WEEKLY ECONOMIC & FINANCIAL COMMENTARY

May 22, 2009

U.S. Review

A More Moderate Contraction

Signs continue to emerge which suggest the rate of decline in economic activity is moderating. Real GDP will still likely post a decline in the second and third quarters but the drops should be considerably less than what we saw in the past two quarters. Job losses should also moderate, although the recent spate of vehicle-assembly plant shutdowns and dealer closings may cause layoffs to spike again this summer.

Recent economic reports support the notion that the contraction is moderating. The Leading Economic Index rose 1.0 percent in April, marking its first increase in seven months and most significant gain since June of last year. Seven of the ten indicators increased during the month, with the most significant gains coming from stock prices, the interest-rate spread and consumer expectations.

The large improvement in the financial components of the LEI takes some of the shine off April's increase. Still, the large aggregate increase is hard to dismiss and confirms other anecdotal reports that suggest conditions are either bottoming out or close to it.

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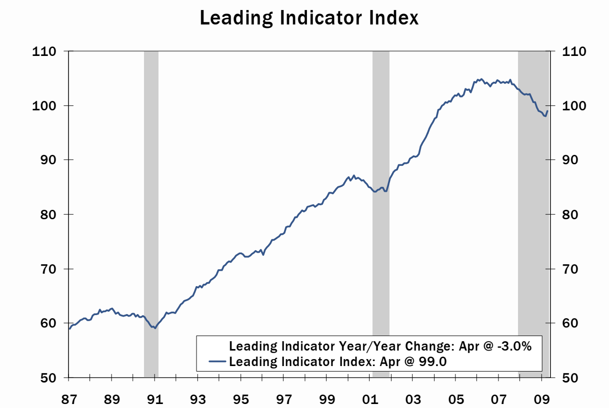

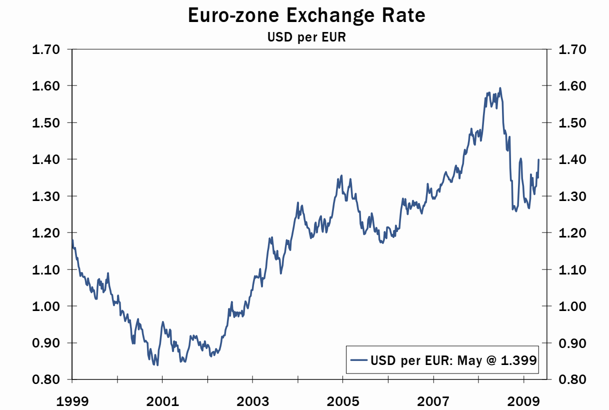

Global Review

Greenback Takes It on the Chin

The dollar got smacked this week. For example, the euro rose to its highest level vis-à-vis the greenback since the beginning of the year (see graph at the left). The euro did receive a bit of a boost from some stronger-than-expected data. As shown in the top graph on page 4, both the manufacturing and service sector PMIs posted sizeable gains in May. Although the indices remain below the demarcation line that separates expansion from contraction, the data suggest that the Euro-zone economy is getting closer to the bottom.

However, there is more to the dollar's broad-based weakness recently than simply better-than-expected data in the Euro-zone. Not only did the greenback fall about 3 percent against the euro this week, but it also slipped 1 percent against the yen and about 4 percent versus sterling and the Canadian dollar. What is going on?

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Recent Special Commentary

Date	Title	Authors
May-20	Spending Without Jobs: The Strange Case of Today's Recession	Silvia & Iqbal
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

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

INSIDE

U.S. Review

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More Moderate Declines Today Point to Growth Later This Year

Critics of the LEI often point to the misleading signal the index sometimes gives. While this is true, applying some simple common sense helps to understand this report. Rising stock prices accounted for 0.4 percentage points of April's increase in the LEI. The increase reflects a 12 percent rise in the S&P 500 that month. The stock market has reversed a surprisingly large part of its losses from last fall. Those losses have been a persistent burden on economic activity, adding to the drag on household wealth from falling home prices and depressing consumer spending. Even the partial reversal we have seen since early March should have some positive impact on consumer behavior, particularly since unanticipated changes in household wealth tend to have a larger impact on consumer behavior than anticipated ones.

While the leading index increased, there is little doubt the recession is still on. The Coincident Index fell 0.2 percent in April, reflecting continued declines in nonfarm employment and industrial production. Income and business sales are both expected to post modest increases for the month.

