Wealth Management

U.S. Recession Scorecard

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Recession probabilities moving higher

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Three of our seven leading indicators of U.S. recession have unequivocally signaled a U.S. economic downturn is on the way. The Conference Board Leading Economic Index joined the recessionary grouping at the end of Q3. Three others are still firmly in expansionary territory but are moving (slowly) in the wrong direction, and the last—the unemployment rate—is sitting at a 53-year low with no immediate prospect of generating a negative signal.

The indicators that have flipped to recessionary status so far, together with the most recent low in unemployment claims (March 2022), point toward a recession getting underway by Q2 2023, in our view.

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

The position of short-term interest rates relative to long-term rates—a.k.a. the shape of the yield curve—has been the most reliable leading indicator of a U.S. recession. Before the start of every recession for the past 75 years, the 1-year Treasury yield has risen above the 10-year yield, indicative of the arrival of tighter credit conditions. About a year after this crossing occurs, on average, a recession begins.

The 1-year yield rose above the 10-year yield decisively in July. The negative gap widened further in October. Thus, history suggests the

U.S. recession scorecard

Indicator	Status: Expansionary	Status: Neutral	Status: 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 4.
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U.S. RECESSION SCORECARD

U.S. economy will be in recession by next summer.

A majority of U.S. banks have begun raising lending standards, corroborating the yield curve's signal that credit conditions are becoming more restrictive. However, loan payment delinquencies and default rates remain very low; therefore, credit could remain accessible, albeit more expensive, for some time yet.

ISM New Orders minus Inventories

The difference between the New Orders and the 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. Therefore, we view this as a corroborative indicator—one to pay attention to if other longer-term indicators are implying a recession is on the way. It has been negative since May.

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 negative in Q3, shifting it to the red column on our Scorecard. It now indicates a U.S. recession will likely be underway by Q2 of next year.

Unemployment claims

This series set its low, so far, for this cycle back in March at 178,000. 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 by spring of next year.

After setting that low in March, the number of claims rose steadily to a peak of 245,000 in July. Since then, new monthly claims have fallen all the way back to 208,000. A new low for the cycle in the coming months can't be entirely ruled out, in our view.

Unemployment rate

The unemployment rate ticked back down to equal a multi-decade low of 3.5% in September. It would need to climb to almost 4.5% by December to signal a recession is definitely on the way. Once that signal is given, on average it has been eight to nine months from the lowest monthly reading until a recession gets underway, although there have been several instances where the time gap was only two to three months.

As for the rest …

Neither the **free cash flow of non-financial corporate business** nor the **federal funds rate vs. nominal GDP growth** appear remotely close to crossing the threshold into a recessionary reading, although in both cases the positive gap is narrowing.

Weighing up the current positioning of all seven indicators and projecting their likely paths over the next couple of quarters continues to point to a growing probability the U.S. will enter recession sometime late in the first half of 2023, in our view.

Research resources

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