WACHOVIA
ECONOMICS GROUP

MONTHLY OUTLOOK

June 06, 2007

U.S. Overview

Economic growth is now widely expected to bounce back solidly from the tepid 0.6 percent pace posted during the first quarter. A consensus seems to be building around real GDP growth rising in the 3 percent range during the current quarter. We see economic activity expanding at a slightly faster rate, with output climbing at a 3.5 percent pace.

The improved economic outlook largely results from a couple of strong reports on factory orders, particularly for nondefense capital goods, and much stronger reports from the national and various regional purchasing managers' surveys. In addition, consumer confidence is holding up better than expected, consumer spending remains solid, and the employment data have strengthened.

The economy's apparent abrupt turnaround has raised inflation fears and dampened expectations of lower interest rates. Several large investment banks have dramatically increased their forecasts for second quarter growth and many have taken rate cuts out of their near-term forecast.

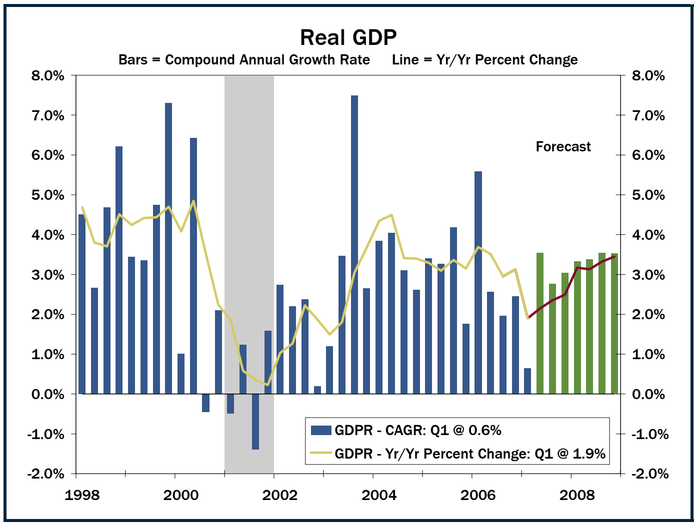
We have had the Fed on hold for quite some time and most of the changes made to our current forecast merely incorporate the latest revisions to first quarter data. First quarter GDP was revised down 0.7 percentage points, mostly due to a larger drawdown in inventories. Our forecast for second quarter real GDP has been raised by a like amount and now shows output expanding at a 3.5 percent pace. From our perspective, the outlook has not changed all that much. What has changed is Wall Street's perception of how strong the economy actually is.

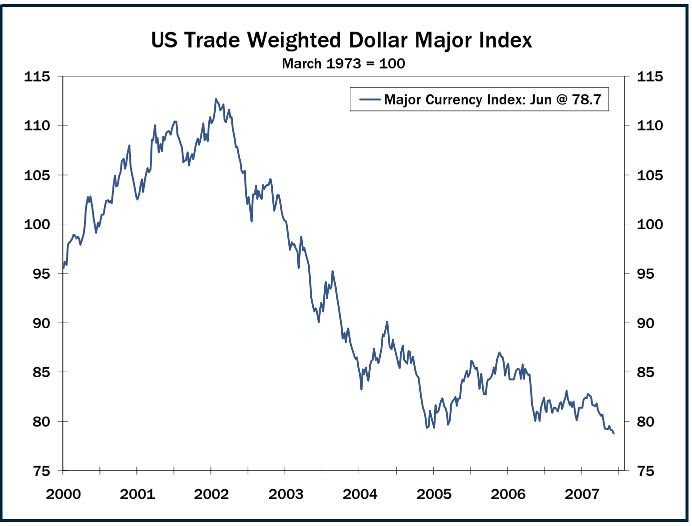
International Overview

After depreciating for most of the year, the dollar has stabilized versus most major currencies over the past month or so. Stronger-than-expected U.S. economic data have poured cold water on the notion that the FOMC would cut rates this year. Interest rate differentials, however, have not yet moved back in the dollar's favor because most foreign central banks have been hiking rates. Although inflation rates in most foreign economies generally remain benign, foreign policymakers want to take pre-emptive steps to ensure that inflation remains under control.

