

### WEEKLY ECONOMIC & FINANCIAL COMMENTARY

October 31, 2008

#### U.S. Review

##### A Whole Month of Halloween

After the month we have had, Halloween should not scare anyone. The financial markets have been exceptionally turbulent and the economic data have been extremely disappointing. Real GDP declined at a 0.3 percent annual rate in the third quarter and it looks like a recession is underway. The current quarter looks like it will be substantially weaker and the pace of layoffs and unemployment rate are both expected to increase.

October marked one of the worst months ever for the financial markets. Through yesterday's close, the Dow Jones Industrial Average was on pace to be the worst month since and MSCI World index is on pace to have its worst month ever. Short-term funding markets, including the commercial paper and Eurodollar markets, seized up for much of the month and only have recently shown signs of thawing somewhat.

While the economic data have not been anywhere near as apocalyptic as the financial data, they do show considerable weakness. Real GDP declined in the third quarter and consumer confidence and factory output both plummeted in October.

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#### Global Review

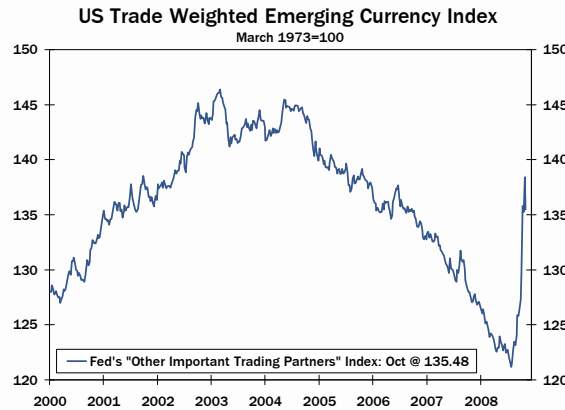
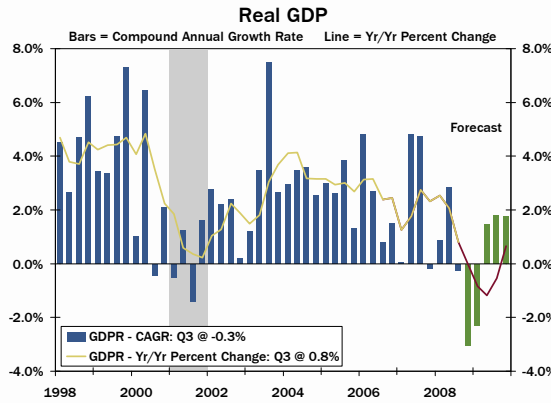
##### Lifelines Thrown to Developing Countries

In our weekly report last Friday we discussed the extraordinary volatility in emerging market currencies that has arisen due to increasing fears of a global recession and a mad scramble for dollar liquidity. This week, steps taken by the International Monetary Fund and the Federal Reserve stopped the run on most emerging market currencies, at least for now (see chart at left).

First, the IMF announced this week that it would lend \$16.5 billion to Ukraine and \$15.7 billion to Hungary. (Additional loans from the World Bank and the European Union bring the overall size of Hungary's package to \$25 billion). The IMF's actions this week follow its \$2.1 billion loan to Iceland last week.

The IMF went even further this week by announcing a new program dubbed the Short-Term

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#### Recent Special Commentary

Date	Title	Authors
October-20	Japan's "Lost Decade": Implications for the U.S. Economy	Bryson
October-09	Global Chartbook - October 2008	Bryson & Quinlan
October-08	Housing Chartbook - October 2008	Vitner & York
October-08	Everyone Seems To Have Gotten The Message	Vitner & Bryson

#### U.S. Forecast

	Actual 2008				Forecast 2009				Actual 2005-2007			Forecast 2008-2010		
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2005	2006	2007	2008	2009	2010
Real Gross Domestic Product <sup>1</sup>	0.9	2.8	-0.7	-3.0	-2.3	1.4	1.8	1.7	2.9	2.8	2.0	1.3	-0.5	1.9
Personal Consumption	0.9	1.2	-3.1	-1.6	-0.6	1.4	1.9	2.1	3.0	3.0	2.8	0.5	-0.2	2.1
Inflation Indicators <sup>2</sup>														
"Core" PCE Deflator	2.2	2.3	2.5	2.2	2.1	2.1	1.8	2.0	2.1	2.3	2.2	2.3	2.0	1.9
Consumer Price Index	4.2	4.3	5.3	3.4	2.5	1.7	0.8	2.0	3.4	3.2	2.9	4.3	1.7	2.4
Industrial Production <sup>1</sup>	0.4	-3.1	-2.4	-3.1	-1.9	0.3	1.6	2.4	3.3	2.2	1.7	-0.3	-1.2	2.5
Corporate Profits Before Taxes <sup>2</sup>	-1.5	-8.3	-7.5	-12.0	-4.0	0.0	8.0	9.2	17.6	15.2	-1.6	-7.3	3.1	8.5
Trade Weighted Dollar Index <sup>3</sup>	70.3	71.0	76.1	77.8	80.0	82.8	84.9	87.2	86.0	81.5	73.3	77.8	87.2	90.0
Unemployment Rate	4.9	5.3	6.0	6.4	6.8	7.1	7.4	7.7	5.1	4.6	4.6	5.7	7.3	8.0
Housing Starts <sup>4</sup>	1.05	1.03	0.91	0.82	0.78	0.78	0.80	0.86	2.07	1.81	1.34	0.95	0.80	1.09
Quarter-End Interest Rates														
Federal Funds Target Rate	2.25	2.00	2.00	1.00	0.75	0.75	0.75	0.75	4.25	5.25	4.25	1.00	0.75	2.00
10 Year Note	3.45	3.99	3.85	3.70	3.80	3.90	3.90	4.00	4.39	4.71	4.04	3.70	4.00	4.20

