

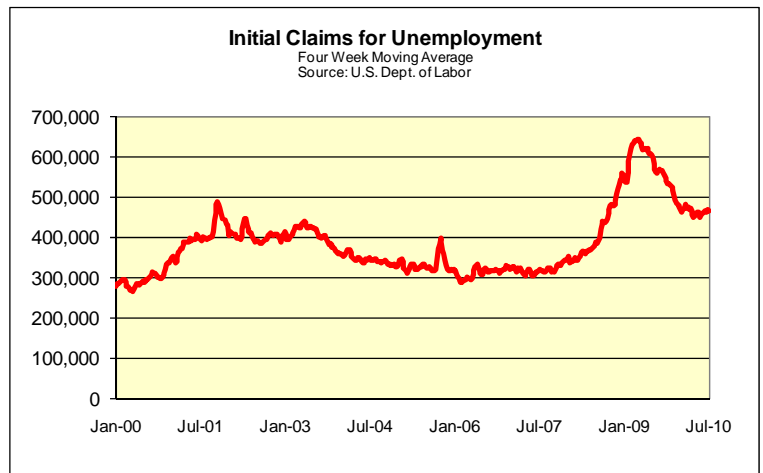
National Economic Trends – July 2010

Economic growth downshifted sharply about the middle of Q2, likely about the same time as that unfortunate parade of really depressing events (financial crises, oil spills, having to pretend to like soccer during the World Cup so the rest of the globe won't laugh at us, etc.) weighed upon the nation's consciousness. The return to a money hoarding cocoon by consumers, businesses and investors reflects how fragile the national psyche remains a year into the current expansion. Despite the recent softness, however, it's still not likely that we will slip into a double dip recession. The consensus is that growth over the next several quarters (including Q2) will decline to around 2%. That isn't great – and won't be strong enough to significantly dent our unemployment problem, if it happens – but also isn't a catastrophe.

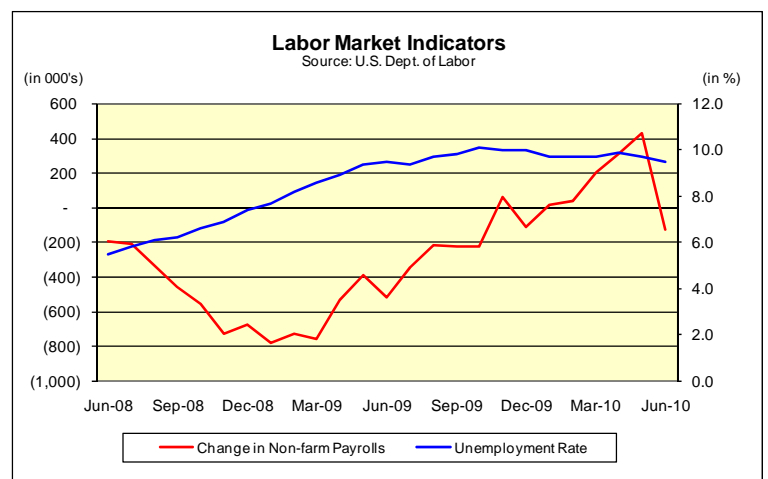
We hesitate to mention the consensus after telling you in our last report all the reasons why you should ignore it. But what the heck – new month, new “restated” opinion. There's a story about Ben Bernanke back when he was merely a Federal Reserve Board member and not the biggest of economic cheeses. After the Commerce Department made some benchmark revisions to GDP that totally changed the economic story over some prior period he told his fellow Feddies that they should take the opportunity to go back and restate interest rates too. We guess you had to be there, but it got a substantial chuckle from the Federal Open Market Committee, which tends to be a tough crowd.

Anyway, several months ago disappointing weekly initial unemployment claims numbers were a definite outlier amongst all the other more positive economic reports. It was a conundrum at the time, because while weekly claims were indicating that the jobs market was beginning to stall, the comprehensive monthly employment report was still showing progress. Well, conundrum solved – we should have paid more attention to this particular leading indicator because the jobs numbers the last several months have been uninspiring. In June we lost 125,000 jobs after gaining 433,000 in May. The temporary hiring and firing of census workers, however, distorted underlying trends in hiring. Total private sector jobs, a better measure of hiring mojo, increased only 83,000 and 33,000 in June and May respectively, following triple digit increases each of the preceding two months. So we aren't losing permanent jobs, but hiring has definitely hit a lull. The unemployment rate has declined (to 9.5%), but that continues to reflect people leaving the workforce.

