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# U.S. Recession Scorecard

August 2023

## Status quo

There have been no changes to the Recession Scorecard indicators so far this summer. Three of the seven remain in the negative red column, meaning each has passed a threshold value beyond which, historically, a recession typically has arrived within a measurable time horizon. Two others were moved into the cautionary yellow column in the spring because they were close to giving an outright negative signal and seemed likely to do so within a few months; one all but did so in July. The last two indicators, still green, continue to suggest there is some way further to go in the economic expansion.

The average time gap from giving a negative signal to the onset of recession for those three indicators that are rated as outright negative so far point toward a recession getting underway this summer, in our view. However, all three have histories with instances of much longer signal-to-recession intervals. **Please note, the official start date of any recession may not be announced until many months or quarters after the fact.**

### Yield curve (10-year to 1-year Treasuries)

The 1-year Treasury yield rose above the 10-year yield decisively in July 2022, and the negative gap has widened over the past year.

U.S. recession scorecard

| Indicator | Status | | |
|---|---|---|---|
| | Expansionary | Neutral | Recessionary |
| Yield curve (10-year to 1-year Treasuries) | | | ✓ |
| Unemployment claims | | ✓ | |
| Unemployment rate | ✓ | | |
| Conference Board Leading Economic Index | | | ✓ |
| Free cash flow of non-financial corporate business | ✓ | | |
| ISM New Orders minus Inventories | | | ✓ |
| Fed funds rate vs. nominal GDP growth | | ✓ | |

Source - RBC Wealth Management

For important and required non-U.S. analyst disclosures, see page 5.

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## U.S. RECESSION SCORECARD

**The average experience of this indicator after crossing into negative territory suggested the U.S. economy would be in recession by this summer.**

The Fed's most recent Senior Loan Officer Survey (released on July 31) further extended the five-quarter-long trend of a majority of U.S. banks raising lending standards on almost every category of business and consumer loan including commercial and industrial loans for businesses of all sizes, credit card loans, consumer installment loans, mortgage loans, and commercial real estate loans.

The same survey also revealed that most banks are reporting reduced demand for commercial and industrial loans, as well as indicating a reduced willingness to make such loans. Most are also requiring higher credit scores for consumer loans and larger down payments for car loans as well as increasing the premium charged for loans to riskier businesses.

### ISM New Orders minus Inventories

The difference between the New Orders and Inventories sub-indexes of the ISM Purchasing Managers' Index has turned negative near the start of most U.S. recessions. But it has also registered occasional false positives—signaling a recession was imminent when none subsequently arrived. Moreover, this indicator only relates to activity in the manufacturing sector (some 15% of the U.S. economy) and is derived from a survey rather than hard data. That being said, **this measure has never before reached its most recent low set in deeply negative territory without a recession eventually following.**

### Conference Board Leading Economic Index

Historically, this series has given reliable early warnings of recession. When the index has fallen below where it was a year earlier, a recession has always followed—usually two to three quarters later.

**This indicator turned decisively negative in Q3 2022, shifting it to the red column on our Scorecard. The latest reading, for June, saw a very small uptick in the year-over-year comparison, but the indicator remains in deeply negative territory. Its past record strongly suggests a U.S. recession will be underway sometime in H2 2023.**

### Unemployment claims

The monthly low for this cycle occurred in September 2022. The cycle low for claims has typically been registered about 12 months before the start of the next recession. So, **if no lower reading is posted in the coming months, its history would suggest a recession could get underway this fall.**

Claims surged higher in June but settled back in July. The smoothed trend appears to be trying to reverse to up from down but has not yet done so convincingly. The fact that both temporary employment and job openings are falling on a year-over-year basis adds to the likelihood the tide is turning for unemployment claims. While we wait either for that shift to be confirmed or for claims to subside once again, this ambiguity warranted shifting the indicator's status to yellow in April.

### Unemployment rate

**The unemployment rate jumped by its biggest monthly increase of this economic cycle in May to 3.7%, but it ticked lower again in June.** Monthly net job additions have been trending steadily lower since setting a cycle high in February 2022. Any move above 4.0% in the Unemployment Rate in the next few of months would turn the smoothed trend of this indicator higher and, in our view, signal a recession is on the way. Once that signal is given, on average, it has been eight to nine months from the lowest monthly posting (which was 3.4% in April) until a recession gets

U.S. RECESSION SCORECARD

underway—although there have been several instances when the time gap was only two to three months.

### Free cash flow of non-financial businesses

This gives an indication of the ability of such businesses, in aggregate, to internally fund any capital spending they want or need to do. Historically, whenever it has posted a year-over-year negative reading, a decline in corporate capital spending has typically followed, either indicating a recession is coming or deepening one that is already under way. This number declined in both Q4 2022 and Q1 of this year but remained well above a negative crossing point. We expect a further deterioration occurred in the Q2 data which will be released early next month.

### Fed funds rate vs. nominal GDP growth

The fed funds rate has risen above the six-month annualized run rate of nominal GDP either before or at the start of every recession in the past 70 years. (Nominal GDP is GDP not adjusted for inflation.) That run rate has been declining since its reopening high of 23% in Q4 2020. By the end of last year, it had slowed to 7.2% but was still well above the fed funds rate, which at the time had risen to 4%. Now the fed funds rate is up to 5.50%, and Q2 GDP data shows the six-month run rate of nominal GDP growth slowed to just 5.4%, just barely meeting that historical precondition of recession. We expect nominal GDP growth will slow some more in Q3, which will widen the gap further.

We shifted this indicator to yellow from green in April.

### Where things stand

Weighing up the current positioning of all seven indicators, and projecting their likely paths over the next couple of quarters, points to a growing probability the U.S. will enter a recession later this year, in our view.

# Research resources

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|---|---|---|---|---|
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