WACHOVIA

ECONOMICS GROUP

Weekly Economic & Financial Commentary

May 29, 2009

U.S. Review

Rising Rates Heighten Risks

Long-term interest rates jumped this week, as the Treasury received only lukewarm demand for it $101 billion in medium-term securities. The spread between the Treasury's 10-year note and 3-month bill rose 27 basis points this week and is the widest since last November.

Ordinarily a steeper yield curve would be a persuasive sign of a recovery. This does not appear to be the case today, however. Long-term yields are rising because of the Treasury's enormous issuance and worries that inflation will accelerate over the long-term. There is little-to-no evidence that investors' appetite for risk has improved or private-sector credit demand has strengthened. Higher long-term interest rates today are a roadblock to recovery not a milepost.

With the run-up in long-term Treasury yields, mortgage rates for 30-year fixed-rate loans have risen above the psychologically important five percent mark. The rise has cut into demand for refinancings and home purchases. Applications for refinancings have fallen 24 percent over the past month. Commercial loan demand has also weakened and remains soft.

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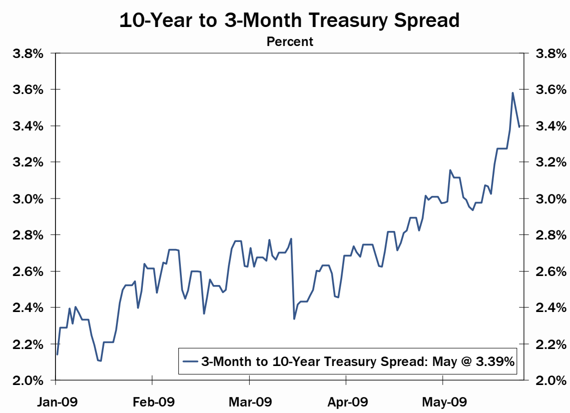

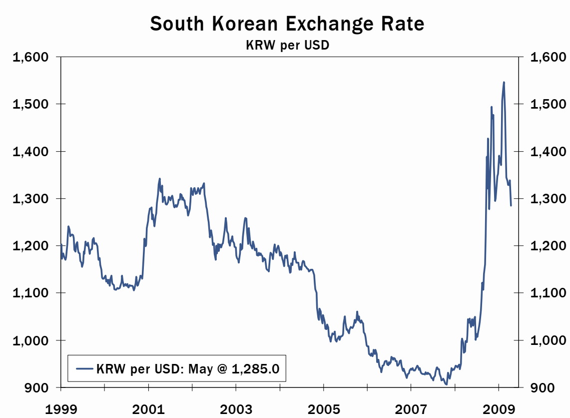

Global Review

Tensions on the Korean Peninsula

Geopolitical tensions rose again this week when North Korea conducted an underground nuclear blast on Monday that was followed by missile tests. South Korea and the United States said that they would stop and search North Korean ships in an effort to stop nuclear trafficking, and Pyongyang responded by saying that it no longer considers itself bound by the 1953 armistice that ended the Korean War. Is war imminent on the Korean peninsula?

Investors don't seem to be worried if the reaction in Korean financial markets is any indication. Yes, the Korean won weakened 1.0 percent versus the dollar (see chart at left) and the Kospi stock index fell 2.0 percent on the day after the tests occurred, but they had largely recouped their losses by the end of the week. Perhaps investors are more focused on South Korean economic news at present.

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Recent Special Commentary

Date	Title	Authors
May-27	Recession Probability Drops Below 50 Percent	Silvia & Iqbal
May-22	Auto Layoffs are Now Driving State Unemployment Rate	Vitner
May-20	Spending Without Jobs: The Strange Case of Today's Recession	Silvia & Iqbal
May-14	Global Chartbook - May 2009	Bryson & Quinlan

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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Economic Reports Remain Consistent With a Fall Recovery

While rising interest rates heighten the risk that the economy will stumble on its way to recovery, we believe the recession will end later this year, probably late summer or early fall. This week's economic reports were generally supportive of that notion. One of the brightest spots was the surprising 15.7 point jump in the Conference Board's Consumer Confidence Index, which brought the index back to its highest level since September.

