



# **Economic Chartbook**

## **January 2011**

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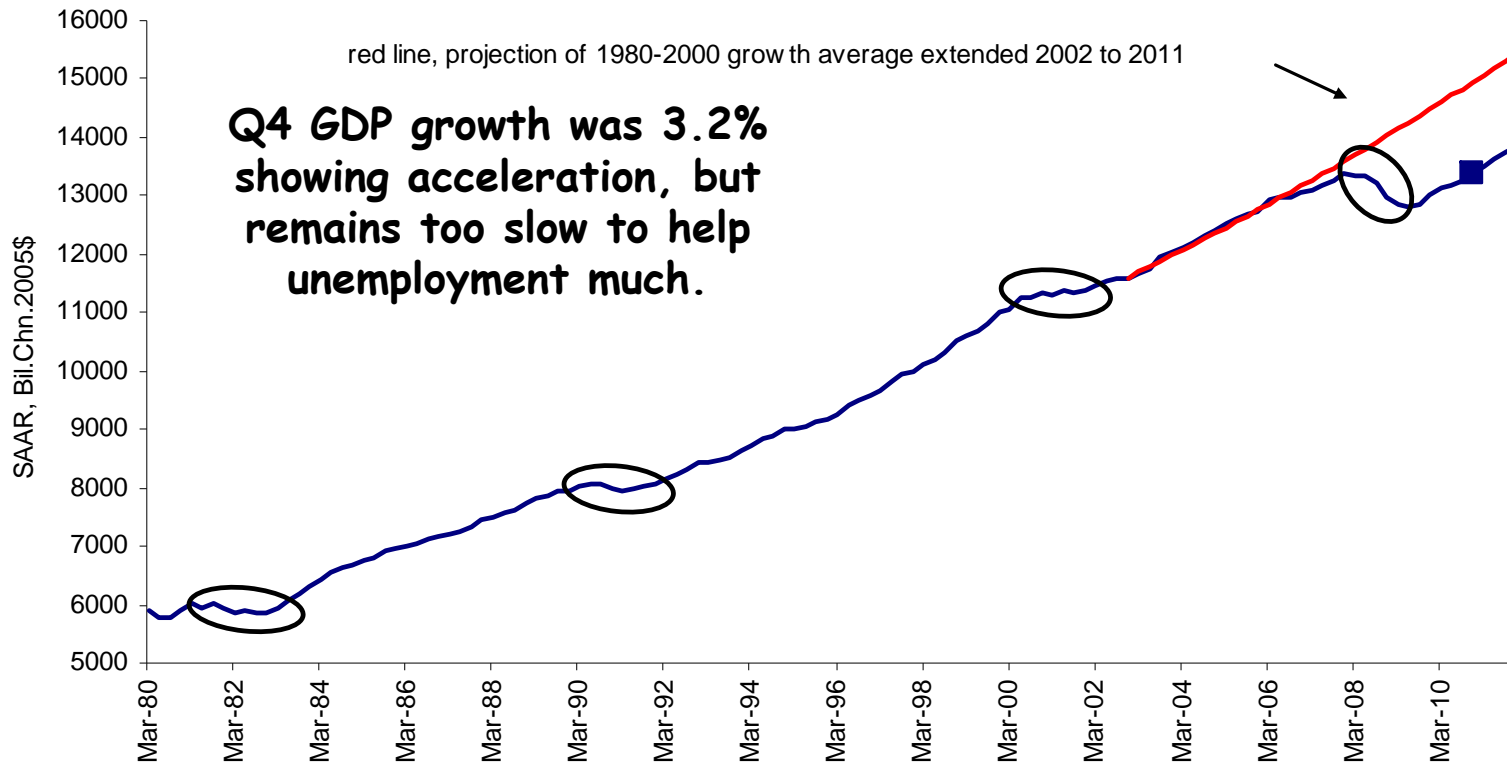
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## 2011 Global Outlook

- **The global expansion is strengthening, but inflation and debt problems will keep growth limited outside of Asia (3.5% in the U.S., under 2% in Europe and Japan, 10% in China).**
- **The Fed's QE2 balance sheet expansion to over \$3 trillion should be curtailed. The Fed's bond holdings shorten the effective maturity of the national debt and risk inflation. They distort markets and create a conflict of interest for the Fed's monetary policy decisions.**
- **The U.S. marketable debt to GDP ratio will rise from 60% to 100%, a red flag for future U.S. growth. Overall U.S. debt is stuck at 245% of GDP. We expect a rolling debt crisis during 2011 as underwater U.S. borrowers fail and southern Europe forces new debt forgiveness mechanisms. I don't expect the euro to break apart – it's too valuable.**
- **U.S. policy is causing a rapid shift of U.S. wealth from savers (being paid very low interest rates) to borrowers, governments and foreign economies. Corporate earnings growth should remain strong, helped by non-U.S. profits, now nearly 25% of total U.S. corporate profits.**

# Real GDP

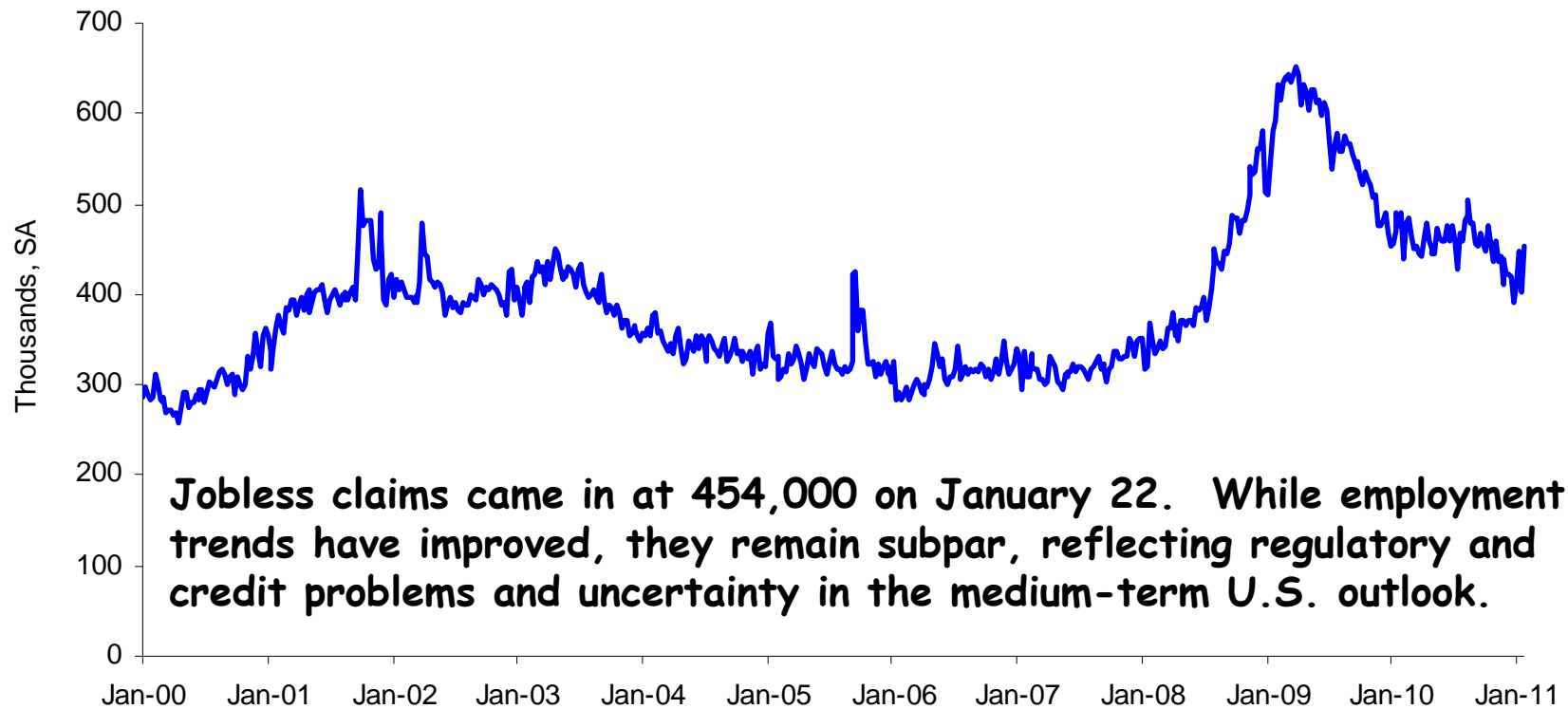
(last obs. blue square Q4 2010, forecast to Q4 2011)



