

ECONOMIC VIEWPOINT

Few Indicators Point to a U.S. Recession

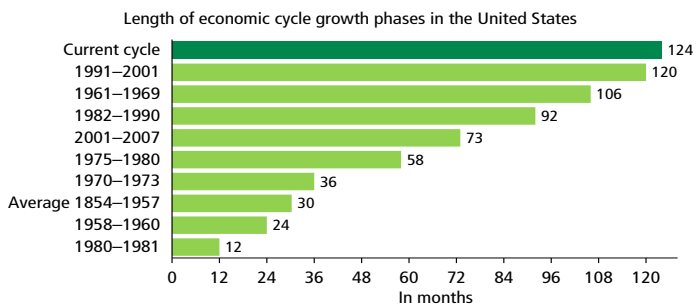
After analyzing recession indicators in the major overseas economies in a recent *Economic Viewpoint*, we now note that concerns about a potential end of cycle in the United States have also increased, especially since the upheaval in the stock market in fall 2018. These fears seem to have peaked last summer when a number of indicators were pointing downwards, stock markets were worried about the Chinese–U.S. trade war and the slope of the yield curve became strongly inverted. Based on a range of indicators on the U.S. economy (the same ones we used in 2008–2009), some signs point to a pending recession in the United States, but they are still scarce. However, the economy remains fragile and the situation will continue to evolve. We will have to keep monitoring these signs to see if they start multiplying.

According to the National Bureau of Economic Research (NBER), the organization that officially dates the start and end of cycles in the United States, the current economic cycle in that country began in July 2009. The United States is therefore 10 years and 4 months into the current growth cycle. The current cycle, which recently surpassed that of the 1990s, has become the longest one in a history dating back to 1854 (graph 1).

jobless rate in fact fell to a low of 3.5% last September, a level not seen since 1969. Our *Economic Viewpoint* published last October also pointed out the signals being flashed in the U.S. job market.

The question is, can a cycle go on for too long? The current cycle is twice as long as the average length of 58.4 months recorded since 1945. This longevity is causing us to ask questions and to worry about each signal that could point to the end of the cycle. The dip in the stock market in fall 2018 was one of these disruptive factors, much like the inversion of the yield curve in mid-2019. In fact, the number of Google searches on “recession” leapt up in August 2019 (graph 2).

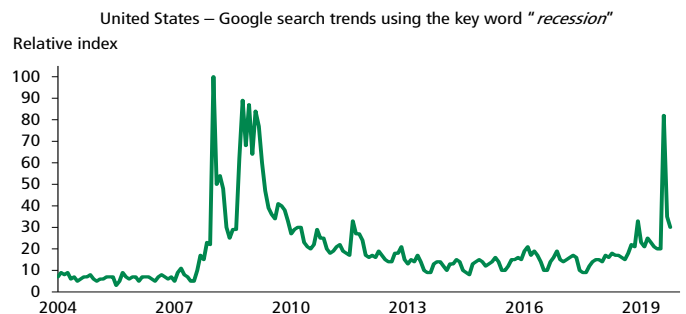
GRAPH 1
The current economic cycle in the United States is the longest ever recorded



Sources: National Bureau of Economic Research and Desjardins, Economic Studies

This longevity has clearly had some significant positive impacts. It has enabled the United States to record total real GDP growth of 26.4% since summer 2009. The labour market has also made huge strides, with zero monthly declines in employment since 2010, helping to create a total of 21,572,000 new jobs. The

GRAPH 2
The recession was back in the headlines last summer, but the curiosity seems to have faded



Sources: Google and Desjardins, Economic Studies

François Dupuis, Vice-President and Chief Economist • Mathieu D’Anjou, Deputy Chief Economist • Francis Généreux, Senior Economist

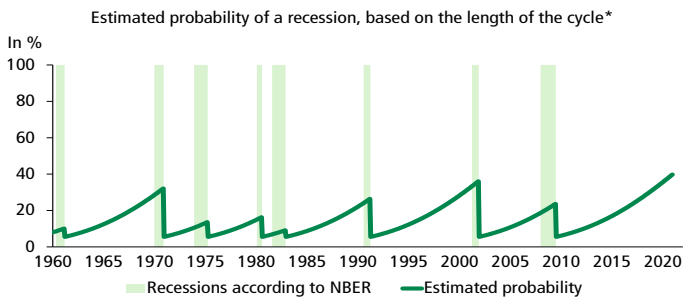
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A simple recession probability model that uses only the length of the growth cycle as the explanatory variable shows that the passing of time has an influence (graph 3). But time is never enough of a factor to cause an economy to contract. Janet Yellen, former Chair of the Federal Reserve (Fed), seemed to be of that opinion in 2015: [“I think it’s a myth that expansions die of old age. I do not think that they die of old age. So the fact that this has been quite a long expansion doesn’t lead me to believe that it’s one that has—its days are numbered.”](#)

