

Plunging into the New Year

Highlights

- Worst recession in post-war period in duration and depth
- U.S. GDP to contract until 2H09
- Another 3.7M jobs could be lost
- Unemployment rate between 8.5% and 9.0%
- A period of deflation is likely
- Consumer spending will resume in 2H09 but remain below average
- Act II: Steep declines in business spending and exports
- Residential real estate will bottom in 2009, but commercial real estate will join the slowdown as job losses mount
- Lower mortgage and corporate bond rates expected

Year Two of Recession

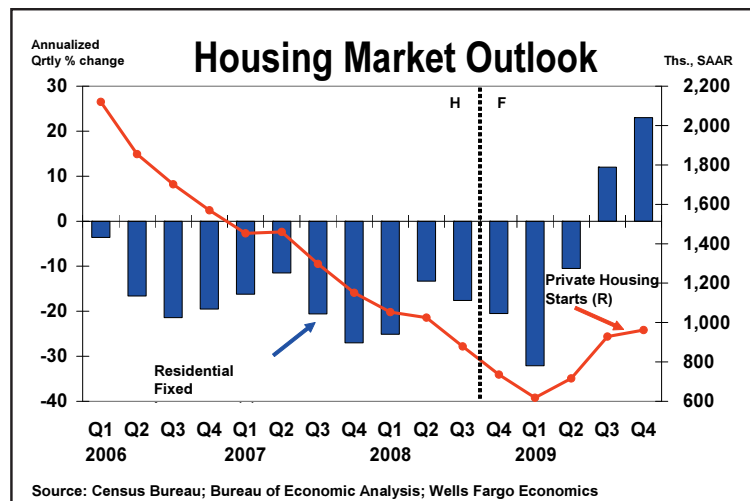
Happy New Year! And welcome to year two of the U.S. recession and year one of the global recession. As we head into 2009, the U.S. economy continues to plunge like an aircraft that has lost all lift. There is very little in the economic tea leaves to give economists hope that a recovery is nigh. I am not one to dwell on the doom and gloom. Honestly, I'm not sure how much more bad news readers can take. So let me start with some positives. First, the sector that led the U.S. economy into this economic and financial morass—housing—is about to turn a corner and start adding, at least modestly, to economic growth in 2009, perhaps as early as this summer. After nearly three years of steep contraction, U.S. home builders, those that remain standing, have been through the worst housing decline since the Great Depression. Building permits have dropped from a cyclical peak of 2.3 million units in September 2005 to a mere 616K units in November 2008. That's a 73 percent decline so far, and takes out the low-water mark on all previous post-war housing declines. It is fairly clear, given the renewed drop in homebuilder confidence and continued oversupply of new homes, that homebuilding will continue lower in the first quarter of 2009, but before year-end, expect housing to be one of the first sectors to lead the U.S. out of recession.

The Economy of the Republic

The primary support for the economy in 2009 will be the U.S. government as it pours trillions of dollars of additional spending into the economy. Some of that additional spending will be non-discretionary, the natural stabilizers that surface as the economy goes into recession. New spending on unemployment benefits, food stamps, and other welfare payments have already jumped and are expected to rise much further over the coming year. In addition, the Obama Administration is expected to pursue an ambitious economic stimulus plan to restart our ailing economy. As of this writing, we anticipate something on the order of \$750 billion in additional spending, spread primarily over the next two years. While details of the plan remain murky and any proposal must still make its way through the new Congress, we already are privy to some vague outlines. A focus on infrastructure spending like roads, bridges and schools is anticipated. This is expected to add new jobs to the economy and perhaps partially offset

steeper declines in general business spending and private commercial real estate. Certainly such spending is sorely needed and will provide economic benefits well beyond the next few years. The downside is that the stimulus will be too concentrated

in only one industry, and won't be an instant panacea for what ails us. Another focal point of any new stimulus package is expected to be middle class tax cuts. This plays a similar role as the instant tax rebate



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checks that were a key provision of the 2007 stimulus package, but is expected to offer a more sustained improvement in consumer spending as people see it as a more permanent adjustment to disposable income than a one-time check. If a stimulus of this magnitude or greater is passed, we believe it will be sufficient to return U.S. GDP growth into the plus column. Much of the stimulus, however, isn't expected to be put to work until the second half of the year and into 2010. Until that time, the U.S. economy will largely have to fend for itself with the stimulus already injected into the economy.

