WACHOVIA

ECONOMICS GROUP

Weekly Economic & Financial Commentary

September 05, 2008

U.S. Review

Even Weaker Than The Headlines

The stronger-than-expected upward revision to second quarter real GDP and better than expected news on factory orders had briefly bolstered optimism about near-term economic prospects. That optimism was dashed this week, however, as jobless claims and the unemployment rate both came in much worse than expected. Monthly chain store and motor vehicle sales also remain exceptionally weak. Conditions feel very recession-like, even though year-to-year real GDP growth remains around 2 percent.

The GDP figures give a deceivingly healthy view of overall economic conditions. Most of last year's growth, and practically all the growth in the second quarter, came from a narrowing in the trade deficit. Exports surged while imports declined. Moreover, while the strength in the economy is narrowly based, the weakness is very broadly based. Domestic demand, which encompasses everything but exports, remains very weak. Gross domestic purchases rose at a paltry 0.2 percent pace in the second quarter and are up 0.4 percent year-to-year.

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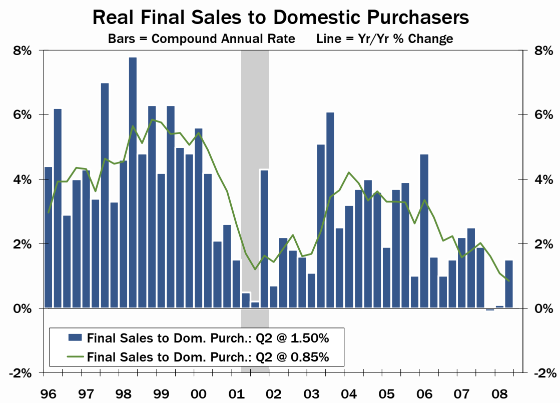

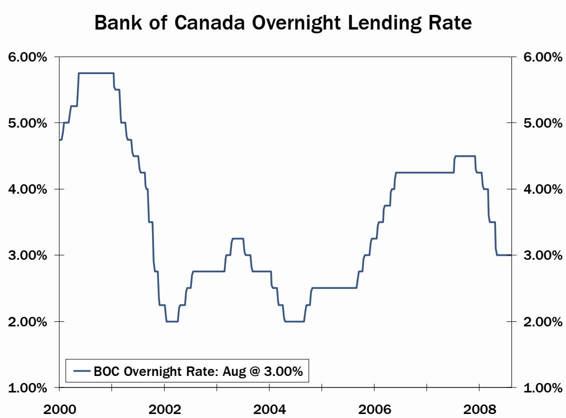

Global Review

Bank of Canada On Hold

Earlier this week the Bank of Canada (BoC) announced it would maintain the current target for the overnight rate at 3.00 percent, as was widely expected. Like many central bankers, BoC Governor Mark Carney faces the difficult situation of a weakening economy and an environment of rising inflation. Canadian Real GDP declined for the first time in five years in Q1, and grew at a less-than expected 0.3 percent annual pace in Q2. Although the overall rate of CPI inflation recently crossed above the top end of the Bank of Canada's target range of 1-3 percent, the core rate of inflation is well within the range. We expect the Bank will remain on hold through the first half of 2009 as it assesses the outlook for growth and inflation.

In its official statement, the BoC expressed the ongoing challenges to economic growth in the months ahead were developing as expected.

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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				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	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

Inside

U.S. Review

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The Changing Mix Of Growth Will Help Tame Inflation

The changing mix of growth is clearly having a much greater impact on the labor market than it is on GDP. Nonfarm employment has fallen for eight consecutive months, producing a net loss of 605,000 jobs. During this period, the unemployment rate has risen 1.2 percentage points to 6.1 percent.

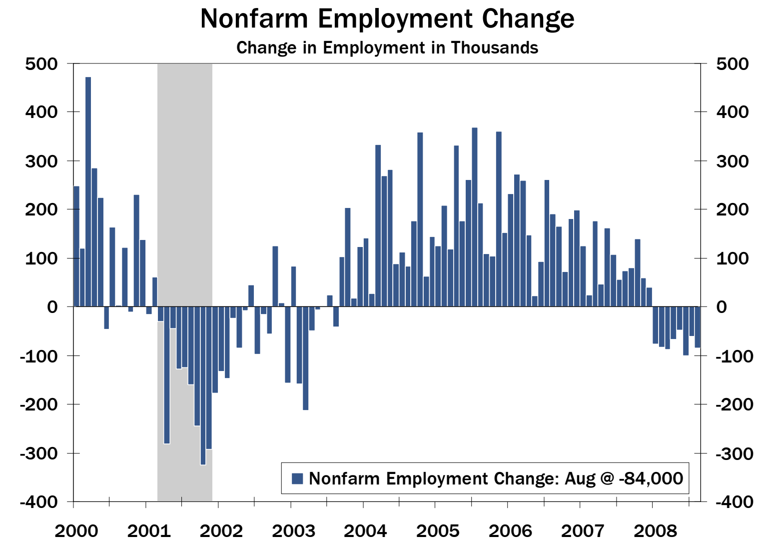
One reason surging exports have not produced greater benefits to the labor market is that exports still encompass a relatively small proportion of overall growth, accounting for just 13.2 percent of GDP. Moreover, a large proportion of U.S. exports tend to be capital intensive, including such items as power generation equipment, commercial airliners, pharmaceuticals, and medical imaging equipment. As a result, the growth in exports provides relatively little net benefit to the employment figures. The weakness in domestic demand, on the other hand, is much more broadly based and tends to impact labor-intensive industries such as construction, retail trade, and financial services.

