WACHOVIA
ECONOMICS GROUP

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

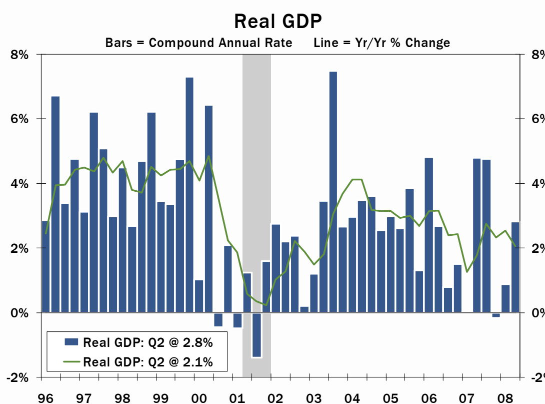
October 10, 2008

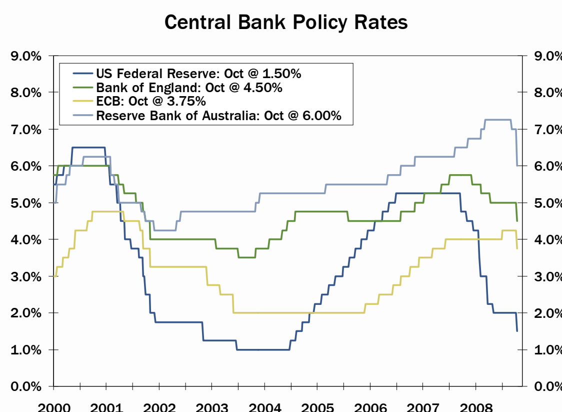
U.S. Review

Recession as the New Benchmark Outlook

Key economic signals of jobless claims, employment declines and a sharp dip in the Institute for Supply Management index have corroborated our model-based forecast for recession. The downturn that began last quarter (we expect a negative GDP report on October 30) will be followed by further declines in the third and fourth quarters. We expect the peak-to-trough decline in real GDP to total 1.5 – 2.0 percent, in line with the contraction registered during the 1990-91 recession. However, we expect that final sales to consumers and businesses will drop about three percent, which would be the largest decline since the 1981-1982 recession.

Consumer spending will be the big loser this cycle compared to the last recession. Job losses and higher gas prices have squeezed consumer confidence and spending—particularly on big tickets items, such as cars and household durable goods. Consumers are also scaling back purchases of smaller items and services. With persistent job pressures and lower wealth levels our expectation is that the recovery of 2009





Global Review

More Needs to Be Done to Unfreeze Credit Markets

On Wednesday, major central banks announced the first coordinated rate cut since the days following the terrorist attacks of September 2001. The Fed joined with central banks in Canada, the Euro-zone, Sweden and Switzerland by cutting respective policy rates by 50 basis points each (see chart at left). The People's Bank of China joined in the action by cutting its benchmark lending rate by 27 basis points, and the Reserve Bank of Australia had sliced its policy rate by 100 basis points earlier in the week.

If the objective of the coordinated rate cuts was to unfreeze the frozen credit markets, then the action largely failed. As shown in the top chart on page 4, three-month LIBOR rates continued to rise after the coordinated reductions in policy rates. U.S. dollar LIBOR rates remain especially elevated. In "normal" times, LIBOR rates are

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Recent Special Commentary

Date	Title	Authors
October-08	Housing Chartbook - October 2008	Vitner & York
October-08	Everyone Seems To Have Gotten The Message	Vitner & Bryson
September-25	Recession Probability Remains Very High	Silvia
September-22	Story Continues: No Bright Light Marking End of Sub-Par Growth	Silvia

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	-0.7	-3.0	-2.3	1.4	1.8	1.7	2.9	2.8	2.0	1.3	-0.5	1.9
Personal Consumption	0.9	1.2	-3.1	-1.6	-0.6	1.4	1.9	2.1	3.0	3.0	2.8	0.5	-0.2	2.1
Inflation Indicators [2]														
"Core" PCE Deflator	2.2	2.3	2.5	2.2	2.1	2.1	1.8	2.0	2.1	2.3	2.2	2.3	2.0	1.9
Consumer Price Index	4.2	4.3	5.3	3.4	2.5	1.7	0.8	2.0	3.4	3.2	2.9	4.3	1.7	2.4
Industrial Production [1]	0.4	-3.1	-2.4	-3.1	-1.9	0.3	1.6	2.4	3.3	2.2	1.7	-0.3	-1.2	2.5
Corporate Profits Before Taxes [2]	-1.5	-8.3	-7.5	-12.0	-4.0	0.0	8.0	9.2	17.6	15.2	-1.6	-7.3	3.1	8.5
Trade Weighted Dollar Index [3]	70.3	71.0	76.1	77.8	80.0	82.8	84.9	87.2	86.0	81.5	73.3	77.8	87.2	90.0
Unemployment Rate	4.9	5.3	6.0	6.4	6.8	7.1	7.4	7.7	5.1	4.6	4.6	5.7	7.3	8.0
Housing Starts [4]	1.05	1.03	0.91	0.82	0.78	0.78	0.80	0.86	2.07	1.81	1.34	0.95	0.80	1.09
Quarter-End Interest Rates														
Federal Funds Target Rate	2.25	2.00	2.00	1.00	0.75	0.75	0.75	0.75	4.25	5.25	4.25	1.00	0.75	2.00
10 Year Note	3.45	3.99	3.85	3.70	3.80	3.90	3.90	4.00	4.39	4.71	4.04	3.70	4.00	4.20

