YoY)** Previous (Apr) 10.36%	**Eurozone** **ZEW Econ Sentiment** Previous (May) -2.4 **U.K.** **CPI (YoY)** Previous (Apr) 3.0%	**Mexico** **Retail Sales (INEGI)** Previous (Mar) 4.3%	**Eurozone** **PMI Manufacturing** Previous (May) 45.1 **Eurozone** **PMI Services** Previous (May) 46.7	**Germany** **IFO Business Climate** Previous (May) 106.9 **Canada** **CPI (YoY)** Previous (Apr) 2.0%

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

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