



## MORNING BRIEFING

August 16, 2017

### Pay Day

See the [collection](#) of the individual charts linked below.

(1) Consumers are earning money and spending it. (2) Real retail sales are really strong. (3) GDPNow now at 3.7%. (4) Hits & misses: Yellen's 3%-4% wage inflation target. (5) Comparing AHE, WGT, and ECI measures. (6) Silver Tsunami of retiring Baby Boomers weighing on average wage measures. (7) Keeping track of individuals' wages.

**US Consumers: Alive & Well.** We knew they had it in them. Consumers are spending money because they are earning good money. Our Earned Income Proxy (EIP) for wages and salaries in the private sector rose 0.5% during July and 4.6% y/y ([Fig. 1](#)). However, recent retail sales reports prior to the one released yesterday were relatively weak. As Debbie discusses below, yesterday's report showed a solid gain of 0.6% m/m last month, with significant upward revisions for the previous two months. As a result, retail sales excluding gasoline rose 4.4% y/y, in line with the gain in our EIP ([Fig. 2](#)).

Debbie doesn't like inflation. So she has a habit of inflation-adjusting retail sales, which also eliminates the impact of volatile gasoline prices. She observes that over the past three months through July, real retail sales rose 7.0% (saar), based on the three-month average, the best gain since March 2015 ([Fig. 3](#)).

The folks who update the Atlanta Fed's GDP-tracking [model](#) reported yesterday: "The GDPNow model forecast for real GDP growth (seasonally adjusted annual rate) in the third quarter of 2017 is 3.7 percent on August 15, up from 3.5 percent on August 9. The forecast of the contribution of personal consumption expenditures to third-quarter real GDP growth increased from 1.91 percentage points to 1.97 percentage points after this morning's retail sales release from the U.S. Census Bureau."

These developments confirm our hunch that the Bureau of Labor Statistics (BLS) has been underestimating wages and salaries in personal income in recent months. So we still expect the data to be revised higher.

**Wages: Mixed Bag.** As we have noted before, while wage growth has been sluggish, it is still outpacing consumer price inflation. Strong employment gains have also been boosting inflation-adjusted incomes. Sluggish wage growth has been one of the major reasons why the FOMC has been normalizing monetary policy at a sub-normal pace. It has remained weak even as the labor market has tightened. While it isn't an official target, Fed Chair Janet Yellen started saying in early 2004 that she expected to see hourly wages growing in a range of 3%-4% y/y as the labor market continued to tighten.

The most widely followed gauge of wage inflation, based on Average Hourly Earnings (AHE) for all private-sector workers, has continued running below 3.0% since May 2009, notwithstanding Yellen's expectations that it would be higher by now ([Fig. 4](#)). The data are available since March 2007 for all workers and since January 1965 for production and nonsupervisory workers.

But that's not the only measure of wage inflation. The Atlanta Fed's [Wage Growth Tracker](#) (WGT) is

already at Yellen's target range. In fact, it has been consistently rising faster than 3.0% since November 2015 ([Fig. 5](#)). So this provides one good answer to the question: Why has wage growth been so sluggish? It hasn't been, according to the WGT, which is available since March 1983. This measure has usually outpaced the wage inflation rate based on AHE for all production and nonsupervisory workers, which is also available that far back so we can compare the two.

I asked Melissa to have a closer look to see if there is an apples-and-oranges issue when comparing AHE and WGT. She found that an important compositional factor is reflected in the monthly WGT but not in the other widely followed measures, including the monthly AHE as well as the quarterly Employment Cost Index (ECI). Consider the following:

(1) *Simple AHE*. The AHE is defined as follows: "To establish average hourly earnings, the reported payroll is divided by the reported worker hours for the same establishments," according to the BLS' *Handbook of Methods*, [Chapter 2](#). That's a simple definition, but it might be too simple.

