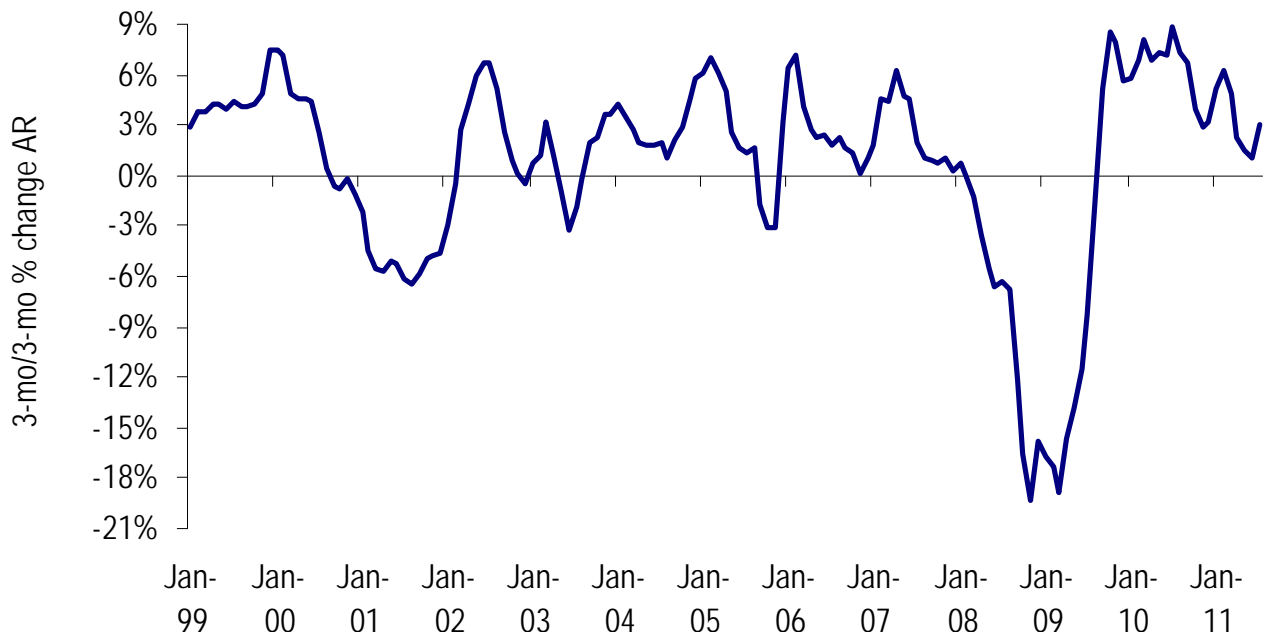


U.S. Production Growth Isn't Enough

We think developments in Europe will continue to outweigh U.S. growth data in the global outlook. The Sarkozy-Merkel press conference scheduled for 12:30pm EDT today will need to convince markets that Germany is committed to funding a “restructuring and convergence” plan for Europe’s sovereign bond markets. We think it can afford it given low funding costs, but don’t know if Chancellor Merkel is prepared to move quickly enough – working against her, gigantic fortunes will be made in financial markets at the expensive of European living standards if the euro breaks apart.

- U.S. industrial production rose 0.9% in July from June, well above the 0.5% expectation. May and June were revised up. We don’t think the August panic attack in markets was justified and think last week’s equity rebound made sense (see Bond Yields Tanking More Than the Economy on August 3.) Under current economic policies, we think the U.S. is dissipating rapidly but not collapsing.

