SMBC SMBC Group

US Macroeconomics

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Much Too Soon to Know What the Next Recession Will Look Like

There is a mistaken notion that if the US economy slips into recession this year or next, it will be mild. It is too soon to say at this point because: one, a downturn has not yet begun; and two, much will depend on what happens whenever the downturn begins. In other words, do fiscal authorities and monetary policymakers respond with aggressive stimulus to limit the depth and duration of the crisis? Or, is there political gridlock and a stubborn Fed?

Next year's Presidential Election makes it highly unlikely that the political parties will find a fiscal compromise to help the economy if it needs it. Moreover, while inflation continues to trend lower (and we expect it to), price appreciation will still be much faster than 2%. So, the Fed may hold the line on rate cuts at least longer than the growth fundamentals might warrant. In addition, market participants typically cannot even agree on when a recession has started.

The 2008-09 downturn started mild and ended severe. This is evident in the table below which shows the originally reported real GDP and employment figures through September 2008, the month Lehman Brothers filed for bankruptcy. The economy grew modestly in Q1 and Q2 2008 and was down only slightly in Q3. This led many economists to believe a recession had been avoided even though employment was declining, albeit modestly.

While nonfarm payrolls were negative in the seven out of nine months leading up to September 2008, their average initial decline was just 28k. So, with real GDP growth still positive, this was the epitome of a mild recession. But it turned out the economic data were much weaker than what had been initially reported, and policymakers allowed Lehman to fail. The failure of Congress to pass the first Troubled Asset Relief Program (TARP) was also a recession catalyst. But the points are the same: Misdiagnosing the onset of recession coupled with policy failures made a bad situation much worse.

Consequently, **it is much too soon to know what the next recession will look like**. Market participants will have a hard enough time agreeing that one has even begun. This suggests that a countercyclical monetary policy response could be slow in the offing, with the Fed keeping rates higher for longer (and possibly hiking again) because the inflation rate is still well above target.

Those Pesky Revisions!

Nonfarm Payrolls	Jan 2008	Feb 2008	Mar 2008	Apr 2008	May 2008	Jun 2008	Jul 2008	Aug 2008	Sep 2008
Initial Print (thous.)	-35	-46	-17	60	-29	-13	11	-33	-75
Current Reading (thous.)	1	-76	-68	-217	-191	-158	-197	-283	-451

Real GDP (QoQar%)	Q1 2008	Q2 2008	Q3 2008
Initial Print	0.6	1.9	-0.3
Current Read	-1.6	2.3	-2.1

Sources: Action Economics, BEA, BLS, Haver, SMBC Nikko

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