Recessionary Anxiety

August 24, 2019

Jerry Haar

Recessions have a lot in common with earthquakes, heart attacks, and school shootings---you have no idea when they will occur. However, unlike the aforementioned calamities, there are indicators, telltale signs when a recession is in the offing.

A recession, in essence, is defined as two consecutive quarters of negative economic growth as measured by gross domestic product (GDP). However, the National Bureau of Economic Research takes a broader approach by including measures of real income, employment, wholesale and retail sales, and industrial production. While U.S. GDP shrunk to 2.1% in the second quarter, down from 3.1%, the unemployment rate is only 3.7% and wages have been growing, although slowly. It is important to note that during the Great Recession, 2007-2009, unemployment hit 10% and the Dow lost more than half its value in just six months. We are nowhere near that economic predicament this time.

However, yellow lights are flashing—most prominently yield curves; for they are now “inverted”. The yield curve is the interest rate on a bond or Treasury. They can have different lengths of duration, from one month to 30 years. The two main yield curves that investors follow for forecasting recessions are the two- and ten-year Treasury bond yields. Normally, longer term bonds pay a higher yield, since one’s money is tied up for a greater period. This time, as in 2007, the yields on short-term bonds are higher than long-term ones—this means investors are fearful, and the issuer (in this case the U.S. government) does not have to pay out more to hold an investor’s money for a longer period of time. History shows that less than 2 years after a yield curve inversion a recession strikes.

Another amber light is the troubling state of the global economy—one characterized by volatility and uncertainty. The UK is experiencing negative GDP (along with Brexit trauma), the German economy is experiencing a downturn, and China is witnessing the lowest production growth in nearly two decades. In the Western Hemisphere, sluggish growth in Mexico, Brazil, Argentina, in particular, are troublesome for the U.S. since the trade relationship with the region exceeds $2 trillion, excluding Canada that is also experiencing declining growth from last year and will negatively affect the $715 billion goods and services trade between our northern neighbor and the U.S.

Most dangerous of all, within the international milieu, is the U.S.-China trade war, one which could possibly spark, or at least exacerbate, a recession. Chetan Ahya, Morgan Stanley’s chief

economist, predicts a *global* recession in nine months if the U.S. raises tariffs on all imports from China. President Trump announced that the U.S. will add levies beginning September 1, on the remaining $300 billion in Chinese imports not already subjected to duties. Two-thirds of these goods are consumer products and will cost the average American $1,000 per year--$400 more per year than they are already paying for goods made in China. Additionally, the U.S. could see nearly 2 million fewer Chinese visitors because of hostile trade relations, travel advisories and rising currency exchange rates, one analysis found. In all, that's projected to cost the U.S. $11 billion in foregone tourist spending.

There are other negative indicators of increasing concern, as well. Factory output in July was the lowest in 17 years, housing starts and building permits have fallen, and debt accumulation is increasing at an extremely alarming rate—federal, state, municipal and consumer. The federal deficit widened by 77% in the first four months of fiscal 2019 and now totals nearly $1 trillion. U.S. consumer debt hit $14 trillion in the first quarter of 2019, encompassing credit cards, auto loans and mortgages.

An August survey of over 200 economists conducted by the National Association of Business Economics reports that 38% believe a recession will occur in 2020, with 34% predicting 2021 and 14% stating after that time period. The Federal Reserve Bank of New York foresees a 31.5% chance of a recession during the next 12 months. Moody's Business Confidence Indicators dropped by 16.6 % in June 2019, compared with a decrease of 13.2 % year on year in the previous month, and U.S. consumer sentiment fell to 92.1 in August, the lowest indicator readout since the start of 2019, according to recent data.

A widening pall of recession anxiety is shrouding not just the U.S. but the world. Here at home interest rates are already low, so new rounds of rate cuts will not provide significant stimulus. Nor do tax cuts appear on the horizon, the mega-cuts enacted in 2018 did little to juice the economy, as they were utilized primarily by large companies to buy back their stock.

To mitigate the worse effects of a coming recession, one needs to understand first of all that recessions, for the most part, are like the flu—they just need to have to run their course. It's the business cycle. Emergency introduce rate cuts and the reintroduction of quantitative easing are wise and necessary courses of action when absolutely necessary. However, no amount of economic rejigging is a substitute for curtailing and cutting profligate federal spending, abandoning the neo-mercantilist idiocy of widespread tariff adoption, and bullying the Federal Reserve Board for reasons of political expediency.

Chaim Potok, in his best-selling novel *The Chosen*, the author acclaims: "I've begun to realize that you can listen to silence and learn from it." Were the self-anointed chosen one presently residing in the White House to heed this wisdom, the impending recession may not be avoided but its length and depth could surely be lessened.

Jerry Haar is a professor of international business at Florida International University and a Global Fellow of the Woodrow Wilson International Center for Scholars in Washington, D.C. His latest book, with Ricardo Ernst, is *Globalization, Competitiveness and Governability*.