

Economics Group

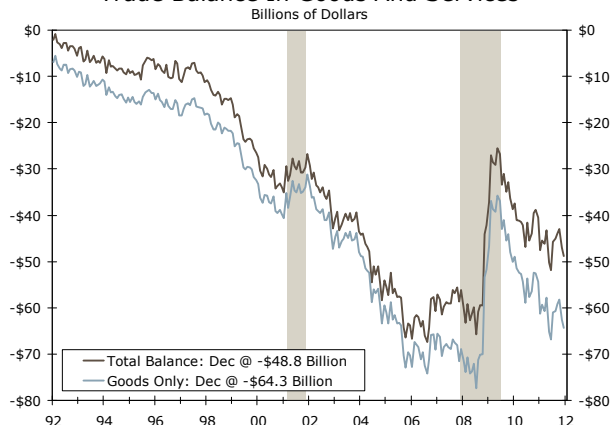
Weekly Economic & Financial Commentary

U.S. Review

The Moderate Economic Recovery is Still Underway

- Consumer credit surged by \$19.3 billion in December, the second consecutive solid monthly increase reflecting growth in credit cards, student loans and car loans.
- Weekly first-time jobless claims fell by 15k to 358k and the Job Openings and Labor Turnover Survey showed the number of job openings in December rose 2.5 percent.
- Data on international trade show the nominal U.S. trade deficit widened 3.7 percent to \$48.8 billion in December from \$47.1 billion in November.

Trade Balance In Goods And Services

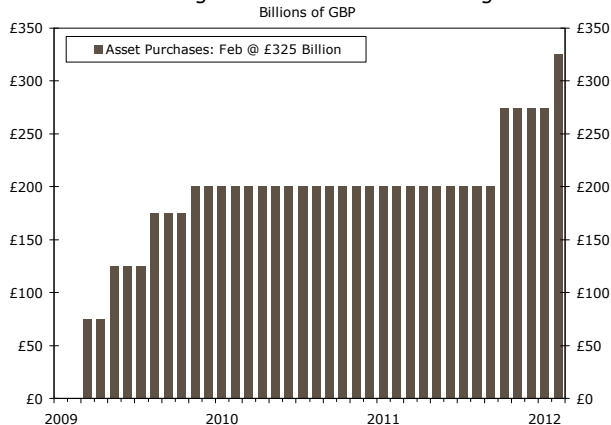


Global Review

Bank of England Eases Further

- Citing “the weak near-term growth outlook,” the Bank of England increased the size of its asset purchase program to £325 billion at this week’s policy meeting. The United Kingdom may avert a “technical” recession by posting positive GDP growth in the first quarter, but the British economy is clearly weak at present.
- The outlook for inflation also supports the case for further policy ease. CPI inflation is well above the Bank’s 2 percent target at present, but the overall rate of inflation should recede markedly over the course of the year.

Bank of England's Asset Purchase Program



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	2.8	1.5	1.6	2.3	2.5	-3.6	3.0	1.7	1.9	2.1
Personal Consumption	2.1	0.7	1.7	2.8	1.8	1.5	1.6	1.8	-2.0	2.0	2.2	1.7	1.4
Inflation Indicators ²													
PCE Deflator	1.8	2.5	2.9	2.6	2.0	1.7	1.6	1.9	0.6	1.8	2.4	1.8	1.9
Consumer Price Index	2.2	3.3	3.8	3.3	2.4	1.8	1.5	1.8	-0.3	1.6	3.1	1.9	2.0
Industrial Production ¹	4.8	0.7	6.3	3.1	3.8	3.6	3.0	2.2	-11.1	5.3	4.1	3.5	2.3
Corporate Profits Before Taxes ²	8.8	8.5	7.5	6.4	6.2	6.0	6.4	6.6	9.1	32.2	7.8	6.3	6.6
Trade Weighted Dollar Index ³	70.6	69.4	72.8	73.3	72.0	73.0	74.0	75.0	77.7	75.6	70.9	73.5	76.3
Unemployment Rate	9.0	9.0	9.1	8.7	8.3	8.2	8.4	8.4	9.3	9.6	9.0	8.3	8.3
Housing Starts ⁴	0.58	0.57	0.62	0.66	0.66	0.70	0.69	0.70	0.55	0.58	0.61	0.69	0.80
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	4.00	4.00	4.10	4.10	5.04	4.69	4.46	4.05	4.25
10 Year Note	3.47	3.18	1.92	1.89	1.90	2.00	2.10	2.20	3.26	3.22	2.78	2.05	2.35

Forecast as of: February 8, 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

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Together we'll go far



U.S. Review

Light Week for Data, but the Economy is Still Improving

Despite headlines dominated by the Eurozone sovereign debt crisis, the flow of economic releases in the U.S. this week was fairly light and continued to reflect an economy growing at a moderate pace. One sign the economy continued to improve was the recently-released data on consumer credit. Consumer credit surged by \$19.3 billion in December, the second consecutive solid monthly increase. The growth in credit continued to reflect increases in credit cards, student loans and car loans.

Indeed, nonrevolving credit rose at an 11.8 percent seasonally adjusted pace to \$1697.3 billion in December. Demand in student loan credit may be getting a boost from many banks now offering fixed-rate student loans with historically low interest rates. Student enrollment also increased as discouraged workers returned to school, but with many universities boosting tuition and cutting back on aid, students are likely seeking additional financial support. Another boon for nonrevolving credit is car loans. We continue to expect manufacturer unit sales to dealers to increase in the coming quarters. Revolving credit also increased, but the trend is likely not sustainable as credit card use will probably trail off. As consumers contend with a lack of real income growth and decline in the saving rate, consumer spending is expected to increase at only a moderate pace over the next few years.

