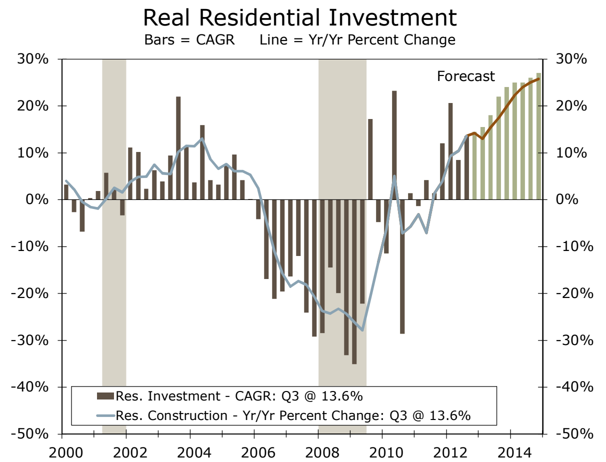
January 11, 2013

Economics Group

Weekly Economic & Financial Commentary

U.S. Review



Slower First Half, Better Second Half in 2013

- How you finish matters more than how you start – true in sports and true for the economy as well. Our expectation is that economic growth in the first half of this year will be modest at best given the uncertainties of fiscal policy and the reality of outright fiscal restraint due to numerous income tax increases.
- Residential investment is expected to continue its recovery in 2013 and will add even more to growth, while business investment, equipment and structures spending will also add to economic momentum. We expect the Fed will remain in an easing mode.

Global Review

ECB Stays on Hold, but Growth Is Very Weak

- As widely expected, the ECB kept its main policy rate on hold this week although growth in the Eurozone is weak. Real GDP in the overall euro area likely contracted for the fifth consecutive quarter in Q4 2012.
- Although the ECB acknowledges the weak state of the Eurozone economy at present, it believes that growth will turn positive again later this year. Financial conditions have eased considerably, destocking will not go on forever, and exports should strengthen somewhat. Unless growth weakens further, the ECB will likely refrain from cutting rates again.

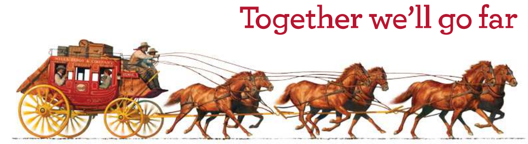
Wells Fargo U.S. Economic Forecast

	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	3.1	1.0	1.0	1.7	2.2	2.4	2.4	1.8	2.2	1.7	2.4
Personal Consumption	2.4	1.5	1.6	2.8	1.1	1.2	1.4	1.6	1.8	2.5	1.9	1.6	1.6
Inflation Indicators [2]													
PCE Deflator	2.4	1.6	1.5	1.5	1.1	1.3	1.3	1.4	1.9	2.4	1.7	1.3	1.9
Consumer Price Index	2.8	1.9	1.7	1.9	1.7	2.0	1.9	1.9	1.6	3.1	2.1	1.8	2.1
Industrial Production [1]	5.9	2.4	0.3	-0.5	2.1	3.5	4.1	4.1	5.4	4.1	3.6	2.0	3.8
Corporate Profits Before Taxes [2]	10.3	6.7	7.5	5.0	4.8	5.2	5.4	5.8	26.8	7.3	7.3	5.3	6.5
Trade Weighted Dollar Index [3]	72.7	74.5	72.7	73.3	74.0	75.0	76.0	77.0	75.4	70.9	73.5	75.5	74.5
Unemployment Rate	8.3	8.2	8.0	7.8	7.7	7.8	7.8	7.8	9.6	8.9	8.1	7.8	7.6
Housing Starts [4]	0.71	0.74	0.77	0.87	0.90	0.96	1.02	1.08	0.59	0.61	0.78	0.99	1.17
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	3.35	3.40	3.40	3.45	3.50	4.69	4.46	3.68	3.44	3.80
10 Year Note	2.23	1.67	1.65	1.78	1.80	1.90	2.00	2.10	3.22	2.78	1.80	1.95	2.50

Forecast as of: January 9, 2013
[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

Inside



U.S. Review

Growth: Strength After Fiscal Constraint

The first half of this year will be a period of short-run adjustment to fiscal restraint as well as uncertainty of policy going forward. Consumer spending is expected to rise at a 1.1 percent pace in Q1, while business fixed investment is expected to decline at a 1.0 percent pace. Overall growth should remain positive, thanks to the continued recovery in residential construction and a narrowing in the trade deficit. Real GDP is expected to grow at a 1.0 percent pace in Q1, matching what we believe growth was in the prior quarter.

Yet, growth is expected to gain momentum over the course of the year, as households and businesses adjust to the new fiscal framework and residential construction steadily improves. Even though real GDP is expected to rise just 1.7 percent in 2013, Q1 is the only period in which growth is expected to be below that figure.

Residential as the Bright Spot: Cycles Matter

Residential construction remains the economy's bright spot. Single-family housing starts are expected to rise 27 percent this year and multifamily starts should rise near 30 percent. The rebound in single-family construction comes from severely depressed levels and will provide only a modest direct boost to overall growth. Homebuilding has considerable knock-on effects, however, and gains in single-family starts will clearly help retailers, financial services, building products manufacturers and commercial development.

