

The NBER's Business-Cycle Dating Procedure

Business Cycle Dating Committee, National Bureau of Economic Research

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According to the most recent data, the U.S. economy continues to evolve as in earlier months. Real personal income has generally been growing over the past year, fell slightly in July, and rose slightly in August and September. Employment generally grew modestly from May through October 2002, but declined slightly in November. The behavior of the economy this year indicates that the decline in activity that began last year may have come to an end. But recent data show that additional time is needed to be confident about the interpretation of the movements of the economy last year and this year. The NBER's Business Cycle Dating Committee will determine the date of a trough in activity when it concludes that a hypothetical subsequent downturn would be a separate recession, not a continuation of the past one. The trough date will mark the end of the recession. The committee will not issue any judgment about whether the economy has reached a trough until it makes its formal decision on this point. The committee waits for many months after an apparent trough to make its decision, because of data revisions and the possibility that the contraction would resume. For example, the committee waited until December 1992 to announce that a trough had occurred in March 1991.

In November 2001, the committee determined that a peak in business activity occurred in the U.S. economy in March 2001. A peak marks the end of an expansion and the beginning of a recession. The determination of a peak date in March is thus a determination that the expansion that began in March 1991 ended in March 2001 and a recession began in March. The expansion lasted exactly 10 years, the longest in the NBER's chronology.

A recession is a significant decline in activity spread across the economy, lasting more than a few months, visible in industrial production, employment, real income, and wholesale-

retail sales. A recession begins just after the economy reaches a peak of activity and ends as the economy reaches its trough. Between trough and peak, the economy is in an expansion. Expansion is the normal state of the economy; most recessions are brief and they have been rare in recent decades.

Because a recession influences the economy broadly and is not confined to one sector, the committee emphasizes economy-wide measures of economic activity. The traditional role of the committee is to maintain a monthly chronology, so the committee refers almost exclusively to monthly indicators. The committee gives relatively little weight to real GDP because it is only measured quarterly.

The committee generally studies two monthly measures of activity across the entire economy: (1) employment and (2) personal income less transfer payments, in real terms (adjusted for price changes). In addition, the committee refers to two indicators with coverage primarily of manufacturing and goods: (3) the volume of sales of the manufacturing and wholesale-retail sectors adjusted for price changes and (4) industrial production. The Bureau of Economic Analysis of the Commerce Department compiles the first and the Federal Reserve Board the second. Because manufacturing is a relatively small part of the economy, the movements of these indicators often differ from those reflecting other sectors.

Although the four indicators described above are the most important measures considered by the NBER in developing its business cycle chronology, there is no fixed rule about which other measures contribute information to the process.

Figure 1 shows the recent movements of employment superimposed on the average movement over the past six recessions. Employment reached a peak in March 2001 and declined through April 2002. Current data show that employment rose slightly from May through October (with a slight decrease in September), then fell by 40,000 in November, the most recent reported month.

Figure 2 shows industrial production. A peak occurred in June 2000 and the index declined over the next 18 months by 7.2 percent to its low point in December 2001. Industrial production rose between January and July 2002, but has fallen in the last three reported months, August to October.

Figure 3 shows real manufacturing and wholesale-retail sales. This measure reached a peak in June 2000, declined until it plunged in September 2001, grew through July 2002, but fell in August and September, the most recent reported month. It is, nevertheless, still above its level at the peak in March 2001.

Figure 4 shows the movements of real personal income less transfers. Real income generally fell from late 2000 through late 2001, and generally rose through the most recently reported month, September 2002, except for a slight decline in July. This indicator is now slightly above its previous peak in November 2000.