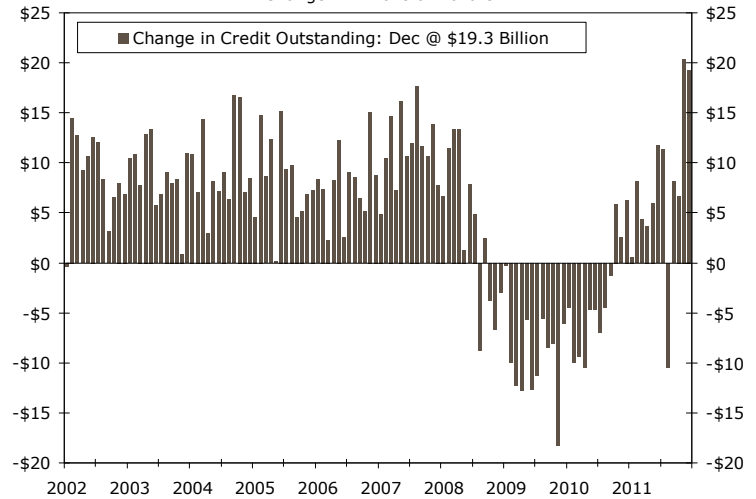
The labor market is also showing strength, as initial jobless claims are now below the 400k threshold for 12 out of the last 14 weeks. Initial jobless claims fell to 358k for the week ending Feb. 4. On a trend basis, the four-week moving average fell by 11k to 366k. While claims are moving in the right direction, the underlying structural issues in the labor market will likely keep the unemployment rate elevated for the foreseeable future.

That said, the Job Openings and Labor Turnover Survey (JOLTS) showed the number of job openings in December rose 2.5 percent, as openings in manufacturing and professional and business services led the way. The ratio of unemployed job seekers to the number of job openings fell to 3.9 in December from 4.3 in November. Although JOLTS data do not show the same pace of improvement as the nonfarm employment report or initial jobless claims, it still illustrates sustainable gains in the labor market.

Data on international trade show the nominal U.S. trade deficit widened 3.7 percent to \$48.8 billion in December from \$47.1 billion in November. Exports rose only 0.7 percent while imports rose 1.3 percent. Based on the BEA's conservative estimate for trade, however, we now expect trade to make a modest contribution to economic growth in the fourth quarter. The NFIB Small Business Optimism Index increased 1.8 points to 93.8 in December, the fourth monthly gain. Also reflecting the elevated unemployment rate, the number of firms with plans to hire pulled back 1.0 percent on the month. One positive aspect of the report was the number of firms expecting real sales to increase did indeed continue to rise.

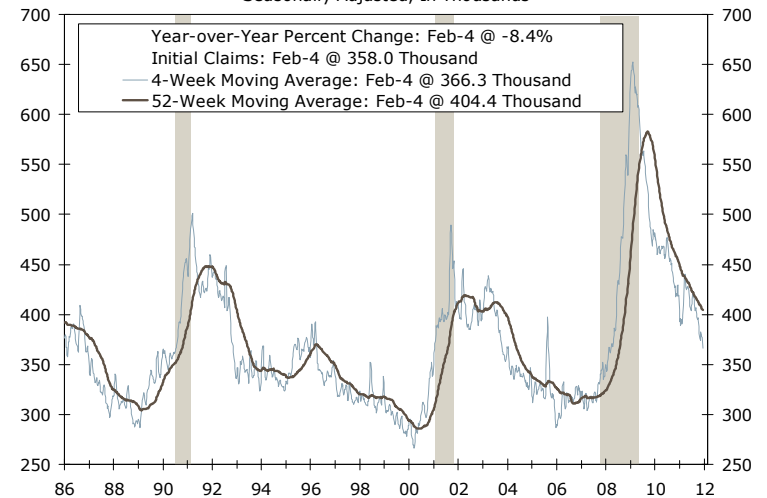
Consumer Credit

Change in Billions of Dollars



Initial Claims for Unemployment

Seasonally Adjusted, In Thousands



Job Openings Rate

Seasonally Adjusted



Retail Sales • Tuesday

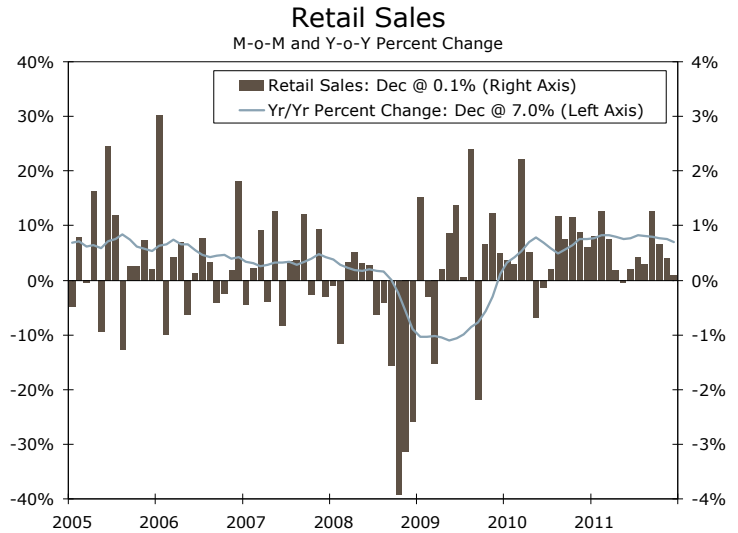
On Tuesday we get retail sales for the month of January and the expectation is for a relatively strong recovery compared to the 0.1 percent growth rate recorded in December. In fact, we are expecting growth to have been 1.1 percent compared to a consensus expectation of only 0.6 percent and the highest since the 1.3 percent growth rate reported in September 2011.

