

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

March 06, 2009

U.S. Review

Plenty to Shout About

There has been a whole lot of shouting going on over the past few weeks, as fears about the economy and financial markets are clearly rattling a lot of nerves. There are growing concerns that economic policy is heading in the wrong direction and that the economic stimulus package will be ineffective or even counterproductive. We feel these judgments are a bit premature and overreaching. The economy will eventually recover and the stimulus package will, at a minimum, play at least a supporting role. In the short-term, however, there is clearly more pain ahead. The big news this week was the February employment report, which showed the economy losing 651,000 nonfarm jobs and the unemployment rate jumping 0.5 percentage points to 8.1 percent. Job losses continue to be incredibly broad-based and previously reported drops in December and January are now shown to be much worse than first reported.

Job losses remain extraordinarily broad based. The diffusion index for nonfarm payrolls was just 23.8 in February and averaged just 22.5 over the past three months.

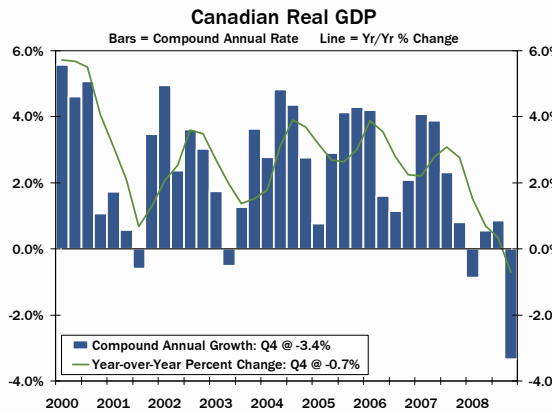
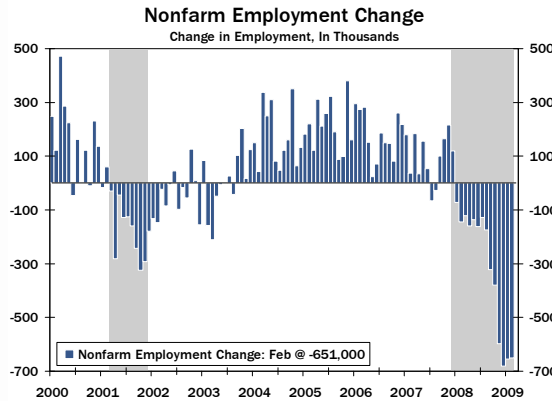
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Global Review

Central Banks Try to Stem the Tide

After a spate of economic indicators came in worse than expected in recent weeks, central banks across the globe scrambled to ratchet down their already dour forecasts to what appears to be the new grim reality of a bad global recession. After Canadian GDP fell at an annualized rate of 3.4 percent in the Q4, the Bank of Canada (BoC) cut its key lending rate to a record low 0.50 percent at its scheduled meeting the next day. The BoC acknowledged its global economic outlook had deteriorated since last month's report "with weaker-than-expected activity" around the world. On the other side of the Atlantic, the Bank of England (BoE) made a similar move, cutting its lending rate to 0.50 percent. In addition, the bank announced a £75 billion plan to buy government and private sector bonds, a move that led to a scant 60 bp drop in the U.K. 10-year government bond yield in two days.

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Recent Special Commentary

Date	Title	Authors
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
February-12	Global Chartbook - February 2009	Bryson & Quinlan

U.S. Forecast

	Actual 2008				Forecast 2009				Actual 2005-2008				Forecast 2009-2010	
	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	-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

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U.S. Review

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First Quarter GDP Should be Worse than the Previous Quarter

Average weekly hours have remained unchanged at 33.3 hours for the past three months, which indicates employers are reducing employment rather than simply cutting back hours. Layoffs have been extraordinary, however, with nearly two million jobs lost in just the past three months. With employment plummeting and the workweek unchanged, total hours worked plunged at an 8.8 percent annual rate over the past three months.

The plunge in aggregate hours worked suggests real GDP will decline even more during the current quarter than it did during the fourth quarter. The sum of aggregate hours worked and nonfarm productivity is a good proxy for real GDP growth. Nonfarm productivity declined at a 0.4 percent annual rate during the fourth quarter and increased 2.2 percent over the past year. Nonfarm productivity has averaged a 1.7 percent pace over the past three years and this is probably the best figure to use to compute an interim GDP estimate. Using that figure results in a 7.1 percent decline in first quarter real GDP, which is close to our early bottoms up estimate for our March Monthly Economic Outlook.

