WACHOVIA ECONOMICS GROUP

Weekly Economic & Financial Commentary

January 16, 2009

U.S. Review

That Deflating Feeling Lingers

Falling energy prices and dramatic discounting by retailers pulled the headline inflation figures much lower during December. Falling prices make last month's retail sales and inventory figures, as well as November's trade data, much harder to interpret. There is no question real GDP declined substantially during the fourth quarter. Our own estimate calls for a 5.3 percent decline at an annual rate and most forecasts call for a drop somewhere between a five and six percent annual rate.

We have noted previously that we do not believe the economy will endure a sustained problematic period of deflation. We are experiencing deflation, however, with prices of many goods, commodities, and assets falling. Wages and salaries are also being cut, although falling prices may temporarily offset some of this impact. In fact, real hourly earnings have soared in recent months as the headline CPI declined.

The Consumer Price Index fell for the third straight month and the year-over-year growth rate fell to nearly zero. The drop in energy prices and a global recession have combined to push inflation lower.

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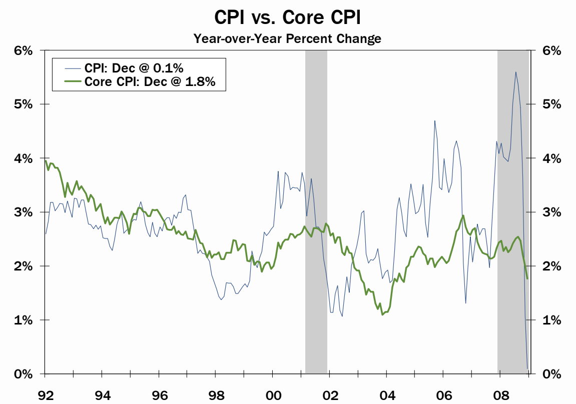

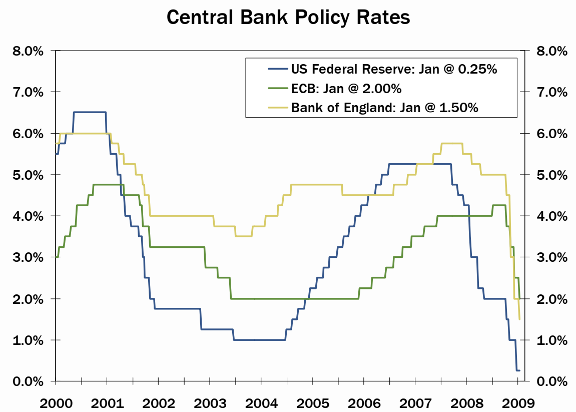

Global Review

ECB Cuts Rates Yet Again

As widely expected, the European Central Bank cut its main policy rate by 50 bps at its meeting this week. The two-week repo rate now stands at 2.00 percent, matching the low set in 2003-04. As we discuss below, we believe the ECB will need to ease policy even further.

In explaining the decision to cut rates in the post-meeting press conference, ECB President Trichet referenced the "significant slowdown" that is underway in the Euro-zone. "Downturn" would probably be a better word to describe what is transpiring at present in the Euro-zone economy. As shown in the top chart on page 4, the purchasing managers' indices for the manufacturing and service sectors have plunged into deep recession territory over the past few months. Indeed, "hard" data from November confirm just how weak the Euro-zone economy is at present. Industrial production

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Recent Special Commentary

Date	Title	Authors
January-16	A Holiday Season for the Record Books	Vitner & York
January-15	Global Chartbook - January 2009	Bryson & Quinlan
December-18	Inflation Chartbook - December 2008	Vitner, York & Whelan
December-16	Global Chartbook - December 2008	Bryson & Quinlan

U.S. Forecast

	Actual			Forecast					Actual			Forecast		
	2008				2009				2005	2006	2007	2008	2009	2010
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
Real Gross Domestic Product [1]	0.9	2.8	-0.5	-5.3	-4.0	-1.9	-0.5	0.9	2.9	2.8	2.0	1.2	-2.3	1.0
Personal Consumption	0.9	1.2	-3.8	-4.0	-1.2	0.0	0.6	1.1	3.0	3.0	2.8	0.3	-1.3	1.2
Inflation Indicators [2]														
"Core" PCE Deflator	2.2	2.3	2.3	1.8	1.4	1.1	0.9	1.2	2.1	2.3	2.2	2.2	1.1	1.6
Consumer Price Index	4.2	4.3	5.3	1.8	0.3	-0.6	-1.5	1.8	3.4	3.2	2.9	3.9	0.0	2.5
Industrial Production [1]	0.4	-3.4	-8.9	-9.2	-9.8	-4.2	-2.0	0.4	3.3	2.2	1.7	-1.6	-6.6	0.9
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	85.7	89.8	92.1	93.3	86.0	81.5	73.3	79.4	93.3	81.2
Unemployment Rate	4.9	5.3	6.0	6.8	7.5	8.1	8.7	9.0	5.1	4.6	4.6	5.8	8.3	9.4
Housing Starts [4]	1.05	1.03	0.88	0.67	0.56	0.60	0.64	0.66	2.07	1.81	1.34	0.90	0.61	0.80
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	1.00
10 Year Note	3.45	3.99	3.85	2.25	2.70	3.00	3.10	3.10	4.39	4.71	4.04	2.25	3.10	3.80

