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# A Closer Look at U.S. Economic Weakness

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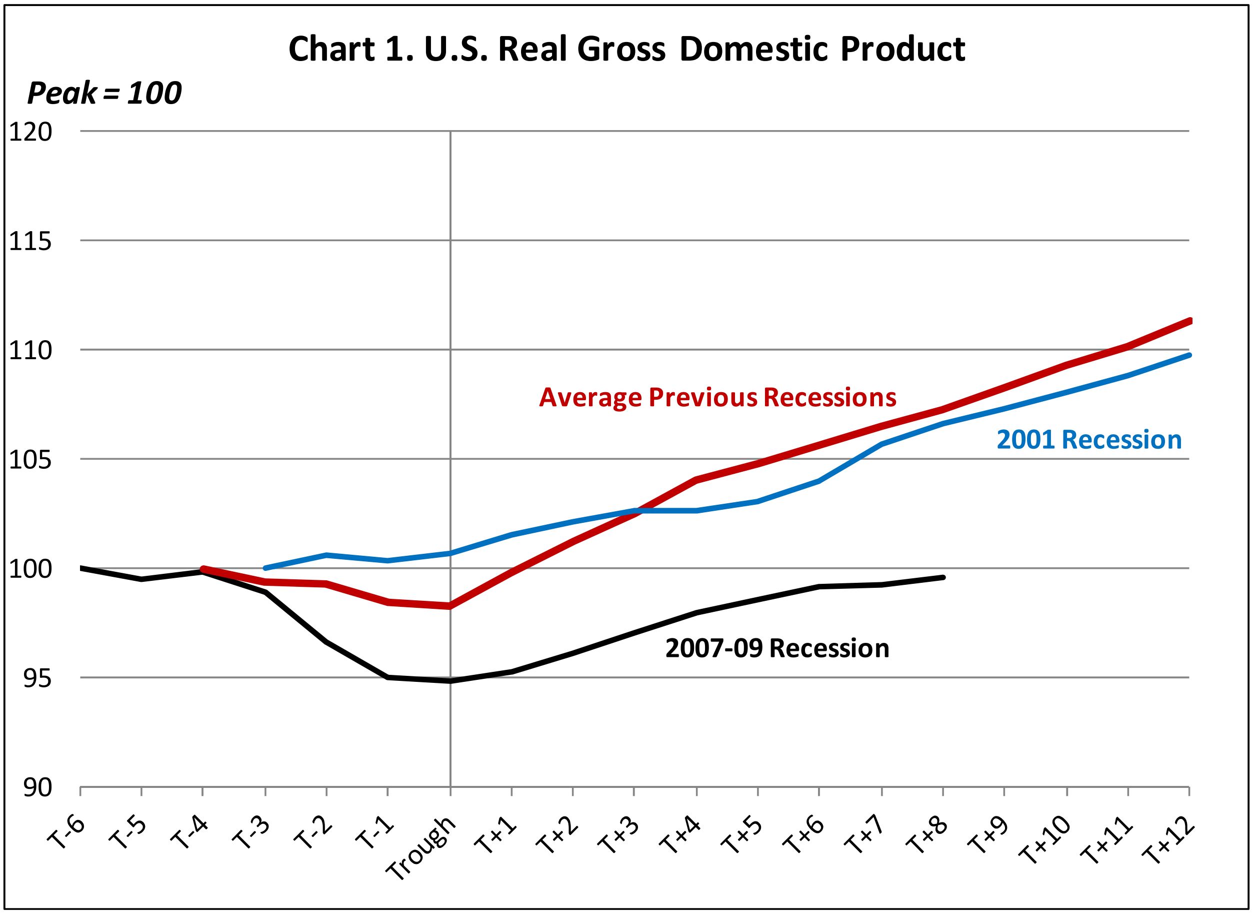
The most recent recession was the deepest of any since World War II. During the 2007-09 recession, U.S. real gross domestic product (GDP) fell 5.1 percent from peak to trough. The average peak-to-trough decline in real GDP during the ten previous recessions was 1.7 percent.

