

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

May 15, 2009

U.S. Review

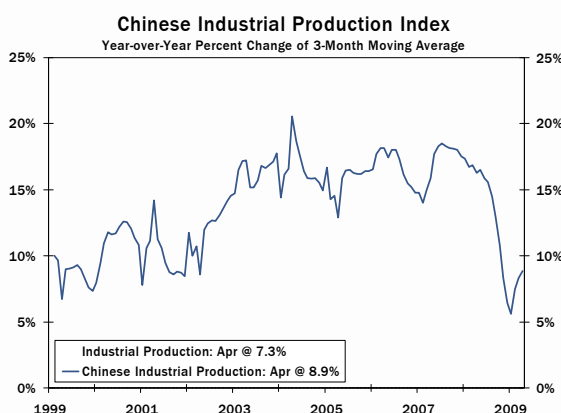
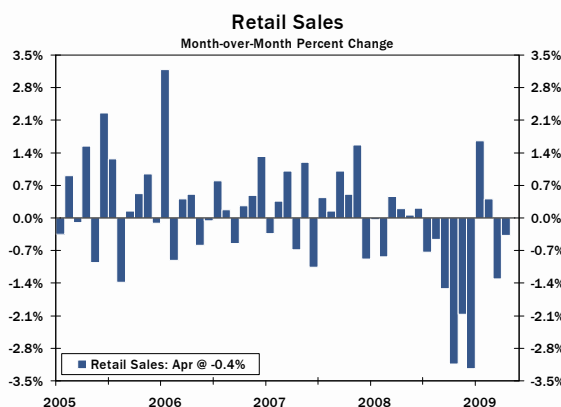
Structural Issues Impede Recovery

Suddenly many of those “green shoots” that gathered so much attention a few weeks ago appear to be losing some of their bloom. One of this week’s major disappointments was a larger-than-expected drop in retail sales. Overall retail sales fell 0.4 percent in April and sales excluding the volatile motor vehicle sector fell 0.5 percent. Moreover, declines for March were somewhat worse than first reported.

Gains in retail sales in January and February had raised hopes that the worst was over. Consumer spending actually posted a modest inflation-adjusted gain in the first quarter. We had warned back in late March that it was too soon to buy into a stabilization of retail sales. Much of the improvement in January and February was merely a statistical artifact, reflecting a smaller than usual decline following an unusually weak holiday season.

Overall retail sales in April fell 0.4 percent, following a 1.3 percent drop the prior month. Part of April’s drop was attributable to falling gasoline prices. Sales at gasoline stations fell 2.3 percent in April.

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Global Review

Relapse in China?

If there has been a country this year where bona fide “green shoots” of recovery have been spotted it would have to be China. For example, the manufacturing PMI has stood in expansion territory over the past two months, and construction activity appears to be picking up. Therefore, it was a bit disappointing to see the year-over-year growth rate of industrial production decline from 8.3 percent in March to 7.3 percent in April (see chart at left). Have “green shoots” in China turned into brown weeds?

It’s difficult to pinpoint the exact reason for the slowdown in industrial production growth in April, but exports may be part of the explanation. Exports, which contracted at a year-over-year rate of 17.1 percent in March, fell 22.6 percent in April (see chart on top of page 4). Continued contraction, albeit at slower rates, appears to be occurring in most

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Recent Special Commentary

Date	Title	Authors
May-14	Global Chartbook - May 2009	Bryson & Quinlan
May-14	Confidence: Does Anybody Have Any?	Silvia, York & Whelan
May-14	Inventories: Rebalancing the Real Economy	Silvia & Whelan
May-14	Are U.S. Consumers on a Diet, or Just Turning Thrifty?	Vitner

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	-6.1	-2.4	-0.2	1.7	2.9	2.8	2.0	1.1	-3.0	1.6
Personal Consumption	0.9	1.2	-3.8	-4.3	2.2	0.1	1.2	1.3	3.0	3.0	2.8	0.2	-0.5	1.3
Inflation Indicators ²														
“Core” PCE Deflator	2.2	2.3	2.3	1.9	1.8	1.5	0.9	0.8	2.1	2.3	2.2	2.2	1.2	0.9
Consumer Price Index	4.2	4.3	5.2	1.5	-0.2	-1.4	-2.7	-0.3	3.4	3.2	2.9	3.8	-1.2	1.0
Industrial Production ¹	0.2	-4.6	-9.0	-12.7	-20.0	-16.2	-4.8	0.1	3.3	2.3	1.5	-2.2	-12.6	-0.2
Corporate Profits Before Taxes ²	-1.5	-8.3	-9.2	-21.5	-30.0	-28.0	-26.0	-10.0	17.6	15.2	-1.6	-10.1	-24.2	5.3
Trade Weighted Dollar Index ³	70.3	71.0	76.1	79.4	82.5	83.3	86.5	89.0	86.0	81.5	73.3	79.4	89.0	85.0
Unemployment Rate	4.9	5.4	6.1	6.9	8.1	9.2	9.8	10.3	5.1	4.6	4.6	5.8	9.3	10.5
Housing Starts ⁴	1.05	1.03	0.88	0.66	0.52	0.48	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	3.20	3.40	3.40	4.39	4.71	4.04	2.25	3.40	3.70