Data As of: January 14, 2009

[1] Compound Annual Growth Rate Quarter-over-Quarter

[2] Year-over-Year Percentage Change

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

[4] Millions of Units

Inside

U.S. Review

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Pipeline Inflation Has Cooled Off Considerably

Excluding food and energy prices, the core CPI was essentially flat in December. Shelter costs, which are 43 percent of the core CPI, rose just 1.9 percent last year. With housing still declining, we do not look for inflationary pressure here in the coming year.

Inflationary pressures continue to ease further back in the production pipeline. The Producer Price Index declined 1.9 percent in December, its fifth consecutive drop. Though energy prices account for much of the pullback, food prices fell 1.5 percent in December, the largest drop in nearly three years. Prices for fresh vegetables plunged at nearly a 15 percent annual rate and prices for beef and veal, milk and canned fruit and juices all moved lower.

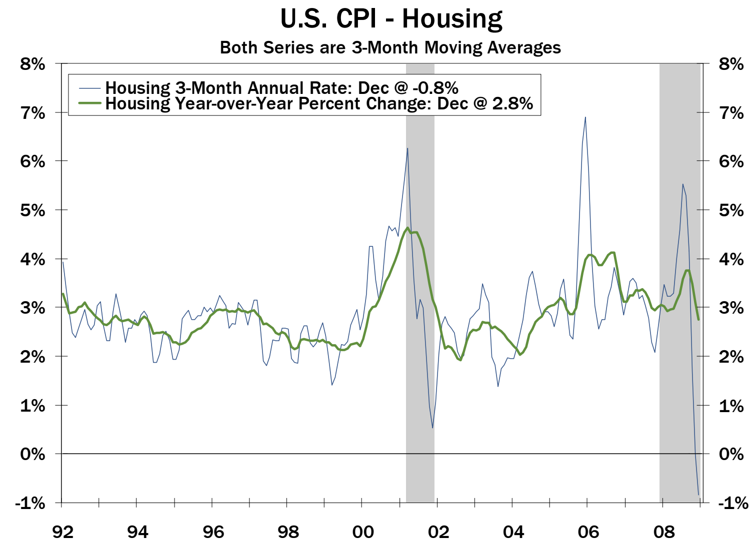
Excluding food and energy items, the PPI rose 0.2 percent and finished the year with a 4.3 percent gain, which was the largest increase since 1988. Core inflation has moderated considerably in recent months, however, and will likely continue to decline in coming months. Prices are falling further back in the production pipeline. Prices for intermediate goods fell 4.2 percent in December and prices for raw materials and crude goods fell 5.3 percent. Both series have fallen for five months in a row. Excluding food and energy items, intermediate and core goods prices are down less but still declined considerably. Prices for core intermediate goods plunged at a 24.6 percent annual rate in the fourth quarter, while prices for core crude goods plummeted at an 82.6 percent pace.

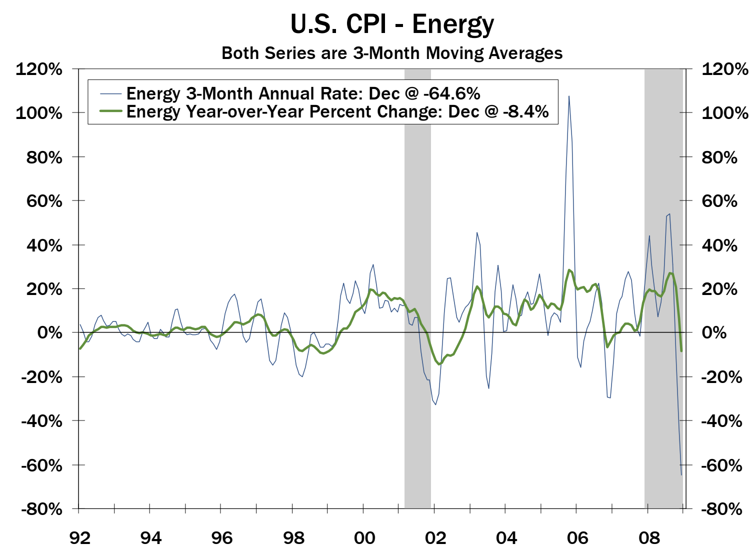
The remarkable declines in energy and commodity prices will make it much more difficult to interpret recent trade figures, retail sales and inventory data. All have plummeted recently but price effects account for much of the drop. Put differently, the volume of imports fell less than the reported record 12 percent drop for November and the volume of retail sales probably did not fall nearly as much as the headline 2.7 percent plunge in retail sales.