Perhaps worse, the recovery has been much slower than those following previous recessions. Real GDP has grown by only 5.0 percent in the two years since the trough and has not yet reached its prerecession peak. In the previous ten recoveries, real GDP reached its prerecession peak between one and two quarters after the trough, and real GDP grew by an average of 9.1 percent in the two years following the recession.

In a recent CBER report, Brown (2011) examined how the financial crisis created such a deep recession and slow recovery. In this report, we examine how various components of GDP spending have fared during the recession and recovery. This examination provides some insight into which aspects of spending have been most greatly affected, how the recovery might proceed and what policy measures might help spur stronger economic activity.

## Recession and Recovery

The United States has endured 11 recessions since World War II. As shown in Chart 1, U.S. real GDP fell much more sharply in the 2007-2009 recession than is the average of the other ten recessions since World War II. The recovery also has been much slower. In contrast, the 2001 recession was shallower than the average and showed a similar recovery pattern as previous recessions.



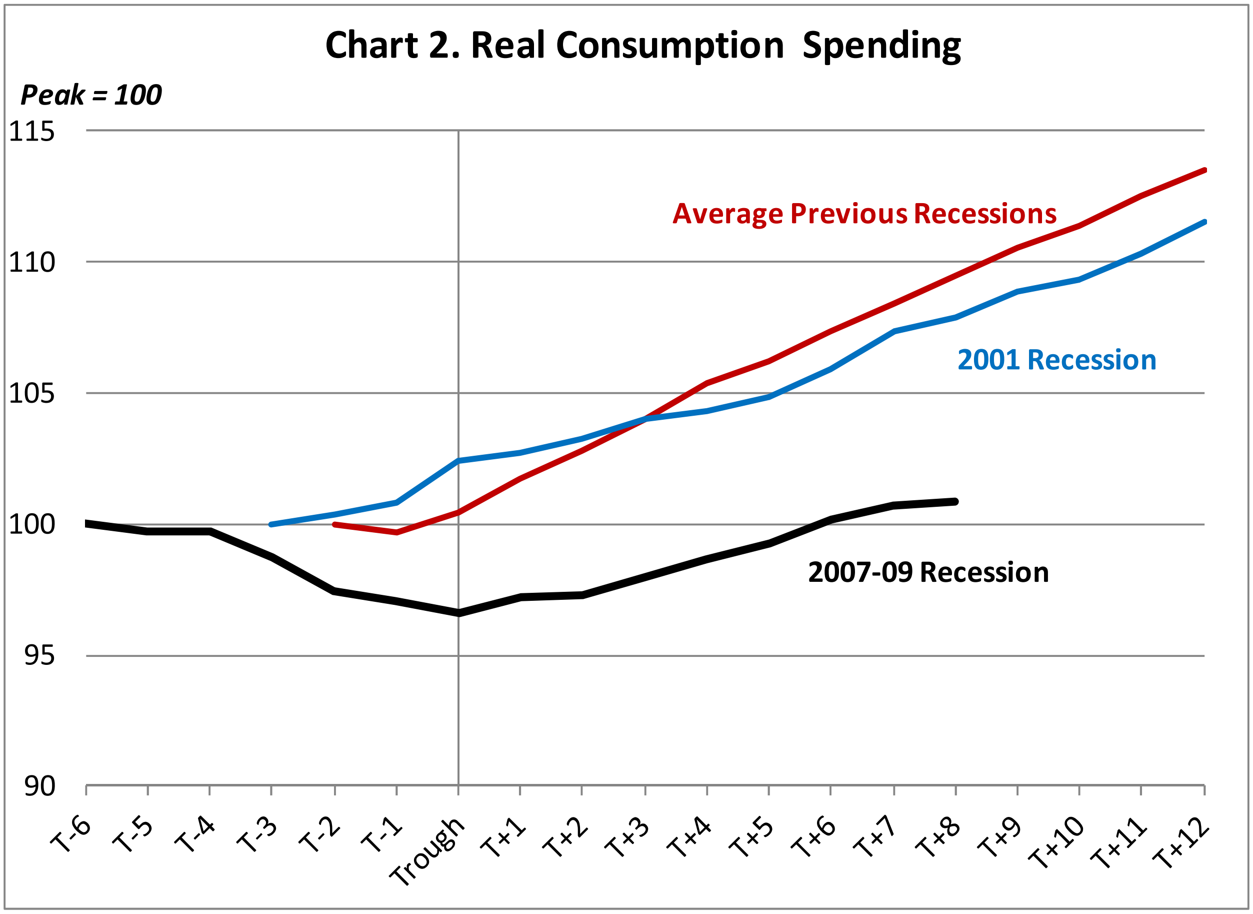

Sources: U.S. Bureau of Economic Analysis; National Bureau of Economic Research

### Consumption Spending

Consumption spending is the largest component of GDP spending. Over the past two business cycles, consumption spending has varied from 65 to 70 percent of total GDP spending, averaging about 68 percent. Consumption spending reflects household purchases of goods and services (other than house purchases).

As shown in Chart 2, consumption spending has been one of the stronger components of economic activity during the recession and recovery. During the recession, consumption spending fell by 3.4 percent below its peak. In the two years since the trough, consumption spending has increased 4.4 percent. Consumption spending reached its prerecession peak six quarters after the trough.

During the ten previous recessions, consumption spending typically began recovering before the trough and was higher than its prerecession peak at the trough. On average, consumption spending increased by 9.0 percent during the two years after the trough in past recoveries. During the recovery from the 2001 recession, consumption spending was similar to the average.



