

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

July 11, 2008

U.S. Review

Headwinds Intensify

Economic activity still appears to be holding up at a pace that is consistent with at least modest economic growth. This week had a relatively light economic release schedule but the reports that were released tended to come in stronger than expected. Major reports include the ICSC chain store sales figures, which came were up 4.3 percent year-to-year. Chain store sales are clearly being bolstered by tax rebates. Most of the impact has been at discount stores and warehouse clubs. Department stores and most specialty apparel chains reported declines for the month. Furniture sales were absolutely awful. The major electronic chains and home improvement centers did not report sales. We suspect spending has held up at electronics chains, which should be one of the largest beneficiaries from rebates. Home improvement stores may also see another strong month for the same reason, with tax rebates trumping the drag from the housing slump.

First-time claims for unemployment insurance fell sharply during early July. Jobless claims probably are not as good as the drop suggests.

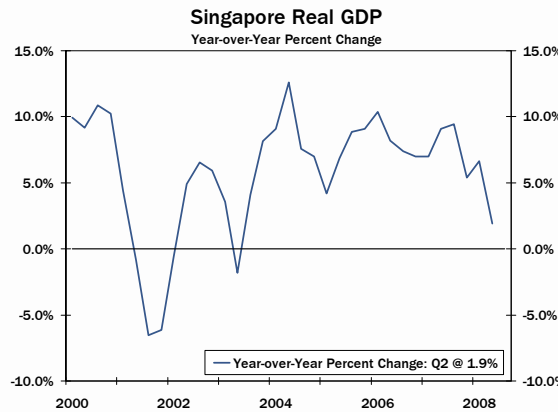
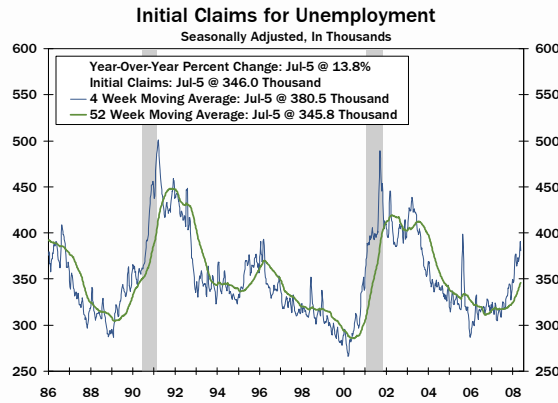
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Global Review

Singapore GDP: Slower Global Growth?

Data released this week showed that real GDP growth in Singapore slowed to only 1.9 percent in the second quarter, the slowest year-over-year rate of growth since the third quarter of 2003. Singapore is small. There are only 4.6 million residents in the city-state and GDP is only \$160 billion, making it a bit more than 1 percent the size of the U.S. economy. However, the reasons for the large slowdown in Singapore may tell us something about the state of the global economy in the second quarter. Let's drill down a bit into Singapore's GDP. Growth in construction industries slowed a bit from 16.9 percent in the first quarter to 15.2 percent in the second quarter, and the service industries saw their growth rate edge down from 7.6 percent to 6.9 percent between the first two quarters of the year.

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Recent Special Commentary

Date	Title	Authors
July-02	No Bright Light Marking the End of Sub-Par Growth in the U.S.	Silvia
June-26	Surging Gas Prices Are Putting the Brakes on Auto Sales	Vitner & Khan
June-24	Despite Challenges, Charlotte Still Finds a Way to Grow	Vitner
June-12	Discretionary Spending Share Held Near All-Time Low	Vitner & York

U.S. Forecast

	Actual				Forecast				Actual				Forecast	
	2007 1Q	2007 2Q	2007 3Q	2007 4Q	2008 1Q	2008 2Q	2008 3Q	2008 4Q	2004	2005	2006	2007	2008	2009
Real Gross Domestic Product ¹	0.6	3.8	4.9	0.6	1.0	2.2	1.4	-0.2	3.6	3.1	2.9	2.2	1.8	0.9
Personal Consumption	3.7	1.4	2.8	2.3	1.1	2.1	2.6	-1.0	3.6	3.2	3.1	2.9	1.8	1.0
Inflation Indicators ²														
Core* PCE Deflator	2.4	2.0	1.9	2.1	2.0	2.1	2.2	2.1	2.1	2.2	2.2	2.1	2.1	2.2
Consumer Price Index	2.4	2.6	2.4	4.0	4.2	4.0	4.2	3.6	2.7	3.4	3.2	2.9	4.0	2.7
Industrial Production ¹	1.5	3.2	3.6	0.3	-0.3	-3.9	-0.2	1.5	2.5	3.3	2.2	1.7	-0.1	1.8
Corporate Profits Before Taxes ²	2.1	4.2	1.8	2.5	1.0	-8.0	-6.0	-10.5	24.0	11.5	13.2	2.7	-5.9	4.9
Trade Weighted Dollar Index ³	80.5	78.7	74.4	73.3	70.3	71.0	70.8	72.5	79.5	86.0	81.5	73.3	72.5	81.9
Unemployment Rate	4.5	4.5	4.7	4.8	4.9	5.3	5.6	5.8	5.5	5.1	4.6	4.6	5.4	6.1
Housing Starts ⁴	1.45	1.46	1.30	1.15	1.05	0.98	0.95	0.93	1.95	2.07	1.81	1.34	0.98	1.00
Quarter-End Interest Rates														
Federal Funds Target Rate	5.25	5.25	4.75	4.25	2.25	2.00	2.00	2.00	2.25	4.25	5.25	4.25	2.00	2.25
10 Year Note	4.65	5.03	4.59	4.04	3.45	3.99	4.00	4.00	4.24	4.39	4.71	4.04	4.00	4.40

