

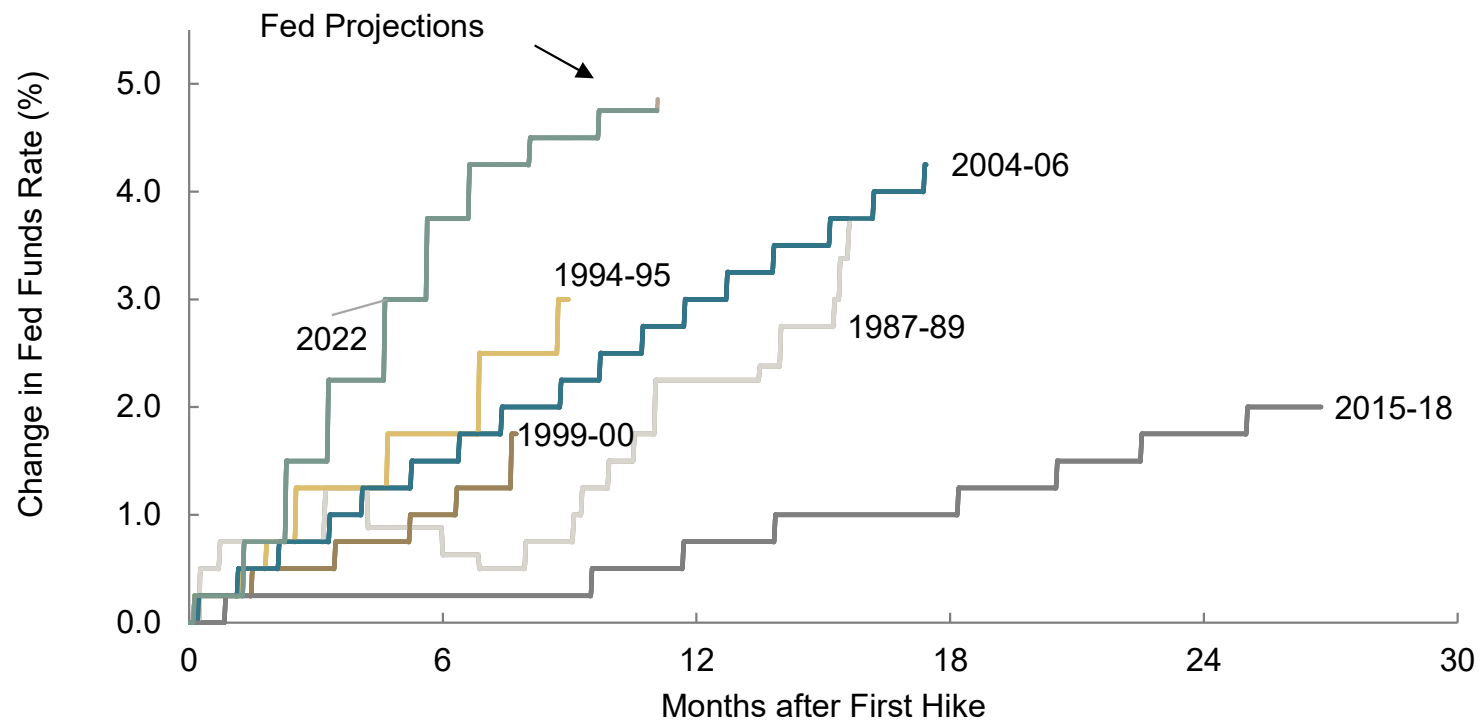
The 2023 Slowcession

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April 20, 2023

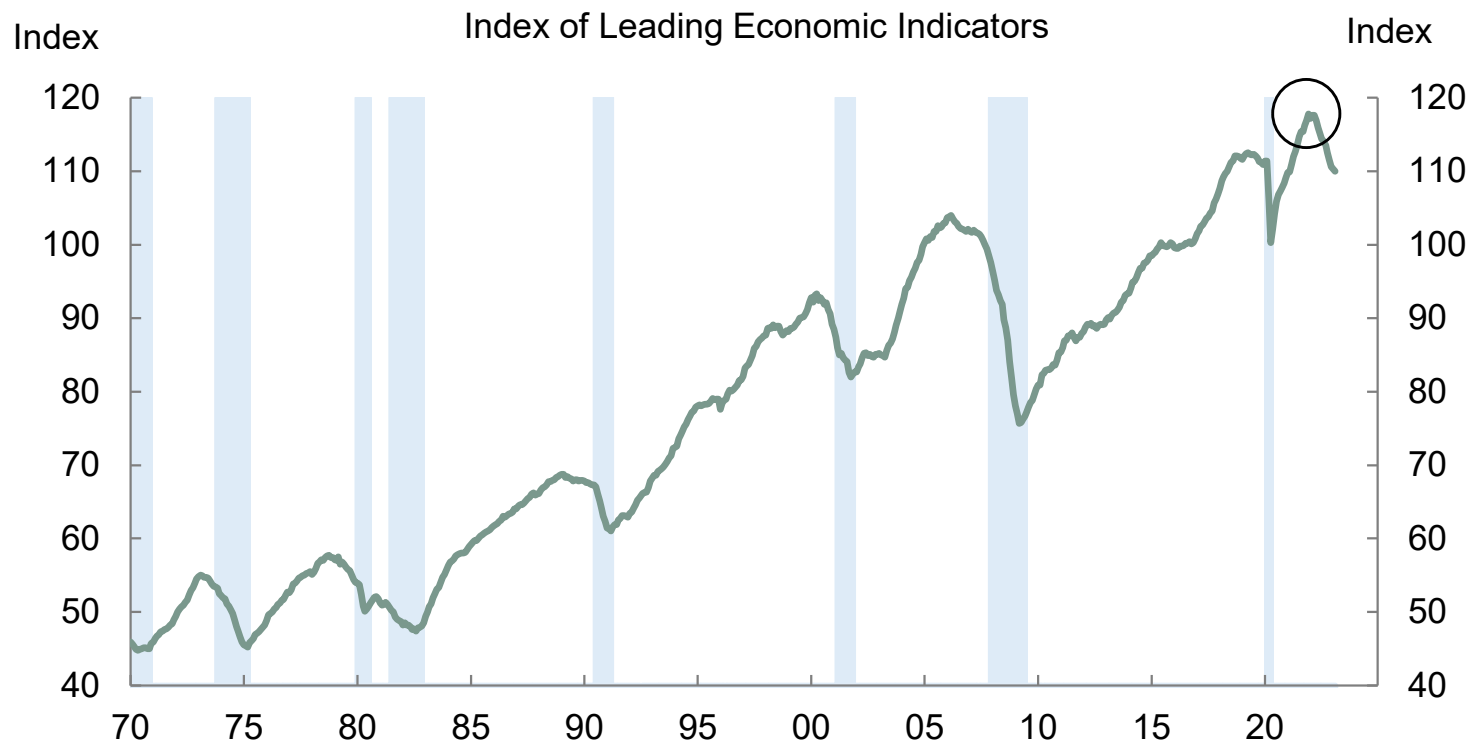
A Record Rise in Fed Funds

The Fed has raised rates at the fastest pace in more than four decades. The funds rate is in highly restrictive territory. This is evident from the slope of the yield curve and the level of real interest rates.



