Charts of the Week

August 29th, 2025

Financial Crises and Recessions Change Things

We have argued that recessions and financial crises can have a profound and lasting impact on an economy for years to come. We had both in 2020. This changed the economy. Change does not mean worse or dystopian. It means different. This economy is different from the 2019 (pre-COVID) version.

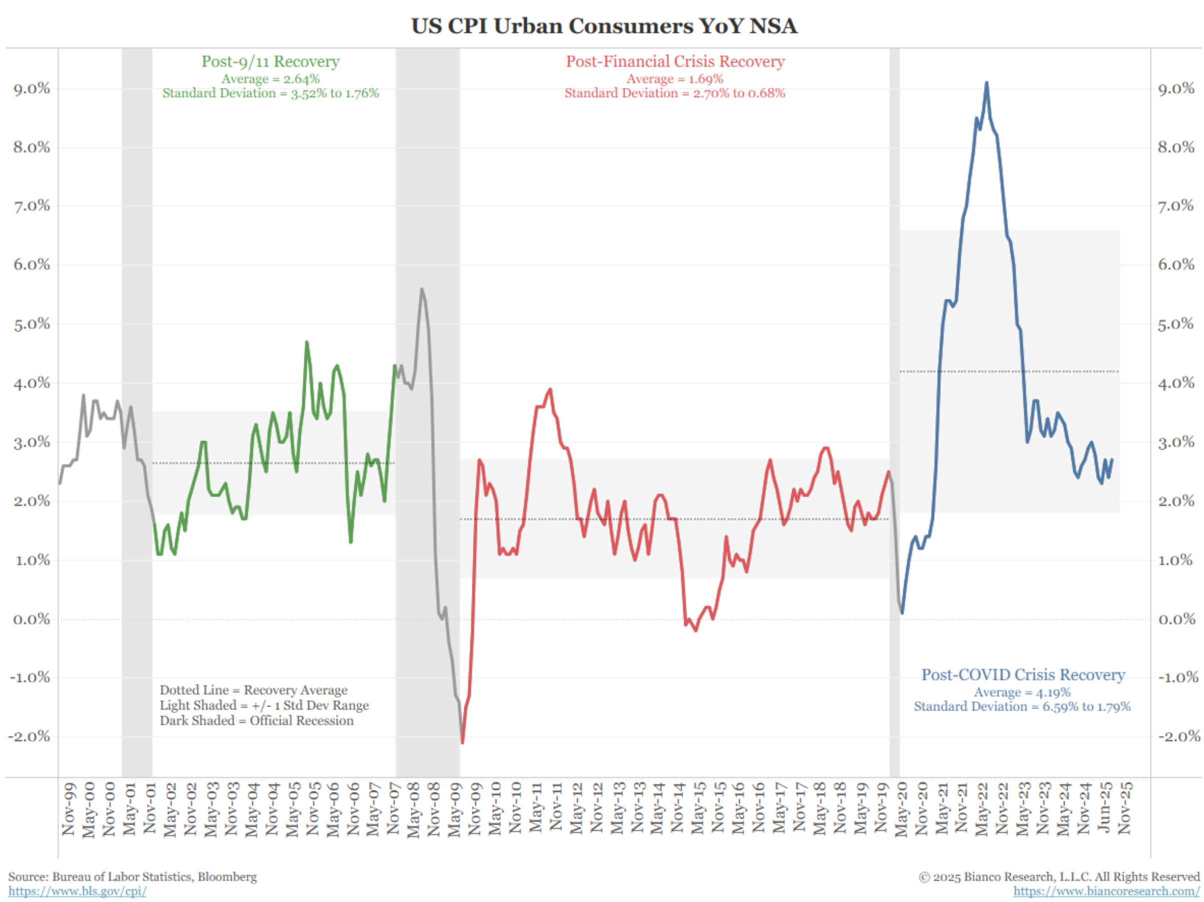
What follows is a series of charts illustrating the changes that have occurred from pre-COVID to post-COVID.

