

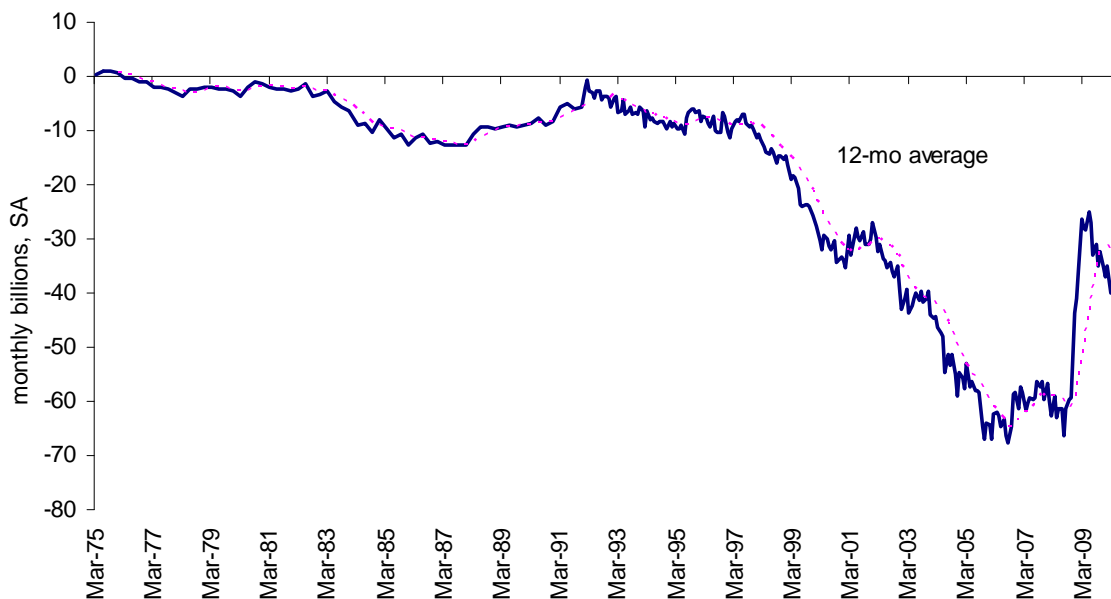
August 11, 2010

U.S. Trade Deficit Continues Widening in June

The 2008-2009 recession narrowed the U.S. trade deficit by reducing imports more than exports. This reflected a combination of the sudden reduction in U.S. demand after the Lehman bankruptcy, the sharp decline in oil prices, and the substantial drawdown in U.S. inventories. The one-month trade deficit narrowed from \$66 billion in July 2008 to \$25 billion in May 2009.

- With the recovery, the trade deficit has been widening, reaching \$49.9 billion in June. Oil prices are back up (doubled since early 2009); personal consumption expenditures have exceeded the pre-recession peak; and inventories have rebuilt some (by \$33.4 billion since their trough in September 2009.)

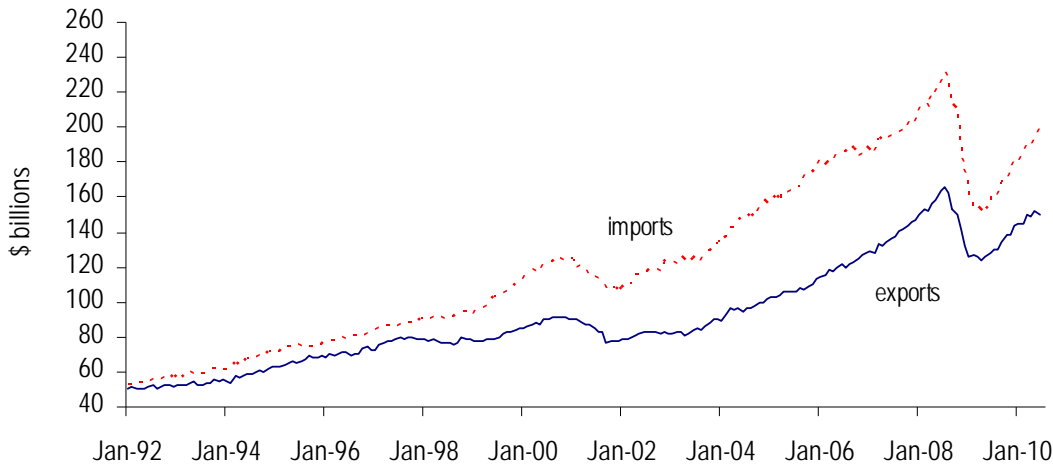
U.S. Trade Balance for Goods and Services (last obs. June 2010)



Source: Census Bureau; Encima Global

- Exports decreased 1.3% in June from May (to \$150.5 billion), while imports increased 3.0% (to \$200.3 billion). The GDP revision for the second quarter will shift down toward 1.0% due to weaker June exports and inventories than the earlier 2.4% GDP growth estimate, with more of the June demand met by imports than earlier estimates.

