

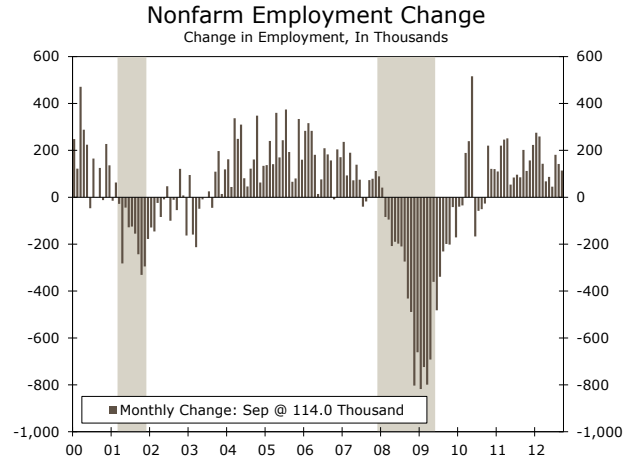
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Unexpected Drop in Unemployment Rate

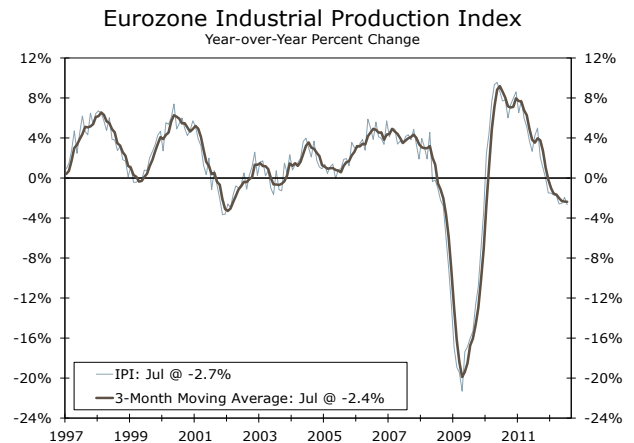
- The labor market appears to be on stronger footing as payrolls rose by 114,000 jobs in September and revisions to previous months' data added a cumulative total of 86,000 jobs in July and August. The unemployment rate dropped to 7.8 percent, the lowest level since January 2009.
- Although, factory orders fell 5.2 percent in August, the outlook for the manufacturing sector is a bit more encouraging based on new orders in September.
- The ISM manufacturing index rebounded in September and now sits above the demarcation line for expansion at 51.5. The new orders component increased to 52.3.



Global Review

Foreign Growth in Q3 Remained Lackluster

- With the third quarter now in the history books, it appears that economic growth in most major foreign economies remained rather sluggish in the most recent three-month period. Real GDP in the Eurozone likely contracted again, and growth in China appears to have been rather weak, at least by Chinese standards.
- Brazil may be the exception to the rule, as its economy appears to have strengthened. That said, we generally do not expect significant acceleration in most foreign economies anytime soon.



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	1.2	1.0	1.5	1.8	1.9	2.4	1.8	2.1	1.4	2.0
Personal Consumption	2.4	1.5	1.8	1.1	0.6	1.5	1.4	1.3	1.8	2.5	1.8	1.2	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	1.6	2.1	2.1	2.6	2.7	2.4	1.6	3.1	2.1	2.4	2.2
Industrial Production ¹	5.9	2.6	0.1	1.1	0.7	3.5	4.1	4.1	5.4	4.1	3.7	2.0	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	73.0	74.0	75.0	76.0	77.0	75.6	70.9	73.2	75.5	74.5
Unemployment Rate	8.3	8.2	8.1	7.6	7.6	7.9	8.1	8.1	9.6	9.0	8.0	7.9	7.8
Housing Starts ⁴	0.71	0.74	0.77	0.84	0.85	0.88	0.91	0.92	0.59	0.61	0.76	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 5, 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, IHS Global Insight and Wells Fargo Securities, LLC

Together we'll go far



U.S. Review

The Labor Market Shows Resilience

The labor market appears to be on stronger footing as payrolls rose by 114,000 jobs in September and revisions to previous months' data added a cumulative total of 86,000 jobs in July and August. Sectors adding jobs were nearly broad based with the exception of manufacturing, information, and temporary help.

