



Economic Chartbook

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David Malpass
dmalpass@encimaglobal.com

Wing Chow
wchow@encimaglobal.com

212.876.4400

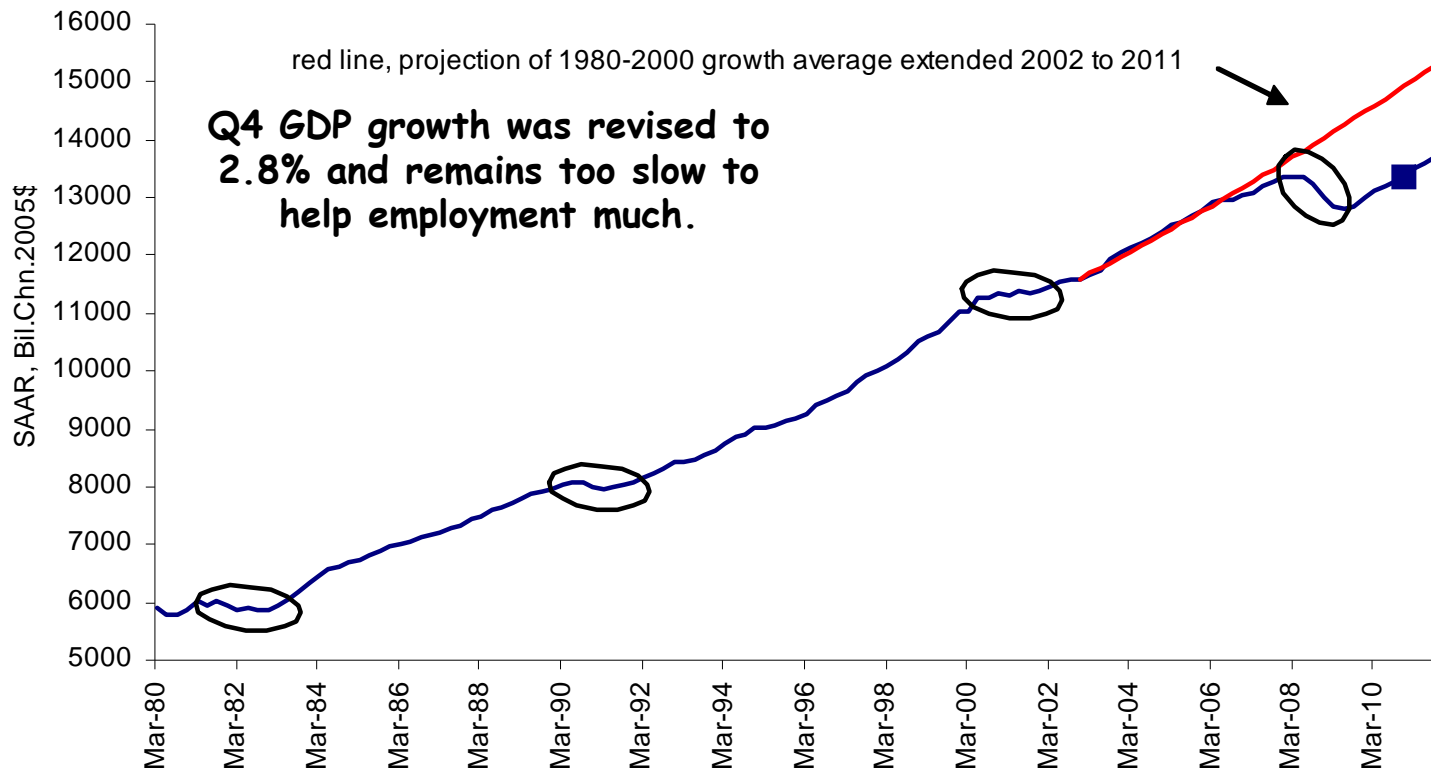
Please read the important disclosure information in the Addendum section of this presentation.

Economic Outlook

- **The economy has strengthened as expected since mid-2010, helped by pent-up demand especially for autos. We expect 4% real growth in the first quarter but with a subsequent letdown as pent up demand is met.**
- **Ultra-loose fiscal and monetary policy do not provide a sound basis for structural improvement in the U.S. economy and are creating lasting inflation and debt problems.**
- **Confidence will suffer as price increases weigh, the Fed stops its asset purchases, state and local cutbacks take hold, and 3.6 million workers hit the 99 week cut-off of unemployment benefits.**
- **While equity markets have bought the dips caused by problems in the Mideast, oil, eurozone debt, and China's tightening, we think the obstacles to fast growth outweigh the engines given the lack of structural reform.**
- **The U.S. is doing better than Japan at kicking the can down the road (i.e. papering over the problems) but is increasingly at risk from the level of federal debt, its short effective maturity, and the economic distortions from the emergency Fed policies still in place.**

Real GDP Growing From a Low Base

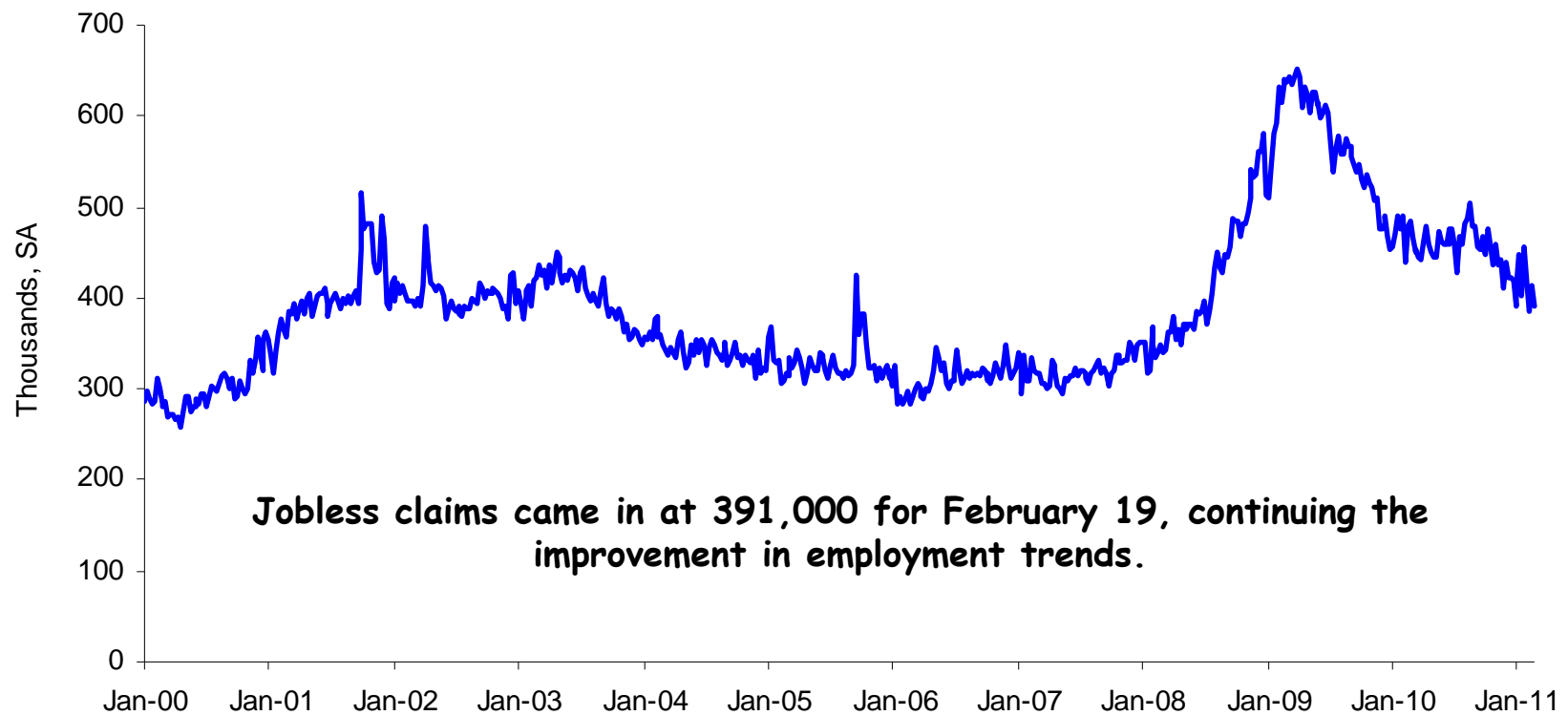
(last obs. blue square Q4 2010, projected to Q4 2011)



Source: Bureau of Economic Analysis; Encima Global

Initial Unemployment Claims

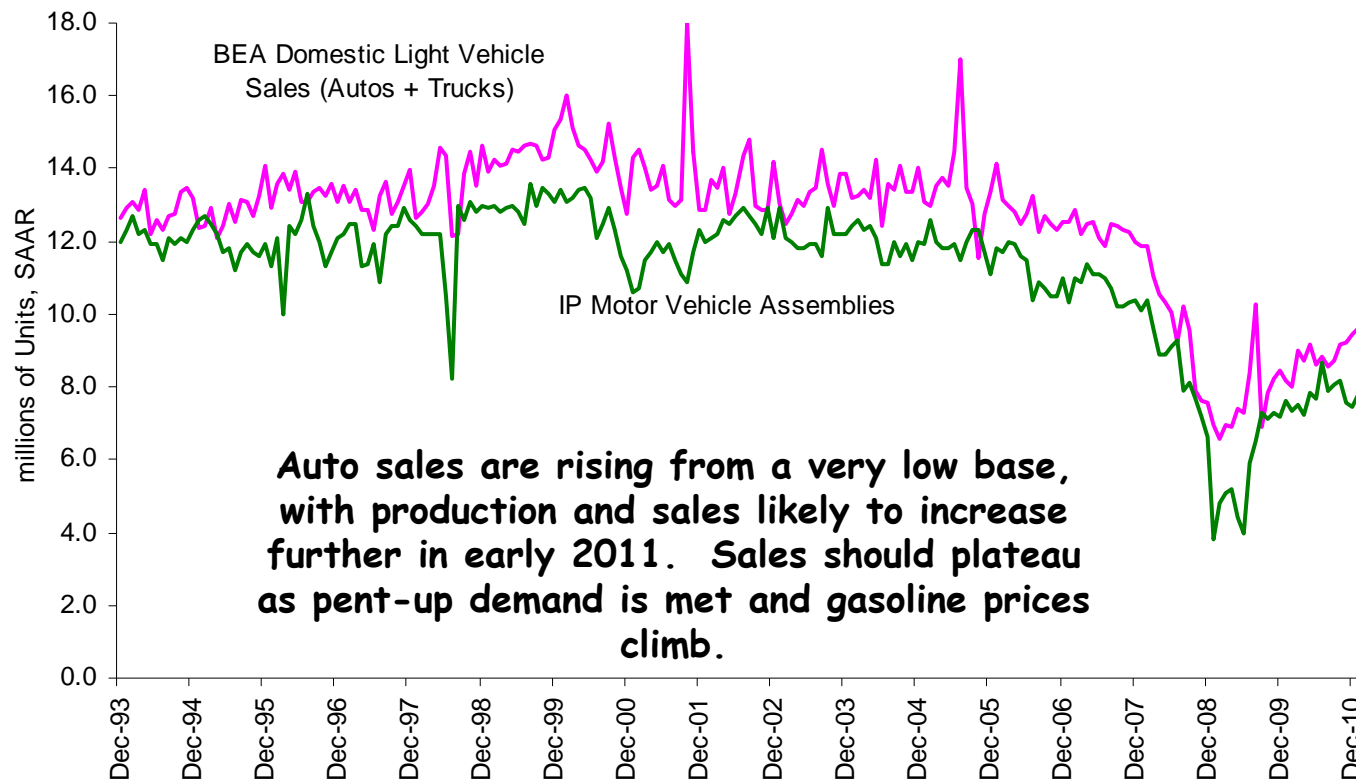
(last obs. February 19, 2011)



Source: Bureau of Labor Statistics; Encima Global

Auto Sales Rising, Production Lagging

(last obs. January 2011)



Source: Federal Reserve; Bureau of Economic Analysis; Encima Global

Retail Sales 12 month % change

(last obs. January 2011)

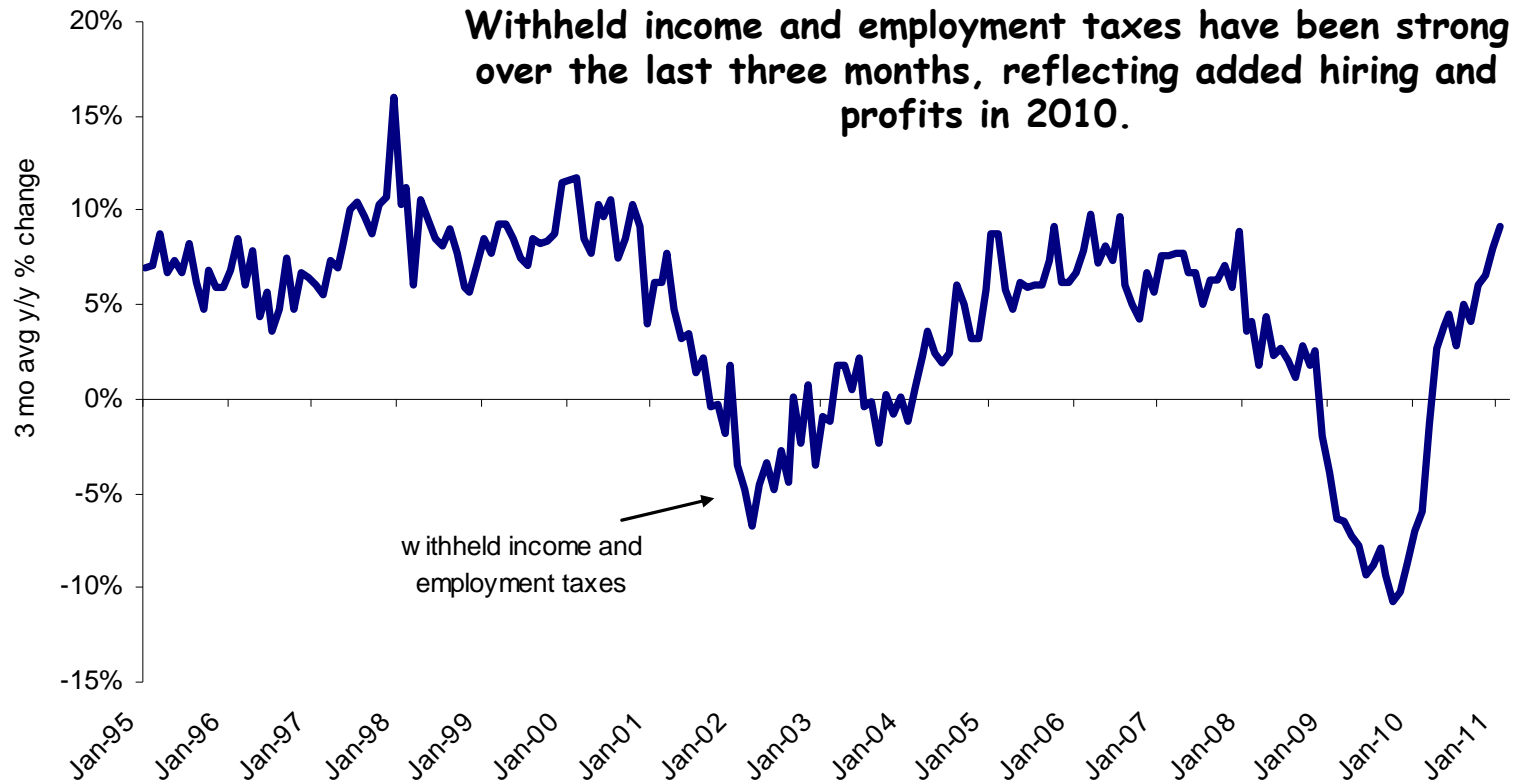
Sales growth picked up in 2010. Given the '08 drop, pent-up demand should add some more to growth. Still, U.S. consumers will play less of a role in the world economy than in the '82-'07 period.



