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2010: A Stabilizing Economy but Uncertainties Remain

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2010: A Stabilizing Economy but Uncertainties Remain

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Preface

This is the sixth paper in NJLM Foundation's "Friends of Local Government" Policy Paper series. This paper, authored by Dr. James Hughes and Dr. Joseph Seneca from Rutgers, the State University of New Jersey, offers analysis of the global economic recession, including the impact on local governments and our taxpayers.

Dr. Hughes and Dr. Seneca authored the very first paper in this series, titled, *From Wall Street to Main Street. 2009: Unprecedented Economic Challenges.* That paper is available on the Foundation's website at www.njlmef.org. This paper is a follow up to that work, highlighting the changes from 2009 to 2010 and what we can look forward to going forward.

On behalf of the Board of the NJLM Educational Foundation, we thank Dr. Hughes and Dr. Seneca for these contributions, and believe you will find this paper informative.

We would also like to note the support of the Foundation's Board for this project, as well as staff from the New Jersey State League of Municipalities, including Bill Dressel, Michael Darcy and Danielle Holland.

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Joseph J. Seneca, Ph.D., has taught at all levels of instruction throughout his Rutgers career and has received numerous awards for exemplary teaching and contributions to public service. A full profile is available at:

It is now Y2K+10. Already one tenth of the 21st century is gone. But, most of the nation, including New Jersey, should be very happy that it is gone. In retrospect, the century's opening 10-year period comprised America's and New Jersey's lost economic decade. For the first time since the 1930s, the nation experienced negative net private-sector job creation, shedding more than 2.9 million private-sector jobs during the entire decade. The "Great American Job Creation Machine" that had generated over 38 million jobs during the late 20th century stalled badly in the new millennium. So, too, was the case for New Jersey's Job Creation Machine. After having a net gain of nearly one-quarter of a million private-sector jobs during the decade of the 1990s, the state subsequently lost 156,100 private-sector jobs in the 2000s.

But, the good news is that the decade of the 2000s has been firmly placed in the history books. Now, as the first year of a new decade unfolds, the nation and New Jersey are no longer staring at the depths of recession, as we were a year ago, but rather are anticipating continuing economic recovery. What a difference a year makes! Let's look at what we've been through, and where we are today.

The Great Recession: A Preliminary Autopsy

Chart 1 shows the length of all the recessions in the United States since the Great Depression. The bottom bar is the Great Depression, which lasted 43 months. The Great Recession – the top bar – officially began in December 2007 according to the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER) – the private, nonprofit, nonpartisan, research organization that decides when recessions and expansions begin and end. When the Great Recession reached its sixteenth month in April 2009, it matched the length of the previous longest downturns since the Great Depression (the 1973-75 and the 1981-82 recessions both lasted 16 months). Thus, in May 2009, the Great Recession set a new record and became the longest recession since the Great Depression at 17 months and counting.

Now it is quite possible that, when the NBER ultimately makes its call, the recession will have ended in the third quarter of 2009. That is why September 2009 in Chart 1 has question marks. In the third quarter of 2009, Gross Domestic Product (GDP) – the total output of the United States economy – went from contraction to expansion, growing by 2.2 percent (see Chart 2). It then increased by 5.6 percent in the fourth quarter of 2009, and a further 2.7 percent in the first quarter of 2010. So three-straight quarters of growth followed four-straight quarters of decline strongly suggest that the recession has ended. The nation's total economic output is again on a positive growth trajectory.

This is also the case for the nation's employment (see Chart 3.) The bars represent the *monthly* private-sector employment change during each of the 29 months following the start of the Great Recession. The first year that payroll employment statistics were compiled was 1939. The two largest annual private-sector job losses in the 81-year period (through 2009) occurred in 2009 and 2008 (see Chart 3). Close to 4.7 million jobs were lost in 2009, the current annual record holder, and more than 3.8 million jobs were lost the year before in 2008, the former record holder. In total, nearly 8.5 million private-sector jobs disappeared in the two years combined. So, it's certainly good news that both years are now in our rear-view economic mirror.

It's also even better news that the nation survived what could have been Great Depression 2.0. During the first eight months of 2008 (through August) – the first eight bars on the left side of chart 3 – the United States experienced employment losses characteristic of a standard generic harsh recession. The nation was sliding down the employment mountain. Then Lehman Brothers failed in September 2008, and the United States labor markets went from sliding down the mountain to falling off the employment cliff. The final four months of 2008 and the first four months of 2009 were nothing less than a full-metal jacket national meltdown, as the nation lost 5.3 million private-sector jobs. If that eight-month period were a movie, it would have been titled "Apocolypse Now." But, job losses finally started to moderate significantly in May 2009, and as 2009 matured, the nation went from falling off the employment cliff to simply sliding down the mountain again, (with the red bars tracking job losses in Chart 3) consistently getting smaller. The economy went from terrifying to merely depressing. And then, a most welcome and much needed transition to positive employment growth took place as the nation entered 2010.