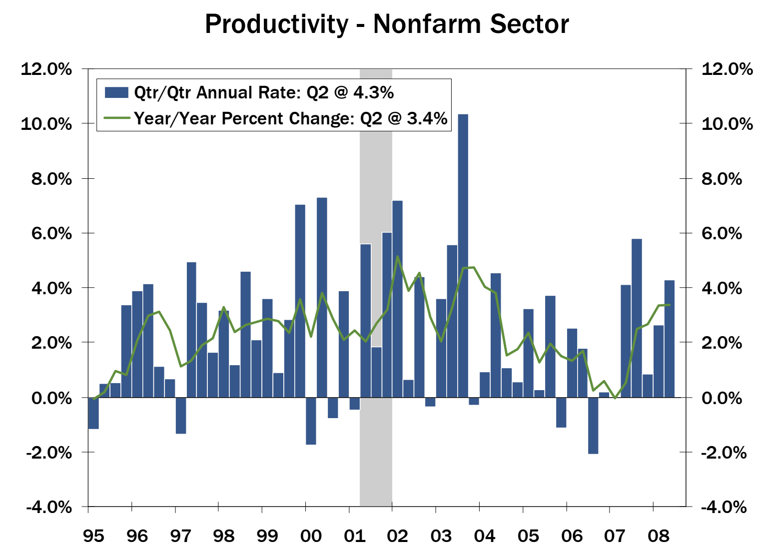
The changing mix of economic growth has several implications for the overall economy. For starters, income growth is holding up better than widely thought. While capital-intensive industries employ a relatively small number of workers relative to the value of their output, those jobs tend to pay very well. In contrast, many jobs in labor-intensive fields, particularly retailing, which has lost 216,100 jobs over the past year, and temporary staffing, which has lost 234,500 jobs, tend to have relatively low wages. Along these lines, the changing mix of economic growth has tended to boost productivity and should help contain inflation. Nonfarm productivity grew at an upwardly-revised 4.3 percent pace in the second quarter and is up 3.4 percent over the past year.

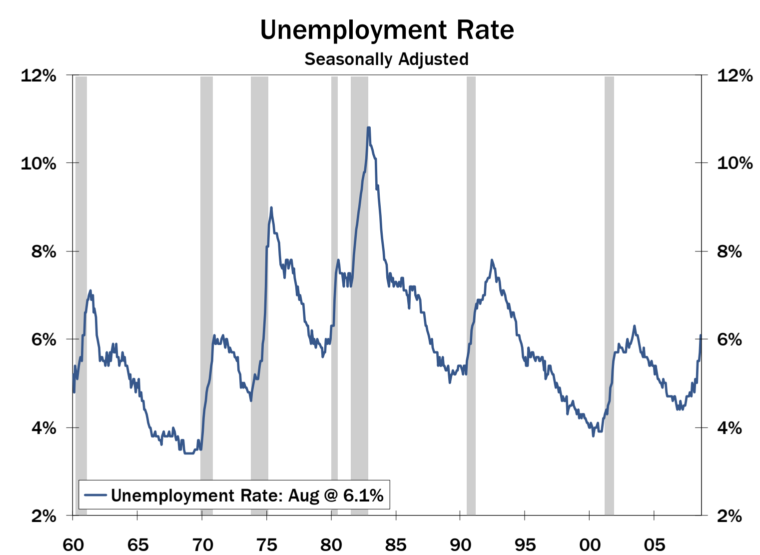
While stronger productivity growth may be a silver lining, it does come at a significant cost. The unemployment rate has risen sharply in recent months, including a 0.5 point jump in May and a 0.4 jump in August. One month jumps of 0.4 or more in the jobless rate are relatively rare, having occurred just 18 times in the past 48 years. The most recent spikes may overstate the extent of the deterioration in the labor market. The May increase was mostly teenagers, which likely reflects the higher minimum wage as well as increased labor force participation by teenagers, whose interest in work may have been piqued by higher gasoline prices. This past month's jump looks like it is tied to the extension of unemployment insurance benefits, which is causing some job-seekers to extend their job search and others to remain in the labor force in name only.

