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A DEEPER DIVE

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This paper takes a modestly deeper dive into the threat of, and prospects for, inflation. It also lays out the current circumstances of the labor market provided by the monthly jobs report.

To summarize the analysis of both the labor market and inflation, it would appear that what at first glance looks like a bright employment picture a.) 481,000 new jobs reported for January and 678,000 for February (Figure A) and b.) a revision in historical employment growth over the last five months of 2021 of nearly 900,000 more jobs than previously reported (also Figure A), turns out to be a.) offset by reductions in the five month period from March 2021 of 1.06 million and b.) average hours worked offsetting employment gains. In fact, the trend of total hours worked from September to January 2021 is distinctly negative, with January's aggregate hours worked per week falling from the preceding month (Figure C). February's total hours worked rose substantially, reflecting employment gains, but average hours worked did not rebound from January's decline. They were instead flat.

Measured increases in consumer price inflation appear to be accurately reflected in the monthly data (Figure D). These increases do not reflect any abnormal monthly patterns and do correspond with Producer Price Index (PPI) inflation, increases in the prices of spot commodities, nominal wage increases, and increased quantities of monetary aggregates. It's not a pretty picture. More price data will soon be released. First, the labor market.

I. The Labor Market

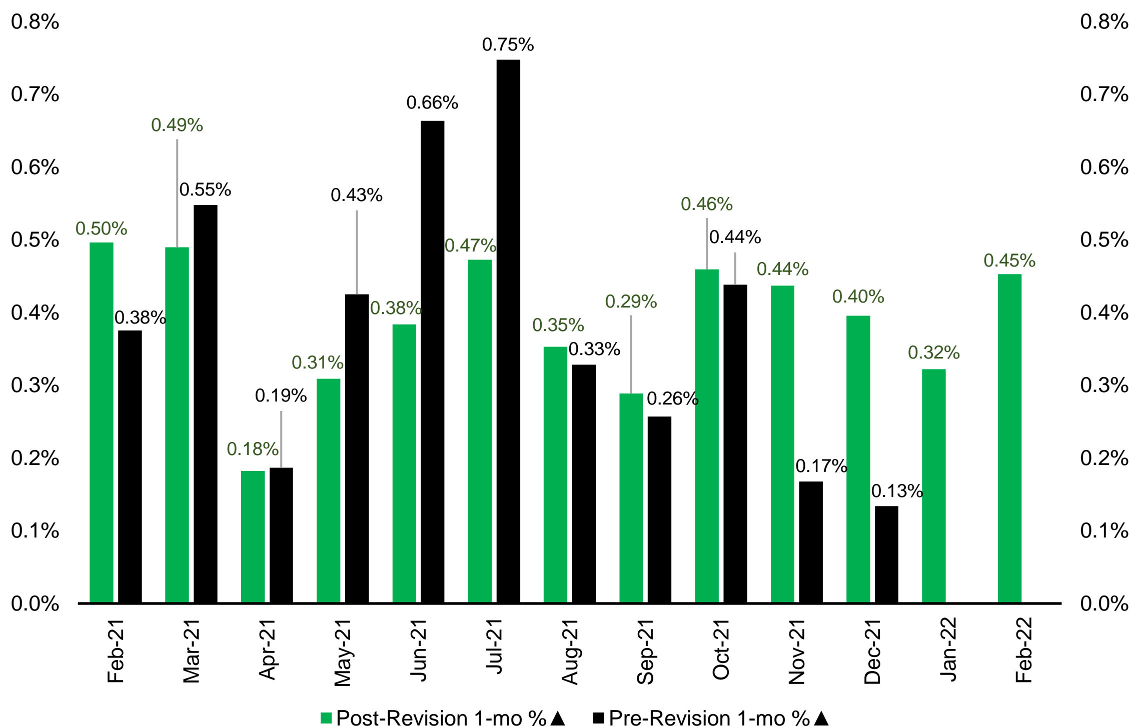
In January, as the February jobs report showed there was a shockingly large increase in total employment in the U.S. by about 467,000 (later revised to +481,000). This number followed substantially smaller original employment (pre-revisions) increases for both November and December as reported in the December and January jobs reports.

