

# Just Because You Call It a Recession Doesn't Make It One

June 14, 2021

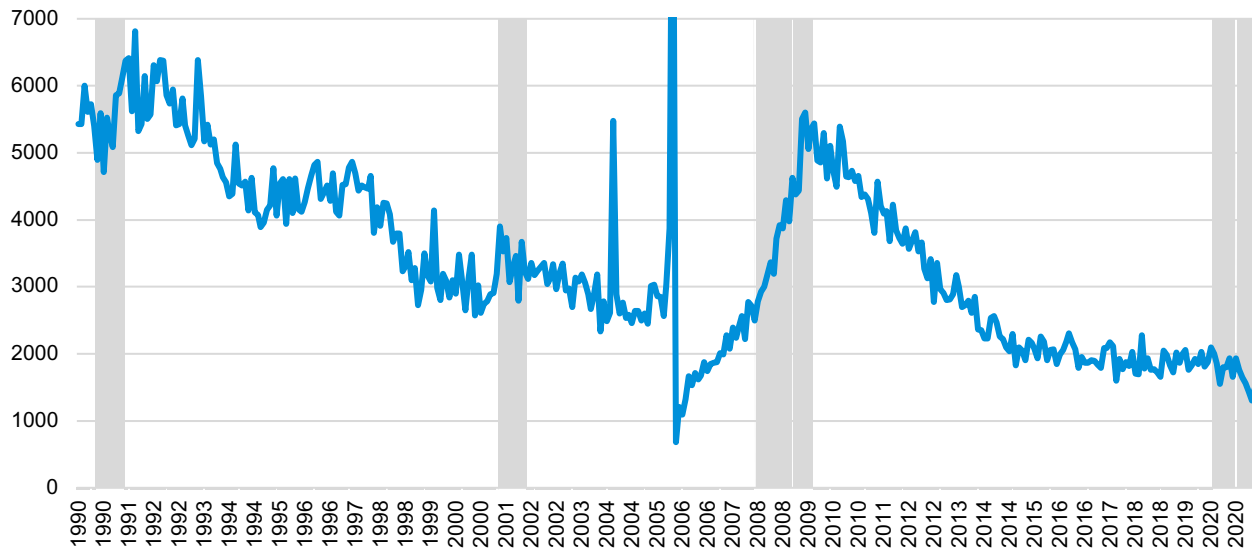
Recessions, though painful, can have positive longer-term effects on economies through the process of creative destruction. Weak, unprofitable (and unproductive) firms go out of business. Workers at those firms and at others where they were not employed to good use, are pushed into a labor force whose demand is driven by the surviving, stronger, more profitable firms. In short, the economy post-recession is typically better than the economy heading into a recession.

At the end of 2019 we were expecting a recession to begin in 2021. Economy-wide margins, which had peaked just under 13% had fallen to just under 11%, historically a sign that firms would soon begin to adjust to strategies restraining expenses to limit that decline.<sup>1</sup> Payroll growth had decelerated marginally in 2019 even as the unemployment rate continued to grind lower over the course of the year.<sup>2</sup> The Fed's balance sheet had been reduced from a peak of just under 25% of GDP to under 19%<sup>3</sup> and the Fed funds rate, which had peaked at 2.375% and had been reduced during the summer of 2019, stood at 1.625%.<sup>4</sup> Marketable government debt-to-GDP at the end of 2019 was just under 77%.<sup>5</sup>

The COVID-19 recession did not have a true historical precedent. Although GDP growth turned to -5.0% q-o-q, annualized in the first quarter of the year<sup>6</sup>, the decline was the result of a government-imposed "lockdown" which caused economic activity in the second half of the last month of the quarter to collapse. The second quarter of 2020 represented the peak decline in activity, at an astounding decline of -31.4% q-o-q, annualized in real terms<sup>7</sup>. As economic actors began to figure out how to operate within the set of imposed restrictions on social activity, the economy began to recover in May and growth was +33.4% q-o-q, annualized in the third quarter of the year<sup>8</sup>. Since then, growth has remained above the historical trend rate, the result of Federal Reserve actions, government stimulus and ongoing economic reopening primarily linked to the domestic COVID vaccination program.

