KENNESAW STATE UNIVERSITY
COLES COLLEGE OF BUSINESS
*Bagwell Center for the Study of Markets and Economic Opportunity*

# COMMENTARY

## *Are We in a Recession? Are We Heading to One?*

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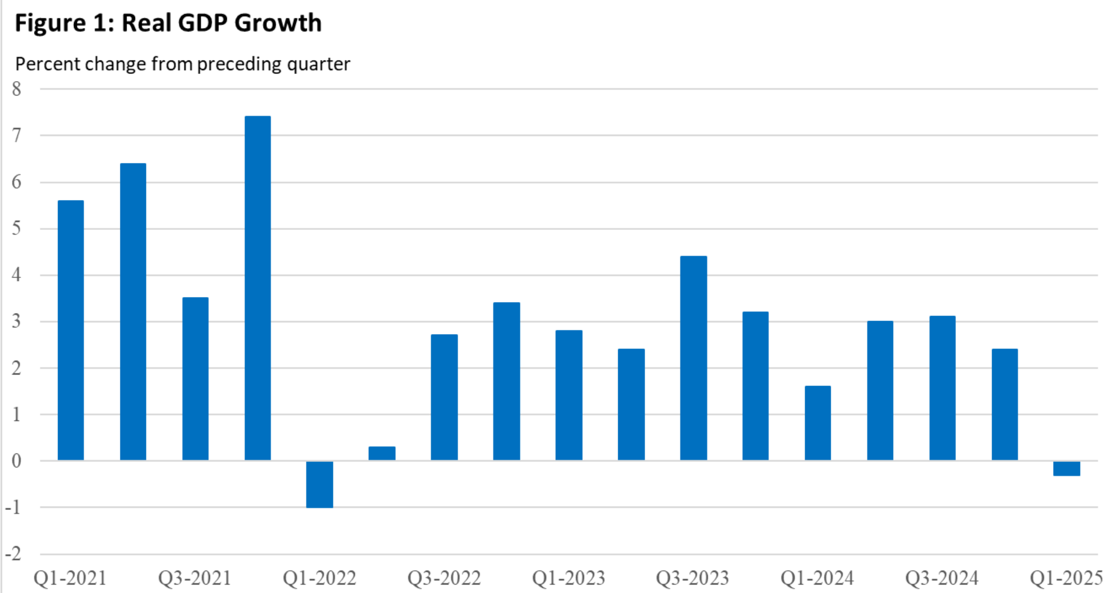
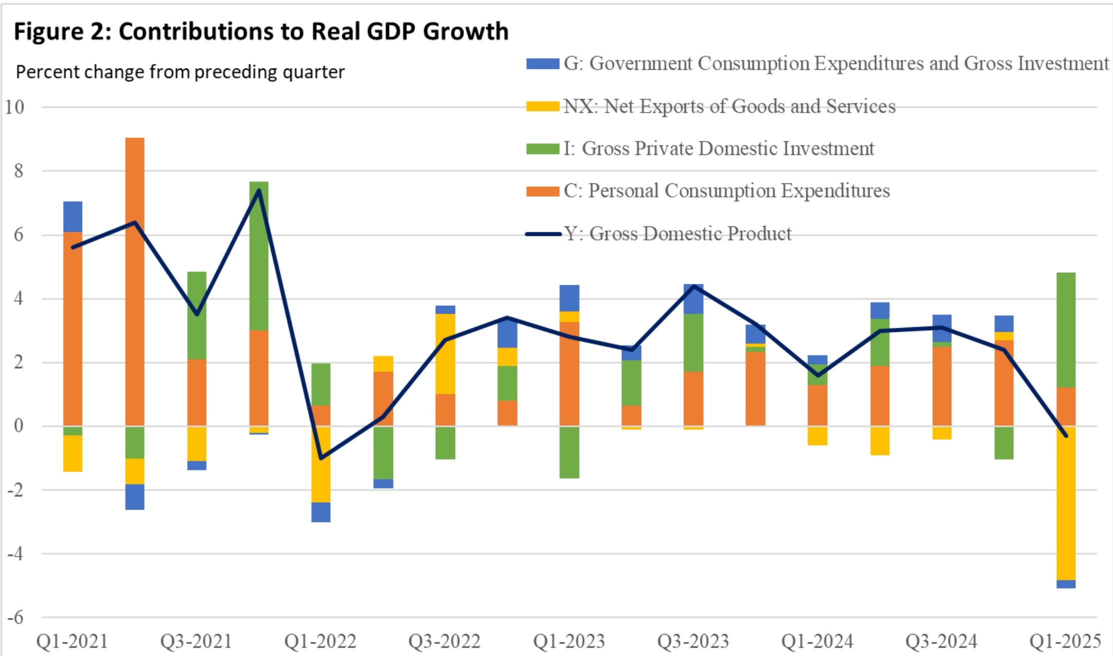
Real gross domestic product (GDP) declined in the first quarter of 2025, according to the Bureau of Economic Analysis's advance estimate (Figure 1). Although the estimated decline is slight (-0.3 percent annual rate) and may be revised in the coming months, it has raised concerns that the U.S. economy may be in a recession or on the verge of one.