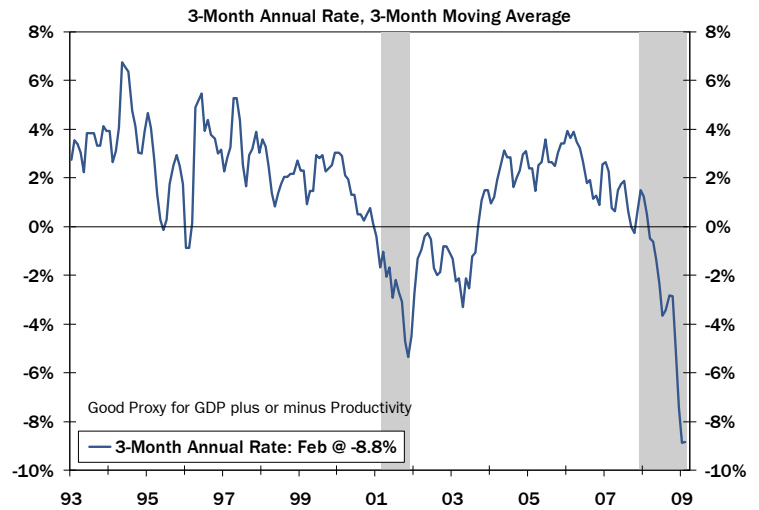
Most of this week's other economic reports also point to an incredibly weak first quarter. Construction spending plunged 3.3 percent in January, with particularly large declines in commercial construction and the formerly strong energy and power sector. Pending home sales and unit car and truck sales also declined, with pending home sales falling 7.7 percent in January. Separately, manufacturers' new vehicle sales to dealers fell by a half million units to a 9.1 million unit annual rate. Factory orders fell 1.9 percent in January, which was slightly less than expected. The previous month's drop was revised a percentage point lower, however, and the key non-defense capital goods orders series plummeted 5.7 percent. The weakness in orders and shipments suggests that business fixed investment will decline sharply in the first quarter and probably all of this year.

The only good news this week was that first time claims for unemployment insurance fell 28,000 to 639,000. It was the first decline in four weeks and leaves jobless claims at a historically high level. Continuing claims also declined, falling 6,000 to 5,106,000. Weekly first-time jobless claims are extremely volatile and this past week's drop probably does not mark a turnaround but rather a slowdown in the rate of deterioration in the labor market. We expect the exceptionally weak employment numbers to persist through the middle of this year and then become progressively less bad during the second half of the year.

