

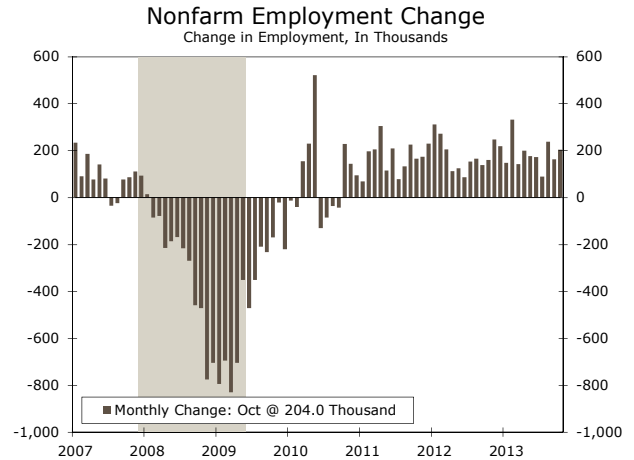
# Economics Group

## Weekly Economic & Financial Commentary

### U.S. Review

#### What Government Shutdown?

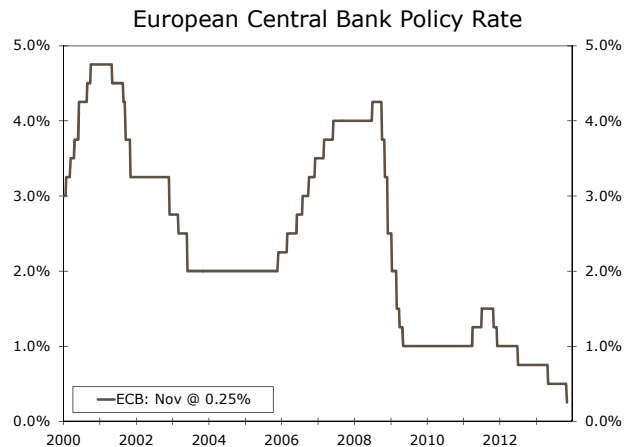
- Nonfarm payrolls surprised to the upside as the federal government shutdown did little to deter private-sector employers from hiring more workers. However, furloughed workers pushed the unemployment rate higher in the household survey.
- Despite a strong headline number, the details of the third quarter GDP numbers were more disappointing. Consumers continue to exhibit weakness, while business investment growth slowed some.



### Global Review

#### Rate Cut From the European Central Bank

- The big international economics story this week was a rate cut from the ECB. In this week's Global review on page 3, we discuss that somewhat unexpected decision in the context of a different approach from the Bank of England, which also met this week.
- Canadian employers added 13.2K workers to their payrolls in October, dropping the unemployment rate to a nearly five-year low.
- The Reserve Bank of Australia left its cash rate unchanged at 2.50 percent.



Wells Fargo U.S. Economic Forecast														
	Actual				Forecast				Actual		Forecast			
	2013				2014				2011	2012	2013	2014	2015	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
Real Gross Domestic Product <sup>1</sup>	1.1	2.5	2.8	1.7	2.0	2.4	2.6	2.7	1.8	2.8	1.7	2.3	2.8	
Personal Consumption	2.3	1.8	1.5	2.1	2.0	2.1	2.2	2.3	2.5	2.2	1.9	2.0	2.4	
Inflation Indicators <sup>2</sup>														
PCE Deflator	1.4	1.1	1.1	1.1	1.3	1.9	1.9	2.1	2.4	1.8	1.2	1.8	2.2	
Consumer Price Index	1.7	1.4	1.6	1.5	1.6	2.1	2.0	2.0	3.1	2.1	1.5	1.9	2.2	
Industrial Production <sup>1</sup>	4.1	1.1	2.3	5.2	4.2	4.3	4.4	4.5	3.4	3.6	2.5	4.0	4.7	
Corporate Profits Before Taxes <sup>2</sup>	2.1	4.5	6.3	5.0	4.1	5.4	6.2	5.3	7.9	7.0	4.5	5.3	5.9	
Trade Weighted Dollar Index <sup>3</sup>	76.2	77.5	75.2	75.3	76.0	76.3	76.8	77.3	70.9	73.5	76.1	76.6	77.9	
Unemployment Rate	7.7	7.6	7.3	7.2	7.1	7.0	7.0	6.9	8.9	8.1	7.5	7.0	6.7	
Housing Starts <sup>4</sup>	0.96	0.87	0.89	0.94	1.03	1.13	1.18	1.20	0.61	0.78	0.93	1.10	1.25	
Quarter-End Interest Rates <sup>5</sup>														
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	0.44	
Conventional Mortgage Rate	3.57	4.07	4.49	4.30	4.40	4.50	4.60	4.70	4.46	3.66	4.11	4.55	4.95	
10 Year Note	1.87	2.52	2.64	2.60	2.70	2.80	2.90	3.00	2.78	1.80	2.41	2.85	3.25	

Forecast as of: November 8, 2013

<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

<sup>5</sup> Annual Numbers Represent Averages

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Source: U.S. Dept. of Commerce, Bloomberg LP, Federal Reserve Board, U.S. Dept. of Labor and Wells Fargo Securities, LLC