In addition to the large increase in total nonfarm payrolls following three consecutive months of ever-smaller increases, the Bureau of Labor Statistics also carried out its annual benchmark revisions in the employment numbers. These benchmark revisions, by themselves, added some 800,000 employees to the previously estimated numbers (Figure A). Thus, if you were to look solely at the number of Americans employed in January à la the February report relative to the number employed in December according to the January report, you would see total employment was some 1.3 million higher in January than December: 800,000 due to the benchmark revisions and 481,000 due to the monthly increase in the revised numbers. The March report covering February added another huge increase in employment of some 678,000 jobs.

In Figure A, we have plotted both the post-revision and the pre-revision job growth data from February of 2021 through February of 2022.

[1] *This material contains the views and opinions of the authors, but not necessarily those of Guggenheim Partners, LLC or its subsidiaries.*

Figure A
Total Nonfarm Payroll Employees: Pre vs. Post Revisions
(monthly, February 2021 through February 2022, percent change from prior month, seasonally adjusted levels)



Source: Bureau of Labor Statistics

Altogether, the benchmark revisions have materially altered—both quantitatively *and* qualitatively—the picture of U.S. job growth over the past twelve months. To wit:

- U.S. revised measured employment *growth* was increased each month for the past seven months.
- For the final quarter of 2021 (Figure A), U.S. growth was revised upward significantly, especially for November and December. Job growth in January and February of 2022 was once again large, adding 481,000 then 687,000 new jobs.
- For the period of March, April, May, June, and July of 2021, employment growth was reduced by the benchmark revisions and in several of those months reduced by a substantial amount (see Figure A).
- By all reckoning, the March numbers (reported in early April) and for the following four months will face a headwind of sharply reduced seasonal factors. Also, as good as the revised numbers are, the number of Americans employed is still some 2.1 million lower than the comparable level in February 2020. After applying the adult population growth trend from February 2020 to February 2022 to total employment, we see that the U.S. falls 4.3 million jobs short of where it should be.

In all, the BLS benchmark revisions altered the seasonal adjustment factors, reflecting data released during the COVID-19 era. The picture that now emerges is that the reported large increases in employment through mid-2021 were reduced to much more modest gains while from August 2021 to the present, the revised data negate the unrevised impression of a significant decline in employment growth. As far as we can tell, these benchmark revisions are coherent, but they fail to relay the whole story. There's a lot more to employment than just the number of people employed.

