

WSJ Print Edition

We Were Promised a Recession

A funny thing happened at the end of 2007, on the brink of the worst downturn since the Great Depression: Two-thirds of economists didn't see even a garden-variety U.S. recession coming. The Federal Reserve had just cut rates three times in the past four months, after all, with more cuts on the way.

The proportions were flipped in The Wall Street Journal's economics survey three years ago when nearly two-thirds of respondents were expecting a recession to begin within a year. One didn't happen, despite several Fed rate hikes in the preceding months and more in 2023.

Predictions are hard, especially about the future. The point of digging through old ones isn't to make fun of economists but to understand what wrong-footed them. Can the warning lights on their dashboards be ignored when the Fed is easing, like it is now?

Possibly the most-reliable indicator of an impending downturn is an inverted yield curve. When the interest rate on longer-term securities like the 10-year Treasury note is lower than that for short-term ones then it signals an expectation of future rate cuts in response to coming economic weakness.

Since the 1960s, an inverted curve had reliably signaled recessions. One of those, in 2019, was right on a technicality—bond traders didn't predict the pandemic.

The inversion that lasted from summer 2022 through last summer was the longest yet. When it ended, some diehards pointed out that the downturn doesn't actually hit until the curve uninverts. Well, it's been a year, and a recession hasn't materialized.

Another previously reliable recession indicator, the ISM's index of U.S. manufacturing activity, was in contraction for a whopping 26 consecutive months through early 2025. It's now on a new six-month contraction streak. The barometer tends to point down just as a recession is beginning.

And finally, bear markets. Stocks nearly always enter one ahead of recessions and they did so in 2022. Economist Paul Samuelson famously cast doubt on this indicator, quipping that "the stock market has predicted nine out of the last five recessions."

Why did most economists misread the past few years, though?

One reason is that the bond market hasn't behaved normally since the Fed adopted powerful new tools in response to the financial crisis. Outright Fed bond buying and nearzero interest rates pack a lot of punch and create distortions, too.

A bigger fly in the ointment might be government spending. Even with the economy growing, the federal budget deficit is at levels previously only experienced during sharp downturns when social and stimulus spending has flowed. That gusher of cash goes a long way.

It also raises the question of how much dry powder Washington will have when warning signs aren't a false alarm and the U.S. really does enter a recession.

—Spencer Jakab