A number of factors are conspiring to put a kibosh on job creation. The private sector is clearly spooked about where regulations and taxes are headed. On the public sector side,



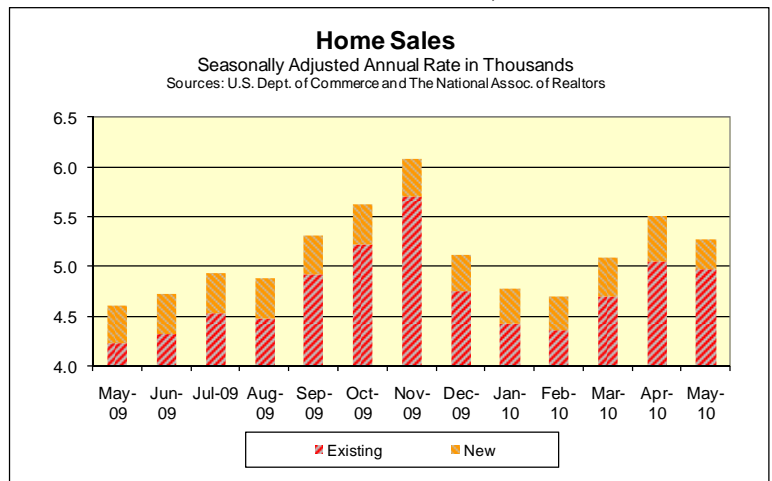
distorted underlying trends in hiring. Total private



putting aside the census distortions, job losses are starting to mount as state and local governments continue to wrestle with budget deficits. Some of the most immediate impact of the stimulus funding was to provide local governments with funds, so that firefighters could continue fighting fires and employees at the DMV could continue ignoring people in line, even as local government tax revenues declined due to the economy. That's all past now, and with the Federal government deficits causing increasing angst amongst voters the possibility of substantial additional stimulus is becoming more remote than another presidential run by Al "That's the Spot Right There" Gore. The other side of that coin, though, is that further extensions of unemployment benefits are also becoming politically unpalatable. There is a compelling body of evidence that shows that extending unemployment benefits actually results in additional unemployment, so the lack of further extensions will likely force some people back to workforce even if it isn't to take jobs they actually want.

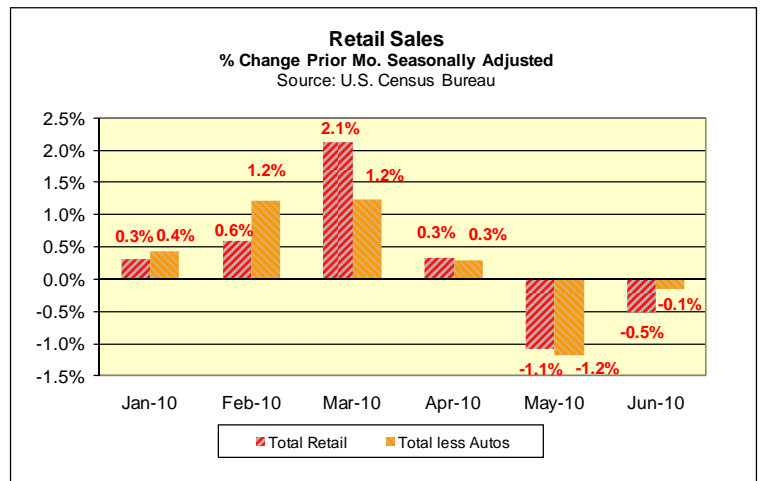
The downside of stimulus is also illustrated by the sharp drop in housing after the expiration of the tax credit in April. (And last November, also, before the credit was extended.) New home sales

dropped 33% in May to the lowest level on record (dating back to 1963). The rate was also 22% of the peak rate of sales during the boom years. Existing home sales did not fall as precipitously, but the immediate outlook for anything related to housing still looks grim. The bright spots, if you want to call them that, are: 1) if you are one of the 17 people in the United States currently looking to purchase a new home, then boy are there some deals available, and interest rates are even lower than last year, 2) residential