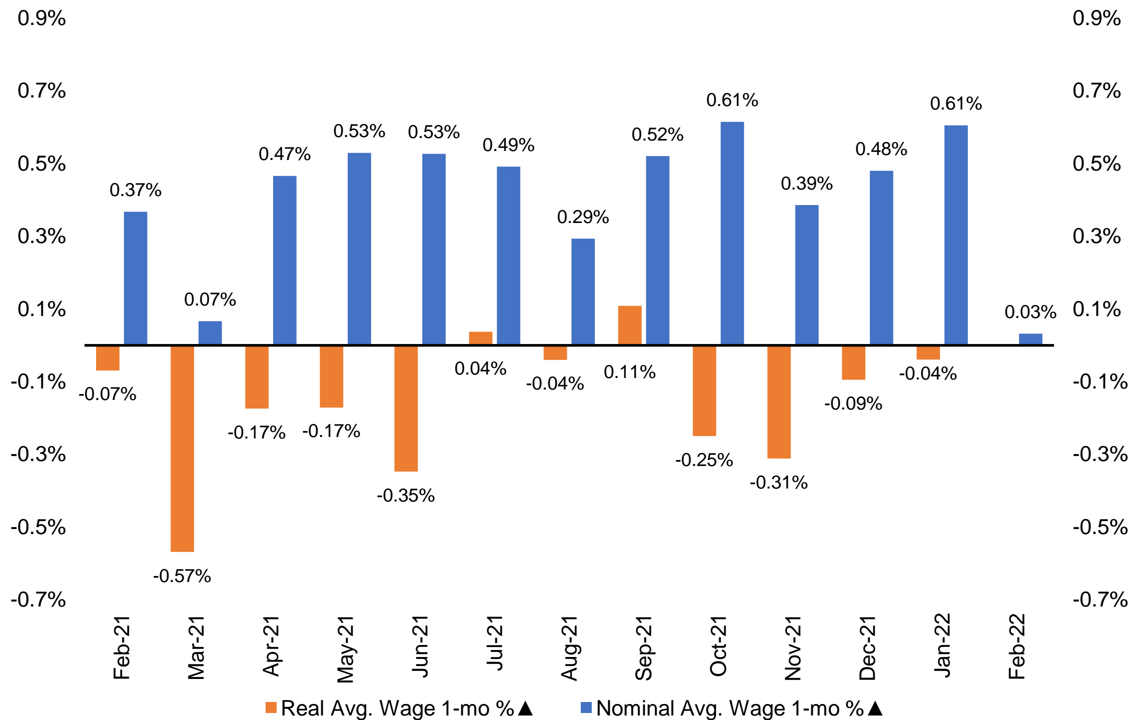
Wages

Given the sharp rise of inflation over the past twelve months, measured increases in hourly nominal wages clearly do not provide the true narrative of what's happening to worker pay. In the Figure B below, we have plotted changes in the average *real* hourly earnings of nonfarm private payroll employees (Figure B, in orange), as well as nominal increases (Figure B, in blue). These numbers include both increases in nominal wages and the effect inflation has on these wage increases.

Figure B

Average Hourly Earnings of Nonfarm Private Payroll Employees: % Change from Previous Month

(monthly, February 2021 through February 2022)



Source: Bureau of Labor Statistics

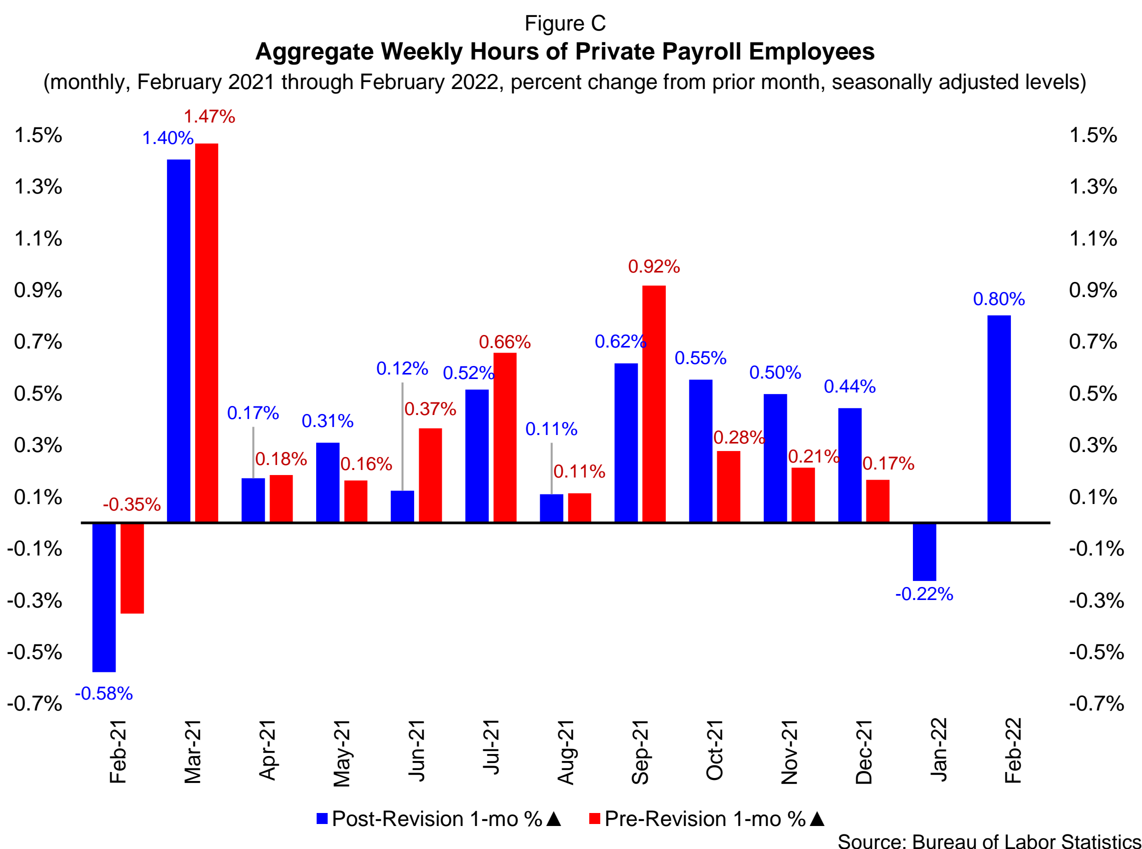
The takeaway here is again straight-forward and to the point: Real wages over the past eleven months have declined by 1.84% in terms of purchasing power as opposed to an increase of 5.09% in nominal wages. Nominal wages appeared to be catching up to inflation until the February data were released. If you believe these data in detail, February real wages crashed. Assuming we won't find miraculous disinflation in the February CPI release later this week, expect a serious blow to the real wage series. We've made no adjustments for taxes.

