Boom and Busts in the U.S. Economy

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Our current economic cycle is in its ninth year, and that has many investors worried about a coming slowdown. Although it may seem like there is risk and volatility in today's economic cycles, a little historical perspective could make us much more comfortable with the current state of economic affairs, especially when compared to the previous 200 hundred years of economic expansion and decline.

During the period of 1870 to 1910, the U.S. economy was in a state of recession 50 percent of the time, and the average length of economic expansions was short, at 25 months. The depths of the resulting recessions were also deep, at an average decline in GDP of 3.7 percent. Boom and bust cycles were common. With no government financial backstop or monetary authority or plan, there was the need for private lenders such as J.P. Morgan himself to step in and loan the government funds to head off full-scale panics.

With the adoption of the Federal Reserve in 1913 and its control of monetary policy, our economy became more stable and less prone to shocks. However, from the period of 1910-1980, the economy was still in a state of recession 26 percent of the time, with short average economic growth periods of just 44 months, and average recession GDP declines of 4.3 percent.

Only in the more recent era of economic policy in the U.S., from 1980 to 2018, have we seen recession periods that are much shorter than in the past, at only 8 percent of the time, with longer economic expansions averaging 101 months and lower GDP declines during recessions of 2.1 percent.

With the creation of the Federal Reserve, this powerful government body became the "lender of last resort" in economic crises, and its influence helped to curtail risks of large-scale financial panics before they began. A major factor for the smoothing of the economic growth cycles over time has been the Fed's responsibility for a "dual mandate" of price stability with full employment. The transparent economic policies of the Federal Reserve, and the focus on a stable inflation rate over the past 40 years, has allowed economic expansions to last longer, and the succeeding recession periods to be more shallow.

In addition to the influence of the Federal Reserve, a shift in what our economy produces has also smoothed economic cycles for the better. During the 1800s, our economy was much more focused on the production and sale of hard goods, with boom and busts in the railroad, agriculture and industrial segments very common. Over time, our economy has rapidly moved away from a goods economy to a services economy. Services are by nature less volatile, and do not depend on raw materials pricing and availability, transportation of products or inventory management. This shift from goods to services has moderated our economic volatility greatly.

While we may fear the ups and downs in our economy with the resulting harmful effects on GDP growth and unemployment, our economy and its growth and decline cycles are far better and more stable than any time in the last 200 years.