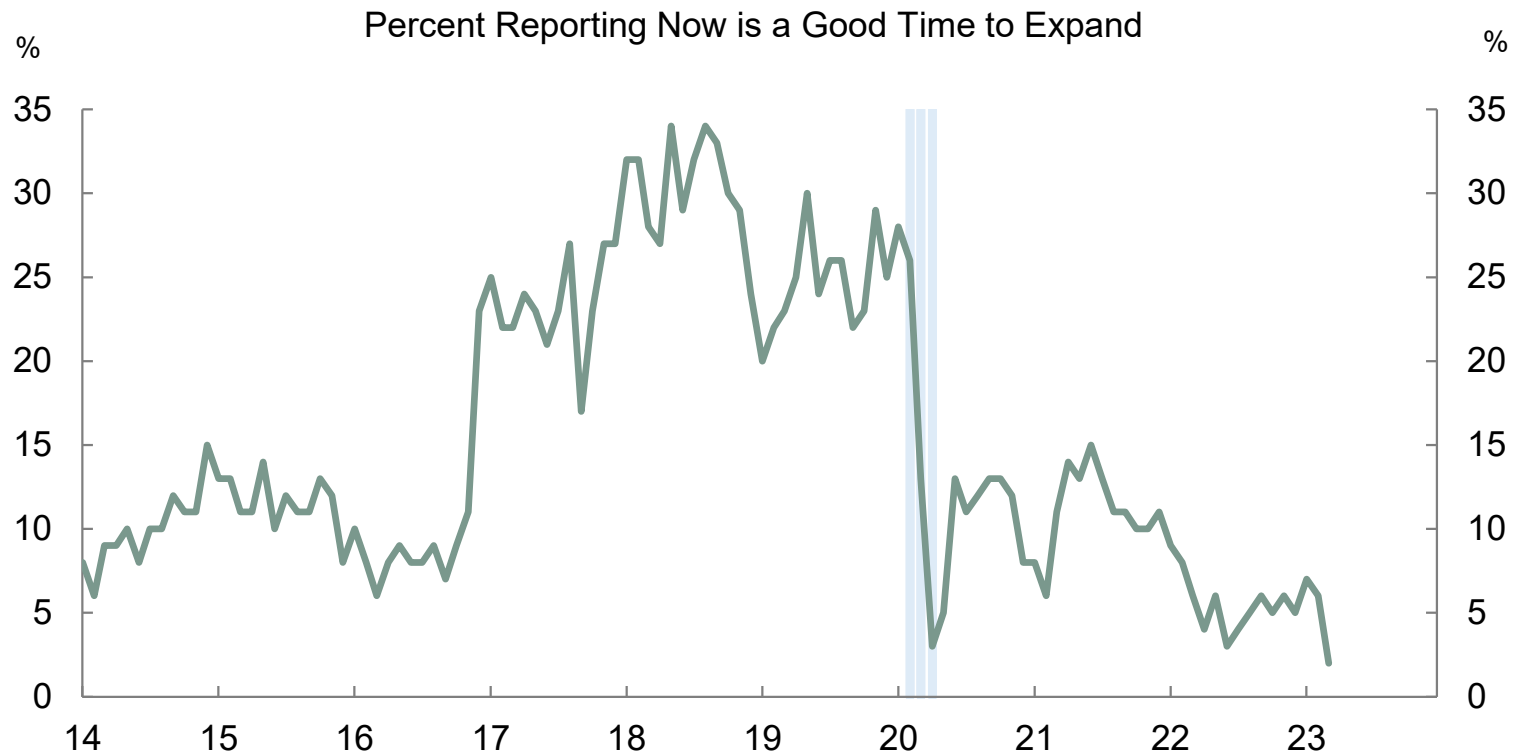
When Does the Recession Begin?

Historically, the Index of Leading Economic Indicators (LEI) tops out 11 months before the peak in GDP. But the lead time can be much longer, as it took 21 months from the 2006 peak in the LEI to the 2007 peak in real GDP.



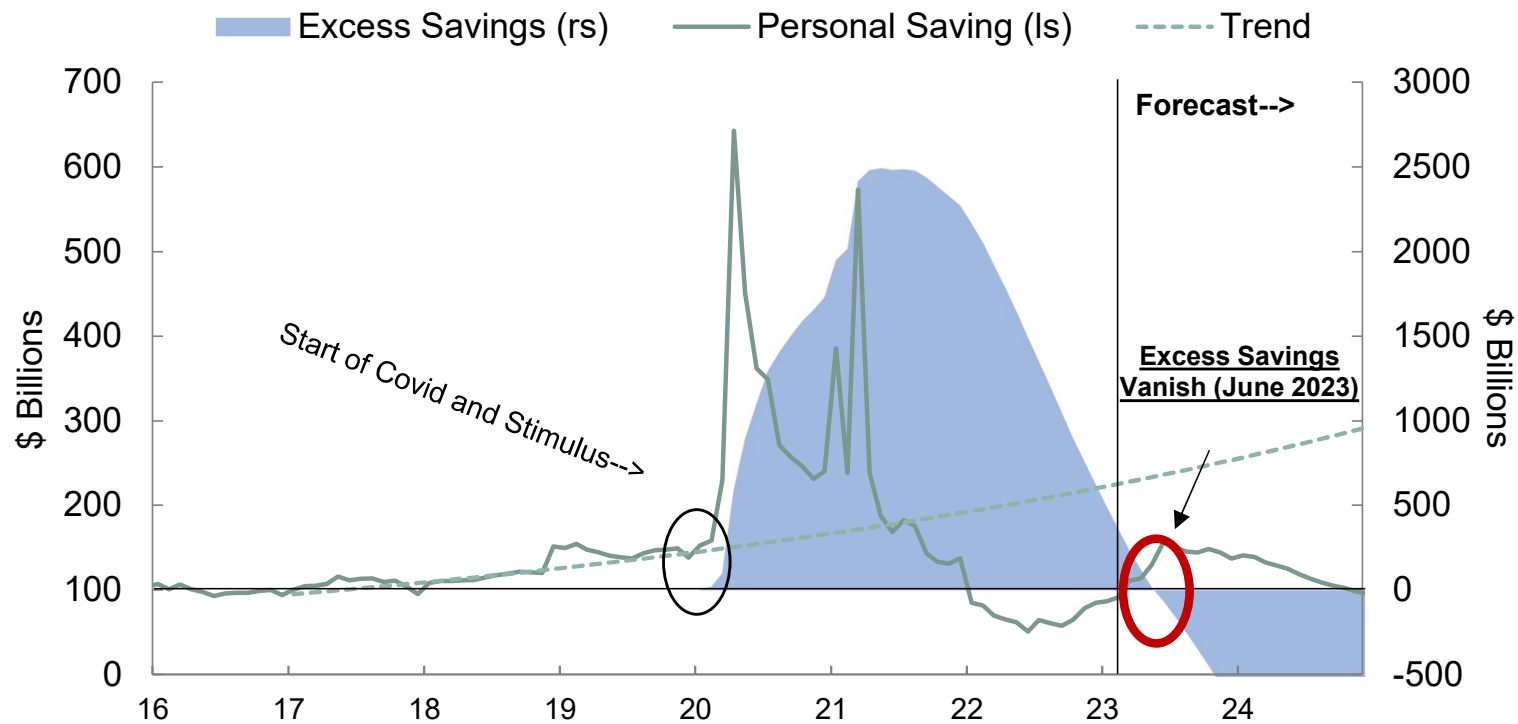
Negativity Abounds

The percent of small businesses reporting that “now is a good time to expand” is hovering near a record low reading.



