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Steno Signals

with Andreas Steno

Steno Research

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Cycles don't die of age; they die of central banks

Our CB decision index, the best medium-term leading indicator we run, projects a cycle peak in Q4... but the oil impulse, a trillion in unused eSLR capacity, and a Fed that just got a -23k payrolls report all argue that the executioners may holster the weapon this time. Here is the full cycle rundown.

Before we get to the business cycle update, with a slightly more forward-looking lean, let's just briefly assess our nowcasts, because they are what's happening right now. And as we showed on Friday, there is every reason to listen to these nowcasts, as they offer upwards of 6 weeks of lead time for financial markets. Currently, the very low inflation probability (USD down, especially the US front-end (e.g., 1y1y rates) down) is a clear expression of that, while the momentum equity case is stabilizing in forward returns, given our growth nowcast stabilizing as well. So on "spot", it seems early to throw in the towel on the business cycle, especially if the Fed adjusts to the softness in the two parts of the mandate (we will release our SOFT CPI preview tomorrow morning, but as pre-warned, it is soft)... but that is of course an important IF...

Chart of the week: Our US nowcasts speak volumes...

Chart 1: US inflation probability has collapsed to ~5% while liquidity holds above 65%

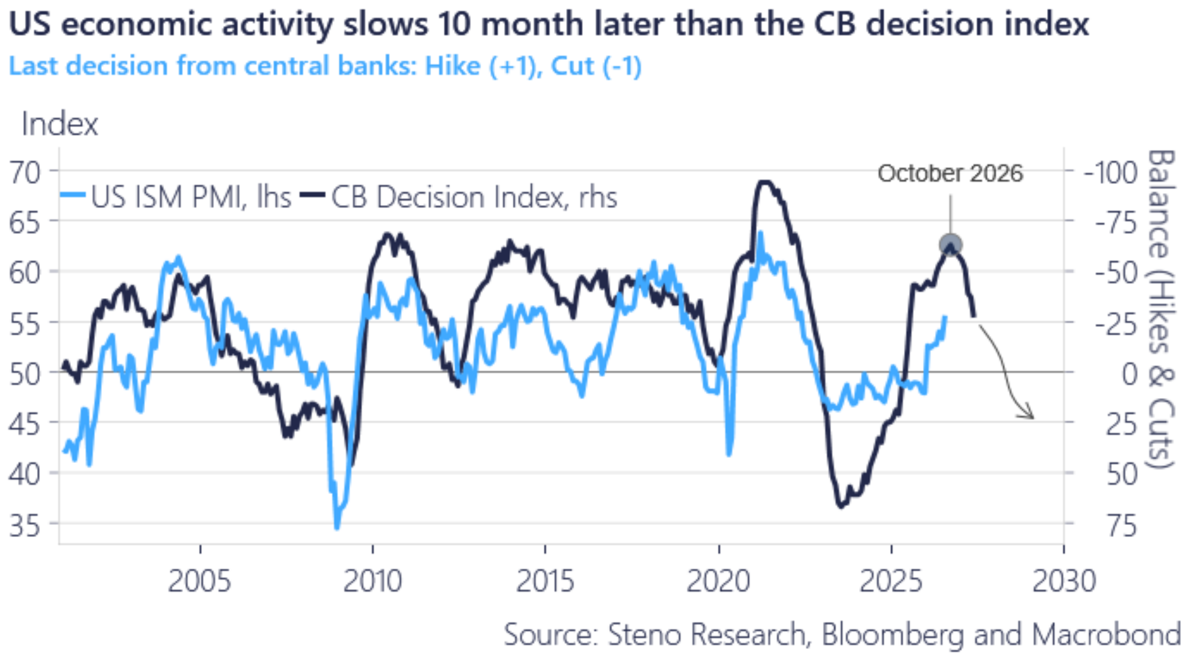
Source: Steno Research Investment Strategy

I have studied business cycles for many years... it has always been my professional niche, alongside liquidity analysis, ever since I first stepped onto a trading floor just after the GFC (2009-2010, the era of free banker tears). And in all those years, I have STILL yet to encounter a business cycle that died of old age. Business cycles do not die peacefully in their sleep surrounded by loved ones. They die when central banks raise the price of credit markedly, into an economy that runs on layer upon layer of debt. In a hyper-financialized economy, that is when cycles die... we feed off the credit spiral, so if you raise the price of the spiral, the spiral stops spiraling. Simple as that.

