

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

December 19, 2008

U.S. Review

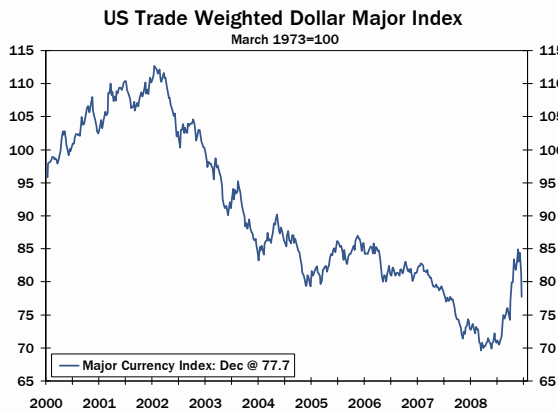
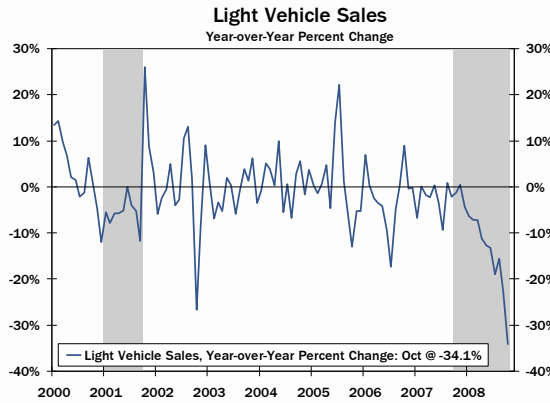
The TARP Rolls into Detroit

President Bush authorized the Treasury to loan the Big Three domestic automakers \$13.4 billion from the Troubled Asset Relief Program to carry them over into the new year. The bridge loan will forestall bankruptcy and allow the companies time to formulate a viable business plan to get a larger loan from either the government or the private sector.

While the President's move is certainly controversial, the use of the TARP money removes some of the immediate downside risk to the economy and forestalls the day of reckoning for at least a few months. The economy and financial markets may be in a better position to deal with bankruptcy or restructuring by then.

The Treasury's bridge loan may also bolster buyer confidence somewhat and give motor vehicle sales a slight, and we stress slight, boost early next year. The recent pace of motor vehicle sales has been below replacement demand and we expect sales to remain below an 11 million unit pace through the first half of 2009. The slow pace of sales will lead to huge production cuts in the first part of next year.

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Global Review

Dollar Gets Pummeled

Remember the dollar rally that started in July? It abruptly came to an end this week. At one point, the euro was up 10 percent versus the greenback before it gave up some of its gains at the end of the week. Moreover, the dollar was broadly beat up this week, (see graph at left) losing ground versus most major currencies and vis-à-vis the currencies of many developing countries.

What explains the dollar's depreciation this week - and will it continue? Let's start with the first part of that question. The catalyst for the dollar's move appears to be the decline in long-term U.S. interest rates that was reinforced by the Fed's policy decision on Tuesday. Not only did the FOMC slash its target for the fed funds rate to a range of 0 bps to 25 bps, but it essentially committed to keep it there "for some time." This commitment to keep short-term

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Recent Special Commentary

Date	Title	Authors
December-18	Inflation Chartbook - December 2008	Vitner, York & Whelan
December-16	Global Chartbook - December 2008	Bryson & Quinlan
December-16	Commercial Real Estate Quarterly: 3rd Quarter	Vitner & Khan
December-11	Housing Chartbook - December 2008	Vitner & York

U.S. Forecast

	Actual				Forecast				Actual			Forecast		
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2005	2006	2007	2008	2009	2010
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

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U.S. Review

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Look for Real GDP to Drop at a Six Percent Pace in the 4th Qtr

Our current forecast has real GDP declining at a six percent annual rate during the fourth quarter and we have output falling at a 3.4 percent pace in the first quarter of next year. Two of the biggest swing variables in our outlook are international trade and inventories. The trade data will subtract between one and two percentage points from fourth quarter real GDP growth because imports have risen sharply and exports have fallen. The rise in imports is mostly petroleum and related products, much of which was shut out of the market in September when hurricanes forced many port facilities, refineries and chemical plants to close. Imports will likely fall back in November and December but not enough to prevent a widening in the trade gap.

While the wider trade deficit will cut into our already weak economic forecast for the fourth quarter, part of the damage will be offset by higher inventories. Inventories are expected to decline during the fourth quarter as manufacturers scale back production and retailers slash prices to sell off merchandise and raise cash. The largest declines in inventories are likely to occur in the first quarter, however, as production is cut back much more severely. The abruptness and depth of the current economic weakness caught many producers, wholesalers and retailers by surprise. As a result, many have far too much raw material, work-in-process, and finished product.

