WACHOVIA

ECONOMICS GROUP

Weekly Economic & Financial Commentary

July 2, 2009

U.S. Review

A Double Dose of Reality

This week's economic numbers may have finally brought an end to the green shoot rally. There is only so far "less bad" economic news can take us. A sustainable recovery will require things to actually get better. This week's big disappointment was the weaker employment data. Nonfarm payrolls declined by a larger than expected 467,000 jobs and the unemployment rate rose 0.1 percentage point to 9.5 percent.

The other bad economic news is the inability of California, and several other large states, to come up with a working budget. California's troubles are receiving the most attention and the state is reportedly set to begin issuing IOUs today, since it has run out of money.

The problems at state governments are the most severe in modern history. Taxes will either have to be increased or spending will have to be cut dramatically. Either way there will be more strains placed on consumers and the broader economy. The severe state fiscal imbalances are putting strains on parts of the economy that usually hold up well during recessions and raise the possibility of a second stimulus program later this year.

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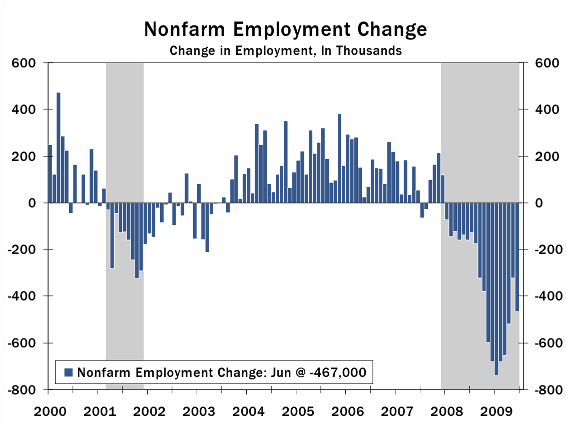

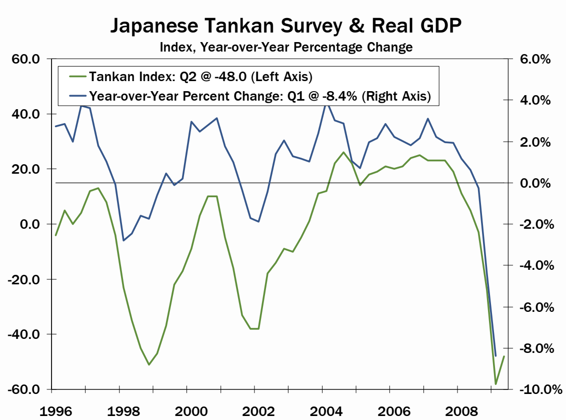

Global Review

Is Japan Recovering?

Data released this week showed that the Tankan index of Japanese business sentiment rose from a reading of -58 in March to -48 in June (see graph at left). The index is widely followed by market participants because it is fairly correlated with Japanese GDP growth. If the past relationship between the Tankan index and the year-over-year growth rate continues to hold, then the latter probably improved somewhat from the steep 8.4 percent contraction registered in the first quarter. Indeed, Japanese real GDP quite possibly rose on a sequential basis in the second quarter following double-digit declines in each of the past two quarters.

"Hard" data also suggest that the economy has bounced. Industrial production rose for the third consecutive month in May (see top chart on page 4). Yes, production is still down 30 percent relative to

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Recent Special Commentary

Date	Title	Authors
July-01	Pass-Through Effect of Housing Weakness	Vitner & Whelan
June-30	New Jersey Outlook - June 2009	Vitner, Khan & Kamar.
June-30	Cash-for-Clunkers Boost to Q3 Auto Sales Likely Unsustainable	Vitner & Khan
June-29	Breakdown, Adjustment and Rebuilding in the Financial Sector	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	-0.5	-6.3	-5.7	-3.4	2.9	2.1	2.9	2.8	2.0	1.1	-2.7	2.1
Personal Consumption	0.9	1.2	-3.8	-4.3	1.5	-1.0	1.7	1.9	3.0	3.0	2.8	0.2	-0.7	1.4
Inflation Indicators [2]														
"Core" PCE Deflator	2.2	2.3	2.3	1.9	1.8	1.7	1.2	1.0	2.1	2.3	2.2	2.2	1.4	0.9
Consumer Price Index	4.2	4.3	5.2	1.5	-0.2	-1.3	-2.6	-0.3	3.4	3.2	2.9	3.8	-1.1	1.1
Industrial Production [1]	0.2	-4.6	-9.0	-12.9	-19.2	-15.5	2.0	2.9	3.3	2.3	1.5	-2.2	-11.4	1.1
Corporate Profits Before Taxes [2]	-1.5	-8.3	-9.2	-21.5	-18.0	-16.0	-12.0	-8.0	17.6	15.2	-1.6	-10.1	-13.8	5.8
Trade Weighted Dollar Index [3]	70.3	71.0	76.1	79.4	82.5	80.0	82.6	85.0	86.0	81.5	73.3	79.4	85.0	85.0
Unemployment Rate	4.9	5.4	6.1	6.9	8.1	9.3	9.9	10.3	5.1	4.6	4.6	5.8	9.4	10.6
Housing Starts [4]	1.06	1.02	0.87	0.66	0.53	0.47	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	3.80	3.80	3.80	4.39	4.71	4.04	2.25	3.80	4.20

