



# ECONOMICS GROUP

## MONTHLY OUTLOOK

July 09, 2008

### U.S. Overview

#### Sub-Par Growth: Economic Workout Continues

Once again, we are faced with the hard reality that the economic workout continues, keeping pressure on profits and household incomes. There is no easy-out for the economy. We expect continued weakness in consumer spending, residential investment and capital spending in the second half of this year. In contrast, government spending and net exports should maintain positive momentum. Overall, our expectation is that real final sales will slow in 2008 and again in 2009 from the 2007 pace of 2.5 percent.

Inflation, measured by the core PCE deflator, remains at the top end of the Fed's perceived target range. Higher priced imports, energy and food are all adding to the upward momentum in prices. This combination of sub-par growth and persistent inflation suggests that the Fed will keep the funds rate on hold through the rest of this year. Finally, sub-par growth coupled with rising input prices should deliver a decline in pre-tax profits for the second half of this year.

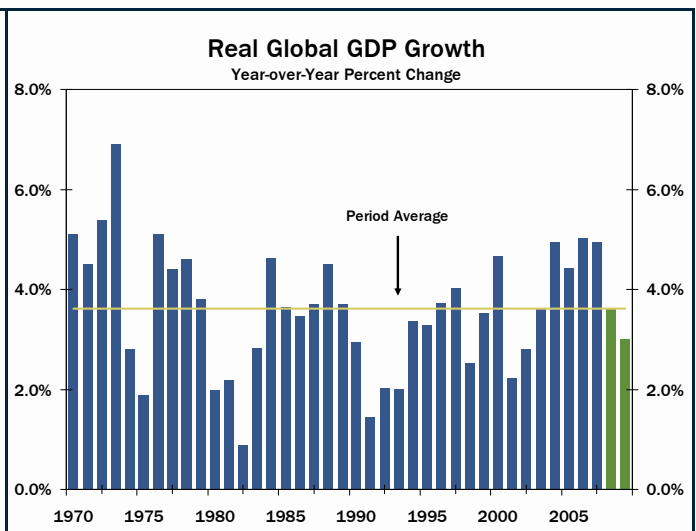
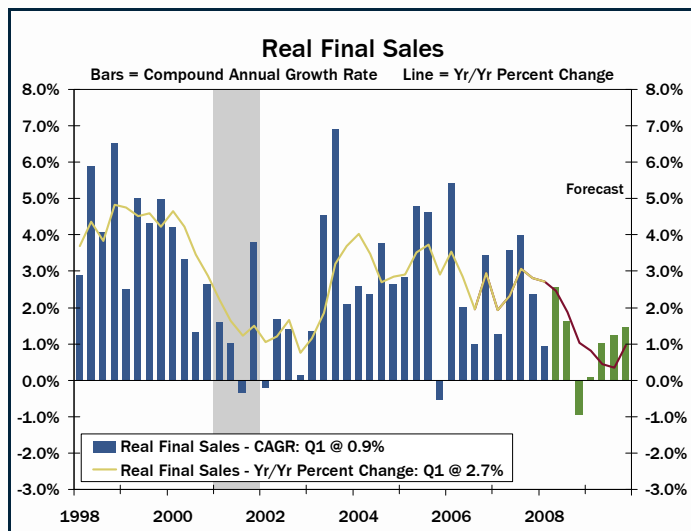
Our forecast has changed modestly over the past month. Estimates for 2009 have been lowered, reflecting more modest growth in consumer spending, a deeper pullback in commercial construction, and less growth in exports. In addition, the BEA will revise the GDP data for the past three years later this month, which may lower the trajectory of economic growth.

### International Overview

#### U.S. Slowdown Spreading to Other Countries

The slowdown in the United States appears to be spreading to other economies. U.K. economic activity is the weakest it has been since 2001, and growth in the Euro-zone seems to have slowed significantly in the second quarter. Even developing countries, which have enjoyed rapid growth over the past few years, have not been immune to the slowdown.