Data As of: October 8, 2008
[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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will be characterized by less of a consumer boom than was typical in prior recoveries.

Business investment spending will likely be on a downward slide through the next four quarters. Equipment spending will be hampered by weak profits, lower final sales expectations and very limited credit supply. Non-residential investment is expected to go through its late cycle recession pattern. Housing remains in its long-term correction to the overbuilding in the past. Even in the recovery of 2009, the longer run pressures of overbuilding will limit any housing recovery to a below historical pace. State and local government spending will also come under increased pressure as tax revenues decline and interest costs rise. Net exports should continue to grow into 2009. While the size of the contribution will be less than in 2008, the gains from trade in 2009 will be the bright spot for the economy.

Unemployment, Inflation and the New Benchmark for Risk

The economic downturn will likely drive the unemployment rate higher than the current consensus expects and cut deeply into personal income growth. The current environment will produce one positive outcome – inflation will moderate and energy prices will fall significantly. Lower inflation will allow the Federal Reserve to follow a more accommodative monetary policy, with 50 to 75 basis points of further easing likely.

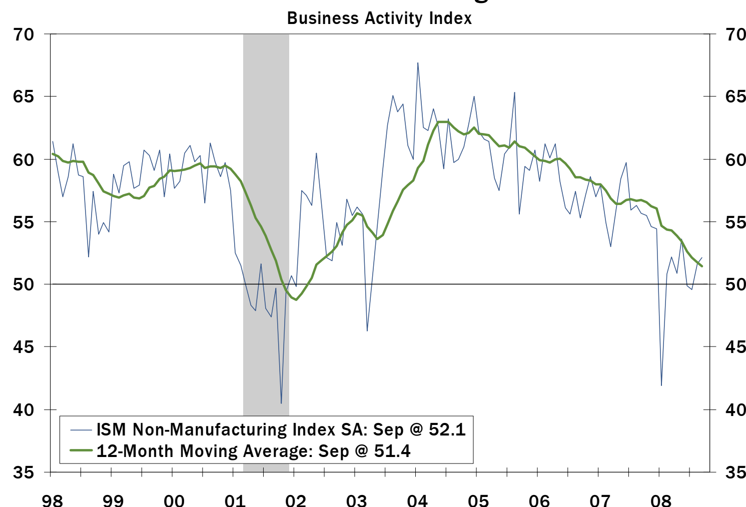
Increased volatility in the financial markets is not only dominating the headlines but also dramatically reshaping the economic outlook. Capital is much harder to come by today for even the strongest of credits and this is already having a debilitating impact on consumer spending, business fixed investment and employment. The heart of the crisis is the lack of transparency (the lemons problem) in complicated financial instruments, which makes it difficult to value certain assets and to determine the creditworthiness of certain financial and non-financial businesses.

