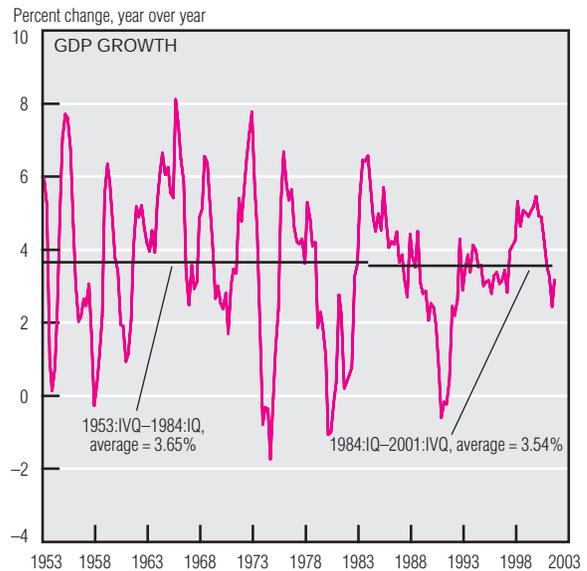
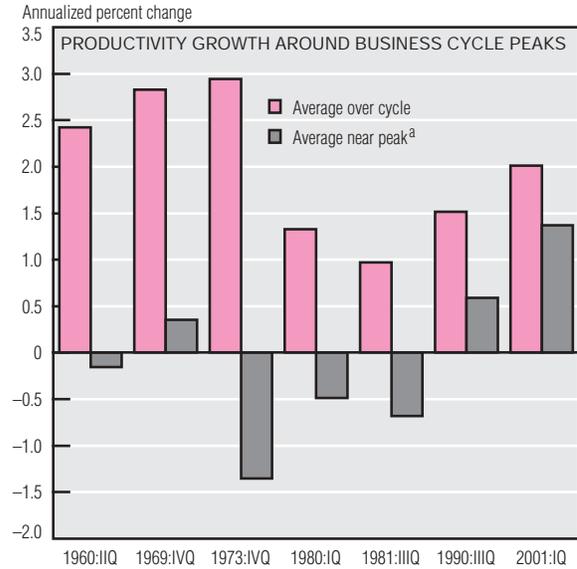
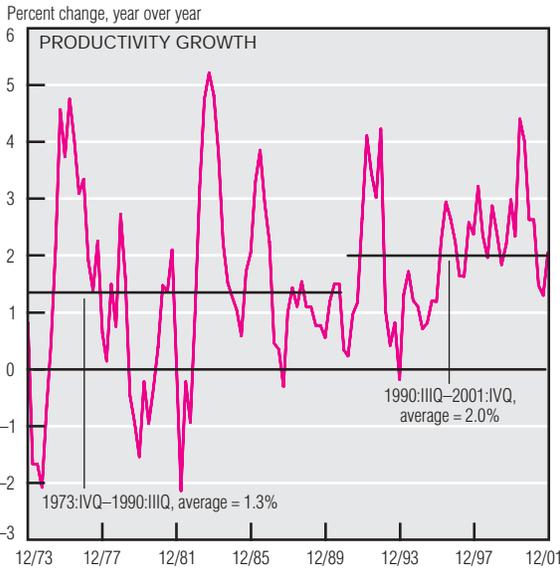


# Money and Financial Markets



a. Annualized percent change from two quarters before a business cycle peak to two quarters after it.  
 SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census; and U.S. Department of Labor, Bureau of Labor Statistics.

Annualized productivity growth in 2001:IVQ, which recently was revised upward from 3.5% to 5.2%, was surprisingly strong. Although productivity growth often spikes near the end of recessions (as in the current episode), it usually stagnates or even becomes negative around business cycle peaks. This did not occur during the most recent downturn, however. In the five quarters centered on the peak, productivity grew at an annual rate of 1.4%, equaling its average pace during 1974–90.

