Globicus Leading Economic Index

Outlook September 2023

Leading Economic Index

Recession Still in the Cards

Globicus Inc.

New York

September 20, 2023

Table of Contents

1. **Executive Summary** 2
2. **Globicus Leading Indexes Mixed** 3
3. **Yield Curves Sharply Negative** 4
4. **No recession** 5
5. **The Fed Pause** 6
6. **Is It Different This Time?** 7
7. **The US Economy Is Still Expanding** 9
8. **Conclusions** 10

©Globicus Inc., 2023

Disclaimer: ***This report is of general nature and does not constitute investment or economic advice to any person, or any recommendation to buy or sell any security or to adopt any particular investment strategy. The report is based on our review and analysis of relevant information and statements published by the US Federal Reserve, other US Federal agencies and international institutions, and various other publicly available information and sources deemed reliable. Opinions and forecasts expressed herein are subject to change without notice.***

1. Executive Summary

Globicus Leading Economic Indexes were mixed in the latest reading for August, suggesting that a US recession may start at the end of 2023 or early 2024. One of the most reliable indicators in the leading index, the yield spread, turned negative last year and when that happens a recession has always followed.
Historically the 10-year–3-month yield spread turns negative several months before a recession and then turns positive prior to the recession starts. However, this did not happen during earlier recessions when inflation was as high as it is today, i.e., nineteen seventies to mid-eighties. Therefore, we may not see a reversal in the spread before the current anticipated recession starts.

The recession may be deeper than the market expects, due to the gigantic monetary and fiscal stimulus that may have postponed the recession and increased imbalances in the economy. This may also make the recession deeper and more difficult to mitigate due to the current fiscal and monetary situation.

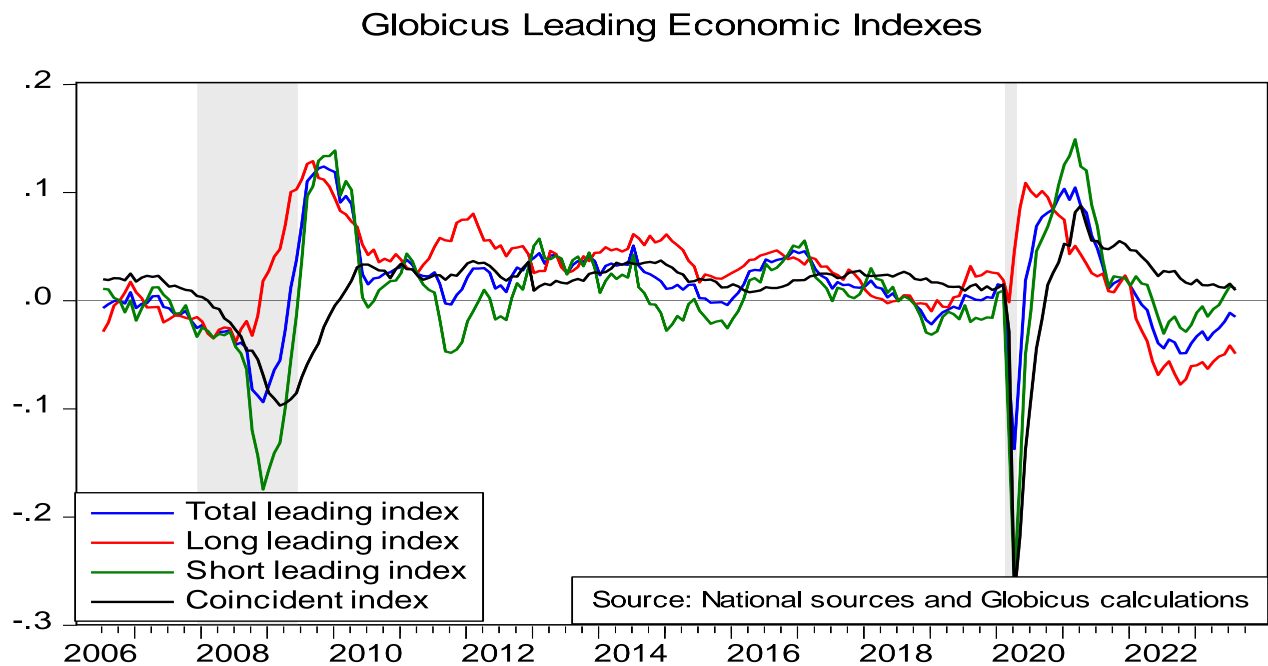
The model has an outstanding historical record having predicted all recessions since the 1960s. The short leading index does not indicate an immediate recession while the long leading index shows the risk of a recession is high. The lags are long and variable for this gauge. The coincident index showed continued growth with robust growth in July that slowed in August. The US economy is clearly not in recession as indicated by the coincident index, Sahm's rule and as per the National Bureau of Economic Research's Business Cycle Dating Committee's recession indicators (NBER)[1] .