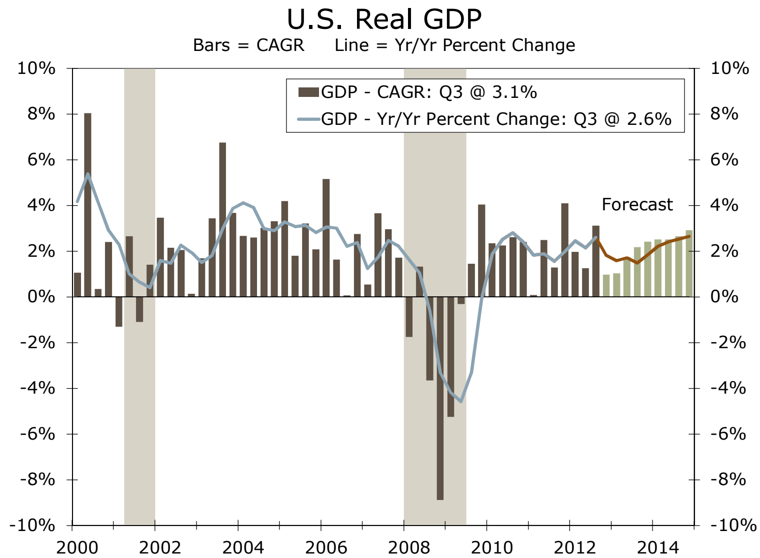
Government spending is still expected to weaken growth throughout 2013, as federal spending restraint will dominate any recovery in state/local spending.

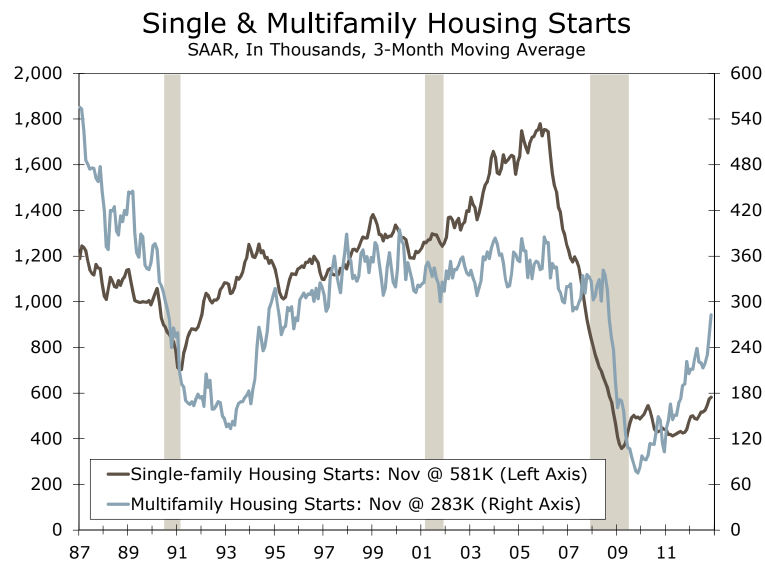
With economic growth off to a slow start in 2013, the Federal Reserve will keep policy on hold for the foreseeable future. The recent debate about whether the Fed is getting set to end its mortgage-purchase program makes for interesting theater, but is unlikely to produce meaningful results.

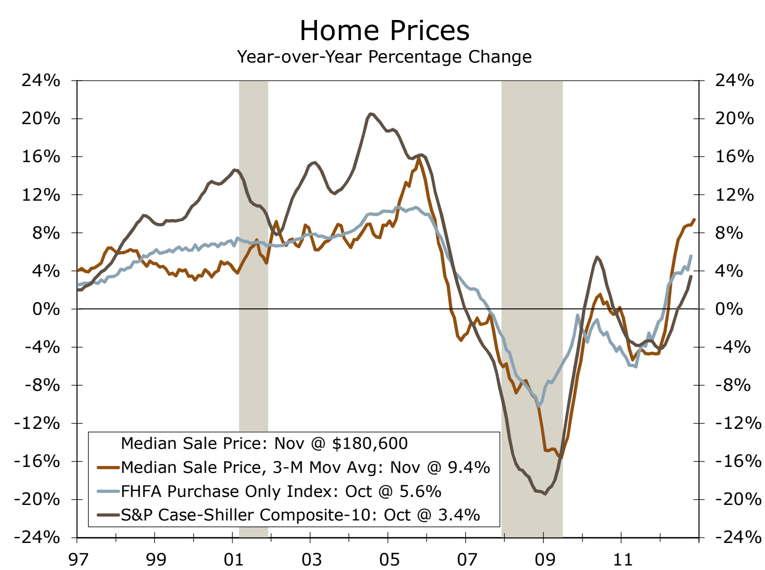
Continued Mending of the Economy –Within Limits

People and business leaders will seek to improve their lives and this basic impulse provides the momentum toward a constant mending of the economy unless nature or politics gets in the way. We have already seen that the housing market continues to strengthen as the excess inventory of homes has gradually diminished, household job/income prospects have improved, bank balance sheets have stabilized and finally, home prices themselves have moved upward. Even average hourly earnings have turned upward in recent months.

In the credit markets, the high-grade and high-yield bond markets along with securitization markets have certainly witnessed a recovery form 2008-2009 and now are in full expansion mode. Corporate profit growth is slowing but profits continue to grow. Our biggest challenge appears to be dealing with an economy that grows but at a slower pace that commands greater constraint on both public and private spending over time.







