PERSPECTIVE

US Business Cycles

Changing faces

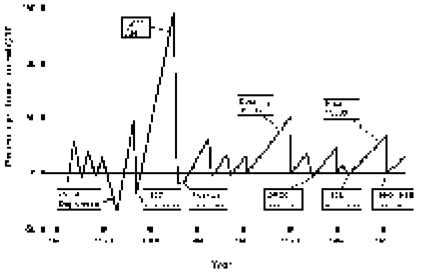
An examination of the pattern of shifts in the US business cycles indicates that adjustments to downturn have been very fast in the past. An attempt to draw a meaningful prediction for the present downturn appears difficult.

The business cycle is an up-n-down movement of business activity. It consists of alternating periods of recessions and booms. Some recessions can be real bad. A good example is the Great Depression in the US. It started in 1929 after a stock market crash. By 1933, the real GDP had fallen by 30 percent and unemployment had increased to 25 percent of the labor force. The most recent slowdown cannot technically be described as recession as the GDP contracted (–1.3 percent) only in the third quarter of 2001. To call it a recession, we need at least two consecutive quarters of negative growth.

Past data reveals that recessions in the US have typically lasted over a year and real GDP has fallen from peak to trough by more than six percent. Expansions have lasted on an average for almost four years and real GDP has increased from trough to peak by an average of 22 percent. The billion dollar question today is whether we can make any meaningful predictions about the pattern of business cycles that may happen in the future. Understanding the structural changes which have taken place in the US in the recent past provides useful insights about why going by the past to predict the future may be dangerous.

Over the years, American labor markets have become more and more flexible. Easy hiring/firing, an increasing number of part-time workers and growing use of variable pay have facilitated quick responses to demand while protecting permanent jobs and maintaining the tempo of consumption by households. The peak unemployment rate of 5.8 percent during December 2001 was well below that during past recessions. For example, during the 1981-91 downturn, the highest unemployment rate was 10.8 percent.

Business Cycles in US



Source: *National Business of Research and Michael Parkin*

Table 1: Past US recessions at a glance

Period	% Change in GDP	% Peak unemployment rate
Nov. 1973 – Mar. 1975	-2.7	9.0
Jan. 1980 – Jul. 1980	-4.3	7.8
Jul. 1981 – Nov. 1982	-2.2	10.8
Jul. 1990 – Mar. 1991	-2.6	7.8
Mar. 01 –	+0.1	5.8

Source: BusinessWeek, *March 18, 2002.*

In recent times, the US has been rapidly transforming itself into a real-time economy.

Another point to note is the sustained productivity growth in the US. From March to December 2001, in spite of the slowdown, output per hour of work grew at an annualized rate of 2.3 percent. Productivity growth during a slump is extremely rare because output tends to fall. Robert Gordon, a famous economist, who has regularly been quoted by *The Economist* as questioning the extent of productivity growth in the US recently admitted to *Fortune* (March 18, 2002) that, "There has been a structural improvement in productivity that is still with us today."

The productivity gains are widespread and not just in computer manufacturing as earlier believed. Indeed, it is strong productivity growth that has kept the disposable income growing and motivated customers to spend even during the slump. Faster productivity growth also means that the economy can grow faster without fueling inflation. It also implies lower Non Accelerating Inflation Rate of Unemployment (NAIRU). As *BusinessWeek* (March 18, 2002) has put it so well, "In economics, accelerating productivity growth is about as close to a free lunch as you can get. Businesses don't need to put through sharp price hikes to lift profit margins and at the same time workers can get pay rises that are in line with the increase in their productivity. Moreover, the Federal Reserve can keep interest rates lower longer without fear that a solid recovery will boost inflation."

The availability of real time information has also enabled the US Federal Reserve to react very fast. The Fed cut interest rates aggressively, a total of 11 times during 2001. This combined with tax rebates has boosted home sales and maintained the tempo of consumer spending. Another unique phenomenon is that reduction in capital spending has not been across the board. While people are hesitant about expanding capacity, they are continuing to buy computers and electronic products. New orders for such products grew at an annualized rate of 20 percent from the third quarter of 2001 to the fourth quarter. The thinking seems to be that such investments can further boost productivity and cut costs.

Another point needs to be mentioned. It is true the US economy's recovery has been quite fast. But there is no guarantee that there will not be one more sudden contraction in the near future. In the real time economy, adjustments to downturns are going to be fast. So, we may well see a few quarters of expansion, followed by a quarter or two of contraction. This will be unlike the past where a boom period would continue for years followed by a recession typically extending over a period of 12-15 months. Indeed, for the real time economy, a new definition of recession may have to be coined! Business and policy makers need to be fast and nimble to survive in the real time economy which will continue to spring surprises. ■

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