U.S. Imports and Exports of Goods and Services (last obs. June 2010)

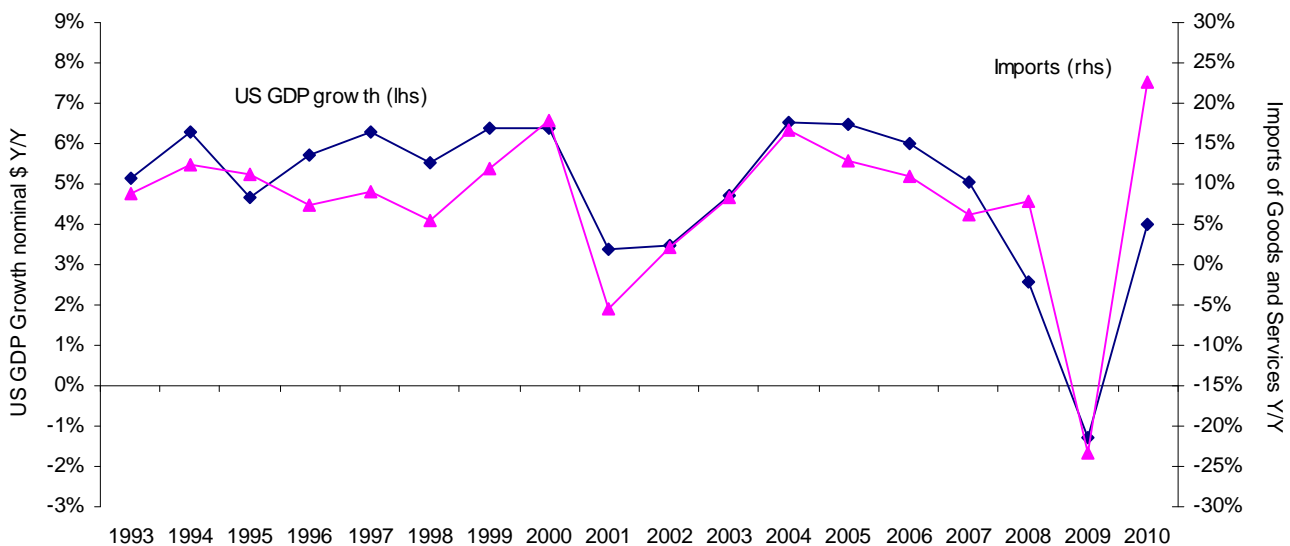


Source: Census Bureau; Encima Global

While some theories suggest that currency weakness might narrow a trade deficit, we think the U.S. trade balance has been more responsive to oil prices, the growth differential between the U.S. and the rest of the world, and the demographic differential (faster population growth in the U.S. than other industrialized countries has tended to strengthen U.S. imports relative to exports.) The wide 2008 U.S. trade deficit coincided with a super-weak dollar and was the product of an oil price bubble and a U.S. credit bubble boosting overall demand.

- In general, U.S. imports reflect growth in the U.S. economy. Despite the sharp second-quarter slowdown, we expect demand to continue growing gradually through year-end, bringing in more imports.

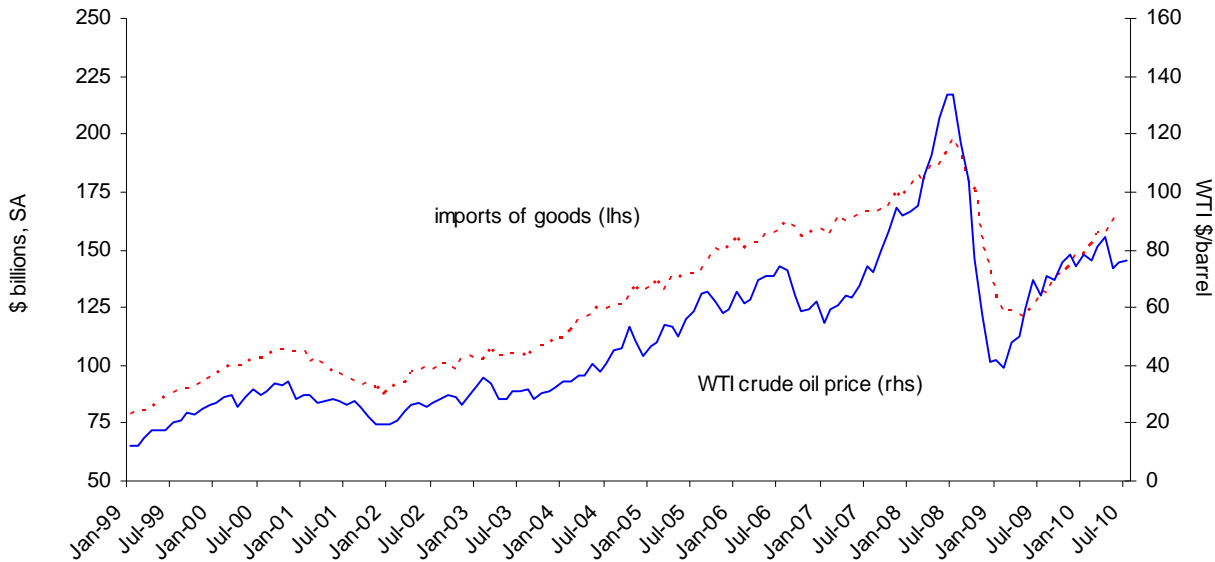
U.S. Imports of Goods and Services and US Nominal GDP (last obs. 2009, 2010 estimate using YTD data through June 2010)



