Forbes.com

Capital

A Rocky Recovery

Thomas F. Cooley and Peter Rupert 05.05.10, 6:00 AM ET

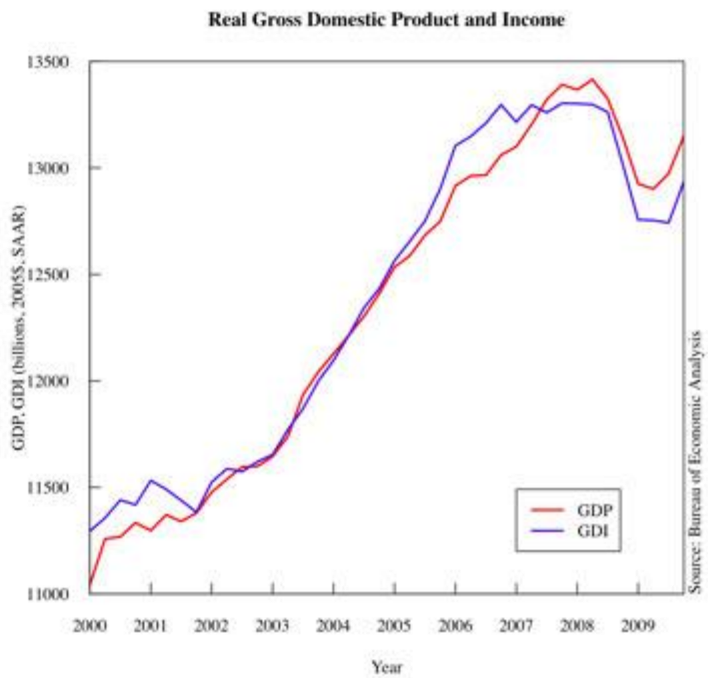
The Business Cycle Dating Committee of the National Bureau of Economic Research identifies the dates at which recessions begin and end. At its most recent meeting on Apr. 12th the committee declined to declare an end to the current recession. This surprised some since gross domestic product rebounded strongly in the last quarter of 2009 and seemed strong through the first months of 2010. It prompted a somewhat public spat when one of its members, Robert Gordon, declared in the *Wall Street Journal*, "It is obvious that the recession is over."

Since dating business cycles is a retrospective exercise, there is not a lot riding on the uncertainty about whether the recession has really ended. Nevertheless it is worth considering whether the NBER committee demurred out of an excess of caution or because of continuing sizable risks to economic recovery. As of Apr. 30 we have new data to consider with the preliminary estimates of GDP and its components for the first quarter of 2010.

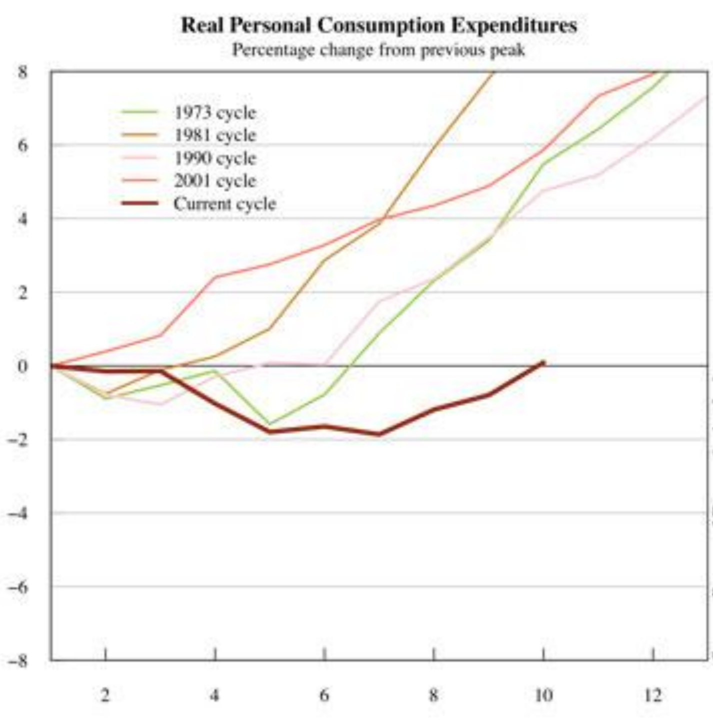
As we have in the past, we present the most up-to-date data in a way that contrasts the current recession and recovery with previous downturns. This gives a good visual representation of the progress of the recovery.

The latest GDP report suggests that the economic recovery is well under way and it is unlikely that we will slide back into recession in 2010. Real GDP increased at a rate of 3.24%. Normally after a sharp, deep downturn like the one just experienced we expect to see a vigorous recovery (a nice comparison of recessions and recoveries can be found here). That is not what we are seeing now, so let's look at the details.

Evidently the behavior of gross domestic income (GDI) played a role in Robert Gordon's pronouncement about the recession. Basically, GDI is just the income-side measure of GDP. (A useful discussion can be found here.) The bottom line is that when GDI and GDP diverge as they have in this recession (theoretically they are supposed to be equal) it is GDP that gets revised. So although GDI has just shown an uptick, it also points to the fact that the recession was deeper and the recovery much less pronounced than the GDP data would indicate. The figure below makes this clear.

