

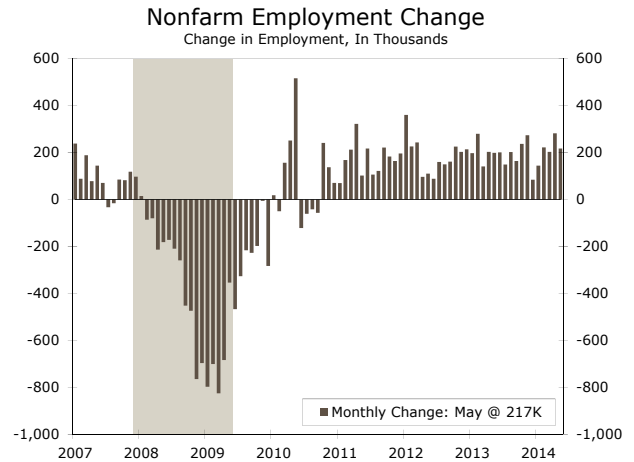
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

No Spring Swoon Going into June

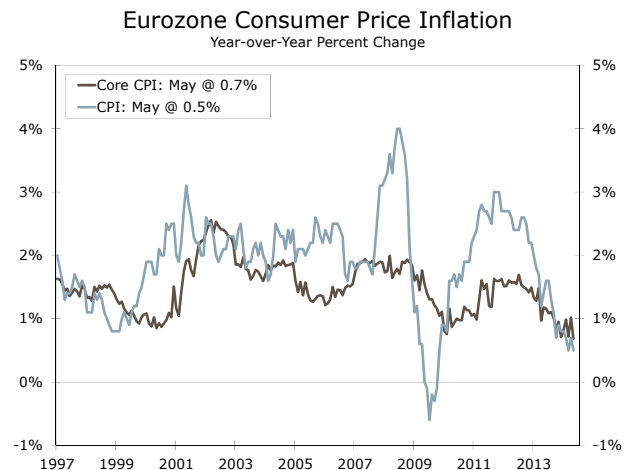
- Payrolls added 217,000 workers in May, recouping all of the jobs lost during the recession, while the unemployment rate remained at 6.3 percent.
- The factory sector continues to make improvements with the ISM manufacturing index rising in May and factory orders picking up in April.
- The trade deficit widened in April and could be a negative to second quarter growth if the trend persists.



Global Review

ECB Announces a Package of Policy Changes

- Data released this week showed that the Eurozone economy continues to expand, but not at a pace that is strong enough to eliminate the possibility of mild deflation setting in. This week's policy actions by the ECB are intended to kickstart bank lending and stimulate economic growth.
- The Bank of England remained on hold this week as incoming data continue to suggest that British growth remains solid. Recent data indicate that Chinese economic growth may be stabilizing.



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 ¹	1.1	2.5	4.1	2.6	-1.0	3.0	2.9	2.9	1.8	2.8	1.9	2.0	2.9
Personal Consumption	2.3	1.8	2.0	3.3	3.1	3.2	2.4	2.6	2.5	2.2	2.0	2.8	2.6
Inflation Indicators ²													
PCE Deflator	1.4	1.1	1.1	1.0	1.1	1.6	1.6	1.8	2.4	1.8	1.1	1.5	2.0
Consumer Price Index	1.7	1.4	1.5	1.2	1.4	1.9	1.9	2.2	3.1	2.1	1.5	1.9	2.2
Industrial Production ¹	4.2	1.9	2.5	4.9	4.5	3.1	4.1	4.3	3.3	3.8	2.9	3.8	4.6
Corporate Profits Before Taxes ²	2.1	4.5	5.7	6.2	-3.0	3.6	3.8	4.0	7.9	7.0	4.6	2.2	4.3
Trade Weighted Dollar Index ³	76.2	77.5	75.2	76.4	76.9	76.5	76.5	76.5	70.9	73.5	75.9	76.6	78.1
Unemployment Rate	7.7	7.5	7.2	7.0	6.7	6.3	6.2	6.1	8.9	8.1	7.4	6.3	5.9
Housing Starts ⁴	0.95	0.86	0.88	1.03	0.92	1.06	1.06	1.07	0.61	0.78	0.92	1.03	1.19
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	0.44
Conventional Mortgage Rate	3.57	4.07	4.49	4.46	4.34	4.30	4.50	4.70	4.46	3.66	3.98	4.46	5.16
10 Year Note	1.87	2.52	2.64	3.04	2.73	2.65	2.90	3.10	2.78	1.80	2.35	2.85	3.56

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Forecast as of: May 30, 2014

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

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

Together we'll go far



U.S. Review

Factory Sector Improves after Tough Winter

The first quarter of 2014 was a difficult one, with real GDP falling by an annualized rate of 1.0 percent. As spring set in, so did worries regarding another swoon, but data this week provide little cause for concern. Nonfarm payrolls finally regained all of the jobs lost during the recession and employment growth accelerated in the first two months of the second quarter, which averaged just less than 250,000 monthly job gains, up from 190,000 for the first quarter. Average hourly earnings improved in line with expectations and the number of people employed part time for economic reasons fell. Although the unemployment rate held steady at 6.3 percent, it had dropped 0.4 percentage points in April.

