Economic Snapshot

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Looking back, 2011 was a tumultuous year marked by wildly fluctuating global share markets, natural disasters, political upheaval, the European debt crisis, and fears that the world economy was slipping into a second recession. In December 2010, economists optimistically predicted that the S&P/ASX 200 would improve 20% in 2011, however investors experienced a disappointing year with a negative 14.5%. The year in review was clearly an argument for diversified portfolio construction with investments across all asset classes.

As if to reinforce this unpredictability, arguably the most surprising 2011 statistic came from the US where the DOW actually gained over the year, increasing 4.5% while forecasts in early 2011 were bleak. When compared with the other major global indices (German DAX decreased 15.4%, UK FTSE lost 7.34%, Japanese NIKKEI decreased 18.7%), the US was the best performer despite the constant warnings in 2011 of a double dip recession.

Looking ahead, uncertainty and the need for diversification remains the theme for 2012. Global economics for 2012 hinge on Europe's response to its debt crisis, the ongoing recovery in the US, and China's ability to avoid a hard landing. In the first week of trading, shares were up in Australia, the US and Germany while the European journey again looks threatening.

Quick Points

- In Australia, consumer sentiment was down, retail sales remain unchanged, the trade surplus was down, but manufacturing expanded for the first time in six months and building approvals increased.
- Trends in the US were largely positive with a decrease in unemployment, a fall in the budget deficit, and high levels of consumer confidence and manufacturing data.
- Fears of a European recession abound as unemployment in the EU is at a historic high, industrial production has decreased and growth was at 0.1%.
- There are further signs that China's economy is cooling as imports and exports grew at their slowest pace in two years and foreign direct investment was down.

Australia

Overall 2011 was a disappointing year for Australia compounded by natural disasters with the devastating floods in January resulting in lower than expected GDP for the beginning of the year. Shares faltered due to worries about Europe, the US, and China, the Australian dollar reached record highs, and retail and housing sales were down as cautious consumers spent less and saved more. However the mining industry had a bumper year and largely kept the two speed Australian economy afloat. Also of note was the RBA cutting interest rates twice in an effort to combat any threat emanating from Europe.

In the last month of 2011, consumer sentiment fell a significant 8.3%, down to its lowest levels since the beginning of the GFC; retails sales were flat; the trade surplus fell slightly to $1.38 bn; and the ALL ORDS ended down 3.85% for a year on year result of -15.2% On the positive side, for the first time in 6 months Australian manufacturing expanded modestly, with the index gaining 2 points, and building approvals increased 8.4%.

Looking forward to 2012, analysts are predicting continued rate cuts from the RBA which could come as soon as the first meeting of the new year in February, and that the Australian dollar will maintain its strong global position, particularly if further monetary easing is introduced in the US and Europe.

Rest of the World

United States

The US economy continued its modest recovery for 2011 despite a slow down in global growth, and indicators for the last month of the year were primarily positive and encouraging for the longer term. Unemployment rates improved to 8.5% with 200,000 jobs added in December and the number of Americans who applied for unemployment benefits was at the lowest levels since June 2008. The US budget deficit fell to 8.3% of its GDP - the lowest levels since May 2009. Consumer confidence and manufacturing data improved to their highest levels since spring and auto sales were at their highest for 2011.

The US Congress voted to extend unemployment and payroll tax breaks until February and the next big political fight will be on extending these benefits through to the end of the year. However, as we near the general election in November, the political brinkmanship exhibited over the debt ceiling debate will likely abate as politicians focus primarily on re-election.

While it's unclear what impact the European debt crisis may have on the US in 2012, December's economic data has injected some optimism into forecasts. Although it's still early, shares have already responded with the S&P 500 reporting 5 month highs in the first week of January.

Europe

Across the Atlantic, the outlook is decidedly gloomier and Europe's debt woes appear set to continue and potentially drag into 2012 if drastic action is not taken. The biggest concern for analysts and world leaders is that Europe will not move quickly enough to avoid a second recession and it will drag the rest of the global economy back into recession. There are signs that Europe is well on its way to a second recession with unemployment across the EU at a record high of 9.8%, a decrease in industrial production, and economic growth at 0.1%.

The international credit agency Fitch seemed to be of the view that Europe is beyond hope, declaring that a, "comprehensive solution to the Euro zone crisis is technically and political beyond reach..." Fitch goes on to hold the ECB responsible for mitigating the risk from the crisis, particularly for those solvent member states. Analysts have echoed Fitch's concerns and there is a pervasive view that the ECB must step up in 2012 through aggressively buying bonds and undertaking quantitative easing. In December, the ECB announced its most noteworthy action to date by allowing Euro zone banks to borrow at 1% for three years in the hopes that the banks will purchase government debt. However one needs to look no further than the opening paragraphs of this newsletter to recognise that forecasters and economists rarely get the one year picture right and accordingly Europe may surprise all if confidence in the deleveraging of debt is passed through to markets.

China

As China's economy began to slow, officials undertook a series of policy shifts to soften the landing including monetary easing and encouraging domestic consumption to make up for a decline in exports. With the latest data from December 2011 showing exports and imports growing at their slowest pace in two years and inflation at a 15-month low, analysts predict further monetary easing in 2012.

China's slow down has shown that it is not immune to European fall out. As 2011 ended, foreign direct investment rose 9%, down from the 17% rise in 2010. At the same time, China's monetary policy seem to be achieving desired outcome as manufacturing activity for December returned to modest expansion and retail sales were up 17% for 2011.

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