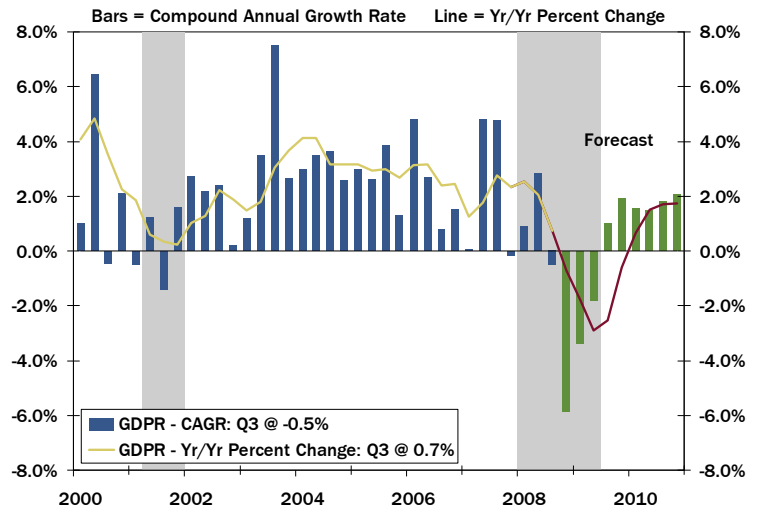
One benefit of having too much inventory and excess productive capacity is that prices are falling. The Consumer Price Index fell 1.7 percent in November, following a 1.0 percent drop in October. Excluding food and energy items, the CPI was unchanged in November following a 0.1 percent drop in October. While falling energy prices account for much of the improvement in the inflation figures, prices for several other items, including cars, clothing and assorted other household items are also falling. Moreover, with housing in obvious oversupply, the inflation figures will remain low and may even decline for a short period of time.

Housing starts plunged 18.9 percent in November to a 625,000 unit pace. Single-family starts fell 16.9 percent and multi-family starts declined 23.3 percent. Builders are having a very tough time getting credit and have been forced to cut development below even what the current depressed level of sales would justify. Permits also declined sharply in the month and remain just below starts. We expect housing starts to fall further in coming months and possibly bottom out in the first half of 2009. The bottom, however, is much lower many people expected only a few months ago.

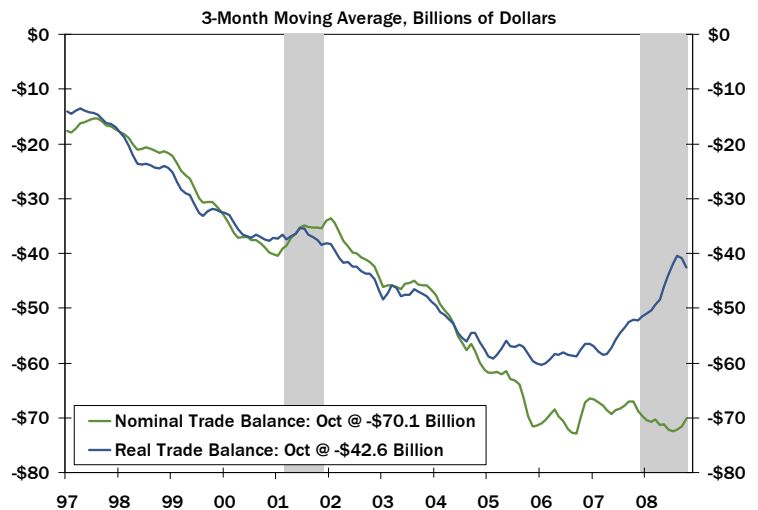
Selected Current Data

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	November - 2008	1.1%
"Core" CPI	November - 2008	2.0%
"Core" PCE Deflator	October - 2008	2.1%
Industrial Production	November - 2008	-5.5%
Unemployment	November - 2008	6.7%
Federal Funds Target Rate	Dec - 19	0.25%