Which brings us to the question of the year: is the execution squad assembling? We are still waiting for the final verdict on whether the Fed joins the hiking party (our jobs and price nowcasting says they won't anytime soon... or at the very least that they SHOULDN'T, and Friday's -23k payrolls print did our arguing for us). But plenty of others have already fired: the ECB hiked in June and the market prices another by year-end, Norges hiked in May and sits as the highest-yielding G10 bank, the BoJ keeps nudging higher on a weak yen, and the Riksbank is openly flirting with late-2026 hikes. A genuine wave of hikes... just not from the bank that actually matters most.

And here is why you should care about counting these decisions at all: there is a remarkably neat correlation between our CB decision index (the running balance of hikes and cuts globally) and the ISM cycle, with the decisions leading US activity by roughly 10 months. On current scores, the index projects a PEAK in the cycle in Q4 this year. That seems fair to me... but there is a caveat, and the caveat is the whole article.

Chart 1: US economic activity follows the CB decision index with a ~10-month lag... and the index says Q4 peak



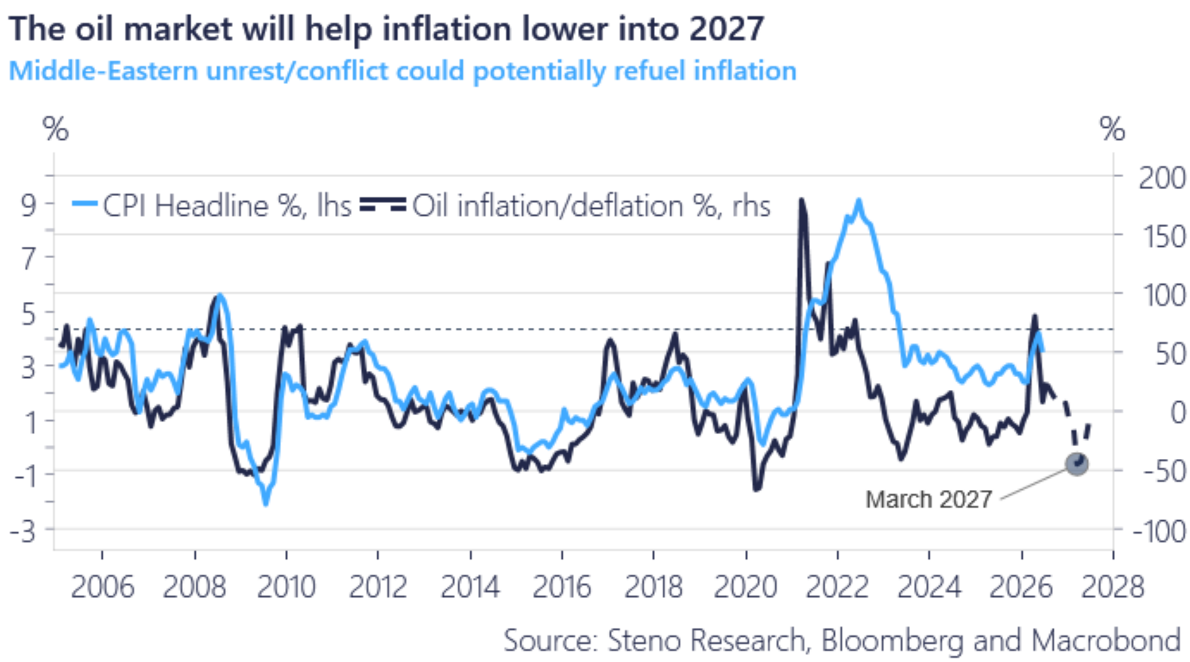
The oil impulse rides to the rescue... with impeccable timing

