THE STAN CLARK FINANCIAL TEAM'S

PERSPECTIVES

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Asset Allocation

MAYBE NOT A RECESSION, DESPITE NEGATIVE GROWTH

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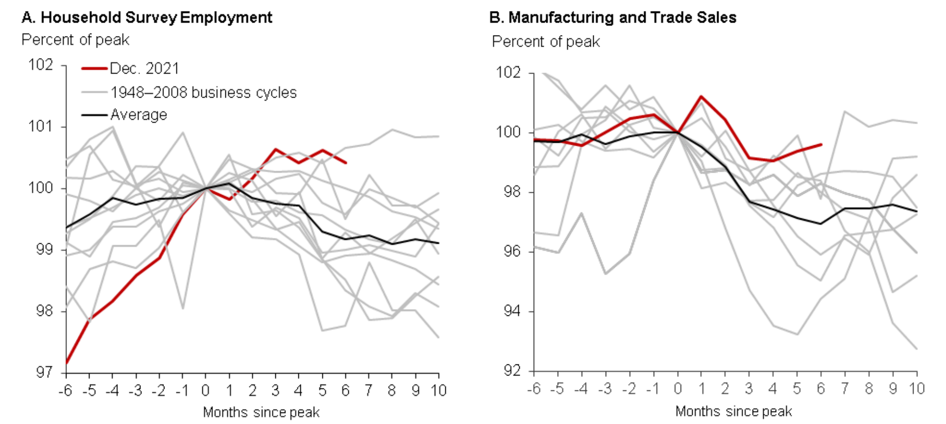
With slowing economic growth and rising interest rates, recession is a popular topic these days. Continuing the discussion from our recent *Mid-Year Review*, we thought it would be timely to delve a little deeper into this subject.

The layperson's definition of *recession* is two consecutive quarters of falling real economic growth. That's easy enough to measure and remember. However, sometimes the economy can drop for odd technical reasons that are not true indicators of economic weakness. The official determination of a recession is based on a broader look at the data – including the labour market, consumer and business spending, industrial production and incomes. For the U.S., the National Bureau of Economic Research (NBER) is the official scorekeeper, defining a recession as "a significant decline in economic activity that is spread across the economy and lasts more than a few months."

The tricky thing is that there are no fixed rules or thresholds that determine what, precisely, constitutes a decline. Also, there's a lag in the reporting of some economic data, so usually the NBER cannot say if we are in a recession until well after it starts.

In the U.S., the economy contracted 1.6% on an annualized basis in the first quarter of 2022 and was followed by a 0.9% decline in the second quarter. While this meets the simple definition mentioned earlier, there are arguments that the U.S. did not fall into recession. The Federal Reserve Bank of Dallas put out its argument for why this might be the case.

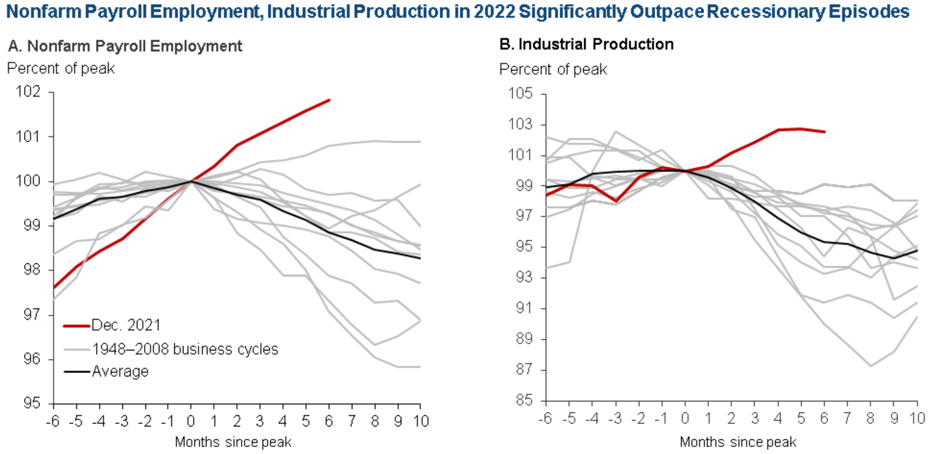
Alternate Measure of Employment, Goods Sales on Upper End of Recession Paths



