

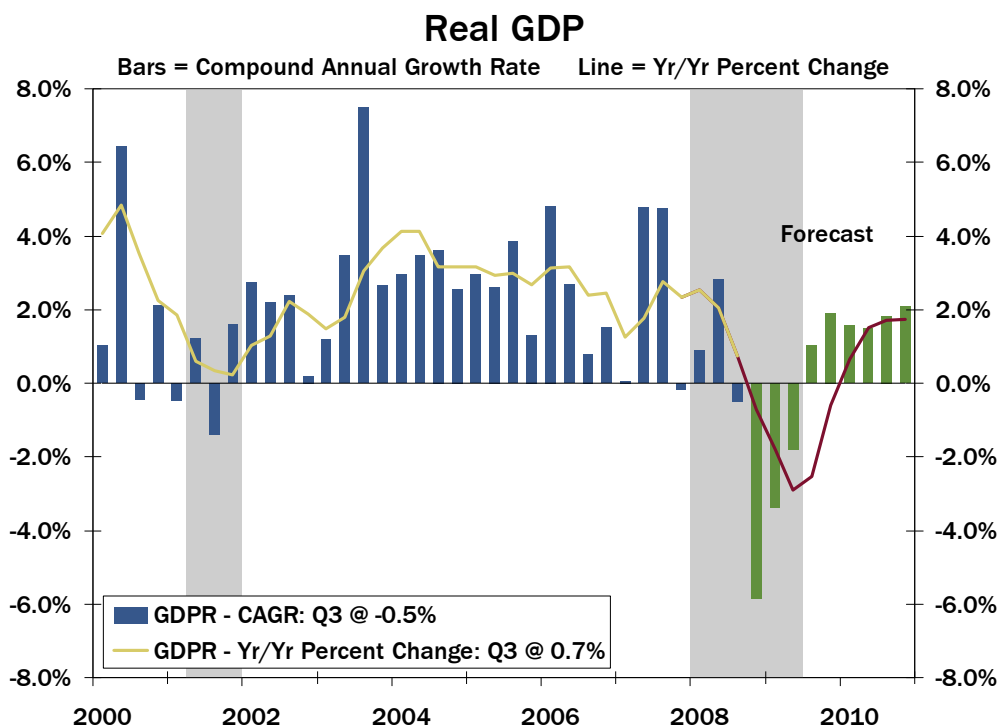
When Will This Horror Show Come to an End?



Table of Contents

Executive Summary	3
The Credit Markets: From Boom to Ka-Boom.....	5
Momentum Shift: The Fundamentals	5
Credit in the New Era: Implications for Growth	6
Housing: The Weakest Link	7
The Vicious Cycle.....	7
Unusual Breadth	8
The Party is Over for the U.S. Consumer	10
This Cycle Will be Different.....	10
Retrenchment in Consumer Spending	11
Policy Implications of a New Administration	12
Evaluating the Policy Initiatives	12
Implications of the Incoming Administration.....	13
Deepest Global Recession Since Early 1980s	14
Outlook for the Dollar	14
Implications for U.S. Net Exports	16
Forecast Tables	18

Figure 1



Source: U.S. Department of Commerce and Wachovia

"If you're going through Hell, keep going."

-Sir Winston Churchill

Executive Summary

The 2008 economic story could have been written and directed by a Hollywood horror master. Watching the developments in financial markets this year was like squinting through closed fingers during the iconic shower scene in Alfred Hitchcock's 1960 thriller, *Psycho*. You could almost hear the soundtrack of screeching violins during televised financial news, and this time it was your assets that were going down the drain.

Since the credit bubble burst in August 2007, banks and other lenders have grown increasingly more restrictive in their lending practices. As a result, our outlook is framed by the character of America's credit cycle, which will dictate the pace and nature of the recovery. The pattern of the credit cycle and its focus on risk avoidance dictates a de-leveraging of the American financial system on both the demand and supply sides. On the demand side, consumers must strengthen their balance sheets by paying down debt, boosting savings and rebuilding equity in their homes. All of this will require the consumer to reduce spending. On the supply side, the banking system must rebuild its capital base, which means it must sell stock and restrain lending.

One of the early victims of the credit crunch was the housing market as the lack of available credit made it tougher for potential homebuyers and builders to qualify for new loans. This put downward pressure on housing prices. This caused lending standards to tighten further, making it tougher still for potential buyers to qualify. This vicious cycle is still playing out as home values are falling across the country and the pool of qualified potential homebuyers is growing smaller.

New home construction is likely to fall further. Rising unemployment, plunging stock prices and tight credit conditions are hardly a formula for increased home sales. These days, one gets the feeling that potential homebuyers would be less afraid staying at the Bates Motel than they are buying a new home. Existing home sales will also likely decline, as deteriorating economic conditions make it tougher for investors to buy foreclosed homes and rent or improve them for resale. Sales of both new and existing homes should bottom in early summer and home construction is expected to bottom in the first half of next year. Home prices should find a floor sometime between late 2009 and early 2010, with the most challenged markets seeing prices begin to stabilize near the end of that period. Foreclosures will not likely top out until 2010. While housing may bottom in the next year or so, the recovery will be agonizingly slow.

The last recession in 2001 was characterized by steady consumer spending supported by rising home prices and easy credit. This cycle, however, will be different as de-leveraging compels strapped consumers to repair their balance sheets. Real personal consumption expenditures tumbled at nearly a four percent annual rate in the third quarter, the largest decline since 1980. We look for further retrenchment over the next few quarters. Consumers have turned exceptionally cautious in light of the recent spike in the unemployment rate and abrupt tightening in credit. Significant declines in house and equity prices this year have eroded household

Our outlook is framed by the character of America's credit cycle, which will dictate the pace and nature of the recovery.

While housing may bottom in the next year or so, the recovery will be agonizingly slow.

wealth, which will also weigh on consumer spending. In many ways consumers are like the counselors at Camp Crystal Lake in *Friday the 13th*; the fun has stopped, the horror has started, and no matter where you try to hide, the axes keep falling. Consumers are not the only ones feeling rattled. Businesses will likely tighten spending by continuing to pare back fixed investment spending and by drawing down inventories significantly, which will also depress growth over the next few quarters.

In an effort to revive the ailing economy, various policy measures will be considered. The incoming Obama administration is likely to enact a second stimulus program, which will provide a boost to growth, at least in the short run. However, unintended consequences of the policy mix could offset much of the stimulus. Higher taxes on dividends and capital gains as well as increased income taxes for higher-income individuals could provide a disincentive to work. A more interventionist government could alter private risk/reward calculations, which could be negative for long-run growth prospects. What little economic growth we had in 2008 was made possible by strong global growth.

Indeed, net exports have helped to prop up U.S. GDP growth over the past few quarters despite weakness in domestic demand. However, that support is in the process of winding down. Every major foreign economy is either already in recession or about to slip into one, due in large part to the pernicious effects of the global credit crunch. Economic growth in the developing world has also slowed this year. Global GDP will expand only one percent or so in 2009, the slowest year for global growth since 1982. We project that the dollar will trend modestly higher against most major currencies in the coming year as the U.S. current account deficit continues to shrink and foreign central banks cut rates sharply.

By the time the economy hits bottom, real GDP will probably have contracted nearly three percent, the worst downturn since 1981-82.

