February 06, 2013

Economics Group

WELLS FARGO SECURITIES

MONTHLY OUTLOOK

U.S. Overview

Relief, But Little Excitement

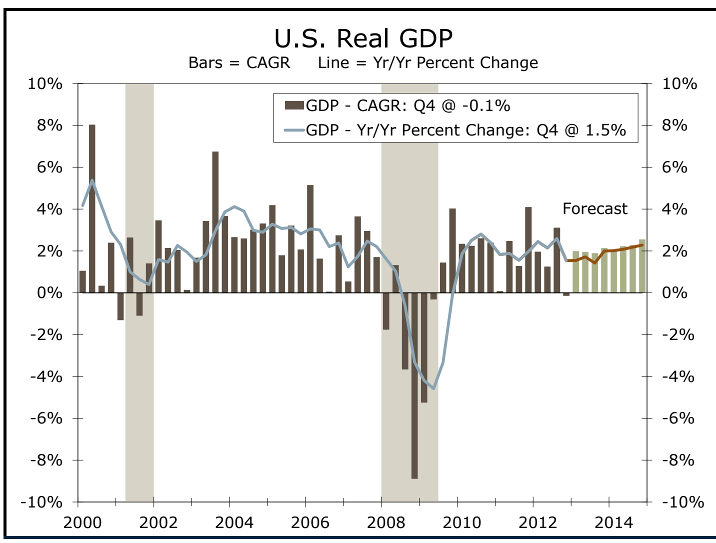
Trend economic growth, low inflation and steady Fed policy provide the framework for our economic outlook. For the first half of this year, our outlook is for trend growth of 2.0 percent with contributions from consumer spending, business investment in both equipment & software and structures, and net exports as well as residential investment. Detracting from growth will be government spending and inventories. Current strength in consumer spending for the first quarter will likely slow as tax increases reduce disposable income. Equipment & software and structures should add to growth in the first half of this year, but at a slower pace than last year, as fiscal restraint hits contract spending and taxes rise. Residential investment will provide some offset to slower domestic demand elsewhere as housing affordability, demographics and the lure of low interest rates relative to home price appreciation support further recovery in the housing sector.

Inflation remains a back-burner issue for the economy and the Federal Reserve. The personal consumption deflator and the consumer price index measures of inflation remain below any threat point for the Fed. Corporate profit growth continues to slow as is typical at this stage of business expansion as unit labor costs rise, while top-line revenue gains remain steady. The outlook for growth and inflation supports the case for the Fed to remain on autopilot, with its open-ended Treasury and MBS bond buying program for the foreseeable future–given the expectation of 7 percent plus unemployment rates for both 2013 and the greater part of next year as well.

International Overview

No Bad News: Good News for the Global Economy

After several years of weak and worrying news coming from the rest of the world, the first impressions coming from the global economy this year seem to have helped the mood for markets all across the world. Recent data confirm that the worst seems to be over and, while the future remains as uncertain as ever, at least there are reasons for optimism. Although the Eurozone is expected to remain in recession through the first quarter of the year, we expect the larger and stronger economies to help pull the region out of its current state during the rest of the year. The developed world is close to its limit in terms of fiscal sustainability and remains a threat to the rest of the global economy. Thus, the developing world will need to be more proactive with its fiscal levers to complement monetary policy expansion. Meanwhile, the global economy is starting to see some improvement coming from the usual suspects, spearheaded by economic growth in the United States and slightly better-than-expected Chinese economic growth. The latest purchasing managers' indices (PMIs) for developed and emerging economies, as well as many manufacturing production indices across the world are pointing to a tenuous but positive recovery in economic activity. Meanwhile, service sector activity continues to advance, indicating that global consumption may be better than expected. It is too early to tell with certainty, but the worst of the global slowdown may be over. And, this is good news.



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

This report is available on wellsfargo.com/economics and on Bloomberg WFEC.

So, This Is the New Normal?