Note: Seasonally adjusted annual rates. Source: U.S. Bureau of Economic Analysis.

**Are we in a recession?**

Examining why real GDP declined can provide insights into its future growth. Figure 2 decomposes real GDP growth into the contributions from its four components: consumption, investment, government spending, and net exports.



Note: Seasonally adjusted annual rates. Source: U.S. Bureau of Economic Analysis.

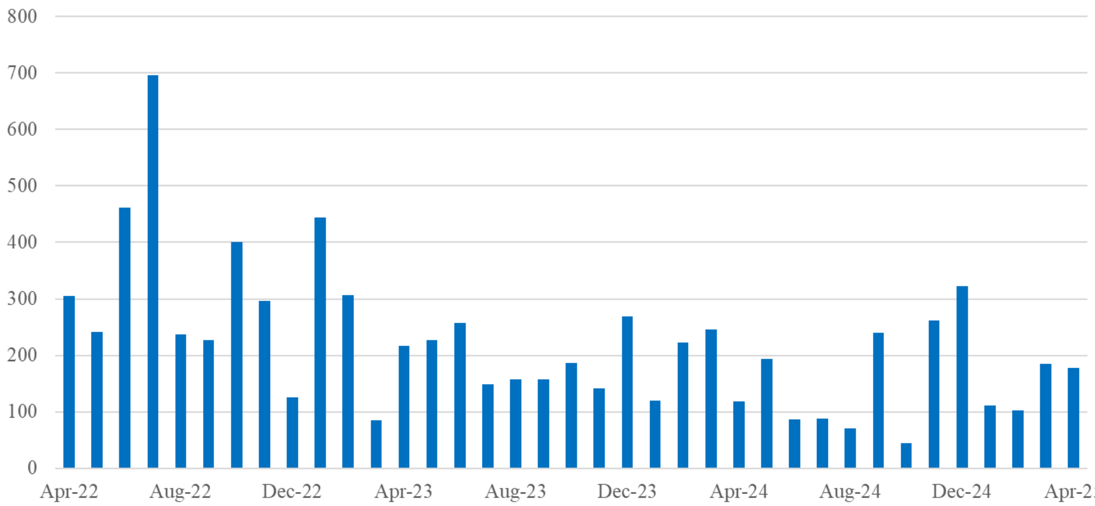
The solid line in Figure 2 plots the real GDP growth rate, while the column bars show the contributions to this overall rate. In the first quarter of 2025, consumption and investment added 1.2 and 3.6 percentage points to annualized GDP growth, respectively. Meanwhile, government spending and net exports *subtracted* 0.3 and 4.8 percentage points from the annualized GDP growth rate, respectively. Hence, the primary reason real GDP declined is that net exports plunged, which in turn occurred because imports surged in anticipation of new tariffs.