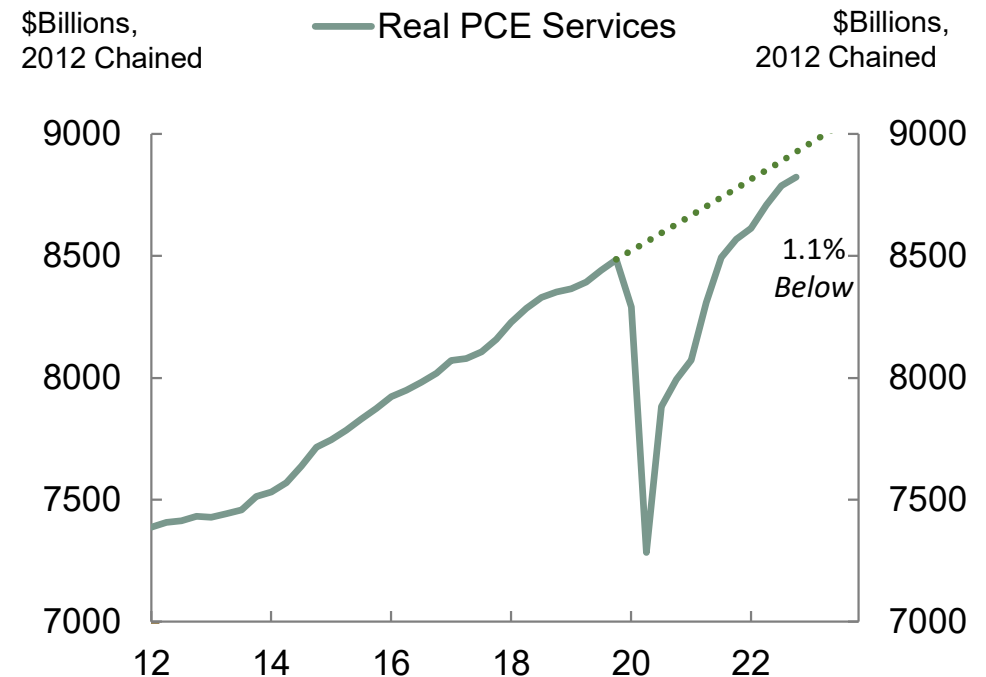
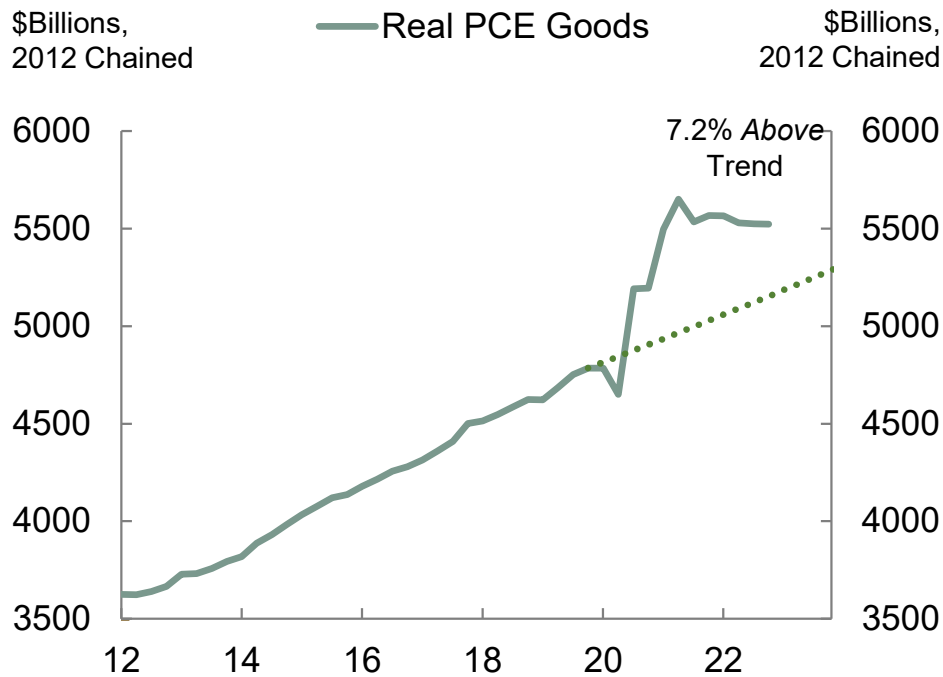
Almost Depleted?

Households may still have “excess savings” from past covid-related stimulus plans. Recent trends suggests these funds may run about by this June.



Lingering Pandemic Effects

Spending on consumer goods is still well above its long-term pre-pandemic trend while spending on services are nearly back its pre-pandemic trend.



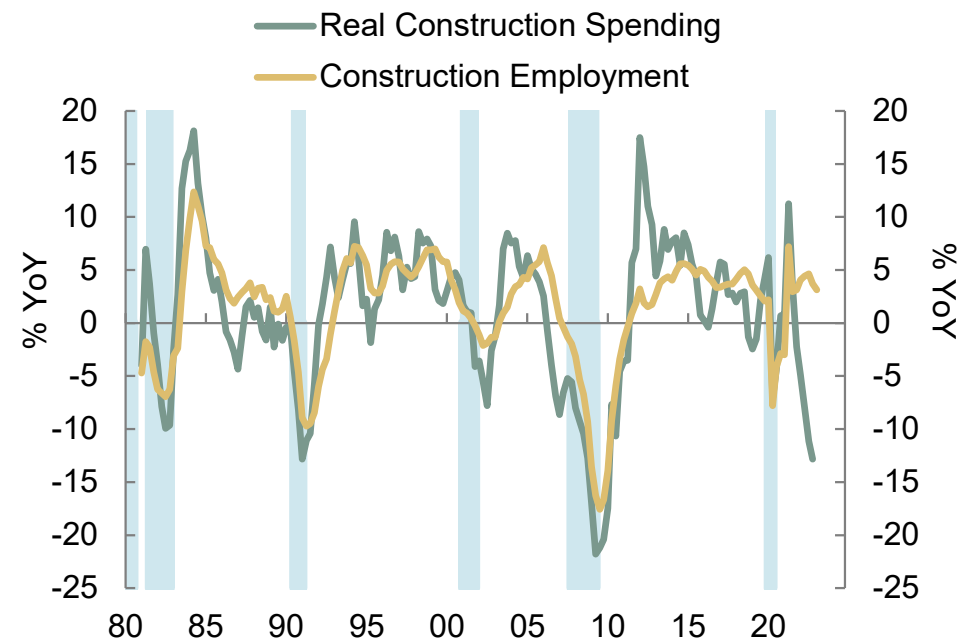
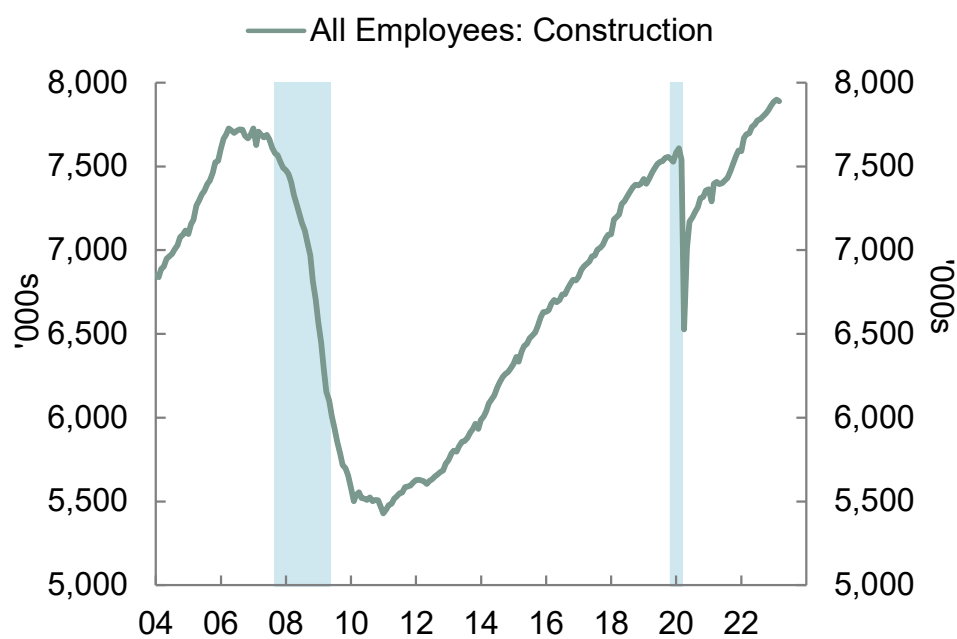
Watch the Unemployment Rate

