

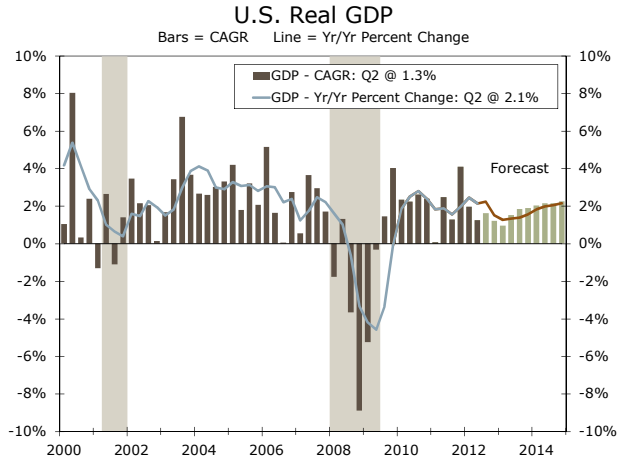
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Searching for Truth in a World of Conflicting Data

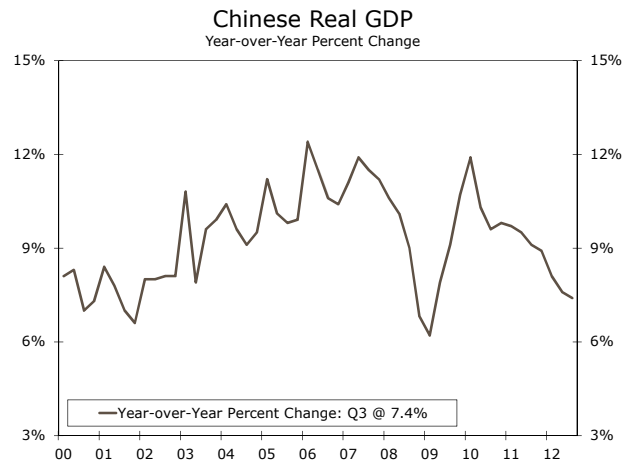
- Walt Whitman wrote that “whatever satisfies the soul is truth.” A 21st century application of the famed poet’s observation might be that regardless of your view of the economy, you can find support for it in recent data. But in an effort to satisfy your intellectual curiosity, if not your soul, our U.S. Review section breaks down this week’s somewhat conflicting data to help you determine what really matters to the economic outlook.
- The one truth that we can be sure of is that our mantra of “slow growth, no double dip” has been the right call, and there was nothing in this week’s data that changed this outlook.



Global Review

Is Chinese Growth Beginning to Stabilize?

- Real GDP growth in China slowed to 7.4 percent in the third quarter, the slowest rate of year-over-year growth since the global financial crisis. It appears that slowdowns in exports and investment spending have weighed on Chinese economic growth this year.
- There are some tentative signs that growth may be bottoming out. However, we do not expect significant acceleration in Chinese economic activity anytime soon. Chinese authorities are trying to transition from a growth model based on super-charged investment spending to a more consumer-oriented economy.



Wells Fargo U.S. Economic Forecast													
	Actual				Forecast				Actual		Forecast		
	2012				2013				2010	2011	2012	2013	2014
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product ¹	2.0	1.3	1.6	1.3	0.8	1.5	1.6	1.9	2.4	1.8	2.1	1.3	2.0
Personal Consumption	2.4	1.5	1.9	1.5	0.6	1.5	1.4	1.3	1.8	2.5	1.9	1.3	1.4
Inflation Indicators ²													
PCE Deflator	2.4	1.6	1.4	1.6	1.3	1.5	1.5	1.5	1.9	2.4	1.7	1.4	1.9
Consumer Price Index	2.8	1.9	1.7	2.4	2.4	2.8	2.8	2.4	1.6	3.1	2.2	2.6	2.2
Industrial Production ¹	5.9	2.6	-0.4	0.5	0.7	3.5	4.1	4.1	5.4	4.1	3.6	1.8	3.8
Corporate Profits Before Taxes ²	10.3	6.7	5.7	5.3	4.8	5.2	5.7	6.3	26.8	7.3	6.9	5.5	7.0
Trade Weighted Dollar Index ³	72.7	74.5	72.7	72.5	73.0	74.0	75.0	76.0	75.4	70.9	73.1	74.5	73.5
Unemployment Rate	8.3	8.2	8.1	7.6	7.6	7.9	8.1	8.0	9.6	9.0	8.0	7.9	7.7
Housing Starts ⁴	0.71	0.74	0.79	0.84	0.85	0.88	0.91	0.92	0.59	0.61	0.77	0.89	1.06
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	3.95	3.68	3.50	3.30	3.30	3.30	3.35	3.40	4.69	4.46	3.61	3.34	3.70
10 Year Note	2.23	1.67	1.65	1.60	1.65	1.70	1.75	1.80	3.22	2.78	1.79	1.73	2.10

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Forecast as of: October 19, 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

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

Together we'll go far



U.S. Review

Surge in Energy Costs Is Boosting Prices

Generally, slow economic growth keeps a lid on inflation. So, the large reported jumps in prices in September took the financial markets by surprise and generally exceeded consensus expectations. The month-over-month increases in the Producer Price Index and the Consumer Price Index were larger than the consensus expected. The primary culprit was increasing energy costs, where gains in core inflation have come in either in line or slightly below what was expected in September. This week, those price dynamics also manifested themselves in some of the regional Federal Reserve surveys where price increases are taking businesses by surprise as well.