Data As of: June 10, 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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The Economy Really Needs Some Genuine Good News

While the economy struggled immensely, the first half of this year turned out to be no worse than widely feared. Moreover, the rate of deterioration in economic activity lessened considerably during the second quarter. Layoffs decreased, motor vehicle sales stopped falling and factory orders actually improved slightly. Real GDP almost certainly declined during the second quarter and our latest working estimate calls for real GDP to decline at around a three percent pace for the quarter. While that marks some improvement from the prior two quarters, the decline is still quite substantial.

June's employment report marks somewhat of a reversal. Employment losses worsened during the month, with nonfarm payrolls falling by 467,000 jobs. Federal government job losses increased, reversing a gain a few months earlier tied to the temporary hiring of Census workers. State and local government payrolls were little changed in the month, with gains in education offsetting job losses in other areas. Private payrolls declined by 415,000 jobs, with losses across nearly every industry. The heaviest losses continue to be in manufacturing and construction but employment is also falling in the service sector, particularly in financial services, retail trade and at temporary staffing companies.

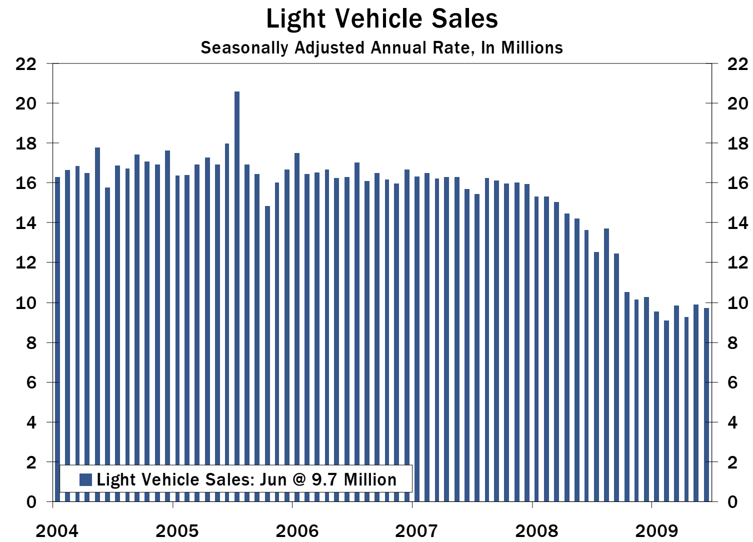
The average workweek also dropped another tenth of hour in June, suggesting that a turnaround in employment is still quite a way off. Businesses typically work their existing workforce longer before they commit to hiring more workers. Even then, businesses typically first turn to temporary staffing companies for workers before they add permanent staff.

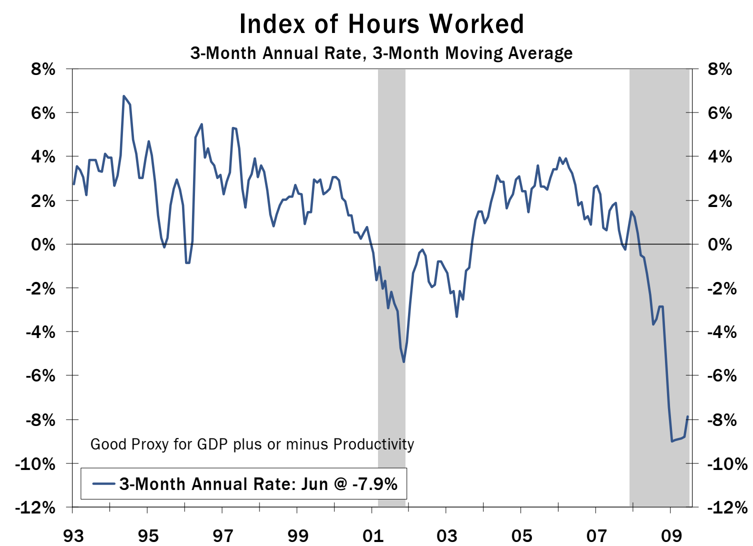
The decline in the average workweek combined with the huge drop in nonfarm payrolls produced a 0.8 percent drop in aggregate hours worked. Hours worked declined at a 7.9 percent annual rate during the second quarter, compared to a 8.9 percent drop in the first quarter. Given our forecast for real GDP to decline at around a three percent pace, the drop in hours worked suggests that productivity growth improved significantly during the quarter.

