Yardeni Research

MORNING BRIEFING
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The ‘Roaring 2020s’ Revisited

Check out the accompanying chart collection.

Executive Summary: Productivity was poor last year—declining more than it has since 1974—and growth in unit labor costs was high. But the final quarter of 2022 saw significant improvements in both, and we think the worst is over for both. If productivity continues to improve as companies increasingly solve their labor challenges with technological innovations, that should lead to lower inflation, higher real wages, and better profit margins. That’s the thesis of our “Roaring 2020s” outlook. … Also: The economy has been experiencing a rolling recession that started last year. Today, we examine rolling recessions, past and present. ... And: Dr. Ed reviews “The Whale” (+ + +).

YRI Weekly Webcast. Join Dr. Ed’s live webcast with Q&A on Mondays at 11 a.m. EST. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*.

US Inflation: Unit Labor Costs Peaking. The headline CPI inflation rate on a y/y basis closely tracks the comparable series for nonfarm business unit labor costs (ULC), which might have peaked during Q3-2022 (*Fig. 1*). The Bureau of Labor Statistics calculates ULC by dividing hourly compensation by productivity, both for the nonfarm business sector. On a y/y basis, productivity fell 1.8% through Q4-2022, the worst annual performance since 1974. Debbie and I think the worst is over, and better times are ahead for productivity, which augurs well for lower inflation, solid gains in real wages, and better profit margins.

Let’s have a closer look at the latest data and revisit our bullish outlook for the rest of the decade, which we still believe could turn out to be the “Roaring 2020s”:

(1) *Labor market turnover.* The aftershocks of the pandemic probably explain why productivity was so weak last year. During 2022, a record 50.5 million workers quit their jobs, i.e., nearly a third of payroll employment (*Fig. 2*)! Hires totaled 76.4 million, or nearly 50% of payroll employment (*Fig. 3*). Even though hires exceeded quits by 25.9 million, job openings averaged a near-record 11.0 million last year (*Fig. 4*).

All that labor market turnover must have weighed on productivity, as an unprecedented number of jobs went unfilled: Demand for labor exceeded the supply of labor by a record 5.3 million workers on average last year (*Fig. 5* and *Fig. 6*).

(2) *Productivity.* Although last year's productivity growth was the worst since 1974, it was mostly attributable to big declines during the first two quarters of 2022 and a weak third-quarter gain (*Fig. 7*). During Q4-2022, productivity rose 1.7% q/q (saar), a significant improvement over the prior three quarters' readings. Debbie and I expect that productivity will continue to improve this year and over the rest of this decade assuming that our Roaring 2020s scenario works out. We believe that employers will solve their chronic labor shortage problem by spending more on productivity-enhancing technologies.

Over the past five years (60 months) through January, the average annual growth rate of the labor force was just 0.6% (*Fig. 8*). Over this same period, productivity grew faster—at a 1.5% average annual rate. We expect to see productivity growth rise to 3.0%-4.0% over the rest of the decade, comparable to the peak growth rates that occurred during the previous productivity booms in the US during the late 1950s, mid-1960s, and second half of the 1990s through the first half of the 2000s (*Fig. 9*).

(3) *Hourly compensation*. Hourly compensation is the broadest measure of labor compensation. It is also much more volatile than the other measures. In any case, it was up 4.9% q/q (saar) and 4.4% y/y during Q4-2022. It includes wages, salaries, and benefits for all workers, as well as imputed labor costs for proprietors. There are three measures of wages: average hourly earnings, wage growth tracker (WGT), and the wage & salary component of the employment cost index (ECI) (*Fig. 10* and *Fig. 11*). The y/y inflation rates of all three peaked last year but they were still elevated at year-end.

Hourly compensation is a volatile series. A smoother measure of total compensation is the ECI, which includes wages, salaries, and benefits (*Fig. 12*). Both are available through Q4-2022. The ECI measure was up 5.1% y/y last quarter, while hourly compensation was up 4.4%. Both seemed to have peaked last year.

(For a comprehensive description of the alternative measures of wages and labor costs, see *Appendix 4.1* from my 2018 book *Predicting the Markets*.)

(4) *Unit labor costs.* The good news is that while ULC was up 6.3% y/y last year, it was up only 3.2% q/q (saar) during Q4. That's the slowest such pace since Q1-2021. The low ULC growth rate during Q4 reflects the fact that the 4.9% increase in hourly compensation was partially offset by the 1.7% increase in productivity.

As noted above, the CPI inflation rate closely tracks the ULC inflation rate, confirming that consumer price inflation is driven by inflation in the labor market. Again, both peaked last year but remain elevated. We expect to see both moving lower this year and next year.

