MORNING BRIEFING
April 7, 2021

No Sign of Wage-Price Spiral

Check out the accompanying chart collection.

(1) T-Fed's flood of liquidity fueling broad-based inflation in asset prices. (2) A fiscal relief plan for MAMU. (3) While cost-push and demand-pull inflation heat up, consumer price inflation remains subdued. (4) Even Professor Gordon is less pessimistic on productivity. (5) Pandemic was a booster shot for capital spending on IT. (6) Wage inflation remains subdued despite signs of labor shortages. (7) An analysis of higher vs lower wages. (8) Progressives' real-pay-stagnation claim is a statistical myth. (9) Real hourly wages up 1.2% per year since 1995.

Inflation I: Appreciating Assets. There is lots of uncertainty about whether all the liquidity provided by T-Fed over the past year will boost consumer price inflation, as we discuss below. There is no question that it continues to boost asset prices. The S&P 500 rose to yet another new record high on Monday. The "meltup in everything" is rapidly turning into the Mother of All Meltups (MAMU), especially in the stock market.

After the American Rescue Plan Act was enacted on March 11, Joe and I anticipated that the latest round of "relief" checks included in the plan would push stock prices to new highs during the second half of March through April. On Monday, CNBC reported that the third batch of stimulus payments has been made to more than 130 million Americans, according to the IRS. This round of relief payments is projected to total $402 billion as 287 million Americans receive $1,400 from Uncle Sam. The previous two rounds provided a total of $438 billion.

All that money certainly is fueling MAMU! We are still predicting that the S&P 500 will rise to 4300 before the end of this year and 4800 before the end of next year—if not by the end of the month.

Inflation II: Productivity Skeptics Less Skeptical. There are lots of signs of actual cost-push inflation, especially in producer prices. There are increasing signs of potentially inflationary labor shortages, though there isn't much convincing evidence that this development is pushing up wage inflation. There are mounting signs of potential demand-pull inflation. Yet there are no indications so far that these inflationary pressures are getting pushed or pulled into consumer prices.

The divergence between the plethora of indicators showing rising inflationary cost pressures and still-subdued consumer prices may result from a lag between the former and the latter. If so, then consumer price inflation may soon accelerate. Fed officials have argued that measures of consumer price inflation are likely to move higher during March, April, and May. But they attribute that to a "base effect." Year-over-year comparisons in the Consumer Price Index (CPI) and the personal consumption expenditures deflator (PCED) are likely to rise simply because consumer prices were depressed by the lockdown recession during those months a year ago. So Fed officials expect that any pickup in consumer price inflation will be transitory.

Debbie and I agree with this assessment. Beyond a temporary pickup in consumer price inflation, we expect that a major rebound in productivity growth during the Roaring 2020s will offset inflationary cost and demand pressures. We've previously noted that nonfarm productivity growth bottomed at 0.6% during Q4-2015 based on the 20-quarter average at an annual rate (*Fig. 1*). It was up to 1.6% during Q4-2020. We expect technological innovations and labor shortages will push productivity much higher over the next few years. The pandemic accelerated the pace of both technological innovation and implementation into business processes.

The April 4 issue of the *WSJ* included an article titled "U.S.'s Long Drought in Worker Productivity Could Be Ending." We liked it a lot because it neatly summarized several of the arguments we have been making in support of a major productivity rebound in the years ahead. The article observed: "Forced to operate with less contact between customers and workers, companies plowed money into technology, automation and videoconferencing software. Consumers have had to embrace digital services such as electronic commerce and telemedicine, and many find they like it."

Even productivity skeptics, such as Northwestern University's Professor Robert Gordon, are turning less skeptical. According to the *WSJ* article cited above: "In 2015 he had predicted productivity growth of only 1.5% a year over the next 25 years. Recent developments have made him more optimistic, and he expects annual productivity growth of about 1.8% this decade." We think he is still too pessimistic, but at least he is changing his views in the right direction, in our opinion.

Now consider the following data on high-tech capital spending in nominal GDP:

(1) Capital spending on technology (including equipment, software, and R&D) rose to a record 50% of nominal GDP during the second half of 2020 (*Fig. 2*).

(2) Such spending rose 8.5% y/y through Q4-2020 to a new record high (*Fig. 3*). That's the fastest pace since Q3-2018. Here are comparable growth rates for information processing equipment (16.3%), software (5.0), and R&D (5.4). All three rose to new record highs at the end of last year (*Fig. 4*).