Why has growth slowed abroad? First, exports to the United States from many countries have weakened. Second, credit market dislocations have weakened growth in countries that are extensively financed via capital markets and/or experienced significant run-ups in house prices. Third, the sharp rise in the price of oil is eating into real income in many countries, effectively slowing consumer spending. Finally, foreign central banks have tightened monetary policy in response to rising inflation, engendered by the sharp rise in the price of oil. We have marked down our global growth forecasts for the rest of this year and 2009, which likely will see the slowest year for global growth since 2002. If there is a silver lining, it is that inflation in many countries should come down going forward. Indeed, core rates of inflation in most countries are lower than overall rates at present. If oil prices stabilize overall rates of inflation should come back down to the core rates in the quarters ahead. Consequently, central banks in most major economies likely will refrain from tightening further.



**Sub-Par Growth: Consumer and Business Restraint**

Consumer spending is expected to remain weak after the initial stimulus from the tax rebates. Real personal income growth has slowed this year relative to the prior two years as inflation has picked up while job growth has turned negative. Slower real income growth, combined with losses in real estate and financial wealth have dragged consumer confidence down and should hold consumer spending to just a 1.8 percent pace this year compared to 2.9 percent in 2007.

Over the second half of the year, much of consumer spending will be concentrated in core needs and non-discretionary items. Consumer spending on discretionary items will likely remain pressured. While the tax rebates may help sustain spending short term, we expect an outright decline in real consumer spending in the fourth quarter once those checks are spent.

Weakness is also the story for business fixed investment. For the second half of this year we anticipate the combination of slower top line revenue expectations, tighter credit, and reduced corporate profits will lead to slower capital spending on equipment and software. Spending on structures is expected to slow significantly. This weakness will be in contrast to the solid gains we have seen in investment during the prior three years.

**Housing Continues to Struggle**

On the downside, residential construction likely declined at over a 20 percent annual rate in the first half of this year and is expected to continue to decline at a double-digit pace in the second half. The fundamentals remain negative. Housing demand is limited by sluggish income growth, low consumer confidence, tighter lending standards and a prevailing concern about further price declines. On the supply side, the inventory of homes remains large relative to the pace of sales in many areas.

Lower interest rates and falling home prices have led to an increase in housing affordability. However the concerns of buyers and creditors have kept many on the sidelines.

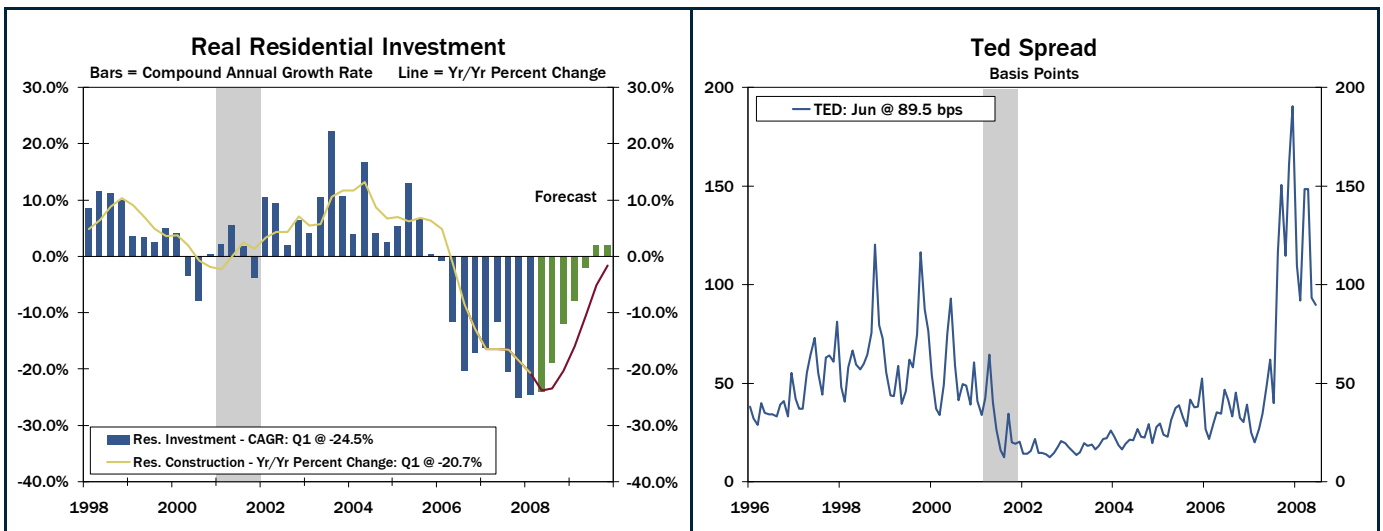
Trade remains a big positive in the economy. We anticipate trade will add one-half of one percent to growth for the second half of 2008. The weaker dollar and stronger growth abroad are the key drivers. Inflation has heated up considerably abroad, however, and central banks, particularly in emerging markets, are beginning to hike interest rates.

