ECONOMICS GROUP

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

June 12, 2009

U.S. Review

Recession and Recovery

Financial markets are acting as if the recession is ending and recent economic data tend to support that notion. We are now projecting that the recession will end this summer. The strength and durability of the recovery remain very much in question, however, and the economy is expected to have a tough time gaining momentum.

This past week had a light schedule of economic reports and the Treasury auctions took center stage, particularly when Wednesday's 10-year auction received tepid demand and 10-year yields touched 4 percent. The rise in yields corresponds with continued bad news on the size of the federal budget deficit and weaker dollar. Combined they suggest overseas investors are less sold on near term economic prospects for the U.S. than equity market investors are.

We now believe the recession will end this summer, which is a few months earlier than previously thought. The decision to move up the end of the downturn was largely driven by the timing of motor vehicle assembly plant shutdowns and restarts, which will produce huge inventory swings.

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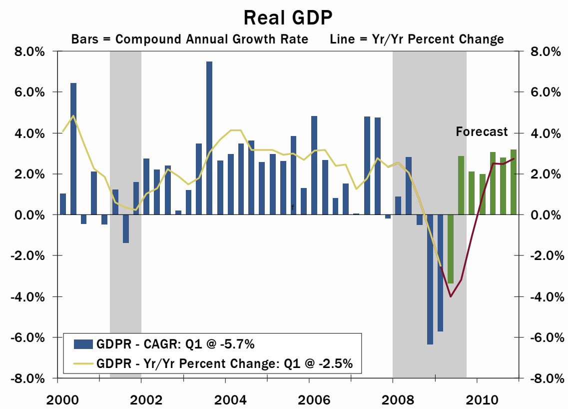

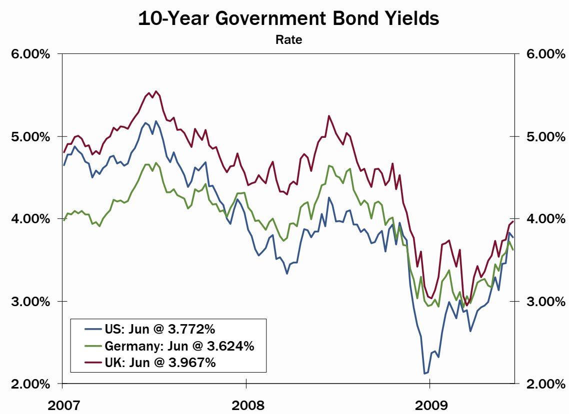

Global Review

Bond Yields Signaling Stronger Growth?

Government bond yields in most major countries have trended higher over the past few weeks (see graph at left). One line of thought claims that the back-up in yields, at least in the United States, reflects reluctance by foreign investors to support the unprecedented budget deficits the federal government is incurring. However, at this week's 30-year bond auction "indirect" bidders, which includes foreign central banks, bought about one-half of the $11 billion worth of securities on offer, casting some doubt on the notion that foreigners are eschewing U.S. securities, at least at present.

The rise in yields over the past few months, not only in the United States but in other major economies as well, is consistent with the expectation that the global economy will stabilize later this year and resume growing again. However,

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Recent Special Commentary

Date	Title	Authors
June-11	Florida Economic Outlook	Vitner & Kamaruddin
June-11	Global Chartbook - June 2009	Bryson & Quinlan
June-11	Housing Chartbook - June 2009	Vitner & York
June-10	Consumers Remain Thrifty Amid Economic Turmoil	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	-6.3	-5.7	-3.4	2.9	2.1	2.9	2.8	2.0	1.1	-2.7	2.1
Personal Consumption	0.9	1.2	-3.8	-4.3	1.5	-1.0	1.7	1.9	3.0	3.0	2.8	0.2	-0.7	1.4
Inflation Indicators [2]														
"Core" PCE Deflator	2.2	2.3	2.3	1.9	1.8	1.7	1.2	1.0	2.1	2.3	2.2	2.2	1.4	0.9
Consumer Price Index	4.2	4.3	5.2	1.5	-0.2	-1.3	-2.6	-0.3	3.4	3.2	2.9	3.8	-1.1	1.1
Industrial Production [1]	0.2	-4.6	-9.0	-12.9	-19.2	-15.5	2.0	2.9	3.3	2.3	1.5	-2.2	-11.4	1.1
Corporate Profits Before Taxes [2]	-1.5	-8.3	-9.2	-21.5	-18.0	-16.0	-12.0	-8.0	17.6	15.2	-1.6	-10.1	-13.8	5.8
Trade Weighted Dollar Index [3]	70.3	71.0	76.1	79.4	82.5	80.0	82.6	85.0	86.0	81.5	73.3	79.4	85.0	85.0
Unemployment Rate	4.9	5.4	6.1	6.9	8.1	9.3	9.9	10.3	5.1	4.6	4.6	5.8	9.4	10.6
Housing Starts [4]	1.06	1.02	0.87	0.66	0.53	0.47	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	3.80	3.80	3.80	4.39	4.71	4.04	2.25	3.80	4.20

