



1/11/2024

AN UPDATE FROM PAUL DIETRICH**2024: HOW LONG CAN CONGRESSIONAL DEFICIT SPENDING PUSH OFF THE RECESSION?**

In early 2023, most economists and economic analysts, including myself, were predicting an imminent recession in 2023.

That hasn't happened yet.

A Soft Landing Before A Recession?

Many leading economists now believe that the recession will start in the first six months of 2024.

They believe the recession in 2023 was pushed off and delayed by the \$11 trillion in deficit spending Congress approved starting in early 2020 during the Covid crisis, when the U.S. deficit was \$23 trillion, until the end of 2023 when Congress increased the U.S. deficit by 48% to the current \$34 trillion.

This \$11 trillion in increased deficits over the past four years went to various economic stimulus programs that distributed those trillions of dollars to federal, state, and local governments, individuals and corporations. During that time, many individual Americans and corporations held record levels of excessive savings.

Now, according to the Federal Reserve, those excess savings for individuals are largely depleted.

Much of that money went into (1) the stock market—temporarily pushing up stock prices to record over-valuations—and, (2) a spending spree on consumer goods and services, like restaurants, cruises, foreign travel and Taylor Swift concert tickets, that people missed out on during the Covid lockdown.

The four-year, \$11 trillion infusion of newly created and printed money, was like a “sugar high” for the U.S. economy.

Economists now believe this monetary infusion is the most likely reason the U.S. economy hasn't contracted more quickly into a full blown recession.

This Past Year HAS BEEN the Soft Landing

In a recent Monday Note, Deutsche Bank analysts stated that over the past 50 years, press articles and discussions of a “soft landing” have tended to precede recessions. They also reported that *“History suggests we're still relatively early in the lag of monetary policy.”*

Lower inflation, strong employment numbers, and indications of a Fed pivot to rate cuts this year have driven most of the soft landing predictions, the note said. They also pointed to a historical review of Bloomberg articles that tracked surging mentions of “soft landing” in their news articles, with similar surges taking place before recessions in the early 1990s, early 2000s, and 2008.

“Everything points to a soft landing—except history,” said Deutsche Bank analyst Jim Reid, listing an array of indicators that are still flashing recession signals on the economy.

Analysts at Rosenberg Research said U.S. stocks currently signal *“maximum bearishness.”*

He said, *“In late 2021, stocks took off on a blockbuster rally. Then in January 2022, sentiment soured, and the rally ran out of steam. Sound familiar?”*

The market in 2024 is looking ‘eerily similar’ to the landscape headed into 2022, when stocks plunged 20%, with positioning, sentiment, and technicals all at extreme readings – matching what we saw in December 2021” according to economist David Rosenberg.

The S&P 500 peaked in early January 2022, then tanked and finished the year down 20%—its worst year since 2008.

Is The U.S. Economy Really As Strong As Media Commentators Believe?

In 2023, the stock market was up and down.

Many investors forget that a little over two months ago on October 31, 2023, the Dow Jones was negative year-to-date and the S&P 500 was only up about 4%. Then in November and December the stock market had an explosive rally ending up about 24% on the year. That all happened in two months.



In the chart above you can see how extremely overvalued the S&P 500 stocks are compared to their 200-day moving average long-term trend.

Most of the 2023 stock market was driven by just seven tech stocks—sometimes called the Magnificent 7—Apple, Amazon, Alphabet, Meta [Facebook], Microsoft, Nvidia and Tesla. These seven tech stocks currently make up over 30% of the entire market capitalization of the S&P 500 Index.

Investors also shrugged off a regional banking crisis, debt ceiling worries, Congressional deficits, and geopolitical tensions in Ukraine, Israel, and Taiwan.

Summary: If unemployment continues to increase and consumers continue to slow their spending, we will see a relatively mild recession this year with Gross Domestic Product [GDP] dropping to -0.5% for at least two consecutive quarters.

A Strong Jobs Market? BUT Unemployment Is Increasing

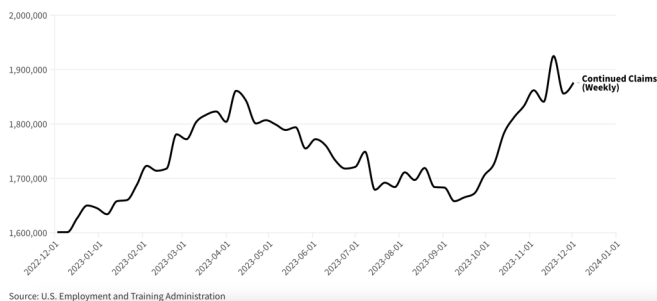
The non-partisan Congressional Budget Office [CBO] is currently forecasting an increase in U.S. unemployment from the current 3.9% to 4.4% this year, signaling job losses for millions of Americans amidst a contracting

Gross Domestic Product [GDP].

