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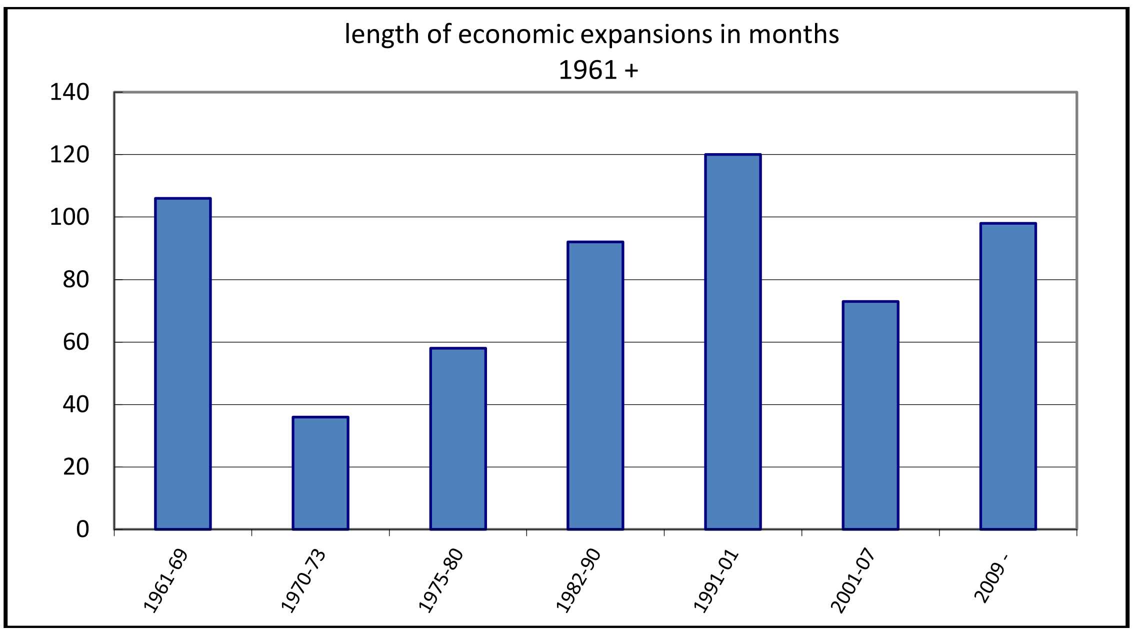
Getting Old or Just Getting Going?

This summer the US economy reached a milestone of sorts, entering its ninth year of expansion and fast approaching the second longest period of uninterrupted growth on record. To casual observers with a penchant for seeing the glass as half empty, this long expansion is now long overdue for a downturn, better known as a recession. The reasoning is simple to a fault: old age.



source: National Bureau of Economic Research

In a recent article, Alan Blinder, professor of economics and public affairs at Princeton University, and former vice-chairman of the Federal Reserve, views things differently. In his piece titled "More Sunny Days Are Likely Ahead for the U.S. Economy", Professor Blinder explains that expansionary periods do not usually die of old age.

This is where most pundits slip in the qualifying ‘but’, explaining why this time is different.

But Professor Blinder is more optimistic. Excerpted here, from The Wall Street Journal, he writes:

> Every op-ed should have a simple take-away, one that's easy for readers to remember. Here's mine: Economic expansions don't die of old age -- they go on until something kills them.
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> … The good news is that the end isn't nigh: Economic indicators suggest growth will continue for the foreseeable future. These signals aren't entirely reassuring, however, because recessions can't be predicted well in advance. But economists do understand how they begin and end. Therein lies the better news: No serious threat is in sight.
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> The most common cause of U.S. recessions in the postwar era has been monetary tightening by the Federal Reserve as a means to fight inflation. If policy makers execute perfectly, they can engineer a "soft landing" from today's low interest rates. That's what the Fed did in 1994-95, when skillful monetary tightening led into a boom. More historical instances of Fed tightening, however, have been followed by recessions. In some cases central bankers actually sought that outcome, as when Paul Volcker sent interest rates skyrocketing to vanquish inflation in the 1980s. In others, they just goofed.
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> Will the Fed kill the current expansion? That seems unlikely. There's no inflation in sight. Janet Yellen and her colleagues are trying to extend the good times by raising interest rates as gradually as possible, ready to pull back if signs of a slowdown emerge. The Fed is fallible, obviously; it could make a mistake. But I doubt it would be a big one.
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> Other recessions have been caused by "oil shocks" -- sharp increases in oil prices that hurt businesses and consumers. Big oil shocks preceded the world-wide recessions in 1973 and 1979, spurred by the Arab oil embargo and then the Iranian revolution.
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> Will an oil shock end the current expansion? Your guess is as good -- or, more accurately, as worthless -- as mine. Oil shocks are unpredictable. That said, neither markets nor experts seem to expect one.
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> What about a financial ruction of some sort, such as a stock-market crash? Many of today's worry warts focus on the long and allegedly excessive run-up in stock prices since 2009. I won't enter the debate over whether stocks are overvalued, because no one can predict the market. But a far simpler point is germane: It takes one hell of a stock-market crash to cause a recession.
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> Recall the way the economy reacted when the tech bubble burst in 2000-02. The Standard & Poor's 500 fell by almost half, and some $9 trillion of wealth was wiped out. But the subsequent recession lasted only eight months and was so mild that annual data show no drop in real gross domestic product.
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> What about 1929? Didn't the Great Crash beget the Great Depression? Not quite. The stock collapse was one of many causes of the Depression -- and by no means the most important.