Data As of: June 10, 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

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U.S. Review

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The Economy Still Faces Significant Hurdles

The recent trend in retail sales also lends support to a turnaround in real GDP during the third quarter. After rising in January and February, retail sales fell in March and April, which meant that second quarter sales started at a low base and will likely post a decline for the second quarter even if sales rebound in May and June. Retail sales did pick up in May, with overall sales rising 0.5 percent. The increase means that consumer spending will likely end the second quarter on a stronger note than it started it and will make it easier for real personal consumption expenditures to post at least a modest gain in the third quarter.

The combination of a positive swing in inventories and modest growth in real personal consumption expenditures means there is a high probability third quarter real GDP will be solidly positive. While one quarter of positive real GDP growth does not guarantee the recession will end, we believe that inventories have been drawn down so much that production will rise throughout the second half of this year just to move back in line with sales.

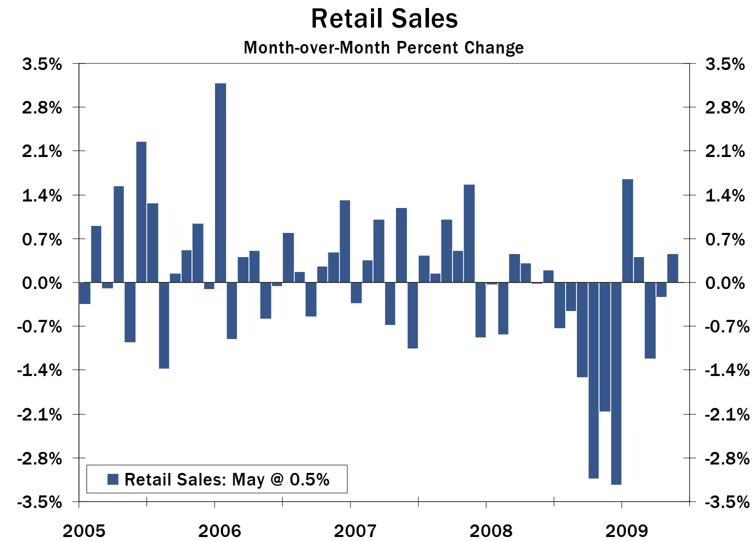
While the recession will likely end in the next few months the economy still faces significant hurdles. Consumer spending is still exceptionally weak and consumers have shown no sign of boosting purchases for big ticket items. To put it bluntly, sales have been horrible for the past eight months and have merely risen slightly from that level. Sales that are a little better than horrible are still pretty horrible.

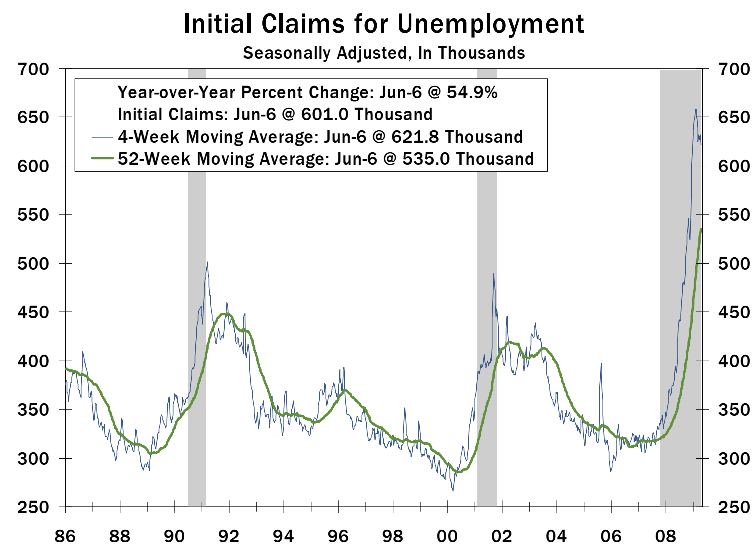
Consumers will not likely spend freely again until they feel better about their employment and income prospects. On that front, the data are a little better than they have been. First time claims for unemployment insurance declined slightly more than expected this past week, falling by 24,000 to 601,000. The drop also helped pull down the four-week moving average by 10,500 to its lowest level in four months. Unfortunately, continuing unemployment claims continued to increase and the insured unemployment rate was revised up 0.1 percent from the prior week to 5.1 percent, where it stayed this past week. The increase suggests the unemployment rate will rise to at least 9.5 percent in June.

