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Economic Indicators June 2021

By Kim W. Suchy

Ok, so it looks like more bricks have been added to the “wall of worry”. Last month it was tax hikes and assorted political drama in D.C. that sent jitters into the market. This month, the inflation bug has added another foot to the wall of worry. Are these inflationary roots transitory as the Fed wants us to believe?

It’s no surprise inflation’s going to run hot for a few months, and not just because of the low base effects of disinflation from a year ago when the economy was ground to a halt. Aggressive monetary and fiscal stimulus, strong U.S. and accelerating global growth, rising wages and rents, pent-up demand and excess savings will work their way into prices. But some combination of slower growth in demand and corrected supply chain imbalances will right the disequilibrium as the intro to economics professors tell us. It will be the process of establishing equilibrium (hopefully a short process) that will reveal spurts of inflation in some segments and disinflation in others until both the Consumer Price Index and the Personal Consumption Expenditure stabilize.

Commodity prices and supply chain disruptions have been at the forefront about rising concerns about inflationary pressures in the U.S. As noted by Carl Tannenbaum, Chief Economist at Northern Trust, wage dynamics deserve more attention. Labor is the primary driver of the cost of services, which accounts for over two-thirds of the U.S. economy and about half of the consumer price basket. In a services economy like the U.S., price pressures come from the labor market, not the lumber market!

Carl continues to highlight the fact that with the U.S. economy reopening, job openings are already 5.3% above their pre-pandemic level. But finding labor is becoming increasingly difficult amid lingering concerns about safety and child care; enhanced unemployment benefits are set to last through August in most states.

The problem appears to be imbedded in the Biden $1.9T stimulus program from March, which extended an unemployment bonus of $300 per week into September. That’s in addition to average weekly unemployment benefits from the states that average $318 per week (within a range of $275-387). That $618 average weekly unemployment benefit in a 40-hour work week is effectively $15.50 per hour.

For lower-wage workers concerned about contracting C19 and/or have child care or public school issues with their kids in states where schools and day care are not yet opened, it makes financial sense to collect unemployment, rather than return to their now-open jobs. As a result, many companies are bidding against these attractive unemployment benefits to entice their employees to come back or attract new workers. Many state governments have recognized this issue and have announced that they will be scaling back the $300 unemployment bonus this month or next. This should facilitate the return to work for many and help resolve the supply chain imbalances.

It is the temporary disruption in the labor market which should be resolved soon that will also help right the supply chain ship and ultimately stabilize prices. It is this process of resolution that keeps me in the transitory inflation camp and make it a bit easier to climb the wall of worry.

Here is your look at developments in the global marketplace.

Positive Developments:

- The National Federation of Independent Business (NFIB) reported that confidence among small business owners continued to improve in April. The employment metrics are gaining steam as they show that small businesses are taking advantage of eased restrictions and an improving economic backdrop by hiring more workers and expanding operations. Businesses are raising compensation in order to attract the right talent. The share of firms increasing worker compensation and those planning to do so was 31% and 20% respectively. This was accompanied by an increase in the share of firms raising average selling prices (36%) and those planning to do so (36%). Both of these indicators are now near the highest levels in the last several decades.

- There is a mounting list of states now announcing they are discontinuing the expanded unemployment benefits that have been a significant headwind to hiring across the U.S., noting that job openings in the United States stand at the highest level in history! This should facilitate employment growth and help with labor shortages in key sectors.

- The Conference Board Leading Economic Index (LEI) for the U.S. increased by 1.6% in April to 113.3 (2016 = 100), following a 1.3% increase in March and a 0.1% decline in February. With April's large monthly gain to start the second quarter, the U.S. LEI has now recovered fully from its C19 contraction. Recall that LEI includes measures related to unemployment, stock prices, manufacturing, building permits and credit loan activity.

- A dividend payout ratio of 60% or less is typically a good sign that a dividend distribution is sustainable, according to The Motley Fool. A dividend payout ratio reflects the amount of money paid out as a dividend relative to a dollar's worth of earnings. In Q1 of this year, the payout ratio on the SP500 was 57.01%.