Since net exports are highly volatile, their impact is likely to dissipate quickly, and real GDP is expected to return to positive growth in the second quarter of 2025. Using the most recent available data, the Atlanta Fed GDPNow model estimates that real GDP is growing at a moderate rate, slightly more than 2 percent, indicating that we are not in a recession.

Contrary to what is often stated, a recession does not necessarily consist of two consecutive quarters of negative real GDP growth. The NBER's Business Cycle Dating Committee emphasizes that "a recession involves a significant decline in economic activity that is spread across the economy and lasts more than a few months." Hence, we need to examine other indicators of income, production, consumption, and employment. The balance of evidence suggests that the U.S. economy is not currently in a recession. For instance, employment grew solidly in April, in line with its average growth in the last two years (Figure 3). Employment increased by 177,000 in April, driven by gains in the healthcare, transportation, and leisure and hospitality sectors.

**Figure 3: Employment Growth**

Change from preceding month, thousands of persons




Note: All Employees, Total Nonfarm, seasonally adjusted.
Source: U.S. Bureau of Labor Statistics, retrieved from FRED, Federal Reserve Bank of St. Louis.

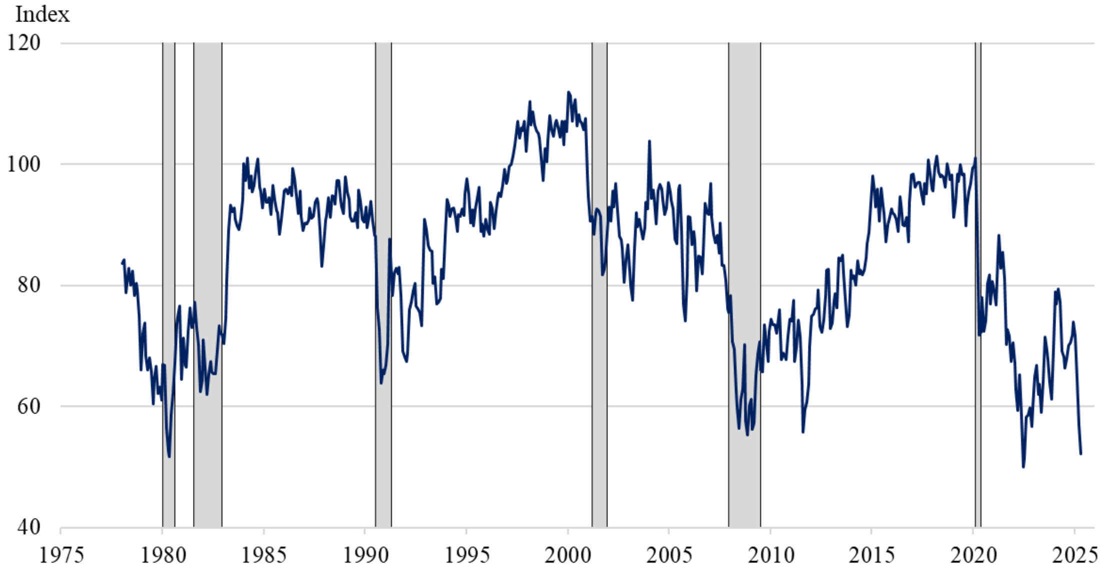
**Are we heading to a recession?**

The Conference Board Leading Economic Index offers an early indication of the economy's direction in the near term. The index has been trending downward since mid-2022. However, the recent decline of the index has not been deep or widespread enough among its components to signal an impending recession, according to the Conference Board.

Measures of consumer sentiment, confidence, and optimism also tend to predict economic activity. The University of Michigan's Consumer Sentiment Index declined to a near historical low level in April (Figure 4). The decline was driven by its Consumer Expectations component, indicating that consumers are increasingly pessimistic about future economic conditions and may reduce their spending. Consumers cited the uncertainty around trade policy, the risk of inflation, and the expectation of weaker income growth.