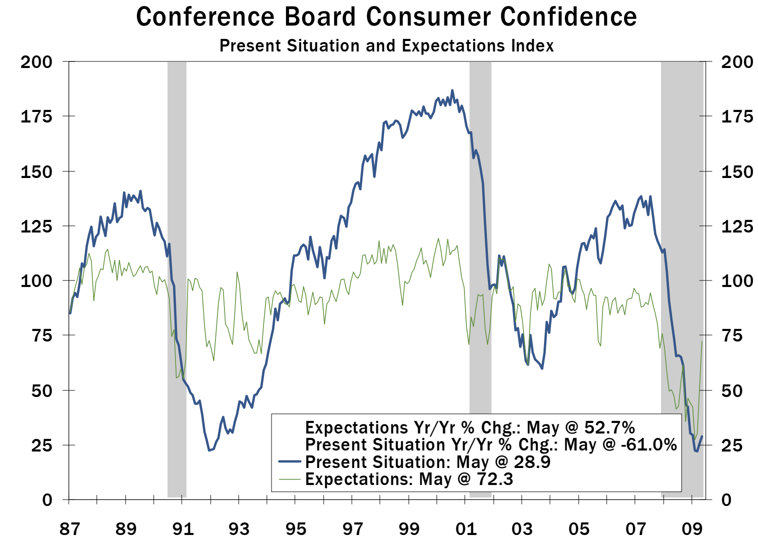
While the Consumer Confidence Index surged, there was a huge gap between expectations of future economic conditions and sentiment about current economic performance. Consumers' assessment of current economic conditions rose just 3.4 points, as many more households remain concerned about the lack of job opportunities and the weakened state of business in general. By contrast consumers' expectations for future economic conditions jumped 21.3 points following a 20.8 point rise in April. The increase coincides with the 28 percent rebound in the Dow Jones Industrial Average. The surprising strength in the Consumer Confidence Index helped send stocks even higher this week, as hopes for a recovery strengthened.

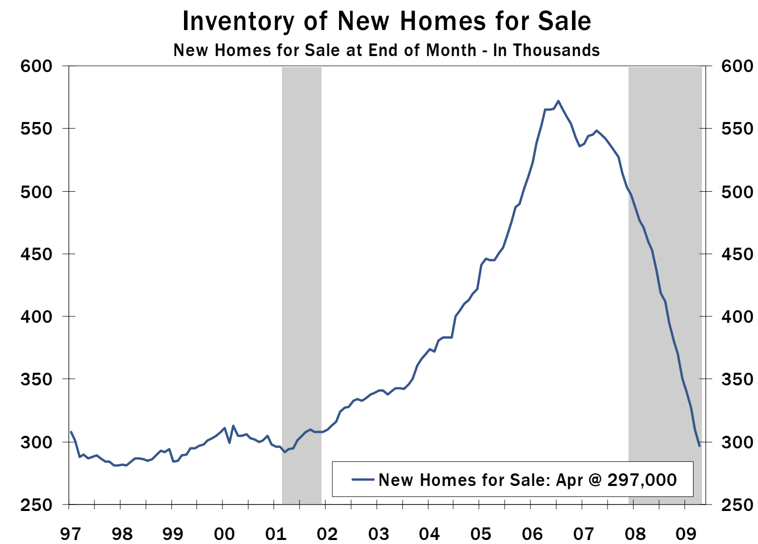
Most of this week's other reports remained consistent with a lessening in the rate of the decline in economic activity. Sales of both new and existing homes rose in April, but data for the previous month were revised down and the underlying demand for housing remains weak. The National Association of Realtors estimates that 45 percent of the homes sold in April were either foreclosure sales or some other form of distressed sale. New homes sales rose 1,000 units in April to a 352,000 unit pace. Data for March were revised down, however, so the increase actually resulted in sales being 8,000 units lower than they reported to be one month earlier. Inventories of unsold new homes continue to decline and have fallen to their pre-boom levels. Cancellation rates remain high, however, and the bulk of the oversupply problem is in existing homes rather than builder inventories.

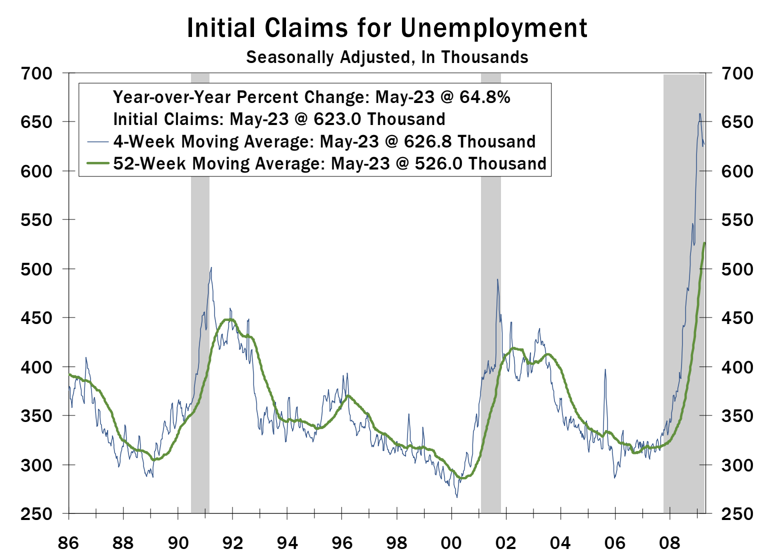
Weekly first-time unemployment claims fell 8,000 to 623,000. The drop marks the 2nd consecutive weekly decline and helped bring the four-week moving average down for the 6th time in the past 7 weeks. Despite the improvement, the actual level of jobless claims remains high and continuing unemployment claims are still rising. The insured unemployment rate rose another 0.1 percentage point, marking the 12th consecutive weekly increase. The current data suggests the unemployment rate will rise to 9.4 percent for the month of May and may reach 10 percent by summer's end.

