Sustainable Recovery in Historical Perspective

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Eakinomics: Sustainable Recovery in Historical Perspective

Financial market volatility and a struggling housing market have prompted recent concerns over the durability of the economic recovery. But where should one look for signs of weakness?

To shed light on the issue, I focus on the contributions of household spending, business investment, and residential investment on economic growth during recoveries. Specifically, I use the National Bureau of Economic Research dates for business cycle troughs, and identify the number of quarters since the trough (e.g, 12 quarters since trough, 22 quarters since trough, and so forth). Finally, I calculate the contribution of each sector to overall growth in gross domestic product (GDP).

The table shows the composition of growth early in the recovery cycle (2nd year), in the middle of the cycle (5th year), and late in the cycle (9th year). Each panel compares the average of all previous recoveries since 1960 to the most recent recovery.

What do we learn? The first thing is that the recovery from the Great Recession started out much different. Compared to the past, early in the recovery the business sector carried a much bigger portion of the load (33 percent versus 9 percent in the past) compared to households (only 41 percent versus 74 percent) and residential investment (a drag of 6 percent versus contributing 14 percent). By mid-cycle, residential investment had taken over the load, but the household sector remained diminished.

Late in the cycle, however, the distribution of the contributions to growth is close to the historical norms.

	Contributions to GDP Growth Over the Recovery			
		Household Spending	Business Investment	Residential Investment
Early-Cycle	Previous Recoveries	74%	9%	14%
	Current Recovery	41%	33%	-6%
Mid-Cycle	Previous Recoveries	69%	30%	-12%
	Current Recovery	41%	21%	25%

Late-Cycle	Previous Recoveries	63%	37%	7%
	Current Recovery	68%	33%	5%

Looking forward, the normalization of growth suggests that one should monitor carefully the condition of the cyclically sensitive household residential and business investment sectors. The investment incentives in the Tax Cuts and Jobs Act are good insurance against the threat of a cyclical downturn. The housing sector, however, has been soft in 2018 and bears further attention.