Slumpy new year

Signs of the recession to come. Unless it never arrives.

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Hi Quartz members,

One swift way to sober up in the first days of the new year was to look at the headlines in the financial press, most of which asked versions of the same question: Will 2023 be the year of a recession?

Consensus is, to say the least, elusive.

A Wall Street Journal survey of economists at 23 large financial institutions showed that two-thirds of them predict a recession this year. “A recession is foretold,” BlackRock Investment Institute said, in a rather Shakespearean vein. But some major banks, including JPMorgan Chase and Goldman Sachs, said the US would sidestep a recession not only this year but next. Most banks believe any forthcoming recession will be mild, but Ned Davis Research put the chances of a severe global downturn at 65%. No one ventured thoughts about the physiognomy of any potential recession: double-dip or single, V-shaped or U-shaped.

The release on Wednesday (Jan. 4) of the minutes of the Federal Reserve’s December meeting darkened the mood further. The Fed has only inflation in its gimlet gaze, and it doesn’t want markets to think blithely that its focus is easing. No one at the meeting thought it likely that the Fed would drop interest rates in 2023.

There’s a line of thinking that all the muttering and fretting about recession (including the muttering of this Weekend Brief!) turns into a self-fulfilling prophecy: Worry enough about tough times to come, and you’ll start cutting spending and laying off workers, bringing about those selfsame tough times you’d worried about. (And of course, the annual extravaganza of muttering-and-fretting kicks off at the World Economic Forum in Davos next week. Sign up for our pop-up Davos newsletter here.) If there’s any truth to this theory, we’re in trouble. Few people in the wider economy seem to be thinking about anything other than the prospect of a recession.

And while it’s true that there are recessions and there are recessions— and no one expects a 2008-style meltdown this year—every one of them hurts. On average, recessions since 1945 have resulted in economic contractions lasting 10 months, with unemployment rising 3.8%, translating to nearly 6.4 million lost jobs. Corporate profits, again on average, fell 15%. Self-fulfilling or not, unexpected or not, mild or not—if a recession comes, the damage will be real.

THE NAYSAYERS

The vast majority of banks are predicting a recession in 2023, and some in 2024. But not everyone is taking this bet. Goldman Sachs, notably, argued last November that the Fed would achieve its ideal soft landing: slowing the labor market without plunging the economy into a recession.

But this is a delicate feat. To achieve it, the demand for labor would have to decrease, as seen in falling job openings and wages. At the same time, the economy would have to avoid a sudden rise in the unemployment rate.

Goldman Sachs analysts also expect goods deflation to lead the way in cooling inflation. This was certainly true in November. Further, the analysts believe that the personal consumption expenditure price index will fall from its present 5% to 3% by December 2023.

A soft landing will still entail a slowdown, though, and consequent damage to the economy. The recent contraction, for instance, has significantly slowed the number of homes that the US is building, which will only worsen the housing shortage.

Moody's Analytics is predicting a "slowcession": an awful, clunky term for a situation in which growth comes nearly to a standstill but never turns negative, as in a recession. Moody's makes this prediction partly on the strength of healthy household balance sheets, record profits for American businesses, and the overall strength of the labor market, even as labor growth slows steadily as inflation drops. Degree by degree, in this way, the US may yet steer away from the cataract.

CENTRAL BLANKING

Inflation is the result of the battle of distribution, former IMF chief economist Olivier Blanchard observed recently on Twitter. Prices move because companies, workers, and taxpayers duke it out to get themselves the better deal in an economy.

Traditionally, the institution that suspends the battle between workers and companies is a country's central bank, which raises interest rates to bring inflation down. "By slowing down the economy, [the Federal Reserve] can force firms to accept lower prices given wages, and workers to accept lower wages given prices," Blanchard wrote.

But interest rate hikes are, in fact, an inefficient way of dealing with this conflict. One would hope, Blanchard wrote, that the constant negotiations between workers, companies, and the state can produce outcomes "without triggering inflation and requiring a painful slowdown."

These inflation fights are particularly painful when they hit food and energy prices, Claudia Sahm, a former Fed economist, wrote in agreement with Blanchard's points. (In her Substack, Sahm included a still from the movie *Fight Club*. Blanchard had stirred up a battle.) "Outrageously, we leave fighting inflation to the Fed alone," she wrote. "An unelected, unaccountable group decides who wins and loses."

The current framework for dealing with inflation is "falling woefully short," Sahm added. But other arms of the government can intervene as well. Congress, for instance, can decide that it will subsidize energy prices and tax excessive profits. The White House has shown that it can tackle inflation by releasing oil from the Strategic Petroleum Reserve and buying oil futures contracts to subsidize production down the line, generating government revenue in the process.

Pushing macroeconomists to become more creative about inflation, Sahm has written, should include banning the Phillips Curve. For more than 60 years, this dubious economic model has argued that the answer to bringing down inflation lies in letting unemployment go up. This is a dangerous notion that inflicts pain on millions of people—precisely the kind of pain that any coming recession will bring with it.

ONE $ THING

In the mid-1980s, a young Canadian student named Campbell Harvey, then at the University of Chicago, wrote his PhD thesis on the US business cycle. Looking back at four earlier recessions, Harvey found that they'd all been preceded by a yield curve inversion—a situation in which short-term interest rates exceed long-term rates. This happened so reliably, Harvey realized, that the yield curve could function as an indicator of a recession around the corner.

Since then, the indicator has forecast another four recessions correctly. More impressive still, as Harvey, now an economist at Duke University, told the college paper, it has never raised a false alarm, calling a recession when there was none.

Except: It's doing so now, according to Harvey himself. The yield curve has been inverted since November, but "I have reason to believe," Harvey told Bloomberg, "that it is flashing a false signal." Perhaps, he ventured, people are adjusting their spending and saving behavior to the inversion quickly enough to help the economy avoid a recession. Or perhaps this particular job market still has enough demand for workers. "When you put all this together," said Harvey, contradicting his model that has never been wrong so far, "it suggests we could dodge the bullet."