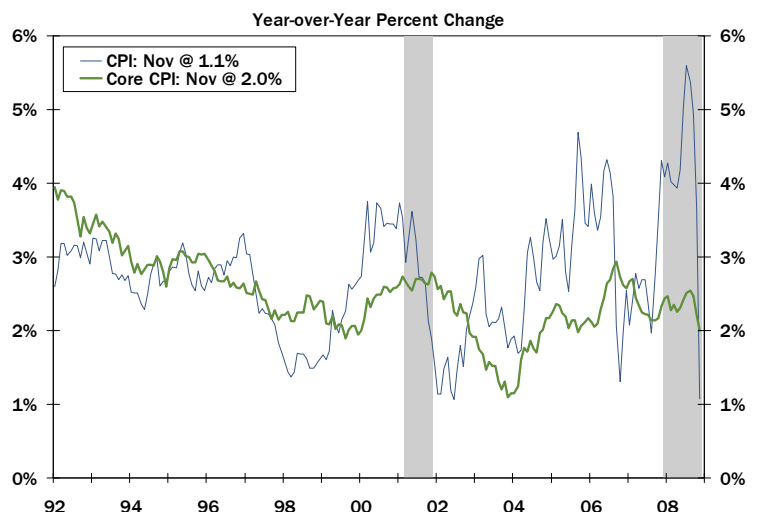
Real GDP



Trade Balance in Goods



CPI vs. Core CPI



Existing Home Sales • Tuesday

Sales of existing homes fell 3.1 percent in October. Prices continued to tumble, with the median price of an existing home plunging a record 11.3 percent over the past year. The for-sale inventory dropped, but not as much as sales. As a result, the months supply rose to 10.2 months. The National Association of Realtors notes that the sales figures were bolstered by foreclosure sales, which they estimate accounted for 45 percent of October's total. The continued large proportion of sales accounted for by foreclosures means that housing has still not found a bottom.

We expect sales to fall 1.4 percent in November to an annualized rate of 4.91 million units. The next few months will be challenged by weather conditions, which often cause the seasonally adjusted figures to swing widely in the winter months. That said, we expect home sales to find a bottom late this winter or early in the spring.

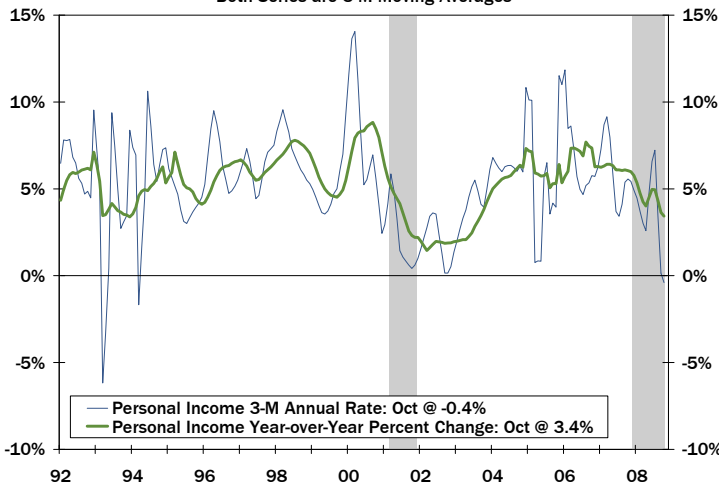
Previous: 4.98M

Wachovia: 4.91M

Consensus: 4.93M

Personal Income

Both Series are 3-M Moving Averages


Durable Goods • Wednesday

Advance durable goods orders for the month of October plunged 6.2 percent as sharp declines in aircraft and defense contributed to the weakness. Excluding the transportation sector, orders were down 4.4 percent. Non-defense capital goods ex-aircraft orders, which is a good proxy for business equipment & software spending, fell 4.0 percent and is down an annualized 18.5 percent over the past three months. Orders will continue to retrench as spending plans readjust.

Driven by slowing business and consumer demand, orders for durable goods should fall 0.1 percent in November. Vehicles and parts should continue to post significant declines. With corporate profits weakening and credit conditions exceptionally tight, business fixed investment should decline in the coming quarters.