Source: Bureau of Census; Encima Global

Withheld Income and Employment Taxes

(last obs. January 2011)

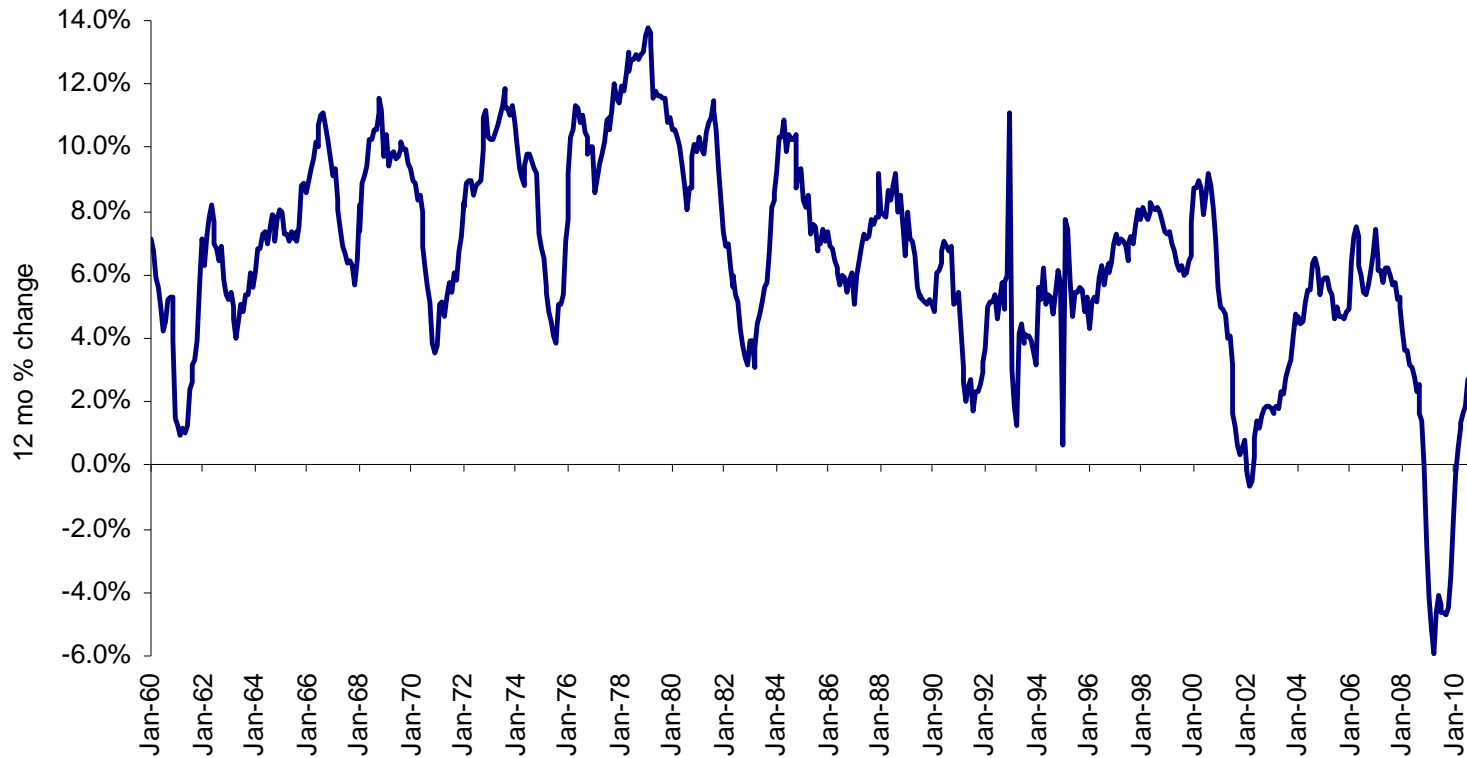


Source: U.S. Treasury; Encima Global

Wages and Salaries Y/Y

(last obs. January 2011)

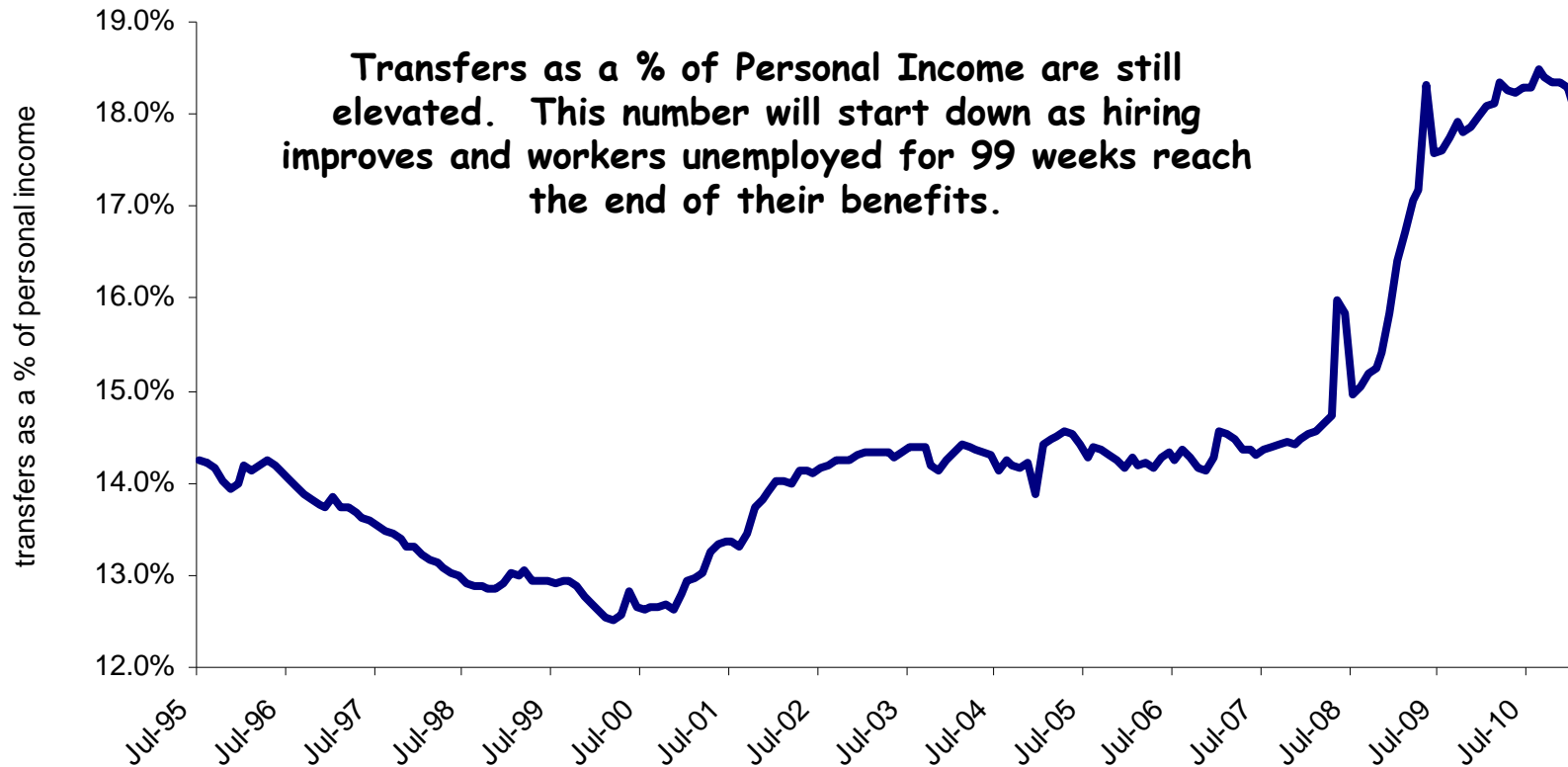
Wage and salary growth up only 3.8% yoy.



Source: Bureau of Economic Analysis; Encima Global

Transfers as % of Personal Income

(last obs. January 2011)

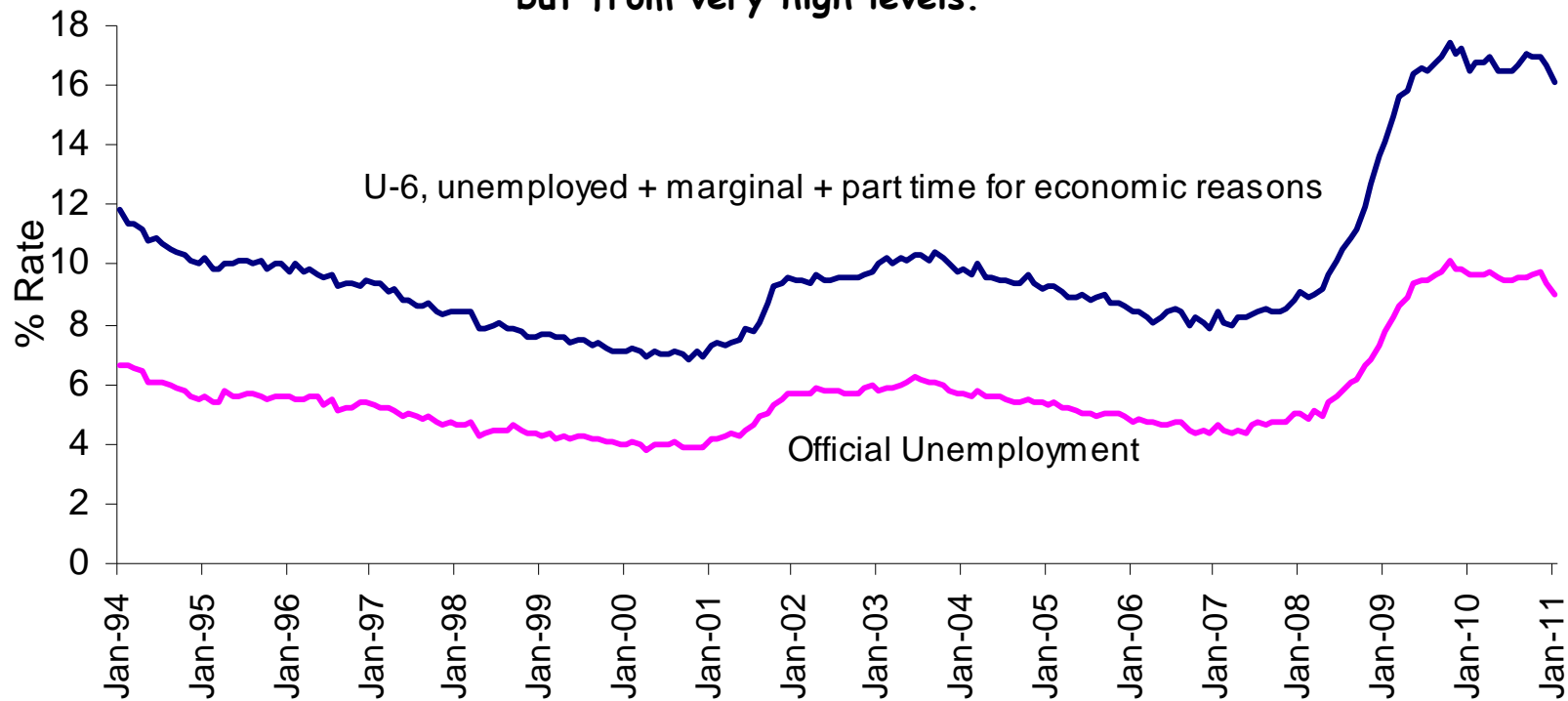


Source: Bureau of Economic Analysis; Encima Global

Unemployment and Underemployment Rates

(last obs. January 2011)

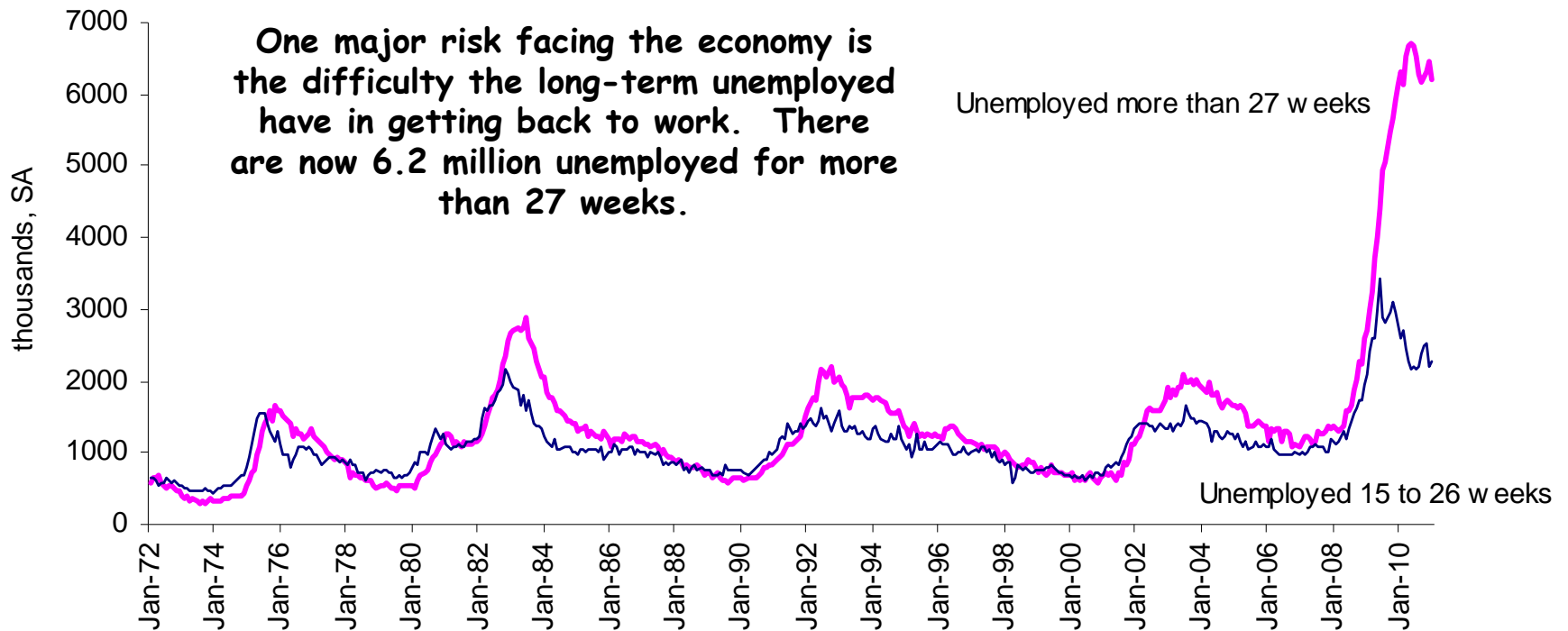
Unemployment and underemployment have improved but from very high levels.