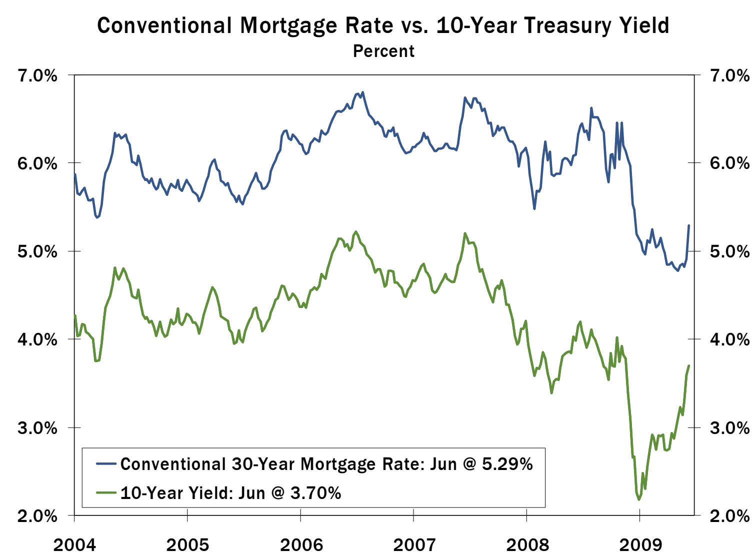
Another huge hurdle for the economy has been the rise in interest rates and weakness in the U.S. dollar. As mentioned earlier, the recent auction for 10-year Treasury notes did not go well. The 30-year auction faired better, but there is a paucity of supply for longer dated issues. The rise in the 10-year Treasury yield has sent mortgage rates sharply higher. Higher interest rates will make it much tougher to engineer a recovery in home sales.

Selected Current Data

Gross Domestic Product - CAGR	Q1 - 2009	-5.7%
GDP Year-over-Year	Q1 - 2009	-2.5%
Personal Consumption	Q1 - 2009	1.5%
Business Fixed Investment	Q1 - 2009	-36.9%
Consumer Price Index	April - 2009	-0.7%
"Core" CPI	April - 2009	1.9%
"Core" PCE Deflator	April - 2009	1.9%
Industrial Production	April - 2009	-12.5%
Unemployment	May - 2009	9.4%
Federal Funds Target Rate	Jun - 12	0.25%







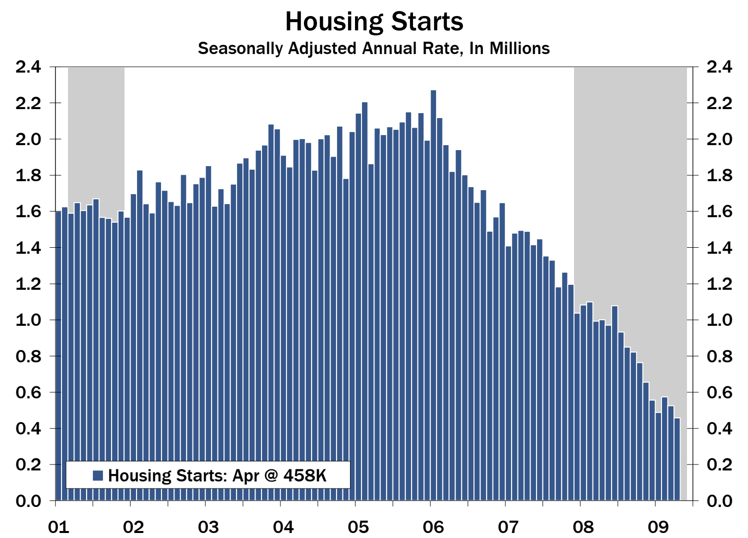
Housing Starts • Tuesday

Housing starts dropped to a new all-time low of just 458K units as multi-family activity plunged to a mere 90K unit annual pace in April. Single-family activity actually moved higher for the second straight month, up 2.8 percent in April.

With signs of stabilization starting to occur in some pockets of the economy, we expect total starts will increase in May to an annualized pace of 520K units. Single family starts should continue to trend higher while the volatile multi-family sector could rebound after plunging to the series record low set in April. The NAHB homebuilder sentiment index has risen three times in the past four months suggesting builders are becoming relatively more optimistic about the immediate housing market outlook. The 30-year fixed mortgage rate showed little change between May and April but has recently picked up above 5.50 percent and could portend a slowdown in sales in June.

