

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

November 07, 2008

U.S. Review

Still A Great Deal Of Uncertainty

Any hopes the U.S. presidential election would provide the financial markets a little more certainty and stability were laid to rest this week as volatility returned. After a solid Election Day rally, the stock market staged one of its largest two-day declines ever. Apparently investors are still using rallies to reduce exposure to the U.S. equity market. Uncertainty and pessimism about the near-term economic outlook also increased. The source of this week's pessimism was another string of weak reports, including both of the ISM surveys, factory orders and monthly chain store sales.

The ISM manufacturing survey plunged 4.6 points to 38.9 in October, which marks the lowest reading for this key series in 26 years. All the major components, including production, new orders, and employment fell sharply and remain well-below the key 50.0 breakeven level. The ISM survey measures the breadth of economic strength and weakness in the economy. A reading below 50 means more firms report conditions are weakening in the factory sector. Broadening economic weakness is a key characteristic of a recession.

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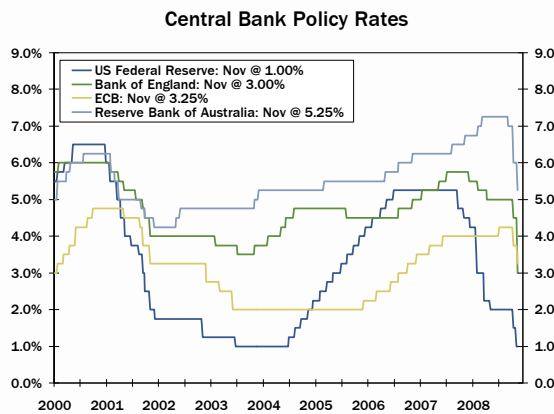
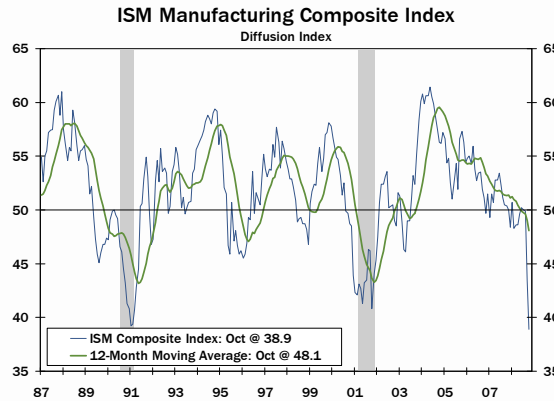
Global Review

The Hundred Year Storm

Fresh signs of continued turmoil in the world's financial markets prompted a wave of rate cuts from foreign central banks this week as financial leaders re-assess their outlook. The prevailing theme in the global economy has been a gradual realization that the economic crisis is worse than many had feared.

The Bank of England (BoE) moved decisively to address the situation by slashing its bank rate by 150 basis points - the largest cut for the BoE since 1981. The Bank's official statement explained that "since mid-September, the global banking system has experienced its most serious disruption for almost a century." In addition to troubles in the banking sector, signs of further deterioration in the British economy manifested themselves this week as well. The Purchasing Managers' Index (PMI) for manufacturing came in at 41.5, and the PMI for

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Recent Special Commentary

Date	Title	Authors
November-05	The Grinch May Roil Holiday Sales This Year	Vitner & York
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

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 ¹	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 ²														
"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 ¹	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 ²	-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 ³	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 ⁴	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

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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Reports Point To More Weakness

The weaker ISM manufacturing report followed similarly weak reports from regional purchasing managers' surveys, including Chicago, Detroit and Milwaukee. In addition, the factory orders report for September came in much weaker than expected, thanks largely to a huge 5.5 percent drop in orders for nondurable goods. This report was a bit of a head-fake, however. Most of the weakness was in orders for petroleum and coal products which tumbled 16.9 percent. The problem there was that Hurricane Ike caused many refineries to be shut down in September. The net result is that we will likely get a slightly stronger-than-expected factory orders report next month. But there is no mistaking the trend in the factory sector has taken a decided turn for the worse.

The ISM non-manufacturing survey also fell sharply in October, with the composite index falling 5.8 points to 44.4. New orders and employment both fell meaningfully during the month, with orders tumbling 6.8 points to 44.0 and employment 2.7 points to 41.2. The weaker employment series, along with the weaker employment data in the manufacturing survey, are key ingredients in many employment forecasts and raised concerns that job losses in this Friday's employment report would be worse than feared.