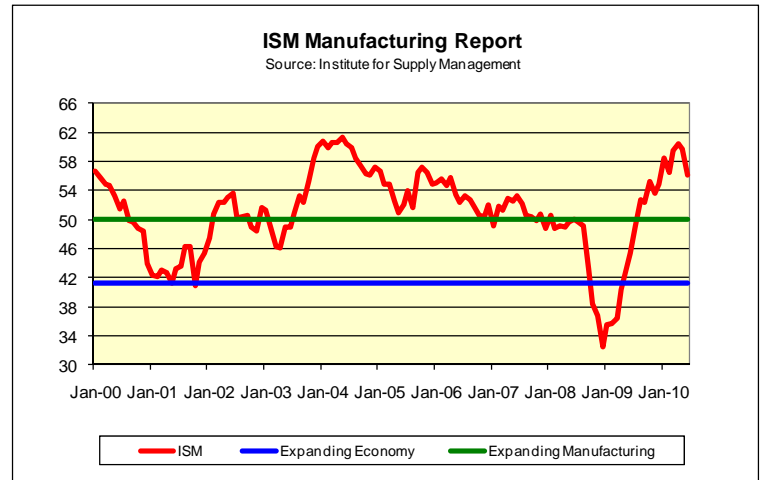


construction is now such a small part of the economy that the big drop in housing will have relatively little impact on gross product, and 3) this episode may finally have convinced policymakers that they should dispense with the gimmicks and just let the market clear.

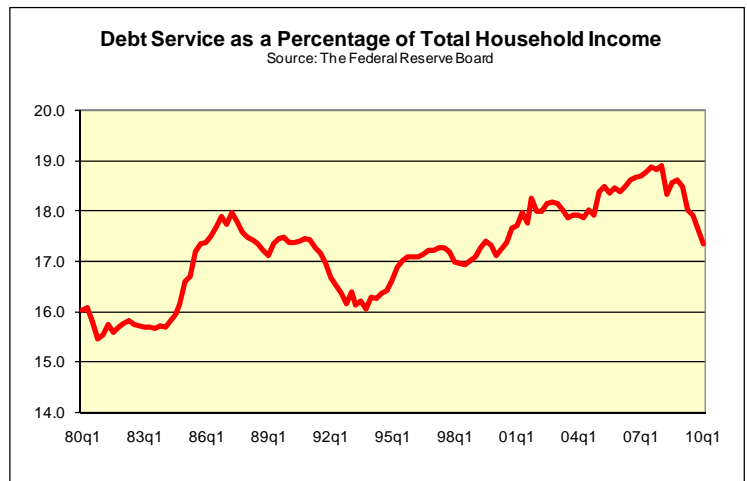
Weaker than expected hiring, lower sales of big-ticket home improvement items after the expiration of housing and appliance tax credits and a flattening auto market all adds up to a big kerplow for retail sales. Top-line retail sales declined in both May and June, although if you back out all these items as well as gasoline prices (which have been declining), then the underlying trend for the balance of retail sales is slightly positive. The auto market is likely to stay flattish for the balance of the summer, as lean inventories provide no impetuous for another round of incentives, but the other items should sort themselves out eventually.



Thank goodness for the industrial sector, which remains a shining beacon of stability in an ocean of uncertainty and angst. Sort of. The latest supply managers' index on manufacturing showed a sharp drop from 59.7 in May to 56.2 in June. Now 56.2 is still a pretty good number and we were expecting some moderation in the rate of growth in manufacturing over the second half of the year anyway. But the drop was larger than expected and driven by softer readings on new orders, exports and pricing, all of which are leading indicators. The stronger dollar and weaker global growth expectations are particularly raising questions about exports. China, in particular, has been trying assiduously to reign in its own property bubble and to throttle back growth to a sustainable level. Although getting good data out of China is next to impossible, recent indications are that they are having some success. Soft landings can be tricky to pull off, however, so the Chinese slowdown has added another layer of uncertainty.



