WACHOVIA ECONOMICS GROUP

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

December 12, 2008

U.S. Review

Bouncing Along the Bottom

The fourth quarter will likely prove to be the weakest quarter of this recession, with real GDP declining at around a six percent annual rate. Most of the damage has already been done, with sales and production plunging in October. The rate of deterioration appears to have diminished somewhat in November and a few reports, including this morning's retail sales figures, have actually come in slightly better than expected.

Retail sales fell 1.8 percent in November, with most of the drop coming from the continued decline in motor vehicle sales and a sharp drop in sales at gasoline stations. Sales at motor vehicle dealers fell 2.8 percent in November, following a 5.5 percent drop in October and 5.8 percent decline in September. Taken together, those declines put motor vehicle sales down at a stunning 43.7 percent annual rate over the past three months and down 25.1 percent over the past year. The one good bit of news in these data is that the rate of decline in motor vehicle sales has clearly slowed, with the sales for motor vehicles now coming below replacement demand.

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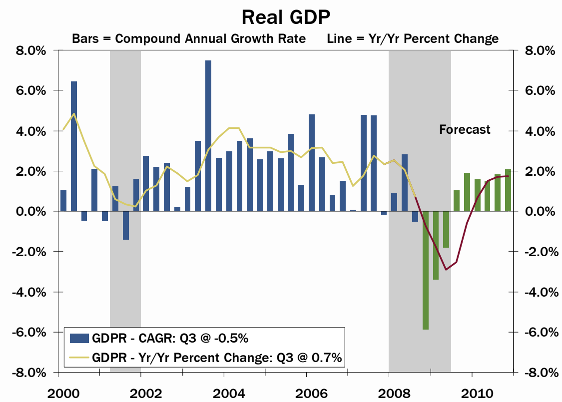

Global Review

Signs of Slower Growth in China

As we have written lately, it appears that the global economy has slipped into its deepest recession since the early 1980s. For a large exporting nation like China, global recession can't be good news. Indeed, recent data confirm that economic growth in China, which has already slowed over the past year or so, has downshifted further in the fourth quarter. That said, the Chinese economy is not falling apart at the seams, at least not yet, as some of its major trading partners, like the United States, appear to be.

Let's start with trade. Although the trade surplus shot up to an all-time high of $40 billion in November (see graph at left), the underlying details were not as sanguine. Exports fell more than 2 percent in November relative to the same month last year, the first time the year-over-year growth rate of exports slipped into negative territory since the last

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Recent Special Commentary

Date	Title	Authors
December-11	Housing Chartbook - December 2008	Vitner & York
December-05	Partial Eclipse in the Lone Star State	Vitner, York & Whelan
December-01	NBER Recession Call: Official Now, But Still Not Over	Silvia
December-01	The Outlook for U.S. Exports Yet Again	Bryson

U.S. Forecast

	Actual			Forecast					Actual			Forecast		
	2008				2009				2005	2006	2007	2008	2009	2010
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
Real Gross Domestic Product [1]	0.9	2.8	-0.5	-5.9	-3.4	-1.8	1.0	1.9	2.9	2.8	2.0	1.1	-2.0	1.4
Personal Consumption	0.9	1.2	-3.7	-5.9	-1.7	-0.1	0.7	1.6	3.0	3.0	2.8	0.1	-1.8	1.4
Inflation Indicators [2]														
"Core" PCE Deflator	2.2	2.3	2.4	1.9	1.6	1.4	1.2	1.4	2.1	2.3	2.2	2.2	1.4	1.7
Consumer Price Index	4.2	4.3	5.3	2.6	1.6	0.7	-0.2	2.2	3.4	3.2	2.9	4.1	1.1	2.5
Industrial Production [1]	0.4	-3.4	-7.6	-8.5	-5.0	-2.7	-1.4	0.3	3.3	2.2	1.7	-1.4	-4.7	1.0
Corporate Profits Before Taxes [2]	-1.5	-8.3	-9.0	-17.5	-25.0	-24.0	-20.0	-14.0	17.6	15.2	-1.6	-9.1	-21.0	5.2
Trade Weighted Dollar Index [3]	70.3	71.0	76.1	83.4	86.8	89.3	91.5	92.5	86.0	81.5	73.3	83.4	92.5	93.8
Unemployment Rate	4.9	5.3	6.0	6.7	7.2	7.7	8.2	8.5	5.1	4.6	4.6	5.7	7.9	8.9
Housing Starts [4]	1.05	1.03	0.88	0.73	0.61	0.61	0.64	0.66	2.07	1.81	1.34	0.92	0.63	0.80
Quarter-End Interest Rates														
Federal Funds Target Rate	2.25	2.00	2.00	0.50	0.25	0.25	0.25	0.25	4.25	5.25	4.25	0.50	0.25	1.00
10 Year Note	3.45	3.99	3.85	2.85	2.95	3.10	3.10	3.10	4.39	4.71	4.04	2.85	3.10	3.80