[1] National Bureau of Economic Research is a private, nonpartisan economic research organization. The NBER's Business Cycle Dating Committee maintains a chronology of US business cycles as well as decides the dates of the recessions.

©Globicus Inc., 2023
Disclaimer: ***This report is of general nature and does not constitute investment or economic advice to any person, or any recommendation to buy or sell any security or to adopt any particular investment strategy. The report is based on our review and analysis of relevant information and statements published by the US Federal Reserve, other US Federal agencies and international institutions, and various other publicly available information and sources deemed reliable. Opinions and forecasts expressed herein are subject to change without notice.***

2. Globicus Leading Indexes Mixed

Globicus Leading Economic Indexes (Total- Long- and Short leading index)[2] were mixed in August, indicating an elevated risk of a recession but not an immediate one. The coincident Index (designed to coincide or measure the overall economy) is moderating in August from robust growth in July.



The total leading index's Six-Month Smoothed Growth Rate ("SMGR")[3] declined to -1.6 from -1.2 in August, the eighteenth consecutive monthly negative reading. This

[2] We are using three leading indexes. The reason for this is that leading indicators have different lead time, and it can be useful to disaggregate what the long and short leading indexes indicates. The total leading index is a combination of the short and the long leading index and is constructed to smooth out the volatility of the individual indexes and to get a timely indication.

[3] For input series X the formula for six-month smoothed growth rate is: Xsmgr= (X(t)/Avg of previous 12 months)^(12/6.5)-1

©Globicus Inc., 2023

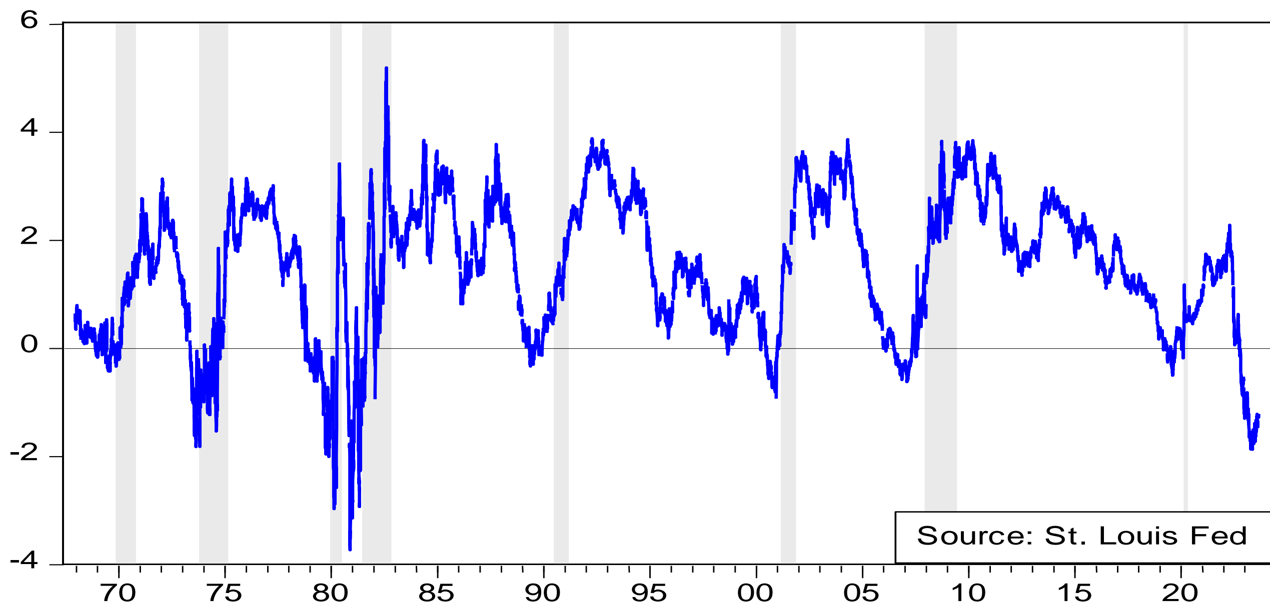
Disclaimer: ***This report is of general nature and does not constitute investment or economic advice to any person, or any recommendation to buy or sell any security or to adopt any particular investment strategy. The report is based on our review and analysis of relevant information and statements published by the US Federal Reserve, other US Federal agencies and international institutions, and various other publicly available information and sources deemed reliable. Opinions and forecasts expressed herein are subject to change without notice.***

