US Macroeconomics

August 2, 2023

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

The 2008 Analog

The current environment is reminiscent of the one leading up to the 2008-09 downturn. It, too, was heavily advertised in late 2006 and 2007, as economists debated the extent to which the subprime meltdown would spill over into the broader economy. The soft landing versus recession narrative was commonplace.

At the time, real GDP was expanding, and the unemployment rate was low. Meanwhile, the Index of Leading Economic Indicators (LEI) was sharply declining, and the Treasury 2s/10s yield curve was inverted. Sound familiar?

The LEI peaked in March 2006, but the economy did not peak until a long 21 months later in December 2007. And when the economy entered recession in January 2008, many investors were still debating whether one had been avoided. Amazingly, the economy grew in the first half of 2008 — at least that is what the initial figures showed with Q1 and Q2 real GDP positive at 0.6% and 1.9%, respectively.

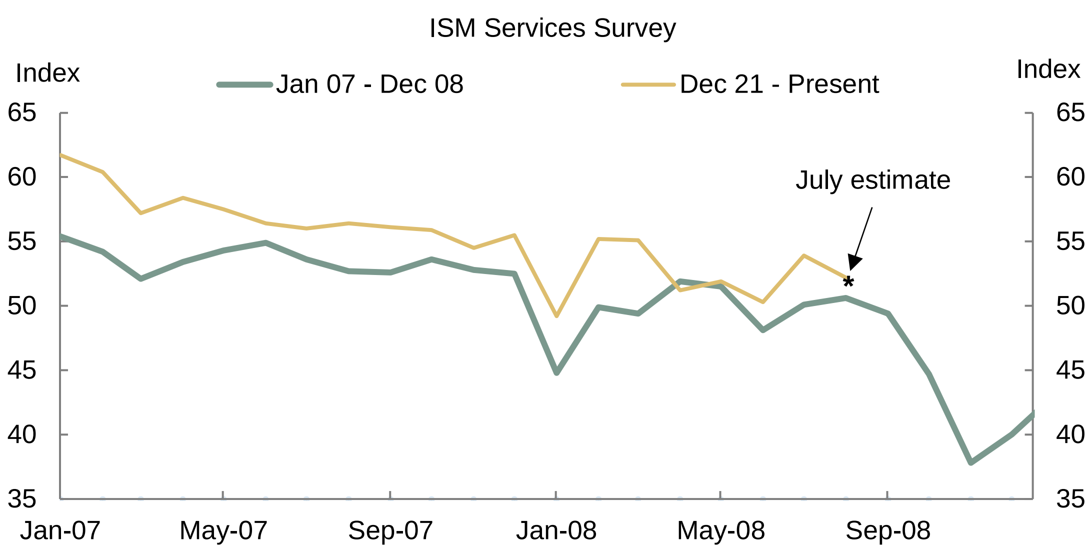
The yield curve first inverted in February 2006 but then went noticeably positive in May 2006 before inverting again in the following month. Like the LEI, the time from the initial inversion to the onset of recession was a long way away. Some market practitioners abandoned their recession call.

In the current cycle, the LEI peaked in December 2021 while 2s10s inverted in July 2022. The lags are such that it is too soon to say whether these leading recession indicators are broken. Given their long-term track record, it is too soon to abandon their foreboding signals.

Another way to see the parallels between today and the period leading up to the 2008-2009 downturn is to look at the behavior of ISM services. The series has the benefit of not being revised in any appreciable way. This makes comparisons to the past much easier.

In the chart below, we graph ISM services for the 12 months before, and then the 12 months after, the peak in economic activity. We compare that to the period from December 2021 (when the LEI peaked) to the present. We then add our estimate for July 2023, which is released tomorrow.

The trends in the two periods are very similar. **Services activity is weakening but at a relatively modest pace just like 2008**. Recent readings above 50 have given investors confidence that the Fed has achieved a soft landing. This happened before as well. History may not repeat but it is rhyming at present.



Sources: ISM, Haver, SMBC Nikko

Disclaimers

This document is provided by SMBC Nikko Securities America, Inc. ("SMBC Nikko"), the US-registered broker-dealer affiliate of Sumitomo Mitsui Banking Corporation, for informational purposes only. This document was prepared by SMBC Nikko's economist(s). The views statements, assumptions and forecasts expressed herein are those of the author(s) and do not reflect the judgment of any other person or of SMBC Nikko, it does not constitute an offer, or solicitation of the sale or purchase, of securities or other investments. The information contained herein is obtained or derived from sources believed to be reliable, but SMBC Nikko and the author(s) make no representations as to its accuracy or completeness. In some cases, such information may be incomplete or summarized. This document has been prepared based on assumptions and parameters determined by the economist(s) in good faith. The assumptions and parameters used are not the only ones that could have been selected, and therefore no guarantee is given as to the accuracy, completeness, or reasonableness of any such quotations, disclosures, or analyses. Past performance is not a reliable indicator of any future results.

This document has been prepared for and is directed at institutional investors and other market professionals and is not intended for use by retail customers. It does not take into account any specific investment objective, financial situation, or particular need of any recipient. The information contained herein should, for whatever purpose, be used solely at the discretion and responsibility of the recipient. SMBC Nikko and its affiliates do not accept any liability or responsibility for any results in connection with the use of such information. Recipients are responsible for making final investment decisions and should do so at their own discretion after conducting a careful examination of all documentation delivered prior to execution, explanatory documents pertaining to listed securities, prospectuses, and other relevant documents, and their own independent analysis and assessment of the merits of any transaction. The financial instruments discussed may be speculative and may involve risks to principal and interest.

Conflicts of Interest Disclosures

The views statements, assumptions and forecasts expressed herein may differ from those expressed in globally branded research produced by SMBC Nikko or its affiliates. The trading desks of SMBC Nikko and its affiliates trade or may trade as principal in the financial instruments that are the subject of this material, and the author(s) of this document may have consulted with the trading desks while preparing this document. The proprietary interests of SMBC Nikko and its affiliates may conflict with those of the recipient. SMBC Nikko and its affiliates may seek to do business with the companies mentioned in this material and the trading desks may have accumulated, be in the process of accumulating, or accumulate long or short positions in the financial instruments mentioned and may have acquired them at prices no longer available. The trading desks may also have or take positions inconsistent with the views expressed in this document or may have already traded on those views.

This material is not a research report, and neither this material nor its author(s) is subject to SMBC Nikko policies and procedures that apply to the globally branded research reports and research analysts of SMBC Nikko and its affiliates or to legal requirements designed to promote the independence of investment research. It is not subject to any prohibition on dealing ahead of the dissemination of investment research. This means that on the date of this document, SMBC Nikko, its affiliates, and their respective directors, representatives, or employees, may have a long or short position in any of the instruments mentioned in this document and may make a market or trade in instruments economically related to the securities, derivatives or other underlying assets mentioned herein, in each case either as principal or as agent.

No part of the author(s) compensation was, is, or will be, directly or indirectly related to the specific recommendations or views expressed herein. The personal views of authors may differ from one another.

Distribution, possession or delivery of this document in, to or from certain jurisdictions may be restricted or prohibited by law. Recipients of this document are required to inform themselves of and comply with all such restrictions or prohibitions.