November 10, 2011

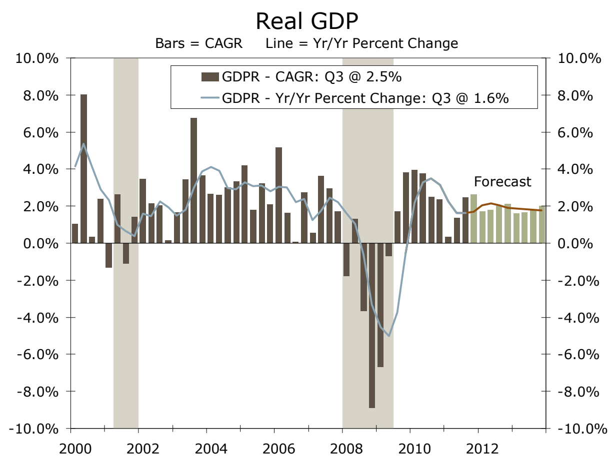
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Economic Data Continue to Point to Moderate Growth

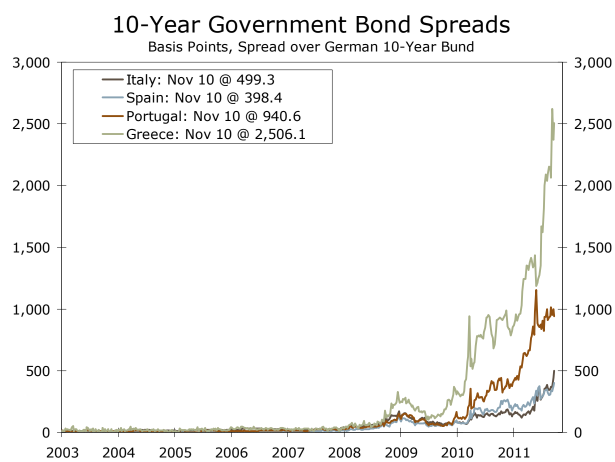
- The trade balance narrowed again in the month of September to -$43.1 billion from -$44.9 billion in August. Exports helped to narrow the deficit, increasing 1.4 percent for the month.
- Small business optimism remained very depressed in October as NFIB survey respondents continued to be disappointed with the pace of sales growth.
- Initial jobless claims continued to trend down last week, falling by 10,000 to 390,000, indicating a slow, gradual pace of improvement on the employment front.



Global Review

Europe Remains Front and Center

- High drama in Greece and Italy over the past week kept global financial markets on edge. Investors cheered the exits of Greek Prime Minister George Papandreou and Italy Prime Minister Silvio Berlusconi. However, optimism about a new way forward for both countries gave way to uncertainty about who would lead the new governments and whether very unpopular austerity measures would ultimately be passed.
- Along with soaring bond yields, slowing industrial production and retail sales are cause for concern and reflect the impact the debt crisis is having on the region.



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	2.5	2.6	1.7	1.8	2.0	2.1	-3.6	3.0	1.8	2.0	1.8
Personal Consumption	2.1	0.7	2.4	2.6	1.3	1.4	1.5	1.4	-2.0	2.0	2.3	1.6	1.3
Inflation Indicators [2]													
"Core" PCE Deflator	1.1	1.3	1.6	1.8	1.8	1.6	1.5	1.6	1.5	1.4	1.5	1.6	1.6
Consumer Price Index	2.2	3.3	3.8	3.7	2.9	2.3	2.0	1.9	-0.3	1.6	3.3	2.3	2.0
Industrial Production [1]	4.8	0.5	5.1	2.0	1.9	2.6	2.8	2.8	-11.1	5.3	3.9	2.5	2.0
Corporate Profits Before Taxes [2]	8.8	8.5	6.5	6.4	6.2	6.0	6.4	6.6	7.9	32.2	7.5	6.3	7.0
Trade Weighted Dollar Index [3]	70.6	69.4	72.8	74.0	75.0	76.0	76.5	77.0	77.7	75.6	71.7	76.1	78.6
Unemployment Rate	8.9	9.1	9.1	9.1	9.3	9.4	9.4	9.4	9.3	9.6	9.1	9.4	9.2
Housing Starts [4]	0.58	0.57	0.62	0.57	0.57	0.60	0.63	0.65	0.55	0.58	0.58	0.61	0.74
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	4.10	4.10	4.10	4.10	4.10	5.04	4.69	4.39	4.10	4.50
10 Year Note	3.47	3.18	1.92	2.30	2.40	2.50	2.50	2.60	3.26	3.22	2.72	2.50	2.80

Forecast as of: November 10, 2011
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change
[3] Federal Reserve Major Currency Index, 1973=100 - Quarter End
[4] Millions of Units
[5] Annual Numbers Represent Averages

Inside

U.S. Review

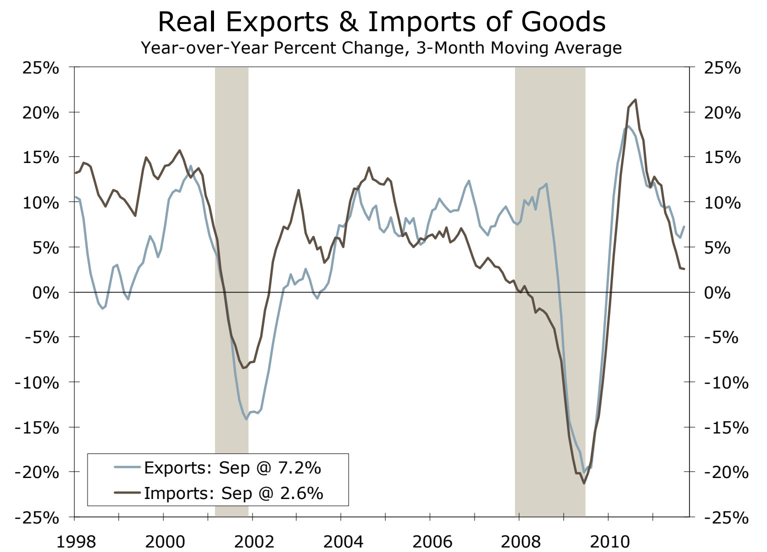
Economic Data Continue to Point to Moderate Growth