Inflation Changed

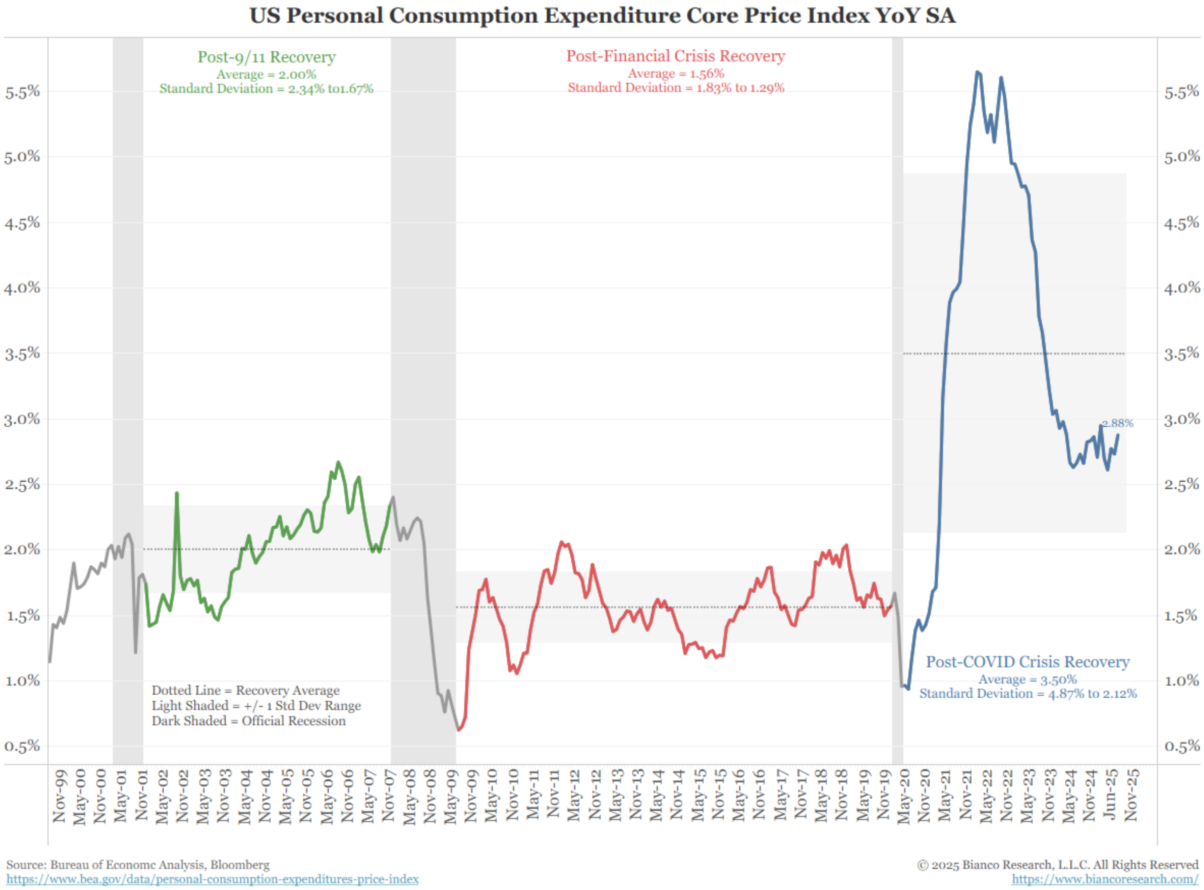
The following chart illustrates the year-over-year change in the Consumer Price Index, which is color-coded.

The dotted horizontal line is the average for that recovery. The shaded area is the standard deviation (66% of the readings in a normally distributed series would be in the shaded area).

This chart illustrates how, following every recession, the tenor of inflation shifts. The current post-COVID recovery, as shown in blue, indicates inflation has reached a significantly higher level, with more volatility (wider standard deviation) than during the post-financial crisis period.



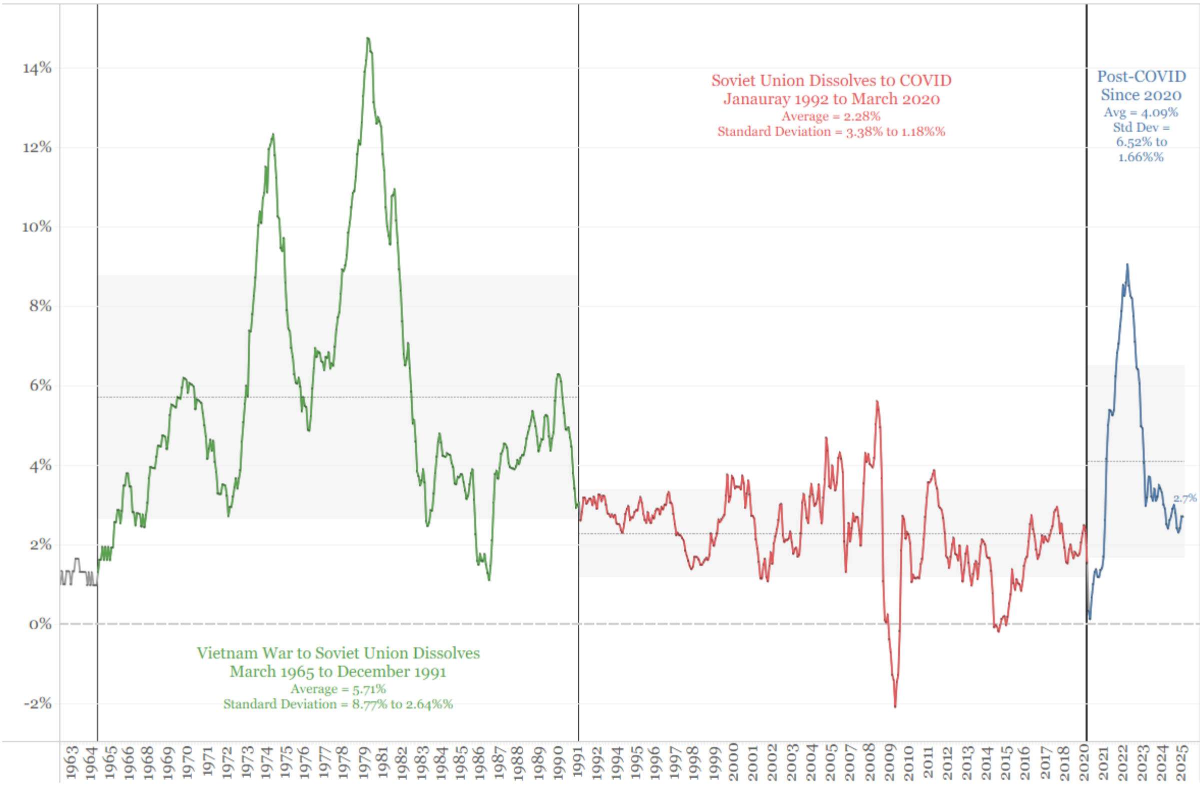
This is even more pronounced in the Fed's preferred metric of inflation, the Core Personal Consumption Expenditure (PCE).



