



A Recession May Be Delayed, Not Avoided

March 2023



KEY INSIGHTS

- Equity markets started the year on a positive note, boosted by economic surprises in the U.S. and improved outlooks in China and Europe.
- In our view, favorable economic news in the near term could mean a more hawkish Federal Reserve, which would be a headwind for the economy and equity markets.



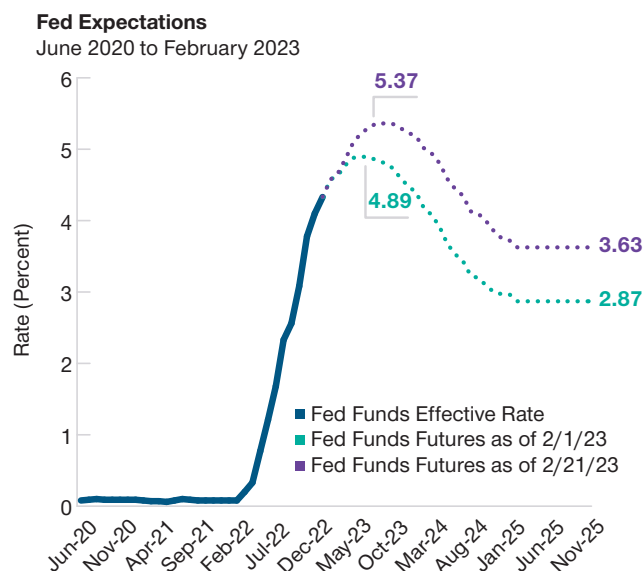
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Equity markets rallied from the beginning of the year into early February, driven by encouraging data regarding the health of the U.S. economy and improved

economic outlooks in China and Europe that were supported by the reopening of the Chinese economy and falling energy prices in Europe.

Positive Economic Data Could Mean Rates Stay Higher for Longer

(Fig. 1) 10-year U.S. Treasury yield and Fed rate hike expectations rose in February



Past performance is not a reliable indicator of future performance. Actual outcomes may differ materially from estimates. Estimates are subject to change.
Source: Bloomberg Finance L.P.

In the U.S., positive economic surprises—including an unexpectedly strong jobs report in January, an uptick in consumer spending, and a slowing trend in inflation—boosted optimism that a U.S. and global recession could be avoided. However, investor sentiment shifted by mid-February amid concerns that these positive developments could lead the Federal Reserve (Fed) to take a more hawkish policy stance. From February 2 through February 21, the 10-year U.S. Treasury yield rose, and futures markets shifted their predictions for both the federal funds rate and the 10-year Treasury yield meaningfully higher (Figure 1).

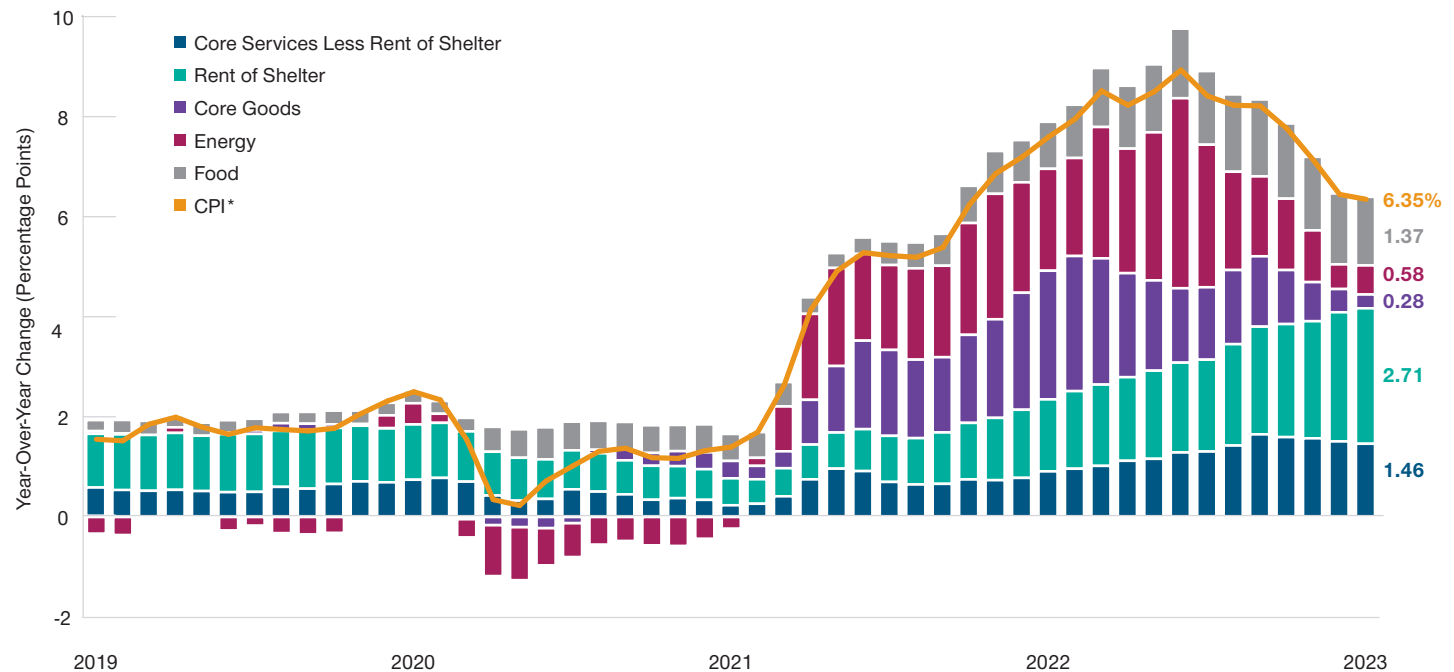
Notably, the Fed has signaled that it remains committed to fighting inflation. Although aggregated data show that inflation is slowing overall, the

“services excluding shelter” category—which is very sensitive to wages—is still problematic (Figure 2). Typically, strong economic indicators suggest a healthy economy, but to the Fed, they also indicate that labor costs are likely to remain stubbornly high and that additional rate hikes may be needed to moderate elevated wage inflation.

In our view, positive economic news may be short-lived as the Fed could be forced to keep raising rates—a headwind for the economy and equity markets. This could mean that, for now, a recession may be delayed, but not avoided. Therefore, we remain cautious, and the T. Rowe Price Asset Allocation Committee is maintaining an underweight position in stocks relative to bonds.

Inflation Is Not Falling Fast Enough

(Fig. 2) Contribution to the consumer price index (CPI) in percentage points



January 2019 to January 2023.

Source: Bloomberg Finance L.P.

*CPI = year-over-year percent change. CPI measures the monthly change in prices paid by consumers and is a widely used measure of inflation.

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