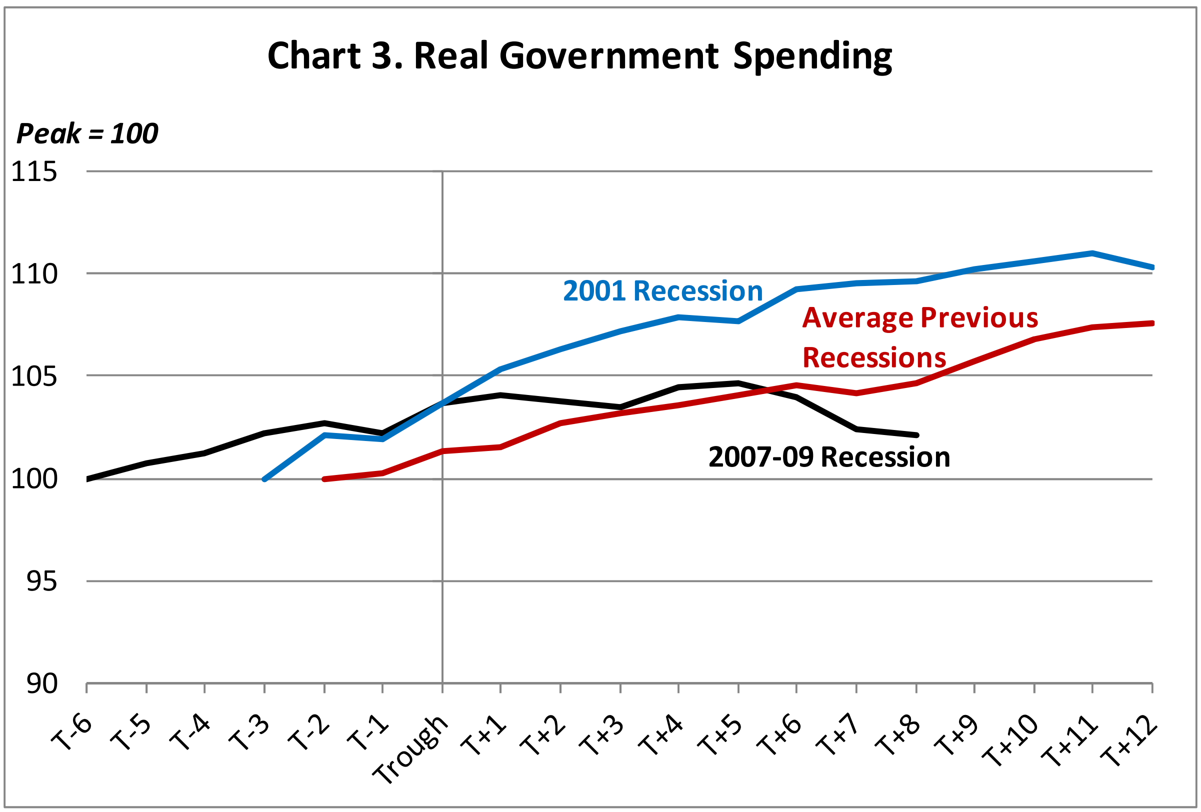

Sources: U.S. Bureau of Economic Analysis; National Bureau of Economic Research

**Government Spending**

Government spending includes the purchases of goods and services made by federal, state and local governments. It excludes transfer payments, such as welfare, unemployment insurance, social security, Medicare and Medicaid. Over the past two business cycles, government spending has averaged about 19 percent of total GDP spending.

As shown in Chart 3, government spending was the strongest component of economic activity during the recession, but has contributed to weakened spending during recovery. During the recession, government spending rose by 3.7 percent. Since the trough, government spending has decreased by 1.5 percent.

During the ten previous recessions, government spending typically rose by 1.3 percent. During the previous ten recoveries, average government spending increased by 3.2 percent over the two years following the trough. During the recovery from the 2001 recession, government spending took a somewhat higher path than the average.



