U.S. Recession Scorecard

May 2024

Discomfort zone?

There have been no changes to our Scorecard ratings for several months; however, one is in the works but not yet confirmed. If the pending change (see "Fed funds rate vs. nominal GDP growth" below) were to be implemented, that would leave the overall rating awkwardly balanced between three arguing a U.S. recession is likely to arrive within a few months, two continuing to give the economic expansion a green light, and two at a neutral setting.

In one sense the "expectations landscape" has arrived at an important timing juncture: On average, recessions have arrived 25 months following the first fed funds rate hike—which, in this case, would be last month, April 2024. However, although the average elapsed time from the "first hike" to recession is slightly more than two years, in more than half the instances measured, the wait time was longer than 25 months.

Our two most reliable leading indicators of U.S. recession are in the outright negative column. While the "average" experience of both pointed to last summer as a recession kick-off date, both have histories with instances of much longer signal-to-recession intervals. Note that the official start date of any recession may not be announced until many months or quarters after the fact, so the soft vs. hard landing debate won't be settled for some considerable time yet.

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Indicator	Status: Expansionary	Status: Neutral	Status: Recessionary
Yield curve (10-year to 1-year Treasuries)			✓
Unemployment claims		✓	
Unemployment rate	✓		
Conference Board Leading Economic Index			✓
Free cash flow of non-financial corporate business	✓		
ISM New Orders minus Inventories		✓	
Fed funds rate vs. nominal GDP growth		✓	

Source - RBC Wealth Management

For important and required non-U.S. analyst disclosures, see page 5.

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Yield curve (10-year to 1-year Treasuries)

The 1-year Treasury yield rose above the 10-year yield decisively in July 2022, with the negative gap growing further over most of the following year, reaching its widest point in June 2023. The average historical experience of this indicator after crossing into negative territory suggests the U.S. economy would have been in recession by late last summer. However, while the average time interval between "inversion" of the yield curve and the onset of recession is 13 months, in four instances the gap was longer than average, with the longest being 23 months.

Yield curve inversion is an unequivocal indication that credit conditions are tightening, a fact underscored by the message delivered consistently for seven consecutive quarters by the Fed's Senior Loan Officer Survey (most recent issue released on Feb. 5). A majority of U.S. banks continue to raise lending standards on almost every category of business and consumer loan, including commercial and industrial loans for businesses of all sizes, credit card loans, consumer installment loans, mortgage loans, and commercial real estate loans.

The negative spread between the 1-year yield and the 10-year yield reached its widest point this cycle so far last June at 158 basis points (bps). It has since narrowed dramatically to just 55 bps, strongly suggesting the period of "de-inversion" is underway. The crossover from "inverted" to "normal" tends to occur just as the recession is starting or a few months before.

Conference Board Leading Economic Index

Historically, this series has given reliable early warnings of recession. When the index has fallen below where it was a year earlier, a recession has always followed—usually two to three quarters later.

This indicator turned decisively negative in Q3 2022, shifting it to the red column on our Scorecard. As of the April 2024 report, the index had fallen for 22 of the preceding 23 months moving deeply into negative territory, although the rate of year-over-year decline has slowed over the past six months. The indicator has never fallen this deeply without a recession arriving.

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 last summer. After three consecutive months in positive territory, we shifted the rating from recessionary (red) to neutral (yellow) despite the fact the new orders component by itself remained decisively negative. That new orders reading finally managed to reach expansionary territory in January 2024. It has oscillated around the zero line for three months, prompting us to leave the indicator rating at yellow.

Unemployment claims

The monthly low for this cycle occurred in September 2022. The cycle low for claims has typically been registered about 12 months before the start of the next recession. So far, no lower reading has been

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posted in the intervening months, so the history of this indicator would suggest a recession could get underway as early as this summer.

The fact that temporary employment, job openings, and average hours worked have all been falling on a year-over-year basis adds to the likelihood the tide may be turning for unemployment claims. While we wait for that shift to be confirmed or for claims to subside once again, we think this ambiguity warrants leaving the indicator's status at yellow.

Unemployment rate

The unemployment rate jumped to 3.9% in February after setting a cycle low of 3.4% back in April of last year. While it edged gradually higher over the intervening 12 months, it has not yet moved into a decisive uptrend. However, any sustained move above 4.0% in the next few months, in our view, would signal a recession is on the way.

Free cash flow of non-financial businesses

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 deepening one that is already underway. These cash flows, while well down from their pandemic peak, were nowhere near a negative crossing point as of Q4 2023. There is a long lag time before this data is reported, with the Q1 release not coming until June.

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 fed funds rate at 5.50%. Now, however, the preliminary Q1 GDP data release shows the six-month run rate of nominal GDP growth, at 4.9%, has fallen below the fed funds rate, satisfying this historical precondition of a recession. We are waiting for confirmation by the second estimate of Q1 GDP to be released in late May before changing our Scorecard rating.

Clock still ticking

Weighing up the current positioning of all seven indicators and projecting their likely paths points to a growing probability the U.S. will enter a recession later this year, in our view.

Research resources

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