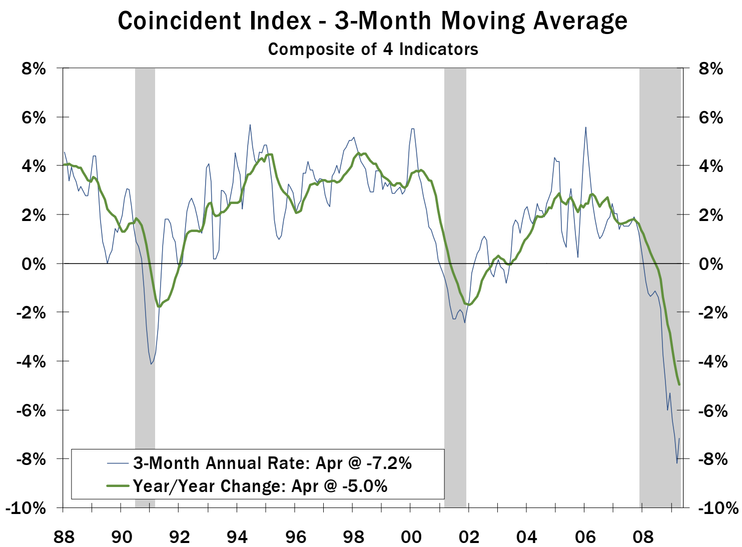
Another way to determine how much weight to give the stronger LEI increase is to ask whether it is consistent with other economic reports. We believe it is, although most reports continue to point more to a lesser rate of deterioration than to an outright turnaround in economic activity. This is the normal progression the economy moves through as it emerges from a recession.

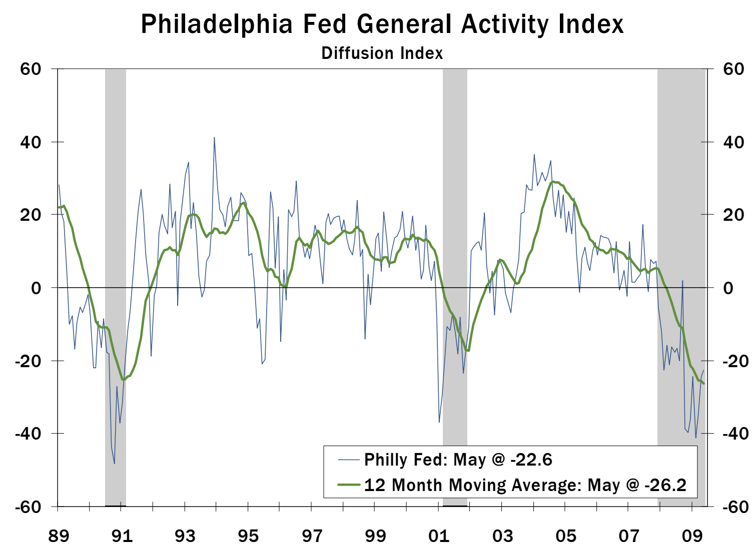
The Philadelphia Fed's survey of manufacturing conditions rose 1.8 points to -22.6 in May, returning the index to its highest level since September. A reading of -22.6 is still very negative and points to continued contraction in the factory sector. The pace of decline is lessening, however. More importantly, the improvement in the index was broad based, consistent across nearly every component and makes intuitive sense. The employment component rose 18.1 points, which was the sixth largest monthly increase on record. The average workweek also increased, climbing 18.0 points. Both series remain in negative territory, at –26.8 and –23.2, respectively.

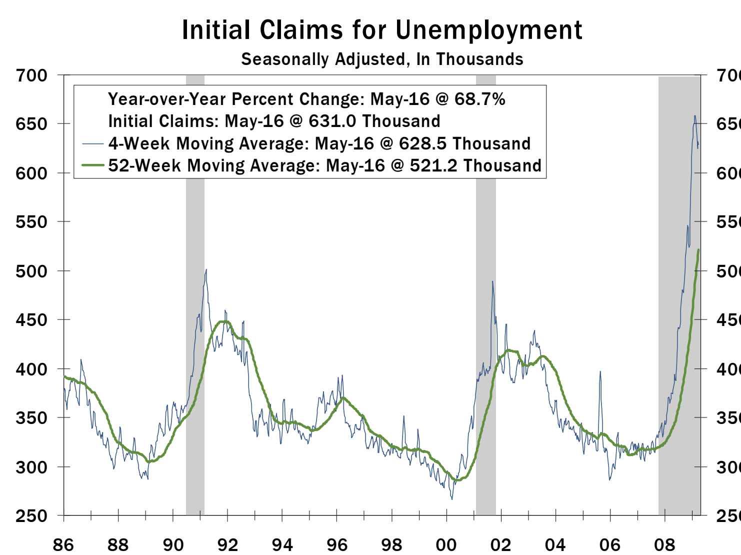
There is no doubt employment conditions will remain negative for some time, but here too there are reasons to hope that future declines will be less negative. Weekly first-time unemployment claims declined by 12,000 and the four-week moving average of jobless claims declined for the fifth time in the past six weeks. The claims are still consistent with large job losses and rising unemployment, but the rate of deterioration in employment conditions should soon begin to moderate.