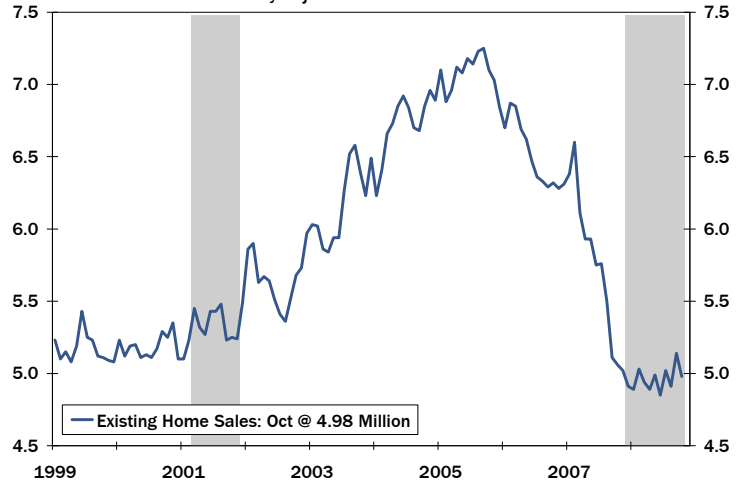
Previous: -6.2%

Wachovia: -0.1%

Consensus: -3.0%

Existing Home Resales

Seasonally Adjusted Annual Rate - In Millions


Personal Income • Wednesday

Personal income rose 0.3 percent in October, despite a rapidly weakening labor market. While income held up, spending virtually plummeted, declining 1.0 percent on the month, the largest decline since the aftermath of September 11th. Real spending fell for the fifth straight month.

We expect personal income will fall 0.2 percent in November as the job market remains weak. Total jobs losses have reached nearly two million since the onset of the current downturn and are probably only half way through the declines. By the end of this recession the U.S. economy will have shed more than four million jobs a number that will rival the most severe recessions in the post-war era. Personal spending should also decline by 0.7 percent - the fifth straight monthly decline - as consumers continue to pull back on making purchases in the face of weaker economic growth and less access to credit.

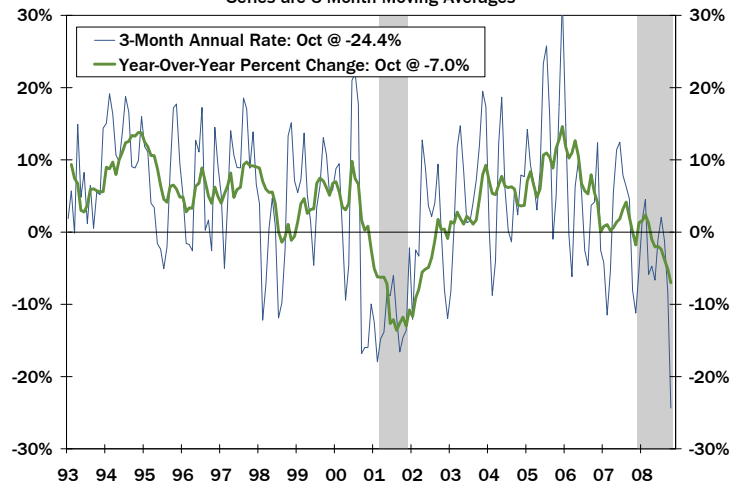
Previous: 0.3%

Wachovia: -0.2%

Consensus: 0.0%

Durable Goods New Orders

Series are 3-Month Moving Averages



Global Review

(Continued from Page 1)

interest rates at exceptionally low levels for the foreseeable future helped to fuel the rally in the Treasury market this week. (See the table of yields on page 7.). Although government bond yields in other countries have declined as well, they have not fallen to the same extent as U.S. Treasury yields. The decline in U.S. yields relative to those abroad has reduced the relative attractiveness of U.S. assets, which contributed to the dollar's decline this week.

Other than riskless Treasury securities, foreign investors are generally shying away from U.S. assets at present. Indeed, foreign investors were net sellers of non-Treasury securities to the tune of nearly \$100 billion in the third quarter (see top graph). If yields on Treasury securities are dropping rapidly and you're not interested in buying anything else due to concerns about credit risk, what's left to buy? Although the current account deficit is starting to narrow (see middle chart), fewer purchases of U.S. assets by foreign investors leads to dollar depreciation.

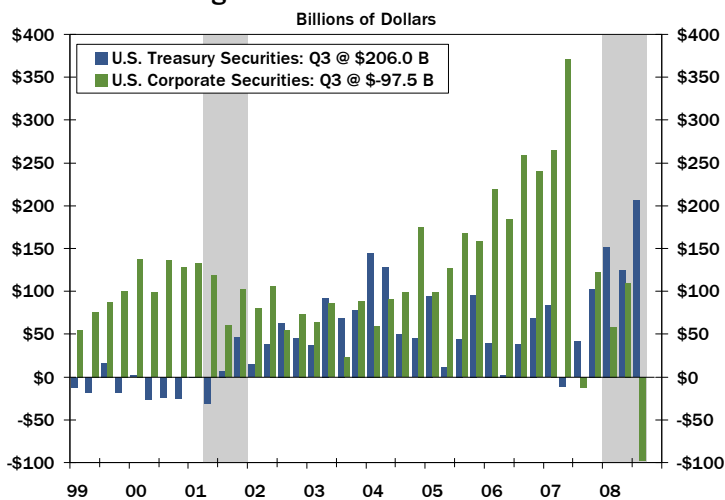
Now for the second question: will the dollar's decline continue? Currency markets are very volatile now and anything could happen in the near-term. Looking further ahead, however, we believe the dollar will regain its footing and trend higher versus most currencies. For starters, the current account deficit should continue to narrow due to the collapse in the price of oil and the sharp downturn in U.S. domestic demand that will lead to further declines in imports. The shrinking current account will exert fewer headwinds on the greenback.