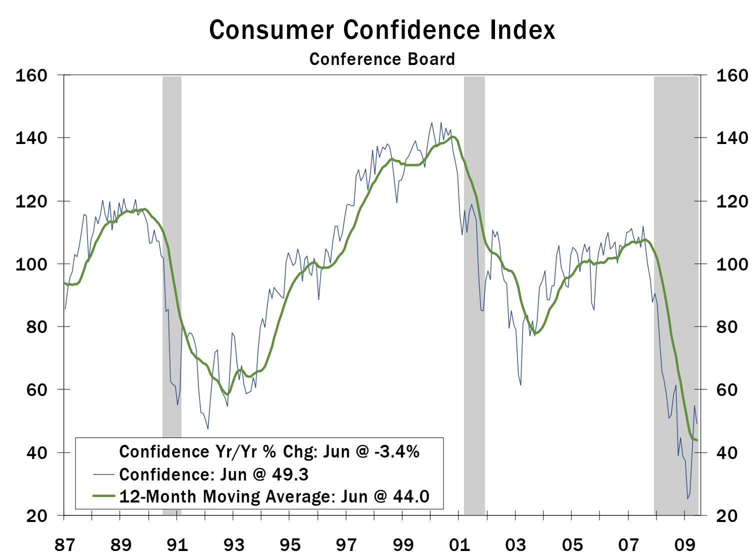
The unemployment rate rose 0.1 percent in June to 9.5 percent. While that represents a 26-year high, the increase in the unemployment rate was less than feared. The labor force declined by 155,000 in June. Apparently, fewer people chose to look for work this summer than usual. Both the labor force participation rate and employment population ratio declined by 0.2 percentage points during the month. Weaker employment conditions are weighing on consumers' minds and were the major factor in June's weaker than expected consumer confidence figures.

Selected Current Data

Gross Domestic Product - CAGR	Q1 - 2009	-5.5%
GDP Year-over-Year	Q1 - 2009	-2.5%
Personal Consumption	Q1 - 2009	1.4%
Business Fixed Investment	Q1 - 2009	-37.3%
Consumer Price Index	May - 2009	-1.3%
"Core" CPI	May - 2009	1.8%
"Core" PCE Deflator	May - 2009	1.8%
Industrial Production	May - 2009	-13.4%
Unemployment	June - 2009	9.5%
Federal Funds Target Rate	Jul - 02	0.25%





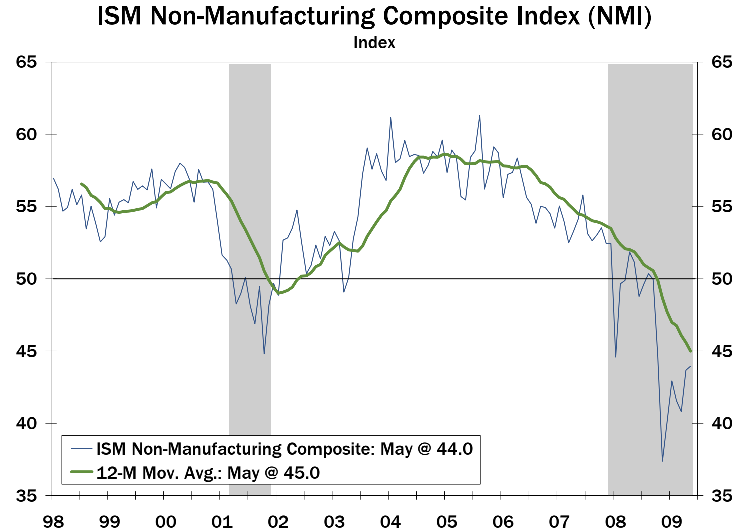


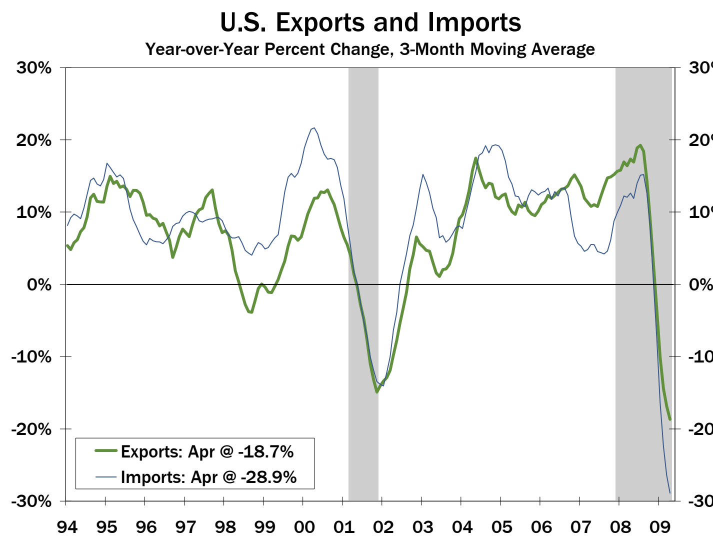
ISM Non-Manufacturing • Monday

The ISM non-manufacturing index likely rose to 45.4 in June, the third consecutive monthly increase. Consistent with sluggish demand for any services or goods these days, the index has remained below 50 for eight consecutive months, suggesting the service sector is still contracting and not yet out of the woods. The rate of contraction, however, is moderating. Moderation in the service sector corroborates the story that the worst declines are behind us, yet conditions remain difficult.

