WACHOVIA
ECONOMICS GROUP

Weekly Economic & Financial Commentary

June 19, 2009

U.S. Review

Lower Inflation Liberates the Fed

Worries about inflation have clearly gotten ahead of themselves. While we believe inflation is a monetary phenomenon over the long run, lags between stronger money growth and rising inflation are long and variable. The Fed still has plenty of time to drain the liquidity it provided in the aftermath of the financial crisis before a troublesome inflation takes hold. Bond investors will likely remain edgy until such a plan materializes, as they should.

Bond investors, policymakers, and consumers are right to be concerned about the rapid money growth. Money supply growth, both M1 and M2, is up at a 9.5 percent annual rate since November and the monetary base is up at a 53.1 percent annual rate over this period, which means money growth would be even stronger if lending actually picked up.

Of course the whole purpose of flooding the economy with reserves was to stabilize the financial markets, so that lending could revive. So the Fed's task is now to drain the excess liquidity they provided just as the economy revives, without killing off the recovery or enraging Congress.

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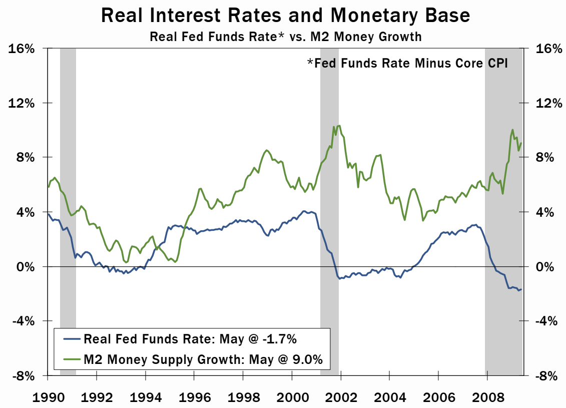

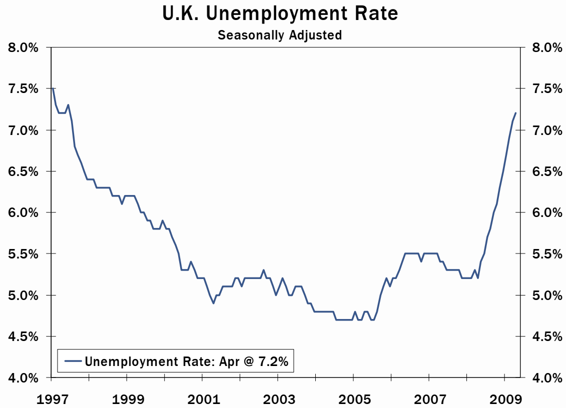

Global Review

Is the U.K. Economy Nearing Bottom?

Real GDP in the United Kingdom dropped at an annualized rate of 7.3 percent in the first quarter, the steepest sequential rate of decline in 30 years, and recent monthly indicators suggest that the economy has continued to contract, albeit at a slower rate, in the second quarter. For starters, the labor market has continued to deteriorate. The number of unemployed workers rose by 39,300 in May, which was not quite as bad as expected. However, the unemployment rate, which has shot up rapidly since last summer, rose further. Indeed, unemployment is currently at the highest rate since the late 1990s.

The weakness in the labor market has caused wage growth to slow sharply in recent months. Last autumn, average earnings (excluding bonuses) were growing at a year-over-year rate of 3.6 percent. In April, earnings were

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Recent Special Commentary

Date	Title	Authors
June-18	Labor Market Evolution: Realities and Romantics	Silvia, York & Whelan
June-18	What Drives Consumer Delinquency Rates?	Vitner & Iqbal
June-18	Personal Income Fell Accross Much of the Country	Vitner
June-11	Florida Economic Outlook	Vitner & Kamaruddin

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

Inside

U.S. Review

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The Economic Environment will Make the Fed's Task Difficult

The economic environment the Fed will likely face during this period will not make things easy for policymakers. While we see the recession ending later this year, unemployment is likely to continue rising well into 2010. The last two recessions saw the unemployment rise 15 months and 19 months, respectively, after the recession ended. If, as we expect, the recession ends this summer, and the unemployment rate rises along the lines that it did following the past two downturns, then the unemployment would peak in late 2010 or early 2011. With the unemployment rate currently at 9.4 percent, the jobless rate will almost certainly top out in the low double digits and could quite possibly rise above the post-depression high of 10.8 percent hit back in 1982.

