



An invisible sun

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**Everything is connected.
You just can't see it now.**

What you want to know

- **Are we in a recession?**
 - ◆ More yes and little no (typical economist)
 - ◆ What's a recession
- **What is holding the economy back**
 - ◆ Fear of the unknown
 - ◆ De-leveraging
- **What is pulling the economy ahead**
 - ◆ Productivity (technological and global)
 - ◆ Trade growth

GDP Breakout by Sector

$$C + I + G - (X-M)$$

$$GDP = 11,720 = 8,341 + 1,694 + 2,088 - 350 *$$

$$71\% + 14\% + 18\% - 3\%$$

* Net exports bottomed out at (\$638) or 5.7% in the 4th quarter of 2005

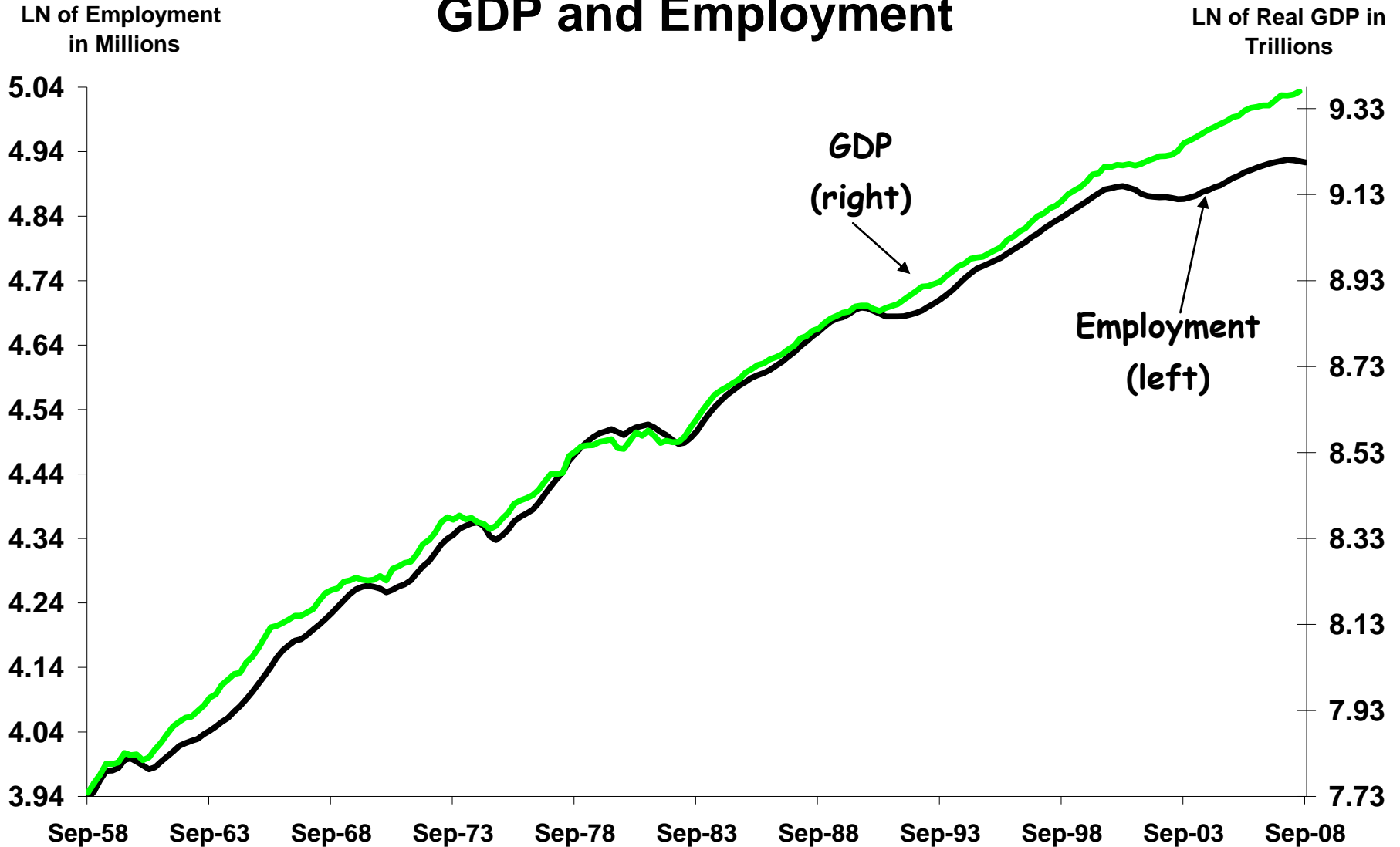
Source: BEA 3rd Qtr – advance release (billions 2000 dollars)

It's hard to put the economy into recession

- Long-term GDP growth is 3%
- Output grows with inputs and productivity
 - ◆ Larger labor pool **0.6%**
 - ◆ More capital invested **1.0%**
 - ◆ Productivity gains **1.4%**
- A recession temporarily reduces demand not supply capacity

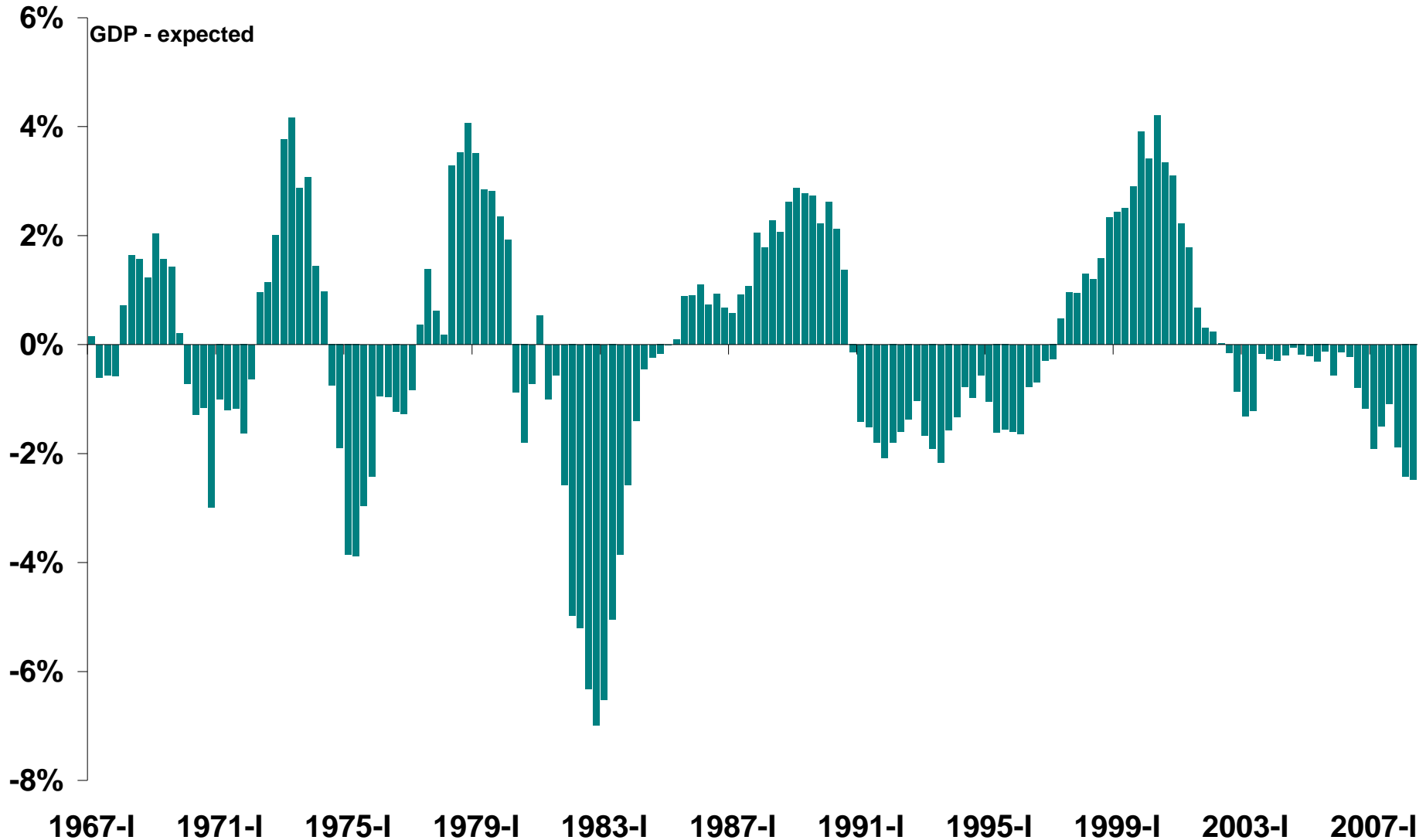
What's changed?

