Signs Point toward Another Jobless Recovery

By Kevin L. Kliesen

The U.S. economy finished 2009 on a high note, as real GDP advanced at about a 6 percent annual rate over the last three months of the year. This was a sharp contrast to the year's dismal start, when the economy was struggling in the throes of a deep recession. Typically, deep recessions tend to be followed by exceptionally rapid growth (6 percent or more), which leads to sharp declines in the unemployment rate but also to worries about rising inflation. However, most forecasters expect only modest growth this year and a slow decline in the unemployment rate. On a brighter note, most forecasters and Federal Reserve policymakers generally expect inflation to remain subdued in 2010.

Modest Recovery Seems Likely

Although the National Bureau of Economic Research (NBER) Business Cycle Dating Committee has yet to make a determination, many economists believe that the recession ended in the summer of 2009. Typically, the rebound in economic activity that follows recessions stems from rising real incomes and improving financial market conditions. As the economy improves, often because of a rebound in interest-sensitive consumer expenditures and the sale of newly built houses, businesses begin ordering new goods from manufacturers and increase their expenditures on new equipment and structures. Since double-dip recessions are extremely rare, the rebound in activity is also a signal to firms to expand their payrolls. This is traditionally why the NBER looks at nonfarm payroll employment to help the committee date business cycle turning points.

Through the first two months of 2010, the data on production, incomes and expenditures suggested that the economy was continuing to expand. Importantly, consumer expenditures appeared to be growing modestly, and business capital spending began turning upward. In particular, manufacturing activity appeared to be advancing briskly. Part of manufacturing's strength was due to a healthy rebound in exports, which was largely a reflection of the global economic recovery. Although there were signs of stabilization in the housing sector, the level of home foreclosures and the inventory of previously sold homes on the market remained quite high. Another source of concern was the commercial real estate (CRE) sector, which saw sharply lower levels of construction and falling rents and, accordingly, rising loan defaults. Problems in the CRE sector hampered small- and medium-size banks, which appear to have more exposure to nonperforming CRE loans than larger banks do.

Overall, the Survey of Professional Forecasters (SPF) expects that real GDP will increase by 3 percent this year and next year, and that inflation, as measured by the CPI, will average about 1.75 percent this year and about 2 percent next. By and large, forecasters expect that the Federal Reserve will exit from its accommodative policy in a manner that neither exacerbates inflation expectations nor prematurely weakens the recovery.

Are Jobless Recoveries the New Norm?

Economists have been closely watching the contours of this recovery to see if the pattern of job growth—or lack, thereof—is similar to those that followed the previous two recessions. Recall that labor markets did not improve until well after these recessions ended. For example, the 2001 recession was deemed to have ended in November 2001, but the unemployment rate did not peak until June 2003 and payroll employment did not reach its trough until August 2003.

Although the current recovery is in its early stages, it nonetheless appears that a similar labor market pattern is developing. Despite rising real GDP in the third and fourth quarters of 2009, firms continued to shed jobs over the second half of 2009 and the first two months of 2010. Although the SPF expects job gains to average about 100,000 per month over the last nine months of 2010, these increases might be much less if not for the hiring associated with the 2010 decennial census.

While perhaps disconcerting to the public and economic policymakers, the lack of job growth in the face of rising real incomes and faster economic growth reflects continued strong gains in labor productivity. In 2009, productivity rose 5.8 percent—the largest annual increase since 1965. To most economists, strong productivity bodes well for the economy over the long run. Indeed, rising living standards depend on little else. In the short run, particularly in the early stages of the recovery, firms use their existing labor force and capital stock to fulfill orders and expand production. Eventually, though, the extremely rapid rate of productivity growth increases the growth of income and consumer spending. As the economy strengthens, firms once again begin to hire, forcing the unemployment rate down to its natural rate. Ω

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