Data As of: May 13, 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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Automotive Cutbacks Will Pull Unemployment Even Higher

Retail sales also fell sharply at grocery stores, with outlays falling 1.0 percent in April. The decline marks the third significant drop in sales in the past three months and has pulled down sales at food stores to just a 1.3 percent gain over the past year. Food prices have been moderating, which may explain part of this drop. Consumers are also becoming thrifty by shifting more purchases to store brands and private labels. In addition, consumers are buying more groceries from warehouse clubs and discount stores.

Spending in the more discretionary categories was weak pretty much across the board. Sales at furniture stores fell 0.5 percent in April, following a 2.3 percent drop in March. Over the past year, sales at furniture stores were down 14.3 percent. Sales at electronics chain stores fell 2.8 percent in April, following a 7.8 percent drop in March. For the year, sales at electronics stores are down 11.9 percent. Clothing stores also had another tough month, with sales falling 0.5 percent. Sales also declined slightly at department stores and non-store retailers.

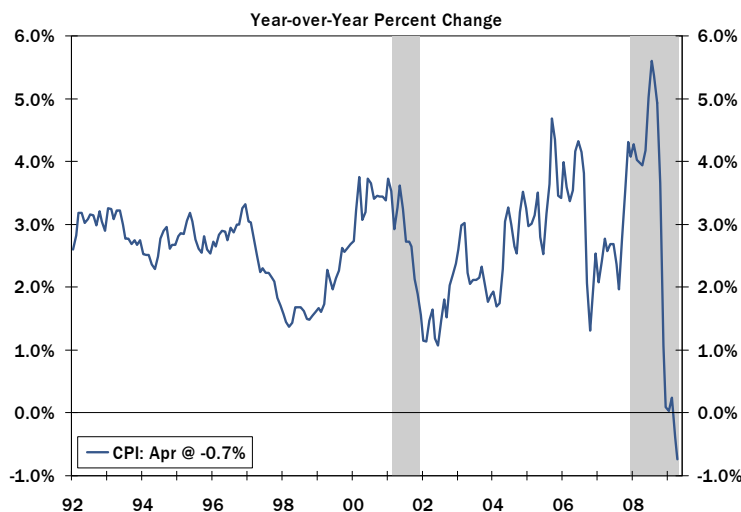
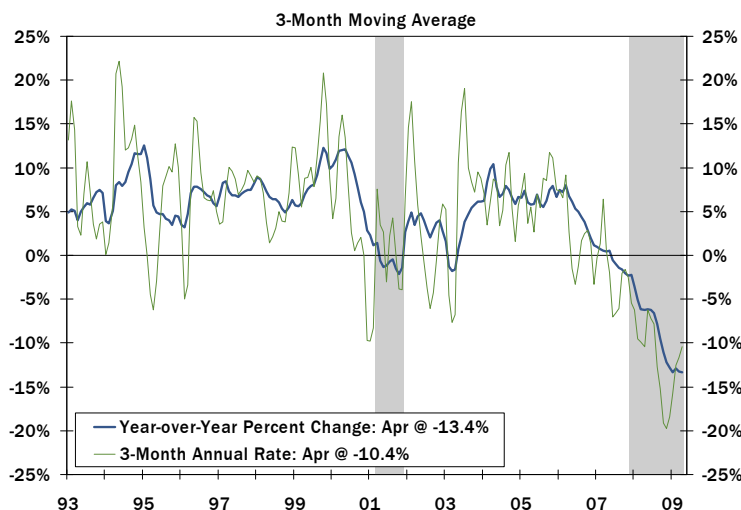
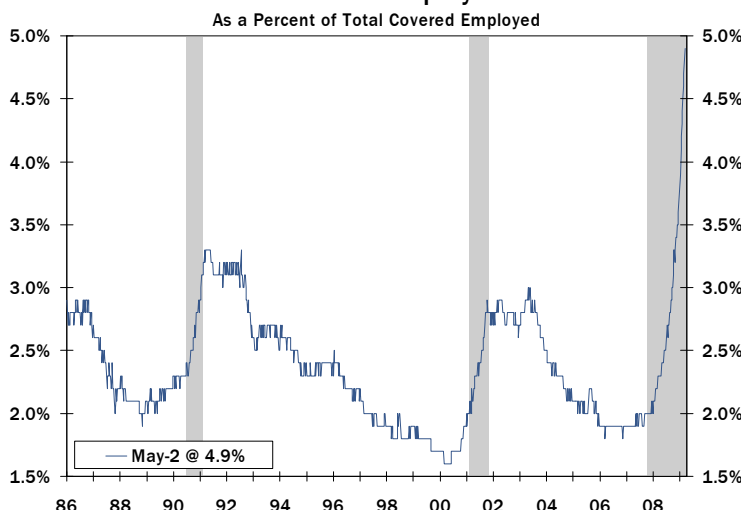
Consumers should catch a bit of a break in coming months. Energy prices remain well-below their year-ago level and food prices are finally beginning to moderate. Lower prices for groceries and gasoline should put a few more dollars in consumers' pockets and free up some additional resources for discretionary purchases.

