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.
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