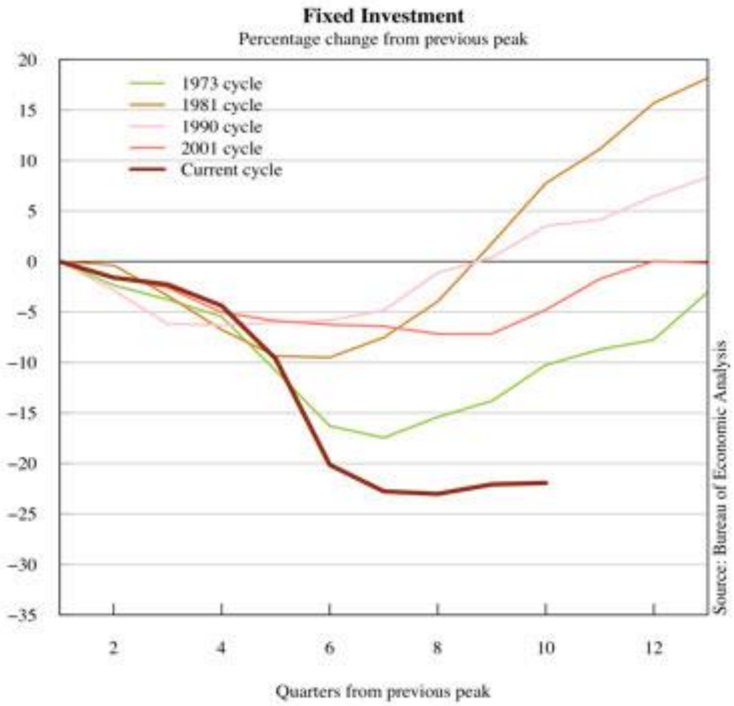


We now describe other data that show the rocky path of this recovery. The first figure below shows the time path of consumption since the beginning of the downturn. It also shows the time path of consumption during four previous recessions, two of them severe, those of 1973 and 1981, and two of them mild, 1990 and 2001.



For the first quarter of 2010 personal consumption increased at a rate of 3.6 percent and contributed 2.55% to the GDP growth of 3.24%.

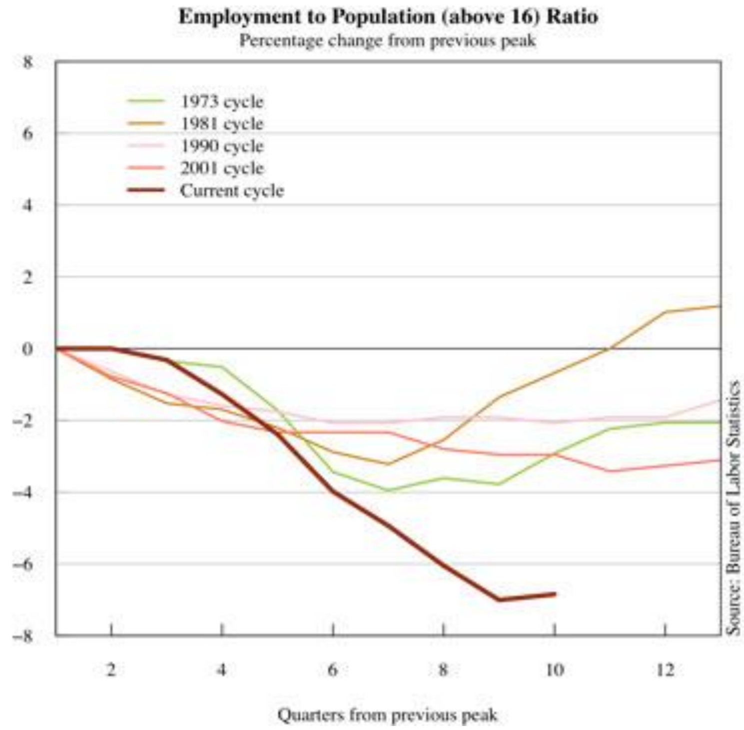
The second figure below shows the path of fixed investment. The current data show a mixture of some good news and some continuing bad news.



Investment in business equipment and software rose at a 13.4% rate, but this was offset by a continuing decline in investment in commercial structures (-14%) and large drop in residential construction (-10.9%), which had shown gains in each of the previous two quarters. Another factor adding to GDP growth was the rise in business inventories--the value of goods in warehouses--that contributed 1.6 percentage points to the GDP growth. Those gains are not likely to persist into the coming quarters.

The other determinants of GDP are government spending and net exports. Neither bodes well for future GDP growth. Federal government spending (both defense and nondefense) has increased and contributed to GDP growth, but it has been more than offset by declines in state and local government spending. Their spending fell at a 3.8% annual rate, and the trend of tightening state and local budgets will only continue as they are forced to slash their budgets. Net exports were a drain on GDP as imports rose much more quickly as the economy began to recover.

The largest continuing drain on the economy is of course the labor market. The figure below shows the path of the employment population ratio.



Finally, the dramatic decline has stopped, but just barely. With 15 million Americans unemployed and about 450,000 initial claims for unemployment insurance per week, it is hard to see how consumption growth can continue to drive a recovery with incomes affected by these levels of unemployment.

So, what can we say about the state of this current recovery? While there are many, many signs that we have begun to rise out of the deep valley, there are also signs that the climb out will likely be slow and rocky.

Thomas F. Cooley, the Paganelli-Bull professor of economics and former dean of the NYU Stern School of Business, writes a weekly column for Forbes. He is a coeditor of the forthcoming book Regulating Wall Street: The New Architecture of Global Finance *(Wiley, 2010).*

Peter Rupert, his coauthor this week, is a professor of economics and associate director of the Laboratory for Aggregate Economics and Finance at the University of California, Santa Barbara.