Minneapolis

Economic Overview

The Minneapolis economy has weakened substantially over the past couple months. Employment plunged 2.4% in December from a year ago as the credit markets froze and the national economy came to a screeching halt. Although the economy remains well diversified, only education/health shows any real sign of strength. Financial services are rebounding, adding jobs for the eleventh consecutive month on a year-ago basis. Information services were flat, while professional business service job losses accelerated. The construction industry has all but imploded as 16K jobs have been lost in just the last four months. Trade and transportation are hemorrhaging jobs as consumers tighten their belts and manufacturers rein in production. Manufacturing has now lost jobs for 37 consecutive months. The unemployment rate rose slightly to 6.3% in December from 6.2% in November as job losses were largely matched by the contraction in the labor force. Mounting job losses and a glut of foreclosure sales have led to accelerating home price declines over the last four months, despite falling inventories. Credit quality has also deteriorated as both prime and sub-prime mortgage delinquency rates in Minnesota have nearly doubled over the last three years.

Outlook

We expect the effects of the housing slump, mounting job losses and financial crisis to contribute to economic contraction in 2009. Tight lending standards, along with rising delinquencies on auto and credit card loans, will weigh on consumer loan growth and spending. Weakness in real estate markets will continue to weigh on construction, while retail, transportation and manufacturing will struggle as spending slows across the board. For 2009, we forecast a 2.7% decline in employment, the unemployment rate to jump to 7.6%, and home prices to fall 9.6%. Home construction will remain very weak for the next couple years amid tight credit and high inventories.

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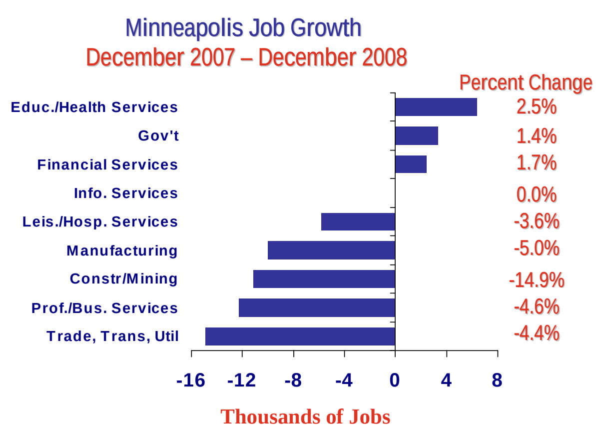
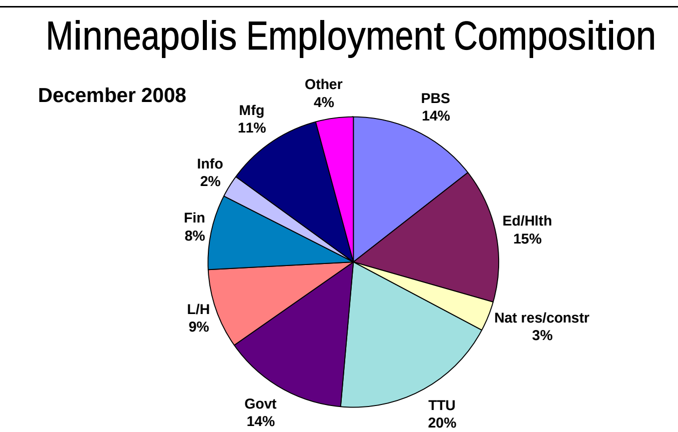
	2003	2004	2005	2006	2007	*2008f*	*2009f*	*2010f*
Gross Metro Product, % chg.	3.2	4.4	1.0	1.0	2.6	*0.0*	*(1.0)*	*1.2*
Employment (ths.)	1724	1738	1765	1787	1798	*1794*	*1745*	*1754*
Employment growth, % chg.	0.2	0.8	1.5	1.3	0.6	*(0.2)*	*(2.7)*	*0.5*
Unemployment rate, %	4.7	4.4	3.9	3.8	4.3	*5.2*	*7.6*	*7.8*
Personal Income growth, % chg.	3.5	6.6	4.1	5.6	6.3	*3.5*	*(0.4)*	*2.1*
Population (ths.)	3078	3107	3133	3165	3199	*3238*	*3274*	*3308*
Population growth, % chg.	0.8	0.9	0.8	1.0	1.1	*1.2*	*1.1*	*1.0*
Net migration (ths.)	0.1	4.4	1.8	6.2	6.9	*11.5*	*7.2*	*5.4*
Median existing home prices, % chg.	9.1	8.3	6.3	2.8	(3.7)	*(13.5)*	*(9.6)*	*(1.2)*
Housing Starts, # of units	26232	25575	22391	16434	10061	*5674*	*3782*	*4916*
Single-family, # of units	21030	20484	18633	13948	8328	*4365*	*2397*	*3115*
Multi-family, # of units	5202	5091	3758	2487	1733	*1309*	*1385*	*1801*

