WACHOVIA
ECONOMICS GROUP

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

January 30, 2009

U.S. Review

Poor Momentum Going into 2009

U.S. real GDP declined at an annualized rate of 3.8 percent in the fourth quarter. Although the decline was the largest contraction since the first quarter of 1982, it was not nearly as bad as the 5.5 percent plunge the consensus expected. The real surprise was the unexpected increase in real inventories, which rose $6.2 billion in the fourth quarter following a $30 billion drawdown in the third quarter. Inventories made a positive contribution to GDP growth equal to 1.3 percentage points in the fourth quarter. Consumer spending plunged at a 3.5 percent pace in the quarter as spending on big-ticket items like motor vehicles and home electronics plummeted. Businesses also cut back on new plant and equipment outlays. Within fixed investment spending, purchases of equipment and software plunged nearly 28 percent -- the sharpest quarterly decline in fifty years. As if to rub salt in the wound, gross exports plunged nearly 20 percent, a by-product of recession in most foreign countries. However, gross imports also tanked (down nearly 16 percent), so there was little overall effect on GDP from net exports.

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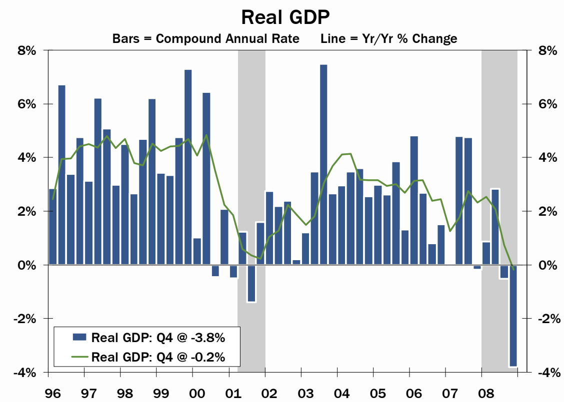

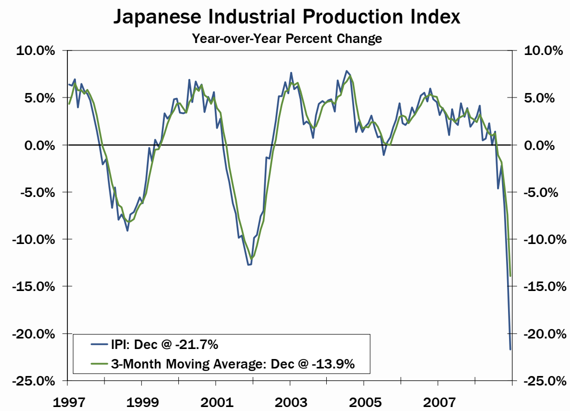

Global Review

Deep Recession in Japan

Data released this week suggest that the Japanese economy, which had already contracted in the previous two quarters, fell off a cliff in the fourth quarter. It seems likely that Japan is mired in its deepest recession since the end of the Second World War.

Industrial production, which had dropped 8.5 percent in November relative to the previous month, fell another 9.6 percent in December. On a year-over-year basis, IP plunged more than 20 percent in December, surpassing the previous record decline of 18 percent set during the deep recession that followed the first oil price shock in the mid-1970s (see graph at left).

Net exports have been an important driver of Japanese economic growth over the past few years, and Japan is clearly feeling the effects of the global downturn. As shown in the top chart on page 4, the volume of Japanese exports nosedived by

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Recent Special Commentary

Date	Title	Authors
January-28	State Employment: December 2008	Vitner, York & Whelan
January-27	Employment: Digging Under the Headlines	Silvia, York & Whelan
January-26	Florida's Labor Market Takes it on the Chin	Vitner & York
January-16	A Holiday Season for the Record Books	Vitner & York

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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Economic Weakness Has Carried Over Into The First Part of 2009

Nominal GDP essentially reflects revenue growth for the overall economy. The shortfall in nominal GDP matches up with the top line revenue figures reported by many major corporations and helps explain why so many firms have been slashing payrolls. Businesses simply do not have the money coming in to continue operating the way they were previously.

Layoff announcements moved to the forefront once again this week, as a number of firms including Caterpillar, Home Depot, Pfizer and Starbucks announced cutbacks this week. Most were made in conjunction with earnings of merger announcements and in some cases the cutbacks were simply rehashing or enlarging previously announced moves. Earnings have largely come in on the low side of expectations and many firms have reduced expectations or stated that they had less visibility of future sales and earnings trends.

Economic weakness has clearly carried over into the first part of 2009. Weekly first-time claims for unemployment insurance rose an additional 3,000 in the latest week, bringing the figure up to 588,000. The small increase confirms last week's larger bounce back and removes any doubts that earlier reported declines in unemployment claims simply reflected holiday timing distortions.

