



MORNING BRIEFING

October 25, 2021

Phillips Curve Making a Comeback?

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

(1) Something different. (2) #1 new release. (3) Johnny Paycheck and the Great Resignation. (4) Quitting for better pay, caregiving at home, less stress, retirement, self-employment, jobless benefits, or health. (5) The oldest Baby Boomers turned 65 in 2011, 75 in 2021. (6) Growth in working-age population and in labor force close to zero. (7) Is the Phillips Curve rising from the dead? (8) The model is missing an important variable, i.e., productivity. (9) Labor shortage likely to depress unemployment rate and boost productivity. (10) Movie review: "Dune" (+).

YRI Monday Webinar: 'Ask Dr. Ed.' It's time for something new and slightly different: Instead of the Sunday video podcast, I'm going to try a webinar on Mondays at 11 a.m. EST as a better way to interact with you. You will receive an email with the link to the webinar one hour before showtime. I will aim to keep them relatively short, say about half an hour. Replays will be available [here](#). As always, we welcome your feedback.

Dr. Ed's New Book. [In Praise of Profits!](#) is already the #1 New Release in Stock Market Investing on Amazon. The main theme is that "profits" isn't a four-letter word but rather the ultimate source of economic prosperity. Subscribers are invited to a free download of the Kindle or pdf version of the book [here](#). You can see key excerpts [here](#) as well.

US Labor Market I: The Great Resignation. More and more American workers are singing Johnny Paycheck's [song](#) "You Can Take This Job and Shove It!" During August, a record 4.3 million workers quit their jobs ([Fig. 1](#)). Over the past 12 months through August, quits totaled a record 43.4 million ([Fig. 2](#)).

Here's a comparison of the number of quits during August in selected industries on a seasonally adjusted basis, in thousands: total (4.3 million), accommodation & food services (892), retail trade (721), professional & business services (706), health care & social assistance (534), manufacturing (306), construction (199), and state & local education (70) ([Fig. 3](#)).

How can we explain the Great Resignation? Actually, it isn't much greater than the previous record wave of 42.2 million quits over the 12 months through January 2020. The labor

market was hot back then. It is even hotter now, as evidenced by the 10.4 million job openings during August, well above the pre-pandemic record high of 7.6 million during November 2018 ([Fig. 4](#)).

Obviously, some of the quitters switched less-than-ideal jobs for better ones; other quitters are officially unemployed (counted as such if they are seeking another job); and still others dropped out of the labor force entirely.

Here's a list of the main reasons that people are quitting their jobs:

(1) *Better pay*. Many of the job switchers must be doing so to get better pay. The Atlanta Fed's Median Wage Growth Tracker showed that during September job switchers saw their wages grow by 5.4% y/y, while job stayers received increases of 3.5% y/y ([Fig. 5](#)). The 190bps spread between these two measures was the highest since the late 1990s, when the labor market was also as hot as it is today ([Fig. 6](#)).

(2) *Stay-at-home caregivers*. Daycare centers are short of workers. It's becoming harder to find quality affordable daycare, giving some parents added reason to stay home with young children rather than return to work. Some people may also have quit their jobs to provide elder care to family members rather than exposing them to the risk of catching Covid in assisted-living facilities.

(3) *Jobs are more stressful*. Employees have to work harder and longer hours because their employers are understaffed. Pandemic border closures have reduced the availability of legal immigrant workers. Jobs that entail dealing with the public, particularly in retailing and food services, have become especially stressful owing to cranky patrons amid the staffing shortages.

(4) *Retirements*. The Baby Boomers are retiring. The oldest of them turned 65 during 2011 and 75 during 2021 ([Fig. 7](#)). The pandemic probably caused many Baby Boomers who had been working past the traditional retirement age of 65 to stop working. Over the past 19 months through September, the number of seniors in the labor market fell by 366,000 compared to the 132,000 increase during the previous 19 months. The number of seniors not in the labor force increased by 3.0 million over the past 19 months through September compared to 2.7 million during the previous 19 months.

(5) *Self-employed*. Some workers who quit have become self-employed. The number of them peaked at a record 16.6 million this July ([Fig. 8](#)). It since has edged down to 16.4

million during September.

(6) *Unemployment benefits.* Federal pandemic relief dollars that many unemployed workers collected until September may have made a lot of them less eager to return to work. Initial unemployment claims have been below 300,000 per week since the week of October 9.

