

Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Jobs Disappoint, but Baby It's Cold Outside

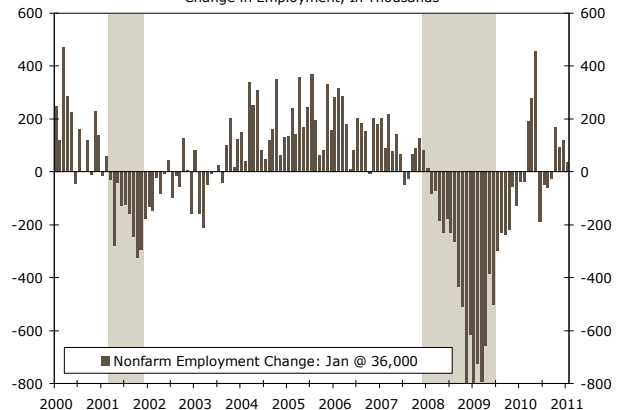
- The unemployment rate dropped to 9.0 percent in January as payrolls increased by only 36,000 jobs. The number was smaller than expected, though the data revealed a spike in workers unable to work due to weather, and the Labor Department noted that the weather likely suppressed job growth in the month.
- Aside from the job market, economic numbers this week have been strong. Personal income and spending data showed a strong finish to 2010 for consumer spending and the ISM survey showed that business spending is off to a good start in 2011.

Global Review

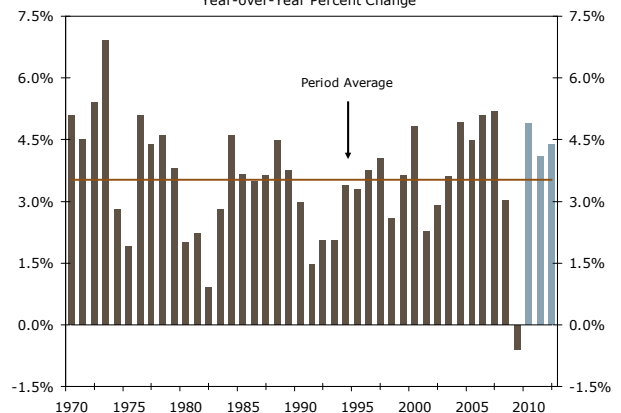
Global Growth Starts the Year on Solid Footing

- The economic data released in Asia and Europe this past week suggest global economic growth remains solid. Fourth-quarter GDP released for the Philippines and Taiwan both easily beat consensus expectations. Readings on China's manufacturing growth for January were mixed depending on which PMI measure one consulted.
- The economic data out of Europe were even clearer. Reuters manufacturing and service PMIs for January jumped in several European countries and in the Eurozone as a whole.

Nonfarm Employment Change
Change in Employment, In Thousands



Real Global GDP Growth
Year-over-Year Percent Change



Wells Fargo U.S. Economic Forecast

	Actual 2010				Forecast 2011				Actual		Forecast		
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2008	2009	2010	2011	2012
Real Gross Domestic Product ¹	3.7	1.7	2.6	3.2	4.2	3.1	2.9	3.0	0.0	-2.6	2.9	3.2	3.1
Personal Consumption	1.9	2.2	2.4	4.4	3.3	1.8	1.9	3.0	-0.3	-1.2	1.8	2.8	2.3
Inflation Indicators ²													
"Core" PCE Deflator	1.8	1.5	1.2	0.8	0.8	0.8	1.0	1.3	2.3	1.5	1.3	1.0	1.6
Consumer Price Index	2.4	1.8	1.2	1.2	1.6	2.3	2.4	2.4	3.8	-0.3	1.6	2.2	2.5
Industrial Production ¹	7.1	7.2	6.5	2.4	5.1	3.7	3.7	3.7	-3.3	-9.3	5.7	4.4	4.2
Corporate Profits Before Taxes ²	37.6	37.0	26.4	12.5	8.2	6.2	6.2	6.7	-16.4	-0.4	27.5	6.8	7.0
Trade Weighted Dollar Index ³	76.1	78.8	73.6	73.2	72.5	73.0	74.0	75.0	74.3	77.7	75.6	73.6	78.0
Unemployment Rate	9.7	9.6	9.6	9.6	9.3	9.4	9.3	9.2	5.8	9.3	9.6	9.3	9.0
Housing Starts ⁴	0.62	0.60	0.59	0.54	0.56	0.61	0.66	0.71	0.90	0.55	0.59	0.64	0.83
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	1.88	0.25	0.25	0.25	0.50
Conventional Mortgage Rate	4.97	4.74	4.35	4.71	5.00	5.10	5.20	5.20	6.04	5.04	4.69	5.13	5.60
10 Year Note	3.84	2.97	2.53	3.30	3.40	3.50	3.60	3.70	3.66	3.26	3.22	3.55	4.08

Forecast as of: February 4, 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