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 - 22	0.25%





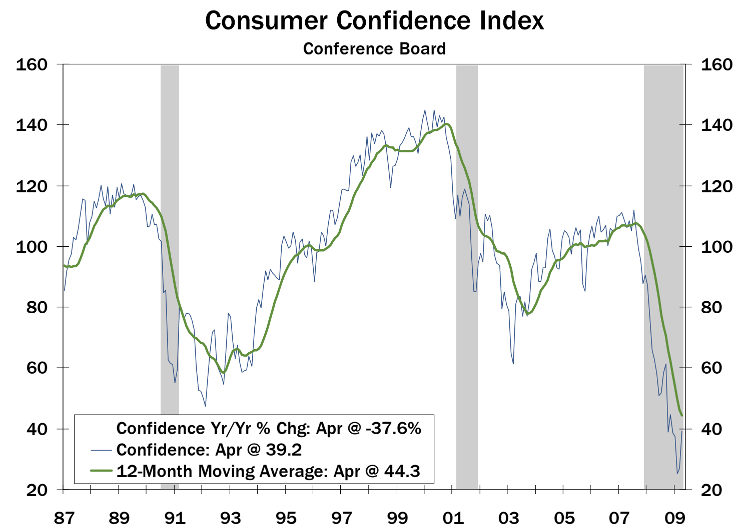


Consumer Confidence • Tuesday

After 14 months of a consistently downward trend, consumer confidence, as measured by the Conference Board, has shown recent signs of stabilizing. Confidence currently stands about 55 percent above its record low reached in February. Prospects of an economic recovery in the second half of the year coupled with significant gains in the stock market have lifted consumer spirits lately. While we expect a third consecutive monthly increase in May, significant headwinds still exist for the consumer. Retail gasoline prices have risen around 16 cents in May and will likely continue to edge higher as we enter the summer driving months. In addition, the labor picture remains bleak with firms continuing to shed jobs. This in turn will keep upward pressure on the unemployment rate which we expect will rise above 10 percent by year end. While confidence does appear to be turning, it is important to remember it is doing so from very depressed levels.

Previous: 39.2 **Wachovia: 41.0**

Consensus: 42.3



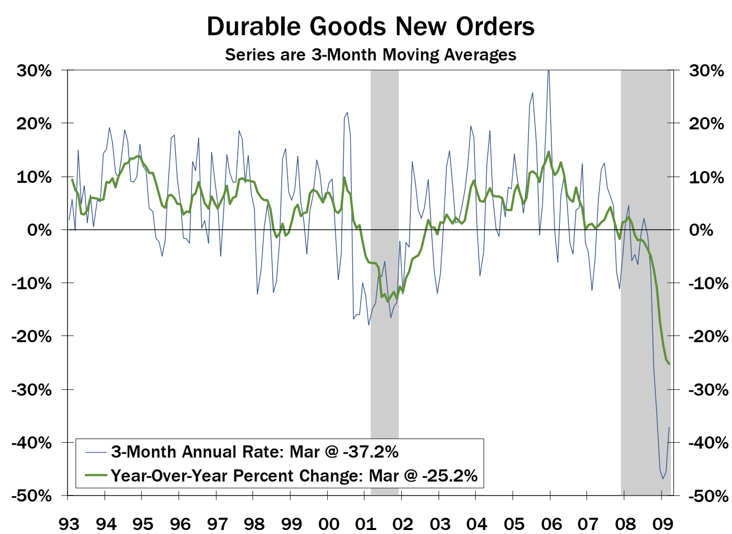
Durable Goods Orders • Thursday

For five out of the last six 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 plainly putting off any big-ticket purchases.

While this series is notably volatile on a month-to-month basis, we expect the downward trend in orders will continue in April with a 1.1 percent decline. Despite signs of stabilization in some of the regional purchasing managers' surveys and the national ISM manufacturing survey, the environment for big-ticket durable good orders is unsupportive, suggesting growth in orders is a ways off.

