Normalization, of a sort…The current expansion, which began in November 2001, followed a mild eight-month contraction (since 1945, the average length of contractions has been 10 months). In one sense, all contractions are alike because the National Bureau of Economic Research (NBER) determines the dates of business cycle peaks and troughs by applying a standard set of measurement criteria. In a nutshell, the NBER defines a contraction as a period of significant decline in economic activity, lasting more than a few months, and in which the decline is spread across the economy and evident in spending, income, sales, production, and employment. An expansion begins when these patterns no longer are evident, although the NBER notes that when an upturn begins, economic activity is “…typically below normal and sometimes remains so well into the expansion.”

Many aspects of economic activity have returned to normal, or nearly normal, conditions. Orders and shipments for manufactured goods have been steadily rising during the past year as business firms, flush with cash, have finally begun to step up the pace of their capital spending. Households have continued buying homes and automobiles in large quantities, but the pace of overall retail sales has been somewhat more subdued. Capacity utilization has been climbing, and the overall rate is now on track with the average of past expansions. Most economic forecasters expect the economy to extend its three-year-long expansion into 2005 and beyond. The economy seems to be on a sustainable expansion track, inflation and inflation expectations are low, and the Federal Reserve has been patiently removing its policy accommodation during the past several months.

Labor markets have performed in a conspicuously atypical manner. Typically, employment continues to fall in the early stages of an expansion, but stops falling in about a year; after two years, employment returns to its prerecession peak. In this expansion, payroll employment did not stop falling for nearly two and one-half years; it has yet to return to its previous peak. The weak pattern seems fairly broad based, suggesting that whatever forces are holding back the pace of net job creation are affecting most industries and regions.

A number of explanations have been advanced for the unusually slow rate of job growth, but analysts have yet to reach a consensus. Some focus on subpar total demand in the economy, while others consider possible mismatches between the labor skills that are in demand by employers and the labor skills being offered in the market. In this view, some employers are constrained from hiring by shortages in the skills they seek, while others can choose workers from an abundant pool. Another analysis holds that job creation, calculated from data collected through the household survey, is stronger than the payroll data indicate. The available evidence does not yet provide a firm explanation for all the facts, and it may well be that no convincing explanation will emerge at all, or at least not without the passage of more time.

In the interim, although some observers question the very sustainability of the expansion in the face of slow employment growth, most others seem to have accepted the notion that the expansion will continue despite the labor market picture. After all, the unemployment rate has gradually declined during the expansion to 5.4%, half a percentage point below its 40-year average. From this perspective, labor markets may be somewhat closer to being in balance than they would be if employment growth were the sole criterion for normalcy.

It is no secret that advances in information processing and telecommunications technologies have profoundly affected how, where, and what businesses produce. These changes have created incentives to replace old capital with new, an activity that proceeded at a feverish pace during the last expansion. At the same time, demand has risen for skills that complement the new technologies and declined for the skills that are most wedded to the old.

When asked why hiring is atypically slow, some business executives say they are being cautious, but others say they can meet growing demand without adding more workers. To achieve this result businesses may acquire more productive equipment, restructure their processes, or do both. Whatever they do, they are finding ways to increase their productivity and, as we know, productivity in this expansion has been growing abnormally fast.

Perhaps all of this just goes to show that labeling business cycles and their components “normal” or “typical” loses its value rather quickly. As Sigmund Freud once said, “Every normal person, in fact, is only normal on the average.” His observation may apply as much to economies as to people.