GDP and Employment



Cyclical still but different

Surfing a Different Wave



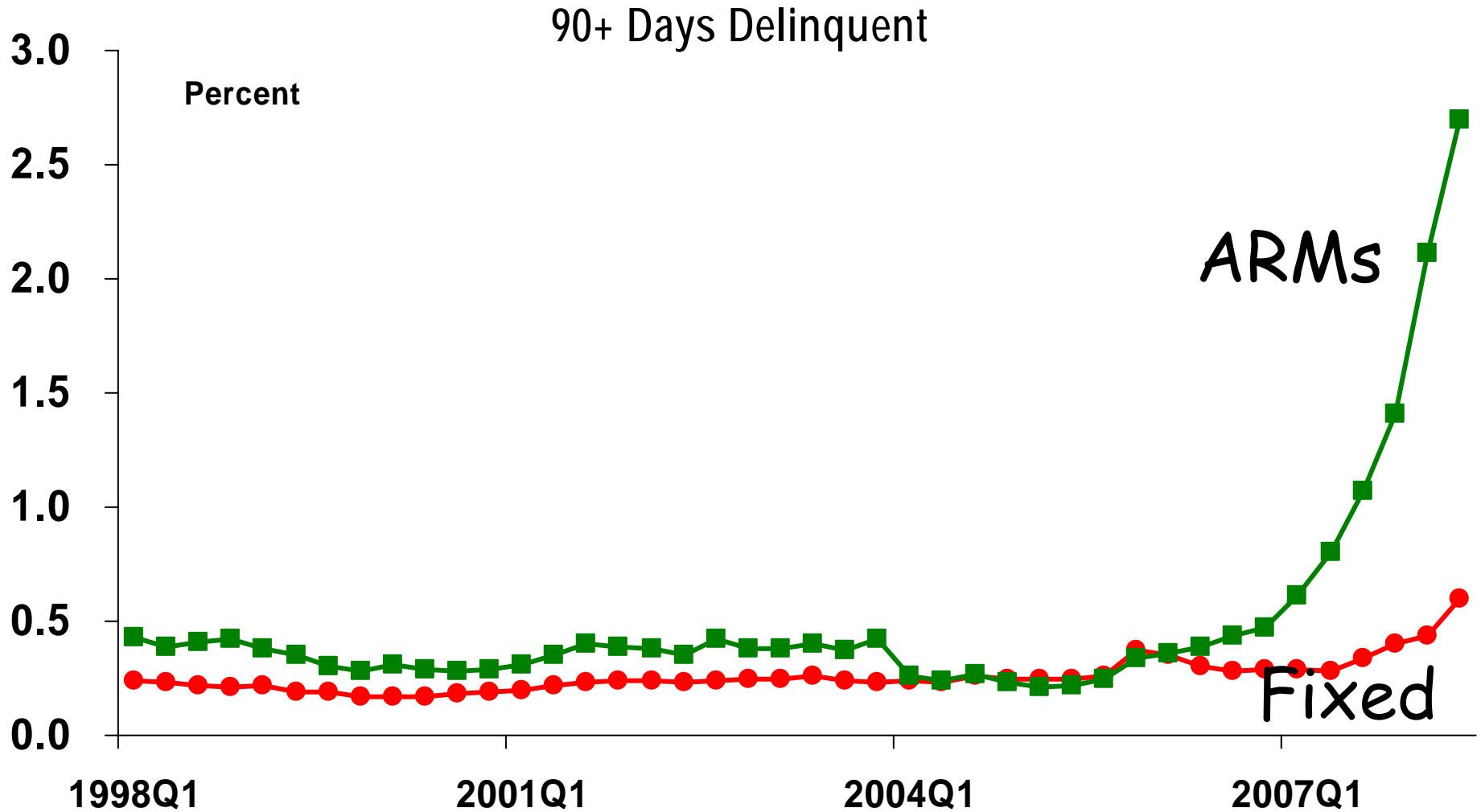
**If housing started this mess,
how is it doing?**

What Type of Housing Market?

- “Over built” or just “Over priced”
 - ◆ Triangle of price, interest rates and income
 - ◆ Interest rates and income still there
 - ◆ Prices need to readjust
- An “ARM problem” not Sub Prime

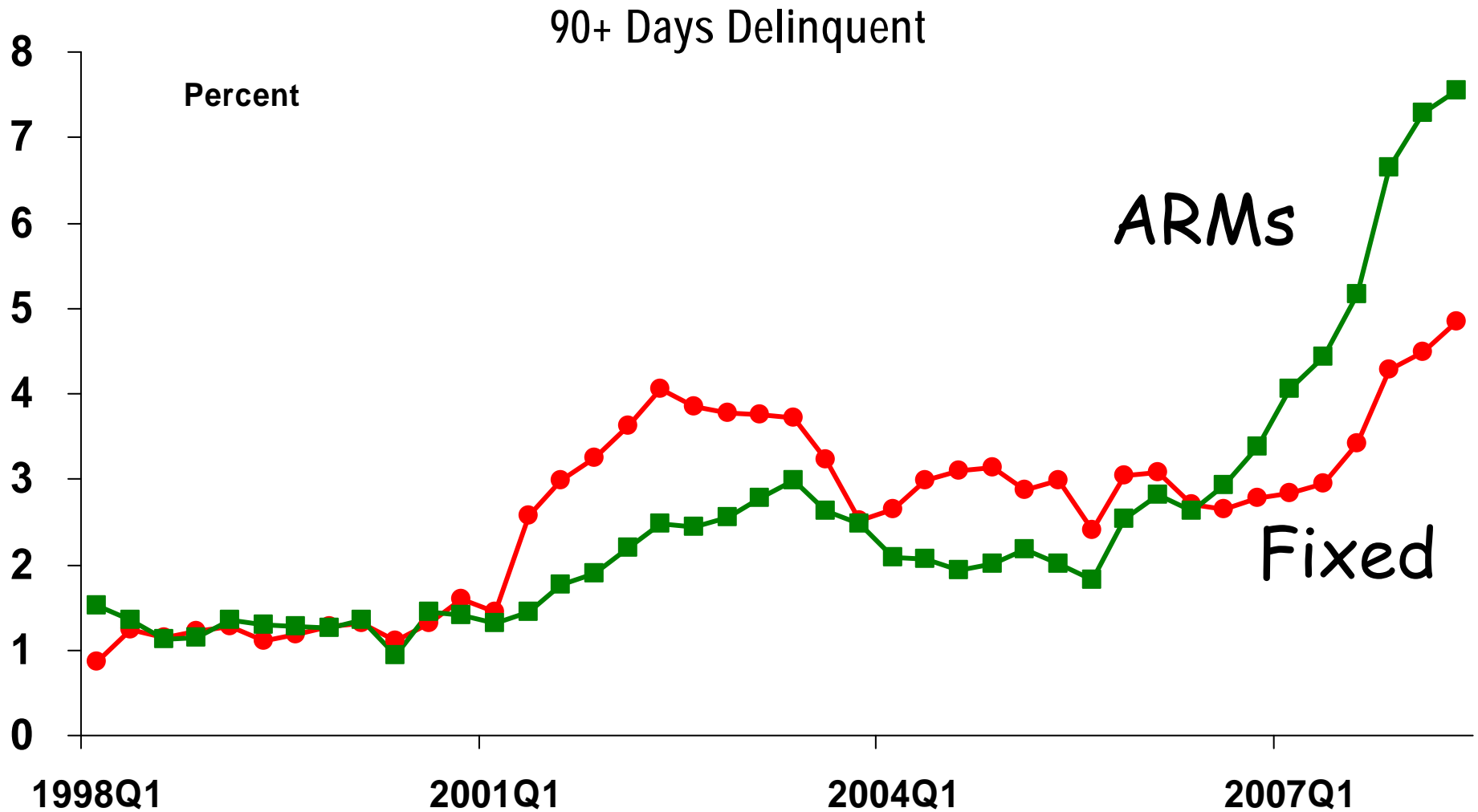
You can't hug your house
with a "nuclear" ARM

