Globicus Leading Economic Index

Outlook March 2025

US Economy Slowing but Recession Not Imminent

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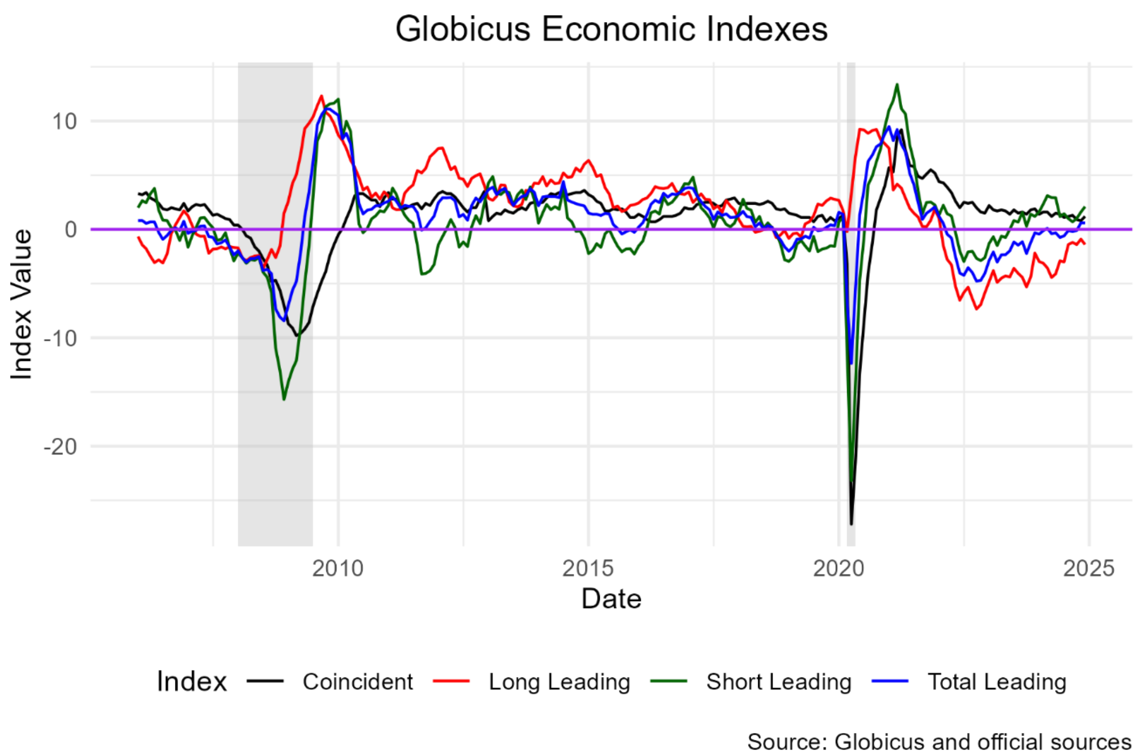
1. Executive Summary

The 10-year/3-month yield curve, a historically reliable recession indicator, turned positive on December 13, 2024, following an over two-year inversion—the longest in history. This spread turned negative again at the end of February and oscillated just below zero in March. (Historically, this spread has been a leading indicator of a coming recession, and the risk may not be over from this single indicator, as the spread usually turns positive before a recession occurs.)

Globicus' Coincident Index, which measures present economic growth, shows continuing strong growth in January. The Sahm Rule, which has signaled the start of previous recessions, has reversed its recession signal. Furthermore, the National Bureau of Economic Research's (NBER) Business Cycle Dating Committee's recession indicators confirm that the U.S. economy is not currently in a recession.

