UNLV | CENTER FOR BUSINESS & ECONOMIC RESEARCH
COLLEGE OF BUSINESS

August 19, 2011

Is the U.S. Economy Headed for a Double-Dip Recession?

Stephen P. A. Brown and Ryan T. Kennelly

In late July, the Bureau of Economic Analysis released revised figures for U.S. gross domestic product (GDP). The new data tell us that the most recent U.S. recession was deeper and the ensuing recovery was much weaker than we previously thought. Moreover, the first half of 2011 showed the weakest economic growth since the official end of the recession in June 2009. The tepid recovery raises a concern that U.S. economy could dip back into recession.

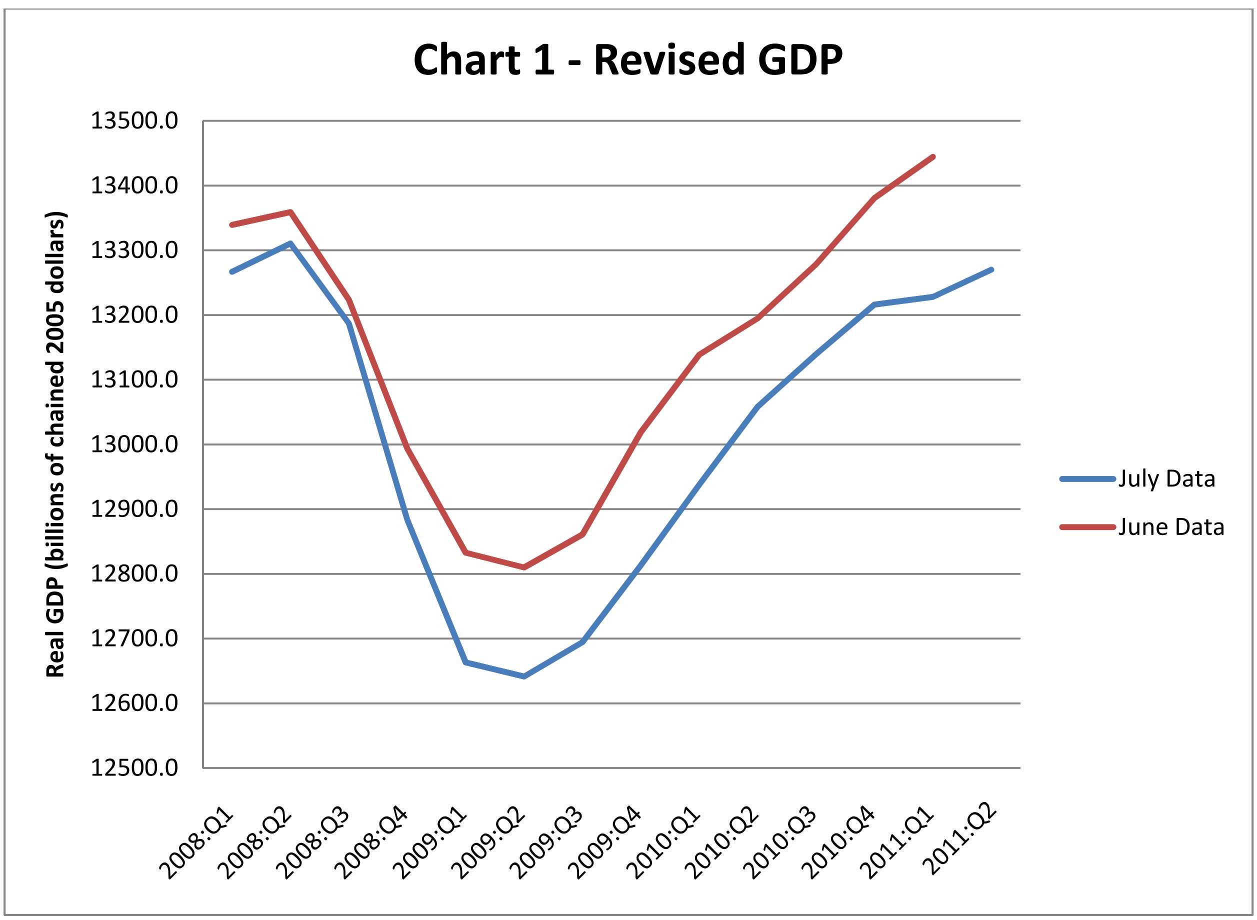
We reexamine U.S. economic conditions and what various economic indicators—including GDP growth, stock market fluctuations, fiscal policy, unemployment, world oil prices, the yield curve and the Index of U.S. Leading Economic Indicators—tell us about the likelihood of another U.S. recession in the near future. Although U.S. economic activity is slow, these indicators provide no convincing evidence that a downturn is imminent. U.S. real GDP is likely to continue growing and reach its prerecession peak before any downturn occurs.

Is the U.S. Economy Headed for a Double-Dip Recession?