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	March - 2009	1.8%
Industrial Production	April - 2009	-12.5%
Unemployment	April - 2009	8.9%
Federal Funds Target Rate	May - 29	0.25%





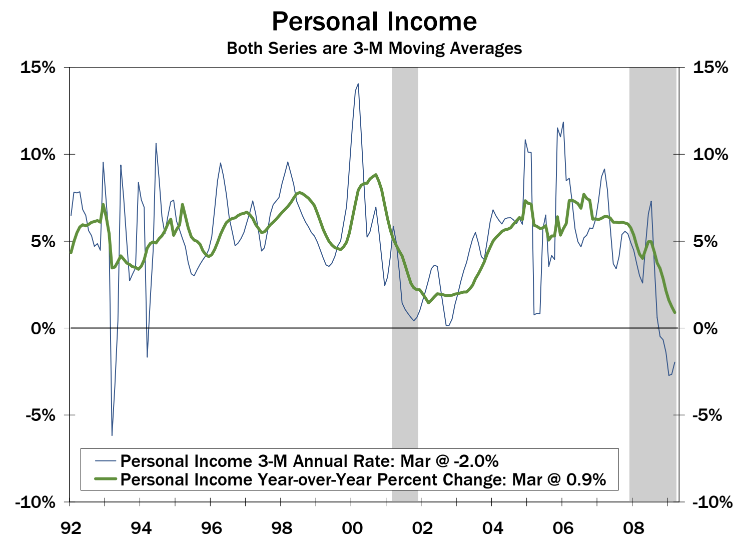


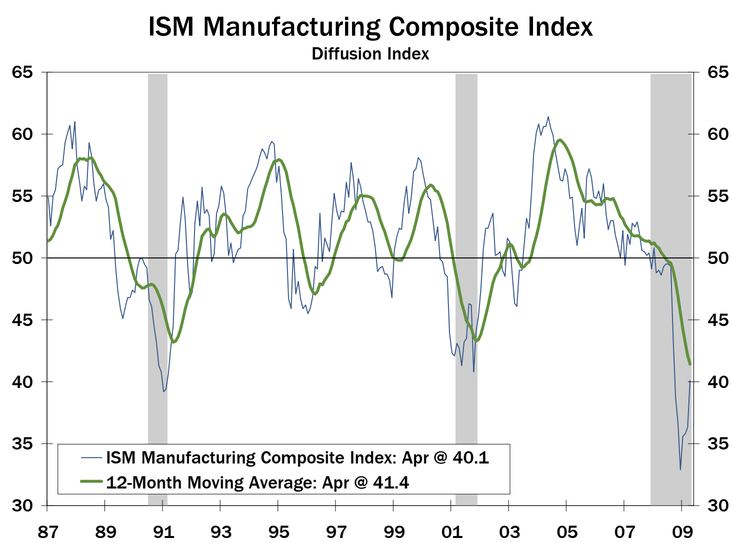
Personal Income • Monday

Personal income fell 0.3 percent in March, led lower by the continued decline in wages & salaries which fell for the fifth straight month. With the labor market remaining extremely weak we do not expect wage & salary growth to pick up for quite sometime. Personal income and more notably disposable income will likely rise significantly in April as withholding tables are changed for the new tax provisions. We expect personal income rose 0.1 percent in April. Spending may climb from here, but growth will be weak. The personal saving rate should remain relatively elevated as consumers continue to exercise caution.

Previous: -0.3% **Wachovia: 0.1%**

Consensus: -0.2%





ISM Manufacturing • Monday

The Institute for Supply Management's (ISM) index of activity in the manufacturing sector likely rose for the fifth consecutive month in May, but remains squarely in recession territory. Weak ISM readings are consistent with declines in industrial production and manufacturing jobs. However, recent increases corroborate the notion that economic recovery will begin late this year. Durable goods orders rose in April, suggesting new orders and order backlogs should also increase, likely indicating strength in the pipeline. The regional purchasing managers' reports remain weak, but have shown tentative signs of improvement. Still, the outlook for the manufacturing sector is that it will remain under considerable pressure.