Data As of: December 10, 2008

[1] Compound Annual Growth Rate Quarter-over-Quarter

[2] Year-over-Year Percentage Change

[3] Federal Reserve Major Currency Index, 1973=100 - Quarter End

[4] Millions of Units

INSIDE

U.S. Review

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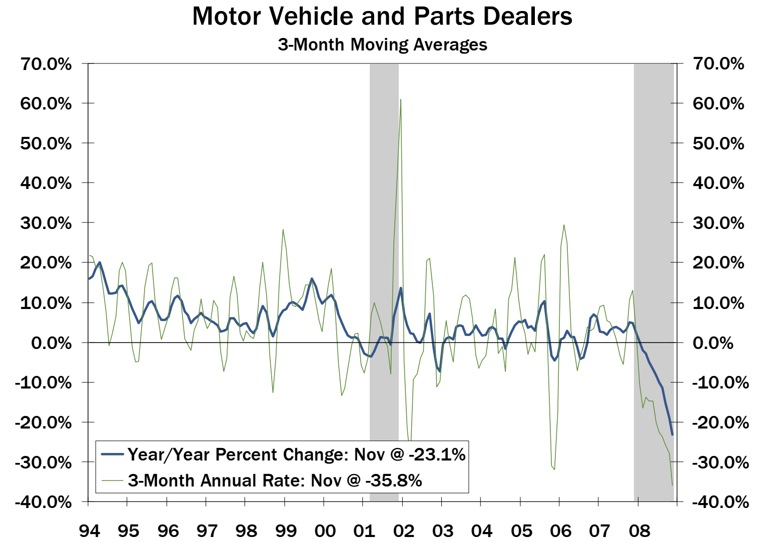
Inventories Will Greatly Complicate the Near-Term Outlook

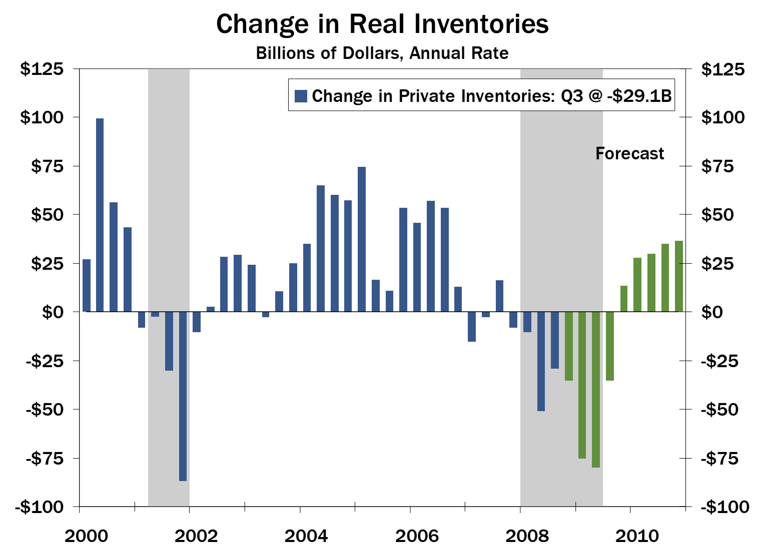
The weakness in motor vehicle sales is hardly surprising. The travails of the domestic automobile makers are on the front page nearly every day and all this bad news is likely keeping a number of consumers away from the showrooms. With sales off so sharply, we have to wonder what is happening to motor vehicle inventories and what that will mean for fourth quarter GDP. We are expecting a sizable drop in overall inventories during the fourth quarter, as production is pulled back sharply. Motor vehicle production did fall more than sales in November but there have been a number of anecdotal reports that inventories of imported vehicles are piling up at various ports.

