



Buckle Up. It Could Be A Bumpy Ride.

MARKETS

SPENCER JAKAB

The U.S. economy's shock absorbers are worn. That could make for a bumpy ride if recent investor anxiety worsens. Normally, but not always, companies and individuals are cushioned by the Treasury bond market when it seems like a slowdown is brewing. One of the best early indicators of a recession is a rush to buy those supersafe securities.

That's convenient for Uncle Sam, who in that case might have to issue more of them for unemployment checks. It's also an indirect lifeline to the private sector.

A slowdown makes default fears rise and credit spreads widen. Those spreads represent the average excess yield lenders demand by credit-rating category, compared with theoretically risk-free Treasury debt. You'll always hear a lot about how spreads are "blowing out" in a crisis, but rarely what actual borrowing costs are.

They can even drop. For example, during the 2000 tech bust and 2001 recession, investment-grade credit spreads widened by around 1.8 percentage points, but the 10-year Treasury note's yield fell by as much as 2.8 points.

Treasury yields are near a quarter-century high. Sometimes they rise for good reasons, but economist David Rosenberg doesn't think this is one of them.

"This is not some benevolent interest-rate cycle where the economy is ripping and rates are going up," he says. "Credit investors are starting to price in, at the margin, some default risk."

Headline U.S. growth is strong. The problem is that basically all of it is from AI data-center investment. The disconnect can be seen in the highly unusual number of slumping stocks at a time when the S&P 500, dominated by tech heavyweights, hit a record this week.

Cautious messages from companies in the most economically sensitive sectors such as trucking, housing, restaurants and retail normally wouldn't coincide with rising Treasury yields, which typically point to a strong economy. They are now.

And there are other forces at play. One is rising jitters about governments' long-term creditworthiness worldwide. The Fed's recently tougher tone about tackling inflation is to blame, too, says Rosenberg, with expectations for rate increases surging in the past six months.

The Fed got militant about inflation in 2022 with a series of rate hikes. That slowed the economy enough to cause a simultaneous rise in credit spreads, just like we're starting to see now. The reason it didn't lead to a recession, says Rosenberg, was \$2 trillion in pandemic-era excess household savings. ————— Note

That's been spent, and governments owe trillions more than they did then. AI companies would like to borrow a few trillion more from the same global pool of savings.

Alarm bells aren't ringing yet, but Rosenberg says the chances of a recession in the next year-and-a-half have risen.

"It's a flip of a coin."

The following is a digital replica of content from the print newspaper and is intended for the personal use of our members. For commercial reproduction or distribution of Dow Jones printed content, contact: Dow Jones Reprints & Licensing at (800) 843-0008 or visit djreprints.com.

For personal, non-commercial use only.