Source: Bureau of Economic Analysis; Encima Global

Workers Unemployed More than 27 Weeks

(last obs. January 2011)



Source: Bureau of Labor Statistics; Encima Global

Inflation Problem

- **We think the Fed is botching monetary policy in a way that distorts the economy and will reduce future growth. Last decade, the Fed kept the Fed funds rate too low (at 1% in 2003, then limited 0.25% hikes starting in 2004). It mistakenly thought there was a deflation problem and then argued that inflation would moderate when it was actually rising. The result was a huge outflow of American capital to foreign countries due to the weakening dollar; and excess house construction due in part to artificially low mortgage rates.**
- **In the 2003 expansion, the economy was able to grow despite inflation. At first the weaker dollar was a plus, reversing the overly strong Clinton-Rubin king dollar that had pushed gold and commodities to historic lows. The 2003 tax cut was a pro-growth reduction in top marginal rates, a contrast with this cycles repeated consumption oriented rebates. We don't expect the current expansion to last as long as the 2003 expansion.**
- **The dollar index remains near its all-time lows even as the euro-zone suffers a debt crisis and Japan and the UK shrink. The dollar is even weaker relative to commodities and gold, a dependable precursor of a strong inflationary trend.**
- **Bottom Line: We think ultra-loose fiscal and monetary policy do not provide a sound basis for structural improvement in the U.S. economy and are creating lasting inflation and debt problems. Pent-up demand has been sustaining the economy, but will not be able to maintain current growth.**

Consumer Price Index Y/Y

(last obs. January 2011)



Source: Bureau of Labor Statistics; Encima Global

Wheat Prices recently top \$9 per bushel

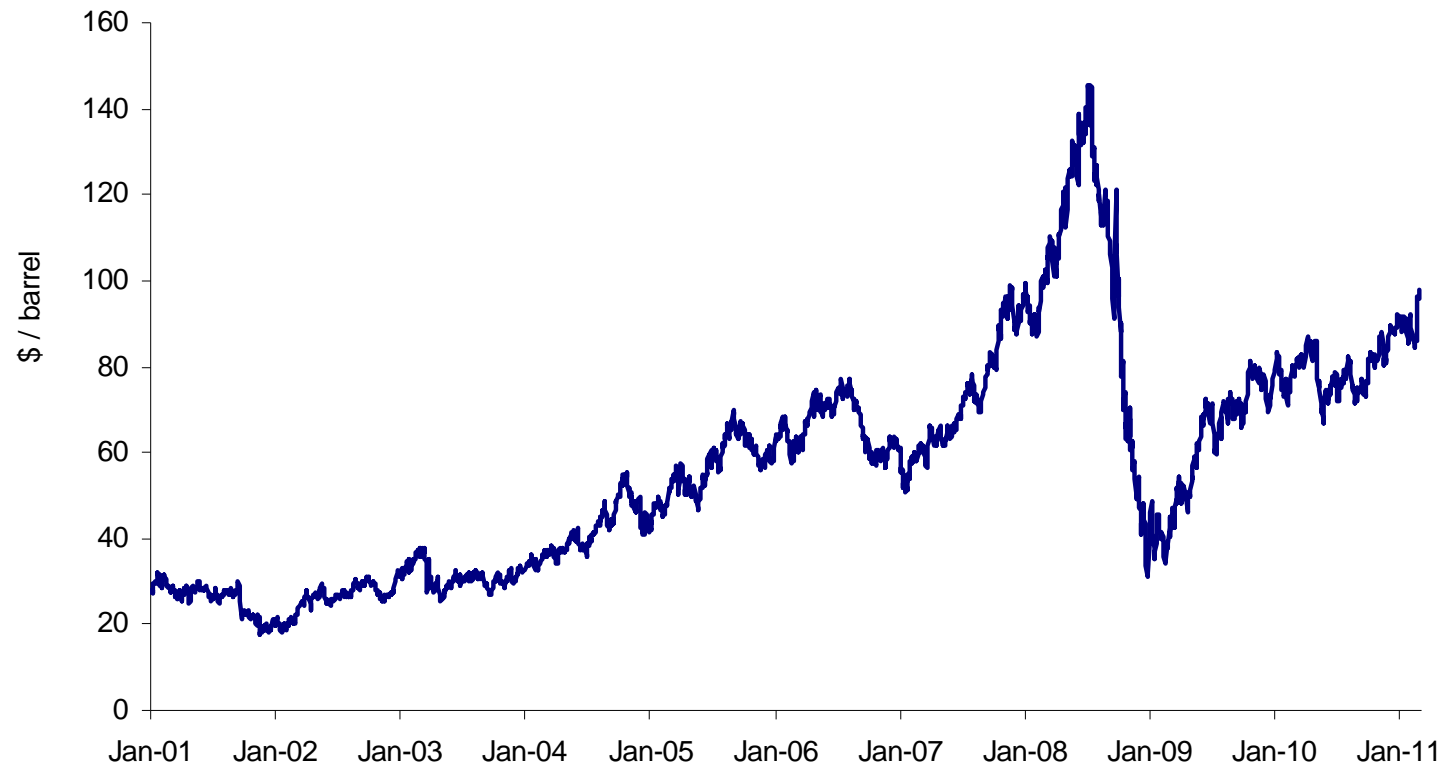
(last obs. February 28, 2011)



Source: Bloomberg; Encima Global

Oil Prices highest since 2008 weak dollar crisis

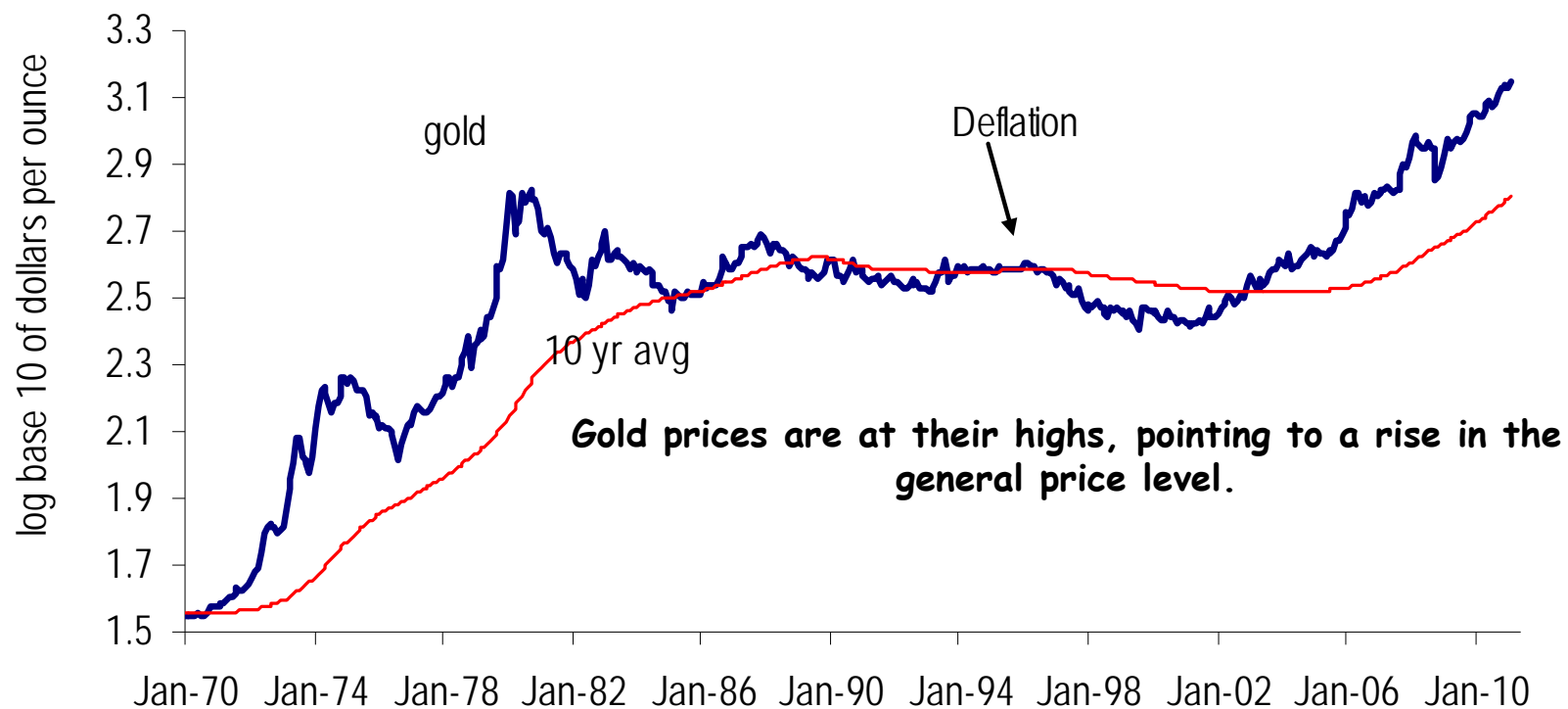
(last obs. February 28, 2011)



Source: Wall Street Journal; Encima Global

Gold prices at highs, precursor of inflationary trends

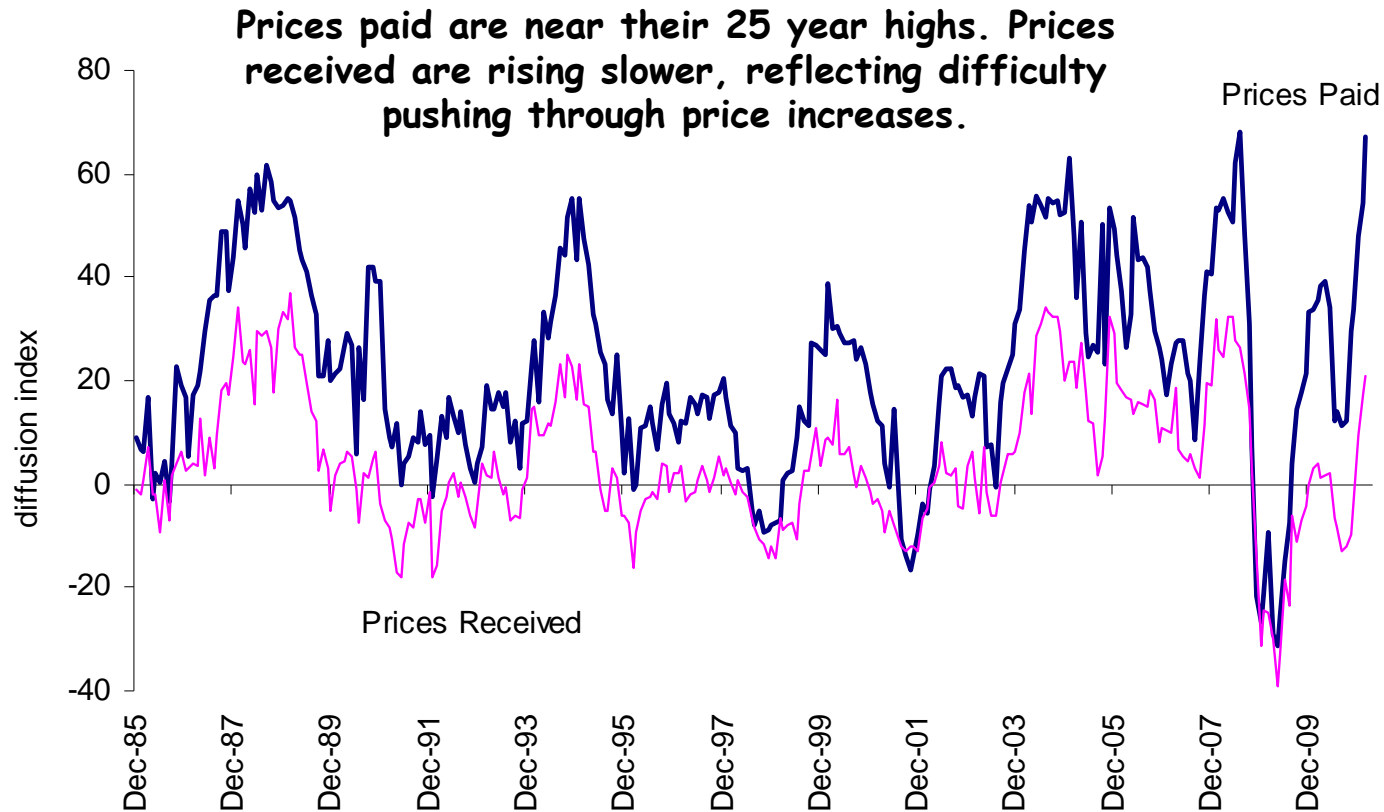
(last obs. February 28, 2011)