Previous: 40.1 **Wachovia: 40.3**

Consensus: 42.0

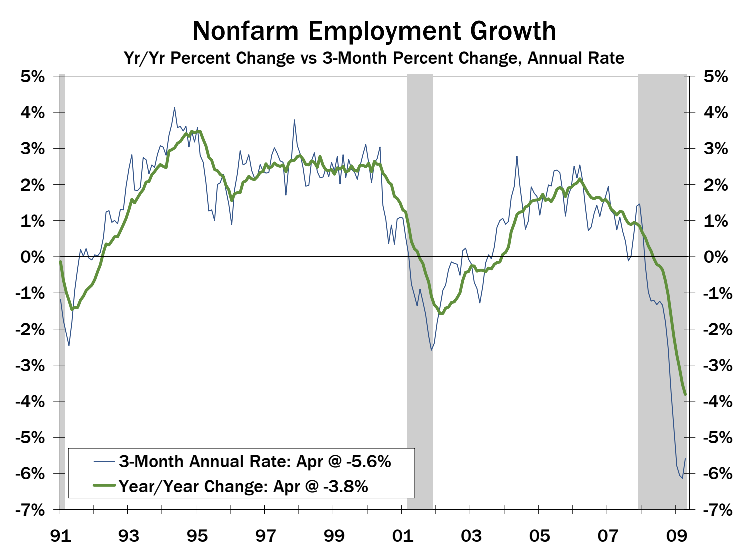
Nonfarm Employment • Friday

Job losses have been extraordinarily broad based, with virtually every industry other than government and education & healthcare posting employment declines. The largest losses continue to be in manufacturing and construction, where close to half the 5.7 million overall job losses have been. Even areas once considered recession resistant like state and local governments are being hit hard.

While weekly first-time unemployment claims have dropped two consecutive weeks, continuing claims have skyrocketed. Additionally, the insured unemployment rate has continued to rise a tenth of a percentage point a week which has matched nearly perfectly with the rise in the unemployment rate. The latest figures suggest the unemployment rate will climb to around 9.4 percent in May. We continue to expect the unemployment rate to rise well into 2010, peaking somewhere around 10.6 percent.

Previous: -539K **Wachovia: -540K**

Consensus: -530K



Global Review

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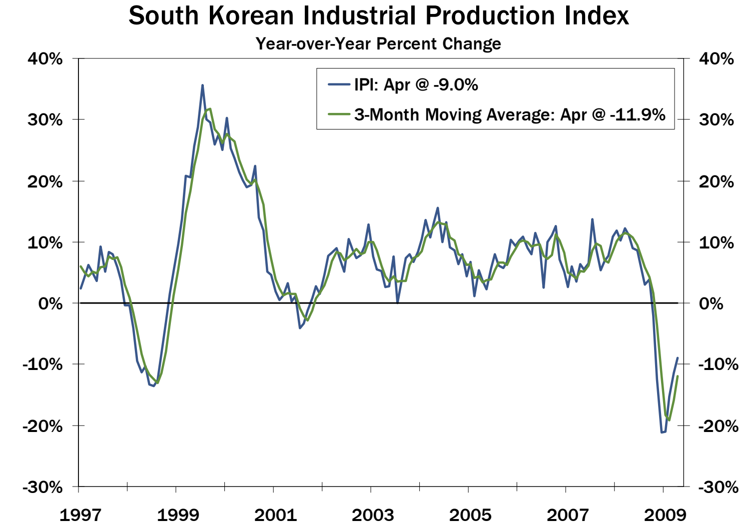
Recovery Under Way in South Korea?

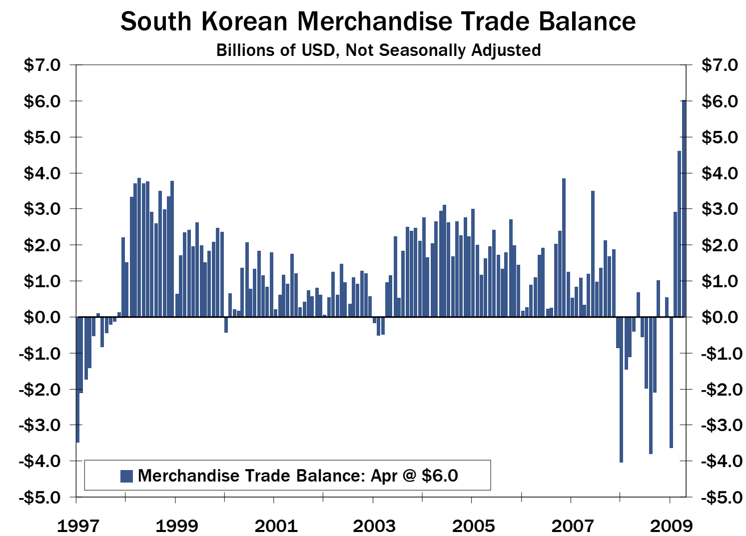
In that regard, recent data suggest that recovery may already be under way in South Korea. Industrial production (IP) rose for the fourth consecutive month in April, bringing its cumulative rise from its cyclical low in December to 18 percent. Moreover, the marked rise in business confidence in May suggests that industrial production has probably continued to increase this month.

