WACHOVIA

ECONOMICS GROUP

WEEKLY ECONOMIC & FINANCIAL COMMENTARY

September 26, 2008

U.S. Review

A Recession Looks More Likely

While the financial markets have garnered most of the attention this week, the economic numbers continue to come in weaker than expected. We now have a whole host of data consistent with the onset of a recession. We still expect real GDP to be slightly positive in the third quarter but the fourth quarter looks to be in negative territory, and the first quarter of 2009 may be down as well.

We update our forecast the week after the employment report. We still have about ten days to gather more data and refine our estimates. Most recent data, however, have been to the downside.

This week's major reports included a much larger than expected jump in weekly first-time unemployment claims to 493,000, a huge 4.5 percent drop in advance orders for durable goods and shipments, and a much steeper than expected 11.5 percent drop in sales of new homes. In addition, second quarter real GDP growth was revised down by a half percentage point to a 2.8 percent annual rate. Taken together, these numbers, along with the credit crisis, set an ominous tone for the second half of the year.

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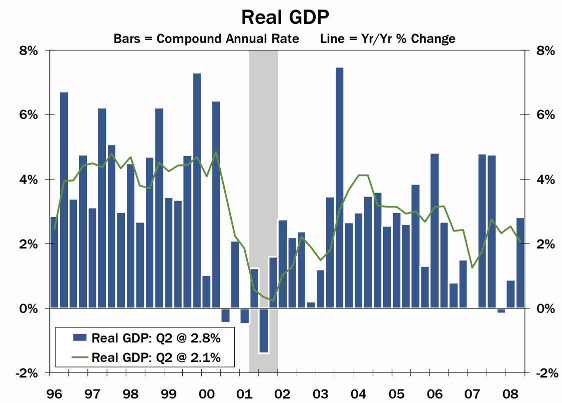

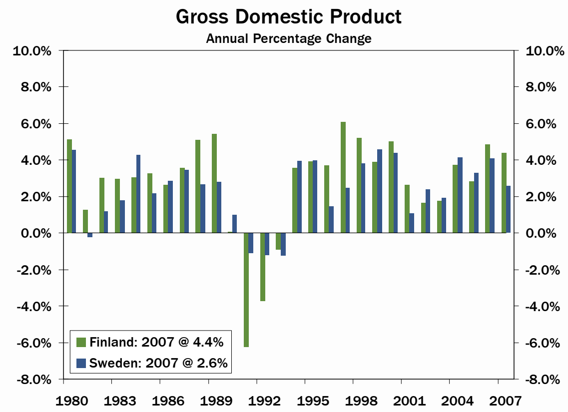

Global Review

Financial Crises in Historical Context

As Congress debates Treasury Secretary Paulson's plan to purchase up to $700 billion of troubled assets from the financial system, critics charge that the government should not be bailing out the private sector for its past mistakes while proponents warn of dire economic consequences if the plan is not adopted. How have other major countries fared in the past in the face of their own financial crises?

The banking system in Scandinavia blew apart in the early 1990s. Deregulation during the previous decade led to lax lending standards and under-capitalization of banking systems in those countries. However, the immediate catalyst for the crisis was the collapse of the Soviet Union that led to steep declines in Scandinavian exports. As those economies slipped into recession, loans started to go bad,

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Recent Special Commentary

Date	Title	Authors
September-25	Recession Probability Remains Very High	Silvia
September-22	Story Continues: No Bright Light Marking End of Sub-Par Growth	Silvia
September-22	Implications of the Treasury's Plan for the Dollar	Bryson
September-18	Global Central Banks Work to Soothe Fears	Vitner

U.S. Forecast

	Actual						Forecast		Actual			Forecast		
	2007				2008				2005	2006	2007	2008	2009	2010
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
Real Gross Domestic Product [1]	0.0	4.8	4.8	-0.2	0.9	3.3	0.8	0.8	2.9	2.8	2.0	1.8	1.8	2.2
Personal Consumption	3.9	2.0	2.0	1.0	0.9	1.7	-0.8	-0.3	3.0	3.0	2.8	1.0	0.9	2.1
Inflation Indicators [2]														
"Core" PCE Deflator	2.3	2.1	2.0	2.2	2.2	2.2	2.3	2.0	2.1	2.3	2.2	2.2	1.9	1.9
Consumer Price Index	2.4	2.6	2.4	4.0	4.2	4.3	5.0	3.3	3.4	3.2	2.9	4.2	2.0	1.9
Industrial Production [1]	1.5	3.2	3.6	0.3	0.4	-3.2	1.7	2.0	3.3	2.2	1.7	0.5	2.2	3.3
Corporate Profits Before Taxes[2]	-1.0	-0.5	-2.7	-2.0	-1.5	-7.0	-7.5	-11.0	17.6	15.2	-1.6	-6.7	4.9	8.5
Trade Weighted Dollar Index[3]	80.5	78.7	74.4	73.3	70.3	71.0	75.6	77.4	86.0	81.5	73.3	77.4	86.0	91.0
Unemployment Rate	4.5	4.5	4.7	4.8	4.9	5.3	6.0	6.2	5.1	4.6	4.6	5.6	6.7	7.4
Housing Starts[4]	1.45	1.46	1.30	1.15	1.05	1.02	0.95	0.92	2.07	1.81	1.34	0.99	1.00	1.30
Quarter-End Interest Rates														
Federal Funds Target Rate	5.25	5.25	4.75	4.25	2.25	2.00	2.00	2.00	4.25	5.25	4.25	2.00	2.00	2.00
10 Year Note	4.65	5.03	4.59	4.04	3.45	3.99	3.70	3.80	4.39	4.71	4.04	3.80	4.10	4.30