GRAPH 3
The passing of time increases the risk of recession



NBER: National Bureau of Economic Research; * Estimated using a Probit model with a constant and a variable representing the cumulative number of months the economy has been expanding.
Sources: NBER and Desjardins, Economic Studies

So if economic cycles don’t die of old age, then we have to find other factors in the economic situation that could help us see if a recession is really on the horizon.

The Recent Economic Snapshot Is a Mixed Bag

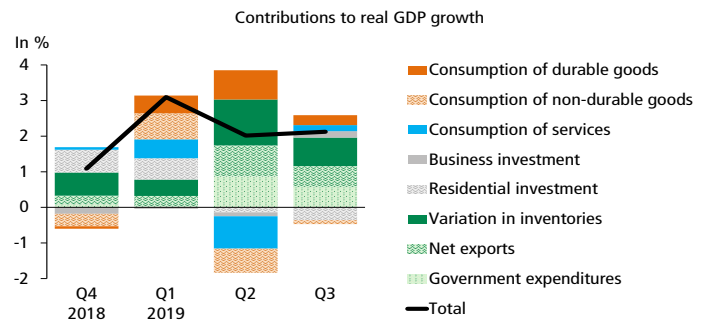
The U.S. economy continues to grow at a rate close to its potential (2.1% according to the Congressional Budget Office). In fact, the annual change in real GDP reached 2.1% in the third quarter as was its quarterly annualized variation (following an increase of 2.0% in the second quarter). So how do we explain this continuation of relatively strong growth and such a long cycle?

A number of factors have supported growth in recent years. First, interest rates at very low levels over a very long period of time have been a factor. The Fed’s monetary policy is one important factor among a number of others, such as global trends in interest rates, weak inflation, an aging population and slower productivity. Second, U.S. consumer (and small business) confidence has been high, especially since the 2016 presidential election. Third, the tax cuts introduced in late 2017 helped temporarily prop up the economy in 2018. Finally, federal government spending ramped up significantly from 2018 onwards.

However, other factors have hurt the health of the U.S. economy, and a number of these issues are central to the concerns about a possible recession. There were interest rate hikes, mostly in 2017 and 2018, when the Fed accelerated the normalization of its monetary policy. Investments in the oil sector also plateaued after a very strong run that fuelled the rapid development of shale oil and gas on U.S. soil. But the most important factor has been the Trump administration’s protectionist measures and the ensuing trade war that erupted between China and the United States, which has been particularly detrimental to business investment and the manufacturing industry. The uncertainty caused by trade tensions has also had an impact on financial market volatility, business confidence and overall economic growth. Beyond trade, the White House’s rather chaotic management of federal public policies (the 2018–2019 shutdown, immigration, health, the environment, pressure on the Fed, etc.) also fuels uncertainty.

In a situation where many factors are pushing and pulling the economy in opposite directions, where is the U.S. economy in all of this? At this point, and as we mentioned earlier, it is managing to grow at close to its potential. Consumption is still resilient and household confidence remains relatively high. Business investment has weakened significantly, however; some negative contributions to real GDP growth were even recorded in the second and third quarter of 2019 (graph 4).

GRAPH 4
Consumption the major driver of U.S. real GDP growth



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

A Recession on the Horizon? Not according to Our Table!

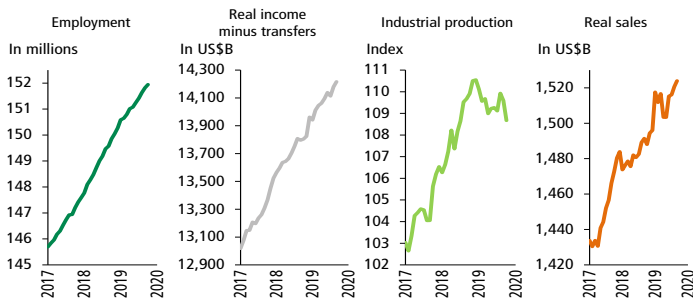
The economic situation is holding on, but there are still some signs of fragility. To pinpoint these signs, we are using a table (on page 5) showing the movements in the indicators over the past few months to provide information about the health of the economy and the risks of a possible setback. This is essentially the same table as the one we used during the Great Recession of 2008–2009. It allowed us to conclude in [February 2008](#) that the risks of a decline in U.S. economic activity, and thus real GDP, in the first two quarters of 2008 were very high. At that time, more than ten indicators pointed to a recession.