Previous: 44.0 **Wachovia: 45.4**

Consensus: 46.0





Trade Balance • Friday

For the third consecutive month, a modest widening of the trade deficit is expected in May driven primarily by a spike in crude oil prices. We expect the trade deficit likely widened to -$30.2B. While the combination of the global recession and the worldwide credit crunch caused trade to dry-up late last year, some signs of life have recently returned. Exports and imports are now down roughly 26 and 34 percent, respectively, from their peak in July 2008, but the pace of decline is moderating. However, oil prices, rather than global growth, will continue to be the main driver of the headline number this month.

Previous: -$29.2B **Wachovia: -$30.2B**

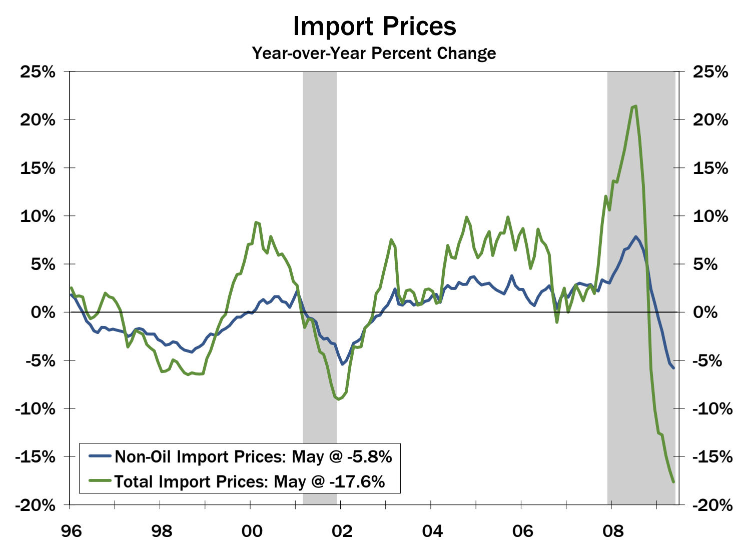
Consensus: -$30.0B

Import Prices • Friday

We expect petroleum prices to continue to boost headline import prices. Import prices likely rose 1.9 percent in June, the fifth consecutive monthly gain. While import prices excluding petroleum are likely being pushed higher due to dollar weakness, the underlying trend is still down. The dollar has given up some of its gains over the past three months as investors have turned less risk averse. Excluding petroleum, import prices were down 5.8 percent in May, the fifth consecutive year-over-year decline. Economic weakness in foreign economies will likely continue to exert downward pressure on U.S. inflation indicators in the months ahead. Moreover, the dollar will likely trend modestly higher against most major currencies through the end of 2009 which will also help to hold import prices down.

Previous: 1.3% **Wachovia: 1.9%**

Consensus: 2.1%



Global Review

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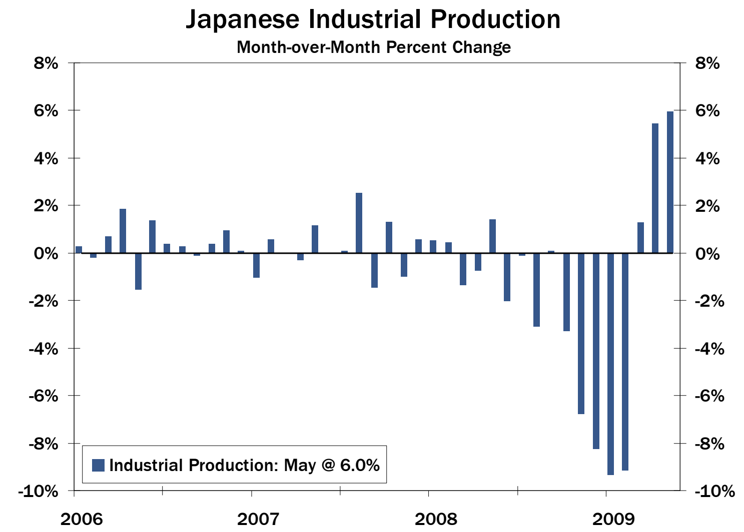
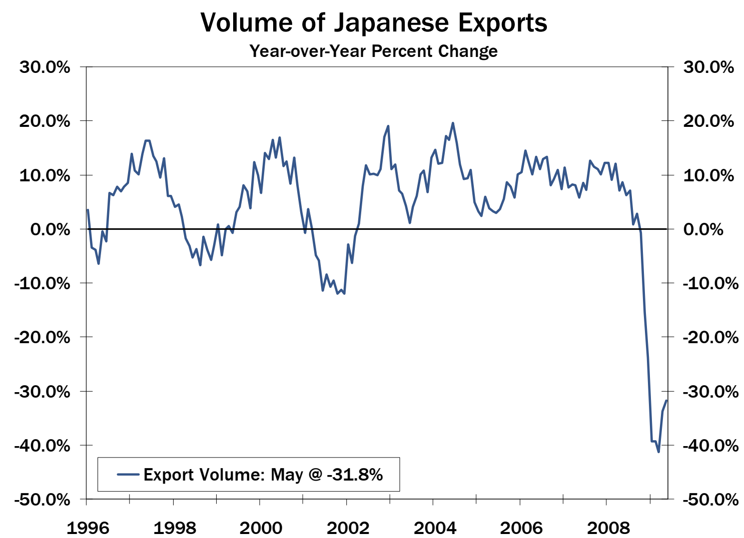
May 2008. The Japanese economy fell into a very deep hole late last year/early this year, and it is still in that hole. However, Japanese IP has risen 14 percent from its low in February. Does recovery begin when you finally emerge from the hole or when you begin to climb from the bottom of the hole? Most economists would say the latter suffices for recovery.

