

**WELLS
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SECURITIES

Economic Outlook for 2011 and Beyond

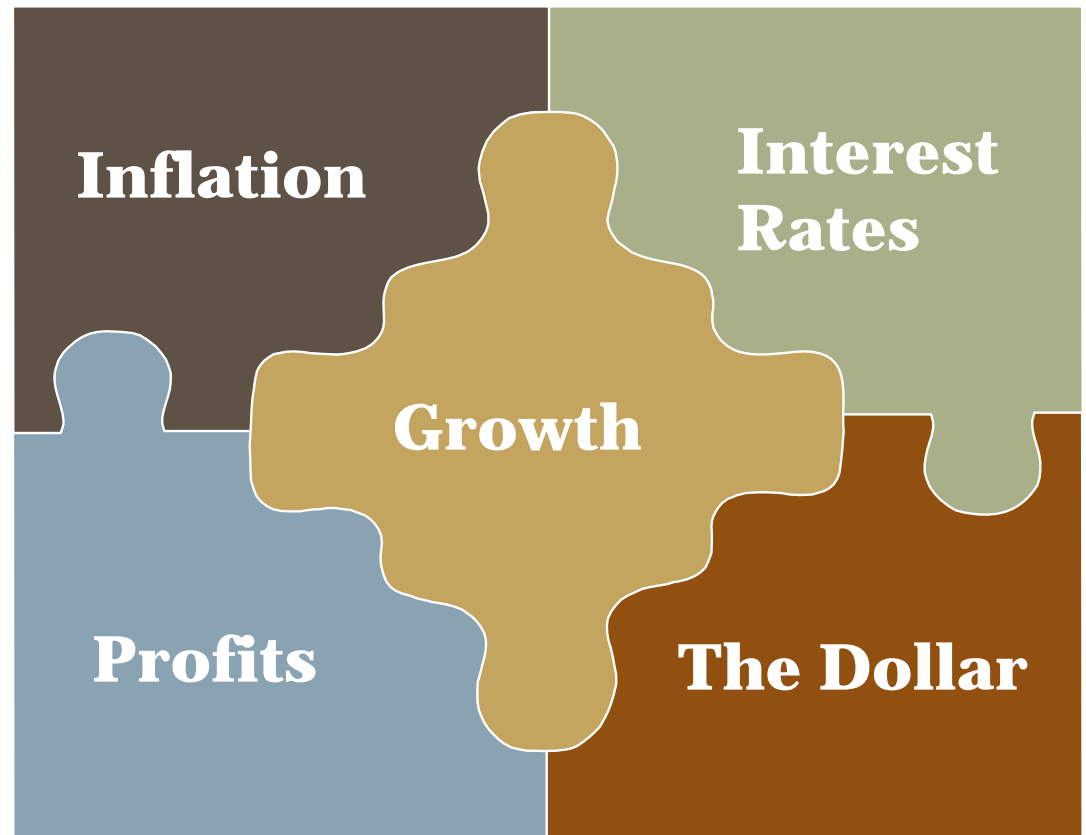
CFA Society of San Antonio

John E. Silvia, Chief Economist
September 28, 2011

Together we'll go far



Five benchmarks for good
decision making

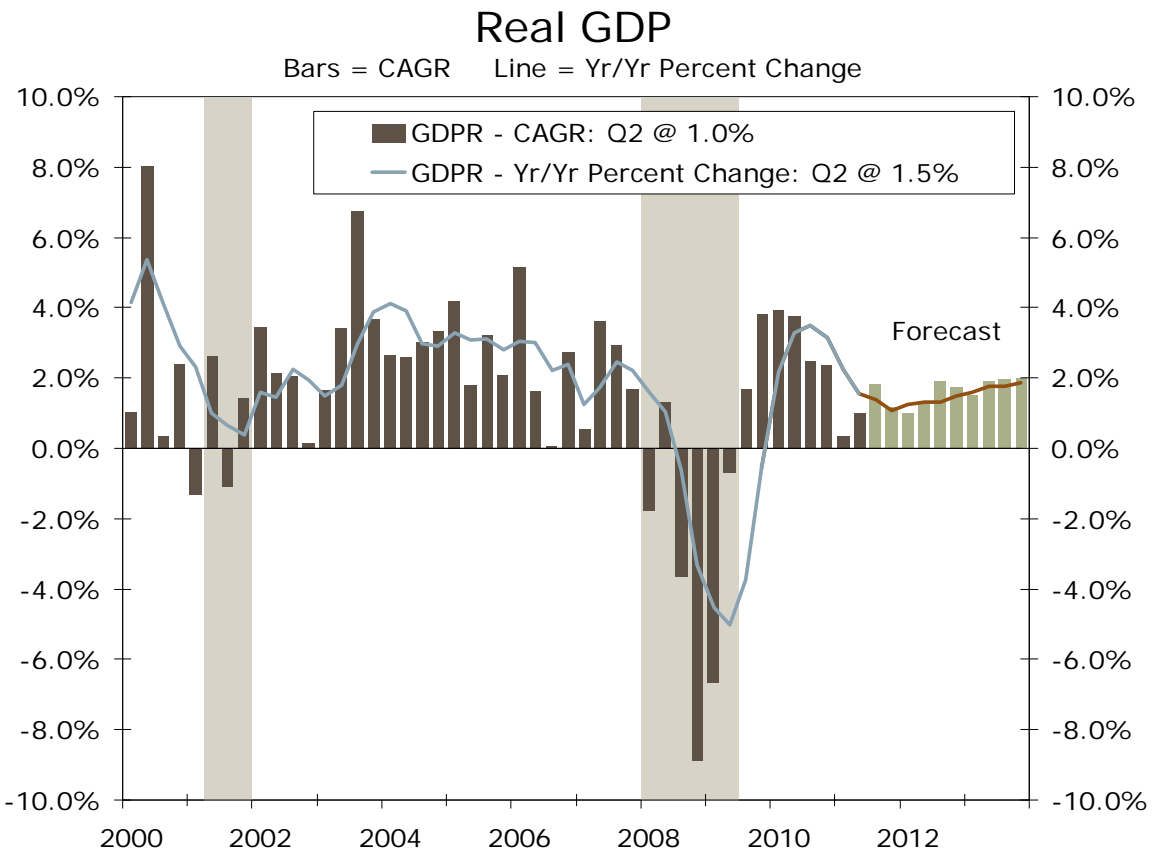


How do we differ from
consensus?

Expectations for the Future

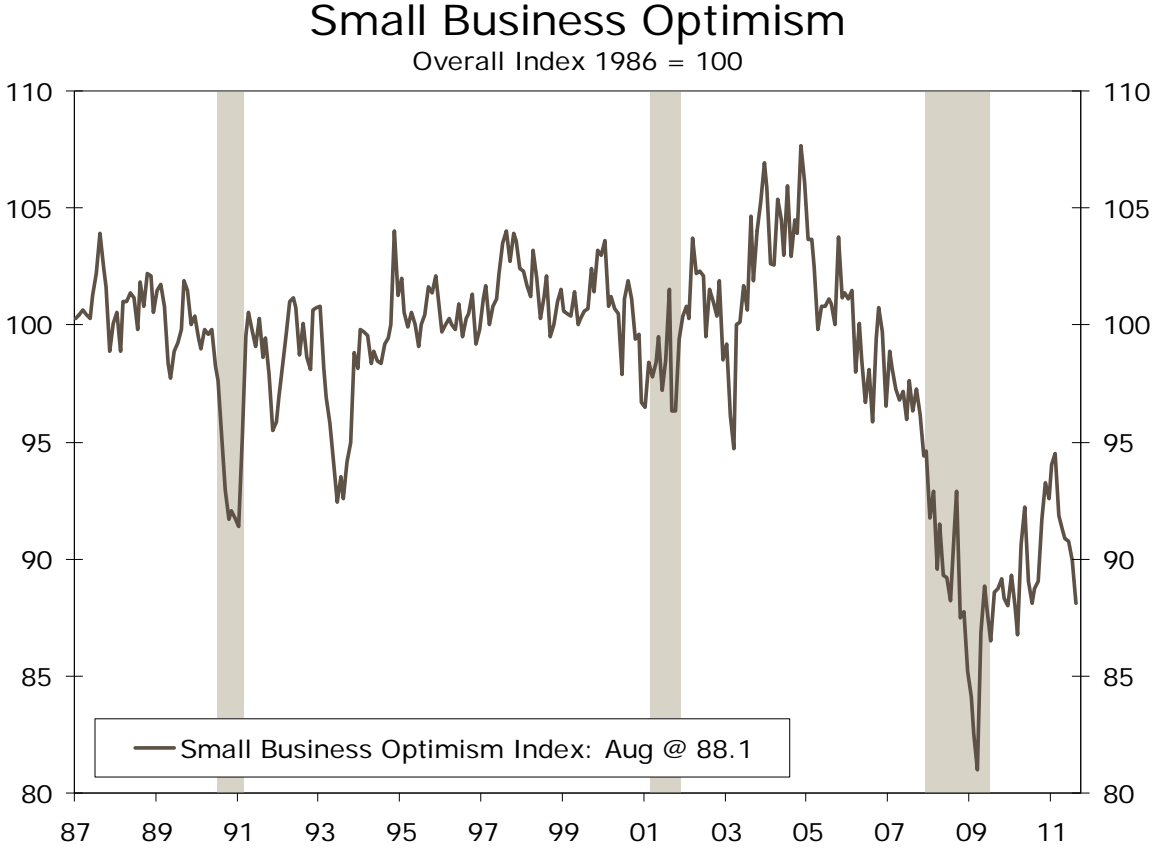
- Sustained below-trend growth
- Still cautious on the consumer
- Still cautious on housing
- Higher inflation expectations
- More bearish on employment: cyclical and structural change

Sustained recovery in 2011 and 2012, but still below historical experience



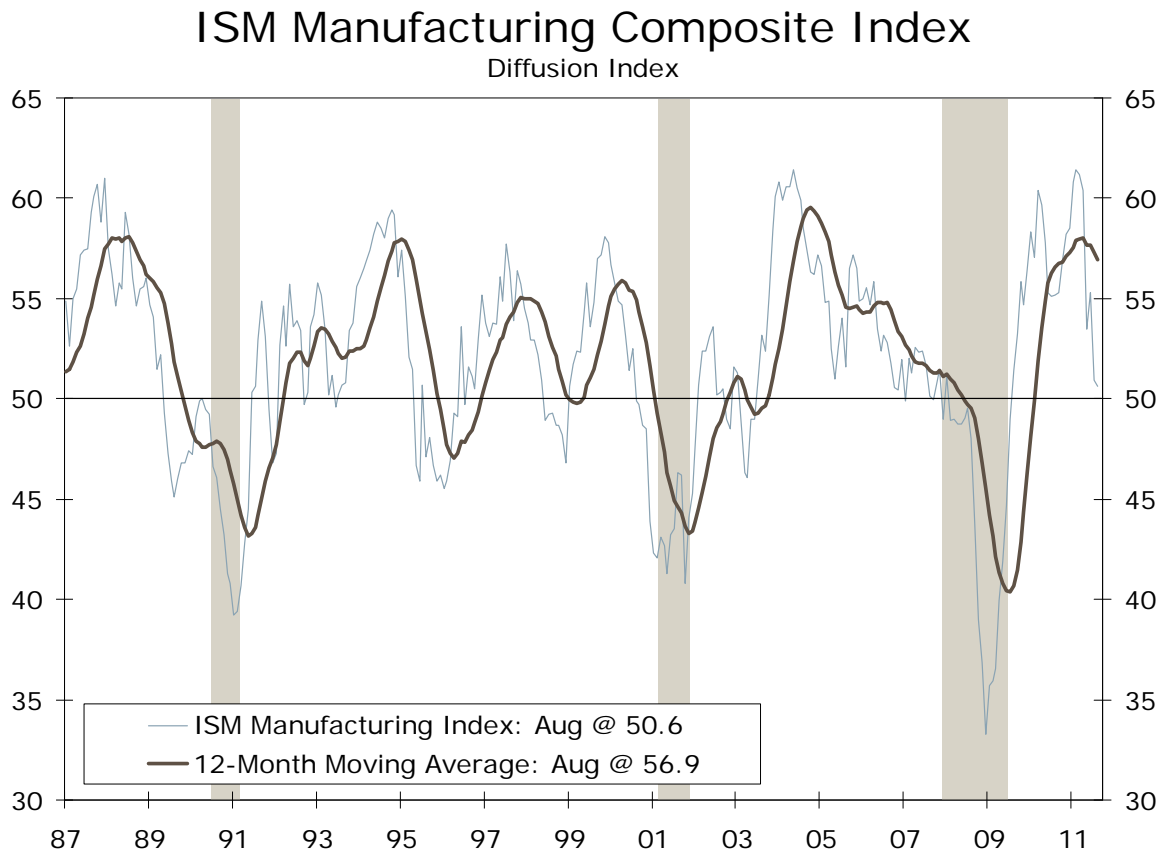
Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