In late July, the Bureau of Economic Analysis released revised figures for U.S. gross domestic product (GDP). The new data tell us that the most recent U.S. recession was deeper and the ensuing recovery was much weaker than we previously thought. Moreover, the first half of 2011 showed the weakest economic growth since the official end of the recession in June 2009. The tepid recovery raises concerns that the U.S. economy could dip back into recession. Accordingly, we reexamine U.S. economic conditions and what seven economic indicators—GDP growth, stock market fluctuations, fiscal policy, unemployment, world oil prices, the yield curve and the Index of U.S. Leading Economic Indicators—tell us about the likelihood of another U.S. recession in the near future.

U.S. Real GDP Revised

As shown in Chart 1, U.S. GDP fell by 5.0 percent from its peak in second quarter 2008 to its trough in second quarter 2009. The prior estimate was a decline of 4.1 percent. From the trough to second quarter 2011, U.S. GDP increased by 5.0 percent. The prior estimate was an increase of 5.0 percent through first quarter 2011. Perhaps more troubling is the fact that the growth of real GDP slowed to an annualized average of 0.8 percent in the first half of 2011.

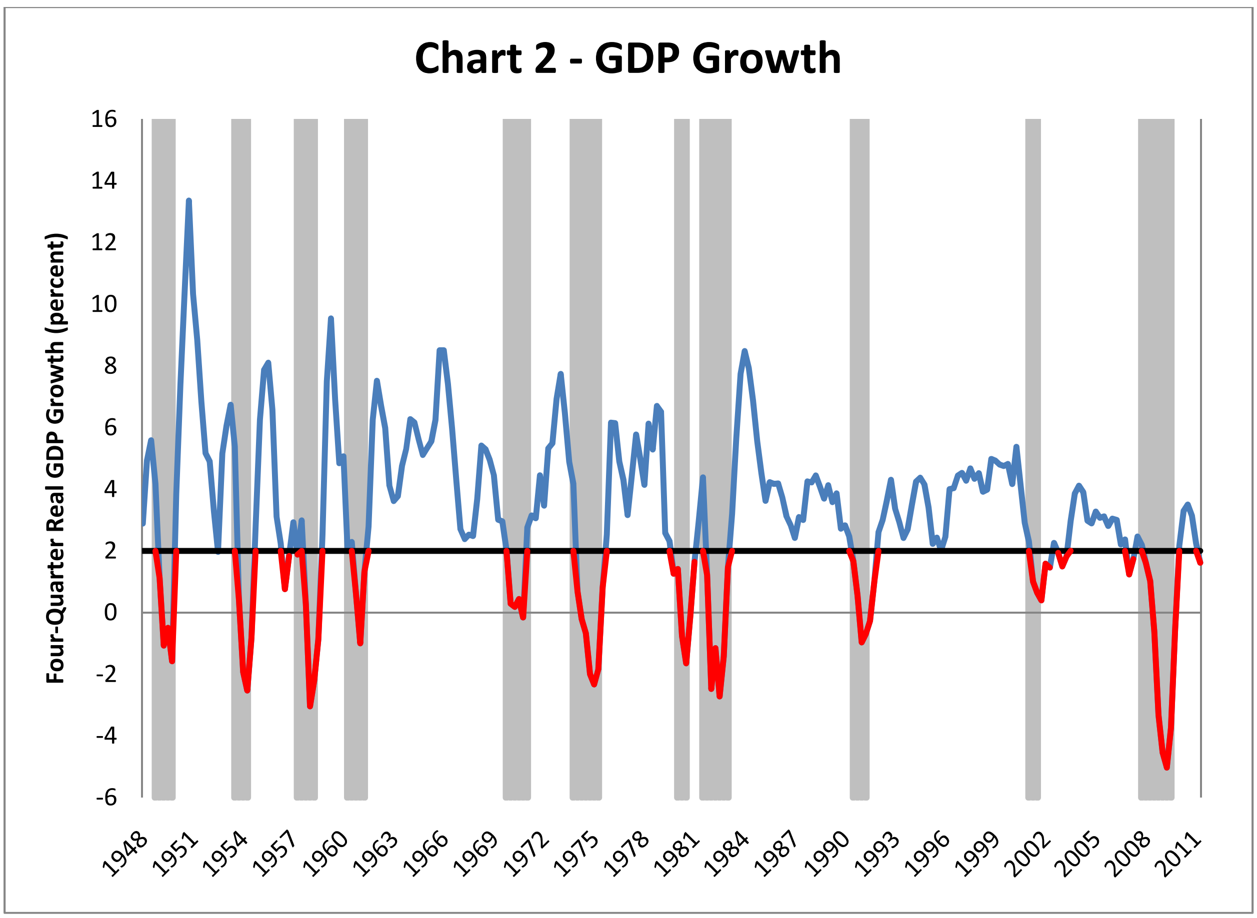


Source: U.S. Bureau of Economic Analysis

With U.S. GDP for second quarter 2011 below the prerecession peak of $13.3105 trillion (2005 $), the onset of recession in third quarter would mean a double-dip recession. The economy will not have reached its previous high before another recession occurs. Should U.S. real GDP grow at an annualized rate of 1.2 percent in third quarter (which is low by historical standards), the U.S. economy will finally reach its prerecession peak and the possibility of a double-dip recession will be averted.