Data As of: September 10, 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

INSIDE

U.S. Review

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The Credit Crunch is Weighing on the Economy

Political officials are debating the merits of the Treasury's financial rescue package. Much of the objection about the program arises from the legitimate concerns about taxpayers bailing out Wall Street. Such concerns miss one vital point - the time for bailing out Wall Street has already passed. The two largest remaining investment banks converted to bank holding companies earlier this past week and several other firms have either been sold or shut down. The concern now is from keeping Wall Street's troubles from further affecting Main Street.

The credit crunch is already having a debilitating impact on Main Street. Several retailers, restaurant chains, manufacturers, car dealers, and wholesalers have already shut their doors because they were denied access to capital. These shutdowns have resulted in significant job losses, which have pushed the unemployment rate back up to highs seen in the aftermath of the 2001 recession. Credit conditions have tightened further in recent weeks, affecting even more firms and also making it more difficult for consumers to qualify for home mortgage and automobile loans.

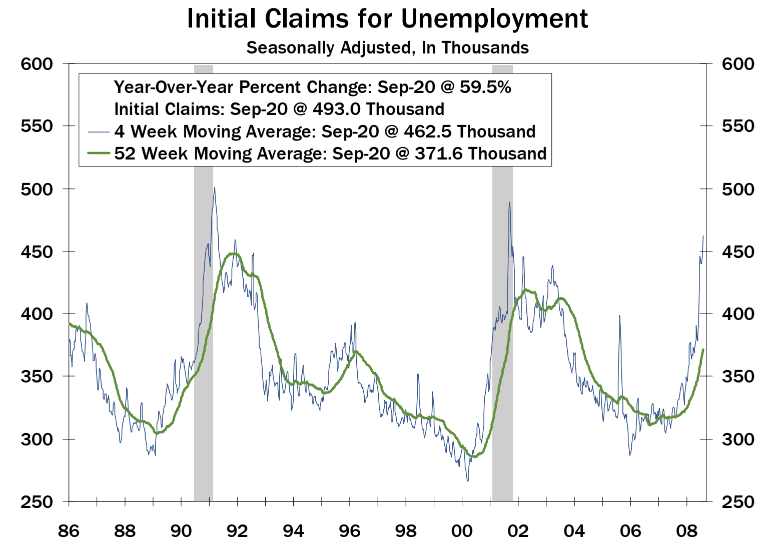
The impact of the credit crunch was clearly evident in recent economic reports. First-time claims for unemployment insurance have clearly accelerated since the onset of the credit crunch. While the numbers have been muddled by the recent hurricanes and the extension of unemployment insurance benefits, the recent spike is simply too much to dismiss. The Labor Department's report on Mass Layoffs shows mass layoff announcements soaring to their highest level since Hurricane Katrina. Unlike the earlier spike, however, the most recent rise has occurred over several months and across a much broader assortment of industries.

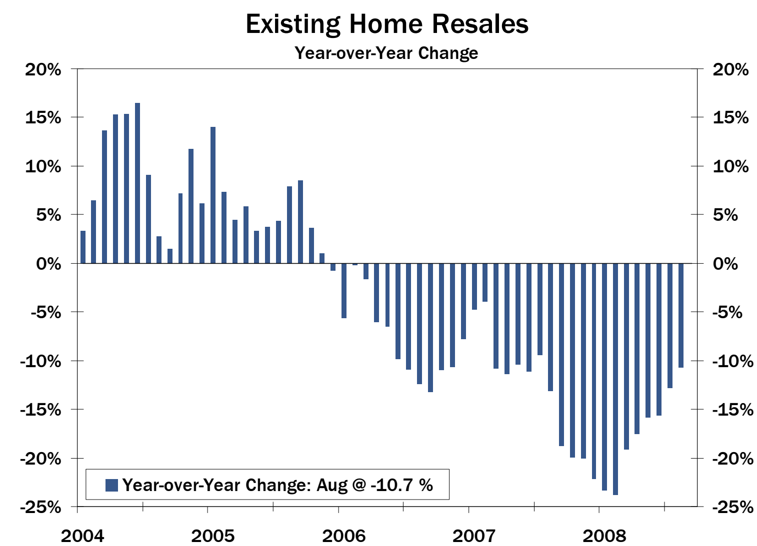
The home sales data also show some contagion from the credit crunch. Sales of existing homes fell 2.2 percent and new home sales tumbled 11.5 percent in August, bringing sales back down to their lowest level since 1991. The weakness in home sales, particularly in light of the firmer pending home sales figures and various surveys of home buying intentions, likely signals that homebuyers are having more difficulty qualifying for home mortgages. That could spell even more trouble for sales in September and October, when the credit crunch really hits.