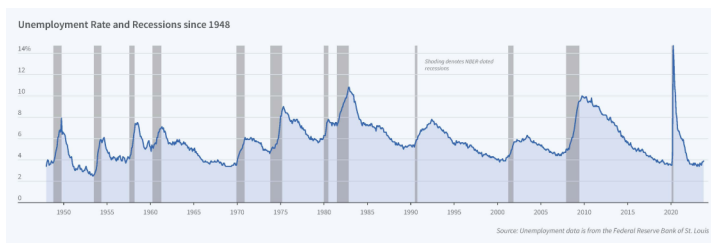
The projected increase in unemployment could affect an estimated 7.4 million people within the workforce.

Current jobless claims support the CBO's outlook, with around 202,000 new unemployment benefits filed in early December, and approximately 1.87 million workers continuing to claim unemployment benefits, indicating a tightening labor market.

Continued Claims (Insured Unemployment)



In the chart below, you can notice how in past recessions, unemployment does not start to dramatically increase until right before the recession formally starts. *Is that beginning now?*



Consumer Spending Has Hit Its Credit Limits

Consumer spending makes up about 70% of the U.S. economy. That is why it is so important and watched so closely.

Excess savings from stimulus spending are now largely gone, according to the Federal Reserve.

Consumers are now continuing to spend by racking up credit card debt at usurious interest rates of 25% to 33%.

With wages tracking inflation and the labor market slowing but still strong, Americans continue to spend.

Unfortunately, they are now hitting their credit card spending limits. When this has happened before,

consumer spending drops dramatically.

We are already seeing major declines in purchases of durable goods and services as consumers focus on paying for essentials and their credit card interest payments.

While the U.S. consumer remains resilient, Deutsche Bank data shows that credit card delinquencies are at their highest rates in more than 12 years.

Savings as a percent of gross national income is now contracting. This has ONLY happened three times since 1947.

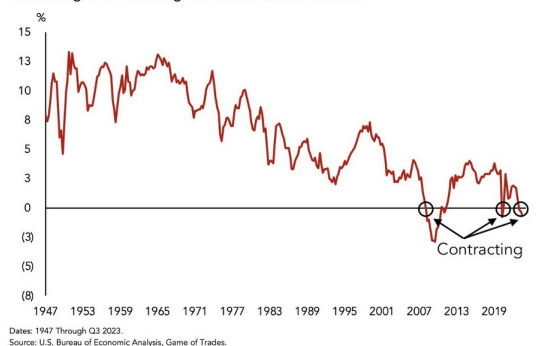
The last two contractions coincided with the:

- 2008 Financial Crisis
- 2020 Pandemic

High interest rates plus a high debt environment is a strong headwind for continued consumer spending.

Savings are Contracting

Net Saving as a Percentage of Gross National Income



Summary: At this rate, major economic volatility may not be far away. If unemployment is increasing and consumer spending is dropping—that is **basically the definition of a recession and economic contraction.**

With Inflation Only Slowly Declining—The Fed Won't Cut Rates Anytime Soon!

The stock market went up 24% in the past two months primarily because of a mass market speculation that the Federal Reserve would start dramatically cutting rates starting in March 2024.

Jerome Powell, the Fed Chair, and other Fed Presidents repeatedly said this view was unwarranted. New York Federal Reserve President John Williams said this week that U.S. interest rates will likely need to stay high “for

some time” until senior central bank officials are confident the rate of inflation is returning to 2%.

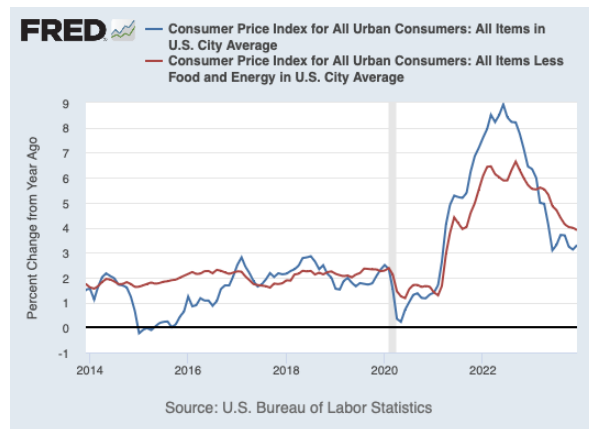
Now that the new Consumer Price Index (CPI) inflation report has been released, no one believes the Fed will start cutting rates anytime soon—and certainly not in March. Inflation increased more than expected in December because of a jump in energy and housing costs. This shows how difficult a job the Fed has in taming price pressures within the economy.

