

Is the US Already in Recession?

Is the US economy in recession? It depends. Measures of economic activity are estimates at best and usually mere guesses.

If it feels like a recession, it is a recession. To the 8.9% of the US labor force (Feb 2011 numbers), it must feel like a recession. Why, if economic growth has rebounded from the lows of 2009 to some 2.7% at the end of 2010, is employment not recovering as quickly?

The reason may lie in a couple of quirks in the way real GDP growth is calculated. We simplify the mathematics a bit by using an approximation that it is enough to subtract the inflation rate from the nominal growth rate to arrive at real growth. Its a good approximation. Nominal growth is 4.1%, PCE inflation is 1.4%, CPI inflation is 1.6% and so real GDP growth is around 2.7%. However, Owner's Equivalent Rent features large in CPI, some 25% in fact. With mortgage rates in decline despite a brief spike in Nov and Dec 2010, and Case Shiller falling at 2.4% p.a. last December, (note that this is not a cash flow item), the rest of the CPI must be rising at some 4 to 4.5%. Anecdotally we see that inflation in the US is not 1.6%. Rising petroleum prices, corn prices, cotton prices are creating more inflation than is picked up by the CPI.

Thus real GDP growth, if we use a deflator of 4% or 4.5% results in a number which is close to zero or negative. If this is true, then we have 0% growth and 0.25% interest rates, 4% inflation and a very interesting problem indeed. If housing prices should begin to recover, the problem facing the Fed could be troublesome.