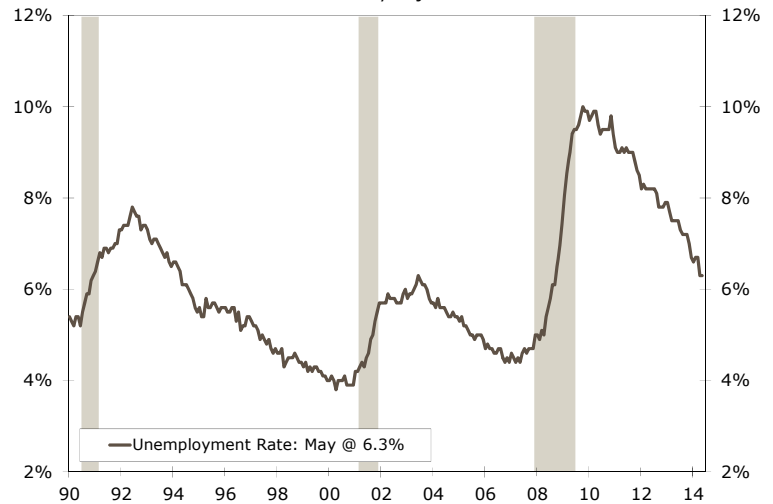
The factory sector is starting to look up, with industry payrolls rising by 10,000 workers in the month. After several revisions, the ISM manufacturing index increased to 55.4 in May from 54.9 the previous month. Production posted the largest gain, rising to 61.0, the highest reading this year. New orders also picked up, while inventories held steady. Inventories took 1.6 percentage points off of real GDP growth in the first quarter after a rather large inventory build at the end of 2013. There are two good reasons to suspect that inventories will remain relatively benign in the second quarter. The ISM inventory index averaged 53.0 for April and May, up from a first quarter average of 49.6. In addition, the factory orders release showed that inventories perked up in April as well.

Overall factory orders picked up in the second quarter after being revised upward for March. Although April's gain was largely due to defense orders, non-defense orders are up 3.9 percent from a year ago. In addition, nondurable shipments regained more than what was lost in the previous month. Core capital goods orders bought back some of the strong gains posted in March, but the broader trend is supportive for continued business investment. The factory sector is not the only source of improvement. The ISM nonmanufacturing index jumped to 56.3 in May, the highest reading in nine months. Furthermore, 17 of 18 industries reported growth over the month and business activity rose at the fastest pace since early 2011.

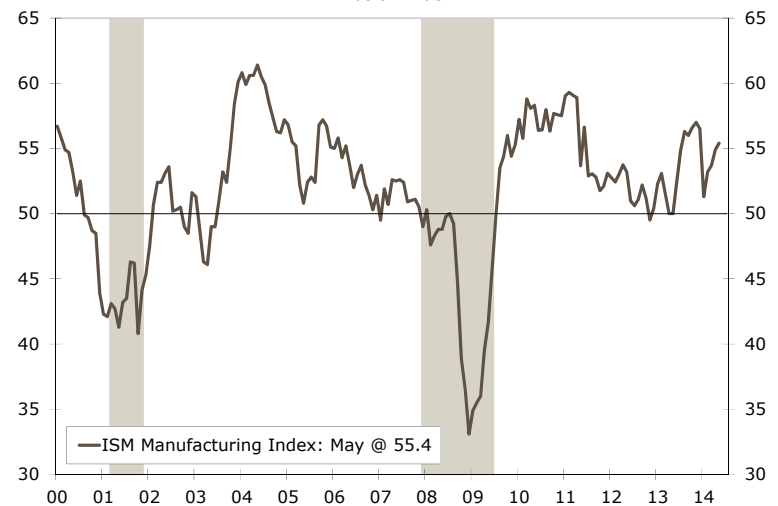
Construction spending has even improved slightly despite the housing market recovery exhibiting some recent weakness. Although construction spending eked out a mere 0.2 percent in April, March's numbers were revised upward to 0.6 percent. Private construction spending has been noticeably absent in the month, although nonresidential public spending posted a sizable gain.

A growing trade deficit was another major contributor to the poor performance in the first quarter, and in April, the deficit widened even more as exports declined slightly in the month. Although this is a negative for real GDP growth, the news is not all bad. Imports posted a sizable 1.2 percent gain in the month, which indicates that domestic demand is alive and well. After excluding petroleum, import growth was even larger, thanks to growing demand for automotive and consumer goods.

Unemployment Rate
Seasonally Adjusted



ISM Manufacturing Composite Index
Diffusion Index



U.S. Trade Balance In Goods And Services
3-Month Moving Average, Billions of Dollars



Source: U.S. Department of Labor, Institute for Supply Management, U.S. Department of Commerce and Wells Fargo Securities, LLC

Retail Sales • Thursday

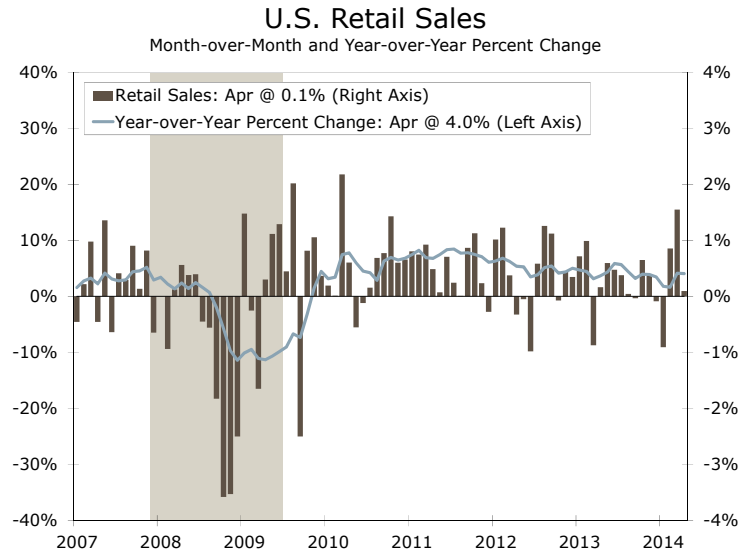
Retail sales sputtered in April, advancing only 0.1 percent. However, the disappointing print followed a sizable 1.5 percent increase in March. On a three-month average annualized basis, sales are rising at a 5.2 percent pace and suggest consumers continue to spend at a decent pace.