Aggregate Weekly Hours Worked

Again, with aggregate weekly hours, which by the way is the more descriptive and conclusive measure of labor input, the benchmark revisions have had a significant affect both qualitatively and quantitatively on the picture of just how well our economy is performing. In Figure C, we've plotted total hours for both the benchmark revised series of total hours worked and the pre-revision series. The implications are startling. Despite employment growth of quite substantial proportions, average hours worked prior to the February number had been falling over the six-month period and in January caused total hours worked to actually decline.

The February data in large part reverses the downward trend of the preceding six months as a result of a considerable increase in employment and virtually unchanged average hours worked. To be precise, the average work week increased from January to February by six minutes.

Figure C
Aggregate Weekly Hours of Private Payroll Employees
(monthly, February 2021 through February 2022, percent change from prior month, seasonally adjusted levels)



Source: Bureau of Labor Statistics

To sum the story of employment, including hours worked and real hourly pay, has taken us from a very rosy picture of the U.S. labor market to a far more accurate but somewhat more measured picture of the U.S. labor market. Increases in the total weekly hours worked by the U.S. labor force had declined consistently month-over-month since September of 2021, but then rose sharply in February. The read for January 2022 of actual aggregate hours worked fell at a monthly rate of 0.2% while February rose by 0.8%. If you believe these data, this is not a robust recovery as touted by the "headline numbers."

