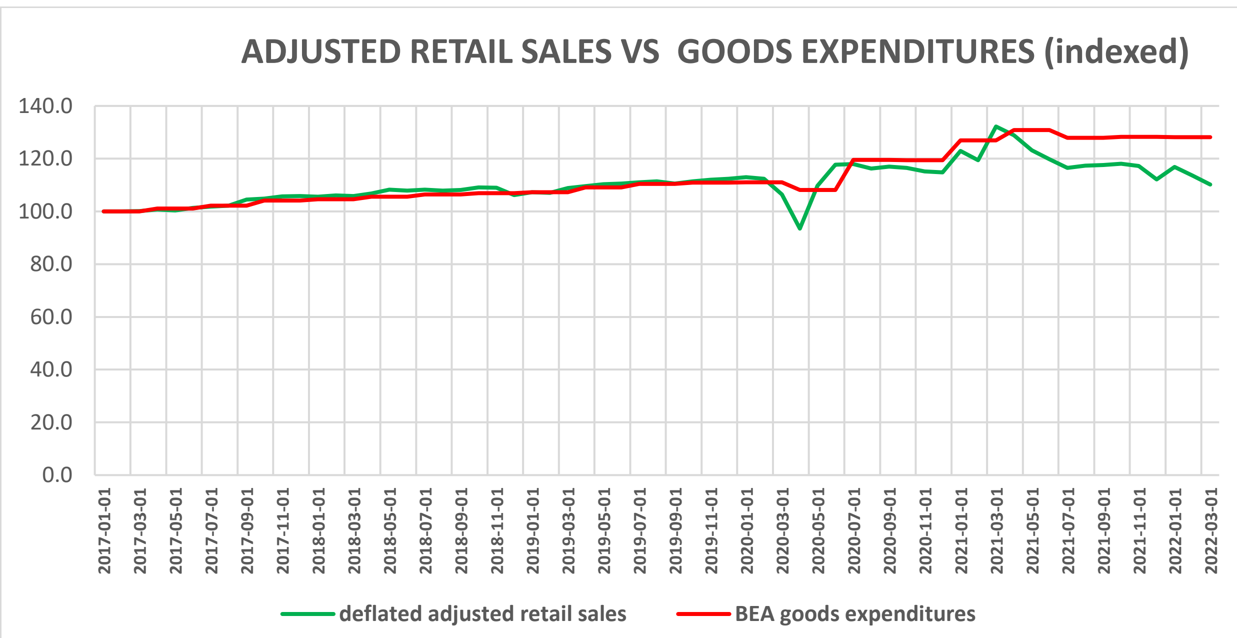
ALL IT TOOK WAS THREE QUARTERS OF A PERCENT.

A mere two rate rises, and the stock markets are tanking. True there is an expectation of more rises to come but nevertheless, it shows how fragile the US economy really is and how dependent it is on cheap and easy money.

One of the main reasons why shares plummeted on Thursday was the outlook provided by leading ecommerce corporates. Following the lead given by Amazon the previous week, they were uniformly bad. Mastercard Credit Pulse said on Thursday that ecommerce sales based on card usage was down 1.8% year on year reducing the overall card spend to 7.2%, compared to inflation of 6.3% (NIPA Table 1.14 line 2). This yields a real increase of 0.9% overall with a fall of 8.1% for ecommerce.

On the other hand the BEA in NIPA Table 1.1.3 estimates the real increase in consumer spending at 4.7% a discrepancy of 3.8%. Once again this confirms the observation in an earlier article that personal consumption expenditures are overinflated and therefore so is US GDP. Below I have reproduced Graph 8 from that article which demonstrates that over the course of the pandemic, variations have opened up due to the deflators for goods consumption not being adjusted for different weightings during the pandemic.. The figure of +3% is in the same ballpark as the Mastercard Data.

Graph 1.



But even this Mastercard figure needs qualifying as credit cards are used more frequently to fund purchases which may have subtracted purchases using other forms of payment. The March credit report by the FED showed that credit card borrowing jumped by $35 billion in March, an annual increase of over $200 billion from the February figure. Total unsecured credit increased by 14%. Seems sales are living on borrowed time, as real term pay-cuts drive up temporary borrowings.

