

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

March 27, 2009

U.S. Review

A Few Good Numbers

Economists explain away economic reports that run contrary to their own forecasts and analysis. In many cases the explanations offered by economists make perfect sense. They explain the perverse effects that seasonal adjustment, odd weather patterns or other quirks in the collection and reporting of data can often have on economic indicators. This past week's rush of more upbeat reports was no exception, with better news on home sales, housing prices and durable goods orders readily dismissed. We think such a quick dismissal is a mistake.

There is no doubt the recent run of more upbeat reports has been exaggerated by numerous unusual factors. Changes in the tone of such a wide variety of economic reports, however, generally tend to mark a change in the economy's underlying momentum. Such a change is not unexpected. We have long held that the fourth quarter of last year and first quarter of this year would mark the darkest hours of the recession. The more recent data are consistent with this view and suggest that the pace of economic decline will moderate this spring.

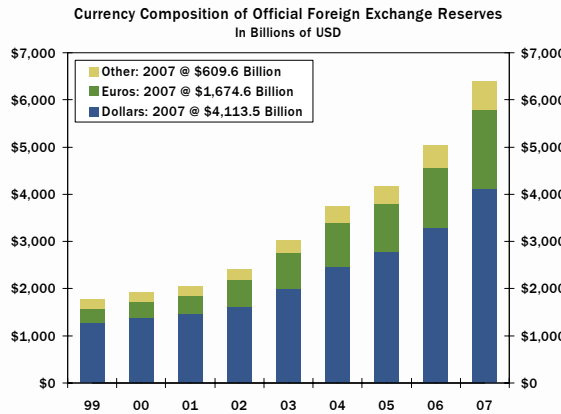
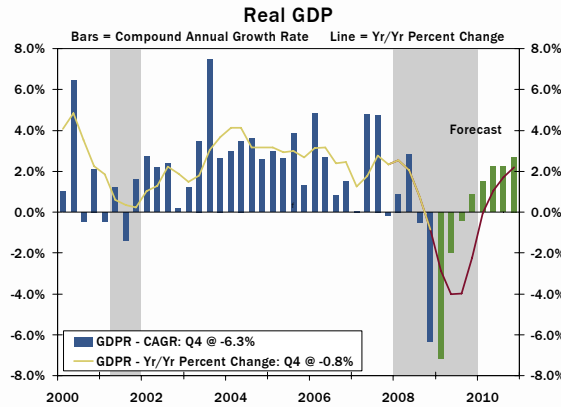
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Global Review

New Reserve Currency?

The governor of China's central bank made a bit of a stir this week when he called for a new currency to eventually replace the dollar as the world's predominant reserve currency. As shown in the chart at the left, the world held more than \$6 trillion worth of foreign exchange reserves at the end of 2007. Although the greenback's share has declined a bit over the past few years, approximately two-thirds of total foreign exchange reserves are still held in dollars. The slide in the value of the dollar since 2002 (see chart at top of page 4) has eroded the purchasing power of many country's foreign exchange reserves. For a country like China, which holds about \$2 trillion worth of reserves (see middle chart on page 4), the decline in the value of the dollar is not an insignificant issue. Is the greenback about to be dethroned in favor of another currency?

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Recent Special Commentary

Date	Title	Authors
March-18	The Long Road Ahead for "Club Med" Countries	Bryson
March-18	FOMC Implication For the Dollar	Bryson
March-18	FOMC March Meeting: Buy Treasuries, More Agency MBS	Silvia
March-17	Economics as Strategic Input to Business Decision-Making	Silvia

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

³ Year-over-Year Percentage Change

⁴ Millions of Units

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U.S. Review

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Housing Is Feeling Its Way Toward a Bottom

Some of the most surprising news this past week was the better than expected data on new and existing home sales for the month of February. Sales of existing homes rose 5.1 percent in February, pushing sales up to a 4.72 million unit annual rate. Foreclosures and short sales continue to account for a large proportion of overall sales, with the National Association of Realtors attributing 45 percent of February's sales to that category. Anecdotally we are seeing strong investor demand for deeply discounted foreclosed homes in many of the hardest hit housing markets. The surge in foreclosure sales is one reason prices are down 15 percent over the past year.

Sales of new homes also improved in February, rising 4.7 percent to a 337,000 unit annual rate. Sales rose nearly ten percent in the South and close to seven percent in the West, but they fell in both the Northeast and Midwest. The improvement in sales combined with dramatic cutbacks in new construction has helped pull inventories down to much more manageable levels. At current trends, housing inventories in unit terms should be back at their pre-boom level by this summer.