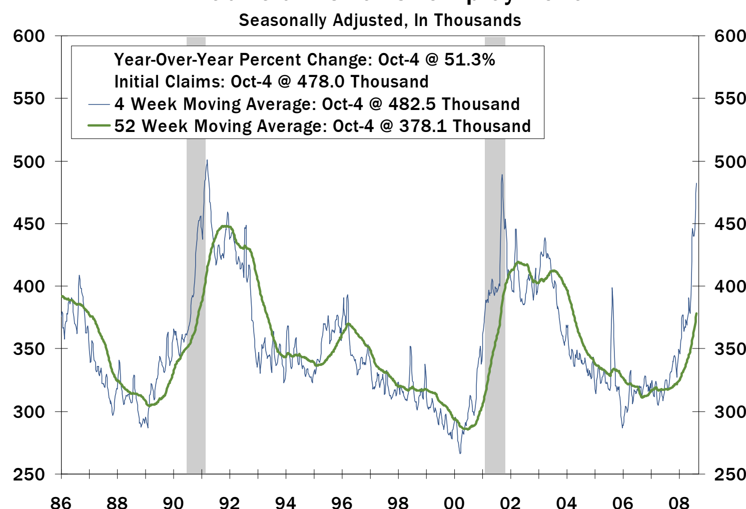
Preparing for Recovery

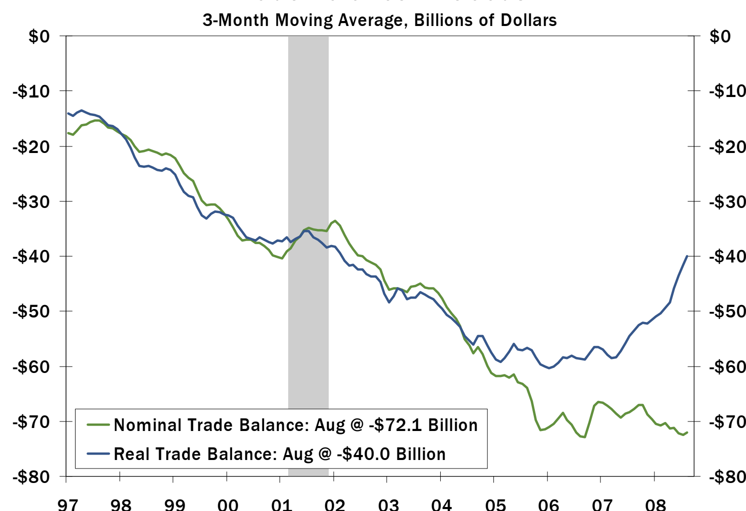
But more than that, the role of credit will define the amplitude and breadth of the economic recovery. Sectors such as housing, commercial real estate and consumer durables are likely to have weaker than normal recoveries, reflecting the problems associated with deleveraging the economy and the loss of purchasing power on the part of the consumer. Meanwhile, exports will take on the role of the water carrier for the economy. At least for 2009, our expectation is that credit will remain tight and inflation modest but persistent. There is no quick fix for the economy for the credit excesses of the last 20 years.

Selected Current Data

Gross Domestic Product - CAGR	Q2 - 2008	2.8%
GDP Year-over-Year	Q2 - 2008	2.1%
Personal Consumption	Q2 - 2008	1.2%
Business Fixed Investment	Q2 - 2008	2.5%
Consumer Price Index	August - 2008	5.4%
"Core" CPI	August - 2008	2.5%
"Core" PCE Deflator	August - 2008	2.6%
Industrial Production	August - 2008	-1.5%
Unemployment	September - 2008	6.1%
Federal Funds Target Rate	Oct - 10	1.50%







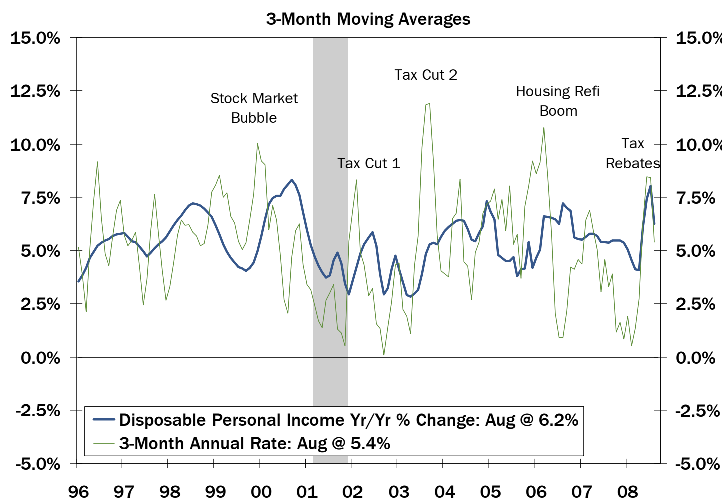
Retail Sales • Wednesday

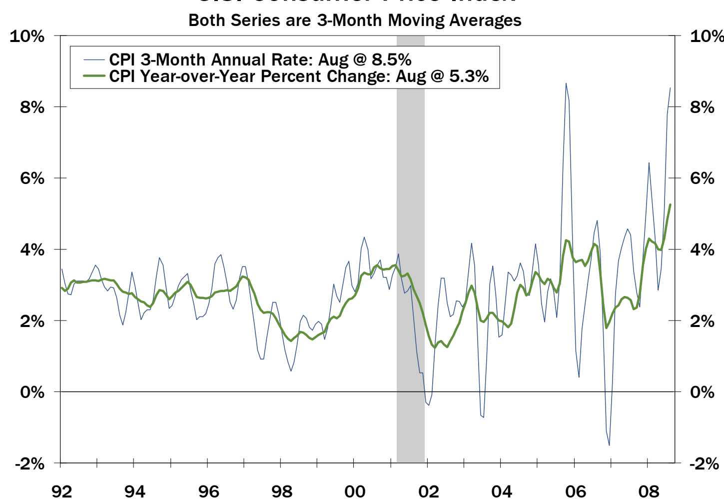
Advance Retail Sales should decline for the third consecutive month with broad-based weakness across retailers as consumers increasingly pull back from discretionary spending. Retail sales excluding the volatile auto sector are also expected to decline. Moderating income growth and a weakening labor market are continuing to put downward pressure on household balance sheets leaving consumers seeking bargains. Discounters and wholesale clubs should be the only bright spots. Hurricanes also put additional stress on retailers, disrupting operations in many parts of the country.

