



MORNING BRIEFING

May 4, 2021

JRB & FDR

Check out the accompanying [chart collection](#).

(1) The end of prohibition. (2) FDR, LBJ, and JRB expand the social welfare state. (3) Lots of plans to Build Back Better. (4) The anti-Reagan is pro-unions. (5) Reversing PATCO. (6) Raising wages by decree. (7) Amazon cares about its workers, so they don't care to unionize. (8) \$15 is becoming the new \$10 for hourly pay. (9) Trickle-down wage increases from Amazon and Walmart. (10) Will Biden restart the wage-price spiral? (11) Wage inflation measures remain subdued, but not for long. (12) Is a refundable child tax credit the start of a universal basic income?

Politics I: Another New Deal. Presidents have been judged by their performance during their first 100 days in office for nearly nine decades. Although 100 days is an arbitrary milestone, the tradition dates back to President Franklin D. Roosevelt, who in his first 100 days enacted sweeping measures to recover from the Great Depression. In those 100 days, FDR declared a bank holiday that stopped the disastrous run on the banks, he took America off the gold standard, and he passed groundbreaking legislation for farmers and homeowners and for the unemployed. He also passed amendments to the hated Volstead Act, which had created prohibition. Immediately, “beer parties” were held all over the country in celebration.

As of April 28, President Joseph Robinette Biden Jr. had been in office for 100 days. JRB and his supporters want to enlarge the social welfare state that was launched by FDR with his New Deal and expanded by Lyndon Baines Johnson with his Great Society. The mantra of today's progressives in the White House and Congress is “Build Back Better.” They have lots of plans for doing so. Their American Rescue Plan was enacted on March 18. Now they are pushing their American Jobs Plan and American Families Plan.

Politics II: Reversing PATCO. Biden aspires to be as transformative a president as was FDR in expanding the scope and scale of the US social welfare state. Biden is also the anti-Reagan president. He loves Big Government as much as President Ronald Reagan hated it. Furthermore, he has as much faith in Big Unions as Reagan distrusted them.

For example, Reagan accelerated the demise of the labor union movement in the private sector when on August 5, 1981 he fired more than 11,000 air traffic controllers who had ignored his order

to return to work after their union, the Professional Air Traffic Controllers Organization (PATCO), had organized an illegal strike. That marked the end of the wage-price spiral of the 1970s, as many private-sector business executives, following in Reagan's path, successfully pushed back against their labor unions.

Biden loves labor unions and intends to do whatever he can to bring them back in the private sector. He is also pushing to raise wages. He has no interest in seeing wages set naturally by a competitive labor market. Consider the following:

(1) *Raising wages at federal contractors.* On April 27, Biden signed an [executive order](#) that requires federal contractors to pay a \$15-an-hour minimum wage. Currently, the minimum wage for federal workers is \$10.95 per hour, and the tipped minimum wage is \$7.65 per hour. According to [The White House Fact Sheet](#), starting on January 30, 2022, all government agencies will need to incorporate a \$15 minimum wage requirement into new contract solicitations, and by March 30, 2022 all agencies will need to implement the minimum wage into new contracts. Additionally, government agencies will need to implement the higher wage into existing contracts when contracts are extended each year.

(2) *Look for the union label.* Wholeheartedly supporting this action by the Biden administration is the Economic Policy Institute (EPI), which estimates that up to 390,000 low-wage federal contractors will see a raise under the policy and that the average annual pay increase for affected year-round workers would be approximately \$3,100. Among those who are expected to see their wages rise, roughly half will be women and roughly half will be Black or Hispanic.

According to its [website](#), the EPI is a nonprofit think tank in Washington, DC created in 1986 "to include the needs of low- and middle-income workers in economic policy discussions." It is mostly funded by unions. The chairman of its [board of directors](#) is Richard L. Trumka, the president of the AFL-CIO. The following unions are also represented on the EPI's board of directors: USW, UAW, SEIU, IAM, AFSCME, CWA, and AFT. The "nonpartisan" group counts the chair of the Democratic National Committee on its board.

(3) *Promoting unions.* On April 26, Biden signed an [executive order](#) that will create a task force to promote labor organizing at a time when just over 6% of US private-sector workers belongs to unions ([Fig. 1](#)). The White House task force will be headed by Vice President Kamala Harris with Labor Secretary Marty Walsh serving as vice chair. The order is in the tradition of the National Labor Relations Act, which was passed in 1935 under FDR to encourage worker organizing.