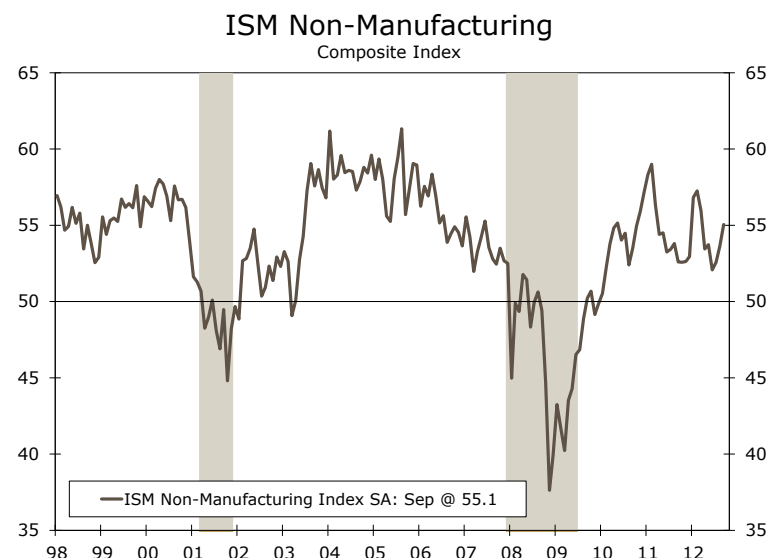
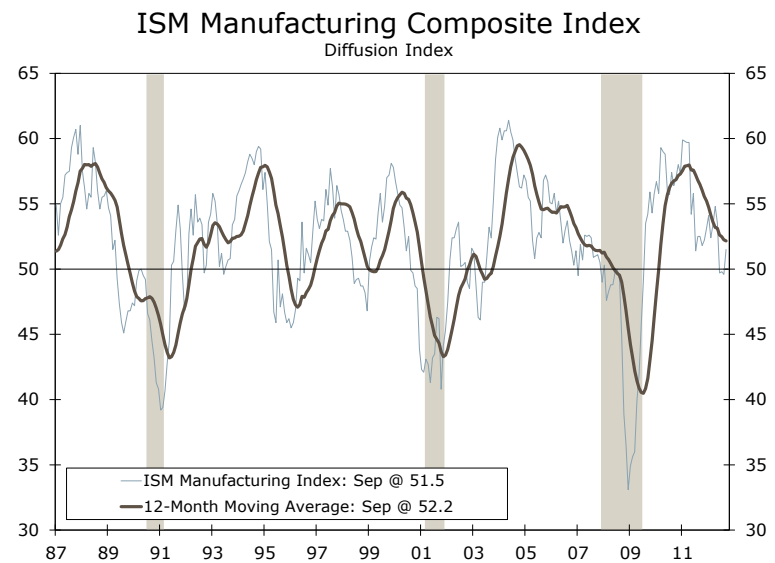
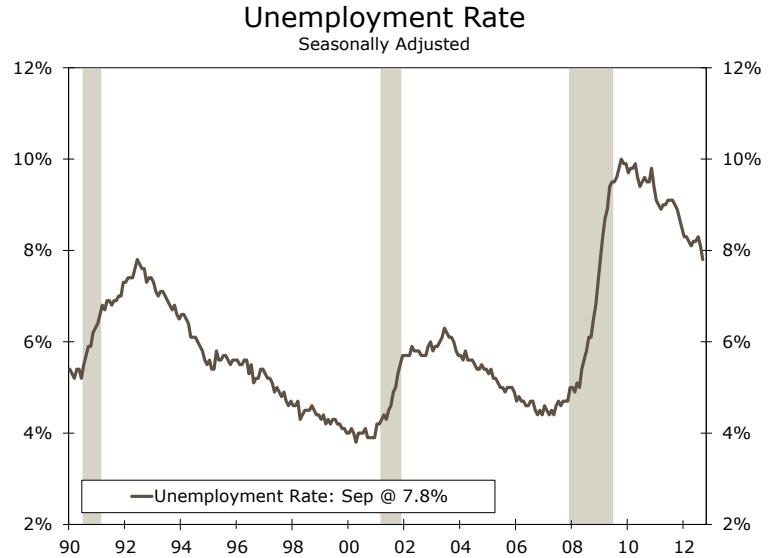
Details of the report are also encouraging. The unemployment rate dropped to 7.8 percent, the lowest level since January 2009, and household employment increased by 873,000 jobs, the biggest gain since 1983. The increase in the labor force participation rate to 63.6 percent was also good news, as it shows that the drop in the unemployment rate is finally retracing for the right reason. Moreover, average hourly earnings rose 1.8 percent over the past year, suggesting that stagnant income growth could see a boost.

There are still components of the report that are concerning. The U-6 unemployment rate (including unemployed workers, those working part-time for economic reasons, and the underemployed), remained flat on the month at 14.7 percent and the average duration increased to 39.8. While it is still too early tell, these components continue to suggest there are elements of the labor market that are seeing some structural changes. In fact, if we continue to add around 146,000 jobs, which is the three-month moving average, and population growth and the labor force participation rate remain constant, it would take about three years to get to what is considered the natural rate of unemployment, which is now considered to be 6.0 percent.

Other economic releases during the week also illustrated steady economic growth. While factory orders fell 5.2 percent in August, much of the decline was concentrated in the volatile sectors such as defense and transportation. Excluding transportation, orders still dropped 1.6 percent, which suggests that businesses are extremely cautious about making large investments, especially with the looming "fiscal cliff" and impending election. The hesitation is well noted as Congressional Budget Office estimates suggest that if all tax cuts are not extended, it could shave a considerable percent off of real GDP in 2013. However, nondefense capital goods orders excluding aircraft looked a bit more promising, increasing 1.1 percent.

The gain in core manufacturing orders corroborates the improvement in the ISM manufacturing survey in September. Following three months in contraction territory, the ISM manufacturing index rebounded in September and now sits above the demarcation line for expansion at 51.5. The new orders component increased 5.2 points to 52.3, and the inventory component fell 2.5 points to 50.5.

Another bright spot in the economy was the ISM nonmanufacturing index, which has increased over the past three months and now sits firmly in expansion territory at 55.1. While the employment component held the headline down by falling 2.7 points to 51.1, forward-looking components such as business activity and new orders both had significant gains.