Data As of: July 9, 2008

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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The Heat Is On

Weekly jobless claims tend to bounce around quite a bit during the summer months, as the labor department often has some difficulty seasonally adjusting annual plant shutdowns for model year changeovers at the domestic auto manufacturers. We could easily see a gain next week that matched this week's decline.

Friday morning brought more good economic news. The nation's trade deficit narrowed much more than expected during May, falling to \$59.8 billion. The improvement was even greater after adjusting for inflation. In real terms, the trade gap fell \$3 billion to \$43.6 billion. All of the improvement was in energy, where higher prices appear to be curbing the appetite for imported oil. Non-petroleum imports actually increased during the month. The improvement in the trade deficit means second quarter real GDP may come in much stronger than expected. If the real trade gap remains at its current level next month, trade will add about 2 percentage points to second quarter real GDP. Our current forecast, which calls for a 2.2 percent rise in second quarter GDP, assumes only a 0.5 percentage point improvement from trade. Later in the morning, the University of Michigan released its consumer sentiment index for July, which showed its first gain (albeit small) since January.

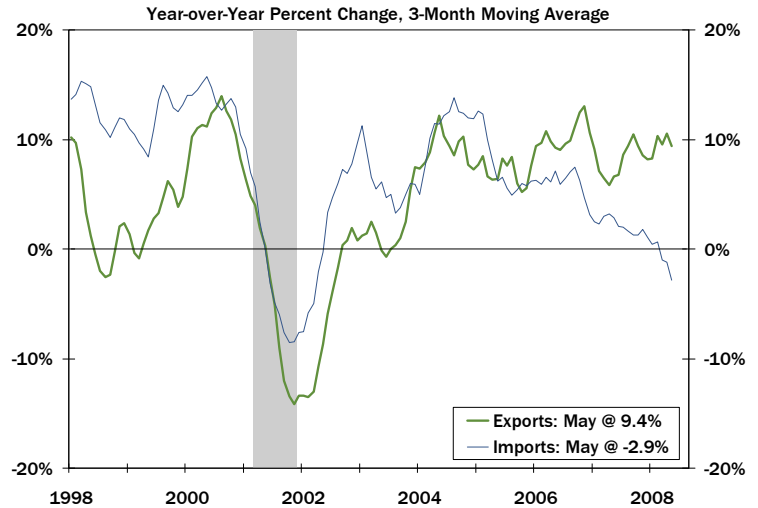
All of this better than expected economic news did little for the financial markets. Rumors about the viability of the two largest government sponsored mortgage firms along with a resurgence in oil prices sent stocks much lower at the start of trading on Friday. Treasury Secretary Hank Paulson attempted to cool off some of those rumors by making a statement of support for Freddie Mac and Fannie Mae later in the morning, but concerns about the financial sector continue to be a major wildcard for the economy. Right now the risk appear to be greatest for shareholders but disruptions in the secondary market for home mortgages will also likely lead to an even wider spread between mortgage rates and the 10-year Treasury. This is the last thing an already stressed housing market needs right now, if affordability comes back down, look for the housing woes to extend even further.

While equities swooned, especially in the financial sector, on Friday morning crude oil extended Thursday's gains and reached new all-time intraday highs. The early part of the week had brought a fleeting hope that some of the energy price pressures the economy was facing would diminish in coming weeks. Another round of energy price increases could again lead economists to lower forecasts for economic activity late this year and into 2009.