Previous: 458K **Wachovia: 520K**

Consensus: 483K



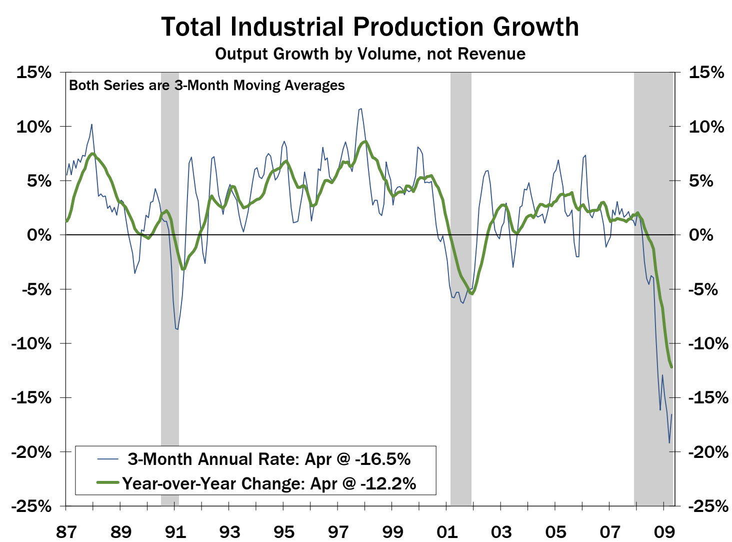
Industrial Production • Tuesday

Industrial production dropped 0.5 percent, in April with manufactured production down 0.3 percent. The declines are now 12.5 and 14.5 percent over the past year, respectively. In turn, capacity utilization dropped further and reached another all-time low at 69.1 percent.

The sharp drop in hours worked in the factory sector suggests that industrial production declined 0.8 percent in May. Manufacturing output is poised for another significant loss as motor vehicle production, which has risen the past two months, is set for a reversal. Machinery, metals and electrical equipment should also register lower output. A modest increase in utility output is in the cards as weather across much of the country was warmer than normal. With continued slack, capacity utilization should register another series low in May.

Previous: -0.5% **Wachovia: -0.8%**

Consensus: -0.8%



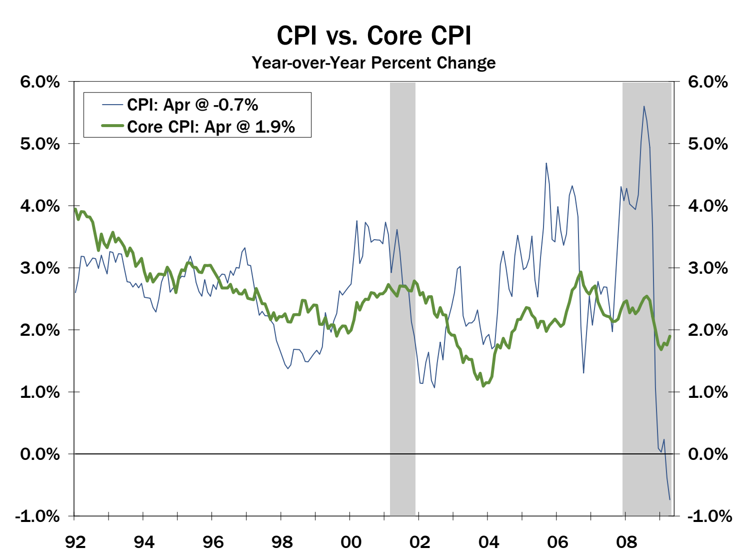
CPI • Wednesday

The Consumer Price Index was unchanged in April and is now down 0.7 percent on a year-to-year basis. Excluding food and energy, the core CPI rose 0.3 percent and remains up 1.9 percent over the past year. Tobacco prices jumped 9.3 percent following an 11.0 percent surge in March due to a tobacco excise tax hike. Excluding the jump in tobacco prices, the core CPI still would have risen 0.2 percent.

We expect headline consumer prices to increase 0.4 percent with prices at the gas pump responsible for most of the gain. Core inflation should rise 0.2 percent with tobacco and owners' equivalent rent driving the gain. We continue to believe neither inflation nor deflation will be a problem in 2009.

