# Anticipating the Next Recession: A Probabilistic Approach

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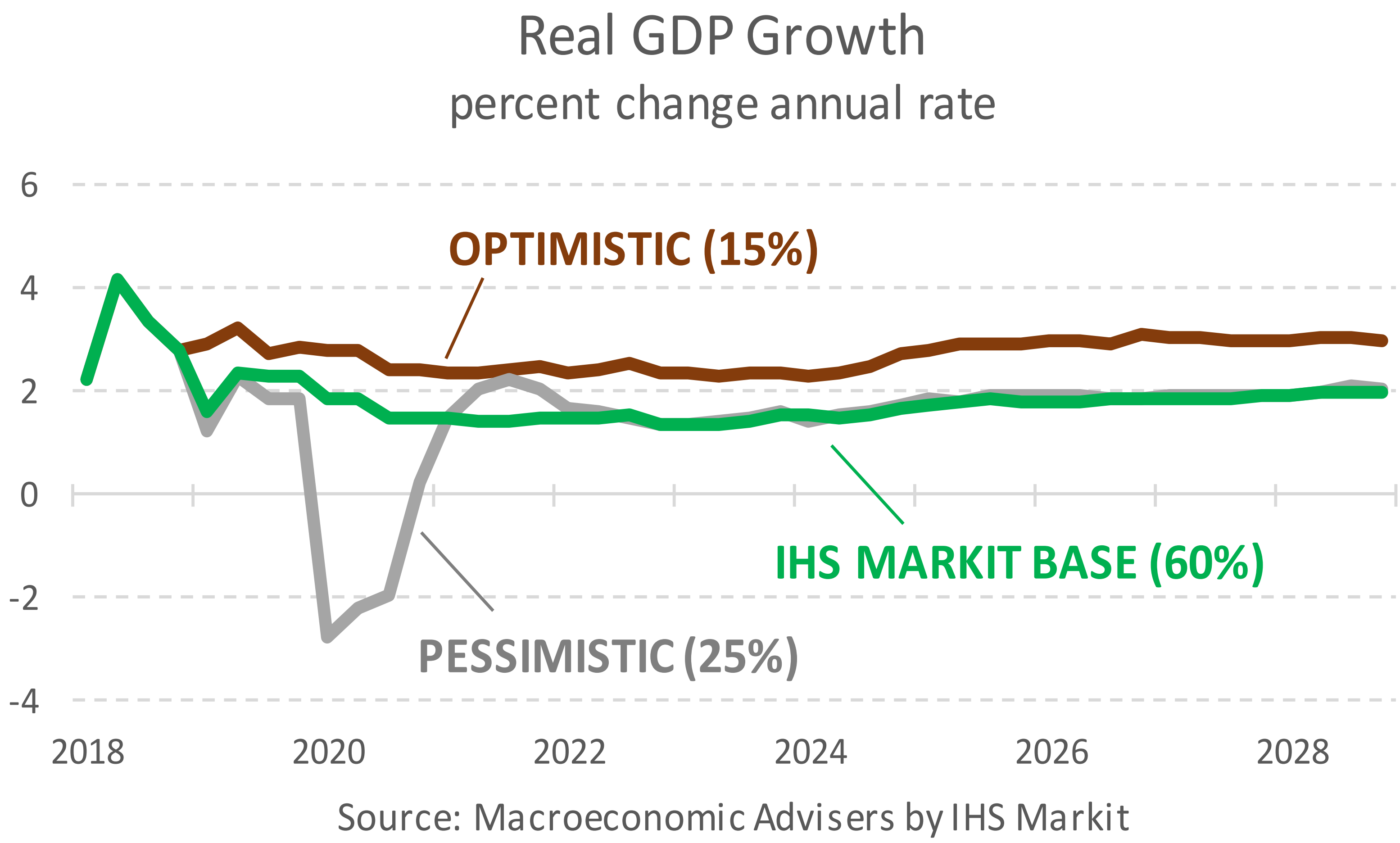
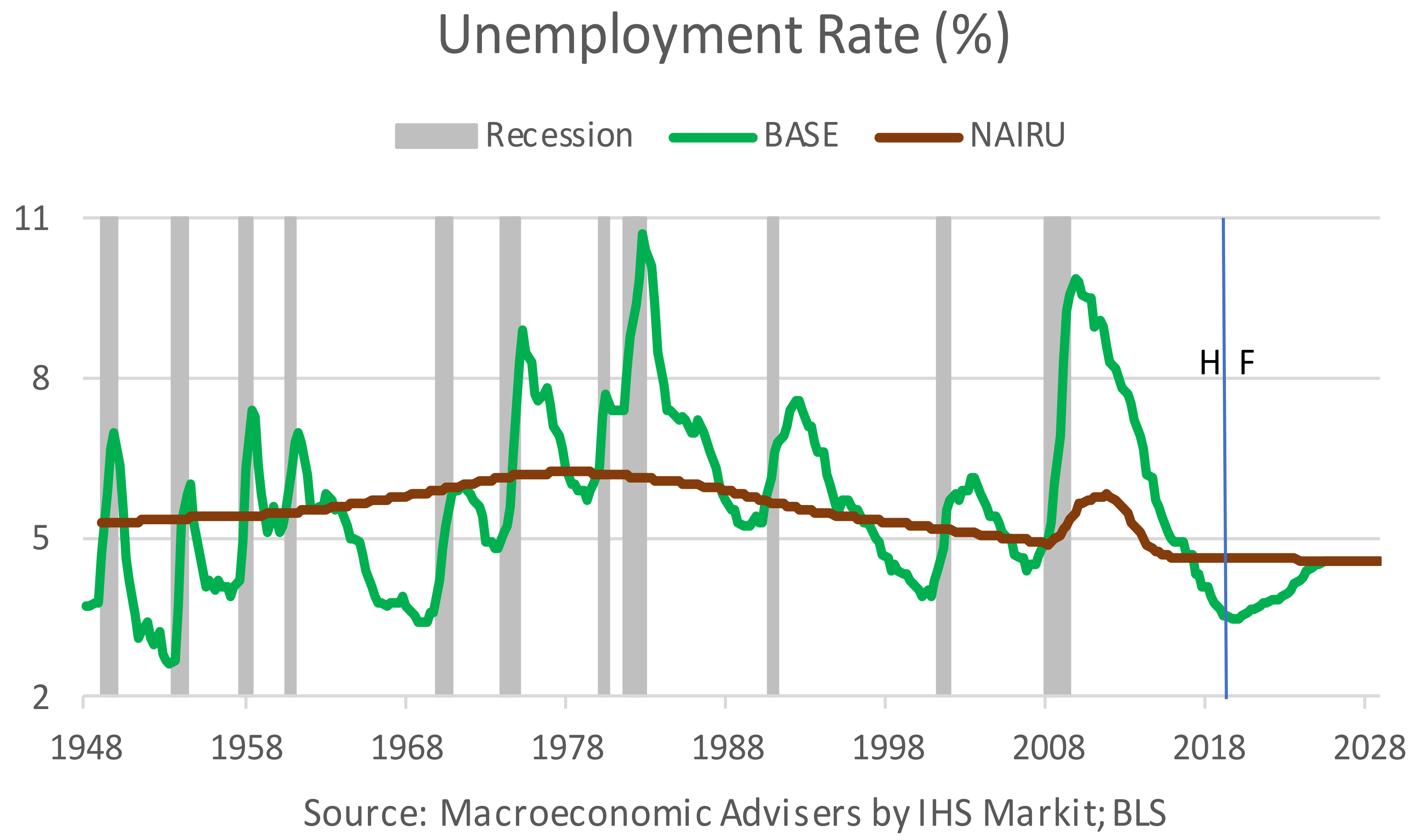
# Background