Prime is hurting as well



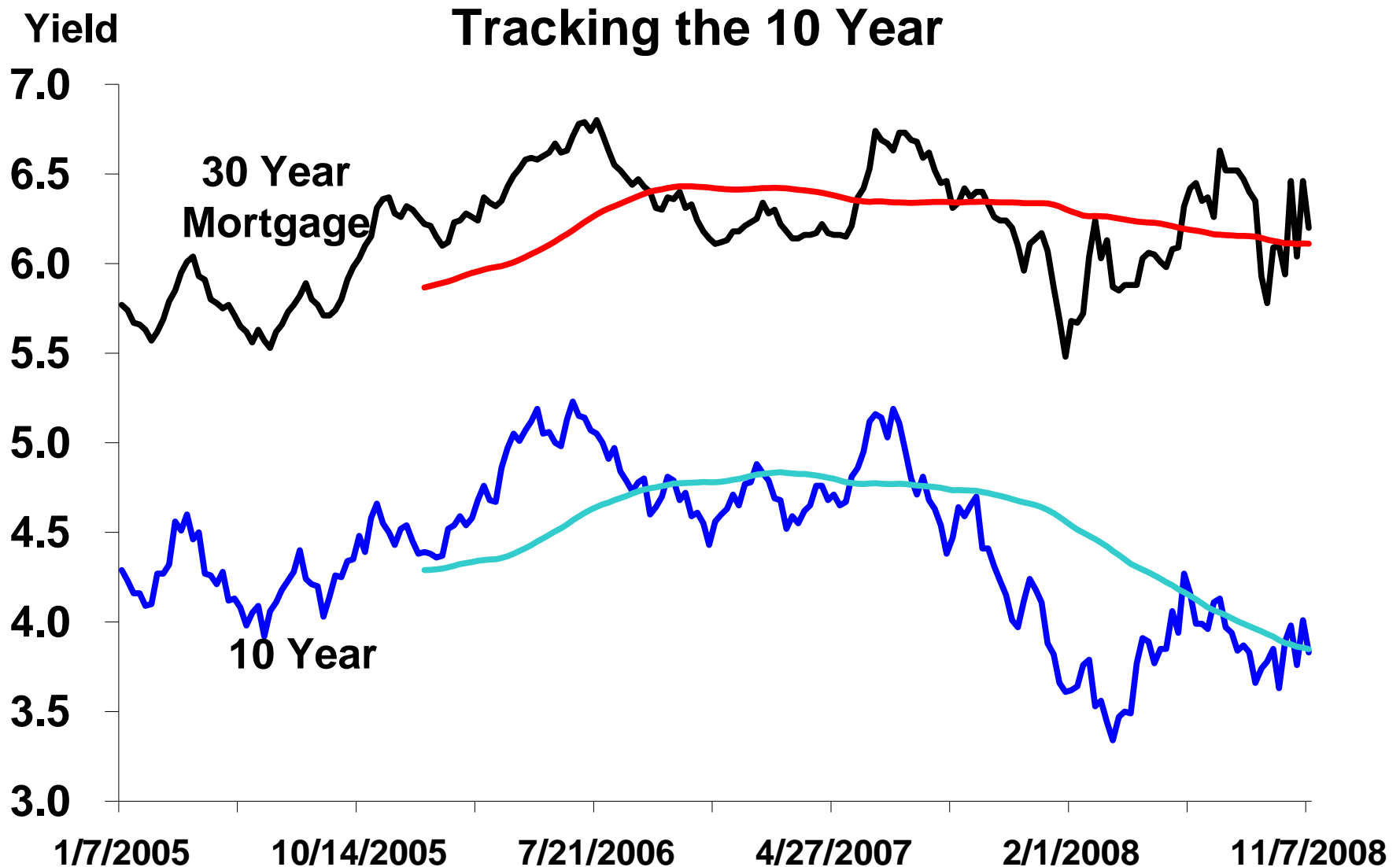
Source: Wells Fargo, MBA

Sub-prime is a complete mess



Source: Wells Fargo, MBA

But, mortgages are still reasonable



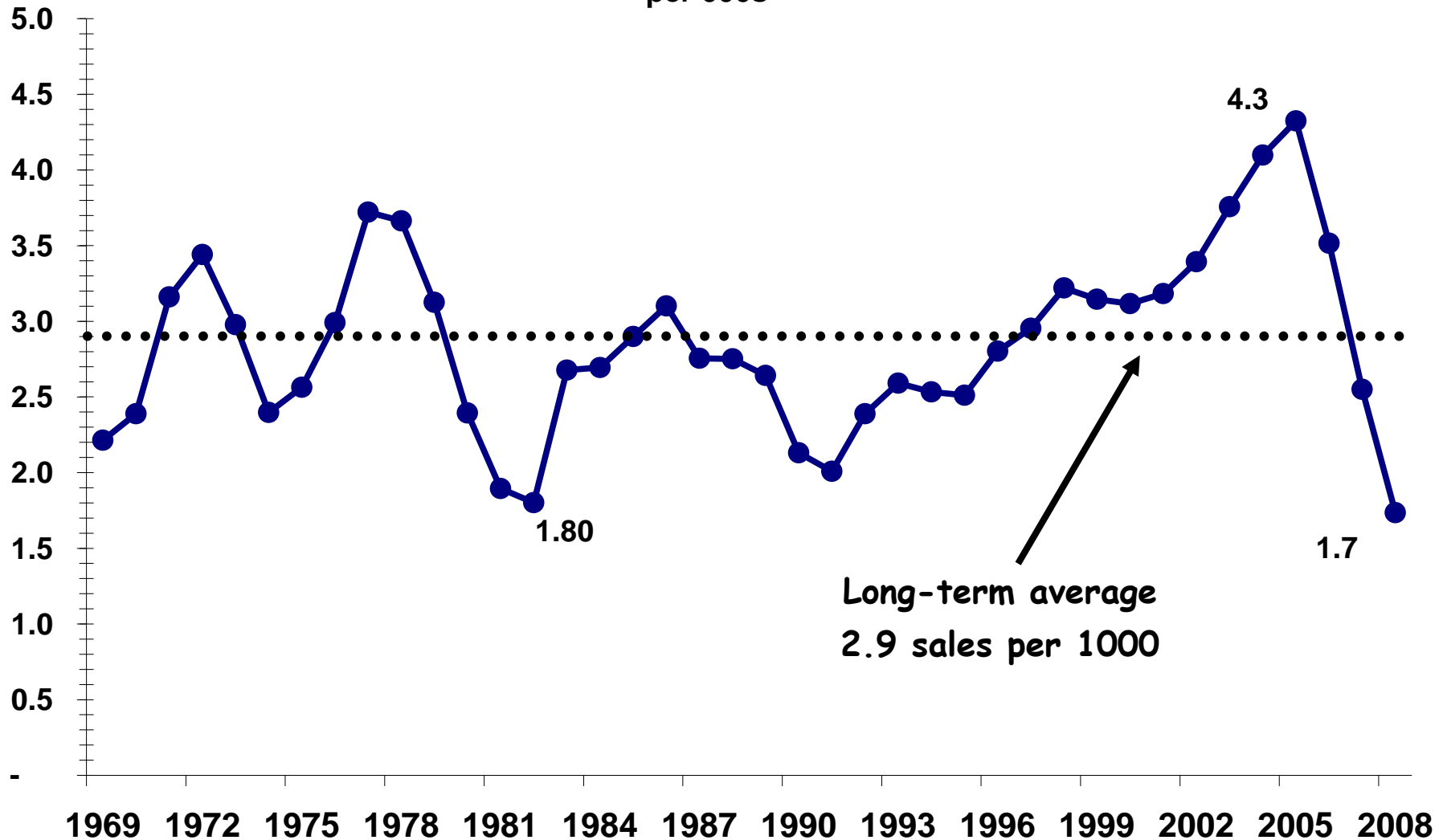
Source: Federal Reserve, Freddie Mac

Can you burn the forest down
twice?

Pinging for the bottom

New construction

per 000s

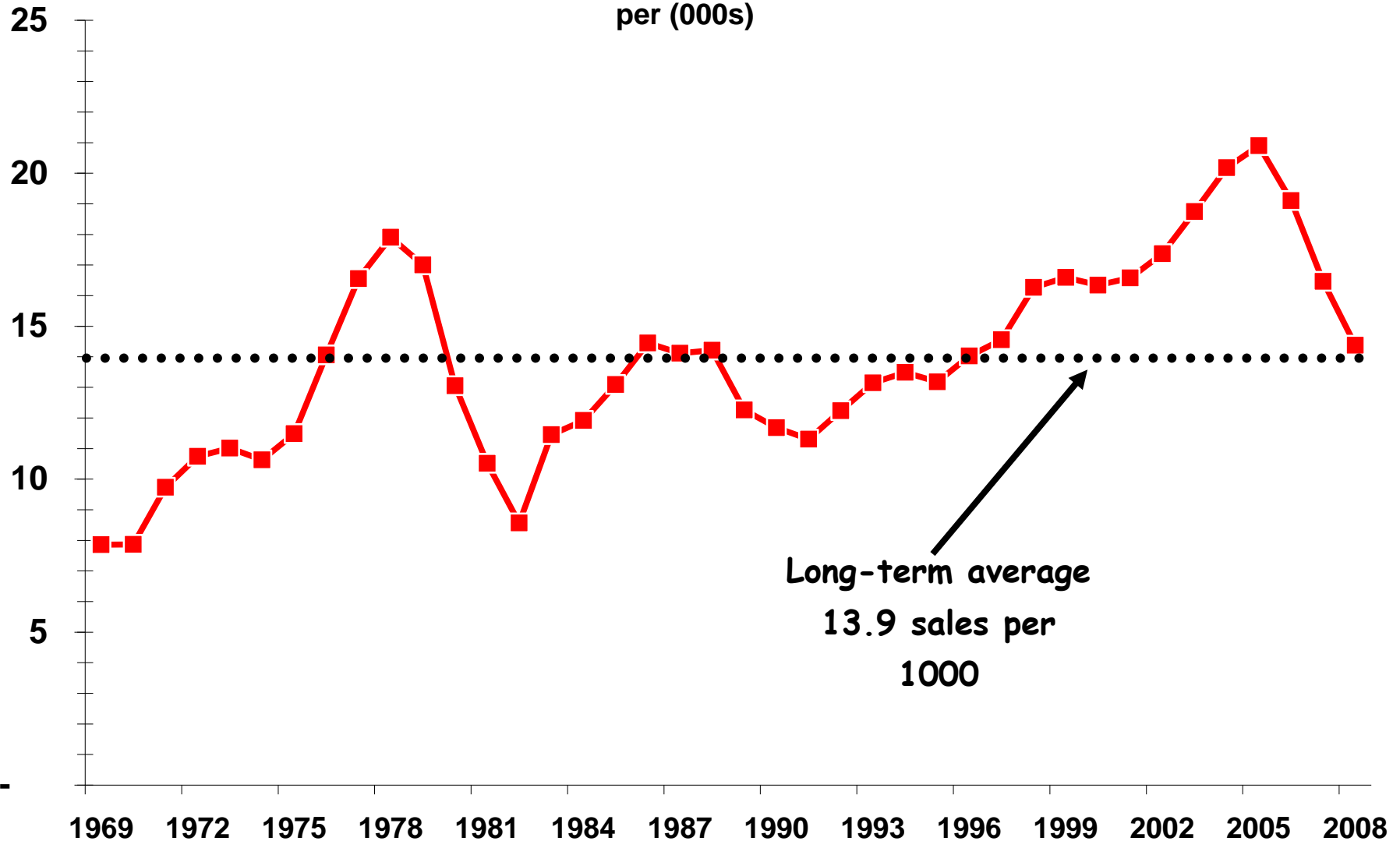


Long-term average
2.9 sales per 1000

What's normal – normally?

Existing sales

per (000s)



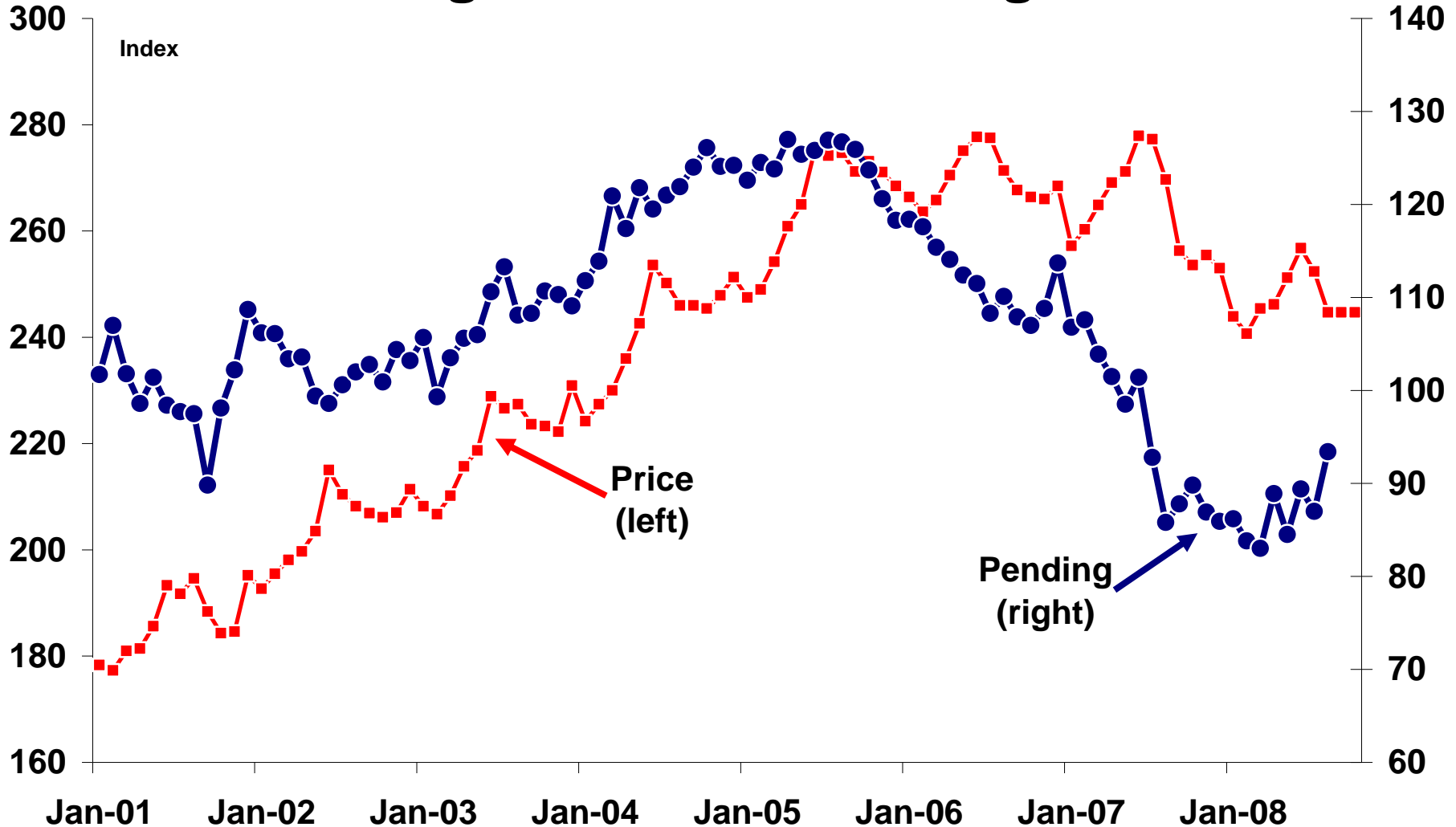
Long-term average
13.9 sales per
1000

How do you fix this mess?