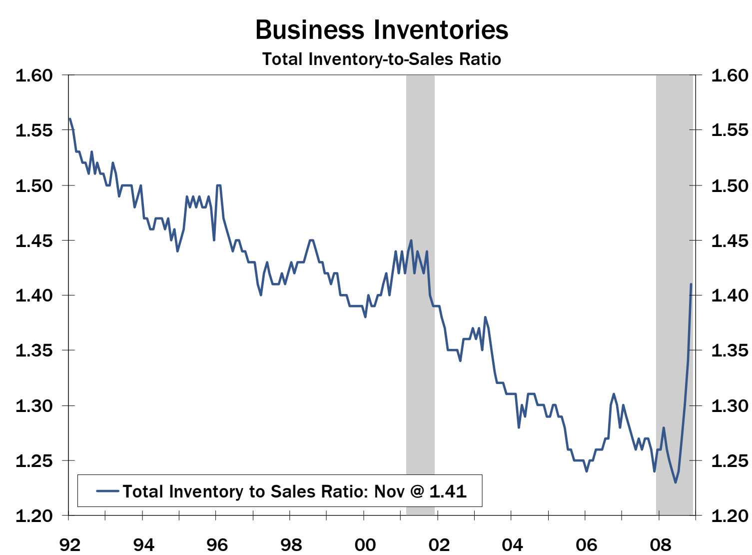
While price changes will make it more difficult to interpret recent economic data, it clearly can be done. Inflation-adjusted trade figures show the nation's trade gap shrinking by $6.1 billion to $39.5 billion. Real retail sales, deflated by the CPI, look like they declined about two percent in December. Consequently, cutbacks in consumer spending were a huge drag on fourth GDP and the recent wide monthly swings in the trade deficit will likely have little effect on the fourth quarter figures. Inventories remain a huge wild card, however. While inventories have declined in recent months, the drop has not kept pace with declines in sales. The inventory/sales ratio has surged in recent months and inventories of imported automobiles have piled up at many major ports.

Selected Current Data

Gross Domestic Product - CAGR	Q3 - 2008	-0.5%
GDP Year-over-Year	Q3 - 2008	0.7%
Personal Consumption	Q3 - 2008	-3.8%
Business Fixed Investment	Q3 - 2008	-1.7%
Consumer Price Index	December - 2008	0.1%
"Core" CPI	December - 2008	1.8%
"Core" PCE Deflator	November - 2008	1.9%
Industrial Production	December - 2008	-7.8%
Unemployment	December - 2008	7.2%
Federal Funds Target Rate	Jan - 16	0.25%







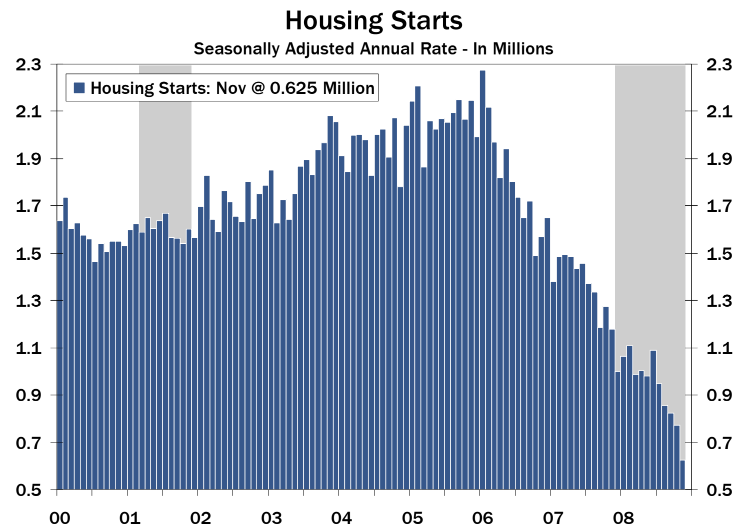
Housing Starts • Thursday

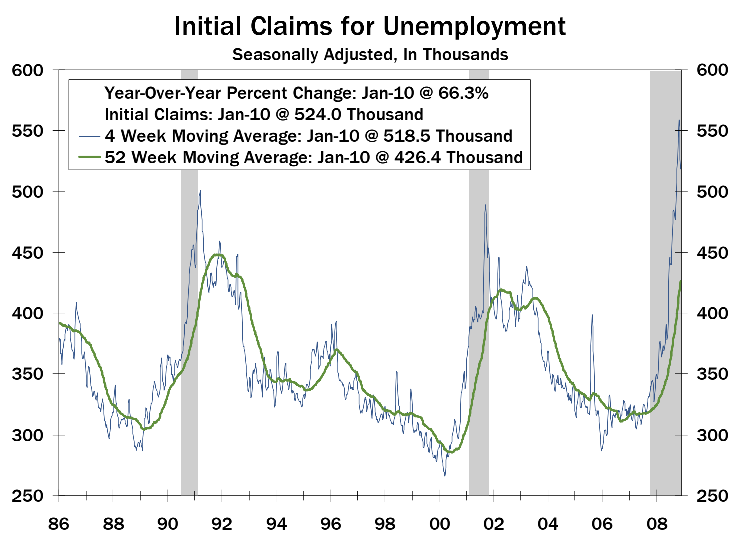
Housing starts fell to just a 625K unit pace in November, another new all-time low, as builders continued to cut back in the face of tighter credit and a weaker economy. Building permits continued to fall as well, down more than 100K units to just a 616K annual pace.

