

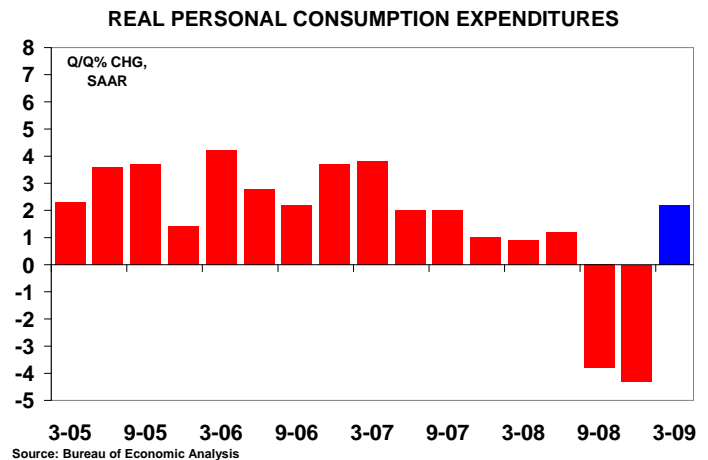
<u>Date</u>	<u>Indicator</u>	<u>For</u>	<u>Estimate</u>	<u>Consensus*</u>	<u>Previous Period</u>
04-May-2009	Construction Spending	MAR	-1.7%	-1.5%	-0.9%
04-May-2009	Pending Home Sales	MAR	82.0		82.1
05-May-2009	ISM-NMI	APR	42.0	42.0	40.8
05-May-2009	ISM-NMI – Prices	APR	40.5		39.1
07-May-2009	Initial Claims 05/02		635K		631K
08-May-2009	Nonfarm Payrolls	APR	-640K	-635K	-663K
08-May-2009	Manufacturing Payrolls	APR	-160K	-160K	-161K
08-May-2009	Unemployment Rate	APR	9.0%	8.8%	8.5%
08-May-2009	Wholesale Inventories	MAR	-1.4%		-1.5%

\*Consensus from Action Economics

**The Patient Leaves the Intensive Care Unit, but Remains in the Hospital**

The U.S. economy, like a patient that has just been through a terrible auto accident, is responding to therapy. The Fed’s round-the-clock care surrounding the bank liquidity crisis and heroic efforts to bring interest rates, especially mortgage rates, to all-time lows is now having a noticeable effect on a number of financial markets and indeed the real economy. But perhaps just as important for this nascent economic recovery is the economy’s own self-healing powers. Any doctor will tell you they just help the patient on their way to recovery, but it is the human body itself that does most of the work. The same can be said of the U.S. economy. Investor optimism has soared and stock prices have jumped. Draconian cuts at U.S. businesses in the first quarter appear to have allowed company earnings to somewhat exceed analysts’ dour expectations. Companies have been preparing for the worst while hoping for the best and seem to be catching up with the drop in aggregate demand. Bond investors are dumping safe and low yielding Treasury bonds, for higher risk, but juicier returns found in corporate bonds. Even junk bonds are finding some love these days.

We can see the self-healing powers of the economy in the details of this week’s Q1 GDP report. Consumer spending recovered, rising a better-than-expected 2.2 percent in real terms. Real final sales, which is GDP excluding the impact of inventory swings, improved to -3.4 percent in Q1 from -6.1 percent in Q4 2008. It wasn’t the miraculous impact of the fiscal stimulus package that caused the consumer rebound. Indeed, Federal government spending actually plunged at a 4.0 percent pace in Q1, while state and local governments trimmed spending at a 3.9 percent pace as the impact of declining tax revenues bit even harder. No, consumers appear to have responded to better real income growth, largely due to declining inflation and gas prices and tax refunds that are running about 25 percent above a year ago. Declining market prices are acting like automatic demand stabilizers, just as Economics 101 says it should.