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	August - 2008	6.1%
Federal Funds Target Rate	Sep - 05	2.00%







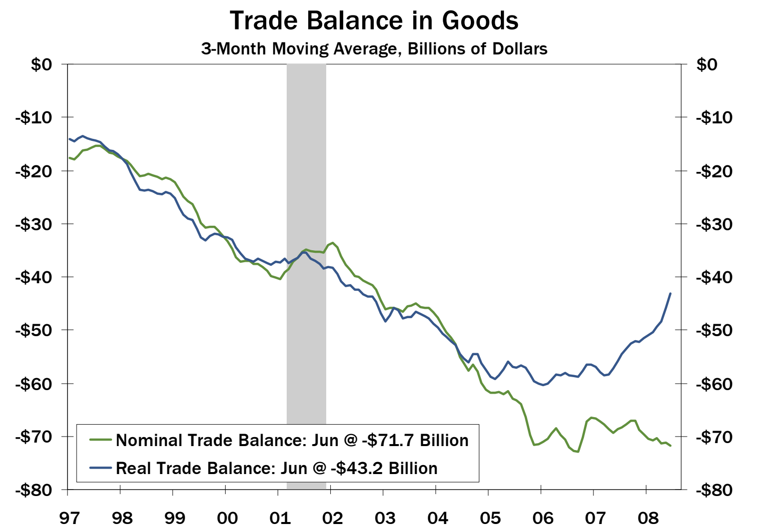
International Trade Balance • Thursday

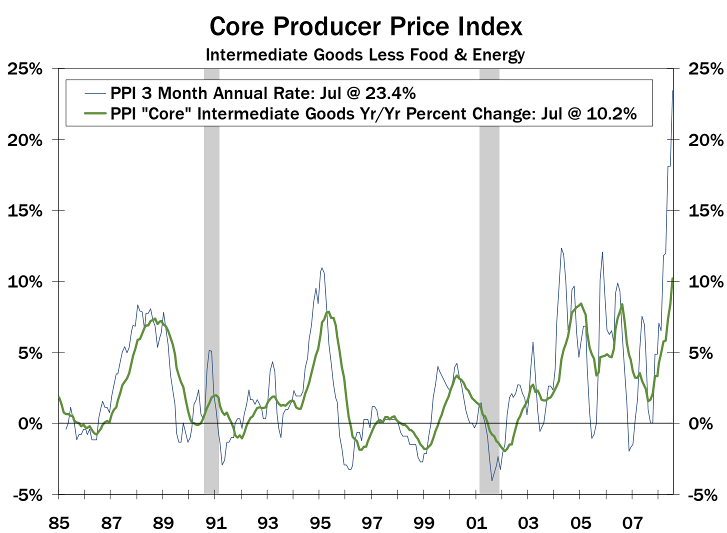
Broad-based strength in exports contributed to the unexpected narrowing in the trade deficit in June. We suspect, however, that most of that narrowing will be reversed in July. A solid price-related gain in petroleum imports should lift total import growth while the pace of export growth should moderate with notable gains expected in capital goods and industrial materials.

The real trade deficit, which is important in the calculation of real GDP, continues to narrow. This is considered a positive for economic growth as a narrowing of the trade deficit is counted as a contribution to overall economic growth. It appears net exports are on track to provide further positive contributions in the third and fourth quarter - albeit the pace of growth will be slower than in previous quarters. This continued contribution of export growth remains critical in trying to keep the overall economy in positive territory in the fourth quarter and into 2009.

Previous: -$56.8B **Wachovia: -$58.7B**

Consensus: -$58.0B





Producer Price Index • Friday

Propelled by solid gains in food and energy, the headline Producer Price Index jumped 1.2 percent in July. Core prices were also stronger than expected, rising 0.7 percent, led by solid gains in autos, light trucks and pharmaceuticals.

After recording readings above one percent for the past three months, we expect headline wholesale prices will post a one percent decline during the month of August. West Texas crude oil has declined roughly 35 percent since the record peak in early July and should help constrain the headline index.

That being said, pipeline pressures remain unfavorable and suggest we will not see a significant pullback in year-over-year measures for at least several months. Slowing domestic demand will help and is key to consensus' expectations that inflation pressures will ease somewhat in the months ahead.

