WACHOVIA
ECONOMICS GROUP

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

March 13, 2009

U.S. Review

Is This the End of the Beginning?

This week's report that retail sales fell much less than the consensus estimate in February and the upward revision to the January sales figures raises the prospect that the worst of this recession may actually be behind us. While such a statement might seem surprising, it is generally consistent with our forecast, which has long noted that late 2008 and early 2009 would mark the darkest hours of this recession. Even if the worst is behind us, the economy still faces a long and arduous road to recovery.

To paraphrase Winston Churchill, this week's improved retail sales figures, sharp decline in inventories, and positive bounce to the stock market do not likely mark the end of the recession, nor do they mark the beginning of the end. Perhaps, however, the apparent bottoming in retail sales combined with the sharp reduction in business inventories will mark the end of the beginning of this downturn.

January's sharp upward revision to retail sales lifted the overall increase to 1.8 percent. This marks the first increase in overall retail sales in seven months and the largest increase since January 2006.

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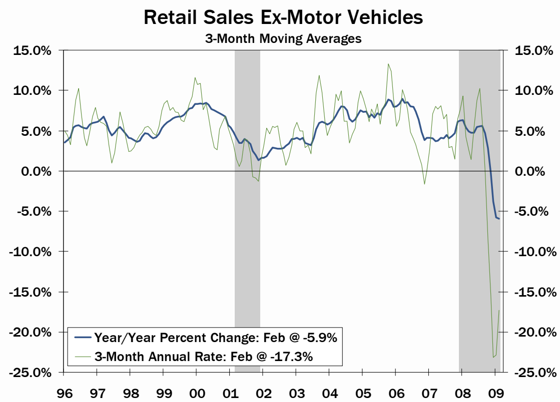

Global Review

China Slowed Further in Q1

China released a slew of economic data this week that gave investors a sense of where the Chinese economy is at present. The bad news is that growth in industrial production appears to have slowed further in the first quarter. The timing of Chinese New Year complicates the interpretation of IP data in the first two months of the year. Industrial production in January, when Chinese New Year occurred this year, dropped 3.4 percent relative to the same month in 2008. In February, IP growth rebounded to 11.0 percent (New Year in 2008 fell in February). Taking the two months together, IP was up only 3.8 percent, down from the 6.4 percent rate that was registered in the fourth quarter (see chart at left).

The continued slowdown in Chinese IP growth reflects, at least in part, economic weakness in the rest of the world. The value of

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Recent Special Commentary

Date	Title	Authors
March-12	Global Chartbook - March 2009	Bryson & Quinlan
March-02	The Evolution of the Economy, Credit & Economic Policy	Silvia
February-23	This Is Not the End of America	Vitner
February-23	Housing & Finance: Still Searching for a New Equilibrium	Silvia

U.S. Forecast

	Actual 2008				Forecast 2009				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	-6.2	-7.2	-2.0	-0.4	0.8	2.9	2.8	2.0	1.1	-3.3	1.2
Personal Consumption	0.9	1.2	-3.8	-4.3	-1.6	0.0	0.1	1.2	3.0	3.0	2.8	0.2	-1.6	1.1
Inflation Indicators [2]														
"Core" PCE Deflator	2.2	2.3	2.3	1.9	1.5	1.3	1.1	1.3	2.1	2.3	2.2	2.2	1.3	1.6
Consumer Price Index	4.2	4.3	5.2	1.5	-0.3	-1.2	-2.3	0.1	3.4	3.2	2.9	3.8	-0.9	1.7
Industrial Production [1]	0.4	-3.4	-8.9	-12.1	-18.0	-7.2	-2.5	0.4	3.3	2.2	1.7	-1.8	-9.9	1.7
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	86.8	89.4	92.0	93.5	86.0	81.5	73.3	79.4	93.5	88.1
Unemployment Rate	4.9	5.4	6.1	6.9	8.0	8.6	9.2	9.6	5.1	4.6	4.6	5.8	8.8	9.9
Housing Starts [4]	1.05	1.03	0.88	0.66	0.45	0.47	0.53	0.59	2.07	1.81	1.34	0.90	0.51	0.74
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	3.00	3.00	3.10	4.39	4.71	4.04	2.25	3.10	3.50

Data As of: March 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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The Darkest Hours of This Recession May Soon be Behind Us

Retail sales fell 0.1 percent in February but even that result was better than expected. The overall sales figures are being distorted by swings in gasoline prices and seasonal distortions. Gasoline prices tumbled late last year and then bounced back in January and February. Higher gasoline prices sent sales at gasoline stations sharply higher, with sales up 2.8 percent and 3.4 percent in January and February, respectively.