The weak ISM non-manufacturing data were reinforced by generally disappointing sales figures from the nation's major chain stores. The ICSC reported that same-store sales plunged 1 percent in October to one of their weakest readings ever. Most of the weakness was at major department stores and specialty chains. A handful of discount stores saw sales increase. Consumers have clearly turned more cautious, which means this holiday season should prove to be a major disappointment.

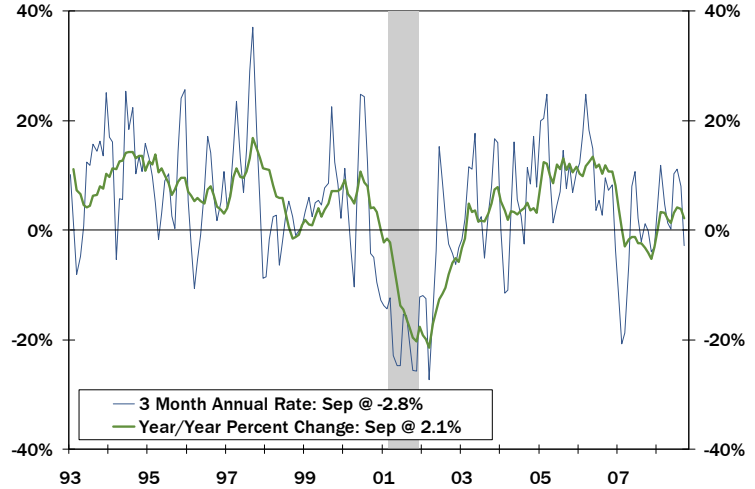
The actual unemployment claims numbers have not been as bad as many had feared. Weekly first-time unemployment claims fell by 4,000 in the latest week and have been hanging around the 480,000 level. The data still point to a deteriorating labor market but nowhere near as much as the survey data from the ISM reports.

The October employment report was a disaster. While job losses in October of 240,000 did not reach some of the worst estimates for the month, the previous two months saw a net revision of -179,000. This brings the total job losses for the year to more than 1.1 million jobs. Job losses continue to accelerate in construction and manufacturing, while even the normally stable service sector has seen employment decline over the past year. We expect job losses will continue through next year and the unemployment rate may exceed eight percent by early 2010.

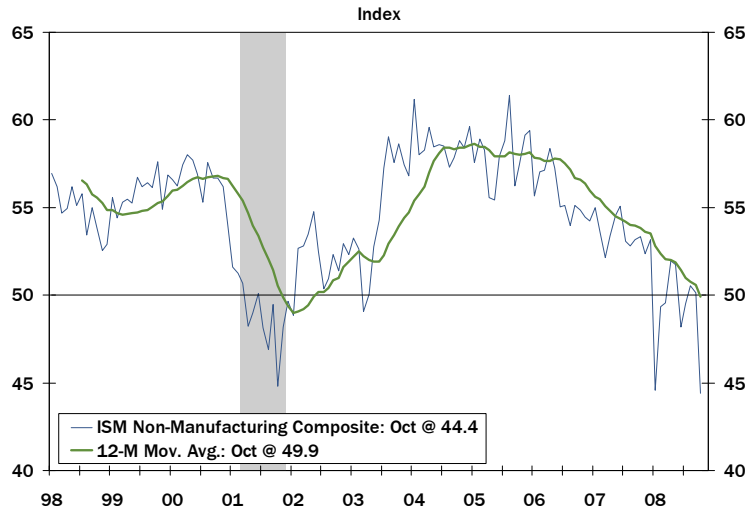
Selected Current Data

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	October - 2008	6.5%
Federal Funds Target Rate	Nov - 07	1.00%