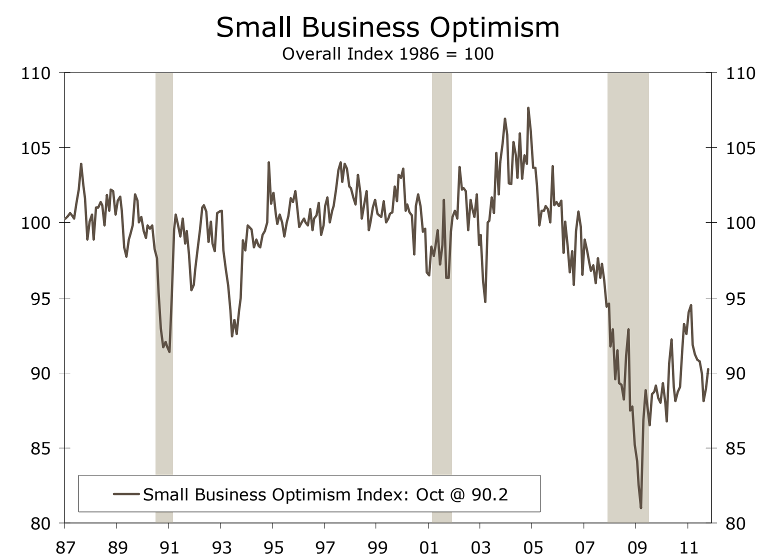
In a week dominated by headlines about the European sovereign debt crisis, the light domestic economic data did not serve as much of a distraction from the ongoing situation in Europe. September trade balance data suggested some upward revision to Q3 GDP, but most of the revision will be offset by a sharp drop in wholesale inventories. The NFIB Small Business Survey signaled that small business optimism is improving, but at a snail's pace. First-time fillings for jobless claims continued to slowly trend downward.

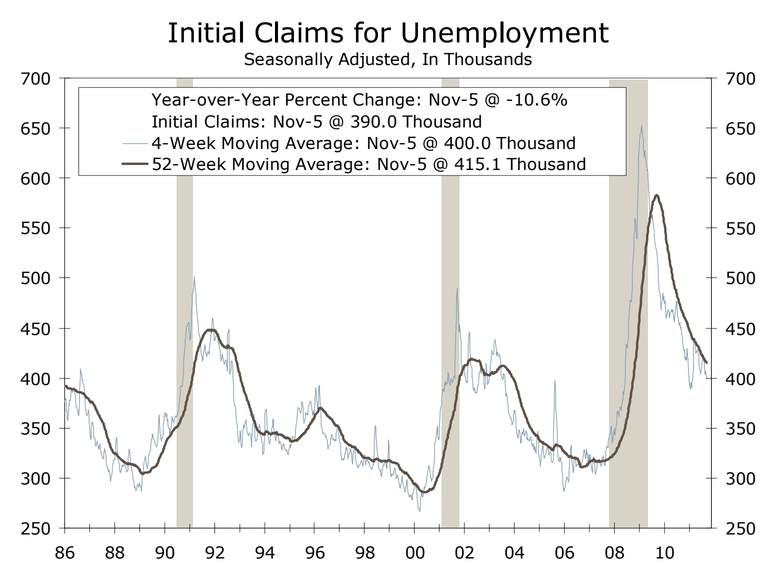
International trade data showed a narrowing of the trade deficit in September as exports grew faster than imports. Exports for the month r0se 1.4 percent, primarily supported by increases in consumer goods and industrial supplies. Imports rose a more modest 0.3 percent as domestic consumer demand remained weak. The trade data suggest a moderate upward revision to Q3 GDP. However, a sharp decline in wholesale inventories in September reported this week suggested a downward revision to Q3 GDP. Between the upward revisions from trade and the downward revision from wholesale inventories, this week's data do not suggest much of a net change to the 2.5 percent economic growth in the third quarter. Prices for imports declined 0.6 percent, led by lower prices for a wide range of imports. Export prices also fell for the month, declining 2.1 percent with sharp declines in the rate of inflation for agricultural, food and industrial supplies.

The NFIB survey for October released this week signaled that small business optimism did improve over the past month, however, overall levels of optimism remain very depressed. Job gains within the small business sector have been difficult to come by lately, a trend not likely to end soon. The number of small businesses reporting plans to hire declined in October to just 3 percent of respondents. Plans to increase spending on capital equipment, such as computers and software, remained weak again in October with only 21 percent of respondents indicating they would increase their spending. Another clear trend from the survey was that the pessimism among small business owners remained high that the economy will get better, suggesting that the small business sector will not likely meaningfully contribute to growth anytime soon.

Initial jobless claims continued their gradual decline last week with 390,000 first-time claims filed in the first week in November, the lowest level for jobless claims in seven months. The four-week moving average, a reflection of the overall trend in jobless claims, fell to the important 400,000 mark that typically signals stronger job growth. On the heels of a modest 80,000 increase in nonfarm payrolls in October the somewhat-faster decline in claims in the first week of November suggested that job growth may pick up slightly in November. However, the overall job growth environment will continue to be weak as the slow pace of economic growth continues to hold back job gains over the next few quarters. The global economic uncertainty coupled with domestic policy and economic uncertainty will