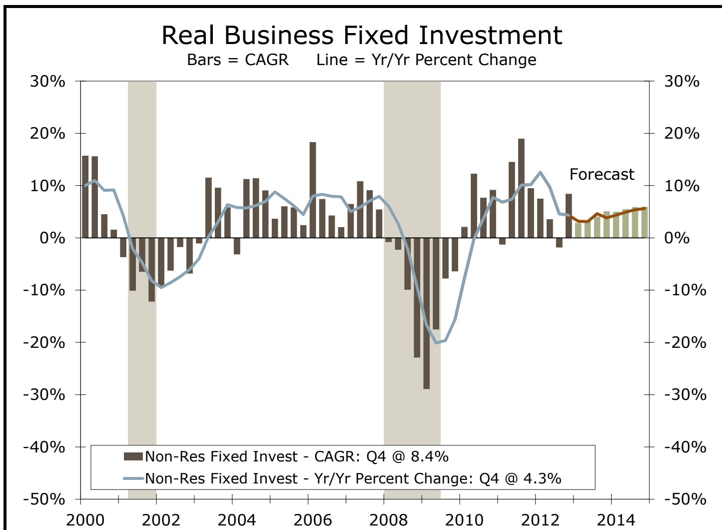
After averaging 2.1 percent GDP growth for the past three years, 2013 is setting up to be a 1.7 percent growth year with unemployment persisting at 7 percent plus and inflation below 2 percent. Meanwhile, interest rates remain remarkably low as we expect the 10-year rate to stay in the 2 percent plus range. So, this is it?

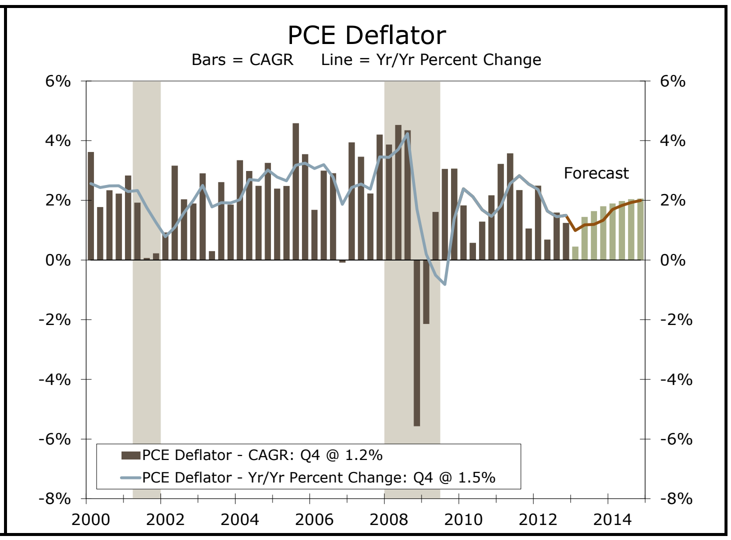
After a dismal fourth quarter, economic growth is expected to resume a trend 2.0 growth path in the first half of this year with gains in consumer spending, structures and residential investment leading the way. Steady gains in nominal personal income and employment should support consumer spending, but the increase in the payroll tax and higher taxes for the Affordable Care Act will limit real disposable income growth. For 2013, we expect consumer spending gains of 1.6 percent compared to 1.9 percent in 2012. Residential investment continues to improve, with housing starts expected to reach 990,000 at an annual rate in 2013 compared to 780,000 last year. Residential investment, both new starts and remodeling, will add to growth, although housing remains a small slice of overall GDP. Commercial real estate should also support growth this year. Office, industrial and retail development will likely see modest gains off its recent low levels. Energy projects and oil and gas development, which had been a huge source of growth, have cooled off in recent quarters.

Unfortunately, the contribution to growth from business investment should slow and government spending will be an outright drag on growth. We expect equipment & software spending will grow about 3 percent in the first half of this year after a gain of almost 7 percent in 2012. Orders for capital goods have slowed, and the diminished effect of the capital tax allowance along with slower profit growth will further hit investment spending. Net exports provide a positive boost to growth in 2013 compared to a flat 2012. Imports have slowed sharply, thereby allowing the net export number to make a solid positive contribution to growth. Federal and local government spending will likely continue to be a drag on growth.

Inflation, Interest Rates and Profits

For the Federal Reserve, the benchmark inflation gauge, the PCE deflator, remains comfortably below the 2 percent target. Latest indications suggest that the CPI benchmark inflation rate will also remain below 2 percent for 2013. Housing and crude oil prices should drift upward as the year unfolds but are not likely to accelerate. As for interest rates, our outlook suggests little to alter the current path of Fed policy and thereby the path of short-term rates. However, the 10-year rate continues its disconnect from inflation as 2013 will represent the third year in a row where consumer inflation exceeds the return on the 10-year Treasury note. Our expectation is that 10-year Treasury and mortgage rates will gradually rise in the year ahead. Moreover, the rise in home prices now exceeds the mortgage rate, so that the persistence of low long-term rates remains a risk to decision makers in the coming year. Profit growth is expected to slow in the year ahead as would be typical of the path of profits over the business cycle. In the first phase of this cycle, top-line sales growth supported a sharp profit rebound as cost efficiencies supported the operating leverage of many companies. Yet, as the cycle continues, we should witness the gradual decline in productivity and the rise in unit labor costs. For the fourth quarter of 2012, for example, we estimate a decline in productivity and a rise in unit labor costs of more than 2 percent, thereby supporting our outlook for a slowdown in pre-tax profits in the fourth quarter that will likely continue into this year.