Seasonal distortions may also make the recent retail sales figures look a little stronger than they truly are. Motor vehicle sales bounced back in January following several months where sales were severely constrained. Sales at department stores and specialty chains also bounced back during the past two months even though nearly every major retailer continues to report sales are under intense pressure. How do we reconcile this discrepancy?

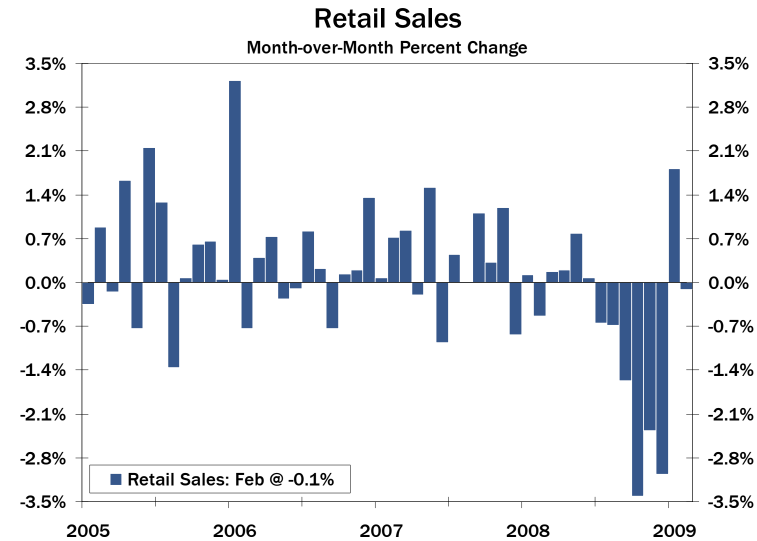
The split between the Department of Commerce's numbers and the chain store sales figures has a great deal to do with how the government and retailers look at sales. The government figures are reported on a month-to-month basis and adjusted for seasonal factors. Normally, sales plunge in January and February, coming down from the holiday season. This past year sales plummeted all throughout the fall, as the widening financial crisis kept shoppers in a dour mood. Since sales fell so sharply during the holiday season, they did not fall as much as they normally do in January and February. As a result, the seasonally adjusted figures showed an increase. Retailers tend to look at sales on a year-to-year basis and on this basis sales are down by both measures.

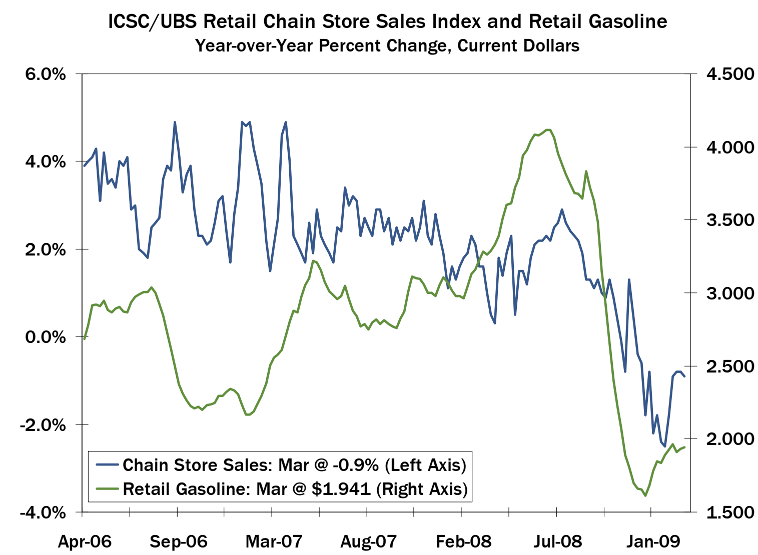
Even though the recent trend in retail sales has been distorted by swings in gasoline prices and seasonal factors, the increased figures still reflect some improvement. Retailers, wholesalers and manufacturers are slashing their inventories, which will eventually set the stage for a revival in orders and production. Business inventories fell 1.1 percent in February, following a revised 1.6 percent drop in January. Inventories will likely subtract around $100 billion from real GDP during the first quarter, which is one of the main reasons we have such a large drop in real GDP projected for the first quarter. After the first quarter's big drop, however, declines in real GDP should be progressively less severe.