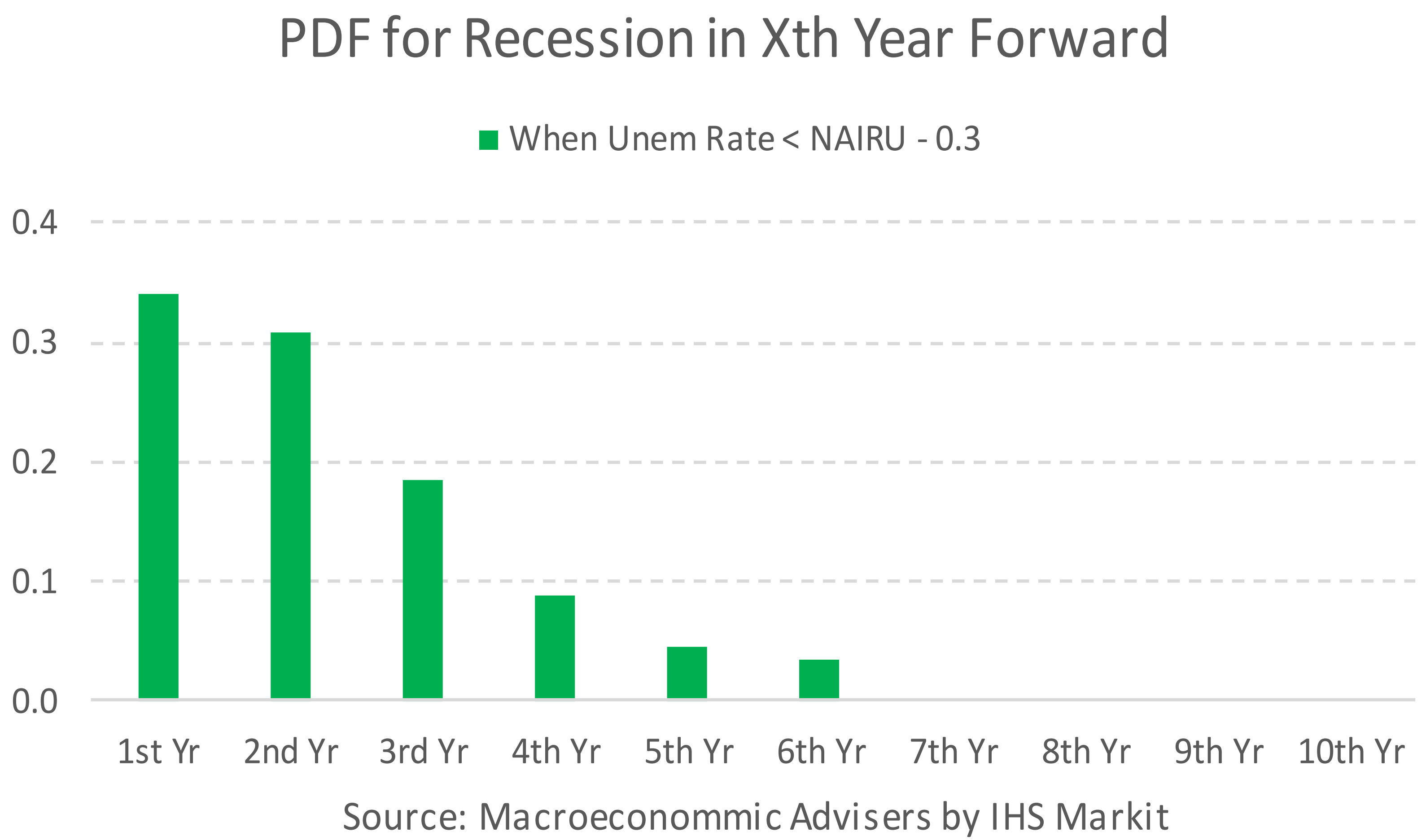
- Upturn in secular growth is possible, but idiosyncratic, so hard to ascribe a probability to that outcome
- (Much) faster cyclical growth seems unlikely
  - > Economy near capacity constraints
  - > Vehicle sales have already peaked, and housing might be peaking
  - > Fiscal stimulus is waning, could shift towards restrictive in 2020; and then 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!”


