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MACROECONOMICS

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U.S. INFLATION OUTLOOK:

THE LABOR MARKET IS THE KEY TO (ALMOST) EVERYTHING

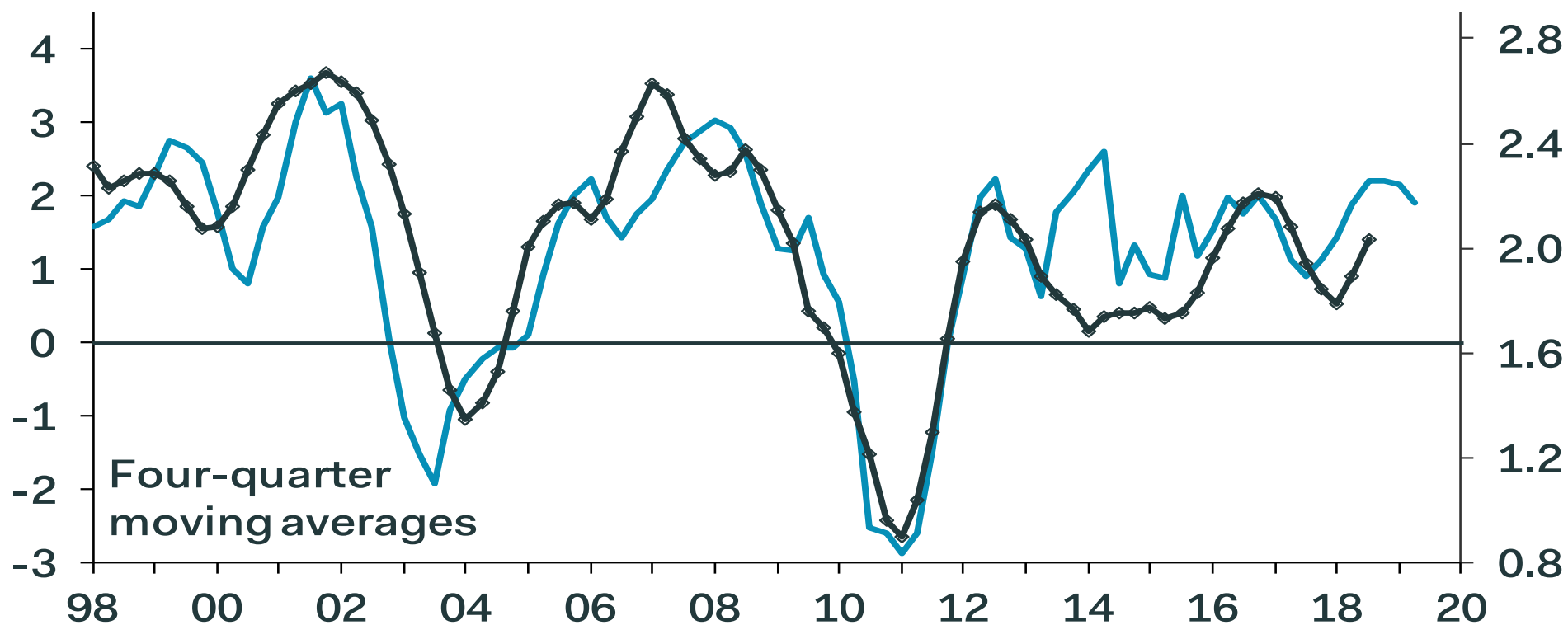
U.S. WEBINAR, NOVEMBER 15, 2018

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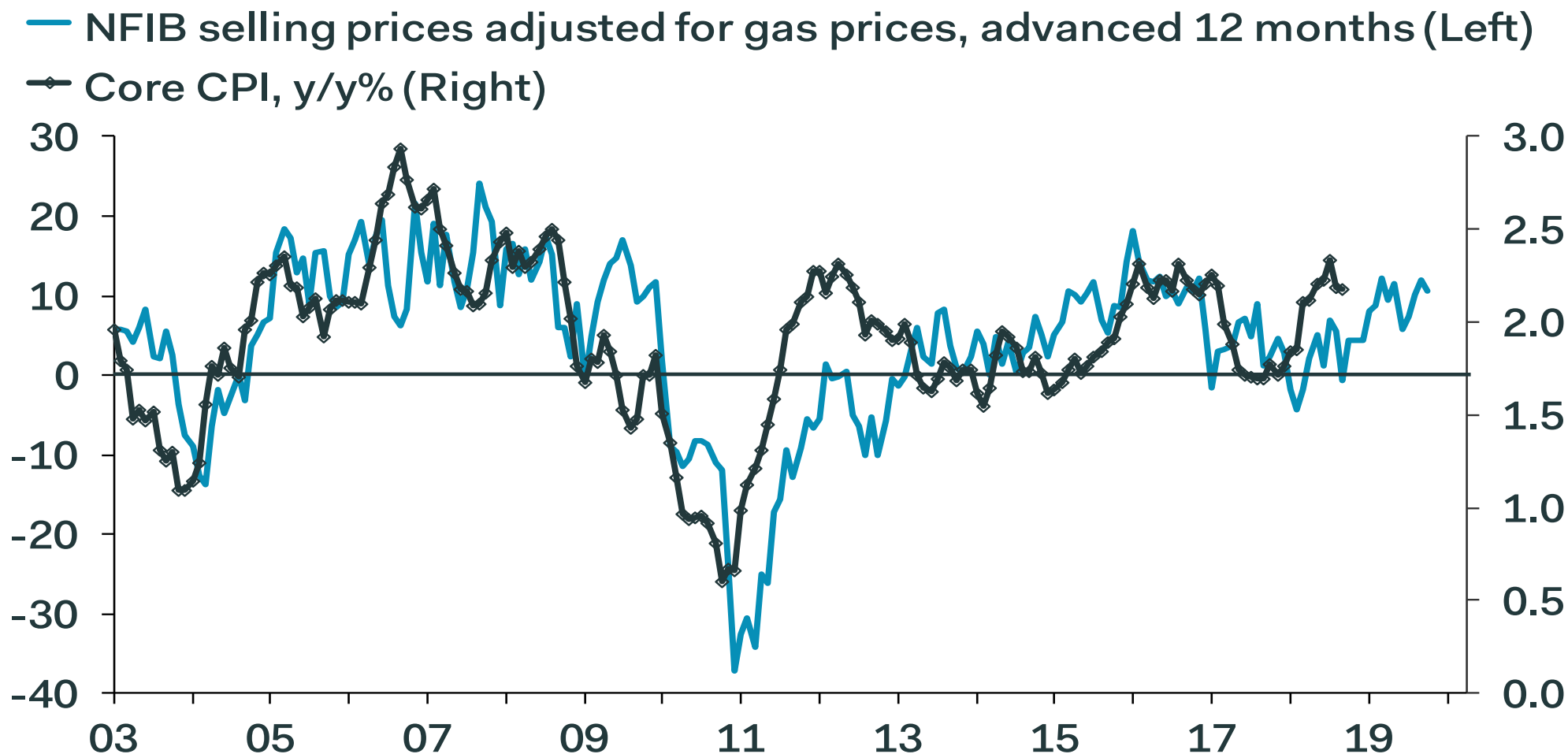
1. NEAR-TERM INFLATION RISK IS VERY LIMITED

- Unit labor costs, y/y% advanced three quarters (Left)
- Core CPI y/y% (Right)



