

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

August 29, 2008

U.S. Review

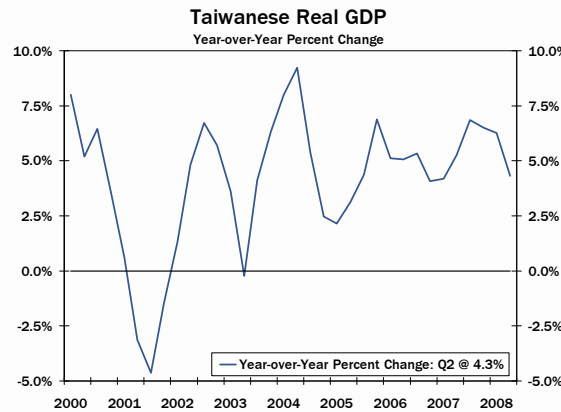
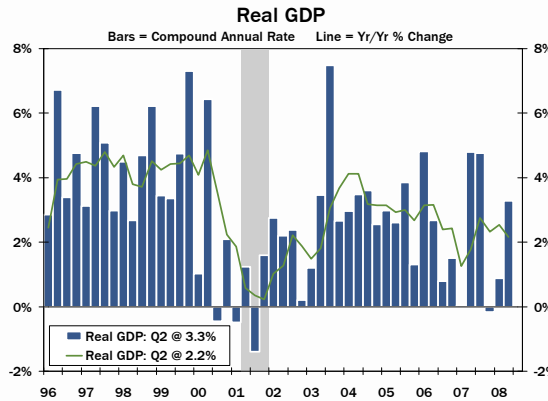
Growth Is Set To Slow

This past week's economic calendar provided some key insights into how much economic growth will moderate in the third and fourth quarters. The biggest headline was generated by Thursday's larger-than-expected upward revision to second quarter real GDP growth. Other key reports include a larger-than-expected rise in July durable goods orders and a much weaker-than-expected report on July personal income and spending. On balance, these reports point to second half real GDP growth around the 1 percent range, which is slightly below our previous projection.

Second quarter real GDP was revised up by 1.4 percentage points to a 3.3 percent pace. The larger-than-expected increase results from a large improvement in net exports and less of a drawdown in business inventories. Consumer spending also rose a bit more than expected.

The trade deficit narrowed by just over \$85 billion in the second quarter, which accounted for 3.1 points of the second quarter's 3.3 percent growth. Exports surged at a 13.2 percent pace, while imports fell at a 7.6 percent pace

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Global Review

Taiwanese Economy Slows Further

As shown in the graph at the left, real GDP growth in Taiwan slowed from a year-over-year rate of 6.3 percent in the first quarter to 4.3 percent in the second quarter. Output declined 2.4 percent on a non-seasonally adjusted basis in the second quarter relative to the previous quarter. (A seasonally adjusted series of real GDP is not readily available.) This decline is larger than the average drop in real GDP that has been registered in the second quarter over the past few years, which suggests that output may have contracted a bit on a seasonally adjusted basis in second quarter of this year.

Why is the Taiwanese economy decelerating? Slower growth in the rest of the world appears to be playing a role. As shown in the top chart on page 4, export growth has clearly slowed this year. This slowdown in export growth is consistent with deceleration in

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Recent Special Commentary

Date	Title	Authors
August-29	California is Still Managing to Eke Out Modest Gains	Vitner & York
August-28	Housing Chartbook - August 2008	Vitner & York
August-19	"Older and More Diverse Nation by Midcentury"	Vitner & York
August-19	Commercial Real Estate Quarterly: Second Quarter	Vitner & Khan

U.S. Forecast

	Actual				Forecast				Actual			Forecast		
	2007	2007	2007	2007	2008	2008	2008	2008	2005	2006	2007	2008	2009	2010
Real Gross Domestic Product ¹	0.0	4.8	4.8	-0.2	0.9	1.9	2.2	1.2	2.9	2.8	2.0	1.8	1.8	2.1
Personal Consumption	3.9	2.0	2.0	1.0	0.9	1.5	-0.7	-0.7	3.0	3.0	2.8	0.9	0.7	2.2
Inflation Indicators ²														
Core* PCE Deflator	2.3	2.1	2.0	2.2	2.2	2.2	2.2	1.9	2.1	2.3	2.2	2.1	1.8	1.9
Consumer Price Index	2.4	2.6	2.4	4.0	4.2	4.3	5.1	3.5	3.4	3.2	2.9	4.3	2.1	1.9
Industrial Production ¹	1.5	3.2	3.6	0.3	0.5	-3.1	0.2	2.0	3.3	2.2	1.7	0.4	2.0	3.3
Corporate Profits Before Taxes ²	-1.0	-0.5	-2.7	-2.0	-1.5	-8.0	-6.0	-10.5	17.6	15.2	-1.6	-6.5	4.9	9.2
Trade Weighted Dollar Index ³	80.5	78.7	74.4	73.3	70.3	71.0	72.5	73.6	86.0	81.5	73.3	73.6	82.4	90.0
Unemployment Rate	4.5	4.5	4.7	4.8	4.9	5.3	5.7	5.8	5.1	4.6	4.6	5.5	6.2	6.3
Housing Starts ⁴	1.45	1.46	1.30	1.15	1.05	1.02	0.91	0.90	2.07	1.81	1.34	0.97	1.00	1.30
Quarter-End Interest Rates														
Federal Funds Target Rate	5.25	5.25	4.75	4.25	2.25	2.00	2.00	2.00	4.25	5.25	4.25	2.00	2.00	3.00
10 Year Note	4.65	5.03	4.59	4.04	3.45	3.99	4.00	3.90	4.39	4.71	4.04	3.90	4.00	5.20