We expect housing starts increased to a 640K unit pace in December as low mortgage rates fueled a surge in refinancings and mortgage applications. However, this up tick does not alleviate the downward trend in starts and permits. With new home completions running north of a one million unit pace, the downward trend in starts should continue to feed into lower completions and eventually less inventory.

Previous: 625K **Wachovia: 640K**

Consensus: 605K





Initial Jobless Claims • Thursday

Initial jobless claims are solidly in recession territory with a four week moving average of 518,500. Continuing claims are also increasing as it becomes even more difficult to find work. We expect the pace to continue as the economy sheds jobs.

In December, nonfarm employment fell 524,000 and the unemployment rate rose to 7.2 percent, changes consistent with past recessions. Since the recession began a little over a year ago, the economy has shed roughly 2.5 million jobs. While the bulk of those earlier losses were in manufacturing and in housing-related industries, job losses have broadened and intensified. Layoff announcements suggest further weakness in the pipeline as payrolls still include recent layoffs. The extraordinary cutbacks in nonfarm payrolls during the fourth quarter are likely to carry over into the first half of 2009.

Previous: 524K

Consensus: 553K

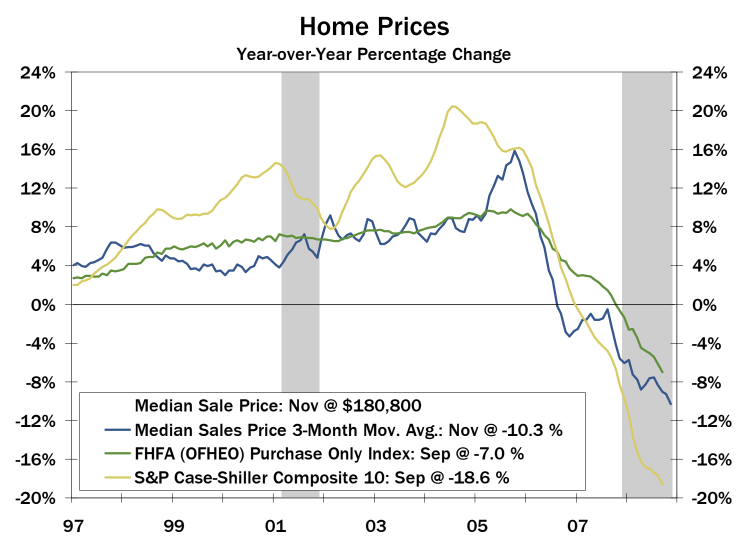
FHFA(OFHEO) Home Price Index • Thursday

Home price declines continued to accelerate across much of the nation in October. Home prices fell 1.1 percent with the Pacific and South Atlantic both declining 2.0 percent. While the worst declines are still concentrated in the former bubble markets, even relatively stable markets are seeing price declines.

Unfortunately price declines may continue for some time even in some of the worst hit markets. We do not expect prices to stop falling nationally before late this year or early 2010 as a deep recession further inhibits the ability to buy a home.

Previous: -1.1%

Consensus: -1.2%



Global Review

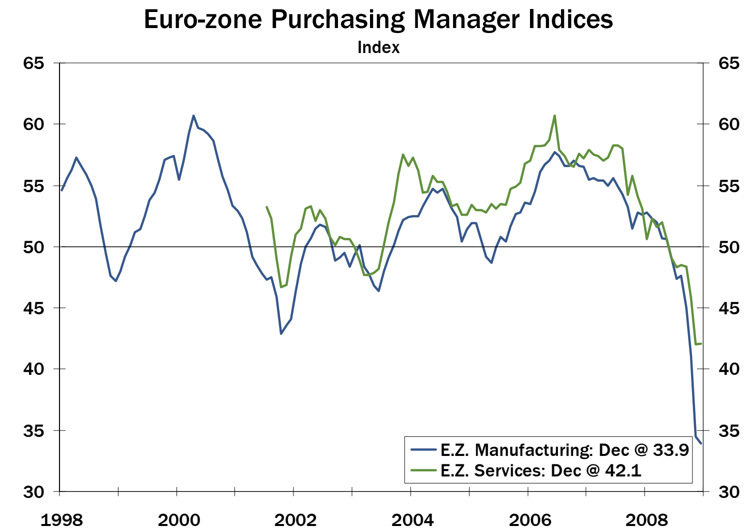
(Continued from Page 1)