The weakness in retail sales means that consumer spending will almost certainly decline in the coming quarters and could be a harbinger of real trouble this holiday season.

Previous: -0.3% **Wachovia: -0.4%**

Consensus: -0.5%





Consumer Price Index • Thursday

Consumer price inflation moderated significantly in August, with the overall CPI declining 0.1 percent and prices excluding food and energy items rising just 0.2 percent. We expect headline CPI to increase modestly in September with food prices remaining one of the notable problem areas. However, the decline in gasoline prices should keep headline inflation at bay even with the effects of Hurricane Ike putting short-term upward pressure on prices at the pump.

Core prices are also expected to post a modest increase as weak motor vehicle prices, apparel and shelter costs help offset increases in medical care and airline tickets. With commodities falling and global economic growth slowing, inflation should continue to moderate in coming months.

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

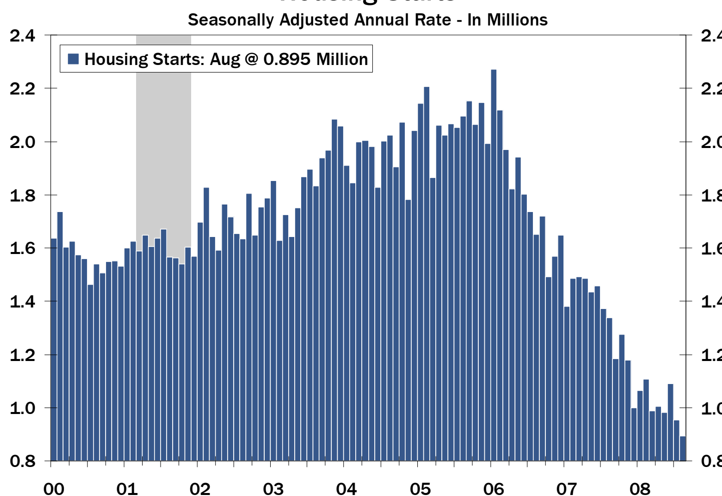
Consensus: 0.1%

Housing Starts • Friday

Single-family activity has been on a steady downtrend for several years. While the pace of declines has moderated during the past couple of months there is clearly room for further declines. We have lowered our forecast for new construction activity significantly as the credit crisis continues to hit builders. The lack of credit for buyers and builders, along with the onset of a recession, should push starts down an additional 10 to 15 percent before bottoming out sometime in the first half of 2009. Single-family markets should bear the brunt of the declines, but multi-family starts will trend lower as well.

Previous: 895K **Wachovia: 895K**

Consensus: 880K



Global Review

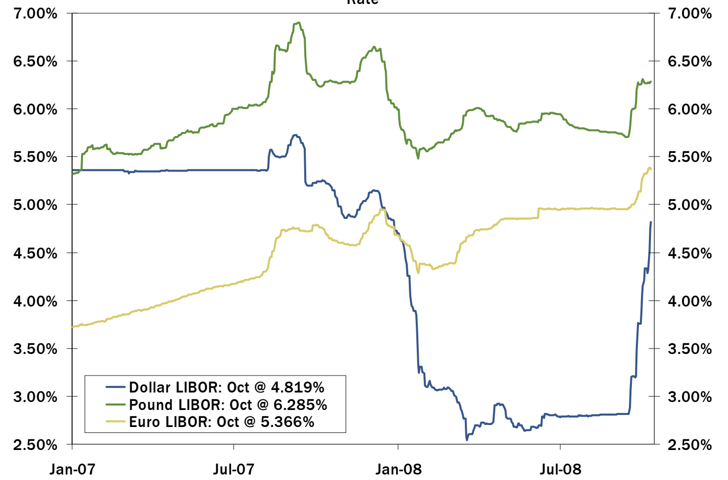
(Continued from Page 1)