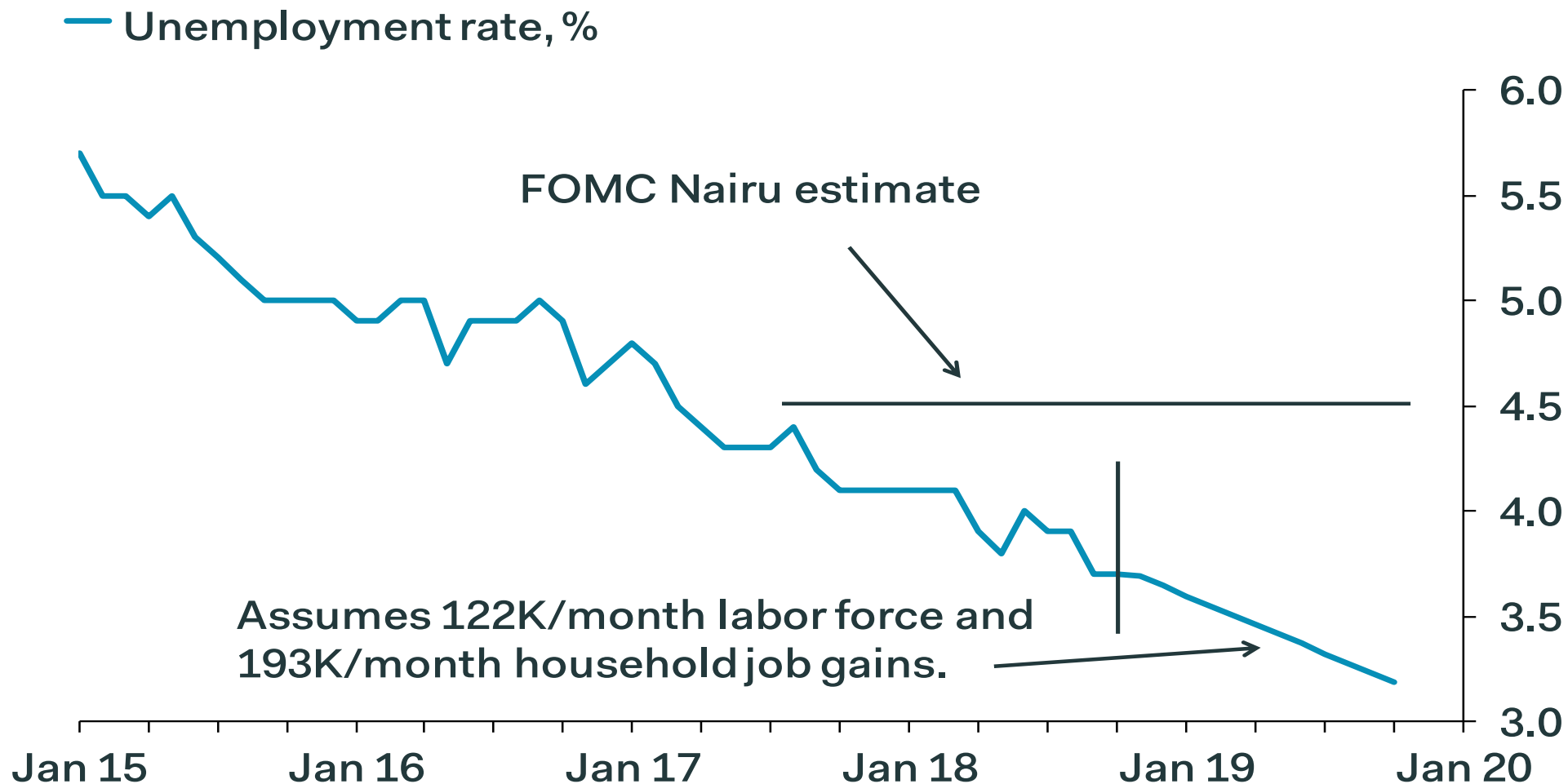


2. BUSINESSES REPORT ONLY MODEST PRICE INCREASES





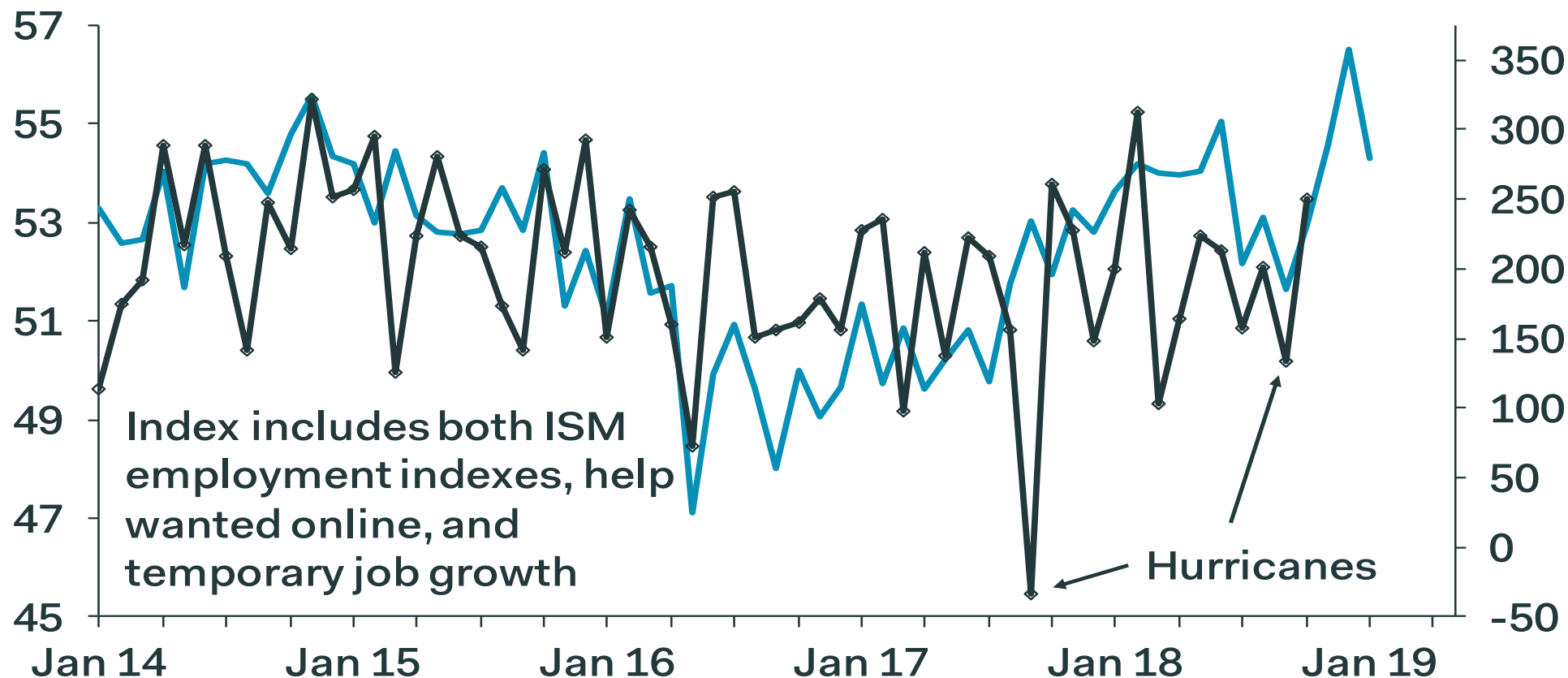
3. ...BUT THE LABOR MARKET CONTINUES TO TIGHTEN RELENTLESSLY





4. LABOR DEMAND HAS RISEN FURTHER THIS YEAR, OUTSTRIPPING SUPPLY

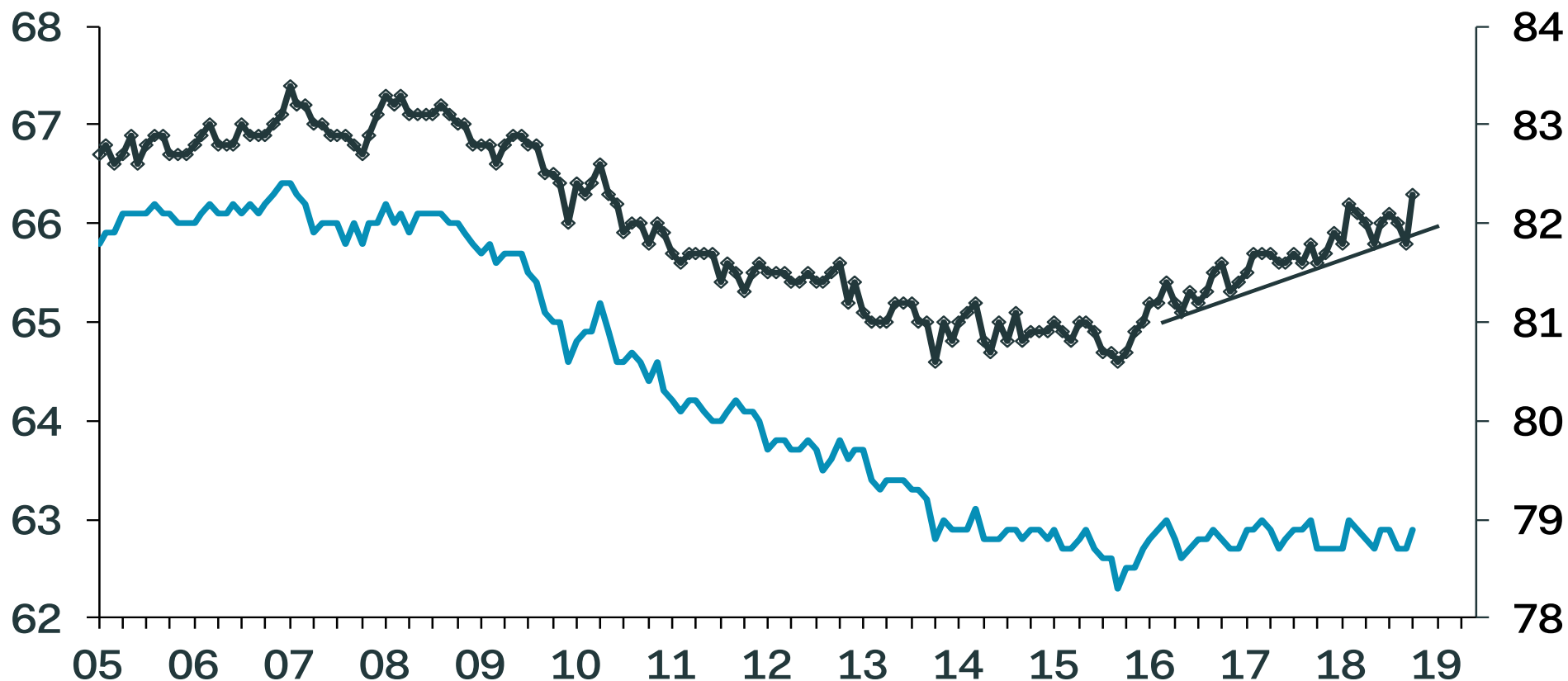
- PM narrow composite hiring index, advanced three months (Left)
- Payrolls ex-Verizon strike, thousands, initial est. (Right)