Does Slowing Economic Growth Portend Recession?

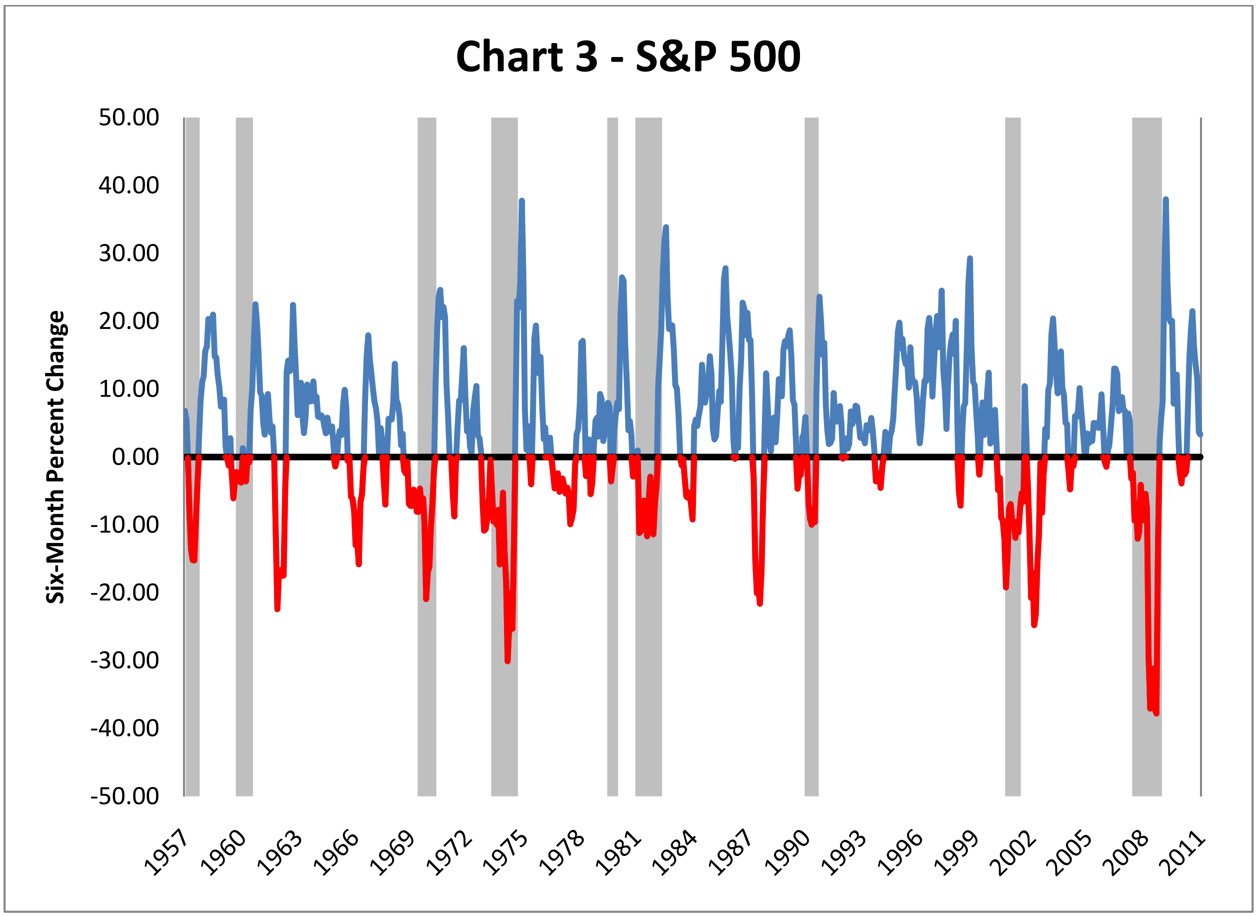
Does slowing economic growth itself indicate the economy is stalling and heading toward another recession? For the most recent four quarters ending in second quarter 2011, the annual growth rate of real GDP has dropped to 1.6 percent (Chart 2). All the recessions since World War II came when the four-quarter growth rate of real GDP fell below 2 percent. In nine of those cases, however, the four-quarter average growth rate provided no advance warning of recession. For only two of the eleven post World War II recessions did the indicator precede onset of the recession. Worse, the series also provided three false warnings that recession was imminent. Hence, we cannot conclude that the recent slowdown portends another recession.