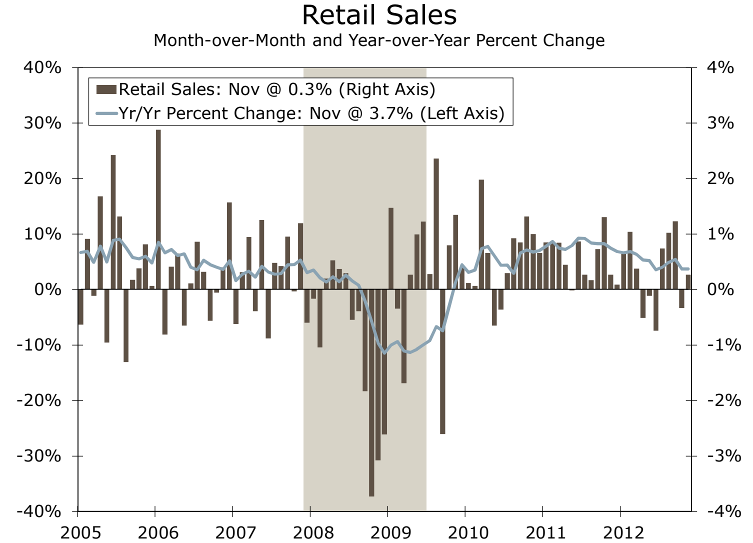
Source: U.S. Dept. of Commerce, S&P, FHFA and Wells Fargo Securities, LLC

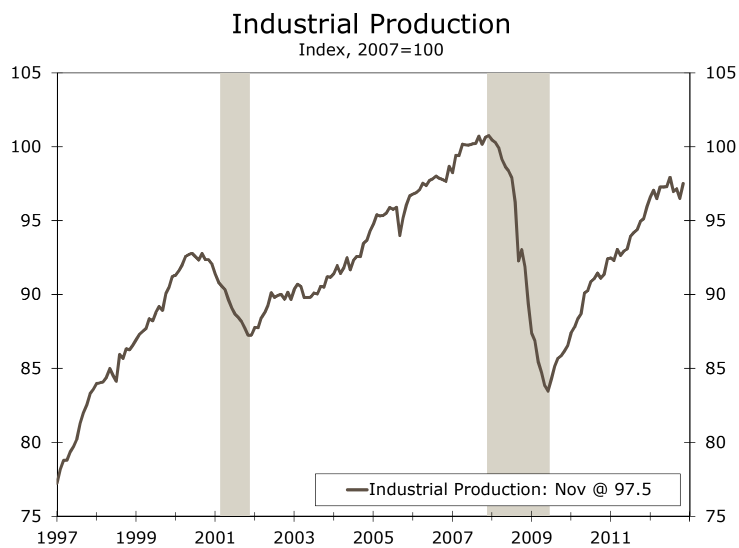
Retail Sales • Tuesday

Retail sales posted a modest rise in November, increasing 0.3 percent. The gain was driven by a rebound in auto sales and building materials, as well as a 3.0 percent increase in non-store sales, as shoppers forego the mall for the Internet. December likely saw another modest increase in retail sales. Total sales were likely dragged down by a 4.2 percent decline in gas prices, but boosted by auto and building material sales, as vehicle replacement and rebuilding efforts in the Northeast continued following Hurricane Sandy. Initial reports on 2012 holiday sales have indicated a weaker season this year. Although retail spending in November intimated consumers had largely shaken concerns over the fiscal cliff, confidence plunged in December and suggests that consumers were likely more cautious during the final weeks of the year. In addition, a series of storms in the Midwest and Northeast in the final days of the season likely kept some shoppers from hitting as many stores.

Previous: 0.3% (Month over Month) Wells Fargo: 0.3%

Consensus: 0.2%





Industrial Production • Wednesday

Following a 0.7 percent decline in October, industrial production rebounded 1.1 percent in November. Production was boosted by a surge in motor vehicles manufacturing and utilities. However, looking through the monthly noise, industrial production has largely moved sideways over the past few months.

With the payback effects of Hurricane Sandy behind us, we look for a flat print for industrial production in December. Purchasing managers' indexes indicate that manufacturing production remained weak in December. The ISM manufacturing survey's production index fell more than one point to 52.5, while the Dallas and Kansas City Federal Reserve Banks reported production declining in their regions. Also potentially weighing on December production was warmer-than-average weather, which would dampen utilities output.

Previous: 1.1% (Month over Month) Wells Fargo: 0.0%

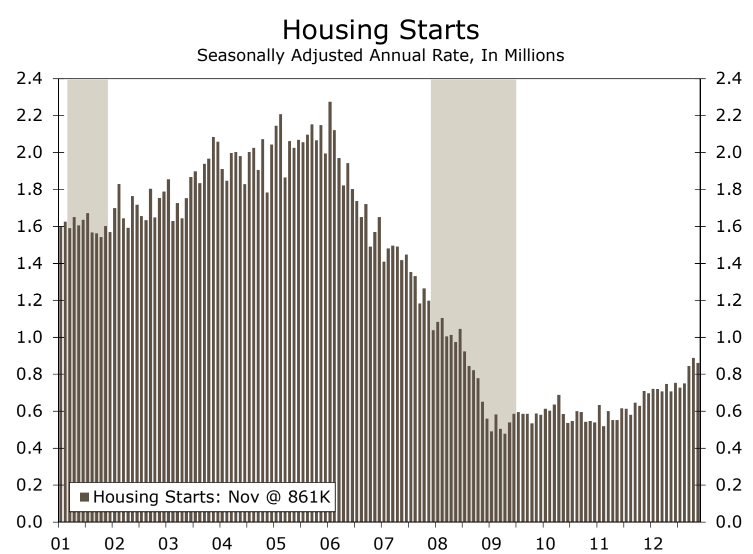
Consensus: 0.2%

Housing Starts • Thursday

Housing starts took a bit of a pause in November following strong gains in October and September. Starts fell 3.0 percent with a pullback in single-family and multifamily building. The decline came as little surprise as starts had been running ahead of permits over the previous three months. However, the solid upward trend in housing starts remains intact. Over the past three months, total starts have averaged 861,000, which is the strongest three-month pace since September 2008 when the financial crisis came to a head, and likely rose 28 percent in 2012. We expect the upward trend to continue, with starts increasing to an 890,000-unit annualized pace in December. Permits rose 3.6 in November and above-average temperatures likely helped more units break ground in December. In addition, builder confidence continued to improve over the month, with the NAHB/Wells Fargo index increasing two points to 47.

