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.
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 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.

This document 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.