In sum, further declines in consumer spending, business fixed investment spending and residential construction translate into continued contraction in real economic activity. By the time the economy hits bottom in the middle of 2009, real GDP will probably have contracted nearly three percent, the worst downturn since 1981-82. Underlying our forecast is the assumption that policymakers will take the necessary steps to prevent the global financial system from locking up again. Should that assumption prove overly optimistic, global economic growth would end up even weaker than our already bleak outlook projects.

After the year we just finished, you might feel like covering your eyes rather than looking at what might be lurking ahead. In this outlook, we explore how the unprecedented financial developments of the past year will unfold over the next 12 months. The villains in this horror flick are the credit crunch, poor public policy decisions and diminishing foreign trade. At the risk of spoiling the ending to this movie, the good news is that we are going through some of the scariest parts right now; by the end of 2009, economic growth should return.

The Credit Markets: From Boom to Ka-Boom

Momentum Shift: The Fundamentals

We have seen the patterns of credit move toward a de-leveraging of the economy against the prevailing pattern of the last twenty-five years. What forces account for this momentum shift in the credit cycle and what does it mean for 2009?

Credit expansion has characterized economic growth over the past few decades (Figure 2), especially during the recent economic upturn that lasted from 2001 to 2007. Innovation in the credit markets resulted in an apparent solution for every situation. A vast number of credit instruments were developed during the expansion to fill in the gaps of creditor and borrower needs. In many ways it appeared that credit markets were becoming more complete markets. They could meet the credit needs of both borrowers and creditors across the spectrum. In addition to a long period of low short-term interest rates, credit expansion was also enhanced by easier credit standards which effectively meant greater supply of credit at any interest rate.

Consumers benefited from this credit environment as housing finance became democratized and auto loans and credit cards were widely available (Figure 3). Businesses large and small benefited from this accommodative lending environment as well. Near the end of the past economic expansion, excesses in credit markets were rampant and characterized by easy lending standards where borrowers overstated their income and lenders never bothered to check. Over the last year and a half, however, we have witnessed significant backtracking which has led to a sharp curtailment of credit that has led to the current economic downturn.

Credit expansion has characterized economic growth over the past few decades, especially during the recent economic upturn that lasted from 2001 to 2007.

Figure 2

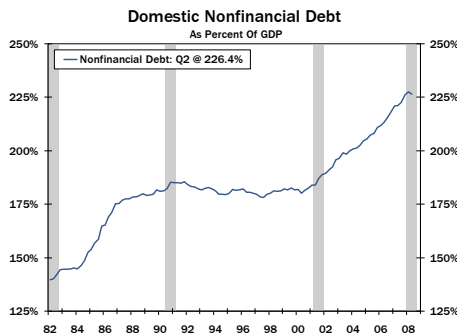
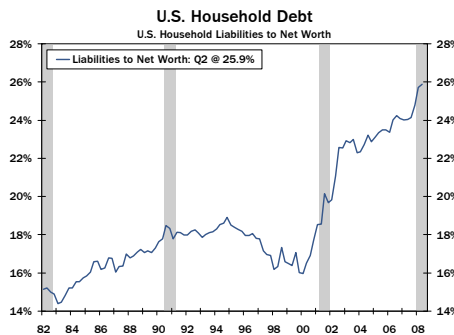


Figure 3



Source: Federal Reserve Board, U.S. Department of Commerce and Wachovia

Looking forward, our outlook is defined by the nature of America's credit cycle which we believe will dictate the pace and nature of the economic recovery. Because of the economy's dependency on credit, we expect that this recession, and the eventual recovery, will differ in both breadth and magnitude compared to previous recessions and recoveries. Two forces are worth noting about the credit outlook.

First, the current focus on risk avoidance dictates a de-leveraging of the American financial system, with particular emphasis on the consumer on the demand side and the banking system on the supply side. The consumer will find credit much more difficult to obtain, and banks, on the supply side, will experience much slower growth in loan portfolios. Immediately this suggests that major credit imbalances will exist across numerous sectors including consumers, financial institutions and government. The financial positions of these sectors reflect old balance sheet

The current focus on risk avoidance dictates a de-leveraging of the American financial system.

relationships in a new era of credit. The adjustments of these imbalances will be complicated and uneven given the financial and real interaction between sectors. Second, the credit markets are still searching for a new balance between risk and reward. There is also a trend toward a more conservative balance of risk-taking relative to any given expectation of reward. Over the past few months we have already witnessed significant declines in the federal funds rate and Treasury yields, but private-sector borrowing rates have not yet receded, especially those further out on the yield and credit curves.

Credit in the New Era: Implications for Growth

As described above, the previous economic expansion was characterized by rapid growth in the global supply of credit to the American consumer, businesses and government. This global supply enabled a rapid expansion in housing and auto credit relative to historical trend. Meanwhile, household demand for credit was boosted by expectations of home price appreciation and the ability to finance purchases through home equity loans.

The credit environment of the next few years will be far different from the past few boom years.

However, the credit environment of the next few years will be far different from the past few boom years. On the demand side, the recession mentality of many consumers will dampen their enthusiasm for more leverage. On the supply side, the recent credit history of many consumers will make credit more difficult to obtain. Lenders will shy away from credit extensions, hesitant to loan in circumstances that would have been customary in earlier expansions. Lending standards and collateral requirements have been raised to the point where they will not be able to facilitate a quick economic recovery.

On net, the changes in risk versus reward calculations by both borrower and lender dictate that the growth in consumer spending over the outlook period will be sluggish relative to the trend of prior expansions. Residential construction and business equipment spending will exhibit sub-par growth in the period ahead. Moreover, if taxes are raised (windfall profit taxes, corporate taxes, dividend and capital gains taxes, etc.), then the after-tax reward for risk-taking would be further diminished. The net result is that the demand for credit would be limited. Weak U.S. and foreign growth suggests that the supply of credit through savings and profits would also be very limited relative to prior recoveries.

Housing: The Weakest Link

The Vicious Cycle

Housing very much remains the weakest link in the U.S. economic outlook. Not only is residential construction activity continuing to decline, but falling housing prices and rising mortgage delinquency rates also continue to put pressure on credit markets. A vicious negative feedback loop has been in play for the past several months. Tightening credit conditions lead to a further slowdown in sales, followed by additional economic weakness, resulting in larger home price declines, higher mortgage delinquency rates and culminating in even tighter lending standards. We expect a much deeper and drawn out housing cycle with a bottom still a ways off. New and existing home sales are both expected to bottom by summer. Residential construction should bottom in the first half of 2009. The bottom, however, will now be significantly lower than previously thought, as tighter credit conditions for home buyers and builders will send activity well below recent lows.

Falling housing prices and rising mortgage delinquency rates continue to put pressure on credit markets.