Inflation III: Wage Inflation Remains Subdued. Now, let's have a look at wage inflation, which is the major determinant of price inflation. Consider the following:

(1) *1970s.* During the 1970s, rapidly rising food and energy consumer prices were passed through to wages through cost-of-living-adjustment clauses (COLAs) in union contracts. Rapidly rising wages were passed through to consumer prices. The result was a wage-price spiral (*Fig. 5*). (For a brief history of the "Great Inflation," see the excerpt from my 2020 book.) Today, there are fewer unions in the private sector and even fewer COLAs in contracts than there were back in the 1970s.

(2) *Help wanted.* Yesterday we observed, "There certainly are lots of help-wanted signs out, notwithstanding the apparent slack in the labor market. Yet wage inflation remains relatively subdued. During January, when the number of unemployed workers was 10.1 million, the number of job openings was 6.9 million, according to the latest JOLTS report. March's survey of small business owners conducted by the National Federation of Independent Business found that a record 42.0% had job openings and that 51.0% of them reported that there were few or no qualified applicants for their job openings … but overall wage inflation remains subdued" (*Fig. 6*).

(3) *LinkedIn poll*. Last week, I ran a YRI LinkedIn Poll with the following question: "Lots of people remain unemployed, yet some employers are reporting a shortage of available workers. What is your experience? If you are an employer, assess the labor market." The poll had 517 respondents. Here are the results: "workers are plentiful" (14%); "all workers hard to find" (6); "skilled workers hard to find" (67); and "have to pay more to fill jobs" (13).

In my opinion, this poll confirms my view that there is a shortage of skilled workers; yet employers aren't bidding up wages to attract those who are available because they recognize that doing so would push up their total payroll costs. Besides, the shortage of skilled workers may be so acute that offering more pay might not even attract more applicants. Better to increase the productivity of one's current labor force using technology.

(4) *Average hourly earnings for all workers.* The average hourly earnings (AHE) measure of wages for production and nonsupervisory workers in the private sector rose 4.4% y/y during March (*Fig. 7*). A year ago, it was 3.7% and jumped to 7.8% during April. That happened because most of the job losses occurred among lower-wage workers. The Atlanta Fed's Wage Growth Tracker is less prone to be distorted by this compositional issue and has remained relatively subdued around 3.5% over the past 12 months.

Inflation IV: Higher vs Lower Wages. It recently dawned on us that we can disaggregate AHE into its higher- and lower-wage components, which would allow us to analyze how they behaved in the past and how they have been affected by the pandemic. We can also monitor whether either or both are showing signs of heating up as the labor market continues to improve. Our preliminary findings are startling: Over the past year, wages have been increasing at a faster pace for lower-wage workers than for higher-wage ones. How is that possible?

Our approach doesn't completely eliminate the AHE's composition problem. Our measure of lower-wage workers might have been boosted by a drop in the number of workers at the lowest wage segments of payrolls. Nevertheless, we think there are some interesting insights from our analysis, as follow:

(1) *Disaggregating AHE.* The Bureau of Labor Statistics (BLS) has been reporting a series for AHE of production and nonsupervisory workers since January 1964. The number of these workers roughly has ranged between 80% and 84% of private payroll employment (*Fig. 8*). Since March 2006, the BLS has also reported AHE for all workers in the private sector (*Fig. 9*). We can easily use these two series to derive the implied AHE for higher-wage earners.

Here are the AHEs of the three groups of earners during March: higher-wage workers ($50.80 per hour), all workers ($30.00), and lower-wage workers ($25.20). Since 2006, the higher-wage workers have tended to earn twice as much as the lower-wage workers (*Fig. 10*).

(2) *Earned Income Proxy.* Every month, when the employment report comes out, we calculate our Earned Income Proxy (EIP) for total wages and salaries in the private industry sector (*Fig. 11*). During March, here is the EIP for the three categories of earners: all workers ($6.7 trillion), lower-wage workers ($4.5 trillion), and higher-wage workers ($2.2 trillion). So in March, higher-wage earners accounted for 18.5% of total private nonfarm payroll employment and 33.0% of total EIP (*Fig. 12* and *Fig. 13*).

(3) *Wage inflation.* Because lower-wage workers (i.e., production and nonsupervisory workers) account for most of private-sector employment, the wage inflation rate of all workers (based on the y/y percentage change in AHE) tends to closely track the comparable series for lower-wage workers (*Fig. 14*). Comparing the wage inflation rates of lower-wage earners to higher-wage earners, we find that the former has been increasing faster than the latter from early 2019 through the pandemic (*Fig. 15*).