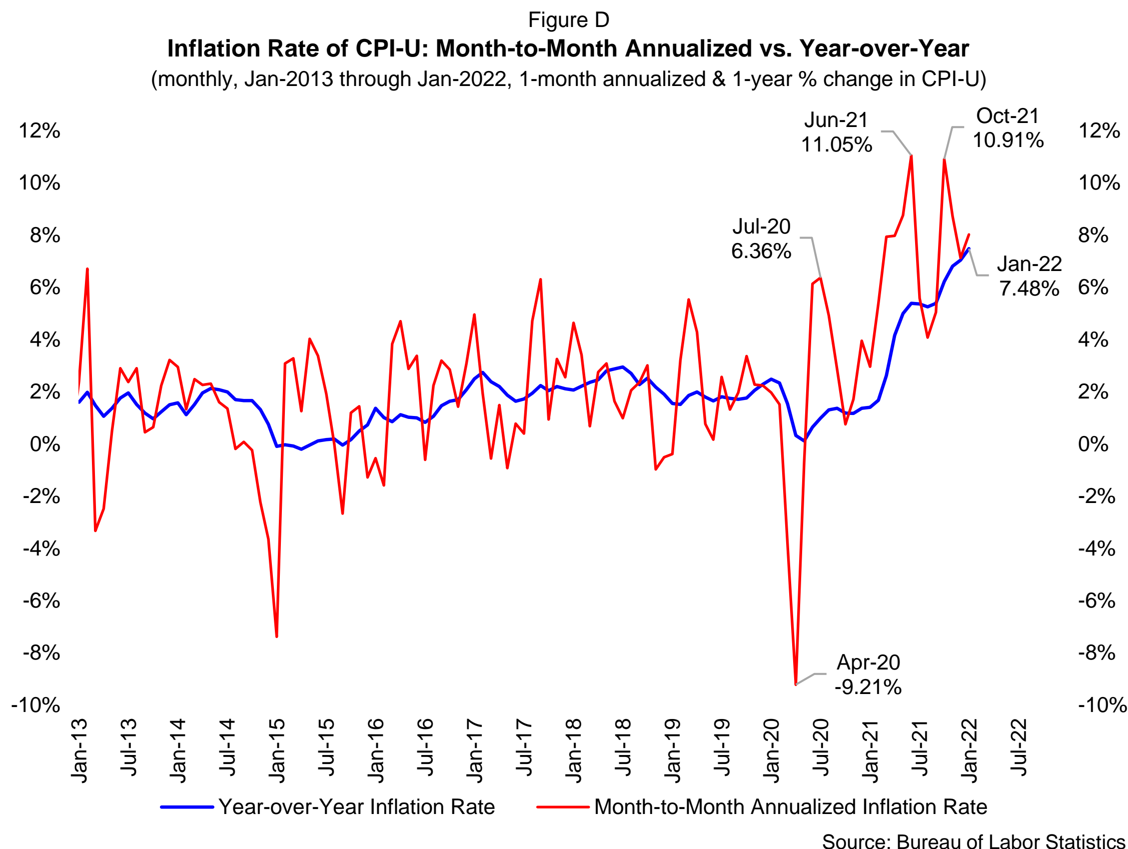
II. Inflation

In January 2022, the Consumer Price Index (CPI) rose 7.5% above the January 2021 level (see Figure D). According to the monthly increases in the CPI, also plotted alongside the twelve-month moving average, there appears to be little reason for optimism. The month-over-month changes, which are quite volatile, assuredly point to modestly higher inflation in the near future.

Figure D

Inflation Rate of CPI-U: Month-to-Month Annualized vs. Year-over-Year

(monthly, Jan-2013 through Jan-2022, 1-month annualized & 1-year % change in CPI-U)



Source: Bureau of Labor Statistics

For the months of March, April, May, and June, the inflation numbers dropping off the twelve-month moving average (7.94%, 7.97%, 8.75%, and 11.05% respectively) are high monthly numbers by historical standards and unless their twelve-month counterparts are also inordinately elevated, the year-over-year CPI headline numbers should either flatten out or perhaps even decline. But this is a red herring for the index as a whole. Once we get to July, August, and September, the CPI year-over-year should once again surge ahead, thus registering new highs on inflation right into the mid-term elections. Just a few days after the elections, we should expect to see a new pause in inflation, considering the relatively low September 2021 level, which grew an annualized 10.9% one month later (Figure E), will be removed from the inflation calculation.

Moving on from the existing pattern of monthly CPI data, there are plenty of reasons not to expect inflation to tamp down anytime soon.

The Producer Price Index (PPI) purports to measure inflation at one stage in the production process prior to the CPI. Looking at the PPI in relation to the CPI, you can readily see that if past is prolog, then the CPI has a lot of catching up to do to match up with the PPI (Figure E).