(5) *Labor market math.* Fed Chair Jerome Powell has often said that monetary policy is aiming to reduce the demand for labor to cool off wages. He has yet to specify how low he would like to see wage inflation go. Let's assume he believes that productivity growth is around 1.0%. We know that he and his colleagues are aiming to lower price inflation to 2.0%. This implies that the Fed is targeting 3.0% for wage inflation. That would leave workers with real wage gains of around 1.0%. That's only going to happen if productivity grows 1.0%. We think it will grow faster than that, allowing for larger wage gains without adding to inflationary pressure on prices.

Interestingly, the trendline growth rate of real average hourly earnings for production and nonsupervisory workers (about 80% of payroll employment) has been 1.2% per year since 1995 (*Fig. 13*). Real AHE has been flat in record-high territory for the past year as prices rose as fast as wages. We think that the upward trend in real AHE might have started to resume late last year. That would be consistent with the improvement in productivity growth late last year.

(6) *Labor market indicators.* Debbie and I are monitoring several labor market indicators that closely track the y/y inflation rate in ECI wages and salaries in private industry. The quit rate leads this ECI inflation rate by about nine months, and it suggests that the latter will fall quite sharply in coming quarters (*Fig. 14*). The Atlanta Fed's Sticky CPI inflation rate, which might have peaked late last year, tends to be a coincident indicator of the ECI wages and salaries inflation rate (*Fig. 15*). The monthly AHE and WGT inflation rates also seem to have peaked last summer (see Fig. 10 and Fig. 11, linked above).

One indicator suggesting that wage inflation will remain high is the "jobs plentiful" series from the monthly consumer confidence survey conducted by The Conference Board (*Fig. 16*). This series is also highly correlated with the JOLTS series for job openings and the NFIB series for small business with job openings (*Fig. 17*). All three of these measures of job openings peaked last year but remain high.

US Economy: A Brief History of Rolling Recessions. I've been asked more frequently recently to explain what I mean by a "rolling recession." In my 2018 book *Predicting the Markets: A Professional Autobiography*, I discuss this concept. Here are some excerpts and subsequent writings:

(1) "There was a recession scare during 1986, which was mostly attributable to the plunge

in oil prices during the second half of 1985 and the first half of 1986. Oil companies in Texas and other oil-producing states had responded to the OPEC oil spike by borrowing and expanding too much. The boom in the oil states, especially Texas, turned into a bust. I described it as a 'rolling recession.'"

(2) "This time [in 1990], the rolling recession hit both residential and commercial real estate hard, while the overall national downturn was relatively short and shallow. That was my forecast after I thoroughly examined the nature of the thrift crisis and concluded that it would be relatively contained."

(3) "Another rolling recession rolled through the oil industry from mid-2014 through early 2016 because of a freefall in the price of oil. Like the one during 1986, it did not spill over to other industries and the broader economy. My assessment at the time was that it wouldn't, though a few other economists rang the recession alarm bells."

(4) Last year, in the August 16 *Morning Briefing*, I wrote: "It's possible that we might all collectively talk ourselves into a recession. It's also possible that we are all hunkering down just enough that any recession will be mild since there won't be too many excesses to worsen it. The downturn could be what we called a 'rolling recession,' during the mid-1980s for the US." (See "Searching For Godot," our August 22, 2022 *Morning Briefing*.)

Since then, I have written that the Index of Leading Economic Indicators "could be signaling a rolling recession that might not make it into the record books." I also predicted: "So any recession that occurs is more likely to be a soft landing rather than a hard landing—i.e., a mild recession rather than a bad one. It could even be a 'rolling recession' hitting different sectors of the economy at different times, resulting in a shallow but protracted 'growth recession.'"

(5) The latest rolling recession started in the single-family housing market early last year. Then industries that produce and distribute goods fell into a recession during H2-2022, as consumers—having binged out on buying goods during 2020 and 2021—pivoted to spending more on services. The tech industry was hit with recession too; tech companies hired too many workers during the pandemic when their sales were booming; now those companies are paring their payrolls, as sales have slowed. And the office real estate market is in an outright depression now that so many workers are working from home.

Movie. "The Whale (+ + +) (*link*) is an outstanding film with an outstanding cast of characters played by outstanding actors. Charlie, played by Brendan Fraser, suffers from obesity that started when his partner died, causing him to eat obsessively to deal with the pain. The result is that his health is poor, he can barely walk, and he never leaves his apartment. He works from home as an English professor who teaches online college writing courses. Charlie works on reconnecting with his estranged teenage daughter during most of the film. The novel *Moby Dick* is mentioned several times as a lesson in what not to do in life.