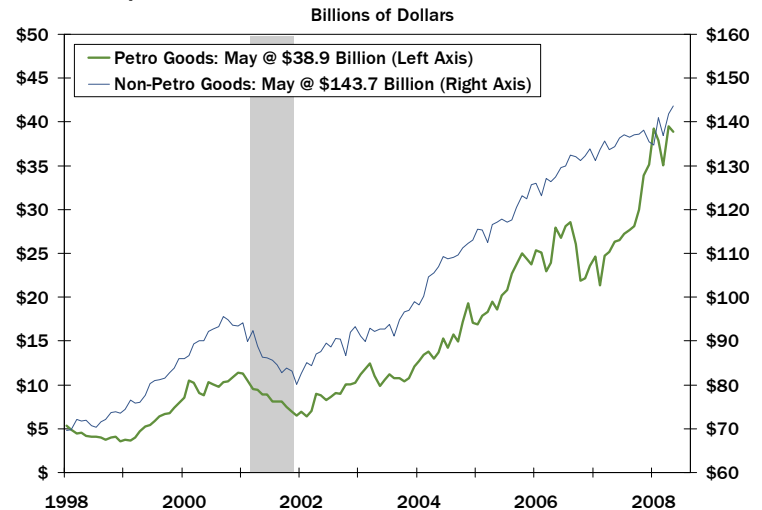
Selected Current Data

Gross Domestic Product - CAGR	Q1 - 2008	1.0%
GDP Year-over-Year	Q1 - 2008	2.5%
Personal Consumption	Q1 - 2008	1.1%
Business Fixed Investment	Q1 - 2008	0.6%
Consumer Price Index	May - 2008	4.2%
"Core" CPI	May - 2008	2.3%
"Core" PCE Deflator	May - 2008	2.1%
Industrial Production	May - 2008	-0.1%
Unemployment	June - 2008	5.5%
Federal Funds Target Rate	Jul - 11	2.00%

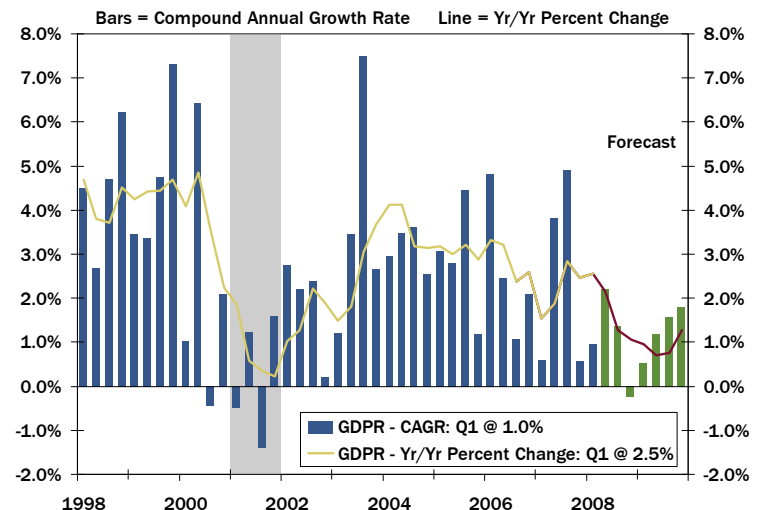
Real Exports & Imports of Goods



Imports of Petroleum and Non-Petroleum Goods



Real GDP



Retail Sales • Tuesday

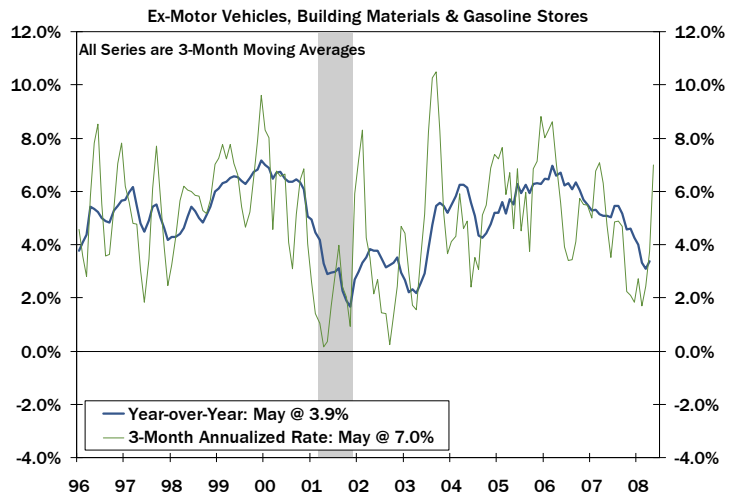
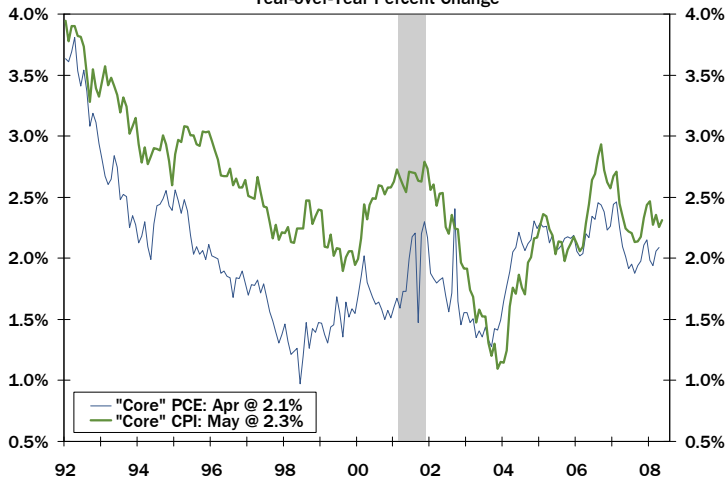
With consumers downtrodden due to rising gasoline costs, lower home prices and a tightening credit environment, little hope of relief was given to the May retail sales report. But in fact, the report showed strong gains across the board. Excluding gasoline, retail sales were up a solid 0.8 percent with notable gains in building materials, general merchandise and eating & drinking establishments. It appears the tax rebate checks are having a positive impact.