The narrowing in interest rate differentials between the United States and the rest of the world that has occurred this year has eroded the relative attractiveness of U.S. assets, leading to a weakening in net capital inflows. Not only have foreign investors reduced their purchases of U.S. assets somewhat, but domestic investors have become more interested in buying foreign securities as rates of return abroad have risen.

Looking forward, we continue to project that the dollar will trend lower versus most currencies over the next few quarters. In our view, interest rate differentials need to swing back in favor of dollar assets before the greenback can start to trend upward again. Although the Fed may not cut rates this year, it likely will not be hiking rates anytime soon either. Looking much further ahead, we project that the dollar will begin to strengthen in the second half of next year as the Federal Reserve begins to tighten anew. To reiterate, however, we believe that the dollar will depreciate further before it starts to appreciate on a sustained basis.





The Economy Appears Set To Spring Forward

Given all the talk about weakness in the housing market, the woes in the sub-prime mortgage market, and the downward adjustment to first quarter real GDP growth to a tepid 0.6 percent annual rate, many people might find it surprising that economic activity could bounce back so solidly in the current quarter. Our forecast for 3.5 percent growth would end a string of four consecutive quarters of below trend growth and would mark the strongest quarterly growth rate since the first quarter of last year.

While we have a high degree of confidence in our forecast, we do not believe that economic activity has heated up as much as the headline numbers suggest. Simply averaging our estimate of second quarter growth along with the first quarter's 0.6 percent gain yields a 2.1 percent pace for the first half of this year. That pace is roughly equal to what has been seen over the past year.

Most of the improvement in second quarter GDP simply results from a bounce back in some of the things that were ***unusually depressed*** in the first quarter. Other areas, such as housing and international trade, which were big drags on first quarter growth, are expected to be less of a problem in the current quarter.

Business inventories, which subtracted 0.9 percentage points off first quarter GDP growth and sliced 1.1 percentage points off fourth quarter growth, are one area primed for a bounce back. We are looking for a modest rebound in the current quarter, with inventories rising by $12.4 billion and adding 0.6 percentage points to growth.

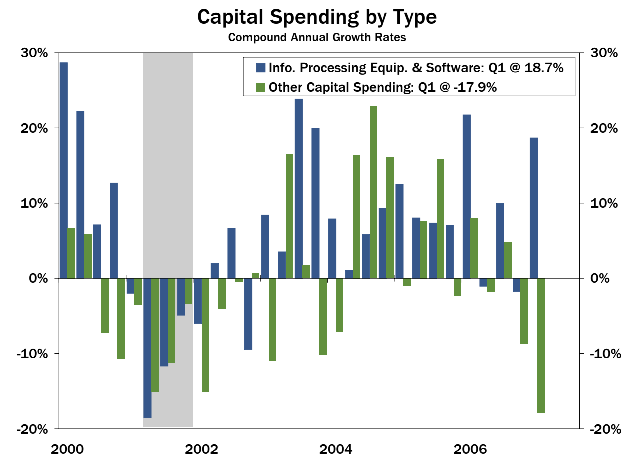
Another area where activity is bouncing back is business fixed investment. Outlays for equipment and software eked out a 2.0 percent annualized gain in the first quarter, following a 4.8 percent drop the previous quarter. All the first quarter's gain was in IT equipment and software, which soared at an 18.7 percent annual rate. By contrast, investment in other business equipment plunged at a 17.9 percent pace, as heavy truck sales continued to suffer from a new EPA mandate on diesel engines. Rental car fleet purchases were also smaller this year, as the big domestic auto producers decided not to go after that market.