Although those actions to stimulate the economy likely helped limit the scope and scale of the downturn, in doing so they inhibited the death of already struggling firms and acted to keep employees at organizations that, in a normal recession, likely would have failed. Additionally, stimulus also kept the consumer spending on goods throughout the downturn, a highly unusual development. A decline in spending on expensive items that may be purchased with credit tends to lead into recessions with significant recessions also seeing the growth in spending on services fall to around zero. This recession saw a brief decline in spending on goods but a sustained decline in spending on services as lockdowns limited the ability of the consumer to engage the service sector as they normally would.

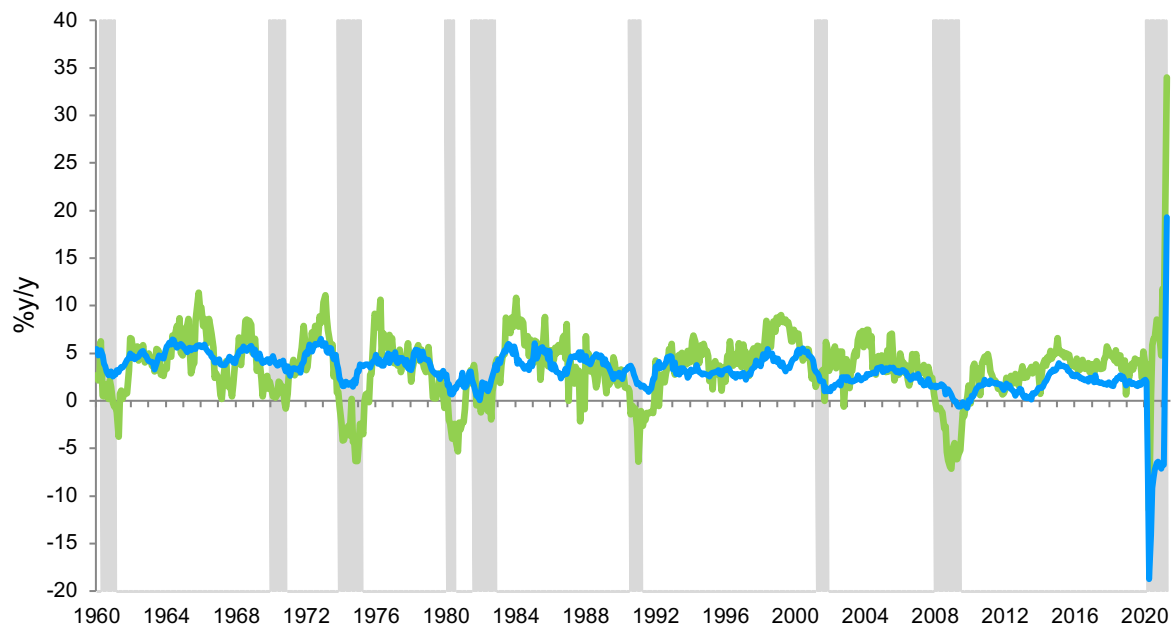
## Bankruptcies have fallen during this recession



Note: Gray bars denote recessions.

