US Economy: These charts show recession odds may be higher than you think

- August payroll numbers point to a year-over-year growth rate of just 1.45 percent, the weakest in six years.
- Business loan growth has slowed dramatically, and a survey of bank loan officers cited decreased customer financing needs as reasons for the weakness.
- Business confidence surveys, especially for the small business segment, remain strong, but they are not showing up either in the pace of hiring or in demand for credit.

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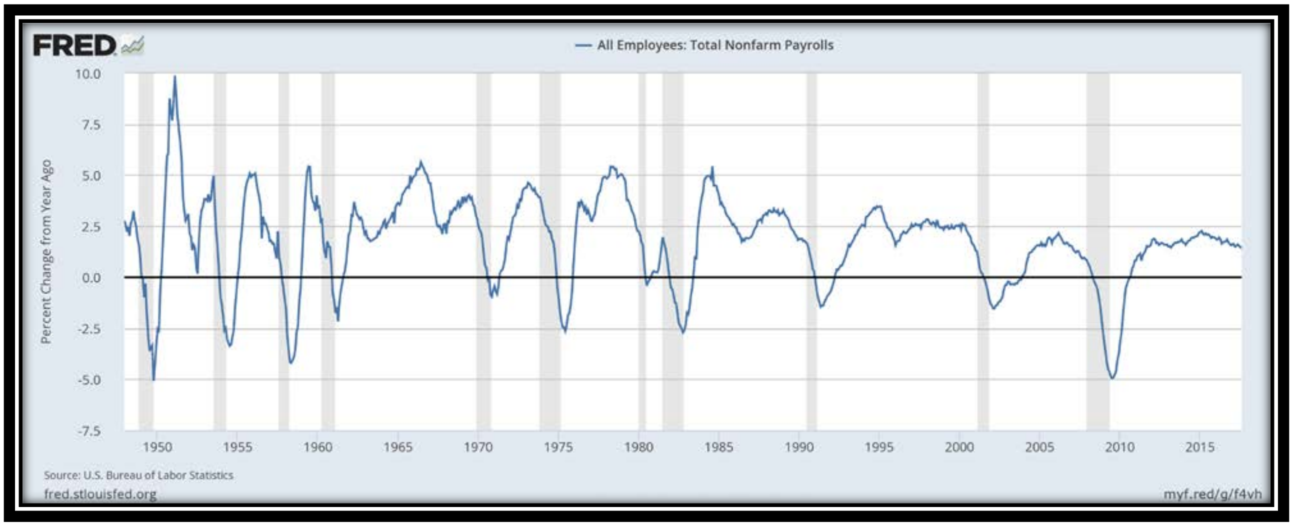
Bryan Woolston | Reuters
A worker assembles a Ford truck at the new Louisville Ford truck plant in Louisville, Kentucky.

While the early assessment of second quarter GDP growth relieved some of the concerns that came from the first quarter's rather anemic 1.2 percent growth, two important forward-looking measures are signaling not just a slowdown but a very strong possibility of recession in 2018.

The absolute level of monthly payroll gains has provided comforting evidence to the bulls that employment remains healthy, but it is the "relative" growth that gives us pause on the potential for consumer spending over the coming 12 months.

Year-to-date payroll gains of 1.405 million compare to 1.548 million for the same period in 2016, with a higher starting base. August payroll numbers pointed to a year-over-year growth rate of only 1.45 percent, the weakest in exactly six years.



Source: Federal Reserve Bank of St. Louis

Twelve months prior to the start of the 2008-2009 recession, payrolls were growing at 1.55 percent. They were growing at 2.6 percent a year before the 2001 recession, and at 2.39 percent a year before the 1990 recession. In fact, payroll gains have averaged 2.67 percent 12 months prior to the beginning of all recessions since 1947.

Put differently, we have never had a situation where payroll growth was this weak on a year-over-year basis and we were not in a recession within the next 12 months. Not since 1947, at least.

With such a growth rate and rather tame real wage growth, the profile of consumer spending over the course of the next four quarters looks quite frail relative to the past several years. That could prompt even weaker hiring, especially in economically sensitive sectors.

The other measure of concern to us is business loan growth, the engine of investment and of job creation. Bank commercial and industrial lending (a.k.a. C&I Loans) has slowed dramatically. A year ago in July, banks were expanding this component of their balance sheets at a rate of 9.35 percent compared to the prior 12 month period. The latest data from the Federal Reserve point to a growth rate of only 1.6 percent over the last 12 months.

Source: Federal Reserve Bank of St. Louis

Bank of America CEO Brian Moynihan argued as such recently by labeling loan demand as "OK" and not "strong" for his bank. The Federal Reserve's recent survey of loan officers indicated that despite less restrictive lending terms, loan demand from large and middle market firms was at its weakest net level since 2010, with over half of the bank officers surveyed citing decreased customer financing needs as reasons for the weakness.

No wonder the growth rate in jobs has weakened. Since the end of World War II, such weak growth rates in business lending have always occurred either during a recession or immediately following one.

And when combining these two all-important indicators, the picture becomes even bleaker. The American economy needs healthy business investment, hiring and consumer spending to sustain growth. And while business confidence surveys, especially for the small business segment, remain strong, they are not showing up either in the pace of hiring or in demand for credit.

Looked at in combination, when growth profiles for both indicators have been this weak historically, we were either in a recession or just coming out of one. Given the age of this cycle, we know that later is not likely. Heading into all recessions since the 1950's (the data from the Federal Reserve on C&I loans only permit us to look at recessions since 1953), we have never had such a weak one-two punches of sub 2.0 percent year-over-year growth rates for the engine of consumer spending and business expansion.

And while a weaker dollar could help improve the trade deficit, and increased government spending on infrastructure, for example, would help increase government consumption, neither impact will be large enough to offset the coming weakness in domestic private demand as implied by the two indicators.

The perpetual optimists are holding tight to the hopes of an eventual spillover from soft into hard data, and/or Washington-induced reform finally coming to fruition. Historical experience and pragmatism tell us otherwise.

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