Calendars

US: Mon: Factory Orders -1.8%. **Tues:** Consumer Credit $22.8b; Wholesale Inventories -0.4%; EIA Short-Term Energy Outlook; Powell Testifies. (Bloomberg estimates)

Global: Mon: Eurozone Retail Sales 1.0%m/m/-1.8%y/y; Eurozone Sentix Investor Confidence -6.3; Spain Consumer Confidence; Germany Current Account Balance; UK BRC Retail Sales Monitor 4.8%; China Trace Balance 80.9b; Australia Retail Sales 1.9%; Australia Trade Balance $12.7b; RBA Statement; Balz; Lane. **Tues:** Germany Factory Orders -1.0%; Spain Industrial Production -0.6%; UK Halifax House Price Index; Japan Current Balance; Lowe; Woods. (Bloomberg estimates)

Strategy Indicators

Global Stock Markets Performance (*link*): The US MSCI index rose 1.9% w/w for its first gain in four weeks, avoiding falling back into a bear market and improving to 16.7% below its record high on December 27, 2021. The US MSCI ranked 22nd of the 48 global stock markets that we follow in a week when 36 of the 48 countries rose in US dollar terms. The AC World ex-US index rose 1.7% for its first gain in five weeks, and is also out of a bear market at 17.5% below its June 15, 2021 record high. All regions rose w/w, but EMU Europe was the best regional performer with a 2.9% gain, ahead of BIC (2.6%), EM Eastern Europe (2.4), EM Asia (1.7), and EAFE (1.7). EM Latin America was the worst performing region last week, albeit with a gain of 0.9%, followed by EMEA (1.2). Peru was the best-performing country last week, with a gain of 6.7%, followed by Sri Lanka (6.1), Ireland (5.6), Mexico (5.2), and Chile (4.2). Among the 22 countries that underperformed the AC World ex-US MSCI last week, the 7.4% decline for Pakistan was the biggest, followed by Egypt (-3.2), Argentina (-2.4), Brazil (-1.9), and Indonesia (-1.8). In February, the US MSCI ranked 25/48 as it fell 2.6%, less than the 3.6% decline for the AC World ex-US index as 13 of the

48 countries moved higher. The Czech Republic was the best performer, with a gain of 10.4%, followed by Greece (9.0), Turkey (5.8), Egypt (5.4), and Austria (3.6). The worst-performing countries in February: Colombia (-16.3), China (-10.4), Thailand (-9.5), Brazil (-9.4), and South Africa (-8.1). All regions fell in February, but EMU was the best performer with a decline of only 0.8%, ahead of EM Eastern Europe (-1.6), EAFE (-2.2), EMEA (-3.0), and the AC World ex-US (-3.6). BIC (-8.8) was February's worst-performing region, followed by EM Asia (-6.9) and EM Latin America (-6.4). Looking at 2023's performance so far, the US MSCI is up 5.8% and ranks 21/48 as 36 of the 48 countries are higher ytd. The AC World ex-US has risen a slightly lower 5.5% ytd, with nearly all regions in positive territory. EMU is the best performer ytd, with a gain of 11.7%, followed by EAFE (6.5) and EM Eastern Europe (6.2). The regional laggards so far in 2023: EMEA (-1.0), BIC (1.4), EM Asia (4.0), and EM Latin America (4.1). This year's best ytd country performers: the Czech Republic (31.3), Greece (22.0), Mexico (21.6), Ireland (18.4), and Italy (15.0). Here are the worst-performing countries of the year so far: Pakistan (-18.5), Colombia (-9.3), India (-5.3), Thailand (-5.0), and Malaysia (-4.5).