**Profits Weak & Interest Rates Flat**

Pre-tax profits are expected to decline about six percent in 2008 compared to a gain of 2.7 percent in 2007 and 13.2 percent two years ago. The downturn in profits is consistent with slower top line revenue as well as higher input costs signaled by manufacturer surveys and commodity indices.

Short-term rates are likely to remain range-bound as the Federal Reserve balances the dual challenge of below-trend economic growth and above-target inflation. Long-term rates are expected to drift upward once calm returns to the financial markets. Concerns about the dollar and further Treasury financing needs are likely to limit any Treasury rallies despite continued soft economic news.

Credit spreads are not expected to narrow, as event risk remains a concern for investors. Capital markets continue to search for a new risk/reward tradeoff. At present, the trend in the TED spread (three month futures contract for U.S. Treasuries less the three month Eurodollar futures contract) suggests the new equilibrium spread will remain higher than where it had been during the 2004-2006 period. Risk is being priced back into the fixed income market, but the market is still determining what the equilibrium price will be.



Wachovia U.S. Economic Forecast

	Actual																Forecast									
	2006				2007				2008				2009				Actual			Forecast						
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2005	2006	2007	2008	2009					
Real Gross Domestic Product (a)	4.8	2.4	1.1	2.1	0.6	3.8	4.9	0.6	1.0	2.2	1.4	-0.2	0.5	1.2	1.6	1.8	3.1	2.9	2.2	1.8	0.9					
Personal Consumption	4.4	2.4	2.8	3.9	3.7	1.4	2.8	2.3	1.1	2.1	2.6	-1.0	0.4	1.8	1.9	2.0	3.2	3.1	2.9	1.8	1.0					
Business Fixed Investment	13.3	4.3	5.1	-1.4	2.1	11.0	9.4	6.0	0.5	1.1	-0.7	-2.8	-3.4	-3.8	-2.8	-1.6	7.1	6.6	4.7	3.0	-2.6					
Equipment and Software	13.0	-0.1	2.9	-4.9	0.3	4.7	6.2	3.1	0.2	-1.8	-2.8	-4.6	-2.3	0.3	2.0	2.2	9.6	5.9	1.3	0.7	-1.5					
Structures	15.0	16.4	10.8	7.4	6.4	26.2	16.4	12.4	1.3	11.0	6.5	3.0	-7.0	-16.0	-17.5	-14.0	0.5	8.4	12.9	9.1	-6.1					
Residential Construction	-0.7	-11.7	-20.4	-17.2	-16.3	-11.8	-20.5	-25.2	-24.5	-22.0	-18.0	-12.0	-8.0	-4.0	1.0	1.5	6.6	-4.6	-17.0	-21.4	-8.8					
Government Purchases	4.9	1.0	0.8	3.5	-0.5	4.1	3.8	1.9	2.1	0.5	0.4	0.3	0.4	0.9	1.2	1.6	0.7	1.8	2.0	1.8	0.7					
