MORNING BRIEFING
December 11, 2023

Hard Luck For Hard Landers

Check out the accompanying chart collection.

Executive Summary: The economy has proven resilient, defying all the reasons it shouldn't be, to which diehard hard landers still cling. We expect that it will remain resilient and that inflation will continue to fall to the Fed's target (a.k.a. "immaculate disinflation"). In this scenario, the Fed won't be rushing to ease and won't ease by much. The Fed's policy stance is perhaps better cast as "normalizing" than tightening that requires undoing. … Labor market supply and demand are coming into better balance, as the Fed would like, though November employment data attest to the labor market's continued strength. … Also: What to make of the fact that GDI is weaker than GDP. … And: Dr. Ed reviews "Reptile" (+).

YRI Bulletin Board. We are planning on launching our new website at the end of this week on December 15. You might have noticed that we already have cut over to a new design for our charts. We think they are more user-friendly and sharper looking.

We will be recharging our batteries for the new year from December 19 to January 2. We won't be publishing the *Morning Briefing* during that period, nor will there be Monday webcasts. We do intend to stay connected with our *QuickTakes*.

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*.

The Fed: Tightening or Merely Normalizing? Based on November's employment report released on Friday, Debbie and I can safely conclude that there is still no sign of an impending recession. The *Godot* recession is still a no-show. Our soft-landing (a.k.a. rolling recession) scenario remains intact, as it has since early last year. The diehard hard landers are still expecting a recession, as they have been since the Fed started to tighten in early 2022. But they now expect it in 2024 and mostly think that it will be a shallow recession.

The widely anticipated recession scenario has been based on a very simple and logical premise: The Fed started raising interest rates aggressively last year during May. Short-term and long-term rates have increased by at least 500bps through the summer (*Fig. 1*). That shocking pivot, following a very long period of ultra-easy monetary policy, must be a terrible shock for the economy, the thinking goes. While the "long and variable lags in monetary policy" have turned out to be longer and more variable this time, a recession will surely occur in 2024, the hard landers figure.

Additionally, the hard landers point out: The yield curve has been inverted since the summer of 2022 (*Fig. 2*). The Index of Leading Economic Indicators has been falling since it peaked at a record high during December 2021 (*Fig. 3*). The y/y growth rate of real M2 has been negative since May 2022 (*Fig. 4*). The real federal funds rate has soared from -8.46% during March 2022 to 2.09% during October (*Fig. 5*). All of them have been mostly accurate leading indicators of recessions in the past.

Yet contrary to this plausible argument, the economy has remained resilient and avoided a recession so far. Here we are in December 2023, and the unemployment rate remains below 4.0%. Full-time employment is at a record high (*Fig. 6*). So is payroll employment, which is one of the four components of the Index of Coincident Economic indicators (CEI). It is the first to come out every month and suggests that the CEI rose to yet another new record high in November, confounding the LEI's followers (*Fig. 7*).

In recent months, we've provided several explanations for why the hard landers and their indicators have been wrong so far. (See, for example, "Captain America," title of our November 8, 2023 *Morning Briefing*.) Here's a new one: Perhaps the Fed hasn't been tightening monetary policy so much as *normalizing* it. Interest rates are back to the Old Normal. They are back to where they were before the New Abnormal period between the Great Financial Crisis and the Great Virus Crisis, during which the Fed pegged interest rates near zero.

The normalization theory implies that the Fed might not lower interest rates next year as much as widely expected. That's because the economy wouldn't require as much easing to reverse the tightening after the tightening has done its job of bringing down inflation. If the economy remains resilient but inflation continues to fall closer to the Fed's 2.0% target next year—both of which we're expecting—then the Fed might lower the federal funds rate twice next year, by 25bps each time, instead of four times or more as widely anticipated. After Friday's employment report, this was less widely anticipated.

US Labor Market I: Working for a Living. Friday's employment report was bullish for November's real personal income, real retail sales, and CEI. Each month when the report is released, Debbie and I calculate our Earned Income Proxy (EIP) for private-sector wages and salaries in personal income. All three of its components registered gains: Payroll employment in the private sector rose 0.1%, average weekly hours increased 0.3%, and average hourly earnings gained 0.4%.