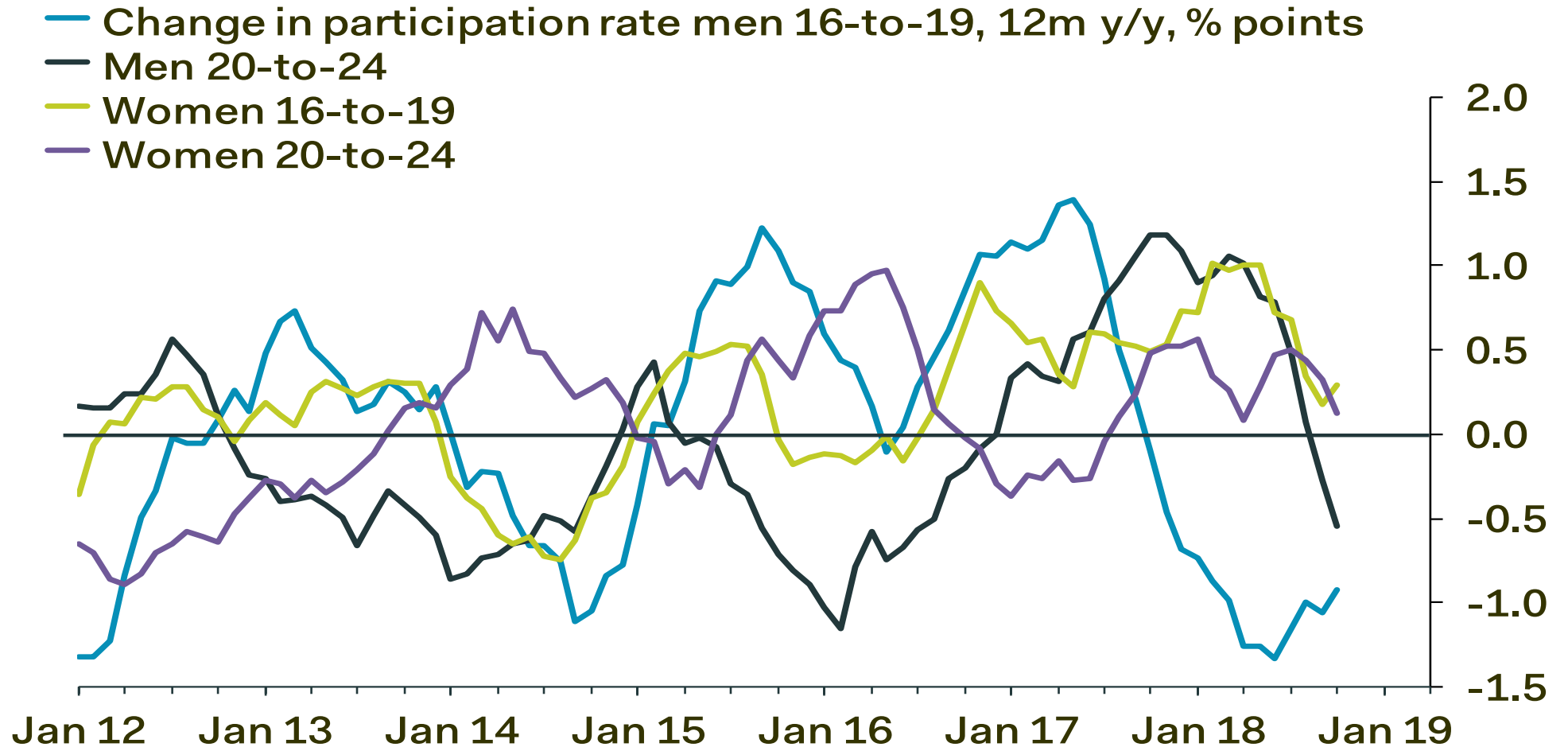
5. STRONG DEMAND IS YET TO LIFT THE PARTICIPATION RATE...

- Participation rate, people aged 16+ (Left)
- Participation, 25-to-54 year-olds (Right)





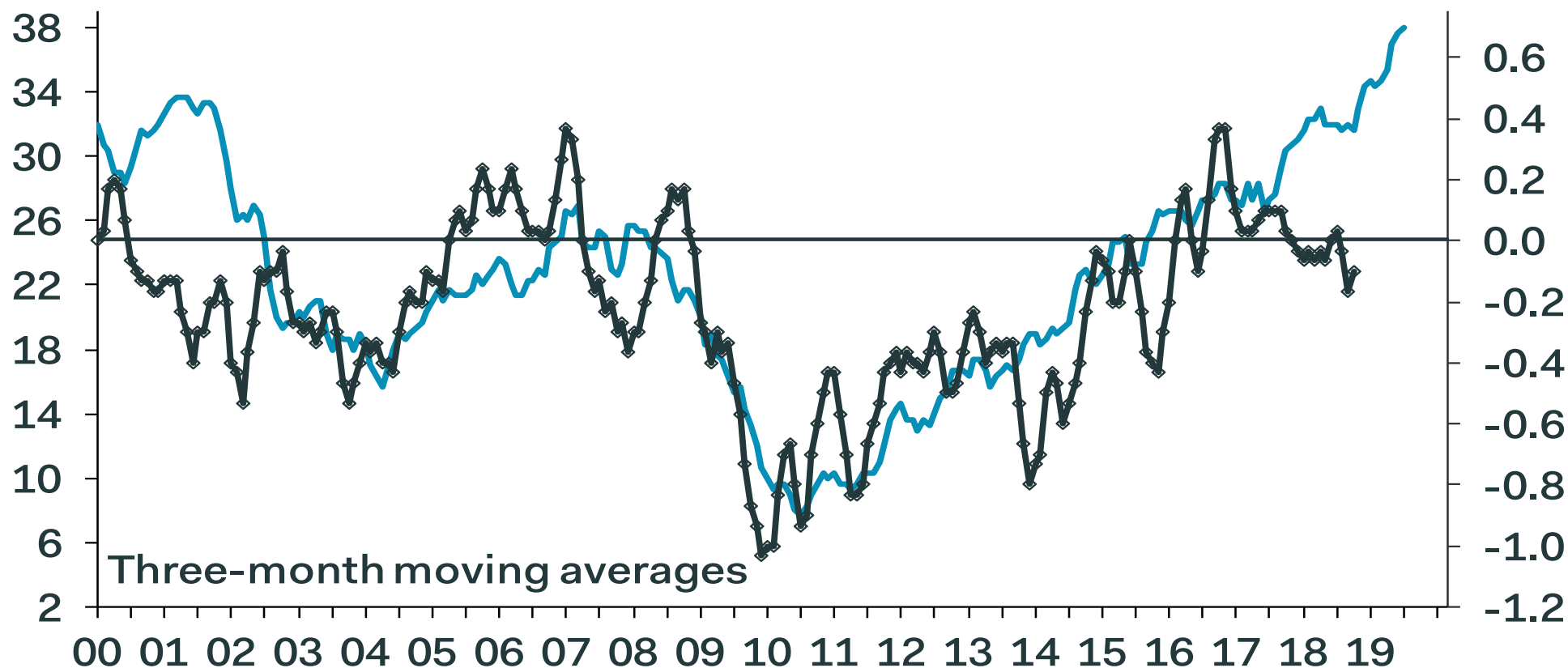
6. YOUNGER MEN ARE LEAVING THE LABOR FORCE





7. ...EVEN THROUGH STRONG DEMAND SHOULD BE PULLING THEM IN

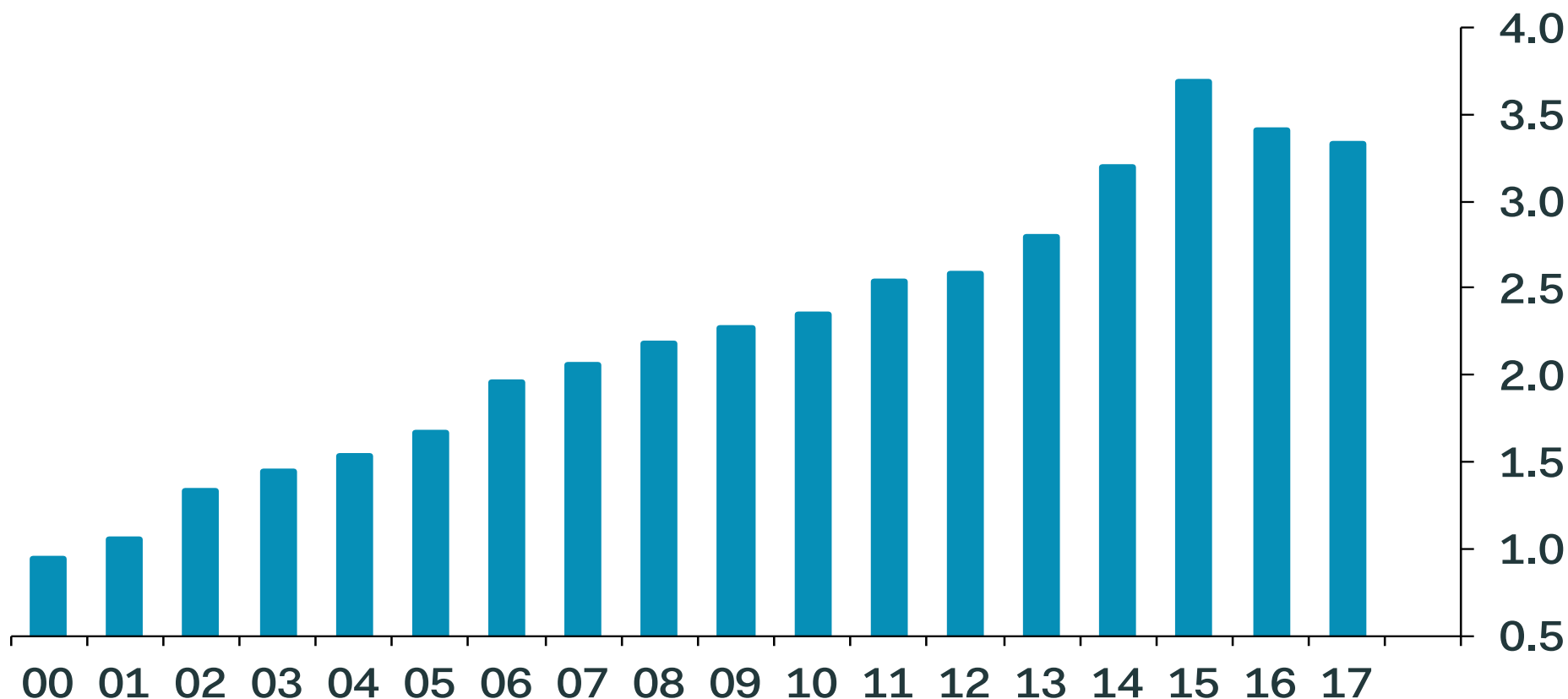
- NFIB one or more unfilled job openings, advanced nine months (Left)
- Participation rate, y/y percentage points (Right)