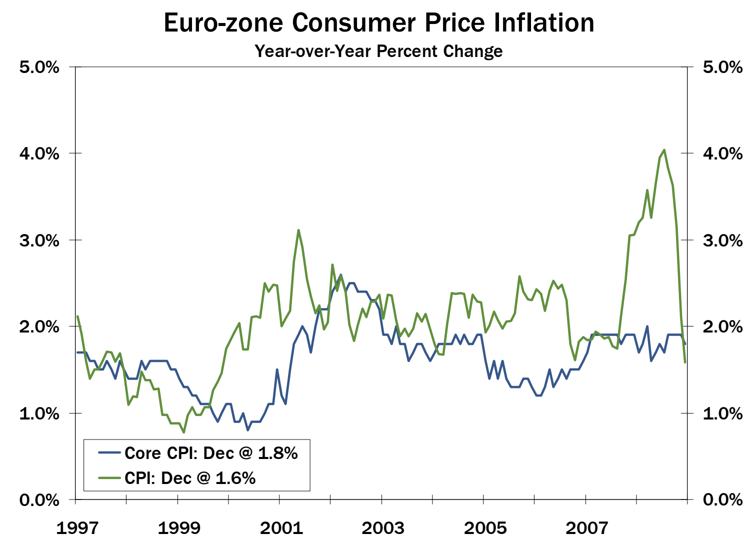
tumbled nearly eight percent relative to November 2007, exceeding the decline registered during the deep recession of the early 1990s, and retail sales in November fell 1.5 percent on a year-over-year basis. Real GDP data for the Euro-zone have not been released yet, but we project that GDP contracted at an annualized rate of about four percent in the fourth quarter relative to the previous quarter. If realized, it would be the sharpest quarterly drop - by a mile - in real GDP since Euro-zone statistics began to be compiled in 1995.

"Price stability" is the ECB's sole mandate, and President Trichet also talked about the outlook for inflation as is customary. Trichet said that the risks to price stability over the medium term appeared to be "broadly balanced." As shown in the middle chart the overall rate of CPI inflation has dropped sharply in recent months, declining to 1.6 percent in December. The stability of the "core" CPI inflation rate over the past year or so relative to the overall inflation rate reflects the sharp rise and subsequent collapse in energy prices over the last year.

In our view, the Euro-zone economy will contract through the first half of this year. On a peak-to-trough basis, we look for real GDP to drop about 2-½ percent, which is a very deep downturn regardless of how one defines recession. As the economic continues to contract, both the overall and core inflation rates should recede further. Indeed, we project that the overall CPI inflation rate will approach zero percent this summer, which will give the ECB scope to cut rates even further. Although the ECB may slow down the pace of easing in the months ahead -- it has slashed rates by 225 bps in only three months – it will need to cut rates further, at least in our view, to help prop up the faltering economy.

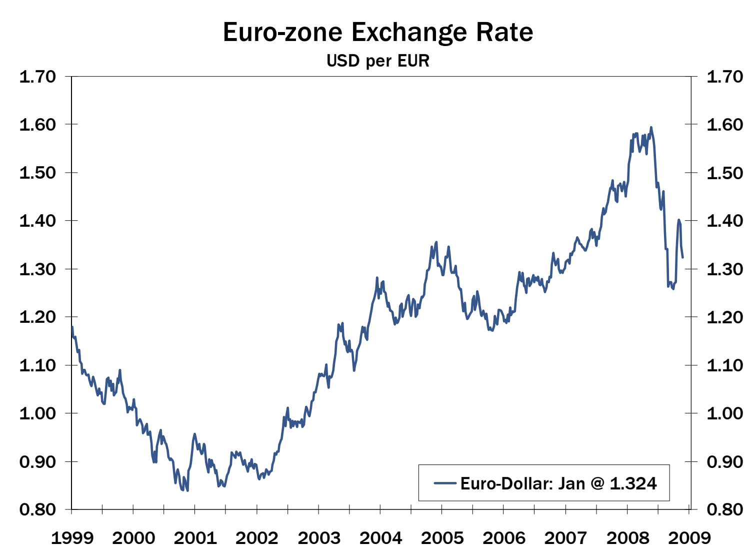
As shown in the bottom chart, the euro has depreciated nearly 20 percent on balance since summer as the outlook for the Euro-zone economy has deteriorated markedly. As long as the ECB is in rate-cutting mode, we believe the euro will continue to trend lower versus the dollar. However, as we describe in our recent *Monthly Economic Outlook*, which is posted at www.wachovia.com/economics, the euro could strengthen again against the greenback later this year as the very sluggish nature of the U.S. economic recovery that we project becomes painfully apparent to investors.





