On the definition of a recession

There seems to be a lot of confusion about “What is a Recession”? Is it the outdated “two consecutive quarters of GDP contraction”- definition? I don’t think so! I’d rather propose to follow the NBER definition:

"A recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales. A recession begins just after the economy reaches a peak of activity and ends as the economy reaches its trough. Between trough and peak, the economy is in an expansion. Expansion is the normal state of the economy; most recessions are brief and they have been rare in recent decades”. As formally defined by the NBER, it is the "Peak to Trough decrease in business activity."


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The National Bureau's Business Cycle Dating Committee maintains a chronology of the U.S. business cycle. The chronology identifies the dates of peaks and troughs that frame economic recession or expansion. The period from a peak to a trough is a recession and the period from a trough to a peak is an expansion. According to the chronology, the most recent peak occurred in March 2001, ending a record-long expansion that began in 1991. The most recent trough occurred in November 2001, inaugurating an expansion.

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On November 26, 2001, the committee determined that the peak of economic activity had occurred in March of that year. For a discussion of the committee's reasoning and the underlying evidence, see http://www.nber.org/cycles/november2001. The March 2001 peak marked the end of the expansion that began in March 1991, an expansion that lasted exactly 10 years and was the longest in the NBER's chronology. On July 16, 2003, the committee determined that a trough in economic activity occurred in November 2001. The committee's announcement of the trough is at http://www.nber.org/cycles/july2003. The trough marks the end of the recession that began in March 2001. The 2001 recession thus lasted eight months, which is somewhat less than the average duration of recessions since World War II. The postwar average, excluding the 2001 recession, is eleven months.

In choosing the dates of business-cycle turning points, the committee follows standard procedures to assure continuity in the chronology. Because a recession influences the economy broadly and is not confined to one sector, the committee emphasizes economy-wide measures of economic activity. The committee views real GDP as the single best measure of aggregate economic activity. In determining whether a recession has occurred and in identifying the approximate dates of the peak and the trough, the committee therefore places considerable weight on the estimates of real GDP issued by the Bureau of Economic Analysis of the U.S. Department of Commerce. The traditional role of the committee is to maintain a monthly chronology, however, and the BEA's real GDP estimates are only available quarterly. For this reason, the committee refers to a variety of monthly indicators to determine the months of peaks and troughs.

The committee places particular emphasis on two monthly measures of activity across the entire
economy: (1) personal income less transfer payments, in real terms and (2) employment. In addition, the committee refers to two indicators with coverage primarily of manufacturing and goods: (3) industrial production and (4) the volume of sales of the manufacturing and wholesale-retail sectors adjusted for price changes. The committee also looks at monthly estimates of real GDP such as those prepared by Macroeconomic Advisers (see http://www.macroadvisers.com). Although these indicators are the most important measures considered by the NBER in developing its business cycle chronology, there is no fixed rule about which other measures contribute information to the process.

Figure 1 shows the recent movements of quarterly real GDP superimposed on the average movement around troughs over the previous six recessions. GDP reached a peak in the fourth quarter of 2000. This was followed by contraction during the first three quarters of 2001 and growth since then. According to revised data released in September 2003 (http://www.bea.doc.gov/bea/newsrel/gdp203p.htm), real GDP increased at an annual rate of 3.3 percent in the second quarter of 2003, and 1.4 percent in the first quarter.

Figure 2 shows the movements in real personal income less transfers. Real personal income fell in early 2001. It reached its low point in October 2001 and then generally rose throughout 2003, reached its highest level in July 2003. It fell slightly in August, the most recent reported month. A comparison of Figures 1 and 2 shows that personal income has grown less rapidly than real GDP. The reasons for this are discussed in the frequently asked question on this topic below.

Figure 3 shows the behavior of payroll employment. The movement of this series is quite different from the output-based measures. Employment reached a peak in February 2001 and declined through July 2002. It rose slightly through November, but with the exception of January 2003, declined throughout 2003 until it rose in September, the most recent reported month. It is now 484,000 below the start of the year, and 2.7 million below the February 2001 peak. The fact that employment continued to decline while output-based measures rose reflects the fact that productivity has risen substantially since late 2001.