Real GDP Growth
percent change annual rate
6
4
2
0
-2
-4
2018
2020
2022
2024
2026
2028
OPTIMISTIC (15%)
IHS MARKIT BASE (60%)
PESSIMISTIC (25%)
Source: Macroeconomic Advisers by IHS Markit

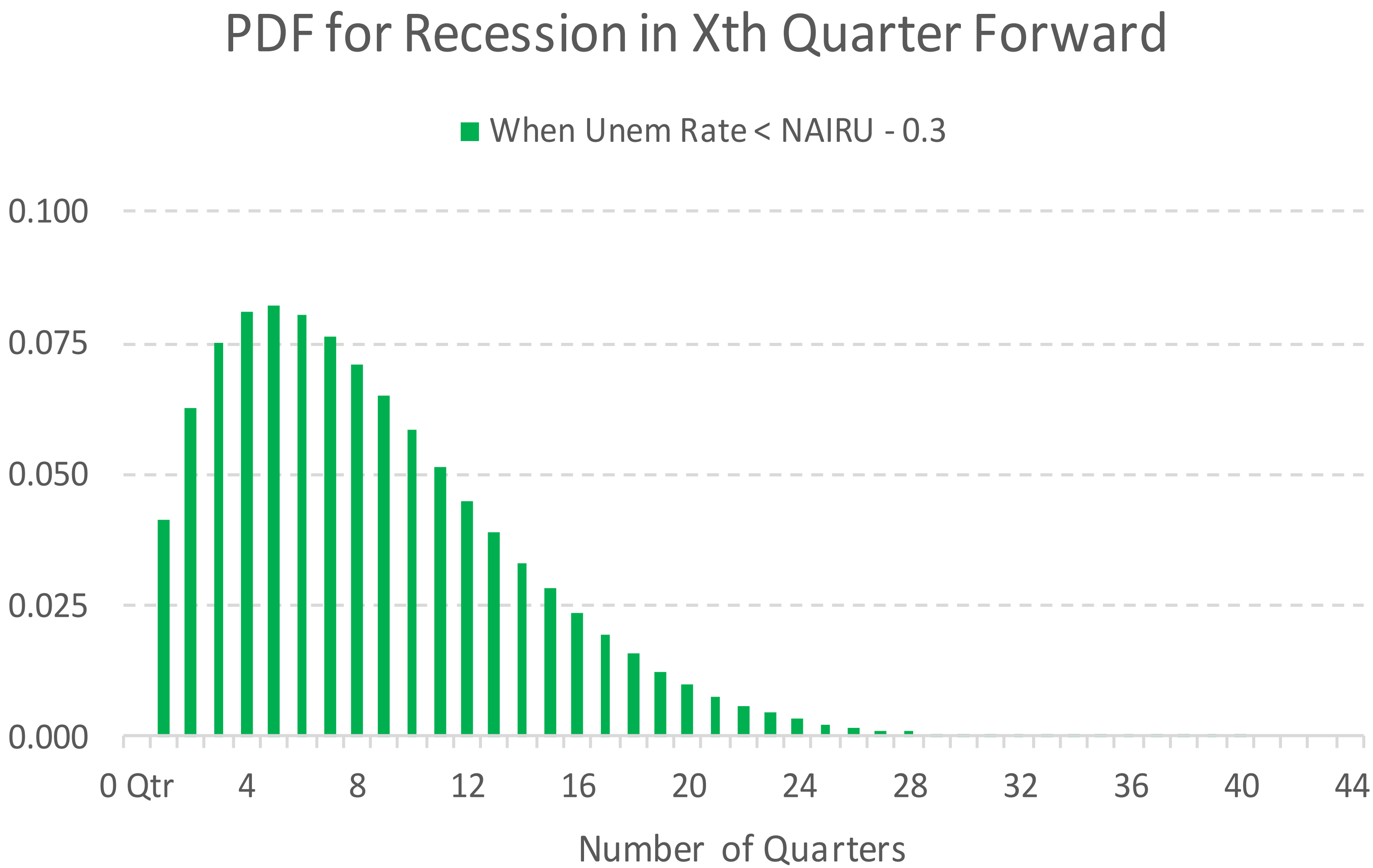
## Recessions don't die of old age, but are killed by shocks / policy mistakes; still…

