Understanding Recession

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Q: The financial press often states the definition of a recession as two consecutive quarters of decline in real GDP. How does that relate to the NBER's recession dating procedure?

A: Most of the recessions identified by our procedures do consist of two or more quarters of declining real GDP, but not all of them. According to current data for 2001, the present recession falls into the general pattern, with three consecutive quarters of decline. Our procedure differs from the two-quarter rule in a number of ways. First, we use monthly indicators to arrive at a monthly chronology. Second, we use indicators subject to much less frequent revision. Third, we consider the depth of the decline in economic activity. Recall that our definition includes the phrase, "a significant decline in activity."

Q: The NBER refers to the recession as having begun in March 2001. Some observers, however, cite April as the start of the recession, reasoning that if the peak ended in March, then the recession began in April.

A: The exact peak occurred sometime in March. For the rest of the days in March, the economy was in recession. So the expansion ended and the recession began in March.

Q: Isn't a recession a period of diminished economic activity?

A: It's more accurate to say that a recession-the way we use the word-is a period of diminishing activity rather than diminished activity. We identify a month when the economy reached a peak of activity and a later month when the economy reached a trough. The time in between is a recession, a period when the economy is contracting. The following period is an expansion. Economic activity is below normal or diminished for some part of the recession and for some part of the following expansion as well. Some call the period of diminished activity a slump.

Q: How does the NBER balance the differing behavior of employment and output?

A: Following the precedents established in many decades of maintaining its business cycle chronology, the NBER considers employment, production, sales, and real income. When special factors-such as unusual productivity growth and favorable shifts in the terms of
trade-make income and production-based measures move differently from those based on employment, we balance the two types of evidence.

Q. You emphasize the payroll survey as a source for data on economy-wide employment. What about the household survey?

A: Although the household survey is a large, well-designed probability sample of the U.S. population, its estimates of total employment appear to be noisier than those from the payroll survey. The two sources agree reasonably closely about the movement of employment in this recession.

Q. How do the movements of unemployment claims inform the Bureau's thinking?

A: A bulge in jobless claims would appear to forecast declining employment, but we don't use forecasts and the claims numbers have a lot of noise.

Q. What about the unemployment rate?

A: Unemployment is generally a lagging indicator. Its rise from a very low level to date is consistent with the employment data.

Q: How do structural changes in the economy in the 1990s affect the NBER's method for dating business cycles? The Bureau notes that industrial production measures a declining part of the economy. What other substitutes for output bear watching, particularly with regard to service-sector activity?

A: Economy-wide employment and real personal income are the most important monthly indicators. At a quarterly frequency, real GDP is informative. Another interesting monthly indicator is aggregate hours of work.

Q: Regarding movements of income as an indicator of recessions, isn't it true that real income has not fallen substantially during five of the past nine recessions?

A: That is why employment is probably the single most reliable indicator.