The Daily Dish

Get Ready for the Sahm Rule

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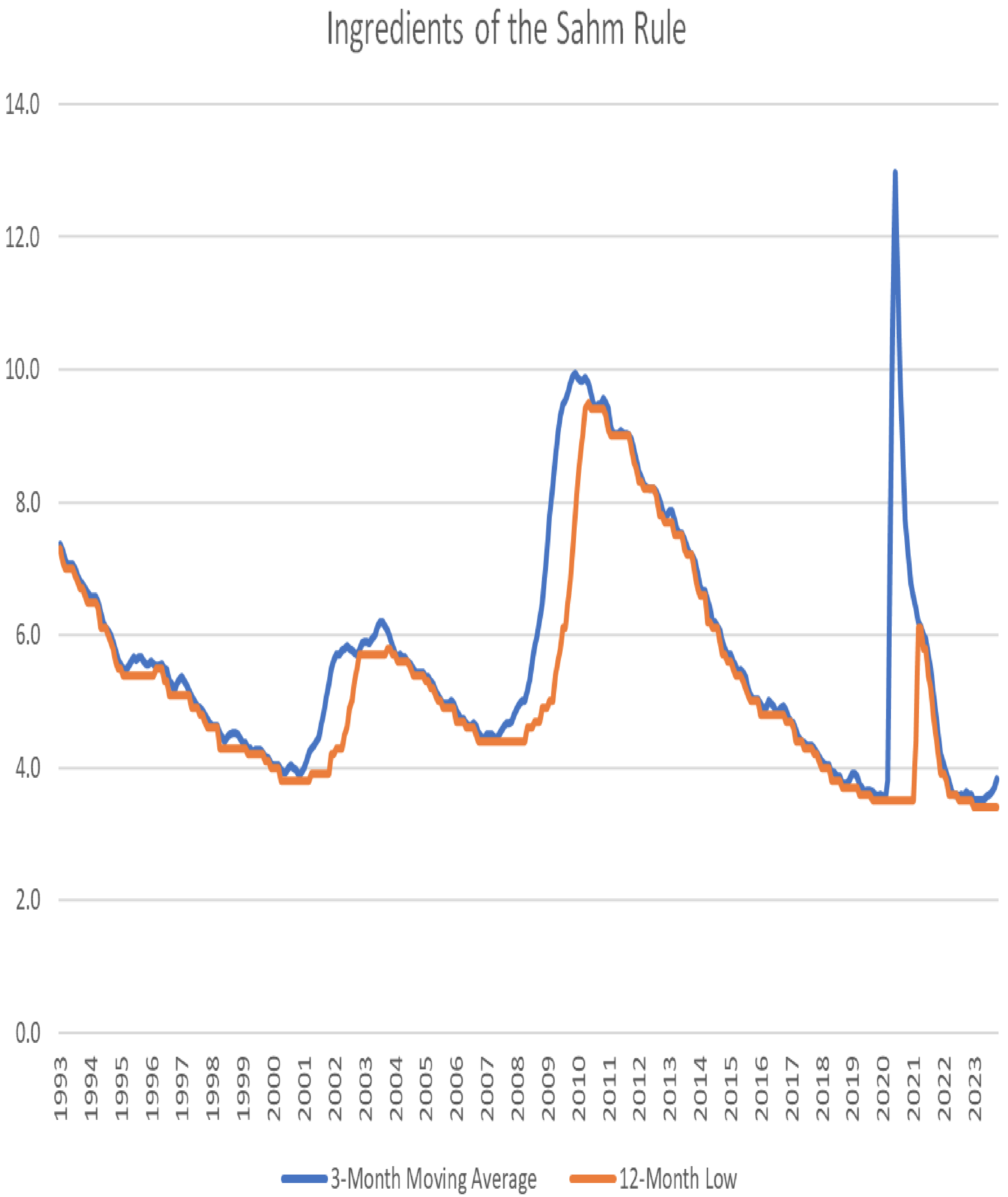
With financial markets and policymakers alike focused on the Fed's attempt to engineer a return to 2 percent inflation without triggering a recession – the unicorn known as a "soft landing" – get ready for lots of invocations of the "Sahm Rule."

The Sahm rule was introduced by former Fed economist Claudia Sahm in a chapter of a Brookings Institution publication. It is an empirical relationship that fits well in the historical data and, perhaps, would be a reliable indicator of the onset of a recession.

The essence of the Sahm rule is to compare the three-month moving average of the unemployment rate with the low over the previous 12 months. The components of the Sahm rule for the past 30 years are graphed below. The blue line is the three-month moving average of the unemployment rate, while the orange line tracks the low unemployment rate over the previous 12 months. As you can see, the moving average at times becomes elevated quickly, and these periods have been associated with recessions.