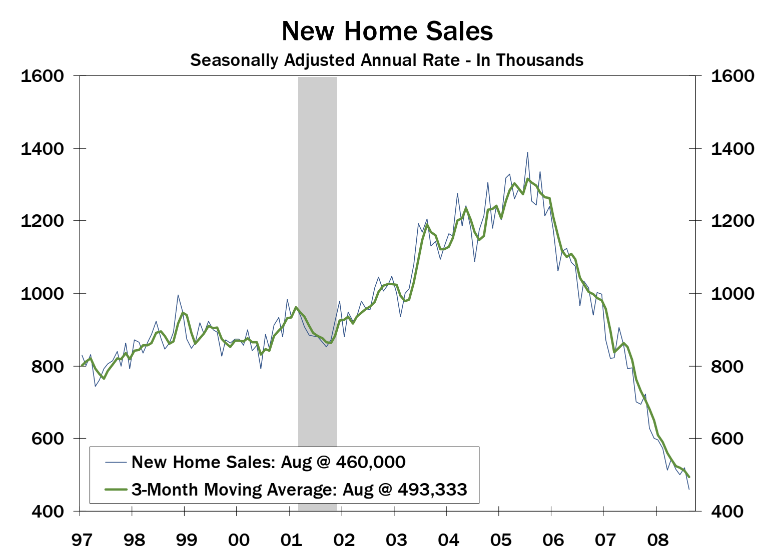
Advance orders for durable goods are also likely being restrained by credit conditions. With financing harder to come by, firms are hoarding capital by putting off expansion plans and scaling back hiring. This should become even more evident when the September jobs figures are reported next week.

Selected Current Data

Gross Domestic Product - CAGR	Q2 - 2008	3.3%
GDP Year-over-Year	Q2 - 2008	2.2%
Personal Consumption	Q2 - 2008	1.7%
Business Fixed Investment	Q2 - 2008	2.2%
Consumer Price Index	August - 2008	5.4%
"Core" CPI	August - 2008	2.5%
"Core" PCE Deflator	July - 2008	2.4%
Industrial Production	August - 2008	-1.5%
Unemployment	August - 2008	6.1%
Federal Funds Target Rate	Sep - 25	2.00%