However, something more may be at play, as larger trends in inflation seem to have shifted with the COVID pandemic, as the following two charts illustrate.

Note that these series are inflation rates using today's methodology, as outlined in a June 2022 paper by Marijn A. Bolhuis, Judd N. L. Cramer, and Lawrence H. Summers.

Inflation (CPI) Back to 1949 Using Today's Methodology
From a June 2022 paper by Marijn A. Bolhuis Judd N. L. Cramer Lawrence H. Summers



Source: BLS, Bloomberg, Bolhuis, Cramer, & Summers
https://www.nber.org/system/files/working_papers/w30116/w30116.pdf

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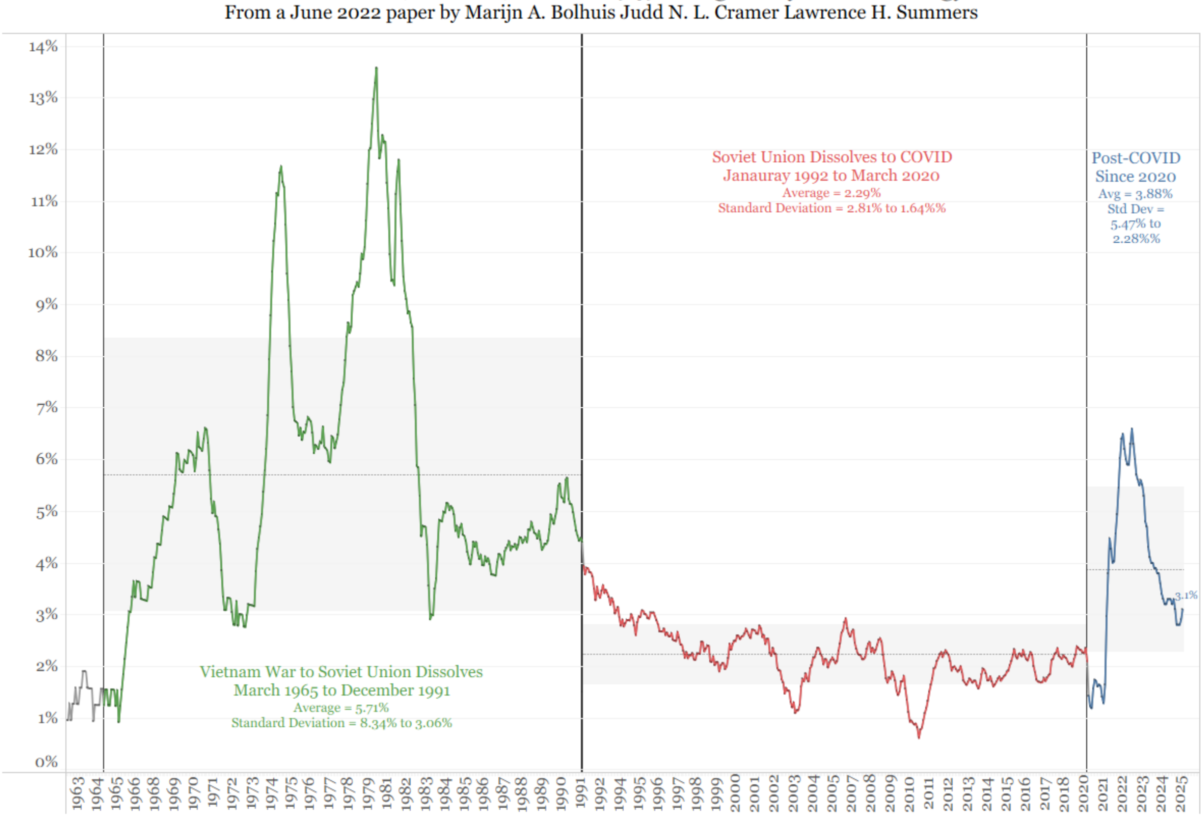
Core Inflation (Core CPI) Back to 1949 Using Today's Methodology
From a June 2022 paper by Marijn A. Bolhuis Judd N. L. Cramer Lawrence H. Summers



Source: BLS, Bloomberg, Bolhuis, Cramer, & Summers
https://www.nber.org/system/files/working_papers/w30116/w30116.pdf

