Globicus Leading Economic Index

Outlook - May 2025

Early Signs of Economic Weakness

Globicus Inc.

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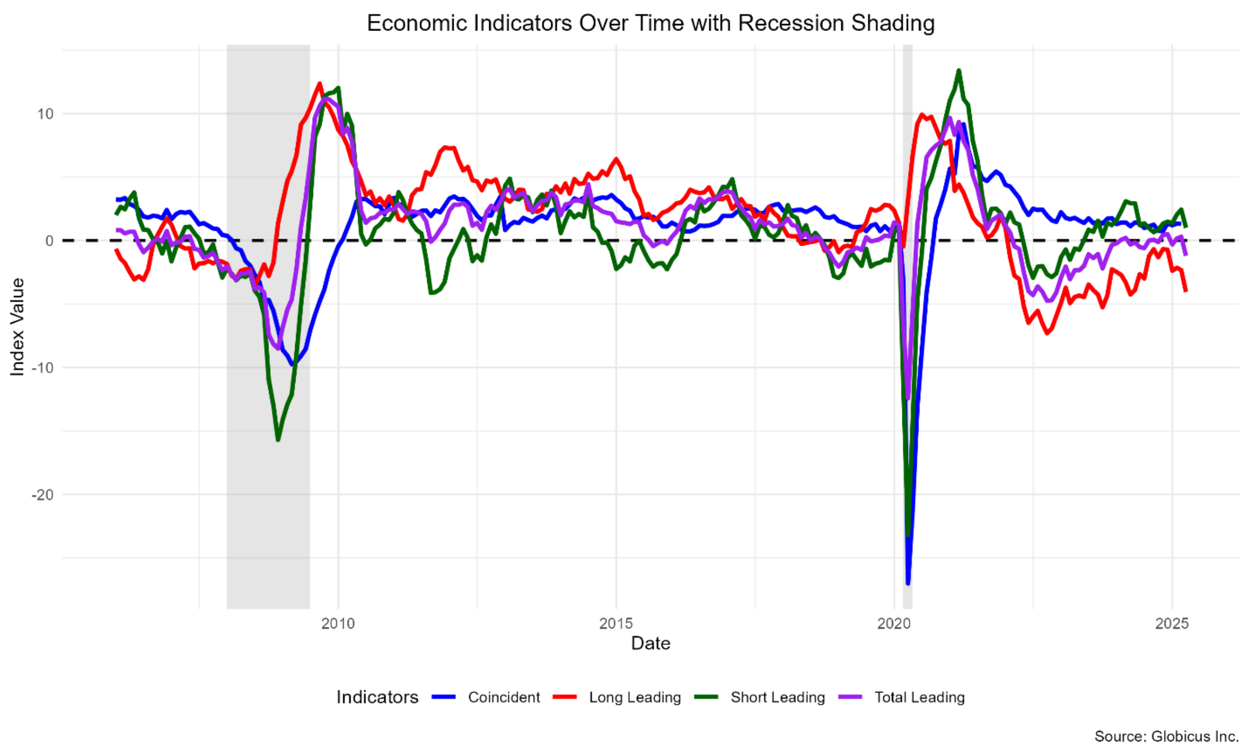
1. Executive Summary

Globicus' Leading Economic Indexes are designed to anticipate turning points in the business cycle, and the latest readings indicate signs of economic deceleration. After showing solid momentum at the end of 2024, the indexes have weakened in the spring of 2025. The Long Leading Index declined from -2.3 in March to -4.1 in April. The Short Leading Index, which had remained positive since mid-2023, fell from 2.4 in March to 1.0 in April. The Total Index, which had hovered around zero over the past year, dropped from 0.3 to -1.2 in April. Collectively, these indicators suggest that while the risk of a recession has risen, a near-term recession remains unlikely.

Meanwhile, Globicus’ Coincident Index—which tracks the current state of the economy based on the most recent macroeconomic data—continues to reflect steady growth. The Sahm Rule, which has historically signaled the onset of recessions, has reversed its recession warning. Additionally, indicators from the National Bureau of Economic Research’s (NBER) Business Cycle Dating Committee confirm that the U.S. economy is not currently in a recession.

