WACHOVIA
ECONOMICS GROUP

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

September 19, 2008

U.S. Review

What A Week!

Dramatic swings in the financial markets more than offset the handful of major economic reports released this week. The Fed, central banks around the world, and the U.S. Treasury pulled out all the stops this week to inject liquidity into the financial markets and put a backstop around the global financial system. While it is still too soon to say the financial crisis has passed, the determination of Treasury, Congress, the Fed, and the Administration have all clearly bolstered confidence and provided a credible path for a recovery.

Treasury Secretary Hank Paulson announced plans to bolster the strength and stability of the financial markets. The Treasury announced that they will provide a temporary one-year guarantee on money market mutual funds and also announced a major plan to deal with the root cause of the financial turmoil, which is the illiquidity of the mortgage market. The Treasury, along with Fannie Mae and Freddie Mac, will increase their purchases of mortgage-back securities and find ways to remove many of the other "illiquid assets clogging the financial system."

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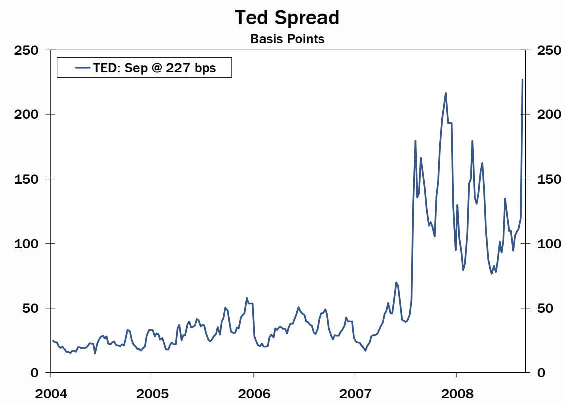

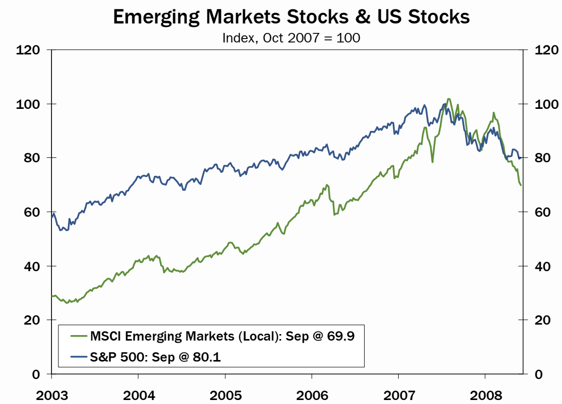

Global Review

Emerging Markets Take a Beating

Since peaking in October 2007, the S&P 500 has declined about 20 percent. However, as shown in the graph at the left, a widely followed index of emerging market stocks has dropped even more than the S&P 500. Indeed, some emerging stock markets have been absolutely hammered lately. For example, the Russian MICEX index has plunged almost 50 percent since mid-May. What in the world is going on in emerging markets?

Part of the recent drop in emerging market stocks may simply reflect pullback from the sharp run-up over the past few years. Between early 2003 and October 2007 the Morgan Stanley Emerging Market Free index rose more than three-fold as investors piled into emerging market stocks. As emerging stock markets started to retreat, get-rich-quick investors undoubtedly streamed for the exits.

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Recent Special Commentary

Date	Title	Authors
September-18	Global Central Banks Work to Soothe Fears	Vitner
September-16	FOMC September Meeting - No Change	Vitner
September-15	FOMC September Meeting - Workout Continues	Silvia
September-11	Global Chartbook - September 2008	Bryson

U.S. Forecast

	Actual						Forecast		Actual			Forecast		
	2007				2008				2005	2006	2007	2008	2009	2010
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
Real Gross Domestic Product [1]	0.0	4.8	4.8	-0.2	0.9	3.3	0.8	0.8	2.9	2.8	2.0	1.8	1.8	2.2
Personal Consumption	3.9	2.0	2.0	1.0	0.9	1.7	-0.8	-0.3	3.0	3.0	2.8	1.0	0.9	2.1
Inflation Indicators [2]														
"Core" PCE Deflator	2.3	2.1	2.0	2.2	2.2	2.2	2.3	2.0	2.1	2.3	2.2	2.2	1.9	1.9
Consumer Price Index	2.4	2.6	2.4	4.0	4.2	4.3	5.0	3.3	3.4	3.2	2.9	4.2	2.0	1.9
Industrial Production [1]	1.5	3.2	3.6	0.3	0.4	-3.2	1.7	2.0	3.3	2.2	1.7	0.5	2.2	3.3
Corporate Profits Before Taxes [2]	-1.0	-0.5	-2.7	-2.0	-1.5	-7.0	-7.5	-11.0	17.6	15.2	-1.6	-6.7	4.9	8.5
Trade Weighted Dollar Index [3]	80.5	78.7	74.4	73.3	70.3	71.0	75.6	77.4	86.0	81.5	73.3	77.4	86.0	91.0
Unemployment Rate	4.5	4.5	4.7	4.8	4.9	5.3	6.0	6.2	5.1	4.6	4.6	5.6	6.7	7.4
Housing Starts [4]	1.45	1.46	1.30	1.15	1.05	1.02	0.95	0.92	2.07	1.81	1.34	0.99	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	2.00
10 Year Note	4.65	5.03	4.59	4.04	3.45	3.99	3.70	3.80	4.39	4.71	4.04	3.80	4.10	4.30

