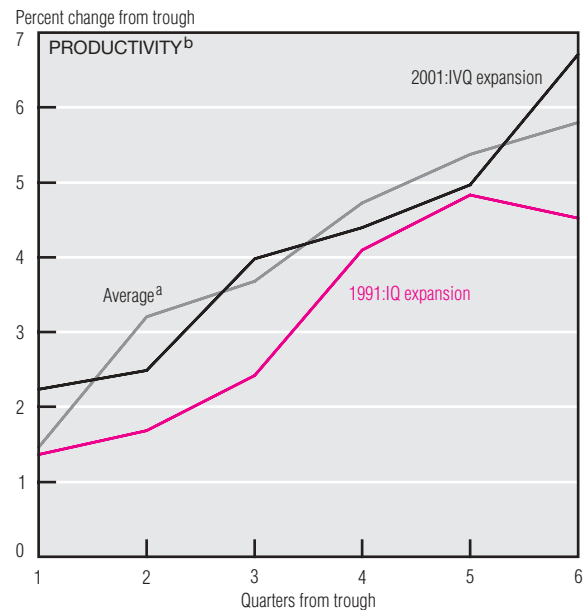
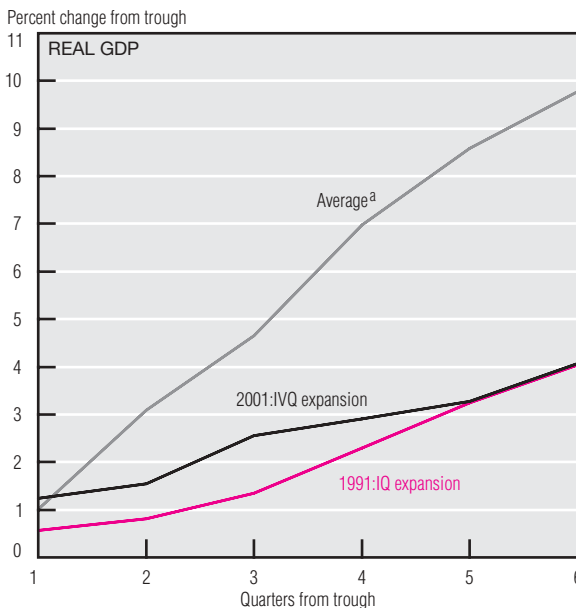
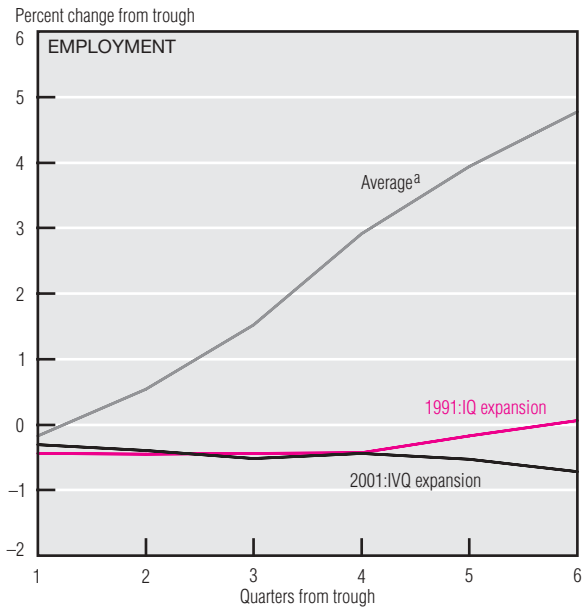
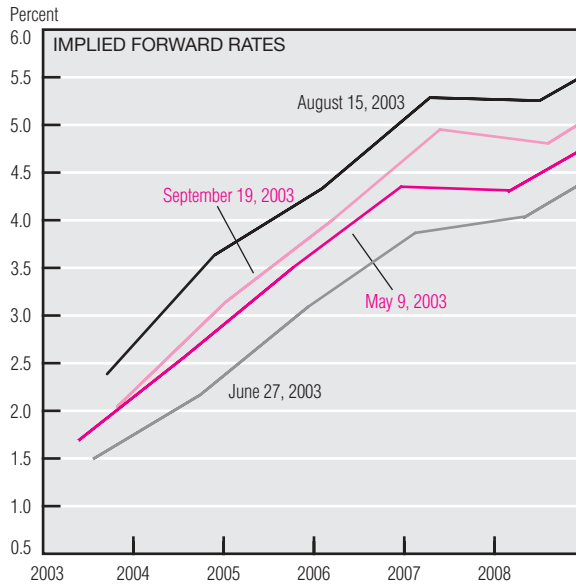


# Business Cycles and Monetary Policy



a. Average of expansions that started in 1975:IQ, 1980:IIIQ, and 1982:IVQ.

b. Nonfarm business sector.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; U.S. Department of Labor, Bureau of Labor Statistics; and Board of Governors of the Federal Reserve System, "Selected Interest Rates," H.15, *Federal Reserve Statistical Releases*.

The period after the 1991 recession, dubbed the "jobless recovery," was not historically typical; the current episode, sometimes called the "job-loss recovery," is even more anomalous. In the typical recovery, employment has increased nearly 5% six quarters after the National Bureau of Economic Research officially announces that the recession is over. In the six quarters since the NBER's most recent end-date announcement, however, employment has fallen nearly 1%. Not surprisingly, real output also has languished, rising only 4% since 2001:IVQ. This contrasts with

the 9% that GDP has usually advanced at this stage in a recovery.