In the near term, the weakness in retail sales pours cold water on the notion the recession is ending. We continue to believe the worst is over but do not see the recession ending until this fall. Consumers simply do not have the wherewithal to increase spending in a major way. Unemployment continues to rise and cutbacks in the auto sector are just beginning to impact the data. Weekly unemployment claims rose 36,000 to 637,000 in the latest week, with most of the increase due to motor vehicle plant layoffs.

Cutbacks in the automobile industry will intensify over the next few weeks, as General Motors joins Chrysler shutting most of their production facilities and notifying dealers their contracts will not be renewed. We expect unemployment claims to surge to new cycle highs in coming weeks, as layoffs spread to suppliers and supporting industries. Continuing unemployment claims posted another large increase, rising to 6.5 million. The increase pushed the insured unemployment rate to 4.9 percent, marking the tenth consecutive weekly increase. The entire gain has shown up in the overall jobless rate. The overall unemployment rate should rise from 8.9 percent in April to 9.3 percent in May and there is considerable risk to the upside over the next few months.

Selected Current Data

Gross Domestic Product - CAGR	Q1 - 2009	-6.1%
GDP Year-over-Year	Q1 - 2009	-2.6%
Personal Consumption	Q1 - 2009	2.2%
Business Fixed Investment	Q1 - 2009	-37.9%
Consumer Price Index	April - 2009	-0.7%
"Core" CPI	April - 2009	1.9%
"Core" PCE Deflator	March - 2009	1.8%
Industrial Production	April - 2009	-12.5%
Unemployment	April - 2009	8.9%
Federal Funds Target Rate	May - 15	0.25%

U.S. Consumer Price Index

Furniture Stores Sales

Insured Unemployed


Housing Starts • Tuesday

Housing starts fell to an annual pace of 510K units in March, giving back most of the surprising strength we had seen in the February data. Permits also dropped to just 513K units, an all-time low. Housing data are notoriously volatile in the winter months and all of the loss can be attributed to the also volatile multi-family segment. The drop in permits to a new all-time low is more disappointing, as declines were spread across segments.

We expect starts will decline to an annual pace of 485K units in April. However, it is still too premature to call an absolute trough. Starts may hover near the half-million unit pace during the first half of this year, but should begin to slowly climb during the second half. We are probably two years away from seeing starts back above one million units, however, as we continue to struggle with excess inventory and a deep recession.

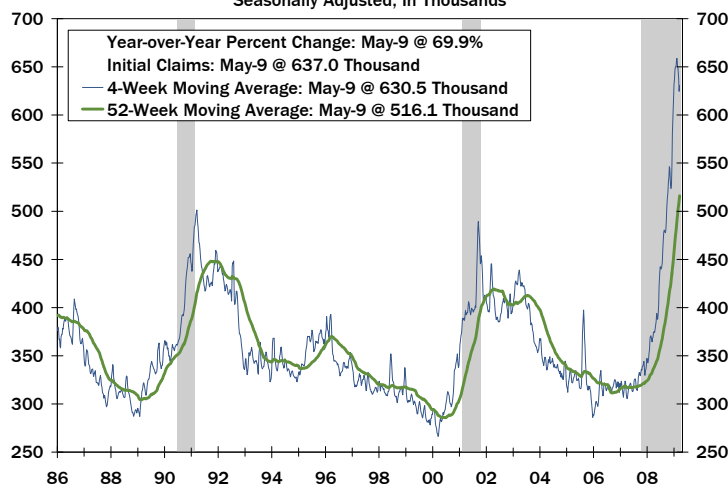
Previous: 510K

Wachovia: 485K

Consensus: 520K

Initial Claims for Unemployment

Seasonally Adjusted, In Thousands


Leading Economic Indicator • Day

The Leading Economic Index (LEI) fell 0.3 percent in March, the third consecutive monthly drop. Building permits, stock prices, and the index of supplier deliveries made large negative contributions to the index this month, more than offsetting continued positive contributions from the money supply and the yield spread.