2. Globicus Leading Indexes Improves

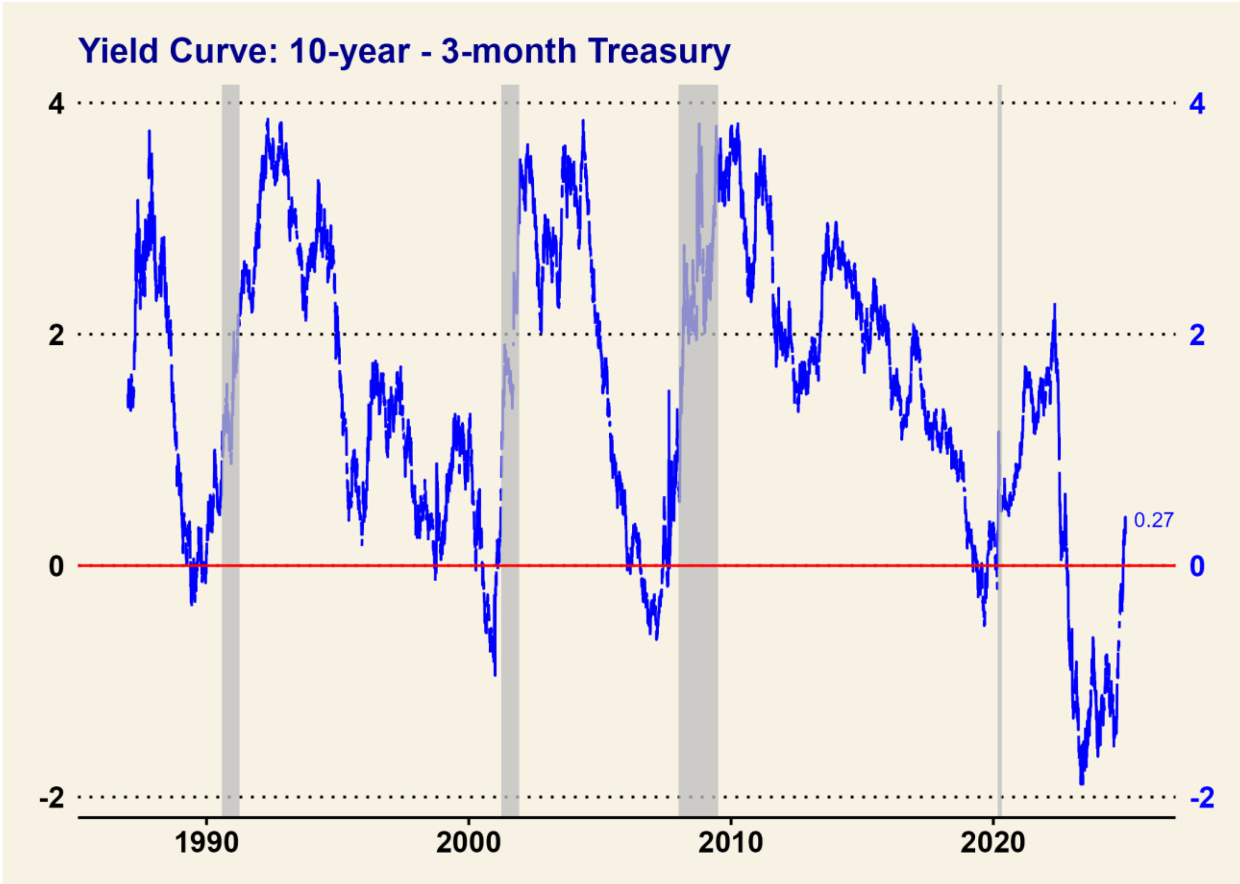
Globicus' Leading Economic Indexes (Total, Long, and Short Leading Indexes) are designed to identify economic turning points and forecast the future direction of the economy, showing a mixed readings.



New and revised data showed that the Total Leading Index growth rate edged up to 0.3 in February from 0.0 in January. The Short Leading Index accelerated to 1.7 in February from 1.4 in January and has been positive since July 2023. However, the Long Leading Index has remained at -1.6 in February, the lowest level since July 2024. Collectively these trends point to a somewhat higher risk of a recession and lower economic growth in the near term. The Coincident Index, which reflects current strong economic growth overall, edged up to 1.8 in February from 1.7 in January.