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Together we'll go far



U.S. Review

Aside From Jobs, Economy Is Firing on all Cylinders

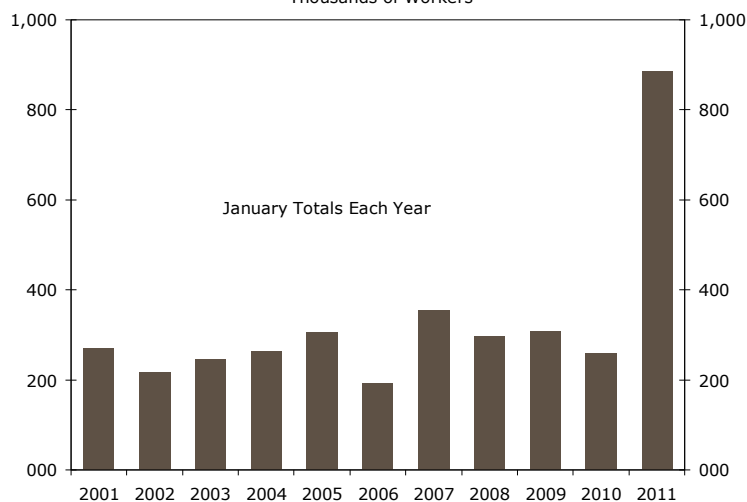
The job report for January revealed that nonfarm payrolls grew only 36,000 in the month. The number was weaker than the consensus had expected, but it appears likely that this winter's snowstorms are distorting the data as job growth in sectors such as construction is held back because of bad weather. Aggregate hours slipped 0.2 percent, but here as well, the snow seems to be the culprit. It is not uncommon for bad weather to keep workers at home in January. On average over the past five years, 282,000 workers were unable to work due to bad weather in January. This January, that number spiked to a whopping 886,000 workers who were snowbound.

Consumer spending finished 2010 on a high note, increasing 0.7 percent in the final month of the year and growing at a 4.4 percent annualized basis in the fourth quarter. This marks the strongest outturn for consumer spending since the first quarter of 2006. While we do look for continued spending growth from here, this break-neck pace of growth does not seem sustainable with nine percent of the workforce still looking for a job. A growth rate between two and three percent for consumer spending seems likely for 2011. The spending gains were fueled by another month of solid income growth. Wages and salary disbursements, for example, rose to the highest level since 2008 and are now only 1.5 percent below the pre-recession peak. The growth here was supported by broad-based gains in wages and salaries for both goods and services producing industries as well as government positions. Perhaps most encouraging is the gain in income outside of transfer payments, which includes categories such as social security payments and unemployment benefits. Stripping away those government payments, personal income is now growing 4.4 percent on a 3-month annualized basis, suggesting solid growth for consumer income.

Signs of increasing momentum are evident in other parts of the economy as well. The ISM manufacturing index rose to 60.8 in January—the highest level since 2004. Combined with other signals of expansion in the factory sector that we have seen in recent regional purchasing managers indexes, this provides affirmation that the manufacturing sector will continue to be supportive of overall economic growth in coming quarters. At the outset of this recovery there was some concern that the manufacturing gains were simply a function of the inventory rebuilding and the growth there would not continue once stockpile levels stabilized. A look at the components of the ISM alleviates those concerns. The employment index and the new orders index both climbed to multi-year highs. More indications of the strength and breadth of the factory sector recovery are evident in the orders report, which was better than expected. Bookings picked up for U.S. manufacturers and nondefense capital goods orders ex-aircraft were also up on the month and are growing at 3-month annualized rate of more than 10 percent. As it is the shipments of this series that goes into the GDP report, a double-digit growth rate in orders means that we have plenty of momentum in business spending heading into 2011.

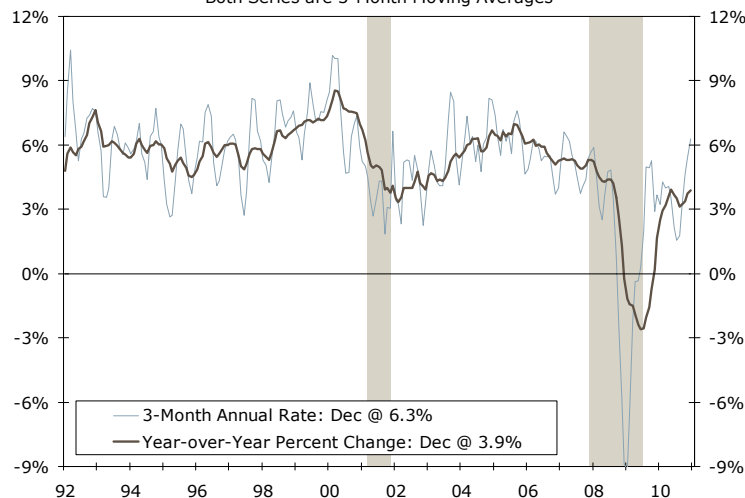
Unable to Work Due to Weather in January

