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INSIGHT

The Sahm Rule Trigger: Is the United States in a Recession?

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The cooling labor market has fueled speculation that the United States could be in or headed for a recession. The unemployment rate has been gradually rising from a low of 3.4% in April 2023, and the July jobs report showed slower job growth and an uptick in the unemployment rate to 4.3%, the highest rate since October 2021. This triggered a popular recession indicator—the Sahm rule. This Insight discusses how recessions are determined and what the recent triggering of the Sahm rule may mean for the economy.

What Is a Recession?

Recessions are not determined by the federal government and are not defined in statute. The National Bureau of Economic Research (NBER), the arbiter of the U.S. business cycle, defines *recession* as a "significant decline in economic activity that is spread across the economy and that lasts more than a few months." It does not have a set formula to define a recession. Instead, the NBER evaluates a downturn based on three criteria—depth, diffusion, and duration—using various indicators, such as income, employment, consumption, sales, and industrial production. The two indicators the NBER most closely considers are real personal income less transfers and nonfarm payroll employment. (For an explanation of business cycles and recessions, see this CRS report.)

The NBER dates recessions after they are underway and sometimes not until they have already ended. For this reason, unofficial indicators—such as the Sahm rule—can provide policymakers with useful real-time information on the state of the macroeconomy.

The Sahm Rule

Economist Claudia Sahm created a real-time indicator in 2019 that is used by many economists and policymakers to identify whether the economy may be in a recession. The Sahm rule is triggered when the three-month moving average of the unemployment rate increases by 0.5 percentage points or more relative to its low in the previous 12 months. The Sahm rule has typically been triggered in the beginning months of a recession, meaning that it does not predict recessions so much as indicate that one is

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occurring. Still, an indicator triggered in the first months of a recession would typically be more timely than an NBER declaration.

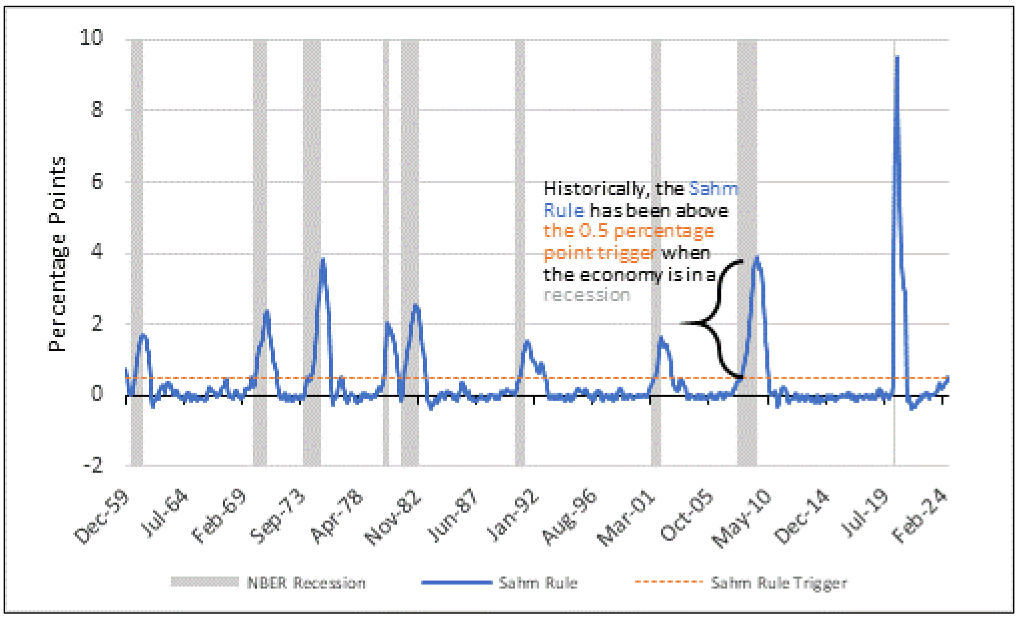
The Sahm rule is based on the historical pattern in which a rise in unemployment above a specific threshold tends to be followed by a further rise in unemployment, making the initial increase a reasonably accurate recession indicator. Sahm originally created the rule as the criteria for triggering fiscal stimulus: She noted a phenomenon that occurs during recessions and could be measured in real time, providing a proxy measure that policymakers could use to facilitate fiscal policy decisions.

In all nine recessions since 1960, the Sahm rule was triggered by month four. In two cases, the rule was triggered prior to a recession occurring and then again during the recession (December 1959 and October 1969). The Sahm rule was triggered in November 1976 without a co-occurring or subsequent recession.

In July 2024, the Sahm rule was triggered when the three-month moving average of the unemployment rate was 0.53 percentage points higher than its low since July 2023 (see **Figure 1**). Absent any decreases in the unemployment rate, the rule is likely to stay triggered for the next few months. (The unemployment rate was at a relative low of 3.7% in November 2023, December 2023, and January 2023.)

Figure 1. Sahm Rule

December 1959 through July 2024



Source: Federal Reserve Bank of St. Louis.

Is the United States in a Recession?

There is no theoretical reason why the criteria used in the Sahm rule is associated with a recession—it is an observed historical relationship for a small sample and may not always hold going forward. Sahm herself has indicated that despite her rule getting triggered, she does not believe that the United States is currently in a recession, although she believes that the risk of recession has increased.

The primary indicators used by the NBER are not currently consistent with a recession, and several remain strong. For example, real gross domestic product has been positive since the third quarter of 2022 and grew by 1.4% and 2.8% in the first and second quarters of 2024, with real personal consumption expenditures up 1.5% and 2.3% over the same period. Real personal income less transfers grew in May and June 2024 and were up 1.8% over the year in June.

Thus far, the only indications of a weakening economy are coming from the labor market, and even there, indicators are inconsistent. Although there has been a 0.9 percentage point increase in the unemployment rate and nonfarm payroll employment growth has slowed, employment growth remained positive, which is inconsistent with a recession. (Recessions typically feature falling employment within the first three months.) Employment as measured by a different survey has shown some decreases, but the NBER does not track this measure as closely.

The unemployment rate could be rising for reasons associated with a weakening economy (e.g., workers losing their jobs) or for neutral reasons (e.g., new entrants to the labor force). Data on the reasons for unemployment suggest that the unemployment rate has risen at least partly because the economy has weakened. Almost two-thirds of the increase in unemployment in the past year has come from people who have lost their jobs (mostly via temporary layoffs or jobs ending), whereas around one-third has come from people entering or reentering the labor force. On the other hand, the rise in unemployment has not coincided with a rise in layoffs and discharges—which are still lower than during the expansion that preceded the pandemic—as would be expected if the economy were entering a recession. Additionally, many economists assessed that the unemployment rate was unsustainably low for over two years. Some cooling in the labor market could indicate a rise to a more sustainable rate. Now the key question is whether it will continue to rise. Unemployment remains low by historical standards, and if it does not rise much further, a recession can be avoided.

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