Source: Bureau of Economic Analysis; Encima Global

# Initial Unemployment Claims

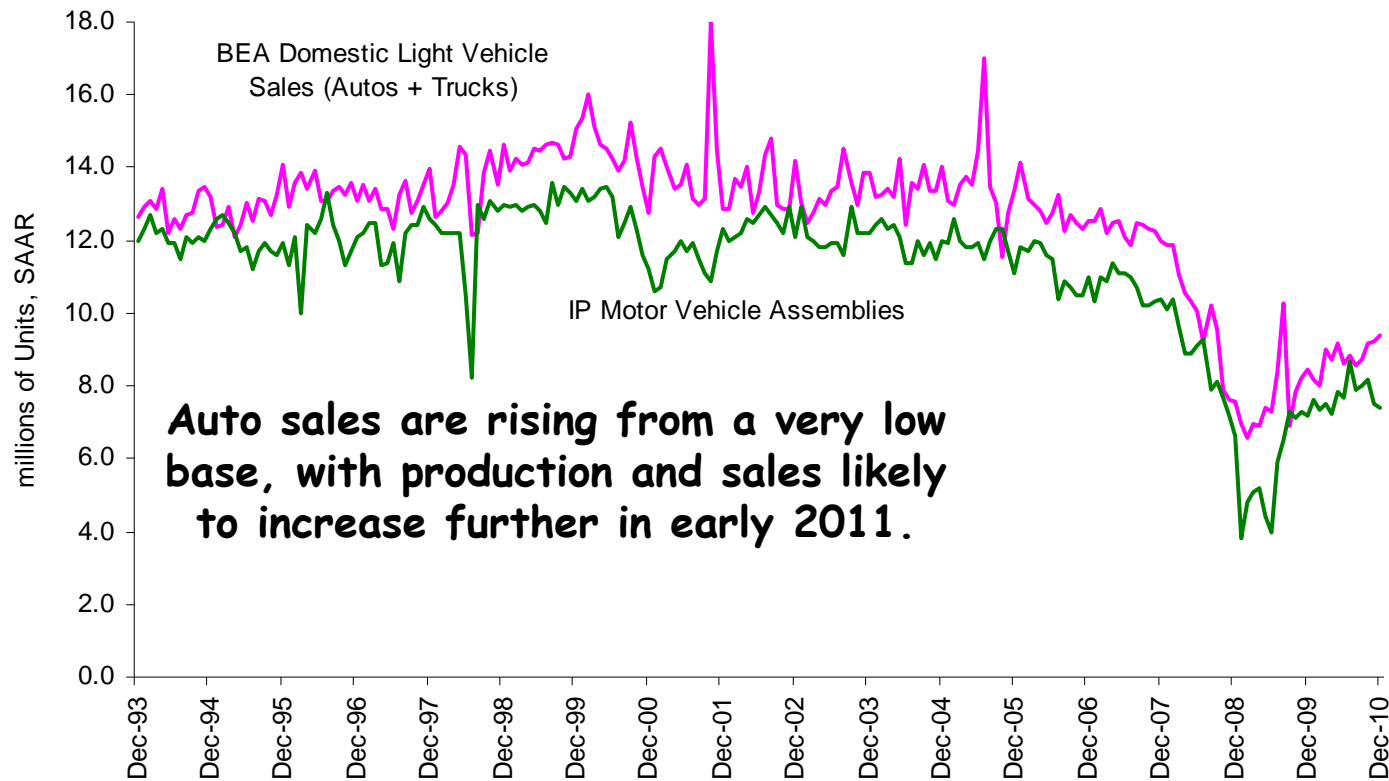
(last obs. January 22, 2011)



Source: Bureau of Labor Statistics; Encima Global

# Auto Sales and Production Below Replacement Rate

(last obs. December 2010)

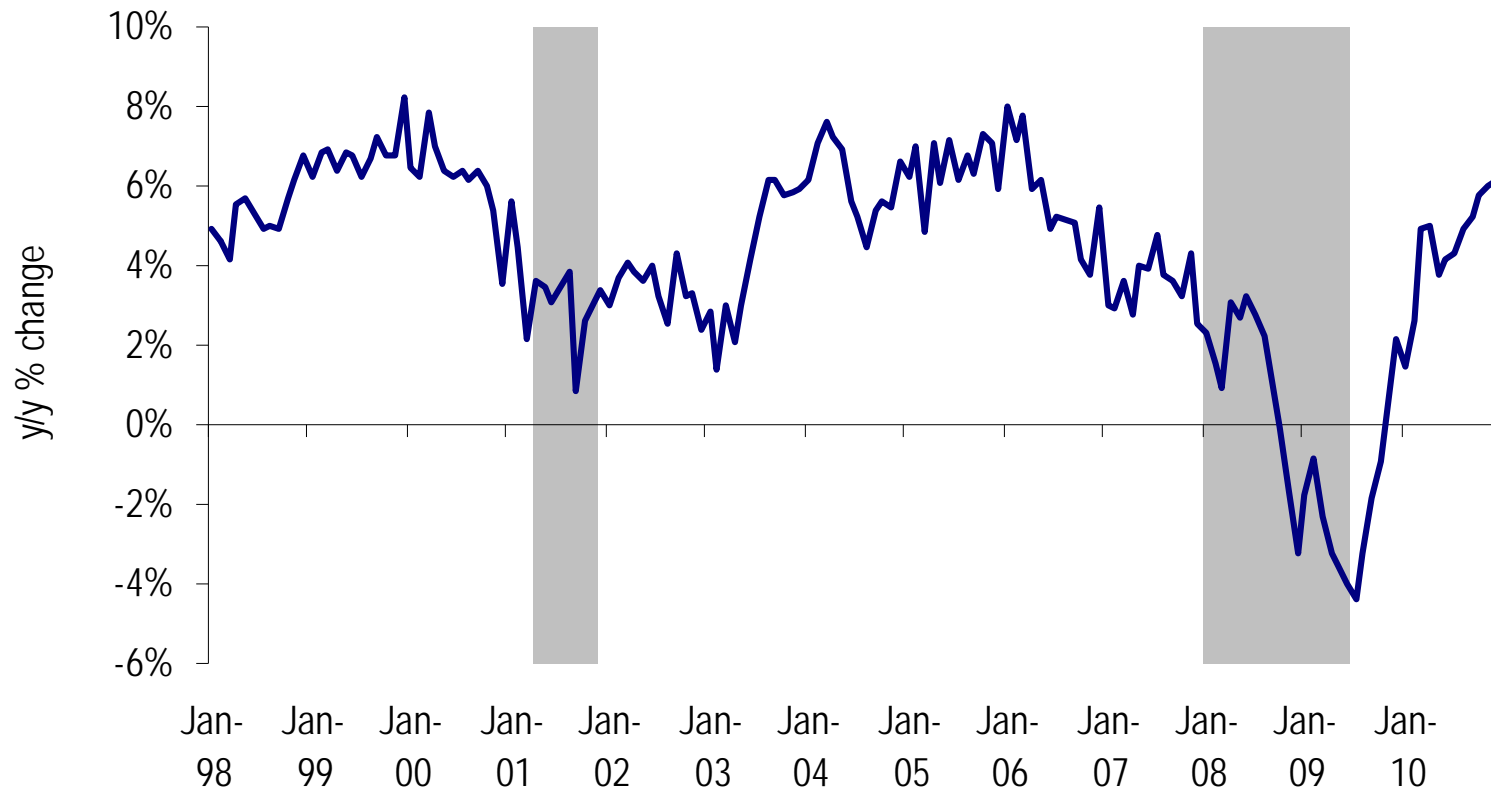


Source: Federal Reserve; Bureau of Economic Analysis; Encima Global

# Retail Sales ex Autos and Gas Y/Y

(last obs. December 2010)

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



Source: Bureau of Census; Encima Global

## Europe Debt Crisis Not Critical in Global Growth

- **The Europe debt fight is over splitting the austerity -- between pensioners, sovereign bondholders, bank creditors, public sector workers, courtiers, home owners and other stakeholders. Almost all are based in Europe.**
- **From a systemic standpoint, many countries have restructured their debts in the past, so there's no reason to think that a Greek debt restructuring (we're expecting one) or even partial debt forgiveness will be traumatic.**
- **The debt crisis won't slow Europe's growth all that much. Investment will be diverted from weaker European countries to stronger ones, with net growth about the same. In April 2010, the IMF forecast 2010 Euro-zone growth at 1%, with Germany at 1.2%. In October, the IMF's 2010 Euro-zone forecast, even after the global softpatch, is for 1.7% growth, with Germany at 3.3%.**
- **The upside or downside for Europe depends on the structural reforms achieved during the crisis.**
- **Assuming the euro stays intact (our view), Europe's debt crisis won't cause as much GDP loss as the 1997 Asia crisis because the Asia crisis was driven by devaluations.**

## DXY – Dollar Index

(last obs. January 28, 2011)



Source: Bloomberg; Encima Global

# Global \$ GDP Should Move Higher In 2011

(\$ billions, October 2010 IMF forecast)

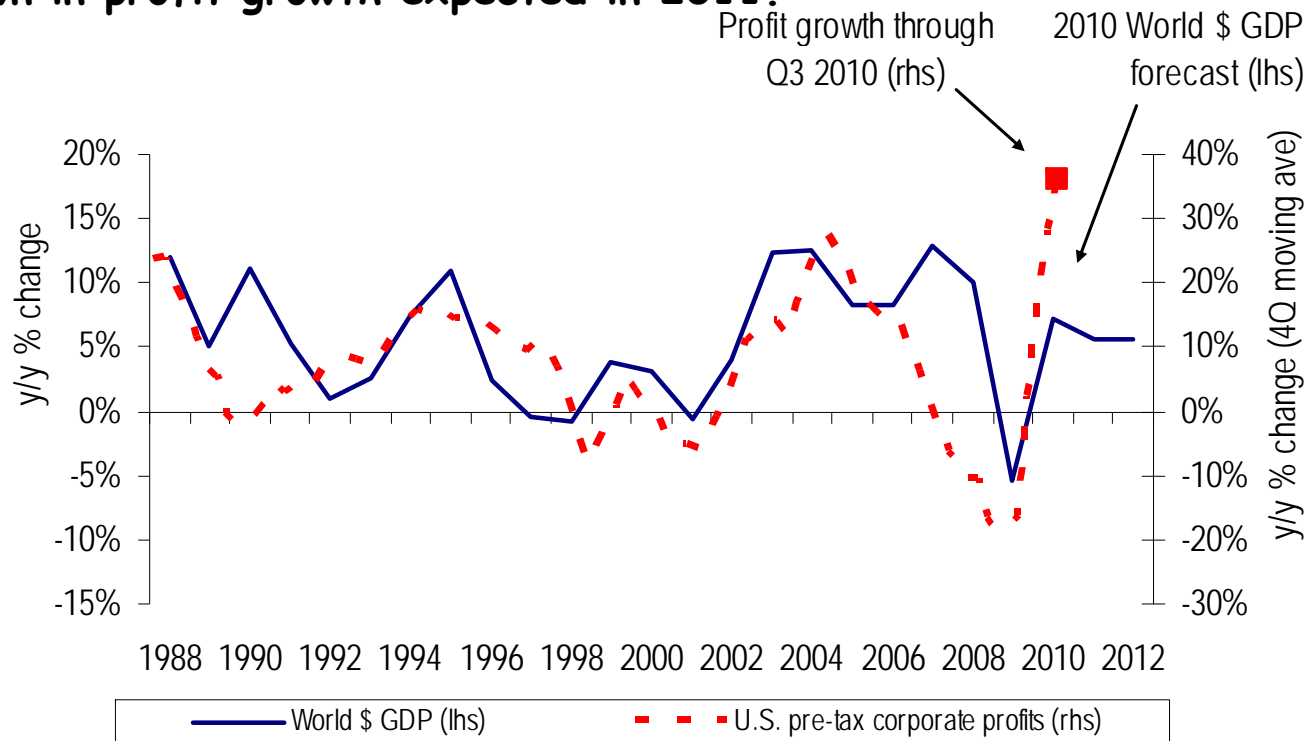
	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
<b>World</b>	61,187	57,843	61,963	65,417	69,125
<b>United States</b>	14,369	14,119	14,624	15,157	15,825
<b>Latin America</b>	4,264	3,965	4,700	5,014	5,306
<b>Developing Asia</b>	7,436	7,876	9,136	10,174	11,257
<b>Eurozone</b>	13,616	12,484	12,067	12,187	12,520
<b>World with pessimistic EUR exchange scenario</b>			61,963	64,147	67,877
<b>Y/Y Growth Rates</b>		<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
<b>World</b>		-5.5%	7.1%	5.6%	5.7%
<b>United States</b>		-1.7%	3.6%	3.6%	4.4%
<b>Latin America</b>		-7.0%	18.5%	6.7%	5.8%
<b>Developing Asia</b>		5.9%	16.0%	11.4%	10.6%
<b>Eurozone</b>		-8.3%	-3.3%	1.0%	2.7%
<b>World with pessimistic EUR exchange scenario</b>				3.5%	5.8%

