WACHOVIA ECONOMICS GROUP

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

February 20, 2009

U.S. Review

Is There A Silver Lining?

This week saw another run of rotten economic news. Housing starts plummeted, industrial production fell sharply, the Philadelphia Fed index hit its lowest level in more than 18 years, and first-time unemployment claims increased. Even the Fed minutes had a weaker tone. With this much crummy news, we wonder if there is a silver lining somewhere.

An apparent bright spot was a rise in the index of leading economic indicators. Though January marks the second consecutive monthly rise for the LEI, it does not likely mark a turn. Most of the improvement in recent months has come from the money supply and interest rate spread. Consumer expectations also improved in January. Expectations turned back down in February, however, and many other indicators also look like they will decline this month as well.

The January price data are both good and bad news. Both rose more than expected in January. Larger-than-expected rises in both indices would normally be bad news. But with so many folks worried about deflation, a little more heat in the PPI and CPI is not all that bad.

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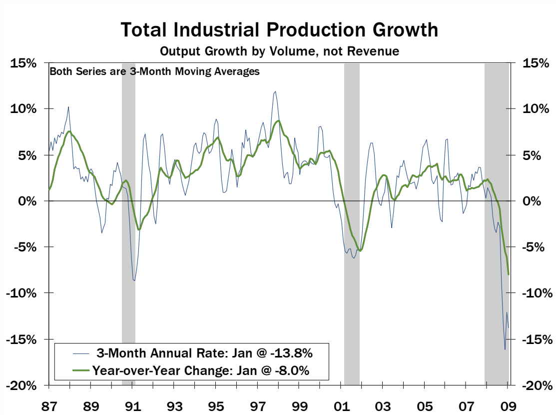

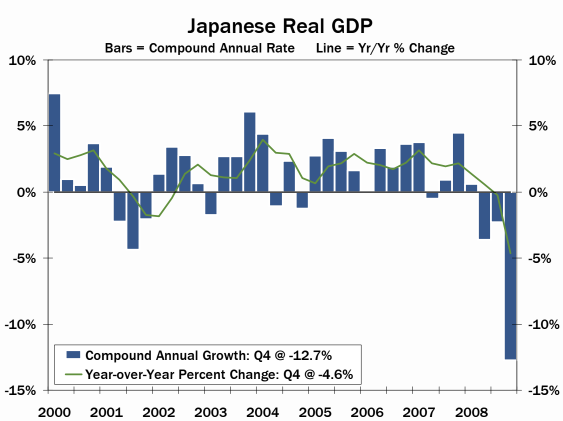

Global Review

Global GDP Tanked Last Quarter

GDP data for foreign economies have trickled in over the past few weeks, and the outturns have been universally bad. As we reported previously, the British and the Euro-zone economies each contracted roughly six percent (annualized rate) in the fourth quarter. It was Asia's turn this week and the news was even worse. As shown in the chart at the left, real GDP in Japan plunged at an annualized rate of 12.7 percent. Moreover, the 4.6 percent year-over-over contraction in Japanese GDP in the fourth quarter was the sharpest decline since records began in 1955. Japan appears to be in its worst downturn since the end of the Second World War.

The sharp drop in Japanese economic activity in the fourth quarter was due at least in part to the eye-popping 45 percent decline in exports. Japan is an important supplier of capital goods to the rest

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Recent Special Commentary

Date	Title	Authors
February-12	Global Chartbook - February 2009	Bryson & Quinlan
February-12	Housing Chartbook - February 2009	Vitner & York
February-10	Five Key Questions for Decision-Makers	Silvia
February-04	Economic Downturn Challenges State and Local Tax Revenue	Vitner & Khan

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	-3.8	-6.7	-1.9	-0.4	0.6	2.9	2.8	2.0	1.3	-2.7	1.1
Personal Consumption	0.9	1.2	-3.8	-3.5	-2.9	-0.4	0.1	1.1	3.0	3.0	2.8	0.3	-1.8	1.0
Inflation Indicators [2]														
"Core" PCE Deflator	2.2	2.3	2.3	1.8	1.4	1.2	0.9	1.2	2.1	2.3	2.2	2.2	1.2	1.6
Consumer Price Index	4.2	4.3	5.3	1.5	-0.3	-1.3	-2.6	0.1	3.4	3.2	2.9	3.8	-1.1	1.7
Industrial Production [1]	0.4	-3.4	-8.9	-11.5	-14.5	-7.2	-2.5	0.4	3.3	2.2	1.7	-1.7	-8.9	0.6
Corporate Profits Before Taxes [2]	-1.5	-8.3	-9.2	-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	79.4	85.6	89.3	91.3	90.9	86.0	81.5	73.3	79.4	90.9	78.7
Unemployment Rate	4.9	5.4	6.1	6.9	7.7	8.3	8.9	9.3	5.1	4.6	4.6	5.8	8.6	9.6
Housing Starts [4]	1.05	1.03	0.88	0.66	0.47	0.51	0.57	0.61	2.07	1.81	1.34	0.90	0.54	0.77
Quarter-End Interest Rates														
Federal Funds Target Rate	2.25	2.00	2.00	0.25	0.25	0.25	0.25	0.25	4.25	5.25	4.25	0.25	0.25	0.50
10 Year Note	3.45	3.99	3.85	2.25	3.00	3.10	3.10	3.10	4.39	4.71	4.04	2.25	3.10	3.50