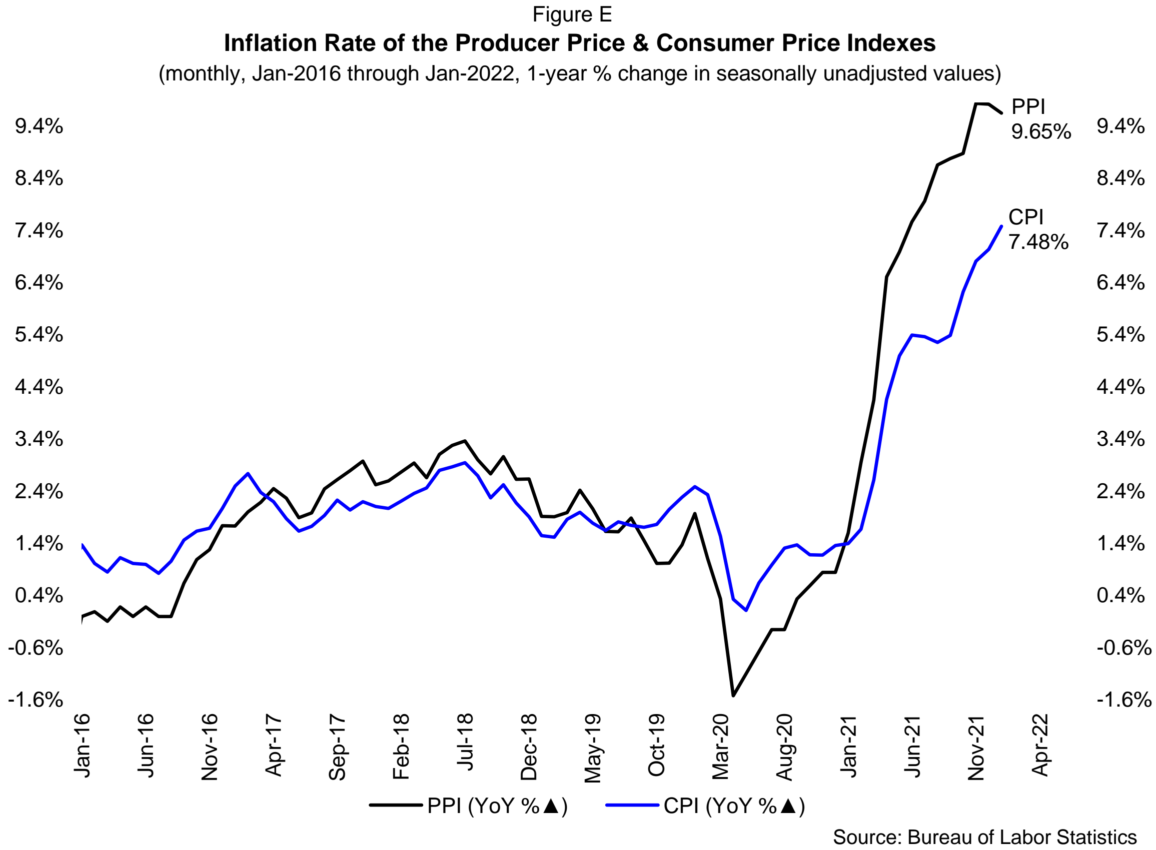


Figure E
Inflation Rate of the Producer Price & Consumer Price Indexes
(monthly, Jan-2016 through Jan-2022, 1-year % change in seasonally unadjusted values)

Source: Bureau of Labor Statistics

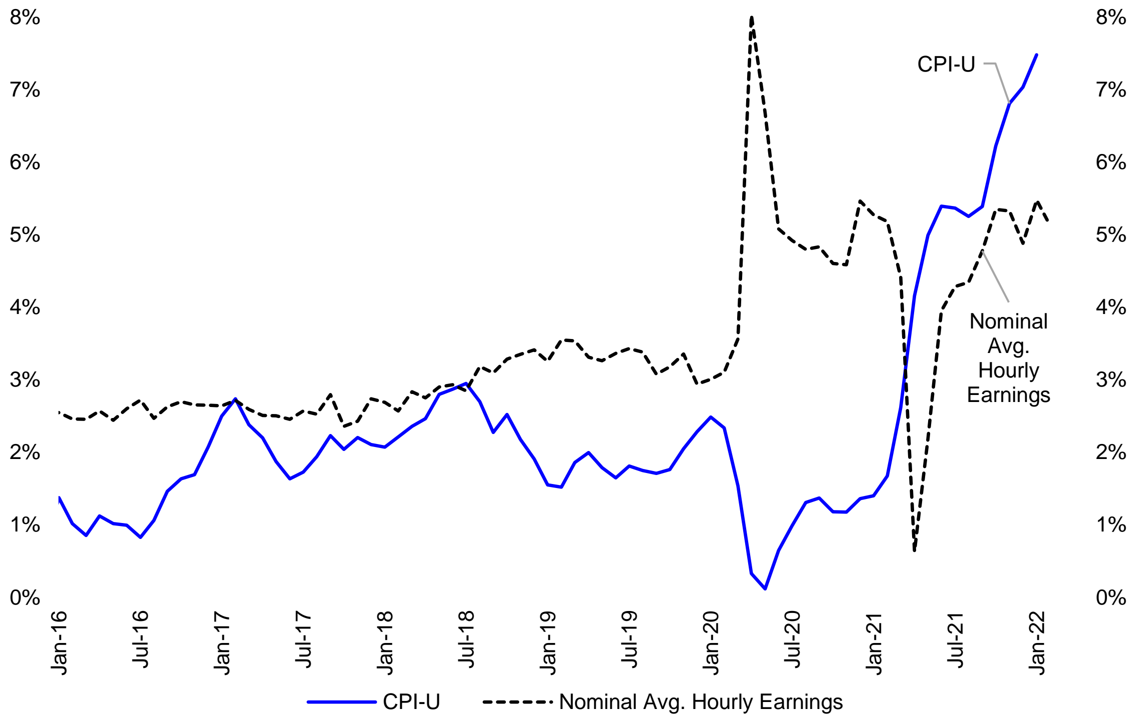
In December, the twelve-month moving average of the PPI hit a several decades high of 10% and then dropped off ever so slightly to 9.65% in January. The reason for this slight dip was because exactly one year earlier, the January 2021 number was dropped out of the calculations, which was an all-time high of 14.96% annualized month-over-month increase. The decline in the PPI would have been much greater had it not been for the January 2022 number of 12.04%, one of the highest monthly numbers in years. We'll just have to wait and see what the next nine months have in store, but if I were you, I wouldn't bet on inflation topping out.