Source: IMF; Encima Global

# World Nominal \$ GDP and US NIPA Corporate Profits

(last obs. Q3 2010, GDP forecast to 2012)

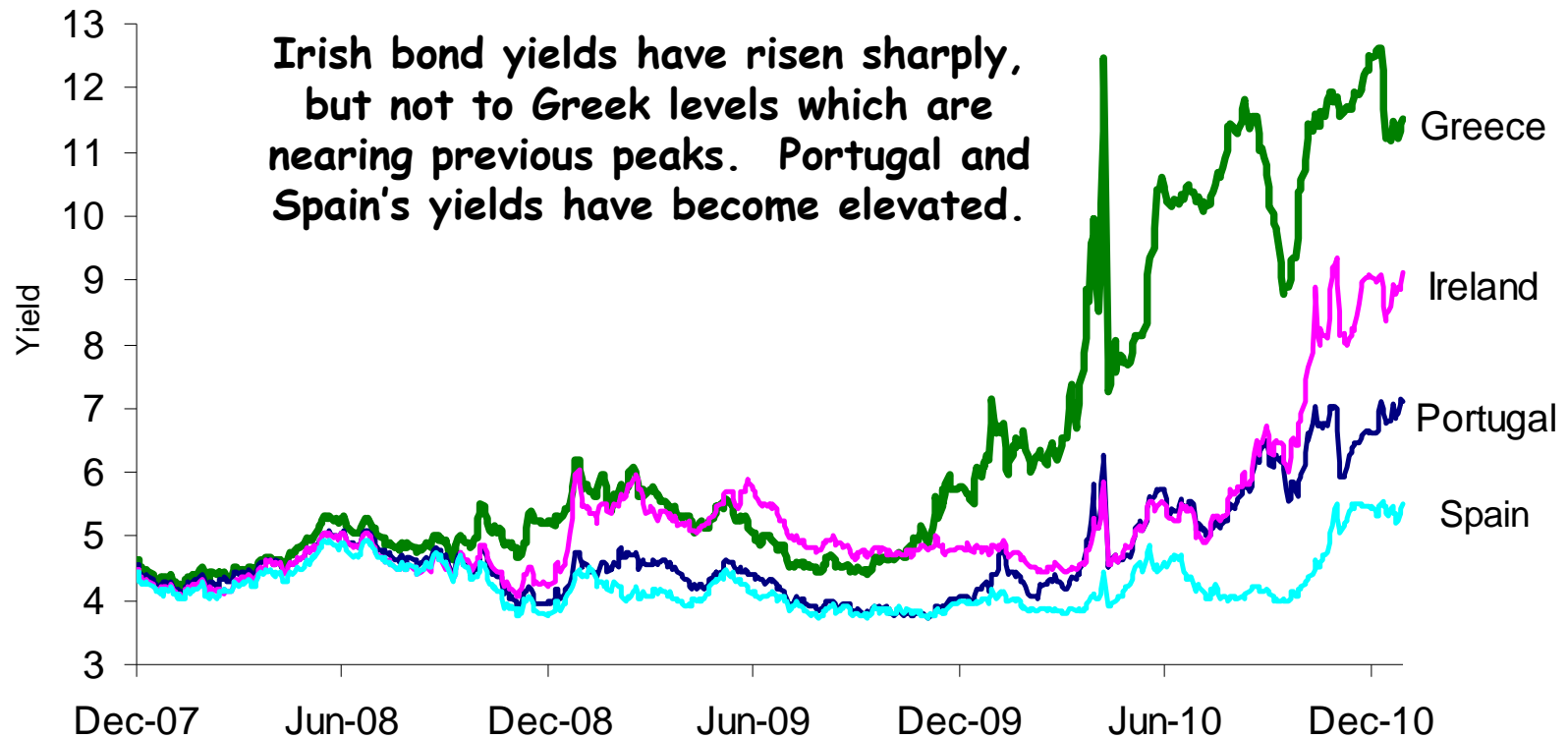
**U.S. corporate profits tend to grow (and shrink) double the world \$ GDP growth rate. 2009 and 2010 saw a wide profit swing, with a slowdown in profit growth expected in 2011.**



Source: IMF; Bureau of Economic Analysis; Encima Global

# Select European 10 Yr Yields

(last obs. January 28, 2010)



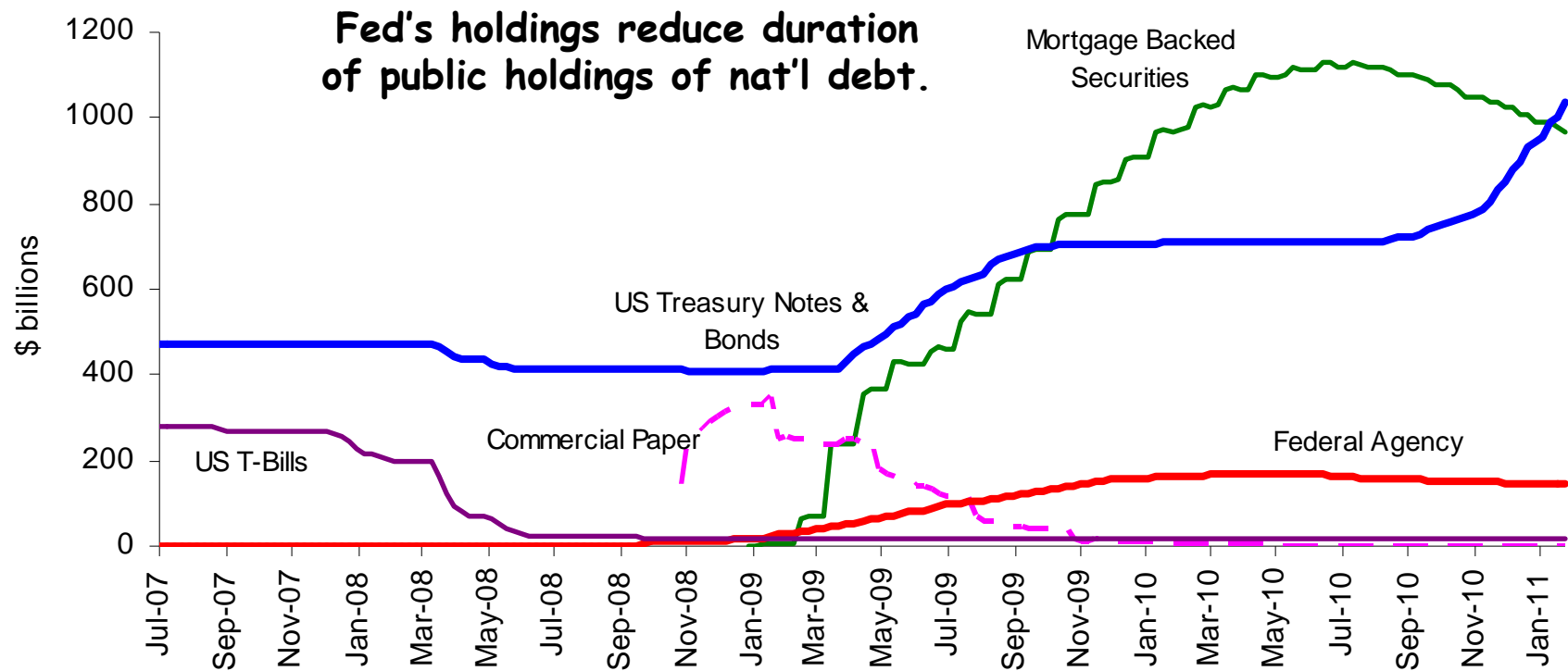
Source: Bloomberg; Encima Global

## **Fed Expansion Isn't Causing Growth**

- **The Fed funds target is 0% to 0.25%. The average \$75 billion per month in net balance sheet expansion offered through June is funding most of the fiscal deficit. The Fed's gross Treasury bond purchases are reaching \$110 billion per month.**
- **This won't have much impact on bank lending or jobs – credit is being rationed by regulatory policy rather than interest rates. The Fed purchases cause the government to absorb the maturity risk of the national debt.**
- **The current Fed policy is costly. The near-zero fed funds rate hurts savers and distorts capital flows. Capital allocation is increasingly being determined by governments, regulators and big corporations, a distinct new negative.**