While weak motor vehicle spending will weigh heavily on total retail sales, gains may be seen in electronics and home improvement. Consumer spending is holding up admirably given the current environment but will diminish later this year when the effect of the stimulus package fades.

Previous: 1.0%

Wachovia: 0.1%

Consensus: 0.3%

Retail Sales

"Core" CPI vs. "Core" PCE
Year-over-Year Percent Change

Consumer Price Index • Tuesday

Primarily due to rising gasoline and food prices, headline inflation has been accelerating in 2008. In the first quarter, headline CPI rose at a 4.2 percent annualized pace. Based on the April and May data and our expectations for June, headline CPI is on track to increase 4.6 percent year over year.

As energy prices continue to climb to record levels, we should see further acceleration in the headline CPI in June. Core CPI is expected to remain better behaved as softer motor vehicle prices, apparel and shelter costs help offset increases in medical care and airline tickets.

While inflation should weigh on real economic growth in the second half of the year, we anticipate the Fed will remain on hold with short term interest rates for the remainder of the year. Rising inflation expectations, however, remain a major concern and could force the Fed to tighten rates sooner than anticipated.

Previous: 0.6%

Wachovia: 0.7%

Consensus: 0.7%

Housing Starts • Thursday

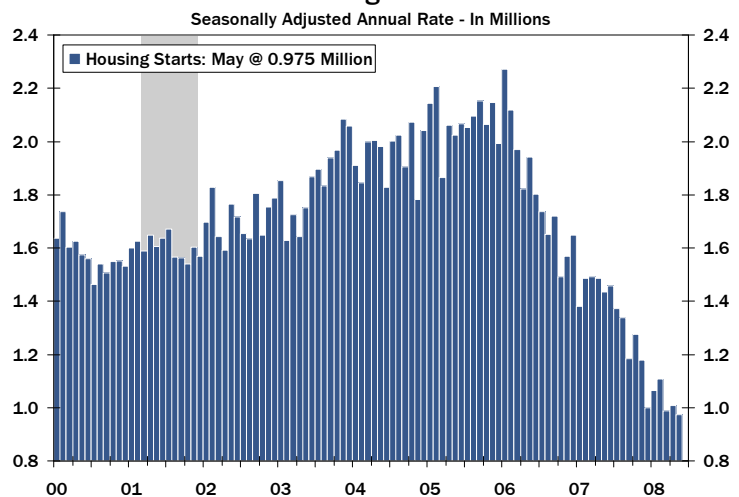
While we expect total starts will contract further in June, down 1.9 percent to an annualized level of 950K, it is important to note that the pace of deterioration is slowing. This is important in the calculation of real GDP. The April-May second quarter average is down only 4.8 percent to an annualized level of 991.5K. That's down from the -8.5 percent and -11.3 percent pace of the first and fourth quarters, respectively.

While tightening credit conditions, increasing foreclosures, and a more sluggish economy will lengthen the housing recovery, most of the reduction in new construction and home sales is behind us. Housing should become sequentially less of a drag on overall economic growth as the year progresses.

Previous: 975K

Wachovia: 950K

Consensus: 968K

Housing Starts


Global Review

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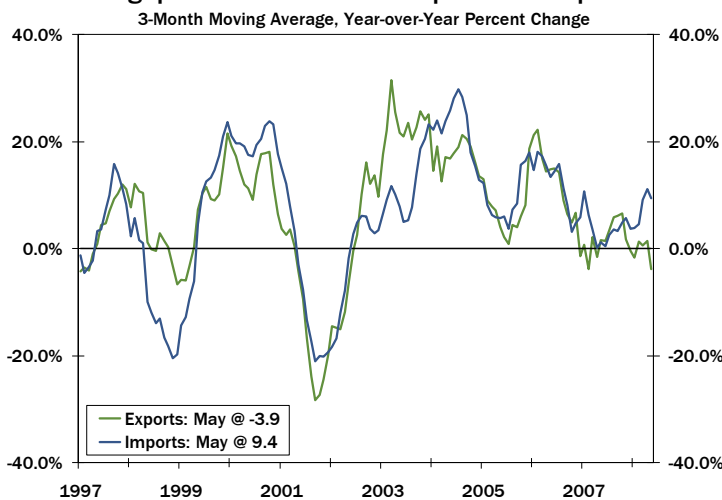
However, the year-over-year growth rate in the goods producing industries, which represents about 30 percent of GDP, tumbled from 12.7 percent in the first quarter to -5.6 percent in the second quarter. Domestic spending appears to have downshifted a bit in the second quarter, which probably contributed to the weakness in goods producing industries. For example, growth in the volume of retail sales slipped from a year-over-year growth rate of 4 percent in the first quarter to 1.5 percent in April, data for May and June are not yet available. However, the external environment also contributed to the marked slowdown in Singaporean GDP growth in the second quarter.

