US Macroeconomics

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Why Recession Still Cannot Be Ruled Out

The Kansas City Fed created two labor market condition indicators which make use of 24 labor market variables. Details can be found here: https://www.kansascityfed.org/data-and-trends/labor-market-conditions-indicators. The series are shown in separate charts below. Readings above zero mean that labor market conditions are above their long-term average and vice versa. Right now, both series are flashing trouble ahead.

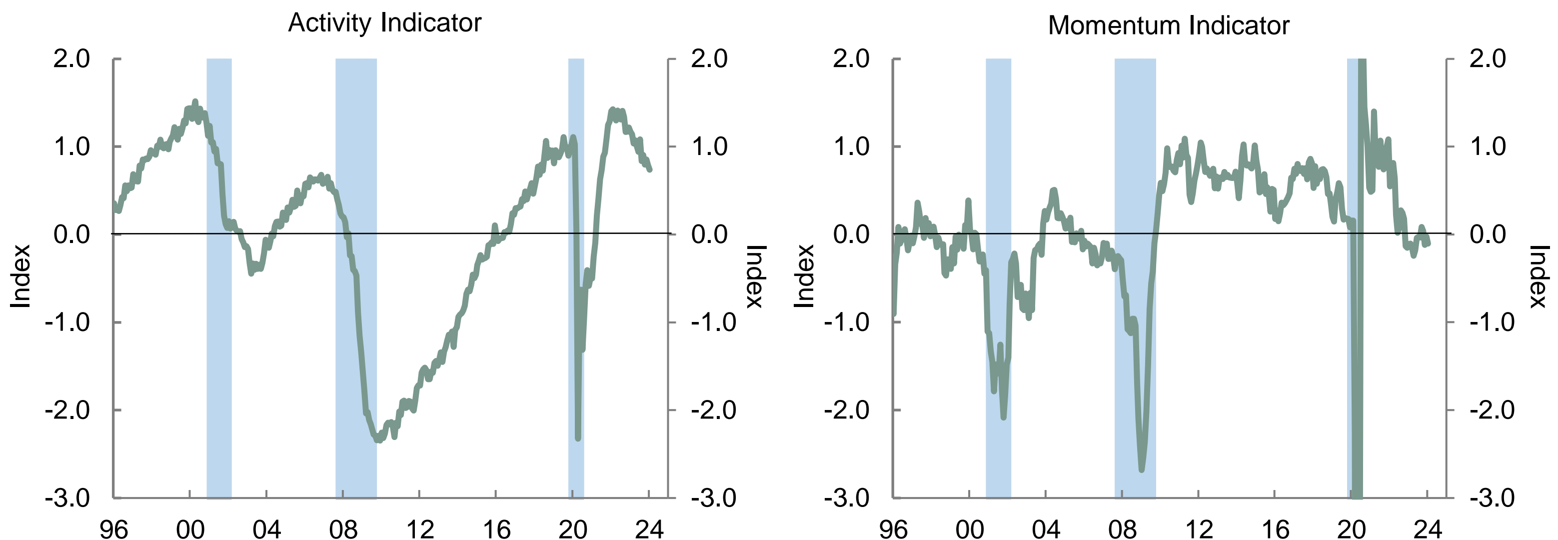
In January, the activity indicator registered a 0.737 reading, its third decline in the last four months. Over the last 12 months, activity is down by a sizeable 40 basis points. And excluding the pandemic, the current reading is the lowest since June 2018. But then, the series was in a sharp uptrend, not a sharp downward as it is now.

When activity has slowed for this long and by this much in the past, the labor market was either in recession (August 2001) or about to enter one (August 2007). For the record, the economy entered recession five months later in January 2008.

Furthermore, current labor market activity is not consistent with either 3%-plus Q4 2023 real GDP growth or a 353k increase in January nonfarm payrolls. Either activity will turn up or the economic data will turn down. Based on labor market momentum, the latter is more likely.

The Kansas City Fed momentum indicator was -0.104 in January versus -0.024 in December. This is the third negative reading in a row and places the January level about 30 bps below its the trailing 12-monnth moving average. Normally if the jobs market is on the cusp of accelerating, the rate of change on the various labor market indicators would be positive. But momentum suggests the exact opposite.

Negative momentum is worrisome because it does not reverse unless the Fed preemptively cuts rates or there is a recession. The latter spawns fiscal and monetary stimulus. For example, negative momentum was reversed after the Fed began cutting rates in July 1995 and September 1998. But monetary accommodation was insufficient in preventing downturns in 2001 and 2008.



Source: Kansas City Fed, Haver, SMBC Nikko

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