

The Rocky Balboa Recovery

Scott Baker, Nick Bloom and Steven J. Davis (June 13 2012)

Every Sylvester Stallone fan knows that Rocky Balboa never gives up. However many times Rocky gets hit, he keeps on coming. Even after Apollo Creed floors him with a vicious hammer punch, Rocky jumps up for more punishment.

So too with the current US economic recovery: on track in the spring, knocked down in the summer. Payroll employment rose strongly in the spring of 2010, then fell back in the summer. Many thought the slump had ended in the spring of 2011, only to be disappointed in the summer. Then again this summer, after encouraging unemployment and growth figures in early 2012, the recovery was knocked back. Like Rocky, the US economy displays an impressive resilience. But also like Rocky, it continues to get whacked.

The obvious question is why the recurrent loss of momentum in the US economic recovery?

One factor we have been studying is the impact of policy uncertainty. Our data – posted at www.policyuncertainty.com and plotted in Figures 1 and 2 – show US and European policy uncertainty at historically high levels in recent years. For the US, we measure policy uncertainty by combining the intensity of newspaper coverage of policy-related economic uncertainty with the extent of disagreement among professional forecasters over future government spending and inflation, and the frequency and importance of scheduled tax code expirations. For Europe, we use the news-based approach exclusively.

Just in the past year, the US recovery has been rocked by a debt-ceiling debacle that threatened to curtail critical government functions, uncertainty surrounding healthcare reform, an impending fiscal cliff that policymakers built into tax and spending law, banking and sovereign debt crises in Europe, political chaos in Greece, and grave doubts about the viability of the Euro. Taken together, these policy developments confront businesses and households with high and complex forms of economic uncertainty.

This uncertainty leads firms to cut back or defer hiring and investment decisions. It also drives consumers to put off buying new goods. As a result, uncertainty stalls both the corporate and consumer sector drivers of a recovery. Indeed, the Federal Reserve Board's recent Beige Book - the summary of their anecdotal evidence from business contacts around the US found here [[link to this http://www.federalreserve.gov/monetarypolicy/beigebook/beigebook201206.htm](http://www.federalreserve.gov/monetarypolicy/beigebook/beigebook201206.htm)] – highlights policy uncertainty as a key issue that businesses claim is stalling the recovery.

Looking ahead, there is more policy uncertainty on the near horizon for the US economy: Presidential and congressional elections, the fiscal cliff, potential for another partisan fight over the federal debt ceiling, and prospects for large-scale battles over taxation. In Europe, there is the specter of an outright Greek default, fiscal collapse in several European countries, the intensification and spread of bank runs, and a possible dissolution of the Eurozone.

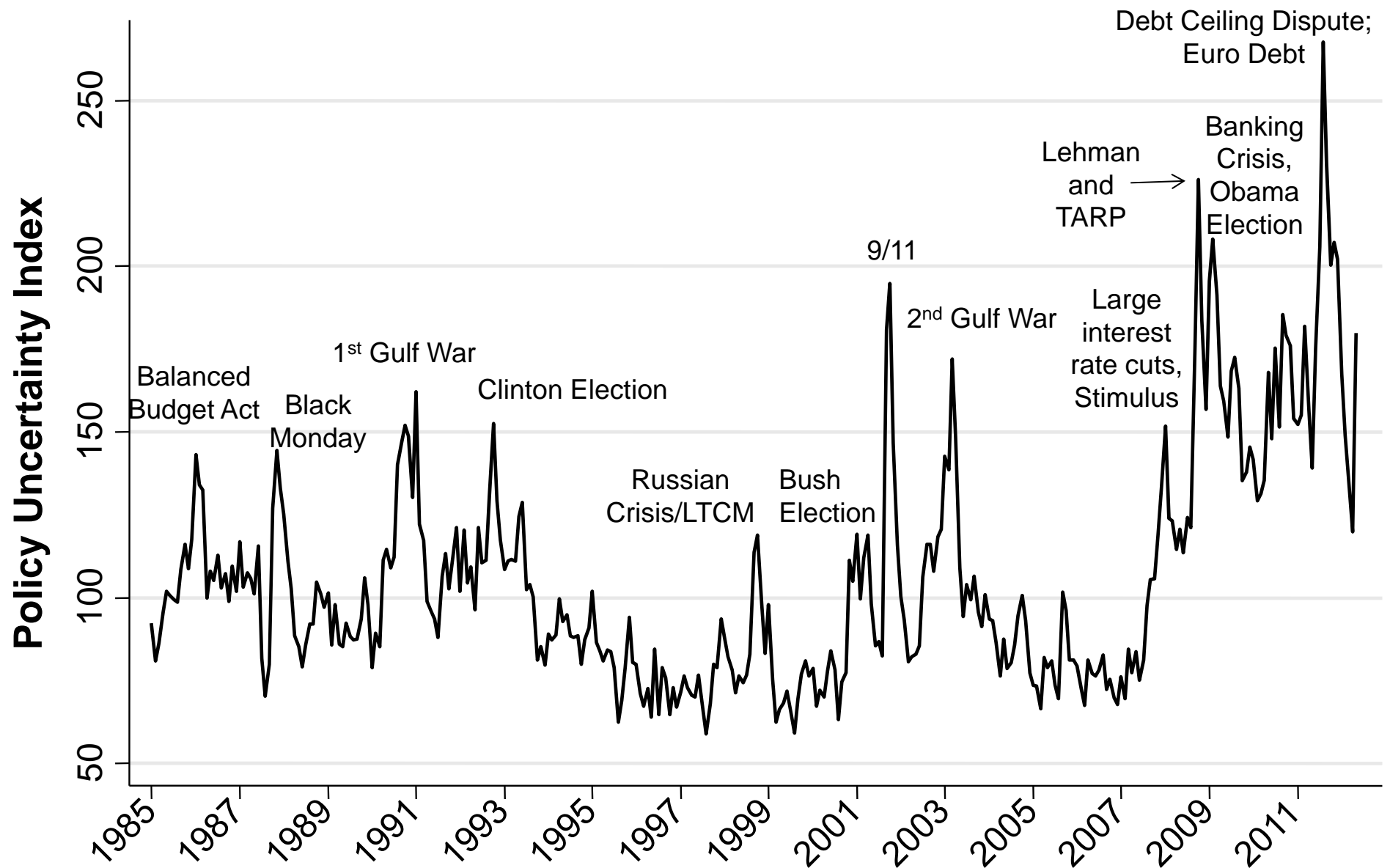
We fear the US recovery, like Rocky, will be down on canvas again, pummeled by another round of policy uncertainty. If that happens, will the US economy spring back again, Rocky like? Perhaps, but even the most resilient fighters suffer long term damage from repeated heavy blows.