The green line in Chart 3 reveals the basic employment-change trend between January 2009, the worst job-loss month of the recession, and April 2010. This led to high expectations for May 2010, with some optimistic forecasters anticipating a gain of over 300,000 private-sector jobs for that month. Unfortunately, reality intruded. The nation added only 41,000 private-sector jobs in May 2010, raising question as to the strength of the employment recovery.

Nonetheless, since the start of 2010, the United States experienced five straight months of job growth.

The broad pattern of moderation which occurred in 2009, and the return to growth in 2010, is also shown clearly in Chart 4, which presents the average monthly change in employment for the last nine quarters. For example, the first quarter of 2009 was the worst of the recession, when we lost on average 752,000 private-sector jobs per month. But, the following three quarters of 2009 experienced a distinct slowing of the pace of decline. That was the first good news of the Great Recession: things were getting worse at a slower pace. The next good news was the employment turnaround that took place in the first quarter of 2010, when the nation experienced a growth of 78,667 private-sector jobs per month, followed by a gain of 130,000 jobs per month during the first two months of the second quarter.

What a Difference a Year Makes

If 2010 were to have an official song, *"What a Difference a Year Makes!"* would be highly appropriate. When the calendar turned to 2008, the November 2001-December 2007 expansion expired, and the first year of the "*Great Recession*" commenced. Throughout 2008, the downturn deeply intensified. So, America entered 2009 in the midst of a virtual economic cataclysm – panic abounded and financial markets were close to collapse. The nation was staring into the economic abyss. But, as federal monetary and fiscal rescue policies took hold, the employment decline continued, but at a *decelerating* pace. By the end of the year, the panic had abated, and financial markets had stabilized.

Although 2009 turned out to be the year when many dire economic forecasts were realized, it also was the year that economic catastrophe was avoided. The *Great Recession* was supplanted by the "*Great Stabilization*." So, the start of 2010 stands in stark contrast to the start of 2009 – the nation is now anticipating an economic recovery versus staring at an economic Armageddon. If 2010 were to be a movie, its title would aptly be "From Eternity to Here" – with eternity consisting of a crushing, seemingly without end, near depression that has been replaced by the here and now of an economy that stabilized and is now showing growth.

The New Jersey Trajectory

During most of the Great Recession, New Jersey's private-sector employment change tracked the nation quite closely. In fact, it looked as if the state was doing somewhat better – or, more precisely, somewhat less worse – than the nation (Chart 5). However, during the September 2009 to January 2010 period, New Jersey seemingly went into reverse relative to the United States, with private-sector employment losses accelerating from -1,000 jobs in September 2009 to -9,800 jobs in January 2010. While two of the next four months showed growth, New Jersey still had a net employment loss for the first five months of 2010 (-3,000 private-sector jobs). This compares to new employment gain for the nation (+495,000 private-sector jobs).

This divergence is also shown in Chart 6, which shows the average monthly private-sector employment change by quarter for New Jersey. While the United States had positive growth in the first quarter of 2010 (Chart 4), New Jersey did not. Net job growth did turn positive in the second quarter, but it appears that state is clearly trailing the nation in employment recovery. Nonetheless, New Jersey is doing far better than one year ago. During the first five months of 2009, New Jersey lost 76,300 private-sector jobs. During the first five months of 2010, the state lost just 3,000 jobs, a far different order of magnitude.

The Shape of the 2010 Recovery: Economic Calligraphy

Historical precedents suggest two different patterns of economic recovery and employment growth as 2010 matures (Chart 7). The first is that deep recessions have traditionally been followed by robust recoveries. And, as we have seen, the *Great Recession* of 2007-2009 was the steepest and longest downturn since the Great Depression. The sheer severity of the employment losses may have been a panic-induced overreaction – too many workers were eliminated too fast. Anorexic-driven cost conscious corporations tightened their belts till they didn't have a waist! Consequently, these businesses may now be caught short when the recovery gathers momentum. This suggests a strong employment bounce back. In terms of economic calligraphy, this would be a *"V-Shaped" Recovery*, a sharp employment rebound following an extraordinarily steep decline.