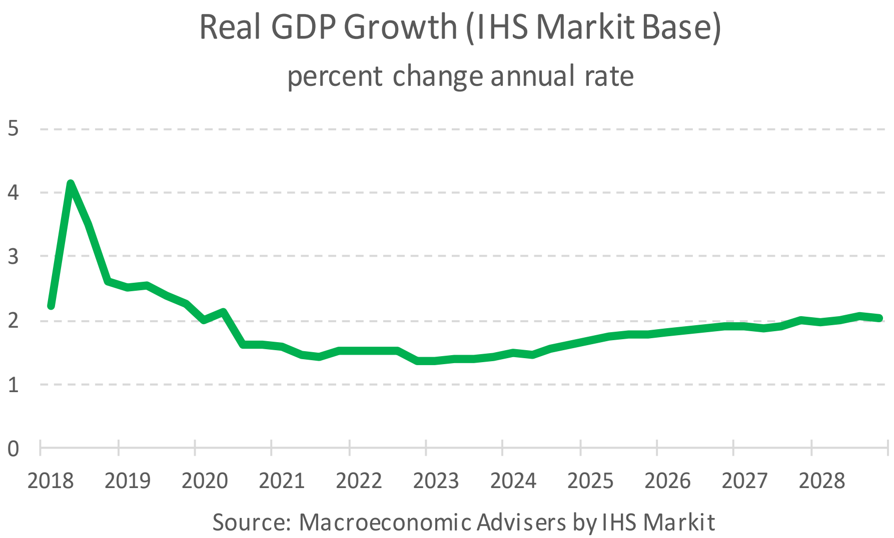


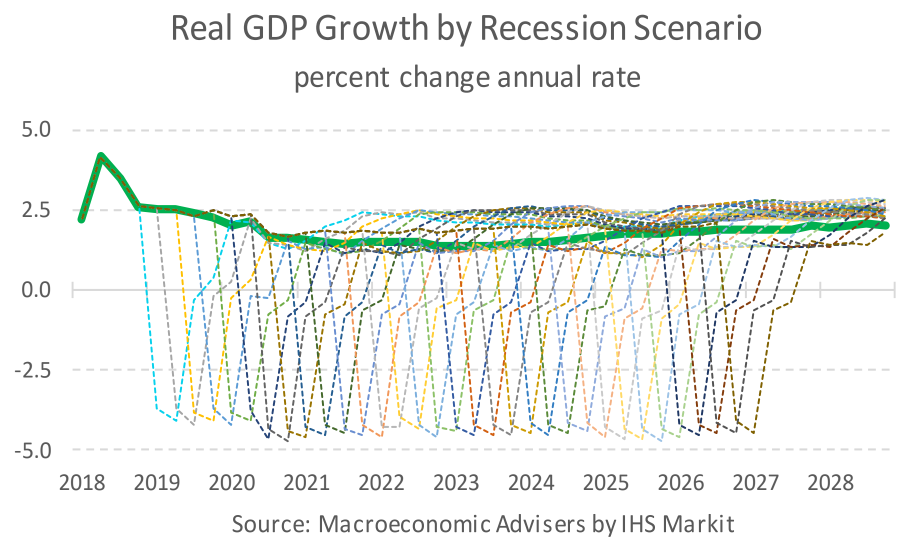
## Recessions are likely to begin sooner when unemployment is low.