Source: U.S. Bureau of Economic Analysis

Stock Market Fluctuations

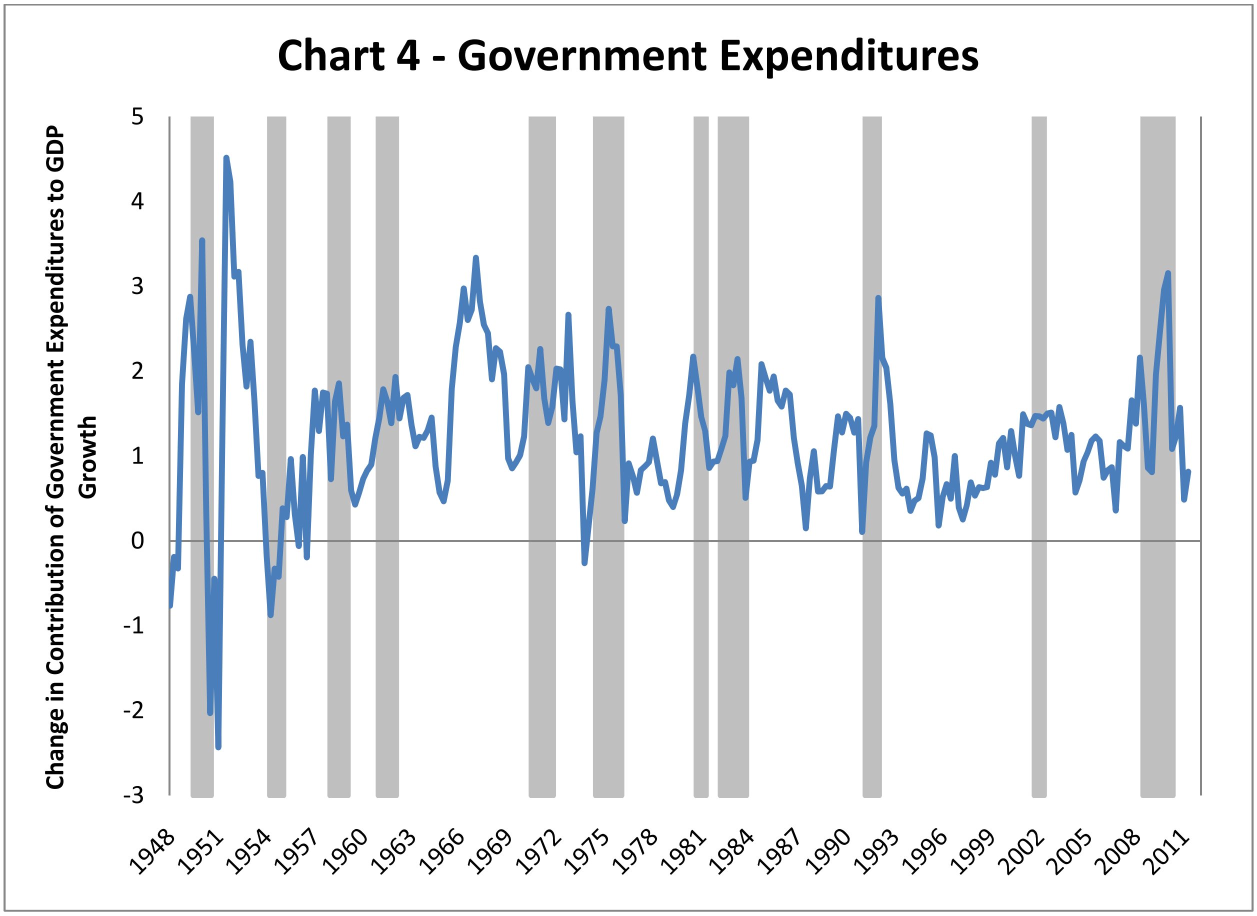
During the past couple of weeks, we have seen the stock market make incredible gains and incur great losses. Those fluctuations have been attributed to debt-ceiling fiasco and subsequent U.S. credit rating downgrade. What do these fluctuations imply for the probability of a double-dip recession? Using the S&P 500 Index to represent the stock market, we can see that it has a history of ups and downs (Chart 3). Declines in the stock market have preceded six of the last eight recessions and accompanied the other two. In addition, the index has produced many false alarms, indicating a possible downturn when none follows, which leaves us with an unreliable indicator that is not currently indicating recession.



