The godfather of the inverted yield curve breaks down why his famous recession indicator with a perfect track record won't be accurate this time around
Cam Harvey

With calls for a recession in 2023 now the **base-case scenario for many economists**, the inverted yield curve looks primed to keep its perfect track record as a predictor.

If yields on the 3-month Treasury bill remain higher than those on the 10-year Treasury note in the new year, Cam Harvey says it will be "code red" territory for the famous indicator, which has preceded the last eight downturns.

That's because, historically speaking, the curve needs to stay inverted for a quarter for the indicator to perform its best, according to Harvey, who discovered the phenomenon as a recession indicator in the 1988 published version of his doctoral thesis. The curve's inversion started on October 18 this year.

Harvey, now a professor at Duke University and the head of strategic research and product development for Research Affiliates, believes that will happen, with the curve the most inverted its been since 2000. Yields on the 3-month Treasury bill sit at 4.32% while 10-year Treasury yields are at 3.45%.
Yield curve inversions have preceded the last eight recessions, which are marked in pink. Research Affiliates

There's only one problem: Harvey doesn't believe a recession awaits the US economy in 2023.

"Do I expect a recession? No," Harvey told Insider. "Each episode is different, and this episode is just so different."

**Why the inverted yield curve will be wrong this time**

Harvey said there are three reasons why this time is different and a recession likely isn't ahead, despite that his indicator is flashing warning signs of an economic slump.

One is the excess demand for labor. The number of job openings in the US is remarkably high at more than 10 million, while unemployment remains historically low at 3.7%. As such, workers who lose their jobs find themselves quickly employed again.

The amount of tech workers, for example, that now find jobs within 3 months of being laid off is 75%.

**Unemployed? Not for long.**

Pct. of laid-off tech workers who found a new job within 3 months

![Chart showing the percentage of laid-off tech workers who found new jobs within 3 months]

*Note: Month and year refer to when workers lost their job.*
Another is that the yield curve is inverted on a nominal basis, but not on a real basis. So, while shorter-term yields, on their face, are higher than longer-term yields, it's a different story when inflation expectations are taken into account. Harvey's dissertation focused on yield curve inversions on a real basis, though the indicator has a perfect track record since 1968 on a nominal basis.

Right now, short-term inflation expectations are much higher than long-term inflation expectations, which means the real-yield on longer-duration bonds are higher.

Below are the Federal Reserve's current inflation expectations (blue line) for a year from now through the next three decades.
prepare for a recession, Harvey said. Doing so then helps to prevent a recession from happening.

"There's this adage that once a signal for forecasting becomes popular it stops working," he said. "You've got an inverted yield curve — people know that that's got a very strong track record. That impacts their expectations, it changes their behavior, and people become more cautious, and yes, economic growth slows."

He continued: "But given that people are more cautious, they actually provide themselves — and companies also — that when the economy does turn down, they're somewhat insulated because they're prepared. They've exercised risk management. And that enables the economy to have a so-called soft landing."

While Harvey doesn't see a recession playing out, he also urged the Fed not to overdo it on rate hikes. While the exact breaking point is unknown, Harvey said raising the fed funds rate too high will eventually send the economy into recession.

**The inverted yield curve's legacy**

The inverted yield curve has come to be revered as an extremely reliable harbinger of economic pain.

The thinking behind it goes that when investors fear that a downturn is coming, they pile into the safe haven 10-year Treasury note in order to lock in returns. Demand for the asset then drives up its price and pushes down its yield. It can also be a symptom of short-term rates mirroring a expectations for the Fed funds rate.

Here's a comparison of today's yield curve versus 2012, when the curve was more normal.

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**US Treasuries Yield Curve**

An app for exploring historical interest rates

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As for what Harvey thinks for the future of the yield curve as a recession indicator?

"Do I believe the model will continue to be a perfect forecaster of recessions? No. Come on. It's a model with one variable," he said. "I'm very pragmatic about this. I'm not hyping any model."
Here's why the inverted yield curve isn't as bad for the stock market as many fear, Leuthold Group's Jim Paulsen says

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