In addition, interest rate differentials will probably become less unfavorable for the dollar. The Fed is now done cutting rates, but we believe that both the Bank of England the European Central Bank have 100 bps to 150 bps of further rate cuts to go. Within a few months, yields on U.S. Treasury securities won't look as bad relative to their foreign counterparts. Moreover, yields on non-Treasury securities have risen significantly, not only in absolute terms but relative to yields on U.S. Treasury securities as well (see bottom chart). Once the economy shows signs of leveling out, investors, both domestic and foreign, will likely become very interested in the yields that high quality corporate bonds offer. In our view, increased capital inflows from foreign investors should cause the dollar to eventually resume its upward trend.

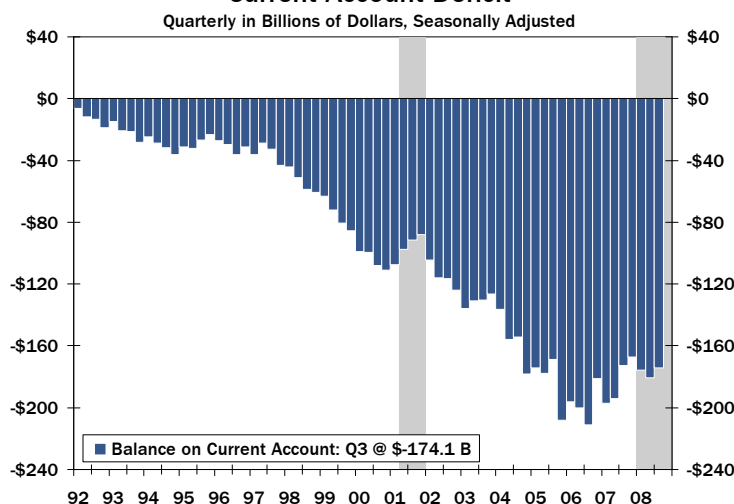
Selected Global Data

Japan	GDP Year-over-Year	Q3 - 2008	-0.5%
	CPI	October - 2008	1.7%
	Unemployment	October - 2008	3.7%
	BoJ Target Rate	Dec - 19	0.10%
Euro-Zone	GDP Year-over-Year	Q3 - 2008	0.6%
	CPI	November - 2008	2.1%
	Unemployment	October - 2008	7.7%
	ECB Target Rate	Dec - 19	2.50%
UK	GDP Year-over-Year	Q3 - 2008	0.3%
	CPI	November - 2008	4.1%
	Unemployment	November - 2008	3.3%
	BoE Target Rate	Dec - 19	2.00%
Canada	GDP Year-over-Year	September - 2008	0.0%
	CPI	November - 2008	2.0%
	Unemployment	November - 2008	6.3%
	BoC Target Rate	Dec - 19	1.50%