The Empire manufacturing index from the New York Federal Reserve signaled contraction in New York factory activity for the third straight month in October. That said, the pace of decline was slower in the current month than it was in September. The prices paid component jumped to 44.1 from 40.4, while prices received only improved to 24.7 from 23.4 the prior month.

This dynamic would be echoed later in the week in the Philadelphia Federal Reserve manufacturing index. In both reports, “prices paid” grew faster than “prices received.” This is not a good signal for corporate profits if businesses are not able to pass on price increases.

The similarities did not end there. Despite a move to expansionary territory for the Philly Fed Index and a slower pace of decline in the Empire Index, the underlying details were troubling. Not only did both reports show a weaker picture for orders, but the labor market indicators also were not good. The number of employees component fell further into contraction territory in Philadelphia and slowed to a standstill in New York. The average workweek is getting cut even shorter in both surveys.

Not Exactly a Bounce-back in Industrial Production

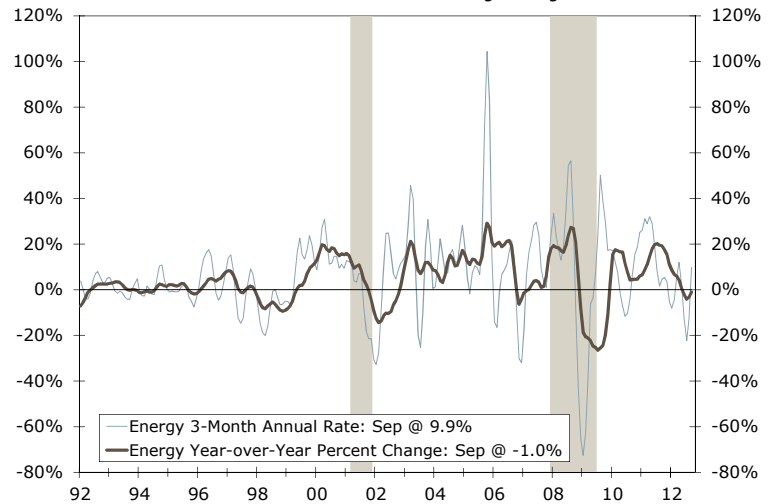
Most media reports about this week’s industrial production report could basically be summed up as “better than expected.” That does not quite capture the essence of the report, in our view. The initially reported 1.2 percent decline in August’s industrial production was revised to a larger drop of 1.4 percent. After taking that revision into account, this week’s report of a 0.4 percent gain in September was roughly in line with the consensus expectation for a 0.2 percent increase.

Details were less encouraging. While it certainly is preferable to see gains rather than the outright declines in output that we saw in August, the biggest increases were in non-manufacturing parts of the industrial landscape such as utilities and mining.

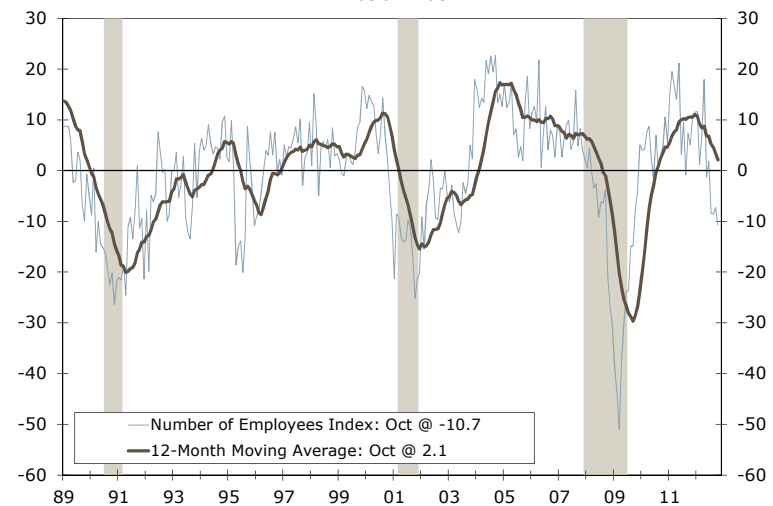
Residential Construction Boosting Economic Growth

Housing seems to be firming up, particularly the residential construction sector. Not only did September housing starts jump to the fastest pace since 2008, but building permits also surged 11.6 percent, the largest monthly jump since the expiration of the homebuyer credit in 2010. We expect improvement in housing to underpin economic growth in 2013.

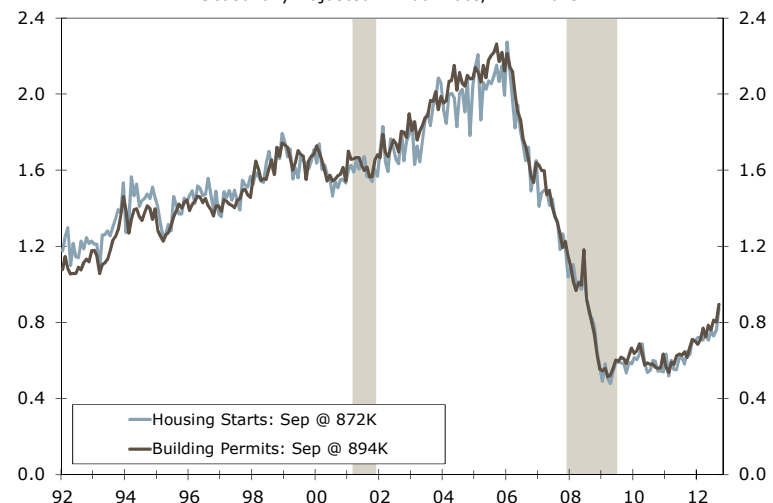
U.S. CPI - Energy
Both Series are 3-Month Moving Averages



