

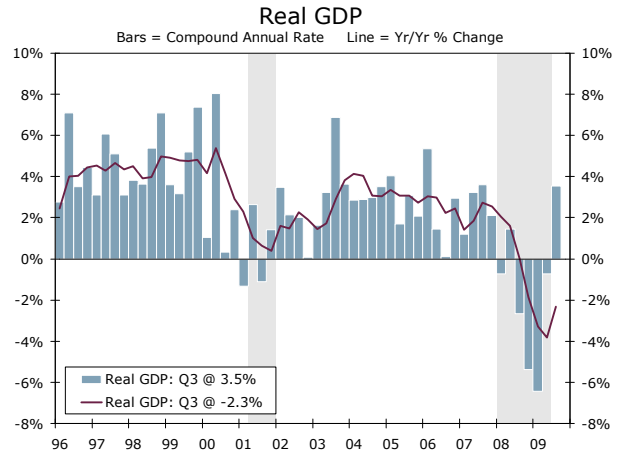
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

GDP: Recovery Yes, But at What Pace? Jobs?

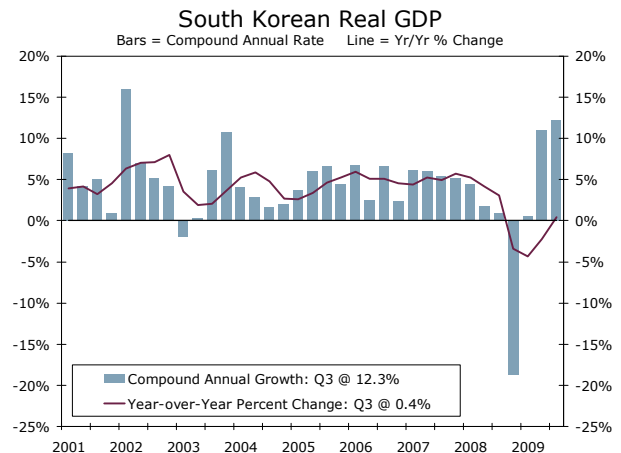
- This week's GDP report signals recovery. Federal spending, as well as tax credit programs for housing and autos, were big positives. The issue going forward will be what the sustainable pace of growth is once the fiscal and monetary stimulus goes away.
- Once again, a jobless recovery appears to be the story for at least the next three months. This pattern where jobs lag growth has become the norm in recent cycles. This suggests that personal income growth and thereby consumer spending will be improve slowly and be subpar relative to the past.



Global Review

Sustainable Recovery in Korea Appears to be Underway

- Real GDP in South Korea rose at an annualized rate of 12.3 percent in the third quarter, the second consecutive quarter of double-digit growth. Although the outturn was flattered by less de-stocking, which cannot lift GDP indefinitely, a self-sustaining recovery appears to be taking hold in Korea.
- Will authorities tighten policy now that prospects for continued growth appear favorable? Benign inflation means that the central bank does not need to slam on the brakes, but we look for it to begin normalizing rates early next year.



Wells Fargo U.S. Economic Forecast														
	Actual				Forecast				Actual			Forecast		
	2008				2009				2006	2007	2008	2009	2010	2011
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
Real Gross Domestic Product ¹	-0.7	1.5	-2.7	-5.4	-6.4	-0.7	3.7	2.8	2.7	2.1	0.4	-2.4	2.4	2.2
Personal Consumption	-0.6	0.1	-3.5	-3.1	0.6	-0.9	2.3	0.0	2.9	2.6	-0.2	-0.8	1.0	1.4
Inflation Indicators ²														
"Core" PCE Deflator	2.4	2.5	2.6	2.0	1.7	1.6	1.3	1.4	2.3	2.4	2.4	1.5	1.2	1.6
Consumer Price Index	4.2	4.3	5.2	1.5	-0.2	-0.9	-1.5	0.9	3.2	2.9	3.8	-0.4	1.6	2.0
Industrial Production ¹	0.2	-4.6	-9.0	-13.0	-19.0	-10.5	3.2	1.7	2.3	1.5	-2.2	-10.4	1.6	3.9
Corporate Profits Before Taxes ²	-4.9	-12.0	-5.4	-25.1	-19.0	-12.6	-11.0	3.5	10.5	-4.1	-11.8	-10.6	7.8	9.8
Trade Weighted Dollar Index ³	70.3	71.0	76.1	79.4	83.2	77.7	74.7	76.0	81.5	73.3	79.4	76.0	81.8	85.3
Unemployment Rate	4.9	5.4	6.1	6.9	8.1	9.3	9.6	10.0	4.6	4.6	5.8	9.2	10.4	9.9
Housing Starts ⁴	1.06	1.02	0.87	0.66	0.53	0.54	0.60	0.60	1.81	1.34	0.90	0.57	0.66	0.80
Quarter-End Interest Rates														
Federal Funds Target Rate	2.25	2.00	2.00	0.25	0.25	0.25	0.25	0.25	5.25	4.25	0.25	0.25	1.25	3.25
Conventional Mortgage Rate	5.97	6.32	6.04	5.33	5.00	5.42	5.19	5.00	6.14	6.10	5.33	5.00	5.50	6.00
10 Year Note	3.45	3.99	3.85	2.25	2.71	3.53	3.31	3.40	4.71	4.04	2.25	3.40	3.80	4.40

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Forecast as of: October 7, 2009
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

Together we'll go far



U.S. Review

**Growth Improves, Final Sales Build Case for Recovery—
Recovery is Here, Just Hold the Champagne for Now**

Third quarter GDP rose 3.5 percent with significant positive contributions from personal consumption, housing, federal spending and inventories. For consumption and housing the improvements reflect tax credit programs. Inventory gains also added nearly one percentage point. Therefore, final sales continue to improve and this provides the underlying demand for growth. However, our expectations are for moderate growth—not a boom.