Data As of: October 8, 2008  
<sup>1</sup> Compound Annual Growth Rate Quarter-over-Quarter  
<sup>2</sup> Year-over-Year Percentage Change

<sup>3</sup> Federal Reserve Major Currency Index, 1973=100 - Quarter End  
<sup>4</sup> Millions of Units

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U.S. Review

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**Consumers Are Clearly Rattled**

The Consumer Confidence Index plunged 21.8 points in October, falling by its largest magnitude and to its lowest level ever. Consumers' assessment of both current economic conditions and expectations for future economic conditions both plummeted during the month and nearly four times as many households expect business conditions to worsen during the next six months than expected them to improve. Consumers are also increasingly pessimistic about future employment prospects, with just 7.4 percent expecting more jobs to be created and a whopping 41.5 percent expecting fewer jobs to be created.

Consumers' pessimism about current and future economic conditions means consumers are unlikely to ramp up spending anytime soon. September's numbers were downright awful, with nominal outlays falling 0.3 percent and inflation-adjusted spending falling 0.4 percent. October's decline marks the third drop in the past four months and puts real consumer spending down at a 3.1 percent annual rate over the past three months. The latest consumer confidence figures show that buying plans plunged in October, which means spending likely dropped again that month.

Continued weakness in consumer spending is bad news for the overall economic outlook. Real GDP declined at a 0.3 percent annual rate during the third quarter and our latest forecast has real GDP declining at around a 3 percent annual rate during the current quarter. Not only will the current quarter be considerably weaker than the prior one but the weakness also appears to be far more broad based, including not only weakness in consumer outlays but also cutbacks in business fixed investment, exports and state and local government spending.

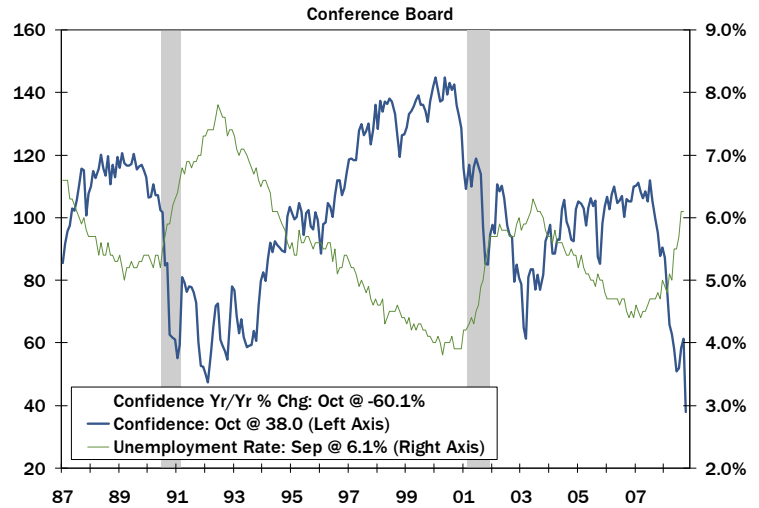
Along with the weaker consumer confidence data, most of the other early data for October show that economic weakness has intensified. First-time claims for unemployment have continued to inch up to the high 400,000 range. The weekly numbers have been disrupted by weather-related distortions and the extension of unemployment claims. There is no disputing the recent trend, however, which has been solidly and consistently upward. Claims remain at a level consistent with the onset of past recessions and layoff announcements have increased in recent weeks.

The only good news reported in recent weeks has been on the inflation front. The personal consumption deflator rose just 0.1 percent in September and was unchanged in August. Gasoline prices have plummeted in recent weeks, which should lead to even tamer readings on inflation in October and November.

