The Daily Dish

Doing the Math on Pessimism

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Eakinomics: Doing the Math on Pessimism

"There's a 100% chance we're going to get another recession. In the next year, I do think trade holds the key, I think it's the key to the span. I think the key to the length of runway between now and the next recession, to a large degree, does relate to trade and hopefully we'll have some answer to that in the next few months." Liz Ann Sonders, Senior Vice President and Chief Investment Strategist at Charles Schwab & Co., Inc.

Sonders' sentiment is not that unusual at the moment. The return of genuine risk to the equity markets, in particular, has generated a lot of negative chatter among the Wall Street class that had been spoiled by easy money and suppressed volatility. And there is no question that the Trump Administration has blown an enormous opportunity. In the aftermath of tax reform and with continued restraint on the regulatory state, the economy was accelerating and optimism was high. But a year of Trump trade policy — a toxic brew of misleading statements, unpredictable pronouncements, confused/confusing negotiating tactics and some outright tariff harm — has taken its toll. Yesterday the latest data indicated that CEO confidence had fallen to levels not seen since 2016. In particular, "This month, 53% of CEOs surveyed said they would increase Capex in 2019—a low for the year, and down from 68% of those polled in November." Without a capex boom, there can be no sustained 3-percent plus growth.

But there is a big difference between growing less rapidly and a recession. There is simply no way to have a recession without the household sector (70 percent of spending) going south. To see this, suppose the remainder of the economy (business investment, residential construction, government, net exports) reverts to growing at the average rate since the economy bottomed out in June 2009. For the overall growth rate of gross domestic product (GDP) to fall into negative territory, (real) personal consumption expenditures (PCE) would have to fall by 1.1 percent. Between the third quarter of 2017 and the third quarter of 2018, PCE grew at a 3 percent annual rate, so this would require a downdraft of 4.1 percent!

Where would that come from? Unemployment is below 4 percent and wages are rising faster than inflation, leading to solid income growth. House prices are rising more slowly — but they are rising. Even the equity markets are roughly at a break even point for 2018 — not falling. Absent an implosion of consumer confidence, there is no way the fundamentals point to such a sharp downshift and near-term recession.

There are lots of things on the economic landscape to worry about — my anxiety closet is always chock-full — but the worry should be commensurate to the size of the risk.