With an export-to-GDP ratio that exceeds 200 percent, Singapore is one of the most open economies in the world. And as shown in the top chart, growth in Singapore's non-oil exports has slipped into negative territory. Because most exports are manufactured, the downturn in Singapore's goods producing industries in the second quarter probably reflects recent weakness in export growth. This is yet another indication that growth in the rest of the world is slowing.

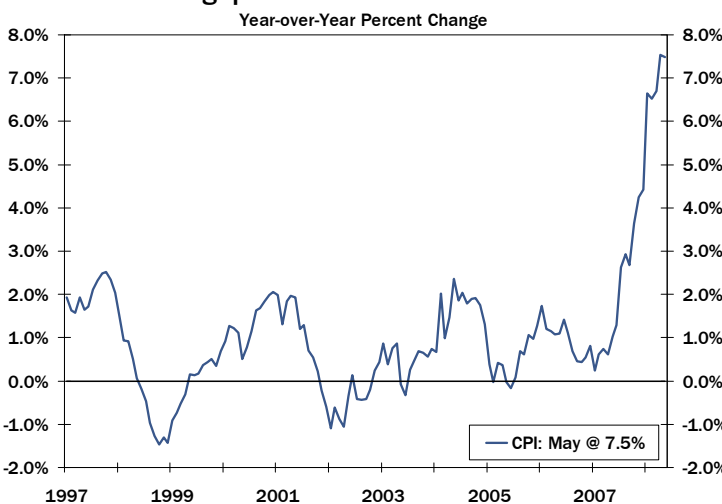
Not only is the Lion City experiencing slower economic growth, but it is suffering from higher inflation as well. As shown in the middle chart, the CPI inflation rate in Singapore has jumped up to 7.5 percent, the highest rate in 26 years. Yes, the 9 percent rise in food prices over the past year has had a disproportionate effect on overall CPI inflation, and the increase in the goods and services tax last summer, which will drop out of the year-over-year calculations in July, contributed to the rise in inflation. That said, non-food prices in Singapore, as in most other Asian economies, appear to have accelerated over the past year.

Because Singapore is such an open economy, the Monetary Authority of Singapore (MAS) manages the trade-weighted value of the Singapore dollar. As shown in the bottom chart the Singapore dollar has strengthened about 35 percent versus the U.S. dollar since the beginning of 2002. Due to the rise in inflation recently, the appreciation of the currency is in Singapore's interest. However, we believe the MAS will slow down the rate of the currency's appreciation now that real GDP growth is showing signs of slowing.

Singapore Non-Petroleum Imports and Exports



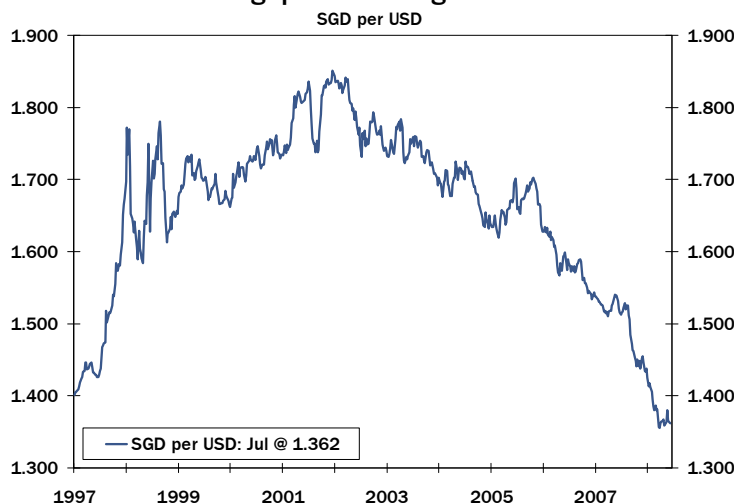
Singapore Consumer Price Index



Selected Global Data

Japan	GDP Year-over-Year	Q1 - 2008	1.3%
	CPI	May - 2008	1.3%
	Unemployment	May - 2008	4.0%
	BoJ Target Rate	Jul - 11	0.50%
Euro-Zone	GDP Year-over-Year	Q1 - 2008	2.1%
	CPI	May - 2008	3.7%
	Unemployment	May - 2008	7.2%
	ECB Target Rate	Jul - 11	4.25%
UK	GDP Year-over-Year	Q1 - 2008	2.3%
	CPI	May - 2008	3.3%
	Unemployment	May - 2008	2.5%
	BoE Target Rate	Jul - 10	5.00%
Canada	GDP Year-over-Year	April - 2008	1.2%
	CPI	May - 2008	2.2%
	Unemployment	June - 2008	6.2%
	BoC Target Rate	Jul - 11	3.00%

