The Tipping Point

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In the near term, the European debt crisis will dominate the financial news, as it has for most of this year. The "too little, too late" approach by the leading nations has caused the crisis to fester. It is now clearly in the red zone, and the sustainability of the union can even be called into question. Even with a new President of the European Central Bank at the helm, it is too late for Europe to grow out of its problems. Instead, it is trying to shrink its way to solvency. With austerity spreading across the union, a still bloated social network, and a slow death spiral from population decline, Europe is in lock-down mode. A new recession is almost inevitable, and the union will experience a long period of economic stagnation ahead.

The possibility of Europe's problems spreading to the United States appears less and less likely as the crisis wears on. The bankruptcy of MF Global due to its leveraged wagers on European sovereign debt has caused hardly a ripple in our financial structure. The vulnerability of European banks is real, but increasingly seems contained within the union itself. There will, however, be some economic spill over as Europe descends into recession. Our exports to Europe will suffer. Exports have been a significant source of strength for our economy for several years now. While it bears watching, our economic growth will depend more heavily on the consumer. Consumption accounts for an estimated 70% of our Gross Domestic Product. Exports by contrast amount to about 13%.

The engine of growth in the world remains emerging Asia. Here too, however, slowing growth is in prospect. Both China and India are wrestling with domestic pressures, notably rising inflation. In addition, China is acting to tamp a dangerous housing bubble. Government policies will probably be successful, but at the cost of some growth. Unlike China which is effectively a dictatorship, India is a democracy. Its growth has been powerful but chaotic. It is reported that India is putting out over three thousand new cars per day on its roads, without the basic infrastructure such as paved roads and traffic controls to handle them. The byzantine approval process companies must follow for expansion in India creates further impediments to healthy growth. Economic expansion in emerging Asia still seems assured, but will throttle back from the unsustainable path of the past few years.

Alone among industrialized nations the United States economy is past its nadir. While political rhetoric would say otherwise a new expansion phase is taking shape. The latest employment statistics were especially notable for the revisions to prior months estimates. Net hiring rose 80,000 in October, with private employment climbing 104,000. The estimates for the previous two months were revised sharply higher. Equally significant, September's new jobs report was the fifth payroll report in which private payrolls were revised higher. The other official survey, the Household Survey, estimated 277,000 new jobs in October. Combined with a steady decline in new unemployment claims since the summer, there is reason to believe that a turn in new private sector hiring has been achieved.

Behind the confusion caused by the onslaught of negative news, other positive trends are appearing. In a recent report the Boston Consulting Group estimated that Chinese wage inflation has closed most of the cost gap with the United States. This seems to be borne out by a number of companies "resourcing" manufacturing to the U.S. Some very large employers are also opting to build new plants domestically, including Caterpillar and Intel. Several foreign firms have announced new investments here. American manufacturing is alive and well, and growing again.

The evidence is compelling that the U.S. economy is near a tipping point. Numerous signs point to this revival. Judging from retail sales trends the consumer is alive and well. United Parcel Service estimates that volume will increase 6.2% this Christmas season and will boost seasonal hiring by 10%. Consumer incomes will increase as new jobs continue to rise, bolstering consumption. The missing ingredient in the positive turn of events is a rise in house prices. This very healthy development may be close at hand. How quickly policy makers acknowledge and address the improving conditions will have a lot to do with the pace of the new growth cycle. As economic prospects rise we believe the United States will be viewed as an attractive place for investment once again.

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