Sustainable consumer spending requires income and thereby job and wage gains. The latest jobless claims data suggest that jobs remain scarce and that wage gains are likely to be very limited as well. Residential investment and equipment spending are also expected to gradually improve. Federal spending stimulus will also add to growth in the fourth quarter this year and the first quarter next year. Therefore, our expectation is that the recovery is sustainable and we anticipate that growth will be at 2.4 percent next year. Inflation remained low in the third quarter with the core PCE deflator up just 1.4 percent, which should allow the Fed to leave the funds rate unchanged for now.

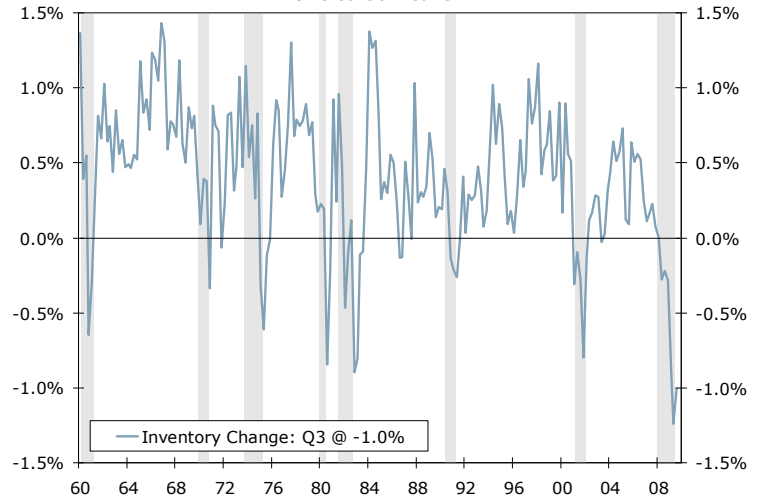
Jobs: Lagging the Recovery Again?

Jobless claims remain stubbornly high at 530,000 consistent with continued jobs losses in the fourth quarter. The emerging pattern in recent economic recoveries is that jobs increasingly lag the recovery. In part, productivity gains in manufacturing have allowed businesses to build output and put existing equipment and plants to work without adding workers right away. Firms hoard skilled labor in a recession and therefore keep workers on the payroll even if they are not always busy. Firms do this because of their concerns about the cost and availability of skilled labor as the recovery begins. For the outlook, the jobs issue becomes an income issue and therefore a challenge to getting the economy up to speed. With weak consumer income gains the pace of consumer spending is also likely to be limited. Our view is that real disposable income will grow just 1.2 percent in 2010 compared to 2.2 percent in 2007. We expect personal consumption to rise just one percent in 2010 compared to 2.6 percent in 2007. Such modest gains in consumer incomes and spending suggest that the demand for auto and mortgage credit will also be subdued relative to the past. This has been noted in the Senior Loan Officer Surveys published by the Fed.

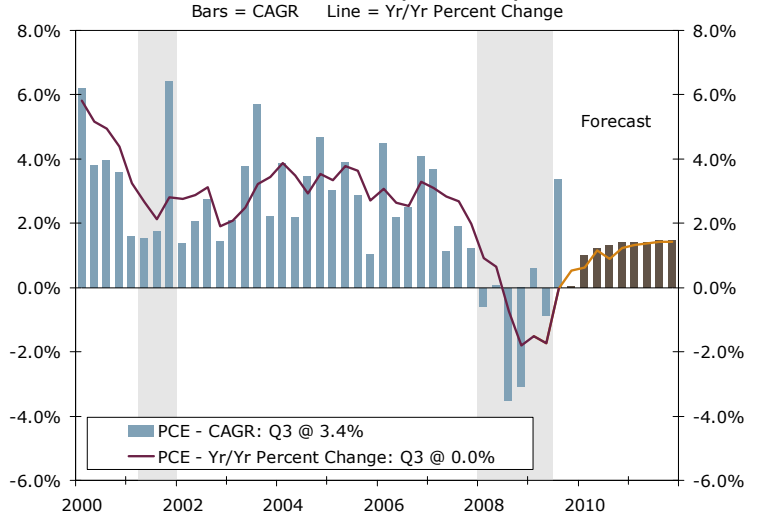
Fundamental Rethink for America?

For our society, modest gains in housing and autos may be reflecting a longer-term change in consumer habits. The deleveraging/increased saving by the consumer suggests that the pace of consumer spending may indicate a slower pace of gains in local property taxes and state income taxes—clearly a challenge to state and local budgets. Slower housing starts and more modest home price appreciation suggests a challenge to the massive housing/home improvement/suburbanization infrastructure that America has built up since World War II. The pace of gains for income and jobs in many states may have to be rethought if the American consumer adopts, or is forced to adopt, a more financially conservative hair shirt.