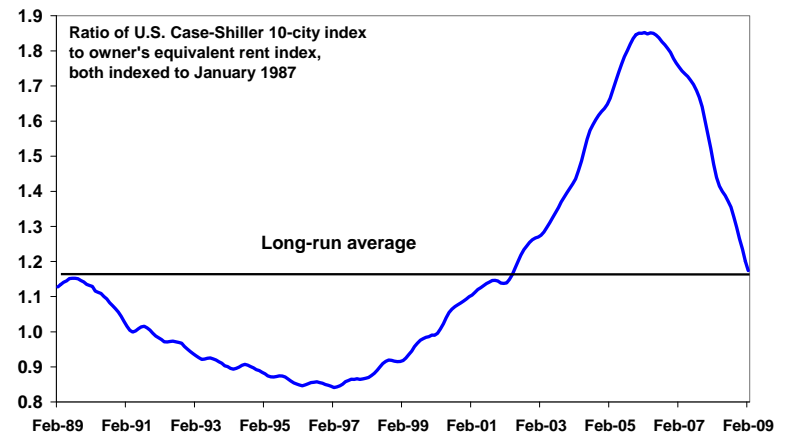
The pullback in business spending was brutal. Non-residential fixed investment dropped at a 37.9 percent pace in Q1. Commercial construction fell at a 44.2 percent pace, ensuring that the drag from commercial construction is now larger than that coming from residential real estate. Inventories plunged by almost \$104 billion, and exports and imports slumped at more than a 30 percent pace. Businesses were largely reacting to the weakness of consumer demand in Q3 and Q4 of 2008. The fact that consumer demand is stabilizing and businesses have already cut so aggressively in Q1 raises the odds the economy will right itself by the third quarter of this year.

The housing market is healing, not through the magic of some Federal program to modify loans or tax credits for new homebuyers, though those programs don’t necessarily hurt, but because homebuilding is off more than 80 percent from its

peak nationwide and is currently trending about 50 percent below what is needed to keep up with current household growth. Homebuyers are now snapping up foreclosed properties that are, in many cases, almost 50 percent below market prices of just a few years ago. Housing is truly affordable TODAY!!!!

There are still some major downside risks to the outlook. The H1N1 flu virus is one of them. So far, the economic impacts on the U.S. appear to be minor, impacting mainly the travel and tourism trade, but that could change quickly should the death rate climb and the virus spread intensifies. Consumer confidence could cool and the number of shopping trips people take severely curtailed. Economic research has shown that a flu pandemic, on the order of the 1918 Spanish flu pandemic that killed between 20 and 40 million people, could swipe 5 to 6 percent off GDP growth. A milder flu pandemic, however, could be hardly noticed, and may only reduce GDP by at most 0.5 or 1.0 percent of GDP.

## Home Price/Rent Ratio



Source: Case Shiller Index; Bureau of Labor Statistics; Wells Fargo Economics

On the policy front, I see some opportunities for major disappointment, which could impact sentiment and the timing and strength of economic recovery. Most pressing is the release of the bank stress test results, which has the potential to trigger another financial shock of its own. Depending on which banks fail to meet the government's arbitrary standards and scenarios, their stock and bonds could be punished by investors. Also, given the fact that banks, in many cases, are disputing the government's results, the entire exercise could end up adding to investor confusion and fear, instead of producing financial transparency and stability.

Another fear of mine is the launch of the government TALF program that is supposed to ramp up to lending of over \$1.0 trillion to help facilitate the purchase of a wide range of asset-backed securities. The success of this program is a critical piece of the Fed's plan to revive and sustain consumer lending in a number of areas. So far, however, investors' appetite has been modest at best, and the Fed itself has stated that it expects the program to start out slowly. If the TALF program fails to live up to its expectations, bank credit could remain tight, or tighten further down the road, dampening the ability of the economy to heal on its own.

Finally, The April FOMC statement released on Wednesday noted the improving economic outlook and didn't add to government's current credit easing commitments. This came as a major disappointment to the long-term Treasury bond market, which is eyeing a tremendous increase in new Federal borrowing and Treasury supply which needs to be absorbed. The Fed's purchase of \$300 billion in Treasury notes and bonds through September may not be enough to keep mortgage and interest rates at record-low levels for long. The Fed will probably have to increase its purchases of such assets if it expects to sustain the mortgage "refi" boom and keep its monetary medicine flowing to the economy.