2. Globicus Leading Indexes Weaken

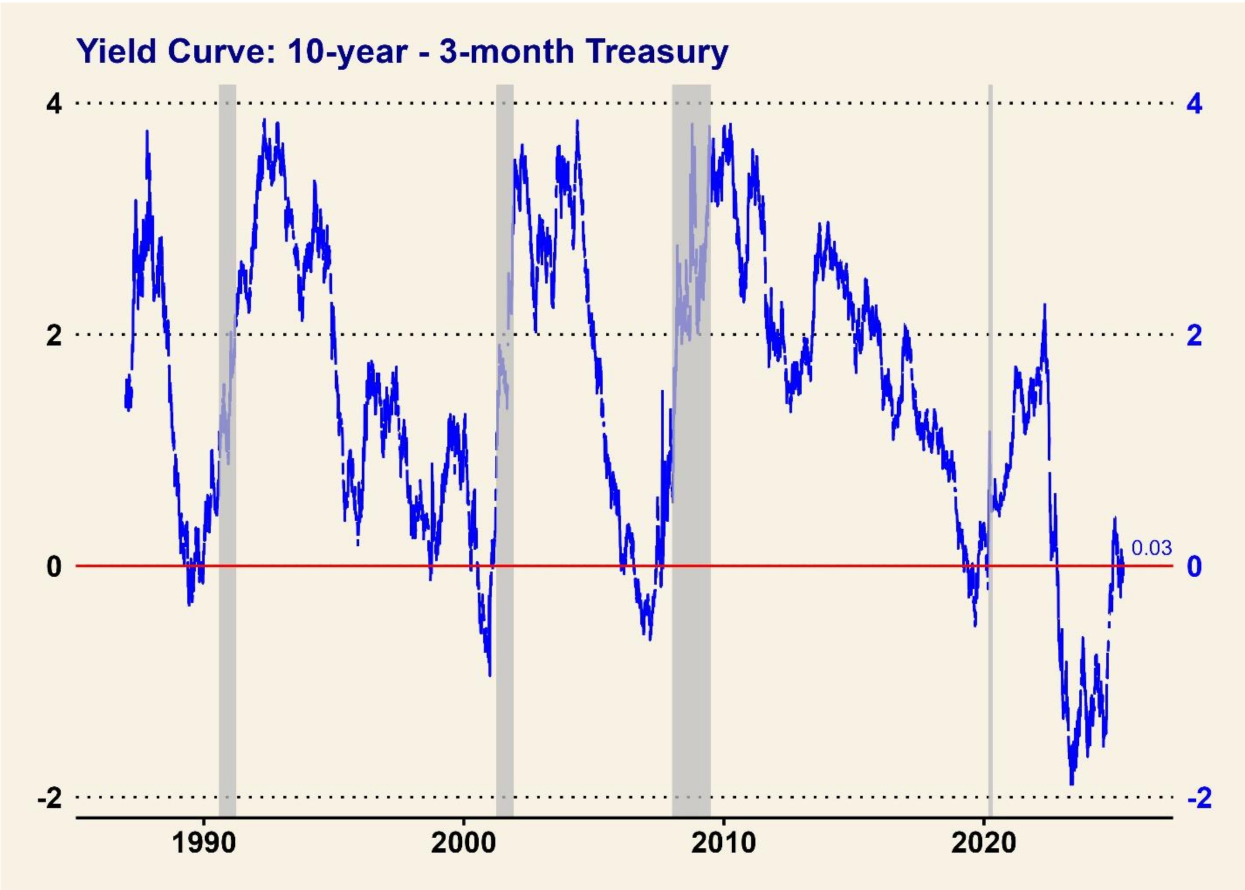
Globicus' Leading Economic Indexes—comprising the Total Leading, Long Leading, and Short Leading Indexes—are designed to identify economic turning points and forecast the future direction of the economy.



New and revised data indicate that the Total Leading Index growth rate declined to -1.2 in April, down from 0.3 in March. The Short Leading Index also weakened, falling to 1.0 in April from 2.4 the previous month. The Long Leading Index, which has remained negative for an extended period, showed signs of improvement late last year but has resumed its decline in 2025—dropping to -4.1 in April from -2.3 in March. Together, these trends suggest a more elevated risk of recession within the next 12 months. In contrast, the Coincident Index—which reflects current overall economic conditions—remains solid, holding steady at 1.3 in both February and March.