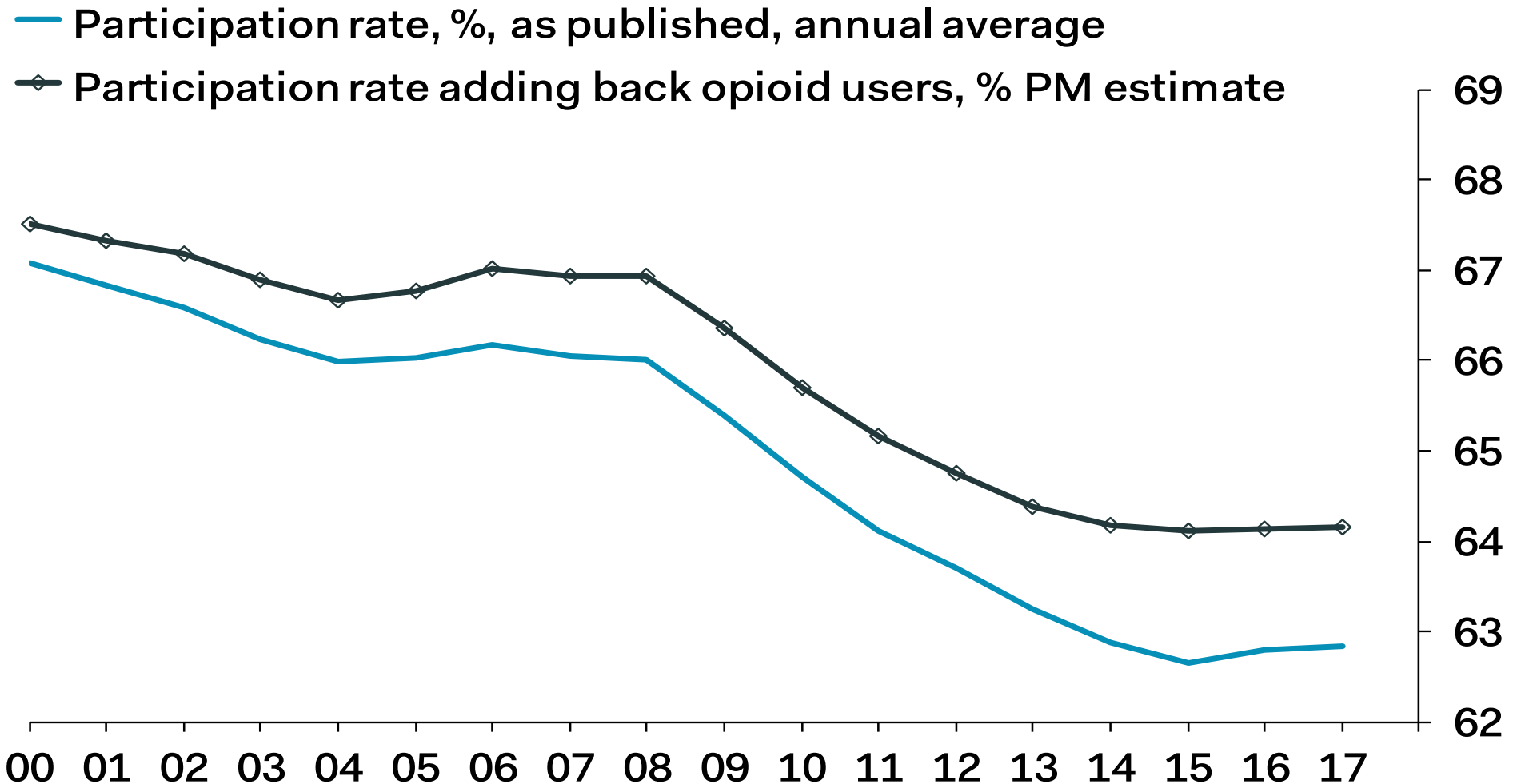
8. IS THE OPIOID EPIDEMIC PART OF THE EXPLANATION?

- Total number of opioid users, millions. Official data from 2015; Pantheon estimates based on death rates for prior years



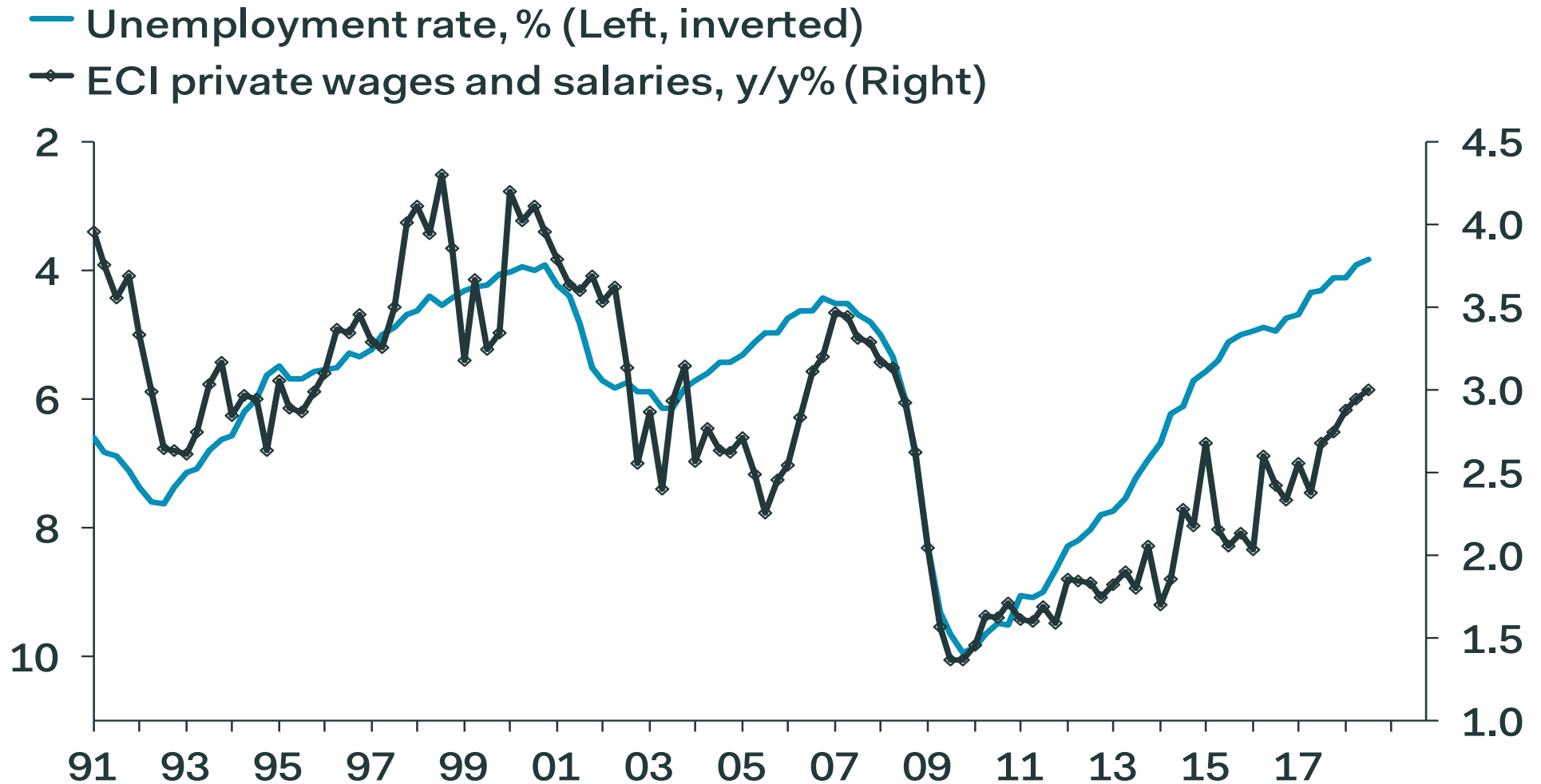


9. ...PARTICIPATION LIKELY WOULD OTHERWISE BE HIGHER





10. FALLING UNEMPLOYMENT HAS LIFTED WAGE GAINS, BUT...



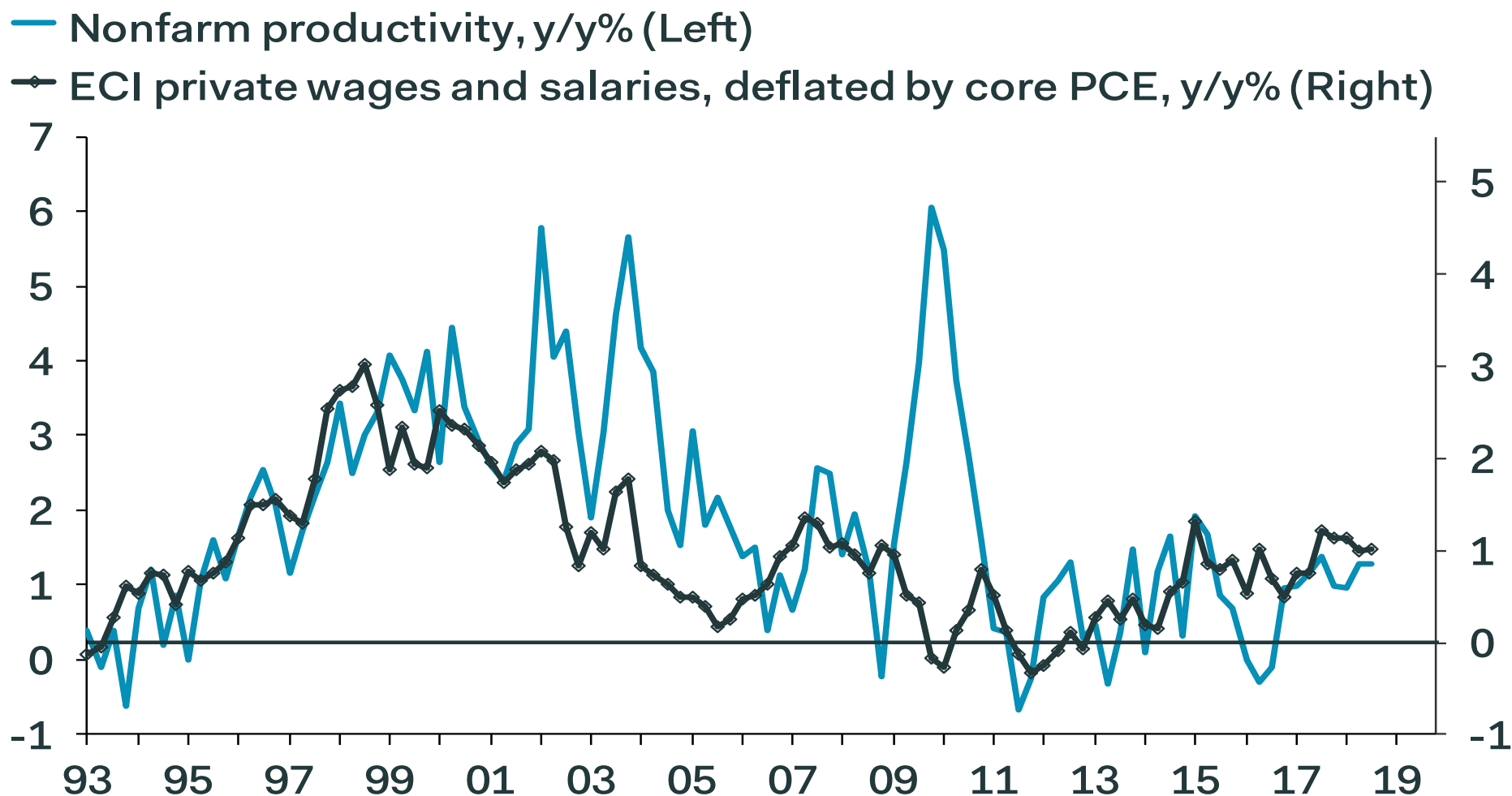


11. WHY HAS WAGE GROWTH BEEN SLUGGISH?

- * Slow productivity growth has constrained real wage growth
- * Inflation compensation has been very low
- * The crash crushed the scarcity premium