Together we'll go far



**U.S. Review**

**Shutdown has “No Discernible Impact”**

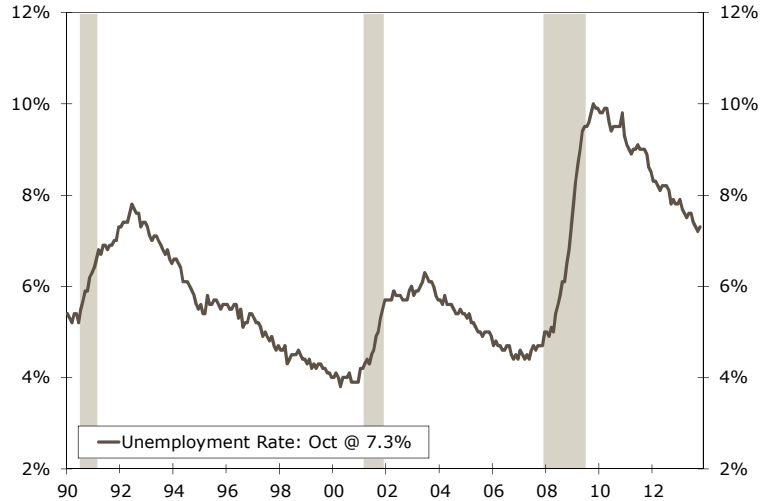
The big news this week is that employment came in much stronger than expected for October. After a disappointing report in September, markets were concerned that payroll growth had lost momentum, but with relatively strong upward revisions of the previous two months, those fears have now dissipated. It appears that the federal government shutdown had little to no effect on the nonfarm payrolls numbers. The establishment survey counts workers as employed if they either worked or were paid for the pay period that included the twelfth of the month. Although most federal workers did not work during this period, they were paid, and thus counted as employed in this survey. The same cannot be said for the household survey, which should have classified federal workers on furlough as “unemployed on temporary layoff.” However, it appears that some of those federal workers were actually wrongly categorized and put under “employed but absent from work.” Nonetheless, the number of unemployed persons increased over the month due to the rise in those on temporary layoff. As a result, the unemployment rate ticked up to 7.3 percent. There also was a substantial drop in the labor force participation rate, though this may also be misleading as survey participants may have indicated that they were neither employed nor looking for work while furloughed. Otherwise, solid private-sector employment gains are consistent with moderate growth in economic output.

**Q3 Finishes in the Middle of the Pack**

Despite upward revisions to employment in August and September, consumption growth, which grew at an annualized 1.5 percent in the third quarter, remained disappointing, though much of this was related to utilities spending. Wage and salary growth has been fairly muted, and the savings rate ticked up in September, further constraining overall consumption growth. The core PCE deflator, one of the Fed’s preferred measures of inflation, was 1.2 percent higher than a year ago in September, leaving plenty of room for it to continue quantitative easing.

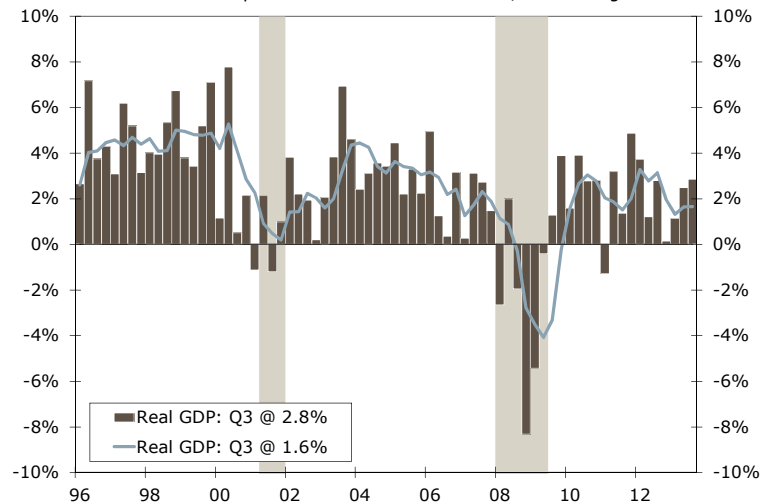
Overall, the GDP numbers were subdued. If one ignores the sizable jump in inventories, GDP grew only 2.0 percent, more in line with expectations than the headline of 2.8 percent. Nonresidential investment slowed some as businesses lowered their purchases of business equipment. In the factory sector, September’s gain in capital goods orders was not enough to make up for the losses felt earlier in the quarter, and after excluding transportation, factory orders declined for the second straight month. However, residential investment kept its strong pace, which reinforces our position that the housing market recovery is still on solid ground despite the recent uptick in mortgage rates. Government spending also eked out a gain for the quarter, thanks to state and local government expenditures making up for the cuts at the federal level. The federal government’s finances remain a constant source of frustration, but state and local governments have removed much of the red ink that plagued their budgets since weak property values decimated a major source of tax revenue.

**Unemployment Rate**  
Seasonally Adjusted



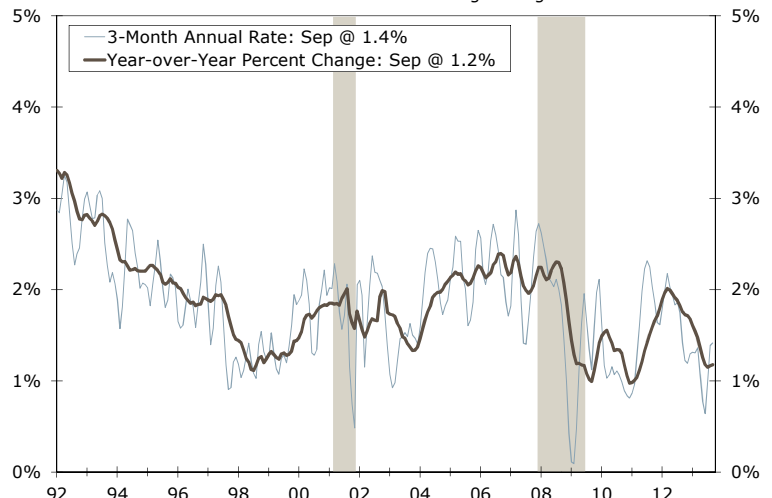
**U.S. Real GDP**

Bars = Compound Annual Rate Line = Yr/Yr % Change



**"Core" PCE Deflator**

Both Series are 3-Month Moving Averages



Source: U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities, LLC

**Trade Balance • Thursday**

The international trade balance was little changed in August. Exports dipped 0.1 percent, while import levels were flat. The pace of import and export growth has slowed over the past year, but an ongoing shift in the pattern of petroleum has helped to narrow the trade deficit. While petroleum exports fell 5.7 percent in volume terms over in August, they are up 8.3 percent year to date. Imports of petroleum over the same period have fallen 2.8 percent as the country’s energy boom has reduced demand for imported energy products.