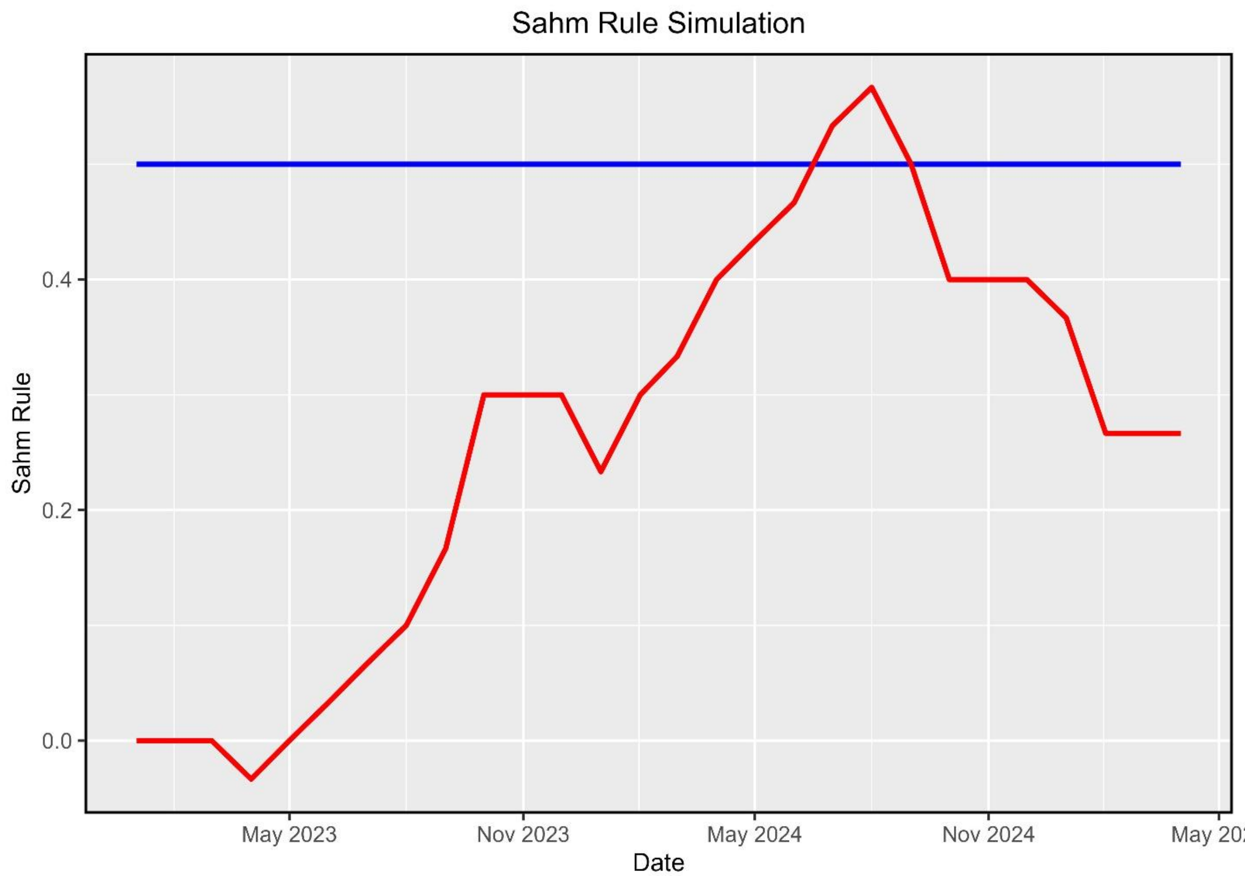
3. Yield Curve has Turned Positive

The 10-year/3-month yield curve—a historically reliable recession indicator—turned positive on December 13, 2024, after more than two years of inversion, marking the longest inversion on record. Historically, a negative yield curve has preceded recessions, and in the last four downturns, the spread turned positive shortly before the recession began, typically as the Federal Reserve began lowering the federal funds rate. While the spread has hovered near zero in early 2025, it currently does not signal an imminent recession.