Source: Standard and Poor's

Tighter Fiscal Policy

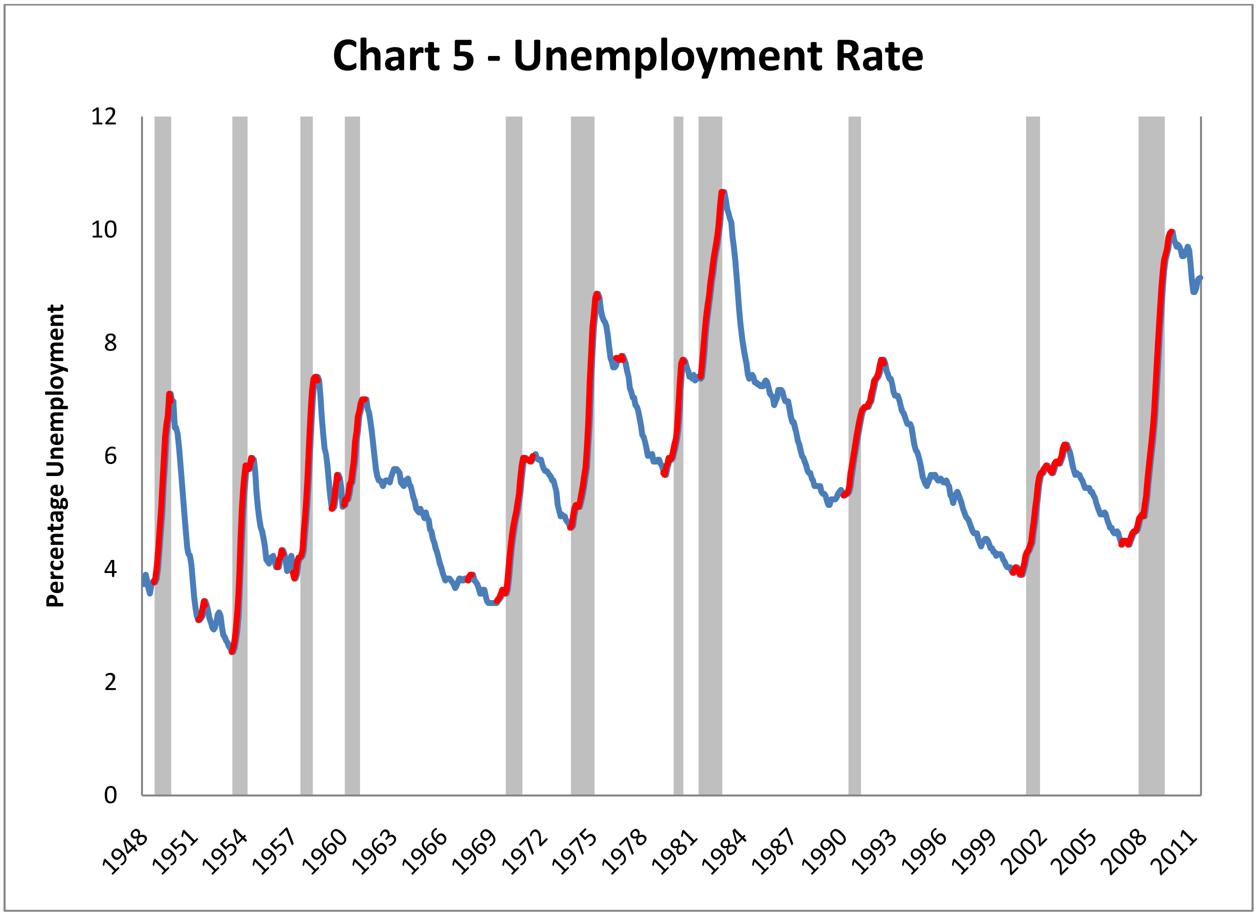
There has been concern that a tightening fiscal policy could push the United States into an economic downturn. Chart 4 illustrates the contribution of government expenditures to GDP growth (as measured quarterly on a year-over-year basis). Although government spending commonly falls after a recession, there is no consistent pattern before recessions. Some recessions are preceded by an increase in government spending and others by a decrease. Therefore, we can't conclude that a tightening of fiscal policy signals another recession—even though such policy could contribute to a recession.