One of the most surprising statistics was the Federal Housing Finance Authority's report of a record 1.7 percent rise in home prices during January, with gains in every region except the West. As much as we would like to believe the report, the price increase seems inconsistent with everything else we are hearing from realtors, builders and lenders. January and February are two of the least important months for housing and sales and prices can be distorted by even slight changes in buyer behavior brought about by unseasonably mild weather or some other special factor.

While there are sound reasons for downplaying the better news on sales and prices, the preponderance of upbeat reports from the housing sector should not be entirely dismissed. When things were really bad in the housing market, even mild weather was not enough to make the numbers look better. At the very least, the rate of deterioration in home sales and housing prices is likely slowing and we are quite possibly finding a bottom.

Advance orders for durable goods also posted a surprising increase in February, rising 3.4 percent. The increase marks the first rise for durable goods orders in seven months and the largest increase in over a year. A large downward revision to the previous month's numbers and a huge 40 percent jump in defense orders, takes some of the shine off this number. Orders for January now show a 7.3 percent drop, compared to a 4.5 percent drop reported earlier.

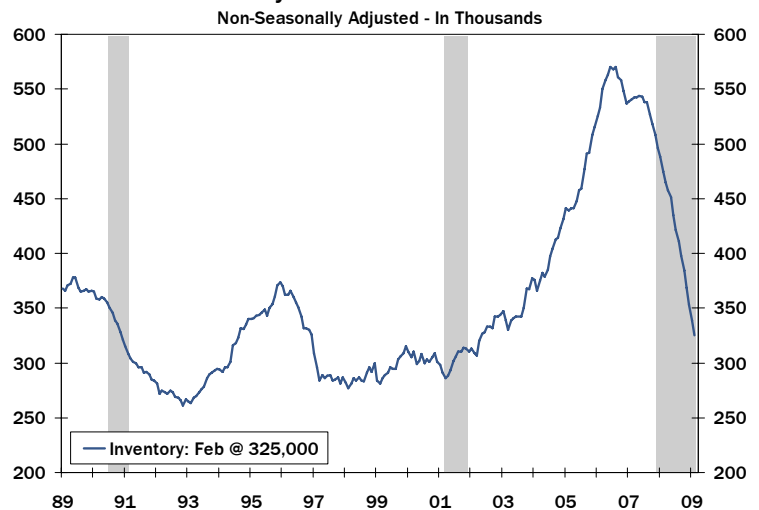
Selected Current Data

Gross Domestic Product - CAGR	Q4 - 2008	-6.3%
GDP Year-over-Year	Q4 - 2008	-0.8%
Personal Consumption	Q4 - 2008	-4.3%
Business Fixed Investment	Q4 - 2008	-21.7%
Consumer Price Index	February - 2009	0.2%
"Core" CPI	February - 2009	1.8%
"Core" PCE Deflator	February - 2009	1.8%
Industrial Production	February - 2009	-11.2%
Unemployment	February - 2009	8.1%
Federal Funds Target Rate	Mar - 27	0.25%