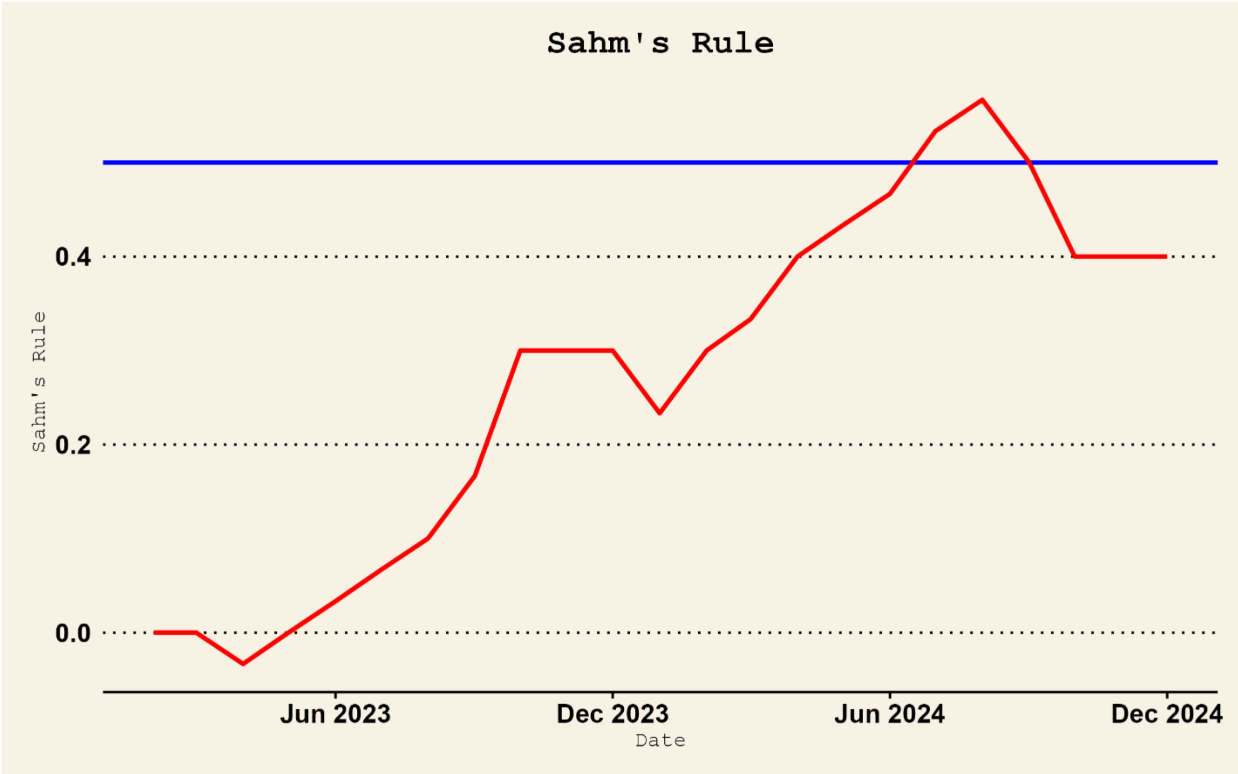
3. Yield Curve has Turned Positive

One of the most reliable components in the Long Leading Index, the 10-year/3-month yield spread, turned negative in October 2022, and remained inverted until December 13, 2024. The spread was 29 basis points on January 23. Historically, a significant negative spread has often preceded a recession, with the notable exception of the 1967 yield curve inversion. However, the risk associated with this particular indicator may not be fully resolved, as yield curve inversions typically reverse prior to the onset of a recession, as the Fed reduces rates. However, it is more likely that the prolonged inversion without a recession was influenced by the historically unprecedented stimulus factors discussed below.