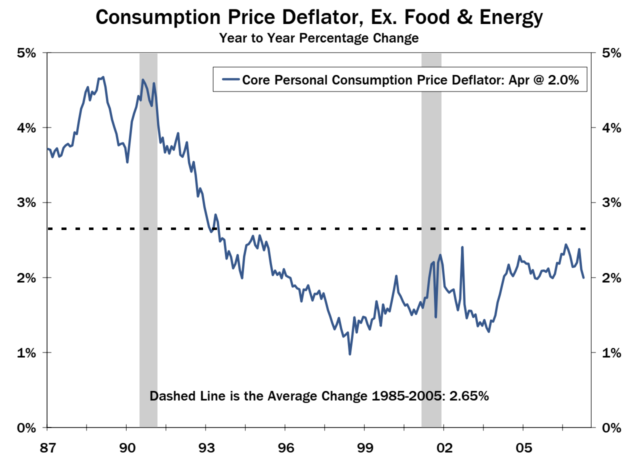
More recent data suggest business investment has picked up. Orders for nondefense capital goods, excluding aircraft, rose 4.6 percent in March and an additional 2.1 percent in April. Moreover, the new orders component of the Chicago Purchasing Managers' survey leapt 14.6 points to 71.1 in May, and several other regional indices posted similar gains. The national ISM survey rose more modestly, climbing 0.3 points to 55.0 in May. The new orders series rose 1.1 points to 59.6.

The improvement in the purchasing managers' surveys bodes well for the upcoming data on May factory orders and shipments. Even a modest improvement in the May numbers would just about insure that business fixed investment will rise at around a seven percent pace, which is what we are projecting for the second quarter.

The rise in the ISM survey and regional purchasing managers' surveys may be giving off an impression of a more lasting improvement than we can count on just yet. Remember that these surveys are diffusion indexes and tell us more about the timing and breadth of any improvement in the economy than they do about the magnitude. The most recent improvement follows a string of weaker numbers late last year and earlier this year. We expect the purchasing managers' surveys, new orders and investment outlays to fall back a little bit in coming months, which should help cool off some of the inflation concerns that have sprung up recently.

The inflation data have improved and will likely continue to do so this summer. While higher gasoline prices remain a risk, there is a growing probability most of the damage is behind us. We are beginning to see some moderation in housing costs, which should help contain core inflation. The core PCE deflator should remain near the top end of the Fed's comfort zone, which should allow the Fed to hold rates steady in 2007. Better news on inflation should also help contain the carnage in the bond market.





