



What Is A Recession?

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Recession. Are we in it? Are we heading for it? What is the answer?

Since most people don't know the definition of a recession, and many people who claim to get it wrong, a precise definition will provide a little relief from all the confusion. You can sleep better knowing that the data shows, among other things, it is far from clear that we are now in a recession.

Here it is in its full, unabridged form.

What Is a Recession?

I am amazed at the amount of people who are predicting that this country is headed for a recession. I'm amazed, because these people obviously have not heard about all the people who say we are already in a recession. This leads me to believe that many people do not actually know what a recession is. Not only the general population, but newscasters and politicians seem to be unaware of the basic definition of a recession.

In macro economic terms, a recession is a period of slowing economic growth measured by a decline in Gross Domestic Product (GDP) for two or more consecutive quarters. GDP measures all goods produced in this country. This includes not only goods and services made and provided by Americans, but goods and services produced by foreign firms within the borders of the United States. Contrast this with Gross National Product (GNP), another widely used economic indicator. GNP does not include goods and services produced by foreign companies, but does include goods and services produced by U.S. firms operating in foreign countries.

The GDP report is released at 8:30 a.m. Eastern Standard Time on the last day of the month after the end of each quarter, and reflects the economic growth or decline in the previous quarter. However, this report is not the final number. The GDP number is released three times. The first report is called the Advance Report. About a month after the Advance Report, the Preliminary Report is released. And finally, about a month after that, the aptly named Final Report is released. Historically, GDP growth has averaged about 2 1/2 to 3% per year.



To cause more confusion, the GDP numbers are reported in current dollar and constant dollar format. As its name implies, the current dollar format is calculated using today's dollar. Because of the effect of inflation, this method makes historical comparison difficult. The second method, called constant dollar, solves this problem by adjusting current information to factor out inflation by pegging the current dollar to the dollar in some year of the past, such as 1970, to allow easy comparisons between periods.

So let's see where we are. In the first quarter of 2007, the GDP was +0.6%. The second and third quarters were +3.8% and +4.9% respectively. The fourth quarter Advance Report and annual numbers for 2007 will be announced on January 30, 2008, the Preliminary Report on February 28, 2008 and the Final Report will be made on March 28. So with the current data, how could anyone predict a recession? Even if the Advance Report numbers are negative, they still will be revised two more times. With only one quarter of GDP results – yet to be announced - those that say we are already in a recession are just flat wrong.

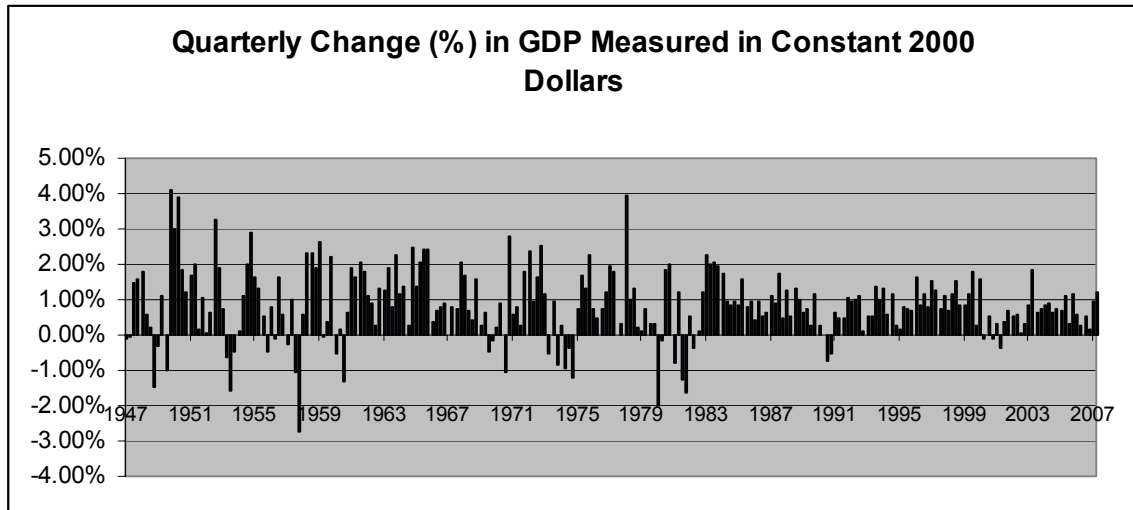
The last negative quarter of GDP was the third quarter of 2001 at an inflation adjusted rate of -1.4%. The last time that we had two consecutive negative quarters of GDP (i.e., the last recession) was in the fourth quarter of 1990 at -3% and the first quarter of 1991 at -2%.

Whether we get to the point of a recession or not, misunderstanding what a recession is causes fear in people, and sometimes hysteria. That can cause the stock market to either soar or fall. Premature reaction to each of the three GDP reports can cause a lot of market movement. As you can see by the market volatility in January and reaction to the impending Advance Report, coupled with existing news, it can cause severe stock market fluctuation. In fact, changes in all three reports cause additional ripples in the markets.

The macro economic definition of recession above is the definition the US government uses in its reports. However, a simple search of the Internet shows that many people have their own definition of recession. Proper understanding of this key definition should help you to make more sound financial decisions.

The graph below shows the quarterly changes in GDP over the last 60 years, measured in constant 2000 dollars. This data was obtained from the [Bureau of Economic Analysis](#).

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