Price the asset correctly.

Here's the correction mechanism

Pending Home and Existing Sales



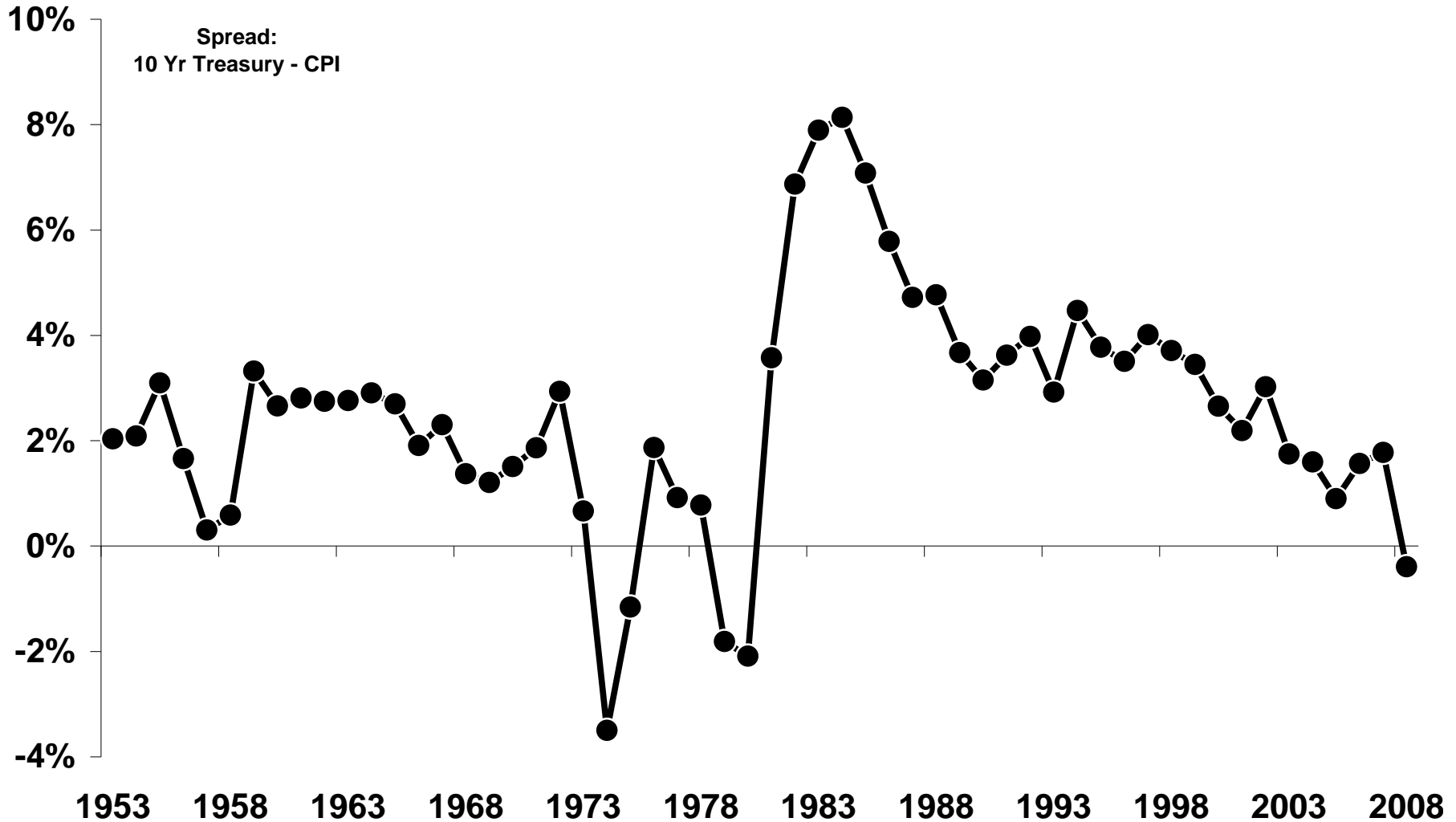
Source: NAR, Wells Fargo Economics

What does money really cost?

That depends of course.