Source: Administrative Office of the U.S. Courts, NBER and MIM

## Consumer spending by type of good shows unusual spending on goods during the recession



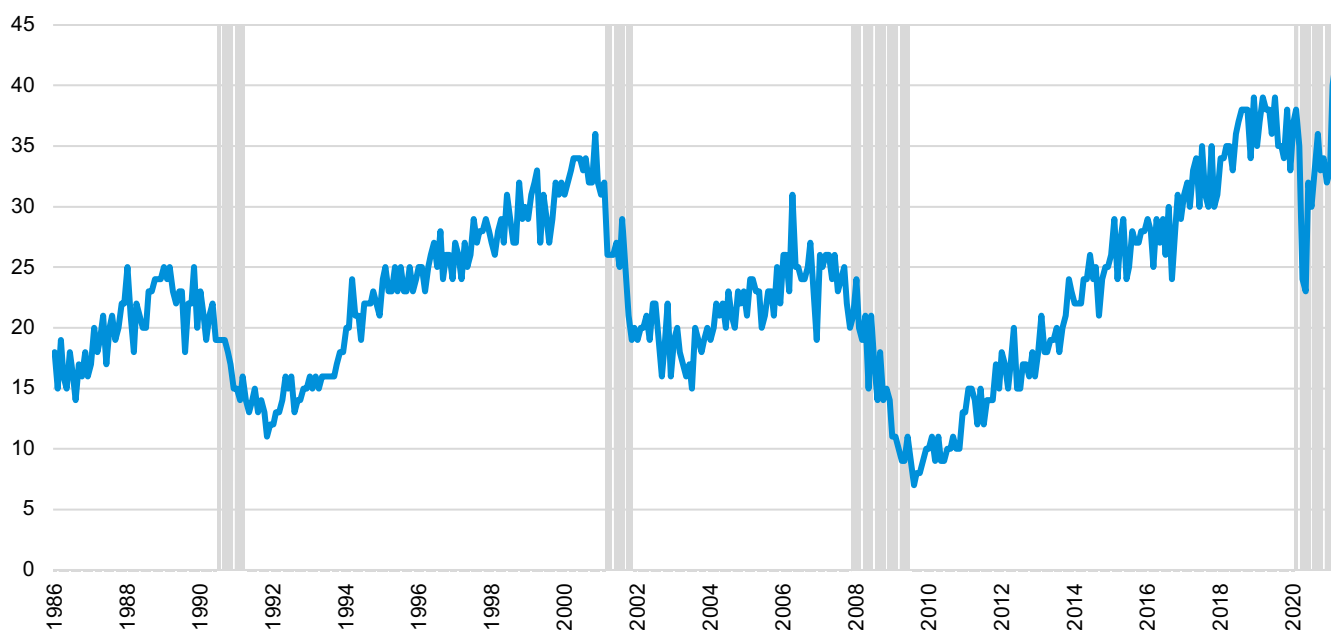
Note: Gray bars denote recessions.

Source: Bureau of Economic Analysis, NBER and MIM

This has left the economy with limited room for rebound despite massive consumer savings. On the demand side, despite currently high levels of consumption, consumers seem to be losing interest in further spending. May's consumer buying intentions showed sharp declines in intentions to buy autos, homes and no increase in plans to take vacations. Further, consumer spending on goods is already up significantly as is spending on services. While there appears to be space for consumer spending on services to pick up, there is limited scope for demand for goods to continue increasing.

Shortages could limit the ability for consumers to spend their savings. Computer chip shortages are impacting numerous sectors and the Beige Book report, the anecdotal survey of companies taken by the Federal Reserve before each FOMC meeting, has seen mentions of "shortages" jump to 44 from 17 immediately before the COVID crisis. The inventory-to-sales ratio for the auto sector is now at historical lows last seen in the mid-1980s. The ISM manufacturing survey reports record low levels of customer inventories and 44% of small businesses report difficulties filling jobs, a record high, a level above the pre-crisis level and unusual given an unemployment rate over 6%. Even if consumers are inclined to buy, this data suggests they may not be able.