Data As of: September 10, 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

INSIDE

U.S. Review

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It's The Economy, Stupid!

The Treasury's plan will require congressional action, which is going to be negotiated over the weekend. Hank Paulson noted the total cost of the program will be in the "hundreds of billions" of dollars. The Treasury, Fed and Congressional leaders met Thursday night and are expected to reach an agreement to fund and implement the Treasury's proposals over the weekend.

Even with a plan in place to clean up the mortgage mess and restore confidence in the financial system, serious challenges remain for the financial markets and broader economy. Lenders remain extremely risk averse and lending will likely remain constrained for some time to come. Moreover, the latest news on the economy, which was hardly noticed this week, has generally been weaker than expected. Industrial production fell much more than expected during August and housing starts plunged to their lowest level since 1991. First-time claims for unemployment insurance rose by 10,000 to 455,000 in mid-September and the Index of Leading Indicators fell 0.5 percent in August.

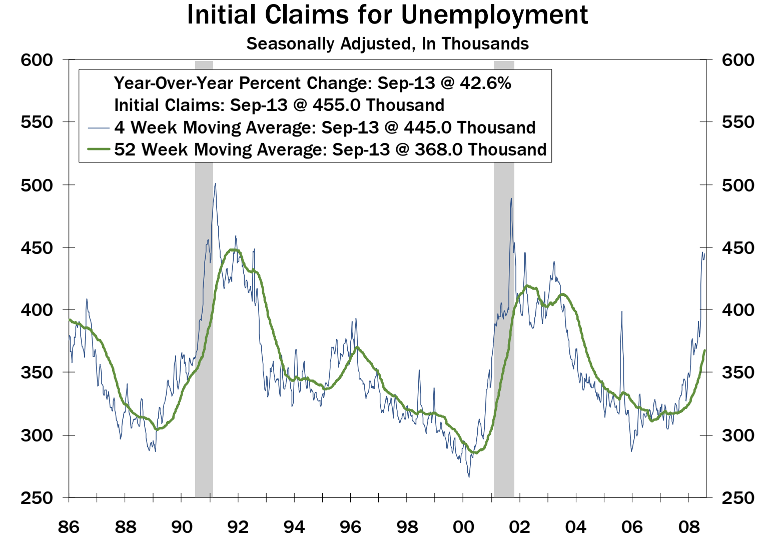
While many people have been quick to say that the economy is in recession, the actual economic data have not supported that view just yet. Real GDP grew at a 3.3 percent pace during the second quarter and the next revision to that number, which will be released next week, is expected to be modestly stronger than that. More recently, the economic data have looked far more threatening.

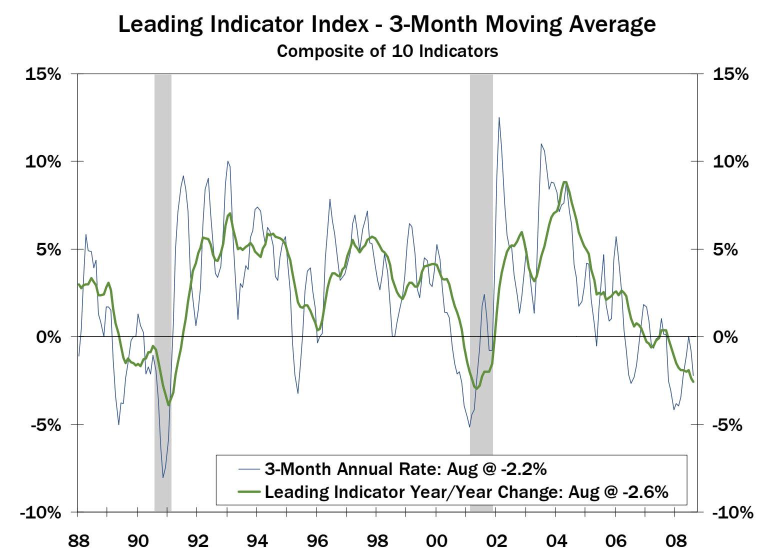
Industrial production fell sharply, led 1.1 percent lower by big losses in manufacturing output. The domestic auto industry continues to struggle mightily and production of motor vehicles & parts are off over 12 percent in the last year. We do not expect to see any near-term improvement in automotive output, major manufacturers have already announced weaker production schedules for the fall in an attempt to meet the continuing weak sales environment.