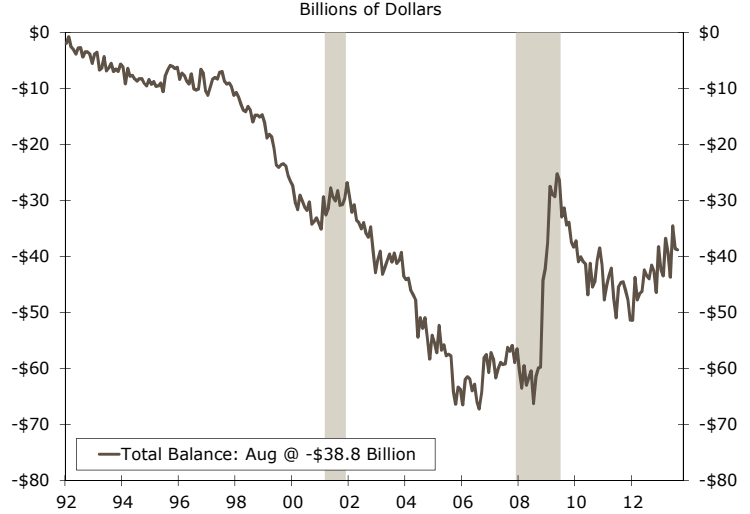
We expect the trade balance to widen slightly in September. Exports should be boosted by economic activity beginning to pick up in some of the nation’s major trading partners, and the dollar weakening slightly. Imports should also rise as domestic demand firms, making trade roughly neutral on GDP growth for the remainder of the year.

**Previous: -\$38.8B**

**Wells Fargo: -\$40.7B**

**Consensus: -\$39.0B**

Trade Balance in Goods and Services



**Nonfarm Productivity • Thursday**

Nonfarm labor productivity—measured by output per hour worked—increased at a 2.3 percent annualized rate in the second quarter, but has slowed significantly over the past year. Since the second quarter of 2012, productivity has risen only 0.3 percent. The slowdown has stemmed from a weaker output growth, while over the same period the pace of hiring has picked up a bit as employers have felt more confident in the economy.

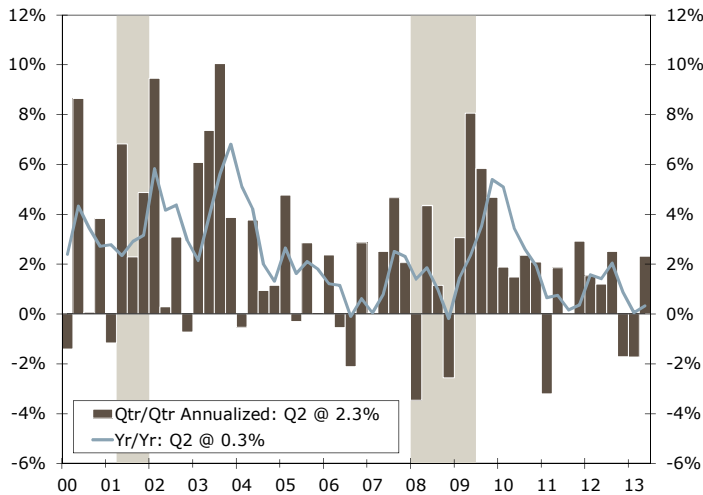
Nonfarm productivity looks to have picked up over the third quarter. Employers added an average 19,000 fewer jobs per month in the third quarter, while the average work week ticked down. In addition, GDP growth accelerated to a 2.8 percent annualized rate from 2.5 percent in the second quarter.

**Previous: 2.3%**

**Wells Fargo: 2.4%**

**Consensus: 2.0%**

Nonfarm Productivity  
Output per Hour Worked, Percent Change



**Industrial Production • Friday**

Industrial production was stronger than expected in September, but the beat was largely due to a 4.4 percent surge in utilities output. Production at manufacturing firms increased only 0.1 percent with mixed readings across sub-industries.

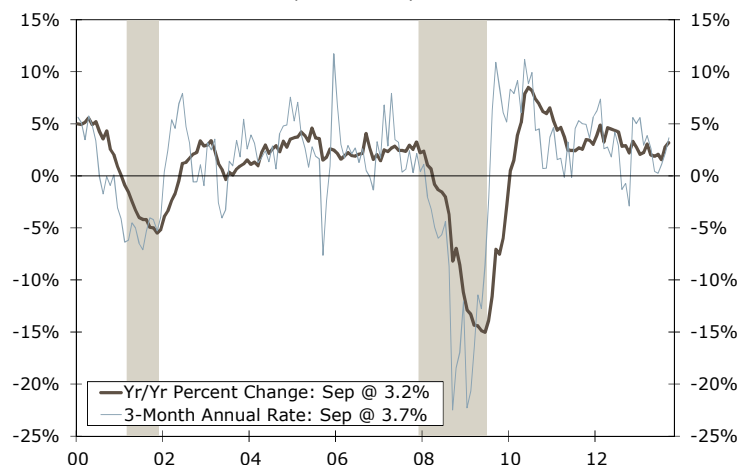
The weak reading on manufacturing raises some questions about the strength of the sector’s recovery from a spring lull. October’s report may reflect some shutdown-related weakness in production as firms awaited the extent of any damage caused by the impasse. However, purchasing managers’ indexes for October suggest manufacturers were generally unfazed by events in Washington. The ISM manufacturing index rose slightly in October and its production component remained firmly in expansion territory at 60.8. Regional indexes reflecting activity earlier in the month weakened on balance but remained positive, while PMIs capturing activity later in the month largely showed some strengthening.