The unemployment rate is an excellent leading indicator of the economy. In the past, it bottomed six months before the onset of recession, rising an average of 40 basis points from its cyclical low.

Trough in Unemployment	Peak in Economic Activity	Lead Time (Months)
October 1948	November 1948	1
June 1953	July 1953	1
March 1957	August 1957	5
February 1960	April 1960	2
May 1969	December 1969	7
October 1973	November 1973	1
May 1979	January 1980	8
July 1981	July 1981	0
March 1989	July 1990	17
April 2000	March 2001	11
May 2007	December 2007	7
	Average ->	5
	Median ->	5

On the Cusp of Major Weakening

While the number construction jobs is close to an all-time time, construction spending has collapsed. This points to a significant pullback in employment, enough to push the unemployment rate up nearly half of one percentage point.



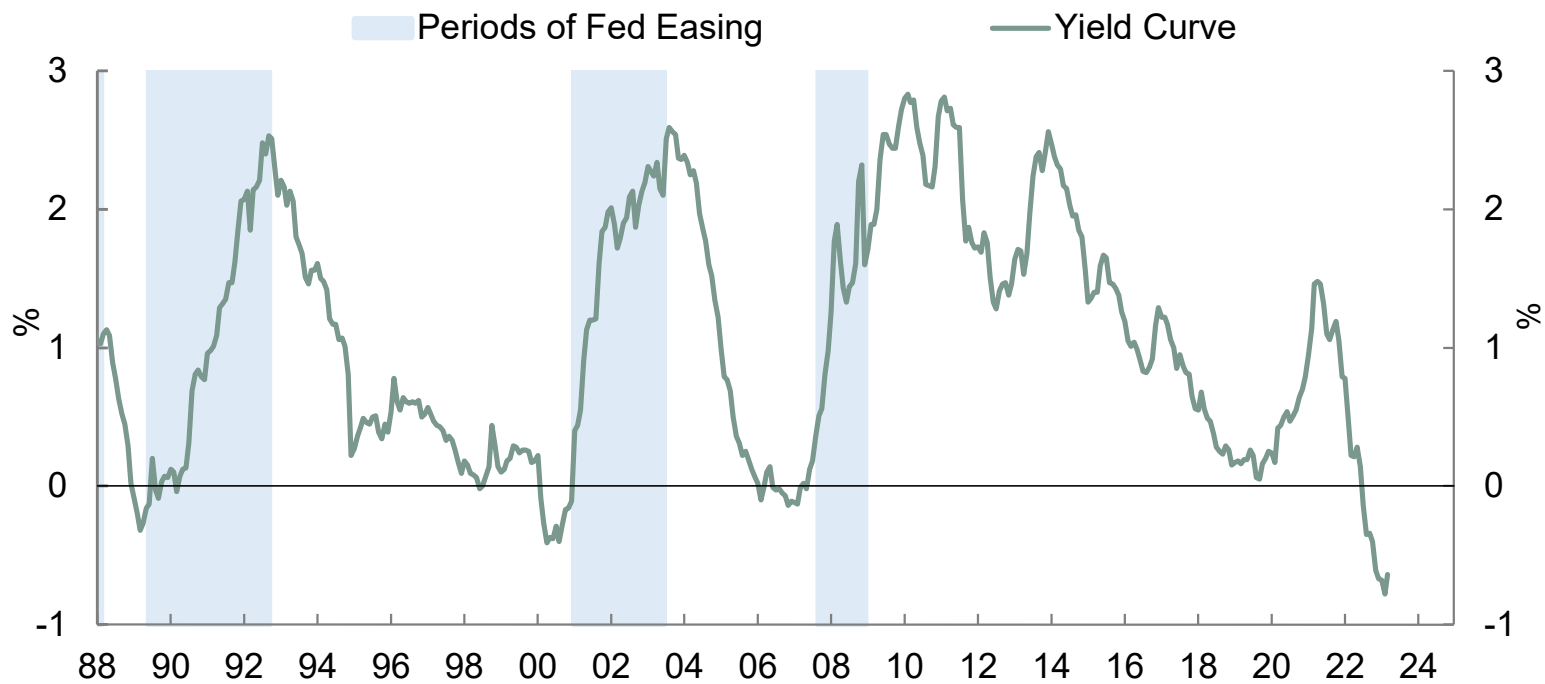
The Bond Market Always Knows

When the 2s/10s treasury curve inverts, a recession always ensues. The curve inverted last July, and the average lead time from inversion to peak economic activity is 13 months.

Date of Yield Curve Inversion	Peak in Economic Activity	Lead Time (Months)
September 1956	August 1957	11
July 1959	April 1960	9
December 1968	December 1969	12
March 1973	November 1973	8
September 1978	January 1980	16
September 1980	July 1981	10
January 1989	July 1990	18
February 2000	March 2001	13
February 2006	December 2007	22
	Average ->	13