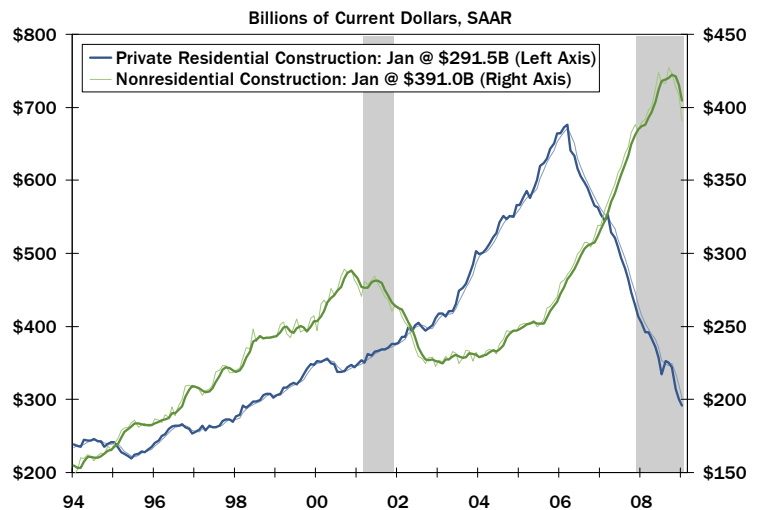
Selected Current Data

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 - 06	0.25%

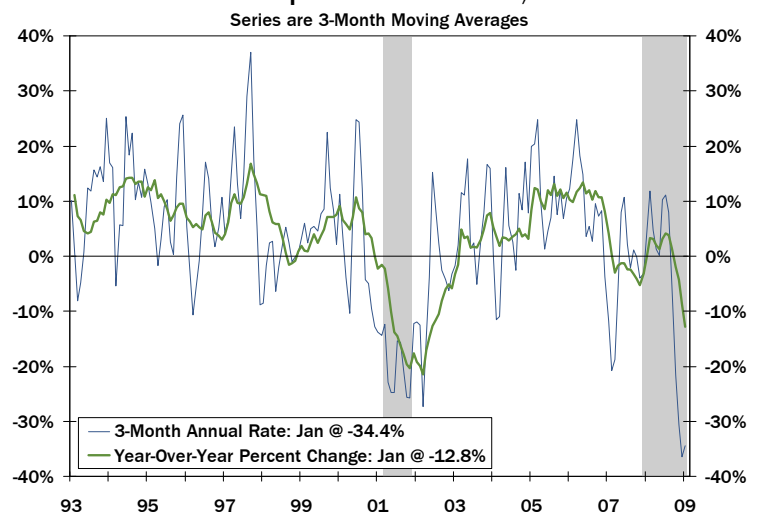
Index of Hours Worked



Residential and Nonresidential Construction



NonDefense Capital Goods Orders, Ex-Aircraft



Retail Sales • Thursday

In January, retail sales posted their largest increase since November 2007, the first gain in seven months. Retail sales rose 1.0 percent in January, and 0.9 percent after excluding the motor vehicle sector. The increase was very broad based but largely reflected a bounce off of the severely depressed levels reached following six consecutive monthly drops. However, January is one of the least important months for retailers, accounting for only a small portion of annual sales.

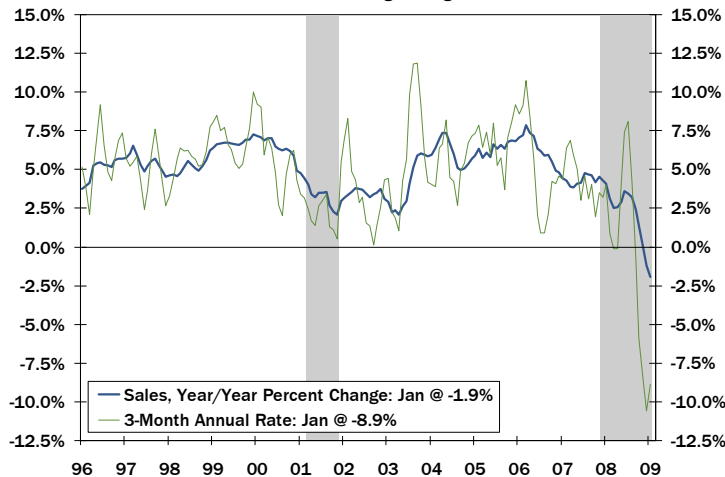
We expect retail sales declined 0.7 percent in February, with most of the drop due to a decline in motor vehicle sales. Retail motor vehicle sales increased 1.6 percent in January, while unit sales to dealers continued to decline. February motor vehicle sales should be more in-line with the decline in unit sales. Retail sales excluding autos should increase 0.7 percent driven by an increase in discount store sales and retail gasoline sales.

Previous: 1.0%

Wachovia: -0.7%

Consensus: -0.5%

Retail Sales Ex-Motor Vehicles & Gasoline Stations
3-Month Moving Averages


Trade Balance • Friday

The trade deficit narrowed from a revised \$41.6 billion to \$39.9 billion in December. While the deficit was wider than expected, the deficit now stands at its narrowest level since February 2003. Imports and exports both continued to slow, with declines in exports outpacing the drop in imports.

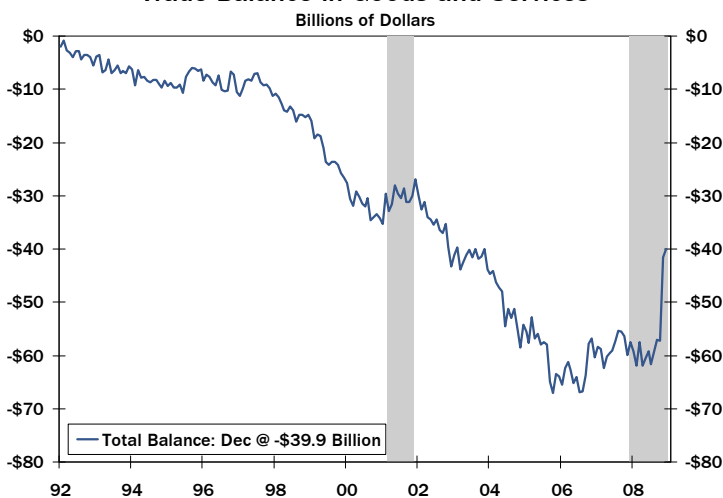
We expect the trade deficit to widen to -\$43.7 billion in January. It is clear that the combination of a global recession and the global credit crunch is causing worldwide trade to dry up. The real trade balance, which is used to calculate real GDP, should also widen.