What is behind the rebound in Korean industrial production? Clearly, foreign trade is playing a role. As shown in the middle chart, the country is posting trade surpluses again. Part of the swing from surplus to deficit and back again reflects the rollercoaster ride in oil prices over the past two years that has led to wide swings in the country's imports. That said, some of the improvement in the trade balance reflects exports, which have risen more than 40 percent in value since January. Exports plunged last autumn as trade finance dried up. Now that credit markets are beginning to function again, exports are rebounding.

There are also some indications that domestic demand is stabilizing. Real retail sales were essentially flat in the first quarter relative to the previous quarter, and the increase in an index of consumer confidence, which rose to a 2-year high in May, bodes favorably for consumer spending going forward. Policymakers have also responded aggressively to the downturn. The sharp contraction in economic activity late last year and the subsequent decline in inflation allowed the Bank of Korea to slash its main policy rate by 325 bps between October and February. In addition, the government enacted a program of infrastructure spending and tax cuts for both businesses and individuals. Expansionary macroeconomic policy has surely helped to stabilize the economy.

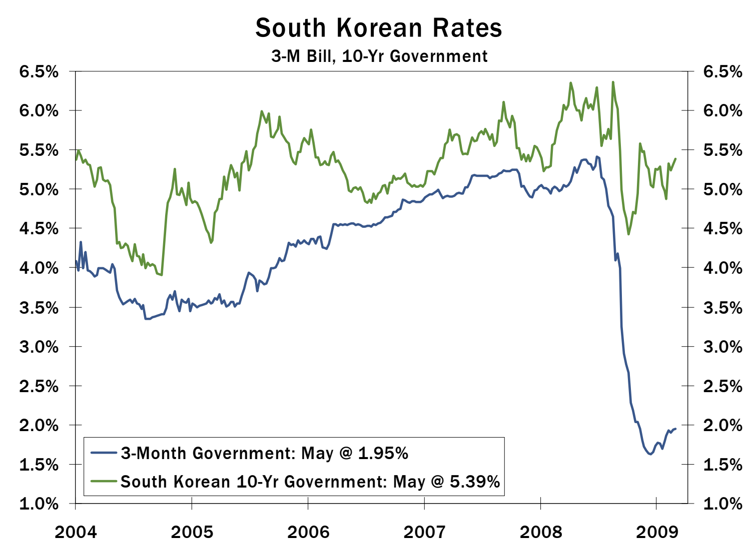
Although economic recovery may be taking hold in Korea, we believe that the pace of the upturn will be rather sluggish. First, the global recovery likely will take some time, which should constrain growth in Korean exports going forward. Second, Korean households have increased their leverage over the past few years, and we expect a period of slow growth in consumer spending as households reduce leverage. That said, Korea appears to be climbing out of its brief, albeit sharp, recession.





Selected Global Data

Japan	GDP Year-over-Year	Q1 - 2009	-9.7%
	CPI	April - 2009	-0.1%
	Unemployment	April - 2009	5.0%
	BoJ Target Rate	May - 29	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 - 29	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 - 29	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 - 28	0.25%



