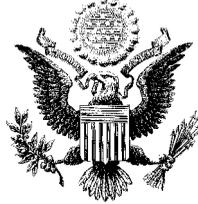


ASSESSMENT OF THE CURRENT ECONOMIC ENVIRONMENT



Chairman Jim Saxton (R-NJ)

**Joint Economic Committee
United States Congress**

July 2001

Executive Summary

After experiencing a remarkably extended period of economic expansion lasting nearly 18 years, the U.S. economy's growth suddenly slowed substantially in mid-2000. The speed and significance of this slowdown surprised most economists. Some analysts believe this slowdown will be brief; the economy's growth should turn around and return to healthy growth quite rapidly. Generally, explanations suggested by economists endorsing this view indicate the factors causing the slowdown are temporary, short-lived, and readily reversible. Once policymakers take remedial action to reverse these factors, economic recovery will readily ensue and the slowdown-recovery can be characterized as "V-shaped" in nature.

Other economists argue that the factors causing the slowdown are longer-term or structural in nature. These explanations portend a longer, more drawn-out slowdown period followed by a significantly weaker, more sluggish recovery. The slowdown-recovery character of the later view is associated with asset price deflation as well as burdensome debt and can be characterized as "U-shaped" in nature. If this set of conditions best characterizes current circumstances, policymakers should undertake faster, more forceful policy responses using reliable indicators to prevent a more serious, protracted downturn while ensuring no meaningful resurgence of inflation.

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ASSESSMENT OF THE CURRENT ECONOMIC ENVIRONMENT¹

INTRODUCTION

In recent years, the U.S. macroeconomy has experienced a remarkably extended (18-year) period of economic expansion interrupted by only a single, brief (8 month), and shallow recession. This lengthy, sustained period of economic expansion led some researchers to contend that the U.S. economy had become both less volatile and less recession prone for several reasons. Since mid-year 2000, however, the U.S. economy's growth has slowed dramatically and the economy has threatened to enter the first recession of the new millennium. The seeds of this slowdown were sown in recent years but became evident only by about mid-year 2000.

Several factors explaining the slowdown suggest it should be brief; the economy should turn around and return to healthy growth quite rapidly. These explanations indicate the slowdown's causal factors are temporary, short-lived, or reversible in nature and the slowdown-recovery can be characterized as "V-shaped". Other explanations cite causal factors that are more structural or fundamental in nature, suggesting a longer, more drawn-out slowdown period followed by a significantly weaker and more sluggish recovery. The slowdown-recovery character of this later view can be characterized as "U-shaped" in nature.

This paper assesses this current economic environment. After briefly reviewing the long sustained period of economic expansion of the 1980s and 1990s (the "long boom") as well as providing explanations of its character, the paper documents the economic slowdown that began in mid-year, 2000 -- the final quarters of the Clinton Administration. Alternative explanations of this slowdown are then briefly reviewed and assessed. Finally, the macroeconomic policy implications of these alternative explanations are reviewed and summarized.

BRIEF BACKGROUND: THE "LONG BOOM"

As indicated above, except for a brief, mild recession in the early 1990s, the U.S. macroeconomy has experienced a lengthy period of uninterrupted growth. This long period of macroeconomic stability is unprecedented.² Some analysts note that the U.S. economy has been in recession only 8 months of the last 18 years, about 4% of time. They point out that prior to 1983, the U.S. was in a recession about 25% of the time.³

As John Taylor has remarked, the cyclical volatility of the U.S. macroeconomy declined beginning in the early 1980s:

¹ Data as of July 2, 2001.

² See, for example, John Taylor, "Remarks for the Panel Discussion on 'Recent Changes in Trend and Cycle', prepared for the conference "Structural Change and Monetary Policy," sponsored by the Federal Reserve Bank of San Francisco and the Stanford Institute for Economic Policy Research, March 3-4, 2000.

³ Goldman Sachs, The Pocket Chartroom, February 2001, p.6.

No matter how you measure it, cyclical volatility from the early 1980s through [early 2000] in the U.S. has been much lower than during the period of similar length immediately before, and perhaps during any period of similar length in history. Whether you look at the size of real output fluctuations around trend, the size of the fluctuations in the growth rate, the length of the expansions, the frequency and severity of recessions, or the softness of soft-landings, the story is the same.⁴

In short, research has established that since the early 1980s, the U.S. became less recession prone and less cyclically volatile. Most research concurs that the preferred watershed date (or break point) marking the beginning of this change occurred in the early 1980s.⁵ Establishing this watershed (or break point) date marking changes in the economy's volatility helps not only to limit the number of possible explanations for the sustained growth but can be useful in identifying explanations for a slowdown should such a turn of fortune occur.