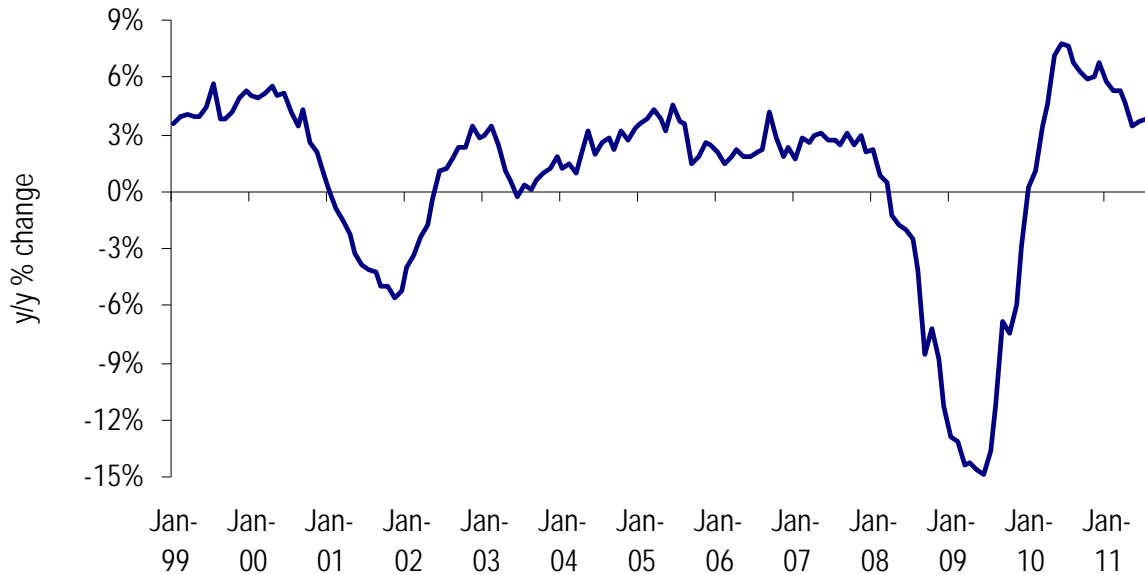
Industrial Production 3mo/3mo annualized (last obs. July 2011)



Source: Federal Reserve; Encima Global

- On a year-over-year basis, industrial production is up 3.7% from July 2010.

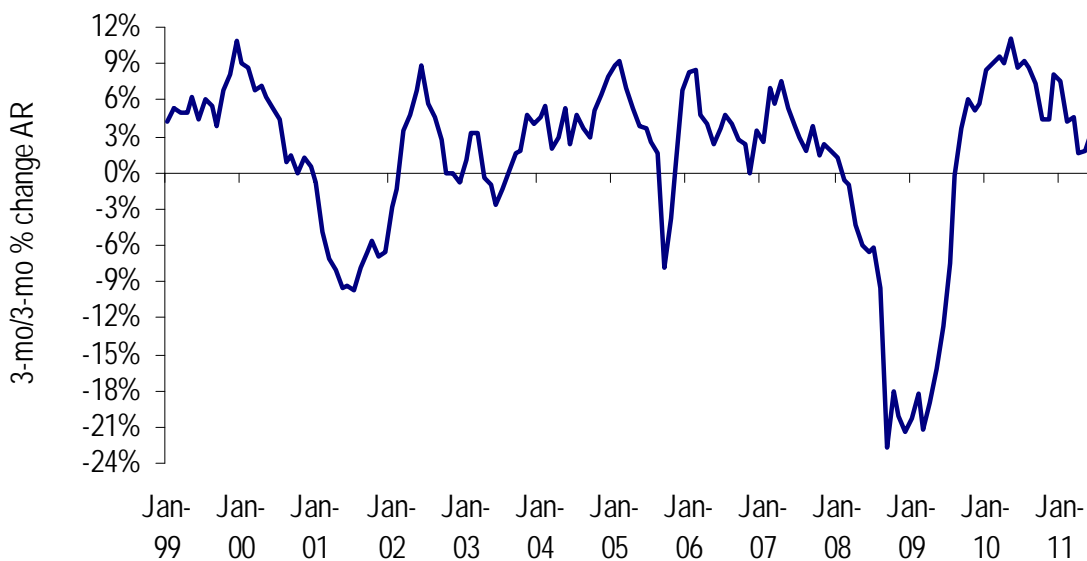
Industrial Production Y/Y (last obs. July 2011)



Source: Federal Reserve; Encima Global

- Contributing to the IP gain, utility output (11.4% of the composite) was up 2.8% due partly to hot weather. July motor vehicle and parts production (4.5% of IP) rose 5.2% from June. Excluding autos, IP is rising at a solid 6.3% 3-mo over 3-mo annual rate.

