Early 1980s recession in the United States

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This article focuses on the early 1980s recession in the United States, for worldwide impact see early 1980s recession.

The United States entered recession in January 1980 and exited six months later, in July 1980.[1] Although recovery took hold, the unemployment rate remained unchanged through the start of a second recession in July 1981.[2] The downturn ended sixteen months later, in November 1982.[1] Following the recession, the economy recovered strongly and experienced a lengthy expansion through 1990.[3]

Principal causes of the 1980 recession were contractionary monetary policy undertaken by the Federal Reserve to combat double digit inflation and residual effects of the energy crisis.[4] The manufacturing and construction sectors failed to recover before more aggressive inflation reducing policy was adopted by the Federal Reserve in 1981, causing a second downturn.[2][4] Due to their proximity and compounded effects, they are commonly referred to as the early 1980s recession, an example of a W-shaped or "double dip" recession.[5]

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Background

Beginning in 1978, inflation began to intensify, reaching double digit levels in 1979. The consumer price index rose considerably between 1978 and 1980. These increases were largely attributed to the oil price shocks of 1979 and 1980, although the core consumer price index which excludes energy and food also posted large increases.[6] Productivity, real gross national product, and personal income remained essentially unchanged during this period, while inflation continued to rise, a phenomenon known as stagflation.[4]

In order to combat rising inflation, recently appointed chairman of the Federal Reserve, Paul Volcker, elected to increase the federal funds rate. Following the October 6, 1979 meeting of the Federal Open Market Committee, the federal funds rate increased gradually from 11.5% to an eventual peak of 17.6% in April 1980.[6] This caused an economic recession beginning in January 1980, and in March 1980, president Jimmy Carter created his own plan for credit controls and budget cuts to beat inflation.[7] In order to cooperate with these new priorities, the federal funds rate was lowered considerably from its April peak.[6]

1980

A recession occurred beginning in January 1980.[1] As a result of the increasing federal funds rate, credit became more difficult to obtain for car and home loans. This caused severe contractions in manufacturing and housing, which were dependent on the availability of consumer credit.[7] Most of the jobs lost during the recession centered around goods producing industries, while the service sector remained largely intact. Over the course of the recession, manufacturing shed 1.1 million jobs, with the recession posting a total loss of 1.3 million jobs, representing 1.2% of payrolls.[3] The automotive industry, already in a poor position due to weak sales in 1979, shed 310,000 jobs, representing 33% of that sector. Construction declined by a similar 300,000. Unemployment rose to a recession peak of 7.8% in June 1980, however it changed very little through the end of the year, averaging 7.5% through the first quarter of 1981.[8]

Official end of the recession was established as July 1980.[1] As interest rates dropped beginning in May, payrolls turned positive. Unemployment among auto workers rose from a low of 4.8% in 1979 to a record high of 24.7%, then fell to 17.4% by the end of the year. Construction unemployment rose to 16.3%, and also moderated near the end of the year.[8] During the final quarter of 1980, there were doubts that the economy was in recovery, and instead was experiencing a temporary respite.[8] These concerns were fueled by poor performance in housing and auto sales in the final months of 1980, as well as a second wave of rising interest rates and stagnate unemployment rate.[8]

1981–1982

As 1981 began, the Federal Reserve reported that there would be little or no economic growth in 1981, as interest rates were to continue rising in an attempt to reduce inflation.[9][10] After failing to gain traction during the weak and brief recovery from the 1980 downturn, weakness in manufacturing and housing caused by rising interest rates began to have an expanded effect on related sectors beginning in mid-1981.[2] Job losses resumed, this time expanding to nearly all employment sectors through the end of 1982.[11]

Reagan gives a televised address from the Oval Office, outlining his plan for tax reductions in July 1981.

Unemployment had changed very little in the period between the end of the 1980 recession and the July 1981 start of the second, never dropping below 7.2%.[2] Unemployment rose to double digits for the first time since 1941 in September 1982, and stood at a postwar high of 10.8% by the end of the year.[11] The total increase in unemployment was 3.6%, which was less than the 1973–75 recession increase of 3.8%, yet still higher than the 2.9% average. Because the recession began with already elevated levels of unemployment, the increase easily pushed it higher than any other post-war recession.[11] Overall, the recession caused the loss of 2.9 million jobs, representing a 3.0% drop in payroll employment, the largest percentage decline since the 1957–1958 recession.[3]

Ronald Reagan, who had assumed office in January 1981, brought his own economic plan to the table. In August 1981, the president signed the Economic Recovery Tax Act of 1981, a three year tax cut plan.[12] As the recession deepened in 1982, Reagan's approval rating also dropped. As a result, during the 1982 midterm elections, Republican gains made in the House of Representatives during the 1980 election were reversed.[13] However, control of the Senate was retained by the Republicans.

Recovery

In July 1983, the official end of the recession was announced as November 1982, with the employment trough occurring in December. At the time of the announcement, output and sales had already met or exceeded levels achieved before the recession began.[14] Through December 1983, nonfarm payrolls rose by 2.9 million and the unemployment rate fell by 2.5%.[15] The auto industry had posted losses of $187 million in the third quarter of 1982, which turned into a gain of $1.2 billion during the same period in 1983.[16] To prevent a new surge of inflation, interest and mortgage rates remained abnormally high throughout 1983, delaying a recovery in construction and housing.[16]

A comparative analysis of the first six quarters of post-war economic recoveries published in the August 1984 issue of the *Monthly Labor Review* indicated the 1983–1984 recovery was stronger than any post-war recovery since that of the 1953 recession.[17] As the third year of recovery drew to a close in 1985, payroll employment had grown by 10 million since the end of the recession.[18] Growth continued through July 1990, creating what was at the time the longest peacetime economic expansion in U.S. history.[3]

Impact

Main article: Savings and loan crisis

Although the economy recovered in 1983, residual effects of the period of high inflation and high interest rates had a profound impact on the savings and loans industry. Savings and loan associations were limited by interest rate ceilings. As a result of rising interest rates, many savings and loan institutions experienced frequent account withdrawals, as depositors moved their money to higher earning accounts offered by commercial banks. The already struggling savings and loans industry posted large losses in both 1981 and 1982.[19] High mortgage rates eroded the value of the primary asset of savings and loan associations, mortgage backed loans. These fixed rate loans were sold at a loss in order to balance withdrawals. This asset liability mismatch was identified as the primary cause of the savings and loan crisis.[20]

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