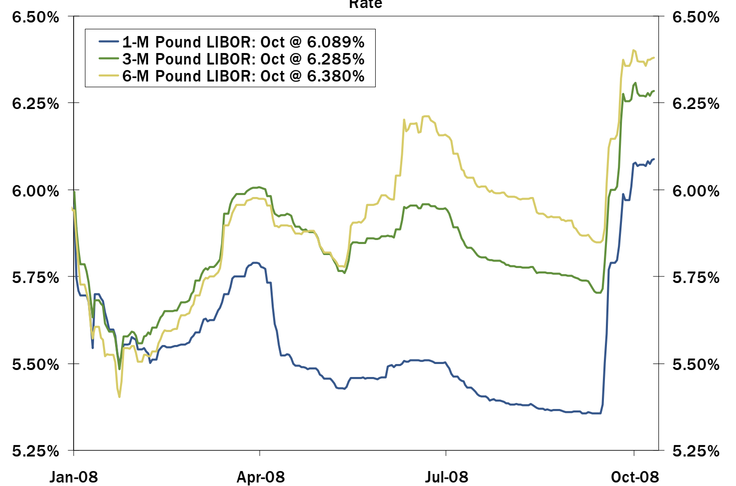
usually just a few basis points above central bank policy rates. Times are hardly normal. For example, the U.S. dollar 3-month LIBOR rate is now more than 325 basis points above the fed funds rate of 1.50 percent. The unprecedented elevation of LIBOR rates relative to central bank policy rates reveals the reluctance of banks to lend to each other.

If coordinated rate cuts are not helping, then what needs to be done to unfreeze credit markets? A closer look at sterling LIBOR rates is instructive (see middle chart). Although sterling LIBOR rates remain elevated, they have not jumped even like dollar LIBOR rates over the past week or so. The relative stability of sterling rates perhaps reflects policy actions that British authorities have announced. The government took the extraordinary step to recapitalize the British banking system by buying up to £50 billion (about $90 billion) in preferred shares. It also will provide a guarantee for bonds issued by British banks worth £250 billion (about $440 billion). These steps should give some assurances to nervous bankers that their counterparts will still be solvent and able to repay when loans mature in a few months.

Similar extraordinary actions may be needed in other countries, including the United States. Fortuitously, finance ministers and central bank governors of the G-7 countries are holding a regularly scheduled meeting this weekend. Perhaps these officials will announce coordinated measures to strengthen the international financial system, perhaps by recapitalizing the banking system in each country. This is a global financial crisis and coordinated global action will be required to end it.

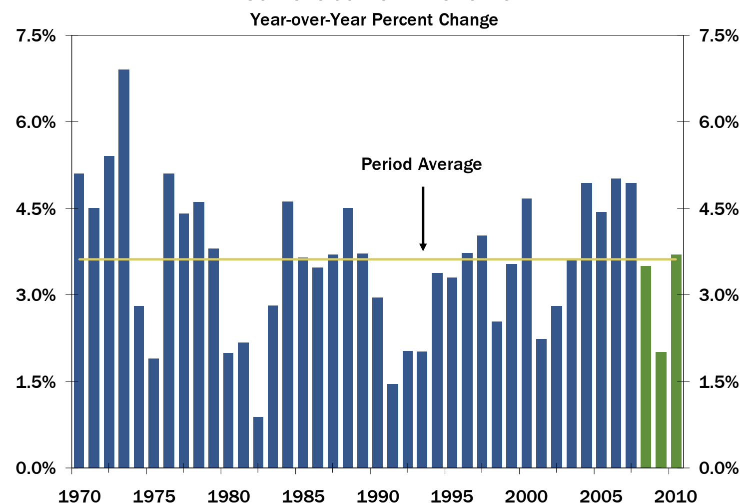
Failure to put out the fire that is engulfing the global financial system would produce an economic calamity. We recently revised our global forecast. (See our *Monthly Economic Outlook*, which is posted at www.wachovia.com/economics.) We now project that global GDP will grow only two percent next year. Not only would this sluggish growth rate qualify as a global recession, but it would also be the slowest year of global growth since the early 1990's (see bottom chart). Underlying our projection of global growth is our assumption that authorities will take the steps necessary to stabilize the global financial system. Failure to do so probably would lead to the deepest global recession in the post-World War II era.





Selected Global Data

Japan	GDP Year-over-Year	Q2 - 2008	0.7%
	CPI	August - 2008	2.1%
	Unemployment	August - 2008	4.2%
	BoJ Target Rate	Oct - 10	0.50%
Euro-Zone	GDP Year-over-Year	Q2 - 2008	1.4%
	CPI	August - 2008	3.8%
	Unemployment	August - 2008	7.5%
	ECB Target Rate	Nov - 06	3.75%
UK	GDP Year-over-Year	Q2 - 2008	1.5%
	CPI	August - 2008	4.7%
	Unemployment	August - 2008	2.8%
	BoE Target Rate	Oct - 10	4.50%
Canada	GDP Year-over-Year	July - 2008	1.2%
	CPI	August - 2008	3.5%
	Unemployment	September - 2008	6.1%
	BoC Target Rate	Oct - 10	2.50%