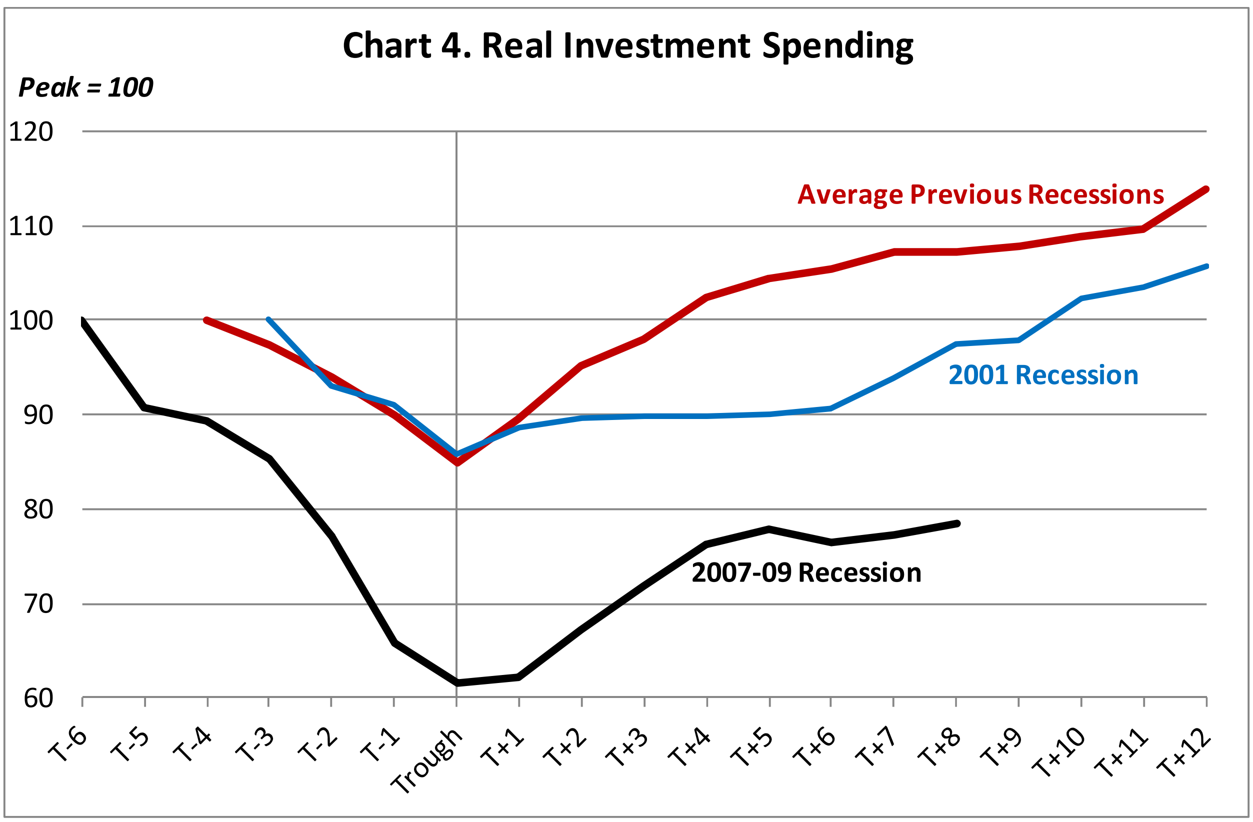

Sources: U.S. Bureau of Economic Analysis; National Bureau of Economic Research

**Investment Spending**

Investment spending is one of the most volatile components of GDP spending. Over the past two business cycles, investment spending has varied from 10 to 18 percent of total GDP spending, averaging about 15 percent. Investment contains three components: business fixed investment, residential investment and inventories.

As shown in Chart 4, investment spending contributed greatly to the decline in spending during the recession and has not contributed as much to the recovery. During the recession, investment spending fell by 38.3 percent. Since the trough, investment spending has increased by 27.3 percent. At eight quarters since the trough, investment spending remains 21.5 percent below its value at the peak.

During the ten previous recessions, investment spending fell an average of 15.1 percent. During the previous ten recoveries, average investment spending increased by 26.3 percent over the two years following the trough. During previous recoveries, investment spending exceeded the prerecession peak an average of four quarters after the trough. Investment spending was below average in the recovery from the 2001 recession.