Small Businesses:
Renewed confidence is still
distant



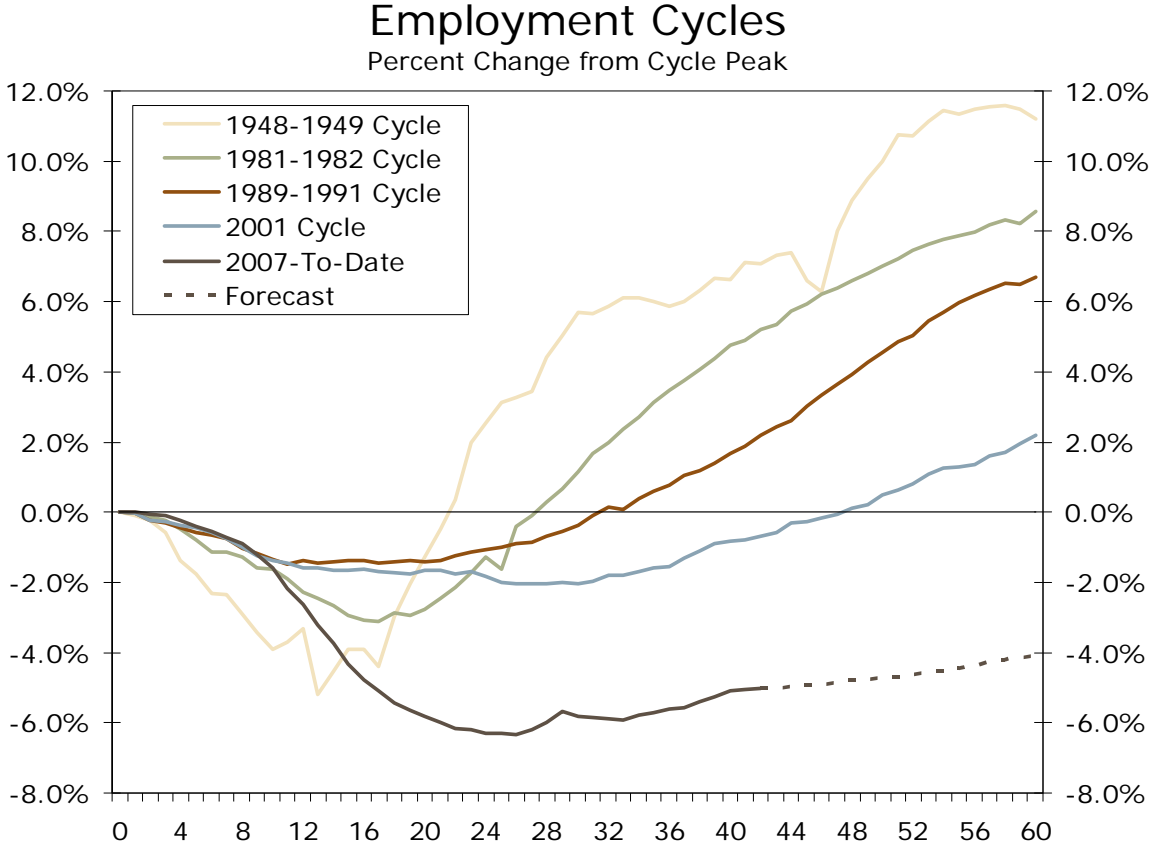
Source: National Federation of Independent Businesses and Wells Fargo Securities, LLC

Large, Global Businesses:
The pace of manufacturing
activity is slowing



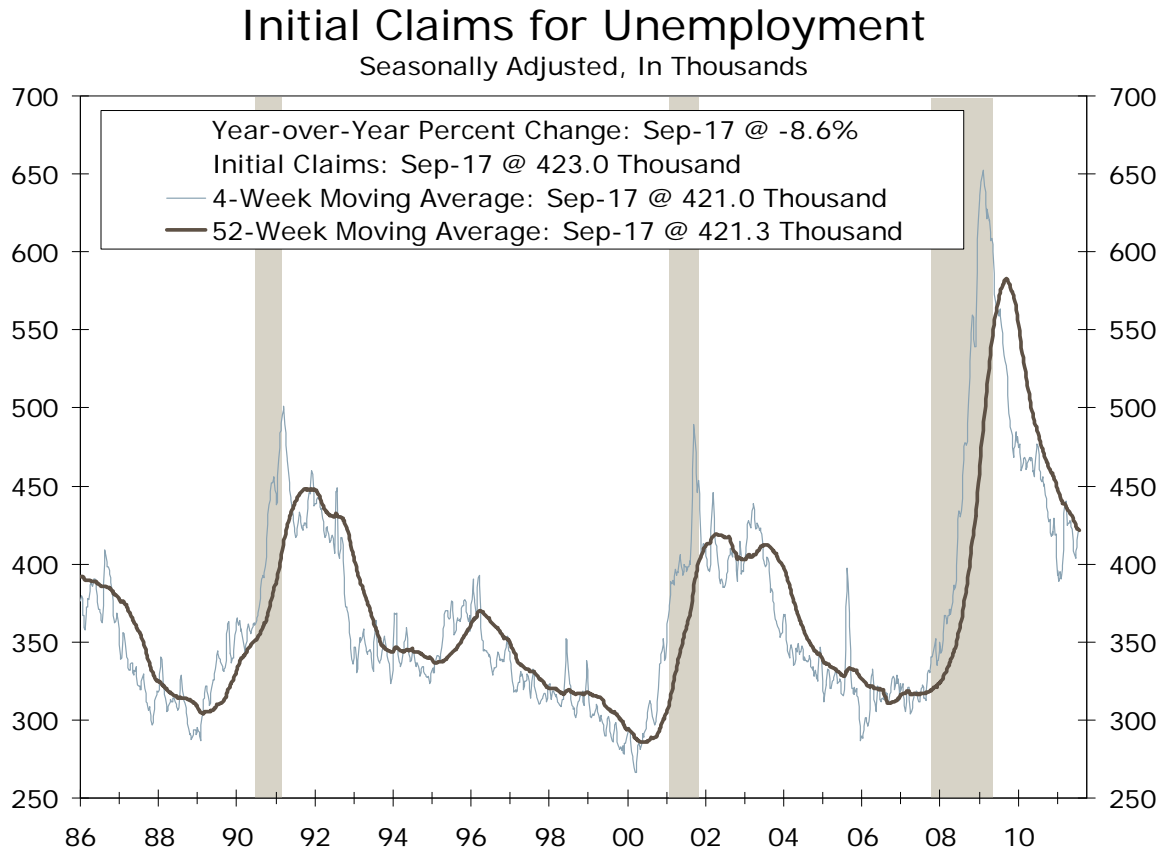
Source: Institute for Supply Management and Wells Fargo Securities, LLC

Employment will eventually regain its peak, but not quickly



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

Turning the corner—slowly—
for job gains

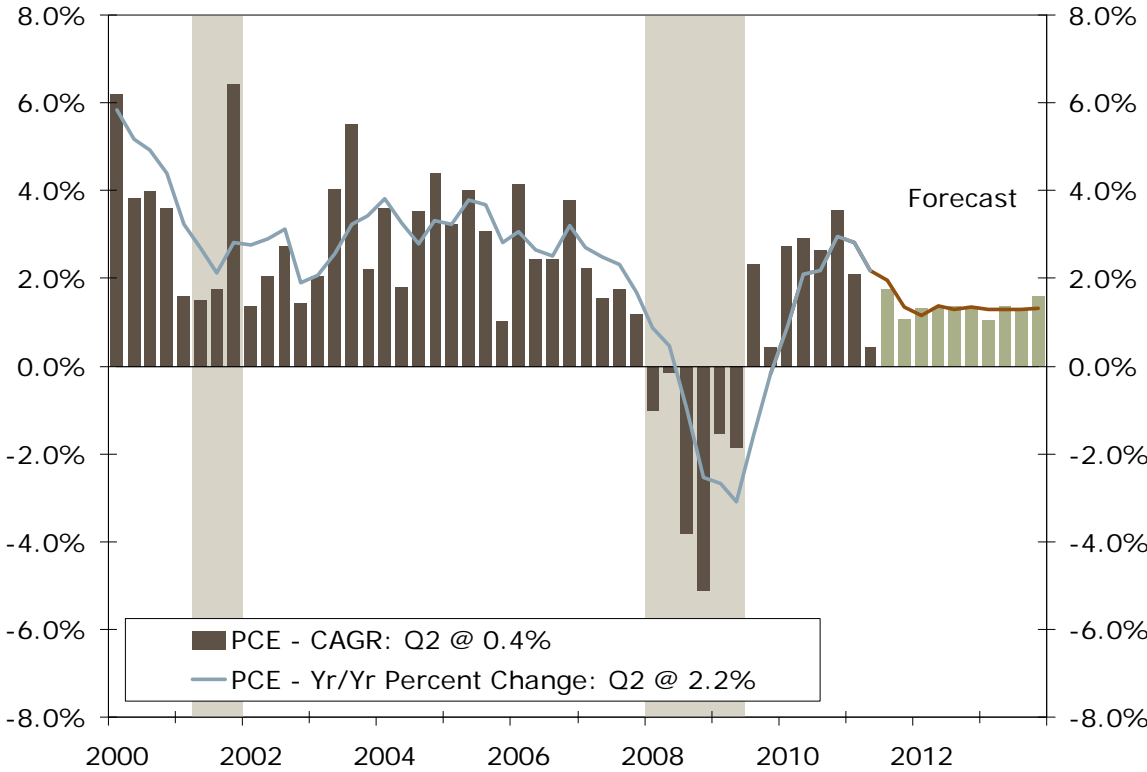


Source: U.S. Department of Labor and Wells Fargo Securities, LLC

Subpar recovery suggests deleveraging consumer, cautious credit and slow job gains

Real Personal Consumption Expenditures

Bars = CAGR Line = Yr/Yr Percent Change

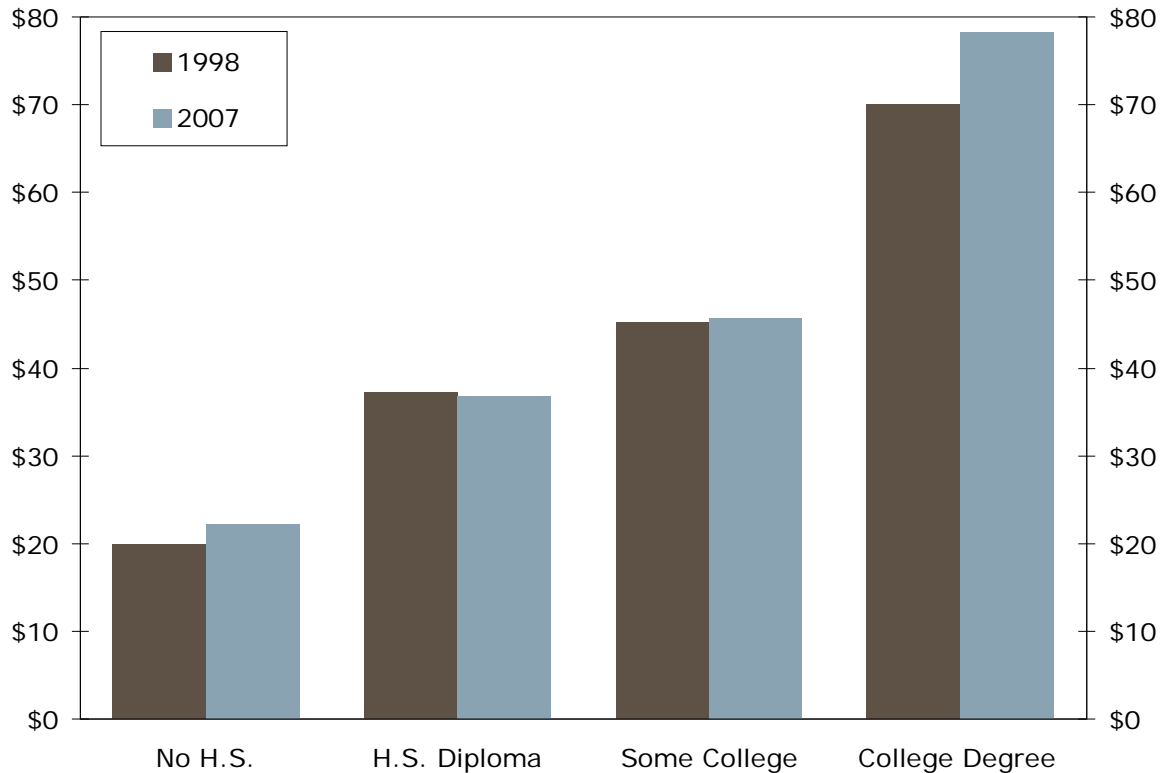


Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

Real income has remained relatively flat over the last decade, except for those with a college degree