(2) *Weightier ECI*. Though obviously less timely, the ECI, also [released](#) by BLS, is considered a more accurate measure of wage inflation than the AHE. The BLS explained in a [note](#): "The Employment Cost Index (ECI) measures the change in the cost of labor, free from the influence of employment shifts among occupations and industries." How so? Without getting too technical, the BLS *Handbook of Methods*, [Chapter 8](#), notes that the ECI "is simply a weighted average of the cumulative average wage changes" within "a narrowly defined set of workers." Though occasionally refreshed, the index weights are fixed.

The AHE and ECI wage inflation rates tend to cycle in a similar fashion, though they have occasionally diverged owing to the few differences in the ways they are calculated ([Fig. 6](#)). However, even the ECI inflation rate has been below 3.0% since Q3-2008 despite the tightening of the labor market.

(By the way, the ECI also happens to have a series including benefits. For comparability purposes, the wages & salaries component is relevant here because the AHE doesn't include benefits.)

(3) *In & out*. Importantly, neither the AHE nor the ECI addresses a different compositional interplay: labor force shifts between workers who recently entered the labor force and those who recently exited it.

In a March 2016 [Economic Letter](#), San Francisco Fed economists explained: "In particular, while higher-wage baby boomers have been retiring, lower-wage workers sidelined during the recession have been taking new full-time jobs. Together these two changes have held down measures of wage growth."

They observed that the problem gets worse in times when labor force shifts are paramount. For example, "[a]s baby boomers have begun to retire, the fraction of exits occurring from above the median wage has gotten larger, reflecting the relatively high earnings of older workers. The exits from full-time employment of older, higher-paid retirees have also pushed down wage growth. Furthermore, with so many of this generation still to retire, the so-called Silver Tsunami will be a drag on aggregate wage growth for some time." But the silver lining is that maybe traditional measures of aggregate wage growth don't make sense in times like these.

(4) *Unique WGT*. WGT measures the wage growth of continuously employed unique workers, discounting the impact of people entering and exiting the workforce. Interestingly, the WGT seems to track the quarterly ECI more closely than the monthly AHE does ([Fig. 7](#)).

Unlike other wage measures that compute an average based on wage levels, the creative folks at the Atlanta Fed used a distribution of wage growth for the WGT. Think of the WGT as the middle data point in the distribution of a wage growth sample—that is not the same as the growth of the middle wage! So the WGT cannot tell us anything about wage inequality, but it can tell us what the same workers are experiencing over time.

According to the Atlanta Fed's [website](#), the WGT “is the time series of the median wage growth of matched individuals. This is not the same as growth in the median wage. Growth in the median wage represents the experience of a worker whose wage is in the middle of the wage distribution in the current month, relative to a worker in the middle of the wage distribution 12 months earlier. These would almost certainly include different workers in each period.”

To determine the WGT median series, the number crunchers at the Atlanta Fed first compile individual hourly earnings data for a sample. Next, the “the hourly earnings of individuals observed in both the current month and 12 months earlier” are matched. Then, “the median of the distribution of individual 12-month wage changes for each month” is computed. Lastly, the data are smoothed using a three-month moving average.

## CALENDARS

**US. Wed:** Housing Starts & Building Permits 1.225mu/1.246mu, MBA Mortgage Applications, Atlanta Fed Business Inflation Expectations, EIA Petroleum Status Report, FOMC Minutes. **Thurs:** Jobless Claims 240k, Leading Indicators 0.3%, Headline & Manufacturing Industrial Production 0.3%/0.2%, Capacity Utilization 76.7%, E-Commerce Retail Sales, Weekly Consumer Comfort Index, Kaplan, Kashkari. (Bloomberg estimates)

**Global. Wed:** Eurozone GDP 0.6%q/q/2.1%y/y, Italy GDP 0.4%q/q/1.4%y/y, UK ILO Unemployment Rate (3m) 4.5%. **Thurs:** Eurozone Headline & Core CPI 1.3%/1.2% y/y, Eurozone Trade Balance (euros) 20.3b, UK Retail Sales 0.1%m/m/1.2%y/y, Australia Employment Change & Unemployment Rate 20k/5.6%, ECB Account of Monetary Policy Meeting. (DailyFX estimates)

