

Last Time Was Different: Why Recession Fears are Overdone

Key Takeaways

- The 2008 financial crisis has colored perceptions of what a recession looks like. The markets and consumers appear to be overreacting to concerns about a recession.
- We expect a normal, perhaps mild next recession toward 2021: we do not see any gross imbalances or threats of a financial crisis that could cause an abnormal recession.
- There is some possibility of a slower than normal recovery, with little help available from policymakers.

Last Time was Different

About one-third of the current labor force has experienced only one recession: the 2008 financial crisis. That, combined with recency bias, appears to be making people exceptionally nervous about the next recession. Following December's stock market plunge, Fed rate cut forecasts shot up to 80% and consumer confidence plummeted.

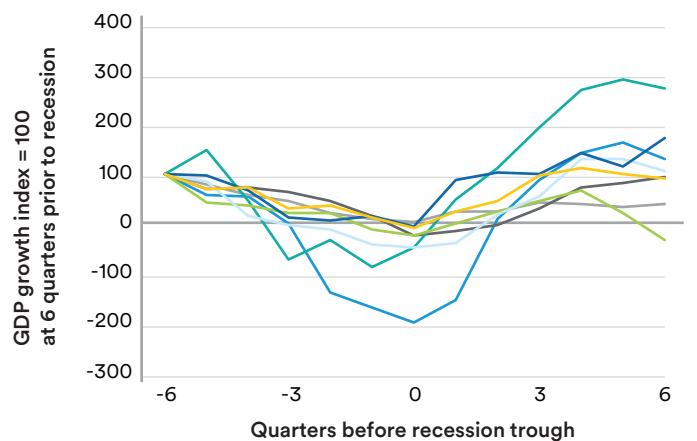
A look back over history shows why we believe that this was an overreaction.

Here's how the last eight recessions looked (see Figure 1). The most recent was clearly worse than all the others. By GDP growth measures, the 2008 recession was twice as bad as the next worst recession (in 1981).

Excluding the most recent—and highly unusual—recession, most recessions tend to range between 1 and 5 quarters of GDP decline, with a maximum quarterly decline at under 3%. On average, they experienced two quarters of decline of between 0.4 and 1.0% before growth restarted.

Financial markets also had a stronger than usual response to the most recent recession. The S&P 500 also declined by the most in

Figure 1 | GDP Growth was Hardest hit in the 2008 Recession



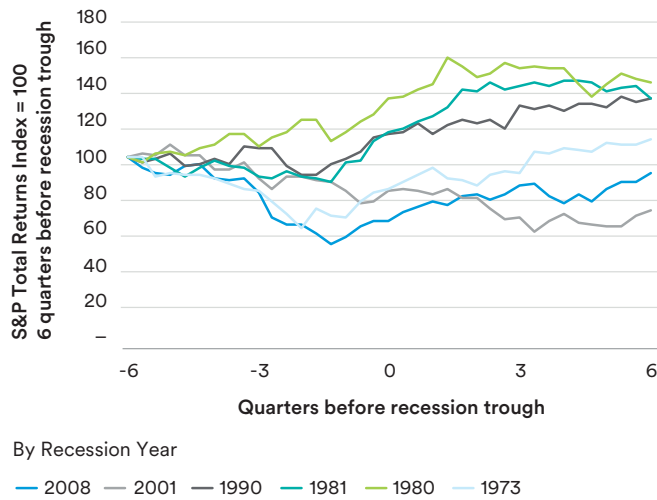
By Recession Year

— 2008 — 2001 — 1990 — 1981 — 1980 — 1973 — 1970 — 1960

Source: NBER, BEA/Haver

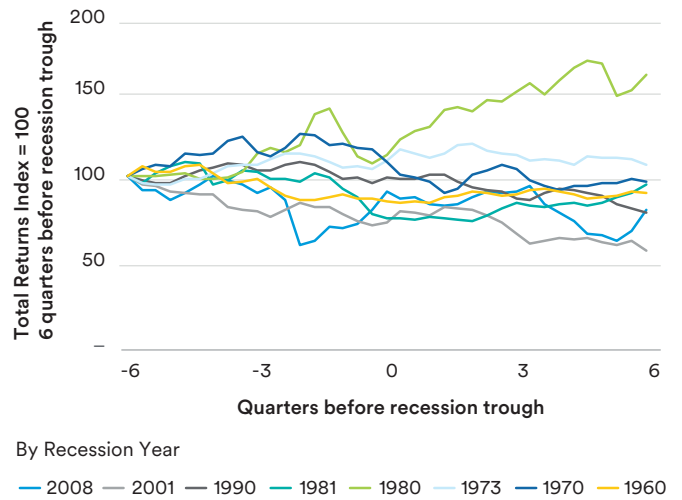
the 2008 recession at its nadir (Figure 2), although the recovery was stronger than some recessions. Similarly, rates fell by the most in the prior recession, although recovery was in line with other recessions (Figure 3).

Figure 2 | S&P Total Returns



Source: S&P/Haver

Figure 3 | 10 Year Yields



Source: FRED, Haver Analytics, MetLife Investment Management (MIM)

Federal Reserve Vulnerability

The main concern the next time around appears to be related to the last recession: the major central banks in the world including the Federal Reserve are still dealing with the aftermath of the last recession. They have less firepower in their arsenal to stimulate the economy. The Fed has historically had to cut rates by at least 500 bps; right now it only has 250 bps worth of rate cuts available at this point. This means balance sheets may again come into play during the next recession. However, balance sheets remain bloated, and it is not clear how much the balance sheets can re-expand to handle a future recession, nor how effective it will be.

| Rate cut period | Rate cut (terminal rate upper bound) |
|----------------------------|--------------------------------------|
| August 2007 – January 2009 | 500 bps (0.25) |
| November 2000 – July 2003 | 550 bps (1.00) |
| May 1989 – October 1992 | 678 bps (3.00) |

Next Time (Probably) Won't Be Different

The next recession is likely to be more normal than the one in 2008. The gross imbalances that were seen then, combined with the involvement of financial markets, led to a rare crisis-type recession that we are unlikely to see repeated under current circumstances. In today's economy, most assets are well within their usual range of valuation, and few areas of the economy are overleveraged.

We forecast continued health for the next two years including a GDP growth of 2.6% in 2019 along with a single rate hike. We expect a downturn around 2021 as we anticipate the credit cycle to overextend and late cycle labor market behavior to intensify.

If the next recession comes in 2021 it is likely to be anti-climactic, particularly for anyone whose only experience is the 2008 financial crisis. There are no deep structural problems in the economy like before the financial crisis. Therefore, we expect a normal, or possibly even shallow recession. However, we flag the current weak policy position of the Fed and point out that this is a potential concern. Speed of recovery may be of greater concern than depth of a future recession.

Global Economic & Market Strategy

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