Data As of: August 6, 2008

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

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U.S. Review

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How Much More Can Trade Improve?

the second quarter's huge drop in the trade deficit will make it much more difficult to get a big gain from trade in the current quarter. Exports are still expected to make a positive contribution to growth during the current quarter but we are only looking for a positive contribution of 0.3 percentage points, or about one-tenth the contribution seen in the second quarter.

Consumer spending will also contribute less to growth in coming quarters. Our most recent forecast has personal consumption expenditures declining at a 0.7 percent annual rate in both the third and fourth quarters. The latest personal income and consumption data suggest spending could drop a bit more than that in the current quarter. Personal income fell 0.7 percent in July and real consumer spending fell at a 0.4 percent pace. If spending is unchanged in both August and September, then real personal consumption expenditures would fall at a 1.4 percent pace in the third quarter. We doubt conditions will be that dire. Gasoline prices plummeted in August and that should free up a little more discretionary income. In addition, incentives on new motor vehicles were increased late in the month and that should provide at least a slight boost to sales in September.

While consumer spending is set to slow, business fixed investment looks like it will be a little more resilient during the second half of the year. Advance orders for durable goods rose 1.3 percent in July, following a similar-sized gain the previous month. Orders for non-defense capital goods, ex aircraft, which is the key component that tends to track business fixed investment, rose 2.6 percent and is up at a 13.5 percent annual rate over the past three months. Capital goods orders are likely benefiting from the bonus depreciation provisions of the Economic Stimulus Act.

Shipments of capital goods rose 0.6 percent in July and are up at a 6.7 percent pace over the past three months. With orders running twice that level, business fixed investment should remain solidly positive in both the second and third quarter.

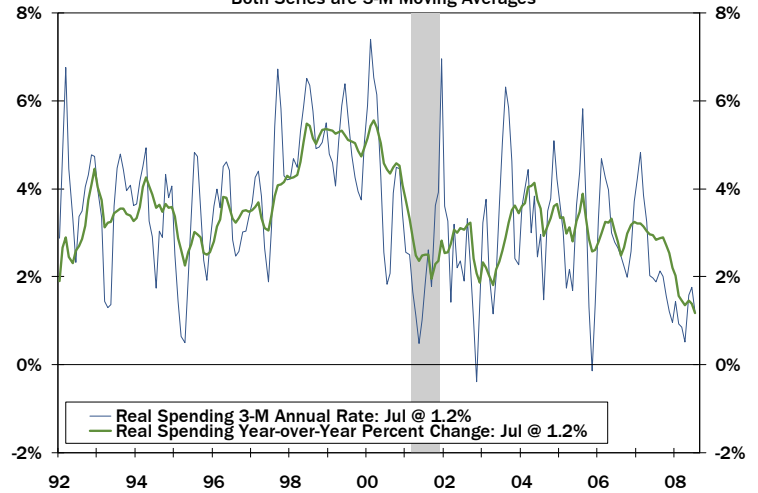
Two other pieces of encouraging news were a much larger than expected increase in the Chicago Purchasing Managers' index and a solid bounce back in the University of Michigan Index of Consumer Sentiment. The Chicago PMI rose 7.1 points to 57.9, with solid gains in production, new orders and order backlogs. The Prices Paid index dipped by about 10 points but remains high at around 80.6. The employment series tumbled 6.7 points, however, to a relatively low 39.2.

Selected Current Data

Gross Domestic Product - CAGR	Q2 - 2008	3.3%
GDP Year-over-Year	Q2 - 2008	2.2%
Personal Consumption	Q2 - 2008	1.7%
Business Fixed Investment	Q2 - 2008	2.2%
Consumer Price Index	July - 2008	5.6%
"Core" CPI	July - 2008	2.5%
"Core" PCE Deflator	July - 2008	2.4%
Industrial Production	July - 2008	-0.1%
Unemployment	July - 2008	5.7%
Federal Funds Target Rate	Aug - 29	2.00%