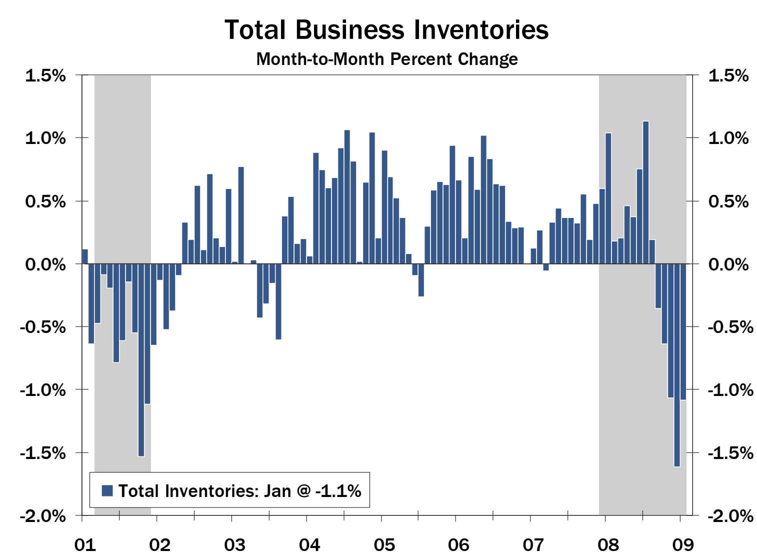
First-time claims for unemployment insurance and continuing claims both rose in the latest week. The four–week moving average through March 7 totals 650,000, up from 608,000 a month earlier. Given the jump, nonfarm payrolls should post another sharp decline for the month of March.

Selected Current Data

Gross Domestic Product - CAGR	Q4 - 2008	-6.2%
GDP Year-over-Year	Q4 - 2008	-0.8%
Personal Consumption	Q4 - 2008	-4.3%
Business Fixed Investment	Q4 - 2008	-21.1%
Consumer Price Index	January - 2009	0.0%
"Core" CPI	January - 2009	1.7%
"Core" PCE Deflator	January - 2009	1.6%
Industrial Production	January - 2009	-10.0%
Unemployment	February - 2009	8.1%
Federal Funds Target Rate	Mar - 13	0.25%







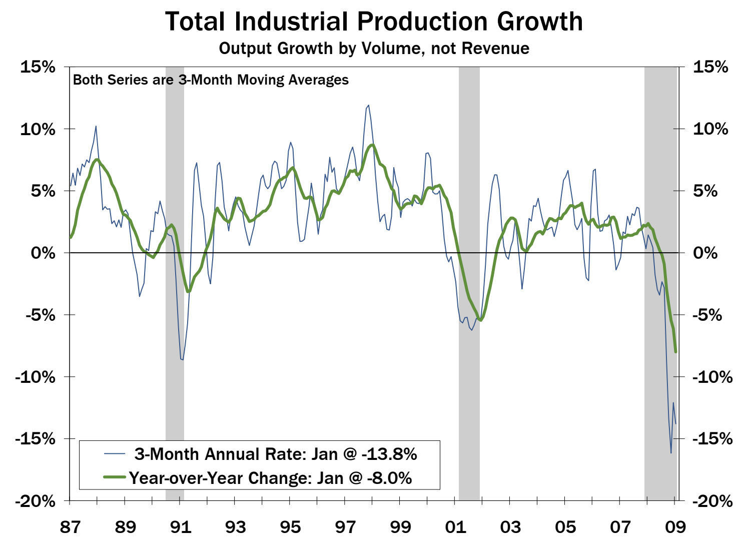
Industrial Production • Monday

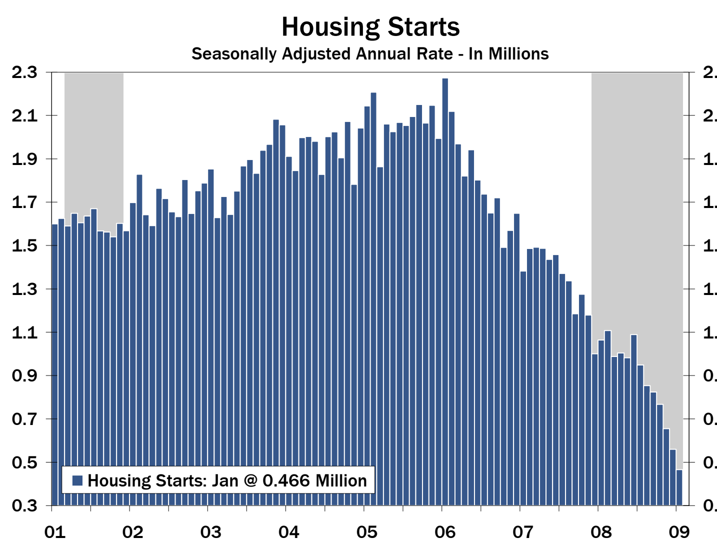
Industrial production fell 1.8 percent in January due to a big drop in auto production as well as weakness in machinery, computers and mining. Auto output plunged 23 percent and is down over 43 percent compared to a year ago. Construction supplies fell, consistent with the housing correction. Capacity utilization levels dropped again suggesting continued weak profits.