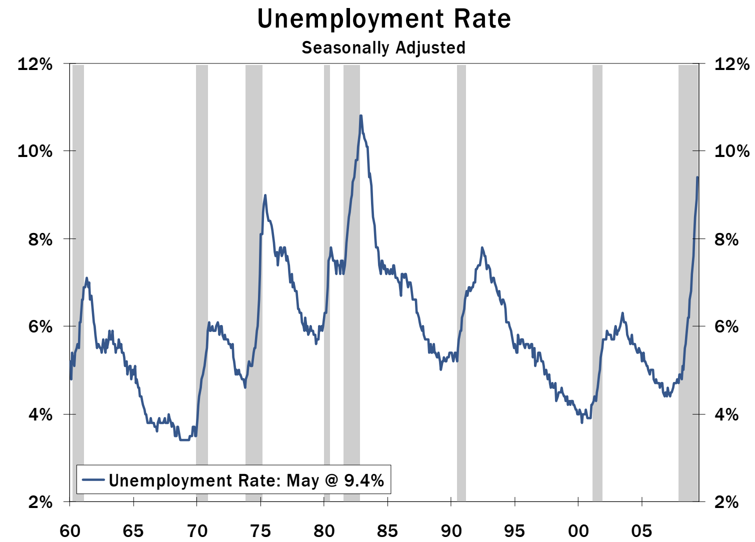
Politics could make the Fed's job even tougher. Next year will mark a contentious mid-term congressional election and voters are likely to be antsy, particularly in states with high unemployment rates. The latest state unemployment figures, which came out today, show that 12 states and the District of Columbia already have unemployment rates above 10 percent, including large states, such as California, Florida, and Michigan. Even if the unemployment rate peaks sooner than it did following the past two recessions, it will still likely be uncomfortably high come election time. Draining liquidity without wrecking the recovery or upsetting Congress would require skills tantamount to pitching back-to-back no hitters.

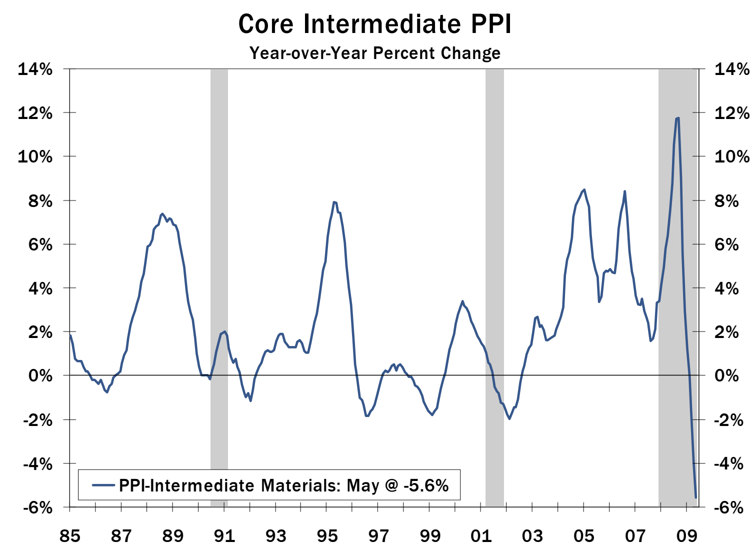
For all the worries about inflation, the latest inflation figures show little reason to be concern. The Consumer Price Index rose just 0.1 percent in May, both on an overall basis and after excluding food and energy prices. Price increases were tame pretty much across the board. One notable exception was gasoline prices, which rose 3.1 percent in May. With the economy struggling, rising gasoline prices are having more of a dampening effect on consumer spending than they are on pushing prices higher in related industries. Prices for airfares, for example, declined sharply. Food prices are also moderating, particularly for fruits and vegetables, which are among items that are most sensitive to higher fuel costs.

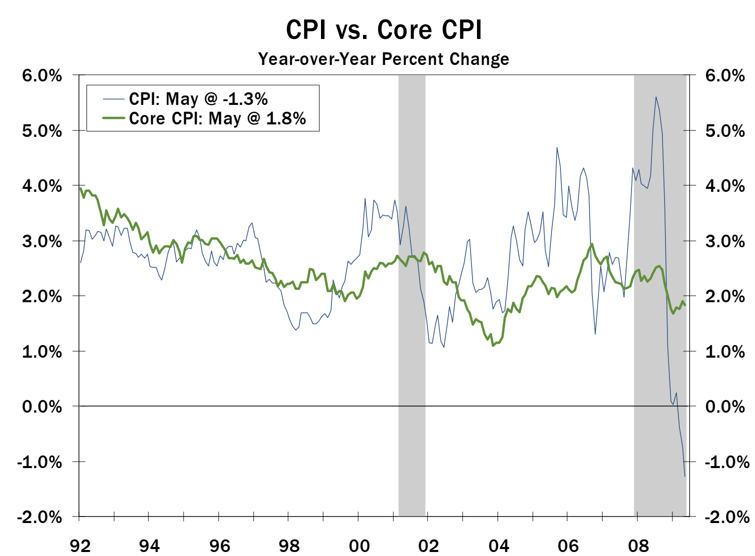
Looking back further in the production pipeline there is even less reason to be concerned about inflation in the near term. The Producer Price Index rose 0.2 percent overall but fell 0.1 percent after excluding food and energy prices. Price increases were even better behaved further back in the production pipeline, with core intermediate goods prices falling 0.2 percent in May and tumbling at a 5.6 percent annual rate over the past three months.

