

ECONOMIC VIEWPOINT

Do Economic Cycles Have an Expiry Date? When Will the Next Global Recession Arrive?

In June, it will be eight years since the U.S. economy emerged from its last recession (graph 1). Given that economic cycles often last between 6 and 10 years, do we need to worry about another recession? This *Economic Viewpoint* shows that time alone is not the best variable for predicting the end of a cycle. In fact, crises instead tend to occur randomly following shocks that are often hard to foresee. The emergence of imbalances and poor budgetary and monetary policy management are also sources of economic fluctuation; in the near term, however, there does not appear to be a reason to be overly concerned. It could take a few years for another recession to hit the United States, dragging the rest of the global economy down in its wake.

GRAPH 1
The last U.S. recession started in January 2008 and ended in June 2009



Heading for a Record-setting U.S. Cycle

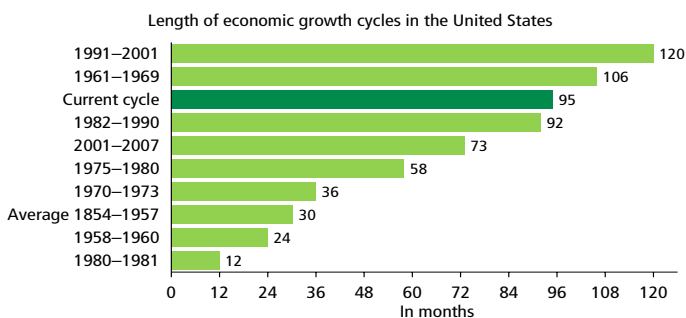
In the United States, the current growth cycle has lasted for 95 months, putting it in third place among previous cycles (graph 2). If the cycle lasts another year, it will take over the

second spot, currently held by the 1961–1969 growth period. In two years, it could become the longest period of growth ever recorded in the United States, beating the 120-month record set from 1991 to 2001.

However, longevity is not the best indicator for predicting the end of a cycle. An econometric model which estimates the probability of a U.S. recession with only cycle lengths never sends a clear signal (graph 3 on page 2). At 95 months, such a model would estimate the probability of a recession as approximately 20%. At 120 months, the probability would be just above 30%.

Examined from other angles, the current cycle is nowhere near a record setter, particularly from the perspective of real GDP growth. Since June 2009, U.S. real GDP growth totals 17%. Within a year, it could be around 20%, perhaps edging above 22% when we project to the end of 2018. In comparison, the long growth periods of 1961–1969 and 1991–2001 saw real GDP growth of 54% and 43% (graph 4 on page 2).

GRAPH 2
The current growth cycle is already one of the longest



Sources: National Bureau of Economic Research and Desjardins, Economic Studies

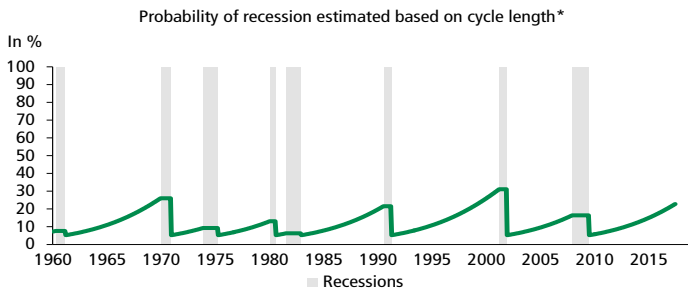
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NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

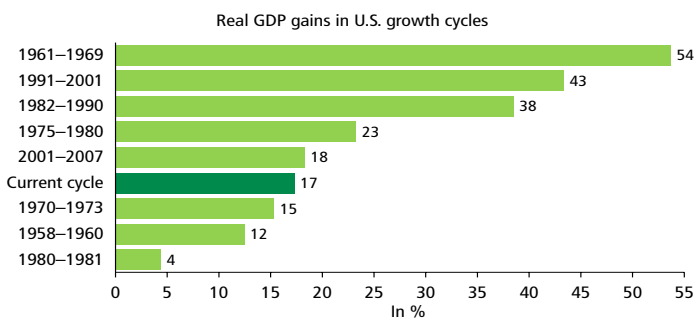
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GRAPH 3
Cycle length alone is a poor indicator of the probability of a recession



