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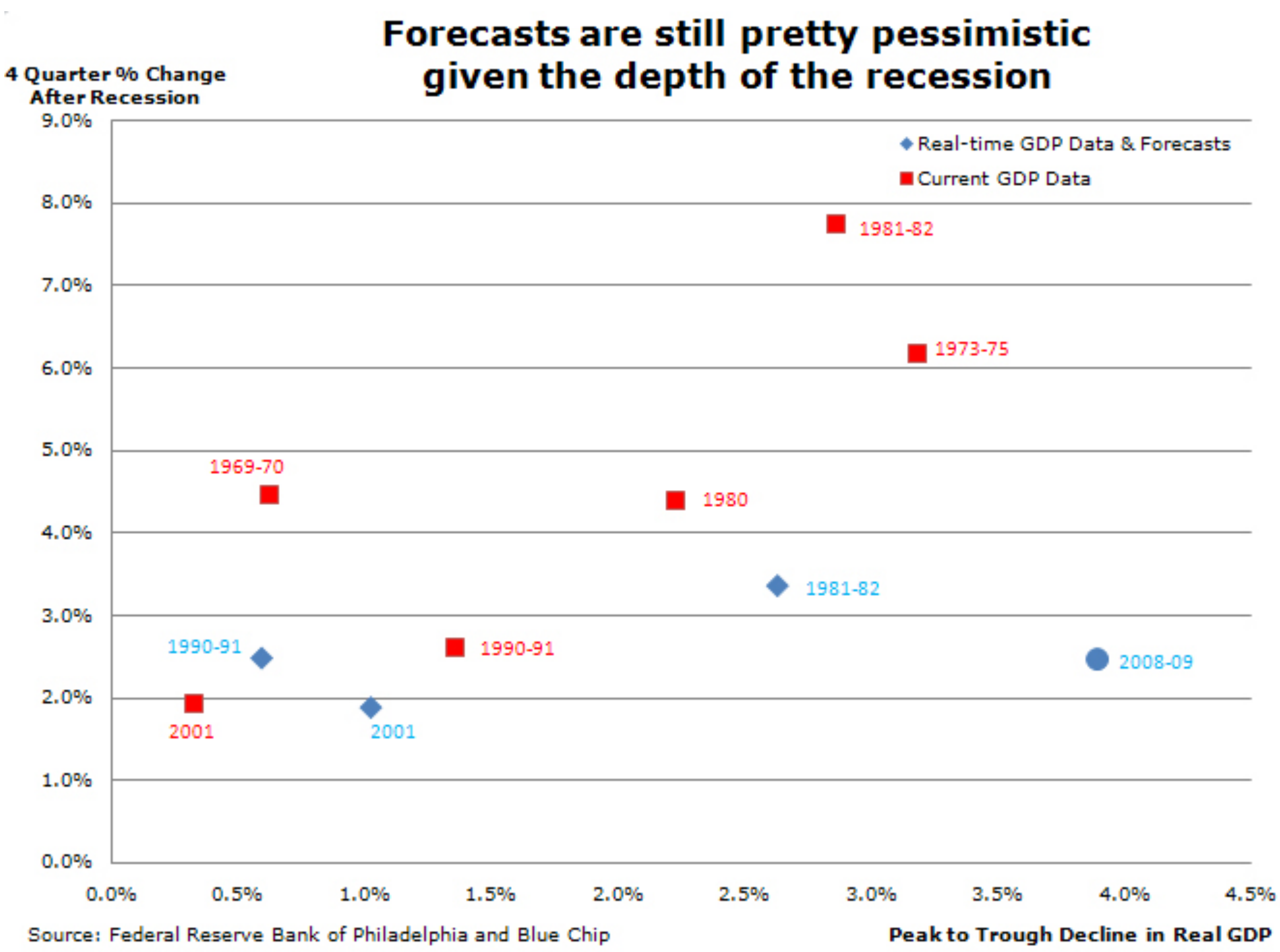
Every recovery is the same; each recovery is different

Two weeks ago, macroblog looked at the rather pessimistic expectations for what the economic recovery might look like this time around. Included was part of the narrative noting that structural adjustments are likely to impede a quick snapback in gross domestic product (GDP) over the coming quarters.

Macroblog reader Bryan Lassiter asked, "Do economists typically predict a weaker recovery than history suggests?" Good question. To state the question in a slightly different way, "Has the United States ever been in a situation where it experienced a deep recession and forecasters subsequently predicted a slow recovery that ultimately proved to be incorrectly pessimistic?"

To get at these questions, we can look at real-time real GDP data and the Survey of Professional Forecasters (SPF) available from the Federal Reserve Bank of Philadelphia (while the SPF started in 1968, forecasts of real GDP began in 1981).



The chart plots the depth of the recession on the x axis and strength of recovery on the y axis (updated from the 7/24 post to include last Friday's GDP release). The blue diamonds were constructed using forecasts that were made in the quarter the recession officially ended; the red squares are what actually happened.

To illustrate the exercise, pretend we're back in the fourth quarter of 2001 and the recession is over (although we didn't know it). Given what we thought we knew about the economy at the time, we can look at what forecasters were expecting in terms of GDP and compare it with what was ultimately reported by the U.S. Bureau of Economic Analysis. Looking at the 2001 recession, we can see that the expectations for recovery were not that far off, but the severity of the recession was lessened—partly because of data revisions and partly because of forecast error. The 1990–91 recession showed a similar pattern, but in reverse. That is, the recovery forecasts were close to the actual experience, but the depth of the recession ended up being more severe than initially thought.

What stands out in the chart is the recovery following the 1981–82 recession. In real time, four-quarter GDP growth was expected to be about 3.5 percent but wound up being much stronger at nearly 8 percent. In this instance, the response is yes to the initial question of whether economists typically predict a weaker recovery. With the 1981–82 episode, we saw a recession where economists had forecast a recovery that ultimately turned out to be much stronger than anticipated. However, the 1981–82 blue diamond was still relatively close to the cluster of other recessions on the chart, meaning the recovery forecast was not exceptionally weak. Thus, the current recession still seems to be an outlier. Given the almost 4 percent decline experienced in GDP, the hope would be to see something stronger than the 2.5 percent growth expected over the next year.

Whatever the impediments to a sharp recovery, forecasts are certainly telling us that economists are treating this recession as being different from previous ones.

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