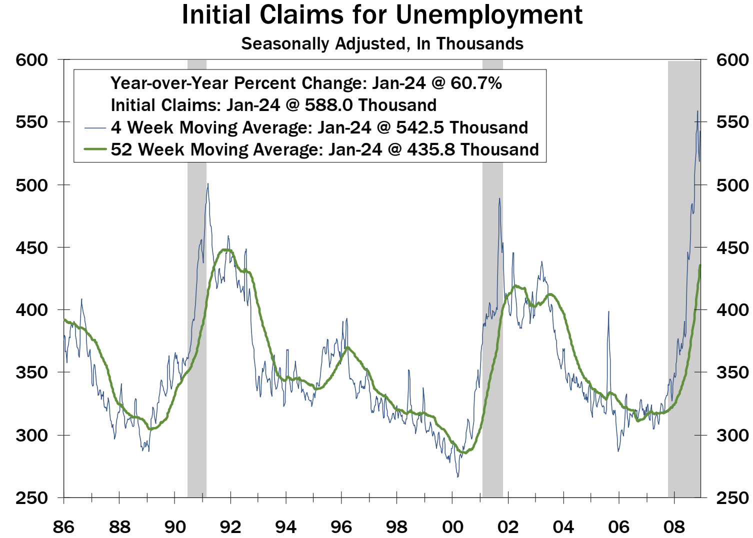
Consumer Confidence also weakened in January. There was some hope that the inauguration of President Obama might generate a slight bump. Instead, the overall figures fell 0.3 points to a record low 37.7, as consumers continue to express worries about the current state of the economy. The employment component of the series actually improved slightly, with the proportion of consumers expressing optimism about employment prospects rising 0.7 percentage points to 7.2 percent and those stating that "jobs are hard to get" falling 0.4 percentage points to 41.1 percent.

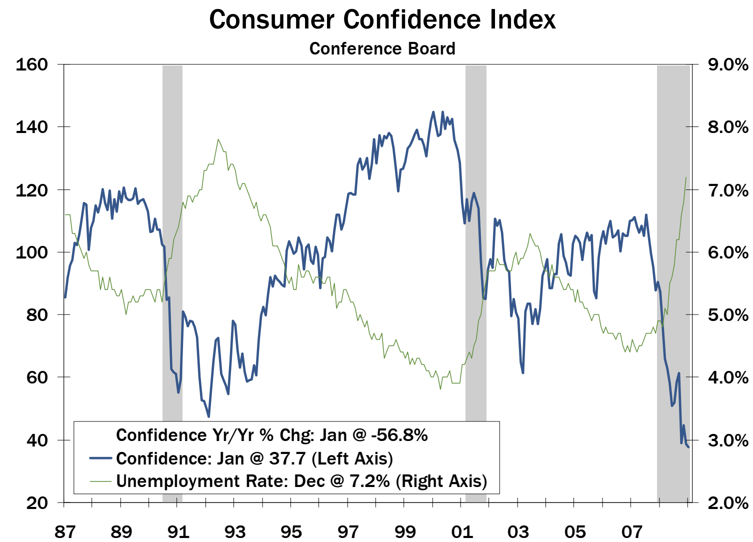
Despite the improvement, the employment component of the Consumer Confidence Index remains consistent with a further increase in the unemployment rate. Our forecast calls for the jobless rate to rise 0.3 percentage points to 7.5 percent. We expect nonfarm employment fell by another 575,000 jobs in January, continuing the carnage seen in the fourth quarter.

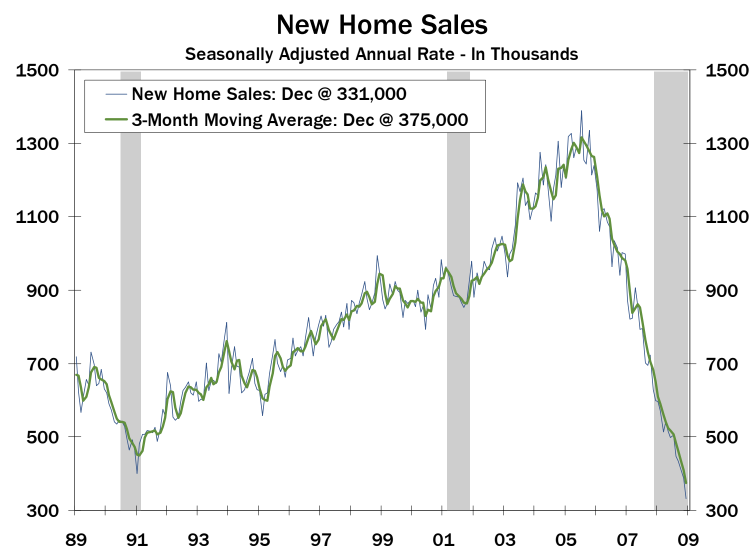
Another key report out this week showed new home sales plummeting 14.7 percent to a paltry 331,000 unit rate. That is the lowest sales figure for the series, which dates back to 1963. One possible contributing factor is that many potential first-time homebuyers are awaiting the more favorable incentives that are included in the economic stimulus package.

