

Downside Risks Abound As Soft Landings and Recessions Initially Look Alike

Joe Lavorgna

Chief US Economist
SMBC Nikko

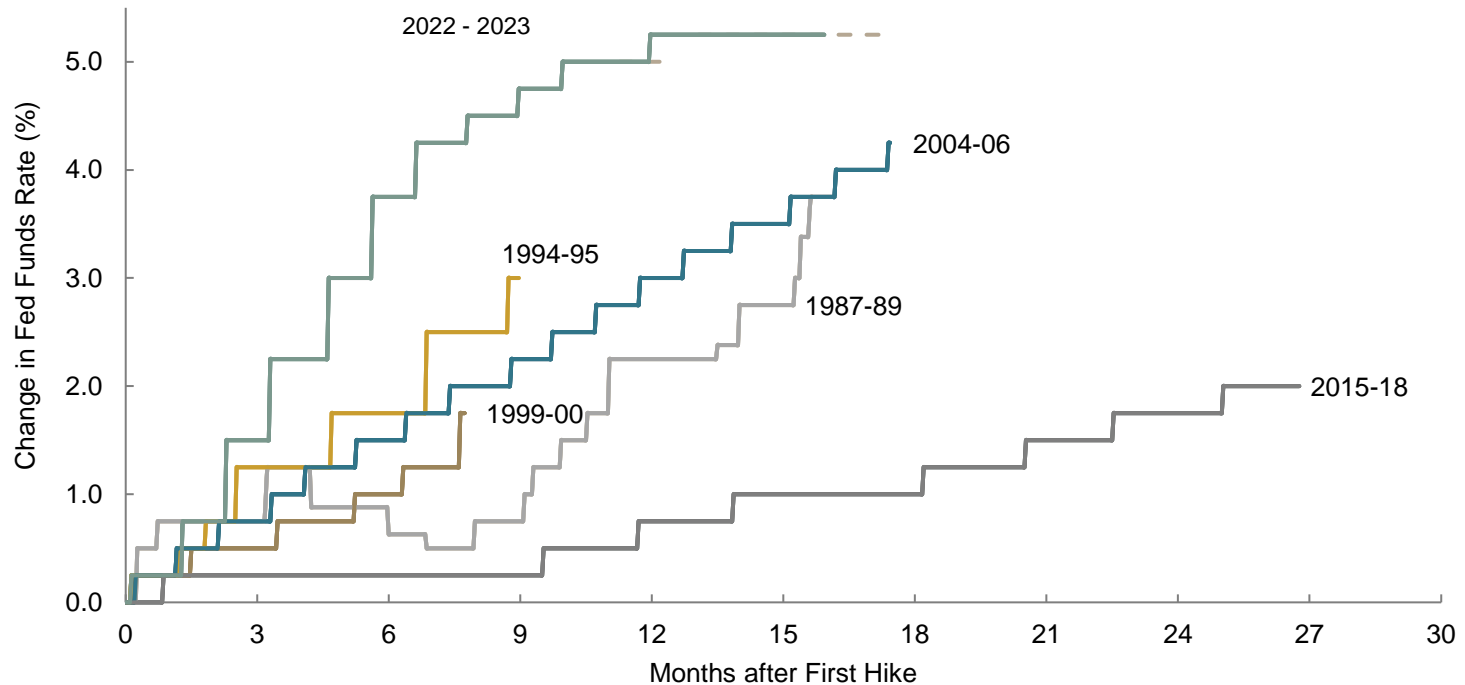
(212)-893-1528

Joseph.Lavorgna@smbcnikko-si.com

November 2023

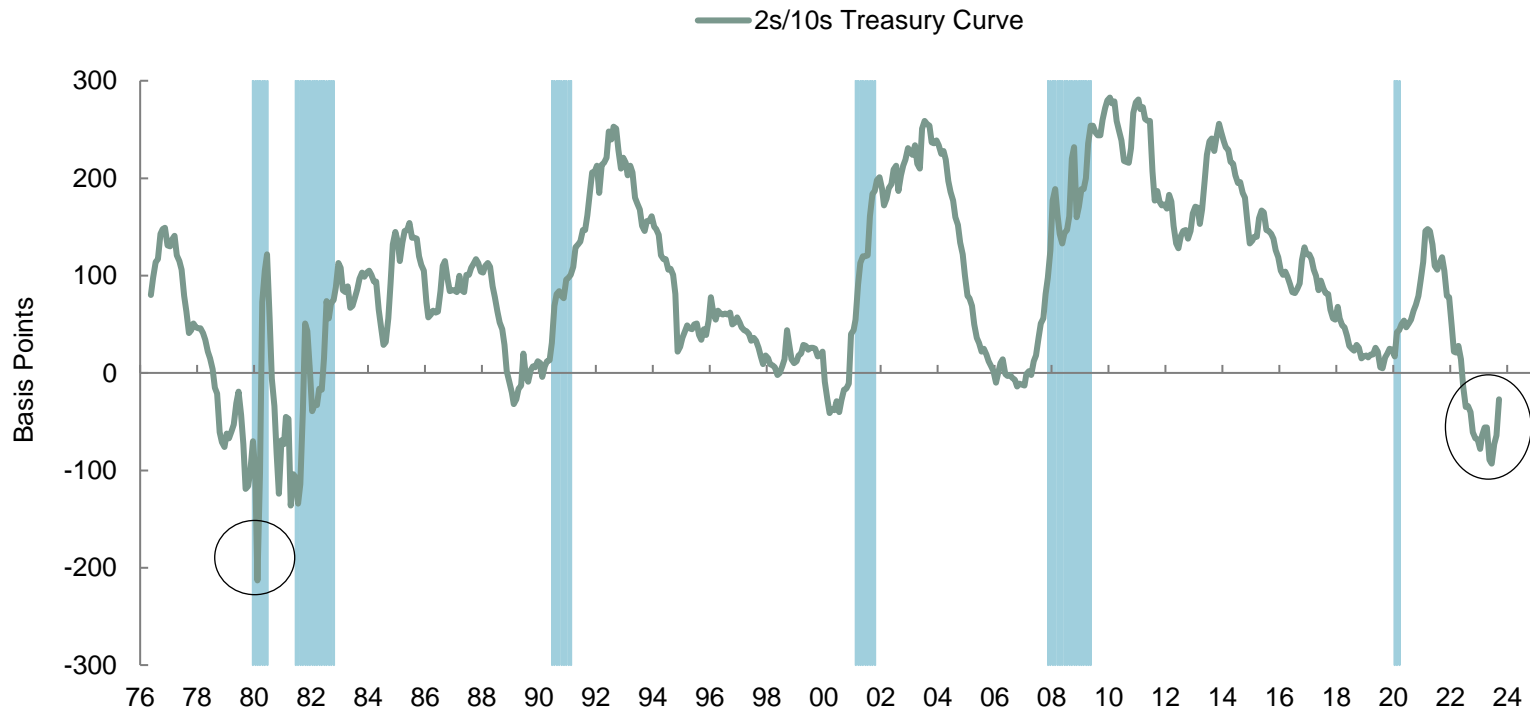
A Record Rise in Fed Funds

The Fed has increased rates at the fastest pace in more than four decades.



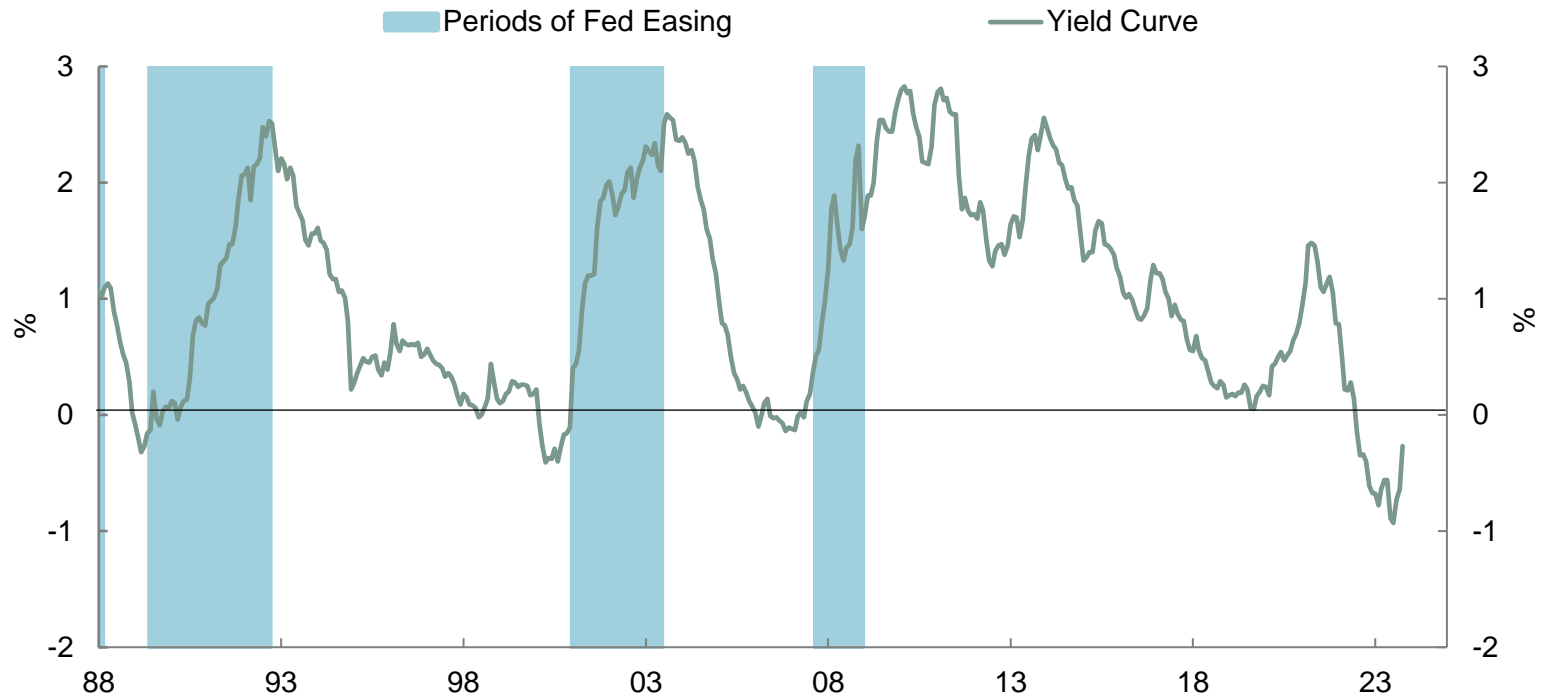
Historic Curve Inversion

The deeply inverted yield curve signals recession and less credit creation.



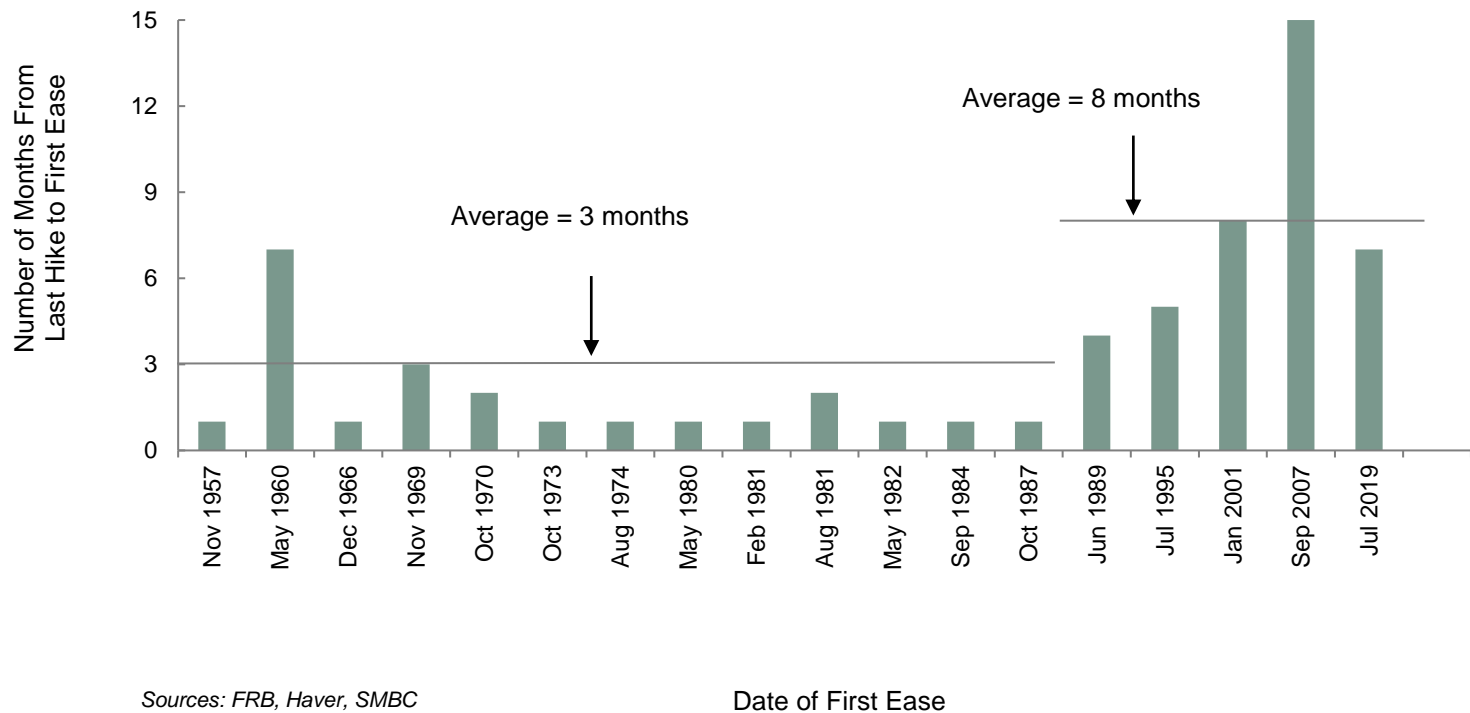
Getting Back to Normal

The yield curve steepens only when the Fed cuts.



When Will the Fed Cut?

On average over the last five cycles, the Fed has cut rates eight months following their last hike.

