

US Macroeconomics

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Unemployment Doesn't Walk, it Runs

Investors hoping for a soft landing cite the tight labor market — the unemployment rate is just 3.5% — as a reason to downplay recession risks. At the same time, the tight labor market worries some Fed policymakers that inflation will remain elevated because of rising wage demands. If so, the fed funds rate needs to move higher and stay there. No doubt the behavior of unemployment is central to the broader economic and financial outlook.

The chart below shows a long history of the unemployment rate along with recessions (denoted by the blue bars). One feature of the graph should immediately jump out. **When the unemployment rate rises, it does so quickly and sharply from its cyclical low.**

There have been 10 recessions in the post-war period excluding the 1980 and pandemic-recessions, which are not considered in our discussion because of their unique characteristics. While the unemployment rate is a leading indicator of economic downturns, the rate does not have to increase much to signal recession.

Over the last 10 business cycles, **the average increase in the unemployment rate from its cyclical low to the peak in economic activity has been just 0.4%**. In one instance, the trough in the unemployment rate coincided with the onset of recession. This happened in June 1981 when unemployment fell to 7.2%, and economic activity peaked in the following month with a steady unemployment rate.

Over the remaining nine business cycles, there were two episodes (1953 and 1969) when the unemployment rate increased only a tenth before onset of recession. Another time (in 1973) the rate increased just a couple of tenths ahead of recession. Then there were three instances when the rate rose 0.4% before recession (1948, 1957, 1960).

The last few recessions have experienced slightly larger increases before the peak in real GDP. The unemployment rate increased half of a point ahead of the 1990 and 2001 downturn, and there was a 0.6% increase ahead of the 2008-09 downturn.

With one exception, the unemployment rate rises before the economy peaks. But the initial increase is not particularly large at just 0.4% on average. This suggests to us that whenever the next downturn begins, most people will not notice until it's too late.



Source: BLS, NBER, Haver, SMBC Nikko

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