Net Exports	-640.1	-626.6	-633.8	-597.3	-612.1	-573.9	-533.1	-503.2	-480.2	-467.0	-453.5	-440.1	-428.5	-423.0	-423.8	-427.7	-618.0	-624.5	-555.6	-460.2	-425.8					
Pct. Point Contribution to GDP	0.1	0.5	-0.3	1.3	-0.5	1.3	1.4	1.0	0.8	0.5	0.5	0.5	0.4	0.2	0.0	-0.1	-0.2	-0.1	0.6	0.8	0.3					
Inventory Change	38.4	51.4	53.9	17.4	0.1	5.8	30.6	-18.3	-19.6	-29.5	-38.0	-17.0	-3.8	1.0	10.4	20.4	33.3	40.3	4.6	-26.0	7.0					
Pct. Point Contribution to GDP	-0.5	0.5	0.1	-1.3	-0.6	0.2	0.9	-1.7	0.0	-0.3	-0.3	0.7	0.4	0.2	0.3	0.3	-0.2	0.1	-0.3	-0.3	0.3					
Nominal GDP	8.4	6.0	3.4	3.8	4.9	6.6	6.0	3.0	3.7	6.2	5.1	2.4	3.0	3.6	3.9	4.1	6.4	6.1	4.9	4.6	3.7					
Real Final Sales	5.4	2.0	1.0	3.5	1.3	3.6	4.0	2.4	0.9	2.6	1.6	-1.0	0.1	1.0	1.3	1.5	3.3	2.8	2.5	2.0	0.6					
Retail Sales (b)	7.6	6.0	5.0	4.6	3.3	4.0	3.9	4.7	3.0	3.5	5.5	2.9	3.3	2.5	0.9	3.6	6.4	5.8	4.0	3.7	2.6					
Inflation Indicators (b)																										
"Core" PCE Deflator	2.0	2.2	2.4	2.3	2.4	2.0	1.9	2.1	2.0	2.1	2.2	2.1	2.1	2.2	2.3	2.3	2.2	2.2	2.1	2.1	2.2					
Consumer Price Index	3.7	3.9	3.3	1.9	2.4	2.6	2.4	4.0	4.2	4.0	4.2	3.6	3.2	2.8	2.5	2.4	3.4	3.2	2.9	4.0	2.7					
"Core" Consumer Price Index	2.1	2.5	2.8	2.7	2.6	2.3	2.1	2.3	2.4	2.3	2.3	2.2	2.1	2.3	2.3	2.4	2.2	2.5	2.3	2.3	2.3					
Producer Price Index	4.5	4.3	2.8	0.3	2.0	3.4	3.6	6.7	7.1	7.0	7.7	6.1	4.4	3.2	2.8	2.7	4.9	3.0	3.9	7.0	3.3					
Employment Cost Index	2.8	3.0	3.3	3.3	3.5	3.3	3.3	3.3	3.3	3.2	3.1	3.0	3.2	3.1	3.0	3.1	3.2	3.1	3.4	3.1	3.1					
Real Disposable Income (a)	4.8	0.2	1.7	6.2	5.4	-0.8	4.0	0.9	1.4	12.5	-3.0	-1.5	2.5	2.0	2.3	2.4	1.7	3.1	3.1	2.7	1.5					
Nominal Personal Income (b)	7.1	6.7	6.8	6.0	6.3	6.1	6.4	6.1	4.7	7.4	7.3	5.4	5.3	2.8	3.0	5.2	5.9	6.6	6.2	6.2	4.1					
Industrial Production (a)	3.2	2.6	1.9	-0.9	1.5	3.2	3.6	0.3	-0.3	-3.9	-0.2	1.5	2.2	2.9	3.6	3.9	3.3	2.2	1.7	-0.1	1.8					
Capacity Utilization	80.8	81.0	81.2	80.7	80.7	81.0	81.3	81.0	80.6	79.5	79.3	79.1	79.0	79.1	79.4	79.9	80.2	80.9	81.0	79.6	79.4					
Corporate Profits Before Taxes (b)	10.1	12.2	22.7	8.4	2.1	4.2	1.8	2.5	1.0	-8.0	-6.0	-10.5	-2.0	5.0	8.0	9.2	11.5	13.2	2.7	-5.9	4.9					
Corporate Profits After Taxes	9.6	10.4	21.3	8.2	1.2	3.3	2.7	3.3	4.3	-9.6	-6.5	-12.0	-1.0	6.0	9.5	11.0	6.1	12.2	2.6	-6.0	6.2					