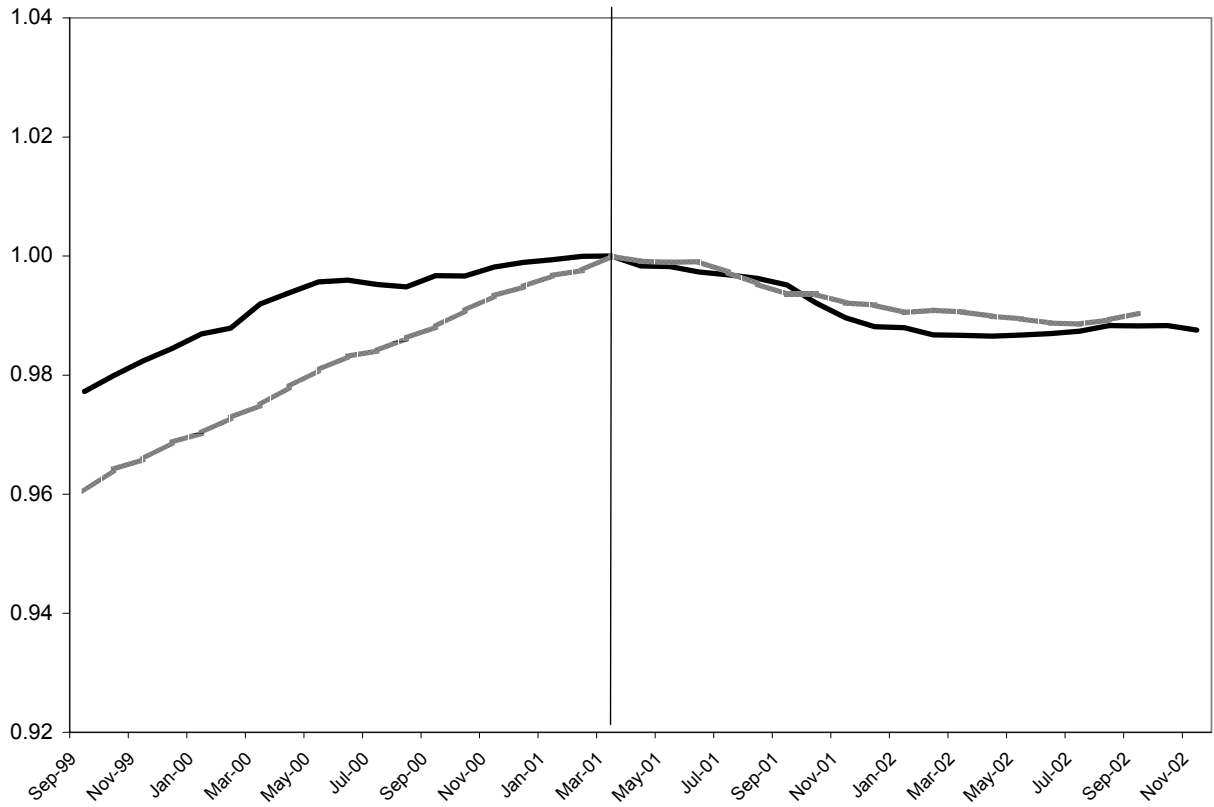


Figure 1. Current Employment

The dark line shows the movement of employment in 1999-2002 and the shaded line the average over the past 6 recessions.