When looking at the oil impulse on inflation, we are going to see a MARKED reversal of the CPI impact from oil into next year. Assuming a steady-state oil price of 65-70 USD (and we just wrote a whole piece on why MoU 2.0 caps the upside), the mechanical oil contribution to inflation flips negative right when the cycle needs central banks to back off again... in Q4 this year and into Q1 next. In other words: exactly when the CB decision index says the tightening bites, the inflation data will be handing central bankers the excuse to stop biting.

This makes it far less obvious to me that THIS cycle gets killed by central banks. The 2026 hiking wave has mostly been a response to the oil shock from the Iran war this spring... not to any broad-based spreading of inflation. And if our nowcasts stand true, there is a clear LIMIT to how much spreading we will see: in the US we observe outright softness in the price data DESPITE the energy shock, when an energy shock of this size would normally be breeding second-order effects all over the place by now. We track a lot of data points on this. The second-order wave simply is not showing up.

So, if this was merely an oil shock that never transforms into a second-order inflation wave, some of these central banks may well be back on the CUTTING path into 2027. I would not rule it out... and a hiking cycle that quietly reverses into cuts is not an execution; it is a warning shot. Cycle prolonged, in case.

Chart 2: The oil market will help inflation lower into 2027... right when the cycle needs central banks to back off



Financial conditions: the dog that has not barked

What is interesting is that despite an oil shock AND a somewhat stronger USD through the spring, overall financial conditions have not really tightened... not even after the series of hikes from the non-US central banks. The Fed is of course the bank that matters for global conditions, but even so: conditions have merely FLATLINED since the war rather than tightened, which does not look remotely alarming. Yes, the momentum toward easier conditions is gone, and yes, there is a wave of hikes outside the US... but the hikes have been limited in scope and paired with remarkably meager forward guidance on more to come. Half-hearted hikes with no follow-through promised is not how you murder a cycle.

Conditions do often tighten BEFORE the economy does, so this is a chart to keep watching rather than filing away... but for now, the honest read is*: nothing to report, beyond the fact that the easing trend that ran all the way until the Iran war has stalled.*

Chart 3: Financial conditions have flatlined since the war... stalled is not the same as tightened

The cycle within the cycle (and the Korea tell)

Then we have the whole AI cycle, which is almost a cycle story WITHIN the broader cycle story... and one growing increasingly dependent on the credit cycle, now that the hyperscalers have begun tapping the bond markets rather than funding the buildout purely from existing cash flows. This is a genuine change versus 2023-2024: back then the hyperscalers were almost POSITIVELY correlated to rates (cash-rich duration monsters earning interest on their war chests), and we can no longer lean on that conclusion. The AI complex is not rate-proof anymore... it is merely rate-resistant, and the difference matters if the executioners ever get serious.

For the spill-over into the real economy, keep watching Korea. The immense capex flowing into data centers is visibly broadening into a manufacturing cycle, and Korean exports (the world's best high-frequency proxy for exactly this) continue to lead the ISM higher. The macro-to-micro transmission we keep banging on about is not a theory at this point... it is on the chart.