Income By Education Level

2007 Dollars Before Taxes, Thousands

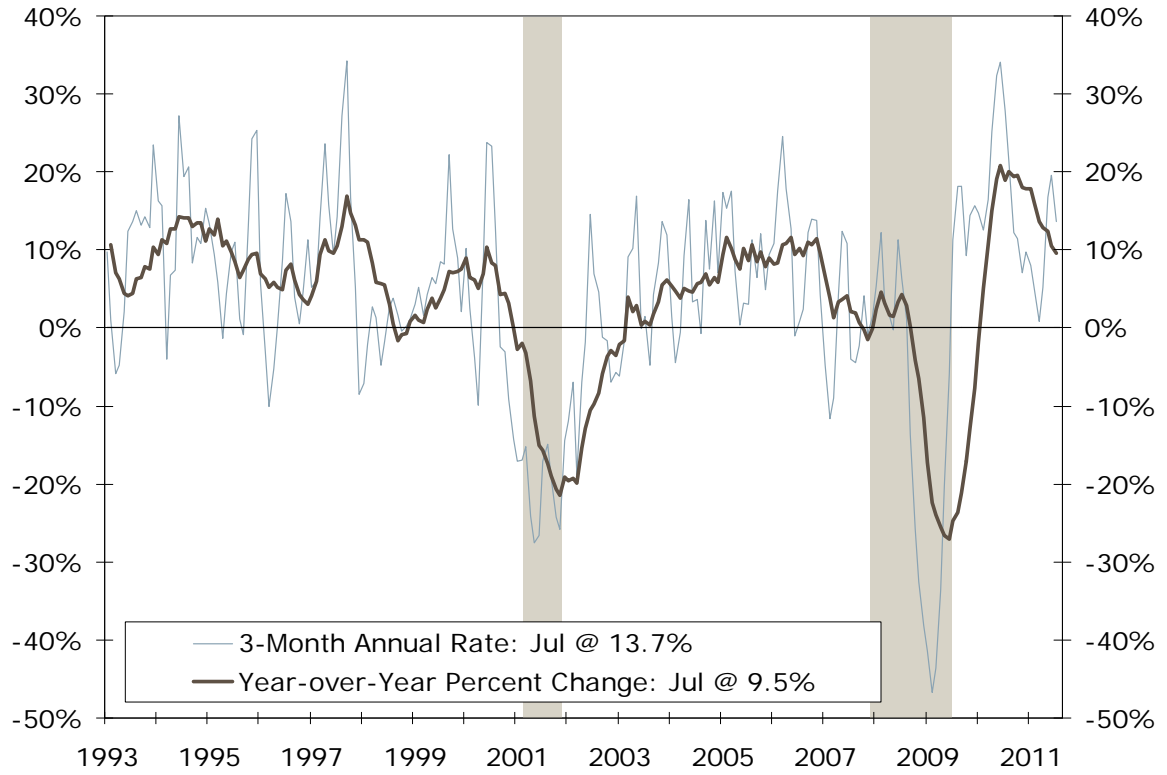


Source: Federal Reserve Board and Wells Fargo Securities, LLC

Signs of life appeared early in capital goods orders—now the slowdown

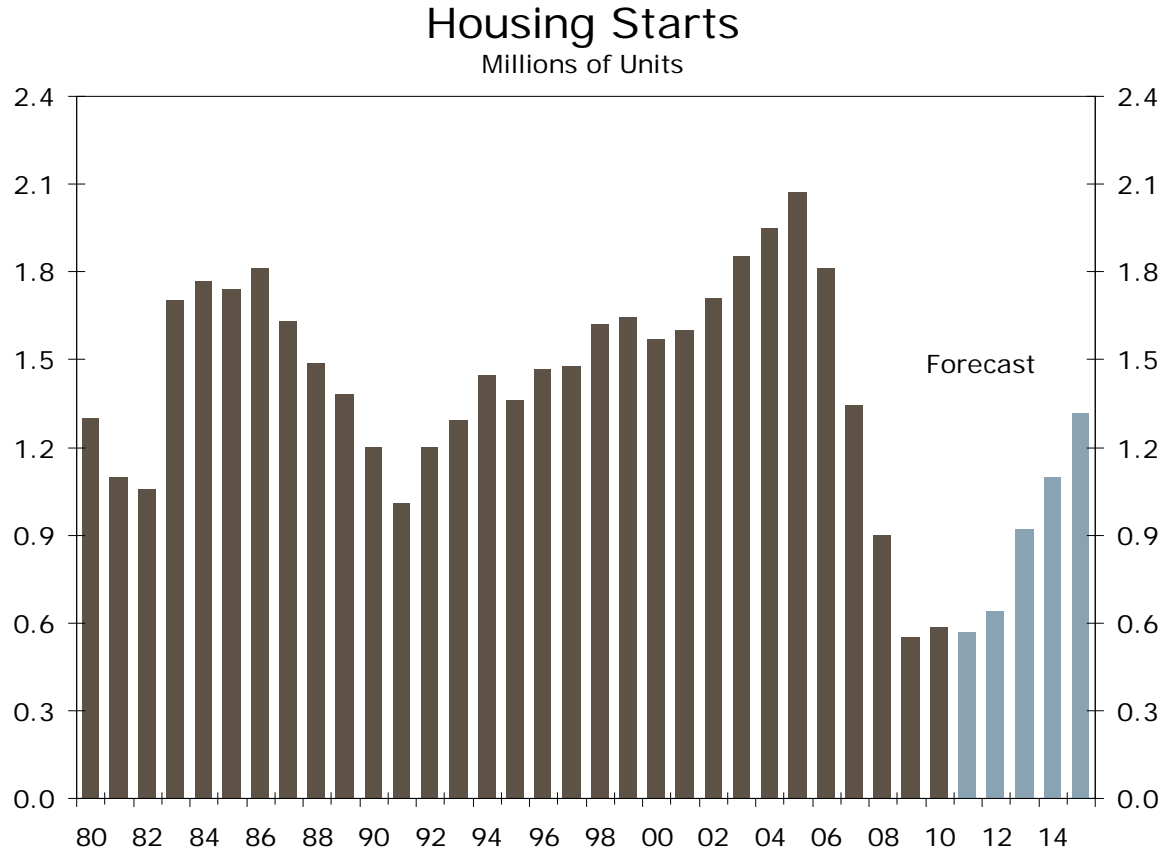
Nondefense Capital Goods Orders, Ex-Aircraft

Series are 3-Month Moving Averages



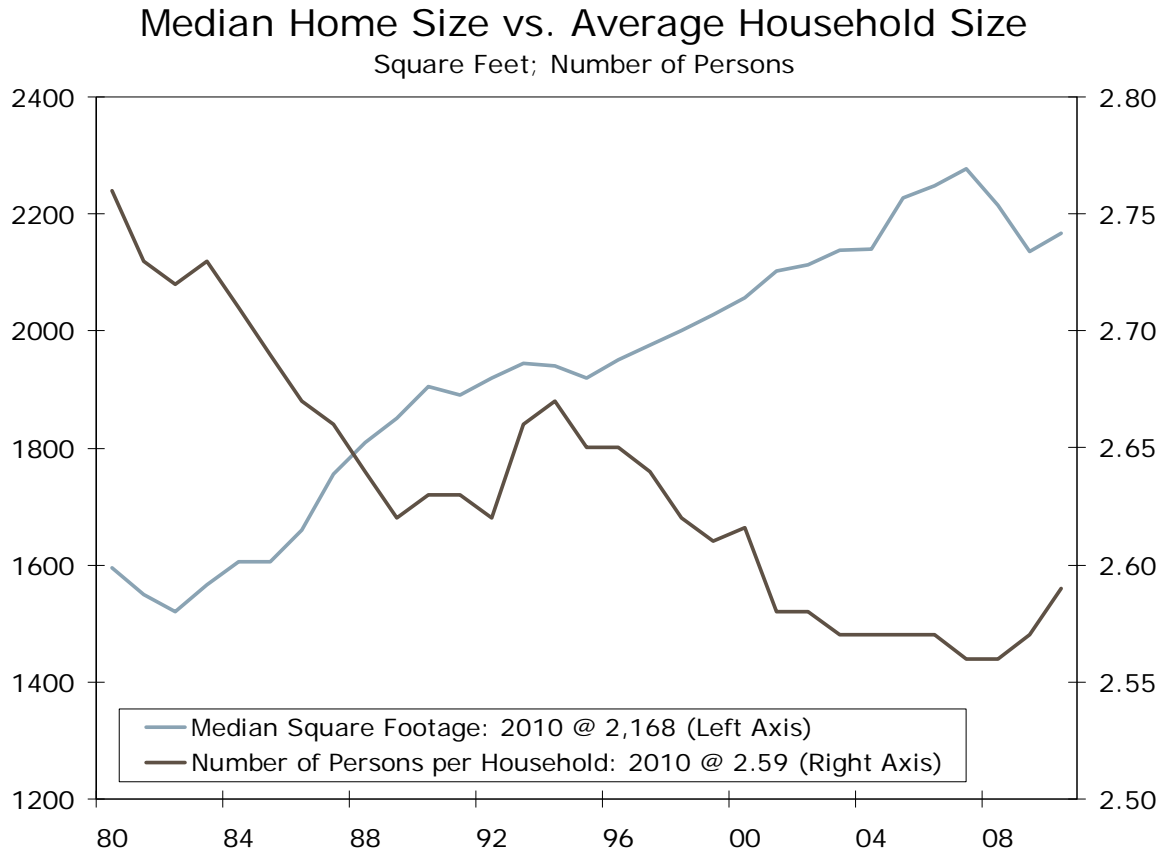
Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

Structural Challenge:
What is the new sustainable
pace? Below 1.5 million?



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

Secular Shift?
Households are living in smaller homes with more people since the recession

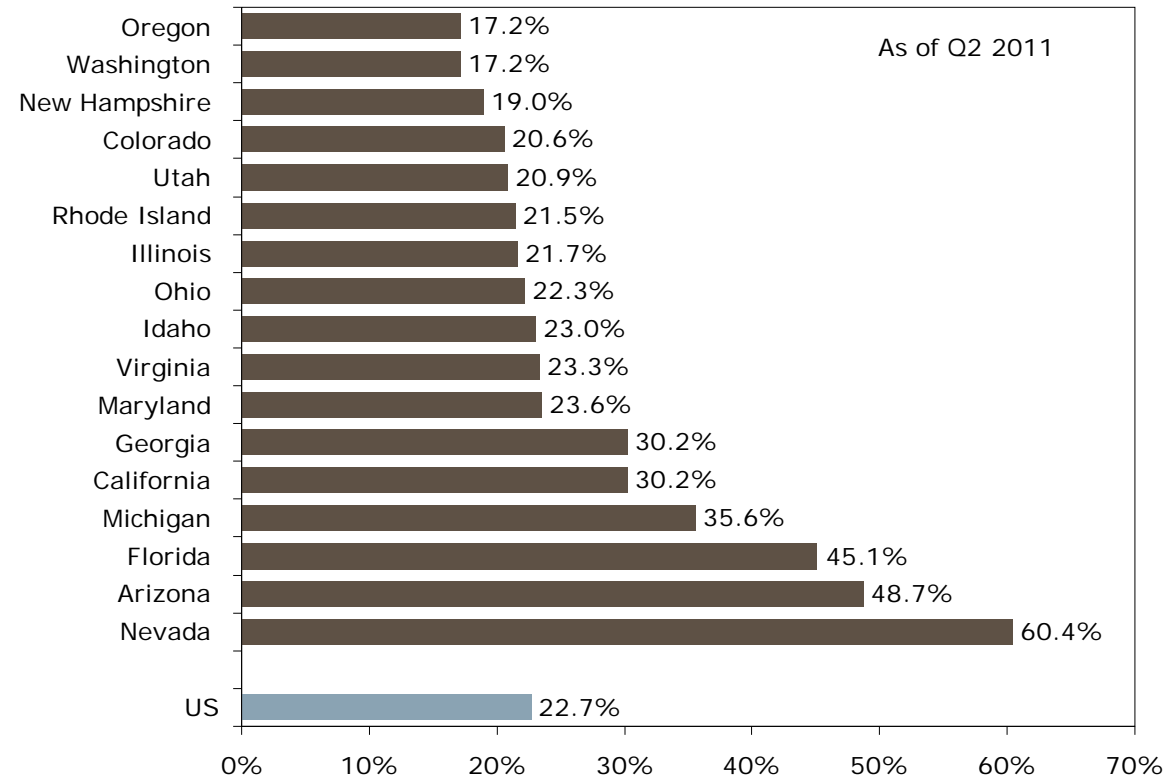


Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

Negative equity in homes has contributed to foreclosures and reduced labor mobility

Negative Equity Mortgages - By State

Percent of Mortgages Outstanding



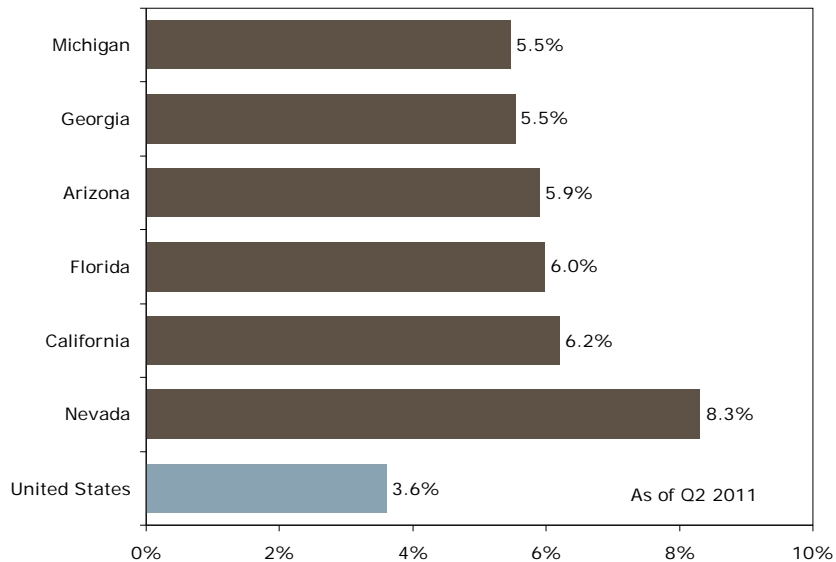
Source: CoreLogic and Wells Fargo Securities, LLC

