

## National and District Overview

**T**he 2002 recovery has been one of the weakest in the post-World War II period. Indeed, the employment gains coming out of the 2001 recession have been unusually tepid, roughly parallel to the so-called jobless recovery in 1991-92. At the same time, inflation and inflation expectations have been mostly contained, affording Federal Reserve policy-makers the luxury of pushing their interest-rate target down to a level not seen since 1961. Why has the recovery been so weak?

### Feet Don't Fail Me Now

According to the preliminary estimate, real GDP grew at a 4 percent annual rate during the third quarter of 2002, measurably stronger than the 1.3 percent growth seen in the second quarter. Faster growth during the third quarter stemmed from another healthy



## RECOVERY HAS A CASE OF THE SLOWS

increase in consumer purchases of new motor vehicles, continued improvement in the growth of business expenditures on equipment and software, and modest increases in residential fixed investment, exports and government expenditures. Still, business investment in structures and buildings remained exceptionally weak, falling at a double-digit rate (20.6 percent) for the fourth consecutive quarter.

Through the first three quarters of 2002, real GDP grew at about a 3.5 percent annual rate. Although respectable, it is significantly weaker than the pace of growth typically seen when the economy is in transition from recession to expansion. Assuming that the 2001 recession ended in December 2001, the pace of growth during this recovery is less than half that seen during the first four quarters of the average recovery (7.4 percent). According to the Philadelphia Fed's Survey of Professional Forecasters, the economy was not expected to improve much during the fourth quarter: Real GDP growth was expected to slow to about 1.25 percent. Monthly data during October and November were generally consistent with this forecast, although the November employment report was clearly weaker than expected. The weaker tone of fourth-quarter data helped spur Federal

By Kevin L. Kliesen

Reserve policy-makers to trim their federal funds interest target 50 basis points to 1.25 percent at their Nov. 6 meeting. The Fed's interest rate target has not been this low since 1961.

A look at three of the key drivers of economic growth in an average post-World War II recovery indicates why the 2002 recovery has been unusually weak. Through the first three quarters of 2002, growth of real consumer expenditures on durable goods was 5.5 percent; for real business fixed investment, it was -3.0 percent; and for residential fixed investment, it was 6.2 percent. During the first four quarters of the average post-war recovery, these annualized gains have been, respectively, 16 percent, 8.1 percent and 25.8 percent.

Slower growth of consumer spending and declines in business fixed investment during the 2002 recovery may partly reflect the sharp declines in equity prices: Through the first 11 months of 2002, the S&P 500 was down by about 18.5 percent, whereas during the typical four-quarter recovery period the S&P 500 rises by about 19.75 percent. All else equal, rising stock prices increase consumer wealth, perhaps leading consumers to increase their purchases by more than planned.

For businesses, rising stock prices spur them to issue equity, which is used to finance investment in plant and equipment. Hence, when equity prices fall, the opposite effects arise. Another reason for the weak business investment performance in 2002 may have been some excess capital investment in high-tech equipment during the latter part of the 1991-2001 business expansion.

### Inflation Remains Low

One heartening aspect of U.S. economic performance in recent years has been the relatively low rate of inflation. After averaging about 4 percent per year from 1980 to 1995, the price index for personal consumption expenditures has risen by about 1.75 percent a year since then. It dipped even lower in early 2002, growing just 0.9 percent between the first quarter of 2001 to the first quarter of 2002. According to some Fed policy-makers, current inflation is in the "zone of price stability." Moreover, after its Nov. 6 meeting, the FOMC announced that inflation and inflation expectations "remain well-contained." For the most part, forecasters and financial markets expect this performance to persist into 2003.

*Kevin L. Kliesen is an economist at the Federal Reserve Bank of St. Louis. Thomas A. Pollmann provided research assistance.*