STATE BOARD OF EQUALIZATION

ECONOMIC PERSPECTIVE

Summary of Recent Economic Developments *February 2002*

❖ *U.S. Economic Developments*

March 2001 Recession Start Date Announced

Coming as no surprise, the National Bureau of Economic Research (NBER) announced that a recession began in March 2001. Real gross domestic product (GDP) rose slightly in the second quarter of 2001, by 0.3 percent, even though the recession had already started. However, real GDP decreased 1.3 percent in the third quarter of 2001, the largest decline since 1991. The advance estimate shows that real GDP increased just 0.2 percent in the fourth quarter and 1.1 percent for all of 2001. (The final estimate of fourth quarter 2001 real GDP is sehcduled to be released in late March.)

Early 2002 Recovery Widely Anticipated

Many economic forecasters believe real GDP will increase less than 1.0 percent in the first quarter, followed by growth of 2.0 to 3.0 percent in subsequent quarters. A Philadelphia Federal Reserve Bank survey of 29 forecasters calls for real GDP to increase 0.8 percent in 2002. This growth rate would be similar in magnitude to that of 2001, but well below the average long-term rate of 3.2 percent per year from 1991 through 2000.

Rising Unemployment Rate Throughout 2001

After averaging 4.5 percent in the second quarter of 2001, the U.S. unemployment rate rose to 4.8 percent in the third quarter and 5.6 percent in the fourth quarter. The rate averaged 4.8 percent for 2001, up sharply from 4.0 percent for 2000. The number of employees on nonagricultural payrolls reached a peak in March 2001, and has generally fallen since then. About 1.4 million nonagricultural jobs were lost from March through December 2001.

(Information derived from: National Bureau of Economic Research (NBER), website: www.nber.org; "Survey of Professional Forecasters," Federal Reserve Bank of Philadelphia, November 20, 2001, website: www.phil.frb.org; U.S. Department of Commerce, STAT-USA website: www.stat-usa.gov.)

❖ *California Economic Developments*

Later Start to California Recession?

Like the U.S. economy, most analysts believe that the California economy is currently in recession. Unlike the U.S. economy, there is no generally recognized organization that determines when recessions start and end for the state. In December 2001, the UCLA Anderson Forecasting Project released its forecast for the California economy.

Given the data available at the time of their forecast, the UCLA economists thought that the state had entered into a recession in the spring of 2001, somewhat later than the nation did.

UCLA Predicts Early 2002 California Turnaround

California nonagricultural employment generally declined from June through December of 2001.[1] (Nonagricultural payroll employment is one of the most comprehensive measures of economic well being available for states on a timely basis.) UCLA predicted that California economic growth, as measured by nonagricultural employment, would slowly increase in the first quarter of 2002. In 2001, nonagricultural employment rose 1.3 percent, based on preliminary figures released by the California Employment Development Department. UCLA forecasted that California nonagricultural employment would increase 0.7 percent in 2002, followed by 2.2 percent growth in 2003. These growth rates are much lower than the average annual growth in nonagricultural employment of 3.2 percent during the last half of the 1990s (1996 through 2000).

California Unemployment Rising

The California unemployment rate reached a low of 4.5 percent about a year ago, in February 2001. The state's unemployment rate generally rose throughout 2001. The rate averaged 5.2 percent for the third quarter and jumped to 6.0 percent for the fourth quarter. For 2001 as a whole, the California unemployment rate was 5.2 percent. In its December 2001 forecast UCLA predicted that the California unemployment rate would continue to rise over the next couple of quarters, averaging 6.3 percent for 2002.

[1] The California Employment Development Department will release revisions of 2001 nonagricultural employment in late February. The revisions could change the monthly pattern.

Sharp Decline in Third Quarter 2001 Taxable Sales

As a consequence of the state's recession, taxable sales growth slowed dramatically in the first half of 2001, and declined sharply in the third quarter of 2001. The Board of Equalization's preliminary estimate shows that taxable sales declined 4.4 percent in the third quarter of 2001 compared to the third quarter of 2000. This is the first decline since 1993, and it follows a weak quarterly trend for the first half of 2001. Compared to their respective quarters of 2000, taxable sales rose 4.3 percent in the first quarter and just 1.2 percent in the second quarter. To put the weakness of these figures in perspective, taxable sales increased 11.9 percent in 2000. For the five-year period 1996 through 2000, taxable sales rose an average of 8.0 percent per year. In 1991, the first complete year of the last recession experienced in California, taxable sales declined 3.9 percent. However, the recession of the early 1990s was much more severe than the current recession is expected to be.