is arguably the longest lead ever, however the lead before the 2008 recession was longer but at that time there were also some positive months.
The long leading index dropped to -5.0 in August from -4.3, the short leading index was 1.0 in August slightly lower than 1.2 in July, new and revised data showed. It is not unprecedented that the short leading index turn positive before a recession, it happened both in the 1981 and 1990 recessions.
Despite the strong showings in the coincident index and short leading index we believe the economic slowdown will occur and spread more broadly throughout the US economy over the coming months with a recession starting at the end of 2023 or early 2024.

3. Yield Curves Sharply Negative

Inverted yield curves usually precede a recession, particularly the spread between 10-year and the 3-month treasury securities turns negative before a recession.
This spread has narrowed dramatically since the Fed started its campaign and turned negative in October 2022 and as of September 20 it was -1.21. This is the lowest level since 1981 when Paul Volker was the chair of the Fed. Usually it turns from negative to positive before the recession starts and has always done so since the 1990 recession. However, that was not the case during the four recessions in the 1970 to 1982 period. These four recessions were all preceded by high inflation in contrast to the following recessions that were accompanied by more modest inflation. Therefore, we may not see a reversal of the negative spread before the recession starts as the high inflation rate today is more reminiscent of the high inflation recessions during the seventies and eighties rather than the more recent lower inflation recessions. More importantly, since the late 60s the inverted yield curve has always been followed by a recession.

©Globicus Inc., 2023
Disclaimer: ***This report is of general nature and does not constitute investment or economic advice to any person, or any recommendation to buy or sell any security or to adopt any particular investment strategy. The report is based on our review and analysis of relevant information and statements published by the US Federal Reserve, other US Federal agencies and international institutions, and various other publicly available information and sources deemed reliable. Opinions and forecasts expressed herein are subject to change without notice.***



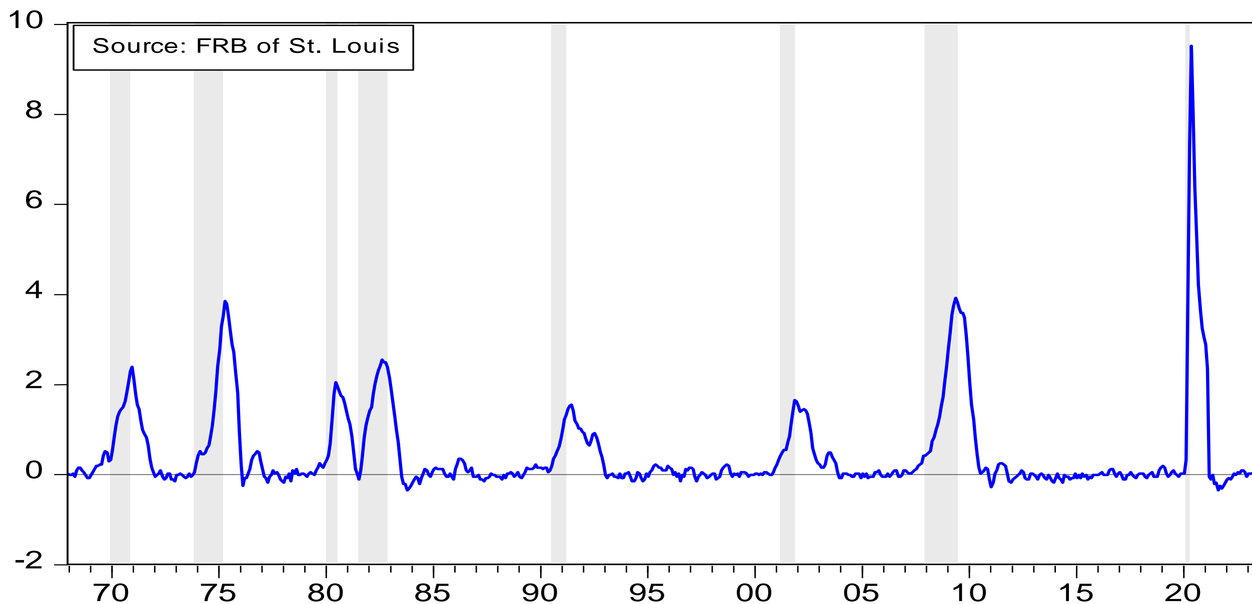
4. No recession

The Sahm Rule[4] identifies signals related to the start of a recession when the three-month moving average of the unemployment rate rises by 0.5% or more from its low during the previous 12 months. This is not a leading indicator but coincides with recessions and as you can see it indicates no recession as unemployment has not risen yet. This indicator also corroborates the coincident index and the NBER recession indicators which also show the US economy still expanding.

