

Economic Outlook for 2012

- ▶ Though economic growth in the U.S. has been subpar, Europe continues to struggle with its heavy debt burden and a deceleration in economic growth.
- ▶ The emerging market economies are growing at a rate 2 - 3 times even the U.S. growth rate, though this is a bit slower than they had been growing.

The U.S. economy grew in 2011, but at a slower rate than everyone expected. Even more surprising than the overall growth rate was the pattern of that growth rate throughout the year. Growth plunged to 0.4% in the first quarter and accelerated throughout the year, with the fourth quarter now likely to produce annualized growth well in excess of 3%.

More Upside than Downside (Though the Downside Is Scary): Morningstar economists' overall forecast for 2012 sees slightly higher growth than the consensus of other economists, but not by a lot. However, the odds of an upside surprise are substantially higher than those of a downside surprise. Potential sources of an upside surprise include increased U.S. oil production, a sharper rebound in automotive and aircraft production, and a stronger housing market.

Corporations Are Scared Even as Consumers Accelerate Spending: It looks like U.S. corporate managers are far more scared about Europe and the economy in general than the U.S. consumer is. Recent reports seem to suggest at least some precautionary spending cuts by corporations in the software arena. Managers also seem to be paring inventories to the bone. However, it appears that U.S. consumers are accelerating spending; they seem to be "thrifty out" and can no longer delay certain purchases, especially autos. This leads Morningstar economists to predict greater production both in the U.S. and in other world economies that export to the U.S. in 2012.

Europe Remains at the Top of the Worry List: The main concern here is the potential of the European sovereign debt crisis to wreak havoc on the worldwide financial system. U.S. exports to Europe represent just 3% of U.S. GDP, and a lot of that is for basic necessities that can't be bought elsewhere. However, with a web of lending in which European banks lend to sovereign governments, and those governments lend the money back to the undercapitalized banks, the failure of any one link could bring down a healthy chunk of the European banking system.

China Slowing Is an Issue for Some, but Potentially Good News for the U.S.: China certainly remains an issue, too, as growth there slows modestly and the construction industry pulls back from its breakneck pace. Slowing there is bad news for a lot of high-profile capital goods manufacturers in the U.S. but, overall, China is an even smaller part of U.S. GDP than Europe. Furthermore, slowing growth in China could mean significantly lower commodity prices, especially in the U.S., which would be good news for low-end U.S. consumers, who were particularly crippled by rising commodity prices in 2011.

A Savvy Consumer May Limit Profit Growth: Corporate margins could begin to shrink in the future as consumers start to gain the upper hand. Consumers are fighting every price increase tooth and nail, with the possible exception of the very high end of the market. The most recent example comes in the banking industry, where a pushback by consumers forced several major banks to cancel proposed increases in debit card fees.

Europe Will Hurt Big Firms More Than U.S. GDP: Although U.S. GDP growth may escape the worst of the effect of a slowing Europe, U.S. multinationals may not. Many of these firms derive 20%-40% of their revenues from Europe. Since many of those goods are produced in Europe or in other non-U.S. markets, they are not counted in the U.S. GDP calculations, and they don't directly add to U.S. employment. Therefore, a weak Europe could significantly affect U.S. companies even if it doesn't make a dent in the U.S. GDP growth rate.

Looking forward to 2012, the U.S. economy is probably better positioned than most of the rest of the world economies, showing accelerating growth even as Europe falls into a recession and as growth in Asian economies slows to a more modest pace.