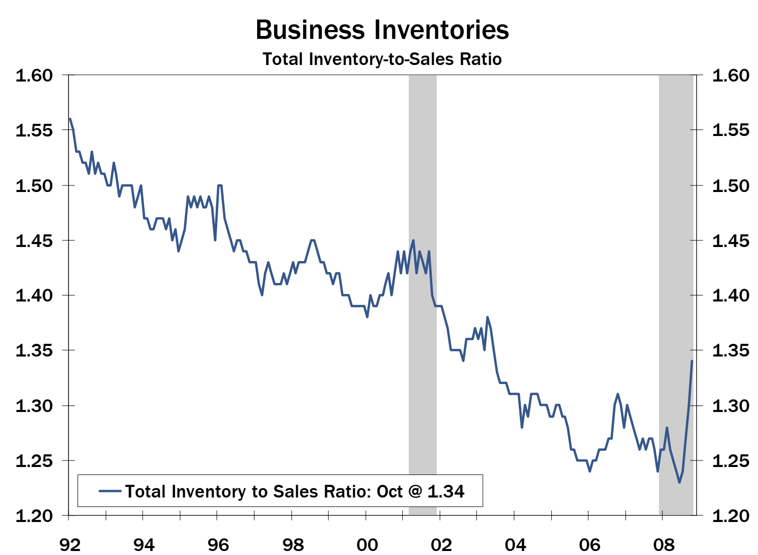
Imports of crude oil are another complicating factor. After dropping sharply in the wake of Hurricane Ike in September, the volume of crude oil imports picked-up considerably in October. Tankers that were unable to offload at facilities shut down by the hurricane made up for some of the lost time, and as a result, the trade balance widened considerably on the month. Net exports have boosted GDP considerably over the last several quarters, adding more than a percentage point to growth in four of the last six quarters. While the sharp rise in oil import volumes was partially offset by a continued decline in non-petroleum imports, we are expecting a negative contribution from trade in the fourth quarter GDP report. In our forecast, released earlier this week ahead of the trade report we were already expecting a slight drag from trade. If the drag is larger than we anticipated it could pose downside risk to our already horrendous estimate of -5.9 percent growth in the fourth quarter. Inventories could offset some of the loss from net exports if the imported product is simply building up in tanks across the country. We have been expecting inventories to be cut considerably on a real basis over the next several quarters as businesses adjust to the new economic realities. In fact, lower levels of inventories at this point in the cycle would be a positive for an eventual recovery, allowing manufacturers to ramp up production faster. Unintentional inventory increases during weak growth pose a considerable risk to production activity. The closely watched ratio of inventory-to-sales at the nations' businesses is rising at an alarming pace, jumping 0.10 points in just four months to 1.34. Wholesalers and retailers alike will look to curtail orders for new products, and manufacturers will have to continue to cut back output. We are looking for a drop of 0.5 percent in industrial production next week, and more broadly speaking we expect production will fall through the next three quarters.

Selected Current Data

Gross Domestic Product - CAGR	Q3 - 2008	-0.5%
GDP Year-over-Year	Q3 - 2008	0.7%
Personal Consumption	Q3 - 2008	-3.7%
Business Fixed Investment	Q3 - 2008	-1.5%
Consumer Price Index	October - 2008	3.7%
"Core" CPI	October - 2008	2.2%
"Core" PCE Deflator	October - 2008	2.1%
Industrial Production	October - 2008	-4.1%
Unemployment	November - 2008	6.7%
Federal Funds Target Rate	Dec - 12	1.00%







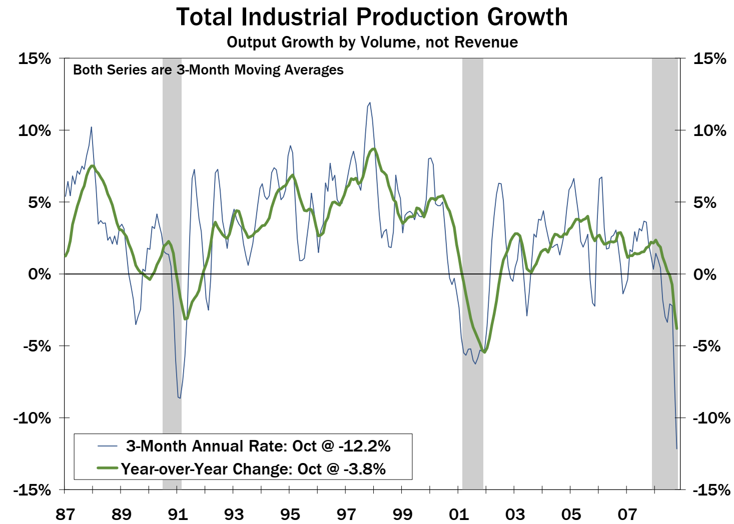
Industrial Production • Monday

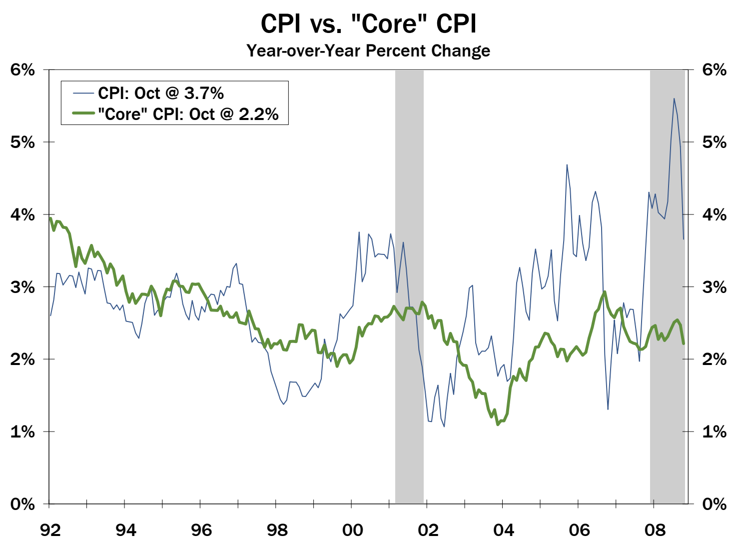
Industrial production rose 1.3 percent in October driven by a post-hurricane bounce-back in mining. However, weakness in autos, business equipment and construction supplies remains. During the third quarter, production of final goods fell six percent. Capacity utilization levels continue to decline, suggesting continued weak profits.

