

Financial Market Weekly

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CHRISTOPHER S. RUPKEY, CFA
MANAGING DIRECTOR
CHIEF FINANCIAL ECONOMIST
ECONOMIC RESEARCH OFFICE (NEW YORK)
(212) 782-5702
crupkey@us.mufg.jp

MUFG Union Bank
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Economic expansion begins year nine tomorrow. Is recession right around the corner?

There's a natural economic or business cycle. A recession comes, bringing the economy down and creating huge job losses. There's a low point for orders and sales and job losses, the economy stops falling, levels off, rebuilds and lifts as companies seeing more sales increase production and rebuild inventories and finally add back the workers shed during the recession's hard times. But what happens after the replenishment demand is finished, people buy the cars they postponed during the recession, and everyone has been put back to work? The economy is showing signs of its age, finishing its eighth full year of forward movement, but does this mean a recession is right around the corner?

Yellen famously told Congress economic expansions don't die of old age. On the other hand, there are not many expansions that have lasted as long as this one has, the last month of the Great Recession as the Federal Reserve calls it, being June 2009. This expansion from the 2007-09 recession completes year eight today, and there are only two longer ones in modern economic times: the ten-year expansion during President

Yellen December 2015 press conference

REBECCA JARVIS. Thank you. Rebecca Jarvis, ABC News. Historically, most economic expansions fade after this long. How confident are you that our economy won't slip back into recession in the near term?

CHAIR YELLEN. So let me start by saying that I feel confident about the fundamentals driving the U.S. economy, the health of U.S. households, and domestic spending. There are pressures on some sectors of the economy, particularly manufacturing and the energy sector, reflecting global developments and developments in commodity markets and energy markets, but the underlying health of the U.S. economy I consider to be quite sound. 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. But the economy does get hit by shocks, and there are both positive shocks and negative shocks. And so there is a significant odd, you know, probability in any year that the economy will suffer some shock that we don't know about that will put it into recession. And so I'm not sure exactly how high that probability is in any year, but maybe at least on the order of 10 percent. So, yes, there is some probability that that could happen, and of course we'd appropriately respond, but it isn't something that is fated to happen because we've had a long expansion, and I don't see anything in the underlying strength of the economy that would lead me to be concerned about that outcome.

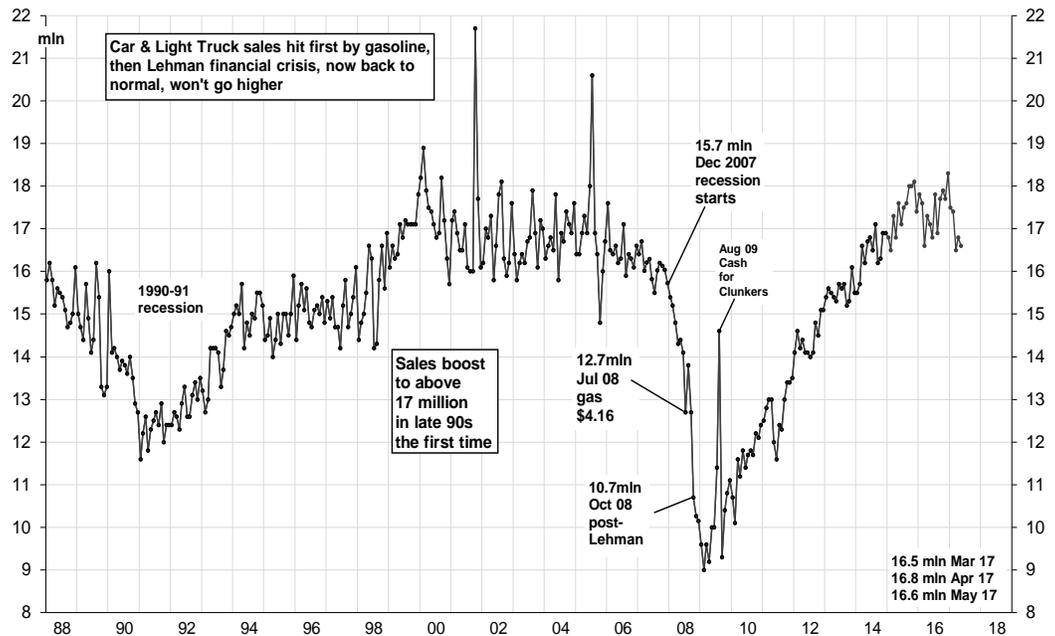
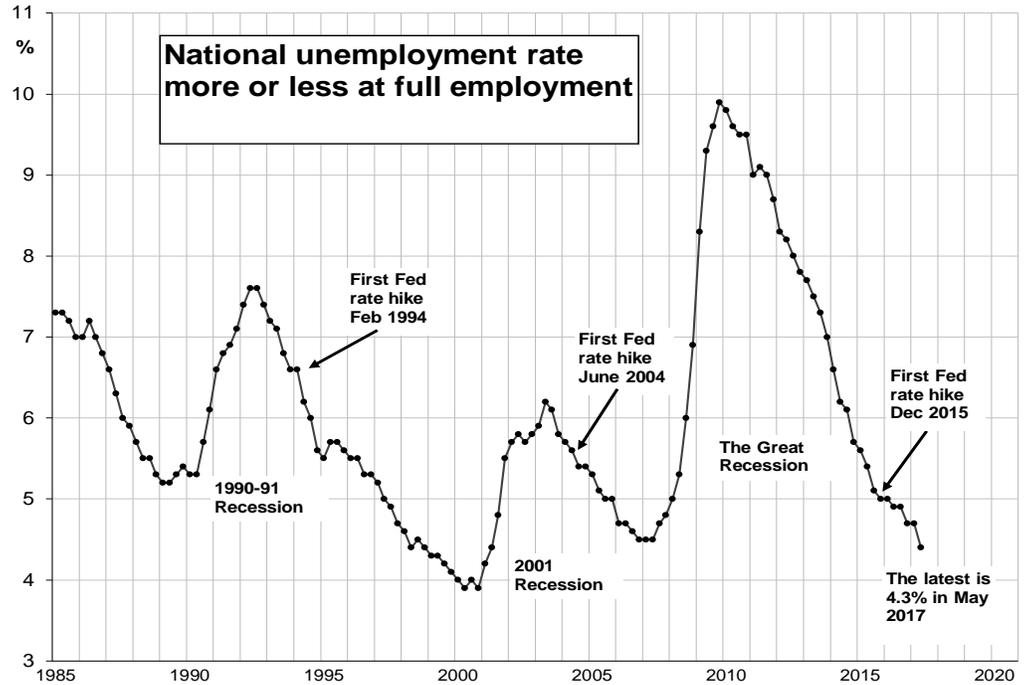
Clinton's terms in office in the 1990s; and an expansion lasting almost nine years in the 1960s. Both of those two long expansions had midterm corrections call it, where the economy slowed dramatically, enough for the Federal Reserve to cut interest rates officials were so worried, before the economy picked up again. The current economic growth period since the June 2009 recession end has had no pronounced slowdown period, although the oil crash starting in 2014 took a lot off of growth.