However, a second historical precedent is that recessions that have been caused primarily by deep financial crises usually produce extended weak recoveries.[1] In the current context, where the nation has just experienced a near financial panic and despite extraordinary levels of employment cuts, lean hiring may, nevertheless, still ensue because of the scale of underemployment that now exists. Many companies, rather than laying-off even more workers, reduced their hours and placed workers on part-time or furlough status. As evidence, the average workweek is still very low. This indicates that there is a large amount of room to expand the hours worked of the existing labor force. Thus, underutilized workers will first be more than fully utilized before new hiring takes place, i.e., there will be a continuum of employment recovery that moves workers from part-time to full-time to over-time prior to the hiring of additional workers. In terms of economic calligraphy, this would lead to an *"L-Shaped" Recovery*, i.e., labor markets bouncing along the employment bottom for an extended period of time. This is also known as a "hockey stick" recovery, where economic stays low in terms of employment gains for a long period following a steep plunge. This pattern also historically is present following a downturn triggered by the bursting of an asset bubble.

Thus, the historical lessons of deep recessions versus deep financial crises offer the sharply different after-effects, and these produce diametrically opposite expectations for employment growth in 2010. Combining them together (since, unfortunately, both conditions were present in the Great Recession) produces a visual result that is best captured by a *"Reverse Square Root" Recovery*! The sharp decline in economic activity would initially be followed by a sharp rebound. But before full recovery is achieved, employment gains level out and are followed by an extended period of minimal growth. This could also be labeled a "half-fledged" recovery, as distinguished from a full-fledged V-shaped recovery, and distinguished also from a "no- fledged" L-shaped recovery.

There is yet a fourth (and lower probability) possibility that would stem from an economy initially rebounding from a recession only to relapse again into a second downturn. This *"W-Shaped" Pattern* is also known as a "double-dip" recession or a "second leg down." The fragility of America's post-stimulus economy and the questionable return of private engines of

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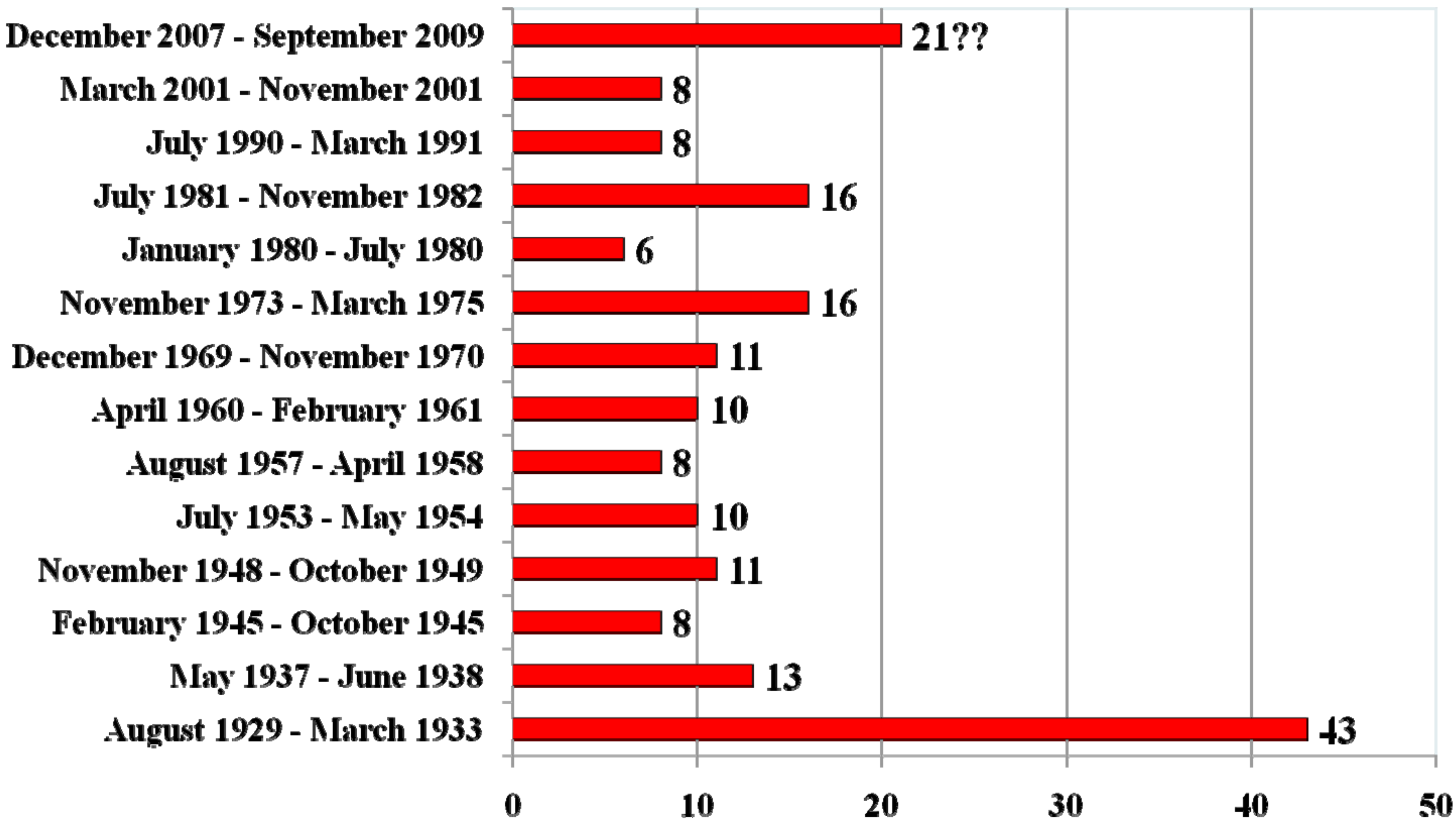
[1] The usual poster-child example is Japan and its loss of two decades of economic growth following the collapse of its overleveraged, under-risk assessed financial sector in early 1990.