Source: Wall Street Journal; Encima Global

Philly Fed Prices Paid and Received

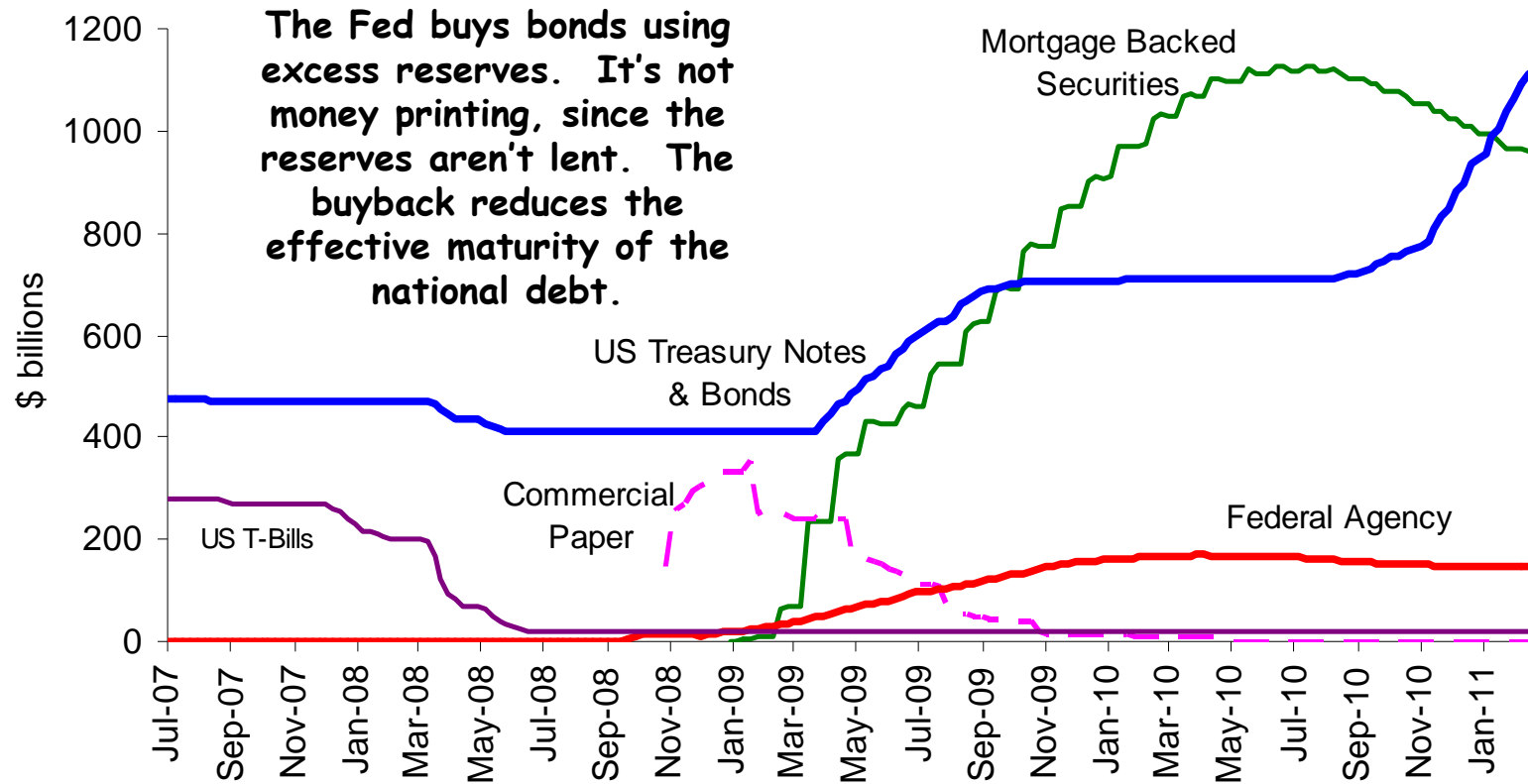
(last obs. February 2011)



Source: Federal Reserve of Philadelphia; Encima Global

Fed assets are increasingly long term

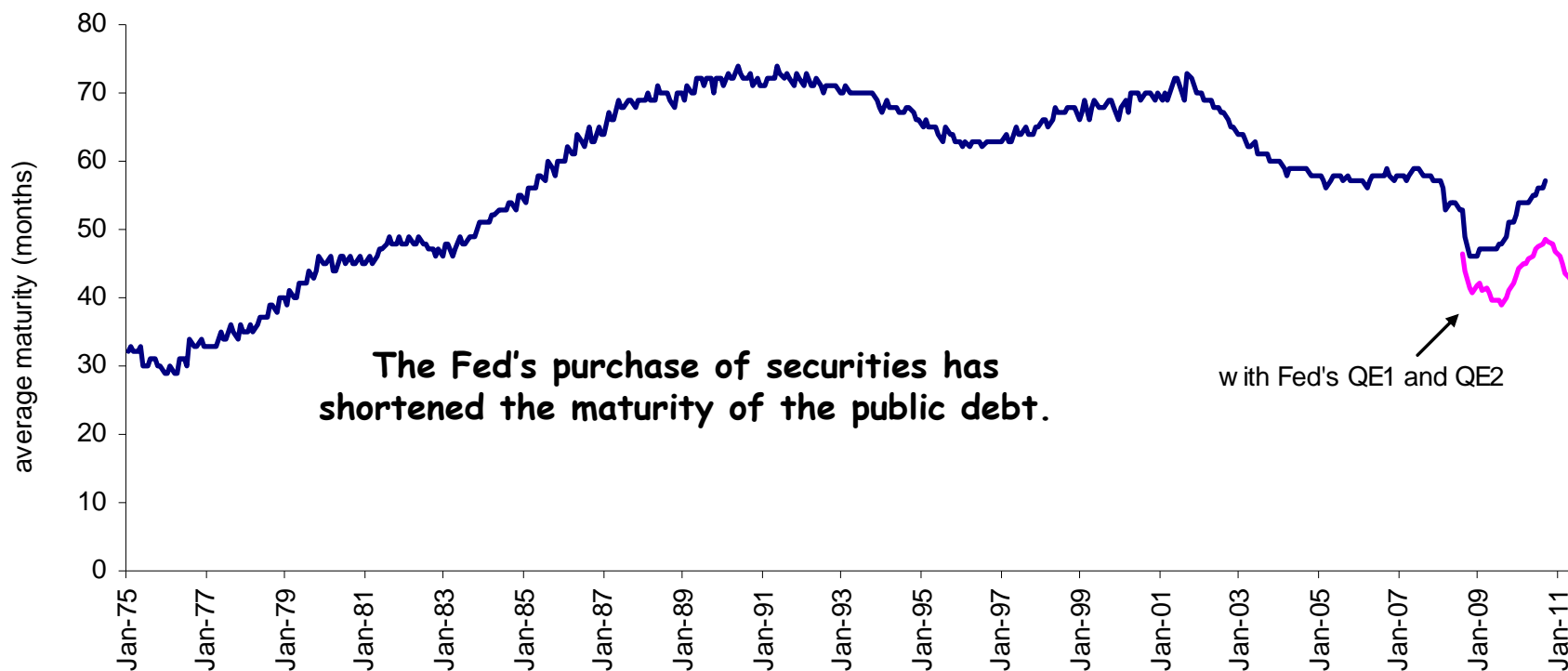
(last obs. February 16, 2011)



Source: Federal Reserve; Encima Global

Average Maturity of Treasury Debt; Effective Maturity with Fed's QE

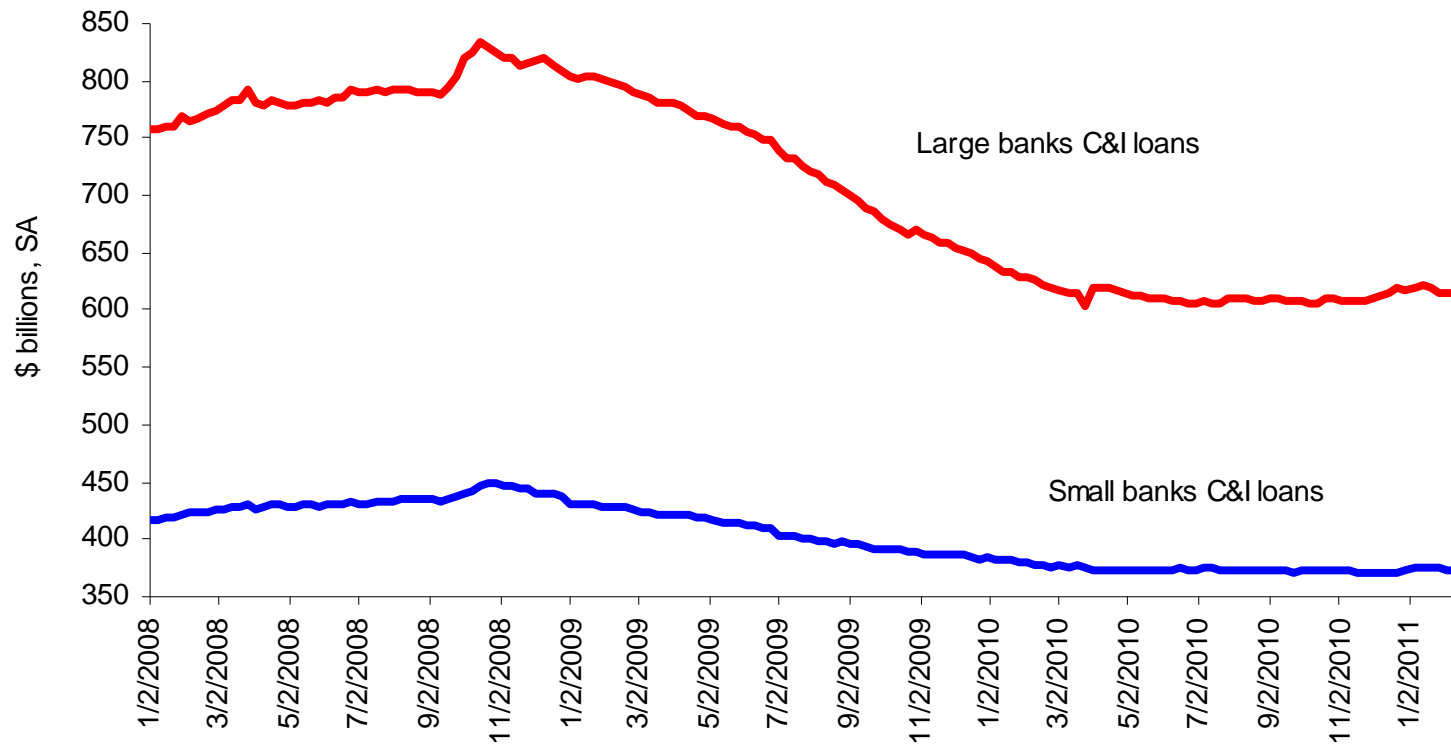
(in months, last obs. Sept 2010; QE2 projected through June 2011)



Source: US Treasury; Federal Reserve; Encima Global

Commercial and Industrial Loans Still Low

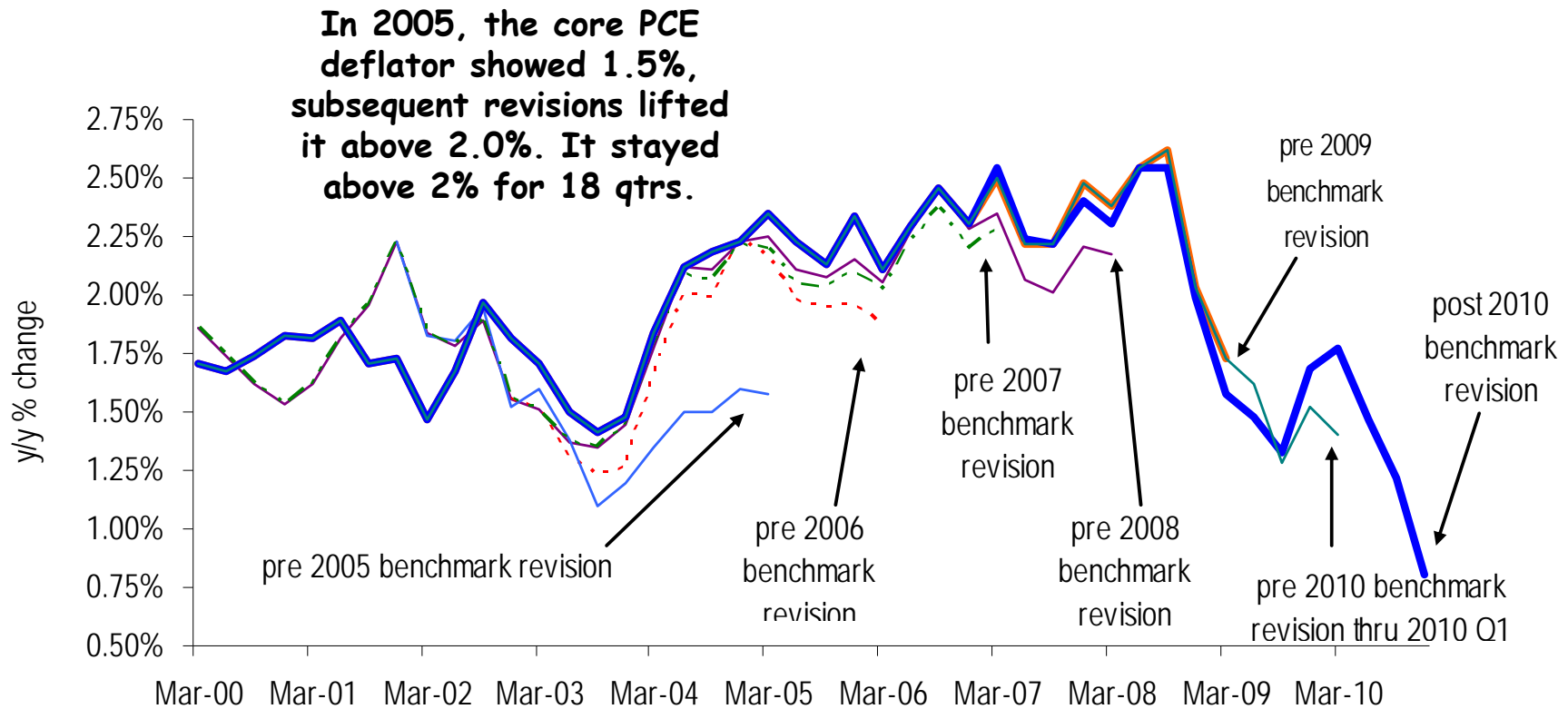
(last obs. February 9, 2011)



Source: Federal Reserve; Encima Global

Core PCE Deflator Routinely Revised Upward

(last obs. Q4 2010)

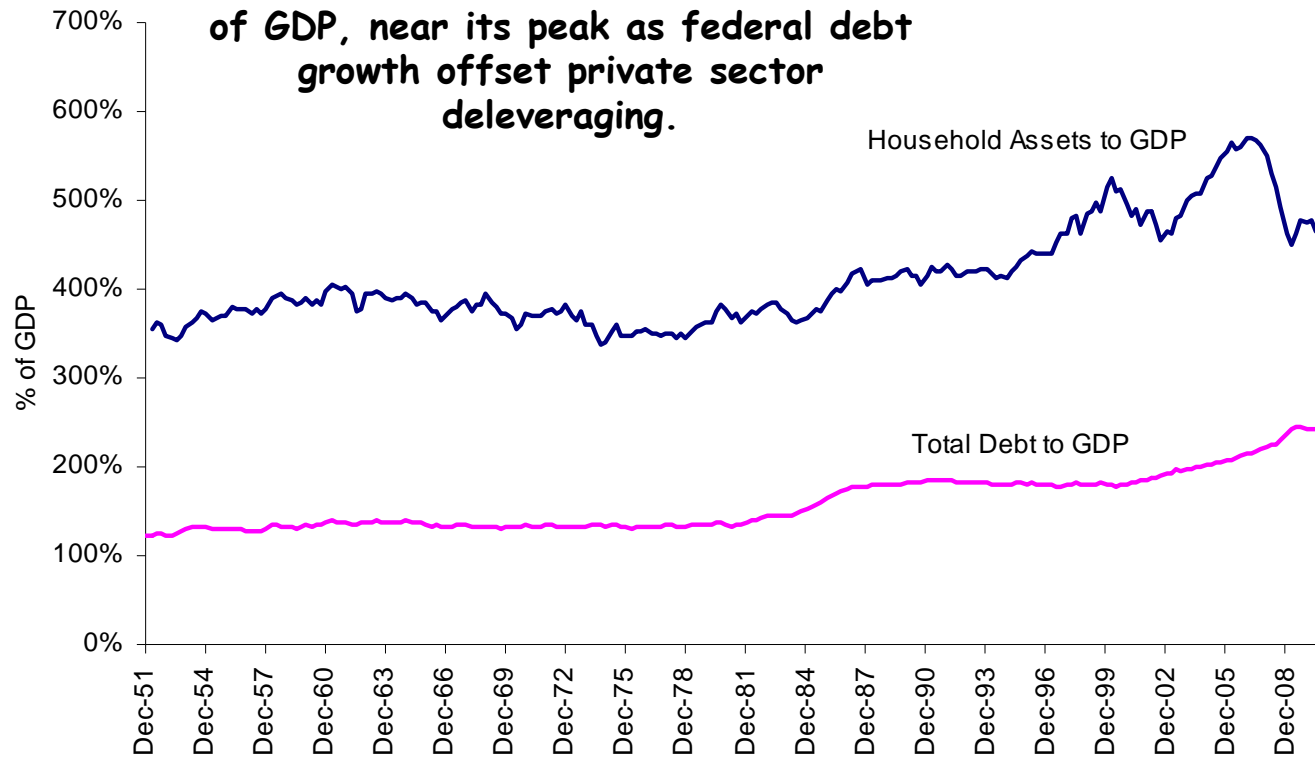


Source: Bureau of Economic Analysis; Encima Global

Household Assets/GDP; Total Debt / GDP

(last obs. Q3 2010)