Wachovia U.S. Economic Forecast

	Actual					Forecast											Actual		Forecast		
	2006				2007				2008				2009				2005	2006	2007	2008	2009
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product (a)	5.6	2.6	2.0	2.5	0.6	3.5	2.8	3.0	3.3	3.4	3.5	3.5	3.5	3.4	3.4	3.2	3.2	3.3	2.2	3.3	3.5
Personal Consumption	4.8	2.6	2.8	4.2	4.4	2.5	3.0	3.0	2.9	3.0	3.1	3.0	3.1	3.1	3.1	3.1	3.5	3.2	3.4	2.9	3.1
Business Fixed Investment	13.7	4.4	10.0	-3.1	2.9	7.0	3.9	3.6	6.0	4.4	4.1	4.2	4.9	4.6	4.3	4.1	6.8	7.2	3.6	4.7	4.5
Equipment and Software	15.6	-1.4	7.7	-4.8	2.0	8.0	3.6	3.3	6.5	4.5	4.0	4.2	5.0	4.7	4.4	4.1	8.9	6.5	2.5	4.8	4.5
Structures	8.8	20.3	15.7	0.9	5.0	5.5	5.0	4.5	4.2	4.3	4.3	4.4	4.3	4.3	4.1	4.0	1.1	9.0	6.4	4.5	4.3
Residential Construction	-0.3	-11.1	-18.6	-19.8	-15.4	-12.0	-8.5	-5.5	-3.0	-1.0	0.0	0.5	1.5	2.0	2.0	2.1	8.6	-4.2	-14.4	-3.8	1.2
Government Purchases	4.9	0.8	1.7	3.4	1.0	2.8	2.4	2.3	2.2	2.1	2.1	2.1	2.1	2.2	2.2	2.1	0.9	2.1	2.1	2.3	2.1
Net Exports	-636.6	-624.2	-628.8	-582.6	-611.8	-607.7	-610.1	-606.1	-601.6	-594.0	-583.0	-569.4	-560.5	-553.8	-547.9	-546.0	-619.2	-618.1	-608.9	-587.0	-552.1
Pct. Point Contribution to GDP	0.0	0.4	-0.2	1.6	-1.0	0.1	-0.1	0.1	0.2	0.3	0.4	0.5	0.3	0.2	0.2	0.1	-0.3	0.0	0.1	0.2	0.3
Inventory Change	41.2	53.7	55.4	22.4	-4.5	12.4	18.7	24.0	28.1	32.2	36.3	36.9	37.2	37.7	38.2	38.7	19.7	43.2	12.7	33.4	38.0
Pct. Point Contribution to GDP	-0.1	0.4	0.1	-1.1	-0.9	0.6	0.2	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	-0.3	0.2	-0.3	0.2	0.0
Nominal GDP	9.0	5.9	3.9	4.1	4.7	6.8	5.2	5.4	5.9	5.9	5.9	5.9	6.0	5.9	6.0	5.8	6.3	6.3	5.1	5.8	5.9
Real Final Sales	5.6	2.1	1.9	3.7	1.6	3.1	2.6	2.9	3.2	3.2	3.4	3.5	3.5	3.4	3.4	3.2	3.5	3.1	2.5	3.1	3.4
Retail Sales (b)	7.9	6.4	5.4	5.0	3.4	3.8	4.4	5.8	5.6	5.7	5.5	5.2	5.1	5.3	5.3	5.4	6.6	6.1	4.4	5.5	5.3
Inflation Indicators (b)																					
"Core" PCE Deflator	2.0	2.2	2.4	2.2	2.2	2.0	1.9	2.0	2.0	2.1	2.2	2.3	2.3	2.3	2.3	2.4	2.1	2.2	2.0	2.1	2.3
Consumer Price Index	3.7	4.0	3.4	1.9	2.4	2.4	2.0	3.0	2.6	2.0	2.2	2.4	2.4	2.4	2.4	2.4	3.4	3.2	2.5	2.3	2.4
"Core" Consumer Price Index	2.1	2.4	2.8	2.7	2.6	2.3	2.0	2.0	2.1	2.2	2.3	2.3	2.2	2.2	2.2	2.3	2.2	2.5	2.2	2.2	2.2
Producer Price Index	4.4	4.4	2.8	0.3	2.0	3.2	3.4	4.7	3.6	2.0	2.0	2.1	2.1	2.2	2.3	2.4	4.9	2.9	3.3	2.4	2.2
Employment Cost Index	2.8	3.0	3.3	3.3	3.5	3.3	3.3	3.2	3.5	3.4	3.3	3.3	3.6	3.5	3.4	3.3	3.2	3.1	3.3	3.4	3.4
Real Disposable Income (a)	4.6	-1.5	3.2	6.4	4.7	0.7	3.6	3.1	3.1	3.2	3.2	3.3	3.3	3.4	3.4	3.4	1.2	2.6	3.5	3.1	3.3
Nominal Personal Income (b)	6.7	6.4	6.6	5.8	5.8	6.0	5.7	5.4	4.6	5.1	5.5	5.9	6.0	6.0	6.0	5.9	5.2	6.4	5.7	5.3	5.9
Industrial Production (a)	5.0	6.5	4.0	-1.5	0.9	4.2	3.1	3.4	3.6	3.8	3.9	4.2	4.1	3.9	3.7	3.7	3.2	4.0	2.2	3.6	3.9