- The 2nd report on Q1 real GDP was pretty much in line with the initial reading last month, showing a 6.4% annualized surge in growth largely due to the rollout of vaccines, fewer restrictions on business activity, and massive government stimulus. Looking at the details on revisions, personal consumption and business investment in intellectual property were revised higher, while inventories and net exports were revised lower according to the Bureau of Economic Analysis.

Neutral Developments:

- Existing home sales fell for a 3rd consecutive month in April, as low inventories and escalating prices continued to weigh on closings. Notably, even with the recent declines sales are still up 2.6% from the February 2020 pre-pandemic high. Further, the median price of an existing home rose to $342K in April (not seasonally adjusted) and is up 19.1% yoy. Average prices are up 13.6% yoy.

- Housing construction retreated in April after booming in March, though signs for continued strength in homebuilding are apparent. Housing starts declined 9.5% in April to a 1.6M million a/r. Starts are up 67.3% yoy. Supply chain constraints for key inputs such as lumber, paired with difficulty in finding qualified workers, has impeded a faster pace of building, but robust demand means that order backlogs continue to grow.

- Home prices in March were 13.2% higher in March, compared with March 2020, according to the Case-Shiller National Home Price Index. That is up from the 12% annual gain in February, and is the 10th straight mo. of accelerating home prices. Demand is driving prices higher as there were just 1.2M homes on the market in April, a 20% drop yoy, according to the National Association of Realtors. The continued shortage of homes, especially at the lower end of the market, forecasts that home prices will not cool off any time soon. *However, limited inventory, rising prices at current levels plus a modest rise in rates could limit the current trajectory in future home sales*

- Goldman Sachs reported that U.S. companies announced $484B in share buybacks in the first four months of 2021, the most for this period in at least 2 decades, according to the Financial Times. Goldman estimates that share repurchases by U.S. companies will increase by 35% on a yoy basis. Strategists believe that the pace of buybacks will increase more quickly than dividend hikes. Share buybacks have a tendency to boost stock prices.
  - *Further note: It also pays for companies to aggressively issue corporate bonds at current-low rates to refinance existing debt since the average return on equity (ROE) at most S&P 500 companies is much higher than money market rates, so buy-backs boost ROE and the underlying earnings per share.*
- Barron’s reports that in Q1 there was a $20B annualized increase in dividends…the largest since 2012.

- The Conference Board Consumer Confidence Index held steady in May, following a gain in April. Consumers' assessment of current conditions improved, suggesting economic growth remains robust in Q2. However, consumers' short-term optimism retreated, prompted by expectations of decelerating growth and softening labor market conditions in the months ahead. Consumers were also less upbeat this month about their income prospects—a reflection, perhaps, of both rising inflation expectations and a waning of further government support. Overall, consumers remain optimistic, and confidence should remain resilient in the short term, as vaccination rates climb, C19 cases decline further, and the economy fully reopens.

Negative Developments:

- There has been much bemoaning of labor shortages, particularly within accommodations and food services, even though there are no available jobs for 1/3 of the job seekers in that sector according to the Economic Policy Institute. Any potential shortage from the recent surge in job openings is likely to be quite short-lived, as many more workers will come back into job-search as it becomes safer to pursue these public facing jobs with improved C19 metrics, as childcare and schooling becomes more reliable, and as wages rise to compensate for the extra risk of working in face-to-face places during C19. Worth noting, the labor market added 241K more jobs in accommodation and food services, so the trend is already moving in the right direction yet this could take a while.
    - According to Barron's C19 has claimed 90,000 restaurants across the country, nearly twice as many as in a typical year.
- Cryptocurrencies have been taking a beating lately. China banned financial institutions and payment companies from providing any services related to crypto. Additionally, China warned investors about trading in crypto. Since cryptocurrencies have their roots in Asia, this ban is devastating for the future of cryptocurrencies. The main reason that financial institutions like PayPal were engaged in crypto transactions is that they were collecting lucrative transaction fees. Tesla's recent refusal to allow its vehicles to be bought via cryptocurrencies (due to Bitcoin's mining practices) also contributed to the cryptocurrency pull back. Long-term, the extreme volatility associated with cryptocurrencies could drive investors to safer shores, which would be good news for gold (which has climbed above $1900/oz.) and mainstream financial markets.
- The Census Bureau reported that durable goods orders slid in April, as supply chain shortages, particularly in semiconductors, continue to hold back activity in some sectors. As I have noted before, housing starts, retail sales, and new home sales are generating a battle between consumers who are back in force as restrictions ease across the country and companies that are struggling to keep up with demand while inputs, including labor, remain in short supply.