We expect LEI will be significantly positive in April with help from stock prices, the yield spread, and initial claims. The money supply, index of supplier deliveries and non-defense capital goods orders should detract from the headline index. We continue to expect an economic recovery to begin later this year.

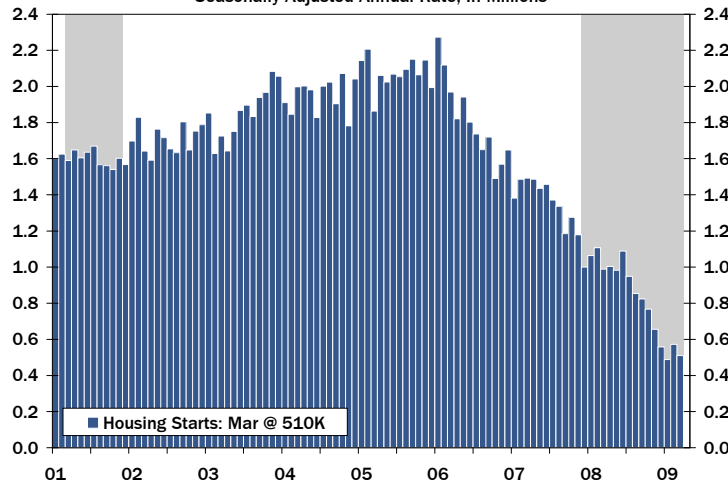
Previous: -0.3%

Wachovia: 1.2%

Consensus: 0.7%

Housing Starts

Seasonally Adjusted Annual Rate, In Millions

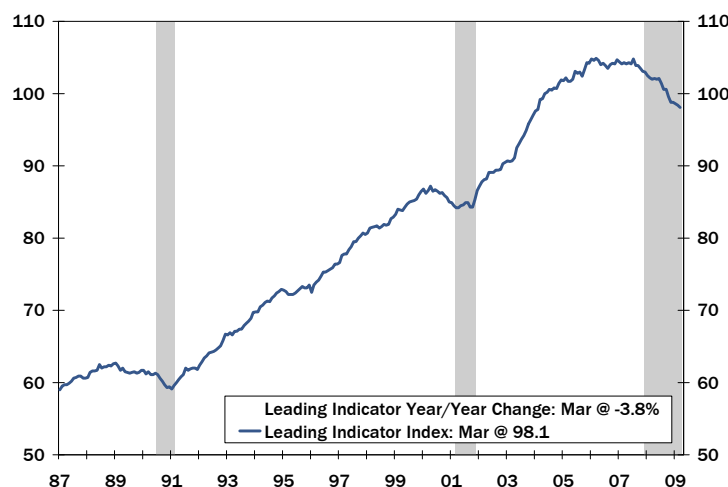

Initial Claims • Thursday

First-time claims for unemployment insurance jumped for the first time in two weeks giving pause to discussions of potential "green shoots." The spike of 32,000 pushed the four-week moving average up to 630,500, but is considerably off its high of 658,750. Recent news of upcoming layoffs suggests more bad news may be in the pipeline so it is a bit premature to call the recent high a peak.

Continuing unemployment claims rose again and the insured unemployment rate rose another tenth of a point to 4.9 percent. The insured unemployment rate has been rising a tenth of a percentage point a week and that has matched up nearly perfectly with the rise in the unemployment rate. The latest figures suggest the unemployment rate will climb to around 9.3 percent in May.

Previous: 637K

Consensus: 625K

Leading Indicator Index


Global Review

(Continued from Page 1)

major economies thus far in the second quarter. Therefore, it is not a huge surprise that Chinese export growth remains weak.

Weak Exports, Strong Domestic Spending

In contrast to weak export data, the domestic part of the Chinese economy appears to be holding up fairly well. The year-over-year growth rate in nominal retail spending held steady at nearly 15 percent in April (see middle chart). With overall consumer prices declining 1.5 percent in April, the rate of growth in real consumption seems to be holding up very well indeed. In addition, total fixed investment spending in the first four months of 2009 was up 30 percent relative to the same period last year, which represents the strongest rate of expansion in three years.

Strength in domestic spending probably reflects, at least in part, the government's efforts to stimulate the economy. Acceleration in infrastructure spending that was announced late last year is showing up in stronger growth in fixed investment spending. In addition, the relaxation of lending restrictions, which were put in place last year when inflation was deemed to be "public enemy #1", appears to be helping construction spending. Various tax cuts that were enacted late last year are probably contributing to the resilience in consumer spending.