Data As of: February 11, 2009
[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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Neither Deflation Nor Inflation Will Be A Problem In 2009

January's slightly larger-than-expected rise in the PPI and CPI does not impact our inflation outlook at all. The PPI for total finished goods rose 0.8 percent in January and prices excluding food and energy rose 0.4 percent. Most of the increase in the headline index was due to sharply higher gasoline prices, which rose 15 percent in January, following twenty percent plus plunges in each of the three previous months. The bounce back in energy prices is not that surprising given how sharply they declined last fall. Energy prices are expected to remain low for the foreseeable future, which should lead to further declines in the year-to-year PPI figures.

Prices outside the energy sector also perked up a bit, with wholesale prices for consumer goods rising 1.0 percent. Here too, prices had declined for some time and a bounce back is not totally unexpected. Consumer goods prices fell 2.5 percent in December and were down 3.2 percent in November. Even with January's increase, prices are down at a startling 17.7 percent annual rate over the past three months. Moreover, prices continue to tumble further back in the production pipeline. Prices for intermediate goods and services fell 0.7 percent in January and are down at a 31.5 percent annual rate over the past three months. Core intermediate goods prices, which have historically shown the strongest relationship to the CPI, fell 1.1 percent in January and are down at a 22.2 percent pace over the past three months.

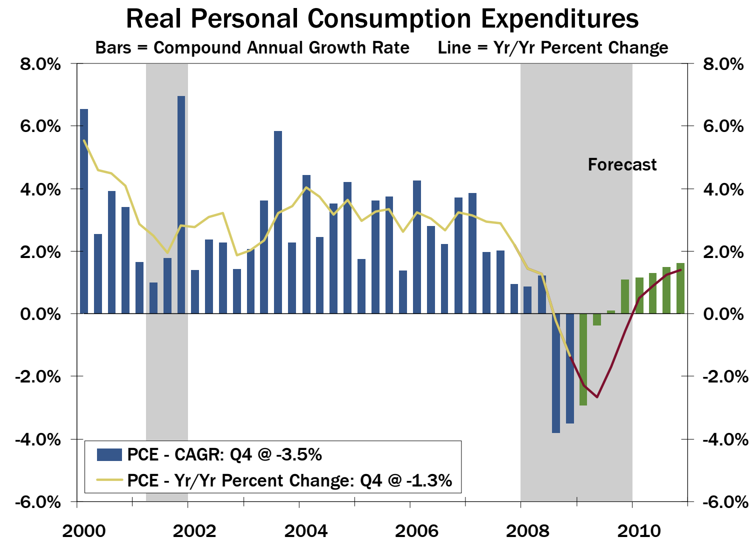
The Consumer Price Index rose 0.3 percent in January, which was right in line with expectations. As with the PPI, rising gasoline prices accounted for most of the increase. Prices excluding food and energy items rose a larger-than-expected 0.2 percent. The increase was broad based but once again, most of the categories posting increases had been down sharply in recent months.

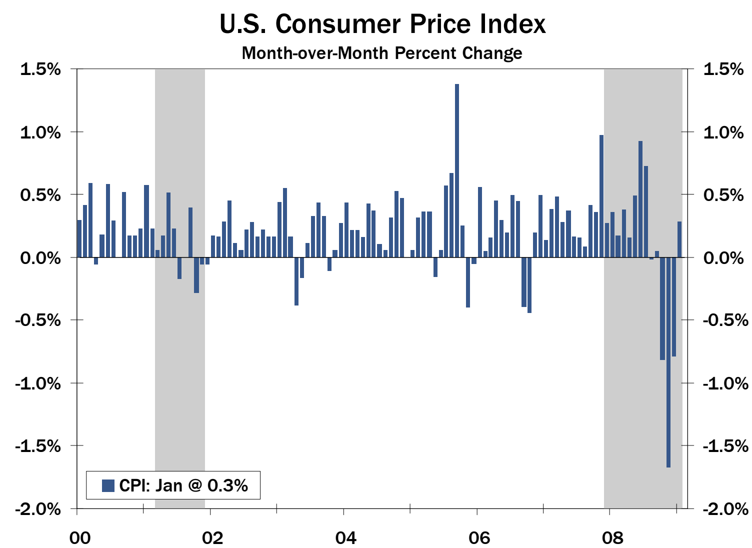
Rent of primary residence and owners' equivalent rent both rose 0.3 percent. The increases seem to fly in the face of the obvious oversupply of housing present throughout the country. The Census Bureau's quarterly survey shows rental vacancy rates at 10.1 percent nationwide. High and rising vacancy rates, along with growing competition from single-family homes and condominiums now being put out for rent, should be driving rents lower.