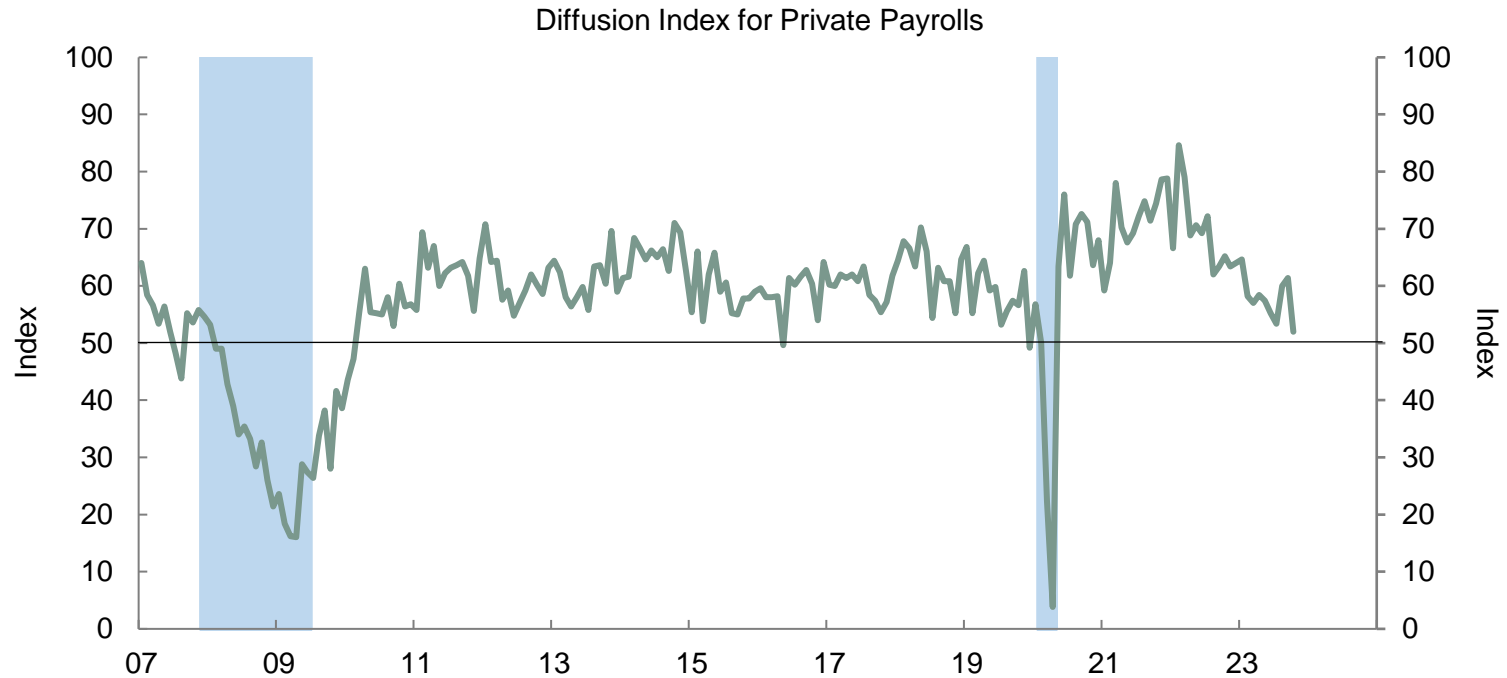


Sources: FRB, Haver, SMBC

Date of First Ease

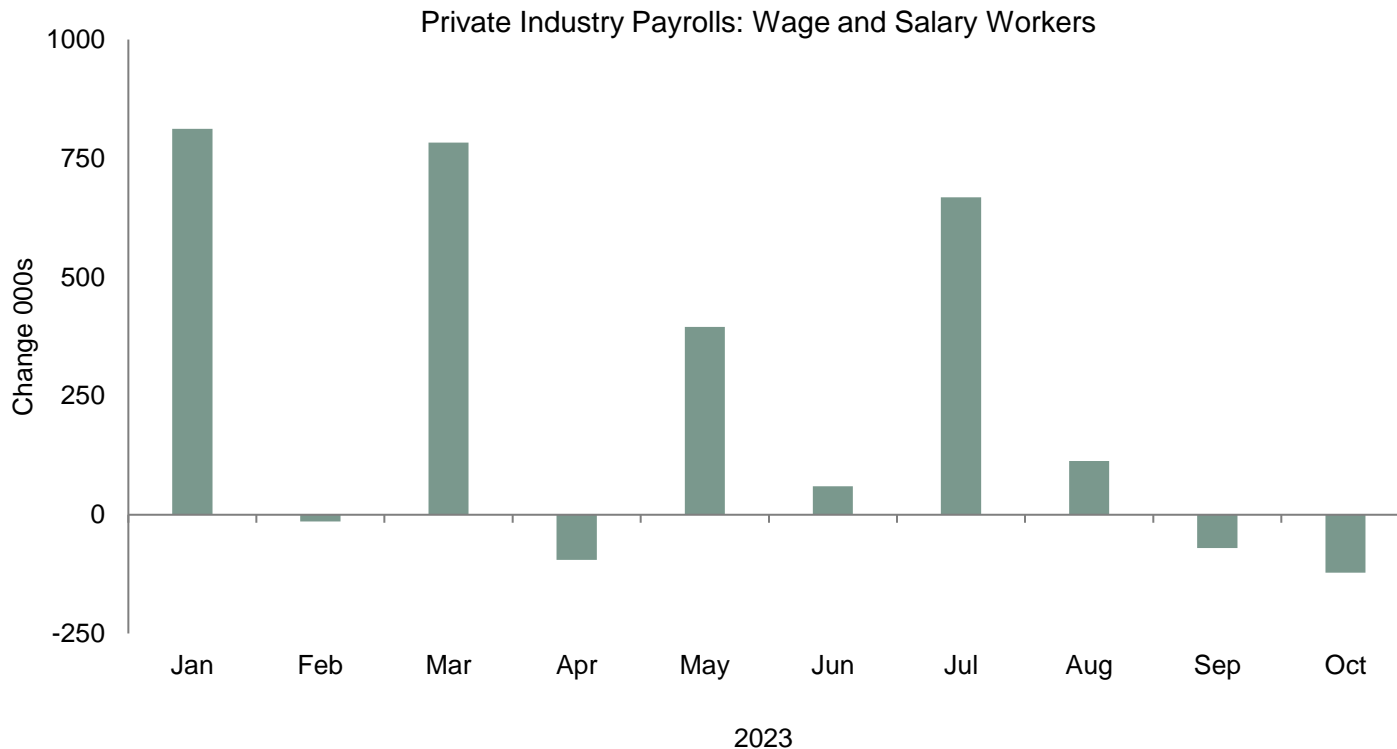
Fewer Sectors Hiring

Last month just 52% of private industries were hiring, a new post-pandemic low.



Another Job Metric Already Negative

While volatile the Household Survey is arguably better at capturing inflection points owing to its changing monthly sample.



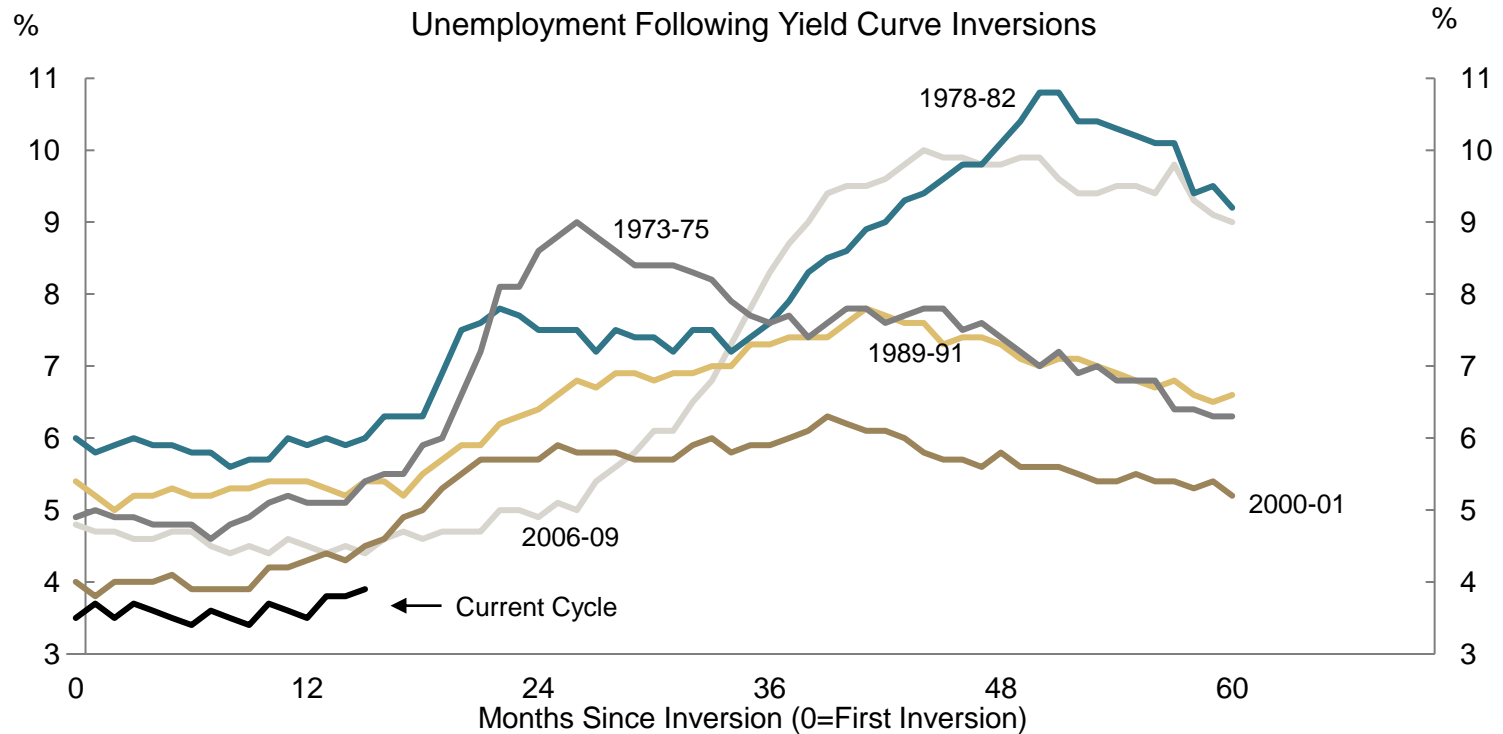
Is This Time Different?

Recession happens every time the unemployment rate rises 50 basis points from its cyclical trough.



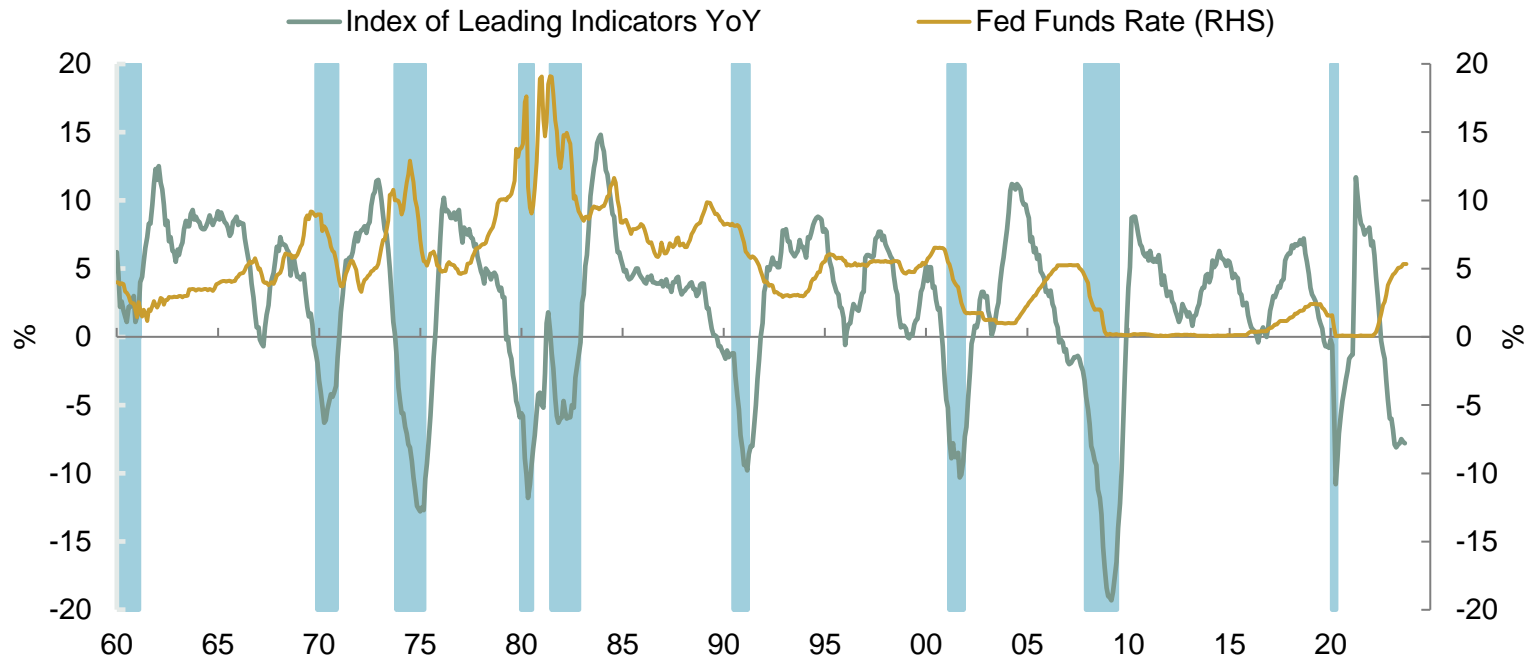
Current Cycle vs. Past Cycles

Unemployment is finally rising.



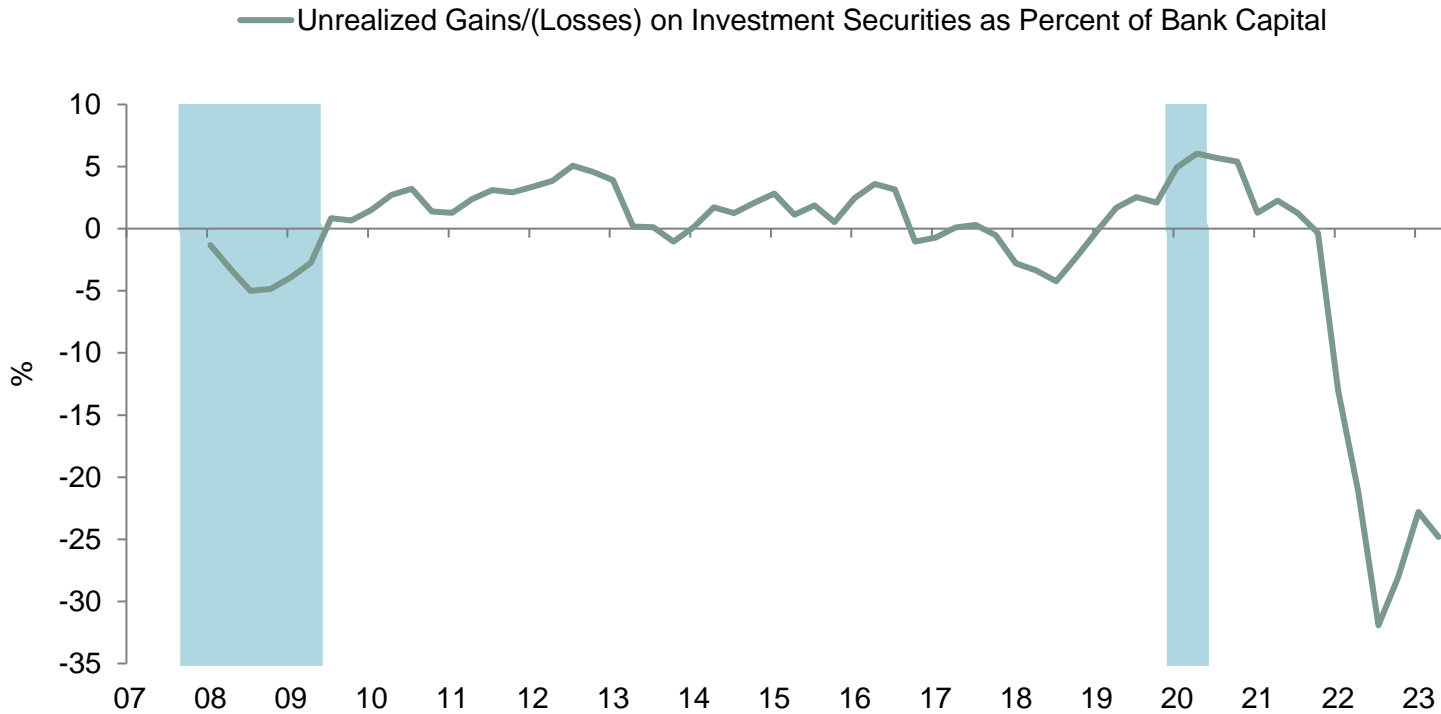
Tightening Into A Downturn

Leading Economic Indicators are declining rapidly.