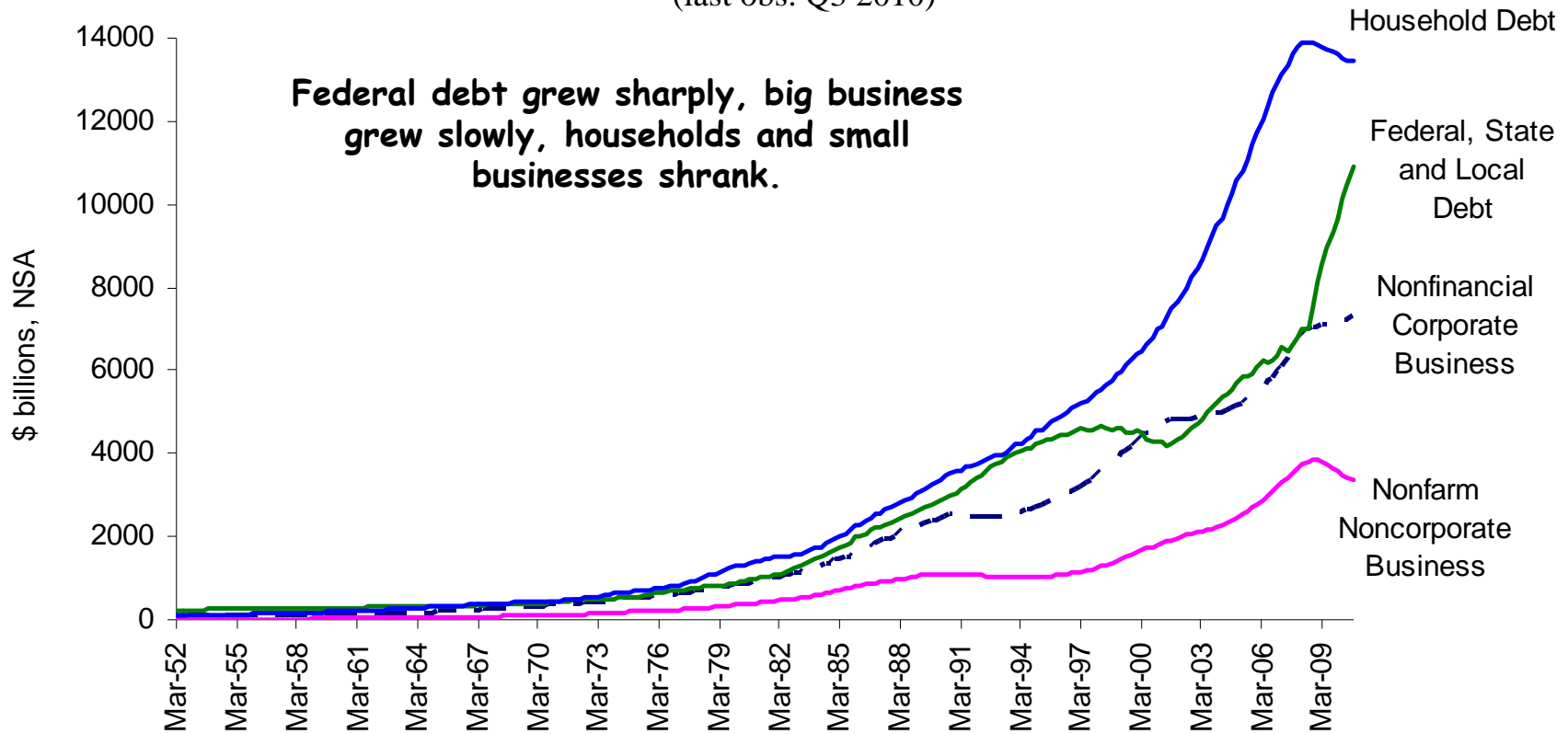
U.S. nonfinancial debt stands at 243% of GDP, near its peak as federal debt growth offset private sector deleveraging.



Source: Federal Reserve: BEA; Encima Global

U.S. Debt in \$Billions by Category

(last obs. Q3 2010)



Source: Federal Reserve: Encima Global

\$35.8 Trillion in Credit Market Debt Outstanding

(last obs. Q3 2010)

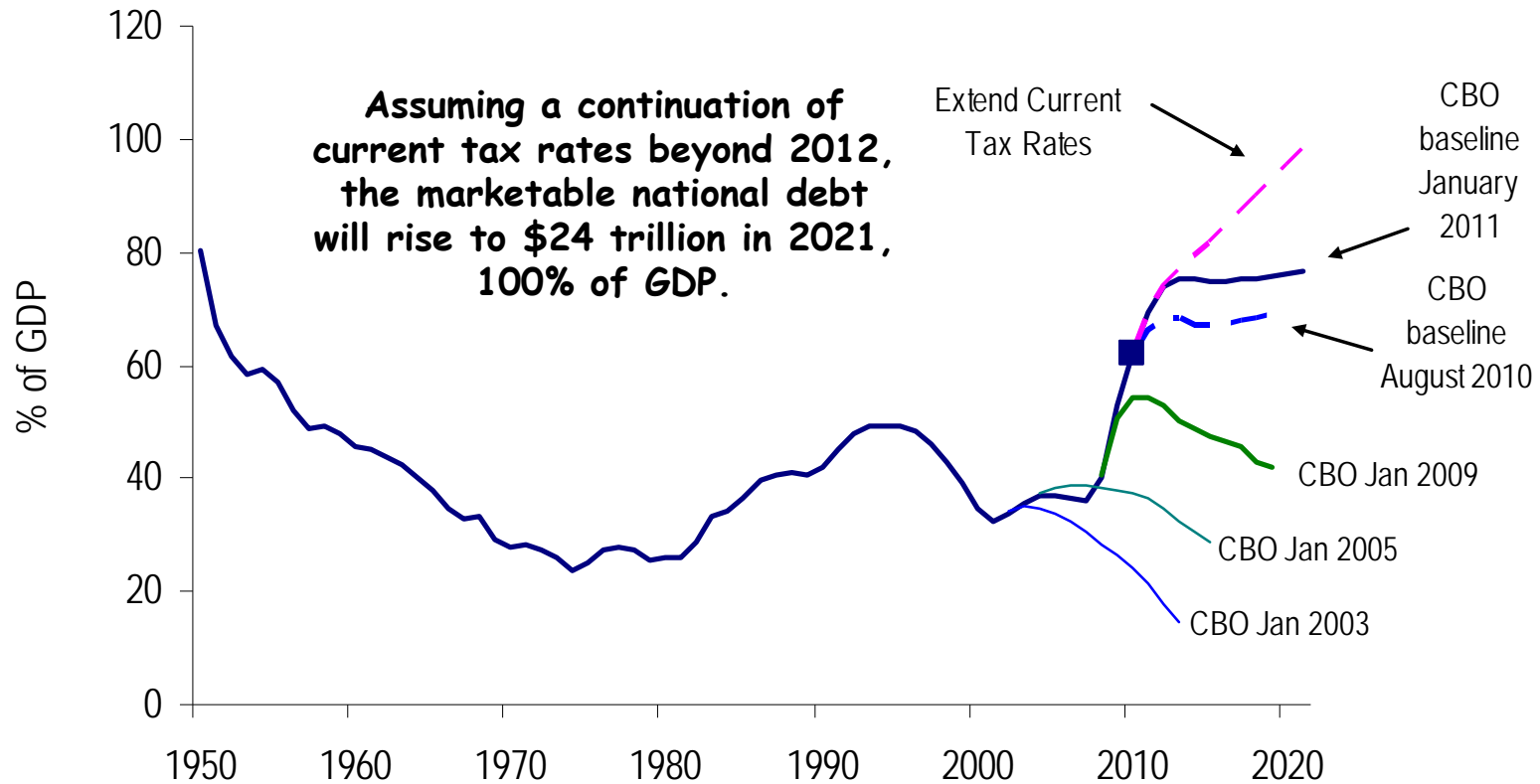
	2010 Q3 (\$ trill)	2010 Q2 (\$ trill)	Yr/Yr % chg 2010 Q3	Yr/Yr % chg 2009 Q3	Yr/Yr % chg 2008 Q3
Domestic Nonfinancial Sectors	\$ 35.8	\$ 35.3	3.7%	4.3%	6.5%
Households	\$ 13.4	\$ 13.5	-1.8%	-1.7%	2.2%
Corporate Business	\$ 7.3	\$ 7.2	3.4%	0.3%	8.3%
Noncorporate Business	\$ 3.4	\$ 3.4	-7.5%	-4.8%	8.7%
Farm Business	\$ 0.2	\$ 0.2	0.3%	0.6%	2.2%
State & Local Govts	\$ 2.4	\$ 2.4	3.3%	3.7%	4.4%
Federal Government	\$ 9.0	\$ 8.6	19.5%	30.1%	15.3%
of which Fed Holds	\$ 0.8	\$ 0.8	5.5%	61.4%	-38.9%
as of Q4 \$1.01 trillion					
memo:					
Federal Govt Trust Funds	\$ 4.6				
of which Soc Sec	\$ 2.6				

Not counting contingent liabilities from GSEs or underfunded trust funds

Source: Federal Reserve: OMB; Encima Global

CBO Forecasts of Federal Debt Per GDP

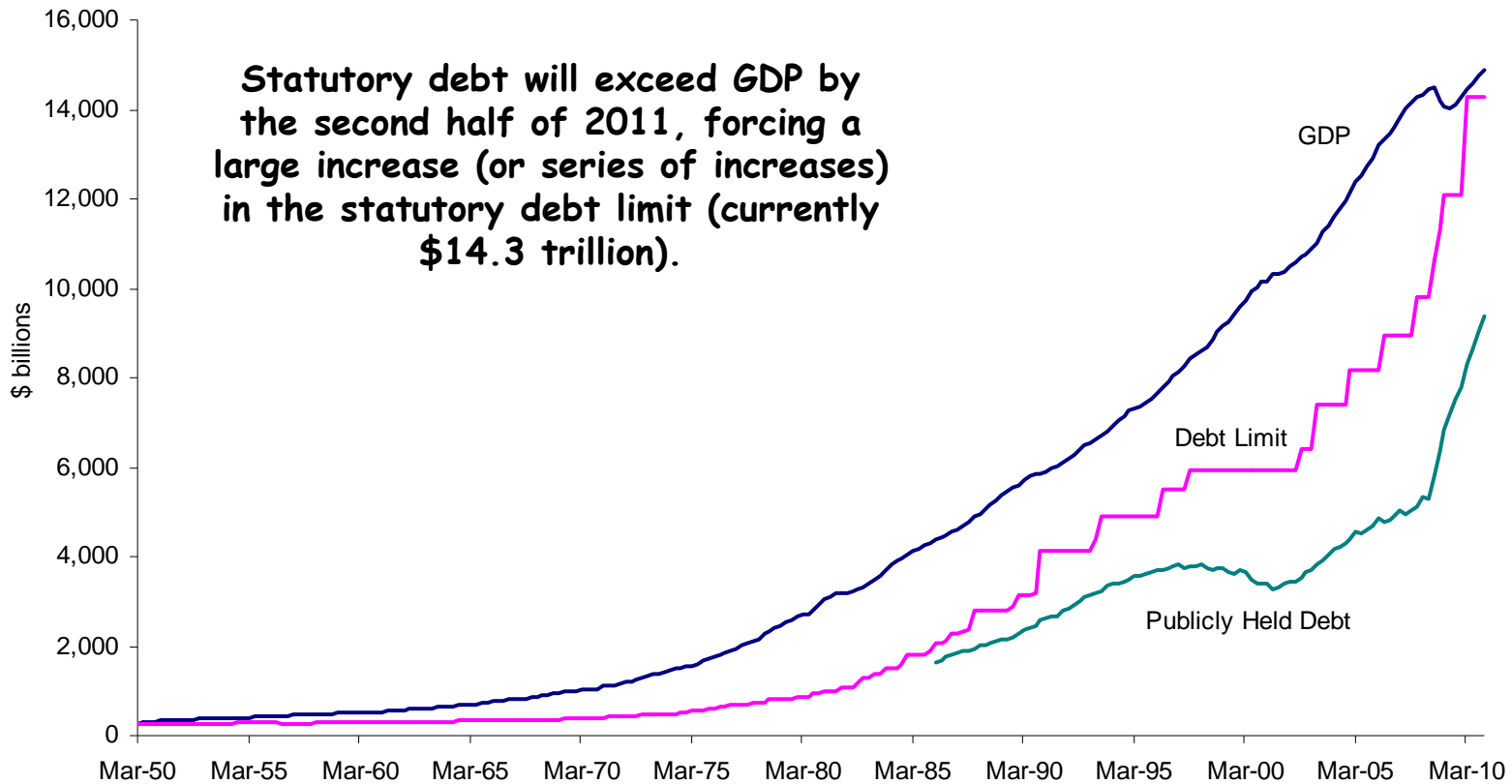
(square is last obs. 2010, CBO forecasts to 2021)



Source: CBO; Encima Global

National Debt Limit At \$14.3 Trillion

(last obs. Q4 2010)