Excluding autos, we are also above consensus, which expects a 0.5 percent increase, at 0.8 percent after a drop of 0.2 percent for December. Thus, we are expecting the year to have started on a very positive note for retail sales. The only caveat for retail sales is that the strength may also be related to the same weather phenomenon that has affected other indicators early in the year, as the winter season has been one of the warmest in many decades in the United States.

Previous: 0.1%

Wells Fargo: 1.1%

Consensus: 0.7% (Month-over-Month)



Industrial Production • Wednesday

Another data point that is probably going to look better than expected is the industrial production index to be released on Wednesday. Weather may have negatively affected utilities' output but utilities comprise only 10.4 percent of the weight on the industrial production index while manufacturing's weight represents 77.9 percent of it.

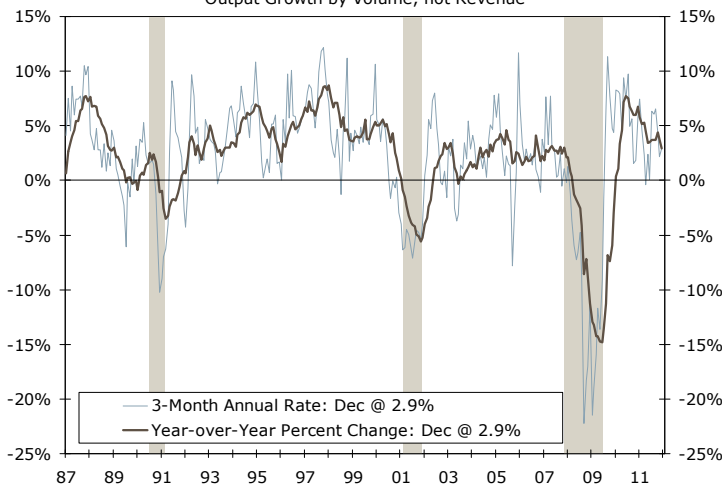
Furthermore, markets will probably be looking at the result for manufacturing production closely as the December number was very strong, showing an increase of 0.9 percent. If this number is revised down for December and/or comes in weaker than expected it could make some noise for the strength in economic activity as the manufacturing sector has been the leading growth sector in the U.S. economy for the last several years. Nevertheless, whatever the number is, markets should also take the result with caution as the weather may factor in.

Previous: 0.4%

Wells Fargo: 0.6%

Consensus: 0.6% (Month-over-Month)

Total Industrial Production Growth
Output Growth by Volume, not Revenue



Consumer Price Index • Friday

After very benign numbers on the inflation front for the last quarter of 2011, the first consumer price number for this year, January's, will be released on Friday. Our expectation is for consumer prices to have increased by 0.3 percent in January after flat readings in both November and December of last year.

Meanwhile, excluding the highly volatile energy and food sector, we are also expecting the number to be relatively high at 0.2 percent after a 0.1 percent increase in December and a 0.2 percent increase in November. However, our expectation for the rest of the year is for inflation to remain muted and trending downward compared to last year's 3.0 percent rate year over year.

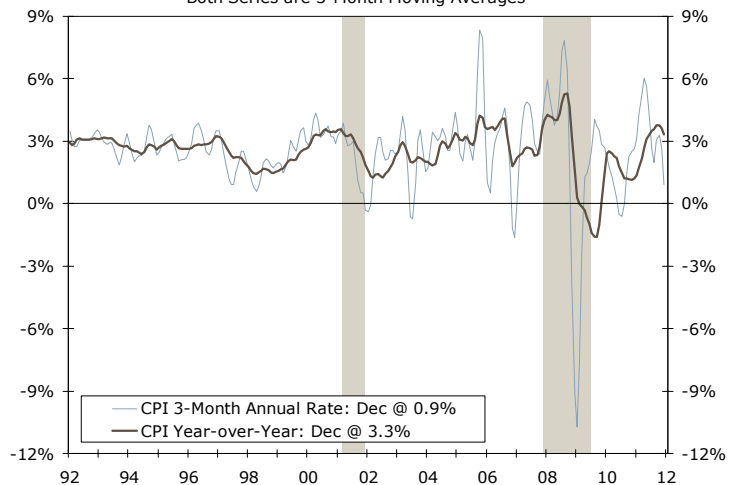
This means that inflation is still out of the Federal Reserve's radar and will remain there for some months to come. This will keep the Federal Reserve in the sidelines regarding interest rates.