EXPLANATIONS OF THE "LONG BOOM"

Explanations of the "long boom" itself may also help in deciphering the causes of a subsequent slowdown. Of the explanations for the extended 18-year expansion that are pertinent to discussions of the current environment, the most plausible appear to be (1) fewer and smaller exogenous shocks, (2) technological change, and (3) changes in monetary policy. John Taylor assessed several of the alternative explanations of the "long boom" and found timing inconsistencies and other problems with many of them.⁶ In Taylor's view, the most plausible explanation appeared to be changes in monetary policy. More specifically, enhanced economic stability is related to the Federal Reserve's gradual eradication of inflation and its adoption of forward-looking policy indicators in pursuit of this goal (which made monetary policy more responsive to inflation than was earlier the case).⁷ An earlier Joint Economic Study argued that in addition to monetary policy, the following factors contributed to the economy's sustained growth:

⁴ Taylor, *op. cit.*, p.1.

⁵ See, for example, Margaret McConnell and Gabriel Perez Quiros (2000), "Output Fluctuations in the U.S.: What has changed since the Early 1980s?", Federal Reserve Bank of New York, paper presented at the conference "Structural Change and Monetary Policy", March 3-4, 2000; John Taylor, (1998) "Monetary Policy and the Long Boom," *Review*, Federal Reserve Bank of St. Louis, December; and Mark Watson, 2000, "Comments," Remarks Prepared for the conference "Structural Change and Monetary Policy", March 3-4, 2000.

⁶ Taylor (2000), *op. cit.* For example, Taylor assessed the following explanations and found them wanting: (1) better control of inventories, (2) fewer or smaller exogenous shocks, (3) a more service-oriented economy, and (4) fiscal explanations.

⁷ See Robert Keleher, "The Roots of the Current Expansion", A Joint Economic Committee Study, April 1997; and Robert Keleher, "Assessing the Current Expansion", A Joint Economic Study, February 2000, for a similar interpretation. See also Manuel Johnson and Robert Keleher, *Monetary Policy, A Market Price Approach*, Quorum Publishers, New York, 1996.

- The growth-promoting effects of credible government spending restraint.
- The long-term growth effects of an efficiency-promoting incentive structure embedded in the tax code.
- The specialization and efficiency-promoting effects of increased international integration and open markets (globalization).
- The effects on aggregate supply and capacity of substantial investment in equipment as well as in productivity-enhancing new technologies.⁸

Presumably, any serious back-sliding with respect to these factors could have adverse effects on the sustainability of the expansion and could be factors helping to explain a significant slowdown.

THE MID-2000 ECONOMIC SLOWDOWN

By mid-year 2000, however, signs of an economic slowdown began to proliferate; it became apparent that an economic slowdown was underway. A number of key economic and financial indicators provided evidence of such slower growth and suggested that future growth could weaken.

A brief summary of important elements of this evidence, for example, would include the following:

- Real GDP slowed from a robust 5.6 percent annualized growth rate in the second quarter of 2000 to 2.2 percent and 1.0 percent in the third and fourth quarters, respectively, before rebounding modestly to 1.2% in the first quarter of 2001.
- Key components of GDP such as real consumption expenditures slowed after mid-year as real income growth moderated, stock market values fell, employment gains lessened, and consumer confidence stalled and then deteriorated. Movements in retail sales generally corroborated these developments.
- Gross private investment also contributed significantly to this general slowdown with most key investment categories registering actual declines by the fourth quarter and advances of non-defense capital goods (ex-aircraft and parts) orders falling sharply after mid-year (on a year-over-year basis).
- The index of leading indicators trended down after January 2000.
- Employment advances slowed dramatically after mid-year. Gains in total non-farm payrolls, for example, averaged about 256,000 per month for the 2 1/2 years prior to mid-year 2000 and 44,000 per month after mid-year 2000. The average workweek also decreased after mid-year.
- The manufacturing sector also has weakened significantly since mid-year 2000. Industrial production, capacity utilization, the Natural Association of Purchasing Managers index, as well as manufacturing employment and workweek have all registered significant declines since mid-year 2000.