Figure 4

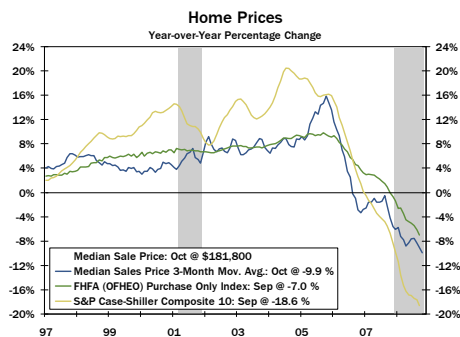
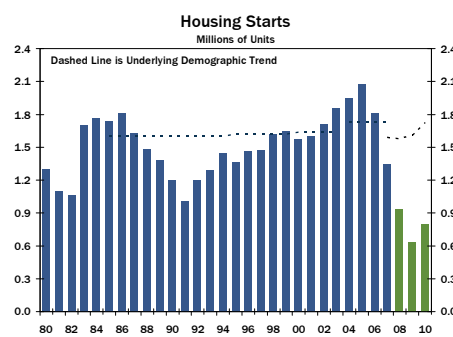


Figure 5



Source: National Association of Realtors, FHFA, S&P Corp. , Dept. of Commerce and Wachovia

Understanding where we are in the housing correction is critical in developing a coherent outlook for the broader economy. The current housing cycle is largely without precedent in timing, depth and breadth. Past housing slumps tended to follow the business cycle. The current slump preceded the broader economic slump by about two years, with sales tumbling once easy and inexpensive mortgage credit became harder to come by. The initial tightening of credit followed a dramatic increase in delinquency rates on most subprime mortgages which were poorly underwritten and thinly collateralized. As a result, delinquency rates soared well ahead of any noticeable slowing in the broader economy, which is something never seen before. By contrast, the more recent rise in mortgage delinquency rates and defaults is the result of the deteriorating economic environment. Unfortunately, the continuing rise in the unemployment rate will send delinquency rates much higher.

The current housing cycle is largely without precedent in timing, depth and breadth.

The peak-to-trough decline in home sales, new construction and prices will also likely exceed anything in the postwar period. New home sales peaked in summer 2005 and have fallen nearly 70 percent nationwide. Home construction peaked at the end of 2005 and has fallen about 65 percent. As measured by the Case-Shiller 10-city composite index, housing prices are down nearly 25 percent since their peak in June 2006.

We expect home sales and new home construction to bottom in the first half of 2009. New homes sales are likely to fall below a 400,000 unit pace early next year and sales of existing homes are expected to at least briefly reach a 4.5 million unit pace during

the first half of the year. This would bring the cumulative peak-to-trough decline in new home sales to more than 70 percent and existing home sales to almost 40 percent. Home construction will fall even more dramatically, with total housing starts at least briefly falling below a 600,000 unit pace, producing a cumulative peak-to-trough decline of nearly 75 percent.

We do not expect to see anything approaching strength in the housing market until 2011 or 2012 at the earliest.

After bottoming, we expect only minimal improvement in home sales and new home construction. Sluggish economic growth, high unemployment and tight lending conditions will likely keep home sales well below the growth in households. This should allow even more of the excess supply of new homes to be absorbed and help bring the overall housing market back into balance by the end of the decade. We do not expect to see anything approaching strength in the housing market until 2011 or 2012 at the earliest.

Unusual Breadth

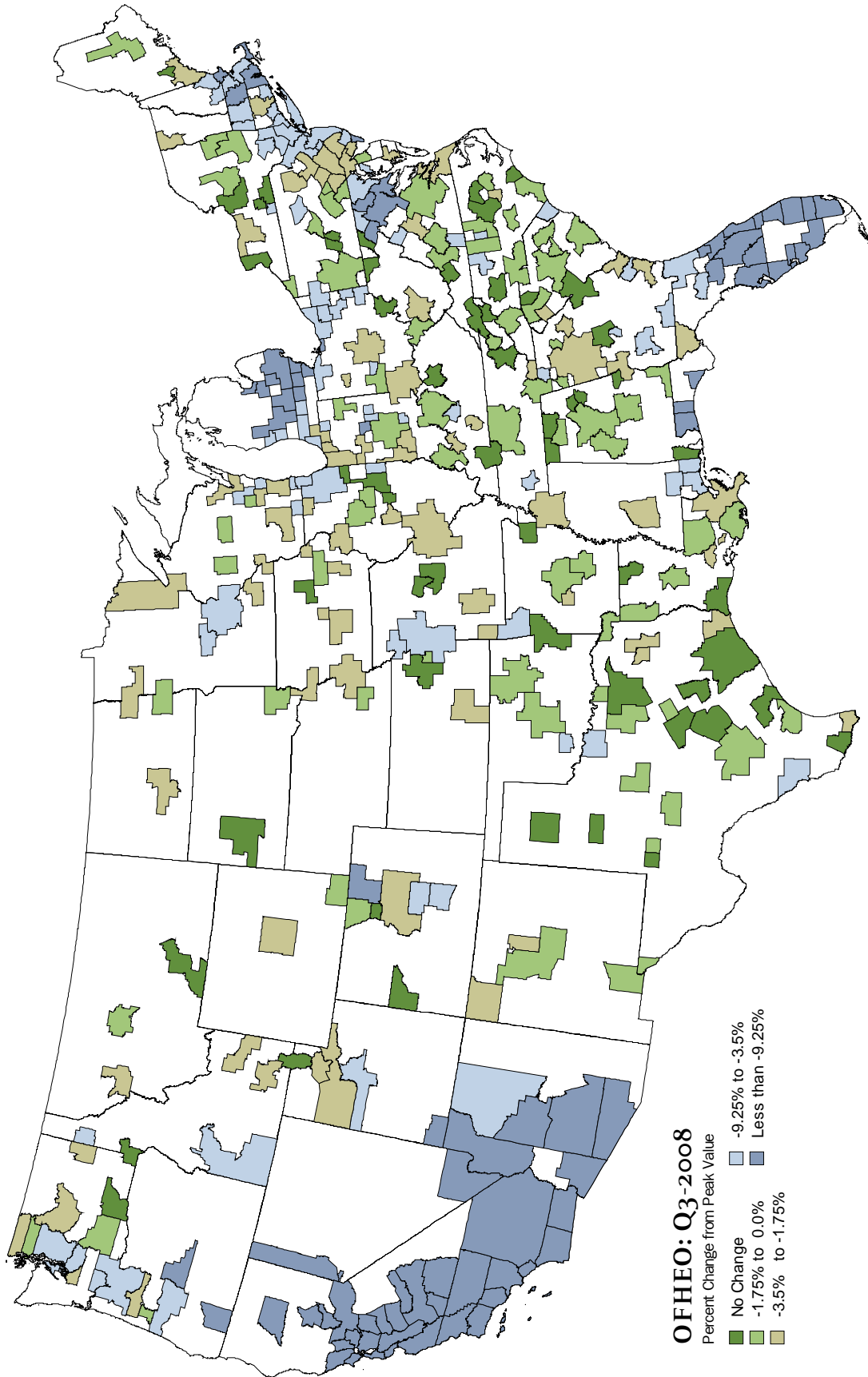
The biggest booms and busts were largely contained to four states: Florida, California, Arizona, and Nevada.

The breadth of this housing slump is also unusual. The bulk of the housing boom and bust took place in just a handful of states. The biggest booms and busts were largely contained to four states: Florida, California, Arizona, and Nevada, which accounted for the greatest amount of speculative home-buying and also saw the largest price gains and declines in the country. Other notable hot spots that turned brutally cold include the outer suburbs of Washington D.C., the greater New York area, the greater Boston area and some of the coastal metropolitan areas in the Carolinas and Georgia.