Previous: -0.8% **Wachovia: -1.1%**

Consensus: 0.5%



GDP • Friday

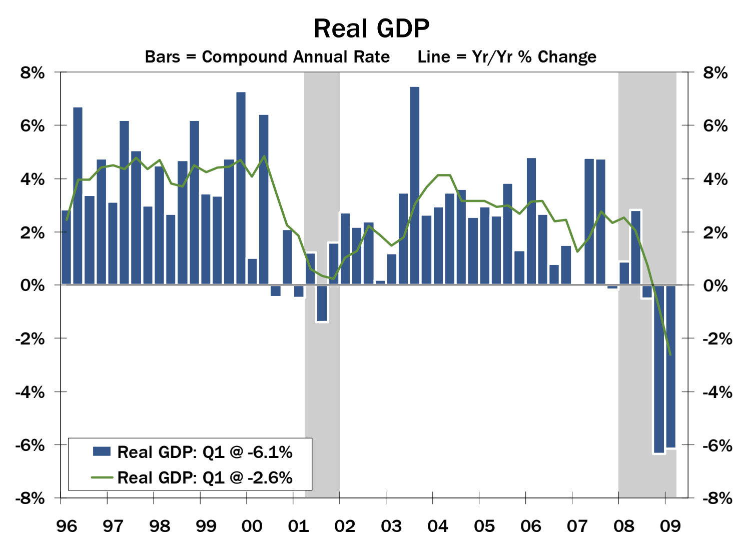
The advance reading of first quarter real GDP declined 6.1 percent as U.S. economic activity was weighed down by an accelerating retrenchment in business investment coupled with significant declines in government spending and inventory investment.

Updated data from the first quarter suggest GDP will be revised slightly higher. The trade data were better than expected in February and March likely resulting in a two-tenths contribution to Q1 GDP.

We expect the fourth and first quarters to be the deepest dives of this recession. Recent economic data suggest some stabilization is occurring with outright improvement in some areas of the economy. We see two more quarters of contraction before the U.S. economy is back in expansionary territory.

Previous: -6.1% **Wachovia: -5.7%**

Consensus: -5.5%



Global Review

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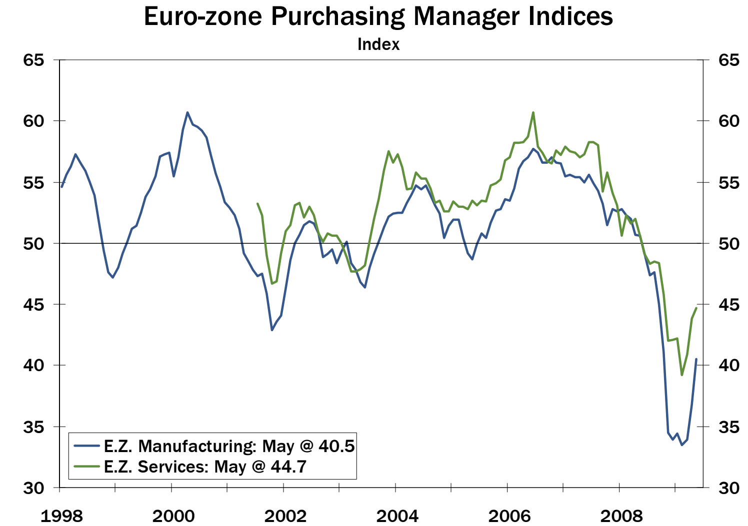
Debt Concerns Contribute to Dollar Weakness

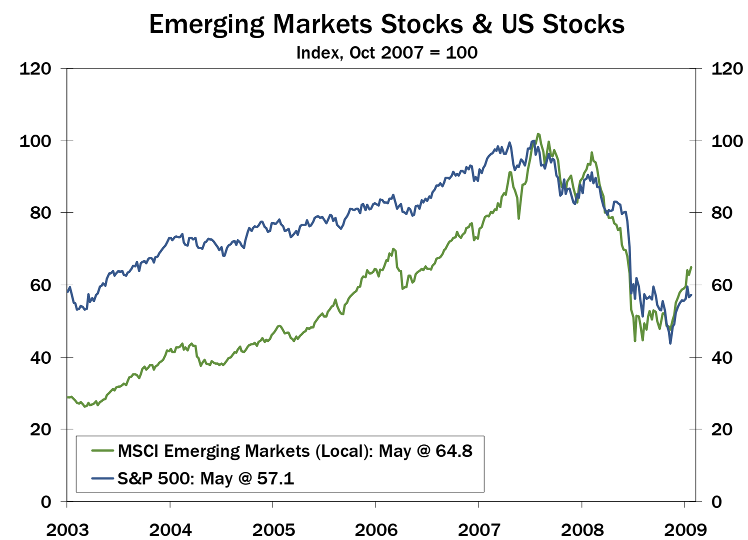
For starters, the dollar has been highly correlated with risk aversion over the past few months. That is, as risk aversion rises the dollar tends to strengthen and vice versa. With investors becoming less risk averse, the greenback has lost some of its safe-haven appeal. The S&P 500 has risen more than 30 percent from its lows in early March, and a widely followed index of emerging market stocks is up nearly 40 percent over that period (see middle chart).