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	May - 2009	-1.3%
"Core" CPI	May - 2009	1.8%
"Core" PCE Deflator	April - 2009	1.9%
Industrial Production	May - 2009	-13.4%
Unemployment	May - 2009	9.4%
Federal Funds Target Rate	Jun - 19	0.25%





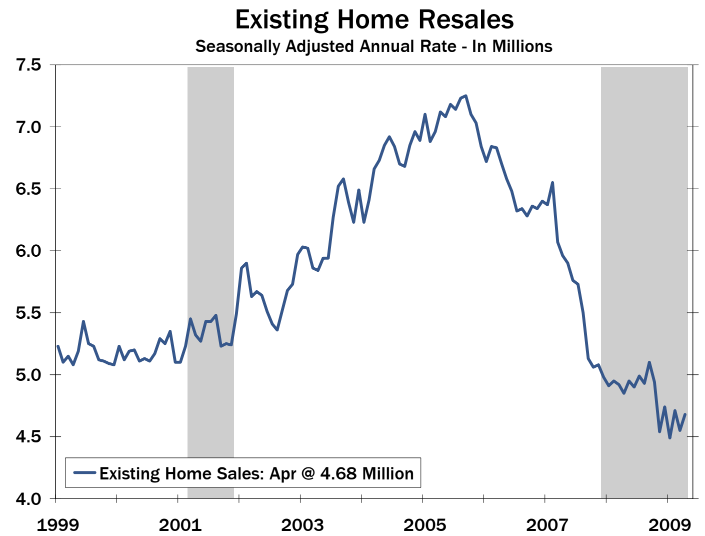


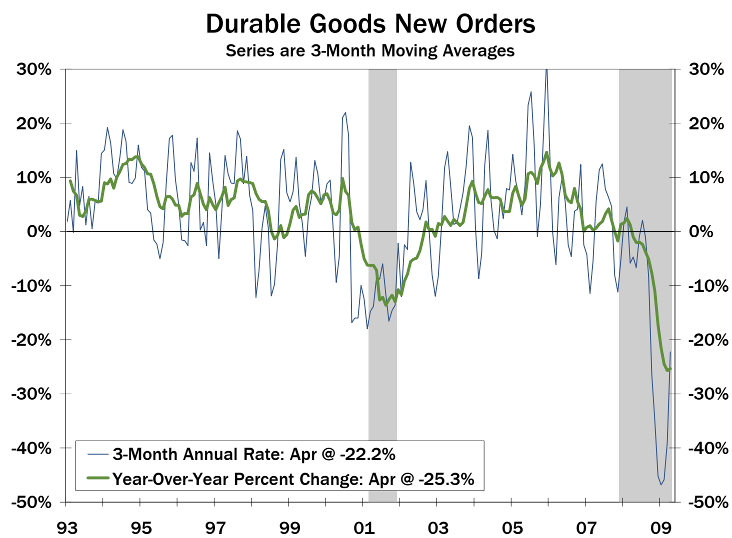
Existing Home Sales • Tuesday

Sales of existing homes were up 2.9 percent in April with increases in both the single-family and multi-family segments. The National Association of Realtors (NAR) noted that the portion of sales that were related to distressed properties fell back to 45 percent from the 50 percent registered in March. Foreclosures are still putting considerable pressure on the market. As such, we expect sales will continue to hold within the same narrow range reached since late 2008 for the seventh consecutive month. Existing sales should increase slightly to 4.7 million units as potential buyers remained on the sideline except in the distressed market. While sales may not have yet reached an absolute bottom, clearly a bottoming process is underway.

Previous: 4.68M **Wachovia: 4.70M**

Consensus: 4.82M





Durable Goods Orders • Wednesday

For five out of the last seven months, durable goods orders have posted monthly declines as manufacturers attempt to align depleting sales with appropriate production levels. As the recession continues, businesses and consumers are delaying big-ticket purchases despite April's jump in new orders to 1.9 percent. The series is notably volatile on a month-to-month basis and we do not expect the gain to stick. Industrial production continued to decline in May, with motor vehicle and parts output accounting for the bulk of the drop. Capacity utilization remains well below the lows of the past two recessions and the abundance of production capacity means pricing power will remain minimal.

We expect the downward trend in orders will continue in May declining a significant 3.9 percent. Despite signs of stabilization in some of the regional purchasing managers' surveys and the national ISM manufacturing survey, sustained growth in durable goods orders is a ways off.

