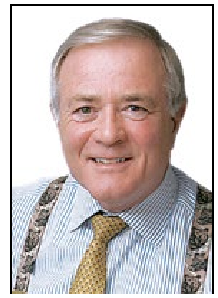
DJC
THE DAILY JOURNAL OF COMMERCE, PORTLAND, OREGON


William Rutherford

Economic expert: The sky is not falling | Opinion

Published August 4, 2023

One day while sitting under an oak tree, an acorn fell upon the head of Chicken Little. She looked everywhere but could not find what had hit her. She concluded that what had fallen on her was part of the sky and decided it was so important that she had to tell the king. So off she ran to tell him that the sky was falling. She ran as fast as she could. Along the way she encountered friends who asked her why she was running so fast. She told them what had happened and that the sky was falling. Alarmed by this news, her friends joined her in running to tell the king, all of them yelling that the sky was falling. The king assured them that the sky was not falling.

Recently, a similar popular mantra has been that we must have a recession to slow inflation. People took up the recession alarm, until recently reported robust big bank earnings suddenly inspired economic optimism. All three of the largest banks beat analyst expectations for revenue and earnings. JPMorgan Chase's earnings jumped 67 percent from a year earlier. Wells Fargo's income was higher by 57 percent. Collectively, the three biggest banks earned $49 billion in net interest income in the most recent quarter – up 31 percent from the previous year.

Not only did the loans increase, but banks charged more. Loans to businesses increased. Higher credit card balances represented more loans to consumers at elevated finance charge rates. Even mortgage originations increased. The banks lifted their forecast for 2023 profits related to lending.

Previously, analysts sounding the alarm had forecast that the economy would continue to slow. And loans might turn sour as interest rates increase. Bank earnings would be impacted as the banks would have to pay higher interest rates to retain deposits from competitors paying higher interest rates. Banks were tightening credit and being more selective in lending. Several months ago, concern by depositors about the impact of increased funding costs from higher interest rates pushed Silicon Valley Bank and Signature Bank to failure. This largely benefited the large banks, as they swooped in to buy the failing banks' deposits and loans and thus grow their own books of business. However, regional and smaller banks lowered their earnings forecasts as they underestimated how much they would have to pay in interest on deposits. Loan defaults increased somewhat but remained historically low.

Recent economic data spurred optimism, and the bad economic forecasts didn't materialize. The economy appears on a solid footing, despite the recent interest rate increases. Tech stocks were up due to both increased earnings and price/earnings multiple expansion. The tech-heavy Nasdaq booked its best first half of the year since 1983, rising 31.7 percent – nearly offsetting its 33.1 percent decline last year. The Nasdaq 100 (the largest companies in the broad index) had its best first half ever with a rise of almost 40 percent. The Dow rose 3 percent in July and had a 13-day streak of higher closes, the longest such record since 1987. It is now up 3.8 percent for the year – about 8 percent below its record high in January 2022. Continued optimism over the transformative possibilities of AI has fueled this rising tide.

In the meantime, in the global perspective, China, the world's second largest economy, has experienced slowing growth and has investors worried.

Indicative of growing optimism in the U.S. is Paul Krugman. Mr. Krugman won the Nobel Memorial Prize in Economic Sciences in 2008 and now writes for the N.Y. Times. In a recent article, he said that inflation seemed to be fading without a recession. In debunking the widely held belief that inflation could not slow without rising unemployment, he said that inflation was in fact falling sharply, even though unemployment was not rising. He cited inflation over the last few months as 2.7 percent, not far from the Federal Reserve's target rate of 2 percent, with hardly any rise in unemployment. He gives reasons, such as the recent rate hikes and the lingering effect of the pandemic. He asked what could go wrong.

Of course, the data may just be a head fake by the market. Others argue that squeezing out the last few data points between the market and Fed goals may be more painful than expected. Mr. Krugman argues that we have been hearing about the falling sky for some time, but a soft landing could be within reach. He says that if it turns out that the recent inflation shock was temporary and ends without more suffering, then the recent economic policy has been good. Fed Chairman Jerome Powell will be entitled to a victory lap.

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