In addition, the dollar was hit this week by concerns about the ballooning deficit and debt of the U.S. federal government. Although there really were no new developments on the U.S. fiscal front this week, the dollar was hit, ironically, by news that the United Kingdom could eventually lose its AAA bond rating from Standard and Poor's. How does news about Britain's bond rating have a negative effect on the dollar? The answer is that the United States could also lose its AAA rating someday as well. If a downgrade were to occur, the safe-haven appeal of the dollar would suffer even more. The yield on the 10-year Treasury security shot up 17 bps on the day the news broke (see bottom chart).

Any downgrade to the United States' bond rating is not imminent. Some analysts speculated that any downgrade, should one even occur, probably would not happen for 3 or 4 years. In response to the concerns over the government's fiscal position, Treasury Secretary Geithner said that the Obama administration is committed to bringing the budget deficit down "to a sustainable level over the medium term."

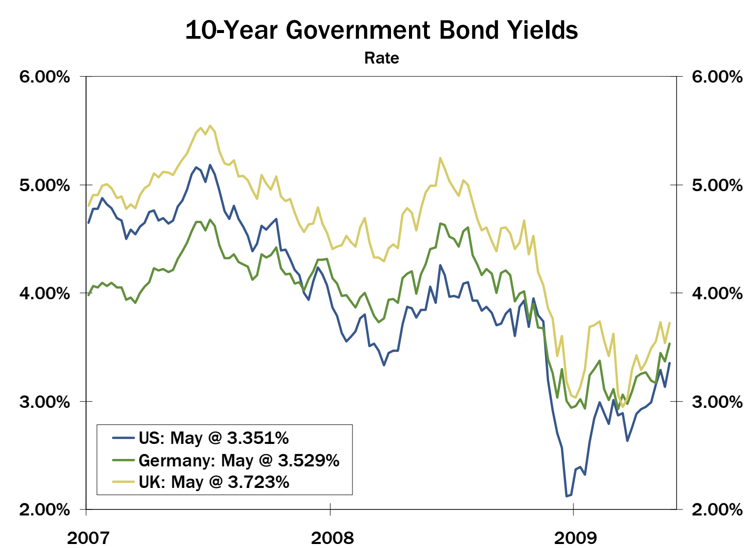
Concerns over the U.S. fiscal outlook are not likely to disappear just because the Treasury Secretary uttered a few reassuring words. Therefore, the dollar could remain under downward pressure, at least in the near term. However, the scrutiny on the U.S. fiscal outlook will probably fade over time, and investors will likely start to re-focus on growth prospects. As we outlined in "The Global Economy: Who Gets Out of the Gate First?" (available on our website), we project that the United States will be one of the first major economies to emerge from the current slump. As growth prospects begin to improve, the dollar should trend higher again. That said, the greenback could suffer some further losses in the near term if investors continue to fret over the U.S. fiscal outlook.





Selected Global Data

Japan	GDP Year-over-Year	Q1 - 2009	-9.7%
	CPI	March - 2009	-0.3%
	Unemployment	March - 2009	4.8%
	BoJ Target Rate	May - 22	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 - 22	1.00%
UK	GDP Year-over-Year	Q1 - 2009	-4.1%
	CPI	April - 2009	2.3%
	Unemployment	April - 2009	4.7%
	BoE Target Rate	May - 22	0.50%
Canada	GDP Year-over-Year	February - 2009	-2.3%
	CPI	April - 2009	0.4%
	Unemployment	April - 2009	8.0%
	BoC Target Rate	May - 22	0.25%