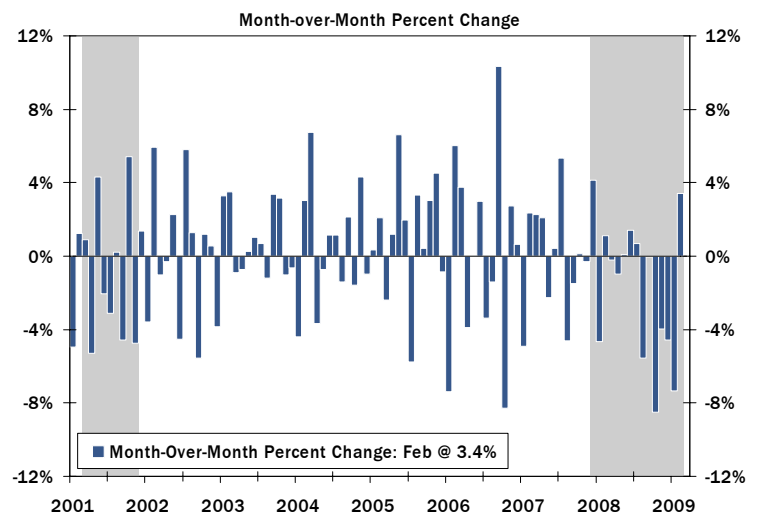
Existing Home Resales



Inventory of New Homes for Sale



Durable Goods New Orders



Consumer Confidence • Tuesday

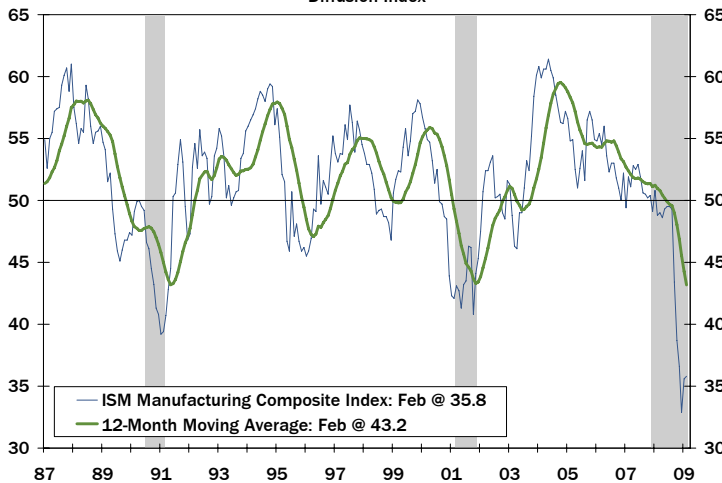
Consumer confidence fell another 12.4 points in February as consumers continued to worry about major headwinds facing both the U.S. economy and their own personal finances. Most of the sub-indexes showed continued weakness, with consumers' assessment of both the present situation and future conditions declining. The expectations index dropped 15 points to just 27.5, another new all-time low.

Consumer confidence has historically had a significant correlation with the labor market, and with total job losses since employment peaked in December 2007 now over 4.2 million, consumer confidence should continue to wane. Given that the labor market will remain severely challenged through 2010, we expect consumer confidence will remain depressed for the foreseeable future. This will put considerable downward pressure on economic growth prospects.

Previous: 25.0

Wachovia: 25.0

Consensus: 27.0

ISM Manufacturing Composite Index
Diffusion Index

Employment • Friday

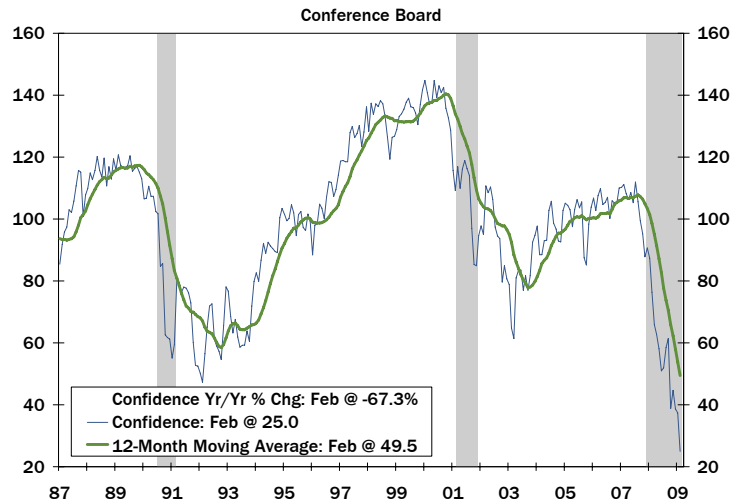
Nonfarm employment fell 651,000 with broad declines in manufacturing, construction and services; while government jobs rose. Aggregate hours declined for the tenth month in a row, signaling continued recession. Consumers remain challenged as earnings slow. The only bright spots remaining are health care & education, which reflect demographic trends.

Initial jobless claims remain solidly in recession territory with the four week moving average surging to 649,000. Continuing claims also remain at historic levels. We expect job losses to continue at an alarming pace in March with the unemployment rate reaching 8.5 percent. With consumers worried about their jobs, the outlook for consumer spending is obviously not very bright.

Previous: -651K

Wachovia: -670K

Consensus: -656K

Consumer Confidence Index

ISM Manufacturing • Wednesday

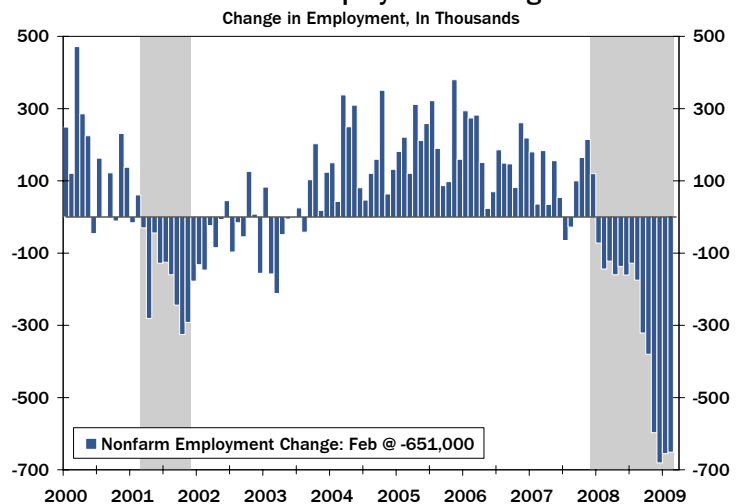
For the second consecutive month, the headline ISM manufacturing index increased slightly to 35.8 in February. The production index increased modestly while new orders stayed flat. After jumping nearly ten points in January, the new orders index remained steady on the month. The outlook for the manufacturing sector, however, remains under considerable pressure and growth is not expected to rebound anytime soon.