Previous: 861,000 Wells Fargo: 890,000

Consensus: 890,000



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

Global Review

ECB Stays on Hold, but Growth Is Very Weak

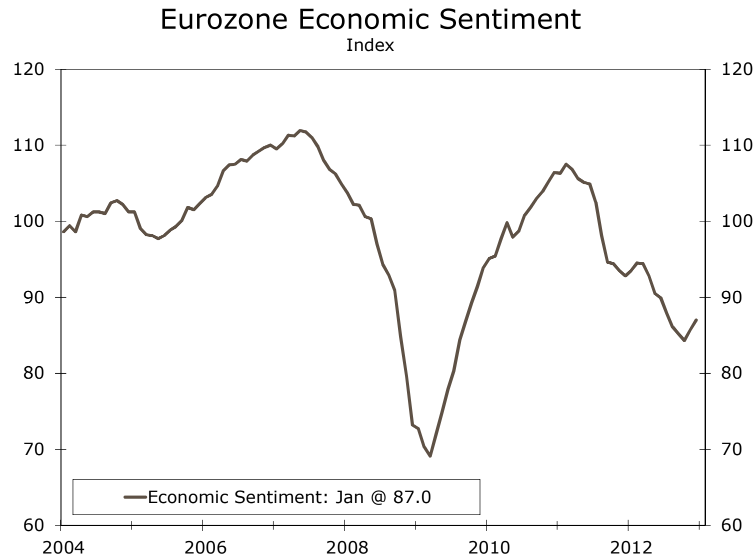
As widely expected the European Central Bank (ECB) decided on Thursday to keep its main policy rate unchanged at 0.75 percent, where it has been maintained since July. Given recent economic data out of the euro area, however, the ECB certainly would have had an excuse to cut rates further.

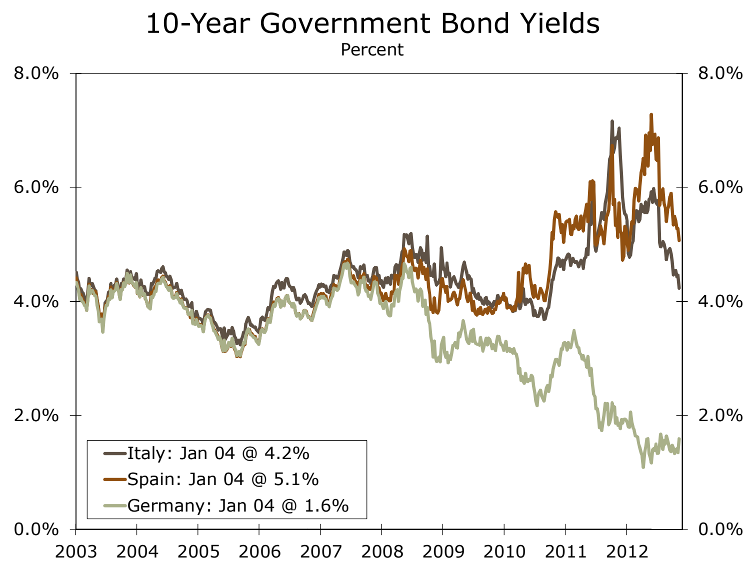
For example, industrial production (IP) in Germany edged up only 0.2 percent in November, a minor increase in light of the 2.0 percent decline that was registered in October. Indeed, German IP in the October-November period was 2.8 percent below the Q3 average, the fastest rate of contraction since autumn 2008 when the global economy was imploding (see the graph on page 1). Although IP in France is not quite as weak as in Germany, the former fell 1.6 percent in the October-November period relative to Q3. In other words, it appears likely that economic growth in Germany, the so-called "strong man" of Europe, and France likely turned negative in Q4.

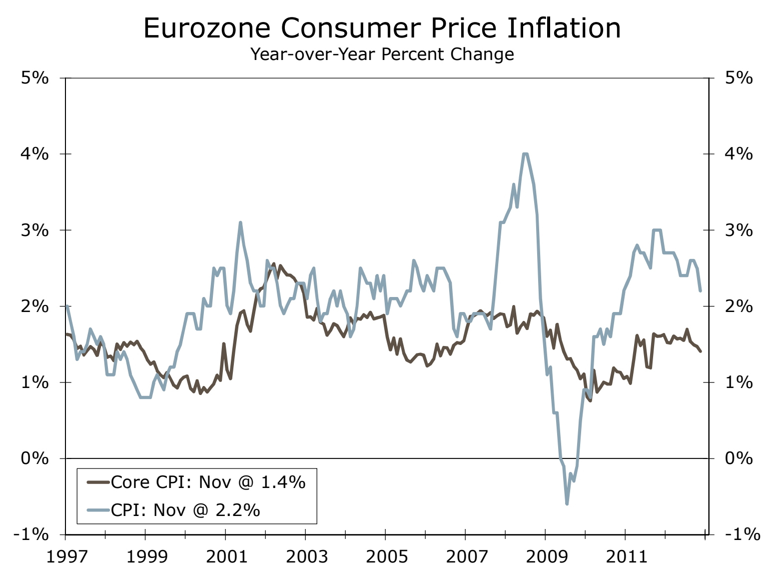
If growth in Germany and France, which together account for half of real GDP in the overall euro area, was negative, then real GDP in the Eurozone likely contracted for the fifth consecutive quarter in Q4 2012. That said, the decline in overall real GDP does not appear to be as severe as the downturn in industrial production would suggest, because available data indicate that the service sector is not quite as weak as the industrial sector. (The service sector in most economies tends to be less volatile than the industrial sector because the latter can be whipped around by inventory swings and foreign trade.) Indeed, there are some indications that economic activity in the Eurozone may be beginning to stabilize, albeit at low levels. For example, the economic sentiment indicator in the Eurozone rose in December and January (top chart).