**Previous: 0.6%**

**Wells Fargo: 0.2%**

**Consensus: 0.2%**

Total Industrial Production Growth  
Output Growth by Volume



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

## Global Review

### European Central Bank Cuts Its Target Rate

The European Central Bank took many market watchers by surprise with its decision this week to cut its main lending rate to 0.25 percent. The main refinancing rate in Europe is now 75 basis points lower than it was at the height of the financial crisis in the autumn of 2008.

We learned last week that the rate of CPI inflation in the Eurozone in October slowed to just 0.7 percent on a year-over-year basis. Not only was that a significant drop from the 1.1 percent rate in the prior month, it also marked the slowest rate of inflation since the global slowdown of 2009. Given its approximate inflation target of 2.0 percent, the weak reading last week somewhat forced the hand of ECB President Mario Draghi.

In addition to the front-and-center problem of inflation, the ECB is also wrestling with how to reverse the slide in bank lending. As the nearby graph shows, loan growth in the Eurozone has been negative for the better part of the past year and a half.

The rate that the ECB pays banks who keep loans on deposit with the central bank was left unchanged at zero. There has been some speculation that Draghi might eventually begin charging commercial lenders for keeping loans on deposit. A penalty rate, or negative deposit rate might incent banks to lend.

GDP figures for the Eurozone are due out next week. A faster growth environment could certainly take some pressure off Mr. Draghi and put some welcome pressure on consumer prices.

### Bank of England on Hold

The Bank of England (BoE) also met this week and determined to leave its target lending rate unchanged and made no modification to its asset purchase program. There was little surprise to this announcement because BoE Governor Mark Carney issued forward guidance at the Bank's August meeting that the key lending rate would remain unchanged until 2016.

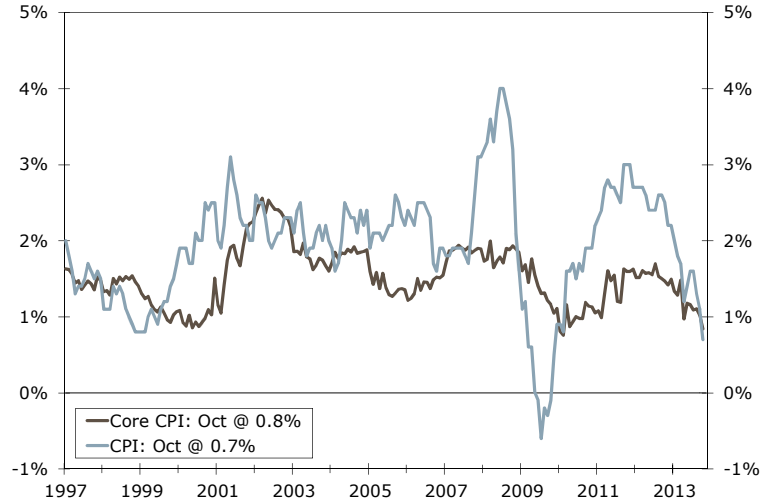
Still the actions of the BoE reflect a confidence that the economy there is gaining traction in a way that remains elusive for the Eurozone. Earlier this week, the service sector PMI in the United Kingdom shot up to 62.5, the highest reading on record for this measure of service sector business confidence (the series began in March 2006). The construction PMI at 59.4 is also an all-time high (series starts July 2008) and manufacturing PMI at 56.0 is not far behind.

Speaking of manufacturing, the September industrial production figures for the United Kingdom came in better than expected, up 0.9 percent on the month and up 2.2 percent on a year-over-year basis. Production in just the manufacturing sector rose by an even larger 1.2 percent in the month of September.

Of course the key economic indicator that really grants the BoE greater flexibility is the CPI numbers. Through September, the most recent figures presently available, the year-over-year rate of inflation in the United Kingdom is 2.7 percent, which is in line with the BoE's acceptable variance from its 2.0 percent target.

