GLOBAL Insight

RBC Wealth Management

U.S. Recession Scorecard

August 2024

Four of seven

A bit more than two years ago, the Recession Scorecard was flashing nothing but expansionary green lights for the U.S. economy. Starting in summer 2022 that unequivocally unanimous rating began to deteriorate. First, the Treasury yield curve inverted in July 2022, i.e., the 1-year Treasury yield rose above the 10-year yield, signaling that credit conditions were tightening in a serious way. Every recession in more than 100 years has been preceded by such a yield shift.

A couple of months later a second of our seven indicators—the Conference Board's Leading Economic Index—changed to recessionary red by falling below where it had been a year earlier. This has occurred before the onset of every U.S. recession since the late 1950s or for as long as this indicator has been around. In the months that followed, three more of the series tracked by the Scorecard shifted out of the expansionary green zone over to the cautionary yellow rating.

A third indicator in the Scorecard was re-rated to the recessionary red column in June. As of Q1, the growth rate of U.S. nominal GDP had fallen below the fed funds rate. Such a crossing point has occurred either before or just after the start of every recession back to the 1950s. Preliminary Q2 GDP data released in late July confirmed that re-rating.

U.S. Recession Scorecard

Indicator	Status		
	Expansionary	Neutral/ Cautionary	Recessionary
Yield curve (10-year to 1-year Treasuries)			✓
Unemployment claims		✓	
Unemployment rate			✓
Conference Board Leading Economic Index			✓
Non-financial corporate cash flows	✓		
ISM New Orders minus Inventories		✓	
Fed funds rate vs. nominal GDP growth			✓

Source - RBC Wealth Management

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All values in U.S. dollars and priced as of market close, July 31, 2024 unless otherwise stated.

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U.S. RECESSION SCORECARD

Now a fourth indicator in our series, the unemployment rate, has been relit as red which brings the majority into that recessionary column.

Yield curve (10-year to 1-year Treasuries)

The 1-year Treasury yield rose above the 10-year yield decisively in July 2022, with the negative gap growing further over most of the following year. While the average time interval between "inversion" of the yield curve and the onset of recession is 13 months, the gap was longer than average in four instances, with the longest being 23 months. As of July, this became the longest inversion in more than 100 years.

Yield curve inversion is an unequivocal indication that credit conditions are tight. The Fed's Senior Loan Officer Survey (most recent issue released on August 5) revealed that most U.S. banks continue to raise lending standards on almost every category of business and consumer loan, including commercial and industrial loans for businesses of all sizes, credit card loans, consumer installment loans, mortgage loans, and commercial real estate loans. The plurality of banks tightening has narrowed in the past three surveys, but the data remains well short of signaling a return to easing of standards.

The negative spread between the 1-year yield and the 10-year yield reached its widest point this cycle so far in June 2023 at 158 basis points (bps). It has since narrowed dramatically to just 31 bps in early August. The crossover from "inverted" back to "normal" has tended to occur just as the recession is starting or a few months before.

Conference Board Leading Economic Index

Historically, this indicator has given reliable early warnings of recession. When the index has fallen below where it was a year earlier, a recession has always followed—usually two to three quarters later.

This indicator turned decisively negative in Q3 2022, shifting it to the recessionary red column. As of the June 2024 report, the index had fallen for 29 of the preceding 30 months moving deeply into negative territory, although the rate of year-over-year decline has slowed over the past seven months. The indicator has never fallen this deeply without a recession arriving.

ISM New Orders minus Inventories

The difference between the New Orders and Inventories sub-indexes of the ISM Purchasing Managers' Index has turned negative near the start of most U.S. recessions. But it has also registered occasional false positives—signaling a recession was imminent when none subsequently arrived. Moreover, this indicator only relates to activity in the manufacturing sector (some 15% of the U.S. economy) and is derived from a survey rather than hard data. For those reasons, we look at it as a corroborative indicator rather than a decisive one taken on its own.

After setting its most recent low in September 2022, this series rose steadily (we use a three-month moving average) and moved back above zero last summer. After three consecutive months in positive territory, we shifted the rating from recessionary red to neutral/cautionary yellow despite the fact the new orders component by itself remained decisively negative. That new orders reading finally managed to reach expansionary territory in January 2024; however, weak readings in May, June, and July have left this indicator teetering barely above zero.

Unemployment claims

The monthly low for this cycle occurred in September 2022. The cycle low for claims has typically been registered about 12 months before the start of the next recession.

U.S. RECESSION SCORECARD

So far, no lower reading has been posted in the intervening months, leaving the indicator's status at yellow. A decisive push in the monthly data above 300,000 claimants would be needed shift this indicator to red. The latest monthly total rose to 238,000.

The fact that temporary employment, job openings, and average hours worked have all been falling on a year-over-year basis adds to the likelihood the tide may have turned for unemployment claims.

Unemployment rate

The unemployment rate rose to 4.3% in July after setting a cycle low of 3.4% in April 2023. While it edged gradually higher over the intervening 14 months, it looks, with the jump in July, to have moved into a decisive uptrend. We have re-rated this indicator to red.

Non-financial corporate cash flows

This gives an indication of the ability of such businesses, in aggregate, to internally fund any capital spending they want or need to do. Historically, whenever it has posted a year-over-year negative reading, a decline in corporate capital spending has typically followed, either indicating a recession is coming or a deepening one is already underway. These cash flows, while well down from their pandemic peak, are still above a negative crossing point as of Q1, which leaves it as the sole indicator still giving the U.S. economy a green light. There is a long lag time before this data is reported with the Q2 release not coming until September.

Fed funds rate vs. nominal GDP growth

The fed funds rate has risen above the six-month annualized run rate of nominal GDP either before or at the start of every recession in the past 70 years. (Nominal GDP is GDP not adjusted for inflation.) That GDP run rate has been declining since its pandemic reopening high of 23% recorded in Q4 2020. By the end of last year, it had slowed to 6.7%, still above the 5.50% fed funds rate. However, the Q1 GDP data release put that six-month run rate of nominal GDP growth at just 4.9%, below the 5.50% fed funds rate, satisfying this historical precondition of a recession. We shifted this indicator into the recessionary red column in June. Preliminary Q2 GDP data confirmed this re-rating.

Tick, tick, tick...

Weighing up the current positioning of the seven indicators and projecting their likely paths points to a growing probability the U.S. will enter a recession in the second half of this year, in our view.

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