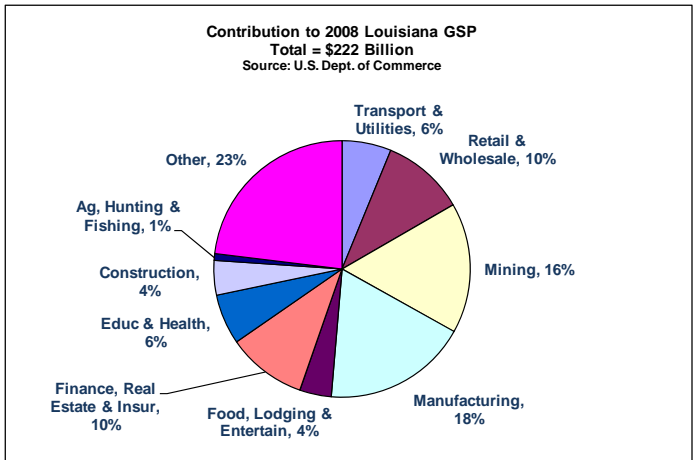
A positive aspect of the recent sluggishness in spending is that it reflects a return to sobriety on the part of consumers. Recessions occur because of imbalances that require correction. If you come out of the recession without correcting those imbalances, all the pain and lost prosperity was for naught. The principal imbalance that caused this last recession was excessive consumption fueled by over accumulation of private debt. One of the positive trends since the recovery started is that consumers have gotten that old time religion with regards to their personal finances. The percentage of consumer income devoted to servicing debt has fallen from a peak of nearly 19% to about 17.5% as of Q1, and likely is even lower now. That doesn't seem like a dramatic move, but 1.5% of total household income is a big number (in the range of \$180 billion annually). If we were the churlish sort we'd point out that some of the decrease was due simply to falling interest rates and the inability of many consumers to access credit markets. No matter, this deleveraging process was overdue and represents a healthy correction that likely isn't over. So while we'd all like to see stronger consumer spending, if it comes at the expense of another unhealthy borrowing binge we'd just be kicking the can down the road.



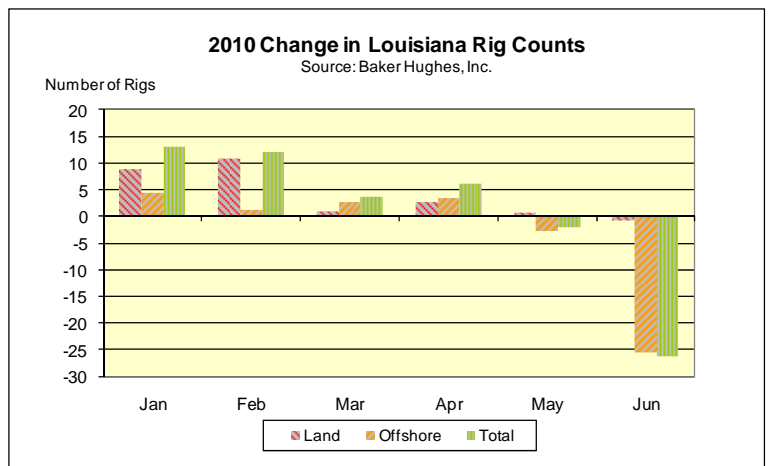
The long-awaited announcement that LeBron James will be laying bricks in Miami next year freed up enough brain space for us to do some figuring on the potential impact of the oil spill on the regional economy. (Although we are still left wondering about how long it will take the three South Beach Amigos to realize that NBA rules stipulate the use of only one basketball at a time. Despite this continued distraction, however, we were able to soldier on.) We concentrated on analyzing the

potential impact on the Louisiana jurisdictions. There will be some impact on Texas, but it should be similar in magnitude and direction to that seen in Louisiana.

As we have discussed in previous discussions on the topic, nearly all of the negative impact will derive from reduced drilling. Fishing and associated processing industries are too small to have a substantive impact, and there is not yet evidence of a substantial hit to tourism. But drilling is big enough to matter – it accounts for better than \$35 billion of economic output in the state and is already being affected by the drilling moratorium. The eventual duration and magnitude of the drilling ban is as unclear as who will play point guard in an offense where three guys will want to take 30 shots a game. (Sorry, must focus). The administration has run into some bad luck in the courts (law, not basketball – we’re in the zone now) in enforcing their moratorium. But no new permits are being issued and companies aren’t going to commit capital to the region until the issue is settled, so the ban remains effectively in place. The longer term impact on costs of more stringent regulations is likely the more relevant issue anyway, but there is no way to do that analysis with any precision right now. So with all this uncertainty still swirling around, what we attempted to do was to estimate a worst case impact on the economy if all offshore exploratory drilling ceases. We then added back some positive offsets from clean-up spending and damage claims to assess the potential net impact. We further assumed that about 80% of the total impact in Louisiana would flow through to operating companies, because the parishes served by ELL, EGSL and ENOI account for that proportion of the total Louisiana economy.