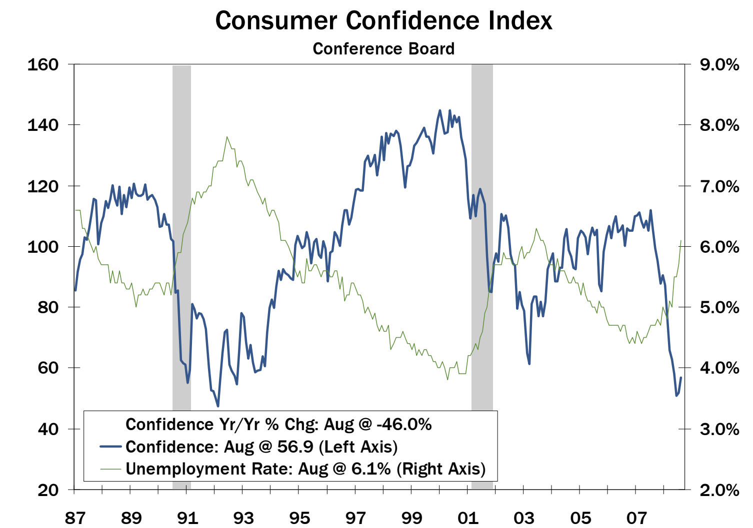


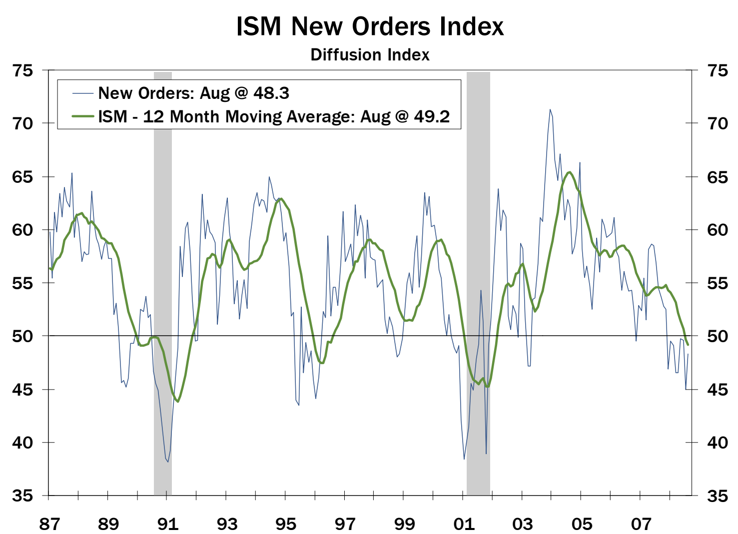
Consumer Confidence • Tuesday

The health of the labor market has historically been a good proxy for this measure of consumer confidence. Nonfarm payrolls have declined for eight consecutive months while the unemployment rate jumped to 6.1 percent in August after starting the year at 4.9 percent. As seen in the top chart, the Conference Board's measure of consumer confidence has dropped to extremely low levels. Since last month's report we have received mixed data regarding the consumer. Initial claims, a forward looking indicator for changes in nonfarm payrolls, has remained elevated suggesting the labor market continues to struggle. Gasoline prices, however, have come off recent highs despite the landfall of Hurricanes Gustav and Ike in the Gulf and could provide an upside surprise. That being said, confidence, in general, should remain depressed given all the headwinds facing the consumer these days. As such, we expect consumer spending to contract in the second half of the year.

Previous: 56.9 **Wachovia: 60.0**

Consensus: 55.0





ISM Manufacturing Index • Wednesday

After waning earlier this year, the Institute for Supply Management's manufacturing index has firmed in recent months. The headline index slipped to 49.9 in August from 50.0 in July. Year-to-date, the ISM manufacturing index has averaged just slightly below the expansion/contraction line at 49.5 – not bad considering the current economic environment.

The regional purchasing manager reports have been mixed so far in September (Philly up, Empire State down). Motor vehicle production likely dropped sharply again in September and as a result, we expect to see a slight decline in the headline ISM manufacturing index to 49.8 in September. The prices index should continue to trend lower as commodity prices in general moderated over the past month.

Previous: 49.9 **Wachovia: 49.8**

Consensus: 49.5

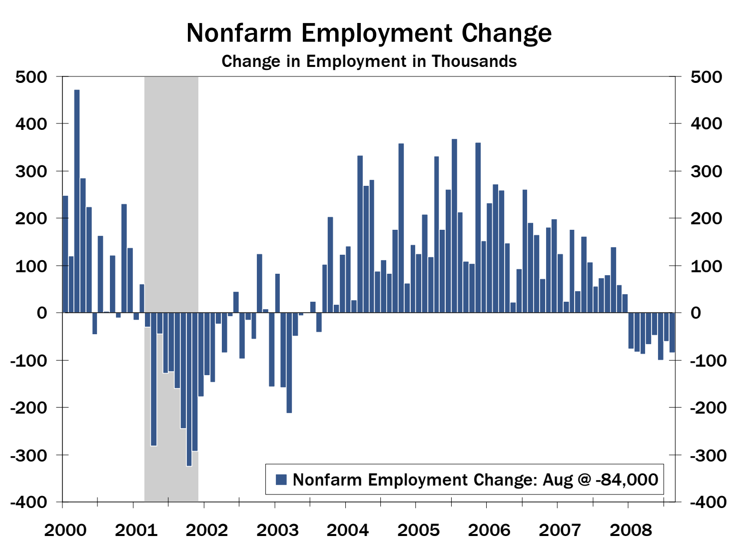
Employment Report • Friday

Nonfarm payroll employment should fall for a ninth consecutive month in September. Initial and continuing claims for unemployment benefits have continued to deteriorate since the August report. While some of that pickup, is attributable to the benefits extension issues as well as the recent Hurricanes Gustav and Ike, the fundamentals for employment growth remain weak and will likely intensify for many months to come. Losses should continue in manufacturing, construction, and financial services. Gains in health care and the government should continue to partially offset some of the weakness.

We expect the unemployment rate to slip slightly to 6.0 percent in September but that respite should not last long. The labor picture should continue to deteriorate as the economy on whole weakens. By the end of 2009, we see the unemployment rate reaching 7.5 percent.

Previous: -84K **Wachovia: -150K**

Consensus: -105K



Global Review

(Continued from Page 1)

which led to many bank failures. As bank lending shriveled up, Scandinavian economies slipped further into recession.

How bad did it get? The chart on the front page shows that the Finnish economy was hammered in the early 1990s. Between late 1989 and mid-1993 real GDP in Finland contracted 12 percent. (Between 1973-Q4 and 1975-Q1 U.S. GDP dropped "only" three percent, making it the deepest U.S. recession in the last forty years.) Sweden did not fare as poorly as its neighbor, but real GDP still contracted about four percent in the early 1990s. The top chart shows that the Finnish unemployment rate shot up from three percent in 1990 to 16 percent in 1993. In Sweden, the unemployment rate breached nine percent.

