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## Are we going into a recession? Financial experts weigh in at the Vail Symposium

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On Sept. 20, the night before the [Federal Reserve raised the interest rate from 3% to 3.25%](#), financial experts expressed concern about inflation during Vail Symposium's Zoom webinar.

"I worry that the Fed is so determined to bring down inflation that they're more likely to do too much than too little in their efforts to slow the economy," said David Wessel, senior fellow in economic studies at Brookings Institution, adding that the Fed could push the economy so close to a recession that the slightest bit of "bad luck," from weather to war to a pandemic, could tip us into a recession. "But I don't think it's going to be a bad recession if there is a recession."

Of course, one of the hot questions of the night was: Are we in, or are we going into, a recession?

Lisa Shalett, chief investment officer of Morgan Stanley Wealth Management, doesn't think so.

"We actually reject that notion," she said. "We don't think the U.S. economy is in a recession, nor do we think the U.S. is going to enter a recession in the next 12 months, and the fundamental reason really has to do with contextualizing where growth was coming from and why that growth was contracting in the first two quarters of this year — from what level."

Coming out of the pandemic, last year's "recovery" was fueled by unprecedented and record stimulus measures (45% of annual GDP), which produced "extraordinary growth in our economy at the same time we had inflation," she said. As a result, the nominal growth at the end of the year hit double digits. In an average year, real growth falls between 2% and 3%, and inflation has been at 1.7%.

During the pandemic, consumers bought more goods and avoided services, like travel, entertainment and dining. As more people start to purchase services, she thinks economic momentum sustains itself.

"As long as people have jobs — and they really do have jobs — and as long as companies have cash and are spending and investing that cash, we're not going to have a recession," she said.

So how will we know if we're heading into a recession?

For Shalett's team, factors include unemployment and durable spending. Unemployment rates recently moved from 3.5% to 3.7%. She said they become concerned growth is contracting when unemployment moves toward 4% or 4.5%.

"The second thing is we would want to see a much more durable collapse in capital spending and durable goods," she said, in terms of a recession. "Durable spending has held up ... that means demand is there."

Wessel is a little less optimistic when it comes to the next 12-18 months. He agrees that the labor market is "impressively strong" and the economy seems to be shaking off effects of the pandemic. But he points to three signs of economic weakness.

First, the stock market has come down (though he doesn't suggest the stock market predicts a recession). Second, globally, the world is slowing, which will reduce some demand, which should decrease commodity prices, "and that should make the Fed relax a little bit." But, the thing he worries about most is:

"I think the Fed is so determined to bring down inflation and so determined to not risk letting inflation get imbedded that they're more likely to do too much than too little," he said. "The Federal Reserve wants to slow the economy."

Inflation comes from too much demand (partially due to stimulus packages) and not enough supply, as well as one-offs like not having enough chips to make cars and pressures from the Russian-Ukraine war, he said. Recent data shows 50% of companies expect job cuts. Wessel said we just don't know yet if there will be a recession, but he's hoping for a "soft landing."

"There's just nothing like this in the historical record, both in the downfall and in the snapback, so of course you're going to have massive dislocations and problems, and they're not going to look like anything in the past," said Norbert Michel, vice president and director for the Center for Monetary and Financial Alternatives at the Cato Institute. "Everybody wants to hang the two-quarter recession thing out there, but the truth is that's only happened five times in the post-war period — two quarterly declines. ... Anyone who looks it up will tell you there is no fixed definition of a recession, so it's hard because everyone wants to label it something and name it something. Things are not great, but why would they be given what we just did and what we just went through? It think it's going to take some time to clear out."

He and Richard Bard, founder and chief executive officer of Bard Capital Group, LLC, agreed that the biggest fear is that the Fed will do too much and create a recession.

"Having been at the Fed, I think the tendency will be to overshoot. It's just the way it is," Bard said. "Part of the problem is their tools take time to be implemented, so the impact of these rate increases is anywhere from nine months or longer."

As Bard pointed out, what we call what's happening doesn't really matter; it's how it impacts the average person, and companies.

Wessel thinks some prices will fall and in three years or so, we'll land in the 2% to 3% range, because the Fed will do what it takes to get us there. But, he warns:

"There are a lot of wildcards (from weather to war and pandemics), so a lot of this has to do with luck," Wessel said. "We had a lot of bad luck last year so I'm hoping we have better luck this year."

Moving forward, prices don't have to return to pre-pandemic levels to fight inflation, Michel said.

"What really matters to people is, is their real income going up? And that's what we have to get back to. If people's wages are going up enough to compensate for increases in prices, we have rising living standards — that's the goal," Wessel said. "I think we'll get back to that, and that's more important than anything else."

But what we probably won't get back to is how "spectacular" financial markets have been for the past 13 years because inflation averaged below the Fed's target of 2%, at 1.7%, Shalett said.

"That period I do not think is going to be replicated," she said, adding they think inflation will settle in somewhere between 3% and 3.5% over the next five to seven years.

She also talked about reshoring American jobs, how achieving cleaner energy will put upward pressure on prices and how strong the U.S. dollar is.

"If the United States dollar starts weakening in a secular move after what has been what we think is a secular appreciation, that will be an inflationary tailwind," she said.

The panel also weighed in on housing, which drives much of the economy.

"We're incredibly constructive over the intermediate term for housing," Shalett said, adding that the younger generation will generate demand.

"We have a shortage of housing. There's going to be demand for it," Wessel said. "But I think in the near-term, housing will take a hit."

The panel also discussed topics like student loan relief, the stock market, the Russian-Ukraine war and China. The hour ended with predictions.

"I think we have inflation that's higher than economic growth, and I think it's going to feel a little tough," Shalett said. "My guess is that the S&P flatlines, and it feels like a roller coaster over the next 12 months but we end up about where we are today. I do think that interest rates get to something with a 4 in front of it before reverting closer to 2.5 ... but I do think we avoid an outright recession."

While Shalett predicts a 50/50 chance of going into a recession, Wessel thinks there's "a greater risk that the Fed will push us into a recession."

"I think we're in for a rough couple of years. It's going to be a bumpy ride," he said. "But I have quite a bit of confidence that we'll come out of this period, and we'll be stronger economically a decade from now than we are now."