Previous: -\$39.9B

Wachovia: -\$43.7B

Consensus: -\$38.1B

Trade Balance in Goods and Services


Business Inventories • Friday

We expect business inventories to continue to decline in January due to the severity of the current economic weakness which caught many producers, wholesalers and retailers by surprise. As a result, many had far too much raw material, work-in-process and finished products. Wholesalers and retailers alike will look to curtail orders for new products, and manufacturers will have to continue to cut back output. Unintentional inventory increases during a weak growth period pose a considerable risk to production activity.

Previous: -1.3%

Consensus: -1.1%

Business Inventories
Total Inventory-to-Sales Ratio



Global Review

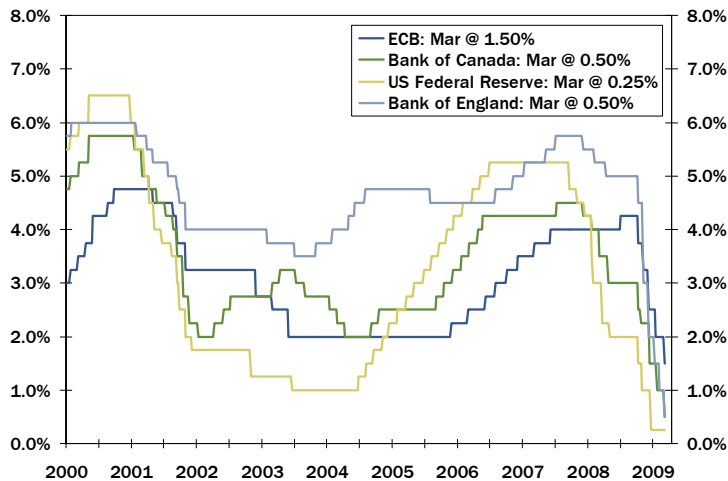
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Bank of England Taking a Cue from the FOMC

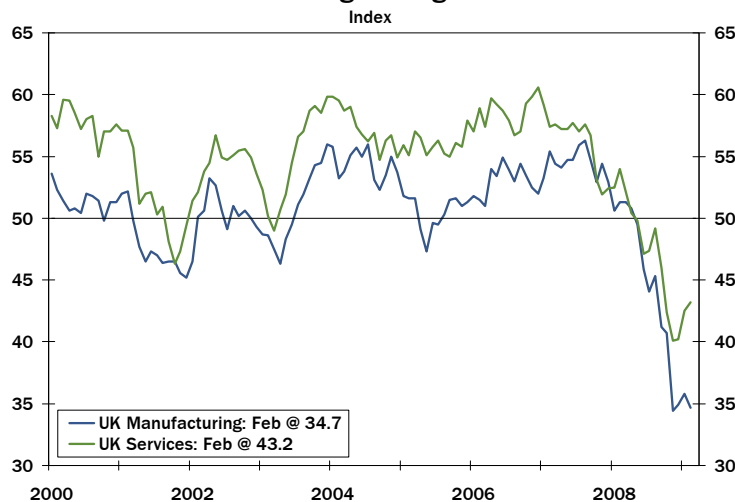
The BoE had been reluctant to cut rates quickly over the last year even as the Federal Reserve was quick to do so. The rationale for not rushing to bring down the lending rate drastically had to do with the BoE's mandate to keep inflation near two percent, when last fall year-over-year inflation was over five percent. But inflation -- at a year-over-year rate of 3.0 percent in January -- poses less of a threat. With just about every major economy around the world mired in recession, there is less danger of runaway inflation taking hold. In addition to the problem of slowing growth abroad, there were signs this week that domestic demand in the United Kingdom was falling apart as well. The purchasing managers' indexes for both manufacturing and the service sector remained in contraction territory in February though the survey for the service sector has begun to show tentative signs of recovery. BoE Governor Mervin King wrote to the Chancellor of the Exchequer noting that in "these highly uncertain times, there are merits to stimulating the economy through a variety of different channels." By means of this correspondence, the BoE governor sought - and received - authorization to print money and buy financial assets. In remarks following the official announcement Chancellor Darling noted that "America has been doing something like this for several months."

