



Can Global Growth Lift Europe?

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Please read the important disclosure information in the Addendum section of this presentation.

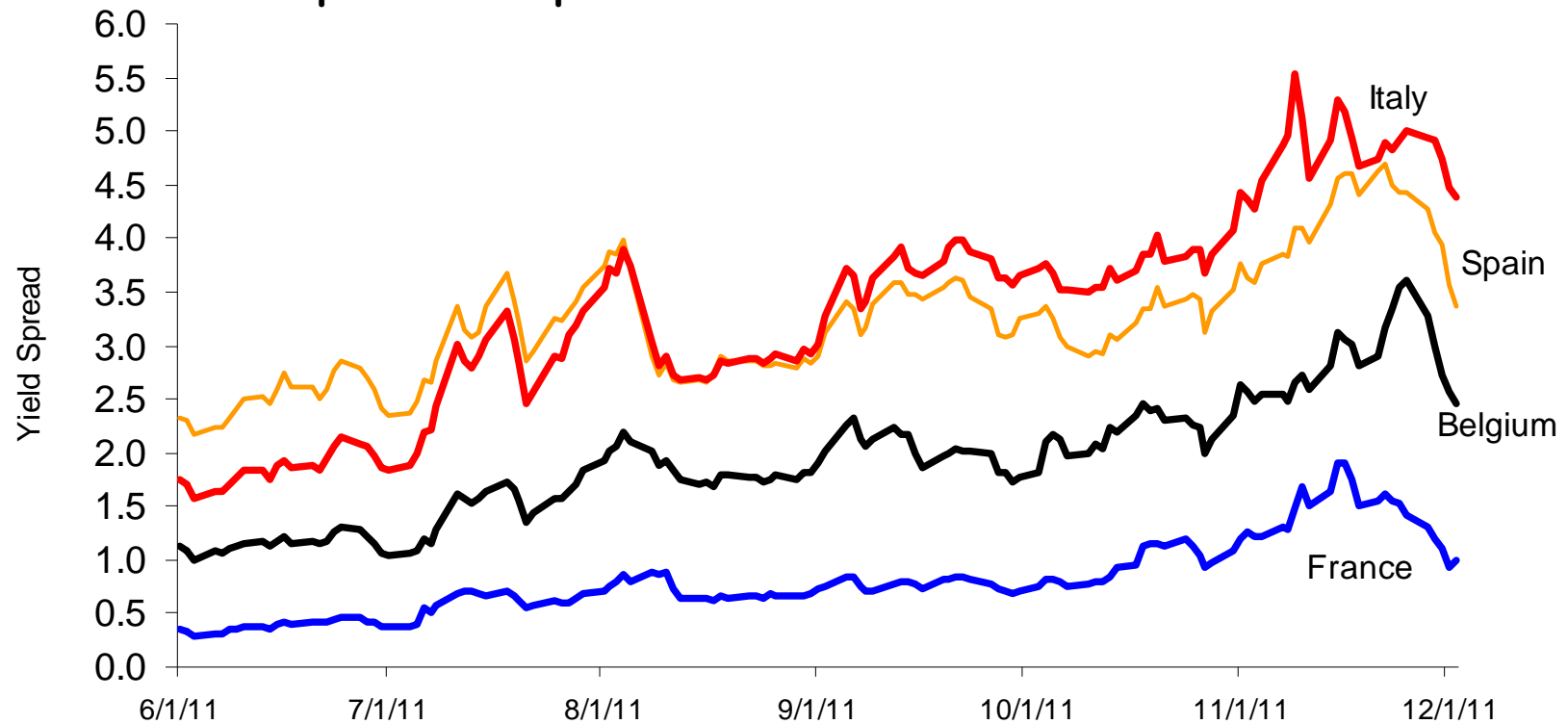
Global Growth Holding Up

- **The U.S. has strengthened from the third quarter into the fourth, with Q4 real GDP growth now looking like at least 3.5%. Corporate profits are still rising – have always fallen prior to recessions.**
 - **China's loosening of monetary policy will begin to offset the contractionary nature of U.S. monetary policy. The Thursday change in coal policy is another plus.**
 - **The key issue is whether Europe will take steps that bring down bond yields in Italy and Spain.**
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Selected European 10 Yr Yield Spreads

(last obs. December 2, 2011)

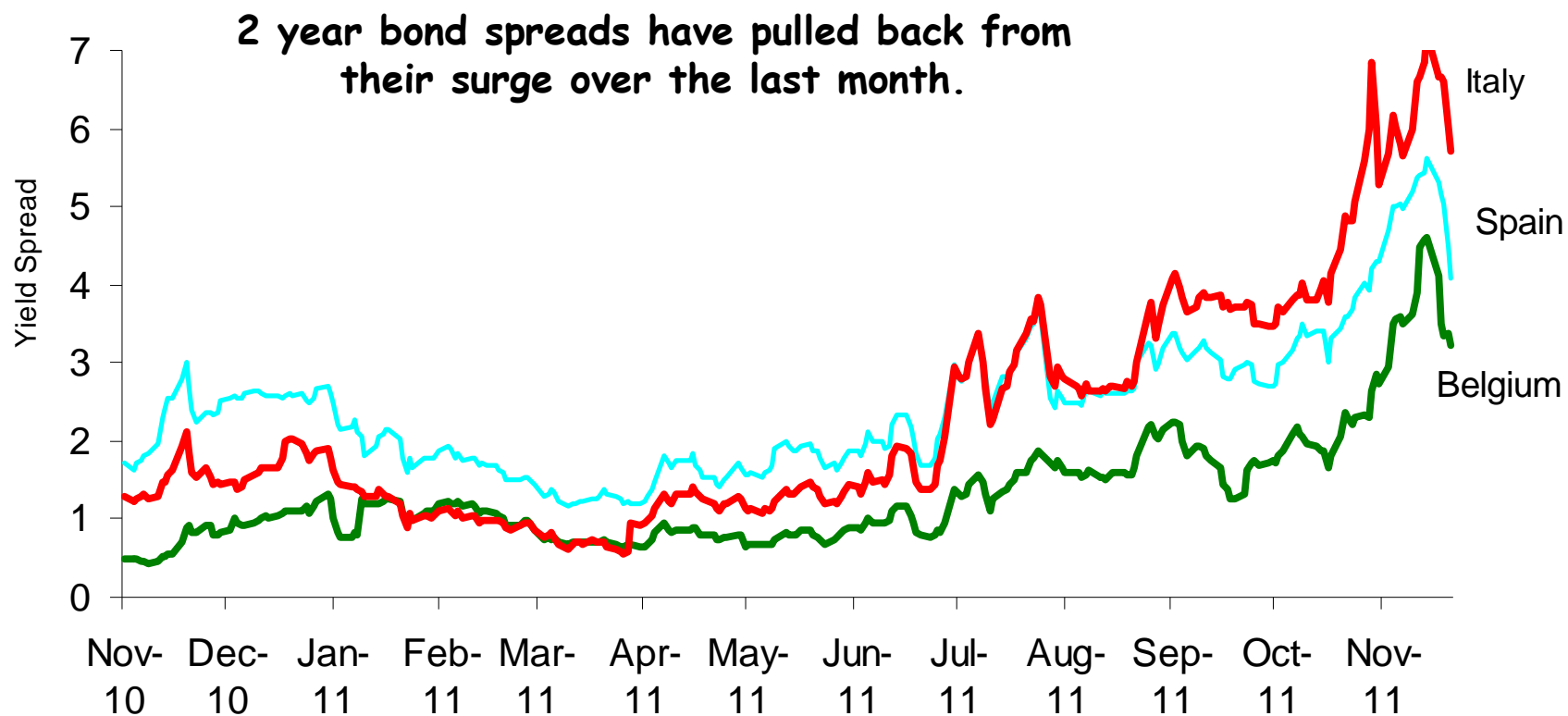
European bond spreads have declined.



Source: Bloomberg; Encima Global

Selected European 2 Yr Yield Spreads

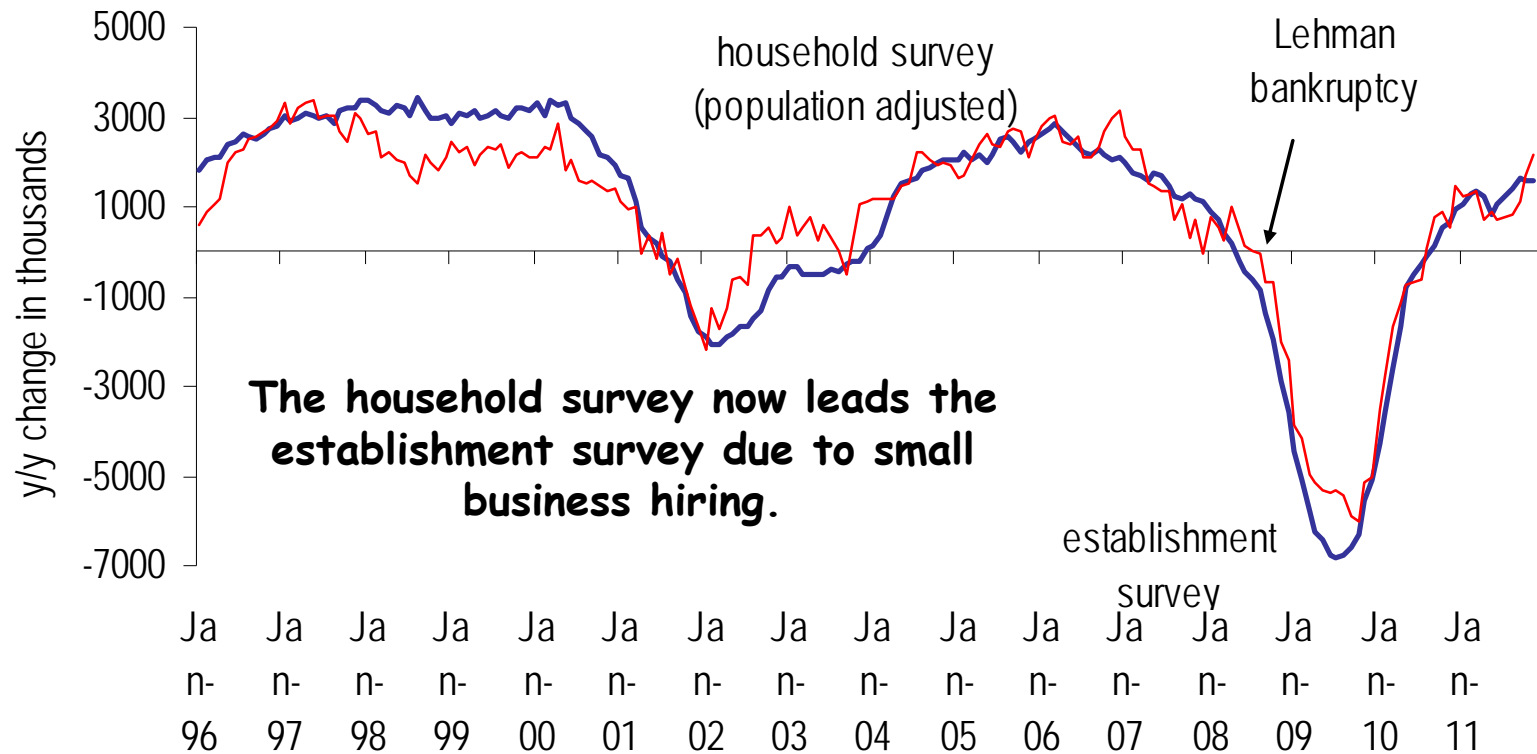
(last obs. December 2, 2011)