In their monumental "Monetary History of the United States," Milton Friedman and Anna Schwartz placed more blame on the Federal Reserve, which allowed the supplies of money and credit to contract violently. Ben Bernanke echoed that criticism while serving as a Fed governor in 2002, when he said at Friedman's 90th birthday party: "You're right, we did it. We're very sorry. But thanks to you, we won't do it again."

If any financial calamity does derail the current expansion, it will be more likely to emanate from the credit markets -- as happened in both the Great Depression and the Great Recession. Fortunately, there are few signs of credit markets behaving badly, unlike in 2007. Households and businesses are less leveraged, banks hold a lot more capital, and financial regulations are much tougher.

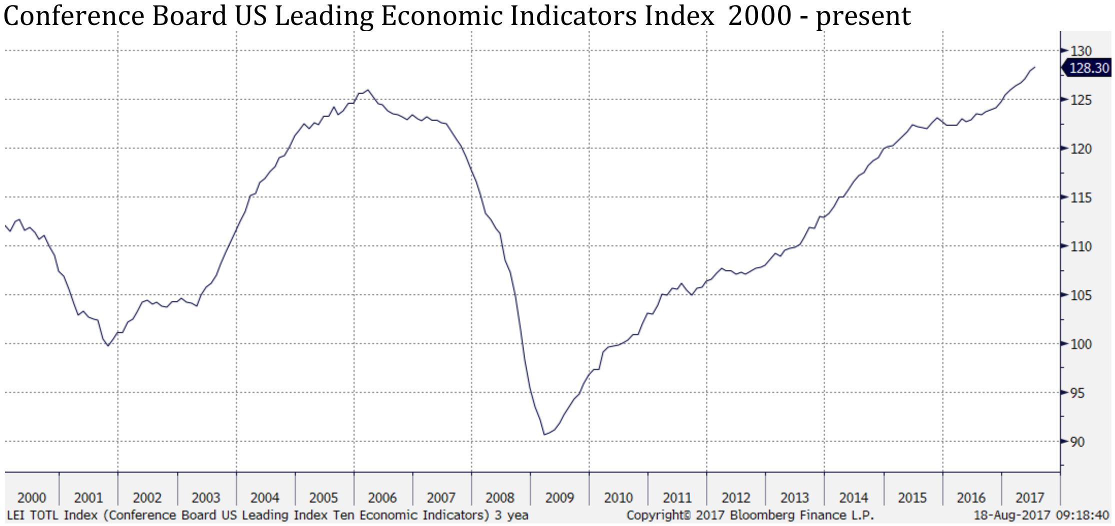
What's left on the worry list? Every once in a while, for reasons that become obvious only after the fact, something shakes consumer or business confidence, causing spending to plummet. When that happens, a recession is all but inevitable. Right now, Americans and companies are both feeling sunny. But as storm clouds gather over North Korea and investigations threaten the White House…

As I said, expansions don't die of old age -- they go on until something kills them.

With superb timing, on the same day of Professor Blinder's reassurances, the index of leading indicators was released, rising a healthy 0.3 percent in July, following June's 0.6 percent increase.

Less widely quoted is the index's overall level, now at all-time highs. The significance of this is that the index has turned lower at least eight months ahead of every recession since 1962. It gives us fair warning. Few Wall Street economists cite this index, probably because it is so simple that anyone can use it, calling into question the value of economists' predictions.