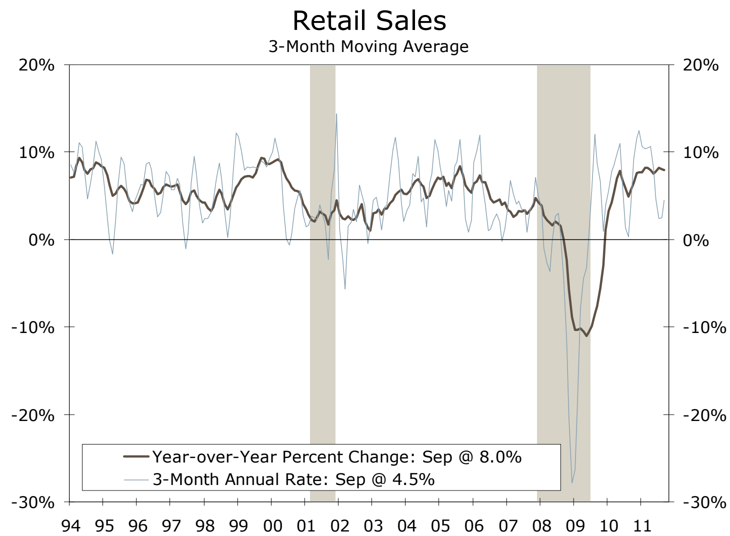


Retail Sales • Tuesday

Retail sales rose solidly in September as motor vehicles and back-to-school sales helped drive sales up 1.1 percent. Motor vehicle sales accounted for most of September's gain, with spending at dealers jumping 4.0 percent. Even with the improvement in supplies following the aftermath of the Japanese earthquake, inventories of many popular models remain in short supply. Moreover, there was less discounting than usual, meaning that higher prices likely accounted for part of the increase. Excluding motor vehicles, retail sales rose 0.6 percent and there were solid gains at both department stores and clothing stores. While the pace of sales will likely moderate in the coming months, the figures point to stronger spending during the third quarter, particularly after being combined with upward revisions to the previous data. This will likely pull GDP growth up and bolster hopes for the fourth quarter and the all-important holiday season.

Previous: 1.1% **Wells Fargo: 0.2%**

Consensus: 0.3% (Month-over-Month)

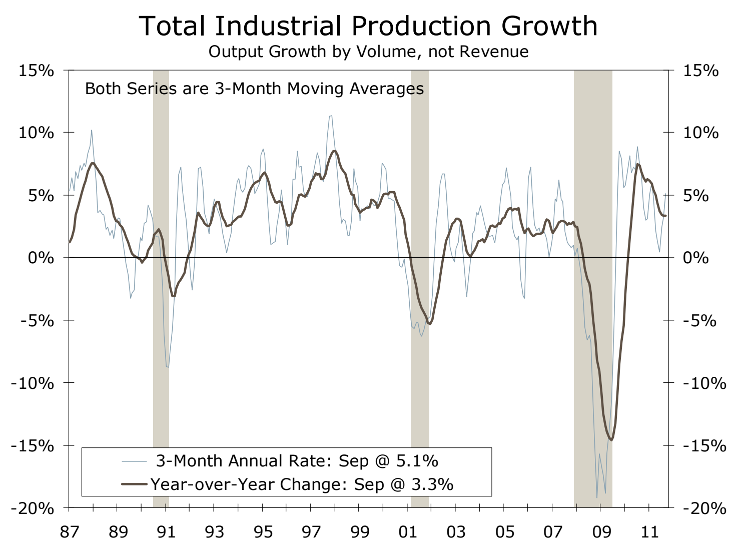


Industrial Production • Wednesday

While the pace of industrial production has moderated, the trajectory remains positive. Industrial production, which is one of the four monthly indicators used by the Business Cycle Dating Committee of the National Bureau of Economic Research to determine economic peaks and troughs, is now up 3.2 percent on a year-ago basis. This pace of output is consistent with slow growth in the second half of the year, but growth nonetheless. Manufacturing, which makes up three quarters of the total output, rose 0.4 percent on the month, the third consecutive increase. Much of the increase has been due to motor vehicle and parts production, which is now up 6.7 percent over the past year. With ISM manufacturing still in expansionary territory and average weekly hours worked in manufacturing up 0.5 percent in October, we expect further improvement in industrial production.

Previous: 0.2% **Wells Fargo: 0.4%**

Consensus: 0.4% (Month-over-Month)

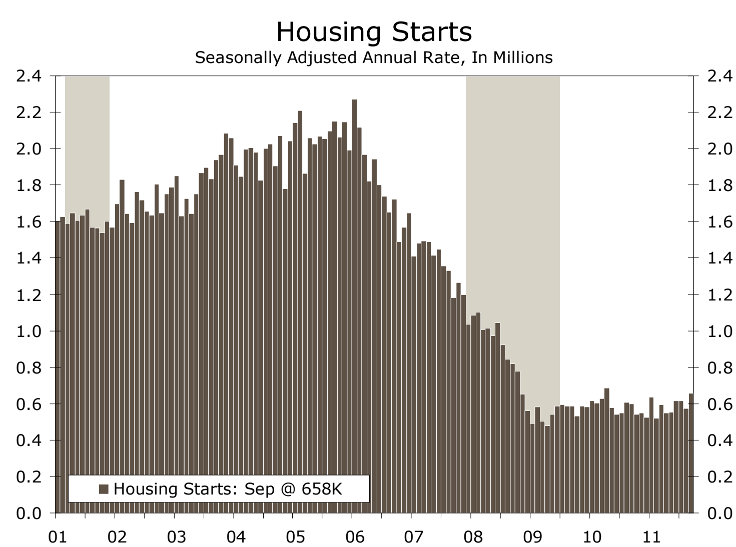


Housing Starts • Thursday

Housing starts rose 15 percent to a 658,000-unit pace in September, with much of the increase in the volatile multifamily component. Multifamily building permits, however, fell 14.5 percent—the second decline in three months. That said, much of the impressive gain in October will likely be reversed in the coming months. Single-family starts rose 1.7 percent on the month on the heels of two consecutive monthly declines. Single-family starts are up 4.7 percent on a year-ago basis, but permits were down on the month. One positive sign for single-family starts, however, is the recent gain in builder sentiment. While the NAHB/Wells Fargo Housing Market Index remains at historic lows, the level increased four percentage points, the largest monthly gain since the homebuyers tax credit. Indeed, builders still have very little incentive to ramp up construction activity in a meaningful way, and the level of starts will likely remain low for some time.