Thousands of Workers



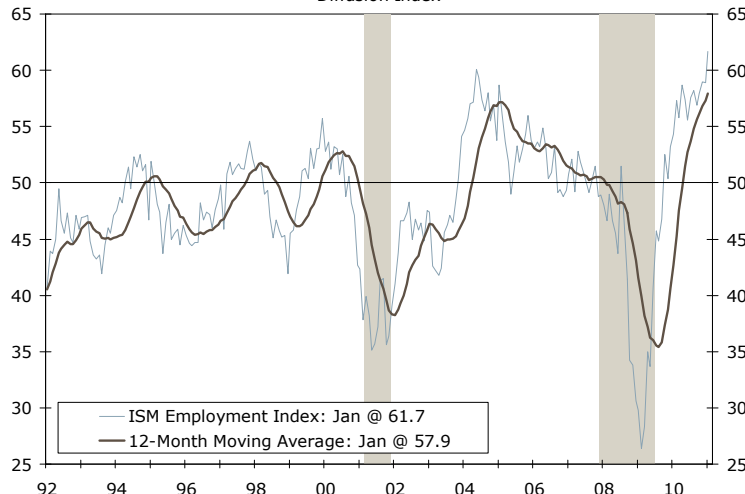
Personal Consumption Expenditures

Both Series are 3-Month Moving Averages



ISM Employment Index

Diffusion Index

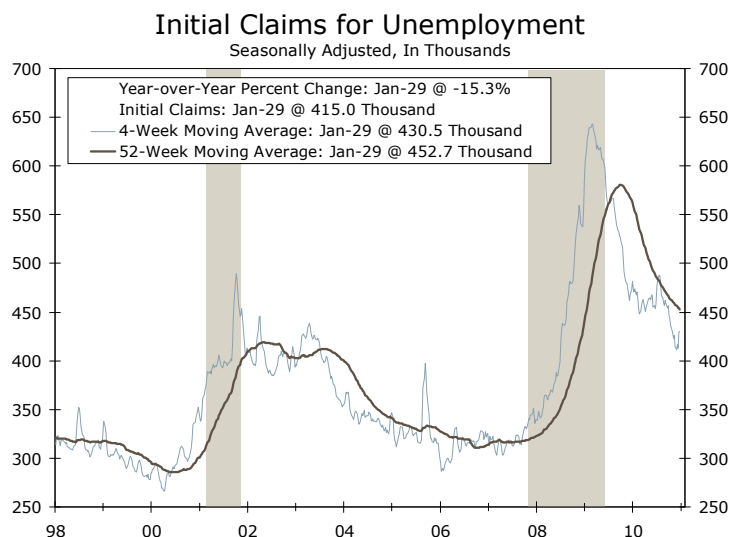


Small Business Optimism • Tuesday

The Small Business Optimism Index dipped slightly to 92.6 in December from 93.2 in November, which was the highest since the recession began. On the positive side, capital-spending plans increased, while sales expectations and hiring plans were the highest in more than two years. Dragging down the index were a drop in plans to increase inventories, a decline in the earnings outlook and a slight worsening of credit conditions. Although hiring plans, spending plans and sales expectations rose, this does not necessarily mean more small businesses will come seeking a loan. Bank loans on the balance sheets of nonfarm, noncorporate businesses have dropped for seven consecutive quarters through the third quarter and are down nearly a third from the peak. Still, the improvement in small business optimism is encouraging as it suggests hiring from small businesses should soon pick up.

Previous: 92.6

Consensus: N/A



Trade Balance • Friday

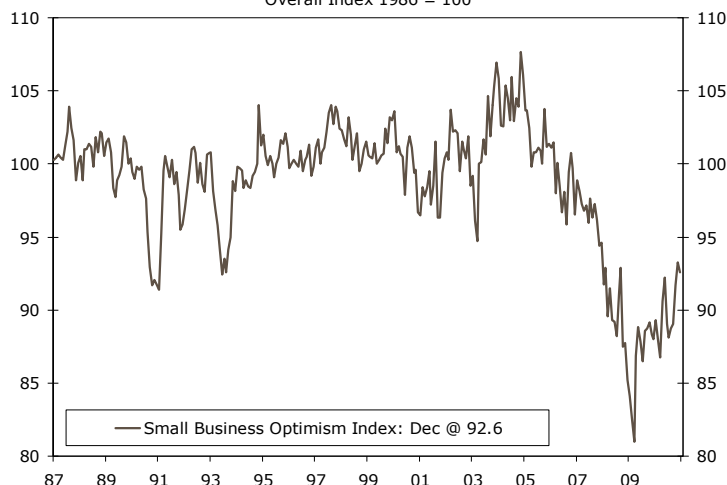
The trade deficit narrowed to -\$38.3 billion in November as export growth outpaced import growth. Exports were driven by pharmaceuticals and foods/feeds/beverages, the latter of which was primarily driven by price increases. Imports rose largely on the back of crude oil imports, as both the average price and the number of barrels imported rose. Imports of consumer goods fell, again driven primarily by a drop in pharmaceuticals. Continued strength in emerging markets and ongoing demand for computers and other equipment to enhance productivity likely kept exports strong in December. Meanwhile, strong domestic growth and elevated oil prices probably kept oil imports high, which could offset the strength in exports and lead to a widening of the deficit for December. Geopolitical tensions, as they pertain to the strength of the dollar and access to vital trade routes, could be important factors for trade in the near term.

Previous: -\$38.3 Billion **Wells Fargo: -\$39.6 Billion**

Consensus: -\$40.3 Billion

Small Business Optimism

Overall Index 1986 = 100



Initial Jobless Claims • Thursday

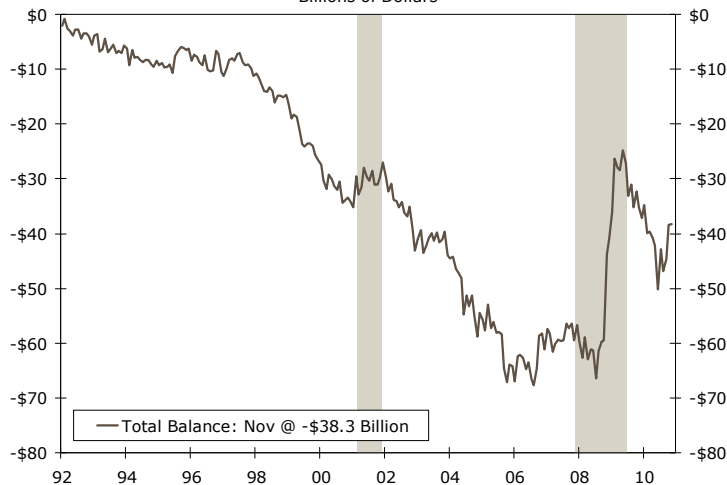
Initial jobless claims fell last week to 415,000 from 457,000 the prior week. Due to seasonal fluctuations and recent volatile weather, the past few weeks of claims data have made it difficult to ascertain the direction of the labor market. Nonetheless, with claims remaining above 400,000, it is clear that there is still a long way to go before the labor market returns to normal. In addition, all types of continuing claims, including emergency unemployment compensation and extended benefits, stand at 9.2 million, showing just how much excess labor supply remains. With so many folks looking for work, wage growth will likely be anemic for quite some time. While this would normally lead to slower consumer spending, spending has held up recently as consumers have dipped into built-up savings to finance their spending. In addition, low inflation has helped real disposable income to improve recently.