Previous: 1.2% **Wachovia: -1.0%**

Consensus: -0.4%

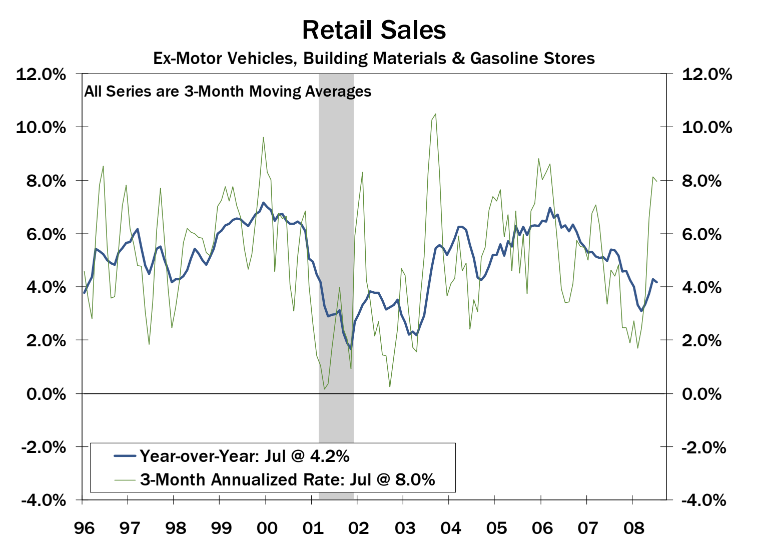
Retail Sales • Friday

Total retail sales dipped slightly in July to -0.1 percent after rising 0.3 percent and 0.8 percent in June and May, respectively, with help from the tax rebate checks.

While the tax rebate momentum has most likely faded, we still expect to see a modest rise in August retail sales, primarily driven by the stronger-than-expected sales pace of motor vehicles. Helped by the stepped up incentive programs last month, sales of light motor vehicles rose to an annualized 13.7M unit pace from 12.5M pace in July.
Consumer confidence appears to be stabilizing since crude oil has receded from record highs in July and is showing up in higher than anticipated same store retail sales growth. We still expect, however, consumer spending growth will continue to pullback in the second half of the year.

Previous: -0.1% **Wachovia: 0.4%**

Consensus: 0.1%



Global Review

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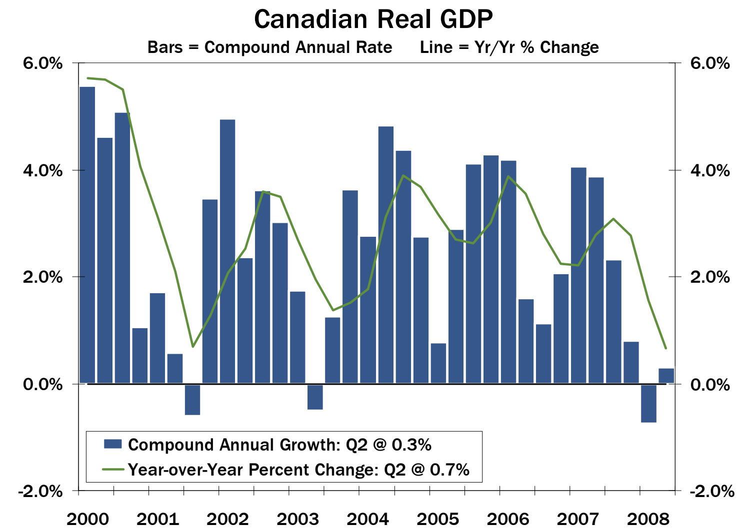
Slowdown in U.S. Economy a Negative For Canadian Exports

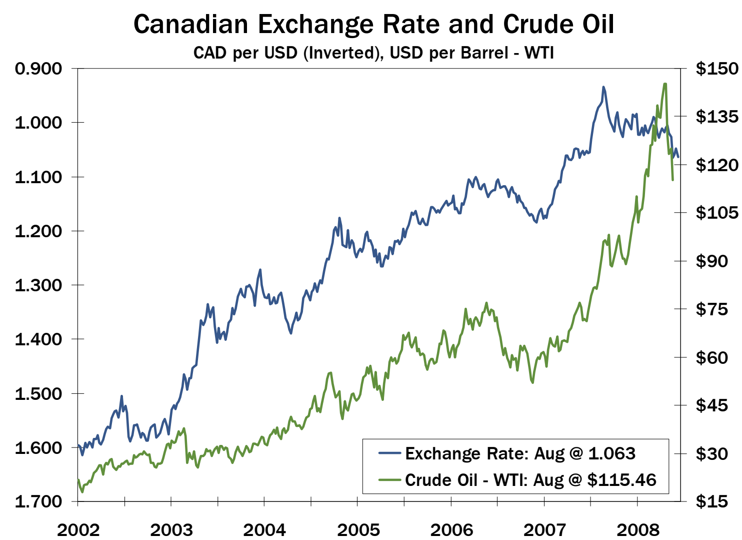
Certainly among the most pressing of these challenges is the slowing of the U.S. economy, because 80 percent of Canadian exports are destined for the United States. Exports sliced 2.3 percentage points from second quarter real GDP growth - the largest negative contribution of any component. Any further slowing of economic growth in the United States would present even greater challenges to exports in Canada.