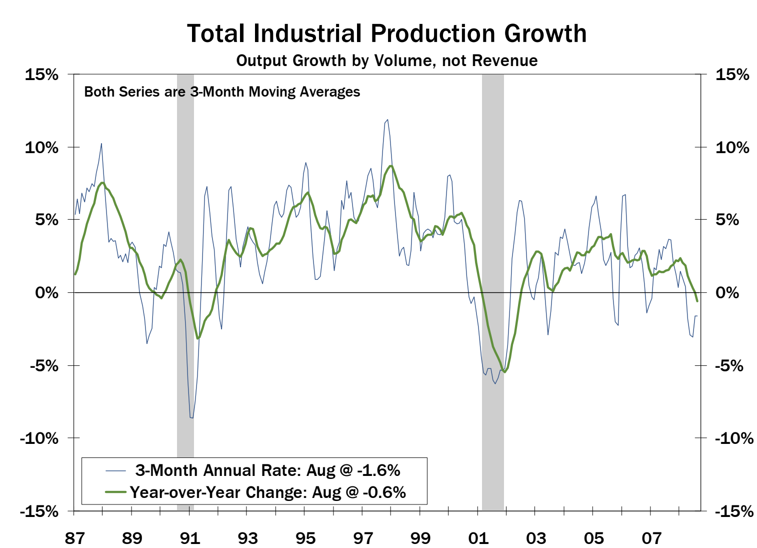
While automotive output has been weak, as have other consumer facing sectors, those with export and business exposure have been fairing better. Computer and machinery production, while not stellar, have been steady. Export growth may slow in coming months, but we do not expect a collapse. Capacity utilization for finished goods fell to just over 75 percent. Lower capacity utilization is a double-edged sword, while we expect less inflationary pressure, especially core inflation, lower utilization will also put downward pressure on corporate profits in coming months.

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	August - 2008	5.4%
"Core" CPI	August - 2008	2.5%
"Core" PCE Deflator	July - 2008	2.4%
Industrial Production	August - 2008	-1.5%
Unemployment	August - 2008	6.1%
Federal Funds Target Rate	Sep - 19	2.00%







Existing Home Sales • Wednesday

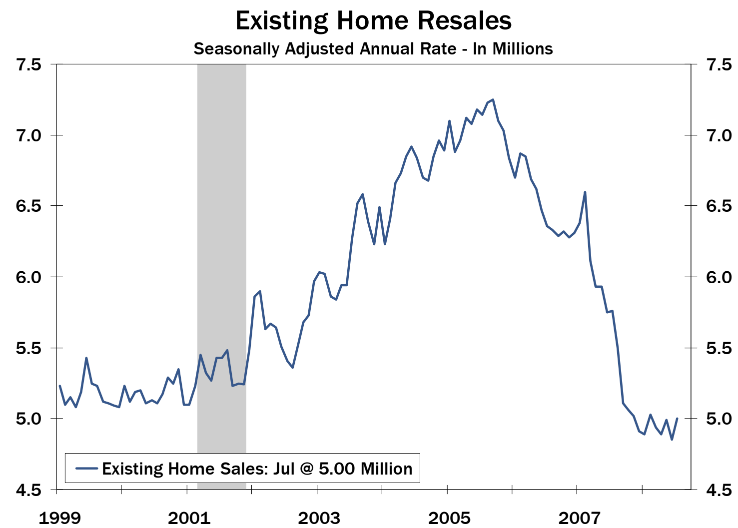
Reflecting recent stability over the past eight months, sales of existing homes increased 3.1 percent in July to an annualized rate of 5.00 million units.

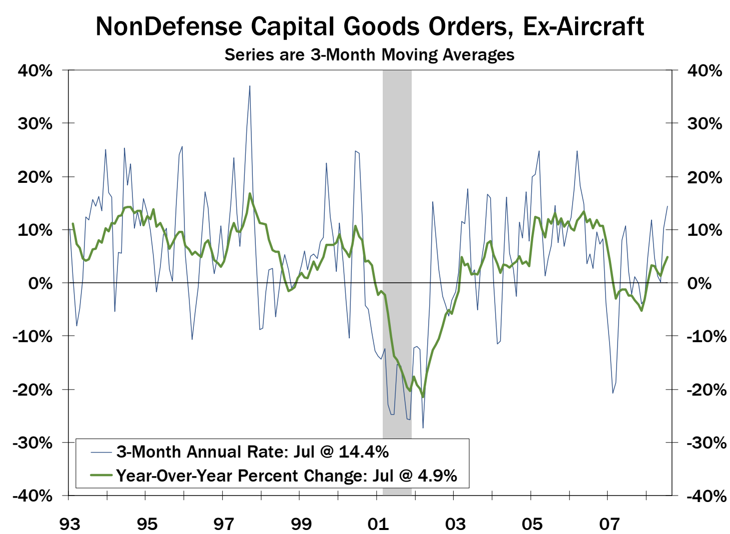
Despite July's gain, we suspect sales slipped further in August. Inventory in the existing home market has changed very little and when coupled with tighter lending standards, a rising unemployment rate and higher mortgage rates, sales of existing and new home should remain weak in the coming months.