Capacity Utilization	81.2	82.0	82.3	81.5	81.3	81.4	81.4	81.5	81.8	81.9	82.1	82.4	82.6	82.8	82.1	81.8	80.2	81.7	81.4	82.0	82.3
Corporate Profits Before Taxes (b)	18.9	18.5	30.6	18.3	6.3	6.0	-4.0	4.5	7.5	7.7	7.8	8.0	8.2	8.3	8.3	8.4	12.5	21.4	3.1	7.8	8.3
Corporate Profits After Taxes	21.0	17.4	31.0	21.0	6.4	7.0	-3.0	5.0	8.0	8.2	8.3	8.5	8.6	8.6	8.7	8.8	5.5	22.5	3.8	8.3	8.7
Federal Budget Balance (c)	-183.6	96.5	-41.7	-80.4	-178.0	152.7	-55.0	-99.0	-153.0	91.0	-59.0	-76.0	-142.0	102.0	-50.0	-69.0	-318.7	-248.2	-160.8	-220.0	-166.0
Current Account Balance (d)	-213.8	-217.7	-229.4	-195.8	-201.0	-204.0	-205.0	-203.0	-199.0	-200.0	-197.0	-192.0	-191.0	-187.0	-184.0	-181.0	-791.5	-856.7	-813.0	-788.0	-743.0
Trade Weighted Dollar Index (e)	85.2	81.4	82.0	81.5	80.5	78.5	76.2	74.9	73.6	73.4	74.6	75.9	77.0	78.3	79.5	80.0	86.0	81.5	74.9	75.9	80.0
Nonfarm Payroll Change (f)	252	124	202	177	142	124	125	128	133	138	143	147	165	170	170	170	212	189	130	140	169
Unemployment Rate	4.7	4.6	4.7	4.5	4.5	4.5	4.5	4.4	4.4	4.3	4.3	4.2	4.2	4.2	4.2	4.1	5.1	4.6	4.5	4.3	4.2
Housing Starts (g)	2.13	1.86	1.70	1.55	1.46	1.50	1.45	1.44	1.46	1.49	1.50	1.52	1.53	1.54	1.57	1.60	2.07	1.81	1.46	1.49	1.56
Light Vehicle Sales (h)	16.9	16.3	16.6	16.3	16.5	16.3	16.4	16.5	16.6	16.6	16.7	16.8	16.7	16.7	16.7	16.7	16.9	16.5	16.4	16.6	16.7
Crude Oil – WTI – Front Contract (i)	63.48	70.70	70.48	60.21	58.16	64.10	65.00	60.00	59.00	62.50	62.50	60.00	62.00	64.00	64.00	62.00	56.56	66.22	61.81	61.00	63.00
Quarter-End Interest Rates																					
Federal Funds Target Rate	4.75	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.50	5.50	5.75	5.75	5.75	5.75	5.75	4.25	5.25	5.25	5.75	5.75
3 Month LIBOR	5.00	5.48	5.37	5.36	5.35	5.35	5.35	5.35	5.35	5.60	5.60	5.80	5.85	5.85	5.90	5.90	4.54	5.36	5.35	5.80	5.90
Prime Rate	7.75	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.50	8.50	8.75	8.75	8.75	8.75	8.75	7.25	8.25	8.25	8.75	8.75
Conventional Mortgage Rate	6.32	6.68	6.40	6.14	6.16	6.45	6.55	6.60	6.70	6.80	6.90	7.10	7.20	7.40	7.45	7.50	6.27	6.14	6.60	7.10	7.50
3 Month Bill	4.63	5.01	4.89	5.02	5.04	5.00	5.00	5.10	5.20	5.40	5.40	5.75	5.80	5.80	5.80	5.80	4.08	5.02	5.10	5.75	5.80
2 Year Note	4.82	5.16	4.71	4.82	4.58	4.85	4.90	4.90	5.00	5.20	5.25	5.40	5.55	5.70	5.80	5.80	4.41	4.82	4.90	5.40	5.80
5 Year Note	4.82	5.10	4.59	4.70	4.54	4.80	4.90	4.95	5.00	5.20	5.30	5.45	5.60	5.75	5.80	5.85	4.35	4.70	4.95	5.45	5.85
10 Year Note	4.86	5.15	4.64	4.71	4.65	4.85	4.95	5.00	5.10	5.20	5.30	5.50	5.60	5.80	5.85	5.90	4.39	4.71	5.00	5.50	5.90
30 Year Bond	4.90	5.19	4.77	4.81	4.84	4.95	5.05	5.10	5.20	5.30	5.40	5.60	5.70	5.90	6.00	6.00	4.51	4.81	5.10	5.60	6.00