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

Wells Fargo U.S. Economic Forecast

	Actual								Forecast								Actual			Forecast	
	2011				2012				2013				2014				2010	2011	2012	2013	2014
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product (a)	0.1	2.5	1.3	4.1	2.0	1.3	3.1	-0.1	2.0	2.0	1.9	2.1	2.1	2.2	2.3	2.6	2.4	1.8	2.2	1.7	2.1
Personal Consumption	3.1	1.0	1.7	2.0	2.4	1.5	1.6	2.2	1.8	1.3	1.1	1.6	1.7	1.8	1.8	1.9	1.8	2.5	1.9	1.6	1.6
Business Fixed Investment	-1.3	14.5	19.0	9.5	7.5	3.6	-1.8	8.4	2.9	3.3	4.1	5.1	5.0	5.5	5.9	6.0	0.7	8.6	7.7	3.7	5.1
Equipment and Software	11.1	7.8	18.3	8.8	5.4	4.8	-2.6	12.4	2.5	3.0	3.8	4.8	4.5	5.0	5.4	5.5	8.9	11.0	6.9	4.2	4.7
Structures	-28.2	35.2	20.7	11.5	12.9	0.6	0.0	-1.1	2.0	4.0	5.0	6.0	6.5	7.0	7.5	7.5	-15.6	2.7	9.6	2.1	6.4
Residential Construction	-1.4	4.2	1.4	12.0	20.6	8.4	13.6	15.3	17.5	18.0	22.0	24.0	25.0	25.0	26.0	27.0	-3.7	-1.4	11.9	17.1	24.3
Government Purchases	-7.0	-0.8	-2.9	-2.2	-3.0	-0.7	3.9	-6.6	-1.3	-3.1	-3.0	-3.7	-3.3	-2.4	-3.9	-3.4	0.6	-3.1	-1.7	-2.4	-3.2
Net Exports	-416.6	-399.6	-397.9	-418.0	-415.5	-407.4	-395.2	-404.0	-391.9	-371.5	-357.2	-344.6	-341.5	-343.0	-339.3	-335.1	-419.7	-408.0	-405.5	-366.3	-339.7
Pct. Point Contribution to GDP	0.0	0.5	0.0	-0.6	0.1	0.2	0.4	-0.3	0.4	0.6	0.4	0.4	0.1	0.0	0.1	0.1	-0.5	0.1	0.0	0.3	0.2
Inventory Change	30.3	27.5	-4.3	70.5	56.9	41.4	60.3	20.0	28.0	33.5	38.5	40.5	41.5	41.5	42.0	42.0	50.9	31.0	44.7	35.1	41.8
Pct. Point Contribution to GDP	-0.5	0.0	-1.1	2.5	-0.4	-0.5	0.7	-1.3	0.2	0.2	0.1	0.1	0.0	0.0	0.0	0.0	1.5	-0.2	0.1	-0.1	0.0
Nominal GDP	2.2	5.2	4.3	4.2	4.2	2.8	5.9	0.5	4.3	4.0	3.9	4.2	4.2	4.4	4.5	4.8	3.8	4.0	4.0	3.6	4.3
Real Final Sales	0.6	2.4	2.4	1.5	2.4	1.7	2.4	1.1	2.1	1.8	1.8	2.1	2.0	2.2	2.3	2.6	0.9	2.0	2.0	1.8	2.1
Retail Sales (b)	7.9	8.1	8.6	7.4	6.6	4.7	4.8	4.2	3.2	4.4	4.4	4.4	4.9	5.4	5.5	5.7	5.5	8.0	5.0	4.1	5.4
Inflation Indicators (b)																					
PCE Deflator	1.8	2.6	2.8	2.5	2.4	1.6	1.5	1.5	1.0	1.2	1.2	1.3	1.7	1.8	1.9	2.0	1.9	2.4	1.7	1.2	1.9
Consumer Price Index	2.1	3.3	3.8	3.3	2.8	1.9	1.7	1.9	1.5	1.8	1.7	1.7	2.1	2.1	2.1	2.2	1.6	3.1	2.1	1.7	2.1
"Core" Consumer Price Index	1.1	1.5	1.9	2.2	2.2	2.3	2.0	1.9	1.8	1.7	1.8	1.9	2.0	2.0	2.1	2.1	1.0	1.7	2.1	1.8	2.0
Producer Price Index	4.8	6.6	7.0	5.5	3.5	1.1	1.5	1.7	1.2	2.7	1.8	1.9	2.5	2.6	2.7	2.7	4.2	6.0	1.9	1.9	2.6
Employment Cost Index	2.0	2.2	2.0	2.0	1.9	1.7	2.0	1.9	2.1	2.0	2.0	2.0	2.8	2.3	2.2	2.3	1.3	2.6	1.9	2.0	2.4
Real Disposable Income (a)	4.4	-1.5	-1.3	-0.2	3.7	2.2	0.5	6.8	-2.1	1.5	1.8	1.8	2.1	2.2	2.3	2.3	1.8	1.3	1.5	1.5	2.0
Nominal Personal Income (b)	6.3	5.3	4.7	4.1	2.9	3.0	3.3	4.9	4.4	4.2	4.5	3.9	3.7	3.8	3.9	3.4	3.8	5.1	3.5	4.3	3.7
