

Economics

IN FOCUS

August 20, 2024

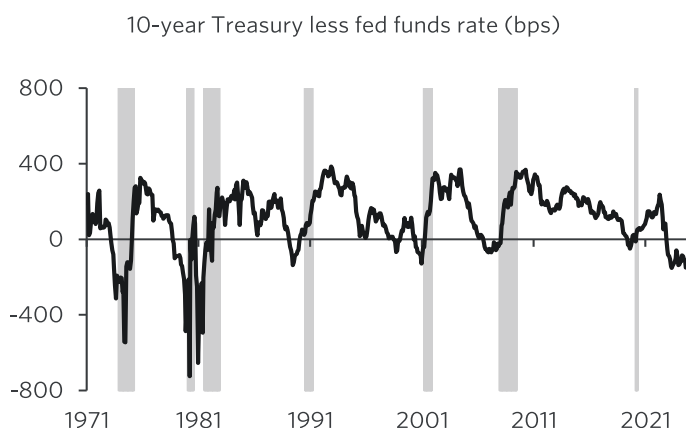
US Recession fears: A picture book

by Avery Shenfeld avery.shenfeld@cibc.com

They're baaack. We never joined the crowd forecasting a US recession in 2023, a consensus view that proved far too gloomy. But while far from a majority, such forecasts are now making a comeback in the wake of the recent uptrend in the jobless rate, and again, we find ourselves among the optimists. The July payrolls figures triggered the "Sahm Rule", as any equivalent rise in unemployment since 1960 has been associated with a recession onset. Other labour market indicators, including jobless claims and nonfarm payrolls growth, haven't been as negative, and some of those warning of a recession backed off that call after strong retail data. Moreover, if the wisdom of crowds gives you some comfort, it's clear that investors, as a group, aren't anticipating a recession, and we have the pictures to prove it.

Let's start with a snapshot of the Treasuries yield curve. Parts of it are no longer inverted, because the market is pricing in a sequence of rate cuts that have lowered two year yields. But if we take the slope between 10 year Treasuries and the fed funds rate (which has yet to change), it's still highly negative, as it often is when a recession is looming (Chart 1).

Chart 1: 10-year to fed funds inversion persists



Source: Bloomberg, CIBC

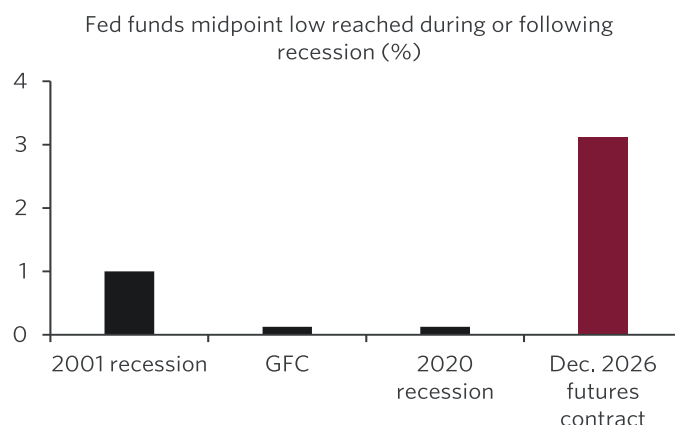
CIBC Capital Markets

But that needn't indicate that the market expects an outright recession, just as the same warning sign in 2023 failed as a recession alarm bell. It could instead be looking for the Fed to cut rates sufficiently to avoid an economic downturn, and that appears to be a better fit to other financial market indicators today.

For one, if we look at where the futures market is pricing the fed funds rate at the end of 2026, it's still at 3.1%. That's a substantial policy easing, but nowhere near the rock bottom levels that have been associated with recessions in recent decades (Chart 2). It's not below the FOMC's last published estimate of the long-run neutral rate of 2.6%, and is close to our own estimate of the neutral rate. A recession in the next two years would almost certainly see the Fed take rates into outright stimulative territory.