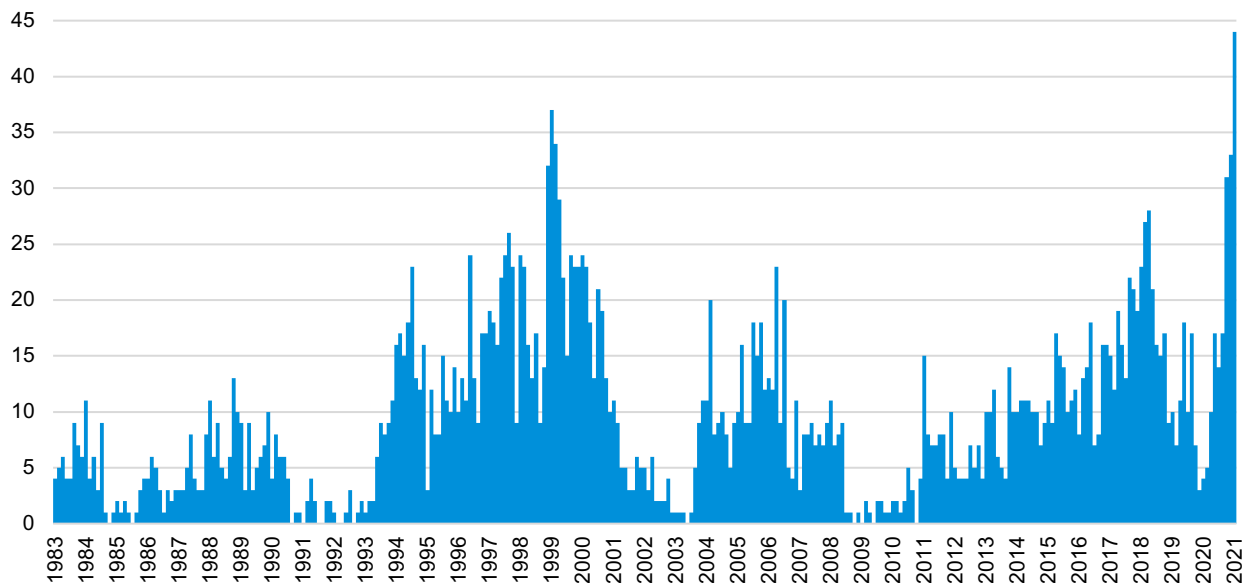
### Small businesses reporting labor hard to find (%)



Note: Gray bars denote recessions.

Source: NFIB, NBER and MIM

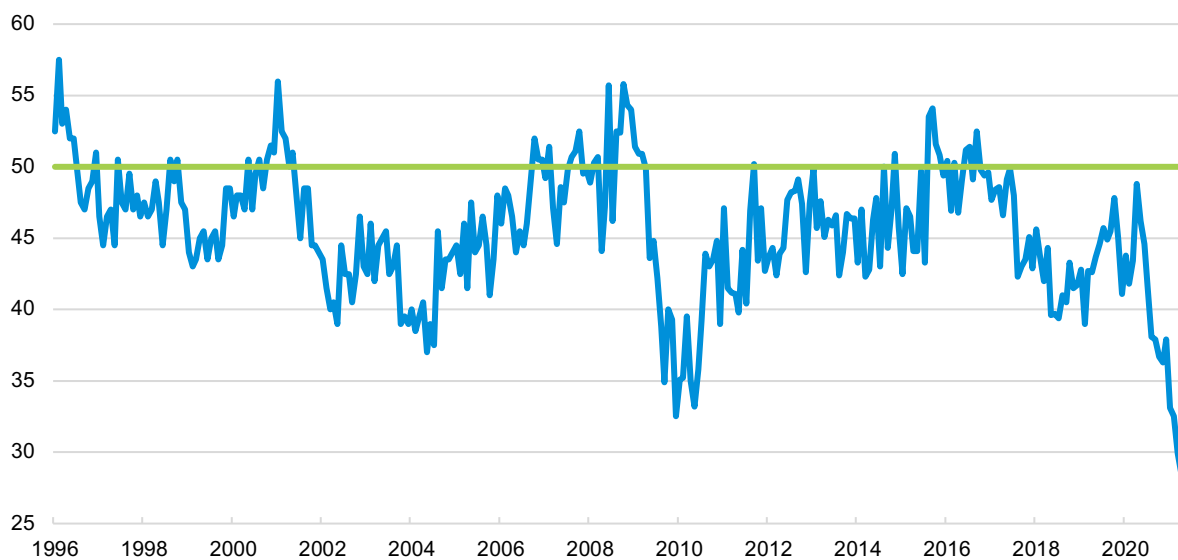
## Number of mentions of “shortages” within Beige Book



Note: Beige Book reports available back to 1983. Prior to that time the Federal Reserve released a different analysis.