Federal Budget Balance (c)	-183.6	96.5	-41.7	-80.4	-178.0	137.5	-40.6	-106.8	-205.9	-56.6	-132.0	-144.0	-238.0	6.0	-139.0	-151.0	-318.7	-248.2	-161.5	-501.4	-515.0					
Current Account Balance (d)	-196.0	-199.9	-210.9	-181.4	-196.9	-194.1	-173.0	-167.2	-176.4	-185.0	-170.0	-155.0	-142.0	-135.0	-130.0	-130.0	-729.0	-788.1	-731.2	-686.4	-537.0					
Trade Weighted Dollar Index (e)	85.2	81.4	82.0	81.5	80.5	78.7	74.4	73.3	70.3	71.0	70.8	72.5	74.9	77.3	79.8	81.9	86.0	81.5	73.3	72.5	81.9					
Nonfarm Payroll Change (f)	255	88	206	151	109	105	71	80	-82	-64	-75	-85	-70	20	75	108	211	175	91	-77	33					
Unemployment Rate	4.7	4.7	4.6	4.4	4.5	4.5	4.7	4.8	4.9	5.3	5.6	5.8	6.0	6.1	6.2	6.1	5.1	4.6	4.6	5.4	6.1					
Housing Starts (g)	2.12	1.86	1.70	1.57	1.45	1.46	1.30	1.15	1.05	0.98	0.95	0.93	0.93	0.96	1.01	1.11	2.07	1.81	1.34	0.98	1.00					
Light Vehicle Sales (h)	16.8	16.3	16.5	16.3	16.4	16.0	15.9	16.1	15.2	14.1	14.4	13.2	14.3	14.3	14.5	14.7	16.9	16.5	16.1	14.2	14.5					
Crude Oil - WTI - Front Contract (i)	63.48	70.70	70.48	60.21	58.16	65.03	75.38	90.68	97.90	123.98	141.50	138.67	133.33	128.33	122.33	120.50	56.56	66.22	72.31	125.51	126.13					
Quarter-End Interest Rates																										
Federal Funds Target Rate	4.75	5.25	5.25	5.25	5.25	5.25	4.75	4.25	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.25	4.25	5.25	4.25	2.00	2.25					
3 Month LIBOR	5.00	5.48	5.37	5.36	5.35	5.36	5.23	4.70	2.69	2.78	2.60	2.35	2.30	2.30	2.40	2.50	4.54	5.36	4.70	2.35	2.50					
Prime Rate	7.75	8.25	8.25	8.25	8.25	8.25	7.75	7.25	5.25	5.00	5.00	5.00	5.00	5.00	5.00	5.25	7.25	8.25	7.25	5.00	5.25					
Conventional Mortgage Rate	6.32	6.68	6.40	6.14	6.16	6.66	6.38	6.10	5.97	6.04	5.95	5.85	5.85	5.95	5.90	6.05	6.27	6.14	6.10	5.85	6.05					
3 Month Bill	4.63	5.01	4.89	5.02	5.04	4.82	3.82	3.36	1.38	1.90	1.85	1.90	1.95	1.95	2.00	2.20	4.08	5.02	3.36	1.90	2.20					
2 Year Note	4.82	5.16	4.71	4.82	4.58	4.87	3.97	3.05	1.62	2.63	2.65	2.60	2.80	3.10	3.40	3.70	4.41	4.82	3.05	2.60	3.70					
5 Year Note	4.82	5.10	4.59	4.70	4.54	4.92	4.23	3.45	2.46	3.34	3.20	3.20	3.25	3.35	3.60	3.90	4.35	4.70	3.45	3.20	3.90					
10 Year Note	4.86	5.15	4.64	4.71	4.65	5.03	4.59	4.04	3.45	3.99	4.00	4.00	4.10	4.25	4.25	4.40	4.39	4.71	4.04	4.00	4.40					
30 Year Bond	4.90	5.19	4.77	4.81	4.84	5.12	4.83	4.45	4.30	4.53	4.55	4.50	4.50	4.50	4.50	4.60	4.51	4.81	4.45	4.50	4.60					

