



MORNING BRIEFING

September 15, 2021

Inflation & Labor

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

(1) Powell scores a point. (2) Three moderating factors. (3) The spectrum of inflation forecasts. (4) Roaring 2020s vs Inflationary 1970s. (5) Inflation expectations remain elevated according to FRB-NY survey. (6) Small business owners raising prices. (7) Diminishing base effect. (8) Rent inflation on the rise. (9) Lots of job openings. (10) A woeful tale from businesses in Richmond area looking for workers.

US Inflation: Transitory vs Persistent. August's headline and core CPI were up less than expected: 0.3% m/m and 0.1% m/m. On a y/y basis, they also eased off but remained elevated at 5.3% and 4.0%.

The CPI results are consistent with Fed Chair Jerome Powell's narrative that the surge in inflation is likely to be transitory rather than persistent. The FOMC is now likely to wait until the committee meets in early November rather than next week to start tapering the pace of its asset purchases.

Some of the moderation in inflation may very well reflect the diminishing impact of the base effect, i.e., comparison against pandemic-depressed year-ago prices, as Powell has been predicting. Some of the moderation might also be attributable to the Delta variant of the Covid virus, which got a good chance to spread more rapidly as a result of July 4th and Labor Day get-togethers. Another moderating factor at play is productivity, which seems to have been boosted by the pandemic.

The spectrum of inflation forecasts covers three possible scenarios currently. On one end is that it is transitory and will prove to be short-lived. In the middle is that it is persistent (but ultimately transitory). At the other end is that it is permanent (or at least long lasting). Debbie and I are somewhere in the middle between transitory and persistent (but transitory). We aren't convinced that the CPI inflation rate will fall back to the Fed's 2.0% target in coming months. But it could do so later next year.

More broadly, for the remainder of the decade, we remain in the Roaring 2020s camp, with productivity-led growth keeping a lid on inflation. However, we are mindful of some of the similarities between the Great Inflation of the 1970s and the current situation. Now consider

the following:

(1) *Inflation expectations remain elevated.* Let's dispense with the bad news on the inflation front. The Federal Reserve Bank of New York compiles a monthly survey of inflation expectations. The data are available since mid-2013. The one-year- and three-year-ahead expectations rose to their series' highs of 5.2% and 4.0% during August ([Fig. 1](#)).

Here are the one-year inflation expectations by age: under 40 (4.5%), 40-60 (4.8), 60 & over (6.0). Here are the same by education: high school (6.0), some college (5.9), BA degree or higher (4.0). And here are the same by annual income: under \$50,000 (5.2), \$50,000-\$100,000 (5.5), over \$100,000 (4.9). (See our [Inflation Expectations](#) chart book.)

(2) *Small business owners raising prices.* There was also bad news on the inflation front in the August survey of small business owners conducted by the National Federation of Independent Business (NFIB), released yesterday. It showed that 49% of them are raising their prices, while 44% are planning to raise their prices ([Fig. 2](#)). Price hikes were the most frequent in wholesale (68% higher, 0% lower), manufacturing (60% higher, 2% lower), and retail (52% higher, 4% lower).

(3) *PPI for personal consumption.* On Monday, we observed that the PPI for personal consumption (C-PPI) rose to 7.4% y/y during August, auguring for higher inflation rates for the CPI and PCED during the month ([Fig. 3](#)). However, as we noted, the C-PPI excludes rents and import prices. Nevertheless, we would be more relieved about inflation had the C-PPI confirmed the easing of inflationary pressures suggested by the CPI.

(4) *Diminishing base effect.* Okay, now we can proceed with the good news in the CPI based on the three-month percentage changes through August at annual rates. Here are the latest three-month inflation rates versus their most recent peaks for the headline CPI (6.6%, 9.3%) and core CPI (5.3, 10.2) ([Fig. 4](#)). These three-month comparisons help us to reduce the impact of the base effect in the y/y comparisons. It is encouraging to see them moderating.

Among the biggest outliers on the inflation front recently were CPI items that had significant base effects: gasoline (31.7%, down from 98.8%), lodging away from home (40.2, 62.4), airfares (-27.0, 84.3), car & truck rental (-32.8, 182.2), and used cars & trucks (36.1, 121.8) ([Fig. 5](#)).

On the other hand, a few items continue to be more inflation prone: new vehicles (20.0%),

motor vehicles & parts (14.1), food (7.6), and nonalcoholic beverages (10.6) ([Fig. 6](#)).

(5) *The rent is due*. Rent is one of the CPI categories with the largest weight in the index. It could be troublesome in coming months as employment and wages increase. Rent of primary residence over the latest three months bottomed at 1.2% (saar) during January. It was up to 2.8% during August ([Fig. 7](#)). Owner's equivalent rent is up from 1.4% during January to 3.5% in August.

US Labor Market I: Mismatches. Last year's pandemic lockdowns resulted in lots of layoffs. The federal government stepped in to help with enhanced federal unemployment benefits. Americans are slowly learning to live with the virus, aided by vaccines and treatments. Businesses are looking for workers again. But they're not having an easy time finding and hiring them. That's mainly attributable to the following three factors:

(1) Federal unemployment benefits may have incentivized lots of workers not to bother looking for a job.