We expect industrial production to fall 1.0 percent and capacity utilization to decline for the fourth consecutive month to 71.5 percent in February. In particular, over the last year we have seen utilization declines in manufacturing, utilities and sharp declines in computers. We should continue to see declines in these sectors as well as soft profits and further layoffs. Businesses are striving to bring production back in-line with sales. So far, cutbacks have not been deep enough, as inventory-to-sales ratios have increased and productivity has declined.

Previous: -1.8% **Wachovia: -1.0%**

Consensus: -1.3%





Housing Starts • Tuesday

The pace of housing starts slowed by almost another 100,000 units in January to just 466,000 units. This marks the fourth all-time low in as many months. Building permits fell 'just' 26,000 to 521,000 units and now sit well above the starts level. Permits were helped by the slight increase in multi-family dwellings.

With an unusually cold February, especially in the South, housing starts will remain depressed. Starts may see an uptick, but levels will remain near historic low levels. Permits should also continue to remain at low levels, but the pace should stay well above starts, signaling a bottom in construction activity may be closer than many expect. However, once we reach a bottom the recovery may be extremely weak and agonizingly slow.

Previous: 466K **Wachovia: 475K**

Consensus: 450K

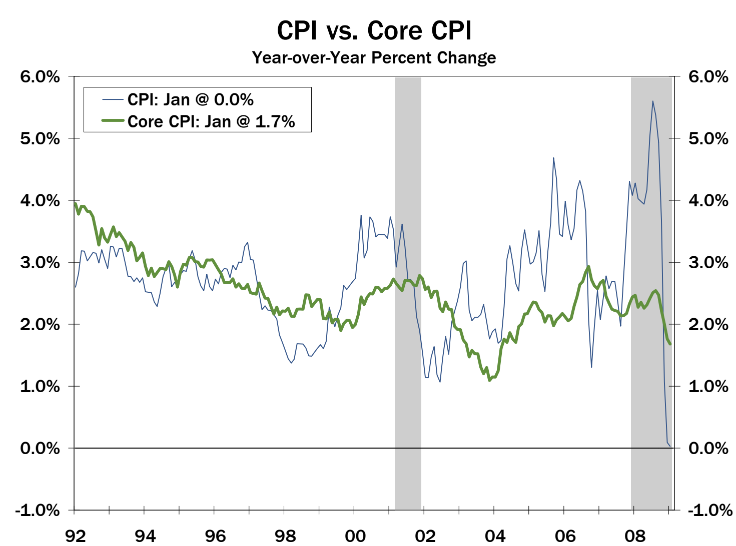
Consumer Price Index • Wednesday

The Consumer Price Index rose 0.3 percent in January, in-line with expectations. 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 most of the categories posting increases were down sharply in recent months.

We expect headline consumer prices to increase 0.4 percent in February due largely to an increase in gasoline prices. Retail gasoline prices increased roughly seven percent in February, but remain well below year ago prices. Core inflation, which excludes food and energy, has seen virtually no growth over the last few months as the economy contracted sharply. We continue to expect core inflation to remain flat in February.

Previous: 0.3% **Wachovia: 0.4%**

Consensus: 0.3%



Global Review

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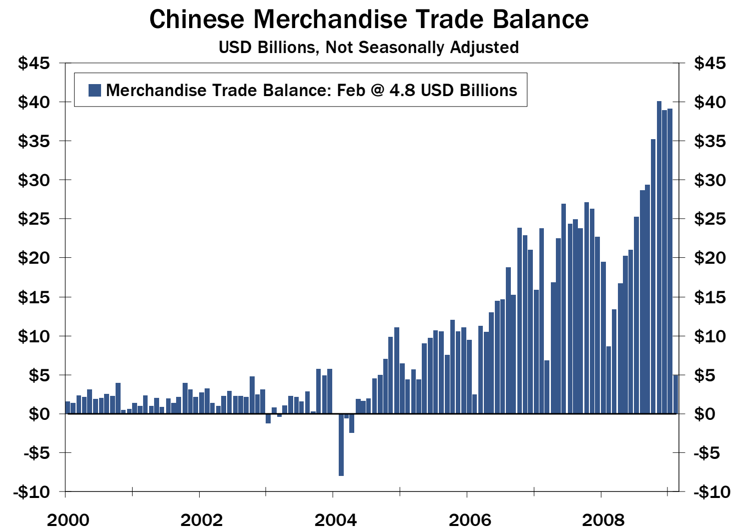
Chinese exports in the first two months of 2009 was down about 22 percent relative to the same two-month period last year. As shown in the top chart, the Chinese trade surplus, which had been running north of $35 billion per month, tumbled to less than $5 billion in February. Although Chinese New Year undoubtedly overstates the "true" decline, we believe that China's trade surplus will gradually narrow this year as most other countries remain in recession.