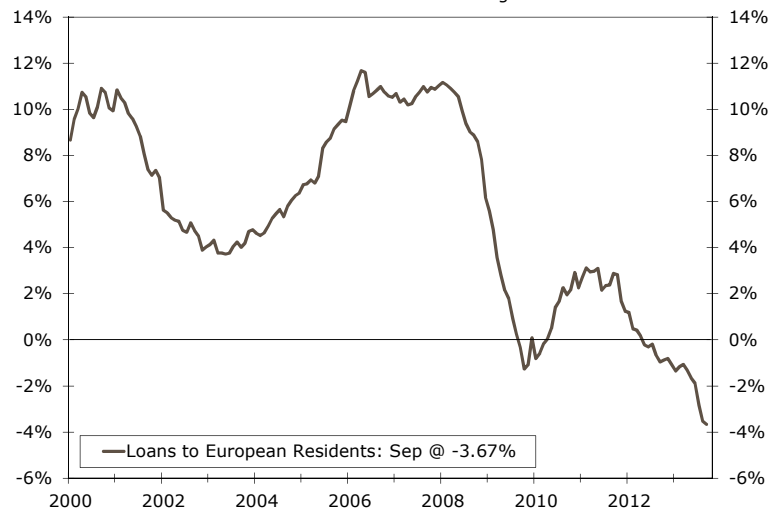
### Eurozone Consumer Price Inflation

Year-over-Year Percent Change



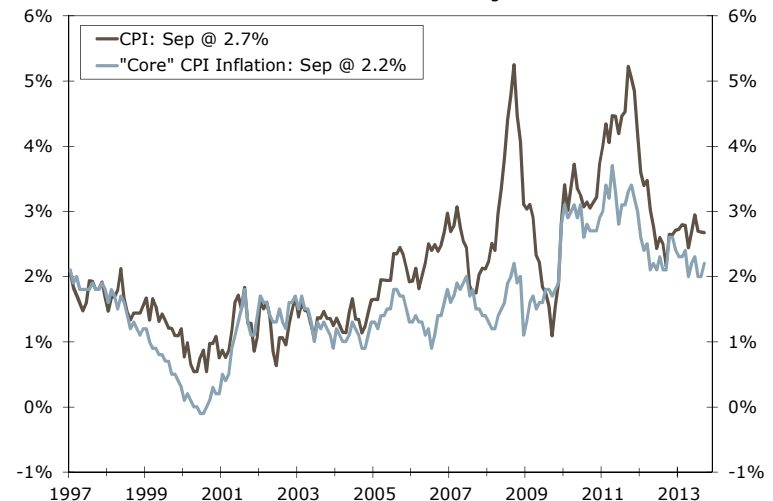
### Eurozone Loan Growth

Year-over-Year Percent Change



### U.K. CPI and "Core" CPI

Year-over-Year Percent Change



Source: IHS Global Insight and Wells Fargo Securities, LLC

**Eurozone Q3 GDP • Wednesday**

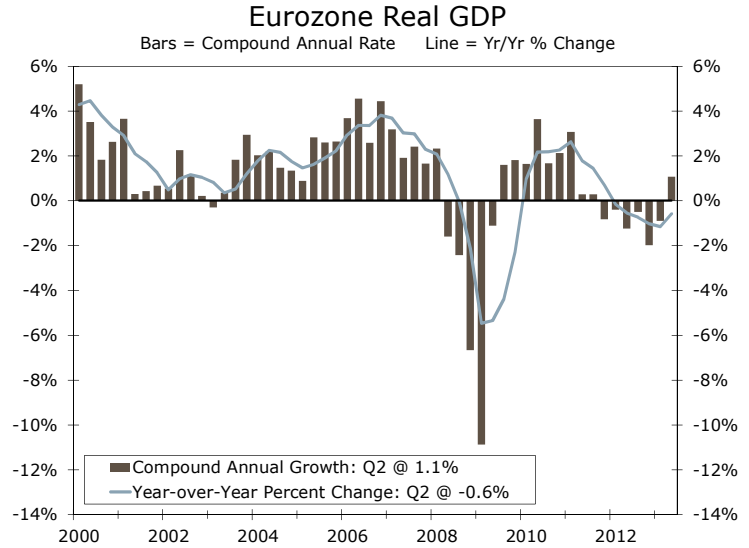
Next week we will have a flurry of numbers coming from the developed economies in the rest of the world and the expectation is for a continued slow recovery, especially from the Eurozone. On Tuesday we will have a preview of industrial production for September in the Eurozone after a relatively strong print of 1.0 percent in August.

This week's surprise decision by the ECB when it lowered interest rates 25 basis points, from 50 percent to 25 percent, is not a very good omen for next week's release on Eurozone GDP. However, we are expecting growth to be at 0.2 percent not annualized during the quarter compared to a print of 0.3 percent during the second quarter of the year. A lower reading will probably put a new twist on the steady but slow recovery for the region, a region that needs to show growth strengthening if markets are going to be convinced on the long-term feasibility of the region.

**Previous: 0.3%**

**Wells Fargo: 0.2%**

**Consensus: 0.1% (Quarter-over-Quarter)**



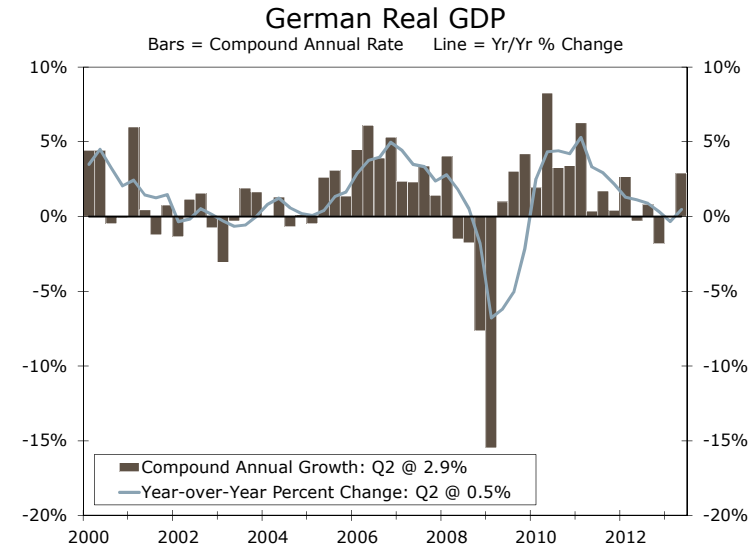
**Germany Q3 GDP • Thursday**

Growth in Germany during the third quarter has already been scaled down from the second quarter print when it posted a 0.7 percent growth rate. Today's expectation for the third quarter is a much lower 0.3 percent which is consistent with a very weak inflation reading over the past several months that finally prompted the ECB to lower the target rate from 50 percent to 25 percent.

The biggest issue with the weakening of the Eurozone performance and with Germany's outcome is that the world economy has been counting on them to help the overall global economy. However, it seems that the world economy will have to wait for that to happen as the positive news coming from the Eurozone have soured during the third quarter of the year. Although we are not expecting the region's economy to go back into recession we are concerned with its inability to grow stronger. With the Social Democrats set to enter the governing coalition, German fiscal policy could become a bit more expansionary, which could boost growth at the margin.