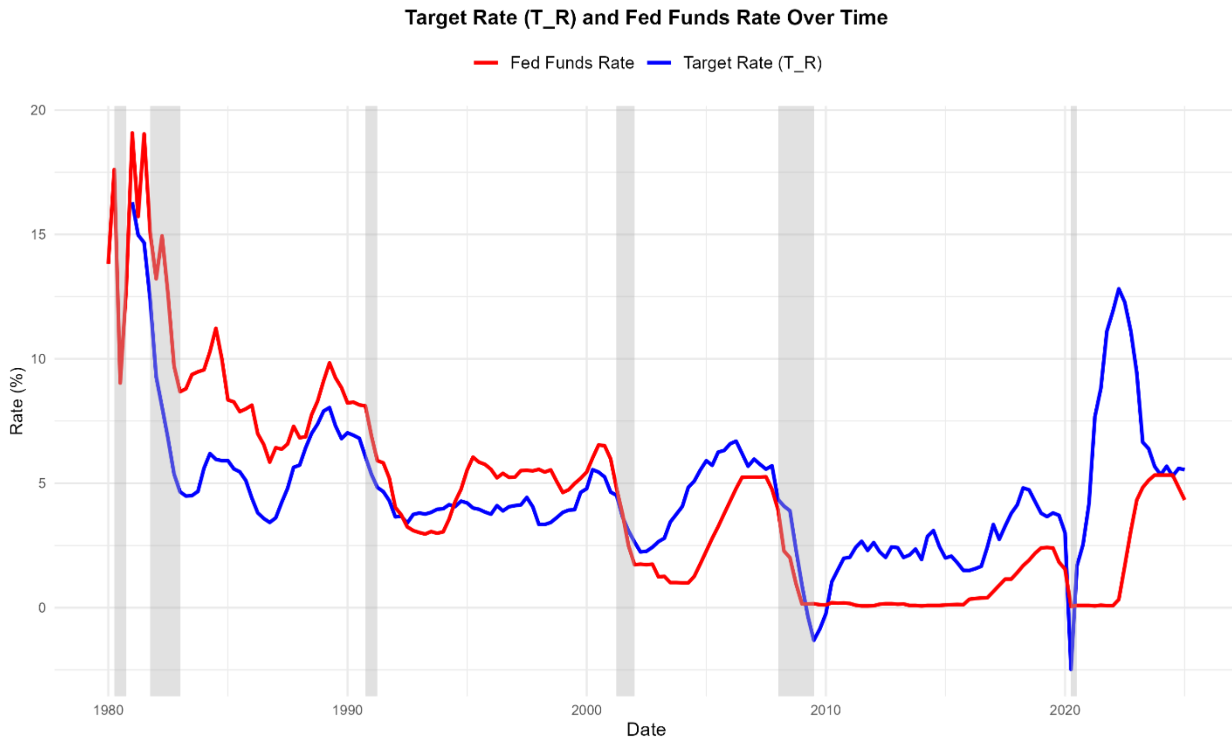
4. No Recession

In July 2024, the unemployment rate spiked to 4.3%, triggering a recession signal of 0.53% according to the Sahm Rule. This rule flags a recession when the three-month moving average of the unemployment rate rises by 0.50 percentage points or more relative to its lowest three-month average over the previous year. However, the rise in unemployment during the summer was short-lived and not followed by additional increases. As of April 2025, the Sahm indicator has declined to 0.27%—a level inconsistent with an active recession. In a typical recession, the unemployment rate tends to rise steadily until the downturn ends.



5. The Taylor Rule

The Taylor Rule, developed by economist John Taylor, is an equation that links the Federal Reserve’s benchmark interest rate to inflation and economic growth. It serves as a guide to help policymakers assess appropriate interest rate levels based on prevailing economic conditions. The rule calculates a recommended federal funds rate using the output gap—the difference between actual and potential output (with potential output estimated by the Congressional Budget Office)—and current inflation, measured here by changes in the Consumer Price Index (CPI). The model assumes a 2% inflation target and a 2% steady-state real interest rate, though these assumptions can be adjusted using alternative measures. The accompanying graph compares the Taylor Rule’s suggested rate (in blue) with the actual federal funds rate (in red) through the first quarter of 2025. It shows that the current fed funds rate is slightly below the rate suggested by this simple Taylor Rule specification, implying that there is no immediate need for the Federal Reserve to cut interest rates.