We expect ISM to have a slight uptick in March, but remain squarely in recession territory. The long run trend, however, is down and the index remains at levels last seen since the early 1980s. New orders and order backlogs should continue to decline, indicating more weakness in the pipeline. Employment should also remain sluggish. The regional purchasing manager reports remain weak, suggesting a decline in the headline number.

Previous: 35.8

Wachovia: 36.1

Consensus: 36.0

Nonfarm Employment Change


Global Review

(Continued from Page 1)

What the Chinese have in mind is a new currency, not an existing one, to replace the dollar's pre-eminent status. After all, another existing currency, say the euro, could depreciate as well in the years ahead.

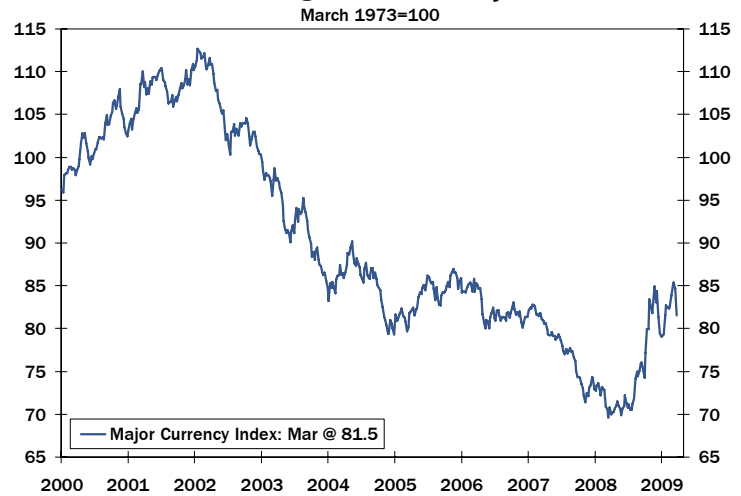
An international currency already exists, which is called the SDR (i.e., Special Drawing Rights at the International Monetary Fund). The SDR is a composite currency that is comprised of the dollar, the euro, the yen, and the British pound. Countries are given SDRs in proportion to their IMF quota. There currently are 21 billion SDRs outstanding (about \$32 billion at current exchange rates), a pittance in relation to the \$6 trillion worth of total reserves. Moreover, SDRs are rarely used, because there are no goods, services or assets that are denominated in SDRs. Why would a country want to hold a large stock of SDRs if their use is limited?

A new currency could be invented, but who would "back" it? The IMF? The IMF is "owned" by the countries of the world, so the ultimate guarantors of the new currency would just be the countries of the world. At the end of the day, you would be left with a new currency that nobody really wants to use.

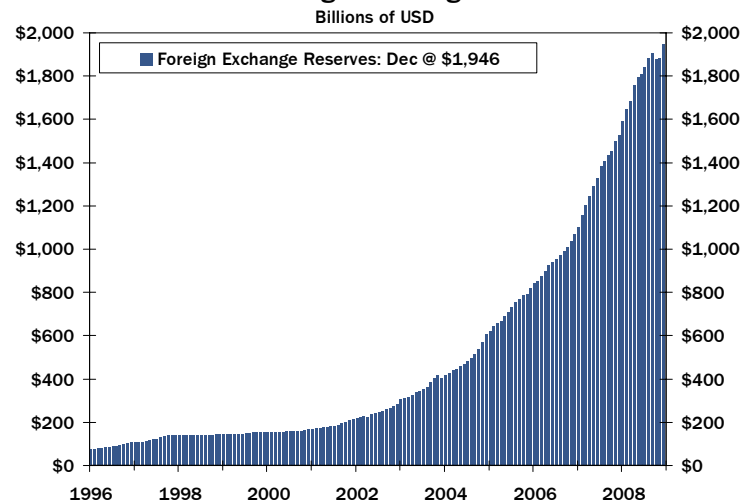
In our view, timing is important in understanding why China is broaching the idea of a new reserve currency. The leaders of the G-20 countries meet next week in London, and increased funding for the IMF will be on the agenda. The IMF is essentially run by the western powers, an arrangement that China finds to be unsatisfactory. If the rest of the world wants China to pony up more resources for the IMF, then China wants more say in how the institution is run. Calling for a new reserve currency at this point is just another way for China to push its geopolitical agenda vis-à-vis the United States.