# Fed Assets Now Long-term

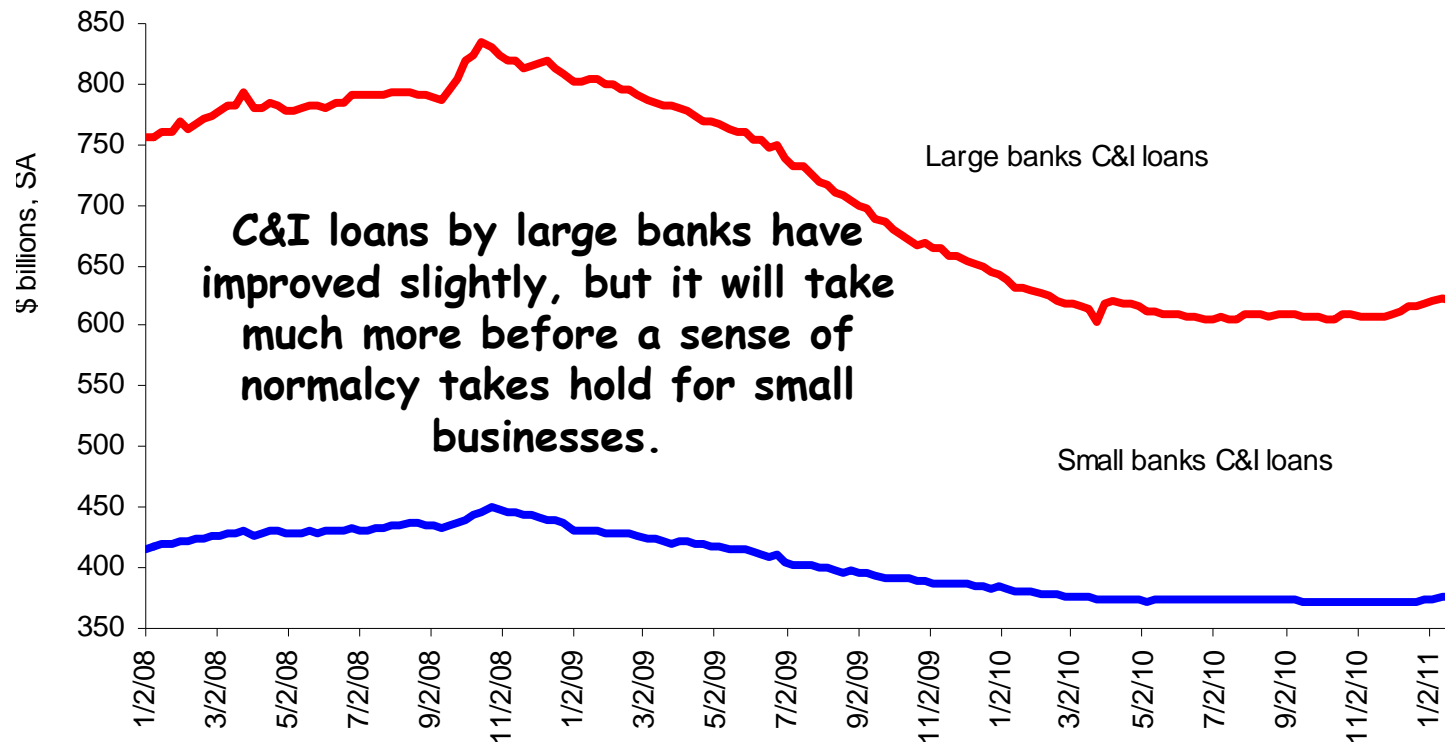
(last obs. January 26, 2011)



Source: Federal Reserve; Encima Global

# Domestic Banks Commercial & Industrial Loans

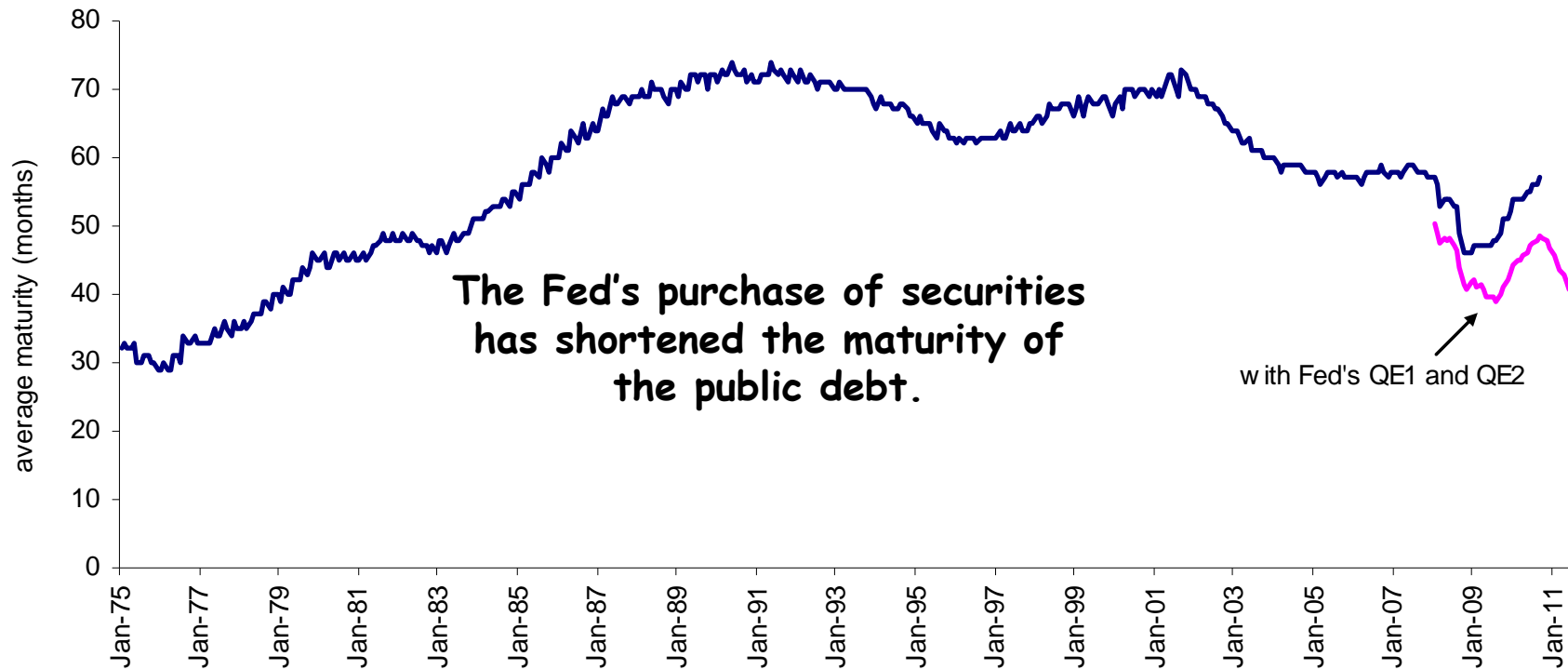
(last obs. January 19, 2010)



Source: Federal Reserve; Encima Global

# Maturity of Publicly Held Debt

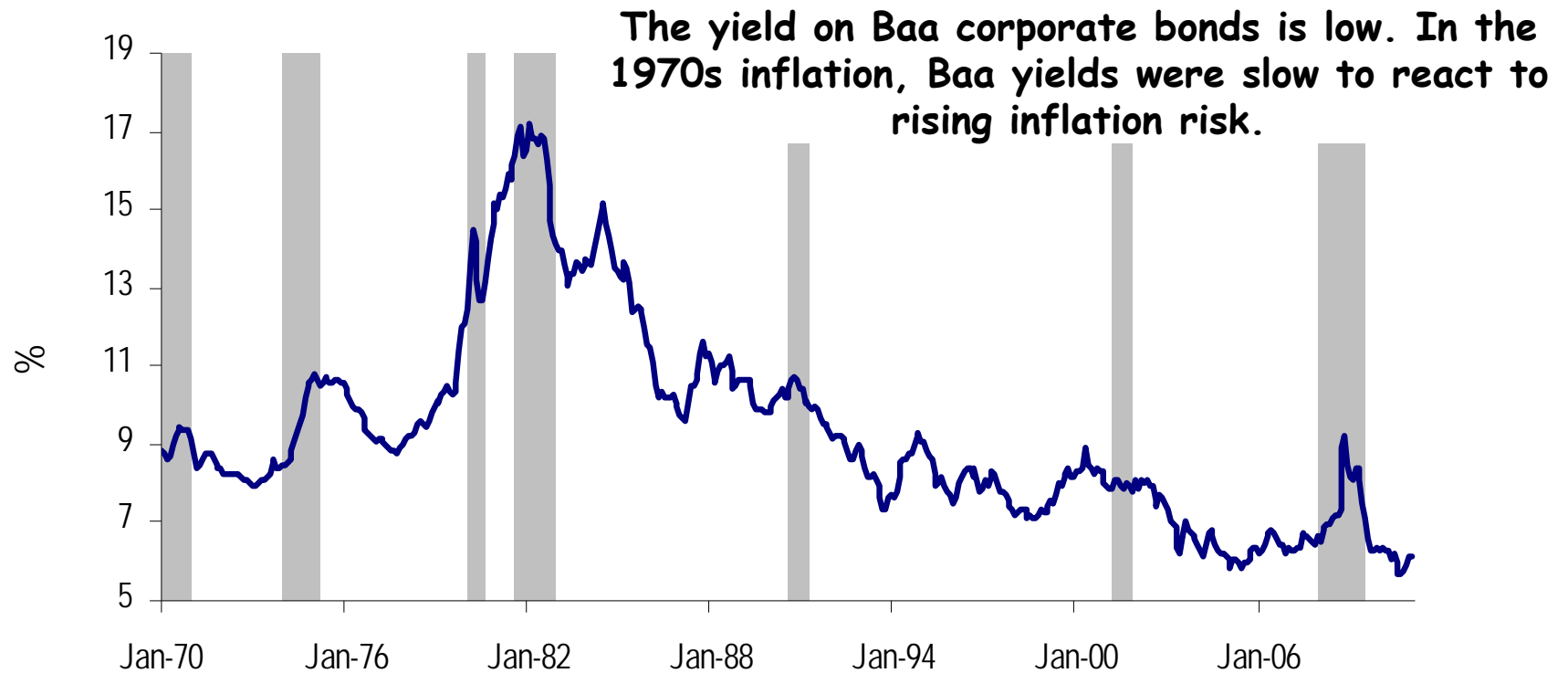
(last obs. January 27, 2010)