Previous: 1.9% **Wachovia: -3.9%**

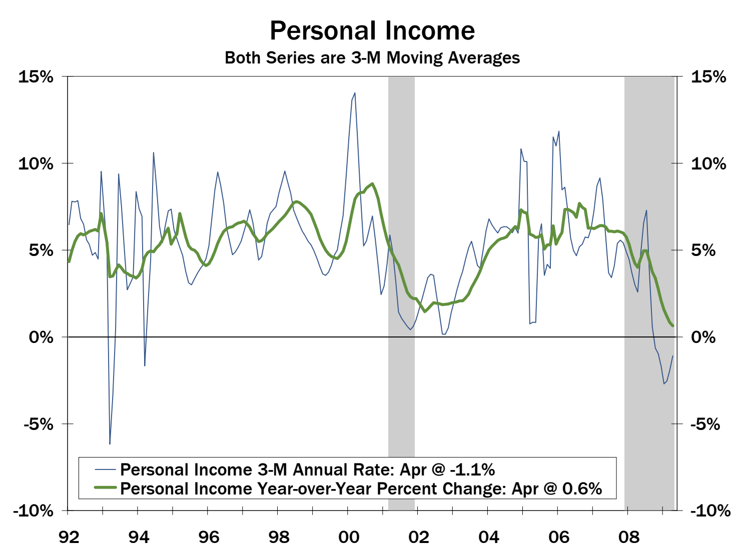
Consensus: -0.8%

Personal Income • Friday

Personal income rose 0.5 percent in April driven primarily by a $45.7 billion increase in personal current transfer receipts with $11.8 billion attributed to stimulus payments. Disposable personal income rose 1.1 percent on the month, both in real and nominal terms. The Bureau of Economic Analysis noted that without the changes from the recent stimulus bill, gains would have been just 0.7 percent. Nonfarm employment losses seem to be moderating, on average, as the economy shed 500,000 jobs during each of the past three months. Aggregate hours worked fell at an 8.6 percent annual rate in May and will likely hold down personal income. We expect personal income fell 0.1 percent in May and personal spending was flat. The personal saving rate should remain relatively elevated as consumers continue to exercise caution.

Previous: 0.5% **Wachovia: -0.1%**

Consensus: 0.3%



Global Review

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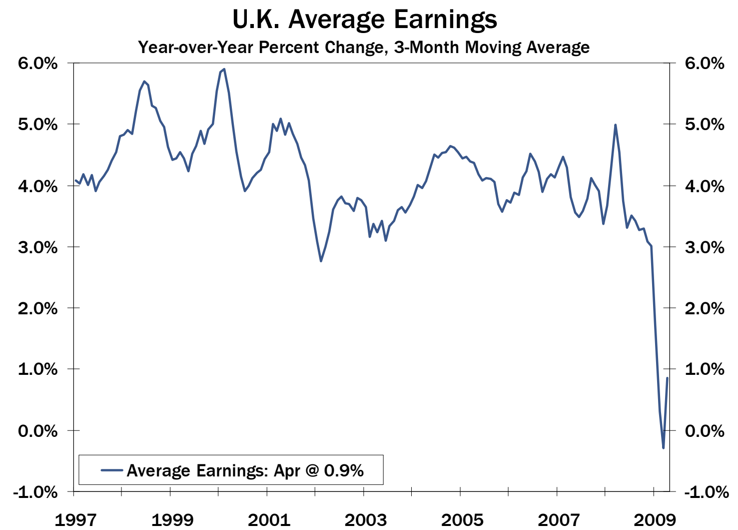
up only 2.7 percent. If bonuses are included, the slowdown is even worse (top chart). Because bonuses for most employees were cut significantly last autumn, total earnings in April were up only 0.8 percent.

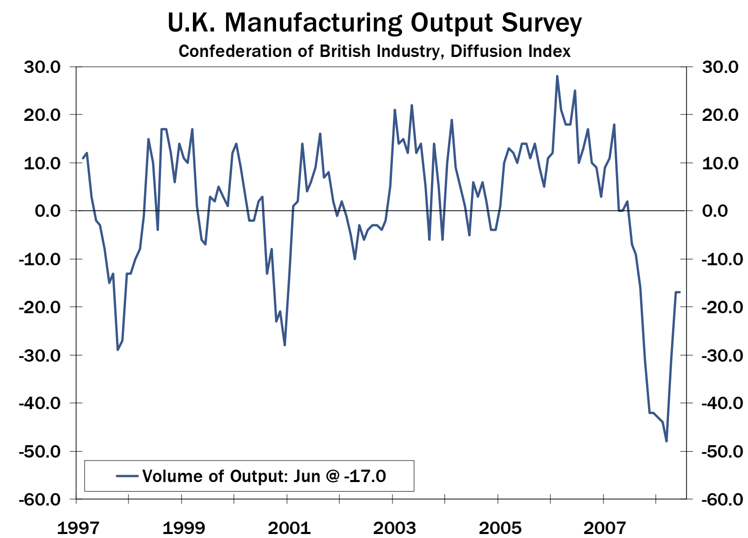
With earnings growing so slowly, it is little wonder that retail spending has slowed significantly over the past year or so. Indeed, real retail sales in May were down 1.6 percent relative to the same month last year. Another factor that may have depressed real spending in May was the rise in consumer prices during the month. Although CPI inflation has receded since last year's spike, which was induced largely by higher energy prices, the overall CPI rose 0.6 percent in May relative to the previous month. Although the increase in petroleum prices helped to lift overall consumer prices in May, the "core" CPI was up 0.4 percent as well. With prices up, consumers have less purchasing power.

