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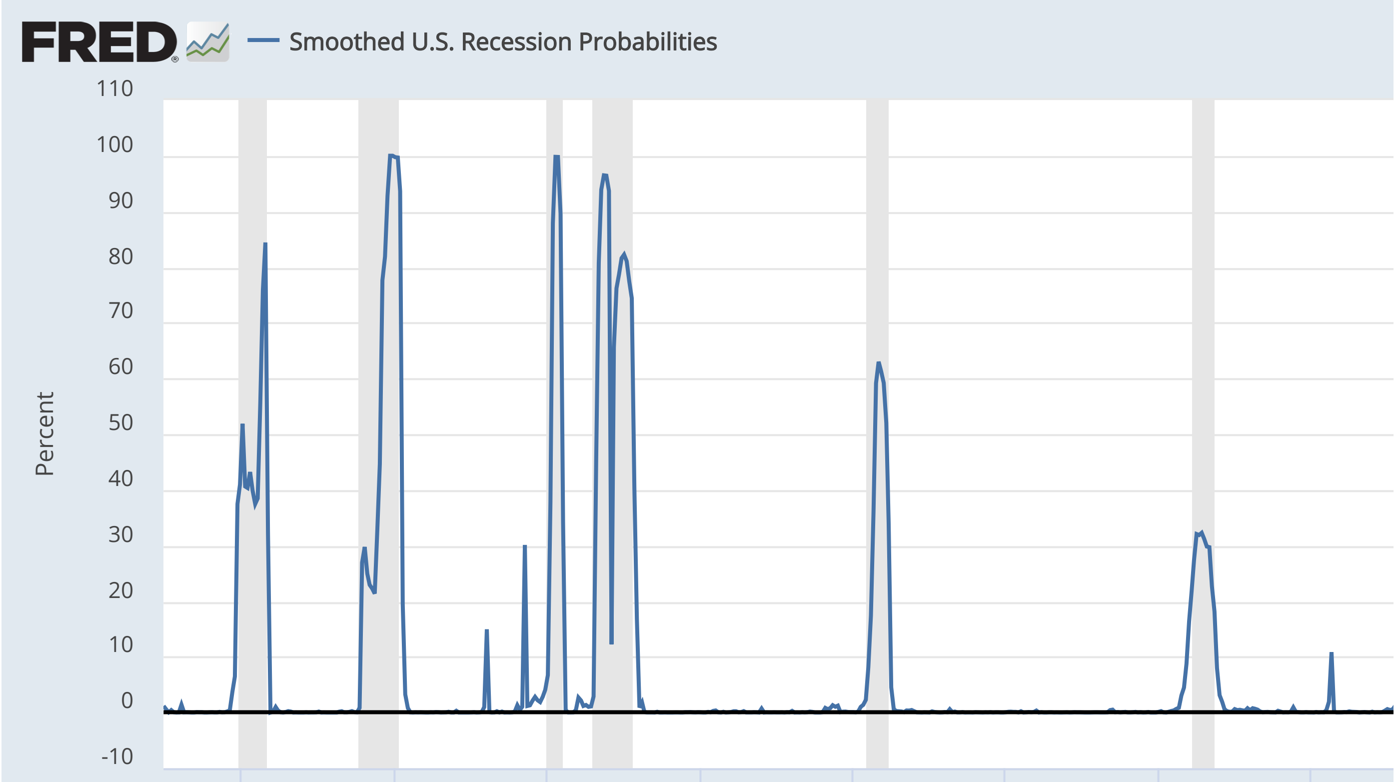
Assessing recession probabilities

The recession-predicting dataset of Chauvet and Piger

Posted on June 22, 2023



While much of the future depends on things that are impossible to forecast or time (for example, a pandemic), *particular* dynamics in *some* economic data have allowed *some* success in predicting a recession in the short run.

The FRED graph above shows data from Marcelle Chauvet and Jeremy Piger; the data set is based on economic data that tend to *lead* business cycle indicators—that is, they provide insight before the other data do. Judging from the graph, every recession (shaded in gray) has been preceded by a small increase in this computed probability of recession. There have been errors, but those errors have always predicted a recession that did *not* happen.

At the time of this writing, these data do not seem to exhibit any noticeable increase, which implies the data are not signaling a significant risk of recession. Hence, if a recession occurred soon, that would mark the first time this indicator would fail in this way. Another indicator, the Sahm Rule, is aligned with this assessment. But who knows? Abnormal things have happened in the data in the past few years.