

## National and District Overview

# Slow Recovery Remains Puzzling

By Kevin L. Kliesen

Despite low interest rates, tax cuts and low inflation, U.S. economic growth remains stubbornly below its long-run average, unable to generate any job growth. It's not often that the profile of the U.S. economy resembles Churchill's comment about Russia: "It is a riddle wrapped in a mystery inside an enigma." More than a year after the probable end of the 2001 recession in November 2001, the economy continues to offer up more puzzles than answers.

### Another Jobless Recovery

Although the National Bureau of Economic Research (NBER) has yet to decide when the 2001 recession ended, some economists believe that its demise occurred during the final three months of 2001. If so, the economy's performance since then has been disappointing when benchmarked against previous economic recoveries. Granted, since the fourth quarter of 2001, the U.S. economy has grown continuously; real GDP has increased at a 2.7 percent annual rate. But since this growth trails the economy's potential rate of growth by about 0.25 to 0.75 percentage points, job growth has been nil. In fact, non-farm payroll employment declined by about 816,000 jobs (0.4 percent annualized) from November 2001 to April 2003. Over that same period, job growth in the seven states that comprise parts or all of the Eighth Federal Reserve District has declined more (0.8 percent annualized).

In some respects, the weak labor market resembles the jobless recovery that followed the 1990-91 recession. Then, payroll employment did not surpass its June 1990 peak until 32 months later (February 1993), 23 months after the recession's end in March 1991. Currently, we are 27 months removed from the 2001 peak of payroll employment (February 2001), and it's not yet clear that employment is poised to turn up. However, unlike the 1991-92 experience, when the unemployment rate continued to rise after the March 1991 trough, reaching 7.8 percent in June

1992, the unemployment rate in the current recovery has remained at about 6 percent since the fourth quarter of 2001. In the Eighth District states, the unemployment rate has averaged even lower—5.6 percent for April. One of the puzzles that has yet to be adequately resolved is why firms continue to trim jobs even though the economy continues to grow and the unemployment rate remains relatively stable.

### Making the Pieces Fit?

In the November 2002 Survey of Professional Forecasters (SPF), published by the Federal Reserve Bank of Philadelphia, real GDP was projected to rise at a 2.6 percent annual rate in the first quarter of 2003 and then rise at 3.1 percent rate in the second quarter. In actuality, real GDP rose at a 1.9 percent rate in the first quarter, and now the SPF is projecting output growth of 1.8 percent in the second quarter. Output growth has remained below trend despite policy-makers' repeated actions designed to spur faster growth. The Fed has pushed its federal funds target rate down to a 41-year low and has kept it there since November 2002. For their part, the Bush administration and Congress have passed two tax cut measures and ramped up government spending.

Some economists believed that an end to the major hostilities in Iraq would also help trigger faster growth—chiefly through reduced risk premiums in corporate bond yields, lower oil prices and higher equity prices. But while oil prices and interest rates have retreated and stock prices have risen markedly, consumer spending and, especially, businesses investment remain unusually weak



compared to previous recoveries. One area of resiliency has been the

housing sector, which continues to benefit from exceptionally low mortgage rates.

There are a few factors that can help explain the economy's puzzling behavior since the end of the 2001 recession. First, slower-than-average growth is a worldwide phenomenon. Second, the economy has been buffeted by numerous shocks over the past couple of years (Sept. 11, corporate scandals and the Iraq war). Third, relatively brisk growth of labor productivity enables employers to meet the existing demand for their products without boosting their existing workforce. Finally, the bust that followed the boom in equity markets and in business fixed investment was sizable. Accordingly, the adjustment process by which consumers respond to reduced wealth and businesses to excess capacity takes time to successfully resolve.

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