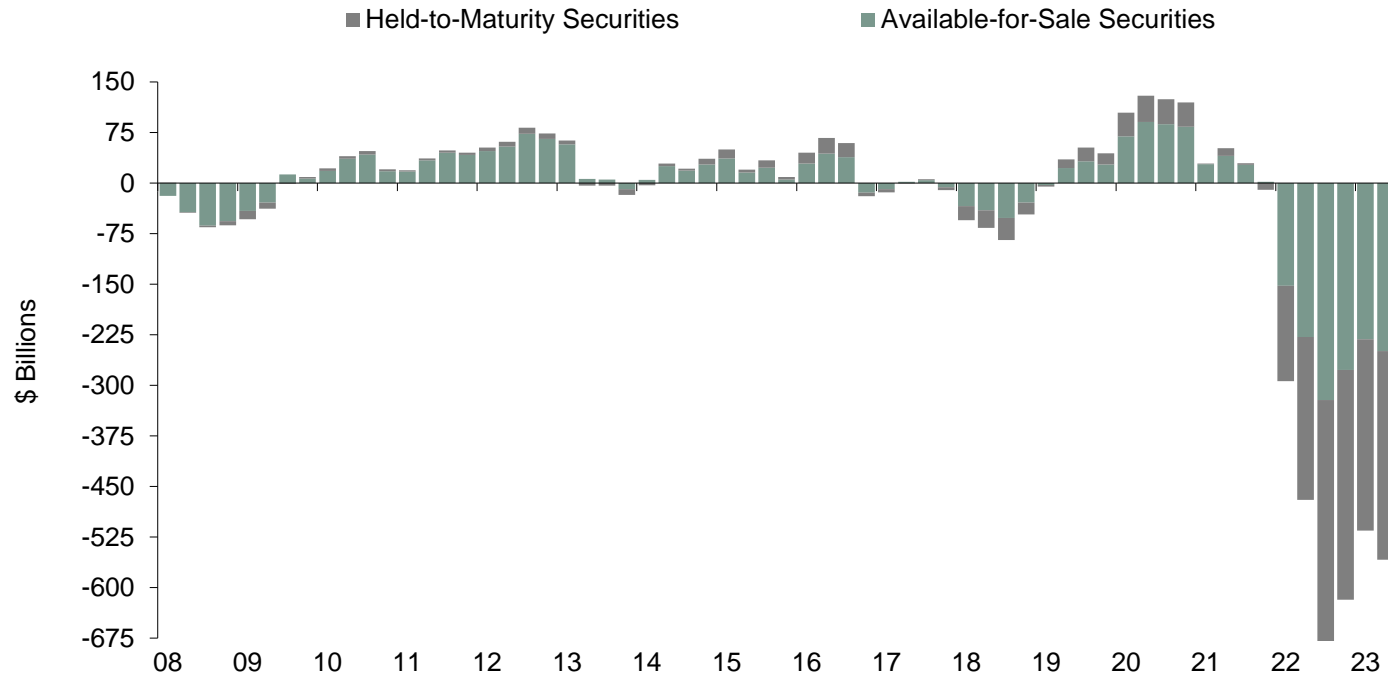
Massive Balance Sheet Losses

Record Fed tightening has decimated commercial bank capital.



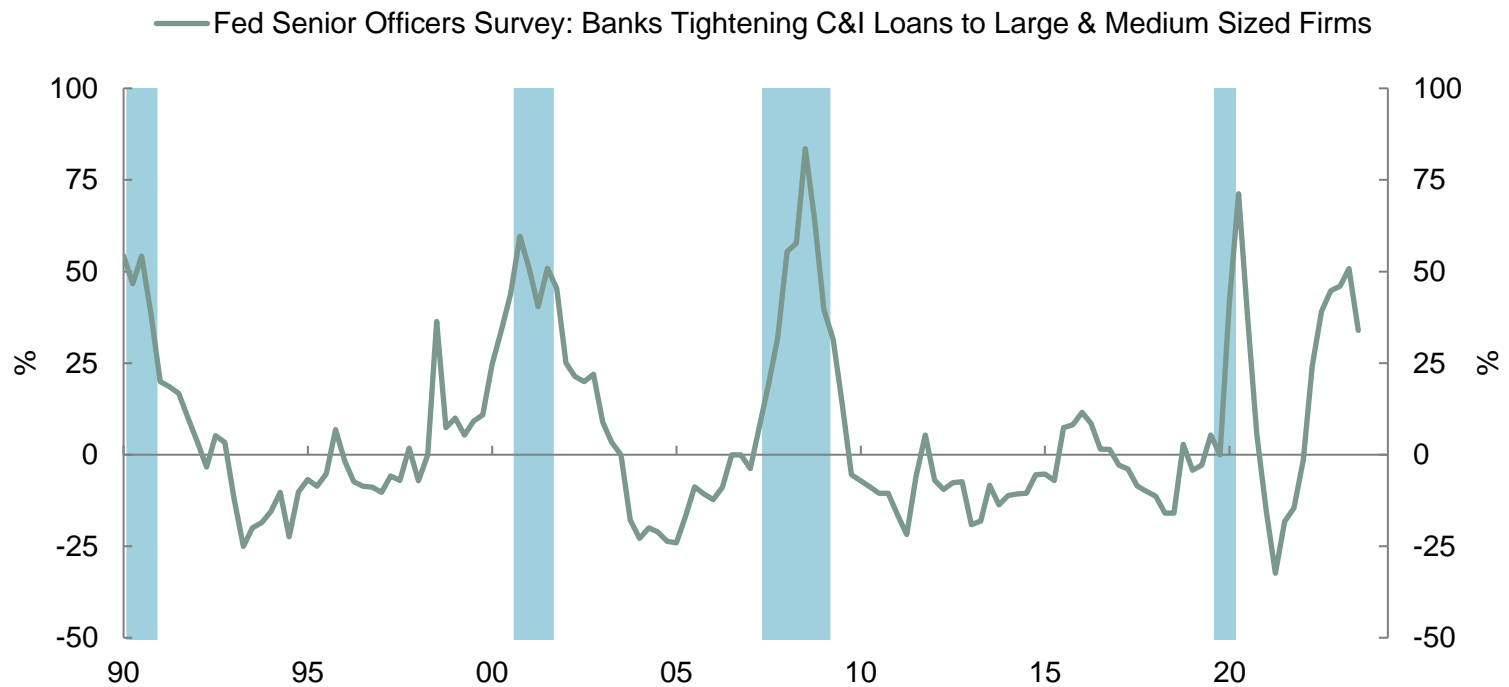
Nowhere To Hide

The drop in value has been in both security accounts.



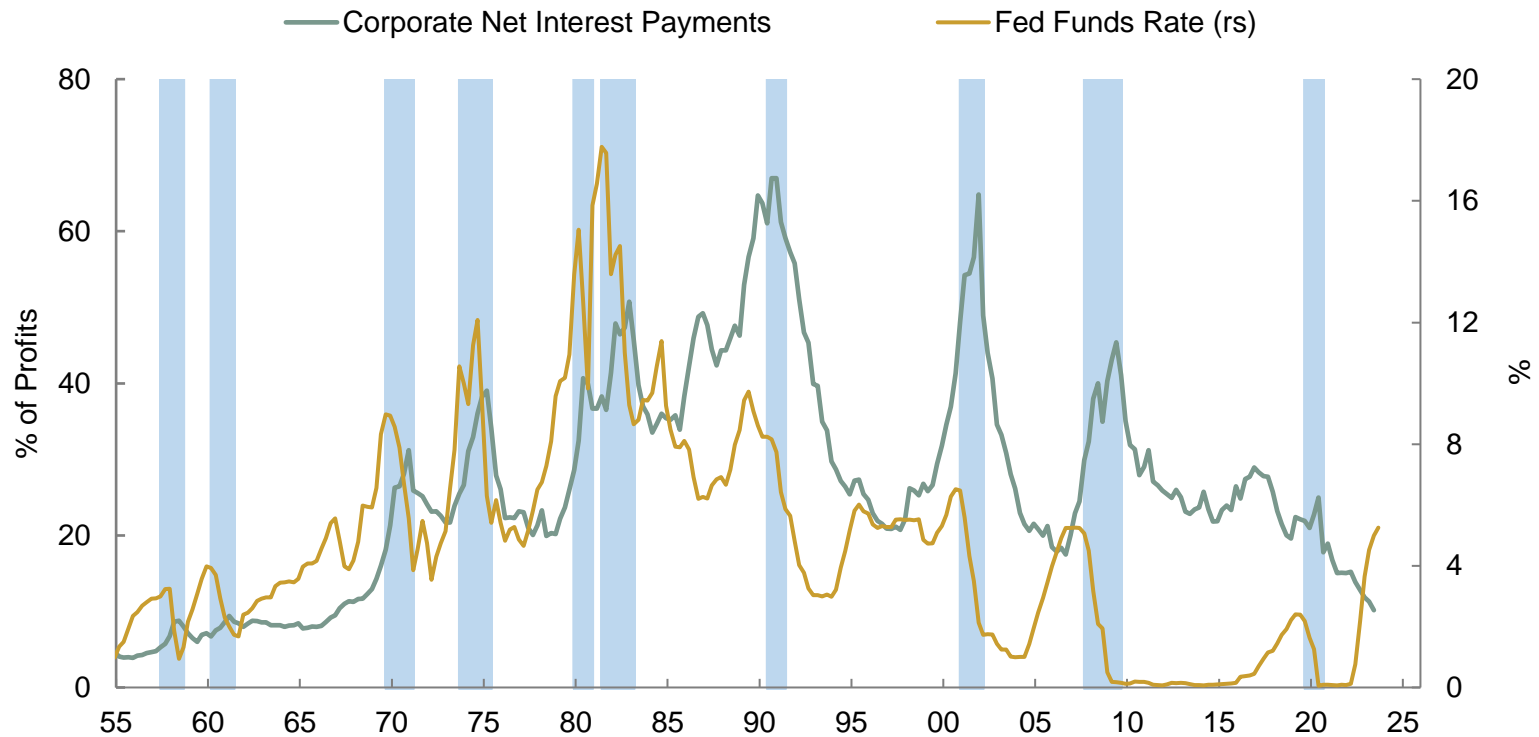
Tightening Credit Conditions

Banks are still tightening standards at a recessionary level.



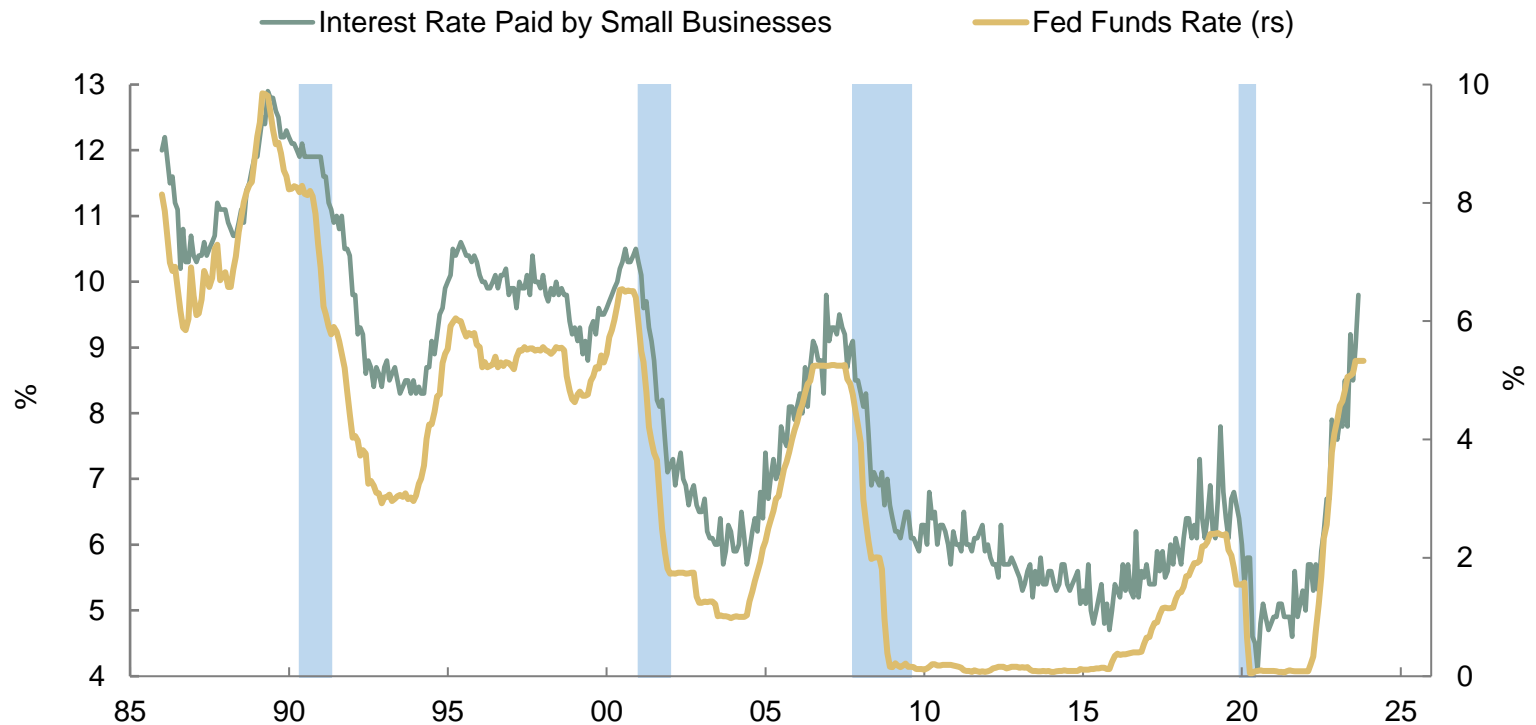
Falling Net Interest Payments

Some large businesses have locked in historically low rates.