Among G-7 countries, the contraction in GDP in the first quarter of 2009 was the deepest in Japan, so how in the world can anybody talk about recovery? Among respondents to the Tankan survey, large manufacturers, which tend to be more exposed to exports than smaller manufacturers and non-manufacturers, reported the most improvement. Although the volume of exports is down more than 30 percent on a year-over-year basis, real exports are up about 13 percent over the past few months (middle chart). Therefore, much of the recent bounce in the Japanese economy appears to be related to foreign sources. Exports to the United States appear to be stabilizing. The Chinese economy is clearly growing again and shipments to China, which account for 15 percent of Japanese exports, have risen about 30 percent over the past few months.

In contrast, domestic demand in Japan remains sluggish. As noted above, small manufacturers and non-manufacturers, who tend to be more dependent on domestic spending than their large manufacturing counterparts, reported much less improvement in the Tankan survey. Indeed, retail spending has been flat to slightly down since the beginning of the year. Employment in May was off two percent relative to the same month last year, and unemployment has risen to the highest rate since Japan crawled out of its last recession in the early years of this decade.

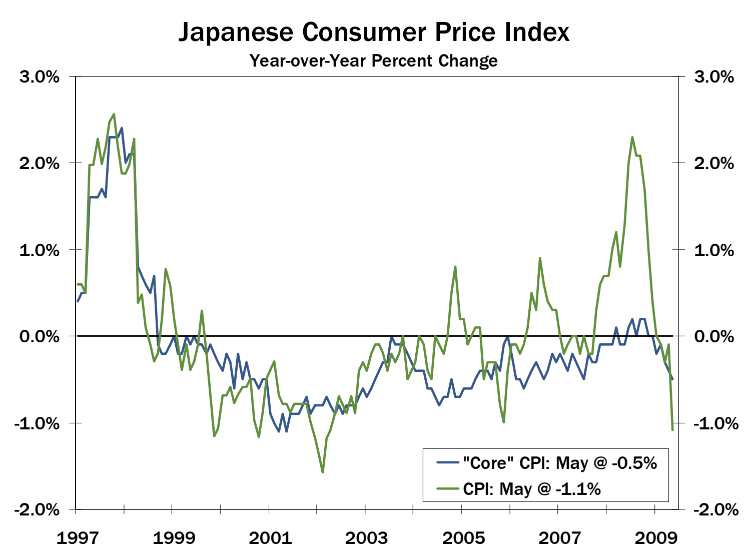
A deep recession and a weak labor market are usually the recipe for declining inflation, and Japan is flirting with deflation with the overall CPI down more than one percent in May (bottom chart). Some of the decline in the overall rate of inflation is due to the collapse in energy prices. However, the core rate of inflation, which excludes food and energy prices, is also in negative territory. Although a global recovery should help Japan to avoid an outright deflationary spiral, Japanese CPI inflation should remain slightly negative for the foreseeable future.





Selected Global Data

Japan	GDP Year-over-Year	Q1 - 2009	-8.8%
	CPI	May - 2009	-1.1%
	Unemployment	May - 2009	5.2%
	BoJ Target Rate	Jul - 02	0.10%
Euro-Zone	GDP Year-over-Year	Q1 - 2009	-4.8%
	CPI	May - 2009	0.0%
	Unemployment	May - 2009	9.5%
	ECB Target Rate	Jul - 02	1.00%
UK	GDP Year-over-Year	Q1 - 2009	-4.9%
	CPI	May - 2009	2.2%
	Unemployment	May - 2009	4.8%
	BoE Target Rate	Jul - 02	0.50%
Canada	GDP Year-over-Year	April - 2009	-3.0%
	CPI	May - 2009	0.1%
	Unemployment	May - 2009	8.4%
	BoC Target Rate	Jul - 01	0.25%