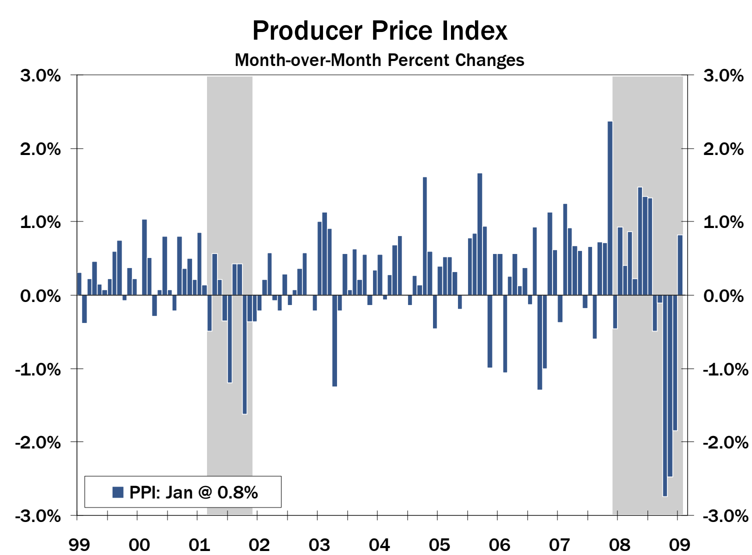
January's rise in rent of primary residence may be a statistical fluke. Many rental agreements include utilities. Since rents are usually fixed for one year terms, a drop in utility costs actually raises the computed rent. This seems to have been the case in January, when prices for fuel oil and other fuels declined 2.7 percent and prices for gas and electricity declined 0.8 percent.

Selected Current Data

Gross Domestic Product - CAGR	Q4 - 2008	-3.8%
GDP Year-over-Year	Q4 - 2008	-0.2%
Personal Consumption	Q4 - 2008	-3.5%
Business Fixed Investment	Q4 - 2008	-19.1%
Consumer Price Index	January - 2009	0.0%
"Core" CPI	January - 2009	1.7%
"Core" PCE Deflator	December - 2008	1.7%
Industrial Production	January - 2009	-10.0%
Unemployment	January - 2009	7.6%
Federal Funds Target Rate	Feb - 20	0.25%







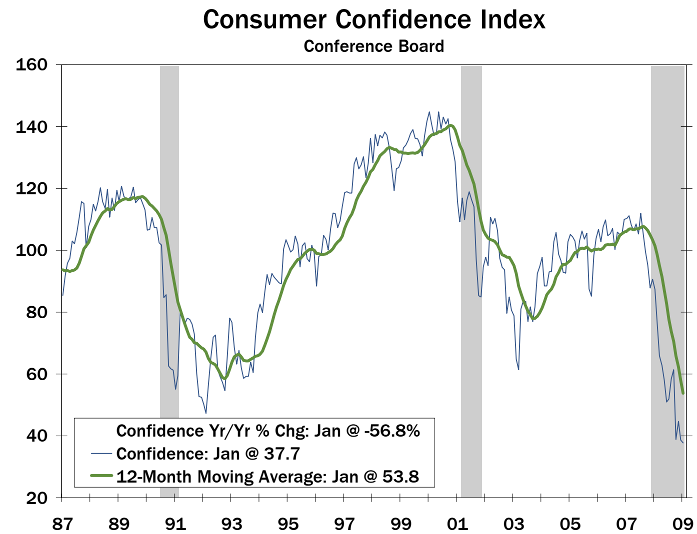
Consumer Confidence • Tuesday

Consumer confidence, as measured by the Conference Board, fell to a new all-time low for the third time in four months. Consumers are grappling with rising unemployment, plunging home prices and a continued credit crunch.

This particular measure of consumer confidence has historically had a significant correlation with the health of the labor market. Employment losses have deepened considerably in recent months, and total job losses are now over 3.5 million since employment peak in December 2007. We expect deterioration in the labor market to continue with the unemployment rate topping out above 9.5 percent in 2010. Given that the labor market will remain severely challenged for all of 2009, we expect consumer confidence will remain depressed for the foreseeable future. This will put considerable downward pressure on economic growth prospects.

