More Slow, Steady Growth in 2012

We saw some strong data at the close of 2011, but that doesn't mean a big boom is coming, says Morningstar's Bob Johnson.

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The economic news flow was very good this week with decent reports on employment, autos, and manufacturing. Retail news was mixed as good top-line growth was offset by deep discounting and lower margins. It was a great holiday season to be a customer but not as good to be a retailer. Exceptionally warm weather didn't help retail sales, either. Overall, the market liked the economic news and finished on the plus side, but worries about Europe slowed down the market by week's end.

December and Fourth-Quarter Data Strong; Pause Possible in Early 2012

A lot of recent data, including this month's jobs report, were unusually strong due to special circumstances. Weather has been great, seasonal factors have been a big help, tax credit expirations aided December, and autos have benefited from a post-tsunami boom. As bullish as I am on the U.S. economy, I caution everyone not to extrapolate recent strong results. In 2010 we had a strong fourth quarter only to see growth drop back to almost zero in the first quarter. While I don't see something that drastic this time around, a fall from 3.0%-3.5% in the fourth quarter to 2% in the first quarter of 2012 is probable--but that doesn't mean we're falling back into the abyss. Growth for 2012 as a whole should still be in the 2.0%-2.5% range, up from 1.8% in 2011.

Earnings Season Could Disappoint

With margins coming under pressure from savvy, discount-oriented consumers and a number of early warnings from the likes of **Texas Instruments** TXN, **Intel** INTC, **Oracle** ORCL, and **Costco** COST, corporate earnings might not show as much improvement as in past quarters. Certainly a slowing Europe won't help matters either, as many S&P 500 companies get 20% or more of their revenues from Europe. General expectations are for earnings growth of about 6% for the fourth quarter compared with 2010's fourth quarter, down substantially from when the quarter began. As I've warned before, I suspect corporate earnings performance and even the stock market might not perform as strongly as the U.S. economy.

Retailers Report a Mixed Holiday Season

Individual same-store retail sales were mixed, and margins were decidedly disappointing. The top-line retail number, at 3.5% for December according to the International Council of Shopping Centers, met expectations, but the performance was far from uniform. Warm weather hit apparel companies hard. And while luxury and low-end retailers did well, companies serving the middle markets like **Best Buy** BBY and **Target** TGT struggled. Deep discounts were prevalent and caused several retailers to warn on margins. The season had a very strong start, faltered in the middle, and closed strong according to weekly ICSC reports.

Same-Store Sales Growth

Week	Year-Over-Year Growth %
5-Nov	2.7
12-Nov	3.1
19-Nov	2.8
26-Nov	4.0
3-Dec	3.8
10-Dec	2.9
17-Dec	4.6
24-Dec	4.5
31-Dec	5.3

Source: International Council of Shopping Centers

Job Growth Acceptable, but Not as Strong as Headline Numbers Suggest

New private sector job growth continued on the slow and steady pace that it has been on since midyear, according to the latest monthly jobs report from the Bureau of Labor Statistics. Looking at a three-month average, year-over-year basis, jobs have grown at a 1.75% rate. To put the rate in more familiar terms, that's approximately 160,000 jobs per month or 1.9 million jobs per year. The private sector lost 8.8 million jobs during the course of the recession, and we have now gained back 2.8 million of those jobs, for a net loss of 6 million jobs. At the current rate, it would take three additional years to get every one of those jobs back. If job growth were to accelerate to an annualized rate of 2.75%, a 1-percentage-point increase from the current rate, which is pretty close to the best case, it would still take two years to get back to the peak levels reached at the very beginning of 2008. Though it provides little solace to the unemployed, even the 1.75% level of employment growth should be more than enough to get economic growth of 2.0%-2.5% that most economists are looking for in 2012.

Employment Growth	
Month	Year-Over-Year Employment Growth % Change (3-Month Moving Avg)
January 2011	1.06%
February	1.27%
March	1.42%
April	1.54%
May	1.58%
June	1.60%
July	1.64%
August	1.66%
September	1.70%
October	1.72%
November	1.75%
December	1.75%
January 2012 (est.)	1.77%

Source: Bureau of Labor Statistics
January Estimate: Morningstar

I prefer to look at the data this way because by looking at year-over-year data, I am bypassing seasonal factors. And by using an average, I smooth out things like strikes and, for December, an unusually large jump in delivery personnel.

Special Factors Boosted December's Reported Job Growth

Speaking of the December numbers, the seasonally adjusted monthly job growth was 212,000 private sector jobs. The report was aided by a large jump in delivery personnel (42,000), retail sales workers (28,000), and construction workers (17,000). The delivery personnel growth probably relates to the boom in online shopping activity; this trend may at least partially reverse itself in January. Comparing the delivery personnel category with last December shows almost no growth, strongly indicating yet another antiquated seasonal adjustment factor. Unusually warm weather in December probably helped the construction industry along a bit, too. This is why I go through the exercise of averaging monthly data and comparing it with the prior year.