We expect industrial production to continue to post declines and look for a contraction of 0.5 percent in November. Declines in ISM Manufacturing, Chicago PMI and manufacturing employment continue to show weakness in the manufacturing sector. In particular, ISM manufacturing and Chicago PMI are at their lowest level since the 1981-82 recession. The outlook for industrial production is worrisome as slower export activity due to a stronger U.S. dollar and slower global growth may limit improvement in the second half of 2008 and early 2009.

Previous: 1.3% **Wachovia: -0.5%**

Consensus: -0.9%





Consumer Price Index • Tuesday

Continued deterioration in energy prices led to a record 1.0 percent decline in headline consumer prices in October, the biggest decline since December 1982. In particular, gasoline prices fell 14.2 percent. Core CPI slipped 0.1 percent on the month with the year-over-year pace sliding substantially to 2.2 percent. The price of discretionary goods like motor vehicles, apparel, and personal computers all declined.

We expect consumer prices fell 1.3 percent in November. Core CPI should post a gain of 0.1 percent. Weak domestic demand and falling energy & commodity prices should pull down consumer inflation over the next few quarters. Growth prospects, not inflation, are the Fed's primary concern today.

Previous: -1.0% **Wachovia: -1.3%**

Consensus: -1.2%

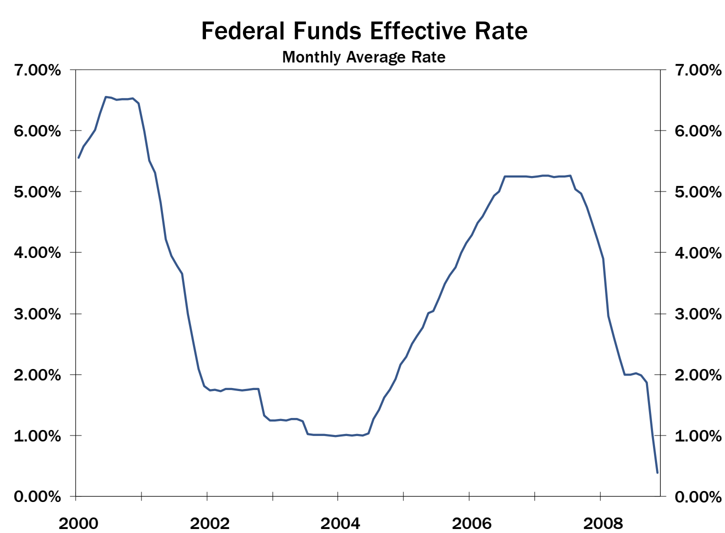
FOMC Rate Decision • Tuesday

The Federal Reserve will continue to try to tame the credit markets and sluggish domestic economic growth by cutting its target for the Fed Funds rate by at least 50 bps. Every major foreign economy is either already in recession or about to slip into one. In particular, real economic growth in the U.S. is expected to contract in the coming quarters with the fourth quarter posting the largest decline. 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.

Now that global growth is slowing sharply and inflation rates are receding, the Fed and other central banks have the green light to ease policy with a clear conscious.

Previous: 1.00% **Wachovia: 0.50%**

Consensus: 0.50%



Global Review

(Continued from Page 1)

global recession earlier this decade. Despite weakness in exports, the trade surplus widened because the value of imports tumbled nearly 18 percent, reflecting, at least in part, sharp declines in commodity prices over the past few months. (China imports commodities and exports finished goods.)

Speaking of lower prices, CPI inflation appears to be dead. As shown in the top chart, the overall rate of CPI inflation, which had risen to nearly nine percent earlier this year, tumbled to only 2.4 percent in November. Food prices, which were largely responsible for the earlier rise in CPI inflation, continue to soften. The sharp decline in inflation over the past few months gives the central bank, which has cut its benchmark lending rate nearly 200 basis points since mid-September, scope to ease further, probably cutting it below the lows of 2002-04 (see middle chart). Lower interest rates should help to support economic growth in China.