Previous: 37.7 **Wachovia: 31.2**

Consensus: 36.0



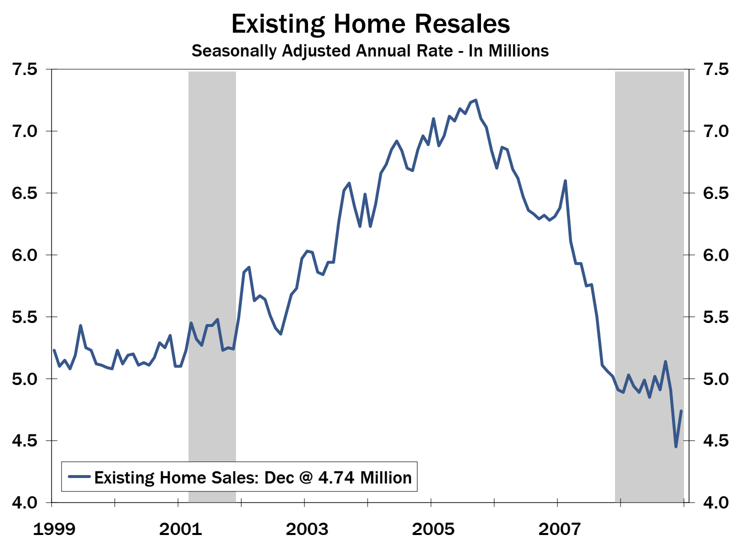
Existing Home Sales • Wednesday

Existing home sales ended 2008 on an upswing, 6.5 percent higher in December. While sales moved higher, they still remained below the range that had held for more than a year through October. The National Association of Realtors noted that the sales figures continued to be bolstered by foreclosure sales, which they estimate accounted for 45 percent of December's total.

Existing homes sales should slip to a 4.60 million annual pace in January. Sales may be volatile in coming months as foreclosure mitigation programs gain a foothold. With nearly half of all sales being driven by foreclosure activity, median prices will likely be pushed lower for the seventh consecutive month.

Previous: 4.74M **Wachovia: 4.60M**

Consensus: 4.81M



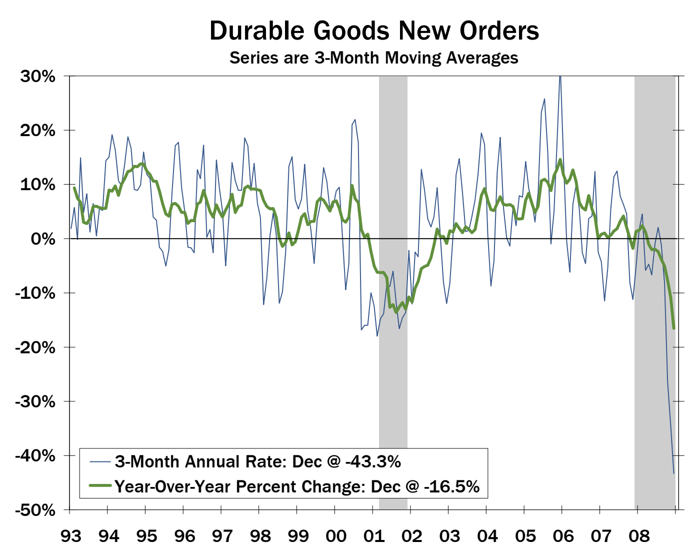
Durable Goods • Thursday

Durable goods orders for the month of December fell 2.6 percent. It was the fourth decline in five months, and orders were led lower by significant declines in computer & electronics products and primary metals. Businesses are cutting back drastically to survive the recession.

Driven by slowing business and consumer demand, orders for durable goods could fall 7.8 percent in January. Vehicles and parts will likely continue to post significant declines. With corporate profits weakening and credit conditions exceptionally tight, business fixed investment will decline in the coming quarters.

Previous: -2.6% **Wachovia: -7.8%**

Consensus: -2.3%



Global Review

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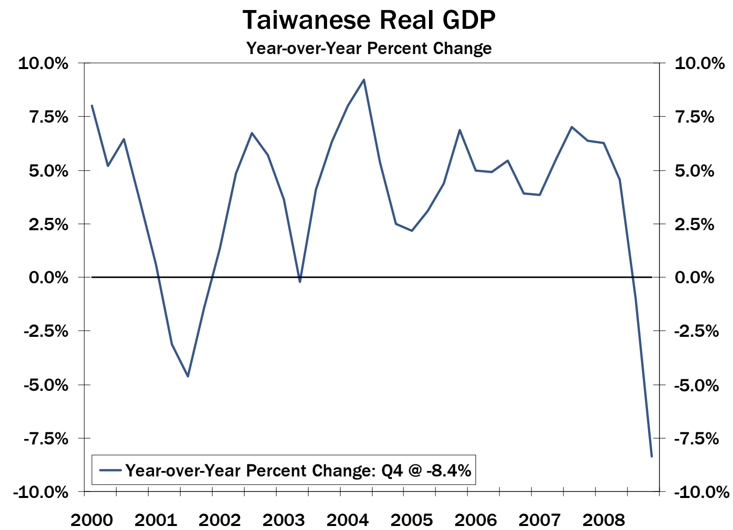
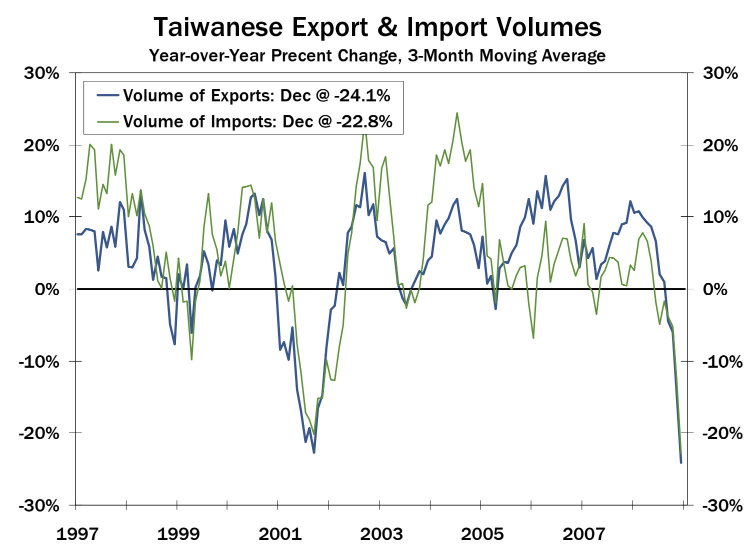
of the world, especially to other Asian economies, and the global recession that is underway is clearly having a very negative effect on the Japanese economy. Domestic spending in Japan is very weak as well. Personal consumption expenditures declined 1.6 percent at an annualized rate in the fourth quarter, and fixed investment spending dropped 11.3 percent.