Data As of: June 6, 2007

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

Dollar Stabilizes, For Now.

After depreciating earlier this year, the dollar has stabilized versus most major currencies over the past month due in part to shifting expectations about Fed policy going forward (see graph on front page). As little as a month ago, many investors had expected the Fed to cut rates this year. However, stronger-than-expected data over the past few weeks have led many market participants to conclude that the U.S. economy does not need easier monetary policy. The back-up in U.S. bond yields recently has lent some support to the greenback. Although the dollar could rally in the near term, we do not believe that sustained appreciation is imminent. Indeed, we continue to project that the greenback will trend lower over the next few quarters.

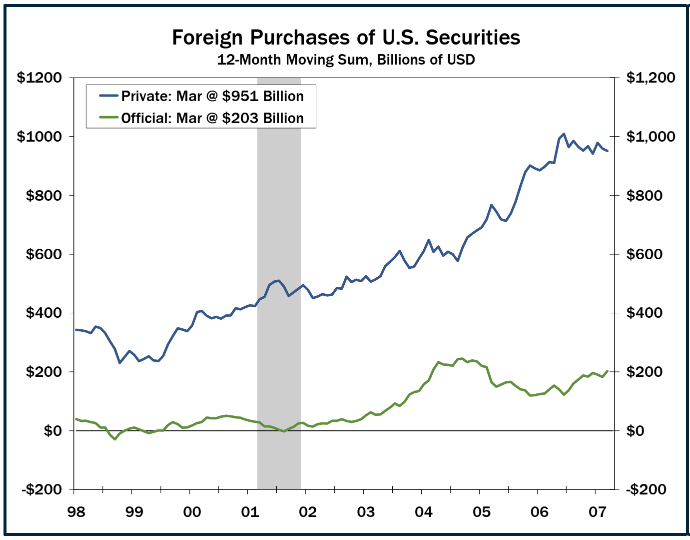
As is widely known, the United States continues to post massive current account deficits that need to be financed via net capital inflows. Although foreign purchases of U.S. securities remain at high levels, they appear to be trending slowly lower (see chart below). At the same time, U.S. purchases of foreign securities have jumped recently (see chart below), meaning that net capital inflows have weakened. Lower net capital inflows have put downward pressure on the greenback.

Interest Rate Differentials Need to Swing Back in Dollar's Favor.