Sources: BLS, BEA, Census Bureau, Case-Shiller Home Price Index, Economy.com, and Wells Fargo Economics



Source: Bureau of Labor Statistics



Source: Bureau of Labor Statistics; Wells Fargo Economics

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Local Banker Observations

Despite all the negative news in the media, clients in the Minneapolis area are reporting business is still pretty good, outside of construction, which continues to languish. Clients are being very cautious, however, and are waiting for the next shoe to drop in the economic crisis. Smaller companies are starting to struggle, and retail is facing a very tough environment. Restaurants are seeing stable traffic, but less spending by patrons. Some small manufacturers, however, remain busy and do not see a recession at all. Some firms are paring staff, reducing employee hours or eliminating overtime to match falling demand and reduce costs. They say it really depends on how you entered the slowdown. Those who entered with lower debt levels are in much better shape.

In time, lower gas prices should help business profits and household budgets. However, as commodity prices have fallen, many buyers are requesting downward price revisions from suppliers and producers. Because their selling price is being revised down, the drop in input costs is not necessarily leading to increased profit margins for some firms. In addition, with credit still tight, some suppliers are shortening their terms on receivables.

Clients are concerned about the impact of all the bailouts, and whether it's the right thing to do. They also remain concerned about the housing market, as they are still not sure when the bottom will come. They are worried that things are going to get worse, but they are not sure how much worse. The feeling is that the economy will be ok if the unemployment rate doesn't get too high. Clients were expecting a lighter recession, as opposed to the doom and gloom being predicted in the media, but are taking measures to weather a worse than expected downturn.

Housing Market

The Minneapolis housing market remains mired in a slump. According to the Case-Shiller Home Price Index, existing single-family home prices fell 16.3% in November from a year ago, the 25th consecutive monthly decline. Total housing starts have contracted every quarter since Q304. Single-family starts were down 39.8% year-over-year in Q308, while multi-family starts dropped 49.1%. The future does not look bright either as permits, a proxy for future construction, were also down, as they have been in every quarter since Q404. Single-family permits were down 34.8%, while multi-family permits were down 10.1%. The declines for permits were noticeably smaller than in Q2, an encouraging sign, but we've seen false alarms before. As the residential market has soured, homebuilders are shifting into apartment construction, but the heavy competition for apartment business is driving margins down.

The credit quality situation is also deteriorating. Delinquency rates for both prime and sub-prime conventional mortgages are the highest they've been in years. The prime delinquency rate in Minnesota rose to 3.20% in Q308, far above the average of 1.71% over the five years prior to the surge, while the sub-prime delinquency rate rebounded to 17.6%, the highest in at least a decade. Foreclosure rates improved in Q3, but this is likely due to loan modifications and foreclosure moratoriums, which may only be delaying the inevitable. The prime foreclosure rate fell to 0.54% from 0.62%, while the sub-prime foreclosure rate fell to 4.38% from 4.95%.

The one piece of good news coming out of the housing market is the fact that affordability has improved. The housing affordability index has risen from a trough of 129.7 in Q106, when home prices peaked, to 162.8 as of Q308 as home prices have plunged. This, combined with a surge in distressed property sales, has led to a much slower rate of decline in home sales, which fell just 1.7% from a year earlier in Q308 following an 18.4% plunge in Q208.