Across the English Channel, the European Central Bank (ECB) moved to cut its rate 50 basis points to 1.50 percent. The ECB has been the "last one in" in the effort by the world's central banks to cut rates and provide liquidity to a choked credit market. The situation in the Euro-zone has quickly gone from bad to worse. Data released this week showed that the 16-country economy contracted at a 5.8 percent annual rate in the fourth quarter. It is unclear in what sector any recovery will begin in the Euro-zone. There is little hope for a quick turnaround in manufacturing as the manufacturing PMI is at an all time low. Consumer spending in the Euro-zone is likely to remain against the ropes as unemployment is now over eight percent and consumer confidence is also at a record low. With EU rules forbidding the ECB from buying government bonds, it is hard to imagine the ECB fostering a rally in government bonds as the BoE did this week.

Central Bank Policy Rates



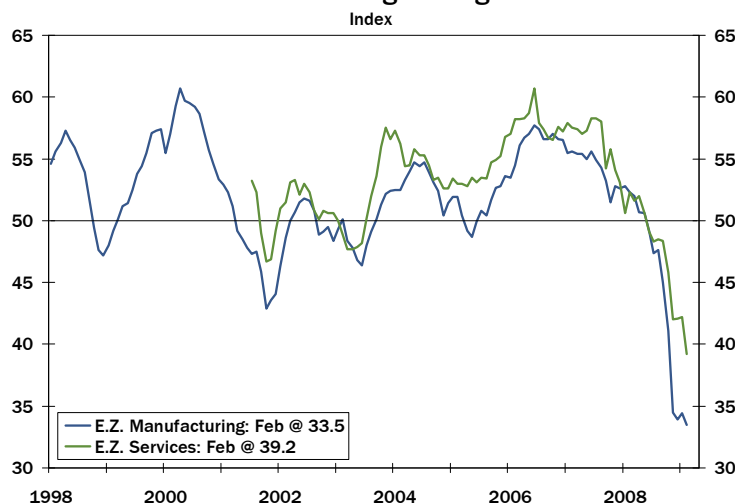
UK Purchasing Manager Indices



Selected Global Data

Japan	GDP Year-over-Year	Q4 - 2008	-4.6%
	CPI	January - 2009	0.0%
	Unemployment	January - 2009	4.1%
	BoJ Target Rate	Mar - 06	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 - 06	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 - 05	0.50%
Canada	GDP Year-over-Year	December - 2008	0.5%
	CPI	January - 2009	1.1%
	Unemployment	January - 2009	7.2%
	BoC Target Rate	Mar - 06	0.50%

Euro-zone Purchasing Manager Indices



Japanese Machinery Orders • Tuesday

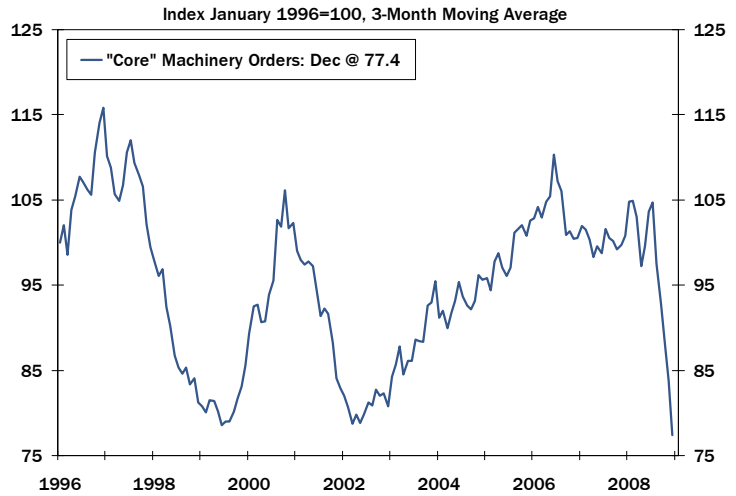
Recent data on “core” machinery orders indicate that capital spending in Japan has weakened sharply, and growth in consumer spending, which has not been very strong over the past few years anyway, has also weakened. We expect the declines in orders from last year will carryover into 2009 and we will likely see substantial declines again in machine orders again in January. The sources of the downturn are numerous. Notably, the volume of exports has essentially collapsed due to deep recessions in many of Japan’s most important trading partners.