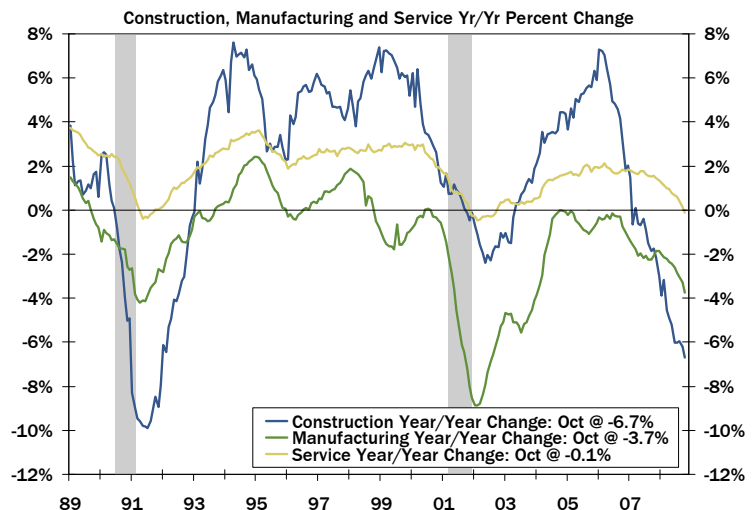
New Orders Non-Defense Capital Goods Ex-Aircraft
Series are 3 Month Moving Averages



ISM Non-Manufacturing Composite Index (NMI)



Job Growth



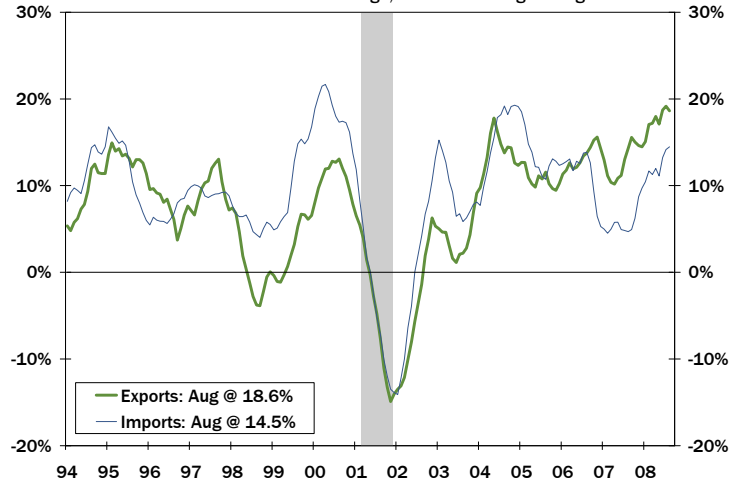
International Trade Balance • Thursday

The goods and services deficit narrowed by 3.5 percent in August to -\$59.1B, mostly due to a drop in petroleum imports. We expect the trade balance to narrow further in September to -\$53.1B. Total imports should remain weak going forward due to depressed U.S. economic growth, falling energy prices and port disruptions caused by Hurricane Ike. Exports should also decline due to slower growth in the rest of the world and Boeing strikes which depressed aircraft orders. Real net exports will probably make a positive contribution to Q3 real GDP growth worth at least one full percentage point.

Previous: -\$59.1B

Wachovia: -\$53.1B

Consensus: -\$57.0B

U.S. Exports and Imports
 Year-over-Year Percent Change, 3-Month Moving Average

Initial Jobless Claims • Thursday

Initial jobless claims are solidly in recession territory with a four week moving average of 476,000. Continuing claims are also increasing as it becomes even more difficult to find work. We expect the pace to continue as the economy sheds jobs.

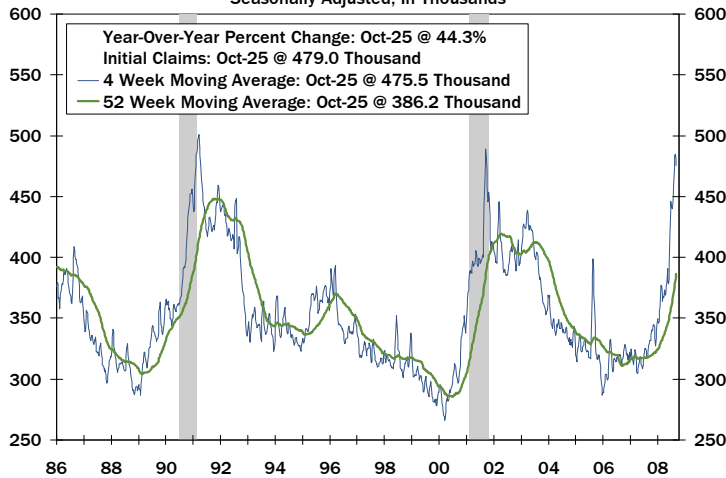
In October, nonfarm employment fell 240,000 with broad based declines across sectors, and the unemployment rate rose to 6.5 percent, which is consistent with past recessions. Layoff announcements suggest further weakness in the pipeline as payrolls still include recent layoffs. By early 2010, we could see the unemployment rate reaching 8.0 percent or higher.