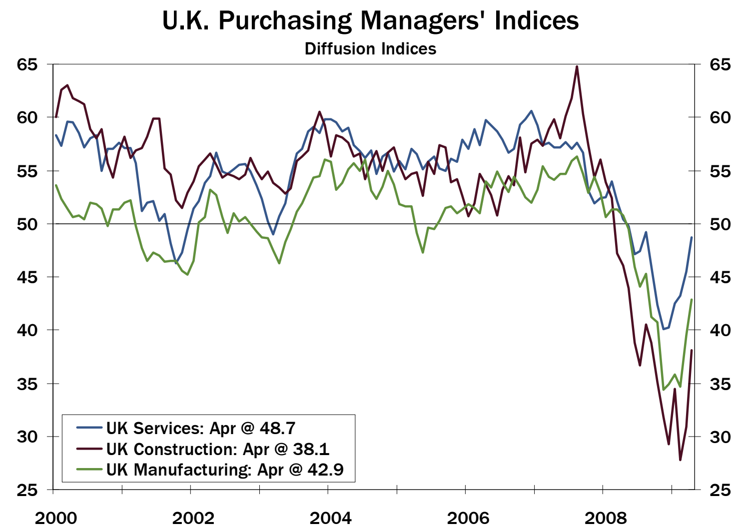
U.K. Manufacturing PMI• Monday

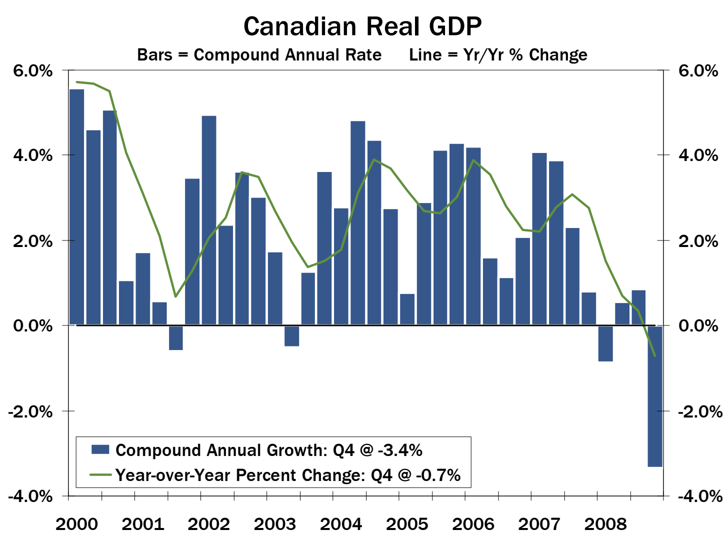
The plunge in the U.K. purchasing managers' index late last year and early this year is consistent with the sharp contraction that has occurred in the U.K. economy. The manufacturing PMI has risen in the past two months, but it still remains below the demarcation line that separates expansion from contraction. Data released on Monday will give investors some insight into the state of the manufacturing sector in May. The PMI for the construction sector will print on Tuesday, and the service sector PMI will be released on Wednesday.

The Bank of England holds its monthly policy meeting on Thursday. The Bank's main policy rate currently stands at 0.50 percent, and few analysts expect it to cut rates further. However, the Bank could announce plans to increase its purchases of government bonds and/or private sector securities.

Previous: 42.9

Consensus: 44.0





Canadian GDP • Monday

On Monday of next week the official numbers for first quarter real GDP will be released. The Canadian economy likely contracted at an annualized rate of roughly seven percent. We expect the change in inventories to have weighed on growth in the first quarter, which may help set the stage for a recovery later on this year. While the Canadian economy contracted substantially in the first quarter, there are several signs that things are turning around. On Thursday of next week we will get some clues about the recovery in residential construction when the building permits data for April are released. In March, permits jumped 23.5 percent, so it wouldn't be a huge surprise to see a give-back in the April data.

The May employment report comes out on Friday. In April, Canada added 35.9K workers to its payrolls even as most other countries were laying people off. Consensus expectation is for a decline in jobs of roughly the same magnitude as April's gain.

Previous: -3.4% (CAGR) **Wachovia: -7.0%**

Consensus: -6.5%

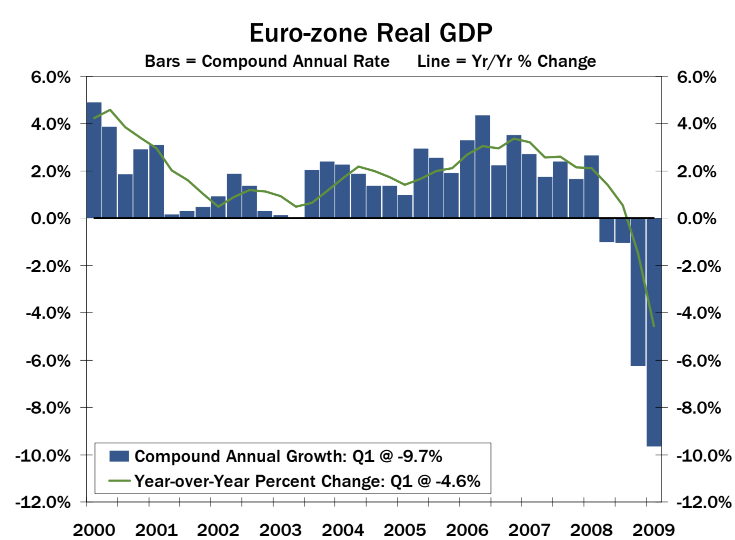
Euro-zone GDP • Wednesday

The Euro-zone released its first estimate of GDP growth in the first quarter a few weeks ago, but the breakdown into the demand-side components was not available at that time. Although the 9.6 percent rate of contraction in the first quarter is not likely to be revised significantly, the information on the demand side components may give investors a clearer understanding of how the economy will evolve from here.