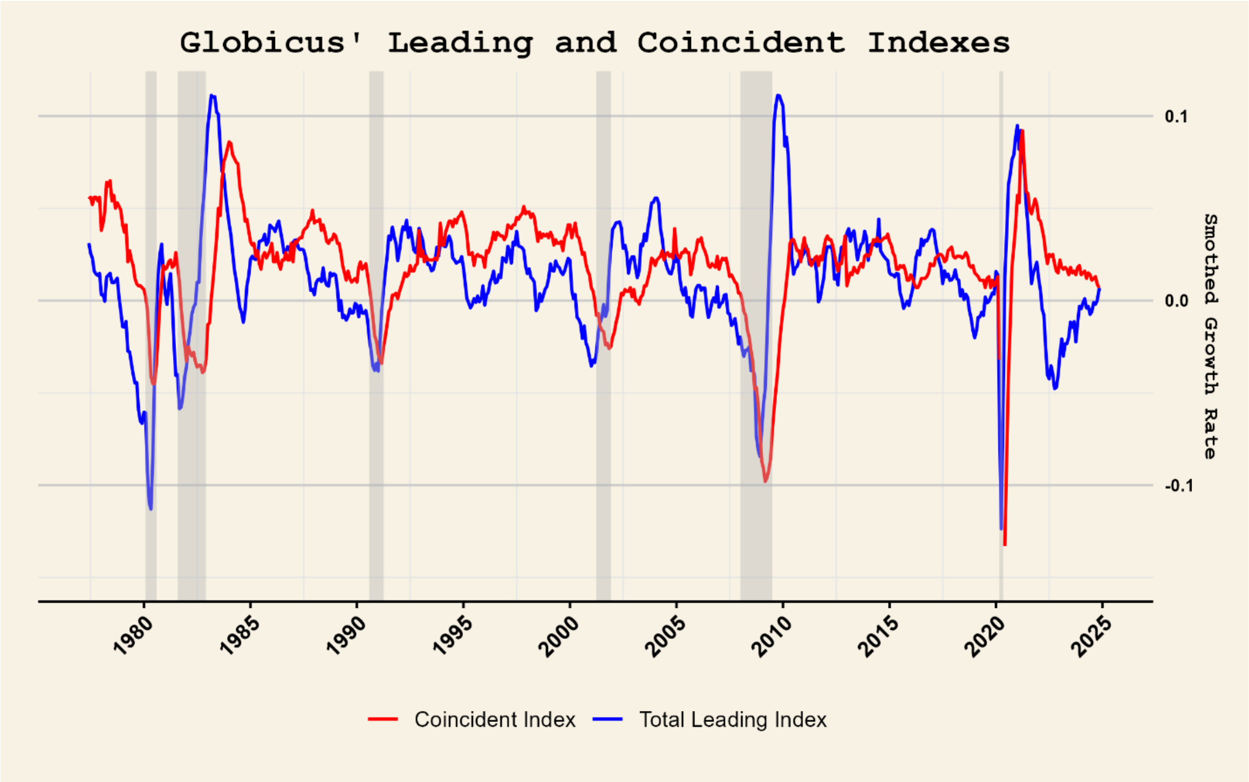
4. No Recession Imminent

The 4.3% unemployment rate in July 2024, triggered a recession signal of 0.53% according to the Sahm Rule. This rule indicates a recession when the three-month moving average of the unemployment rate rises by 0.50% or more compared to the lowest three-month average from the previous 12 months. However, the higher unemployment rate during the summer subsided and was not followed by further increases. As a result, the Sahm indicator fell to 0.4% in December, a level inconsistent with being in a recession. In a typical recession, unemployment rates would continue to rise steadily until the recession ends.



5. A False Recession Signal

Below are the Globicus' Leading Economic Index and Coincident Index since 1978. The blue line is the Total Leading Index growth rate, designed to forecast economic activity and recessions. The red line is the Coincident Index growth rate, designed to measure current economic activity. The Total Leading Economic Index reveals an intriguing economic narrative. Historically, when the Total Leading Index turns negative, it signals an impending recession within about a year. In mid-2022, the index dropped sharply, suggesting a high recession risk. However, a recession never materialized, challenging this economic forecasting model.