The 18 indicators in this new table are divided into 6 categories: the variables used by NBER to set official recession dates, leading indicators, activity indexes (ISM indexes, confidence), labour market indicators, other indicators (housing starts and business inventories) and, lastly, financial markets. An amplitude criterion for each indicator is used to make sure it provides a conclusive sign of recession. For example, a decline of a few points in the household confidence index is not much to worry about, but a drop of more than 20 points sends a much more serious message.

The number of indicators pointing to a recession started to rise last winter. The number of signals remained relatively modest, peaking at five in April. By the end of the summer, the number was down to two. In October, four out of 14 indicators now available pointed to a recession.

Of the four indicators used by NBER to date business cycles, we can see that only **industrial production** is declining (graph 5). This sector peaked in December 2018 and had a tough start to 2019. Industrial production has been impacted by the problems facing the entire manufacturing sector, which has been impeded by the slowdown in world trade. Automobiles, equipment, materials and chemicals are among the most affected sectors. The strike at General Motors (GM), which began in mid-September and ended in early November, likely amplified the recent decline in production.

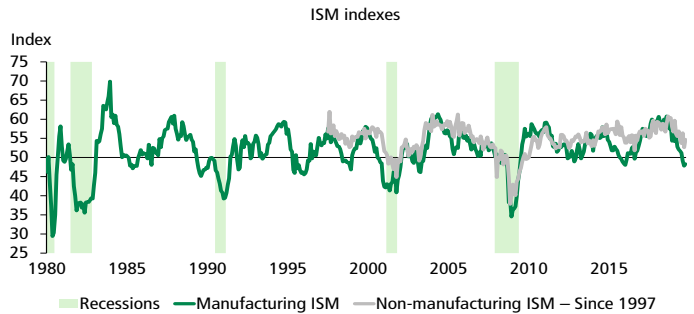
GRAPH 5
Most of the variables used by NBER continue to improve



NBER: National Bureau of Economic Research
Sources: Bureau of Labor Statistics, Bureau of Economic Analysis, Federal Reserve Board, U.S. Census Bureau and Desjardins, Economic Studies

Among the activity indexes, we note that the **manufacturing ISM** is also signalling a recession. It is suffering from the same effects that have led to a decline in industrial production, with the trade war front and centre. However, the negative signal being sent is not terribly strong. It would be more worrisome if the non-manufacturing ISM also fell below 50 (graph 6).

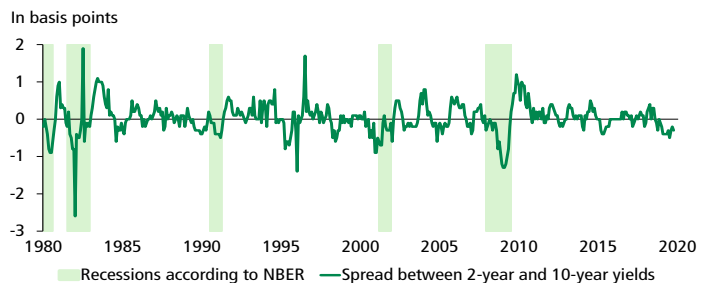
GRAPH 6
The ISM non-manufacturing index would also have to fall below 50 to signal an economic contraction



Sources: Institute for Supply Management and Desjardins, Economic Studies

The third negative indicator is the **worked hours** in the manufacturing sector. Again, this signal is directly related to the manufacturing problems that began in 2018. We should add that this indicator, which is quite volatile, sends many false signals (graph 7). We should also keep in mind that the manufacturing industry in the United States accounts for only 8.5% of jobs and 11.0% of GDP.