Selected Current Data

Gross Domestic Product - CAGR	Q4 - 2008	-3.8%
GDP Year-over-Year	Q4 - 2008	-0.2%
Personal Consumption	Q4 - 2008	-3.5%
Business Fixed Investment	Q4 - 2008	-19.1%
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 - 30	0.25%







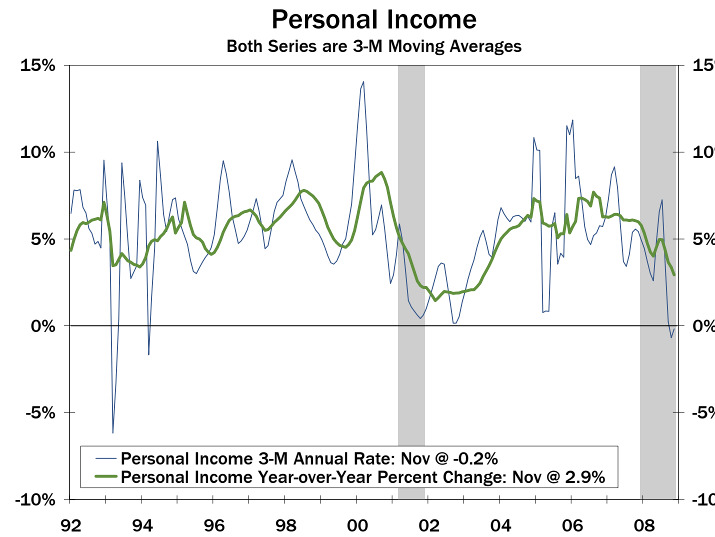
Personal Income • Monday

Personal income fell 0.2 percent in November and spending dropped 0.6 percent. However, real consumer spending rose 0.6 percent, with the core PCE deflator up 1.9 percent year-over-year, the lowest since 2004. Falling prices helped to offset losses in real consumer spending. The saving rate rose to 2.8 percent.

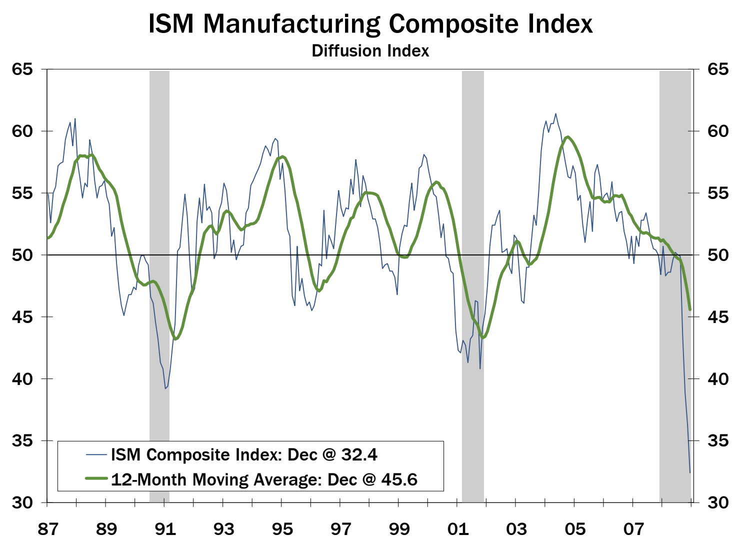
With employment and hours worked down sharply in recent months, personal income will likely remain under pressure, which means lower interest rates and lower gasoline prices will provide less relief to shell-shocked consumers. We expect personal income and spending will fall 0.1 and 0.8 percent, respectively. The saving rate should continue to increase as consumers pull back on making purchases in the face of weaker economic growth and less access to credit.

Previous: -0.2% **Wachovia: -0.1%**

Consensus: -0.3%



ISM Manufacturing • Monday



December's ISM manufacturing index came in at 32.4, well within recession territory and consistent with levels of the 1980-82 recessionary period. Weakness remains in new orders, production and employment. Prices paid fell sharply to 1949 lows and suggests lower inflation ahead.

We expect January's ISM manufacturing index will remain in recession territory at 33.7. The regional purchasing manger reports including Empire, Chicago and Philadelphia, were are all down, suggesting continued weakness in the headline number. Motor vehicle production is also down and will continue to be a headwind for the ISM in coming months. New orders and order backlogs should also continue their declines, indicating more weakness in the pipeline.

