

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

May 1, 2009

U.S. Review

On The Road To Recovery

The past week's first quarter GDP report likely marks the end of the economy's free fall, which began when Lehman Brothers declared bankruptcy. A similar fall is unlikely to follow yesterday's announcement that Chrysler is seeking bankruptcy protection and the economy should be able to handle whatever resolution unfolds for General Motors.

Real GDP declined at a 6.1 percent annual rate during the first quarter, with a huge \$103.7 billion plunge in inventories accounting for 2.8 percentage points of the drop. Consumer spending rebounded slightly during the quarter but business fixed investment was astonishingly weak. Government spending was another surprisingly weak sector and net exports added 2.0 percentage points to the first quarter figures. Imports fell more than exports during the quarter.

While the first quarter's decline nearly matches the fourth quarter's 6.3 percent plunge, the composition was very different. The huge drop in inventories helps pave the way for a rebound in orders and output and puts the economy firmly back on the road to recovery.

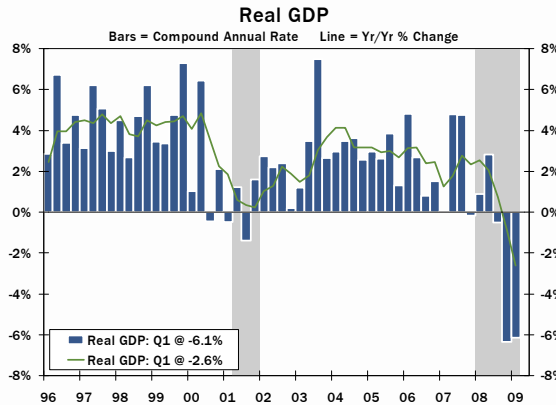
Please turn to page 2

Global Review

Euro-zone in Deep Recession

Unlike the United States, the Euro-zone has not yet released official GDP data for the first quarter of the year. However, preliminary estimates from some individual countries suggest that the official outturn will not be pretty when it is released on May 15. As shown in the chart at the left, real GDP in Spain plunged at an annualized rate of 7 percent in the first quarter relative to the fourth quarter of 2008, the sharpest rate of contraction in years if not decades. A breakdown of Spanish real GDP into its underlying demand components is not yet available, but the 10 percent drop in nominal retail sales in the first quarter (year-over-year change) suggests that consumer spending was a major reason overall GDP growth dropped as sharply as it did. The Spanish labor market has fallen completely apart. From the eight percent or so rate that prevailed

Please turn to page 4



Recent Special Commentary

Date	Title	Authors
April-30	Is What's Good for GM Still Good for the Country?	Vitner
April-29	North Carolina - Momentum Slows in the Tar Heel State	Silvia, York & Whelan
April-28	Economic Effects of the Swine Flue - Mexico and Beyond	Bryson
April-22	The Global Economy: Who Gets Out of the Gate First?	Bryson

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	-6.3	-5.8	-0.9	-1.7	0.3	2.9	2.8	2.0	1.1	-2.9	0.9
Personal Consumption	0.9	1.2	-3.8	-4.3	1.3	0.3	0.7	1.2	3.0	3.0	2.8	0.2	-0.7	1.2
Inflation Indicators ²														
Core PCE Deflator	2.2	2.3	2.3	1.9	1.7	1.4	1.0	0.9	2.1	2.3	2.2	2.2	1.3	0.9
Consumer Price Index	4.2	4.3	5.2	1.5	-0.2	-1.5	-2.9	-0.5	3.4	3.2	2.9	3.8	-1.3	1.2
Industrial Production ¹	0.2	-4.6	-9.0	-12.7	-19.6	-7.6	-2.5	0.4	3.3	2.3	1.5	-2.2	-10.6	1.7
Corporate Profits Before Taxes ²	-1.5	-8.3	-9.2	-21.5	-32.0	-30.0	-26.0	-14.0	17.6	15.2	-1.6	-10.1	-26.1	4.5
Trade Weighted Dollar Index ³	70.3	71.0	76.1	79.4	82.5	85.0	87.6	89.9	86.0	81.5	73.3	79.4	89.9	87.1
Unemployment Rate	4.9	5.4	6.1	6.9	8.1	9.1	9.7	10.1	5.1	4.6	4.6	5.8	9.2	10.6
Housing Starts ⁴	1.05	1.03	0.88	0.66	0.52	0.48	0.51	0.55	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	2.71	2.80	2.90	2.90	4.39	4.71	4.04	2.25	2.90	3.60

Data As of: April 8, 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

INSIDE

U.S. Review	2
U.S. Outlook	3
Global Review	4
Global Outlook	5
Point of View	6
Market Data	7

U.S. Review

(Continued from Page 1)

The Road To Recovery Will Likely Have a Few Potholes in It

Being on the road to recovery is not the same thing as being in a recovery. Excesses that developed before the recession still need to be corrected and this will take more time. Progress is underway. Inventories are coming down and planned shutdowns by Chrysler in May and General Motors this summer should go a long way toward clearing out the oversupply of cars and light trucks.