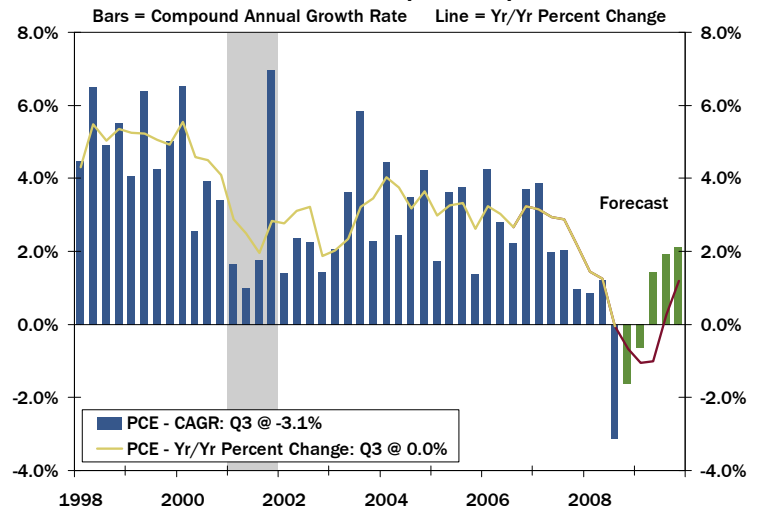
**Selected Current Data**

Gross Domestic Product - CAGR	Q3 - 2008	-0.3%
GDP Year-over-Year	Q3 - 2008	0.8%
Personal Consumption	Q3 - 2008	-3.1%
Business Fixed Investment	Q3 - 2008	-1.0%
Consumer Price Index	September - 2008	4.9%
"Core" CPI	September - 2008	2.5%
"Core" PCE Deflator	September - 2008	2.4%
Industrial Production	September - 2008	-4.5%
Unemployment	September - 2008	6.1%
Federal Funds Target Rate	Oct - 31	1.00%

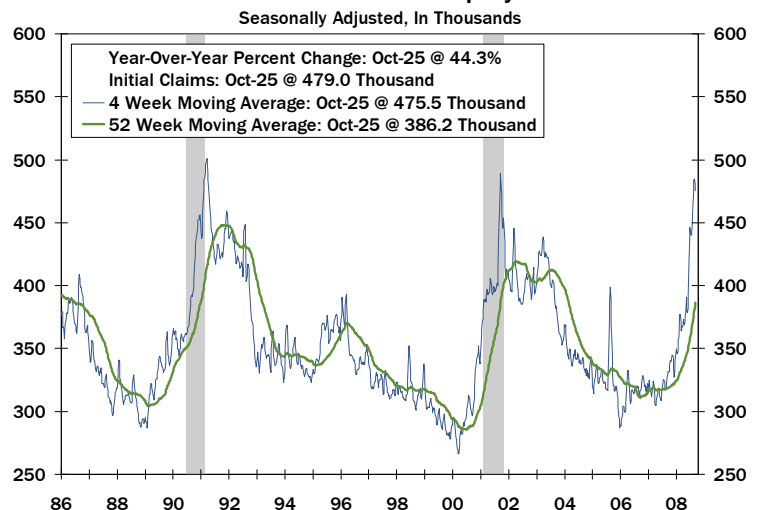
**Consumer Confidence Index**



**Real Personal Consumption Expenditures**



**Initial Claims for Unemployment**



**Light Vehicle Sales • Monday**

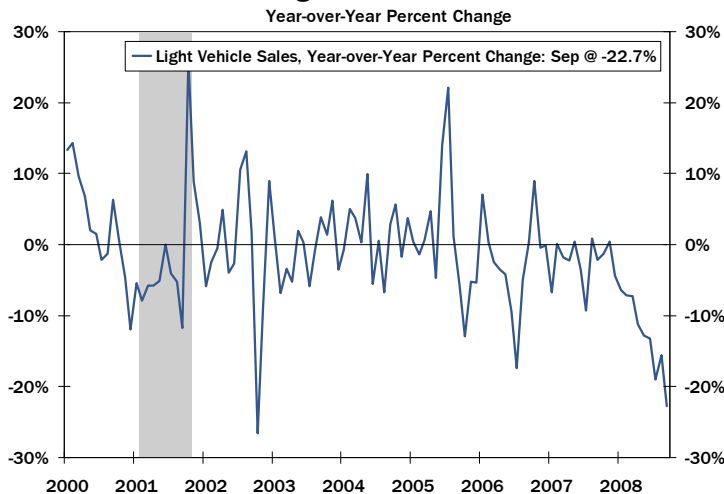
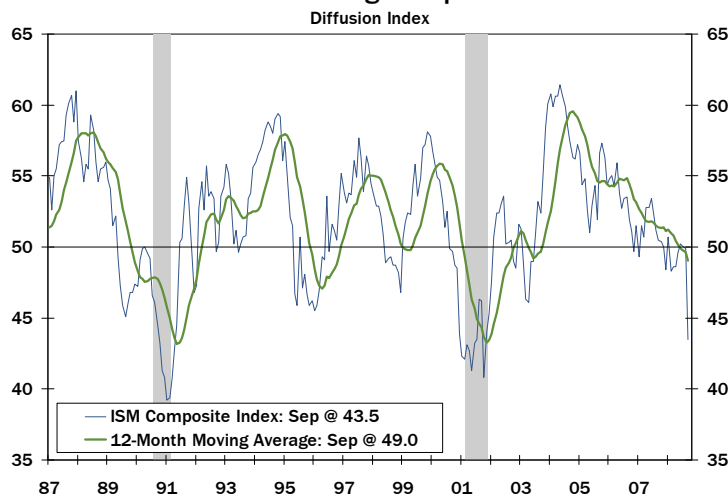
The domestic three auto manufacturers are in crisis and are reaching for any available lifeline to stay afloat. We expect October light vehicle sales will remain flat at an annualized pace of 12.5 million. We haven't seen numbers this low since 1992. However, we may see a slight pick up in light truck sales as retail gas prices have declined considerably and dealer and manufacturer incentives make driving gas guzzlers somewhat en vogue once again.