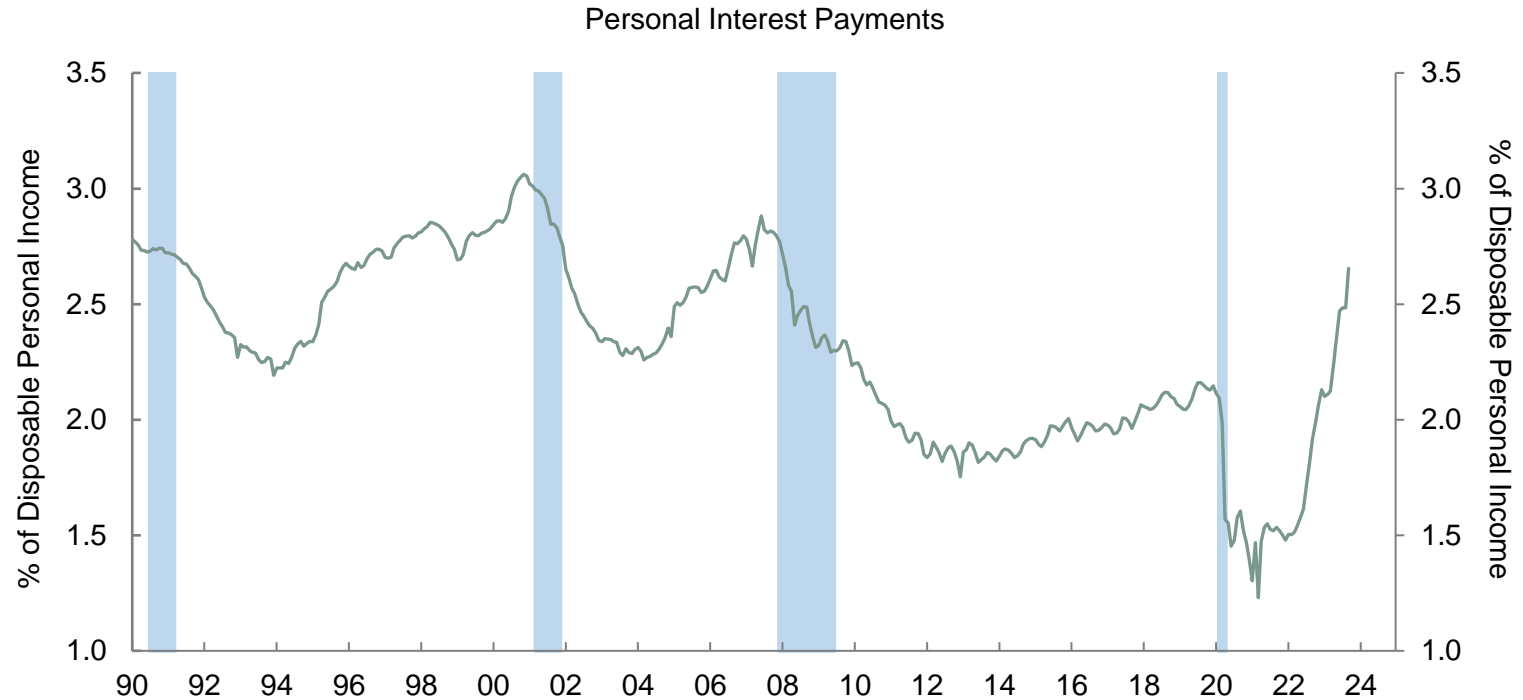
Small Business Blues

But this has not been the case with small businesses.



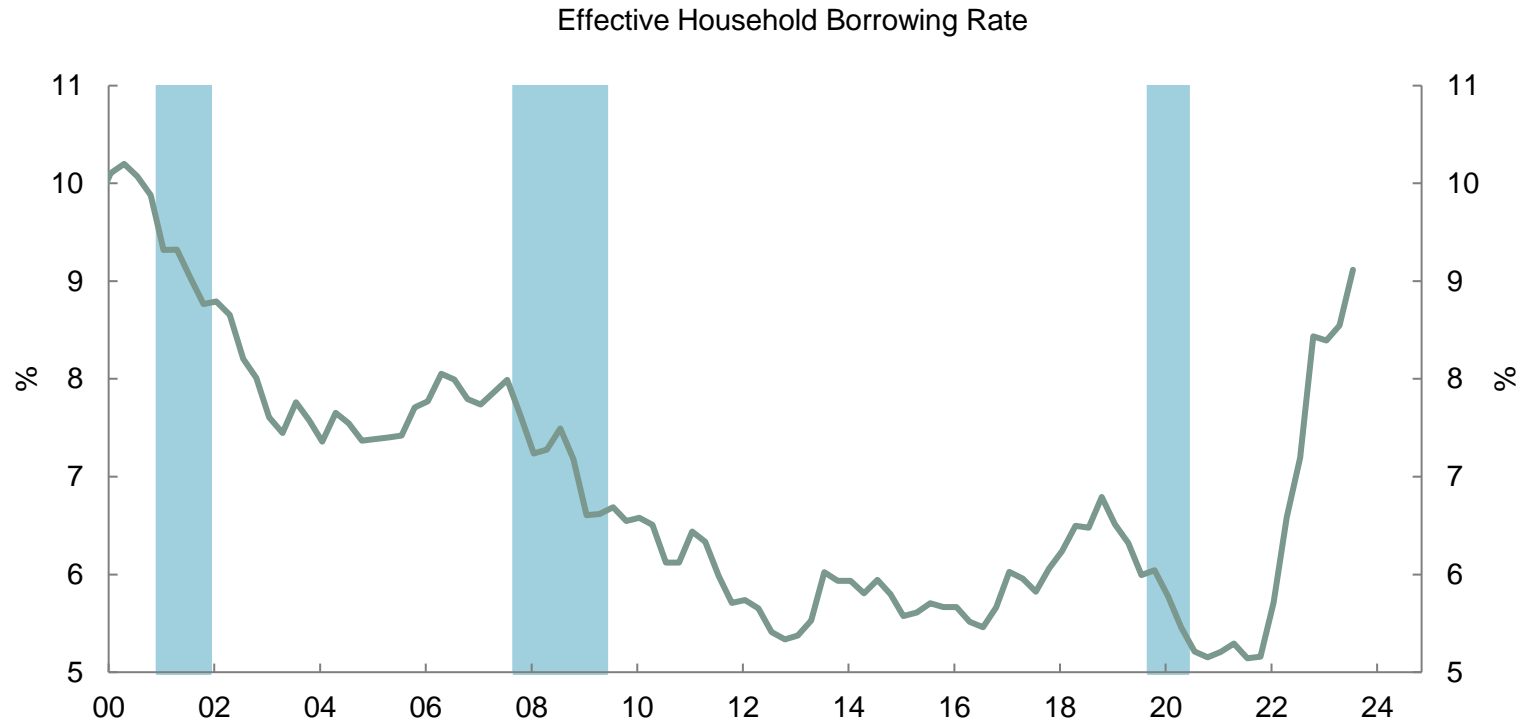
Higher Interest Payments

Consumer non-mortgage interest payments haven't risen sharply too.



Soaring Borrowing Costs

Consumers are facing the highest interest rates in over two decades.



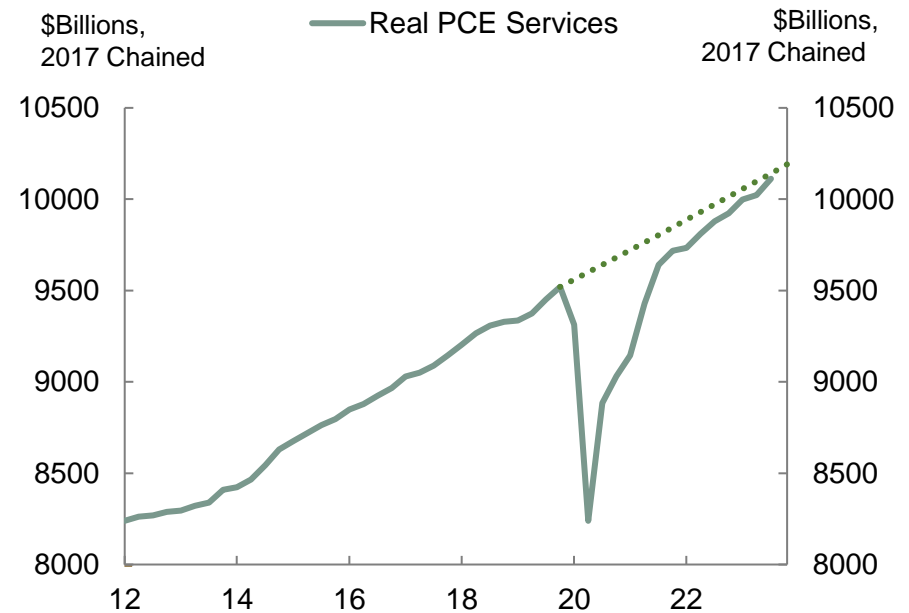
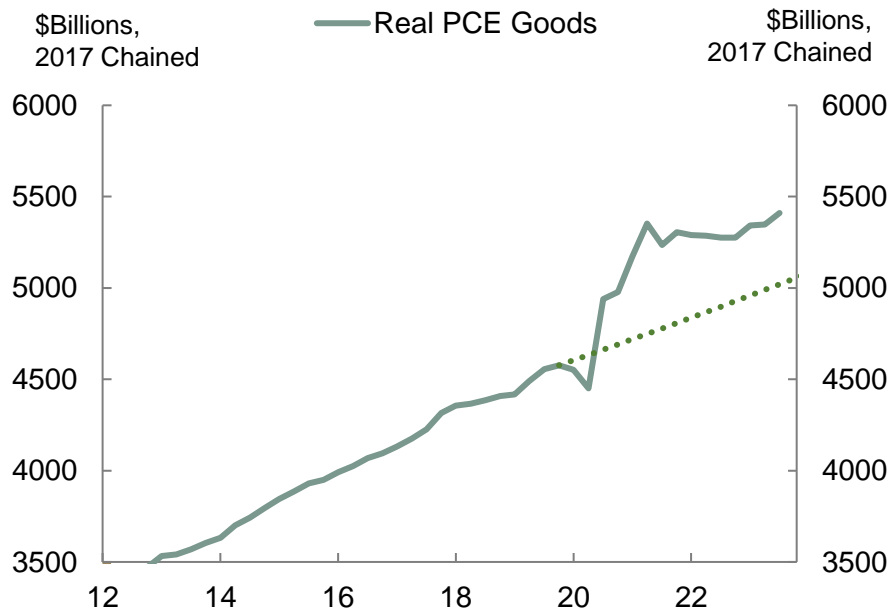
Reining in Consumer Lending

Households are struggling to obtain credit.



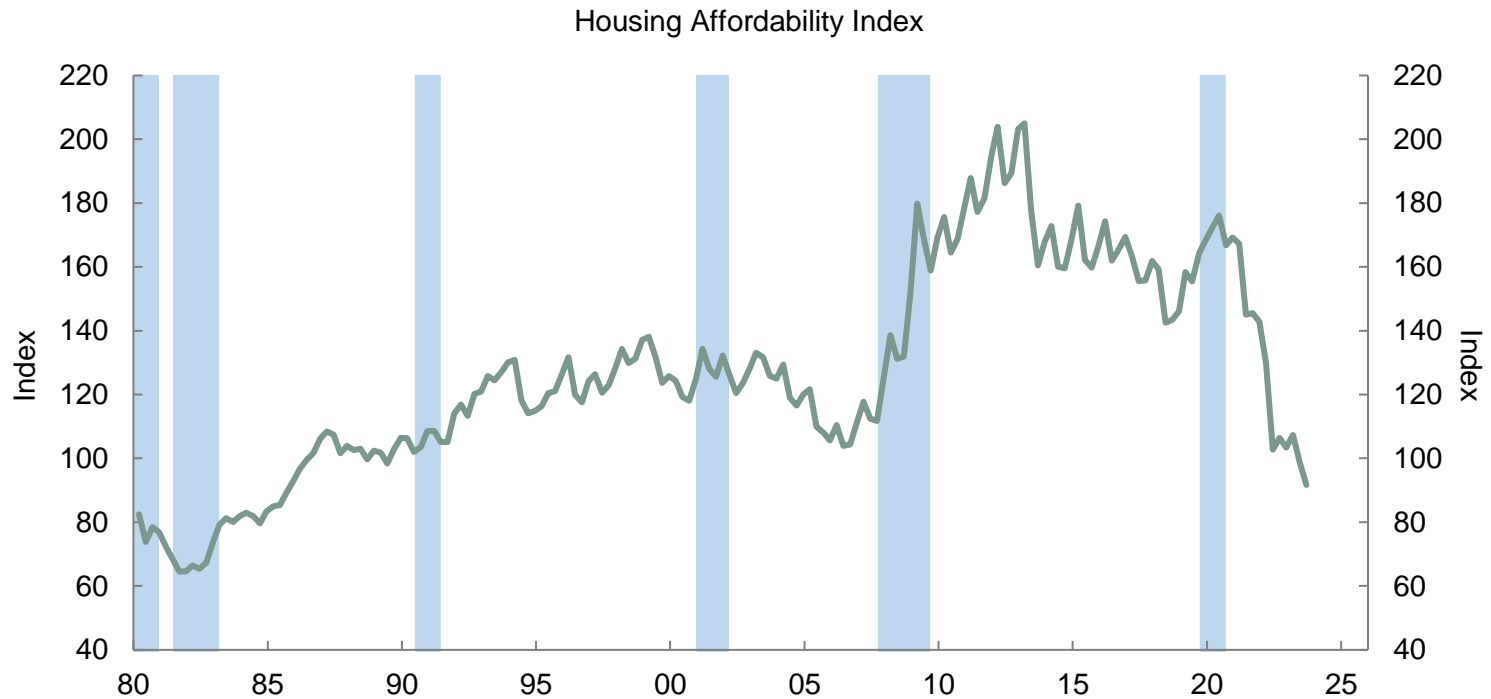
A Return to Trend?

Goods spending is well above its pre-pandemic trend.



