Does No Landing Mean Hard Landing?

Joseph A. LaVorgna
Chief US Economist
SMBC Nikko

(212)-893-1528
Joseph.Lavorgna@smbcnikko-si.com
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Executive Summary

- **An aggressive Fed tightening cycle has lifted household borrowing rates to a two-decade high.**

- **The labor market is showing cracks, and various leading indicators of the economy continue to point to significantly slower activity ahead.**

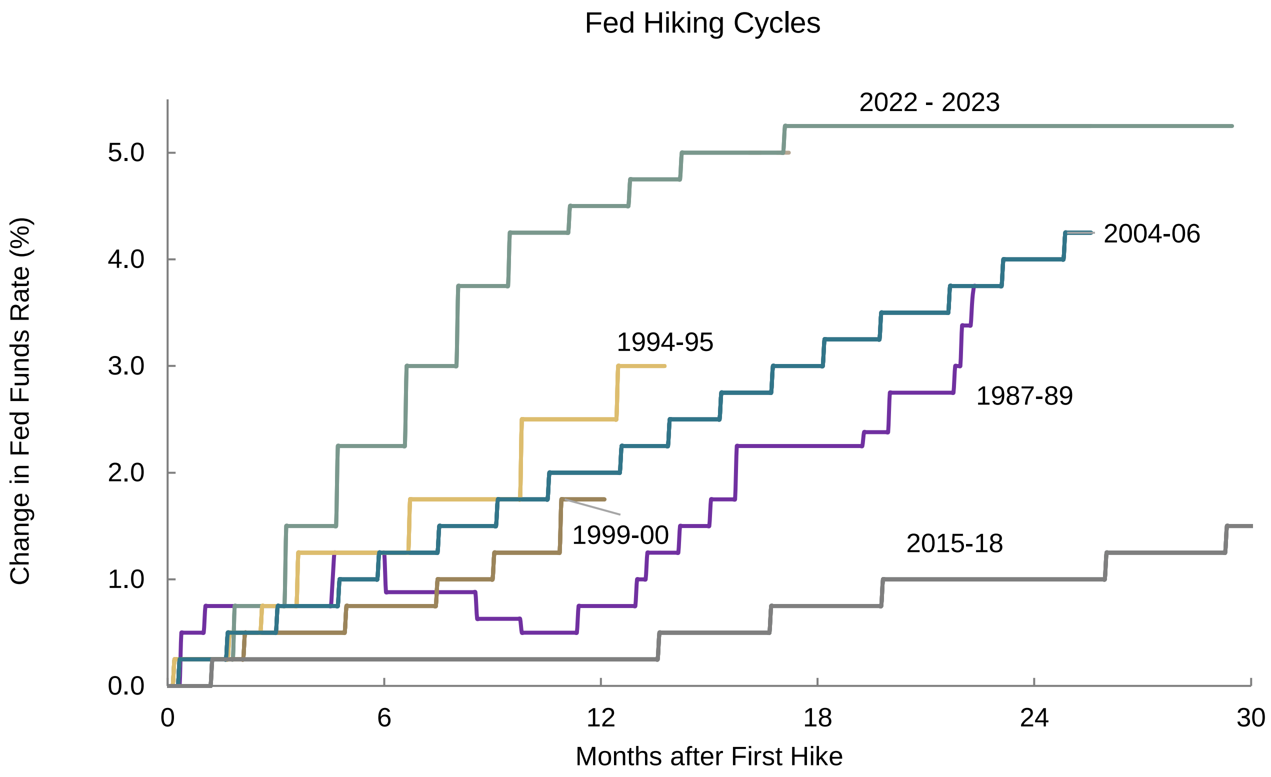
- **The Fed's next move will be an interest rate cut but it will not happen until late this year. Substantial easing of policy is expected next year.**

- **However, unprecedented fiscal spending combined with optimism over a soft landing has lifted stocks and massively stimulated financial conditions. This, as a result, has provided an offset to higher real interest rates.**

- **Unless there is an immaculate disinflation, a recession may be unavoidable because inflation is likely to prove sticky in either a "no landing" or a "soft landing" scenario.**

Record Rise in Fed Funds

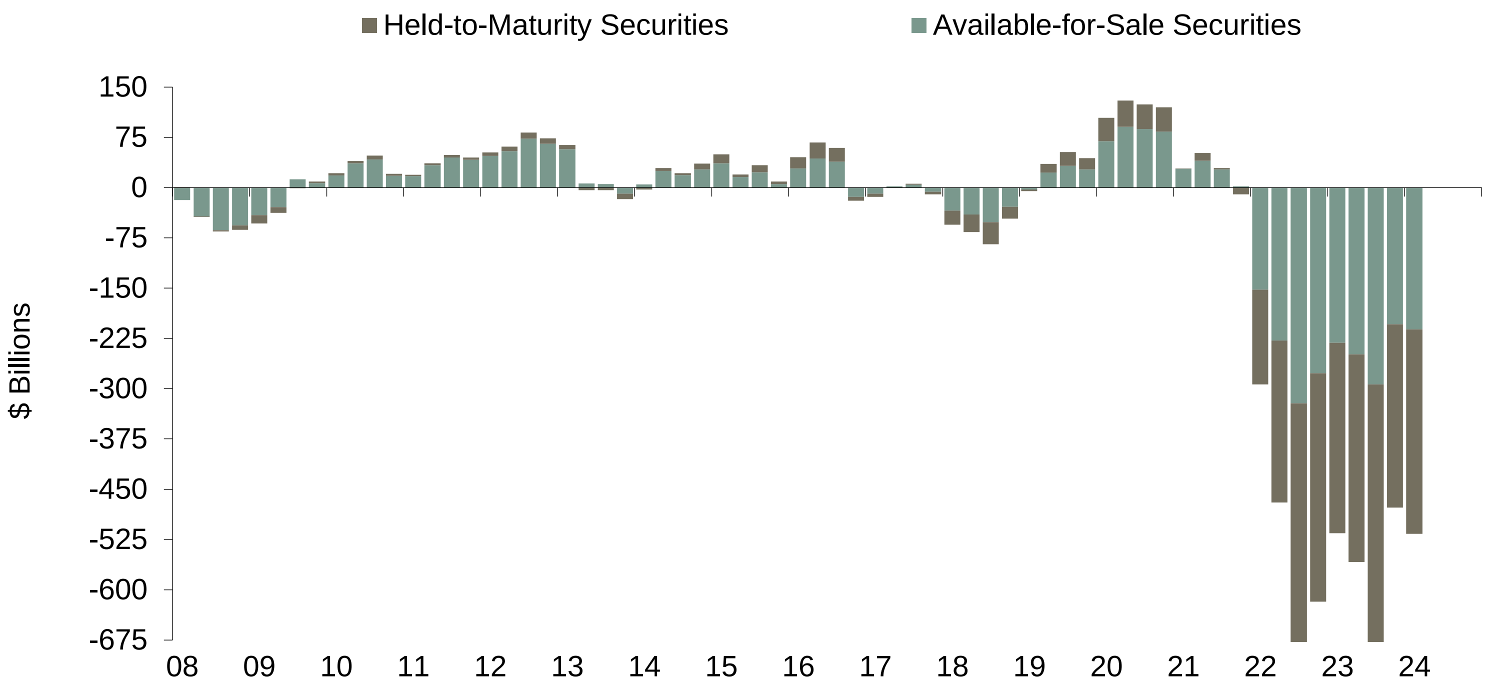
The recent hiking cycle was the most aggressive in over four decades.



Source: Federal Reserve, SMBC Nikko

Massive Commercial Bank Balance Sheet Losses

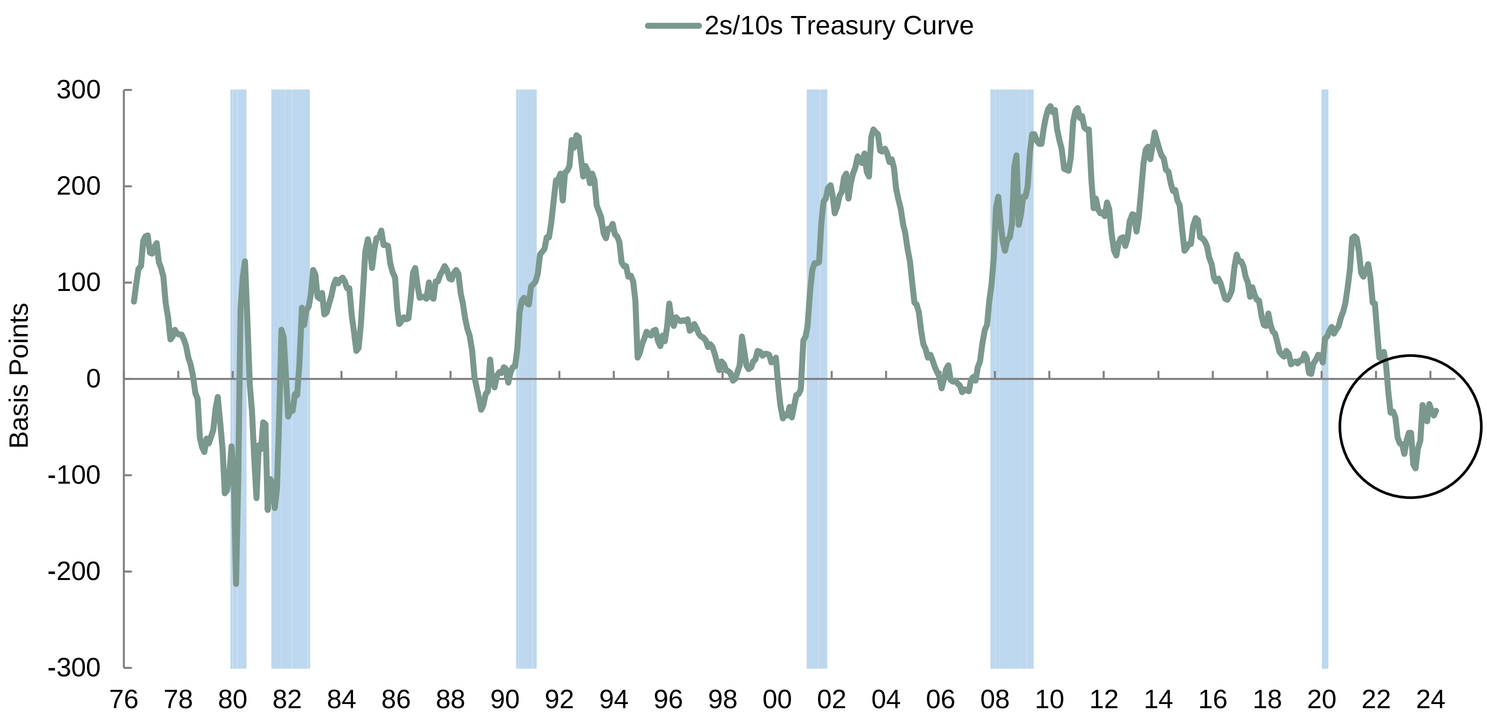
Rapid tightening led to record large portfolio losses in the commercial banking sector.



Source: FDIC, SMBC Nikko

Historic Yield Curve Inversion

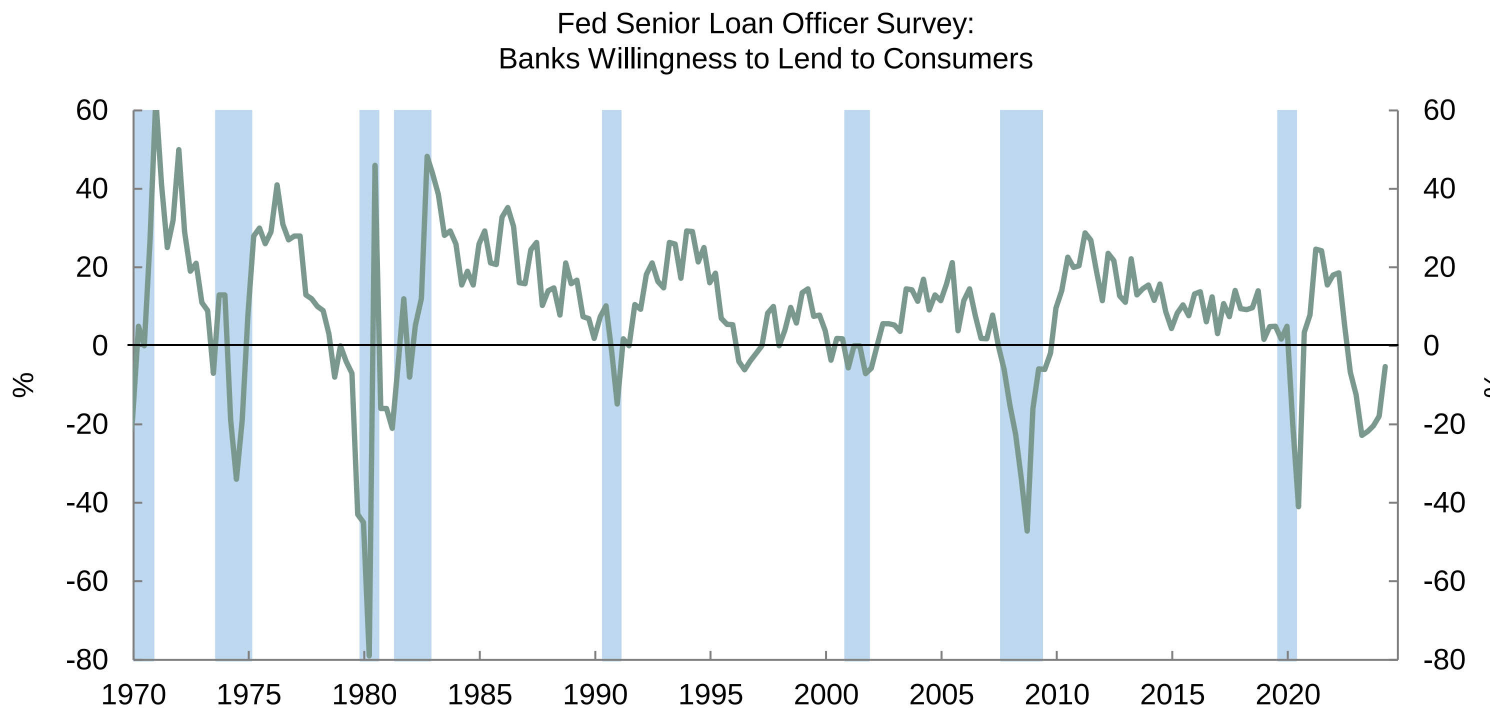
The curve has been inverted for a record long 24 months, thus leading to a consumer credit crunch.