[4] Sahm, Claudia, Sahm Rule Recession Indicator [SAHMCURRENT], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SAHMCURRENT

©Globicus Inc., 2023

Disclaimer: ***This report is of general nature and does not constitute investment or economic advice to any person, or any recommendation to buy or sell any security or to adopt any particular investment strategy. The report is based on our review and analysis of relevant information and statements published by the US Federal Reserve, other US Federal agencies and international institutions, and various other publicly available information and sources deemed reliable. Opinions and forecasts expressed herein are subject to change without notice.***



5. The Fed Pause

The Fed kept the fed funds rate unchanged at 5.25–5.50% and indicated that rate would stay high for longer at its September 20 meeting. The FOMC statement read: "Recent indicators suggest that economic activity has been expanding at a solid pace. Job gains have slowed in recent months but remain strong, and the unemployment rate has remained low. Inflation remains elevated."[5]

The Summary of Economic Projections (SEP)[6] showed that 12 of the 19 Fed officials expect to raise rates once more this year and their anticipated rate cuts in 2024 were cut in half to 50 bp in 2024. In addition, the officials seem to think that a "soft-landing" is likely as they lowered their unemployment forecast and projected

[5] https://www.federalreserve.gov/newsevents/pressreleases/monetary20230920a.htm
[6] https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20230920.pdf

©Globicus Inc., 2023
Disclaimer: ***This report is of general nature and does not constitute investment or economic advice to any person, or any recommendation to buy or sell any security or to adopt any particular investment strategy. The report is based on our review and analysis of relevant information and statements published by the US Federal Reserve, other US Federal agencies and international institutions, and various other publicly available information and sources deemed reliable. Opinions and forecasts expressed herein are subject to change without notice.***

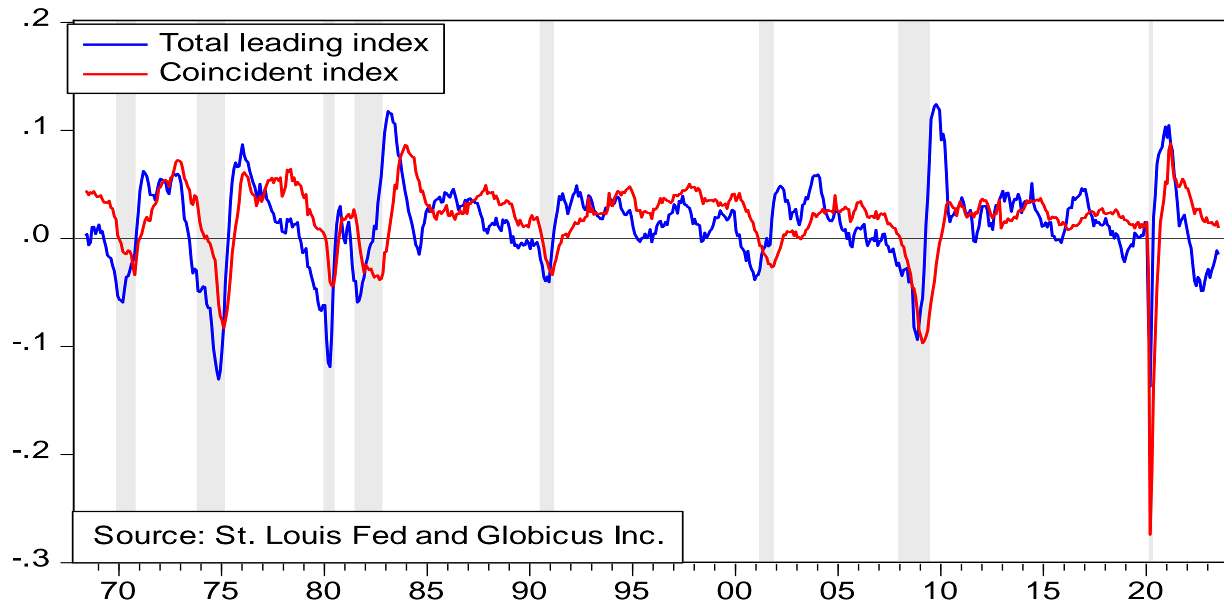
stronger economic growth for this year and next.[7] Participants see the unemployment rate, at 3.8% for this year, rising to 4.1% next year. They increased their economic growth forecasts for this year to 2.1% and 1.5% for 2024 and lowered their CPI “core” inflation to 3.7% for year-end 2023, falling to 2.6% by the end of 2024. On balance the dot plots showed a more hawkish outlook from the FOMC.