Sources: U.S. Bureau of Economic Analysis; National Bureau of Economic Research

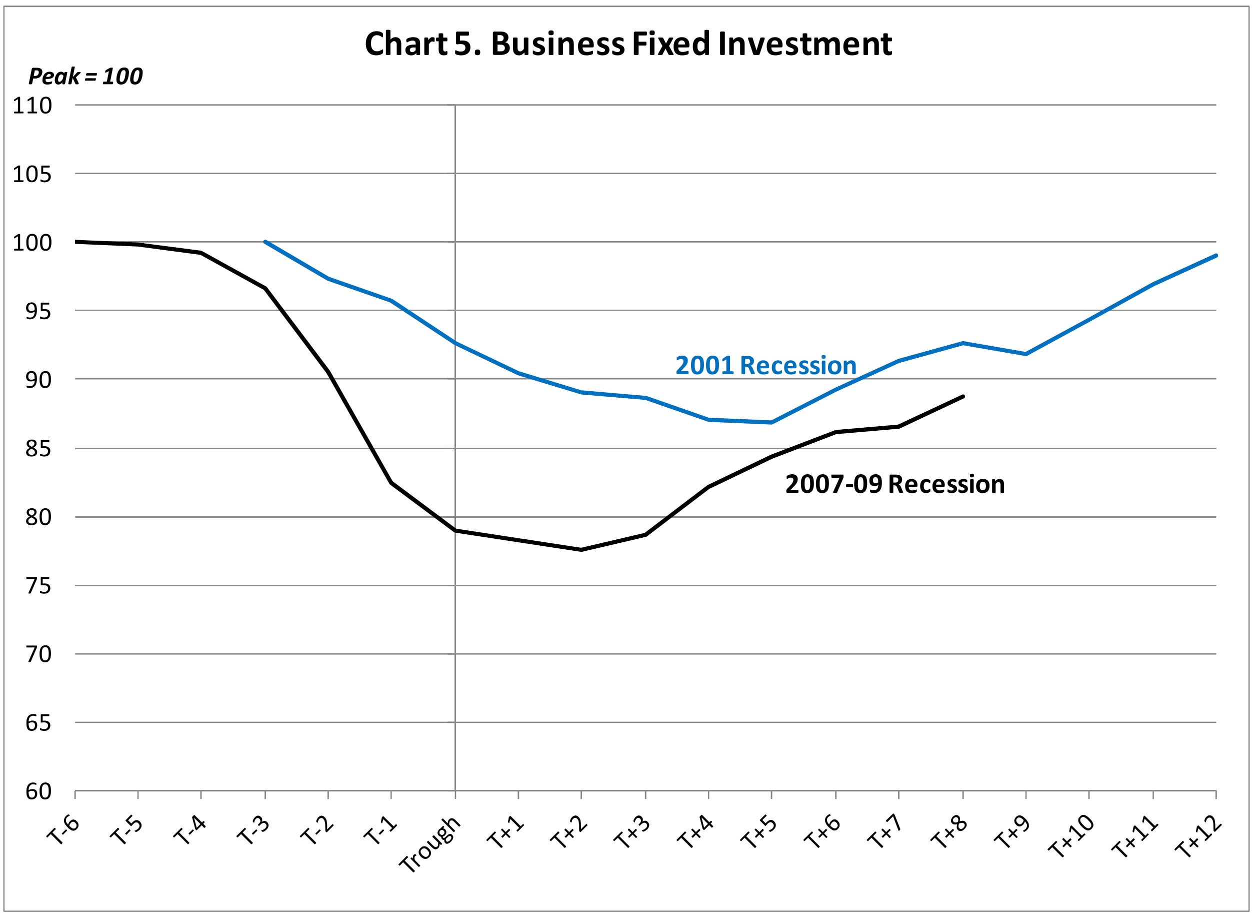
## Uneven Investment Spending

Knowing that investment spending is weak during the current recovery provides a somewhat incomplete picture. Both business fixed investment and residential investment are weaker than they were during the previous recovery. Residential investment spending is much weaker. Inventory investment spending is relatively robust.

## Business Fixed Investment

As shown in Chart 5, business fixed investment spending reached bottom five quarters after the trough of the 2001 recession. At its nadir, business fixed investment spending was 14.2 percent below its prerecession peak. Eight quarters after the trough, business fixed investment spending was 7.4 percent below its prerecession peak. Business fixed investment spending did not exceed its prerecession peak until 13 quarters after the trough. (Data on business fixed investment spending are not available for the recessions prior to 2001.)

In the current recovery, business fixed investment spending reached bottom two quarters after the trough, but it fell by 22.4 percent below its prerecession peak. Since hitting its most recent bottom, business fixed investment rose by 14.4 percent. Eight quarters after the trough, business fixed investment remains 11.2 percent below its prerecession peak.