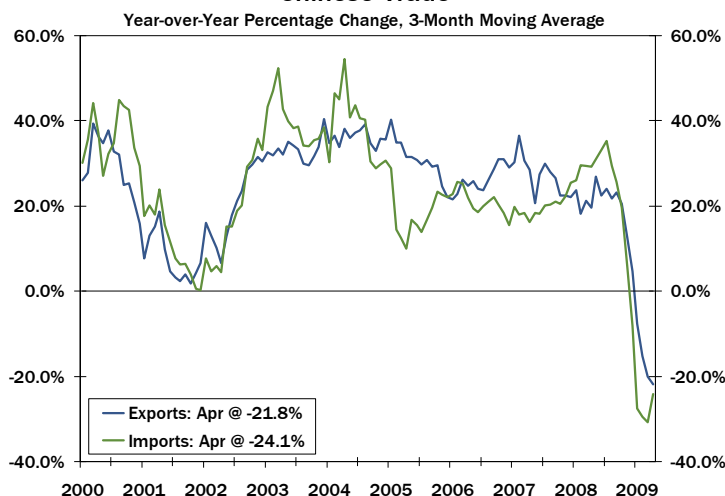
Despite the slowdown in industrial production growth in April, we think it would be premature to write off the Chinese economic expansion that seemed to be a surer bet just a few weeks ago. If rates of contraction in foreign economies continue to slow, which we believe they will, the downturn in Chinese exports should also level out. In addition, macroeconomic stimulus will continue to shore up the economy for the next few quarters. That said, we will be watching Chinese economic data very closely in the months ahead for any signs of slowing in the pace of overall GDP growth.

After allowing the renminbi to strengthen 10 percent versus the dollar between July 2007 and July 2008, the Chinese government has subsequently held the exchange rate steady (see bottom chart). Until the Chinese government is comfortable that foreign economies have hit bottom and will start to grow again, it likely will permit very little renminbi appreciation. Therefore, we project that the exchange value of the Chinese currency vis-à-vis the dollar will remain essentially steady through year end.

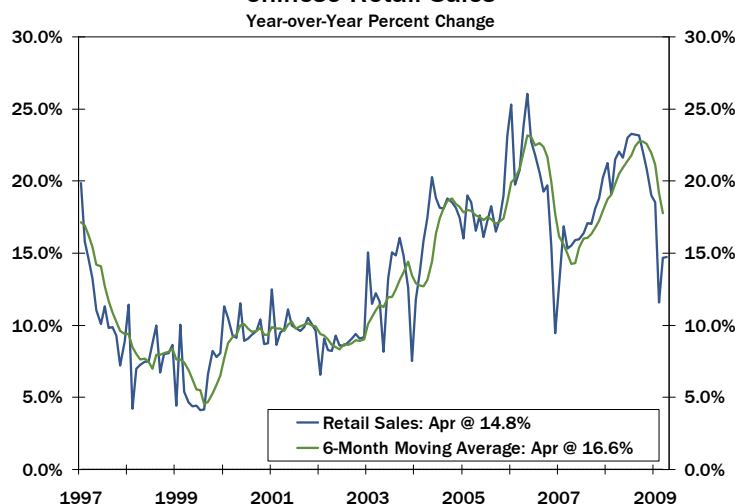
Selected Global Data

Japan	GDP Year-over-Year	Q4 - 2008	-4.3%
	CPI	March - 2009	-0.3%
	Unemployment	March - 2009	4.8%
	BoJ Target Rate	May - 15	0.10%
Euro-Zone	GDP Year-over-Year	Q1 - 2009	-4.6%
	CPI	April - 2009	0.6%
	Unemployment	March - 2009	8.9%
	ECB Target Rate	May - 15	1.00%
UK	GDP Year-over-Year	Q1 - 2009	-4.1%
	CPI	March - 2009	2.9%
	Unemployment	April - 2009	4.7%
	BoE Target Rate	May - 15	0.50%
Canada	GDP Year-over-Year	February - 2009	-2.3%
	CPI	March - 2009	1.2%
	Unemployment	April - 2009	8.0%
	BoC Target Rate	May - 14	0.25%