Previous: 415K

Consensus: 410K

Trade Balance in Goods and Services

Billions of Dollars



Global Review

Global Economic Warming

Global economic data continue to come in on the hot side of expectations. The downside of this growth story is that inflation pressures are clearly emerging in many corners of the world.

Asian Tigers Roar

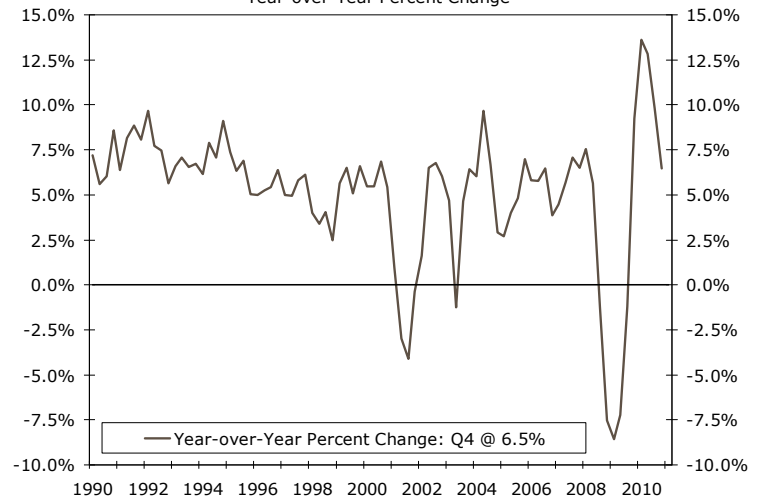
Taiwan's preliminary reading on GDP growth for the fourth quarter increased 6.48 percent from a year ago, compared to the median consensus estimate that was looking for a 4.9 percent gain. This was down from the third quarter's 9.8 percent reading, but it did ensure a blistering Taiwan growth rate of 10.5 percent for 2010. The highest annual growth rate for Taiwan in 23 years, and on par with Mainland China's annual 2010 growth of 10.3 percent. Taiwan's official projection for annual growth in 2011 is now 5.03 percent, up from a previous estimate of 4.51 percent. A strong finish to Taiwan exports in the fourth quarter, especially from electronics, as well as a continuing pick-up in private consumption, likely drove the solid increase in GDP in the fourth quarter. The Philippines also released fourth quarter GDP that exceeded market expectations, increasing 3.0 percent or 12.5 percent at an annualized rate. For the year as a whole, Philippines GDP increased 7.3 percent in 2010.

South Korean exports increased 1.2 percent in January from the month before, increasing South Korea's export gains over the past year to an impressive 46.0 percent, a record increase for the country. Global demand is certainly entering the year on a solid footing. China PMI indexes for January were mixed. The HSBC/Markit PMI improved to 54.5 from 54.4 in December, while the Chinese government's official PMI cooled to 52.9 from 53.9. Both manufacturing PMIs remain comfortably in expansion territory and given the strength of the economic and export data in the region, it doesn't appear that the Chinese manufacturing slowdown, if it exists at all, is all that large at this point.

Europe's Economic Recovery Is Also Strengthening

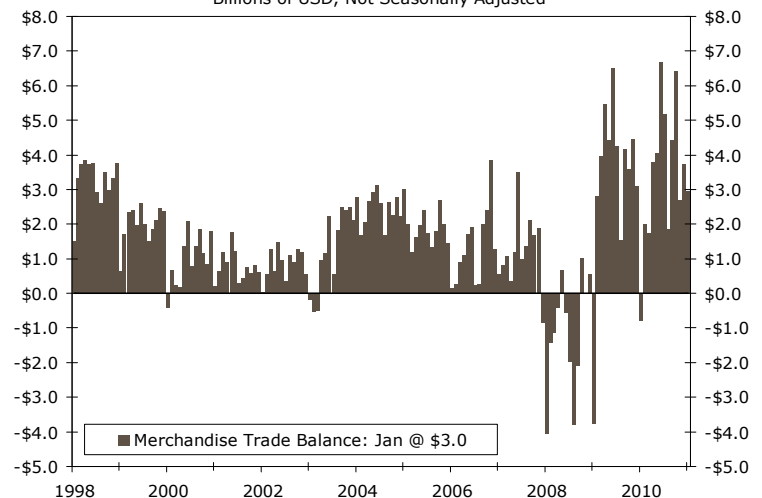
Europe's manufacturing and service companies are reporting that their businesses expanded at a brisker pace in January. The final manufacturing PMI for the Eurozone increased to 57.3 in January from a 56.9 preliminary reading and from 57.1 in December. There was an upward revision in the preliminary PMIs for Germany, France, and Italy. A reading above 50.0 indicates expansion. On the services side the growth acceleration was even more visible. Europe's services PMI increased to 55.9 in January from a preliminary estimate of 55.2 and a December reading of 54.2. Solid January service expansion gains came from both Germany and France. The ECB statement from the February meeting noted the positive underlying momentum in euro area economic activity, specifically citing the expectation that euro area exports will benefit from the on-going global recovery. The ECB left its key policy rate unchanged and saw evidence of short-term inflation pressures, but expected inflation in the medium to long-term to remain contained. This language reduced expectations that an ECB rate hike is imminent, causing the euro to lose significant ground against the U.S. dollar.