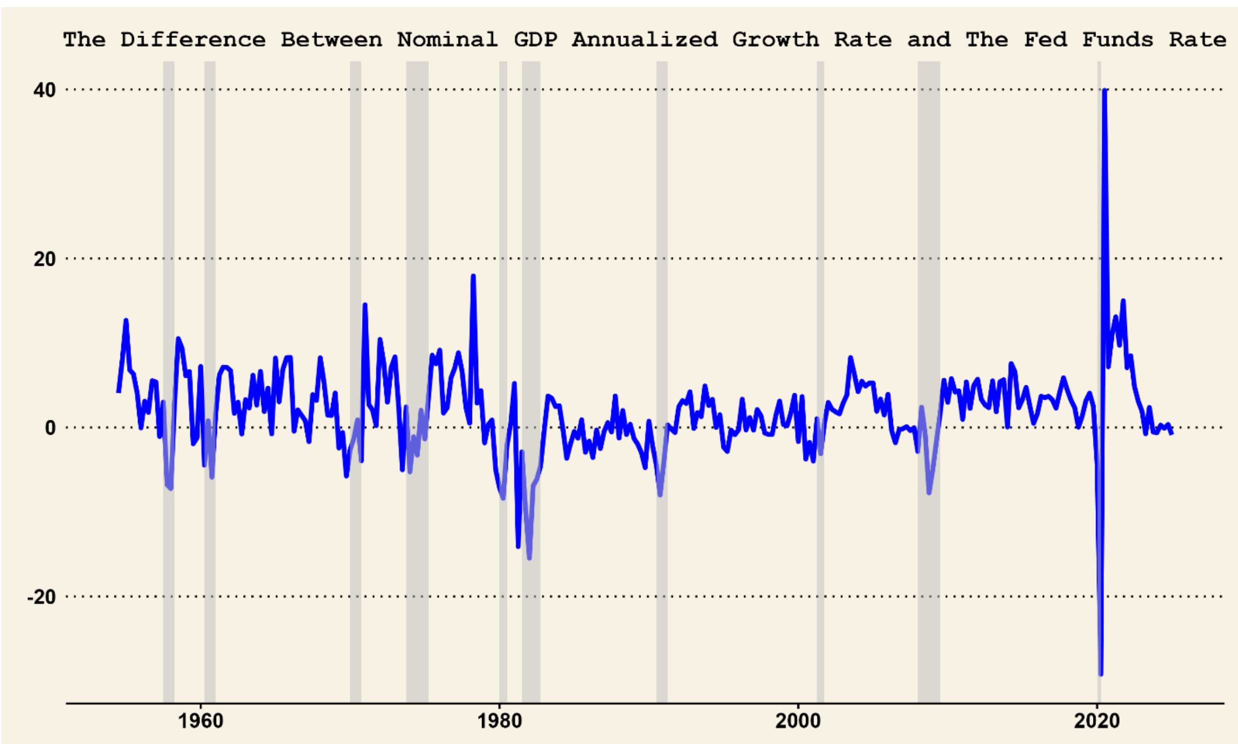


The proposed Trump tariffs are likely to complicate the Federal Reserve's policy decisions. Tariffs generally raise prices, contributing to inflation, while simultaneously dampening economic activity—a combination that presents a classic policy dilemma. According to the Taylor Rule, the Fed should raise interest rates in response to rising inflation and cut rates when economic activity slows. But in this case, both forces are happening at once: inflation is expected to rise while growth slows. This constitutes a supply shock—similar to a tax increase on the economy and presents a policy dilemma for the Fed. In such a scenario, the most prudent course of action for the Fed may be to hold rates steady. However, if unemployment begins to rise, political pressure to lower interest rates could intensify significantly.

6. Has the Fed managed a Soft Landing?

It may still be too early to determine whether the Federal Open Market Committee (FOMC) has successfully brought inflation back to its target without triggering a recession. While inflation remains above the 2% goal and a recession cannot yet be ruled out, the Fed's policy actions to date have not resulted in a downturn. This suggests that, so far, the Fed has managed a delicate balancing act—tightening policy without derailing the broader economy.

There are several ways to assess the stance of monetary policy, and one useful approach is to compare the annualized growth rate of nominal GDP with the federal funds rate. This comparison offers insight into whether policy is stimulative or restrictive. The chart below illustrates this relationship across economic cycles. Notably, during the current cycle, the spread between nominal GDP growth and the federal funds rate only briefly dipped into negative territory. This stands in contrast to previous recessions, where the spread turned significantly negative ahead of recessions, reflecting a much tighter monetary policy stance.



