US Economy Special

AIB Treasury Economic Research Unit

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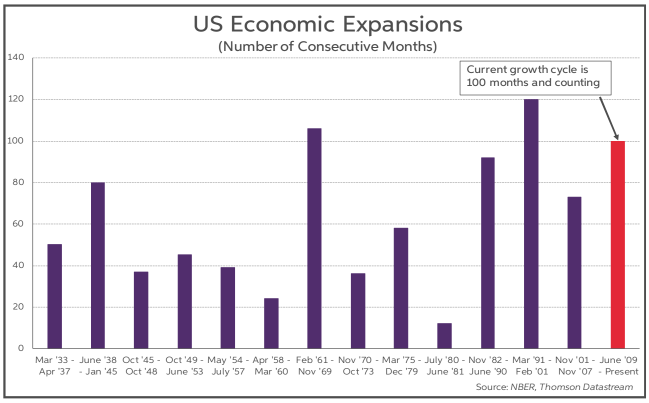
Current US Expansion Could Prove Longest on Record

Economists do not have a great track record in predicting recessions as the financial crisis and economic crash of 2008 -09 clearly showed. This is because the shocks that often cause recessions are by their nature hard to predict, while economic models are not good at predicting downturns. It is also the case that recessions are becoming fewer and fewer, with an unmistakeable tendency for longer business cycles in recent decades.

The world economy is expected to register steady growth over the next number of years. However, if a downturn hits, it could well become apparent first in the US, given where it stands in the business cycle. The US recovery is the most mature of the major economies, with the unemployment rate down to 4.4% and the Fed now on a rate hiking path as the economy reaches full employment.



The current US expansion began in mid-2009 and, at 100 months, is now the third longest of 33 US business cycles going back to 1854. Only the expansions in the 1960s and 1990s proved longer than the current cycle. It is also noteworthy that four of the six longest US business cycles since 1854 have been in the period since 1982.

A number of reasons can be advanced for the longer business cycles evident in recent decades. The more volatile manufacturing and agriculture sectors have shrunk in importance relative to the more stable services sector, including the public sector. Globalisation and increased competition has dampened inflation, allowing the US Federal Reserve to pursue a more accommodative monetary policy, with much less fluctuations in interest rates. The growth in the availability of credit has also allowed households and business more scope to smooth out spending patterns.

The current US expansion will become the longest on record if it lasts until mid-2019. The general expectation is that it will. Indeed, growth may get a boost in 2018-19 if President Trump can implement some of his expansionary fiscal plans. The US should also be supported by the strengthening growth evident in the global economy.

Meanwhile, although official interest rates have risen in the US in the past year, they remain at a very low level of just above 1%. Subdued inflation means that the Fed should be able to continue to hike interest rates at a moderate pace in the next couple of years, thereby not greatly impacting economic activity.

Neither is the current expansion showing any signs of major imbalances emerging that were associated with triggering previous recessions, such as overheating property and labour markets, high inflation, excessive credit growth or problems in the financial sector.

It may be that the deep recession of 2008-09 and subsequent slow recovery has laid the foundation for a very long cycle. The usual imbalances that can emerge have been kept at bay, allowing the Fed to keep interest rates at very low levels.

Nonetheless, all cycles end at some stage and economists need to be wary of past misjudgements in not forecasting economic downturns. One risk lies in US rates rising at a much quicker pace than markets expect, which the Fed has warned could happen. Elevated equity markets, low bond yields and very tight credit spreads all point to overstretched markets that are vulnerable to rate hikes.

Memories of 2008-09 are still fresh and a significant correction in markets could dent business and consumer confidence and see a marked tightening in lending standards by banks, with knock-on consequences for real economic activity and employment. Thus, while the current US expansion looks set to become the longest on record, there is no room for complacency.

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