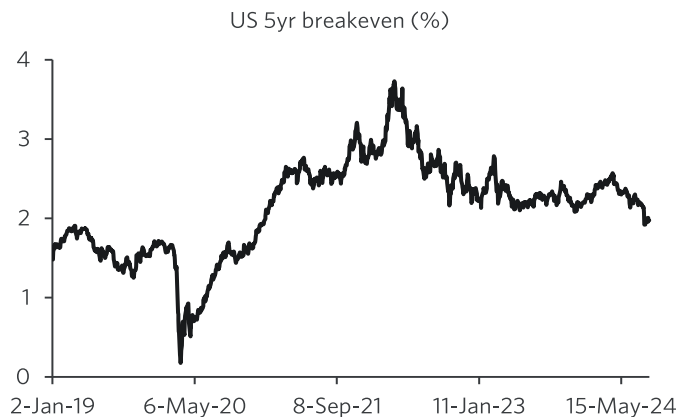
An easing path towards a 3% overnight rate could easily be warranted both as a precautionary measure to prevent a recession, or simply as a reward to the economy for having achieved the Fed's 2% inflation target. Markets are priced for

Chart 2: Expected funds rate well above recessionary levels



Source: Bloomberg, CIBC

Chart 3: Inflation expected to be on target



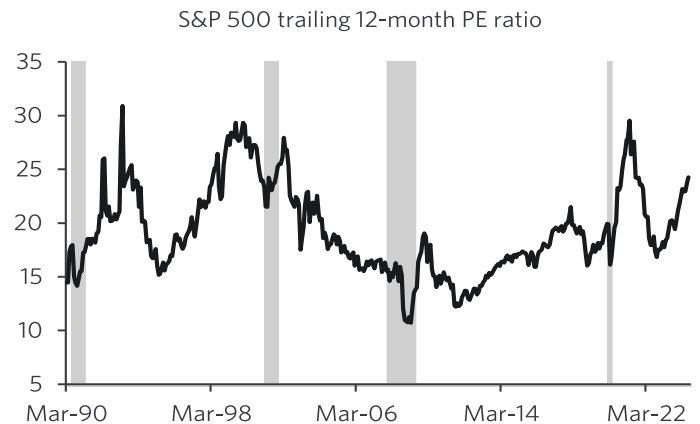
Source: Bloomberg, CIBC

inflation in the next five years to run exactly at the Fed's target (Chart 3), having fully erased earlier fears of persistent inflation. Typically, a recession would see inflation expectations drop to below the target level. Moreover, if, as seems likely, the Fed shares the view that inflation is destined to settle at 2%, keeping rates at current levels, implying a punitive real short rate of 3%, would be unsustainable and an unnecessary drag on growth and employment.

The bond market also expresses its views on recession risks in the corporate space. Recessions trigger defaults and heightened credit risks that widen spreads between corporate issues and Treasuries. While spreads are off their lows, they're still tight relative to what we see in a recession (Chart 4).

Finally, we can look at equities. While Wall Street stocks have had their jittery moments, there's clearly no material fear of a recession. Trailing earnings multiples haven't plunged (Chart 5), and while that's been helped by lower bond yields, it's unlikely that investors would be paying that much for each dollar of

Chart 5: Equities not pricing-in a recession



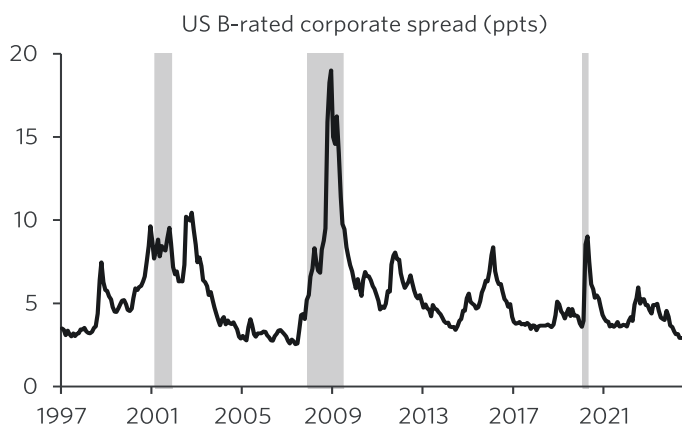
Source: Bloomberg, CIBC

trailing earnings if they were anticipating that future earnings would be dramatically weaker.