Previous: 32.4 **Wachovia: 33.7**

Consensus: 33.0

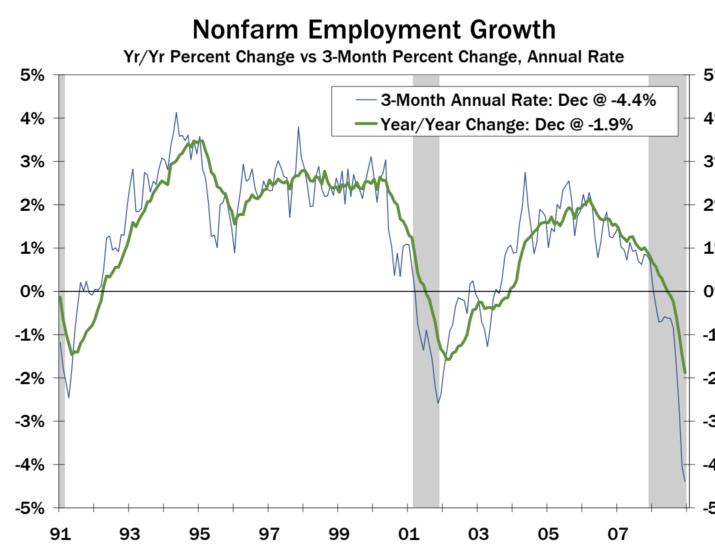
Employment • Friday

Nonfarm employment fell by 524,000 in December with broad declines in manufacturing, construction, and services. Aggregate hours declined for the ninth month in a row, signaling continued weakness in output.

We expect jobs fell another 575,000 in January, which would bring the total number of jobs lost since the onset of the recession to more than three million. While the bulk of early losses were in manufacturing and in housing-related industries, job losses have broadened and intensified over the last several months. The rising unemployment rate is consistent with weakness in consumer spending and continued drops in consumer sentiment. We expect the unemployment rate will reach 7.5 percent in January, the highest rate since 1993. The string of disappointing announcements by major companies should continue to put downward pressure on nonfarm employment for months to come.

Previous: -524,000 **Wachovia: -575,000**

Consensus: -500,000



Global Review

(Continued from Page 1)

roughly 25 percent in December. Japan is an important supplier of capital goods to other Asian countries, and data show that Japanese exports to its Asian trading partners have cratered in recent months. Little wonder that Japanese industrial production has imploded.

But there are other factors as well behind the downturn in Japan. The value of retail sales fell 1.4 percent in the fourth quarter relative to the previous quarter. With inflation near zero percent in Japan, the drop in the value of retail sales probably translates into an outright decline in real consumer spending in the fourth quarter. And with the unemployment rate up sharply in recent months–- it jumped from 3.7 percent in October to 4.4 percent in December –- a near-term turnaround in consumer spending does not seem credible. In addition, survey data suggest that businesses plan deep cuts in fixed investment spending. The 28 percent drop in "core" machinery orders since last summer shows that the downturn in capital spending is well underway.

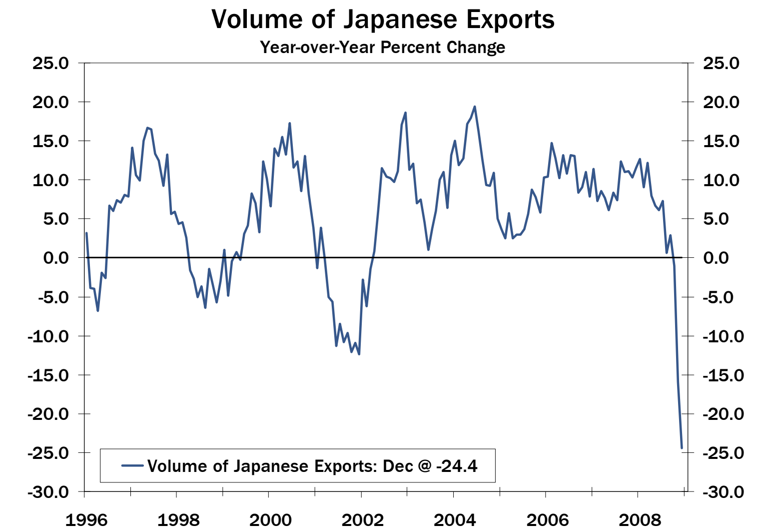
Unfortunately, the ability of Japanese policymakers to stimulate the economy is rather limited. The Bank of Japan has cut its policy rate to only 10 bps, and massive fiscal stimulus is constrained by the government debt-to-GDP ratio that has risen to 170 percent, the highest ratio by far in the developed world. Therefore, Japan will need the engine of stronger growth in the rest of the world to pull its own economy up. It may be waiting quite a while.