**Previous: 0.7%**

**Consensus: 0.3% (Quarter-over-Quarter)**



**Japan Q3 GDP • Thursday**

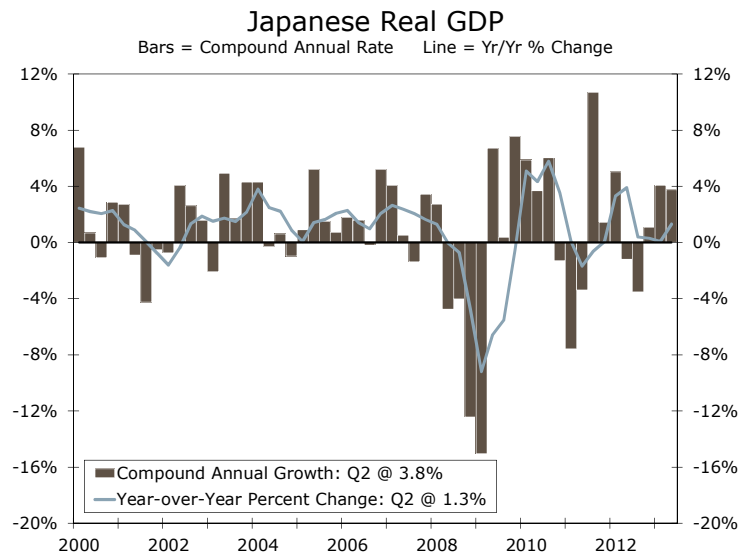
It seems that it is, once again, Japan's time to save the world economy, especially considering the not-so-great news coming from the Eurozone. While expectations are down compared to the almost torrid pace by Japanese economic growth standards lately markets are expecting growth to come in at 0.4 percent compared to a 0.9 percent print during the second quarter of the year.

Thus, expect a better reading to have a positive impact in markets even though a potentially better number for Japan will probably not be enough to counteract the less than stellar news coming from the Eurozone. Having said this, better news coming from the United States and some improvement in some of the economies of Latin America may be enough to minimize the concerns that a weaker Eurozone continues to have over the prospects of the global economy.

**Previous: 0.9%**

**Wells Fargo: 0.9%**

**Consensus: 0.4% (Quarter-over-Quarter)**



Source: IHS Global Insight and Wells Fargo Securities, LLC

**Interest Rate Watch**

**GDP Overstated: No Fed Move Now**

Policy fundamentals do not support the case for any Fed move to taper before the March 18/19 meeting. Third quarter GDP at 2.8 percent overstates the strength of the economy as final sales came in at two percent and an inventory build accounted for 0.8 percent of the gain in GDP. In part, the market appears to reflect a concern that the Fed did not see the government shutdown as a significant drag on the economy. We did not see the partial shutdown as a big drag either and believed that much of the commentary was sound and fury signifying nothing.

**Yellen Confirmation**

Next Thursday, Janet Yellen faces her confirmation hearing in the U.S. Senate. We expect confirmation. Yellen will be tested on her dovish views on the economy and her leaning towards continued easy monetary policy.

For the markets, the focus will be on any signal that Yellen will lean toward an early tapering of Fed easing. What are her benchmarks for policy action? How about altering the unemployment rate target as reflected in the IMF papers cited this week in the press?

Meanwhile, we expect that Yellen will reinforce the view that current inflation indicators remain well within the tolerance levels at the Fed. Although fiscal policy issues will come up, we expect that Yellen will diplomatically sidestep those issues.

**The Steeper Yield Curve: Rhetoric**

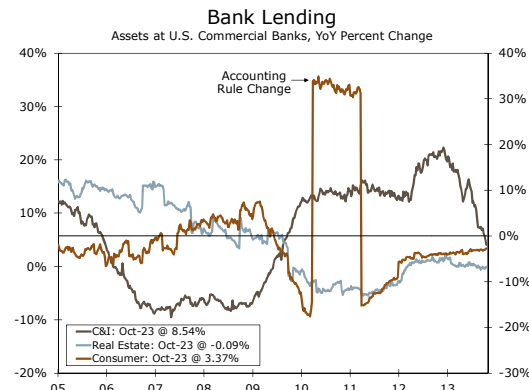
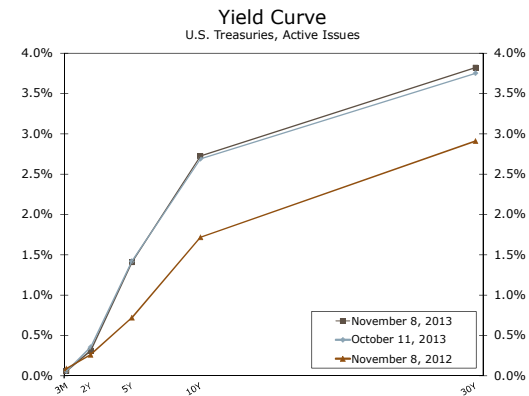
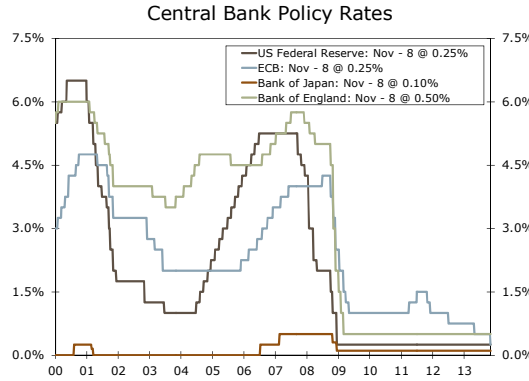
While the Federal Reserve continually indicates that it is not ready to raise interest rates, the reality of the marketplace is that while the Fed can control the short end of the yield curve by anchoring the federal funds rate, the longer end of the Treasury curve continues to steepen as illustrated in the middle graph on this page. Looking at the 10-year Treasury, if the Fed were to start hiking interest rates in the second half of 2015, that leaves approximately 8 years until maturity of the bond in a higher interest rate environment. Markets are going to need to begin discounting for this fact which should result in a further steepening of the yield curve.

**Credit Market Insights**

**Continued Weakness in Credit Cards Could Dampen Holiday Sales**

Consumer credit continued to expand in September, though overall growth was slower than it has been in the past three quarters. Once again, the major weight on total credit growth has been the fourth straight monthly decline in revolving credit, which mainly consists of credit card debt. Growth in retail sales is closely linked to growth in this important component of consumer credit. As the holiday season approaches, the consistent decline in revolving credit may place downward pressures on holiday sales. In an attempt to bolster sales, department stores may choose to lower the minimum accepted FICA score or generally loosen their lending standards for their in-store credit cards.