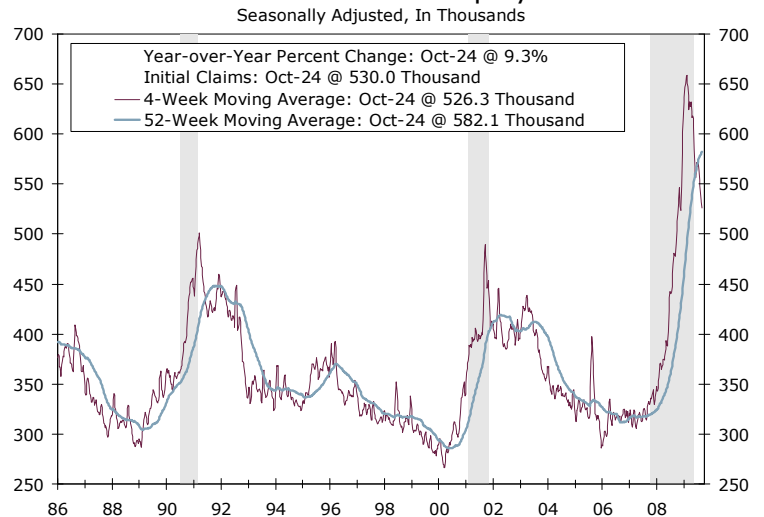
Inventory Change
As Percent of Real GDP



Real Personal Consumption Expenditures



Initial Claims for Unemployment



ISM Manufacturing • Monday

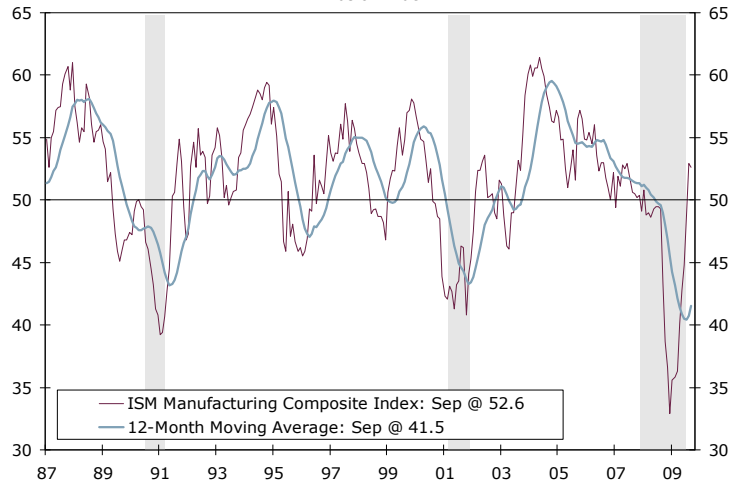
The Institute for Supply Management’s “headline” manufacturing index remained in expansionary territory for the second consecutive month in September. Both the Chicago purchasing managers’ index and Empire Manufacturing Index rose significantly in October suggesting the “headline” ISM will remain in expansionary territory. The forward-looking new orders index has remained well above the threshold of 50 for three consecutive months and will likely remain in expansionary territory. With inventory levels still lean, the spread between the new orders and the inventories indexes continues to suggest further gains in production are likely in coming months. The employment index should remain below break-even suggesting continued job losses in the manufacturing sector for the rest of this year. This is consistent with our estimate of a jobless first year of recovery.

Previous: 52.6

Wells Fargo: 53.8

Consensus: 53.0

ISM Manufacturing Composite Index
Diffusion Index



Nonfarm Productivity • Thursday

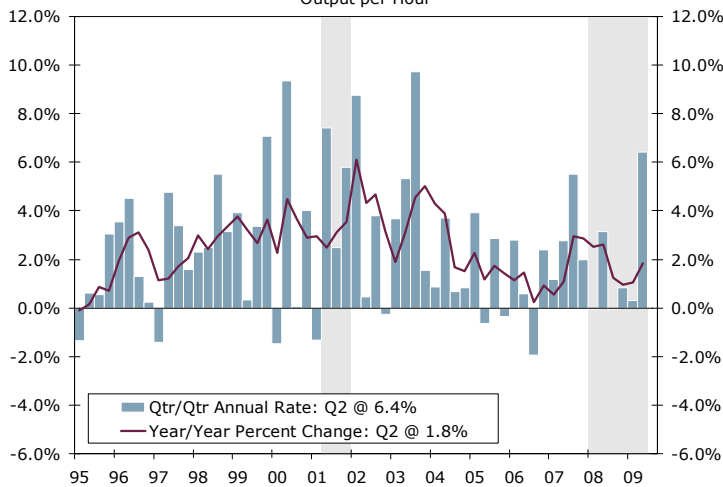
Nonfarm productivity will likely post its second solid gain in the third quarter. Productivity surged in the second quarter after growing at an anemic 1 percent annual rate since the recession began. Slow labor productivity growth is typical during recessions as output contracts and businesses aggressively cut costs. Productivity growth is very cyclical, however, and tends to spike the quarter after the recession ends as output picks up and hours worked continue to fall. Productivity growth should remain elevated well into the first year of recovery. With economic growth rising at 3.5 percent annual rate in the third quarter and hours worked continuing to decline, we expect productivity will surge to an annual rate of 7.0 percent in the third quarter. Unit labor costs should remain at fairly low levels suggesting no inflationary pressure.