(7) *Pandemic-related.* Some workers have quit because they are sick with Covid or are caring for someone who contracted the virus.

US Labor Market II: Chronic Labor Shortages. As discussed above, there are lots of good explanations for why people are quitting their jobs and why employers have so many jobs openings that are hard to fill. However, the most compelling structural reason for widespread labor shortages is a demographic one, as Melissa and I often discuss. Consider the following:

(1) *Working-age population.* The working-age civilian population 16 years old and older is growing at a slower pace, mostly because Baby Boom seniors are retiring at a faster pace while the rest of the working-age population (i.e., excluding seniors) stopped growing in recent years ([Fig. 9](#)). The average annualized growth rate over the past 60 months (i.e., the five years through September) of the total working-age population was only 0.6%, while the same excluding seniors was -0.1% ([Fig. 10](#)).

(2) *Labor force.* The civilian noninstitutional labor force reflects the underlying population trends, with the five-year average growth rate at 0.2% through September ([Fig. 11](#)). Excluding the seniors, who undoubtedly will continue to retire at a faster pace, the comparable growth rate is zero.

US Labor Market III: Productivity to the Rescue? Labor shortages are likely to be long term rather than short term in nature. So recent upward pressures on wages are likely to persist.

Prior to the pandemic, Fed officials were surprised that their easy monetary policies, which succeeded in lowering the unemployment rate to 3.5% during the first two months of 2020, failed to boost wage and price inflation as they had hoped. They concluded that the Phillips Curve, which posits an inverse relationship between the jobless rate and inflation, had flattened.

Since the pandemic, the Phillips Curve has risen from the dead, as the unemployment rate

fell and both wage and price inflation have accelerated. Given that labor shortages are chronic, won't that mean that we're in for a long-lasting wage-price spiral like the one during the 1970s ([Fig. 12](#))?

Not necessarily, because the simplistic Phillips Curve model is missing an important determinant of inflation, i.e., productivity. A tighter labor market can boost wage inflation, but it also can stimulate productivity. In this scenario, nominal wages will rise without putting as much upward pressure on consumer prices.

An alternative model that adjusts for this is my Real Phillips Curve Model, which compares the unemployment rate to the growth rates of both productivity and inflation-adjusted hourly compensation. Here's what it tells us:

(1) With few exceptions, there has been an inverse correlation between the unemployment rate and the growth rate of productivity (using the 20-quarter percent change at an annual rate) ([Fig. 13](#)). Productivity growth tends to be best (worst) when the jobless rate is low (high). That makes sense: Unemployment tends to be high during recessions, when weak demand depresses productivity because output falls faster than hours worked.

(2) The 1970s was a decade of relatively high unemployment, resulting in a sharp drop in productivity growth, which contributed to the decade's wage-price spiral. During the 2020s, I believe that labor will continue to be relatively scarce, which is why I expect a productivity boom over the remainder of the decade, which should help to subdue price inflation.

(3) Interestingly, there is also an inverse correlation between the unemployment rate and inflation-adjusted hourly compensation ([Fig. 14](#)). High unemployment depresses real pay because it depresses productivity. Low unemployment boosts productivity, which boosts real pay without boosting consumer price inflation.

(4) I conclude that labor shortages are likely to depress the unemployment rate while boosting productivity growth. If so, then a 1970s-style wage-price spiral isn't likely to occur.

Movie. "Dune" (+) ([link](#)) is a sci-fi flick based on the 1965 book with the same title. My wife enjoyed the movie more than I did. That's probably because I didn't read the book, but she did and told me that the movie's script is true to the original. She is also a Trekkie, while I am not even though I did quote Mr. Spock in my new book, saying "Live long and prosper." The movie is visually impressive, especially since we saw it on an IMAX screen. It's also very dusty, as it was filmed mostly in the deserts of Jordan and Abu Dhabi. It's reminiscent

of the “Star Wars” movies and “Lawrence of Arabia.” I would love to fly in one of the film’s dragonfly-like helicopters. I just don’t understand why the battle scenes included old-fashioned hand-to-hand sword fights instead of fights using laser swords or guns. Climate-change activists undoubtedly would see this film as prophetic.