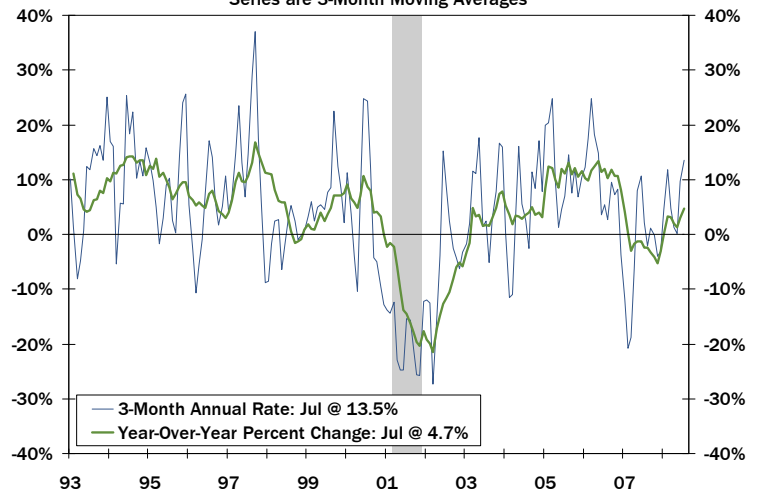
Real Consumer Spending

Both Series are 3-M Moving Averages



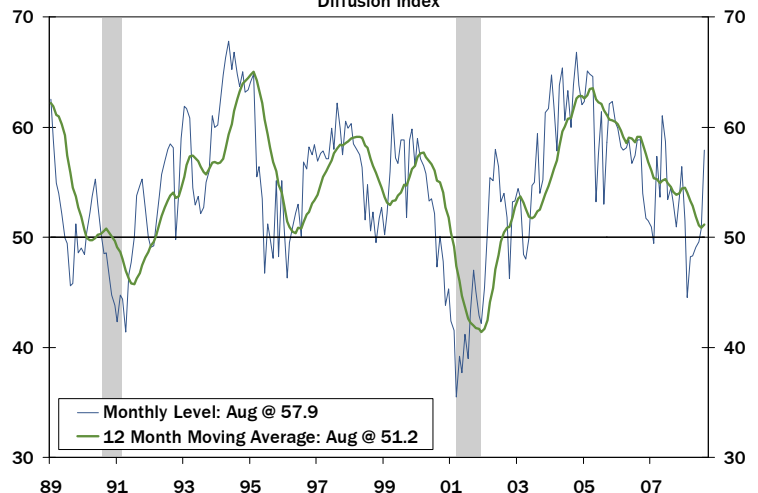
NonDefense Capital Goods Orders, Ex-Aircraft

Series are 3-Month Moving Averages



Chicago Purchasing Managers' Index

Diffusion Index



ISM Manufacturing Index • Tuesday

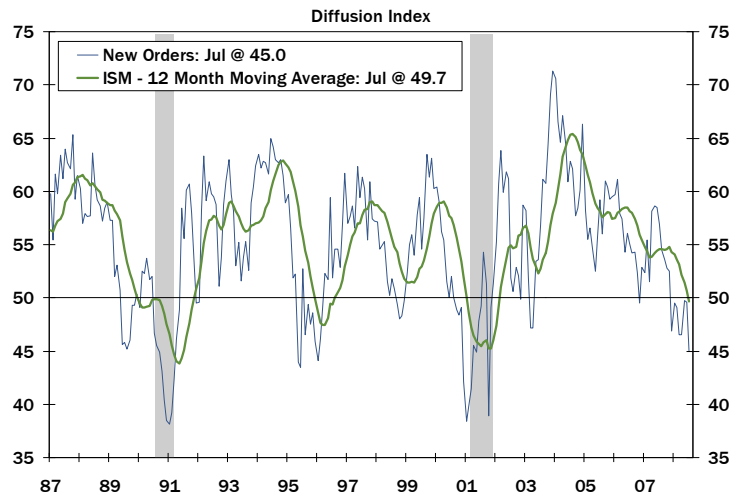
The Institute for Supply Management's purchasing managers' index for manufacturers slipped to the expansion/contraction line of 50.0 in July. The forward looking new orders index fell 4.6 points to 45.0 - marking the lowest level since right after the September 11th attack and suggesting continued weakness in the manufacturing sector in the coming months.

Regional purchasing managers' indices have been mixed this month (Chicago & NY up, Philly down) and suggest little change to the national ISM index in August. Limiting any improvement in the headline index will be a significant pullback in the employment index which showed a strong 8.2 point jump in July - an increase that was likely more seasonal than fundamental. In general, commodity prices have been coming off historical highs and should lead to some slippage in the prices paid index. Higher prices, however, should remain problematic for manufacturers and non-manufacturers.