Undoubtedly, country leaders will promise to "study" the issue of a new reserve currency. However, we expect little to come of the effort. At some point in the distant future, the Chinese renminbi may be held as a reserve asset by other central banks. A precondition for reserve currency status is open capital markets, something that China lacks at present and probably won't have for a number of years. In the meantime, the Chinese will continue to build foreign exchange reserves, and they probably will continue to keep the value of their currency fairly stable versus the dollar.

US Trade Weighted Dollar Major Index



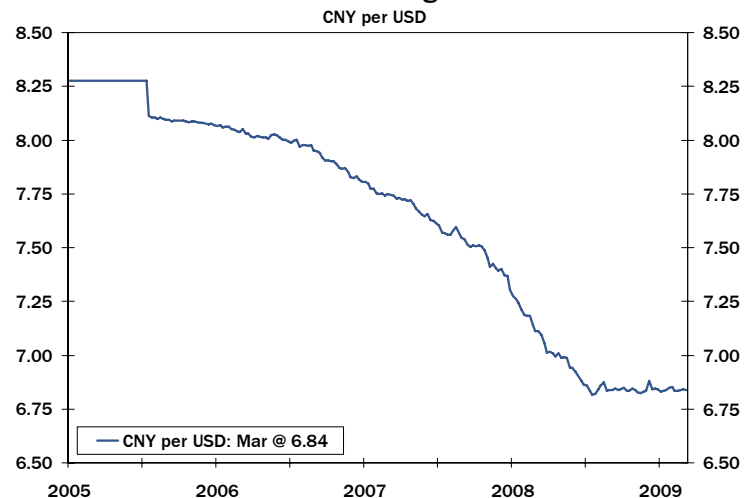
Chinese Foreign Exchange Reserves



Selected Global Data

Japan	GDP Year-over-Year	Q4 - 2008	-4.3%
	CPI	February - 2009	-0.1%
	Unemployment	January - 2009	4.1%
	BoJ Target Rate	Mar - 27	0.10%
Euro-Zone	GDP Year-over-Year	Q4 - 2008	-1.3%
	CPI	February - 2009	1.2%
	Unemployment	January - 2009	8.2%
	ECB Target Rate	Mar - 26	1.50%
UK	GDP Year-over-Year	Q4 - 2008	-2.0%
	CPI	February - 2009	3.2%
	Unemployment	February - 2009	4.3%
	BoE Target Rate	Mar - 27	0.50%
Canada	GDP Year-over-Year	December - 2008	0.5%
	CPI	February - 2009	1.4%
	Unemployment	February - 2009	7.7%
	BoC Target Rate	Mar - 27	0.50%

Chinese Exchange Rate



Japanese Tankan Index • Wednesday

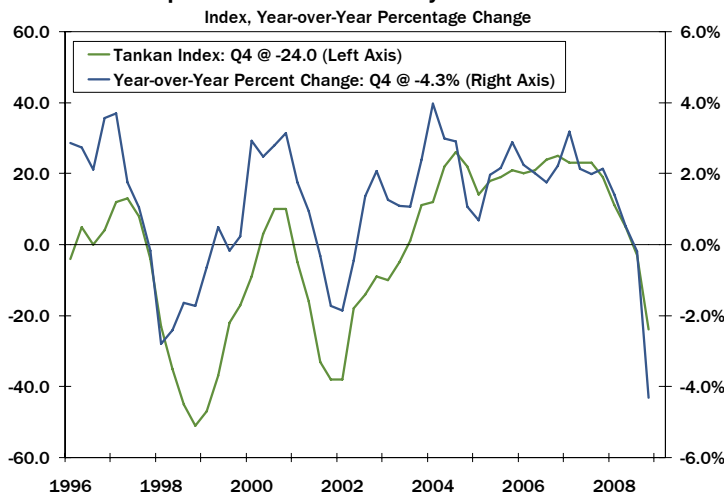
The Tankan index of Japanese business sentiment, which is highly correlated with the year-over-year rate of real GDP growth, fell sharply in the fourth quarter. Unfortunately, most investors are braced for a further plunge in the index in the first quarter, suggesting that the economy contracted even further. Indeed, our forecast looks for the economy to contract over 7 percent on a year-over-year basis in the current quarter.