Previous: 0.0%

Wells Fargo: 0.3%

Consensus: 0.3% (Month-over-Month)

U.S. Consumer Price Index
Both Series are 3-Month Moving Averages



Global Review

Bank of England Eases Further

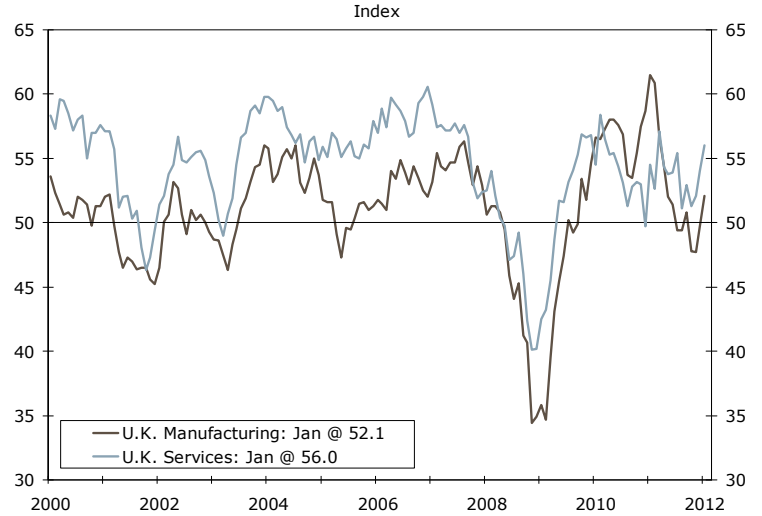
As widely expected, the Monetary Policy Committee (MPC) of the Bank of England kept its main policy rate unchanged at 0.5 percent, where it has been maintained since March 2009, at its meeting this week. However, the MPC eased policy further by increasing the size of its asset purchase program (its “quantitative easing” program) to £325 billion from £275 billion (see chart on front page).

The MPC pointed to “the weak near-term growth outlook” as a factor warranting further policy easing. Real GDP grew only 0.8 percent on a year-over-year basis in the fourth quarter and the pace of economic growth likely will remain sluggish, at least for the foreseeable future. There have recently been some signs of improvement in the British economy. The manufacturing PMI in January rebounded above the demarcation line separating expansion from contraction, and the service sector PMI shot up to its highest level in nearly a year (top chart). That said, the PMI may be overstating the strength of the service sector at present as retailers reported disappointing sales growth in January. Although we expect that the British economy will avert a “technical” recession by posting positive real GDP growth in the first quarter, we share the MPC’s belief that the pace of economic growth likely will remain sluggish in the near term.

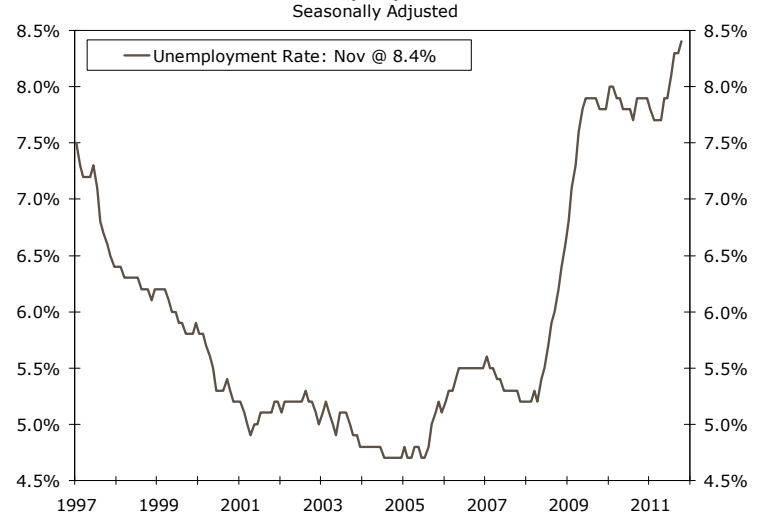
Moreover, the outlook for inflation also supports the case for further policy ease. Although CPI inflation is well above the Bank’s 2 percent target at present—the year-over-year rate stood at 4.2 percent in December (see graph on page 5)—inflation is expected to recede markedly this year as the effects of last January’s hike in the value-added tax drop out of the calculations. Inflationary pressures further up the production pipeline are easing as producer price inflation has dropped more than 2 percentage points since peaking in September. In addition, spare capacity should also help to keep CPI inflation well in check. The unemployment rate has risen to 8.4 percent, the highest rate in nearly 17 years (middle chart). Average wages are up less than 2 percent on a year-ago basis, and the high unemployment rate will probably limit wage acceleration. By the fourth quarter of this year, we project that the overall CPI inflation rate will recede to less than 2 percent. Projections by the Bank of England also show a marked decline in CPI inflation this year.

As shown in the graph on the front page, the Bank’s asset purchases program has been in place for nearly three years. Has it “worked”? That is, have the Bank’s purchases of U.K. government bonds and other long-term securities brought borrowing costs down? There are many factors that influence long-term interest rates, and trying to isolate the precise impact of the Bank’s purchases on rates is very difficult. That said, long-term interest rates have come down significantly over the past few years with the yield on the 10-year U.K. government bond hovering just above 2 percent, the lowest rate in decades (bottom chart). The British economy may be anemic at present, but it would probably be even weaker without the Bank’s actions.