At the ECB press conference, ECB President Draghi characterized the Eurozone economy as weak at present, but he stated that a gradual recovery should take hold later this year. We too look for growth to turn modestly positive again in the next quarter or two. Inventories fell sharply in Q3, which contributed to the contraction in real GDP, so an eventual inventory correction is inevitable, which should help support GDP. Moreover, financial conditions have eased markedly. Yields on Italian and Spanish government bonds have receded significantly (middle chart), and loan growth may be stabilizing, albeit at weak levels. The U.S. economy continues to expand and growth in Asia is looking a bit stronger, which together should help underpin European export growth. That said, further fiscal consolidation this year in some highly indebted European countries should constrain the pace of economic growth in the Eurozone.

CPI inflation is benign, which gives the ECB scope to ease further, should it choose to do so. However, the decision to keep rates on hold was unanimous this week, which means that the ECB will probably not cut rates again unless the economic data take a decided turn for the worst.







Source: IHS Global Insight and Wells Fargo Securities

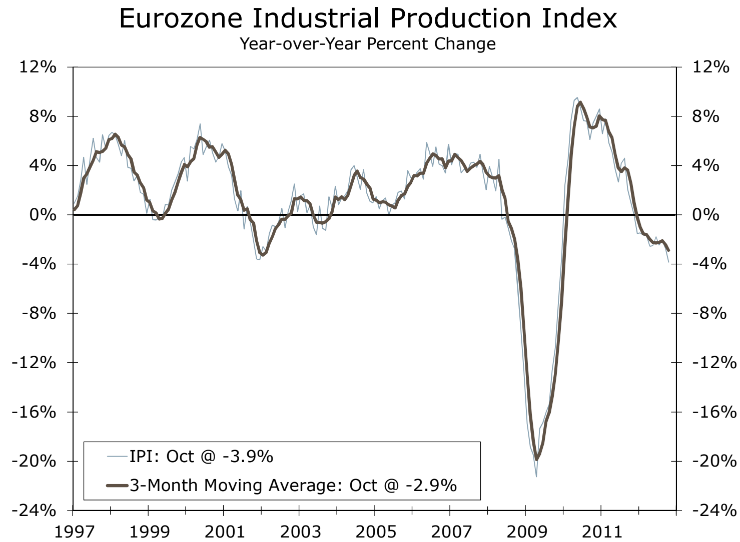
Eurozone Industrial Production • Monday

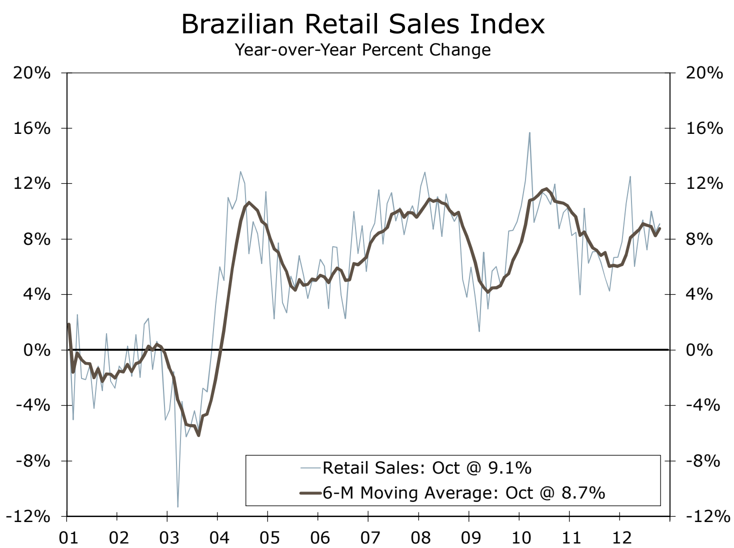
On Monday, we will get the release of the Eurozone industrial production (IP) data for November. Given the modest increase in IP in Germany and France in November (see page 4), a slight rise in IP in the overall euro area seems likely. That said, the year-over-year rate will likely remain in negative territory. Although IP may stabilize on a sequential basis over the next few months, we do not expect a rapid acceleration anytime soon due to continued fiscal consolidation in some important European countries.

On Tuesday, German statistical authorities will release their annual GDP growth estimate for 2012. Although Q4 GDP data will not be released until mid-February, analysts will be able to infer a growth rate for Q4 from the annual estimate. As noted on page 4, it seems likely that the German economy contracted in Q4. Next week's data will indicate how rapid the pace of contraction was.