* Estimated using a Probit type model with a constant and variable that represent the cumulative length of growth cycles.
 Source: Desjardins, Economic Studies

GRAPH 4
The current cycle is showing weak real GDP growth overall



Sources: Datastream, National Bureau of Economic Research and Desjardins, Economic Studies

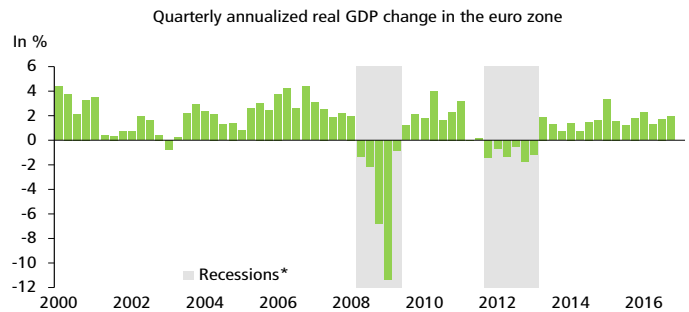
For some people, the weak real GDP growth since 2009 could be an argument in favour of the end of the cycle still being a long way off. However, history tells us that a recession can occur even without strong initial real GDP growth. Moreover, in terms of growth, the current cycle is similar to the one that preceded it. U.S. real GDP had expanded 18% from the 2001 trough to the 2007 peak.

A Shorter Cycle in the Other Advanced Nations

Most of the other advanced nations have already experienced an end of cycle since the 2008–2009 recession. In the euro zone, the financial difficulties that faced several governments and fears about the banking system triggered a recession starting in 2011 that lasted until early 2013 (graph 5). The euro zone's current growth cycle is therefore only four years long.

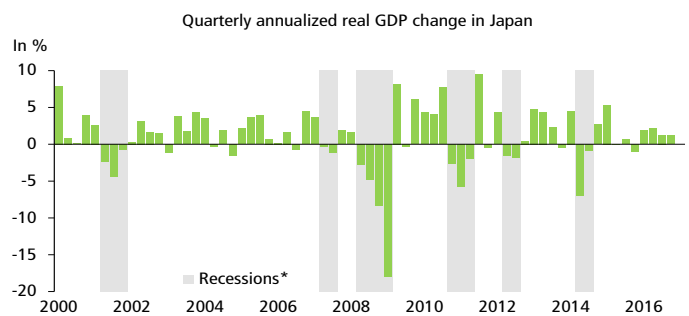
In Japan, it has been even less time since the last recession. Sharper demographic ageing there reduces average economic growth so much that real GDP growth frequently goes into negative territory with the least shock. Japanese real GDP has posted at least two consecutive quarterly declines five times in the last 10 years (graph 6). The two quarters of

GRAPH 5
Following the 2008–2009 recession, the sovereign debt crisis struck the euro zone in 2011–2013



* Recessions as dated by the Centre for Economic Policy Research (CEPR).
 Sources: Datastream and Desjardins, Economic Studies

GRAPH 6
Phases of GDP contraction are more frequent in Japan



* Recessions defined by at least two consecutive quarters of real GDP contraction.
 Sources: Datastream and Desjardins, Economic Studies

contraction rule is often used to identify recessions.¹ The 2008–2009 recession was the worst, followed by 2010–2011. The last recession, in 2014, was triggered by a sales tax increase. The Japanese initially moved up some spending then, after the tax increase came into effect, slashed consumption.

