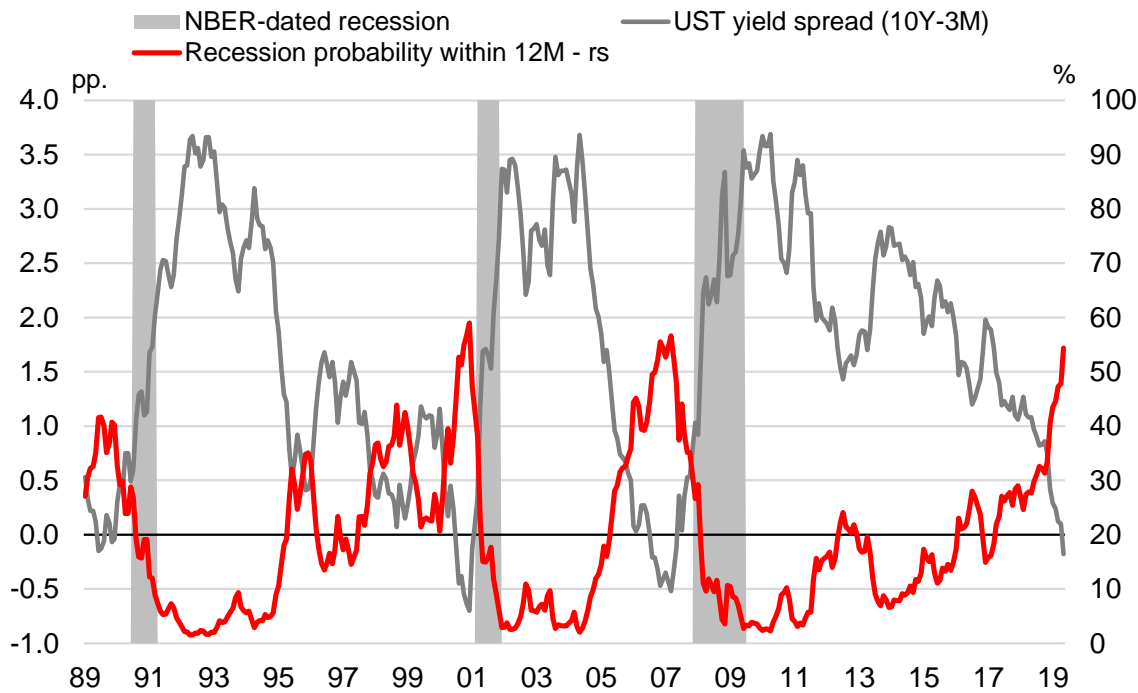


The US yield curve warning light is glowing red



Source: Bloomberg, UniCredit Research

- It is widely known that US recessions tend to be preceded by an inversion of the yield curve; that is, long-term rates fall below short-term rates. Our *Chart of the Week* plots the difference in yields between the 10-year Treasury note and the 3-month Treasury bill (grey line, left-scale), with the grey shaded areas denoting NBER-dated recessions. This yield spread turns negative (i.e. the slope of the yield curve becomes inverted) a few quarters before a recession. Ominously then, this past week the yield spread turned negative.
- A simple probit regression for the probability of a recession *within* the next year based on the yield spread gives the probability of a recession in the next 12 months at 54% (red line, right-scale). The model uses monthly data since April 1953 and has managed to correctly predict the vast majority of NBER recessions since then (i.e. the implied probability rose above 0.5 within 12 months of the recession). Of course, structural change, not least unconventional monetary policy, could be distorting the signal this time around. Still, this financial market warning signal is in line with our view that the US economy will likely enter recession next year.

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