

The Kiplinger Letter

FORECASTS FOR MANAGEMENT DECISIONMAKING

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Dear Client:

Washington, Jan. 6, 2012

While global oil supplies grow shakier...
most recently in light of saber rattling by Iran...
U.S. and Canadian oil output is surging.

ENERGY

Along with natural gas and biofuels...
It will fill 80% of U.S. fuel needs by 2016,
compared with 68% this year and just 50% in 2005.

Driving the boom: Vast new oil discoveries
in N.D., Texas, Colo. and Ohio, as well as Canada,
and cost-effective drilling technology breakthroughs
for tapping oil in hard-to-reach shale formations.

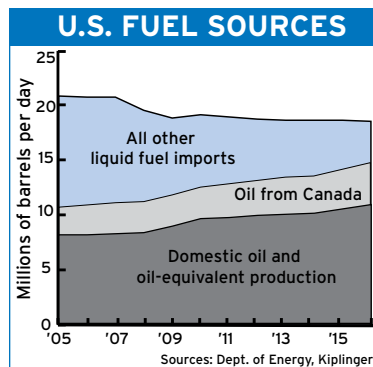
Huge natural gas deposits in Ohio, Texas,
La. and elsewhere, many of them near big oil plays.
Though decried by environmentalists, fracking,
a method for extracting gas, will unlock decades
of supply, not only for fuel, but for other needs, too.

Also, the continuing march of biofuels,
which are becoming a larger part of the energy mix,
despite the end of federal tax credits for them.

All this lowers the risk of fuel shortages,
should foreign oil shipments be suddenly curtailed.

It won't affect gasoline prices very much.

What motorists pay will continue to hinge on global supply-and-demand trends.



Though fuel consumption is heading down in the U.S...
China, India and many other parts of the world
are soaking up more as their economies expand.
They'll press prices upward even as supplies grow.

New finds will make the U.S. a net exporter of natural gas
by 2016 or so, a welcome U-turn from recent scenarios
that had the nation poised to be a major importer.

In fact, Houston-based Cheniere Energy is retrofitting
its liquefied natural gas import terminals for export.
Other refiners are likely to follow in its footsteps.

Still, lots of natural gas to go around for domestic users...
good news for utilities, producers of plastics and fertilizer
plus other energy-intensive firms. They'll pay less for the stuff than their foreign rivals.

What could undermine rising output? A sustained drop in global oil prices...
not likely in the face of rising world demand...would lessen drilling incentives.

And opposition from environmentalists, citing risks of groundwater pollution.
Blocking Canada's carbon-intense oil sands projects is a particular focus for them.

But in the end, economic forces will win out. Canada's 170 billion barrels
of known oil reserves and the U.S.' big shale gas fields are too valuable not to exploit,
giving America a surer grip on its energy future while reducing the need to import.

ECONOMIC FORECASTS

↑	GDP growth	NEW
	Rising to 2.3% this year, from 1.8% in '11	
↑	Interest rates	
	10-year Treasuries near 2.5% in mid-'12	
↓	Inflation	
	Slipping back to 2% in '12, after hitting 3.3% in '11	
↓	Unemployment	NEW
	Below 8.5% by year-end, despite upticks early in '12	
↓	Crude oil	
	Highly volatile, but trending toward \$90-\$95/bbl. into spring	
↑	Retail	NEW
	Solid 6% growth, but slower than in '11	

[Click here for exclusive, Web-only details of these Kiplinger forecasts](#)

**THE
ECONOMY**

Job growth is improving, but matching 2007 employment is still years away.
By 2013, only half of the 8.75 million jobs lost since then will have been filled.
 Meanwhile, a record 43% of the 13 million unemployed haven't earned a paycheck in at least six months, and about 8 million part-timers can't find full-time work.

Figure on about 2 million net new jobs in 2012, after a 1.6-million gain in 2011. That'll barely move the needle on the unemployment rate. By year-end, it'll wind up only slightly below the current 8.5%, though it's likely to bounce up by just a bit in early 2012, as more folks are encouraged to start hunting for jobs.

It won't be even that good if home prices don't turn upward this year...
 though we expect them to, fueling growth in home building and related industries. A longer, deeper recession in Europe than now anticipated would be a spoiler as well.

Where will growth come from? Health care will remain the standout sector, despite a slowdown in the pace of hiring. Also added to payrolls this year: Restaurant and bar workers, IT specialists, accountants, engineers and temporary workers.