⁸ See Robert Keleher, "Assessing the Current Expansion", A Joint Economic Committee Study, February, 2000.

- Financial equity markets began to deteriorate about mid-year 2000 as well. In short, there can be little doubt that a significant economic slowdown or retrenchment began about mid-year 2000 in the last quarters of the Clinton Administration.

ALTERNATIVE EXPLANATIONS OF THE MID-2000 SLOWDOWN

This slowdown's magnitude and the speed at which it developed surprised most economic forecasters. Nonetheless, there are several obvious contributing factors and explanations for the current slowdown. These explanations can be separated into two categories: (1) some indicate that the causal factors are short-lived or reversible in nature and consequently, the resulting slowdown-recovery can be characterized as "V-shaped;" (2) others cite causal factors that are non-cyclical or structural in character, suggesting a longer, more drawn-out slowdown period followed by a significantly weaker and more sluggish recovery that can be characterized as "U-shaped".

"V-SHAPED" EXPLANATIONS

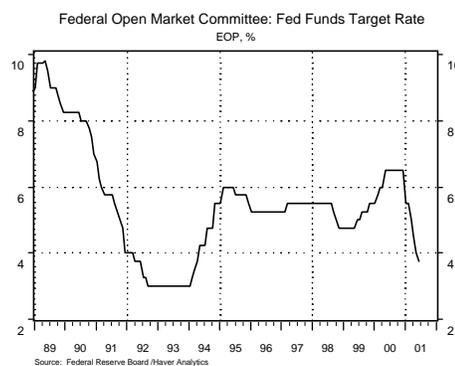
A number of factors help to explain a "V-shaped" slowdown-recovery. First, the Federal Reserve raised interest rates six times and 175 basis points from June 1999 to May 2000, putting the Federal funds rate at 6.5 percent, the highest level since 1991 (see Chart 1). For the most part, these moves were taken despite evidence from jointly assessed market price indicators suggesting that a resurgence of inflation was not likely and that significant inflationary pressures were not an important concern.⁹ Notably, JEC Vice Chairman Saxton wrote a letter to Federal Reserve Chairman Greenspan in the spring of 2000 expressing concern about an overly restrictive stance at that time.¹⁰ Further, as the effect of this tightening began to impact credit markets and the economy and market interest rates declined, the Federal Reserve held short-term rates up, exacerbating existing policy tightness.

Additionally, this restrictive monetary policy stance occurred at the same time that the Federal Reserve survey of loan officers indicated that commercial banks were imposing more restrictive credit and lending standards, making for even more restrictive credit conditions. The resulting restrictive monetary policy affected financial (including equity) markets and interest-sensitive sectors of the economy such as auto sales, other durable consumption categories, as well as several categories of investment.

⁹ See Robert Keleher, "The Performance of Current Monetary Policy Indicators," A Joint Economic Committee Study, October, 2000.

¹⁰ See letter from Saxton to Greenspan dated March 31, 2000. This letter was described and linked in an April 3, 2000 JEC Press Release, and can be found online at <http://www.house.gov/jec/press/let-4-03.htm>.

Chart 1



Second, substantial energy (oil, natural gas, electricity) price increases also adversely impacted the economy in a number of ways (see Chart 2). Consumers, spending more on higher-priced energy products, have less to spend on other consumer products of a discretionary nature. So consumption of such items is adversely affected. Analogously, such energy price increases will have a negative impact on economic activity since purchasing power is transferred to oil-producing countries from oil-consuming countries. The severity of this effect, of course, depends in part on how oil producers use their increased oil revenue. Such energy price increases also impact the supply-side of the economy; they raise costs, reduce aggregate supply, and lead to output reductions. As part of this process, higher costs of energy inputs have squeezed businesses' earnings and profits, thereby adversely impacting the non-energy sectors of the stock market.

Third, these factors taken together have worked in concert with other forces to weaken a somewhat overvalued stock market, which, in turn, could reverse that market's "wealth effect" boost to consumption (see Chart 3). The associated higher cost of capital also contributes to a slowdown in investment activity. Thus, stock market weakness in and of itself (and the negative net worth that such weakness sometimes entails) also adversely impacts the economy.