6. Exploring the Absent Recession

The COVID-19 pandemic led to extraordinary monetary and fiscal interventions that profoundly reshaped economic dynamics. The Federal Reserve and the federal government implemented unprecedented liquidity and stimulus measures to stabilize the economy.

These policies not only achieved economic stabilization but also significantly increased assets and liquidity for individuals, businesses, and state and local governments. This substantial stimulus played a key role in driving both economic growth and inflation.

Economic analysis has traditionally emphasized flow data, but stock data is equally important in understanding broader economic trends. A key source of aggregated stock data is the Board of Governors' *Financial Accounts of the United States,* which offers comprehensive insights into the levels of U.S. financial assets and liabilities.[1]

To evaluate the impact of U.S. fiscal and monetary policies implemented during and after the COVID-19 pandemic, analyzing the development of *Households and Nonprofit Organizations: Net Worth* provides valuable insights. During this period, GDP growth has been notably strong, with personal consumption expenditures—typically comprising just under 70% of GDP—remaining resilient. This prompts the question of whether the wealth effect has significantly contributed to sustaining consumption spending.

At its core, the consumption function is driven by three primary factors: disposable income, wealth, and interest rates.[2]

The strong personal consumption expenditures observed suggest that the wealth effect—where increased net worth leads to higher consumption—may have played a significant role. For instance, rising asset prices, such as stock market gains or increases in home values, can enhance perceived permanent income, encouraging greater spending.

The Congressional Budget Office (CBO) provides valuable benchmarks for assessing economic trends. Between 2020 and 2024, the CBO projected potential GDP growth to average a modest 1.8% annually, tapering slightly to 1.7% in 2024. However, actual GDP performance tells a more dynamic story: a contraction of 2.2% in 2020, followed by robust growth of 6.1% in 2021, 2.5% in 2022, 2.9% in 2023, and an anticipated 2.8% year-over-year increase in 2024. This remarkable

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[1] https://www.federalreserve.gov/relesees/z1

[2] Consumption function components:

1.**Disposable Income:** The after-tax income available to households for spending and saving.

2. Wealth: The net worth of households, which encompasses financial and non-financial assets minus liabilities.

3. Interest Rates: These influence borrowing costs and the opportunity cost of spending versus saving.

outperformance highlights the need to examine key underlying drivers, including the impacts of fiscal and monetary policies and the role of wealth in sustaining economic momentum.

Integrating both flow and stock data perspectives provides deeper insights into the dynamics shaping the post-COVID economic landscape. This approach helps explain the resilience in consumption spending, which has defied expectations of an imminent recession. From the third quarter of 2020 to the third quarter of 2024, disposable personal income increased by 23.35%, representing an annual growth rate of 5.39%. Over the same period, net worth grew by an impressive 36.73%, equivalent to an annual rate of 8.13%.