The other monthly series were generally declining in 2001 but have for the most part been rising since then. Industrial production fell until December 2001 and then rose rapidly until July 2002. It has fallen slightly since then. Real manufacturing wholesale-retail sales reached its low in September 2001. This series has generally risen since then. May, June, and July 2003, the three most recent reported months, all show substantial increases. Real GDP, according to monthly estimates provided by Macroeconomic Advisers, also reached a low in September 2001 and has generally been growing since then. It reached its highest point ever in July 2003, but was followed by a slight drop in August, the most recent reported month.

For more information, see the FAQs at the end of this memo, and also see http://www.nber.org/cycles/main.html. An Excel spreadsheet containing the data and figures for a number of indicators of economic activity considered by the committee is available at that page as well.
Figure 1. Quarterly Real GDP
The dark line shows the movement of quarterly real GDP in 2000-2003 and the shaded line the average over the previous 6 recessions. Source: Bureau of Economic Analysis, U.S. Department of Commerce (http://www.bea.doc.gov/)

Figure 2. Real Personal Income Less Transfers
The dark line shows the movement of income from May 2000 to the present and the shaded line the average over the previous 6 recessions. Source: Bureau of Economic Analysis, U.S. Department of Commerce
Source: The Conference Board (http://www.globalindicators.org)
FAQs

Q: The financial press often states the definition of a recession as two consecutive quarters of decline in real GDP. How does that relate to the NBER's recession dating procedure?

A: Most of the recessions identified by our procedures do consist of two or more quarters of declining real GDP, but not all of them. The most recent recession in our chronology was in 2001. According to data as of July 2008, the 2001 recession involved declines in the first and third quarters of 2001 but not in two consecutive quarters. Our procedure differs from the two-quarter rule in a number of ways. First, we consider the depth as well as the duration of the decline in economic activity. Recall that our definition includes the phrase, "a significant decline in economic activity." Second, we use a broader array of indicators than just real GDP. One reason for this is that the GDP data are subject to considerable revision. Third, we use monthly indicators to arrive at a monthly chronology.

Q: Could you give an example illustrating this point?

A: On July 31, 2002, the Bureau of Economic Analysis released revised figures for gross domestic product that showed three quarters of negative growth in 2001—quarters 1, 2 and 3—where previously the data had shown only quarter 3 as negative. This revision shows why the committee does not rely on a simple rule of thumb such as two consecutive quarters of negative growth, nor on GDP data alone, in making its determinations, but rather looks at a broader array of statistics. In November 2001, the committee determined the date of the peak in activity as March 2001 using its normal indicators. The two-quarter-decline rule of thumb would not have allowed the declaration of the recession until August 2002, let alone a declaration that it had begun early in 2001, as in the statement that the committee made in November 2001. It was not until eight months later that revisions in the GDP data showed declining real GDP for the first, second, and third quarters of 2001. Above we noted that the revisions through July 2008 showed only two quarters of declining real GDP.

Q: Isn't a recession a period of diminished economic activity?

A: It's more accurate to say that a recession—the way we use the word—is a period of diminishing activity rather than diminished activity. We identify a month when the economy reached a peak of activity and a later month when the economy reached a trough. The time in between is a recession, a period when the economy is contracting. The following period is an expansion. Economic activity is below normal or diminished for some part of the recession and for some part of the following expansion as well. Some call the period of diminished activity a slump.

Q: How does the NBER balance the differing behavior of employment and output?

A: The NBER considers real GDP to be the single measure that comes closest to capturing what it means by "aggregate economic activity." The committee therefore places considerable weight on real GDP and other output measures. Following the precedents established in many decades of maintaining its business cycle chronology, however, the committee considers a wide range of indicators of economic activity. There is no fixed rule for how the different indicators are weighted.
Q: In the period following November 2001, the unemployment rate rose from 5.6 percent to 6.4 percent and payroll employment fell by almost a million jobs. How can the NBER say that the economy began an expansion in November 2001?

