ECONOMY & MARKETS

Are micro recessions the new normal?

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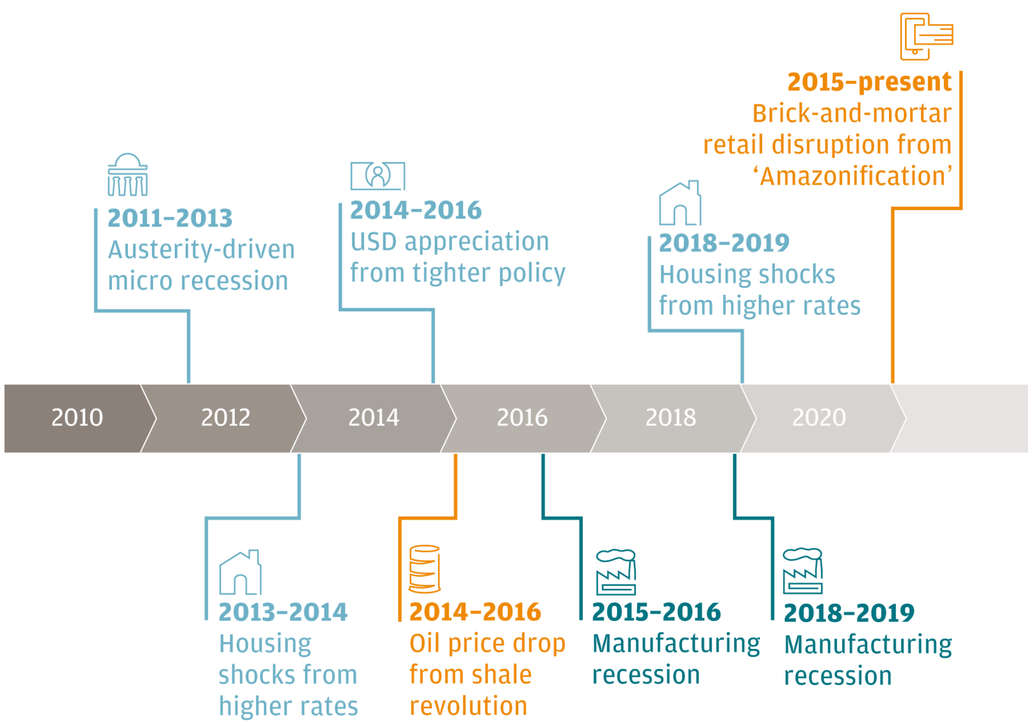
A series of mini booms and busts may be to thank for keeping the historic U.S. expansion going—and going.

Since the end of the financial crisis of 2007 to 2008, investors have fixated on forecasting the next economic recession. There have been a few scares, but a true economic recession has not materialized in the United States. Why not? It may be that a series of "micro recessions" have kept investor, business and consumer enthusiasm in check but not done enough damage to bring down the economy or markets as a whole. Over the next few years, we think it is more likely we will see a few more of these micro recessions than it is we will see the end of the cycle.

Micro recessions, which we define as a substantial decline in employment and output of a given industry, have defined the contours of the U.S. economy over the last 10 years. The catalysts of these micro recessions fall into three broad categories: monetary and fiscal policy, global industrial cycle and technological disruption.

Past causes of micro recessions and the likelihood of them causing the next



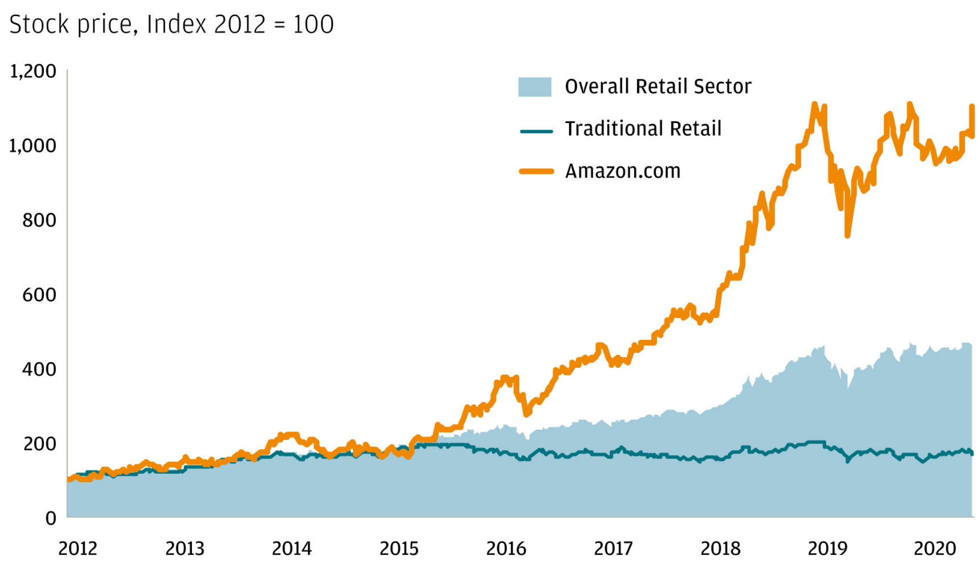
Source of micro recession	Outlook
Monetary/fiscal policy shock	Unlikely to turn restrictive anytime soon
Global growth and industrial cycle	Unlikely to turn restrictive anytime soon
Technological disruption	Most likely source of future micro recessions Candidates: Clean energy; transportation sector; financial services

Source: J.P. Morgan Private Bank. Data as of February 4, 2020.