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

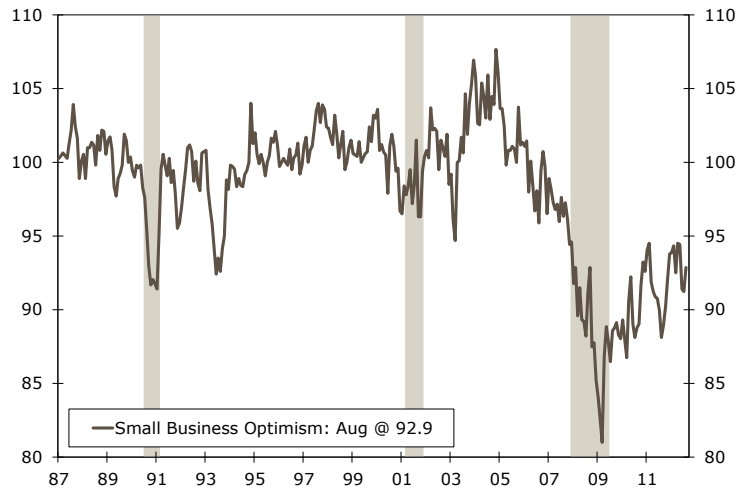
NFIB Small Business Optimism • Tuesday

The NFIB Small Business Optimism Index edged higher in August, as plans to hire and expectations that the economy will improve helped to boost the headline index 1.9 percent. The jump in the index was the largest monthly change since April of this year. In addition, more survey respondents reported their expectations for higher sales; however, 28 percent fewer survey respondents reported positive earnings trends. The August reading of the small business index was welcomed news from a key job creating sector of the economy. The consensus expectation for September's reading is that the positive trend will continue with a slightly higher 93.3 reading for the month. The tepid pace of job growth along with increasing political uncertainty in the second half of the year, however, likely will keep small business optimism below pre-recession levels.

Previous: 92.9

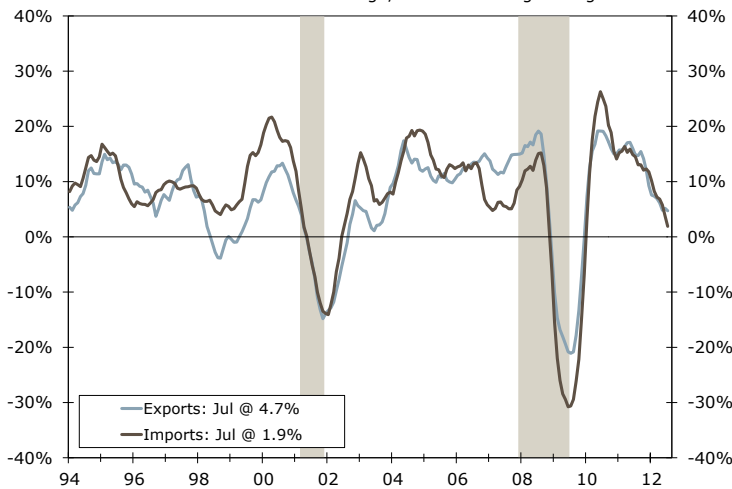
Consensus: 93.3

NFIB Small Business Optimism
Overall Index 1986 = 100



U.S. Exports and Imports

Year-over-Year Percent Change, 3-Month Moving Average



International Trade Balance • Thursday

The trade deficit remained roughly unchanged in July at \$42.0 billion from the \$41.9 billion deficit recorded in June. A rise in agricultural prices on the heels of last summer's drought helped to overstate exports, while a pullback in oil prices in July put a damper on import growth. Net of the price effects, the real trade deficit widened significantly for the month. We expect the trade balance to widen slightly in August to a trade deficit of \$43.3 billion. Our major trading partners continue to face slow economic growth. Thus, we expect our exports to these countries to downshift over the next few months. The net result is that trade likely will not meaningfully affect Q3 GDP growth, as the slow pace of import growth will be offset by a slowdown in export growth. Q4 should see some modest improvement in export growth, which should help to add around 0.3 percent to Q4 economic growth.

Previous: -\$42.0B

Wells Fargo: -\$43.3B

Consensus: -\$44.0B

Producer Price Index • Friday

Producer prices jumped in August as agricultural commodities prices began to reflect the effects from the summer drought. Besides the drought effects, a host of consumer goods prices also rose for the month. Fewer motor vehicle incentives translated to higher prices for passenger cars, while the prices for light trucks rose 1.1 percent, the largest increase since November 2009. Energy prices declined for the fifth straight month in August as oil prices moderated. We expect producer prices to continue to rise again in September as oil prices have moved higher, while further price pressures from agricultural commodities continues to be felt by producers. Although year-over-year gains in producer prices likely will not be as sharp this year compared to last year, we expect somewhat higher producer prices through the end of the year. It likely will only be a matter of time before a portion of these price pressures are passed on to end consumers.

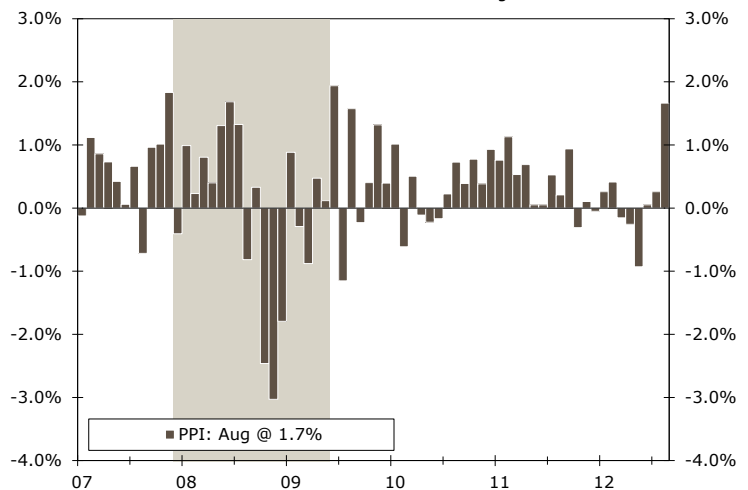
Previous: 1.7%

Wells Fargo: 0.7%

Consensus: 0.7% (Month-over-month)

