Economic Review

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

Musings & Amusings: *European Vacation*

Clark (in London): There's Buckingham Palace where the Queen lives and works.
Daughter: What does she do, Dad?
Clark: She queens. And she vacuums.

Clark (in Paris): There's the Left Bank, kids. I bet you can't guess what bank is on the right?
Son: Bank of America?

Wife (in London): Clark, you're on the wrong side of the road!
Clark: Yes, I know, Honey. I'm also on the wrong side of the car.

European Vacation. Europe has always fascinated me. I've been there more than a dozen times, including a couple of trips with my kids. They've said that travelling with me is like being with Chevy Chase (Clark Griswold) in the movie *European Vacation*.

Although not a great movie, it has some very funny moments. A favorite is when Chevy backs his car into one of those huge pillars at Stonehenge and then drives off oblivious to the fact that he has caused the ancient structure to collapse in domino fashion behind him.

I guess that segues to a discussion of the European economy. It certainly did not fall like the Roman Empire, although there were fears that Greece would implode and the Euro would collapse. Europe is in the midst of a recovery that is even slower than the United States'.

For perspective, the table shows Gross Domestic Product (GDP) for a number of European nations, with a few extras for comparison. The U.S. is the world's largest economy by a wide margin, followed by China and Japan. Global GDP is about $80 trillion so that the top three account for 35 percent of world output.

The GDP for the entire European Union (EU) is just a tad smaller than the U.S. The EU is an economic and political union of 28 countries. It includes the 15 nation Euro zone plus others with their own currencies such as the United Kingdom, Sweden, and Switzerland. Its predecessor was the European Common Market.

European unemployment ranges from 3 percent in Switzerland to 25 percent in Spain, with an average of 12 percent for the Euro zone compared to 6 percent in the United States. Inflation is very low. Consumer prices rose only 0.5 percent during the past 12 months compared with 2 percent in the United States. Fears of imminent deflation and a replay of Japan's long malaise have replaced worries about a breakup of the Euro.

The risk of deflation is large enough that the European Central Bank (ECB), which sets Euro zone monetary policy, has recently introduced *negative interest rates*. (The other EU members have their own central banks such as the Bank of England). Usually, central banks *pay* interest on excess reserves they hold for member banks. (Excess reserves are above those required to cover consumer and business deposits). The ECB is *charging banks a fee* on excess reserves to encourage lending. In a recent blog, I jokingly suggested that one way to have negative interest rates is for banks to require depositors to bring them a toaster for taking their deposits. This is Perna's Reverse Toaster program!

Let's take a quick look at some of the European nations. This will be a bit like one of those week-long tours where you get to visit a different country every day... maybe two if you're lucky.

Starting in the West, the UK is doing fairly well, partly because it did not adopt the Euro currency and has thus been able to pursue more flexible policies.

In September, Scotland will vote on whether to become independent of England. Right now, the Scots have about the same type of authority as a Canadian province or U.S. state. Monetary and budget policies are made in London. The Scottish currency is really the English pound sterling in disguise. Private banks can issue currency provided it is backed 100 percent by official British pounds. Whether the Scots will vote for independence, and what it might mean, remain to be seen.

Although GDP growth is modest, Germany is doing well. Germany really didn't have much of a budget deficit problem, so it wasn't hurt by the budget austerity programs that were the bane of other Euro nations. Exports have been quite good, partly because the problems in other countries have weakened the Euro

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enough to make Germany's efficient industries even more competitive. I got a chuckle from a recent article in the *Economist* magazine that courses in humor are being offered in Germany. It seems that Germans have a hard time telling, or taking, a joke...

Most other northern European countries are performing well even though they do not use the Euro: Denmark, Norway, Sweden, and Switzerland. Maybe, like England, this is because they have not adopted the Euro.

Southern Europe is still a mess. Unemployment is 25 percent in Spain and Greece, 15 percent in Portugal, 12 percent in Italy, and 10 percent in France. What these nations have in common – in addition to good food – is that they were hit hardest by the austerity policies used to deal with the European version of the Great Recession.

After causing a financial panic by defaulting on its sovereign debt in 1998, Russia had been doing rather well. It was helped by the movement from notoriously inefficient state-run factories to more productive enterprises run by notoriously powerful oligarchs. Russia has also benefitted from the boom in oil and gas prices.

Putin's invasion of Ukraine adds considerable uncertainty to the outlook for all of Europe because of Russia's importance as a trading partner and supplier of energy. I think that one reason why Putin invaded Ukraine was to divert attention from the economic slowdown that was already underway. The situation should be resolved in the not too distant future because Russia and the rest of Europe have too much to lose if it is not.

Looking back, there was no way that Europe could have avoided the financial collapse of a few years ago and the recession that followed. However, a much better job could have been done in dealing with the ensuing problems. Banks were in trouble and many national budgets were in deep deficit, but there was no reason why unemployment had to go to levels not seen since the Great Depression. Excessive budget austerity and overly tight monetary policy made a bad situation worse.

Now back to the New World. I recently came across some interesting data on regional GDP. These are available in *current* and *constant* (2009) dollars. If someone asks, 'How big is the Connecticut economy?', use the current dollar number and say, 'Connecticut's GDP is $249 billion.' However, in order to calculate how fast the economy is growing, you use the constant dollars which are adjusted for inflation. By the way, New England's GDP (current dollar) was $901 billion in 2013 – about one-third the size of "Old" England and around 65 percent as large as Canada. The large New York economy is about the same size as Spain's. Rhode Island's is similar in size to Luxembourg.

In terms of growth, all Northeast states lagged the national average of 1.8 percent last year. Interestingly, Connecticut was not – as commonly cited – dead last. That honor goes to Alaska (I shall refrain from any Sarah Palin comments). Also very interesting is New Hampshire's finishing just behind Connecticut. Most people would have said that New Hampshire was one of the fastest growing states in the country! North Dakota was first and Wyoming second. It really pays to be able to extract oil and gas.

Looking ahead, I would expect the states in our region to catch up a bit and reduce the gap vis-à-vis the nation. However, the rankings probably won't change a lot.

Final thought: Wouldn't it be a hoot for Chevy Chase and Beverly D'Angelo to make a sequel? A working title might be *Senior Citizen New England Staycation*.

INTERNATIONAL ECONOMIC INDICATORS

	GDP 2013 Current $	Unemployment % 2014	Real GDP Growth % 2013	2014	2015
United Kingdom	2,536	6.6	1.8	3.0	2.6
France	2,737	10.4	0.3	0.8	1.3
Germany	3,636	6.7	0.5	2.0	2.0
Greece	242	26.6	-3.9	0	2.3
Italy	2,072	12.6	-1.9	0.3	1.0
Russia	2,118	5.3	1.3	0.5	1.3
Spain	1,359	25.1	-1.2	0.9	0.4
Switzerland	651	3.2	2.0	2.0	2.2
United States	16,701	6.3	1.9	2.3	3.0
China	9,181	4.1	7.7	7.3	7.0
Japan	4,902	3.6	1.5	1.4	1.3

**most recent month*

GDP BY STATE 2013

	Current $ (Billions)	Real % change vs. 2012	Rank
Connecticut	249	0.9	39
Massachusetts	446	1.6	28
Rhode Island	53	1.4	33
New York	1,311	0.7	46
United States	16,701	1.8	
New England	901	1.3	

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