



MORNING BRIEFING

September 1, 2021

Modern Monetary Theory in Practice

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

(1) Forward earnings continue to lead S&P 500 to record highs. (2) Another crisis, another opportunity for politicians. (3) MMT on steroids and speed. (4) A guide to sausage making in DC. (5) Will moderate Democrats avert a progressive onslaught? (6) Powell's inflation dashboard missing some dials. (7) Different measures of inflationary expectations show different readings. (8) Powell admits progress has been made, but continues to accentuate the negatives in the jobs market.

Strategy: Forward Earnings by the Numbers. The meltup in the stock market continues to be led by forward earnings, the time-weighted average of industry analysts' consensus expectations for this year's and next year's earnings. They've been raising their S&P 500 estimates for 2021 and 2022 because companies have significantly beat Q1 and Q2 expectations ([Fig. 1](#)). As a result, during the final week of August, they estimated that S&P 500 operating earnings per share will be \$201 this year and \$220 next year, putting forward earnings at a record \$213 ([Fig. 2](#)).

I asked Joe to calculate the percent changes in the forward earnings of the S&P 500 and its 11 sectors since their post-lockdown lows last year through the week of August 19: Energy (1,558.2%), Materials (91.2), Consumer Discretionary (89.2), Financials (67.7), Industrials (66.1), Communication Services (54.8), S&P 500 (50.9), Information Technology (41.3), Real Estate (25.9), Health Care (25.5), Consumer Staples (17.6), and Utilities (4.0) ([Fig. 3](#)).

Fiscal Policy: Moderate vs Progressive Dems. "Never let a serious crisis go to waste." Rahm Emanuel famously said so when he was President Barack Obama's chief of staff. But the idea has been a guiding principle for politicians since the second oldest profession came into being. The pandemic has unleashed US politicians, resulting in unprecedented programs of monetary and fiscal stimulus. Modern Monetary Theory on steroids and speed has been implemented. Our supreme leaders have made sure that this serious health crisis will not go to waste. Let's start with the latest machinations of our congressional representatives.

We are grateful for our friend James Lucier at [Capital Alpha Partners](#) because he keeps us up to date on all the sausage making in Washington, DC. Lately, there is a whole lot of pork

being tossed around. In his August 24 Macro update note, Jim writes that “House moderates who are keen to vote on the \$550 billion bipartisan infrastructure plan may get their way sooner than expected—perhaps by September 27.”

Jim adds: “House progressives want no such vote anytime soon—not until after a later and much larger budget reconciliation bill passes or is assured of passage. The larger bill is often described as a notional \$3.5 trillion package.” That’s because the “resolution passed by the Senate calls for up to \$3.5 trillion in new spending, which is a maximum and not a guaranteed minimum.” The notional package allows the new spending to be fully paid for with up to \$3.5 trillion in new taxes—but “the Senate’s budget resolution allows for the possibility of \$1.75 trillion in new spending that is not paid for at all,” he explains.

“The reconciliation bill would be a single package that fulfills the terms of the budget resolution once the House and Senate have acted. It would be the vehicle for the bulk of the president’s climate and clean energy spending programs ... More prominent will be an ambitious social agenda, which includes tax credit programs designed to establish a form of a universal basic income (UBI) program, universal pre-kindergarten schooling, free community college, paid family and medical leave, childcare, elder care, and the expansion of Medicare—all paid for by higher taxes on individuals and corporations,” Jim writes.

He adds: “House progressives want the bipartisan infrastructure plan linked to budget reconciliation because they fear that House moderates will not otherwise vote for the ambitious package that the progressives want.” Jim observes that the “parts of the reconciliation package that will be most difficult to pass will be the tax provisions.”

One of the major steps to “victory for the moderates would be securing a time certain for the infrastructure vote. There was no time certain mentioned in the original rule. Instead, [House Speaker Nancy] Pelosi initially offered an unwritten assurance that the House would vote by October 1. The moderates rejected this. A second plan was to offer a non-binding House resolution that still committed to a vote by September 28. Finally, the Rules Committee adopted language that set the legislative day of September 27 as a deadline House consideration of the bill.”

Headwinds for securing the vote on time include the developments in Afghanistan and the health and economic consequences arising from the Delta Covid-19 variant. Both issues will take congressional attention away from infrastructure. However, the headwinds could quickly become a tailwind if congressional Democrats (progressives and moderates alike) decide that a quick win is necessary to restore the popularity of the President.

Monetary Policy I: Powell's Inflation Dashboard. Melissa and I have long wanted Fed Chair Jerome Powell to provide a dashboard of specific metrics that he is watching. He came close to doing so last week in his Jackson Hole virtual [speech](#). Now when Powell explains whether “substantial further progress” (SFP) has been made toward the Fed's rather subjective goals of maximum employment and stable prices, we can see what he is seeing as evidence for why. (Fed officials have been using the catchphrase “substantial further progress” regarding these goals since the end of last year.)