S&P 500/400/600 Performance (*link*): All three of these indexes rose w/w. LargeCap's gain was its first in four weeks, and MidCap moved back out of correction territory again. LargeCap rose 1.9% w/w, slightly ahead of the 1.8% gains for MidCap and SmallCap. At the week's end, LargeCap finished at 15.7% below its record high on January 3, 2022, MidCap at 9.0% below its record high on November 16, 2021, and SmallCap at 13.4% below its November 8, 2021 record high. Twenty-three of the 33 LargeCap and SMidCap sectors moved higher for the week, up from just three rising a week earlier. SmallCap Energy was the best performer, with an increase of 8.0%, followed by SmallCap Materials (6.1), MidCap Materials (5.9), LargeCap Materials (4.0), and MidCap Energy (3.9). Among the worst performers for the week were MidCap Communication Services (-2.4), SmallCap Utilities (-1.5), MidCap Utilities (-1.3), MidCap Financials (-0.9), and LargeCap Utilities (-0.7). During February, LargeCap fell 2.6%, more than the declines for SmallCap (-1.4) and MidCap (-2.0). Six of the 33 sectors rose in February compared to 30 rising in January. February's best performers: SmallCap Consumer Staples (1.3), MidCap Industrials (1.2), MidCap Tech (0.9), SmallCap Industrials (0.7), and SmallCap Materials (0.6). February's biggest laggards: LargeCap Energy (-7.6), MidCap Energy (-7.4), SmallCap Real Estate (-6.8), LargeCap Utilities (-6.4), and LargeCap Real Estate (-6.1). Looking at performances so far in 2023, LargeCap's 5.4% gain continues to trail those of SmallCap (9.7) and MidCap (9.0) as 27 of the 33 sectors are higher ytd. The top sector performers in 2023: SmallCap Communication Services (17.6), SmallCap Materials (17.6), SmallCap Consumer Discretionary (17.3), MidCap Materials (15.5), and MidCap Tech (14.3). Here are 2023's biggest laggards: LargeCap Utilities (-6.6), LargeCap Health Care (-5.2), MidCap Utilities (-

3.9), LargeCap Consumer Staples (-3.0), and SmallCap Utilities (-2.5).

S&P 500 Sectors and Industries Performance (*link*): Nine of the 11 S&P 500 sectors rose last week, and five outperformed the composite index's 1.9% gain. That compares to a 2.7% decline for the S&P 500 a week earlier, when one sector rose and four outperformed the index. Materials was the best performer, with a gain of 4.0%, followed by Communication Services (3.3%), Industrials (3.3), Energy (2.9), and Tech (2.9). Utilities was the worst performer with a 0.7% decline, followed by Consumer Staples (-0.4), Health Care (0.5), Financials (0.8), Real Estate (1.6), and Consumer Discretionary (1.6). The S&P 500 fell 2.6% in February after rising 6.2% in January for its best start in three years. Just one of the 11 sectors moved higher during February, and five outperformed the broader index. That compares to eight sectors rising and six outperforming the S&P 500's performance in January. The leading sectors in February: Tech (0.3), Industrials (-1.2), Consumer Discretionary (-2.3), Financials (-2.4), and Consumer Staples (-2.5). February's laggards: Energy (-7.6), Utilities (-6.4), Real Estate (-6.1), Health Care (-4.7), Communication Services (-4.7), and Materials (-3.5). Looking at 2023's performance so far, the S&P 500 is up 5.4% ytd with just four sectors outperforming the index and seven higher for the year. The best ytd performers: Consumer Discretionary (12.9), Tech (12.4), Communication Services (11.7), and Materials (8.7). These are 2023's worst performers: Utilities (-6.6), Health Care (-5.2), Consumer Staples (-3.0), Energy (-1.2), Real Estate (4.7), Financials (4.8), and Industrials (5.2).

S&P 500 Technical Indicators (*link*): The S&P 500 rose 1.9% last week and improved relative to its 50-day moving average (50-dma) and 200-day moving average (200-dma). The index moved back above its 50-dma after falling below a week earlier for the first time in seven weeks, but remained above its 200-dma for an eight straight week. That's the index's longest positive 200-dma streak since January 2021, when it had been above its 200-dma for 81 straight weeks through February 2021. The S&P 500's 50-dma improved to 1.3% above its rising 50-dma from 0.2% below a week earlier. That compares to a four-month low of 10.6% below at the end of September, a 23-month high of 8.7% above the index's rising 50-dma in early August, and a 27-month low of 11.1% below its falling 50-dma in mid-June. The index had been mostly trading above its 50-dma from late April 2020 to early April 2022; 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 closed Friday at 2.8% above its rising 200-dma, up from 0.8% above its rising 200-dma a week earlier; that compares to a 13-month high of 5.1% above in early February. The 200-dma moved lower w/w after rising for two straight weeks. It has moved higher in just four of the past 42 weeks. The S&P 500 is well above its 26-month low of 17.1% below its falling 200-dma in mid-June; that compares to 10.8% above its rising 200-dma in November 2021. That also compares to 17.0% above in December 2020, which was the highest since November 2009 and up from the 26.6% below registered during the Great Virus Crisis on March 23, 2020—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*): Six of the 11 S&P 500 sectors are trading above their 50-dmas, up from three above a week earlier. These five sectors still trade below their 50-dma: Consumer Staples, Energy, Health Care, Real Estate, and Utilities. Seven sectors have a rising 50-dma, down from eight a week earlier. Energy's 50-dma turned down w/w and joined these three sectors are still in the declining 50-dma club: Consumer Staples, Health Care, and Utilities. Looking at the more stable longer-term 200-dmas, one sectors rose above that measure in the latest week. That leaves these five sectors still trading below their 200-dma: Consumer Discretionary, Consumer Staples, Health Care, Real Estate, and Utilities. The rising 200-dma club has just Financials and Industrials as members now, down from six a week earlier, as these four sectors turned down w/w: Consumer Discretionary, Consumer Staples, Energy, and Tech.