Government spending is also poised to rebound now that the stimulus package is rolling out. The pace of government spending may prove to be less than many are expecting, however. Federal outlays fell at a 4.0 percent annual rate in the first quarter, with spending for national defense falling at a 6.4 percent pace. Apparently, the unwinding of the Iraq War has led to cutbacks in equipment purchases and the planned buildup in Afghanistan is not large enough to offset them. Further cutbacks in military procurement are likely, although part of these cuts will be offset with increased outlays for military construction.

State and local government outlays fell at a 3.9 percent pace, with cutbacks in construction, equipment purchases, and manpower accounting for the drop. Many municipalities are facing severe financial challenges and are limited as to how much they can raise taxes or issue debt. As a result, many state and local governments have dipped into rainy-day funds, trust funds and maintenance accounts. Spending for actual maintenance and repairs is being deferred. As a result, increased funding from the federal government may not provide as much of a lift as many people expected. Instead of building new highways and bridges, federal money may end up going toward fixing potholes.

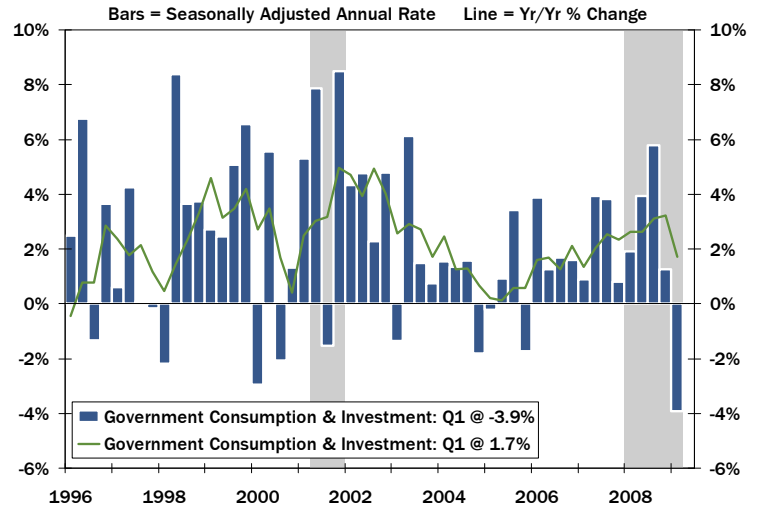
Another potential challenge for the economy is the consumer. While spending rebounded at a 2.2 percent annual rate, it ended on a weak note, with spending falling 0.2 percent in March. That means we will have to see hefty gains in April and May just to keep outlays from falling in the second quarter. While there is some anecdotal evidence that the tax cuts are helping we do not expect it to be enough. Our first look at the second quarter calls for outlays to fall at a 1.5 percent annual rate, which will make it tougher to bring inventories completely back into balance.

The ISM manufacturing survey, as well as most regional manufacturing surveys, improved during April. New orders and order backlogs have increased and inventories continue to decline. The indices remain firmly in recession territory but are moving in the right direction and show the factory sector is actually a little further down the road to recovery than the economy as a whole.

