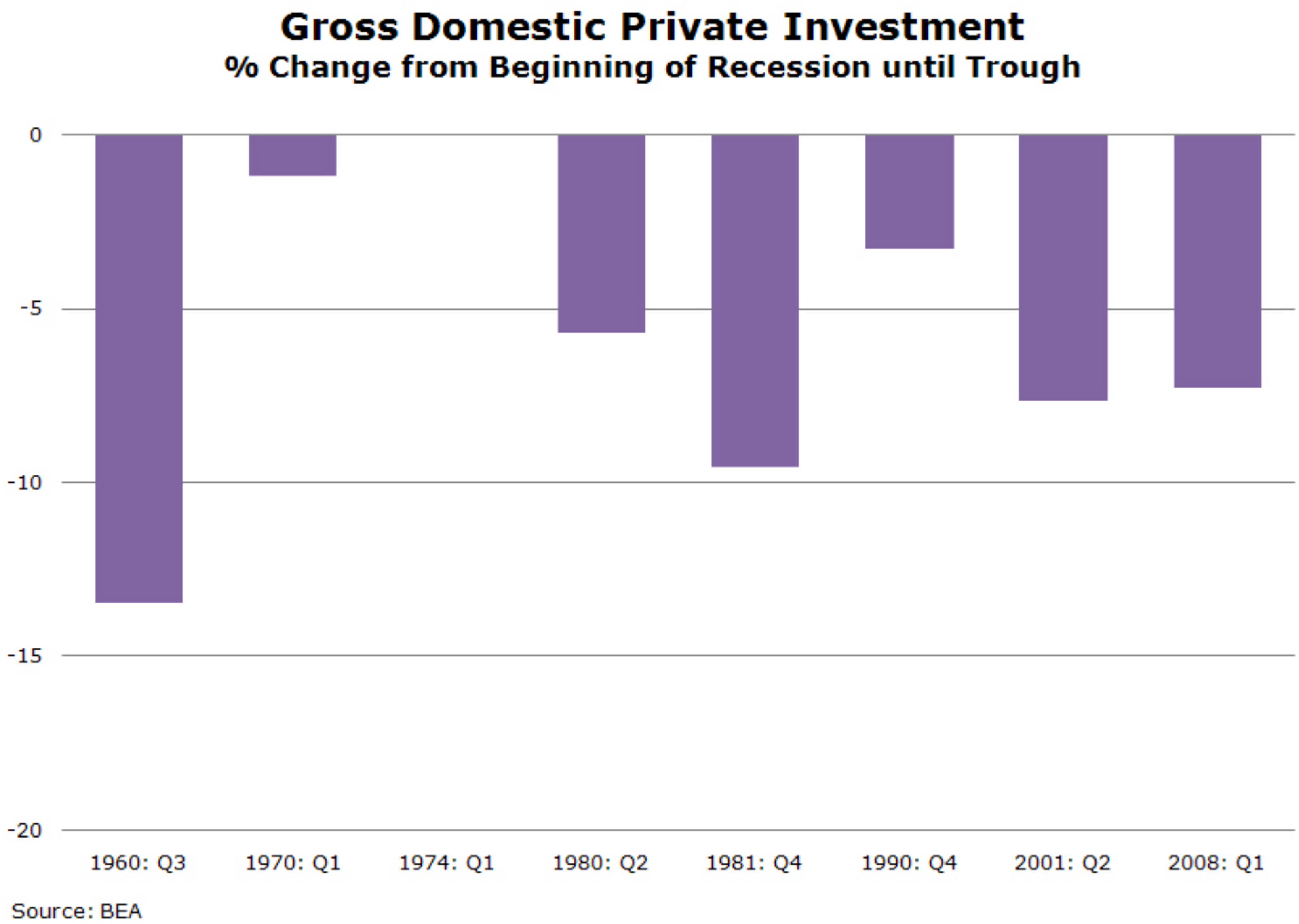
April 24, 2009

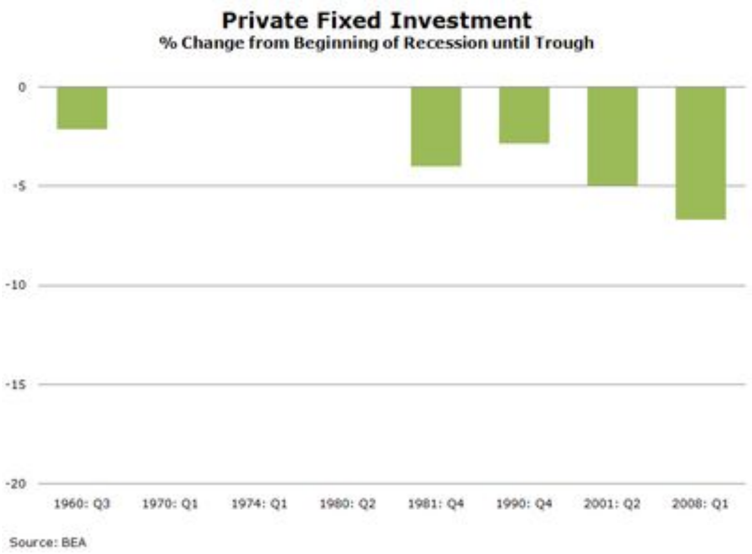
Is the investment trend in the current recession “run of the mill”?