Previous: 658K **Wells Fargo: 603K**

Consensus: 605K



Global Review

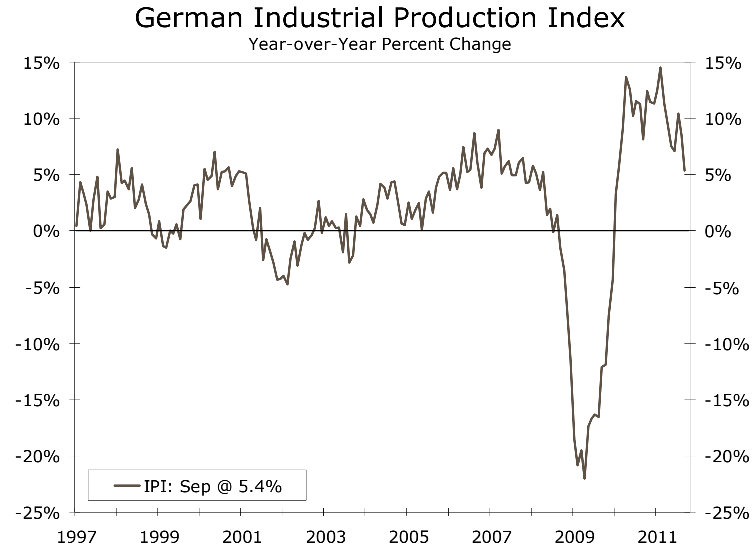
Europe Remains Front and Center

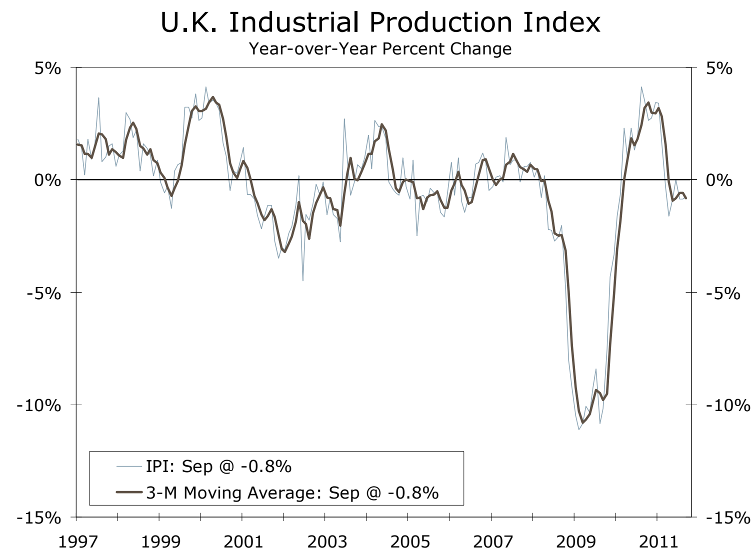
The news from Europe came fast and furious this past week. Following a vote of confidence late on Nov. 4, Greek Prime Minister George Papandreou agreed to step down as a condition toward forming a national unity government in an effort to pass the austerity measures agreed to on Oct. 26. Initially, disagreement with Antonis Samaras, the leader of the opposition New Democracy Party, over who should be the new prime minister left financial markets awash in uncertainty. However, after four days of intense political negotiations, former vice president of the European Central Bank Lucas Papademos was named as the prime minister of the new Greek interim government. This agreement gave the markets some much needed near-term clarity, but the real challenge will be whether Papademos has the wherewithal to keep his debt-strapped country out of bankruptcy. We suspect that he does not and that Greece will inevitably be forced to restructure its debt.

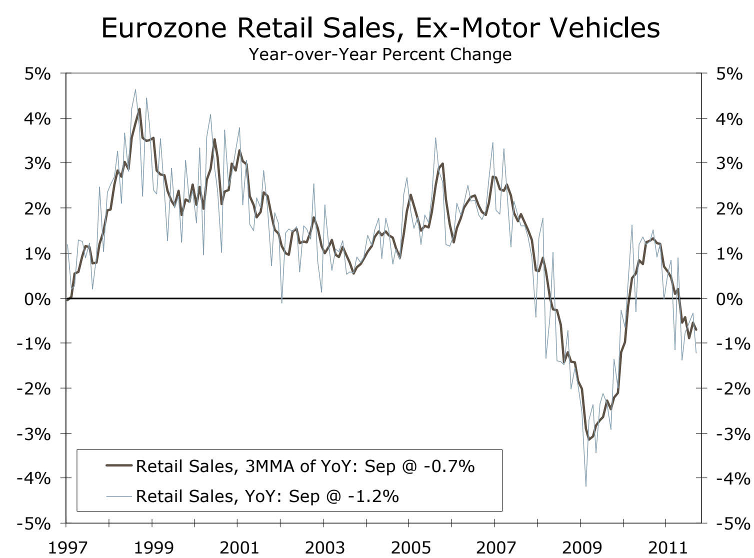
Over in Italy, the situation is just as murky, if not worse. On Nov. 4, in an effort to boost confidence, Italian Prime Minister Silvio Berlusconi asked the IMF to begin monitoring Italy's debt-cutting efforts. Then, following his failure to receive the required 316-vote majority in a routine parliamentary budget ballot on Nov. 8, Berlusconi offered to resign as soon as Parliament passes Italy's austerity plans in the coming days. However, as was the case in Greece, plenty of uncertainty remains about who will be the next prime minister and whether the austerity measures will pass. Because elections must be held between 45 and 75 days after the president has dissolved Parliament, calling for elections, which Berlusconi favors, could further delay implementation of the austerity package and prolong market uncertainty. Adding to the urgency of the situation was another spike in Italian 10-year yields on Nov. 9 to a euro-era record 7.23 percent as the clearing house LCH Clearnet SA nearly doubled its deposit requirement to trade Italian bonds. With yields now above 7.0 percent, the threshold breached by Greece, Portugal and Ireland that necessitated a bailout, it is possible that a short-term technocratic government, charged with pushing through reforms quickly, could be put in place. In a show of force, European Union Economic and Monetary Affairs Commissioner Olli Rehn has demanded an answer to some very specific questions regarding Italy's economic pledges by the weekend. The severity of the debt crisis was underscored late on Nov. 9 when German lawmakers said they want to make it possible for Eurozone members to leave the currency union without losing European Union membership, which is prohibited under the 1992 Maastricht Treaty. This suggests a breakup of the euro can no longer be ruled out.