Previous: -1.4% (Month over Month)

Consensus: 0.2%





Brazilian Retail Sales • Tuesday

Brazilian economic growth has been one of the biggest casualties of the worldwide slowdown, as Brazilian exports have been one of the pillars of economic growth since the devaluation of the currency in January 1999. However, since the slowdown in growth started, the central bank has lowered interest considerably in an attempt to keep the currency from appreciating further, while at the same time pushing Brazilians to consume domestically produced goods.

The central bank has been relatively successful in this objective as retail sales have improved but it has not been so successful in weakening the currency to push Brazilians to consume more goods produced domestically rather than traveling to other parts of the world and/or buy imported goods. Tuesday's release of the retail sales number for November will probably confirm that domestic consumption remains strong but that it is not enough to put the Brazilian economy on a stronger economic growth path.

Previous: 9.1% (Year over Year)

Consensus: 8.3%

Chinese GDP • Thursday

On Thursday, markets will have a chance to either confirm or reject recent speculation on the strength of the Chinese economy during Q4 2012 when the Chinese government releases the results for Chinese GDP for the last quarter of the year. Markets are expecting Q4 GDP growth to come in at 7.8 percent year over year compared to a 7.4 percent print during Q3 2012. Meanwhile, the expectation for economic growth for 2012 is 7.7 percent, down from a 9.3 percent rate during 2011 and 10.5 percent in 2010.

A better-than-expected release could be good news for commodity prices as well as emerging markets, as higher economic growth will probably keep commodity prices high and give some more ammunition for higher emerging market growth. However, the party will not be complete without stronger growth coming from the Eurozone and the United States.

Previous: 7.4% (Year over Year) **Wells Fargo: 7.6%**

Consensus: 7.8%

Source: IHS Global Insight and Wells Fargo Securities

Interest Rate Watch

Domestic and Global Forces

Treasury benchmark rates trade in a global marketplace and that has become evident in recent years and again this past week. Within the U.S. domestic market, the Fed still sets the benchmark for short-term interest rates and with economic growth off to a slow start in 2013, the Federal Reserve will keep policy on hold for the foreseeable future. We expect Fed purchases of securities to continue, thereby increasing its balance sheet, and liquidity in the marketplace to continue all year.

Global Influences: Growth

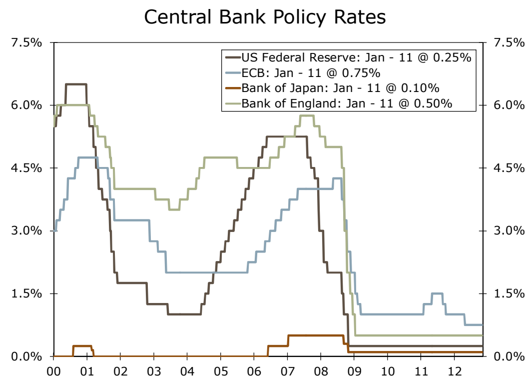
Yet, at the long-end of the curve, global perceptions of growth and sovereign risk continue to move the markets. Reports of a larger trade surplus in China indicate that its trading partners may be exhibiting stronger growth and so China growth may also be improving. In our 2013 outlook, we forecast stronger growth in China to 8.0 percent this year from 7.7 percent last year along with gains in Korea, India and Brazil. Our outlook has also improved for growth in the Eurozone. Our view has always been that Europe would muddle through and indeed it has.

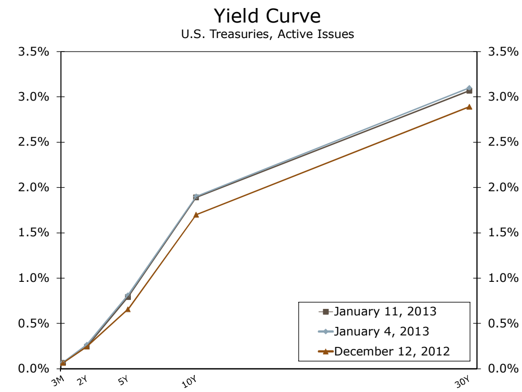
Yet, the recent concerns about Cyprus once again provide a flight-to-safety bid for the dollar and U.S. Treasury notes. The European debt crisis remains a long-term workout with the additional risk that private investors in sovereign debt may be asked to accept principal losses. Upcoming Italian elections reawaken concerns about political risk. Spain may also be in line for a financial bailout if financing costs continue their upswing.

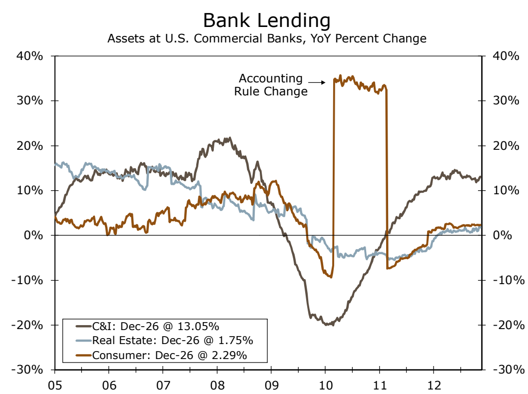
Domestic Politics

Debt ceiling and sequestration issues face us now. Our view is that there will be a bid for Treasury debt that will reflect the possible failure to raise the debt ceiling which will result in a shortage of floating Treasury debt for a while.

Over time, however, the debt ceiling will be raised and federal spending will continue such that our debt to GDP ratio will rise. As long as the Federal Reserve, China and Japan continue to buy Treasury debt then we expect the rise in Treasury yields in 2013 will be modest.