So our EIP rose 0.8% m/m during November (*Fig. 8*). That undoubtedly well exceeded the month's inflation rate, boosting the purchasing power of consumers. That should be reflected in a solid increase in the month's retail sales and CEI.

Here are some other signs of labor market strength in November's employment report:

(1) The household measure of employment also rose to a record high last month. In fact, it jumped by 747,000 to 162.0 million. Its full-employment component rose 347,000 to a record-high 134.8 million.

(2) The increase in household employment exceeded the 532,000 increase in the labor force. So the number of unemployed workers fell by 215,000 last month to 6.3 million (*Fig. 9*). The average duration of unemployment fell 10.2% to 19.4 weeks (*Fig. 10*).

(3) The labor force participation rate rose to 62.8%, matching its highest readings since February 2020 (*Fig. 11*). Despite the sharp increase in the labor force, the unemployment rate fell to 3.7%. It was down to just 3.4% for adults (*Fig. 12*).

(4) A closer look at the payroll measure of employment shows that lots of industries reported record payrolls along with the total measure. Particularly strong gains continue to be reported by private education & health services (99,000) and leisure & hospitality (40,000) (*Fig. 13*). On the other hand, the retail trade payroll count was particularly weak during November (-38,400).

US Labor Market II: Real Pay Gains. In the past, Fed Chair Jerome Powell has indicated that wage inflation would probably have to slow to 3.0% (from 4.0%-5.0% currently) to get to the Fed's 2.0% target for price inflation. He addressed this issue in a November 30, 2022 *speech* titled "Inflation and the Labor Market." Powell observed: "In the labor market, demand for workers far exceeds the supply of available workers, and nominal wages have been growing at a pace well above what would be consistent with 2 percent inflation over time. Thus, another condition we are looking for is the restoration of balance between supply and demand in the labor market."

That seems to be happening. Consider the following:

(1) *Supply and demand.* In his speech at the end of last year, Powell presented a clever

chart showing the supply of labor as the labor force, and the demand for labor as the sum of employment plus job openings (with the latter pushed ahead by one month) (*Fig. 14*). It is showing that the demand for labor is down 700,000 since the start of the year, while the supply has increased by 2.5 million. Demand still exceeds supply by 2.4 million workers, but that's down from a peak of 6.1 million during April 2022.

(2) *Wages.* Average hourly earnings (AHE) continued to moderate in November. It was down to 4.0% and 4.3% for all private-sector workers and for production and nonsupervisory workers (lower-wage workers), who account for about 80% of payroll employment. The AHE of higher-wage workers has been bouncing around 3.0% y/y since early 2022 (*Fig. 15*).

US Economy: GDP vs GDI. Then again: *USA TODAY* Economics and Jobs Reporter Paul Davidson observed in a December 1 *story* that while Q3's real GDP was revised up to an annual rate of 5.2%, real gross domestic income (GDI) is up just 1.5%. It "has grown feebly over the past year even while GDP has advanced solidly. Over the past four quarters, GDP has increased 3% while GDI has fallen 0.16%." Davidson concluded that maybe the economy "isn't so resilient after all."

In theory, GDP should equal GDI since the former measures the demand for goods and services, while the latter measures the income available for purchasing those very same goods and services. In practice, there is always a statistical discrepancy. During Q3, real GDP was 2.6% higher than real GDI, the highest discrepancy since 1993 (*Fig. 16*).

The discrepancy is even greater between nonfarm business output (NFBO), which jumped 6.1% (saar) during Q3, and GDI. The former is the series used to measure productivity.

(Business sector output is a chain-type, current-weighted index constructed after excluding from GDP the following outputs: general government, nonprofit institutions, and households [including owner-occupied housing]. Nonfarm business, which excludes farming, accounted for about 76% of GDP in 2022.)