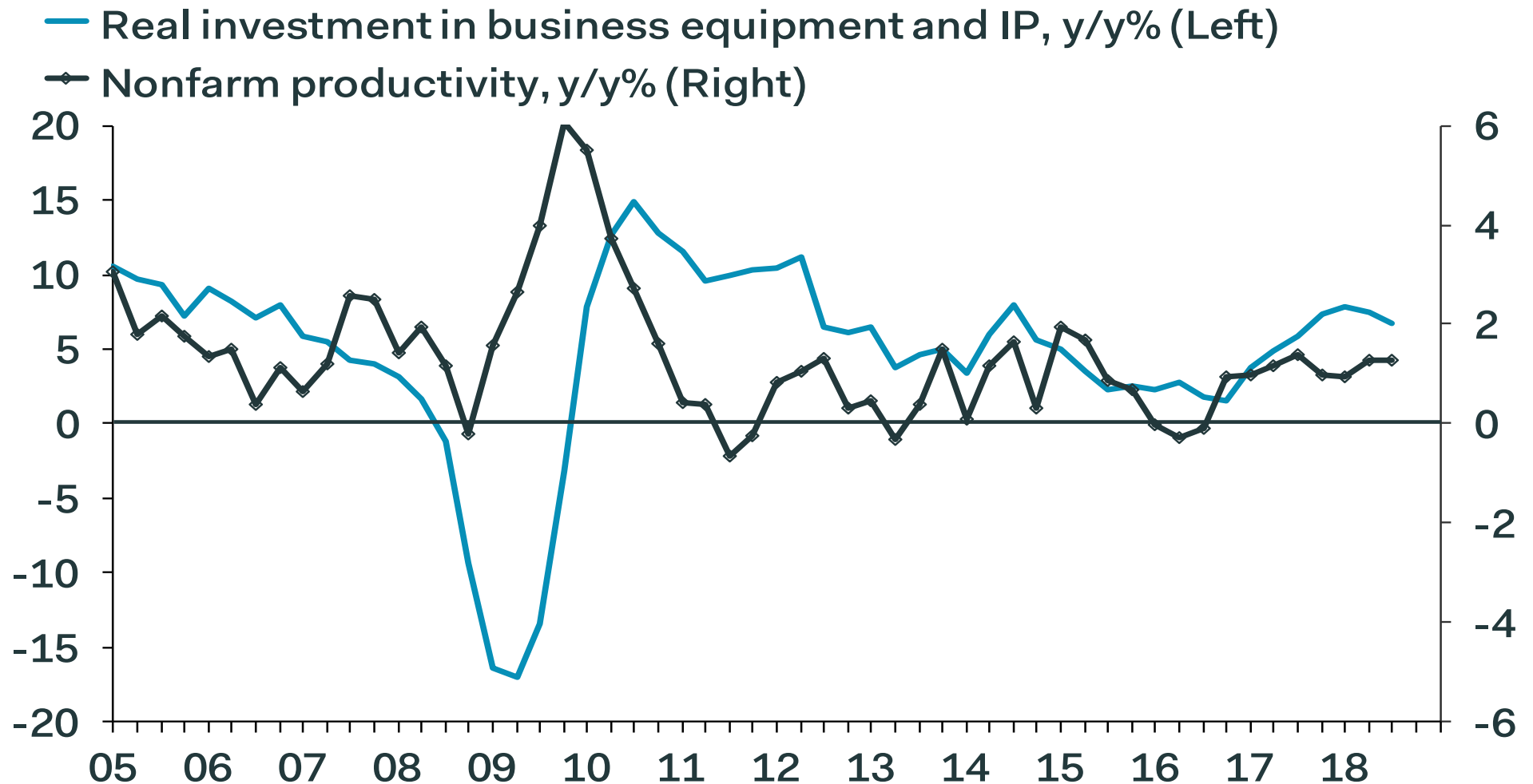


12. PRODUCTIVITY GROWTH HAS BEEN WEAK SINCE THE LATE NINETIES





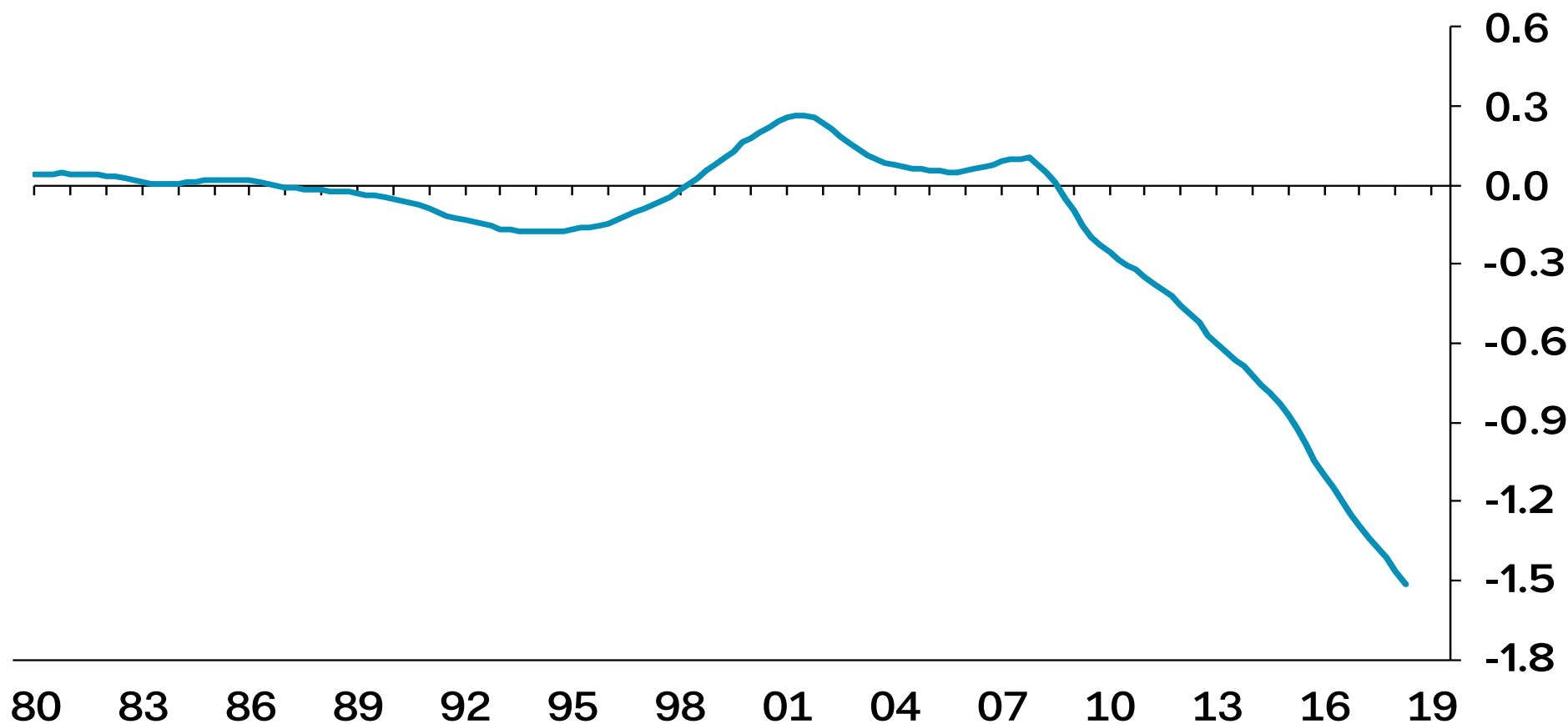
13. ...BUT RISING CAPEX IS NOW PUSHING PRODUCTIVITY GROWTH UP





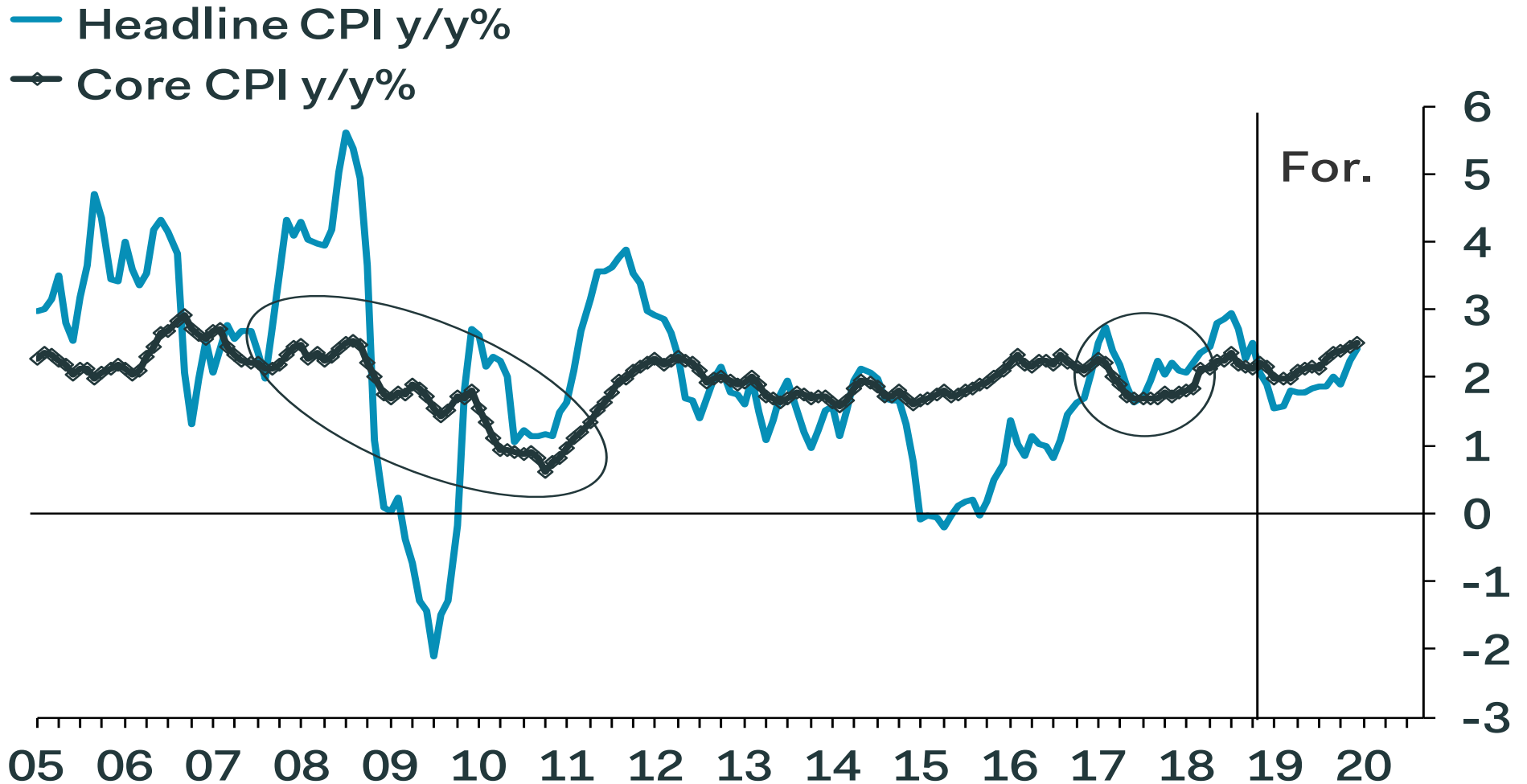
14. ...AND THERE'S STILL A GREAT DEAL LEFT TO DO