Cheap money = high values

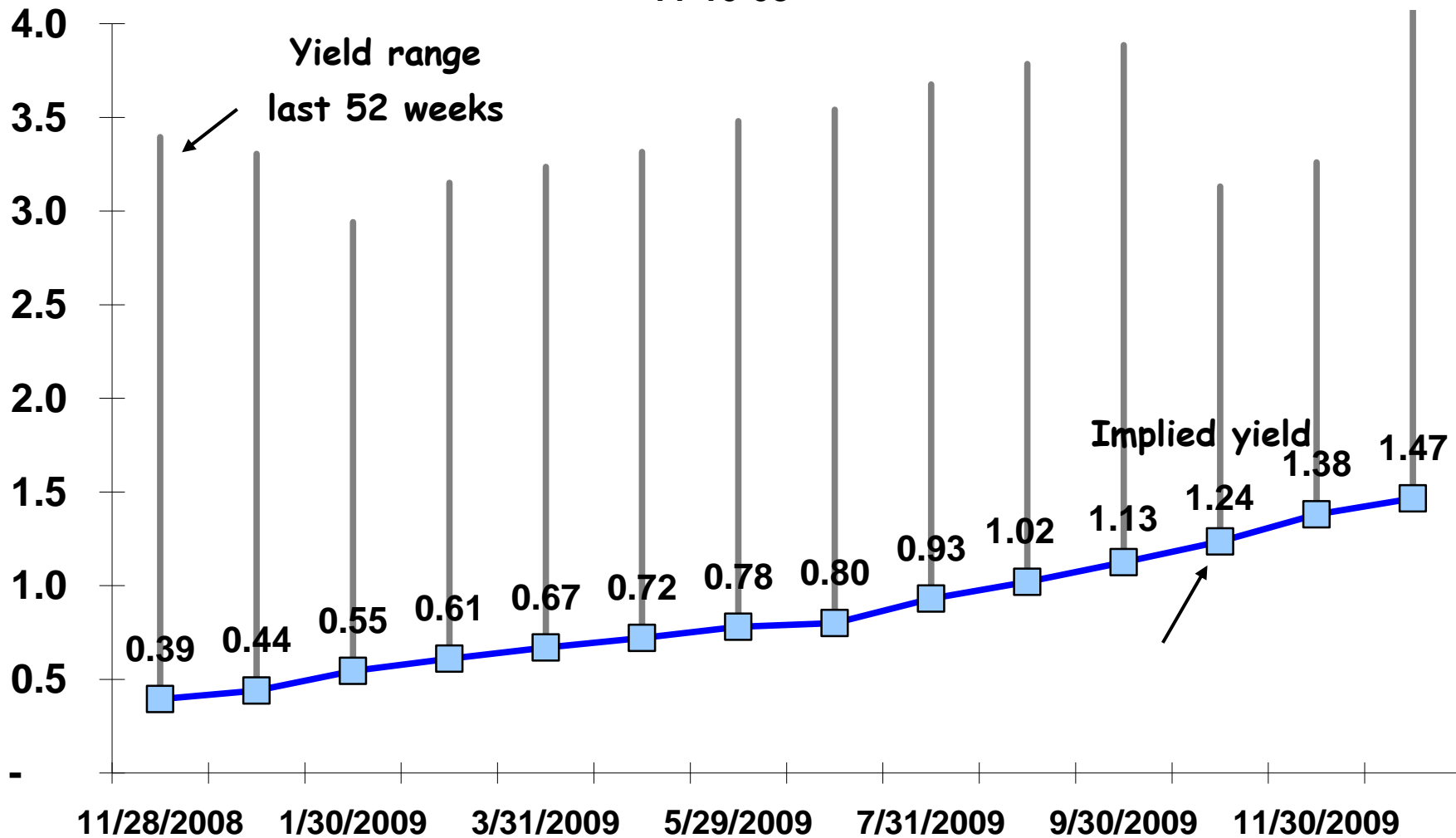
Memories are Short



What the Fed controls

Fed Funds Futures

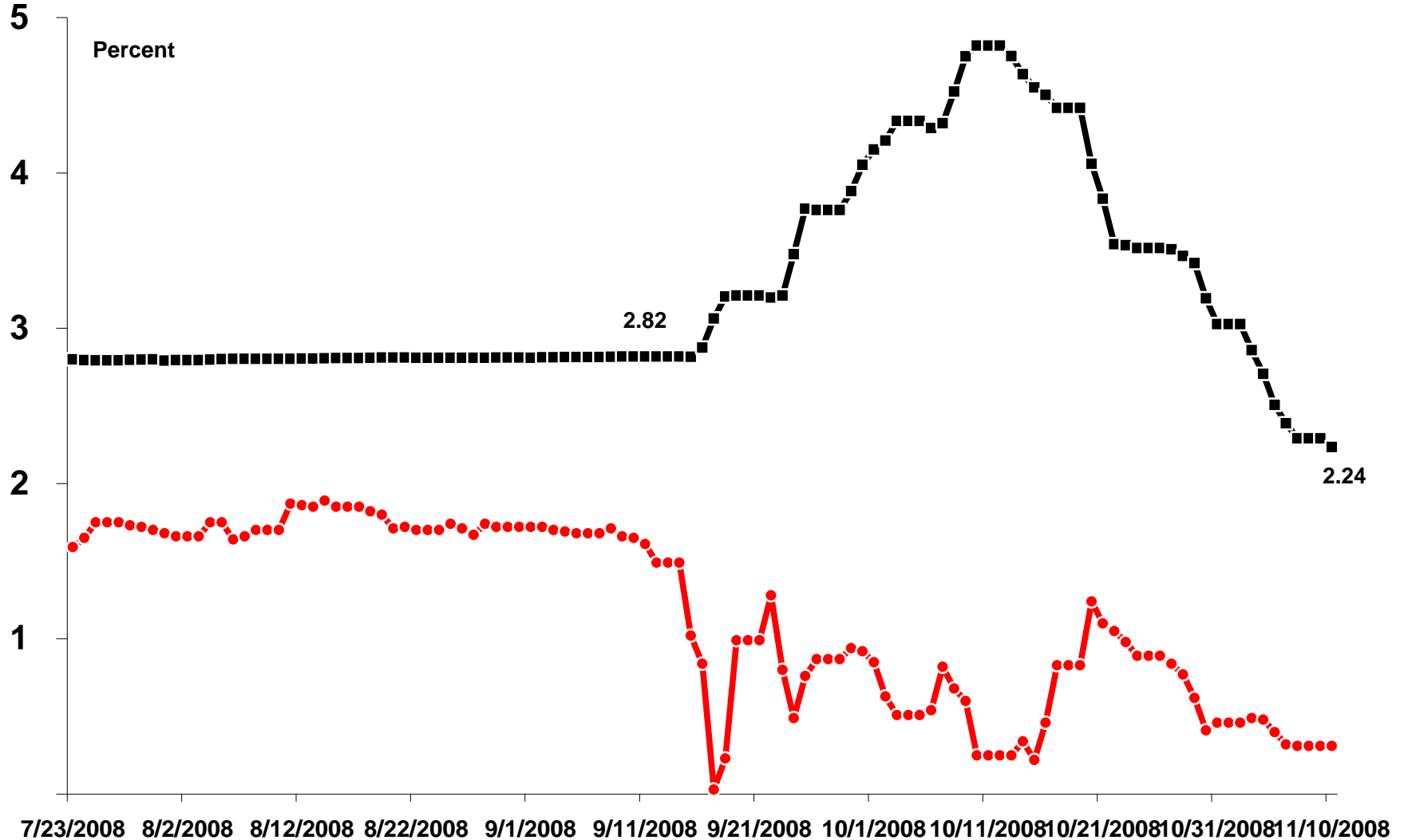
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Source: CBOT, WF Economics