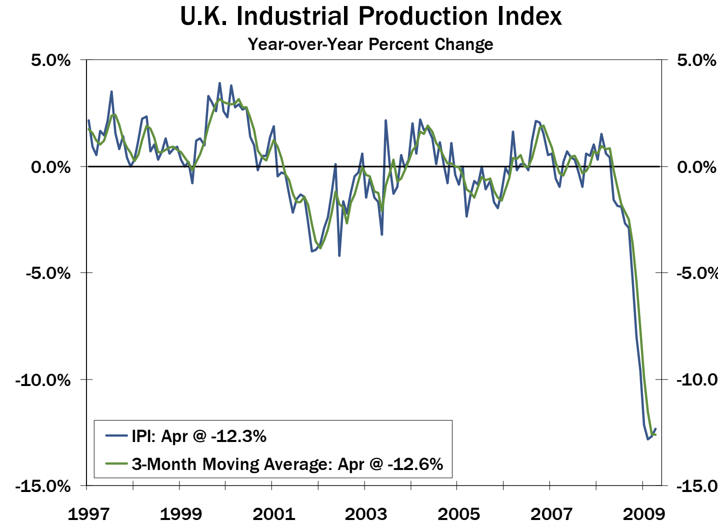
U.K. Industrial Production • Tuesday

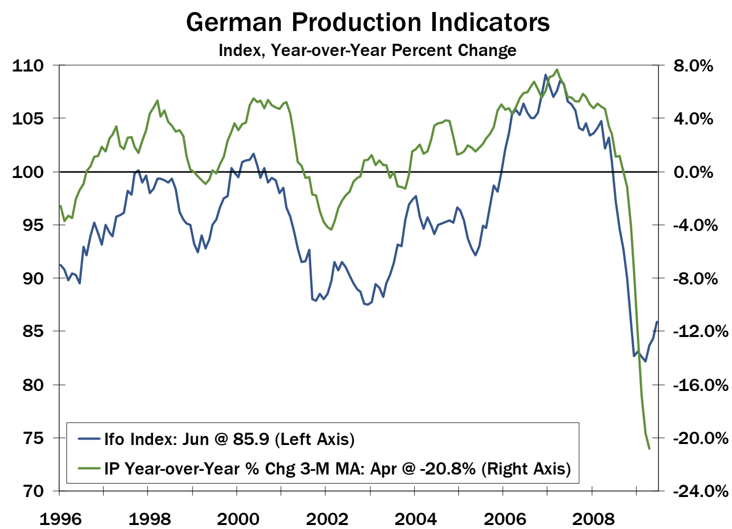
Industrial production (IP) in the United Kingdom was hammered late last year and early this year as the global economy fell into a deep recession. However, IP edged up 0.3 percent in April, the first monthly increase since February 2008. If the manufacturing PMI is any indication, then the worst may be over for the British manufacturing sector. How much of the stabilization in industrial production is due to the foreign sector? Data on international trade in May, which will be released on Thursday, will help analysts answer that question.

The performance of the British economy in the second quarter is starting to come into focus, and a highly respected think tank will release its estimate of GDP on Tuesday night. The Bank of England holds a policy meeting on Thursday, but we do not look for it to change its current policy stance.

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

Consensus: 0.2%





German Industrial Production • Wednesday

German industrial production has tanked since last fall. The Ifo index of German business sentiment has risen a bit from its record low in March, which suggests that a bottom in production should be close at hand. However, the bottom has not yet been reached, at least not through April. Data for German industrial production in May will print on Wednesday, and comparable data for France and Italy are slated for release on Friday.

Factory orders lead industrial production, and orders in Germany have stabilized, albeit at a very low level, over the past two months. Data on factory orders in May will be released on Tuesday and further stability, let alone an increase, could signal that the worst is over for the German manufacturing sector.

Previous: -1.9% (month-on-month change)

Consensus: N/A

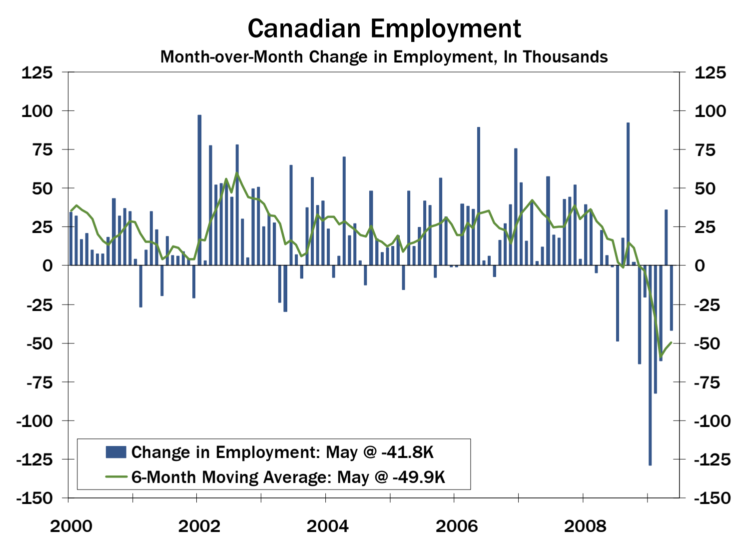
Canadian Labor Market Report • Friday

The Canadian economy has lost jobs in six of the last seven months and the unemployment rate has spiked to its highest level in 11 years. That said the number of monthly job losses appears to be shrinking and most Canadian market-watchers expect that moderation to continue when the official numbers for June employment print on Friday of next week. The consensus is looking for a decline of 30K jobs, which would be a smaller decline than average over the last six months.