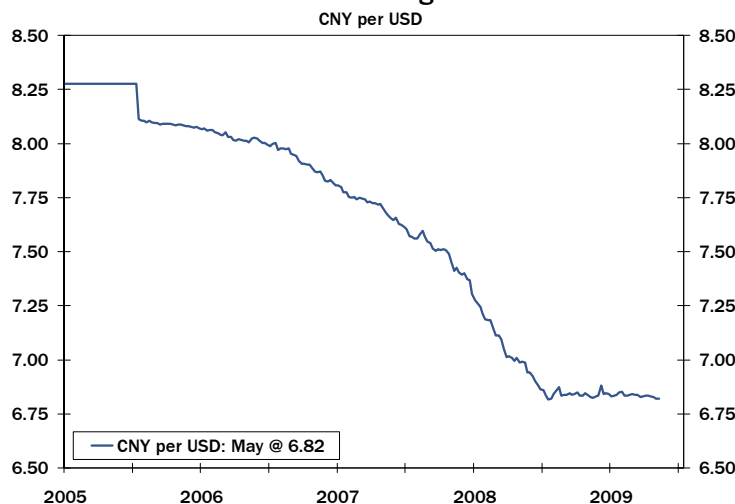
Chinese Trade



Chinese Retail Sales



Chinese Exchange Rate



Japanese GDP • Tuesday

Japanese GDP plunged at an annualized rate of 12.1 percent in the fourth quarter, the sharpest sequential rate of contraction in decades. Although estimating Japanese GDP on a quarter-by-quarter basis is inherently problematic, most analysts project that the Japanese economy continued to contract at a very rapid rate in the first quarter. Indeed, Japanese industrial production in March plunged 34 percent (year-over-year rate), nearly doubling the rate of contraction posted during the deep recession in the mid-1970s. It is clear that Japan is in its worst slump since the country emerged from the utter devastation of the Second World War.

The Bank of Japan (BoJ) holds its monthly policy meeting on Friday. Unless the BoJ decides to increase its purchases of government and corporate bonds, the meeting should be essentially a non-event. The BoJ's main policy rate is only 0.10 percent at present.

Previous: -12.1% (quarterly annualized rate) Wachovia: -12.6%

Consensus: -16.2%

United Kingdom Retail Sales



Canadian Retail Sales • Friday

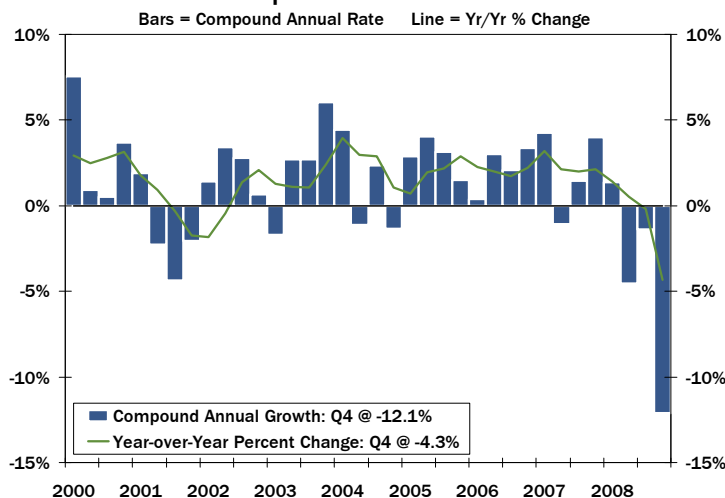
Retail sales in Canada were in freefall in the fourth quarter of 2008; however, there have been signs of life this year with back-to-back gains in retail sales in the first two months of 2009. While the increases were small, there have been other encouraging signs for consumer spending. The Canadian job market seemed to defy gravity in April adding 35.9K jobs. Sales of autos climbed more than expected in March, so we would not be surprised to see another month of modest gains in March retail sales. But any lasting strength in consumer spending would need to be ushered in by consistently strong job growth, and despite a strong month in April, we are just not there yet.

CPI data will print earlier in the week on Wednesday. We expect modest gains overall. The year-over-year rate of inflation will likely come in rather low, reflecting the drop in oil prices since last year. The core rate will likely increase a little less than two percent.

Previous: 0.2%

Consensus: 0.5%

Japanese Real GDP



U.K. Retail Sales • Thursday

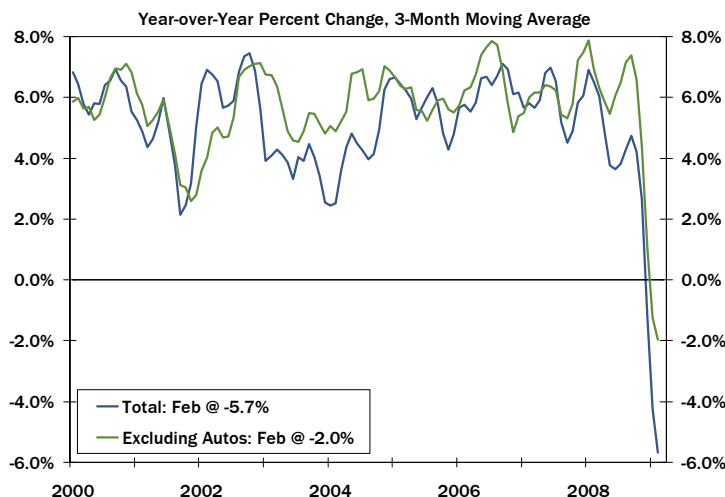
Preliminary data showed that British GDP fell at an annualized rate of 7.4 percent in the first quarter, the sharpest sequential rate of contraction since 1979. Despite the downturn in the economy and the marked rise in the unemployment rate, growth in retail spending has held up remarkably well. Indeed, real retail sales in the first quarter of 2009 were up 1.9 percent relative to the same period last year. Data on retail spending in April will print on Thursday, and the consensus forecast anticipates an increase of 0.5 percent in April relative to March.