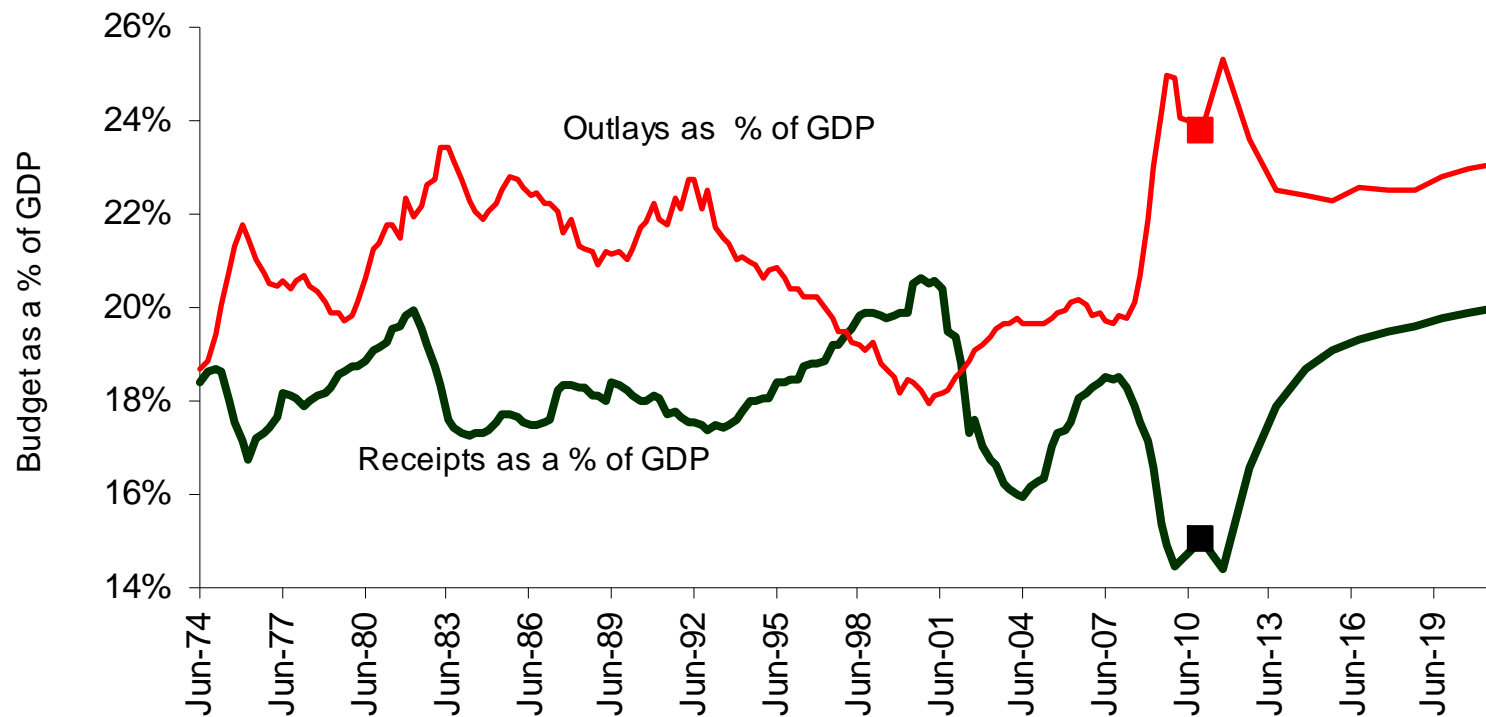


Source: Bureau of Economic Analysis; U.S. Treasury; Wikipedia; Encima Global

Federal Gov't Receipts and Outlays as a % of GDP

(\$ trillions, last obs. December 2010, OMB projected to 2021)

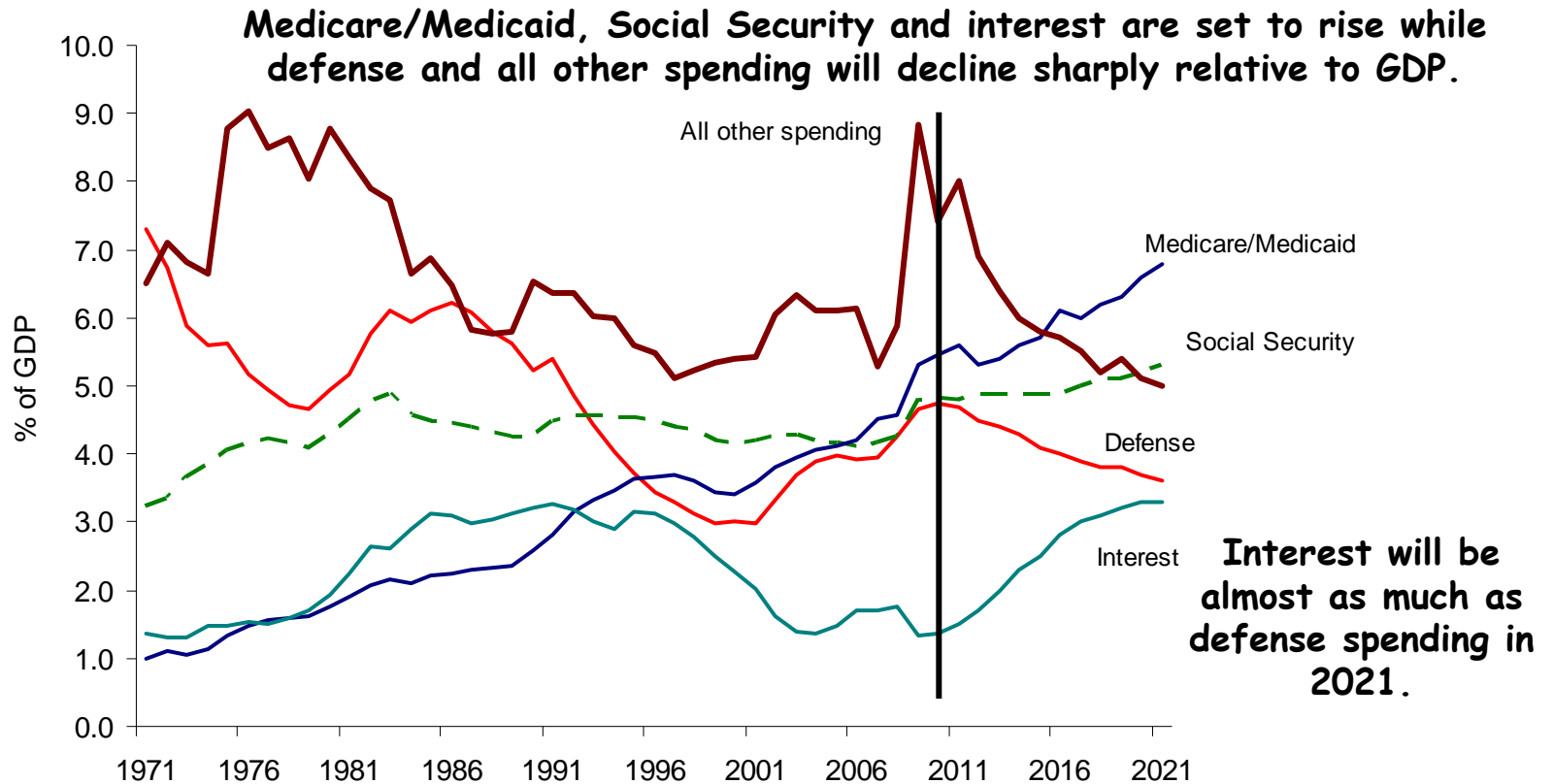
In the Administration's budget, outlays are expected to remain above 22% of GDP for the next ten years. Receipts are projected to rise quickly and then stay consistently above 19% of GDP after 2015. While some spending cuts are likely, the deficit will remain wide.



Source: OMB; Encima Global

Expenditures as a Percent of GDP by Major Category

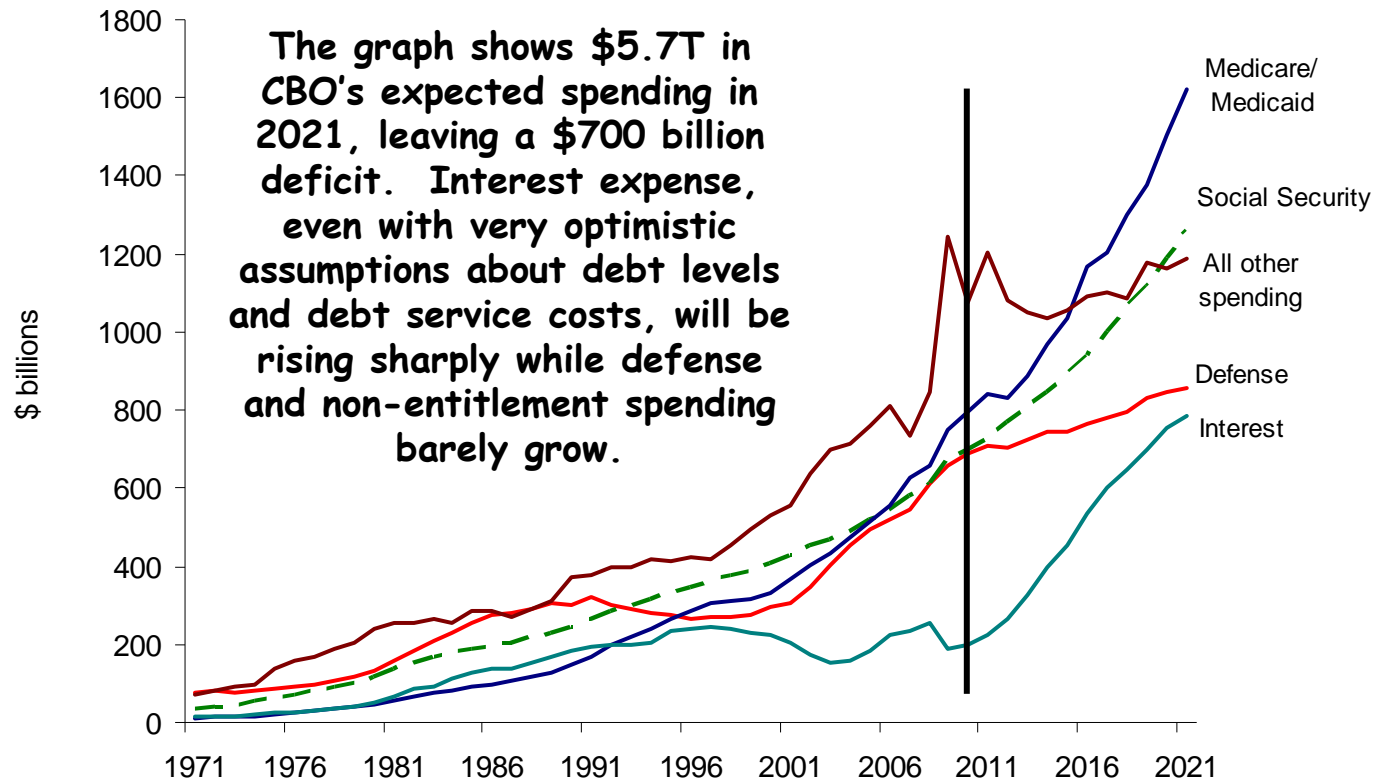
(last obs. 2010, CBO projections to 2021)



Source: CBO; Encima Global

Expenditures in \$ billions by Major Category

(last obs. 2010, CBO projections to 2021)



Source: CBO; Encima Global

Europe Debt Situation

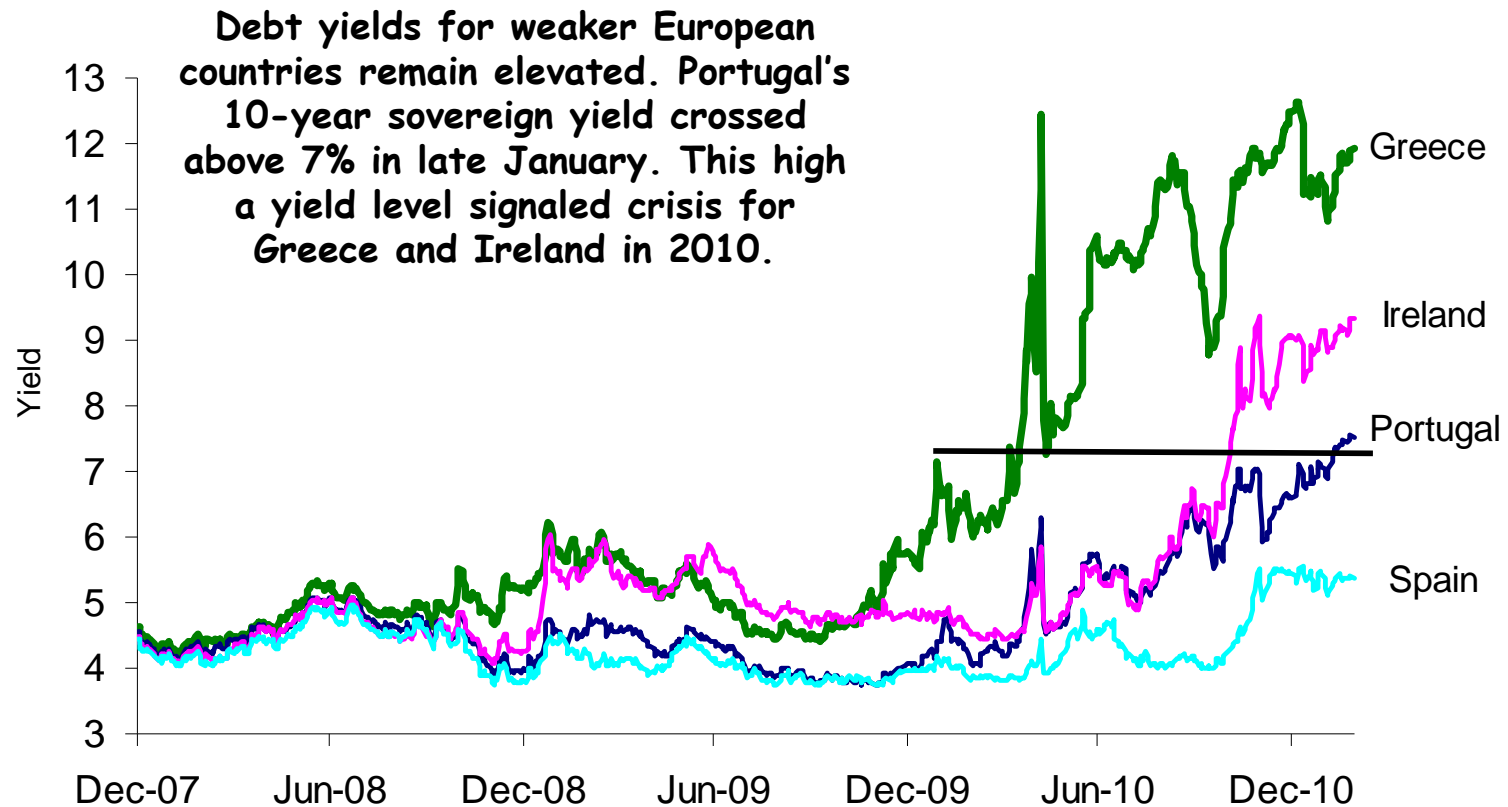
- **Europe's debt problems, while serious for individual countries and bond holders, shouldn't hurt overall European growth much.**
- **New investment is being channeled into more productive northern Europe, especially Germany.**
- **As in the U.S., European debt is consolidating, with direct aid, IMF loans and EFSF bond auctions replacing weaker country debt.**
- **We expect the focus of the debt crisis to shift to Italy – too big to fail, too big for Germany to save, especially with Weber leaving the ECB.**