The price of used cars was seen as indicative of supply shortages driving up prices. However, this period is over. Used car sales declined 15% in April from March and have lost 6.4% in price since January or about one third of their annual gain. At the same time sales of new car increased in April though they remain 16% below 2018-9 levels. It seems vehicle sales are normalising so it will be possible to detect underlying trends for the first time.

It is worth ending on soft survey data. The most reliable being the Institute of Supply Managers survey or the ISM report. It continues to conclude in its latest report that the economy remained "*demand-driven, supply chain-constrained environment*". In short the view from the production side is that demand is steady despite the index of new orders falling from 61.7 in February to 53.5, its lowest level since May 2020.

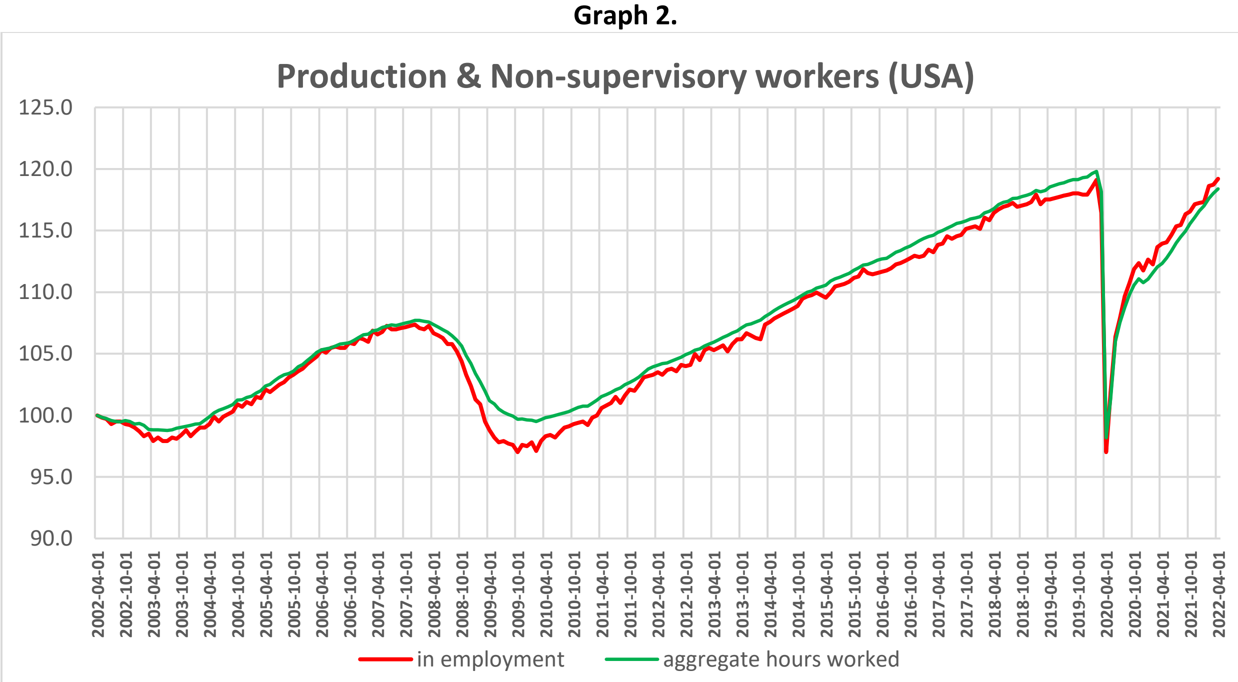
It is worth discussing the savings rate. The savings rate has fallen to a low last seen in 2013. Paradoxically this is good for consumption. The savings rate is one of the most misunderstood items in the National Accounts. In fact it is not a real number, but the balancing number used to align the two sides of the T accounts – the income side with the spending side. The higher the rate of consumption, but not the rate of investment, the lower will be the savings rate. Thus a low rate of savings is consistent with a higher degree of spending while a rising savings rate is consistent with falling consumption. However, this is can be obscured in a period of high inflation which affects the two sides differentially.