economic growth – as well as the potential contagion of European economic and fiscal distress – could produce such an outcome.

Consequently, there are many alternative economic paths for the United States and New Jersey in 2010, with the precise outcome among these possibilities still not yet clear. Thus, the nation and state still face substantial economic uncertainties, but the new year and new decade are off to a much better economic start than where we were just a year ago. The worst is clearly over. However, there is still a very long economic road to travel before the fiscal and budgetary problems of states and municipalities can be ameliorated.

Chart 1

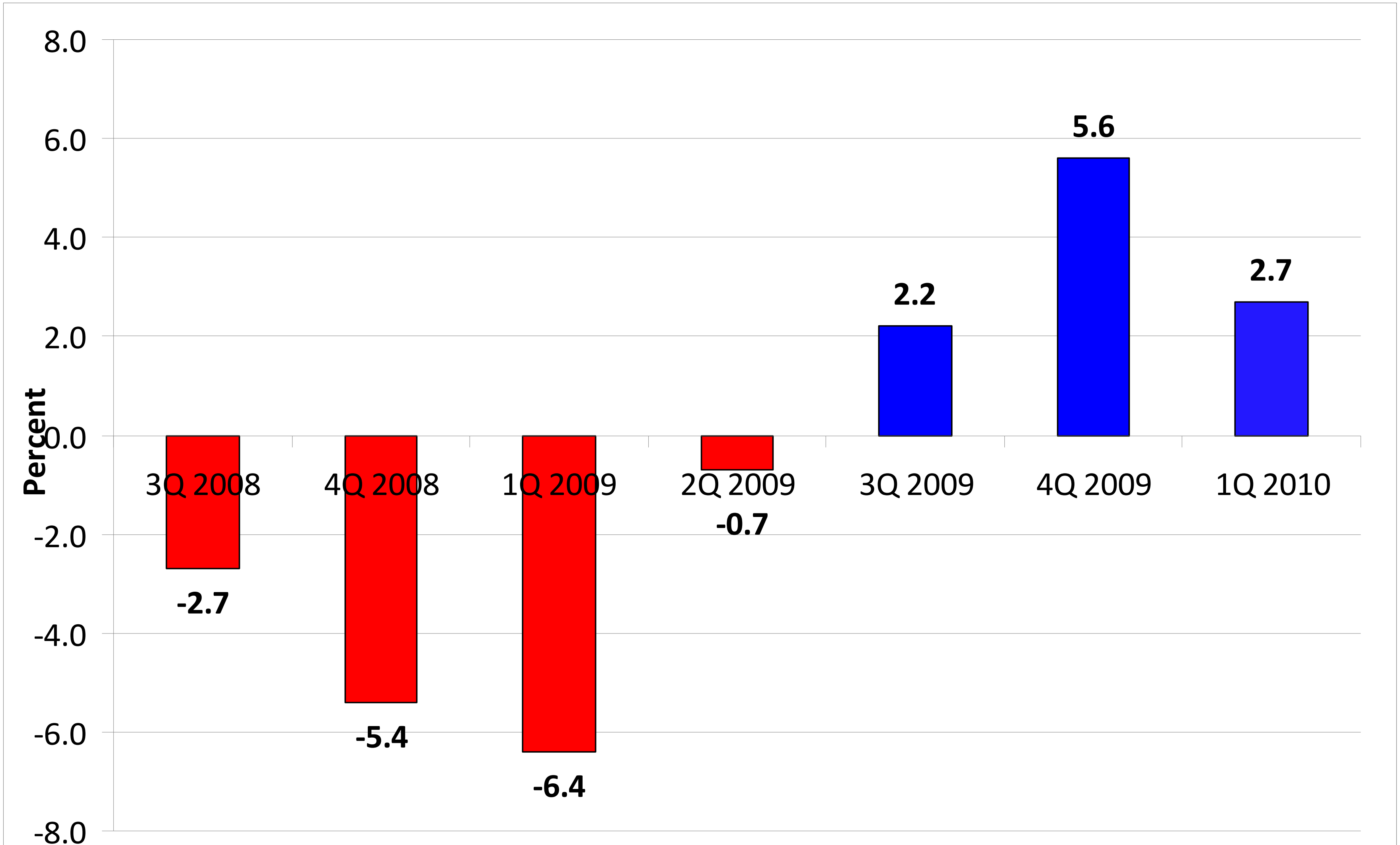
Length of Recessions in Months Since 1933