Singapore Exchange Rate

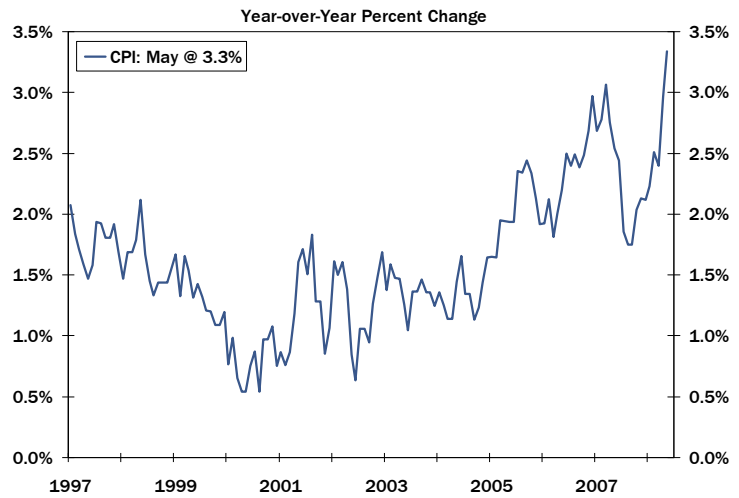
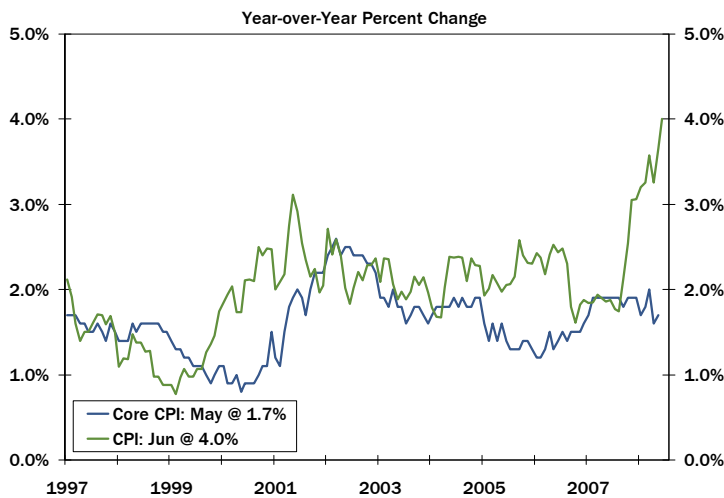


U.K. CPI Inflation • Tuesday

As required by law, Bank of England Governor Mervyn King wrote an open letter last month to Chancellor of the Exchequer Darling explaining why CPI inflation in May was more than one full percentage point above the Bank's target of 2 percent. If, as expected, CPI inflation rose even further in June, Governor King will be busy writing another letter next week. Inflation that is well above target is the primary reason the Bank has brought an end, at least for now, to its easing cycle.

However, the U.K. economy may be sliding into recession. Survey data that are slated for release on Monday evening will give some indications on the state of retail spending in June. The labor market report, which is on the docket on Wednesday, is expected to show that the number of unemployed workers rose in June.

Previous: 3.3% (year-over-year) Wachovia: 3.7%
Consensus: 3.6%

U.K. Consumer Price Index

Euro-zone Consumer Price Inflation

Euro-zone CPI Inflation • Wednesday

The "flash" estimate released two weeks ago showed CPI inflation in the Euro-zone shot up to 4.0 percent in June, the highest rate since the ECB came into existence in 1999. The final estimate is not expected to deviate from the "flash" estimate. Perhaps of more interest will be the first look at the core rate of inflation in June. An increase in the core rate of inflation, which so far remains benign, could induce the ECB to hike rates again.

Although the ECB may be willing to hike rates again to ensure inflation expectations remain contained, the economy is showing clear signs of weakening. Industrial production data for Germany, France and Italy were all much weaker than expected in May. Therefore, IP data for the entire Euro-zone, which print on Monday, likely will show a significant decline. Data on construction orders and the trade balance are also on the docket next week.

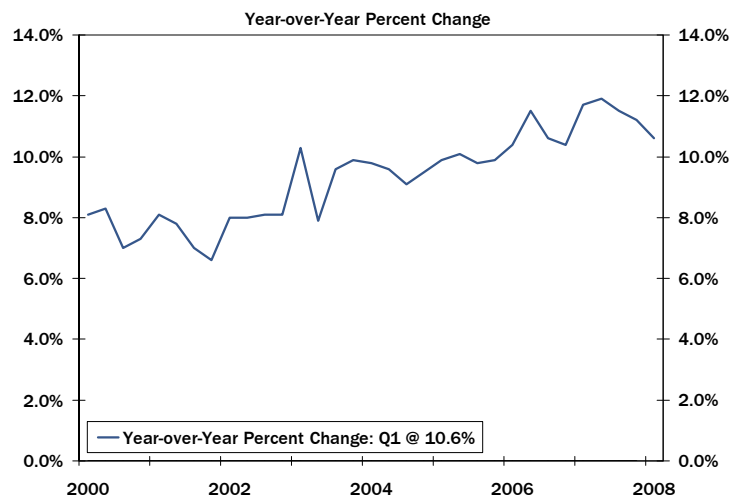
Previous: 4.0% Wachovia: 4.0%
Consensus: 4.0%