Has economy hit the wall of "full employment?"

The economy is at full employment and growth could be expected to slow. But activity does not have to slow enough that the economy actually turns down and goes into a recession. Future growth will be held back by the lack of workers as time goes on. This should not be enough to cause a recession however.

There have been worries about what the decline in car & light truck sales mean this year. Sales were 18.0 million at an annual rate in the fourth quarter of last year, but have run at the 16 million annual rate level for the last three months. Car sales have turned down, and while it looks dramatic, there is no recession weakness yet. Going forward maybe the car sales trend bounces

16.5 to 17.5 million for a while, just like it did during housing bubble economy years a decade ago.



Similarly, business spending on equipment, investment that makes the economy go, had come off full recovery levels with the downturn in oil prices but orders are now holding in a sideways pattern. Equipment orders don't look ready to signal an outright recession any time soon. There is normally a sharper, more sudden falloff in new orders preceding a recession.

Bottom line is the economic model for forecasting the future is broken at the moment. Broken, or maybe better, it is harder than ever to forecast a recession because every recession since the 70s was caused by the Fed chasing after a rising inflation trend that was sparked by an upward spike in crude oil prices. The

Fed raised rates too high to slow inflation. Higher interest rates by the Fed broke the economy and sent us into a recession. Based on this model, we can't go into a recession without higher inflation caused by oil prices. Difficult to see this happening right now with all of the U.S. supply of oil from fracking. Long-term oil demand from the world doesn't look likely to rise faster than supply (push up prices) until 2020.



We always remember the head of research at the Fed in Washington a couple months before the 2001 recession saying they cannot forecast a recession. "All of a sudden things just go vertical." Can't be predicted in advance. We won't forecast a recession at this point. The economic data will give us an indication several weeks or sometimes three or four months ahead of time, but there is no such signal right now that a recession is imminent. Probably no need to monitor these more timely economic indicators as Bernanke called them either, especially now that Europe is doing better and the commodity bust from mid-2014 to early 2016 has passed.

Economics isn't a science. Spending in the economy from consumers and new investment from business is very psychological and can turn on a dime, but no recession looks likely in the near term. A recession won't even be on the horizon until this easy money monetary policy period ends, and Washington officials get the Fed funds rate up to more normal 3% levels from 1.25% today. That's a ways off. The Fed doesn't plan on the Fed funds rate getting to 3% until the end of 2019 based on their latest forecasts.

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