



Kristina Hooper
Chief Global Market Strategist



Banking crisis

The banking mini-crisis has subsided, and it does appear it was idiosyncratic rather than systemic.

Inflation reports

Elevated inflation remains a concern in many parts of the world, such as the UK and Japan, but Canada's experience gives hope to the US.

Earnings season

Early reports have seen some positive earnings surprises, but make no mistake – earnings are expected to decline this quarter.

April has gone by in the blink of an eye. The month was packed with data releases that gave us insight into how the global economy is faring despite aggressive monetary policy and the battle against inflation. Below are nine things we learned this month that are relevant for investors.

1. A major banking crisis seems to have been averted

The banking mini-crisis has subsided, and it does appear it was idiosyncratic rather than systemic. After rising above 26 in March at the height of the turmoil, the VIX volatility index has calmed down significantly and finished last week below 17.¹ But it's not over, as we've seen thus far in the current earnings season. So far, banks have reported or are expected to report revenue growth well above 10%,² but the details vary:

- The big money center banks have generally had far better earnings reports, although they share some of the same headwinds as banks in general (i.e., increasing loan loss provisions in anticipation of an economic slowdown, need to increase deposit rates.)
- Regional banks are a mixed bag – some reported continued loss of deposits and are clearly still under stress, while others reported recent gains in deposits. The KBW Regional Banking Index weakened significantly in early March and has been trading in a lower range ever since then, suggesting continued pessimism about at least some of the regional banks. The key takeaway is that a major crisis seems to have been averted.

One financial services CEO aptly described the first quarter as a "real life stress test"; it showed that if policymakers act quickly and effectively, the banking industry will prove resilient.³

2. Credit conditions are tightening

The most significant outcome from the banking crisis is that credit conditions are tightening. It was reported in the latest Federal Reserve Beige Book that, in general, economic activity remained steady, but credit conditions were tightening in a number of districts. For example, the Dallas Fed reported that "Loan demand weakened further, loan volumes fell, and credit conditions tightened", while the San Francisco Fed noted that "Lending standards tightened notably, and several depository institutions opted to reduce loan volumes, especially for new clients, despite reporting ample liquidity."⁴

Additionally, the latest American Bankers Association Credit Conditions Index shows that bank economists anticipate significantly weaker credit market conditions and tighter credit standards over the next six months.⁵

3. We're getting confusing signals about the US economy

Some signals suggest the US economy is in trouble, while others suggest it's very resilient, even rebounding. The Philly Fed Manufacturing Business Outlook Survey showed the lowest level of activity since May 2020, while the New York Fed's Empire State Manufacturing Survey is showing growth for first time in five months.⁶ And flash S&P Global Purchasing Managers' Indexes (PMI) for the US economy were impressive with Services PMI at a 12-month high, and even Manufacturing PMI at a 6-month high.⁷ The preponderance of data suggests that the US economy remains resilient, although it is vulnerable to the lagged effects of monetary policy tightening.

4. The eurozone economy remains resilient

We continue to get positive economic data from the eurozone, which has proven far more resilient than expected. The flash S&P composite PMI for the euro area clocked in at 54.4, an 11-month high.⁸ This was driven by services activity, which is at a 12-month high; we continue to see weakness in manufacturing.

5. Elevated inflation remains a concern in many parts of the world

Prices in the services sector of the eurozone economy are stubbornly high, as seen in the S&P Global PMI surveys. The UK Consumer Price Index for March was a higher-than-expected 10.1% year over year.⁹ This is down from an even more surprising 10.4% in February,¹⁰ but it's not where policymakers want to see it as it raises concerns that inflation may have become more entrenched.

Japan reported inflation of 3.2% in March, year-over-year, which is a modest decline from February.¹¹ However, the core rate, ex-food and energy, was 3.8% vs. 3.5% in February – a very significant increase.¹¹ This could help to put pressure on the new Bank of Japan governor to make alterations to monetary policy.

6. But elevated inflation isn't a concern everywhere

Canadian Producer Price Index (PPI) inflation actually turned negative on an annualized basis in March after peaking in March 2022. The large decline in PPI implies that the pace of disinflation may be underestimated by markets. And don't forget that this data comes after the Bank of Canada hit the pause button back in January, reminding us of a very real policy lag. Also, in this cycle, Canadian inflation has led US inflation, which suggests the US may soon follow in Canada's footsteps.

7. China's reopening has boosted the economy

We continue to get largely good news on economic activity in China as the reopening continues. The Chinese economy grew by 4.5% in the first quarter of 2023, beating estimates of 4% and coming in well above fourth-quarter growth of 2.9%.¹² Even more encouraging, China retail sales rose 10.6% in March, up from 3.5% for January-February.¹³ It is clear that "revenge living" is underway. The CEO of Airbus gushed that, "The reopening of China is proving to be a strong driver

of air traffic as it progressively recovers, and all regions should now converge towards normalized levels or even higher levels than before COVID.”¹⁴

There were some modest disappointments in terms of industrial production and fixed asset investments, but that should improve as business confidence improves. Urban unemployment is moving in the right direction, and I would expect youth unemployment to follow as the reopening continues. I also believe the reopening is contributing to an improvement in global supply chain pressures, which are now at pre-pandemic levels according to the New York Fed Global Supply Chain Pressure Index.