Previous: 0.0% **Wachovia: 0.4%**

Consensus: 0.3%



Global Review

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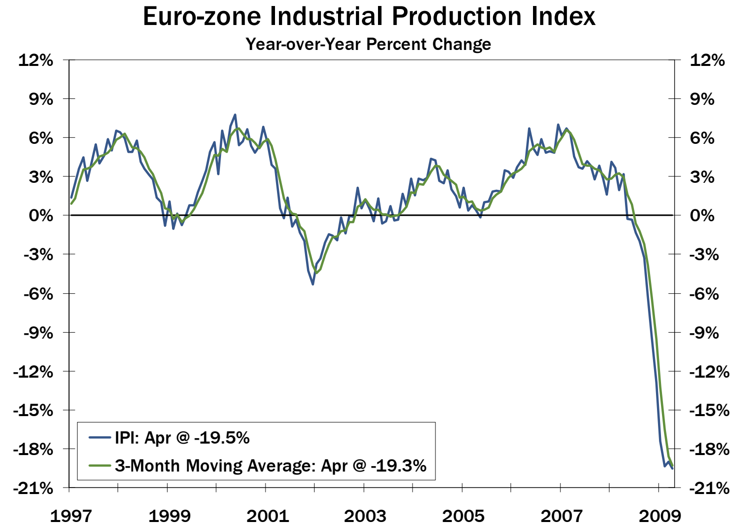
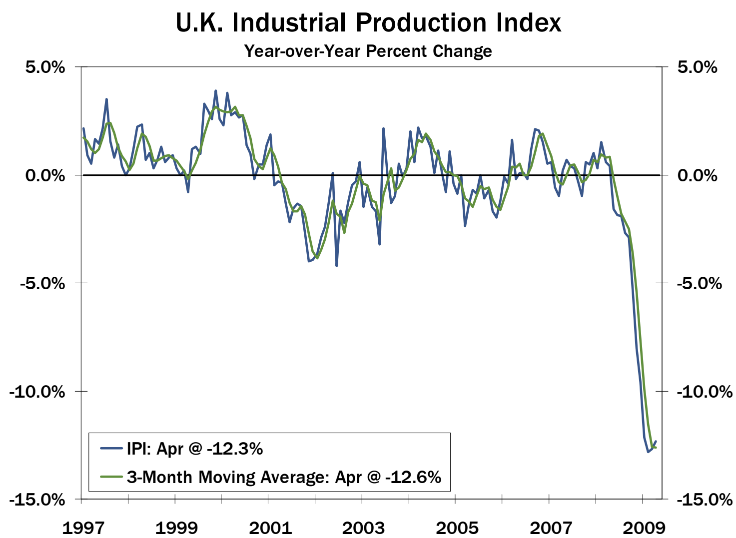
some recent data releases show that growth has not yet turned positive, at least not in some important economies. For example, industrial production (IP) in the 16-member Euro-zone tumbled 1.9.percent in April relative to the previous month, bringing its rate of decline over the past 12 months to nearly 20 percent (top chart).

In Germany, IP also fell 1.9 percent in April relative to March, which was much weaker than most investors had expected. Germany is an important supplier of capital goods to Eastern Europe, and the economic meltdown in that region is having a negative effect on the German economy. In that regard, the value of Germany's exports declined 4.8 percent in April from March.

U.K. economic data have not been quite as downbeat recently. British IP was up 0.3 percent in April, the first monthly increase in 13 months. Yes, IP is still off 12 percent on a year-over-year basis, but the rise in the PMIs over the past few months—the service sector PMI is now back in positive territory—suggests that the British economy may be nearing bottom. A widely followed index calculated by a research institution indicates that British GDP contracted 0.9 percent (not annualized) between February and May, not nearly as bad as the 2.2 percent nosedive recorded between December and March. That said, it appears that Britain will record another negative growth rate in the second quarter.

If there is one country in the world where real "green shoots" have popped up—that is, where growth is actually positive again—it is China. Data released this week showed that the year-over-year growth rate of industrial production rose from 7.3 percent in April to 8.9 percent in May (bottom chart). Interestingly, the acceleration in Chinese IP since its nadir a few months ago does not appear to be linked to exports, which were down 26 percent in May, more than the 23 percent decline registered in April. Rather, domestic sources of spending appear to be propelling the Chinese economy higher at present. Growth in retail spending strengthened from 14.8 percent in April to 15.2 percent in May, and investment spending was up 33 percent in May, the strongest growth rate in five years. In response to the global financial crisis last autumn, the Chinese government decided to accelerate infrastructure spending and relax lending restrictions that were put in place when inflation was seen as Public Enemy #1. Its efforts appear to be bearing fruit.





Selected Global Data

Japan	GDP Year-over-Year	Q1 - 2009	-8.8%
	CPI	April - 2009	-0.1%
	Unemployment	April - 2009	5.0%
	BoJ Target Rate	Jun - 12	0.10%
Euro-Zone	GDP Year-over-Year	Q1 - 2009	-4.8%
	CPI	April - 2009	0.6%
	Unemployment	April - 2009	9.2%
	ECB Target Rate	Jun - 12	1.00%
UK	GDP Year-over-Year	Q1 - 2009	-4.1%
	CPI	April - 2009	2.3%
	Unemployment	April - 2009	4.7%
	BoE Target Rate	Jun - 12	0.50%
Canada	GDP Year-over-Year	March - 2009	0.0%
	CPI	April - 2009	0.4%
	Unemployment	May - 2009	8.4%
	BoC Target Rate	Jun - 12	0.25%