We expect retail sales to have grown 0.4 percent in May. Strong sales at motor vehicles and part stores should give a boost to the headline, as auto sales for May, at a 16.7 million annualized rate, were the strongest since early 2007. After falling flat in April, sales excluding autos are also expected to rise, as consumer confidence climbed higher over the month and the labor market continues to improve.

Previous: 0.1%

Wells Fargo: 0.4%

Consensus: 0.6%



Business Inventories • Thursday

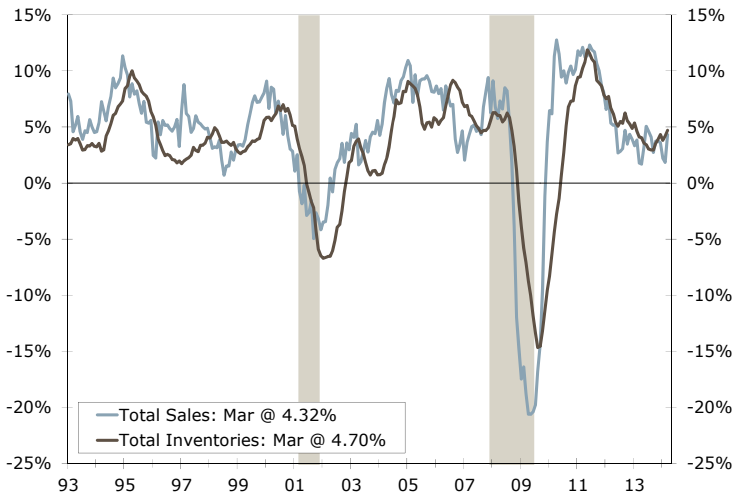
Slower inventory growth wreaked havoc on first-quarter GDP, with nonfarm inventories slicing 1.5 percentage points off of headline GDP. The reduced pace of inventory building comes as businesses try to right size stockpiles following a surge in inventory growth in the second half of 2013. With recent months' inventories still elevated relative to sales, we expect growth in business inventories to have remained fairly modest in April. Data from the factory orders report show manufacturing inventories increased 0.4 percent in April. Inventories in the retail sector are likely to have risen for the first time in two months as April's retail sales report showed a paltry 0.1 percent increase. However, growth in wholesale inventories, which will be released on Tuesday, is likely to have moderated and should keep overall growth in business inventories restrained around 0.5 percent.

Previous: 0.4%

Wells Fargo: 0.5%

Consensus: 0.4%

Total Inventories vs. Sales
Year-over-Year Percent Change



PPI Final Demand • Friday

Inflation pressures remain relatively tame, but have begun to intensify in recent months. The Producer Price Index for final demand rose 0.6 percent in April and followed a 0.5 percent increase in March. On a year-ago basis, the PPI is now up more than 2 percent, and is rising at more than a 4 percent annualized rate over the past three months.

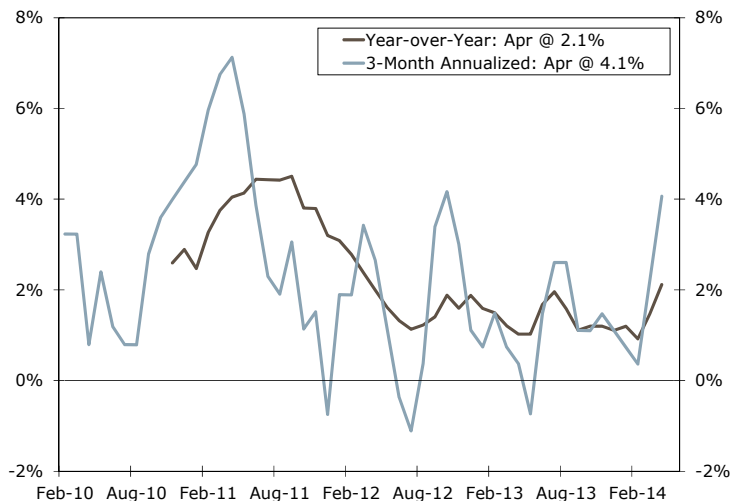
We expect a more muted monthly increase in the PPI for May. Prices for goods have surged in recent months on rising food costs, but last month's 2.7 percent increase in food will be tough to replicate. Selling prices for services have also been on the rise, but have been driven in large part by the volatile trade services component, which are measured by margins. Some giveback may be due following two consecutive months of 1.4 percent gains in trade services, although prices for services ex-trade have also been steadily increasing in recent months.

Previous: 0.6%

Wells Fargo: -0.1%

Consensus: 0.1%

PPI Final Demand
Seasonally Adjusted



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

Global Review

ECB Announces a Package of Policy Changes

The main focus of market participants this week was on the policy meeting at the European Central Bank (ECB). As we detail in a special report the ECB made a number of policy moves that it hopes will stimulate lending growth, thereby leading to stronger economic growth and reducing the possibility of deflation. (See “ECB Announces a Package of Policy Changes” posted on our website.)