Philadelphia Fed Number of Employees Index
Diffusion Index



Housing Starts and Building Permits
Seasonally Adjusted Annual Rate, In Millions



Source: U.S. Dept. of Commerce, U.S. Dept. of Labor, Federal Reserve Bank of Philadelphia and Wells Fargo Securities, LLC

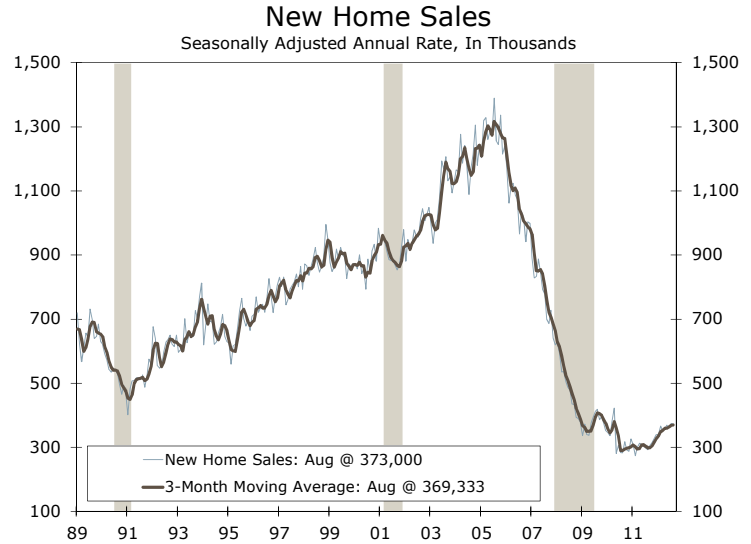
New Home Sales • Wednesday

New home sales pulled back in August, declining 0.3 percent to a 373,000-unit pace for the month after a sharp 3.6 percent rise in July. The decline was concentrated in the South, with the other major regions all posting increases. Even with the pullback in August, new home sales are still up 27.7 percent over last year. The inventory of new homes remains very depressed at 4.5 months' supply. The other big news from the August report was an 11.2 percent jump in median new home prices for the month. We expect September new home sales to bounce back in September, rising 3.5 percent to a 386,000-unit pace. The stabilization and modest appreciation in existing home prices is helping to narrow the price spread between new and existing homes. As a result, builder confidence continues to rise, indicating a gradual pace of firming in the new home market.

Previous: 373K

Wells Fargo: 386K

Consensus: 385K



Durable Goods Orders • Thursday

Durable goods orders plunged in August, dropping 13.2 percent. The big drag to new orders for the month came from the transportation orders component that fell 34.9 percent mostly due to a pullback in civilian aircraft orders. Motor vehicle and parts order also declined for the month. Another factor that held back new orders was a 40.1 percent drop in defense capital goods. The big take-away from last month's report was the weakening trend in capital goods orders suggesting weaker business equipment investment in the third quarter. We expect durable goods orders to bounce back in September, rising 6.0 percent, reversing some of the steep declines of the previous month. Even with a bounce-back in orders, we still expect weaker business spending through year-end as global economic uncertainty, along with the impending fiscal cliff weigh on capital goods orders over the next few months.