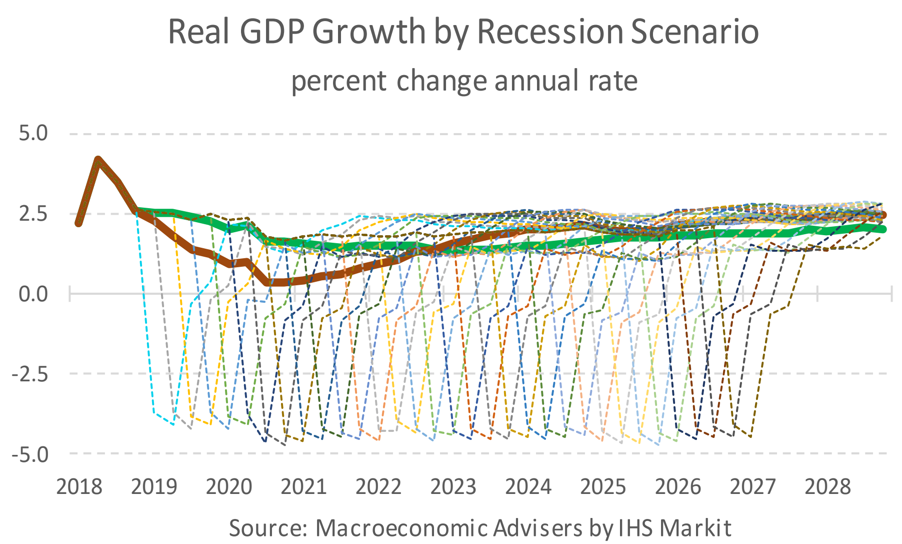


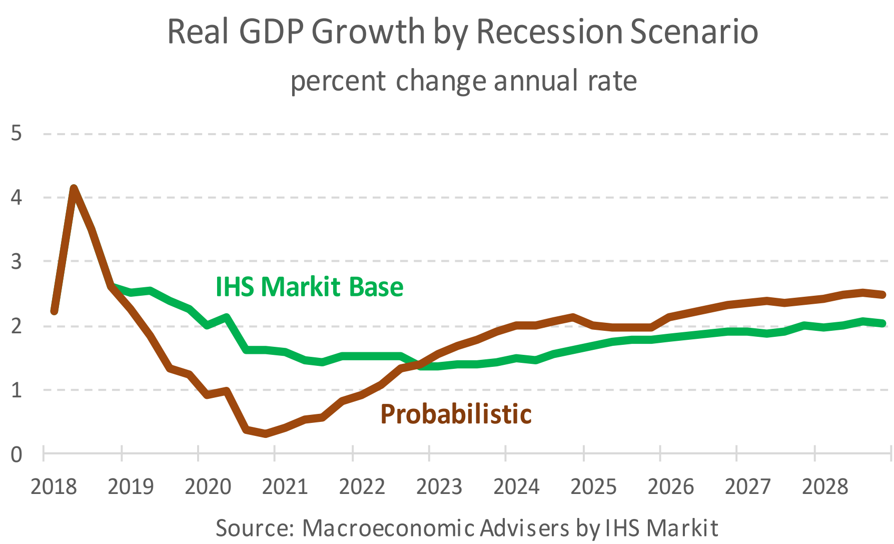
# Interpolating (Beta function) to a quarterly frequency…




Real GDP Growth (IHS Markit Base)
percent change annual rate
5
4
3
2
1
0
2018
2019
2020
2021
2022
2023
2024
2025
2026
2027
2028
Source: Macroeconomic Advisers by IHS Markit

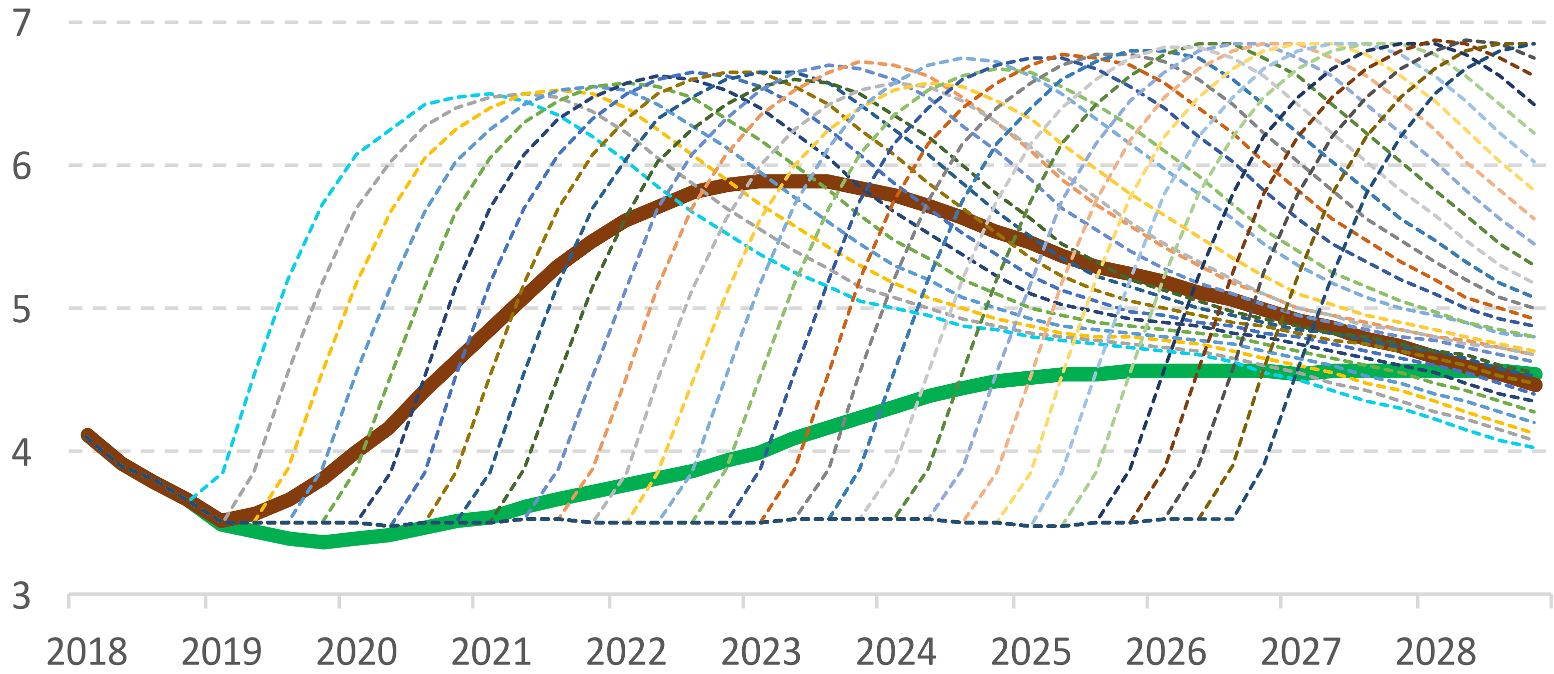

Real GDP Growth by Recession Scenario
percent change annual rate
5.0
2.5
0.0
-2.5
-5.0
2018
2019
2020
2021
2022
2023
2024
2025
2026
2027
2028
Source: Macroeconomic Advisers by IHS Markit