In that regard, data that were released this week showed that the overall rate of CPI inflation declined to only 0.5 percent in May while the “core” rate receded to 0.7 percent (see chart on page 1). Meanwhile, “soft” data suggest that the pace of overall economic activity in the Eurozone may have slowed a bit in May as the manufacturing PMI edged down while the comparable index for the service sector essentially held steady (top chart). The bottom line is that the Eurozone economy continues to expand, but not at a pace that is strong enough to eliminate the possibility of a mild case of deflation taking hold in the overall euro area.

Central Banks in Britain and Canada Remain on Hold

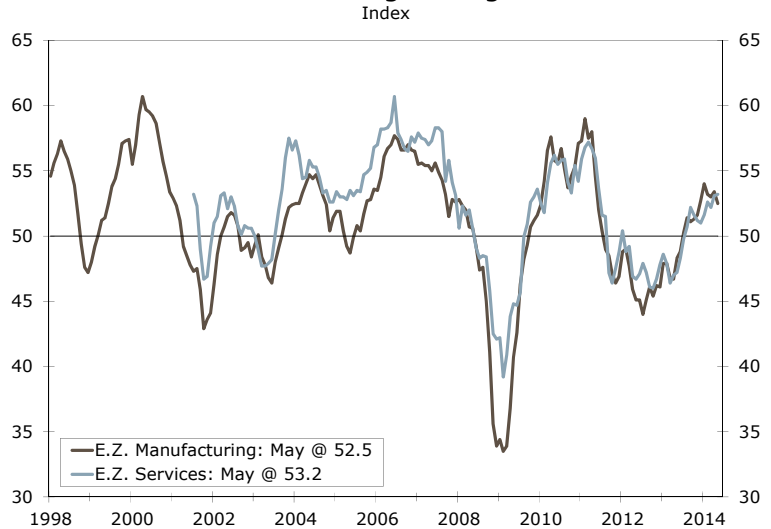
Across the English Channel the Bank of England held policy steady yet again, a decision which surprised nobody. Real GDP in the United Kingdom rose 3.1 percent in the first quarter, the strongest year-over-year growth rate in six years, and the level of the purchasing managers’ indices suggest that economic growth remains strong thus far in the second quarter (middle chart). If, as we expect, real GDP growth remains solid in the coming quarters, the Bank of England will likely begin to hike rates in mid-2015.

The Bank of Canada (BoC) also held a policy meeting this week and, as widely expected, kept its main policy rate unchanged at 1.00 percent, where it has been maintained since September 2010. Moreover, the BoC does not seem to be in any hurry to tighten policy, noting “recent developments give slightly greater weight to downside risks.” Indeed, data released last week showed that real GDP in Canada rose only 1.2 percent at an annualized rate in Q1 2014. Although the overall rate of CPI inflation recently ticked up to 2.0 percent, the mid-point of the BoC’s target range of 1 percent to 3 percent, we look for the BoC to remain on hold for the remainder of 2014.

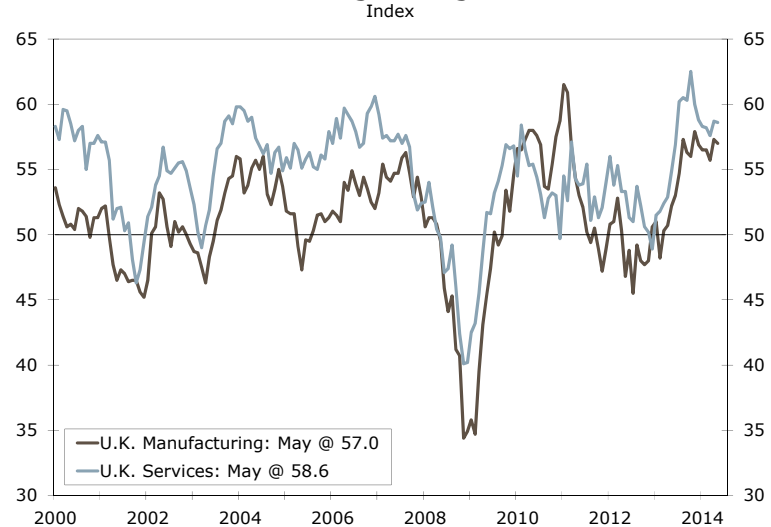
Economic Growth in China Appears to be Stabilizing

Finally, the Chinese economic data that were released this week were consistent with general stabilization in the rate of Chinese economic growth. For example, the “official” manufacturing PMI rose for the third consecutive month in May (bottom chart), which is consistent with the recent trend in a widely followed manufacturing PMI that is produced by a private sector firm. The non-manufacturing PMI has also trended higher in recent months, suggesting that activity in the service sector in China remains solid. We look for further moderation in the rate of Chinese GDP growth over the next two years, but we do not expect the Chinese economy to “crash and burn.”

