

Not All Recession Theories Make Sense

Austrians are different than Keynesians. Austrians think recessions are caused by government failure, while Keynesians think they are caused by market failure. Take the 2008 financial panic. Was it market failure and bad business models or was it using the government to subsidize housing plus mark-to-market accounting? We believe the latter...without the subsidies and bad accounting rule, the recession might not have happened at all.

Why does this matter now? We think a recession is coming because the economy was artificially stimulated during COVID but the M2 money supply has declined in the past year. In addition, by rewarding short-term cash, the inverted yield curve should eventually limit business investment and risk-taking in general.

Others argue that mortgage rates (along with credit card and auto loan rates) are so high now that those taking out credit at current higher rates will be squeezed enough to cause spending to fall in other areas, leading to a slowdown in the economy.

Superficially, this theory might make sense. Back in 2021 the median existing home sold for about \$350,000 while the typical 30-year fixed mortgage rate was near 3.00%. If the buyer put 20% down, the principal and interest payment would be \$1,180 per month. Now the median existing home sells for about \$400,000 while the typical mortgage rate is about 6.8%. As a result, a purchaser putting 20% down faces a monthly payment of \$2,086.

That's an increase of 77% or extra mortgage payments of \$10,872 per year, which is a heavy lift for most households. No wonder some analysts and investors are concerned.

But, digging below the surface, the argument has some serious problems. First, it's important to recognize that those extra mortgage payments don't disappear into some sort of economic black hole; the extra money is paid to the lender who now has more purchasing power than they'd otherwise have.

Second, if the extra payments were accompanied by plummeting home prices and adjustable rates resetting higher that could be a problem because some homeowners might strategically default, setting off a bank problem like in 2008-09. But home prices aren't steeply declining and are unlikely to do so. Few of the new homeowners with higher mortgage rates are going to find themselves "underwater" (with negative equity).

And third, while mortgage rates are up, consumers are earning more interest income on bank accounts or other investments. The annual rate of interest income for consumers is up \$121 billion versus a year ago.

Still others argue that student loan payments, or gas prices, or food prices will undermine consumer spending. But, once again, that spending is income to someone else. Adding up all the things that may hurt some individuals is not how Austrians forecast the economy.

Government policy matters and the massive stimulus and lockdowns during COVID, some of the biggest policy mistakes in US history, require a price to be paid. We get it, forecasting in unprecedented times is difficult. But, if a recession happens, it's not the little things that matter. It's the big things.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-31 / 8:45 am	Chicago PMI – Jul	43.5	41.4	42.8	41.5
8-1 / 9:00 am	ISM Index – Jul	46.9	46.6		46.0
9:00 am	Construction Spending – Jun	+0.6%	+0.3%		+0.9%
afternoon	Total Car/Truck Sales – Jul	15.8 Mil	16.0 Mil		15.7 Mil
afternoon	Domestic Car/Truck Sales – Jul	12.4 Mil	12.6 Mil		12.4 Mil
8-3 / 7:30 am	Initial Claims – Jul 29	225K	227K		221K
7:30 am	Q2 Non-Farm Productivity	+2.2%	+2.3%		-2.1%
7:30 am	Q2 Unit Labor Costs	+2.5%	+2.6%		+4.2%
9:00 am	ISM Non Mfg Index – Jul	53.0	53.3		53.9
9:00 am	Factory Orders – Jun	+2.2%	+2.3%		+0.3%
8-4 / 7:30 am	Non-Farm Payrolls – Jul	200K	210K		209K
7:30 am	Private Payrolls – Jul	180K	180K		149K
7:30 am	Manufacturing Payrolls – Jul	5K	10K		7K
7:30 am	Unemployment Rate – Jul	3.6%	3.6%		3.6%
7:30 am	Average Hourly Earnings – Jul	+0.3%	+0.4%		+0.4%
7:30 am	Average Weekly Hours – Jul	34.4	34.4		34.4