Capital Markets Strategy
Essential inCights for the C-Suite

Chart of the Day

Did the recession start on Friday, March 10? If it did not, it probably will soon, though we will not "officially" know for months.

The implications of Friday's SVB insolvency, the 16th largest bank in the US and the 2nd largest US bank failure in US history, should not be under-estimated. **Notably, pressure on the financial sector has begun exactly one year after the Fed began raising rates** (which was one year ago tomorrow). The intolerance for higher rates across the financial system has quickly become evident.

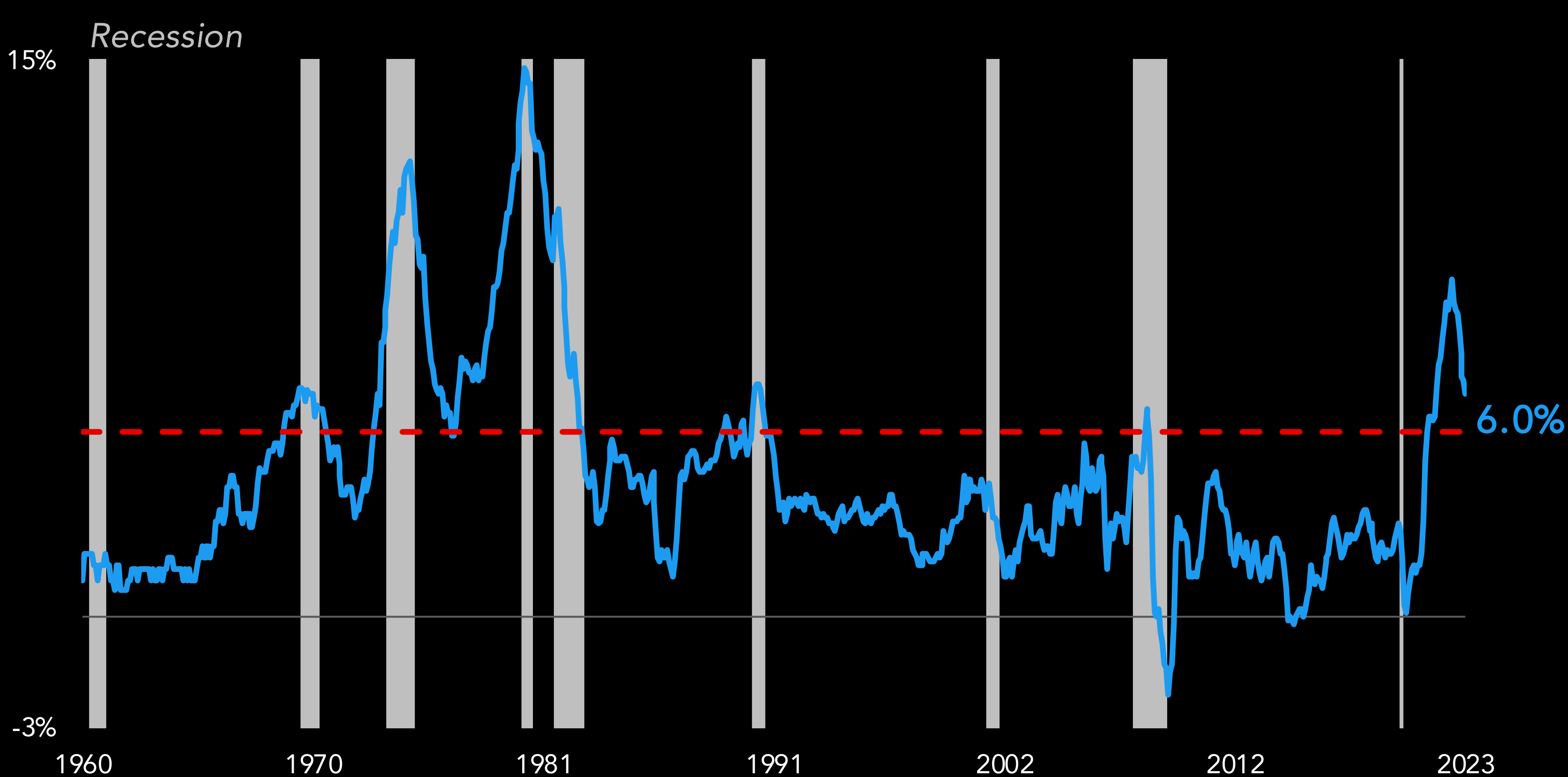
As such, financial conditions have tightened markedly across the entire credit spectrum from capital markets to banks. **The squeeze on the "real economy" is likely to be rapid and strong. Elevated interest rates have now become the transmission mechanism for deteriorating credit conditions.** The risk of a rolling series of "unexpected" credit events remains high. Not 2008, but unanticipated casualties of Fed tightening nonetheless.