The domestic side of the economy is showing a bit more resilience. Growth in retail spending in the first two months of the year declined to 15.2 percent (see middle chart). However, some of the deceleration in the value of retail spending may reflect the decline in prices over the past few months. CPI inflation averaged 2.5 percent in the fourth quarter of 2008. In February, consumer prices fell 1.6 percent relative to the same month last year. Therefore, growth in real retail spending probably is holding up better than nominal spending. Another source of strength is fixed asset investment, which in the first two months of the year was up 26.5 percent, up modestly from the 26.1 percent growth rate that was registered in December. It appears that the government's intention to accelerate infrastructure spending is starting to bear some fruit.

In sum, the year-over-year GDP growth rate, which was 6.8 percent in the fourth quarter of 2008, probably slowed to four or five percent in the first quarter of this year (see bottom chart). However, the economy may be in the process of bottoming. The fiscal stimulus package that the government announced last fall is in the pipeline, and it should slowly lift the year-over-year growth rate as the year progresses. Another sign of stabilization can be seen in the stock market. The Shanghai composite index is up about 17 percent this year. Stock markets in most other major countries are off ten to twenty percent on balance. Perhaps investors are signaling that growth will return to China sooner than in most other economies.

The value of the Chinese renminbi has been essentially unchanged versus the dollar since last summer. As long as the global economic outlook remains clouded—we think it will for the next few quarters—the Chinese government will likely maintain the sideways trend in the yuan/dollar exchange rate.



Selected Global Data

Japan	GDP Year-over-Year	Q4 - 2008	-4.3%
	CPI	January - 2009	0.0%
	Unemployment	January - 2009	4.1%
	BoJ Target Rate	Mar - 13	0.10%
Euro-Zone	GDP Year-over-Year	Q4 - 2008	-1.3%
	CPI	January - 2009	1.1%
	Unemployment	January - 2009	8.2%
	ECB Target Rate	Mar - 13	1.50%
UK	GDP Year-over-Year	Q4 - 2008	-1.9%
	CPI	January - 2009	3.0%
	Unemployment	January - 2009	3.8%
	BoE Target Rate	Mar - 12	0.50%
Canada	GDP Year-over-Year	December - 2008	0.5%
	CPI	January - 2009	1.1%
	Unemployment	February - 2009	7.7%
	BoC Target Rate	Mar - 13	0.50%