To calculate a rig count we assumed that none of the rigs taken out of service between May and July will be returned to service this year, then only about half by the end of 2012. Based on publically-available data from Baker Hughes, the number of offshore drilling rigs operating in Louisiana dropped by 33 from April to July. (Onshore counts stayed roughly steady.) Employment data indicates that the average offshore rig employs about 230 individuals directly. Economists generally assume that around six

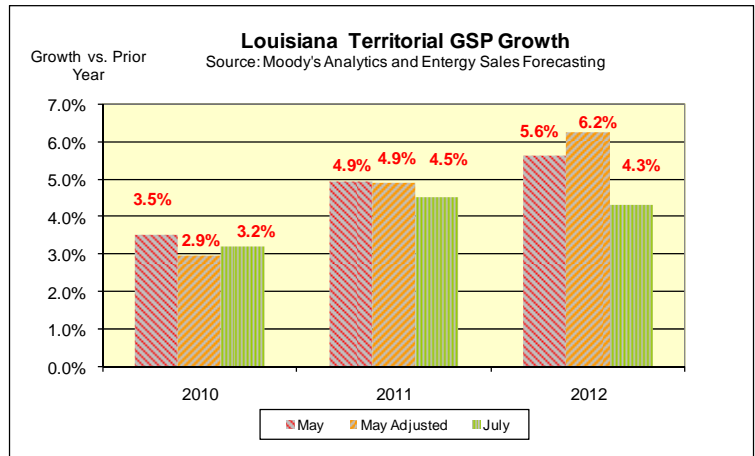


support jobs are lost for each drilling job, plus an additional three jobs or so from indirect effects like reduced consumer spending. We calculated the total impact on lost wages from all these presumed job losses, then slapped on a multiplier of 1.5 to account for further cascading impact on gross product from the loss of income. Think of it as stimulus analysis in reverse.

To calculate the positive offset, we assumed that clean-up spending will continue at the current levels of better than \$100 million per month through the end of the summer (at which time the well will hopefully be plugged), then gradually taper off over the next few years. We further assumed that

about a third of the spending is actually on things like boats and people on the scene, and that a third of that spending is winding up in Louisiana. On the damage claims side, we took the rough payment schedule from the BP press release about the expected timing of disbursements, which essentially amounts to about \$5 billion per year, and assumed a third of that is directed to Louisiana. We'd love to tell you that these assumptions are anything but SWAGs, but that would be misleading and we'd hate to do that to you. We contacted BP in an attempt to obtain some guidance from the horse's...uh...mouth, and have been told so far to bugger off. We know they are busy right now, but we did kind of assume they might be in the mood to make some friends. Apparently not.

At any rate, the calculated net impact is slightly negative through the end of 2011, then slightly positive in 2012. The accompanying graphic shows a comparison of the Moody's forecast for economic growth in ELL, EGSL and ENOI combined from their May forecasting run (the last that doesn't have any impact from the spill), with the same May forecast adjusted for the spill impact, as well as the latest (July) forecast from Moody's. Their modeling is more sophisticated than the back of the envelop



calculation outlined here, but it arrives at about the same place. The higher rates of growth in the adjusted analysis probably stem from the inclusion of the claims offset in our analysis. Moody's hasn't quite figured out yet how that particular bucket of money should flow through their models.

The takeaway from this analysis is not that we don't have to worry about the economic impact of the spill, but that the likely scenario is not nearly as bad as what you'd believe from listening to hyperventilating newsreaders. And that forecasting is tricky and you should always be skeptical of prognostications, including ours. The only exception is Paul the Octopus. Paul is a resident of an aquarium in Oberhausen Germany who correctly picked the winner of all seven of Germany's World Cup soccer matches. For each selection they gave him the choice of two tanks, each of which contained a tasty mussel and the flag of a competing team plastered on the side. The tank he ate from was his choice. He correctly picked all of Germany's wins and both losses, including the semi-final loss to Spain that resulted in some ugly speculations on how Paul would taste grilled. You'll be happy to know, though, that according to the Associated Press story (by Kirsten Grieshaber) "His handlers say he is coping with fame well." His notoriety grew to such an extent that his pick of the final game between Spain and the Netherlands was televised live to "Germany, Great Britain, Taiwan and elsewhere". Breaths were baited and tension mounted as Paul approached the two tanks, paused to reflect, and then tragically ate LeBron James, who happened to be in the same studio for his ESPN special. Also, Paul correctly picked Spain as the eventual winner. And was offered a tickertape parade by the city of Cleveland. (The odds, by the way, of picking eight random events correctly are 1 in 256 (or 0.4%). His handlers should blow off this penny ante World Cup stuff and take Paul directly to Vegas. Come to think of it, though, if the casinos take a dim view of card counting you can imagine their reaction to a bunch of scientists showing up at the roulette wheel with their magic octopus.)