Source: Federal Reserve; US Treasury; Encima Global

# Low Bond Yields Count On Low-Inflation Recovery

(last obs. January 28, 2011)



Source: Federal Reserve; Encima Global

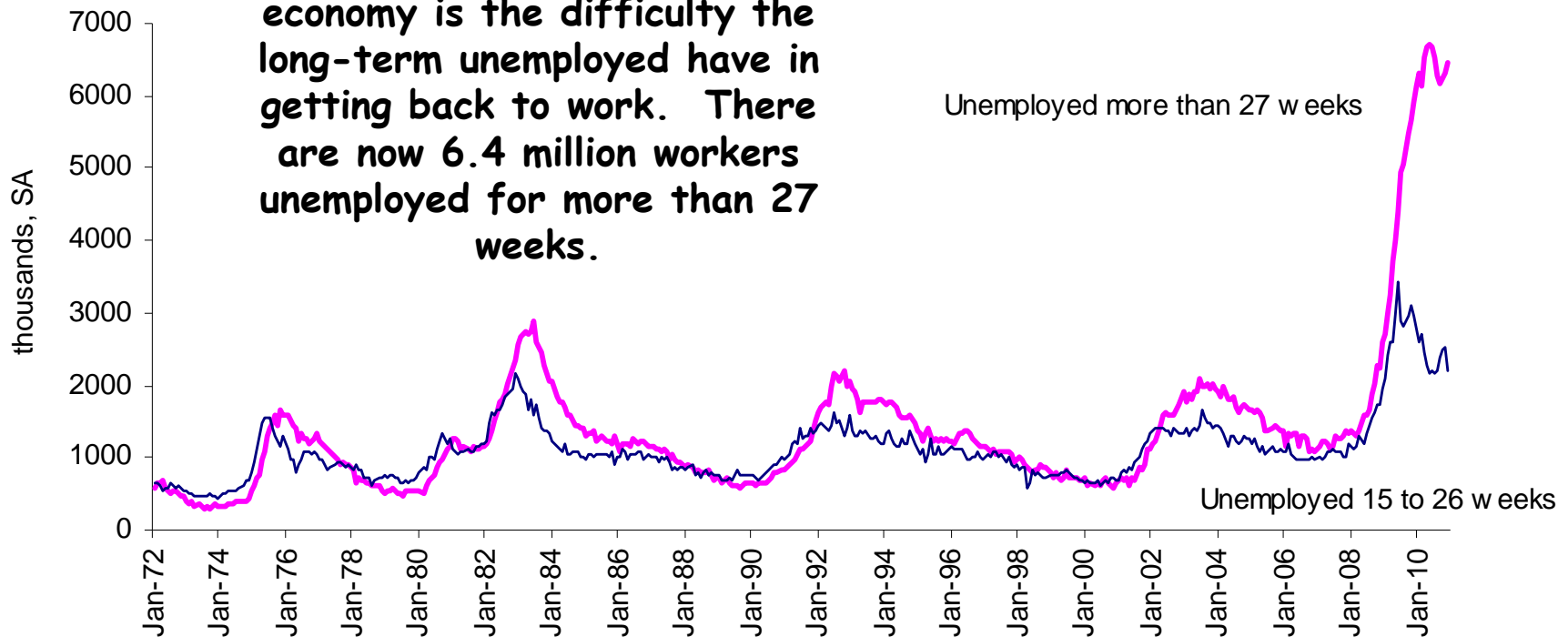
## Key U.S. Variables

- **The amount of U.S. federal spending cuts. Watch the March 4, 2011 spending bill (continuing resolution) and the spring increase in the debt limit. If the spending cuts are large or actually slow the long-term spending path, we think the dollar will strengthen materially and commodity prices fall. For now, the consensus has priced in only small reductions in the bloated FY2010 spending levels and little in the way of long-term spending restraint. We emphasize the wide range of settling points for the dollar and commodity prices after the large 2003-2008 devaluation.**
- **Similarly, an early Fed wind-down of QE2 (unlikely) would trigger dollar strength, break the commodity price uptrend and cause greater investment of global capital in the U.S. We think unemployment would fall faster than consensus, as it did in the strengthening-dollar 1990s.**
- **U.S. bank regulatory policy. Banks already have over \$1 trillion in excess reserves deposited at the Fed, with the Fed in the process of borrowing another \$600 billion from them to buy Treasury bonds. If Washington's bank regulators were to change their policies in a way that encouraged the banks to lend some of this excess, it would bring faster job growth and small business growth. It would also lead to materially higher bond yields and an increase in the Fed interest rate paid on excess bank reserves.**

# Workers Unemployed More than 27 Weeks

(last obs. December 2010)

**One major risk facing the economy is the difficulty the long-term unemployed have in getting back to work. There are now 6.4 million workers unemployed for more than 27 weeks.**



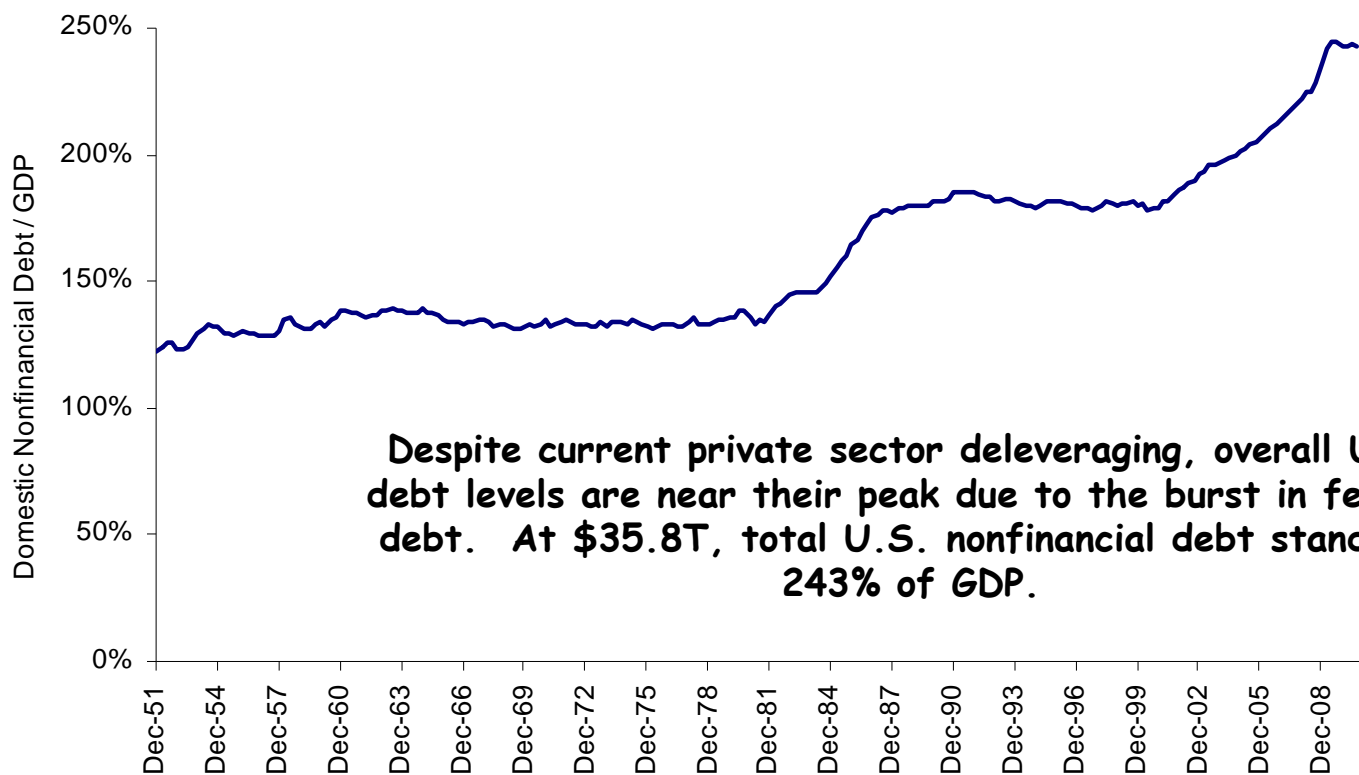
Source: Bureau of Labor Statistics; Encima Global

## 2011 Debt Outlook

- **Despite current private sector deleveraging, overall U.S. debt levels are being sustained at a very high level.**
- **Small businesses are finally getting some oxygen, but many debtors are still underwater – homeowners, small and medium sized businesses, states and municipalities. It's going to take quite a bit of time in 2011 to see how far these debt problems really extend and how big their drag on growth.**
- **The housing situation, foreclosures and mortgages remain in bad condition, which reduces labor mobility. We expect an improvement in some parts of the country in 2011, but mortgage rates are rising and Washington still isn't improving the tangles in the legal system.**
- **The U.S. state and municipal debt and over-spending problems will pit pensions against creditors against current government services. This will take a long time to resolve through courts, elections and attrition.**
- **As the economic acceleration becomes clearer, we think global policies will shift further toward fiscal and monetary restraint. If this also occurs in the U.S., it points to a stronger dollar, weaker commodity prices, lower U.S. bond yields after the latest run-up, and a reallocation of equity investment -- away from commodities and materials and toward the U.S. and non-commodity emerging markets.**

# Total U.S. Nonfinancial Debt / GDP

(last obs. Q3 2010)