Previous: 50.0

Wachovia: 50.2

Consensus: 49.5

ISM New Orders Index

Total Vehicle Sales • Wednesday

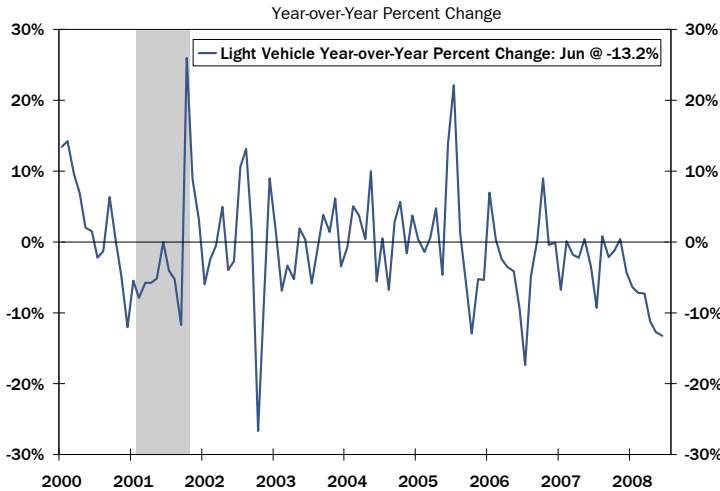
Falling to a sixteen year low, total light motor vehicle sales fell to a 12.5 million unit annualized pace in July as consumers continue to avoid major durable goods purchases. Year-to-date, total light motor vehicle sales have averaged 14.3 million units - compared to 16.2 million units for all of 2007.

It appears, however, that increased incentive activity may have led to some improvement in the light motor vehicle sales pace in August. Even with a potential increase this month, motor vehicle sales remain very depressed as consumers continue to fret about their job and personal finance prospects.

Previous: 12.5M

Wachovia: 12.9M

Consensus: 13.0M

Light Vehicle Sales

Employment Report • Friday

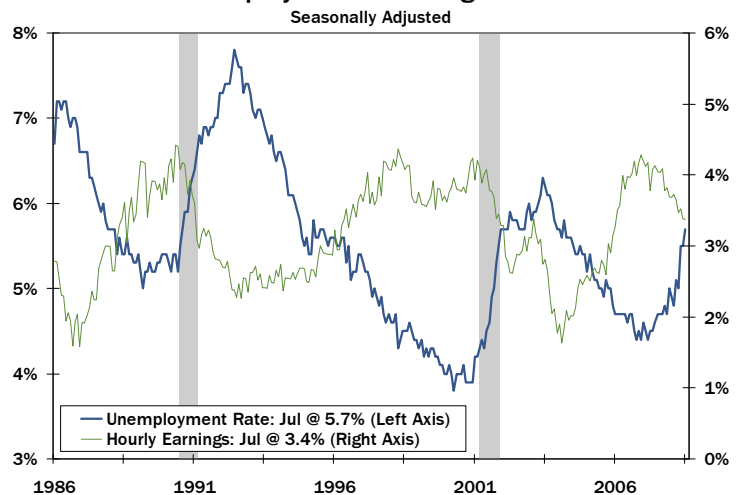
Falling for the seventh consecutive month, nonfarm payrolls declined 51 thousand in July. The household survey reported a 72K decline in employment and coupled with a 213K increase in the labor force raised the unemployment rate 0.2 percentage points to 5.7 percent - the highest level since March 2004.

Given the distortion caused by the extension of unemployment benefits it is almost impossible to get a clear reading of the underlying picture regarding initial claims. Since the correlation of claims to changes in nonfarm payrolls is strong, we are likely to see a wide range of payroll estimates this month as economists look at other metrics to help forecast this particular month's payroll figure. We expect to see further deterioration in August with our call of -97K. The unemployment rate will likely drift higher in coming months but should remain steady at 5.7 percent in August.

Previous: -51K

Wachovia: -97K

Consensus: -70K

Unemployment and Wage Rates


Global Review

(Continued from Page 1)

industrial production this year. Industrial production, which rose more than 12 percent (year-over-year) in the first quarter grew less than 7 percent in the second quarter and it was up only 1.1% in July, indicating the third quarter has gotten off to a sluggish start.

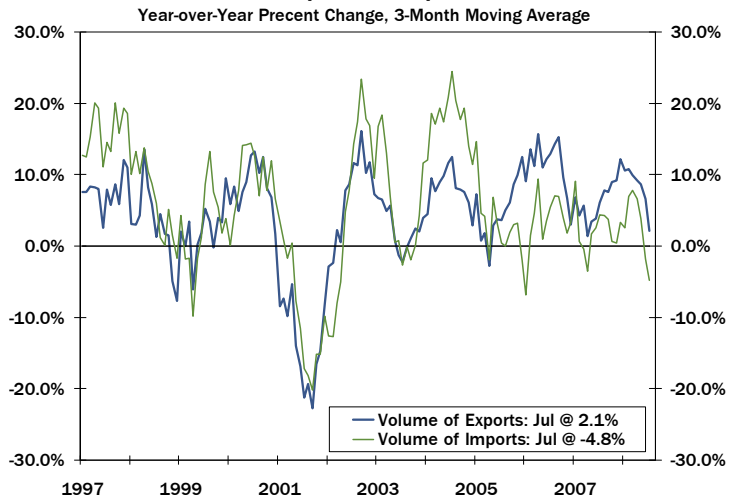
Taiwan experienced a “bubble” in credit card borrowing earlier this decade, which has kept growth in consumer spending rather tepid over the past few years. Therefore, exports have played a large role in driving GDP growth, and deceleration in exports has had a significant effect on the overall economy. That said, there is more to the recent Taiwanese growth slowdown than simply exports.