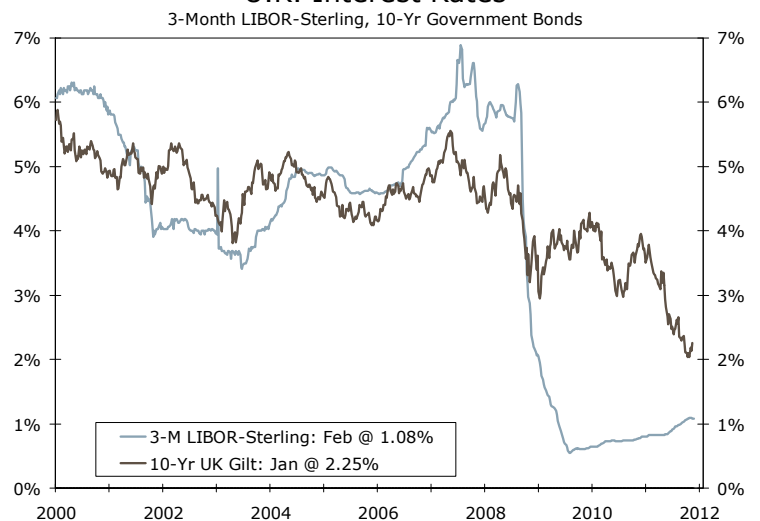
U.K. Purchasing Managers' Indices



U.K. Unemployment Rate



U.K. Interest Rates



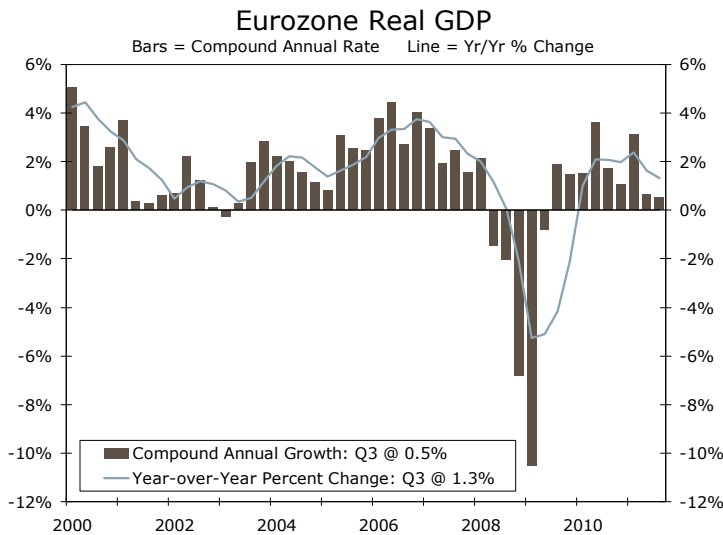
United Kingdom CPI • Tuesday

As discussed on page four, the U.K. economy is very weak at present. GDP contracted at a 0.8 percent annualized rate in the past quarter, and headline GDP growth has been negative in three of the past five quarters. If a “technical” recession were to develop it would likely be mild. The U.K. manufacturing PMI returned to expansion territory in January, coming in at 52.1 and the service sector PMI soared to 56.0, the highest level since March 2011.

Despite the weak pace of economic growth, CPI inflation is currently well above the Bank of England’s target of 2 percent. On Tuesday next week we will get a look at January CPI numbers. The Monetary Policy Committee (MPC) of the Bank of England projects the weak economy will cause inflation to return to target over the next year or so. We believe the MPC will keep its benchmark policy rate on hold indefinitely due to the clouded economic outlook.

Previous: 4.2%

Consensus: 3.6% (Year-over-Year)



Canadian CPI • Friday

The Canadian economy continues to expand, but it seems to have lost some momentum in recent months. In the past five months the job market has shed roughly 50K full-time jobs, resulting in an uptick in the unemployment rate to 7.6 percent in January from 7.2 percent in September.

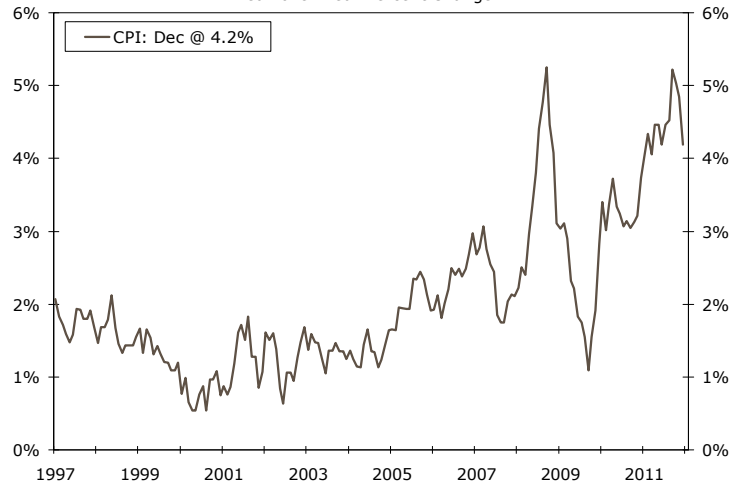
Monthly GDP data have been disappointing as well, as headline growth was flat in October and down slightly in November.

The headline rate of inflation, presently at 2.3 percent, is right in line with the Bank of Canada’s (BoC) target range and the core rate of inflation is also subdued at 1.9 percent on a year-over-year basis. This benign rate of inflation, combined with tepid economic growth, means that the BoC will most likely remain on hold for the foreseeable future.