Source: U.S. Bureau of Economic Analysis

Unemployment Rate Rises

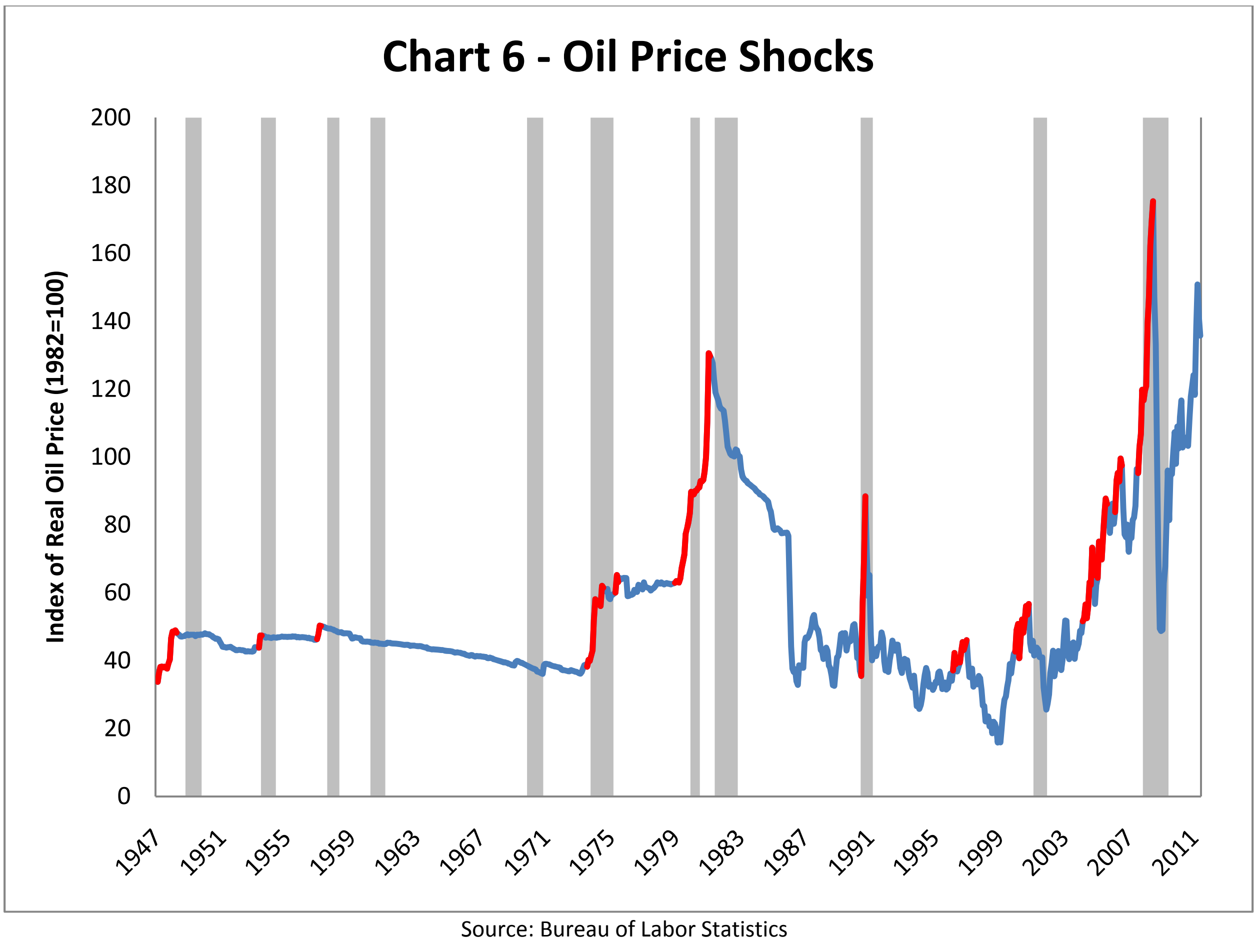
During every recession, the unemployment rate rises rapidly. Less than half the time, however, has an increasing unemployment preceded a recession. As shown in Chart 5, the unemployment rate increased quickly (0.33 percentage points higher than the most recent low) during six of the last eleven recessions, but only five times prior to a recession. The measure also provided five false warnings. Although the unemployment rate does not currently suggest recession, the indicator does not rule out an imminent recession because swelling unemployment rates often coincide with recessions, rather than precede them.



Source: Bureau of Labor Statistics

World Oil Price Shocks

As shown in Chart 6, sharply rising oil prices (which take oil prices higher than they have been the previous three years) preceded all but two of the U.S. recessions since World War II. The exceptions are the 1960 and 1970 recessions. The indicator provided two false signals—in the mid-1990s and from 2002 to 2005. Most attribute the 2008-2009 recession to a financial market meltdown rather than the 2007 oil price spike. Economist James Hamilton argues that had oil prices not risen, the economy would have merely slowed down rather than dropped into recession.[1] Currently, oil prices do not show the sharp increases that have preceded most of the past 11 recessions.