Real GDP Growth by Recession Scenario
percent change annual rate
5.0
2.5
0.0
-2.5
-5.0
2018
2019
2020
2021
2022
2023
2024
2025
2026
2027
2028
Source: Macroeconomic Advisers by IHS Markit


Real GDP Growth by Recession Scenario
percent change annual rate
IHS Markit Base
Probabilistic
5
4
3
2
1
0
2018
2019
2020
2021
2022
2023
2024
2025
2026
2027
2028
Source: Macroeconomic Advisers by IHS Markit

# Unemployment Rate by Recession Scenarios

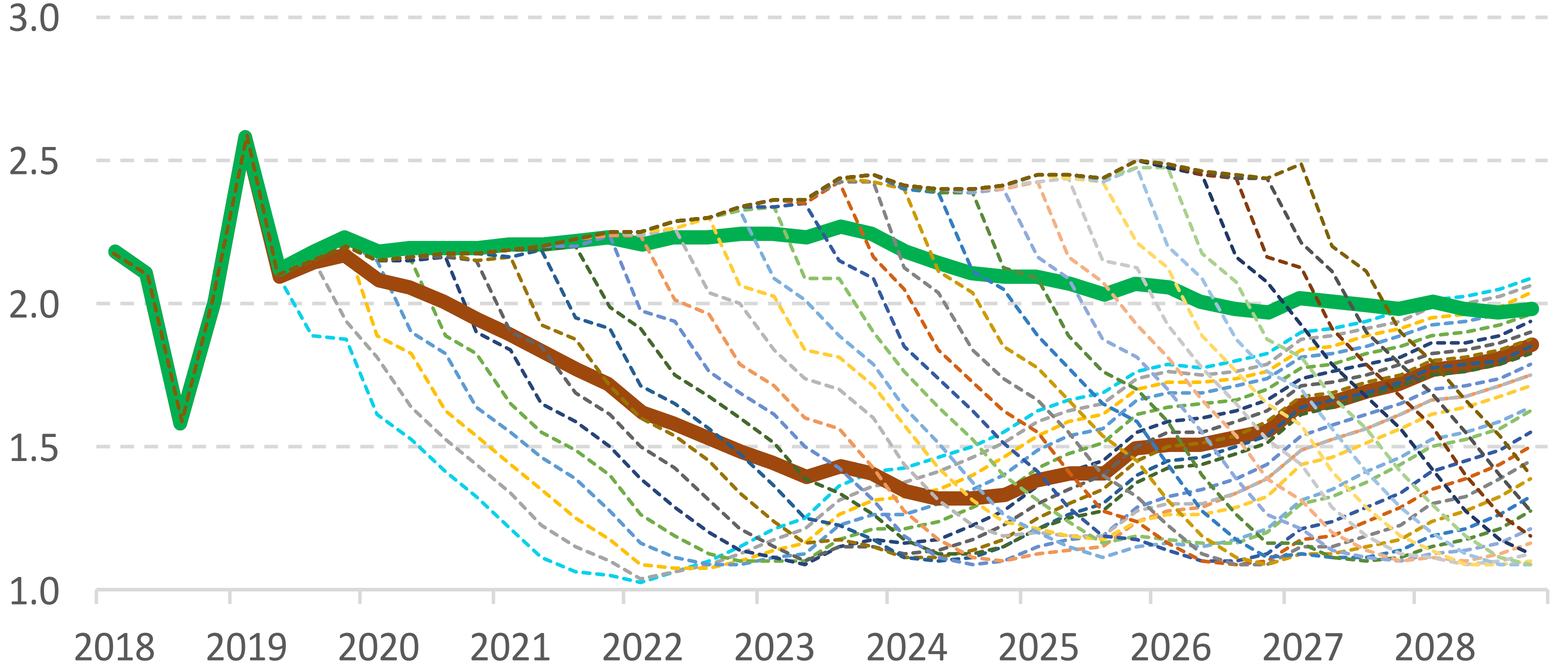
percent



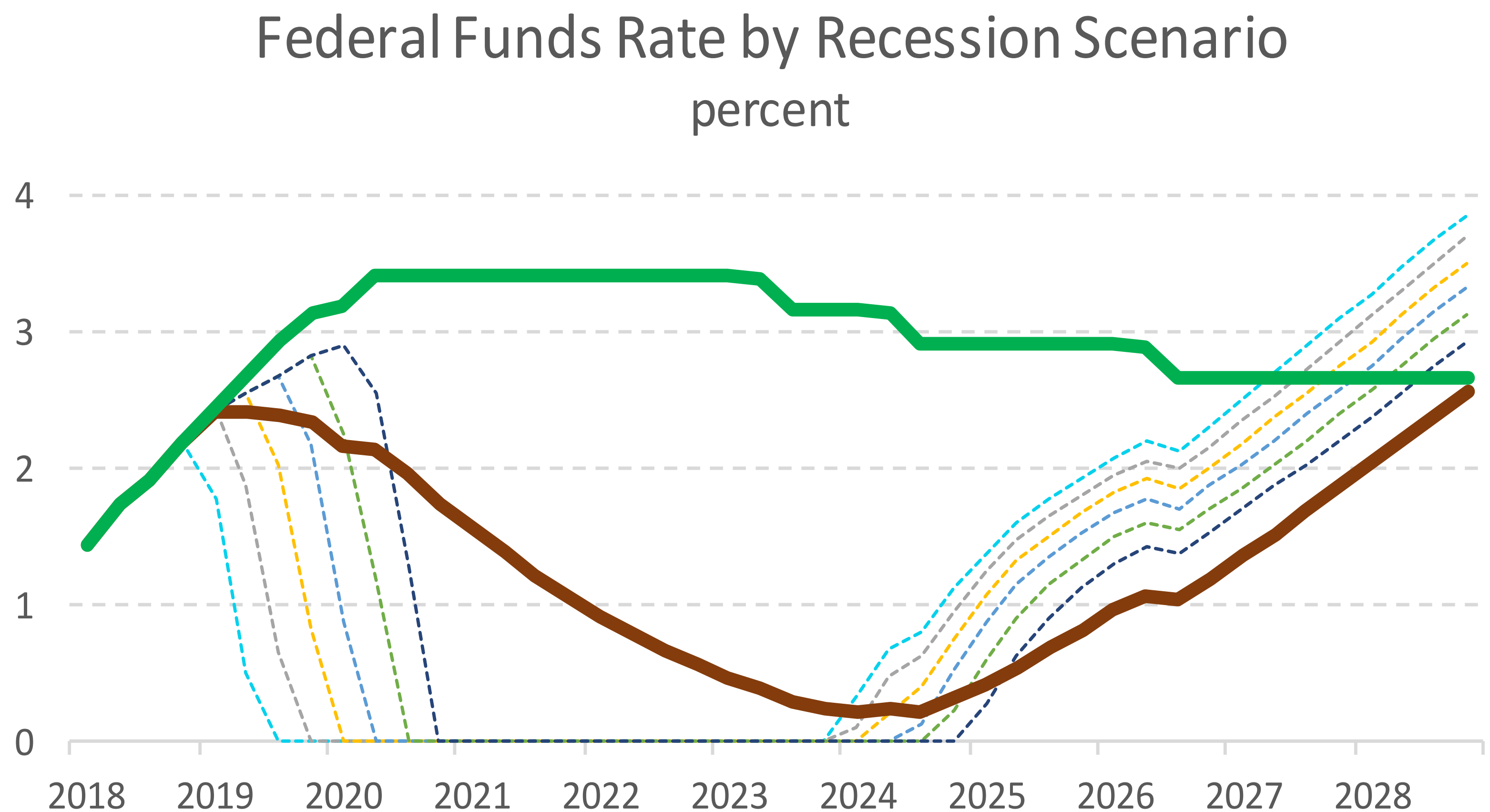

Source: Macroeconomic Advisers by IHS Markit

# Core PCE Inflation by Recession Scenario

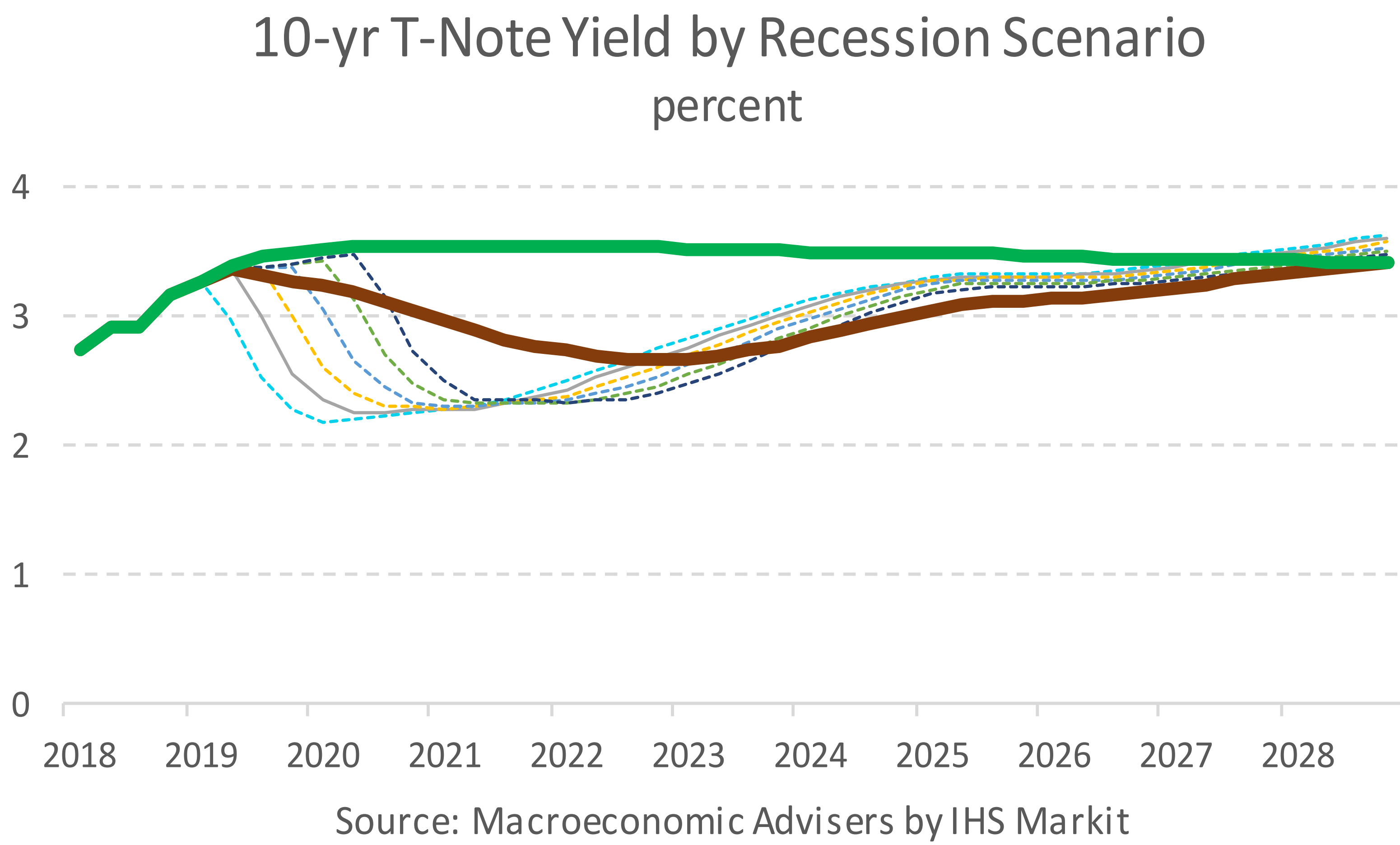