Previous: 481K

Consensus: N/A

Initial Claims for Unemployment

Seasonally Adjusted, In Thousands


Retail Sales • Friday

Retail sales is expected to fall 2.0 percent on the month, its second consecutive decline as consumers continue to pullback on discretionary items. Falling retail gas prices and weak auto sales will also exert downward pressure on headline retail sales. We expect retail sales less autos to fall -1.2 percent driven by broad-based weakness as consumers continue to face a weak labor market and moderating income growth.

Same store sales fell 0.9 percent in October with apparel, department and luxury stores continuing to struggle. Consumers are continuing to seek bargains at discount stores and wholesale clubs, but at a slower pace.

Previous: -1.2%

Wachovia: -2.0%

Consensus: -1.5%

Retail Sales Ex-Motor Vehicles

3-Month Moving Averages



Global Review

(Continued from Page 1)

construction came in at 37.8; both PMIs are at levels that would suggest recession has taken hold.

The European Central Bank (ECB) cut its lending rate by 50 basis points to 3.25 percent. ECB President Trichet described “the intensification and broadening of the financial market turmoil” and lamented the fact that “tensions increasingly spill over from the financial sector to the real economy and from advanced economies to emerging market economies.”

The Reserve Bank of Australia cut its target rate by another 75 basis points this week. Australia’s central bank has now cut rates by a full two percentage points since the summer, and we expect further easing in monetary policy is on the way.

As discussed in the U.S. section, the American job market has gone from bad to worse. However, the labor market report in Canada posted another month of surprisingly-solid gains. The economy gained 9,500 jobs in October, though the unemployment rate ticked higher to 6.2 percent. The consensus was expecting a decline in payrolls on the heels of September’s record gain. In our view, the recent strength in Canada’s reported numbers seems unsustainable against the backdrop of a broad global recession. The Bank of Canada, which has cut its policy rate by 75 basis points in the past month, will likely ease further in the months ahead as the deepening U.S. recession depresses Canadian exports.

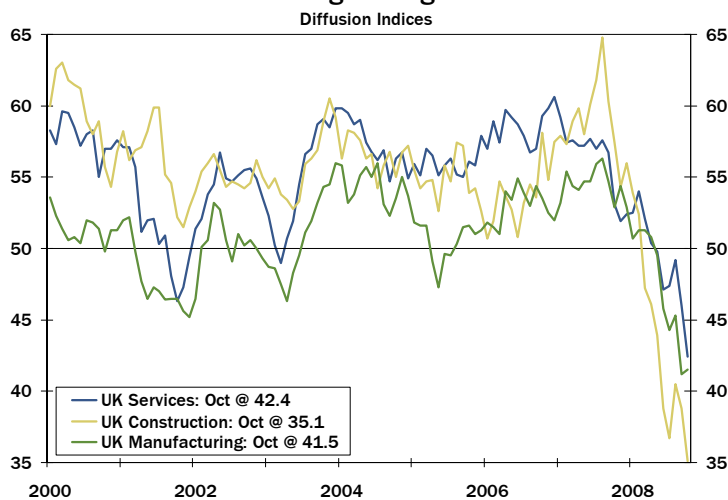
Slowing Global Growth

In our conference call last week, “The Global Economic Outlook: Is Global Recession Imminent?”, we announced downward revisions to our forecast. We made these revisions in light of the unprecedented credit market dislocations in the wake of the Lehman Brothers bankruptcy. On Thursday of this week, the International Monetary Fund (IMF) announced that it was cutting its already-bearish forecast even further. The IMF is now calling for global growth to slow to 2.2 percent next year. That would be less than half the rate at which it grew last year and a significant downward revision to its call for 3.0 percent growth just a month ago. In the same report, the IMF also ratcheted down its forecast for GDP growth in advanced economies to a negative 0.3 percent in 2009. This would be the first negative annual GDP figure for advanced economies since the second world war.