Mortgage rates have declined over the last few months as a dramatic drop in oil prices and slowing global growth have reduced inflation expectations, while government programs designed to reduce foreclosures and increase liquidity in the mortgage market have led to a decline in yields on mortgage-backed securities. This is good news for homebuyers, but uncertainty about when prices will stop falling continues to keep many buyers on the sidelines. In addition, although the months' supply of homes has declined recently, inventories are still significantly higher than that of a normal market. Buyer hesitance, mounting job losses, tighter lending standards, still-high inventories and rising foreclosures and short sales will lead to further price declines in 2009.

-Ed Kashmarek, Economist
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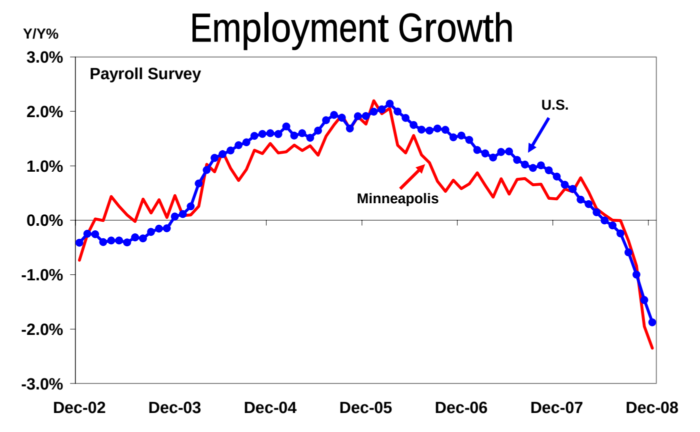
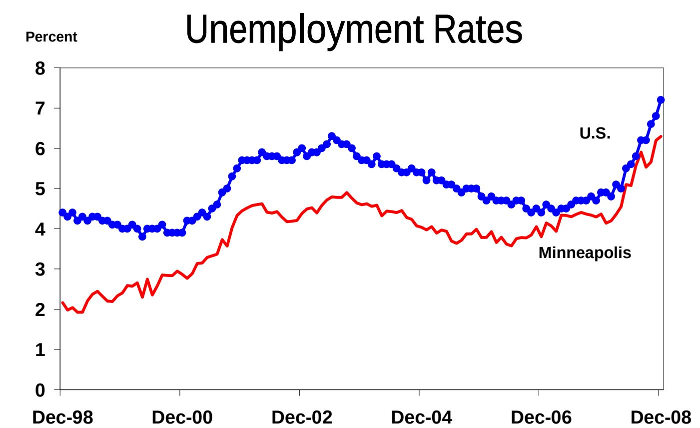


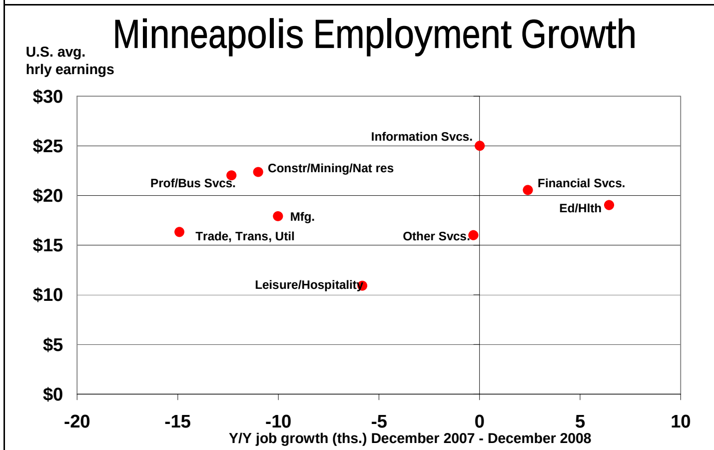
Source: Bureau of Labor Statistics; Wells Fargo Economics

Minneapolis job growth has followed the nation off the cliff. The decline in December was the worst as far back as records go to 1991.