Selected Global Data

Japan	GDP Year-over-Year	Q3 - 2008	-0.5%
	CPI	November - 2008	1.0%
	Unemployment	November - 2008	3.9%
	BoJ Target Rate	Jan - 15	0.10%
Euro-Zone	GDP Year-over-Year	Q3 - 2008	0.6%
	CPI	December - 2008	1.6%
	Unemployment	November - 2008	7.8%
	ECB Target Rate	Jan - 15	2.00%
UK	GDP Year-over-Year	Q3 - 2008	0.3%
	CPI	November - 2008	4.1%
	Unemployment	November - 2008	3.3%
	BoE Target Rate	Jan - 15	1.50%
Canada	GDP Year-over-Year	October - 2008	0.2%
	CPI	November - 2008	2.0%
	Unemployment	December - 2008	6.6%
	BoC Target Rate	Jan - 15	1.50%



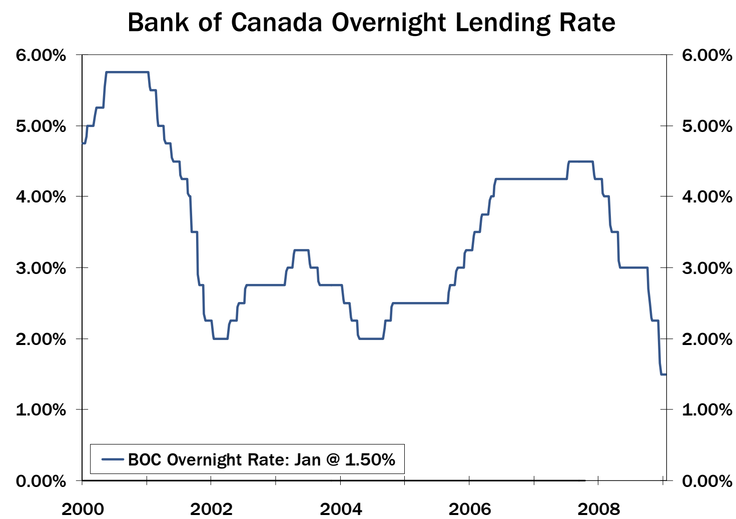
Bank of Canada Policy Rate • Tuesday

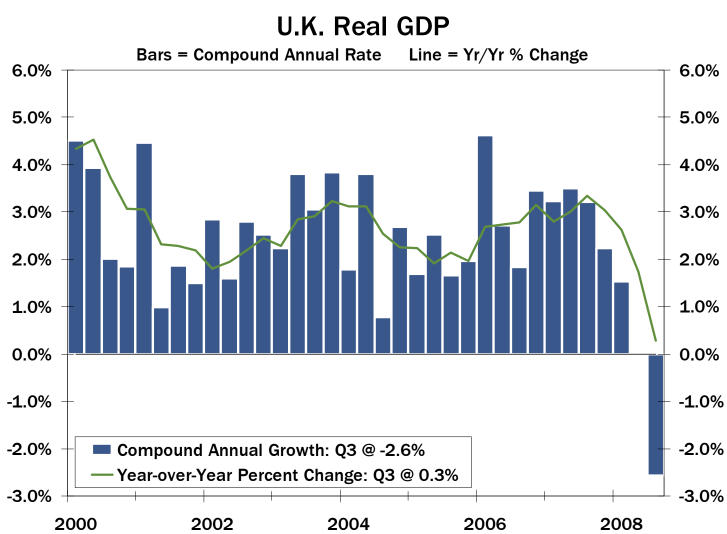
The Bank of Canada, which has cut rates by 300 bps since December 2007, will hold a regularly scheduled policy meeting on Tuesday. At the last meeting in December, policymakers acknowledged that the Canadian economy had slipped into recession. Data subsequent to that meeting, including the large drop in payrolls in December, are consistent with recession. We are in line with the consensus forecast in anticipating a 50 bps rate cut at Tuesday's meeting.

Data on the docket next week, including manufacturing shipments on Tuesday and retail sales on Thursday, will give investors a sense of just how weak the Canadian economy was in the fourth quarter. CPI inflation data for December will print on Friday, although growth (or lack thereof) has overtaken inflation as the biggest economic issue at present.

Current Policy Rate: 1.50% **Wachovia: 1.00%**

Consensus: 1.00%





U.K. Real GDP Growth • Friday

The U.K. economy contracted 0.6 percent (not annualized) in the third quarter, signaling the onset of Britain's first recession since the early 1990s. Sadly, the freefall in economic activity that appears to have occurred during the fourth quarter makes the contraction in the previous quarter seem small by comparison. By our reckoning, real GDP fell 1.4 percent in the fourth quarter, slightly worst than the consensus forecast.

The preliminary GDP data will not include a breakdown into the underlying GDP components. However, retail sales data for December, which will be released on Friday as well, will offer some insights into the current state of consumer spending. Data on CPI inflation (Tuesday) and the labor market (Wednesday) will round out a very busy week on the data front.