Producer Price Index

Month-over-Month Percent Change



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

Global Review

Foreign Growth in Q3 Remained Lackluster

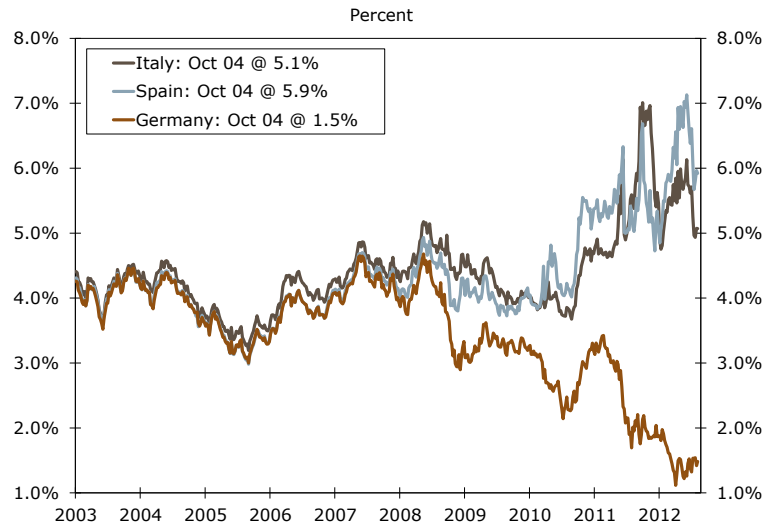
With the third quarter of 2012 now in the history books, it appears that economic growth in most major foreign economies remained rather sluggish in the most recent three-month period. Let's start with Europe. The position of the purchasing managers' indices—both of the manufacturing and service sector PMIs remained below the demarcation line separating expansion from contraction throughout the quarter—suggest that overall economic activity contracted again (see graph on front page). Real GDP in the Eurozone edged down at an annualized rate of 0.7 percent in the second quarter, and we estimate that output contracted a bit faster in the third quarter.

If there is any good news in the Eurozone, it is that the sovereign debt crisis remains largely on the back burner, at least for now. Borrowing costs faced by the Spanish and Italian governments, although remaining elevated, have declined significantly over the past two months due largely to the announcement by the ECB that it has put in place a program to buy government bonds provided that governments pursue economic reforms. The relative calm in financial markets over the past two months may lead to some spending stability in Europe. With inventories among European businesses very lean, output could subsequently stabilize and begin to edge higher in the coming months. However, Europe is hardly "fixed" yet, and financial market instability could return at any time if governments appear to be backtracking on their promises of economic reforms. As widely expected, the ECB kept policy unchanged at its meeting this week. The Bank of England also remained on hold, although we look for the Monetary Policy Committee to further increase the size of its asset purchase program by the end of the year.

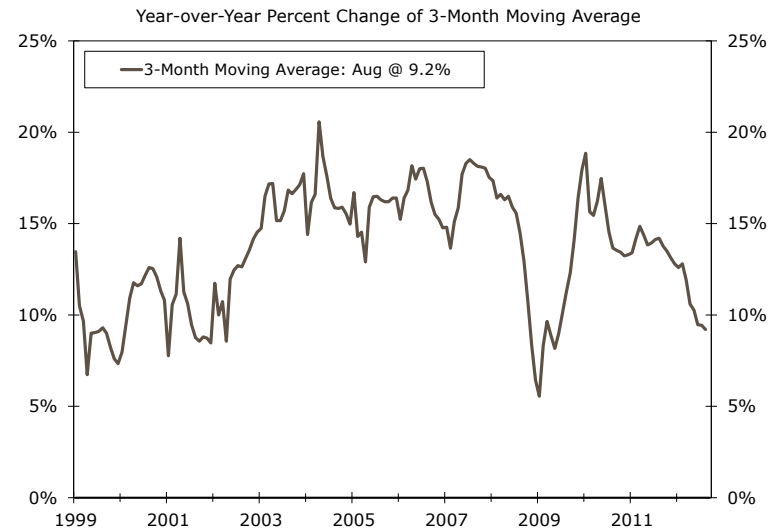
In Asia, growth also appears to have remained lackluster in the third quarter. Growth in Chinese industrial production has slowed sharply this year, and continued weakness in the manufacturing PMI through September suggests that an acceleration in Chinese economic activity is not yet at hand (middle chart). Survey evidence in many other Asian countries suggests that growth in those economies was also sluggish in the third quarter. In Japan, the 2.5 percent (not annualized) drop in industrial production in the July-August period raises the possibility that overall GDP growth in Japan may have turned negative again in the third quarter.

Brazil appears to be an exception to the rule of continued slow growth in the third quarter. Following four consecutive quarters of decline, Brazilian industrial production in the first two months of Q3 was up 1.1 percent (not annualized) relative to Q2. The Brazilian central bank has slashed its main policy rate by 500 bps over the past year, and lower interest rates may be starting to have a positive effect on the economy (bottom chart). For example, car sales were up more than 30 percent year-over-year in August. Brazil notwithstanding, it appears that economic growth in the global economy remained rather lackluster in the third quarter, and we do not expect significant acceleration in global economic activity anytime soon.