So which is it? Are the economy and productivity as resilient and strong as suggested by NFBO and GDP, or are they both as weak as suggested by GDI? Economists tend to pick data that support their story. The hard landers love the GDI story. We are prone to that bias, but we do our best to be balanced and tell you both sides of the story, as we are doing now. Some economists simply take the average of GDP and GDI. For now, we see plenty of evidence to stick with our views that the economy is resilient and productivity growth is making a comeback. The stock market seems to agree with us.

Movie. "Reptile" (+) (*link*) stars Benicio Monserrate Rafael del Toro Sánchez in this crime drama, which is almost as long as his name. The plot is interesting but is a bit too slow paced. Then again, Del Toro is always fun to watch. His understated intensity is ever-present in the roles he plays. This movie is about a murder, real estate agents, drugs, and cops. Alicia Silverstone and Justin Timberlake have parts, but they don't add much to the movie.

Calendars

US: **Mon:** Consumer Inflation Expectations. **Tues:** Headline & Core CPI 0.0%m/m/3.1%y/y & 0.3%m/m/4.0%y/y; NFIB Small Business Optimism; API Weekly Crude Oil Inventories. (FXStreet estimates)

Global: **Mon:** Japan Machine Tool Orders; Japan PPI 0.2%m/m/0.1%y/y; Australia NAB Business Survey; McCaul. **Tues:** Germany ZEW Economic Sentiment 8.8; Germany WPI -0.1%; UK Average Earnings Index Including & Excluding Bonuses 7.8%/7.4%; UK Unemployment Rate 4.2%; UK Claimant Count Change 20.3k; Japan Tankan Survey. (FXStreet estimates)

Strategy Indicators

Global Stock Markets Performance (*link*): The US MSCI index rose 0.2% last week to a 20-month high and moved further away from correction territory to finish at 5.0% below its record high on December 27, 2021. Last week's gain was its sixth straight rise, which is the best winning streak in four years. The US MSCI ranked 23rd of the 48 global stock markets that we follow in a week when 25 of the 48 countries rose in US dollar terms. The AC World ex-US index was unchanged last week and remains in a 16.1% correction from its June 15, 2021 record high. EMU was the best regional performer with a gain of 1.4%, ahead of EM Eastern Europe (0.5%) and EAFE (0.4). BIC was the worst performer last week with a drop of 1.1%, followed by EMEA (-0.7), EM Asia (-0.6), and EM Latin America (-0.6). Pakistan was the best-performing country last week, with a gain of 7.3%, followed by India (3.0), Sweden (2.8), Argentina (2.5), and Belgium (1.8). Among the 20 countries that underperformed the AC World ex-US MSCI last week, China's 3.6% decline was the worst, followed by those of South Africa (-3.3), Denmark (-3.0), and Norway (-2.7). Looking at 2023's performance so far, the US MSCI is up 20.6%, as its ytd ranking remained steady w/w at 12/48. The AC World ex-US's ytd gain of 7.4% is trailing the US's, with 32/48 countries in positive territory. EM Eastern Europe is the best regional performer ytd with a gain of 36.5%, followed by EMU (16.6), EM Latin America (16.5), and EAFE (10.0). The regional laggards so far in 2023: BIC (-3.8), EM Asia (0.9), and EMEA (2.0). This year's best ytd country performers: Argentina (56.8), Egypt (43.5), Poland (39.1), Greece (38.3), and Hungary (36.9). Here are the worst-performing countries of the year so far: Hong Kong (-23.7), Thailand (-18.0), China (-15.2), Finland (-11.7), and South Africa (-9.6).