Source: Federal Reserve, Haver, SMBC Nikko

Loan Officers Still Reticent to Lend

Commercial bank lending standards are still relatively tight.



Source: Federal Reserve, Haver, SMBC Nikko

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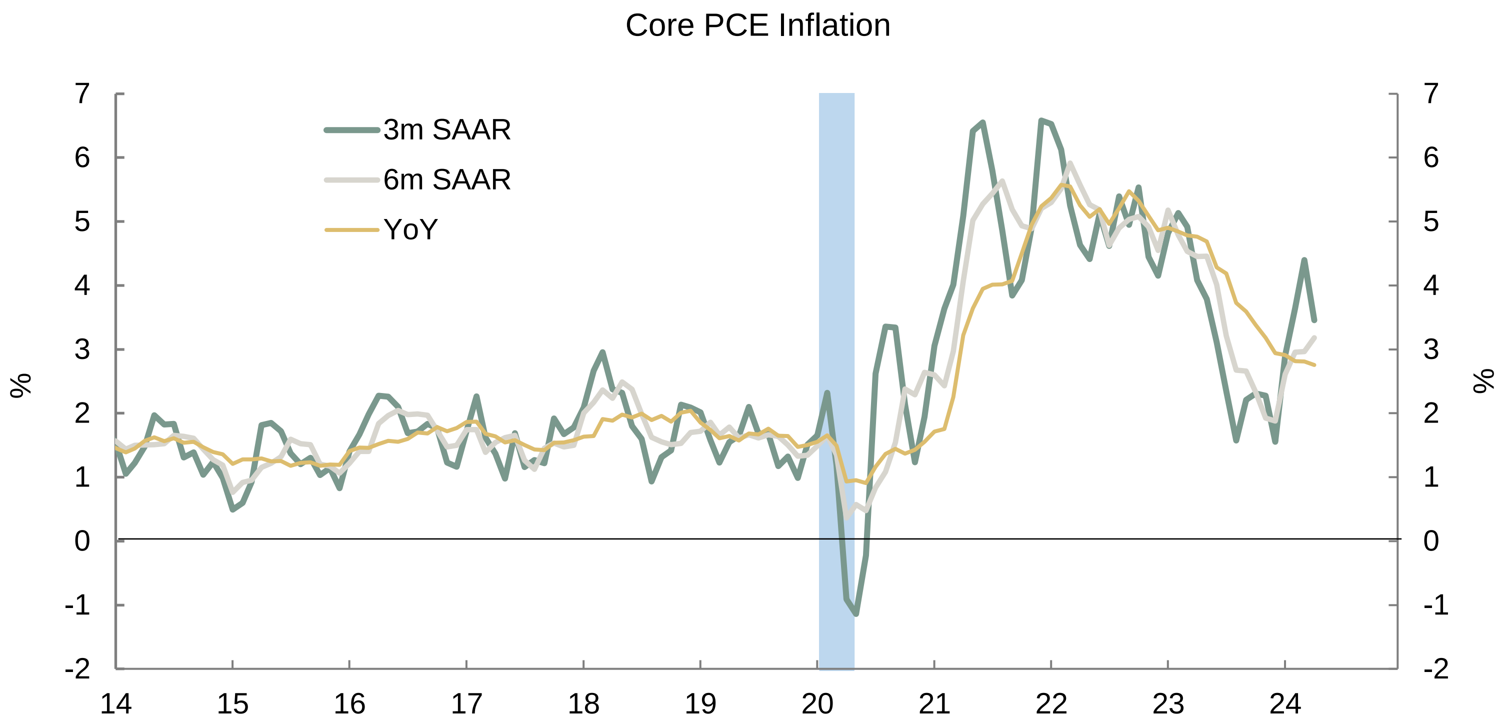
Moving in the Wrong Direction

Chair Powell wanted to pivot but an unexpected acceleration in inflation prevented him.



Source: BEA, Haver, SMBC Nikko

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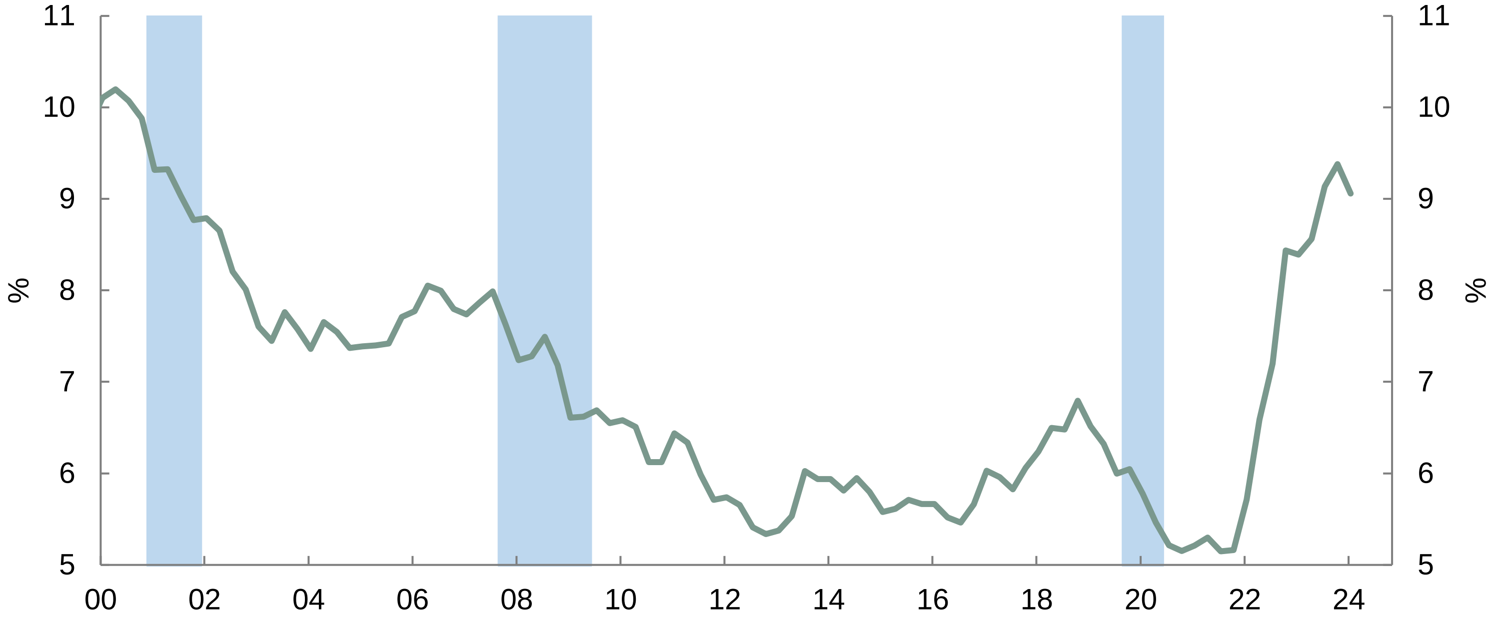
Soaring Borrowing Costs

Money is expensive as interest rates are hovering near a two-decade high.

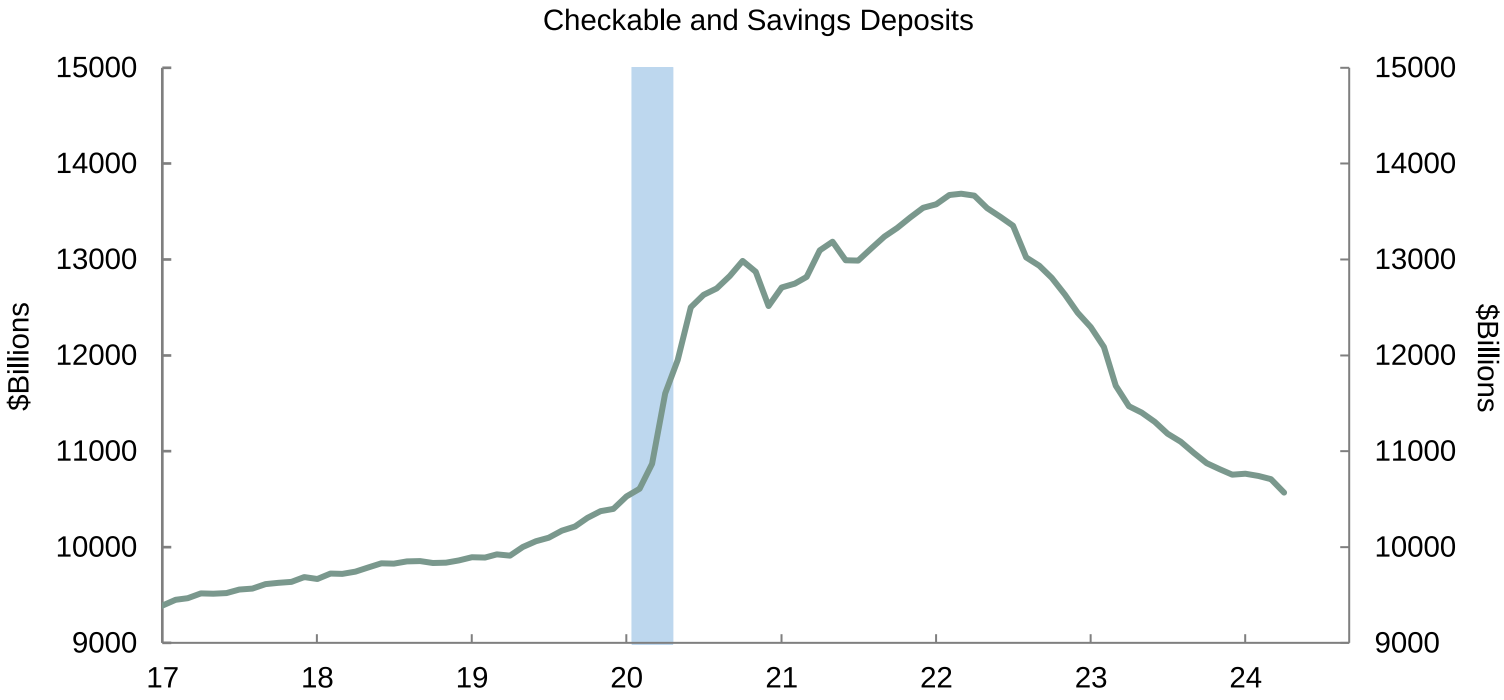
Effective Household Borrowing Rate



Source: FRBNY, Freddie Mac, FRB, Haver, SMBC Nikko

Tapped Out Consumers

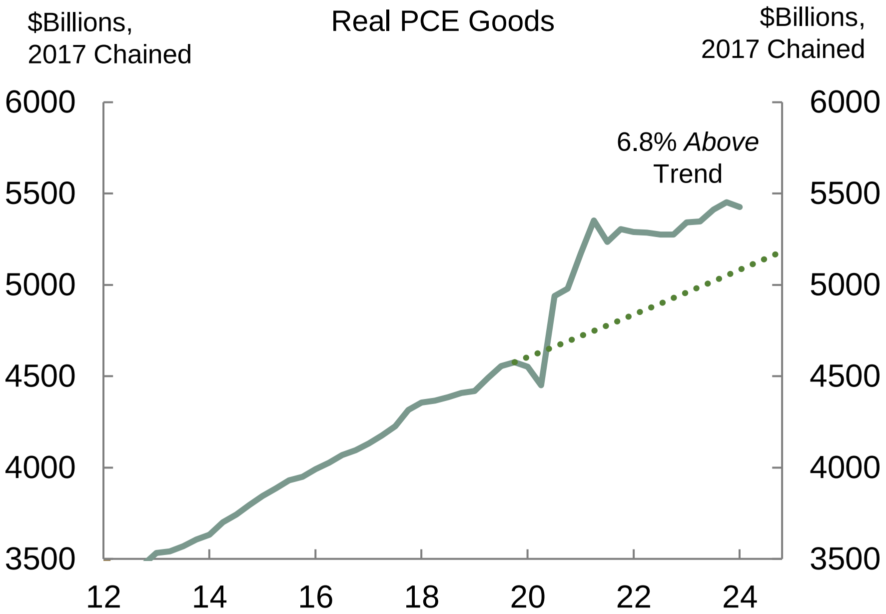
Households' excess savings have been exhausted are now well below underlying trend.