While acknowledging some deterioration in domestic demand, the Bank said that demand within Canada "remains strong" and "still close to the economy's production capacity."

The final concern expressed by the BoC was one that should sound familiar in just about any economy around the world these days: global inflationary pressures. With oil down more than 25 percent, and other commodities down from their summer highs, these pressures have been alleviated to some extent. This has offsetting effects for Canada, however. Cooling commodity prices translates into a decline in the value of the Canadian dollar relative to the U.S. dollar. On the other hand, as the overall inflation rate comes back in line within the 1-3 percent target range, the Bank has the flexibility to ease lending rates without fear of engendering inflation. For now it appears economic growth is slowing in many foreign economies and the Bank concludes that "the weaker global growth and the decline of the Canadian dollar will have opposing effects on the demand for Canadian goods and services."

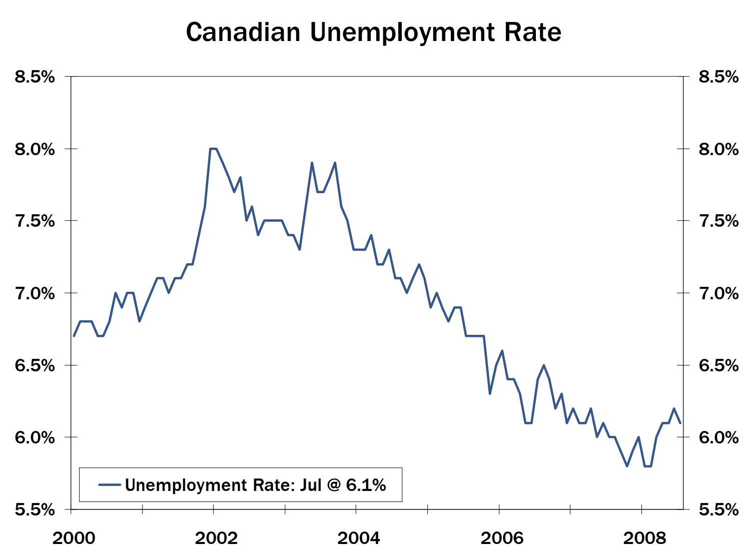
After two consecutive monthly declines in Canadian employment, jobs increased by a more-than-expected 15.2K in August as the unemployment rate stayed constant at 6.2 percent. The positive payroll growth in August is a welcome turnaround after fairly substantial job losses in July. While the Canadian labor market certainly has its challenges, it is not struggling like its neighbor to the south. The U.S. unemployment rate has risen by 1.7 percentage points since March 2007, while Canadian unemployment increased by only 0.3 percentage points since its cycle low in February of this year. Relatively solid employment growth in Canada should continue to support consumer spending in the third quarter. Indeed, real consumer spending was up 4.3 percent on a year-over-year basis in the second quarter.





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	Sep - 05	0.50%
Euro-Zone	GDP Year-over-Year	Q2 - 2008	1.4%
	CPI	July - 2008	4.0%
	Unemployment	July - 2008	7.3%
	ECB Target Rate	Sep - 05	4.25%
UK	GDP Year-over-Year	Q2 - 2008	1.4%
	CPI	July - 2008	4.4%
	Unemployment	July - 2008	2.7%
	BoE Target Rate	Sep - 05	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 - 04	3.00%



