Where are we on the business cycle?

Frances Donald, Chief Economist and Head of Macroeconomic Strategy, Manulife Investment Management

Now, for those of you who took Econ 101, which is most of you, the rest of you did take it, you just don't remember, you have PTSD.

You might remember learning about this, the business cycle. Right? Is it coming back to you? Yeah, I see smiles, I see tears.

The business cycle. This is the classic economic concept that every economy goes through. Booms and busts, good times and bad times, but we always come back to this long term stable average, right? You all remember this? Looks a lot like the relationship I have with my mother.

What we're learning, however, is that the world doesn't look like this at all. The world looks a lot more like this, which is that we still have ups and downs, good times and bad times, but they're happening along a long-term down trend. Now, I sit on a host of investment teams. I contribute as a senior leader on an asset allocation team, and I effectively have two jobs. There are two reasons why I come in to work every day and why I work with asset allocation at Manulife Investment Management, and the first is to help our teams understand where we are on the dotted line. Where are we on the cycle?

And you can see, right now. I actually think we're at an inflection point, and I could give you a whole presentation on why that is. We could talk about the fact that in the past 18 months, we've had a severe deterioration in global manufacturing. A global manufacturing recession is what I call it, driven by inventory de-stockings, slower China, the tensions on trade and how that weighed on global growth, and now we're at a point where the worst of that is behind us and we're expecting the global economy to re-accelerate. And if I was giving you that type of presentation, I might also say, "I know this, so do all of markets, it is already priced in. In fact, we are priced to perfection, and we are very vulnerable to a shock."

Potential GDP is an economist's estimate of how fast the economy can grow if everything is perfect. If everybody who wants a job has a job, if companies are hiring and spending exactly as much as they want to, what is the growth rate of the economy? And we calculate it with this formula, the change in the labour force participation rate, the change in the productivity. Forget all that for a minute, let's just take a look at how we estimate these things and what happened.

In the 1970s, we were capable of growing 3, 4, 5%. That was a walk in the park for us. Easy day. Today, we grow at half that. One and a half to 2% is about our potential, our best run at growth in that particular environment. There are other ways I think about potential. I've used this example for many years, I think it's the most effective and it resonates with a lot of our end clients, your clients.

I want you to think about an economy in these pretty simple terms, but it works. Think about an economy like a McDonald's, and the GDP of McDonald's is the number of hamburgers it produces. Pretty fair? The number of hamburgers that a McDonald's produces is a function of two things, how many people work behind the counter and how fast each one of those people makes a hamburger. Labour force participation rate, and productivity. No matter where I am in the world, no matter what I'm doing, if I'm reacting on BNN to news, or I'm sitting on the trading floor, every piece of economic data that comes in will eventually flow into one of those two categories: how many people are working, and how good are they at their jobs?

Another way I think about potential... This one is hard for me, I remember, as a child, I got a C- on a math test, my mother took away my TV privileges for the week. The next week, my brother got a C- on his geography test, and we all went to Chuck-E Cheese to celebrate. I remember asking my mother, you know, "What gives?"

She said, "Sweetheart, I have different estimates of your potential." Fair.

The biggest call that I have been making, and will continue to make, the biggest call in my career is not where we are on the cycle. That fluctuates all the time. But the idea that we are probably trapped in 2% growth for an extended period of time, for many decades, that is my bold call. And the number one reason that I believe that we are stuck near 2% growth for an extended period of time is because we simply don't have enough people working behind our metaphorical counters. We do not have the labour force strength in our economy that we had in the past.

Here's an example of this. This is U.S. employment to population ratio. I've used the U.S., you can look at most developed countries, including Canada, and they'll tell you a similar story. This is just the share of how many people are working versus how many are alive. It's a very intuitive economic data point. And you can see we've had some recoveries since the great financial crisis, but this statistic didn't peak in 2008, it peaked in 2001. And we're not going back to those levels that we've seen in the past. We're not going back to 2001 levels of the population working to this extreme.

Now, many of you will look at this and you will intuitively understand: this must be aging. This must be a component of our population that is now retired, they've paid their dues, they don't have to work anymore. And you'd be right, that's a huge component of what we have going on here.

So that green line is that same line from the back page, and the blue line, I took out everybody over the age of 55. You don't have to leave the room, it's just on the chart. And even here, you can see depressed levels of what we call the prime age workforce actually participating in this economy. So now I'm talking about things that I never thought I would talk about. In the United States, 6% of Americans are currently collecting disability, 4.5% not working because of it. In the 1970s, the number one reason people collected disability was heart disease. Any idea what it is today? Back pain. Back pain. The funny thing about disability is it actually helps us understand what's happening in the economy, because when wages start to rise, when job opportunities get better, we actually see fewer and fewer people claiming disability. Suddenly, their backs don't hurt, right? That's an interesting indicator.

Another thing that I didn't learn in school: you know half the men between 25 and 54 years old in the United States who are not working are currently taking daily opioids? I didn't learn about that. New things. Here's another one: 1% of Americans currently incarcerated. One out ofa 100. That's okay, they're not really included in our data. Most of the data we look at is just civilians. But 25% of Americans have some form of criminal record. Wow.

Now, that shouldn't really be an issue, it doesn't matter to me. Like, for example, my husband was arrested for graffiti at 17 years old, and I find that very attractive. But how many of us here had to fill out a background report, or a background check at some point in our careers, just to make sure? You know, most of us. A room full of criminals? We all did, right?

So, we know people are being limited, and we're starting to hear stories, particularly, and this is why we believe we're in a rebound environment, we're starting to hear stories, actually, in the United States, of actual employers going to prison to recruit people because there's nobody else to hire. I heard a story about a woman in Maine who would actually... She works in the steel industry, she set up a steel training company within the prison so that she could train people and have them ready to work as soon as they come out.

So, some of these dynamics are things that we never learned in our Econ 101 textbooks, but in this environment, where labour is so tight, we have no choice but to look at some of those alternative explanations.

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