Previous: 6.6%

Wells Fargo: 7.0%

Consensus: 5.8%

Nonfarm Productivity
Output per Hour



Employment • Friday

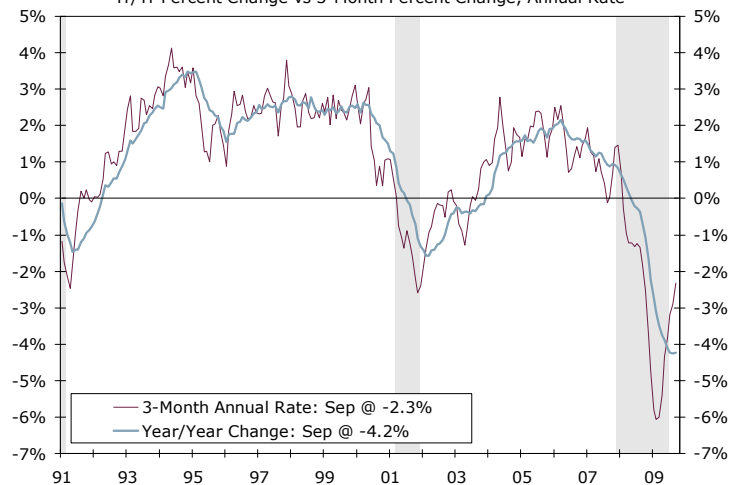
Nonfarm employment fell by 263,000 jobs in September producing a net loss of 7.2 million jobs since the recession began. While job losses continue to mount, the pace of declines has moderated. Weekly first-time unemployment claims peaked in March and are down 21 percent from their high suggesting layoffs have likely subsided. Job openings, however, have fallen 50 percent from their exceeding the peak-to-trough decline for the last recession. It appears businesses are in no rush to hire until economic growth is sustainable. Hence, we expect nonfarm employment likely dropped by 225,000 jobs with the unemployment rate reaching 9.9 percent in October. Nonfarm employment is likely to continue declining into 2010 and the unemployment rate will probably not top out until the middle of next year.

Previous: -263K

Wells Fargo: -225K

Consensus: -166K

Nonfarm Employment Growth
Yr/Yr Percent Change vs 3-Month Percent Change, Annual Rate



Global Review

Sustainable Recovery in Korea Appears to be Underway

Data released this week showed that real GDP in Korea rose at an annualized rate of 12.3 percent in the third quarter, marking the second consecutive quarter in which the Korean economy has expanded at a double-digit rate (see graph on front page). At first glance, one could dismiss the strong growth in the third quarter as nothing more than a short-lived inventory swing. Korean businesses slashed inventories earlier this year when they were convinced that the economy was on the cusp of a very deep recession, but they ended up cutting too deeply. Although businesses continued to pare stocks in the third quarter, the less rapid pace of inventory liquidation helped to lift GDP growth by more than 11 percentage points. Won't the economy roll over again when the frenetic pace of restocking comes to an end?

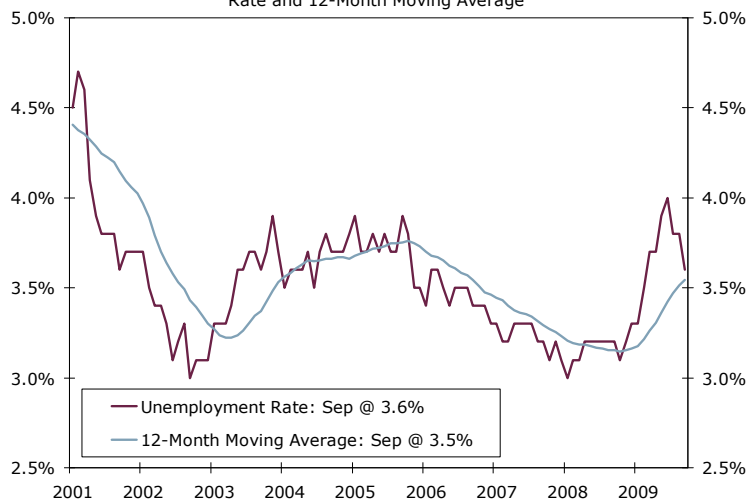
Probably not, because a closer look at the GDP details shows that a sustainable recovery appears to be taking hold. For starters, consumer spending grew nearly six percent during the third quarter, which follows the 16 percent increase registered in the previous quarter. A widely followed measure of consumer confidence has shot up since the spring as the labor market has started to recover. Earlier this year, employment growth was negative on a year-over-year basis. However, payrolls are starting to increase again, helping to boost income. After reaching an eight year high of 4.0 percent in June, the unemployment rate has subsequently declined steadily (top chart).

In addition, growth in fixed investment spending was up nearly four percent in the third quarter. Some of the increase likely reflects temporary infrastructure spending that the government has put in place, but private sources of investment appear to be recovering. Construction spending edged lower in the third quarter, which represents some payback for strength observed during the two previous quarters, but business spending on machinery and equipment rebounded in the third quarter. Moreover, economic recovery in the rest of the world, especially in other Asian countries, to which Korea sends 50 percent of its exports, is helping to stimulate growth in Korea. On a year-over-year basis, real export growth has now returned to positive territory (middle chart). The sequential GDP growth rate in the third quarter would have been even stronger had imports not shot up 30 percent.

Growth in Korea clearly will slow in the quarters ahead. No economy, especially an advanced one like Korea's, can continue to post double-digit growth rates *ad infinitum*. As noted above, however, a self-sustaining recovery appears to be taking hold, and we look for solid Korean GDP growth over the next two years. So will prospects of continued growth cause Korean authorities to tighten policy? The global economic meltdown led the Bank of Korea (BoK) to slash its main policy rate from 5.50 percent to 2.00 percent between October 2008 and February 2009. Although the BoK won't cut any further, a rate hike doesn't look imminent either with the rate of CPI inflation currently benign (bottom chart). That said, most analysts, we included, look for the BoK to begin normalizing rates by early next year.

