2 Numbers to Watch for Signs of a Recession

Description

Investors lost a tremendous amount of money this week as the **S&P/TSX Composite Index** lost hundreds of points alongside similar losses in other major indices from across the globe. Capital markets appear poised for a pullback in economic growth and a recession in the near term.

However, shocking plunges in the stock market are not the best indicators of recessions. A technical recession is defined as two consequent quarters of negative gross domestic product growth.

Canada's economy is on track to grow 0.4% in nominal terms and 0.3% in real terms this year, which while frustratingly low is not recessionary.

However, official data is historical, which means that investors need some indicators to help them determine whether a recession is fast approaching — or already here. Here are the two indicators I believe offer the best clues:

The inverted yield curve

Bonds offered by governments usually offer higher yields for investors willing to wait longer. So, a 10-year government bond should ideally offer a higher yield than a one-year bond. However, when the market inverts this dynamic, it is a strong sign of an upcoming recession.

An inverted yield curve has accurately predicted a recession over the past 50 years. Canadian Imperial Bank of Commerce Deputy Chief Economist Benjamin Tal told BNN Bloomberg, "The yield curve is the best economist out there."

At the moment, Canada's 10-year government bond offers a yield 40 basis points below the rate on three-month bills. The yield curve isn't just inverted here. The United States and the United Kingdom have also joined this dreadful club over the past year.

Unemployment

The unemployment rate, in my opinion, is far less complex and far more valuable as an indicator of upcoming recessions. Canada's economy relies heavily on consumer spending.

The economy is also deeply correlated with that of the United States, which is also consumption driven.

Dips in consumption have an immediate and noticeable impact on North America's economy, and the most effective way to cut consumption is to stem the flow of household income.

About 70% of Canada's labour pool is employed by someone else. So any uptick in the nation's unemployment rate is a forward indicator of economic trouble.

After hitting a historical low of 5.4% in the last quarter of 2018, Canada's unemployment rate has been creeping up this year. It now stands at 5.7%.

Concerned investors should probably monitor this number for any further spikes.

Bottom line

Bond investors and job seekers offer the best clues about the state of the economy. I believe that investors should monitor the government bonds yield curve and the quarterly unemployment figures to determine whether their portfolio needs to be bolstered for a potential recession.

At the moment, both indicators are flashing red, which has me concerned. I'll try adding some safe passive investments if the valuations drop in the near-term.

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Date
2025/09/09
Date Created
2019/08/15
Author

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