Taiwan did not fare much better last quarter. As shown in the top chart, Taiwanese GDP in the fourth quarter fell 8.4 percent on a year-over-year basis, surpassing the previous record decline that was set during the "tech" collapse in 2001. As in the case of Japan, the rest of the world contributed to the weakness in the Taiwanese economy. As shown in the middle chart, the volume of exports nosedived in the fourth quarter. However, domestic demand in Taiwan, which hasn't been very strong over the past few years, weakened even further in the fourth quarter.

Unfortunately, it appears that global economy has continued to contract at a sharp rate thus far in the first quarter. As shown in the bottom chart, the manufacturing and service sector PMIs in the Euro-zone, which both edged higher in January, set new lows in February. Manufacturing indices in the United States also weakened further in February.

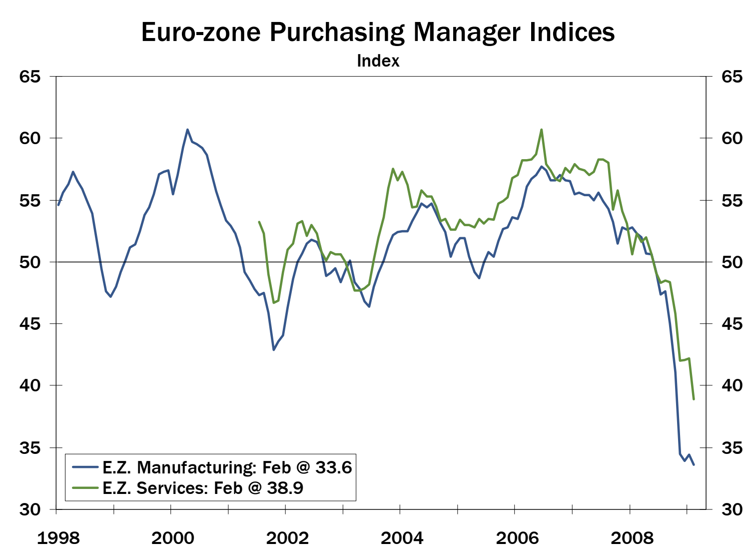
Although there is not much good news at present, there are a number of forces that sooner or later will stabilize global economic activity and eventually lead to recovery. First, short-term interest rates in most countries have declined significantly. Although the usual channels of monetary transmission may be impaired somewhat at present, lower interest rates should eventually help. Most countries have also announced fiscal stimulus plans that will kick in over the course of the year. In addition, lower energy prices will help. If oil prices average $50/barrel this year (WTI is below $40/barrel at present), then roughly $1.5 trillion worth of purchasing power will be transferred from oil-producing nations, which tend to have relatively high propensities to save, to oil-consuming nations, which tend to have higher propensities to consume. This transfer of purchasing power should help to eventually stabilize global economic activity. In the meantime, however, the global economy remains mired in a very deep slump.





Selected Global Data

Japan	GDP Year-over-Year	Q4 - 2008	-4.6%
	CPI	December - 2008	0.4%
	Unemployment	December - 2008	4.4%
	BoJ Target Rate	Feb - 20	0.10%
Euro-Zone	GDP Year-over-Year	Q4 - 2008	-1.2%
	CPI	December - 2008	1.6%
	Unemployment	December - 2008	8.0%
	ECB Target Rate	Feb - 20	2.00%
UK	GDP Year-over-Year	Q4 - 2008	-1.8%
	CPI	January - 2009	3.0%
	Unemployment	January - 2009	3.8%
	BoE Target Rate	Feb - 20	1.00%
Canada	GDP Year-over-Year	November - 2008	-0.8%
	CPI	January - 2009	1.1%
	Unemployment	January - 2009	7.2%
	BoC Target Rate	Feb - 20	1.00%



