US Macroeconomics

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A Fool's Errand

Recessions are nonlinear events, meaning that there are sudden breaks in the data which lead to parabolic moves. Take the unemployment rate. As we can see in the chart below, when the unemployment rate turns upward, it does so suddenly and quickly. In the past, upward inflection points began after the rate moved up 50 basis points from its cyclical low. That is where we are today. The unemployment rate is currently 3.9%, up from a 3.4% trough in January and April 2023.

Since the rise in the unemployment rate hints that a peak in economic activity may be near, market participants have begun discussing what the next recession might look like. Will it be short and shallow like 2001 or will it be long and deep like 1981-1982 or 2008-2009? The answer is: It depends. The reason is because **we do not know a priori what the policy response will be when the next downturn inevitably comes**. The current environment is also fraught with many risks, arguably more so than in the recent past.

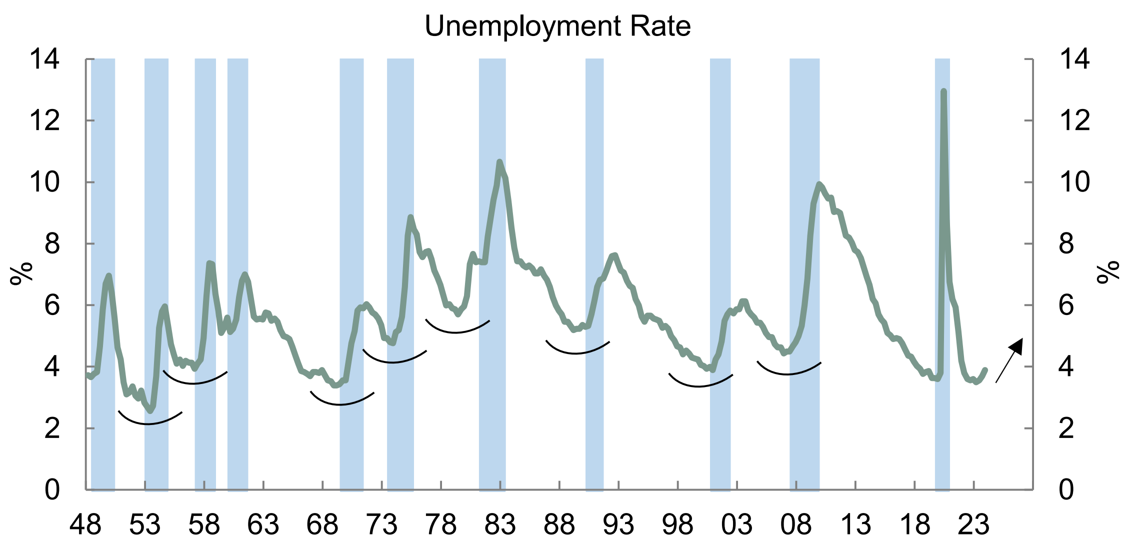
Will the Fed cut interest rates aggressively? Will the government cut taxes and increase spending? In the early stages of the 2008 downturn, we had both. The Fed was dramatically cutting rates, and the Bush Administration passed the Economic Stimulus Act. Yet, the recession that ensued was the deepest since the Depression.

Remember the economy was doing relatively well during the first half of 2008. Only after Lehman Brothers failed and Congress failed to pass the first Troubled Assets Relief Plan did employers shed labor and financial markets began hemorrhaging. One of the mildest recessions on record turned into one of the deepest.

Admittedly, the current economic backdrop is much different today than in the late 2000s. But maybe monetary and fiscal authorities will not pursue counter-cyclical policies as quickly as they did then. Why? Maybe the persistence of elevated inflation (not our view) keeps monetary policy too restrictive. Maybe historically massive budget deficits prevent Congress from cutting taxes or providing income support as it did during the onset of the pandemic.

Furthermore, how does next year's Election enter into the policy calculus? And if a 2024 recession drags into 2025, will the possibility of divided government mean little chance of fiscal support? We do not know. Surely, future policy errors would compound any recession even if it started off as being mild.

Given the historical difficulty in predicting the onset of economic downturns, it is the proverbial fool's errand to know what it is going to look like whenever it comes.



Sources: BLS, Haver, SMBC Nikko

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