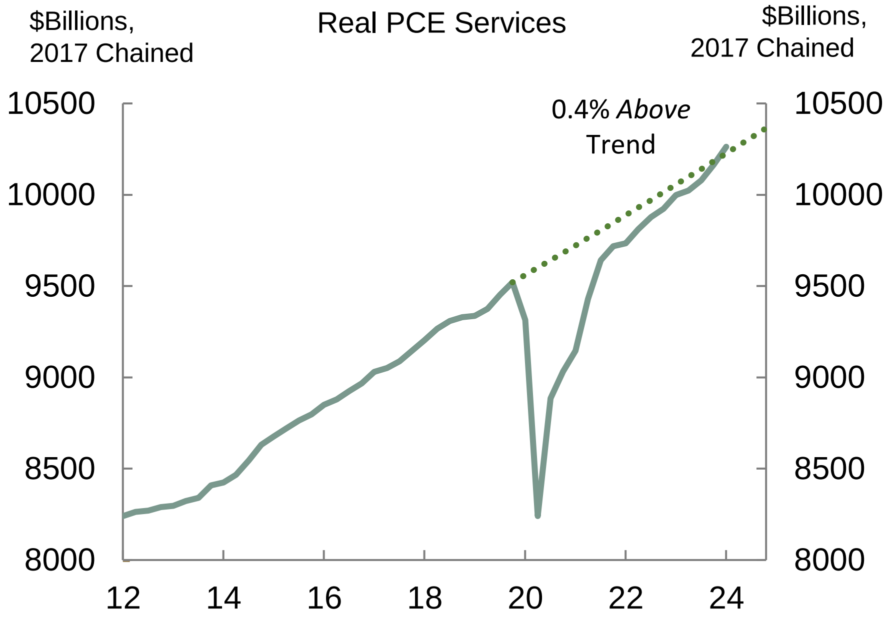


Source: FRB, Haver, SMBC Nikko

A Return to Trend

April real retail sales are below the pre-covid trend, pointing to more broad-based weakness ahead.

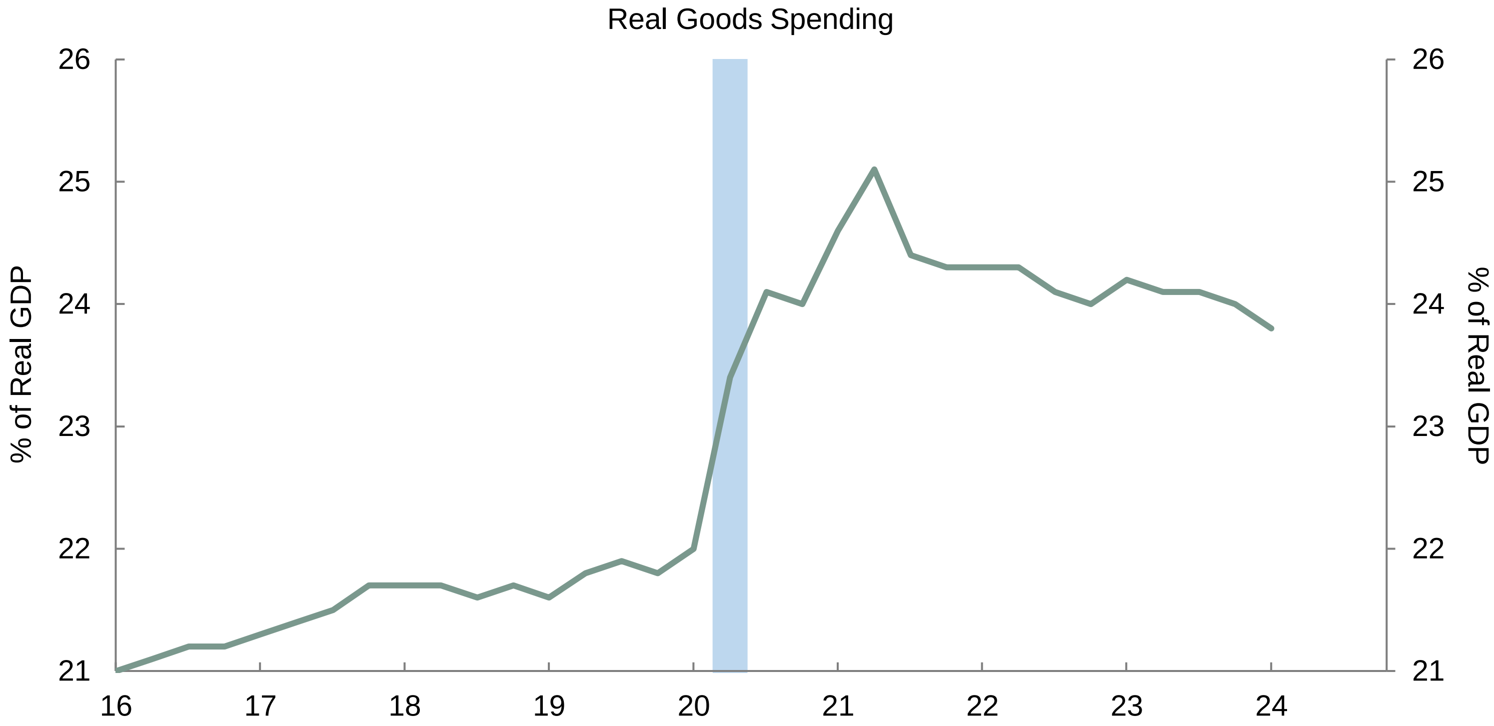




Source: BEA, Haver, SMBC Nikko

Vulnerable to a Pullback

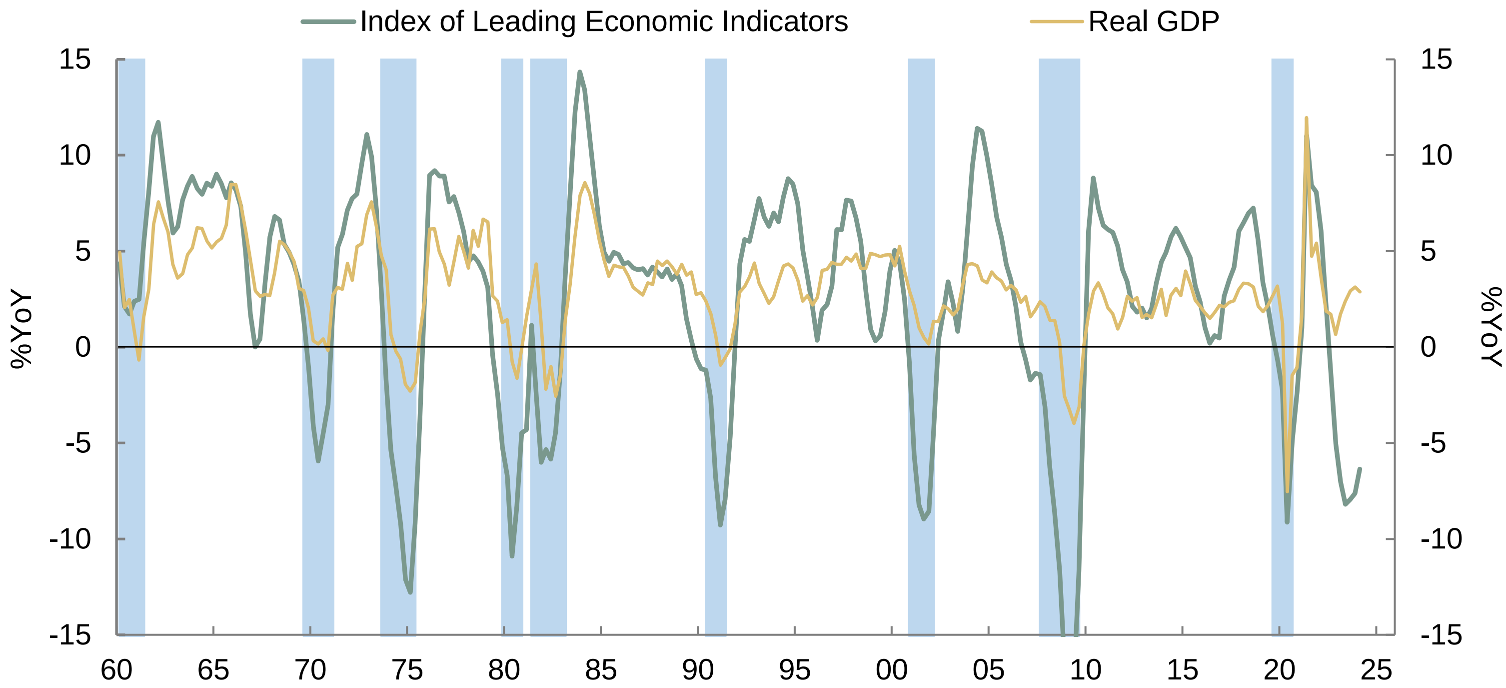
A return to pre-pandemic levels could take two percentage points of real GDP growth.



Source: BEA, Haver, SMBC Nikko

Still Negative

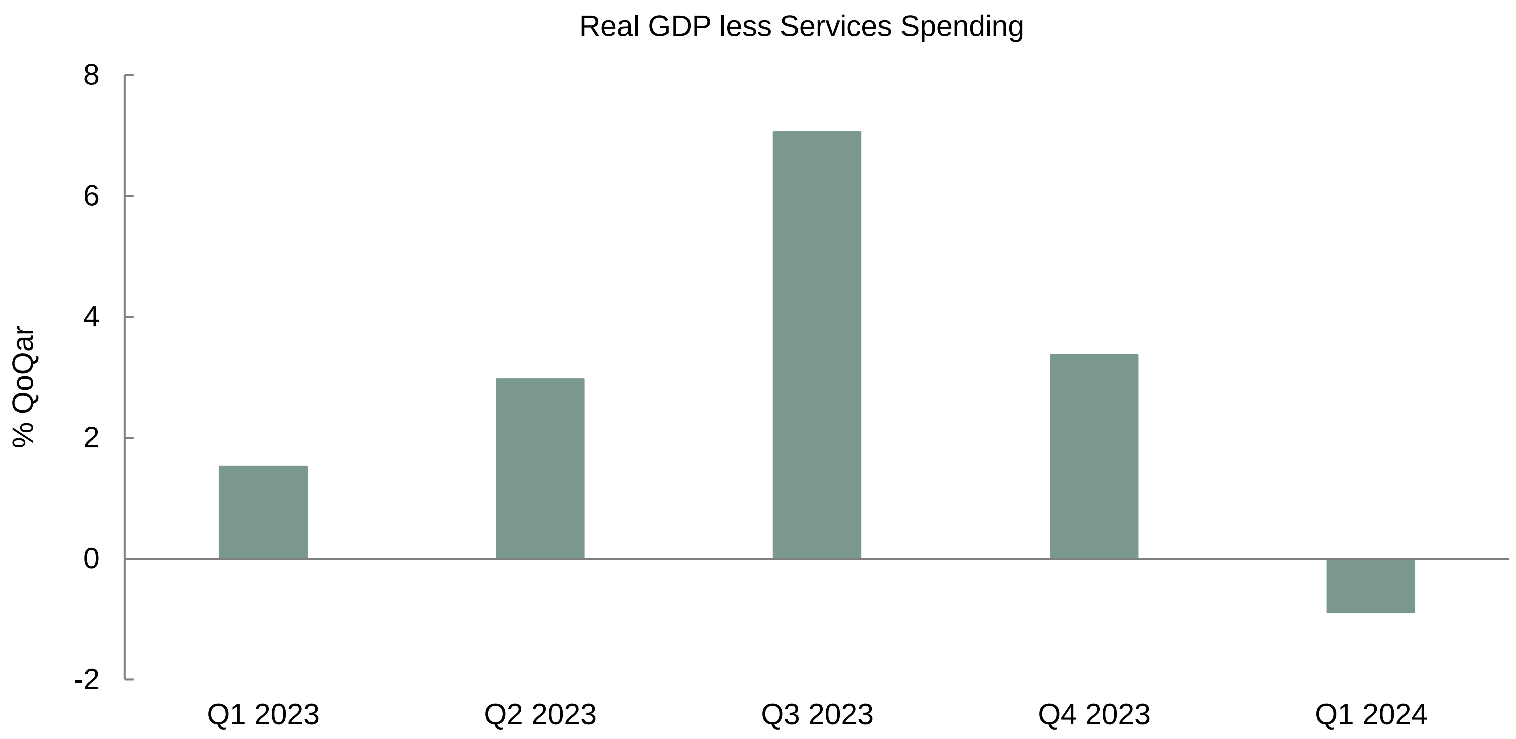
Leading indicators tells us a recession is still possible this year.



