



Letter to the Editor – The Definition of a Recession

Several of our readers questioned the definition of a recession given in our [article](#) last week. One of these letters is below, along with the response by Jim Lavorgna, the author of the article.

Dear Editor:

Check out the [NBER site](#). [Ed. Note: the NBER is the National Bureau of Economic Research, a private organization.] They are actually the organization responsible for deciding when the US "officially" enters a recession and they define it different than the two negative quarters the author used. It's interesting that he seemed to imply that his definition is set in stone (which is the one many people use) when the NBER's definition is the closest thing we have to an official definition. I'm not sure what he meant when he said that the US government uses his definition in reports, but he could be right for different groups like the BEA [Ed. Note: the BEA is the Bureau of Economic Analysis, a branch of the US Department of Commerce].

The NBER defines a recession as:

A recession is a significant decline in activity spread across the economy, lasting more than a few months, visible in: a) industrial production, b) employment, c) real personal income, and d) wholesale-retail trade sales. A recession involves a substantial decline in output and employment. In the past 6 recessions, industrial production fell by an average of 4.6 percent and employment by 1.1 percent.

Todd J. Brunette
Northstar Capital Management
Florida

Jim Lavorgna replies:

Your response brings out some of the points I am trying to make in my article. First, the markets need "a precise definition" for measurement. While the NBER analysis may be helpful for looking at certain types of cycles, it is vague. The NBER definition is not easy to measure, even once the final GDP numbers are quantified. Second, I pointed out that "[the] definition of recession above is the definition the U.S. government uses in its reports." I said this because it "is" the definition that the government uses. The U.S. Department of Commerce, through the [Economics and Statistics Administration](#) bases economic changes on



information produced by the Bureau of Economic Analysis, and which in its own words maintains the highest possible quality Federal statistical system.

In addition, the following parts of our government use [BEA](#) GDP measurements in the following areas:

- White House and Congress in preparing budget estimates and projections.
- Federal Reserve to set monetary policy.
- Federal Government agencies to calculate international price indexes and understand behavior of multinational companies.
- Federal Government to distribute federal funds.
- State governments to plan state spending, make revenue estimates, and track state economies.

Third, I stated, "many people have their own definition of recession." It is like the Constitution. Some folks are strict constructionists. Others feel that they can interpret it to find new meanings. The NBER definition is just one example of this type of alternate measurement. The following statement from the NBER website demonstrates this point.

Q: Why is the NBER considered the official source of economic cycle turning point dates?

A: In 1961, the U.S. Department of Commerce's Bureau of Economic Analysis informed us that it planned to publish our chronology of business cycle turning points in its monthly publication about the business cycle. Doing so served to demonstrate that the government considered our dates "official."

Although the BEA decided to publish "the chronology of business cycle turning points in its monthly publication about the business cycle," it does not state that the Department of Commerce considers it the measure for recession. According to [Bruce T. Grimm](#), the BEA views the quarterly GDP as the best measure of overall economic activity.

The Grimm paper, "Alternative Measures of U.S. Economic Activity in Business Cycles and Business Cycle Dating," illustrates two points. First, the NBER method of calculation is much more robust of an indicator (aggressive) than just one indicator and it is sometimes contradictory. Second, it is too subjective to be a measure of recession.

On its face, the NBER's definition causes a problem:



A recession is a significant decline in activity spread across the economy, lasting more than a few months, visible in industrial production, employment, real income, and wholesale-retail trade. A recession begins just after the economy reaches a peak of activity and ends as the economy reaches its trough.

In the first part of the first sentence, the word significant is too vague. There is too much wiggle room. One could gleam from the second part of the first sentence that the Great Depression was nothing more than a long recession.

This being said, BEA does use the NBER data for measuring peaks and troughs on a monthly basis. I do not believe it is quantifiable, nor that accurate. For all the reasons listed above, I do not use it to measure a recession.

James A. Lavorgna
CEO
Forsyth Wealth Management

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