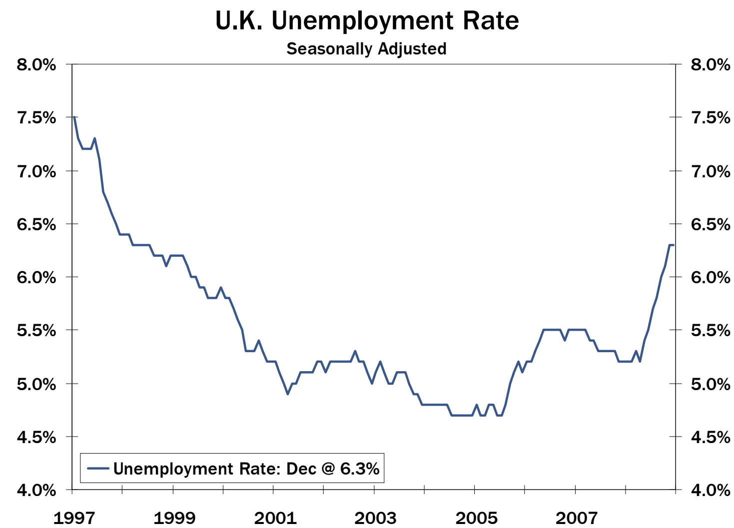
U.K. Unemployment Rate • Wednesday

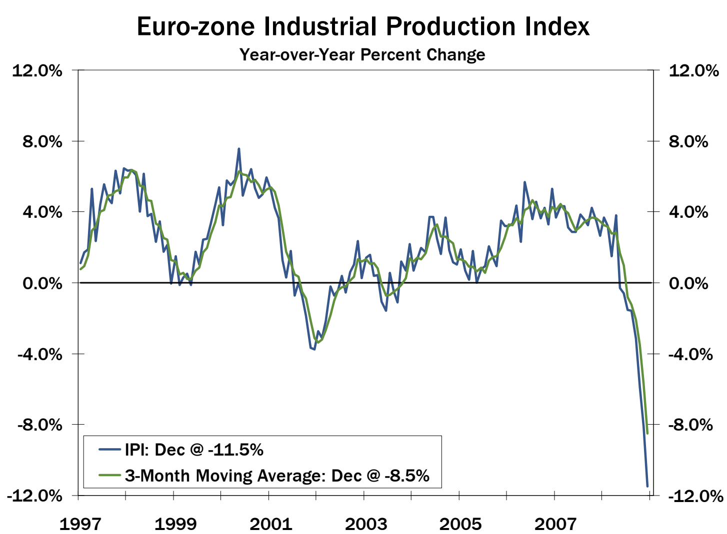
The downturn in the U.K. economy (real GDP plunged at an annualized rate of 6.0 percent in the fourth quarter relative to the previous quarter) has caused the unemployment rate to rise to an 11-year high of 6.3 percent. Unemployment data for January will print on Wednesday. With the economy continuing to contract in the first quarter, the unemployment rate is sure to rise even further. The only questions are where and when will the unemployment rate top out?

Also slated for release on Wednesday are the minutes of the Bank of England's policy meeting on March 5, at which the MPC cut the policy rate to 0.50 percent and announced a program to buy government bonds. The minutes should provide investors with further insight into the Bank's "unconventional" methods to stimulate the economy.

Previous: 6.3%

Consensus: 6.5%





Euro-zone Industrial Production • Thursday

Industrial production in the Euro-zone plunged in the fourth quarter as global trade came to a screeching halt. Sadly, the manufacturing PMI in the Euro-zone has suggested that production has weakened further in the first quarter. Indeed, the market consensus forecast anticipates that IP fell 1.5 percent in January relative to the previous month.

Inflation data for February are also on the docket next week. The "flash" estimate showed that the overall rate of CPI inflation fell from 1.6 percent in January to 1.1 percent in February. Data on "core" prices, which will print on Monday, should show the overall rate of "core" inflation receding from 1.6 percent in January to 1.5 percent in February. If so, it would be the lowest rate of "core" CPI inflation in more than two years.

Previous: -2.6% (month-over-month change)

Consensus: -1.5%

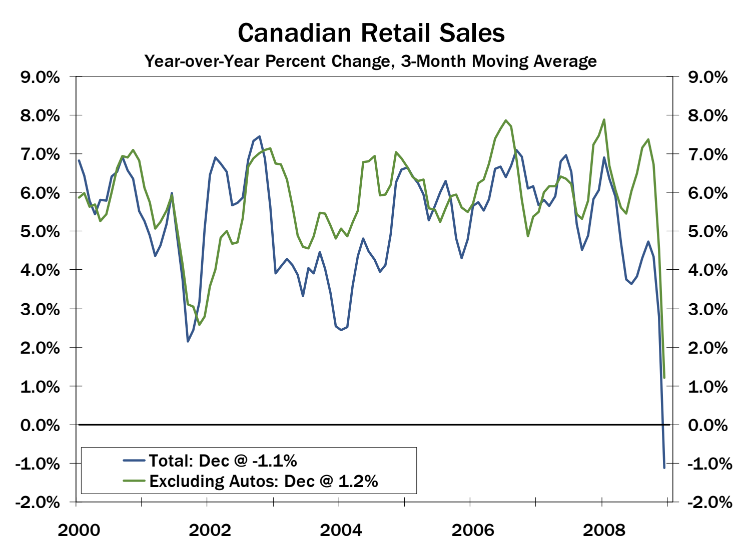
Canadian Retail Sales • Friday

At the end of next week, Canadian retail sales data will likely show that stores suffered their fourth consecutive month of lost sales in January. Weak domestic demand can be attributed primarily to a labor market that has suffered consecutive months of devastating losses in nonfarm payrolls. Friday's reported decline of 82.6K jobs, when added to January's losses adds up to a total of over 200K jobs in two months. This would be comparable to roughly two million lost jobs in the United States.

Beyond the details of challenges with the consumer, next week also brings detail on the current state of the manufacturing sector. Manufacturing shipments and wholesale sales data will likely show continued declines, as business spending slows at home and abroad.

