Panel Discussion: Dating Business Cycles

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Any opinions expressed here are mine and do not necessarily reflect those of other Federal Open Market Committee members.
NBER Dating Process

- Mitchell’s dissertation, 1913.¹
- Burns and Mitchell, 1946.²
- Process developed and put in place without being informed by modern macroeconomic theory.
- Theory offers guidance about more natural summary measures of economic performance.
- Binary nature is bothersome and may be harmful if it acts as an informational signal.

STATISTICAL MODELS: AUTOMATION

- Why do this via judgement call by the Dating Committee?
- Statistical models exist and do a better job.
- Everyone can replicate the recession call.
- This would be an important improvement.
**Binary Nature**

- Throws away information—why?
- Simple summary of the state of the economy should be continuous.
- Two-state nature influences research questions and analysis.
- “Recession” is an artificial construction putting “special emphasis” on certain time periods.
We know expectations are critical to how the macroeconomy operates. Recession call is a signal—it can act as a coordinating device. We want firms to assess their own markets and prospects for earnings. Sending a signal can send firms into “recession state.” Creates amplified and spurious cyclical patterns in economy.
**Example: Learning and the Great Moderation***

- Regime-switching shocks; two-state Markov.
- Households and firms must infer state via Bayesian inference.
- Confusion about states moderates behavior.
- Clarity about states exacerbates behavior: “Sounding the siren.”

**Undefined Level of Activity from Burns and Mitchell**

- The Burns and Mitchell idea of leaving the level of activity undefined is mystifying.
- Theory gives us guidance about what we would like to summarize.
- Theory says: utility.
- This would suggest an index of consumption and leisure.
- Most approaches to summarizing the economy have steadfastly avoided leisure measures.
- But: consider comparisons of the U.S. and European workplace.
- WWII was not a utility-raising event.
**ZERO AS A BENCHMARK NUMBER**

- Declines in the level of activity as defining events.
- This makes little sense from a growth theory perspective.
- We expect economies to grow on average.
- Growth averages differ across economies.
- Implies “recession” experiences differ across economies because of arbitrary definition.
- More sensible “two standard deviations below normal.”
Hodrick–Prescott Filtering and Related Methods

- More consistent with established growth theory.
- Trends can be tracked.
- Below par – above par performance half the time.
- Avoids the alarm bell problem.
- Controls for differing growth rates across economies.
Recession dating has become part of the American psyche.
It has been handed to us from a pre-modern theory era.
Arguably harmful.
Easy ways to improve:
- Statistical methods could automate the process.
- Tie closer to standard theory for ideas about what to measure.