Threats to Europe Have Increased

- **Southern Europe is exposed to the turmoil in North Africa at a time when its economies are already at risk from high unemployment and debt. Europe has a big population from North Africa. Refugees will cause political and economic complications. Turmoil in North Africa raises terrorism risks for Europe.**
 - **Recent developments in northern Europe add to the pressure. Axel Weber declined to be considered to head the ECB. German Chancellor Merkel's party lost heavily in Hamburg elections. German voters are showing no inclination toward the concessionary interest rates needed for loans to Greece, Ireland and elsewhere. Ireland is suffering emigration, adding to the medium-term growth and debt problem.**
 - **Debt yields for weaker European countries remain elevated. We expect the European debt crisis to take years to resolve, with corresponding economic weakness in southern Europe.**
 - **European inflation is already rising. We expect the European Central Bank to increase the refi rate in mid-2011 in accordance with its mandate to provide price stability.**
 - **While turmoil in North Africa creates a new downside risk for Europe, we are still of the view that southern Europe's problems will not cause much drag on global growth due to the pro-growth shift in investment toward northern Europe. Despite debt problems, we don't think the euro is at risk of devaluation or breakup given ECB and German policies.**
-

Select European 10 Yr Yields

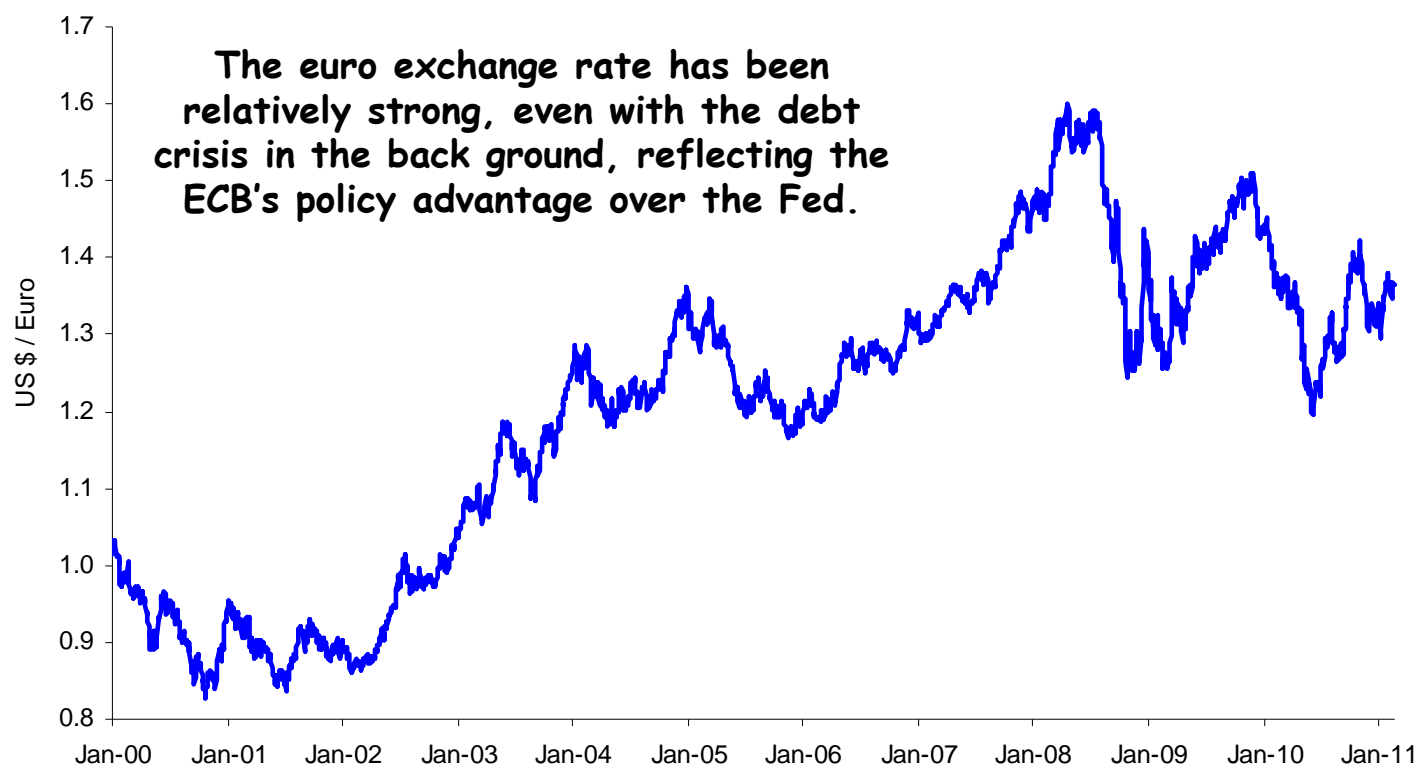
(last obs. February 24, 2011)



Source: Bloomberg; Encima Global

Euro exchange rate (US \$ / euro)

(last obs. February 24, 2011)

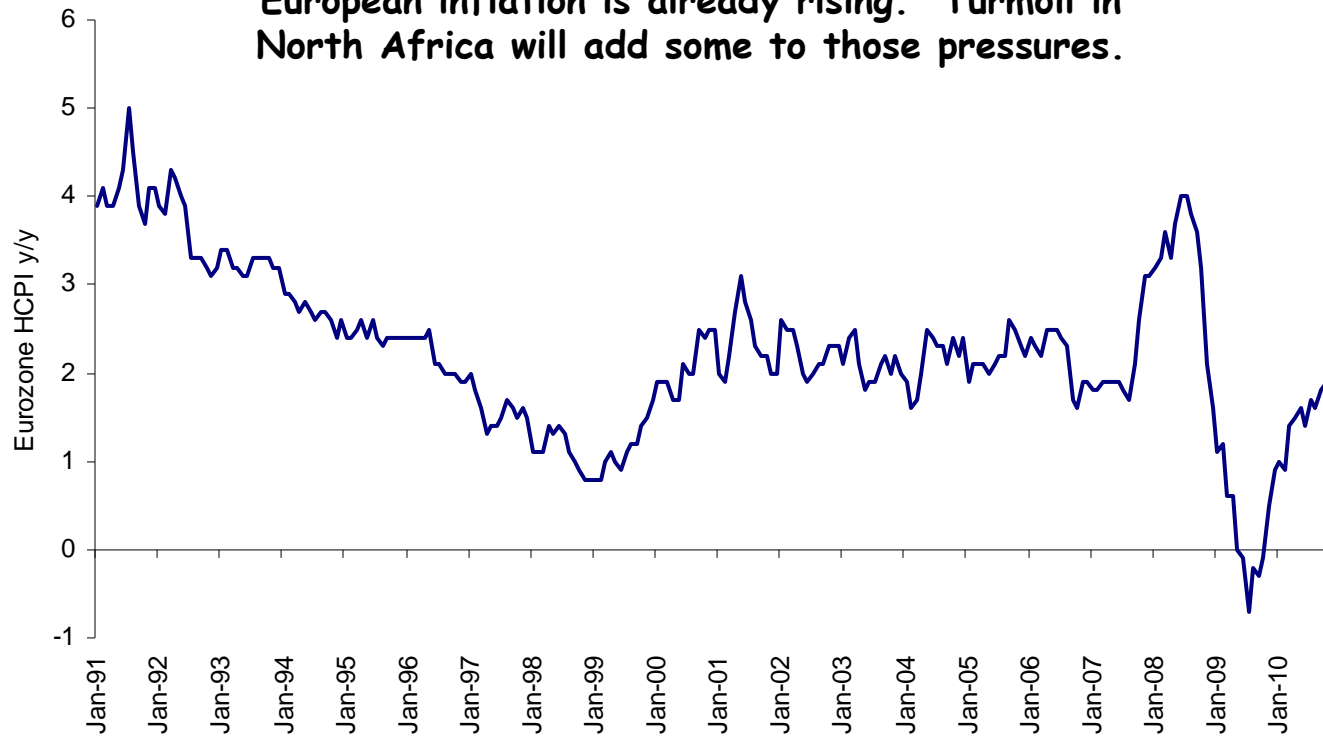


Source: Federal Reserve Board; Encima Global

Eurozone Inflation Rising

(last obs. January 2011)

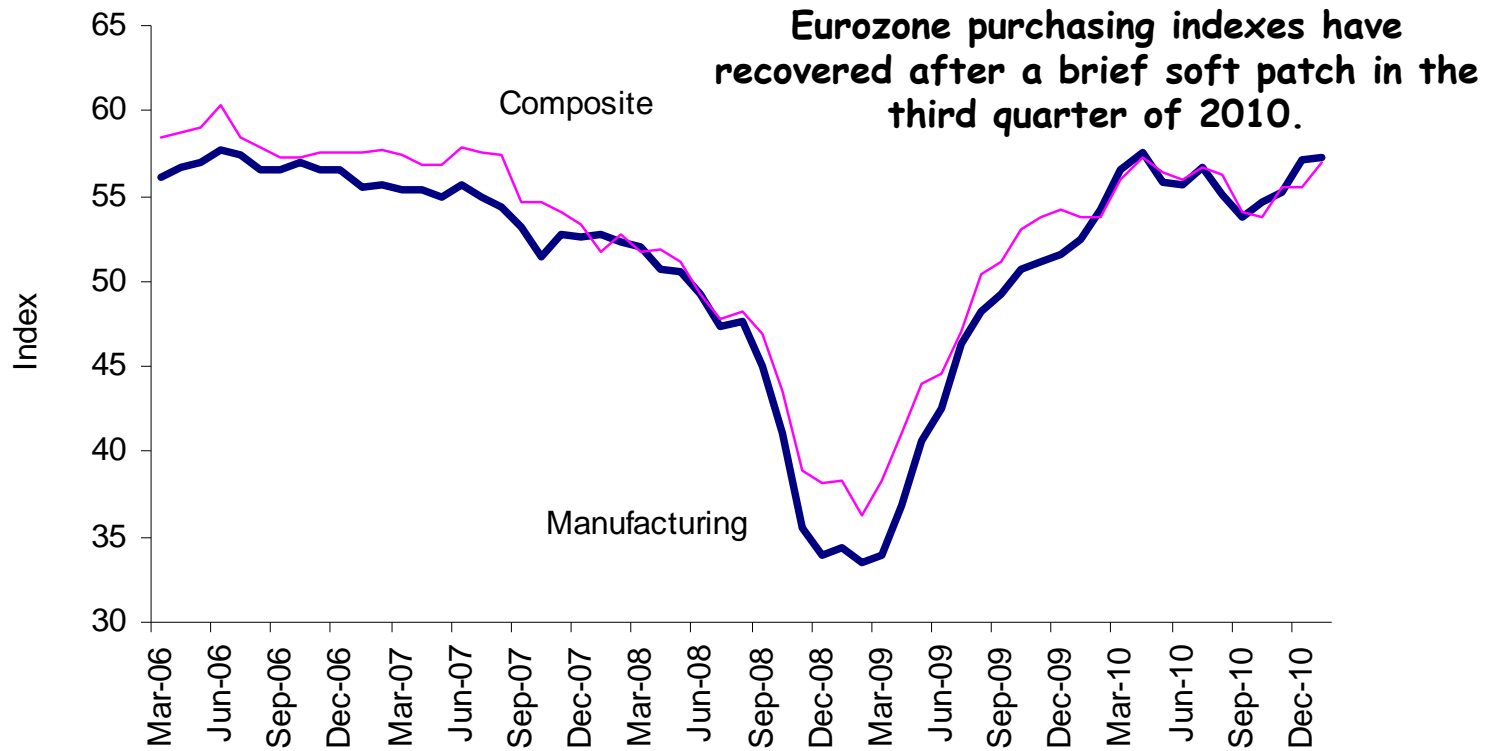
European inflation is already rising. Turmoil in North Africa will add some to those pressures.



Source: Bloomberg; Encima Global

Eurozone Purchasing Managers' Index

(last obs. January 2011)

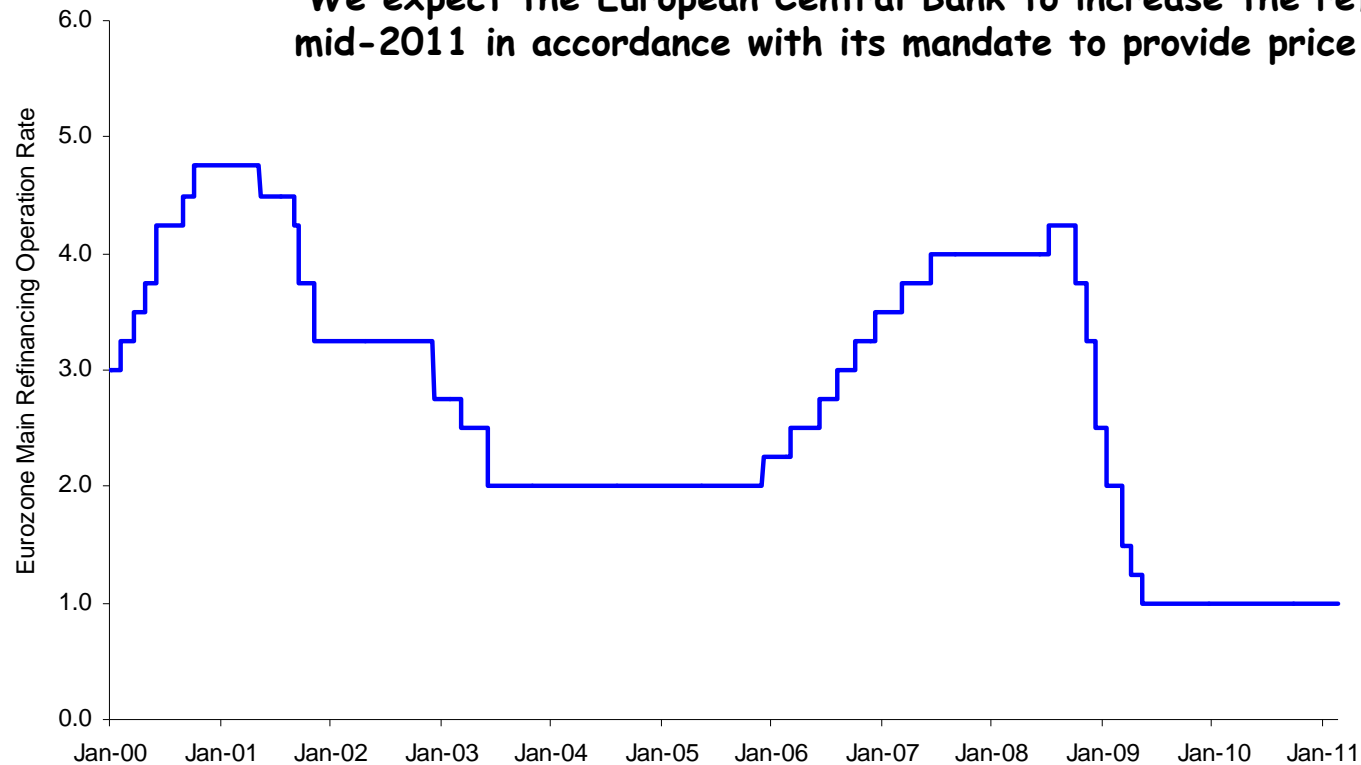


Source: Bloomberg; Encima Global

ECB Policy Rate At 1%

(last obs. February 24, 2011)