Buddy, Can you Spare a Dime? Deficit Nation

But if economics teaches us anything, it is that there is no such thing as a "free lunch." So, what are some likely side effects from the application of such powerful fiscal medicine? The glaringly obvious one is that we will see a rapid acceleration in the U.S. Federal deficit both in nominal terms and as a share of GDP. While point estimates of the FY 2009 budget deficit are difficult, I believe we can be assured of a budget deficit comfortably over \$1.0 trillion in 2009 and 2010. We are currently estimating a \$1.3 trillion dollar deficit for 2009. In the first two months of the fiscal year alone the Treasury reported a deficit of \$408 billion. If these estimates were to come to pass, the Federal deficit, as a share of GDP, would balloon to 9.1 percent from just under 3.0 percent currently. Any deficit figure over 6.0 percent of GDP makes economists nervous about a possible collapse in the currency or other nasty side effects such as a bout of inflation that would push bond yields higher, increasing the cost of borrowing for most consumers and businesses. Also, in the long-run you have to service that debt or pay it down, which means higher tax

rates and slower economic growth in the future. While many of these side effects of fiscal stimulus are not in our baseline forecast for the coming year, the risks rise longer-term.

Labor Gets the Axe

Get ready for one of the worst labor markets in many decades. The economy has lost 1.9 million jobs

of non-farm payrolls.

Lower Interest Rates Might Not Help All That Much

The Fed has come to the end of its ability to throw its traditional lever of monetary policy—the Fed funds target rate—to lower interest rates on Treasury

plunged about a percentage point on the news, dropping from 6.0 percent on the 30-year fixed rate to around 5.0 percent), there is reason to worry that this too might be a false start. First our credit problems are not just ones of insufficient credit demand; it is also a problem of credit supply. If the Fed flattens the yield curve by bringing down long-term lending rates, while the short-term interest rate is already around zero and can't fall any further, this will work to reduce the profits that banks derive from the spread they receive between their cost of funds and the rate at which they can lend. This might make banks even more reluctant to lend in the future, even as borrowers become more enthusiastic about borrowing. Another factor working against the Fed in 2009 will be the decline in inflation. Even if the Fed is successful in reducing long-term market rates for borrowers, a drop in inflation of a similar amount would completely offset any improvement in the real interest rate, or the rate of interest after adjusting for inflation, which is the "true" cost of borrowing. In other words, a drop in nominal rates may just be a mirage, and borrowers could find that their real costs of borrowing aren't really that attractive after all.

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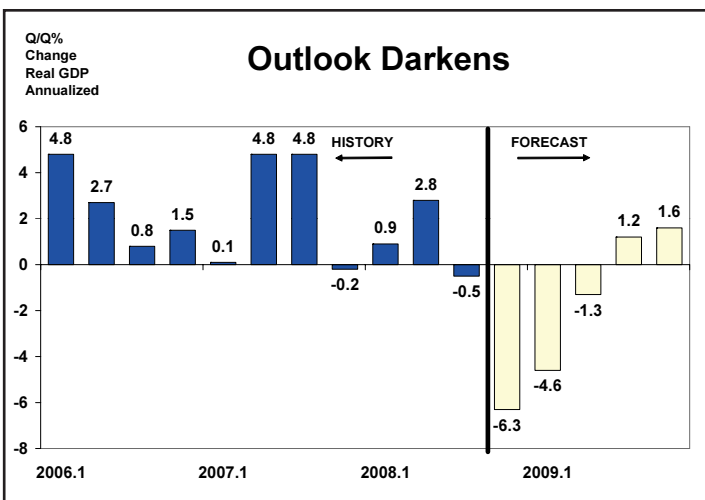
	PCE (%)	NRFI (%)	UE (PP)	Jobs (%)	Jobs (#, mil)
'73-'75	-1.8%	NA	+4.1	-2.0%	-1.6
'81-'82	-0.8%	NA	+3.3	-3.0%	-2.7
'90-'91	-1.1%	-8.2%	+2.3	-1.4%	-1.5
'08-'09	-3.1%	-12.3%	+4.4	-4.0%	-5.5