Japanese real GDP contracted at an annualized rate of 12.7 percent in the fourth quarter of 2008. The single biggest contributor to the sharp drop in overall GDP was the 45 percent annualized plunge in exports that is consistent with the nosedive in industrial production in the fourth quarter.

Previous: -1.7%

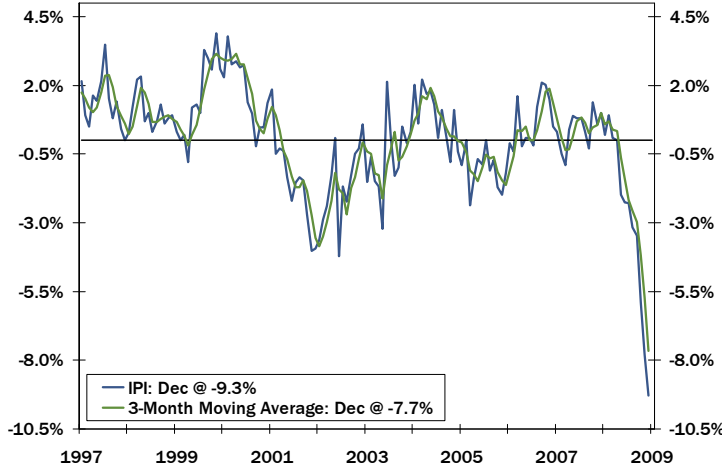
Consensus: -5.0%

Japanese "Core" Machinery Orders



U.K. Industrial Production Index

Year-over-Year Percent Change



UK Industrial Production • Tuesday

Real GDP in the United Kingdom contracted at an annualized rate of 5.9 percent in the fourth quarter, the sharpest rate of contraction since the second quarter of 1980. As mentioned in the “Global Review” section of this report, purchasing managers’ indices remained at very low levels in February, indicating that the economy likely contracted further in the start of the first quarter. Industrial production data, released Tuesday, will give us a good indication of the extent to which manufacturing slowed going into the first quarter.

Two other pieces of information will give investors a sense of how GDP is shaping up in the first quarter. Later in the day on Tuesday an estimate for the three month change in GDP becomes available. Then on Wednesday, the details on the trade balance will print. As the global recession takes hold, we hold out little hope for a turnaround in Q1.

Previous: -1.7%

Consensus: -1.2%

Canadian Employment Report • Friday

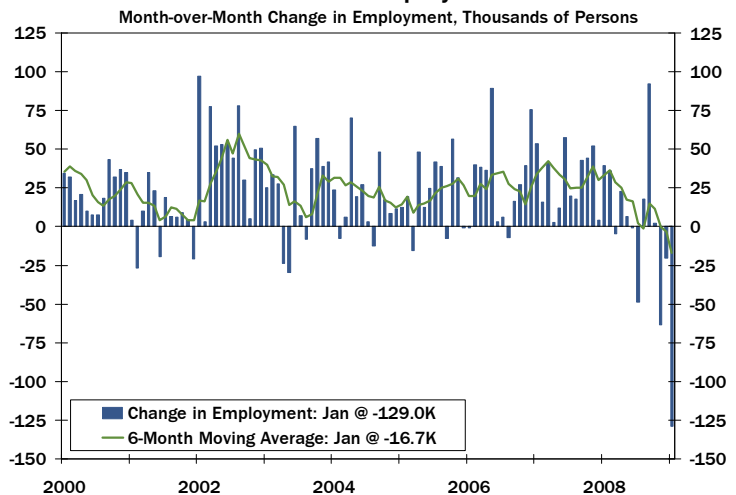
Canada’s labor market sustained a jaw-dropping contraction of 129,000 jobs in January, as the unemployment rate jumped to 7.2 percent. As recently as September, the Canadian economy was still adding jobs at a healthy pace, but not even Canada’s once-resilient economy can be shielded from the effects of global recession. The consensus is looking for another decline of 50,000 jobs. Coming at the heels of the record layoffs in January, a decline of that magnitude would likely drive the unemployment rate to nearly 7.5 percent and would be a huge impediment to consumer spending in the first quarter.