Taiwanese Real GDP
Year-over-Year Percent Change



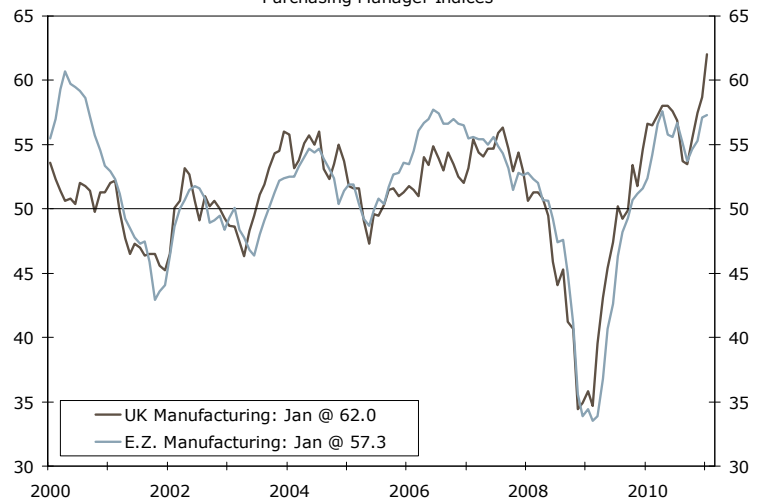
South Korean Merchandise Trade Balance

Billions of USD, Not Seasonally Adjusted



European Manufacturing

Purchasing Manager Indices



German Industrial Production • Tuesday

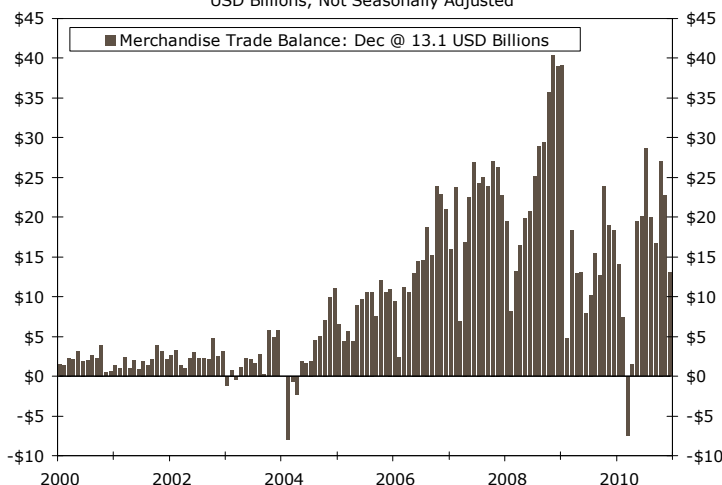
Some important indicators on the state of the German industrial sector at the end of last year will be released next week. First, data on factory orders will print on Monday. Although orders may fall back a bit in December, the 5.2 percent surge in orders in November relative to the previous month shows the production pipeline is full at present. The Ifo index of business sentiment, which currently stands at a post-unification high, is another indication that the industrial sector continues to enjoy positive momentum. On a year-over-year basis, German industrial production (IP) is currently growing at a double-digit pace.

IP in France and Italy is also growing, albeit not as rapidly as in Germany. Data that are slated for release on Thursday will give investors some insights into the state of the French and Italian industrial sectors in December.

Previous: -0.7%

Consensus: 0.0% (Month-over-Month)

Chinese Merchandise Trade Balance
USD Billions, Not Seasonally Adjusted



Bank of England Meeting • Thursday

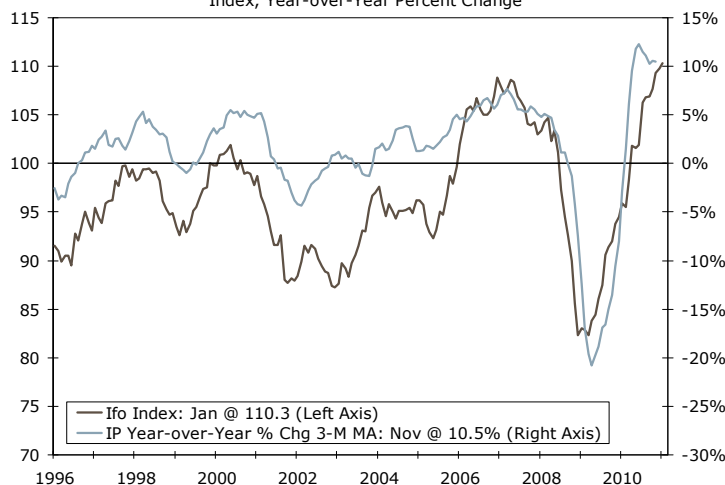
The Bank of England has maintained its policy rate at 0.50 percent since March 2009, and most analysts, we included, look for no change from the Monetary Policy Committee (MPC) on Thursday. That said, two members of the MPC voted to hike rates by 25 bps at the January policy meeting. It will be interesting to see if any more MPC members join the dissenters this month, although the surprisingly weak GDP data in the fourth quarter take some force away from the hawks' arguments.

