cardinal
economics
& finance

COMMENTARY 20191118

Expansion length tells us nothing about chances of recession

November 18, 2019

Carl Riccadonna from Bloomberg Economics presented to the CFA Society of Detroit annual forecast luncheon on November 8. He made two high level points about the current 10.5-year economic expansion in the U.S. First, the length of an expansion has nothing to do with the probability of entering a recession. The current expansion has been long, but the total increase in real output remains below average. Second, real growth above 2.0 per cent is hard to achieve at the low, current rate of workforce expansion. Productivity gains are low, despite technological advances. My thesis is that technological advances enhance our lives and lead to better allocation of assets, and utilization of resources (both human and physical capital). But only part of these improvements flow through to increases in measurable output. We don't save take all the time saved on travel, errands and communication and use that as opportunity to simply do more work.

Carl Riccadonna from Bloomberg Economics presented to the CFA Society of Detroit annual forecast luncheon on Friday, November 8 2019.

Economic projections from Bloomberg Economics are:

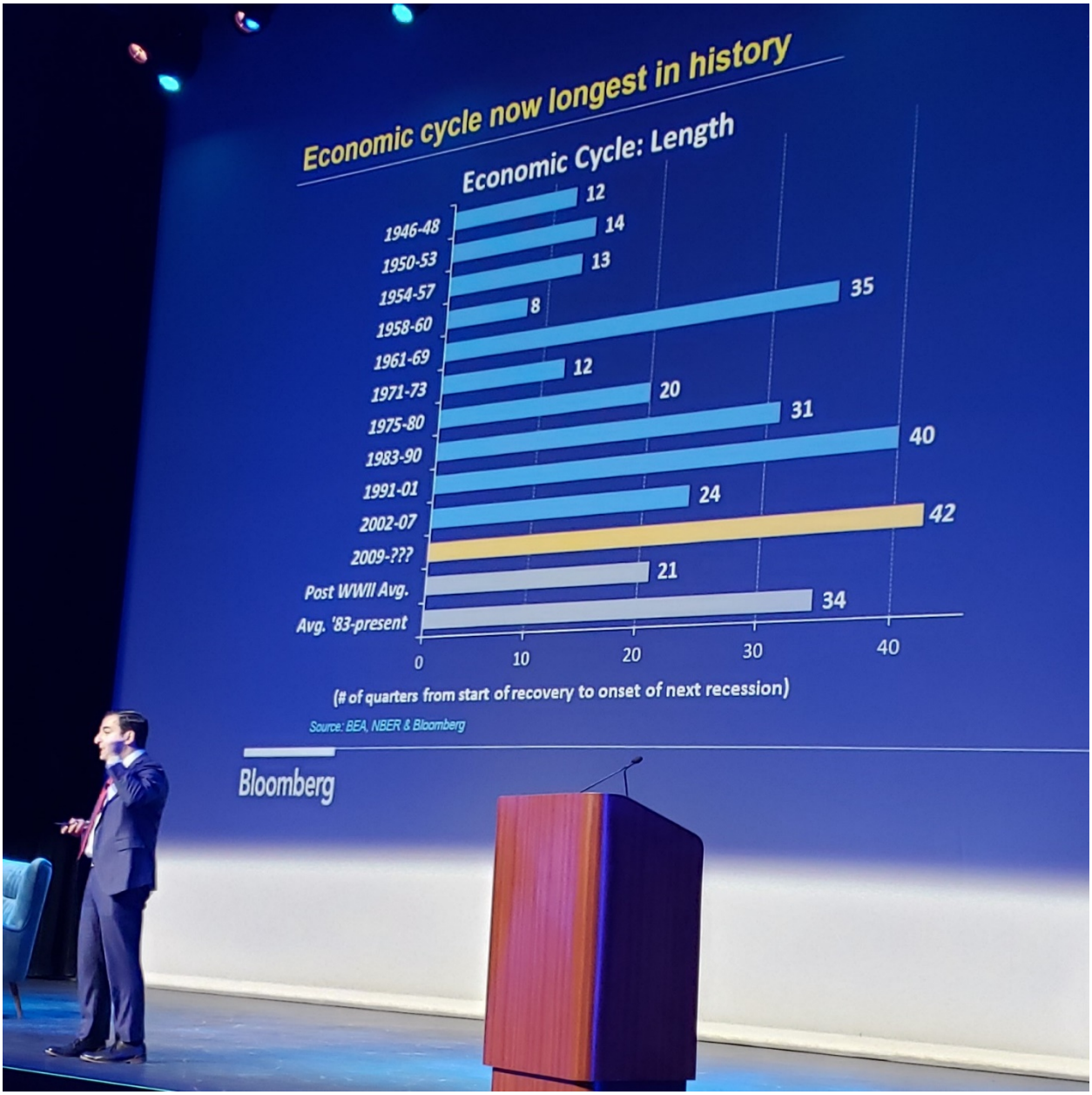
- Real GDP growth of 1.7 per cent in the fourth quarter of 2019, rising to 2.0 per cent in 2020 (the U.S. Federal Reserve has the same 2.0 per cent forecast, falling to 1.9 per cent in 2021 and 1.8 per cent in 2022);[1]
- Unemployment of 3.5 per cent in the fourth quarter of 2019, falling to 3.4 per cent in 2020 (the U.S. Federal Reserve is less optimistic, forecasting an unemployment rate of 3.7 per cent in 2020, rising to 3.8 per cent in 2021 and 3.9 per cent in 2022); and
- Yield on 10-year treasury bonds of 2.25 per cent in 2020, compared to 1.84 per cent today.