Source: Census Bureau; IMF; Encima Global

- Looking forward, we think a resumption of the weak dollar trend will add to the cost of U.S. imports, especially oil, and channel capital away from the U.S. into emerging markets, adding to their production (spurring our imports, not exports).

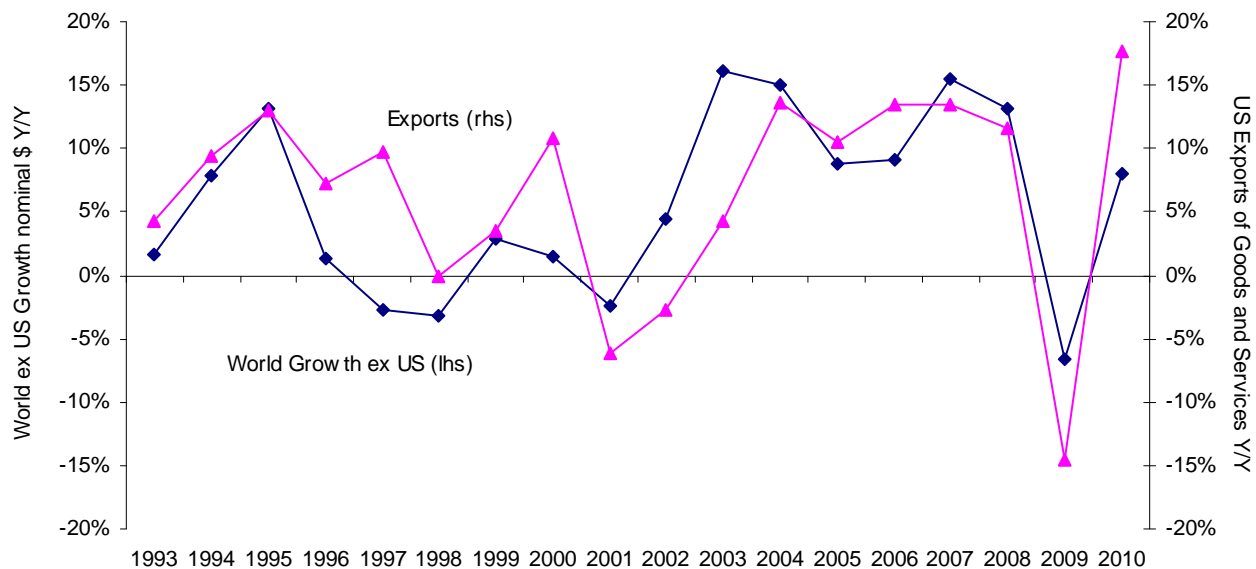
U.S. Imports of Goods and WTI Price (last obs. June 2010)



Source: Census Bureau; Encima Global

- In general, U.S. exports reflect growth in foreign economies.

U.S. Exports of Goods and Services and World ex US Nominal \$ GDP (last obs. 2009, 2010 estimate using YTD data through June 2010)



Source: Census Bureau; IMF; Encima Global

- The IMF lifted the world growth forecast based on better results from the emerging markets economies. While China has orchestrated a slowdown from 2009, we expect it to continue growing fast along with many other emerging markets. Northern Europe should also enjoy a stronger second half, contributing to continued gradual growth in U.S. exports.

IMF World Real GDP Growth Forecast

	July-2010	April-2010	January-2010	October-2009
	<u>Real GDP Y/Y</u>	<u>Real GDP Y/Y</u>	<u>Real GDP Y/Y</u>	<u>Real GDP Y/Y</u>
World	3.6%	3.3%	3.0%	2.3%
US	3.3%	3.1%	2.7%	1.5%
Europe	1.0%	1.0%	1.0%	0.3%
China	10.5%	10.0%	10.0%	9.0%
Brazil	7.1%	5.5%	4.7%	3.5%

Source: IMF; Encima Global

- Given these trends, we expect U.S. exports to grow about as fast as imports (in percent terms). This would leave the U.S. trade deficit widening gradually, but not soon reaching the peak 2008 trade deficits above \$66 billion per month unless the U.S. accelerates substantially.

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