We do not expect a near term turnaround as consumers continue to deal with moderating income growth, a weak labor market and tight lending standards, which will continue to put downward pressure on light vehicle sales. We expect consumer spending will contract in the fourth and first quarter, mostly attributable to declining auto sales.

Previous: 12.5M

Wachovia: 12.5M

Consensus: 12.0M

**Light Vehicle Sales**

**ISM Manufacturing Composite Index**

**ISM Manufacturing Index • Monday**

The Institute for Supply Management's purchasing managers' index for manufactures is squarely in recession territory and is expected to decline to 42.9, the lowest level since October 2001. New orders and order backlogs should also decline sharply, indicating more weakness is in the pipeline.

The regional purchasing manger reports (Empire, Philadelphia, and Richmond) are all down, suggesting a decline in the headline number. Motor vehicle production is also down and will exert downward pressure on ISM.

Previous: 43.5

Wachovia: 42.9

Consensus: 42.0

**Employment Report • Friday**

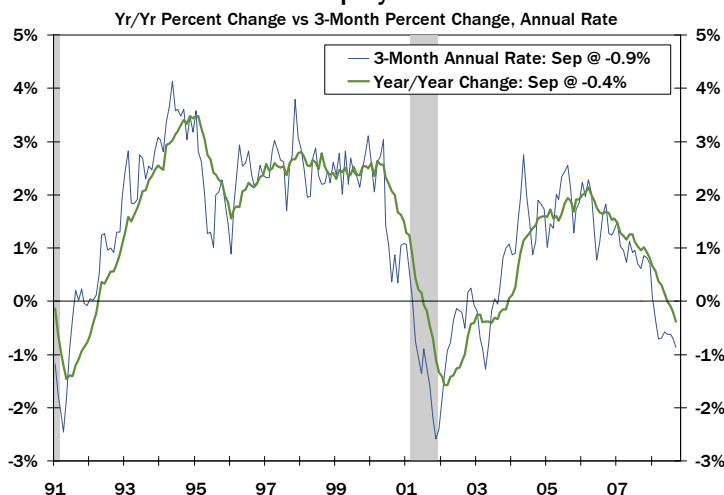
Nonfarm payroll employment is expected to fall for the tenth consecutive month in October. In October, initial and continuing claims for unemployment benefits continued to deteriorate and remain in recession territory suggesting further weakness in nonfarm payroll numbers. Losses should continue in manufacturing, construction, and financial services, but have begun to spread to other sectors. Broad based sector weakness in payroll numbers is consistent with past recessions. While job losses have yet to decline to levels seen in previous recessions, layoff announcements suggest further weakness in the pipeline as payrolls still include recent layoffs.

We expect the unemployment rate to tick up to 6.2 percent in October. By 2010, we see the unemployment rate reaching 8.0 percent.

Previous: -159K

Wachovia: -220K

Consensus: -180K

**Nonfarm Employment Growth**


**Global Review**

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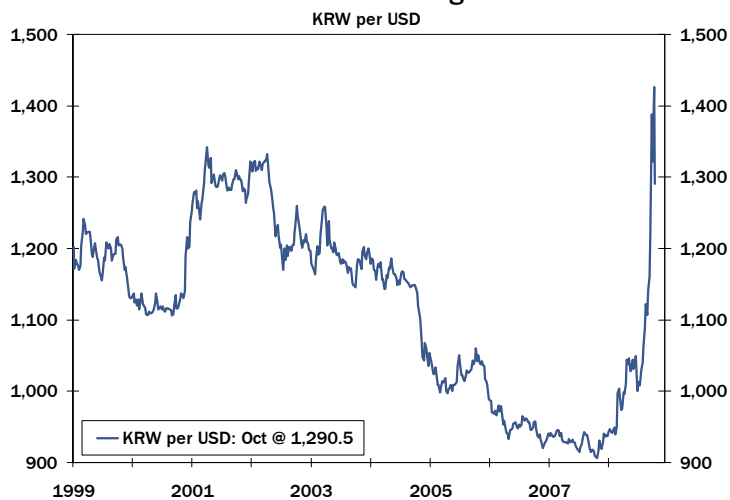
Liquidity Facility (SLF). Loans extended to Hungary, Iceland and Ukraine will follow “traditional” IMF guidelines. In return for the loans, the respective governments will take steps (e.g., tighter monetary and fiscal policies) to reduce imbalances (e.g., inflation and excessive current account deficits) in their economies that usually result in short-term economic pain. However, there are many developing countries with sound macroeconomic fundamentals that have seen their currencies hammered during the current liquidity crunch. The SLF will allow those countries to borrow from the IMF on a short-term basis to address liquidity issues without making unnecessary policy adjustments.