Previous: -0.6% (not annualized) **Wachovia: -1.4%**

Consensus: -1.2%

Chinese Real GDP Growth

Year-on-year real GDP growth in China has slowed continuously since the second quarter of 2007, and recent monthly data suggest that growth slowed even further in fourth quarter. If the consensus forecast proves to be correct, then Chinese real GDP growth in the fourth quarter would have declined to its slowest rate since 1999 in the aftermath of the Asian economic crisis. We are not as pessimistic as the consensus, but we also look for a significant slowdown in Chinese economic growth. Although seasonally adjusted data will not be released, the sharp decline in the year-over-year growth rate implies that the Chinese economy may have contracted on a seasonally adjusted basis in the fourth quarter.

December data on producer prices, consumer prices, industrial production, and retail sales will give investors even more insights into the state of the Chinese economy at the end of last year.

Previous: 9.0% (year-over-year rate) **Wachovia: 7.7%**

Consensus: 6.8%

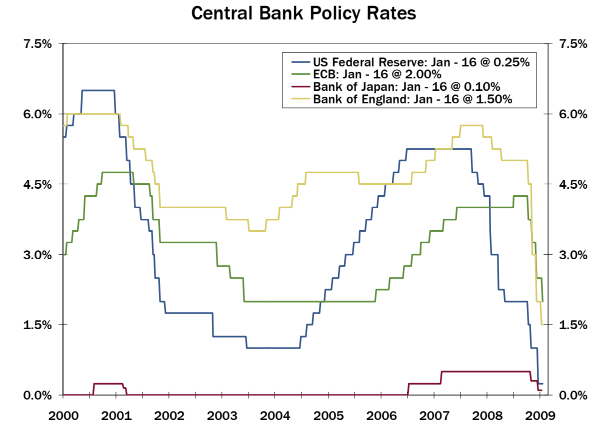
Interest Rate Watch

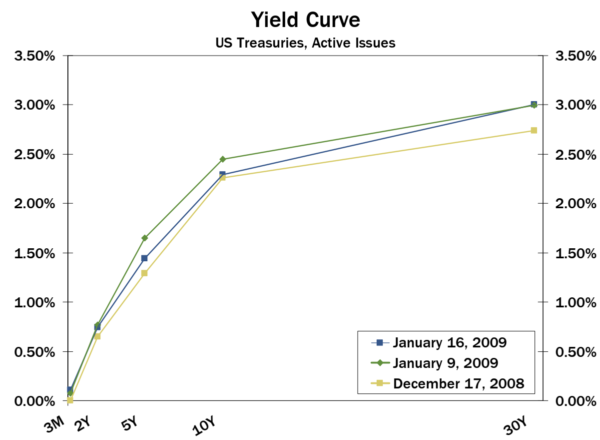
Rates in an Unbalanced Economy

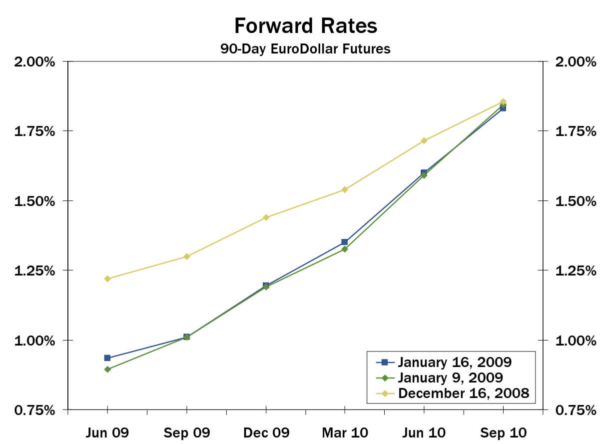
For some time now the pattern of interest rates, both short-term and long-term, has been driven by fear more than economic fundamentals. Our current forecast maintains our fear-driven interest rate outlook, despite our unease at the break between fundamentals and rates that we see. At the short end of the curve we expect that the Fed will remain very accommodative given their fear of deflation and further downward pressures on credit availability. A minimal federal funds rate and swelling balance sheet will keep three month LIBOR as well as commercial paper at the low end of long term historical experience.

Ten-year Treasury rates remain very low, as fear has pushed the flight to quality trade to extremes. However, we feel the current level of rates is inconsistent with the long-run economic/financial fundamentals. Will the Fed act with deliberate speed to withdraw liquidity as the recovery begins later this year? Second, will the federal spending associated with "stimulus" be moderated as the economy recovers such that future federal deficits are brought down to earth? We remain skeptical on both counts. Therefore, our expectation is that longer term Treasury rates will rise despite a steady federal funds rate.