(4) *Private sector responding.* The private sector is getting the message. On April 26, Amazon

[announced](#) it will spend over \$1 billion to hike pay by anywhere from 50 cents to \$3 an hour for over half a million of its US operations employees. In 2018, Amazon raised its minimum wage to \$15 an hour for all US employees following pressure from politicians and worker advocacy groups. The company has thrown its weight behind the Raise the Wage Act, a bill backed by President Biden and top Democrats, that would increase the federal minimum wage to \$15.00 an hour from \$7.25 an hour by 2025. Amazon also touted its \$15-an-hour starting pay as part of its argument against unionization amid a high-stakes election at one of its warehouses in Alabama earlier this month.

On April 29, Amazon reported \$108 billion in Q1 revenue and \$8.1 billion in Q1 profit, smashing analysts' expectations. Profit for the 12 months ending March was \$26.9 billion, more than the previous three years combined.

(5) *Spillover effect.* As the fifth largest employer in the world, Amazon wields huge power in the labor market. A recent [study](#) by Ellora Derenoncourt of the University of California, Berkeley and Clemens Noelke and David Weil of Brandeis University found that when big American firms increase hourly wages, other local employers tend to follow suit. Using a database of online job ads from Burning Glass Technologies, a labor-market analytics firm, and surveys from Glassdoor, an employer-review website, the researchers found that when Amazon raised its minimum wage by 20% to \$15 in October 2018, employers near an Amazon warehouse increased their advertised hourly wages by 4.7% on average. The authors observed similar spillovers in response to wage increases at Walmart, Target, and Costco.

(6) *800-pound gorillas.* An April 30 [article](#) in *The Economist* observed: "In a competitive market determined by supply and demand, wages would be governed by the marginal productivity of labour, or the additional output generated by an additional worker. Any deviation from this market wage, by Amazon or any other employer, would not affect the wages of anyone else. The fact that other firms respond to the wage policies of Amazon and Walmart suggests that these big employers have monopsony power that allows them to set local wages."

On April 14, Walmart US [announced](#) that two-thirds of the company's store employees will be full-time by the end of its current fiscal year, up from 53% during 2016. That means 100,000 more full-time positions versus five years ago. Such a move promotes Walmart as a career-building destination, and a sharper focus on steady schedules, skills training, and new pathways for growth in the retail business should help Walmart better attract and retain top talent, according to a company spokesperson. The firm is also lifting associates' wages to over \$15 an hour.

(7) *Bezos cares.* In his [annual letter to shareholders](#) dated April 15, Amazon founder Jeff Bezos

acknowledged that Amazon has to do better for its workers and vowed to make Amazon a safer place to work. The letter came a week after Amazon workers in Alabama voted against forming a union, cutting off a path that labor activists had hoped would lead to similar efforts throughout the company. Bezos said he is focusing on making warehouse jobs safer by, among other measures, changing up the work that physical workers do to minimize injuries caused by repetitive motions.

Politics III: The Great Rewind for Inflation? Reagan's PATCO move was the beginning of the end of the wage-price spiral of the 1970s. Will Biden's moves bring back the wage-price spiral? Should we worry about the Great Rewind?

We are on the lookout for—but don't expect—an inflationary wage-price spiral. We do expect to see wages rising more rapidly in coming months given all of the above. But we expect that rapidly rising productivity growth will offset the inflationary consequences of this development. So far, so good. But a rapidly tightening labor market—together with moves the Biden administration is taking—undoubtedly will push wage inflation higher in coming months. Consider the following:

(1) *Employment cost index (ECI)*. The ECI inflation rate remained subdued during Q1. It was up 2.8% y/y, with wages and salaries up 3.0% and benefits up 2.5% ([Fig. 2](#)). No big deal so far.

(2) *Average hourly earnings (AHE)*. During the year prior to the pandemic, the wage inflation rate on a y/y basis based on the AHE for all workers was hovering around 3.0%. It jumped to peak at 8.2% last year during April but remained north of 4.0% since then through March ([Fig. 3](#)). During March, AHE was up 4.2% for all workers and 4.4% for production and nonsupervisory workers.

This seems more worrisome than the ECI. However, the AHE has been distorted because most of the pandemic-related decline in employment has occurred among low-wage workers, which increased the weight of high-wage workers in the AHE. The ECI isn't distorted by this composition effect. Until the pandemic hit, the AHE measure of wage inflation closely tracked the ECI's measure, which was around 3.0% and still is ([Fig. 4](#)). For now, the true story on wages is probably more accurately portrayed by the ECI than the AHE. (See my "[Alternative Measures of Wages & Labor Costs](#)" in my 2018 book, [Predicting the Markets](#).)