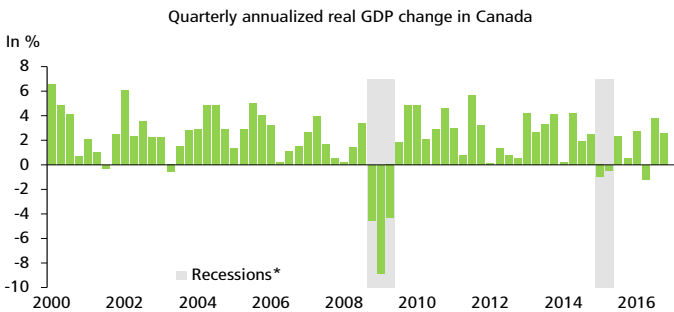
In Canada, the drop in oil prices triggered a short-lived two-quarter contraction by real GDP in early 2015 (graph 7 on page 3). The shock was big enough to persuade the Bank of Canada to cut its key rates twice. Canada's current growth cycle has therefore only lasted two years, making it one of the shortest among the advanced economies.

The U.S. Cycle's Importance to the Global Cycle

Although several advanced economies are posting shorter periods of growth, this does not necessarily protect them from a new shock, especially if the U.S. economy were to stumble. In

¹ In the United States, the National Bureau of Economic Research (NBER) uses the change in four other variables to pinpoint the starts and ends of cycles: employment, personal income, industrial production, and business sales. The resulting dating is generally fairly consistent with the rule of two consecutive real GDP declines.

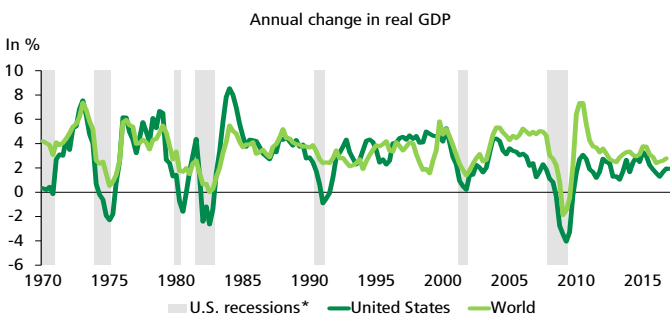
GRAPH 7
At the end of 2014, plunging oil prices triggered two consecutive quarterly declines in Canada's GDP



* Recessions defined by at least two consecutive quarters of real GDP contraction.
Sources: Datastream and Desjardins, Economic Studies

fact, there is a strong similarity between the U.S. and the global cycles (graph 8). Moreover, causality tests generally show that the U.S. cycle has a significant impact on the cycles of the major advanced economies.² The U.S. economy can stand up to shocks from other countries fairly well but, in contrast, many countries face difficulties when the U.S. cycle ends.

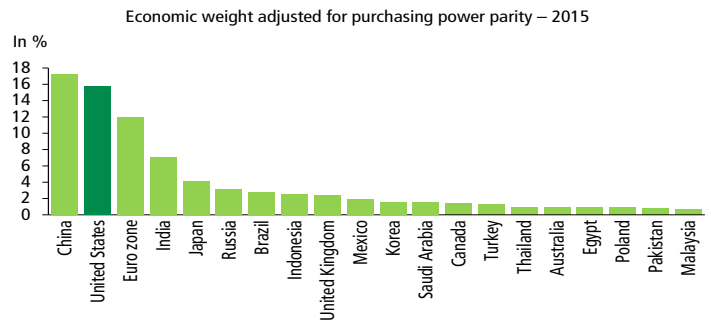
GRAPH 8
The global cycle tracks the U.S. cycle fairly well



* Recessions as dated by the National Bureau of Economic Research (NBER).
Sources: Datastream, NBER and Desjardins, Economic Studies