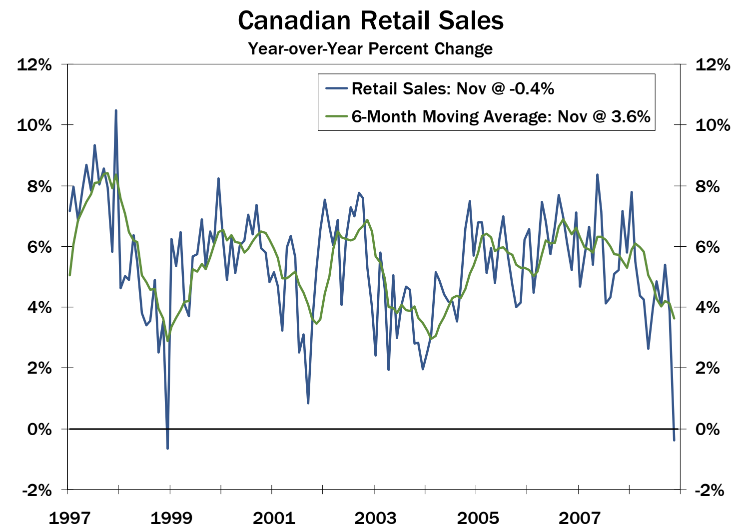
Canadian Retail Sales• Monday

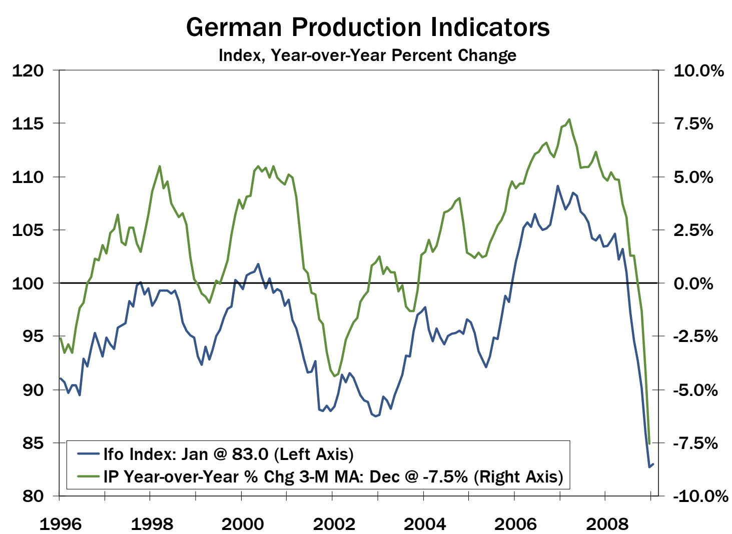
The Canadian economy, which has been showing signs of weakness for the last few month appears to have deteriorated further in recent weeks. Manufacturing shipments for December, announced last week, declined 8.0 percent. This was more than the 5.3 percent that had been expected and a particularly troubling sign for Canada's export-driven economy.

Retail sales for December will be reported on Monday and we suspect that will show the third consecutive month of declines for Canadian consumer spending. The employment report for January revealed a jaw-dropping loss of 129,000 jobs. Given Canada's smaller population, this would be roughly comparable to a monthly loss of more than one million jobs in the United States. As the unemployment rate climbs toward eight percent we expect consumer spending will likely remain constrained in coming months as well.

Previous: -2.4%

Consensus: -2.7%





German Ifo Index• Tuesday

The plunge in German industrial production that has occurred over the past few months was foreshadowed by the collapse in the Ifo index of business sentiment. Therefore, it will be interesting to see how sentiment among German businesses is holding up in February. Even if sentiment remains essentially unchanged, which the consensus forecast anticipates, investors will infer that the German economy remains mired in deep recession. Indeed, the Euro-zone PMIs for January that were mentioned in the main body of this report, set a new low in February.

Speaking of the Euro-zone, the economic confidence indicator for February will print on Thursday. Friday sees the release of January data on CPI inflation, which is expected to recede, and unemployment, which is expected to rise.