Source: National Bureau of Economic Research. **A-1**

Chart 2

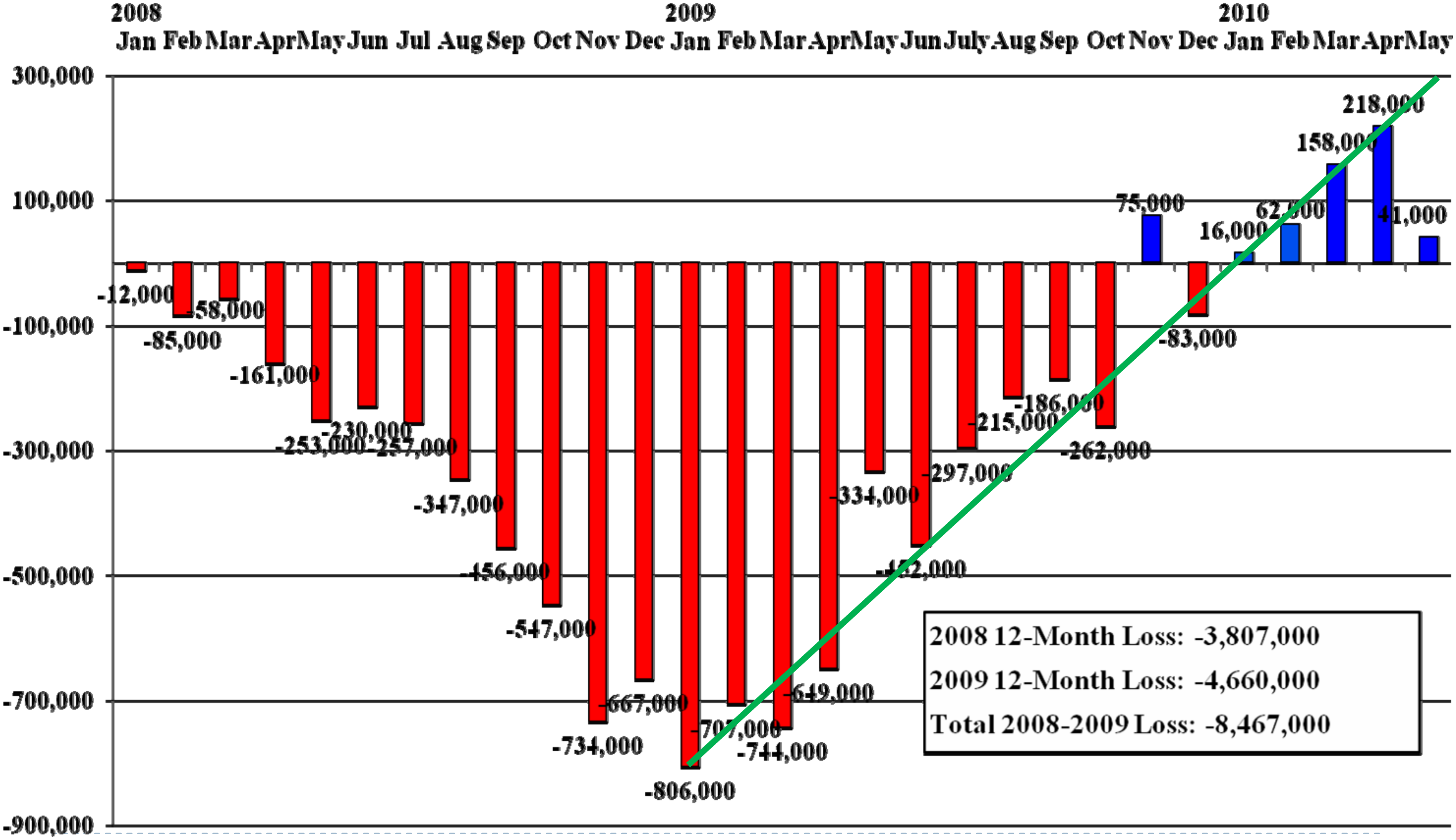
Percent Change in Real GDP: U.S.
(seasonally adjusted at annual rates)



