Slow Motion Downturn

The Index of Leading Economic Indicators (LEI) for March, released this Thursday, is projected to decline 0.7% after back-to-back -0.3% readings. If accurate, this produces the 12th consecutive decline in the LEI and lowers its year-over-year growth rate to a new low of -7.1% versus -6.5% in February. The last time the series was this negative for this long was during 2007 to 2009. While a recession still lies ahead, its timing remains in doubt.

Excluding the pandemic there have been eight recessions since 1959, and the LEI has led every downturn. There have been no false positives. This historical fact is illustrated in the chart below which shows the level of the LEI along with recession bars. The index always peaks before the onset of recession. However, there is substantial variability in lead times among the business cycles.

The average lead-time from the peak in the LEI to the peak in the economy is 11 months. But the LEI led the 1960 economic peak (not shown in chart for scaling purposes) by just two months. Then before the 1969 and 1973 recessions, the lead times were eight and nine months, respectively.

However, the recession that began in 1980 saw the LEI peak 15 months earlier (October 1978) but then just eight months before the July 1981 top. The variability continued into the next business cycle where there was a 17-month gap between the LEI and the economy ahead of the 1990 recession.

Next, the LEI peaked 11 months before the 2001 downturn but then led by a whopping 21 months before the economy hit its zenith in December 2007. This is by far the longest lead time of the eight business cycles, and our hunch is that history could repeat. Consequently, if we duplicate this episode, it implies the economy will continue to grow until this September. This is a still a long way away given how many forecasters have been calling for recession for a while.

Right now, the bond market effectively has a similar view as the LEI in that a downturn is at least a handful of months away. The fed funds futures are predicting one last 25 basis point (bp) rate hike at the May 3rd FOMC meeting but then expects a 25 bp cut at the September 20th FOMC meeting. Stay tuned.
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