Delinquencies and inventories have come down somewhat from their all-time peaks, but still remain elevated

Delinquencies

Mortgages 90+ Days Delinquent - By State

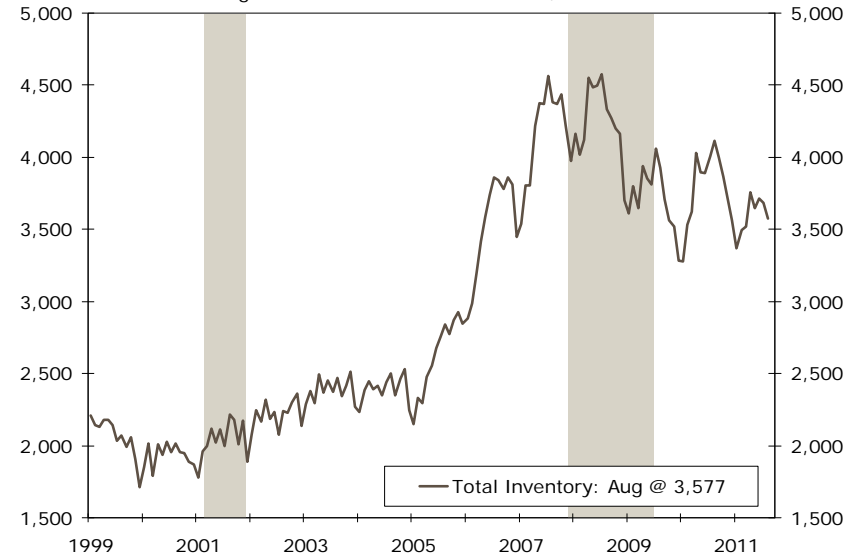
Percent of Mortgages Outstanding



Inventory

Inventory of Existing Homes for Sale

Existing Homes for Sale at End of Month, In Thousands



Source: Mortgage Bankers Association, National Association of Realtors and Wells Fargo Securities, LLC

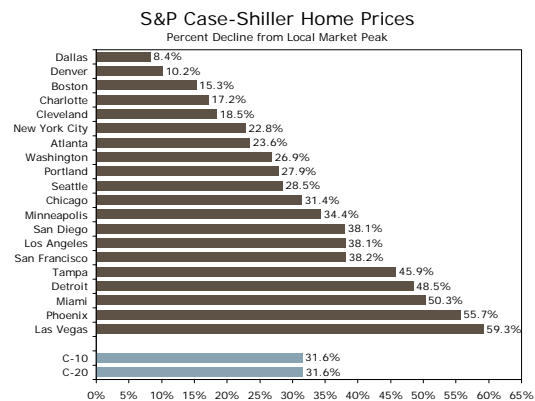
Timing of Recovery Will Vary Across Metro Areas

S&P/Case-Shiller Home Price Index – June

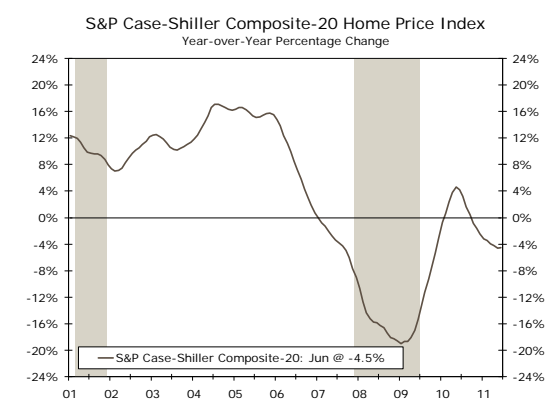
	<u>Yr/Yr % Change</u>	<u>3-Month Annual Rate</u>
Charlotte	-4.10%	1.93%
Dallas	-4.39%	-7.29%
Los Angeles	-3.39%	-2.02%
San Francisco	-5.39%	-0.45%
New York City	-3.64%	5.67%
Washington, DC	-1.20%	0.04%

The steepest declines are behind us, but recovery will be slow in areas with excess supply

Historical Perspective

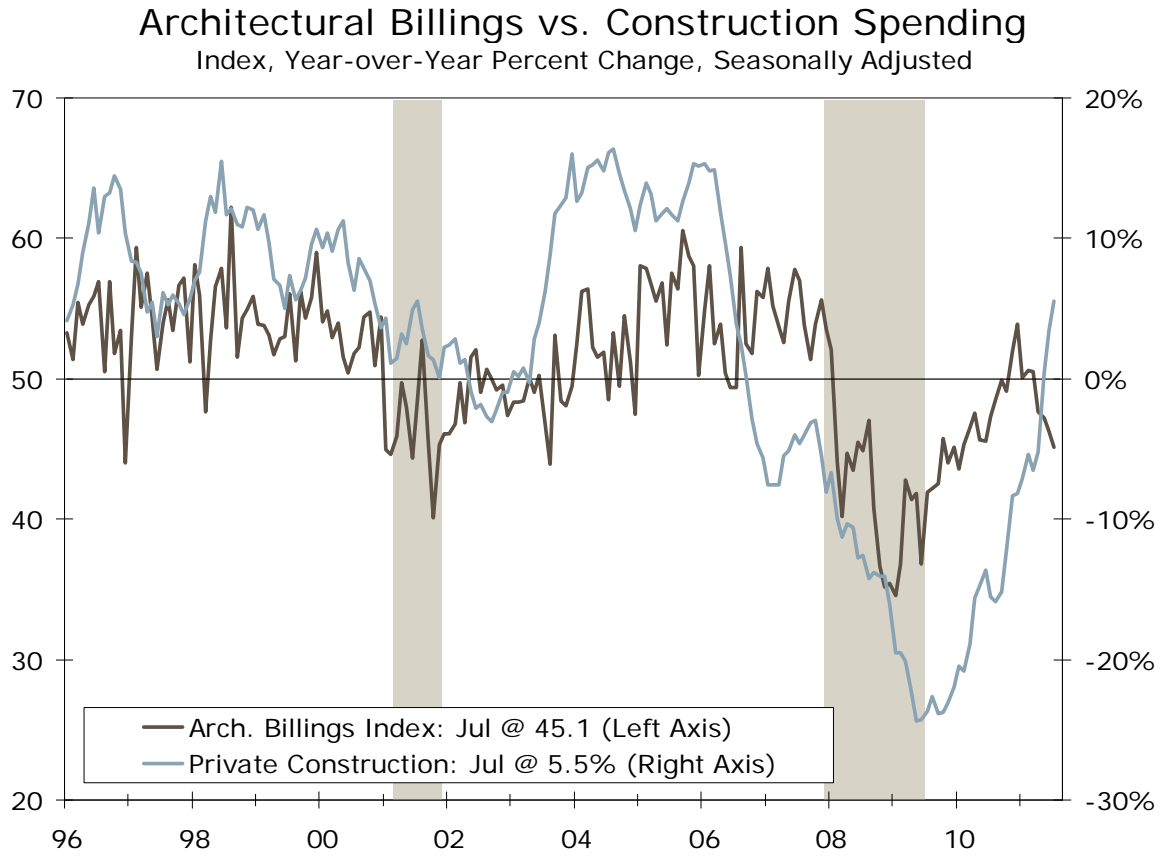


Historical Perspective



Source: S&P Case-Shiller and Wells Fargo Securities, LLC

Typical Cyclical Pattern:
Commercial and industrial
billings has gained momentum
due to increased activity in the
manufacturing sector

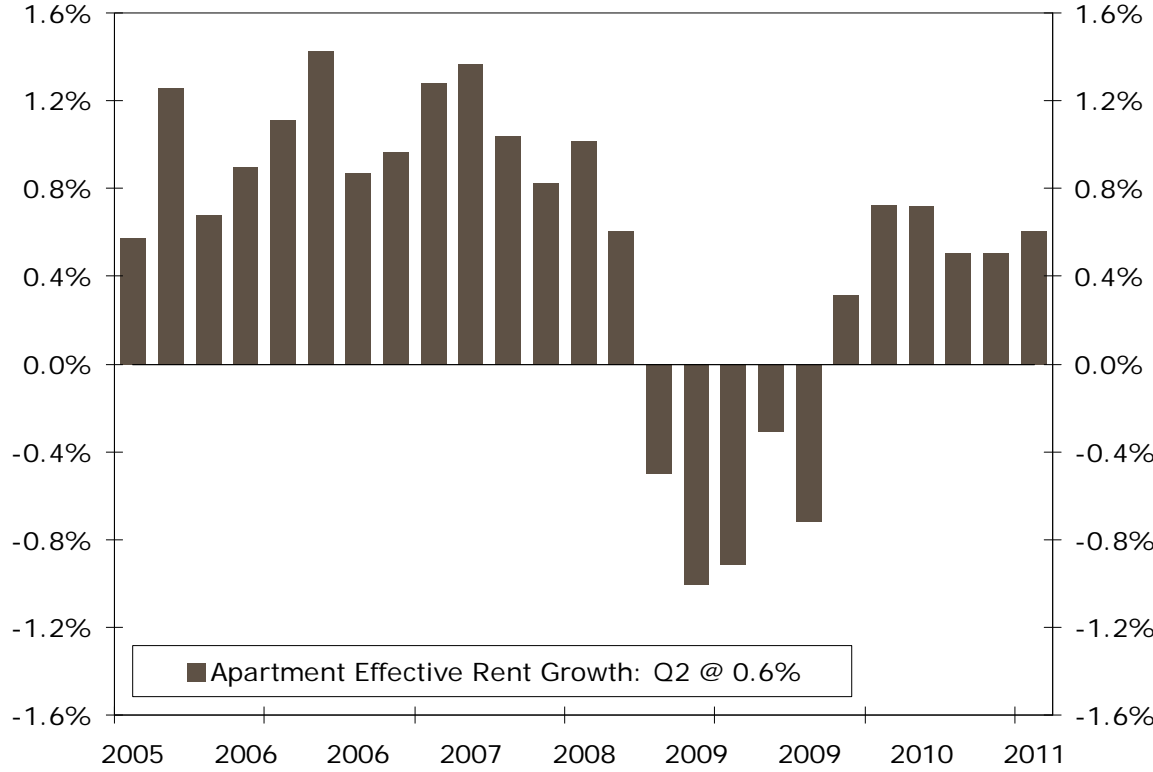


Source: The American Institute of Architects, U.S. Department of Commerce and Wells Fargo Securities, LLC

The apartment market is firming

Apartment Effective Rent Growth

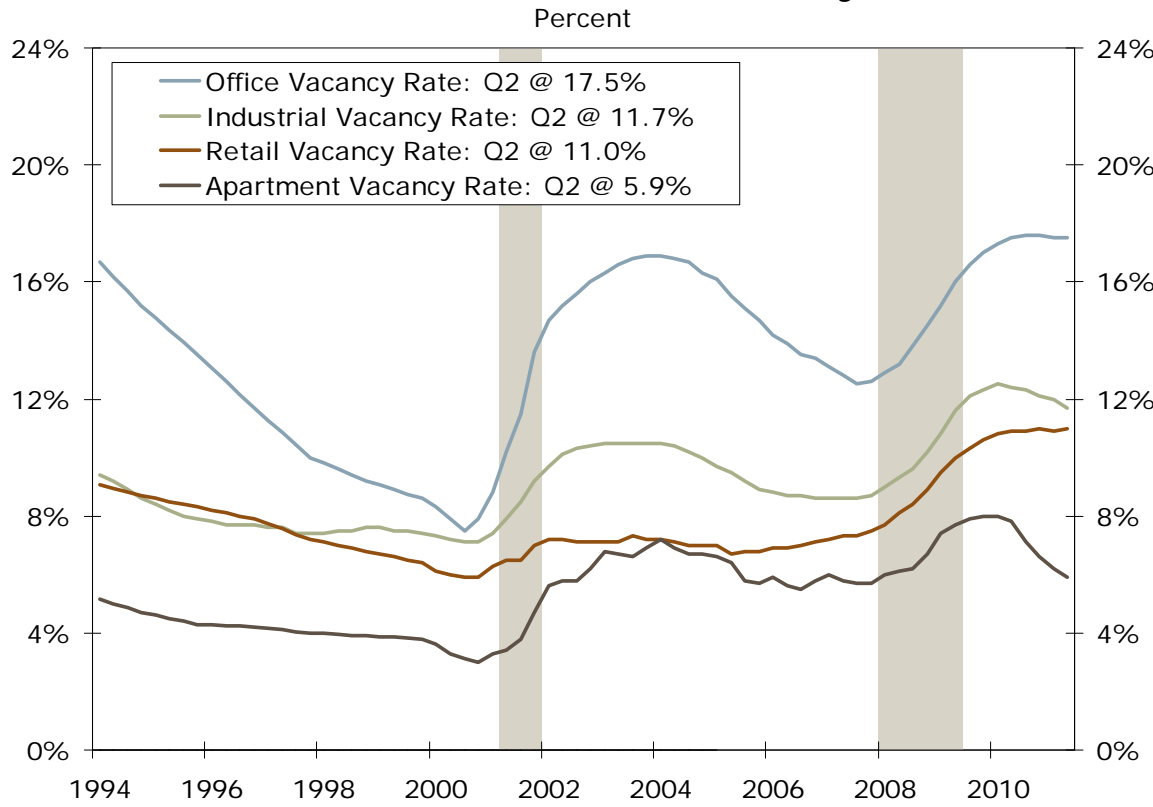
Quarter-over-Quarter Percent Change



Source: Reis, Inc. and Wells Fargo Securities, LLC

Improvement in the commercial real estate market remains uneven across product categories