Source: U.S. Bureau of Economic Analysis. **A-2**

Chart 3

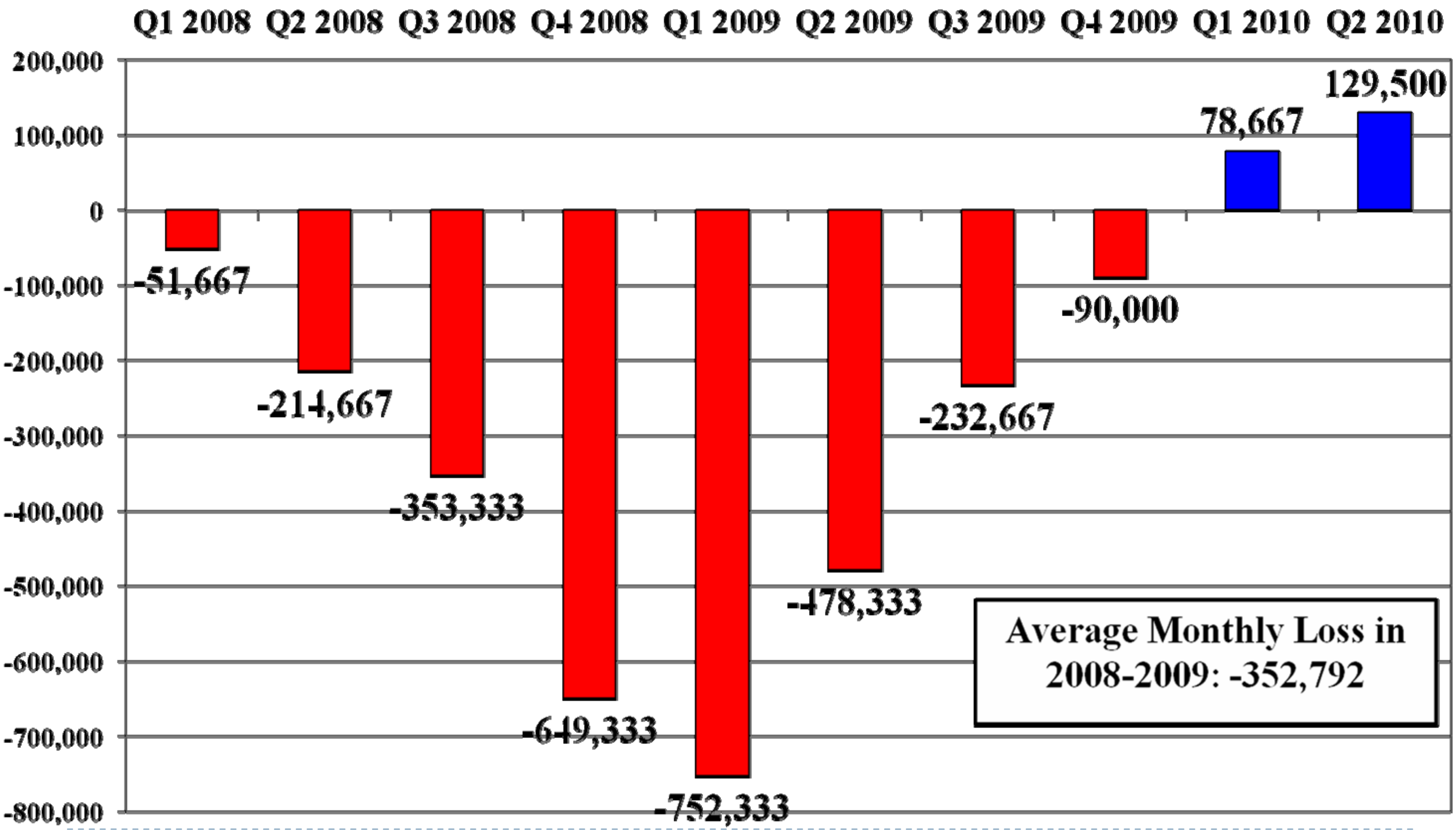
U.S. Private-Sector Employment Change 2008 - 2010



Source: U.S. Bureau of Labor Statistics.

