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Musings & Amusings: Groaners

"I'm reading a book about anti-gravity and I can't put it down."

"I used to be a banker, but then I lost interest."

"The earthquake in Washington was obviously the government's fault."

with Nicholas S. Perna, Ph.D., Webster Bank Economic Advisor

Looking back and ahead and at less than six degrees of separation. Last year, the Massachusetts Institute of Technology (MIT) Economics Department further increased its domination of the world monetary system. Ben Bernanke was already Chairman of the Federal Reserve and Mario Draghi took over the helm of the European Central Bank in 2011. Both have PhDs from MIT. Furthermore, it was pointed out by the press, that three of the top Federal Reserve staff economists are from MIT.

But it gets better (or worse, if you're from Harvard). Stanley Fischer, the newly nominated Vice Chairman of the Fed is from MIT. (He received his PhD the same year I did). And Janet Yellen (President Obama's choice for Fed Chair) has so many MIT connections that she might as well have gone there. Her husband (Nobel Laureate, George Acklerlof) has a degree from MIT. And many of the faculty members at Yale, where she did her graduate work, are from that wonderful place on the banks of the Charles River. (Those envious Hahvud types like to refer to it as the "trade school on the Charles"). Among those Yale faculty members are William Nordhaus, Ray Fair, Nobel Laureate Robert Shiller and moi. Who would you rather have in charge of the monetary system? Yellen and Fischer or the Winkelvoss twins? (More on that later).

More seriously, last year was really weird. For the most part, economic growth was sluggish and Congress tried hard to make it even worse by shutting the government down and coming close to defaulting on the debt they have been piling up for years. Even so, the Dow Jones index managed to soar more than 20 percent despite a rise in bond yields term arising from fears that the Federal Reserve would soon begin winding down its massive purchases of government securities. Go figure!

By December, optimism about the economy started to rise and – of course – the stock market began to wilt. Job gains helped lower the unemployment rate to 7 percent. Although "Black Friday" was disappointing, "Cyber Monday" was encouraging. (I find both overused terms annoying, along with "Staycation" and "Selfie"). And people bought cars at an impressive rate towards year-end. Not only that, but Congress did the unthinkable and reached a budget deal before the deadline, thereby removing the threat of another imminent government shutdown – until after the Congressional elections next November.

Looking ahead, most economists expect real GDP growth to accelerate to 3 percent from 2 percent in 2013 and the unemployment rate to fall further to 6.5 percent. Inflation should remain low at around 2 percent or below.

Yellen and Fischer officially take over the leadership of the Federal Reserve in January. They'll have no choice but to continue reducing the Fed's purchases of bonds, thereby putting some upward pressure on yields during the course of the year. The Fed took a first small step in this direction at the December meeting. However, the Fed will most likely honor the pledge to leave short term interest rates close to zero during the 2014.

While the New Year is getting off to a good start, there are still some major issues up in the air. Congress has not yet extended the debt ceiling which will be hit in a couple of months, leaving the threat of default hanging over us. Also, it is not clear whether there will be any significant economic fallout from the less than impressive launch of the ObamaCare websites. In particular, will consumer confidence suffer?

My Two-bits on Bitcoin. What do you get when you cross an economist with the Godfather? An offer you can't understand. What do you get when you let computer geeks who distrust government try to design a monetary system? Bitcoin! When I attempt to explain it to people, their eyes glaze over. Bitcoin claims to be a currency system free from the control of unreliable governments and central banks. It was invented by a mysterious person (or group) who goes by the *nom de computer* of Satoshi Nakamoto. "He" wrote a complex computer program that enables people to buy, hold, trade, pay with "electronic" coins. Bitcoins can be kept in on-line "wallets" and traded at various exchanges that will also convert them into dollars, euros or whatever.

Since the essence of a stable currency is limited supply, the program permits the supply to rise to a maximum of 21 million "coins" by 2040. In an analogy with the gold standard, this cyber money supply grows as coins are obtained by "miners" who obtain them by solving complex computer problems. At present, 25 Bitcoins can be "mined" every ten minutes; but this pace is scheduled to be halved every four years until the maximum is hit.

The advantages purportedly include very low cost transactions free from those nosy government bank regulators and tax people. In addition, Bitcoins are supposedly free from the risk that they will plummet in value because the issuing authority decides to run the printing presses (computers) around the clock.

As you've probably surmised, I'm not a big fan of Bitcoins even though they've increased in value from next to nothing to as high as $1,200 each during the past year. At present, they're selling in the vicinity of $700. For one thing, there have been a number of instances of large-scale thievery where Bitcoins have disappeared from "wallets" and exchanges. There's very little recourse for the losers because movements of Bitcoins can get extremely difficult to trace. Also, how can we be sure that the supply is ultimately limited to 21 million units? What about counterfeiters?

I also have some deeper reservations. In a conventional "fiat" money system, the government issuer usually gets to keep the difference between the transaction value of a coin and the cost of minting it. Economists have a fancy name for this: seignorage and it accrues to the benefit of the government, the people, the dictator and so on. However, the Bitcoin seignorage belongs to the "miners" who play computer games to get them!

I'm also uncomfortable with the size of the gains that have gone to those who got in early. Among the big winners in 2013 were the Winkelvoss twins, who scored a ton of money from Mark Zuckerberg when they claimed he stole the idea for Facebook from them. (Did you see *The Social Network*)? When the movie about Bitcoin is made, I recommend that Will Ferrell be allowed to play both Cameron and Tyler Winkelvoss! Meanwhile, the twins are laughing all the way to the bank – most likely a traditional one that deals in dollars.

The government attitude towards Bitcoins (and competing creations) is mixed. The Chinese government has recently greatly restricted their use, helping to drive the price down a lot. So have the French. However, the U.S. has taken a more hands-off approach. How long this U.S. attitude lasts depends on whether thievery and the use of Bitcoins to transact illicit activities can be controlled.

Stay tuned and, meanwhile, try not to get *bit*!

The Region: more of same but better. The geographic areas served by Webster Bank are expected to do well over the next two years. According to independent forecasts, job growth in Massachusetts and metro New York City will slow a bit in 2014 before picking up in 2015. And at long last, Connecticut and Rhode Island will experience decent job growth.

Of course, this regional outlook is heavily dependent on the performance of the national economy. Any slowdown in U.S. growth would quickly be transmitted to the region. Faster national expansion would benefit the region, but the region would most likely still lag behind the U.S. somewhat.

Outlook for Job Growth (annual %)

	2013	2014	2015
Connecticut	0.9	1.1	1.5
Massachusetts	1.5	1.3	1.8
Rhode Island	0.6	1.1	1.7
Metro NYC	1.9	1.7	2.1
United States	1.6	1.8	2.4

Sources: New England Economic Partnership and Moody's Analytics.

However, area-specific issues will also play an important role in the outlook. The experts say that Rhode Island needs to address major competitiveness issues such as cost of doing business, highway infrastructure, and worker productivity to achieve decent growth over the longer term. While Connecticut enjoys high productivity, the state seems to experience chronic budget problems. It took very large tax increases and some spending cuts to pull the budget out of deep deficit a few years ago. There have been recent warnings of large deficits not too far in the future.

How these issues are addressed will affect future job growth to the extent that they change the competitive environment. In an address to Connecticut legislators in the early 1990s, Michael Porter, the competitiveness expert from the Harvard Business School, said that states should not focus on trying to pick winners and losers. Rather, they should strive to create a winning environment that benefits all. This even-handed strategy is sound advice for all levels of government – **even if it comes from Harvard and not MIT.**

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