

## **A New Indicator Might Predict Recessions Faster Than Before** **The technique involves a modified view of unemployment.**

By Erik Sherman

An economist at the Federal Reserve Bank of San Francisco thinks he's found a new signifier of a coming recession that could offer a timelier indication than other techniques in common use.

The US is deep in what you could call the Recession Follies — one of those times when the economy is slowing. People wonder if the result will be a gentle landing or plow-into-the-ground recession. That's why there is so much churning over signs, like Treasury yield curve inversions, as though economists were an ancient Greece and poking through a pile of bird entrails.

Some say comparing the 3-month and 10-month is the gold standard. Others opt for different ones or a mix of several yield inversions. But there's a problem with such semiotic exercises: timing. Depending on the types of Treasuries involved in the inversion, you could be looking at about a recession somewhere from a year to two in the future.

Although that provides more time to prepare, the actual timing is unknown, like a Heisenberg uncertainty principal of economics. You know what will likely happen, but good luck knowing exactly when to put plans into play.

Thomas Mertens, a vice president of economic research at the Federal Reserve Bank of San Francisco, published some research this week suggesting a new approach based on the jobless unemployment rates. That's unemployment including workers in a number of categories that might not be considered technically unemployed based on the definitions the Bureau of Labor Statistics uses.

Mertens used a three-month moving average of the number, which is somewhat similar to the Sahm Rule, developed by former Fed economist Claudia Sahm in 2019. Her approach is an early indicator of when the economy has already fallen into a recession.

Mertens took the moving average and turned it into a predictor with a different treatment. He takes the first derivative (the rate of change) of the jobless unemployment rate, and then plots that against the second derivative, or how fast the change is changing. Numbers are plotted in what Mertens calls a clock, but which seems to be a polar coordinate plot. The lines can spin about within a quadrant or move into others in a generally clockwise pattern.

The graph is also divided into quadrants: top right being I; bottom right, II; bottom left, III; and top left, IV. Recession danger comes when the jobless unemployment trend moves from the IV quadrant to I, or top left into top right. The three-month moving average of the angle of the current time on the plot line becomes a probability.

Mertens wrote that according to this approach, the trend moved into the top right quadrant, but the three-month moving average still hasn't in a sustained way, which would suggest no immediate recession. But as he also wrote, "This assessment could change quickly if the unemployment rate ticks up in coming months."