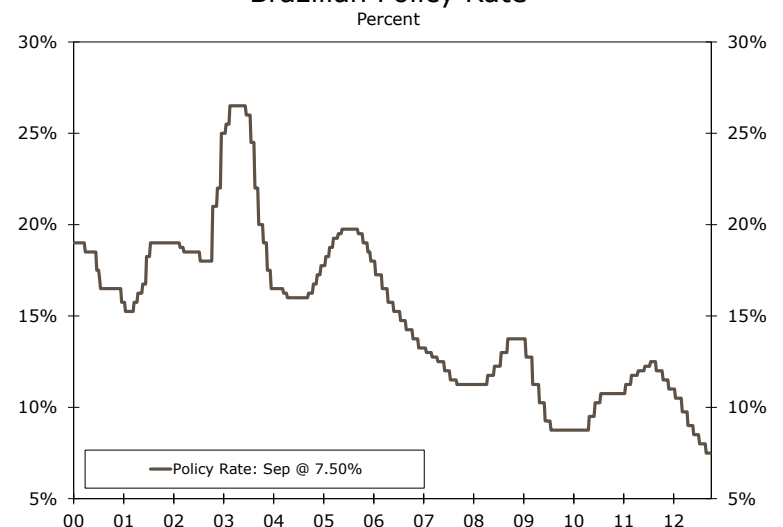
10-Year Government Bond Yields



Chinese Industrial Production Index



Brazilian Policy Rate



Source: IHS Global Insight and Wells Fargo Securities, LLC

Japanese Current Account • Tuesday

In the second quarter Japan's account surplus narrowed as the trade gap approached record levels. The trade surplus appears to be narrowing as the ongoing situation in Europe weighs on exports. As in the United States and China, exports in Japan likely will remain weak until the situation in Europe is either "fixed," which could take years, or at least shows signs of improving.

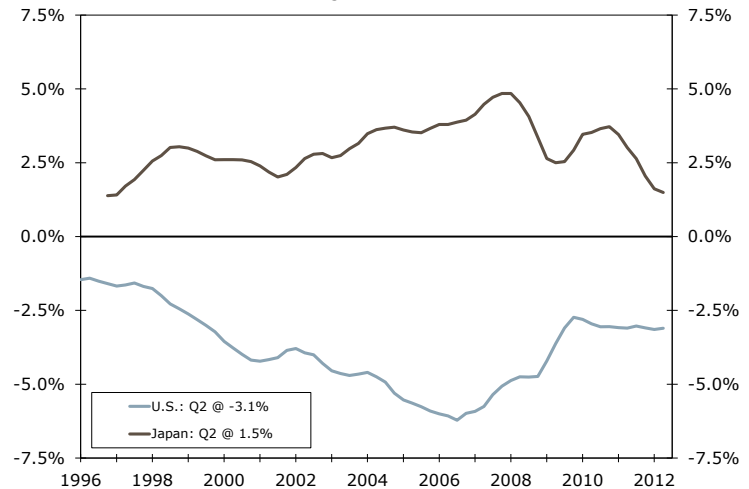
We estimate that net trade will exert about a 0.3 percentage point drag on real GDP growth in Japan in the third quarter.

We will get a better sense of the Q3 trade picture when current account data for August hit the wire on Tuesday of next week.

Previous: ¥625.4B

Consensus: ¥421.1B

Japanese and U.S. Current Account Balance
Percentage of Nominal GDP



U.K. Industrial Production • Tuesday

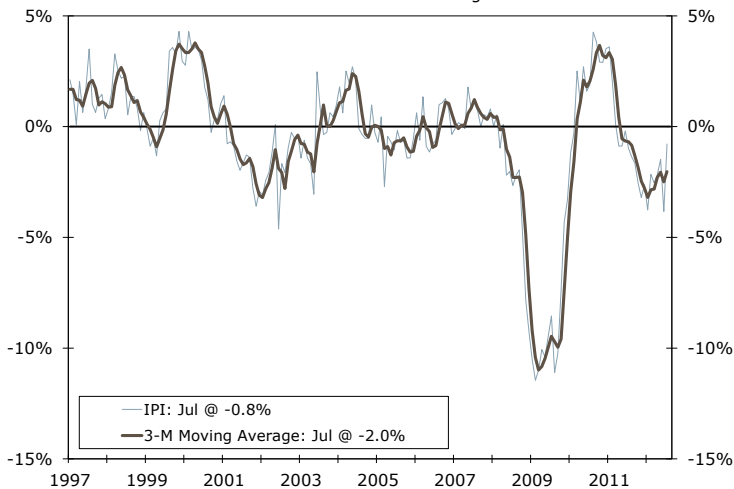
The Queen's Jubilee this summer injected a lot of volatility into the industrial production data in the United Kingdom, as days were taken from June and added to July. The result was a plunge of 2.4 percent in June followed by what nominally appeared to be the biggest sequential monthly jump in industrial production in 25 years—hardly the outcome you might expect for an economy in recession.

On Tuesday, we will get our first look at output data that should no longer be affected by the timing of the Jubilee. Overall industrial production remains off by more than 11.4 percent from pre-recession levels. At 48.4, manufacturing PMI in the United Kingdom remains in contraction territory, so we do not hold out much hope for a swift recovery of the U.K. factory sector.

