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The Recession Is Over! But Don’t Get Too Excited.

Economies take a long time to recover after the trough

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- *With record economic growth and hiring this summer, we may soon learn that the recession is already technically over.*
- *But the end of the recession doesn’t mean the economy has recovered, only that the worst is behind us in terms of lost economic output, income, and jobs.*
- *Expect the recovery in GDP to take another year, while regaining the lost jobs will take closer to two years. That’s just to get back to pre-pandemic levels. Getting back to the former trajectory—regaining the lost growth as well as the lost output and jobs—will take longer still.*
- *Investors should be mindful that the path forward will be slow and uneven, even after the recession is declared to be over.*

Next Thursday the Bureau of Economic Analysis will release its first estimate of economic growth for the third quarter of 2020. Almost certainly it will set records for the greatest absolute and percentage quarterly Gross National Product (“GDP”) gains since the government started calculating national income accounts just after WWII. Only three times has real GDP jumped more than 15% in a quarter, most recently in 1978. The current record holder occurred in 1Q50 when GDP soared 16.7% following a moderate recession in 1949.

The next GDP report should blow past that mark comfortably, as much of the nation’s productive capacity reopened this summer. The October Economic Forecasting Survey by the Wall Street Journal anticipates a 28.5% gain, while the respected GDPNow model from the Atlanta Fed predicts 3Q20 GDP will grow by 35.3%—more than twice the current record. Even better, at least psychologically, the National Bureau of Economic Research (“NBER”)—the official arbiters for U.S. business cycles—may soon pronounce that the recession is already over, assuming third-quarter growth is sustained. (Normally an economic downturn must be sustained for more than a few months to be deemed a recession. However, the NBER has already informally concluded that “the drop in activity had been so great and so widely diffused throughout the economy that the downturn should be classified as a recession even if it proved to be quite brief.”)

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Time to pop the champagne? Not quite yet. Just because a recession is officially over doesn't mean that the economy has healed. On the contrary, a recession is deemed to have ended once it hits bottom, not when it gets back to its pre-recession peak. In the words of the NBER, "[R]ecessions and expansions refer to the direction of change in economic activity, not its level." So an economy growing from its trough is said to be in an "expansion" phase, even if economic activity is still below prior levels. (Note that the NBER considers a range of economic metrics beyond just GDP to demarcate business cycle phases.)

If GDP grew by, say, 30% in the third quarter, the level of economic output would still be $800 billion or 4% below its year-end 2019 level. That may not sound like much, given the wild gyrations in economic activity during this pandemic, but that's still nearly twice the *entire* 2.1% decline in GDP averaged during the last five recessions. Further, employment at the end of September was still down 10.3 million jobs or 6.8% from the end of last year. So, still a long way to go.

The Long Road to Full Economic Recovery

How long might it take to get to a full recovery? Much as Tolstoy observed that "every unhappy family is unhappy in its own way," every economic downturn has a unique set of causes and issues, and so each has its own path and trajectory to recovery.

But though every recession is different, recent history can help us frame the parameters of the eventual recovery. Shown in Figure 1 below is the path of economic loss and recovery following each of the past five recessions, plus the initial track for the current pandemic recession, all indexed to the same percentage losses and gains. On average it has taken a bit over six quarters (1½ years) to get back to pre-recession levels of economic output, or about five quarters if we exclude the Great Financial Crisis ("GFC") that started in late 2007 and was a clear outlier.