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

Credit Market Insights

Student Loans: A Growing Burden on the U.S. Economy

In the past, individuals assumed obtaining higher education unequivocally translated to professional success, but recent data suggest that obtaining a college degree in itself does not necessarily produce economic prosperity, especially in light of the high level of debt students often incur in the process. Over time, student loans as a percentage of non-mortgage debt outstanding has followed a positive, linear trajectory, rising to 35.3 percent in Q3 2012 from approximately 12 percent in 2003 and is now the main source of non-mortgage debt.

On Tuesday, the Federal Reserve released the Consumer Credit report for November, which revealed that non-revolving debt rose at an annual rate of 9.5 percent, or $15.2 billion. A majority of the increase in non-revolving debt stemmed from the federal government, whose main lending is in the form of student loans.

As college tuition rises at an accelerating pace, students continue to turn to the federal government for loans. Loans in which initial payments typically come due six months after graduation whether an individual is employed or not. Thus, student loans may have become more burdensome for recent graduates, whose average debt burden in 2011 was $26,600. Based on its current trajectory, the rising burden will continue to crowd out other types of borrowing as well as consumer spending.

Credit Market Data

Mortgage Rates	Current	Week Ago	4 Weeks Ago	Year Ago
30-Yr Fixed	3.40%	3.34%	3.32%	3.89%
15-Yr Fixed	2.66%	2.64%	2.66%	3.16%
5/1 ARM	2.67%	2.71%	2.70%	2.82%
1-Yr ARM	2.60%	2.57%	2.53%	2.76%

Bank Lending	Current Assets (Billions)	1-Week Change (SAAR)	4-Week Change (SAAR)	Year-Ago Change
Commercial & Industrial	$1,513.5	45.43%	40.88%	13.05%
Revolving Home Equity	$514.0	-5.85%	-9.85%	-6.36%
Residential Mortgages	$1,617.4	17.31%	7.12%	5.60%
Commerical Real Estate	$1,425.5	11.92%	7.67%	0.73%
Consumer	$1,117.3	10.86%	1.38%	2.29%

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

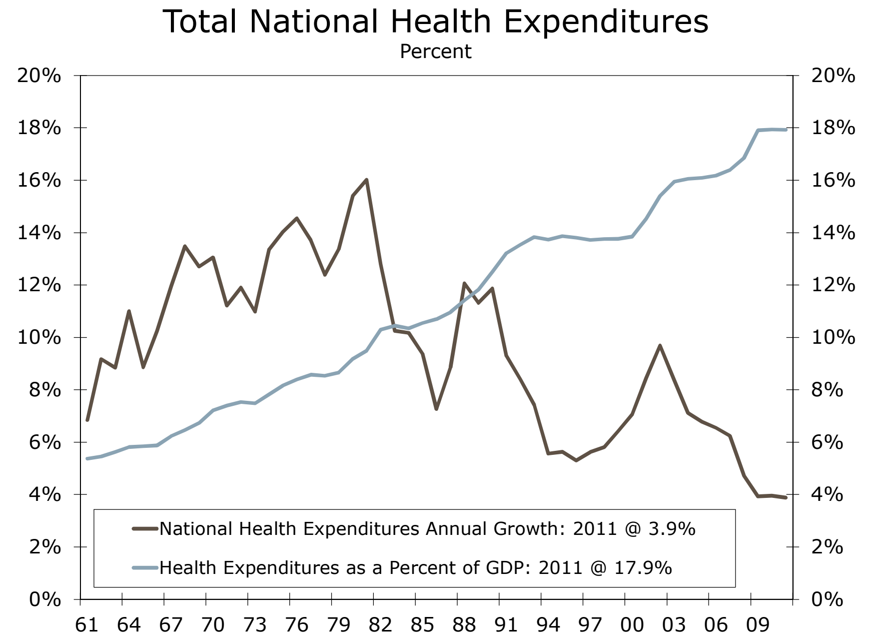
Topic of the Week

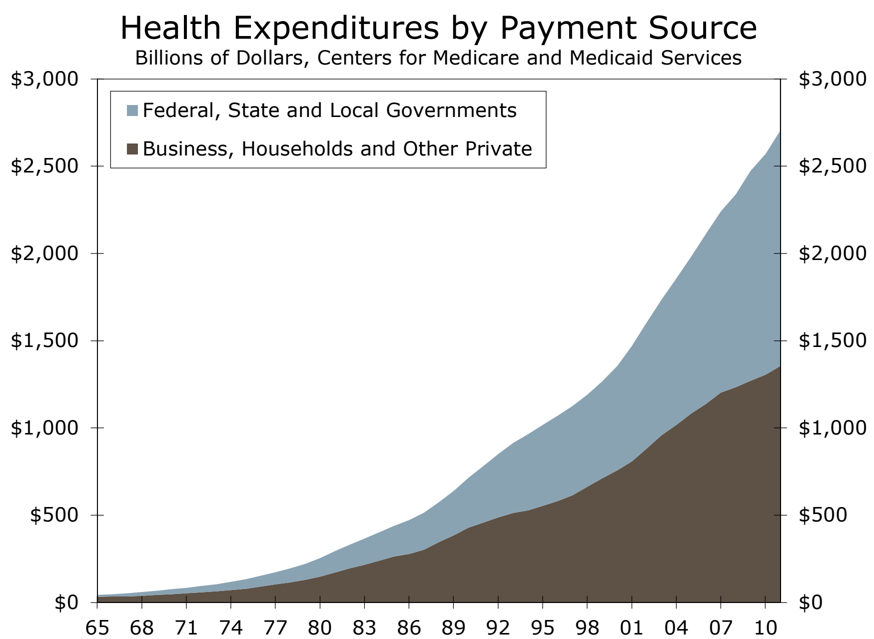
Health Spending: Secular Growth, Cyclical Trend

The United States spent $2.7 trillion, or roughly $8,680 per capita, on health care and health investments in 2011, an increase of 3.9 percent from 2010, showed a report by the Centers for Medicare & Medicaid Services (CMS) earlier this week. Moreover, health expenditures as a share of GDP remained high at 17.9 percent, continuing its long-run upward trend (top graph).