CPI data for April will print on Tuesday. With such a sharp downturn, however, inflation is not likely to be a problem for the foreseeable future. Speaking of downturns, the second estimate of first quarter GDP growth, which includes the breakdown into underlying demand components, will be released on Friday.

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

Consensus: 0.5%

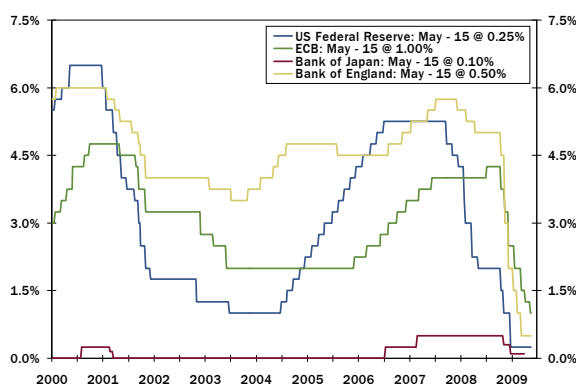
Canadian Retail Sales



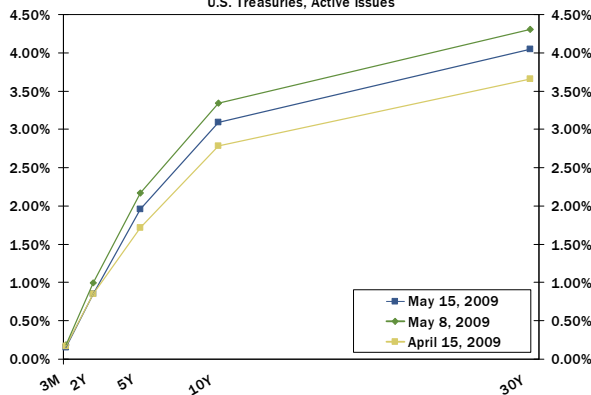
Interest Rate Watch
Production, CPI Dictate No Fed Change

Data on growth and inflation this week support the view that the Federal Reserve is unlikely to alter the federal funds rate anytime soon. Industrial production dropped in April as mining, machinery and computers production declined. During the next three months, we expect auto plant facility shutdowns will weaken growth further. Meanwhile, CPI inflation data came in flat, suggesting no inflation pressures for the immediate future. As for credit policy, the Federal Reserve has continued to purchase more Treasury debt and will probably continue purchases beyond the \$300B target until September. We expect the Fed to continue its commitment to supply liquidity this year. In the fourth quarter, however, the Fed's position will become more difficult as the outline of a modest economic recovery becomes clearer.

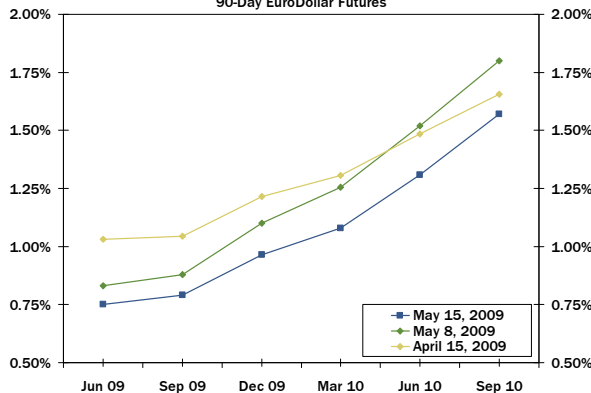
At the long end of the curve, there was new evidence that foreign investors were returning to U.S. capital markets. The Treasury reported that net purchases of long-term U.S. securities by foreign investors rose in March. There were concerns about the interest and risk tolerance of foreign investors for U.S. securities. The modest drift upward in Treasury yields lately may represent a decline in the flight-to-safety trade as well as a response to rising federal budget deficit estimates. Anecdotal information on Chinese concerns about U.S. deficits and spending intentions may also have played a role. This week's data on foreign purchases helps to diminish these concerns—at least for now. We continue to have reservations over the longer run as continued easy monetary and fiscal policy to promote economic growth may generate rising interest rates on inflation and deficit concerns.

