Is a Recession Around the Corner?
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Thank you very much for inviting me to join you this morning. It's a pleasure to have the opportunity to speak with you again. With apologies to those of you who heard me speak last year, I'd like to start by telling you a bit about myself, and then I'll share my perspective on the national economy.

I joined the Richmond Fed two years ago after a 30-year career in consulting at McKinsey, where I was our CFO and led our offices in the South. I've spent my professional life helping firms make decisions about hiring, compensation and prices, and I've made a lot of those decisions myself. So I hope I'm bringing a different perspective to the Federal Open Market Committee (FOMC). My colleagues on the committee are some of the most talented macroeconomists, bankers, academics and financial regulators in the country. But as the only committee member coming from management, I approach things differently.

To help inform my perspective, I've made it a priority to travel throughout the Richmond Fed's district, talking to business and community leaders to make sure I'm in close touch with what's happening in our economy. I'm in Maryland a lot, and I really appreciate the opportunity to meet with groups like this and hear your reactions and questions.

Today, I want to focus on a question I hear a lot: Is there a recession around the corner? This is a reasonable question to ask. After all, at more than 10 years, the current upturn is the longest on record. They call it the business "cycle" for a reason—at some point things are going to turn back down, aren't they? We've also seen yield curve inversions recently, which historically have been very good predictors of a recession. And, after more than a year of relatively strong GDP growth, the economy has slowed recently, toward around 2 percent.

When it comes to answering this question, economists are notoriously bad at predicting the future. Fortunately, I'm not an economist… but it's not clear that businesspeople are that great at it either. At the end of 2018, nearly half of CFOs in the Duke CFO survey were predicting a recession by the end of 2019—one that hasn't yet happened. As Yogi Berra famously said, "It's tough to make predictions—especially about the future."

But I'm here and I have a microphone so let me try to answer anyway. Before I say more, however, I have to note that the views I express are my own and not necessarily those of my colleagues on the FOMC or in the Federal Reserve System.[1]

Current Signs of Economic Strength

Now, it's true that this has been a long expansion. But expansions don't die of old age; they die of heart attacks. One pundit once said, about the Volcker years, that the Fed murders them.

Look at the recessions over the past 40 years. In the early 1980s, the Fed's policies to tame runaway inflation caused two recessions back-to-back. A decade later, the savings and loan crisis and an oil price shock led to the 1991 recession. The dot-com bust and the tragedy of Sept. 11 precipitated the recession in 2001, and the subprime mortgage crisis and ensuing financial meltdown created the Great Recession in 2007-09. None of these were a situation where we gradually drifted into a recession—to find one like that you'd have to go back to the 1970s.

In fact, along many dimensions the economy looks quite healthy. First and foremost, the labor market is very strong. The unemployment rate was 3.5 percent in November—the lowest rate since 1969—and the economy added 266,000 jobs. There are about 1 million more job openings than job seekers. Consequently, we're seeing employers willing to take a chance on people they might have passed over a few years ago. And wage growth is picking up—earnings have increased 3.1 percent over the past 12 months and even more for lower-paying jobs. At the same time, inflation is low and stable at around 1.6 percent. The resulting increase in real wages matters.

The strength of the labor market helps consumers feel confident: They have jobs, and their earnings are increasing. Credit markets are open. Both consumer spending and saving are strong.

I did mention that GDP growth has slowed. But "slowing" isn't the same as "underperforming." Why is that? To put it very simply, economic growth depends on how many people are working and how productive they are. That means the economy can only grow as quickly as workforce growth plus productivity growth. Productivity growth averaged just 1 percent between 2013 and 2018. Over the same period, workforce growth averaged 0.8 percent. Adding these up, we'd predict GDP growth of around 2 percent—which is right where we are. To me, the current numbers suggest we're converging to normal levels rather than underperforming.

Would I like to see faster GDP growth? Of course. That requires boosting productivity growth or increasing the size of the workforce. To achieve the latter, we need to either draw people off the sidelines of the labor force or increase immigration, which has contributed to about half of workforce growth since the 1990s. These topics are beyond the scope of my remarks today, but they're important for policymakers to pay attention to.[2]

The upshot is that the economy is growing at about the rate we would expect it to grow.

The Future: The Upside

Of course, today isn't a promise of tomorrow. Let me tell a cautionary tale: During the year preceding the 1970 recession, GDP growth averaged 3 percent and unemployment averaged 3.5 percent. Before the 2001 recession, we experienced 3 percent GDP growth and 4 percent unemployment. And in the year before home prices peaked in mid-2006, GDP averaged 3.4 percent and unemployment averaged under 5 percent. Things can change.

So what indicators am I watching for signs that a change might be coming? I pay a lot of attention to what consumers are spending on big ticket items, because consumer spending is almost 70 percent of GDP. If you feel unsure about the future, you might delay buying a house or car or new furniture. But right now consumers remain confident and are buying. Real consumer spending on durable goods was up 5.6 percent over the previous year in the third quarter of 2019 and has increased every quarter since 2011. Housing demand is solid: Pending home sales are up 4.4 percent over the same time last year, and housing starts are trending up. In addition, the demand for automobiles remains strong; vehicle sales reached 17.1 million (at an annual rate) in November.

Consumers are willing to spend when they have jobs. Another leading indicator is initial claims for unemployment insurance, which you can think of as a proxy for layoffs. Right now, initial claims are near a 50-year low even though the labor force is larger than ever.