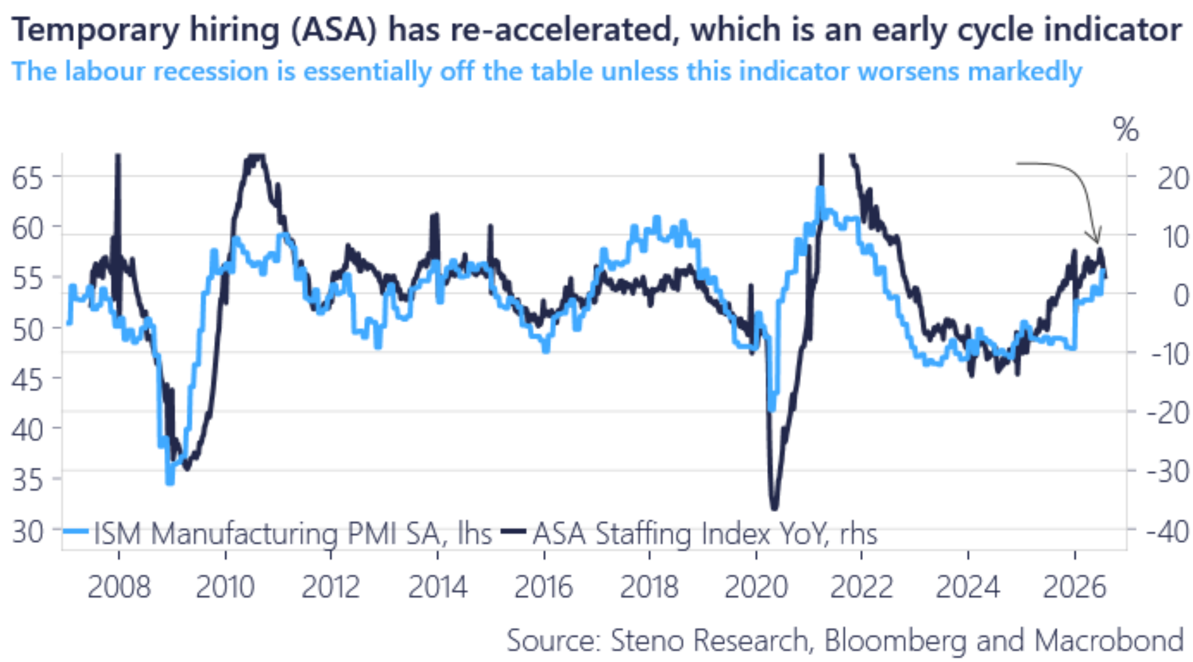
Chart 4: Korea is a solid leading indicator for the ISM… and the AI capex spill-over is visible in real time

Labor: the early warning that is warning, a little

In terms of the labor market, we were among the very few who got the re-acceleration right earlier this year, well in advance of the actual hiring, citing, among other things, the ASA staffing index as the tell for upcoming hiring. That indicator has now PLATEAUED again… and as our tax-based indicators rightfully predicted on Friday (consensus 80k, us at the bottom of the street, actual -23k), we are basically back to flat-to-slightly-negative hiring in the US.

The ASA index is another strong coincident indicator for the ISM cycle, and it is why we are not ruling out that the TEMPORARY peak in ISM sits closer than the Q4 top projected by the CB decision index, which remains our favorite medium-term leading indicator. A lot depends on the AI buildout and how forcefully the data-center capex keeps spilling into manufacturing. Let's see how far we go…

Chart 5: Temporary hiring (ASA) has plateaued... the early-cycle engine is idling, not stalling