A: The NBER defines expansions and recessions in terms of whether aggregate economic activity is rising or falling, and it views real GDP as the single best measure of economic activity. Real GDP rose substantially after November 2001. However, this growth in real GDP resulted entirely from productivity growth for an extended period. As a result, the growth in real GDP was accompanied by falling employment. Unemployment rose because of falling employment and because the labor force was rising. While the NBER has traditionally placed substantial weight on output measures, one could instead define expansions and recessions in terms of whether the fraction of the economy's productive resources that is being used is rising or falling (in which case the behavior of the unemployment rate would be a critical guide to whether the economy was in expansion or recession), or in terms of whether the quantity of productive resources being used was rising or falling (in which case employment would be a critical indicator). Either of these alternative definitions is defensible, and either might lead to the conclusion that the 2001 recession lasted much longer than 8 months and that it might not have ended yet. But if the NBER adopted either definition in dating the 2001 recession, it would have been dating the recession in a way that was inconsistent with the procedures it used it to date earlier recessions.

Q: You emphasize the payroll survey as a source for data on economy-wide employment. What about the household survey?

A: Although the household survey is a large, well-designed probability sample of the U.S. population, its estimates of total employment appear to be noisier than those from the payroll survey. For a careful reconciliation of the two surveys over the business cycle, see the Bureau of Labor Statistics study.

Q: How do the movements of unemployment claims inform the Bureau's thinking?

A: A bulge in jobless claims would appear to forecast declining employment, but we do not use forecasts and the claims numbers have a lot of noise.

Q: What about the unemployment rate?

A: Unemployment is generally a lagging indicator, so it is not as useful as indicators more directly related to economic activity, such as real GDP and employment.

Q: How do structural changes in the economy affect the NBER's method for dating business cycles? The Bureau notes that industrial production measures a declining part of the economy. What other substitutes for output bear watching, particularly with regard to service-sector activity?

A: At a quarterly frequency, real GDP is very informative. Real personal income and economy-wide employment are the most important monthly indicators. As described above, the committee also looks at monthly estimates of real GDP. Manufacturing, while a declining fraction of the U.S. economy, remains an important and cyclically sensitive sector and so warrants continued attention.

Q. Can you describe the monthly real GDP estimates?

A: The specific series the committee has been looking at is monthly real GDP prepared by Macroeconomic Advisers, a consulting firm. Many of the ingredients of the quarterly GDP figures are published at a monthly frequency by the government statistical agencies that produce them. Macroeconomic Advisers aggregates them, and then uses a statistical procedure to adjust the monthly estimates for each quarter to make them consistent with the Commerce Department's official quarterly figure. The monthly GDP numbers are fairly noisy and are subject to considerable revision.

Q. Has the committee ever before changed a cycle date based on new information?

A: In the past, the NBER has made some small changes to cycle dates, most recently in 1975. No changes have occurred since 1978 when the Business Cycle Dating Committee was formed and the current chairman was appointed. The committee would change the date of a recent peak or trough if it concluded that the date it had chosen was incorrect.

Q. Typically, how long after the beginning of a recession does the BCDC declare that a recession has started?

A: Anywhere from 6 to 18 months. We wait long enough so that the existence of a recession is not at all in doubt. We concentrate on finding the date of the peak in activity. We wait until we can assign an accurate date. We are very aware of revisions in the data, in particular.

Q. How long after the expansion starts does it take the BCDC to say that the recession has ended?

A: Same answer-around 6 to 18 months.

Q. When the BCDC says that the last recession began in January 2001 and ended in November 2001, is there a specific date in November or January?

A: Conceptually, there is some such date. We actually identify the month when the peak or trough occurred, without taking a stand on the date in the month. Thus, November 2001 is both the month when the recession ended and the month when the expansion began.

Q. When did the NBER first establish its business cycle dates?

A: The NBER was founded in 1920, and published its first business cycle dates in 1929.

Q. When was your committee first formed?
Q. How is the committee's membership determined?

A: The President of the NBER appoints the members, who include directors of the macro-related programs of the NBER plus other members with specialties in business-cycle research.

A file of historical background data is available in these formats:
Microsoft Excel 2000 Spreadsheet | HTML (MSIE 5+, Windows only) | Adobe PDF