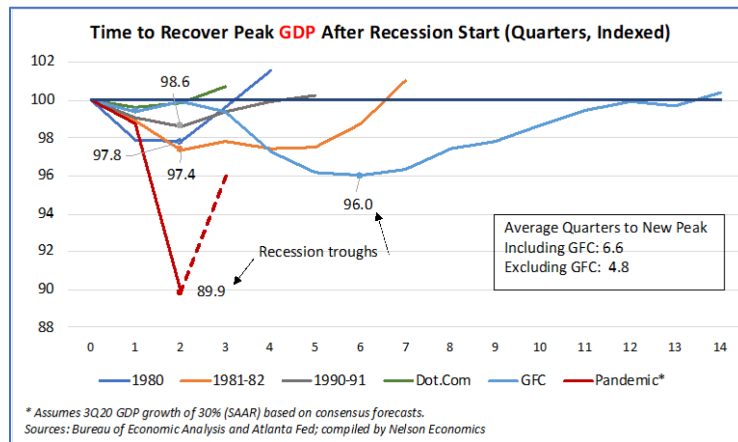

Figure 1

Aside from the average recovery periods, the other comparison to note is that even with the robust third-quarter growth, the *remaining* GDP loss in this recession would still exceed or match the *total* loss in every other recent recession.

Recovering jobs lost in a recession takes considerably longer. First, job losses almost always exceed output declines on a percentage basis. Then, employers initially replace laid-off workers with capital investments to increase the productivity of the remaining workers before they start rehiring. In fact, the jobs recovery period in recent recessions has averaged twice as long as the GDP recovery period, as shown in Figure 2. Also evident is that the job recovery period has lengthened with each successive recession.

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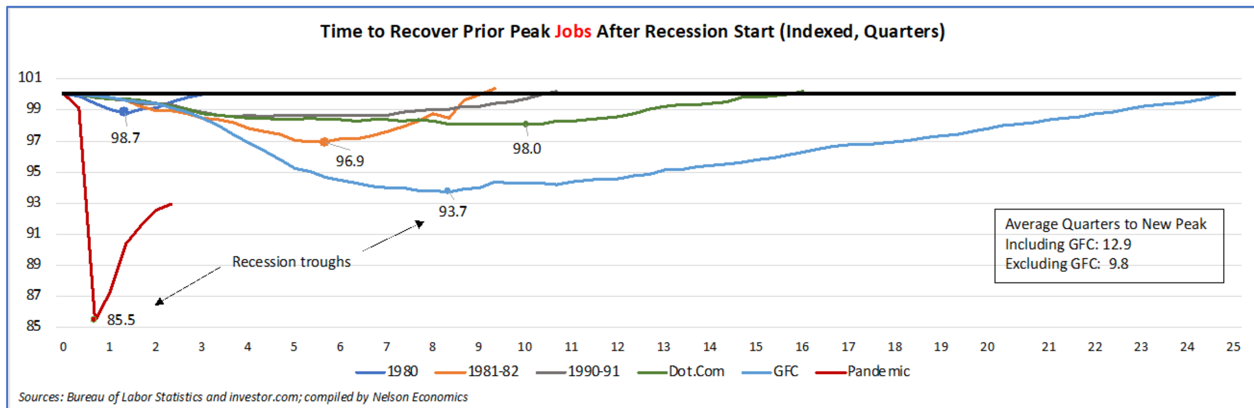

Figure 2

These graphs also illustrate that it generally takes more time to recover the lost economic output and jobs after their trough—that is, after the recession is officially over—than it does to lose them. In other words, the descent is typically faster than the following ascent, as detailed in Figure 3.

The Long Road to Economic Recovery after a Recession
Averages During Last Five Recessions

	Average Including GFC			Average Excluding GFC		
	Real GDP	**Income***	**Jobs**	**Real GDP**	**Income***	**Jobs**
Percent loss at trough	-2.1%	-1.8%	-2.7%	-1.6%	-0.8%	-1.8%
Quarters falling to trough	2.6	3.2	5.8	1.8	2.5	5.2
Qtrs growing after trough	4.0	3.4	7.1	3.0	3.0	4.7
Quarters to full recovery	6.6	6.6	12.9	4.8	5.5	9.8

** Personal Income net of unemployent insurance benefits, adjusted for inflation.*
Sources: Bureau of Economic Analysis and Bureau of Labor Statistics; compiled by Nelson Economics

Figure 3

Also shown are the loss and growth rates for personal income, from which I had deducted unemployment insurance benefits to focus on ongoing, non-recessionary income. We care about income because it ultimately supports consumer spending, which accounts for more than two-thirds of GDP. Personal income dips during recessions, though not as much as GDP or jobs because of automatic income stabilizers such as social security and pensions, which continue to be paid even during downturns. Nonetheless, income generally takes longer than GDP to regain pre-recession levels, though not as long as jobs.