Peak to trough changes

Source: BEA; BLS; Wells Fargo Economics

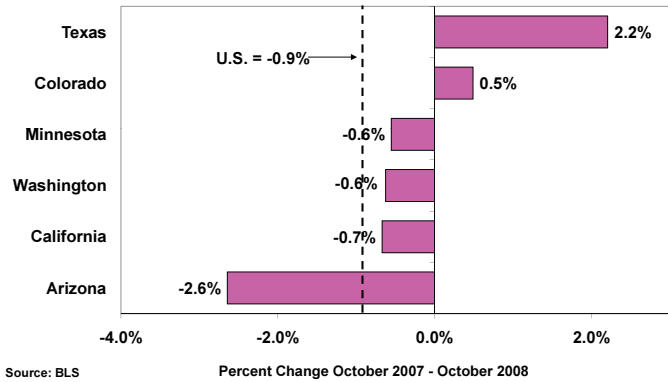
since the start of the recession, and many more will disappear before the economy rights itself. The job losses through August were a mere trickle compared to the numbers that were slashed in September, October and November (1.3 M), as businesses in nearly all industries began to hunker down for a prolonged period of declining revenue and sales. We are forecasting another 3.7 million job losses in 2009 as service businesses find themselves overstaffed to meet expected demand. Since services businesses comprise about 85 percent of total non-farm payrolls, the weakest service sector in decades will have an outsized impact on the national unemployment rate and total job losses. This brings the expected total recession job losses to around 5.5 million for a peak to trough decline of 4.0 percent in non-farm payrolls. This will push the U.S. unemployment rate by year-end to between 8.5 and 9.0 percent. How does that stack up to past recessions? In the 1981-'82 recession, the labor market shed 2.7 million jobs or 3.0 percent

bonds, mortgages and corporate bonds. In order for monetary policy to be effective in the coming year, the Fed needs to embark on a new tactic: buying hundreds of billions of dollars of longer-term MBS directly in order to directly push down longer-term mortgage rates and restart the demand for credit. This program may be expanded to include longer-term Treasury bonds or even corporate bonds in the year ahead. While widely welcomed by the markets (mortgage rates have