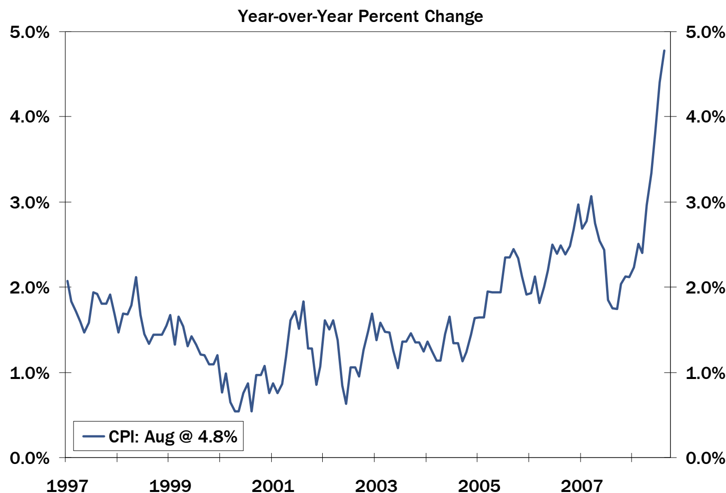
U.K. CPI Inflation • Tuesday

The sharp rise in energy prices earlier this year has caused inflation to shoot up in the United Kingdom. Although the current CPI inflation rate is well above the Bank of England's two percent target rate, the Bank joined other major central banks this week in a coordinated move to cut interest rates. Although the consensus forecast anticipates that the inflation rate climbed even higher in September, inflation should soon recede due to the marked decline in energy prices since July and to the incipient British recession. Declining inflation will give the Bank scope to ease further in the months ahead.

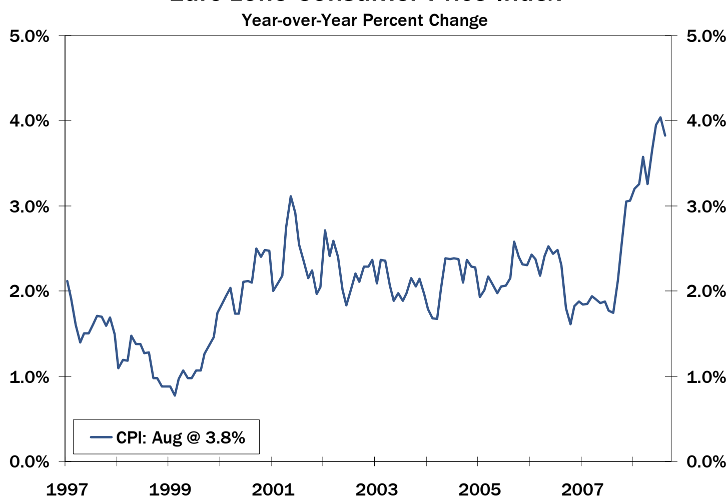
Labor market data will also be released next week. The economy is slowing rapidly, so it is only a matter of time before unemployment begins to rise. Indeed, most investors look for an increase in the unemployment rate in September.

Previous: 4.7% (year-over-year)

Consensus: 5.0%



Euro-zone CPI Inflation • Wednesday



CPI inflation in the Euro-zone has risen well above the 2 percent rate that the ECB considers to be consistent with "price stability." Nevertheless, the ECB joined other major central banks this week in a coordinated move to cut interest rates. Because growth is slowing quickly and energy prices have dropped significantly, ECB policymakers reckoned that inflation will continue to recede in the months ahead. A benign reading on the core rate of inflation could open the door for another ECB rate cut next month.

Data on Euro-zone industrial production in August will print on Tuesday. Although the consensus forecast anticipates that industrial production rose 1.1 percent in August relative to the previous month, growth should slow markedly in the months ahead.

Previous: 3.8% (year-over-year)

