Fed Unfiltered

Reports - This Week (Dec 19-30)

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Fed: "Research and analysis about consumers, their financial experiences, and the communities in which they live inform Federal Reserve policymaking." – Fed Board

Fed Unfiltered: Each week we'll read through and outline the most relevant information for your decision-making.

This Week: The SF Fed and the St. Louis Fed published articles about the chances of a recession. The KC Fed analyzed the modern monetary policy lag and had an interesting conclusion.

SF Fed – Recession is Possible but Not in Next 2 Quarters

- "This Economic Letter discusses how the jobless unemployment rate can be turned into a predictor for recessions. The resulting predictions are surprisingly accurate, on par with those derived from the more commonly used Treasury yield curve. The Letter further argues that the same methodology used for the jobless unemployment rate can also be applied to other macroeconomic time series to forecast recessions."
- "This recession prediction closely relates to the "Sahm rule" (Sahm 2019). According to this rule, a recession occurs when the three-month moving average of the overall unemployment rate has risen at least half a percentage point above its minimum over the previous 12 months. The main difference is that the recession clock developed here is an advance predictor of recessions, whereas the Sahm rule typically indicates a recession after it has already started."
- "These combined results suggest that an accumulation of evidence is the best predictor of recessions. When initial UI claims have been rising, the slope of the yield curve is inverted, and housing starts and the vacancy-to-unemployment ratio are falling on a sustained basis, a situation emerges that has historically been associated with a runup to a recession."
- "Currently, none of these predictors indicate an upcoming recession over the next two quarters. However, the underlying trend in these macroeconomic time series has started to turn and the predictions might change in the coming months."

  SF Fed, Report: Recession Prediction on the Clock, 12/27/22
  https://fedunfiltered.com/sf-fed-report-recession-prediction-on-the-clock/

St. Louis Fed – 2 States away from a National Recession

- "Economists view recessions as national events. However, past recessions have shown that some states' economies continued to expand during a recession—particularly when the national recession was relatively mild. The Federal Reserve Bank of Philadelphia's state coincident indexes (SCIs) can be used to assess whether recession-like conditions have developed in each of the states. And if so, whether there is a threshold in the number of states that might signal a national recession."
- "Briefly, the SCIs are calculated with a dynamic single-factor model using each state's nonfarm payroll employment, average hours worked in manufacturing by production workers, the unemployment rate, and wage and salary disbursements (deflated by the U.S. city average consumer price index). Each state's SCI trend is also set to match the long-term trend of its gross domestic product (GDP). In other words, for each state, the long-term growth of its SCI matches the long-term growth of the state's GDP."
- "In sum, a threshold estimate based on this analysis shows that 26 states need to have negative growth in the SCI to have reasonable confidence that the national economy entered into a recession. Excluding the 2008 outlier raises the threshold to 29 states."
- "So, where are we now? In October 2022, 27 states had negative growth in the SCI. That would exceed the six-recession average of 26 states but would fall short of the outlier-adjusted estimate (excluding 2008) of 29. One caveat is worth noting: Populous states like California, Texas and Florida that have disproportionately large economies can sometimes exert a large influence on national economic activity. This analysis does not adjust for this fact."

  St. Louis Fed, Report: Are State Economic Conditions a Harbinger of a National Recession? 12/28/22
  https://fedunfiltered.com/st-louis-fed-report-are-state-economic-conditions-a-harbinger-of-a-national-recession/

KC Fed – Monetary Policy Lag Might Only be 12-months

- "In response to rising inflation, the Federal Open Market Committee (FOMC) tightened monetary policy significantly in 2022, raising the target federal funds rate to 4.25–4.50 percent as of December. Nonetheless, inflation has remained persistently high. Many policymakers expect changes in the federal funds rate—the FOMC's primary policy tool—to affect the macroeconomy with a lag. However, since 2009, the FOMC has also employed additional monetary policy tools. Financial markets may react to changes in forward guidance on the future path of the federal funds rate and changes in the Federal Reserve's balance sheet even before the FOMC changes the federal funds rate, suggesting lags in policy transmission may have shortened since 2009."
- "In summary, we find evidence for a shorter lag in the peak response of inflation to a policy shock in the post-2009 period even after we adjust the shock definition to incorporate forward guidance and balance sheet policy. Our results suggest the peak deceleration in inflation may occur about one year after policy tightening."

  KC Fed, Report: Have Lags in Monetary Policy Transmission Shortened? 12/21/22
  https://fedunfiltered.com/kc-fed-report-have-lags-in-monetary-policy-transmission-shortened/

Quote of the Week
"Most folks are about as happy as they make up their minds to be." --- Abraham Lincoln