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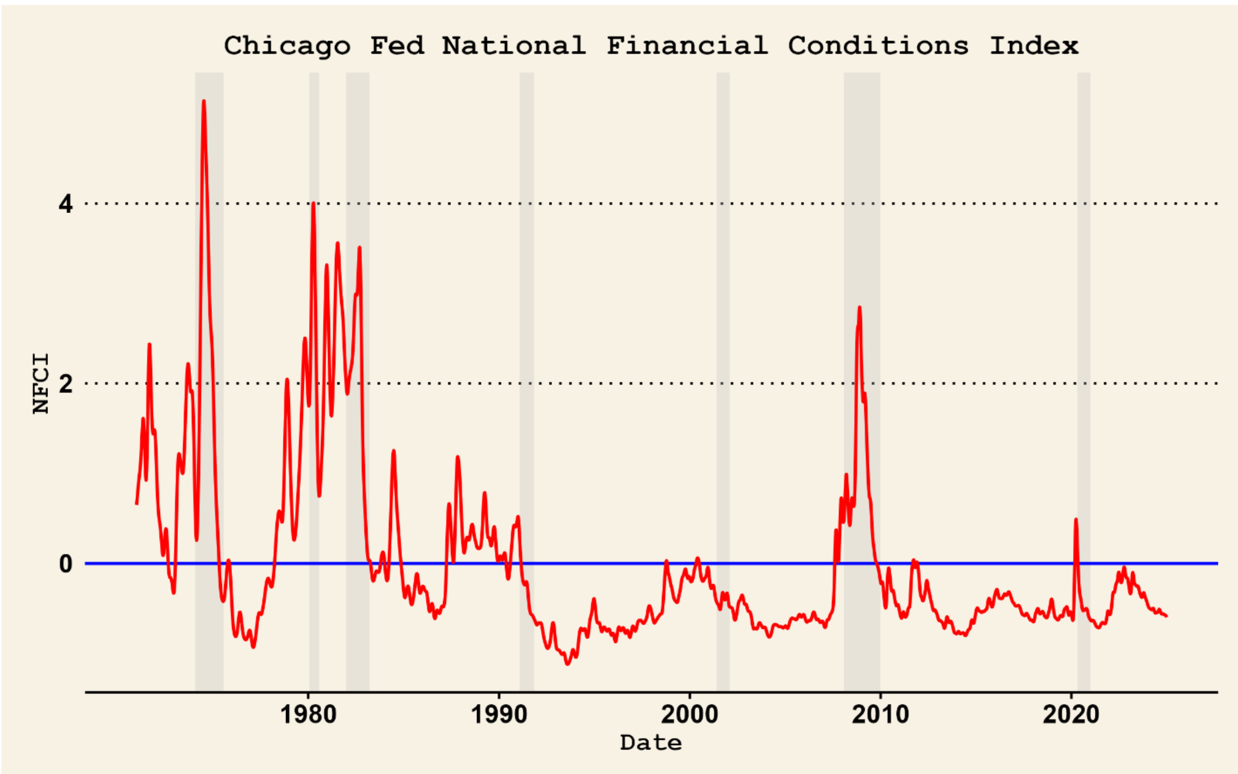
Another perspective on the Federal Reserve's policy stance is to examine how financial conditions have evolved over time. The Chicago Fed's Adjusted National Financial Conditions Index[1] offers a comprehensive weekly assessment of U.S. financial conditions across money, debt, and equity markets, including both traditional and shadow banking system. 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.