Canada was dealt a major blow when global trade dried up last winter and U.S. consumers and businesses stopped spending money. Earlier this year, the definitive measure of business sentiment, the Ivey purchasing managers' index, fell to 36.1—the lowest level since series data began in 1999. The demarcation line between growth and contraction is 50 and the consensus expects a reading of 50 when June data become available on Tuesday.

Previous: -41.6K

Consensus: -30.0K

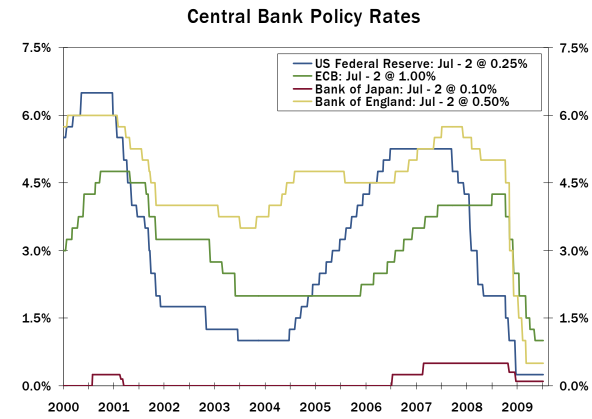


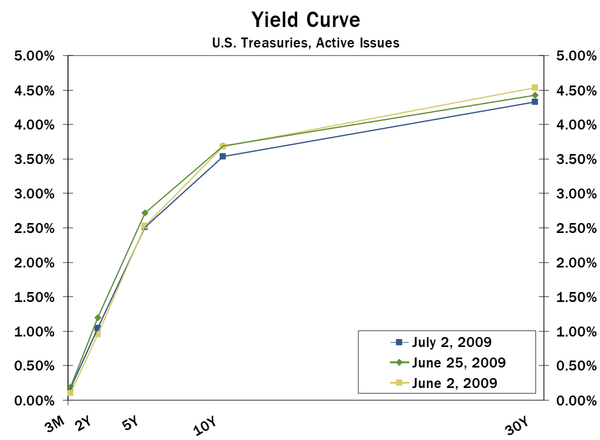
Interest Rate Watch

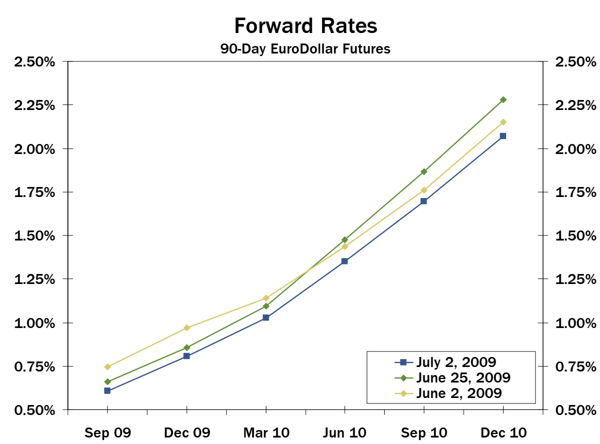
Credit: Who's Better, Who's Best?

The jobs report reinforces our view that weak income gains will generate below-trend growth in the second half of this year. Moreover, weak average hourly earnings data suggests that there will be little upward pressure on labor costs and inflation. With Ben Bernanke playing the role of pinball wizard, the bouncing back and forth from not too strong economic growth and not too weak inflation suggests a steady federal funds rate but with volatility in the one- and two-year Treasuries. Meanwhile, the market remains in the "I can't explain" mode for long Treasuries as alternatively deficits, inflation or currency concerns dominate pricing. From here, our concern is that the longer run outlook of below-trend economic growth will lead to higher-than-expected federal deficits. These deficits, as cited by Niall Ferguson at the Aspen Conference earlier this week, would represent much higher future tax burdens not only for my generation but also my children's. All of which suggests that there remains an upward bias on long rates for the next two years. As for credit, weak employment reinforces the focus on risk avoidance and the deleveraging of the American financial system. Credit remains more difficult to obtain on the demand side while lenders will be more leery of extending credit particularly for people without established credit, even when the kids are alright. Weak U.S. and foreign growth suggests that the supply of credit through savings and profits would also be very limited.