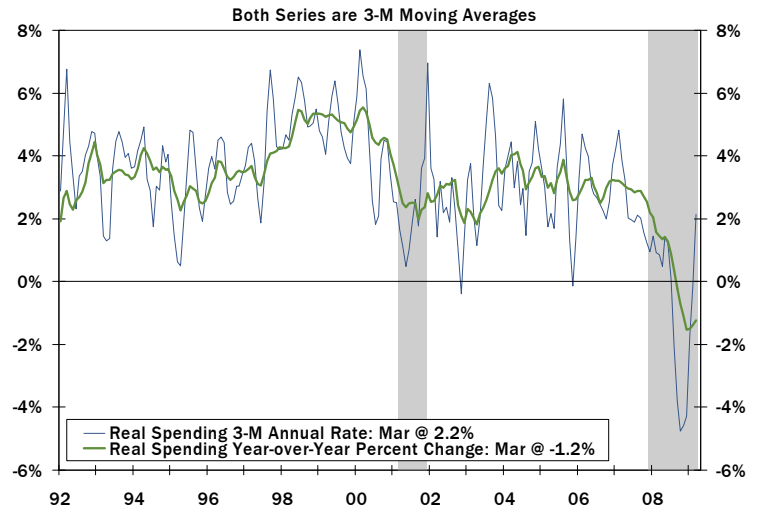
Selected Current Data

Gross Domestic Product - CAGR	Q1 - 2009	-6.1%
GDP Year-over-Year	Q1 - 2009	-2.6%
Personal Consumption	Q1 - 2009	2.2%
Business Fixed Investment	Q1 - 2009	-37.9%
Consumer Price Index	March - 2009	-0.4%
"Core" CPI	March - 2009	1.8%
"Core" PCE Deflator	March - 2009	1.8%
Industrial Production	March - 2009	-12.8%
Unemployment	March - 2009	8.5%
Federal Funds Target Rate	May - 01	0.25%

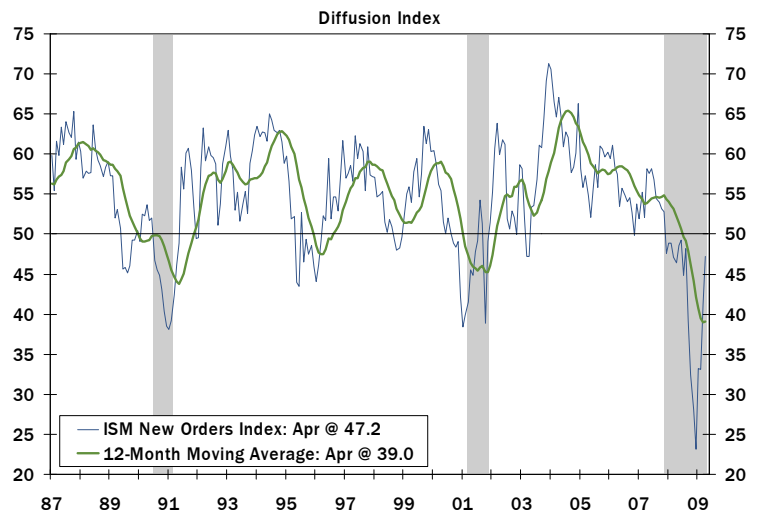
Real Government Consumption & Investment