Existing home prices are still falling. While affordability measures have improved, price stability is still far off. We expect home prices will likely bottom out some time either late next year or in the first half of 2010.

Previous: 5.00M **Wachovia: 4.96M**

Consensus: 4.95M





Durable Goods Orders • Thursday

With the help of solid export activity, durable goods orders registered a 1.3 percent gain in July on top of a 1.4 percent gain in June. Not bad given the dismal automotive picture and weak economic environment.

We look for a large pullback in August as aircraft and motor vehicle production sank last month. Commodity-related products, like primary and fabricated metals, will likely pullback too as commodity prices in general have receded. One positive, however, should be machinery orders which continue to be fueled by solid export demand.

Business fixed investment looks like it will eke out low single-digit growth in the third and fourth quarters, but with corporate profits weakening and credit conditions exceptionally tight, this growth looks suspect.

Previous: 1.3% **Wachovia: -4.0%**

Consensus: -1.5%

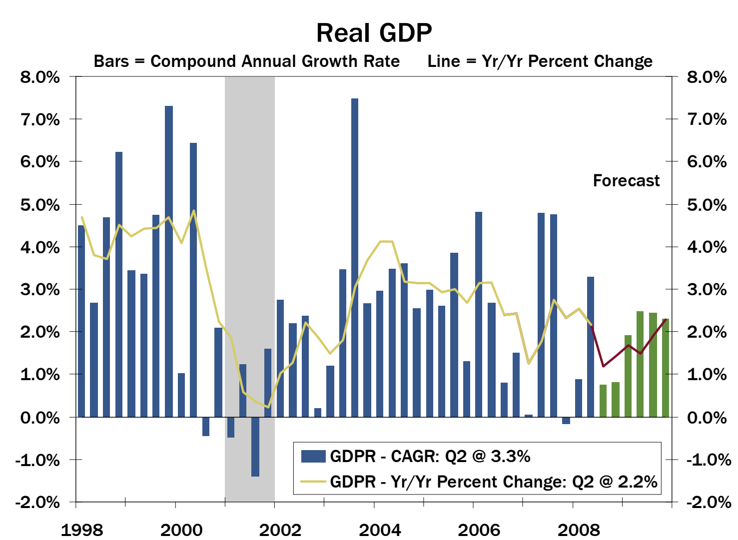
GDP • Friday

The next few quarters will be the most trying time for the U.S. economy in the past two decades. Our forecast has real GDP rising at a 1.9 percent pace over the next year and core GDP, which measures private domestic demand (excluding swings in inventories, net exports and government spending), rising at just a 0.5 percent pace. Conditions will feel even weaker than this.

Consumer spending is being affected by rising unemployment, slower income growth and falling home prices. Consumer spending is now expected to decline in the third and fourth quarters and post anemic gains in the first half of 2009. Exports have provided an enormous boost for the economy over the past year but are now expected to slow. Global economic growth is moderating faster than many investors had anticipated earlier this year.

Previous: 3.3% **Wachovia: 3.4%**

Consensus: 3.3%



Global Review

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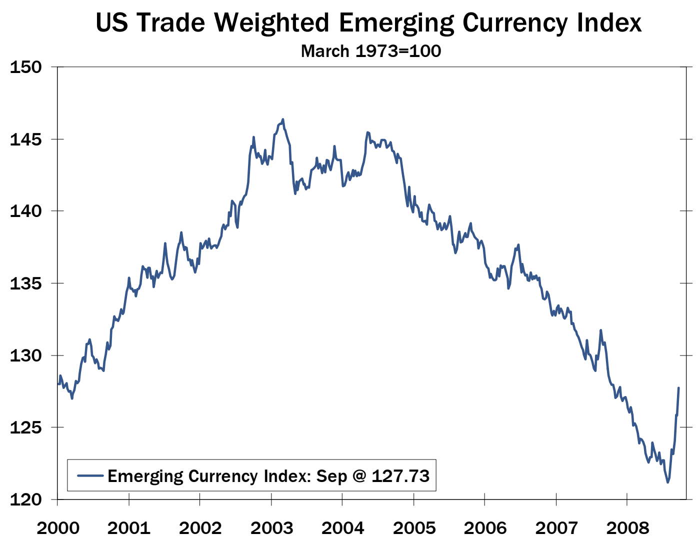
Although a pullout by short-term investors may have added to the downward pressure on emerging stock markets, the rout that started last autumn needed a spark. That catalyst was prospects for slower growth in the developing world. For example, growth in Chinese industrial production has slowed visibly over the past year (see top chart). Similar slowdowns are apparent in most other developing countries as well. Not only have slowdowns in major economies contributed to deceleration in emerging economies, but tighter economic policies in many developing countries, in response to the sharp rise in inflation this year, have also acted to slow growth. Slower economic growth usually translates into smaller increases, if not absolute declines, in stock markets.