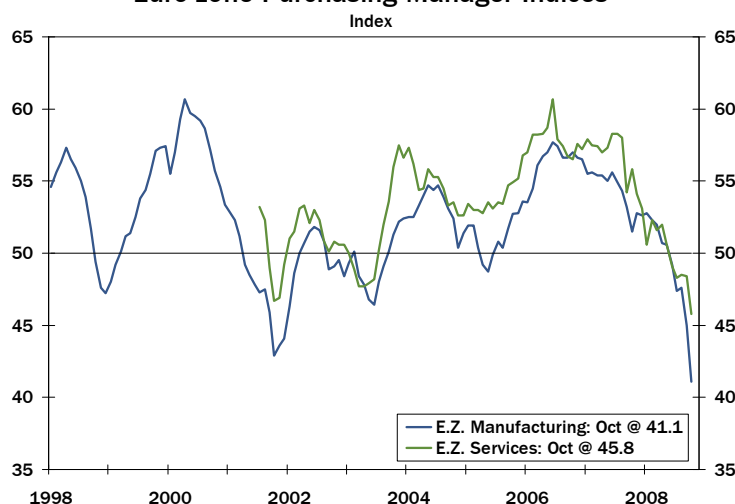
Selected Global Data

Japan	GDP Year-over-Year	Q2 - 2008	0.7%
	CPI	September - 2008	2.1%
	Unemployment	September - 2008	4.0%
	BoJ Target Rate	Nov - 07	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	Nov - 07	3.25%
UK	GDP Year-over-Year	Q3 - 2008	0.3%
	CPI	September - 2008	5.2%
	Unemployment	September - 2008	2.9%
	BoE Target Rate	Nov - 06	3.00%
Canada	GDP Year-over-Year	August - 2008	0.6%
	CPI	September - 2008	3.4%
	Unemployment	October - 2008	6.2%
	BoC Target Rate	Nov - 07	2.25%

UK Purchasing Managers Indices



Euro-zone Purchasing Manager Indices



Canadian Unemployment Rate



U.K. Labor Market Report • Tuesday

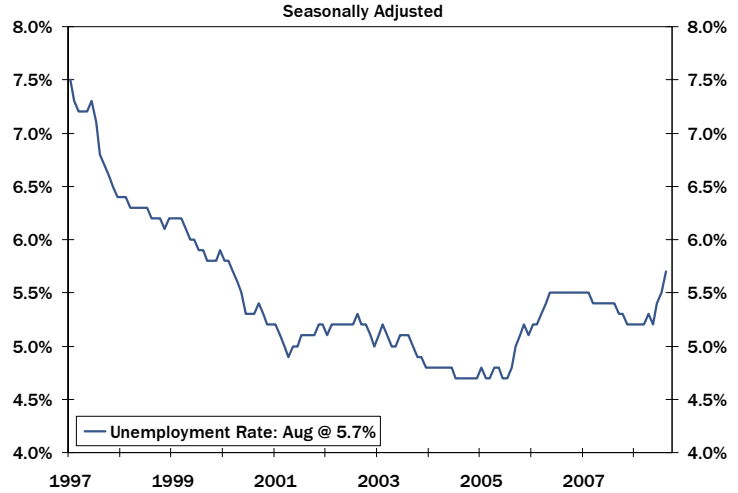
The recent onslaught of bad economic news has contributed to a jump in unemployment in the United Kingdom to 5.7 percent in August. This upward trend is likely to continue in coming months as economic conditions have deteriorated further. The unemployment rate is expected to come in at 5.8 percent for the three month period that ended in September.

The sharp rise in energy prices earlier this year has caused inflation to shoot up in the United Kingdom. The BoE had expressed reservations about cutting interest rates as recently as late summer out of concern about fueling inflation. The bank put those concerns aside as the full threats to the U.K. economy came into focus and it became clear that slowing global growth would snuff out the inflation fire. Producer price data due out this week will likely confirm the Bank's suspicions by showing a decline of 2.5 percent in October.

