

Anatomy of a Recovery

With the recession seemingly over, what will the recovery look like?

At some point during the last few months, the economy bottomed out as the longest and deepest recession since the Great Depression came to an end. The exact month that the 2007–09 recession ended won't be announced by the National Bureau of Economic Research (NBER) until next year or even later.¹ Last time around, after the 2001 recession, the NBER took 20 months to officially date November 2001 as the end. The onset of this recession, in December 2007, wasn't officially acknowledged by the NBER until the recession was 12 months old in December 2008.

The first notable green shoot, as any hopeful sign of improvement came to be known during this recession, materialized back in April when initial claims for unemployment insurance benefits seemed to peak. This peak was encouraging because initial claims had peaked one or two months before the end of four of the five previous recessions. But as job losses continued to mount and the unemployment rate skyrocketed to 26-year highs during the summer, most forecasters saw the

recession dragging on through at least the third quarter before a sluggish recovery developed. Dwindling household wealth from shrinking home and stock values, high debt, tight credit, a weak labor market and slow wage growth would limit any sort of consumer spending rebound, which in turn would curb the speed and strength of economic recovery.

Other leading economic indicators, however, also turned positive in late April and May, reinforcing the notion that the economy was getting less bad sooner than most expected and that the recovery might arrive sooner and stronger than initially anticipated. The Conference Board's Leading Index of Economic Indicators advanced in April after slipping for nearly two years and has been climbing since. Help-wanted ads online leveled off in the same month, providing further evidence that the economy was close to turning the corner. The Institute of Supply Management's index—the ISM, considered to be the single best snapshot of the nation's factory sector—bottomed out in March and

climbed steadily over the next five months before moving above the growth neutral mark of 50 in August. The 50-plus reading suggests that the nation's manufacturers are expanding production after a year of sharp contraction.

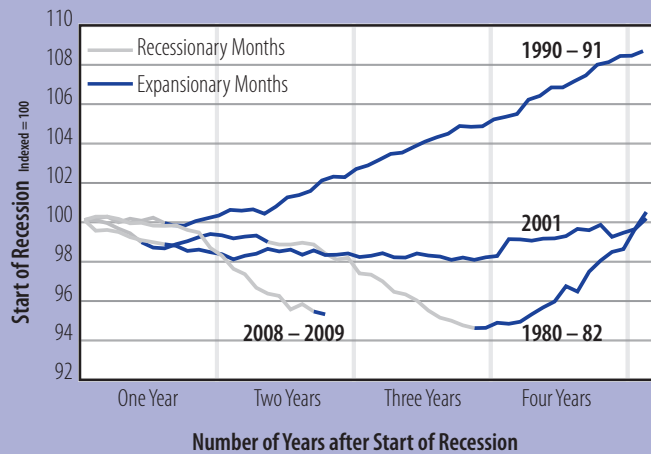
Other key indicators, including retail sales, consumer confidence, home sales, housing starts and home-builder confidence, have also turned around faster than anticipated despite the deteriorating labor market.

Economic growth forecasts for the rest of the year and 2010



FIGURE 1

Employment Changes in Recent Recessions and Recoveries*



*1980 and 1981-82 recessions are treated as one downturn

Source: Current Employment Statistics, Minnesota Department of Employment and Economic Development

have been revised upward over the last few months as a result of the better-than-anticipated indicators. The stock market's bullish 50 percent run-up since the March low reflects the more upbeat economic expectations.

The 2.8 percent annual pace of gross domestic product (GDP) growth in the third quarter of 2009 was good news and consistent with the hopeful signals thrown off by leading indicators during the past six months. In sum, it confirmed that the recession ended sometime during the summer. Economic output, after having declined four straight quarters, is again expanding, propelled by higher consumer spending, including for vehicles purchased

in the “Cash for Clunkers” program. The first increase in home-building activity in four years and expanding exports, climbing federal spending and a slowdown in the reduction of business inventories also contributed to GDP growth.

debate is now focusing on the speed, strength and durability of the recovery and, more importantly, when job growth will resume. Severe recessions have typically been followed by strong recoveries. The most recent example of this was the double-dip recessions of the early 1980s. In Minnesota, wage and salary employment plunged 5.7 percent between the start of the 1980 and the end of the 1981-82 recessions. The 101,000 payroll jobs lost over three years were regained in just 15 months, by early 1984, as the economy roared back.

The next two recessions, 1990-91 and 2001, were mild by comparison, lasting just eight months each. Job growth

nationwide after these two recent recessions didn't turn positive until one and two years, respectively, after production had resumed expanding. The initial expansion years after the 1990-91 and 2001 recessions became known as jobless recoveries. Minnesota's economy managed to avoid most of the first jobless recovery but suffered through the second jobless recovery as workers continued to be slowly shed before job growth gradually gained traction in 2004.