US Economic Indicators

Auto Sales (*link*): Auto sales in February dipped to 15.2mu (saar) after rebounding 2.6mu in December to 16.2mu—which was the highest level since May 2021. *Domestic light-truck sales* slipped to 9.5mu (saar) last month after soaring from 8.0mu in December to 10.0mu in January, which was the highest since April 2021. *Domestic car sales* continue to fluctuate in a volatile flat trend, slipping from 2.3mu to 2.1mu (saar) in February; it's averaged 2.2mu the past seven months. Sales of *imports* remain on a volatile uptrend, though fell to 3.6mu (saar) during February after climbing from a recent low of 3.0mu last May to an 18-month high of 3.9mu this January.

US Non-Manufacturing PMIs (*link*): Activity in the service sector remained robust in February, while inflationary pressures were still elevated, though are easing. The sector continues to benefit from a switch in consumer spending from goods to services. ISM's NM-PMI was little changed at 55.1 during February after jumping from 49.2 in December (lowest since May 2020) to 55.2 at the start of this year. It was at a record-high 67.6 in November 2021. Of the four components of the NM-PMI, the forward-looking *new orders* gauge improved to a 15-month high of 62.6 in February, after dipping below 50.0 in December for the first time since the pandemic, while the *business activity* (to 56.3 from 60.4) measure eased a bit, remained strong. The service sector's *employment* gauge was the strongest since the end of 2021, climbing for the second month from 49.4 in December to 54.0 during February. The *supplier deliveries* component sank to 47.6—indicating the fastest delivery performance since June 2009! On the *inflation* front, the price index continued to ease, slowing to a 25-month low of 65.6 last month; it was at a record-high 84.5 at the end of 2021.

Global Economic Indicators

Global Composite PMIs (*link*): Global economic activity and new orders in February expanded for the first time in seven months, led by the service sector, while the manufacturing sector was back at the breakeven point after contracting the prior five months. The *C-PMI* climbed to 52.1 last month, the first reading above the 50.0 demarcation line between expansion and contraction since last July. The *NM-PMI* climbed from 48.0 during the final two months of 2022 to an eight-month high of 52.6 in February, while the *M-PMI* rose from 48.7 in December (the lowest since mid-2020) to 50.0 last month. *Geographically*, the report notes that of the 14 countries for which data are available, 12 experienced an expansion in growth. There was a wide variation in C-PMIs among countries, ranging from the strong upturns of India (59.0) and Spain (55.7) to only negligible growth in the US (50.1). Mainland China (54.2) and Japan (51.1) saw an expansion in activity for the second straight month, while Brazil (49.7) and Kazakhstan (48.0) were the only countries showing a contraction in activity. By *industry*, five of the six sub-industries covered by the survey showed an expansion in economic activity last month—business services, consumer goods, consumer services, financial services, and investment goods. The intermediate goods category continued to contract, though eased to a six-month low. Turning to prices, input price inflation saw a modest easing, with costs at the second lowest rate in over two years; both the manufacturing and services sectors benefitted from lower costs. Meanwhile, output charges increased for the 32nd consecutive month, accelerating at a slightly faster pace than in January.

Eurozone CPI Flash Estimates (*link*): The headline CPI rate for February is expected to slow for the fourth month to 8.5% y/y, according to the flash estimate, after accelerating to a record-high 10.6% in October. For perspective, the rate was as low as -0.3% at the end of 2020. Looking at the main components, once again *energy* is forecast to record the largest gain, though is forecast to slow for the fourth month in February to 13.7% from 41.5% in

October; it was at a record high of 44.3% last March. The rate for *food, alcohol & tobacco* is predicted to soar to a record-high 15.0% in February—accelerating steadily from June 2021's 0.5%—while the rate for *non-energy industrial goods* is forecast to reach a new record high of 6.8%. The *services'* rate is expected to accelerate 4.8% y/y in February—the highest since October 1993—from 4.4% in both January and December and 4.2% in November. Of the *top four Eurozone economies*, rates are available for all four, with Italy (9.9% y/y) and Germany (9.3) forecast to be above the Eurozone's rate of 8.5% and rates for France (7.2) and Spain (6.1) expected to be below.

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