The top chart also makes it clear that import growth has weakened significantly, which is often symptomatic of slower growth in domestic spending. Indeed, domestic demand declined at a year-over-year rate of 1.3 percent in the second quarter due in part to the 7.7 percent drop in investment spending. As noted above, growth in consumer spending has been lackluster, and real consumer expenditures, which rose only 1.9 percent over the course of last year, were up just 1.1 percent in the second quarter. The sharp increase in energy prices earlier this year has likely exerted a slowing effect on real consumer spending in Taiwan.

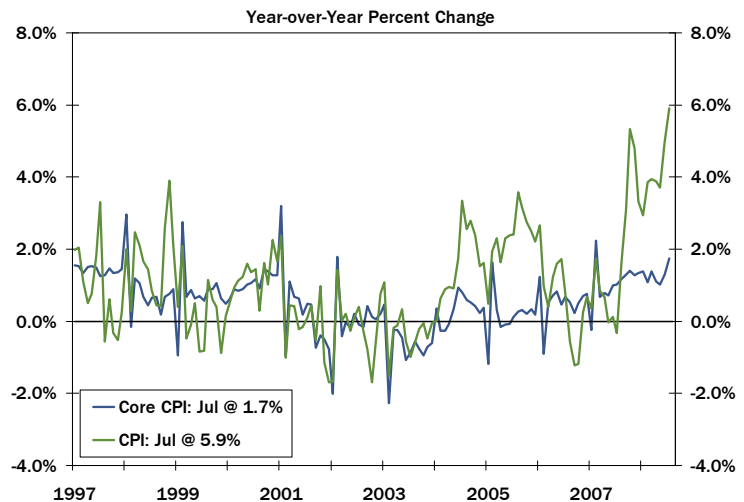
Speaking of energy prices, the middle chart shows that CPI inflation has risen to nearly 6 percent, the highest year-over-year inflation rate since the early 1990s. However, the chart makes it clear that most of the rise in the overall rate of CPI inflation is attributable to food and energy prices. With the subsequent decline in these commodities prices, the overall rate of CPI inflation should recede in the months ahead. That said, the central bank has been gradually lifting its discount rate to insure that previous increases in food and energy prices do not feed through into “core” prices. With the economy slowing and wage growth showing very few signs of acceleration, a significant increase in core CPI inflation does not seem likely.

The Taiwanese dollar, which rose to an 11-year high versus the U.S. dollar earlier this year, has given up some of its gains over the past month due largely to signs that growth in Taiwan, not to mention most other economies, is slowing. The Taiwanese dollar could experience further losses, at least in the near term, if investors continue to have doubts about the Taiwanese economic outlook.

Taiwanese Export & Import Volumes



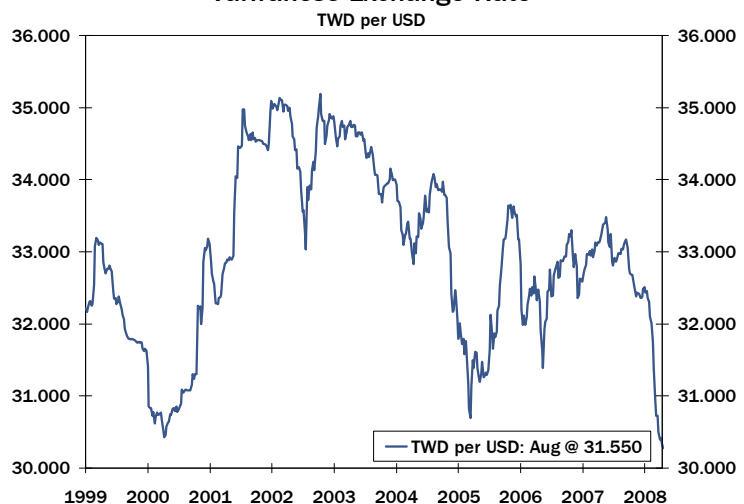
Taiwanese Consumer Price Index



Selected Global Data

Japan	GDP Year-over-Year	Q2 - 2008	1.0%
	CPI	July - 2008	2.3%
	Unemployment	July - 2008	4.0%
	BoJ Target Rate	Aug - 29	0.50%
Euro-Zone	GDP Year-over-Year	Q2 - 2008	1.5%
	CPI	July - 2008	4.0%
	Unemployment	July - 2008	7.3%
	ECB Target Rate	Aug - 29	4.25%
UK	GDP Year-over-Year	Q2 - 2008	1.4%
	CPI	July - 2008	4.4%
	Unemployment	July - 2008	2.7%
	BoE Target Rate	Aug - 28	5.00%
Canada	GDP Year-over-Year	June - 2008	0.0%
	CPI	July - 2008	3.4%
	Unemployment	July - 2008	6.1%
	BoC Target Rate	Aug - 29	3.00%