Previous: 2.9% (Month-over-month)

Consensus: -0.5%

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



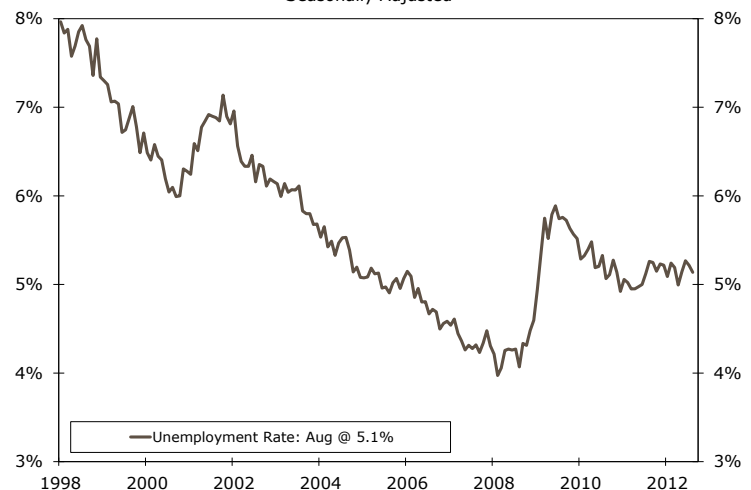
Australian Jobs Report • Thursday

With an unemployment rate of 5.1 percent, the Australian economy boasts one of the most vibrant job markets among the developed economies of the world, as its economic growth has generally outpaced other large, developed economies. That is not to say that the employment picture in Australia is impervious to the maladies that weigh on growth prospects throughout the rest of the world, such as slower growth in China and the ongoing recession in Europe. Indeed, the Aussie labor market shed 8,800 jobs in July, a decline that would be commensurate with a monthly job loss of more than 100,000 in the United States when adjusted for the smaller size of the Aussie labor force. We get a look at the change in September payrolls on Thursday of next week. The Reserve Bank cut its key lending rate this week in an effort to boost economic growth and attempt to offset some of the deleterious effects of the crisis in Europe.

Previous: 5.1%

Consensus: 5.3%

Australian Unemployment Rate
Seasonally Adjusted



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

Interest Rate Watch

QE3 Should Hold Rates Down

September's employment data sent yields modestly higher this morning. The employment report showed the unemployment rate falling a surprising 0.3 percentage points to 7.8 percent, with a huge 873,000 increase in household employment accounting for much of the improvement. The drop in the unemployment rate comes after the release of the Fed minutes where there was a great deal of discussion about whether to set formal targets for the unemployment rate or labor market, more generally in terms of deciding when it would be appropriate for the Fed to end its unusually accommodative monetary policy.

We do not see this report as marking a major change in the employment situation. Nonfarm payrolls rose largely in line with expectations, climbing by 114,000 jobs, with gains in healthcare offsetting a second month in a row of cutbacks in manufacturing payrolls. Government employment was also revised up in previous months. Moreover, 80 percent of the surge in household employment occurred among persons working part-time for economic reasons or the self-employed. The recovery remains on the slow track, and we believe the Fed will keep its word about maintaining the fed funds rate at its current level through the middle of 2015.

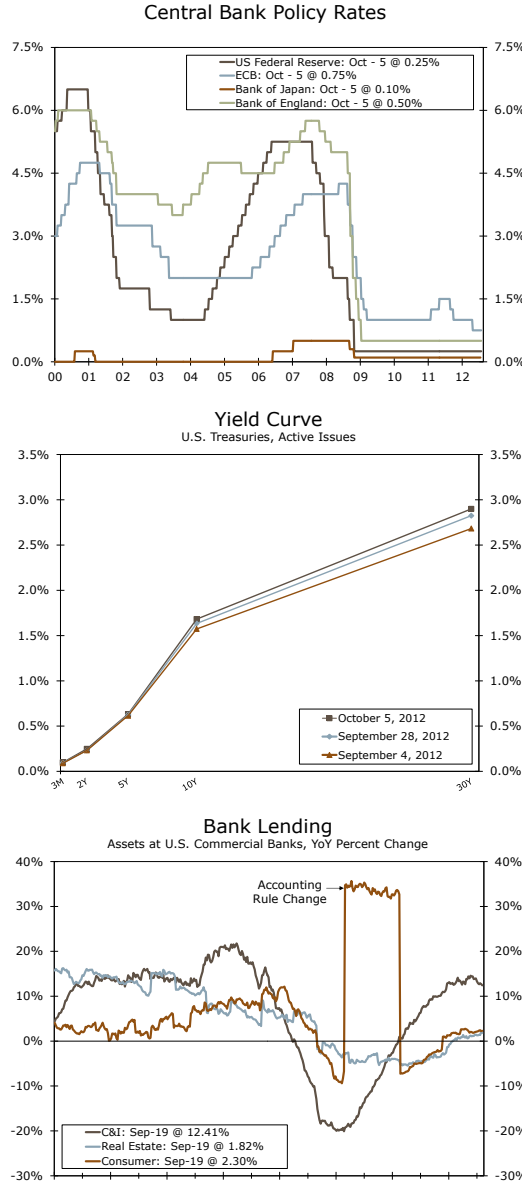
The Fed's inability to agree on a specific level of the unemployment rate that would need to be reached to adjust monetary policy at its September FOMC meeting is an acknowledgment by the central bank that the unemployment rate is no longer an accurate gauge of the health of the labor market. This could make for some interesting discussions at future FOMC meetings if the jobless rate declines much further. For now, the financial markets appear to believe the Fed's argument and are expecting the Fed to maintain the recent pace of securities purchases into 2013. Those securities purchases will keep long-term interest rates near their current exceptionally low levels and also gradually narrow the spread between the interest rate on conventional 30-year fixed-rate mortgages and the 10-year Treasury.