NOTES: Horizontal axis "0" denotes peak of business cycle, with preceding and succeeding months depicted. Manufacturing and trade sales are measured in 2012 dollars.
SOURCES: Bureau of Labor Statistics; The Conference Board; National Bureau of Economic Research; authors' calculations.
Federal Reserve Bank of Dallas

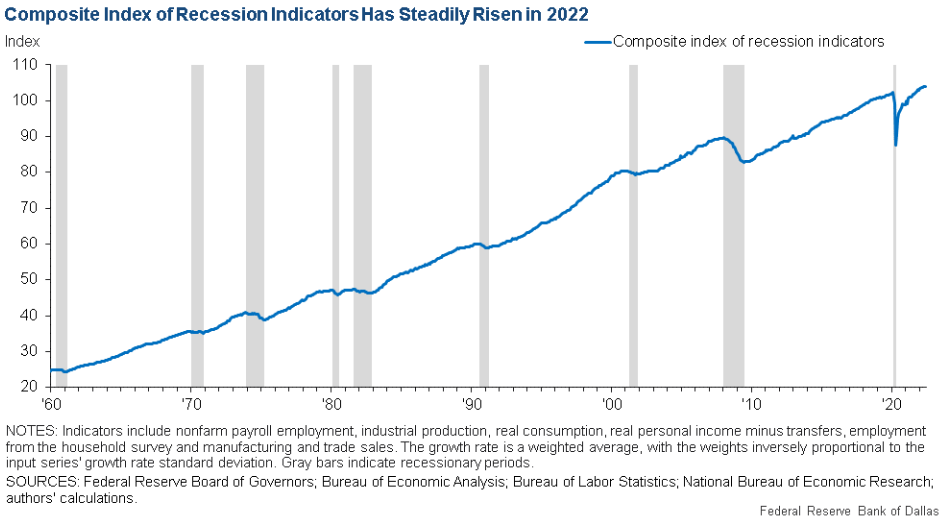
Employment and industrial production are two factors that NBER uses. The grey lines show the movements in previous business cycles. The black line is the average and the red line is what's happened in the past year. As you can see with the red lines, employment and industrial output have both been much stronger than in every previous recession at a similar point.

Nonfarm Payroll Employment, Industrial Production in 2022 Significantly Outpace Recessionary Episodes



NOTE: Horizontal axis "0" denotes peak of business cycle, with preceding and succeeding months depicted.
SOURCES: Bureau of Labor Statistics; Federal Reserve Board of Governors; National Bureau of Economic Research; authors' calculations.
Federal Reserve Bank of Dallas

This strength, not typical for a supposed recession, held for other measures, too.



While not as prominent as in Chart 1, the red lines remained at the higher end of the distribution and are much higher than average recession paths. Similar charts exist for consumption and income.

We can also look at a composite of recession indicators. The chart on the following page shows that, from 1959 onwards, there was a decline from the peak point in every recession. But there has been no decline in recent months.

But how to explain the contraction in the economy, despite positive economic indicators such as employment and industrial production? The contraction could be due to a number of things: lower worker productivity, drop in inventories, ongoing supply chain issues and the war in Ukraine. These could cause the headline numbers to go negative while the economy is still reasonably strong.

Recession talk in and of itself can have an impact on changing people's economic behaviour. Too much talk could even cause or worsen a recession. That's perhaps why policymakers are reluctant to use the "R" word, especially so close to the U.S. mid-term elections. On the other hand, concern over recessions can also help to reduce excesses, lessening any subsequent need to correct those excesses.

So what does all this mean? According to the Dallas Fed, a recession is unlikely to have started in the first quarter of 2022. Of course, going forward, things may change (for either better or worse), but the Fed's comment also tells us that things are not always as simple as they seem. The economic slowdown we've seen so far this year may not be the game-changing "official" recession so widely feared. If a real recession does shows up, hopefully it will be mild. It's also possible that we avoid a recession and instead enter a period of slower and more sustainable growth that dampens inflation expectations. This is exactly what the Federal Reserve, Bank of Canada and other central banks are trying to achieve by increasing interest rates, reversing quantitative tightening, and their "threats" to keep doing so until inflation is tamed. It's very tricky, like maneuvering a supertanker through an obstacle course, and only time will tell how successful they will be.

In any event, conflicting opinions are another reason why having a financial plan that is resilient and stress-tested through a range of scenarios – and then sticking to that plan – is key to your long-term financial success.

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