Industrial Production (a)	4.4	1.2	5.6	5.1	5.9	2.4	0.4	1.0	2.4	3.5	4.1	4.1	3.5	3.8	4.1	4.1	5.4	4.1	3.7	2.4	3.8
Capacity Utilization	76.2	76.3	77.1	77.9	78.7	78.9	78.6	78.5	78.8	79.1	79.4	79.5	79.6	79.8	80.0	80.2	73.7	76.8	78.7	79.2	79.9
Corporate Profits Before Taxes (b)	4.6	10.8	4.7	9.2	10.3	6.7	7.5	5.0	4.8	5.2	5.3	5.7	6.1	6.3	6.5	6.7	26.8	7.3	7.3	5.3	6.4
Corporate Profits After Taxes	2.1	11.0	7.8	14.5	9.2	4.4	3.2	3.7	4.0	4.5	4.6	5.1	5.5	5.7	5.9	6.0	23.9	8.9	5.0	4.6	5.8
Federal Budget Balance (c)	-460.5	-141.1	-326.3	-321.7	-457.2	-125.3	-185.0	-292.4	-232.6	-155.0	-220.0	-200.0	-215.0	-165.0	-220.0	-200.0	-1294.2	-1296.8	-1089.2	-900.0	-800.0
Current Account Balance (d)	-120.0	-119.1	-108.2	-118.7	-133.6	-118.1	-107.5	-110.0	-115.0	-120.0	-120.0	-125.0	-125.0	-125.0	-130.0	-130.0	-442.0	-465.9	-469.2	-480.0	-510.0
Trade Weighted Dollar Index (e)	70.5	69.2	72.8	73.3	72.7	74.5	72.7	73.4	73.0	74.0	75.0	76.0	76.5	76.5	77.0	77.0	75.4	70.9	73.5	74.5	76.8
Nonfarm Payroll Change (f)	156.7	209.3	145.0	190.0	262.3	108.0	152.0	201.0	164.7	170.0	180.0	180.0	180.0	180.0	180.0	210.0	85.2	175.3	180.8	173.7	187.5
Unemployment Rate	9.0	9.0	9.0	8.7	8.3	8.2	8.0	7.8	7.8	7.6	7.5	7.4	7.3	7.2	7.1	7.0	9.6	8.9	8.1	7.6	7.2
Housing Starts (g)	0.58	0.57	0.61	0.68	0.71	0.74	0.77	0.90	0.90	0.96	1.02	1.08	1.12	1.15	1.20	1.23	0.59	0.61	0.78	0.99	1.18
Light Vehicle Sales (h)	12.7	12.2	12.6	13.5	14.1	14.1	14.5	15.0	14.8	14.5	14.8	15.0	15.2	15.3	15.4	15.5	11.6	12.7	14.4	14.8	15.4
Crude Oil - Brent - Front Contract (i)	105.21	116.88	111.79	108.43	118.12	108.68	109.03	109.56	112.00	113.00	115.00	116.00	118.00	120.00	122.00	124.00	80.47	110.58	111.35	114.0	121.0
Quarter-End Interest Rates (j)																					
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	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3 Month LIBOR	0.30	0.25	0.37	0.58	0.47	0.46	0.36	0.31	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.34	0.34	0.43	0.30	0.30
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Conventional Mortgage Rate	4.84	4.51	4.11	3.96	3.95	3.68	3.50	3.35	3.50	3.60	3.70	3.80	3.90	4.10	4.30	4.50	4.69	4.46	3.66	3.65	4.20
3 Month Bill	0.09	0.03	0.02	0.02	0.07	0.09	0.10	0.05	0.10	0.15	0.20	0.30	0.30	0.35	0.40	0.45	0.14	0.05	0.09	0.19	0.38
2 Year Note	0.80	0.45	0.25	0.25	0.33	0.33	0.23	0.25	0.30	0.40	0.50	0.60	0.70	0.90	1.10	1.20	0.70	0.45	0.28	0.45	0.98
5 Year Note	2.24	1.76	0.96	0.83	1.04	0.72	0.62	0.72	0.80	0.90	1.00	1.10	1.20	1.40	1.60	1.80	1.93	1.52	0.76	0.95	1.50
10 Year Note	3.47	3.18	1.92	1.89	2.23	1.67	1.65	1.78	1.90	2.00	2.10	2.20	2.30	2.50	2.70	2.90	3.22	2.78	1.80	2.05	2.60
30 Year Bond	4.51	4.38	2.90	2.89	3.35	2.76	2.82	2.95	2.80	2.90	3.00	3.10	3.20	3.40	3.60	3.80	4.25	3.91	2.92	2.95	3.50