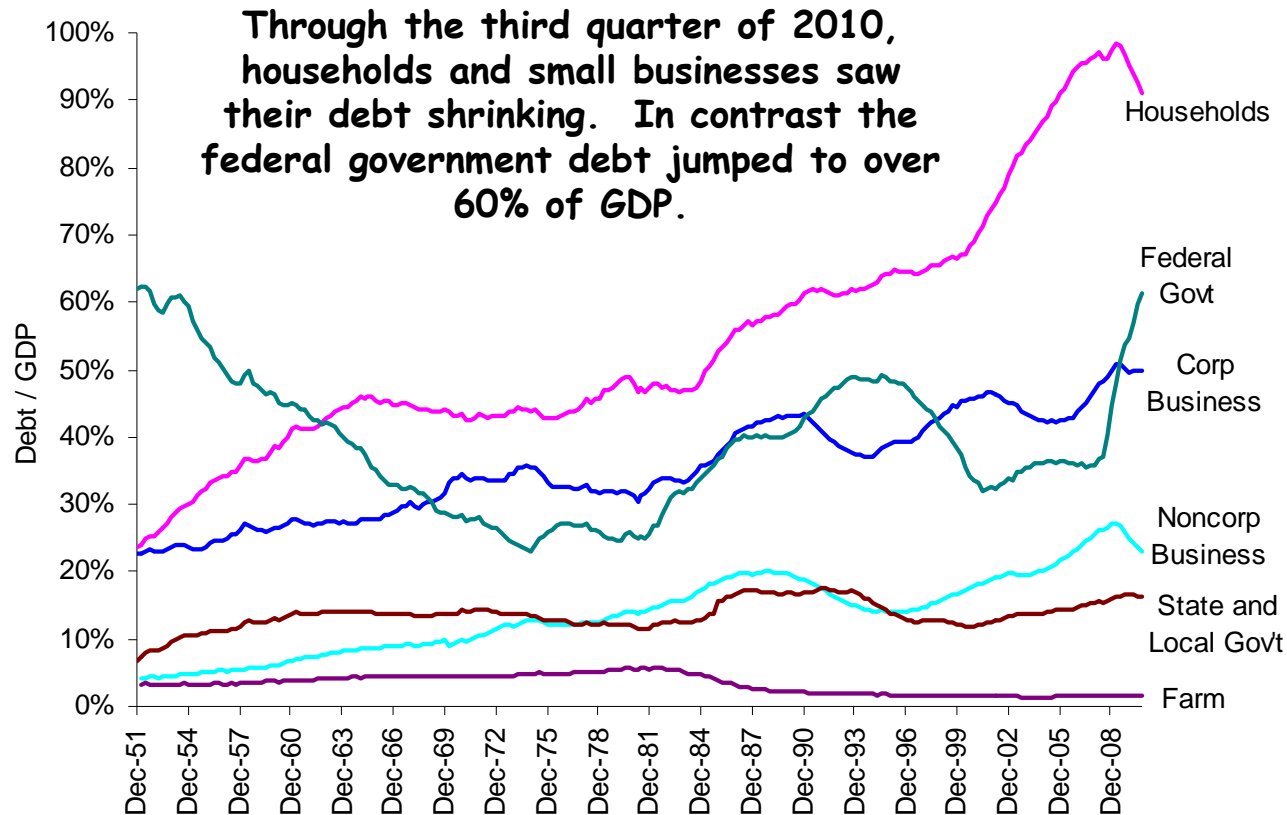
**Despite current private sector deleveraging, overall U.S. debt levels are near their peak due to the burst in federal debt. At \$35.8T, total U.S. nonfinancial debt stands at 243% of GDP.**

Source: Federal Reserve: Flow of Funds; Encima Global

# Debt / GDP by Sector:

## Fed Gov't Expected to Rise Much More

(last obs. Q3 2010)



Source: Federal Reserve: Flow of Funds; Encima Global

## Credit Market Debt Outstanding

(last obs. Q3 2010)

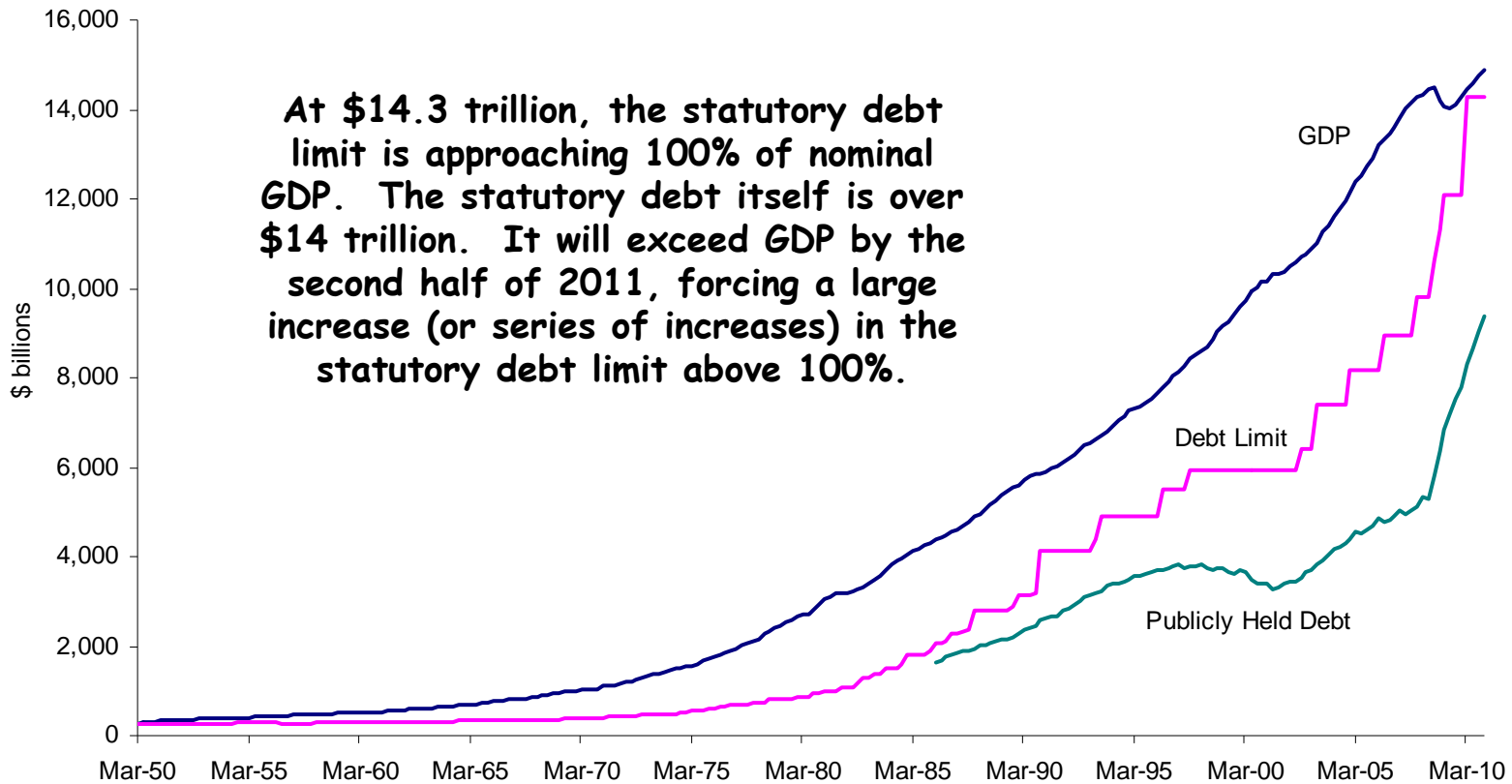
	2010 Q3 (\$ trill)	2010 Q2 (\$ trill)	Yr/Yr % chg 2010 Q3	Yr/Yr % chg 2009 Q3	Yr/Yr % chg 2008 Q3
<b>Domestic Nonfinancial Sectors</b>	\$ 35.8	\$ 35.3	3.7%	4.3%	6.5%
Households	\$ 13.4	\$ 13.5	-1.8%	-1.7%	2.2%
Corporate Business	\$ 7.3	\$ 7.2	3.4%	0.3%	8.3%
Noncorporate Business	\$ 3.4	\$ 3.4	-7.5%	-4.8%	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					
<b>memo:</b>					
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: Flow of Funds; Encima Global

# National Debt Limit At \$14.3T Is Approaching GDP

(last obs. Q4 2010, GDP estimate)



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

# Federal Government Receipts and Outlays

(last obs. December 2010, CBO forecasts to 2021)