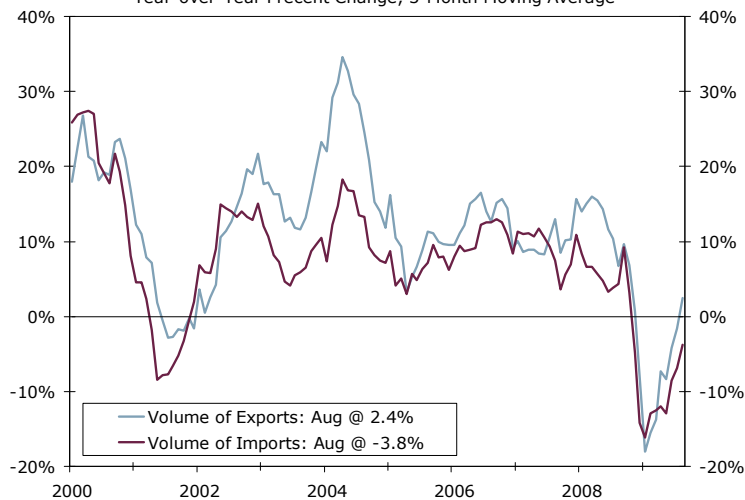
South Korean Unemployment Rate

Rate and 12-Month Moving Average



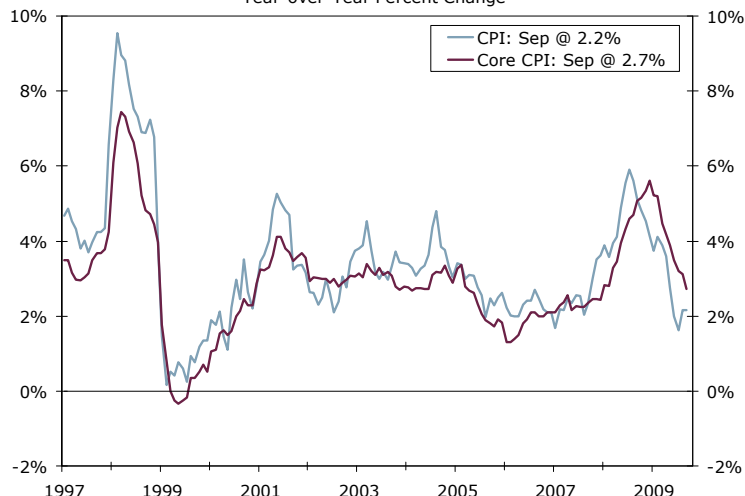
South Korean Export & Import Volumes

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



South Korean Consumer Prices

Year-over-Year Percent Change



Bank of England Policy Meeting • Thursday

The probability is rather low that the Bank of England reduces its main policy rate from 0.50 percent, where it has been maintained since early March. However, in the wake of weaker-than-expected GDP data, which showed the economy continued to contract in the third quarter, there is a fair chance that the MPC announces an increase in its program to purchase government and corporate bonds that is currently targeted at £175 billion.

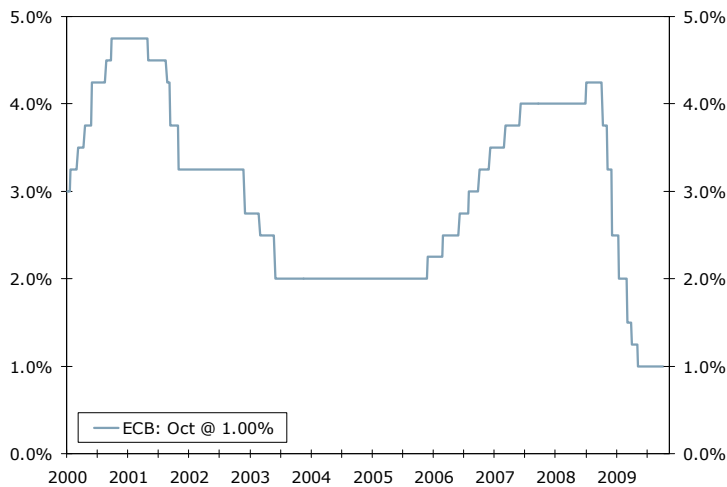
Earlier in the week, the purchasing managers' indices for the manufacturing (Monday), construction (Tuesday) and service sectors (Wednesday) will provide anecdotal evidence of how these sectors fared during October. "Hard" data on industrial production in September are slated for release on Thursday before the Bank of England's decision is announced. A bounce-back from the sharp decline that occurred in August would be welcome news.

Current Policy Rate: 0.50%

Wells Fargo: 0.50%

Consensus: 0.50%

European Central Bank Policy Rate



Canadian Employment Report • Friday

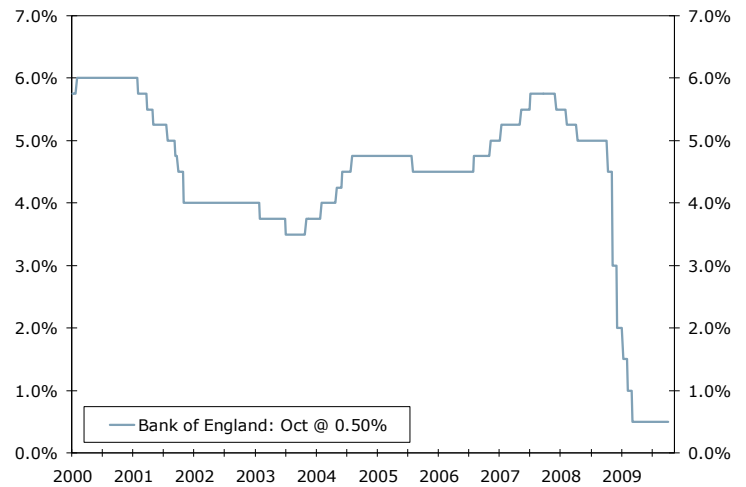
Despite some conflicting signals on the direction of the Canadian economy at present, Canadian employers have added over 50,000 workers to their payrolls over the last two months. On Friday of next week we will find out if the recent strength in the labor market has legs when the Canadian jobs report for October will be released. The consensus is expecting a modest gain. If we do see an increase, it would be a welcome sign of stability in income for Canadian consumers, which could be supportive of consumer spending during the economic recovery.