# Major Economic Indicators

May 1, 2009

Economic Data	History					Forecast				Q4 to Q4 % Chg or Annual Average						
	2008.1	2008.2	2008.3	2008.4	2009.1	2009.2	2009.3	2009.4	2010.1	2010.2	2010.3	2010.4	2007	2008	2009	2010
Real GDP*	0.9	2.8	-0.5	-6.3	-6.1	-1.8	0.1	1.8	2.0	3.7	3.7	3.0	2.3	-0.8	-1.6	3.1
Personal Consumption Expenditures*	0.9	1.2	-3.7	-4.3	2.2	-1.0	-1.0	1.4	1.6	2.4	2.0	2.2	2.2	-1.5	0.4	2.1
Private Housing Starts (000s units)	1,053	1,025	876	661	523	478	630	736	832	996	1,002	1,083	2,073	904	592	978
Vehicle Sales (mill. Units, annualized)	15.2	14.1	12.9	10.3	9.5	10.2	10.6	10.9	11.2	11.7	12.1	12.5	16.5	13.1	10.3	11.9
Nonfarm Payroll Employment (mil.)	137.9	137.7	137.3	135.6	133.6	132.2	131.2	130.7	130.8	131.3	132.1	133.1	136.1	137.6	131.9	131.8
Unemployment rate	4.9	5.3	6.0	6.9	8.1	8.9	9.3	9.6	9.7	9.7	9.7	9.5	4.6	4.6	9.0	9.7
CPI* (percent)	4.4	4.4	6.1	-8.6	-2.3	0.5	1.2	0.8	0.8	0.5	0.6	0.4	4.0	1.5	0.0	0.6
PPI* (percent)	7.9	9.6	9.4	-20.4	-4.5	-0.2	0.3	0.1	0.3	-0.6	-0.3	-0.3	6.8	1.4	-1.1	-0.2
Compensation Per Hour*	3.7	1.7	5.7	5.1	4.2	3.2	2.0	1.9	2.0	2.0	1.7	1.3	3.6	4.1	2.8	1.8
Productivity*	2.6	4.7	2.1	-0.5	0.5	2.3	2.2	2.2	2.5	2.8	2.6	2.5	2.7	2.2	1.8	2.6

\*Quarterly Data Percent Change At Annual rate; Annual Data Q4 to Q4 % Chg.

Financial Data	History				Month-to-Date		Current	Forecast (monthly)								
	2008.10	2008.11	2008.12	2009.01	2009.02	2009.03	2009.04	5/1/2009	2009.05	2009.06	2009.07	2009.08	2009.09	2009.10	2009.11	2009.12
S & P 500	969	883	877	867	806	757	849	874								
Dow Jones Industrial Average	9,177	8,620	8,590	8,408	7,698	7,235	7,996	8,179								
NASDAQ	1,730	1,542	1,526	1,539	1,488	1,432	1,642	1,716								
Federal Funds Rate	0.63	0.42	0.13	0.17	0.23	0.22	0.15	0.25	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Treasury-3 Month Bills (yield)	0.67	0.19	0.03	0.13	0.30	0.22	0.16	0.15	0.18	0.20	0.23	0.23	0.23	0.23	0.23	0.23
Treasury-10 Year Notes (yield)	3.82	3.51	2.41	2.50	2.87	2.82	2.93	3.19	3.03	2.93	2.98	3.03	3.08	3.13	3.18	3.23
Prime Rate	4.54	4.00	3.61	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
Libor 3-Mo. U.S. Dollar	4.06	2.28	1.80	1.22	1.24	1.27	1.11	1.01	1.04	1.01	1.01	1.01	1.01	1.01	1.01	1.01
Mortgage-15 Year (yield)	5.85	5.86	5.17	4.73	4.79	4.65	4.51	4.48	4.46	4.36	4.41	4.46	4.51	4.56	4.61	4.66
Mortgage-Adjustable (yield)	5.18	5.29	5.02	4.90	4.88	4.85	4.83	4.77	4.77	4.67	4.72	4.77	4.82	4.87	4.92	4.97
Mortgage-30 Year (yield)	6.16	6.16	5.42	5.05	5.13	5.02	4.82	4.78	4.77	4.67	4.72	4.77	4.82	4.87	4.92	4.97
GNMA (yield)	5.28	5.86	5.76	5.28	5.19	5.13	4.83	4.59	4.43	4.33	4.38	4.43	4.48	4.53	4.58	4.63
BAA Corporate (yield)	8.87	9.20	8.42	8.13	8.09	8.42	8.40	8.24	8.08	7.98	8.03	8.08	8.13	8.18	8.23	8.28

Source: Wells Fargo Economics, Macroeconomic Advisers, Bloomberg, Federal Reserve