Previous: 2.3%

Consensus: 2.3% (Year-over-Year)

U.K. Consumer Price Index
Year-over-Year Percent Change



Eurozone GDP • Wednesday

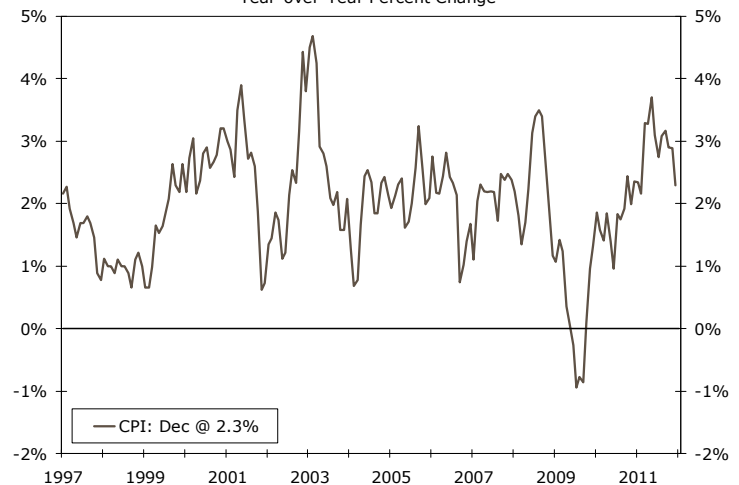
Three-month Labor has been trending lower for the past five weeks and Italian government bond yields are similarly coming back down to earth. Taken together, these developments suggest interbank lending is not as tight as it was in early January and the market’s perception of Italian sovereign bonds is improving. Despite these developments, the Eurozone appears to be slipping back into recession. The purchasing managers’ indices for both are mixed with the manufacturing measure stuck in contraction and the service sectors’ PMI having finally broken above 50.

Fourth-quarter GDPs are due out on Wednesday of next week and we expect to see an annualized pace of contraction on the order of 1.5 percent or so. In our view, the sovereign debt crisis represents the biggest downside risk to the global economic outlook, and despite recent welcome improvements, the situation remains very fluid and could be with us for some time.

Previous: 1.3%

Consensus: 0.7% (Year-over-Year)

Canadian Consumer Price Index
Year-over-Year Percent Change



Interest Rate Watch

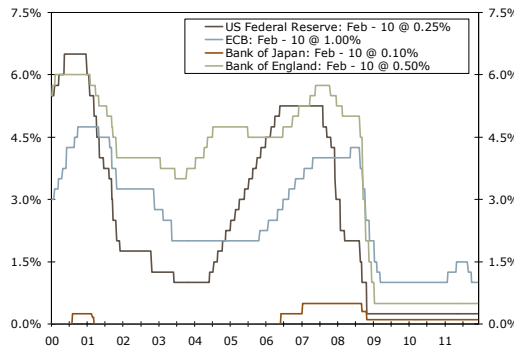
Cyclical Recovery and Continued Low Interest Rates thru 2014? An Uneasy Truce.

Winning a battle does not mean winning a war in the battle of supply and demand in the credit market. In the short term, the Fed's provision of liquidity may keep interest rates low for now, but we are skeptical of the ability of the Fed to keep both short and long-term rates this low through 2014. Economics will dominate policy and the bias, certainly for long rates, will be on the upside. Investors should be skeptical of policy intentions in the face of real-world developments.

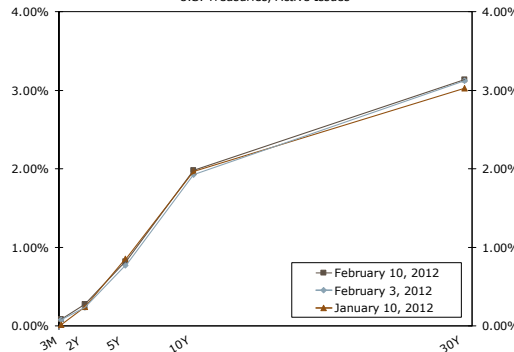
We expect the U.S. economy is now in a self-sustaining recovery with steady inflation, as measured by the PCE (Personal consumption deflator, the Fed's target), at 1.6–2.0 percent for 2012. Recent evidence from the January employment report and the Senior Loan Officer Opinion Survey suggests the demand for workers and credit picked up. The Fed appears committed to maintaining an easy posture as it perceives the economy is weaker than we do. Meanwhile, increases in public sector demand for credit appear to continue and little progress is expected on a reduction on expected future federal deficits. In the short-run, we expect that the Fed's easy policy will keep rates arbitrarily low but that over time the demand for credit from both private and public sources will force credit spreads over Treasuries and longer-term interest rates upward before the end of 2014. The selloff after the recent employment release suggests the bias in long rates is indeed moving upward.

We remain skeptical that the Fed maintains its easy policy through 2014 and we think business and public-sector decision makers would do well to anticipate a rise in market rates before then. Finally, we are cautious about the global effects on U.S. domestic rates. A Chinese economic slowdown could suggest smaller capital outflows to the U.S. Treasury market and thereby put upward pressure on U.S. interest rates and downward pressure on the dollar. Meanwhile, progress in Europe will also reinforce these moves.

