

Focus: Documenting the Yo-Yo Years

Our prediction of more frequent recessions in developed economies has come to pass, with most major economies experiencing additional recessionary downswings since the Global Financial Crisis.

Forecast vs. Actual Over five and a half years ago, before the Lehman Brothers failure, we presented an analysis showing growth in U.S. GDP and jobs stair-stepping down in successive expansions, starting in the 1970s (*USCO, August 2008*). We also said that such longer-term patterns in the trend rate of economic growth would have significant cyclical implications as it, along with cyclical volatility, impacts the duration of expansions or alternatively, the frequency of recessions. We now have confirmation that this has already happened, and there is little reason to believe it is over.

Our research has shown that, in the U.S. and internationally, when the trend rate of growth rises, cyclical volatility falls, or both, economic expansions last longer. On the flip side, when trend growth falls, volatility rises, or both, shorter expansions and more frequent recessions are the result. The logic is clear, for as trend growth gets closer to zero it is easier for a cyclical downswing to pull growth below zero. As a result, the risk of a business cycle recession rises.

Soon after our 2008 finding, we anticipated the advent of an era of more frequent recessions than anyone had been used to since at least the early 1980s (*ICO, January 2009*), and we concluded that internationally, “if the current global crisis results in higher cyclical volatility, lower trend growth, or both, the incidence of business cycles is likely to increase,” (*ICO, June 2009*).

Later on, we described the era we were in as “the yo-yo years.” Observers like Mohamed El-Erian and Larry Summers have tried to explain feeble economic growth using terms like “the New Normal” or “secular stagnation.” The New Normal paradigm linked the prolonged period of low economic growth and high unemployment that is part of the yo-yo years with the process of deleveraging that followed the Great Recession. Larry Summers, on the other hand, has recalled the notion of “secular stagnation,” originally described by Alvin E. Hansen in 1939 as a period with “sick recoveries which die in their infancy and depressions which feed on themselves and leave a hard and seemingly immovable core of unemployment.” But it is really the essence of the yo-yo years – its

condition of falling trend growth – that such terms attempt to capture.

Five years after our first report on the subject, there is clear evidence that the yo-yo years are well underway, and that major developed economies have indeed been experiencing more frequent recessions. Notably, this is happening even with cycle volatility staying muted in the face of massive worldwide monetary accommodation in recent years.

The Evidence In order to confirm the advent of the yo-yo years, we examined GDP growth in each of the G7 economies, as well as Spain. Because of the seasonal adjustment issues that we identified a couple of years ago (*USCO, January 2012*), which has distorted data following the Global Financial Crisis (GFC), we looked at the straightforward year-over-year (yoy) growth rates to sidestep the issue. The black horizontal lines in the following charts have been drawn at zero, while the red ones are positioned at the lowest post-GFC yoy GDP growth readings for each country, except in the case of Japan. In the latter, with two post-GFC recessions, the red line has been placed at the most recent GDP growth trough.

Japan is the yo-yo years’ poster child, experiencing six recessions in 21 years, a period now commonly known as Japan’s lost decades. It is clear from Chart 2a that yoy Japanese GDP growth had trended down

Chart 2a: Japanese GDP, Growth Rate (%)