Real Consumer Spending

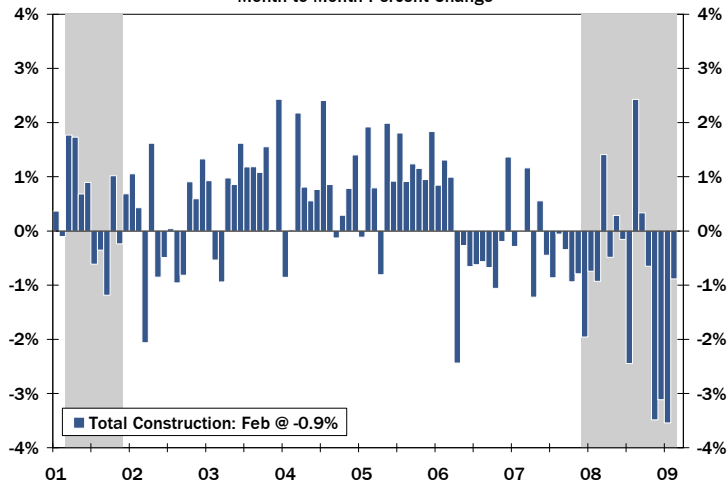


ISM New Orders Index

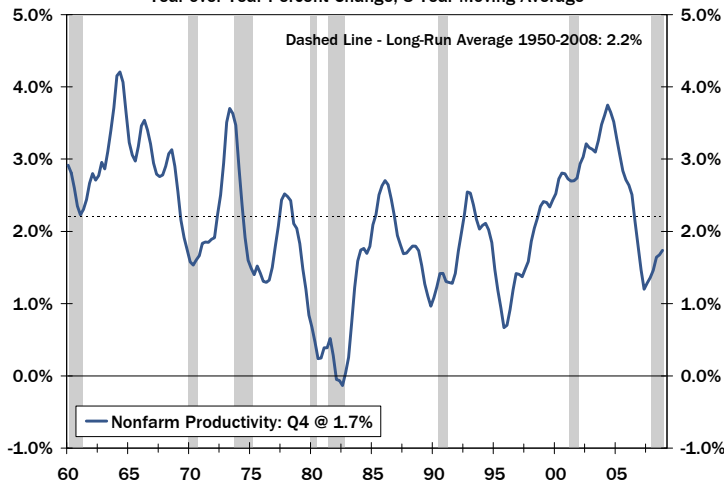


Construction Spending • Monday

Total construction spending was down 0.9 percent in February, which was significantly less than previous declines. Nonresidential construction spending increased 0.5 percent, but we do not expect the gain to stick. The economic downturn and tight credit conditions should continue to put downward pressure on total construction spending throughout the rest of the year. While residential construction has accounted for the bulk of declines in recent months, signs of tentative stabilization in the housing market should begin to help slow the pace of declines. However, nonresidential construction spending, which tends to be a lagging indicator, should begin to show large declines over the coming quarters. Recently released first quarter GDP numbers show nonresidential structures fell at a record 44.2 percent rate led by a substantial decline in petroleum structures. We should continue to see nonresidential construction spending decline well into 2010.

Previous: -0.9%
Wachovia: -1.0%
Consensus: -1.5%
Total Construction
 Month to Month Percent Change

Productivity - Total Nonfarm

Year-over-Year Percent Change, 3-Year Moving Average


Nonfarm Productivity • Thursday

Productivity growth contributes to corporate profitability. Output at nonfarm businesses declined at an 8.7 percent annual rate during the fourth quarter, while hours worked fell at just an 8.3 percent pace. The net result was a 0.4 percent drop in productivity. However, recent figures show hours worked fell more than gross value added in the non-farm sector, which suggests that productivity increased in the first quarter and means businesses may be getting a better handle on production and employment, which are preconditions for an economic recovery.

However, while we are beginning to see tentative signs of stabilization, we are not out of the woods yet. Employment tends to be a lagging indicator and should continue to show declines well into 2010, albeit at a slower pace.

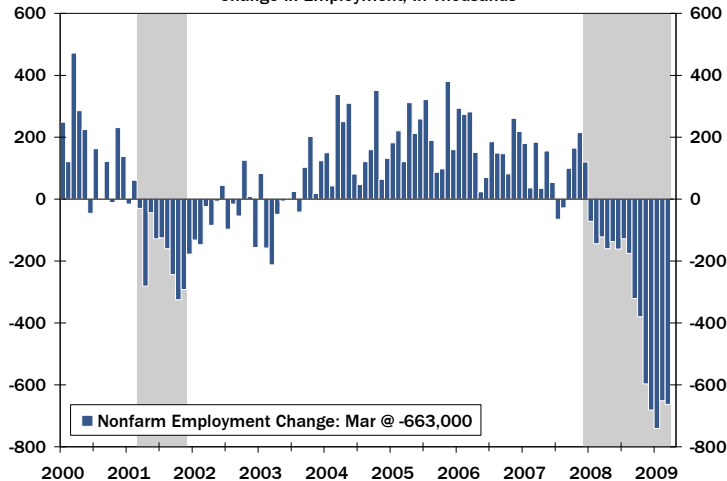
Previous: -0.4%
Wachovia: 2.3%
Consensus: 0.9%
Employment • Friday

Job losses have been extraordinarily broad based, with virtually every industry other than government, education and healthcare posting employment declines. The largest losses continue to be in manufacturing and construction, where close to half the 5.1 million overall job losses have been. Even once considered recession resistant areas like state and local government are being hit hard. However, weekly first-time unemployment claims suggest job losses may be leveling off with the four-week moving average declining for the third consecutive week.

Additionally, the insured unemployment rate has been rising a tenth of a percentage point a week which has matched nearly perfectly with the rise in the unemployment rate. The latest figures suggest the unemployment rate will climb to around nine percent in April. We continue to expect the unemployment rate to rise throughout 2010, peaking at well over 10 percent.

Previous: -663K
Wachovia: -605K
Consensus: -610K
Nonfarm Employment Change

Change in Employment, In Thousands



Global Review

(Continued from Page 1)

throughout 2006 and 2007, the unemployment rate in Spain has surged to more than 17 percent recently.

Spain is suffering from a housing market bubble that has subsequently burst, a fate that has also befallen Ireland. As shown in the top chart, unemployment in Ireland has shot up to its highest rate in more than a decade. In its recently released *World Economic Outlook*, the International Monetary Fund projects the Irish economy will contract 8 percent this year following the 2.2 percent decline in real GDP that occurred in 2008.