In support of the IMF, the Federal Reserve announced this week the establishment of \$30 billion swap lines to Brazil, Korea, Mexico and Singapore that are authorized until April 30, 2009. The swap lines allow central banks in those countries to borrow dollars from the Fed to help meet acute short-term dollar funding needs in those countries. Following the announcement, the Korean won, which has been battered over the past few weeks, strengthened more than 15 percent against the greenback (see top chart). The Brazilian real (middle chart) and the Mexican peso (bottom chart) also clawed back some lost ground this week.

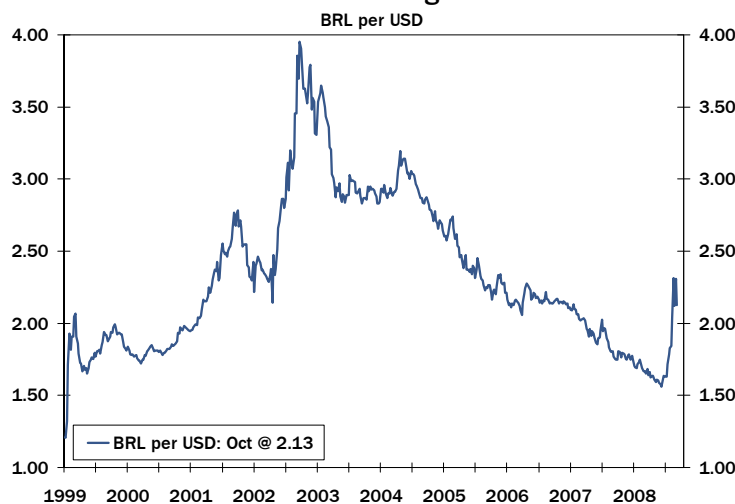
The steps taken this week by the IMF and the Fed are yet another indication, if any more are needed, that policymakers understand the dire implications for the global economy if the global credit crunch continues. The extraordinary programs announced by governments in many countries over the past few weeks should eventually ease strains in credit markets. Even Japanese policymakers got into the act this week when the Bank of Japan announced a 20 basis point reduction in its main policy rate. (The BoJ cut its target for the overnight interbank rate from 0.50 percent to 0.30 percent.)

Indeed, financial market tensions appear to be easing somewhat. The 3-month U.S. dollar LIBOR rate, which spiked up to 4.82 percent on October 10 when credit market were completely frozen, ended this week at 3.03 percent. Although LIBOR rates, which serve as important benchmarks for other short-term interest rates, remain elevated relative to where they “should” be, are moving in the right direction.

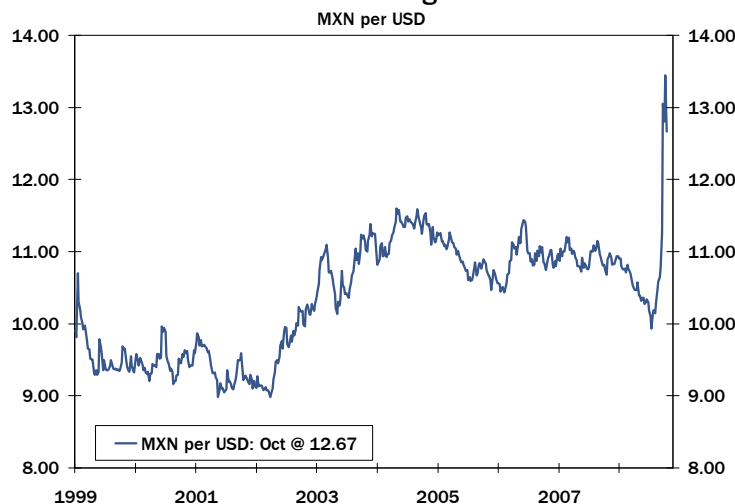
**South Korean Exchange Rate**



**Brazilian Exchange Rate**



**Mexican Exchange Rate**



**Selected Global Data**

Japan	GDP Year-over-Year	Q2 - 2008	0.7%
	CPI	September - 2008	2.1%
	Unemployment	September - 2008	4.0%
	BoJ Target Rate	Oct - 31	0.30%
Euro-Zone	GDP Year-over-Year	Q2 - 2008	1.4%
	CPI	September - 2008	3.6%
	Unemployment	September - 2008	7.5%
	ECB Target Rate	Oct - 31	3.75%
UK	GDP Year-over-Year	Q3 - 2008	0.3%
	CPI	September - 2008	5.2%
	Unemployment	September - 2008	2.9%
	BoE Target Rate	Oct - 31	4.50%
Canada	GDP Year-over-Year	August - 2008	0.6%
	CPI	September - 2008	3.4%
	Unemployment	September - 2008	6.1%
	BoC Target Rate	Oct - 31	2.25%