Also on the docket next week are data on industrial production growth in December as well as an estimate of overall GDP growth in the first month of the year. Given the surprising decline in GDP in the fourth quarter, it will be interesting to see what happened to overall economic activity in January.

Current Policy Rate: 0.50% Wells Fargo: 0.50%

Consensus: 0.50%

German Production Indicators
Index, Year-over-Year Percent Change



Chinese Trade Balance • Thursday

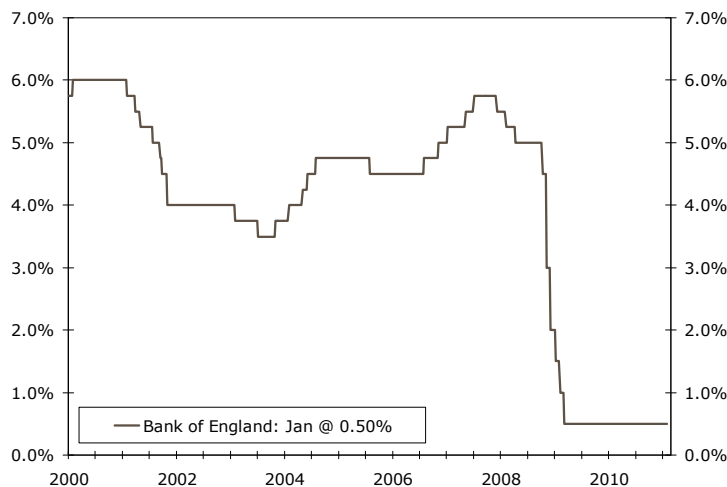
After peaking at close to \$300 billion in 2008, the Chinese trade surplus has been shrinking. Indeed, the \$185 billion surplus that was registered in 2010 was the smallest surplus since 2006. Trade data for January will print on Thursday, and the consensus forecast looks for a further decline in the trade surplus. Although the year-over-year rate of export growth is about 20 percent at present, imports are growing more rapidly due to robust growth in Chinese domestic demand. The nonmanufacturing PMI, which also is slated for release next week, should show that the service sector continues to expand at a decent clip.

The narrowing in the trade surplus suggests the overall rate of GDP growth likely will slow somewhat this year. That said, we project that the Chinese economy will grow about 9 percent in 2011, which is hardly "slow."

Previous: \$13.08 billion

Consensus: \$10.20 billion

Bank of England Policy Rate



Interest Rate Watch

Long Ago, Yet Could Be Tomorrow

Economies and financial markets move by surprises. The conventional wisdom is already discounted in the marketplace.

Today's conventional wisdom is that growth will remain consistent with continued low inflation. Yet the consensus on inflation is so modest that just a moderate pace of inflation of 2-3 percent this year would upset the consensus.

We have been down this road before in recent history.

During 1994-1995, a sharp rise in commodity prices generated concern at the Federal Reserve and in the markets that inflation was about to pick up again. At a time when the inflation dragon was presumed dead, these new fears found most investors on the wrong side of the trade. Interest rates rose abruptly as the Federal Reserve shifted policy to tighten quickly.

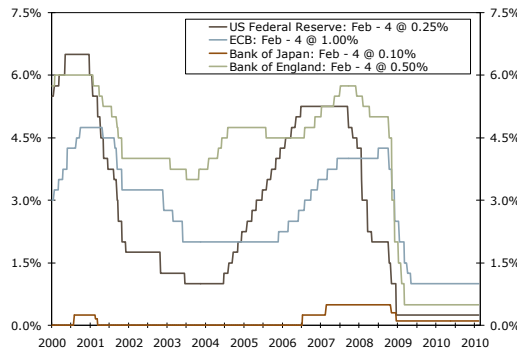
Our best case calls for moderate growth in the economy of 3.0-3.5 percent and continued low but modestly rising inflation. As a result, Federal Reserve policy would remain unchanged. However, for us, the risk is for a pick-up in inflation sooner than our best case.

Double-Dip Disappointment

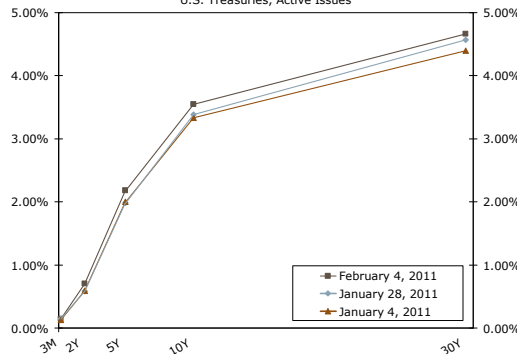
For decision-makers, a pick-up in inflation would catch many on the wrong side of the boat. Over the past three years, so many investors have bought Treasury debt at very low interest rates with very little cushion for a surprise in inflation. A pick-up of inflation of just two percent would put most Treasury debt of five years or less maturity bought in the past three years under water in real returns even before taxes are paid. Meanwhile, many corporations have held lots of cash which would decline in real value very quickly when inflation picks up just a bit.

Economies and financial markets move in response to surprises to the consensus. Today's consensus is weighted heavily towards continued low inflation for a long period of time. History does not favor that outcome. Moreover, benchmarks of slack, such as the unemployment rate, may overstate the output gap. Stay Tuned.