There are also a few places where prices have slumped even though they never enjoyed a housing boom. Most of these areas are in the Midwest, and include the areas in and around Detroit and Cleveland. Housing prices have fallen precipitously in these areas largely due to extremely depressed economic conditions, a disproportionate amount of subprime lending and deteriorating demographics. Home prices in the Detroit area, for example, have been falling since late 2005 and are now down to levels last seen in 1998—a cumulative drop of roughly 30 percent. Other notable soft spots that did not share the limelight of the housing boom include Atlanta and Minneapolis, among others.

Much of the rest of the country did not really see much of a boom or bust. Housing prices rose largely in line with their long-run averages and there was relatively little speculative activity to note. Sales and construction of new homes is down less in these areas and home values are generally holding up relative to other markets. Credit conditions are tightening nearly everywhere, however, and sales and construction will remain under pressure next year.

FHFA (OFHEO) Home Price Index



The Party is Over for the U.S. Consumer

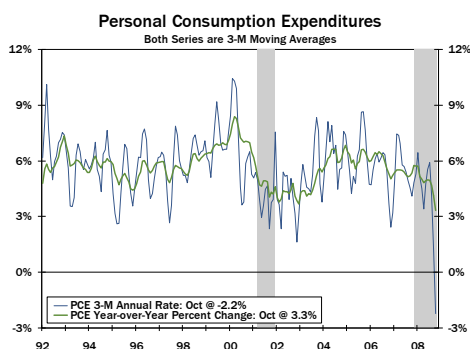
This Cycle Will be Different

Home values have dropped and de-leveraging compels strapped consumers to repair their balance sheets.

Consumer spending is expected to be a significant drag on economic growth throughout 2009 and 2010. During the last recession, consumer spending remained steady thanks to the solid underpinning of rising home prices and easy credit. This cycle will be different as home values have dropped and de-leveraging compels strapped consumers to repair their balance sheets. Real personal consumption expenditures ended 2008 on a particularly weak note and nearly all the underlying fundamentals point to continued struggles in 2009. Real personal consumption expenditures plummeted at a 3.7 percent annual rate during the third quarter of 2008 and we believe outlays fell at an even greater pace in the fourth quarter. Consumers have turned exceptionally cautious in light of the recent spike in the unemployment rate and the abrupt tightening in credit. Unfortunately, these conditions are expected to remain in place through at least the first half of next year.

The combination of deteriorating employment prospects and tightening credit is a powerful one-two punch that has led to substantial cutbacks in discretionary purchases. Spending for big-ticket items has been hit hardest, with motor vehicle sales tumbling to just a 10.2 million unit annual pace in late 2008. Auto sales are expected to recover to just an 11.0 million unit pace for all of 2009. Consumers are also ratcheting back purchases of other big-ticket items such as furniture, household appliances and home electronics.

Figure 6



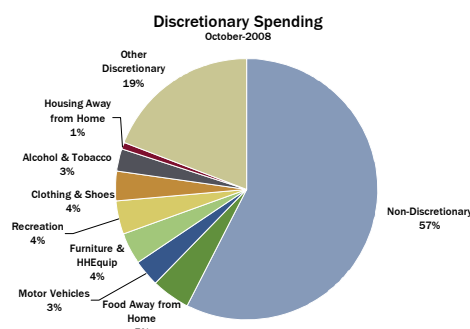
Source: U.S. Department of Commerce and Wachovia

Spending has been scaled back substantially in nearly every discretionary category. Restaurant dining and travel have been hit especially hard. Consumers have also cut back on clothing purchases and are making fewer trips to the shopping mall. According to the International Council of Shopping Centers, November chain store sales fell by their largest amount in 39 years. With that drop, holiday retail sales are expected to decline slightly in 2008, which will likely lead to substantial markdowns at the start of the year.

Falling home prices and the stock market collapse will cut household wealth between nine and ten trillion dollars.

Despite lower prices for many consumer goods, purchasing power will still be constrained by slower income growth and tight credit conditions. Real disposable income is expected to fall at a 0.8 percent pace in 2009, with the slowest growth occurring in the first half of the year. The wealth effect will also cut into purchasing power, with falling home prices and the stock market collapse cutting household wealth between nine and ten trillion dollars by the end of the cycle, which would

Figure 7



represent a 15 percent decline relative to the peak in 2007. Even a conservative estimate of the wealth effect would cut spending between three and four hundred billion dollars.

Retrenchment in Consumer Spending

Consumers will have little choice but to ride out this tough environment. Rising credit card delinquency rates and falling home prices will keep credit tight all through 2009. Recent efforts by the Treasury and Federal Reserve will likely prevent credit from completely freezing up, but credit will clearly be harder to get in 2009 than it has been for some time. With unemployment rising, consumers will also likely remain reluctant to add to their debt burden. We expect the saving rate to rise modestly over the coming year as a new saving ethic begins to take hold.

With unemployment rising, consumers will also likely remain reluctant to add to their debt burden.

Figure 8

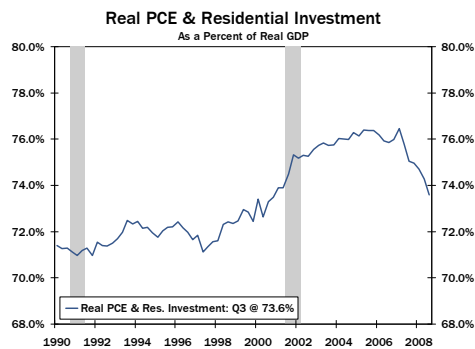
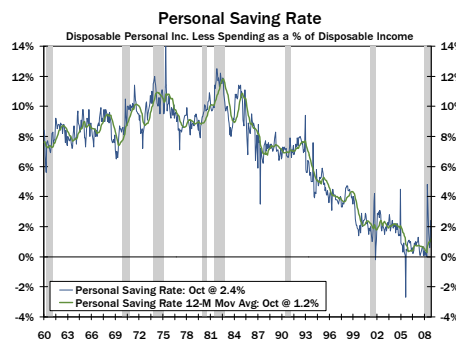


Figure 9



Source: U.S. Department of Commerce and Wachovia

While spending is expected to remain weak, most of the damage will be done prior to the new year. Real personal consumption outlays declined at an annualized pace of 3.7 percent in the third quarter and are expected to plummet to nearly a six percent annualized pace in the fourth quarter. Spending for nondurable goods is also expected to drop, and outlays for services should grow much more slowly. Outlays should continue to decline in the first quarter, then begin a modest recovery in the spring. With so much of the decline concentrated in the later half of 2008 and first half of 2009, consumer outlays will drop roughly two percent for the year as a whole, marking the weakest year for consumer spending since 1942.

Consumer outlays will post around a two percent drop for the year as a whole, marking the weakest year for consumer spending since 1942.

A retrenchment in consumer spending is long overdue. Consumer spending had risen faster than income during the past several years, with purchasing power being bolstered by abundant and inexpensive credit. The credit boom helped to send the saving rate to roughly zero percent. At its peak, consumer spending and residential investment accounted for 76.5 percent of GDP, some three percentage points above the average maintained since 1990. The ending of the housing boom began to send the ratio back toward its historic norm and that adjustment is likely to continue well into the next few years. Even when spending begins to rise again, we expect the rate of growth to remain slightly below income growth, thereby allowing for the saving rate to gradually recover.