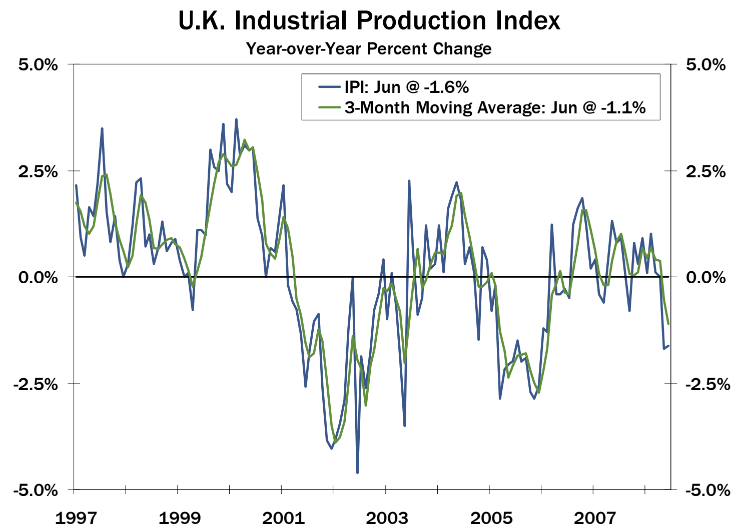
UK Industrial Production • Tuesday

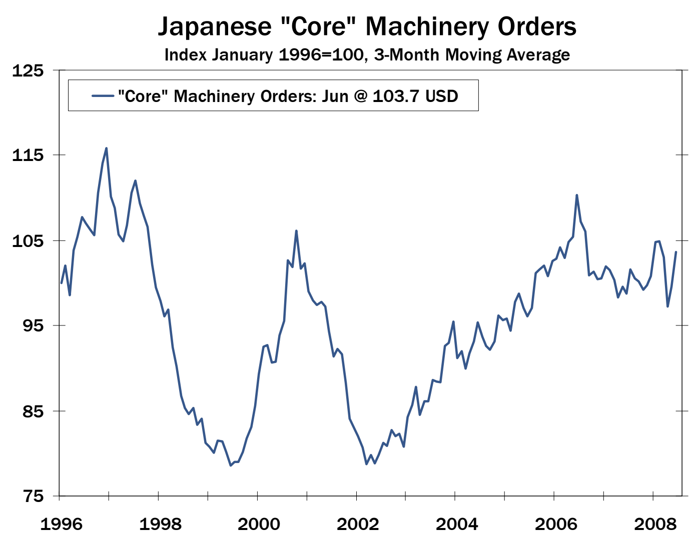
Despite positive second quarter GDP growth, the U.K. economy appears to be sliding into recession. Manufacturing in the U.K. has been slowing at a faster pace than it is in the Euro-zone. We will get more insights into the present state of the British factory sector when the latest reading of industrial production prints on Tuesday. It is likely that the index declined further in July, though potentially at a slower rate than it did in June. This still suggests that economic growth is slipped further.

Real GDP grew at an annualized rate of only 0.2 percent in second quarter, and estimates for GDP growth through the month of August will also print on Tuesday. These estimates will help gauge whether or not economic growth has turned negative in the third quarter. Trade balance data released on Wednesday will indicate the extent to which net exports will impact economic growth.

Previous: -0.2%

Consensus: -0.1%





Japanese Machinery Orders • Thursday

Japanese real GDP growth turned negative in the second quarter. Although machinery orders, a good leading indicator of capital spending, rebounded in April and May, that strength appears to have been short-lived. Machine orders dropped 2.6 percent in June from the previous month. The trend in this volatile series is trying to find a direction. Continued weakening, as is broadly expected when this number hits the wire on Wednesday, combined with more challenging operating conditions would suggest weakness in third quarter business spending.

Other data releases on the docket next week will give investors final confirmation on second quarter GDP growth (Thursday) as well as insights into industrial production and capacity utilization – both on Friday.

Previous: -2.6%

Consensus: -4.4%

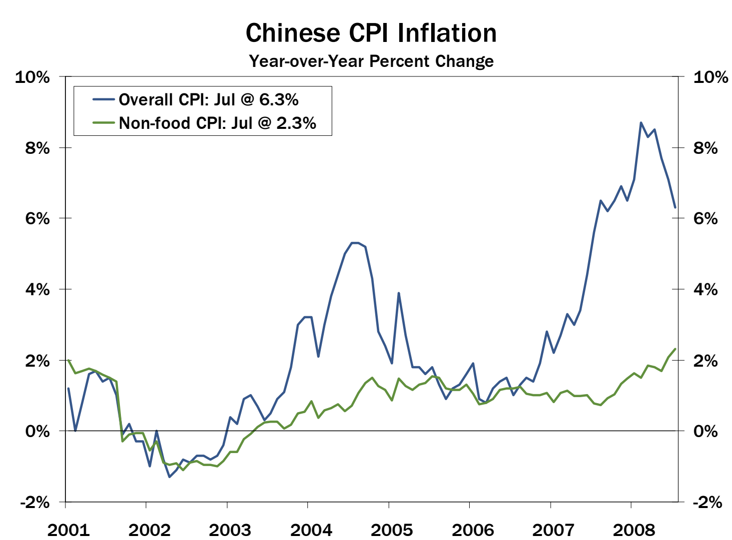
Chinese CPI Inflation • Thursday

The overall rate of CPI inflation in China breached 8 percent early this year, but it has subsequently receded as food prices have dropped. The consensus forecast looks for another sizeable decline in the overall rate of CPI inflation when data for August print on Thursday. However, non-food price inflation has trended higher in recent months due in part to rising wages and the government's decision to reduce gasoline price subsidies.