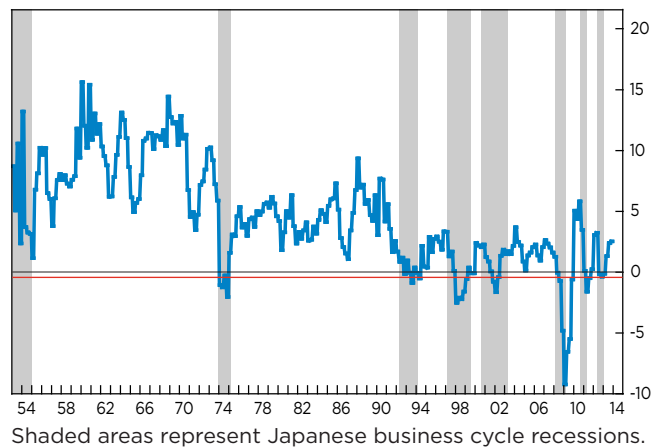
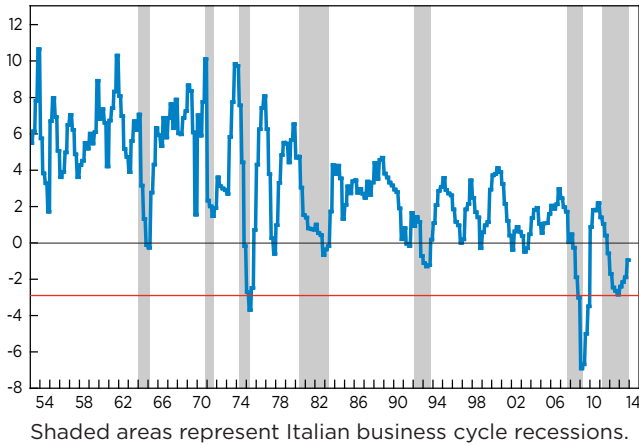


Chart 2b: Italian GDP, Growth Rate (%)



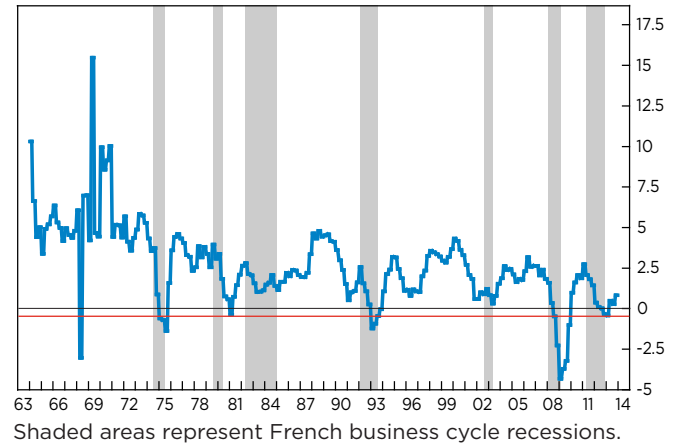
since the early 1960s and 1970s, when double-digit readings were common. By the early 1990s, GDP growth was generally not far above zero. The result was that almost every cyclical downturn in growth carried it into negative territory and the economy into recession. Indeed, in the aftermath of the GFC, Japan experienced two full-blown business cycle recessions. Incidentally, Japan's economy is in a fresh cyclical slowdown, and has now entered its third "lost decade." ([ICO, October 2013](#))

While Japan was the unfortunate pioneer, its yo-yo years experience is no longer an exception among its developed-economy peers. Since the GFC, the yo-yo years have been clearly present in the economies of southern Europe as well, and, as we shall see, also in Germany and the U.S. In Italy, trend GDP growth had turned negative following the crisis (not shown), so when economic growth entered a cyclical downswing in 2011, it culminated in a fresh recession, with GDP growth hitting a low (red horizontal line) seen only during the global recessions of 1973-75 and 2008-09 (Chart 2b).

Chart 2c: Spanish GDP, Growth Rate (%)



Chart 2d: French GDP, Growth Rate (%)



Similarly, in Spain, with trend growth falling below zero (not shown), the latest cyclical downswing pulled GDP growth well into negative territory, deepening a recession already in progress (Chart 2c). In our view, Spain experienced a protracted five-year recession with a growth rate cycle upswing in 2009-10 that brought GDP growth above zero only briefly, in a way that was insufficient to amount to a business cycle expansion. This is reminiscent of the 1929-33 U.S. recession, during which, despite a growth rate cycle upturn in 1930-31, the economy remained mired in recession.

Although the French case is not as severe as in most of southern Europe, here too, trend GDP growth has been moving closer and closer to zero (not shown). As a result, in early 2013, yoy GDP growth (Chart 2d) fell to a low (red horizontal line) not seen outside a recessionary context except for Q2 1968, when yoy GDP growth plunged briefly but deeply into negative territory, due to the severe civil unrest of May 1968 that brought the economy to a temporary standstill.