Consumer Market Insights

Credit Supporting Higher Auto Sales

Data this week showed that total light vehicle sales to dealers rose to a 14.9 million unit annualized pace in September, the strongest print since early 2008. Domestically, sales have held up fairly well despite sluggish consumer spending. Domestic sales to dealers dipped slightly in September, but remain near a four-year high, and retail auto sales have held up even as total sales have slowed.

The improvement in domestic sales has been helped by a rebound in auto credit. Household auto loan debt has risen nearly \$50 billion from its post-recession low in 2010 and currently stands at \$750 billion. Delinquencies are also declining, with the percent of loan balances 90+ days past due now lower than any other major type of household debt, including home equity, mortgage and student loan debt. Lending terms are looking more favorable for consumers, which has helped to boost demand. The average interest rate on a 48-month new car loan in the second quarter fell to its lowest mark (4.87 percent) since the Fed began recording rates in 1972. Moreover, investors seem to have an increasing appetite for auto-backed loans. Issuance of auto-backed securities through September has already surpassed annual levels for 2008-2011 and is on track to exceed issuance in 2007. Improving credit conditions should help auto sales remain above the 14-million mark through the remainder of the year, even as real consumer spending growth slows.



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	3.36%	3.40%	3.55%
15-Yr Fixed	2.69%	2.73%	2.86%	3.26%
5/1 ARM	2.72%	2.71%	2.75%	2.96%
1-Yr ARM	2.57%	2.60%	2.61%	2.95%

Bank Lending	Current Assets (Billions)	1-Week Change (SAAR)	4-Week Change (SAAR)	Year-Ago Change
	Commercial & Industrial	\$1,455.2	-13.71%	-5.52%
Revolving Home Equity	\$528.8	-9.16%	-10.54%	-4.74%
Residential Mortgages	\$1,606.8	-14.41%	18.35%	6.83%
Commerical Real Estate	\$1,412.9	-0.91%	1.54%	-0.92%
Consumer	\$1,110.7	-0.39%	1.07%	2.30%

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

Topic of the Week

Local Budgets Under Pressure: A Fiscal Outlook

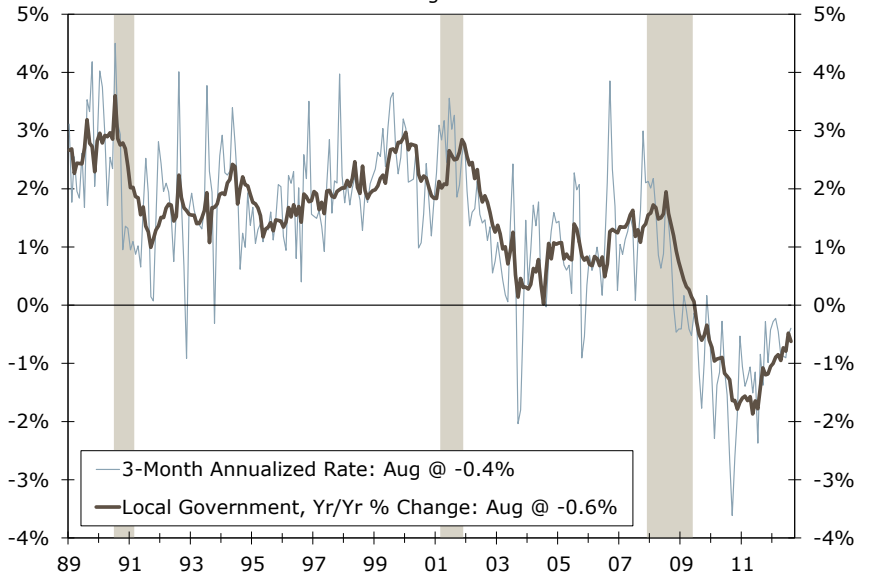
Over the past year, local budgets have been under pressure as the home price declines of the housing bust have put a damper on property tax collections, and slower consumer spending has held back growth in local sales tax revenues. The result has been budget cuts at the local level that have affected funding for such areas as school districts, city services and local infrastructure projects. A consequence of these cuts has been a decline in local government employment by 11 percent since July 2009 when the first local layoffs began. Besides the effects on the labor market, local government consumption, which makes up the bulk of total government spending, continues to detract from top-line economic growth.

The two main sources of local government revenue include property taxes (40 percent) and local sales taxes (22 percent). The pullback in property tax collections following the housing bubble lagged the decline in home prices and, along with stimulus funding from the Recovery Act, delayed the inevitable onset of cuts at the local level. The new long-term challenges facing local governments, besides slower revenue growth is the rising costs of healthcare and pensions for local government employees as well as reducing funding due to restructuring at the state and federal level.

Our outlook continues to call for slow revenue growth for local governments as a result of sales and property tax collections growing below historical trends. To cope with this, tough choices will need to be made at the local level about public pensions and healthcare benefits. As a result, we believe local governments will continue to struggle on a regional basis. The new rebalancing effort at the local level implies that fewer workers will be needed in the current environment. Thus local government layoffs should subside, but overall employment levels will likely remain relatively unchanged over the next year. For more information, please see the full report, *Local Budgets Under Pressure: A Fiscal Outlook*, available on our website.