Consensus: 3.6%

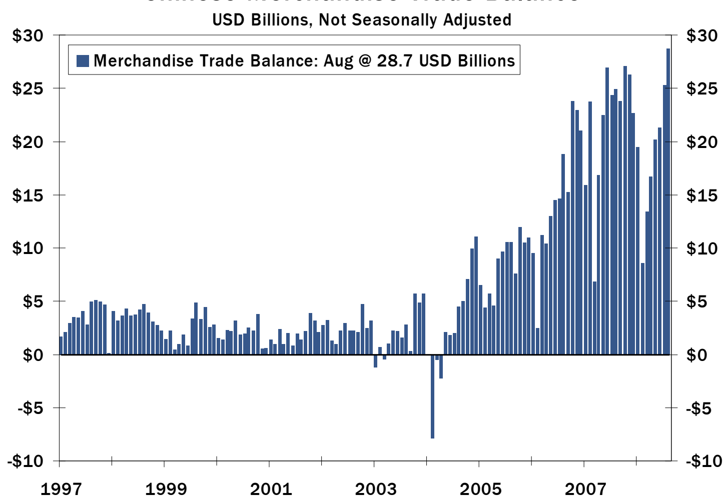
Chinese Trade Balance

Although the Chinese trade surplus jumped to a record in August, the overall surplus for the first eight months of the year is about 7 percent lower than it was during the same period last year. The market consensus forecast looks for a significantly lower surplus in September than in August, and the trade balance should narrow further in the months ahead as slower economic growth in the rest of the world weighs on Chinese export growth.

Other September data releases next week include foreign direct investment and the money supply. This data, in conjunction with some other releases the following week, should give investors insights into how the Chinese economy fared during the third quarter.

Previous: $28.6 billion

Consensus: $23.4 billion



Interest Rate Watch

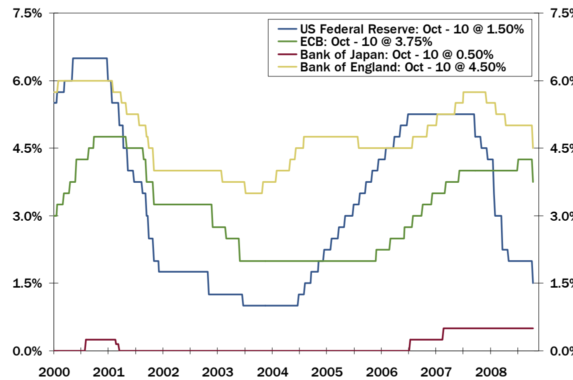
Solvency Trumps Liquidity in an Uncertain Economy

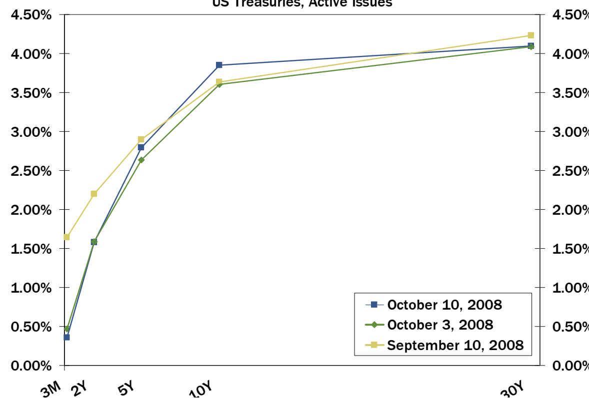
Easier Federal Reserve policy this week and expected further easing ahead does provide liquidity to the capital markets. But as outlined in our global outlook, the questions on capital and solvency appear to be the driving factors in credit markets right now. Volatility in the financial markets reflects the inability to properly assess capital adequacy and counterparty risk in an environment where information on the proper price of financial assets is practically impossible to gather. Capital is much harder to come by today for even the strongest of credits and this is already having a debilitating impact on consumer spending, business fixed investment and employment.

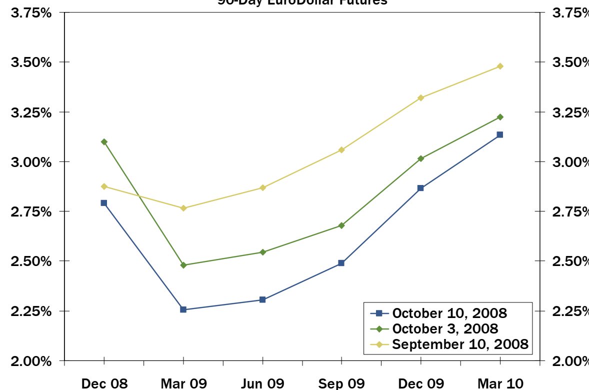
Financial markets cannot properly price assets due to the lack of transparency in complicated financial instruments. Financial instruments are difficult to value and credit quality perceptions change daily. Therefore commercial paper issuance and trading had dried up even though this paper has been among the most liquid and tradable instruments in the past.

Less Credit at any Rate for Private Credits

At the long end of the yield curve, credit is feeling the pinch too. Interest rates on conventional home mortgages are around three-quarters of a percentage point higher than they should be and qualifications for a home mortgage have swung from much too easy to far too tight. Home equity lines have also been scaled back and in some cases, credit card limits have been cut. The troubles in the commercial paper market have been particularly bad news for the auto sector, with dealer financing and buyer financing both drying up.







Topic of the Week

U.S. Commercial Paper Market Continues to Decline

The U.S. commercial paper market declined by $56.4 billion for the week ending Wednesday, the fourth consecutive week of declines and the lowest level since August 2005. The preceding week, commercial paper registered a decline of $94.9 billion the largest weekly decline recorded since the Federal Reserve began tracking the data series in 2001.

