

J. Bradford DeLong: The Fed Should Buy Recession Insurance

If the United States falls into recession in the next year or two, the US Federal Reserve may have very little room to loosen policy, yet it is not taking any steps to cover that risk. Unless the Fed rectifies this soon, the US – and the world – may well face much bigger problems later, writes **J. Bradford DeLong**



Source: iStock

The odds of recession

The next global downturn may still be a little way off. The chances that the North Atlantic as a whole will be in recession a year from now have fallen to about one in four. German growth may well be positive this quarter, while China could rebound, too. And although US growth is definitely slowing – to 1% or so this quarter – this may yet turn out to be a blip.

Let's hope so. Because if the next downturn is looming, North Atlantic central banks do not have the policy room to fight it effectively. Should a recession arrive, the US Federal Reserve would ideally be able to cut interest rates by five percentage points, as is customary in such situations. But with short-term safe interest rates currently at 2.4%, it cannot. And with euro and yen interest

rates still around zero, the European Central Bank and the Bank of Japan would be unable to help much, either.

Looking ahead, therefore, the big risk is not that inflation will start spiraling upward, with the Fed unable to raise interest rates fast enough to stabilize the economy. Rather, it is the downside risk that a year from now, the North Atlantic will be in recession, governments will not provide enough fiscal stimulus, and the Fed won't be able to reduce interest rates enough – leaving it nearly helpless to even try to stabilize the economy.

The Fed's options

The logical response to such an asymmetric risk is – or ought to be – to buy insurance to cover it. Worryingly, however, the Fed is not taking out any policy insurance at all against a possible recession, despite having at least three possible options from which to choose.

- For starters, the Fed could raise interest rates further now, creating more room for rate cuts if the US economy subsequently falls into recession. But Fed Chair Jerome Powell seems to have ruled out this option for the time being. In a recent interview, Powell said the Fed's policy rate "is in an appropriate place" in view of "muted" US inflation and increasing evidence that the global economy is slowing. "We're going to wait and see how those conditions evolve before we make any changes to our interest-rate policy," he said.
- Alternatively, the Fed could cut interest rates today to try to compensate for its inability to reduce rates enough in a future downturn. If growth then recovers and strengthens – as more likely than not it will – there is no harm done. US inflation expectations are well anchored, so the Fed could fully and cheaply offset looser monetary policy now with a tighter stance later. But if growth does not pick up, and the North Atlantic falls into recession, the Fed will have to cut interest rates frantically at the end of this year. And it will greatly regret that it did not get ahead of the curve by preemptively lowering rates today.
- The Fed's third option is to leave interest rates unchanged for now, but clearly and aggressively explain how it would fight a recession effectively, should one arrive over the course of the next year. In doing so, the Fed would need to be far more convincing than it was from 2010 onward, when the US economy was struggling to recover from the 2008 financial crisis. On that occasion, then-Fed Chair Ben Bernanke's monetary policy – and his pleas to Republican legislators and austerity hawks to put the national interest ahead of partisan point-scoring and support aggressive fiscal stimulus – were completely ineffective in generating growth above previous trend rates. As a result, the US recovery was anemic and unsatisfactory.

A more credible Fed plan to fight a possible recession in 2020, 2021, or thereafter might well boost business confidence and make the central bank's policies more effective. At the very least, it would reassure companies and investors who, fearing that US aggregate demand will be weak in 2020, might be starting to pull back. But this third option would require an aggressive intellectual and communications effort from the Fed, and there is currently no evidence of one.

If the US falls into recession over the next year or two, the Fed may have very little room to loosen policy. And yet it is not taking any steps to cover that risk. That is unwise. Unless the Fed buys some recession insurance soon, the US – and the world – may well face much bigger problems later.

This article was originally published by [Project Syndicate on 15 March 2019](#)

Author

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com