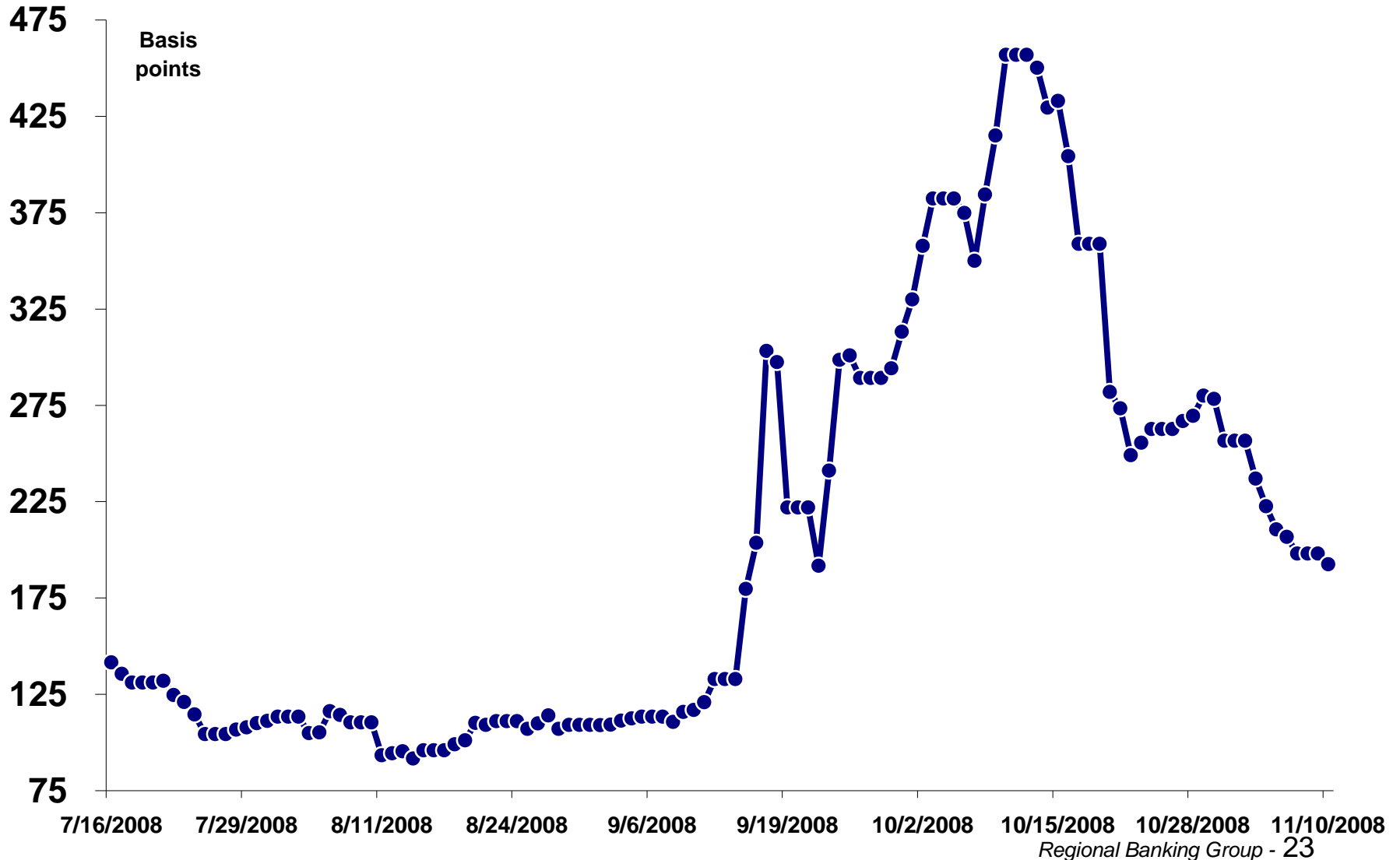
What it doesn't control

3 Month Libor and Treasury



Whether you like it or not

Spreads 3 Month: Libor - Treasury

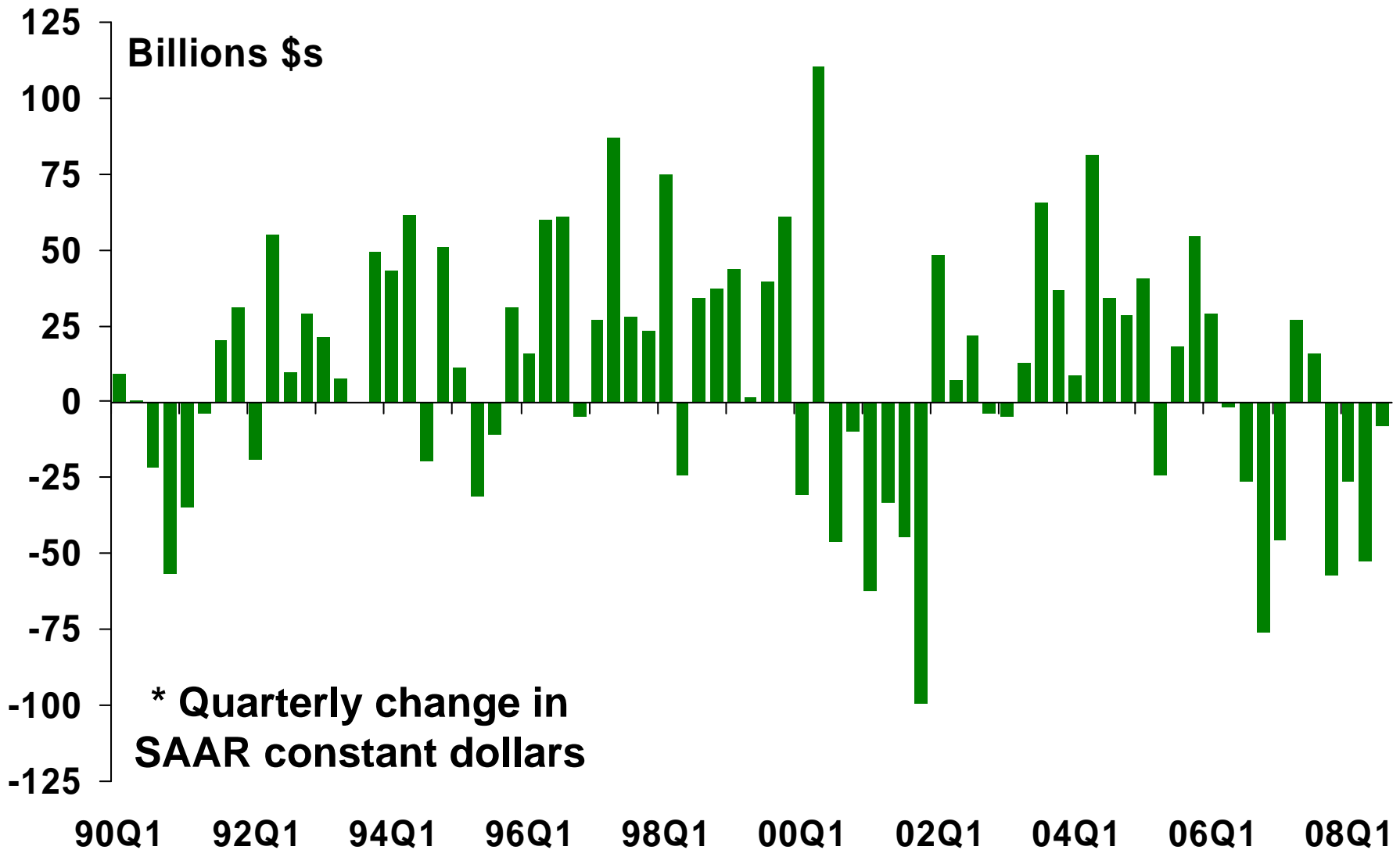


Deleveraging: Is painful

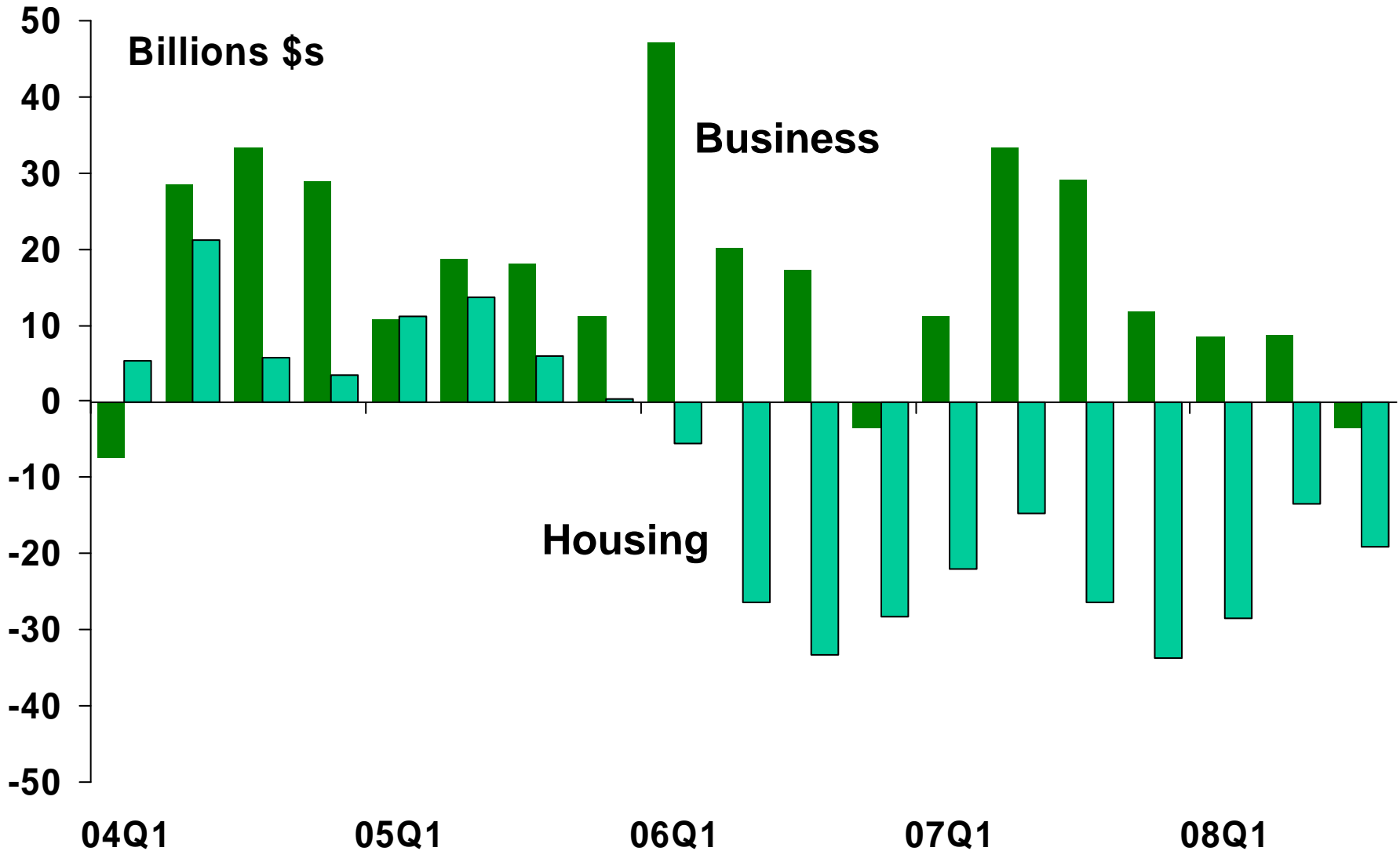
- **Increased economic volatility**
 - ◆ Price volatility
 - ◆ Demand volatility
- **Asset valuations**
 - ◆ Cost of money
 - ◆ Predictability of cash flow

$$\pi = P \cdot Q - (W \cdot X) - FC$$

Investment will bounce back – but when?