The Ivey PMI, a key measure business sentiment, will print on Thursday. In September, the index climbed to its highest level since the summer of 2008, so a modest pullback after recent gains would not come as a complete surprise.

Previous: 30.6K

Consensus: 10.0K

Bank of England Policy Rate



ECB Policy Meeting • Thursday

The European Central Bank has maintained its main policy rate at 1.00 percent since May, and there is very little chance that the Governing Council will decide to change the rate on Thursday. The press conference that ECB President Trichet will host after the policy meeting will be of more interest. Perhaps the statements that Trichet will make will give investors some insights into the stance of policy going forward.

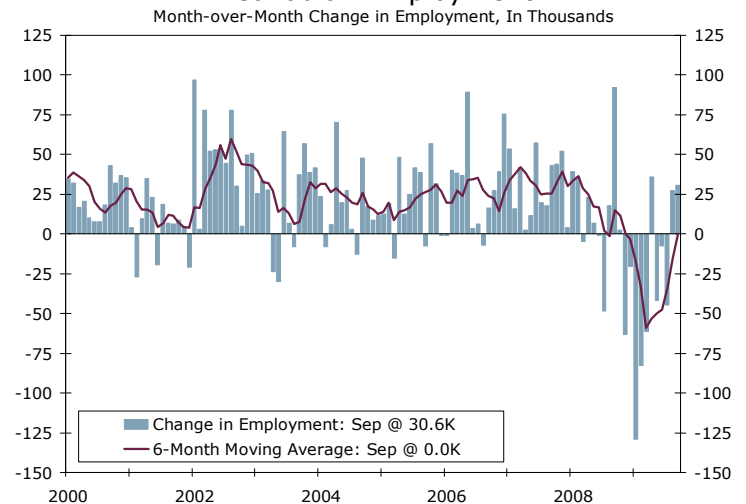
The final PMIs for the Euro-zone manufacturing and service sectors in October will be released earlier in the week, but major revisions to the indices, which both showed significant improvement relative to September, are not expected. Germany will release "hard" data on factory orders on Friday.

Current Policy Rate: 1.00%

Wells Fargo: 1.00%

Consensus: 1.00%

Canadian Employment



Interest Rate Watch

Interest Rates: Uncertainty as We Move Back to Real Market Pricing

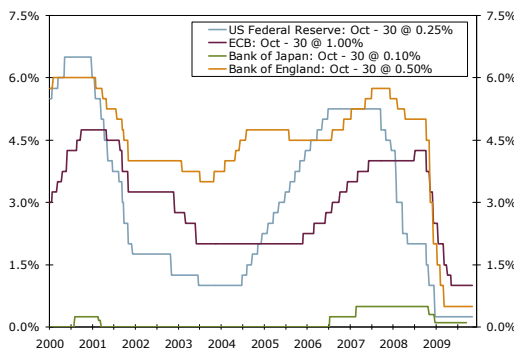
For decision-makers, the major risk over the next six months is the transition from today's government-subsidized interest rates to the unknown true free-market rates as the Federal Reserve ends its purchases and the Obama administration potentially proposes a sustainable fiscal policy.

Monetary policy has generated an excess supply of credit to mop up the excess supply of autos and housing. This excess credit supply is reflected in very low nominal interest rates which are unsustainable over time. Moreover, real interest rates are very high relative to a flat path for real GDP. This relationship gives rise to a debt burden that increases faster than income. In today's economy the thrust of fiscal policy is so strong that the monetary authority could lose its handle on inflation even if the central bank retains control over the monetary base.

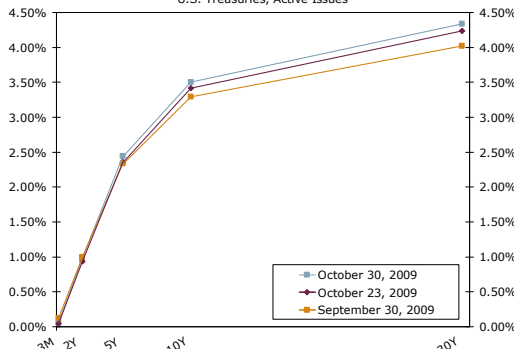
Excess supply of credit is also evident in the very low Ted spread that is reminiscent of the spreads that existed prior to the Lehman. Risk spreads have not normalized because such normalization would certainly have taken account of greater risk given the current state of an uncertain economic recovery and the likely subpar pace of any such recovery. This suggests that spreads are too narrow relative to risk. Other yield spreads also appear distorted. For example, high grade bonds spreads have declined but the Federal Reserve has bought about ten percent of Treasury issuance in recent months. Pricing distortions are even more prevalent in MBS and ABS.

Risks abound as rates and spreads are seriously distorted by government intervention and do not represent free market pricing. For decision-makers there are two challenges—first, there is no clear indication of what the free market yield spread is and second, there is no clear indication how quickly the Fed will withdraw.