Debt Crisis Taking Its Toll on Regional Economies

If rising bond yields weren't enough to push European leaders to resolve their political and financial woes soon, real economic data should be. Industrial production has slowed noticeably in Germany and has been below year-ago levels for several months. Meanwhile, in the Eurozone, retail sales fell in September by the most since May as consumer confidence has plummeted.







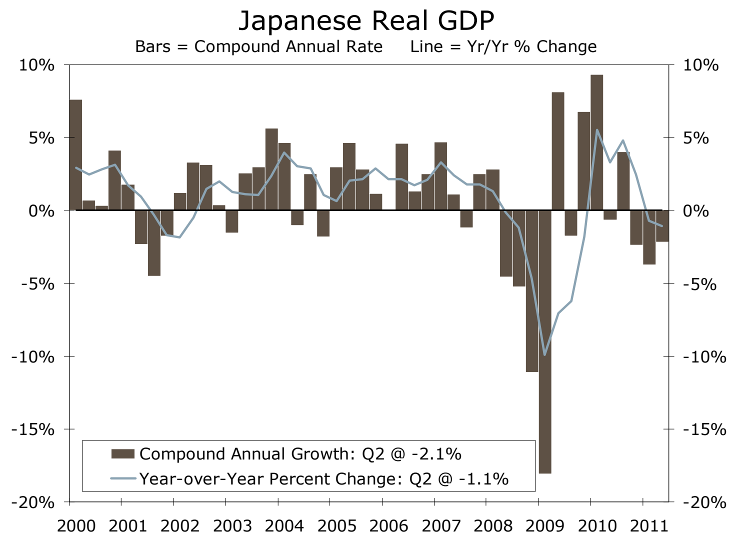
Japanese GDP • Monday

If recessions are defined as periods of negative GDP growth, then Japan had slipped back into recession late in 2010 and earlier this year. However, there are some special factors that explain, at least in part, the decline in Japanese GDP earlier this year. Notably, the natural disasters in March caused production in some key sectors, especially in the auto sector, to shut down for a while late in the first quarter and early in the second quarter.

Natural disasters usually have a temporary negative effect on an economy. Production facilities that were temporarily closed resume operations, and rebuilding also imparts a short-term boost to growth. The consensus forecast anticipates that real GDP grew strongly in the third quarter. Although we look for real GDP growth in Japan to slow in the quarters ahead from the artificially boosted rate in the third quarter, we project that the recovery will remain intact.

Previous: -2.1% **Wells Fargo: 3.6%**

Consensus: 5.9% (Annualized Rate)



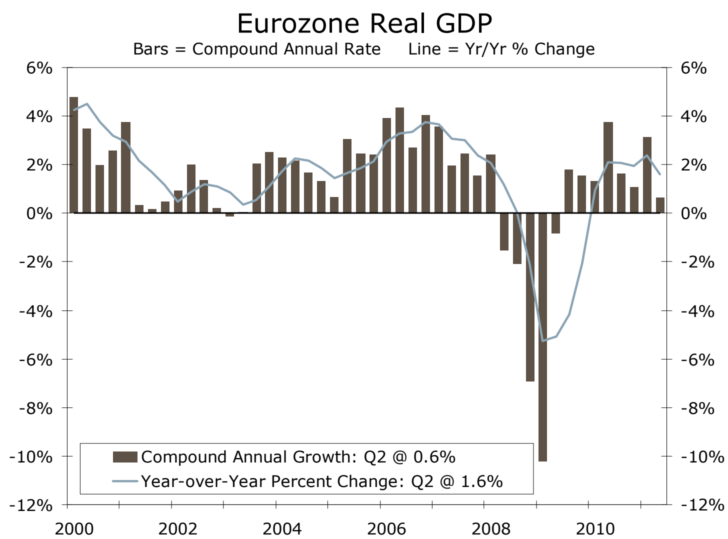
Eurozone GDP • Tuesday

Real GDP in the Eurozone has been growing at a slow pace over the past two years, and available indicators suggest that growth remained positive in the third quarter. Indeed, growth may have picked up somewhat in the third quarter relative to the very slow annualized rate of 0.6 percent that was registered in the second quarter. That said, available indicators suggest that economic growth in the overall euro area likely is turning negative in the fourth quarter. Uncertainties engendered by the European sovereign debt crisis appear to be leading businesses and consumers to hunker down.

Growth has been uneven across the euro area in the current recovery with Germany growing at a strong pace, but with Greece and Portugal experiencing continued contraction. Real GDP data for individual countries will show whether the bifurcation continued in the third quarter.