And then we also have wage inflation, which is finally starting to catch up with the CPI. In Figure F, we have plotted increases in monthly wages along with same month CPI inflation. It sure looks as though we're heading into a cost push inflation as well as everything else.

Figure F

CPI-U vs. Nominal Average Hourly Earnings: Year-over-Year Percent Change

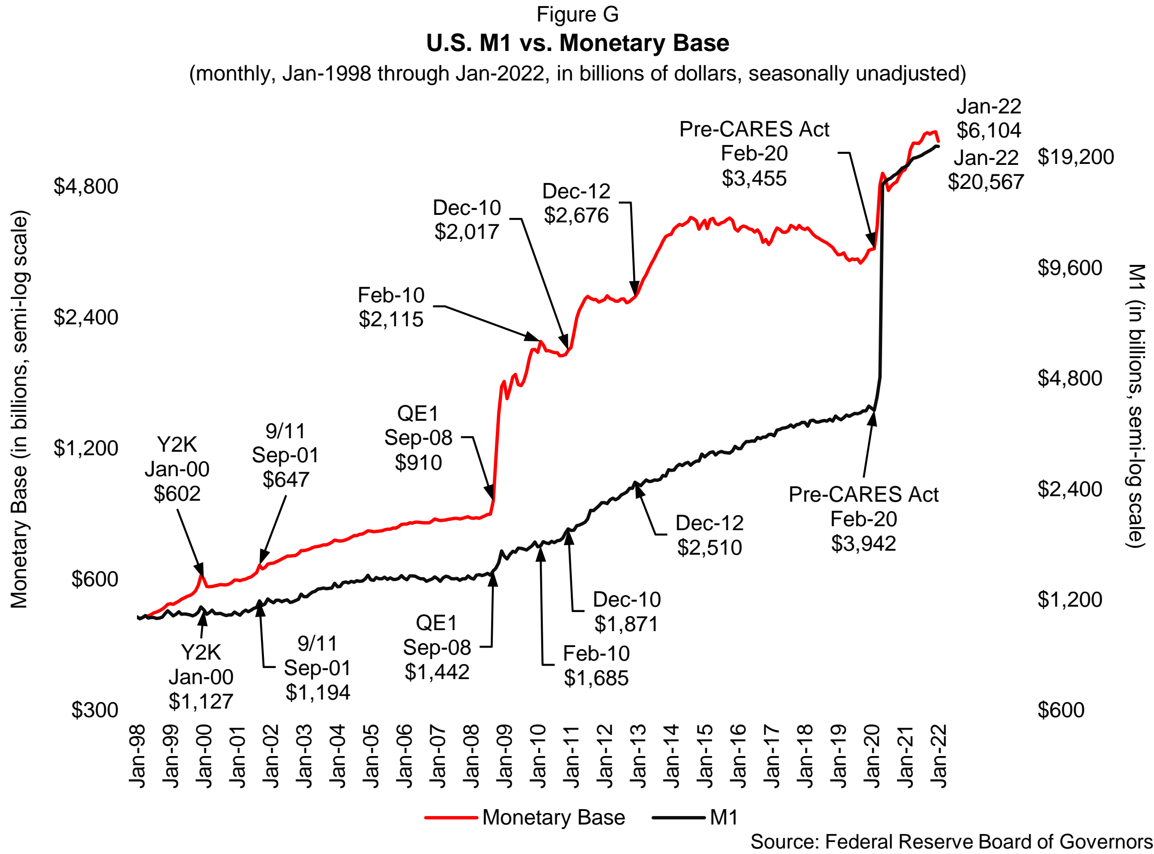
(monthly, Jan-2016 through Jan-2022 (Feb-2022 for wages), annual growth rates)



