VICTORIA
Capital Management, Inc.

Weekly Market Missive

Is the Panic Over?

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So far, April has been a good month for financial assets. Even in the face of a run on two regional banks, the Fed and the FDIC stepped up and guaranteed depositors that they would not lose money. Even accounts with deposits over the $250,000 limit received assurances that they would be made whole. Like the pandemic, the crisis led to a massive government intervention that saved the economy. The only problem was that the pandemic-related stimulus was excessive, and all that money translated into an increase in demand for goods and services that drove prices higher. Inflation, at one point, rose to a 9.1% annual rate as measured by the consumer price index (June 2022). The Federal Reserve acted quickly and raised interest rates continually throughout last year and even through April of this year to drive that inflation number lower. The Fed's announced target was to get that rate down to 2% on an annual basis.

The question is whether those interest rate increases have succeeded. At least the recent data on inflation say they have been somewhat successful. Last week, the CPI for the month was reported up only 0.1% or 5% for the year. This level is still elevated but the trajectory is downwards. Meanwhile, the producer price index (PPI) declined by 0.5%, well below consensus expectations. For the year, this measure of inflation is up only 2.7%. Also, last week's earnings for the big banks came in above expectations signaling that higher interest rates are benefiting the bottom line and boosting profits. Over the next two weeks, companies will be reporting earnings for the first quarter and trends continue to be favorable; although many companies that benefitted from the government's spending programs could experience one or more periods of disappointing earnings.

Not only has the Fed been tight, but fiscal policy stimulus has also slowed down appreciably. The change in Congressional leadership last November has put a break on the Administration's plans for large spending increases that could reinvigorate inflation. Also, the proposal for massive tax increases would slow the economy at a time when the data tell us the economy is already slowing. Another factor that could affect the outlook is the fact that the government's debt limit could be breached over the next few months leading to a stalemate. Every year there is a discussion about increasing the debt limit due to an impending government shutdown. And each year, the government has increased the debt limit. So, the impact on the economy of such discussions is usually limited, and this time is no different.

Fears of a recession i.e., a downturn in economic growth have also abated recently. An important reason for that belief is the continued strong data on employment growth. Even though several large corporations have announced layoffs, these have not affected measures of employment. Additionally, there are still millions of jobs out there waiting for applicants. The reduction in spending on programs related to the pandemic may also be encouraging people to go back to work. The war in Ukraine is still a thorn in the side of the global economic outlook but the latest data on several economies and financial markets are signaling that the panic is over.

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