The overall Euro-zone economy should continue to contract in the second quarter, but the rate of decline likely will not be as extreme as in the first quarter. As shown in the middle chart, the purchasing managers' indices for both the manufacturing and service sector remained in recession territory in April. However, both indices have improved over the past two months, suggesting that the rate of decline in the economy is starting to slow. In addition, the economic confidence indicator that is compiled by the European Commission rose in April, the first increase in the index in nearly a year. Although we wouldn't want to proclaim yet that the "green shoots" of recovery are starting to show up in the Euro-zone, recent economic data have not been as universally bad as a few months ago.

Against this backdrop, the European Central Bank (ECB) holds its next policy meeting on May 7. Most analysts (ourselves included) expect the ECB to cut its main policy rate by 25 bps, which would bring it to 1.00 percent. However, most ECB policymakers seem reluctant to take the policy rate below 1.00 percent. Unless the economy goes into freefall again, which we do not expect, the ECB will probably keep its policy rate unchanged at 1.00 percent well into next year.

As shown in the bottom chart, the euro continues to move sideways against the dollar. However, because American authorities have taken more aggressive steps to stimulate the U.S. economy than their European colleagues have done to the Euro-zone, we expect that the "green shoots" of recovery will become more apparent sooner on this side of the Atlantic. Therefore, we look for the greenback to strengthen vis-à-vis the euro in the quarters ahead. (See our *Monthly Economic Outlook* for details.)

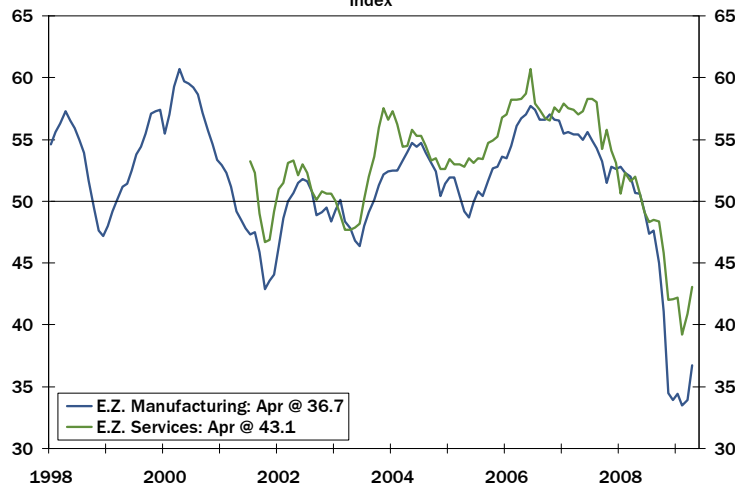
Ireland Unemployment Rate

Seasonally Adjusted



Euro-zone Purchasing Manager Indices

Index



Selected Global Data

Japan	GDP Year-over-Year	Q4 - 2008	-4.3%
	CPI	March - 2009	-0.3%
	Unemployment	March - 2009	4.8%
	BoJ Target Rate	May - 01	0.10%
Euro-Zone	GDP Year-over-Year	Q4 - 2008	-1.4%
	CPI	March - 2009	0.6%
	Unemployment	March - 2009	8.9%
	ECB Target Rate	Apr - 30	1.25%
UK	GDP Year-over-Year	Q1 - 2009	-4.1%
	CPI	March - 2009	2.9%
	Unemployment	March - 2009	4.5%
	BoE Target Rate	May - 01	0.50%
Canada	GDP Year-over-Year	February - 2009	-2.3%
	CPI	March - 2009	1.2%
	Unemployment	March - 2009	8.0%
	BoC Target Rate	May - 01	0.25%

Euro-zone Exchange Rate

USD per EUR



U.K. Service Sector PMI • Wednesday

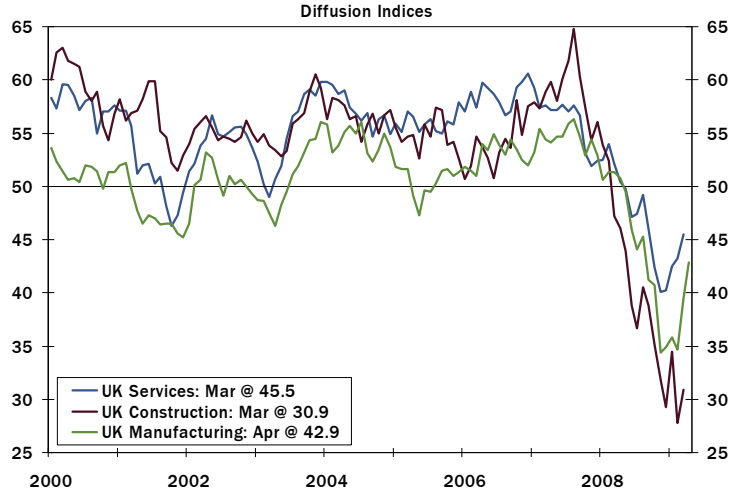
U.K. real GDP plunged at an annualized rate of 7.4 percent in the first quarter, the sharpest rate of contraction since the dark days of 1979-80. However, recent indicators suggest that the rate of decline in the second quarter should be much smaller than in the previous quarter. In that regard, investors await the purchasing managers' indices for the construction (Tuesday) and service (Wednesday) sectors to see if they continued to improve in April.