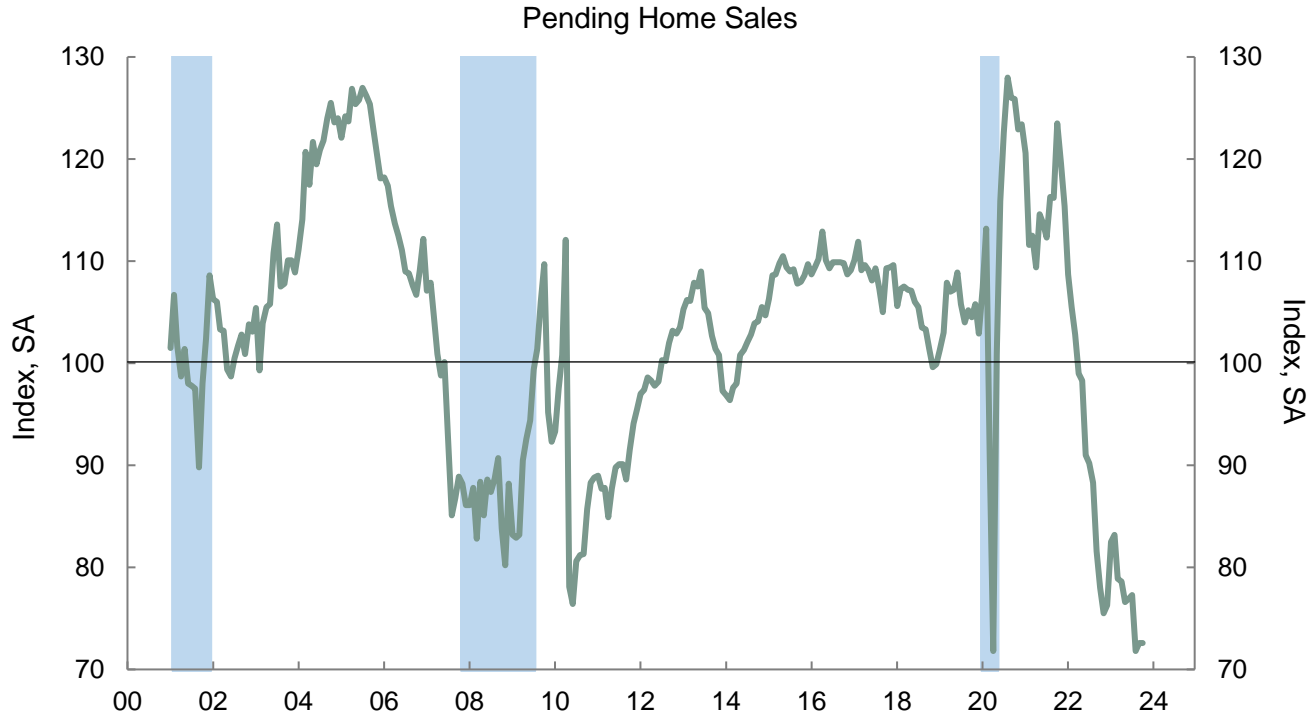
Homes Are Expensive!

Affordability has declined to a multi-decade low.



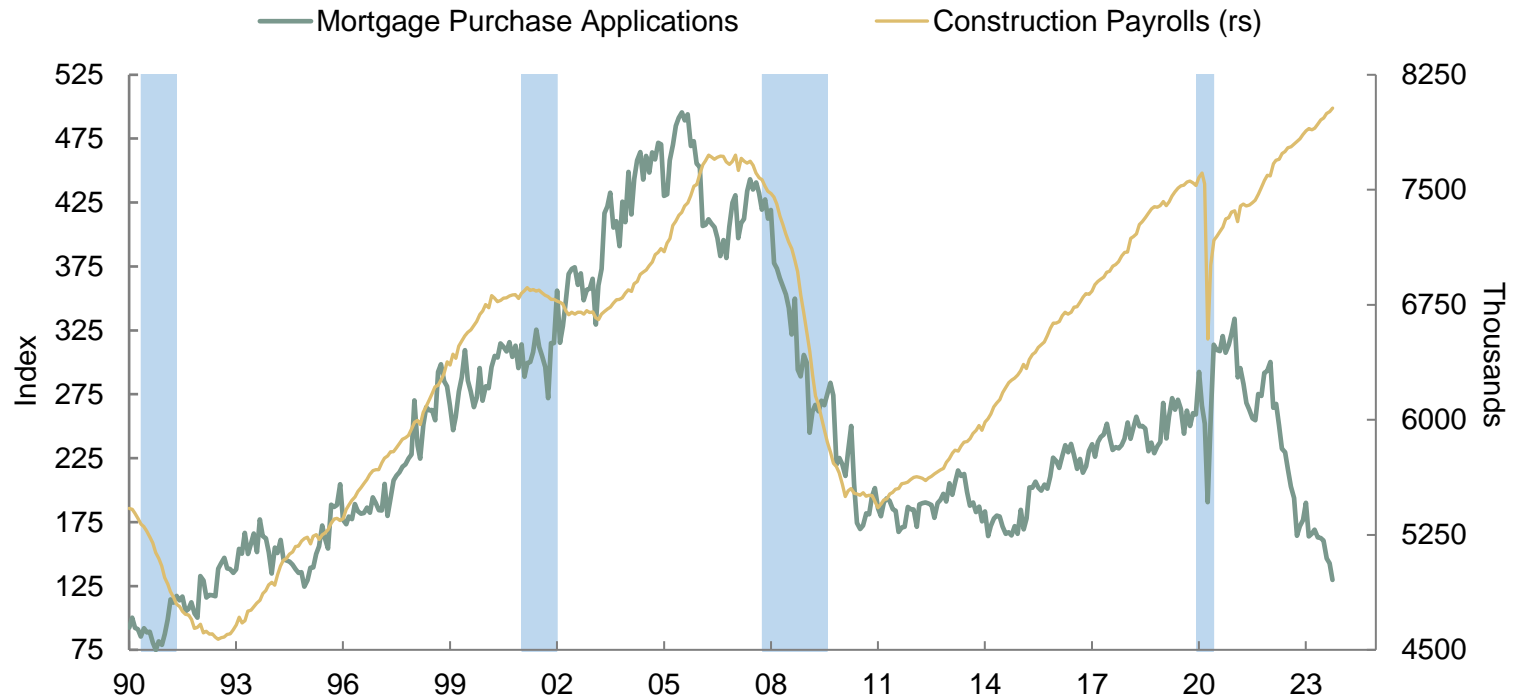
Collapse In Transactions

Pending home sales are at all-time lows.



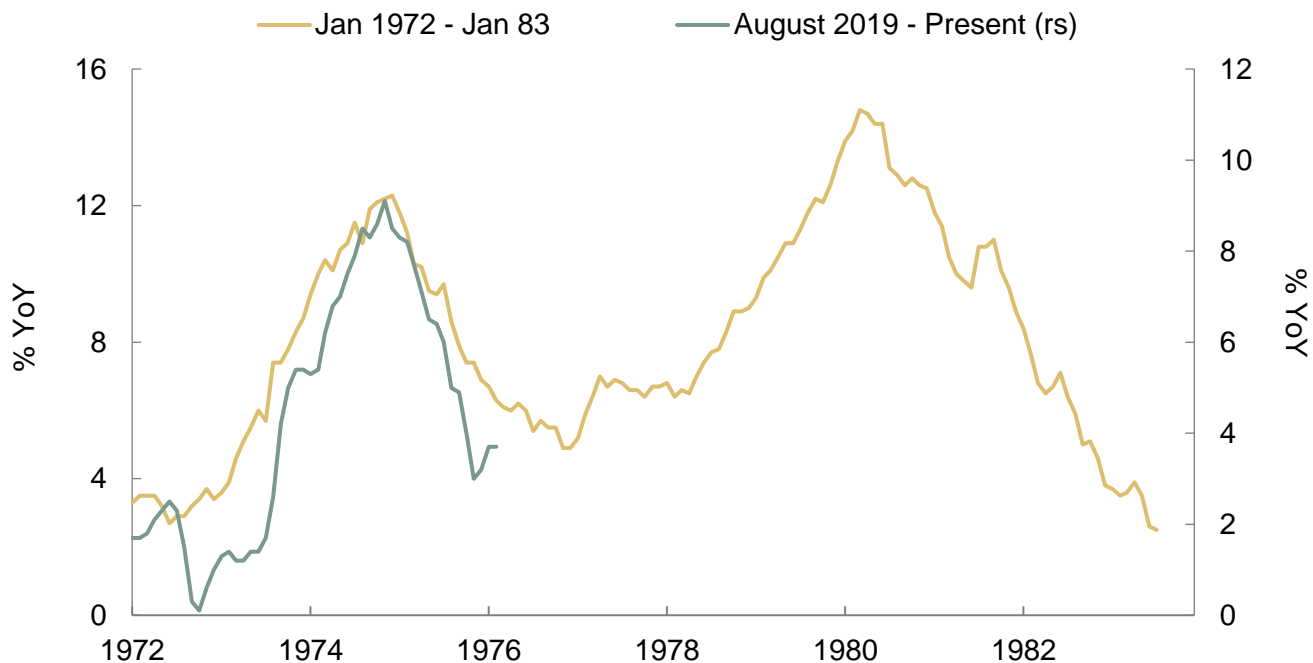
Massive Disconnect

Construction employment is extremely elevated relative to current housing demand.



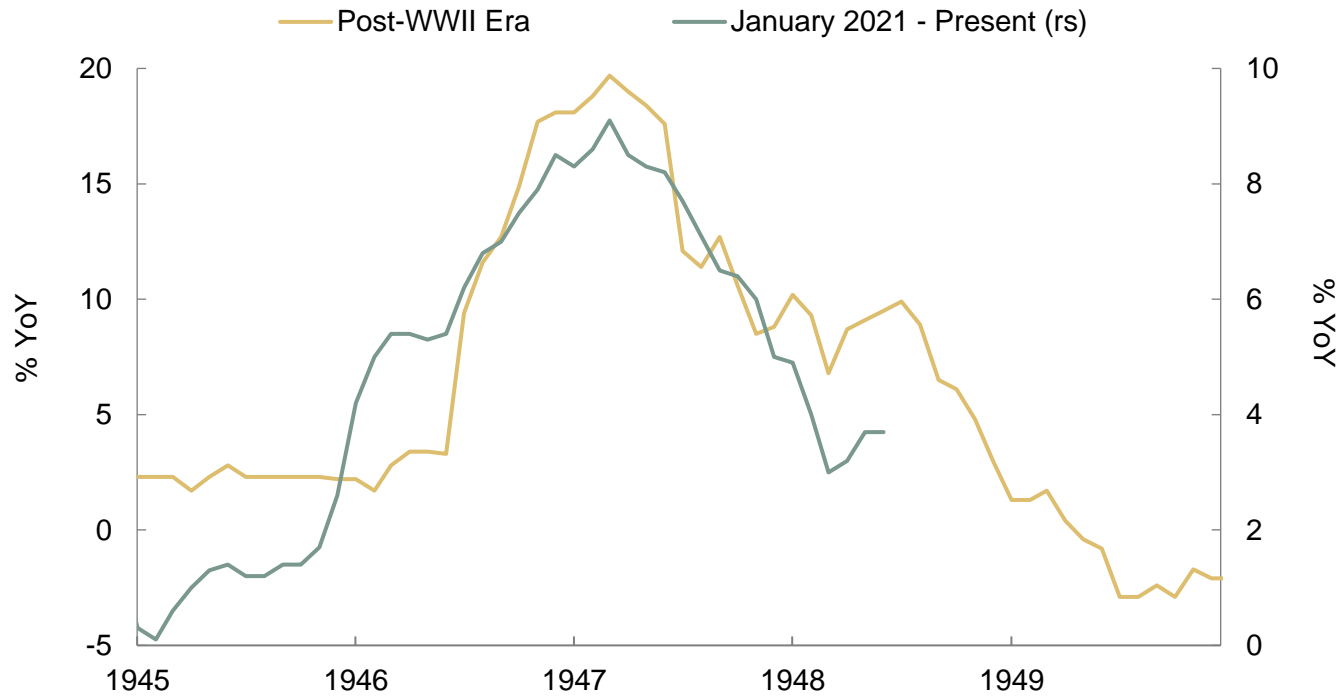
Parallels With The 1970s

The Fed does not want to repeat the mistakes of the 1970s by easing rates too soon.



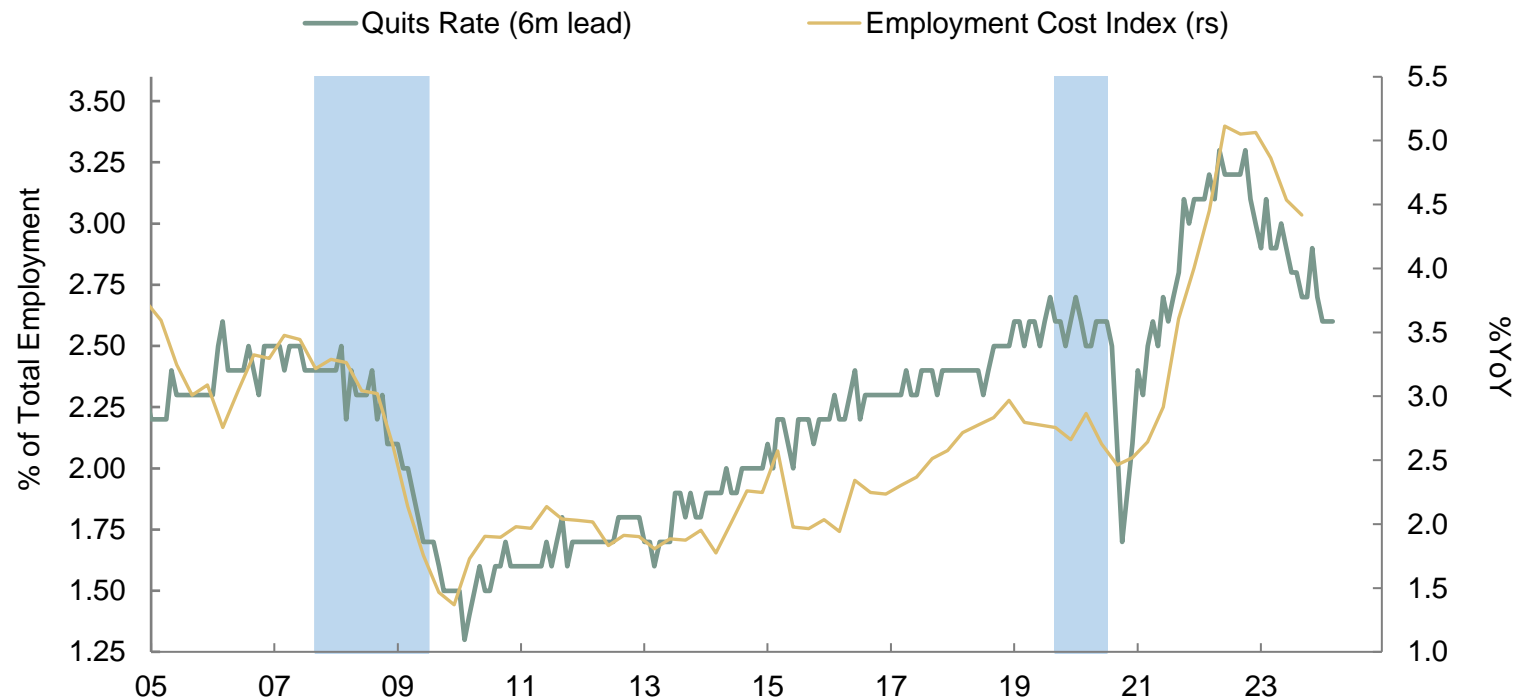
Parallels To The 1940s

But what if today's environment is more like the post-WWII era?