(3) *Tight labor market*. Plenty of indicators confirm that the labor market is tight even though lots of people remain unemployed. Debbie and I have been on top of this story for some time. Our February 10 [Morning Briefing](#) was titled "Help Wanted." Since then, we've observed that the ratio of unemployed workers to job openings has plunged from last year's peak of 5.0 to 1.4 in February, the lowest since March 2020 ([Fig. 5](#) and [Fig. 6](#)). Job openings numbered 7.4 million in February, the highest since January 2019 ([Fig. 7](#)). The number of quits rose to 3.4 million in February,

consistent with readings during 2018 ([Fig. 8](#)).

According to April's Consumer Confidence survey, 37.9% of respondents said that jobs are plentiful, while only 13.2% said they are hard to get ([Fig. 9](#)). Both readings are consistent with relatively tight labor markets in the past. The Consumer Confidence Index is very sensitive to labor market conditions, and it spiked upward in April to the best level since February 2020 ([Fig. 10](#)).

The latest labor market indicators from the March survey of small business owners, conducted by the National Federation of Independent Business, showed that a record 42% have job openings, with 51% of them saying that they have few or no qualified applicants for those openings ([Fig. 11](#)). The survey also found that 28% raised their workers' compensation over the past three months, while 17% plan to do so over the next three months ([Fig. 12](#)). Both are relatively high readings, especially only a year after a recession.

Politics IV: Expanding the Great Society. Melissa and I will be closely monitoring JRB's impact on the US economy. His plans to expand the social welfare state significantly and rapidly will have numerous consequences for the economy and for financial markets. Yesterday, we discussed the outlook for taxes. Above, we focused on wages. Now, let's review one of the many ways that Biden's plans expand the social welfare state.

The American Rescue Plan Act (ARPA) of 2021 greatly expanded the child tax credit (CTC), which is a tax benefit granted to American taxpayers for each qualifying dependent child. It is estimated that the new rules will reduce by 45% the number of American children living in poverty. Here is how it works according to [Investopedia](#):

(1) *Higher CTC in 2021.* The CTC decreases taxpayers' tax liability on a dollar-for-dollar basis. ARPA increased the maximum annual credit and child eligibility age from \$2,000 per child under 17 years old in 2020 to \$3,000 per child under 18 and \$3,600 per child under 6 for 2021.

(2) *Fully refundable CTC.* While the 2020 credit was partially refundable, the 2021 credit is fully refundable, which means that if the credit takes a taxpayer's tax liability down below zero, the negative amount is refunded to the taxpayer. (Most tax credits are non-refundable, so a tax liability below zero results in no refund to the taxpayer.)

(3) *Advance payments.* During 2021—possibly as soon as July—the IRS plans to start distributing advance CTC payments monthly of up to \$250 per child under age 18 and \$300 per child under 6. Recipients would be entitled to claim credit for the unpaid balance—i.e., for the months prior to the start of advance payments—on their 2021 tax returns.

(4) *Original intent.* When the CTC was first enacted in 1997, it was intended to benefit low- and moderate-income families; it phased out gradually at higher income levels. However, the CTC has been criticized regularly for providing little or no benefit to the poorest families, many of whom are not taxpayers and do not file tax returns.

(5) *Extending beyond 2021.* In [Fact Sheet: The American Families Plan](#), the Biden administration proposes to extend the credit to 2025 and make it fully refundable permanently. The fact sheet observes: “For a family with two parents earning a combined \$24,000 per year and two children under six, the expansion means even more, with a credit increase of than \$4,400 because the full credit was not previously fully available to them.”

(6) *Universal basic income.* The extension of the refundable CTC sure seems like the start of a universal basic income. If you are not gainfully employed, having kids will provide you with a steady income from the government. The amount would not be much, but it might incent some people to stay home and have more children. That’s especially so if the government also provides free childcare and two years of free college, which are included in the American Family Plan.

Another consequence might be more single-parent households, which likely would be more dependent on the government than two-parent households. But then, that’s how socialism is designed to work: The citizenry becomes increasingly dependent on the government, which gets bigger and bigger for our own good.