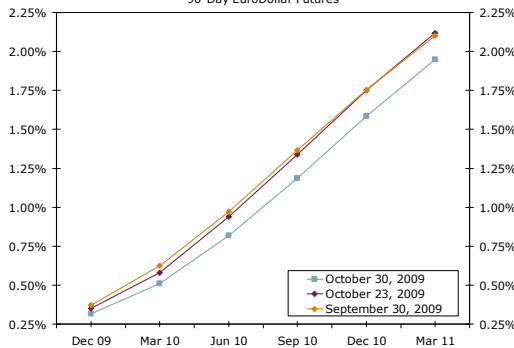
Central Bank Policy Rates



Yield Curve
U.S. Treasuries, Active Issues



Forward Rates
90-Day EuroDollar Futures



Consumer Credit Insights

Recent Evidence Supports Moderate Consumer Gains—No Boom

Consumer confidence, jobless claims and new home sales data support the outlook for a moderate gain in consumer spending—not the boom that would be typical of past recoveries. The recession is over—yet the recovery will likely be modest. Federal programs have helped in the short-run but there appears to be limited follow-on from such programs.

Consumer confidence fell in October and has not improved in three months. The core issue appears to be the lack of jobs. The jobs hard to get series has risen the last two months while the jobs plentiful series has declined. This picture is corroborated by the jobless claims data. Claims have stopped declining and have stalled at the 530,000 mark. This level is consistent with at least 200,000 job losses in the payroll survey as well as a continued rise in the unemployment rate.

The outgrowth of job uncertainty is reflected in the new home sales data. Sales of new homes fell in September as the expiration of the first-time home buyer tax credit probably altered the timing of sales. However, one element in the consumer confidence data suggests a deeper problem. Consumer buying plans for a new car fell to an all-time low. There is no follow-through on car buying and home buying from one-time federal subsidies without job creation and that still appears to be months away. The recovery is here but the pace of recovery will disappoint.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	5.03%	5.00%	4.94%	6.46%
15-Yr Fixed	4.46%	4.43%	4.36%	6.19%
5/1 ARM	4.42%	4.40%	4.42%	6.36%
1-Yr ARM	4.57%	4.54%	4.49%	5.38%
MBA Applications				
Composite	562.3	641.0	649.6	476.7
Purchase	254.9	268.8	270.4	303.1
Refinance	2,352.5	2,808.0	2,857.3	1,489.4

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

Topic of the Week

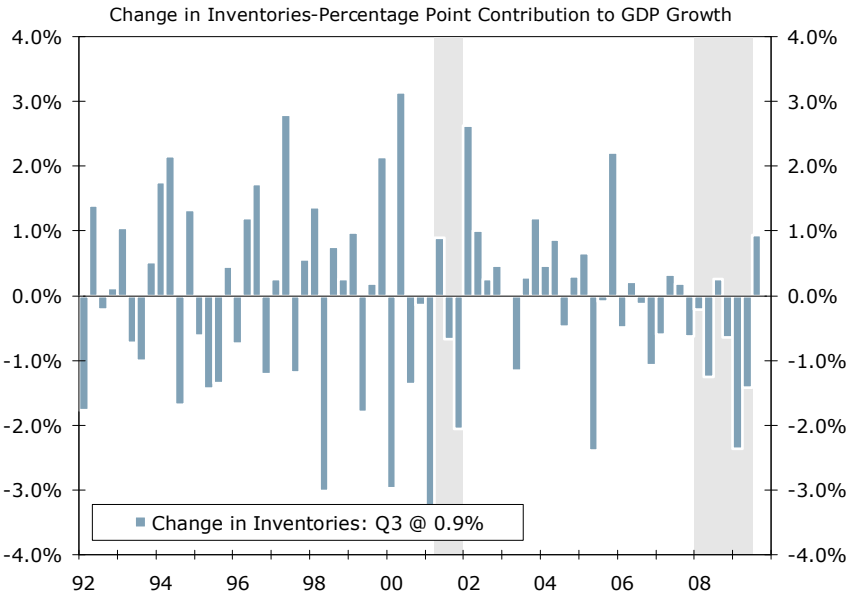
Stimulus Helps to Push Up Q3 GDP

As noted in the domestic section of this report, real GDP grew at an annualized rate of 3.5 percent in the third quarter. Over the past few quarters, there have been various stimulus programs that have been enacted and these measures showed up in the overall growth number. For starters, consumer purchases of durable goods shot up 22.3 percent. Remember “cash for clunkers”? This program was clearly behind the strong growth in durable goods purchases last quarter. Residential construction soared 23.4 percent, the first positive outturn in this series in nearly four years. The \$8000 tax credit for first time homebuyers undoubtedly contributed to the upturn in housing starts over the past few months. In addition, non-defense expenditures by the federal government rose 6.8 percent.