Fourth, the tax burden or "fiscal drag" has grown significantly in recent years as tax revenues have persistently grown faster than the economy. As the recent extended recovery persisted over a number of years, real growth in conjunction with the progressive tax system generated ever increasing tax revenues; individuals were driven into higher tax brackets. Capital gains tax revenues also contributed to these larger tax revenues. Eventually, as tax revenues increase beyond a certain proportion of GDP, these tax revenues become increasingly burdensome and in turn adversely impact the economy's growth. This effect is referred to as "fiscal drag" and it likely has burdened the economy recently since federal tax revenue as a proportion of GDP is at the highest level since World War II (see Chart 4).

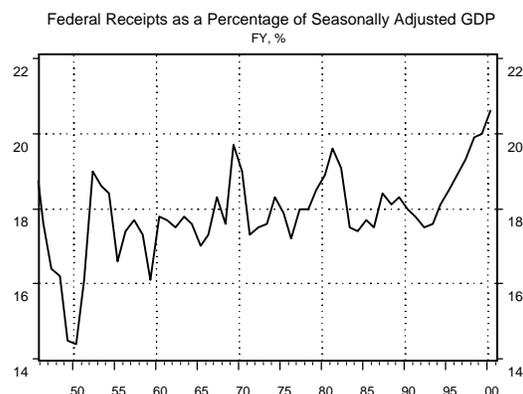
Chart 2



Chart 3



Chart 4



For the most part, these casual factors were influencing financial markets and the economy by mid-2000. Examination of the chronology of events confirm this; the seeds of this slowdown were sown during the latter stages of the Clinton Administration.

According to some analysts emphasizing these factors, much of the impact of this slowdown manifested itself in the form of a conventional short-term inventory cycle concentrated in manufacturing with involuntary inventory accumulation spawning production cut-backs until inventories were again in line with sales projections. In short, many of these analysts contend that these effects will be limited to a relatively short-lived inventory cycle. Further, since much of these explanations are temporary or readily reversible in nature, many analysts expect their effects to be relatively brief.

More specifically, some analysts argue that monetary policy restrictiveness has already been in large part reversed with sizeable rate reductions in 2001. Energy prices (especially natural gas prices) have generally retreated. Both of these reversals are expected to help support the stock market. Moreover, tax relief will eventually occur and to some extent offset the “tax drag” currently burdening the macroeconomy. Additionally, over-investment is largely concentrated in information-computer-technology equipment, which has rapid depreciation rates, helping to shorten the investment slowdown. According to this view, then, the economy should turn around and return to more robust growth in relatively short order. Investment in particular is seen as bouncing back in the near term. In sum, these explanations suggest the key causal factors are for the most part short-lived in nature and, accordingly, the associated slowdown-recovery can be characterized as “V-shaped” in nature.

POLICY IMPLICATIONS OF A “V-SHAPED” SLOWDOWN-RECOVERY

If this set of conditions best characterizes existing circumstances, there are several notable policy implications that should be recognized and acted on. First, monetary policy should adopt a policy stance that fully offsets the tightness of earlier policy and further, fosters gradual expansion while ensuring no resurgence of inflation or violation of an inflation targeting strategy. This does not necessarily imply a basis-point for basis-point reversal of the federal funds rate. Rather, policy should be eased until market price indicators jointly signal policy ease (i.e., until these indicators jointly signal no deflationary concerns).

Second, an energy policy should be pursued that encourages conservation as well as exploration and fosters production and supply (both domestically and internationally) of a broad array of energy sources. Such a strategy would include flexible market prices, tax incentives, and an adjustment of excessive EPA regulations when appropriate.

Third, fiscal policy should offset “fiscal (or tax) drag” so as to remove accumulated tax burdens on the economy. Ideally, this should be done in a manner that restores incentives for and encourages long-term economic growth. Further, such a strategy would constrain government spending in the face of continuing sizeable government surpluses.

ALTERNATIVE “U-SHAPED” EXPLANATIONS

Another, diverse set of analysts have drawn attention to an alternative set of longer-term, structural factors affecting the slowdown-recovery. These factors portend a larger, more drawn-out, and significant slowdown period followed by a significantly weaker, more sluggish recovery, resulting in a “U-shaped” slowdown-recovery.