S&P 500/400/600 Performance (*link*): All three of these indexes rose last week. SmallCap's 1.3% gain was well ahead of the 0.2% gains for MidCap and LargeCap. LargeCap's current six-week winning streak is its longest in 49 months. At Friday's close, LargeCap was at a 20-month high and improved to 4.0% shy of its record high on January 3, 2022, MidCap slipped further out of a correction at 9.6% from its record high on November 16, 2021, and SmallCap moved further out of bear market territory to 16.8% from its November 8, 2021 record high. Twenty-two of the 33 LargeCap and SMidCap sectors moved higher for the week, down from 30 sectors rising a week earlier. SmallCap Financials was the week's best performer with a gain of 3.2%, followed by SmallCap Consumer Staples (2.1%), SmallCap Consumer Discretionary (2.0), SmallCap Real Estate (1.6), MidCap Financials (1.5), and SmallCap Tech (1.5). The biggest underperformers for the week were SmallCap Energy (-5.3), MidCap Energy (-5.1), LargeCap Energy (-3.3), LargeCap Materials (-1.7), and LargeCap Consumer Staples (-1.2). Looking at performances so far in 2023, LargeCap, with a gain of 19.9%, remains far ahead of MidCap (8.3) and SmallCap (5.4); 19 of the 33 sectors are higher ytd. The top sector performers in 2023: LargeCap Tech (52.0), LargeCap Communication Services (49.0), LargeCap Consumer Discretionary (36.2), MidCap Industrials (22.8), and SmallCap Industrials (21.1). Here are 2023's biggest laggards: MidCap Utilities (-18.0), MidCap Communication Services (-14.5), SmallCap Health Care (-13.2), SmallCap Utilities (-12.8), and LargeCap Utilities (-10.9).

S&P 500 Sectors and Industries Performance (*link*): Five of the 11 S&P 500 sectors rose last week, and three outperformed the composite index's 0.2% gain. That compares to a 0.8% gain for the S&P 500 a week earlier, when nine sectors rose and six outperformed the index. Communication Services was the best performer, with a gain of 1.4%, followed by Consumer Discretionary (1.1%) and Information Technology (0.7). Energy was the worst performer, with a decline of 3.3%, followed by Materials (-1.7), Consumer Staples (-1.2), Real Estate (-0.4), Utilities (-0.3), Financials (-0.1), Health Care (0.2), and Industrials (0.2).

Looking at 2023's performance so far, the S&P 500 is up 19.9% ytd, with just three sectors still outperforming the index and seven higher for the year. The best ytd performers: Tech (52.0), Communication Services (49.0), and Consumer Discretionary (36.2). These are 2023's worst performers: Utilities (-10.9), Energy (-7.3), Consumer Staples (-5.3), Health Care (-3.1), Real Estate (2.0), Materials (5.0), Financials (5.1), and Industrials (10.5).

S&P 500 Technical Indicators (*link*): The S&P 500 rose 0.2% last week, but weakened slightly relative to its 50-day moving average (50-dma) and its 200-day moving average (200-dma). The index was above its 50-dma for a sixth week after eight weeks below, and was also above its 200-dma for a sixth week after dropping below for the first time in 30 weeks. As for what the dmas themselves have been doing, the 50-dma moved higher for a fourth week after dropping for eight weeks, and the 200-dma rose for a 28th week in its longest positive streak since its 70-week streak ended in March 2022. The S&P 500 dropped to 4.8% above its rising 50-dma from a 20-week high of 5.3% a week earlier and compares to a 53-week low of 5.5% at the beginning of November. For perspective, the latest reading is down from a 20-week high of 5.4% above its (rising) 50-dma in mid-June. Other comparison points include: a four-month low of 10.6% below its (falling) 50-dma at the end of September 2022, a 23-month high of 8.7% above its (rising) 50-dma in August 2022, and a 27-month low of 11.1% below its (falling) 50-dma in June 2022. The index had been trading above its 50-dma from most of 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. Turning to the 200-dma, the price index edged down to 6.8% above its rising 200-dma from an 11-week high of 6.9% above a week earlier and compares to a 42-week low of 3.1% below its rising 200-dma at the beginning of November. That also compares to a 24-month high of 12.4% above its (rising) 200-dma in mid-July. The S&P 500 is well above its 26-month low of 17.1% below its (falling) 200-dma in June 2022 and 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 level of the Great Financial Crisis following the failure of Lehman Brothers, the S&P 500 index was 39.6% below its 200-dma on November 11, 2008.

