Overview of the Recent Business Cycle

The recent recession and recovery mark the seventh business cycle in the U.S. economy since 1960. This cycle shares some common features with previous business cycles. According to the National Bureau of Economic Research (NBER), the unofficial arbiter of U.S. business cycles, a *recession* is "a period of falling economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales." The recent recession, like others, has involved a downturn in economic activity of sufficient depth, duration, and breadth to be judged a recession by the NBER.

The NBER also identifies the *peaks* and *troughs* of economic activity that mark when recessions begin and end. In November 2001, the NBER determined that the economy had peaked in March 2001. However, revisions to economic data since the NBER's initial decision suggest that the peak in activity was actually months earlier (Box 1-1). In July 2003, the NBER determined that the economy had reached a trough in November 2001.

Despite the similarities between the recent business cycle and previous ones, this most recent cycle was distinctive in important and instructive ways. One noteworthy difference is that real GDP fell much less in this recession than has been typical. Chart 1-1 shows the path of real GDP over the past several years compared with the average path of the six prior recessions, with the level of real GDP at the economy's peak set equal to 100 in each case. (All of the charts in this *Report* assume that the peak for the recent recession was in the fourth quarter of 2000.) The chart shows that the decline in real GDP in the recent recession was smaller than the historical average; indeed, it was the second smallest in any recession since 1960.

Box 1-1: When Did the Recent Recession Begin?

The National Bureau of Economic Research (NBER) uses a variety of economic data to determine the dates of business-cycle peaks and troughs. This task is made more difficult because many of these data series are subject to revision. For example, on November 26, 2001, the NBER announced that a recession had begun in March 2001. Since then, the four data series that the NBER used to determine the timing of the recession have been revised. The revisions to these series suggest that the recent recession began earlier than March 2001.

The four series cited by the NBER in their decision about the recent business-cycle peak were revised as follows:

Box 1-1 — *continued*

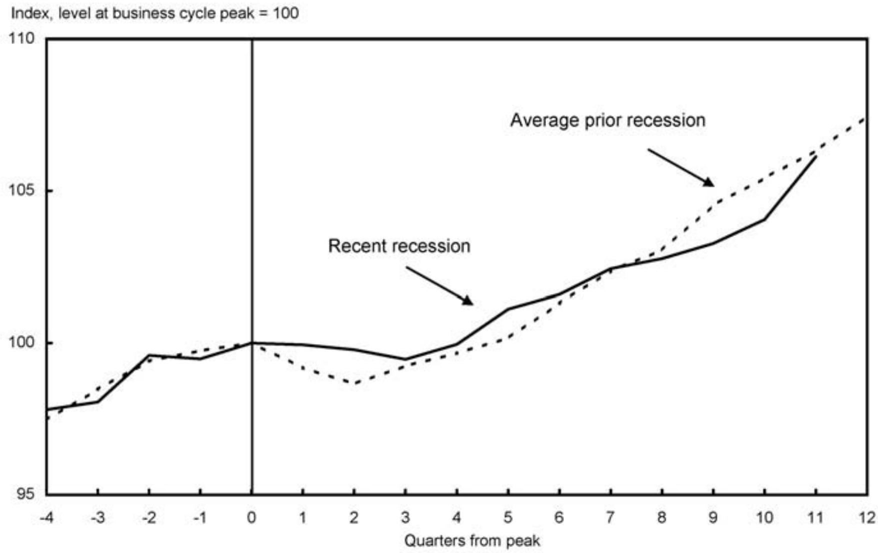
- *Real personal income less transfers:* When the NBER dated the recession, this series showed a generally steady rise throughout 2000 and early 2001. Subsequent revisions reveal that income peaked in October 2000.
- *Nonfarm payroll employment:* The data at the time of the recession announcement showed employment growing at a substantial pace in early 2001, with 287,000 jobs added from December 2000 to its peak in March 2001. Revised data show that employment grew less than one-third of this amount in early 2001 and peaked in February 2001.
- *Industrial production:* The original data used by the NBER showed that this series peaked in September 2000. Revised data show that this peak came even earlier, in June 2000.
- *Manufacturing and trade sales:* Original data showed a peak in August 2000; the most recent data show a peak in June 2000.

Thus, the revised data show that the *latest* peak among the four series was February 2001, with some series peaking considerably earlier. Moreover, another data series, which the NBER has recently announced it will incorporate into its business-cycle dating process, also shows a peak before March 2001: *monthly GDP* reached a high point in February 2001, according to the most recently available estimates computed by a private economic consulting firm.

While some arbitrariness in determining the date on which a recession began is inevitable, revisions since the NBER made its decision for the most recent recession strongly suggest that the business-cycle peak was before March 2001. The median date of the peak for the five series discussed here is October 2000. Other data support the notion that economic activity had slowed sharply or even begun to decline by this point, including the stock market, business investment, and initial unemployment claims. For these reasons, the analyses throughout this chapter (including the charts that compare this recession to past recessions) use the fourth quarter of 2000 as the peak of economic activity and the start of the recession.

In October 2003, the NBER announced that it would defer consideration of whether the latest business-cycle peak should be revised until the results of the coming comprehensive revision of the National Income and Product Accounts were released. The major results of this revision were announced in December 2003, but the monthly manufacturing and trade sales data and some of the detail needed to estimate monthly GDP had not been released at the time this *Report* went to press.

Chart 1-1 **Real GDP**
Real GDP fell less in the recent recession than it typically has.



Note: Recent peak set by Council of Economic Advisers at 2000:Q4. Average based on prior recessions since 1960.
Source: Department of Commerce (Bureau of Economic Analysis).

This relatively mild decline in output can be attributed to unusually resilient household spending. Consumer spending on goods and services held up well throughout the slowdown, and investment in housing increased at a fairly steady pace rather than declining as has been typical in past recessions. In contrast, business investment in capital equipment and structures has been quite soft in this cycle. As discussed below, business spending during the past few years has likely been held down by overinvestment in the late 1990s, as well as by heightened business caution owing to terrorism and corporate scandals. As a result of these forces, investment weakened sooner and has recovered more slowly than in the typical cycle.

Another distinguishing feature of this cycle has been the weakness in labor markets relative to output. In particular, the recovery in employment—although now under way—lagged the upturn in output by a much longer period than in prior recessions. This difference was associated with unusually large productivity gains.

The balance of this chapter draws five distinctive lessons from the recent business cycle in the United States. Chapter 3, *The Year in Review and the Years Ahead*, presents details about developments over the past year and discusses the Administration's forecast.