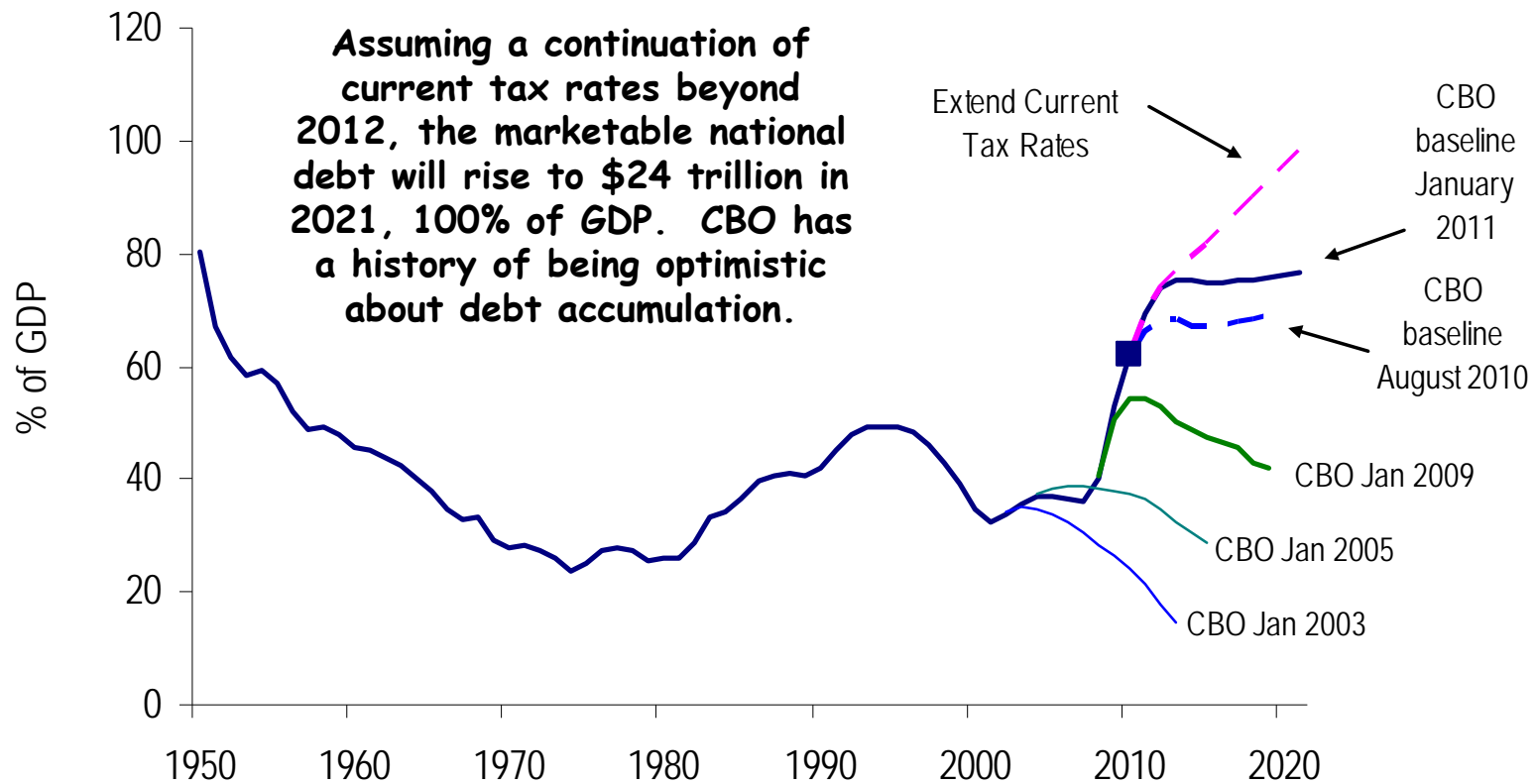
**CBO increased its deficit projections for 2011 to \$1.5 trillion from \$1.1 trillion and for 2012 to \$1.1 trillion from \$700 billion. Their baseline 10-year deficit and increment in marketable national debt is \$7.7 trillion, up from \$6.2 trillion in CBO's August 2010 outlook.**



Source: US Treasury; CBO; Encima Global

# Federal Debt to GDP Projections

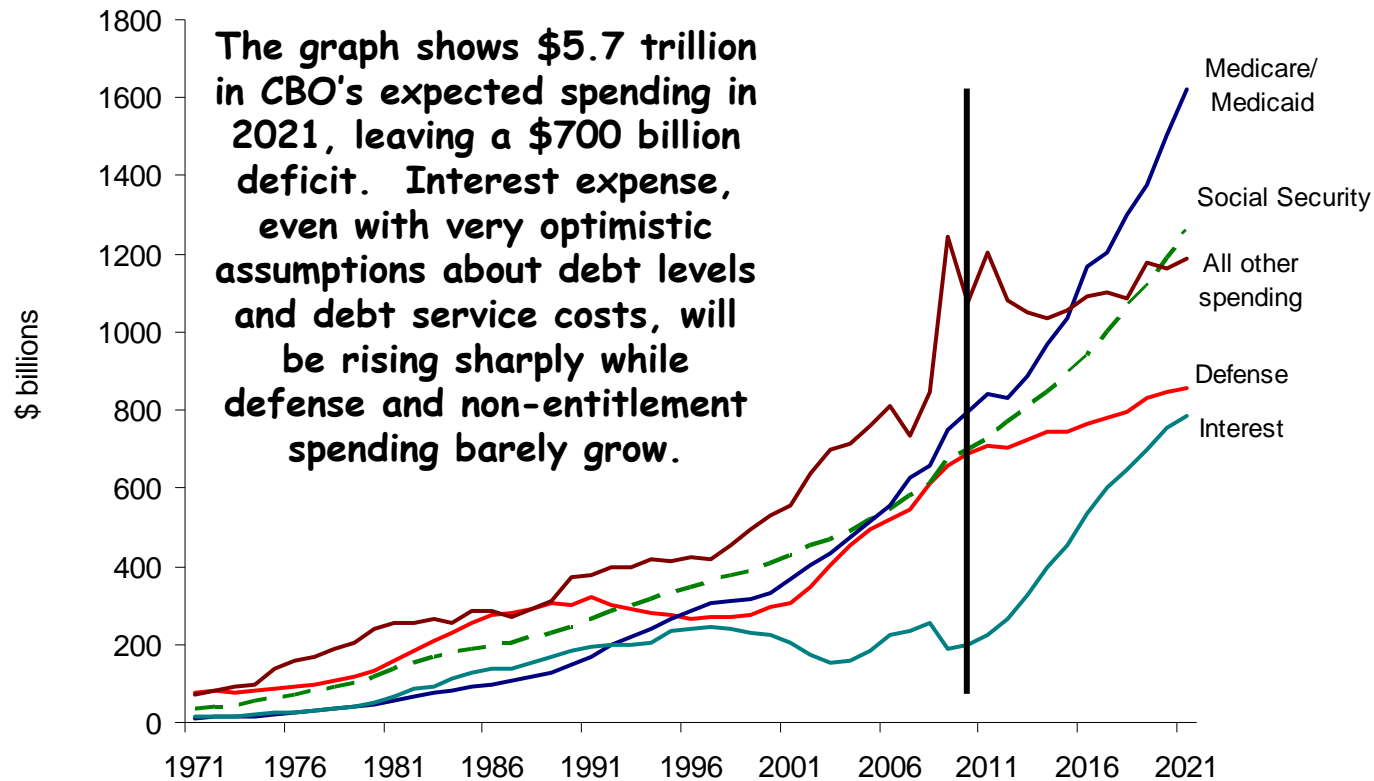
(square is last obs. 2010, forecasts to 2021)



Source: CBO; OMB; Encima Global

# Federal Expenditures by Major Categories

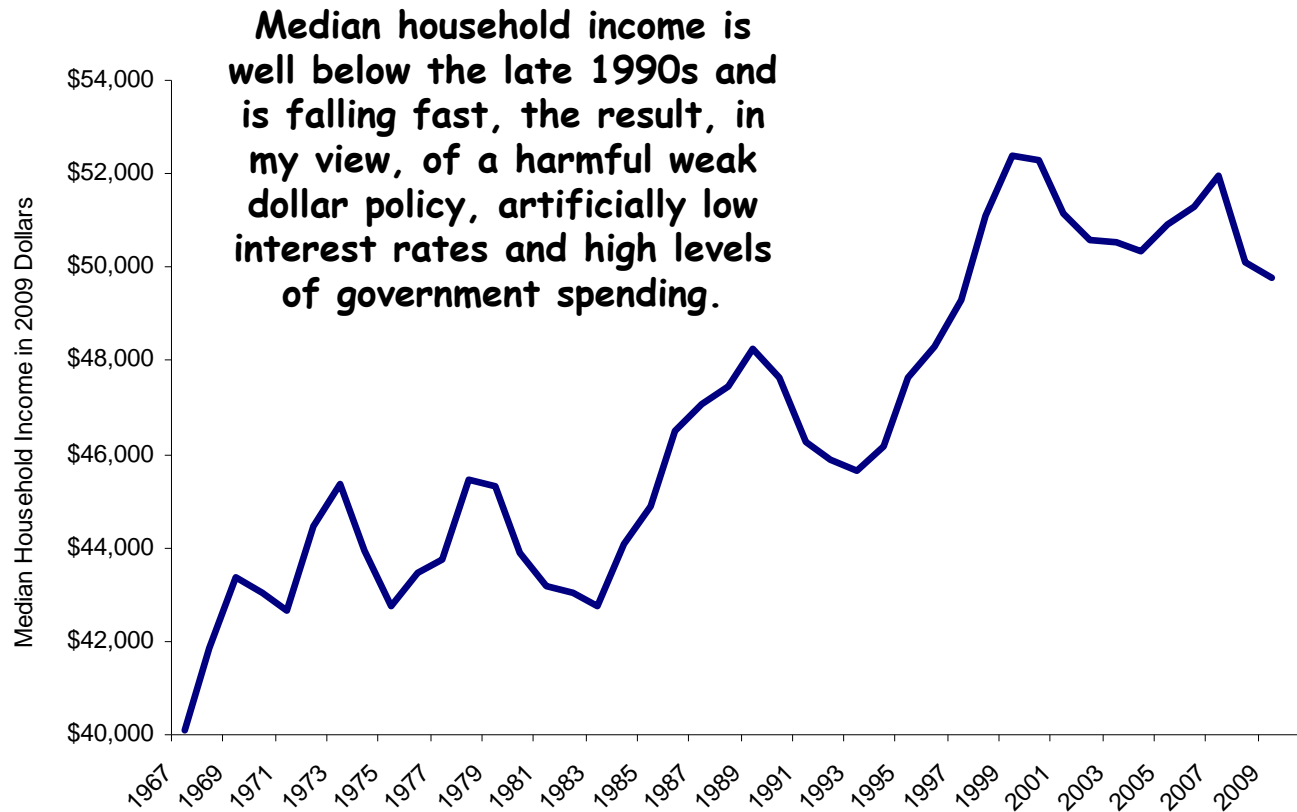
(last obs. 2010, forecasts to 2021)



Source: CBO; OMB; Encima Global

# Median Household Income

(real 2009\$, last obs. 2009)