In the U.K., with trend GDP growth approaching zero (not shown), the economy experienced two back-

Chart 2e: U.K. GDP, Growth Rate (%)

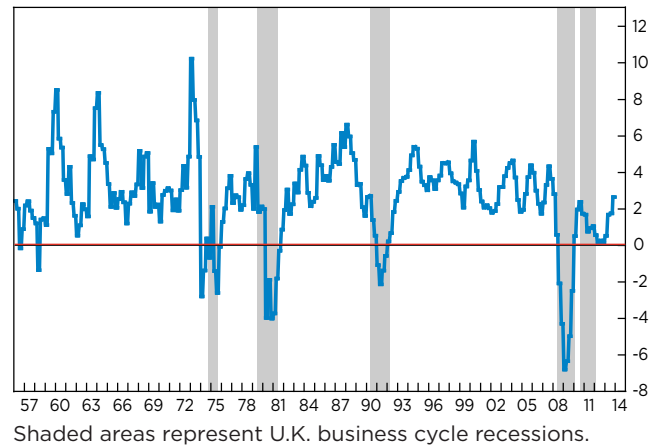
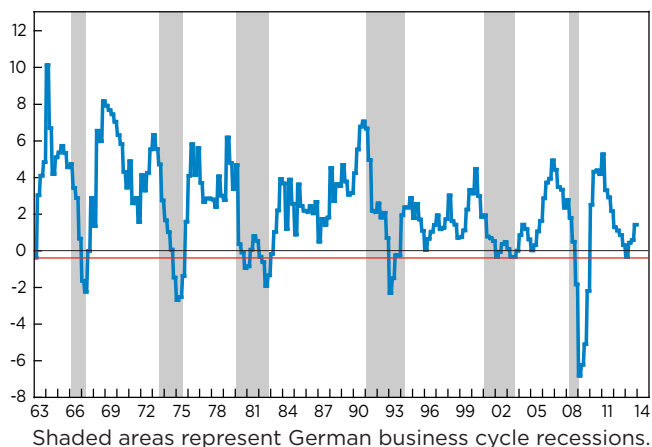


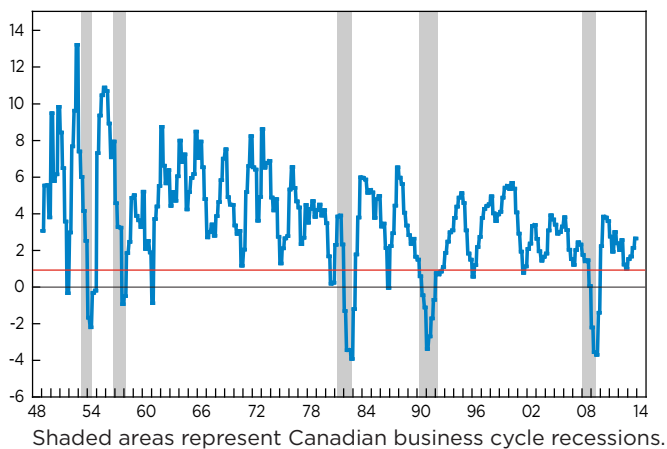
Chart 2f: German GDP, Growth Rate (%)



to-back recessions between 2008 and 2012, with only a seven-month break in between. Here again, GDP growth fell to readings not seen away from recessions in the last 50 years (Chart 2e).

Meanwhile, for Germany, our 2011 analysis ([ICO, December 2011](#)) showed that growth was not trending down as in other developed economies, making it somewhat less susceptible to the yo-yo years. Even so, in the most recent slowdown, quarter-over-quarter (qoq) GDP growth (not shown) turned negative in Q4 2012, and in the following quarter amazingly registered precisely 0.00% growth, thereby barely averting what is sometimes termed a technical recession, featuring two consecutive quarters of negative GDP growth. Interestingly, the 0.00% reading was critically dependent on that quarter's seasonal adjustment factor, which happened to be at its lowest standing in five years. Therefore, although Germany appears to have escaped a recession, its yoy GDP growth still fell to lows not seen away from recession in the past 50 years (Chart 2f, red horizontal line). Thus, despite Germany's structural resilience, it

Chart 2g: Canadian GDP, Growth Rate (%)



also experienced near-recessionary conditions.