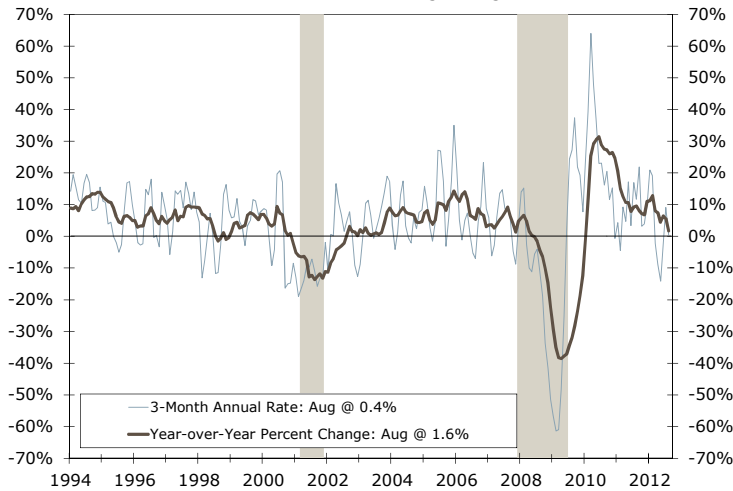
Previous: -13.2%

Wells Fargo: 6.0%

Consensus: 6.5%

Durable Goods New Orders

Series are 3-Month Moving Averages



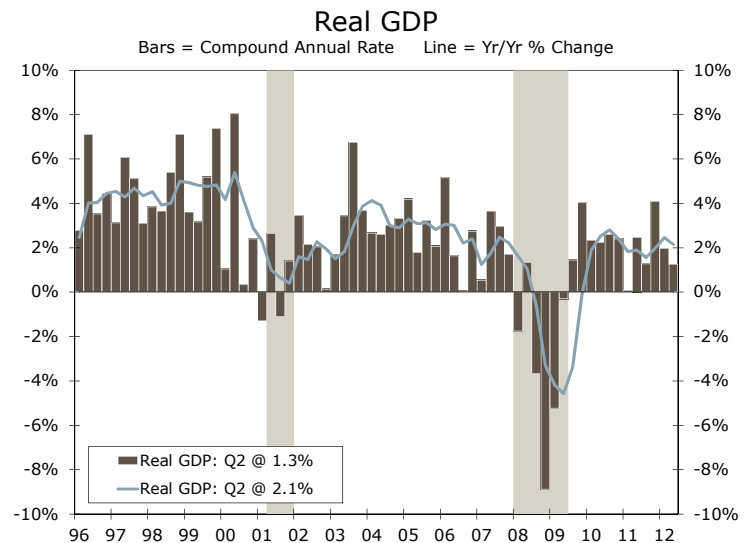
Gross Domestic Product • Friday

GDP growth came in at 1.3 percent in the second quarter with support from residential construction, business fixed investment, net exports and personal consumption. Detracting from growth were inventories and government consumption. In the third release of second-quarter GDP, we learned of a sharp downward revision to farm inventories that reflected the effects of the drought over the summer months. We expect third-quarter GDP of around 1.6 percent, only a modest improvement from the second quarter. Personal consumption expenditures should remain modest, rising around 1.8 percent for the quarter. We expect government expenditures to continue to detract from third-quarter growth as both state & local and federal spending remain constrained. We expect growth to slow through year-end to around 1.3 percent in the fourth quarter, with the weakness likely carrying over to the first half of 2013.

Previous: 1.3%

Wells Fargo: 1.6%

Consensus: 1.8%



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

Global Review

Is Chinese Growth Beginning to Stabilize?

As widely expected, the real GDP data reported this week in China indicated that the economy slowed further. Specifically, the year-over-year rate of real GDP growth in the third quarter slowed to 7.4 percent—the slowest rate of growth since the global financial crisis—from 7.6 percent during the previous quarter (see chart on front page).

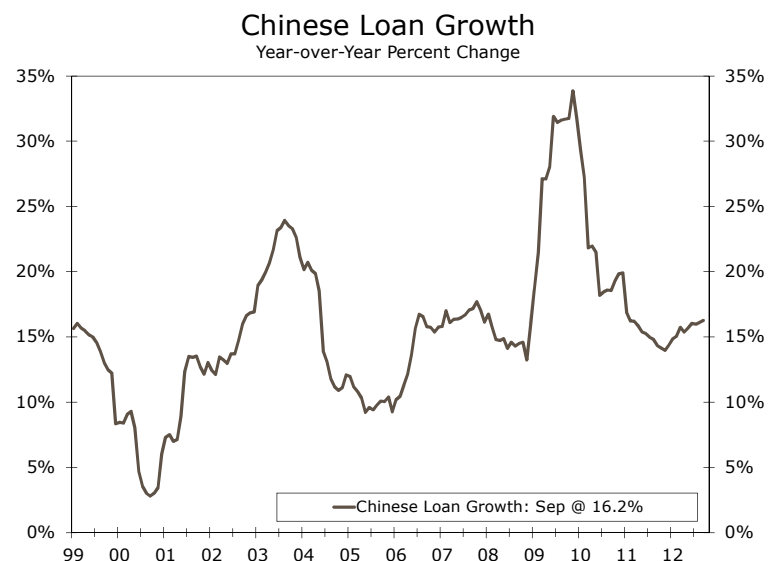
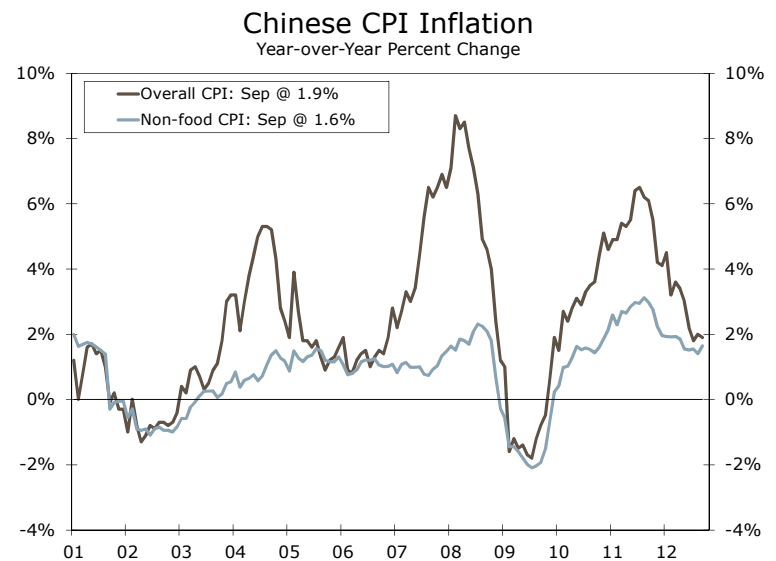
A breakdown of real GDP into its underlying demand components is not readily available. However, monthly data offer some clues as to the source of the slowdown. First, export growth has slowed markedly over the past few quarters due to sluggish growth in the rest of the world (top chart). In addition, growth in investment spending in China also has downshifted over the past few quarters. Not only were Chinese officials worried last year by the sharp run-up in house prices, but the rise in CPI inflation also unnerved them (middle chart). Consequently, authorities tightened policies to prevent the economy from overheating.

The good news is that the subsequent slowdown has contributed to a relaxation in inflationary pressures this year, which has allowed authorities to ease policies on the margin. For example, loan growth has stabilized over the past few months as authorities have encouraged banks to relax lending standards (bottom chart).