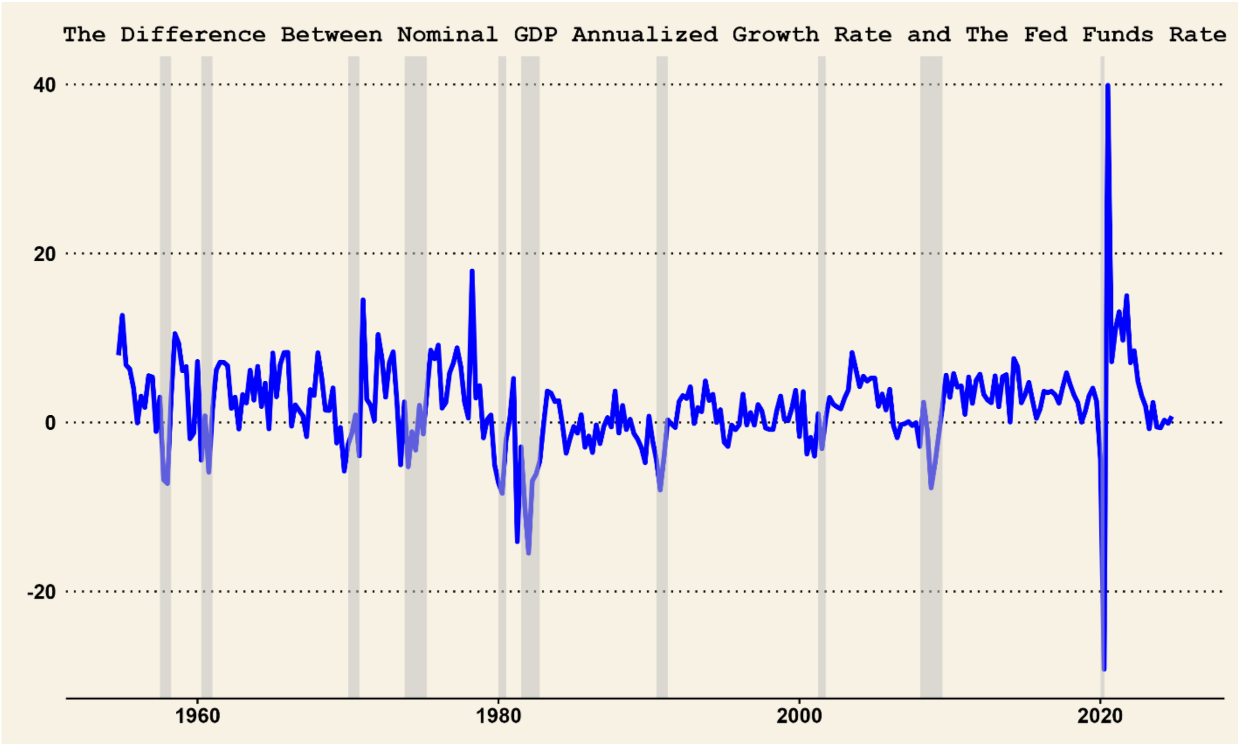
The significant increase in household net worth played a key role in boosting economic activity, making the Federal Reserve's tightening measures less restrictive than they might have been otherwise. Despite being late to the tightening cycle, the Fed's rapid monetary tightening effectively slowed inflation without causing an economic downturn, defying traditional economic expectations.

In addition, the U.S. federal government's interest payments have doubled since 2020. This is the result of higher government spending, debt, and interest rates. Interest payments were $1,117 billion in the third quarter of 2024, more than the $1,091 billion in defense spending. As a percentage of GDP, interest expenditure was 3.8% of nominal GDP, up from 2.4% in 2020, which has offset Fed's intended policy of reducing aggregate demand.

7. Has the Fed managed a Soft Landing?

It may be too early to decide if the Federal Open Market Committee (FOMC) has been successful in returning inflation to its target without causing a recession. A recession can still occur, and inflation is still above target.

There are multiple methods for assessing the stringency of monetary policy. One effective approach is to compare the annualized nominal GDP growth rate with the federal funds rate. This comparison provides insight into the Federal Reserve's monetary policy stance. The chart below illustrates this relationship. It reveals that during the current economic cycle, the spread between these two metrics only marginally entered negative territory. This contrasts sharply with previous recessionary periods, where the spread between the NGDP growth rate and the federal funds rate became significantly negative, ultimately precipitating economic downturns.



Another perspective on the Federal Reserve's policy stance is to examine how financial conditions have evolved over time. The Chicago Fed's Adjusted National Financial Conditions Index[3] offers a comprehensive weekly assessment of U.S. financial conditions across money markets, debt and equity markets, as well as traditional and "shadow" banking systems. Positive NFCI values signify tighter-than-average financial conditions, while negative values indicate looser-than-average conditions. As shown in the chart below, financial conditions have remained accommodative throughout the Fed's tightening campaign.