— Real capital stock, deviation from 1979-to-2006 trend, \$T 2012 prices





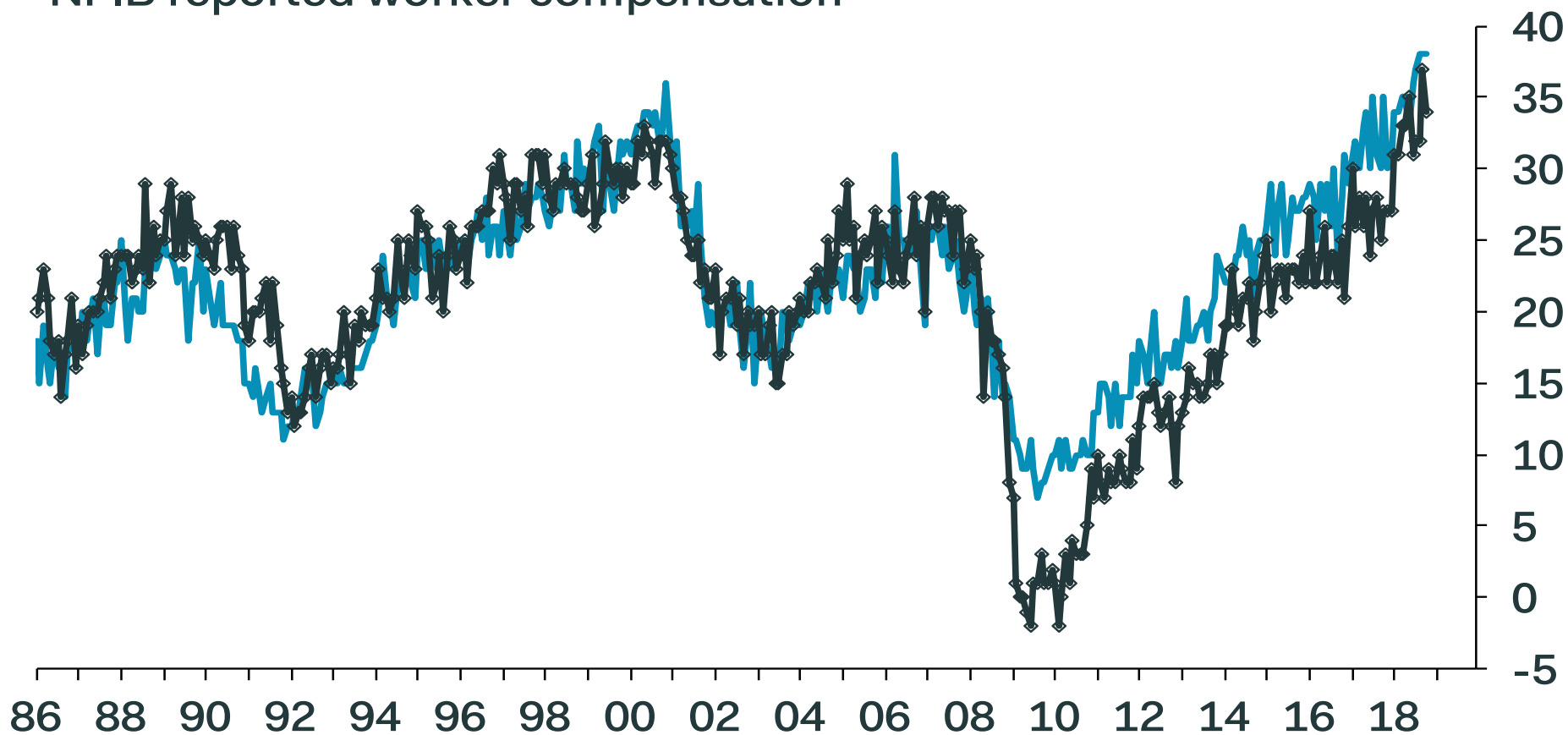
15. MEANWHILE, INFLATION HAS RISEN FROM ITS CYCLE LOWS





16. LABOR HAS BECOME VERY SCARCE

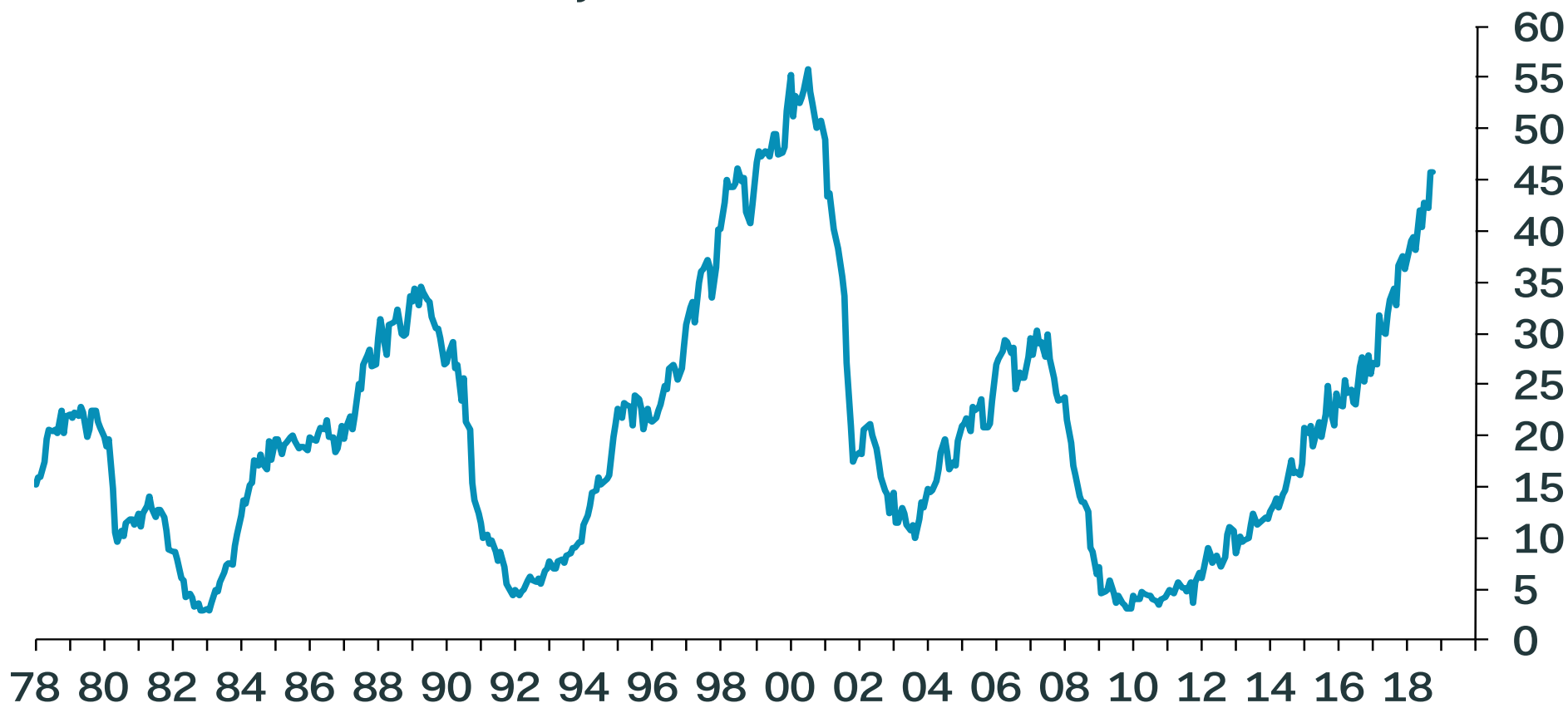
- NFIB jobs hard to fill
- ◆ NFIB reported worker compensation