Interest rates will edge up in 2012, but don't blame the Federal Reserve.
 With the economy still subpar and inflation likely to ease to just 2% this year, there's little prospect that the Fed will jettison today's near-zero short-term rates. Indeed, Chm. Bernanke should hear less grumbling on the Fed's policy-setting arm, as three inflation hawks soon depart and two middle-of-the roaders join the group.

It's long-term rates, not directly controlled by the Fed, that will climb, reflecting expectations of higher inflation plus renewed investor focus on federal debt and stalemate in Washington. And demand for credit will pick up as the economy does.

Still, rates won't surge. Treasuries will remain an appealing safe haven. Though the U.S. economy isn't in great shape, it's fitter than most around the globe. Look for 10-year Treasuries to hit about 2.5% by midyear, adding half a point or so to a four-year car loan and a three-year small business loan. Thirty-year mortgages... up a full point by year-end, due to higher Treasury rates and stronger housing demand.

Though the U.S. economy will up the pace this year, world growth won't.
 As Europe enters recession, the overall world gain will slow to 3.4% in 2012.

That's sure to spur a fresh wave of protectionism, as governments try to insulate their nations' industries and workers from the competition of imports.

Expect at least 500 trade-restricting moves this year...up 50% from 2011...
 with the potential to cut \$800 billion from exports and further curb world growth.

Top targets: Iron ore, steel, machinery, plastics, chemicals and meat.
 China and India are already using tariffs to shield their fledgling automakers. Mercosur, the South American trade bloc, is imposing a stiff 35% tariff on textiles, chemicals and other imports that it claims harm the continent's domestic producers.

As a result, world exports will grow less than 6% this year. In 2011...7.5%.

Looking for bright spots in the gloomy world economy? The BRIC countries continue to offer the most shine. Although the breakneck speed of their recent gains will ease, they're still heading the pack of major economies. For Brazil...3.5% growth this year. The same for Russia. India...slipping a tad to 7.5%. And China...8.5%.

Taiwan and South Korea will lead the more industrialized countries, with hikes of 5% and 4.4%, respectively. Two small European nations, Lithuania and Estonia, will buck the slowdown there with 3.5%-4% growth, better than most.

Some of the world's smallest, least developed economies will grow fastest...
 not surprising, considering how low their starting points are. Among those poised to make leaps this year: Mongolia...up about 12% as it benefits from new copper and coal mining operations plus infrastructure spending. Niger and Angola...up 11% to 12%. And Sierra Leone, getting a short-term 50% boost from new iron ore mines. But all such less developed nations combined make up just 2% of the global economy.



POLITICS

That eight-vote win in Iowa by GOP presidential hopeful Mitt Romney? Might as well have been 8,000. No one can keep him from the nomination, which the former Mass. governor will wrap up decisively in the coming months. Runner-up Rick Santorum of Pa. won't have the cash to compete... Especially while Newt Gingrich and Ron Paul stay in and siphon support of Republicans interested in backing someone other than Romney this winter. Romney's next win...by a big margin in N.H. on Jan. 10...will propel him. Santorum or Gingrich may do well in S.C. Romney's in the clear after that, especially in February and March, when the primary calendar gets more crowded. He has the money and organization to deal with multiple races. Others don't.

But the general election won't end up just Romney vs. President Obama. Look for a third candidate...someone who won't win but can be a spoiler. That candidate will be picked by Americans Elect...working to get on fall ballots in every state. The nominee, chosen online in June, can come from either party or be an independent. The nominee's running mate can't be from the same party. New York Mayor Michael Bloomberg won't be the guy. He'd run to win... not just for the sake of being on the ballot with no chance of claiming victory. So who might run as a potential spoiler? Don't rule out Paul just yet. His strong grassroots backing could pay a big dividend in an online campaign. The Texas congressman won't attract enough support from independents or from Democrats to contend. But Republicans worry he could hurt Romney... the way Ross Perot took votes from President George H.W. Bush back in 1992.

WHITE HOUSE

Don't expect Obama to seek more stimulus in his State of the Union speech. He knows the effort would fall on deaf ears in Congress in an election year... fueled by GOP objections in both the House and Senate...and be used against him. Instead, the Jan. 24 address will focus on jobs and the rich-vs.-poor divide... the same issues the president will use as the backbone of his reelection campaign. He'll criticize lawmakers for dragging their feet on the payroll tax cut extension. As part of his pitch, Obama will call for raising taxes on millionaire earners. That has zero shot of passing but will give him a chance to pressure Republicans on an issue that racks up broad backing from likely voters in public opinion surveys. He'll also use the televised joint session to defend his health care law. The Supreme Court will hear arguments and decide whether the law is constitutional. Obama is banking on public support for many provisions of the sweeping law, while Republicans are framing the measure as Uncle Sam meddling in state affairs.