Other data releases for February that are on the docket next week will paint a more complete picture of the Japanese economy at present. Of particular interest will be the industrial production figures. Data on retail spending, unemployment, housing starts, and CPI inflation will also print next week.

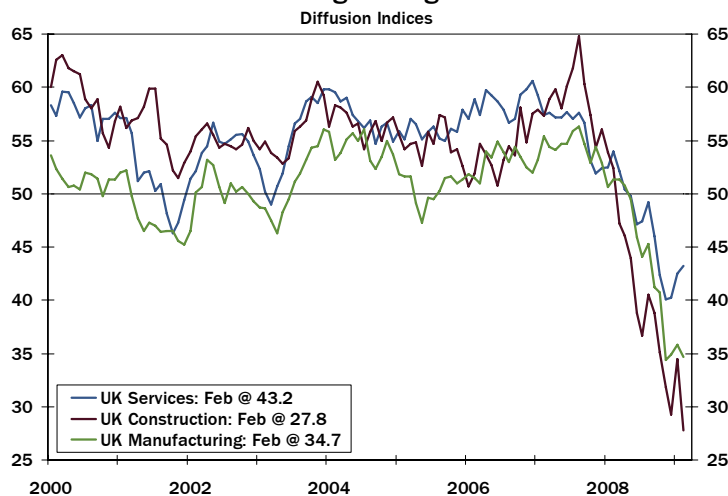
Previous: -24

Consensus: -55

Japanese Tankan Survey & Real GDP



U.K. Purchasing Manager's Indices



U.K. Manufacturing PMI • Friday

The British economy contracted at an annualized rate of 6.0 percent in the fourth quarter relative to the previous quarter, and the depressed level of the PMIs for the manufacturing, construction and services sectors through February suggest that real GDP continues to decline at a marked rate. Therefore, investors will be very interested to see if the PMIs for manufacturing (Wednesday), construction (Thursday) and services (Friday) improved at all in March.

Some other data releases on the docket next week will provide more information about the current state of the U.K. economy. Statistics on mortgage approvals, consumer credit and consumer confidence will print on Monday, and a widely-followed index of house prices is slated for release at some point next week.

Previous Manufacturing PMI: 34.7 Consensus: 35.0

Previous Services PMI: 43.2 Consensus: 43.5

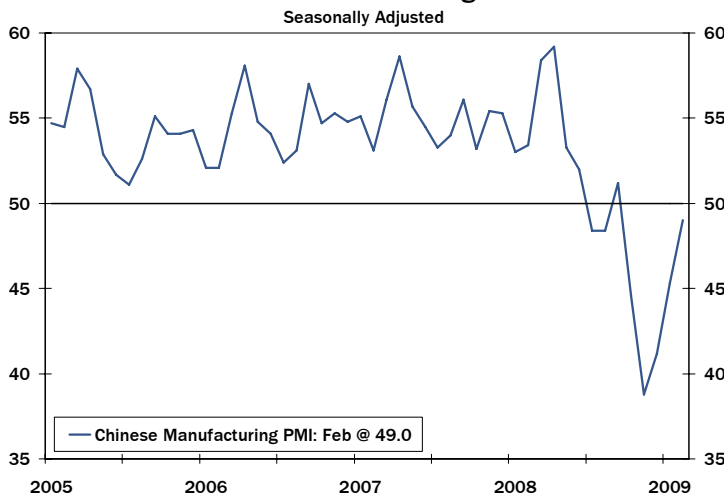
Chinese Manufacturing PMI • Friday

The Chinese economy has not been immune to the global slowdown. Indeed, real GDP grew only 6.8 percent in the fourth quarter, the slowest year-over-year growth rate in seven years. Available monthly data from the current quarter suggest that growth has slowed even further.

However, the economy may be nearing a turning point due in part to the fiscal stimulus the government put in place at the end of last year. The manufacturing PMI, which fell sharply in the fourth quarter, rebounded in January and February. Will the PMI cross "50," the demarcation line that separates expansion from contraction in the manufacturing sector? If it does, investors may reason that the worst of the slowdown has already occurred in the Chinese economy.

Previous: 49.0

Chinese Manufacturing PMI



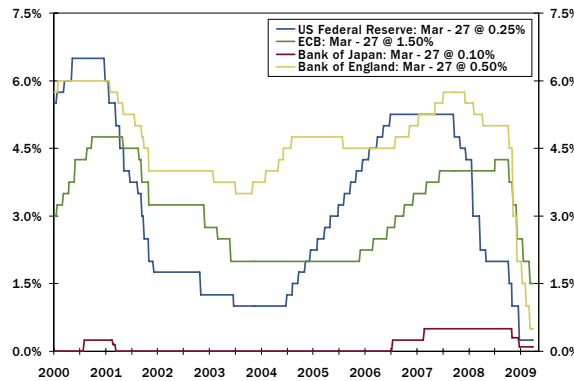
Interest Rate Watch
Bond Market Vigilantes

Worries about the ability to finance growing budget deficits in the United States and the United Kingdom came to a head on Wednesday when the British governments auction of longer term gilts did not attract enough buyers to sell the bonds. The failure marked the first time a gilt auction failed to attract enough buyers since 1995. The Congressional Budget office raised its estimate for this year's budget deficit to \$1.8 trillion and the Treasury's auction of five-year notes was received with just tepid demand.