Previous: 0.2% **Wells Fargo: 0.4%**

Consensus: 0.2% (Not Annualized)



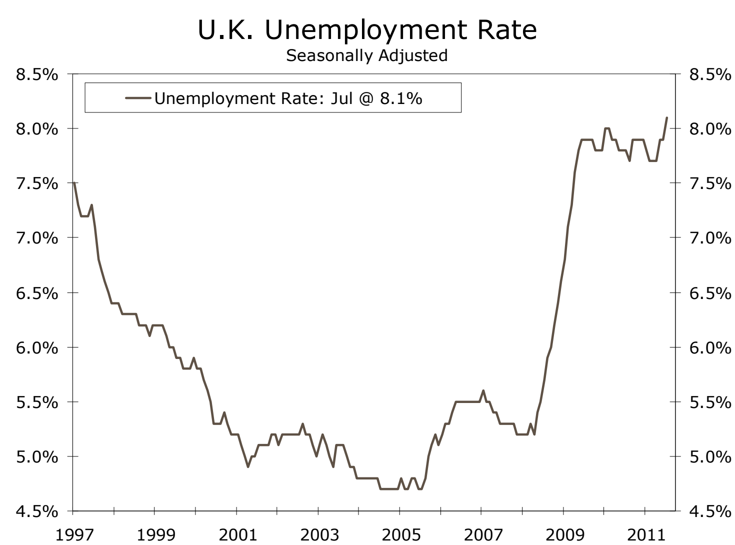
U.K. Unemployment • Wednesday

The British economy has been in recovery mode for two years, but the pace of growth has not been strong enough to reduce the unemployment rate. Indeed, the rate rose to a 15-year high of 8.1 percent in July. With economic growth widely expected to remain sluggish for the foreseeable future, significant relief on the unemployment front does not seem likely anytime soon.

There are a few other data releases on the docket that will give investors some insights into the state of the British economy in October, including CPI inflation, which is to be released on Tuesday, and retail sales, which prints on Thursday. In addition, the Bank of England's quarterly *Inflation Report* will include the bank's latest forecasts. Further policy easing, which likely would take the form of more asset purchases, could be in the cards if the bank projects weak growth and rapidly receding CPI inflation in the months ahead.

Previous: 8.1%

Consensus: 8.2% (3-Month Average)



Interest Rate Watch

Euro Uncertainty: U.S. Rates

Globalization in the capital markets has once again moved out front as the driving force in setting interest rates.

Concerns about the state of Italian and Greek debt are affecting interest rates. At the short end, money market funds have lowered their demand for bank paper—particularly French banks—while on the supply side, French bank LIBOR rates have risen steadily relative to the benchmark three-month LIBOR market rate. Ratings downgrades have reinforced these trends as buyers shy away and sellers need higher rates to entice the remaining buyers.

Italy and the Long End of the Curve

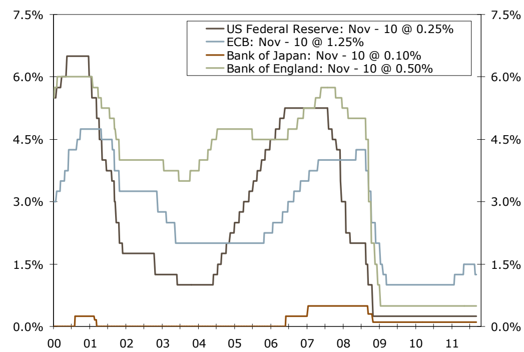
Meanwhile, at the long end, Italian bonds have risen above 7 percent, as buyers have sought greater interest rate protection. Two factors are central here. First, both Portugal and Ireland sought financial bailouts after their rates exceeded 7 percent, which many analysts consider unsustainable given that nominal GDP growth in Italy is likely to be only 3 percent in the year ahead. Essentially, the growth of interest expense, measured by the interest rate, is outpacing the growth of the economy to pay that debt.

This debt problem is now compounded by the questionable value of using CDS to hedge the risk of a Greek or Italian default. Since the 50 percent haircut on Greek debt was declared not a credit event, investors are forced to hedge the default risk with a higher interest rate on the actual debt. As a result, Italian bond yields have risen sharply in recent weeks.

Meanwhile, the Federal Reserve continues with Operation Twist which will add, along with the flight to safety for global investors, to the downward pressure on the long end of the Treasury curve.

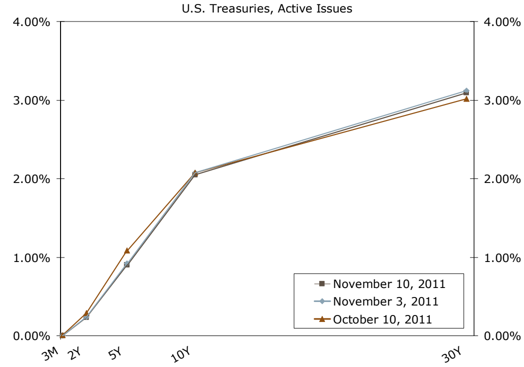
Our outlook from the November monthly economic report is for the 10-year benchmark Treasury rate to drift up modestly in 2012 and end the year at 2.6 percent. We expect no change in the Fed funds rate, and therefore, we anticipate a fairly flat yield curve throughout the year. This is consistent with our moderate growth/slower top-line inflation outlook.

Central Bank Policy Rates



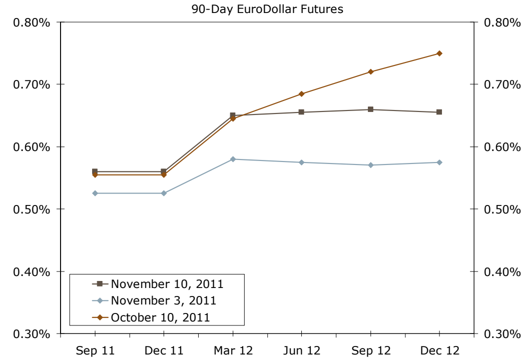
Yield Curve

U.S. Treasuries, Active Issues



Forward Rates

90-Day EuroDollar Futures



Credit Market Insights

Europe Worries Dent Bank Lending

This week's Senior Loan Officer Survey (SLOS) showed that, relative to previous quarters, fewer banks eased lending standards in the third quarter to large and medium-sized firms for commercial and industrial (C&I) loans. On the demand side, many U.S. banks reported a drop in C&I loan demand from firms of all sizes, reflecting concerns about the European sovereign debt crisis's effect on U.S. economic growth. Not surprising, the SLOS also showed that a large number of domestic and foreign lenders tightened standards on loans to European banks.