6. Is It Different This Time?

Below are the model’s results since 1970. The blue line is the model’s total leading growth rate, designed to forecast economic activity and recessions. The red line is the coincident index, designed to measure current economic activity. How reliable is the model? We have high confidence in the recession prediction. The model has predicted all recessions since the 1970s. And we do not think it is different this time. However, the exact timing of the start of a recession is more challenging. When the total leading index turns negative it precedes a recession on average by 9 months. However, these leads vary. The total index turned negative 18 months ago so by historical standards we should already be in a recession. The strong labor market, the unprecedented lax monetary policy including the Fed’s lateness in beginning its tightening cycle and the unprecedented fiscal policy expansion may all have contributed to postponing the recession.
The great economist Rudi Dornbusch once said, “the crisis takes a much longer time coming than you think, and then it happens much faster than you would have thought.”[8] We are convinced that the recession will come but the timing is uncertain. Therefore, we conclude that there will be a recession and it will probably start at the end of 2023 or in the first part of 2024.

[7] Compared to last SEP from June.
[8] United States. Congress. Senate. Committee on the Budget (2012). Concurrent Resolution on the Budget Fiscal Year 2013. p. 95

©Globicus Inc., 2023
Disclaimer: ***This report is of general nature and does not constitute investment or economic advice to any person, or any recommendation to buy or sell any security or to adopt any particular investment strategy. The report is based on our review and analysis of relevant information and statements published by the US Federal Reserve, other US Federal agencies and international institutions, and various other publicly available information and sources deemed reliable. Opinions and forecasts expressed herein are subject to change without notice.***



There isn't, as far as we know, any reliable way to forecast the depth of a recession. Still, many forecasters predicting a recession, also predict a shallow recession because of a strong labor market, over-sized pandemic savings and no major imbalances. There has been a long time with very low interest rates, and imbalance may not show up until the recession is upon us. It is possible that one can get a rough idea of the depth of the recession from the depth of the decline in the leading indicators. In November the total leadining indicator stood at -4.9. This is the lowest reading, before a recession that has been observed, exept for the reading of this index before the onset of the 1980 recession. The total leading index generally falls further during the earlier parts of the recession. The total leading index is similar to the reading for the 2008 recession and the four high inflation recessions in the seventies and early eighties. During these five recessions unemployment rate rose on average 2.8 percentage points and the downturn lasted on average 14 months. During the 1990 and 2001 moderate inflation recessions, the average unemployment rate increased 1.25 percentage points and the downturn lasted only 7 months. This is less than half compared to the other

©Globicus Inc., 2023

Disclaimer: ***This report is of general nature and does not constitute investment or economic advice to any person, or any recommendation to buy or sell any security or to adopt any particular investment strategy. The report is based on our review and analysis of relevant information and statements published by the US Federal Reserve, other US Federal agencies and international institutions, and various other publicly available information and sources deemed reliable. Opinions and forecasts expressed herein are subject to change without notice.***

recessions when the total leading index declined significantly. Therefore, we don't believe this recession will be shallow.

7. The US Economy Is Still Expanding

NBER's Business Cycle Dating Committee maintains a chronology of the US business cycles. The committee's definition of a recession is "a significant decline in economic activity that is spread across the economy and that lasts more than a few months."[9]