Source: Conference Board, BEA, Haver, SMBC Nikko

Services Spending Keeping Things Afloat

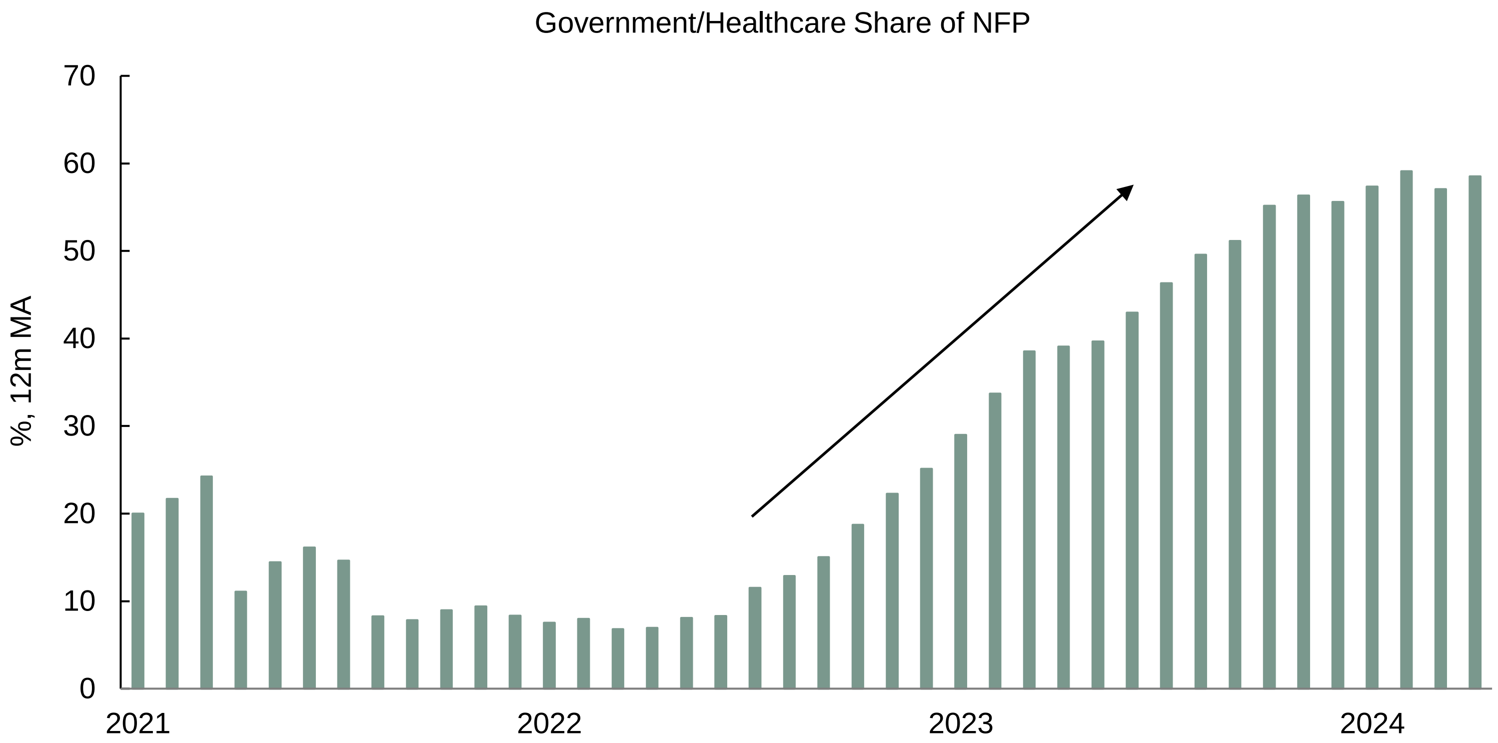
The economy was weak outside of services.



Source: BEA, Haver, SMBC Nikko

Less Robust Than Headline Suggests

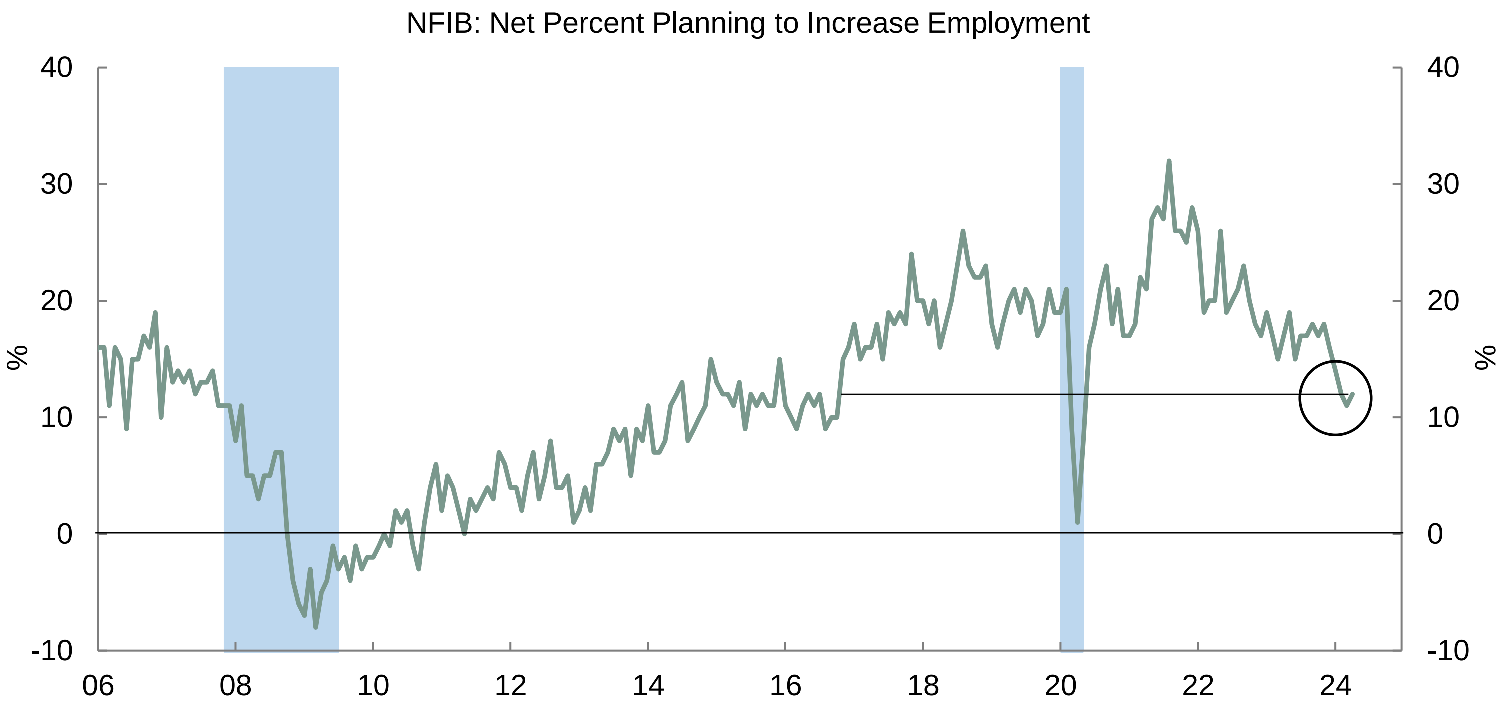
Nearly 60% of employment has been concentrated in government and healthcare.



Source: BLS, Haver, SMBC Nikko

Dimming Job Prospects

Small businesses account for over 40% of employment and their hiring plans are slowing.



Source: NFIB, Haver, SMBC Nikko

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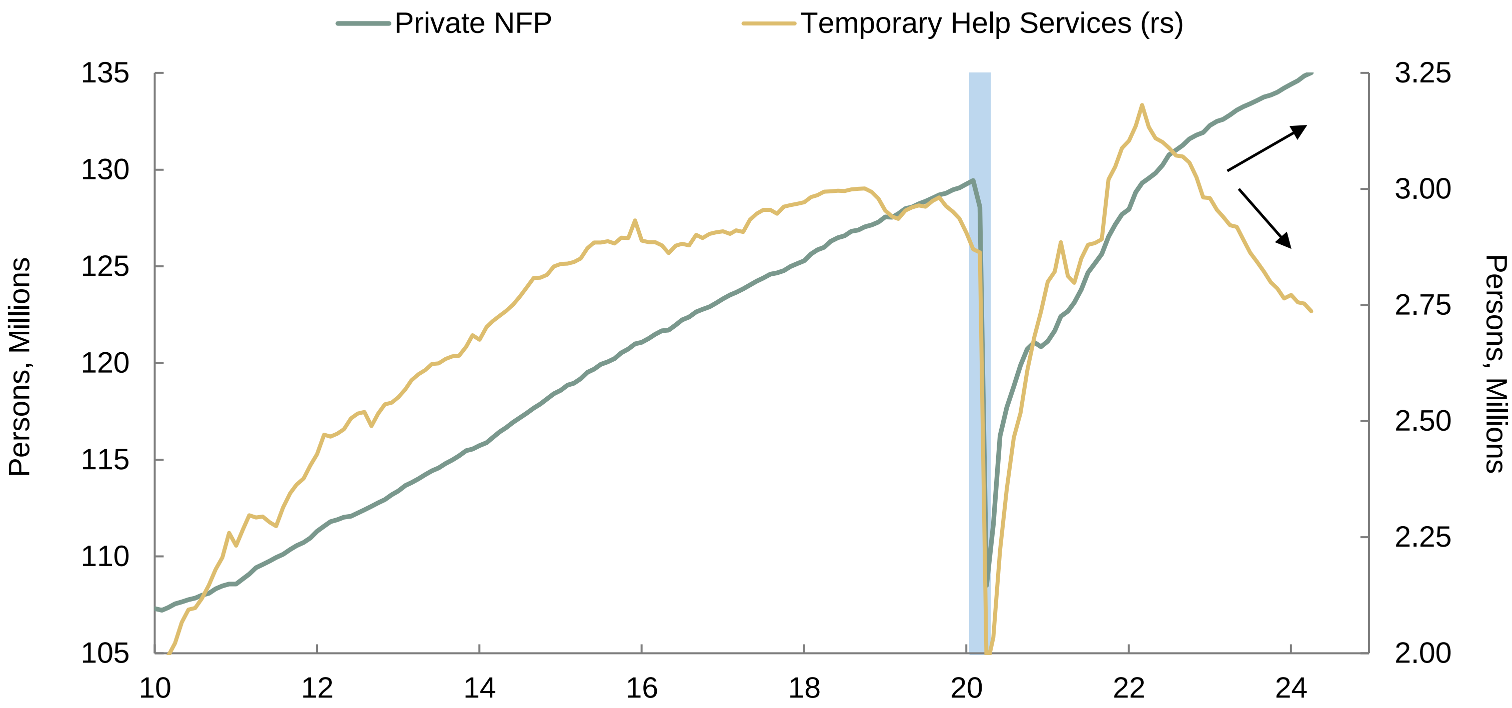
Labor Demand on the Wane

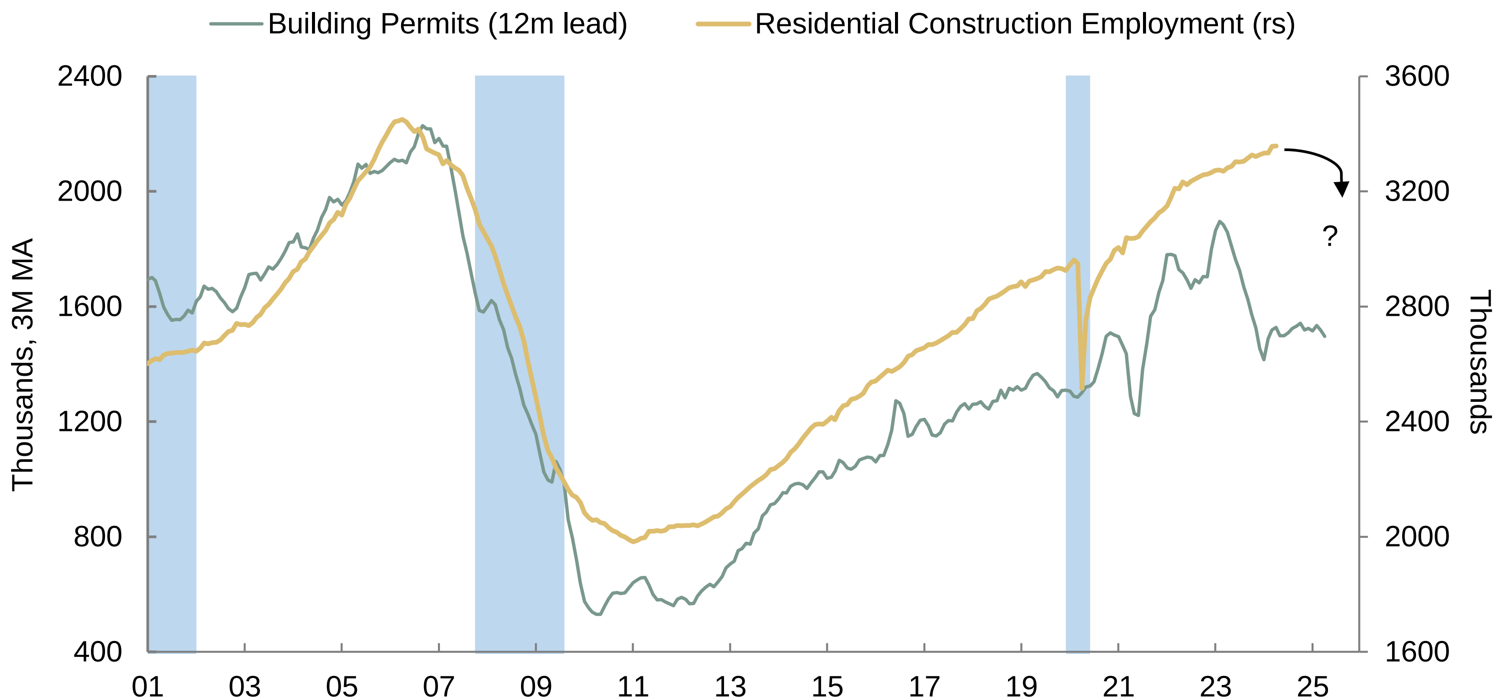
The demand for temps has collapsed, which like Leading Indicators, also points to recession.