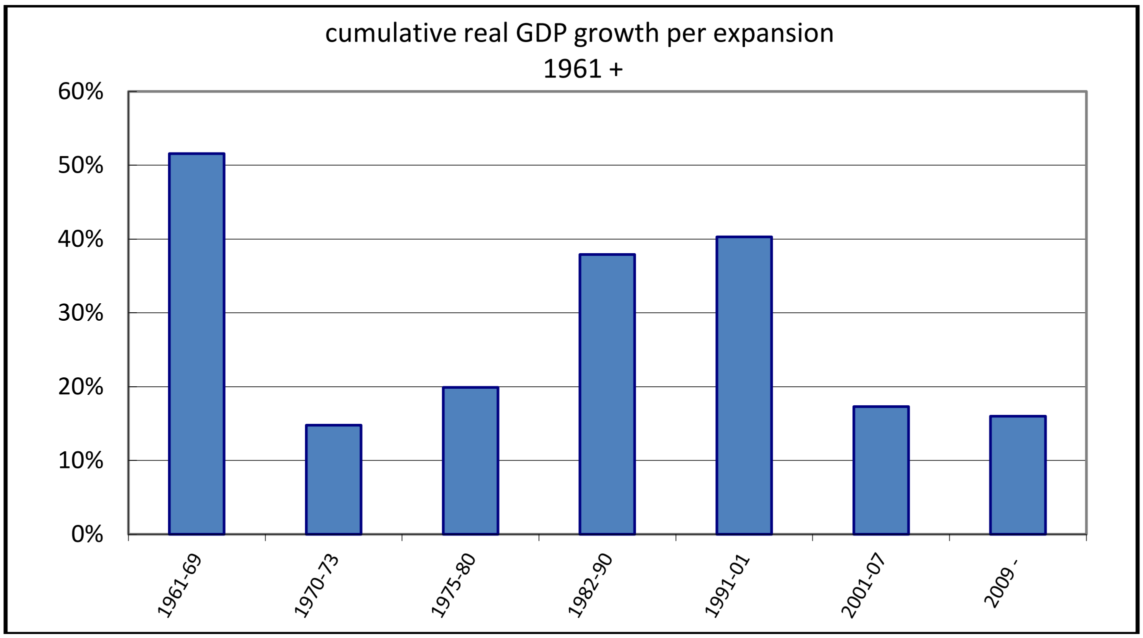
Conference Board US Leading Economic Indicators Index 2000 - present



So, what are we to make of this elongated period of growth?

One theory holds that economic expansions should be measured not in time, but in cumulative growth and rate of growth. If an economy doubles in size over a 10-year period, over-heating should be a concern. If the doubling takes 30 years, don't worry, be happy. The current expansion is closer to the latter pace. Indeed, our economy still has not matched the cumulative growth attained in the six-year expansion wedged between the tech bubble's bursting and the financial crisis -- an expansion considered sub-standard by most measures.

While far from ideal, slow and steady growth might provide an expansion that continues on for much longer than usual. At the very least, we should stop worrying about our economy dying of old age.



figures are estimates, using annual GDP data

Source:
Bloomberg
National Bureau of Economic Research
The Wall Street Journal

Tidbits..

Organization for Economic Cooperation and Development forecasts all 45 of world's major economies expanding in 2017, first synchronized growth in 10 years.
Japan's economy expands for six consecutive quarters, longest growth streak in 11 years.
US GDP growth rate hits three percent, highest level in two years.

Dow Jones Industrial Average records lowest sustained volatility since 1995.
Investment-grade bond inflows reach record levels in search for yield in low rate environment.

Auto maker Volvo plans to phase out internal combustion engine, offer only fully electric or hybrid vehicles beginning 2019.
Audi launches new A8 sedan with world's most advanced autonomous driving features, claims "The driver no longer needs to monitor the car permanently."
Tesla rolls out model 3, mid-priced electric vehicle in search of broader market, profitability.

Seattle, WA city council approves income tax on the wealthy, in a state that prohibits income taxes.
Hartford, CT debt rating is downgraded to junk status.
Large US public pension plans are underfunded by 30 percent, Wilshire Consulting study says.
If 30 percent sounds worrisome, just wait for the next bear market.

President Trump signs executive order meant to streamline infrastructure project permitting, reversing Obama-era policy.
Taiwan manufacturing giant Foxconn Technology Group to build multi-billion-dollar plants in Wisconsin and Michigan.
Toyota and Mazda plan new auto production facility in US, expect to create 4,000 jobs.
Ohio utility American Electric Power to invest 4.5 billion dollars in Oklahoma wind farm project.
Industrial America re-awakening.

White House Strategy and Policy Council, and Manufacturing Jobs Council, comprised of US business leaders, disband amidst exodus of high profile members.
Senate Republicans abandon health care reform efforts.
Same old swamp, different color.

Federal regulators begin revision of Volcker Rule restrictions on bank trading activity.
Home equity lines of credit regain popularity, reach highest level since 2008, as households again tap into rising home values.
In lieu of higher incomes, borrow.

Amazon completes acquisition of Whole Foods, immediately cuts prices.
Newly-approved Novartis cancer treatment comes with 475,000-dollar price tag.