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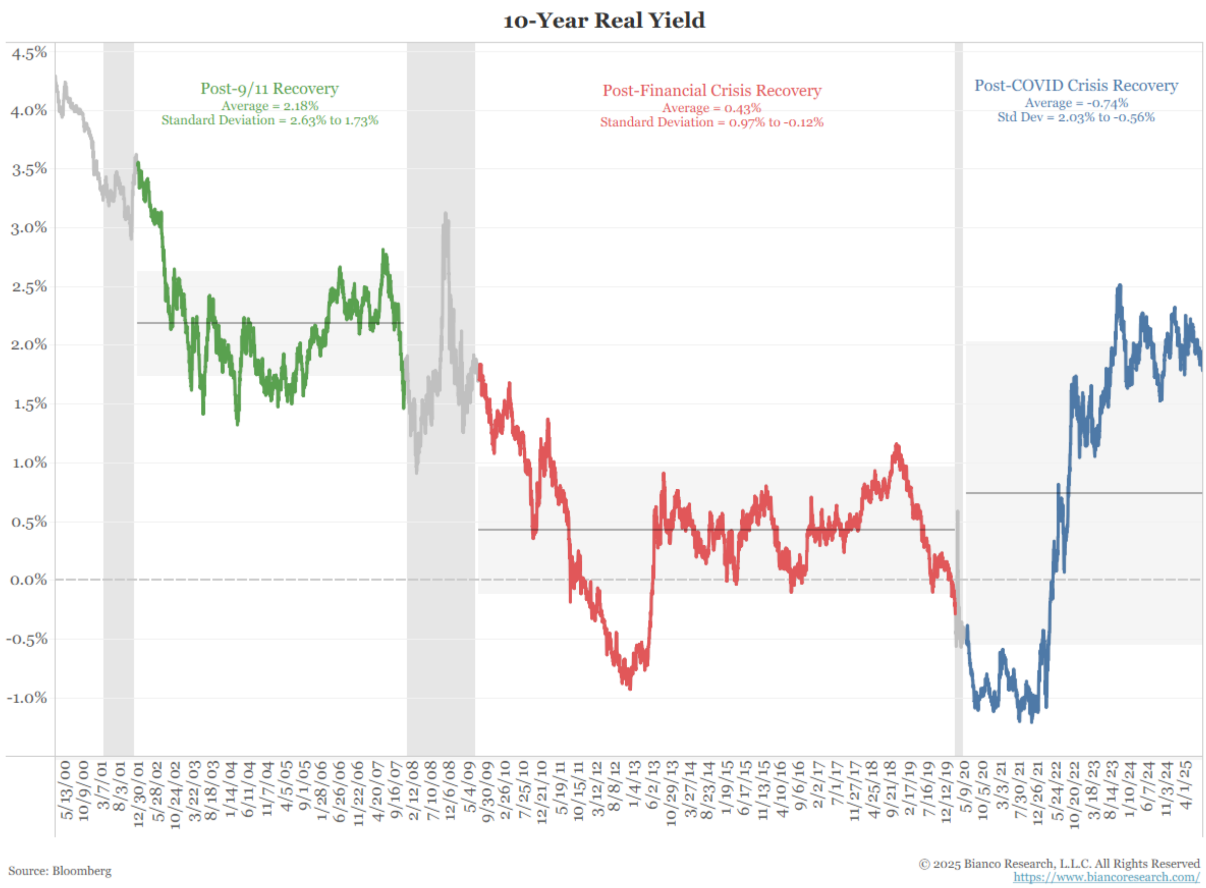
Impact on Inflation Expectations and Real Rates

The impact of the inflation charts above is evident in the markets, as shown below.