While the consumer is cutting back in Canada, consumers are cutting back abroad as well – particularly in the United States. This is a major drag on net exports. We will find out how much of a drag when the trade balance for January is reported later in the day on Friday.

Previous: -129.0K

Consensus: -50.0K

Canadian Employment



Interest Rate Watch

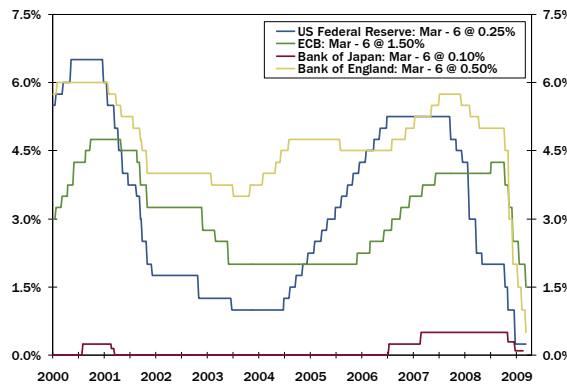
Topic of the Week

Forward Looking Markets

In recent days there have been assertions that the market is not forward looking because the market failed to accurately anticipate the current difficulties. This is convenient Monday morning quarterbacking and totally off the mark. Capital markets are forward-looking in the sense that prices anticipate future developments and price accordingly. For example, the research on long-term interest rates suggests that longer-term interest rates can be described by the expectations hypothesis which posits that the interest rate on a longer-term bond is the simple average of future short-term interest rates plus a constant term premium (Campbell & Shiller Review of Economic Studies, 1991). Such forward-looking behavior is well established in the literature elsewhere as well. Contrary to the brash statements made by some commentators, forecasts that may turn out incorrect do not mean that those statements are not forward-looking. Our economic outlook is always forward looking. The fact that the economy was in recession last quarter does not help us forecast interest rates for the year ahead. What matters are our forward-looking expectations for economic growth, inflation, monetary policy, federal deficits and the dollar.

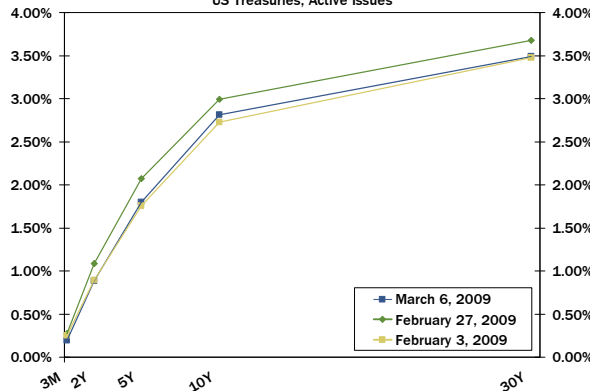
Unfortunately, our expectations also reflect our view on the political outcomes of the many policy initiatives currently in Washington. Moreover, when all market participants express their expectations then the market prices today reflect the expected impact of all published policy proposals. This is disappointing to commentators who wish to blame current market conditions on past mistakes but for investors it is the future that matters.

Central Bank Policy Rates



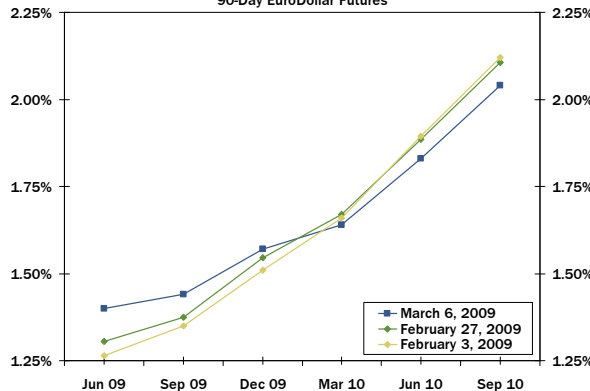
Yield Curve

US Treasuries, Active Issues



Forward Rates

90-Day EuroDollar Futures



Mortgage Delinquencies Skyrocket

The Mortgage Bankers Association's National Delinquency Survey, released earlier this week, puts the mortgage delinquency rate at 7.88 percent for the fourth quarter of 2008, nearly one percentage point higher than the third quarter. The current delinquency rate is the highest on record. The series began in 1972 - and the sharp jump from the third quarter is also the largest on record. Early in the cycle rising mortgage delinquencies were due to poor underwriting and loose credit standards, now they are increasingly caused by declining wage and salary growth and skyrocketing job losses.

