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America's economy in the European mirror

Paul Krugman

Last week Eurostat, the European Union's statistical agency, released a revised estimate of the euro area's February inflation rate. It wasn't a happy report: Consumer prices were up 5.9 percent from a year earlier, more than most analysts had expected. And it's going to get worse, as the effects of the Ukraine war weigh on food and energy prices.

Britain hasn't yet released its February inflation number, but the Bank of England expects it to match the rate in the euro area.

Of course, U.S. inflation is even higher, with February consumer prices up 7.9 percent from a year earlier. These numbers aren't exactly comparable, for technical reasons, but inflation in the U.S. does seem to be running around two percentage points higher than in Europe. I'll come back to that difference and what might explain it. But surely the fact that inflation is up a lot in many countries, not just America, is worth noting.

After all, the entire Republican Party and a fair number of conservative Democrats insist that the recent surge in U.S. inflation was caused by President Biden's big spending policies. Europe, however, had nothing comparable to Biden's American Rescue Plan; last year the euro area's structural budget deficit, a standard measure of fiscal stimulus, was only about a third as large, as a percentage of G.D.P., as America's.

So why is inflation up in Europe?

Part of the answer is rising energy prices. Last week I noted that Kevin McCarthy, the Republican House minority leader, has declared that gasoline prices "are not Putin gas prices. They are President Biden gas prices." Let me elaborate on the absurdity of that claim, using British data.

In late December 2020 gasoline in Britain cost 116 pence per liter — $5.94 a gallon. By mid-March that was up to $8.23 a gallon. Over the same period U.S. gas prices rose from $2.24 to $4.32. Taking Britain's high gas taxes into account, the price increases were similar, even though Joe Biden is not, as far as I know, the British prime minister.

But it's not just energy prices. U.S. inflation has been driven up in part by pervasive supply-chain problems, with a big shift of demand toward goods straining ports, shipping capacity and more; these same strains, which have lasted much longer than many of us expected, have afflicted Europe, too.

What spiking inflation Over There tells us about policy here.

So what does high inflation in Europe tell us? First, that a large part — maybe two-thirds — of the acceleration in U.S. inflation reflects global forces rather than specifically American policies and developments. Second, because these global forces may abate if we finally emerge from this dark tunnel of pandemic and war, U.S. inflation may eventually decline substantially even without drastic changes in policy. (Notice how I avoided using the word "transitory"? Oh, wait.)

That said, inflation is running hotter on this side of the Atlantic. Why? One main factor, almost surely, is that the economy of the United States has recovered faster than that of Europe. In the fourth quarter of 2021 real gross domestic product in the U.S. was 3 percent larger than it had been before the pandemic, while the euro area had barely recovered its losses. And in case you're wondering, you don't need to discount those numbers for faster U.S. population growth; our working-age population has in fact stagnated since 2019, largely thanks to a collapse in immigration.

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And U.S. economic growth has helped workers as well as G.D.P. Although hourly real wages have been eroded by inflation, total labor compensation is up 13.6 percent since the eve of the pandemic, compared with only 5.2 percent in Europe.

Now, excess inflation suggests that recent U.S. economic growth has been too much of a good thing. Our economy looks clearly overheated, which is why the Federal Reserve is right to have started raising interest rates and should keep doing it until inflation subsides.

But while overheating is a problem, we shouldn't let it overshadow the good things that have happened. We recovered fast from the pandemic recession and seem to have avoided the long-term "scarring" effects that many feared. Most though not all of the inflation we're experiencing reflects probably temporary global forces, and multiple indicators — consumer surveys, professional forecasters and financial markets — suggest that longer-term expectations of inflation remain "anchored," that is, inflation isn't getting entrenched in the economy.

There's still the question of why Americans feel so lousy about the economy, or at least tell pollsters that they feel lousy (they're spending as if they're optimistic). We're not unique in this respect: European consumer sentiment has also taken a hit in the face of inflation, although nothing like the plunge we've seen here. But that's a topic I'll return to another day.

For now, I'd just urge Americans to look at their economy in the European mirror. Recovering from the pandemic was always going to be tough, and Vladimir Putin has made it tougher. But under the circumstances, we're actually doing relatively OK.