Source: Bureau of Labor Statistics

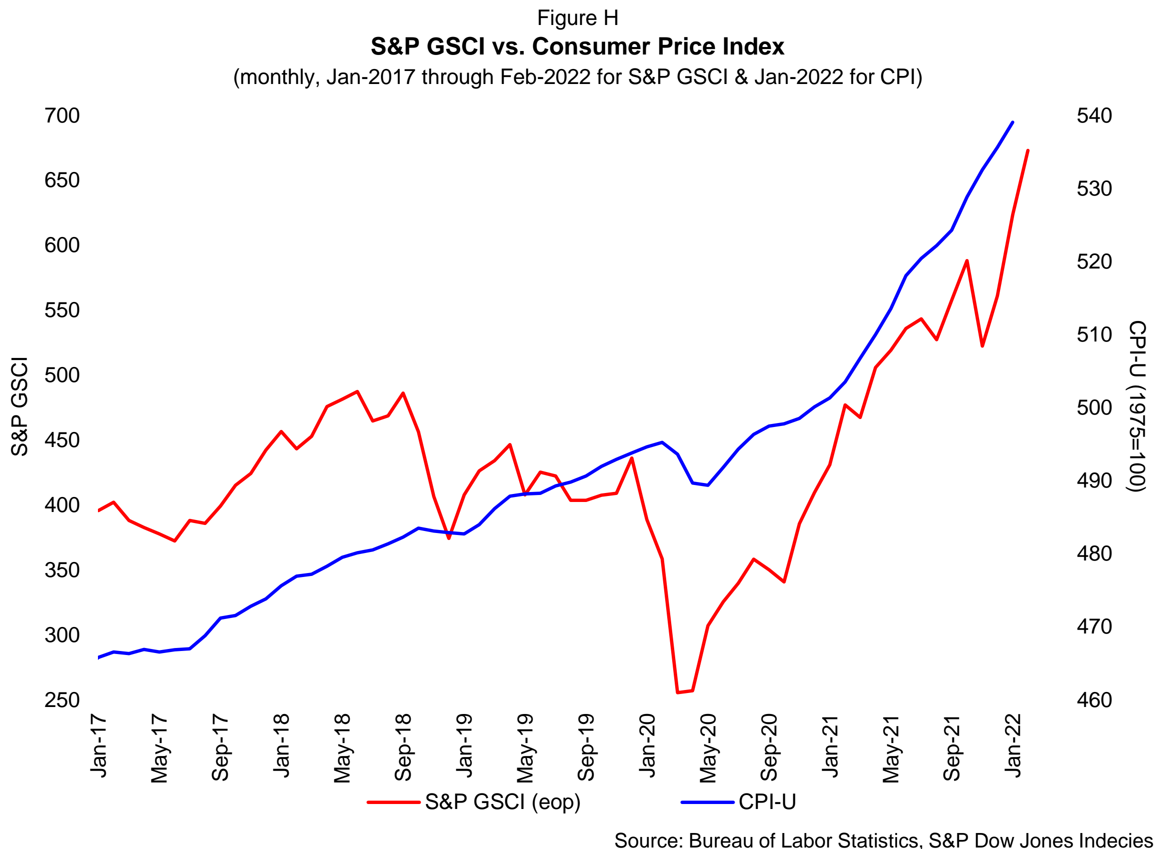
As two final indicators of future inflation, we have plotted i.) The U.S. money supply (M1) and the U.S. monetary Base (Figure G). If there's anything to the notion of too much money chasing too few goods, we're in for one helluva inflation ride. And finally we've plotted ii.) An index of commodity prices (Figure H). Again, these are the prices of the most sensitive market-driven commodities in our economy.

Figure G
U.S. M1 vs. Monetary Base
(monthly, Jan-1998 through Jan-2022, in billions of dollars, seasonally unadjusted)



Source: Federal Reserve Board of Governors

Figure H
S&P GSCI vs. Consumer Price Index
(monthly, Jan-2017 through Feb-2022 for S&P GSCI & Jan-2022 for CPI)



Source: Bureau of Labor Statistics, S&P Dow Jones Indecies

If this doesn't scare you, I don't know what will. The only bright spot is that the dollar remains strong in the currency markets.

To summarize, inflation looks at least as bad as the current reported figures describe, and perhaps worse. The employment numbers look somewhat worse than the reported headline statistics. Put on your seatbelts.

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