Commercial Real Estate Vacancy Rates



Source: Reis, Inc., PPR and Wells Fargo Securities, LLC



Inflation Remains Low, But is Rising

Inflation Indicators

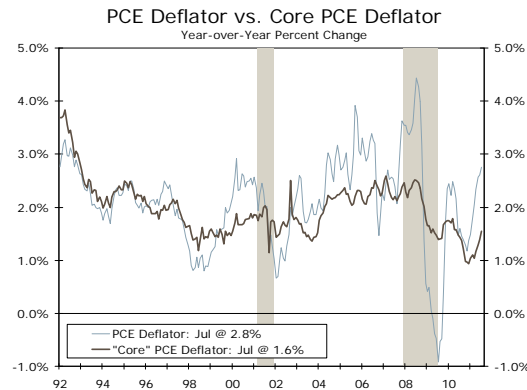
(Yr/Yr Percent Change)

July-11

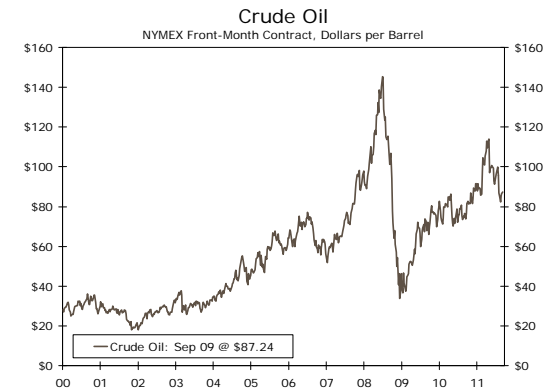
PCE Deflator	2.8%
Core PCE Deflator	1.6%
Average Hourly Earnings	2.1%
Crude Oil	26.1%

Rising inflation will limit the policy actions of the Fed

Historical Perspective



Historical Perspective

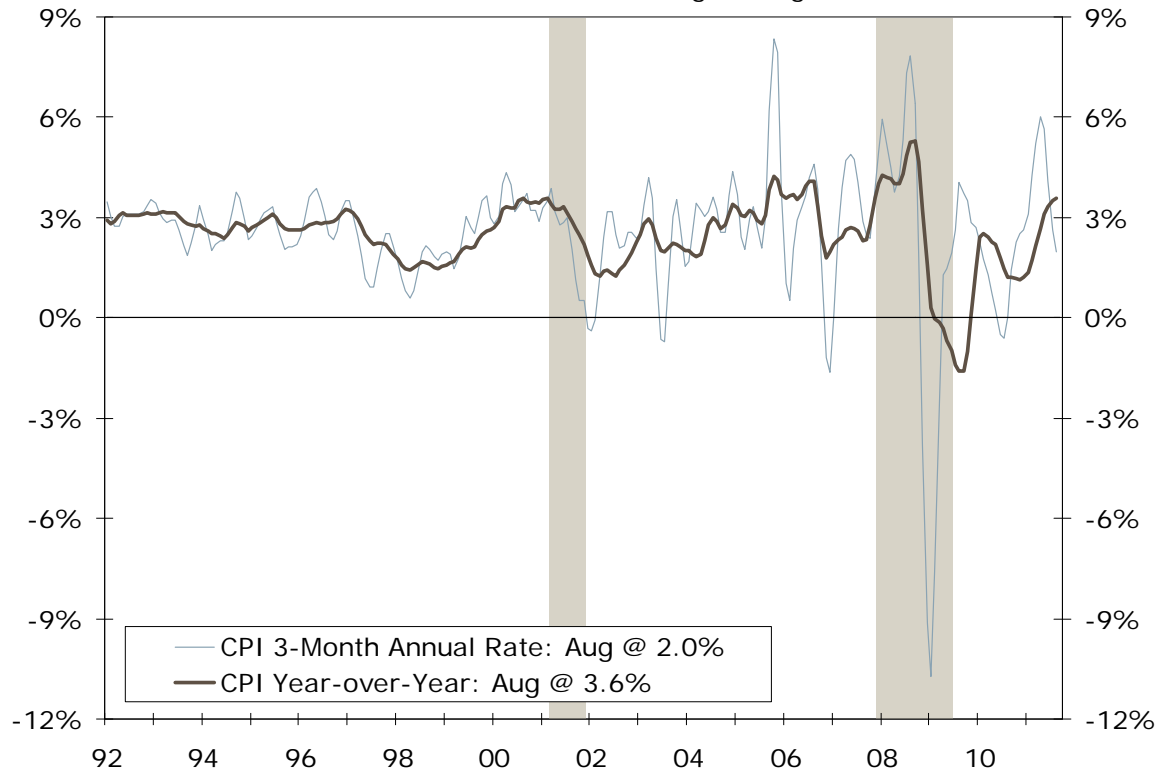


Source: U.S. Department of Commerce, U.S. Department of Labor, NYMEX and Wells Fargo Securities, LLC

Consumer prices are beginning to pick up on the heels of higher food and energy prices

U.S. Consumer Price Index

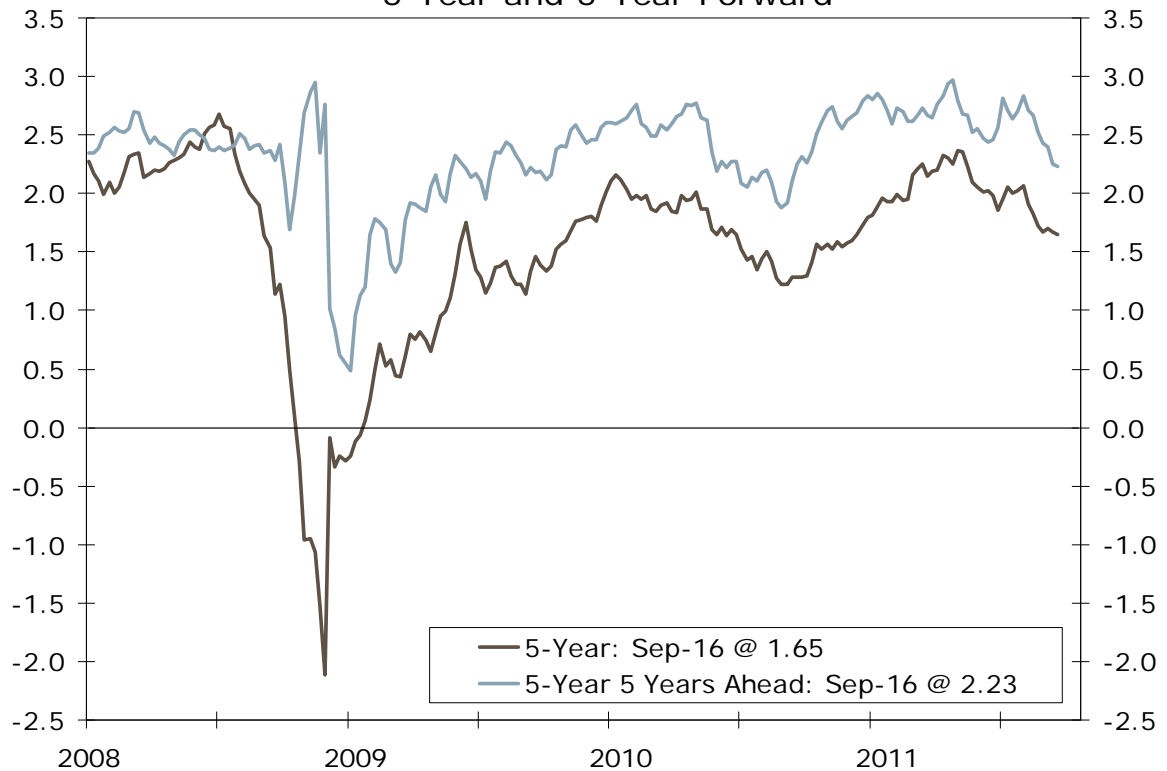
Both Series are 3-Month Moving Averages



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

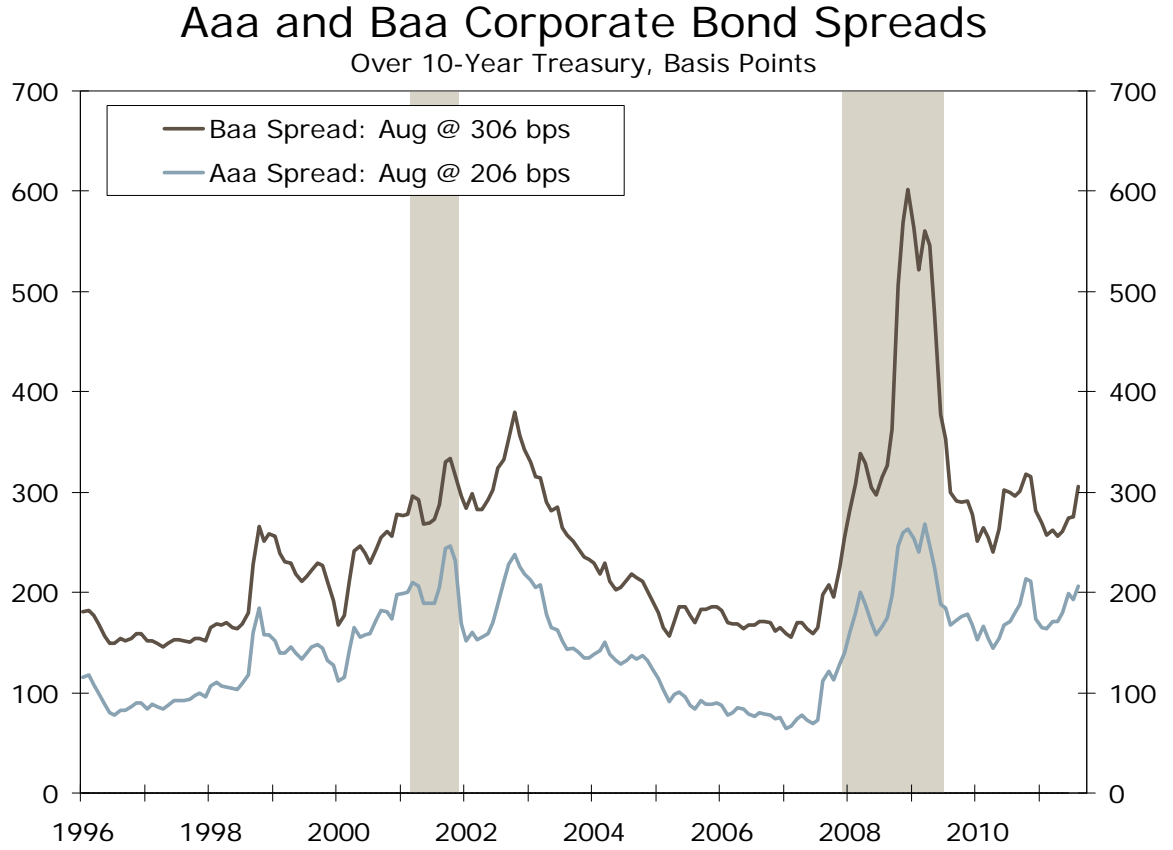
Inflation expectations have moderated in recent weeks