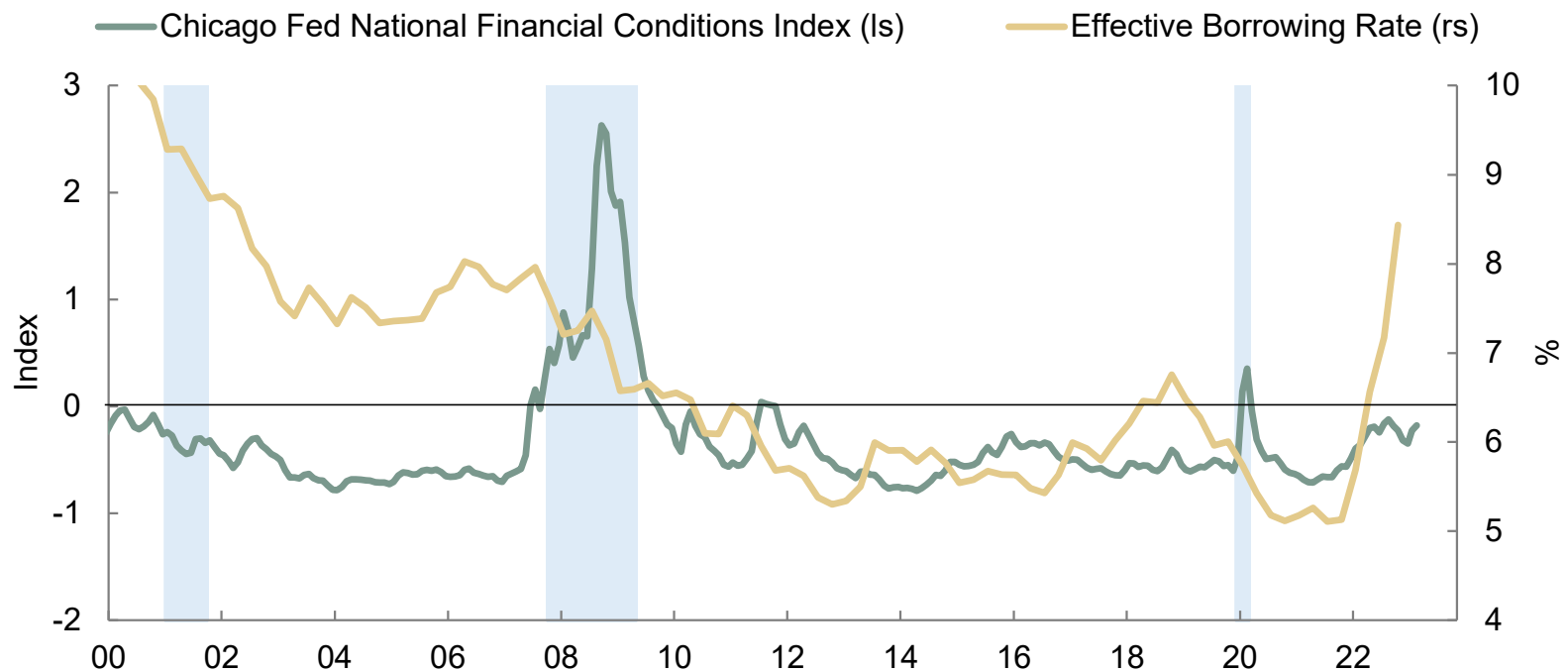
Massive Bear Flattening

The 2s/10s curve steepens or normalizes only when the Fed lowers interest rates. When will the Fed cut?



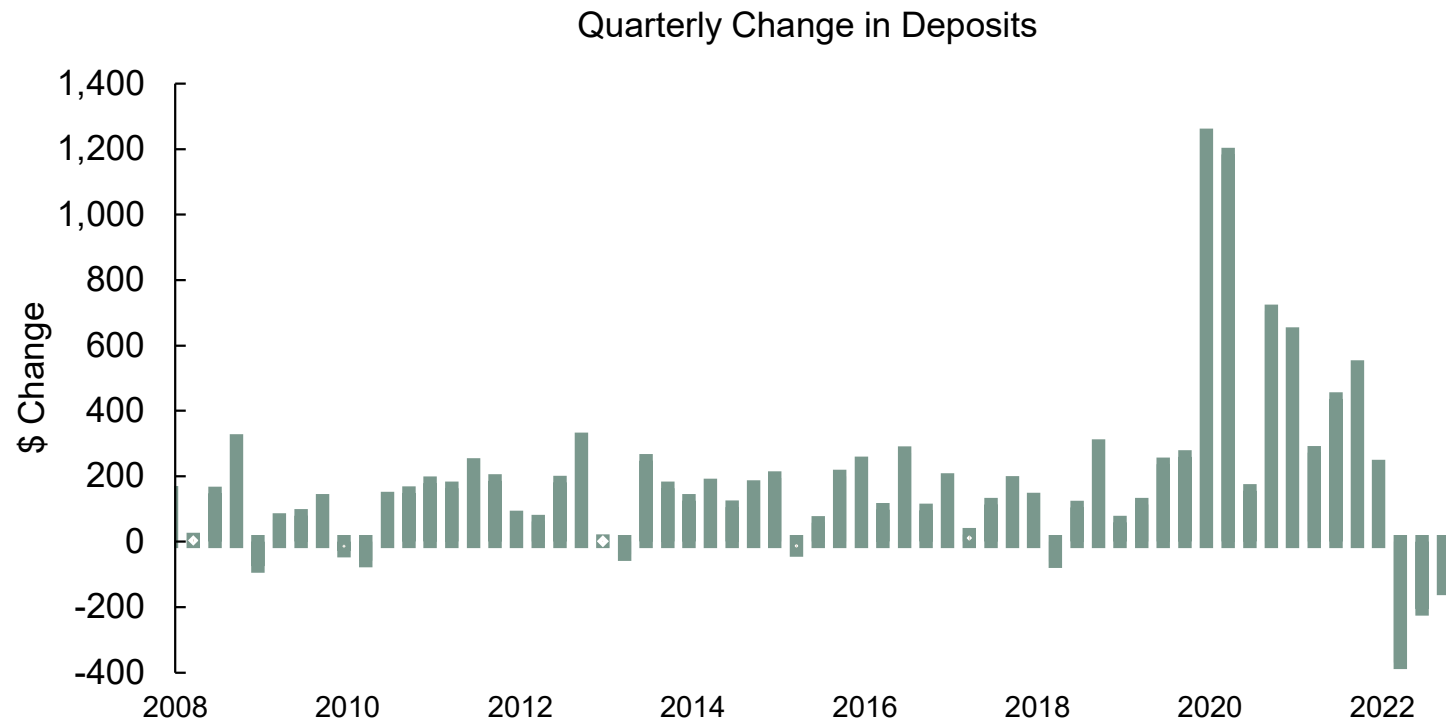
Looking at the Wrong Metric

Financial conditions for consumers have significantly tightened. Borrowing costs for homes, autos, credit cards and personal loans are at their highest readings in over two decades.