Previous: 83.0

Consensus: 83.1

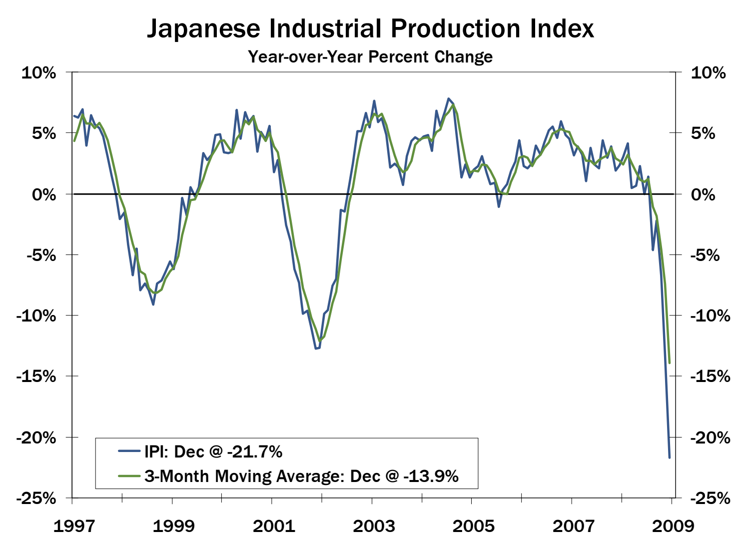
Japanese Industrial Production • Friday

Next week sees the usual end-of-month barrage of Japanese economic statistics. Perhaps of most interest will be data on industrial production in January. IP plunged in the fourth quarter as global trade tanked. Unfortunately, the consensus forecast anticipates that IP dropped another 10 percent in January relative to the previous month. If realized, industrial production in January would be down an unprecedented 29 percent relative to the same month last year. Can you say "depression"?

Data on retail trade and housing starts in January, which are also slated for release on Friday, are expected to post further declines. The jobless rate, which stood at 4.4 percent in December, is expected to rise to 4.6 percent in January.

Previous: -9.8% (month-over-month change)

Consensus: -10%



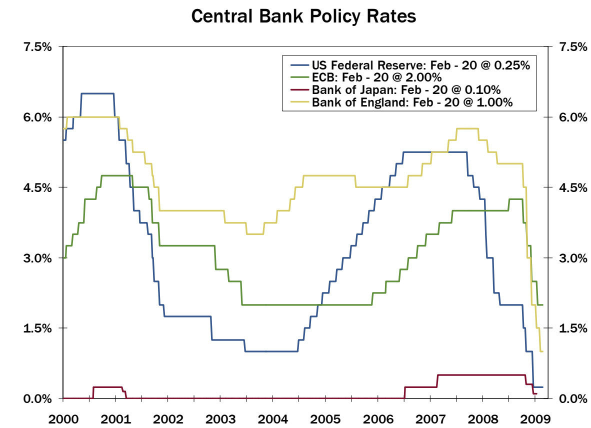
Interest Rate Watch

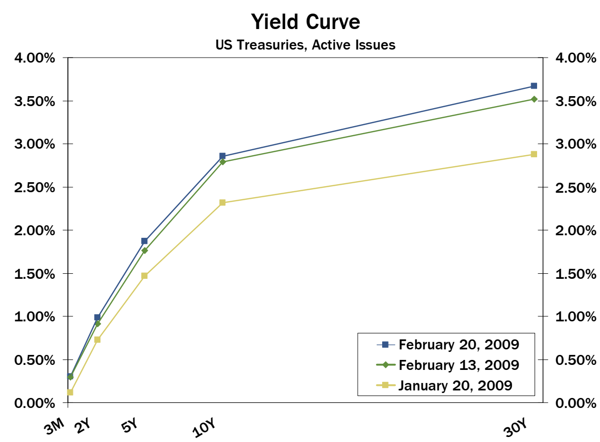
Comments from the 2009 Banking Industry Outlook Conference

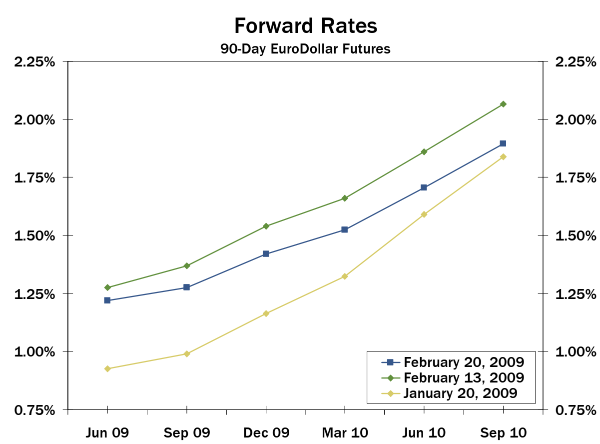
Banks reflect the economic fundamentals that drive consumer spending and economic growth. Our outlook is for continued recession and weakness in jobs and consumer spending, which presents challenges. Delinquencies for both prime and sub-prime mortgages continue to rise. Also, vacancy rates for commercial properties continue to rise. The loss of jobs is consistent with the rising vacancy rates for office space.

Financial stability and economic recovery continue to be the primary intermediate-term policy targets for the Fed. In addition, the Fed is committing to a continued expansion of its balance sheet to support financial markets. However, the Fed cannot be everywhere. The Fed is like a policeman that stands on one corner and the crime rate goes down on that corner. Yet, at a corner that the policeman is not present, crime continues. Over the last three months, the Fed's efforts to provide liquidity to short-term markets, commercial paper and mortgage back securities have lowered rates and improved liquidity. Yet in markets where the Fed is not present, corporate high yield and CMBS markets, spreads remain wide and liquidity minimal.