Recent survey data from the manufacturing sector also are consistent with continued contraction. A widely followed monthly survey indicates that the volume of output produced remained weak through June (middle chart). That said, the survey also suggests that the contraction in output in the second quarter was not as rapid as it was in the first quarter. Indeed, "hard" data that were released last week showed that industrial production in April edged up 0.3 percent relative to March, the first monthly increase in more than a year.

In sum, the evidence suggests that the British economy, which has already contracted for four consecutive quarters, has not hit bottom yet. By our reckoning, real GDP will decline at an annualized rate between one and two percent in the second quarter. Although growth should turn positive in the second half of the year, we project that the upturn next year will remain sluggish as indebted consumers reduce leverage.

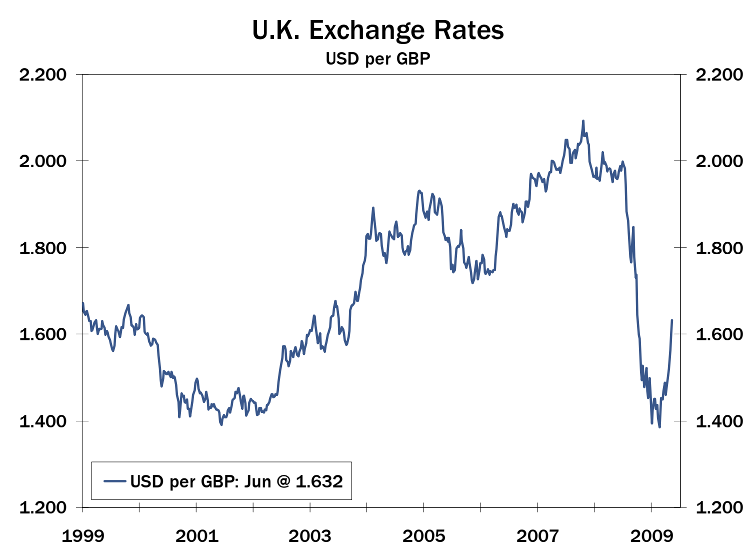
Signs that the U.K. economy may be nearing bottom have contributed to sterling's rise versus the dollar over the past few months (bottom chart). The pound has come a long way in a fairly short period of time, so some retracement is inevitable. Sterling probably won't fall back to the lows of early 2009, but a pullback seems likely in the months ahead as investors question the sustainability of the eventual recovery.





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 - 19	0.10%
Euro-Zone	GDP Year-over-Year	Q1 - 2009	-4.8%
	CPI	May - 2009	0.0%
	Unemployment	April - 2009	9.2%
	ECB Target Rate	Jun - 19	1.00%
UK	GDP Year-over-Year	Q1 - 2009	-4.1%
	CPI	May - 2009	2.2%
	Unemployment	May - 2009	4.8%
	BoE Target Rate	Jun - 19	0.50%
Canada	GDP Year-over-Year	March - 2009	0.0%
	CPI	May - 2009	0.1%
	Unemployment	May - 2009	8.4%
	BoC Target Rate	Jun - 19	0.25%



