



### Improbability.

*A recent statistical study showed that celebrating birthdays is healthy. Those people who celebrate the most birthdays become the oldest.*

*All probabilities are really 50% ... either something happens, or it doesn't*

*Try this simple probability test: flip a coin, over and over again, calling out "Heads" or "Tails" after each flip. Half the time people will ask you to please stop.*

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

**Lotto and Other Long Shots:** After extensive – and erroneous – analysis, I did not win the lottery. However, a number of other long shots do seem to be paying off. The federal budget deficit is declining. And several notable economic laggards are showing signs of rebounding.

**Powerball.** I like figuring things out in my head, with a little help from my cell phone calculator. While waiting to order my sausage and mozzarella pizza at my favorite New Haven-area pizzeria, (name supplied upon request) I calculated which size was the best buy. I did this by comparing the area of the pizza (pi times the radius squared – pun intended) with each price to obtain the cost per square inch. Answer: large.

I then moved on to bigger things: the Powerball Lottery. I'd read that the odds of getting all six numbers right was 175 million-to-1! But the payoff recently went close to \$600 million. So far, this looks like a good bet but you have to make some adjustments. The \$600 million was the total paid out over 30 years. The lump sum payout option, which would be about \$375 million, approximates the "present value" of the prize. Then there are taxes. After paying them, the lump sum is about \$225 million which still seems like a good deal in terms of the odds of winning. So I bought a handful of "quick picks" at the local variety store, confident that this was a "no brainer." Even if I didn't win, I was at least making a rational economic/statistical decision.

However, as I got into my car, I realized that since each ticket cost \$2, the payoff per dollar was only half as large as the \$225. And by the time I pulled into my driveway, it occurred to me that I might have to share the top prize with one or more of the other people lined up at the variety store.

This was getting far too complicated for me so I searched the Internet and found that some statistician with far too much time on his hands had figured that I had paid \$2 for the prospect of winning only about \$0.75 – not a good bet at all. He also pointed out that if you have to drive a mile each way to buy the tickets, the odds of being killed in an auto accident were 6 times greater than those of winning the jackpot ...

**The Federal Deficit:** Who would have bet just a few short months ago that the Federal Deficit would be shrinking faster than practically anybody thought? It is falling so fast that the dreaded "debt ceiling" – which was supposed to be hit in May – has now been postponed to sometime in the fall.

The deficit, which had been running more than \$1 trillion during each of the past several fiscal years, is now projected to be a "mere" \$642 billion during the current fiscal year which ends September 30. Some of this improvement reflects lower spending as a result of the sequester and other actions. It also embodies higher revenues as businesses and individuals rushed to take income and dividends ahead of anticipated tax increases. There were also large dividend checks sent by Fannie Mae and Freddie Mac to the Treasury in partial repayment for the huge bailout by the government a few years ago.

---

*The deficit, which had been running more than \$1 trillion during each of the past several fiscal years, is now projected to be a "mere" \$642 billion during the current fiscal year ...*

---

What does this mean? The significantly lower deficit does take some of the pressure off Washington to make additional cuts. This might be a good thing if you are among those who feel that excessive budget tightness is holding economic growth back as evidenced by high unemployment.

Without further action, however, the improvement is largely temporary since the deficit is expected to rise again in a few years thanks largely to Social Security and Medicare costs.

The *deficit* is the annual amount the Treasury must borrow because spending exceeds revenues. As such, it is the annual increase in the amount of outstanding government debt – the total amount owed by the federal government. The smaller deficits mean that the debt will grow at a slower rate – but it will still grow.



Where do we stand relative to that 90-percent ratio of debt to GDP that is supposed to lead to slower economic growth? Right now, outstanding federal debt is around 75-percent of GDP and is expected to be stay above 70-percent but not get near 90-percent. Note: this is the “publicly held” portion that excludes debt owed by one federal entity to another. It does, however, include the debt held by China and the Federal Reserve.

Besides, it turns out that the authors of the influential study that linked debt levels to economic growth made some serious errors in their computations. Upon recalculating, high debt is not so bad after all. So I don't feel so bad about my Lotto faux pas.

---

*Right now, outstanding federal debt is around 75-percent of GDP and is expected to be stay above 70-percent but not get near 90-percent.*

---

**Abenomics:** Wanna place a “respectable” and fully legal bet? (And this has nothing to do with ‘Honest Abe Lincoln’ who seems to be everywhere these days). Then buy or sell a futures contract or an option! These allow you to bet on the future price of many things. Your home heating oil company most likely buys oil futures contracts for those who participate in the fixed price plan.

If you believe a stock is undervalued, you can buy an option that will lock in a purchase price today that will (hopefully) be lower than the price prevailing when the option expires. When the option matures, you can purchase the stock at the price agreed upon earlier and keep it or sell it for a nice profit.

If the bet turns out wrong, you have the option not to buy the stock. Your loss will be limited to the amount you had to pay for the option. If you'd bought options on the Japanese stock market in December, by May, you would have made a killing as the Japanese stock market had soared nearly 70-percent in a few months. (Maybe I should have done this instead of buying Powerball tickets.)

What's going on is that the new Prime Minister, Sinzo Abe, has really been shaking things up with huge amounts of fiscal and monetary stimulation, as well as deregulation. Japan has endured more than two decades of slow growth, deflation, and depressed asset prices. The Nikkei average of 225 major stocks, which peaked at 40,000 in 1990, was below 10,000 as recently as December. By mid-May it was hovering around 17,000! GDP growth has accelerated.

Abe, whose previous stint as Prime Minister was less than impressive, has moved quickly to pass his fiscal package. He has also replaced leaders of the Bank of Japan with officials willing to go all out with “quantitative easing.” By purchasing large quantities of securities, they hope to increase the inflation rate to 2-percent! Yes, to increase inflation in order to get out of the deflation quicksand. The stock market responded favorably and the resulting increase in wealth and confidence has helped stimulate all kinds of economic activity. As the normally staid *Economist* magazine pointed out, the prices and demand for certain services in Tokyo's red light district have been climbing!

Furthermore, the monetary stimulation and inflation prospects have weakened the yen – which is just what the Japanese economy needs! A weaker yen means stronger exports. But aren't these stronger exports at the expense of those areas whose currencies are strengthening vis-à-vis the yen? Yes, but only in a narrow minded view of things. A faster growing Japan will help stimulate world economic activity, starting with China and South Korea, but then pretty much permeating the globe. Moreover, those who don't like what Japan is doing to them might try emulating Japan! Europe, which is mired in recession, could benefit big time from adopting Abe-like fiscal and monetary stimulation. We wish Mr. Abe and Japan much luck. Here's hoping that their very big and bold bets pay off. If they win, we'll all share the prize money!

However, before you decide to bet the ranch on the Japanese recovery, you should be aware that stocks in Tokyo lost some ground after the big Abenomics rally. There is concern in Japan and elsewhere that monetary “shock therapy” may be losing its effectiveness. Hopefully, these worries are temporary with respect to Japan and much of the rest of the world.

**Ka-ching in New England?** Just when I was beginning to despair about Connecticut and Rhode Island, both states showed some signs of life in recent labor market reports. Now, it is still far too early to break open the champagne – maybe a Bud Lite or Diet Coke is more appropriate. But both states recorded sizeable job gains in the March-April period after seeming to run out of steam. Problem is, these monthly numbers are quite volatile and very conducive to manic-depressive assessments of the regional economy. We'll have to watch this very closely, so please keep your fingers and toes crossed and hope that the region is truly on a winning streak!