The Bank of England holds a regular monthly policy meeting on Thursday. With its policy rate already at an all-time low of 0.50 percent, there is not much room to cut further. Indeed, the Bank will likely maintain its policy rate at 0.50 percent well into next year. The Bank potentially could announce further unconventional policy steps, but we really do not expect anything new next week.

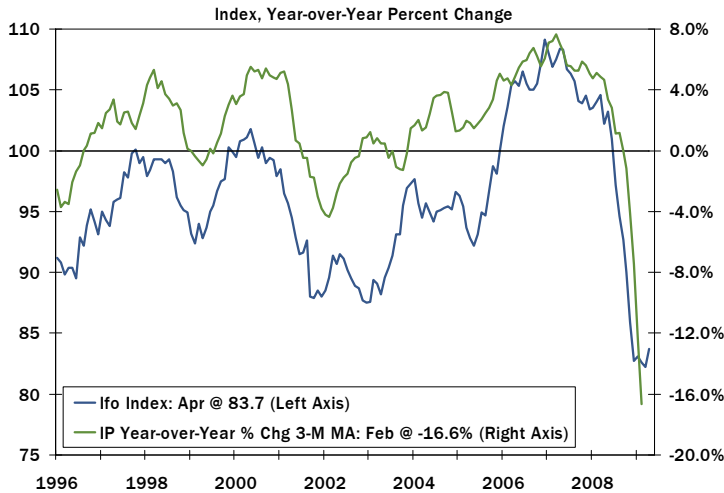
Previous: 45.5

Consensus: 46.5

U.K. Purchasing Managers' Indices



German Production Indicators



German Industrial Production • Friday

The freefall in German industrial production (IP) that has occurred over the past few months was well telegraphed by the nosedive in the Ifo index of business sentiment. The Ifo index remained at a very depressed level in April, which probably means that German industrial production declined again during that month. Indeed, the consensus forecast anticipates that IP weakened again in March. Data on German retail sales (Monday) and factory orders (Thursday) are also on the docket next week.

As noted in the main body of this report, the ECB holds a policy meeting next week. The ECB will probably cut rates by 25 bps, and it could also announce potential unconventional policy steps. Revised PMIs for the manufacturing and service sectors in April will also be released next week.

Previous: -2.9% (month-on-month change)

Consensus: -1.3%

Canadian Labor Market Report • Friday

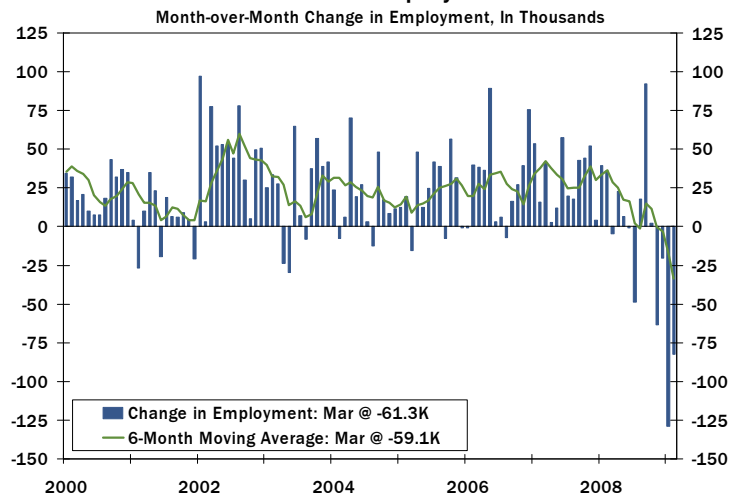
Canada's labor market has been getting hammered as employers have cut over 350,000 jobs in the last five months and the unemployment rate has jumped to 8.0 percent. The April employment report is released Friday. While the consensus is looking for another decline, the drop will likely be smaller than it has been in recent months, which would suggest the pace of decline is slowing in the Canadian labor market. Still, the current job situation is not likely to be supportive of consumer spending or the housing market for the foreseeable future.