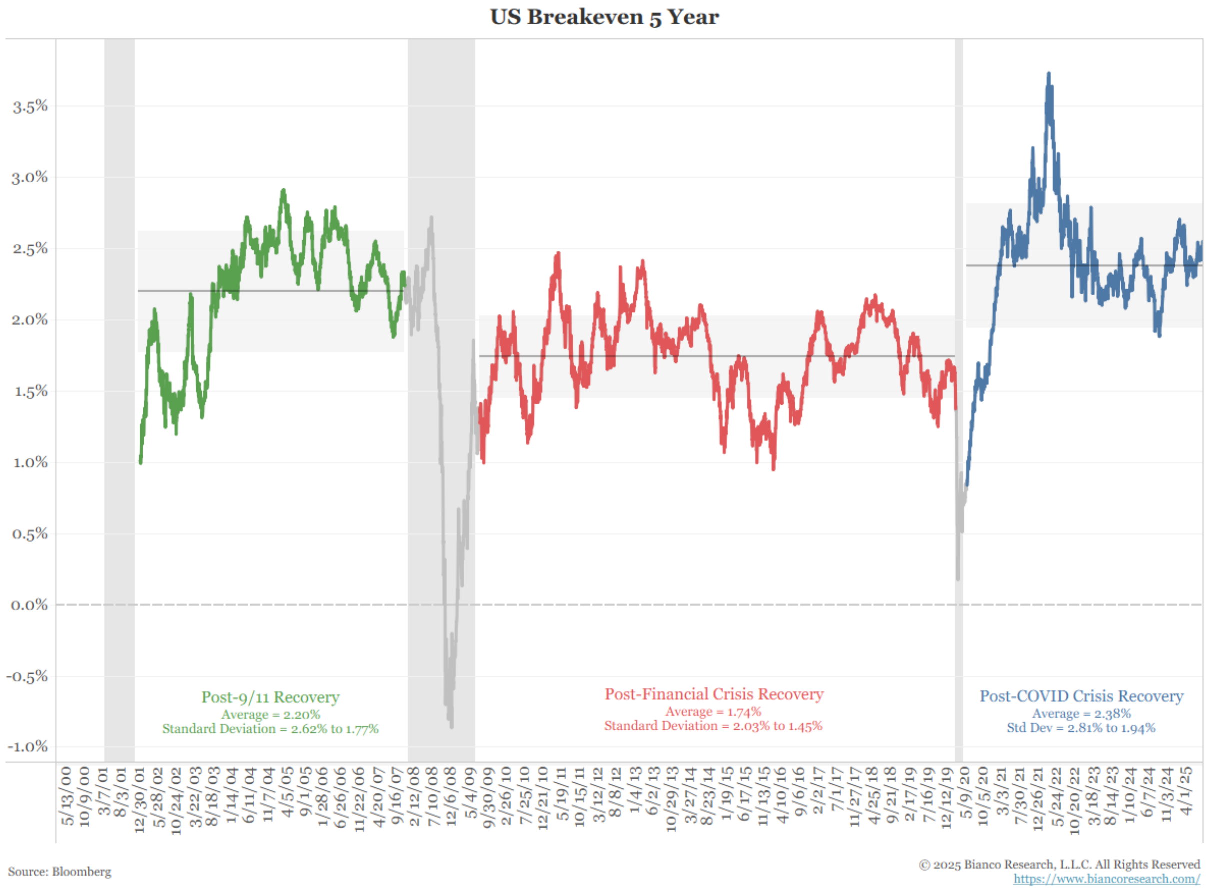
It's a 20-year decline in 10-year real yields (inflation-adjusted) through the post-9/11 recovery, and the financial crisis recovery has ended. As the blue line indicates, the average is now higher than it was during the previous recovery, and volatility is significantly greater (as shown by the standard deviation band).



Driving these higher yields is the expectation of higher inflation.

As the inflation charts above show, we've had several years of elevated inflation. The following chart shows the five-year Treasury Inflation-Protected Securities (TIPS) inflation break-even rate. That is the five-year yield less the five-year real yield from the TIPS market.

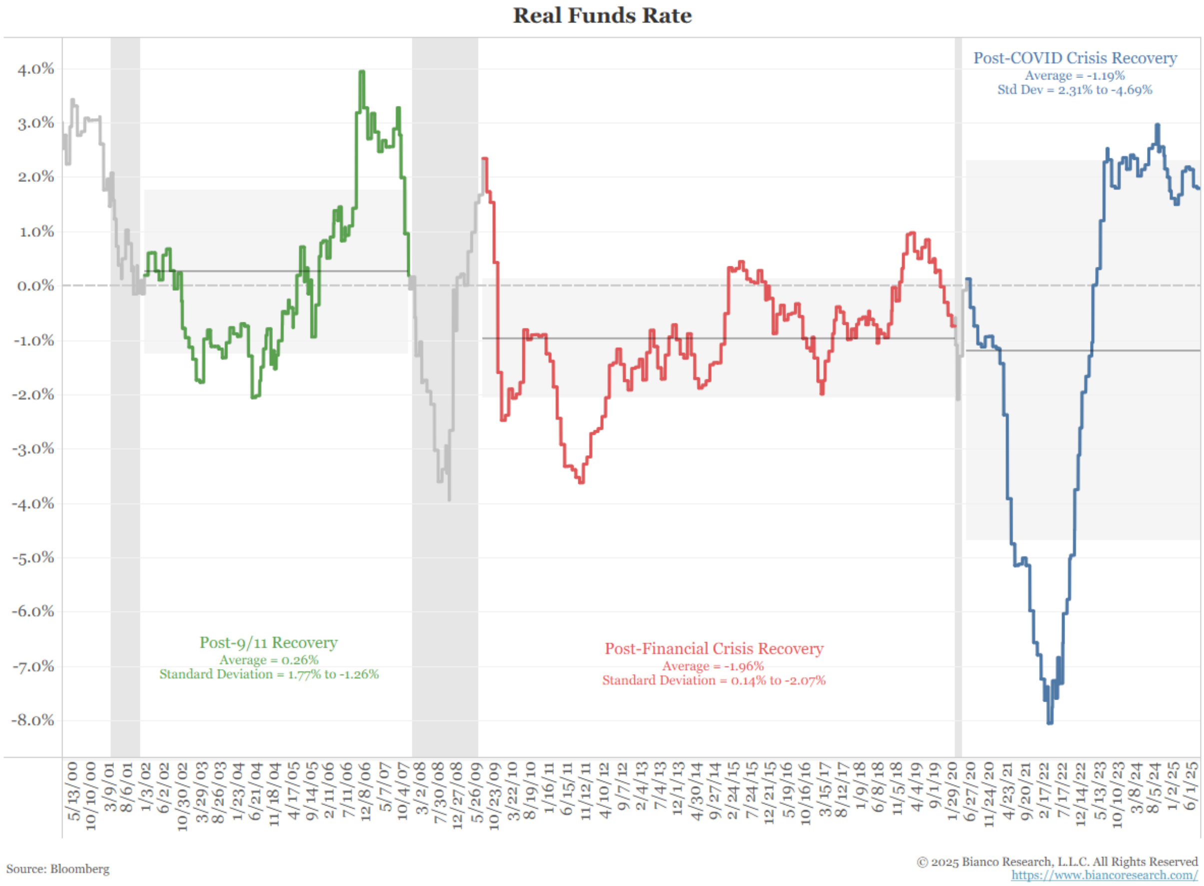
It remains elevated in the post-COVID.