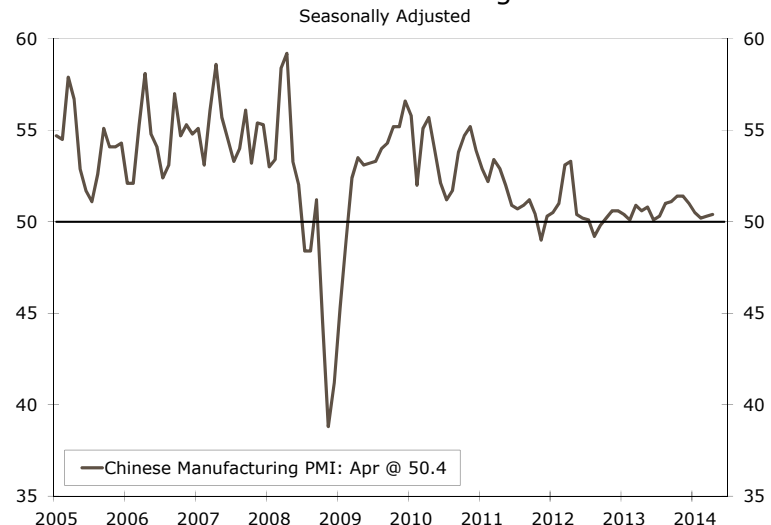
Eurozone Purchasing Managers' Indices



U.K. Purchasing Managers' Indices



Chinese Manufacturing PMI



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

Canadian Housing Starts • Monday

During the expansionary years between 2003 and 2007, the annual rate of Canadian housing starts averaged 227,000. While residential construction activity in Canada avoided the crash experienced in the United States, homebuilding activity has not been as strong in the years that have followed the global recession of 2009.

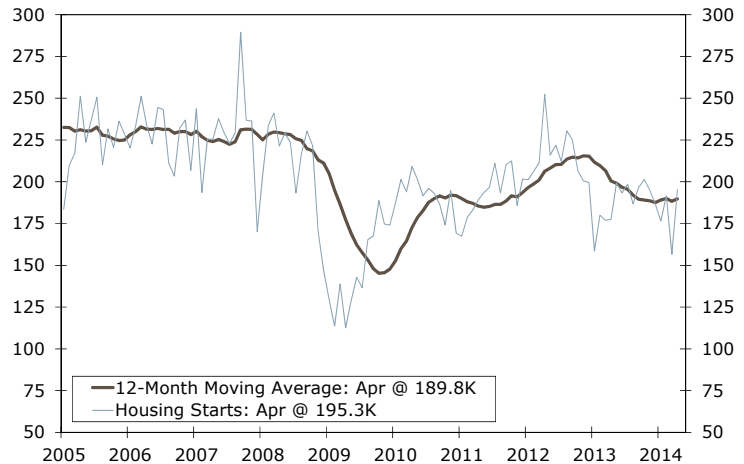
The current 12-month moving average for housing starts is 189,800, although as recently as March, the annual rate fell to just 156,00 before rebounding somewhat as the weather improved in April.

On Monday of next week, Canadian housing starts data for the month of May will hit the wire. Given the weakness in recent building permit data, the consensus expectation is that starts will slow again in May.

Previous: 195,300

Consensus: 185,000

Canadian Housing Starts
In Thousands



U.K. Industrial Production • Tuesday

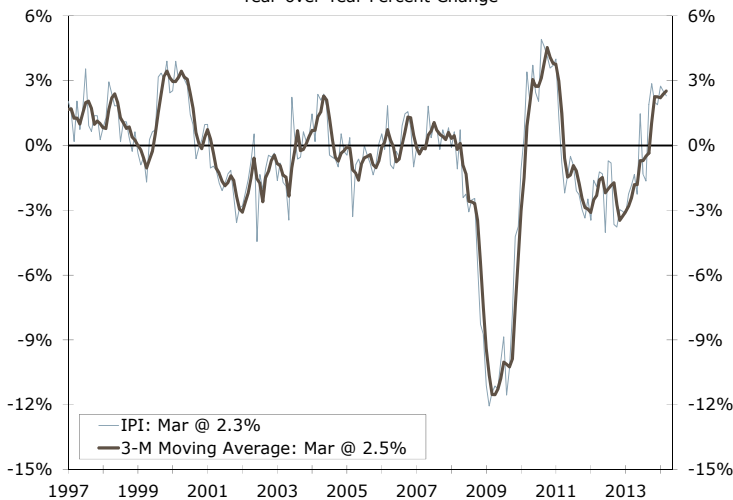
Real GDP growth in the United Kingdom has been positive for five straight quarters and the recovery there remains firmly intact with the year-over-year rate of growth coming in at 3.1 percent in each of the past two quarters.

Year-over-year industrial production growth has not been quite as strong, coming in at just 2.3 percent year over year through March. Output has been held back by weakness in energy production. Looking just at manufacturing, the year-over-year growth rate was 3.3 percent. The manufacturing PMI has been trending higher for the past year and a half or so and has been above 57 for two straight months which indicates expansion in the factory sector. U.K. industrial production figures are due out on Tuesday. If the consensus expectation for a 4.1 percent year-over-year growth rate is realized, it would be the fastest manufacturing growth since 2011.

Previous: -0.1% (Month-over-Month)

Consensus: 0.4%

U.K. Industrial Production Index
Year-over-Year Percent Change



Japanese Machine Orders • Thursday

The recent pattern of economic activity in Japan has been affected dramatically by the April increase in the consumption tax. Retail sales, for example, surged 6.4 percent in March only to drop 13.7 percent in April.