percent change annual rate



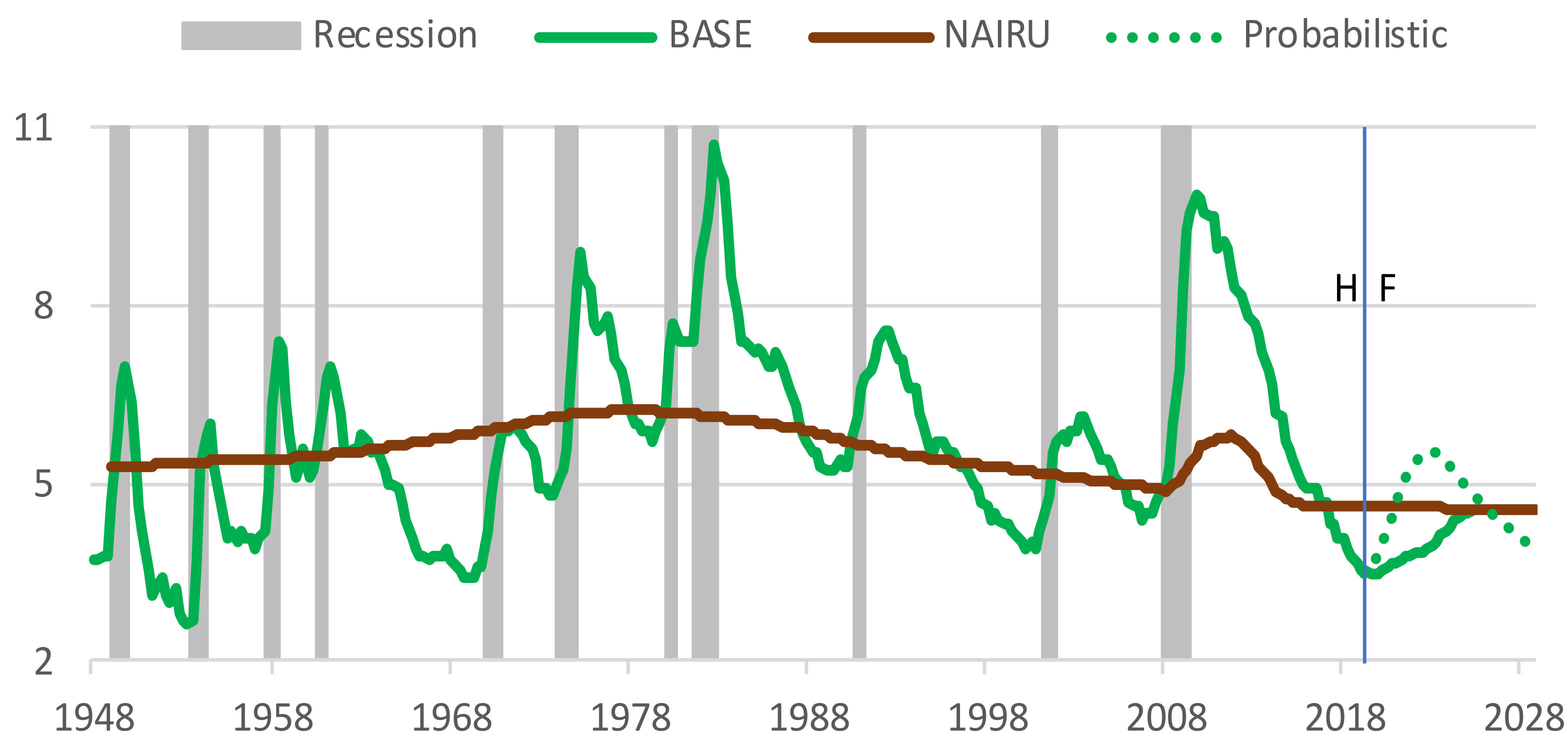

Source: Macroeconomic Advisers by IHS Markit




Source: Macroeconomic Advisers by IHS Markit


10-yr T-Note Yield by Recession Scenario
percent
4
3
2
1
0
2018
2019
2020
2021
2022
2023
2024
2025
2026
2027
2028
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.