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Joseph Lavorgna, Chief US Economist | 212.893.1528 | joseph.lavorgna@smbcnikko-si.com

Thoughts on Growth and Rates

There is a quintet of data we have historically followed which continues to foreshadow a hard landing. Note that this list is not meant to be all inclusive. These are simply a set of indicators that have worked well for predicting past economic downturns. There are other indicators, too.

The Leading Economic Indicators peaked in December 2021 and has fallen in 27 out of the 29 months since then. The current string of weakness is the longest on record without a recession.

The **Treasury yield curve**, defined as the difference in yield between 2- and 10-year notes, inverted in July 2022 and has been negative ever since, a record. Every recession has been preceded by an inverted yield curve.

Employment for temporary help services topped out in March 2022 and has declined in all but one month since then. The current episode's length and depth of decline is larger than what preceded the 2001 and 2008-09 downturns.

Commercial bank lending standards have been tightening since Q2 2022 and hit a cyclical peak of 51% in Q3 2023. Each of the previous three instances when standards crossed the 50% mark, the economy was either on the cusp of recession or in one.

The **unemployment rate** is currently 4.1%, up from a 3.4% cyclical low (January and April 2023). In the past, every time the unemployment rate rose 0.5% from its trough, the economy entered recession and generally within 12 months.

Since these indicators remain weak, it is prudent to warn of downside risks to the economy even though overall economic activity continues to hold up. Unexpected strength in June retail sales led the Atlanta Fed to upgrade its Q2 forecast to 2.5% from 2.0% previously.

Absent these aforementioned indicators, the probability of Fed easing would be de minis because the economy appears to be growing at or above trend, and inflation is still well above target. On the surface, this is not the type of backdrop that would appear to warrant Fed easing.

Still, the futures market is fully discounting a September 18 rate cut. **While we have long advocated for rate cuts because of the deeply inverted yield curve, this is not an argument the Fed has made. Instead, policymakers desire to cut rates seems to be due to some combination of better inflation data and concern that the labor market could suddenly slow**.

However, the Fed missed the 2021 acceleration in inflation and was wrongfooted again this year when inflation re-accelerated in Q1 2024.

Nevertheless, we remain surprised how willing policymakers are to reduce rates, as it appears to contravene what they had been telling us is the reaction function.

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