Inflation V: Myth of Stagnating Real Wages. In the past, Melissa and I often have observed that, contrary to popular belief, inflation-adjusted wages have been expanding rather than stagnating for many years. Wage stagnation has been a popular myth perpetuated by progressives bemoaning workers' plight to promote their own political agenda. Naturally, progressives want even more progressive income taxes on higher-income workers and more social benefits for lower-income ones. Their goal is to redistribute income to reduce income inequality. They've actually succeeded in doing so, but they never seem to be satisfied. They always want more taxes and more benefits. The result is more "big government." For now, let's update the data that belie their basic claims:

(1) *The wrong measure of inflation-adjusted wages.* One measure of real wages seems to confirm the progressives' stagnation thesis. Inflation-adjusted wages—defined as AHE divided by the CPI—peaked at a then-record high of $23.49 per hour during January 1973 (*Fig. 16*). It remained below that level until April 2020. That's over 47 years! As of February 2021, it was only 1.4% above the 1973 peak. That's pathetic.

We mean that analysis is pathetic. The CPI is widely known to be biased to the upside. A far better measure of consumer prices is the PCED. When we use that series to deflate the AHE series, we find that inflation-adjusted wages did stagnate during most of the 1970s through the mid-1990s. But it started moving higher around 1995 and has been achieving new highs since January 1999, rising along a trend line of 1.2% per year (*Fig. 17*).

(2) *Rising standard of living.* That represents a very solid increase in the purchasing power of consumers and in their standards of living! The real wage has increased 38% over the past 26 years from $16.18 during February 1995 to $22.34 during February 2021. Keep in mind that we are using AHE for production and nonsupervisory workers, who account for roughly 80% of private payrolls. This series certainly isn't upwardly biased by the earnings of higher-wage workers.

Data available since 2006 show that AHE for higher-wage workers, on an inflation-adjusted basis using the PCED, rose 12.0% from the start of that year through February of this year (*Fig. 18*). Over the same period, AHE rose 19.5% for lower-wage workers.

Any way we slice or dice the data, the conclusion is the same: The income stagnation story is a myth. Standards of living have been rising for most Americans most of the time.

CALENDARS

US: **Wed:** Consumer Credit $5.0b, Balance of Trade -$70.5b, MBA Mortgage Applications, EIA Crude Oil Inventories, FOMC Minutes, Evans, Barkin. **Thurs:** Initial & Continuous Jobless Claims 683k/3.65m, EIA Natural Gas Stocks. (DailyFX estimates)

Global: **Wed:** Eurozone, Germany, and France, C-PMIs 52.5/56.8/49.5, Eurozone, Germany, and France NM-PMIs 48.8/50.8/47.8, UK C-PMI & NM-PMI 56.6/56.8, Japan Leading & Coincident Indicators. **Thurs:** Germany Factory Orders 1.2%, China CPI & PPI 0.2%/3.5% y/y, Japan Consumer Confidence, ECB Monetary Policy Meeting. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings (*link*): Forward earnings rose for all three of these indexes last week and were at record highs simultaneously for a fourth week and the first time since October 2018. LargeCap's was at a record high for a fifth straight week; MidCap's for an eighth week; and SmallCap's for the eighth time in nine weeks. In what has shaped up to be a typical V-shaped recovery, LargeCap's forward earnings has risen during 45 of the past 46 weeks, with the one down week in late December due to Tesla's addition to the index. MidCap's is up in 42 of the past 44 weeks, and SmallCap's posted 42 gains in the past 45 weeks. LargeCap's forward earnings is now up 29.2% from its lowest level since August 2017; MidCap's has risen 62.3% from its lowest level since May 2015; and SmallCap's is up 96.4% from its lowest point since August 2013. These indexes had been on a forward-earnings uptrend from November 2019 until mid-February, before tumbling due to the Covid-19 economic shutdown. The yearly change in forward earnings soared to cyclical highs during 2018 due to the boost from the Tax Cuts and Jobs Act (TCJA) but began to tumble in October 2018 as y/y comparisons became more difficult. In the latest week, the yearly rate of change in LargeCap's forward earnings improved to a 26-month high of 11.3% y/y from 7.3%. That's up from mid-May's -19.3%, which was the lowest since October 2009, and down from 23.2% in September 2018, which was the highest since January 2011. The yearly rate of change in MidCap's forward earnings rose w/w to a 29-month high of 23.3% y/y from 17.6% y/y and is up from a record low of -32.7% at the end of May; that compares to a TCJA-boosted 24.1% in September 2018 (the highest since April 2011). SmallCap's rate turned higher too, rising to an 11-year high of 36.5% y/y from 26.4% y/y; it is up from a record low of -41.5% in early June. SmallCap's prior record low in its y/y percent change occurred during July 2009 and compares to the TCJA-boosted eight-year high of 35.3% in October 2018. Analysts' y/y earnings growth forecasts have been improving since July as companies easily beat low-balled consensus estimates for Q2, Q3, and Q4. Here are the latest consensus earnings growth rates for 2021 and 2022: LargeCap (25.8%, 15.2%), MidCap (44.3, 14.1), and SmallCap (70.4, 20.3).

