

TUESDAY NOVEMBER 3, 2009

UP FRONT BLOG

## Putting the Expected Strength of the Recovery into Historical Context

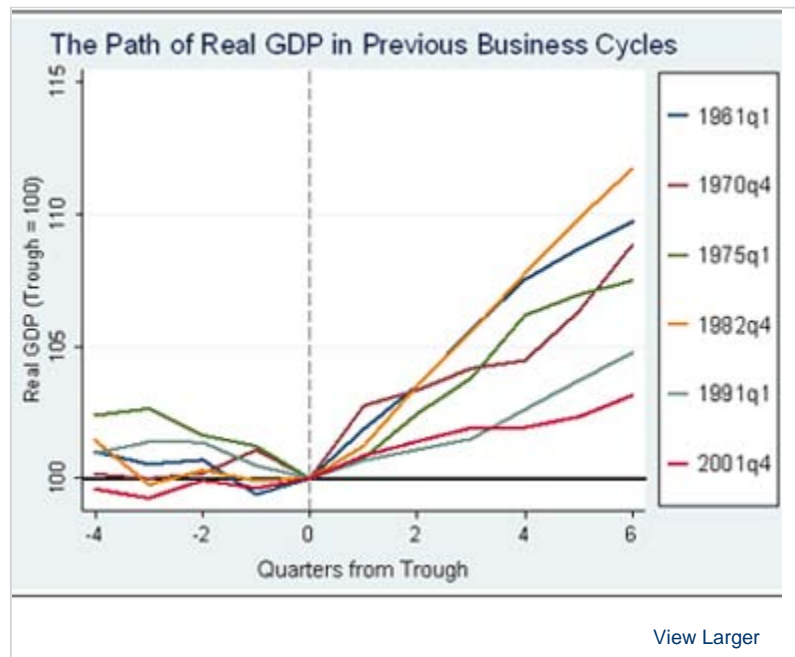
U.S. Economy, U.S. Economic Growth

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OCTOBER 30, 2009 — In my [testimony before the Joint Economic Committee](#) yesterday, I said that I share what seems to be the consensus view that we are not likely to see the rapid snapback in activity that has followed many previous downturns. What exactly does this mean?

The chart below compares the path of real GDP - our nation's output of goods and services - in previous recoveries over the past half century. To facilitate the comparison, the level of real GDP is set equal to 100 at the cyclical trough, marked with a vertical line. The trough is the quarter at which the National Bureau of Economic Research has determined that the economy bottomed out in each recession. Thus, the vertical scale tells you how fast the economy expanded after each trough. For example, if the line for a given recession equals 103 four quarters after the trough, that means that real GDP expanded 3 percent over those four quarters. I have left the recovery after the 1980 recession off of the graph because it did not really take hold; just a year after the trough, the economy went into recession again.



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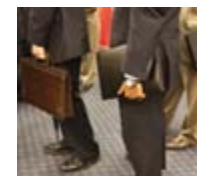
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A survey done by the Wall Street Journal earlier this month suggested that most forecasters think the recession is over, and that view was supported by yesterday's GDP release, which showed that the real GDP expanded at an annual rate of 3½ percent in the third quarter. However, on average, forecasters expect the economy to expand at a rate of about 2-3/4 percent during the first year of the recovery. The graph shows us that, in previous business cycles, real GDP growth averaged 5 percent over the first four quarters after the trough. Among the weaker recoveries was the upturn that began in late 2001, but that followed a recession that was quite mild by historical standards. The next most muted recovery followed the 1990-91 recession. That business cycle shared some important features of the current episode - including a need by consumers to rebuild their balance sheets and an overhang in property markets (though mainly on the commercial side) - that would be expected to slow the speed of recovery.

The most important implication of the expected slow recovery is that the economy is unlikely to see full employment for many years. Since the recession began, payroll employment has fallen by more than 7 million, and, as Chair of the Council of Economic Advisors Christina Romer pointed out last week, this statistic understates the problems in labor markets because employment growth of nearly 100,000 per month is needed just to keep pace with normal labor force growth. All told, the expected slow recovery will prolong the current economic distress for millions of households.

This analysis underscores a key challenge that is currently facing policymakers. The other witnesses at yesterday's hearing and I discussed a number of options to bolster the recovery. However, as I emphasized, when weighing these options, policymakers need to be mindful not only of the short-run benefits but also of the potential long-run costs. While it may make sense for Congress to take steps that increase the speed of recovery, it is imperative that policymakers form a plan to bring revenues back in line with spending over the longer run. High budget deficits reduce saving and investment and, in turn, damp long-term economic growth; they also risk inducing a crisis in which the holders of U.S. debt lose their appetite for that debt.