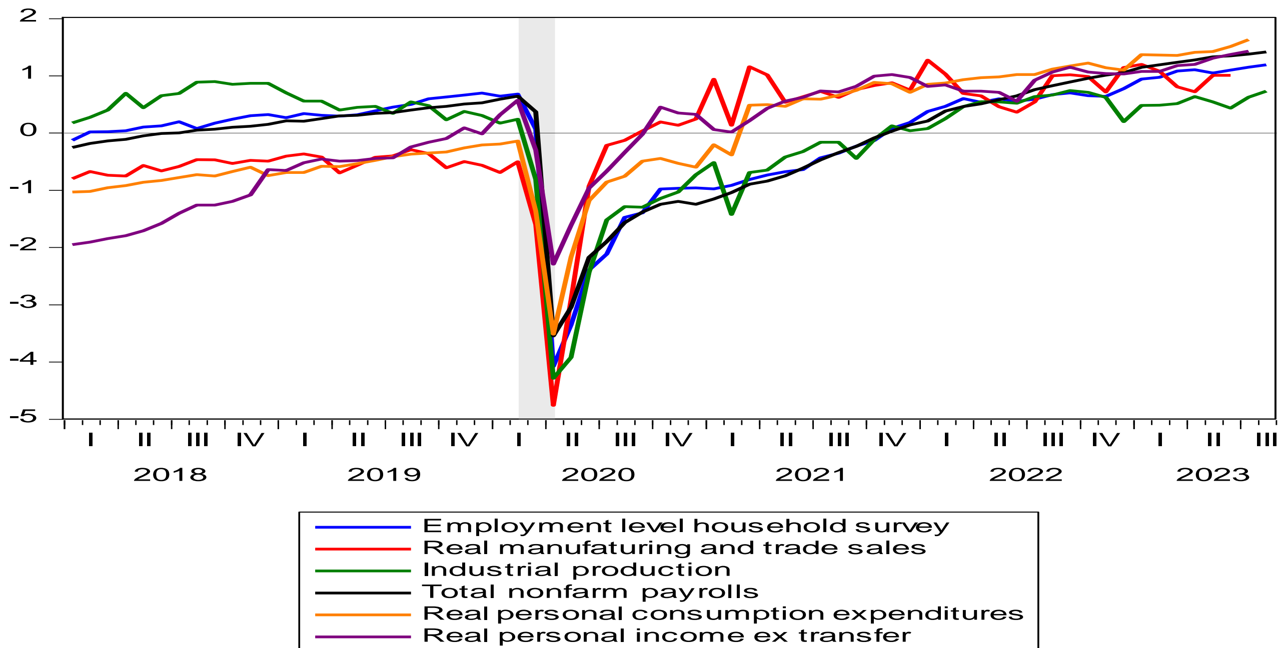
The committee's determination of the months of peaks and troughs is based on a range of monthly measures of aggregate real economic activity. These include real personal income less transfers, nonfarm payroll employment, employment as measured by the household survey, real personal consumption expenditures, wholesale-retail sales adjusted for price changes, and industrial production. In addition to the monthly indicators, they use two quarterly indicators, gross domestic product (GDP) and gross domestic income (GDI). GDP rose 2.1% in the second quarter following 2.0% in the first quarter and GDI rose 0.5% in the second quarter following a decline of 1.8% in the first quarter.

The monthly indicators the Dating Committee uses are shown in the graph below. These indicators were mostly expanding mixed for the latest available data. The only two that showed some weaknesses were industrial production and manufacturing and trade sales, but they were flat. In conclusion we don't think the Dating Committee will call a recession on these numbers as the economic weakness is not widespread and has not lasted more than a few months, which are the NBER's criteria for a recession.

[9] NBER Business Cycle Dating; https://www.nber.org/research/business-cycle-dating

©Globicus Inc., 2023

Disclaimer: ***This report is of general nature and does not constitute investment or economic advice to any person, or any recommendation to buy or sell any security or to adopt any particular investment strategy. The report is based on our review and analysis of relevant information and statements published by the US Federal Reserve, other US Federal agencies and international institutions, and various other publicly available information and sources deemed reliable. Opinions and forecasts expressed herein are subject to change without notice.***



8. Conclusions

In summary, the total leading index suggests that a recession will start at the end of 2023 or early 2024. It will not be different this time. However, the strength in the labor market, the strength in the coincident index and the consolidation in the leading indexes may support the economy for another few months.

From Globicus' coincident index and NBER's Dating Committee's data used to track recessions it is very unlikely that the economy is in a recession now[10].

[10] Neither was the economy in a recession in 2022, despite two consecutive quarters of negative growth in the first half of 2022, which some pundits have classified as a recession.

©Globicus Inc., 2023

***Disclaimer:** This report is of general nature and does not constitute investment or economic advice to any person, or any recommendation to buy or sell any security or to adopt any particular investment strategy. The report is based on our review and analysis of relevant information and statements published by the US Federal Reserve, other US Federal agencies and international institutions, and various other publicly available information and sources deemed reliable. Opinions and forecasts expressed herein are subject to change without notice.*