Source: Bloomberg; Encima Global

U.S. Annual Employment Growth

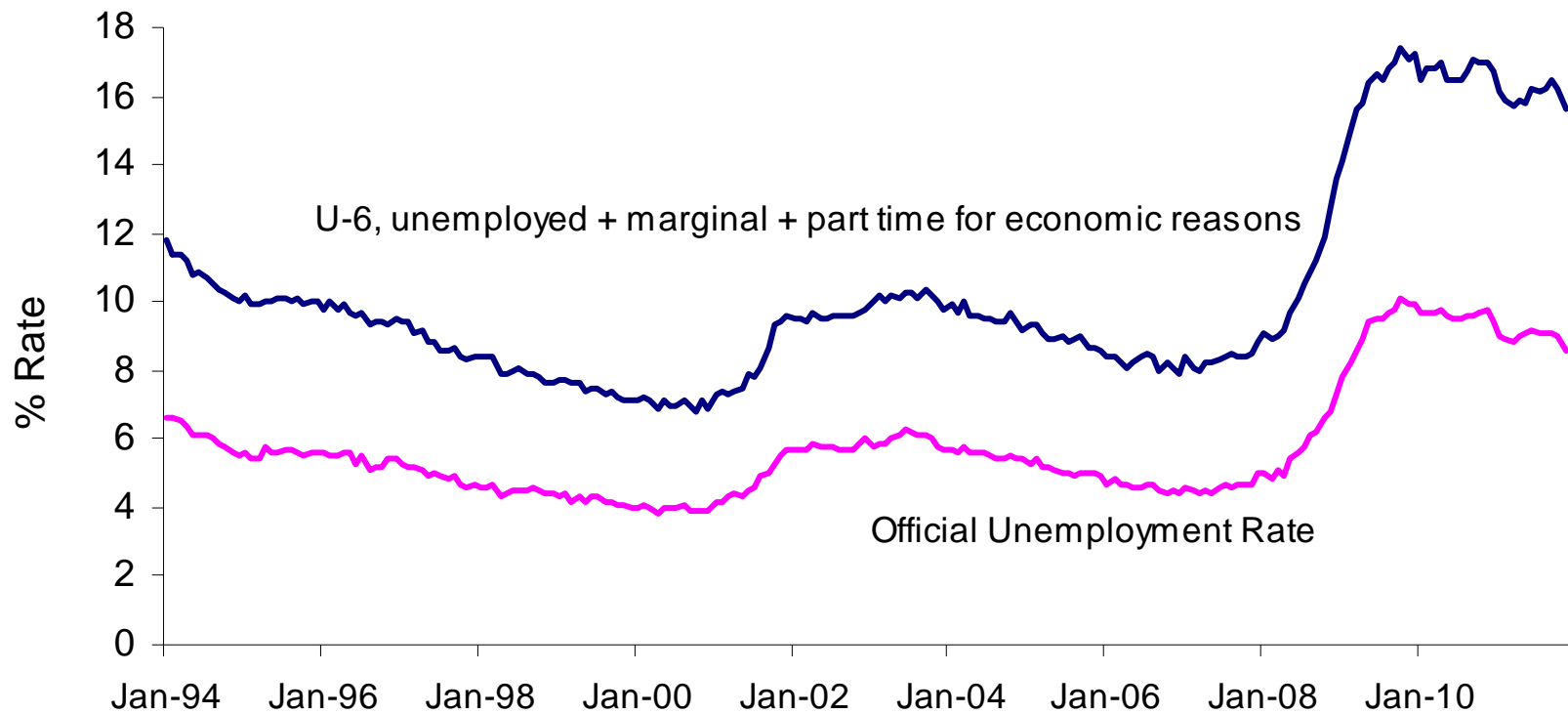
(last obs. November 2011)



Source: Bureau of Labor Statistics; Encima Global

Unemployment and Underemployment Rates Falling

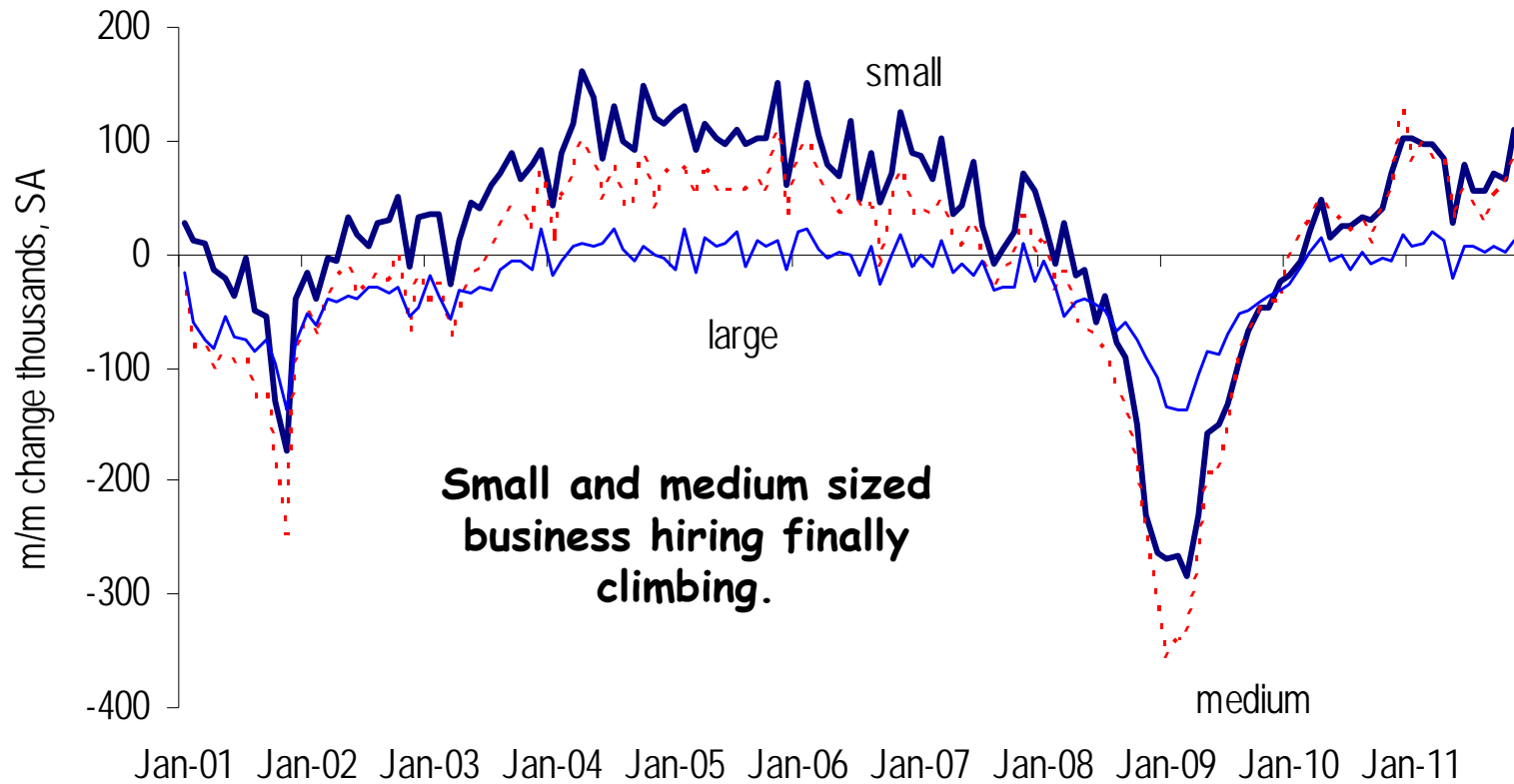
(last obs. October 2011, unemployment 8.6%, underemployment 15.6%)



Source: Bureau of Labor Statistics; Encima Global

ADP Monthly Jobs Growth by Company Size

(last obs. November 2011)