The U.S. Labor Department said the Consumer Price Index, a broad measure of the price of everyday goods including gasoline, groceries and rent, “*rose 0.3% in December from the previous month, more than expected. Prices climbed 3.4% from the same time last year, coming in above both the expectation from Refinitiv economists and the 3.1% gain recorded in November.*”

Core prices, which exclude the more volatile measurements of food and energy, climbed 0.3%, or 3.9% annually.

Altogether, the report indicates that while inflation has fallen considerably from a peak of 9.1%, core prices remain almost double the percentage above the Federal Reserve's 2% target.

High inflation has created a severe financial burden on most U.S. households, which are forced to pay more for everyday necessities like food and rent.



You can see in the chart above how much higher inflation is now than over the previous decade. You can also see how core inflation, excluding energy and food, is starting to trend sideways.

Summary: Many Fed Presidents have suggested recently that rate hikes are over, but they have

specifically said they need more sustained data before they are willing to cut rates. This new inflation report means the Fed is unlikely to cut interest rates as early as markets are currently anticipating. It is clear that many stock market analysts and pundits have gotten a little overexcited around the timing of rate cuts.

Congressional Deficit Russian Roulette—How Inflation Really Works

Right after Covid, politicians printed almost \$6 trillion out of thin air to boost the economy.

That increased the U.S. money supply by about 26%. It also created a massive unfunded deficit for the U.S. government that as of January 2024 is now at \$34 trillion.

Make no mistake about it. This unfunded spending has caused the inflation we see now.

It was the unfunded printing of money in the late 1960s and early 1970s to fund the Vietnam War and President Johnson's Great Society spending programs that gave us a decade of runaway inflation.

Since 2020, we have added a total of \$11 trillion in U.S. debt. This is by far the largest four-year debt increase in U.S. history. Unfortunately, "free money" from stimulus payments and Congressional deficit spending will go down as one of the most costly handouts of all time.

Inflation is the biggest involuntary tax in the world.

It is also worth noting that the national debt increased from \$9 trillion to \$23 trillion from 2008 to 2020. The national debt didn't hit \$1 trillion until 1981.

Fiscal Year Debt (\$ Trillions)	
2019	23
2020	27
2021	28
2022	31
2023	33
2024	34

Source: U.S. Treasury

There Are Only Three Ways To Pay Off The Unfunded Printing Of Money

- 1] **The government can raise taxes.** No politician wants to do that, and the few liberals who do want to raise taxes, don't have the votes to get the vote through Congress.
- 2] **The government can cut spending.** But 85% of the budget is made up of Social Security, Medicare, Veteran's Benefits, debt service and defense spending. With the upcoming Debt Ceiling Legislation, Speaker Mike Johnson is trying to negotiate cuts in spending. Both he and President Biden will claim the ultimate bill will cut spending over the next few years. But that will not be true! According to the independent and non-partisan Congressional Budget Office, they projected higher budget deficits over the next ten years, even though the Trump Tax Cuts will expire or sunset in early 2025. Congress never cuts any spending. The deficit reduction will come from the increases in taxes after the Trump Tax Cuts expire. It will all be a "shell game" by Biden and Mike Johnson. That is the reason why most Republican Freedom Caucus members and the far-left Progressives will vote against the legislation.
- 3] **The government can deflate and devalue the U.S. currency.** This is what the Congress has decided to do. It is called inflation. Since the government spent \$6 trillion on economic stimulus in 2020 and 2021 that increased the money supply by 26%. That means we have to devalue the U.S. dollar by 26% over time.

How Do We Devalue The U.S. Dollar?

We do it through inflation. But to make sure that inflation doesn't permanently raise the price of everything by 26% all at once, the Federal Reserve raises rates to slow inflation over time.

The inflation rate for all of 2022 was 6.5%. Analysts estimate that the real inflation rate for 2023 will be close to 4%. That means we still have to devalue the U.S. dollar by another 15%, in order to negate the original 26% increase in the U.S. money supply. It will take us about 3-4 years at 4% - 5% inflation to do that, not including the approximately \$1 trillion a year that we are printing in unfunded deficits for each of the next few

years. That has to be eventually included.

