Harry's Take

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The Most Classic Recession Warning Is Flashing: The Yield Curve

In the last several months, I've given our subscribers many leading indicators and warning signals that say a recession is coming sooner rather than later: Stock capitalization to GDP, stock price to sales, discounted future dividends, Shiller cyclically adjusted PE (price to earnings) ratio, slowing labor productivity, first negative M2 (money supply) since 1930, Fed balance sheet falling $1 trillion, job openings declining, both mortgage purchase and refinance indices falling big time, the conference board leading indicator, and bank credit tightening fast.

Classic Warning Signal: Largest Yield Curve Inversion Since 1978-1982!

Source: Federal Reserve Bank of St. Louis, 10-Year Treasury Constant Maturity Minus 2-Year Treasury Constant Maturity [T10Y2Y], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/T10Y2Y, November 5, 2023.

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But the most classic indicator of recession is the yield curve. When short-term rates rise higher than longer-term rates, that is another sign that credit is getting tight and near-term inflation is threatening the economic expansion. The Fed made a big mistake by overreacting to the short-term COVID crisis with $5.2 in monetary stimulus alone that created 9.1% inflation suddenly. This chart shows that the current yield-curve inversion is the highest since 1978-1982. That one followed the highest inflation rates in modern history and was the biggest driver of those that forced the Fed to raise short-term rates dramatically to slow the economy… and this current one has been the biggest rate hike since back then.

This clearly is not likely to end well. Don't mistake an economy that is not reacting quickly to the tightening as a sign of underlying strength. That strength is 100% from the $5.2T overreaction and will wear off quickly into 2024.

Harry

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