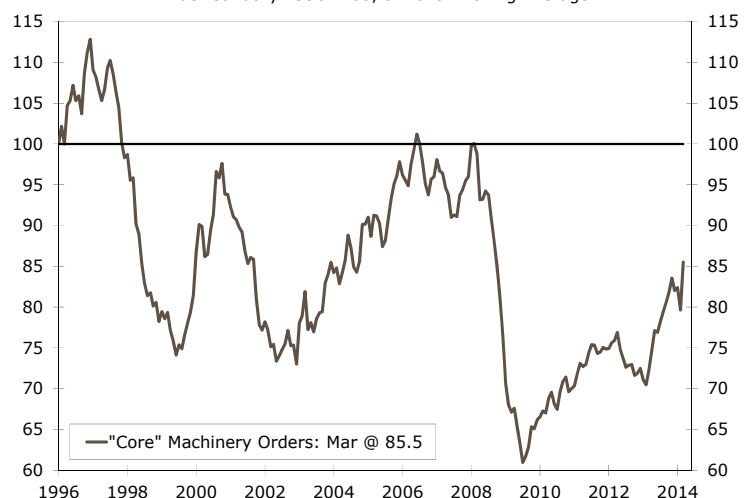
Machine orders soared 19.1 percent in March, but like the short-lived jump in retail sales, this was likely just a function of the consumption tax increase. We will get a better sense of that when April machine orders hit the wire on Wednesday.

We also get a revised look at first-quarter GDP; though no major change is expected. Second-quarter GDP growth will likely be negative largely due to the tax hike.

Previous: 19.1% (Month-over-Month)

Consensus: -10.8%

Japanese "Core" Machinery Orders
Index January 1996=100, 3-Month Moving Average



Source: IHS Global Insight and Wells Fargo Securities, LLC

Interest Rate Watch

Three Key Decisions for the Outlook

Second Half Growth: One-off or Trend?

Labor productivity and, its associated byproduct, income, have both downshifted in the past few years (top graph). This pattern is in contrast to the rapid productivity gains of the early post-WWII period and the early gains derived from technology from 1998-2004. Meanwhile, labor force growth has been slowing since 1982 followed by the decline in participation since the last recession. The combination of slower productivity and labor force growth suggests a baseline for potential economic growth of approximately 2.5-2.75 percent. This pace of growth indicates that the next four quarters of 3 percent growth is more of a one-off before U.S. growth returns to a lower pace by the end of next year.

Inflation: Gradual Climb or Acceleration?

For more than year, average hourly earnings have been rising, as illustrated in the middle graph. This pattern has accompanied a rise in the housing cost components of the CPI. As a result, we expect the PCE deflator, the benchmark for monetary policy, to near the Fed's 2 percent target by the end of this year. Too many commentators have focused on "low" inflation as a comforting factor for their outlook. However, it is rising inflation that will matter to investors and ultimately the Fed over the year ahead.

Global Bond Market—The New Driver?

Most forecasts for interest rates postulate that the U.S. market is a large market in the sense that the U.S. actions tend to drive global rates but global rates have little effect on U.S. rates. Perhaps this model was useful up to the last decade but increasingly we have witnessed that the effects run both ways. U.S. deficits are large and are financed in global markets, particularly by Japan and China. In addition, we have witnessed that weakness in Europe has prompted many foreign investors to substitute between U.S. and European sovereign debt (bottom graph). Therefore, sovereign debt markets have indeed become global and the influence runs both ways.

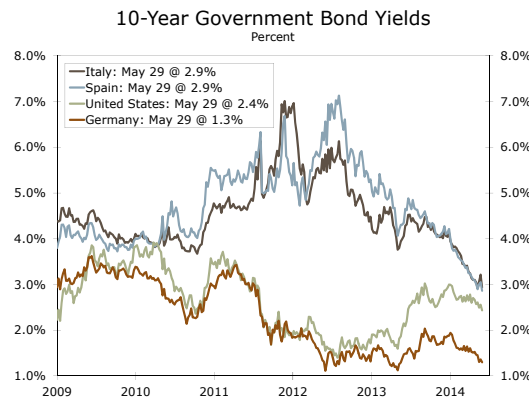
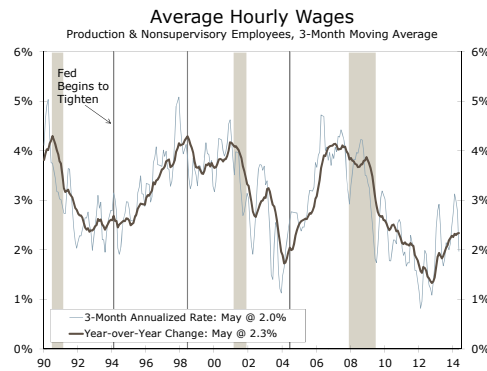
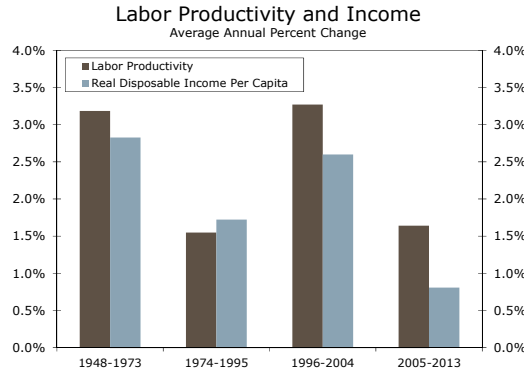
Credit Market Insights

Household Net Worth Strengthens

According to the Federal Reserve Board's Flow of Funds report, the net worth of households and nonprofits in Q1 increased 1.9 percent from Q4 and is at a record high. The previous peak of \$68.9 trillion from Q2 2007 was surpassed this quarter after reaching \$81.8 trillion in Q1 2014. A rise in home prices and a lower level of mortgage debt (down \$37 billion) allowed household real estate valuation to play a key role in the increased net worth, rising \$758 billion to \$20.2 trillion. In addition, rising stock prices have boosted the financial assets of households by \$721 billion. Household debt increased 2 percent, as consumer credit grew 6.6 percent in the quarter. However, mortgage originations fell 0.9 percent, probably held back due to poor weather at the first of the year.