Revised data on the manufacturing PMI in May will be released on Monday, and the service sector PMI will print on Wednesday. On Thursday, the European Central Bank will hold its monthly policy meeting. Although most analysts expect the ECB to maintain its main policy rate at 1.00 percent on Thursday, the central bank could announce further unconventional steps to support the economy.

Previous: -9.6% (CAGR)

Consensus: -9.6%



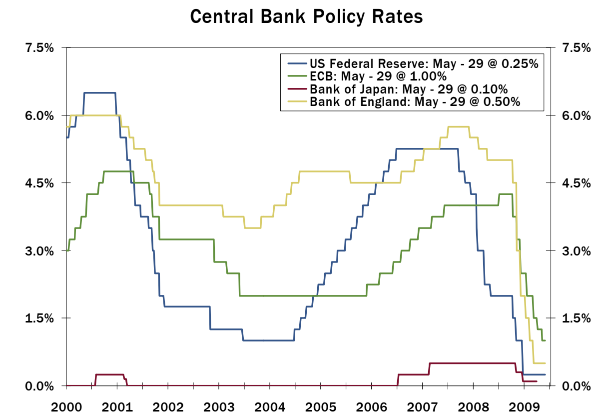
Interest Rate Watch

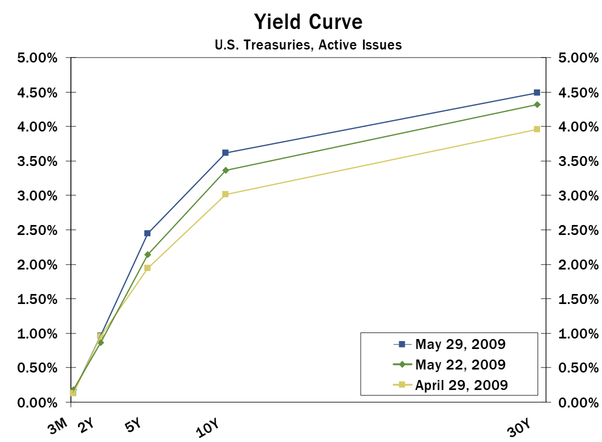
Fiscal Policy and Federal Deficits

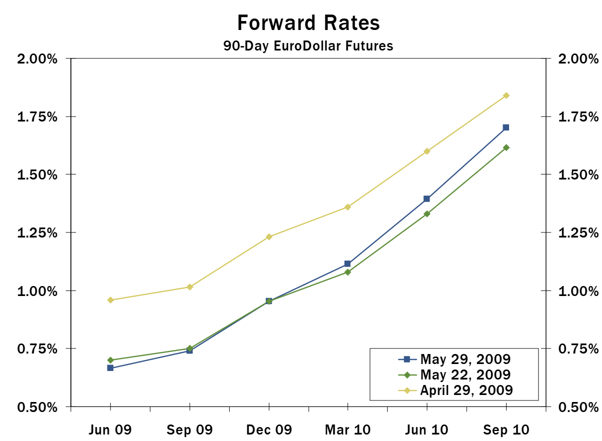
Monetary and fiscal policies are not independent. Each policy has an impact on the economy and in turn, forces a response from other policies which may contradict publicly stated policy objectives. Current fiscal policy is highly expansionary in an attempt to increase aggregate demand and thereby lead this economy out of recession. But this also puts upward pressure on capital markets and interest rates. In an environment of global weakness from last fall to mid-May, this effect had been offset by the flight-to-safety bet of investors, the easier monetary policy and Treasury purchases by the Federal Reserve. But this game is rapidly ending.

Future federal deficits will not decline as rapidly as promised. Continued, large fiscal deficits have called into question the quality premium attached to U.S. Treasury debt. Unfortunately this draws monetary policy into the mix. Monetary policy is not independent of the contradictions between budget promises and realities. Fiscal policy stimulus multipliers anticipate that the federal funds rate will remain at zero for a long time after the hike in government spending, and that the fiscal stimulus is expected to be temporary. But what if fiscal stimulus lasts longer than expected?

Increasingly, private estimates of the budget deficits and estimates by the Congressional Budget Office suggest large, rising federal deficits, but is this consistent with a zero interest rate policy? Will the Federal Reserve continue to buy more Treasury debt? Effectively, if not on purpose, these purchases will keep today's interest rates low, but at the risk of higher inflation and interest rates down the road. At present, private markets are already voting on this outcome.







Topic of the Week

Recession Probability Drops

In a significant turn, the probability of recession six months from now has downshifted sharply. After taking a look at a very broad set of economic variables, we have developed a monthly recession model which predicts the probability of recession six months from now. Plugging in the April data, the model indicates that the probability of recession six months from now has dropped from 97 percent in March to 47 percent in April. This is a significant change and signals to us that the current recession could be on course to end in the second half of this year. While the official recovery call will come from the National Bureau of Economic Research, our outlook is that the recovery will begin in the fourth quarter led by federal government spending and a modest improvement in consumer spending as well as from diminishing drags in residential construction and inventory investment.