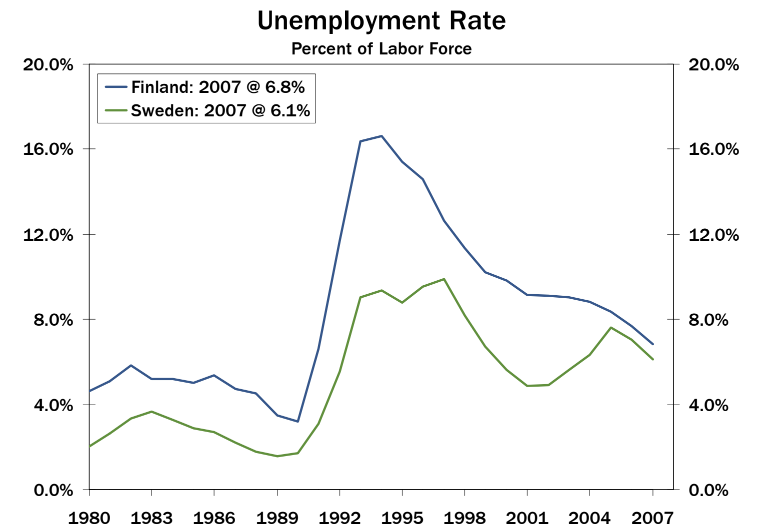
The bursting of land and stock market bubbles in Japan in 1990 led to extreme weakness in the Japanese banking system. As shown in the middle chart, Japanese GDP growth did not slip into negative territory on a sustained basis. However, the Japanese economy has never been the same. Between 1980 and 1990, real GDP growth averaged about four percent per annum. Since the bubbles broke, the annual growth has slipped to only 1.4 percent per annum. Moreover, the economy contracted a mild case of deflation in the late-1990s, from which it has not really escaped.

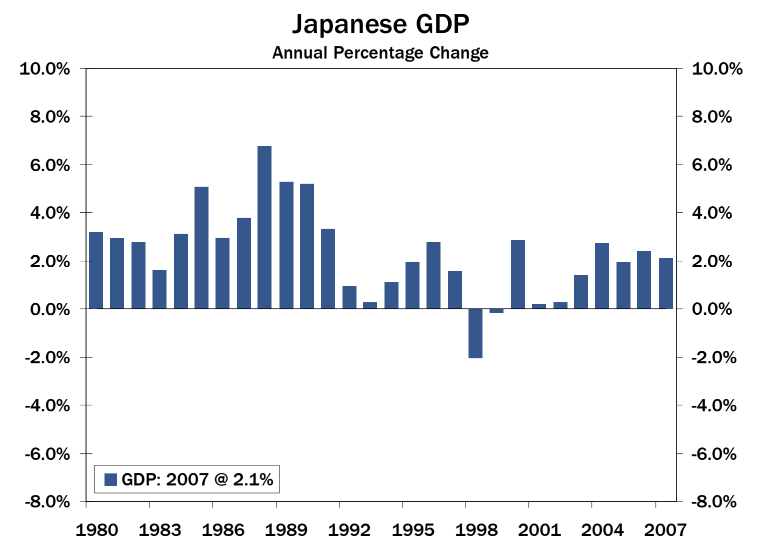
Many Asian countries experienced their own financial crises in 1997-98 that led to significant recessions in those countries. For example, real GDP in Korea contracted nine percent between late 1997 and mid-1998 (see bottom chart). The unemployment rate in Korea shot up from two percent to seven percent. Indonesia, where the banking system essentially collapsed, suffered a 13 percent decline in real GDP between 1997 and 1998.

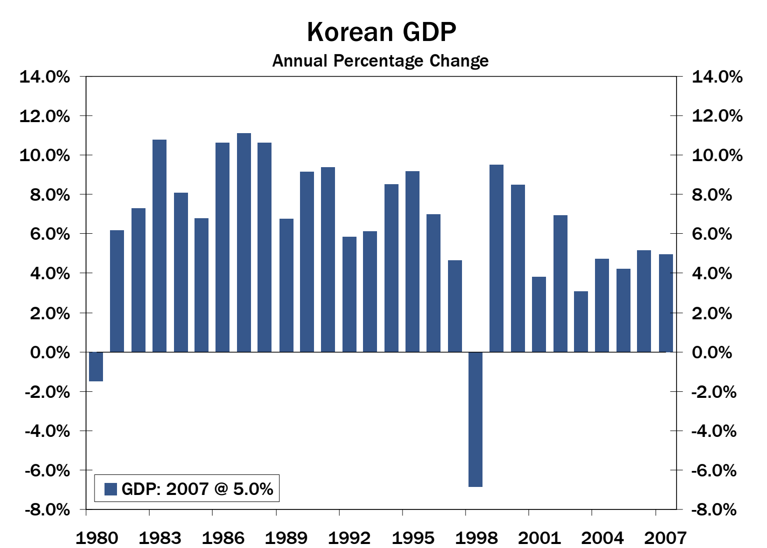
The bottom line is that financial crises are usually associated with large hits to economic activity. In some cases, sharp recessions and significant increases in unemployment follow (e.g. Scandinavia and Korea). In other cases, sharp recessions do not occur, but the economy remains stagnant for a number of years (e.g. Japan). It is not for us to state what Congress "should" do. That is a value judgment. However, a failure to enact some package of support to the financial system, whether as proposed by Secretary Paulson or modified by Congress, would pose significant downside risks to the U.S. economy.