Source: BLS, Haver, SMBC Nikko

An Imminent Construction Slowdown?

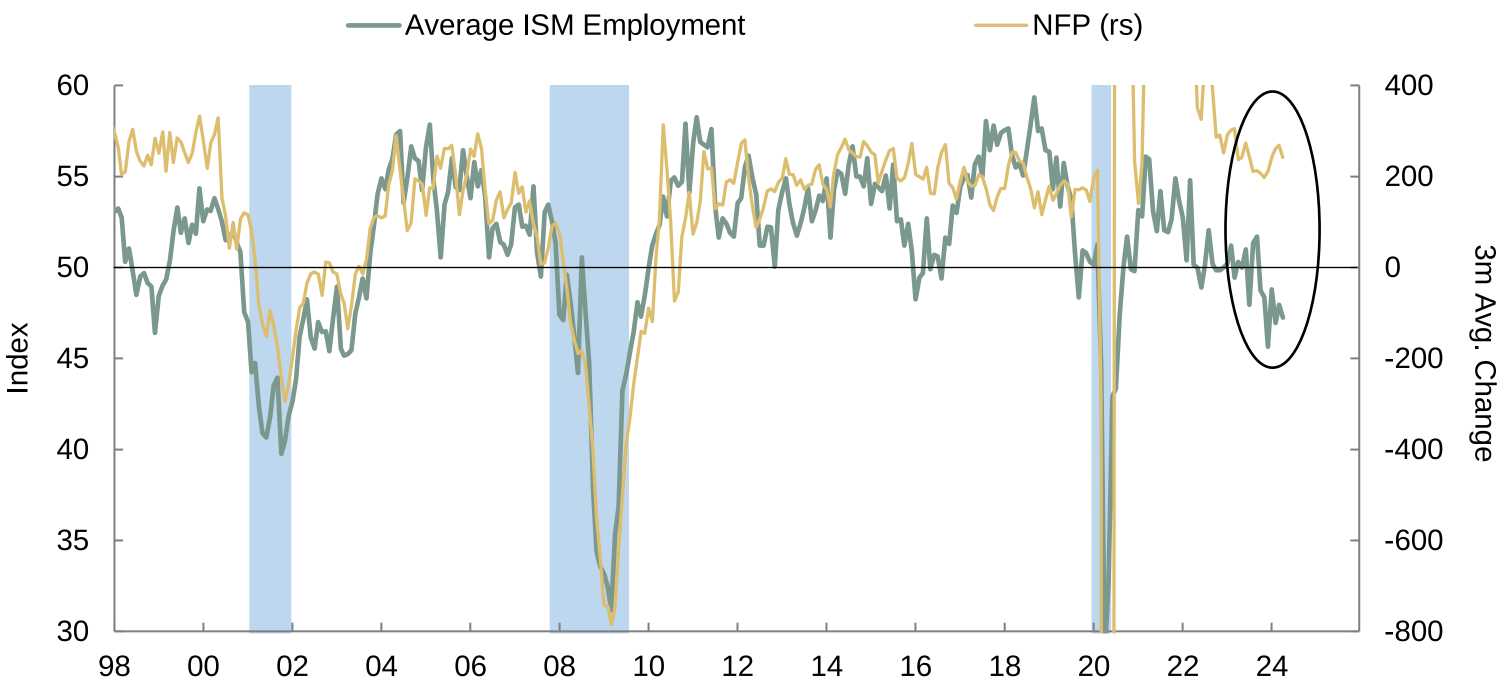
Construction employment continues to massively outstrip residential demand.



Source: Census, BLS, Haver, SMBC Nikko

Jobs Slowdown Incoming?

The Institute for Supply Management's employment surveys are signaling that the labor is soft.



Source: ISM, BLS, Haver, SMBC Nikko

Inflection Point?

The unemployment rate is up half a point, which has always been a recessionary trigger point.

Source: BLS, Haver, SMBC Nikko

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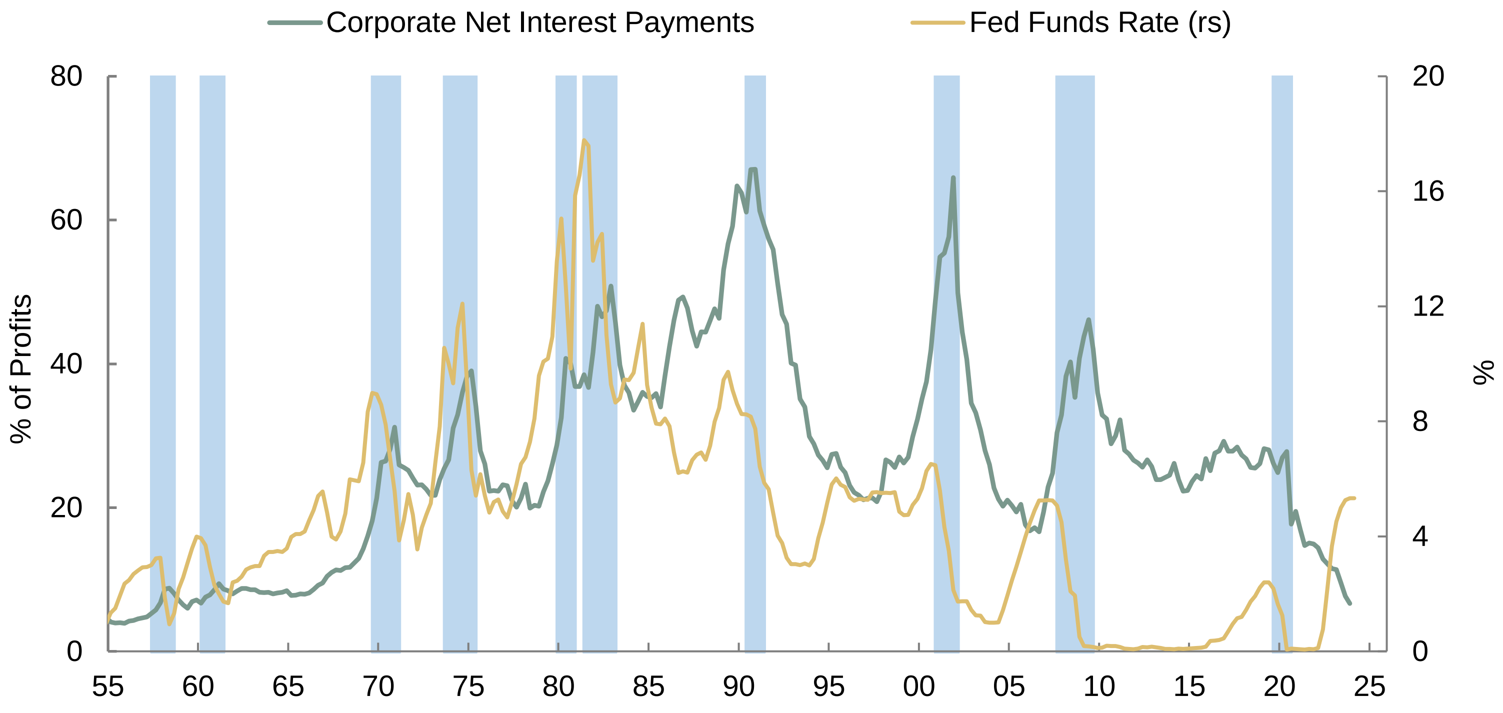
Low Rates Locked in During Pandemic

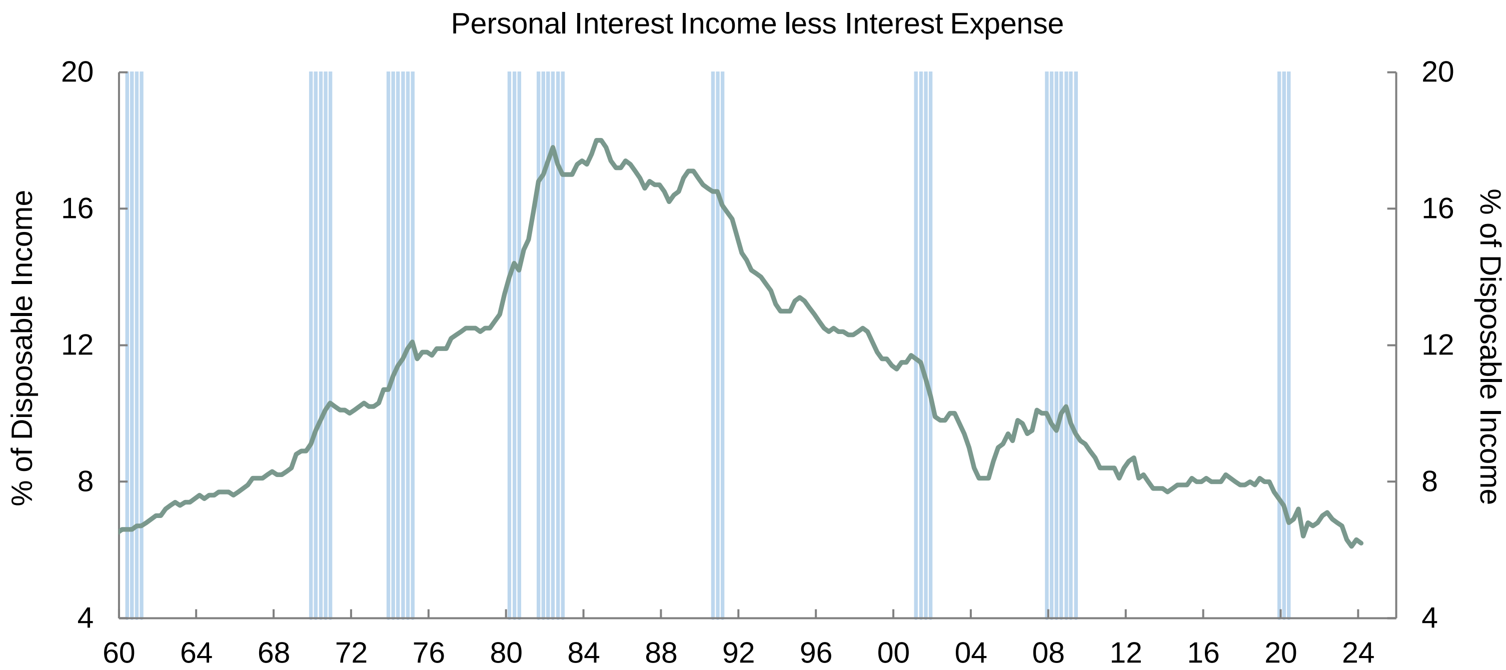
A mitigating recession factor has been healthy corporate balance sheets.



Source: BEA, Federal Reserve, Haver, SMBC Nikko

Pinched By Higher Rates

High interest rates are not helping the aggregate household sector.