S&P 500/400/600 Valuation (*link*): Valuations rose for two of these three indexes last week. LargeCap's forward P/E rose 0.2pts to 22.1. That's down from a 19-year high of 22.7 in early January and up from 13.3 in March 2020, which was the lowest since March 2013. MidCap's edged up 0.1pt to 19.7, but is down from a seven-month high of 20.5 in early March. Its current level is 3.2pts below its record high of 22.9 in early June. SmallCap's ticked down 0.1pt w/w to 20.3. It's now down 6.4pts from its record high of 26.7 in early June. That compares to MidCap's 10.7 and SmallCap's 11.1 in March 2020, which were their lowest readings since March 2009. LargeCap's forward P/E in February 2020—before Covid-19 decimated forward earnings—was 18.9, the highest level since June 2002. Of course, that high was still well below the tech-bubble record high of 25.7 in July 1999. Last week's level compares to the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap's P/E was below LargeCap's P/E yet again last week, as it has been for most of the time since August 2018. In contrast, it was last solidly above LargeCap's from April 2009 to August 2017. SmallCap's P/E was below LargeCap's for a 32nd week. That's the longest stretch at a discount since May and during 2002-03. SmallCap's P/E had been mostly below from May 2019 to May 2020 after being solidly above since 2003. SmallCap's P/E was at a premium to MidCap's for a 12th week after 11 weeks at a discount. At the beginning of the year, it had been at the steepest discount to that index since January 2006.

S&P 500 Sectors Quarterly Earnings Outlook (*link*): Since the Q2-2020 earnings season—which came in substantially better than greatly reduced forecasts—analysts as a whole have been raising their consensus forecasts for all future quarters instead of lowering them as is the norm. In the latest week, the S&P 500's Q1-2021 estimate rose 13 cents to $39.88, instead of declining steeply as typically seen in the last week of the quarter. That $39.88 estimate for Q1-2021 represents a gain of 20.4% y/y on a frozen actual basis and a 24.2% y/y gain on a pro forma basis. That would be the first quarter of double-digit percentage growth since Q4-2018 and compares to a pro forma 3.8% gain in Q4-2020. Nine sectors are currently expected to post positive y/y earnings growth in Q1-2021, but the final results are likely to be higher y/y for all but the Industrials sector. Here are the S&P 500 sectors' latest expected earnings growth rates for Q1-2021 versus their final Q4-2020 growth rates: Consumer Discretionary (99.0% in Q1-2021 versus -5.0% in Q4-2020), Financials (68.9, 20.4), Materials (47.0, 22.7), Information Technology (24.3, 20.4), S&P 500 (24.2, 3.8), Health Care (17.9, 10.6), Communication Services (13.6, 10.1), Utilities (2.6, -2.6), Consumer Staples (0.3, 5.4), Real Estate (0.2, -10.7), Energy (-5.1, -105.0), and Industrials (-13.4, -37.7).

US ECONOMIC INDICATORS

JOLTS (*link*): Job openings picked up during the first two months of 2021, pushing the job openings rate to a record high of 4.9%. Openings climbed 268,000 during February and 615,000 over the two-month period to a 25-month high of 7.37 million—led by health care & social assistance (+233,000), accommodations & food services (+104,000), and arts, entertainment & recreation (+56,000) during February. There were 10 million unemployed in February, leaving less than two unemployed workers competing for every job opening that month. Openings were as low as 4.63 million last April. Total hires climbed 273,000 in February to 5.74 million, its strongest monthly gain in nine months, though total hires are still 241,000 below last February's level, just before the coronavirus intensified. February hirings got a boost as declines in Covid-19 cases, rising vaccinations, and additional fiscal stimulus boosted domestic demand—with accommodation & food services accounting for just over 80% of February's gain. Total separations—which include quits, layoffs & discharges—rose 133,000 to 5.46 million, after a two-month drop of 421,000. The number of quits rose 51,000 to 3.36 million after a loss of 101,000 and a gain of 111,000. The quits rate has hovered around 2.6% the past six months.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-775-6823