Source: ADP; Encima Global

Initial Jobless Claims Showing Expansion Underway

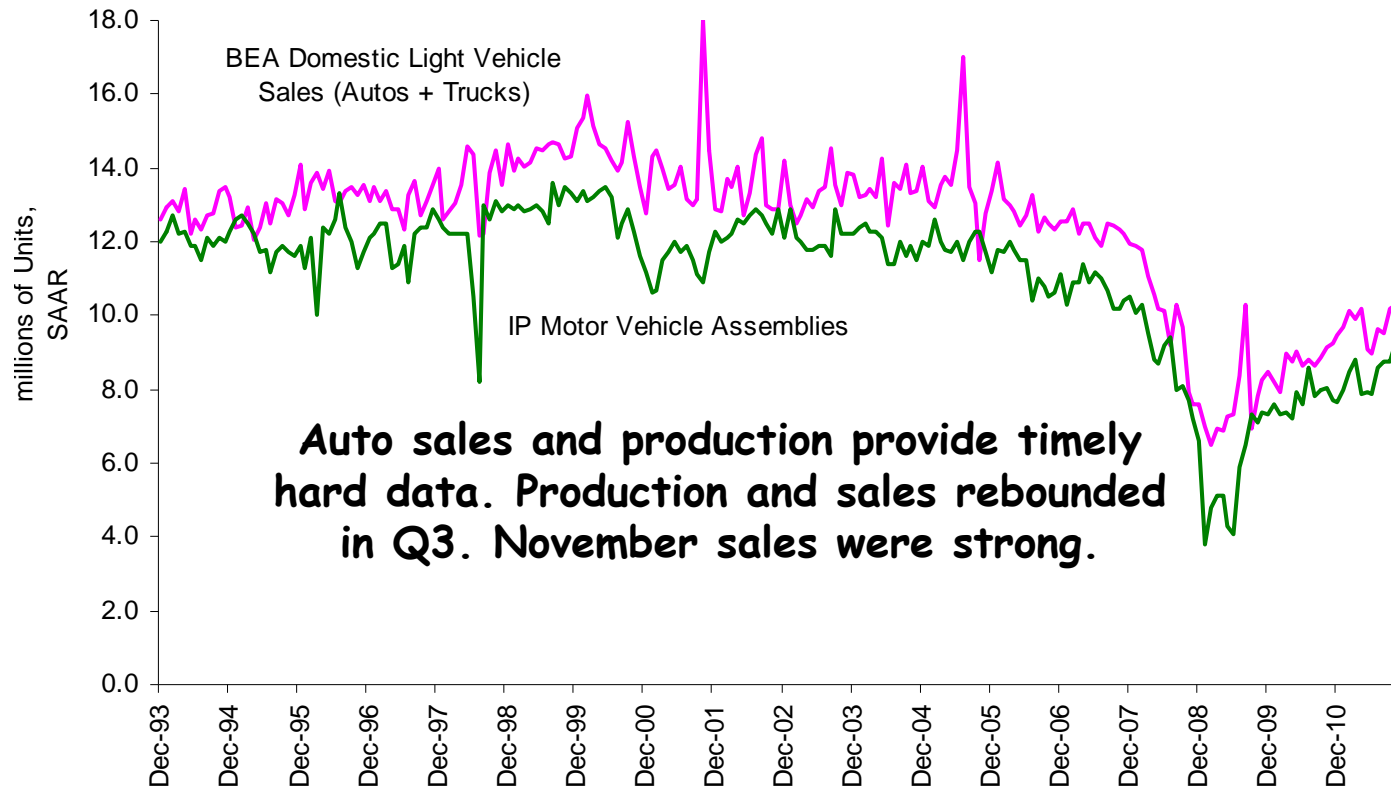
(last obs. November 26, 2011)



Source: Department of Labor: Encima Global

Auto Sales and Production

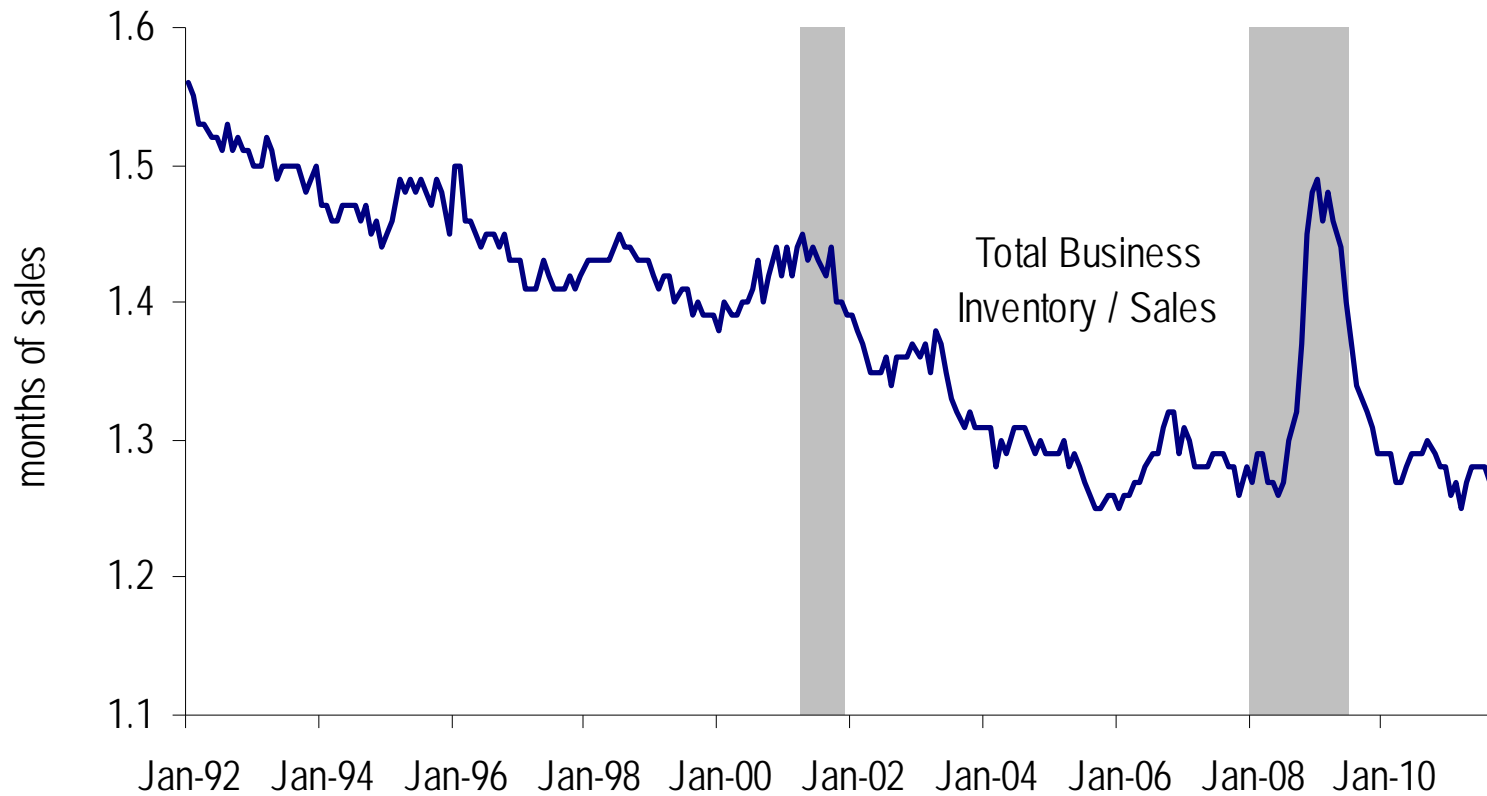
(last IP obs. October 2011, sales for November 2011)



Source: BEA; Federal Reserve; Encima Global

Cyclical Boost: Inventory to Sales Ratio Is Low

(last obs. September 2011)



Source: Census Bureau; Encima Global

ISM Manufacturing

(last obs. November 2011 at 52.7)

ISM manufacturing rose in November. The new orders index was up sharply to 56.7.

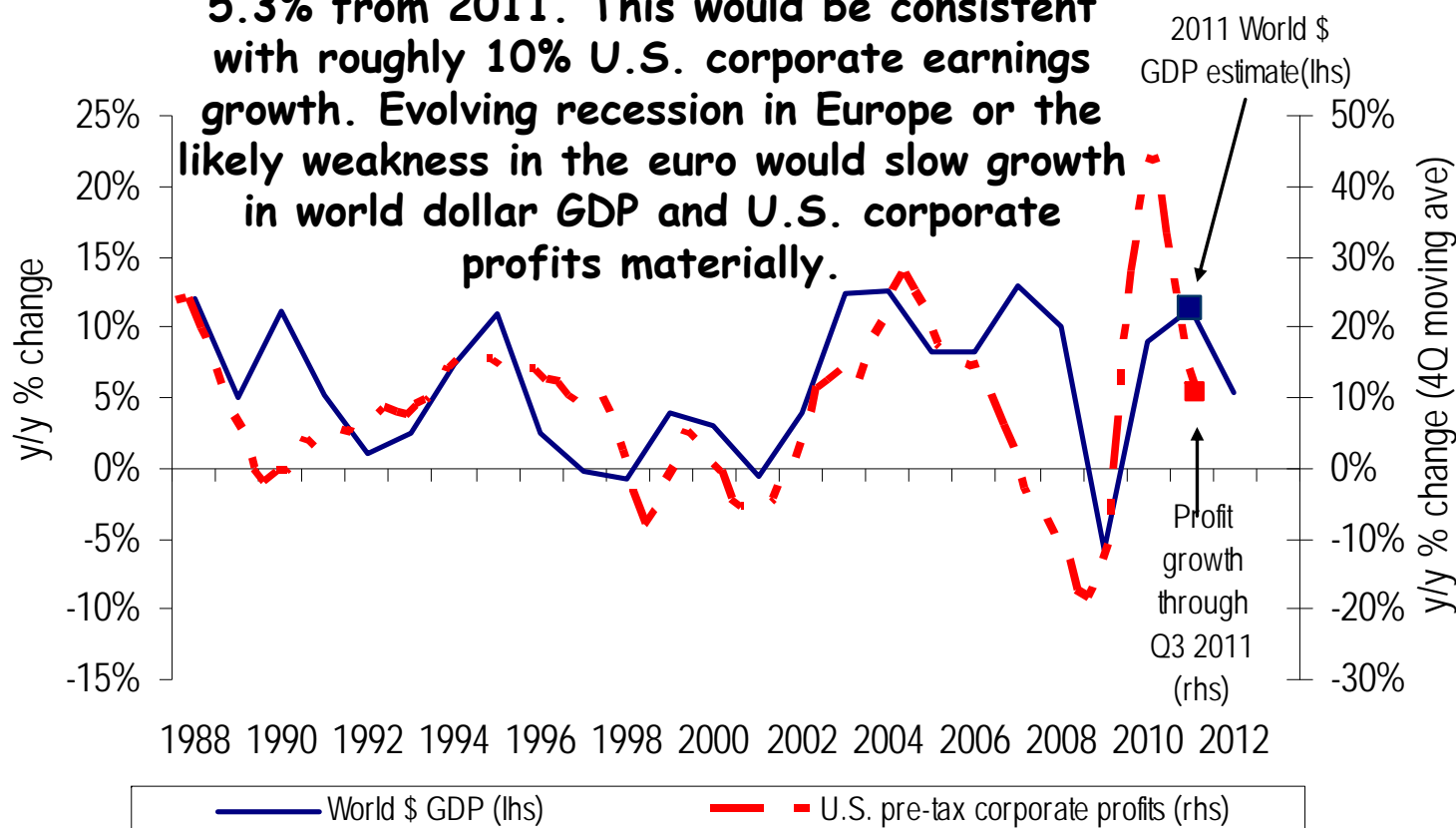


Source: ISM; Encima Global

U.S. Corporate Profits Grow with World \$ GDP

(last obs. Q3 2011 for NIPA corporate profits, IMF forecasts for \$ GDP to 2012)

In 2012, world nominal dollar GDP is expected to reach almost \$74 trillion, up 5.3% from 2011. This would be consistent with roughly 10% U.S. corporate earnings growth. Evolving recession in Europe or the likely weakness in the euro would slow growth in world dollar GDP and U.S. corporate profits materially.

