Do Economic Recoveries Die of Old Age?

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The US economy is clearly slowing. After adjusting for inflation, GDP grew by 2.9% in 2018, and by an even better 3.1% in 19Q1. But growth slowed to just 2% in 19Q2, is expected to grow at a similar pace the rest of this year, and to then slow further in 2020. According to some pundits, this rapid slowing is a clear sign we are in the final stages of this economic recovery and that a recession is fast approaching. They point out that we are in the 11th year of this recovery, making it the longest one in history, and as such we are simply due for a recession. Fortunately, they are wrong, expansions do not die of old age. Let me explain.

Prior to WWII, the idea that expansions were more likely to end as they got older was very common and was frequently mentioned in business and economics textbooks. And indeed, it was justified by the data. Using a statistical technique called survival analysis, which looks at the probability of some particular event occurring given the age of the subject, be it a person or a car or sports team, it is clear that prior to WWII recessions were more likely to happen the longer the recovery.

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The intuitive starting point is based on analogies to human mortality. In short, this presumption suggests that as an economic recovery ages, assorted imbalances and rigidities accumulate that hobble the economy and make it more fragile. As a result, a recovery is increasingly put at risk by smaller and smaller shocks, and it becomes increasingly likely the economic expansion will fall into recession the longer it lasts. Analogies to cars are also frequently cited. All else equal, as a car ages, the probability that it will suffer a mechanical breakdown increases. Thus, older cars are considered less reliable and generally command a lower price than new ones.

Happily, however, various postwar changes in the economy have contributed to more robust and longer-lived expansions! One key change has been the rise in the share of services produced in the economy and the concomitant decline in goods. This change has diminished the importance of inventory fluctuations and, as a result, has moderated the business cycle.

The role of the federal government has also drastically changed. Since WWII, government activity has, among other things, increasingly focused on stabilizing the economy. In short, the government has gone from a laissez-faire hands-off attitude towards the economy to a forceful, countercyclical policy. This approach has not only prolonged business cycles but has, importantly, eliminated the pattern of cycles becoming increasingly fragile as they age. In a sharp reversal, it is now recessions that are increasingly likely to end the longer they last as policymakers take action to revive growth, such as passing tax cuts and spending increases and lowering interest rates. In closing, enjoy the current expansion. Treat it like a good friend or a fine glass of wine and savor every extra month together. While it is almost ten and a half years old, it might well last another year, two if we are lucky. Better yet, the recession that follows is not likely to be particularly deep, as there are no asset bubbles in the making, nor are the sectors of the economy that usually drive us into recession growing inappropriately quickly.

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