Source: BEA, Haver, SMBC Nikko

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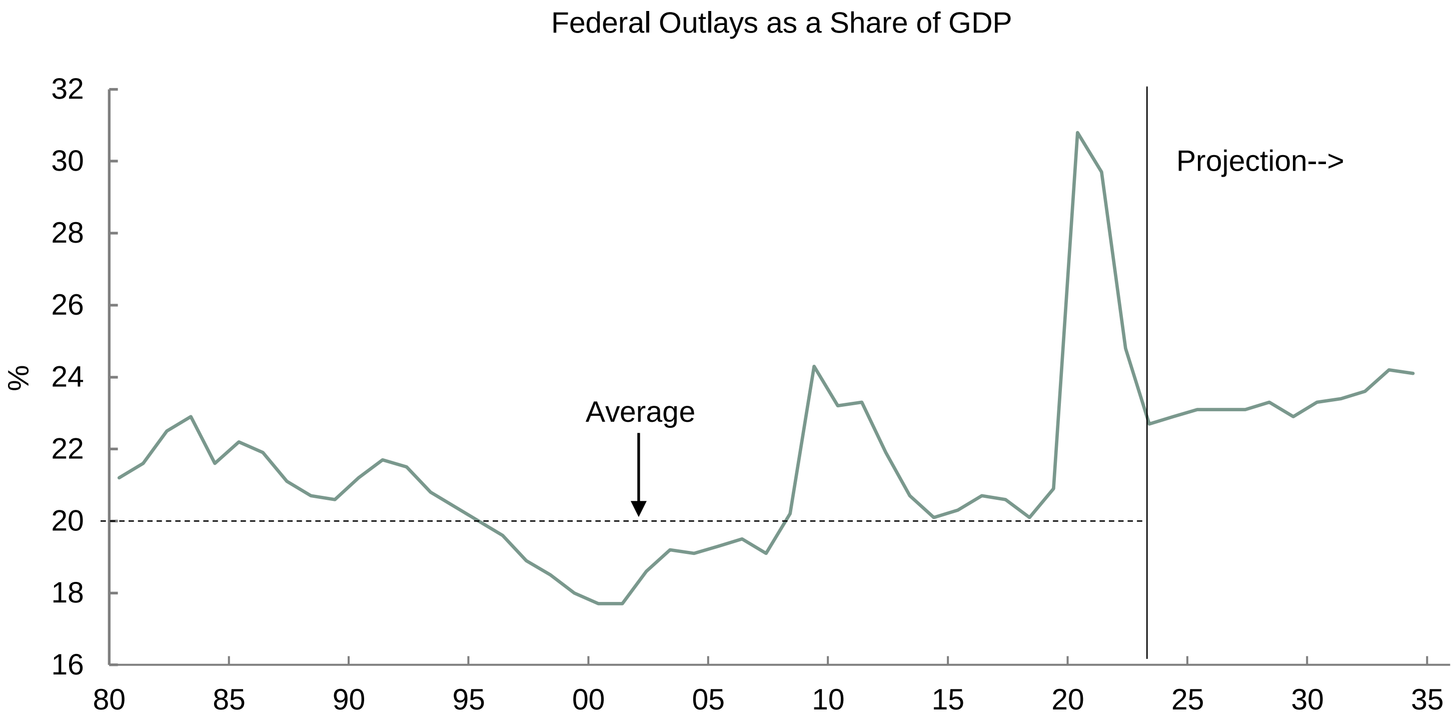
Excessive Spending

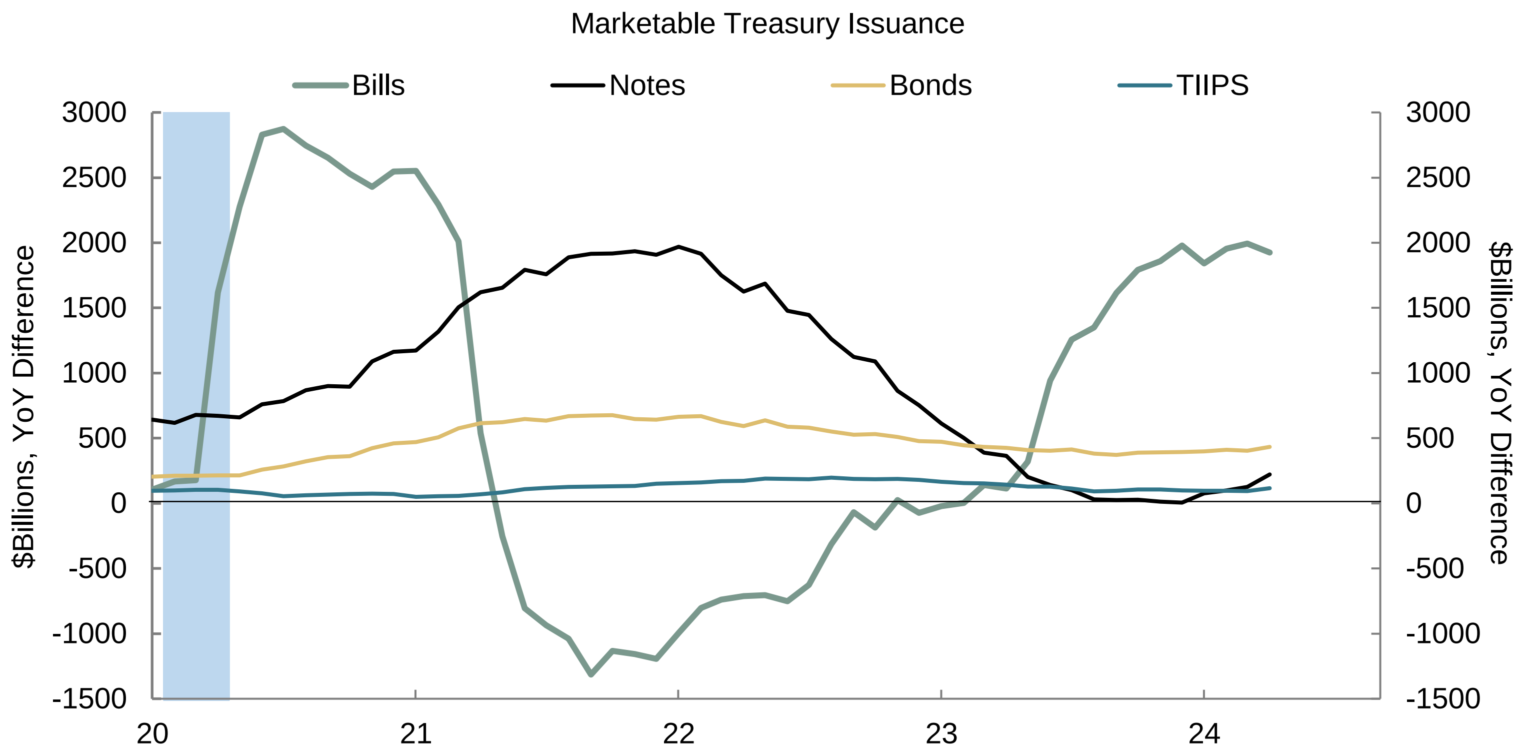
Unprecedented government spending is also keeping the economy afloat.



Source: CBO, Haver, SMBC Nikko

Front-end Financing

Nearly three-quarters of all Treasury issuance has been in bills.



Source: US Treasury, Haver, SMBC Nikko

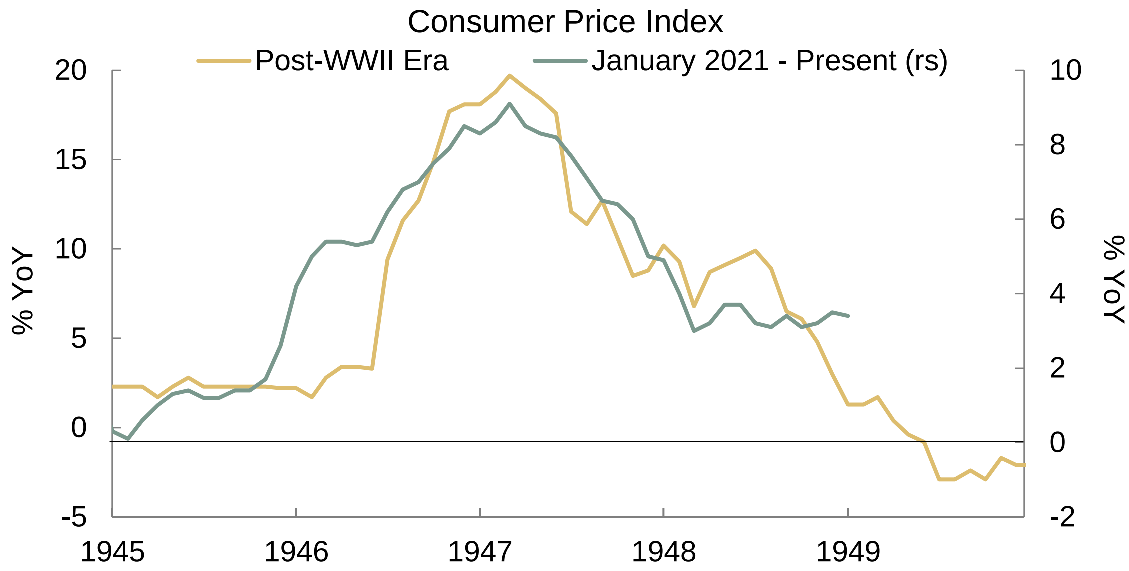
Priming the Pump

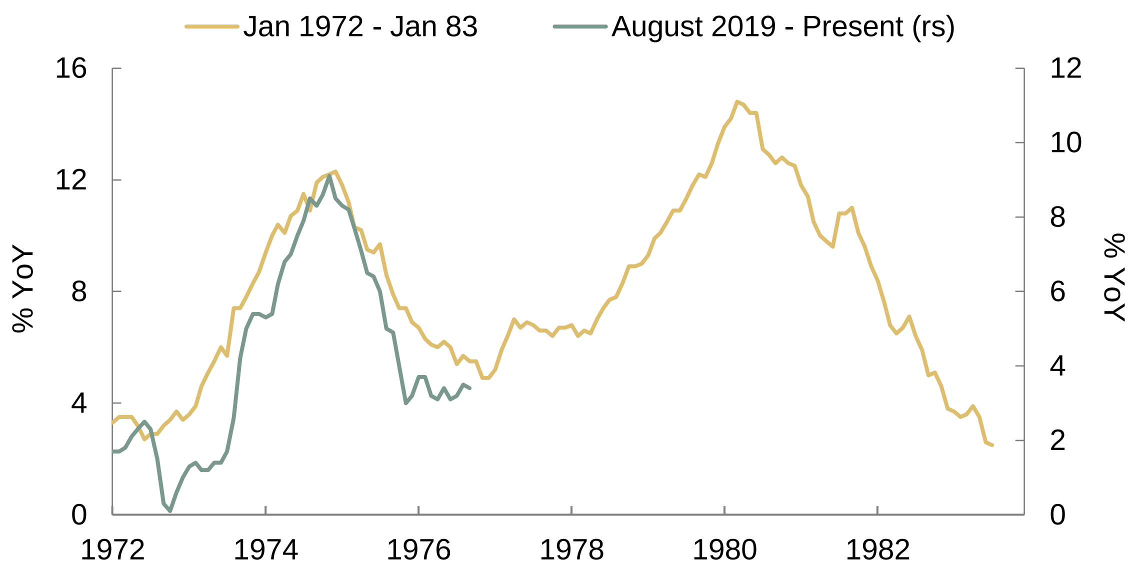
The US fiscal stance is likely to remain highly stimulative according to the CBO.

Percentage of GDP	Average, 1994–2023	Actual, 2023	2024	2034	2044	2054
Revenues	**17.2**	**16.5**	**17.5**	**17.9**	**18.4**	**18.8**
Individual income taxes	8.0	8.1	8.8	9.5	9.9	10.3
Payroll taxes	6.1	6.0	5.9	5.9	5.9	5.8
Corporate income taxes	1.7	1.6	2.0	1.3	1.4	1.4
Other	1.4	0.8	0.8	1.2	1.2	1.3
Outlays	**21.0**	**22.7**	**23.1**	**24.1**	**25.7**	**27.3**
Mandatory	12.1	13.9	13.9	15.1	15.8	16.2
Social Security	4.5	5.0	5.2	5.9	5.8	5.9
Major health care programs	4.3	5.8	5.6	6.7	7.8	8.3
Medicare	2.6	3.1	3.2	4.2	5.1	5.4
Medicaid, CHIP, and premium tax credits and related spending	1.7	2.7	2.4	2.5	2.7	2.8
Other mandatory	3.3	3.1	3.1	2.5	2.3	2.0
Discretionary	7.0	6.4	6.2	5.1	4.9	4.9
Net interest	1.8	2.4	3.1	3.9	5.0	6.3
Total deficit (-)	**-3.8**	**-6.2**	**-5.6**	**-6.1**	**-7.3**	**-8.5**
Primary deficit (-)	-2.0	-3.8	-2.5	-2.2	-2.4	-2.2
Debt held by the public at the end of each period	58	97	99	116	139	166

Source: CBO, SMBC Nikko

What Is The Proper Analog?