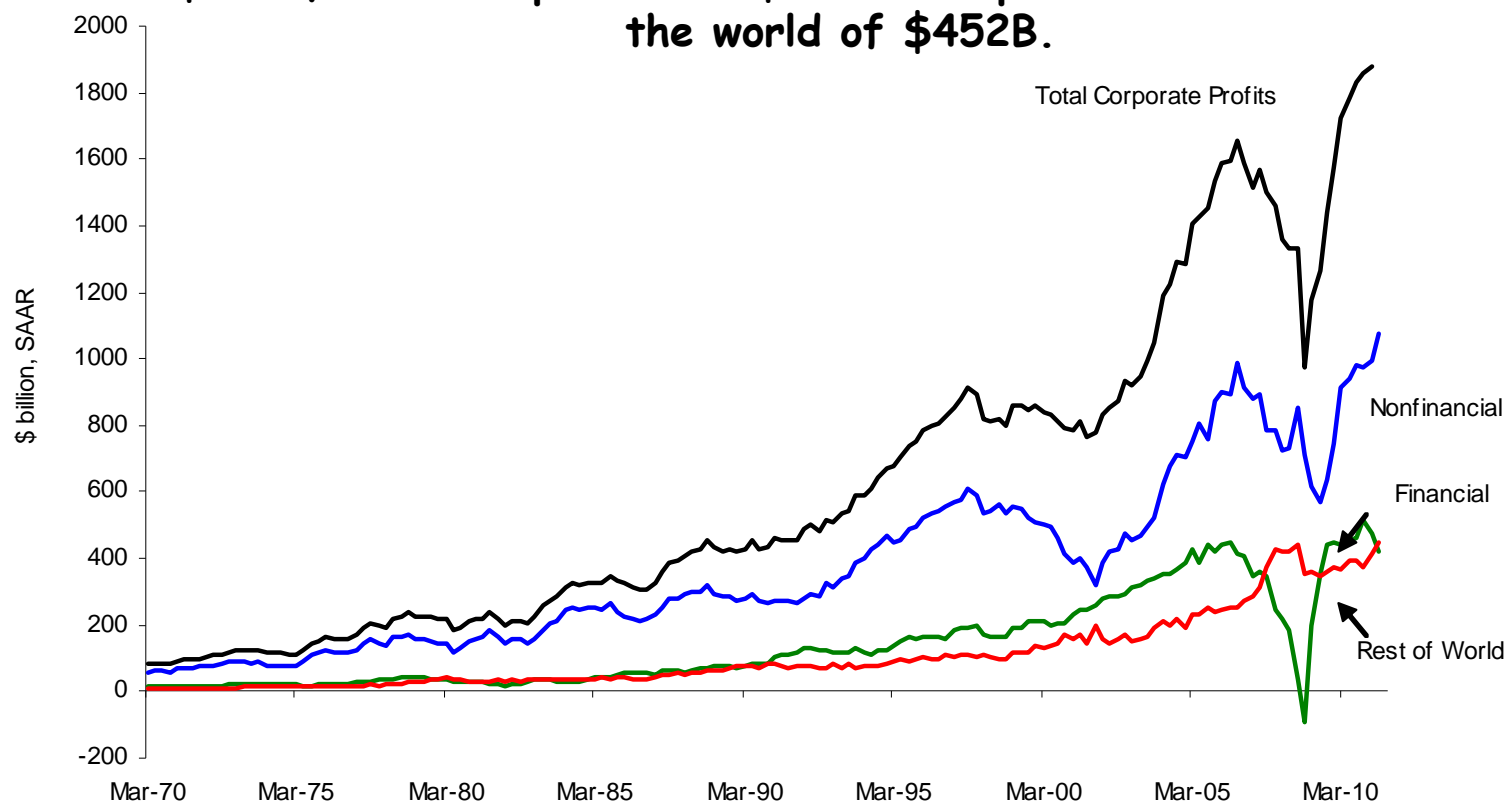


Source: Bureau of Economic Analysis; IMF; Encima Global

U.S. Corporate Profits

(pre-tax SAAR, last obs. Q3 2011 for NIPA corporate profits)

Third quarter profits were \$2 trillion annualized and are up 7.9% y/y. That was composed of domestic nonfinancial profits of \$1.1T, financial profits of \$435B and profits from the rest of the world of \$452B.



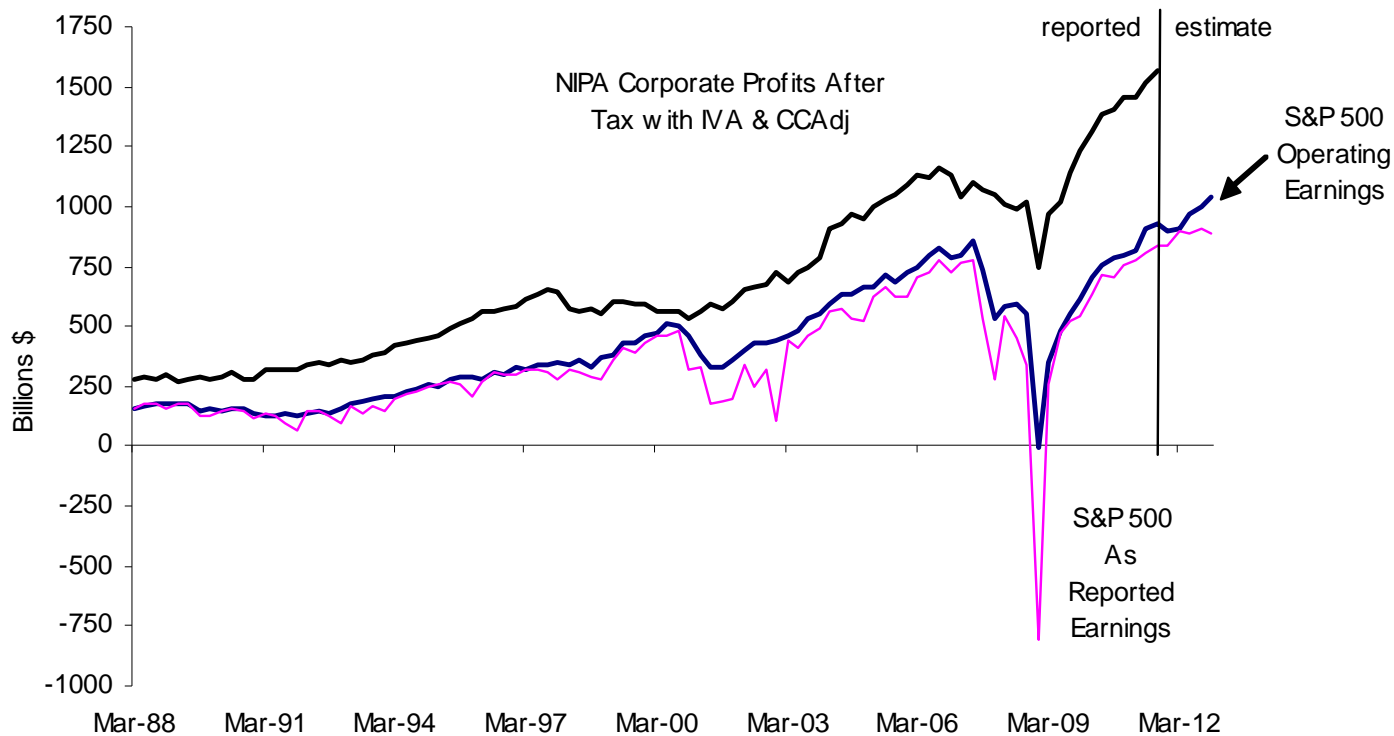
Source: Bureau of Economic Analysis; IMF; Encima Global

NIPA Corporate Profits and S&P Earnings

(after-tax SAAR, last obs. Q3 2011 for NIPA corporate profits)

S&P expects operating earnings to weaken slightly over the next two quarters, but then pick up again in the second half of 2012.

We think that reacceleration in earnings is possible only if Europe changes the policies that are causing debt contagion.



Source: Bureau of Economic Analysis; Standard and Poors'; Encima Global

10 Year U.S. Treasury Yield Too Low

(last obs. December 1, 2011)

Investors have been buying bonds to protect against deflation and gold to protect against inflation (the barbell trade). This leaves less capital for growth. We think both bonds and gold are in a bubble that will pop if better policies emerge.



