Harry's Take

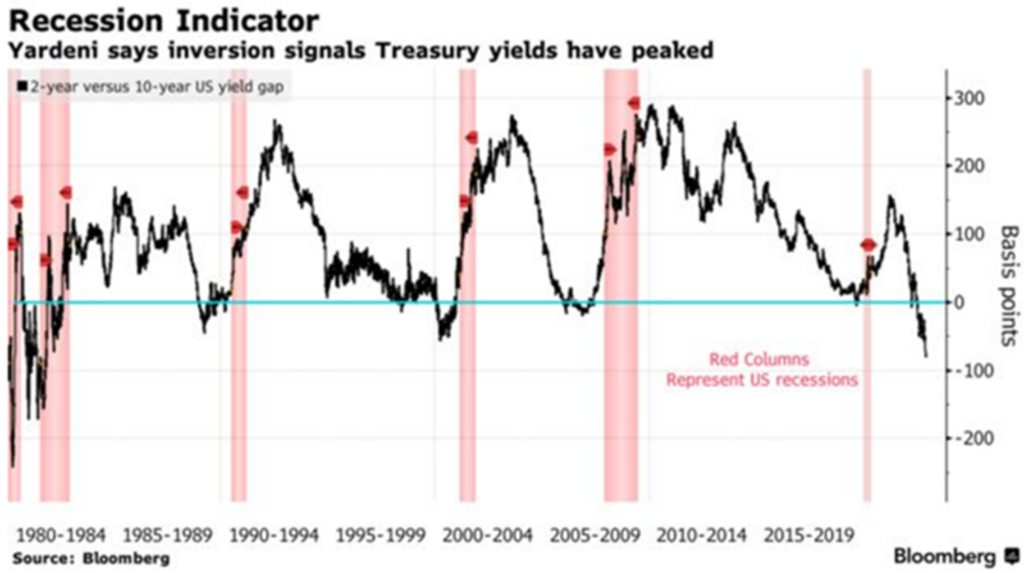
December 13, 2022

Biggest Yield-Curve Inversion Since 1980: Not Just Another Recession

Many leading indicators have been warning us of a big downturn and stock crash to come, but this one is the classic: when the yield curve inverts. Now, the long-term, 10-year Treasury bond yield has moved below the short-term, two-year yield, which tends to mean that inflation is high or is still high. But the economy looks like it is about to slow, which means inflation and yields will fall ahead from recent highs… which says a recession is coming.

This sort of thing happens rarely and just before recessions, as this chart clearly shows, where the 2-year minus the 10-year yield goes negative below the light blue line.

Biggest Treasury Yield Curve Inversion Since 1980: Recession Ahead!



Source: https://www.bloomberg.com/news/articles/2022-11-28/yardeni-says-curve-inversion-shows-bonds-stocks-have-bottomed

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The yield-curve inversion was at its highest around 250 bps (basis points, or 2.5% points) in early 1980, just before the worst recession since the Great Depression. (The 1980s recession was off-and-on from 1980 to 1983.) The yield-curve inversion was at 40 bps before the less-severe 1990 recession and at 50 bps before the minor recession of 2001. It even inverted very briefly by about 20 bps before the brief COVID recession in 2020. But now, the yield curve has inverted by just over 80 bps, and that inversion likely will deepen just ahead. That indicates a big recession is coming, like in the early 1980s, only this time will be even worse.

More economists and indicators are finally seeing a recession, but as usual, they almost all think it will be milder this time. So, after what is now the second bubble in recent times and after the largest and most extreme and global bubble in history bursts, we're supposed to get a mild recession at worst? Tell that to those who went through the crash of 1929–1932, 2000–2002, or 2008–2009.

Note that when you get a series of recessions, each successive recession tends to get worse, not less severe, until the trends turn upward again for the long term. In the last such set, which included the 1970–1971, 1973–1975, and 1980–1983 recessions, unemployment worsened and stocks crashed lower each time.

The 2008 downturn was much worse than the very minor recession of late 2000 to early 2001, which lasted only two quarters. And this downturn will be much worse than 2008–2009. I am predicting a crash that's 50% worse both in stocks and unemployment. The 2008–2009 crash was by 57% on the S&P 500. I'm predicting a crash of around 86% this time.

This crash also will last longer, and hopefully central banks will lose enough credibility here not to be able to blow their way out of this one as quickly and massively. I think stocks will bottom much lower, by very late 2023 at the earliest and likely well into 2024.

This extreme yield-curve inversion, which again likely has not yet bottomed, also says that this downturn will be much worse than 2008–2009. That's no surprise to me, as this recession would have to be worse: the demographic trends underlying it are even weaker now, and the central banks didn't let the last recession do its work in debt and financial asset deleveraging…

It's just another brick in the wall of the "great recession" ahead. Of course, I see that turning into a short Great Depression! It is massive debt and financial asset bubble deleveraging that distinguish a depression from a deep recession.

Harry

Got a question or comment? You can contact us at info@hsdent.com.