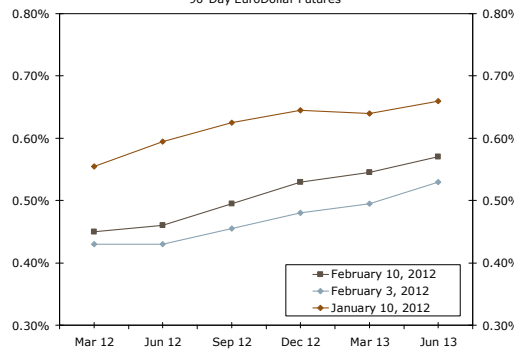
Central Bank Policy Rates



Yield Curve
U.S. Treasuries, Active Issues



Forward Rates
90-Day EuroDollar Futures



Credit Market Insights

C&I Lending Demand Picks up

Commercial and industrial (C&I) lending, an indicator of lending to small and medium sized businesses, continued to trend up in January. Total C&I loans are now up 10.8 percent on a year-over-year basis, signaling that borrowing activity among the small and medium business segment continues to pick up. Total C&I loans amounted to \$1.3 trillion for the month of December, closing a year of steady growth in commercial and industrial lending.

The most recent Senior Loan Officer Survey indicated that domestic banks reported stronger C&I loan demand from firms of all sizes. In addition, the number of banks reporting increased demand from smaller firms rose to its highest level since 2005. While credit standards are little changed, the demand for C&I loans continues to rise. As a result, competition among leaders is resulting in eased pricing terms for some C&I loans. The data from the Senior Loan Officer Survey pointed out that over the last three months a large number of banks have reported easing pricing conditions for C&I loans directly due to increased competition.

The continued pickup in C&I lending, particularly in the small business segment, is a positive sign. The demand for loans is a good sign for continued capital investments and perhaps somewhat stronger employment growth within the small business sector, a key sector for job creation within the economy.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	3.87%	3.87%	3.89%	4.27%
15-Yr Fixed	3.16%	3.14%	3.16%	3.72%
5/1 ARM	2.83%	2.80%	2.82%	3.47%
1-Yr ARM	2.78%	2.76%	2.76%	3.40%
MBA Applications				
Composite	810.0	753.3	663.1	464.7
Purchase	181.9	181.7	177.1	186.1
Refinance	4,500.7	4,113.8	3,560.6	2,086.4

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

Topic of the Week

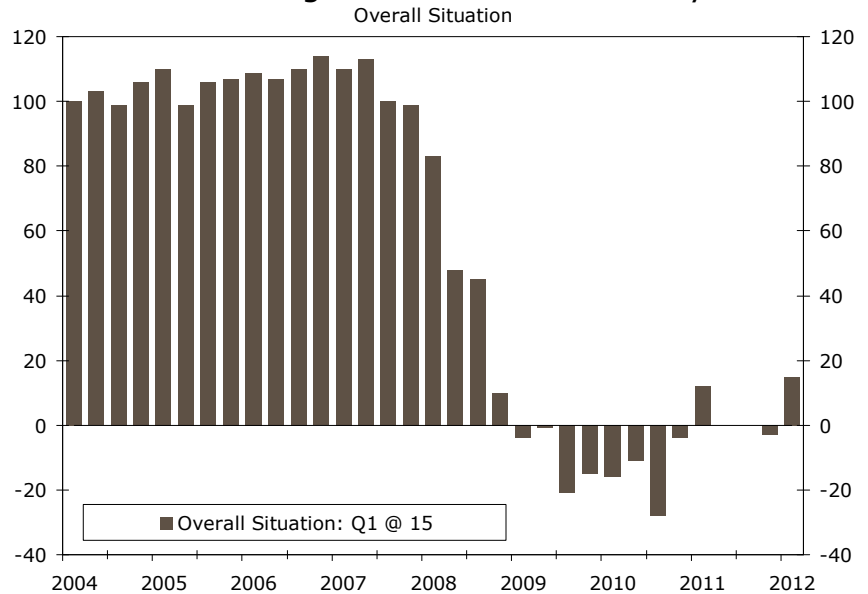
Small Business Optimism Picking up

Moderate growth in the economy over the past few months is helping to improve small business optimism. The Wells Fargo/Gallup Small Business Survey for the first quarter showed that small businesses' assessments of the overall economy rose to the highest mark since before the financial crisis. Views on the present situation remain historically downbeat but have improved in recent quarters. Revenues continue to be a challenge as a net percentage of respondents reported a decrease over the past 12 months. However, the percentage of respondents seeing revenues rise picked up significantly in the first quarter while optimism about future revenues also improved substantially. This coincides with better economic news, such as lower jobless claims and higher equity markets.

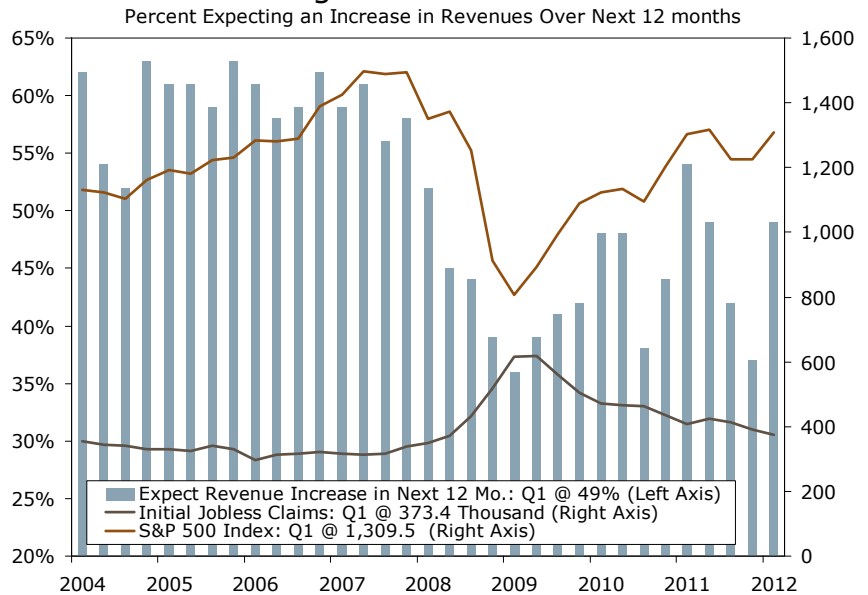
Strengthening revenues—both in current and future expectations—will influence small businesses' upcoming decisions about investment and hiring. While a net percent of companies reported a decrease in capital expenditures over the past 12 months, this gap has been narrowing. Investment plans have likely received a boost from easier credit. According to the Fed's Senior Loan Officer Opinion Survey, credit standards for small business lending eased over 2011. Although standards tightened slightly in the first quarter of this year, generally easier credit will facilitate the net increase in capital spending small businesses are planning over the next year, and contribute to business-fixed investment.