Source: Bureau of the Census; Encima Global

# Household Balance Sheet

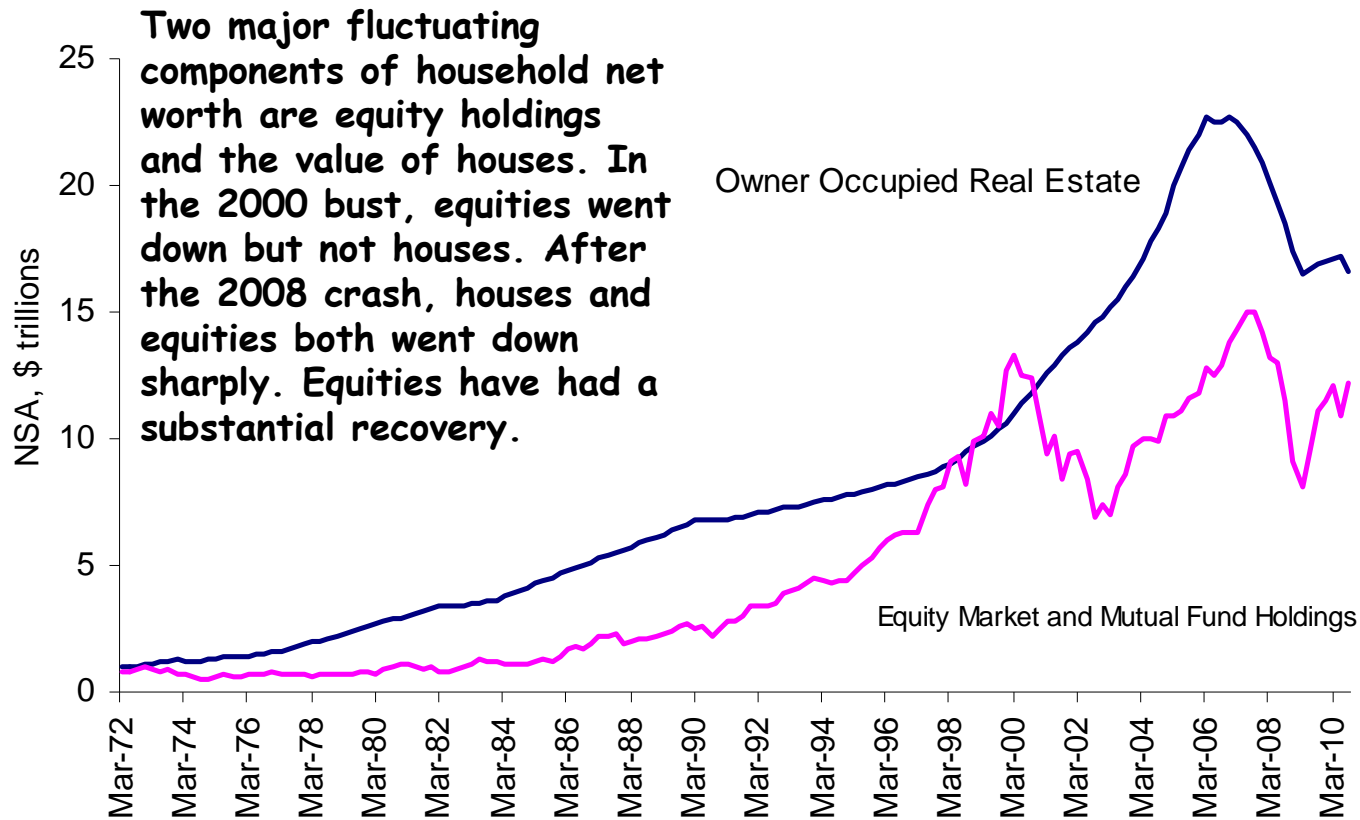
(last obs. Q3 2010)

	2010 Q3 (\$ trill)	2010 Q2 (\$ trill)	Yr/Yr % chg 2010 Q3	Yr/Yr % chg 2009 Q3	Yr/Yr % chg 2008 Q3
<b>Total assets</b>	\$68.8	\$67.7	2.3%	-5.9%	-10.4%
Tangible assets	\$23.2	\$23.8	-1.3%	-8.0%	-10.8%
Real Estate	\$18.3	\$19.0	-2.1%	-9.8%	-13.6%
Other tangible assets	\$4.9	\$4.9	1.7%	-0.1%	3.9%
Financial assets	\$45.7	\$43.8	4.3%	-4.8%	-10.2%
Checkable deposits & money funds	\$1.3	\$1.3	-20.7%	6.0%	14.3%
Time and savings deposits	\$6.3	\$6.3	5.6%	-1.6%	5.7%
Credit market instruments	\$4.2	\$4.3	0.1%	1.4%	5.3%
Equities (direct)	\$7.8	\$6.9	9.5%	-4.9%	-26.9%
Mutual funds	\$4.4	\$4.0	11.5%	-0.1%	-15.5%
Pension reserves/life insurance	\$13.6	\$12.9	6.2%	-1.8%	-12.0%
Equity in unincorporated business	\$6.5	\$6.6	-1.4%	-16.8%	-11.2%
Other financial assets	\$1.5	\$1.5	4.7%	-17.4%	20.6%
<b>Total Liabilities</b>	\$13.9	\$13.9	-1.2%	-3.1%	3.0%
Mortgages	\$10.1	\$10.2	-2.6%	-1.6%	1.5%
Credit card	\$0.8	\$0.8	-9.8%	-8.2%	5.7%
Nonrevolving consumer credit	\$1.6	\$1.6	0.0%	-0.7%	2.2%
Other	\$1.4	\$1.4	16.0%	-13.6%	15.1%
<b>Net worth</b>	\$54.9	\$53.7	3.3%	-6.6%	-13.3%
<b>Financial net worth</b> (financial assets minus total liabilities)	\$31.7	\$29.9	6.9%	-5.5%	-15.3%

Source: Federal Reserve: Flow of Funds; Encima Global

# Equity Market Assets and Owner Occupied Real Estate

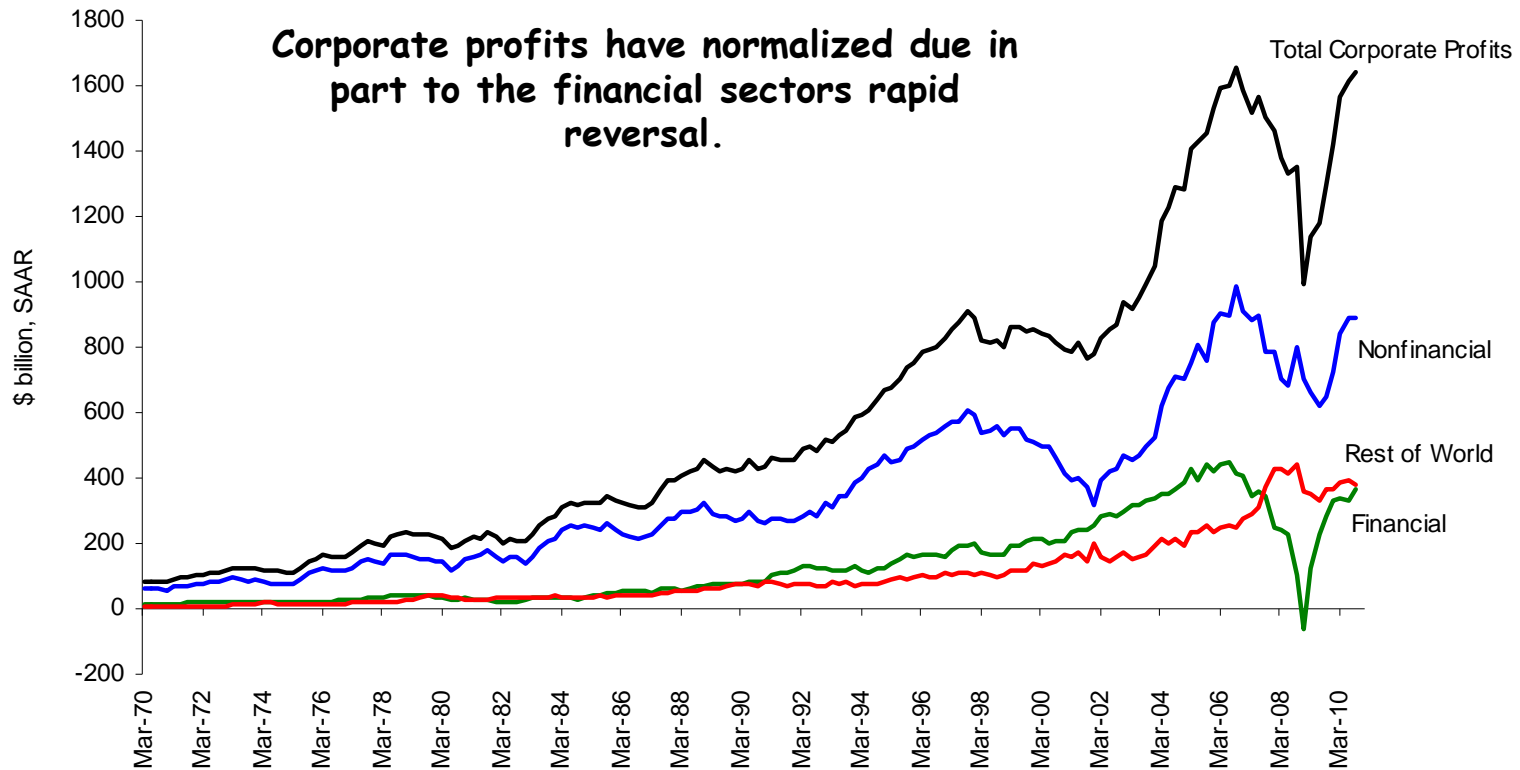
(last obs. Q3 2010)



Source: Federal Reserve: Flow of Funds; Encima Global

# Corporate Profits by Sector

(last obs. Q3 2010)



Source: Bureau of Economic Analysis; Encima Global



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