Finally, while the real funds rate has been highly volatile in the post-COVID period, it is settling at around 2%.

This would imply a neutral funds rate of at least 4% if the Fed could hit its 2% target. The problem is, as the inflation charts show above, they're nowhere close to their 2% target.

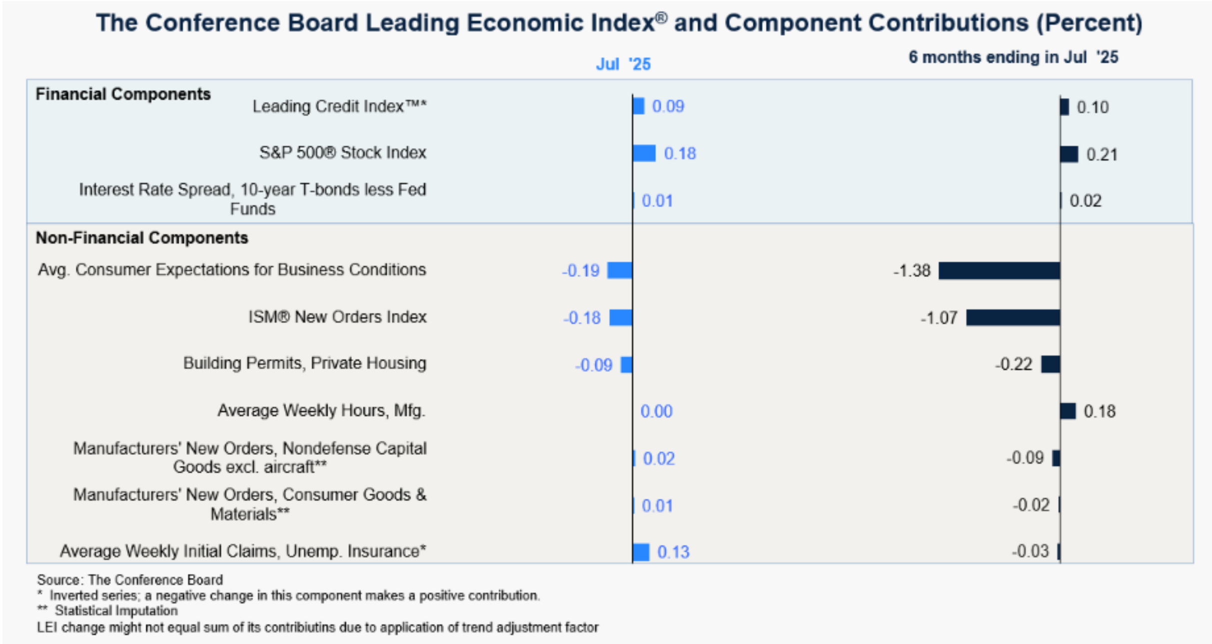
This implies the Fed is not nearly as restrictive as they think they are. And if they're about to go into another round of cutting rates, they could easily go into stimulative territory, fostering fears of even more inflation.