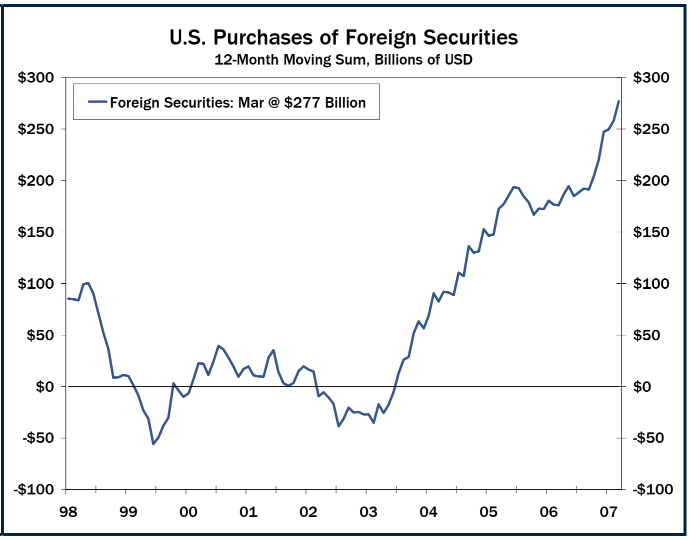
What's behind the slowdown in net capital inflows? Narrowing interest rate differentials between the United States and the rest of the world have eroded the relative attractiveness of U.S. assets. The Fed has been on hold for nearly a year, which has resulted in little net change in U.S. bond yields over the past year. On the other hand, many foreign central banks have tightened policy over the past year. For example, the European Central Bank has raised its policy rate by 150 basis points since last June. Whereas the 2-year government bond yield in the United States is unchanged on balance since last June, the comparable yield in the Euro-zone is up more than 100 basis points over that period. Little wonder that net capital inflows have been weakening.

As expectations of Fed easing have dissipated recently, the dollar has stabilized. However, we believe that interest rate differentials will need to move back in favor of dollar assets for a sustained dollar rally to take place. Although the Fed may not ease policy, it still is a long way away from hiking rates. In the meantime, other central banks, which generally have lagged the Federal Reserve in this tightening cycle, will likely continue to hike rates, and with good reason. Growth rates in most foreign economies remain very solid, and it is hard to make a convincing case that global financial conditions are restrictive at present. Although inflation rates in most foreign economies remain benign, foreign central banks will want to take preemptive steps to insure that inflation rates do indeed remain under control. Therefore, rates abroad should continue to head higher at a modest pace.

Looking far ahead, our forecast calls for the dollar to strengthen in the second half of next year. We generally try to refrain from picking turning points in dollar exchange rates far in the future. However, the greenback has been depreciating on a trend basis for five years, and it is bound to turn around sooner or later. Besides, the turnaround we project is consistent with our expectations that the FOMC will tighten anew next year. As interest rate differentials move back in favor of the dollar, the relative attractiveness of dollar assets will begin to improve, which should lead to stronger capital inflows. To reiterate, however, we believe that the dollar will weaken further before it begins a sustained turnaround. In our view, higher rates in the United States are needed before a trend change in the dollar can begin. Although the FOMC may ease policy, it is still a long way from raising rates.


Foreign Purchases of U.S. Securities

12-Month Moving Sum, Billions of USD


U.S. Purchases of Foreign Securities

12-Month Moving Sum, Billions of USD

June 6, 2007

Wachovia International Economic Forecast

(Year-over-Year Percentage Change)

	GDP			CPI		
	2006	2007	2008	2006	2007	2008
Global	5.4%	4.3%	4.6%	N/A	N/A	N/A
Major Economies						
United States	3.3%	2.2%	3.3%	3.2%	2.5%	2.3%
Eurozone	2.8%	2.7%	2.3%	2.2%	2.0%	2.1%
Germany	3.0%	2.9%	2.3%	1.8%	2.1%	1.8%
France	2.2%	2.1%	2.3%	1.9%	1.6%	2.0%
Italy	1.9%	1.7%	1.5%	2.2%	1.9%	1.9%
UK	2.8%	2.8%	2.4%	2.3%	2.3%	2.0%
Japan	2.2%	2.4%	2.3%	0.2%	0.0%	0.4%
Canada	2.8%	2.5%	2.8%	2.0%	2.3%	2.1%
Developing Economies						
China	10.7%	10.2%	9.6%	1.5%	2.7%	2.4%
India	9.4%	8.1%	8.6%	5.9%	6.6%	5.2%
Mexico	4.8%	2.9%	3.6%	3.6%	3.7%	3.3%
Brazil	3.7%	3.9%	3.5%	4.2%	3.5%	3.2%