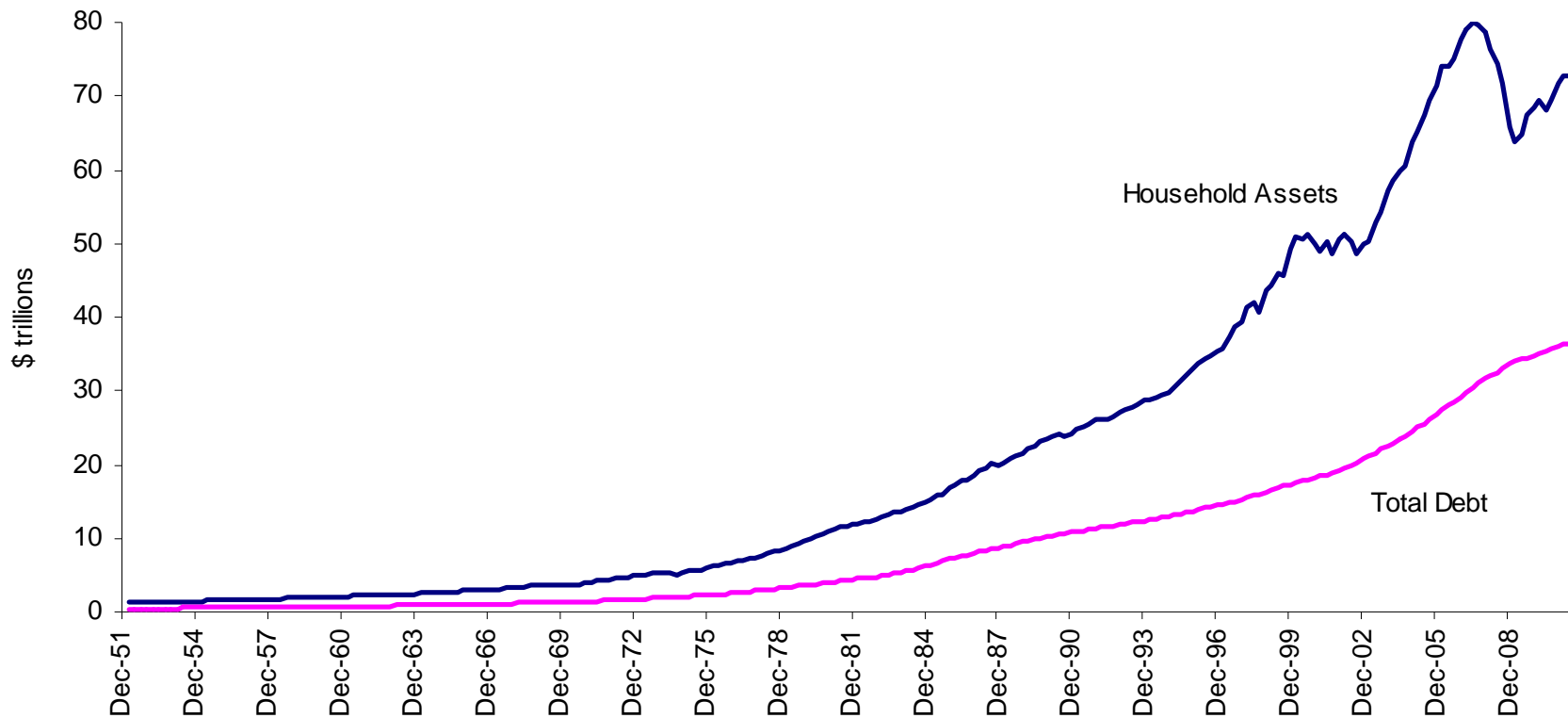
Source: Federal Reserve Board; Encima Global

Disagree with Perma-Bear

- **That economies are destined to grow slowly after a deep financial crisis due to deleveraging. Growth depends on policies.**
 - **That the U.S. is near a recession (they said that in Aug '10 too.)**
 - **That the euro has to break up.**
 - **That China will slow hard to 5%. It may slow below 9%, but banks are protected, bubble popping is common, and economy evolves.**
 - **That we're heading for a Lehman crisis or a Japan-style deflation.**
 - **That the Fed printed money, \$ will crash, and fast inflation is near.**
 - **However, U.S. and European debt problems are still increasing. Any additional risk of a breakup of the euro would be a major negative in the global outlook.**
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U.S. Household Assets Twice Total Debt

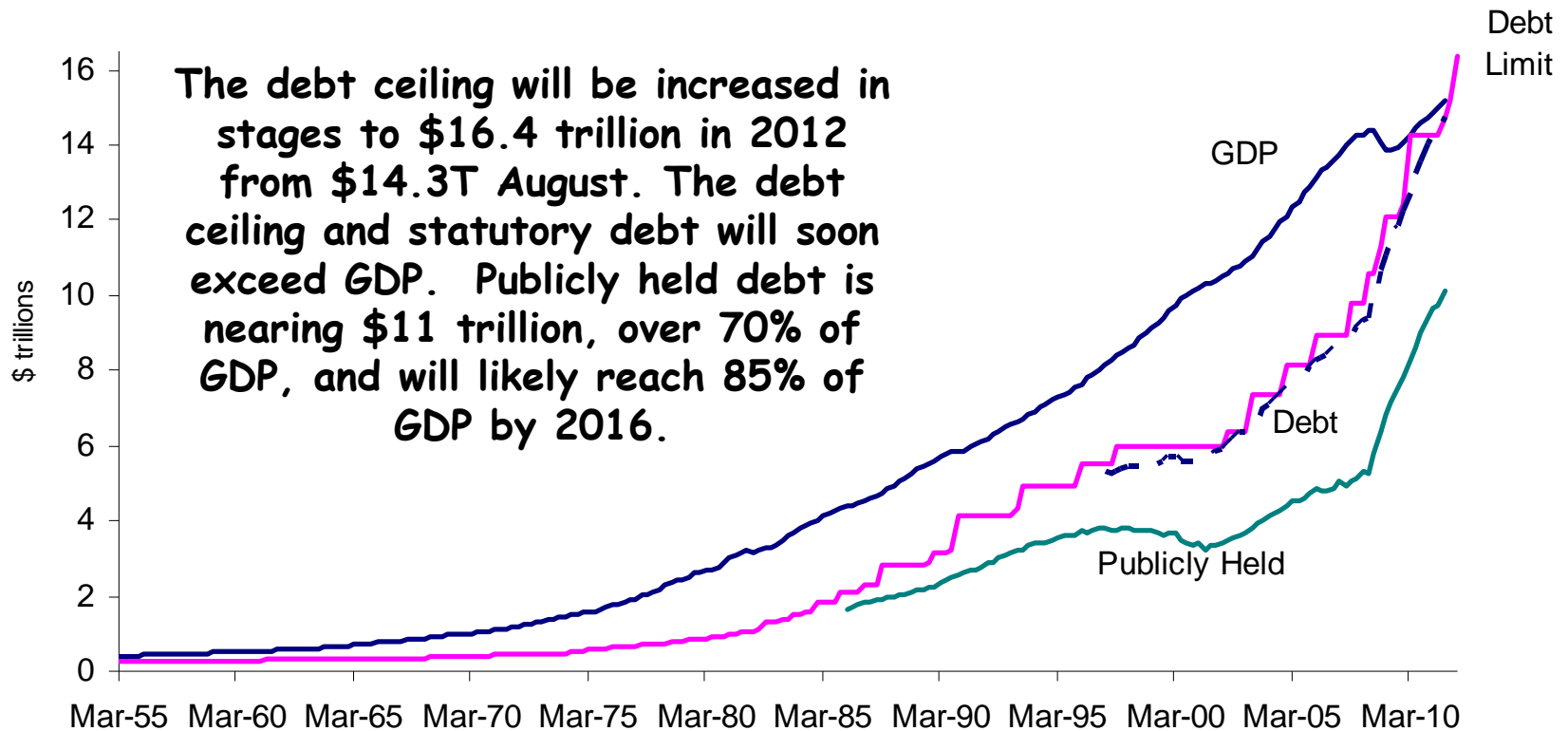
(last obs. Q2 2011, Assets \$72.6T, Total Debt \$36.5T)



Source: Federal Reserve: Flow of Funds; Encima Global

Publicly Held Debt Reaching 70% of GDP

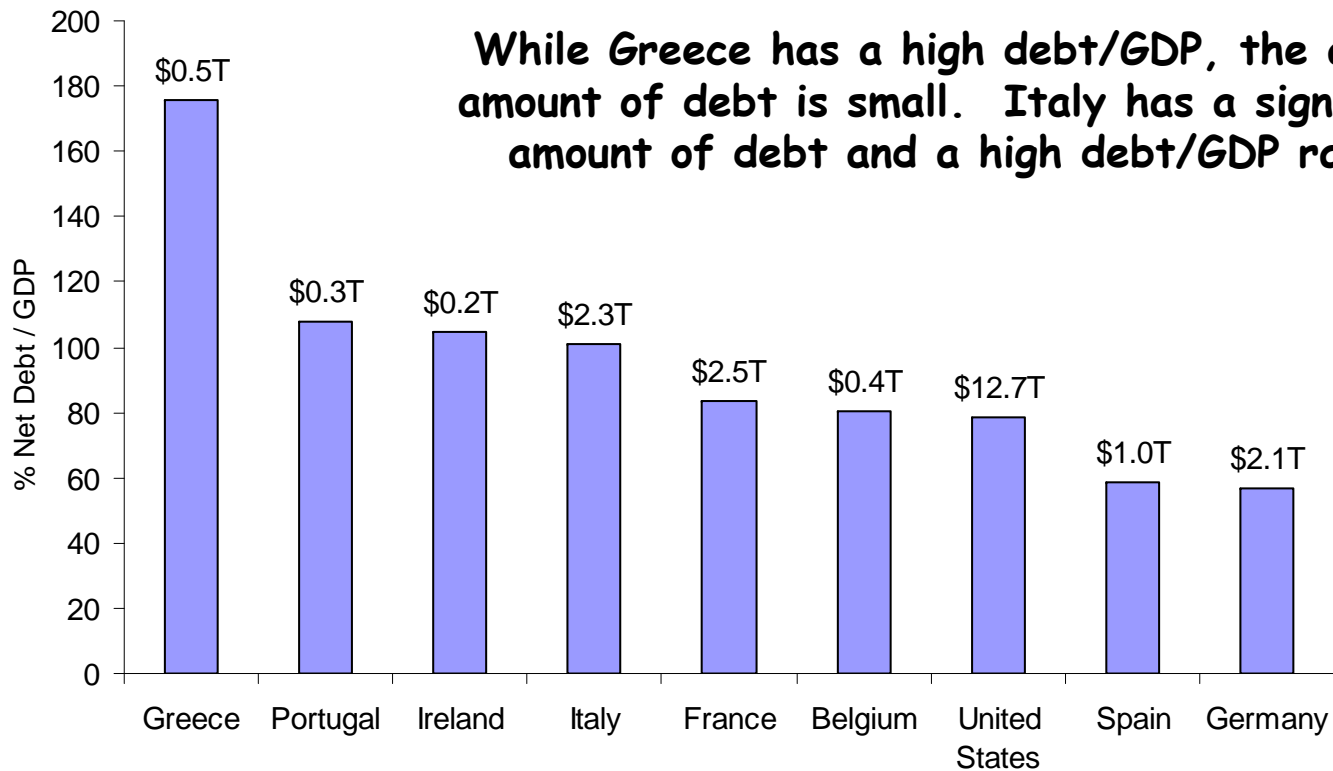
(last obs. Q3 2011, Q1 2012 for debt limit)