- The federal deficit is coming in at $2.3T this year, according to the Congressional Budget Office. That would be 10.3% of GDP, the 2nd highest level since 1945, topped only by the 14.9% shortfall last year. *Deficit spending should decline as the economy recovers and tax revenues increase.*

The Markets:

U.S. Index	Last Month (% return)	YTD (%)
S&P500	0.8	12.6
Dow	2.0	13.7
NASDAQ Comp	-0.4	6.7
Russell 2000	-1.2	14.9

On the international front, the European markets were strong performers while Asian markets were mixed. China experienced a healthy rebound last month as the word is they are fully recovered from C19 related issues. Gold surged this month as investors seek an inflationary hedge.

International Index	Last Month (% return)	YTD (%)
Euro Stoxx 50	2.5	15.4
Hang Seng	3.9	8.2
Germany	2.9	14.3
Nikkei	-1.8	5.0
FTSE-U.K.	2.7	10.0
China Shanghai Comp.	5.3	4.4
Gold	6.6	0.8

The year 2021 began with the 10-year Treasury Note yield at 0.90%. The 10-year closed May at 1.63%, essentially the same level as the April close. The 2-year Treasury closed May yielding .15%, just 1bp lower than it was in April. There was a very modest steepening as the curve widened 10/2 spread is at 148bps or 2bps higher lower than last month.

News You Can Use:

- Phil Mickelson, 50 years old, became the oldest player to win a major championship with his victory at the PGA Championship in Kiawah. Before the tournament began, Phil stood at 300-1 odds to win. He was ranked 115th in the world and 168th in the FedExCup standings. He had only 2 victories in the last seven years and had no top-20 finishes in 14 starts this year.
  - https://www.pgatour.com/news/2021/05/23/phil-mickelson-wins-pga-championship-kiawah-island-oldest-ever-major-winner.html

- A report from WalletHub, a personal finance website, summated taxes owed by citizens of all 50 states and DC. The report suggested Illinois has the highest tax burden in the country. In Illinois, the effective rate on a household with the median income is 15.01%, which is 39% above the national average. A median income household in Illinois can expect to pay $9,488 per year in state and local taxes. In neighboring Indiana, the figures would be 11.75% and $7,430.; in Florida, 8.23% and $5,204. Indiana and Florida are among the most popular destinations for people leaving Illinois. The report also indicated Illinois has the third highest gas taxes in the country.
  - https://wallethub.com/edu/best-worst-states-to-be-a-taxpayer/2416

- Since May 10, the July futures contract price per thousand board feet of 2x4's has fallen from over $1,700 to $1,328 as of May 27. Lumber futures pre-pandemic typically traded in the $300 to $500 range. Some experts say the price surge may have climaxed, however, absent a significant increase in mortgage rates or a Covid resurgence, it is hard to imagine what could cause lumber demand to drop and prices to moderate in the foreseeable future.
  - https://www.msn.com/en-us/money/realestate/no-relief-for-diyers-lumber-s-retail-price-hits-all-time-high-up-323/ar-AAKkOUH
  - https://futures.tradingcharts.com/marketquotes/LS.html

As always, if I can be of additional guidance, please feel free to call me at 312.485.6847.

Best regards,

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