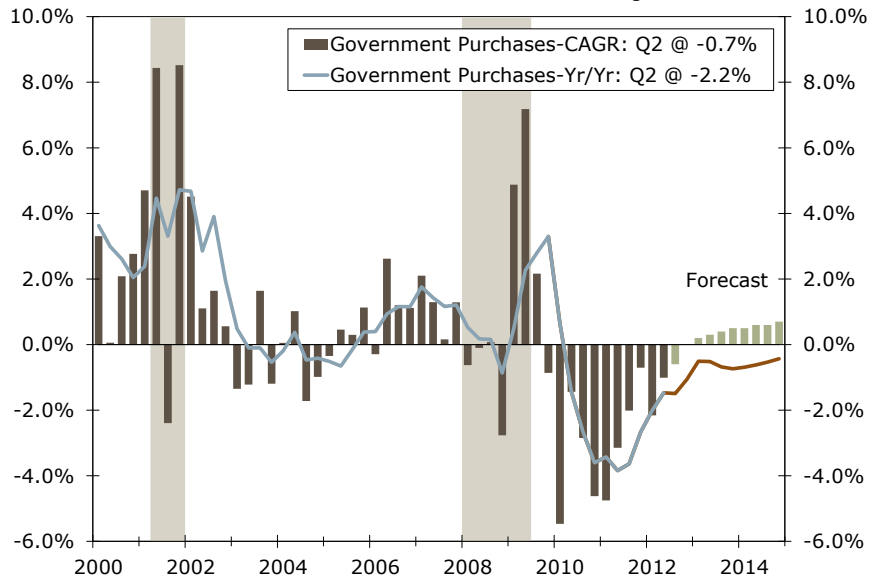
Local Government Job Growth

Year-over-Year Percent Change vs. 3-Month Annualized Rate



Real State & Local Government Purchases

Bars = CAGR Line = Yr/Yr Percent Change



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

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 10/5/2012	1 Week Ago	1 Year Ago
3-Month T-Bill	0.10	0.09	0.00
3-Month LIBOR	0.35	0.36	0.38
1-Year Treasury	0.16	0.15	0.14
2-Year Treasury	0.25	0.23	0.26
5-Year Treasury	0.66	0.63	0.95
10-Year Treasury	1.72	1.63	1.89
30-Year Treasury	2.95	2.82	2.85
Bond Buyer Index	3.61	3.67	4.14

Foreign Exchange Rates

	Friday 10/5/2012	1 Week Ago	1 Year Ago
Euro (\$/€)	1.306	1.286	1.335
British Pound (\$/£)	1.620	1.617	1.546
British Pound (£/€)	0.806	0.795	0.863
Japanese Yen (¥/\$)	78.680	77.960	76.790
Canadian Dollar (C\$/)\$)	0.976	0.984	1.040
Swiss Franc (CHF/\$)	0.929	0.940	0.923
Australian Dollar (US\$/A\$)	1.022	1.038	0.966
Mexican Peso (MXN/\$)	12.702	12.859	13.554
Chinese Yuan (CNY/\$)	6.324	6.306	6.360
Indian Rupee (INR/\$)	51.855	52.860	49.348
Brazilian Real (BRL/\$)	2.026	2.026	1.833
U.S. Dollar Index	79.231	79.935	78.919

Foreign Interest Rates

	Friday 10/5/2012	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.15	0.15	1.50
3-Month Sterling LIBOR	0.56	0.60	0.96
3-Month Canadian LIBOR	1.27	1.27	1.20
3-Month Yen LIBOR	0.19	0.19	0.19
2-Year German	0.06	0.02	0.50
2-Year U.K.	0.21	0.19	0.58
2-Year Canadian	1.14	1.06	0.91
2-Year Japanese	0.10	0.10	0.14
10-Year German	1.52	1.44	1.84
10-Year U.K.	1.77	1.73	2.36
10-Year Canadian	1.81	1.73	2.14
10-Year Japanese	0.78	0.78	0.97

Commodity Prices

	Friday 10/5/2012	1 Week Ago	1 Year Ago
WTI Crude (\$/Barrel)	89.28	92.19	79.68
Gold (\$/Ounce)	1781.75	1772.10	1641.05
Hot-Rolled Steel (\$/S.Ton)	602.00	598.00	665.00
Copper (¢/Pound)	377.65	375.80	310.60
Soybeans (\$/Bushel)	15.59	15.76	11.20
Natural Gas (\$/MMBTU)	3.39	3.32	3.57
Nickel (\$/Metric Ton)	18,619	18,299	18,719
CRB Spot Inds.	527.98	530.57	533.44

Next Week's Economic Calendar

	Monday 8	Tuesday 9	Wednesday 10	Thursday 11	Friday 12	
U.S. Data			Wholesale Inventories July 0.7% August 0.4% (C)	Trade Balance July -\$42.0B August -\$43.3B (W)	PPI August 1.7% September 0.7% (W)	
				Import Price Index August 0.7% September 0.7% (W)	Core PPI August 0.2% September 0.1% (W)	
	Global Data	Eurozone Industrial Production Previous (July) -1.4%	U.K. Industrial Production Previous (July) -0.5%	Japan Machine Tool Orders Previous (Aug) -2.7%	Australia Jobs Report Previous (Aug) 5.1%	Mexico Industrial Production Previous (July) 4.9%
			Japan Current Account Previous (July) ¥421.1B			

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

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