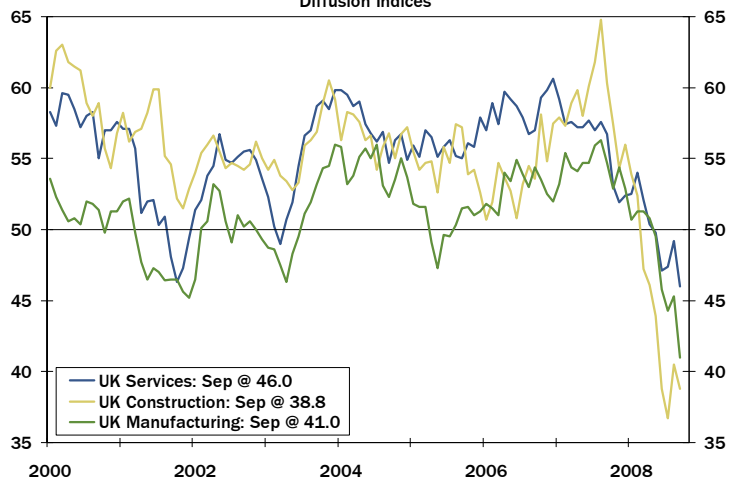
### U.K. Purchasing Managers Indices

Purchasing managers' indices in the United Kingdom have slumped to recession-like levels over the past few months. Indeed, data released last week showed that real GDP contracted at an annualized rate of 2.0 percent in the third quarter, the first negative quarter of growth since 1992. The October PMI's for the manufacturing, service and construction sectors should give investors some insights into the present state of the British economy.

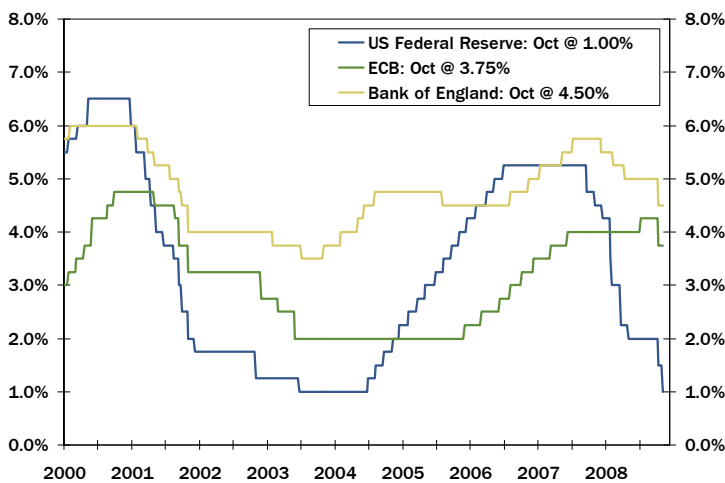
Sadly, a few more quarters of negative growth appear likely. In our view, Great Britain is currently in a recession that will prove almost as severe as that experienced in the early 1990s when real GDP contracted 2.5 percent (peak to trough). As we discuss below, the Bank of England will ease policy further to help cushion the blow to the real economy.

**Previous Manufacturing PMI: 41.0      Consensus: 40.2**  
**Previous Service PMI: 46.0      Consensus: 44.5**

### UK Purchasing Managers Indices



### Central Bank Policy Rates



### Central Bank Policy Meetings • Thursday

Both the European Central Bank (ECB) and the Bank of England (BoE) hold much anticipated policy meetings on Thursday. Both central banks joined the Fed (along with central banks in Canada, Sweden and Switzerland) in cutting rates in a coordinated fashion on October 8. The Fed shaved another 50 basis points off of the fed funds rate this week. Will the ECB and the BoE join the Fed by easing policy further next week?

In our view, the real question is how much they will cut rather than whether they will cut. We look for the ECB to reduce its main policy rate by 50 basis points, which is the consensus view. Most investors expect the BoE to cut rates by 50 basis points as well. However, with a full-blown recession taking hold in the United Kingdom we would not be surprised to see the BoE ease by 75 basis points.

**Previous: -3.5% (month-on-month change)**  
**Consensus:**

### Canadian Labor Market Report • Friday

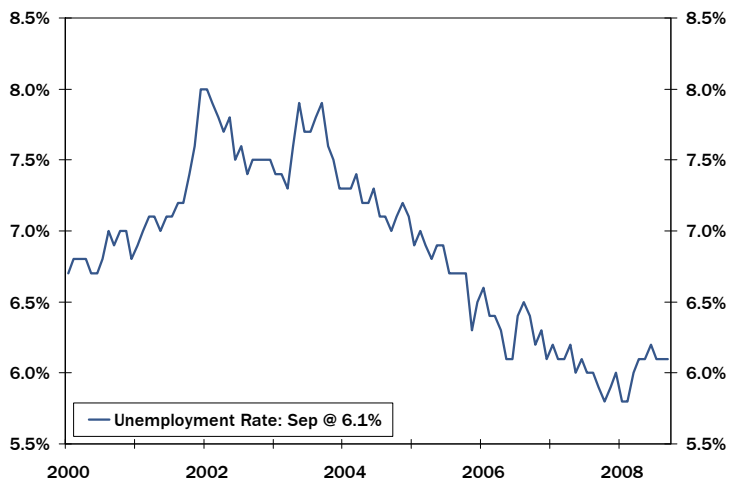
The September jobs report in Canada revealed a jaw-dropping gain of 106.9K jobs in the labor force - the largest monthly gain ever reported. While Canada's economy has been somewhat resilient, last month's record gain in the context of the current global economic slowdown seems out of synch. Real gross domestic product contracted in 0.3 percent August, and while Q3 economic growth will remain positive, we expect Q4 will likely turn negative.