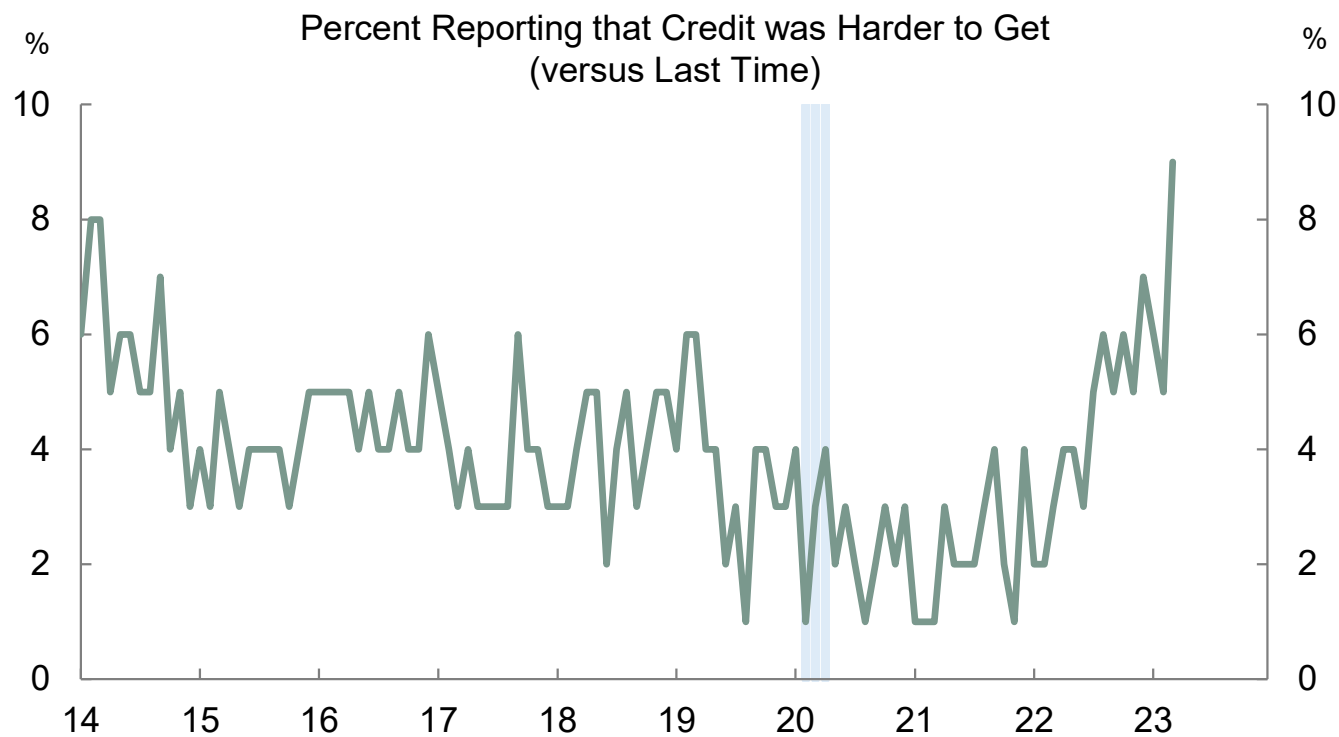
Massive Outflow of Deposits

Last year commercial banks saw record deposit flight because their customers sought higher yields elsewhere. The persistence of an elevated fed funds rate will prolong this dynamic.



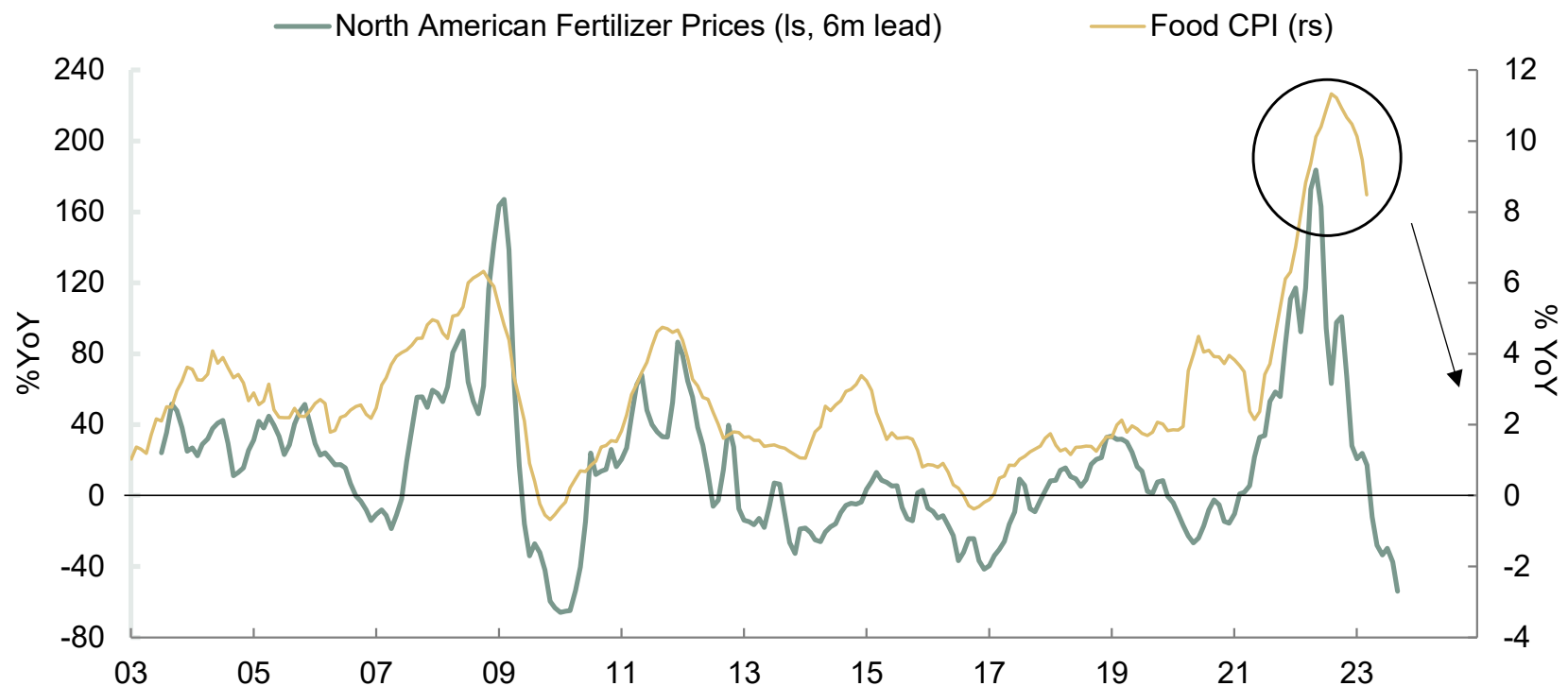
Credit Crunch Ahead

Small businesses are reporting much greater difficulty obtaining credit. This development should be a headwind to economic growth.