Data As of: July 9, 2008

Notes: (a) Compound Annual Growth Rate Quarter-over Quarter

(b) Year-over-Year Percentage Change

(c) Quarterly Sum - Billions USD; Annual Data Represents Fiscal Year

(d) Quarterly Sum - Billions USD

(e) Federal Reserve Major Currency Index, 1973=100 - Quarter End

Notes: (f) Average Monthly Change

(g) Millions of Units

(h) Quarterly Data - Average Monthly SAAR ; Annual Data - Actual Total Vehicles Sold

(i) Quarterly Average of Daily Close

Real GDP growth in the United States has been quite weak over the past few quarters, and now it seems like the U.S. slowdown is catching up to many foreign economies as well. For example, the manufacturing PMIs in both the Euro-zone and the United Kingdom have moved below the demarcation line that separates expansion from contraction (see chart below). Although the indices are not yet in territory that is consistent with recession (at least not for the Euro-zone), the indicators suggest growth in these economies slowed significantly in the second quarter. In addition, growth rates in many developing countries appear to have downshifted a notch as well. For example, the purchasing managers' index in China fell to a 2-year low in June, although it remains above "50".

So why is foreign economic growth slowing? Let us count the ways. First, the slowdown in the U.S. economy, which accounts for roughly 25 percent of global GDP, is causing export growth in most countries to slow. Indeed, the volume of U.S. imports in the first four months of the year was down about 1 percent relative to the same period in 2007.

Second, dislocations in credit markets are weighing on growth in many economies, especially those that are extensively financed via capital markets and/or experienced significant run-ups in house prices. For example, the volume of new housing orders in the United Kingdom was down 33 percent in the first two months of the second quarter relative to the same period last year. Building permits in Spain are down more than 40 percent so far this year.