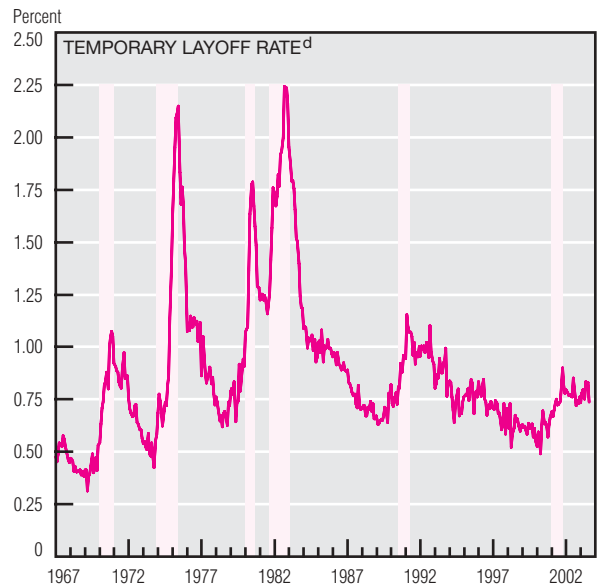
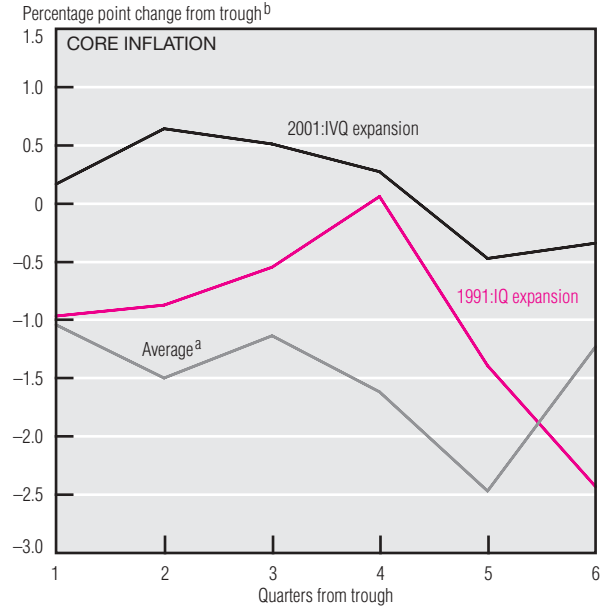
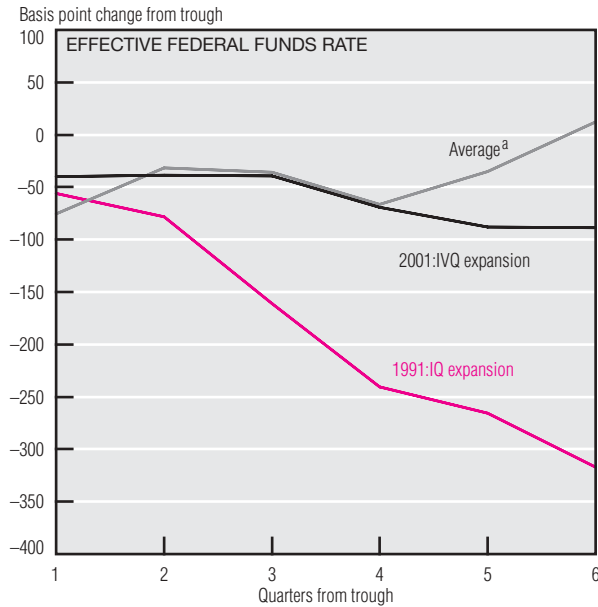
Should monetary policy concern itself with slow job growth? Initially, the answer seems unambiguous. Job losses—and thus a stubbornly high unemployment rate—suggest slack or unused economic resources. Monetary policy could potentially help employ these resources. According to this view, output running below potential has also kept inflation low—indeed, it has decreased inflation somewhat—since the recession ended. This bleak situation is masked by strong growth in productivity,

which has increased more since the trough than it typically does. Potential output, led by strong productivity, is advancing, but GDP's inability to keep up with these advances leaves a persistently high output gap.

The view that monetary policy should try to stimulate output is not universal, however. Some fear that the federal funds rate, currently at 1%, cannot be further eased without pushing it to a point where further cuts would be impossible. At that point, monetary policy might be powerless to offset further unwelcome

*(continued on next page)*

## Business Cycles and Monetary Policy (cont.)



NOTE: Shaded areas indicate recessions.

a. Average of expansions that started in 1975:IQ, 1980:IIIQ, and 1982:IVQ.

b. Inflation is calculated from personal consumption expenditures less food and energy, Chain Price Index.

c. Median expected change in consumer prices as measured by the University of Michigan's *Survey of Consumers*.

d. Shaded areas indicate recessions.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; U.S. Department of Labor, Bureau of Labor Statistics; Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases* H.15; and University of Michigan.

declines in inflation or forestall another recession.

Even without these worries, it is not certain that monetary policy should be accommodative. This prescription generally assumes that there is a positive output gap. Unfortunately, the output gap is not observable, so monetary policymakers must try to gauge it by examining other variables, such as unemployment and inflation. But this is an imperfect method that can be misleading for at least two reasons.

First, falling inflation does not necessarily imply a positive output gap. There is a lot of persistence in the inflation series, so inflation may continue to decline even after the gap has been closed. Adherents of this view observe that, although inflation has declined slightly since the trough, the drop is smaller than is typical during a recovery. Nor do the job losses since the trough, troubling though they are, necessarily indicate a positive output gap. The so-called natural rate of unemployment (the unemployment rate

consistent with "full employment") is also unobservable. During periods when the economy is undergoing major structural change, this natural rate will be high. Even though the causes of the current job-loss recovery are still unclear, it seems increasingly likely that much of its unemployment results from structural, rather than cyclical, changes. Temporary layoffs, which indicate cyclical unemployment, barely increased during the most recent recession.