Domestically, U.S. banks continue to cite increased demand for commercial real estate (CRE) loans, but that demand remains disparate across sectors. Much of the increased demand for CRE loans is concentrated in the industrial sector, specifically for new equipment and power facilities, while demand remains tepid in the retail sector. The office sector is seeing some improvement in loan demand, but it is very much a regional story: data and tech centers, such as Charleston and San Jose, are performing well and increasing available office space, while demand remains weak in largely oversupplied markets, such as Atlanta and Los Angeles.

On the consumer side, U.S. banks continue to ease standards for auto and credit card loans. Car sales have been running at an impressive rate in recent months, but with income growth very sluggish, sales could moderate in the coming months.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	3.99%	4.00%	4.12%	4.27%
15-Yr Fixed	3.30%	3.31%	3.37%	3.72%
5/1 ARM	2.98%	2.96%	3.06%	3.47%
1-Yr ARM	2.95%	2.88%	2.90%	3.40%
MBA Applications				
Composite	734.3	665.6	744.3	833.3
Purchase	183.1	174.8	177.1	188.7
Refinance	3,967.5	3,539.3	4,072.3	4,587.7

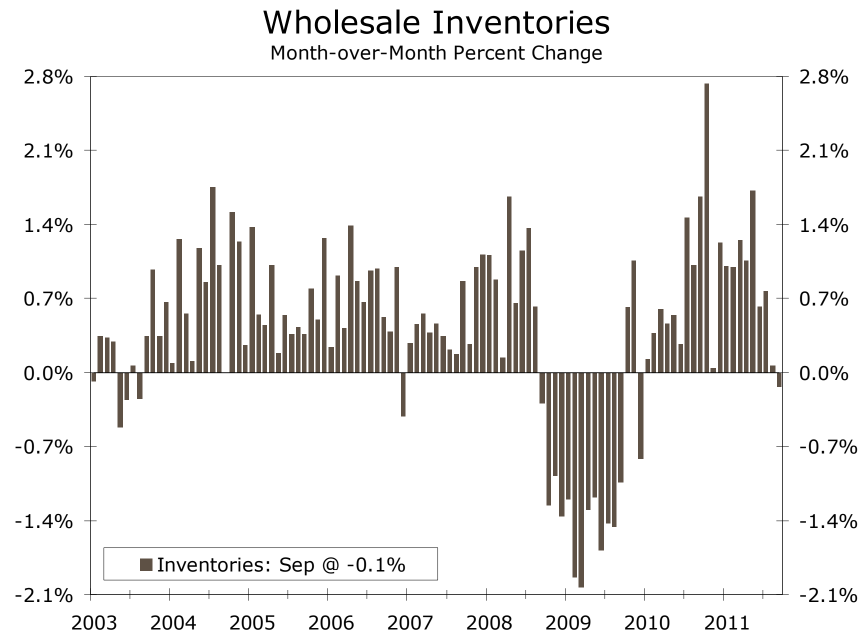
Source: Freddie Mac, Mortgage Bankers Association and Wells Fargo Securities, LLC

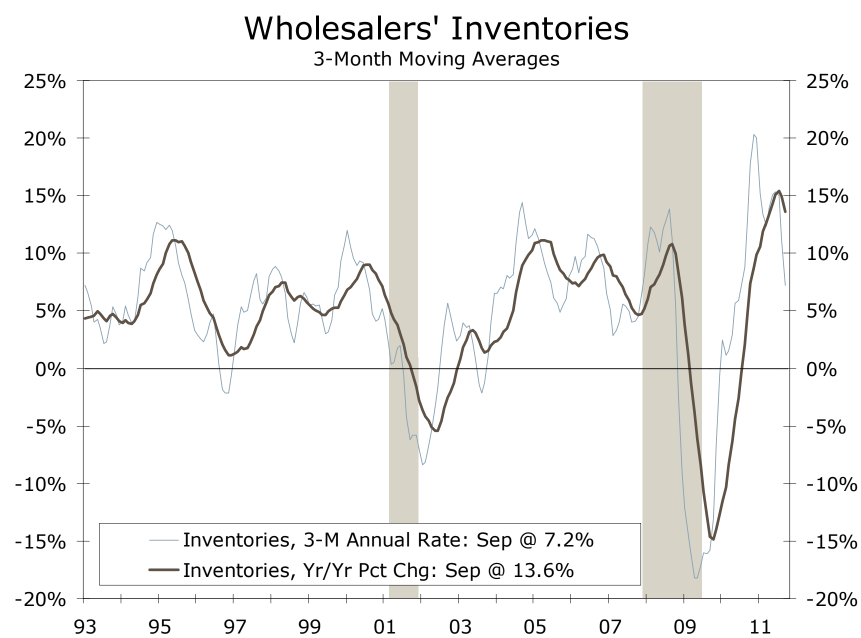
Topic of the Week

Beware Inventory Swings

Economic forecasting is always treacherous business, but perhaps the most difficult component of GDP to forecast is the quarterly inventory change. Indeed, the hit or miss on inventories can often make or break a forecaster's record. First, a little background. Inventories show up in the GDP expenditure calculation as a sub-component of gross private domestic investment. Moreover, it is the change in inventories for that quarter that is measured not the level. For example, when inventories increase over the quarter, it adds to U.S. GDP, but when inventories fall over the quarter, it subtracts from GDP. The idea is that increasing inventories is production that isn't consumed, so it should add to aggregate production or GDP. When aggregate expenditures draw down inventories in a quarter, you are consuming more than is currently produced, so that amount is subtracted from GDP. Sounds simple enough in theory, but swings in inventory can be notoriously volatile, and the series is subject to constant revision in subsequent periods as more detailed data become available.

