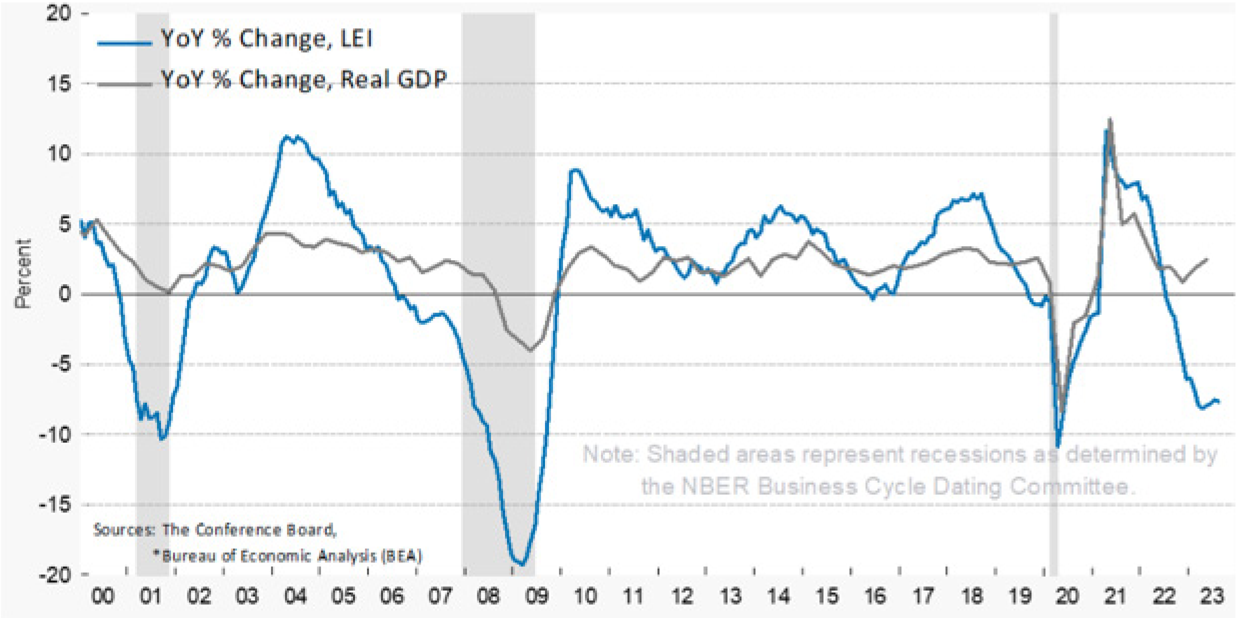
Pallas Perspective

September 29, 2023

Leading Economic Indicator Signals a Potential Brake on Rising Rates

The Conference Board Leading Economic Index (LEI) provides an early indication of significant turning points in the business cycle. The release of August data for the LEI showed that the U.S. index declined by 0.4%. It is now down 3.8% over the past six months and 7.7% over the past twelve months, continuing the downward trend that began in the first quarter of 2022. The leading index was negatively impacted in August by weak new orders, deteriorating consumer expectations of business conditions, high-interest rates, and tight credit circumstances. All these factors suggest that economic activity will likely decelerate going forward and experience a brief but mild contraction.

U.S. Leading Economic index



While a sustained downturn in the LEI has historically predicted recessions, U.S. real GDP forecasts for 2023 have been revived upward since the beginning of the year. The Conference Board's real GDP forecast currently anticipates 2.2% growth in 2023. However, there are mounting concerns, including the rapid recent increase in interest rates and declining consumer confidence expectations, which have also been predictive indicators of a looming recession.

The rapid rise in interest rates, particularly at the long end of the curve, has led to increased volatility in the markets. Both the equity markets and bond markets are coming under pressure.

The investment situation has been exacerbated by the resilience and even upward inflection in U.S. economic growth relative to expectations in 2023. This has led the Federal Reserve to retain a hawkish stance towards maintaining higher rates.

However, if the LEI is correct in forecasting deteriorating economic conditions, there may be less pressure on long-term interest rates, and, as a result their upward trajectory may ease.The Conference Board is, in fact, forecasting such a slowdown, with the U.S. real GDP expected to fall to 0.8% growth for 2024, indicating a shallow recession.

Such an outcome should ultimately provide support to the financial markets looking forward. However, the path may remain a bumpy ride as fears propagate about the upward spiral in long-term interest rates, which increases the potential for a harder economic landing.

Pallas Capital Advisors will continue to monitor the investment landscape and look to position portfolios to navigate through the current environment while keeping on course with the long-term goals of our clients.