Taiwanese Exchange Rate



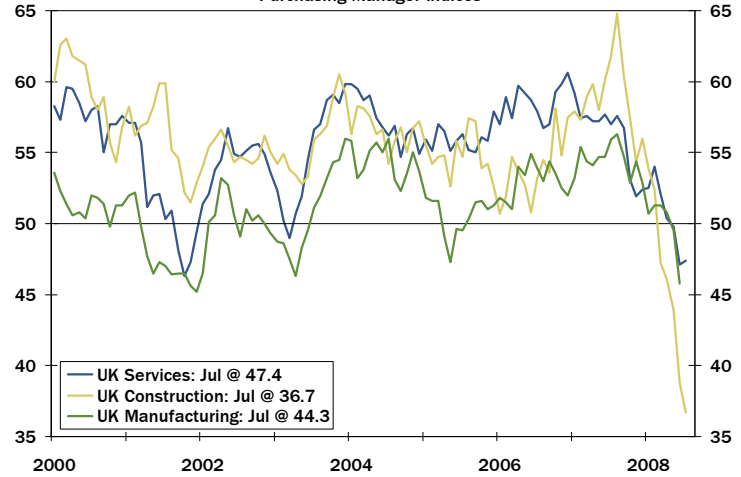
U.K. Purchasing Managers' Indices

The U.K. purchasing managers' indices are widely followed because they offer insights into the current state of the U.K. economy. The construction PMI, which will be released on Tuesday, has essentially collapsed, which is consistent with weakness in construction spending this year. And the manufacturing (Monday) and service sector (Wednesday) PMIs have each dropped below "50", suggesting that these sectors are struggling. Data on mortgage approvals and consumer confidence will offer further insights into the present state of the economy.

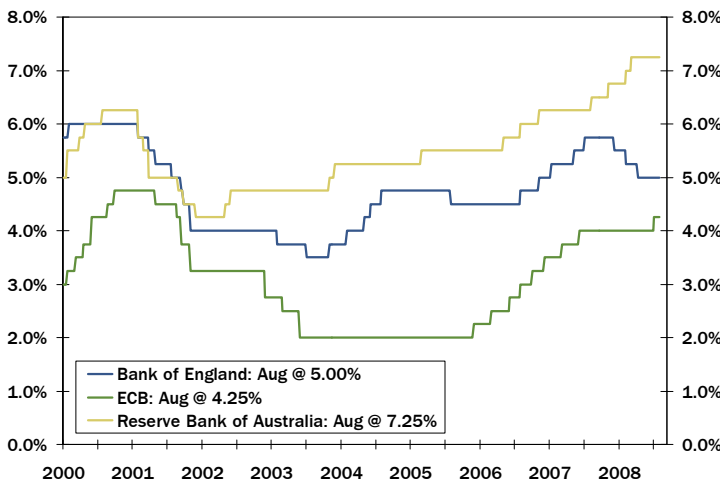
In our view, the U.K. economy has slipped into recession and we look for GDP to contract over the next few quarters. That said, we do not expect the Bank of England to cut rates soon (see below for discussion) due to lingering concerns about inflation.

Previous Man PMI: 44.3 Consensus Man PMI: 44.5
 Previous Services PMI: 47.4 Consensus Services PMI: 47.0

UK Purchasing Managers Indices



Central Bank Policy Rates



Central Bank Meetings

Four foreign central banks hold policy meetings next week. The Reserve Bank of Australia kicks off the schedule early on Tuesday morning (U.S. time), and many investors look for the first rate cut since 2001. Growth down-under appears to be slowing quickly, and the RBA adopted a "bias" to ease last month.

Elsewhere, major central banks likely will keep rates on hold. The Bank of Canada, which meets on Wednesday, has cut rates by 150 basis points since December. Like the Federal Reserve, the BoC likely will remain on hold for the foreseeable future. The Bank of England and the European Central Bank, which both hold policy meetings on Thursday, will likely refrain from cutting rates for the next few months because inflation in both economies are well above rates that each bank considers to be acceptable.

Current RBA Rate: 7.25% Current BoC Rate: 3.00%
 Current BoE Rate: 5.00% Current ECB Rate: 4.25%

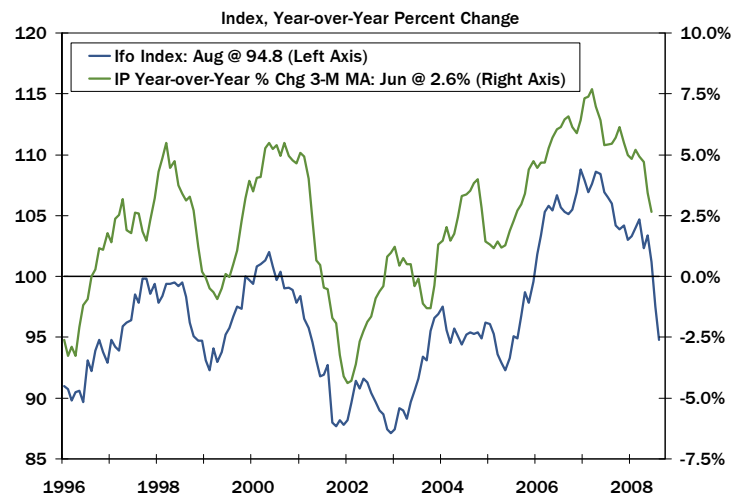
German Industrial Production • Friday

The German economy appears to be slowing quickly. Real GDP declined at an annualized rate of 2.0 percent in the second quarter, which partially reflects statistical payback for the very strong 5.2 percent rate registered in the first quarter. However, more recent indicators suggest that growth in the third quarter likely will be weak. The Ifo index of German business sentiment, which is highly correlated with growth in industrial production, has plunged to its lowest level since mid-2005. "Hard" data on industrial production in July likely will confirm other signs of slowing growth.