Forecast as of: February 6, 2013

Notes: (a) Compound Annual Growth Rate Quarter-over-Quarter
(b) Year-over-Year Percentage Change
(c) Quarterly Sum - Billions USD; Annual Data Represents Fiscal Yr.
(d) Quarterly Sum - Billions USD
(e) Federal Reserve Major Currency Index, 1973=100 - Quarter End
(f) Average Monthly Change
(g) Millions of Units
(h) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold
(i) Quarterly Average of Daily Close
(j) Annual Numbers Represent Averages

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

No Bad News: Good News for the Global Economy

After several years of weak and worrying news coming from the rest of the world, recent data coming from the global economy this year seem to have helped the mood for markets all across the world. The news that has been coming in confirms that the worst seems to be over and, although the future remains as uncertain as ever, at least there are reasons for optimism. While the Eurozone is expected to remain in recession during the first quarter of the year and some of the periphery countries are still trapped in a vicious downward spiral, we expect the larger and stronger economies to help pull the region out of its current state during the rest of the year.

However, for this to occur, the world needs better news coming from the U.S. economy and larger emerging markets, especially from the Chinese economy. Up to now, we were looking at the glass half-empty, while today markets seem to be concentrating more on the glass half-full. The global economy needs to see more growth across those countries that make a difference. And, this is not going to be easy. Much of the emerging market economies were growing through exports and were taking advantage of selling goods to high-income consumers from developed countries. However, this export-oriented model showed its cracks as the developed countries of the world entered the financial crisis of 2008 and 2009 and have been hindered since by the costs associated with preventing an economic depression.

The developed world today is close to its limit in terms of fiscal sustainability and remains a threat, not only to itself but, most important, to the rest of the global economy. This means that there is little the developed world can do to lift economic growth through active fiscal policies and will have to be content with continuing to use monetary policy and hope that this alone can do the trick. Thus, the developing world will need to be more proactive with its fiscal levers to complement monetary policy expansion from the developed world.