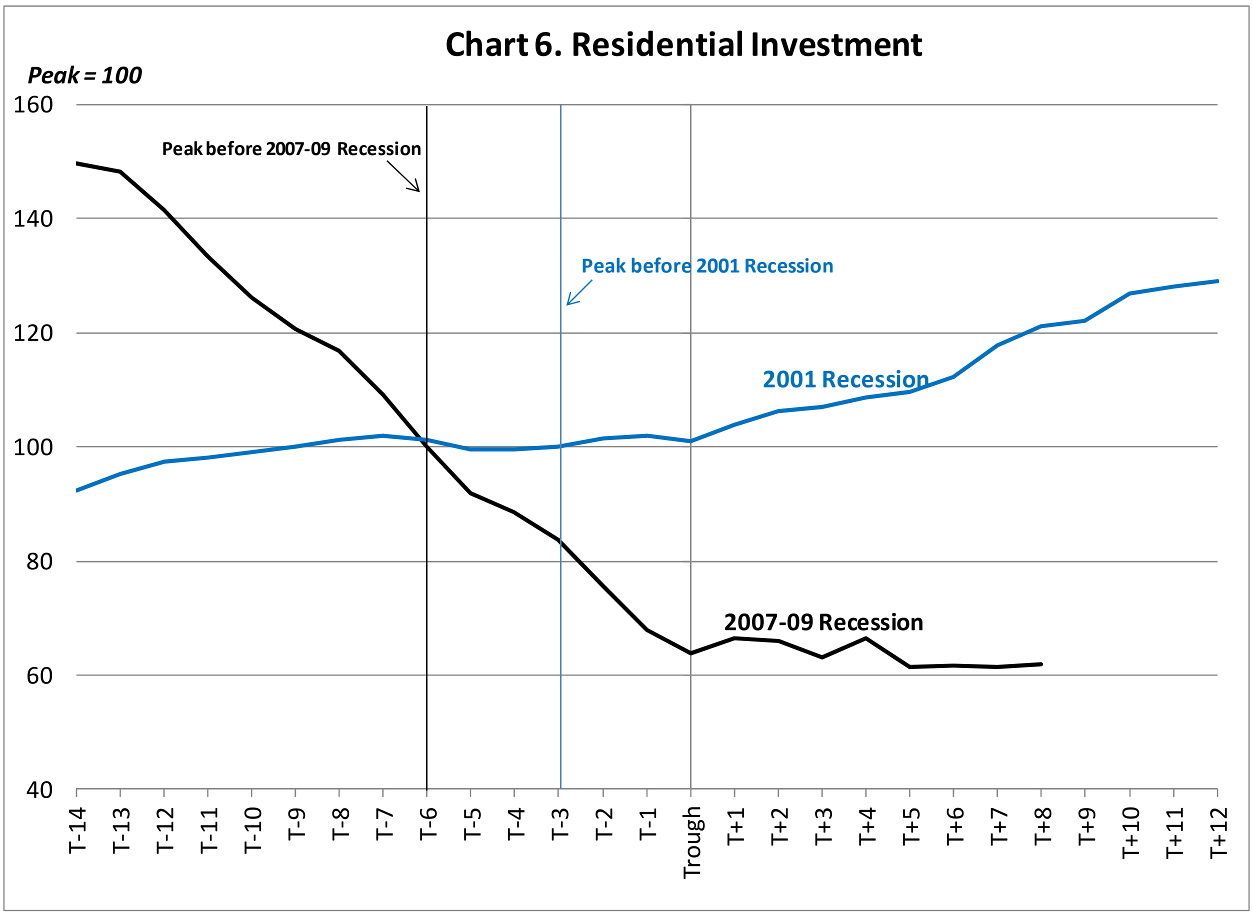



Sources: U.S. Bureau of Economic Analysis; National Bureau of Economic Research

**Residential Investment**

As shown in Chart 6, residential investment spending increased by 1.1 percent during the 2001 recession. In the first eight months of the recovery following that recession, residential investment spending increased by another 19.7 percent. (Data on residential investment spending are not available for the recessions prior to 2001.)

In the eight quarters leading up to the most recent recession, residential investment spending fell by 33.2 percent. During the recession, residential investment spending fell by another 36.2 percent. Since the trough, residential investment spending continued to slip for another seven quarters. Finally turning up eight quarters since the trough, business fixed investment is 38.0 percent below its value at GDP prerecession peak and 59.6 percent below its own peak in fourth quarter 2005.




Sources: U.S. Bureau of Economic Analysis; National Bureau of Economic Research

**Restoring Spending and Economic Growth**

During the current recovery, weakness can be found throughout spending. None of the major categories of spending is tracking that of previous recoveries. Investment spending stands out as remaining the farthest below its prerecession peak. Within investment spending, residential investment spending is by far the weakest.

Weak residential investment spending may be the inevitable result of a financial crisis that resulted from a housing bubble. But, this particular weakness also suggests that a recovery in residential investment spending is likely a key component of a much stronger economy. A speedy resolution of all the underwater mortgages—whether accomplished through accelerated foreclosures or an influx of government funding—is likely necessary before we will see a strong recovery in residential investment spending.

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## Reference

Brown, Stephen P. A. (2011), "Why Such a Slow Recovery of the U.S. Economy?" Economic Commentary Report, Center for Business and Economic Research, University of Nevada, Las Vegas (September 23). http://business.unlv.edu/wp-content/uploads/2011/03/CBERonSlowRecovery.pdf