# *PERSONALLY SPEAKING*

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## IS THE U.S. ECONOMY HEADED TOWARD RECESSION?

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**The U.S. economy most definitely will experience a recession. The Federal Reserve Board of Governors knows this, the President's Council of Economic Advisors knows this, the Congressional Joint Economic Committee knows this, the U.S. Treasury Department knows this, and so do virtually all economic analysts. The problem is not *if* a recession is coming -- a market economy is characterized by cycles of expansion and contraction – but *when* and *how severe*. Sadly, neither the Federal Reserve, Council of Economic Advisers, Joint Economic Committee, U.S. Treasury, or anyone else knows with certainty *when* or *how severe*. Like the weather, the economy is a very complex system which makes forecasting very difficult and filled with uncertainties. In December the Federal Open Market Committee pointed out the "uncertainty surrounding the outlook for economic growth and inflation."**

**The reasons are several and in dispute by economists. Consequently, there is no universal agreement as to how to prevent a recession from occurring in the immediate future or how best to respond to one that is taking place at the moment. In general, however, there are three basic strategies available: deal with it through increased government spending or lower taxes even at the risk of aggravating the federal budget deficit; address it by expanding the money supply and lowering interest rates even at the risk of worsening inflationary pressures; let the markets sort out the problem even at the risk that they may stumble in the face of conditions beyond their control and many Americans may suffer additionally until Congress and the president or the central bank finally intervene. In short, fiscal policy, monetary policy, or simply *laissez-faire*.**

**The problem extends beyond what causes a recession, how to prevent it from happening, and how to respond to it when it occurs. First, the Business Cycle Dating Committee of the National Bureau of Economic Research defines a recession as a period of diminishing economic activity in which real gross domestic product is the best single measure of that activity. GDP is an estimate of the value of the goods and services produced by all companies operating in the United States whether those companies are U.S. owned or foreign owned. Real or constant-dollar GDP refers to estimated GDP in which a special price index is used to remove the influence of changing prices over time.**

**GDP estimates derive from a quarterly survey of employers and are released to the public in advance form based on incomplete source data one month after the close of the quarter and in preliminary form and final form based on more detailed and comprehensive data two months and three months later. Thus, real GDP data in final form for fourth quarter**

**2007, for example, will not be available until March 2008. If one suspects that a recession is underway in October, that suspicion cannot be confirmed with GDP data until March. Even if economic analysts agreed fully on what causes a recession, the GDP data are not available in timely enough fashion to help policymakers prevent it from occurring.**

**For years a recession was defined as two consecutive quarters of declining GDP. Notice how this definition makes it even more difficult to intervene in a timely manner. If a recession begins in January one cannot confirm it until the following September.**

**Second, in addition to GDP data, the Business Cycle Dating Committee uses estimates of employment, sales, personal income, and industrial production. These estimates are not cranked into a formula that yields a definitive answer regarding the course of the economy. Instead a seven-member committee considers and weighs the data and reaches a consensus judgment regarding the start of a recession. The Committee announces its consensus to the public anywhere from six to eighteen months after the start of a recession. Since WW II, the average duration of recessions has been eleven months. It follows that the Committee's consensus on the start of a recession often is reached after the economy has reached a trough and has begun recovering.**

**Thus, economic analysts, government officials, and the general public at times are left to their own devices regarding the start of a recession. Clearly, accurate information that is available in timely fashion is a critical consideration. Mayo Research Institute recommends using seasonally-adjusted estimates of employment and unemployment both of which are available on a monthly basis and released to the public on the first Friday of the month following the month in which they were collected.**

**Employment data are obtained from two sources: the household survey and the payroll survey. Our preference is the data drawn from the monthly household survey because it counts the number of *persons* employed whereas the payroll survey counts the number of *jobs*. The two figures diverge for a number of reasons including the fact that some workers are multiple jobholders. The unemployment estimate is a count of the number of persons who are not working, looking for work, able to work, and available for work. The Institute includes in its unemployment estimate a count of the number of discouraged workers who are not working, able and available for work, but not looking for work. These persons are not included in the official unemployment estimate.**

**One important reason for selecting these two data sets is that they define recession not in terms of things such as sales, GDP, or industrial output but in terms of human well-being. Work has a powerful impact on the person who works not only in terms of income earned but also regarding a personal sense of belonging that working in the company of others engenders and the opportunities the workplace affords to utilize a person's creative talents and energies. Unemployment, especially long-term unemployment, strips away those beneficial effects.**

**The Institute recommends interpreting these two data sets as follows. The economy has entered a Stage I recession when the number of persons employed has been falling and the**

**number of persons unemployed (including discouraged workers) has been rising for three consecutive months. It has entered a Stage II recession if that trend continues into a fourth consecutive month. According to official estimates for 2007 the U.S. has not entered Stage I. However, these data are disquieting for two reasons. First, comparing month-to-month change, unemployment (not including discouraged workers) was higher in eight of the last twelve months and employment was lower in seven of the last twelve months. Second, by far the largest monthly increase in unemployment in 2007 occurred between November and December when the number of unemployed persons rose by 475,000.**

**Intervention in the U.S. economy is called for only when Stage II has been entered or the unemployment rate (including discouraged workers) reaches six percent or higher. This recommended interpretation is less than ideal but is timely, workable, and helpful to policymakers in preventing an economic "soft-landing" from turning into a "crash."**

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