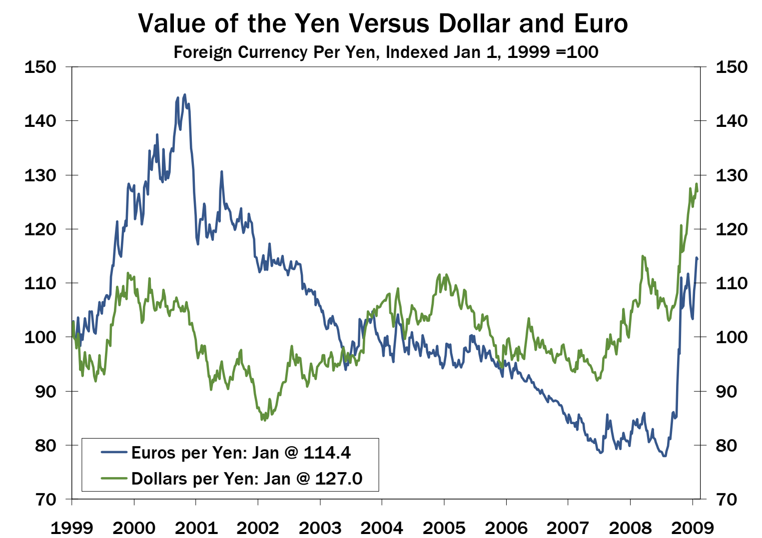
So if the Japanese economy is on its knees and its outlook is grim why is the yen so strong? (See middle chart.) For starters, Japan has a large current account surplus (see bottom chart). That is, Japan is a net lender to the rest of the world. When investors turn risk averse, as they have done over the past year or so, international capital flows tend to weaken. Countries with current account surpluses naturally feel upward pressure on their currencies.

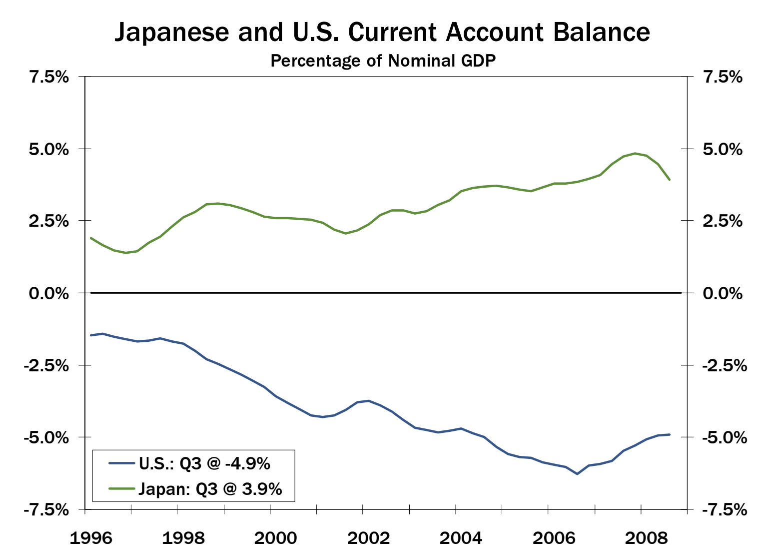
Astute readers will note that China also has a large current account surplus, yet its currency has been stable versus the dollar since last summer. The difference between China and Japan is that policymakers in the former intervene in the foreign exchange market to keep their currency stable. In contrast, Japanese officials generally allow their currency to fluctuate freely. Until risk aversion subsides, the yen likely will remain strong.

Selected Global Data

Japan	GDP Year-over-Year	Q3 - 2008	-0.5%
	CPI	December - 2008	0.4%
	Unemployment	December - 2008	4.4%
	BoJ Target Rate	Jan - 30	0.10%
Euro-Zone	GDP Year-over-Year	Q3 - 2008	0.6%
	CPI	December - 2008	1.6%
	Unemployment	December - 2008	8.0%
	ECB Target Rate	Jan - 30	2.00%
UK	GDP Year-over-Year	Q4 - 2008	-1.8%
	CPI	December - 2008	3.1%
	Unemployment	December - 2008	3.6%
	BoE Target Rate	Jan - 30	1.50%
Canada	GDP Year-over-Year	November - 2008	-0.8%
	CPI	December - 2008	1.2%
	Unemployment	December - 2008	6.6%
	BoC Target Rate	Jan - 30	1.00%