The delinquency numbers continue to be driven by key deteriorating housing markets - California, Nevada, Arizona and Michigan. But the recent report also showed sharp increases in seriously delinquent loans in Louisiana, New York, Georgia, Texas and Mississippi, suggesting that the impact of the deepening recession is affecting housing markets nationwide.

The foreclosure inventory rate increased sharply to 3.30 percent, more than three times the value during the housing market's peak in 2006. Distressed homes accounted for about 45 percent of existing home sales in January putting considerable downward pressure on home prices. Increased delinquency rates will likely cause many lenders to tighten standards further, preventing many buyers from entering the market.

So far, the peak in delinquency rates is still not in sight. Historically, delinquency rates tend to lag the business cycle, usually peaking late in, or after, the recession. We expect that in this business cycle, delinquency rates may not peak until the recovery begins.

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

	Friday 2/27/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.25	0.27	1.96
3-Month LIBOR	1.26	1.25	3.09
1-Year Treasury	0.79	0.66	1.89
2-Year Treasury	1.04	0.94	1.99
5-Year Treasury	2.06	1.83	2.89
10-Year Treasury	3.03	2.79	3.85
30-Year Treasury	3.71	3.57	4.65
Bond Buyer Index	4.87	4.89	5.11

Foreign Interest Rates

	Friday 2/27/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.83	1.88	4.39
3-Month Sterling LIBOR	2.05	2.07	5.70
3-Month Canadian LIBOR	1.35	1.48	3.85
3-Month Yen LIBOR	0.64	0.63	0.90
2-Year German	1.32	1.31	3.36
2-Year U.K.	1.43	1.48	4.31
2-Year Canadian	1.17	1.23	3.06
2-Year Japanese	0.41	0.39	0.63
10-Year German	3.12	3.01	4.09
10-Year U.K.	3.61	3.42	4.70
10-Year Canadian	3.12	2.87	3.82
10-Year Japanese	1.28	1.28	1.48

Foreign Exchange Rates

	Friday 2/27/2009	1 Week Ago	1 Year Ago
Euro (\$/€)	1.269	1.283	1.512
British Pound (\$/£)	1.430	1.443	1.982
British Pound (£/€)	0.887	0.889	0.763
Japanese Yen (¥/\$)	97.809	93.348	106.490
Canadian Dollar (C\$/ \$)	1.269	1.252	0.980
Swiss Franc (CHF/\$)	1.167	1.156	1.063
Australian Dollar (US\$/A\$)	0.643	0.645	0.942
Mexican Peso (MXN/\$)	15.079	14.777	10.699
Chinese Yuan (CNY/\$)	6.840	6.837	7.142
Indian Rupee (INR/\$)	51.161	49.770	39.785
Brazilian Real (BRL/\$)	2.372	2.384	1.670
U.S. Dollar Index	88.119	86.488	74.213

Commodity Prices

	Friday 2/27/2009	1 Week Ago	1 Year Ago
W. Texas Crude (\$/Barrel)	43.65	38.94	99.64
Gold (\$/Ounce)	938.28	992.90	957.84
Hot-Rolled Steel (\$/S.Ton)	475.00	475.00	700.00
Copper (¢/Pound)	153.65	141.60	383.80
Soybeans (\$/Bushel)	8.64	8.80	14.22
Natural Gas (\$/MMBTU)	4.15	4.01	8.93
Nickel (\$/Metric Ton)	9,980	9,821	27,729
CRB Spot Inds.	335.61	337.87	503.47

Next Week's Economic Calendar

	Monday 9	Tuesday 10	Wednesday 11	Thursday 12	Friday 13
U.S. Data		Wholesale Inventories December -1.4% January -1.0% (C)		Retail Sales January 1.0% February -0.7% (W) Retail Sales Less Autos January 0.9% February 0.7% (W)	Trade Balance December -\$39.9B January -\$43.7B (W) Import Price Index January -1.1% February -0.2% (W)
Global Data		UK Indus. Production (MoM) Previous (Dec) -1.7%	Japan Machine Orders (MoM) Previous (Dec) -1.7%	Japan GDP Annualized Previous (4Q) -12.7% Euro-zone PPI (MoM) Previous (Dec) -1.3%	Canada Unemployment Rate Previous (Jan) 7.2% Canada Net Chan. in Employment Previous (Jan) -129K

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

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