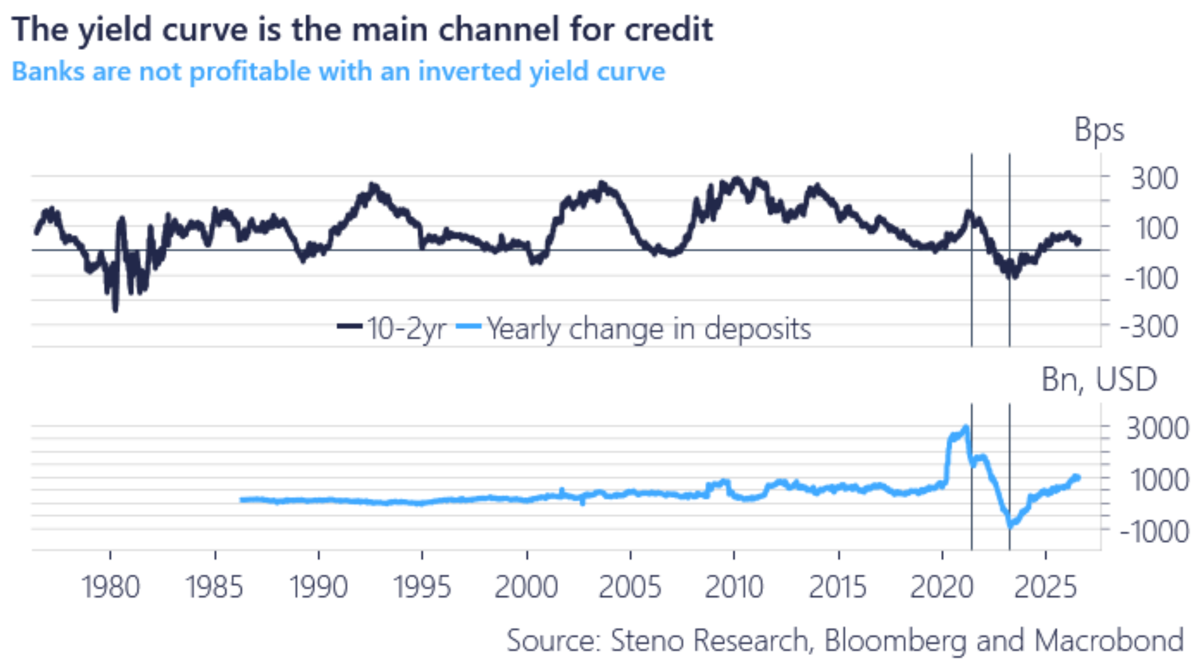


The credit channel: What Japan just taught everyone

What is genuinely tricky in this cycle is assessing the impact of a fundamentally CHANGED liquidity and regulatory policy, in the US and elsewhere. Japan is the textbook case: a re-awakening of the classic credit cycle after it lay dead and buried for decades, because yield curve control incentivized precisely zero bank lending. Remember what a bank business model actually IS: if the curve is steep, a bank makes money. If it is flat as a pancake, it does not. There is no third option, whatever the equity analysts tell you. When the Japanese yield curve was allowed to function again, the private sector woke up almost immediately... and we have seen shades of the same trend elsewhere, including in the US.

This mechanism is harder to forecast, but it is, once again, correlated to the central bank cycle: when central banks tighten the grip, they typically flatten the curve, which dis-incentivizes credit creation from the commercial banks. So the pass-through from CB decisions to the credit cycle runs through the curve... as it should, and as it always has.

Chart 6: The yield curve is the main channel for credit… flatten it and the lending dies with it



But this time, the regulator is pushing the OTHER way

And here is the twist that makes this cycle different from every other one of my professional career: banks are seeing more LENIENT regulation for the first time in roughly 20 years. The screws have been tightened on banks continuously since I entered the sector post-GFC… and the Trump administration has now moved the needle the other way, with the eSLR reform live since April 1 as the flagship.

For those who missed our deep-dive earlier this summer, the short version: regulators stepped back from what had become an overly punitive leverage framework, scaling the extra buffer with systemic importance instead of applying a flat add-on. Most large banks see leverage requirements fall from roughly 5% to 3.5-4.25%, and the SUBSIDIARIES… the entities that actually hold Treasury inventories, run repo with hedge funds, and clear derivatives… drop from an effective 6% to the same scaled range. That implies capacity multiples of 1.41x to 1.71x, or 41-71% additional balance-sheet room exactly where market plumbing lives. We estimated well over 1 trillion USD of additional usable capacity in the safe parts of the balance sheet, with the practical increase in lending and credit capacity closer to 300-350bn after other constraints… still a meaningful expansion, and one deliberately aimed at Treasuries and repo (Bessent's soft-QE-via-commercial-banks, as we called it).

