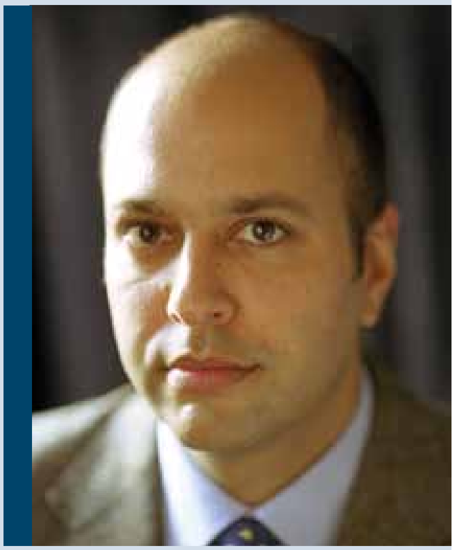
Question & Answer

"Long Expansions Are Very, Very Useful"



An Interview With Lakshman Achuthan, Economic Researcher

LAKSHMAN ACHUTHAN

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Other	Achuthan has been at the Economic Cycle Research Institute since April 1996. He has been a board member of the Levy Economics Institute of Bard College since 2004. From 1991 to 1996, he was director of marketing for Columbia University's Center for International Business Cycle Research. His book, *Beating the Business Cycle*, was published in 2004.

Economists pore over myriad data to understand past economic events better, to get a clearer idea of the present economic situation, and to try to anticipate what is around the corner. Lakshman Achuthan, managing director of the Economic Cycle Research Institute, focuses on studying business cycles: what causes them, how they affect the overall economy, and what they can tell about future economic events. He specializes in forecasting economic and inflation cycles for major economies around the world.

EconSouth: *Why do you foresee the peaks and troughs of expansion and recession getting shallower and closer together in the future?*
Lakshman Achuthan: Basically, this observation is different than our leading index observation where we're forecasting things out based on these leading indicators. Rather, it's an observation where we step back and look at really big cyclical patterns. We see two trends or patterns that are pretty well developed that virtually dictate more frequent recessions, or getting these troughs bunched closer and closer together than anyone's been used to, say, in the last quarter century. I need to describe each of these two ingredients in some detail.

First, a recession is when growth goes below zero for the key coincident indicators in the economy and stays there for more than a couple of quarters. It's a pronounced decline in activity that persists for more than a couple of quarters, and it's pervasive across all aspects of the economy. In thinking about it, there are two ways to avoid having the cycle go below zero. One way to avoid having the down cycle go negative is to just lift up the trend growth rate of the economy. If the trend growth was a couple of percent and if you lifted it up a couple of percent, even a downturn—while slower growth—wouldn't be negative growth.

ES: *Can you cite an example of lifting trend growth?*
Achuthan: A really good example of an economy where this trend growth has happened would be China. For the past 20 years, the Chinese trend growth rate for its economy has been about 10 percent. Even though they've had downturns in growth, it's never taken them to negative growth, to a recession. So they haven't had a recession in almost two decades.

ES: *Is there another way to avoid downturns?*
Achuthan: The other way you can avoid an economy's downturn in growth is to have a smoother cycle, where the volatility, the amount of the downturn, is less than it used to be—a more moderate, a smoother, or a tamer business cycle. A good example of that is actually the U.S. economy from the period of the mid-1980s

until 2007, [when] the size of the fluctuations up and down in U.S. economic growth was really, really low. And the economists and academics—including Fed Chairman Ben Bernanke—talked about this period as the "great moderation" of the business cycle.

ES: *How do you see growth trends in this country?*

Achuthan: If we look at growth trends with respect to the United States, we find that the news is not very good. In terms of our trend growth during expansions, we can see that the trend growth rate has been getting weaker and weaker for decades. It's a very well-established trend that the key coincident indicators—GDP [gross domestic product], jobs growth, sales, production, or income, all of these coincident measures of aggregate activity—show that the trend growth rate during expansion has been stepping down since the 1970s. That's a very well-established trend. The last expansion was the weakest expansion on record on every one of those counts: GDP, jobs, sales, and income. Every one of those was the weakest in the whole post-World War II period. And it continues this very clear trend from the 1970s until now.

We have to be prepared that the cyclical volatility, which has already increased, will remain higher than what we've seen between the mid-1980s and 2007.

So, judging by that trend, we're failing. The United States is not doing well. And I don't know of anyone or any theory or any reason why we can argue that that trend is about to change and go in the other direction. I don't know of any clear argument as to why our trend growth rate is now going to start increasing. When we get to the next recession, I think there's a very good chance that the trend growth in this expansion of those coincident indicators is basically a continuation of that weaker trend growth that we've seen for decades.

ES: *You mentioned a second component involved with the frequency of recessions.*

Achuthan: The second component of how you get a recession is through volatility, or this great moderation. This great recession that we just [came through] certainly breaks the trend of that great moderation and really calls into question if it can continue or if we're going to revert back to some sort of low-volatility business cycle. On this score, we have to be prepared that the cyclical volatility, which has already increased, will remain higher than what we've seen between the mid-1980s and 2007.

If we have higher cyclical volatility and the low trend growth rate of the expansion, then the opportunity for us to fall into a new recession is dramatically higher. The odds go up very quickly. We're unlikely to see an eight-, nine-, or 10-year expansion, which is what a lot of people have experienced during their lifetimes. [Americans] have kind of come to expect long expansions.

ES: *What's the value of long expansions?*

Achuthan: Long expansions are very, very useful because they give governments the opportunity to adjust their debt loads. They give central banks the opportunity to raise interest rates. They give the job market an opportunity to heal. On all of those scores, if we have a short expansion, then you have to start really seriously thinking about going into a new recession with elevated unemployment, a weakened balance sheet nationally, and not a lot of room for cutting of interest rates because they probably haven't been raised that much. If anything, those kind of scenarios may limit the ability to make the next recession softer—in other words, more volatility.

To put this in perspective, we're not necessarily talking about going back to the booms and busts that we saw in the United States before the Great Depression. Those were really of a whole other ilk. But I think it is reasonable to think about the kind of recession frequency that we saw in the United States in the 1970s. From the late 1960s into the early 1980s, we had four recessions. You can also look at Japan over the last couple of decades, where it's had fairly low trend growth, and again you see a few recessions in a fairly short period of time. Each expansion there averaged about three years. That's a very different environment than what most decision makers have become used to. ∎

This interview was conducted by Ed English, a staff writer for EconSouth*. The views expressed by Lakshman Achuthan are his and do not necessarily reflect the views of the Atlanta Fed.*