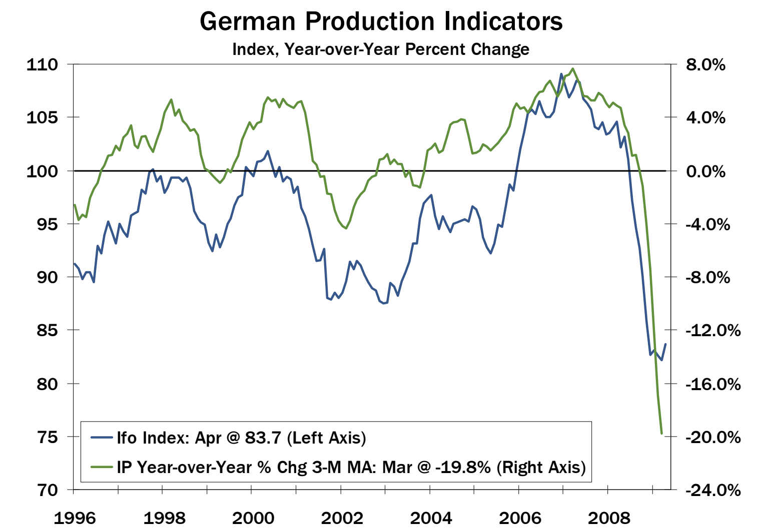
German Ifo Index • Monday

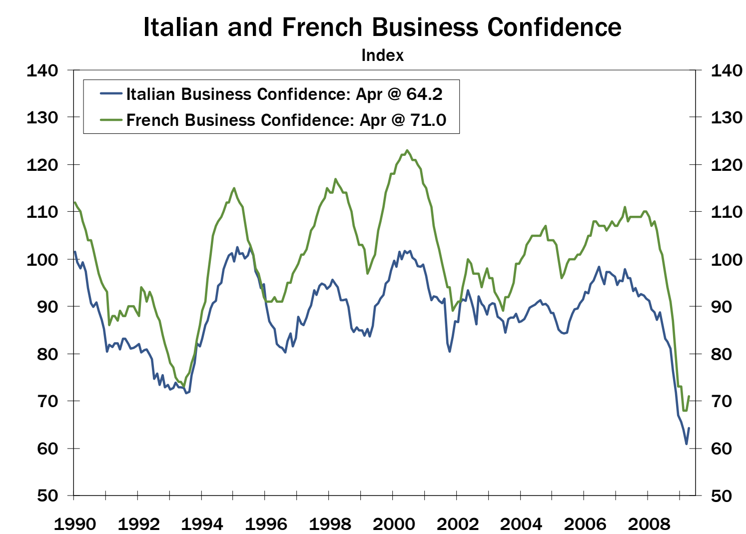
The Ifo index of German business sentiment is widely followed because it is highly correlated with growth in German industrial production (IP). The nosedive in the index starting last summer correctly predicted the collapse in IP that has transpired. The index ticked up in April, and the consensus forecast anticipates another increase in May. If the gain is realized, it would be consistent with a slowing in the pace of decline.

Investors also await German data on the labor market (Thursday) and retail sales (Friday). The week economy should cause the unemployment rate to rise further in the months ahead. Data on German retail spending has been disappointing recently, but most analysts are looking for a modest rebound in sales in April.

Previous: 83.7

Consensus: 84.8





European Confidence Indicators• Thursday

Indicators of business and consumer confidence will be released next week, not only for the broad Euro-zone but also for France and Italy. Business confidence edged up April, and most analysts look for further improvement in May. That said, most confidence indicators in Europe remain in very depressed territory. Economic activity in the Euro-zone appears to be contracting still, although probably at a less rapid rate than in the first quarter.

Data on French consumer spending, which has generally weakened over the past few quarters, will be released on Wednesday. The market consensus forecast anticipated a small decline in spending following the 1.1 percent increase in March. Data on French housing starts in April will be released on Thursday.

Previous: 71.0 (France), 64.2 (Italy)

Consensus: 73 (France), 66.0 (Italy)

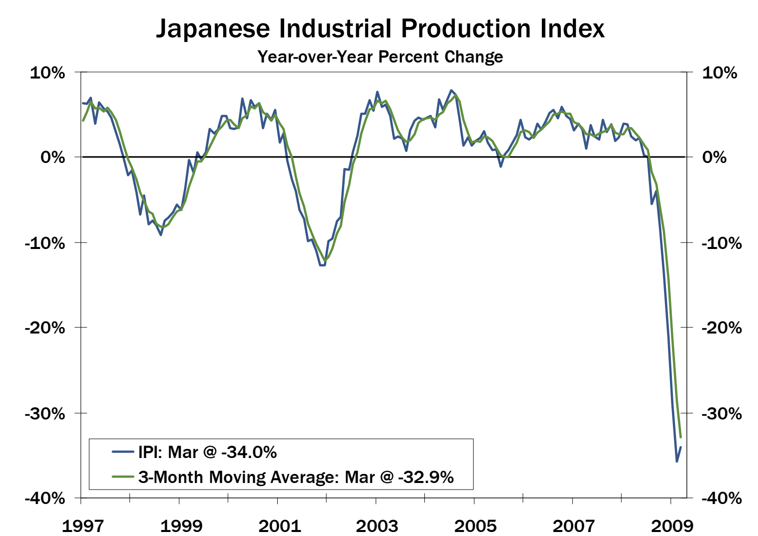
Japanese Industrial Production• Friday

The usual end-of-month barrage of Japanese economic data occurs next week. In that regard, industrial production (IP) is probably the most anticipated release of the bunch. Japanese IP nosedived late last year and earlier this year as global trade collapsed. However, IP rose 1.6 percent in March, and the market consensus forecast anticipates a more sizeable increase in April.