(Information derived from: *The UCLA Anderson Forecast*, December 2001 website: www.uclaforecast.com; California Employment Development Department (EDD), *Labor Market Conditions in California,* January 11, 2002, EDD Labor Market Information website: www.calmis.ca.gov; California Department of Finance, *Governor's Budget Summary: 2002-03,* website: www.ca.dof.gov; Board of Equalization, News Release #62, December 19, 2001, *Taxable Sales in California,* website: www.boe.ca.gov.)

❖ *What Kind of Recession Will This Be?*

Now that the U.S. economy is in a recession, what kind of recession is it likely to be? Historical data indicate that recessions have varied considerably. They can be deep (associated with large declines in real GDP) or shallow, long or short in duration.

Recession Definitions

Economists generally accept the conclusions of the National Bureau of Economic Research (NBER) Business Cycle Dating Committee as to the definition of a recession and when they begin and end.[2] NEBR defines a recession as "… a significant decline in activity spread across the economy, lasting more than a few months, visible in industrial production, employment, real income, and wholesale-retail trade." A simpler definition, often cited in the financial press, is that a recession is two consecutive quarters of decline in real GDP. NBER notes that most, but not all, recessions do consist of two or more quarters of declining real GDP. However, while NBER considers real GDP as one of many factors going into its recession date determinations, it suffers two major problems: it is only available quarterly, not monthly, and it is subject to large historical revisions.

Major Economic Indicators of Recessions

The NBER website has two articles[3] discussing the four most important monthly indicators they consider in determining recession starting and ending dates. These are: (1) employment, (2) real personal income excluding transfer payments,[4] (3) industrial pr oduction and (4) real manufacturing and trade sales (combined). The first two indicators are broad, including both goods and services, while the last two indicators more narrowly measure activity only for goods and manufacturing. The NBER articles each include four charts comparing these variables for the current recession and the average of the six recessions since 1960, nine months before and after the recession start dates. (For the current recession, the data are shown for as many months as the data are available, generally through November 2001.)

Employment Decline Average

Monthly employment reached its highest level in March 2001, the same month as the start of the recession. Employment was growing faster than the average of these six recessions prior to the start of the current recession, and it has declined very close to average so far (through December 2001, the most recent data available for the January 10, 2002 article). From March through December 2001 employment declined 1.0 percent, close to the total decline of the average recession. Based on this factor alone, the current recession appears to be about average in depth, as long as there are no further declines in employment.

Income Decline Less Than Average

Real personal income excluding transfer payments reached a peak in September 2001, six months after the recession started. In the average recession, personal income less transfers started to decline when the recession began. Based on this factor alone, the current recession appears to be milder than average in depth so far.

Industrial Production Declines for Longer Period

Industrial production reached its peak in September 2000, more than six months prior to the start of the recession. From September 2000 through November 2001 industrial production has declined almost 7 percent, far surpassing

[2] NBER describes themselves on their website as "…a private, nonprofit, nonpartisan research organization dedicated to promoting a greater understanding of how the economy works."

[3] The original article was published in November 2001, and it was updated in January 2002.

[4] Transfer payments are income payments for which no current services are performed. They include private retirement benefits, social security, unemployment insurance, food stamps, and public assistance, among other kinds of transfer payments. NBER excludes these payments since they are not related to current production (GDP) and because some of them, such as unemployment insurance, food stamps, and public assistance tend to increase during recessions.

the average recession decline of 4.6 percent. However, since the start of the recession in March 2001, the declines in industrial production have been about the same as those of the average recession.

Sales Decline Less Than Average

Real manufacturing and trade sales reached its peak in the autumn of 2000, at approximately the same time as industrial production. However, real manufacturing and trade sales has not declined as much since March 2001 as it has for average recessions. Furthermore, real manufacturing and trade sales jumped sharply in October 2001, very uncharacteristic of the average recession. October trade sales were boosted by very strong auto sales, caused by widespread zero-interest rate financing incentives.

❖ *Milder Than Average Recession?*

Therefore, if one considers the period since March 2001 only, these four indicators suggest that the current recession will be somewhat milder in depth than the average recession since 1960, given the data available so far. However, it is possible that future data revisions may change the relative comparisons of these factors in relation to their respective averages.

How Long a Recession?

It is also possible that the current recession could last longer than average. Trends observed since March 2001 in these four indicators say nothing about how long the recession will last in relation to the average recession. The average recession since 1960 has lasted almost one year. The NBER Business Cycle Dating Committee concludes their January article by stating that "…there is no suggestion in the data as yet of a trough in economic activity." In its December 2001 forecast, UCLA provided an in-depth analysis of the current recession compared to nine previous post World War II recessions using these and other economic indicators. They and many other forecasters expect that the current recession will be about average in duration and that an economic expansion will begin sometime in the spring.

(Information derived from: *"The Business-Cycle Peak of March 2001,"* November 26, 2001; *"The NBER's Business-Cycle Dating Procedure,"* January 10, 2002, National Bureau of Economic Research (NBER) website: www.nber.org.)

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