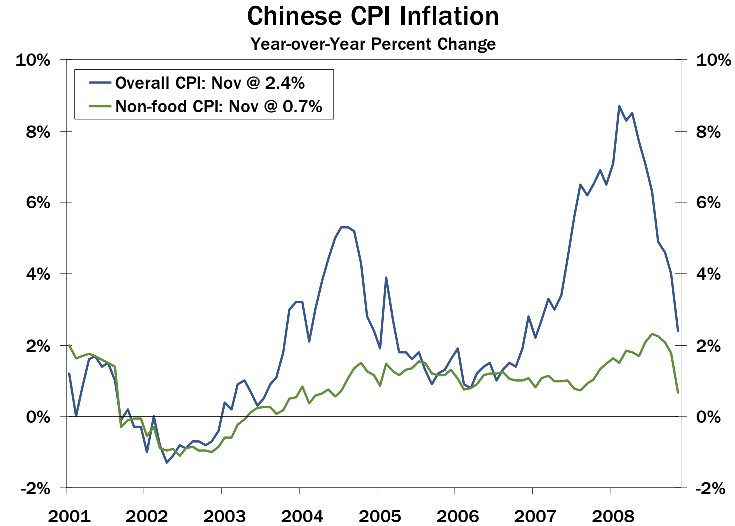
Despite the evident slowdown in export growth, consumer spending appears to be holding up reasonably well. As shown in the bottom chart, the year-over-year growth rate of retail sales edged down from 22.0 percent in October to 20.8 percent in November. Clearly, consumer spending is hardly falling apart in China at present. Moreover, the sharp drop in CPI inflation over the past few months implies that the growth rate of real consumer spending has likely remained solid.

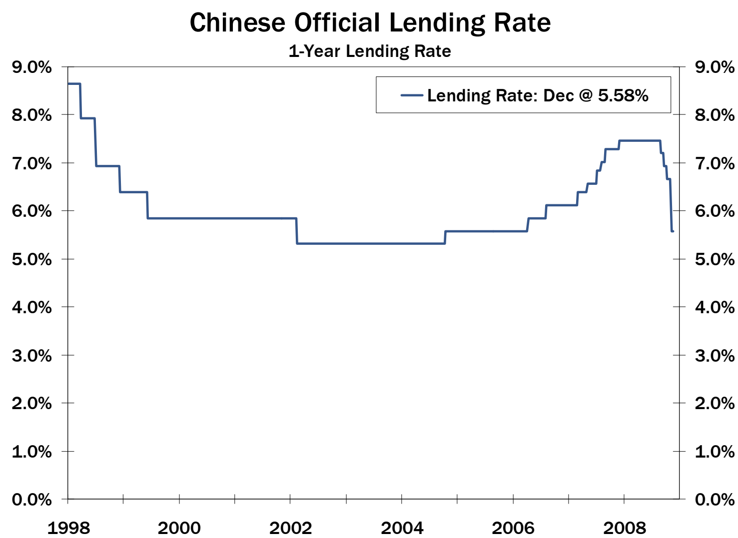
In sum, it appears that growth in China continues to slow. After rising to 12.6 percent in the second quarter of 2007, real GDP growth slowed to 9.0 percent (year-over-year basis) in the third quarter of this year and further slowing seems likely in the fourth quarter. Indeed, real GDP may have contracted somewhat between the third and fourth quarters on a seasonally adjusted basis.

However, income growth remains solid, which has helped to support consumer spending, and economic policies have turned stimulative. The Chinese government has announced plans to accelerate rebuilding in Sichuan province, which was devastated by the earthquake in May, and significant infrastructure spending in central and western China will help to support growth. As noted above, the central bank is easing. Although growth should slow further over the next few quarters the Chinese economy will probably not fall apart.

Selected Global Data

Japan	GDP Year-over-Year	Q3 - 2008	-0.5%
	CPI	October - 2008	1.7%
	Unemployment	October - 2008	3.7%
	BoJ Target Rate	Dec - 12	0.30%
Euro-Zone	GDP Year-over-Year	Q3 - 2008	0.6%
	CPI	October - 2008	3.2%
	Unemployment	October - 2008	7.7%
	ECB Target Rate	Dec - 12	2.50%
UK	GDP Year-over-Year	Q3 - 2008	0.3%
	CPI	October - 2008	4.5%
	Unemployment	October - 2008	3.0%
	BoE Target Rate	Dec - 12	2.00%
Canada	GDP Year-over-Year	September - 2008	0.0%
	CPI	October - 2008	2.6%
	Unemployment	November - 2008	6.3%
	BoC Target Rate	Dec - 12	1.50%