A shortage of workers or the hoarding of workers?

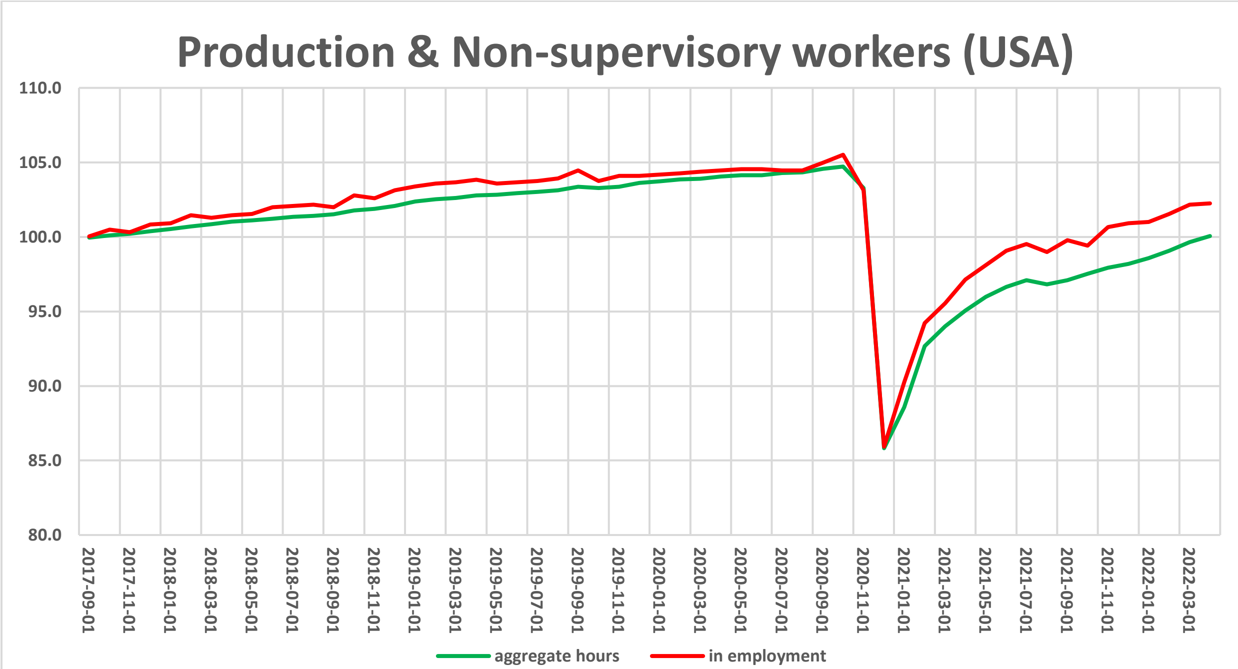
Before looking at the worst productivity and labour cost data for 75 years, also released on Thursday, it is necessary to look at the employment data first. The productivity and labour cost data were so bad that it raises questions about the reliability of the data, especially when the productivity figures for the previous quarter were revised from -6.6% to + 6.5%, a monumental revision.

But before doing so it is worth investigating an anomaly between the employment data and the aggregate hours worked.

Graph 2.



Graph 3.



Graph 2 illustrates that normally the hours worked tends to grow faster than employment. In other words the red graph has tended to sit just above the green graph. In Graph 3 which is rebased to include only the last five years, the number of workers has grown faster than the hours worked, particularly in the recent period. Provided this data is reliable, the most likely conclusion is that companies are hoarding workers which means they are exacerbating the alleged shortage of workers.

If this is due to supply problems then this is reminiscent of the Soviet Union. There enterprise managers hoarded workers to throw at production to meet planned targets in the face of unreliable inputs. From the capitalist point of view, hoarding workers means adding to capital and deducting from profit, which is why it is an aberration in contrast to the USSR, where it was the norm.