Calendars

US: Mon: Dallas Fed Manufacturing Index, Chicago Fed National Activity Index. **Tues:** Consumer Confidence 108.8, New Home Sales 755k, Richmond Fed Manufacturing Index, S&P/CS HPI Composite 20 City 1.4%/m/m/20.1%/y/y, Crude Oil Inventories. (Bloomberg estimates)

Global: Mon: Germany Ifo Business Climate, Current Assessment, and Expectations 97.9/99/496.4, Japan Leading Index, Tenreyro. **Tues:** Australia CPI 0.8%/m/m/3.1%/y/y, China Industrial Profits. (Bloomberg estimates)

Strategy Indicators

Global Stock Markets Performance ([link](#)): The US MSCI index turned in its third straight weekly rise last week, gaining 1.6% and ending the week 0.2% below its record high on Thursday. The US MSCI ranked 13th of the 49 global stock markets that we follow in a week as 29 of the 49 countries rose in US dollar terms. The AC World ex-US index performed worse, rising 0.7% to 2.7% below its September 15 record high, as nearly all regions rose. EM Asia was the best-performing region last week, with a gain of 1.6%, ahead of BRIC (1.0%). EM Latin America was the biggest underperformer with a decline of 7.1%, followed by EM Eastern Europe (-1.1), EMEA (0.4), EAFE (0.6), and EMU (0.7). Portugal was the best-performing country last week, with a gain of 4.4%, followed by Denmark (3.9), China (3.7), Pakistan (3.6), and Sweden (2.8). Brazil was the worst performer, with a decline of 11.4%, followed by the Czech Republic (-5.3), Colombia (-2.9), Peru (-2.3), and Poland (-1.9). EM Eastern Europe is still the top-performing region ytd, with a gain of 30.3%, ahead of EMEA (29.6), the United States (20.5), EMU (11.8), EAFE (8.9), and the AC World ex-US (7.2). The following regions are lagging the AC World ex-US: EM Latin America (-13.0), BRIC (-3.7), and EM Asia (-2.0). The top-performing countries ytd: Austria (37.4), Russia (33.7), the Czech Republic (32.9), the Netherlands (30.5), and Argentina

(30.1). The biggest laggards of 2021 so far: Pakistan (-24.5), Turkey (-24.0), Brazil (-23.3), Peru (-16.1), and Chile (-15.6).

S&P 1500/500/400/600 Performance ([link](#)): All three of these indexes rose last week, but SmallCap was up for a sixth week in a row compared to three straight gains for LargeCap and MidCap. MidCap's 1.8% rise beat out the gains for LargeCap (1.6%) and SmallCap (1.3). LargeCap ended the week 0.1% below its new record high on Thursday, its first since September 2. MidCap finished the week at its first record high since September 2, but SmallCap finished 2.3% below its June 8 record. Twenty-nine of the 33 sectors were higher for the week, compared to 27 sectors rising a week earlier. LargeCap Real Estate was the best performer of the week, with a gain of 3.2%, ahead of LargeCap Health Care (2.9), LargeCap Financials (2.8), and MidCap Health Care (2.7). SmallCap Communication Services was the worst performer, with a decline of 1.3%, followed by SmallCap Materials (-1.2), LargeCap Communication Services (-0.6), SmallCap Utilities (-0.3), and MidCap Utilities (0.0). SmallCap continues to lead in the 2021 derby with a gain of 23.4% ytd as MidCap (21.3) remained slightly ahead of LargeCap (21.0). All 33 sectors are higher ytd, paced by these best sector performers: SmallCap Energy (89.4), MidCap Energy (76.8), LargeCap Energy (53.6), LargeCap Financials (37.7), and SmallCap Consumer Discretionary (37.2). The biggest laggards so far in 2021: MidCap Communication Services (3.8), MidCap Consumer Staples (5.9), LargeCap Consumer Staples (6.4), SmallCap Health Care (6.4), and LargeCap Utilities (7.1).