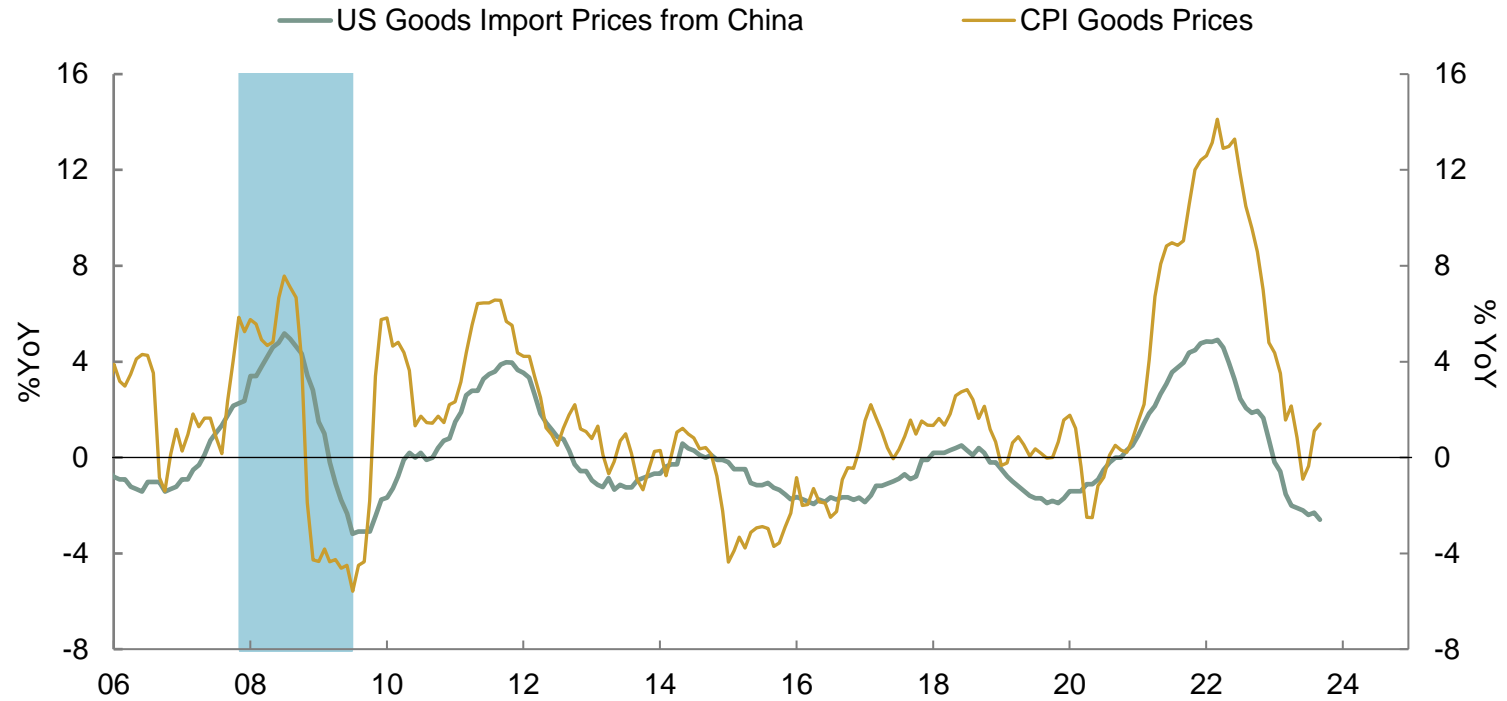
Declining Quits Signals Lower Wage Costs

The quits rate is back to pre-pandemic levels.



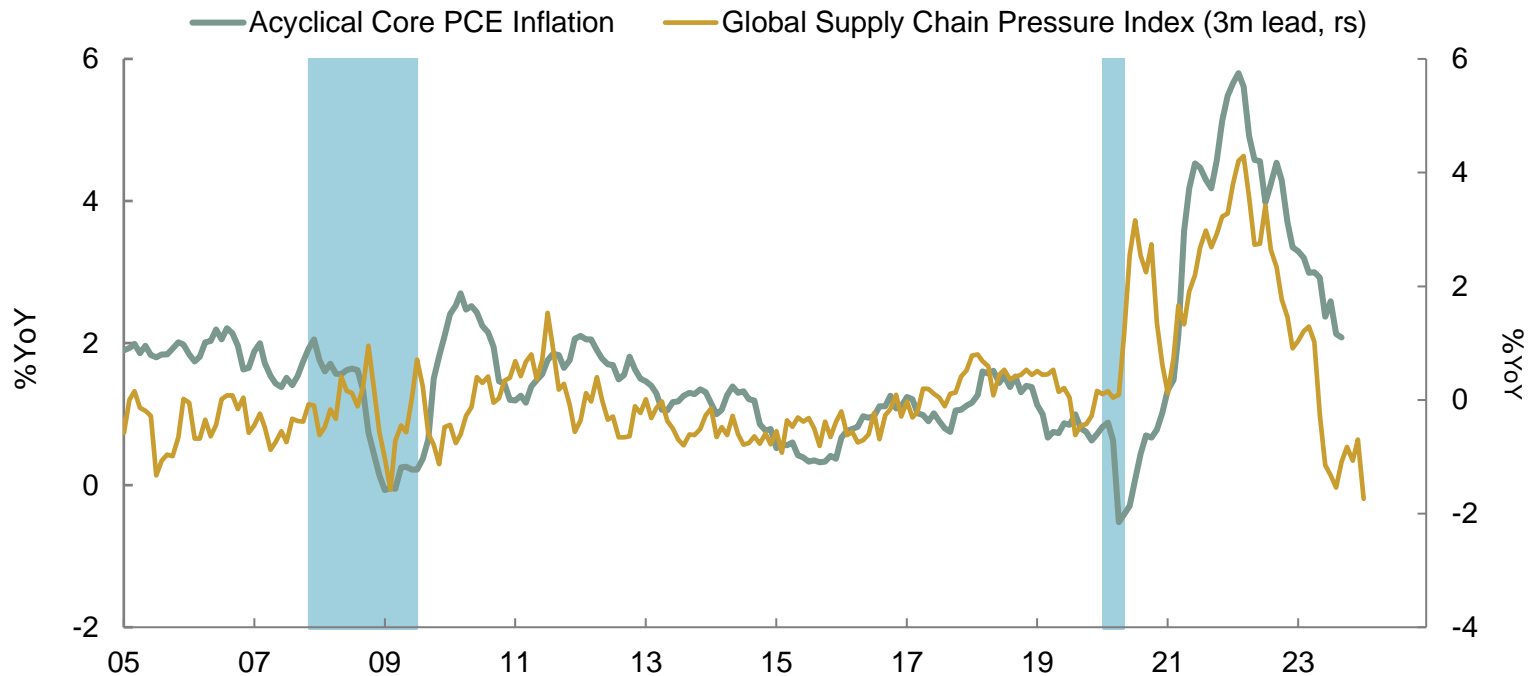
Inflation – Goods Prices vs. Import Prices

China is exporting deflation.



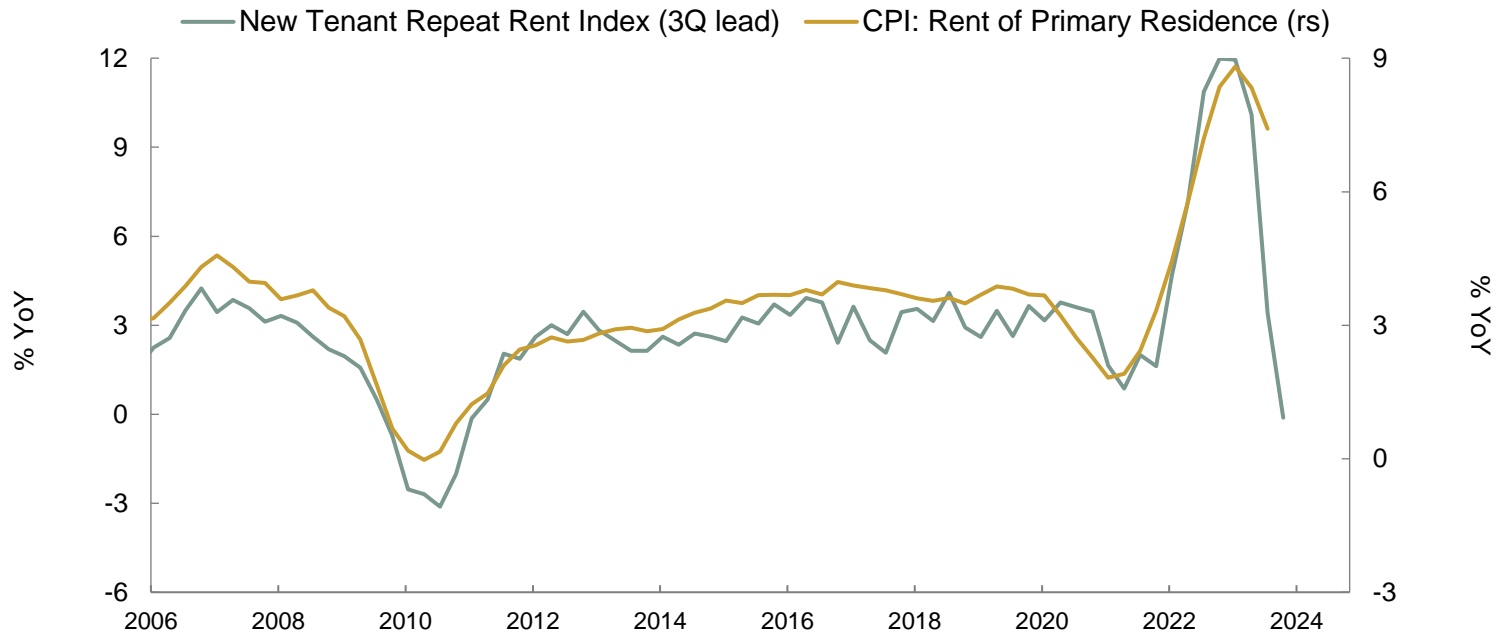
Receding Acyclical Inflation

There are no bottlenecks in the global supply chain.



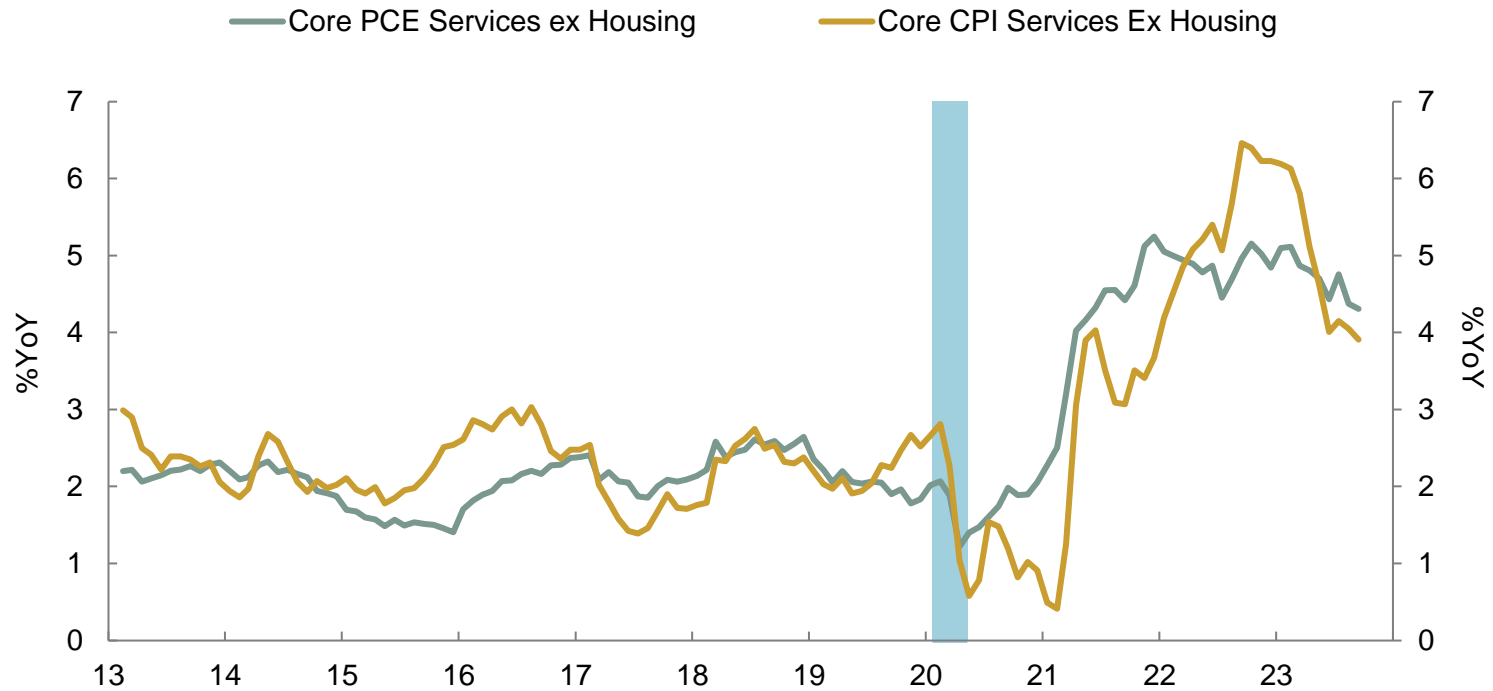
Rent Relief Coming

Rents have yet to slow due to the nature of the BLS' index construction. However, rental data from the Cleveland Fed suggests the opposite.