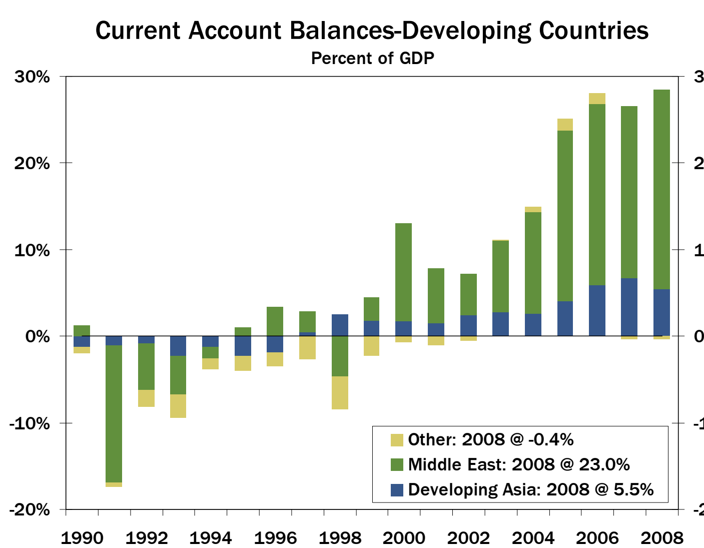
Stresses in emerging markets are visible in other financial prices as well. Yields on government bonds in most developing countries, which trended higher over most of the summer, shot up sharply this week. That said, spreads over U.S. Treasury yields have not blown out to the same extent that they did earlier this decade when global growth slowed sharply. As shown in the middle chart, most emerging currencies have weakened versus the dollar recently. Indeed, the Fed's "Other Important Trading Partners" index, which measures the value of the dollar versus 19 non-major currencies, has risen more than 5 percent over the past two months.

As noted above, yield spreads of developing countries' government debt generally remain well short of levels reached earlier this decade. In our view, economic fundamentals in most developing countries are better today than they were a decade ago. As shown in the bottom chart, developing countries generally incurred current account deficit a decade or so ago. Although Middle Eastern counties (i.e., OPEC countries) account for much of the massive surpluses at present, current accounts are largely under control today (some Eastern European countries may be the exception to the rule). Fiscal deficits in many developing countries have largely been brought under control as well. Due to improved economic fundamentals, capital flight, which has plagued many developing countries in the past, should not be a problem in the current cycle. Although we look for further modest depreciation against the greenback in the quarters ahead, we are not expecting a generalized collapse of emerging currencies.



Selected Global Data

Japan	GDP Year-over-Year	Q2 - 2008	0.7%
	CPI	July - 2008	2.3%
	Unemployment	July - 2008	4.0%
	BoJ Target Rate	Sep - 19	0.50%
Euro-Zone	GDP Year-over-Year	Q2 - 2008	1.4%
	CPI	August - 2008	3.8%
	Unemployment	July - 2008	7.3%
	ECB Target Rate	Sep - 19	4.25%
UK	GDP Year-over-Year	Q2 - 2008	1.4%
	CPI	August - 2008	4.7%
	Unemployment	August - 2008	2.8%
	BoE Target Rate	Sep - 19	5.00%
Canada	GDP Year-over-Year	June - 2008	0.3%
	CPI	July - 2008	3.4%
	Unemployment	August - 2008	6.1%
	BoC Target Rate	Sep - 19	3.00%