While we do expect recovery in the pace of economic growth, employment remains an issue for both cyclical and structural reasons. Job declines have been widespread with the only bright spot in the healthcare and education sectors, but even there gains have decreased. Another signal of the weakness in the job market is the rise in the duration of unemployment. The impact on those losing jobs will be more severe. Moreover, the structural trend of declining employment in blue-collar manufacturing continues as it has since the early 1970s. These declines reflect the high cost of labor relative to capital that has prompted the increased use of technology and capital to substitute for skilled workers as well as the evolution of consumer demand from "goods" to "services".

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 5/29/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.13	0.17	1.90
3-Month LIBOR	0.66	0.66	2.68
1-Year Treasury	0.21	0.10	2.35
2-Year Treasury	0.92	0.88	2.68
5-Year Treasury	2.37	2.20	3.42
10-Year Treasury	3.50	3.45	4.08
30-Year Treasury	4.38	4.38	4.75
Bond Buyer Index	4.61	4.44	4.62

Foreign Exchange Rates

	Friday 5/29/2009	1 Week Ago	1 Year Ago
Euro ($/€)	1.412	1.400	1.552
British Pound ($/£)	1.616	1.593	1.977
British Pound (£/€)	0.874	0.879	0.785
Japanese Yen (¥/$)	95.455	94.783	105.505
Canadian Dollar (C$/$)	1.092	1.119	0.988
Swiss Franc (CHF/$)	1.069	1.086	1.049
Australian Dollar (US$/A$)	0.800	0.783	0.956
Mexican Peso (MXN/$)	13.176	13.190	10.329
Chinese Yuan (CNY/$)	6.829	6.823	6.938
Indian Rupee (INR/$)	47.091	47.131	42.785
Brazilian Real (BRL/$)	1.969	2.027	1.637
U.S. Dollar Index	79.429	80.558	73.023

Foreign Interest Rates

	Friday 5/29/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.27	1.26	4.86
3-Month Sterling LIBOR	1.28	1.30	5.86
3-Month Canadian LIBOR	0.70	0.73	3.35
3-Month Yen LIBOR	0.52	0.53	0.92
2-Year German	1.40	1.31	4.34
2-Year U.K.	1.09	1.05	5.12
2-Year Canadian	1.26	1.15	3.11
2-Year Japanese	0.36	0.36	0.90
10-Year German	3.59	3.55	4.43
10-Year U.K.	3.75	3.67	5.03
10-Year Canadian	3.42	3.26	3.72
10-Year Japanese	1.49	1.44	1.80

Commodity Prices

	Friday 5/29/2009	1 Week Ago	1 Year Ago
W. Texas Crude ($/Barrel)	66.00	61.05	126.62
Gold ($/Ounce)	978.68	957.35	877.90
Hot-Rolled Steel ($/S.Ton)	375.00	375.00	1080.00
Copper (¢/Pound)	219.85	205.40	356.90
Soybeans ($/Bushel)	11.85	11.75	13.48
Natural Gas ($/MMBTU)	3.90	3.60	11.47
Nickel ($/Metric Ton)	13,425	12,591	22,355
CRB Spot Inds.	381.55	384.03	503.00

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	1	2	3	4	5
U.S. Data	**ISM Manufacturing** April 40.1 May 40.3 (W) **Personal Income** March -0.3% April 0.1% (W) **Personal Spending** March -0.2% April 0.2% (W)	**Total Vehicle Sales** April 9.3M May 9.3M (W)	**ISM Non-Manufacturing** April 43.7 May 44.5 (W) **Factory Orders** March -0.9% April 0.5% (W)	**Nonfarm Productivity** 2009:1Q (Advance) 0.8% 2009:1Q (Prm.) 1.7% (W) **Unit Labor Cost** 2009:1Q (Advance) 3.3% 2009:1Q (Prm.) 2.0% (W)	**Nonfarm Payrolls** April -539K May -540K (W) **Unemployment Rate** April 8.9% May 9.4% (W)
Global Data	**UK** **PMI Manufacturing** Previous (Apr) 42.9 **Canada** **GDP** Previous (4Q) -3.4%		**UK** **PMI Services** Previous (Apr) 48.7 **Euro-zone** **GDP (QoQ)** Previous (4Q) -1.6%	**UK** **BOE Announces Rates** Previous 0.50% **Euro-zone** **ECB Announces Rates** Previous 1.00%	**Canada** **Change in Employment** Previous (Apr) 35.9K

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

Wachovia Economics Group

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