Policy Implications of a New Administration

Evaluating the Policy Initiatives

Unemployment is likely to rise to 9.0 percent by mid 2010.

With housing and consumer spending struggling, we project that the severity of the current recession will be somewhere between the 1973-75 downturn and 1980-82 twin recession periods. Unemployment is likely to rise to 9.0 percent by mid 2010. Into the breach steps President-elect Obama with his own party firmly in control of both houses of Congress. The urgency of the current financial crisis combined with the honeymoon period typically granted in the early days of a new presidency affords the new president an opportunity for sweeping changes. Expectations are running high for the new president, which has many people wondering, "What can we expect in the way of policy initiatives and will those initiatives work?"

Figure 10

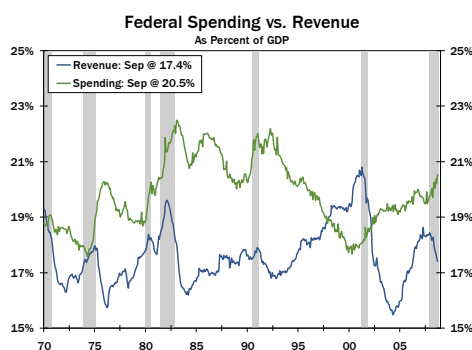
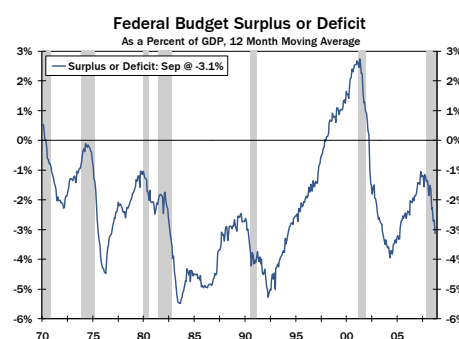


Figure 11



Source: U.S. Department of the Treasury, U.S. Department of Commerce and Wachovia

Early remarks from the incoming economic team suggest selective infrastructure spending rather than another round of checks to consumers. We think this form of spending makes more sense than rebate checks. Despite the help of fiscal stimulus, however, we believe real GDP will decline by two percent for all of 2009 with consumption and business investment remaining very weak. Why? To answer that question we turn to the work of Robert Lucas, the 1995 Nobel laureate for economics.

Lucas observed that the policy stimulus of the 1970s did not have the desired result, but rather stagflation was the reality of the day. The Lucas Critique asserted that it is naïve to try to predict the effects of a change in economic policy entirely on the basis of relationships observed in historical data, especially highly aggregated historical data.¹ Lucas emphasized that individual behavior can change in reaction to policy initiatives, which could render those initiatives ineffective. We had a real-life example of the Lucas Critique earlier this year with the Economic Stimulus Act of 2008. While the stimulus did lead to a brief pick-up in retail spending, it did not generate an ongoing economic recovery. Certainly there were other factors involved, but the basic lesson was that such "rebates" were simply handouts that did not alter individual incentives to work, save or invest. In the short run, policy endeavors may appear effective at the macro level, but without any change in individual incentives, there is no permanent stimulus to the economy.

¹ Lucas, Robert (1976). "Econometric Policy Evaluation: A Critique." Carnegie-Rochester Conference Series on Public Policy 1:19-46.

Implications of the Incoming Administration

What implications does the Lucas Critique have for economic policy in the incoming Obama administration? Although increased infrastructure spending should stimulate the economy, at least in theory, potential tax increases, which were part of President-elect Obama's platform, could carry significant negative microeconomic incentives that could largely offset the macro boost from higher government spending. Not only could higher taxes on dividends, capital gains and higher-income individuals provide a disincentive to work, but they could also induce households to pursue a variety of tax avoidance schemes that provide little macroeconomic benefit. Not only do tax increases reduce the expected after-tax returns to saving and investment in the United States, they could provide incentives for investment and production to move abroad.

In addition, a more interventionist government in terms of regulation and direct government allocation of real economic resources could alter private risk/reward calculations. If these allocations did not reflect the careful economic calculation of costs and benefits, such political interventions would lead to economic outcomes that are inconsistent with those achieved in a purely private calculation of returns. For example, tougher regulation of financial firms, which will increase the cost of capital for borrowers, suggests that the price and availability of credit will be limited relative to previous expansions. Health care mandates will raise costs of labor-intensive firms. Such mandates include family leave, medical leave and caregiver initiatives. If implemented, price controls on drug prices (Medicare Part D pricing) are likely to discourage innovation at the margin and thereby reduce expected returns to research and development spending.

In sum, the microeconomic implications of proposed policy initiatives could be more significant in their impact on the economy and investors than the broad aggregate macroeconomic "stimulus" programs that are frequently the focus of conventional analysis. The incentives implied in policy proposals under discussion raise both the short-run costs and risks associated with implied economic adjustments. Such implications are negative to growth and investment returns.

Potential tax increases could carry significant negative incentives that could offset the boost from higher government spending.

Every G-7 economy is either in recession at present or about to slip into one.

We project global GDP will expand only 0.8 percent in 2009, the slowest year for global growth since 1982.

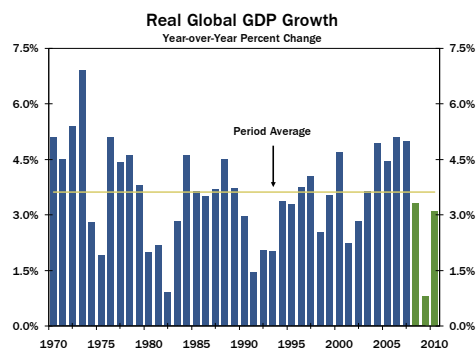
Deepest Global Recession Since Early 1980s

Global economic growth averaged nearly five percent per annum from 2004 to 2007, the strongest four-year period of growth in decades. However, real GDP growth rates slowed in most countries in the first half of 2008, and it appears that many major economies have now slipped into recession due in part to the effects of the global credit crunch. Real GDP in the United Kingdom fell at an annualized rate of two percent in the third quarter, the first drop since 1992. Unfortunately, further declines in British GDP over the next few quarters appear certain. The Euro-zone and Japanese economies have each posted two consecutive quarters of GDP contraction. Growth in Canada has remained positive thus far, but it seems like only a matter of time before the sharp downturn in the United States pulls Canada into recession. In other words, every G-7 economy is either in recession at present or about to slip into one.

Economic growth in the developing world has also slowed this year. However, economic fundamentals in many developing countries are generally stronger today than in the past, making those countries more resilient to downturns in the developed world than in previous cycles. Although some individual countries will experience recession, the developing world in general will probably continue to experience positive economic growth, albeit at a rate that is significantly slower than the average of the past few years. We project global GDP will expand less than one percent in 2009, the slowest year for global growth since 1982. Underlying all of our projections is the assumption that policymakers will take the necessary steps to prevent the global financial system from locking up again. If that assumption proves to be overly optimistic, then global economic growth would end up even weaker than our already grim outlook projects.