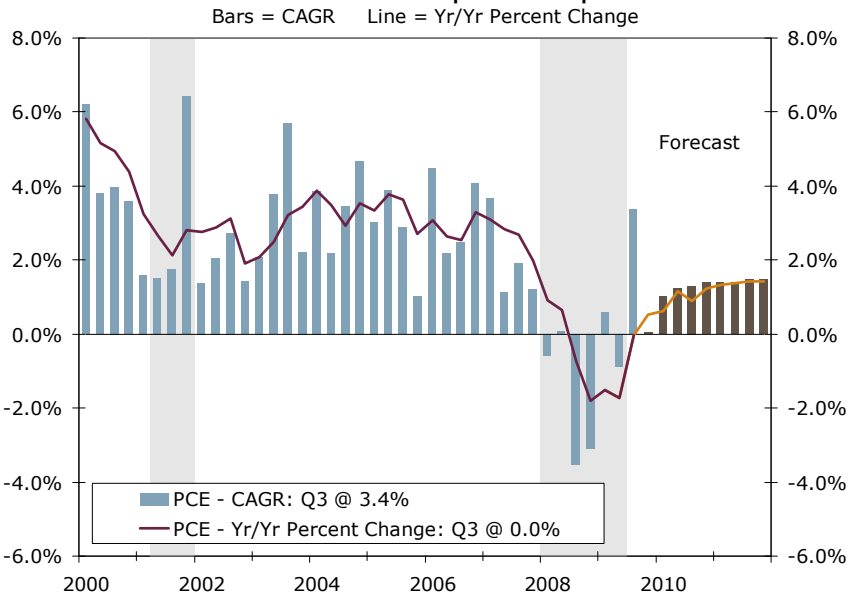
However, it would be a mistake to claim that the third quarter’s growth rate reflects nothing more than the temporary effects of fiscal stimulus that soon will fade. For example, non-durable consumer spending was up 2.0 percent and expenditures on services rose 1.0 percent. Business spending on equipment and software edged up 1.1 percent, and exports grew 14.7 percent. It is difficult to make the case that all of these categories were impacted significantly by fiscal stimulus. Moreover, the less rapid pace of inventory liquidation also helped to lift overall GDP growth.

Fiscal stimulus clearly helped to push up growth in the third quarter, but it is not the entire story. In our view, the economy will be hard pressed to register 3 percent GDP growth over the next few quarters. Consumer spending and residential construction will clearly be weaker in the fourth quarter now that “cash for clunkers” has ended and the home buyer tax credit is winding down. However, exports should continue to post decent growth and business fixed investment spending should also remain positive. The inventory swing will also add positively to growth. Although the pace of growth likely will be sluggish, we nevertheless look for continued recovery.

Real Gross Private Domestic Investment



Real Personal Consumption Expenditures



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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 10/30/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.05	0.05	0.38
3-Month LIBOR	0.28	0.28	3.19
1-Year Treasury	0.46	0.45	1.15
2-Year Treasury	0.94	1.00	1.56
5-Year Treasury	2.37	2.45	2.80
10-Year Treasury	3.44	3.49	3.96
30-Year Treasury	4.27	4.29	4.33
Bond Buyer Index	4.39	4.31	5.35

Foreign Exchange Rates

	Friday 10/30/2009	1 Week Ago	1 Year Ago
Euro (\$/€)	1.480	1.501	1.292
British Pound (\$/£)	1.653	1.631	1.645
British Pound (£/€)	0.895	0.920	0.785
Japanese Yen (¥/\$)	91.029	92.060	98.608
Canadian Dollar (C\$/¥)	1.080	1.054	1.200
Swiss Franc (CHF/\$)	1.022	1.009	1.139
Australian Dollar (US\$/A\$)	0.910	0.922	0.682
Mexican Peso (MXN/\$)	13.058	13.089	12.584
Chinese Yuan (CNY/\$)	6.827	6.829	6.841
Indian Rupee (INR/\$)	46.975	46.520	49.675
Brazilian Real (BRL/\$)	1.729	1.717	2.105
U.S. Dollar Index	76.158	75.468	84.556

Foreign Interest Rates

	Friday 10/30/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.67	0.69	4.79
3-Month Sterling LIBOR	0.59	0.60	5.88
3-Month Canadian LIBOR	0.50	0.50	3.10
3-Month Yen LIBOR	0.33	0.33	0.98
2-Year German	1.32	1.38	2.47
2-Year U.K.	0.88	0.91	2.95
2-Year Canadian	1.43	1.52	2.03
2-Year Japanese	0.26	0.28	0.59
10-Year German	3.27	3.35	3.77
10-Year U.K.	3.64	3.68	4.44
10-Year Canadian	3.45	3.50	3.72
10-Year Japanese	1.42	1.37	1.50

Commodity Prices

	Friday 10/30/2009	1 Week Ago	1 Year Ago
WTI Crude (\$/Barrel)	79.25	80.50	65.96
Gold (\$/Ounce)	1043.13	1055.40	738.13
Hot-Rolled Steel (\$/S.Ton)	485.00	515.00	860.00
Copper (¢/Pound)	299.15	302.40	188.85
Soybeans (\$/Bushel)	9.78	10.01	9.09
Natural Gas (\$/MMBTU)	5.23	4.79	6.43
Nickel (\$/Metric Ton)	18,620	19,078	13,457
CRB Spot Inds.	438.48	434.30	379.82

Next Week's Economic Calendar

	Monday 2	Tuesday 3	Wednesday 4	Thursday 5	Friday 6
U.S. Data	ISM Manufacturing September 52.6 October 53.8 (W) Construction Spending August 0.8% September -0.2% (W)	Factory Orders August -0.8% September 0.8% (W) Total Vehicle Sales September 9.2M October 9.8M (W)	ISM Non-Manufacturing September 50.9 October 51.3 (W) FOMC Rate Decision Previous 0.25% Expected 0.25% (W)	Nonfarm Productivity 2Q 6.6% 3Q 7.0% (W) Unit Labor Costs 2Q -5.9% 3Q -5.5% (W)	Nonfarm Payrolls September -263K October -225K (W) Unemployment Rate September 9.8% October 9.9% (W)
Global Data	UK PMI Manufacturing Previous (Sep) 49.5		UK PMI Services Previous (Sep) 55.3	UK BOE Announces Rates Previous 0.50% Euro-zone ECB Announces Rates Previous 1.00%	Canada Net Chg in Employment Previous (Sep) 30.6K Germany Factory Orders (MoM) Previous (Aug) 1.4%

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

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