Domestic fiscal and monetary policy is not restrictive now, and the global industrial cycle appears to be at a local trough. That leaves technological disruption as the most likely cause of the next micro recession.

Could technological disruption cause a *macro* economic recession—a substantial decline in *overall* output and employment? We doubt it. When innovations occur, they tend to offset the losses elsewhere in the economy. Online shopping platforms, for example, operate with a superior cost structure compared to physical market places. As such, they are a deflationary force, which in turn causes consumers to purchase more goods. Even though traditional retail jobs are lost, new jobs are created in industries like distribution services, warehousing and logistics. For the retail sector as a whole, activity keeps expanding, but the winners and losers have changed.

Retail: All shopping isn't distributed equally



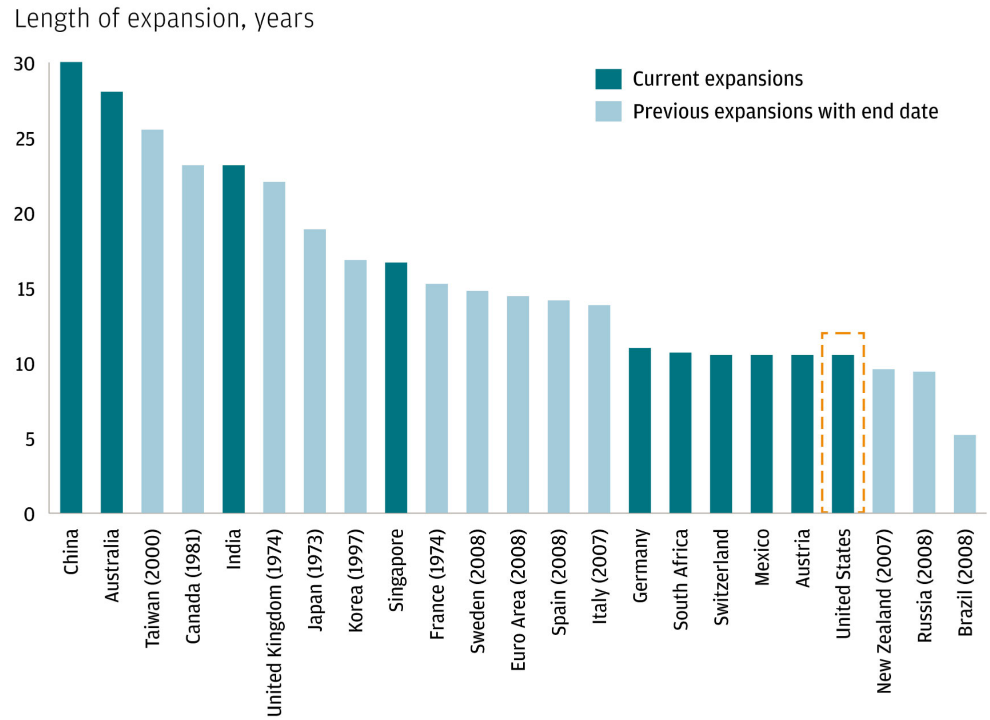
Source: Bloomberg, J.P. Morgan Private Bank Economics. Data as of January 31, 2020.
Past performance is not a reliable indicator of future results.

Possible candidates for the next *micro* recession are the energy and transportation sectors as clean energy and electric/autonomous driving gain traction. Another is the financial sector, which is going through a number of technological transitions that are ultimately beneficial for the broader economy (in the form of reduced costs and increased access for financial products and services), but could result in job losses.

Let's assume our hypothesis correctly explains the current expansion: repeated micro recessions allowing for an extended macro expansion. Could this pattern go on for another, say, five years? How about 10?

There's no law in economics that says it can't. While the U.S. expansion is aged compared to its own history, it is not especially long in an international context. Australia is currently in a 28-year expansion, which had its own share of micro wobbles along the way. Canada has a 23-year expansion in its history.

Relative to other countries, the U.S. expansion doesn't seem extraordinary



Source: FactSet, Standard and Poor's. Data is as of January 30, 2020.

What if we are wrong?

What might cause a macro economic recession? The most proximate cause could be the presidential election in the United States. The Progressive candidates have advocated remaking American capitalism. If those proposals become policy, it might disrupt the current expansion. However, even if a progressive were to become president, it is unlikely a radical policy would win enough votes in Congress to become law.

Another possible spark for a macro economic recession could be a return of wage pressures and price inflation, which the Fed would have to step in to control. The Fed might overtighten and cause a significant downturn (which was the risk in 2018). However, this scenario seems unlikely in the near term, as inflation continues to be capped by secular forces such as demographics and technological disruption.

An alternative "overheating" scenario could be that low interest rates and easy money finally incentivize the kind of animal spirits that have largely been dormant since the global financial crisis. Exuberance builds excesses, which eventually unwind. However, although asset valuations are certainly full, we see few signs of systemic exuberance at the moment.

To us, it seems more likely that, during the next few years, imbalances will not emerge at the macro level because a series of micro booms and busts will keep the macro in check. A common refrain is that "expansions don't die of old age." Indeed, if micro recessions continue to keep the macro backdrop contained, the U.S. expansion could live to see a very old age.

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