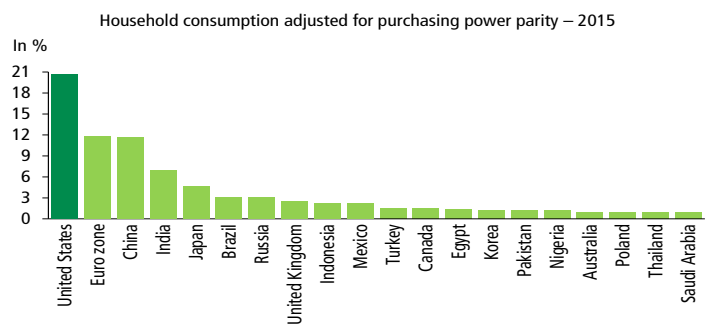
This observation is consistent with the U.S. economy's heavy weight compared with the rest of the global economy. The United States accounts for about 16% of global GDP, putting it in second place behind China (graph 9). However, the U.S.'s weight is heavier if we only look at consumer spending. U.S. households represent just over 20% of global consumption, well ahead of the euro zone and China, which come in second and third (graph 10). If U.S. consumption tumbles, the potential impact on the rest of the global economy clearly seems larger than if the shock came from another country.

GRAPH 9
The United States is the world's second largest economy



Sources: World Bank and Desjardins, Economic Studies

GRAPH 10
The United States ranks first for consumption



Sources: World Bank and Desjardins, Economic Studies

Indebtedness Is Still a Threat

While time alone may not cause recessions, it can allow imbalances to mount that can jeopardize an economic cycle's durability. Overinvestment and debt overload are examples. In the United States and other countries, the 2008–2009 recession was preceded by a heavy period of residential investment in which household debt loads soared. U.S. households are now in a much sounder position and the last decade's real estate euphoria has not returned. On the other hand, we can see that public debt has jumped (graph 11 on page 4). U.S. corporate debt loads have also posted remarkable growth, recently returning to their 2008 peak.

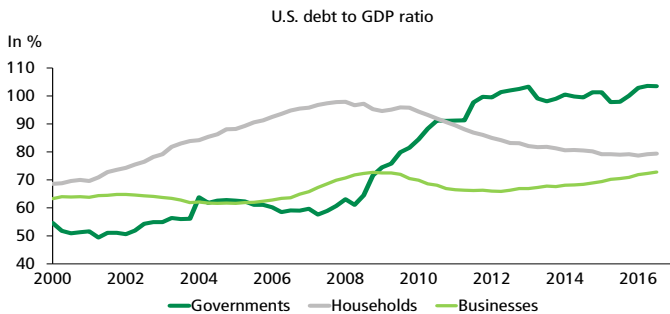
The public debt problem is not unique to the United States but is shared by nearly all advanced nations (graph 12 on page 4). In emerging nations, it is corporate debt that has surged in the last few years (graph 13 on page 4). Together, the result is that total global debt is higher now than it was in 2008.

Beware of Rising Interest Rates

From their high in the early 1980s, interest rates have oscillated around a downtrend. This has certainly been a facilitating factor

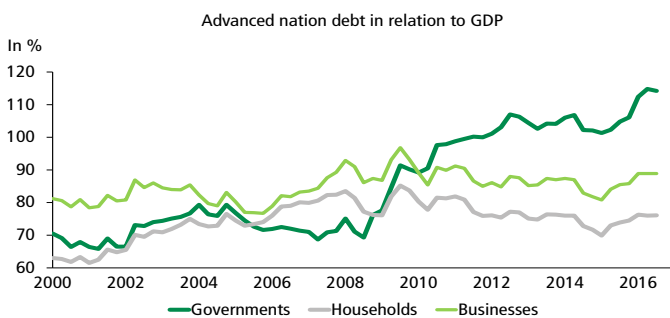
² The tests performed are Granger causality tests. Econometric tools were used to verify whether quarterly changes in U.S. real GDP explained changes in the GDPs of other parts of the world, and vice versa.