In a welcome turn, plans for hiring have also improved. The percent of small businesses expecting to hire new employees over the next year jumped from 15 percent to 22 percent, while the percent of firms expecting future employment to decrease fell to its lowest rate since the 2007 recession began. As firms with less than 50 employees account for nearly half of total employment, small business hiring plans should support continued employment gains throughout the year. We look for employment to increase by 1.9 million jobs this year.

Wells Fargo Small Business Survey



Wells Fargo Small Business Index



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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 2/10/2012	1 Week Ago	1 Year Ago
3-Month T-Bill	0.08	0.07	0.11
3-Month LIBOR	0.51	0.53	0.31
1-Year Treasury	0.18	0.15	0.27
2-Year Treasury	0.27	0.23	0.83
5-Year Treasury	0.82	0.77	2.39
10-Year Treasury	1.98	1.92	3.69
30-Year Treasury	3.13	3.12	4.76
Bond Buyer Index	3.70	3.60	5.29

Foreign Exchange Rates

	Friday 2/10/2012	1 Week Ago	1 Year Ago
Euro (\$/€)	1.318	1.316	1.360
British Pound (\$/£)	1.577	1.582	1.610
British Pound (£/€)	0.836	0.832	0.845
Japanese Yen (¥/\$)	77.680	76.600	83.230
Canadian Dollar (C\$/)\$)	1.002	0.993	0.995
Swiss Franc (CHF/\$)	0.918	0.918	0.969
Australian Dollar (US\$/A\$)	1.067	1.077	1.004
Mexican Peso (MXN/\$)	12.783	12.660	12.075
Chinese Yuan (CNY/\$)	6.300	6.303	6.586
Indian Rupee (INR/\$)	49.410	48.695	45.733
Brazilian Real (BRL/\$)	1.727	1.718	1.668
U.S. Dollar Index	79.101	78.924	78.250

Foreign Interest Rates

	Friday 2/10/2012	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.99	1.03	1.05
3-Month Sterling LIBOR	1.08	1.08	0.81
3-Month Canadian LIBOR	1.39	1.39	1.21
3-Month Yen LIBOR	0.20	0.20	0.19
2-Year German	0.24	0.20	1.45
2-Year U.K.	0.40	0.42	1.56
2-Year Canadian	1.08	1.04	1.88
2-Year Japanese	0.13	0.14	0.25
10-Year German	1.94	1.93	3.30
10-Year U.K.	2.14	2.18	3.88
10-Year Canadian	2.05	2.02	3.47
10-Year Japanese	0.98	0.95	1.31

Commodity Prices

	Friday 2/10/2012	1 Week Ago	1 Year Ago
WTI Crude (\$/Barrel)	97.61	97.84	86.73
Gold (\$/Ounce)	1713.40	1726.25	1363.80
Hot-Rolled Steel (\$/S.Ton)	720.00	720.00	795.00
Copper (¢/Pound)	389.10	390.15	454.35
Soybeans (\$/Bushel)	12.20	12.10	14.29
Natural Gas (\$/MMBTU)	2.47	2.50	3.99
Nickel (\$/Metric Ton)	21,424	20,791	28,356
CRB Spot Inds.	549.43	547.99	615.03

Next Week's Economic Calendar

	Monday 13	Tuesday 14	Wednesday 15	Thursday 16	Friday 17
U.S. Data		Retail Sales	Industrial Production	PPI (MoM)	CPI (MoM)
		December 0.1%	December 0.4%	December -0.1%	December 0.0%
		January 1.1% (W)	January 0.6% (W)	January 0.3% (W)	January 0.3% (W)
		Import Price Index	TIC	Housing Starts	CPI (YoY)
		December -0.1%	December \$48.6 B	December 657K	December 3.0%
		January 0.4% (W)		January 671K (W)	January 2.9% (W)
Global Data		Business Inventories	FOMC Meeting Minutes	Building Permits	LEI
		November 0.3%		December 671K	December 0.4%
		December 0.7% (W)		January 680K (C)	January 0.5% (W)
		Eurozone	Eurozone	Australia	Canada
		IP (MoM)	GDP (YoY)	Employment Change	CPI (YoY)
		Previous (Nov) 0.1%	Previous (3Q) 1.3%	Previous (Dec) -29.3K	Previous (Dec) 2.3%
	U.K.	Germany		U.K.	
	CPI (YoY)	GDP (YoY)		Retail Sales (MoM)	
	Previous (Dec) 4.2%	Previous (3Q) 2.6%		Previous (Dec) 0.6%	

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

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