Some analysts fear that Chinese economic growth will slow sharply now that the Olympics are over. August data on retail spending and the trade balance will give investors an up-to-date look at the present state of the Chinese economy.

Previous: 6.3%

Consensus: 5.5%



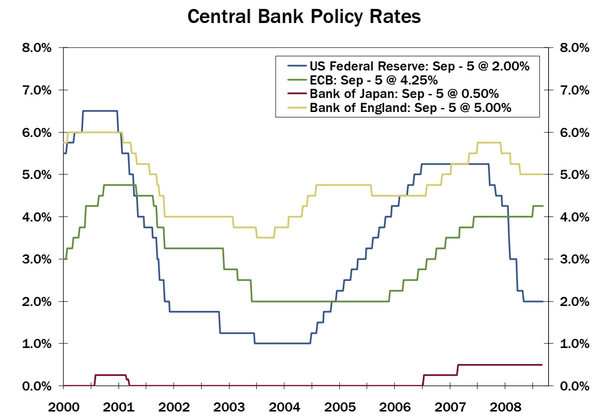
Interest Rate Watch

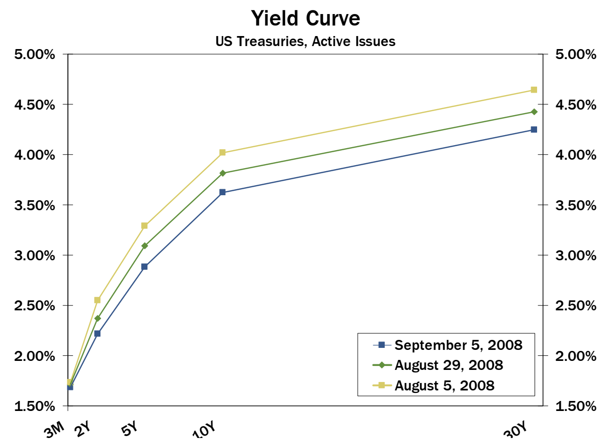
Lower Inflation Will Remove Any Lingering Doubts About Fed Policy

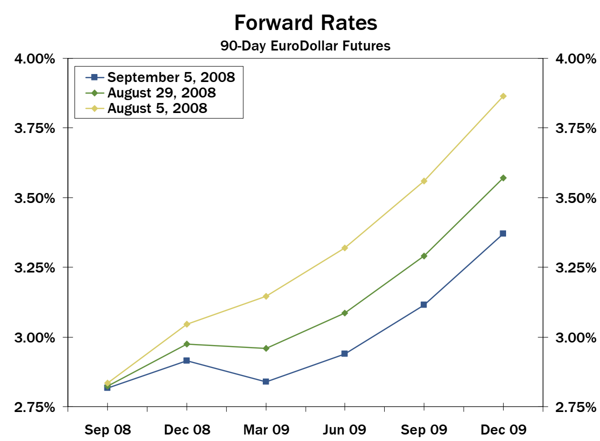
Even though we continue to hear a little noise from the more hawkish members of the Federal Open Market Committee, there is little doubt the Fed remains firmly on hold. The Fed is not about to begin to raise interest rates with the unemployment rate rising and economy teetering on the edge of recession. Moreover, inflation is set to moderate significantly in coming months, with falling oil prices paving the way for outright declines in the most widely followed inflation gauges.

From a more fundamental perspective, inflation looks set to moderate significantly over the coming year. Productivity growth has ramped up and unit costs have moderated. Nonfarm productivity increased 3.4 percent over the past year, while unit labor costs rose just 0.6 percent. Moreover, weaker economic growth around the globe should help bolster the dollar and further reverse the run-up in commodity prices. While higher interest rates are off the table, more has to happen before the Fed can consider lowering rates. The Fed eased much more than the economic data alone would have justified earlier this year in order to combat the credit crunch and has less room to maneuver today that they would like. We will need to see much more economic weakness or another credit event in order for the Fed to move. We doubt that will happen before the presidential election.

Slower economic growth overseas will likely have a less immediate effect on curbing inflation there. Wages and prices are rising rapidly overseas and that makes for a more intractable inflation problem. As a result, overseas rates will likely come down very gradually and too slow to keep their economies out of recession.







