December 23, 2008

Are modern recessions different?

In case you are hungering for something to while away the time as the holiday approaches—since apparently you are not out shopping—Barbara Kiviat provides some food for thought at The Curious Capitalist:

> "Let me leave you with something to toss into the conversation when your family starts talking about the economy…
>
> "Since WWII, recessions have lasted 10 months on average. We hear that a lot. Our current recession started in December 2007. Even though this go-around seems worse [than] usual, that's still a little cause for optimism.
>
> "Or maybe not. This week Merrill Lynch economist David Rosenberg put out a report—thanks for the tip, John!—questioning why we'd only look at recessions over the past 60 years."

She then quotes Rosenberg…

> "This recession has more in common with the pre-WWII era. However, most of the data we have and most of the analysis still being conducted is done within the context of post-World War II cycles. That will not work, as this is a balance sheet recession and not just within the confines of the financial sector, but within the broad US household sector. This involves debt repayment and asset liquidation, and for the first time in recorded history, the entire $70 trillion household balance sheet is in the process of shrinking."

… and goes on to provide the punchline:

> "He then goes back to 1855 (a better timeframe for true historical context, he figures), and finds that recessions last an average 18 months. If his logic is right, then we're not due for sunnier skies until mid-2009."

Interestingly enough, Berkeley's Christina Romer—the next chair of the president's Council of Economic Advisers—has in the past had a fair amount to say about comparing recessions past and present. First, the statement of an obvious problem:

> "The obvious series to compare over time are standard macroeconomic indicators such as real GNP, industrial production, and unemployment. Such comparisons, however, are complicated by the fact that contemporaneous data on these quantities have only been collected for part of the 20th century. For example, the Federal Reserve Board index of industrial production begins in 1919, the Commerce Department GNP series begins in 1929, and the Bureau of Labor Statistics unemployment rate series begins in 1940. Furthermore, because World War II marked a radical change in the data collection efforts of the U.S. government, many of these series are only available on a truly consistent basis after 1947."

In the paper Professor Romer goes on to recap her efforts to reconcile the older (pre-World War II) data with that of the modern era. The details reveal the considerable novelty for which she is duly admired among economists—part of the solution is to forgo the impossible task of making bad data good and instead induce comparability by making the good data bad—but I will leave those details to you and get right to the point:

> "The first finding is that recessions have not become noticeably shorter over time. The average length of recessions is actually one month longer in the post-World War II era than in the pre-World War I era. There is also no obvious change in the distribution of the length of recessions between the prewar and postwar eras. Most recessions lasted from 6 to 12 months in both eras. Recessions were somewhat longer in the interwar era. However, an average for this period is virtually impossible to interpret since it includes the Great Depression, where 34 months elapsed between the peak and the trough. Probably the most sensible conclusion to draw for the interwar period echoes that from the previous section: the 1920s and 1930s were simply very peculiar."

So, if you are inclined to buy the argument that comparisons of the current downturn to pre-WWII era contractions is a legitimate exercise, there's some comfort for these cold winter nights. Happy holidays.

By David Altig, senior vice president and research director of the Federal Reserve Bank of Atlanta

Because of the Christmas holiday, today's posting will be the only macroblog posting for this week.

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