Source: Bureau of Economic Analysis; U.S. Treasury; Encima Global

Net Debt / GDP

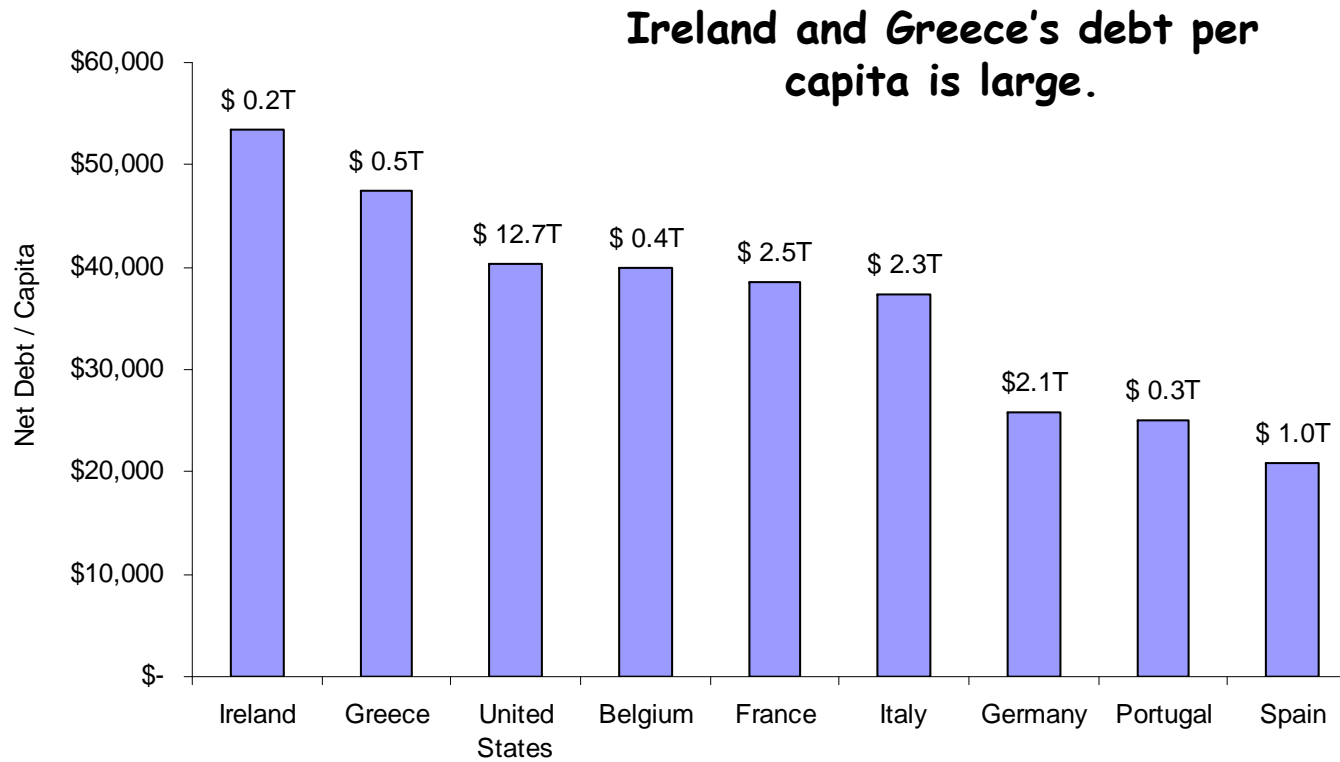
(General govt; nets out intra-govt debt; IMF projections for 2012)



Source: IMF; Encima Global

Net Debt / Capita

(General govt incl state and local; nets out intra-govt debt; IMF projections for 2012)



Source: IMF; Encima Global

Good News, But Europe Still Has to Act

- **China lowered its bank reserve requirement to 21% from 21.5%. This is probably the first of several reductions. The prospect of a declining PBOC reserve requirement should be quite stimulative, helping offset the anti-growth U.S. monetary policy which uses a near-zero interest rate to channel lending to the government, big businesses and investments abroad.**
- **The Fed lowered the interest spread it will charge the ECB on dollar-euro swaps to 0.5% from 1% on top of the OIS rate (currently 0.1% annual rate) and a group of central banks offered the ECB swap lines in their currencies. The action shows important multilateral support for the ECB and European banks, in keeping with the November 22 IMF announcement of a new liquidity facility for sovereigns. However, we don't think the announcement is a powerful change in terms of substance since the ECB has unlimited borrowing capacity on its own. It's a "neutral holding action confirming the severity of Europe's bank problem."**
- **Europe needs to make progress on: 1) stopping the burn-off of bank liabilities; and 2) addressing the burn rate for weaker sovereigns including their rising borrowing costs and deepening recessions. We're only mildly encouraged.**
- **A clear enforceable support mechanism keeping debt contagion away from Italy and Spain as they cut government spending and sell government assets would be a very positive direction but will take a major new euro-zone action to be convincing.**

U.S. Bank Lending Y/Y

(last obs. November 2011)



Source: Federal Reserve; Encima Global

China's Countercyclical Bank Lending Policy

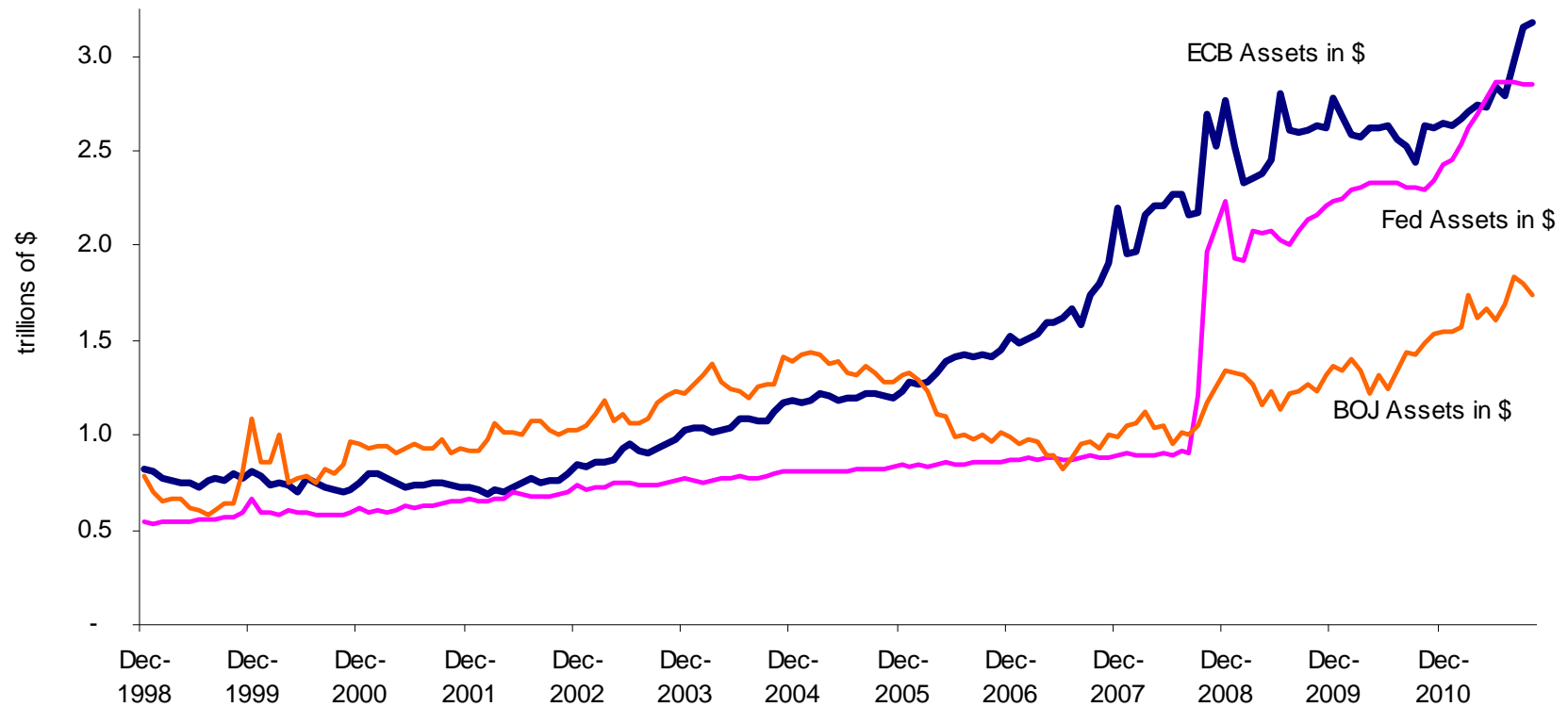
(last obs. October 2011)



Source: Bloomberg; Encima Global

ECB, Federal Reserve & Bank of Japan Assets

(last obs. October 2011)

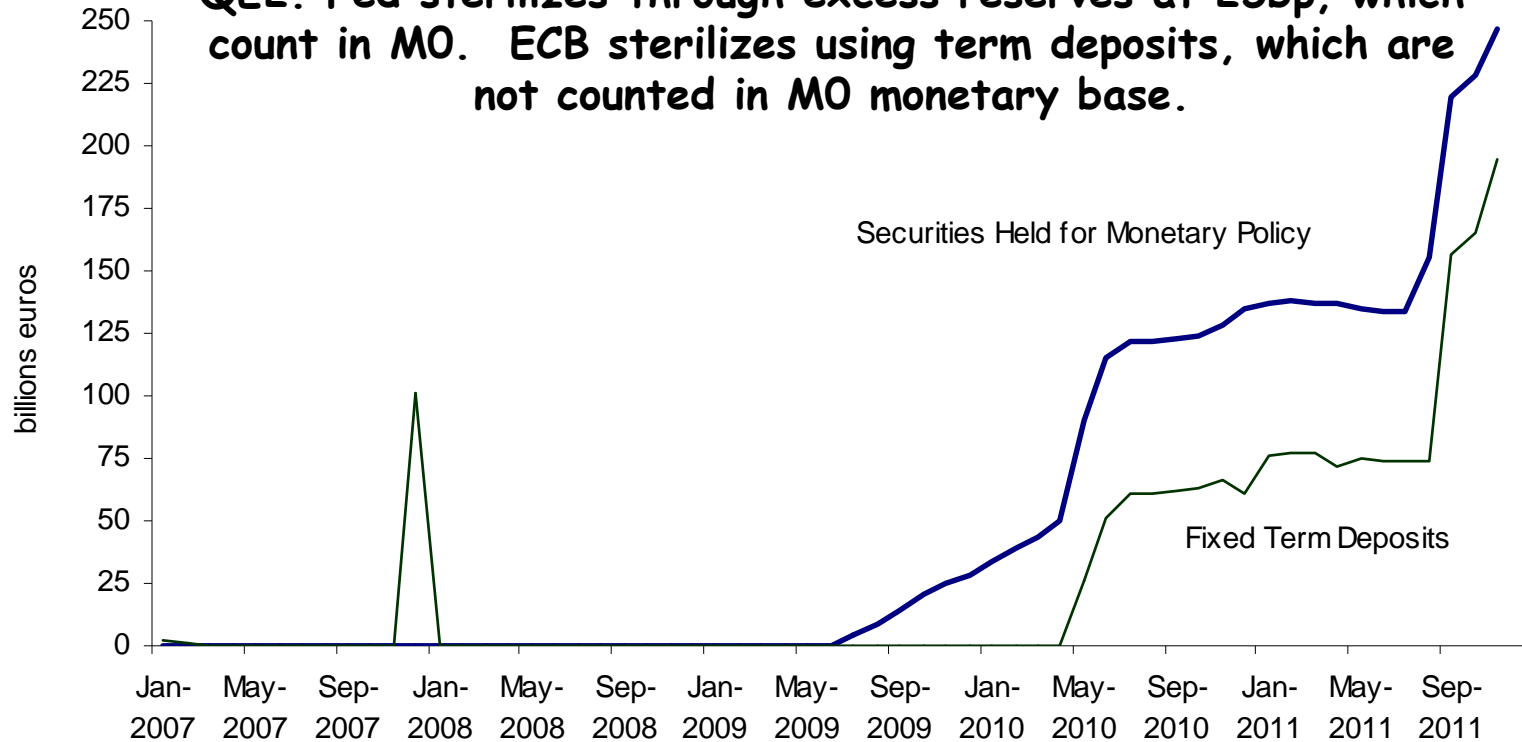


Source: Federal Reserve; ECB; Bank of Japan; Encima Global

ECB Sterilizing Bond Purchases Like Fed

(last obs. November 24, 2011)