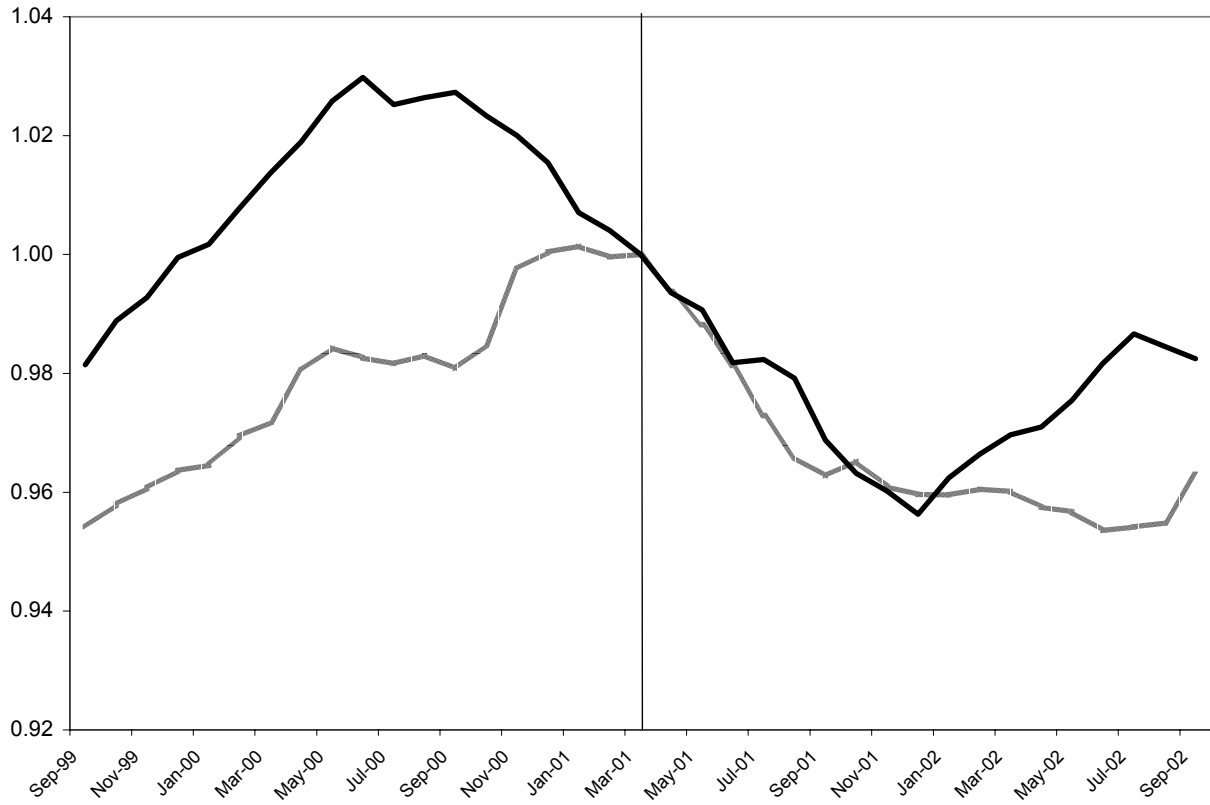


Figure 2. Current Industrial Production

The dark line shows the movement of industrial production in 1999-2002 and the shaded line the average over the past 6 recessions.

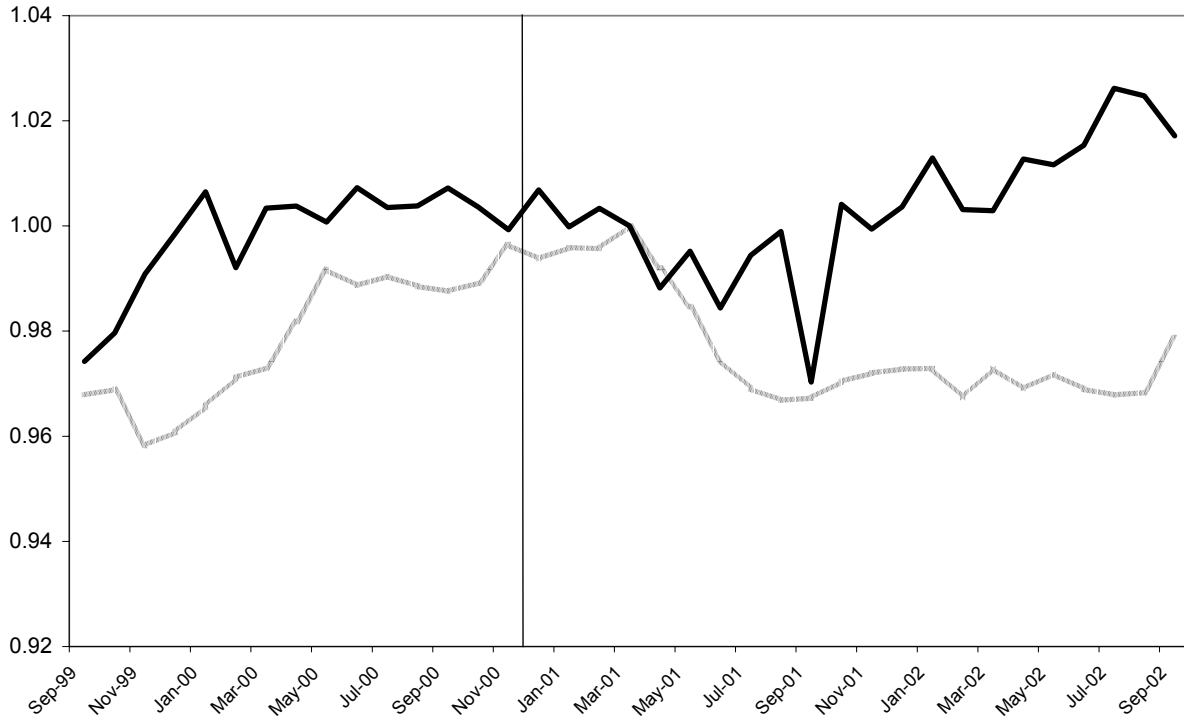


Figure 3. Real Manufacturing and Wholesale-Retail Sales

The dark line shows the movement of sales in 1999-2002 and the shaded line the average over the past 6 recessions. Source: The Conference Board (<http://www.globalindicators.org>)

