Capital Markets Strategy
Essential inCights for the C-Suite

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Chart of the Day

The timing and strength of potential US recession will be a key driver of how markets perform in 2023. In a recent January 23rd Bloomberg survey of economists, the average probability assessment of US recession in 2023 rose to 67%. Further, 50 of the 56 economists surveyed assigned at least a 50% probability of US recession in 2023.

In recent months, however, markets have begun to price in a "softer landing" scenario, the possibility the US avoids a recession altogether. Several prominent economists have also taken this position.

In our view, if the US economy does in fact side-step a recession in 2023, dozens of historically reliable US recession signals would have been incorrect in the current cycle (i.e., "this time is different"). We continue to believe that a "short and shallow" 2023 recession is more likely, as evidenced by the steady progression of US recession signals over recent months.

First, UST yield curves, which began their inversion in April, and more earnestly in July, remain deeply inverted today. Historically, UST yield curve inversion has been the most accurate signal of US recessions going back to WWII, typically with a 9-15 month lag (depending on the part of the curve).

Secondly, we learned this week that the Conference Board's index of Leading Economic Indicators (or LEI) declined in December for the 10th consecutive month. Bloomberg columnist John Authers cleverly notes that the LEI index is not a terribly "leading" indicator, but rather a "lagging" aggregation of data previously released. Nonetheless, the LEI index has historically been a highly reliable US recession signal in that it closely mirrors the actual performance of the economy. In fact, December's LEI reading was weaker than 92% of LEI data points since 1960 (having been worse on only 6 occasions since 1960, each a recessionary period).

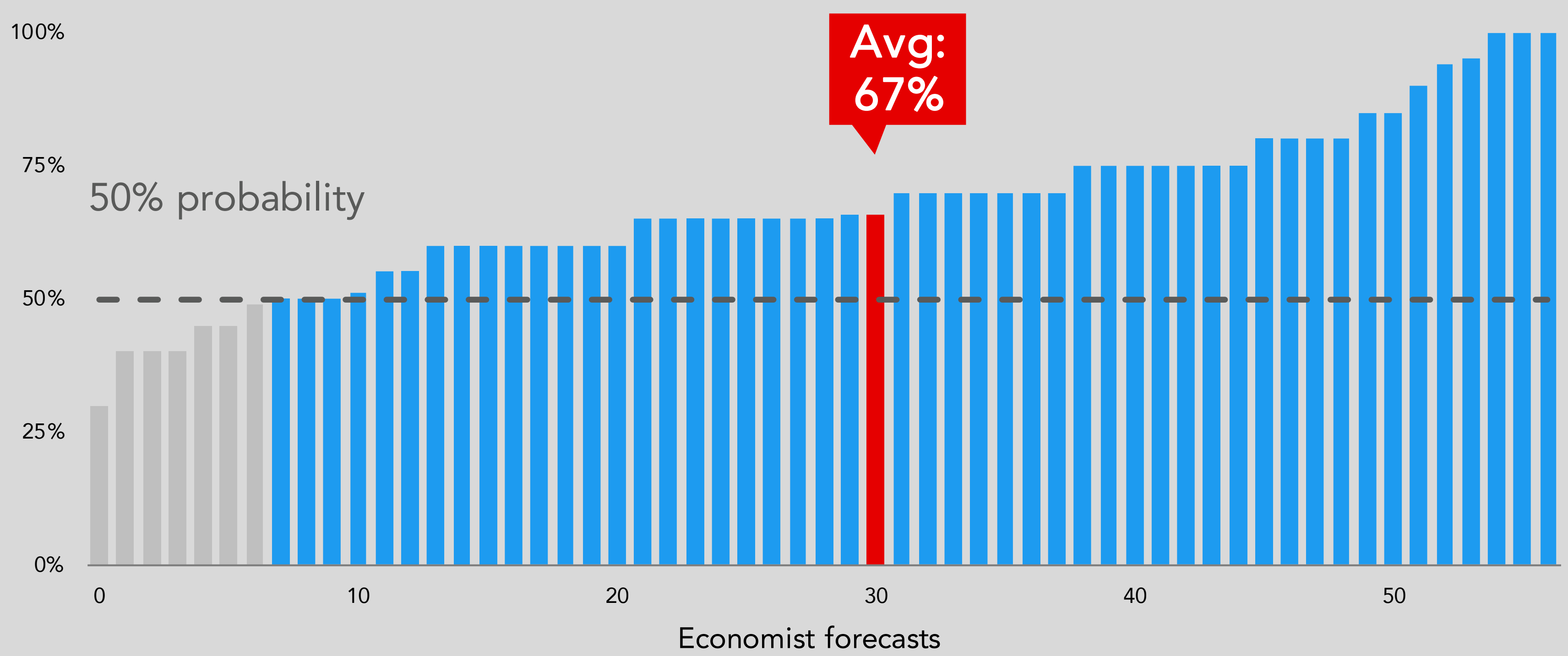
Third, numerous "survey-based" economic activity indicators began to drop sharply in early Q4. Notably, US ISM manufacturing PMI, which has historically provided an accurate view of the economy six months forward, dipped into contraction territory in both November and December. US consumer sentiment readings have been well below historic US recession thresholds for months now, and at current levels, have historically signaled large declines in real consumption.

Lastly, even as labor markets remain tight, the "hard economic data" has more recently begun to soften as well. Below consensus readings on US retail sales, industrial production and manufacturing new orders lead the list of weakening data points in this regard.

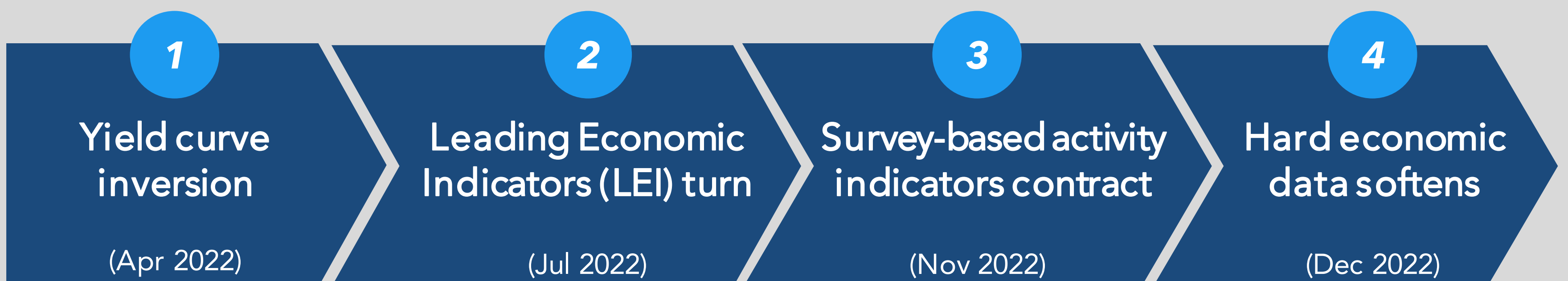
So is this time different? Will the US economy sidestep recession in 2023, rendering numerous reliable recession signals to the "false positives" bucket of US economic history? Such an outcome is certainly possible, though in our view, doubtful. Shallow recession, shallow recovery, remains more likely.

50 of 57 economists surveyed by Bloomberg assign > 50% probability of US recession in 2023

Probability of US recession in 2023



The Evolution of US Recession Signals



Source: (1) Bloomberg. Data as of January 23, 2023. Recession probability forecasts from Bloomberg contributors.

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"Macro stability isn't everything, but without it, you have nothing."