Recession Now and Then

Wall Street says that the economic downturn is bad, and we may have a second recession, a “double-dip.” The president is upbeat about the economy. He says that its foundations are strong. Alan Greenspan at the Federal Reserve says the economy is not bad enough to cut interest rates again but holds out the possibility for future rate cuts. What’s going on?

In economics, history is the only evidence that we have to go on. Perhaps we could compare this recession to those in the past, to see how bad it is and how the recovery might go. The trouble with this strategy (fortunately) is that this is only the second recession in the past 20 years. The other one was marked as starting in July 1990 and ending in March 1991. Not much to go on. Still, how does this recession compare to that one?

It’s easy to see why Wall Street is gloomy. The fall in stock prices since early 2000 has been huge. Back in 1990-91, stock prices stopped increasing for just a few months. This time, the Dow Jones Industrial Average has fallen 25 percent in two-and-a-half years. The NASDAQ stock index, with all its high-tech businesses, has fallen about 70 percent from its monthly high in February 2000. That’s a crash almost as bad as 1929.

Consumer spending grew rapidly during the 1990s expansion. The rise in stock prices was thought to be a reason. People with stocks felt richer, so they spent more. Now that the market has fallen, consumer spending is growing more slowly. Spending was growing 5 percent a year 1999; this year, it will grow about 3 percent. But back in ’91, consumer spending actually fell from 1990 to 1991. One difference is auto sales. This time, sales haven’t dropped much at all. Consumers will buy about 16 million vehicles this year, about the same as during the 1990s expansion. In the last recession, auto sales dropped to around 12 million a year.

Investment in buildings and equipment is especially volatile in recessions. This year, investment is down about 7 percent from its early-2001 high. But last time, investment fell nearly 10 percent. A big difference is housing construction. It has continued as if there was no recession at all. Contractors will build about 1.7 million homes this year. They built only 1 million in 1991.

The unemployment rate has increased but only to 5.9 percent so far. After the last recession, the unemployment rate kept rising for a year after the recession ended. The rate peaked at
7.8 percent. Inflation is lower this time, too. Prices will increase less than 2 percent this year. Last time, inflation was more than 5 percent per year at the start of the recession, 3 percent at the end.

The last recession helped shrink our trade deficit with the rest of the world. The value of the dollar had been falling for several years, and this made our exports cheaper to buy. Exports kept growing, but consumers bought fewer imports. This time, though, the value of the dollar has only recently started falling, and the rest of the world is experiencing recession. This makes it harder to sell goods overseas. Imports have dropped, but exports have dropped more. The trade deficit has gotten bigger. As a share of total output, it’s bigger than it has ever been.

So, except for the stock market and international trade, this recession seems milder than the last one. What about the recovery? The last recovery turned into the 10-year 1990s expansion. But that expansion really had two parts—a very slow beginning (we were worried about a double-dip recession in 1992) and a very rapid middle and end.

That’s probably what will happen again. Unless there’s another shock from the Middle East (a new war, an oil price hike), we should have slow growth for a year or two and maybe a bit more unemployment. But consumers will keep spending. As everyone is fond of saying, consumers are two-thirds of the economy. If they are going to spend 3 percent more each year, there’s no way we can have a double-dip recession.

8-22-02

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