Powell stated in his opening speech that inflation had passed the SFP test, while employment had made progress short of “substantial.” Nevertheless, Powell indicated that if the labor market continues to improve it would be appropriate to reduce the Fed's pandemic-related asset purchases (i.e., to taper) by the end of “this year.”

Although Powell said inflation had met the SFP criterion, he contended that its pace remains moderate. That seems to be the main reason interest rate hikes aren't in the Fed's view for now. We'll be watching all the metrics that Powell discussed—especially those related to the Fed's “maximum employment” goal—for further signs of recovery (or shortfall), which could push Powell's taper timeline up (or back) from this year and affect rate-hike timing.

Let's start with what Powell is seeing on inflation before turning to employment:

(1) *Durable goods prices.* Powell observed that price inflation for goods, primarily for durable goods, is pushing the broader measures higher. Booming consumer spending on goods has resulted in supply bottlenecks, in his opinion. He didn't acknowledge that excessively stimulative monetary and fiscal policies were behind the boom.

During July, the CPI and PCED for goods surged 9.1% y/y and 5.3% y/y, while services registered more moderate increases of 3.0% y/y and 3.5% y/y ([Fig. 4](#) and [Fig. 5](#)). Drilling down further into goods inflation, the CPI and PCED for durable goods surged 14.3% and 7.0% through July while nondurables rose 7.2% and 4.4% ([Fig. 6](#) and [Fig. 7](#)). Powell pointed to consumer demand for used autos as a key driver pushing up prices following the pandemic.

(2) *Trimmed CPI.* Powell cited an alternative measure of inflation as evidence of the narrowness of the recent inflation surge. The Trimmed-Mean CPI, calculated by the Federal Reserve Bank of Cleveland, measures core inflation by excluding the most volatile CPI

components (i.e., those with the highest and lowest one-month price changes). The measure has risen 3.0% y/y through July, while the core CPI and core PCED, which exclude food and energy prices, have risen 4.3% and 3.6% y/y through July ([Fig. 8](#)).

(3) *Wage inflation*. Powell also watches wage inflation because, he said, significant wage inflation that leads to increases in producer prices that are passed onto the consumer could prove to be a dangerous trend that has played out in the past.

But, for now, inflationary red flags are not lurking in wages. Powell observed that the moderate rises in the Atlanta Fed's Wage Growth Tracker of 3.7% y/y through July and the Employment Cost Index for wages and salaries of 3.6% y/y through Q2 were no cause for alarm ([Fig. 9](#)).

(4) *Inflationary expectations*. The Fed chair also observed that measures of expected inflation remain moderate. The Philadelphia Fed Survey of Professional Forecasters' CPI expectation over the next 10 years and the University of Michigan's Consumer Sentiment Index measure of expected inflation over the next five years were 2.4% and 2.9% during August ([Fig. 10](#)).

However, he chose to ignore the survey of inflationary expectations conducted monthly by the Federal Reserve Bank of New York (FRB-NY). During July, it showed one-year-ahead and three-years-ahead inflationary expectations of 4.8% and 3.7% ([Fig. 11](#)).

(5) *Global inflation*. Global disinflationary forces are keeping a lid on inflation in the US, Powell pointed out. Specifically, he showed that inflation has remained low in Canada, Sweden, the Eurozone, Japan, and Switzerland.

By the way, in addition to ignoring the FRB-NY's series on inflationary expectations, he never mentioned the regional business surveys conducted by five of the Fed district banks showing elevated inflationary pressures in both their prices-paid and prices-received indexes, as we discussed [yesterday](#).

Monetary Policy II: Powell's Employment Dashboard. Here are the metrics that Powell watches to assess the state of the Fed's maximum employment goal:

(1) *Employment*. Payroll employment has not yet fully recovered from the pandemic, Powell emphasized. Joblessness has been hardest hit for lower-income service industries like restaurants, air travel, and dentists, he noted. Of the 5.7 million shortfall in total payroll

employment compared to the February 2020 level, 4.2 million is in services ([Fig. 12](#)). Powell also mentioned that leisure and hospitality employment has been improving but remains short of the SFP bar ([Fig. 13](#)).

The recent pace of new hiring has boosted employment levels, Powell said. However, he remains especially concerned about long-term unemployment and labor force participation rates. The rate of short-term unemployment has nearly entirely recovered to its pre-pandemic rate, but the long-term unemployment rate hasn't fully recovered ([Fig. 14](#)). The longer that the unemployed remain so, the more likely they are to drop out of the labor force entirely.