Chart 4

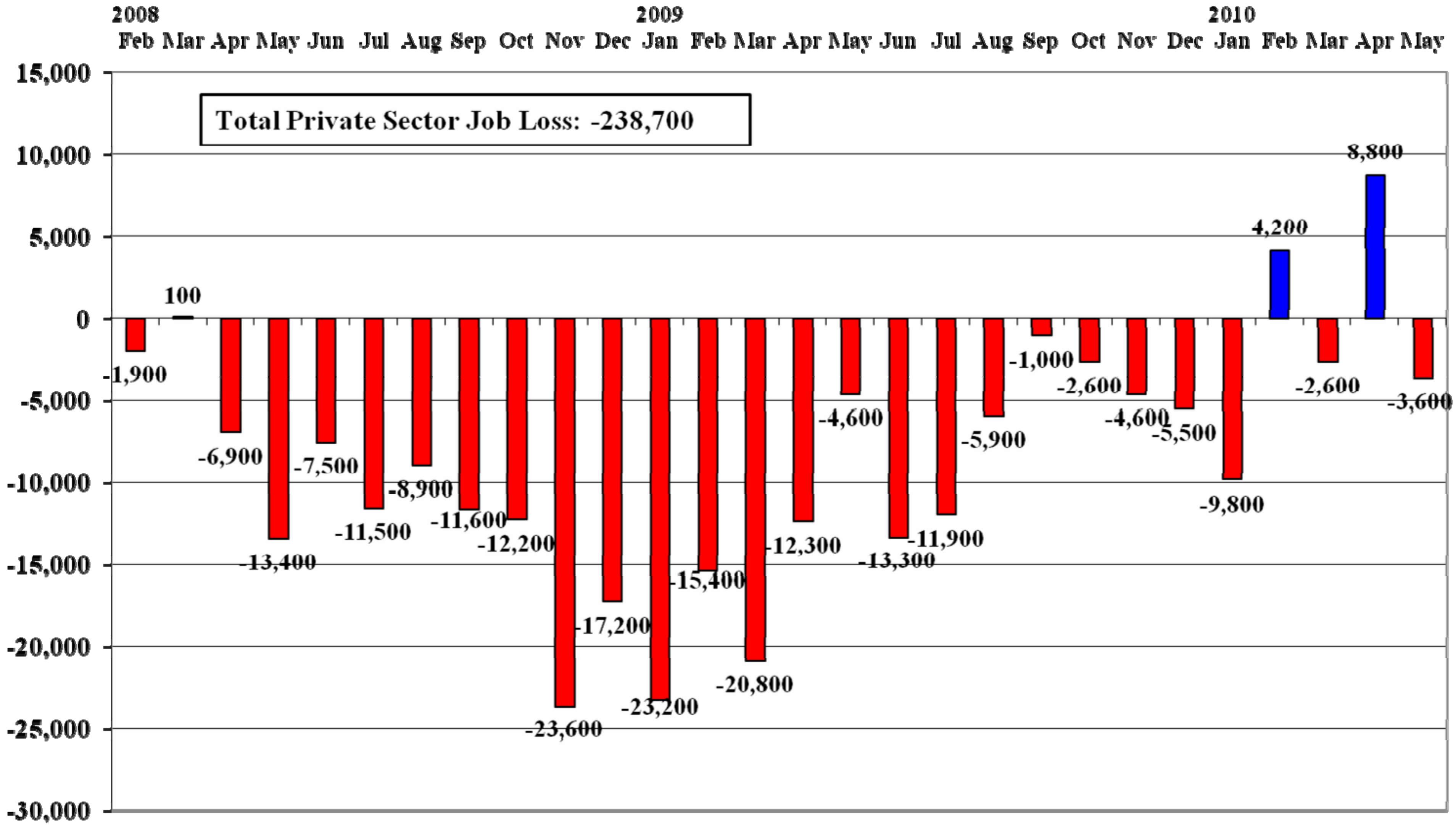
U.S. Private-Sector Employment Average Monthly Change, Q1 2008 – Q2 2010



Source: U.S. Bureau of Labor Statistics. Q2 2010 includes data for April and May only.