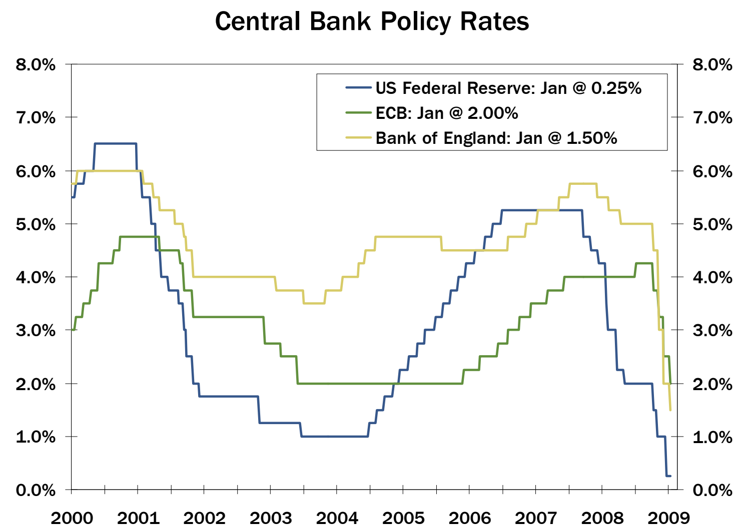
Bank of England Policy Rate • Thursday

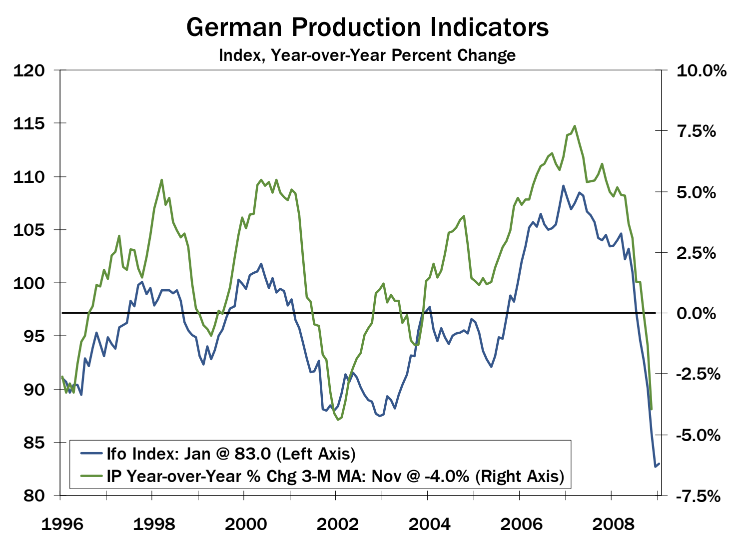
The Bank of England holds its monthly policy meeting on Thursday, and we are in line with the consensus forecast in anticipating another 50 bps rate cut. At its last policy meeting on January 8, eight members of the Monetary Policy Committee voted to cut rates by 50 bps, but one member argued that the MPC should slash its rate by 100 bps. We think the rest of the MPC will deliver the other half of his preference at this meeting.

Since the last MPC meeting, economic data have continued to paint a very dismal picture of the U.K. economy, with real GDP plunging 1.5 percent (not annualized) in the fourth quarter. Although the rate of decline in the first quarter may be slowing somewhat – available indicators suggest that it may be – the economy continues to contract. With inflation receding rapidly, another rate cut seems to be a no brainer.

Previous: 1.50% **Wachovia: 1.00%**

Consensus: 1.00%





ECB Policy Rate • Thursday

The European Central Bank holds its monthly policy meeting on Thursday, and recent statements by policymakers seem to indicate that the Governing Council will keep rates on hold at this meeting. However, the deep recession that is underway in the Euro-zone makes it likely that the ECB will need to ease further in the months ahead. Therefore, we would not be shocked if the ECB opted to cut rates again on February 5.

Indeed, data that are slated for release next week should make for very grim reading. The PMIs for the manufacturing and service sector, which are slated for release on Monday, should remain mired in deep recession territory. And the recent freefall in the Ifo index of German business sentiment is consistent with very weak industrial production in December. ("Hard" data on German IP are slated for release on Friday.)

Previous: 2.00% **Wachovia: 2.00%**

Consensus: 2.00%

Canadian Unemployment Rate • Friday

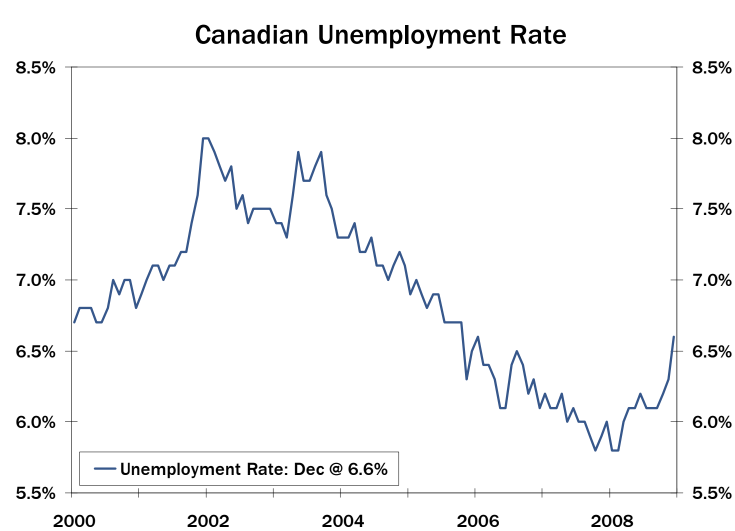
The Canadian housing market has struggled in the fourth quarter. Building permits have posted double digit declines in consecutive months. Building permits data for December will be released Thursday; we will likely see a third straight monthly drop.

