U.S. Recession Scorecard

January 2025

New year, same Scorecard

For most of the first half of last year the Scorecard—that had been all expansionary "green" in 2021—looked to be sliding inexorably toward all recessionary "red." However, the second half saw little to no movement among the indicator ratings. And, as the U.S. economy enters 2025, the Scorecard's leading indicators are looking more undecided than ever. One or two could ease back into more optimistic ratings if some modestly positive trends were to firm up, while others could become more negative.

Many are of the view that time has run out on the possibility of a recession arriving in the wake of a Fed rate-hiking cycle that looks to be over. It would be nice to think so, but we think there are at least two "clocks" still ticking.

Recessions since the early 1950s have started an average of 10 quarters after the first Fed rate hike. We have just completed the 11th. For more than half those recessions, the first-hike-to-recession gap was longer than the 10-quarter average.

And, as noted below, the yield curve had de-inverted before or just as the recession got underway for seven of the past 10 U.S. recessions. De-inversion in the current instance occurred in November.

U.S. Recession Scorecard

Indicator	Status		
	Expansionary	Neutral/ Cautionary	Recessionary
Yield curve (10-year to 1-year Treasuries)			✓
Unemployment claims		✓	
Unemployment rate			✓
Conference Board Leading Economic Index			✓
Non-financial corporate cash flows	✓		
ISM New Orders minus Inventories		✓	
Fed funds rate vs. nominal GDP growth			✓

Source - RBC Wealth Management

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All values in U.S. dollars and priced as of market close, Dec. 31, 2024 unless otherwise stated.

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U.S. RECESSION SCORECARD

On balance, we are of the view that a mixed Scorecard argues for a watchful, cautious approach for investors.

Yield curve

In November, the yield curve finally returned to a normal positioning—that is, short-term Treasury yields are once again lower than long-term yields. Most of this shift from inversion to normalization of the curve occurred in the last four months of the year as a succession of Fed rate cuts lowered short yields by about 100 basis points. Over the same interval, the 10-year Treasury yield was heading in the opposite direction, rising by about 100 basis points, as investors worried that inflation might stay higher than hoped under the influence of a stronger-than-expected U.S. economy and the prospect for broad implementation of tariffs.

This crossover late last year ended the longest-ever inversion of the curve—29 months—from July 2022 to November 2024. The good news is that the drag from the extended period of tight monetary conditions should gradually abate across the economy. However, the historical record would argue there remains room for a recession. In seven of the past 10 U.S. recessions, the yield curve had de-inverted before or just as the recession got underway.

Occasionally, Fed tightening produced a soft landing rather than a recession. In those instances, while interest rates rose by a meaningful amount, banks did not overtly tighten lending standards. However, whenever they did, the combination of high rates and tight lending conditions produced a recession.

In this latest Fed tightening cycle, a growing majority of banks progressively raised lending standards alongside Fed rate hikes. And even with the Fed having cut its funds rate by 100 basis points, for most categories of loans a majority of banks (albeit a narrowing one) continue to raise lending standards.

Nor have loan rates come down appreciably:

- Credit card rates today average close to 24% vs. 16% three years ago;
- Car loans cost just shy of 9% vs. 4.5%; and
- 30-year mortgage rates sit at 7.2% vs. 3%.

This “stickiness” of both loan rates and bank lending standards after four months and 100 basis points of Fed rate cutting conforms with the notion that monetary policy changes act with a lag of six months to a year. To move the yield curve rating out of the “red” column we would want to see the gap between short and long rates widen further accompanied by a measurable decline in borrowing rates with a clear majority of banks easing lending standards.

Conference Board Leading Economic Index

The U.S. leading index rose by 0.3% in November after 30 straight months of decline. That increase is being interpreted by the Conference Board as signaling no U.S. recession is imminent. For our part, we would need to see several months of a sustained reversal in trend before moving this indicator to a more benign rating.

Unemployment claims

Claims set a low for this cycle in September 2022, but subsequently they have failed to establish the sustained upward trend that typically precedes the start of a recession. The weekly count jumped sharply higher in early December, but the seasonal adjustment factor around the holiday period is generally regarded as unreliable. We think “undecided” is the correct interpretation of the claims data as things stand.

U.S. RECESSION SCORECARD

Unemployment rate

The unemployment rate usually surges higher just before or just as a recession is getting underway. Typically, it takes an upward move of as little as half-of-one percentage point from the cycle low to signal the start of recession. The low for the unemployment rate was set at 3.4% in April 2023, so that condition has been met. However, as with claims, the anticipated "surge" higher has been more of a "creep" to a recent high of 4.3%. The unemployment rate sits at 4.2% as of this writing.

Also, like claims, seasonality adjustments in December and January may be suspect. That concern notwithstanding, were the unemployment rate to settle back below 4%, we would re-rate this indicator to "neutral/cautionary."

ISM New Orders minus Inventories

The difference between the New Orders and Inventories sub-indexes of the ISM Purchasing Managers' Index has turned negative near the start of most U.S. recessions. But it has also registered occasional false positives—signaling a recession was imminent when none subsequently arrived. Moreover, this indicator only relates to activity in the manufacturing sector (some 15% of the U.S. economy) and is derived from a survey rather than hard data. For those reasons, we look at it as a corroborative indicator rather than a decisive one taken on its own.

After setting its most recent low in September 2022, this series rose steadily (we use a three-month moving average) and moved back above zero in August 2023. It has managed to stay above zero over the intervening 16 months, despite the fact the new orders component by itself remained predominantly negative, recording only three positive monthly readings over the past 27 months. The rating for this indicator remains at "neutral/cautionary."

Fed funds rate vs. nominal GDP growth

The fed funds rate has risen above the six-month annualized run rate of nominal GDP either before or at the start of every recession in the past 70 years. (Nominal GDP is GDP not adjusted for inflation.) That GDP run rate has been declining since its pandemic reopening high of 23% recorded in Q4 2020. By the end of last year, it had slowed to 6.7%, still above the 5.50% fed funds rate. However, for Q2 and most of Q3 the six-month annualized run rate of nominal GDP was running below where the fed funds rate sat at the time, meeting the condition observed before every recession. This indicator remains in the recessionary "red" column.

Non-financial corporate cash flows

This gives an indication of the ability of such businesses, in aggregate, to internally fund any capital spending they want or need to do. Historically, whenever it has posted a year-over-year negative reading, a decline in corporate capital spending has typically followed, either indicating a recession is coming or a deepening one is already underway. These cash flows, while down from their pandemic peak, are still above a negative crossing point as of Q3, which leaves it as the sole indicator still giving the U.S. economy an expansionary "green" light. There is a long lag time before this data is reported with the Q4 release not coming until March.

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