Chart 5

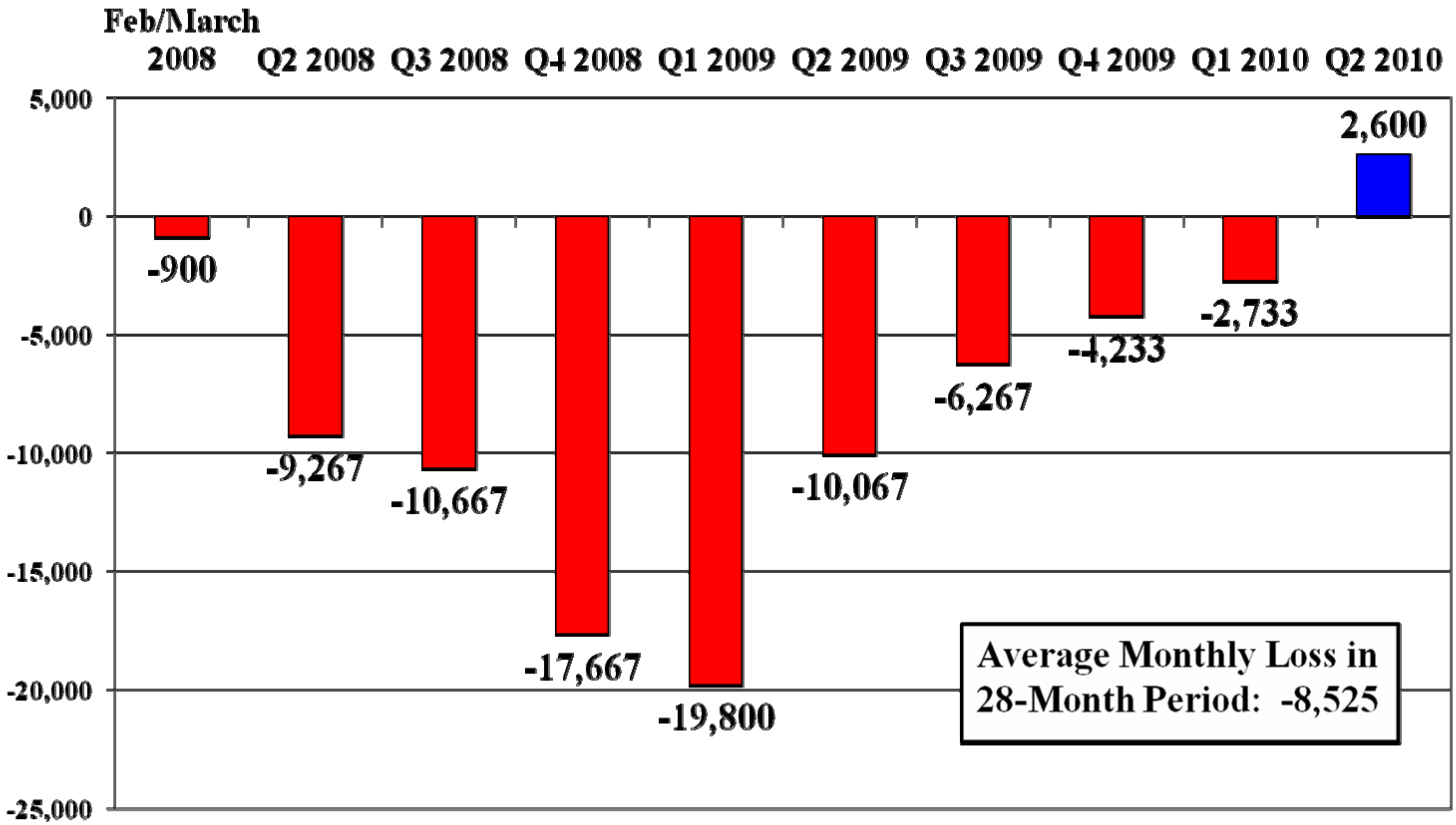
New Jersey Private Sector Employment Change 2008 - 2010



Source: New Jersey Department of Labor and Workforce Development. **A-5**

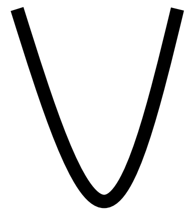
Chart 6

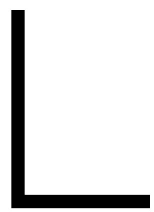
NJ Private-Sector Employment
Average Monthly Change Feb/Mar 2008 – Q2 2010

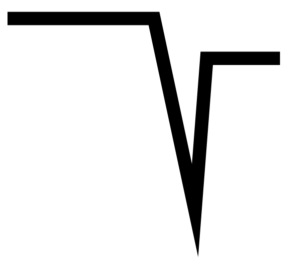


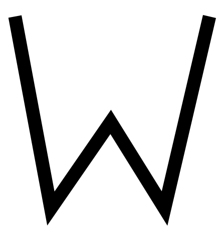
Source: New Jersey Dept. of Labor and Workforce Development. Q2 2010 includes data for April and May only. **A-6**

Economic Calligraphy


- shaped recovery


- shaped recovery


“reverse square root” recovery


- shaped recovery