As most of the world's largest economies are slipping into recession, Canada's major economic challenge is weak exports. But signs of cooling domestic demand have been showing up lately as well. Canadian retail sales fell 2.4 percent in November, which was more than expected. On Thursday of next week, the Ivey purchasing managers index will give us a sense of how Canadian business and government spending will fare in the near future.

The labor market remains under intense pressure as the economy has shed over 100,000 jobs in November and December. Look for another drop in January payrolls as unemployment trends higher.

Previous: 6.6%

Consensus: 6.8%



Interest Rate Watch

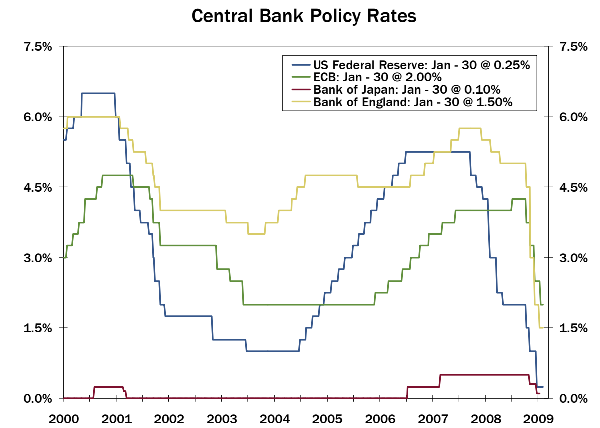
Fed Policy: Sustained Policy Ease Suggests Continued Low Short Rates

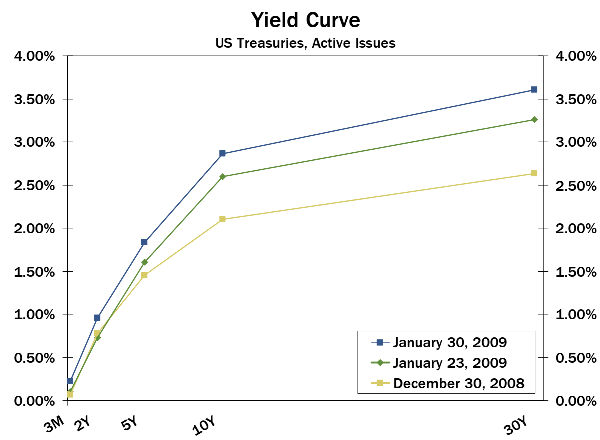
Financial stability and economic recovery continue to be the primary intermediate-term policy targets for the Fed. Yet, both targets are a distance away from being reached. The longer-term goal is, of course, price stability with sustainable real economic growth. To promote financial stability and economic recovery, the FOMC retained its 0 to 25 basis point target range for the federal funds rate. In addition, the Fed is committing to a continued expansion of its balance sheet to support financial markets. The Fed will continue with its outright purchases of Government Sponsored Enterprise (GSE) debt and Agency mortgage backed securities. Monetary policy continues to adjust to an environment of economic recession, lower inflation expectations and the imbalance of asset valuations.

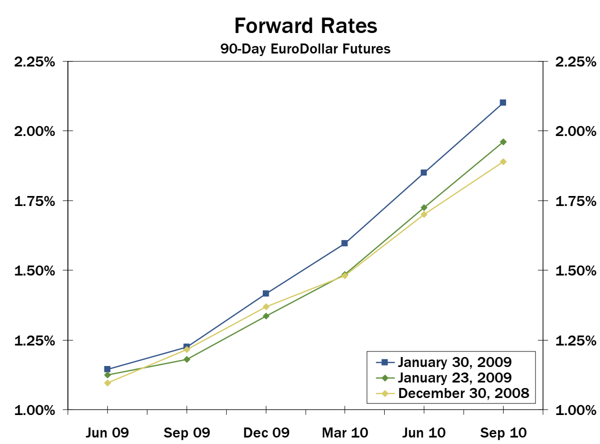
Inflation: Below Desired Levels

In a rare comment, the FOMC cited that they see "some risk that inflation could persist for a time below rates that best foster economic growth and price stability in the longer term." Such a comment supports the FOMC's suggestion that "economic conditions are likely to warrant exceptionally low levels of the federal funds rate for some time." There certainly is no incentive from the inflation data for the Fed to alter its ultra-easy policy.

Therefore, we will stay with our expectation that the federal funds rate will remain in the 0.00 - 0.25 percent range for the rest of this year. Our concern, however, is that yields on longer-dated debt instruments will drift upward 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.