A Slowing Recovery? Or a Double-Dip Recession?

Despite the blockbuster GDP report due next week, there is ample evidence that the recovery will not continue at a torrid pace and in fact that the rebound has already slowed sharply. GDP is published only quarterly, but higher-frequency metrics reveal the drop-off in recent months. The rate of growth in industrial output—the value of U.S. manufacturing plants, mines, and utilities—published by the Federal Reserve has been declining every month since June and was actually negative in September. Gauges of business sentiment from the Institute for Supply Management for manufacturing and services similarly show that the pace of production and new orders are slowing, though remain in positive territory. And regional economic indices from the various Federal Reserve districts generally show continued growth but at a slower rate.

Job growth, too, is positive but has been slowing each month. In a recent article, I showed that the jobs recovery is stalling as "temporary" furloughs convert into permanent job losses, hiring slows, new unemployment claims remain stubbornly high, and more layoffs loom.

By now we can assume that most businesses that could reopen already have, and that firms have already rehired most workers needed to support their volume of business. Further job growth will depend on repairing the damaged economy and beating back the coronavirus. In short, the low-hanging fruit has been picked, and reaching the higher fruit be more difficult and will take longer.

And the recovery might well reverse course, particularly absent more government support. A double-dip recession is by no means inevitable, but it's not hard to construct such a scenario, based on three factors. Most importantly, the pandemic is continuing apace, with a third wave of infections building in the U.S. Fortunately, the increase in cases does not seem to be causing a commensurate rise in hospitalizations, and the death rate appears to be flat for now. (The rising caseload appears to reflect mostly increased testing, and a rising share of cases are infecting younger, less vulnerable populations, as explained here.) Still, the rising caseload is worrying, and could well precipitate more restrictions on economic activities if it continues to intensify, even if few analysts expect another round of widespread lockdowns like those we endured this spring.

Second, most of the pandemic relief programs have expired, and prospects for new or augmented programs seem uncertain at best. Without this support, millions of businesses and households could be headed for bankruptcy, reducing consumer and business spending, and increasing layoffs. Moreover, numerous state and local governments are suffering severe budget deficits from fall revenues and increased costs, precipitating even more layoffs.

Finally, the coming of winter portends a significant economic decline in some key sectors assuming a vaccine is not widely available. Many businesses that adapted to the coronavirus this summer by moving activities like dining outdoors will be forced to close. A report by Gusto projects that the cold weather could induce the loss of between 1.4 and 2.8 million jobs in the Leisure and Hospitality sector alone, with significant direct hits to economic activity (e.g., lost restaurant sales) as well as knock-on hits to GDP (e.g., reduced spending by restaurant workers who lose their jobs).

All of which together point to a possible "W-shaped" recovery. Here, it must be emphasized that growth is continuing at rates that would be cause for celebration in normal times. The 660,000 jobs added in September would rank as the third-highest monthly job gain in the last 50 years prior to this year. Most economic metrics remain positive. Thus, a second downturn this winter is not the most likely scenario, but it does remain a definite risk.

Outlook

With record economic growth and hiring this summer, we may soon learn that the recession is already technically over. But that doesn't mean the economy has recovered, only that the worst is behind us in terms of lost economic output, income, and jobs. And though this recession certainly differs from any other in our history in its particulars, recent recessions of all stripes together suggest that getting back to pre-pandemic levels will take some time: on average a year for GDP and closer to two years for jobs, after the trough has been reached, as it most likely was in the spring.

That's the timeframe just to get back to pre-pandemic levels. Getting back to the former trajectory—regaining the lost growth as well as the lost output and jobs—will take longer still. Investors should be mindful that the path forward will be slow and uneven, even after the recession is declared to be over. Consumer spending and confidence will not return to their prior peak levels for a while.

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