And is it working? Commercial banks added almost 100bn USD of Treasuries this year alone and expanded reverse repo by a similar amount through March, with primary dealer financing books climbing steadily since. But here is the point for the CYCLE: banks have so far utilized only a FRACTION of the fresh capacity. There is roughly a trillion still sitting on the shelf. That is not what a late-cycle, constrained, executioner-ready system looks like.. that is dry powder for credit creation, sanctioned by the regulator, in the middle of a bank-lending revival.

Chart 7: Roughly 1 trillion of fresh eSLR capacity is STILL sitting unused… dry powder, regulator-approved

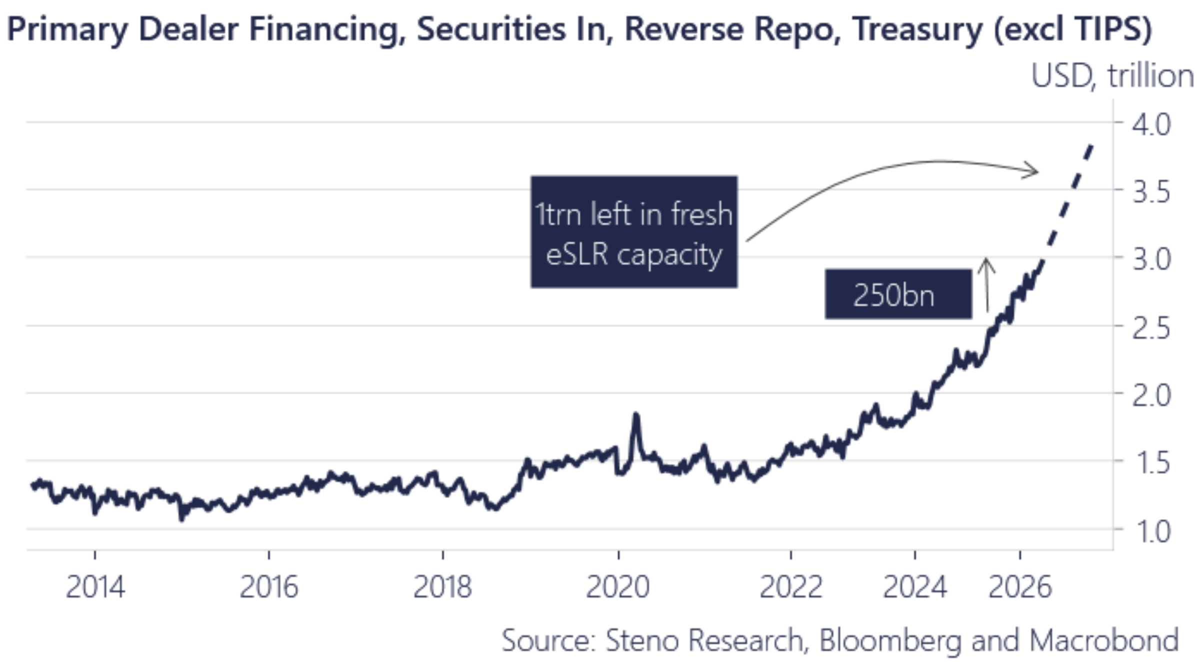
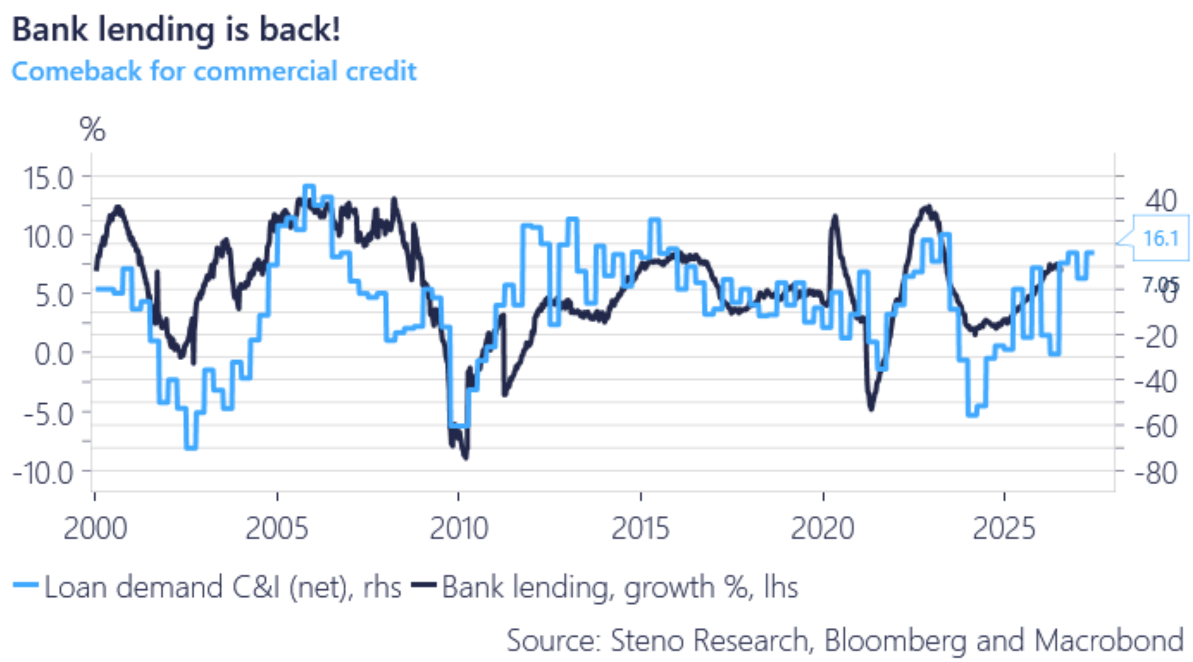


