Economic Review

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

Musings & Amusings: *Third grade weather jokes:*

Q: What happens when fog lifts in California? — *A: UCLA!*

Q: What did one hurricane say to the other hurricane? — *A: I have my eye on you!*

Q: What did the tornado say to the sports car? — *A: Want to go for a spin?*

Hurricane Season. I often feel a bit uneasy this time of year. Summer is over, with its wonderfully relaxed tempo, and it's back to school and work. And along the shore, we start worrying about hurricanes. Most of the "biggies" seem to have hit around September and October, even though the storm season officially starts in June. The Great Hurricane of 1938 arrived September 21 and Sandy on October 29.

Now, I'm certainly not about to claim that a big economic storm is heading our way. Rather, there seem to be some interesting parallels between meteorology and economics. In fact, I've often thought that I might have become a meteorologist instead of an economist. (Hmmm... Nick Perna, AMS instead of Nick Perna, Ph.D. Maybe both? I digress...)

All hurricanes get their start in the warm waters near the equator. When their winds reach a certain speed, they become tropical depressions, then tropical storms and, finally, hurricanes. Most that threaten the East Coast fizzle or miss us. Under the right conditions, a few move up the East Coast or head towards the Gulf of Mexico (Katrina) leaving misery in their wake. By the way, on the West Coast, hurricanes are called typhoons. In Australia, they're called cyclones.

A unique (we hope) set of circumstances spawned the Hurricane of 1938 that devastated much of New England and Long Island. The most unusual feature of this storm with no name (the Weather Bureau didn't start naming them until the 1950s) was that it didn't make landfall until Long Island. Hence, it grew in fury as it moved over open water instead of losing momentum by coming ashore in Florida or the Carolinas like most storms. Two other weather systems, one to each side of the storm, kept it from making landfall until New York.

The 1938 storm was the fastest moving hurricane ever recorded and was moving 50 miles per hour when it touched land – which is 3 to 4 times faster than a normal storm. At times, it had been clocked at 70 mph! Thus, its 120 mph winds felt much stronger. The disaster was amplified by a storm surge that reached 20 feet in some places – about double Sandy's 2012 surge.

Finally, there was little warning that disaster was on the way. There was no radar, and tracking reports relied on sporadic observations from ships at sea. Supposedly, one neophyte government meteorologist warned that this would be a really big one, but his call was overruled by more senior folk.

Economic Climate. OK, so what's this got to do with the economy? Conditions are currently quite good in the United States but a bunch of tropical depressions could mess things up. (The weather was beautiful in the hours before the 1938 storm struck. Katharine Hepburn played golf and went for a swim before the fury roared across Long Island Sound).

Real Gross Domestic Product (GDP) has been unusually volatile so far this year, mostly as a result of some severe winter weather. However, we seem to be currently growing at close to a 3 percent annual rate, which is rather decent, especially compared with contractions in Europe and major portions of Latin America.

Inflation is still quite modest even though rising food and energy costs have pushed the Consumer Price Index towards 2 percent.

Unemployment has fallen to 6 percent from a peak of 10 percent five years ago. However, this may not be as good as it first seems. Many people have stopped looking for work and an unusually large proportion of those who continue to search have been out of work for a long time.

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Unemployment is becoming increasingly structural or permanent in nature. Further evidence of this is the existence of a large number of job vacancies alongside a large number of unemployed people. Perhaps the situation is similar to global warming where lack of rain in the West, and blistering summer heat in the Northeast, may be more permanent features.

What's the outlook for the economic climate? The consensus for the next couple of years is for 3 percent GDP gains, 2 percent inflation, and a further decline in the unemployment rate to about 5.5 percent. The Federal Reserve is predicted to start raising short-term interest rates by next summer. Bond yields, which are less than 2.5 percent today for the 10-year Treasury note, are forecast to hit 3¾ percent by the end of next year.

But suppose some of those "tropical depressions" around the globe grow into "hurricanes" or "cyclones" or whatever. Right now, there are a number of storms brewing. Europe dropped back into recession around the middle of the year. France and Italy are still being pulled under by the tide of austerity measures introduced in recent years. Germany is being hurt by the problems of its neighbors. All are feeling the effects of Russia's recession and Ukraine's chaos. And deflation – not inflation – has become a real threat.

Russia will probably prevail and keep the Crimea and other portions of Ukraine under its influence. Western Europeans are afraid to push Putin too hard because he might restrict natural gas exports in the coming winter and because they would feel the effects of a deeper Russian slowdown brought on by stricter sanctions.

In Latin America, Brazil is in a slump following the disappointing World Cup soccer outcome. Inflation is getting worse and so are the budget deficits. Argentina has gone into default for the second time in 12 years over a legal battle with some hedge funds that bought the distressed debt on the cheap. Hopefully, this is an isolated disturbance, but one never knows with global financial markets.

The Middle East is always a hot spot, but the temperature seems especially torrid at the present time. One of my fears is that the increasingly aggressive and sophisticated terrorists will be able to interrupt oil supplies, thereby letting loose waves of inflation and clouds of uncertainty.

In the United States, a storm is brewing over the proper stance of Federal Reserve policy. Several members of the Fed are arguing that interest rates must rise sooner rather than later to avoid a build-up of inflationary pressures. Although in the minority at the Fed, they do have vocal supporters in Congress and the media. The danger is that financial markets could overreact to tightening by the Fed and push bond yields up faster than is warranted. This would almost certainly sink the equity and housing markets.

The Region. We can think of the Great Recession of 2008-2009 as a category 5 hurricane that affected the entire United States. The first column of the Regional Jobs table shows the current economic climate as measured by recent job growth in Boston and metro New York City are currently keeping up with the nation. Rhode Island and Connecticut are lagging.

The second column shows how much "storm damage" has been repaired by comparing the latest jobs counts with the levels just before the recession hit. The U.S. has regained all of the 8 million lost jobs plus a few more. Boston and metro NYC have done much better, with jobs well above the pre-recession peaks. This reflects the facts that their downturns were milder and their recoveries were better than elsewhere. The opposite is true for Connecticut and Rhode Island. "Little Rhody" had one of the worst downturns in the nation and its recovery started off very slow but has been gaining momentum. Connecticut had a more average downturn that was followed initially by a decent expansion which has since lost steam.

Keep your fingers crossed and hope that the economic climate continues to improve and those "tropical depressions" simply peter out. Ironically, as I'm writing this, a hurricane is moving up the Eastern Seaboard. Forecasters say it will move out to sea, but meteorologists aren't much better than economists when it comes to predicting the future…

REGIONAL JOBS JULY 2014

	% change from July '13	% above or below peak
Connecticut	0.6	-2.5
Massachusetts	2.0	2.9
Boston	2.2	4.2
Rhode Island	1.2	-3.6
Metro New York City	2.2	5.0
United States	1.9	0.5

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