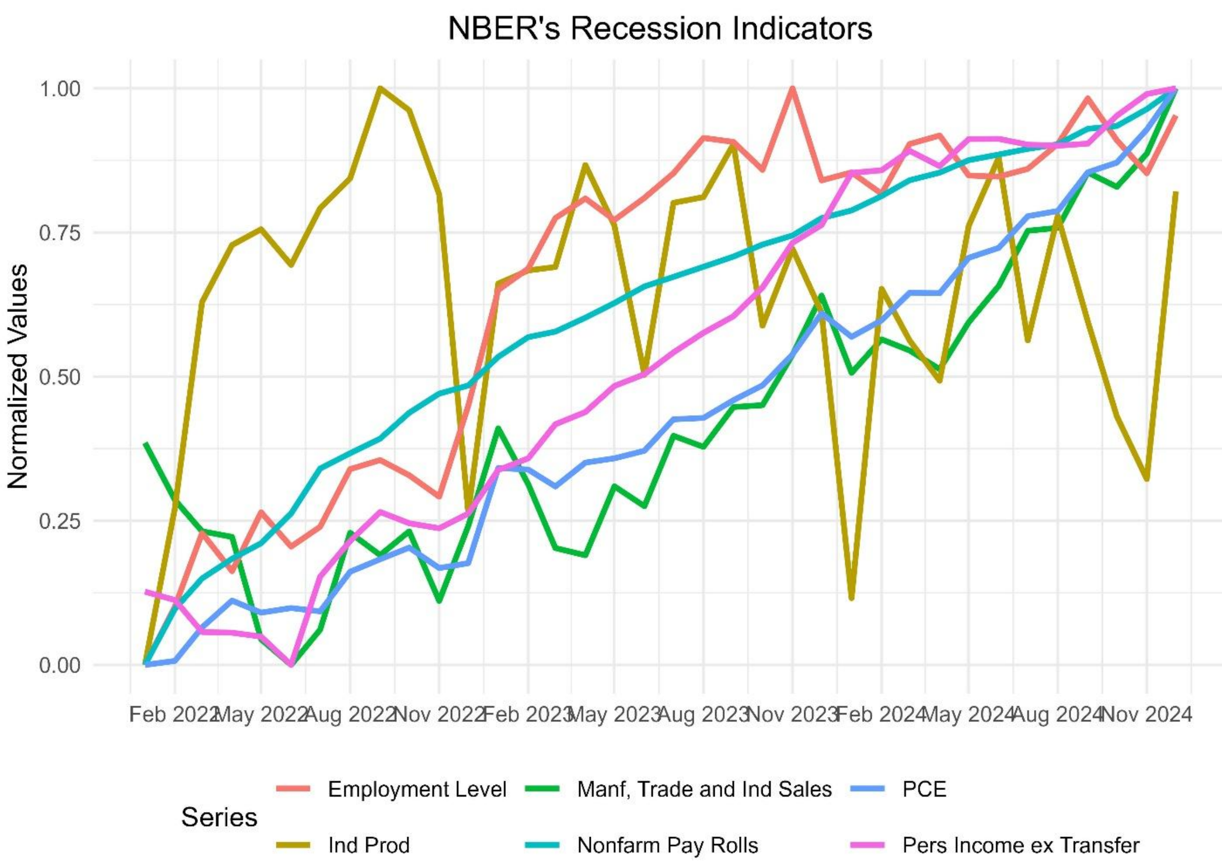
[1] The adjusted NFCI (ANFCI). This index isolates a component of financial conditions uncorrelated with economic conditions to provide an update on how financial conditions compare with current economic conditions.

7. The US Economy Is Still Expanding

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

To identify the beginning and end of a recession, the committee evaluates a broad range of monthly indicators reflecting real aggregate economic activity. These include real personal income (excluding government transfers), nonfarm payroll employment, household employment, real personal consumption expenditures, inflation-adjusted retail and wholesale sales, and industrial production.

As shown in the chart below, the latest data from these key indicators show continued strength rather than weakness— .all advanced in the most recent readings, providing no evidence of a broad-based economic downturn.



In addition to monthly indicators, the NBER Business Cycle Dating Committee also considers two key quarterly measures: Gross Domestic Product (GDP) and Gross Domestic Income (GDI). In the first quarter of 2025, GDP declined by 0.3% (seasonally adjusted annual rate, saar), though it was still up 2.0% year-over-year. This follows a 2.4% saar growth in the fourth quarter of 2024. The slight contraction in the first quarter is largely attributed to a surge in imports, as businesses front-loaded purchases ahead of proposed tariff increases.

Meanwhile, GDI grew by 4.4% saar in the fourth quarter, accelerating from 1.4% saar in the previous quarter. First-quarter GDI data for 2025 has not yet been released.

All of the monthly and quarterly indicators the committee monitors have recently shown strength. As a result, there is currently no basis for the committee to declare the start of a recession. For a recession to be officially recognized, the economic weakness must be both broad-based and sustained over several months.