17. PEOPLE KNOW THEY CAN GET A JOB

— Proportion of respondents who think jobs are plentiful,
Conference Board survey





18. ...AND LAYOFFS ARE AT AN ALL-TIME LOW

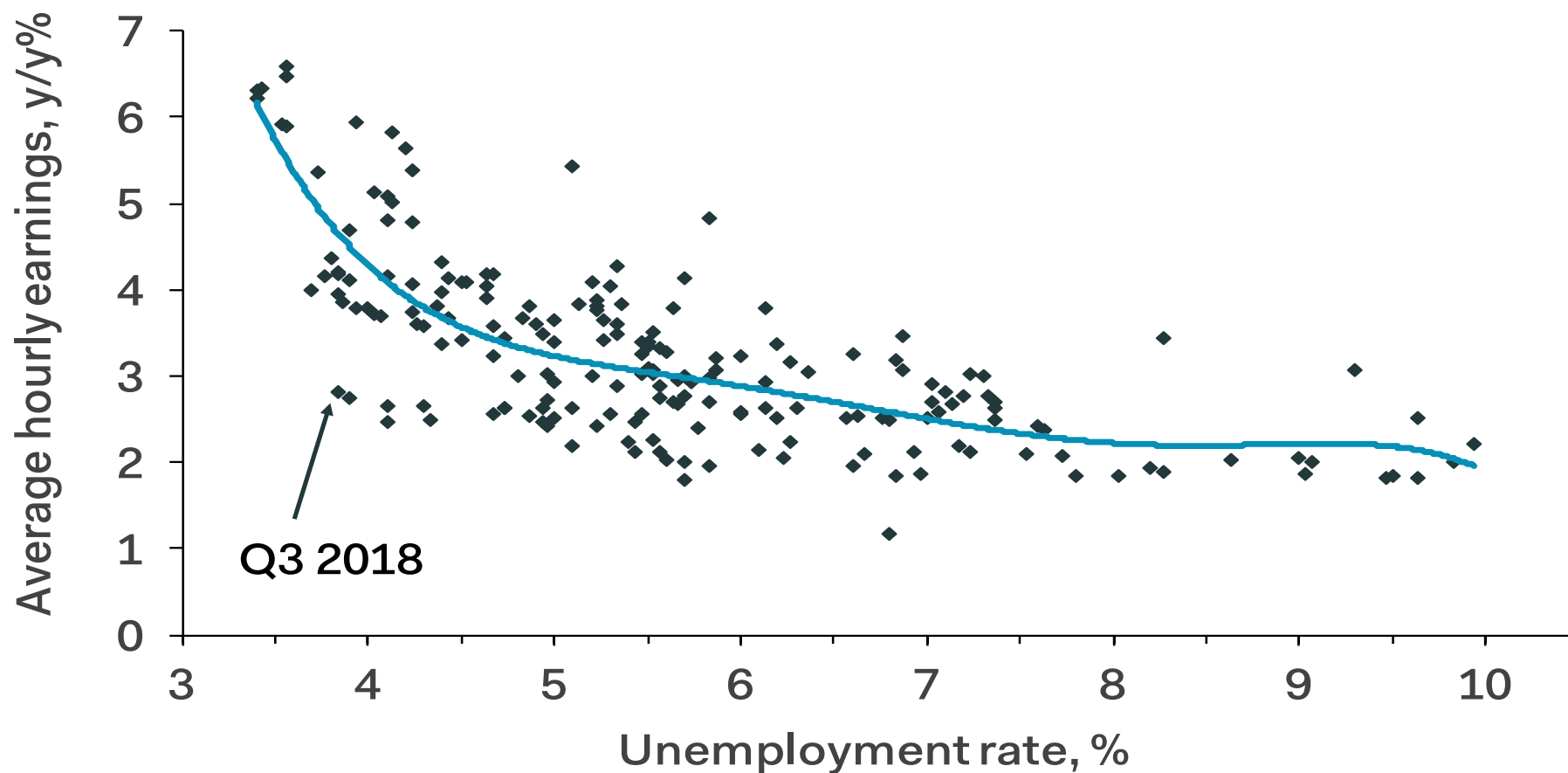
— Jobless claims as % private payrolls,...





19. THE SCARCITY PREMIUM OUGHT TO RISE, SOON

U.S. Phillips Curve, using data from 1955-to-69, and 1985 to date



20. ...THE FED WANTS SOME SCARCITY PREMIUM, BUT HOW MUCH?

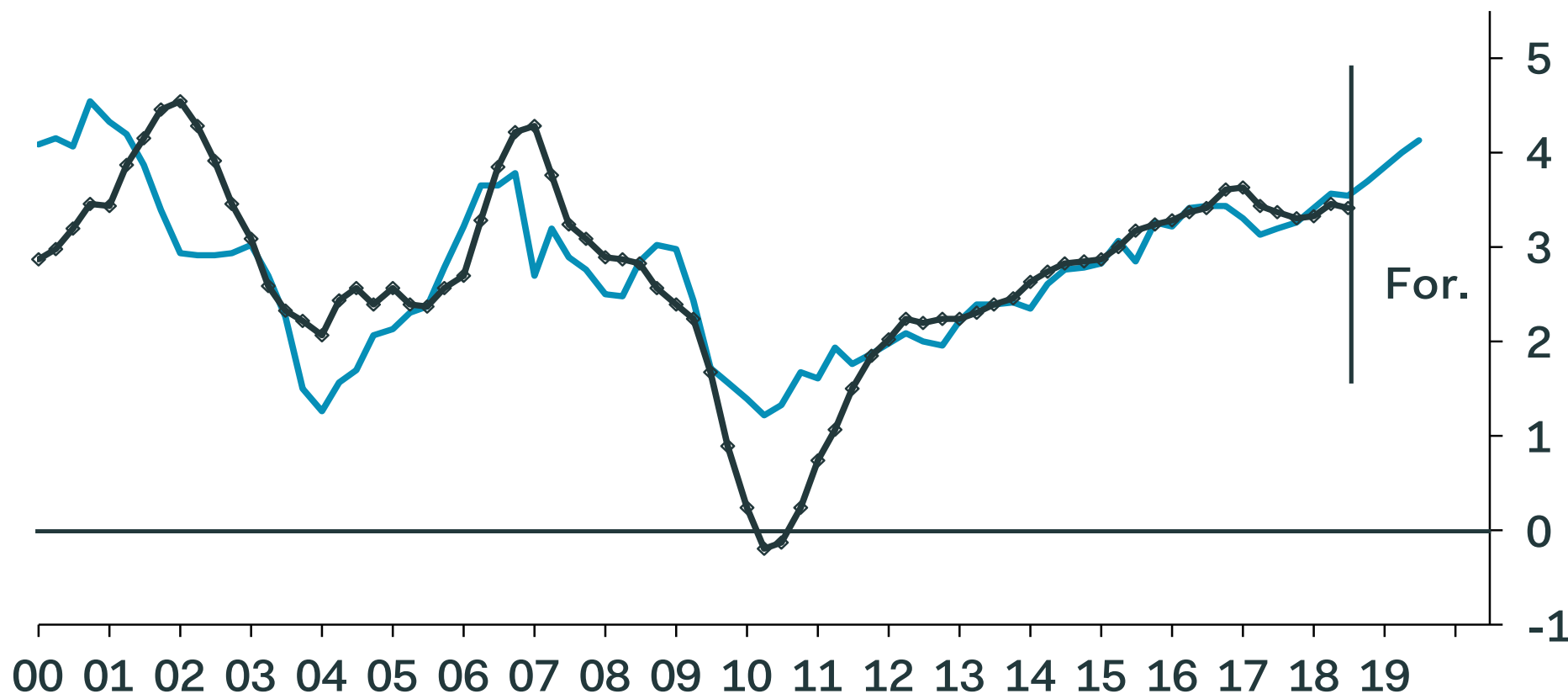
A sustained rise in inflation-adjusted, or “real,” wages at or above the pace of productivity growth is typical in an economy operating in the vicinity of full employment, and we are starting to see some evidence of this. I certainly hope it continues.

Fed Vice-Chair Clarida, October 25



21. LABOR COST-PUSH ASIDE, RENTS ARE THE BIGGEST THREAT TO CORE CPI

- Pantheon blended rent model, fitted from vacancies and wages, y/y%
- Blended Primary rent/OER, y/y%