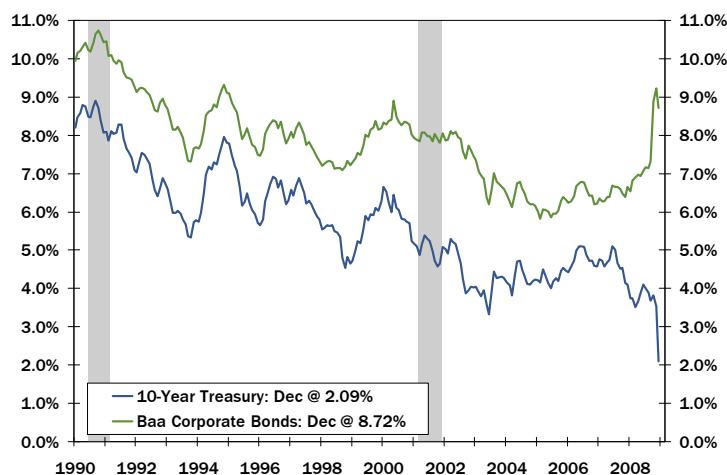
Foreign Purchase of U.S. Securities



Current Account Deficit



10-Yr Treasury and BAA Corporate Bond Yield



U.K. GDP • Tuesday

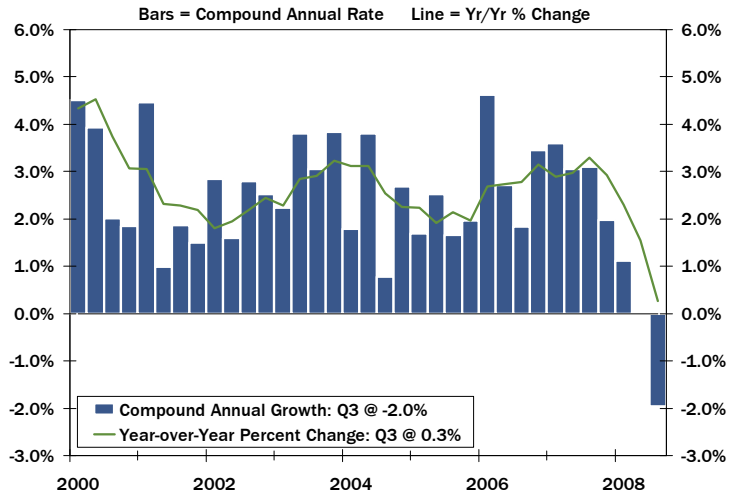
The final estimate of U.K. GDP growth in the third quarter will be released on Tuesday. Previously released data showed that real GDP dropped at an annualized rate of 2.0 percent in the third quarter relative to the previous quarter, the first contraction in the U.K. economy since 1992. Although a significant change in the overall growth rate is not expected, revised data on some of the underlying demand components could impart some information on prospects for the economy in the current quarter.

Data on the current account deficit in the third quarter and home loans in November are also on the docket. However, British financial markets likely will be relatively quiet next week as market participants hunker down for the holidays.

Previous: -2.0% (annualized sequential growth rate)

Consensus: -2.0%

U.K. Real GDP



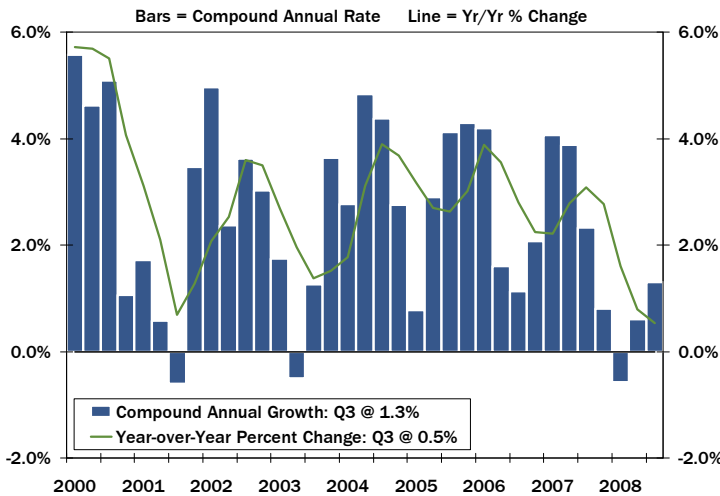
Canadian GDP • Wednesday

Canada is the only major country to release GDP data on a monthly basis. (Every other major economy releases GDP data on a quarterly basis.) The Canadian economy grew at an annualized pace of 1.3 percent in the third quarter, but the consensus forecast anticipates that real GDP edged down 0.2 percent in October relative to the previous month. Indeed, we project that Canadian GDP will decline nearly 3 percent (annualized rate) in the fourth quarter, ushering in the first recession in the Great White North since 1990.

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

Consensus: -0.2%

Canadian Real GDP



Japanese Industrial Production • Friday

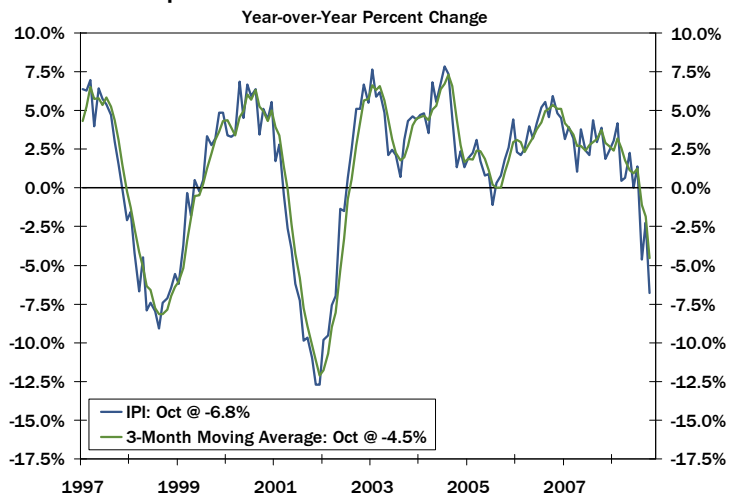
A slew of Japanese economic data for November will be released on Friday that will give investors a better idea of how the Japanese economy is faring in the fourth quarter. Unfortunately, the current quarter got off to a very weak start, which sets the stage for another quarter of negative GDP growth, as industrial production tumbled 3.1 percent in October relative to the previous month. Moreover, the consensus forecast anticipates that IP plunged nearly 7 percent in November relative to the previous month.