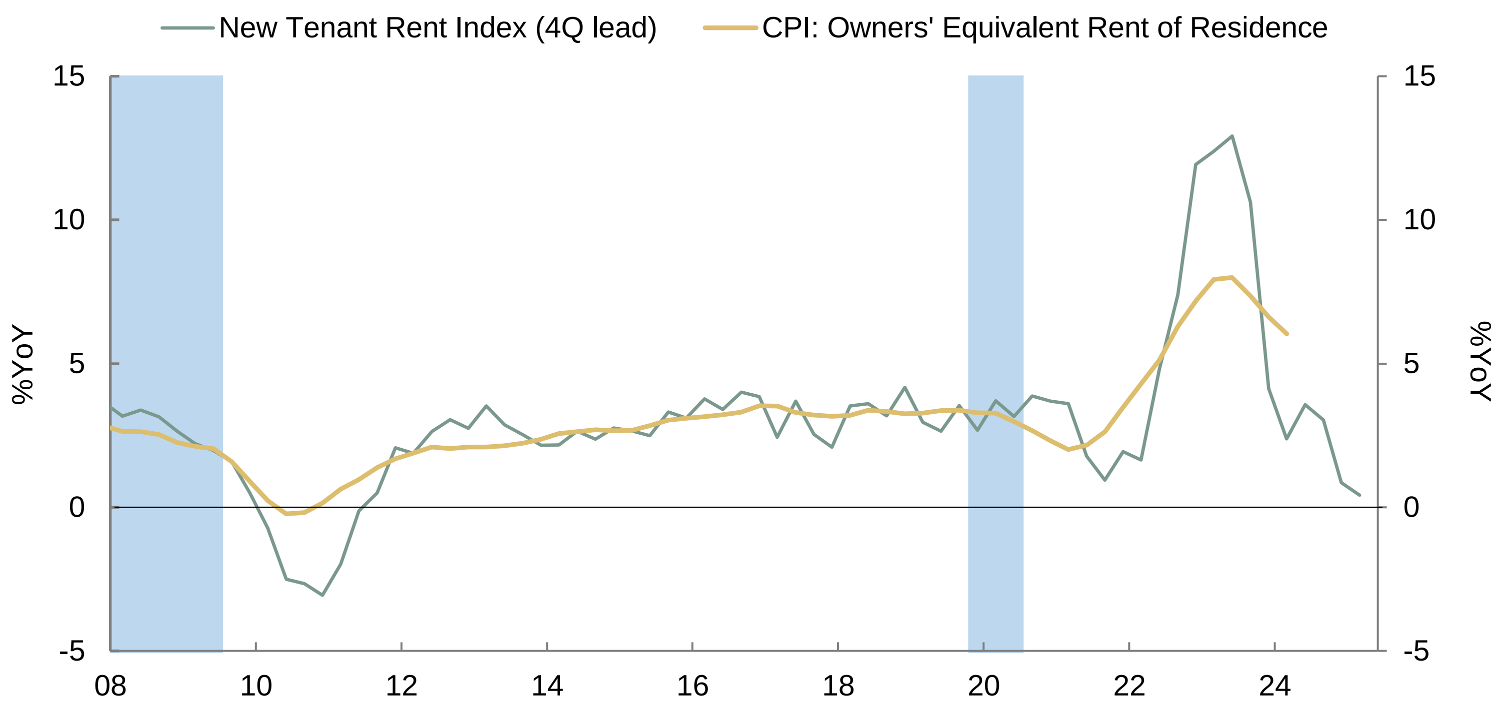




Source: BLS, Haver, SMBC Nikko

Inflation to Deflation?

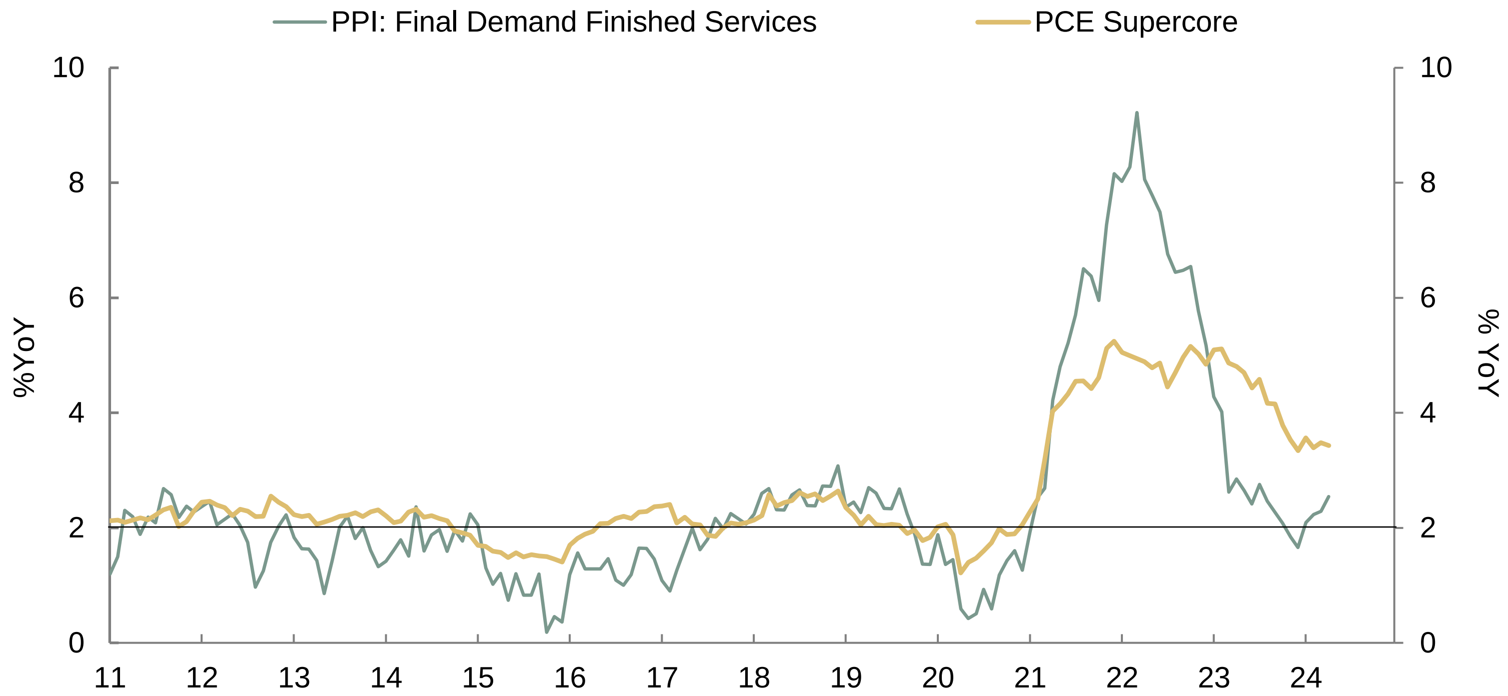
Housing is the largest component of the consumer price index and poised to rapidly slow.



Source: BLS, Haver, SMBC Nikko

Sticky Prices?

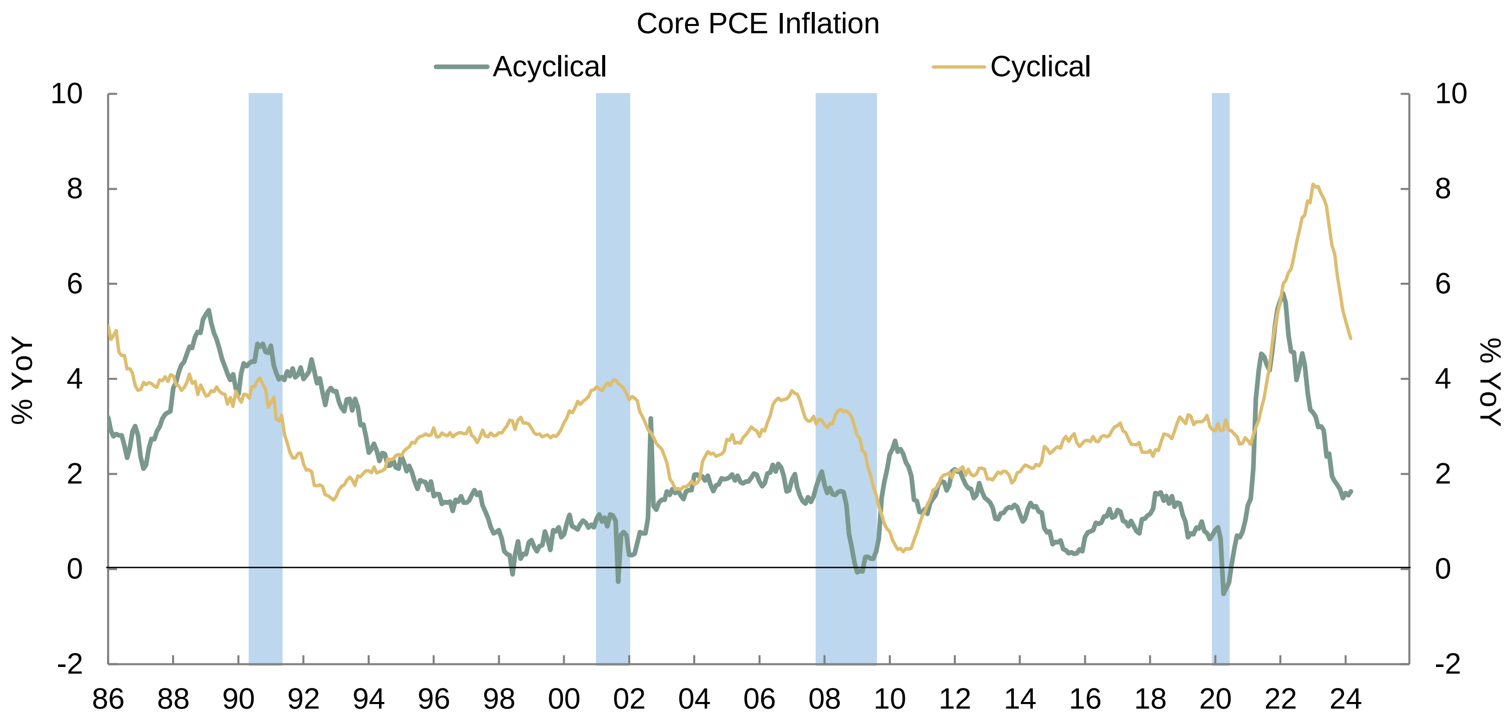
However, core PCE services excluding housing has stopped slowing.



Source: BLS, BEA, Haver, SMBC Nikko

Splitting Inflation Into Two Parts

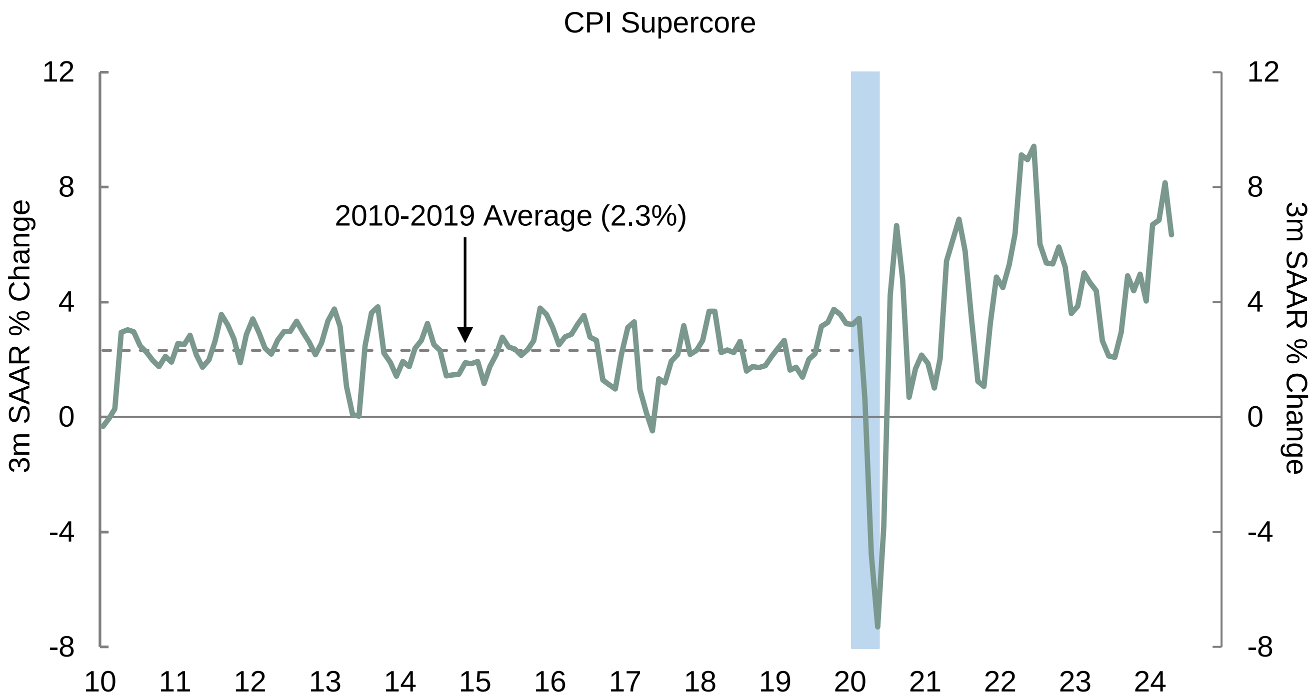
Acyclical prices have leveled off, and cyclical prices need to fall over two percentage points.