These analysts emphasize important differences between current circumstances and those of typical slowdown-recoveries of the post World War II era. They point out, for example, that the current slowdown:

- is the first significant slowdown of the information age as well as the globalization era.
- is not associated with significant inflation and therefore may be similar to business cycles prior to World War I.
- is the first significant slowdown occurring with sizeable percentages of Americans holding (directly or indirectly) shares of stock.

These observations lead these analysts to suggest that the current slowdown-recovery may be associated with more rapid adjustments involving the global economy. Whereas some analysts expect a U.S. slowdown to be offset or counter-balanced by expansions overseas, globalization may dictate that slowdowns are more synchronized. The current slowdown may not be anti-inflation demand driven but more likely will involve the equity markets and supply-side imbalances. Furthermore, these analysts contend that this slowdown will experience structural “headwinds” involving necessary balance sheet adjustments associated with accumulated debt burdens. These adjustments suggest the slowdown-recovery may last longer and may be deeper than inflation-driven recessions.

The slowdown-recovery emphasized by these analysts often is characterized by excess or mal-investment, low savings, asset bubbles, and high levels of debt and structural balance sheet dislocations that may take extended periods to remedy. Theoretically, these analysts describe a process similar to what is known as an Austrian mal-investment theory of the business cycle, which often includes an asset bubble. According to this view, the expansion phase of such an economic cycle occurs when the natural rate of interest i_n (the rate which equates saving and investment) increases relative to the bank rate of interest i_b (the rate set by the central bank). This may occur either because of a technological advance increasing the return to capital (raising i_n relative to i_b) or, equivalently by an expansionary monetary policy (lowering i_b relative to i_n).

In either case, the divergence between i_n and i_b (and the increased return to capital) is associated with credit expansion, which produces and fosters a significant increase in spending and investment (relative to saving). This increased credit supply encourages borrowing and spending, and in turn increased earnings, as well as increases in capital investment and capacity. As profits and earnings advance, the stock market advances. Increases in perceived wealth encourage more spending, borrowing and debt accumulation. Indeed, rapidly rising equity prices tempt business to expand capacity too quickly and can encourage a credit binge, rapid investment, and excess capacity. This process is often associated with asset price bubbles (e.g.,

sharp increases in the prices of equity, real estate, or collectables), over-investment, excess capital accumulation, and rapid debt accumulation.

Eventually, the over-investment and excess capacity creates earnings shortfalls; the over-investment puts downward pressure on returns to capital. This, of course, could be triggered by an interest rate shock or a surprise increase in energy prices. Indeed, earnings can decline sharply, causing equity prices to decline and investment spending to fall off, sometimes rapidly. Businesses' efforts to sustain profitability often result in lower output (to reduce inventories), reduced spending, and layoffs. These efforts, in turn, encourage further slowdown. The equity bubble often bursts. As equity value and net worth decline, households may be burdened by residual elevated debt levels and consequent balance sheet dislocations. As a result, spending declines, as households and business attempt to work off these significant debt burdens. These imbalances are structural in nature and may take an extended period of time to be worked off.

Chart 5

EVIDENCE

Data do exist consistent with this view, making for a plausible “U-shaped” slowdown-recovery scenario. In recent years, for example, technological advances have raised returns to capital, encouraging rapid growth in investment relative to GDP. Much of this rapid investment growth has been concentrated in the business equipment and software category (see Chart 5). As stock prices soared (especially in the technology sector) and household net worth positions advanced, households experienced a “wealth effect”, increased their borrowing, and consumed larger portions of their income, thereby diminishing savings as a percentage of disposable income (see Chart 6).

A diminution of wealth, however, occurs with earnings disappointments and a bursting of the asset price bubble -- as epitomized by the technology-laden NASDAQ index (see Chart 7).¹¹ A diminished net worth position leaves some households with a sizeable debt burden as reflected in higher debt-to-income ratios and higher debt servicing costs as a percentage of disposable income (see