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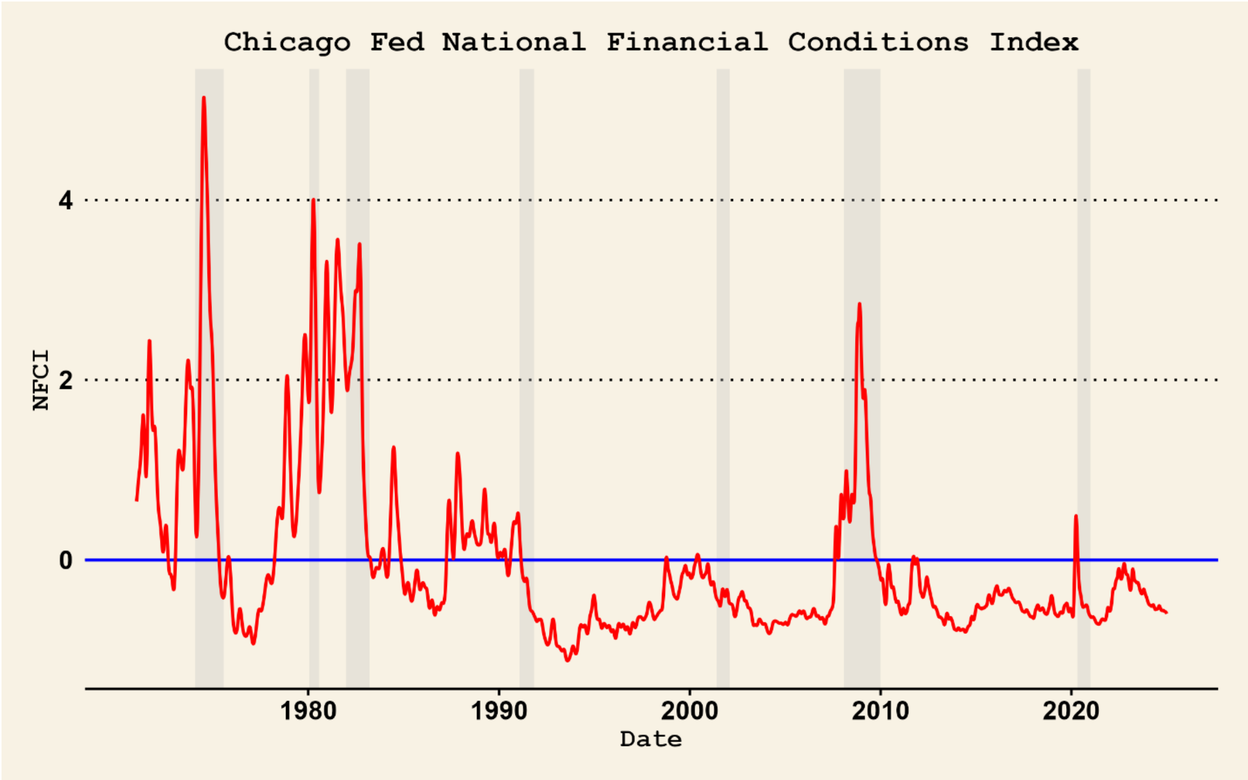
[3] The adjusted NFCI (ANFCI). This index isolates a component of financial conditions uncorrelated with economic conditions to provide an update on how financial conditions compare with current economic conditions.