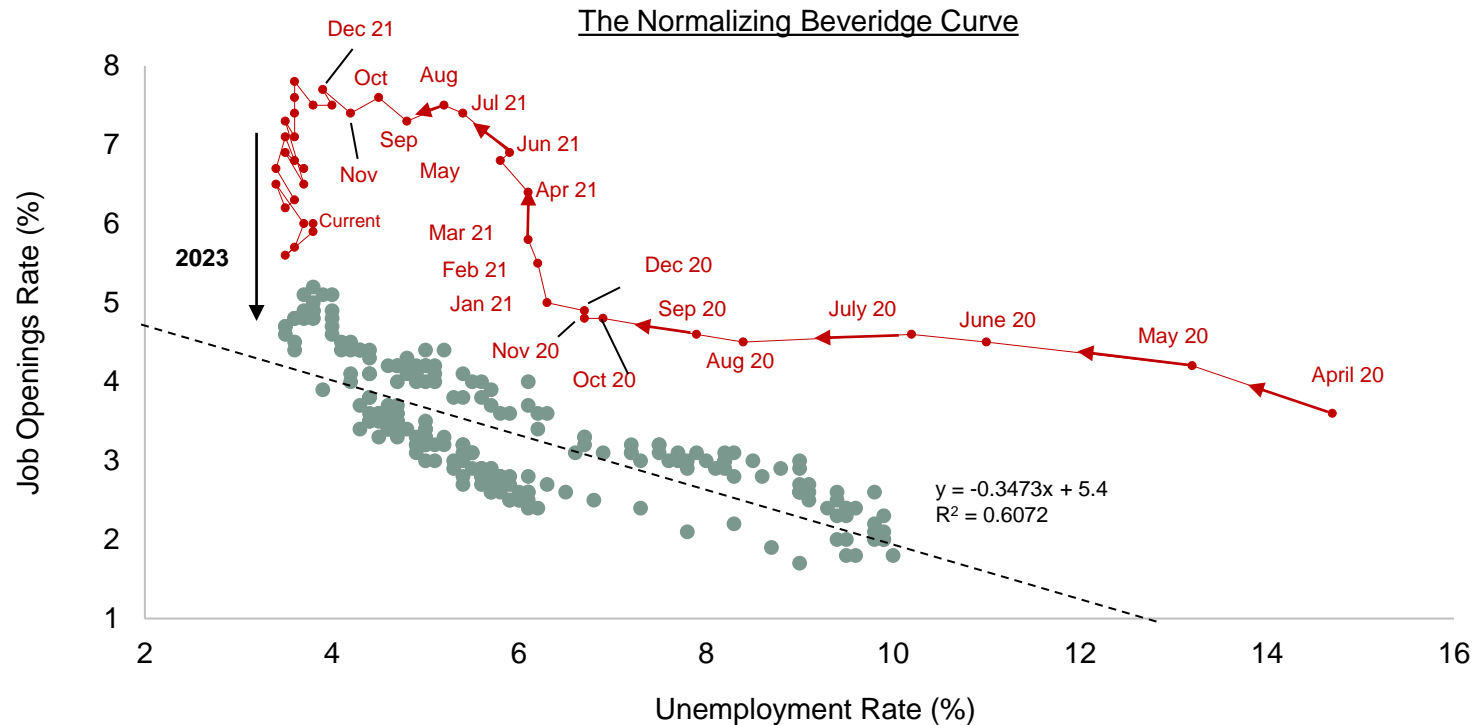
Inflation – Core Services ex Housing

The “super core” is easing.



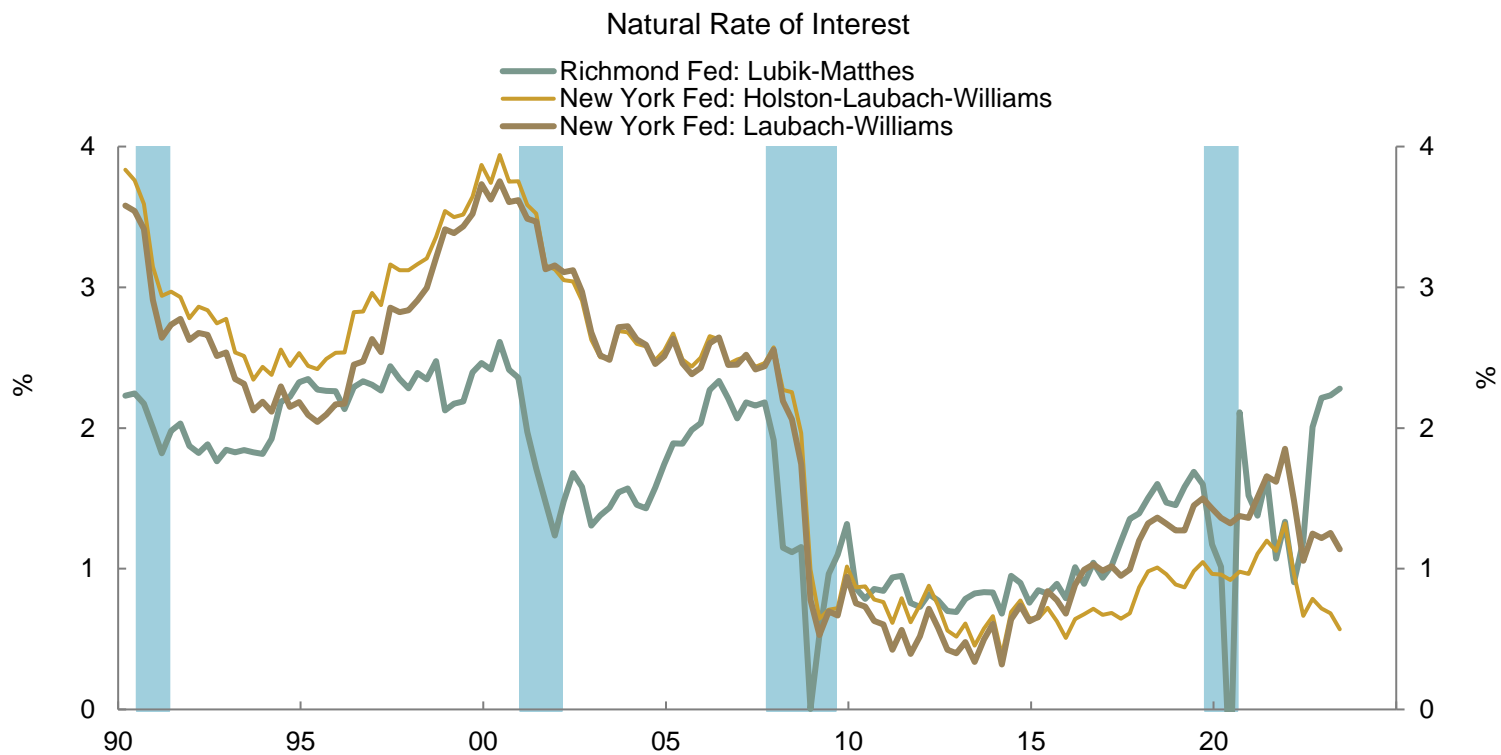
Labor Market Normalizing

The labor market is retreating to its pre-pandemic trend, following three years of overheating.



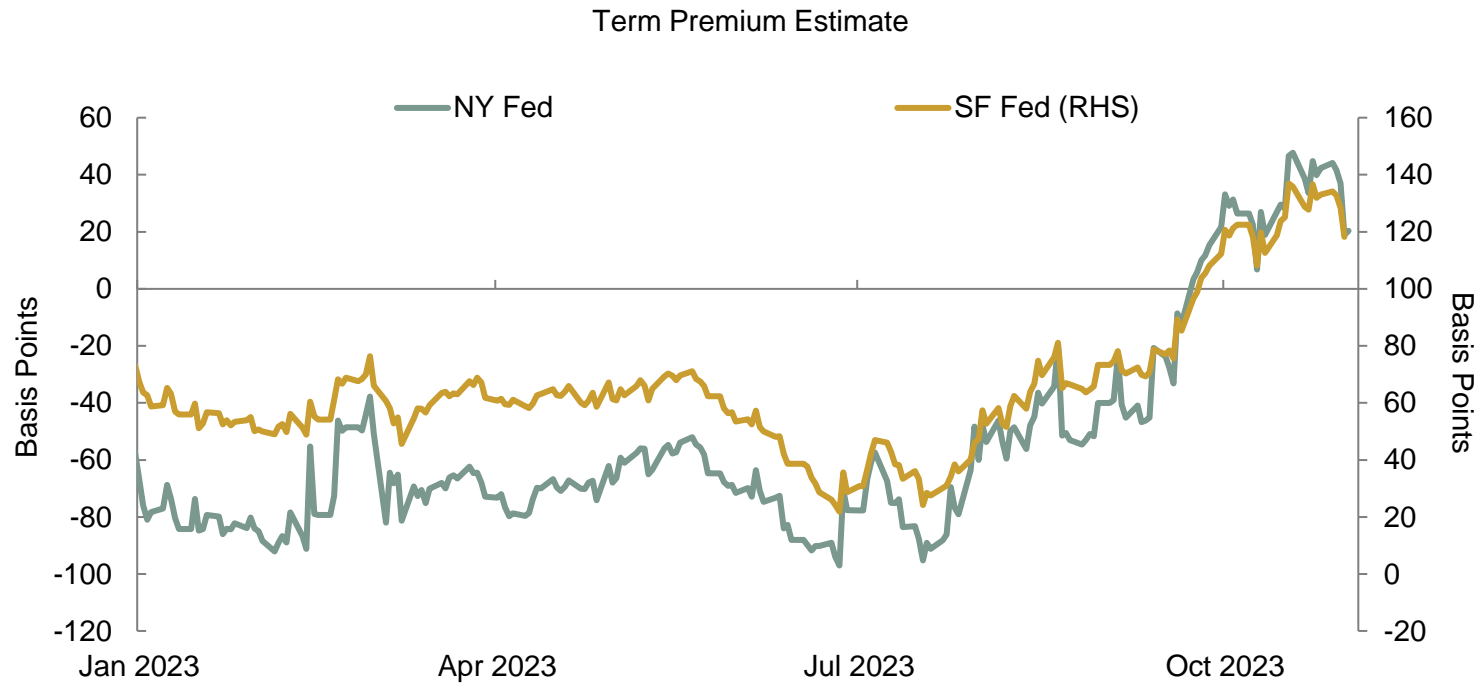
Where is Neutral?

There are widely varying estimates of R-Star.



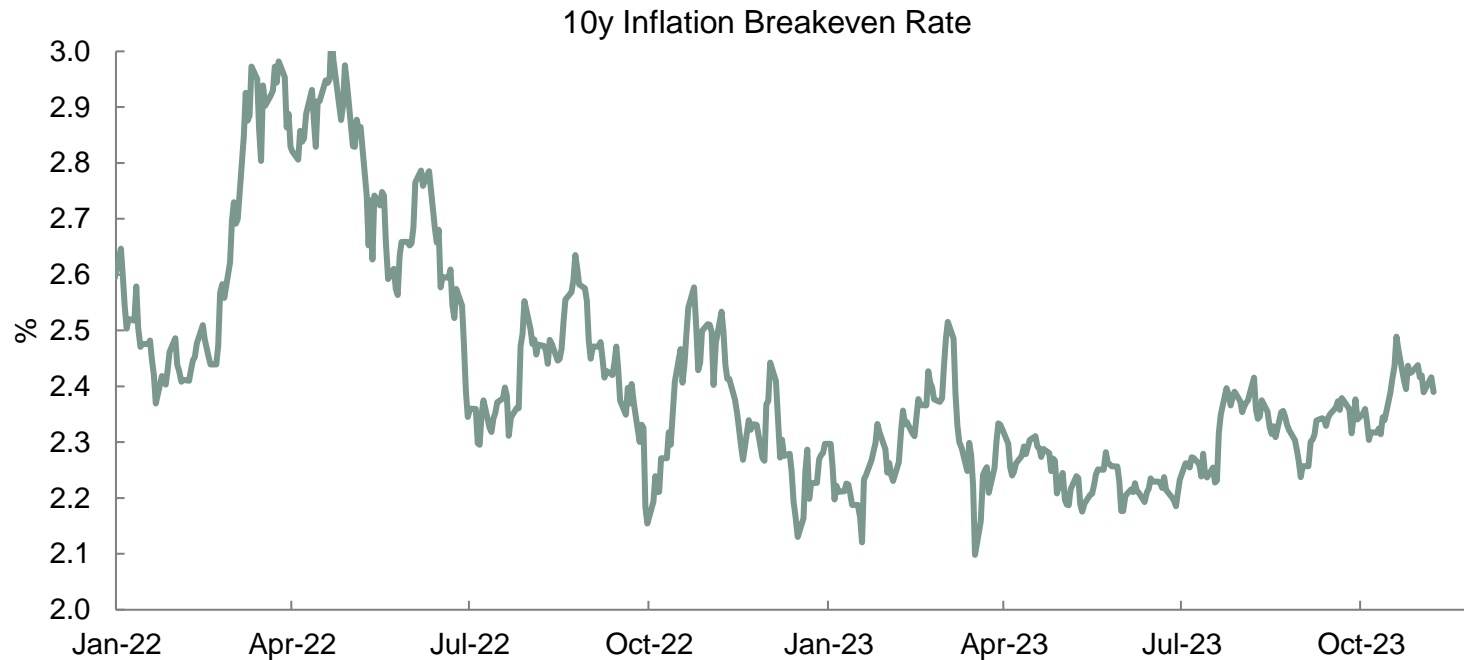
Surging Treasury Term Premium

The large increase in term premium is doing the Fed's work.



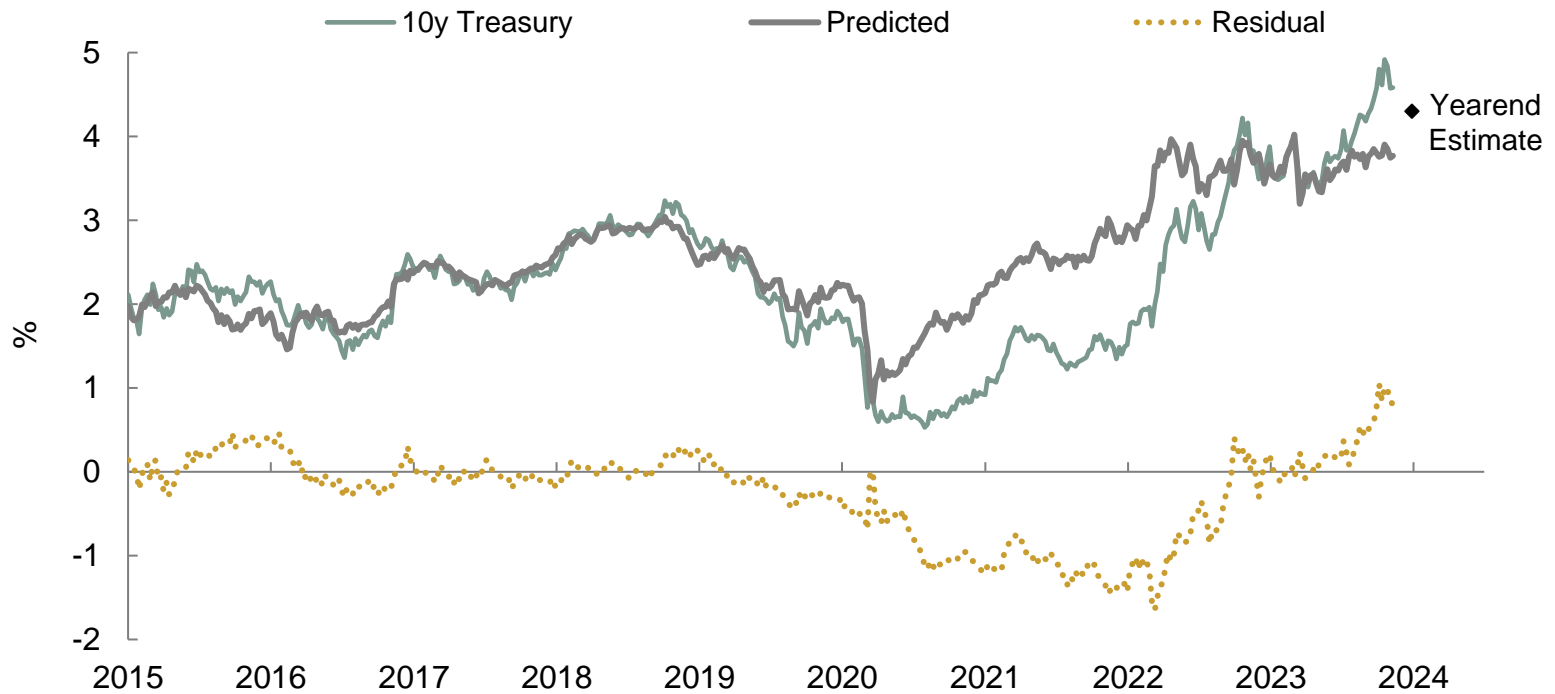
Stable Inflation Expectations

The bond market remains sanguine on inflation.