Scott Baker is a Graduate Student in the Economics Department at Stanford University

Nick Bloom is a Professor of Economics at Stanford, and an Associate of the National Bureau of Economic Research and The Center for Economic Policy Research.

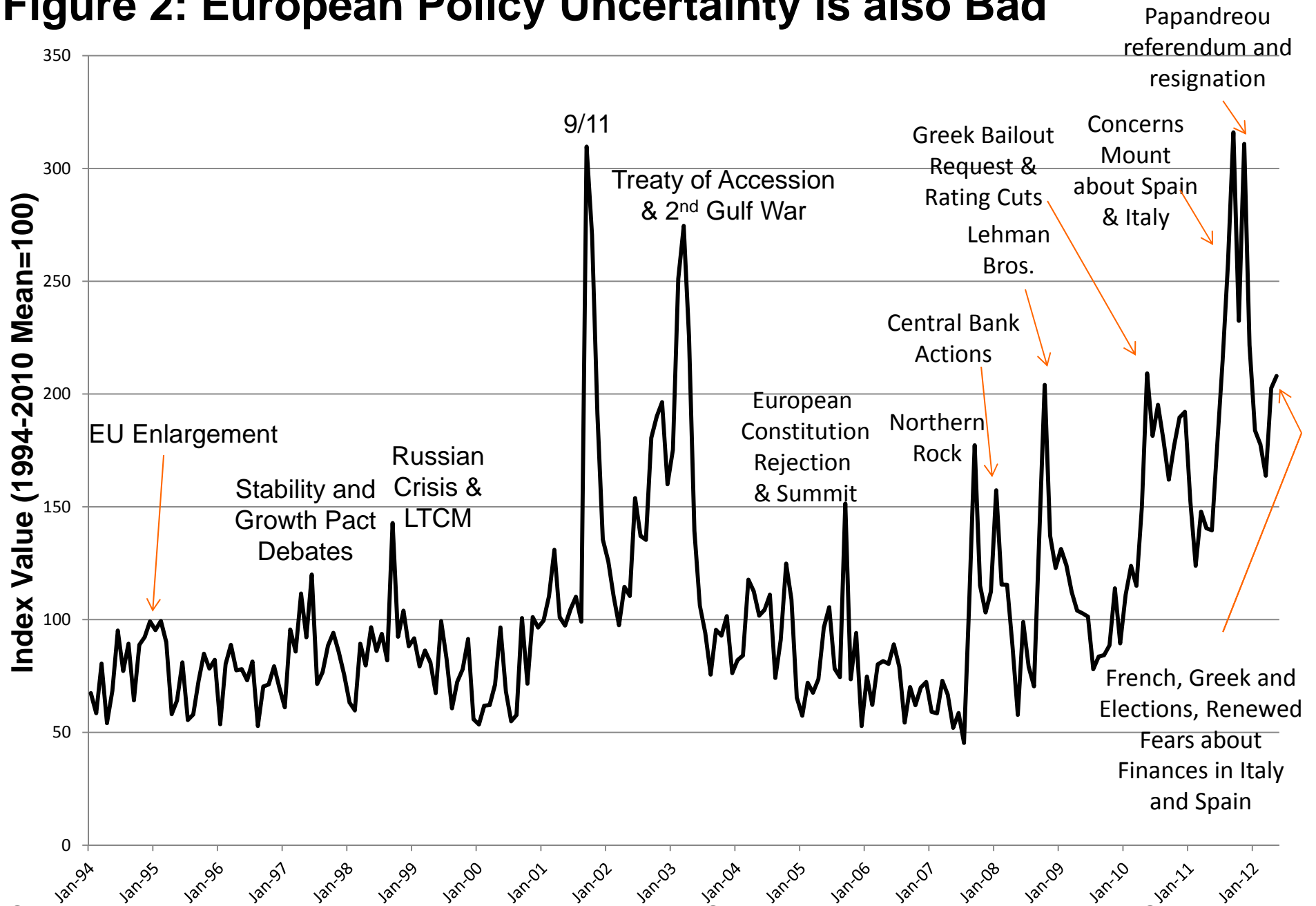
Steve Davis is the Deputy Dean for the Faculty, University of Chicago Booth School of Business, Visiting Scholar, American Enterprise Institute and an Associate of the National Bureau of Economic Research

Figure 1: US Economic Policy Uncertainty is an Issue



Source: "Measuring Economic Policy Uncertainty" by Scott Baker, Nicholas Bloom and Steven J. Davis, November 2011, all data at www.policyuncertainty.com

Figure 2: European Policy Uncertainty is also Bad



Source: "Measuring Economic Policy Uncertainty" by Scott Baker, Nicholas Bloom and Steven J. Davis, November 2011, all data at www.policyuncertainty.com