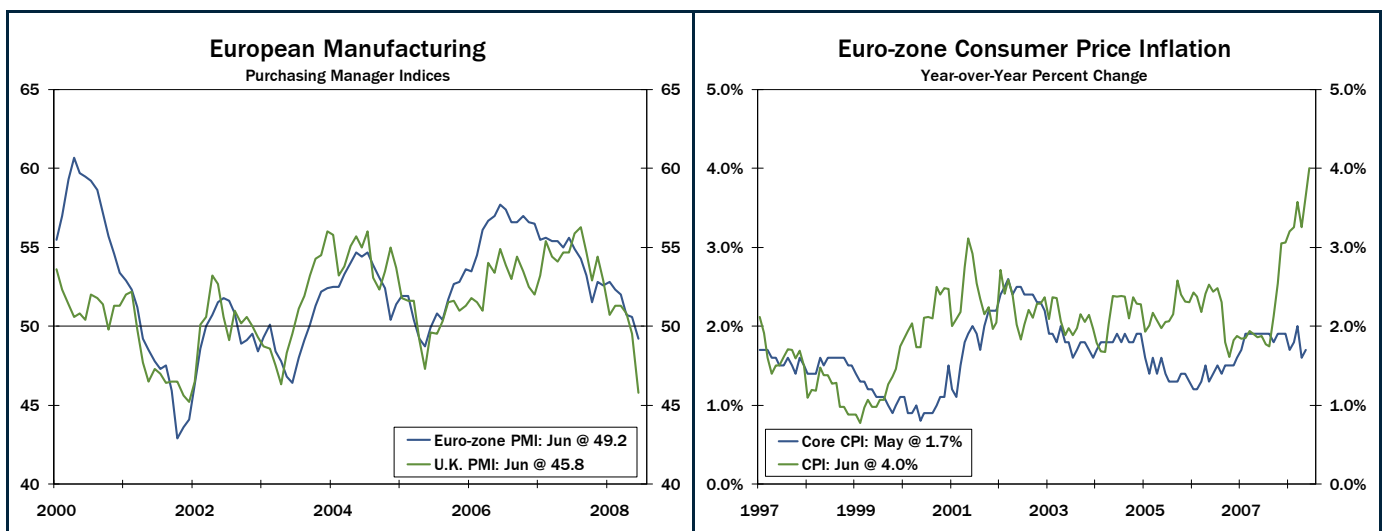
Third, the soaring price of oil is taking its toll on growth in many economies. True, strong global growth, especially strong growth in developing economies, caused the trend increase in the price of oil over the past few years. However, the 40 percent increase since the beginning of

the year suggests the price of oil is becoming divorced from the fundamentals. Moreover, the reduction in subsidies that many governments have announced recently (e.g., China, Indonesia, and Malaysia) will lead to slower growth in consumer spending in those countries.

Speaking of soaring petroleum prices, many central banks have tightened monetary policy recently to ensure a wage-price spiral does not develop in their respective economies. Although the recent rate hikes are not associated with the slowdown earlier this year, growth should slow further as higher interest rates begin to bite.

Consequently, we have marked down our forecasts for global GDP growth in 2008 and 2009 (see page 5). The global economy came into the year with a significant amount of momentum but, as discussed above, growth is slowing. As the chart on the front page shows, we project that global growth in 2008 will be approximately equal to its long-run average of 3.6 percent per annum. Our global growth forecast for next year is only 3 percent, which would be the slowest year for global growth since 2002. Therefore, the bad news is that growth is in the process of slowing and further deceleration seems very likely.

If there is a silver lining to slower growth, however, it is that inflation in many countries should come down over the course of the year. As shown in the chart below, the overall rate of CPI inflation in the Euro-zone has shot up to 4 percent, the highest rate since the ECB came into existence in 1999. However, the core rate of inflation is much more benign. If oil prices stabilize (not to mention decline), the overall rate of inflation should come back down to the core rate. And with growth in the Euro-zone slowing, the core rate of inflation should not rise significantly. Indeed, our forecast on page 5 looks for lower inflation in most countries next year.



July 9, 2008

Wachovia International Economic Forecast						
(Year-over-Year Percentage Change)						
	GDP			CPI		
	2007	2008	2009	2007	2008	2009
Global	4.9%	3.6%	3.0%	3.9%	5.7%	4.2%
Major Economies						
United States	2.2%	1.8%	0.9%	2.9%	4.0%	2.7%
Eurozone	2.7%	1.7%	1.2%	2.1%	3.4%	2.1%
Germany	2.6%	1.7%	1.3%	2.3%	2.9%	1.9%
France	2.1%	1.6%	1.2%	1.6%	3.3%	1.9%
Italy	1.4%	0.5%	0.8%	2.0%	3.7%	2.0%
UK	3.1%	1.4%	1.2%	2.3%	3.2%	1.9%
Japan	2.0%	1.4%	1.0%	0.1%	1.1%	0.4%
Canada	2.7%	0.9%	1.5%	2.1%	2.3%	1.9%
Developing Economies						
China	11.6%	9.7%	9.0%	4.8%	6.9%	3.8%
India	9.0%	7.5%	7.5%	6.5%	6.9%	5.5%
Mexico	3.3%	2.3%	2.1%	4.0%	4.7%	3.8%
Brazil	5.4%	4.5%	3.4%	3.6%	5.5%	4.6%

