July 24, 2009

A look at the recovery

Earlier this week my boss, Atlanta Fed President Dennis Lockhart, weighed in with his views about the shape of the economic recovery to come while speaking at a meeting of the Nashville, Tenn., Rotary Club:

> "The economy is stabilizing and recovery will begin in the second half. The recovery will be weak compared with historic recoveries from recession. The recovery will be weak because the economy must make structural adjustments before the healthiest possible rate of growth can be achieved."

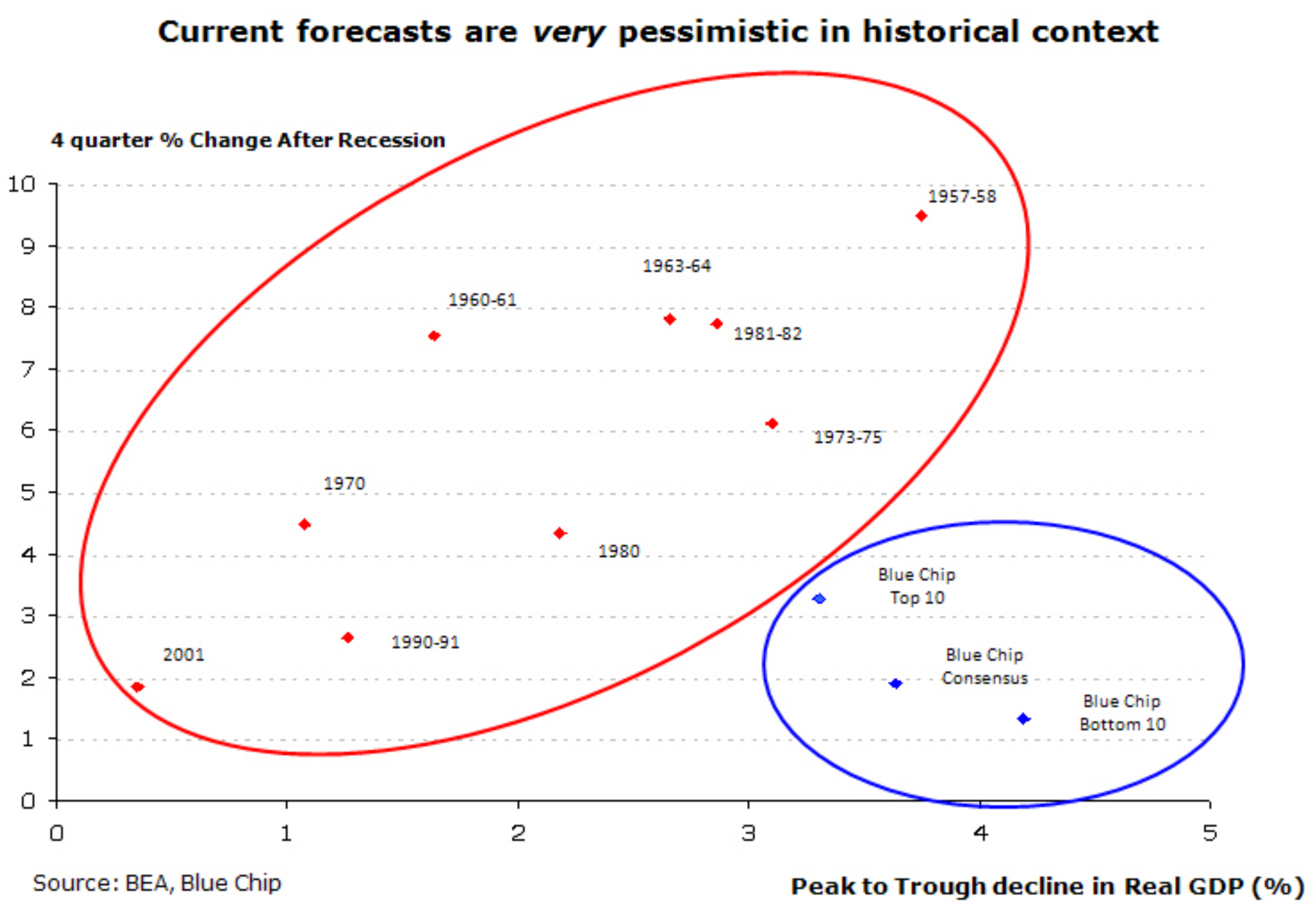
This quote was noted by Rebecca Wilder at News N Economics, along with similar sentiments from Nouriel Roubini and Mary Daly at the Federal Reserve Bank of San Francisco. You might add to the list Tim Duy's comments at Wall Street Pit and this assumption from Moody's Investor Services, reported at Seeking Alpha:

> "Moody's predicts a 'hook-shaped' recovery path for banks, 'characterized by an upward tilt that lies somewhere in between a U- and an L-shaped economic recovery, implying a painful journey.' "

Says Dr. Wilder of the prospective recovery: "pathetic."

More colorful language than I would use, but if current forecasts come true, the early stages of the recovery will be as unusual as the recession itself.

How unusual? See for yourself:



The chart plots the four-quarter growth rate of gross domestic product (GDP) from the trough of a recession against the depth of the corresponding contraction, as measured by the cumulative loss of GDP over the course of the downturn. The points within the red circle represent all previous postwar recessions, and they form a nice, neat, easily discernible pattern. That is, the pace of growth in the first year after a recession has, in our history, been reliably related to how bad the recession was. The deeper the recession, the faster the recovery.

The points within the blue circle are based on forecasts of GDP growth from the third quarter of this year through the third quarter of 2010, obtained from the latest issue of Blue Chip Economic Indicators (which reports survey results from "America's leading business economists"). From top left of the circle to bottom right, the points represent the 10 lowest forecasts of the most optimistic members of the 50 Blue Chip forecasting panel, the panel's consensus (or average) forecast, and the 10 highest forecasts of the most pessimistic panel participants.

I chose the third quarter as the reference point because nearly two-thirds of the Blue Chip respondents indicate that, in their view, the recession will indeed end in the third quarter of this year. Assuming this occurs, this recovery would appear to be a big outlier. Either we are about to continue making history—and not in a good way—or current guesses about the medium-term economy are way too pessimistic.

On another note, if you would like to do a little prognosticating of your own, I commend to you our new weekly editions of Economic Highlights and Financial Highlights.

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