US Macroeconomics

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Leading Indicators Extends its Streak to 13 Months

The Index of Leading Economic Indicators (LEI) fell 0.6% last month, its 13th consecutive drop. This is the longest streak of declines since the period spanning April 2007 to March 2009. The downturn that ensued in 2008 was the deepest since the 1930s.

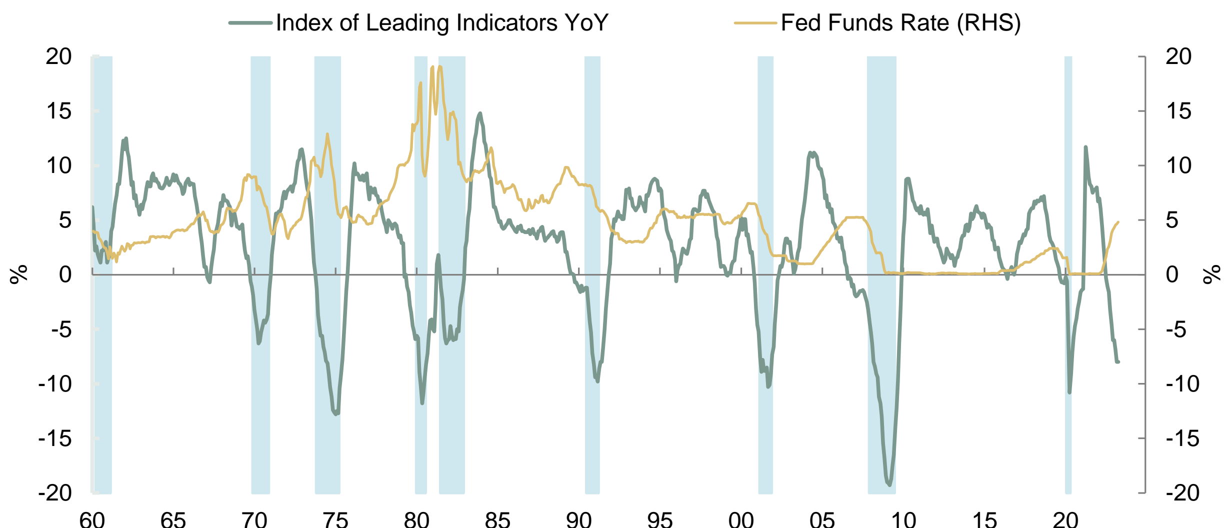
The decrease in the April places the series 8% below where it was one year ago, which is the steepest decline since the 12 months ending September 2009 (-9.8%). Given the duration and magnitude of the decline in the LEI, there is an extraordinarily high probability of a recession. In fact, a downturn has never been avoided when the LEI has declined so much. This time is unlikely to be different.

When will the recession begin? Using the 2007 to 2009 analog, when the LEI peaked in 2006 and the economy peaked in December 2007, we estimate a downturn begins this September. The Fed should be considering rate cuts but is not.

While an aggressive pivot toward rate cuts may not avoid recession, it will certainly moderate the extent of it because it would neuter the most recent tightening in policy that has yet to fully work through the financial markets and the broader economy. Unfortunately, recent Fed commentary suggests the opposite.

Some policymakers have highlighted the possibility of more rate hikes if inflation stays elevated while others have said they do not see the case for a rate pause. This pushed yields on 10-year treasury notes up 25 basis points to 3.65% in just the last week. However, most of the increase has been due to higher real yields and not inflation expectations as the breakeven rate is up only 5 bps to 2.23%.

With the LEI in freefall, the last thing the economy needs is higher real yields, which will dampen activity and drain liquidity from risk markets. Despite Fed rhetoric, once the unemployment rate begins its ascent, policymakers will have an excuse to cut. This is what always happens, and the fact that inflation will still be above target, will not change the Fed's reaction function. Stay tuned.



Sources: Conference Board, Federal Reserve, NBER, Haver, SMBC Nikko

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