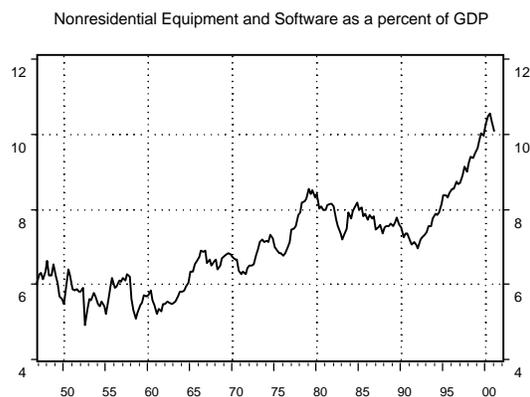
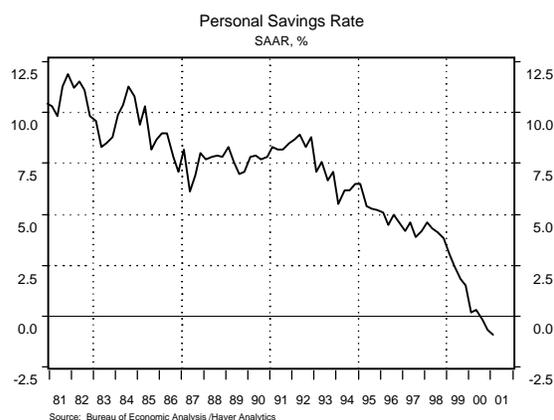


Chart 6



¹¹ Generally, most other stock price indices did not decline to the same extent as the NASDAQ index. The “asset bubble” phenomenon was epitomized by this technology-laden index.

Chart 8). In fact, sizeable household and business debt burdens may remain after asset prices have declined.

To the extent these factors describe U.S. circumstances and the character of the current slowdown-expansion, the sharpness and extent of downward adjustments may surprise many analysts. Further, global weakness may be synchronized with U.S. weakness and hence serve to exacerbate such sluggishness. Stiff “headwinds” could confront the U.S. economy for an extended period of time as the debt accumulated during the asset-bubble period requires a lengthy work-off period after such asset bubbles burst.

POLICY IMPLICATIONS OF A “U-SHAPED” SLOWDOWN-RECOVERY

While the factors underlying a U-shaped scenario may, in fact, exist, it is notoriously difficult to predict exactly when and to what degree these factors impact household and business behavior: i.e., it is very difficult to predict how these factors translate into GDP forecasts or projections. Nonetheless, if these conditions describing a rapidly adjusting “U-shaped” slowdown-recovery best characterize existing circumstances, several key implications merit policymaker attention. In addition to those policies appropriate for a “V-shaped” slowdown-recovery described above, “U-shaped” circumstances (which include asset bubble collapses and consequent increased debt burdens) in certain cases may call for additional policy action.

Monetary policy should respond to asset price changes when such changes help to forecast inflationary or deflationary pressures; when such asset price changes signal changes in expected inflation or signal changes in financial stability.¹² If this is the case, monetary policy responses to these circumstances should be substantial, rapid, wary of systemic financial considerations, and based on indicators known to be reliable in these peculiar circumstances.

More specifically, in the aftermath of an asset bubble collapse (and consequent increased debt burdens), monetary policy changes must be significant or potent enough to offset the

Chart 7

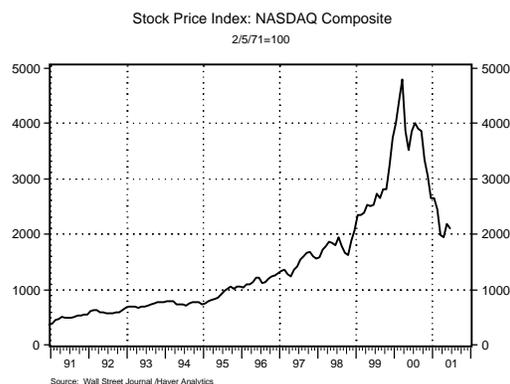
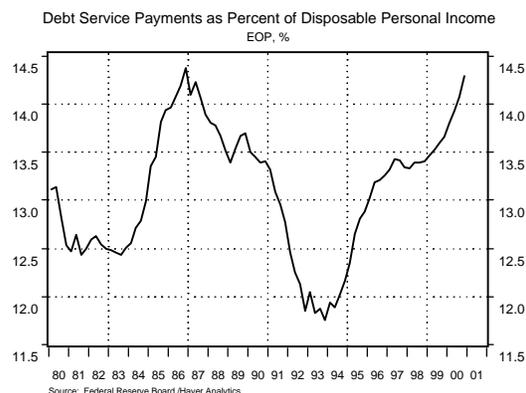


Chart 8



¹² See, for example, Bernanke, Ben, and Mark Gertler, “Monetary Policy and Asset Price Volatility,” New Challenges for Monetary Policy, Federal Reserve Bank of Kansas City, 1999, p. 115.