Selected Global Data

Japan	GDP Year-over-Year	Q1 - 2007	2.0%
	CPI	April - 2007	0.0%
	Unemployment	April - 2007	3.8%
	BoJ Target Rate	Jun - 05	0.50%
Euro-Zone	GDP Year-over-Year	Q1 - 2007	3.0%
	CPI	April - 2007	1.9%
	Unemployment	April - 2007	7.1%
	ECB Target Rate	Jun - 05	3.75%
UK	GDP Year-over-Year	Q1 - 2007	2.9%
	CPI	April - 2007	2.8%
	Unemployment	April - 2007	2.8%
	BoE Target Rate	Jun - 05	5.50%
Canada	GDP Year-over-Year	March - 2007	2.3%
	CPI	April - 2007	2.2%
	Unemployment	April - 2007	6.1%
	BoC Target Rate	Jun - 05	4.25%







German Unemployment Rate • Tuesday

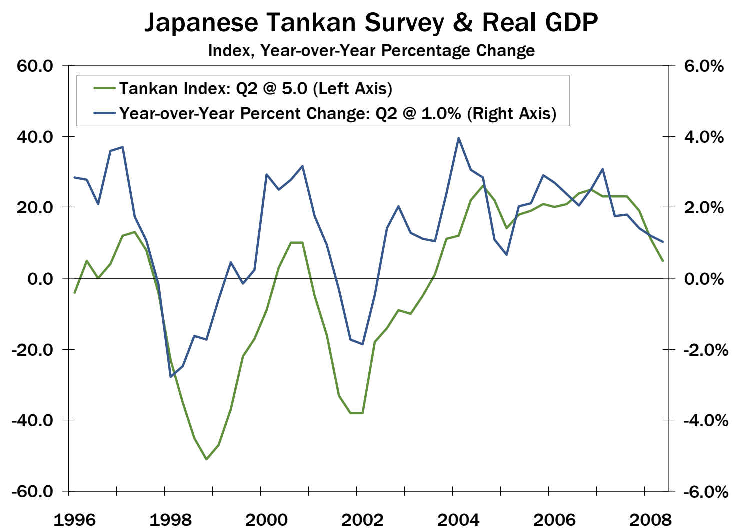
The unemployment rate in Germany has fallen significantly over the past few years to 7.6% in August, the lowest rate in 16 years. However, the economy is showing unmistakable signs of slowing. For example, the Ifo index of German business sentiment, which is highly correlated with growth in industrial production, dropped to a 3-year low in September. If the unemployment rate does not tick up this month, it seems only a matter of time before it does so. Softer labor market conditions should eventually weigh on consumer spending.

Speaking of consumer spending, data on German retail sales in August will print on Tuesday as well. Revised data on the manufacturing and service sector PMI's in the Euro-zone, which have tumbled to multi-year lows, will be released on Wednesday and Friday, respectively.

Previous: 7.6%

Consensus: 7.6%

Japanese Tankan Index • Wednesday



The data highlight in Japan next week will be the quarterly Tankan index, which will print on Wednesday. The index is widely followed because it is highly correlated with Japanese GDP growth. If, as is expected, the index slips into negative territory for the first time since 2003, it will reinforce the notion that the Japanese economy has slipped into a modest recession.

The Tankan index will be the highlight of the week, but other data releases will provide additional insights into the state of the Japanese economy in August. Data on retail sales, industrial production, unemployment and housing starts are all slated to be released next week.

Previous: 5

Consensus: -2

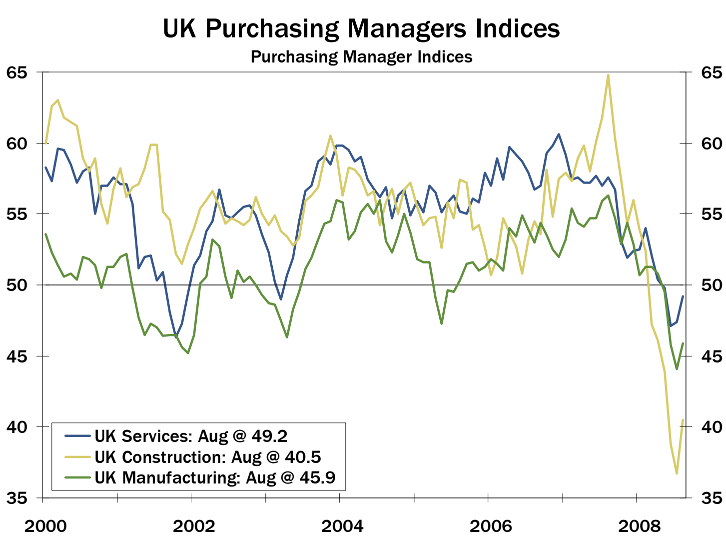
U.K. Manufacturing PMI

Purchasing managers' indices in the United Kingdom tumbled earlier this year as British economic growth weakened. The construction PMI stands at its lowest level on record, and the comparable indices for the manufacturing and service sectors have dropped to levels that are consistent with mild recession. Indeed, real GDP growth in the United Kingdom likely will be negative in the third quarter.