With the question of when the recession will end seemingly answered, the

Figure 1 displays Minnesota's wage and salary employment changes during recent recessions and recoveries. Just as no two recessions are alike, no two job recoveries are alike. The job rebound this time around is expected by most analysts to be slow in arriving and subdued even under the recently upgraded GDP forecasts. Unlike other recent deep recessions, this recession is intertwined with a financial bubble that has spread credit woes across all sectors of the economy that may linger for years. Downturns caused by bursting bubbles are notorious for generating subpar recoveries.

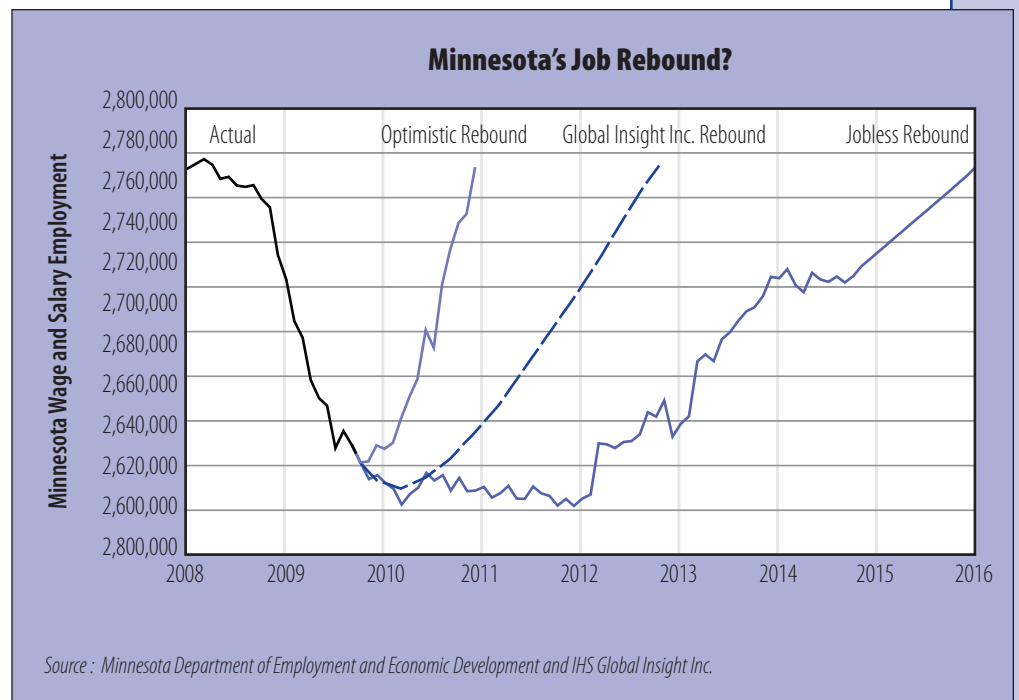
If firms have the capacity to expand production without adding new employees, hiring will remain modest over the next year even if the economy rebounds faster than expected. The average work week is extremely low now as firms have

tried to minimize job cuts by reducing employee hours. The high percentage of involuntary part-time workers is also contributing to the short work week. If there is any cause for optimism about job growth over the next year, it might be that many of the same arguments being thrown around today to support predictions of a lackluster job market turned out to be wrong in previous recessions.

Many forecasters have been too pessimistic about when this recession would end, so perhaps the weak job growth forecasts also will be off the mark. The speed and depth of the downturn between October and March might have been due more to panic than anything else. Now that much of the uncertainty surrounding the economy's future has been reduced, it is possible that job growth will turn out to be stronger than expected.

Figure 2 provides three possible job rebound tracks for Minnesota over the next few years. The most optimistic job rebound scenario mimics the robust job recovery after the double dip recession in the early 1980s. In that scenario, Minnesota regains the 132,000

FIGURE 2



payroll jobs lost between December 2007 and September 2009 with sustained job growth starting in the fourth quarter of 2009. The second scenario is a jobless rebound that copies the state's job growth performance after the 2001 recession with no job growth for another two years. It takes eight years under this alarming scenario for Minnesota to regain its pre-recession employment level. That would be twice as long as any other job recovery.

A third track is the Global Insight scenario, which is the

most likely and is based on Minnesota's job growth over the next few years tracking the U.S. job growth forecasted in early October by economists at Global Insight Inc., a national forecasting firm.² Under this scenario, job losses will continue into the first quarter of next year before hiring finally picks up. The pre-recession employment level will be reached in late 2012 or nearly five years after the deepest, longest and broadest recession in six decades commenced, and more than three years after it ended. **T**

ENDNOTES:

¹Past expansion and recession announcements by the NBER are available at www.dev.nber.org/cycles/cyclesmain.html.

²U.S. economic forecasts by Global Insight are the starting point for the Department of Finance's budget forecast.