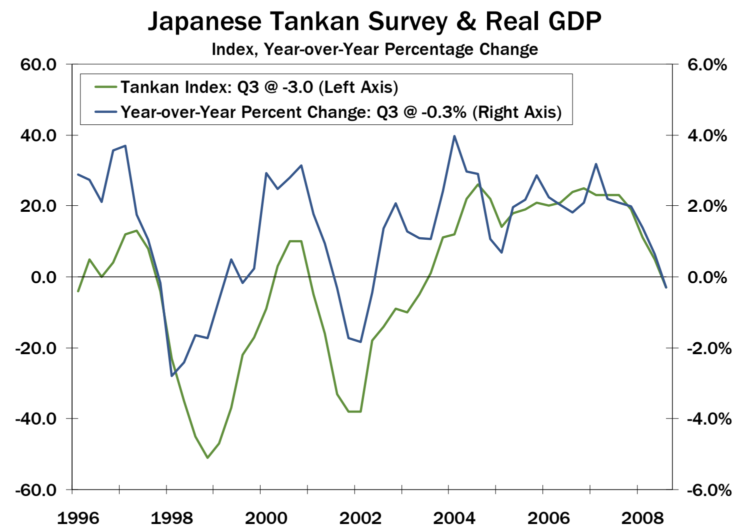
Japanese Tankan Index • Monday

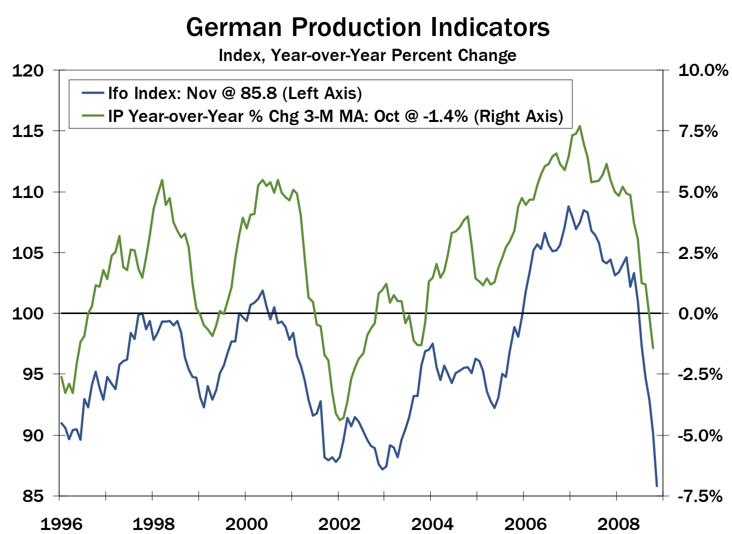
The Tankan survey of business sentiment is widely followed because it is highly correlated with Japanese GDP growth. The consensus forecast anticipates that the "headline" index will plunge from -3 in the third quarter to -23 in the fourth quarter. If realized, not only would the index fall to its lowest level since 2002 but it would be consistent with a large decline in real GDP in the fourth quarter. In our view, the Japanese economy will probably remain mired in recession for the next few quarters.

The Bank of Japan, which cut its main policy rate from 0.50 percent to 0.30 percent in late October, holds a policy meeting on Friday. The BoJ probably will remain on hold at this meeting, but we expect it to shave a few more basis points off of its main policy rate early next year.

Previous: -3

Consensus: -23





German Ifo Index• Thursday

The Ifo index of German business sentiment, which is highly correlated with industrial production growth, has fallen off a cliff recently. Indeed, the index fell in November to its lowest level since the deep recession of the early 1990s, and "hard" data show that IP weakened sharply in October. The consensus forecast anticipates that the index will decline again in December. However, the consensus also projects (hopes?) that the rate of decline will start to level out.

Final data on Euro-zone CPI inflation in November are slated for release on Wednesday. With a sharp economic downturn underway in the Euro-zone, investors probably won't pay as much attention to this number as they did a few months ago. Indeed, the "flash" estimate showed that the overall rate of CPI inflation dropped from 3.2 percent in October to only 2.1 percent in November.

Previous: 85.8

Consensus: 84.0

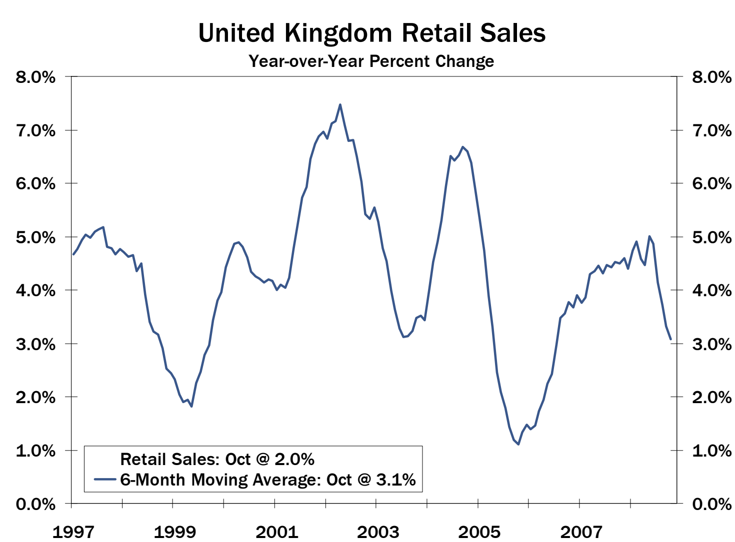
U.K. Retail Sales • Thursday

The British economy has slipped into its first recession since the early 1990s, and data that are slated for release next week will help investors estimate how badly the economy has slumped in the fourth quarter. The consensus forecast anticipates that the volume of retail sales fell 0.4 percent in November relative to the previous month. If realized, then consumer spending will be on pace to contract sharply in the fourth quarter.