Mr Riccadonna noted two key high level points.

First, the length of time an economy has been in expansion has nothing to do with the probability of entering a recession. Many people talk about a business cycle, as if there is some normal length of time that an economy is expanding or contracting. But this is not true. The current expansion in the United States has been running for 42 quarters, the longest periuod of expansion since records have been kept.

[1] https://fred.stlouisfed.org/release/tables?rid=326&eid=783029&od=2020-01-01# accessed on November 18, 2019.

Figure 1. Expansion length

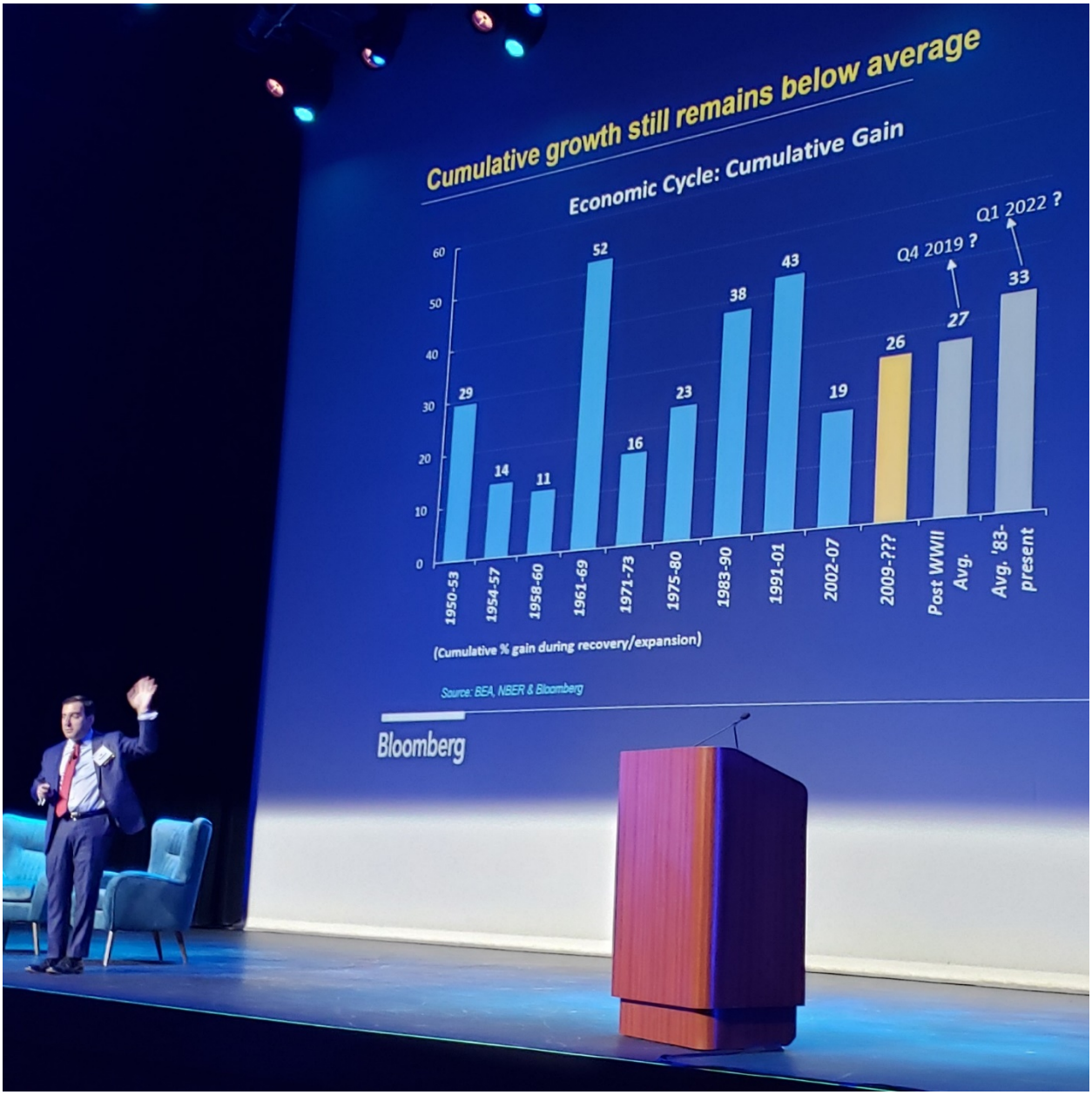


The average length of expansion since the 2nd World War is 21 quarters, and the average length of expansion since 1983 is 34 quarters. The year 1983 matters because this coincides with Paul Volcker's term as Chair of the Federal Reserve from 1979 to 1987, when the Federal Reserve began using interest rates to keep inflation at a low, stable level.

Even though the expansion has been running for 10.5 years, the cumulative expansion in the size of the economy is below average. In real terms the economy has expanded by 26 per cent since 2009. On average during expansions the total increase in the size of the economy has been 27 per cent since World War II, and 33 per cent since 1983. So the U.S. is in a long-running, steady economy expansion, as opposed to a short, rapid-growth expansion.

Even though the expansion has been running for 10.5 years, the cumulative expansion is the size of the economy is below average. In real terms the economy has expanded by 26 per cent since 2009. On average during expansions the total increase in the size of the economy has been 27 per cent since World War II, and 33 per cent since 1983. So we are in a long-running, steady economic expansion, as opposed to a short, rapid-growth expansion.

Figure 2. Expansion size



Second, productivity gains are low, compared to past decades. As shown in the figure below, it is challenging to grow the U.S. economy at real, annual rates above 2.0 per cent. Real growth was 4 per cent in the 1960's as workforce participation increased and productivity per worker improved with innovation. Growth slowed to 3 per cent in the subsequent four decades as productivity fluctuated and there was reduced growth in

workforce participation. And in the most recent decade we have not seen substantial productivity gains in ways that show up in GDP figures.

Figure 3. 10-year average U.S. economic growth rates

My view is that technological advances enhance our lives but do not necessarily show up in growth statistics. In the past week I've:

- Used ride-share services (Lyft, Uber – this has slashed the cost of travel, increased the utilization of assets, and given workers the opportunities to earn additional income);
- Had groceries delivered (Meijer, Shipt – this freed up time at home and, again, gave a worker the opportunity to earn additional income), and
- Streamed entertainment (Xfinity, Amazon, Netflix).

Only some of these innovations lead to additional economic output. For instance, the workers' additional income and the reduced cost of services will flow to spending and investment. But I didn't necessarily say with respect to the free time, "Great, that gives me an opportunity to do more work."