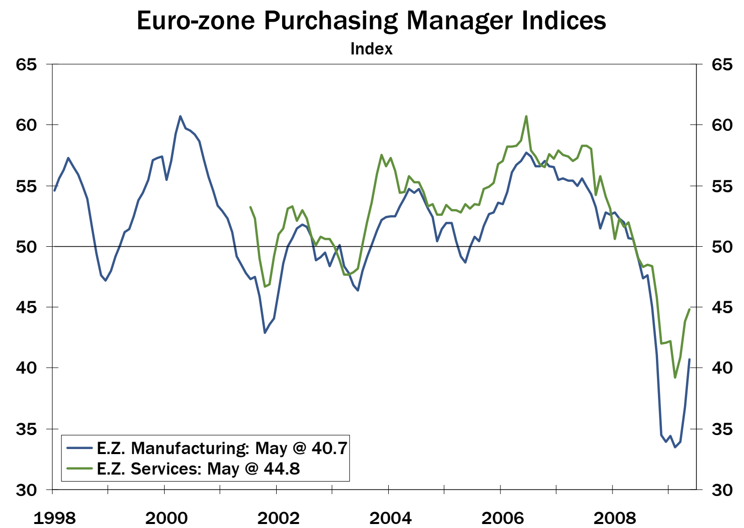
Euro-zone PMIs • Tuesday

The plunge in the Euro-zone purchasing managers' indices late last year was a harbinger of the sharp contraction in real GDP that has occurred over the past two quarters. However, the PMIs for both the manufacturing and service sectors have risen lately, implying that the rate of contraction in the Euro-zone economy is slowing. Investors expect some further improvement when the "flash" estimate for June is released on Tuesday.

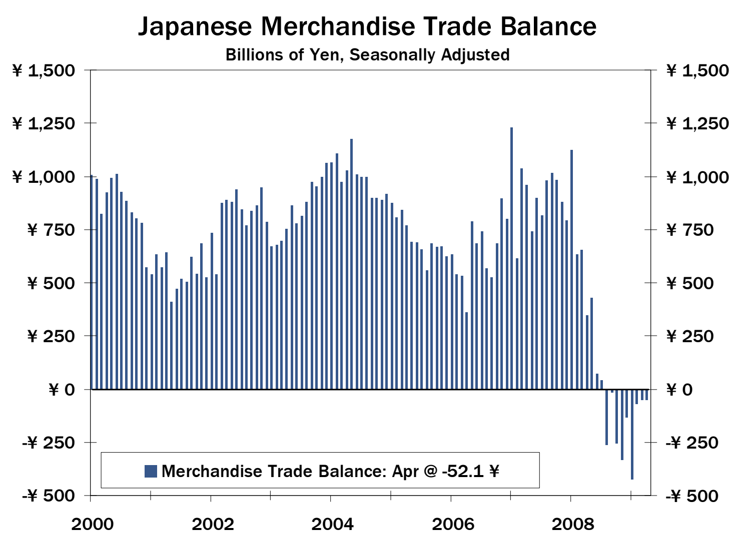
The Ifo index of German business sentiment, which is also a closely followed index, will be released on Monday, and the business confidence indicator in France will print on Tuesday. Hard data on Euro-zone industrial orders in April are slated for release on Friday. In general, the data next week are expected to show the rate of decline in the Euro-zone economy has slowed further.

Current Manufacturing PMI: 40.7 **Consensus: 42.0**

Current Services PMI: 44.8 **Consensus: 45.6**



Japanese Trade Balance • Wednesday



Japan had registered chronic trade surpluses for the past few decades until the second half of last year. Although the sharp decline in oil prices reduced the country's import bill, the collapse in global trade in the wake of the Lehman Brother bankruptcy has weighed heavily on Japan's exports. Indeed, the Japanese economy has contracted nine percent over the past four quarters due, at least in part, to the 37 percent decline in real exports that has occurred over that period.

Data on Japanese consumer prices will print on Friday. In April, the overall CPI was down 0.1 percent (year-over-year change). However, the consensus forecast anticipates that the CPI was down 1.0 percent in May. Oil prices were surging a year ago, and their subsequent collapse should lead to modest deflation over the next few months.

Previous: ¥52.2 billion

Consensus: ¥203.5 billion

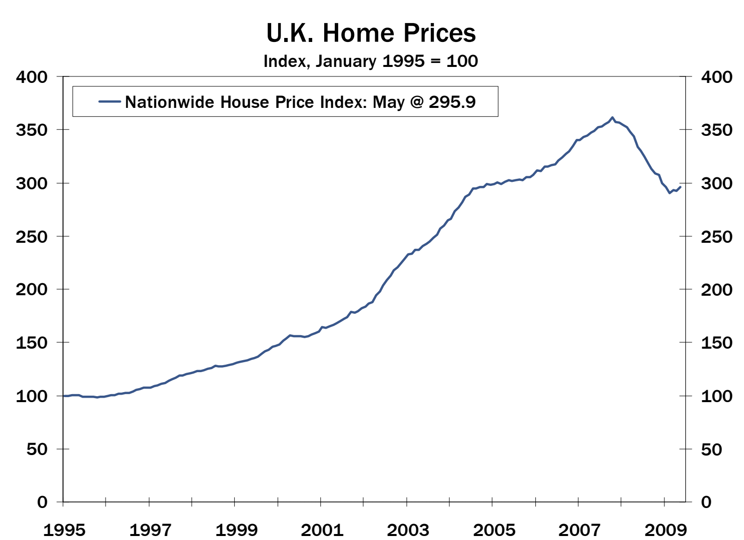
U.K. House Prices

As in the United States, house prices in Great Britain rose sharply in the earlier years of this decade. However, the Nationwide index of U.K. house prices has declined nearly 20 percent on balance since late 2007. As discussed in the main body of the report, however, the sharp contraction in the U.K. economy appears to be slowing, and house prices have shown some tentative signs of stabilizing. Indeed, the consensus forecast anticipates that the index edged up 0.2 percent in June relative to the previous month. If realized, it would be the third month out of the last four that the index would have risen.

