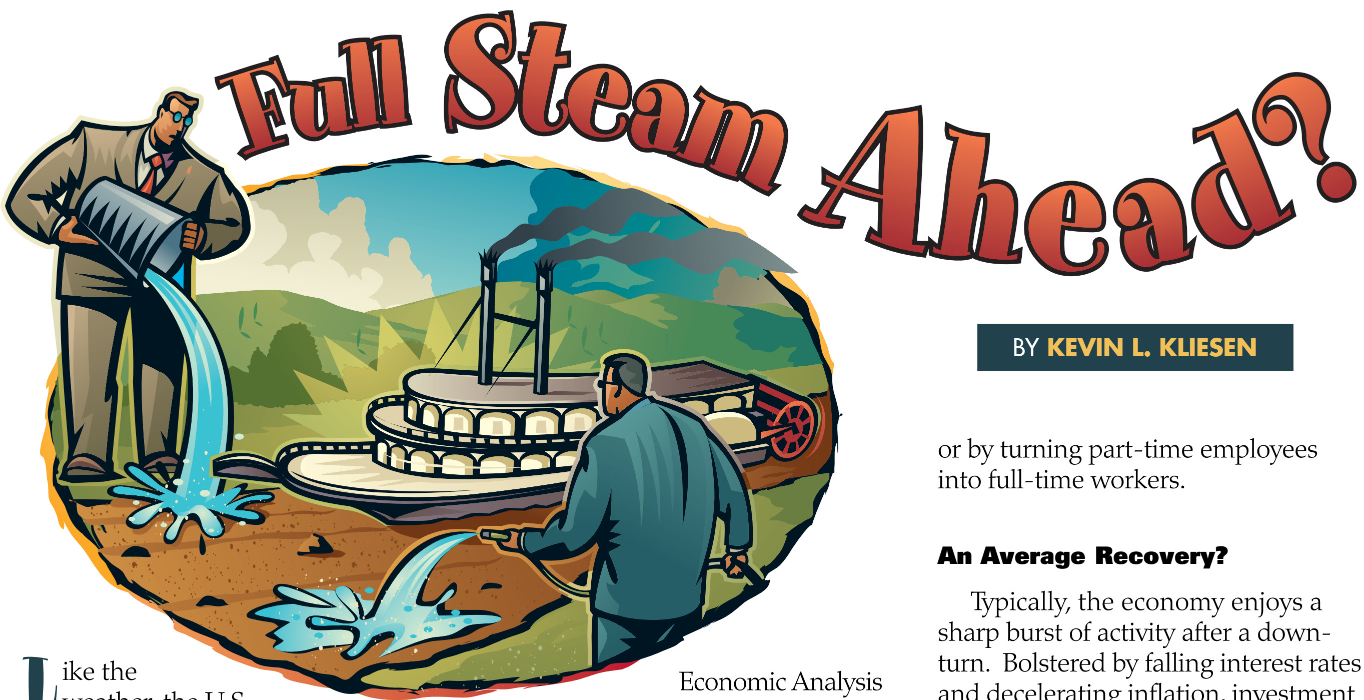
National and District Overview



Full Steam Ahead?

BY KEVIN L. KLIESEN

Like the weather, the U.S. economy continues to surprise. Indeed, revised estimates show appreciably stronger economic growth during the fourth quarter of 2001 than originally depicted. Accordingly, many economists now believe that the nation might never have had an official recession without the terrorist attacks of Sept. 11. While the economy appeared to pick up speed during the early stages of 2002, some economists think the recovery will be more subdued than the average.

What Recession?

When the National Bureau of Economic Research announced Nov. 26, 2001, that the nation's longest expansion ended in March 2001, few economists were willing to believe otherwise. After all, employment was falling, manufacturers had been trimming production for a year and real GDP had declined at a 1.3 percent annual rate during the third quarter. Moreover, widespread uncertainty still prevailed after the tragic events of Sept. 11. According to the Blue Chip Consensus forecast issued in early November, the U.S. economy was projected to contract at about a 2 percent annual rate during the fourth quarter of 2001 and then eke out a 0.5 percent rate of gain during the first quarter of 2002.

Now, it is debatable whether a recession would have occurred at all without the Sept. 11 terrorist attacks. Some economists began to have doubts when the Bureau of Economic Analysis (BEA) reported in January that real GDP rose at a 0.2 percent annual rate over the final three months of 2001, rather than declining as most forecasters expected. But since many firms continued to trim payrolls and draw down inventories, it seemed possible that subsequent revisions would show negative growth.

These doubts were further magnified when the BEA revised upward its estimate of fourth-quarter real GDP growth to 1.4 percent in late February. The GDP revision buttressed the emerging signs of strength that were evident in January and February: In inflation-adjusted terms, consumer spending, construction outlays and new factory orders all posted solid gains in January, while sales of existing homes rose to a record high. Moreover, the monthly report issued by the Institute for Supply Management implied that manufacturing activity in February increased for the first time since July 2000.

Demand for labor might also be stabilizing. Initial claims for state unemployment benefits continue to trend downward, while nonfarm payroll employment rose 66,000 in February, the first increase since July 2001. In addition, the index of aggregate hours worked inched upward in February, and the civilian unemployment rate edged downward for the second consecutive month, measuring 5.5 percent. Usually, labor market conditions do not improve until several months after the end of the recession, as firms tend to initially boost output by working existing employees longer or by turning part-time employees into full-time workers.

An Average Recovery?

Typically, the economy enjoys a sharp burst of activity after a downturn. Bolstered by falling interest rates and decelerating inflation, investment spending is usually the key driver. In an "average" post-World War II recovery, defined as the four quarters following the business cycle's trough, real GDP growth averages about 7.5 percent, with real investment spending growing 13 percent on average. Rising incomes, profits and equity prices also help boost real personal consumption expenditures: The average increase in a recovery is about 5.75 percent.

Some economists, however, believe that the pace of economic activity following the 2001 recession will be more tempered. For example, in presenting the Federal Reserve's semiannual Monetary Policy Report to Congress on Feb. 27, Chairman Alan Greenspan said that "certain factors, such as the lack of pent-up demand in the consumer sector, significant levels of excess capacity in a number of industries, weakness and financial fragility in some key international trading partners, and persistent caution in financial markets at home, seem likely to restrain the near-term performance of the economy." In light of these concerns, "the forecasts of the members of the Federal Open Market Committee are for real GDP to rise 2.5 to 3 percent during 2002 … with the price index for personal consumption expenditure increasing about 1.5 percent." Given last year's aggressive easing in fiscal and monetary policy, though, faster growth and higher inflation would not be too surprising to some economists.

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