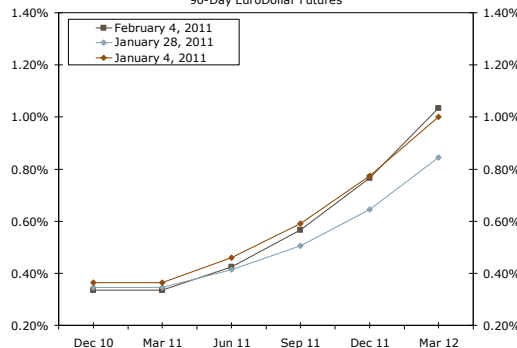
Central Bank Policy Rates



Yield Curve
U.S. Treasuries, Active Issues



Forward Rates
90-Day EuroDollar Futures



Credit Market Insights

Senior Loan Officers Have Spoken

This week's release of the Senior Loan Officer Survey (SLOS) showed that both supply and demand in bank lending continue to improve. On the supply side, banks have stopped tightening standards for commercial and industrial (C&I) loans, with a modest net fraction continuing to ease standards. A very small fraction still reported tightening standards on residential mortgages, however. On the demand side, roughly 30 percent of banks, on net, reported greater demand for C&I loans from large and middle-market firms, and about 5 percent reported stronger demand from small firms. On balance, however, there was little change in demand for other types of loans. Ongoing supply and demand improvements in bank lending—especially for C&I loans—can be attributed to better economic conditions, which have increased competition among banks and nonbank lenders.

From time to time, the SLOS reports on a special question asked to lenders. The current question asks lenders about their outlook for delinquencies and charge-offs across major loan categories in 2011. The response was very upbeat with a moderate to large net fraction of banks reporting that they expect improvements in delinquency and charge-off rates during 2011 in every major loan category. However, among these loan categories, banks reported that they were least likely to expect improvement in the quality of residential real estate loans.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.81%	4.80%	4.77%	5.01%
15-Yr Fixed	4.08%	4.09%	4.13%	4.40%
5/1 ARM	3.69%	3.70%	3.75%	4.27%
1-Yr ARM	3.26%	3.26%	3.24%	4.22%
MBA Applications				
Composite	491.7	441.8	472.1	620.7
Purchase	188.7	172.3	199.8	237.8
Refinance	2,261.2	2,025.2	2,115.4	2,854.8

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

Topic of the Week

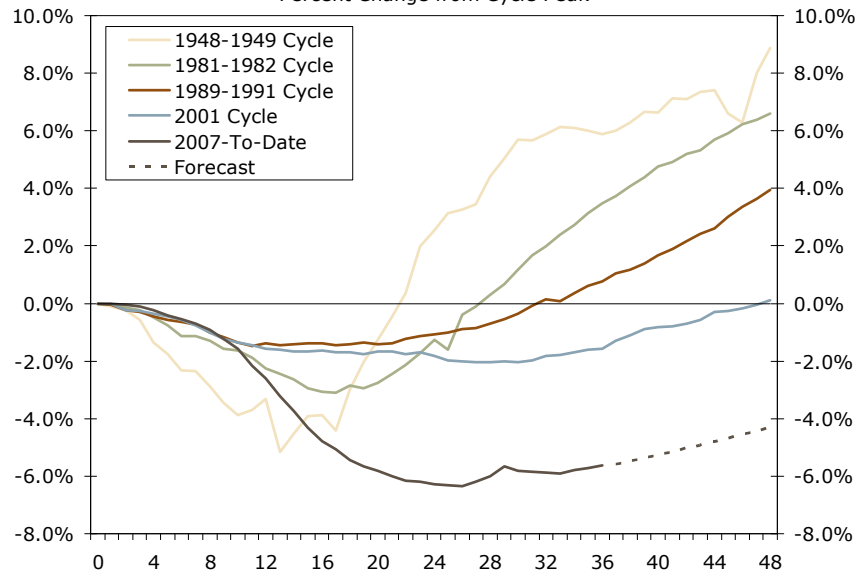
The Employment Cycle: Are We There Yet?

With fourth-quarter GDP surpassing its prerecession peak, the economy has moved from recovery to expansion. The labor market, however, has yet to show signs of nearing its prerecession state. The 2007-2009 recession saw a loss of 8.7 million jobs, or 6.3 percent of payrolls, marking the most severe decline in employment in the post-WWII era. More than a year after the trough, the level of payrolls remains more than 5 percent below its peak. Over the past three months, an average of 83,000 jobs has been added, and if that pace were to continue, employment would not reach its prerecession peak until mid-2018. Fortunately this pace is expected to improve throughout 2011 and 2012, but the recovery will continue to feel slow. Productivity has improved over the downturn—increasing 8.0 percent since 2008—which has reduced the need for firms to hire as demand for goods and services improves. Furthermore, the number of workers employed part-time for economic reasons remains elevated, leaving room for employers to add hours for existing part-time staff before making additions to payrolls.

Another painful component of the current labor market recovery is the stubbornly high rate of unemployment. Although joblessness did not climb as high after this most recent recession as it did in the 1981-1982 cycle, it has not been as quick to fall. The unemployment rate has remained above 9 percent for 21 months, surpassing the previous post-WWII record of 19 months and is likely to remain north of 9 percent throughout 2011. In addition to the persistently high unemployment rate, labor force participation has declined more than two percentage points since nonfarm payrolls began to fall in January 2008. This is the steepest cyclical decline since the series began in 1948 and, as the economy improves and workers reenter the labor force, will keep the unemployment rate elevated. As a result, despite the overall economy expanding once again, it will still be some time before the labor market reaches its prerecession state.