Yet, over the past couple of years, the growth of health expenditures has downshifted, likely reflecting the effects of the most recent recession. The economic downturn and the loss of more than 8.7 million jobs has constrained income growth and decreased the number of people with health insurance, likely altering health care consumption decisions even after the recession ended. As the pace of overall growth in health spending declined in 2011, expenditures for personal healthcare advanced 4.1 percent, accelerating over the 3.7 percent rate of the previous year. CMS attributes the growth to an increase in the use and intensity of services rather than rising prices. Despite acceleration in 2011, growth in physician and clinical services and retail prescription drug spending remains low compared to earlier years. The widespread substitution of generic prescription drugs for brand name drugs likely aided in the downshift. Hospital spending, on the other hand, continued on its downward trend and growth slowed to 4.3 percent in 2011 due to a number of factors, including waning hospital price growth and service usage.

Government has gradually increased its share of national health expenditures, rising to 45 percent in 2011from about 30 percent in 2002 (bottom graph). The aging of baby boomers and the expansion of Medicaid will edge the government's share even higher in the coming years. Moderate economic growth will keep health expenditures in check in 2012; however, continued improvement and the introduction of policies aimed at increasing the availability and use of health care will impose upward pressure on costs in the years ahead.





Source: Centers for Medicare & Medicaid Services and Wells Fargo Securities, LLC

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 1/11/2013	1 Week Ago	1 Year Ago
3-Month T-Bill	0.06	0.07	0.02
3-Month LIBOR	0.30	0.31	0.58
1-Year Treasury	0.16	0.20	0.15
2-Year Treasury	0.24	0.26	0.23
5-Year Treasury	0.79	0.81	0.82
10-Year Treasury	1.89	1.90	1.90
30-Year Treasury	3.07	3.10	2.96
Bond Buyer Index	3.60	3.68	3.62

Foreign Exchange Rates

	Friday 1/11/2013	1 Week Ago	1 Year Ago
Euro ($/€)	1.328	1.307	1.271
British Pound ($/£)	1.612	1.607	1.533
British Pound (£/€)	0.824	0.813	0.829
Japanese Yen (¥/$)	88.990	88.150	76.850
Canadian Dollar (C$/$)	0.983	0.987	1.020
Swiss Franc (CHF/$)	0.916	0.925	0.954
Australian Dollar (US$/A$	1.057	1.048	1.031
Mexican Peso (MXN/$)	12.620	12.742	13.609
Chinese Yuan (CNY/$)	6.216	6.231	6.315
Indian Rupee (INR/$)	54.763	55.075	51.895
Brazilian Real (BRL/$)	2.033	2.033	1.803
U.S. Dollar Index	79.830	80.499	81.351

Foreign Interest Rates

	Friday 1/11/2013	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.13	0.13	1.20
3-Month Sterling LIBOR	0.51	0.52	1.09
3-Month Canadian LIBOR	1.23	1.24	1.36
3-Month Yen LIBOR	0.17	0.17	0.20
2-Year German	0.11	0.08	0.14
2-Year U.K.	0.39	0.46	0.39
2-Year Canadian	1.19	1.21	0.95
2-Year Japanese	0.09	0.10	0.13
10-Year German	1.56	1.54	1.81
10-Year U.K.	2.06	2.12	2.01
10-Year Canadian	1.94	1.94	1.94
10-Year Japanese	0.82	0.83	0.97

Commodity Prices

	Friday 1/11/2013	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	93.15	93.09	100.87
Gold ($/Ounce)	1668.38	1655.65	1641.97
Hot-Rolled Steel ($/S.Ton)	640.00	645.00	733.00
Copper (¢/Pound)	367.75	369.35	354.60
Soybeans ($/Bushel)	13.99	14.16	12.14
Natural Gas ($/MMBTU)	3.25	3.29	2.77
Nickel ($/Metric Ton)	17,344	17,446	19,485
CRB Spot Inds.	532.50	529.06	522.47

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	14	15	16	17	18
U.S. Data		**Retail Sales** November 0.3% December 0.3% (W) **PPI** November -0.8% December -0.1% (W) **Business Inventories** October 0.4% November 0.4% (W)	**CPI** November -0.3% December 0.0% (W) **Industrial Production** November 1.1% December 0.0% (W) **Capacity Utilization** November 78.4% December 78.4% (W)	**Housing Starts** November 861K December 890K (W) **Building Permits** November 900K December 904K (C)	
Global Data	**Eurozone** **IP (YoY)** Previous (Oct) -3.6%	**Brazil** **Retail Sales (YoY)** Previous (Oct) 9.1% **Japan** **Machine Tool Orders** Previous (Nov) -21.3%		**China** **Real GDP (YoY)** Previous (3Q) 7.4% **China** **IP (YoY)** Previous (Nov) 10.1%	

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

Source: Bloomberg LP and Wells Fargo Securities, LLC

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