Back in July 2022, in a publication called "*Mixed Signals: An Assessment of US Recession Risk in the Year Ahead*," **we assigned an "above consensus" 60% probability of US recession within 12 months (Bloomberg consensus at the time was 47.5%)**. That probability has since risen markedly. In subsequent months, with inflation high and the Fed rapidly tightening, we proceeded to characterize the forthcoming contraction as one of the most "highly telegraphed" US recessions on record.

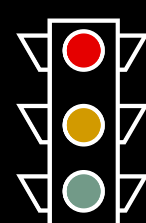
Our conclusion was anchored in the fact that **every time US inflation rises above 5%, an accelerated Fed tightening cycle, "unintended consequences" and US recession have followed.** In addition, the most accurate predictor of post WW2 US recessions (yield curve inversion), typically with a 9-15 month lag, had just occurred three months earlier in April 2022. To avoid recession, most of the traditional signals we are seeing would need to be wrong.

Going back to 1950, every time headline US inflation has risen above 5%, an accelerated tightening cycle and US recession have followed.

US CPI inflation, y/y



We have updated the "traffic light" matrix of US recession signals from our "Mixed Signals" publication in July. Importantly, some indicators like "yield curve inversion" have been reliable "leading" indicators, while others such as labor market data have historically been "lagging" indicators.



Red:

- Consumer price inflation
- Producer price inflation
- Inflation expectations
- Consumer confidence
- Leading economic indicators
- Manufacturing outlook
- PMI manufacturing
- ISM subcomponents (orders to inventory ratio)
- Rate volatility
- Inverted yield curves
- Financial conditions
- Cash / bonds outperforming equities
- Auto sales
- Mortgage rates
- New & existing home sales
- Equity market correction
- Financial & bank stocks
- Bank & financial sector spreads
- C&I bank loans
- Interbank lending markets
- Industrial metal prices
- CCC sector leverage
- Small business optimism
- CEO & business confidence

Yellow:

- Economic surprise index
- Retail sales
- Credit card balances
- Building permits
- Business spending & capex
- Corporate earnings & margins
- Liquid assets / ST liabilities
- Durable goods
- Fed bond distress indices
- IG & HY spreads
- IG & HY fund flows
- Corporate leverage
- Equity volatility
- Cyclical stocks (US defensives)
- Oil and energy prices

Green:

- Unemployment rate
- Job openings
- Jobless claims
- Wages
- PMI services
- ISM business employment
- Housing prices
- Consumer savings
- Consumer leverage
- Corporate balance sheets
- Corporate default rates
- Interest coverage ratios

Source: (1) Bloomberg. Data as of March 15, 2023. Oxford Economics. Capital Economics. ISM. Fed. OECD. CreditSights. BLS.

Global Corporate & Investment Banking
Capital Markets Strategy Team

Tom Joyce
Managing Director
Tom.Joyce@mufgsecurities.com
(212) 405-7472

Hailey Orr
Director
Hailey.Orr@mufgsecurities.com
(212) 405-7429

Stephanie Kendal
Associate
Stephanie.Kendal@mufgsecurities.com
(212) 405-7443

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