The consensus forecast for the manufacturing PMI, which is slated for release on Wednesday, looks for another decline. The construction index (Thursday) and the services index (Friday) will likely post declines as well. A widely followed index of housing prices, which will be released on Thursday, is expected to show that house prices fell more than 12 percent in September relative to the same month last year.

Previous: 45.9

Consensus: 45.0



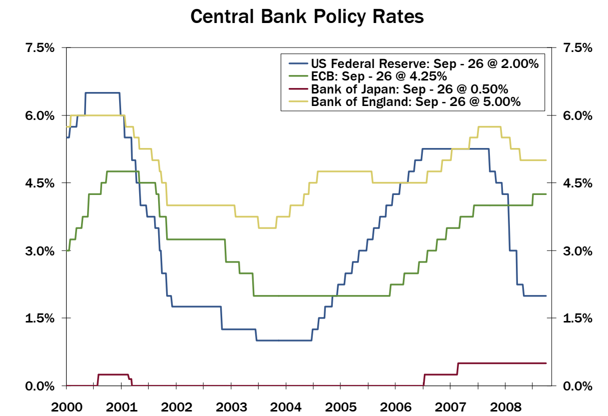
Interest Rate Watch

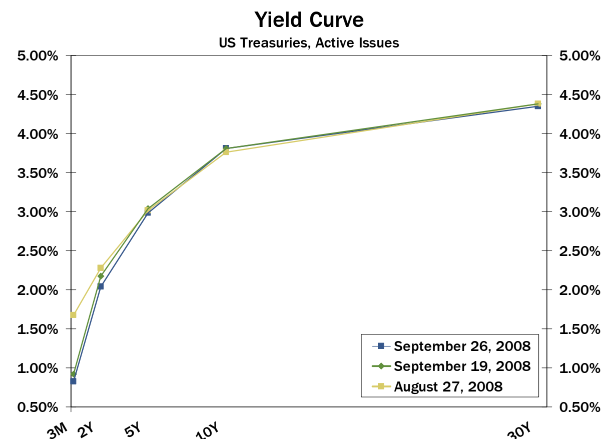
Steady Funds Rate, but Easing Through the Back Door Continues

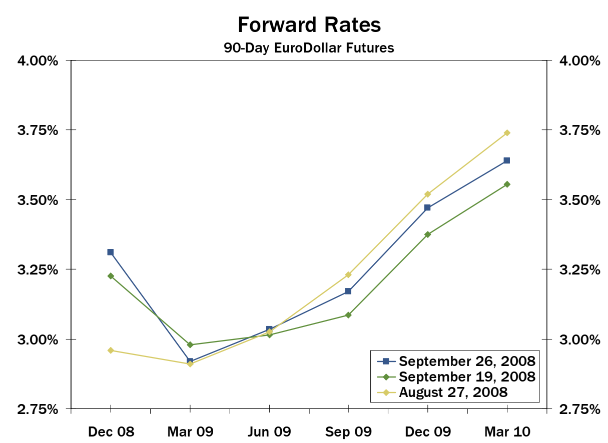
For now, we expect that the Fed will keep the funds rate at two percent at the October meeting. However, the bias remains toward ease as credit problems are compounding the economic weakness. Through the back door, the Fed and the Treasury will continue to provide liquidity to ease the financial burden on the economy. This suggests that short-term rates will remain very low. Investors will continue to avoid risk and thereby push down Treasury bill rates lower relative to Libor and other short-term private rates.

Market Liquidity - Making Lemonade out of Lemons

The Fed and Treasury are easing dramatically by using the federal balance sheet to provide more liquidity to the markets than would have been available via a cut in the funds rate. As suggested by our note two weeks ago, the interaction between quality heterogeneity and asymmetric information can lead to the disappearance of a market where guarantees are indefinite. In this model, as quality is indistinguishable beforehand by the buyer (due to the asymmetry of information). Because of the information/quality problems, we have watched the evolution toward a no-trade market where demand and supply never meet at any positive price. Markets fail to exist altogether in situations involving quality uncertainty. Time and again we have seen the failure of market pricing to affect the ability to trade securities and price both housing and financial assets. Into this breach has stepped the Fed and the Treasury to bridge the market gap. Through the back door, both institutions are providing the liquidity needed while also altering the rules.