However, on the upside, nonrevolving credit continues to grow strongly, thanks to persistent demand for auto and student loans. Auto rates reversed their downward trend in Q3, but still remain at very low levels. The uptick in rates does not seem to have discouraged consumers from financing their car purchases. In addition, the modest improvement in the labor market has not stopped students from piling on more student debt. With so many people unable to find jobs, the unemployed sought to build skills through continued education. As a result, student loan debt has approximately quadrupled in the past ten years, though some of this may also be the result of rising tuition costs.



Source: IHS Global Insight, Bloomberg LP and Wells Fargo Securities, LLC

Credit Market Data				
Mortgage Rates	Current	Week Ago	4 Weeks Ago	Year Ago
	30-Yr Fixed	4.16%	4.10%	4.23%
15-Yr Fixed	3.27%	3.20%	3.31%	2.69%
5/1 ARM	2.96%	2.96%	3.05%	2.73%
1-Yr ARM	2.61%	2.64%	2.64%	2.59%
Bank Lending	Current Assets (Billions)	1-Week Change (SAAR)	4-Week Change (SAAR)	Year-Ago Change
	Commercial & Industrial	\$1,598.3	-17.60%	23.54%
Revolving Home Equity	\$480.1	-4.19%	-1.72%	-7.71%
Residential Mortgages	\$1,564.3	11.23%	-11.92%	-1.20%
Commercial Real Estate	\$1,471.7	7.10%	10.40%	3.96%
Consumer	\$1,147.6	6.00%	5.91%	3.37%

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

## Topic of the Week

### Reassessing the Housing Recovery

The Federal Open Market Committee downgraded its assessment of the housing recovery at its October meeting, noting that “the recovery in the housing sector slowed somewhat in recent months.” The statement itself is hardly a surprise. Most of the recent data on the housing sector have been on the weak side, and the most recent data on mortgage applications, builder confidence and pending home sales have continued to be disappointing. The lone exception has been home prices, which, for the most part, have continued to rebound solidly. Home prices, however, have largely risen independently of any improvement in underlying demand.

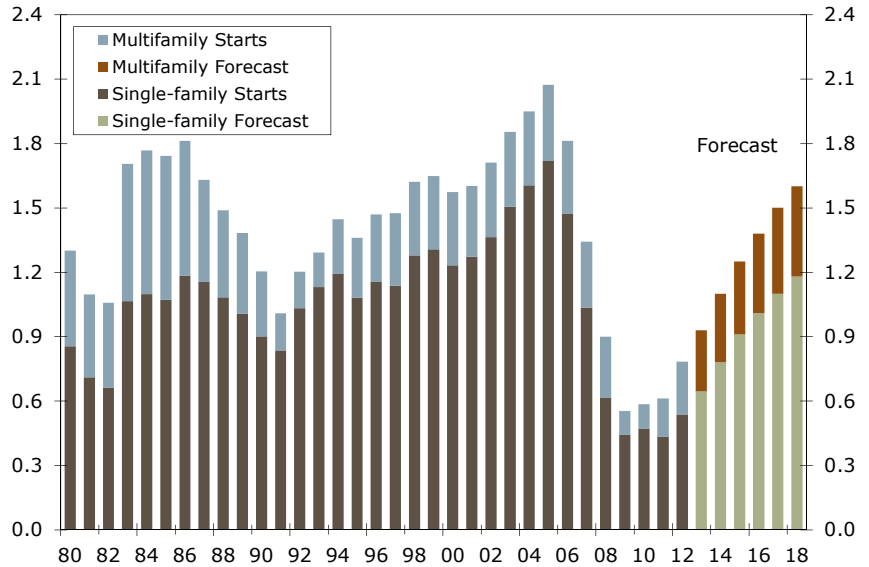
The rebound in home prices is a critical building block to a sustainable housing recovery. Rising prices are a sure sign that excess inventories are being worked down, which helps provide some clarity to the appraisal process and bolster confidence of potential homebuyers. Higher prices also mean that more homeowners have enough equity to trade up to a more desirable residence.

We reassess our housing outlook each month and generally make small modifications to our forecast for home sales, housing starts and home prices. The government shutdown has created somewhat of a void, with data for new home sales and housing starts available only through August. Using the data on hand, we have decided to slightly reduce our forecast for home sales and new home construction over the next few years. The recovery still remains intact, with population growth and slowly healing employment conditions gradually helping to revive household formation. The main reason we have become more cautious is that when mortgage rates rose this summer, home sales pulled back dramatically, which raises doubt about how many households actually are prepared to become homeowners.

We now expect new home sales to rise 19 percent in 2013 to 440,000 units while starts of new single-family homes rise 20.5 percent to 645,000 units. Starts of multifamily units are expected to rise 16.2 percent to 285,000 units. Sales and new home construction are expected to steadily gain momentum over the next few years.