Previous: 5.7%

Consensus: 5.8%

U.K. Unemployment Rate



Euro-zone CPI Inflation • Friday

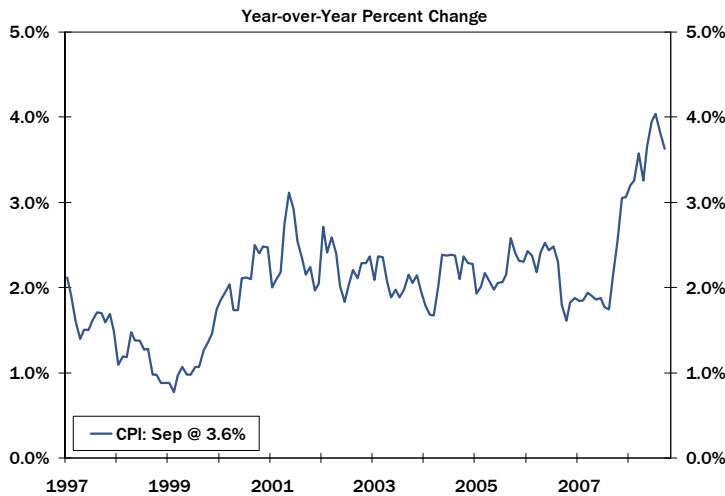
CPI inflation in the Euro-zone has risen well above the two percent rate that the ECB considers to be consistent with "price stability." Nevertheless, the ECB joined other major central banks in a coordinated move to cut interest rates on October 8th, and cut by another 50 basis points this week. Like many of the world's central banks, the ECB has apparently considered the drop in energy and commodity prices in the context of a global slowdown in economic growth and determined that inflation will continue to recede in the months ahead. A benign reading on the core rate of inflation could open the door for another ECB rate in the months ahead.

Data on Euro-zone GDP for Q3 will also print on Friday. Given the weakness in the Euro-zone PMIs and soft consumer confidence numbers, we are in-line with the consensus call for a contraction on the order of -0.2 percent for Q3. GDP is reported quarterly, but not on an annualized basis in the Euro-zone.

Previous: 1.9%

Consensus: 1.9%

Euro-zone Consumer Price Index



Chinese Trade Balance • Friday

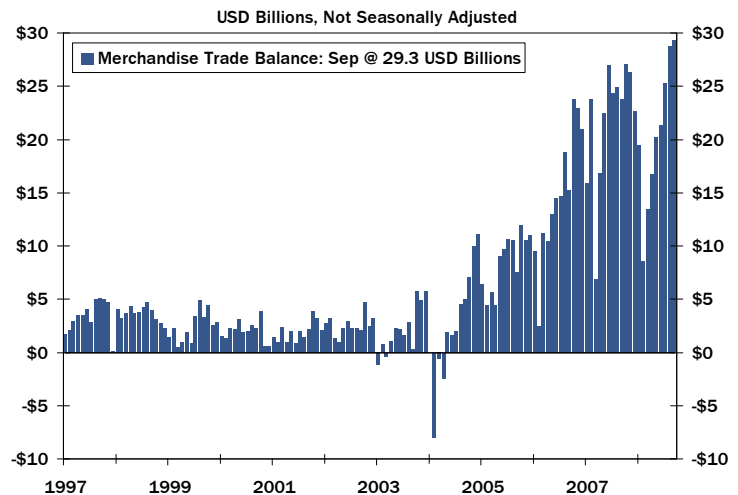
The Chinese trade surplus jumped to new records in August and again in September. This strength seem incongruous with the broader slowdown and economic challenges in the rest of the world. Despite the fact that the rest of the world seems to be tempest-tossed by what many market-watchers have called the worst global financial crisis in memory, the market consensus forecast looks for another record surplus in September. Such strength at this stage of the game strikes us as unlikely and we expect the trade balance to narrow further in the months ahead as slower economic growth in the rest of the world weighs on Chinese export growth.

Other October data releases next week include industrial production and retail sales. These data, in conjunction with some other releases the following week, will give investors a look at how the Chinese economy will fare in the fourth quarter.

