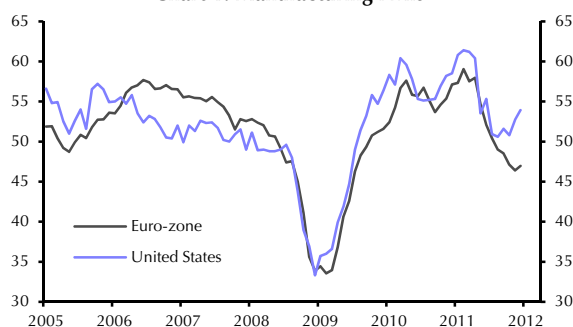


US manufacturing continues to shrug off euro-zone woes

- Manufacturing surveys for December suggest the US economy continued to resist the slowdown in Europe right up to the end of 2011. Although US growth is likely to slow this year, we expect this divergence between the US and Europe to persist throughout 2012 and 2013.
- The manufacturing PMI surveys for December add to evidence of a sharp divergence between the US and euro-zone economies during the second half of 2011. (See Chart 1.) The US ISM, released today, jumped to 53.9 in December, up from 50.8 only two months earlier. By comparison, the euro-zone PMI increased only marginally in December, and at 46.9 it still points to a deep recession. This divergence is also clear from other recent data. For example, the US unemployment rate fell from a peak of 9.2% in the summer to 8.6% in November, while unemployment in the euro-zone rose to 10.3% in October.
- In fact, **we now estimate that the US economy grew by around 2.5% on an annualised basis in the fourth quarter of 2011, while GDP in the euro-zone was already contracting at a similar rate.** Moreover, the weakness in Europe is set to persist during 2012 as its debt crisis deepens.
- Chart 2 illustrates the divergence we expect between US and euro-zone growth this year and in 2013. Admittedly, it also shows that, **since 1980, there has been only one previous year during which GDP in the euro-zone economies contracted while the US continued to grow** – but that was in 1993 in the wake of the collapse of the ERM and German reunification.
- **There are good reasons to believe the US may be able to ride out the euro-zone crisis without being dragged into recession itself.** Most importantly, the US banking sector has limited exposure to Europe and is well capitalised, and the Federal Reserve is well placed to stave off a liquidity crunch. (See our *US Economics Weekly*, “What to watch in 2012”, 27th December.) Also, only 19% of US exports now go to Europe, down from 28% in 1980, suggesting the correlation between the two economies may have fallen in the past decades.
- However, despite its ability to withstand a euro break-up, we expect US growth to edge down to around 1.5% this year from 1.7% in 2011, whereas the consensus forecast is for growth of over 2%. This is largely for domestic reasons, the most important being further fiscal austerity and continued weakness of the housing and labour markets. **And if the euro-zone crisis spins out of control more fully and rapidly than we currently expect, then the US would not be immune.**
- The manufacturing PMIs also showed a slight improvement in December for most of the major emerging economies and for Japan. But in all cases they still point to weak manufacturing growth or outright contraction. Moreover, **the manufacturing PMIs in the four “BRIC” economies, the euro-zone, Japan, the US and the UK are all well below their levels in January last year.**
- As a result, the *global* manufacturing purchasing managers’ survey also increased in December, to above the 50-mark which supposedly divides contraction from expansion, but it too ended the year well below its reading in January 2011. Given the bleak outlook for the euro-zone and the continued fiscal austerity in the US and elsewhere, we do not think the upturn in December will be sustained for long in the new year. Overall, we expect global GDP growth to drop from just below 4% in 2011 to 3% this year – well below the average growth rate of over 4% during the pre-crisis years from 2000 to 2008. **In short, the relatively encouraging end to 2011 should not detract from the gloomy outlook for 2012.**

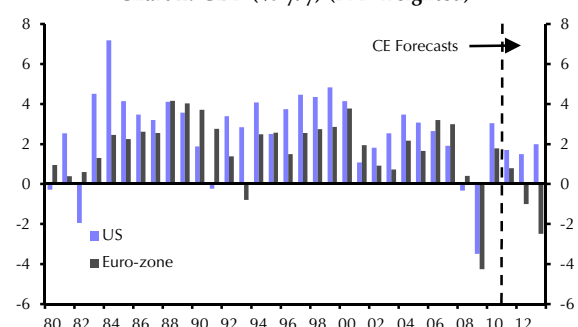
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Chart 1: Manufacturing PMIs



Sources – Markit, Capital Economics

Chart 2: GDP (% y/y) (PPP-weighted)



Sources – IMF, Capital Economics