ECB bond purchases still small compared to Fed's QE1 or QE2. Fed sterilizes through excess reserves at 25bp, which count in M0. ECB sterilizes using term deposits, which are not counted in M0 monetary base.

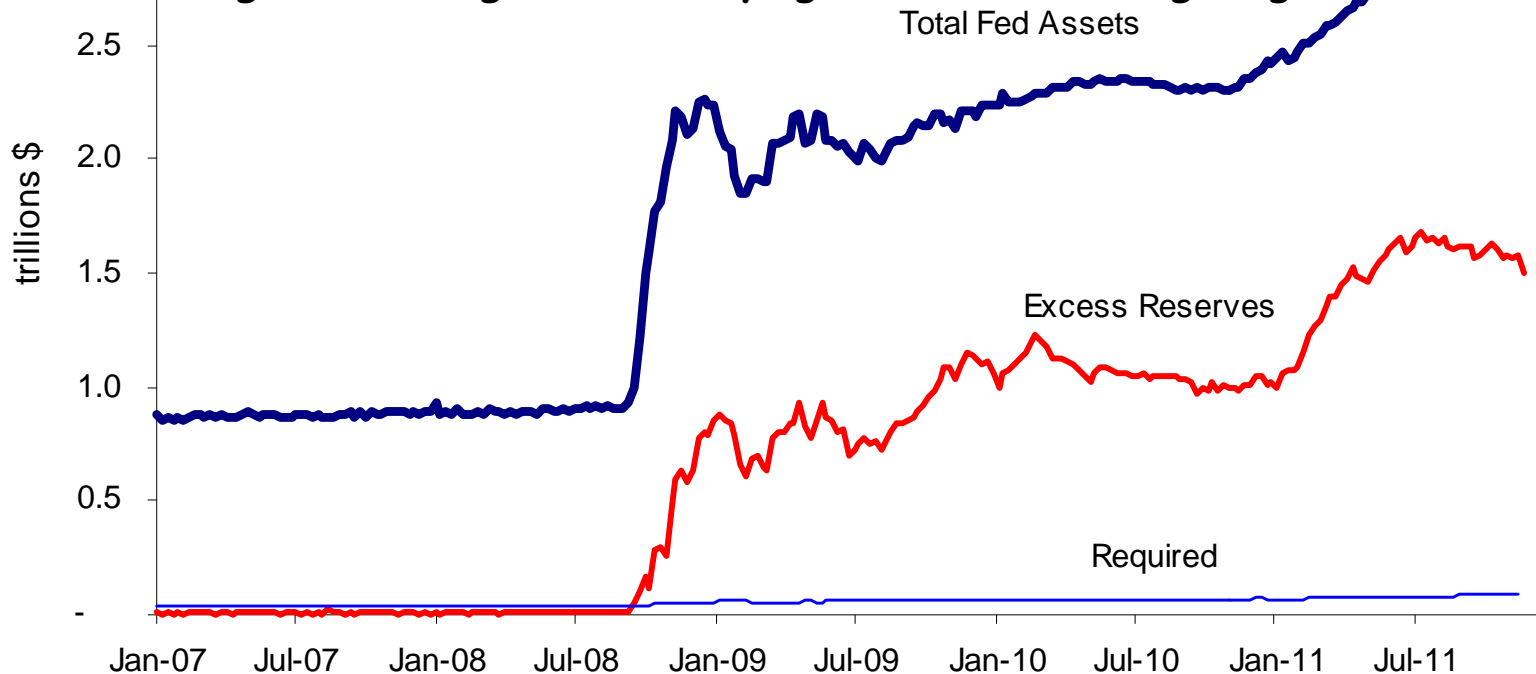


Source: ECB; Encima Global

Fed 'Sterilized' QE2 Through 25bp rate and Credit Rationing -- 'Pushing on a String'

(last obs. November 16, 2011)

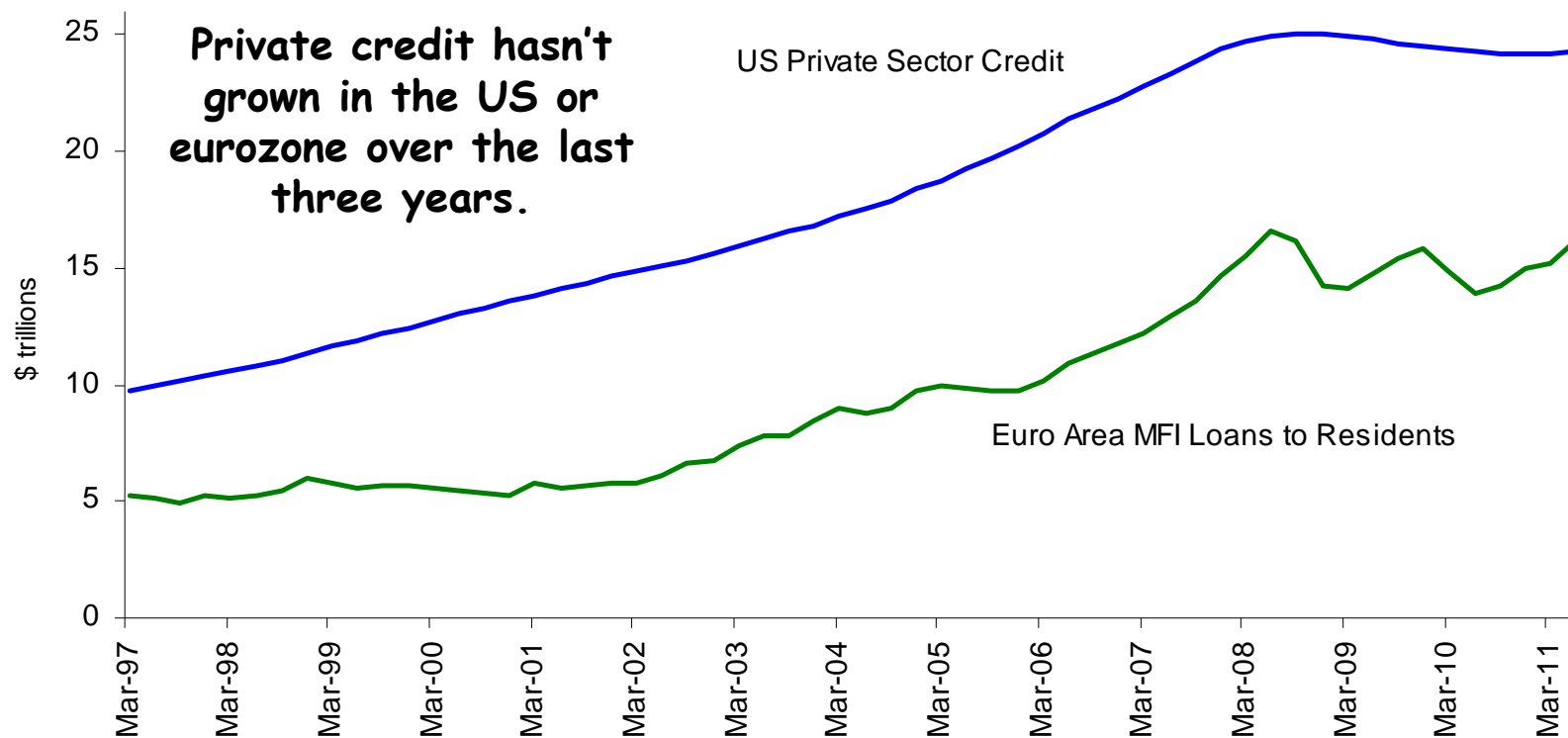
The fed will maintain a \$2.8 trillion balance sheet funded with interest-bearing excess reserves. Fed now a giant leveraged SIV, buying short and lending long.