22. THE VACANCY RATE IS VERY LOW...

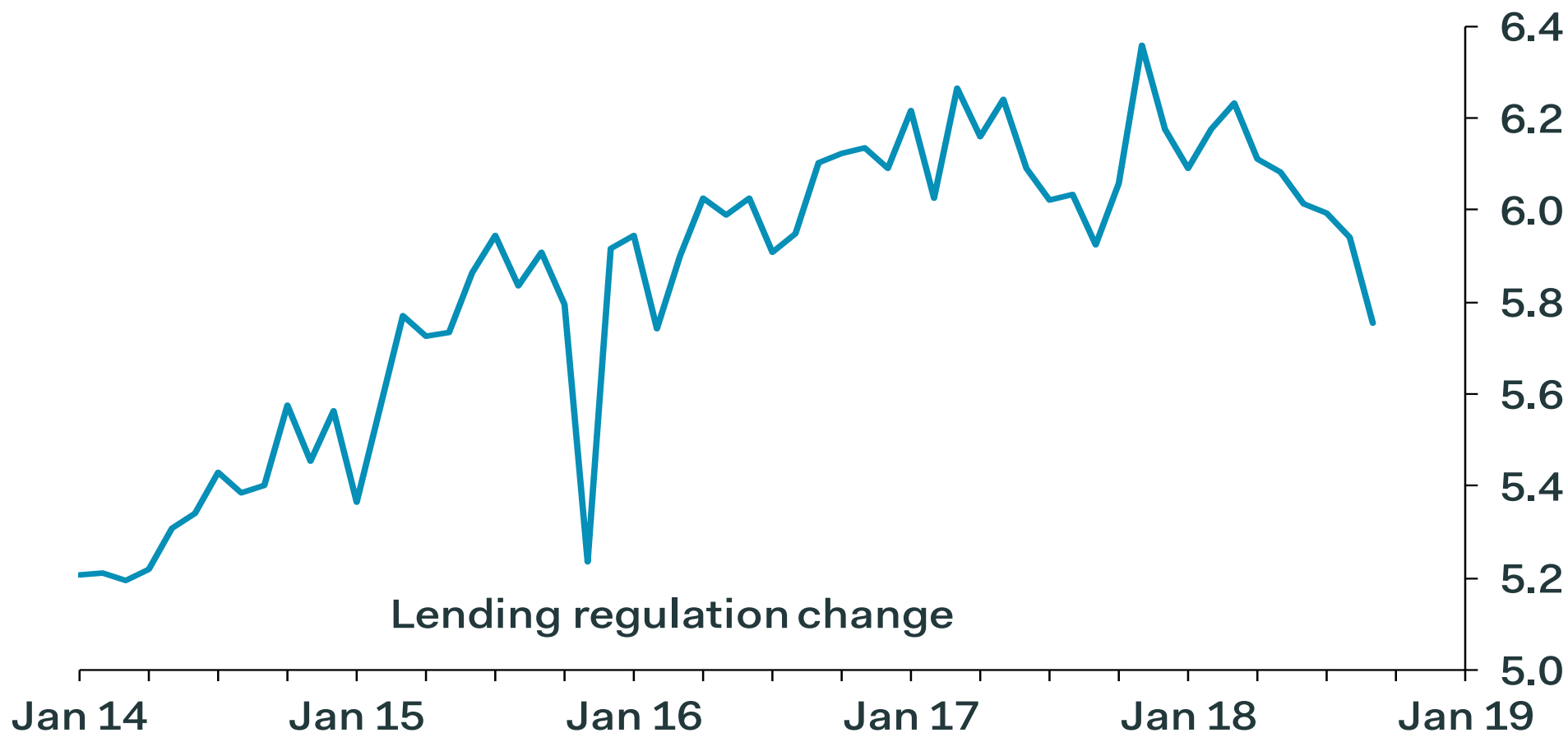
— Residential vacancy rate, %





23. ...RISING MORTGAGE RATES HAVE DEPRESSED THE HOUSING MARKET

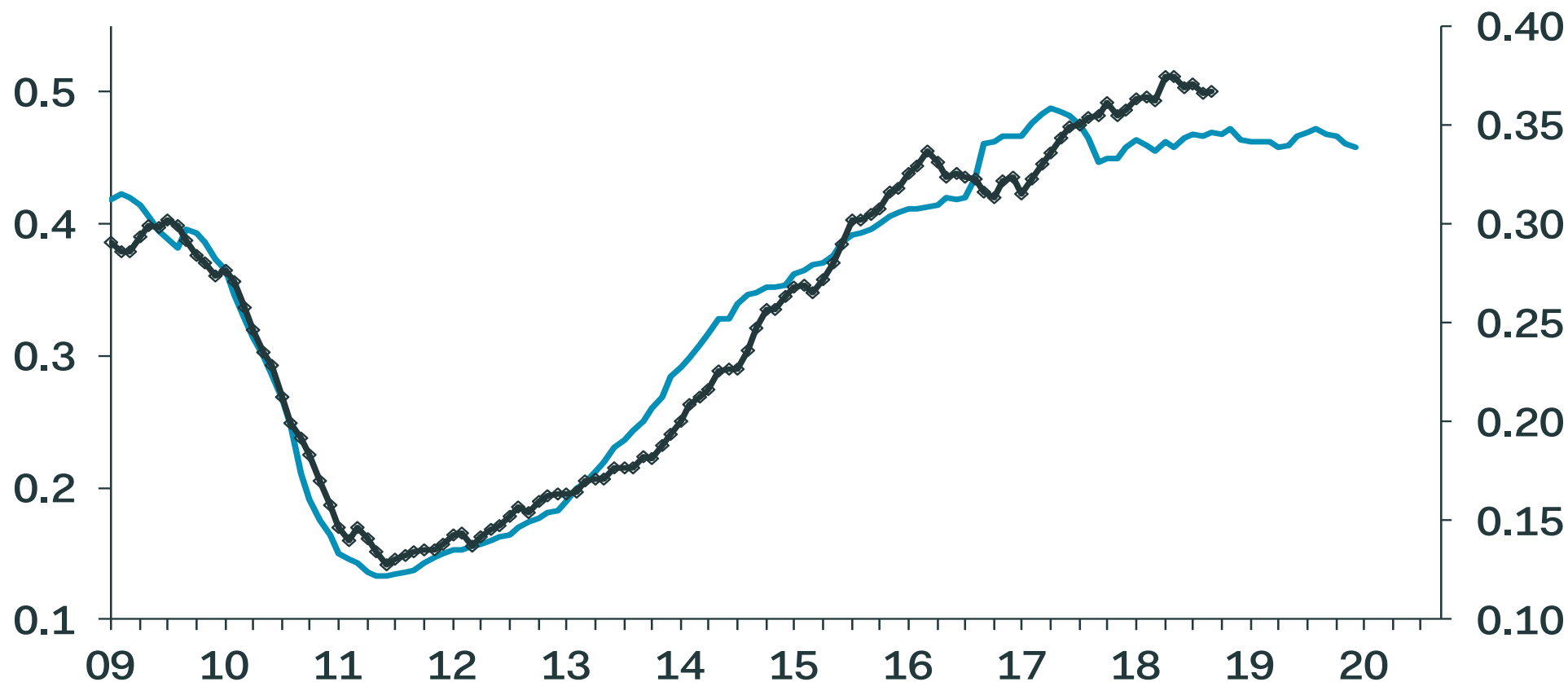
— Total home sales, millions





24. ...AND THE SURGE IN MULTI-FAMILY CONSTRUCTION IS OVER

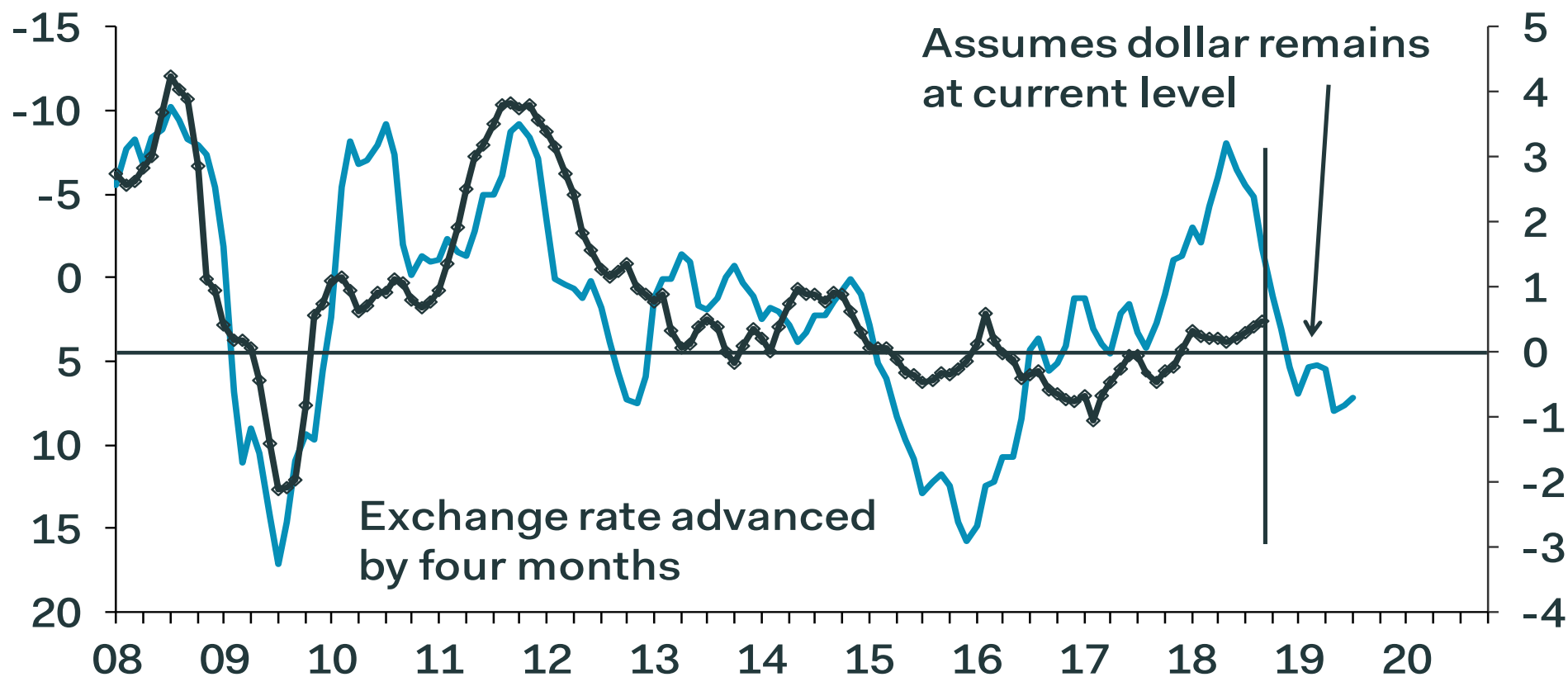
- Multi-family building permits, millions, 12m average, adv. 15 months
- Completions





25. THE STRONG DOLLAR IS HOLDING DOWN GOODS PRICES

- Fed broad dollar index, y/y%, inverted (Left)
- CPI goods ex-gasoline, y/y%. PM estimate. (Right)





26. BUT THE DROP IN OIL PRICES WON'T HIT CORE CPI UNTIL LATE 2019

- Crude oil price, y/y%, advanced six quarters (Left)
- ◆ Annual change in core CPI inflation rate, percentage points (Right)





27. THE WILD CARD: 25% TARIFFS ON ALL CONSUMER GOODS = DISASTER

— CPI laundry equipment, year-over-year %





28. SUMMARY

- * **Near-term inflation risk is limited, unless tariffs are applied to consumer goods**
- * **The Fed's focus has always been the labor market; the current inflation rate and immediate outlook are no barrier to tighter policy**
- * **Real rates at zero and 3.7% unemployment – and falling – are unsustainable**