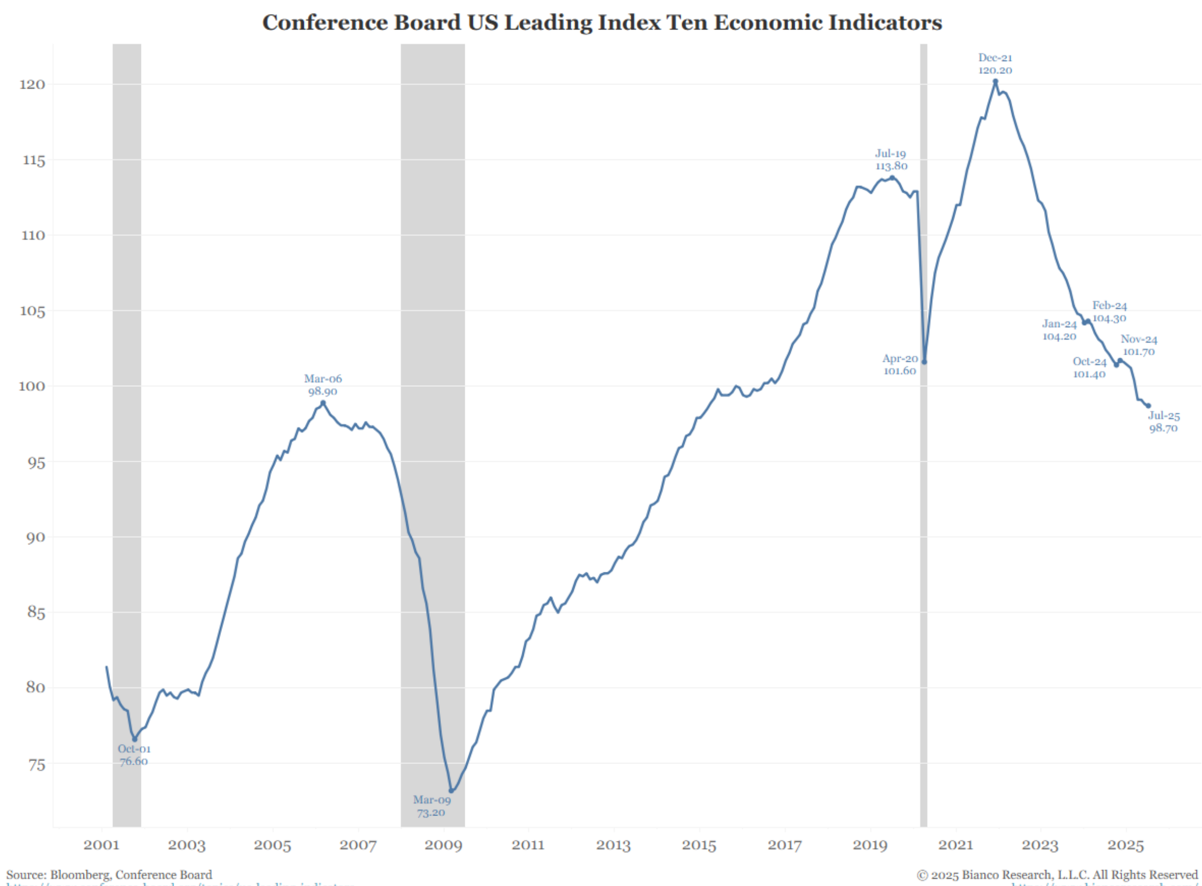
Measuring the Economy

The two chart sections above illustrate that inflation has changed, and this shift has altered the market dynamics. This has been difficult for people to understand because the basic measurement of the economy is becoming more complicated than usual.

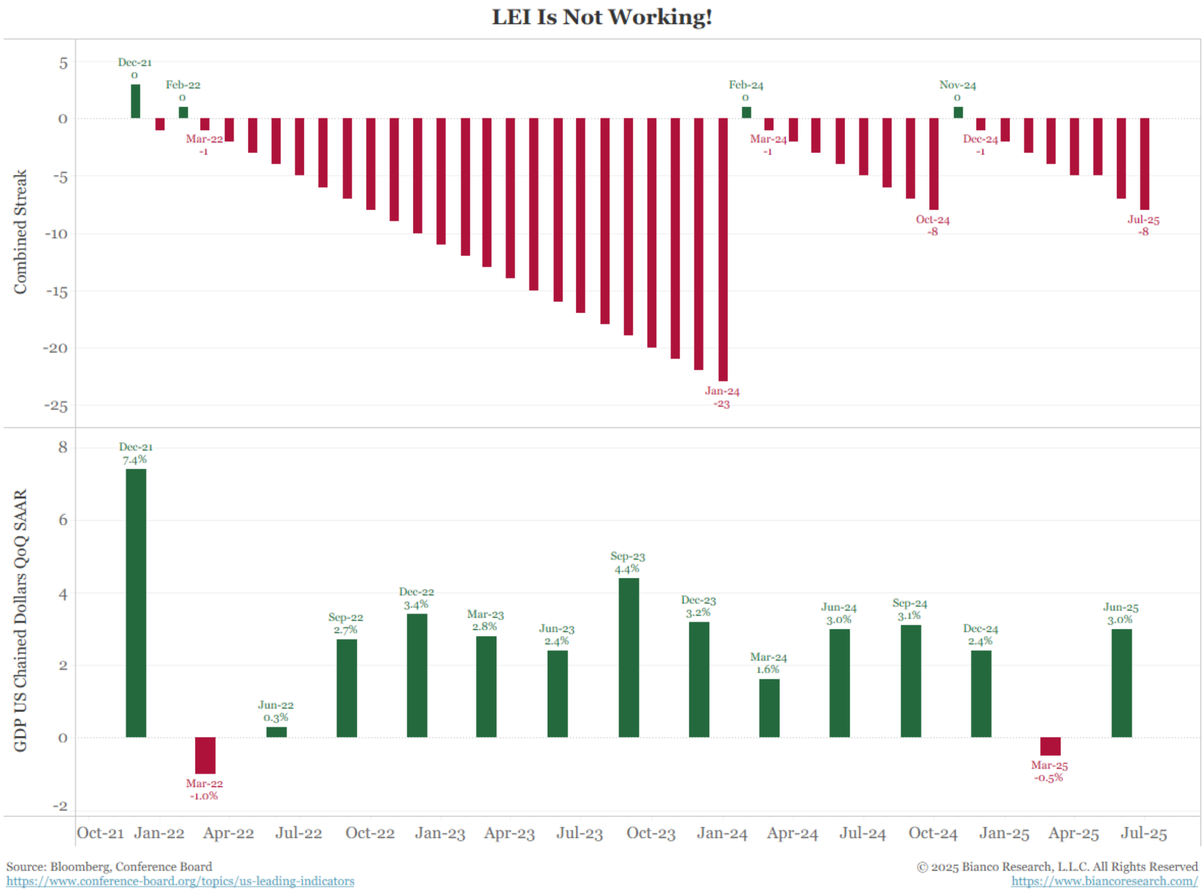
The Confidence Board's Index of Leading Economic Indicators (LEI). It is an index of ten economic indicators designed to predict the next movement in the economy.