Moreover, there are some tentative signs of stabilization in the rate of economic growth. In seasonally adjusted sequential terms, real GDP rose 2.2 percent (not annualized) in the third quarter, up a bit from the 2.0 percent rate that was registered in the second quarter. Year-over-year growth rates of industrial production and exports strengthened in September from the previous month. (Growth in industrial production strengthened to 9.2 percent in September from 8.9 percent in August. Growth in the value of exports rose to 9.9 percent from 2.7 percent.)

Although growth in China may be bottoming out, we do not look for significant acceleration in economic activity anytime soon. Indeed, we project that this year's growth rate will come in at 7.6 percent, which would be the slowest annual rate of real GDP growth since 2001, and we forecast that the economy will grow 7.8 percent next year. Although strong by western standards, these growth rates are a far cry from the double-digit rates that were commonplace in the previous decade.

The current government has recognized that the model of super-charged growth in investment spending at the expense of consumer spending is no longer sustainable. Therefore, unless the global economy implodes à la 2008-2009, which we do not expect, Chinese officials are not likely to loosen the policy reins in a wholesale fashion to jumpstart investment spending. Of course, the upcoming leadership transition introduces some risk to this view. The new leadership could eventually decide that the old model should not be shelved so soon. If so, the Chinese economy could return to double-digit growth rates, at least for awhile. Until an apparent change of policy occurs, however, we will continue to forecast high single-digit growth rates for China for the next few years.



Source: CEIC, IHS Global Insight and Wells Fargo Securities, LLC

Mexican Real Retail Sales • Monday

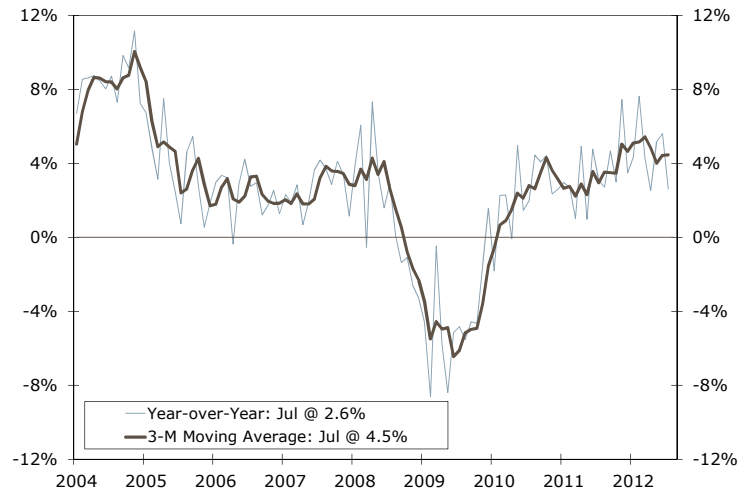
The Mexican economy will need some help from its domestic market to keep up with its stellar growth during the second half of the year as export growth has weakened considerably during the past several months. An increase in real retail sales would signal welcomed improvement in domestic demand for an economy that has relied considerably on exports with strong petroleum prices and exports to the United States.

The news for July was not the best for real retail sales, which were up by only 2.6 percent on a year-earlier basis but down from a 5.6 percent rate for the year ending in June. Furthermore, on Wednesday, the August proxy for GDP will be released and this will give us a good picture of whether the Mexican economy has been able to sustain growth going into the second half of the year. If growth weakens further, the Mexican central bank may be inclined to bring interest rates down further.

Previous: 2.6%

Consensus: 3.4%

Mexican Retail Sales
Real Value Terms



Eurozone PMIs • Wednesday

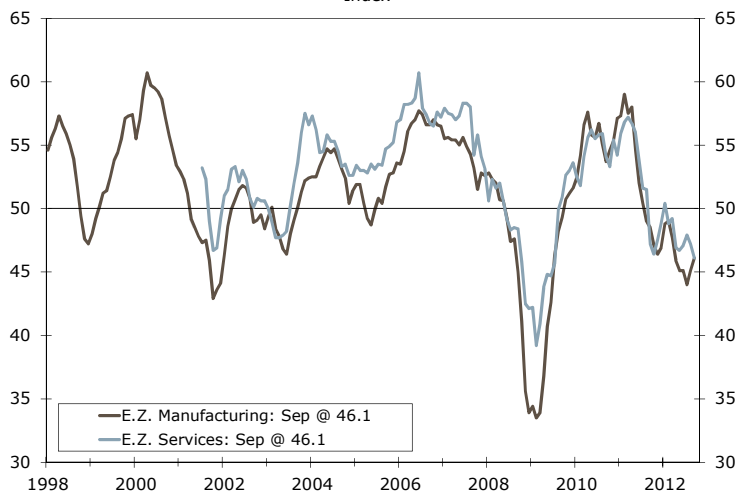
Markets will have a chance to look into the evolution of the Eurozone economies when the PMIs are released on Wednesday. However, the markets are not expecting much in terms of positive news. The only good news probably will be that the economies of the region have not continued to deteriorate which, in the current Eurozone environment, is a positive development.

The advance service PMI for October is expected to come in at 46.4, a bit higher than the 46.1 number reported in September. Meanwhile, the advance manufacturing PMI also is expected to show a marginal improvement, to 46.5 in October from 46.1 in September. This is certainly nothing to celebrate but the factory sector is not deteriorating further. On the negative side, the factory sector is not recovering, which means the crisis is not over and things could get worse before they start to get better.