As discussed previously, retail spending has been soft lately. Survey data that are slated for release on Wednesday will give investors insight into the state of consumer spending in June.

Previous: -11.3% (year-over-year change)

Consensus: -10.2%



Interest Rate Watch

Update on Credit & Interest Rates

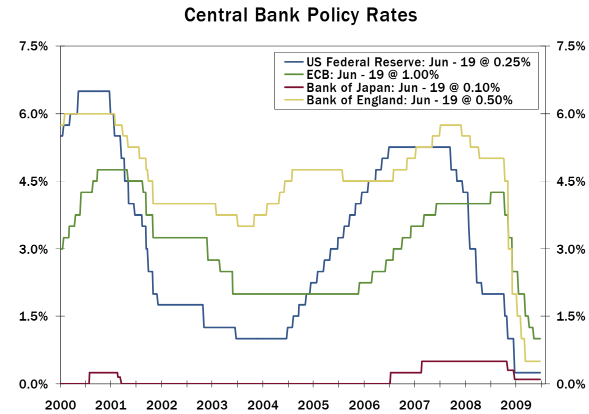
From the 2009 Annual Outlook:

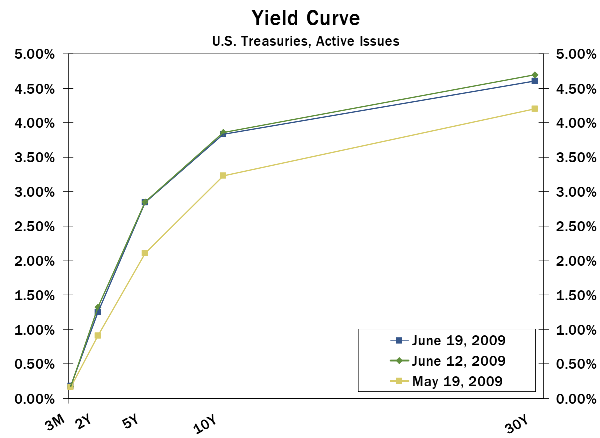
"Looking forward, our outlook is defined by the nature of America's credit cycle which we believe will dictate the characteristic of the economic recovery. Because of the economy's dependency on credit, we expect that this recession and recovery will differ in both breadth and magnitude compared to previous business cycles. Two forces are worth noting about the credit outlook.

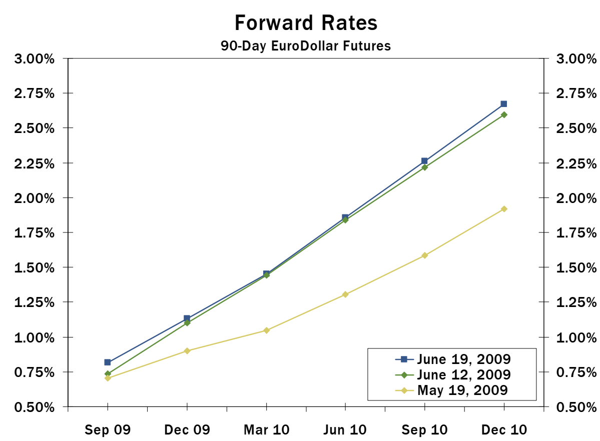
First, the current focus on risk avoidance dictates a deleveraging of the American financial system, with particular emphasis on the consumer on the demand side and the banking system on the supply side. The consumer will find credit more difficult to obtain, and banks will experience much slower growth in loan portfolios, resulting in limited demand for credit. Weak U.S. and foreign growth suggests that the supply of credit through savings and profits would also be very limited relative to prior recoveries."

As of June, the deleveraging of the consumer has become very obvious. Household saving rates are up and the consensus from Blue Chip is that consumer spending will be down 0.7 percent this year and up just 1.8 percent next year. Housing starts and auto sales are estimated at 770,000 starts and 11.8 million units, respectively, for next year—sub par for an economic recovery.

Along with the "very limited" supply of savings we have seen rising concern about foreign buying of U.S. financial assets, particularly U.S. Treasury bonds, given the decline in the flight to safety trade and the rising deficit estimates. Finally, foreign confidence in U.S. economic policy has waned and this reinforces the dollar/interest rate concerns in the capital markets.