Weak growth will reinforce concerns about the U.S. credit quality and the dollar. Foreign investors will pray they won't get fooled again as in the 1970s with higher inflation and a weaker currency and thereby investment losses on the "risk free" U.S. Treasury.







Topic of the Week

Cash-for-Clunkers Boost to Q3 Auto Sales Likely Unsustainable

The cash for clunkers program, which will provide consumers with a voucher ranging from $3,500 to $4,500 to encourage trade-ins for more fuel efficient new vehicles, should provide a slight boost to motor vehicle sales during the third quarter. Vouchers would be limited to vehicles costing under $45,000. Rising unemployment and a whole host of restrictions in the program will limit its success, but sales should rise.

Even a small boost in sales could prove to be a crucial piece of the recovery puzzle. Auto production was already slated to increase in the third quarter, reflecting sharp cutbacks in output earlier this year and a decline in dealer inventories. Even a slight pick up in sales would build on this momentum and help keep assembly lines running further into the year.

The bill, which appropriated $1 billion for the program, will likely boost auto sales in the third quarter by a much-smaller-than-expected 250,000 units versus the originally proposed 1 million units. With the program running for three months, the difference in the closely watched annual sales rate is a 1 million unit boost versus 4 million units. In order to get a more sustained boost to auto sales, the program would need to run for a full calendar year. The program's short duration means that sales will likely give back a good part of their gains in the fourth quarter.

We do not want to be overly critical about the cash-for-clunkers program, because it will boost sales. The program, however, would be even more successful if it started a little earlier, ran a little longer and had fewer restrictions.

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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Thursday 7/2/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.16	0.17	1.81
3-Month LIBOR	0.58	0.60	2.79
1-Year Treasury	0.15	0.26	2.14
2-Year Treasury	0.99	1.13	2.58
5-Year Treasury	2.43	2.58	3.30
10-Year Treasury	3.49	3.54	3.96
30-Year Treasury	4.32	4.33	4.50
Bond Buyer Index	4.79	4.86	4.83

Foreign Exchange Rates

	Thursday 7/2/2009	1 Week Ago	1 Year Ago
Euro ($/€)	1.401	1.399	1.588
British Pound ($/₤)	1.639	1.637	1.993
British Pound (₤/€)	0.855	0.855	0.797
Japanese Yen (¥/$)	95.885	95.950	105.915
Canadian Dollar (C$/$)	1.161	1.155	1.012
Swiss Franc (CHF/$)	1.084	1.094	1.014
Australian Dollar (US$/A$)	0.794	0.803	0.962
Mexican Peso (MXN/$)	13.164	13.218	10.392
Chinese Yuan (CNY/$)	6.831	6.835	6.859
Indian Rupee (INR/$)	47.950	48.607	43.175
Brazilian Real (BRL/$)	1.957	1.943	1.609
U.S. Dollar Index	80.259	80.403	72.029

Foreign Interest Rates

	Thursday 7/2/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	1.06	1.14	4.95
3-Month Sterling LIBOR	1.16	1.20	5.93
3-Month Canadian LIBOR	0.60	0.60	3.45
3-Month Yen LIBOR	0.45	0.47	0.93
2-Year German	1.22	1.32	4.63
2-Year U.K.	1.30	1.15	5.16
2-Year Canadian	1.18	1.27	3.24
2-Year Japanese	0.28	0.32	0.84
10-Year German	3.32	3.43	4.65
10-Year U.K.	3.74	3.71	5.13
10-Year Canadian	3.36	3.45	3.75
10-Year Japanese	1.36	1.39	1.67

Commodity Prices

	Thursday 7/2/2009	1 Week Ago	1 Year Ago
W. Texas Crude ($/Barrel)	66.94	70.23	143.57
Gold ($/Ounce)	929.15	939.25	945.15
Hot-Rolled Steel ($/S.Ton)	335.00	335.00	1125.00
Copper (¢/Pound)	227.25	230.00	407.75
Soybeans ($/Bushel)	12.63	11.89	16.25
Natural Gas ($/MMBTU)	3.75	3.84	13.39
Nickel ($/Metric Ton)	16,416	15,409	21,395
CRB Spot Inds.	407.79	399.02	503.61

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	6	7	8	9	10
U.S. Data	**ISM Non-Manufacturing** May 44.0 June 45.4 (W)		**Consumer Credit** April -$15.7 B May -$7.8 B (C)	**Wholesale Inventories** April -1.4% May -1.0% (C)	**Trade Balance** April -$29.2 B May -$30.2 B (W) **Import Price Index** May 1.3% June 1.9% (W)
Global Data		**Germany** **Factory Orders (MoM)** Previous (Apr) 0.0% **UK** **Indus. Production (MoM)** Previous (Apr) 0.3%	**Germany** **Indus. Production (MoM)** Previous (Apr) -1.9% **Japan** **Machine Orders (MoM)** Previous (Apr) -5.4%	**UK** **BOE Announces Rates** Previous 0.50%	**Canada** **Net Chg in Employment** Previous (May) -41.8K

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

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