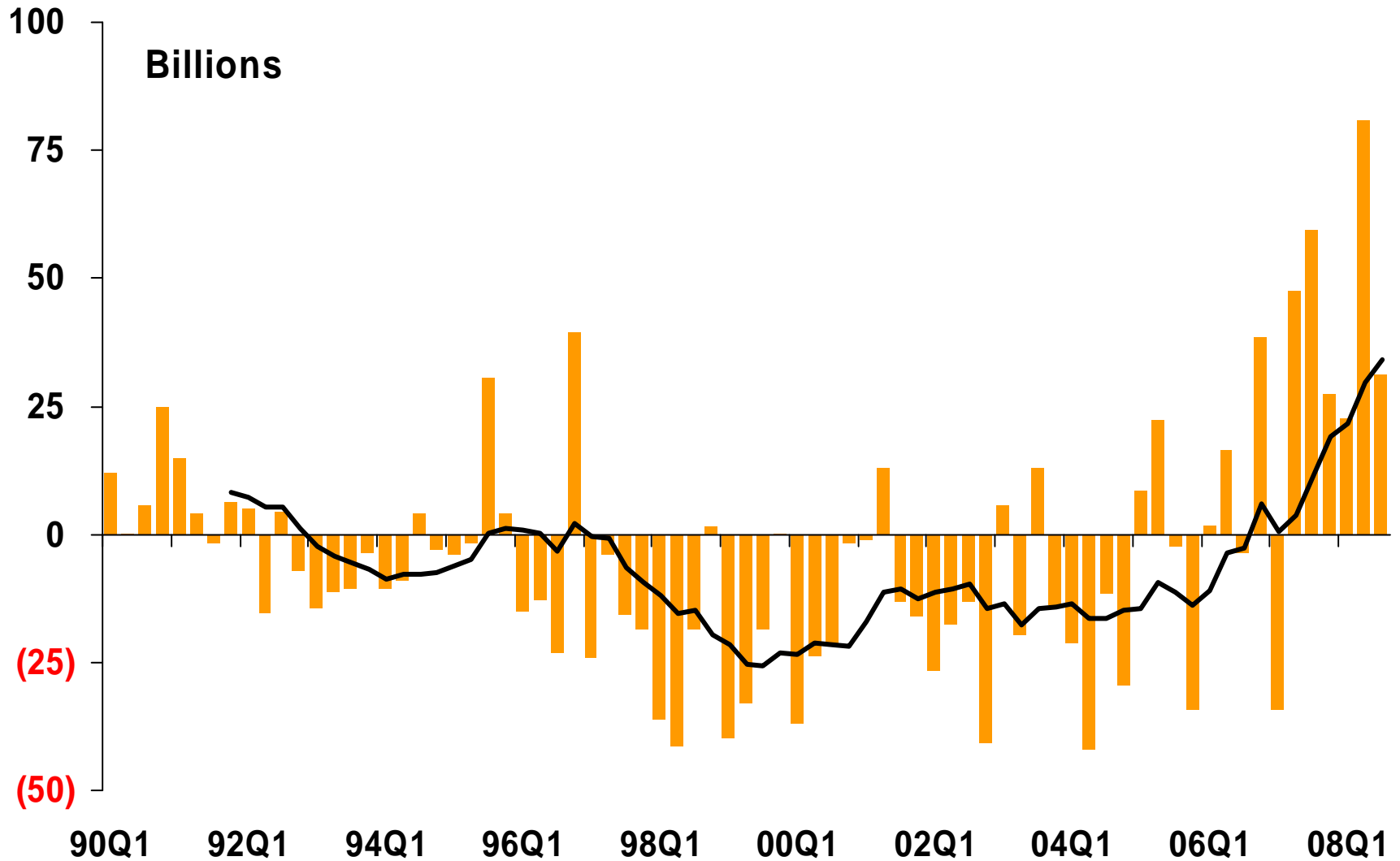


Tale of two different sectors



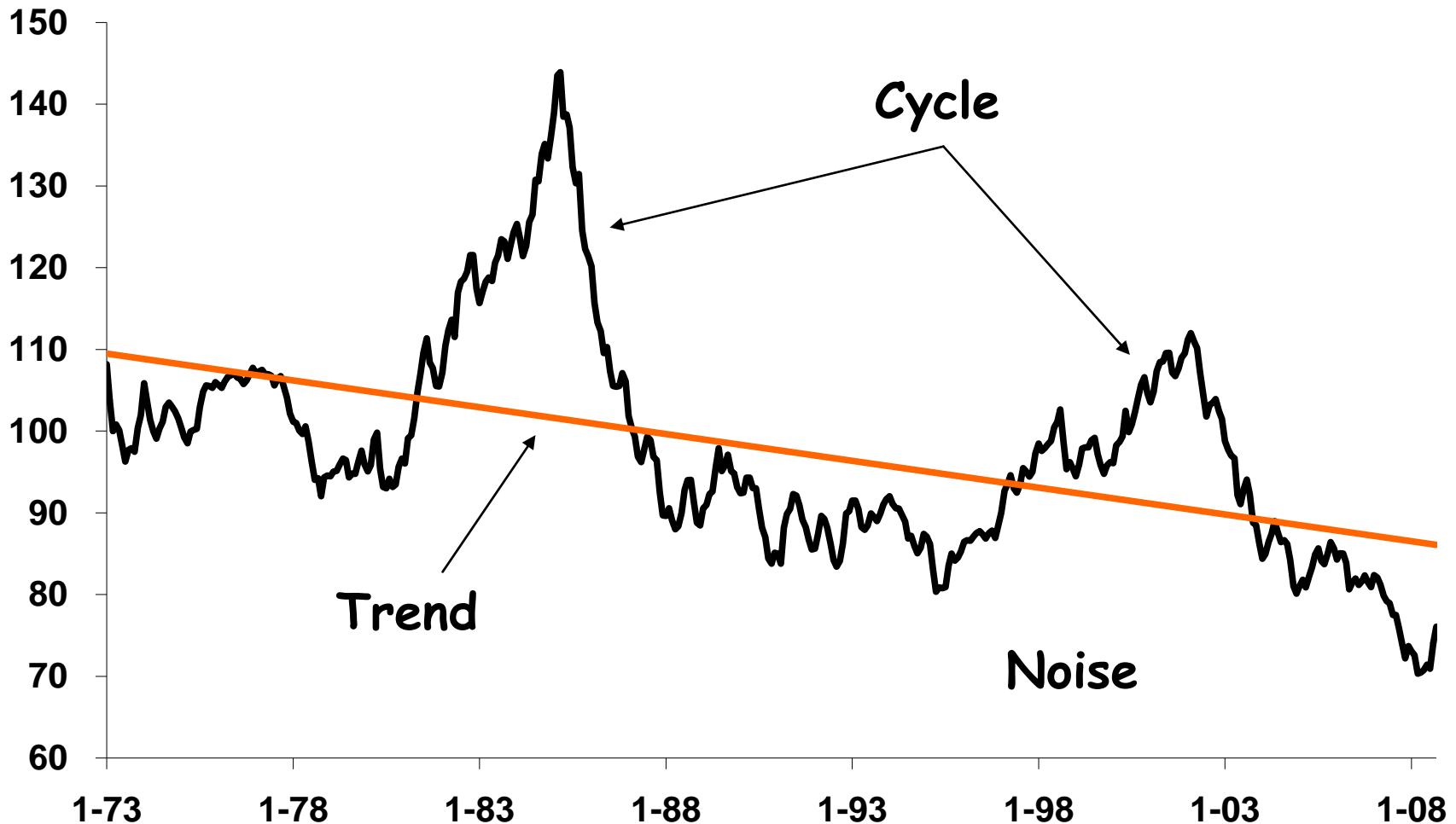
Trade – An improving disaster

Net Exports



A two edged sword

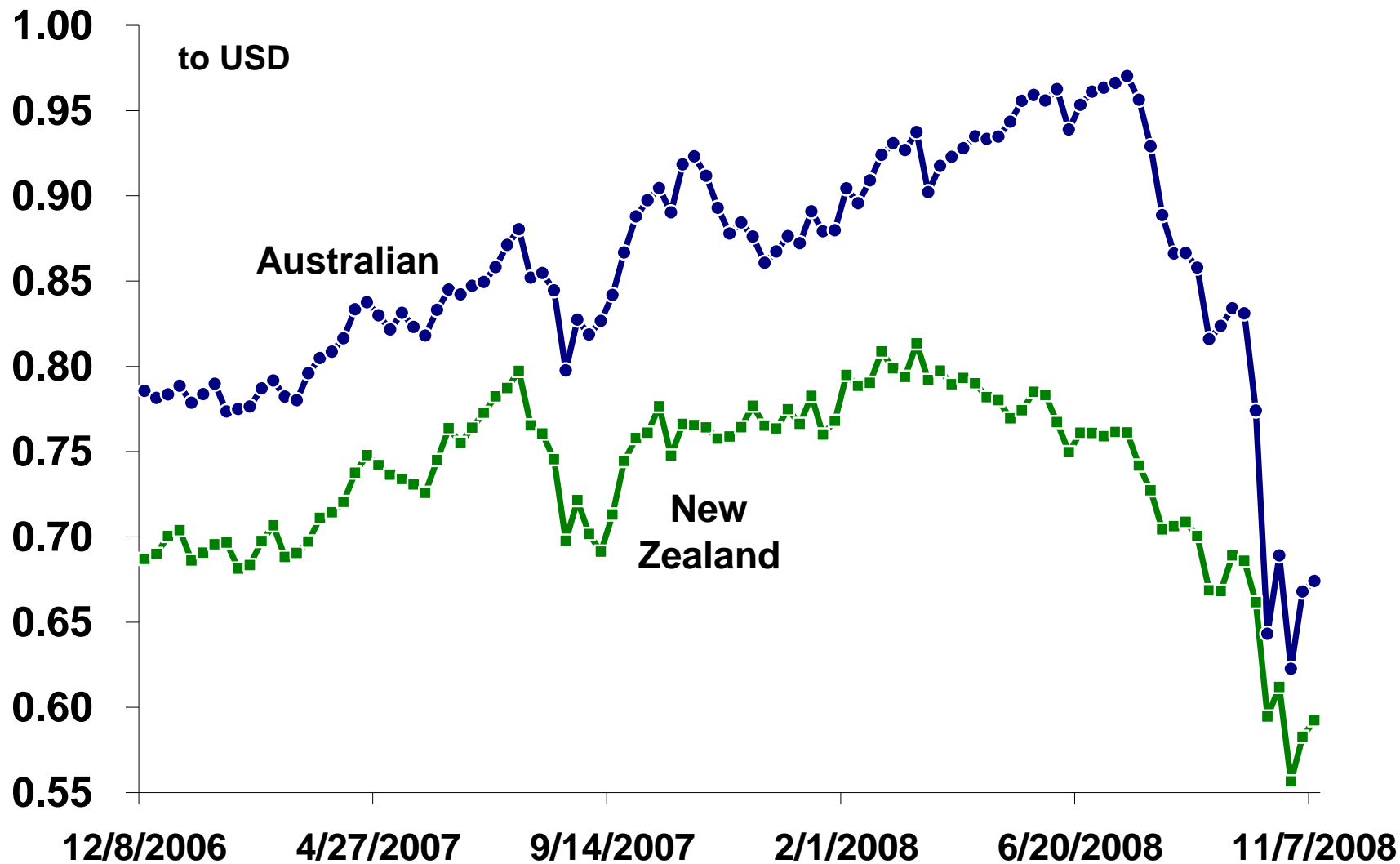
US Trade Weighted Dollar



Source: Federal Reserve, Wells Fargo Economics

Commodities are about specific currencies

Australian and New Zealand Dollar



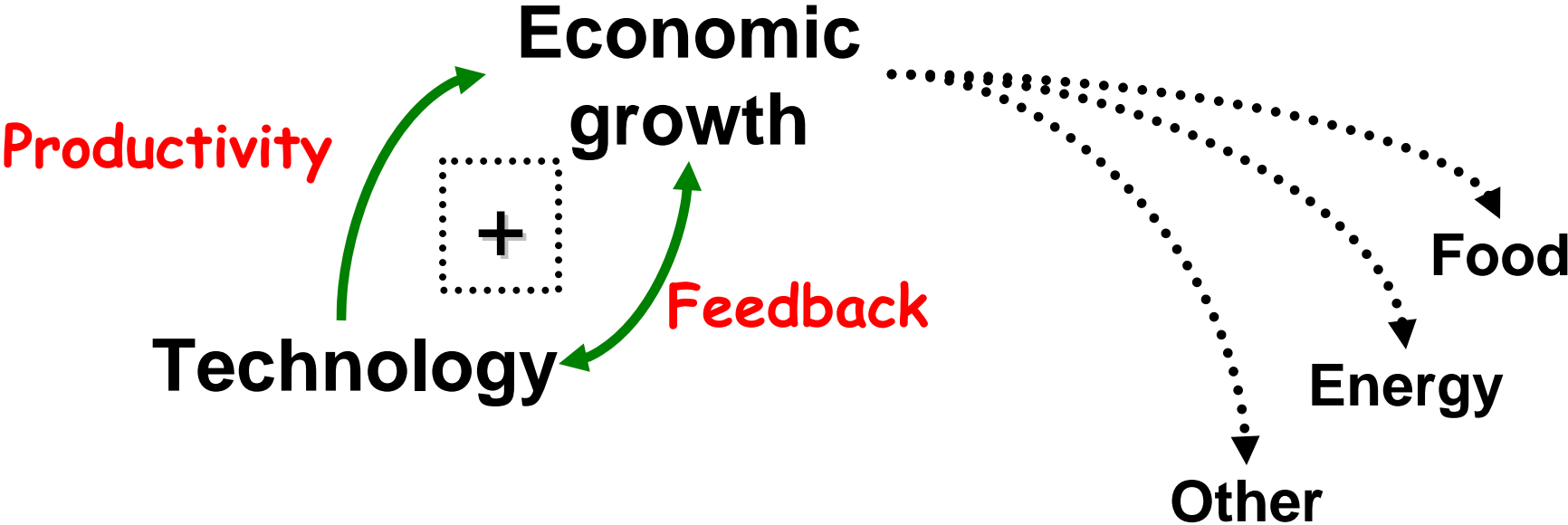
Who's at risk?