The labor market report will be released on Wednesday. The unemployment rate has risen from 5.2 percent (ILO definition) in May to 5.8 percent currently. The market consensus forecast anticipates that it will rise to 6 percent. Data on CPI inflation, which will print on Tuesday, are expected to show the year-over-year rate falling from 4.5 percent in October to 3.9 percent in November.

Previous: -0.1% (month-on-month change)

Consensus: -0.4%

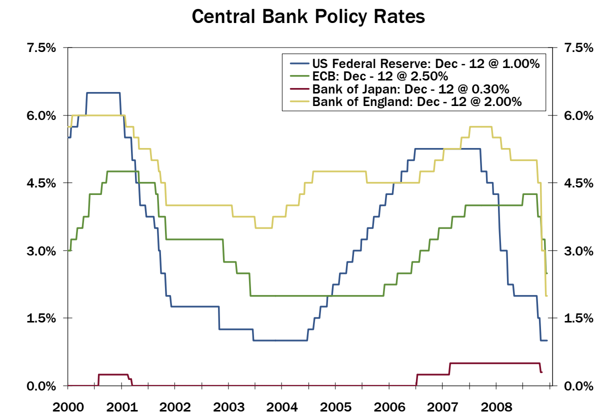


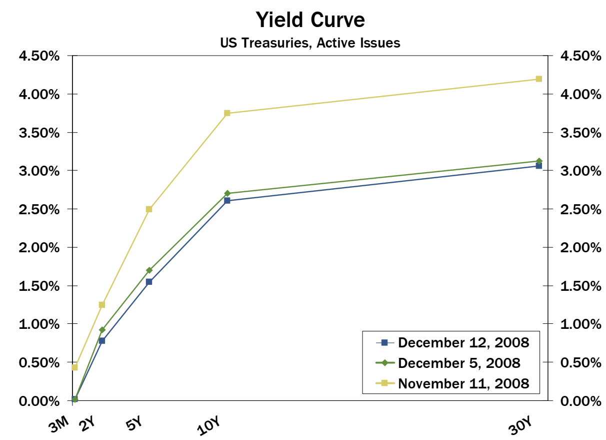
Interest Rate Watch

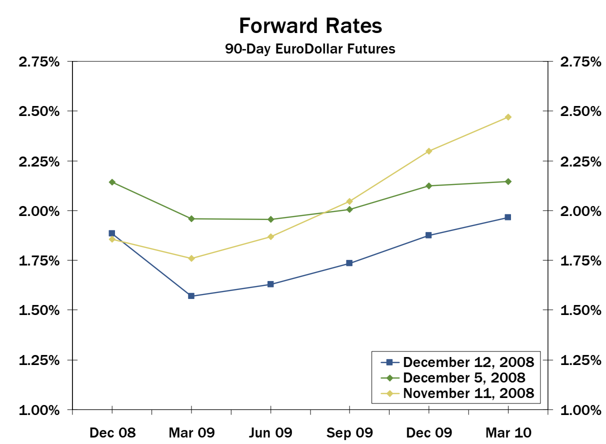
Annual Outlook: Credit and Rates

Within this week's release of our Annual Outlook we highlight the rising tide of credit restraint since the credit cycle began to correct in mid-2007. Increased restraint in credit lending practices will frame the character of America's credit cycle which, in turn, will dictate the pace and nature of the economic 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—particularly on durable goods and housing. On the supply side, the banking system must rebuild its capital base, which means it must sell stock and restrain lending. As a result, we expect that the Federal Reserve will maintain a low federal funds rate throughout next year. Yet, relative to the Fed benchmark rate, longer term rates will reflect credit quality and Treasury financing risks. Financing the federal deficit in a low economic growth environment will be increasingly challenging. Our annual outlook documents our expectation that the Federal deficit will range between $800 Billion to $1Trillion over the next two years. Over this period we do have the ten-year benchmark Treasury rate rising gradually over the same time period.

For the private sector, there has been a significant change in the willingness of investors to supply credit at the narrow credit spreads experienced during the 2002-2006 period. The question before us remains: how much will credit spreads adjust?