Previous: manufacturing: 46.1 services: 46.1

Consensus: manufacturing: 46.5 services: 46.4

Eurozone Purchasing Managers' Indices
Index



Germany IFO • Wednesday

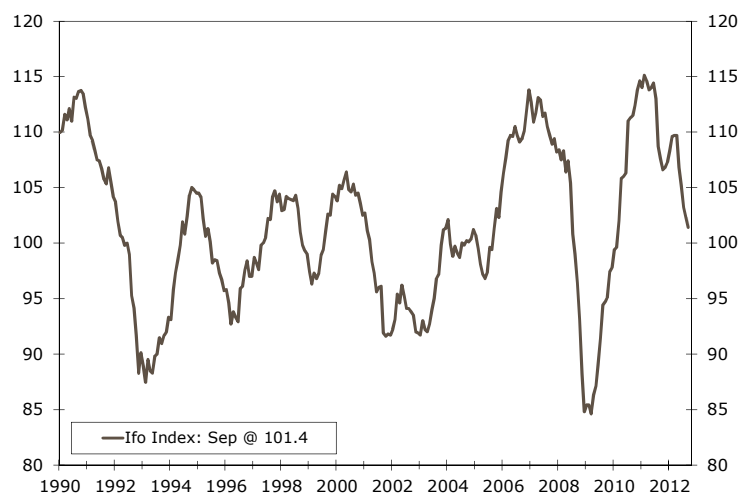
Germany continues to be the key to any recovery in the Eurozone region even though the country could benefit considerably from an improvement of the Eurozone economies to which it exports a large portion of its production. In this light, the news has not been very promising lately as the measures put forward by the ECB several weeks ago are still in the process of being implemented.

This probably will be reflected on the IFO measures for October. Consensus has the IFO business climate index coming in marginally above the September number, to 101.6 from 101.4, while the expectation index is expected higher at 93.9 from September's 93.2. The current assessment index, however, is expected to be a bit lower at 110.0 compared to 110.3 reported for September. Overall, this does not bode well for the prospects of an economic recovery.

Previous: 101.4

Consensus: 101.6

German IFO Index



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

Interest Rate Watch

Once More into the Breach?

In recent weeks, capital market commentary has returned to Payment In Kind (PIK) bonds and covenant-light issues, discussions reminiscent of to 2005-2007 before the Great Recession.

In an earlier time, high-yield bonds were the rage, and then the collapse hit in the early 1990s. One interesting note is that capital market players learned to recognize the excesses of the earlier high-yield bond era, and now high-yield bonds are a significant and useful part of the financial landscape. In an even earlier era, commercial paper also had its excesses and then resumption in an effective way to help finance economic growth.

Taking on Risk: The Fed Gets Its Way

Financial market participants on the demand and supply side appear to be following the Fed's lead as the markets are issuing and buying riskier financial products (relative to Treasury yields).

On the buy side, the demand for additional yield from instruments such as asset-backed securities has helped promote auto sales and thereby the overall economy. Corporate bond issuers find a ready market for their bonds in an investor class seeking higher yield. This year has been a strong one for high-grade, high-yield and leverage loan finance issuance as both sellers and buyers of credit are moving out the risk curve in line with the Fed's wishes.

That Delicate Balance: How Far is Too Far?

Yet, the lessons of financial markets are that any opportunity can be pushed too far when the economics can no longer generate the returns promised on increasingly risky assets. This brings us back to the PIK and covenant-light bonds. Has the investor public learned its lesson in properly judging risk given a very uncertain economic environment? Our caution here reflects our view that interest rates likely will rise sometime and that recessions tend to show at very inconvenient times.

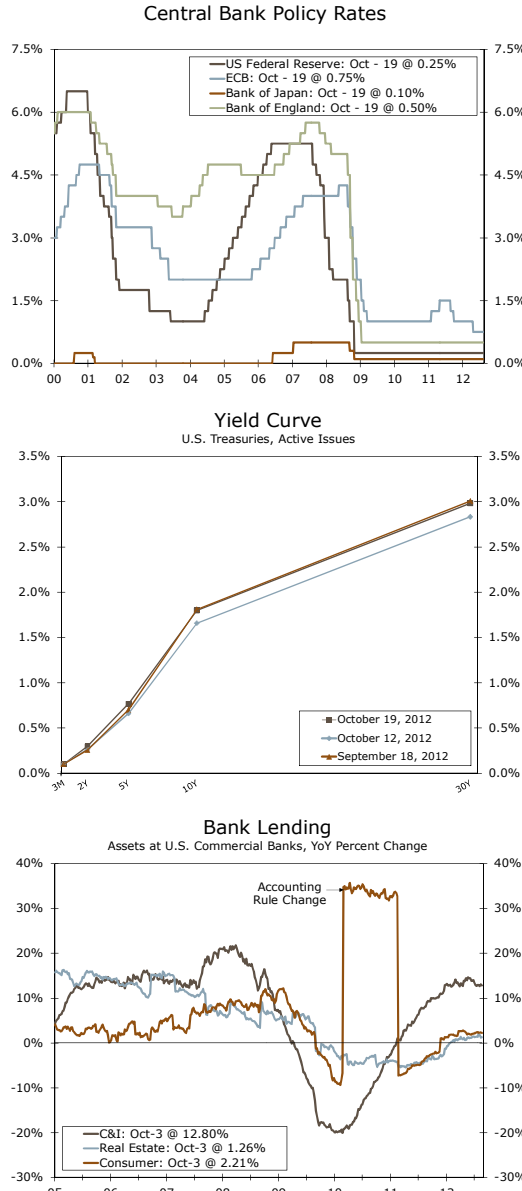
The economy does not do whatever the federal government says it should do. The compensation for inflation/higher interest rate/recession risks would appear to be very thin given the degree of uncertainty we see in the market.