Data on German retail sales in July are expected to be released at some point next week, and data on factory orders will give some clues to the outlook for industrial production in the next few months.

Previous: 0.2% (month-on-month change)
 Consensus: -0.5%

German Production Indicators



Interest Rate Watch
Real GDP-Inflation Data Keeps Fed on Hold

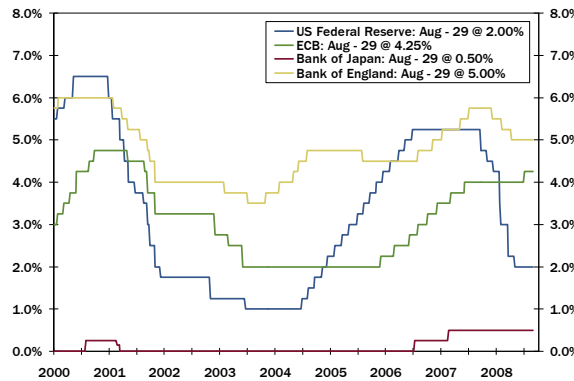
This week's release of second quarter GDP revealed strong exports but a weak domestic economy. Consumer spending was boosted by the rebates but the outlook remains uncertain. As a result, the downside risks to the economy remain in place. Our outlook remains for below par growth in the second half of the year. Meanwhile, core inflation remains just above the Fed's perceived target ceiling. Therefore, short-term rates are likely to remain steady as the Federal Reserve faces the dual imbalance of below-trend economic growth and above-target inflation.

For the long end of the Treasury curve, we expect inflation stability will keep the ten-year rate in a tight 3.8 - 4.0 percent range. We remain cautious on the recent dollar improvement and we are concerned that the federal deficit outlook has deteriorated faster than expected. The U.S. reliance on capital inflows in a weak economy/higher inflation period is a perilous balance.

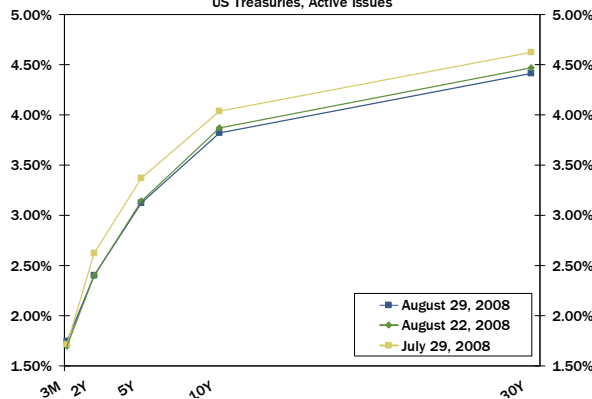
Credit Spreads: Width Defines Risk

There is no easy out for creditors or debtors in our outlook. A difficult workout remains ahead. Credit spreads are not expected to tighten in the near term. Negative financial news reminds creditors of the event risk in company announcements.

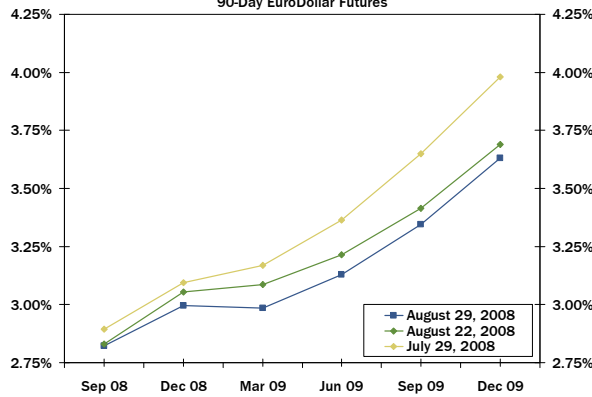
Capital markets continue to search for a new risk/reward tradeoff. At present, credit spreads suggest that credit remains limited relative to a neutral position. The financial markets continue to search for a new equilibrium spread. Our expectation is any new equilibrium will be higher than what it was during the 2004-2006 period. Risk is being more fairly priced—we just haven't seen what the new equilibrium price is quite yet.

Central Bank Policy Rates

Yield Curve

US Treasuries, Active Issues


Forward Rates

90-Day EuroDollar Futures


Topic of the Week
A Long Slog Remains Ahead For Housing

The mid-year data on home sales, home construction and housing prices all suggest there is still more work to be done before housing finds a definitive bottom. Sales are probably closest to bottoming. Sales of both new and existing homes have more or less fluctuated around recent levels for the past three or four months and price declines appear to be moderating. New home construction remains in free fall, however, particularly single-family starts. While some of the more recent numbers on the housing industry have come in a little better than expected, we caution against drawing too many conclusions. Much of the recent improvement in existing home sales has come from foreclosure sales, particularly in hard-hit markets like California, Florida, Arizona, and Nevada.