Previous: -5.4%

Consensus: N/A



Interest Rate Watch

We're With Wen Jiabao

"BEIJING -- Premier Wen Jiabao voiced confidence in China's economy, saying his government's finances give it room to spend even more to support growth if needed, but expressed concern about the outlook for the U.S. and the safety of its Treasury bonds.

The forceful comments from Mr. Wen's annual press conference -- a rare opportunity for domestic and foreign reporters to ask a top Chinese official questions directly – helped depress the U.S. dollar and prices of U.S. Treasurys in Asian trading Friday."

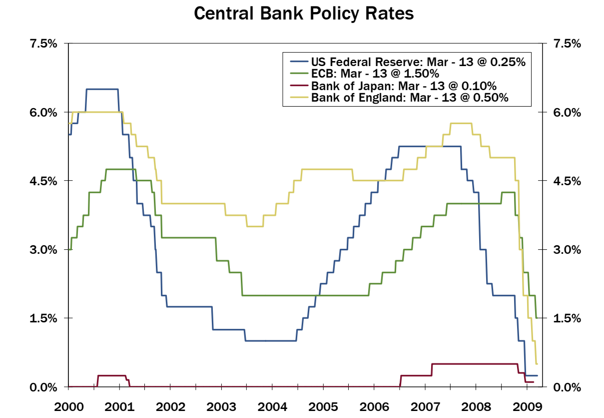
-WSJ March 13, 2009

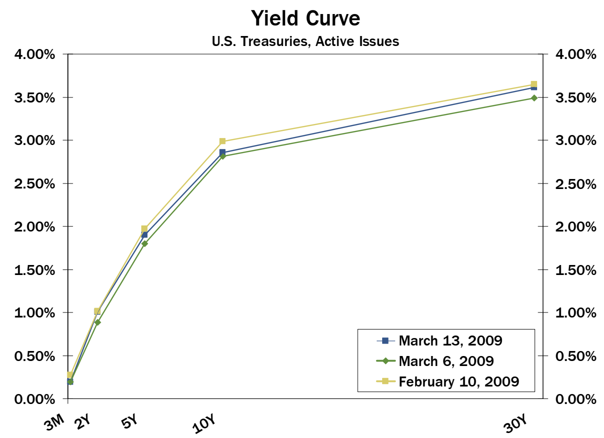
We agree. Forward-looking investors must have some expectation with respect to future federal deficits and the willingness of foreign investors to fund federal spending. After the flight-to-safety trade evaporates, the cost of credit to the U.S. is likely to rise. This will be evident in higher interest rates, lower price-to-earnings ratios or depreciation in the dollar relative to earlier this decade.

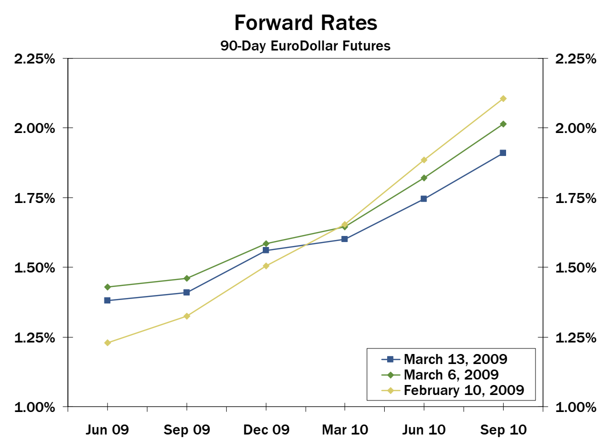
For monetary policy the choice is between a Federal Reserve Board that will tolerate higher inflation than currently discounted in the marketplace or a Fed that will target inflation at or near currently discounted rates. Ten-year Treasury rates at 2.9 percent do not leave much room for error on the upside for the inflation assumption currently embedded in market rates.

For fiscal policy, the estimates of budget deficits at $712 billion for fiscal year 2019 (ten years out) provides little comfort to investors. Deficits actually peak in 2013 according to the latest administration estimates and actually fall from 2013 to the ten-year horizon.

The Chinese are correct to express their concerns. So should U.S. investors.