## US ECONOMIC INDICATORS

**Retail Sales** ([link](#)): Amazon's Prime Day helped boost July retail sales to a new record high, while there were upward revisions to June and May. Headline sales jumped 0.6%—the biggest monthly gain this year—while June (to 0.3% from -0.2%) and May (0.0 from -0.1) declines were revised away. Core retail sales also rose 0.6%, and there were slight upward revisions to June (0.1% from -0.1%) and May (0.1% from 0.0%). (BEA uses this core retail sales measure to estimate personal consumption expenditures each month.) Meanwhile, we estimate real retail sales climbed for the fifth straight month by 0.6% m/m and 2.9% over the period. These sales accelerated 7.0% (saar) in the three months through July, based on the three-month average, up from 0.7% in March and the largest three-month advance since March 2015. Real core retail sales expanded 0.5% m/m and 8.0% (saar) over the comparable three-month period, holding around June's 8.2%, which was the strongest since March 2015. Ten of the 13 major nominal retail sales categories rose in July, while three fell. The biggest gains were posted by miscellaneous store (1.8%), nonstore (1.3), motor vehicle (1.2), and building material (1.2) retailers; retailers of furniture & home furnishings, food & beverage, health & personal care, sporting goods, and food services posted gains from 0.3% to 0.4%. General merchandise store sales edged up 0.1% last month, though department stores posted a 1.0% jump after a two-month loss of 1.4%. Sales were fractionally lower for retailers of electronics & appliances (-0.5), gasoline (-0.4), and clothing & accessories (-0.2).

**Business Sales & Inventories** ([link](#)): Nominal business sales in June reached a new record high, while real sales in May continued to fluctuate just below its record high. The details: Nominal manufacturing & trade sales (MTS) climbed 0.3% in June after a revised 0.1% gain in May, first reported as a 0.2% decline; these sales were up 4.3% y/y, slowing from its recent peak of 7.1% in February. Inflation-adjusted MTS climbed 0.4% in May after a 0.3% loss and a 0.2% gain the prior two months; these sales accelerated 3.1% y/y. Real sales of retailers climbed to a new record high in May, while wholesalers' remained stalled at record highs; manufacturers' sales gave back some of their recent gains, though edged up 0.1% during the latest month. May's real inventories-to-sales ratio slipped to 1.43, matching December's reading, which was the lowest since January 2015; it was at a cyclical high of 1.47 last May. June's nominal inventories-to-sales ratio moved up to 1.38 after holding at a two-year low of 1.37 for six months; it had peaked at 1.42 during the first four months of 2016.

**Regional M-PMI** ([link](#)): The New York Fed district, the first to report on manufacturing for this month, shows business activity expanded in August at its fastest pace in nearly three years. The composite index soared 15.4 points to 25.2—the best reading since September 2014—led by the fastest pace in orders (to 20.6 from 13.3) since March's cyclical peak of 21.3; shipments (12.4 from 10.5) also contributed to this month's strength. Labor market indicators revealed an acceleration in both employment (6.2 from 3.9) and hours worked (10.9 from 0.0), while delivery times (5.4 from 4.7) lengthened slightly. Meanwhile, inventories (-3.1 from 2.4) contracted for the first time in three months. Measures assessing the six-month outlook were very optimistic, with the index of future business conditions jumping 10.3 points to 45.2 on widespread strength.

**US Import Prices** ([link](#)): Import prices in July advanced 1.5% y/y for the second month, after easing the prior four months from February's 4.7%—which was the biggest 12-month gain since February 2012. It had bottomed at -11.6% in September 2015. Petroleum prices advanced 8.3% in the 12 months through July, double June's 4.2%, but considerably below February's seven-year high of 74.1%. The yearly gain in nonpetroleum products slowed to 0.9% y/y from its recent high of 1.4% in both June and April; the yearly rate had turned positive in December (0.3% y/y) for the first time since November 2014. Total import prices edged up 0.1% after falling 0.2% and 0.1% the prior two months; nonpetroleum import prices were flat after a 0.1% uptick in June and no change in May.

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