Considering the fact that the Bank of Canada has eased its overnight lending rate by 75 basis points this month, it must be concerned about the country's growth prospects as well.

The consensus looks for a gain of 5,000 jobs in September. After such a huge number in August, we wouldn't be shocked to see a statistical payback in September resulting in an outright decline.

**Previous: 6.1% (Unemployment Rate)**  
**Consensus: 6.2%**

### Canadian Unemployment Rate



**Interest Rate Watch**
**Economy Concerns Drive Fed Ease**

Weak economy concerns promoted another cut in the fed funds rate, this time by 50 basis points to one percent. Looking ahead we expect another Fed ease of 25 basis points in December. By then the weakness in holiday sales (column on opposite page) will suggest a sharp decline in overall economic growth in the fourth quarter.

Our outlook is that the recession, which appears to be underway, will be the driving factor that will keep the Fed ease on liquidity provision going forward until mid-Spring of next year. This suggests that short-term interest rates will remain low for an extended period of time.

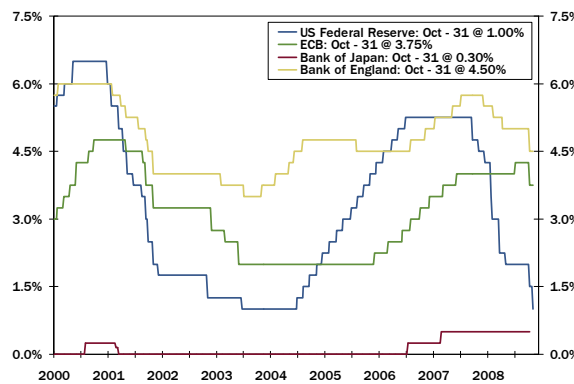
Moreover, we have seen in the last few days an improvement in lower private market rates such as LIBOR. This suggests that credit supply may be coming back into the market and that the worse of the credit problem may have passed—at least at the short-end of the curve.

**Credit Aversion at the Long End**

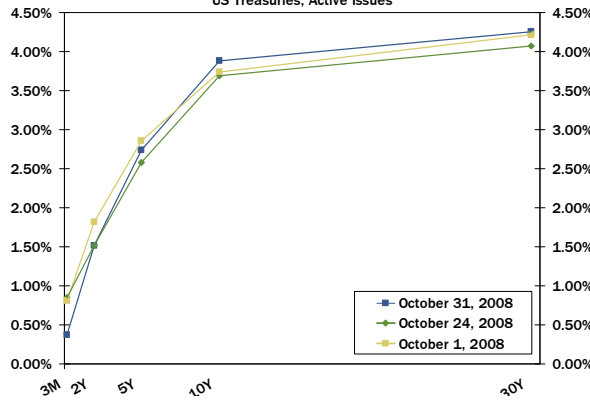
However, financial markets have evidenced only modest improvement in credit spreads and credit supply at the long end. The search for that new equilibrium remains in progress.

Investment grade spreads remain above the 400 basis point level compared to the 100 basis points of the 2002-2006 expansion. Five year CMBS spreads exceed 500 basis points compared to less than 100 in the earlier period. For the markets there remains an aversion to going out the yield curve to take on risk.

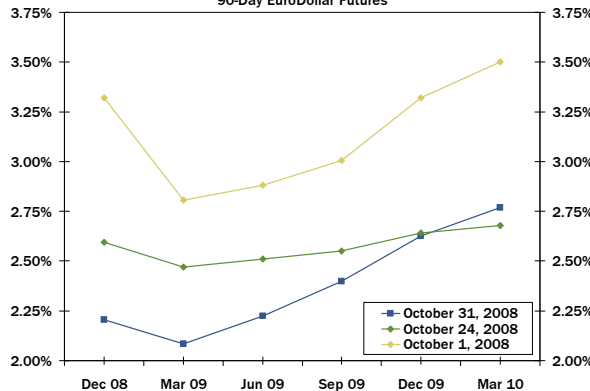
Financial markets and the economy remain constrained by political and regulatory risk issues as well as the weak economy. Any credit correction will take time and the price and supply of credit will adjust slowly.

**Central Bank Policy Rates**

**Yield Curve**

US Treasuries, Active Issues


**Forward Rates**

90-Day EuroDollar Futures


**Topic of the Week**
**Holiday Sales May be Abysmal**

The combination of a weaker labor market, the deepest recession since 1981-82, and the ongoing credit crunch will most likely pull holiday sales down to their first recorded loss since data became available on a comparable basis, in 1992. The weakest year currently on record, 2001, saw growth of just 2.8 percent with the economy in recession and the attacks of September 11th still fresh in consumers' minds. There are few (if any) positive signs on the horizon for consumers this year. The lone bright light might be the rapid fall in gasoline prices, though this may be too little too late, as the U.S. and the global economies appear to have already slipped into a deep recession.