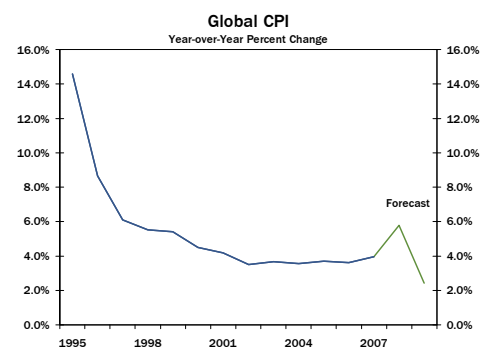
Inflation rates in most countries shot higher in the first half of 2008 as commodity prices went through the roof. However, commodity prices have subsequently collapsed as economic growth has slowed sharply. Indeed, if there is a silver lining to slower global growth, it is that global inflation should recede significantly next year, giving most central banks scope to cut rates further. After rising to nearly six percent in 2008, which is the highest rate in about 10 years, global inflation should recede to about two and a half percent next year.

Figure 12



Source: International Monetary Fund and Wachovia

Figure 13



Outlook for the Dollar

The U.S. dollar followed a downward trend against most major currencies between early 2002 and mid-2008. There are a number of reasons for the dollar's decline. For

starters, the large U.S. current account deficit exerted downward pressure on the greenback. Interest rate differentials moved against the United States, which reduced the relative attractiveness of U.S. assets to foreign investors. In addition, dislocations in credit markets caused new issuance of structured fixed income products, which foreign investors had purchased in droves, to plummet starting in the autumn of last year.

However, the dollar has enjoyed a broad-based rally since mid-July. The dollar's recent appreciation is not a reflection of a positive near-term outlook for the U.S. economy. Rather, the prognosis for many foreign economies has deteriorated more rapidly than for the U.S. economy since midsummer. Whereas many investors had expected most foreign economies to avoid recession, it has become painfully clear recently that those economies will experience their own downturns.

Looking forward, we project that the dollar will continue to trend higher against most major currencies in the coming year. For starters, the current account deficit is about to get significantly smaller, which will exert fewer headwinds on the greenback. The underlying trade deficit has narrowed markedly as real exports have grown much faster than real imports. Now that oil prices have collapsed, the nominal trade deficit should decline rapidly. In addition, foreign central banks probably will be cutting rates more than the Federal Reserve in the months ahead. As interest rate differentials narrow, foreign capital inflows should strengthen, which should lead to dollar appreciation.

As interest rate differentials narrow, foreign capital inflows should strengthen, which should lead to dollar appreciation.

Many emerging market currencies have been hammered over the last month or so, as risk aversion has spiked and de-leveraging has soared. As risk aversion retreats from extreme levels, many emerging market currencies could recoup some of their losses. That said, we project that the dollar will grind higher next year versus most emerging currencies as central banks in developing countries cut rates due to slowing economic growth and receding inflation.

Figure 14

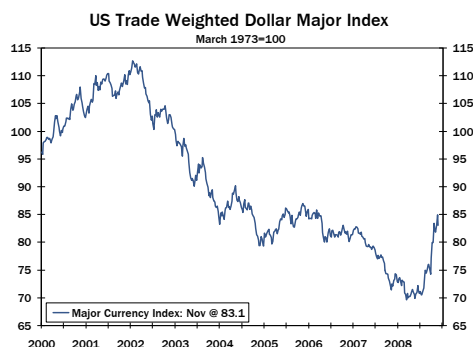
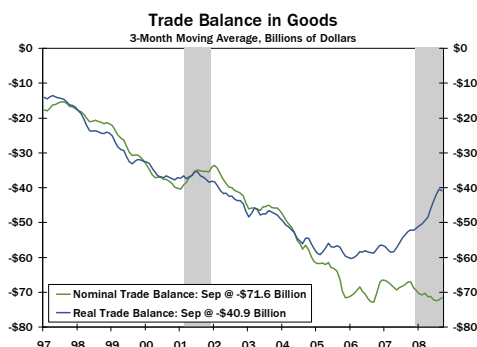


Figure 15



Source: Federal Reserve Board, U.S. Department of Commerce and Wachovia

Implications for U.S. Net Exports

Growth in U.S. exports has been very strong over the past few years, but the combination of weak economic growth in most of America's important trading partners and modest dollar appreciation should cause export growth to slow in the quarters ahead. On the other hand, the volume of imports has dropped about three percent since mid-2007, and weakness in the U.S. economy should lead to further contraction in real imports. Therefore, real net exports should partially offset weakness in domestic demand, although the positive contribution to real GDP growth from net exports will likely be smaller in the quarters ahead than it has over the past year.