Outside of the household, domestic nonfinancial debt at businesses rose at a 7.3 percent annualized rate, state and local government debt declined at a 0.7 annualized rate and federal government debt rose at an annual rate of 7.1 percent in the first quarter. Combined, business and government debt made up \$29.4 trillion of the total \$42.6 trillion domestic nonfinancial debt outstanding.

This report helps to firm our position of a strong second quarter ahead. As household and businesses grow their balance sheets, GDP should push past its current negative standing to a 3.0 percent growth rate for the spring.



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	4.14%	4.12%	4.20%
15-Yr Fixed	3.23%	3.21%	3.29%	3.03%
5/1 ARM	2.93%	2.96%	3.01%	2.74%
1-Yr ARM	2.40%	2.41%	2.43%	2.58%

Bank Lending	Current Assets (Billions)	1-Week Change (SAAR)	4-Week Change (SAAR)	Year-Ago Change
	Commercial & Industrial	\$1,702.5	14.10%	14.35%
Revolving Home Equity	\$466.3	-2.55%	-2.18%	-5.60%
Residential Mortgages	\$1,578.1	78.23%	2.14%	-1.73%
Commercial Real Estate	\$1,535.7	7.35%	6.95%	6.53%
Consumer	\$1,166.9	2.42%	8.89%	2.99%

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

Topic of the Week

Who Turned Off the Power?

Structure investment fell for the second consecutive quarter with power construction spending accounting for the largest detractor in the headline. Power outlays, which make up about one-fifth of total spending, fell at a 4.5 percent pace in the first quarter and a 2.7 percent rate in the fourth quarter. The details of the report show that much of the decline was in electric spending, which includes nuclear, oil, gas and alternative energy sources like wind, solar, and hydroelectric power plants. We suspect slower spending in this component is due to a pullback in nuclear and wind capacity additions.

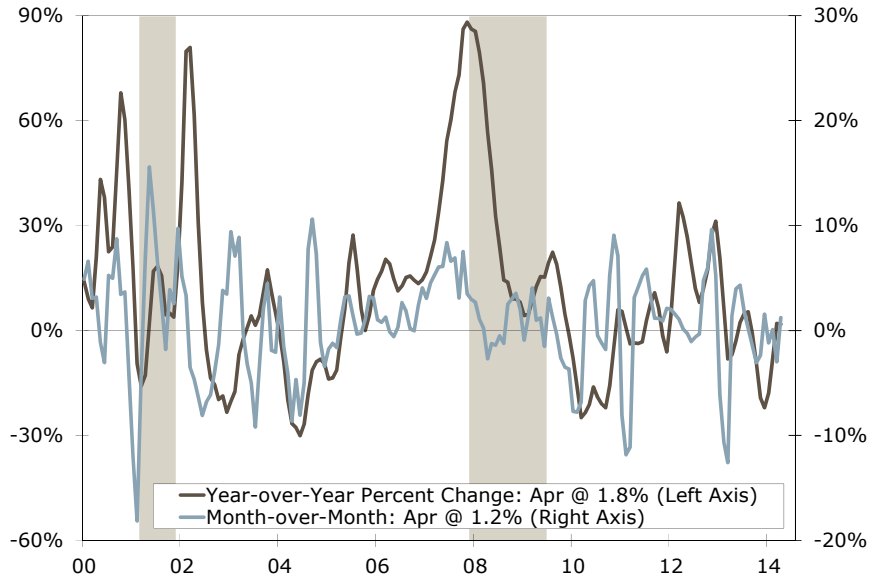
In 2012, electric power spending rose markedly with the help of the federal renewable production tax credit (PTC). In fact, the rush to beat the planned expiration by the end of that year helped push power outlays up 128.9 percent in the fourth quarter. The PTC is a per-kilowatt tax credit for electricity generated by renewable energy sources such as wind, biomass and geothermal, for the first 10 years of operation. According to the EIA, wind capacity additions accounted for nearly one-half of total capacity additions in 2012 with 12,620 MW added, the highest annual wind capacity installed on record. Wind capacity additions in 2012 even outpaced natural gas in 2012. The rush to take advantage of the PTC is evident in the monthly capacity figures with 40 percent of activity in 2012 occurring in December as developers rushed to complete wind projects before the expected deadline. However, without the pressure to complete projects by year end, wind projects have fallen.

Natural gas has also been a boon for electric power spending as a surge in production due to horizontal drilling and hydraulic fracturing have fueled power plant additions. From 2000 to 2010, more than 80 percent of total generation capacity additions were in natural gas. However, natural gas capacity additions took a breather in 2013, adding only 6861 MW, a 25.5 percent drop over the past year. Going forward, natural gas fire plants are expected to account for nearly three-fourths of capacity over the next three decades, but construction costs and electric demand will determine the pace of the growth.

For further discussion, see *"Power Outlays Pull Structure Investment Lower in Q1"*, which is available on our website.