Initial claims are one component of the Conference Board's Leading Economic Index, another measure I watch closely because it has been a good predictor of recessions in the past.[3] The index also includes indicators such as new building permits, manufacturing activity and consumer lending. It has declined slightly the past few months, but it's still well above the levels that would indicate a recession is on the horizon.

The Future: The Downside

The data I've described so far point to continued growth. But you might feel less optimistic looking at the yield curve, which, as I noted, has inverted several times recently. It's true that an inverted yield curve has preceded recessions in the past—but it doesn't *cause* recessions. If underlying economic conditions change, so could the meaning of the signal. For example, recent research by the Richmond Fed found that term premiums (the compensation one receives or pays for locking up their funds for a period of time) have fallen significantly since the 1980s. This makes the yield curve structurally flatter, and therefore makes an inversion more likely even if no recession is coming. We could also be seeing international savings move toward higher-yielding U.S. Treasury bills at a time when negative interest rates make their home government bonds relatively unattractive. I think the current behavior of the yield curve reflects the flow of funds rather than a looming recession.

Some observers also are concerned about recent contractions in manufacturing activity, as measured by declines in the ISM's Purchasing Managers Index. But we saw similar dips in 2012 and 2015, after which activity rebounded, and the index is still well above the level that indicates the economy as a whole is contracting. In addition, manufacturing has declined considerably as a share of nominal GDP (from about 30 percent in the early 1950s to 12 percent in 2015) and as a share of employment (from 30 percent to just 8 percent). So it might not have the same explanatory power.

Now, business investment is an area I watch closely, and that I do worry about. It has been weak recently, falling 3 percent in the third quarter of 2019.

What explains that weakness? In my view, it's uncertainty. Between Brexit, the Middle East, immigration and the ongoing negotiations with China—to name just a few—it's been a roller coaster both here and abroad. Economists from Northwestern, Stanford and the University of Chicago have developed an "economic uncertainty index" that gauges the degree of uncertainty in 24 different countries. The "global" index hit its all-time high in August, and it remains elevated.[4]

Add political polarization and regulatory uncertainty to the mix and it's tough for businesses to feel like they're on solid ground—and how can you invest when you don't know the rules? Uncertainty can also make firms less confident about hiring and pricing. So I don't discount the idea that we could talk ourselves into a recession, particularly if the uncertainty begins to affect consumer confidence and spending.[5]

And of course there's always the possibility of a "heart attack," or shock, perhaps caused by global risks. Imagine an escalation with Iran or a collapse in international economies. Financial risks are also worth watching: Markets recently hit their all-time highs. In addition, corporate debt has increased significantly at the same time the covenants governing those loans have become more lax. Between 70 and 75 percent of these loans are not on banks' books, which means regulators have very little visibility into the potential risks.

Another area where regulators lack full visibility is cybersecurity, and these risks keep me up at night too.

Implications for Policy

So far I've described an economy that looks healthy in many respects, although we face some downside risks and potential shocks. In this context, what should policymakers do?

The FOMC bought some "insurance," as Chair Powell has described it, against the uncertainty last year by lowering the fed funds target rate 75 basis points. I think we're seeing this insurance pay off through the traditional channels, such as auto and home sales. Policymakers are also continuing to promote financial stability. We've made a lot of progress over the past decade, but we need to continue to be proactive about monitoring the risks we might face in the future.

The current environment makes it even more important to step up on the fiscal side. By this, I don't mean using the traditional levers of spending and taxation. Today, I think we have to broaden the definition of fiscal policy to incorporate the climate for business. That includes trade actions and trade uncertainty, regulatory changes and regulatory uncertainty, geopolitical challenges and domestic politics. In my view, the biggest boost to our economy would come from lessening the uncertainty and lowering the volume. I am hopeful that the recent election in the United Kingdom, the passage of the United States-Mexico-Canada Agreement (USMCA) and the trade deal with China will do that. That would build business confidence, build consumer confidence and lead to increased investment, spending and hiring. I like to say that American businesses are creative. Give them the rules—almost any set of rules—and they will make things happen. We've seen that with Brexit. Three years ago, the current path was projected to be economically destructive. But you see the positive reaction with the election—businesses just want to know the rules.

Net, the economy is still healthy. I'm encouraged by recent jobs reports and the pace of holiday spending. I'm hopeful recent events will lessen uncertainty and build confidence. While there is always the risk of a shock, the Fed has done a lot to support the economy's continued expansion and to provide buffers against the downside.

I would note that recession isn't inevitable. Australia has gone 27 years without one. Or another way to say that is that a policymaker, like me, is still allowed to dream!

Thank you, and now I'd love to take your questions.

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[1] Thank you to Jessie Romero for assistance preparing these remarks.

[2] Thomas I. Barkin, "Ensuring Longer-Term Growth," Speech at the Greater Raleigh Chamber of Commerce's 2019 Economic Forecast Event, Raleigh, N.C., January 10, 2019; "A Practitioner's Perspective on the Productivity Slowdown," Speech at the Virginia Association of Economists' Annual Meeting, Richmond, Va., April 4, 2019; "Getting People off the Sidelines: The Ultimate Workforce Development Plan," Speech at the Danville Chamber of Commerce's Workforce Summit, Danville, Va., November 12, 2019.

[3] Matthew Murphy, Jessie Romero, and Roy Webb, "Predicting Recessions," Federal Reserve Bank of Richmond *Economic Brief* no. 19-12, December 2019.

[4] Scott R. Baker, Nicholas Bloom, and Steven J. Davis, Economic Policy Uncertainty Index.

[5] Thomas I. Barkin, "Sentiment and the Real Economy," Speech to the New York Association for Business Economics, New York, N.Y., May 15, 2019.