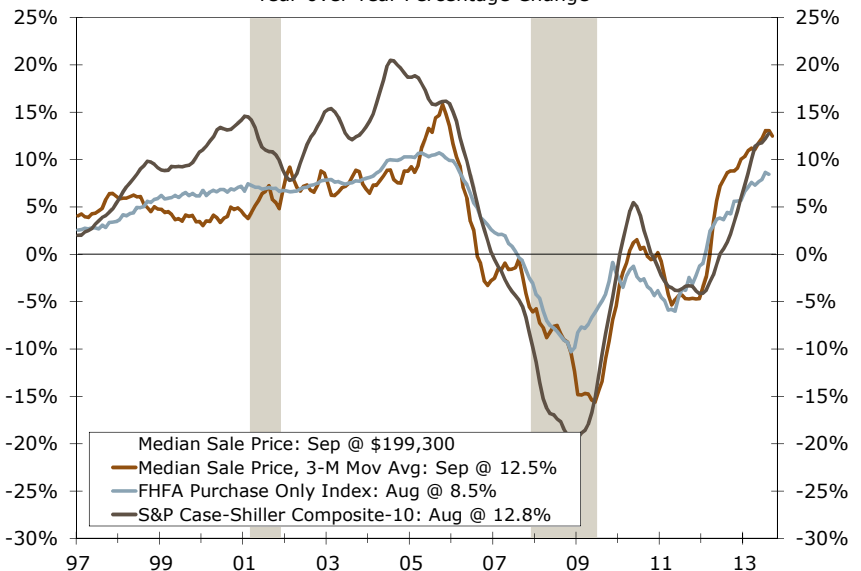
### Housing Starts

Millions of Units



### Home Prices

Year-over-Year Percentage Change



Source: U.S. Department of Commerce, S&P Corp., Federal Housing Finance Agency, National Association of Realtors and Wells Fargo Securities, LLC

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## Market Data ♦ Mid-Day Friday

## U.S. Interest Rates

	Friday 11/8/2013	1 Week Ago	1 Year Ago
3-Month T-Bill	0.06	0.04	0.09
3-Month LIBOR	0.24	0.24	0.31
1-Year Treasury	0.12	0.15	0.17
2-Year Treasury	0.31	0.31	0.26
5-Year Treasury	1.41	1.37	0.64
10-Year Treasury	2.72	2.62	1.61
30-Year Treasury	3.82	3.70	2.75
Bond Buyer Index	4.56	4.48	3.55

## Foreign Exchange Rates

	Friday 11/8/2013	1 Week Ago	1 Year Ago
Euro (\$/€)	1.337	1.349	1.275
British Pound (\$/£)	1.602	1.593	1.598
British Pound (£/€)	0.835	0.847	0.798
Japanese Yen (¥/\$)	98.780	98.670	79.470
Canadian Dollar (C\$/\\$)	1.049	1.042	1.000
Swiss Franc (CHF/\\$)	0.920	0.912	0.946
Australian Dollar (US\$/A\\$)	0.939	0.944	1.041
Mexican Peso (MXN/\\$)	13.323	13.060	13.178
Chinese Yuan (CNY/\\$)	6.091	6.099	6.243
Indian Rupee (INR/\\$)	62.475	61.730	54.375
Brazilian Real (BRL/\\$)	2.336	2.254	2.041
U.S. Dollar Index	81.179	80.716	80.793

Source: Bloomberg LP and Wells Fargo Securities, LLC

## Foreign Interest Rates

	Friday 11/8/2013	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.17	0.17	0.13
3-Month Sterling LIBOR	0.52	0.52	0.53
3-Month Canadian LIBOR	1.17	1.17	1.31
3-Month Yen LIBOR	0.14	0.14	0.19
2-Year German	0.11	0.11	-0.03
2-Year U.K.	0.47	0.42	0.23
2-Year Canadian	1.13	1.12	1.07
2-Year Japanese	0.09	0.10	0.10
10-Year German	1.74	1.69	1.36
10-Year U.K.	2.75	2.65	1.77
10-Year Canadian	2.60	2.50	1.71
10-Year Japanese	0.59	0.60	0.75

## Commodity Prices

	Friday 11/8/2013	1 Week Ago	1 Year Ago
WTI Crude (\\$/Barrel)	94.22	94.61	85.09
Gold (\\$/Ounce)	1292.47	1316.20	1731.45
Hot-Rolled Steel (\\$/S.Ton)	667.00	659.00	618.00
Copper (\\$/Pound)	322.95	329.85	346.95
Soybeans (\\$/Bushel)	12.84	12.85	15.13
Natural Gas (\\$/MMBTU)	3.56	3.51	3.61
Nickel (\\$/Metric Ton)	13,936	14,557	15,946
CRB Spot Inds.	517.39	515.78	498.90

## Next Week's Economic Calendar

	Monday 11	Tuesday 12	Wednesday 13	Thursday 14	Friday 15
U.S. Data		NFIB Small Business Optimism		Trade Balance	Industrial Production (MoM)
		September 93.9		August -\$3.8B	September 0.6%
		October 93.5 (C)		September -\$40.7B (W)	October 0.2% (W)
					Import Price Index (MoM)
					September 0.2%
					October -0.5% (W)
Global Data	Mexico	United Kingdom	Eurozone	United Kingdom	Eurozone
	Industrial Production (YoY)	PPI (MoM)	Industrial Production (MoM)	Retail Sales Ex-Auto (MoM)	CPI (YoY)
	Previous (Aug) -0.7%	Previous (Sep) -0.1%	Previous (Aug) 1.0%	Previous (Sep) 0.7%	Previous (Sep) 1.1%
			Japan		
		GDP (QoQ)			
		Previous (Q2) 0.9%			

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

Source: Bloomberg LP and Wells Fargo Securities, LLC



## Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Sarah Watt	Economist	(704) 410-3282	sarah.watt@wellsfargo.com
Michael T. Wolf	Economist	(704) 410-3286	michael.t.wolf@wellsfargo.com
Sara Silverman	Economic Analyst	(704) 410-3281	sara.silverman@wellsfargo.com
Zachary Griffiths	Economic Analyst	(704) 410-3284	zachary.griffiths@wellsfargo.com
Mackenzie Miller	Economic Analyst	(704) 410-3358	mackenzie.miller@wellsfargo.com
Blaire Zachary	Economic Analyst	(704) 410-3359	blaire.a.zachary@wellsfargo.com
Peg Gavin	Executive Assistant	(704) 410-3279	peg.gavin@wellsfargo.com
Cyndi Burris	Senior Admin. Assistant	(704) 410-3272	cyndi.burris@wellsfargo.com

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