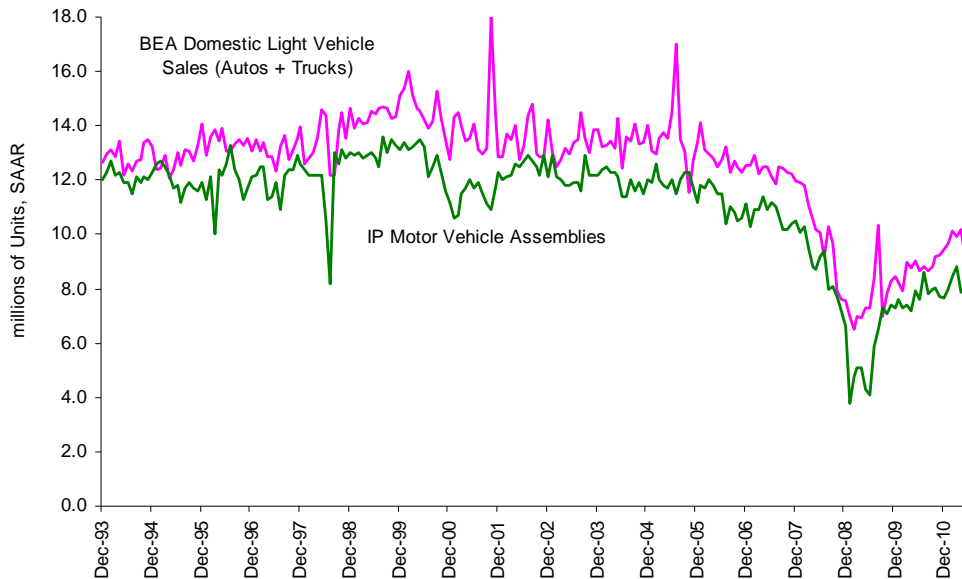
Industrial Production ex Autos 3mo/3mo annualized (last obs. July 2011)



Source: Federal Reserve; Encima Global

- July domestic auto assemblies recovered from the Japan supply disruptions. In March, domestic assemblies were 8.8 million (seasonally-adjusted annualized rate). They fell to 7.9 million in April through June and recovered to 8.7 million in July.

Auto Sales and Production (last obs. July 2011)



Source: Federal Reserve; Encima Global

That's the good news. We note major growth problems for the U.S. and Europe. Europe reported second quarter GDP at 0.2% quarter-over-quarter. That's 0.8% annualized, somewhat below the 1.3% U.S. second quarter rate, though that rate will probably be revised down.

- Bonds and gold are still in fear bubbles that harm the U.S. growth outlook. Chairman Bernanke's Jackson Hole speech at the end of August will set the tone. For now, the barbell trade reflects simultaneous expectations of severe inflation and deflation. Bonds and gold have priced in an extreme anti-growth monetary and financial regulatory policy and an imminent tipping point -- a seizure of the global financial system that might come from a breakup of the euro or a surprise intervention in a major German bank or a sudden move by core European sovereigns like Italy to stop bond payments.
- We don't expect this type of seizure, but think it will take an affirmative change in Fed policy to allow private sector growth to get beyond this risk. Last week's FOMC statement locking the Fed into near-zero rates and causing speculation about the Fed employing a range of anti-growth tools is heading in the wrong direction. This compounds Washington's fiscal crisis and its apparent inability to start on structural reforms until 2013 at the earliest.

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