US Macroeconomics

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Unprecedented Slowing Absent Recession

With respect to economic peaks, unemployment is a leading indicator, and inflation is a lagging indicator. Every post-WWII recession has been preceded by a half-point increase in the unemployment rate. There have been no exceptions. Meanwhile, since 1960 the inflation rate peaked during recession and always bottomed after the economic recovery ensued.

The chart below shows the unemployment and inflation rates along with recessions as denoted by the shaded regions. **The unemployment rate is currently 3.9%, up from its 3.4% cyclical low** (set in January and April 2023) and consistent with a looming downturn.

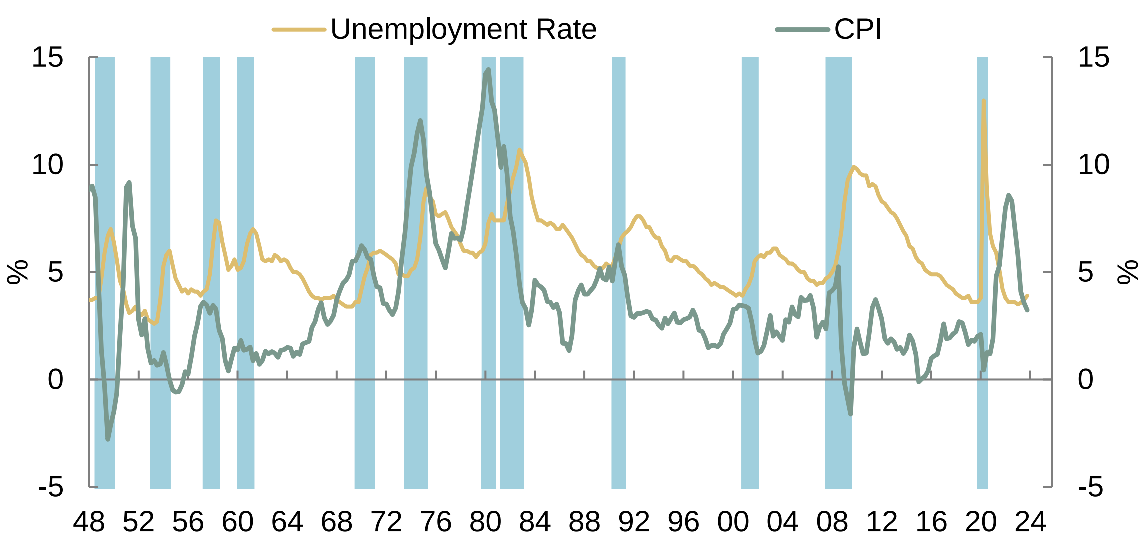
It is evident from the graph below that **when the unemployment rate starts to turn upward, it does so quickly and by a large amount**. This is why macroeconomists describe downturns as nonlinear events. It is also why recessions are often hard to predict.

Moreover, it does not matter what the level is when the unemployment rate begins to rise. All business cycles experience substantial increases in unemployment regardless of the starting point.

For example, the unemployment rate was at an all-time low in 1953 (2.5%) and yet surged above 6% the following year. And there were similarly large jumps following sub-4% readings in other business cycles, too, such as 1957-1958, 1969-1970 and 2000-2003. This means unemployment could easily top 6% in the next downturn whenever it comes.

Regarding inflation, its performance has been unusual given the behavior of the unemployment rate. Normally, **the inflation rate peaks during recession and comes down hard after an economic recovery has begun**. But this time has been different. Inflation peaked at 8.9% in June 2022, and its growth rate has since collapsed to just 3.2% as of last month. This is an unprecedented slowdown absent the onset of recession.

Why does this matter? It matters because if there is an economic downturn, the inflation rate is going much lower in lagged response to excessive labor/product market slack and weakening aggregate demand. In turn, a discussion around the risk of deflation could resurface. Stay tuned.



Sources: BLS, Haver, SMBC Nikko

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