In the last macroblog post, David Altig examined personal consumption expenditures during recessionary periods. Reader Dave Backus, the Heinz Riehl Professor of International Economics and Finance at New York University's Stern School of Business, sent us a follow-up email asking about other components of gross domestic product, and investment in particular. Good question, so let's take a look at investment during the current and past recessions.

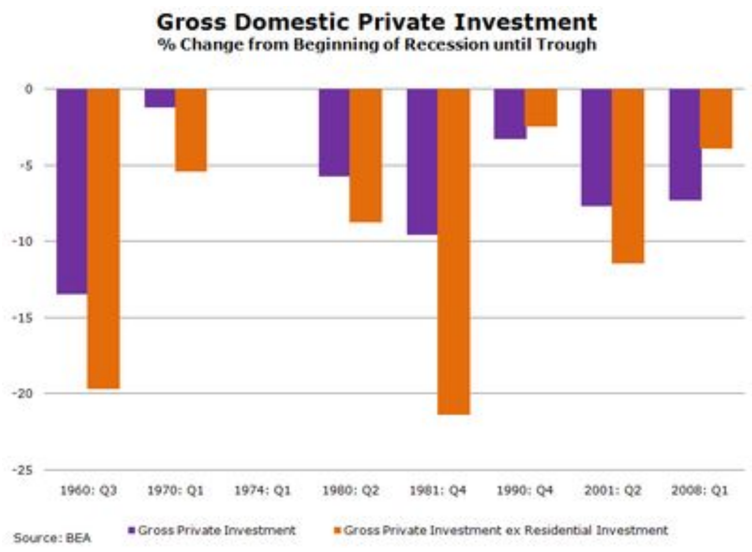
Earlier this year, the University of Chicago's Casey Mulligan, writing in the *New York Times'* Economix blog, examined real investment trends for the past four recessions and called the current investment trend in this recession "run of the mill." Employing the same basic idea from our previous macroblog post, below is a chart showing the percentage change from the first quarter to the trough of the last eight recessions, along with the percentage change from the current recession's first quarter to the first quarter of this year.



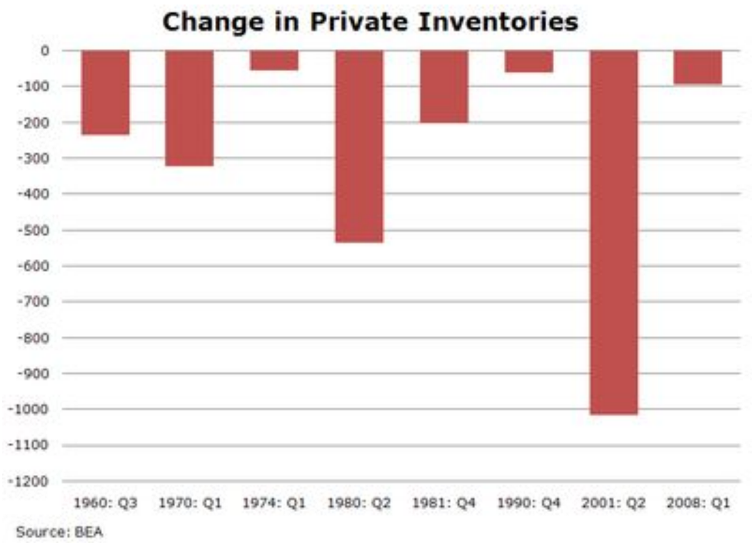
Prof. Mulligan's point emerges pretty clearly. Matched up against previous recessions, there is nothing spectacularly unusual about the declines in overall investment expenditure—not yet, at any rate. But that picture may be a bit deceiving. Here's the same sort of graph for *fixed* investment—that is, all investment expenditures other than changes in inventories.



The current recession—which is not yet over as far as we know—does not stack up so favorably when it comes to fixed investment spending. In fact it leads the pack in terms of investment decline among the eight recessions since 1960. This fact is not too surprising given the the relative impact of residential private investment in the current recession. This impact can be seen by comparing gross domestic private investment with gross domestic private investment excluding residential private investment. In all previous recessions apart from 1990, the percentage change in gross domestic private investment excluding residential private investment significantly exceeds the drop in gross private investment, and in the 1990 recession they were roughly comparable. In the current recession, gross domestic private investment excluding residential investment is significantly less than the gross domestic private investment.



In addition to that difference, the comparison of gross investment patterns is significantly affected by the behavior of inventory changes across recessions. The modest decline in overall inventories in the current downturn is the reason for the relatively benign view of investment highlighted in Casey Mulligan's Economix piece.



So, let's consider again whether the current investment trend in this recession is "run of the mill." Perhaps at first glance it is, but when we break down the components of gross domestic private investment, these charts inform us that the relative declines in the various components of gross domestic private investment are quite different in this recession. And just how benign that picture is depends, in part, on whether the slow pace of inventory decumulation thus far proves a lasting feature of this recession. On that, we will just have to wait and see.

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