Ingredients of the Sahm Rule
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
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2004
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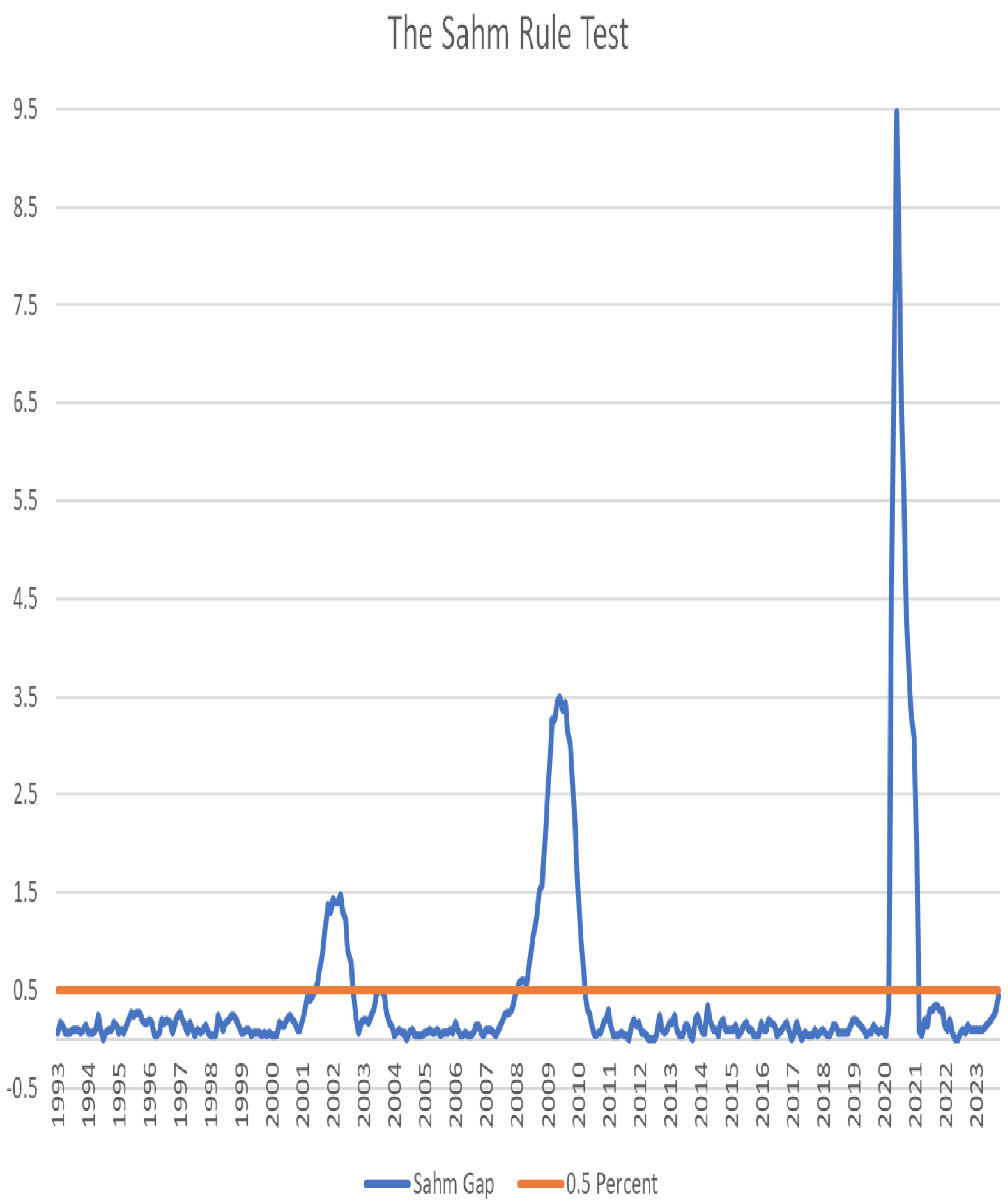
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
3-Month Moving Average
12-Month Low

The actual Sahm rule test is to compare the difference between the two lines in the previous graph with the threshold of 0.5 percent. This comparison is shown below.



The Sahm rule is informative of the mild recession at the turn of the century, the Great Recession, and the

Pandemic Recession. Of note, the recent rise in the unemployment rate is tiptoeing up to the Sahm rule threshold.

Now, like all “rules” developed based on empirical regularities in historical data, there is no guarantee that the Sahm rule will continue to be reliable in the future. But it provides a convenient way to summarize information regarding the labor market in a business cycle context.