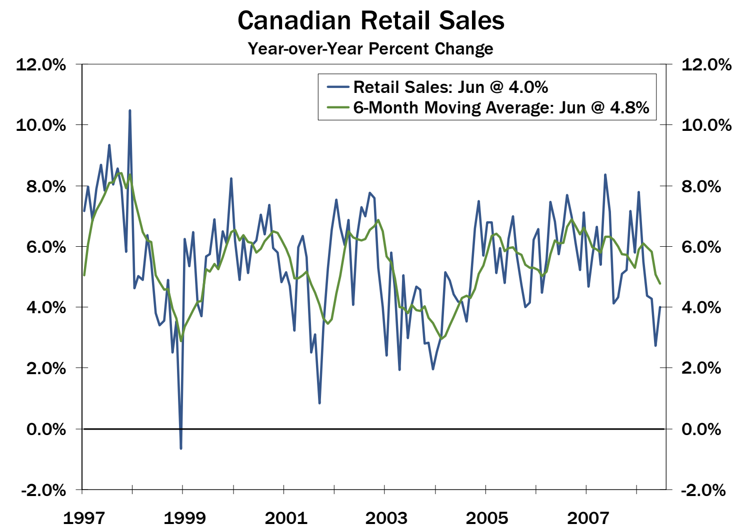
Canadian Retail Sales • Monday

Growth in Canadian consumer spending has generally remained solid this year. However, as is the case in the United States, growth in consumer spending north of the border has slowed this year. If, as the market consensus forecast anticipates, retail sales rose 0.3% in July relative to the previous month, then the year-over-year growth rate would rise to 5.1% from 4.0% in June.

After cutting rates by 150 basis points in four months, the Bank of Canada has kept its policy rate unchanged at 3.00% since April. However, benign inflation gives the Bank scope to ease further if necessary. In that regard, CPI inflation data for August, which print on Tuesday, will offer some insights into the course of Canadian monetary policy going forward. The consensus forecast looks for a 0.1% decline in consumer prices in August.

Previous: 0.5% (month-on-month)

Consensus: 0.3%



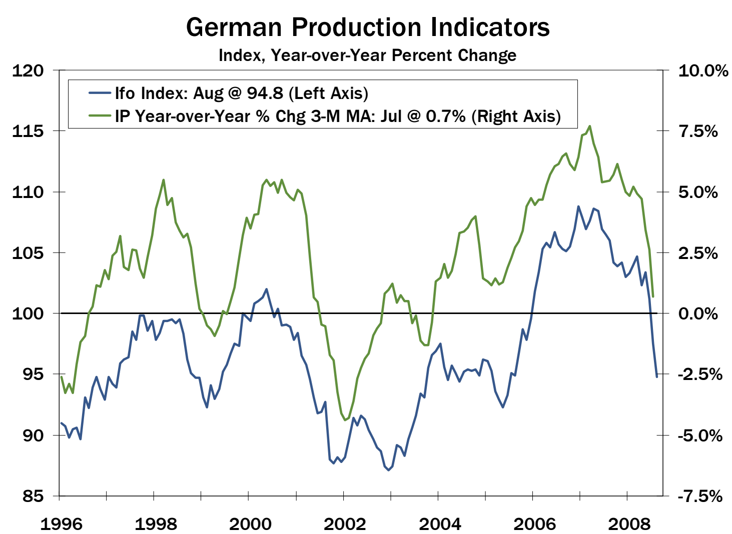
German Ifo Index• Wednesday

The Ifo index of German business sentiment, which is highly correlated with growth in industrial production, slumped in August to its lowest level in about three years. Unfortunately, the consensus forecast anticipates that the index declined more this month. In other words, growth in Germany has probably slowed further.

Economic indicators from the broader Euro-zone are also on tap next week. Data on industrial orders in July will be released on Tuesday as will purchasing managers' indices for the manufacturing and service sectors in September. Orders are expected to have declined, and the PMI's probably remained near 5-year lows. Data on the M3 money supply, a favorite indicator of the ECB's, print on Thursday.

Previous: 94.8

Consensus: 94.0



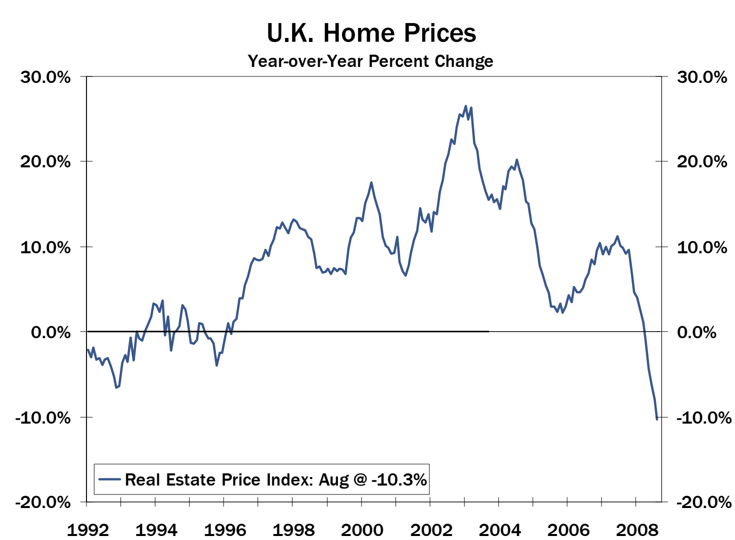
Nationwide Index of U.K. House Prices

In many respects the U.K. economy looks and smells like the U.S. economy, especially when it comes to home prices. Indeed, a widely followed index of U.K. house prices dropped more than 10% in August relative to the same month last year. Data that are expected to be released at the end of next week likely will show that the trend decline in house prices continued this month.

