US Macroeconomics

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Looking for Replacements

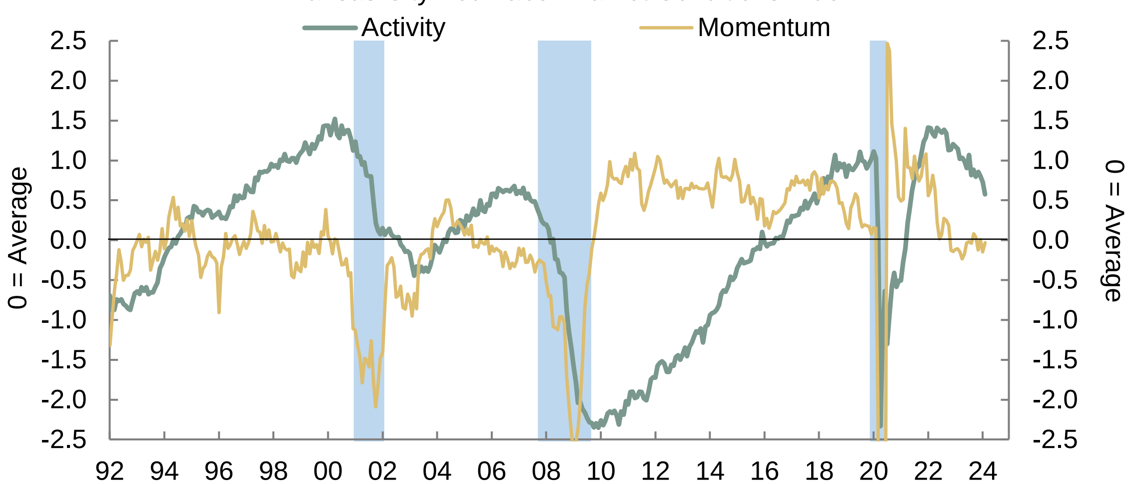
The Treasury yield curve and Leading Economic Indicators are still sending recessionary signals, but investors are rightly questioning the forecasting power of these series given the now record length of time in which they have been flashing yellow. To find other potentially useful leading indicators of the economy, we highlight work from the Kansas City Fed which created two labor market conditions indicators which use 24 labor market variables. The details can be found here: https://www.kansascityfed.org/data-and-trends/labor-market-conditions-indicators. We show the two series below. While neither series is forecasting a recession, each suggests the risks to the broader economy, but particularly the labor market, are tilted to the downside.

The KC Fed labor market activity index slipped to 0.58 in February versus 0.73 in January. A reading above zero means that labor market conditions are higher than their long-term average. But notice that the activity series has been consistently slowing since August 2022. It is now at its lowest non-pandemic related reading since January 2018. But then, the series was in a long-term uptrend not a downtrend. So the current reading is somewhat troubling. For reference, the activity series was 0.21 when the economy peaked in December 2007.

Meanwhile, **the momentum indicator registered a -0.03 reading in February compared to -0.15 in January**. The series is now down in three of the last four months. Normally if the jobs market is on the cusp of accelerating, the rate of change on the various labor market indicators would be positive. But momentum suggests the exact opposite.

The signal regarding future activity is more powerful when both series are trending in the same direction. **The combination of slowing labor market activity and negative-to-flat momentum is troubling because this is what typically happens before a recession**. At a minimum, the KC Fed labor market indicators suggest GDP will slow from last year's 3% pace. Already, the unemployment rate is up half of a percentage point from its cyclical low, and private sector job creation outside of healthcare is running at just around 135k per month. Against this backdrop, worker wage demands should moderate and with it some of the inflation concerns from Fed policymakers that are still fixated on the Phillips Curve.

Kansas City Fed Labor Market Conditions Index



Source: FRB KC, Haver, SMBC Nikko

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