We maintain our expectation that the federal funds rate will remain in the 0.00 - 0.25 percent range for the rest of this year. Our concern, however, is that yields on longer-dated debt instruments will drift upward as inflation concerns rise and the flight-to-safety trade falls away. In addition, dollar weakness may reappear as this year ages and this will add to our inflation concerns.







Topic of the Week

Housing Should Find a Bottom in '09

After three years of declining sales and construction, we expect housing to finally bottom out in 2009. Merely finding a bottom will not mark the end of troubles in the housing industry. The absolute level of sales is expected to remain very low and price declines and rising foreclosures will likely carry over into 2010. A bottom in sales and construction will mark the beginning of the end of the housing bust and will go a long way toward providing visibility in solving the more intractable problems facing the industry.

As bad as things are in the housing market, conditions are beginning to improve. While we admit it is hard to see much sign of improvement, you just have to dig a little deeper beneath the surface to find the evidence. On the surface sales are plummeting, prices are tumbling and foreclosures are skyrocketing. Beneath the surface, however, inventories are declining, affordability has largely been restored and population growth is steadily building up demand.

Home sales are likely to weaken during the first part of 2009, reflecting the dramatic weakening in the labor market, where we expect another 1.5 million jobs to be eliminated during the next three months. We believe the bottom for both new and existing home sales will occur in the first half of 2009. Sales will not bounce much off of that bottom but they should improve during the second half of the year, when lower prices, lower mortgages rates and stabilizing home prices in many key housing markets should boost demand. A strong recovery in the housing market, however, will not likely take hold until 2011 for sales and 2012 for new construction. Click here to see our latest housing chartbook.

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 2/20/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.26	0.29	2.22
3-Month LIBOR	1.25	1.24	3.08
1-Year Treasury	0.66	0.45	1.94
2-Year Treasury	0.89	0.96	2.12
5-Year Treasury	1.73	1.87	2.98
10-Year Treasury	2.70	2.89	3.89
30-Year Treasury	3.50	3.67	4.61
Bond Buyer Index	4.89	4.89	4.66

Foreign Exchange Rates

	Friday 2/20/2009	1 Week Ago	1 Year Ago
Euro ($/€)	1.280	1.286	1.471
British Pound ($/£)	1.444	1.435	1.942
British Pound (£/€)	0.886	0.896	0.758
Japanese Yen (¥/$)	93.376	91.889	108.120
Canadian Dollar (C$/$)	1.253	1.235	1.013
Swiss Franc (CHF/$)	1.156	1.161	1.100
Australian Dollar (US$/A$)	0.645	0.658	0.918
Mexican Peso (MXN/$)	14.904	14.496	10.782
Chinese Yuan (CNY/$)	6.837	6.833	7.144
Indian Rupee (INR/$)	49.730	48.600	40.200
Brazilian Real (BRL/$)	2.399	2.256	1.725
U.S. Dollar Index	86.963	86.547	76.116

Foreign Interest Rates

	Friday 2/20/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.88	1.94	4.36
3-Month Sterling LIBOR	2.07	2.07	5.65
3-Month Canadian LIBOR	1.48	1.45	3.86
3-Month Yen LIBOR	0.63	0.64	0.90
2-Year German	1.29	1.31	3.24
2-Year U.K.	1.49	1.32	4.25
2-Year Canadian	1.23	1.15	3.15
2-Year Japanese	0.39	0.40	0.58
10-Year German	3.01	3.11	4.03
10-Year U.K.	3.42	3.56	4.69
10-Year Canadian	2.83	2.90	3.93
10-Year Japanese	1.28	1.27	1.44

Commodity Prices

	Friday 2/20/2009	1 Week Ago	1 Year Ago
W. Texas Crude ($/Barrel)	38.71	33.98	100.74
Gold ($/Ounce)	999.30	941.70	944.10
Hot-Rolled Steel ($/S.Ton)	475.00	475.00	700.00
Copper (¢/Pound)	140.40	152.95	370.55
Soybeans ($/Bushel)	8.80	9.71	13.49
Natural Gas ($/MMBTU)	4.00	4.49	8.97
Nickel ($/Metric Ton)	9,821	10,216	27,975
CRB Spot Inds.	337.87	340.55	493.41

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	23	**24**	**25**	**26**	**27**
U.S. Data		**Consumer Confidence** January 37.7 February 31.2 (W)	**Existing Home Sales** December 4.74M January 4.60M (W)	**Durable Goods Orders** December -2.6% January -7.8% (W) **Durables Ex Transp.** December -3.6% January -5.6% (W) **New Home Sales** December 331K January 320K (W)	**GDP** 4Q (Advance) -3.8% 4Q (Preliminary) -5.5% (W)
Global Data	**Canada** **Retail Sales (MoM)** Previous (Nov) -2.4%	**Germany** **IFO - Business Climate** Previous (Jan) 83.0		**Germany** **Unemployment Rate** Previous (Dec) 7.2%	**Japan** **Jobless Rate** Previous (Dec) 4.4% **Japan** **Indus. Production (MoM)** Previous (Dec) -9.8%

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

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