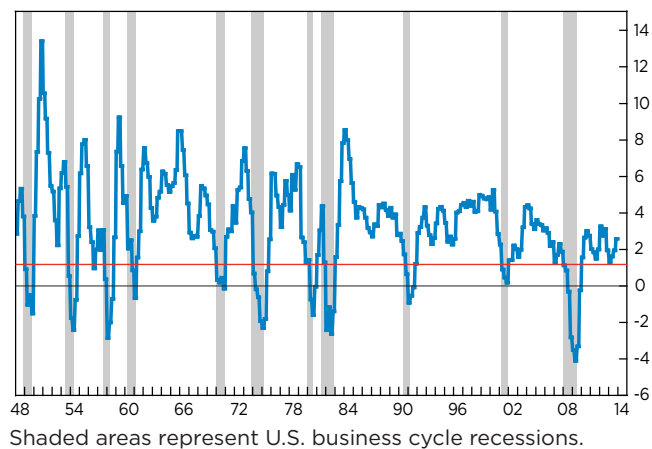
Similarly, in Canada the pattern of falling trend GDP growth was not compelling enough to suggest a heightened risk for more frequent recessions. Indeed, we find that in 2013, yoy GDP growth fell to a level historically associated with recessions approximately half of the time (Chart 2g). It is worth noting, however, that half of the time this threshold was reached was in non-recessionary episodes associated with recessions in the U.S., Canada's largest trading partner. So, although Canada might have experienced only a slowdown starting in 2010, consistent with its longer-term trend growth not declining in recent decades, Canadian GDP growth did veer close to readings often seen alongside U.S. recessions.

With the exception of Canada, therefore, every G7 economy examined thus far, as well as Spain, has experienced renewed recessionary or near-recessionary conditions following the GFC. In Japan, this happened twice between 2010 and 2013.

But how about the U.S.? Our past analysis placed the U.S. in the high-risk category, with trend GDP growth in an undeniable multi-decade decline. Despite the hope that the U.S. is somehow different, and must therefore escape this new reality, the numbers already tell a different story.

For Q4 2012, qoq annualized GDP growth was first reported as -0.1%, later revised to 0.1%. For the following quarter, this GDP measure was revised down to only 1.1%. So, between Q4 2012 and Q1 2013, GDP growth averaged just a fraction of 1%. Because of a cyclical characteristic of U.S. GDP data compilation – that it is subject to substantial downward revisions around recessions, years after the fact – significant restatements of this data are yet to come. But, even assuming no further revisions, taking the current data at face value, yoy GDP growth hit readings never

Chart 2h: U.S. GDP, Growth Rate (%)



seen away from recession in more than 50 years (red horizontal line, Chart 2h).

It is Not Over Our longstanding prediction of more frequent recessions in the developed economies is now a reality. Among the G7 economies, all except Canada have seen yoy GDP growth decline to lows never seen outside recessions. Even in Germany and the U.S., which are widely touted as having comfortably skirted recession, GDP growth fell to lows not seen away from recessions in 50 years of data. What makes this even more striking is that all of these recessionary and near-recessionary GDP readings occurred despite unprecedented, concerted and massive global monetary accommodation, alongside other policies designed to pull demand forward ([USCO, November 2013](#)).

As long as low trend growth continues to plague the developed economies, the yo-yo years will persist, with relatively short recoveries punctuated by recessions. This condition brings many associated challenges. For example, youth unemployment has become greatly elevated in most western economies, and especially in southern Europe, and weak growth promises to keep joblessness at levels that may be socially and politically untenable ([ICO, June 2012](#)). Undoubtedly, stubbornly high unemployment will have far-reaching implications for income growth and government budgets, especially in a low-growth world.

The yo-yo years seem to have confounded both the consensus and policymakers, who are still hopeful that anemic economic growth is a temporary anomaly. Under the circumstances, the risk of being blindsided by cycle turns in either direction runs high. In this new economic terrain, with heightened cyclical risk in the U.S. and abroad, it becomes more critical than ever to monitor a framework designed to navigate economic and inflation cycles. ECRI's framework, and its array of objective leading indexes, provides that early warning for real-time cyclical monitoring. ■