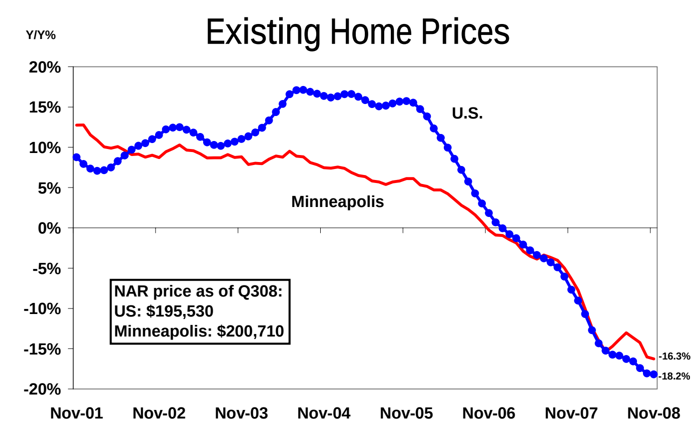
Source: Bureau of Labor Statistics; Wells Fargo Economics

The unemployment rate rose slightly in December as further household job losses were largely matched by the contraction in the labor force. Unemployment will continue to rise this year.



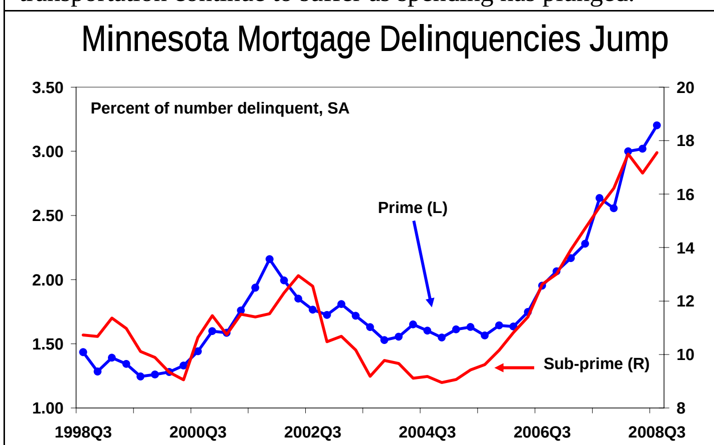
Source: Bureau of Labor Statistics; Wells Fargo Economics

Education/health continues to drive the Minneapolis economy, while, ironically, financial services have improved. Retail and transportation continue to suffer as spending has plunged.



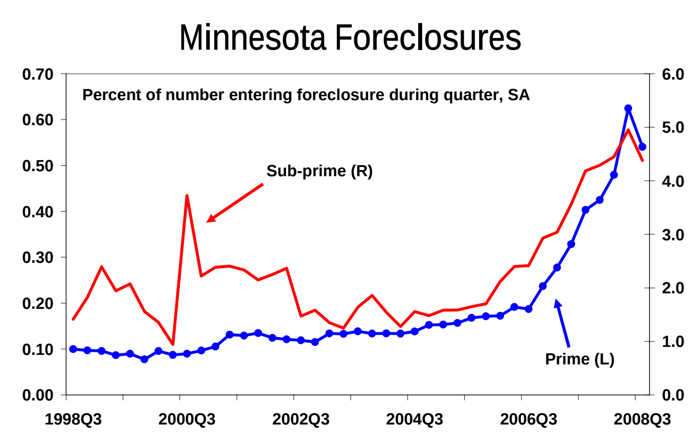
Source: Case-Shiller Home Price Index; Wells Fargo Economics

Home price declines in Minneapolis slowed briefly in August, but have resumed their downward trend. Mounting layoffs and rising foreclosures will keep downward pressure on prices.



Source: Mortgage Bankers Association; Wells Fargo Economics

Sub-prime delinquency rates briefly improved in Q2, but rebounded in Q3. The prime delinquency rate also continues to worsen.



Source: Mortgage Bankers Association; Wells Fargo Economics

Foreclosure rates improved in Q3 for both prime and sub-prime loans. However, this is likely due to loan modifications and foreclosure moratoriums, which may only delay the inevitable.

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