Previous: \$28.6 billion

Consensus: \$23.4 billion

Chinese Merchandise Trade Balance



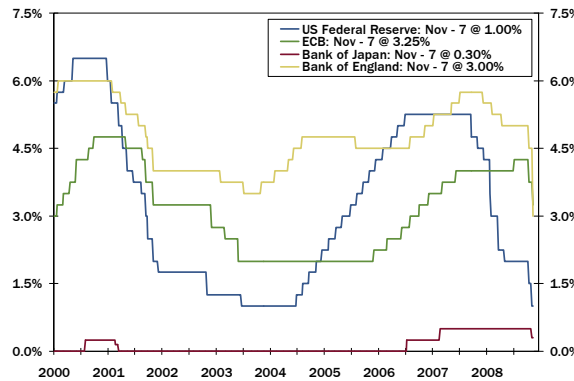
Interest Rate Watch
Recession Fears Drive Fed & Credit

Recession concerns were reinforced this week by economic weakness in jobs, factory orders and manufacturing surveys. This information will lead to another Fed ease but also an increased aversion to risk-taking in the private markets. Recession, which appears to be underway, will be the driving factor that will keep the Fed providing liquidity until mid-spring of next year. This suggests that short-term interest rates will remain low for an extended period of time. At this point we expect a 25 basis point ease in December with a further bias to ease next year. Inflation concerns are just not a barrier to further Fed ease. Through its liquidity facilities we expect the Fed to maintain ample credit to banks.

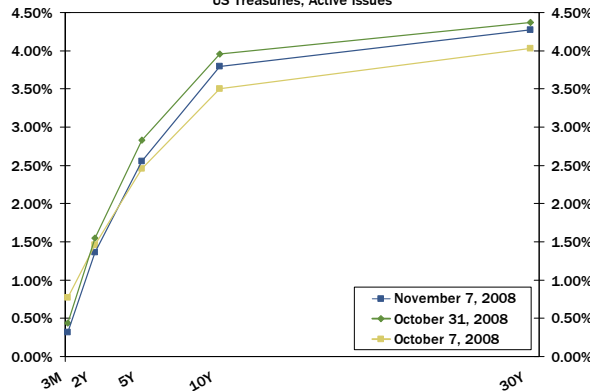
Credit: The Long and Short of It

At the short end of the yield curve we have seen an improvement in lower private market rates such as LIBOR. This suggests credit availability is coming back into the market, at least for interbank lending, and that the worse of the credit problem may have passed—at least at the short-end of the curve. However, the credit channel from banks to non-bank borrowers is still dry as banks remain highly risk-averse given the decline in final sales and absolute drop-off in profits. In the short-run banks are improving their balance sheet but lending is not yet ready for prime time.

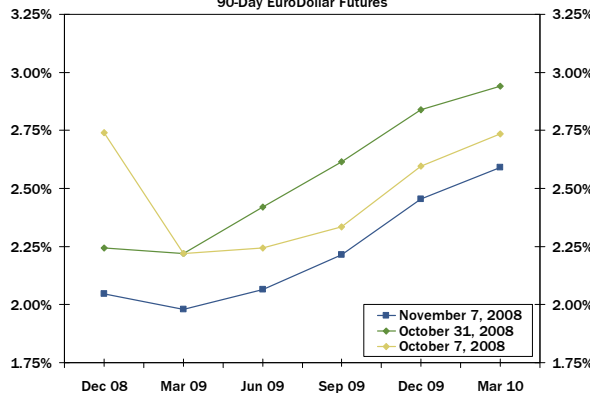
At the long end, there has been little improvement in credit spreads and supplies. Investment grade credit spreads remain above 500 basis points, compared to 100 basis points in the 2002-2006 expansion. Credit spreads on commercial mortgages, high yield and sub-prime CMBS spreads all remain well-above “normal” levels. No one is willing going out the yield curve to take on risk.

Central Bank Policy Rates

Yield Curve

US Treasuries, Active Issues


Forward Rates

90-Day EuroDollar Futures


Topic of the Week
Fed Balance Sheet Reaches Historic Levels

As the Federal Reserve tries to combat a financial crisis and recession, the Fed's balance sheet increased to its most rapid pace on record and now stands at \$2.075 trillion in the week ended November 5th. The Fed's balance sheet has grown roughly \$1.2 trillion since the beginning of the year, roughly 14 percent of GDP.

To aggressively attack the financial crisis the Fed has deployed innovative tools like the Commercial Paper Funding Facility, which is providing a backstop to U.S. issuers of commercial paper through special purpose vehicles and the Money Market Investor Funding Facility, which is providing senior secured funding also to special purpose vehicles. We expect the Fed to continue to use innovation by further expanding its balance sheet until the financial crisis is quelled making its balance sheet practically unlimited.