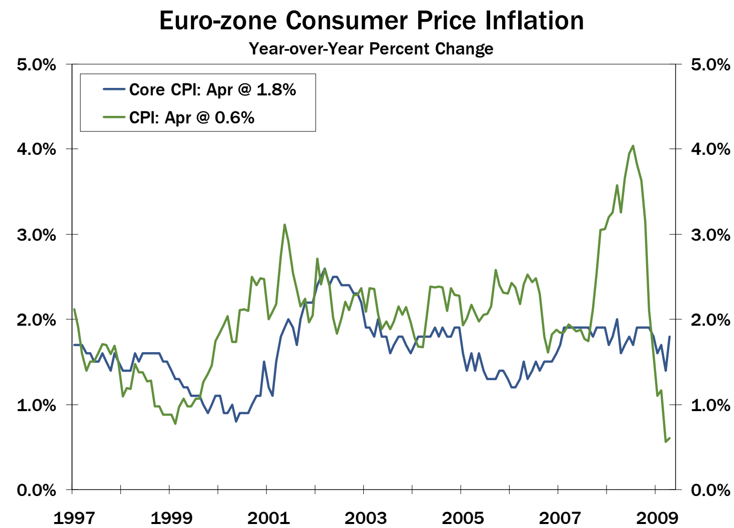
Euro-zone CPI Inflation • Tuesday

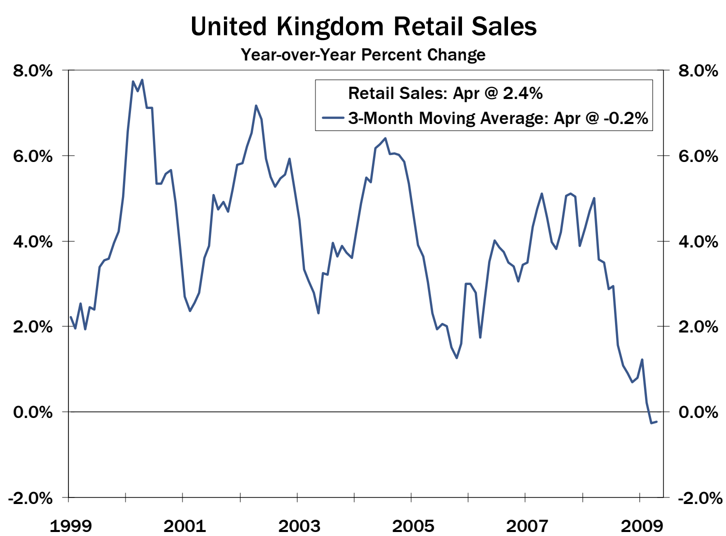
It appears that the Euro-zone is about to slip into a mild case of deflation. The overall CPI inflation rate was only 0.6 percent in April, but the "flash" estimate for May showed that consumer prices were flat on a year-over-year basis. Over the next few months, the overall inflation rate likely will turn negative. That said, the core rate of inflation, which excludes food and energy prices, is well above 0 percent at present. The consensus forecast anticipates that the core rate of inflation edged down from 1.8 percent in April to 1.6 percent in May.

The German ZEW index, which is an index of economic sentiment among institutional investors, has risen sharply over the past few months, indicating that investors expect the German economy to recover later this year. The reading for June will be released on Tuesday.

Previous: 0.6% (year-over-year change)

Consensus: 0.0%





U.K. Retail Sales • Thursday

Next week sees a number of U.K. data releases, including retail sales in May, which will give investors an up-to-date look at the British economy. Growth in retail spending has slowed markedly over the past year as the U.K. economy tumbled into recession. That said, real retail sales rose in April relative to the previous month, and the consensus forecast looks for another increase in May. If so, it will be yet another indication that the recession may be nearing an end.

Speaking of recession, the U.K. unemployment rate has shot up from about five percent last spring to more than seven percent at present. Data that are slated for release on Wednesday should show that it rose further in April. CPI inflation data will print on Tuesday.

Previous: 0.9% (month-on-month change)

Consensus: 0.5%

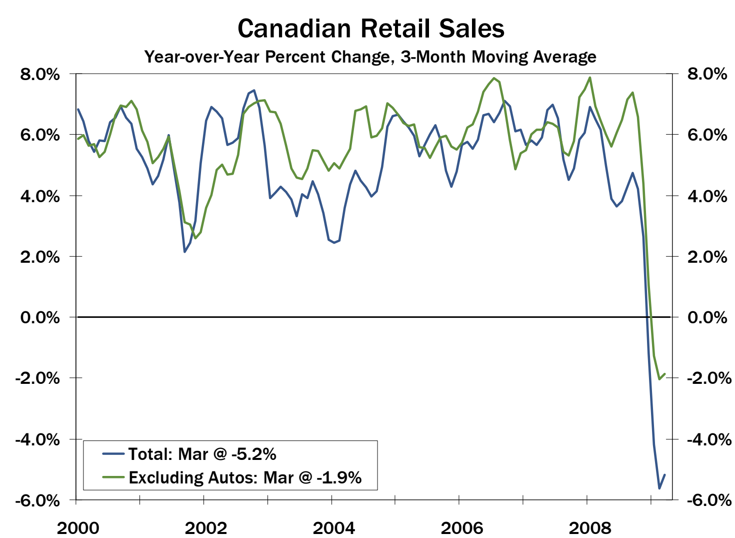
Canadian Retail Sales • Thursday

Retail sales in Canada have increased each month so far in 2009. While this is a sign that domestic demand remains resilient in the face of the recession, it helps that the increases are off a very low base established last December, when holiday sales were a major disappointment. New car sales jumped in March in response to big rebates and other dealer incentives. Otherwise, the categories showing signs of strength are consistent with the frugal shopping patterns you might expect during a recession. Pharmacies, supermarkets and beer and wine stores have posted increases while electronic stores and clothing stores retreated in March. Sales for April will likely be flat as consumer sentiment remains contained by challenges in the job market.

