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Economics Group

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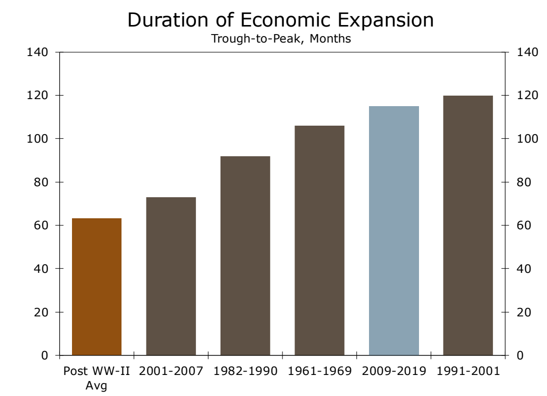
Dating Advice

As this expansion nears the longest ever, we examine the indicators that define a recession. Recession is coming, it's just a question of when. Dating the economic cycle is not easy; this short series of reports is our best advice.

Long in the Tooth

Since 1945 there have been 12 U.S. recessions that have lasted, on average, 10.8 months. Add up the duration of every post-war recession and you get 130 months or just shy of 11 years. That is less than 15% of the time. Said differently, more than 85% of the time the economy is in expansion. The average expansion during that same time period is just under five years, and the longest (1991-2001) was 120 months. If the U.S. economy is still in expansion in July as we expect it to be, this will become the longest U.S. economic expansion on record.

In the lead-up to the financial crisis in 2008-2009, there were very few economists calling for recession, let alone the worst contraction in output since the Great Depression. What explains this reluctance? And what does it mean for identifying the eventual end of the current cycle?

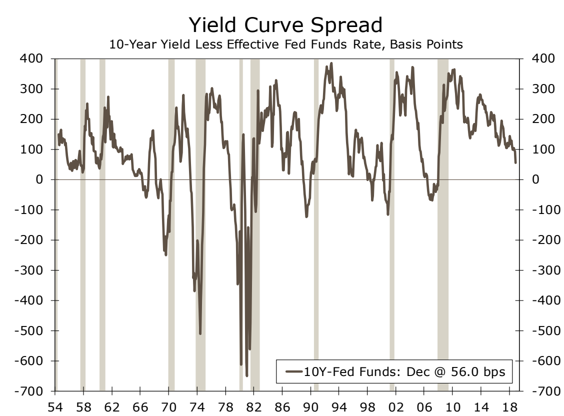


Why the Reluctance About Calling a Recession?

Imbalances in the economy can be identified in advance. Yet pinning down the precise date for *when* those imbalances lead to recession requires advance knowledge of what the initial spark that saps confidence will be.

Making a recession call well ahead of a downturn therefore means sticking your neck out. John Maynard Keynes lamented that "worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally." An untested model or even a well-informed hunch lacks the sufficient basis for a recession call.

Even for the economist with the guts to do it, the incentives are misaligned. If the call does not go your way, you are accused of "crying wolf," and if 85% of the time the economy is in expansion, why chance it?



Night Gathers and My Watch Begins

Why chance it? Because that's our job. The length of this expansion alone implores a hard look at when the next recession may strike. More crucially, sailing is anything but smooth at present. Risks are mounting and early warning signals of a recession keep popping up. Global growth is slowing. The world's most influential central bank, the Fed, is teetering on restrictive monetary policy. U.S. policy uncertainty is at a five-year high amid ongoing trade disputes and only tentative resolution to the government shutdown. The leading economic index, a key yardstick for the direction of the economy, is losing momentum. Perhaps most ominously, an inverted yield curve has preceded each of the past seven recessions, and we are uncomfortably close to inversion again.

So what defines recession and what should we be watching? The official call is up to the National Bureau of Economic Research, whose dating committee determines the start and end dates for each cycle. It considers recession to be "a significant decline in economic activity…normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales."

In a series of notes over the course of this week, we will unpack each of these components. None of these four horsemen of the apocalypse are signaling recession yet. But what do the leading indicators for each signal in light of the gathering clouds? The next recession is coming, it is just a question of when. These reports will help you identify the leading indicators to watch. Dating the economic cycle is not easy; these reports are our best advice.

Source: Federal Reserve Board, U.S. Department of Commerce and Wells Fargo Securities

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