[1]Data As of: June 6, 2007

Wachovia Currency Forecast

(End of Quarter Rates)

	2007			2008			
	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Major Currencies							
Euro ($/€)	1.34	1.38	1.40	1.42	1.42	1.40	1.38
U.K. ($/£)	1.97	2.03	2.07	2.12	2.12	2.10	2.08
U.K. (£/€)	0.68	0.68	0.68	0.67	0.67	0.67	0.66
Japan (¥/$)	120	118	116	114	112	110	109
Other Industrialized							
Canada (C$/US$)	1.08	1.04	1.02	1.00	1.00	1.04	1.08
Switzerland (CHF/$)	1.23	1.19	1.17	1.15	1.15	1.16	1.17
Norway (NOK/$)	6.00	5.80	5.65	5.50	5.50	5.55	5.60
Sweden (SEK/$)	6.95	6.70	6.60	6.45	6.40	6.45	6.50
Australia (US$/A$)	0.84	0.86	0.88	0.88	0.86	0.84	0.80
Developing Economies							
Mexico (MXN/$)	10.70	10.40	10.20	10.00	10.00	10.10	10.20
Brazil (BRL/$)	1.90	1.85	1.80	1.75	1.75	1.80	1.90
Poland (PLN/$)	2.80	2.70	2.60	2.55	2.50	2.50	2.55
Russia (RUB/$)	25.80	25.25	24.75	24.25	23.75	23.50	23.25
Turkey (TRY/$)	1.32	1.30	1.28	1.25	1.25	1.28	1.32
South Africa (ZAR/$)	7.05	7.00	6.90	6.85	6.85	7.00	7.20
China (CNY/$)	7.62	7.50	7.35	7.20	7.10	6.95	6.80
India (INR/$)	40.00	39.00	38.00	38.50	38.25	38.00	37.75
Korea (KRW/$)	920	910	900	890	885	880	875
Singapore (S$/US$)	1.52	1.50	1.48	1.46	1.45	1.44	1.43
Taiwan (TWD/$)	32.75	32.25	31.75	31.50	31.25	31.00	30.75

[1]Data As of: June 6, 2007

Wachovia International Interest Rate Forecast

(End of Quarter Rates)

	3-Month LIBOR							10-Yr Government Security						
	2007			2008				2007			2008			
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q2	Q3	Q4	Q1	Q2	Q3	Q4
United States	5.35%	5.35%	5.35%	5.35%	5.60%	5.60%	5.80%	4.85%	4.95%	5.00%	5.10%	5.20%	5.30%	5.50%
Japan	0.70%	0.85%	0.90%	1.10%	1.20%	1.30%	1.40%	1.80%	2.00%	2.05%	2.10%	2.15%	2.20%	2.25%
Euroland	4.20%	4.35%	4.35%	4.35%	4.35%	4.35%	4.35%	4.70%	4.90%	5.00%	5.00%	4.95%	4.85%	4.75%
U.K.	5.80%	5.85%	5.85%	5.85%	5.85%	5.85%	5.85%	5.40%	5.60%	5.70%	5.70%	5.60%	5.50%	5.40%
Canada	4.50%	4.85%	4.85%	4.85%	4.85%	4.85%	4.85%	4.60%	4.90%	5.00%	5.00%	4.95%	4.90%	4.85%

[1]Data As of: June 6, 2007

Wachovia Economics

John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wachovia.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wachovia.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wachovia.com
Sam Bullard	Economist	(704) 383-7372	sam.bullard@wachovia.com
Huiwen Lai, Ph.D.	Quantitative Analyst	(704) 715-7415	huiwen.lai@wachovia.com
Jason Schenker	Economist	(704) 383-3695	jason.schenker@wachovia.com
Adam York	Economic Analyst	(704) 715-9660	adam.york@wachovia.com
Tim Quinlan	Economic Analyst	(704) 374-4407	tim.quinlan@wachovia.com

WACHOVIA