Economic Review

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

***A Note from Nick:** Immediately after I sent this to the editors, global stock markets swooned! The Dow Jones average lost almost 15 percent of its value from the highs earlier in the year through late August. Then they rebounded. It's premature to guess what this might mean for the economy without seeing whether stocks will decline a lot more or rally.*

Even really big stock market declines don't necessarily signal a recession. In October 1987, the Dow plunged 23 percent in a single day, bringing the drop over the previous couple of weeks to more than 30 percent. However, the economy hardly skipped a beat and didn't go into recession until 1990. And I think that contraction had more to do with Saddam Hussein's invasion of Kuwait than "Black Monday" 28 years ago.

Mezza Mezza Recovery: There are many ways to describe current economic conditions: *mezza mezza*, *mediocre* and *meh*. And that's just the m-words! My Dad would often say "mezza mezza" when he meant "so so" or "not so hot." Literally, this translates to "half and half" and is a pretty good description of the economy where some indicators are doing well, while others languish.

Home sales have picked up but are still sluggish. Sure, interest rates are low but loan terms are still restrictive. Car sales are very strong thanks to replacement demand and cheap gas. Credit is readily available and buyers are more willing to plunk down $25,000 for a new set of wheels than $250,000 for a new home – especially when renting is a reasonable alternative.

Real Gross Domestic Product (GDP) growth continues to disappoint as it has for most of the time since the "Great Recession" ended. This rebound has been the slowest since World War II even though the recession was the worst. GDP is now only nine percent above the pre-recession peak of late 2007. It should have grown at least twice as much. In Europe, GDP is still three percent *below* the previous peak.

However, jobs have been rising rapidly, close to 250,000 per month over the past year. The unemployment rate has fallen about a point to 5.3 percent. And only a small portion of that decline reflects people dropping out of the workforce.

Slow GDP alongside fairly rapid job growth is worrisome. Most likely it reflects slow productivity growth, which has negative consequences for costs, profits, and even living standards.

Some argue that GDP is understated by things like the rapid spread of smart phones and "free" social media. However, be careful: I don't pay to use Facebook, but advertisers do. (Actually, Facebook should *pay me* for having to put up with all those silly dog photos and extremely annoying political rants!) While there's some merit to the understatement thesis, I think we are, unfortunately, reverting to slower secular rates of productivity improvement.

Inflation has been very tame. During the past year, the CPI (Consumer Price Index) has barely risen thanks to plummeting energy prices. Excluding energy, the CPI rose less than two percent. The Federal Reserve has expressed concern that inflation might be too low, increasing the risk of deflation. The Fed has also been worried about the very slow growth of wages as discussed below.

Conditions outside the United States are at best "comme ci, come ca" or luke warm and probably not even that good. The latest debt agreement will put the Greek economy into recession for at least another two years and further reduce their ability to repay. Elsewhere in Europe, economic growth is soft. Russia is still stuck in recession thanks to plunging oil prices and Putin's pigheadedness. As Yogi Berra famously said, "It ain't over 'til it's over."

Concern is spreading about China. GDP growth has slowed substantially. Equities and real estate have both tanked. Surprisingly, China has allowed its currency to devalue. There are doubts that Chinese leaders possess the skills needed to manage the situation. However, they have lots of policy options and few political limitations. Even lousy marksmen can hit the target if they have enough ammunition.

Mediocre Wages: You know we must live in interesting times when the Federal Reserve complains that wages aren't rising fast enough!

The most familiar measure, average hourly earnings, has risen about two percent. Compensation per hour is a better indicator since it is more inclusive and not affected by shifts in mix between higher and lower paid workers. Even so, it shows the same thing.

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WAGES (% CHANGE FROM A YEAR AGO)

	2015	
	Q2	July
Average hourly earnings	2.2	2.1
Compensation per hour	2.0	
Wages & Salaries	2.1	
Benefits	1.8	
Wages & Salary Payments	4.2	
Nonfarm Employment	2.1	
CPI	1.1	0.2

Shouldn't Chairman Janet Yellen be warning about inflation if wages rise faster? Perhaps eventually, but right now slow wage growth poses a number of problems. Since some upper incomes are increasing rapidly, it aggravates income inequality. However, the Fed's primary concern is that inadequate wage growth could undermine the moderate recovery currently underway.

This becomes clear by examining wage and salary payments, which are the total dollars paid out to workers. These payments are the largest contributor to consumer purchasing power and have increased by four percent in the past year, which is quite decent compared to the zero percent rise in the CPI!

The problem is that this just isn't sustainable. Most forecasters, the Fed included, expect the CPI to start rising about two percent some time during the coming year or so as oil prices stop falling. Since the CPI excluding energy rose 1.8 percent, it is quite easy for the overall index to hit two percent. And unless wages accelerate, this would cut the "real" gain in half.

Furthermore, those rapid employment gains will probably start slowing as labor markets tighten further. The growth of wage and salary payments is approximately equal to the rise in average hourly earnings and employment. As the table shows, jobs have been providing half the rise of wage and salary payments.

Some folks say things aren't as bad as they look. Much of the wage slowdown is because the number of lower paid jobs is rising faster than the number of higher paid positions. Well, that might explain average hourly earnings, but the Employment Cost Index is constructed to avoid exactly this problem.

Maybe labor markets aren't as tight as suggested by the overall unemployment rate which is now close five percent. The numbers of long term unemployed and those working part-time who want full time work are still fairly high. And there are lots of labor force dropouts sitting on the sidelines who might be holding wages down.

Janet Yellen has spoken of "pent-up wage deflation" where many employers may have wanted to cut wages during the recession but didn't or couldn't. This may mean they can now hire without having to raise pay scales.

Since we really don't know why, the best we can do is hope that the pace of pay gains will pick up. The recent spate of minimum wage law increases by state and local governments should provide some assistance as should announcements of pay hikes by a number of large businesses.

The Region: Enough of this so-so stuff! I was asked recently how big the Connecticut economy is. My answer appears in the table in terms of GDP and jobs for our region plus several comparisons. GDP measures the value of total output of goods and services produced within an area's borders. Payroll jobs exclude farm workers and self-employed folks whose output is included in GDP. These omissions are not very important in making rough comparisons.

Massachusetts is the largest economy in New England. It has it has twice as many jobs as Connecticut, but its GDP is only two-thirds bigger. That's because Connecticut has higher GDP per worker, which helps explain why it has higher per capita income than Massachusetts and all the other states.

Metro New York not only covers the "Big Apple" but also the nearby suburbs, including eastern New Jersey and southwestern Connecticut. When I was growing up in Stamford, I felt much more like a New Yorker than a Nutmegger. My Dad bought the New York newspapers and we watched the New York TV stations. One Connecticut state politician claimed that a constituent once asked if she minded driving to Albany every day. I'm certain the story is apocryphal but it does get the point across. Interestingly, Fairfield County is not in the First Federal Reserve District with the rest of New England. Instead, it is part of the New York District.

As big as Metro New York is, it is dwarfed by California. If California was a nation, it would have the eighth largest economy in the world! It is eight to nine times bigger than Connecticut depending on whether we use GDP or jobs as the yardstick.

So So long.

REGIONAL ECONOMIES: 2014

	GDP*	Jobs**
Connecticut	253	1.7
Massachusetts	425	3.4
Rhode Island	51	0.5
Metro New York	974	6.5
United States	15,774	139.0
California	2,113	15.6

** Billion 2009 ** Non-farm payrolls percent change*

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