S&P 500 Sectors Technical Indicators (*link*): Ten of the 11 S&P 500 sectors trade above their 50-dmas, unchanged from the prior two weeks. Energy is now the only sector still trading below its 50-dma. Ten sectors have a rising 50-dma, up from nine a week earlier as Utilities turned up w/w and left Energy as the only sector still trading below its 50-dma. Looking at the more stable longer-term 200-dmas, eight sectors trade above that level, unchanged from a week earlier. These three sectors still trade below their 200-dmas: Consumer Staples, Energy, and Utilities. The rising 200-dma club lost the Materials sector this week, leaving that club with six members and these five sectors in the falling 200-dma club: Consumer Staples, Energy, Materials, Real Estate, and Utilities.

US Economic Indicators

Employment (***link***): Employment in November beat expectations as 50,000 striking Hollywood and auto-industry employees returned to work. *Payroll employment* rose 199,000 (vs 190,000 expected), with October's gain unrevised at 150,000, while September's was revised down by 35,000 (to 262,000 from 297,000). November's increase is in line with recent months, but below the average monthly gain of 240,000 posted the prior 12 months. *Private* payroll employment rose 150,000, better than October's strike-related 85,000 but below the average monthly increase of 186,800 the first nine months of the year. *Government* jobs increased 49,000 last month, entirely state (17,000) and local 32,000) government payrolls, in line with the average monthly gain of 55,000 the prior 12 months. Private *service-providing* industries increased 121,000 in November—weaker than the Q3's average quarterly gain of 132,300. The advance *within service-providing* jobs was once again led by health care (77,000) and social assistance (16,000), with the former above its average monthly gain of 54,000 over the prior 12 months and the latter below its of 23,000. Leisure & hospitality (40,000) continues to trend higher, with November's gain almost entirely in food service and drinking places (38,300). Leisure & hospitality averaged 51,000 per month over the prior 12-month period. The increase in information services (10,000), reflects the resolution of the labor disputes, though has declined 104,000 since last November's peak. Retail trade lost 38,000 jobs last month, and has shown little growth year to date, climbing only 12,900. Transportation & warehousing (-5,000) payrolls also dipped in November and are down 56,000 since last October's peak. *Goods-producing* jobs rose 29,000 in November, led by a 28,000 rebound in manufacturing payrolls, in turn led by a 30,000 gain in motor vehicle & parts workers returning from a strike. Meanwhile, construction (+2,000) jobs barely budged in November, after averaging monthly gains of 21,700 the prior six months, though the level reached another new record high. Mining & logging payrolls dipped 1,000 last month, and are up only 16,000 ytd. Here's a list of the *industries that are above their February 2020 pre-pandemic levels*: professional & business services (+1.5 million), transportation & warehousing (+895,100), health care (+733,000), construction (+425,000), social assistance (+325,200), financial activities (+283,000), wholesale trade (+207,500), information services (+117,000), education (+158,400), durable goods manufacturing (146,000), and nondurable goods manufacturing (+54,000). Here are the *industries that are below their February 2020 pre-pandemic levels*: retail trade (-29,000), mining & logging (-42,000) and leisure & hospitality (-158,000).

Wages (***link***): Average hourly earnings (AHE) for all workers rose in November by 0.4%, double October's 0.2% increase, which was the lowest monthly gain since February 2022. The yearly rate slowed to 4.0%, down from its recent high of 5.9% during March 2022 and matching its lowest rate since mid-2021. November's 4.0% yearly rate was 0.8ppt above October's CPI rate of 3.2% and a percentage point above the PCED's rate of 3.0%. Private industry wages rose 3.3% (saar) over the three months through November, slowing from June's 4.8% rate and below its yearly rate of 4.0%. The service-providing (2.8% saar & 3.6 y/y) industries' three-month rate was below its yearly rate, while for goods-producing (5.2 & 5.3) industries, the two rates are nearly identical. *Service-providing industries showing three-month rates above their yearly rates*: leisure & hospitality (5.1 & 4.6) and information services (2.5 & 2.3), though the latter's rates are similar. *Service-providing industries showing three-month rates below their yearly rates:* wholesale trade (1.6 & 4.3), education & health services (2.1 & 2.5), retail trade (2.5 & 2.9), other services (2.5 & 2.9), financial services (4.4 & 5.5), utilities (4.5 & 4.8), and transportation & warehousing (5.2 & 5.5), with the professional & business services' (4.0 & 4.1) rates nearly the same. *Goods-producing industries*: Three-month rates are below yearly rates for natural resources (4.1 & 5.9) and nondurable goods manufacturing (4.3 & 5.4), while above for durable goods manufacturing (6.2 & 5.2) and nearly identical for construction (4.7 & 4.9).