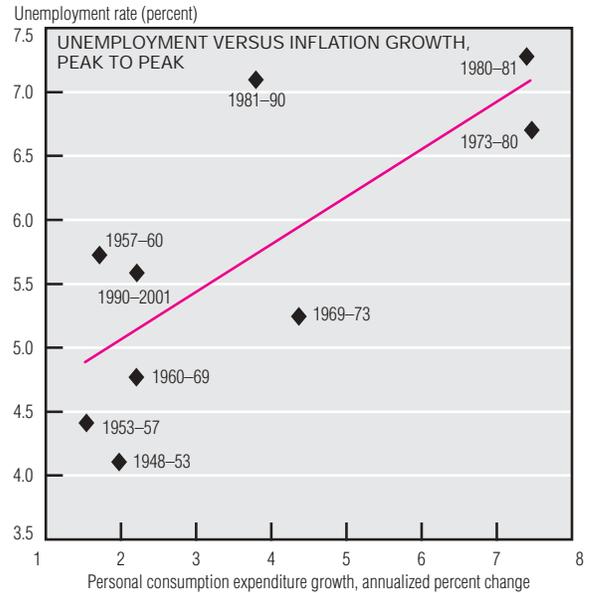
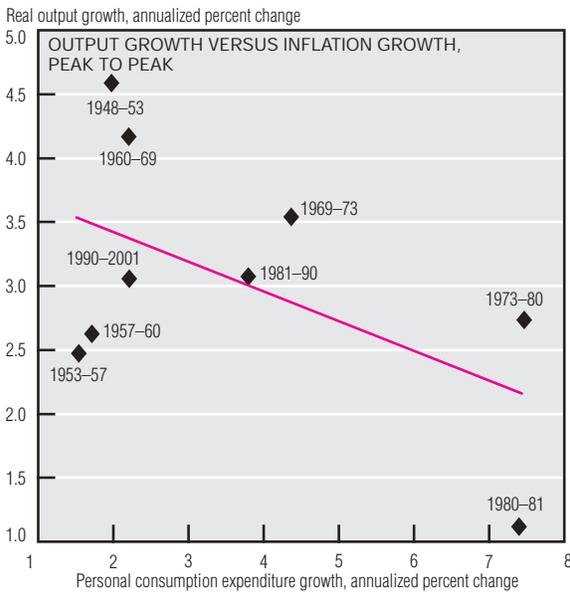
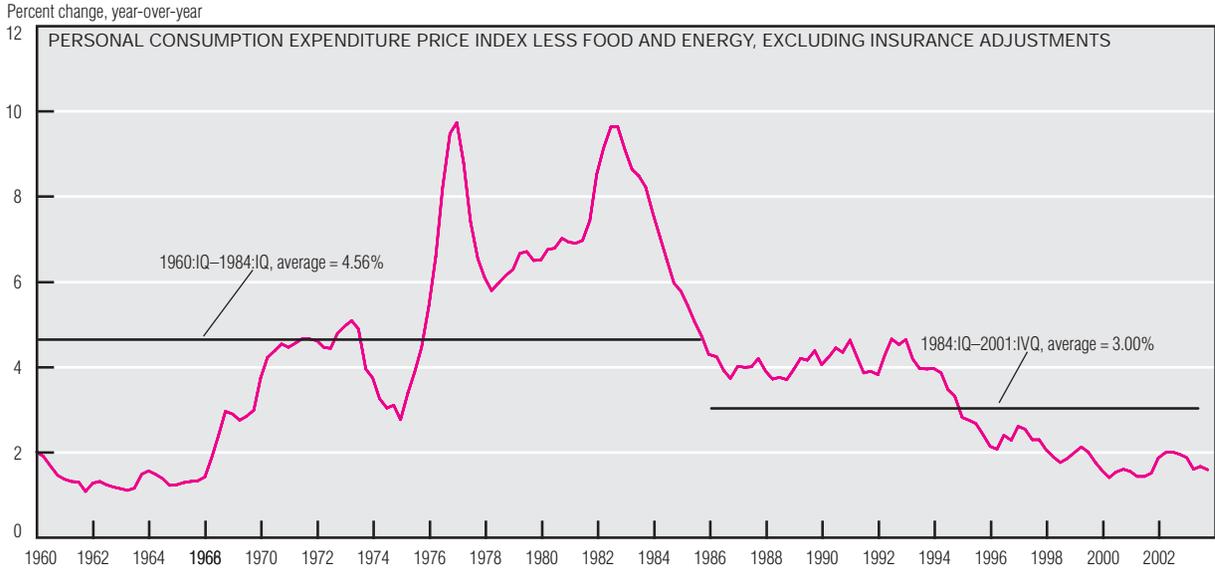
By historical standards, the most recent contraction has been small. The dampening of productivity and output has been consistent with a more generalized reduction in the volatility of economic activity since the mid-1980s. This pattern has been attributed to at least three factors: the improvement of inventory management related to developments in information technology; better monetary policy; and the absence of especially large, negative supply

effects (such as the OPEC-related shocks of 1973–79).

Technological improvements have allowed firms to increase the efficiency of their supply-chain management. This has made production less sensitive to demand shocks, thus curbing business cycle fluctuations. The durable goods sector provides some support for this view: Breaking down the GDP variance into its components shows that roughly two-thirds of the drop in GDP volatility

(continued on next page)

# Money and Financial Markets (cont.)



NOTE: The personal consumption expenditure price index is chain-weighted.  
 SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; and U.S. Department of Labor, Bureau of Labor Statistics.

since 1984 can be explained by a reduction in the volatility of durable goods production. Durable goods industries have been investing most heavily in information technology capital than nondurable goods industries have been and have also had larger reductions in inventory-to-sales ratios.

However, some analysts attribute the lower variability of GDP to monetary policy that pays more single-minded attention to price stability,

which has reduced inflation's volatility as well as its level over the past 20 years. Advocates of this view associate the 1970s' huge swings in output and inflation with "stop-and-go" monetary policies that focused excessively on output stabilization, which only increased inflation. They argue that a subtle policy change that occurred in 1979 put less emphasis on stabilizing output around its uncertain potential, concentrating on the inflation outlook instead.

Comparison of unemployment and inflation across business cycles provides scant evidence of a trade-off, contrary to the conventional view. Rather low inflation is associated with low unemployment. A similar comparison between output growth and inflation shows that low inflation is associated on average with higher output growth, making it the sine qua non of a healthy, growing economy.