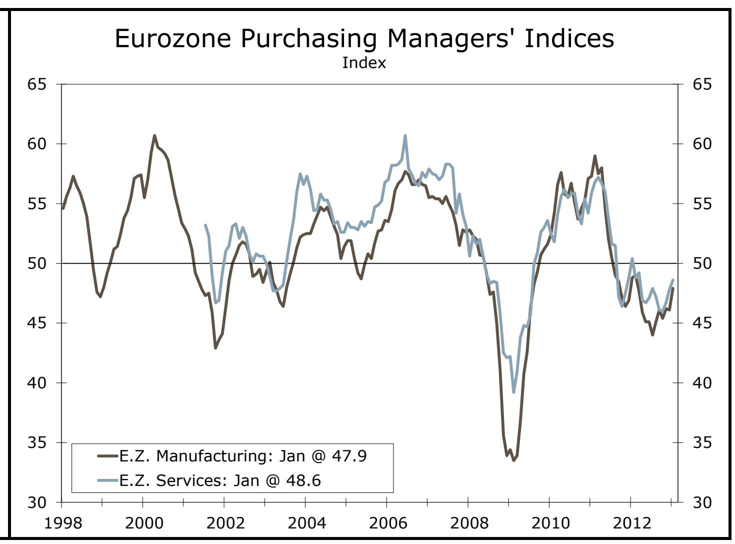
However, the limits posed by the problems facing developed countries are also threatening the sustainability of export-oriented growth of very open economies, such as Germany and Japan, and most emerging nations, as they have put almost all of their eggs in the same basket, i.e., in the export-oriented growth basket. Some of these countries, especially the developing countries, are in the process of reassessing their models to put more weight on internal demand, something that is easier said than done. For the euro region, this is also difficult as the larger export-oriented countries have come to depend on consumption from other Eurozone members' citizens, which today are incapable of delivering.

China, which has relied on robust investment spending and exports to drive economic growth over the past few decades, is trying to transition to a more consumer-driven model of growth. The process will not happen overnight and GDP growth likely will be slower in the coming decade than it has been. However, economic growth in China likely will be more sustainable in the long run if Chinese policymakers succeed in their attempts to reorient the economy.

Better Economic Performance Expected

The global economy is starting to see some improvements coming from the usual suspects, spearheaded by stability from economic growth in the United States and slightly better-than-expected Chinese economic growth.

The latest purchasing manager's indices (PMIs) for developed and emerging economies as well as many manufacturing production indices across the world are pointing to a tenuous but positive recovery in economic activity. Meanwhile, service sector activity continues to advance, indicating that global consumption may be better than expected. It is too early to tell with certainty, but the worst of the global slowdown may be over. And, this is good news.



Source: Bloomberg LP and Wells Fargo Securities, LLC

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP			CPI		
	2012	2013	2014	2012	2013	2014
Global (PPP weights)	2.7%	2.8%	3.5%	4.2%	4.1%	4.1%
Global (Market Exchange Rates)	1.5%	1.6%	2.2%	n/a	n/a	n/a
Advanced Economies[1]	1.3%	1.1%	2.3%	2.1%	1.5%	1.9%
United States	2.2%	1.7%	2.1%	2.1%	1.7%	2.1%
Eurozone	-0.5%	0.2%	1.8%	2.5%	1.5%	1.9%
United Kingdom	0.0%	1.0%	2.0%	2.8%	2.3%	2.0%
Japan	2.0%	0.4%	2.4%	0.0%	0.0%	0.1%
Korea	2.1%	2.3%	4.1%	2.2%	2.6%	3.1%
Canada	2.0%	1.7%	2.7%	1.5%	1.3%	2.0%
Developing Economies[1]	4.5%	4.9%	5.4%	6.7%	7.0%	7.2%
China	7.7%	8.1%	8.4%	2.7%	3.2%	3.5%
India	5.4%	6.3%	6.8%	9.3%	8.7%	8.9%
Mexico	4.1%	3.3%	3.4%	4.1%	4.1%	4.8%
Brazil	0.8%	2.2%	4.2%	5.4%	6.3%	6.1%
Russia	3.4%	3.1%	3.7%	5.1%	6.0%	5.5%

Forecast as of: February 6, 2013

[1]Aggregated Using PPP Weights

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	3-Month LIBOR						10-Year Bond					
	2013				2014		2013				2014	
	Q1	Q2	Q3	Q4	Q1	Q2	Q1	Q2	Q3	Q4	Q1	Q2
U.S.	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	1.90%	2.00%	2.10%	2.20%	2.30%	2.50%
Japan	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.85%	0.90%	0.95%	1.05%	1.10%	1.15%
Euroland*	0.15%	0.20%	0.30%	0.40%	0.60%	0.80%	1.60%	1.70%	1.90%	2.10%	2.40%	2.70%
U.K.	0.50%	0.50%	0.50%	0.50%	0.60%	0.70%	2.15%	2.25%	2.40%	2.60%	2.80%	3.20%
Canada	1.20%	1.20%	1.20%	1.40%	1.50%	1.70%	2.00%	2.20%	2.40%	2.80%	3.20%	3.30%

Forecast as of: February 6, 2013

*10-year German Government Bond Yield

Source: IHS Global Insight and Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

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