This index peaked in December 2021.



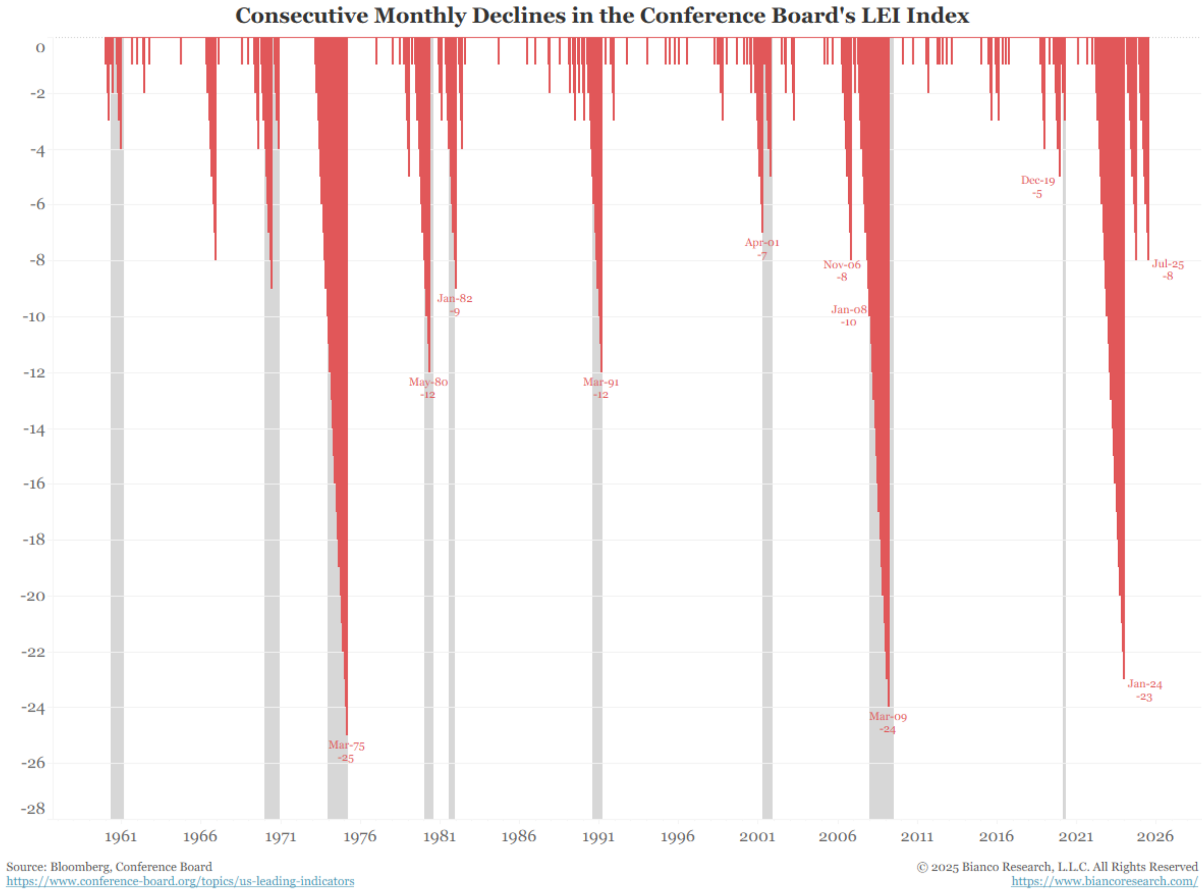
As the top panel below shows, starting in February 2022, the decline has been sustained in 39 of the last 41 months.



The following chart above goes back to 1960. The shaded areas are recessions. A streak of declines of at least seven months has historically been a predictor of a recession. The longest streak before a recession was ten months in January 2008, when the Great Recession started.

Since 2022, this indicator has experienced a streak of declines totaling 23 (as of January 2024), 8 (as of October 2024), and is currently on another streak of 8 declines (as of July 2025).

Any one of these three should signal the start of a recession. However, the bottom panel in the chart above indicates the economy hasn't been close to a recession.



We often highlight the quote:

“All models are wrong, but some are useful” – UK statistician George Box.

We are not going back to 2019. That was the “pre-COVID” cycle. We are now in the “post-COVID” cycle. This is why data dependence does not work. You must assume a set of relationships between the economy and its measures, such as payrolls, inflation, and retail sales. However, if the economy is shocked by a change, like in 2020, these relationships will not work in the new cycle.

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