Credit Market Insights

Growing Student Loan Burdens

Data released yesterday showed that the average debt burden for college graduates continues to grow at a swift pace. The Institute for College Access & Success, a nonprofit research organization, reported that about two-thirds of the class of 2011 graduated with student loan debt. Of those graduates with debt, the average amount owed on loans rose to \$26,600, a 5.3 percent increase over the class of 2010.

More recently, the total amount of student loan debt outstanding has continued to climb. Data from the Federal Reserve Bank of New York's Household Debt and Credit Report (HDCR) showed total student loan debt outstanding climbing to \$914 billion in the second quarter, a 7.4 percent increase over the past year. Yesterday's data confirm that even with rising enrollment, the average debt burden is growing. These burdens also are becoming increasingly difficult to manage. The HDCR showed that the balance of student loans 90+ days delinquent remains elevated at 8.9 percent in the second quarter compared to 7.3 percent in 2007 and 6.3 percent for mortgages in the second quarter. Tough labor market conditions, where unemployment is still high and wages are struggling to keep pace with inflation only make the picture darker for young workers with student loan debt. Growing debt burdens will have a dampening effect on economic growth as repayments cut into other spending and delay major economic milestones, such as purchasing a home.



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	3.37%	3.39%	3.49%
15-Yr Fixed	2.66%	2.70%	2.77%	3.38%
5/1 ARM	2.75%	2.73%	2.76%	3.01%
1-Yr ARM	2.60%	2.59%	2.61%	2.94%

Bank Lending	Current Assets (Billions)	1-Week Change (SAAR)	4-Week Change (SAAR)	Year-Ago Change
	Commercial & Industrial	\$1,472.4	19.75%	8.38%
Revolving Home Equity	\$525.7	-17.35%	-12.59%	-5.12%
Residential Mortgages	\$1,594.6	18.97%	4.00%	5.37%
Commerical Real Estate	\$1,414.2	8.90%	2.12%	-0.62%
Consumer	\$1,113.7	3.99%	1.24%	2.21%

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

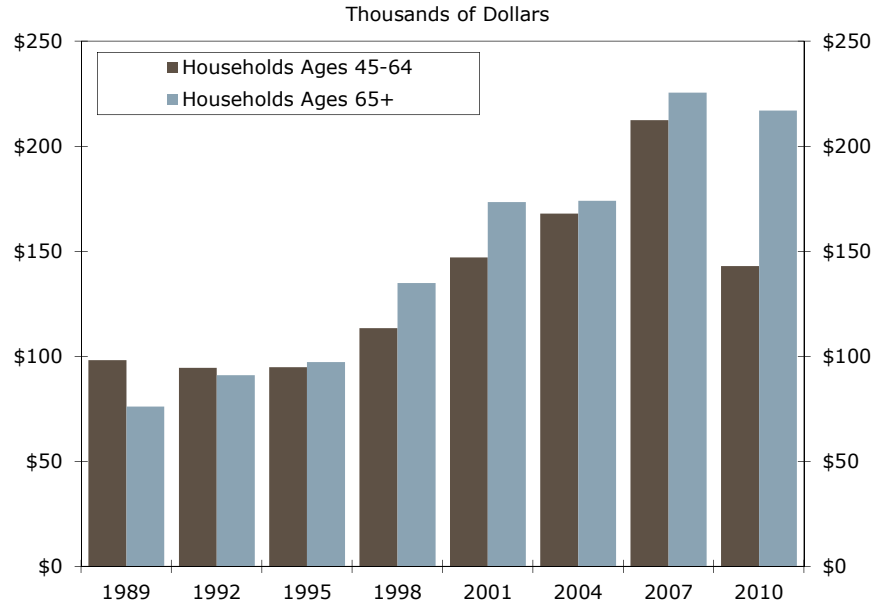
Topic of the Week

Retirement: Extending the Finish Line

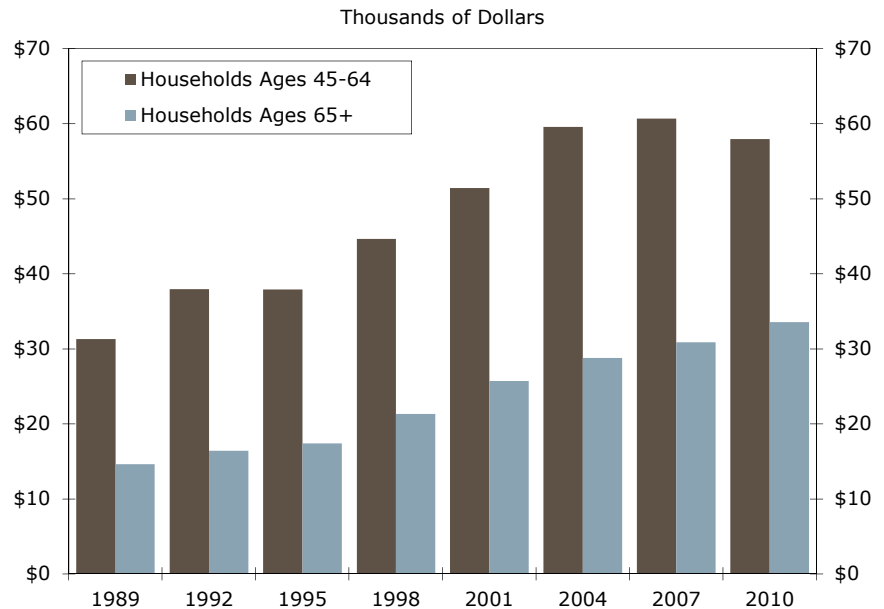
The severity of the 2008-2009 recession left household balance sheets deeply scarred. Many households fell into a financial hole, particularly those closest to retirement with the least amount of working years to recover their financial position. Using data from the 2010 Survey of Consumer Finances, we looked at the financial positions of households most likely to be in retirement (ages 65+) and those nearing retirement (ages 45-64). Both cohorts saw net worth decline between 2007 and 2010 following the Great Recession, although wealth deteriorated more substantially for pre-retirement households. One of the major reasons for the more severe decline in net worth for pre-retirement households lies in the housing market. Non-financial assets accounted for a higher share of total assets for pre-retirement households than for post-retirement households, which caused the decline in home prices between 2007 and 2010 to have a more detrimental effect on pre-retirees' balance sheets. In addition, pre-retirement households suffered a loss in financial assets, whereas the average value post-retirement households' financial assets had increased over the period, likely due to more risk-averse portfolios. Adding to pre-retirees' financial woes was a drop in income. Between 2007 and 2010, the median household income for pre-retirees fell 5 percent compared to a 9 percent increase for seniors.

