Anticipating the Next Recession: A Probabilistic Approach

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Background
- Upturn in secular growth is possible, but idiosyncratic, so hard to ascribe a probability to that outcome
- (Much) faster cyclical growth seems unlikely
  - Economy near capacity constraints
  - Vehicle sales have already peaked, and housing might be peaking
  - Fiscal stimulus is waning, could shift towards restrictive in 2020, and there’s the shutdown
  - Monetary policy is tightening, and could shift towards restrictive by 2020
  - Trade policy is a downside risk, as is recent financial turmoil
  - Global growth is slowing, and the dollar is strong
  - And plenty of geo-political uncertainty being here at home
- So, a plausible “optimistic” scenario is continued trend-like growth until the next recession
- We know that’s coming, but not sure when, so we make it an alternative with a (subjective) probability
- Still, the current unemployment rate is (likely) unsustainable
- How do we eventually transition back to a higher unemployment rate?
- By showing a base forecast including a “growth recession” and the mystical “soft landing from below”
- But is this the best “expected” outcome upon which clients should base their plans?
- Spoiler alert. I’m going to suggest “maybe not!”
Recessions don't die of old age, but are killed by shocks / policy mistakes; still...

Unemployment Rate (%)
Recessions are likely to begin sooner when unemployment is low.

PDF for Recession in Xth Year Forward

- When Unem Rate < NARIU - 0.3

Source: Macroeconomic Advisers by IHS Markit

Interpolating (Beta function) to a quarterly frequency...

PDF for Recession in Xth Quarter Forward

- When Unem Rate < NARIU - 0.3
10-yr T-Note Yield by Recession Scenario
percent

Source: Macroeconomic Advisers by IHS Markit

Unemployment Rate (%)

Source: Macroeconomic Advisers by IHS Markit; BLS
Key Take-Away

Maybe we all should all be putting more emphasis on the expectation of a macro environment that is softer than is suggested by the typical or consensus-like forecast

Thank You Questions?

See also: "Anticipating the Next Downturn: A Probabilistic Approach" (Macroeconomic Advisers by IHS Markit, MACRO FOCUS, December 12, 2018.)