Given how tight credit conditions are today and how much mortgage rates have backed up, even the modest amount of stability we are seeing in home sales is encouraging. A renewed slide cannot be ruled out, however, with overall economic growth poised to slow during the second half of the year, continued challenges in the secondary mortgage market and caution by mortgage providers.

Against this backdrop, forecasts of the housing market are fraught with trepidation. We are sticking with the forecast we have had for much of this year. Sales of both new and existing homes are expected to bottom in the next nine months and home construction is expected to bottom by the middle of next year. Home prices are expected to find a bottom sometime between the middle of 2009 and the middle of 2010, with the most challenged markets seeing prices bottom near the end of that period.

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Market Data ♦ Mid-Day Friday
U.S. Interest Rates

	Friday 8/29/2008	1 Week Ago	1 Year Ago
3-Month T-Bill	1.74	1.69	4.00
3-Month LIBOR	2.81	2.81	5.54
1-Year Treasury	1.99	1.96	3.94
2-Year Treasury	2.40	2.40	4.16
5-Year Treasury	3.12	3.14	4.30
10-Year Treasury	3.82	3.87	4.56
30-Year Treasury	4.41	4.47	4.88
Bond Buyer Index	4.68	4.64	4.70

Foreign Interest Rates

	Friday 8/29/2008	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	4.96	4.95	4.73
3-Month Sterling LIBOR	5.75	5.76	6.61
3-Month Canadian LIBOR	3.35	3.34	5.03
3-Month Yen LIBOR	0.88	0.87	0.98
2-Year German	4.12	4.13	3.97
2-Year U.K.	4.52	4.58	5.35
2-Year Canadian	2.73	2.92	4.22
2-Year Japanese	0.73	0.69	0.88
10-Year German	4.18	4.22	4.23
10-Year U.K.	4.49	4.57	5.04
10-Year Canadian	3.54	3.62	4.39
10-Year Japanese	1.42	1.45	1.59

Foreign Exchange Rates

	Friday 8/29/2008	1 Week Ago	1 Year Ago
Euro (\$/€)	1.471	1.479	1.368
British Pound (\$/£)	1.825	1.853	2.018
British Pound (£/€)	0.806	0.799	0.678
Japanese Yen (¥/\$)	108.830	110.075	116.175
Canadian Dollar (C\$/ \$)	1.055	1.047	1.060
Swiss Franc (CHF/\$)	1.099	1.099	1.200
Australian Dollar (US\$/A\$)	0.861	0.867	0.822
Mexican Peso (MXN/\$)	10.280	10.145	11.077
Chinese Yuan (CNY/\$)	6.840	6.834	7.550
Indian Rupee (INR/\$)	43.938	43.425	41.111
Brazilian Real (BRL/\$)	1.630	1.627	1.966
U.S. Dollar Index	77.036	76.805	80.700

Commodity Prices

	Friday 8/29/2008	1 Week Ago	1 Year Ago
W. Texas Crude (\$/Barrel)	118.18	114.59	73.51
Gold (\$/Ounce)	834.19	823.05	667.60
Hot-Rolled Steel (\$/S.Ton)	1065.00	1125.00	540.00
Copper (¢/Pound)	340.50	347.25	335.00
Soybeans (\$/Bushel)	13.24	13.48	8.17
Natural Gas (\$/MMBTU)	8.28	7.84	5.43
Nickel (\$/Metric Ton)	20,430	19,865	27,395
CRB Spot Inds.	474.93	478.60	474.01

Next Week's Economic Calendar

	Monday 1	Tuesday 2	Wednesday 3	Thursday 4	Friday 5
U.S. Data		ISM Manufacturing July 50.0 August 50.2 (W) Construction Spending June -0.4% July -1.1% (W)	Total Vehicle Sales July 12.5M August 12.9 (W) Factory Orders June 1.7% July 1.0% (W)	Nonfarm Productivity 1Q 2.6% 2Q 2.9% (W) Unit Labor Cost 1Q 2.5% 2Q 0.6% (W) ISM Non-Manufacturing July 49.5 August 49.0 (W)	Nonfarm Payrolls July -51K August -97K (W) Unemployment Rate July 5.7% August 5.7% (W)
Global Data	UK PMI Manufacturing Previous (Jul) 44.3	UK PMI Construction Previous (Jul) 36.7	UK PMI Services Previous (Jul) 47.4 Canada Bank of Canada Rate Previous 3.00%	UK BOE Announces Rates Previous 5.00% Euro Zone ECB Announces Rates Previous 4.25%	Canada Unemployment Rate Previous(Jul) 6.1% Germany Indus. Production (MoM) Previous(Jun) 0.2%

Note: (W) = Wachovia Estimate (c) = Consensus Estimate

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