This is the reason investors, economists and politicians are dreaming if they think inflation will come down to the Fed target rate of 2% anytime within the next five years or so.

Bottom Line: 3% to 4% annual inflation is here to stay for the foreseeable future!

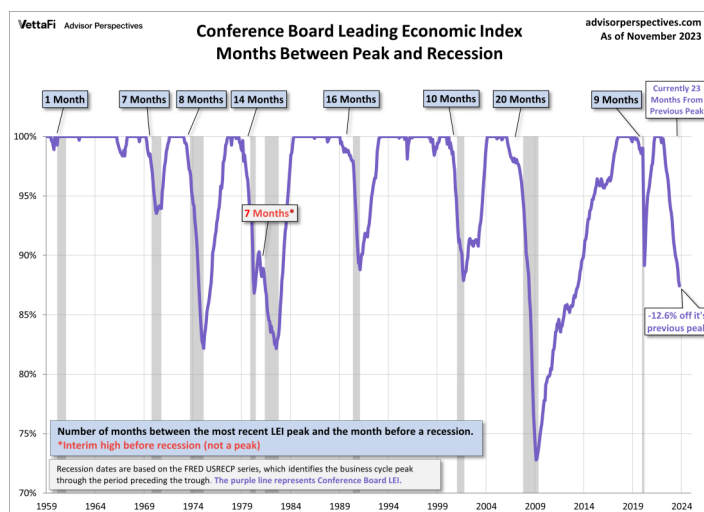
Are The Leading Economic Indicators & The Inverted Yield Curve Still Signaling A Recession?

Yes they are.

Historically, recession warnings, like the inverted yield curve and the Conference Board's Composite of Leading Economic Indicators signal a recession as an "early warning system" nine months to eighteen months in advance of the start of a recession.

Those recession signals were sounded in the fourth quarter of 2022. We are now slightly over a year since those signals formally warned of an upcoming recession. This is still within the normal time range of these "signals leading to recession", considering the patterns established over 100+ years that the Conference Board has tracked data since its founding in 1917 by the U.S. government as an independent research institute.

Here are the current cycle's numbers compared to prior inversions and recessions.



U.S. Leading Economic Indicators

The Conference Board Leading Economic Index® (LEI) for the U.S. declined in November for the 20th consecutive month.

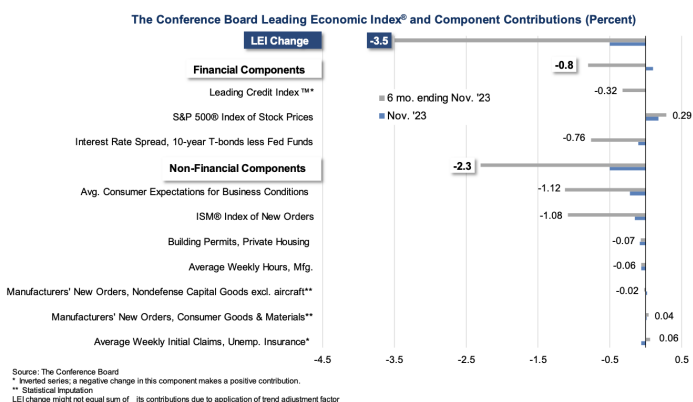
This 20-month streak was only exceeded in the 2008 recession period and 1974 recession period.

The Conference Board marks a recession trigger when the growth rate of the LEI falls below -4.5%.

The growth rate fell again in November which marked the 14th consecutive month since the US LEI formally signaled a recession.

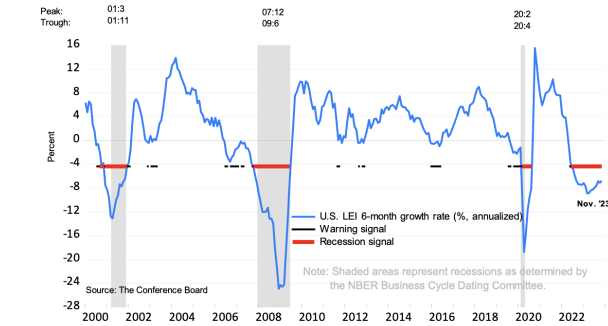
According to the Conference Board press release, "The US LEI continued declining in November, with stock prices making virtually the only positive contribution to the index in the month," said Justyna Zabinska-La Monica, Senior Manager, Business Cycle Indicators, at The Conference Board. "Housing and labor market indicators weakened in November, reflecting warning areas for the economy. The Leading Credit Index™ and manufacturing new orders were essentially unchanged, pointing to a lack of economic growth momentum in the near term. Despite the economy's ongoing resilience—as revealed by the US CEI [The Conference Board Coincident Economic Index®]—and December's improvement in consumer confidence, the US LEI suggests a downshift of economic activity ahead. As a result, The Conference Board forecasts a short and shallow recession in the first half of 2024."