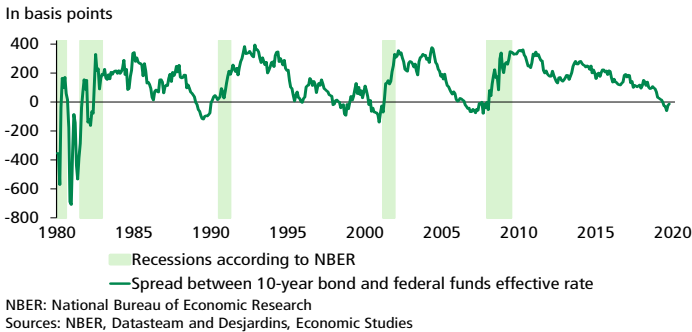
GRAPH 7
The change in hours is negative, but there are numerous false signals



NBER: National Bureau of Economic Research
Sources: NBER, Bureau of Labor Statistics and Desjardins, Economic Studies

The last negative indicator is perhaps the most talked about of 2019: the inversion of the **yield curve**, represented here by the spread between the U.S. 10-year federal government rate and the effective federal funds rate. The slope slipping to below zero last summer alone was often viewed as a glaring signal of an impending recession. False signals are in fact rather rare, and the slope accurately signalled the latest setbacks in the economy (graph 8 on page 4). However, the management of U.S. monetary policy since the Great Recession, especially the Fed's inflated balance sheet, has meant that the signal given by the slope is now less clear. The Bank of Canada has previously stated that "[such inversions could become more frequent and](#)

GRAPH 8
Recent U.S. recessions preceded by an inversion of the yield curve

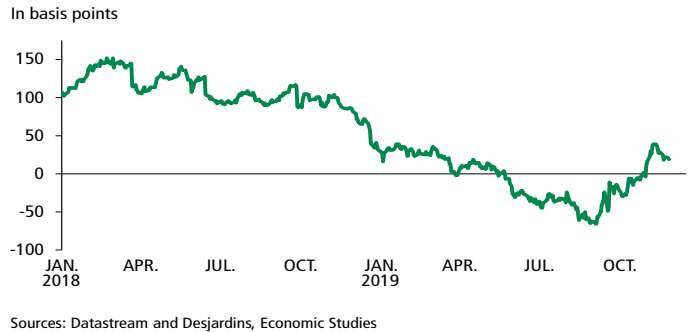


[much less indicative of a recession than in the past.](#) In addition, the recent rise in bond yields has pushed the slope back into positive territory in recent weeks (graph 9).

Signs of a Recession Still Scarce

All in all, there are few indicators suggesting that the economy is suffering a sudden setback. The U.S. economy does not look poised to fall into an imminent recession. There are weaknesses, however, especially in the manufacturing sector, which is more strongly affected by the trade war and the slowdown in global demand. These weaknesses, especially if they end up undermining job creation and consumer sentiment, signal that a major shock could topple the economy.

GRAPH 9
The slope tilted back into positive territory very recently



The economic situation must therefore be watched closely. We will need to continue monitoring whether the number of indicators pointing to a recession rises in the near term. Only then will we be able to truly think that a recession is likely to occur. Should we cross that bridge, we will also have to expect the Fed and the federal government to react in a way that minimizes any potential impact on growth and jobs.