S&P 500 Sectors and Industries Performance ([link](#)): Ten of the 11 S&P 500 sectors rose last week, and five outperformed the composite index's 1.6% gain. That compares to a 1.8% rise for the S&P 500 a week earlier, when ten sectors rose and five outperformed the index. Real Estate was the best performer, with a gain of 3.2%, ahead of Health Care (2.9%), Financials (2.8), Utilities (2.3), and Industrials (1.8). The worst performers this week: Communication Services (-0.6), Consumer Staples (0.8), Materials (0.9), Energy (1.2), Consumer Discretionary (1.5), and Tech (1.6). With respect to 2021's performance, the S&P 500 has risen 21.0% so far, with all 11 sectors higher ytd and five beating the broader index. Energy remains in the top spot as the leading sector with a gain of 53.6% ytd, followed by Financials (37.7), Real Estate (30.7), Communication Services (21.5), and Tech (21.4). This year's laggards to date, albeit with gains: Consumer Staples (6.4), Utilities (7.1), Health Care (15.9), Materials (16.9), Consumer Discretionary (17.1), and Industrials (18.2).

S&P 500 Technical Indicators ([link](#)): The S&P 500 rose 1.6% last week and improved relative to its 50-day moving average (50-dma) and 200-day moving average (200-dma). The index closed above its 50-dma for a second week after two weeks below, and was

above its 200-dma for a 69th straight week. The S&P 500's 50-dma moved higher for a second week after falling for two weeks for the first time since last October. The index improved to 2.2% above its rising 50-dma from 0.7% above a week earlier and is up from an 11-month low of 2.0% below several weeks before that. The index had been mostly trading above its 50-dma since late April 2020; in June 2020, it was 11.7% above, which was the highest since its record high of 14.0% in May 2009. That compares to 27.7% below on March 23, 2020—its lowest reading since it was 29.7% below on Black Monday, October 19, 1987. The price index was above its 200-dma for a 69th week last week, and improved to 8.2% above its rising 200-dma from 6.9% above a week earlier and an 11-month low of 5.0% several weeks before that. That compares to 17.0% above in early December, which was the highest since November 2009 and up from the 26.6% below registered on March 23—the lowest reading since March 2009. At its worst levels of the Great Financial Crisis, the S&P 500 index was 25.5% below its 50-dma on October 10, 2008 and 39.6% below its 200-dma on November 11, 2008.

S&P 500 Sectors Technical Indicators ([link](#)): Nine of the 11 S&P 500 sectors traded above their 50-dmas last week, up from six a week earlier as Consumer Staples, Real Estate, and Utilities moved back above. These two sectors remain below their 50-dma: Communication Services and Health Care. That compares to all 11 sectors above at the beginning of May. Real Estate's 50-dma turned higher; it along with Consumer Discretionary, Energy, Financials, and Tech are the only five sectors with a rising 50-dma. Looking at the more stable longer-term 200-dmas, all sectors are above again, up from nine at the beginning of October when Materials and Utilities dropped out of the club for one week. All 11 sectors have had rising 200-dmas for 32 straight weeks. For perspective, back in April 2020, just one sector (Health Care) was trading above its 200-dma. Notably, Energy's 200-dma finally turned higher in mid-December after mostly falling since October 2018.

US Economic Indicators

Leading Indicators ([link](#)): Leading indicators continued its sharp ascent last month, climbing to yet another record high, though the pace has slowed. "The U.S. LEI rose again in September, though at a slower rate, suggesting the economy remains on a more moderate growth trajectory compared to the first half of the year," said Ataman Ozyildirim, Senior Director of Economic Research at The Conference Board. "The Delta variant, rising inflation fears, and supply chain disruptions are all creating headwinds for the US economy."

Despite the LEI's slower growth in recent months, the strengths among the components remain widespread." The specifics: Leading Economic Indicators (LEI) edged up 0.2% in September, after averaging monthly gains of 1.1% the prior six months—not posting a decline since bottoming last April—expanding 21.4% over the period. Of the 10 components of the LEI, six rose, while four declined. September's gain was led by ISM orders diffusion index (+0.23pt), followed by interest rate spread (+0.14), jobless claims (+0.11), and leading credit index (+0.09), with real consumer goods orders and real core capital goods orders both contributing 0.01ppt. Building permits (-0.23) was the biggest drag, followed by consumer expectations (-0.09), average workweek (-0.07), and stock prices (-0.01). The Conference Board continues to forecast strong growth ahead: 5.7% y/y for 2021 and 3.8% for 2022.