We will get a better sense of how residential construction is holding up when housing starts data are released later in the day on Friday. Builders have been applying for fewer permits, which leads us to believe that housing starts likely declined in April.

Previous: -61,300 change in employment

Consensus: -42,000

Canadian Employment

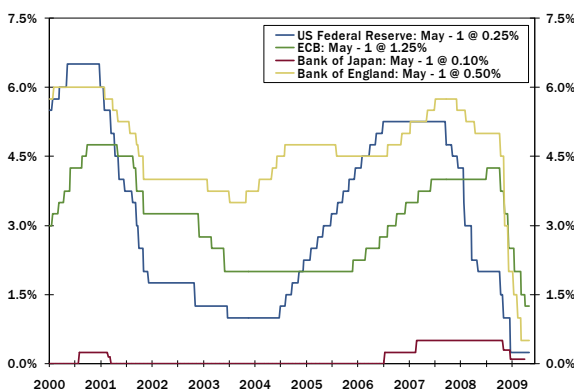


Interest Rate Watch
FOMC Leaves Policy on Easy Track

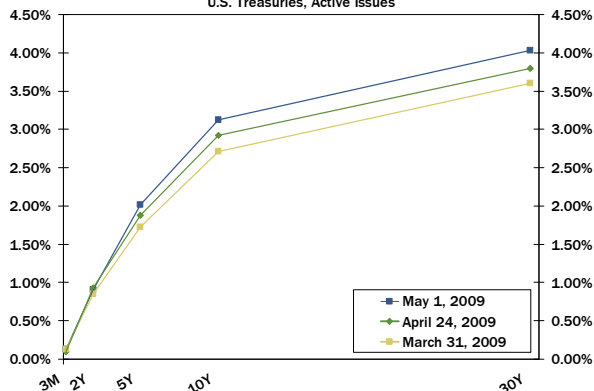
This week the Federal Open Market Committee (FOMC) continued its easy interest rate/credit policy. Financial stability and economic recovery remain the primary intermediate-term policy targets for the Fed. To achieve these goals the FOMC left its interest rate target, the fed funds rate, unchanged thereby guaranteeing a continued very positive yield curve. This will support bank lending and rebuilding of the balance sheet. Meanwhile, Fed purchases of Treasury, Government Sponsored Enterprise (GSE) debt and Agency mortgage backed securities will continue at the same pace.

This continued pace of Federal Reserve purchases disappointed the market yet we view the Fed's decision as a good sign. An increase in Fed purchases with signs of an economic turn now beginning to appear would suggest a greater risk of the Fed supplying too much liquidity and creating a set of false prices of market securities. Over time, continued injections of liquidity when the economy is beginning to turn would risk higher inflation pressures in the future. While we support the Fed's commitment to a continued injection of liquidity as the economy expands, an increase in the pace of such injections would raise the risks of too much liquidity/inflation down the road.

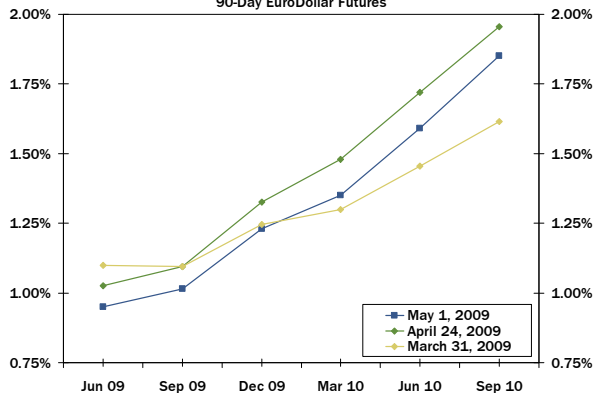
Our concern remains that yields on longer-dated debt instruments will drift upward as the year wears on as inflation concerns rise and the flight-to-safety trade falls away. In addition, dollar weakness may reappear as this year ages and this will add to our inflation concerns. Rising federal budget deficit estimates reinforce our concerns of a volatile mix of rising debt, rising inflation expectations and a declining dollar.

Central Bank Policy Rates

Yield Curve

U.S. Treasuries, Active Issues


Forward Rates

90-Day EuroDollar Futures


Topic of the Week
Is What's Good for GM Still Good for the Country?