Source: Federal Reserve: Encima Global

U.S. and Euro Zone Private Sector Credit

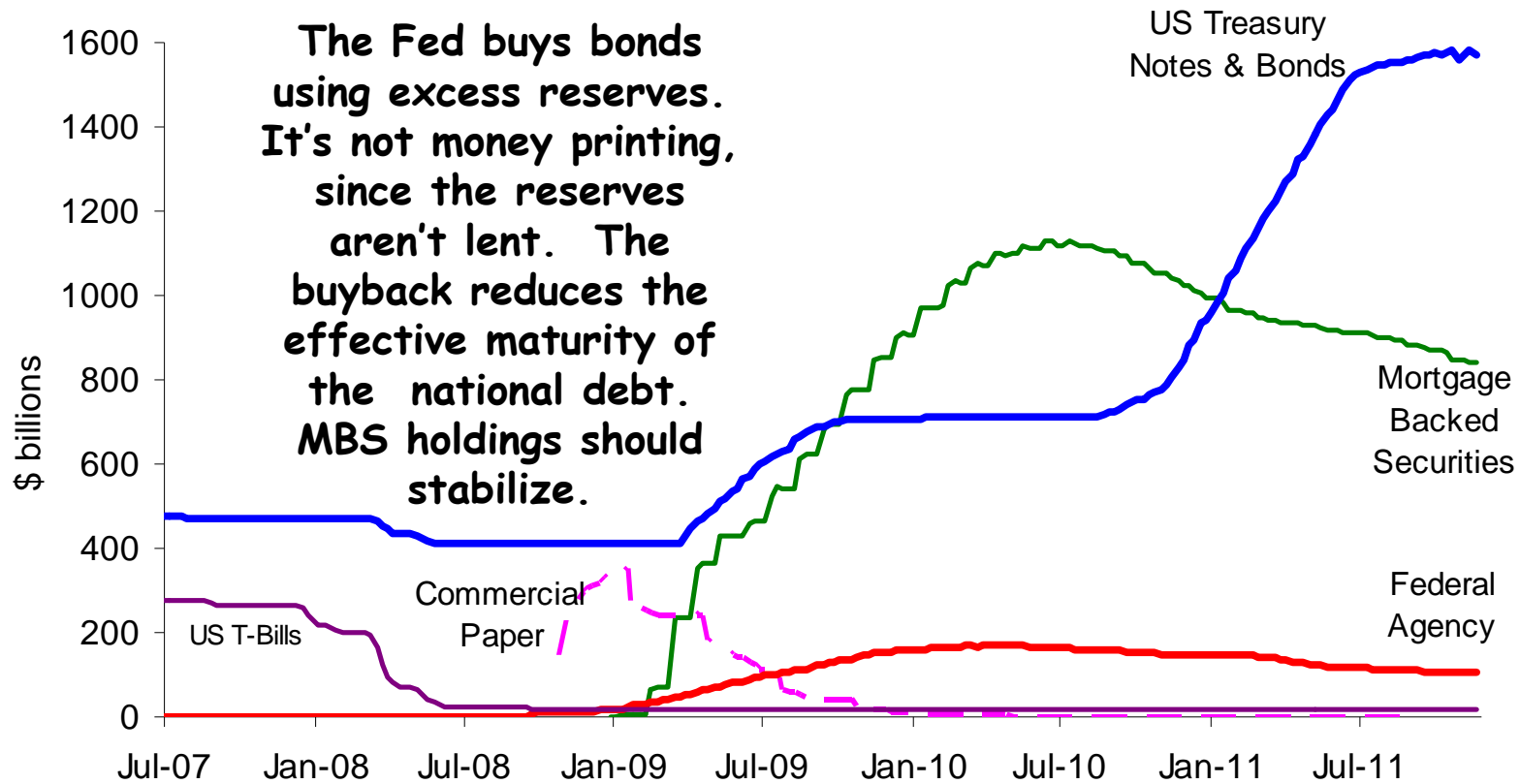
(last obs. Q2 2011, Euro area converted to dollars)



Source: Federal Reserve; ECB; Encima Global

Fed Assets

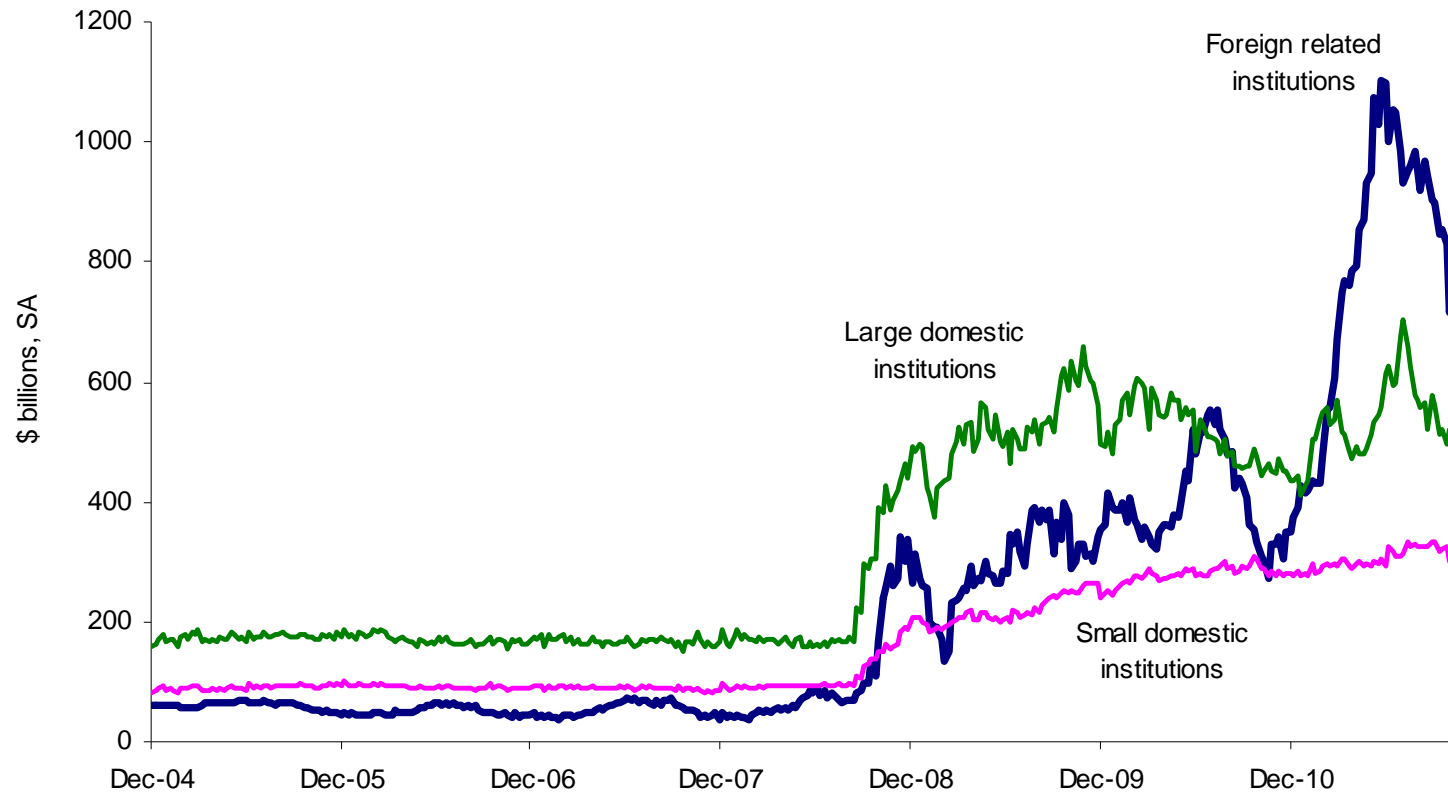
(last obs. November 16, 2011)



Source: Federal Reserve: Encima Global

Commercial Banks Cash Assets

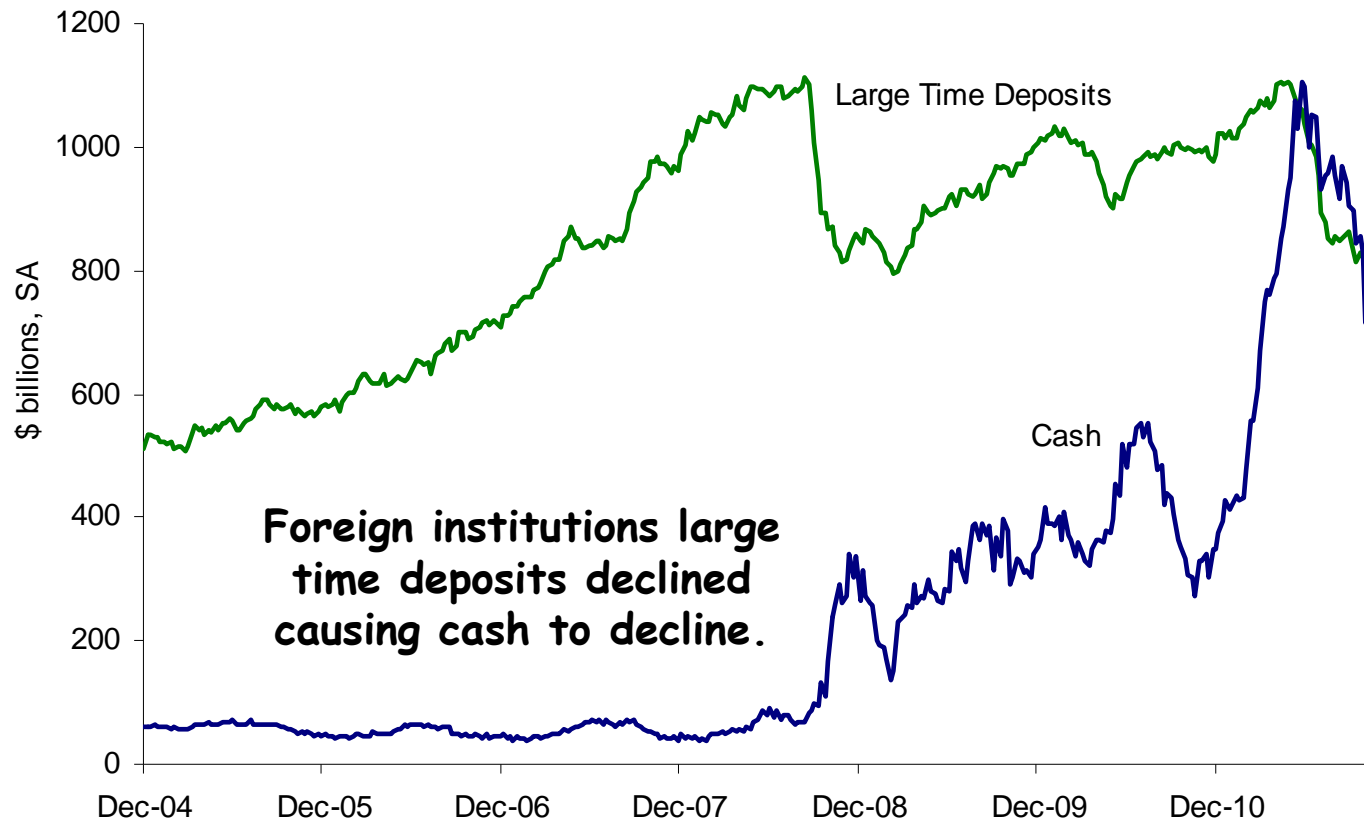
(last obs. November 16, 2011)



Source: Federal Reserve: Encima Global

Foreign Related Institutions Cash and Large Time Deposits

(last obs. November 16, 2011)



Source: Federal Reserve: Encima Global



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