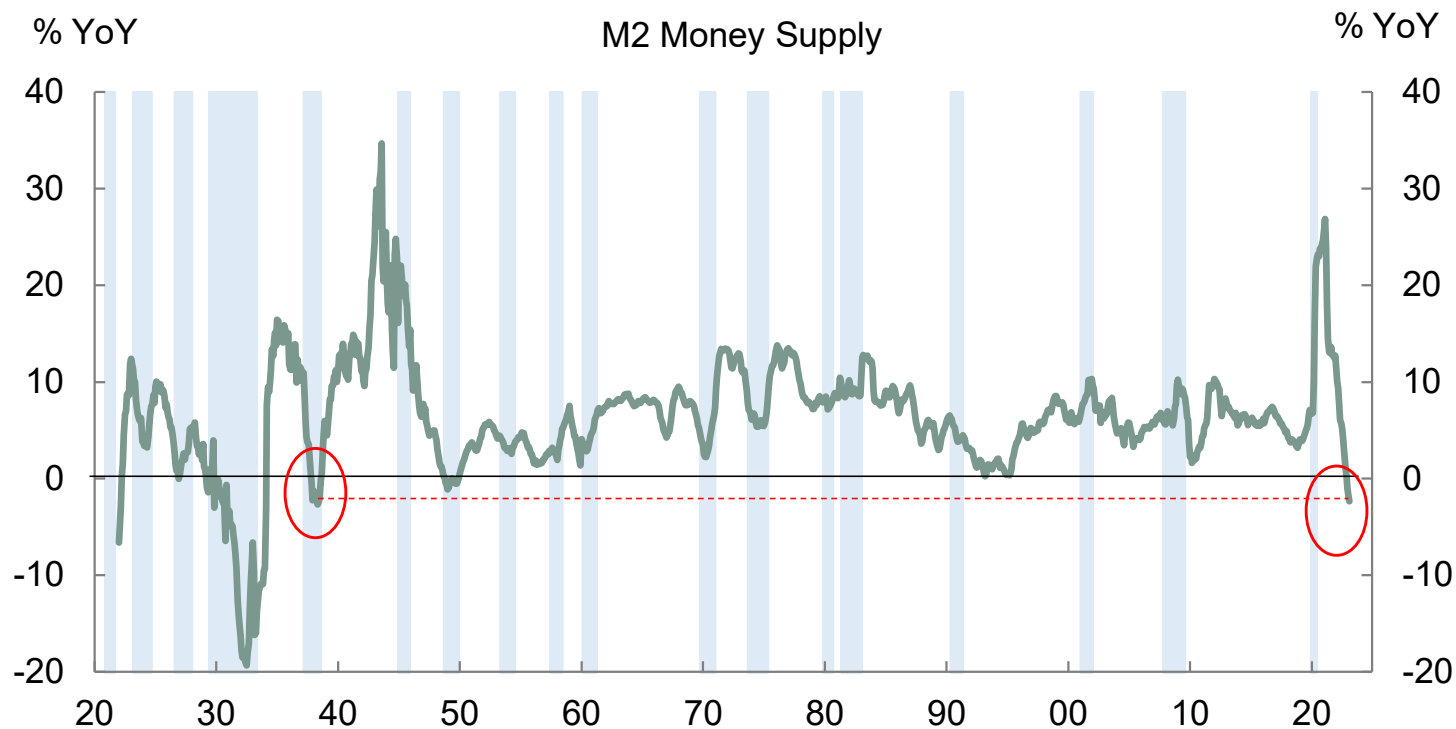
Inflation Peaked

Food accounts for nearly 14% of headline inflation and were a key factor pushing prices higher last year. The sharp decline fertilizer prices points to lower food costs in the months immediately ahead.



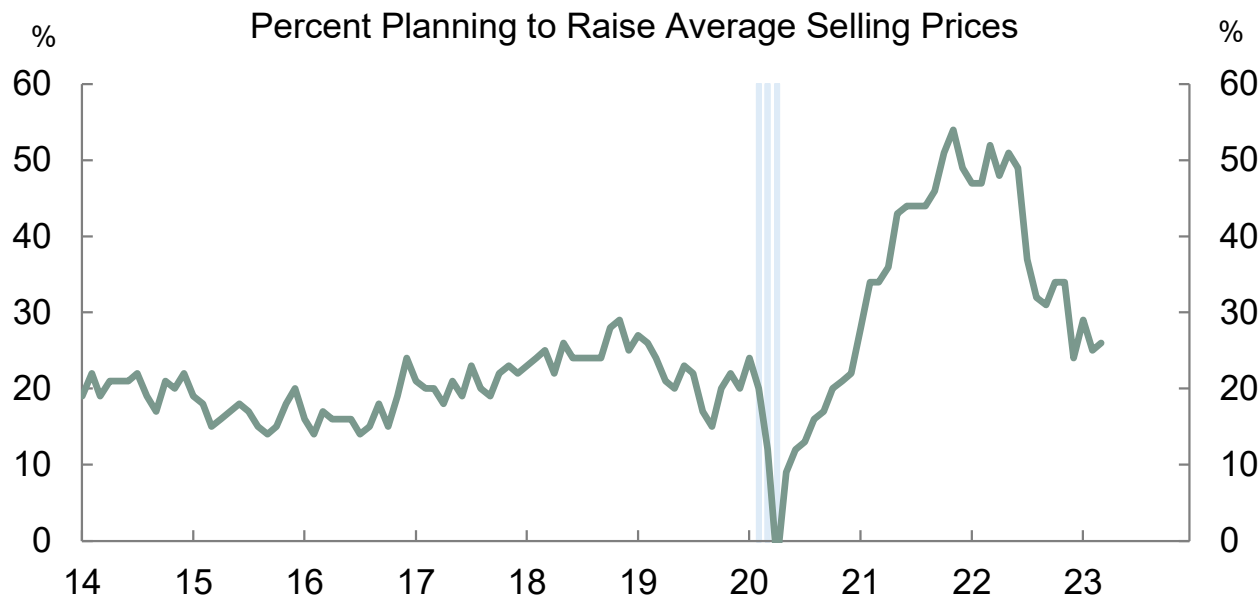
Record Surge Followed by Record Decline

An epic surge in money growth has given way to an epic slowdown in money growth. This is another reason the economy is past its inflation inflection point.



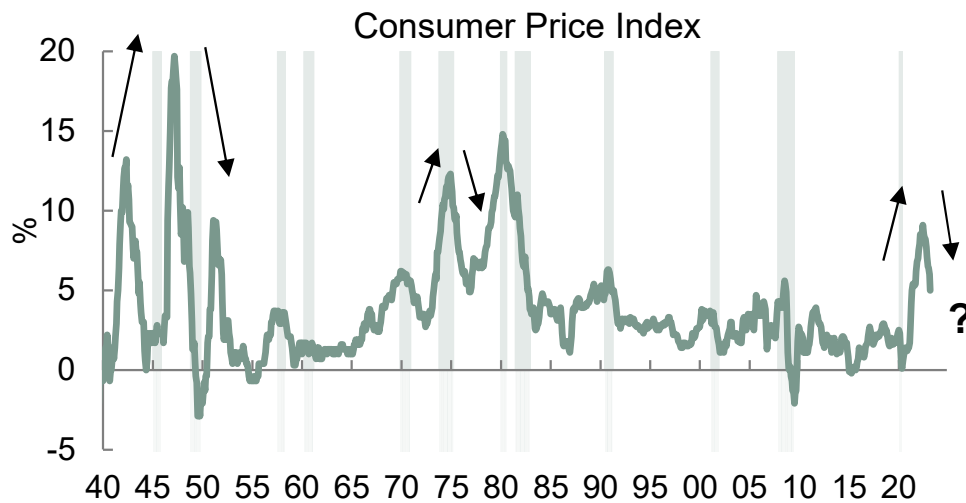
Weakening Pricing Power

The percent of small businesses planning to raise average selling prices has fallen dramatically and is close to its pre-covid readings. If the economy slows sharply in the quarters ahead, pricing power should meaningfully weaken.