Job losses are cutting into income growth and taking a huge toll on consumer confidence. Savings are also taking a big hit. The major equity indices have fallen as much as 40 percent from their 2007 peaks, erasing nearly \$2 trillion in household financial assets through the second quarter alone, the most recent period for which comprehensive data are available. Finally, adding to the weak consumer picture are the continuing problems in the nations housing market, where construction activity has been declining for more than three years at this point. As a result we expect that holiday sales will decline between zero and two percent.

Look for our full report early next week.

**The Week Ahead**

Our weekly review and outlook is also available in audio format on our podcast. *The Week Ahead* is posted each Friday afternoon on our website. <http://www.wachovia.com/misc/0,1466,00.html>

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

	Friday 10/31/2008	1 Week Ago	1 Year Ago
3-Month T-Bill	0.43	0.84	3.91
3-Month LIBOR	3.03	3.52	4.89
1-Year Treasury	1.17	1.28	3.68
2-Year Treasury	1.56	1.51	3.95
5-Year Treasury	2.78	2.58	4.17
10-Year Treasury	3.93	3.69	4.47
30-Year Treasury	4.31	4.07	4.75
Bond Buyer Index	5.35	5.32	4.40

**Foreign Interest Rates**

	Friday 10/31/2008	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	4.77	4.91	4.60
3-Month Sterling LIBOR	5.84	5.98	6.28
3-Month Canadian LIBOR	3.09	3.11	4.83
3-Month Yen LIBOR	0.94	1.00	0.90
2-Year German	2.54	2.67	4.06
2-Year U.K.	2.94	3.09	5.10
2-Year Canadian	2.01	2.09	4.16
2-Year Japanese	0.55	0.72	0.79
10-Year German	3.91	3.75	4.24
10-Year U.K.	4.53	4.36	4.93
10-Year Canadian	3.70	3.63	4.31
10-Year Japanese	1.48	1.50	1.61

**Foreign Exchange Rates**

	Friday 10/31/2008	1 Week Ago	1 Year Ago
Euro (\$/€)	1.273	1.262	1.449
British Pound (\$/£)	1.613	1.590	2.080
British Pound (£/€)	0.790	0.794	0.697
Japanese Yen (¥/\$)	97.913	94.323	115.435
Canadian Dollar (C\$/\\$)	1.217	1.278	0.943
Swiss Franc (CHF/\\$)	1.160	1.167	1.158
Australian Dollar (US\$/A\\$)	0.661	0.623	0.934
Mexican Peso (MXN/\\$)	12.721	13.384	10.654
Chinese Yuan (CNY/\\$)	6.839	6.844	7.463
Indian Rupee (INR/\\$)	49.458	49.983	39.326
Brazilian Real (BRL/\\$)	2.133	2.308	1.736
U.S. Dollar Index	85.770	86.440	76.479

**Commodity Prices**

	Friday 10/31/2008	1 Week Ago	1 Year Ago
W. Texas Crude (\\$/Barrel)	64.49	64.15	94.53
Gold (\\$/Ounce)	727.50	734.75	796.59
Hot-Rolled Steel (\\$/S.Ton)	790.00	860.00	520.00
Copper (\\$/Pound)	181.75	167.50	346.80
Soybeans (\\$/Bushel)	9.06	8.55	9.47
Natural Gas (\\$/MMBTU)	6.50	6.24	8.33
Nickel (\\$/Metric Ton)	11,729	9,173	31,150
CRB Spot Inds.	375.15	368.00	491.40

**Next Week's Economic Calendar**

	Monday 3	Tuesday 4	Wednesday 5	Thursday 6	Friday 7
<b>U.S. Data</b>	<b>ISM-Manufacturing</b> September 43.5 October 42.9 (W) <b>Total Vehicle Sales</b> September 12.5M October 12.5M (W) <b>Construction Spending</b> August 0.0% September -0.8% (W)	<b>Factory Orders</b> August -4.0% September -0.1% (W)	<b>ISM Non-Manufacturing</b> September 50.2 October 49.0 (W)	<b>Nonfarm Productivity</b> 2Q 4.3% 3Q 1.5% (W) <b>Unit Labor Costs</b> 2Q -0.5% 3Q 2.2% (W)	<b>Nonfarm Payrolls</b> September -159K October -220K (W) <b>Unemployment Rate</b> September 6.1% October 6.2% (W)
	<b>UK</b> <b>PMI Manufacturing</b> Previous (Sep) 41.0	<b>UK</b> <b>PMI Construction</b> Previous (Sep) 38.8	<b>UK</b> <b>Indus. Production (MoM)</b> Previous (Aug) -0.6% <b>UK</b> <b>PMI Services</b> Previous (Sep) 46.0	<b>UK</b> <b>BOE Announces Rates</b> Previous 4.50% <b>Eurozone</b> <b>ECB Announces Rates</b> Previous 3.75%	<b>Germany</b> <b>Indus. Production (MoM)</b> Previous (Aug) 3.4% <b>Canada</b> <b>Unemployment Rate</b> Previous (Sep) 6.1%

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

## Wachovia Economics Group

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