

US Macroeconomics

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When Does the Recession Begin?

Last year, the economy experienced an inflationary recession whereby elevated price readings exceeded nominal economic activity. In turn, real GDP growth fell 1.6% in Q1 2022 and 0.6% in Q2 2022. But this did not lead to job loss, so this development was not considered an “official” downturn. However, **based on the performance of the Index of Leading Economic Indicators (LEI), a more traditional recession still awaits us.** The key question is how far away is the next official downturn?

A graph of the LEI and recession bars is shown below. Excluding the pandemic there have been eight recessions since 1959 which is when the LEI series starts. For scaling purposes, the 1960s is not shown in the chart. It is clear that **the LEI always peaks before the economy peaks.** While the series has a perfect track record, accurate in eight out of eight instances, there is substantial variability in lead times among the business cycles.

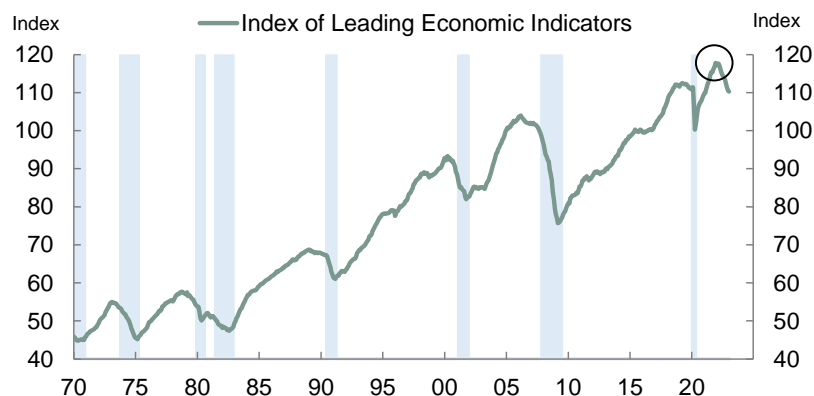
For example, the LEI peaked in February 1960, just two months before the economy peaked in April 1960. In the next two business cycles, the lead times were eight (April 1969) and nine (February 1973) months respectively before the economy topped in December 1969 and November 1973.

The recession that began in 1980 saw the LEI peak 15 months earlier (October 1978) but then just eight months before the July 1981 peak. As we can see from the chart, **the lead time of the LEI lengthened over the next three business cycles.** This has us now speculating that recession may not be imminent. Weather considerations aside, the latest batch of economic data is consistent with a pushing back of the recession start date.

There was a 17-month lead from the LEI to the economy in the February 1989 to July 1990 period. And there were 11 months in between the April 2000 and March 2001 peaks. But notice what happened before the 2008-2009 recession: **The LEI topped out a whopping 21 months before the economy hit its zenith in December 2007.** This is by far the longest lead time of the eight business cycles. For the record, the average over the eight cycles is 11 months.

Given the recent tendency for a lengthening in the onset of recession, a 21-month lead time equates to a September 2023 peak in the economy, which is still a relatively long six months away. This may make some investors skeptical of the LEI’s usefulness. Monetary policy works with long and variable lags, and the Fed is on track for more rate increases. When the economy slows, it tends to do so suddenly and quickly. The LEI is prepping us for such an outcome.

Leading Indicators Always Peak Before Recession



Sources: Conference Board, NBER, Haver, SMBC Nikko

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