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Life in the Slow (down) Lane. Economic growth is slowing in much of the world. While the U.S. has avoided the dreaded "double dip", Europe is now entering recession. China is losing momentum. Although these cycles are supposed to be mild, there's always the possibility that they'll feed on each other. Can you be in an increasingly crowded slowdown lane without getting rear ended?

The United States has picked up some speed, lowering the odds of re-entering recession before fully recovering from the last one. The consensus for 2012 is for 2 ½ percent real Gross Domestic Product (GDP) growth. While far short of "pedal to the metal" velocity, it is faster than the first half of last year. Unemployment should decline a bit more to 8 percent by year-end from 8.5 percent at present and the recession peak of 10 percent.

The really good news is that inflation, as measured by the Consumer Price Index (CPI) is predicted to be in the vicinity of 2 percent. And, of course, the Federal Reserve has promised to hold short-term interest rates where they are until late 2014. During 2012, long term rates are projected to climb less than one percentage point from their recent historic lows. These are some advantages from travel in the slow lane.

Among the U.S. bright spots is manufacturing which is benefiting from stronger car sales and exports. Labor markets are looking a bit better. Job growth has been picking up and new claims for unemployment insurance have been falling. Even housing is showing some signs of coming out of its prolonged slump. There's a noticeable pickup in home sales and in construction activity.

Of course current *levels* of activity are still far below normal. During the past 2 ½ years of "recovery," the U.S. has regained less than a third of the 8.7 million jobs lost during the "Great Recession." That's why I've been calling this the "Not So Great Recovery." Car sales and housing starts are better than the recession lows but way below previous peaks.

Household finances are far from fully healed. Economists at the Federal Reserve calculated that the 33 percent home price decline since 2006 has erased $7 trillion of homeowners' equity --- half of what existed in 2006. At present, 20 percent of mortgages in the country are "under water," with the amount owed exceeding the value of the house. In states such as Arizona, Nevada and Florida the figure is closer to 50 percent.

And there's still a lot of uncertainty about budget policy in an election year. Last December, the payroll tax cut was only extended for two months and comes up again soon for debate.

Against this economic backdrop, it is interesting to take an early peek at predictions of November's presidential elections. Ray Fair, who's both a graduate school classmate of mine and Yale colleague, has developed a model that forecasts the popular vote split. He gives President Obama a 50-50 chance of staying in the White House.

That model, which is based on nearly a century of voting data, finds that it is mostly the *trends* in economic growth, especially during the year before the election, as well as the inflation rate that influence voters. Hence, the recent pickup in real GDP growth is a positive for the incumbent even though unemployment remains high. Since so much can happen over the coming months, I wouldn't bet the ranch – or even a Starbucks latte – on the basis of this prediction.

Europe has slipped into recession. Germany, which is the largest economy on the continent, has joined troubled nations like Greece and Ireland where fiscal austerity has been exacting a heavy toll for a while. Double digit unemployment seems to be the inevitable result of slamming on the fiscal brakes.

A recent poll by the respected publication, *The Economist*, showed forecasters expecting a brief recession. However, it seems to me that the severity of the downturn depends -- in large part -- on how the contraction affects the ability of nations to service their debt as well as the troubled European banking sector.

Musings & Amusings: *Some really bad puns*

A lot of money is tainted - It taint yours and it taint mine

Once you've seen one shopping center, you've seen a mall

Does the name Pavlov ring a bell?

Recently, interest rates on sovereign (national) debt have been falling even though there are nagging concerns over the ability of Greece and others to avoid default. This improvement results largely from large-scale efforts by the European Central Bank (ECB) under its new president. Now that Mario Draghi is in the driver's seat, the ECB has been lending lots of money to the banks at bargain basement rates and encouraging them to buy sovereign bonds. However, in a recession, the banks might curtail these purchases as losses from private lending mount. Interest costs on sovereign debt would then probably rise again.

On the plus side is the recent decline in the value of the Euro which should help exports. Another positive is the flexibility of the ECB's new president who has been much more willing to use monetary policy to steer clear of a financial collapse than his inflation-fighting predecessor. Draghi is looking more and more like Ben Bernanke. Both were awarded PhDs in economics within two years of each other at MIT.

China, which is now the world's second largest economy, has seen GDP growth slow from better than 10 percent to 8 percent. For China, this is a major deceleration and is contributing to the price decline in the country's overheated real estate markets. Chinese authorities have been trying to cool speculation in building and land through tighter monetary policy. Hopefully, they'll be able to accomplish this without a hard landing. A much greater slowdown could lead to political unrest and expose weaknesses in parts of the banking system.

There are some reasons for optimism such as their ability to control foreign exchange and interest rates. Both are tightly regulated by the monetary and government authorities. And since China is a creditor nation, rather than a borrower, there's no need to worry about repayment of sovereign debt.

Global growth, however, will be only a little slower in 2012 than last year. According to the IMF (International Monetary Funds), world GDP will rise 3.3 percent this year down from 3.8 percent in 2011. As recently as 2010, world output rose better than 5 percent. Another slow lane benefit: oil prices are apt to stay flat or even come down, unless there's political turmoil in the Middle East.

New England presents a mixed picture with Massachusetts doing well in the "passing lane" while Connecticut and Rhode Island are growing less rapidly. Jobs are predicted to rise slowly over the next few years, but the GDP growth is of "high quality" as explained below.

Massachusetts has outperformed the region and the nation during both the recession and the subsequent recovery. The Bay State's peak unemployment rate of 8.8 percent and job losses of 4.3 percent were considerably smaller and recent jobs growth has been notably faster. Connecticut's job gain during the past year has lagged the nation. So has Rhode Island, which is recovering from a downturn that was considerably worse than in neighboring states.

Forecasts of the region call for little or no job growth this year and modest increases over the next few years. I think these 2012 forecasts, which were completed last fall, are on the pessimistic side given the pickup in the national economy which should have some positive spillover for the region.

However, jobs don't tell the entire story. Productivity in Connecticut and Massachusetts is forecast to continue to grow faster than the nation. This reflects the presence of high-value industries in the region (defense, high tech, etc) as well as a workforce that is better educated than the rest of the nation.

The greater the contribution of the productivity to the GDP, the higher the "quality" of that growth. This is "high quality" growth that sustains their high per capita income rankings. Both states are expected to continue to be affluent places to do business. I guess this just goes to show that there can still be life in the slow lane …

Regional Growth Comparisons
(ANNUAL % GROWTH 2011-15)

	JOBS	GDP	PROD
CT	0.6	2.3	1.0
MA	1.1	2.8	1.7
RI	1.6	2.2	0.5
U.S.	2.1	3.4	1.3

Source: NEEP and Economy.com

Current Job Conditions

	Unemployment Rate		Jobs			
	Peak	12/11	Lost in recession		Regained	Latest Growth*
	%		%	000s	%	%
Connecticut	9.2	8.2	7.0	119	29	0.6
Massachusetts	8.8	6.8	4.3	143	51	1.5
Rhode Island	11.5	10.8	8.2	40	1	0.4
United States	10.0	8.5	6.3	8,750	30	1.2

*June-Nov 2011 vs. June-Nov 2010

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