This Page Intentionally Left Blank

When Will This Horror Show Come to an End?
December 10, 2008

Forecast Tables

Wachovia U.S. Economic Forecast

	Actual																Forecast				
	2007				2008				2009				2010				Actual		Forecast		
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2006	2007	2008	2009	2010
Real Gross Domestic Product (a)	0.1	4.8	4.8	-0.2	0.9	2.8	-0.5	-5.9	-3.4	-1.8	1.0	1.9	1.6	1.5	1.8	2.1	2.8	2.0	1.1	-2.0	1.4
Personal Consumption	3.9	2.0	2.0	1.0	0.9	1.2	-3.7	-5.9	-1.7	-0.1	0.7	1.6	1.7	1.5	1.6	1.7	3.0	2.8	0.1	-1.8	1.4
Business Fixed Investment	3.4	10.3	8.7	3.4	2.4	2.5	-1.5	-12.5	-10.4	-11.8	-9.3	-6.8	-4.8	-0.2	0.8	4.1	7.5	4.9	2.3	-8.9	-4.2
Equipment and Software	0.0	6.9	3.6	1.0	-0.5	-5.0	-5.6	-12.7	-9.8	-9.7	-7.0	-4.2	3.0	2.2	2.2	4.7	7.2	1.7	-1.6	-8.9	-0.7
Structures	11.2	18.3	20.5	8.6	8.7	18.4	6.6	-7.5	-12.0	-18.0	-16.0	-15.0	-10.0	-8.0	-4.0	2.0	8.2	12.7	11.0	-9.2	-10.6
Residential Construction	-16.2	-11.6	-20.6	-27.0	-25.0	-13.3	-17.6	-30.0	-18.0	-9.0	-3.0	0.0	5.0	5.0	7.5	9.0	-7.1	-17.9	-21.4	-15.9	2.7
Government Purchases	0.9	3.9	3.8	0.8	1.9	3.9	5.3	0.9	-0.1	-0.3	0.6	0.8	1.3	1.5	1.7	1.8	1.7	2.1	2.8	1.1	1.1
Net Exports	-618.6	-571.2	-511.8	-484.5	-462.0	-381.3	-352.3	-356.4	-327.6	-322.1	-322.0	-331.1	-331.1	-331.7	-333.7	-339.0	-615.7	-546.5	-388.0	-325.7	-333.9
Pct. Point Contribution to GDP	-1.2	1.7	2.0	0.9	0.8	2.9	1.1	-0.1	1.0	0.2	0.0	-0.3	0.0	0.0	-0.1	-0.2	0.0	0.6	1.4	0.5	-0.1
Inventory Change	-15.0	-2.8	16.0	-8.1	-10.2	-50.6	-29.1	-35.0	-75.0	-80.0	-35.2	13.4	27.6	29.7	34.9	36.4	42.3	-2.5	-31.2	-44.2	32.2
Pct. Point Contribution to GDP	-1.1	0.5	0.7	-1.0	0.0	-1.5	0.9	-0.2	-1.4	-0.2	1.6	1.7	0.5	0.1	0.2	0.1	0.0	-0.4	-0.2	-0.1	0.7
Nominal GDP	4.3	6.9	6.4	2.3	3.5	4.1	3.6	-7.0	-1.2	-0.4	2.5	3.5	3.3	3.3	3.8	4.1	6.1	4.8	3.3	-0.5	3.1
Real Final Sales	1.1	4.3	4.0	0.8	0.9	4.4	-1.4	-5.5	-2.0	-1.6	-0.5	0.2	1.1	1.4	1.6	2.0	2.8	2.4	1.4	-1.8	0.7
Retail Sales (b)	3.3	4.0	4.1	4.9	3.0	2.6	0.7	-5.0	-5.1	-5.3	-3.3	2.4	3.6	3.8	3.8	3.7	5.8	4.1	0.3	-2.9	3.8
Inflation Indicators (b)																					
"Core" PCE Deflator	2.3	2.1	2.0	2.2	2.2	2.3	2.4	1.9	1.6	1.4	1.2	1.4	1.6	1.7	1.7	1.8	2.3	2.2	2.2	1.4	1.7
Consumer Price Index	2.4	2.6	2.4	4.0	4.2	4.3	5.3	2.6	1.6	0.7	-0.2	2.2	2.7	2.8	2.6	1.9	3.2	2.9	4.1	1.1	2.5
"Core" Consumer Price Index	2.6	2.3	2.1	2.3	2.4	2.3	2.5	2.0	1.7	1.6	1.2	1.5	1.7	1.8	1.9	1.9	2.5	2.3	2.3	1.5	1.8
Producer Price Index	2.0	3.4	3.6	6.7	7.1	7.6	9.4	1.6	-1.2	-3.1	-4.6	1.0	2.1	1.9	1.9	1.9	3.0	3.9	6.4	-2.0	2.0
Employment Cost Index	3.5	3.3	3.3	3.3	3.3	3.1	2.9	2.7	2.9	2.7	2.6	2.5	2.7	2.5	2.5	2.4	3.1	3.4	3.0	2.7	2.5
Real Disposable Income (a)	4.4	-0.6	3.1	0.6	-0.7	10.7	-9.2	0.2	-1.5	0.0	0.7	1.1	1.6	1.7	1.9	2.0	3.5	2.8	1.0	-0.8	1.4
Nominal Personal Income (b)	6.4	6.1	6.1	5.8	4.2	5.0	3.6	1.8	-0.1	-1.4	-1.0	0.0	1.8	2.4	3.0	3.8	7.1	6.1	3.7	-0.6	2.8
Industrial Production (a)	1.5	3.2	3.6	0.3	0.4	-3.4	-7.6	-8.5	-5.0	-2.7	-1.4	0.3	1.4	2.2	2.9	3.3	2.2	1.7	-1.4	-4.7	1.0
Capacity Utilization	80.7	81.0	81.3	81.0	80.7	79.7	77.9	75.7	73.8	72.5	71.5	71.0	70.6	70.5	70.6	70.7	80.9	81.0	78.5	72.2	70.6
Corporate Profits Before Taxes (b)	-1.0	-0.5	-2.7	-2.0	-1.5	-8.3	-9.0	-17.5	-25.0	-24.0	-20.0	-14.0	-4.0	8.8	8.2	8.0	15.2	-1.6	-9.1	-21.0	5.2
Corporate Profits After Taxes	-0.9	-0.2	-0.8	-0.6	1.8	-6.4	-12.0	-18.0	-24.5	-28.5	-20.5	-16.0	-2.0	10.8	10.5	10.4	16.0	-0.6	-8.7	-22.7	7.2
Federal Budget Balance (c)	-178.0	137.5	-40.6	-106.8	-205.9	26.9	-168.9	-467.4	-279.6	-69.0	-184.0	-304.0	-338.0	-24.0	-139.0	-153.0	-248.2	-161.5	-454.8	-1000.0	-805.0
Current Account Balance (d)	-196.9	-194.1	-173.0	-167.2	-175.6	-183.1	-175.0	-140.0	-125.0	-115.0	-110.0	-105.0	-100.0	-98.0	-95.0	-95.0	-788.1	-731.2	-673.8	-455.0	-388.0
Trade Weighted Dollar Index (e)	80.5	78.7	74.4	73.3	70.3	71.0	76.1	83.4	86.8	89.3	91.5	92.5	93.0	93.8	93.8	93.8	81.5	73.3	83.4	92.5	93.8
Nonfarm Payroll Change (f)	109	105	71	80	-82	-71	-199	-408	-250	-180	-133	-83	-20	40	80	105	175	91	-190	-162	51
Unemployment Rate	4.5	4.5	4.7	4.8	4.9	5.3	6.0	6.7	7.2	7.7	8.2	8.5	8.6	8.8	9.0	9.0	4.6	4.6	5.7	7.9	8.9
Housing Starts (g)	1.45	1.46	1.30	1.15	1.05	1.03	0.88	0.73	0.61	0.61	0.64	0.66	0.70	0.76	0.84	0.92	1.81	1.34	0.92	0.63	0.80
Light Vehicle Sales (h)	16.3	16.1	15.9	16.0	15.2	14.1	12.9	10.4	10.9	10.8	11.1	11.1	11.4	11.6	11.6	11.8	16.5	16.1	13.1	11.0	11.6
Crude Oil - WTI - Front Contract (i)	58.16	65.03	75.38	90.68	97.90	123.98	117.98	60.15	37.00	36.00	39.00	40.00	43.00	44.00	45.00	46.00	66.22	72.31	100.00	38.00	44.50
Quarter-End Interest Rates																					
Federal Funds Target Rate	5.25	5.25	4.75	4.25	2.25	2.00	2.00	0.50	0.25	0.25	0.25	0.25	0.25	0.50	1.00	1.00	5.25	4.25	0.50	0.25	1.00
3 Month LIBOR	5.35	5.36	5.23	4.70	2.69	2.78	4.05	2.00	1.80	1.50	1.20	0.90	1.00	1.20	1.30	1.40	5.36	4.70	2.00	0.90	1.40
Prime Rate	8.25	8.25	7.75	7.25	5.25	5.00	5.00	3.50	3.25	3.25	3.25	3.25	3.25	3.50	4.00	4.00	8.25	7.25	3.50	3.25	4.00
Conventional Mortgage Rate	6.16	6.66	6.38	6.10	5.97	6.32	6.48	4.85	4.90	5.00	5.00	4.95	4.95	5.15	5.35	5.55	6.14	6.10	4.85	4.95	5.55
3 Month Bill	5.04	4.82	3.82	3.36	1.38	1.90	0.92	0.20	0.20	0.20	0.20	0.20	0.40	0.70	0.90	1.00	5.02	3.36	0.20	0.20	1.00
2 Year Note	4.58	4.87	3.97	3.05	1.62	2.63	2.00	1.10	1.30	1.30	1.40	1.50	1.60	1.70	1.80	1.90	4.82	3.05	1.10	1.50	1.90
5 Year Note	4.54	4.92	4.23	3.45	2.46	3.34	2.98	1.85	2.00	2.10	2.20	2.20	2.30	2.50	2.80	3.10	4.70	3.45	1.85	2.20	3.10
10 Year Note	4.65	5.03	4.59	4.04	3.45	3.99	3.85	2.85	2.95	3.10	3.10	3.10	3.20	3.40	3.60	3.80	4.71	4.04	2.85	3.10	3.80
30 Year Bond	4.84	5.12	4.83	4.45	4.30	4.53	4.31	3.35	3.35	3.40	3.30	3.30	3.40	3.60	3.80	4.00	4.81	4.45	3.35	3.30	4.00