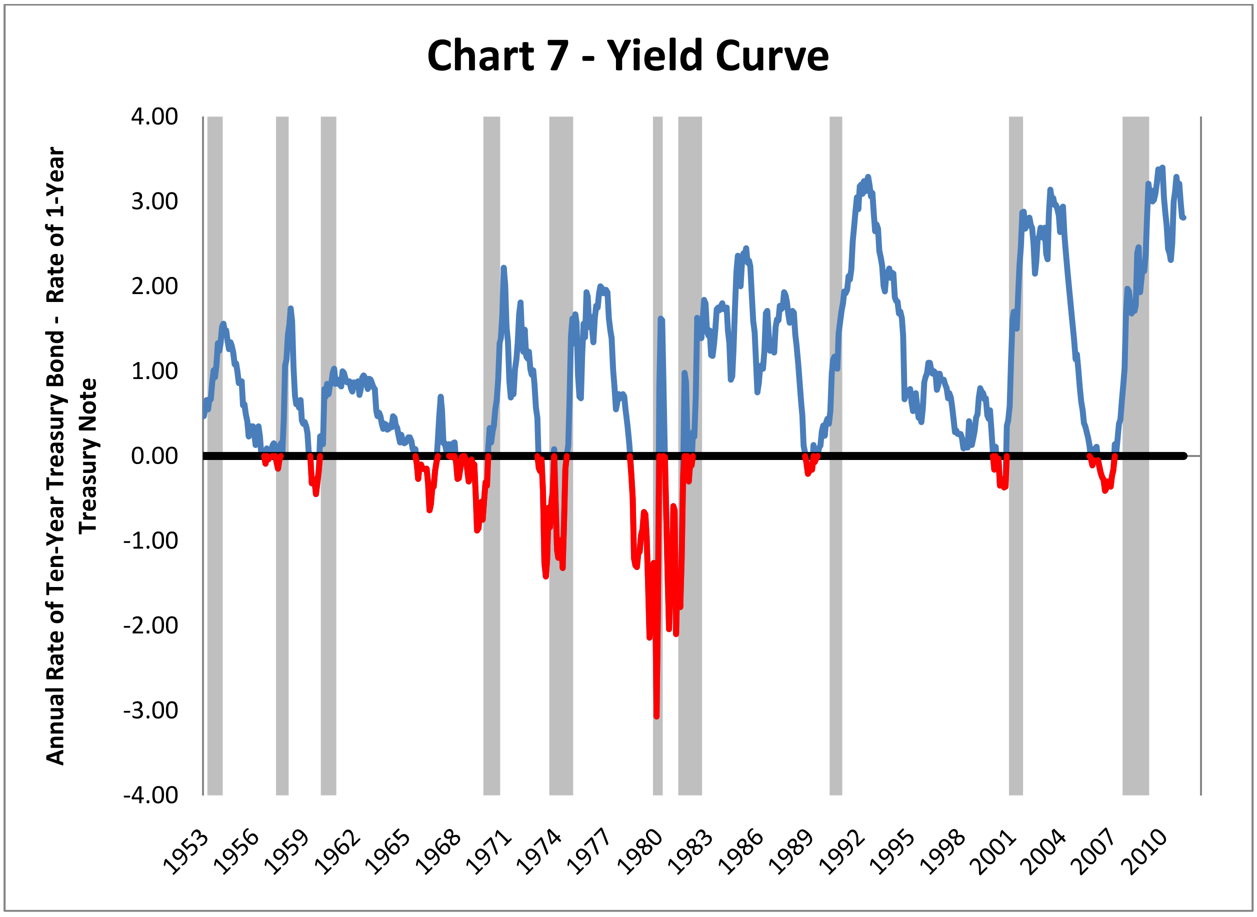


[1] James D. Hamilton, "Causes and Consequences of the Oil Shock of 2007-08," *Brookings Papers on Economic Activity*, Spring 2009, pp. 215-84.

Yield Curve Inverts

One of the most reliable indicators of impending U.S. recessions is inversion of the yield curve on U.S. Treasury securities. The yield curve is calculated by subtracting the interest rate on the one-year Treasury note from the interest rate on the ten-year Treasury bond. The explanation for the predictive power of an inverted yield curve is that long-term interest rates represent a combination of today's short-term rates and expectations of future short-term rates. If long-term rates are lower than short-term rates, the market expects interest rates to fall. Because short-term interest rates are procyclical, market expectations of falling rates are indicative of weakening economic activity.