BUDGET WOES

Watch for more cash-strapped communities to use a new way to save money: Downsizing police departments and hiring private security firms instead. Foley, Minn., for example, will save more than \$10,000 a month using private guards instead of police on neighborhood patrols. School districts, too, are making the switch. One Pa. district saved a teacher's job by using private guards to provide traffic control for less than the local police department was charging the schools for the same work. Firms such as Neb.-based Signal 88 Security expect more communities to follow suit.

TECH

Smart phones will keep getting smarter and laptops will keep getting thinner, opening new possibilities this year for wired business and personal users. Among gadgets you'll find at this month's Consumer Electronics Show in Las Vegas: Phones with more processing power, sharper screen resolution and better cameras. And more than 50 models of Ultrabook computers...the PC response to MacBook Air, which was upgraded by Apple in mid-2011. The laptops are less than one inch thick, weigh three pounds and cost about as much as a tablet computer...\$700 to \$800.



SELLING

Holiday gift cards are the gifts that keep on giving to retailers' bottom lines. Sales aren't logged until the cards are redeemed, mostly in Jan. and Feb. With sales climbing 18% in the just-ended 2011 holiday season...the largest jump since 2006...retailers should be able to sidestep an early-in-the-year slump.

Consumers plunked down nearly \$28 billion on gift cards in Nov. and Dec., spending an average of \$155. One reason: Stores offered few must-have holiday gifts.

Looking for new markets and customers? Then don't overlook Univision.

The Spanish-language giant is the fastest-growing TV network in the U.S. It's a cable mainstay, and boasts of reaching 95% of Hispanic homes in the nation. Since the number of Hispanics in the U.S. tops 50 million, that's a big customer base. Volkswagen is already a major advertiser, pitching to those under 49 years old... a key cash-spending demographic that boosts the network's ratings in many locales.

Univision ads cost up to 75% less than English-language competitors charge.

And its multiple channels and local ad options are ideal for small businesses.

THE WORLD

Jobs will be plentiful for U.S. firms in postwar Iraq, but there's a cost: Security can eat up as much as a quarter of a company's operating budget. Many of the positions will be filled by contractors who worked for the Pentagon, with most of the opportunities found in rebuilding oil production and infrastructure.

Uncle Sam will spend at least \$5 billion on contractors in Iraq this year... for 7,000 security contractors and about the same number to provide support services. Many contracts will stretch on for years, in part because Iraq was ravaged by the war and partly because the electric grid and other systems there are so antiquated.

If you follow commodities markets, start paying more attention to Burma.

U.S. efforts to mend diplomatic ties will put more resources in play... tin, zinc, copper, tungsten, lead, coal and natural gas. Also, cement and fertilizer.

Normal trade between the U.S. and Burma is likely but remains years away. If unofficial chats with Burmese officials go well this spring, expect formal discussions with the U.S. in 2013 or 2014. Burma first needs to initiate democratic reforms. The U.S. broke off ties with the Southeast Asian nation, also known as Myanmar, after the military refused to accept results of parliamentary elections back in 1990.

TAXES


Some changes to keep in mind that may affect your 2012 federal tax bill: The maximum 401(k) contribution this year is \$17,000, a \$500 increase. But if you were born before 1963, you can contribute more...to as much as \$22,500.

The Social Security wage base is \$110,100 this year...up by \$3,300. Wages beyond that amount will not be subject to Social Security withholding. (The earnings limits have changed, too. Folks who turn 66 this year won't lose benefits if they earn \$38,880 or less before they reach that age. Those who are at least 62... but not older than 65...can make \$14,640 before seeing monthly checks reduced. There is no earnings cap once a beneficiary reaches his or her 66th birthday.)

The estate tax exemption gets an inflation adjustment...to \$5.12 million.

Want more about taxes? Get three free issues of *The Kiplinger Tax Letter*... our online New Year's gift to you as a valued subscriber to *The Kiplinger Letter*. Go to kiplinger.com/go/freetaxletter and follow instructions to create an account. You'll be able to use the same log-in details for electronic access to the regular Letter. Already have a Kiplinger account? Just log in to the Tax Letter and start reading.

Yours very truly


THE KIPLINGER WASHINGTON EDITORS

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