Chinese Real GDP Growth

Chinese real GDP growth has trended lower since the peak rate of 11.9 percent in the second quarter of 2007, and further slowing seems likely in the quarters ahead. That said, the consensus forecast anticipates that growth slowed to a still robust rate of 10.2 percent in the second quarter. A wild card is the earthquake that rocked central China in May. Although the economy of Sichuan province is rather small relative to national economy, the destruction of production facilities in the province could impart a temporary depressing effect on overall GDP growth.

Although the GDP release for the second quarter should be the highlight of the week, June data on retail sales, producer prices, consumer prices, and industrial production will also be released next week.

Previous: 10.6%
Consensus: 10.2%

Chinese Real GDP


Interest Rate Watch
Housing, Energy and Credit Dictate No Fed Funds Rate Change

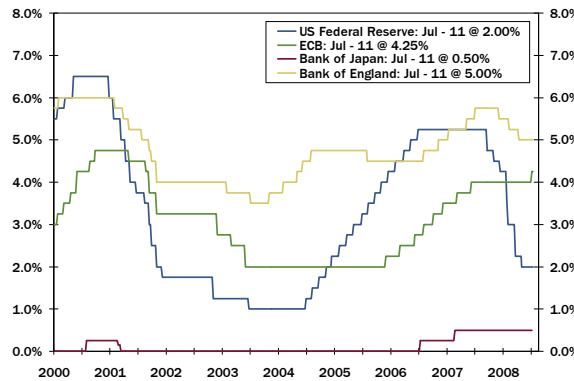
The three issues we have emphasized: housing, energy prices and credit continue to suggest no change in the federal funds rate at least through September. Therefore, the view expressed in the press that some analysts are split on the growth/inflation choice reflects a false dichotomy. The domestic private economy is in recession in part because rising prices of essential commodities such as energy and food have reduced the gains in real disposable income for consumers and lowered profits for non-financial companies. Moreover, deflation in asset prices for homes and equities that has lowered household wealth and delivered large profit losses for financial sectors. The U.S. economy is experiencing a significant shift in relative prices for financial and real assets relative to globally traded commodities and this naturally brings hardship in the transition.

While below trend economic growth remains our expectation for the rest of this year, as it has been since January, some sectors such as agriculture, technology and exports are doing well. Once again there is no clear, across-the-board theme in the economy. There are opportunities as well as pitfalls.

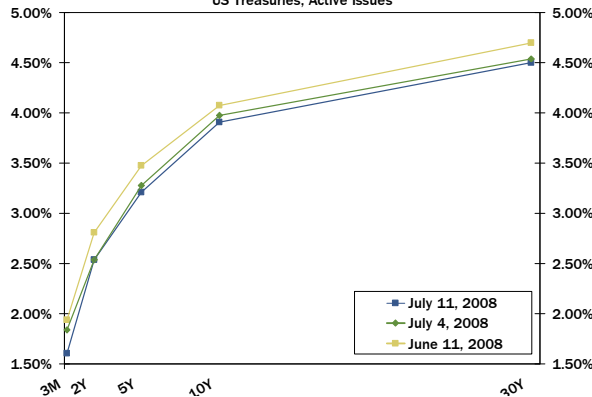
Therefore, the balance of the growth/inflation outlook suggests that the Federal Reserve will remain on hold for the rest of this year. Yet within that framework we see both relative price and economic performance variations.

Credit Spreads Widen Again

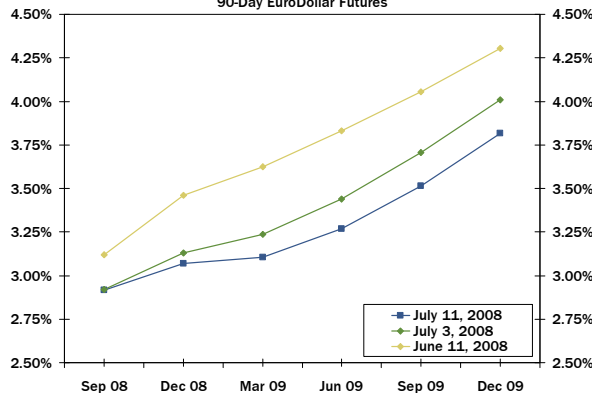
Credit spreads have widened over the last month for both high grade and high yield corporate bonds. This is further reason for the Fed to go slow in making any policy change.