This current hoarding of workers seems to be confirmed by the latest BLS release. "Worker productivity fell to start 2022 at its fastest pace in nearly 75 years while labor costs soared." *"Nonfarm business sector labor productivity decreased 7.5 percent in the first quarter of 2022, the U.S. Bureau of Labor Statistics reported today, as output decreased 2.4 percent and hours worked increased 5.5 percent. This is the largest decline in quarterly productivity since the third quarter of 1947, when the measure decreased 11.7 percent. Unit labor costs in the nonfarm business sector increased 11.6 percent in the first quarter of 2022, reflecting a 3.2-percent increase in hourly compensation and a 7.5-percent decrease in productivity. Unit labor costs increased 7.2 percent over the last four quarters. (See table A1.) This is the largest four-quarter increase in this measure since an 8.2-percent increase in the third quarter of 1982."* In short, while the hours worked increased by 5.8% output fell by 2.3% compared to the previous quarter.

The data can be seen in the replicated tables below taken from the report. In manufacturing on the other hand, there was a slight improvement in productivity resulting in labour costs rising by only 2.1% compared to 11.6% for non-farm business.

Table 1.

Table A1. Labor productivity growth and related measures - preliminary first-quarter 2022
(percent change from previous quarter at annual rate and from same quarter a year ago)

Sector	Percent change from:	Labor productivity	Output	Hours worked	Hourly compensation	Real hourly compensation	Unit labor costs
Nonfarm business	Previous quarter	-7.5	-2.4	5.5	3.2	-5.5	11.6
	A year ago	-0.6	4.2	4.8	6.5	-1.4	7.2
Business	Previous quarter	-7.7	-2.3	5.8	3.0	-5.7	11.6
	A year ago	-0.6	4.0	4.6	6.7	-1.2	7.3
Manufacturing	Previous quarter	0.7	5.7	5.1	2.8	-5.9	2.1
	A Year ago	1.7	5.2	3.5	3.5	-4.2	1.8
Durable manufacturing	Previous quarter	1.4	7.9	6.4	1.9	-6.7	0.5
	A year ago	2.1	5.2	3.0	1.4	-6.1	-0.8
Nondurable manufacturing	Previous quarter	0.5	3.4	2.9	4.2	-4.5	3.7
	A year ago	0.9	5.2	4.2	7.6	-0.4	6.6

However these figures compared to the GDP data raises questions. In terms of GDP, the quarterly fall was 0.4% while the annual fall deepened to 1.4%. The BLS data however shows a year-on-year rise in output of 4.0% compared to a fall of 2.3% in quarterly output, a reverse image. It is therefore likely this data will not be revised upwards in the same manner as the previous quarter was.

It is also worth noting how real wages have plummeted. Real hourly compensation fell by 5.7% quarter on quarter and by 1.2% on an annualised basis. This was not enough to defray the increase in labour costs which rose 11.6% on a quarterly basis and by 7.3% on an annual basis. This is very ominous for the corporate profit report due out next month. In contrast analysists such as FactSet continue to project near record profit margins for the S&P 500 this year.

On a final note, orders for capital goods have been strong over the last 6 months. This is likely to be driven by companies seeking to automate production in the face of a tight labour market driving up wages.

The FED speaks loudly and carries a small stick.

For the first time in twenty years the FED raised its lending rate by 0.5% bringing the rate up to a whopping 1.0%. A half hour later on Wednesday at his press conference, Chairman Powell debunked the possibility of future 0.75% rate rises. This announcement was the equivalent of firing a starting gun for the markets, they soared as speculators who had bet on 0.75% rate rises had to reverse their shorts (bets the market would fall on the predicted stance of the FED). New retail money flowed into the market as investors felt the bottom had been reached.

The next day they were taken to the cleaners. By Friday's close the Nasdaq had fallen close to 7% though its weekly fall was less. Its cumulative fall from its November highs is approaching 25%. The S&P 500 is down 14%, as too is the Wilshire 500 which includes 97% of all US listed shares. This is shown in the Graph below. Though it appears that the Wilshire has fallen back to trend it should be remembered that the previous rise took place in a benign interest rate environment, not the current more hostile rate environment.