However, industrial production is not the only release on the docket. Data on housing starts, the labor market, and retail sales are also slated to print next week. The November CPI will also be released, but inflation has taken a back seat to data on real economic activity due to the slump in the Japanese economy.

Previous: -3.1% (month-on-month change)

Consensus: -6.8%

Japanese Industrial Production Index



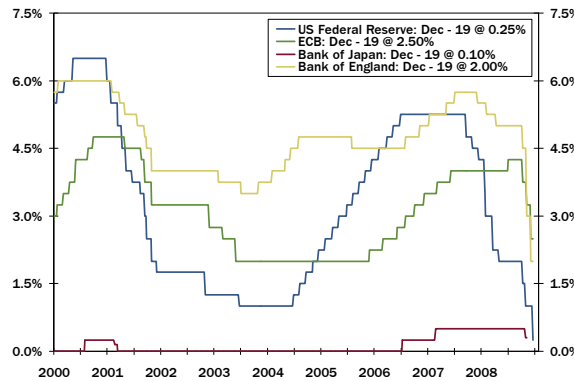
Interest Rate Watch
Fed Policy As Base for Interest Rates

With easing of Fed policy this week, we witnessed a shift in interest rate expectations as well. First, as the FOMC lowered the funds rate target they also suggested that the “exceptionally low levels of the federal funds rate” will remain in place for “some time” given the “weak economic conditions.” Our outlook is for the funds rate to remain at or below 25 basis points for all of 2009. We also expect that the three-month LIBOR rate will decline during next year to end the year at below one percent.

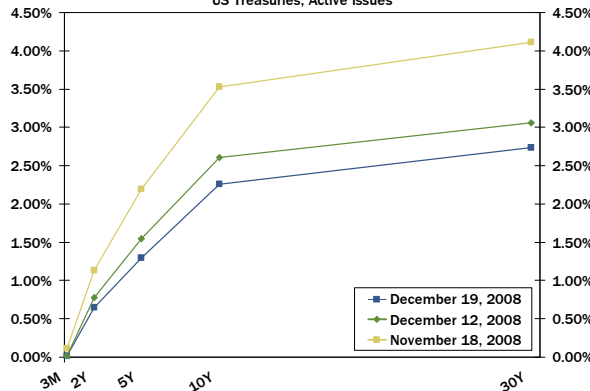
In addition, the Fed held out hope at the longer end of the curve and for private market instruments. The Fed will “employ all available tools to promote the resumption of sustainable growth and to preserve price stability.” Effectively, the Fed is committing to a continued expansion of its balance sheet to support financial markets and the U.S. economy. This balance sheet expansion will reflect Fed purchases of agency as well as mortgage-backed securities.

For the outlook this suggests that mortgage rates will come down and will remain at or slightly below five percent. This will provide some basis for a recovery in housing starts, even if only modest, in the second half of next year.

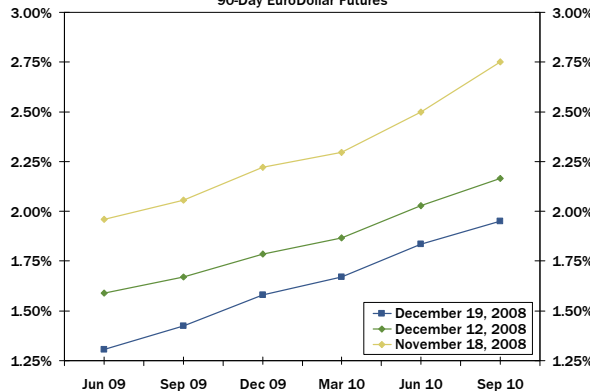
Over the long-run, however, we are very cautious on the current extent and duration of policy ease. We remain concerned about the impact on the dollar’s exchange value as well as inflation expectations. Given the current criticism of the easy money regime of the 2002-2005 period we believe decision-makers need to recognize the Fed’s need to pull the punch bowl away before the party gets too exciting.