Equities (S&P 500 Index) were the only positive contribution to the US LEI in November.



Note: Starting with September 2023 release Leading Credit Index™ calculations (from 2020 to current) use the SOFR Overnight Financing Rate in the USD Swap spread semiannual 2 year instead of LIBOR rate. LIBOR remains in the USD Swap spread semiannual 2 year from 1990 to 2020.

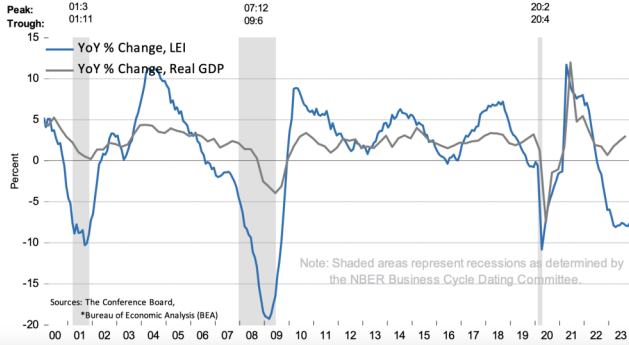
The US LEI continues signaling recession.



Note: The chart illustrates the so-called 30's rule which is a reliable rule of thumb to interpret the duration, depth, and diffusion – the 30's – of a downward movement in the LEI. Duration refers to how long-lasting a decline in the index is, and depth denotes how large the decline is. Duration and depth are measured by the rate of change of the index over the last six months. Diffusion is a measure of how widespread the decline is (i.e., the diffusion index of the LEI ranges from 0 to 100 and numbers below 50 indicate most of the components are weakening). The 30's rule provides signals of impending recessions 1) when the diffusion index falls below the threshold of 50 (denoted by the black dotted line in the chart), and simultaneously 2) when the decline in the index over the most recent six months falls below the threshold of -4.4 percent. The red dotted line is drawn at the threshold value (measured by the median, -4.4 percent) on the months when both criteria are met simultaneously. Thus, the red dots signal a recession.

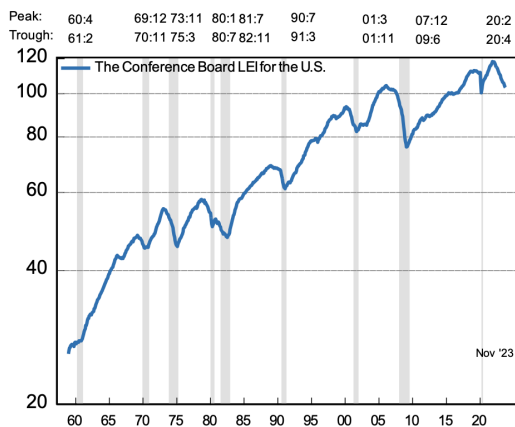
The annual growth rate of the LEI remains negative, and has hovered around -8% since Q1 2023

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Below is a graph of the US LEI over 60 years.

U.S. Composite Economic Indexes (2016=100)



As A Leading Economic Indicator, The Inverted Yield Curve Also Has An Almost Perfect Record In Predicting Recessions

As further confirmation of an impending recession, the inverted yield curve is a leading indicator with a near-perfect track record in predicting recessions long before they happen.

Investors watch for an inverted yield curve using the 10-year Treasury bond yield against the 2-year Treasury bond yield. The inversion of this indicator has forecast the past six recessions.

Here is the chart of the 10-year and 2-year Inverted Yield Curve as of January 12, 2024. It is clearly in negative recession territory. The Inverted Yield Curve is also at its lowest inversion point in 40 years.

You can see in the chart below that the Yield Curve is now below "0" and is giving an inverted recession signal stronger than any recession since 1981-1982.

The recession signal was triggered on July 12, 2022, almost 17 months ago. Historically, the average recession signal comes 9 to 18 months in advance of the start of a recession.



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Paul Dietrich is focused on managing investments for private investors, retirement funds and private institutions throughout the United States. He also serves as an on-air commentator and contributes market analysis to business and financial media including *CNBC*, *Fox Business*, *Bloomberg TV*, *CNN*, *The Wall Street Journal*, *Yahoo! Finance*, *Reuters* and *The Washington Post*.

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