While the swings in the market have been unusually severe, with 3% variations becoming common, there has yet to be a full-blown panic. Blood has been spilt. Some of the most leveraged hedge funds are already down 40% this year, but there has been no large-scale default or seizing up of any part of the market.

Graph 4.

Preceding and following the FOMC (FED) rate rise the discussion focused on what the "natural rate" for the FED rate should be. For a useful synopsis of this discussion read the 6th May [Financial Times](#) article "*FED aggression fails to mask dovish undertones*." This so-called natural rate, defined as one which neither stimulates nor inhibits economic growth, and which is as elusive as the holy grail, is variously estimated to be between 2 and 5% currently. According to Colby Smith the author of the article, the FED puts it at between 2 and 3%. In other words, the FED has only made half the progress it needs to achieve its minimum target of 2%.

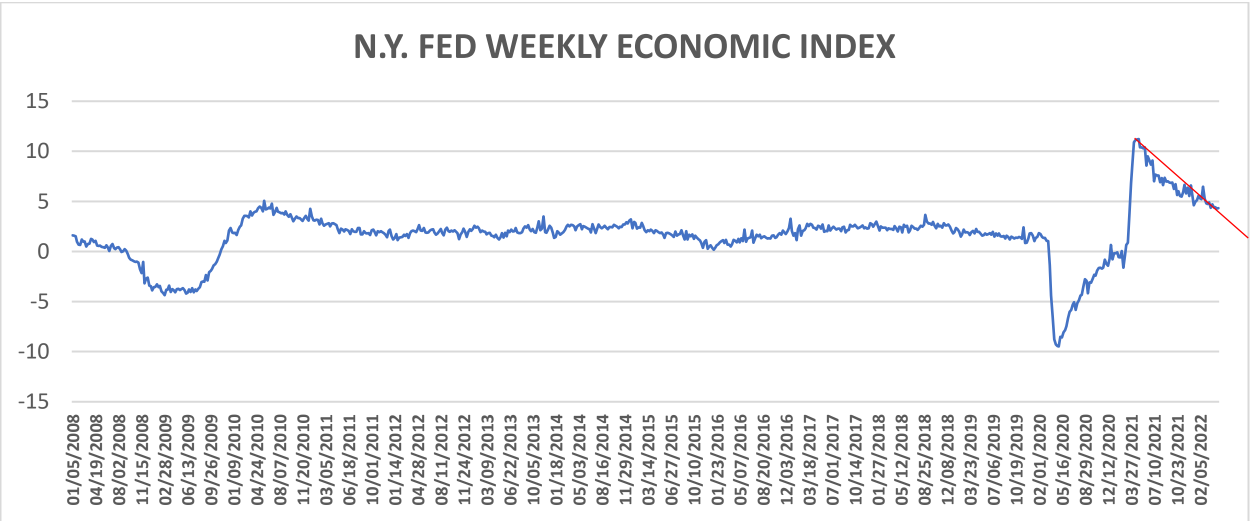
I do not believe we will ever see 2%, perhaps only 1.5%. There is no such thing as a natural rate. The rate of interest is a function of the rate of profit. When the rate of profit rises encouraging investment, it drags up the rate of interest with it and when it falls, discouraging investment and therefore the demand for funds, the rate of interest falls. The renewed discussion on the "natural rate" of interest actually implies a decoupling between the rate of profit and the rate of interest due to central banks' ill-conceived interventions into the money markets.

What is unsettling the market is the dot plot, how many more rate rises there could be. But the fact is that a mere two rises out of a possible ten has already spooked the markets and driven the economy into reverse. This shows just how fragile the economy is and how hooked it is on cheap money. But it is unlikely that the FED will ever lose the plot, which is to prevent fictitious markets plunging by more than 40%. But that could turn out to be its *Mission Impossible*.

The outlook.