Calendars

US: Tues: Balance of Trade -\$74.3b, Factory Orders 1.3%, API Crude Oil Inventories. **Wed:** ADP Employment Change 815k, C-PMI & NM-PMI 62.2/63.1, MBA Mortgage Applications, EIA Crude Oil Inventories, Macklem. (DailyFX estimates)

Global: Tues: UK M-PMI 60.7, UK Mortgage Lending £5.8b, Canada Balance of Trade \$0.8b, RBA Interest Rate Decision 0.1%. **Wed:** Eurozone, Germany, and France, C-PMIs 53.7/56.0/51.7, Eurozone, Germany, France, and Italy NM-PMIs 50.3/50.1/50.4/50.0. (DailyFX estimates)

Strategy Indicators

S&P 500/400/600 Forward Earnings ([link](#)): Forward earnings soared for all three of these indexes last week and were at record highs simultaneously for an eighth week and the first time since October 2018. LargeCap's rose at the fastest rate in 12 years and was at a record high for a ninth straight week, MidCap's was at a record for a 12th week, and SmallCap's for the 12th time in 13 weeks. In what has shaped up to be a typical V-shaped recovery, LargeCap's forward earnings has risen during 49 of the past 50 weeks, with the one down week in late December due to Tesla's addition to the index. MidCap's is up in 46 of the past 48 weeks, and SmallCap's posted 46 gains in the past 49 weeks. LargeCap's forward earnings is now up 36.4% from its lowest level since August 2017; MidCap's has risen 70.0% from its lowest level since May 2015; and SmallCap's is up 105.3% 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 an 11-year high of 33.8% y/y from 28.1%. That's up from mid-May's -19.3%, which was the lowest since October 2009. The yearly rate of change in MidCap's forward earnings rose w/w to a record high of 55.9% y/y from 46.4% y/y and is up from a record low of -32.7% at the end of May. SmallCap's rate turned higher too, rising to a record high of 83.2% y/y from 67.9% y/y; it is up from a record low of -41.5% in early June. Analysts' y/y earnings growth forecasts have been improving since July as companies have been easily beating consensus estimates since the Q2-2020 earnings season. Here are the latest consensus earnings growth rates for 2021 and 2022: LargeCap (32.4%, 12.5%), MidCap (50.5, 12.2), and SmallCap (76.3, 18.8).

S&P 500/400/600 Valuation ([link](#)): Valuations dropped for all three of these indexes last week. LargeCap's forward P/E fell 0.6pt to a six-week low of 21.7. That's down from a 19-year high of 22.7 from early January and is up from 13.3 in March 2020, which was the lowest since March 2013. MidCap's dropped to 19.4 from 20.0, and is down from a seven-month high of 20.5 in early March. Its current level is 3.5pts below its record high of 22.9 in early June. SmallCap's ticked down 0.6pts w/w to 19.5. It's now down 7.2pts 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 34th week. That's the longest stretch at a discount since last 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 16th 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 showed another upside hook as it rose by \$3.14 to \$45.83. That \$45.83 estimate for Q1-2021 represents a gain of 38.3% y/y on a frozen actual basis and a 46.3% y/y gain on a pro forma basis. That marks the first quarter of double-digit percentage growth since Q4-2018 and compares to a pro forma 3.8% gain in Q4-2020. All but the Industrials sector are currently expected to post positive y/y earnings growth in Q1-2021. Here are the S&P 500 sectors' latest expected blended earnings growth rates for Q1-2021 versus their final Q4-2020 growth rates: Consumer Discretionary (169.6% in Q1-2021 versus -5.0% in Q4-2020), Financials (130.1, 20.4), Materials (55.4, 22.7), Communication Services (48.1, 10.1), S&P 500 (46.3, 3.8), Information Technology (42.5, 20.4), Health Care (22.6, 10.6), Energy (8.0, -105.0), Consumer Staples (6.5, 5.4), Real Estate (2.9, -10.7), Utilities (2.5, -2.6), and Industrials (-2.4, -37.7).

S&P 500 Q1 Earnings Season Monitor ([link](#)): With 61% of S&P 500 companies finished reporting revenues and earnings for Q1-2021, revenues are beating the consensus forecast by a well-above-trend 3.9%, and earnings have crushed estimates by 23.3% due to loan loss reversals at the banks and stellar results from the Mag-5 stocks. At the same point during the Q4 season, revenues were 3.2% above forecast and earnings beat by 17.7%. The S&P 500's Q1 earnings surprise excluding Financials drops to 19.6% from 23.3%. For the 305 companies that have reported through mid-day Monday, aggregate y/y revenue and earnings growth and the percentage of companies reporting a positive revenue and earnings surprise have improved from their Q4 measures. The Q1 reporters so far has a y/y revenue gain of 11.0% and an earnings gain of 54.0%, which rises to 11.2% and drops to 34.7%, respectively, when Financials are excluded. A whopping 87% of the Q1 reporters so far has reported a positive earnings surprise, and 78% has beaten revenues forecasts. Slightly more companies have reported positive y/y earnings growth in Q1 (78%) than positive y/y revenue growth (77%). These figures will change less markedly as more Q1-2021 results are reported in the coming weeks.

