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What ECRI is thinking?

The idea of double-dip recession is in fashion those days.

The Economic Research Institute's Weekly leading index (ECRI's WLI) plunge non-stop since October of 2009. Since WLI has forged an inevitable reputation for accurately calling recessions and recoveries well in advance, many people believe that U.S. economy is going to fall into recession. Are they correct? Is ECRI going to make a recession call? In our view, the answer is NO.

On June 14, Lakshman Achuthan, Managing Director of ECRI, blasted the Wall Street Journal for misleading reporting. In a comment in response to the WSJ article, he wrote:

"While we certainly appreciate the attention given to our Weekly Leading Index, I'd like to clarify a few points raised in the article. First, according to the Economist magazine, "the ECRI" has not ever given false alarm on a recession forecast.

The purported false alarms from "the ECRI" mentioned in this article come from a mistaken and simplistic view that negative growth in ECRI's Weekly Leading Index is tantamount to a recession forecast. In fact, since 1983, cyclical downturns have taken WLI growth under the zero line a dozen times, but recessions have followed on only three of those occasions – times when ECRI actually made a recession forecast.

Since ECRI itself has never used WLI growing negative as a recession signal, it is important that such "false alarms" are attributed not to ECRI or even to the WLI, but to what is a mistaken interpretation of the WLI.

In fact, at the very least, ECRI itself would need to see a "pronounced, pervasive and persistent" decline in the level of WLI (not merely readings in its growth rate) following a "pronounced, pervasive and persistent" decline in the Long Leading Index (LLI), before it makes a recession call."

Surprisingly, some people discovered that the ECRI did not actually predict the recession until we were in it for several months. The summary of the report – ECRI US Cyclical Outlook – November 2007 Vol.XII, No.11 is shown below:

"Following ECRI's accurate prediction of the 2001 recession, we have not predicted another recession, despite Fed rate hikes, major oil shocks, a 100-year flood and a serious housing downturn. It desisted from calling a recession despite an inverted yield curve, which many economists have long considered to be the best predictor of a recession.

The difference this time is that, good leading indexes like the USLLI are not yet showing recessionary weakness, whereas in the past such recessionary vulnerability was followed by the shock. This is a key reason why the economy is not yet in a recession.

In fact, the level of the USLLI is already a little lower now than it was three months earlier. However, this weakness is not pronounced, pervasive and persistent enough to be recessionary."

Then, on March 28, 2008, ECRI suddenly stated that we were on the recession track. At that time, the recession was already underway for about three months. According to NBER, U.S. economy has fallen into recession in Dec 2007.

It seems that ECRI would like to “postpone” the recession call so as to prevent making mistakes. Also, there may be problems in making recession call by using WLI alone. If WLI alone is enough for the study, why ECRI still upload the weekly data on their website for free? We don't know the exact methodology that ECRI is using, but we are sure that it hasn't made the recession alarm yet.

We believe that double-dip recession and bear market are not coming shortly, at least, by the end of next year.

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