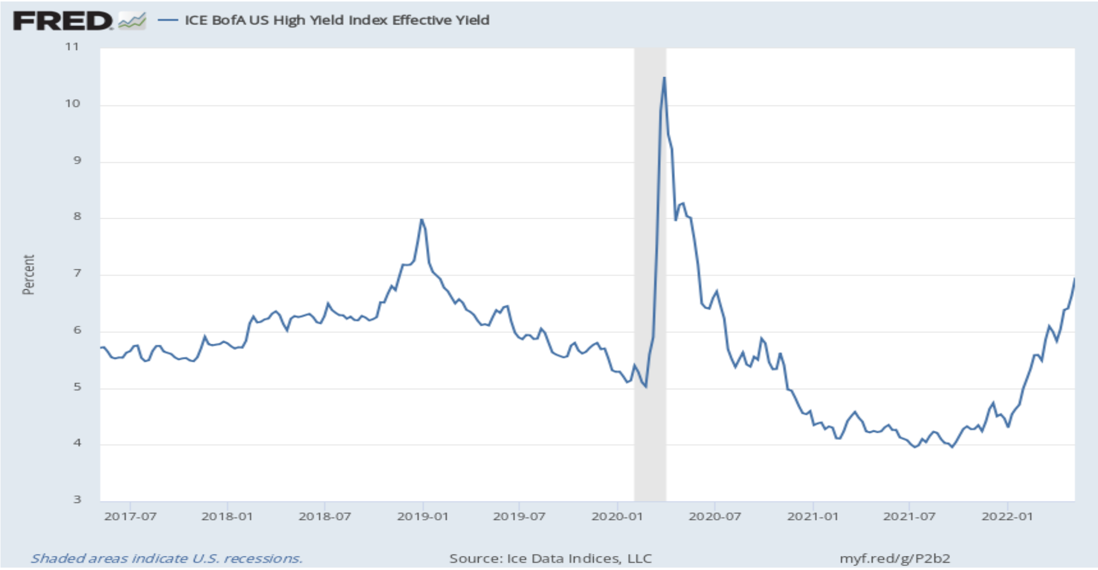
UPS volumes were down 1.5% in the first quarter because of the fall in ecommerce sales. However, FreightWaves latest report suggests freight traffic may have improved in April. The New York Fed high frequency data shown in the graph below suggests that the deceleration in consumption is on-going. In fact, because this index excludes ecommerce, the fall in the rate of consumption could be bigger, meaning that at best the rate has returned to 2019 levels.

Graph 5.



I am not inclined to comment too much on April data due to the paucity of data. But it is necessary to keep a close eye on the high yield or speculative bond market. The FRED graph below shows that effective yields are approaching their 2019 peak. Tens of billions but not hundreds of billions of these bonds are in distress measured by an effective yield of over 10%. One thing holding back defaults is that corporations borrowed heavily at low rates to boost their liquidity and they benefited from the COVID relief packages in 2020/1. However, this is only delaying the inevitable as economic headwinds build.

Graph 6.



Conclusion.

I will finish on this point. The US economy has been driven by personal consumption. The rise in inequality means that consumption is skewed towards spending by the rich, whose habits in turn are influenced by the gains or losses they make through speculation. For example Bloomberg just announced that the richest 500 global capitalists have already lost a trillion dollars this year due to falls in the share and bond markets. Shame. But the point remains. The top 10% of society consumes as much as the bottom 80%. Should share and bond prices continue to fall they will join the bottom 80% who have already declared their intention to curb their expenditures.

The lurching stock market between Wednesday and Friday reveals the tug of war between the real economy and the enduring influence of the FED. This week the real economy won over the Powell promise to be gentle with rate rises. In the end, the FED will not be so concerned with tight labour markets and rising prices. It knows the beating heart of the economy, which used to be primed by the investor has long since been replaced by the consumer, and it will change tack if it feels consumption is collapsing, regardless of any other considerations. This is why it is unlikely that the FED rate will ever arrive at 2%. The die has been cast, paid for by the world's reserve currency, and it can only be broken by revolution.

Brian Green, 7th May 2022.