potentially contractionary or deflationary effects of a set of rare, unusual events that sometimes occur in these circumstances. Such events include the contractionary impact of a rapid asset (e.g., equity) price decline and adverse effects on collateral that this may entail; the subsequent contractionary effects of debt/balance sheet adjustments made by households, businesses, and financial institutions; and the restrictive effects of tighter lending/credit standards implemented by commercial banks and other financial institutions in light of these events. These effects can be potent and may block traditional (bank) transmission effects of monetary policy. To be effective in these circumstances, therefore, changes in monetary policy must be substantial enough to offset or outweigh such effects.¹³ Further, since debt ratios often weigh important in these circumstances, monetary policy must ensure that no deflation takes place since price declines could significantly worsen existing debt burdens. Attention to commodity price indicators and other measures of price expectations could help on this score.

In addition to offsetting the above factors, monetary policy may need to respond more rapidly to unfolding events in the current environment. As Chairman Greenspan detailed in his February 2001 Congressional testimony, economic adjustments in this slowdown are occurring much faster in the current information age than was previously the case. Accordingly, it is becoming increasingly apparent that for monetary policy to be effective in this new environment, it must react in a timelier, pre-emptive, and forward-looking fashion to ever-changing events.

In practice, for this to happen, monetary policy indicators must be chosen that are well-suited for this new environment. These indicators should not only be accurate inflation guides, but should be flexible, forward-looking, and sensitive to new information and unfolding events. One clear lesson of monetary history is that short-term interest rate levels have been notoriously poor monetary policy indicators or guides in such situations, and especially in deflationary environments on the downside of an asset price bubble-bursting episode. Instead, joint assessments of market price indicators such as commodity price indices, foreign exchange rates, and long-term bond yields have proven more reliable.¹⁴

“U-shaped” slowdown-recovery conditions have implications for fiscal policy as well. While fiscal policy should continue to remove “tax drag” with pro-growth tax and spending policies, tax rate cuts would help to cushion debt burdens, mitigate balance-sheet distortions, and bolster cash flows. Over time, capital gains tax relief could aid the equity market. To aid investment, tax incentives for accelerated depreciation as well as expanded limits for expensing should be considered. Further, to the extent possible, such tax policy should be “front-loaded”, made retroactive, or simply quickly enacted so as to boost near-term economic activity.

¹³ To reliably offset such portfolio-related effects, central banks and regulatory authorities must recognize the impact of asset price fluctuation on the financial system’s stability. Accordingly, authorities may want to lessen lenders’ portfolio distortions during asset price booms since their soundness will be compromised when loan collateral falls in value on the downside. (See Anna Schwartz, “Asset Price Inflation and Monetary Policy”, paper presented at American Financial Associations Meeting, New Orleans January 7, 2001, p18.)

¹⁴ See Johnson and Keleher, *op. cit.* especially chapters 11-13.

SUMMARY AND CONCLUSIONS

After experiencing a remarkably extended period of economic expansion lasting nearly 18 years, the U.S. economy's growth suddenly slowed substantially in mid-2000. The speed and significance of this slowdown surprised most economists. Some analysts believe this slowdown will be brief; the economy's growth should turn around and return to healthy growth quite rapidly. Generally, explanations suggested by economists endorsing this view indicate the factors causing the slowdown are temporary, short-lived, and readily reversible. Once policymakers take remedial action to reverse these factors, economic recovery will readily ensue and the slowdown-recovery can be characterized as "V-shaped" in nature.

Other economists argue that the factors causing the slowdown are longer-term or structural in nature. These explanations portend a longer, more drawn-out slowdown period followed by a significantly weaker, more sluggish recovery. The slowdown-recovery character of the later view is associated with asset price deflation as well as burdensome debt and can be characterized as "U-shaped" in nature. If this set of conditions best characterizes current circumstances, policymakers should undertake faster, forceful policy responses using reliable indicators to prevent a more serious, protracted downturn.

Currently, several forces making for a near-term slowdown have reversed themselves or are on the wane and moving in the right direction. At this time, therefore, the odds appear to favor a recovery in the near-term. On the other hand, there are signs and potential risks of longer-term causal factors at work. Given the fragility of the economy, policymakers must be prepared to react and further precautionary (insurance) steps should be considered.

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