Central Bank Policy Rates

Yield Curve

US Treasuries, Active Issues


Forward Rates

90-Day EuroDollar Futures


Topic of the Week
Nasty Global Recession is Underway

Global economic growth averaged nearly 5 percent per annum between 2004 and 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 most major economies have now slipped into recession due in part to the effects of the global credit crunch. We project global GDP will expand less than 1 percent in 2009, the slowest year for global growth since 1982. Although steps announced by governments over the past month or so appear to be leading to a gradual relaxation of financial market tension, credit markets remain very fragile. Underlying all of our projections is our 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. Recessions appear to be underway in other major economies as well. Real GDP in the United Kingdom fell at an annualized rate of 2.0 percent in the third quarter, the first drop since 1992. Unfortunately, further declines in British GDP over the next few quarters appear certain. Japanese growth turned negative recently, and the Euro-zone economy has also contracted for two consecutive quarters. 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.

For more details on our global economic outlook, read our December [Global Chartbook](#).

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

	Friday 12/19/2008	1 Week Ago	1 Year Ago
3-Month T-Bill	0.00	0.01	2.89
3-Month LIBOR	1.50	1.92	4.91
1-Year Treasury	0.11	0.26	3.24
2-Year Treasury	0.75	0.76	3.10
5-Year Treasury	1.34	1.51	3.43
10-Year Treasury	2.10	2.57	4.03
30-Year Treasury	2.54	3.04	4.45
Bond Buyer Index	5.46	5.85	4.39

Foreign Interest Rates

	Friday 12/19/2008	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	3.11	3.33	4.85
3-Month Sterling LIBOR	2.98	3.19	6.21
3-Month Canadian LIBOR	2.30	2.46	4.95
3-Month Yen LIBOR	0.90	0.94	0.97
2-Year German	1.83	2.25	3.99
2-Year U.K.	1.27	1.72	4.53
2-Year Canadian	1.25	1.49	3.78
2-Year Japanese	0.43	0.54	0.72
10-Year German	3.01	3.30	4.28
10-Year U.K.	3.17	3.60	4.68
10-Year Canadian	2.78	3.09	3.99
10-Year Japanese	1.24	1.40	1.50

Foreign Exchange Rates

	Friday 12/19/2008	1 Week Ago	1 Year Ago
Euro (\$/€)	1.386	1.337	1.438
British Pound (\$/£)	1.485	1.495	1.998
British Pound (£/€)	0.933	0.894	0.720
Japanese Yen (¥/\$)	89.595	91.155	113.425
Canadian Dollar (C\$/ \$)	1.231	1.248	1.002
Swiss Franc (CHF/\$)	1.111	1.177	1.155
Australian Dollar (US\$/A\$)	0.678	0.664	0.859
Mexican Peso (MXN/\$)	13.121	13.583	10.840
Chinese Yuan (CNY/\$)	6.836	6.845	7.377
Indian Rupee (INR/\$)	47.255	48.453	39.566
Brazilian Real (BRL/\$)	2.380	2.365	1.799
U.S. Dollar Index	81.545	83.644	77.587

Commodity Prices

	Friday 12/19/2008	1 Week Ago	1 Year Ago
W. Texas Crude (\$/Barrel)	35.20	46.28	91.24
Gold (\$/Ounce)	837.45	822.35	802.19
Hot-Rolled Steel (\$/S.Ton)	550.00	660.00	520.00
Copper (¢/Pound)	130.00	140.60	294.55
Soybeans (\$/Bushel)	8.57	8.42	11.12
Natural Gas (\$/MMBTU)	5.60	5.49	7.18
Nickel (\$/Metric Ton)	9,658	11,000	25,615
CRB Spot Inds.	322.51	321.48	472.14

Next Week's Economic Calendar

	Monday 22	Tuesday 23	Wednesday 24	Thursday 25	Friday 26
U.S. Data		GDP Annualized 2Q 2.8% 3Q -0.5% (W) New Home Sales October 433K November 410K (W) Existing Home Sales October 4.98M November 4.91M (W)	Personal Income October 0.3% November -0.2% (W) Personal Spending October -1.0% November -0.7% (W) Durable Goods Orders October -6.9% November -0.1% (W)	Christmas Day U.S. Markets Closed	
Global Data		UK GDP Annualized Previous (3Q) -2.0%	Canada GDP (MoM) Previous (Sep) 0.1%		Japan Jobless Rate Previous (Oct) 3.7% Japan Indus. Production (MoM) Previous (Oct) -3.1%

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

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