Anecdotal evidence over the past few months has suggested that retail spending has been very weak. Incredibly, however, "hard" data on retail sales over the past two months have come out much stronger than most investors had expected. Therefore, a trade report that is scheduled for release on Thursday will be read with much interest.

Previous: -10.5% (year-over-year)

Consensus:



Interest Rate Watch

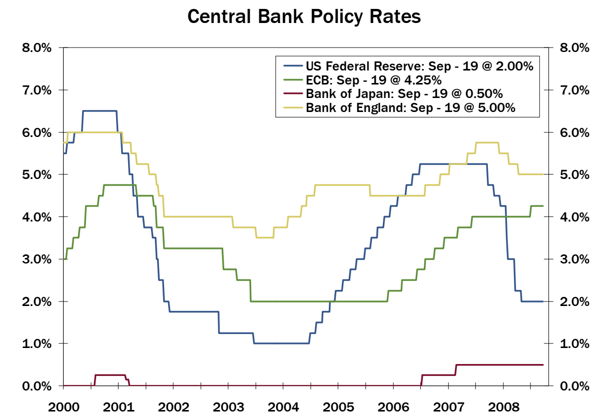
Fed Stays on Hold at the Front Door—Ease out the Back Door

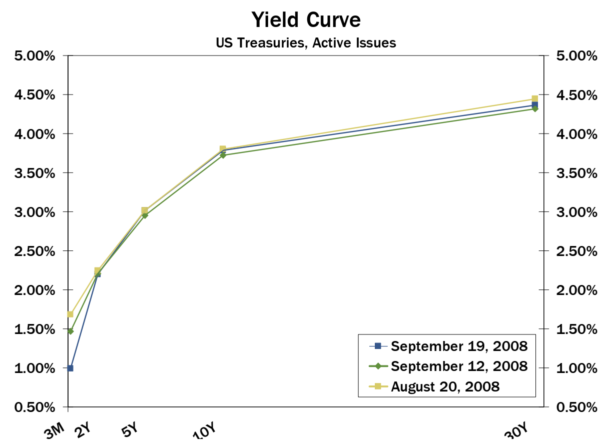
As expected the Federal Reserve did not ease the Federal funds rate at their meeting earlier this week. For the Fed, the focus of policy remains on the intermediate term—the next six to twelve months. From that policy horizon, a balanced view of inflation and economic prospects remains the most reasonable. Our outlook is that the Fed will remain on hold at the October meeting.

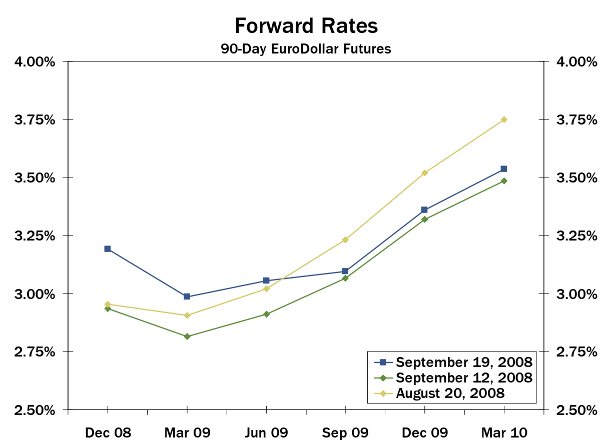
Making Lemonade out of Lemons – Market Liquidity

Yet the Fed is easing dramatically by using its balance sheet to provide more liquidity to the financial markets than would have been available via a cut in the funds rate. As suggested by our note last week, the interaction between quality heterogeneity and asymmetric information can lead to the disappearance of a market where guarantees are indefinite. In this model, as quality is indistinguishable beforehand by the buyer (due to the asymmetry of information). Because of the information/quality problems, we have watched the evolution toward a no-trade market where demand and supply never meet at any positive price. Markets fail to exist altogether in situations involving quality uncertainty.

Into this breach steps the Fed and the Treasury to bridge the market gap. Through the back door, both institutions are providing the liquidity needed and altering the rules, actually they were more like guidelines, to do whatever is needed to buy time. Real solutions are yet to appear.