Also due out next week in Canada is inflation data for May. The Bank of Canada has repeatedly stated the global slowdown will keep downward pressure on inflation.

Previous: 0.3% (month-on-month change)

Consensus: 0.0%



Interest Rate Watch

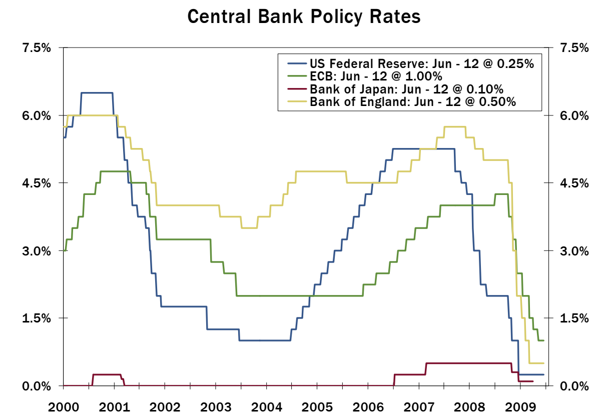
Why are Rates Rising?

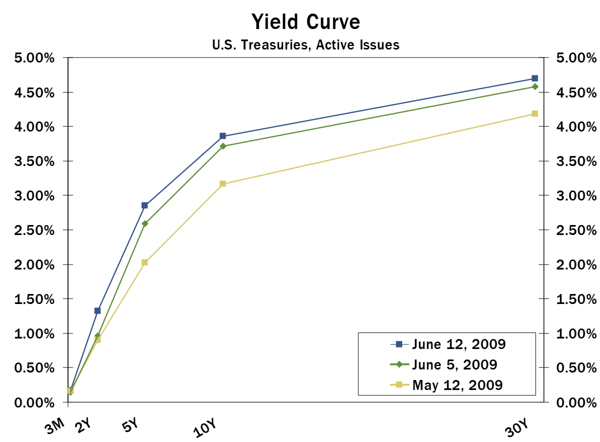
Why have long-term interest rates risen so much over the past month? One theory is the reversal of the flight to quality trade that began when the financial crisis intensified last fall. Another theory suggests the enormous increase in the federal budget deficit has flooded the market with new supply, driving rates higher. Yet another theory says investors are fleeing U.S. assets on worries of dollar depreciation and heightened inflation risks.

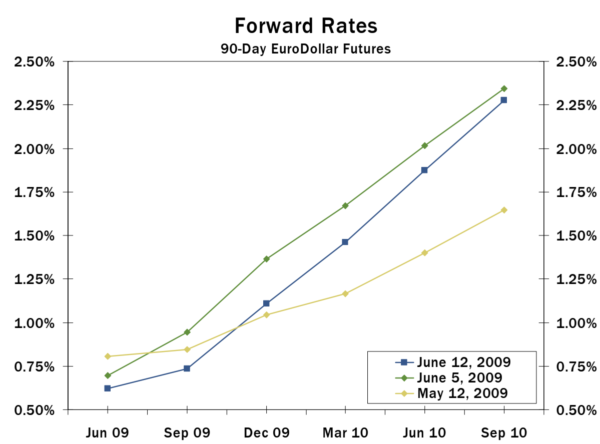
Which theory is right? We believe all three have merit. There is no doubt the risks to near term economic growth have diminished. Armageddon is off the table. Businesses, investors and households are taking on more risks and these actions directly translate into a steeper yield curve.

Supply concerns are also contributing to the run-up in yields. The federal budget deficit may be larger than some people realize and the Treasury's auctions have been met with lukewarm demand, particularly for intermediate issues. As for the final concern, inflation is indeed headed higher. We will not wake up one day and find out the U.S. is Zimbabwe, but inflation will be higher in the next ten years than it was in the last, and a higher interest rate will be needed to compensate investors for holding U.S. Treasuries.

While there are valid reasons for the run-up in Treasury yields, we believe all of these concerns have gotten well ahead of themselves. Inflation will likely decelerate over the next year and credit demands should remain light. Yields should back off a bit in coming weeks. Talk of a Fed rate hike by year end is also off-base. We would not expect the Fed to make a move until next year at the earliest.