GRAPH 11
Businesses and public administrations have taken over in the area of U.S. debt



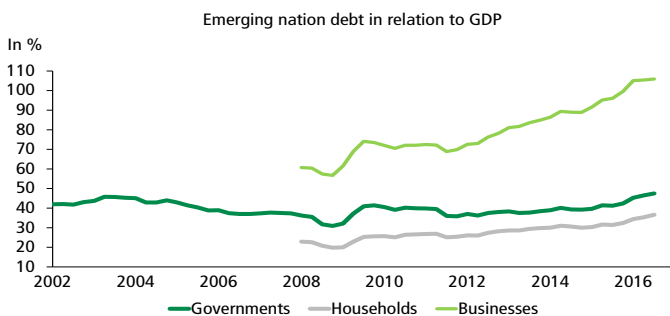
Sources: Bank for International Settlements and Desjardins, Economic Studies

GRAPH 12
Public debt is worrisome in the advanced nations



Sources: Bank for International Settlements and Desjardins, Economic Studies

GRAPH 13
In emerging nations, it is corporate debt that is raising concern



Sources: Bank for International Settlements and Desjardins, Economic Studies

in rising debt loads worldwide. Another uptrend, however slight, could weigh heavily on borrowers, including governments in advanced nations that have sharply increased their debt loads. Higher borrowing costs after many years of low rates could force them to cut spending or tax more. Either scenario would penalize global demand.

Investors could also be affected. A rise by bond yields would mean losses on the value of bonds. The race for returns in the last few years may also have skewed the assessment of some risk premiums, so rate movements could be even sharper for risky bonds. Companies that have resorted to bond financing could have trouble refinancing.

Donald Trump's Policies

The current U.S. president promised to stimulate the economy by cutting taxes and increasing infrastructure spending. The problem is that this would probably only have a temporary impact on growth, subsequently leaving the impression that the economy is slowing, which could hurt consumer, business and investor confidence. Moreover, there is a real danger in stimulating the economy in a context in which the U.S. job market is already tighter (graph 14). Wages and inflation could shoot up, forcing the Federal Reserve (Fed) to further increase its key interest rates. Not to mention the fact that Donald Trump's promised measures would expand the already hefty U.S. public debt.

GRAPH 14
The U.S. jobless rate recently hit the low point reached in the previous economic cycle



* Recessions as dated by the National Bureau of Economic Research (NBER).
 Sources: Datastream, NBER and Desjardins, Economic Studies

President Donald Trump also has protectionist aims. The possible proliferation of customs tariffs in the United States would hurt global trade and economic growth in general. The impact would be magnified if other countries decided to retaliate with their own protectionist measures. Despite weaker growth, inflation could stay high in response to the increase in import prices and the difficulty in finding inexpensive local substitutes. Interest rates would also be higher.

Not to Mention Surprises

Recessions can be triggered by a multitude of surprise shocks. A major armed conflict could break out and impact global trade and confidence. Nature's vagaries, including flooding, a tsunami, or major storm, also have the potential to make output contract. Sometimes, the surprises are generated by governments which, for example, suddenly change their budgetary or tax policies, or vote in legislation that can undermine a major segment of the economy. For large corporations, scandals and financial problems

can sharply increase market volatility and end up penalizing economic growth. Sudden changes in commodity prices are other potential threats.

Like Russian Roulette

In conclusion, economic cycles do not have a pre-determined expiry date. Their length is fairly varied. However, they do not last forever. Like Russian roulette, time ends up being the enemy, as imbalances can mount, and shocks constantly threaten to destabilize the situation.

For some time now, our medium-range scenarios have included the end of the cycle in the United States. Other countries will probably experience the same thing. By 2020, the public debt problem could increase due to the expected rise by interest rates. The economy is also expected to lose steam once the impact of the stimulus that should be applied in the United States will have waned. Nor can we rule out the possibility of greater U.S. protectionism. Moreover, other unpredictable shocks could occur. Here, the tense global geopolitical situation is more fertile ground.

More positively, it would still be surprising for the next end of cycle to be as severe as it was in 2008–2009. Among other things, households in the United States and in some other countries are in a better situation than they were then. The financial system is also sounder. In this context, it would probably be easier for a new growth cycle to get off the ground. To help, the Fed and other central banks could go back to more stimulating monetary policy and postpone key interest rate normalization.

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