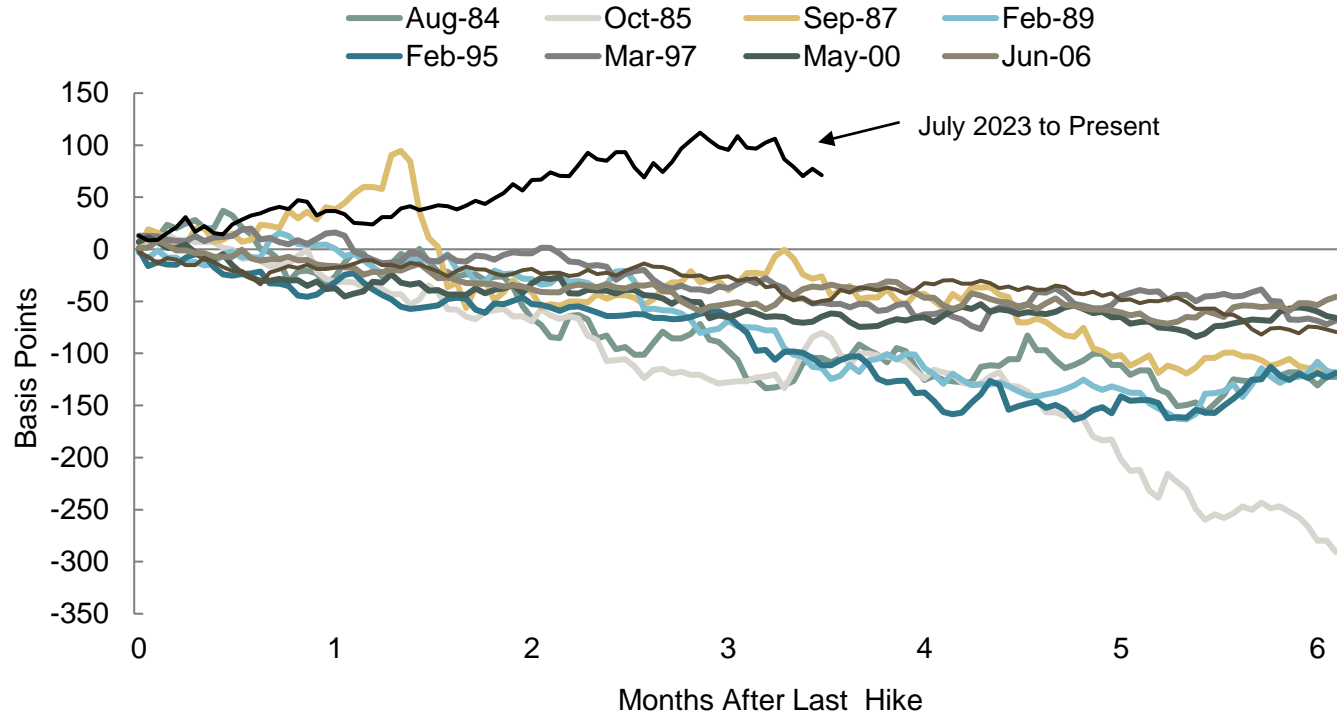
Whither Fair Value?

The 10-year treasury note is oversold.



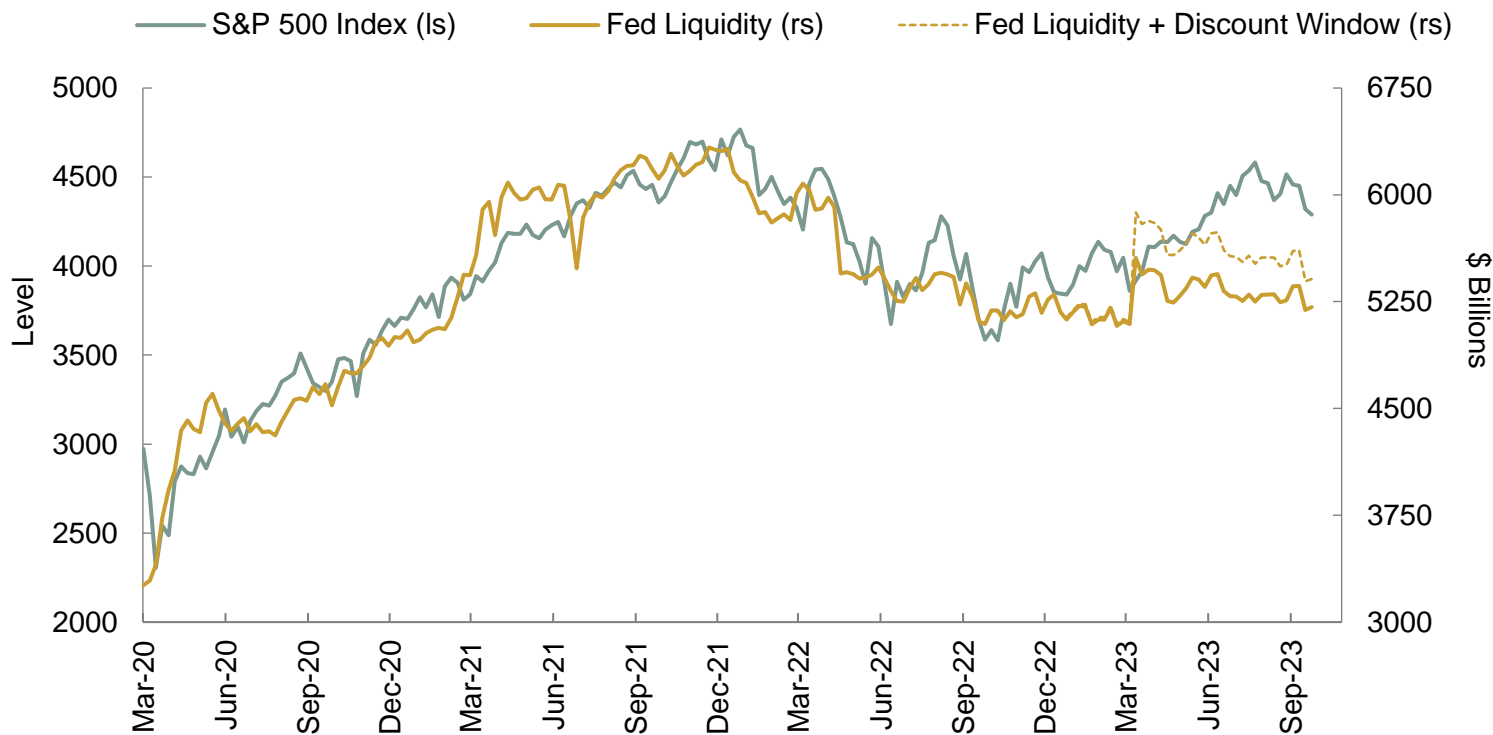
Big Rally But Not Yet

When the Fed is done tightening the yield on the 10-year note falls about 100 basis points within six months.



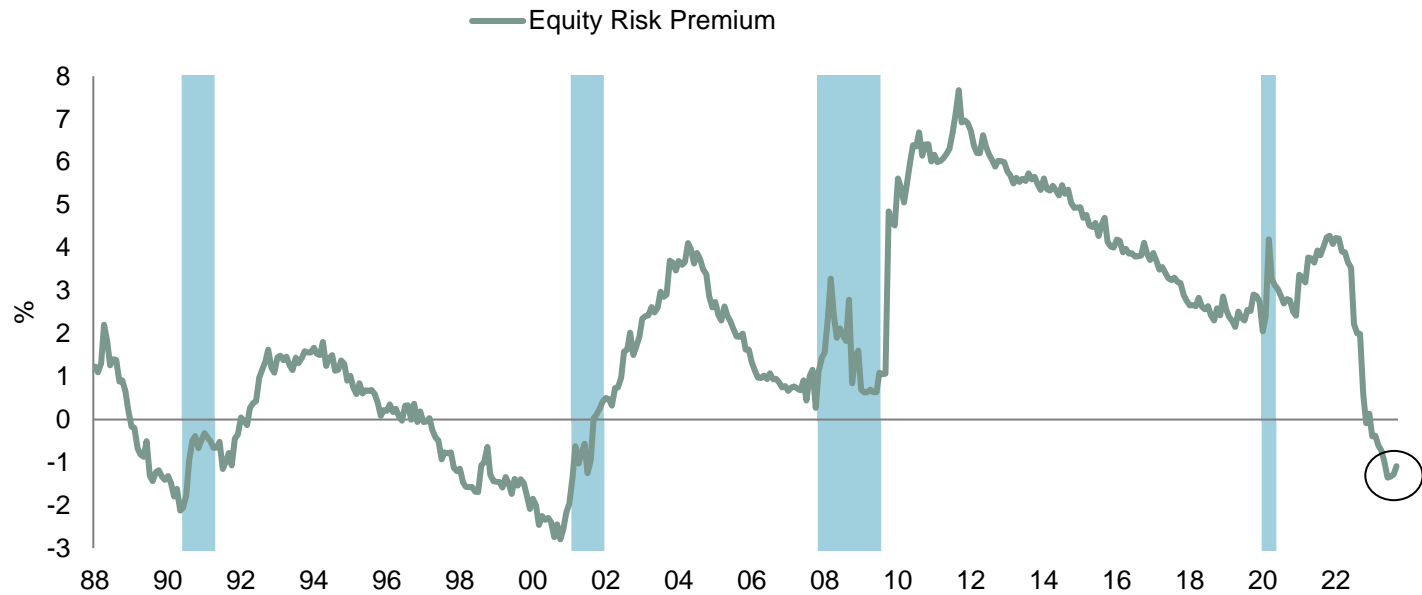
Fellow Travelers

Stocks generally trend with liquidity.



Negative Equity Risk Premium

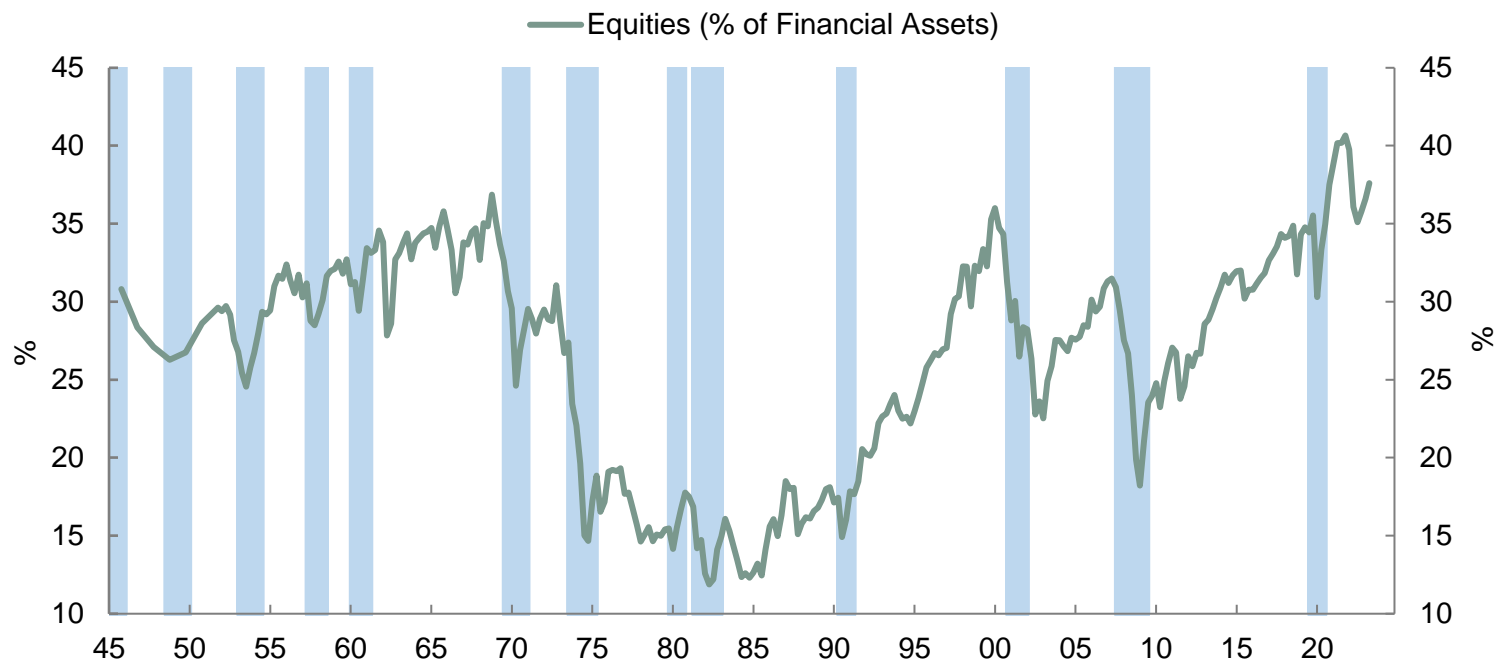
Equities have not been this overvalued relative to Treasuries since the late 1990s tech bubble.



Sources: FRB, Standard & Poor's, Haver, SMBC

Buying The Dip

Future returns lag when exposure is high.



Disclaimers

This document is provided by SMBC Group (including, collectively or individually, Sumitomo Mitsui Banking Corporation, SMBC Nikko Securities America, Inc., and their affiliates, as applicable) for informational purposes only. This document was prepared by SMBC Group'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 Group. 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 Group 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 Group does 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 Group. The trading desks of SMBC Group 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 Group may conflict with those of the recipient. SMBC Group 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 policies and procedures that apply to the globally branded research reports and research analysts of SMBC Group 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 Group, and its 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.

© 2023 SMBC Group. All rights reserved.