What Goes Up Quickly, Comes Down Quickly

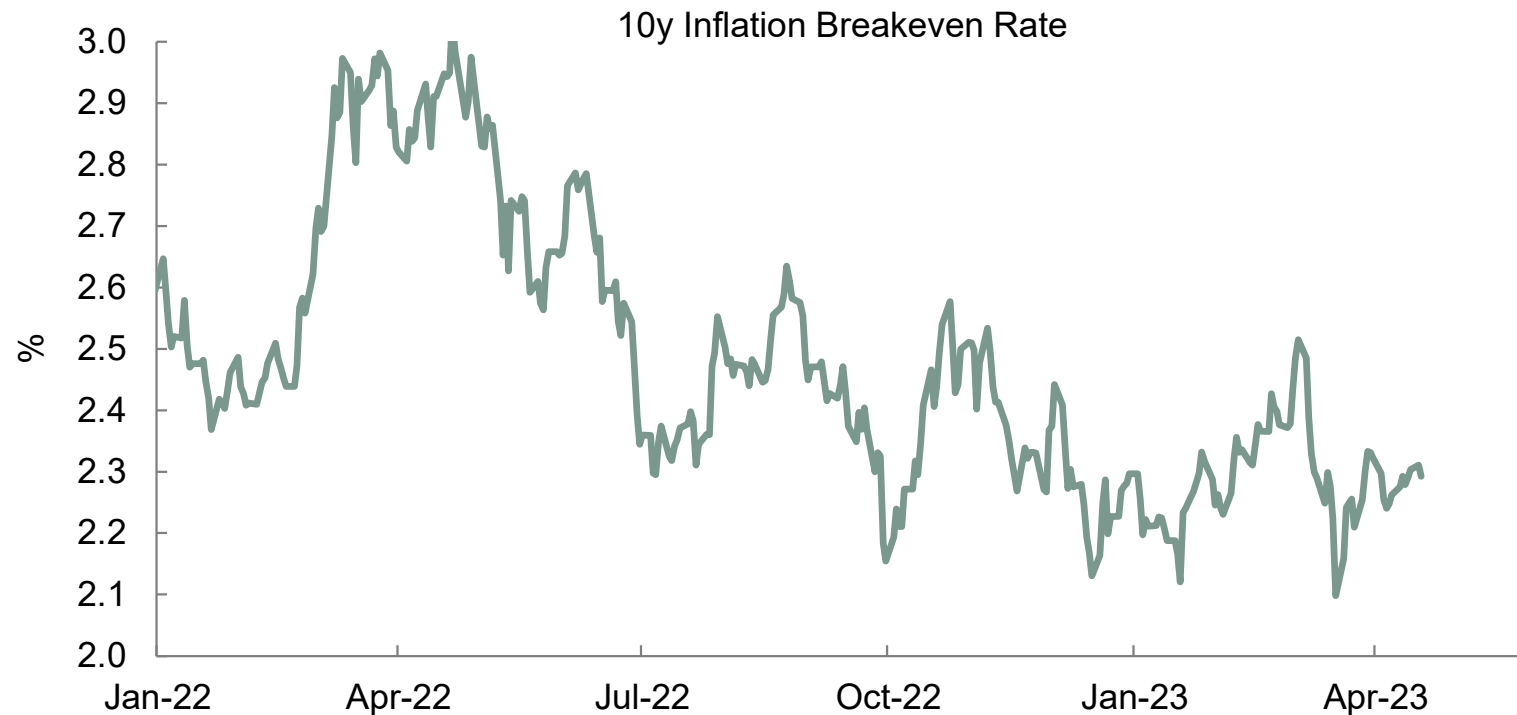
inflation does not plateau, rather it spikes. More importantly, the acceleration in inflation is equally matched a deceleration in inflation. History is currently repeating.



Inflation Upwing	Slope	Inflation Downwing	Slope
Sep 1940 to May 1942	0.35	May 1942 to May 1944	-0.47
Feb 1946 - Mar 1947	1.61	Mar 1947 to Apr 1949	-0.66
Jul 1949 - Feb 1951	0.58	Feb 1951 to Oct 1954	-0.21
May 1967 - Dec 1969	0.12	Dec 1969 - Jun 1972	-0.12
Jun 1972 to Dec 1974	0.37	Dec 1974 to Nov 1976	-0.31
Nov 1976 to Mar 1980	0.22	Mar 1980 to Jun 1983	-0.31
Jun 1986 to Sep 1990	0.07	Sep 1990 to Jan 1992	-0.25
Aug 2007 to Jul 2008	0.22	July 2008 to Dec 2008	-1.19
May 2020 to Jun 2022	0.38	Jun 2022 to ?	
Average 1940-2008	0.44	Average 1940-2008	-0.44

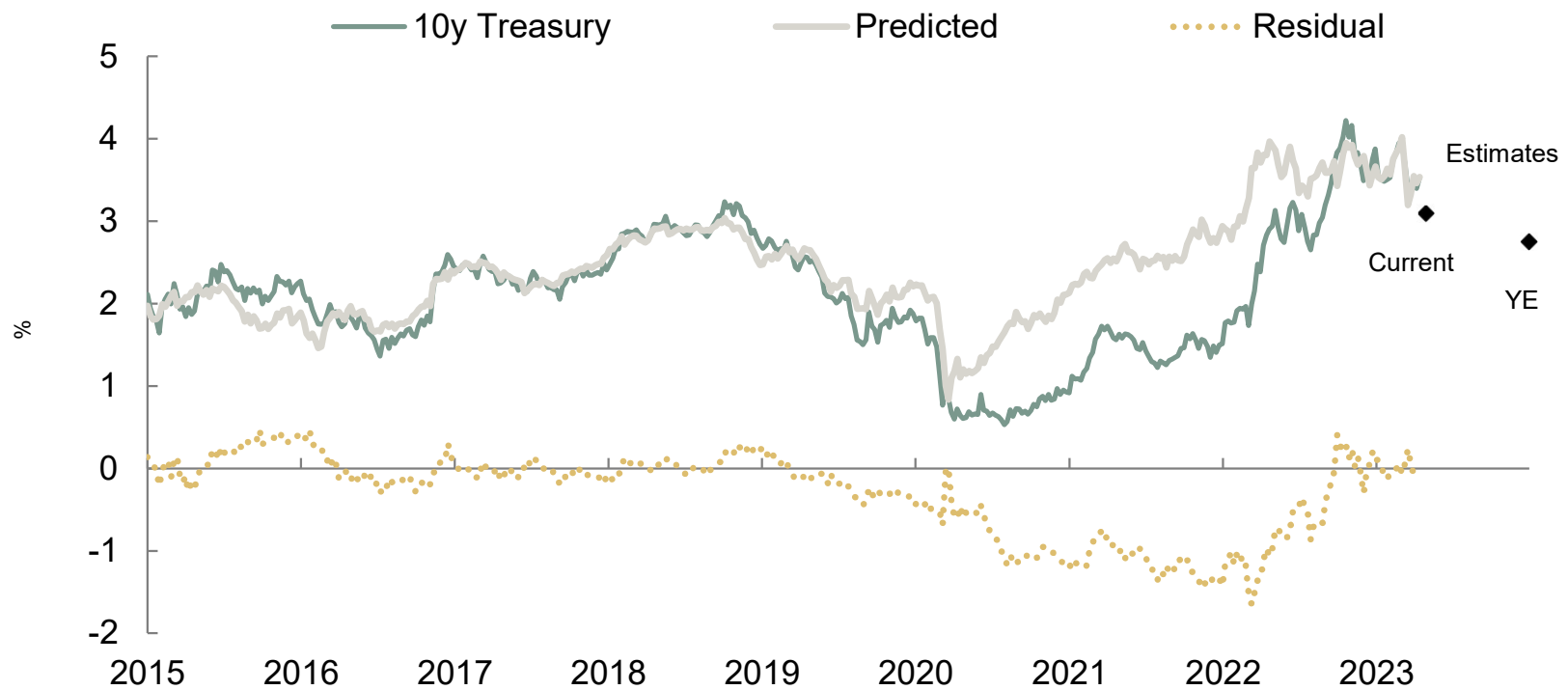
Stable Inflation Expectations

Despite elevated inflation, the bond market remains sanguine on the inflation outlook. Breakeven inflation has been low and stable.



Whither Long-Term Interest Rates?

Breakeven inflation and the one-year forward fed funds contract explains 90% of the yield on the 10-year treasury note. If inflation expectations remain stable, the direction of long-term yields will be dictated the path of the fed funds rate.



How Low Can They go?

When the Fed eases policy, official interest rates generally fall a lot. The average decline in the fed funds rate is over 400 basis points.

How Much does the Fed Cut in Cutting Cycles?		
First Fed Rate Cut (Month)	Total Cuts (Bps)	Occurring over... (Months)
March 1960	280	17
December 1966	197	8
September 1969	547	18
October 1973	556	20
January 1980	479	7
February 1981	438	2
July 1981	1059	20
September 1984	563	24
November 1987	81	4
June 1989	681	40
July 1995	75	7
September 1998	75	3
January 2001	550	30
September 2007	513	16
July 2019	75	3
Average ->	411	15

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