The term spread – the difference between long- and short-term interest rates – has historically been a good predictor of recessions. When the term spread becomes negative, we say that the yield curve becomes inverted, and an economic recession often follows within a year or so. The New York Fed model uses the term spread to estimate the probability that the economy will be in recession one year in the future (from the present month). Between January and April, this probability increased from 23% to 30% (Figure 5). In a previous Bagwell Center Commentary, I modified the New York Fed model to capture the effect of Quantitative Easing on the probability of recession. According to my model, the QE-adjusted recession probability has increased from 4% to 7% (Figure 5). Both models indicate that the recession probability has increased over the past few months but remains below 50%, suggesting that continued expansion remains more likely than a recession.

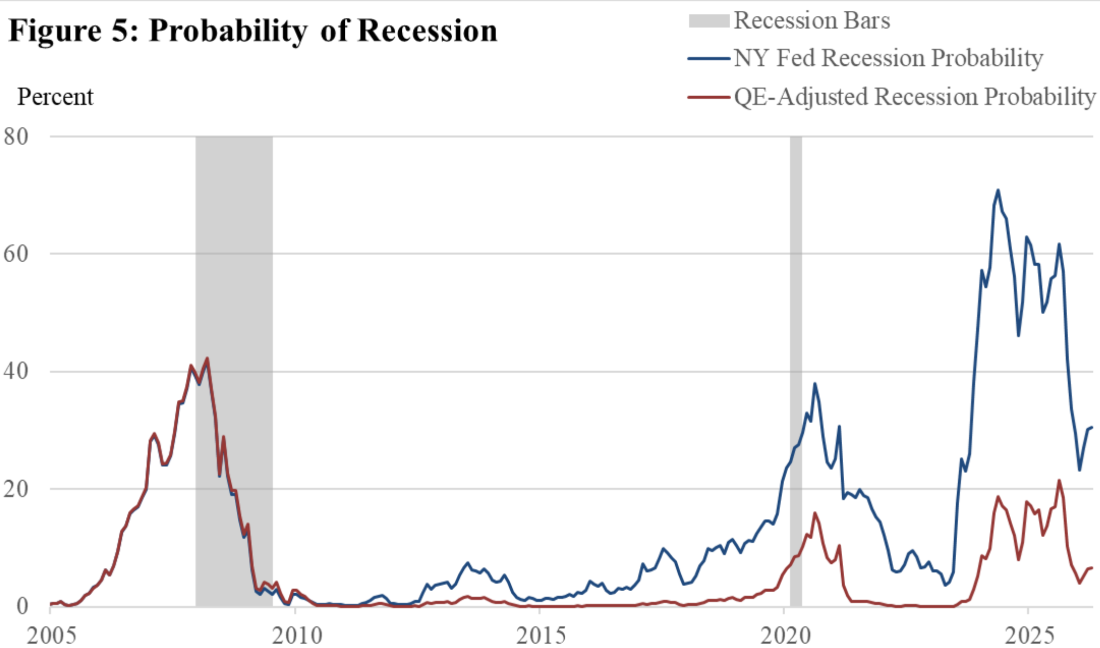
**Figure 4: University of Michigan Consumer Sentiment**




Note: Shaded areas indicate U.S. recessions.
Source: Surveys of Consumers, University of Michigan; FRED, Federal Reserve Bank of St. Louis.

In sum, the balance of evidence indicates that the U.S. economy is not in a recession. The Conference Board Leading Economic Index and the New York Fed Recession Probability model suggest that the economy is likely to continue expanding this year. However, recession risks have increased over the past few months, and the economy's future path will depend, at least in part, on the final levels of tariffs.

**Figure 5: Probability of Recession**




Note: The NY Fed recession probability is computed using the previous-year term spread. The QE-adjusted recession probability is adjusted for the Fed's quantitative easing programs.
Sources: Bureau of Economic Analysis; Federal Reserve Bank of New York; Board of Governors of the Federal Reserve; National Bureau of Economic Research; NY Fed authors' calculations; author's calculations.