Many investors, in particular money market mutual funds, are reluctant to purchase commercial paper due to liquidity pressures and market uncertainty. In a recent release announcing the Commercial Paper Funding Facility (CPFF), the Federal Reserve noted, "…the volume of outstanding commercial paper has shrunk, interest rates on longer-term commercial paper have increased significantly, and an increasingly high percentage of outstanding paper must now be refinanced each day.

The CPFF will provide a liquidity backstop to U.S. issuers of commercial paper through a special purpose vehicle (SPV) that will purchase three-month unsecured and asset-backed commercial paper directly from eligible issuers. Commercial paper purchased by the SPV must be rated at least A1/P1/F1. Commercial paper that is not asset-backed can be secured with up-front fees paid by the issuer or with other forms of collateral.

The Federal Reserve also stated, "By eliminating much of the risk that eligible issuers will not be able to repay investors by rolling over their maturing commercial paper obligations, this facility should encourage investors to once again engage in term lending in the commercial paper market. "

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 10/10/2008	1 Week Ago	1 Year Ago
3-Month T-Bill	0.18	0.47	4.04
3-Month LIBOR	4.82	4.33	5.25
1-Year Treasury	1.22	1.22	4.03
2-Year Treasury	1.63	1.58	4.14
5-Year Treasury	2.76	2.63	4.37
10-Year Treasury	3.87	3.60	4.65
30-Year Treasury	4.14	4.09	4.87
Bond Buyer Index	5.47	5.36	4.48

Foreign Exchange Rates

	Friday 10/10/2008	1 Week Ago	1 Year Ago
Euro ($/€)	1.331	1.377	1.415
British Pound ($/£)	1.690	1.771	2.043
British Pound (£/€)	0.787	0.778	0.693
Japanese Yen (¥/$)	99.750	105.320	117.245
Canadian Dollar (C$/$)	1.203	1.083	0.982
Swiss Franc (CHF/$)	1.140	1.128	1.183
Australian Dollar (US$/A$)	0.636	0.774	0.898
Mexican Peso (MXN/$)	13.198	11.255	10.826
Chinese Yuan (CNY/$)	6.836	6.847	7.511
Indian Rupee (INR/$)	48.470	47.063	39.315
Brazilian Real (BRL/$)	2.313	2.044	1.804
U.S. Dollar Index	82.989	80.313	78.375

Foreign Interest Rates

	Friday 10/10/2008	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	5.37	5.33	4.74
3-Month Sterling LIBOR	6.29	6.27	6.27
3-Month Canadian LIBOR	3.80	4.20	4.97
3-Month Yen LIBOR	1.08	1.03	1.01
2-Year German	3.04	3.28	4.07
2-Year U.K.	3.53	4.03	5.25
2-Year Canadian	2.22	2.52	4.37
2-Year Japanese	0.85	0.74	0.91
10-Year German	4.00	3.92	4.35
10-Year U.K.	4.47	4.41	4.98
10-Year Canadian	3.79	3.59	4.45
10-Year Japanese	1.53	1.46	1.74

Commodity Prices

	Friday 10/10/2008	1 Week Ago	1 Year Ago
W. Texas Crude ($/Barrel)	79.59	93.88	81.30
Gold ($/Ounce)	839.84	835.50	741.10
Hot-Rolled Steel ($/S.Ton)	940.00	940.00	520.00
Copper (¢/Pound)	215.65	270.50	367.60
Soybeans ($/Bushel)	9.25	9.42	8.98
Natural Gas ($/MMBTU)	6.61	7.36	7.01
Nickel ($/Metric Ton)	13,200	15,070	30,350
CRB Spot Inds.	414.34	436.56	489.72

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	11	**12**	**13**	**14**	**15**
U.S. Data	**Factory Orders** Mar 3.5% Apr 0.6% (c)	**ISM Non-Manufacturing** Apr 56.0 May 55.8 (W)	**Non-Farm Productivity** 1QP 1.7% 1QF 1.1% (W) **Unit Labor Costs** 1QP 0.6% 1QF 1.3% (c)	**Consumer Credit** Mar $13.5B Apr $6.0 (c) **Wholesale Inventories** Mar 0.3% Apr 0.3% (W)	**International Trade** Mar: -$63.9B Apr: -$63.5B (W)
Global Data			**Euro-zone** **Policy Rate** Previous - May: 3.75%	**U.K.** **Policy Rates** Previous - May: 5.50%	**Japan** **Machine Orders (MoM)** Previous - Mar: -4.5% **Canada** **Unemployment Rate** Previous - Apr: 6.1%

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

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