Central Bank Policy Rates

Yield Curve

U.S. Treasuries, Active Issues


Forward Rates

90-Day EuroDollar Futures


Topic of the Week
Are Consumers on a Diet?

Real personal consumption expenditures for food items have fallen for three consecutive quarters, marking the longest consecutive string of declines since data became available back in 1990. The declines have been substantial, with spending for food plunging at a 7.3 percent annual rate in the 3rd quarter of 2008, 14.7 percent rate in the 4th quarter, and then a more modest 0.8 percent annual rate in the 1st quarter. On a year-to-year basis, spending for food, after adjusting for inflation, has fallen 4.9 percent.

Are consumers really buying nearly 5 percent less food than they did a year ago? We doubt it. Population growth alone means there are an additional 2.9 million mouths to feed than there were a year earlier. So what explains the drop? The BEA puts the food outlays data together by measuring food purchases at grocery stores, discount stores, warehouse clubs, convenience stores and other places food is sold. They then adjust the sales figures for price changes, as reported in the CPI. The real personal consumption expenditures figure for food thus does not truly measure the volume of food being purchased and is likely being depressed by significant changes in the mix of products and places where consumers are buying their groceries.

The combination of rising food prices and deteriorating employment conditions has produced significant changes in consumer buying habits. One such change was that consumers switched to more store brands, which typically sell for lower prices. Competition for grocery dollars is expected to remain intense as retailers fight for the declining number of trips consumers are making to stores. Visit our website for the report.

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 5/15/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.16	0.17	1.83
3-Month LIBOR	0.83	0.94	2.72
1-Year Treasury	0.18	0.43	2.29
2-Year Treasury	0.85	0.98	2.42
5-Year Treasury	2.00	2.14	3.08
10-Year Treasury	3.15	3.29	3.81
30-Year Treasury	4.10	4.27	4.55
Bond Buyer Index	4.54	4.63	4.53

Foreign Exchange Rates

	Friday 5/15/2009	1 Week Ago	1 Year Ago
Euro (\$/€)	1.354	1.363	1.545
British Pound (\$/£)	1.520	1.523	1.947
British Pound (£/€)	0.891	0.895	0.793
Japanese Yen (¥/\$)	95.032	98.469	104.745
Canadian Dollar (C\$/ \$)	1.176	1.149	1.000
Swiss Franc (CHF/\$)	1.116	1.105	1.057
Australian Dollar (US\$/A\$)	0.753	0.769	0.940
Mexican Peso (MXN/\$)	13.240	13.032	10.447
Chinese Yuan (CNY/\$)	6.826	6.822	6.995
Indian Rupee (INR/\$)	49.395	49.285	42.705
Brazilian Real (BRL/\$)	2.082	2.061	1.655
U.S. Dollar Index	82.726	82.529	73.350

Foreign Interest Rates

	Friday 5/15/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.25	1.31	4.86
3-Month Sterling LIBOR	1.36	1.42	5.84
3-Month Canadian LIBOR	0.80	0.80	3.30
3-Month Yen LIBOR	0.53	0.54	0.91
2-Year German	1.26	1.31	3.98
2-Year U.K.	1.07	1.22	4.77
2-Year Canadian	1.10	1.12	2.78
2-Year Japanese	0.38	0.41	0.85
10-Year German	3.36	3.45	4.20
10-Year U.K.	3.53	3.73	4.84
10-Year Canadian	3.11	3.16	3.56
10-Year Japanese	1.43	1.46	1.68

Commodity Prices

	Friday 5/15/2009	1 Week Ago	1 Year Ago
W. Texas Crude (\$/Barrel)	56.84	58.63	124.12
Gold (\$/Ounce)	931.84	916.65	881.65
Hot-Rolled Steel (\$/S.Ton)	375.00	400.00	1065.00
Copper (¢/Pound)	202.00	214.70	376.10
Soybeans (\$/Bushel)	11.52	11.07	13.54
Natural Gas (\$/MMBTU)	4.16	4.31	11.40
Nickel (\$/Metric Ton)	12,471	13,222	26,393
CRB Spot Inds.	379.26	373.42	522.85

Next Week's Economic Calendar

	Monday 18	Tuesday 19	Wednesday 20	Thursday 21	Friday 22
U.S. Data		Housing Starts March 510K April 485K (W)		Leading Indicators March -0.3% April 1.2% (W) Philadelphia Fed March -24.4	
Global Data			Japan GDP Annualized Previous (Q1) -12.1% Canada CPI (YoY) Previous (Q1) 1.2%	Euro-zone PMI Manufacturing Previous (Apr) 36.7 UK Retail Sales (MoM) Previous (Mar) 0.3%	Canada Retail Sales (MoM) Previous (Mar) 0.2%

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

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