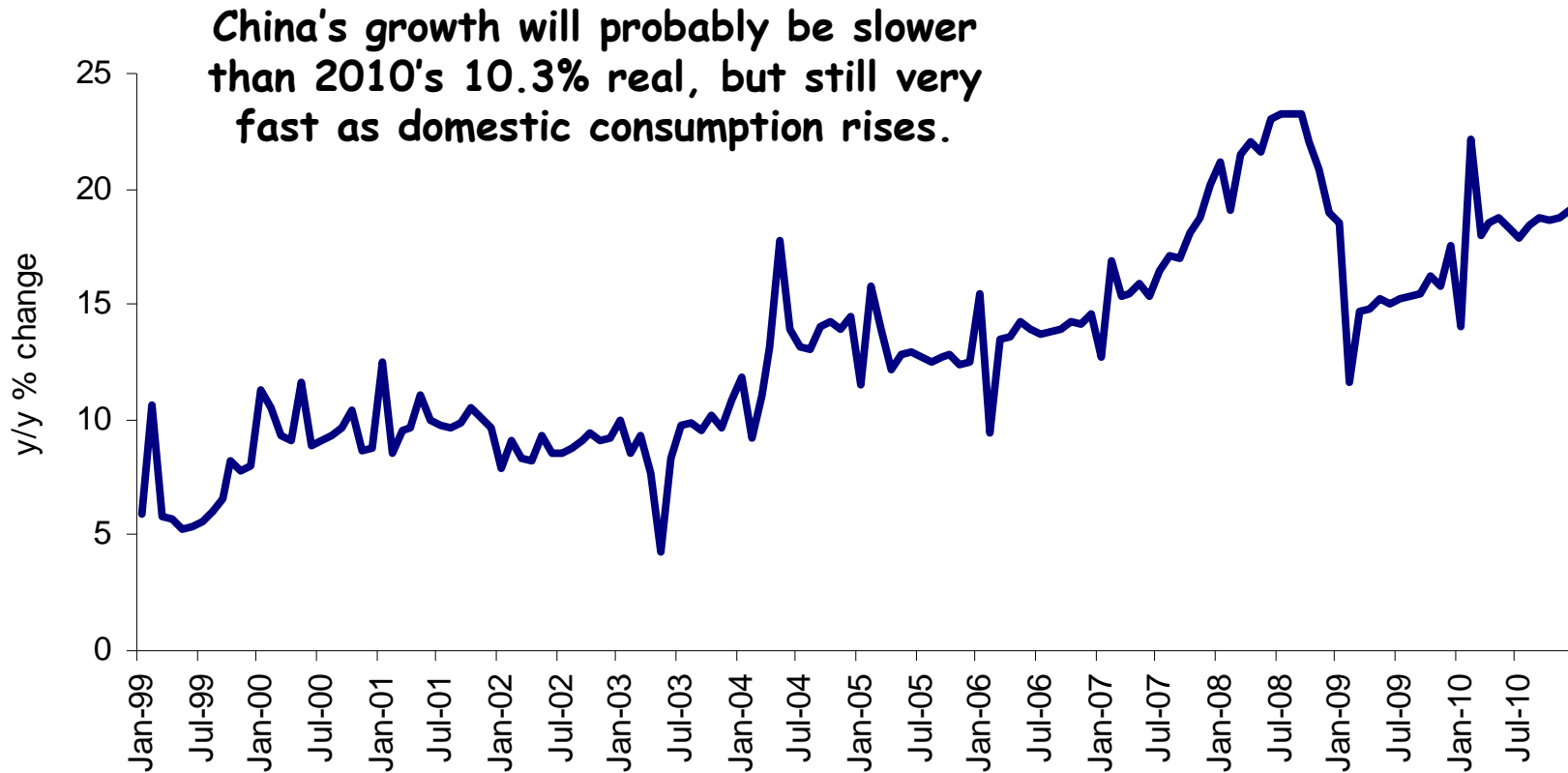
We expect the European Central Bank to increase the refi rate in mid-2011 in accordance with its mandate to provide price stability.



Source: European Central Bank; Encima Global

China's Retail Sales Y/Y

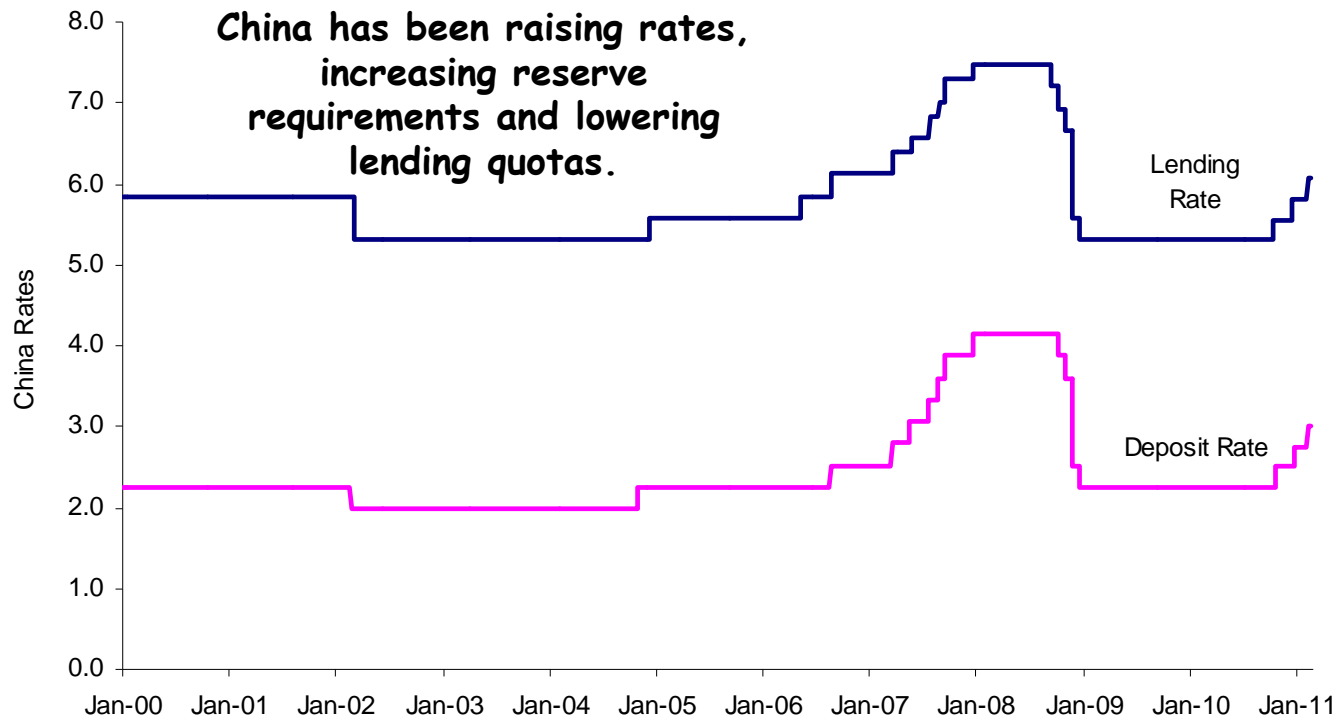
(last obs. December 2010)



Source: Bloomberg; Encima Global

China Lending and Deposit Rates

(last obs. February 28, 2011)

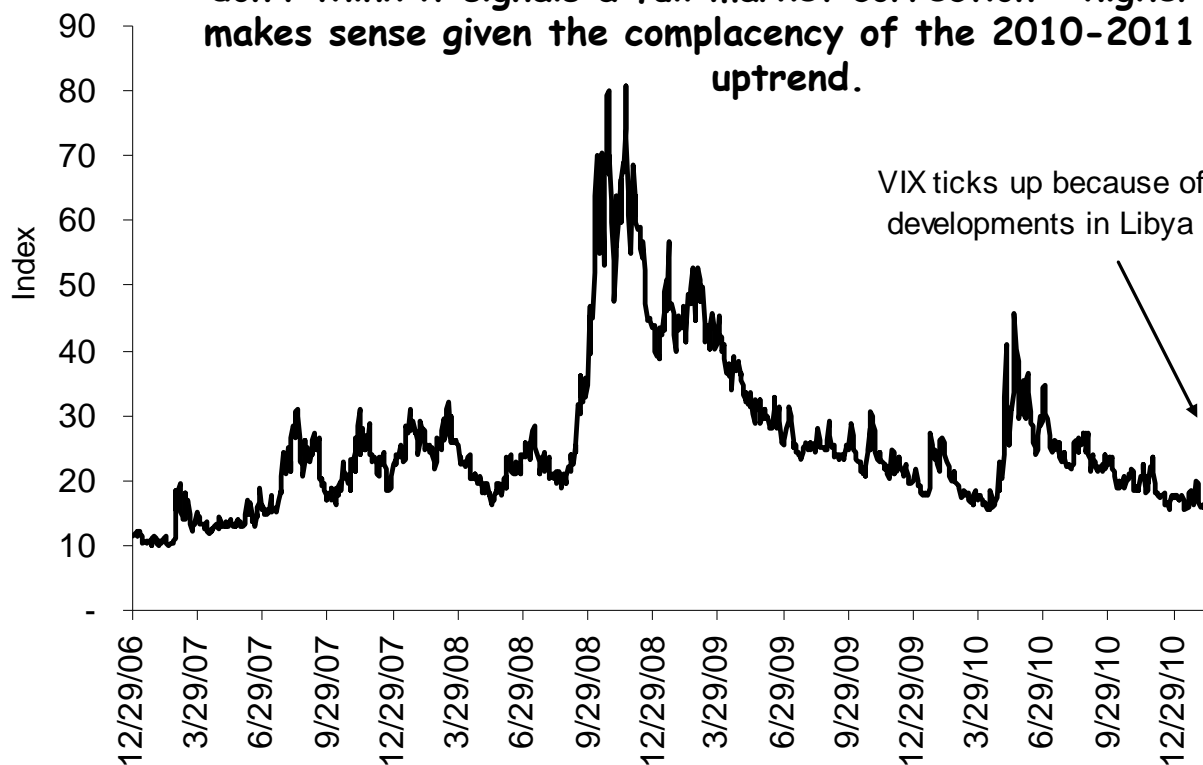


Source: Bloomberg; Encima Global

VIX – Volatility Index

(last obs. February 28, 2011)

Market volatility has increased some with events in Libya. We don't think it signals a full market correction - higher volatility makes sense given the complacency of the 2010-2011 "risk-on" uptrend.



Source: CBOE; Encima Global

Low Bond Yields Count On Low-Inflation Recovery

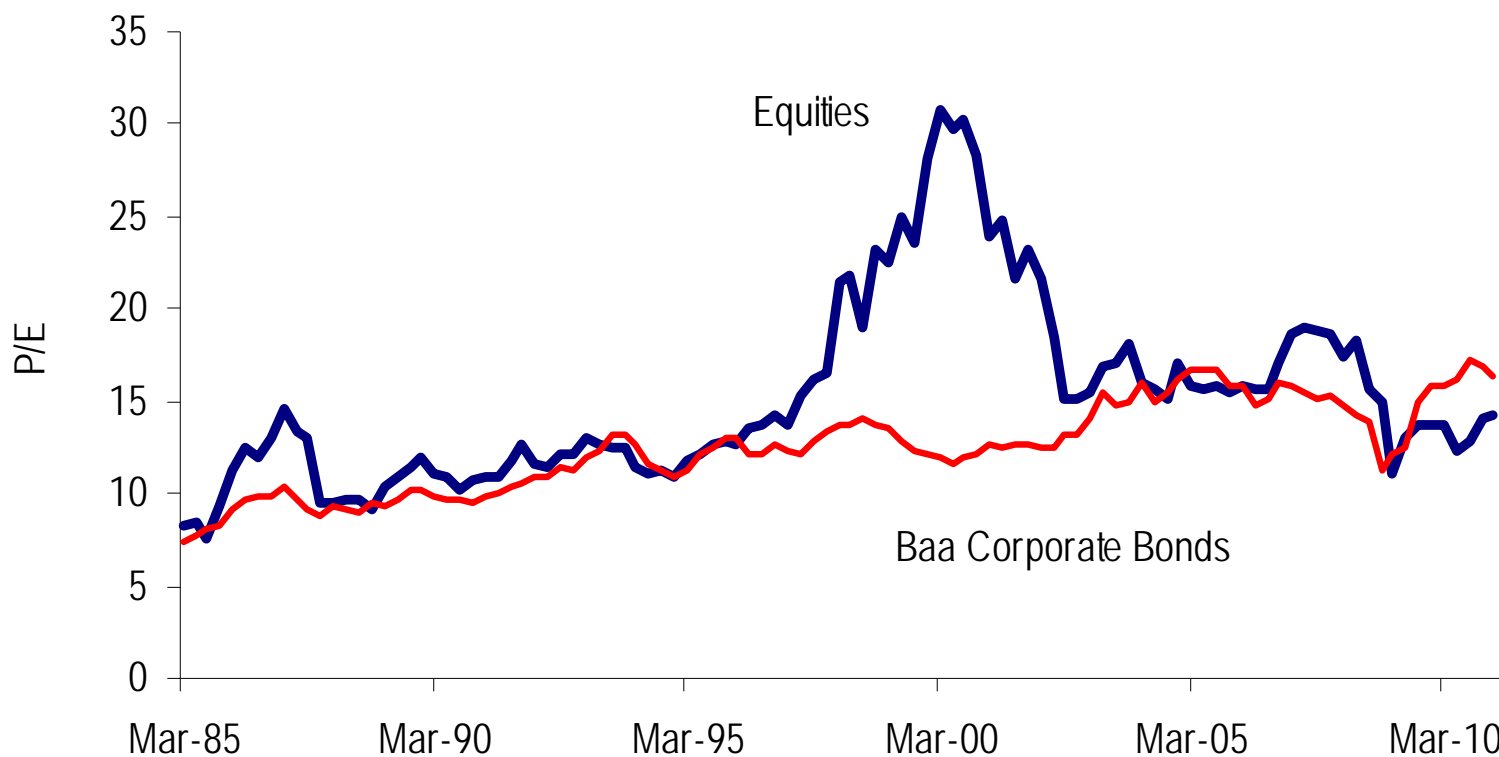
(last obs. February 25, 2011)



Source: Federal Reserve; Encima Global

Based on P/E, Equities Attractive Relative to Bonds

(last obs. Q4 2010, estimated Q1 2011)



Source: Haver; Bureau of Economic Analysis; Federal Reserve; Encima Global



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