Topic of the Week

Housing is Key to U.S. Banks

No one industry is more important to the health of the U.S. banking sector than residential real estate. According to third quarter data from the Federal Deposit Insurance Corporation, banks held \$2.1 trillion in single family mortgage loans – by far the largest category of loans held by banks. Banks also have exposure to real estate through home equity lines (\$652B), construction and development loans (\$617B), and nonfarm nonresidential loans (\$1.04T). That comes to almost 60 percent of total loans held at U.S. banks secured by real estate collateral.

As home prices tumbled over the past few years, banks have been affected through increasing nonperforming loans made to homebuilders – particularly in California, Florida, Nevada and Arizona where much of the overbuilding took place. Credit quality of the banks' loan portfolio has thus deteriorated. The industry reported that net-charge offs totaled \$27.9 billion in the third quarter with two-thirds of that increase consisting of loans secured by real estate.

The housing market has yet to find a bottom and as such prospects for a solid economic recovery occurring in 2009 appear quite dim. Rising unemployment, tighter credit conditions, and slower consumer spending and business investment will likely impair banks' earnings for the foreseeable future. As the economy continues to worsen, banks are finding themselves raising their loan loss reserves – although at slower pace than the growth in noncurrent loans.

With expectations that a floor in the housing market will not be reached until sometime in 2009 or early 2010, profitability for most banks across the U.S. will remain under considerable pressure.

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 1/30/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.23	0.10	2.15
3-Month LIBOR	1.18	1.17	3.24
1-Year Treasury	0.47	0.30	2.33
2-Year Treasury	0.93	0.81	2.17
5-Year Treasury	1.85	1.63	2.84
10-Year Treasury	2.82	2.62	3.67
30-Year Treasury	3.58	3.32	4.38
Bond Buyer Index	5.16	5.13	4.39

Foreign Exchange Rates

	Friday 1/30/2009	1 Week Ago	1 Year Ago
Euro ($/€)	1.284	1.297	1.486
British Pound ($/£)	1.445	1.380	1.986
British Pound (£/€)	0.889	0.940	0.748
Japanese Yen (¥/$)	89.826	88.779	106.270
Canadian Dollar (C$/$)	1.235	1.231	0.993
Swiss Franc (CHF/$)	1.159	1.154	1.083
Australian Dollar (US$/A$)	0.639	0.654	0.893
Mexican Peso (MXN/$)	14.356	14.011	10.839
Chinese Yuan (CNY/$)	6.847	6.847	7.192
Indian Rupee (INR/$)	48.970	49.200	39.391
Brazilian Real (BRL/$)	2.318	2.330	1.761
U.S. Dollar Index	86.014	85.608	75.032

Foreign Interest Rates

	Friday 1/30/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	2.09	2.19	4.38
3-Month Sterling LIBOR	2.17	2.19	5.59
3-Month Canadian LIBOR	1.62	1.54	4.06
3-Month Yen LIBOR	0.67	0.69	0.88
2-Year German	1.53	1.43	3.48
2-Year U.K.	1.48	1.48	4.43
2-Year Canadian	1.35	1.24	3.22
2-Year Japanese	0.41	0.37	0.55
10-Year German	3.29	3.24	4.02
10-Year U.K.	3.70	3.69	4.57
10-Year Canadian	3.00	2.82	3.90
10-Year Japanese	1.30	1.24	1.44

Commodity Prices

	Friday 1/30/2009	1 Week Ago	1 Year Ago
W. Texas Crude ($/Barrel)	41.49	46.47	92.33
Gold ($/Ounce)	919.77	899.75	929.40
Hot-Rolled Steel ($/S.Ton)	475.00	515.00	520.00
Copper (¢/Pound)	143.30	145.75	321.60
Soybeans ($/Bushel)	9.61	10.05	12.19
Natural Gas ($/MMBTU)	4.47	4.52	8.05
Nickel ($/Metric Ton)	11,349	10,957	27,500
CRB Spot Inds.	332.55	336.90	477.86

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	2	3	4	5	6
U.S. Data	**Personal Income** November -0.2% December -0.1% (W) **Personal Spending** November -0.6% December -0.8% (W) **ISM Manufacturing** December 32.9 January 33.7 (W)	**Total Vehicle Sales** December 10.3M January 10.5M (W)	**ISM Non-Manufacturing** December 40.1 January 40.5(W)	**Factory Orders** November -4.6% December -2.5% (W) **Nonfarm Productivity** 3Q 1.3% 4Q 2.8% (W) **Unit Labor Cost** 3Q 2.8% 4Q -2.2% (W)	**Nonfarm Payrolls** December -524K January -575K (W) **Unemployment Rate** December 7.2% January 7.5% (W)
Global Data				**Euro-zone** **ECB Announces Rates** Previous 2.00% **UK** **BOE Announces Rates** Previous 1.50%	**Canada** **Unemployment Rate** Previous(Dec) 6.6% **Germany** **Indus. Production (MoM)** Previous(Nov) -3.1%

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

Wachovia Economics Group

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 H. 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	Economic Analyst	(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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