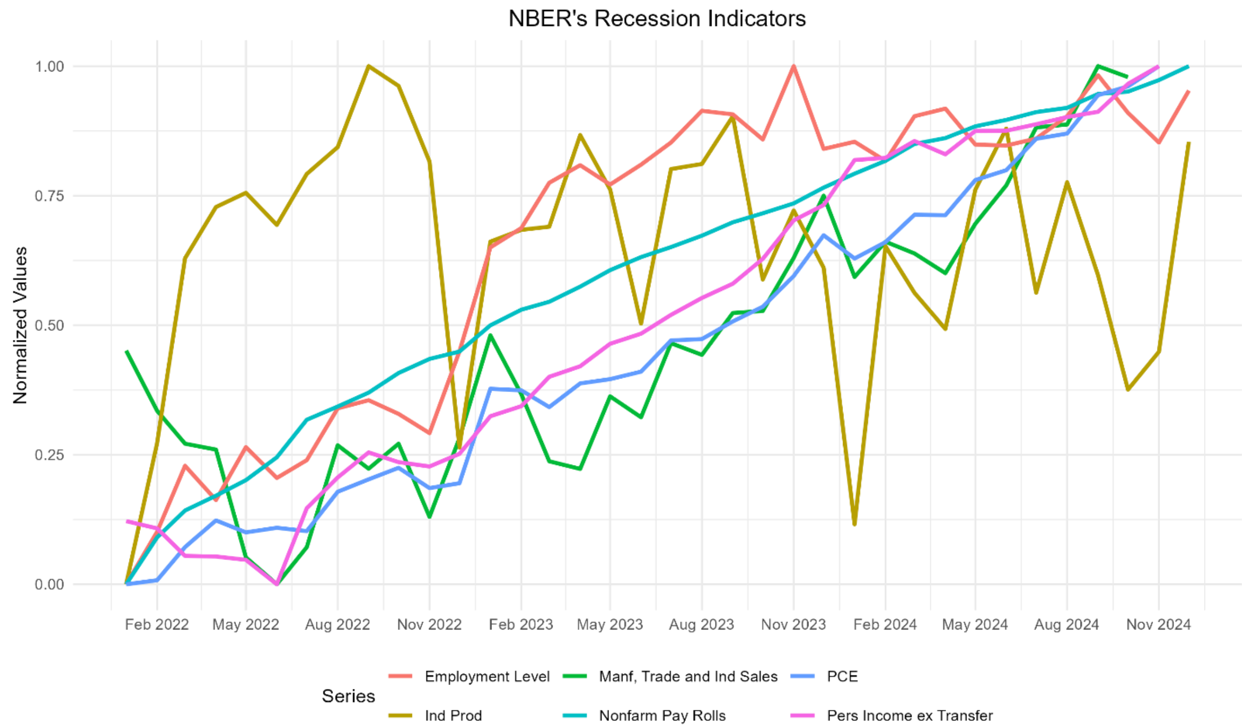


8. The US Economy Is Still Expanding

he National Bureau of Economic Research (NBER) Business Cycle Dating Committee is responsible for maintaining the official chronology of U.S. business cycles. The committee defines a recession as “a significant decline in economic activity that is spread across the economy and lasts more than a few months.”

To determine the start and end of a recession, the committee examines a range of monthly indicators of aggregate real economic activity. These indicators include real personal income (excluding transfers), nonfarm payroll employment, household employment levels, real personal consumption expenditures, inflation-adjusted wholesale and retail sales, and industrial production.

As shown in the chart below, most of these indicators currently do not indicate any significant decline.



In addition to monthly data, the NBER Business Cycle Dating Committee considers two key quarterly measures: gross domestic product (GDP) and gross domestic income (GDI). In the third quarter, GDP grew by 3.1% (seasonally adjusted annual rate, saar), representing a 2.7% year-over-year increase. This follows a 3.0% saar growth in the second quarter. Meanwhile, GDI rose by 2.4% saar in the third quarter, up from 2.0% saar in the previous quarter.

The indicators analyzed by the committee to assess the start and end of recessions have generally shown growth in the most recent data. While industrial production and employment levels have stagnated, there is no evidence of a significant or sustained downturn across the broader economy.

Based on this data, the committee is unlikely to declare a recession at this time. For a recession to be officially recognized, economic weakness must be both widespread and persist for more than a few months.

9. Conclusions

The latest readings from Globicus' leading indexes indicate that the U.S. economic expansion is likely to continue. In December, the total leading index growth rate was 0.6, while the short leading index accelerated to 2.2. Although the long leading index remains in negative territory at -1.4, it is showing signs of improvement.

In summary, the leading indexes suggest that the U.S. economic expansion will extend into early 2025, with a low likelihood of an imminent recession. Globicus' coincident index, along with Sahm's rule and data analyzed by the NBER's Business Cycle Dating Committee, further confirms that the U.S. economy is currently in an expansionary phase.