On November 4th, Dallas Fed President Richard Fisher predicted the balance sheet could reach \$3 trillion - “You can see the size and breadth of the Fed's efforts to counter the collapse of the credit mechanism in our balance sheet. At the beginning of this year, the assets on the books of the Fed totaled \$960 billion. Today, our assets exceed \$1.9 trillion. I would not be surprised to see them aggregate to \$3 trillion—roughly 20 percent of GDP—by the time we ring in the New Year.”

The Fed is now in uncharted territory with such rapid accumulation of its balance sheet that long-term effects are difficult to decipher. However, once the economy begins to recover we may need more innovation to cool the economy down.

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

	Friday 11/7/2008	1 Week Ago	1 Year Ago
3-Month T-Bill	0.29	0.44	3.45
3-Month LIBOR	2.29	3.03	4.90
1-Year Treasury	0.89	1.17	3.72
2-Year Treasury	1.33	1.55	3.54
5-Year Treasury	2.54	2.83	3.87
10-Year Treasury	3.78	3.95	4.31
30-Year Treasury	4.25	4.37	4.65
Bond Buyer Index	5.35	5.32	4.40

Foreign Exchange Rates

	Friday 11/7/2008	1 Week Ago	1 Year Ago
Euro (\$/€)	1.278	1.273	1.464
British Pound (\$/£)	1.577	1.608	2.104
British Pound (£/€)	0.810	0.792	0.696
Japanese Yen (¥/\$)	98.215	98.465	112.625
Canadian Dollar (C\$/\\$)	1.183	1.213	0.931
Swiss Franc (CHF/\\$)	1.176	1.158	1.134
Australian Dollar (US\$/A\\$)	0.673	0.668	0.928
Mexican Peso (MXN/\\$)	12.850	12.826	10.793
Chinese Yuan (CNY/\\$)	6.826	6.839	7.442
Indian Rupee (INR/\\$)	47.663	49.458	39.308
Brazilian Real (BRL/\\$)	2.153	2.159	1.740
U.S. Dollar Index	85.774	85.633	75.412

Foreign Interest Rates

	Friday 11/7/2008	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	4.47	4.77	4.58
3-Month Sterling LIBOR	4.50	5.84	6.28
3-Month Canadian LIBOR	3.10	3.09	4.85
3-Month Yen LIBOR	0.89	0.94	0.87
2-Year German	2.40	2.54	3.91
2-Year U.K.	2.50	2.93	4.93
2-Year Canadian	1.94	2.02	4.01
2-Year Japanese	0.58	0.59	0.78
10-Year German	3.68	3.90	4.15
10-Year U.K.	4.19	4.52	4.83
10-Year Canadian	3.72	3.76	4.28
10-Year Japanese	1.52	1.50	1.57

Commodity Prices

	Friday 11/7/2008	1 Week Ago	1 Year Ago
W. Texas Crude (\\$/Barrel)	61.16	67.81	96.37
Gold (\\$/Ounce)	736.85	724.55	831.09
Hot-Rolled Steel (\\$/S.Ton)	790.00	790.00	520.00
Copper (\\$/Pound)	170.90	184.40	325.10
Soybeans (\\$/Bushel)	8.70	9.06	10.00
Natural Gas (\\$/MMBTU)	6.82	6.78	7.62
Nickel (\\$/Metric Ton)	11,237	11,729	31,925
CRB Spot Inds.	360.30	367.57	493.39

Next Week's Economic Calendar

	Monday 10	Tuesday 11	Wednesday 12	Thursday 13	Friday 14
U.S. Data				Trade Balance August -\$59.1B September -\$53.1B (W)	Retail Sales September -1.2% October -2.0% (W) Retail Sales Less Autos September -0.6% October -1.2% (W)
Global Data	UK PPI Input NSA (MoM) Previous (Sep) -1.2% Japan Machine Orders (MoM) Previous (Aug) -14.5%		UK ILO Unemployment Rate Previous (Aug) 5.7%		Euro-Zone GDP SA (QoQ) Previous (2Q) -0.2% Euro-Zone Core CPI (YoY) Previous (Sep) 1.9%

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

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