The steep decline in net worth and income for pre-retirement households suggests that many families will face a higher hurdle to reach their retirement savings goals than they would have only a few years ago. To the extent that home prices recover from their depressed levels, financial positions should improve. However, should the 45-64 year old age cohort maintain elevated saving rates to repair their balance sheets, then growth in consumer spending and, by extension, growth in the overall economy could remain lackluster for the foreseeable future. For a more detailed analysis, please see our report *Retirement in America: Extending the Finish Line* on our website, or available upon request.

Median Household Net Worth



Median Income



Source: Federal Reserve Board and Wells Fargo Securities, LLC

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 10/19/2012	1 Week Ago	1 Year Ago
3-Month T-Bill	0.10	0.10	0.02
3-Month LIBOR	0.32	0.33	0.41
1-Year Treasury	0.19	0.18	0.14
2-Year Treasury	0.29	0.26	0.27
5-Year Treasury	0.77	0.66	1.04
10-Year Treasury	1.80	1.66	2.16
30-Year Treasury	2.98	2.83	3.18
Bond Buyer Index	3.68	3.64	4.08

Foreign Exchange Rates

	Friday 10/19/2012	1 Week Ago	1 Year Ago
Euro (\$/€)	1.304	1.295	1.376
British Pound (\$/£)	1.604	1.607	1.577
British Pound (£/€)	0.813	0.806	0.872
Japanese Yen (¥/\$)	79.240	78.440	76.810
Canadian Dollar (C\$/A\$)	0.989	0.980	1.021
Swiss Franc (CHF/\$)	0.927	0.934	0.903
Australian Dollar (US\$/A\$)	1.036	1.023	1.022
Mexican Peso (MXN/\$)	12.877	12.868	13.460
Chinese Yuan (CNY/\$)	6.254	6.266	6.378
Indian Rupee (INR/\$)	53.840	52.820	49.153
Brazilian Real (BRL/\$)	2.028	2.043	1.774
U.S. Dollar Index	79.481	79.667	77.114

Foreign Interest Rates

	Friday 10/19/2012	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.14	0.14	1.51
3-Month Sterling LIBOR	0.53	0.54	0.97
3-Month Canadian LIBOR	1.24	1.26	1.23
3-Month Yen LIBOR	0.19	0.19	0.20
2-Year German	0.11	0.04	0.62
2-Year U.K.	0.25	0.21	0.60
2-Year Canadian	1.11	1.14	1.04
2-Year Japanese	0.11	0.10	0.15
10-Year German	1.60	1.45	2.06
10-Year U.K.	1.89	1.72	2.47
10-Year Canadian	1.88	1.80	2.33
10-Year Japanese	0.79	0.77	1.02

Commodity Prices

	Friday 10/19/2012	1 Week Ago	1 Year Ago
WTI Crude (\$/Barrel)	92.30	91.86	86.11
Gold (\$/Ounce)	1733.63	1754.48	1640.75
Hot-Rolled Steel (\$/S.Ton)	592.00	595.00	665.00
Copper (¢/Pound)	369.50	370.30	325.80
Soybeans (\$/Bushel)	15.52	15.55	12.18
Natural Gas (\$/MMBTU)	3.62	3.61	3.59
Nickel (\$/Metric Ton)	17,251	17,662	19,114
CRB Spot Inds.	518.21	517.98	536.27

Next Week's Economic Calendar

	Monday 22	Tuesday 23	Wednesday 24	Thursday 25	Friday 26
U.S. Data			New Home Sales August 373K September 386K (W)	Durable Goods Orders August -13.2% September 6.0% (W)	GDP (QoQ) 2Q T 1.3% 3Q A 1.6% (W)
			FOMC Rate Decision September 0.25% October 0.25% (W)	Durables Ex. Transp. August -1.6% September 1.0% (W)	
Global Data	Mexico Retail Sales (INEGI) Previous (Jul) 2.6%	Eurozone Consumer Confidence Previous (Sep) -25.9	Eurozone PMI (Manufacturing) Previous (Sep) 46.1	United Kingdom GDP (YoY) Previous (2Q) -0.5%	
			Eurozone PMI (Services) Previous (Sep) 46.1		

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

Wells Fargo Securities, LLC Economics Group

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