Chart 8: Bank lending is BACK.. the first regulatory tailwind of my professional career



So… who shoots the cycle?

Putting it together: the CB decision index says the tightening already delivered will bite into a Q4 activity peak, and we respect that indicator too much to wave it away. But every accomplice the executioners need is going missing: the oil impulse turns disinflationary into year-end, the second-order inflation wave refuses to show up in our nowcasts, financial conditions have stalled rather than tightened, the Fed just received a payrolls report that makes hiking politically and intellectually absurd, and the banking system is sitting on a trillion of freshly deregulated balance-sheet capacity in the middle of a lending revival. Cycles do not die of old age.. and right now, the only people capable of killing this one are being talked out of it by their own data. We stay constructive on the cycle into 2027, with the CB decision index as the tripwire to watch if the hikers find their conviction again, but it could admittedly get pretty nasty fast if the Fed hikes into this, especially since real rates have already shot up a lot just by them saying nothing.

So the Fed will (as per usual) be key here, and I still hold high hopes that they can deliver a pivot from the pivot, but some of the members have already semi-cornered themselves with rhetoric supporting a hike, right as the data on jobs and prices turns on them. As I have said in recent months: I continue to think that the data points to a cut rather than a hike from the Fed (since our inflation data is so soft), but there is a long way to go before the committee admits to that. A prolonged "status quo" is probably the best we can hope for, but that should also be sufficient to keep the cycle alive into 2027...

Best of luck out there...

Andreas Steno

Andreas is the core macro consultant in Steno Research. Building on years of experience as Global Chief Strategist at Nordea Bank, he is one of the most quoted and sought-after macro analysts out there. Andreas' expertise is the FX/rates, energy, real estate and equity spaces, but doesn't shy away from hot takes on other topics if the underlying analysis is strong enough. Andreas anchors the weekly editorial 'Steno Signals'.

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