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Who Will Struggle in 2012?

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By Rick Herman

There's a small chance of a happy economic surprise in 2012. Leaders in Europe might finally find a way to reinforce the euro zone stitching that has been unraveling for the last three years. In Washington, Republicans and Democrats might go see Hugo together and become inspired to help their country. Ben Bernanke might show up at your door with a bag of money.

The odds are probably higher that something unsettling will happen. Investors, of course, are girding for the partial or complete dismantlement of the euro zone, with a return to national currencies like the Greek drachma and Italian lira. Rating agencies could downgrade the U.S. credit rating again, triggering another downward reset of the floor for stock prices. There could be a military confrontation with Iran, making Americans nostalgic for the happy days of $4 gas.

Of course, it's also possible that nothing all that dramatic will happen in 2012. "It will not be a year of crisis," predicts economist Barry Eichengreen of the University of California, Berkeley. "Nor will it bring an end to our current economic troubles. Rather, it will be a year of muddling through."

If 2012 brings more of the same, it could still be a tumultuous year for investors and a challenging time for many American families. The economy has strengthened somewhat in recent months, but many economists expect that to be a temporary spurt, with weaker growth in 2012. With little margin for shocks, a worse-than-expected crisis in Europe could trigger a recession in the United States and elsewhere. Even if that doesn't happen, unemployment is likely to remain high, and the housing market depressed. If there are no upside surprises in 2012, here's who is likely to struggle:

Homeowners. Even though prices have fallen by more than 30 percent since 2006, they're likely to drop another 3 to 5 percent or so in 2012, according to Moody's Analytics. The pace of foreclosures, which has been slowed by official investigations in many states, may pick up again as those inquiries wrap up. The housing market has to bottom out and start to rebound at some point, but most economists think that it won't happen till 2013 at the earliest. Until then, homeowners will have to contend with a further loss of equity, and low sales prices if they're forced to unload their home.

Investors with a low tolerance for drama. The investing outlook for 2012 calls for a lot of volatility and brinksmanship—perhaps even more than in 2011. The European debt crisis could reach a boiling point, with Greece finally defaulting on its debts or dropping out of the euro zone. "That's going to be a very messy day," David Zervos of investing firm Jefferies advised clients recently. "The equity markets will drop 5 to 10 percent, and some banks will fail or be nationalized."

But that sort of wipeout may be the very thing that triggers assertive political action across Europe and finally helps resolve the crisis. Plus, the Federal Reserve and European Central Bank would probably step in to halt a complete run on Europe's financial system and the worldwide contagion that would ensue. Many investors who are hoarding cash now feel the time to buy stocks will be the moment of maximum panic following a rupture of the euro zone. But the faint-hearted among them may have overdosed on Valium by then.

Banks and their shareholders. It may be little consolation to Wall Street "occupiers," but the financial industry is enduring a degree of comeuppance. Share prices are depressed and likely to remain that way, as investors worry that a financial crisis in Europe could spread to U.S. banks. More tough new regulations will go into effect in 2012, hindering profitability, which in turn could lead to more pay cuts and job losses at banks. Some analysts think the morose outlook could leave bank stocks underpriced at some point in 2012, with nice gains possible if the recovery picks up steam and the worst fears about Europe don't materialize. But for now, the sell orders heavily outnumber the buys.

The long-term unemployed. The job market seems likely to continue its gradual improvement in 2012, but those out of work for six months or more could be at even greater risk of falling through the cracks. Many of the nation's nearly 6 million long-term unemployed workers are jobless because there's declining demand for their skills, or simply too many people who do what they do. There's no reason to expect a surge in demand for such workers over the next year. If a housing rebound materializes in 2013 or 2014, that might help employ an army of idle construction workers. But until then, conditions might get even tougher for those out of work, as Washington and state governments begin to phase out certain benefits for the jobless.

Drivers. Oil prices have been a curiosity lately. Ordinarily, they'd fall on the kinds of concerns that have been surrounding Europe, and the distinct possibility of a global recession. Instead, they've been hovering around the healthy $100-per-barrel mark. Some analysts think that's because of worries about Iran's nuclear program, which seems likely to provoke some kind of confrontation eventually. If that happens, oil prices could easily exceed the modern peak of roughly $150-per-barrel, since Iran is the world's third-largest exporter of crude. **Bernard Baumohl of the Economic Outlook Group** believes current oil prices may reflect a $10 to $20 premium related to fears about Iran. If military action were to shut down Iran's exports, gas prices might hit $5 per gallon or even $6. That alone could be enough to tip the economy back into recession.

American consumers. Where have they been getting the money? Spending picked up smartly toward the end of 2011—but incomes didn't. That means shoppers were saving less and taking on more credit-card debt to finance purchases. But debt levels are already too high and Americans need to save more to rebuild retirement funds that have been ravaged by plunging home values and a dicey stock market. "This spending is not coming out of income, so there's a limit as to how long it can go on," says Nigel Gault of forecasting firm IHS Global Insight. Unless there's a surprising jolt to the economy in 2012, many consumers will have to revert the thriftier habits that got them through the recession.

Savers. The Federal Reserve has been clearer than ever about its determination to keep interest rates low until at least 2013. That's meant to stimulate lending, investing, and overall economy activity, but it also punishes savers intent on investing conservatively. Bank of America Merrill Lynch predicts that the yield on cash in 2012 will be a mere 0.5 percent, a rate that would require 138 years to double your money.

Government workers. States and municipalities have been aggressively trimming their payrolls to keep their budgets balanced, with job losses likely to continue for at least one more year. Budget-cutting will soon turn to the federal payroll as well, as Congress gets more serious about cutting spending. The ax could start to fall in 2012, as lawmakers look for new cuts they can enact in lieu of automatic reductions in defense spending scheduled to begin in 2013. Even if that doesn't happen, the federal payroll seems certain to shrink in coming years. And a federal pay freeze that's been in effect for two years could be continued indefinitely.

President Obama. The most senior federal employee may be the most endangered. Even though the economic "recovery" will probably continue, a slowdown in growth and spending in 2012 will feel recessionary to many. The unemployment rate on Election Day will probably still be close to 9 percent, and many Americans may doubt that things are getting better. There are many intangibles, but the economy is the ultimate pocketbook issue, and Obama's best hope for re-election may be a weak Republican opponent. Like much else in 2012, the outcome of the November election may be a heartstopper that goes down to the wire.