	Exports as % of Demand
Sugar	2%
Corn	16%
Soybeans	34%
Wheat	44%
Cotton	77%

	Exports as % of Demand
Pork	21%
Poultry	16%
Beef	6%
Dairy	5%

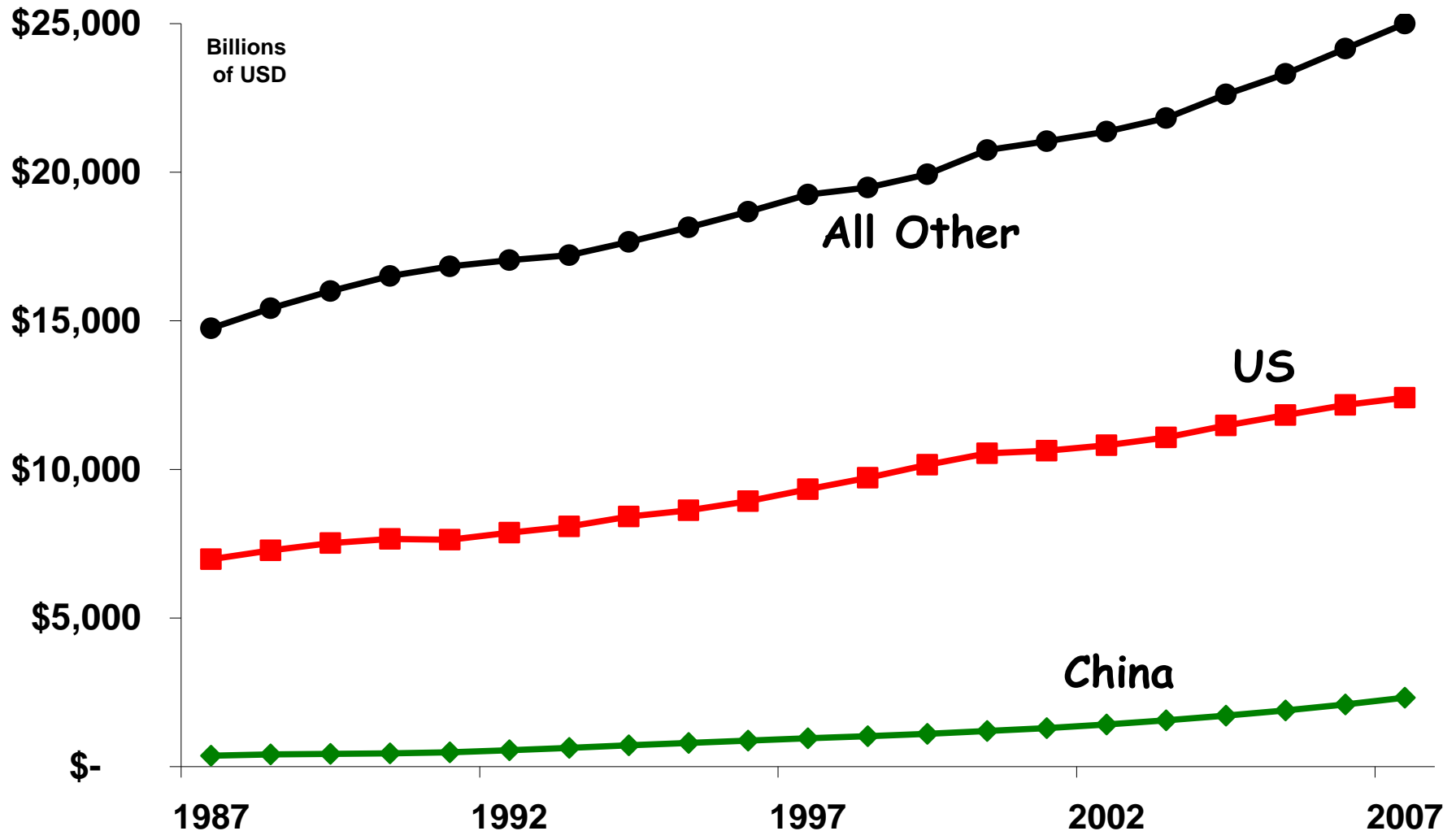
All models are **wrong**.
Some are **useful**.

Accelerating global demand



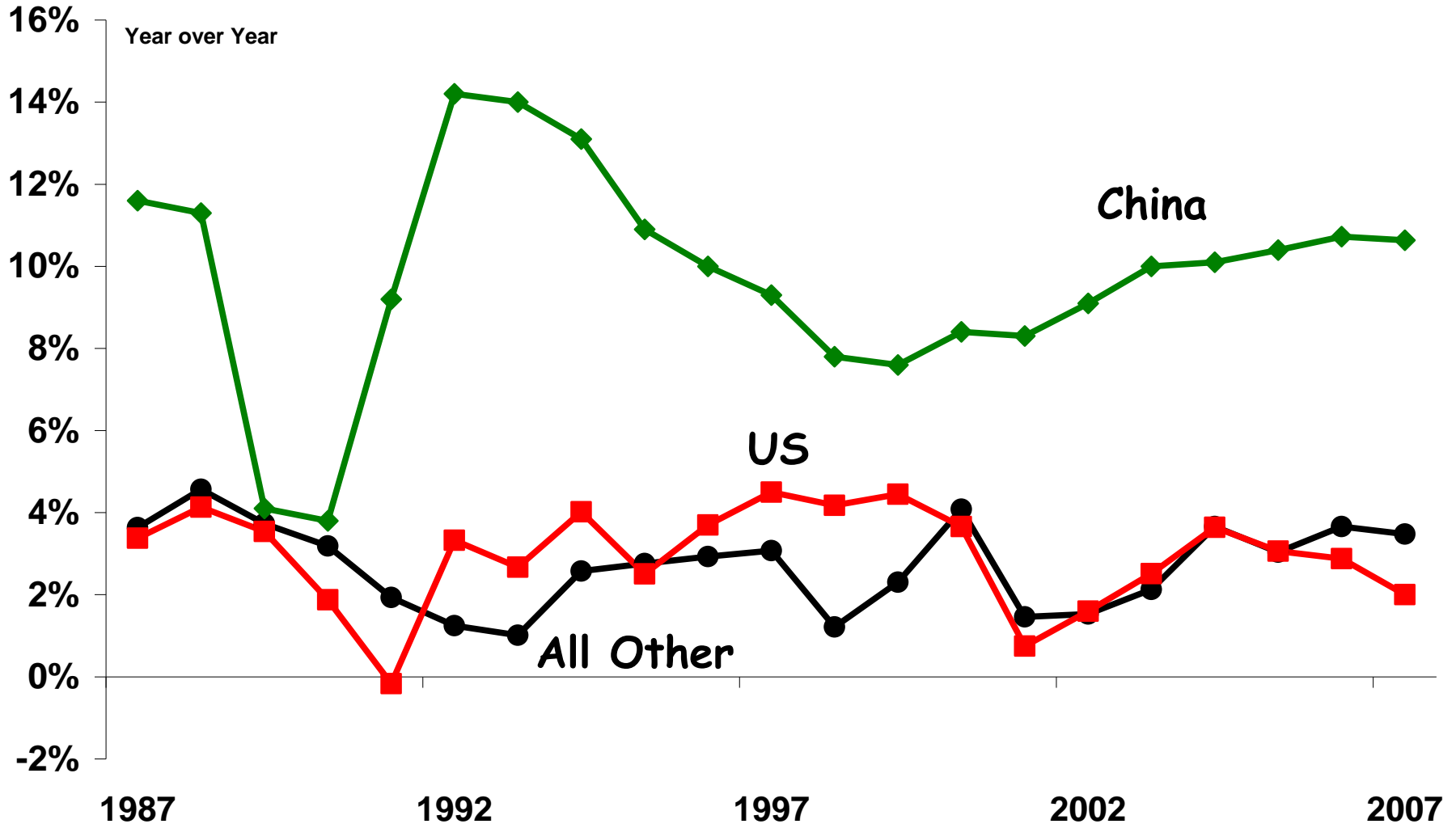
Climbing up Maslow's hierarchy

Global GDP

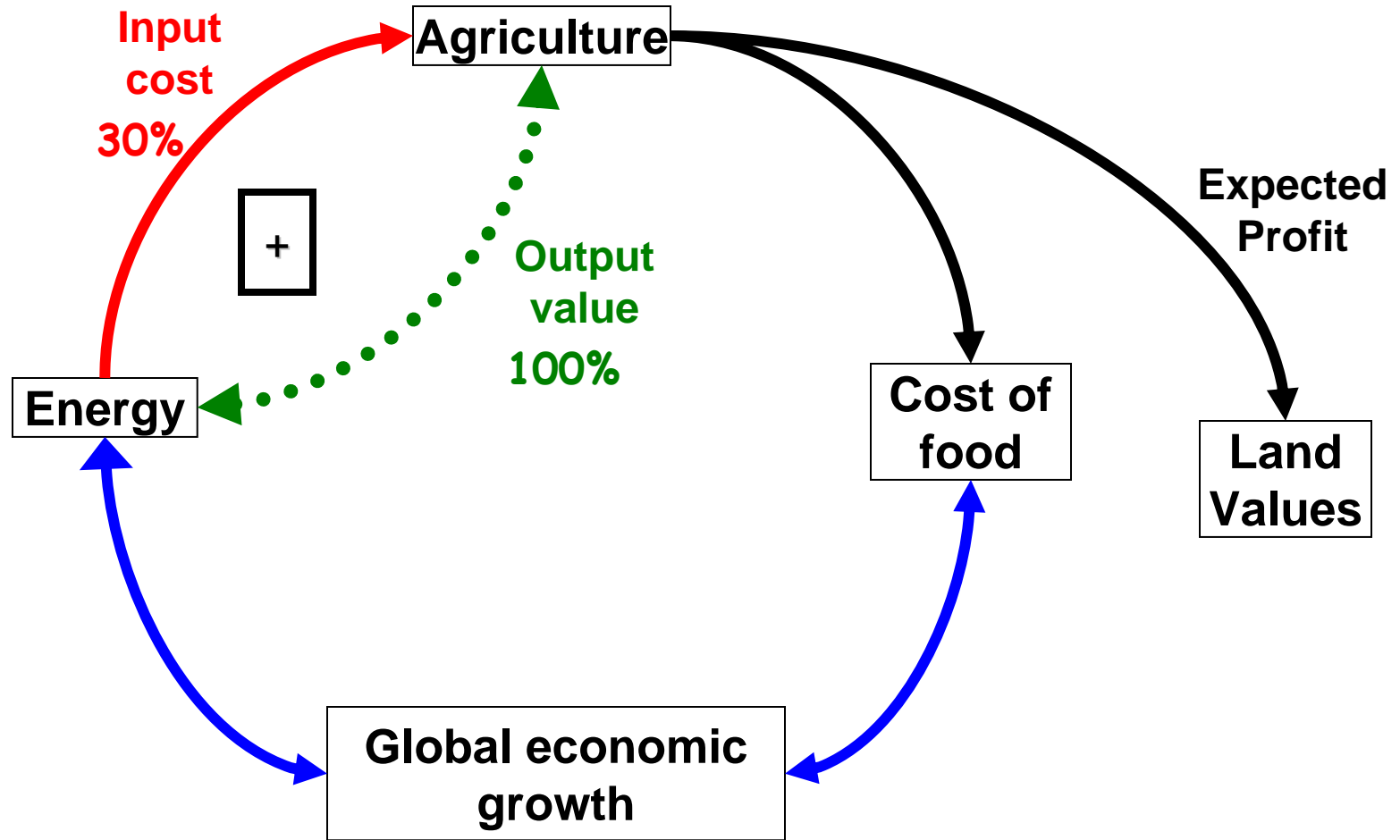


Will you bet against it?

Global GDP



(Un?)intended Consequence



Take-aways

- **A real recession**
 - ◆ 3-5 quarters, 7% plus unemployment
 - ◆ Stimulative fiscal and monetary policy
 - ◆ High price and demand volatility
- **Long-term return to 3% plus growth**
- **Cost of money increases – leverage declines**
 - ◆ Asset values compress
 - ◆ Decoupling is challenged



**WELLS
FARGO**

Wells Fargo – Economics A Partner in Knowledge

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