(2) *Participation*. Powell observed that unemployment would be substantially higher, even near 10%, if labor force participation, which currently stands at 61.7%, were a few points higher ([Fig. 15](#)). Before the pandemic, during February 2020, the labor force participation rate stood at 63.3%. Powell hopes that the rise in vaccinations, reopening of schools, and end of extended unemployment benefits will drive more people out of long-term unemployment and back into the labor force. By the way, we find it curious that Powell said nothing of early retirements, which could result in structurally lower participation rates.

(3) *Cohorts*. African Americans, less educated Americans, and low-income Americans have experienced greater unemployment and a slower recovery in joblessness than other groups of Americans, Powell also pointed out ([Fig. 16](#)).

Calendars

US: Wed: ADP Employment Change 625k, ISM Manufacturing & Price Indexes 58.7/83.8, Motor Vehicle Sales, Construction Spending 0.2%, MBA Mortgage Applications, Crude Oil Inventories, Bostic. **Thurs:** Productivity & Unit Labor Costs 2.4%/1.0%, Advance Trade Balance -\$71.0b, Initial & Continuous Jobless Claims 345k/2.78m, Factory Orders 0.4%, Natural Gas Storage. (Bloomberg estimates)

Global: Wed: Eurozone, Germany, France, Italy, and Spain M-PMIs 61.5/62.7/57.3/60.1/58.9, Eurozone Unemployment Rate 7.6%, Germany Retail Sales - 0.9%/m/m/3.7%/y/y, UK Manufacturing M-PMI 60.1, Weidmann, Wuermeling, Kataoka. **Thurs:** Canada Trade Balance \$1.4b, Australia Retail Sales. (Bloomberg estimates)

US Economic Indicators

Consumer Confidence ([link](#)): “Concerns about the Delta variant—and, to a lesser degree, rising gas and food prices—resulted in a less favorable view of current conditions and short-term growth prospects,” said Lynn Franco, senior director of economic indicators at The Conference Board. However, she went on to say, “While the resurgence of Covid-19 and inflation concerns have dampened confidence, it is too soon to conclude this decline will result in consumers significantly curtailing their spending in the months ahead.” The inflation rate continued to accelerate, reaching 6.8% in August—the highest since October 2008; a year ago, it was at 5.8%. In August, 60.9% of respondents said they expect inflation to head higher, while only 12.2% expect it to head lower, though the former was down from 64.0% in July and the latter was up from 10.6%. The Consumer Confidence Index (CCI) fell for the second month in August to a six-month low of 113.8, from July’s downwardly revised 125.1 (from 129.1)—after climbing steadily from 95.2 in February to 128.9 by June. Both the present situation (to 147.3 from 159.6 in June) and expectations (91.4 from 108.5) components declined over the two-month period. Consumers’ appraisal of current conditions deteriorated in August, with the percentage of consumers claiming business conditions are good (to 19.9% from 24.6%) falling and those claiming business conditions are bad (24.0 from 20.0) rising. Consumers’ assessment of the labor market remained strong in August—holding around recent readings. Respondents saying jobs are plentiful (to 54.6% from 55.2%) was little changed from July—which was the highest since July 2000. Likewise, the percentage saying jobs are hard to get (11.8 from 11.1) was little changed from July—and not far from June’s 10.5%—which was the lowest since July 2000. In the meantime, the percentage of consumers expecting business conditions to improve (to 22.9% from 30.9%) also fell in August, as the percentage expecting business conditions to worsen (17.8 from 11.9) rose. Consumers’ outlook regarding the job market continued to weaken. The percentage expecting more jobs (to 23.0% from 25.5%) moved down, while the percentage expecting fewer jobs (18.6 from 17.8) moved up. The former peaked recently at 35.4% in March, while the latter bottomed at 14.4% in June.

Global Economic Indicators

Eurozone CPI Flash Estimate ([link](#)): August’s CPI headline rate is expected to accelerate for the second month to 3.0% y/y—the highest since November 2011—after slowing from a

then-30-month high of 2.0% in May to 1.9% in June. Looking at the main components, once again energy (to 15.4% from 14.3% y/y) is expected to post the biggest gain, recording its largest year-over-year increase since July 2008, while the rate for non-energy industrial goods is predicted to accelerate sharply from 0.7% to 2.7% y/y—the highest since the mid-1990s. Meanwhile, the yearly rate for food, alcohol & tobacco (to 2.0% from 1.6% y/y) is expected to accelerate for the second month, with August's rate quadruple both May and June's 0.5%. The services inflation rate is predicted to make a round trip, ticking slightly higher for the second month in August to 1.1% y/y, after slowing from 1.1% in May to 0.7% in June—which was the slowest since the end of 2020. Of the top four Eurozone economies, rates for Germany (3.4% y/y) and Spain (3.3) are expected to be above August's headline rate of 3.0%, while rates for Italy (2.6) and France (2.4) are expected to be below.

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](#).