Topic of the Week

Household Net Worth Declines Foreshadowing Weak Holiday Sales

Household net worth fell 0.8 percent in the second quarter marking its third straight quarter-over-quarter decline. Household net worth now totals $56 trillion, which is down 3.5 percent year-over-year, the sharpest decline since 2003. As home prices continue to decline and stock market volatility stresses household balance sheets, consumer spending is projected to contract in the coming two quarters. Assets fell 2 percent, while liabilities grew 3.9 percent year-over-year. In particular, household real estate is down for the second straight month and corporate equities declined roughly 20 percent year-over-year. Household liabilities fell for the first time since 1983 quarter-over-quarter, potentially showing that consumers are slowly deleveraging. The decline was led by security credit, which saw a roughly 20 percent decline over the last quarter. Weaker household balance sheets certainly cast an ominous light on future consumer spending.

Consumer Spending & Holiday Sales

Consumer spending is being affected by rising unemployment, slower income growth, falling home prices and now weak household balance sheets. The unemployment rate is expected to top out at 7.5 percent, which will further cut into income growth. Falling home prices are still a source of angst and housing has not bottomed out just yet, although we are beginning to see some tentative signs of stabilization. All of these factors signal weak holiday sales. Holiday sales, however, rarely decline year-to-year. Our early look at the holiday season shows sales rising between zero and two percent from last year. (For further commentary, see our Consumer Chartbook.)

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 9/19/2008	1 Week Ago	1 Year Ago
3-Month T-Bill	0.96	1.47	3.90
3-Month LIBOR	3.21	2.82	5.24
1-Year Treasury	1.36	1.88	3.88
2-Year Treasury	2.19	2.20	3.99
5-Year Treasury	3.02	2.95	4.21
10-Year Treasury	3.78	3.72	4.55
30-Year Treasury	4.36	4.31	4.84
Bond Buyer Index	5.03	4.54	4.51

Foreign Exchange Rates

	Friday 9/19/2008	1 Week Ago	1 Year Ago
Euro ($/€)	1.437	1.423	1.396
British Pound ($/£)	1.829	1.794	2.001
British Pound (£/€)	0.786	0.793	0.698
Japanese Yen (¥/$)	107.159	107.945	116.098
Canadian Dollar (C$/$)	1.047	1.060	1.015
Swiss Franc (CHF/$)	1.111	1.131	1.184
Australian Dollar (US$/A$)	0.828	0.824	0.857
Mexican Peso (MXN/$)	10.604	10.595	10.990
Chinese Yuan (CNY/$)	6.838	6.844	7.514
Indian Rupee (INR/$)	45.830	45.715	40.200
Brazilian Real (BRL/$)	1.821	1.781	1.868
U.S. Dollar Index	78.018	78.966	79.300

Foreign Interest Rates

	Friday 9/19/2008	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	5.00	4.95	4.72
3-Month Sterling LIBOR	6.00	5.70	6.55
3-Month Canadian LIBOR	3.80	3.52	5.14
3-Month Yen LIBOR	0.90	0.89	1.00
2-Year German	4.02	3.96	4.06
2-Year U.K.	4.38	4.54	5.18
2-Year Canadian	2.87	2.78	4.24
2-Year Japanese	0.80	0.75	0.80
10-Year German	4.22	4.19	4.28
10-Year U.K.	4.59	4.60	4.99
10-Year Canadian	3.68	3.60	4.40
10-Year Japanese	1.49	1.51	1.60

Commodity Prices

	Friday 9/19/2008	1 Week Ago	1 Year Ago
W. Texas Crude ($/Barrel)	99.65	101.18	81.93
Gold ($/Ounce)	856.17	765.50	721.40
Hot-Rolled Steel ($/S.Ton)	940.00	940.00	520.00
Copper (¢/Pound)	319.95	320.80	357.60
Soybeans ($/Bushel)	10.44	11.71	9.09
Natural Gas ($/MMBTU)	7.55	7.37	6.18
Nickel ($/Metric Ton)	16,555	18,423	30,485
CRB Spot Inds.	445.83	459.30	483.21

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	22	23	24	25	26
U.S. Data			**Existing Home Sales** July 5.00M August 4.96M (W)	**Durable Goods Orders** July 1.3% August -4.0% (W) **Durables Ex Transp.** July 0.7% August -2.3% (W) **New Home Sales** July 515K August 500K (W)	**GDP (QoQ)** 1Q 0.9% 2Q 3.4% (W)
Global Data	**Canada** **Retail Sales (MoM)** Previous (Jun) 0.5%	**Euro Zone** **PMI Manufacturing** Previous (Aug) 47.6 **Canada** **CPI (MoM)** Previous (Jul) 0.3%	**Germany** **IFO - Business Climate** Previous (Aug) 94.8		**Japan** **CPI (YoY)** Previous (Jul) 2.3%

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

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