Moreover, we are concerned about the response of international investors to the pattern of persistent, large fiscal deficits of $ 1 trillion plus. Such deficits represent a three standard deviation event. Therefore, such a deficit pushes the limits of investors to tolerate such supply. Only an extreme flight-to-quality fear can offset such an extreme supply of government bonds. Such a balance between two extremes is unlikely to be very stable over time.







Topic of the Week

We Still Have a Ways to Go

Real economic activity fell off a cliff during the fourth quarter, producing a sharp drop in employment, output and spending. More than 1.5 million jobs were lost during the period and total hours worked plummeted to a 7.7 percent annual rate. Real GDP did not likely decline that much, as faltering demand in the U.S. cut demand for imports and thus exported a good part of U.S. weakness. We currently expect real GDP to decline at a 5.3 percent annual rate during the fourth quarter. While GDP growth did not fall as much as had been feared, a decline of 5.3 percent is still a pretty ferocious drop and we expect declines will persist for five consecutive quarters, the longest period of consecutive declines on record.

Moreover, production cutbacks announced by the major domestic motor vehicle manufacturers along with many transplant operations, will likely result in a much weaker start to 2009. The fourth quarter of last year and the first quarter of 2009 will likely mark the darkest hours of this downturn. The Federal Reserve is expected to keep its target rate near zero for all of 2009. While we see real GDP bottoming this summer, a strong sustainable recovery is not likely to take hold until sometime in 2010. We expect the unemployment rate to eventually reach around 9.5 percent, but not until next year.

We expect the actual recession period to last nearly two years and expect the recovery to be unusually feeble. By contrast, the longest recessions during the postwar era lasted sixteen months and the average recession lasted just nine months. The longer recession is the result of both cyclical and structural imbalances, which will take much more time to unwind.

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 1/16/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.11	0.06	3.12
3-Month LIBOR	1.14	1.26	3.95
1-Year Treasury	0.40	0.43	2.64
2-Year Treasury	0.70	0.75	2.50
5-Year Treasury	1.43	1.51	3.01
10-Year Treasury	2.29	2.39	3.73
30-Year Treasury	2.87	3.06	4.34
Bond Buyer Index	4.80	5.02	4.15

Foreign Exchange Rates

	Friday 1/16/2009	1 Week Ago	1 Year Ago
Euro ($/€)	1.325	1.347	1.465
British Pound ($/£)	1.468	1.516	1.964
British Pound (£/€)	0.903	0.889	0.746
Japanese Yen (¥/$)	90.328	90.400	107.640
Canadian Dollar (C$/$)	1.252	1.186	1.025
Swiss Franc (CHF/$)	1.115	1.113	1.101
Australian Dollar (US$/A$)	0.667	0.703	0.880
Mexican Peso (MXN/$)	13.920	13.620	10.940
Chinese Yuan (CNY/$)	6.845	6.841	7.243
Indian Rupee (INR/$)	48.720	48.260	39.294
Brazilian Real (BRL/$)	2.336	2.252	1.773
U.S. Dollar Index	84.075	82.663	76.258

Foreign Interest Rates

	Friday 1/16/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	2.45	2.69	4.50
3-Month Sterling LIBOR	2.26	2.38	5.62
3-Month Canadian LIBOR	1.60	1.80	4.13
3-Month Yen LIBOR	0.72	0.78	0.90
2-Year German	1.45	1.51	3.56
2-Year U.K.	1.61	1.61	4.26
2-Year Canadian	0.95	1.10	3.29
2-Year Japanese	0.37	0.38	0.60
10-Year German	2.93	3.02	3.98
10-Year U.K.	3.30	3.14	4.38
10-Year Canadian	2.61	2.81	3.82
10-Year Japanese	1.23	1.31	1.39

Commodity Prices

	Friday 1/16/2009	1 Week Ago	1 Year Ago
W. Texas Crude ($/Barrel)	34.62	40.83	90.84
Gold ($/Ounce)	837.80	854.20	877.03
Hot-Rolled Steel ($/S.Ton)	475.00	515.00	520.00
Copper (¢/Pound)	152.35	154.55	316.15
Soybeans ($/Bushel)	9.81	9.76	12.33
Natural Gas ($/MMBTU)	4.81	5.52	8.13
Nickel ($/Metric Ton)	10,626	11,462	28,160
CRB Spot Inds.	340.32	340.06	477.55

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	19	20	21	22	23
U.S. Data			**NAHB Housing Mkt Ind.** December 9.0 January 9.0 (C)	**Housing Starts** November 625K December 640K (W) **House Price Index (MoM)** October -1.1% November -1.2% (C)	
Global Data		**Canada** **Bank of Canada Rate** Previous 1.50% **UK** **CPI (YoY)** Previous (Nov) 4.1%	**UK** **Unemployment Rate** Previous (Oct) 6.0%	**Canada** **Retail Sales (MoM)** Previous (Oct) -0.9%	**UK** **GDP (YoY)** Previous(3Q) 0.3% **UK** **Retail Sales (MoM)** Previous(Nov) 0.3%

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

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