CRS Insights

What Is the Current State of the Economic Recovery?
Craig K. Elwell, Specialist in Macroeconomic Policy (celwell@crs.loc.gov, 7-7757)
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A Slow but Steady Recovery

The U.S. economy's recovery from the 2007-2009 recession has been steady but historically slow. From the recession's end in mid-2009 through the third quarter of 2014, as measured by real GDP growth (i.e., gross domestic product adjusted for inflation), the economy's average annual rate of growth has been about 2.2%, compared to the 4.5% pace typical of previous post-WWII recoveries. After a temporary setback in the first quarter of 2014, growth rebounded above the recovery's slow average pace over the next two quarters with gains of 4.2% and 3.9%, respectively.

The current recovery has taken longer than the 5-year average of previous recoveries. After 5½ years it is still short of completion. Through mid-2014, the economy's output gap (i.e., the shortfall of actual output below the economy's estimated potential) was 3.5%, much improved from the 7.5% output gap during the recession, but well short of the historical average of about 0.5%.

- A corollary of a slow-paced economic recovery has been a slow reduction of the joblessness induced by the 2008-2009 recession. From a peak of 10.1% in 2009, the unemployment rate had decreased to 5.8% by October of 2014, close to some estimates of the economy's long-run normal unemployment rate. However, other indicators, such as fall in labor force participation, high rate of long-term unemployment, and weak worker earnings growth, suggest that substantial slack still persists in labor markets.

Inflation has remained low during the recovery, with the consumer price index (CPI-U) typically increasing by less than 2.0%. For the 12 months ending in October 2014, the CPI was up 1.7%. The low inflation numbers suggest the presence of substantial economic slack.

- Economic policy has had mixed effects on the pace of economic recovery. Fiscal policy since 2010 has been restrictive, slowing the pace of GDP growth. In 2013, fiscal drag was particularly strong, reflecting the dampening effects of the expiration of a payroll tax cut, increased taxes on higher-income households, and sequestration caps on discretionary spending. The waning contractionary effects of tax increases and the easing of sequestration spending cuts decreased fiscal drag in 2014. Monetary policy was highly expansionary during the recovery, with the Federal Reserve (Fed) engaging in unprecedented asset purchases (commonly called quantitative easing, or QE1, QE2, and QE3) and holding the policy interest rate near zero. In response to improved labor market conditions, the Fed ended its large-scale asset purchase program in October 2014. The federal funds rate remains near zero.

Sources of the Economy's Momentum

Personal Consumption Spending

After falling a cumulative 2.7% during the 2008-2009 recession, real consumer spending, representing about two-thirds of aggregate spending, increased at an average annual rate of 2.2% through the third quarter of 2014. This is a slow pace in comparison to the 4%-5% pace typical of previous economic recoveries, but sufficient to give the ongoing recovery steady underlying momentum. Several factors are likely supporting steady growth of consumer spending:

- *Rising employment*. From mid-2009 through June 2014, non-farm payroll employment has increased by about 8.7 million jobs. During 2014, payroll employment increased at a rate of 230,000 jobs per month.

- *Increased household net worth*. Through the second quarter of 2014, household net worth has increased by nearly $25 trillion from its 2009 trough of $57 trillion, reaching about $81.5 trillion. It now exceeds the pre-recession high of $64 trillion.
- *Improved credit conditions.* The Fed's October 2014 *Senior Loan Officer Opinion Survey on Bank Lending Practices* showed a continued easing of lending standards and terms for many types of loan categories amid a broad-based pickup in demand for loans.

Investment Spending

Investment spending by businesses on new plants and equipment—representing about 18% of aggregate spending—is particularly sensitive to economic conditions. It contracted sharply during the recession, decreasing a cumulative 31%, and bounced back during the recovery, increasing at an average annual rate of 8.3%, a pace comparable to previous recoveries. Investment spending is stimulated by the need to expand productive capacity and the availability of the means to do so.

- *Rising capacity utilization.* As rising production reduces excess capacity, willingness to invest in new plant and equipment generally increases. Since 2009, U.S. industry's rate of capacity utilization has increased from a recession low of 67% in 2009 to 78.9% in October 2014, and it is close to the historical average of about 80.0%.
- *High profits and low interest rates*. The availability of ample retained earnings and low-cost borrowing enhances businesses' ability to finance new investment projects. In mid-2014, corporate profits stood at $2.1 trillion, up from a recession-induced low of $1.0 trillion in 2009. The rate on Aaa corporate bonds was about 3.9% in October 2014, substantially below the 5.5%-6.5% rates that prevailed during the recovery from the 2001 recession.

Exports

During the recovery, real exports, representing about 13% of aggregate spending, have increased at a 6.6% average annual rate, making steady and substantial contributions to the pace of economy-wide growth. Drivers of export growth included petroleum products and agricultural goods. Export performance has been assisted by a relatively competitive dollar exchange rate and strong economic growth in China and other emerging economies, tailwinds that are currently waning. Strong export growth has occurred despite economic weakness in the European Union and Japan.

Prospects and Risks

The Blue Chip Forecast (i.e., a consensus of 56 private forecasters) predicts that U.S. real GDP will increase at a rate of 3.0% in 2015 and the average unemployment rate will decrease to 5.6%. Downside risks to the outlook include increases in fiscal drag due to federal government budget actions; increased volatility and risk premiums in financial markets; slower growth in emerging markets; and higher oil prices due to rising geopolitical tensions. Upside risks to the outlook include stronger improvement in business investment and increased mortgage availability giving a boost to residential investment.