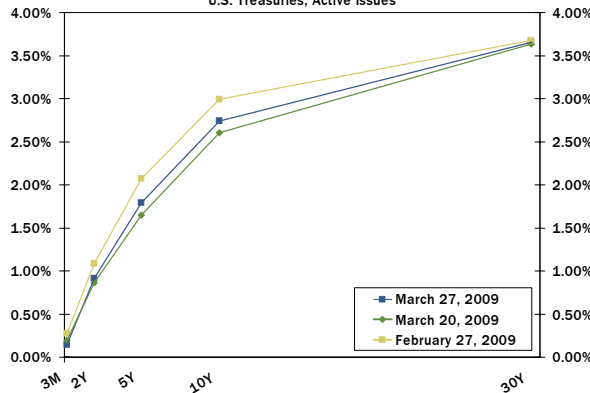
For a few minutes it really looked like the wheels were coming off the bus. Chinese officials made headlines during the week, with reports circulating that they would like a new global reserve currency, perhaps issued by the IMF. Such talk has been readily dismissed. The new currency talk signals a loud protest to rapidly growing deficits and faster money growth in many developed nations.

Nerves appeared to cool off later in the week. The Treasury's auction of seven year notes went well and bond yield remain exceptionally low. The Federal Reserve has begun its trillion dollar purchase program of Treasury bonds and mortgage backed issues. The program has helped drive conventional mortgage rates below 5 percent and set off a refinancing boom.

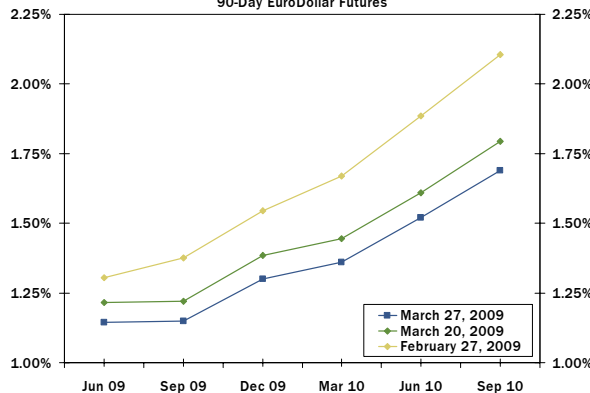
Yields on three month Treasury bills dropped below zero, as quarter end liquidity pressures and a lack of confidence in other credit instruments led to exceptionally strong demand for short-term bills. While the drop into negative territory does not signal the onset of a new liquidity crisis, credit spreads do remain exceptionally wide and the corporate market does not seem to be anywhere near as upbeat as the equity market was this week.

Central Bank Policy Rates

Yield Curve

U.S. Treasuries, Active Issues


Forward Rates

90-Day EuroDollar Futures


Topic of the Week
"Club Med" Countries Hamstrung

Most economies in the European Economic and Monetary Union (EMU) appear to be in the midst of their deepest recessions in decades. However, policymakers in Greece, Italy and Spain, so-called "Club Med" countries, are hamstrung. Monetary policy is the domain of the politically independent European Central Bank (ECB), and high government debt-to-GDP ratios constrain the ability to engage in countercyclical fiscal policy. In addition, exchange rate depreciation versus other EMU countries, with which the "Club Med" countries have extensive trade ties, is out of the question due to the common use of the euro.

Greece, Italy and Spain all have sizeable current account deficits at present, a byproduct of their overvalued real exchange rates. With nominal exchange rate depreciation vis-à-vis other EMU countries impossible, unit labor costs will need to decline in the "Club Med" countries relative to major trading partners. Either productivity needs to accelerate, which is an uncertain prospect, or relative wages need to decline. In other words, Greece, Italy and Spain could be in for a long period of sub-par growth until their real exchange rates depreciate to more sustainable levels.

Some investors believe that a "Club Med" country could decide to abandon the euro between now and the end of next year, but there does not appear to be much political support for such a radical step at present. If the Greek, Italian and Spanish economies remain stagnant for a number of years, then political momentum could begin to build for a re-introduction of national currencies.