US Economic Indicators

Construction Spending ([link](#)): Construction expenditures advanced in March for the fifth time in six months, and the March reading was only a fraction below January's record high. Total spending edged up 0.2% in March after edging down 0.6% in February; it had jumped 6.7% during the four months through January to a new record high. Private construction spending climbed for the eighth time in 10 months, by 0.7% in March and 15.7% over the period, to yet another record high. Public construction spending contracted the first three months of this year by a total of 3.4%; the latter was at a record high a year ago. Within private construction, residential spending expanded its consecutive-monthly-gain string to 10 months, rising 1.7% in March and 34.4% over the period to a new series high; nonresidential expenditures has posted only one gain in the past nine months, falling 0.9% in March and 6.5% over the nine months through March. The rebound in residential construction has been widespread: Single-family (46.4%), home-improvement (24.6), and multi-family (18.2) construction all posted big upswings during the 10 months through March—with single-family construction soaring to a new cyclical high this March, while home-improvement and multi-family (-1.4) construction slipped a bit from their record highs during December and January, respectively.

Global Economic Indicators

Global Manufacturing PMIs ([link](#)): “Manufacturing activity expanded at the fastest pace in over a decade,” according to April's report. The JP Morgan M-PMI accelerated for the third month to 55.8 last month (the strongest since April 2010) after dipping slightly in January to 53.6. The index is up 16.2 points since bottoming at 39.6 last April. The M-PMI for the advanced economies has increased all 12 months since bottoming in last April by 22.5 points (to 59.3 from 36.8 in April), while the M-PMI for the emerging economies rose in April for the first time in five months, to 52.2, after falling from 53.9 in November to 51.3 by March. Geographically, 21 out of the 24 nations for which April data were available had an M-PMI reading above the 50.0 mark—with the top three all from the Eurozone. Here's a country ranking of April M-PMIs from highest to lowest: Netherlands (67.2), Germany (66.2), Austria (64.7), EUROZONE (62.9), Taiwan (62.4), UK (60.7), Italy (60.7), US (60.5), Australia (59.7), France (58.9), Czech Republic (58.9), Spain (57.7), Canada (57.2), WORLD (55.8), India (55.5), South Korea (54.6), Indonesia (54.6), Colombia (54.0), Malaysia (53.9), Japan (53.6), Brazil (52.3), China (51.9), Turkey (50.4), Philippines (49.0), Mexico (48.4), and Myanmar (33.0). Inflationary pressures continued to mount last month as raw material delivery times continued to lengthen. The resulting shortages caused input prices to accelerate at the fastest pace in a decade, which in turn led to a series-record increase in factory gate prices.

US Manufacturing PMIs ([link](#)): Manufacturing activity in April remained robust according to both M-PMI measures, though ISM's slowed a bit while IHS Markit's reached a new record high. Price pressures continued to intensify. ISM's M-PMI (60.7) showed the manufacturing sector continued to expand in April at a strong pace, though was down from March's 64.7—which was its best reading since 1983! Four of the five M-PMI components showed a slowing in growth, while the inventories (to 46.5 from 50.8) measure dipped back into contractionary territory. Both the new orders (to 64.3 from 68.0) and production (62.5 from 68.1) indexes remained above 60.0, but both slowed from their March pace, which was the strongest for both since January 2004. The new export orders (to 54.9 from 54.5) sub-index continued to bounce in a volatile flat trend around recent highs. Meanwhile, manufacturers expanded payrolls (to 55.1 from 59.6) for the fifth successive month last month, though slowed from March's three-year high. The supplier deliveries component of the M-PMI was little changed at 75.0 after climbing steadily from 55.9 last July to 76.6 this March, reflecting the difficulties suppliers continue to experience due to Covid-19 impacts. ISM's price (to 89.6 from 85.6) index shows prices accelerating at the fastest pace since July 2008; it was at 35.3 a year ago. IHS Markit's M-PMI (to 60.5 from 59.1) shows manufacturers enjoying their best year in the history of this series going back to May 2007. New orders expanded at the fastest rate in 11 years, due to stronger client demand. According to the report, some companies mentioned that customers were placing larger orders amid substantial supplier delivery delays. At the same time, new export orders expanded at the second-quickest rate on record as lockdown restrictions eased in key export markets. Input costs rose at the fastest pace since July 2008, due to material shortages and higher transportation costs. Firms were able to pass on the higher costs, with April's output costs the second fastest on record behind March's.

Contact us by [email](#) or call 480-664-1333.

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, 570-228-9102

Copyright (c) Yardeni Research, Inc. Please read complete [copyright and hedge clause](#).