Data on the merchandise trade balance, retail sales, the labor market, consumer prices and housing starts are also on the docket at the end of the week. Japanese real GDP plunged at an annualized rate of 15.2 percent in the first quarter. The consensus view is that the Japanese economy remains in a contraction phase at present, but the rate of decline is probably starting to level out. The data barrage will help to test that view.

Previous: 1.6% (month-on-month change)

Consensus: 3.3%



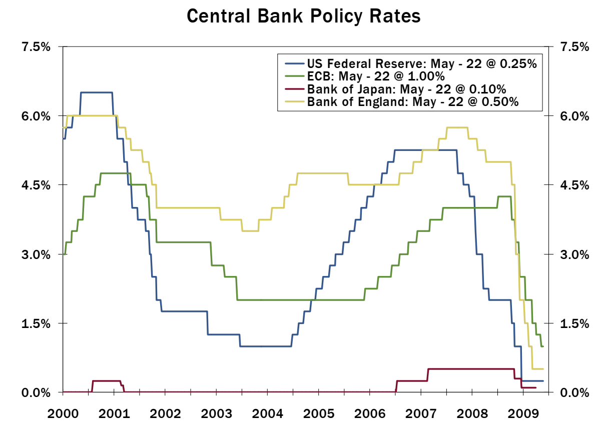
Interest Rate Watch

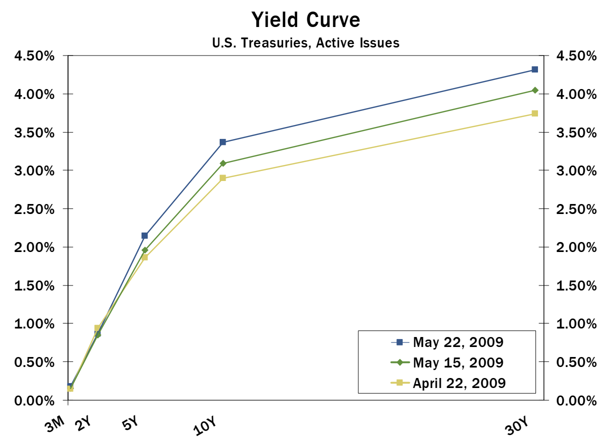
Policy Contradictions Appearing

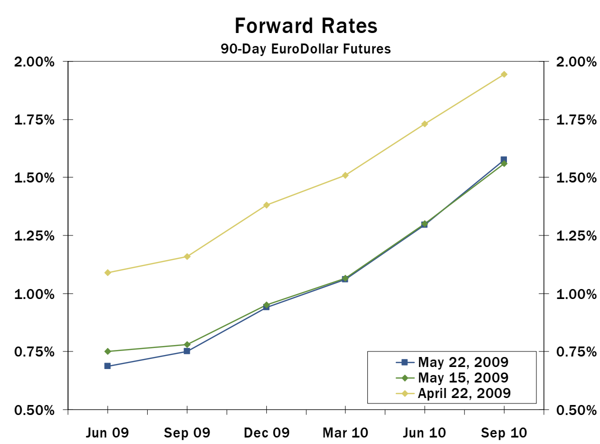
Questions and commentary about fiscal and monetary policy contradictions began to appear in the markets and media this week. Much of that commentary follows on issues we already presented at a meeting in Richmond. In theory, fiscal stimulus should boost economic growth in the short run. However, the longer run problem is fiscal discipline. Is there an exit strategy for reducing federal spending down the road? Failure to pursue a reasonable program of reducing Treasury finance may have negative implications for the dollar, interest rates and, as indicated this week, the U.S. Treasury credit rating.

Meanwhile, over the last year the Fed's balance sheet has risen dramatically from $800 billion to over $2 trillion, while the money supply, M2, has grown 14 percent over the last six months. Such expansionary monetary policy is not likely to be sustainable over time without significant changes in inflation, interest rates, the value of the dollar and the pace and character of economic growth. Moreover, current credit policy at the Fed suggests that market rates on Treasuries and other instruments are being driven by the Federal Reserve to lower-than-sustainable levels in a non-inflationary, trend growth environment. We view this as counter-productive in the longer-run since the real market price for these assets is not revealed and thus there is no true price discovery.

As economic "green shoots" appear more frequently and a consensus develops that recovery is coming, the exit strategy for policymakers becomes more imperative. The challenge of the timing and perfect execution of an exit strategy from extremely easy monetary and fiscal policy should be clear.