Topic of the Week

Housing is Near a Bottom But Not a Recovery

The U.S. economy appears set to begin a recovery before the housing market does. Our latest forecast has real GDP moving back into positive territory during the third quarter and we now expect the recession to end at some point this summer. Home sales and new home construction should bottom out at around the same time as the overall economy. A recovery in home sales and new home construction still appears to be a long ways off, however, as the unwinding from the housing boom still has not entirely played out. Foreclosures are still rising, prices are still falling, and a large proportion of recent home sales have been foreclosures sales, short sales or some other type of distressed transaction.

There are formidable hurdles to a sustained recovery in home sales and residential construction. First and foremost, consumers appear to be in no mood to buy a new home. While there is some evidence suggesting that layoffs are slowing, there is no sign that hiring is picking up. The economy is still losing jobs at a rapid clip and the unemployment rate has risen to its highest level in more than a quarter century. We expect the jobless rate to top out about a year from now somewhere between 10.5 and 11 percent.

The continued rise in the unemployment rate means foreclosures will likely remain problematic well into 2010. Past experience has shown that foreclosures tend to peak about six months after the unemployment rate tops out. This means that at a minimum foreclosures will remain high, which will keep pressure on housing prices.

The full report is available on our webstite.

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 6/12/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.17	0.18	1.99
3-Month LIBOR	0.62	0.63	2.78
1-Year Treasury	0.43	0.27	2.42
2-Year Treasury	1.29	1.29	3.04
5-Year Treasury	2.79	2.83	3.69
10-Year Treasury	3.77	3.83	4.21
30-Year Treasury	4.61	4.63	4.76
Bond Buyer Index	4.86	4.71	4.69

Foreign Exchange Rates

	Friday 6/12/2009	1 Week Ago	1 Year Ago
Euro ($/€)	1.400	1.397	1.544
British Pound ($/₤)	1.646	1.598	1.946
British Pound (₤/€)	0.850	0.874	0.793
Japanese Yen (¥/$)	98.245	98.640	107.960
Canadian Dollar (C$/$)	1.118	1.119	1.024
Swiss Franc (CHF/$)	1.080	1.085	1.042
Australian Dollar (US$/A$)	0.811	0.793	0.934
Mexican Peso (MXN/$)	13.396	13.297	10.372
Chinese Yuan (CNY/$)	6.835	6.833	6.907
Indian Rupee (INR/$)	47.607	47.105	42.845
Brazilian Real (BRL/$)	1.931	1.962	1.634
U.S. Dollar Index	80.128	80.670	73.859

Foreign Interest Rates

	Friday 6/12/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.26	1.27	4.96
3-Month Sterling LIBOR	1.25	1.26	5.95
3-Month Canadian LIBOR	0.65	0.63	3.39
3-Month Yen LIBOR	0.49	0.51	0.92
2-Year German	1.68	1.67	4.55
2-Year U.K.	1.46	1.32	5.40
2-Year Canadian	1.39	1.26	3.40
2-Year Japanese	0.38	0.35	1.00
10-Year German	3.63	3.72	4.60
10-Year U.K.	3.97	3.92	5.16
10-Year Canadian	3.50	3.44	3.88
10-Year Japanese	1.52	1.50	1.81

Commodity Prices

	Friday 6/12/2009	1 Week Ago	1 Year Ago
W. Texas Crude ($/Barrel)	72.13	68.44	136.74
Gold ($/Ounce)	941.65	955.25	868.20
Hot-Rolled Steel ($/S.Ton)	335.00	375.00	1110.00
Copper (¢/Pound)	237.30	228.10	353.25
Soybeans ($/Bushel)	12.65	12.34	14.98
Natural Gas ($/MMBTU)	3.88	3.87	12.80
Nickel ($/Metric Ton)	15,707	14,623	23,275
CRB Spot Inds.	410.57	399.78	493.55

Next Week's Economic Calendar

	Monday 15	Tuesday 16	Wednesday 17	Thursday 18	Friday 19
U.S. Data		**Industrial Production** April -0.5% May -0.8% (W) **Housing Starts** April 458K May 520K (W) **PPI** April 0.3% May 0.0% (W)	**CPI** April 0.0% May 0.4% (W) **Core CPI** April 0.3% May 0.2% (W) **Current Account Balance** 2008:4Q -$132.8B 2009:1Q -$88.0B (W)	**Leading Indicators** April 1.0% May 1.1% (W) **Philadelphia Fed.** May: -22.6 June: -17.0 (c)	
Global Data		**Euro-zone** **CPI (YoY)** Previous (Apr) 0.6% **UK** **CPI (YoY)** Previous (Apr) 2.3%	**UK** **Unemployment Rate** Previous (Mar) 7.1%	**UK** **Retail Sales (MoM)** Previous (Apr) 0.9% **Canada** **CPI (YoY)** Previous (Apr) 0.4%	**Canada** **Retail Sales (MoM)** Previous (Mar) 0.3%

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

Wachovia Economics Group

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