TIPS Inflation Compensation 5-Year and 5-Year Forward



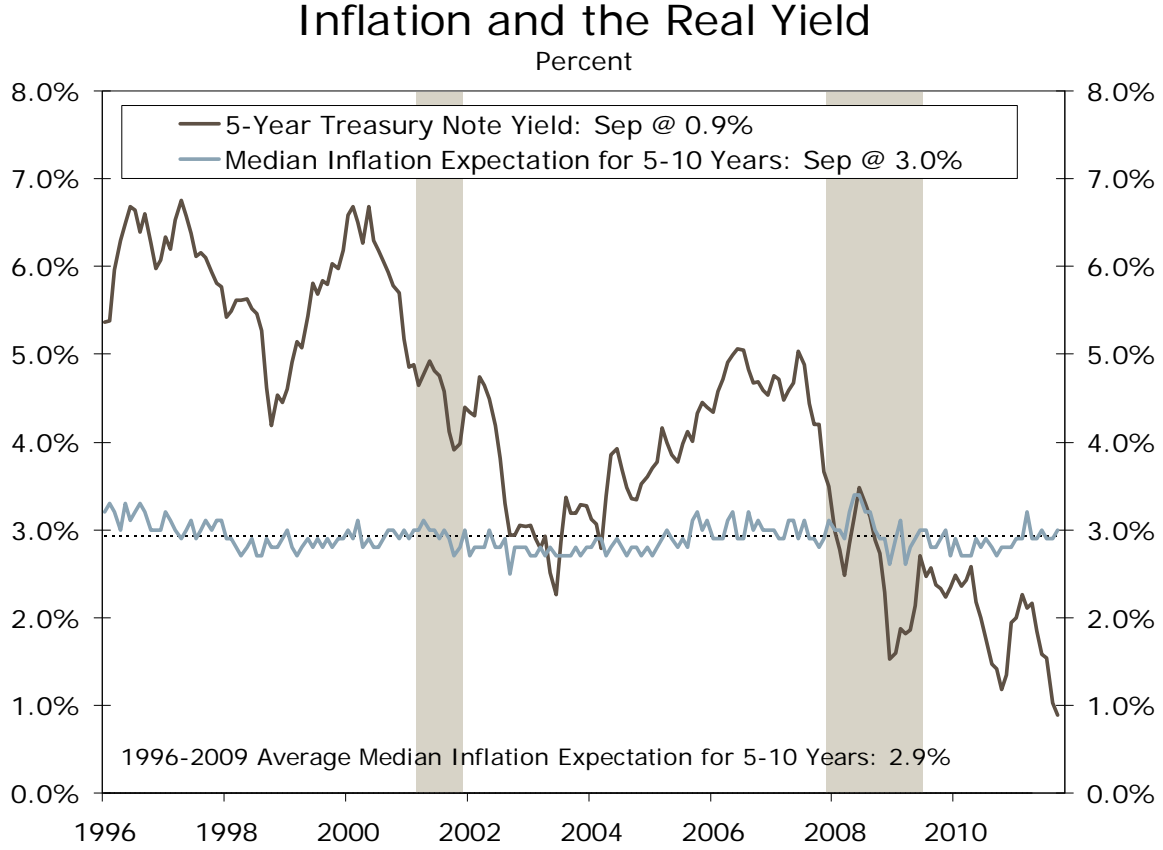
Source: Federal Reserve Board and Wells Fargo Securities, LLC

Spreads have returned to a more normal level; bond issuance is strong



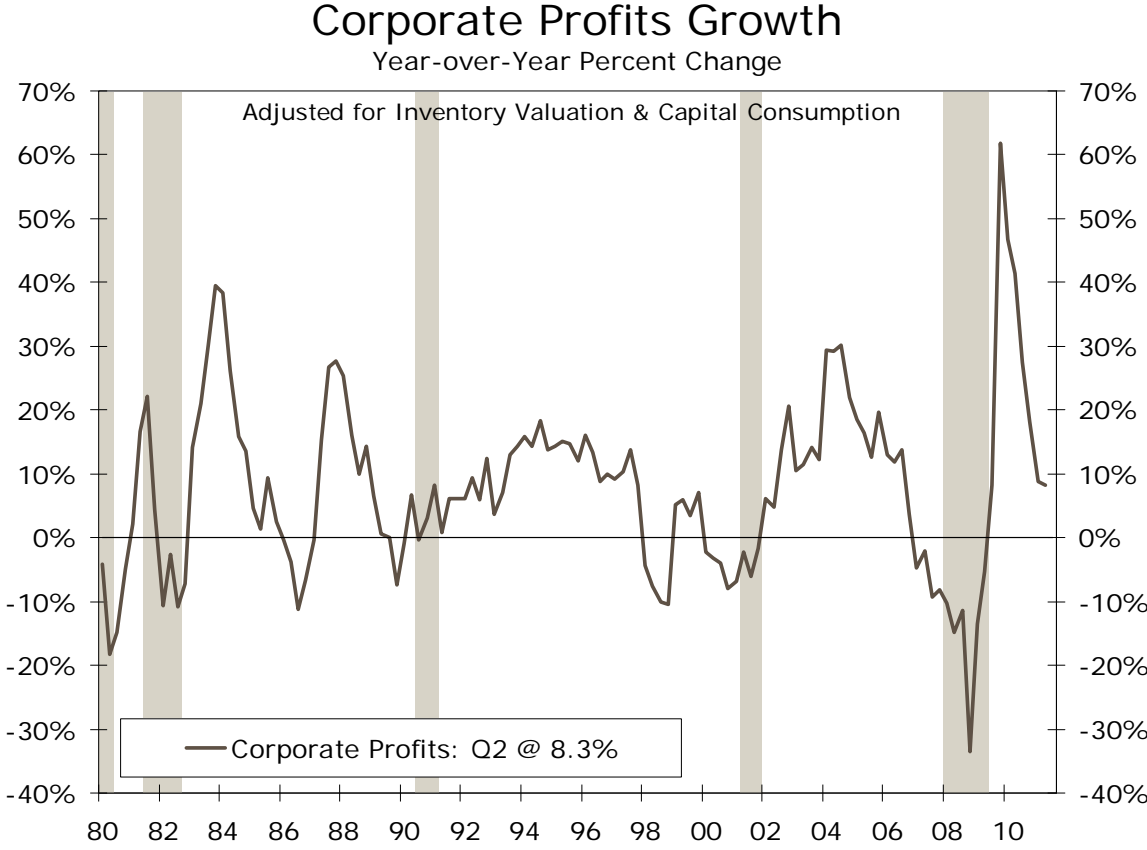
Source: Federal Reserve Board and Wells Fargo Securities, LLC

Inflation expectations exceed nominal returns



Source: Federal Reserve Board and Wells Fargo Securities, LLC

Profits growth is starting to moderate—typical cyclical pattern



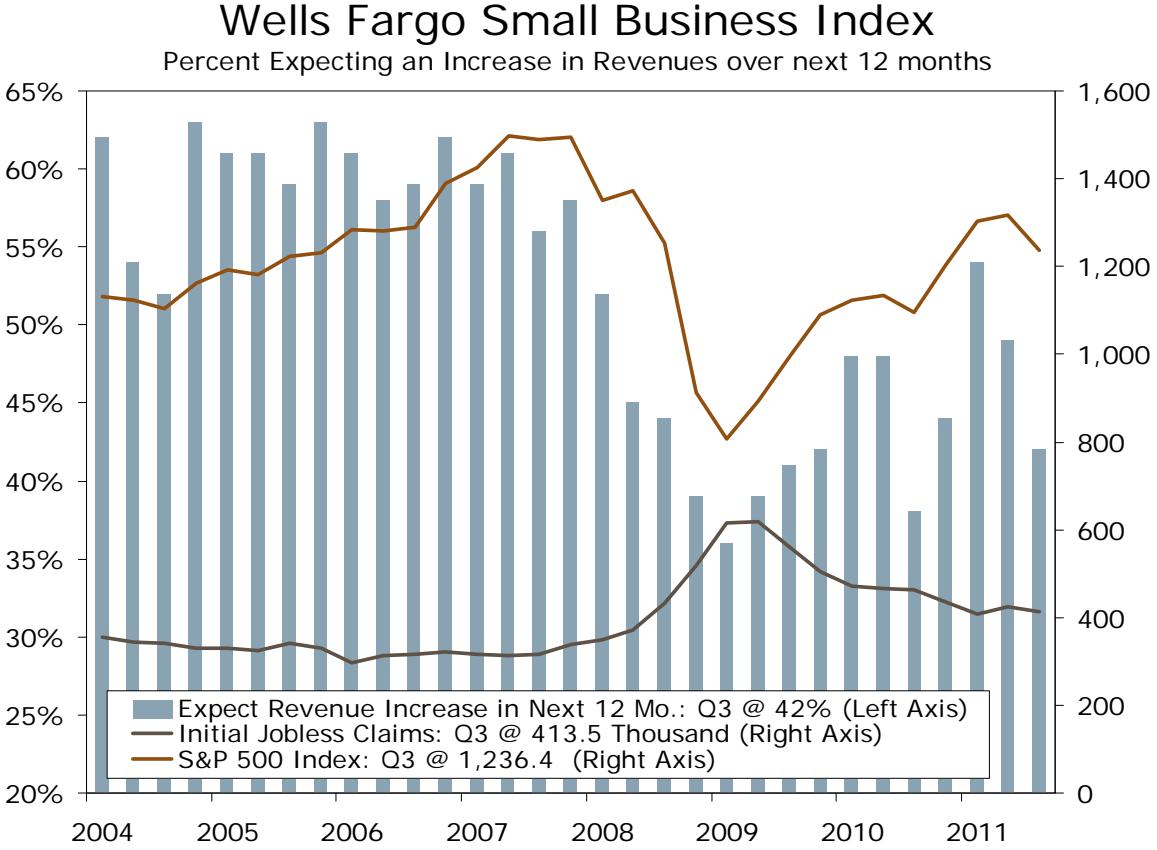
Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

A significant portion of profits are being earned abroad

Globalization and Corporate Profits	
Sector	Percentage of Total Sales Earned Abroad (07-09 Average)
Information Technology	56.9%
Energy	48.1%
Materials	44.9%
Industrials	36.7%
Consumer Staples	27.5%
Consumer Discretionary	24.0%
Financials	18.0%
Health Care	17.4%
Telecommunications	0.6%

Source: Factset and Wells Fargo Securities, LLC

Revenue expectations for small businesses rise in line with increases in the equity market and decreases in jobless claims: recent moderation to watch—growth, but no boom

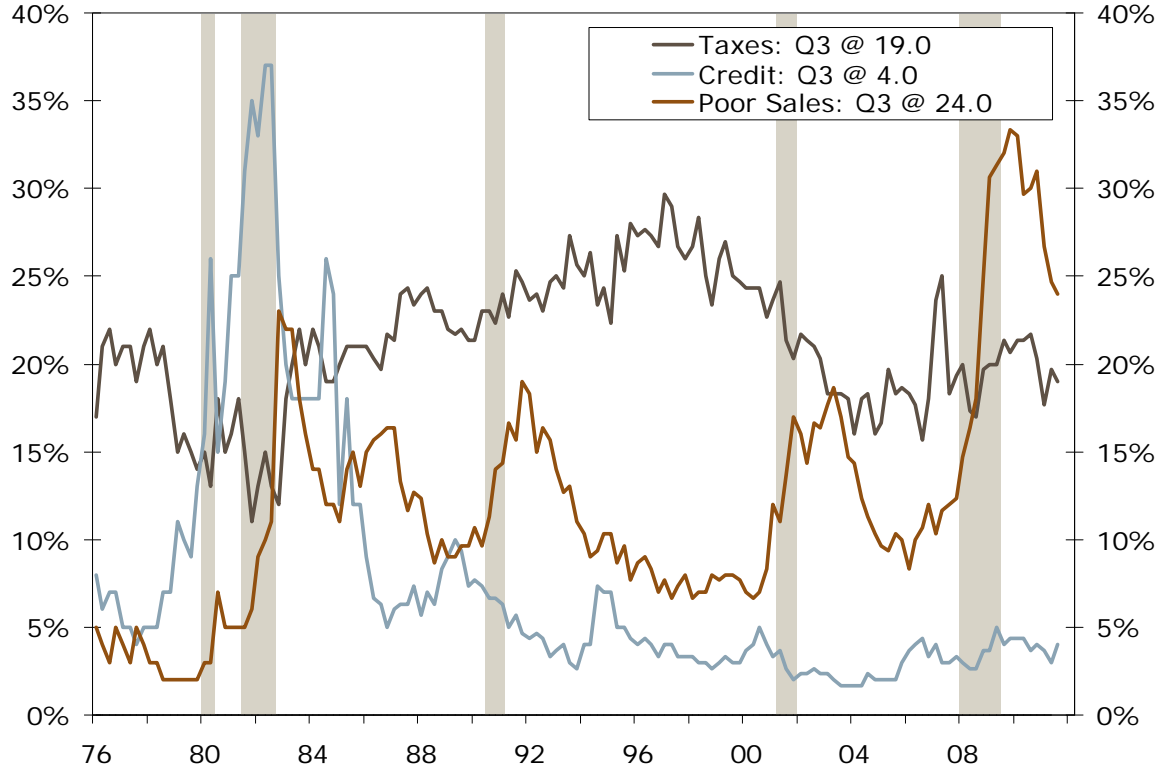


Source: U.S. Department of Labor, IHS Global Insight, Gallup, Wells Fargo & Co. and Wells Fargo Securities, LLC

Weak sales remain a top concern of businesses

Small Businesses: Most Important Problems

Percent of Firms

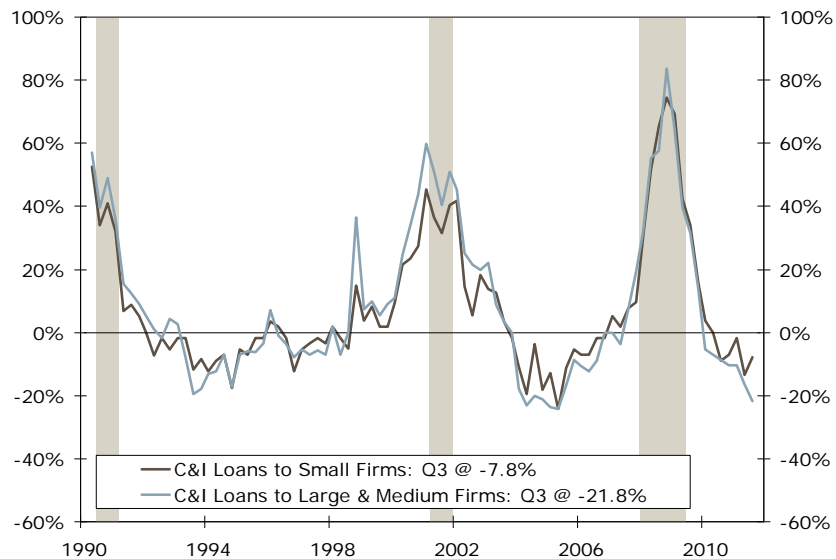


Source: National Federation of Independent Businesses and Wells Fargo Securities, LLC