Francis Généreux, Senior Economist

TABLE
Summary of U.S. recessions indicators

IN VARIATION (EXCEPT IF INDICATED)	INDICATORS USED BY NBER				LEADING INDICATORS		ACTIVITY INDICATORS				LABOUR MARKET				OTHER INDICATORS		FINANCIAL MARKET		NUMBER OF POSITIVE CRITERIA
	Employment	Industr. prod.	Real sales	Real income	Conference Board	OECD	Manuf. ISM	Non-manuf. ISM	Consumer confidence	Chicago Fed index	Jobless rate	Initial jobless claims	Worked hours ²	Part time workers ³	Housing starts	Inventory/sales ratio	S&P 500	Yield ⁶	
	3-month < 0	3-month < 0	3-month < 0	3-month < 0	6-month ann. < -2	6-month ann. < -2	index < 48.5	index < 50	peak ¹ < -20	3mma < -0.7	6-month > 0	3-month/3mma > 25	6-month < 0	ann. > 8	peak ⁴ < -30	trough ⁵ > 0.1	ann. < -10	% < 0	
Periods for 2018																			
January	0.38	0.60	0.36	1.48	7.05	1.16	59.6	59.4	-4.6	-0.27	-0.20	-2.0	-0.1	-13.4	0.8	0.02	23.9	1.1	1/18
February	0.46	0.42	-0.33	1.07	7.62	1.20	60.7	59.1	-0.6	0.71	-0.30	-14.3	0.2	-8.7	-3.0	0.02	14.8	1.5	1/18
March	0.46	0.67	-0.72	0.84	7.60	1.12	59.3	58.7	-1.9	0.24	-0.20	-16.3	0.3	-8.9	-0.2	0.02	11.8	1.4	1/18
April	0.48	1.84	0.12	0.58	6.34	0.94	57.9	57.2	-2.3	0.38	-0.18	-16.3	0.4	-6.2	-5.1	-0.03	11.1	1.1	0/18
May	0.44	0.68	0.39	0.50	5.54	0.72	58.7	58.9	-1.5	-0.36	-0.37	-10.0	0.0	-6.0	-0.2	-0.03	12.2	1.4	0/18
June	0.49	0.86	0.14	0.50	5.31	0.46	60.0	58.7	-4.6	0.38	-0.06	-3.7	0.3	-10.1	-11.6	-0.03	12.2	1.0	0/18
July	0.48	0.40	0.47	0.80	5.47	0.17	58.4	56.7	-3.5	0.28	-0.27	-7.7	0.3	-13.1	-11.3	0.02	14.0	0.9	0/18
August	0.49	2.01	0.48	1.06	5.05	-0.16	60.8	58.8	-3.8	0.46	-0.30	-8.0	0.0	-16.6	-4.2	0.02	17.4	0.9	0/18
September	0.38	1.39	0.73	0.67	5.61	-0.50	59.5	60.8	0.0	0.08	-0.32	-9.3	-0.1	-10.1	-7.4	0.02	15.7	1.1	1/18
October	0.45	1.16	0.37	0.38	4.26	-0.86	57.5	60.0	-1.3	0.02	-0.16	-3.3	-0.3	-5.7	-9.3	0.04	5.3	1.0	1/18
November	0.39	0.90	0.35	0.12	4.45	-1.23	58.8	60.4	-2.7	0.26	-0.09	1.3	0.0	-1.7	-10.0	0.04	4.3	0.9	0/18
December	0.47	0.80	0.31	1.20	2.94	-1.58	54.3	58.0	-3.9	-0.05	-0.18	6.3	-0.1	-6.6	-14.5	0.04	-6.2	0.7	1/18
Periods for 2019																			
January	0.49	0.18	1.98	0.99	1.64	-1.88	56.6	56.7	-11.7	-0.04	0.15	6.0	-0.2	3.3	-3.3	0.04	-4.2	0.3	2/18
February	0.40	-0.85	1.16	1.36	1.08	-2.07	54.2	59.7	-6.7	-0.61	-0.01	0.0	-0.4	-15.7	-13.9	0.04	2.6	0.3	3/18
March	0.35	-0.79	1.38	0.60	0.36	-2.12	55.3	56.1	-1.9	-0.06	0.12	-4.0	-0.4	-9.5	-10.2	0.04	7.3	0.2	4/18
April	0.28	-1.03	-0.93	0.87	0.72	-2.05	52.8	55.5	-3.4	-0.84	-0.17	-12.7	-0.4	-6.0	-4.9	0.01	11.2	0.1	5/18
May	0.29	-0.31	-0.56	0.60	0.54	-1.90	52.1	56.9	3.3	-0.14	-0.08	-9.7	-0.4	-11.5	-5.3	0.01	1.7	0.0	4/18
June	0.30	-0.38	-0.09	0.66	0.90	-1.73	51.7	55.1	-4.5	0.10	-0.19	-8.0	-0.3	-8.2	-7.6	0.01	8.2	-0.3	4/18
July	0.27	0.12	0.76	0.36	1.62	-1.58	51.2	53.7	-3.2	-0.41	-0.29	7.7	-0.5	-13.2	-9.8	-0.01	5.8	-0.3	2/18
August	0.37	0.64	1.44	0.59	0.90	-1.46	49.1	56.4	-14.5	0.15	-0.13	11.0	-0.3	0.3	3.0	-0.01	0.9	-0.6	2/18
September	0.37	0.30	0.82	0.55	0.18	-1.31	47.8	52.6	-10.8	-0.45	-0.29	8.3	-0.2	-6.6	-7.9	-0.01	2.2	-0.2	3/18
October	0.35	-0.41	1.13	n/a	-0.18	n/a	48.3	54.7	-9.9	n/a	-0.02	1.3	-0.3	-4.1	-4.4	n/a	12.0	-0.1	4/14

NBER: National Bureau of Economic Research; OECD: Organisation for Economic Co-operation and Development; ISM: Institute for Supply Management; Fed: Federal Reserve; n/a: not available; 3mma: 3-month moving average; ¹ Variation from the last 12 month peak, University of Michigan Index; ² In the manufacturing sector; ³ On an involuntary basis;

⁴ Variation since the last 2 years peak; ⁵ Variation since the last 2 years trough; ⁶ Yield curve slope: 10-year rate minus federal funds effective rate. NOTE: A green box means the data indicates an early recession.

Sources: Datastream and Desjardins, Economic Studies