Central Bank Policy Rates

Yield Curve

US Treasuries, Active Issues


Forward Rates

90-Day EuroDollar Futures


Topic of the Week
Below Trend Global Growth in 2009

Global real GDP growth averaged nearly 5 percent per annum between 2004 and 2007, the strongest four-year period of growth in decades. However, real GDP growth rates have slowed in most countries thus far in 2008, and we look for further deceleration ahead. Indeed, global GDP growth should fall below its long-run average next year, making it the slowest year for global growth since 2002. Although global growth should slow further, the probability of a global recession is rather low because economic fundamentals in many countries, especially in the developing world, are much stronger today than in previous cycles.

Slower growth is starting to show up in other economies as well. For example, economic activity in the United Kingdom is the weakest it has been since 2001, and monthly indicators suggest growth in the Euro-zone slowed significantly in the second quarter. The Japanese economy appears to have stalled, and most large developing countries have not been immune from slower growth.

Why has growth slowed abroad? First, exports to the United States from many countries have weakened. Second, dislocations in credit markets since last summer have weakened growth in countries that are extensively financed via capital markets and/or experienced significant run-ups in house prices. Third, the sharp rise in the price of oil is eating into real income in many countries, leading to slower growth in consumer spending. Finally, central banks in many countries have tightened monetary policy in response to rising inflation rates that have been engendered by the sharp rise in the price of oil.

Read on in the [July Global Chartbook](#).

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

	Friday 7/11/2008	1 Week Ago	1 Year Ago
3-Month T-Bill	1.60	1.84	4.94
3-Month LIBOR	2.79	2.79	5.36
1-Year Treasury	1.96	2.14	4.87
2-Year Treasury	2.53	2.53	4.89
5-Year Treasury	3.21	3.28	4.97
10-Year Treasury	3.90	3.98	5.09
30-Year Treasury	4.50	4.53	5.19
Bond Buyer Index	4.56	4.67	4.60

Foreign Interest Rates

	Friday 7/11/2008	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	4.96	4.96	4.20
3-Month Sterling LIBOR	5.83	5.89	6.01
3-Month Canadian LIBOR	3.43	3.47	4.60
3-Month Yen LIBOR	0.92	0.93	0.77
2-Year German	4.43	4.41	4.48
2-Year U.K.	4.89	4.99	5.75
2-Year Canadian	3.14	3.19	4.63
2-Year Japanese	0.78	0.84	1.05
10-Year German	4.44	4.50	4.58
10-Year U.K.	4.90	4.96	5.44
10-Year Canadian	3.74	3.71	4.61
10-Year Japanese	1.60	1.65	1.89

Foreign Exchange Rates

	Friday 7/11/2008	1 Week Ago	1 Year Ago
Euro (\$/€)	1.589	1.571	1.375
British Pound (\$/£)	1.989	1.982	2.032
British Pound (£/€)	0.799	0.792	0.676
Japanese Yen (¥/\$)	106.150	106.800	122.485
Canadian Dollar (C\$/\\$)	1.009	1.019	1.054
Swiss Franc (CHF/\\$)	1.017	1.026	1.207
Australian Dollar (US\$/A\\$)	0.967	0.964	0.863
Mexican Peso (MXN/\\$)	10.309	10.335	10.802
Chinese Yuan (CNY/\\$)	6.834	6.859	7.563
Indian Rupee (INR/\\$)	42.885	43.149	40.375
Brazilian Real (BRL/\\$)	1.606	1.608	1.890
U.S. Dollar Index	71.986	72.742	80.730

Commodity Prices

	Friday 7/11/2008	1 Week Ago	1 Year Ago
W. Texas Crude (\\$/Barrel)	144.13	145.29	72.56
Gold (\\$/Ounce)	960.55	933.25	660.65
Hot-Rolled Steel (\\$/S.Ton)	1125.00	1125.00	540.00
Copper (\\$/Pound)	374.50	396.30	364.15
Soybeans (\\$/Bushel)	16.05	16.42	8.41
Natural Gas (\\$/MMBTU)	12.04	13.58	6.60
Nickel (\\$/Metric Ton)	21,755	20,700	32,805
CRB Spot Inds.	496.33	504.18	483.42

Next Week's Economic Calendar

	Monday 14	Tuesday 15	Wednesday 16	Thursday 17	Friday 18
U.S. Data		PPI (MoM) May 1.4% June 1.0% (W) Retail Sales May 1.0% June 0.1% (W)	CPI (MoM) May 0.6% June 0.7% (W) Industrial Production May -0.2% June 0.0% (W)	Housing Starts May 975K June 950K (W)	
Global Data	Euro Zone Industrial Prod. (MoM) Previous (Apr) 0.9%	UK CPI (YoY) Previous (May) 3.3%	Euro Zone CPI (YoY) Previous (May) 4.0% UK Unemployment Rate Previous (Apr) 5.3%		China Industrial Prod. (YoY) Previous (May) 16.0%

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

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