According to the BEA's advance estimate of third-quarter GDP, the $33.7 billion drop in inventory gains in the third quarter subtracted 1.08 percentage points off of third-quarter GDP. So, if inventory growth had not slowed, third-quarter GDP would have been 3.58 percent in the third quarter instead of the officially reported 2.5 percent, quite a difference in perspective. That is why some economists report final sales figures at the same time they report GDP, so one can see what was happening to demand during the quarter without the distortion of the inventory change. On Wednesday, we received the September wholesale inventories report, where inventories fell 0.1 percent on the month when the markets had been anticipating a 0.6 percent gain. August inventories were also revised down to 0.1 percent from 0.4 percent. The revision of wholesale inventories should result in a reduction to the originally reported 2.5 percent GDP estimate for the third quarter.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Thursday 11/10/2011	1 Week Ago	1 Year Ago
3-Month T-Bill	0.00	0.00	0.13
3-Month LIBOR	0.45	0.44	0.29
1-Year Treasury	0.10	0.12	0.20
2-Year Treasury	0.23	0.24	0.42
5-Year Treasury	0.90	0.92	1.20
10-Year Treasury	2.05	2.07	2.63
30-Year Treasury	3.08	3.12	4.23
Bond Buyer Index	4.02	4.12	4.02

Foreign Exchange Rates

	Thursday 11/10/2011	1 Week Ago	1 Year Ago
Euro ($/€)	1.360	1.382	1.378
British Pound ($/£)	1.595	1.604	1.612
British Pound (£/€)	0.853	0.862	0.855
Japanese Yen (¥/$)	77.690	78.060	82.280
Canadian Dollar (C$/$)	1.019	1.007	1.001
Swiss Franc (CHF/$)	0.905	0.878	0.971
Australian Dollar (US$/A$)	1.017	1.042	1.005
Mexican Peso (MXN/$)	13.540	13.333	12.219
Chinese Yuan (CNY/$)	6.347	6.344	6.634
Indian Rupee (INR/$)	50.175	49.188	44.325
Brazilian Real (BRL/$)	1.759	1.738	1.708
U.S. Dollar Index	77.560	76.672	77.634

Foreign Interest Rates

	Thursday 11/10/2011	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.42	1.52	0.99
3-Month Sterling LIBOR	1.00	0.99	0.74
3-Month Canadian LIBOR	1.28	1.27	1.20
3-Month Yen LIBOR	0.20	0.19	0.19
2-Year German	0.38	0.40	0.97
2-Year U.K.	0.52	0.55	0.77
2-Year Canadian	0.94	1.00	1.58
2-Year Japanese	0.13	0.14	0.15
10-Year German	1.77	1.91	2.44
10-Year U.K.	2.22	2.38	3.16
10-Year Canadian	2.14	2.21	2.97
10-Year Japanese	0.97	1.00	1.00

Commodity Prices

	Thursday 11/10/2011	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	97.31	94.07	87.81
Gold ($/Ounce)	1765.95	1763.82	1403.90
Hot-Rolled Steel ($/S.Ton)	635.00	635.00	550.00
Copper (¢/Pound)	336.00	358.45	396.60
Soybeans ($/Bushel)	11.56	11.78	12.94
Natural Gas ($/MMBTU)	3.67	3.78	4.05
Nickel ($/Metric Ton)	18,031	18,557	24,552
CRB Spot Inds.	531.06	533.05	565.84

Next Week's Economic Calendar

	Monday 14	Tuesday 15	Wednesday 16	Thursday 17	Friday 18
U.S. Data		**PPI (MoM)** Septmeber 0.8% October -0.3% (W) **Retail Sales (MoM)** September 1.1% October 0.2% (W) **Business Inventories** August 0.5% September 0.3% (W)	**CPI (MoM)** September 0.3% October 0.0% (W) **Industrial Production** September 0.2% October 0.4% (W) **Total Net TIC Flows** August $89.6B	**Housing Starts** September 658K October 603K (W) **Building Permits** September 589K October 600K (c) **Philadelphia Fed.** October 8.7 November 9.0 (c)	**LEI** September 0.2% October 0.7% (W)
Global Data	**Japan** **GDP (Annualized)** Previous (Q2) -2.1% **Eurozone** **IP (MoM)** Previous (Aug) 1.6%	**Eurozone** **GDP (QoQ)** Previous (Q2) 0.2% **Germany** **ZEW-Econ Sentiment** Previous (Oct) -48.3	**Eurozone** **CPI (MoM)** Previous (Sep) 0.8% **U.K.** **ILO Unemployment** Previous (Jul) 8.1%		**Germany** **PPI (MoM)** Previous (Sep) 0.3% **Canada** **CPI (MoM)** Previous (Sep) 0.2%

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

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research & Economics	(704) 715-8437 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wellsfargo.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wellsfargo.com
Scott Anderson, Ph.D.	Senior Economist	(612) 667-9281	scott.a.anderson@wellsfargo.com
Eugenio Aleman, Ph.D.	Senior Economist	(704) 715-0314	eugenio.j.aleman@wellsfargo.com
Sam Bullard	Senior Economist	(704) 383-7372	sam.bullard@wellsfargo.com
Anika Khan	Economist	(704) 715-0575	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wellsfargo.com
Ed Kashmarek	Economist	(612) 667-0479	ed.kashmarek@wellsfargo.com
Tim Quinlan	Economist	(704) 374-4407	tim.quinlan@wellsfargo.com
Michael A. Brown	Economist	(704) 715-0569	michael.a.brown@wellsfargo.com
Joe Seydl	Economic Analyst	(704) 715-1488	joseph.seydl@wellsfargo.com
Sarah Watt	Economic Analyst	(704) 374-7142	sarah.watt@wellsfargo.com
Kaylyn Swankoski	Economic Analyst	(704) 715-0526	kaylyn.swankoski@wellsfargo.com

WELLS FARGO SECURITIES