Standards are being relaxed; demand for loans is improving

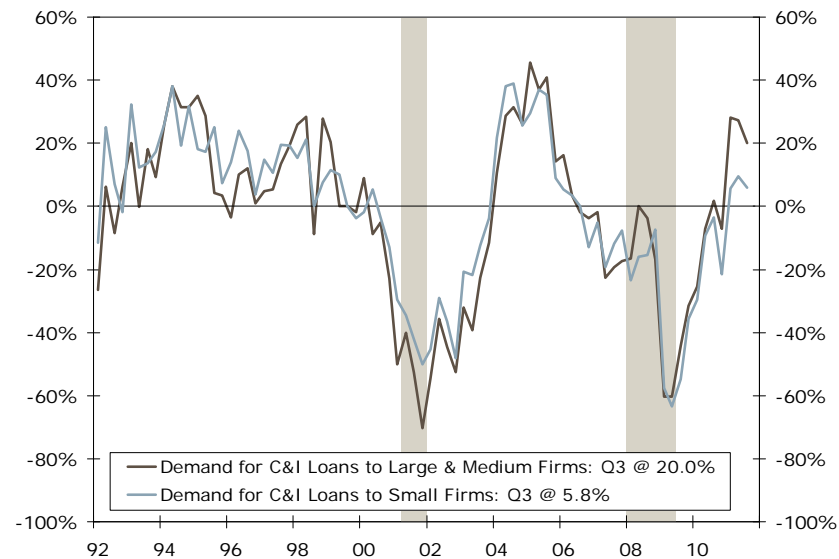
Standards

Net Percentage of Banks Tightening Standards
Commercial & Industrial Loans



Demand

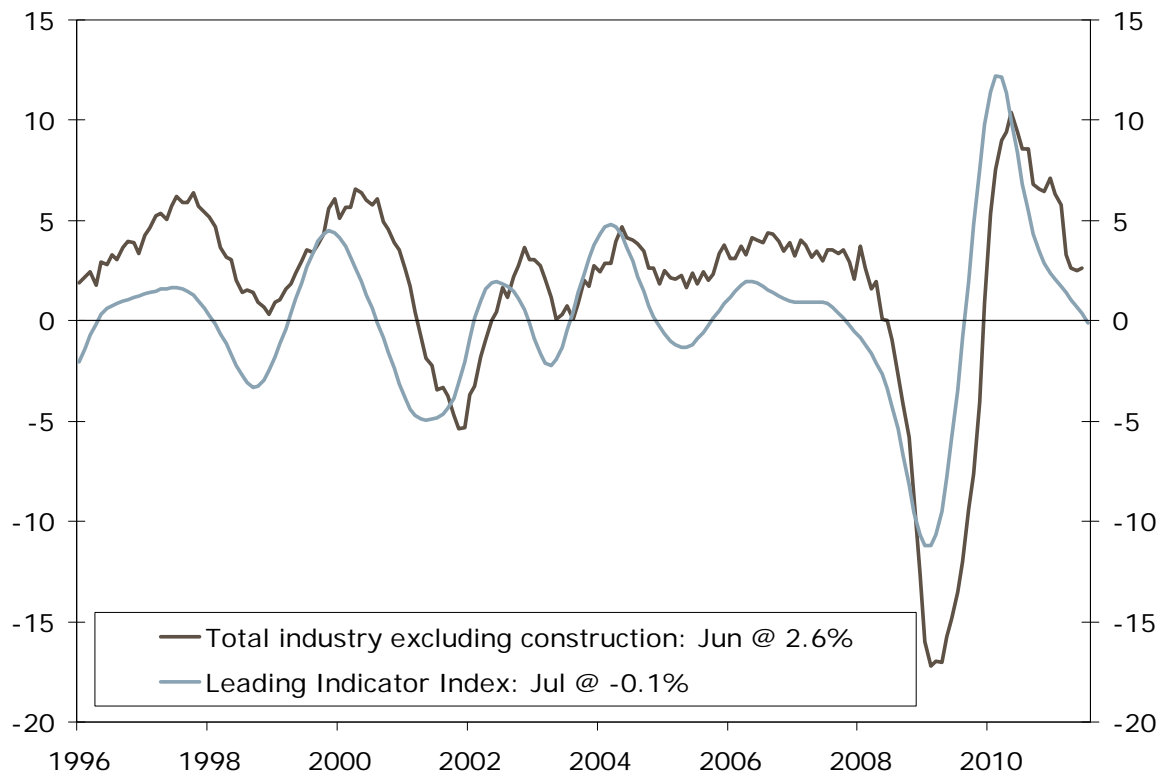
Net Percent of Banks Reporting Stronger Demand
Commercial and Industrial Loans



Source: Federal Reserve Board and Wells Fargo Securities, LLC

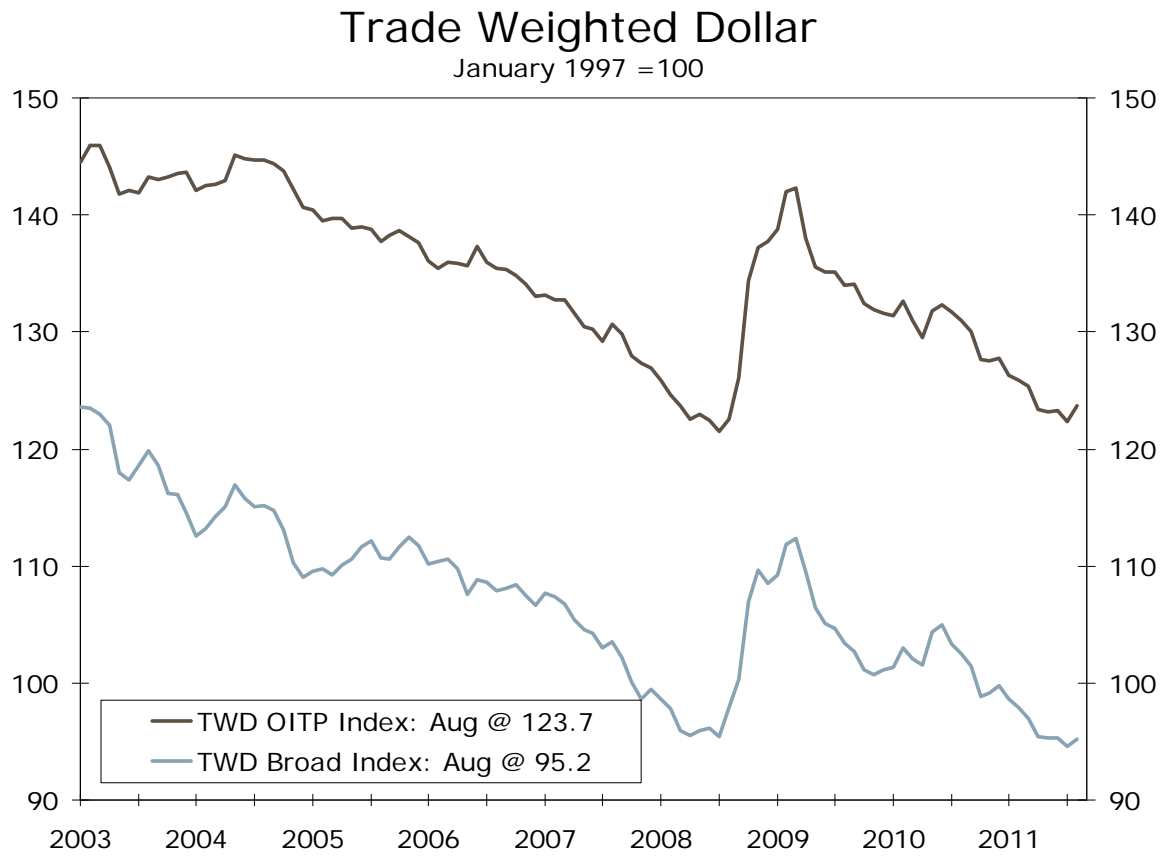
Industrial production has begun to recover after plunging in 2009, but the rate of recovery is poised to slow

OECD Industrial Production vs. Leading Index
Year-over-Year Percent Change



Source: OECD and Wells Fargo Securities, LLC

Economic fundamentals and risks abroad will drive the dollar. Effects of Fed QE2—good for exporters, negative for importers

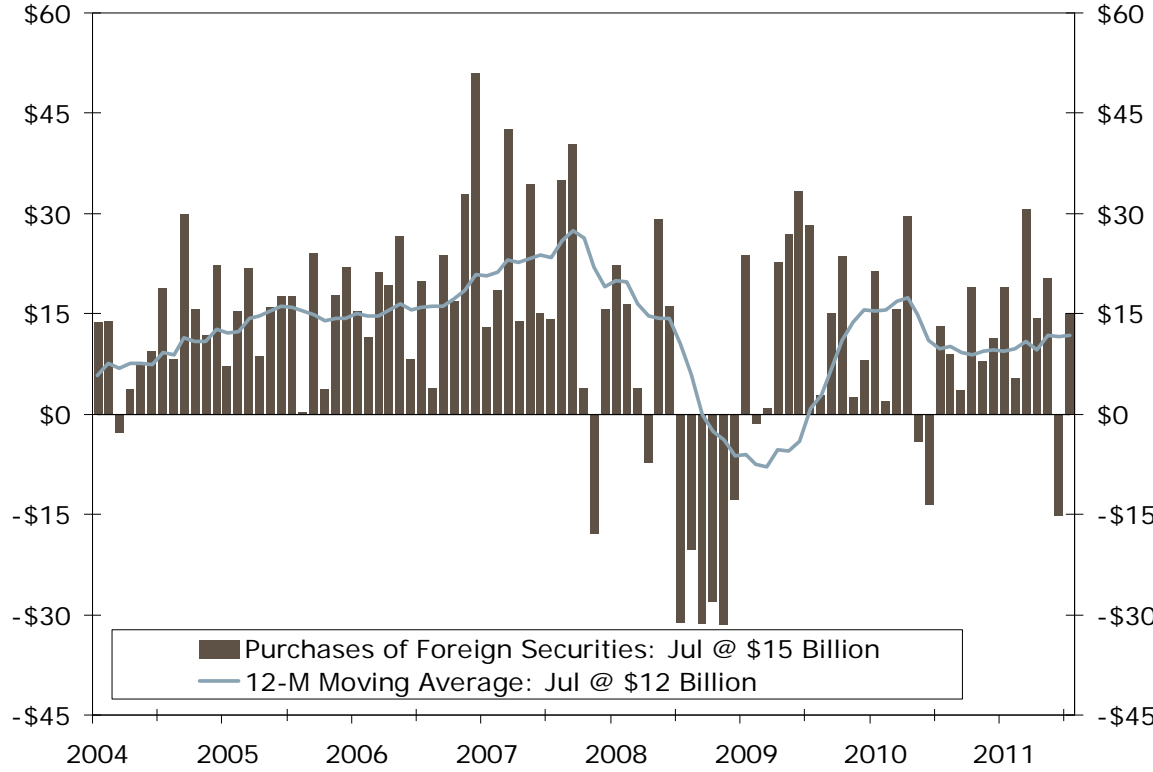


Source: Federal Reserve Board and Wells Fargo Securities, LLC

Demand has swung toward foreign securities

U.S. Purchases of Foreign Securities

Billions of Dollars

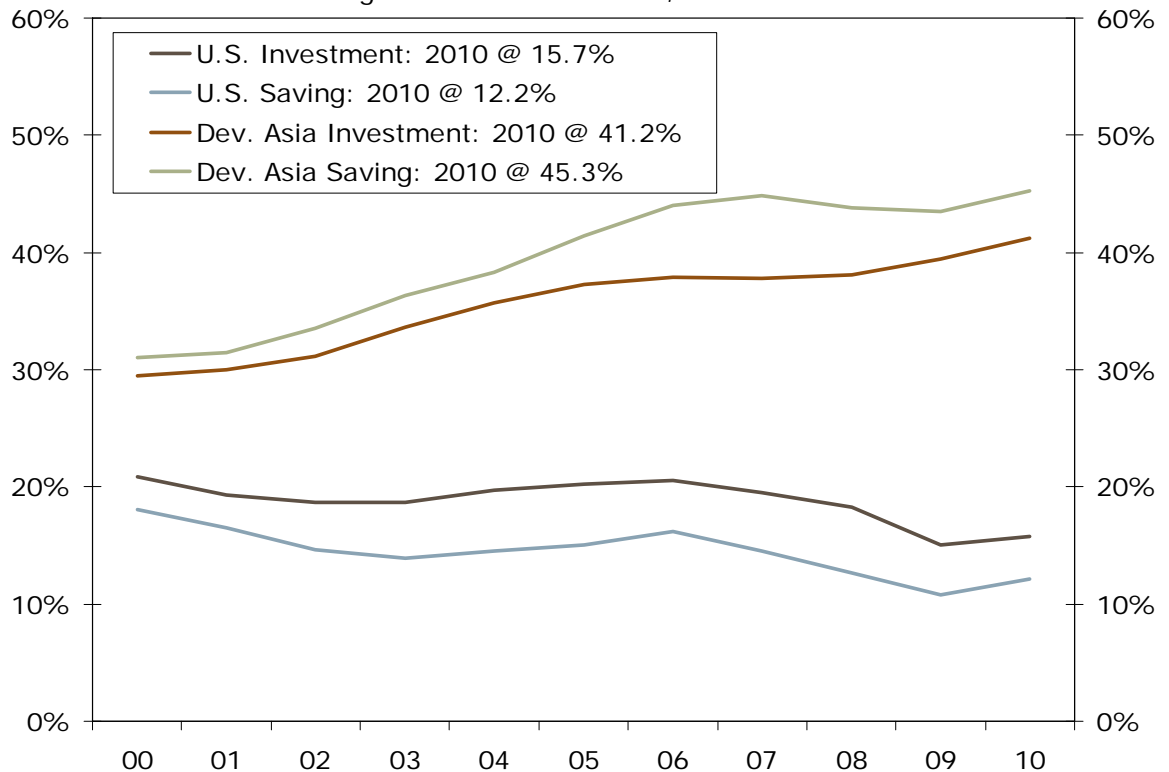


Source: Federal Reserve Board and Wells Fargo Securities, LLC

High saving/investment rates in Asia should continue to underpin strong economic growth for the foreseeable future