So the bottom line is that investors, as a group, aren't buying into the US recession story at this point. Instead, the market's behaviour is consistent with our view that rates are coming down because inflation has been vanquished, and that an easing in policy would help avoid a true economic downturn.

Markets aren't always right of course. But given that they are forward looking, those who see only a moderation in growth, rather than an outright US recession, can take some comfort that they're in good company.

Chart 4: Corporate spreads not signalling recession



Source: FRED, CIBC

Contacts:

Avery Shenfeld
avery.shenfeld@cibc.com

Benjamin Tal
benjamin.tal@cibc.com

Andrew Grantham
andrew.grantham@cibc.com

Ali Jaffery
ali.jaffery@cibc.com

Katherine Judge
katherine.judge@cibc.com

CIBC Capital Markets
PO Box 500
161 Bay Street, Brookfield Place
Toronto, Canada, M5J 2S8
[Bloomberg @ CIBC](#)

economics.cibccm.com

CIBC World Markets Inc., CIBC World Markets Corp., CIBC World Markets Plc., CIBC Australia Limited and certain other corporate banking and capital markets activities of Canadian Imperial Bank of Commerce operate under the brand name CIBC Capital Markets.

This report is issued and approved for distribution by (a) in Canada, CIBC World Markets Inc., a member of the Canadian Investment Regulatory Organization, the Toronto Stock Exchange, the TSX Venture Exchange and a Member of the Canadian Investor Protection Fund, (b) in the United Kingdom, CIBC World Markets plc, which is regulated by the Financial Services Authority, and (c) in Australia, CIBC Australia Limited, a member of the Australian Stock Exchange and regulated by the ASIC (collectively, "CIBC") and (d) in the United States either by (i) CIBC World Markets Inc. for distribution only to U.S. Major Institutional Investors ("MII") (as such term is defined in SEC Rule 15a-6) or (ii) CIBC World Markets Corp., a member of the Financial Industry Regulatory Authority. U.S. MIs receiving this report from CIBC World Markets Inc. (the Canadian broker-dealer) are required to effect transactions (other than negotiating their terms) in securities discussed in the report through CIBC World Markets Corp. (the U.S. broker-dealer).

This report is provided, for informational purposes only, to institutional investor and retail clients of CIBC World Markets Inc. in Canada, and does not constitute an offer or solicitation to buy or sell any securities discussed herein in any jurisdiction where such offer or solicitation would be prohibited. This document and any of the products and information contained herein are not intended for the use of private investors in the United Kingdom. Such investors will not be able to enter into agreements or purchase products mentioned herein from CIBC World Markets plc. The comments and views expressed in this document are meant for the general interests of wholesale clients of CIBC Australia Limited.

This report does not take into account the investment objectives, financial situation or specific needs of any particular client of CIBC. Before making an investment decision on the basis of any information contained in this report, the recipient should consider whether such information is appropriate given the recipient's particular investment needs, objectives and financial circumstances. CIBC suggests that, prior to acting on any information contained herein, you contact one of our client advisers in your jurisdiction to discuss your particular circumstances. Since the levels and bases of taxation can change, any reference in this report to the impact of taxation should not be construed as offering tax advice; as with any transaction having potential tax implications, clients should consult with their own tax advisors. Past performance is not a guarantee of future results.

The information and any statistical data contained herein were obtained from sources that we believe to be reliable, but we do not represent that they are accurate or complete, and they should not be relied upon as such. All estimates and opinions expressed herein constitute judgments as of the date of this report and are subject to change without notice. This report may provide addresses of, or contain hyperlinks to, Internet web sites. CIBC has not reviewed the linked Internet web site of any third party and takes no responsibility for the contents thereof. Each such address or hyperlink is provided solely for the recipient's convenience and information, and the content of linked third-party web sites is not in any way incorporated into this document. Recipients who choose to access such third-party web sites or follow such hyperlinks do so at their own risk.

© 2024 CIBC World Markets Inc. All rights reserved. Unauthorized use, distribution, duplication or disclosure without the prior written permission of CIBC World Markets Inc. is prohibited by law and may result in prosecution.

The CIBC logo and "CIBC Capital Markets" are trademarks of CIBC, used under license.