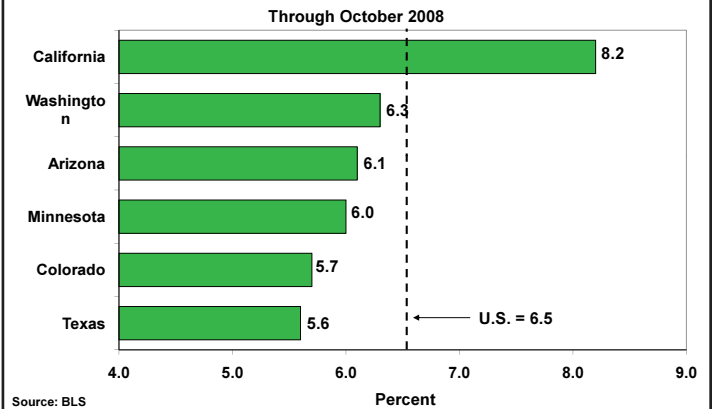


Regional Overview

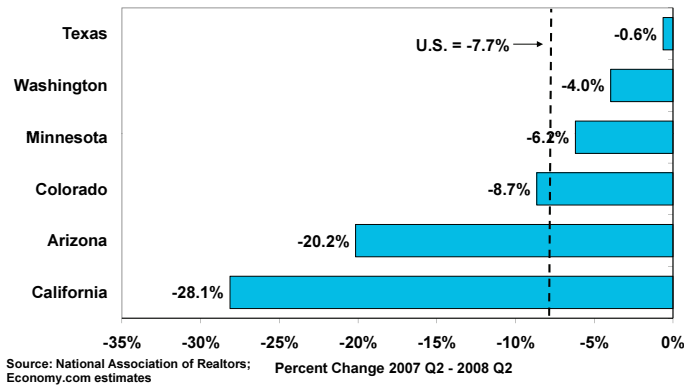
Employment Growth



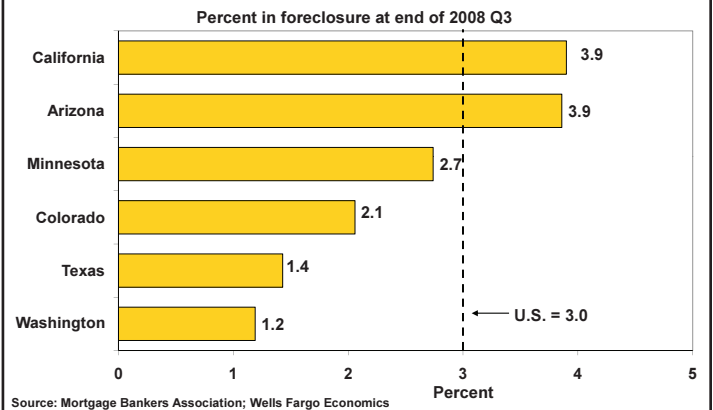
Unemployment Rates



Median Home Prices



Foreclosure Rates



Economic Data	History				Forecast				Q4/Q4 % chg or Annual Average			
	2008.1	2008.2	2008.3	2008.4	2009.1	2009.2	2009.3	2009.4	2006	2007	2008	2009
Real GDP*	0.9	2.8	-0.5	-6.3	-4.6	-1.3	1.2	1.6	2.4	2.3	-0.8	-0.8
Personal Consumption Expenditures*	0.9	1.2	-3.7	-4.3	-3.0	-1.5	1.4	1.4	3.2	2.2	-1.5	-0.4
Private Housing Starts (000s units)	1,053	1,025	879	736	618	716	929	962	2,073	1,341	923	806
Vehicle Sales (mill. Units)	15.2	14.1	12.9	10.3	10.7	10.9	11.2	11.6	16.5	16.1	13.1	11.1
Nonfarm Payroll Employment (mil.)	137.9	137.7	137.4	136.2	134.9	133.8	133.0	132.5	136.1	137.6	137.3	133.6
Unemployment rate	4.9	5.3	6.0	6.8	7.5	8.0	8.5	8.8	4.6	4.6	5.8	8.2
CPI* (percent)	4.3	5.0	6.7	-7.2	-1.7	0.6	1.1	0.9	1.9	4.0	2.2	0.2
PPI* (percent)	9.2	10.6	8.6	-18.8	-6.3	-1.0	1.0	0.2	0.3	6.7	2.2	-1.5
Compensation Per Hour*	3.8	0.9	4.1	5.4	3.6	2.4	1.9	1.8	5.0	3.6	3.6	2.4
Productivity*	2.6	3.6	1.3	-0.5	-0.2	3.0	3.7	2.8	0.8	2.7	1.8	2.3

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

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

State and Area Job Forecast 2007-2009

State/Area	2007 Jobs (000s)	Percent Change			State/Area	2007 Jobs (000s)	Percent Change		
		08e	09f	10f			08e	09f	10f
California	15,166	(0.4)	(2.5)	0.8	Alaska	317	0.7	(0.6)	1.2
Southern California	8,209	(1.1)	(2.9)	0.6	Washington	2,931	1.0	0.0	1.7
LA-Long Beach	4,118	(0.7)	(3.2)	0.1	Seattle-Tacoma	1,457	1.9	0.5	1.9
Orange County Area	1,513	(2.0)	(3.3)	1.0	Oregon	1,732	0.0	(0.5)	1.4
San Diego	1,308	(0.4)	(2.1)	0.9	Portland	1,037	0.3	(1.2)	1.3
Riverside	1,269	(1.8)	(2.0)	1.3	Idaho	655	(0.4)	(0.6)	1.5
Bay Area	2,943	(0.2)	(3.0)	0.6	Utah	1,251	0.8	(1.6)	0.3
San Francisco	987	0.9	(3.1)	0.5	Salt Lake City	639	0.8	(2.5)	0.5
Oakland	1,048	(1.6)	(3.2)	0.5	Colorado	2,330	1.2	0.2	1.8
San Jose	908	0.1	(2.9)	0.9	Denver	1,241	1.0	(0.6)	1.4
Central California	1,009	0.7	(1.8)	0.3	Wyoming	288	2.7	0.4	0.9
Sacramento	904	(0.8)	(2.2)	1.2	Montana	445	1.5	(0.1)	0.1
Nevada	1,292	(0.6)	(0.9)	2.1	North Dakota	358	1.2	(0.6)	0.4
Las Vegas	927	(0.2)	0.0	2.1	South Dakota	407	1.4	(0.0)	0.8
Arizona	2,667	(1.2)	(1.2)	1.7	Nebraska	963	1.1	0.1	1.3
Phoenix	1,909	(1.4)	(2.1)	1.1	Iowa	1,517	0.4	(1.1)	(0.3)
New Mexico	843	0.6	(0.1)	1.5	Minnesota	2,772	(0.1)	(0.7)	1.1
Texas	10,592	2.2	0.7	2.1	Minneapolis-St. Paul	1,798	(0.0)	(1.1)	1.4
Dallas Area	3,004	2.2	1.1	2.3	Wisconsin	2,882	(0.6)	(1.3)	(0.1)
Houston	2,612	2.5	1.3	2.2	Milwaukee	857	(0.9)	(2.1)	(0.3)
San Antonio	850	2.1	1.4	2.3	Indiana	2,989	(0.4)	(1.0)	1.0
Austin	756	2.4	2.0	3.0	Illinois	5,980	0.0	(1.3)	0.3
					United States (millions)	137.6	(0.2)	(2.8)	0.4