Topic of the Week

Empirical Recession Probability High

Unfortunately the probability of recession remains high. The latest probability calculation is consistent with prior recessionary periods at nearly 90 percent. Our model takes a look at a very broad set of predictors and does not impose limitations on which variables to examine in the model. As a result, we did not find that a commonly used model (based on the yield curve alone) would outperform our approach.

Beginning in the fourth quarter of last year the recession probability rose sharply, and since then the probability remains high. While the official recession call will come from the National Bureau of Economic Research sometime next year, for decision-makers, the operational guideline is a recession-like outlook today.

Other Key Indicators

Over the last year the leading indicator series has dropped into negative territory in a pattern reminiscent of 1990/91 and 2001 recession periods. Over the last three months we have seen deterioration in leading indicator components of unemployment claims and money growth. As expected, the building permits component continues to be weak as it has been over the last two years.

Over the last three months the performance of the Chicago Purchasing Managers' Survey employment component has weakened markedly. This weakness is consistent with the decline in employment we have seen this year. Unfortunately, employment declines are consistent with weakness in consumer incomes and thereby weaker consumer spending. Our outlook is for declines in real consumer spending in the second half of this year. This will be particularly hard on consumer discretionary items.

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 9/26/2008	1 Week Ago	1 Year Ago
3-Month T-Bill	0.82	0.88	3.69
3-Month LIBOR	3.76	3.21	5.20
1-Year Treasury	1.76	1.36	3.89
2-Year Treasury	2.03	2.17	3.98
5-Year Treasury	2.98	3.04	4.26
10-Year Treasury	3.80	3.81	4.62
30-Year Treasury	4.35	4.38	4.89
Bond Buyer Index	5.23	5.03	4.48

Foreign Exchange Rates

	Friday 9/26/2008	1 Week Ago	1 Year Ago
Euro ($/€)	1.461	1.447	1.413
British Pound ($/£)	1.838	1.832	2.016
British Pound (£/€)	0.795	0.790	0.701
Japanese Yen (¥/$)	106.139	107.450	115.555
Canadian Dollar (C$/$)	1.033	1.047	1.004
Swiss Franc (CHF/$)	1.089	1.105	1.171
Australian Dollar (US$/A$)	0.832	0.834	0.877
Mexican Peso (MXN/$)	10.802	10.659	10.920
Chinese Yuan (CNY/$)	6.843	6.838	7.514
Indian Rupee (INR/$)	46.548	45.830	39.704
Brazilian Real (BRL/$)	1.847	1.830	1.846
U.S. Dollar Index	77.018	77.680	78.493

Foreign Interest Rates

	Friday 9/26/2008	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	5.14	5.00	4.73
3-Month Sterling LIBOR	6.26	6.00	6.32
3-Month Canadian LIBOR	4.10	3.80	4.94
3-Month Yen LIBOR	0.94	0.90	1.00
2-Year German	3.67	4.00	4.08
2-Year U.K.	4.24	4.39	5.15
2-Year Canadian	2.78	2.88	4.17
2-Year Japanese	0.83	0.76	0.87
10-Year German	4.17	4.21	4.39
10-Year U.K.	4.55	4.61	5.06
10-Year Canadian	3.64	3.69	4.42
10-Year Japanese	1.47	1.50	1.68

Commodity Prices

	Friday 9/26/2008	1 Week Ago	1 Year Ago
W. Texas Crude ($/Barrel)	104.93	104.55	80.30
Gold ($/Ounce)	887.00	873.55	728.80
Hot-Rolled Steel ($/S.Ton)	940.00	940.00	520.00
Copper (¢/Pound)	306.30	318.85	361.00
Soybeans ($/Bushel)	11.16	10.44	9.18
Natural Gas ($/MMBTU)	7.37	7.53	6.42
Nickel ($/Metric Ton)	16,870	16,555	32,255
CRB Spot Inds.	448.12	445.53	490.74

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	29	30	1	2	3
U.S. Data	**Personal Income** July -0.7% August 0.2% (W) **Personal Spending** July 0.2% August 0.1% (W) **PCE Deflator (YoY)** July 4.5% August 4.5% (W)	**Consumer Confidence** August 56.9 September 60.0 (W)	**Total Vehicle Sales** August 13.7M September 13.7M (W) **ISM Manufacturing** August 49.9 September 49.8 (W) **Construction Spending** July -0.6% August -0.6% (W)	**Factory Orders** July 1.30% August -1.90% (W)	**Nonfarm Payrolls** August -84K September -150K (W) **Unemployment Rate** August 6.1% September 6.0% (W) **ISM Non-Manufacturing** August 50.6 September 50.0 (W)
Global Data		**Germany** **Unemployment Rate** Previous (Aug) 7.6% **Canada** **GDP (MoM)** Previous (Jun) 0.1%	**Japan** **Lge Manufacturers Index** Previous (2Q) 5.0 **UK** **PMI Manufacturing** Previous (Aug) 45.9	**UK** **PMI construction** Previous (Aug) 40.5	**UK** **PMI Services** Previous (Aug) 49.2

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

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