Topic of the Week

Spending Without Jobs

Four economic indicators provide the framework for this recession – real personal income, real business sales, industrial production and employment. What is presently intriguing but also ominous is the disparity between income and production. Employment has broken down sharply relative to the typical weakness of prior recessions. Industrial production has also exhibited a dramatic breakdown relative to its behavior in prior recessions. This also should come as no surprise to those familiar with the headline news of structural challenges facing the auto industry as well as housing-related durable goods such as appliances, rugs, etc…

However, what is rather interesting is the behavior of income does not reflect the same degree of dramatic decline in economic activity that one senses in employment and production. In this case, the disparity between production and income suggests both cyclical and structural changes that may signal an evolution of the character of the American business cycle.

Perhaps what we are beginning to see is a society that, at the margin, may be less dependent on employment for its income than what we are accustomed to in the past. Of course, this does not apply to the majority of people of working age, but there appears to be a sense that transfer payments, either by welfare or Social Security—especially the rapid rise in disability payments in recent years—has given rise to income gains that are much stronger than one would have expected if the focus was just on jobs. Is the link between jobs and spending weakening or are households simply over-smoothing their consumption? Full report at wachovia.com/economics.

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 5/22/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.18	0.16	1.86
3-Month LIBOR	0.66	0.83	2.64
1-Year Treasury	0.14	0.18	2.13
2-Year Treasury	0.87	0.85	2.52
5-Year Treasury	2.17	2.00	3.22
10-Year Treasury	3.39	3.13	3.91
30-Year Treasury	4.33	4.08	4.62
Bond Buyer Index	4.44	4.54	4.52

Foreign Exchange Rates

	Friday 5/22/2009	1 Week Ago	1 Year Ago
Euro ($/€)	1.398	1.350	1.573
British Pound ($/£)	1.586	1.518	1.980
British Pound (£/€)	0.881	0.889	0.794
Japanese Yen (¥/$)	94.670	95.210	104.075
Canadian Dollar (C$/$)	1.126	1.178	0.985
Swiss Franc (CHF/$)	1.088	1.121	1.031
Australian Dollar (US$/A$)	0.784	0.749	0.956
Mexican Peso (MXN/$)	13.157	13.260	10.366
Chinese Yuan (CNY/$)	6.823	6.826	6.943
Indian Rupee (INR/$)	47.131	49.395	42.965
Brazilian Real (BRL/$)	2.026	2.115	1.658
U.S. Dollar Index	80.116	83.024	71.899

Foreign Interest Rates

	Friday 5/22/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.26	1.25	4.86
3-Month Sterling LIBOR	1.29	1.36	5.85
3-Month Canadian LIBOR	0.70	0.80	3.30
3-Month Yen LIBOR	0.53	0.53	0.91
2-Year German	1.31	1.26	4.19
2-Year U.K.	1.03	1.07	5.00
2-Year Canadian	1.16	1.10	3.02
2-Year Japanese	0.36	0.38	0.80
10-Year German	3.53	3.37	4.30
10-Year U.K.	3.73	3.54	4.95
10-Year Canadian	3.27	3.09	3.67
10-Year Japanese	1.44	1.43	1.68

Commodity Prices

	Friday 5/22/2009	1 Week Ago	1 Year Ago
W. Texas Crude ($/Barrel)	61.08	56.34	130.81
Gold ($/Ounce)	957.56	931.80	921.85
Hot-Rolled Steel ($/S.Ton)	375.00	375.00	1080.00
Copper (¢/Pound)	210.00	202.80	372.25
Soybeans ($/Bushel)	11.81	11.52	13.24
Natural Gas ($/MMBTU)	3.55	4.10	11.70
Nickel ($/Metric Ton)	12,047	12,471	25,055
CRB Spot Inds.	381.26	379.26	510.35

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	25	26	27	28	29
U.S. Data	**Memorial Day Holiday** Markets Closed	**Consumer Confidence** April 39.2 May 41.0 (W)	**Existing Home Sales** March 4.57M April 4.52M (W)	**Durable Goods Orders** March -0.8% April -1.1% (W) **Durables Ex Transp.** March -0.6% April -3.3% (W) **New Home Sales** March 356K April 350K (W)	**GDP (QoQ)** 2009:1Q (Advance) -6.1% 2009:1Q (Prm.) -5.7% (W)
Global Data	**Germany** **IFO - Business Climate** Previous (Apr) 83.7			**Germany** **Unemployment Rate** Previous (Apr) 8.3%	**Japan** **Jobless Rate** Previous (Mar) 4.8% **Japan** **Indus. Production (MoM)** Previous (Mar) 1.6%

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

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