Recession risks for the United States in 2019

By Dean Baker
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As we reach the end of the year, the economic recovery in the United States is approaching a new record for duration. In June, it will have its tenth birthday, passing the 1990s recovery as the longest one in US history. While recoveries do not die of old age, they do die. The length of this recovery has many looking for recession prospects on the horizon. At the moment, they are not clearly visible.

Before examining the risks, it is worth saying a bit about the good news. The length of the recovery has allowed the unemployment rate to fall to 3.7 percent, the lowest rate in almost 50 years.

It is important to remember that many people, including many in policymaking positions at the Federal Reserve Board, did not want the unemployment rate to fall this low. They argued that the inflation rate would begin to spiral upward if the unemployment rate fell below 5.0 percent.

We hit the 5.0 percent level in September of 2015. The world would look very different today if the inflation hawks had carried the day and the Fed raised interest rates enough to prevent the unemployment rate from dipping below this 5.0 percent mark.

If we flip the story and looked at employment rates, the employment rate for prime-age workers (ages 25 to 54) was 2.5 percentage points lower in September of 2015 than it is today. That translates into another 3.2 million people with jobs.

Furthermore, the beneficiaries have been overwhelmingly the most disadvantaged in the labor market. The unemployment rate for African Americans has fallen by 3.3 percentage points in the last three years. For Hispanics, the drop has been almost 2.0 percentage points. For workers with just a high school degree, the drop was 1.7 percentage points, and for workers without a high school degree, the drop was 2.3 percentage points.

The tighter labor market has also meant rising wages for those at the middle and bottom of the income ladder. The average hourly wage was rising at just over a 2.0 percent annual rate in the fall of 2015. In the most recent data, it was rising at a rate of slightly more than 3.0 percent.

Based on this acceleration in wage growth, it reasonable to speculate that wages for workers at the middle and bottom end of the labor market are 1.0-1.5 percent higher than they would have been if the Fed had slammed on the breaks back in 2015. While that may not sound like a big deal, for a worker earning $40,000 a year, that could be another $600 a year in wage income.

In aggregate, if a tighter labor market raised wages for the bottom half of the workforce by 1.5 percentage points, this translates into roughly another $50 billion a year in higher wages for this group. If we assume that most of the 3.2 million new jobs went to people in the bottom half, that amounts to another $90 billion in wage income. It is very hard to envision a new or expanded social program that gives $140 billion a year to people in the bottom half of the income distribution.

But enough of the good news, what about the next recession? Everyone keeps looking back to the last recession and trying to identify a bubble that will burst, causing another financial crisis and sinking the economy. Fortunately, there is no serious story here.

Many analysts point to the corporate bond market where there has been a large expansion of risky debt. While it is totally plausible that much of this debt will default if the economy slows, there is just not the same basis for the

sort of downward spiral we saw with the collapse of the housing bubble.

In worst case scenarios, the holders of this debt take a hit of $300-$400 billion. That's bad news for them, but in an economy with close to $100 trillion in assets, that is not the stuff of recessions, much less major financial crises.

The stock market continues to be high by historical standards and could quite plausibly drop another 10 percent. This would be a hit to the wealth of many high- and upper middle-income people. But unlike the late 1990s, the stock market is not now driving the economy. The lost consumption as a result of diminished stock wealth would dampen growth by perhaps 0.5 percentage points at the low end, to 1.0 percentage points at the high end. Such loss would not drop the economy into a recession.

Housing prices are high, as I have noted in the past, but they seem driven by the fundamentals in the market, which are also driving up rents. Furthermore, construction has remained weak in this recovery, so there is not much room to fall, unlike in the bubble years.

With no obvious bubbles to burst, this leaves rate hikes from the Fed as the most likely source of the next recession. The Fed's rate hikes to date have undoubtedly had the effect of slowing growth. This is most evident in the housing market where most data on sales and construction are down from year-ago levels.

The Fed's rate hikes have also helped to push up the value of the dollar, which has increased the trade deficit. Higher rates have also played some role in dampening private investment as well as infrastructure investment by state and local governments.

The Fed has been reasonably cautious to date. Past rate hikes are unlikely to sink the recovery. Hopefully its caution will continue and it will allow workers to get further gains from a tight labor market. But if I had to take a bet as to what would be the cause of the next recession, it would be the Fed. After all, excessive rate hikes by the Fed have been the cause of most prior post-war recessions. They will also be the most likely cause of the next one.