Topic of the Week

Labor Market Evolution

Evolution in the labor market has knocked down the romantic ideals of manufactured goods stamped with "Made in the U.S.A." being of primary importance to the nation's economy. In a recent report we identified four secular trends that call into the question the idealized notion of lifetime employment based upon the belief that only manufacturing jobs are worthy jobs. In a similar way in an earlier era some believed only agriculture was a true measure of economic strength. President Thomas Jefferson, known as a staunch believer in agrarianism, initially opposed diversifying from agriculture into manufacturing, however even he eventually came around. He admitted, "We must now place the manufacturer by the side of the agriculturalist… experience has taught me that manufactures are now as necessary to our independence as to our comfort." Similarly, the modern era is faced with a transition from a primarily goods-producing economy to a primarily services-producing economy, and must realize that each is part of economic strength.

The composition of jobs available in the United States has changed and will likely continuously adjust to new economic realities going forward. The pace of job gains has lagged economic gains in the most recent recoveries and we expect that pattern to reoccur in the current cycle. How we get paid has evolved from primarily wages to an almost equal split between wages and non-wage/benefit incomes. Finally, the defining reason for our pay has become our education and its use on the job. Working smarter—not harder--has become the benchmark.

To see our full report, please go to the "Specials" section of our website.

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 6/19/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.17	0.17	1.90
3-Month LIBOR	0.61	0.62	2.80
1-Year Treasury	0.34	0.43	2.36
2-Year Treasury	1.27	1.26	2.93
5-Year Treasury	2.86	2.78	3.65
10-Year Treasury	3.86	3.79	4.21
30-Year Treasury	4.61	4.64	4.76
Bond Buyer Index	4.86	4.86	4.76

Foreign Exchange Rates

	Friday 6/19/2009	1 Week Ago	1 Year Ago
Euro ($/€)	1.393	1.402	1.550
British Pound ($/₤)	1.642	1.644	1.972
British Pound (₤/€)	0.848	0.852	0.786
Japanese Yen (¥/$)	96.830	98.435	108.005
Canadian Dollar (C$/$)	1.134	1.119	1.016
Swiss Franc (CHF/$)	1.086	1.079	1.045
Australian Dollar (US$/A$)	0.806	0.812	0.951
Mexican Peso (MXN/$)	13.310	13.404	10.307
Chinese Yuan (CNY/$)	6.836	6.835	6.878
Indian Rupee (INR/$)	48.085	47.607	42.973
Brazilian Real (BRL/$)	1.956	1.926	1.603
U.S. Dollar Index	80.556	80.142	73.483

Foreign Interest Rates

	Friday 6/19/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.23	1.26	4.96
3-Month Sterling LIBOR	1.24	1.25	5.96
3-Month Canadian LIBOR	0.61	0.65	3.45
3-Month Yen LIBOR	0.49	0.49	0.92
2-Year German	1.48	1.68	4.70
2-Year U.K.	1.32	1.47	5.52
2-Year Canadian	1.30	1.40	3.35
2-Year Japanese	0.36	0.38	0.90
10-Year German	3.52	3.63	4.68
10-Year U.K.	3.82	3.97	5.24
10-Year Canadian	3.51	3.51	3.87
10-Year Japanese	1.45	1.52	1.80

Commodity Prices

	Friday 6/19/2009	1 Week Ago	1 Year Ago
W. Texas Crude ($/Barrel)	71.77	72.04	131.93
Gold ($/Ounce)	934.90	939.30	898.47
Hot-Rolled Steel ($/S.Ton)	335.00	335.00	1125.00
Copper (¢/Pound)	228.20	236.75	377.75
Soybeans ($/Bushel)	12.11	12.65	15.40
Natural Gas ($/MMBTU)	4.12	3.86	12.86
Nickel ($/Metric Ton)	14,919	15,707	22,920
CRB Spot Inds.	400.28	410.57	496.84

Next Week's Economic Calendar

	Monday 22	Tuesday 23	Wednesday 24	Thursday 25	Friday 26
U.S. Data		**Existing Home Sales** April 4.68M May 4.7M (W)	**FOMC Rate Decision** Previous 0.25% Expected 0.25% (W) **Durable Goods Orders** April 1.9% May -3.9% (W) **New Home Sales** April 352K May 354K (W)	**GDP** 2009:1Q (P) -5.7% 2009:1Q(F) -5.7% (W)	**Personal Income** April 0.5% May -0.1% (W) **Personal Spending** April -0.1% May 0.0% (W) **PCE Deflator** April 0.4% May 0.2% (W)
Global Data	**Germany** **Ifo - Business Climate** Previous (May) 84.2	**Euro-zone** **PMI Manufacturing** Previous (May) 40.7 **Euro-zone** **PMI Services** Previous (May) 44.8	**Japan** **Adjusted Trade Balance** Previous (Apr) -52.2B (Yen)		**Japan** **CPI (YoY)** Previous (Apr) -0.1%

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

Wachovia Economics Group

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