Coincident Indicators ([link](#)): The Coincident Economic Index (CEI) was unchanged in September, after a six-month gain of 2.7%. It is up 14.0% since its April 2020 low to within 1.5% of its pre-pandemic level. Three of the four components of the CEI contributed positively, with industrial production the only one in the red. Here's a look at how the four components performed in September, with employment once again the biggest positive contributor: 1) Payroll employment (+0.07ppt) was well below consensus expectations for the second month in September, as the leisure & hospitality industry—which has been the biggest job engine—recorded another subpar job gain. Payroll employment rose only 194,000 (versus consensus estimates of 500,000), though there were upward revisions to both August and July, for a net gain of 169,000. Total payroll employment has recovered 17.4 million jobs since bottoming last April, though is still 5.0 million below its pre-pandemic level. Private payrolls expanded 317,000, with revisions to August and July adding a 107,000 jobs. 2) Real personal income less transfer payments (+0.05) increased in September for the sixth time in seven months, by 0.2% m/m and 1.3% over the period—to within 0.1% of February 2020's record high. 3) Real manufacturing & trade sales (+0.03) advanced for the third time in four months, by 0.2% m/m and 0.9% over the four months through September to within 1.6% of its record high in March of this year. 4) Industrial production (-0.19) continued to be challenged by supply constraints—with the auto sector the hardest hit “as shortages of semiconductors continued to hobble operations,” the Fed reported. Headline production tumbled an unexpected 1.3% last month, while August's 0.4% gain was revised to a 0.1% loss. Manufacturing output sank 0.8% in September and 1.2% during the two months through September, as motor vehicle production plunged 7.2% and 10.1% over the comparable periods to its lowest level since mid-2020.

Regional M-PMIs ([link](#)): Two Fed districts (New York and Philadelphia) now have reported on manufacturing activity for October and show the manufacturing sector expanded at

slower, though still robust, pace. The composite index slipped to 21.8 this month after rebounding from 18.9 to 32.5 in September, as the New York (to 19.8 from 34.3) and Philadelphia (23.8 from 30.7) measures slowed though remained elevated. Meanwhile, new orders (to 27.6 from 24.8) continued to accelerate back toward April's 31.5—which was the highest since July 2004—as billings in both the Philadelphia (to 30.8 from 15.9) and New York (24.3 from 33.7) regions expanded at a robust pace this month, though growth accelerated in the former and slowed in the latter. Job gains remained solid, with the employment (to 23.9 from 23.4) measure showing job growth holding around this rate for the seventh month—more than double last October's rate. Philadelphia (to 30.7 from 26.3) factories are hiring at nearly double the pace of New York's (17.1 from 20.5), though the latter is holding around its recent highs. Inflationary pressures remain elevated, with Philadelphia's prices-received (51.1 from 52.9) measure holding near August's rate of 53.9, which was the highest since 1974, and with the prices-paid measure (70.3) fluctuating in a flat trend just below June's 80.7, which was the highest since 1979. New York's prices-received measure eased to 43.5 after accelerating to a record high 47.8 in September, while the prices-paid measure rose to 78.7 this month after slowing steadily from May's record high of 83.5 to 75.7 by September.

Existing Home Sales ([link](#)): "Some improvement in supply during prior months helped nudge up sales in September," said Lawrence Yun, NAR's chief economist. "Housing demand remains strong as buyers likely want to secure a home before mortgage rates increase even further next year." Existing home sales in September increased for the third time in four months, by 7.0% m/m and 8.8% over the period to 6.29mu (saar)—the highest since the start of the year, and 10.4% above its pre-pandemic level. Sales had plunged 13.2% during the four months through April. Sales of single-family homes rebounded 7.7% in September to 5.59mu (saar), climbing 10.3% during the four months through September following a five-month slump of 14.4%, while multi-family sales remain in a volatile flat trend around recent highs. Regionally, total sales rose in all four regions in September, with three still below year-ago levels: South (+8.6% m/m & 0.0% y/y), West (+6.5 & -3.0), Northeast (+5.5 & -8.3), and Midwest (+5.1 & -2.7). The inventory of existing homes had been improving a few months ago—from 1.03 million units at the start of the year to 1.31 million during July—but since has stalled, with September's 1.27 million down 0.8% from August. The gain in median existing home prices has eased dramatically, dropping into single digits in three of the four regions. Here's a regional look at September's yearly rates and how far they've slowed from recent peaks: West (8.3% from 24.2%), Midwest (9.1 from 18.5), Northeast (9.2 from 23.6), and South (to 14.8 from 22.4).

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