<sup>1</sup>Data As of: July 9, 2008

Wachovia Currency Forecast								
(End of Quarter Rates)								
	2008		2009				2010	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Major Currencies								
Euro (\$/€)	1.58	1.55	1.50	1.45	1.40	1.35	1.30	1.26
U.K. (\$/£)	1.98	1.94	1.90	1.85	1.80	1.75	1.72	1.70
U.K. (£/€)	0.80	0.80	0.79	0.78	0.78	0.77	0.76	0.74
Japan (¥/\$)	106	110	114	116	118	120	122	125
Other Industrialized								
Canada (C\$/US\$)	1.00	1.02	1.06	1.10	1.14	1.16	1.18	1.20
Switzerland (CHF/\$)	1.02	1.04	1.07	1.10	1.14	1.18	1.22	1.25
Norway (NOK/\$)	5.00	5.10	5.20	5.40	5.60	5.80	5.90	6.00
Sweden (SEK/\$)	5.95	6.05	6.20	6.40	6.60	6.80	7.00	7.20
Australia (US\$/A\$)	0.96	0.94	0.92	0.88	0.84	0.80	0.76	0.72
Developing Economies								
Mexico (MXN/\$)	10.30	10.40	10.60	10.80	11.00	11.20	11.40	11.50
Brazil (BRL/\$)	1.55	1.60	1.65	1.70	1.75	1.80	1.85	1.90
Poland (PLN/\$)	2.10	2.15	2.20	2.30	2.35	2.40	2.45	2.50
Russia (RUB/\$)	23.80	23.60	23.40	23.20	23.00	22.80	22.60	22.40
Turkey (TRY/\$)	1.22	1.25	1.28	1.32	1.34	1.36	1.38	1.40
South Africa (ZAR/\$)	7.60	7.80	8.00	8.20	8.40	8.60	8.80	9.00
China (CNY/\$)	6.80	6.60	6.50	6.40	6.30	6.20	6.10	6.00
India (INR/\$)	43.50	43.25	43.00	42.75	42.50	42.25	42.00	41.80
Korea (KRW/\$)	1040	1030	1020	1010	1000	980	970	960
Singapore (S\$/US\$)	1.37	1.36	1.35	1.34	1.33	1.32	1.31	1.30
Taiwan (TWD/\$)	30.40	30.20	30.00	29.80	29.60	29.40	29.20	29.00

<sup>2</sup>Data as of: July 9, 2008

Wachovia International Interest Rate Forecast																
(End of Quarter Rates)																
	3-Month LIBOR								10-Yr Government Security							
	2008		2009				2010		2008		2009				2010	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
United States	2.60%	2.35%	2.30%	2.30%	2.40%	2.50%	N/A	N/A	4.00%	4.00%	4.10%	4.25%	4.25%	4.40%	N/A	N/A
Japan	0.85%	0.75%	0.70%	0.70%	0.70%	0.90%	0.90%	0.90%	1.50%	1.55%	1.60%	1.80%	2.00%	2.10%	2.05%	2.00%
Euroland	4.95%	4.80%	4.50%	3.90%	3.90%	3.90%	4.20%	4.40%	4.50%	4.25%	4.00%	4.10%	4.30%	4.50%	4.60%	4.70%
U.K.	5.70%	5.30%	4.80%	4.15%	4.15%	4.15%	4.40%	4.70%	4.90%	4.70%	4.50%	4.50%	4.60%	4.80%	5.00%	5.10%
Canada	3.40%	3.20%	3.20%	3.20%	3.50%	3.75%	4.00%	4.20%	3.70%	3.75%	3.90%	4.10%	4.20%	4.30%	4.40%	4.50%

<sup>3</sup>Data As of: July 9, 2008

## Wachovia Economics Group

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