(2) School closures forced many parents to stay at home to care for their kids.

(3) Many seniors in the workforce decided to retire.

It's possible that the worker shortage is about to reverse, at least in part, given that the enhanced benefits expired on Labor Day and many kids returned to in-person learning the day after. Workers who retired as a result of the pandemic are unlikely to return to the labor force.

A more structural problem may be skills and geographic mismatches between available jobs and workers seeking employment. This would certainly explain why there are so many job openings when unemployment remains relatively high. A new complication is that the Biden administration has asked companies to fire workers who refuse to be vaccinated or to be tested on a weekly basis.

US Labor Market II: Lots of Help Wanted. The employment reports for September and October should provide insights into how these developments are impacting the labor market. For now, let's see what the recent employment reports tell us:

(1) *Record job openings*. The number of unemployed workers fell to 8.4 million during August ([Fig. 8](#)). That's only 2.7 million above the level during February 2020 before the

lockdowns. Meanwhile, the number of job openings totaled a record 10.9 million during July. That's 3.9 million more than during February 2020.

Job openings have soared to a record high of 7.4% of payroll employment ([Fig. 9](#)). Of the total job openings, nearly 5.5 million are in leisure and hospitality, professional and business services, and health care and social assistance—at about 1.8 million openings for each of these industries.

(2) *Small businesses seeking help.* August's NFIB survey of small business owners found that they have lots of job openings. A record 50% of them reported having job openings, and 60% (91% of those hiring or trying to hire!) said they're finding few or no qualified applicants for the open positions ([Fig. 10](#)). Specifically, 31% of owners reported few qualified applicants for their open positions (unchanged from the July percentage), and 29% reported none (up 3 points), a 48-year record high!

(3) *Labor shortages in Richmond district.* The Federal Reserve Bank of Richmond is one of the five Fed district banks that conducts a regional business survey every month. It's the only one that asks about wages and the availability of skills needed ([Fig. 11](#) and [Fig. 12](#)). The following is the [woeful tale](#) told by the Richmond Fed about the district's labor market:

“Throughout the pandemic, many manufacturers have reported increased absenteeism, often resulting from employees quarantining after contracting or being exposed to the virus. In addition, manufacturers have seen employees leave their jobs and have struggled to replace them. In our April survey, 43 percent of manufacturing firms cited difficulty finding workers as their top challenge to increasing supply. In August, 75 percent of manufacturing survey respondents reported having difficulty hiring workers since the spring. Without sufficient labor, employers have in some cases needed to change their policies to retain employees. For example, one firm in our manufacturing panel reported having to relax the company's attendance policy to avoid terminating a large portion of its workforce. Another firm instituted an attendance incentive program.

“Survey respondents have also reported that employees, on average, are working longer hours. In April, the diffusion index for hours in the average workweek reached its highest level since 2004. Firms have also been raising wages to attract workers. In August, the wage index on our manufacturing survey hit a record high. However, firms still reported that it was increasingly difficult to find workers.”

Calendars

US: Wednesday: Headline & Manufacturing Industrial Production 0.4%/0.4%, Capacity Utilization Rate 76.4%, Empire State Manufacturing Index 18.0, Import & Export Prices 0.3%/0.4%, MBA Mortgage Applications, Crude Oil Inventories. **Thursday:** Retail Sales Total & Control Group -0.8%/-0.1%, Business Inventories 0.5%, Initial & Continuous Jobless Claims 328k/2.785m, Philadelphia Fed Manufacturing Index 19.0, Net Capital Flows, Natural Gas Storage. (Bloomberg estimates)

Global: Wednesday: Eurozone Industrial Production 0.6%_{m/m}/6.3%_{y/y}, France CPI 2.4%_{y/y}, Italy CPI 2.1%_{y/y}, UK Headline & Core CPI 2.9%/2.9%_{y/y}, UK PPI Input & Output 10.3%/5.4%_{y/y}, Canada CPI 3.9%_{y/y}, Australia Employment Change -90k, Australia Unemployment & Participation Rates 4.9%/65.7%, RBA Bulletin, Schnabel, Lane, Balz. **Thursday:** Eurozone Trade Balance, Canada Housing Starts 268k, Japan Core CPI -0.4%_{y/y}, BOE FPC Meeting Minutes, Lagarde. (Bloomberg estimates)