Source: SF Fed, BEA, Haver, SMBC Nikko

Elevated Supercore

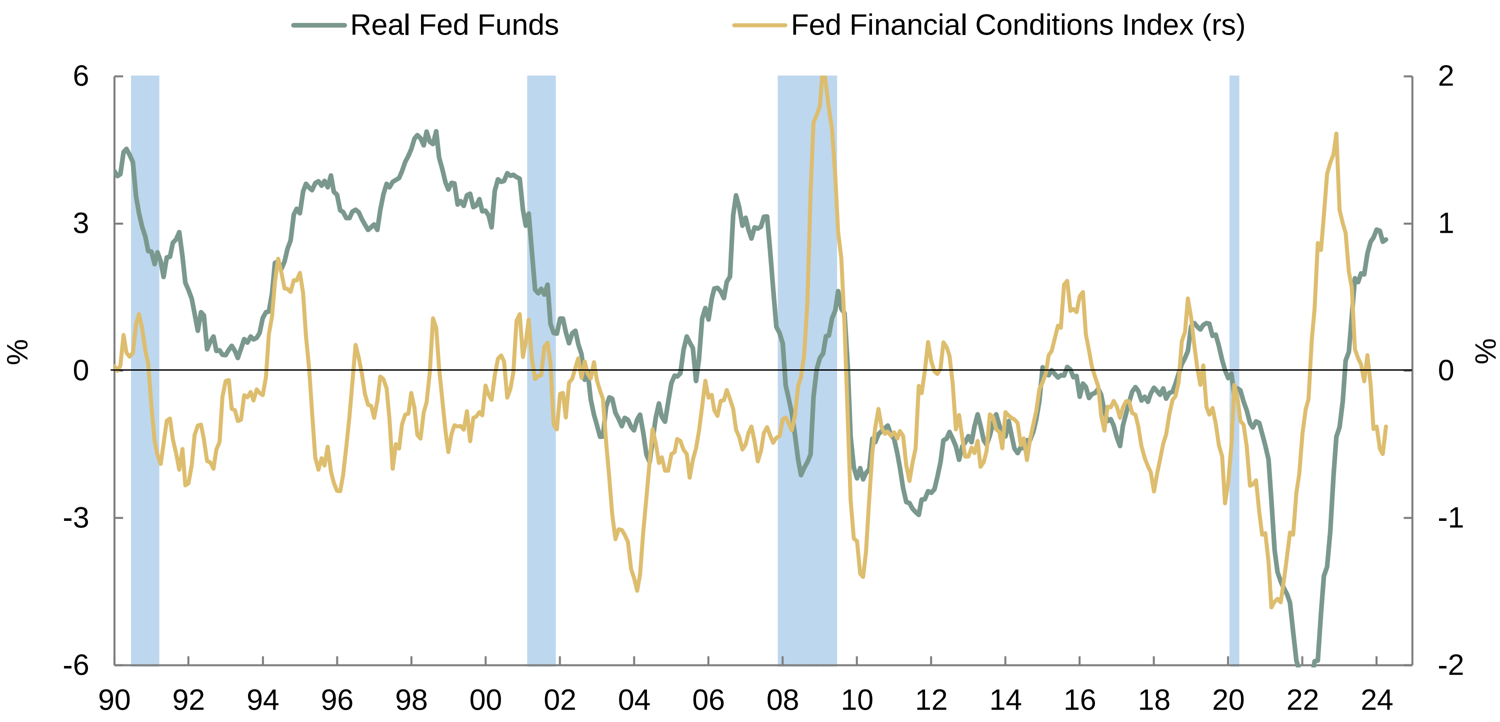
Powell's favorite inflation metric has been stubbornly high.



Source: BLS, Haver, SMBC Nikko

Restrictive Fed Funds But Loose Financial Conditions

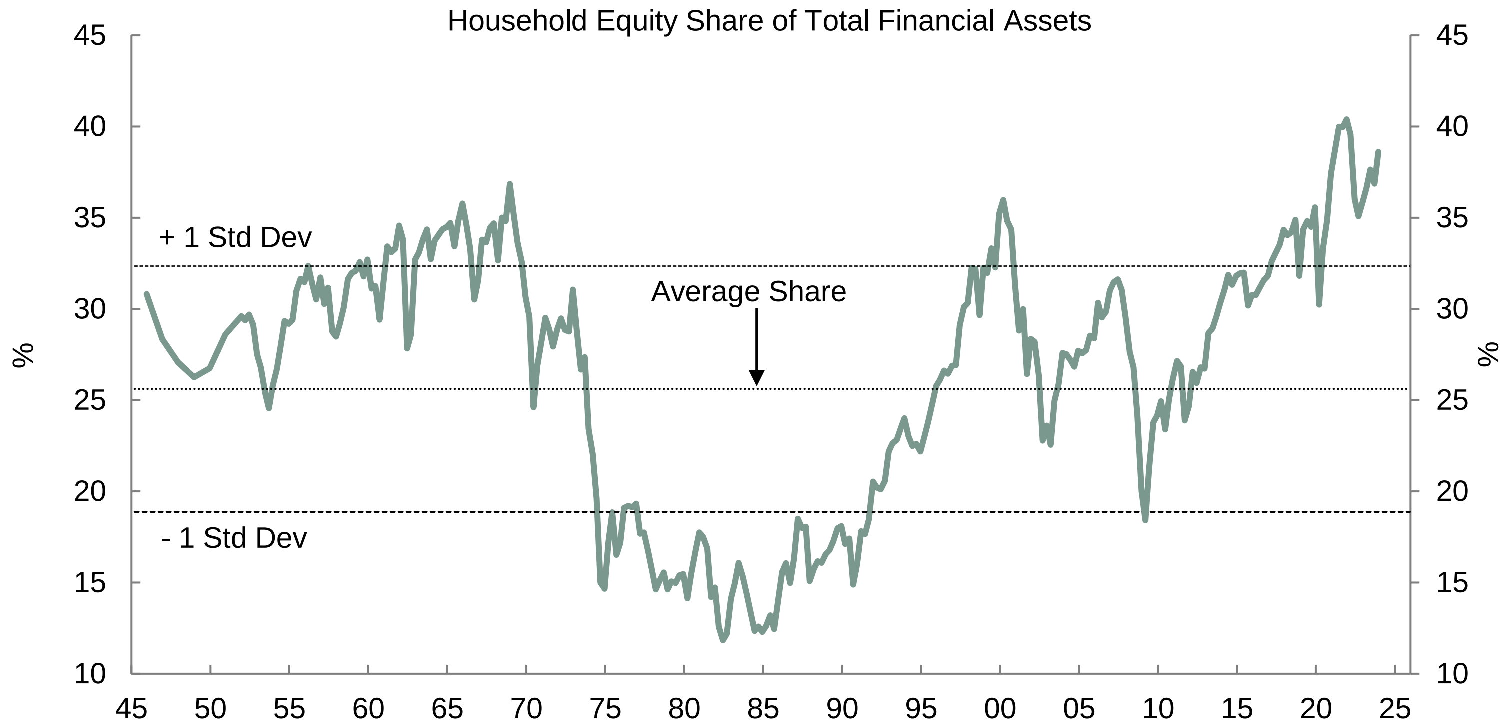
A high funds rate has been offset by easy financial market conditions.



Source: Federal Reserve, BLS, Haver, SMBC Nikko

High Household Equity Exposure

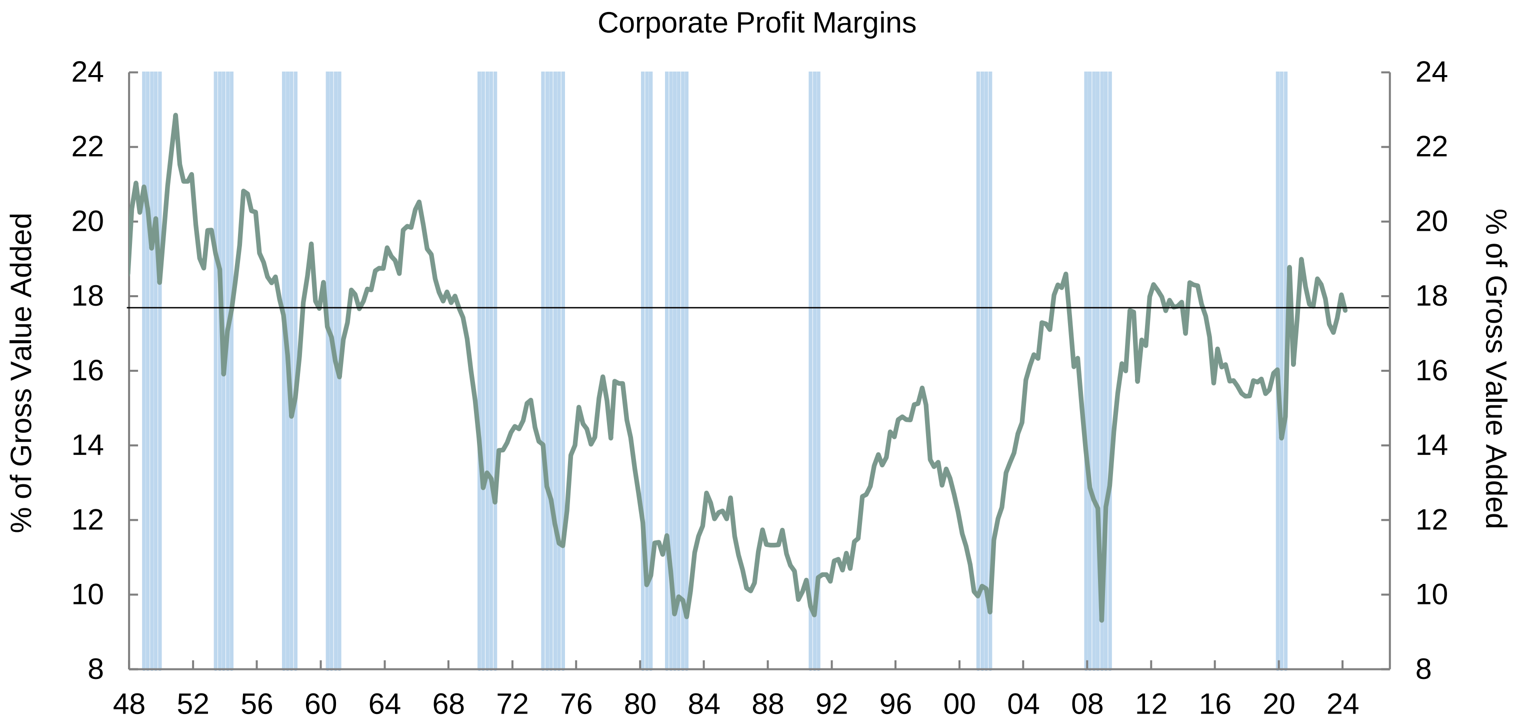
Future returns lag when household exposure is high.



Source: Federal Reserve, Haver, SMBC Nikko

Elevated Profit Margins

Unless potential GDP growth increases, lower inflation means lower margins.



Source: BEA, Haver, SMBC Nikko

How Much Lead Time Does the Stock Market Give Us?

Stocks tend to peak four months ahead of the economy but there is substantial variability.

Peak in…		Lead Time (Months)
S&P 500	Economy	
January 1953	January 1953	0
July 1957 *	August 1957	1
July 1959	April 1960	9
December 1968	December 1969	12
January 1973	November 1973	10
February 1980	January 1980	-1
November 1980	July 1981	8
July 1990	July 1990	0
August 2000	March 2001	7
October 2007	December 2007	2
February 2020	March 2020	1
	Average -->	4

Source: S&P, NBER, Haver, SMBC Nikko

Biography: Joseph A. LaVorgna

Joseph A. LaVorgna

Managing Director

Chief Economist

SMBC Nikko Securities America, Inc.

277 Park Avenue
New York, NY 10017

Office: +1-212-893-1528

joseph.lavorgna@smbcnikko-si.com

Joseph (Joe) LaVorgna is a Managing Director and Chief Economist for SMBC Nikko Securities America, Inc. Joe joined the firm in September 2022 and is based in New York. Joe has spent more than 25 years in the financial services industry.

He was previously the Chief Economist for the Americas at Natixis. While there, Joe took a one-year leave of absence to serve at the White House, where he was Special Assistant to the President, and Chief Economist of the National Economic Council.

Prior to Natixis, Joe spent 20 years with Deutsche Bank Securities in the Global Markets Division, where he was considered one of the leading Wall Street economists. His team was perennially ranked in the prestigious *Institutional Investor* All-Star Fixed Income Survey.

Joe is also a Senior Fellow at the America First Policy Institute, a Washington, D.C.-based think tank. He holds a Bachelor of Arts degree in economics from Vassar College and did graduate work at New York University.

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