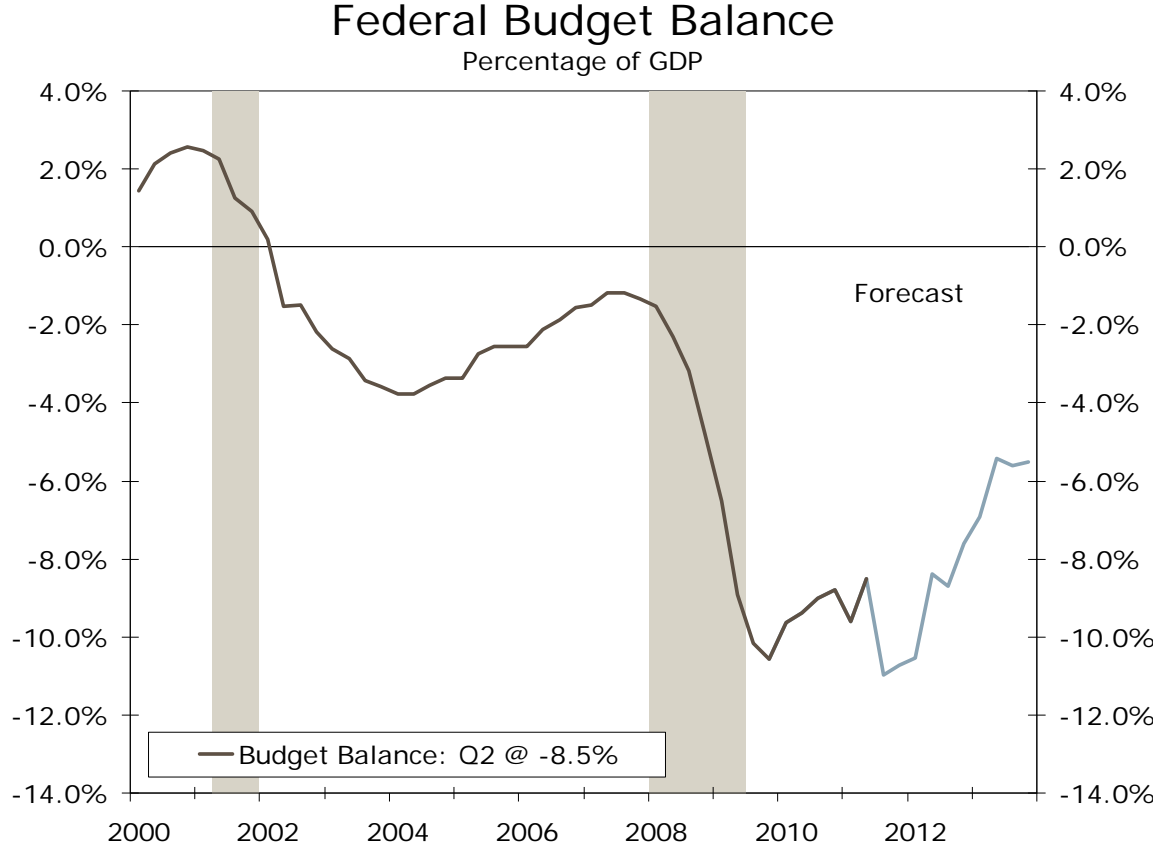
United States and Developing Asia

Saving and Investment Rates, Percent of GDP



Source: International Monetary Funds and Wells Fargo Securities, LLC

The nation has entered uncharted waters in fiscal policy



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

Components of the Federal Budget

Percentage of GDP

	<u>1970</u>	<u>2011</u>	<u>2021 June Baseline</u>
Revenues	19.0	14.8	20.8
Outlays	19.3	24.1	23.9
Social Security, Medicare, and Medicaid	3.8	10.4	12.2
Defense	8.1	4.7	3.6
Other mandatory spending and nondefense discretionary spending	6.0	7.6	4.7
Net interest	1.4	1.4	3.4
Deficit	0.3	9.3	3.1

Note: Figures are shown net of offsetting receipts where relevant. CBO, June 23, 2011

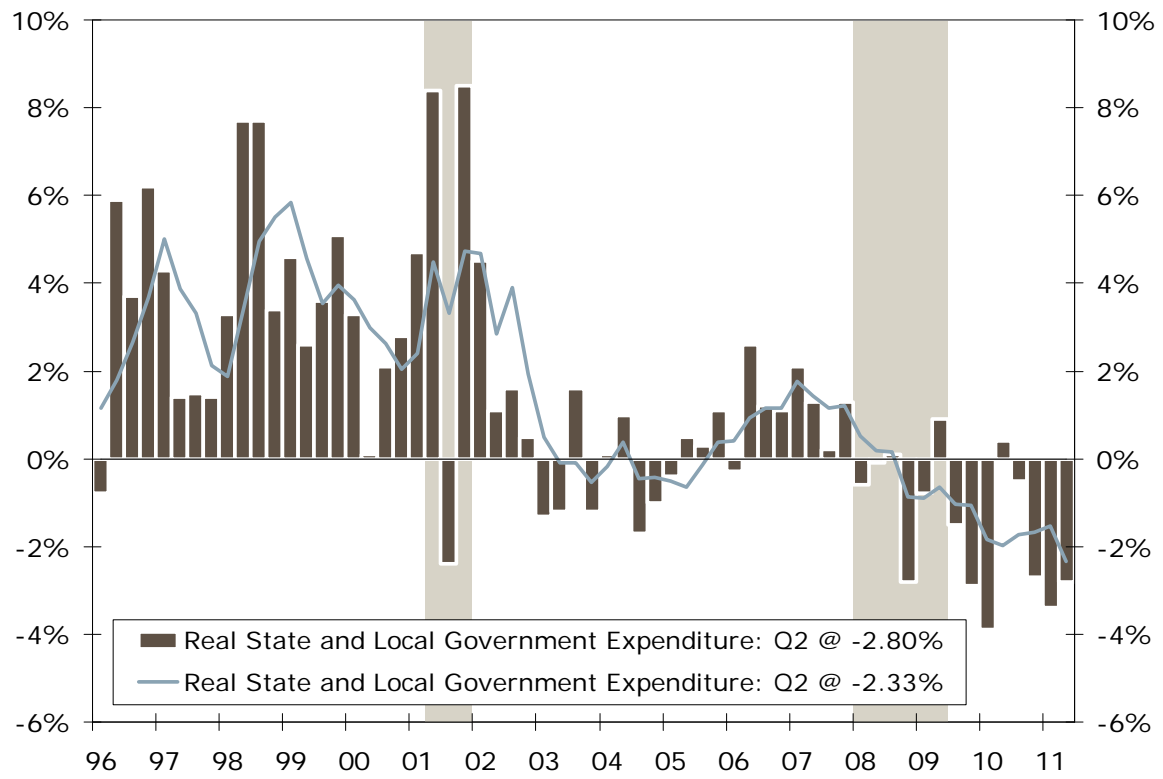
Source: Congressional Budget Office and Wells Fargo Securities, LLC

The future budget picture shows entitlement spending accelerating

State and local fiscal conditions will limit expenditures and gains in GDP

Real State & Local Government Expenditure

Bars = Compound Annual Rate Line = Yr/Yr % Change



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

What are the primary risks to the outlook?

Potential Challenges to the Outlook

- Easier monetary policy brings questions for the dollar, inflation, interest rate and outlook
- Stronger job recovery takes hold
- Fiscal policy: spending completely unconstrained
- Housing: unable to sustain growth on its own
- European debt crisis weighs on global growth

Wells Fargo U.S. Economic Outlook

	Actual			Forecas	
	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Real Gross Domestic Product ¹	-0.4	-3.6	3.0	1.6	1.3
Personal Consumption	-0.7	-2.0	2.0	2.1	1.3
Equipment and Software	-4.1	-16.3	14.6	9.2	5.8
Government Purchases	2.5	1.7	0.7	-2.2	-1.8
Consumer Price Index ²	3.8	-0.3	1.6	3.3	2.7
Corporate Profits Before Taxes ²	-16.4	7.9	32.2	7.5	6.3
10-Year Treasury Note	3.66	3.26	3.22	2.54	2.23

Forecast as of: September 16, 2011

¹ Compound Annual Growth Rate Quarter-over-Quarter

² Year-over-Year Percentage Change

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

Appendix

A Sampling of Our Recent Special, Regional & Industry Commentary

Recent Special Commentary

Date	Title	Authors
September-21	"Operation Twist" Gets Underway	Bryson
September-20	Credit Quality Monitor: September 2011	Anderson & Kashmarek
September-16	Global Chartbook: September 2011	
September-09	The Direction of Treasury Rates: A Japanese Story?	Anderson, Bryson & Seydl
September-08	Long-Term Unemployment: Costs & Consequences	Silvia & Watt
September-07	Housing Data Wrap-Up: September 2011	Vitner, Khan & Seydl
September-07	Brazil: GDP and Central Bank Autonomy	Aleman
September-06	Strength of Currency Weighs on Swiss GDP Growth	Bryson
September-02	Is Another Recession Brewing in Germany?	Bryson & Kruse
September-01	Housing and Arizona, Rebuilding a Marketplace	Aleman & Kruse
August-30	The Evolution of Economic Relationships: The PMI and Growth	Silvia, Iqbal & Watt
August-26	Tacking in Treacherous Water: No Full Sail for QE3	Silvia
August-26	Barzilian Economy: Growing Pains	Aleman
August-24	Will the Renminbi Eventually Rival the Dollar?	Bryson
August-23	State Coincident Indicators Highlight A Disturbing Trend	Vitner & Brown
August-23	Are We Headed for Another Global Recession?	Bryson, Quinlan & Kruse
August-22	Philadelphia Fed Index: Can It Predict a Recession?	Silvia, Khan, Iqbal & Kruse
August-22	Gold Bubble Fears Overblown	Anderson & Kashmarek
August-22	Mexican Economy Grows Despite Slowdown in Q2	Aleman
August-22	The Kids Are Alright	Silvia, Quinlan & Seydl
August-19	Even Slower Growth with Significant Downside Risk	Silvia
August-15	Why Is France in the Crosshairs?	Bryson & Kruse
August-11	Commercial Real Estate Chartbook: Quarter 2	Vitner, Khan & Seydl
August-11	Employment: Beyond the Sound Bites—Reading the Signals III	Silvia & Watt
August-07	S&P Downgrade of Treasury /Fed Credit: Fiscal Imbalances	Silvia & Vitner
August-05	What are the Risks of Recession?	Vitner
August-02	Economic Implications of the Debt Ceiling Compromise	Silvia, Vitner, Bullard & Brown
August-02	Real GDP Per Capita Stalled Out In the First Half of 2011	Vitner & Seydl
August-01	Employment: Beyond the Sound Bites—Reading the Signals II	Silvia & Watt
July-29	Housing Chartbook: July 2011	Vitner, Khan & Seydl
July-27	With Greece "Stabilized," Will the Fire Spread?	Bryson & Kruse
July-25	Is the Greek Debt Problem "Solved?"	Bryson & Kruse
July-21	Employment: Beyond the Sound Bites—Reading the Signals I	Silvia & Watt
July-21	Moody's Blues: Implications for a U.S. Downgrade	Bryson, Quinlan & Seydl
July-15	Employment Issues Linger in New Jersey	Vitner, Khan & Watt
July-15	Global Chartbook: July 2011	
June-30	Maryland: Economic Diversity Breeds Uneven Growth	Silvia, Brown & Kruse
June-30	The Brazilian Exchange Rate Conundrum	Aleman
June-29	Housing Data Wrap-Up: June 2011	Vitner, Khan & Seydl
June-24	Texas Budget: 2012-2013 Biennium	Aleman & Kruse
June-24	Regional Chart Book: Quarter 2	Vitner, Brown & Seydl
June-22	Credit Quality Monitor	Anderson & Kashmarek
June-22	FOMC: Steady as She Goes	Bullard
June-21	An Economic Framework for Financial Services	Silvia, Brown & Watt
June-01	U.K. Trip Notes: Will the Expansion Continue?	Bryson

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