

John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday December 14, 2022

Economists and CEOs of several big banks have issued recession warnings for 2023. The group includes Citigroup, Bank of America, Goldman Sachs and JPMorgan. Jamie Dimon, CEO of JP Morgan was one of the first to talk about a recession in 2023. Initially he was concerned that the Fed would have to raise interest rates so high that we would end up in a nasty recession. More recently he has modified his view by saying that the coming recession could be easy or hard depending on how things play out. Inflation, of course, is his biggest concern.

In the December 3 issue the editors of the Economist magazine looked back at the 1980s to see what it took to beat inflation back then. One lesson is that a central bank can only do so much.

“Inflation was not conquered in the 1980s by monetary policy alone” argues John Cochrane of Stanford University. In the 1980s policymakers across the world recognized, as they had failed to do in the 1970s, that loose fiscal policy could add fuel to the inflationary fire. They held back on spending even as household real incomes declined.”

This time inflation was ignited by policymakers in the Biden administration. Their war on American fossil fuel production pushed up the oil price and raised the cost of energy for everyone from homeowners to farmers. In addition, the Biden Administration boosted spending, flooding the economy with cash. Will this make taming inflation more difficult? Here is what the editors of the Economist have to say:

“Do policymakers today have the stomach for the fight? Coming so soon after the fiscally austere 2010s, many are reluctant to tighten the tax-and-spending screws once again. Indeed, many politicians have gone the other way, and now seem uncomfortable with the notion that anyone should lose out from anything ever. They are offering hundreds of billions of dollars-worth of deficit-financed fiscal support that will fuel inflation, whether by subsidizing energy bills (in Europe), offering “cost-of-living payments” (in Australia and New Zealand) or forgiving student debt (in America).

Policymakers are thus ignoring the fundamental lesson of the 1980s. Fighting inflation is hard. It requires all hands on deck, and immense courage over a long period of time. It is also, unfortunately, almost inevitable that some groups lose out, if only in the short term. As politicians run scared, the 2020s risk earning a special place in the history books, too - for failing to tame inflation.”

The editors of the Economist are not generally optimists. If anything, they tend to be very liberal pessimists. Still, they have a point. It took the combination of Paul Volker as Fed chair and Ronald Regan as President to beat inflation in America in the 1980s. Reagan cut spending and encouraged production while Volker tightened monetary policy. This time politicians including Elizabeth Warren are not only refusing fiscal policy restraint - they are warning the Fed not to drive the economy into recession. They are ignoring the fact that inflation is very painful for voters. Thank goodness there will be a Republican majority in the House come January.

There is at least one major difference between now and the 1980s. This time a Covid pandemic disrupted supply lines and added significantly to the upward pressure on

prices. As the pandemic winds down the supply line issues are being resolved. Although some bottle necks still exist. China imposed draconian lockdowns on its economy. People were confined to their apartments and could not leave. Food was delivered but it was what the government sent not what anyone ordered. These lockdowns persisted too long, and the Chinese economy is struggling to recover. How many products do we import from China? “Made in China” is found on lots of stuff. The Chinese supply line is still clogged. It will take time for that to be resolved and for China to get its production back on line. Other supply line factors are rapidly being resolved. Hopefully, that will add enough to the supply side to satisfy demand. That, in turn, could stop the upward spiral in prices and be a huge help in cooling inflation. Combine that with the Republicans’ ability to block any further big government spending plans and we may bring inflation down without the Fed having to raise interest rates as high as they did in the 1980s.

As you can see the inflation situation is confusing and complicated and therefore impossible to predict. Jamie Dimon is right - we don’t know if there will be a recession, and if there is, will it be mild or hard? The Fed, for its part, will do everything to cool inflation without causing a hard recession. The Biden Administration either is out of touch with the inflation reality or just doesn’t care. That does make it more difficult to avoid a recession, but not impossible.

Stocks have liked the decline in long-term interest rates and have not reacted to the recession debate. In my opinion long-term interest rates and inflation still are investors’ chief concerns. Once there is convincing evidence that inflation is cooling stocks will move higher.

I will have the next market review and update for you one week from today on
Wednesday, December 21, 2022.

All the best,

John Dessauer

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