

US Macroeconomics

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The Fed’s Wishful Thinking

Whenever the unemployment rate begins its ascent, it will almost certainly breach 5%. There have been 11 recessions since 1945 excluding the 2020 pandemic-related downturn. In eight instances the unemployment rate troughed below 5%. These periods were 1948, 1953, 1957, 1960, 1969, 1973, 2000 and 2007. Only three times did the rate not break below 5%. These periods were 1979, 1981 and 1989.

The unemployment rate is shown in the chart below along with recession bars and a horizontal line at 5%. **The Fed’s current forecasts are inconsistent with history.**

Over the next 18 months, monetary policymakers have central tendency predictions on unemployment from 4.3% to 4.9%. The range of forecasts, which includes outliers on both sides of the distribution, still only goes from 4.0% to 5.2%. These estimates are much too low for an upcoming recession.

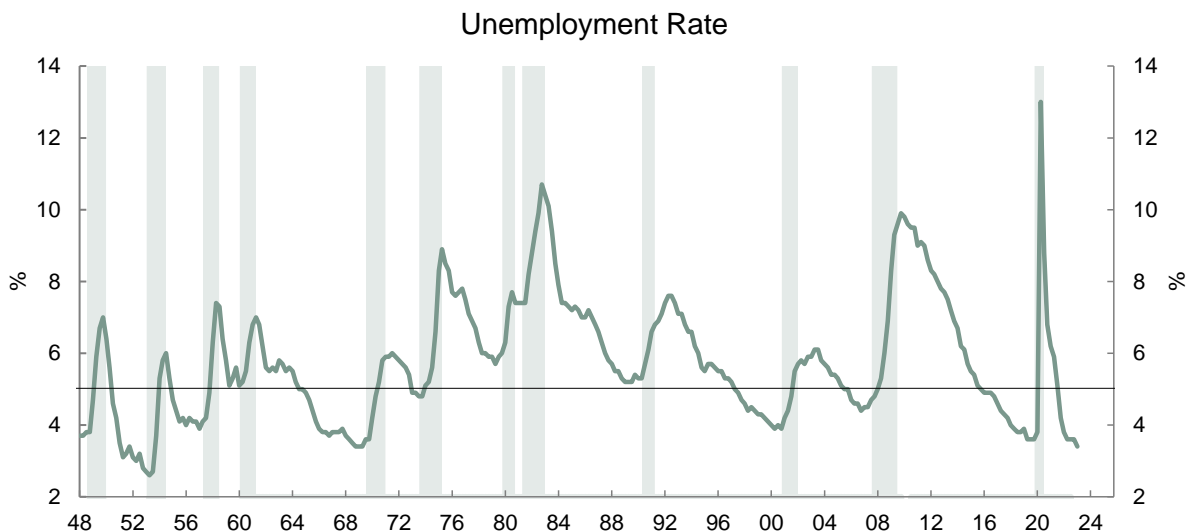
As we can see in the chart below, **the lowest peak in the unemployment rate was 6.1%**, which happened two times — once in 1954 and again in 1969. The next lowest peak occurred in 2003, when the unemployment rate topped out at 6.3%.

These increases began from low levels (2.5% in 1961, 3.4% in 1969 and 3.8% in 2000), like where the labor market is today. The current unemployment rate is just 3.4%, a five-decade low. When unemployment begins to move up, it moves up a lot. Are there caveats? No.

Some may argue that today’s low labor force participation rate means that we will avert a similarly large increase as in the past. But participation was substantially lower in all the business cycles prior to 1980 and yet unemployment soared when the US entered a downturn anyway.

Others may argue that unemployment will not go up much if we experience only a “mild” recession. But this happened in 2001 and unemployment went from 3.8% to 6.3%.

It is time for the Fed to sharpen its pencils and redo its forecasts ahead of next month’s forecast update.



Sources: BLS, NBER, Haver, SMBC Nikko

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