The question itself is a spin on former General Motor's president Charles Erwin Wilson's statement back in the early 1950s at his confirmation hearing to be President Eisenhower's Secretary of Defense. Wilson was asked if, as Defense Secretary, he could remain independent if he had to make a decision that would be adverse to General Motors. His response was that he could not think of such a circumstance because he had long thought that "what was good for our country was good for General Motors, and vice versa." Over the years Wilson's statement has often been turned around and used as a metaphor for the notion that what is good for business is good for the country.

GM's predicament is much closer to the current state of the broader U.S. economy. General Motors is as large as many countries and has a vast reach within the economy. Every job lost at vehicle assembly plants is likely to result in six to ten jobs lost in other industries. The challenges GM faces are all too familiar to much of the economy - weakening demand, a cost structure that is out of line with today's global competitive environment, a glut of excess capacity, and an ongoing battle to contain health care and retirement costs. Solving these issues requires tough choices, both within GM and for the country as a whole.

So while it may seem that GM's troubles only impact a small subset of the economy, they are emblematic of the challenges the entire economy faces. How these challenges are resolved and how well the auto industry recovers will likely have a direct impact on when and how the overall economy emerges from the recession. Click here for the full report.

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

	Friday 5/1/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.15	0.10	1.40
3-Month LIBOR	1.01	1.07	2.78
1-Year Treasury	0.38	0.39	1.90
2-Year Treasury	0.92	0.96	2.37
5-Year Treasury	2.03	1.94	3.08
10-Year Treasury	3.17	2.99	3.76
30-Year Treasury	4.09	3.88	4.50
Bond Buyer Index	4.57	4.78	4.68

Foreign Exchange Rates

	Friday 5/1/2009	1 Week Ago	1 Year Ago
Euro (\$/€)	1.327	1.324	1.547
British Pound (\$/£)	1.489	1.468	1.975
British Pound (£/€)	0.891	0.903	0.784
Japanese Yen (¥/\$)	99.317	97.169	104.430
Canadian Dollar (C\$/A\$)	1.187	1.210	1.020
Swiss Franc (CHF/\$)	1.136	1.139	1.048
Australian Dollar (US\$/A\$)	0.730	0.723	0.934
Mexican Peso (MXN/\$)	13.823	13.340	10.496
Chinese Yuan (CNY/\$)	6.821	6.830	6.988
Indian Rupee (INR/\$)	50.092	50.345	40.485
Brazilian Real (BRL/\$)	2.177	2.184	1.663
U.S. Dollar Index	84.567	84.714	73.275

Foreign Interest Rates

	Friday 5/1/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.36	1.40	4.85
3-Month Sterling LIBOR	1.45	1.49	5.83
3-Month Canadian LIBOR	0.85	0.91	3.40
3-Month Yen LIBOR	0.55	0.55	0.92
2-Year German	1.32	1.45	3.76
2-Year U.K.	1.08	1.23	4.39
2-Year Canadian	1.00	0.99	2.74
2-Year Japanese	0.39	0.41	0.75
10-Year German	3.16	3.22	4.12
10-Year U.K.	3.55	3.49	4.62
10-Year Canadian	3.11	3.02	3.57
10-Year Japanese	1.41	1.44	1.59

Commodity Prices

	Friday 5/1/2009	1 Week Ago	1 Year Ago
W. Texas Crude (\$/Barrel)	52.65	51.55	112.52
Gold (\$/Ounce)	884.23	913.20	852.70
Hot-Rolled Steel (\$/S.Ton)	400.00	400.00	1065.00
Copper (¢/Pound)	208.00	207.10	372.55
Soybeans (\$/Bushel)	10.63	10.27	12.86
Natural Gas (\$/MMBTU)	3.55	3.30	10.56
Nickel (\$/Metric Ton)	11,626	11,294	28,395
CRB Spot Inds.	362.33	363.90	524.30

Next Week's Economic Calendar

	Monday 4	Tuesday 5	Wednesday 6	Thursday 7	Friday 8
U.S. Data	Construction Spending February -0.9% March -1.0% (W)	ISM Non-Manufacturing March 40.8 April 41.9 (W)		Nonfarm Productivity 2008:4Q -0.4% 2009:1Q 2.3% (W) Unit Labor Cost 2008:4Q 5.7% 2009:1Q 2.5% (W)	Nonfarm Payrolls March -663K April -605K (W) Unemployment Rate March 8.5% April 9.0% (W)
Global Data			UK PMI Services Previous (Mar) 45.5	UK BOE Announces Rates Previous 0.50% Euro-zone ECB Announces Rates Previous 1.25%	Germany Indus. Production (MoM) Previous (Feb) -2.9% Canada Net Chg. in Employment Previous (Mar) -61.3K

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

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