GLOBAL
Insight

Wealth Management

U.S. Recession Scorecard

September 8, 2022

Coming into focus

Three of our seven leading indicators of U.S. recession have unequivocally reached levels that would signal an economic downturn is on the way. The Conference Board Leading Economic Index is the latest indicator to join the recessionary club. Three more are still firmly in expansionary territory but are moving (slowly) in the wrong direction, and the last, the unemployment rate, is very marginally above its all-time low.

The indicators that have flipped to recessionary status so far, together with the most recent low in unemployment claims (March 2022), point toward a recession getting underway by Q2 2023.

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

The position of short-term interest rates relative to long-term rates—aka the shape of the yield curve—has been the most reliable leading indicator of a U.S. recession. Before the start of every recession for the past 75 years, the 1-year Treasury yield has risen above the 10-year yield, indicative of the arrival of tighter credit conditions. About a year after this crossing occurs, a recession begins.

The 1-year yield rose above the 10-year yield decisively in July. History suggests the U.S. economy will be in recession by next summer.

U.S. Recession Scorecard

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

Source - RBC Wealth Management

U.S. RECESSION SCORECARD

A majority of U.S. banks have begun raising lending standards, corroborating the yield curve's signal that credit conditions are becoming more restrictive. However, loan payment delinquencies and default rates remain very low; therefore, credit is likely to remain accessible, albeit more expensive, for some time.

ISM New Orders minus Inventories

The difference between the New Orders component and the Inventories component 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. Therefore, we view this as a corroborative indicator—one to pay attention to if other longer-term indicators are implying a recession is on the way. It has been negative since May.

Conference Board Leading Economic Index

Historically, this series 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 was still positive at the end of Q2. But the July data put the year-over-year comparison into recessionary territory while the comparative data for August and September 2021, and indeed for Q4 2021, suggest there is little to no chance of this crossover being reversed anytime soon. We are revising the status of this indicator to red. It now indicates a U.S. recession will likely be underway by Q2 of next year.

Unemployment claims

This series set its low, so far, for this cycle back in March. The cycle low for claims has typically been registered about 12 months before the start of the next recession. So, if no lower reading is posted in the coming months, its history would suggest a recession could get underway by the spring of next year.

Unemployment rate

The unemployment rate ticked higher in August to 3.7% from a multi-decade low of 3.5% in July. It would need to climb to almost 4.5% by December to signal a recession is definitely on the way. Once that signal is given, on average it has been 10–11 months before the recession gets underway although there have been several instances where the time gap was only five to seven months.

As for the rest ...

Neither the **free cash flow of non-financial corporate business** nor the **fed funds rate vs. nominal GDP growth** appear remotely close to crossing the threshold into a recessionary reading.

Weighing up the current positioning of all seven indicators and projecting their likely paths over the next couple of quarters continues to point to a growing probability the U.S. will enter recession sometime in H1 2023.

Research resources

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