8. Earnings season thus far has been relatively positive

So far, 18% of S&P 500 Index companies have reported first-quarter earnings.¹⁵ Of those companies, 76% have had a positive earnings surprise.¹⁵ Positive earnings have been led by health care, consumer discretionary and financials. However, make no mistake – these are “beats” on downwardly revised earnings expectations. Earnings are expected to decline this quarter. That’s OK – that seems to be what markets were anticipating when they sold off last year. And I believe falling rates should be a countervailing force that helps multiples expand even as lower earnings exert downward pressure on stock prices.

9. Divergence had accelerated

While volatility has fallen for equities, volatility has actually increased for bonds. This divergence began in mid-2022, but it has accelerated recently. Uncertainty about the path going forward for the Federal Reserve may be to blame. I would anticipate implied volatility to increase for equities as the US gets closer to hitting the debt ceiling without a resolution.

Conclusion

All in all, the picture that has developed in April is of a global economy that continues to battle inflation in many parts of the world; however, there is hope that inflation could soon decline quickly from here (at least in the US). We see signs the global economy has held up well despite aggressive monetary policy, and it is certainly getting a boost from China’s re-opening. We’re in a waiting game to see just what an impact tightening will have on these economies, what central banks will do going forward and how quickly the debt ceiling issue will be resolved.

With contributions from Paul Jackson and Andras Vig

Notes

¹Source: Bloomberg, as of April 21, 2023

²Source: FactSet Earnings Insight, April 21, 2023

³Source: The Economic Times, April 18, 2023

⁴Source: Federal Reserve Beige Book, April 19, 2023

⁵Source: American Bankers Association, "ABA Report: Bank Economists Expect Slowing Economic Growth to Tighten Credit Conditions," April 6, 2023

⁶Source: Federal Reserve Bank of Philadelphia, April 2023, and Federal Reserve Bank of New York, April 2023

⁷Source: S&P Global, April 21, 2023

⁸Source: S&P Global, April 21, 2023

⁹Source: Office for National Statistics, April 19, 2023

¹⁰Source: Office for National Statistics, March 22, 2023

¹¹Source: Ministry of Internal Affairs and Communications, April 20, 2023

¹²Source: National Bureau of Statistics, April 17, 2023

¹³Source: National Bureau of Statistics, April 22, 2023

¹⁴Source: Financial Post, "Airbus CEO says air traffic heading back to normal post-pandemic," April 19, 2023

¹⁵Source: FactSet Earnings Insight, April 20, 2022

Important information

Past performance is not a guarantee of future results.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

All investing involves risk, including the risk of loss.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

The profitability of businesses in the financial services sector depends on the availability and cost of money and may fluctuate significantly in response to changes in government regulation, interest rates and general economic conditions. These businesses often operate with substantial financial leverage.

The health care industry is subject to risks relating to government regulation, obsolescence caused by scientific advances and technological innovations.

The CBOE Volatility Index® (VIX®) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. VIX is the ticker symbol for the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility.

The KBW Regional Banking Index seeks to reflect the performance of US companies that do business as regional banks or thrifts.

Purchasing Managers' Indexes are based on monthly surveys of companies worldwide, and gauge business conditions within the manufacturing and services sectors. Flash PMI are estimates based on about 85% to 90% of respondents.

The Consumer Price Index (CPI) measures change in consumer prices. Core CPI excludes food and energy prices while headline CPI includes them.

The Producer Price Index (PPI) is compiled by the US Bureau of Labor Statistics and measures the average change over time in the selling prices received by domestic producers for their output.

The Federal Reserve Beige Book is a summary of anecdotal information on current economic conditions in each of the Fed's 12 districts.

The Credit Conditions Index is a suite of proprietary diffusion indices derived by the American Bankers Association from surveys of bank chief economists from major North American banking institutions.

The Philly Manufacturing Business Outlook Survey is a monthly survey of manufacturers in the Third Federal Reserve District.

The Empire State Manufacturing Index rates the relative level of general business conditions New York state. A level above 0.0 indicates improving conditions, below indicates worsening conditions. The reading is compiled from a survey of about 200 manufacturers in New York state.

The New York Fed's Global Supply Chain Pressure Index integrates a number of commonly used metrics with an aim to provide a more comprehensive summary of potential disruptions affecting global supply chains.

Tightening is a monetary policy used by central banks to normalize balance sheets.

A multiple is any ratio that uses the share price of a company along with some specific per-share financial metric to measure value. Generally speaking, the higher the multiple, the more expensive the stock.

The opinions referenced above are those of the author as of April 24, 2023. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.