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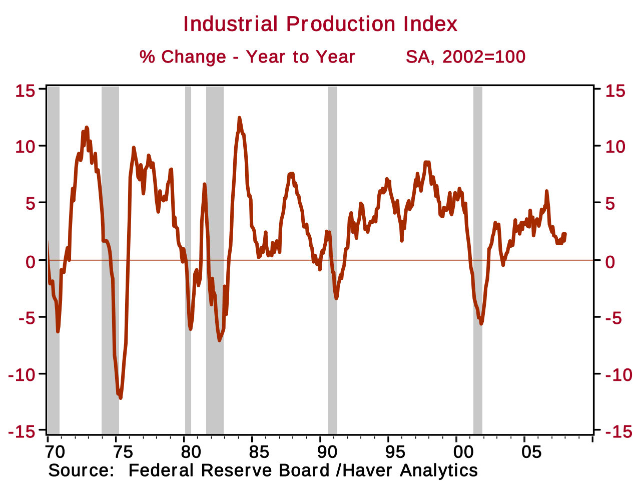
Recession Talk Premature

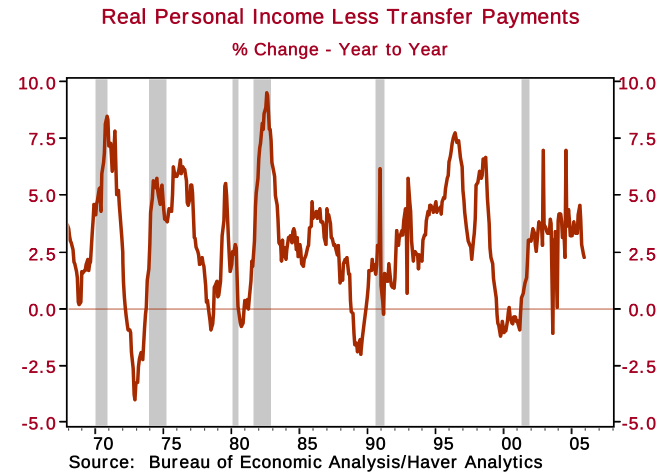
Most people describe a recession as two consecutive quarters of negative real GDP growth. But it's not really that simple. According to the National Bureau of Economic Research (NBER), a recession is a "significant decline in economic activity spread across the economy, lasting more than a few months." To be a recession, a decline in economic activity has to affect the broad economy, not just one sector.

The NBER – an economic research organization affiliated with Harvard University – has been considered the "official" arbiter of when recessions begin and end since the early 1960s. The NBER's Business Cycle Dating Committee consists of seven prominent and widely respected economists who ultimately make the decision about when recessions start and end (see gray shading in charts).



To assess whether the broad US economy is expanding or contracting the Committee watches four key pieces of economic data. These include real, or inflation-adjusted, personal income excluding transfer payments, real total sales (at retailers, manufacturers, and wholesalers), employment, and industrial production.

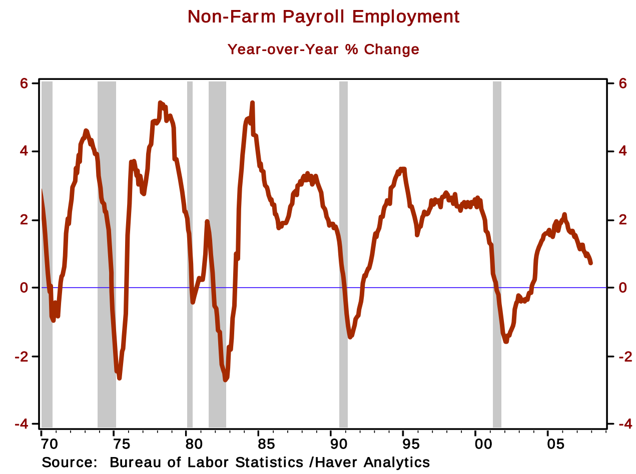
The Committee is careful with its credibility, prides itself on an unemotional analysis of the facts and is keenly aware that economic data is often revised significantly. As a result, a downturn is typically well underway before the NBER begins to "officially" call it a recession.



The key data included in the four charts imbedded in this piece make it clear that talk of recession is premature. In fact, despite some wobbly data, a recession remains highly unlikely. Tax rates are relatively low, monetary policy has yet to get tight during the economic expansion that started in late 2001, and the US has not increased barriers to international trade.

The kinds of imbalances in the business sector that usually precede recessions are simply not present. Inventory-to-sales ratios are very thin and businesses have invested the smallest share of profits since the 1960s (indicating the lack of an overhang in capacity, such as in the late 1990s). In addition, there is no evidence that businesses have hired too many workers: the labor compensation share of GDP remains relatively low.

While there have been fears that fourth quarter GDP data would be revised to show negative growth, it now looks like Q4 will be revised slightly up. Inventories were the big downward surprise in the fourth quarter. Without them, real final sales (GDP, excluding inventories) grew at a 1.9 annual rate in Q4. This reflects a continued solid underpinning of demand by both consumers and businesses.



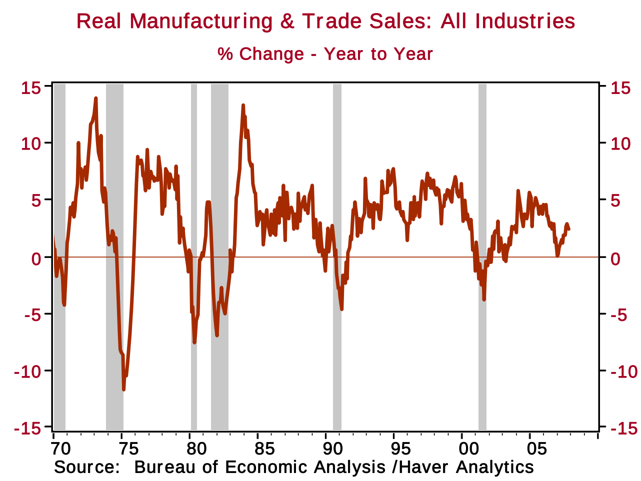
And early data for the first quarter of 2008 suggests that real GDP will grow at a 2.5% annual rate, and be 2.9% above its level in Q1-2007.

Looking closely at the charts included in this piece reveals some moderation, but the year-over-year percent changes are all still positive and well above levels associated with previous recessions.

Personal income data looks little different than it has for the past five years. There has been a recent dip in real incomes, as rising oil prices in the near-term push up the inflation adjustment, but once oil prices stabilize this will reverse. Nominal income trends remain strong.

Real manufacturing and trade sales are also rebounding after showing slower growth in late 2006 and early 2007, while the same is true for industrial production. Employment clearly reflects a slowdown, but this is easily understood because of the massive drop in housing activity. Nonetheless, job growth is still occurring in the other 95% of the economy.

If anything, recent data resembles what have been called in the past – "mid-course corrections." In the mid-1980s and mid-1990s, a pause or hesitation seems to have occurred, and it may be that this is happening again today.



None of this is an attempt to say that a recession is impossible. Recessions are always possible. But neither the policy pre-conditions, nor the data, suggest we are anywhere near a recession today. Current fears of a recession are premature.

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