Topic of the Week

Partial Eclipse in the Lone Star State

Texas has held up better than much of the nation but it is still feeling the impact from the recession. Nonfarm employment growth has slowed substantially during recent months and the unemployment rate has increased. Home sales and residential construction have also stumbled, as tighter credit conditions have made it more difficult for would-be homebuyers to qualify for a home mortgage. Commercial construction has remained strong but sales of commercial properties have weakened considerably and the pipeline of new development projects is drying up. Even the energy business is taking some hits now that oil and gas prices have fallen.

While growth is slowing across the Lone Star state, at least there is growth. We estimate real gross domestic product by state grew at a 3.8 percent pace during the third quarter and increased 3.9 percent over the past year. Nationally, GDP fell at a 0.5 percent annual rate in the third quarter and increased just 0.8 percent over the past year. Employment increased 1.8 percent in Texas during the first ten months of this year but fell 0.9 percent nationwide.

Hiring is up across most major industry categories and most metro areas. The rate of job growth has clearly moderated, however, and we expect growth to slow further in coming months. Texas avoided many of the problems facing other parts of the country because of its heavy concentration in the energy sector and the absence of any major overbuilding in residential construction.

To see our full report, please go to our website www.wachovia.com/economics and look under "Regional Economics".

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 12/12/2008	1 Week Ago	1 Year Ago
3-Month T-Bill	0.01	0.01	2.86
3-Month LIBOR	1.92	2.19	5.06
1-Year Treasury	0.26	0.43	2.99
2-Year Treasury	0.84	0.92	3.13
5-Year Treasury	1.67	1.69	3.46
10-Year Treasury	2.70	2.70	4.09
30-Year Treasury	3.13	3.13	4.54
Bond Buyer Index	5.85	5.58	4.46

Foreign Exchange Rates

	Friday 12/12/2008	1 Week Ago	1 Year Ago
Euro ($/€)	1.334	1.272	1.471
British Pound ($/£)	1.493	1.469	2.047
British Pound (£/€)	0.894	0.866	0.719
Japanese Yen (¥/$)	91.260	92.835	112.243
Canadian Dollar (C$/$)	1.244	1.270	1.012
Swiss Franc (CHF/$)	1.180	1.220	1.135
Australian Dollar (US$/A$)	0.660	0.646	0.883
Mexican Peso (MXN/$)	13.460	13.597	10.841
Chinese Yuan (CNY/$)	6.843	6.881	7.375
Indian Rupee (INR/$)	48.578	49.600	39.365
Brazilian Real (BRL/$)	2.375	2.434	1.773
U.S. Dollar Index	83.743	87.121	76.144

Foreign Interest Rates

	Friday 12/12/2008	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	3.29	3.57	4.95
3-Month Sterling LIBOR	3.19	3.38	6.63
3-Month Canadian LIBOR	2.46	2.50	5.00
3-Month Yen LIBOR	0.94	0.95	1.04
2-Year German	2.27	2.05	4.01
2-Year U.K.	1.69	1.85	4.64
2-Year Canadian	1.52	1.56	3.80
2-Year Japanese	0.54	0.57	0.73
10-Year German	3.28	3.03	4.31
10-Year U.K.	3.60	3.42	4.80
10-Year Canadian	3.11	3.08	4.03
10-Year Japanese	1.40	1.38	1.52

Commodity Prices

	Friday 12/12/2008	1 Week Ago	1 Year Ago
W. Texas Crude ($/Barrel)	45.89	40.81	94.39
Gold ($/Ounce)	821.25	756.45	813.48
Hot-Rolled Steel ($/S.Ton)	660.00	770.00	520.00
Copper (¢/Pound)	141.90	135.50	301.60
Soybeans ($/Bushel)	8.42	7.86	11.03
Natural Gas ($/MMBTU)	5.51	5.74	7.41
Nickel ($/Metric Ton)	11,000	9,130	26,372
CRB Spot Inds.	320.50	333.56	477.82

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	15	16	17	18	19
U.S. Data	**Industrial Production** October 1.3% November -0.5% (W) **Capacity Utilization** October 76.4% November 75.3% (W)	**FOMC Rate Decision** Previous 1.00% Expected 0.50% (W) **CPI (MoM)** October -1.0% November -1.3% (W) **Housing Starts** October 791K November 650K (W)	**Current Account Balance** 2Q - $183.1B 3Q - $175B (W)	**Leading Indicators** October -0.8% November -0.4% (W)	
Global Data	**China** **Indus. Production (YoY)** Previous (Oct) 8.2% **Japan** **Tankan Lge Mfg Index** Previous (3Q) -3.0	**Canada** **Mfg Shipments (MoM)** Previous (Sep) 0.1% **UK** **CPI (YoY)** Previous (Oct) 4.5%	**UK** **ILO Unemployment Rate** Previous (Sep) 5.8%	**UK** **Retail Sales (MoM)** Previous (Oct) -0.1%	**Germany** **IFO - Business Climate** Previous (Nov) 85.8

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

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