Topic of the Week

California Eking Out Modest Gains

California's economy eked out modest growth during the second quarter, consistent with our estimate of state GDP growing at a 0.2 percent annual rate. Growth over the past year is only slightly better at 0.5 percent. Given the carnage in the Golden State's housing sector, even this miniscule gain seems quite remarkable. The rise reflects continued solid growth in the state's technology and defense sectors, increased exports, and continued gains in health care and education. Housing and mortgage finance continue to be huge drags on the state's economy.

California's economy will continue to struggle over the next couple of years, mostly due to the housing slump. We feel confident that about 2/3 of the carnage in the housing sector is already behind us. Sales of existing homes have increased, with short sales and sales of foreclosed properties accounting for much of the increase. The rise in foreclosure sales has contributed to a 40% yr/yr decline in home prices in many of the state's most overbuilt markets. Home prices are down less than that statewide, however.

We expect home prices to continue to slide in California for about another year, but most of the damage is already done. The price declines making headlines today reflect many of the most overbuilt and overvalued markets in the state, which include large parts of the Inland Empire and areas up through the Central Valley.

Aside from housing, CA's economy is holding up about as well as the rest of the country. Growth has slowed but remains positive. Exports are a notable bright spot but imports have slowed, producing cutbacks in wholesale trade and distribution. State & local governments are also slow spending, reflecting faltering tax receipts.

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 9/5/2008	1 Week Ago	1 Year Ago
3-Month T-Bill	1.68	1.73	4.38
3-Month LIBOR	2.81	2.81	5.72
1-Year Treasury	1.81	1.98	4.08
2-Year Treasury	2.20	2.36	4.01
5-Year Treasury	2.88	3.04	4.15
10-Year Treasury	3.62	3.78	4.47
30-Year Treasury	4.25	4.38	4.77
Bond Buyer Index	4.62	4.68	4.57

Foreign Exchange Rates

	Friday 9/5/2008	1 Week Ago	1 Year Ago
Euro ($/€)	1.426	1.467	1.365
British Pound ($/£)	1.765	1.821	2.020
British Pound (£/€)	0.808	0.806	0.676
Japanese Yen (¥/$)	107.010	108.800	115.280
Canadian Dollar (C$/$)	1.065	1.064	1.054
Swiss Franc (CHF/$)	1.114	1.101	1.204
Australian Dollar (US$/A$)	0.812	0.858	0.822
Mexican Peso (MXN/$)	10.485	10.287	11.079
Chinese Yuan (CNY/$)	6.840	6.840	7.550
Indian Rupee (INR/$)	44.665	43.938	40.933
Brazilian Real (BRL/$)	1.721	1.632	1.967
U.S. Dollar Index	78.846	77.151	80.622

Foreign Interest Rates

	Friday 9/5/2008	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	4.96	4.96	4.76
3-Month Sterling LIBOR	5.74	5.75	6.80
3-Month Canadian LIBOR	3.40	3.35	5.14
3-Month Yen LIBOR	0.90	0.88	0.97
2-Year German	3.97	4.11	4.01
2-Year U.K.	4.34	4.51	5.36
2-Year Canadian	2.71	2.74	4.22
2-Year Japanese	0.73	0.73	0.84
10-Year German	4.00	4.18	4.21
10-Year U.K.	4.38	4.48	5.04
10-Year Canadian	3.45	3.52	4.35
10-Year Japanese	1.47	1.42	1.63

Commodity Prices

	Friday 9/5/2008	1 Week Ago	1 Year Ago
W. Texas Crude ($/Barrel)	106.11	115.59	75.73
Gold ($/Ounce)	801.38	831.15	681.80
Hot-Rolled Steel ($/S.Ton)	1125.00	1125.00	520.00
Copper (¢/Pound)	313.25	342.70	327.90
Soybeans ($/Bushel)	12.35	13.48	8.53
Natural Gas ($/MMBTU)	7.38	8.05	5.80
Nickel ($/Metric Ton)	19,140	20,430	28,440
CRB Spot Inds.	465.37	477.24	475.78

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	8	9	10	11	12
U.S. Data	**Consumer Credit** June $14.3 Billion July $9.0 Billion (C)			**Trade Balance** June -$56.8 Billion July -$58.7 Billion (W)	**PPI** July 1.2% August -1.0% (W) **Retail Sales** July -0.1% August 0.4% (W)
Global Data		**UK** **Indus. Production (MoM)** Previous (Jun) -0.2% **UK** **NIESR GDP Estimate** Previous (Jul) 0.1%		**Japan** **Machine Orders (MoM)** Previous (Jun) -2.6% **China** **CPI (YoY)** Previous (Jul) 6.3%	**China** **Retail Sales (YoY)** Previous (Jul) 23.3% **Euro Zone** **Indus. Production (MoM)** Previous (Jun) 0.0%

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

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