Data As of: December 10, 2008

Notes: (a) Compound Annual Growth Rate Quarter-over-Quarter (f) Average Monthly Change
 (b) Year-over-Year Percentage Change (g) Millions of Units
 (c) Quarterly Sum - Billions USD; Annual Data Representer (h) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold
 (d) Quarterly Sum - Billions USD (i) Quarterly Average of Daily Close
 (e) Federal Reserve Major Currency Index, 1973=100 - Quarter End

December 10, 2008

Wachovia Currency Forecast

(End of Quarter Rates)

	2008		2009				2010		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	
Major Currencies									
Euro (\$/€)	1.32	1.26	1.22	1.18	1.17	1.16	1.15	1.15	
U.K. (\$/£)	1.54	1.48	1.44	1.42	1.41	1.41	1.40	1.40	
U.K. (£/€)	0.86	0.85	0.85	0.83	0.83	0.82	0.82	0.82	
Japan (¥/\$)	95	100	105	110	112	114	115	115	
Other Industrialized									
Canada (C\$/US\$)	1.22	1.25	1.27	1.28	1.29	1.29	1.30	1.30	
Switzerland (CHF/\$)	1.18	1.24	1.28	1.30	1.31	1.32	1.33	1.33	
Norway (NOK/\$)	6.90	7.20	7.40	7.45	7.50	7.55	7.60	7.60	
Sweden (SEK/\$)	7.80	8.30	8.40	8.50	8.55	8.55	8.60	8.60	
Australia (US\$/A\$)	0.68	0.66	0.65	0.64	0.63	0.63	0.62	0.62	
Developing Economies									
Mexico (MXN/\$)	13.25	13.50	13.75	13.80	13.90	13.90	14.00	14.00	
Brazil (BRL/\$)	2.35	2.40	2.50	2.55	2.57	2.58	2.60	2.60	
Poland (PLN/\$)	2.95	3.10	3.30	3.35	3.40	3.40	3.50	3.50	
Russia (RUB/\$)	27.75	28.50	29.00	29.25	29.50	29.75	30.00	30.00	
Turkey (TRY/\$)	1.55	1.62	1.66	1.70	1.71	1.71	1.72	1.72	
South Africa (ZAR/\$)	9.90	10.25	10.50	10.75	10.90	10.95	11.00	11.00	
China (CNY/\$)	6.90	6.88	6.85	6.80	6.70	6.60	6.50	6.40	
India (INR/\$)	48.80	49.50	50.00	50.25	50.40	50.40	50.50	50.50	
Korea (KRW/\$)	1400	1450	1460	1480	1490	1495	1500	1500	
Singapore (S\$/US\$)	1.50	1.54	1.55	1.56	1.57	1.57	1.58	1.58	
Taiwan (TWD/\$)	33.25	33.50	33.70	33.80	33.90	33.90	34.00	34.00	

Wachovia International Economic Forecast

(Year-over-Year Percentage Change)

	GDP			CPI		
	2008	2009	2010	2008	2009	2010
Global	3.3%	0.8%	3.1%	5.8%	2.4%	2.8%
Major Economies						
United States	1.1%	-2.0%	1.4%	4.1%	1.1%	2.5%
Eurozone	0.9%	-1.1%	1.5%	3.3%	1.3%	1.4%
Germany	1.3%	-1.2%	1.6%	2.8%	1.1%	1.3%
France	0.8%	-0.9%	1.9%	3.3%	1.2%	1.4%
Italy	-0.4%	-1.1%	1.1%	3.5%	1.5%	1.2%
UK	0.7%	-1.4%	1.5%	3.6%	1.6%	1.4%
Japan	0.1%	-1.3%	1.4%	1.5%	0.3%	0.1%
Canada	0.6%	-0.6%	2.5%	2.5%	1.4%	1.7%
Developing Economies						
China	9.4%	7.2%	8.8%	6.1%	1.0%	1.5%
India	6.5%	5.5%	7.3%	7.4%	5.9%	4.5%
Mexico	1.6%	-0.4%	2.4%	5.0%	4.0%	3.3%
Brazil	5.0%	2.0%	3.0%	5.7%	4.6%	3.9%

¹Data As of: December 10, 2008

¹Data as of: December 10, 2008

Wachovia International Interest Rate Forecast

(End of Quarter Rates)

	3-Month LIBOR						10-Yr Government Security									
	2008		2009		2010		2008		2009		2010					
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3				
United States	2.00%	1.80%	1.50%	1.20%	0.90%	1.00%	1.20%	1.30%	2.85%	2.95%	3.10%	3.10%	3.10%	3.20%	3.40%	3.60%
Japan	0.90%	0.70%	0.40%	0.30%	0.30%	0.30%	0.40%	0.70%	1.30%	1.35%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
Euroland	3.20%	2.00%	1.55%	1.40%	1.50%	2.00%	2.75%	3.00%	3.10%	3.20%	3.60%	4.00%	4.30%	4.40%	4.45%	4.50%
U.K.	3.10%	1.50%	0.80%	0.65%	0.70%	1.25%	2.00%	2.75%	3.50%	3.60%	3.90%	4.25%	4.50%	4.60%	4.65%	4.70%
Canada	2.00%	1.30%	1.10%	1.20%	1.75%	2.25%	2.75%	3.25%	3.10%	3.30%	3.60%	4.00%	4.30%	4.40%	4.45%	4.50%

¹Data As of: December 10, 2008

Wachovia Economics Group

John E. Silvia, Ph. D.	Chief Economist	(704) 374-7034	john.silvia@wachovia.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wachovia.com
Jay H. Bryson, Ph. D.	Global Economist	(704) 383-3518	jay.bryson@wachovia.com
Sam Bullard	Economist	(704) 383-7372	sam.bullard@wachovia.com
Anika Khan	Economist	(704) 715-0575	anika.khan@wachovia.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wachovia.com
Adam G. York	Economic Analyst	(704) 715-9660	adam.york@wachovia.com
Tim Quinlan	Economic Analyst	(704) 374-4407	tim.quinlan@wachovia.com
Kim Whelan	Economic Analyst	(704) 715-8457	kim.whelan@wachovia.com
Yasmine Kamaruddin	Economic Analyst	(704) 374-2992	yasmine.kamaruddin@wachovia.com

Wachovia Corporation Economics Group publications are distributed by Wachovia Corporation directly and through subsidiaries including, but not limited to, Wachovia Capital Markets, LLC, Wachovia Securities, LLC and Wachovia Securities International Limited.

The information and opinions herein are for general information use only. Wachovia does not guarantee their accuracy or completeness, nor does Wachovia assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. © 2008 Wachovia Corp.



WACHOVIA