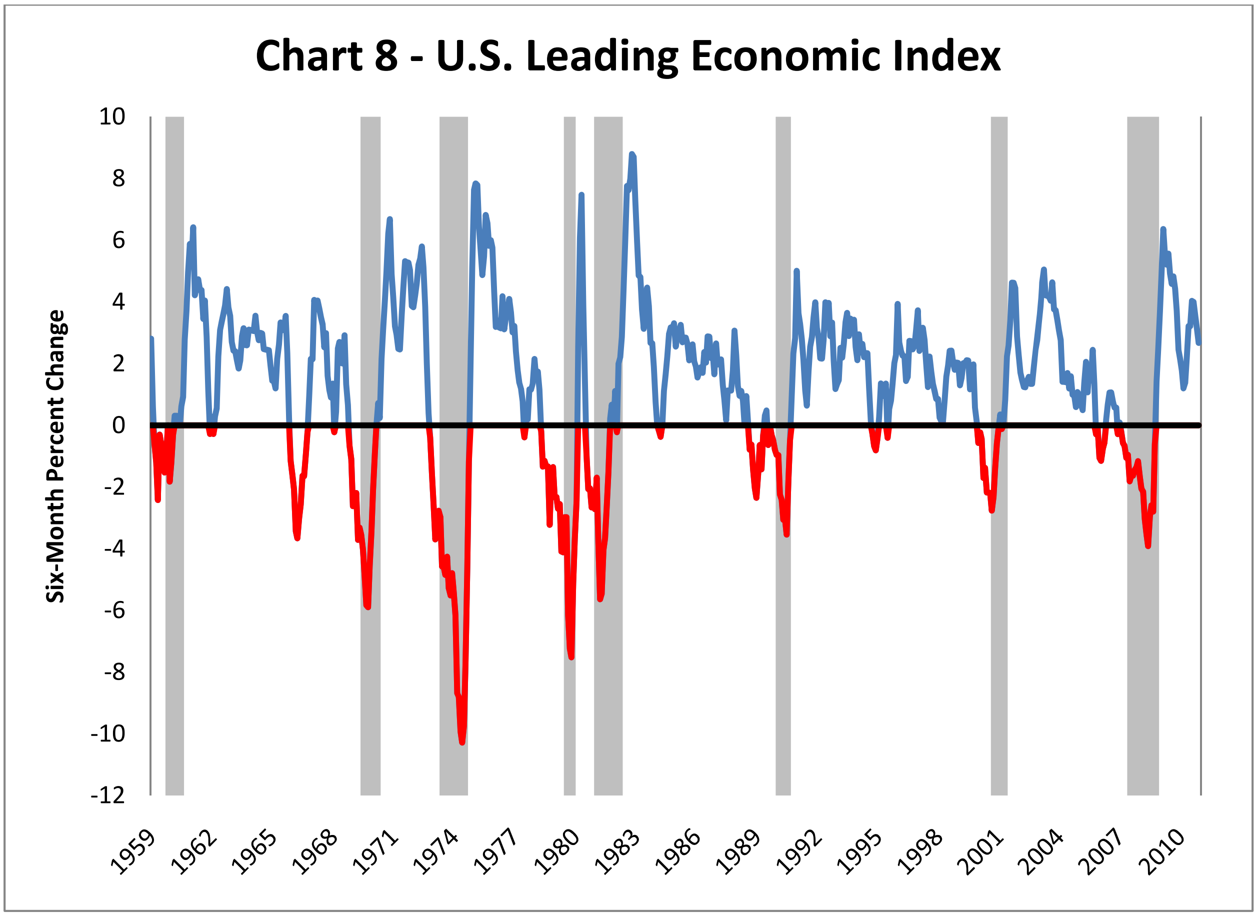
As shown in Chart 7, an inverted yield curve has provided advance warning for all of the last nine U.S. recessions. It provided a false alarm only in the mid-1960s. Currently, the yield curve does not suggest a recession is coming, but there is a possibility that the current U.S. monetary policy is distorting the measure by holding short-term rates artificially low and preventing the yield curve from inverting.



Source: Board of Governors of the Federal Reserve System

Leading Economic Indicators

Since 1959, the U.S. Index of Leading Economic Indicators (published by the Conference Board) has been an invaluable tool for predicting U.S. economic activity. As shown in Chart 8, the index has declined sharply prior to all eight of the recessions since its creation. The index has turned down six times without a subsequent recession, but only two were major declines and four were relatively minor. Currently, the six-month percentage change in the index is positive, suggesting that the economy will expand in the near future rather than head toward another recession.



Source: Conference Board

Outlook: No U.S. Recession Imminent

Taken together, the seven indicators we examined suggest that another U.S. recession is not imminent. Only one of the seven indicators that we considered—slowing GDP—suggests that a recession might be imminent (Table 1). That indicator has a history of providing false warnings, which means that its warning ought to be disregarded. None of the other six indicators shows that a recession is impending.

Three of these indicators—the stock market, fiscal policy and the unemployment rate—are unreliable as harbingers of recession and probably shouldn't be consulted for that purpose. The other three indicators—world oil price shocks, an inverted yield curve and the Index of U.S. Leading Economic Indicators—have solid records and indicate no recession is imminent. Therefore, U.S. real GDP is likely to continue growing. Even a moderate rate of growth in third quarter 2011 will push U.S. real GDP to its prerecession peak of $13.3105 trillion (2005 $), eliminating the possibility of a double-dip recession.

Table 1. Current Status of U.S. Indicators of Recession

Indicator	Current Status	Reliability	Evaluation
Slowing GDP	Recession	Generates false warnings; provides late warnings	Disregard
Stock Market	No Recession	Unreliable	Disregard
Tighter Fiscal Policy	Unclear	Unreliable	Disregard
Unemployment Rate	No Recession	Unreliable	Disregard
World Oil Price Shocks	No Recession	Missed only 2 of 11 recessions; generated several warnings	No Recession
Inverted Yield Curve	No Recession	Preceded 9 of last 9 recessions; generated a false warning	No Recession
Index of U.S. Leading Economic Indicators	No Recession	Preceded 8 of last 8 recessions; generated several false warnings	No Recession

Stephen P. A. Brown, Ph.D.
Director, Center for Business and Economic Research
University of Nevada, Las Vegas

Ryan Kennelly
Graduate Assistant, Center for Business and Economic Research
University of Nevada, Las Vegas