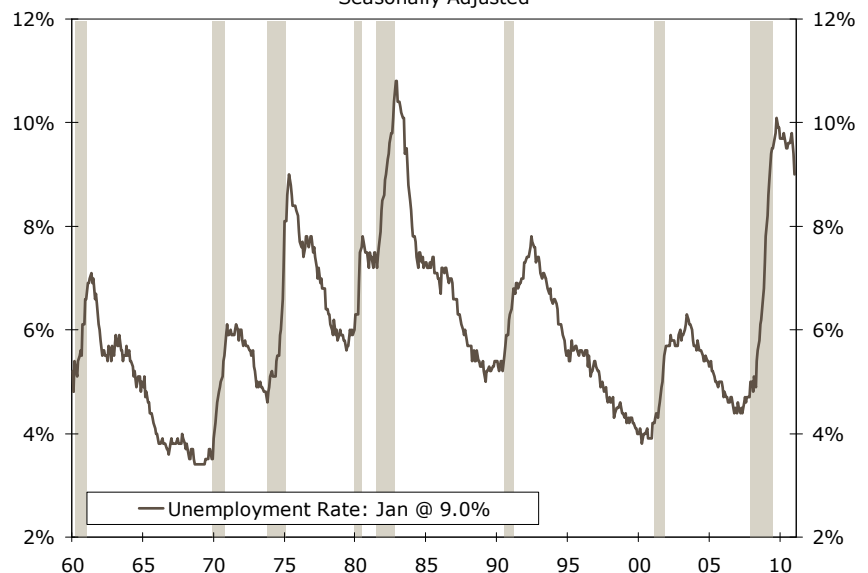
Employment Cycles

Percent Change from Cycle Peak



Unemployment Rate

Seasonally Adjusted



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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 2/4/2011	1 Week Ago	1 Year Ago
3-Month T-Bill	0.15	0.14	0.08
3-Month LIBOR	0.31	0.30	0.25
1-Year Treasury	0.28	0.19	0.31
2-Year Treasury	0.72	0.54	0.80
5-Year Treasury	2.21	1.91	2.30
10-Year Treasury	3.58	3.32	3.61
30-Year Treasury	4.68	4.53	4.55
Bond Buyer Index	5.25	5.25	4.36

Foreign Exchange Rates

	Friday 2/4/2011	1 Week Ago	1 Year Ago
Euro (\$/€)	1.360	1.361	1.372
British Pound (\$/£)	1.609	1.586	1.575
British Pound (£/€)	0.845	0.858	0.871
Japanese Yen (¥/\$)	81.710	82.120	89.050
Canadian Dollar (C\$/£)	0.985	1.001	1.074
Swiss Franc (CHF/\$)	0.954	0.942	1.067
Australian Dollar (US\$/A\$)	1.019	0.994	0.865
Mexican Peso (MXN/\$)	11.976	12.206	13.166
Chinese Yuan (CNY/\$)	6.585	6.586	6.827
Indian Rupee (INR/\$)	45.600	45.756	46.254
Brazilian Real (BRL/\$)	1.667	1.683	1.877
U.S. Dollar Index	77.926	78.133	79.916

Foreign Interest Rates

	Friday 2/4/2011	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.03	1.01	0.61
3-Month Sterling LIBOR	0.79	0.78	0.62
3-Month Canadian LIBOR	1.21	1.22	0.43
3-Month Yen LIBOR	0.19	0.19	0.26
2-Year German	1.39	1.37	1.06
2-Year U.K.	1.48	1.26	1.17
2-Year Canadian	1.83	1.68	1.28
2-Year Japanese	0.22	0.21	0.17
10-Year German	3.23	3.15	3.16
10-Year U.K.	3.79	3.65	3.90
10-Year Canadian	3.44	3.25	3.37
10-Year Japanese	1.29	1.22	1.39

Commodity Prices

	Friday 2/4/2011	1 Week Ago	1 Year Ago
WTI Crude (\$/Barrel)	91.42	89.34	73.14
Gold (\$/Ounce)	1352.18	1336.75	1063.70
Hot-Rolled Steel (\$/S.Ton)	800.00	765.00	595.00
Copper (¢/Pound)	455.35	436.55	287.55
Soybeans (\$/Bushel)	14.11	13.75	8.91
Natural Gas (\$/MMBTU)	4.32	4.32	5.42
Nickel (\$/Metric Ton)	27,930	26,463	18,274
CRB Spot Inds.	612.72	603.57	469.44

Next Week's Economic Calendar

	Monday 7	Tuesday 8	Wednesday 9	Thursday 10	Friday 11
U.S. Data	Consumer Credit			Wholesale Inventories	
	November \$1.346B			November -0.2%	
	December \$2.0B (C)			December 0.8% (C)	
				Trade Balance	
				November -\$38.3B	
				December -\$39.6B (W)	

Global Data	Germany	Germany	China	U.K.	India
	Factory Orders (MoM)	IP (MoM)	Trade Balance	IP (MoM)	IP (YOY)
	Previous (Nov) 5.2%	Previous (Nov) -0.7%	Previous (Dec) \$13.08B	Previous (Nov) 0.4%	Previous (Nov) 2.7%
			Japan	U.K.	Mexico
			Machine Orders (MoM)	Policy Rate	IP (YOY)
			Previous (Nov) -3.0%	Previous (Jan) 0.5%	Previous (Nov) 5.3%

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

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