Strategy Indicators

S&P 500 Growth vs Value ([link](#)): The S&P 500 Growth price index has risen 21.4% ytd through Monday's close, just 5.2ppts ahead of the S&P 500 Value index's 16.2% rise. Growth had lagged Value through March 8, but has soared 26.3% since then. That's nearly quadruple the 7.5% rise for Value's price index. Growth's price index is now 2.13 times higher than Value's, which is just a bit below its September 1, 2020 record high of 2.17. Since the S&P 500's low on March 23, 2020, Growth remains ahead with a gain of 115.2% compared to an 80.7% rise for Value. However, both remain near record highs. Growth is 1.7% below its September 7 record high on Monday, while Value is 1.6% below its August 11 record high. Looking at the fundamentals, Growth is expected to deliver higher revenue growth (STRG) than Value over the next 12 months, but Value is expected to have higher earnings growth (STEG). Specifically, 11.0% STRG and 12.8% STEG are projected for Growth, respectively, versus 7.3% and 16.3% for Value. Valuations have eased for both indexes from their recent multi-year highs. Growth's forward P/E of 28.1 is down 7.4% from a 20-year high of 30.4 on January 26. Value's forward P/E has had a bigger hit; it's down 11.7% to 16.2 from 18.3 on January 6 and compares to a 21-year high of 18.6 during June 2020. Growth's P/E is now 1.75 times higher than Value's; that's the highest spread in over 20 years. Regarding NERI, Growth's was positive in August for a 13th straight month as it edged down to 22.4% from a record high of 23.4% in July. Value's NERI was also positive

for a 13th month in August, but dropped to 21.5% from a record-high 23.3% in July. During 2018, the Tax Cuts and Jobs Act propelled consensus forward earnings estimates and profit margins to record highs for both Growth and Value. They're all at record highs again now. Growth's forward profit margin of 17.7% on June 17 is 1.0pt above its prior record high of 16.7% during September 2018, while Value's 11.2% is 0.7pt above its prior record of 10.5% in December 2018.

US Economic Indicators

CPI ([link](#)): August's CPI advanced a smaller-than-expected 0.3%, slowing from 0.5% and 0.9% the prior two months, with core prices ticking up only 0.1% last month, after increases of 0.3% and 0.9% in July and June, respectively. The yearly rates slowed, with the core rate easing to 4.0% in August from 4.5% in June, while the headline rate ticked down to 5.3% from 5.4% in July and June. Looking at the three-month percent changes, annualized, the core rate rose 5.3%—half June's 10.2%. Consumer durable goods prices slowed to a 15.9% rate of gain from 41.8% in June, while the rate for nondurable goods accelerated from 6.3% to 10.5%; services inflation eased to 3.1% from 5.6% over the same period. Looking at the three-month percent changes in core goods' prices, annualized, there was a steep slowdown in prices for used cars & trucks (to 36.1% in August from 121.8% in June) and household furniture & bedding (9.6 from 19.2), while the apparel (4.5 from 9.0) rate was cut in half; the rates for other household equipment & furnishings (-7.2%) and prescription drug (-2.6) prices fell further into negative territory. Meanwhile, the three-month percent change in prices for new vehicles (20.0%) held near recent highs, while prices for motor vehicle parts & equipment accelerated from a recent low of 2.1% in March to 14.1% in August. Looking at the same three-month percent change exercise for services, prices for airfares (to -27.0% from 84.3% in June) and car & truck rentals (-32.8 from 148.0) have dropped significantly during the three months through August, while costs for tuition & child care (2.0 from 3.0) slowed slightly. Meanwhile, shelter (to 4.3% from 4.8%) costs during the three months through August were little changed from June's three-month annualized pace, with the rate for lodging away from home (40.2 from 62.4) slowing noticeably from June's pace, while owners' equivalent (3.5 from 3.4) and tenant (2.8 from 2.7) rents held steady around recent highs. The three-month annualized rate for medical care services (to 2.3% from -0.7%) has climbed a bit, with both physicians' (2.7 from -0.2) and hospital (6.5 from 2.3) services accelerating, with the latter the highest since the end of 2019.

NFIB Small Business Optimism Index ([link](#)): "As the economy moves into the fourth

quarter, small business owners are losing confidence in the strength of future business conditions,” said NFIB Chief Economist Bill Dunkelberg. “The biggest problems facing small employers right now is finding enough labor to meet their demand and for many, managing supply chain disruptions.” That being said, the job openings component of the Small Business Optimism Index (SBOI) reached another record high in August, at 50%—more than double the 48-year historical average of 22%. The SBOI edged up 0.4 point in August to 100.1, with five of the 10 index components contributing positively to the index, four negatively, while expected credit conditions was unchanged. Plans to increase employment (to 32% from 27%) and inventories (11 from 6) recorded the biggest positive contributions, followed by plans to make capital outlays (30 from 26), sales expectations (-2 from -4), and current job openings (50 from 49). Owners have grown more pessimistic, as those expecting the economy to improve over the next six months (to -28% from -20%) was the biggest negative contributor last month, and is down 16ppts the past two months to its lowest percentage since January 2013. Also dragging the SBOI lower were now is a good time to expand (10% from 13%), earnings trends (-15 from -13), and current inventory (11 from 12). Of the owners surveyed, quality of labor (28%) remained the top business problem, followed by taxes (16), inflation (13), government requirements (12), and cost of labor (10)—with inflation concerns, quality of labor, and cost of labor on steep uptrends. Tax concerns have dropped to an 11-month low. Meanwhile, the Uncertainty Index fell to 69 in August—the lowest since January 2016—down from a recent peak of 98 in October.

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