January's Jobs Report Might Not Look as Good

As these special conditions fade in January, I wouldn't be shocked if monthly private sector job growth dipped to the 100,000-120,000 level for a month or two. Interestingly, even at that level, the year-over-year, three-month average growth rate would remain at the 1.75% level that typified the second half of 2011. That still won't stop the headline writers from proclaiming "Job growth gets cut in half, presaging another recession." Don't believe it when you read it next month.

Government Jobs Sink Again

While news was good in the private sector, governments managed to lose another 12,000 jobs in December. Since the recovery began, government has shed nearly half a million jobs. The only good news here is that the rate of job loss appears to be slowing. (December losses were half the level the 2011 average, and meaningfully lower than November.) The worst of the budget crunches and cutbacks at the state level are probably behind us as retail sales tax and personal income taxes improve. Normally I would suspect that the federal employment would stabilize too, but ongoing issues at the U.S. Postal Service and with defense spending mean that federal employment could be down again in 2012.

Unemployment Rate, Hours and Wages All Look a Little Better, Too

The headline unemployment rate fell to 8.5% in December from an upwardly revised 8.7% for November and the 9.1% rate that prevailed in January of 2011. This month's improvement came primarily from increased employment with a small help from labor force dropouts. I was a little surprised that after last month's strong numbers more people sitting on the sidelines didn't re-enter the job force.

After hourly wages were flat in November, they popped 0.2% (2.4% annualized) during the month of December, indicating a least some labor market improvement. Boosts to state minimum wages in January could help this figure along during the next several months--perhaps at the cost of at least a few jobs.

Positive and Confirming News From Other Labor Reports

While none of data from this month's official labor report looked very exciting, the improvements have been steady and relatively broad-based. It's probably better than a cycle of big booms followed by similar busts. There are a lot of other indicators out there pointing to continued improvement. Initial unemployment claims continue to fall and are at the best levels of this recovery. Initial claims, on a four-week moving average basis, have fallen from 422,000 in mid-September to 373,250 for the last week of the year. Also, the Challenger Gray layoff report was down once again in December. The forward-looking ISM Purchasing Managers Report for December showed continued improvement in the employment category. And the Labor Departments Job Openings Report also showed improved hiring, more openings, and more people voluntarily quitting their jobs (a sign of strength in the labor market).

U.S. Manufacturing Bouncing Back...Europe and China, Not so Much

The ISM Purchasing Managers Survey showed its second straight monthly improvement in December, moving to 53.9 from 52.7 in November compared with the 2011 low of 50.8 reached in October. The composite index reached a six-month high in December. Government new orders reports and industrial production reports all seem to indicate that the industrial economy is not about to fall back into the abyss as many had feared this summer. In fact, there are signs of modest improvement. The new orders component of the PMI report showed nice growth from November to December; at 57.6, it was one of the strongest components of the report. Orders are particularly important because they presage better production and employment in the months ahead. Every other category, except the two inventory reports, showed improvement in December.

Interpreting inventory data is particularly tricky. The official interpretation is that low inventories are bad because it indicates a lack of business confidence. However, low inventories in the face of decent demand mean that manufacturers must build inventories in the months ahead, necessitating increased production.

The PMI numbers out of Europe and China were not as good. Most of those PMI readings were relatively weak as most European Indexes remained below 50 (i.e., more people thought things were slowing than improving), though December's readings were generally higher than November's. China's official government PMI crept back over 50, but an independent survey, while modestly higher, was still below 50 and did not show as much improvement as the official number. However, like the Japanese tsunami, the floods in Thailand are weighing on some production numbers. Unfortunately, measuring that effect is remarkably difficult.

Auto Sales Close Out 2011 on a High Note

Auto sales for December came in at an annualized rate of 13.56 millions, just a touch below November's 13.63 million units and the second-best month of 2011. This would certainly seem to indicate that consumers are not in a mass panic over the European situation. SUVs, pickups, and small cars all did well, while large cars and minivans did not.

On a full-year basis, sales were up about 10% to 12.8 million units. That's a healthy improvement, but it was weighed down by poor sales midyear due to supply constraints resulting from the Japanese tsunami. Expectations are for an even better 2012--estimates range from 13.0 million to 14.5 million units. Our auto analyst, Dave Whiston, noted that **Ford** F mentioned that 50 million U.S. vehicles are between 11 and 15 years old. This amount is over 20% of the fleet, and even the thriftiest consumers can't drive these old vehicles forever.

Those improved sales levels will lead to better production as well, with manufacturers penciling in a 5% production increase in the first quarter of 2012. That should bode well for the U.S. manufacturing sector.

Auto Sales

	Millions of Units
2009	10.4
2010	11.6
2011	12.8
2012E	13.6

Source: Automotive News