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

	Friday 3/27/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.13	0.20	1.26
3-Month LIBOR	1.22	1.22	2.70
1-Year Treasury	0.54	0.53	1.54
2-Year Treasury	0.88	0.87	1.69
5-Year Treasury	1.76	1.64	2.54
10-Year Treasury	2.71	2.63	3.53
30-Year Treasury	3.61	3.66	4.39
Bond Buyer Index	5.00	4.98	4.96

Foreign Interest Rates

	Friday 3/27/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.53	1.57	4.73
3-Month Sterling LIBOR	1.68	1.75	6.00
3-Month Canadian LIBOR	1.02	1.10	3.59
3-Month Yen LIBOR	0.61	0.61	0.95
2-Year German	1.30	1.32	3.42
2-Year U.K.	1.29	1.34	4.12
2-Year Canadian	1.16	1.01	2.58
2-Year Japanese	0.42	0.40	0.59
10-Year German	3.07	2.97	3.92
10-Year U.K.	3.28	3.03	4.50
10-Year Canadian	2.90	2.74	3.47
10-Year Japanese	1.33	1.27	1.28

Foreign Exchange Rates

	Friday 3/27/2009	1 Week Ago	1 Year Ago
Euro (\$/€)	1.329	1.358	1.578
British Pound (\$/£)	1.433	1.446	2.007
British Pound (£/€)	0.927	0.939	0.786
Japanese Yen (¥/\$)	97.960	95.942	99.650
Canadian Dollar (C\$/\\$)	1.241	1.241	1.019
Swiss Franc (CHF/\\$)	1.144	1.127	0.994
Australian Dollar (US\$/A\\$)	0.692	0.687	0.919
Mexican Peso (MXN/\\$)	14.330	14.171	10.694
Chinese Yuan (CNY/\\$)	6.832	6.828	7.012
Indian Rupee (INR/\\$)	50.604	50.390	40.145
Brazilian Real (BRL/\\$)	2.274	2.270	1.736
U.S. Dollar Index	85.136	83.841	71.660

Commodity Prices

	Friday 3/27/2009	1 Week Ago	1 Year Ago
W. Texas Crude (\\$/Barrel)	52.19	51.06	107.58
Gold (\\$/Ounce)	923.05	952.20	947.20
Hot-Rolled Steel (\\$/S.Ton)	450.00	450.00	830.00
Copper (\\$/Pound)	181.40	179.00	390.35
Soybeans (\\$/Bushel)	9.44	9.45	12.93
Natural Gas (\\$/MMBTU)	3.80	4.23	9.58
Nickel (\\$/Metric Ton)	9,633	9,922	29,550
CRB Spot Inds.	334.81	329.21	510.82

Next Week's Economic Calendar

	Monday 30	Tuesday 31	Wednesday 1	Thursday 2	Friday 3
U.S. Data		Consumer Confidence February 25.0 March 25.0 (W)	ISM Manufacturing February 35.8 March 36.1 (W) Construction Spending January -3.3% February -1.0% (W) Total Vehicle Sales February 9.1M March 9.0M (W)	Factory Orders January -1.9% February 1.0% (W)	Nonfarm Payrolls February -651K March -670K (W) Unemployment Rate February 8.1% March 8.5% (W) ISM Non-Manufacturing February 41.6 March 41.2 (W)
Global Data	Japan Indus. Production (MoM) Previous (Jan) -10.2%	Japan Unemployment Rate Previous (Jan) 4.1% Germany Unemployment Rate Previous (Feb) 7.9%	Japan Tankan Mfg Index Previous (4Q) -24 UK PMI Manufacturing Previous (Feb) 34.7		UK PMI Services Previous (Feb) 43.2 China PMI Manufacturing Previous (Feb) 49.0

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

Wachovia Economics Group

Diane Schumaker-Krieg	Global Head of Research & Economics	(704) 715-8437 (212) 214-5070	diane.schumaker@wachovia.com
John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wachovia.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wachovia.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wachovia.com
Sam Bullard	Economist	(704) 383-7372	sam.bullard@wachovia.com
Anika Khan	Economist	(704) 715-0575	anika.khan@wachovia.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wachovia.com
Adam G. York	Economist	(704) 715-9660	adam.york@wachovia.com
Tim Quinlan	Economic Analyst	(704) 374-4407	tim.quinlan@wachovia.com
Kim Whelan	Economic Analyst	(704) 715-8457	kim.whelan@wachovia.com
Yasmine Kamaruddin	Economic Analyst	(704) 374-2992	yasmine.kamaruddin@wachovia.com

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