Topic of the Week

Inventories Set Sights Low

Inventories have been a recurring theme this week as the earliest clues to first quarter changes were reported in wholesale, retail and manufacturing-summed up in Thursday's business inventories report. Inventories across the board are plunging as businesses work off excess supply. Unfortunately with almost nonexistent sales, it is extremely difficult to make tangible progress. As a result, inventories-to-sales ratios are reaching highs not seen since new technology improved supply chain management and the popularization of just-in-time inventory management reduced the need to maintain significant stocks. The only bright spot was in the retail sector where sales fell less than expected, allowing the inventories-to-sales ratio to finally turn down after soaring for months. If the consumer finds traction, retail stocks will fall much more rapidly, and eventually help the manufacturing and wholesale sectors as well. However, it may be too early to start counting on a consumer-driven turnaround as jobless claims continue to mount and confidence broods at all-time lows. Inventories can also be an important, sometimes surprising component of GDP. Businesses were caught early in the cycle with a glut of product which they now seek to liquidate. A large downward revision to the inventory data last month took more than a percentage point off of the advance estimate of fourth quarter GDP. Stocks will fall significantly further in the first quarter based on early indications, which will pull GDP down two percentage points or more. On a positive note, after working off the bulk of excess stock, inventory could become additive to GDP, contributing to the overall growth picture by the second half.

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 3/13/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.18	0.20	1.36
3-Month LIBOR	1.32	1.29	2.80
1-Year Treasury	0.70	0.63	1.51
2-Year Treasury	0.95	0.95	1.63
5-Year Treasury	1.85	1.88	2.50
10-Year Treasury	2.84	2.87	3.53
30-Year Treasury	3.63	3.55	4.45
Bond Buyer Index	5.03	4.96	4.94

Foreign Exchange Rates

	Friday 3/13/2009	1 Week Ago	1 Year Ago
Euro ($/€)	1.289	1.265	1.564
British Pound ($/£)	1.397	1.409	2.034
British Pound (£/€)	0.923	0.898	0.769
Japanese Yen (¥/$)	98.016	98.255	100.650
Canadian Dollar (C$/$)	1.273	1.287	0.984
Swiss Franc (CHF/$)	1.188	1.158	1.009
Australian Dollar (US$/A$)	0.657	0.641	0.947
Mexican Peso (MXN/$)	14.585	15.194	10.751
Chinese Yuan (CNY/$)	6.838	6.840	7.095
Indian Rupee (INR/$)	51.515	51.710	40.425
Brazilian Real (BRL/$)	2.313	2.376	1.692
U.S. Dollar Index	87.463	88.512	72.072

Foreign Interest Rates

	Friday 3/13/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.64	1.73	4.60
3-Month Sterling LIBOR	1.87	1.95	5.84
3-Month Canadian LIBOR	1.05	1.20	3.70
3-Month Yen LIBOR	0.62	0.63	0.98
2-Year German	1.33	1.18	3.31
2-Year U.K.	1.40	1.27	3.89
2-Year Canadian	0.96	0.96	2.55
2-Year Japanese	0.42	0.41	0.57
10-Year German	3.05	2.93	3.76
10-Year U.K.	2.94	3.06	4.36
10-Year Canadian	2.87	2.93	3.52
10-Year Japanese	1.32	1.30	1.30

Commodity Prices

	Friday 3/13/2009	1 Week Ago	1 Year Ago
W. Texas Crude ($/Barrel)	47.70	45.52	110.33
Gold ($/Ounce)	928.81	939.35	994.83
Hot-Rolled Steel ($/S.Ton)	465.00	465.00	830.00
Copper (¢/Pound)	166.30	168.05	384.00
Soybeans ($/Bushel)	8.87	8.57	13.29
Natural Gas ($/MMBTU)	4.02	3.95	10.23
Nickel ($/Metric Ton)	9,374	9,752	31,695
CRB Spot Inds.	326.01	334.88	515.07

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	16	17	18	19	20
U.S. Data	**Industrial Production** January -1.8% February -1.0% (W) **Capacity Utilization** January 72.0% February 71.5% (W)	**Housing Starts** January 466K February 475K (W) **PPI** January 0.8% February 0.1% (W) **Core PPI** January 0.4% February 0.0% (W)	**CPI** January 0.3% February 0.4% (W) **Core CPI** January 0.2% February 0.1% (W) **FOMC Rate Decision** Previous 0.25% Expected 0.25% (W)	**Leading Indicators** January 0.4% February -0.8% (W)	
Global Data	**Euro-zone** **CPI (YoY)** Previous (Jan) 1.1%	**Canada** **Mfg Shipments (MoM)** Previous (Dec) -8.0% **Germany** **ZEW Sentiment** Previous (Feb) -5.8%	**UK** **Unemployment Rate** Previous (Dec) 6.3%	**Canada** **CPI (YoY)** Previous (Jan) 1.1% **Euro-zone** **Indus. Production (MoM)** Previous (Dec) -2.6%	**Canada** **Retail Sales (MoM)** Previous (Dec) -5.4%

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

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