Source: Federal Reserve and MIM

## ISM Customer Inventories at All-time lows

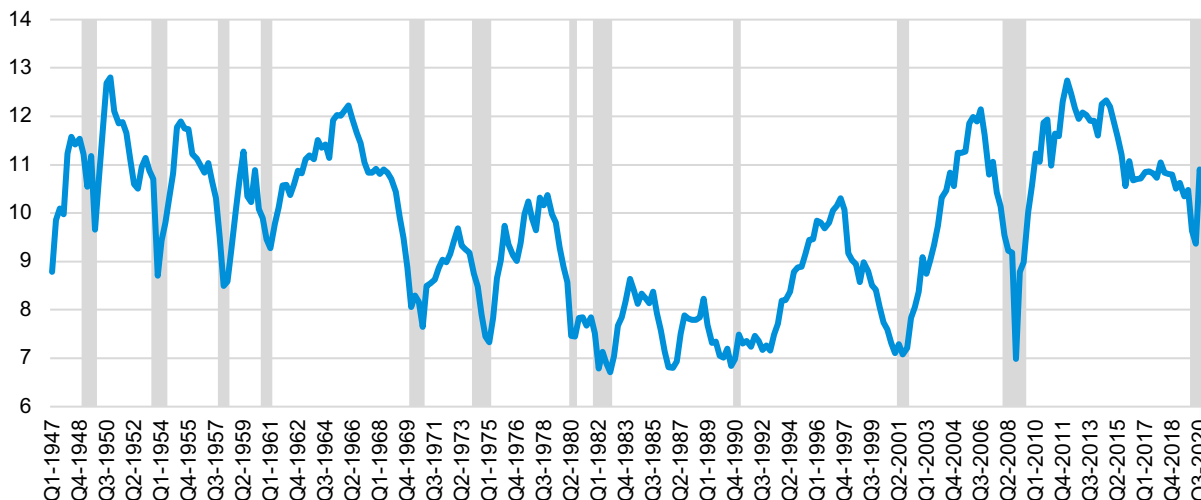


Note: Readings below 50 indicate inventories are “too low”.

Source: ISM and MIM

Economy-wide margins have returned to the same level they were at in mid-2019 and, with cost pressures already rising and labor hard to come by, it seems that the ability to maintain margins will be dependent on the ability to pass through price increases. Without that ability, it seems reasonable that firms will switch focus to reducing expenses, a precursor towards reducing labor demand and capital spending. Repeated across a large number of firms and that is the precursor to recession.

## Economy-wide margins have returned to pre-COVID levels



Note: Gray bars denote recessions.

Source: Bureau of Economic Analysis, NBER and MIM

<sup>1</sup> U.S. Bureau of Economic Analysis, MetLife Investment Management calculations

<sup>2</sup> U.S. Bureau of Labor Statistics

<sup>3</sup> U.S. Bureau of Economic Analysis, Board of Governors of the Federal Reserve and MetLife Investment Management calculations

<sup>4</sup> Board of Governors of the Federal Reserve

<sup>5</sup> U.S. Treasury Department, Haver Analytics

<sup>6</sup> U.S. Bureau of Economic Analysis

<sup>7</sup> Ibid.

<sup>8</sup> Ibid.

## Author



### DREW MATUS

#### Chief Market Strategist

Drew Matus is chief market strategist for MetLife Investment Management (MIM). In this capacity Matus is responsible for formulating MIM's global outlooks, which ultimately help to shape the company's portfolio management and business decisions. His team also conducts research on investment themes to advise and inform MIM's global team of investment professionals.

Prior to joining MetLife, Matus was the deputy chief U.S. economist at UBS Securities LLC. He has also worked as a senior economist at Bank of America-Merrill Lynch and as the senior financial markets economist at Lehman Brothers, Inc. Prior to his work in banking, Matus worked in the market research group at Moore Capital Management, a hedge fund in New York and also worked on the open market desk of the Federal Reserve Bank of New York assisting in the implementation and analysis of monetary policy operations and conducting Treasury market surveillance on behalf of several regulatory agencies.

Matus frequently appears on CNBC and Bloomberg to discuss his views on the economy and markets. He has also been quoted in The Wall Street Journal, The New York Times and other business publications.

*Matus holds an MBA with specializations in economics and finance from the Stern School of Business at New York University and a Bachelor of Arts in economics from Colby College.*

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