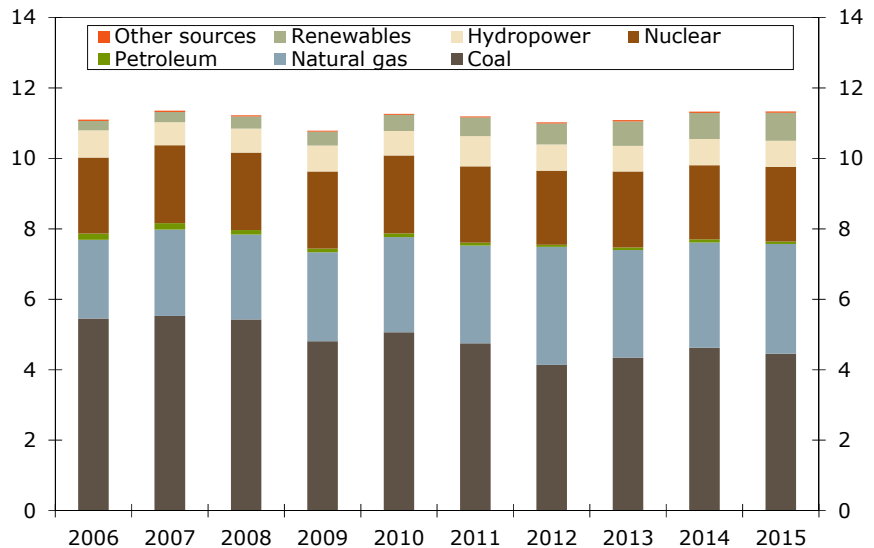
Private Power Construction

Percent Change, 3-Month Moving Average



Electricity Generation by Fuel

Millions of Megawatthours per Day



Source: U.S. Energy Information Administration and Wells Fargo Securities, LLC

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 6/6/2014	1 Week Ago	1 Year Ago
3-Month T-Bill	0.03	0.03	0.05
3-Month LIBOR	0.23	0.23	0.27
1-Year Treasury	0.13	0.12	0.13
2-Year Treasury	0.39	0.37	0.29
5-Year Treasury	1.63	1.54	1.01
10-Year Treasury	2.57	2.48	2.08
30-Year Treasury	3.42	3.33	3.24
Bond Buyer Index	4.26	4.28	3.84

Foreign Exchange Rates

	Friday 6/6/2014	1 Week Ago	1 Year Ago
Euro (\$/€)	1.364	1.364	1.325
British Pound (\$/£)	1.679	1.676	1.560
British Pound (£/€)	0.812	0.814	0.849
Japanese Yen (¥/\$)	102.530	101.770	96.970
Canadian Dollar (C\$/\\$)	1.094	1.085	1.026
Swiss Franc (CHF/\\$)	0.894	0.895	0.929
Australian Dollar (US\$/A\\$)	0.933	0.931	0.960
Mexican Peso (MXN/\\$)	12.886	12.858	12.804
Chinese Yuan (CNY/\\$)	6.251	6.247	6.136
Indian Rupee (INR/\\$)	59.183	59.103	56.850
Brazilian Real (BRL/\\$)	2.242	2.242	2.130
U.S. Dollar Index	80.478	80.369	81.537

Source: Bloomberg LP and Wells Fargo Securities, LLC

Foreign Interest Rates

	Friday 6/6/2014	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.25	0.29	0.12
3-Month Sterling LIBOR	0.53	0.53	0.51
3-Month Canada Banker's Acceptance	1.27	1.27	1.27
3-Month Yen LIBOR	0.14	0.14	0.15
2-Year German	0.05	0.06	0.14
2-Year U.K.	0.68	0.67	0.37
2-Year Canadian	1.06	1.05	1.05
2-Year Japanese	0.09	0.09	0.13
10-Year German	1.36	1.36	1.52
10-Year U.K.	2.66	2.57	2.02
10-Year Canadian	2.30	2.25	2.04
10-Year Japanese	0.60	0.58	0.83

Commodity Prices

	Friday 6/6/2014	1 Week Ago	1 Year Ago
WTI Crude (\\$/Barrel)	102.79	102.71	94.76
Gold (\\$/Ounce)	1250.46	1249.73	1413.91
Hot-Rolled Steel (\\$/S.Ton)	667.00	670.00	588.00
Copper (¢/Pound)	304.50	312.35	331.90
Soybeans (\\$/Bushel)	14.70	15.16	15.37
Natural Gas (\\$/MMBTU)	4.70	4.54	3.83
Nickel (\\$/Metric Ton)	18,973	18,873	15,135
CRB Spot Inds.	539.08	542.00	528.19

Next Week's Economic Calendar

	Monday 9	Tuesday 10	Wednesday 11	Thursday 12	Friday 13
U.S. Data		NFIB Small Business April 95.2 May		Retail Sales April 0.1% May 0.4% (W)	Producer Price Index April 0.6% May -0.1% (W)
				Import Price Index April -0.4% May 0.4% (W)	
	Mexico CPI (YoY) Previous (Apr) 3.50%	United Kingdom Industrial Production Previous (Mar) -0.1%	Australia Unemployment Rate Previous (Apr) 5.8%	Japan Machine Orders Previous (Mar) 19.1%	India Industrial Production (YOY) Previous (Apr) -0.5%
	Canada Housing Starts Previous (Apr) 195.3K			Brazil Retail Sales (YoY) Previous (Mar) -1.1%	

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

Source: Bloomberg LP and Wells Fargo Securities, LLC

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