Earned Income Proxy (***link***): Our Earned Income Proxy (EIP), which tracks consumer incomes and spending closely, increased 0.8% last month to another new record high, after no change in October. It has increased for 41 of the last 43 months, for a cumulative climb over the period of 41.3%. In November, *average hourly earnings* advanced 0.4%, while *aggregate weekly* hours also rose 0.4%—with private payroll employment increasing 0.1% and the average workweek rising 0.3%. Over the past 12 months, our EIP advanced 5.3%, up from October's 4.9%—with aggregate weekly hours up 1.3% and average hourly earnings up 4.0%; November's rate is below the 8.1% at the start of this year. The EIP peaked at 11.8% during February 2022, which was the fastest since spring 2021.

Unemployment (***link***): The unemployment rate fell from 3.9% in October, the highest since January 2022, to a five-month low of 3.7% in November. The participation rate ticked up to 62.8% last month, matching its recent highs during both August and September—which were the highest since February 2020; it held steady at 62.6% from March through July. It remains below its pre-pandemic reading of 63.3%. By race: The unemployment rates for Hispanics (to 4.6% from 4.8%) and Whites (3.3 from 3.5) fell 0.2ppt, while the rate for

Asians (3.5 from 3.1) rose 0.4ppt; the rate for African Americans was unchanged at 5.8%. *By education*: The rate for those for those with less than a high school diploma rose for the fourth month, from 5.2% in July to a 22-month high of 6.3% in November, while those with a high school degree continues to hover around 4.0%, ticking up to 4.1% last month from 4.0% in October. The rate for those with some college fell from 3.1% to 2.8% in November—the lowest since January 2020—while the rate for those with a college degree or higher was unchanged 2.1%. Here are the current rates compared to their record lows: less than a high school degree (6.3% vs 4.4%), high school degree (4.1 vs 3.2), some college or associates degree (2.8 vs 2.4), and bachelor's degree or higher (2.1 vs 1.5).

Global Economic Indicators

Germany Industrial Production (*link*): German industrial production contracted for the fifth successive month in October to its lowest level since August 2020. Germany's *headline production*, which includes construction, dropped 0.4% in October and 3.8% over the five-month period. Meanwhile, *production excluding construction* (which the overall Eurozone uses) has increased only one month since the two-month gain of 3.4% the first two months of this year, sliding 6.0% during the six months through October. Looking at the main industrial groupings, *capital goods* production fell four of the past five months, dropping 1.1% m/m and 5.4% over the period, though remains at a relatively high level. *Consumer durable goods* production is down sharply since March, sinking 12.4% over the period, though eked out a 0.3% increase in October, while *consumer nondurable goods* production followed a similar pattern, dropping 6.3% since February, though ticked up 0.4% in October. Meanwhile, *intermediate goods* output remains on a steep downtrend, falling 11.0% from its recent peak during March 2021. On a *y/y basis*, headline production dropped 3.5% including construction and 3.9% excluding construction. Looking at the *main industrial groupings*, energy (-13.7% y/y) output posted a double-digit decline versus a year ago, followed by consumer durable goods (-9.2), consumer nondurable (-6.9) goods, and intermediate (-4.7) goods, with capital (-0.8% y/y) goods production dipping below zero for the first time since April 2022 and down from its recent peak of 14.0% this March.

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