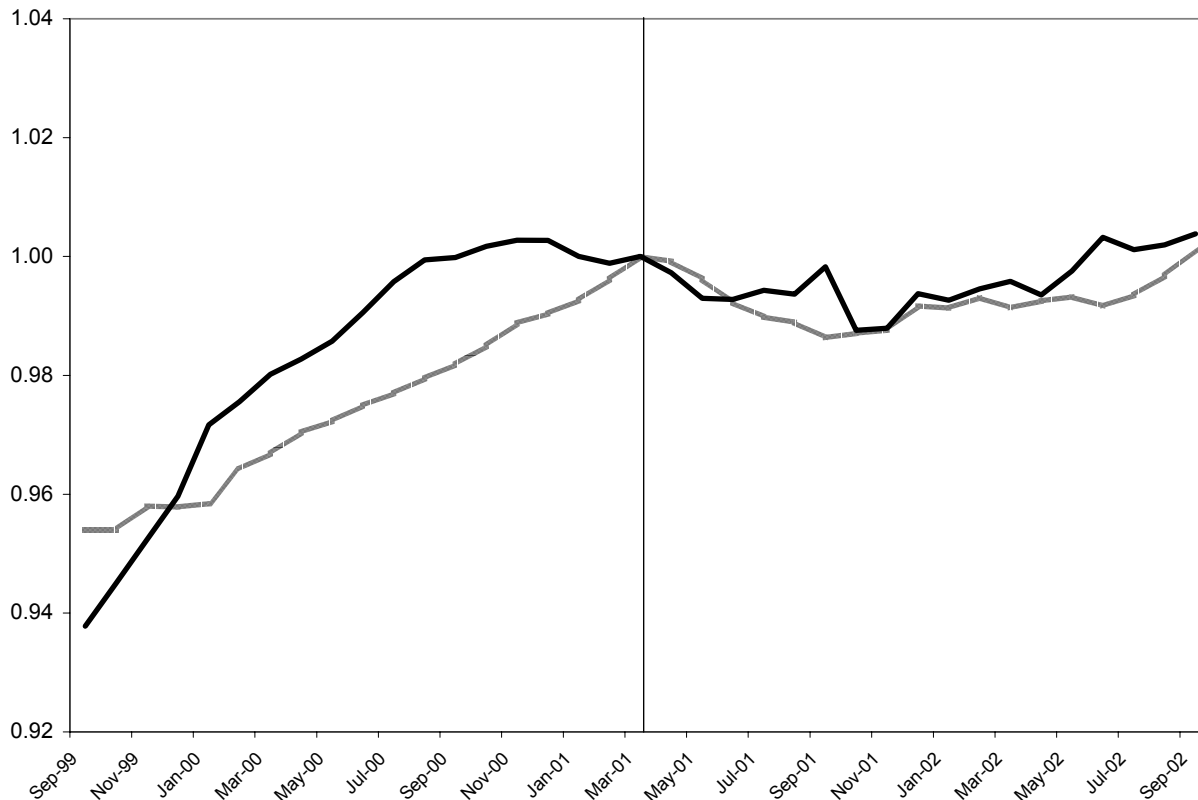


Figure 4. Current Real Personal Income Less Transfers

The dark line shows the movement of income in 1999-2002 and the shaded line the average over the past 6 recessions. Source: The Conference Board (<http://www.globalindicators.org>)

In 2002, indicators measuring output and income generally have been rising, while employment has been essentially constant. The primary factor accounting for the more favorable performance of income and production relative to employment is the continuation of rapid productivity growth resulting in corresponding growth in real wages.

According to data released in November (<http://www.bea.doc.gov/bea/newsrel/gdpnewsrelease.htm>), real GDP increased at an annual rate of 4.0 percent in the third quarter of 2002, and 1.3 percent in the second quarter. GDP reached a peak in the fourth quarter of 2000. This was followed by contraction during the first three quarters of 2001 and growth since then. In the fourth quarter of 2001, real GDP surpassed the earlier peak. This performance of real GDP is consistent with the other data considered by the committee. Output fell less than employment during the recession and currently is rising faster than employment because of unusual productivity growth.

For more information, see the FAQs at the end of this memo, and also see <http://www.nber.org/cycles.html>. An Excel spreadsheet containing the data and figures is available from that page as well.

FAQs

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.

Q: Is the NBER committee considering re-dating the beginning of the recession, based on the revised GDP data which seem to indicate that the peak of the last cycle was reached before your current date? Has the committee ever before changed a cycle date based on new information?

A: There has been a discussion, but it is not active currently. To our knowledge, there has never been a change, and definitely not since 1978 when the current chairman was appointed.

Q: When did the NBER first establish its business cycle dates?

A: The NBER first compiled a chronology in the early 1920s, soon after the founding of the Bureau in 1920.

Q. When was your committee first formed?

A: When Martin Feldstein became president of the NBER in 1978. Robert Hall has chaired the committee since its inception.

Q: How is the committee's membership determined?

A: The President of the NBER appoints the members, who include directors of the macro-related programs of the NBER plus other members with specialties in business-cycle research.