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Portfolio Strategy

Wages, Labour Shortages and the Outlook for Inflation

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Portfolio Strategy: Wages, labour shortages and the outlook for inflation

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Despite numerous headlines of companies struggling to hire workers we have not seen anything in recent data that convinces us that this is anything other than a temporary bottleneck, narrow in breadth and short in duration. Thus, we do not think that post-reopening wages will lead inflation higher.

Unemployment may have fallen but the pick-up in labour participation remains low, aggregate wages are not accelerating and where there has been a bottleneck, it is against the background of furlough and income support schemes still being in place.

We think that the reopening inflation "blip" will likely be followed by a period of inflation that is higher than before the pandemic but still below the current run rate of price increases.

The pandemic will likely have brought forward job losses due to automation that would have happened in the coming years, as evidenced by the recent pick up in robot sales globally.

The wage-depressing effect of automaton can be partly offset by two forces. One is the demographic outlook of declining labour force size which seems very likely but slow moving. The second is the likely evolution of policy to support the bargaining power of labour and to push back on the gig economy and globalisation.

The bottom line is that this is consistent with the notion that inflation does not become unanchored. This path is also consistent with the idea that inflation is still dependent on being nurtured by policy (eg monetary policy, and political decisions around the pricing power of labour).

Analyst Page

Bernstein Events

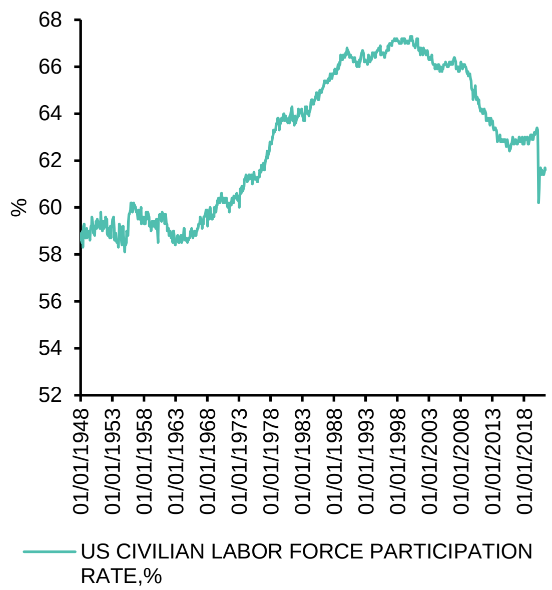
DETAILS

Inflation is probably the key tactical and strategic issue for investors. What makes this difficult to position for is that there is likely to be a transition over the next 12-18 months from a reopening trade blip in inflation to a post-reopening equilibrium. We think it is likely that this equilibrium sees inflation at a higher level than before the pandemic but below the current run rate of price increases. Making this even harder to navigate is that the policy response to inflation is still uncertain. Lags in the monetary policy transmission mechanism would usually imply that monetary policy will not respond to the high levels of near-term inflation if it is indeed transitory. Moreover, we think there is a good case that politicians will want a bias for inflation to be above target.

In the midst of this environment, the outlook for wages is key. The current headlines are awash with stories of labour shortages, but so far we have not seen anything that convinces us that this is anything other than a labour “shortage” that is narrow in breadth (mostly in Leisure & Hospitality, Retail and Construction) and short in duration. Despite these headlines actual aggregate wage increases have been small and also they are still in the context of furlough and other income support schemes still being in place.

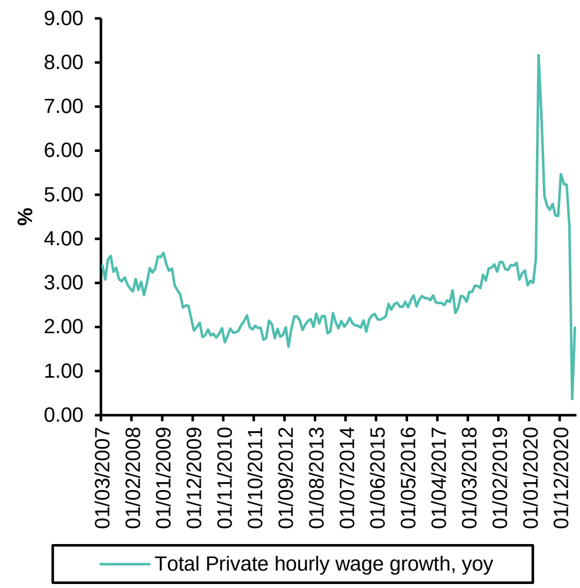
As we show in Exhibit 1 the US labour force participation rate has recovered from the COVID trough but at 61.6% currently it is significantly below historic average and the pre-COVID level of around 63%, suggesting there is still a lot of labour slack in the economy. The total hourly wage growth has also risen in the past few months but still remains below average since 2007.

EXHIBIT 1: **US Labour force participation rate**



Source: BLS, Bernstein analysis

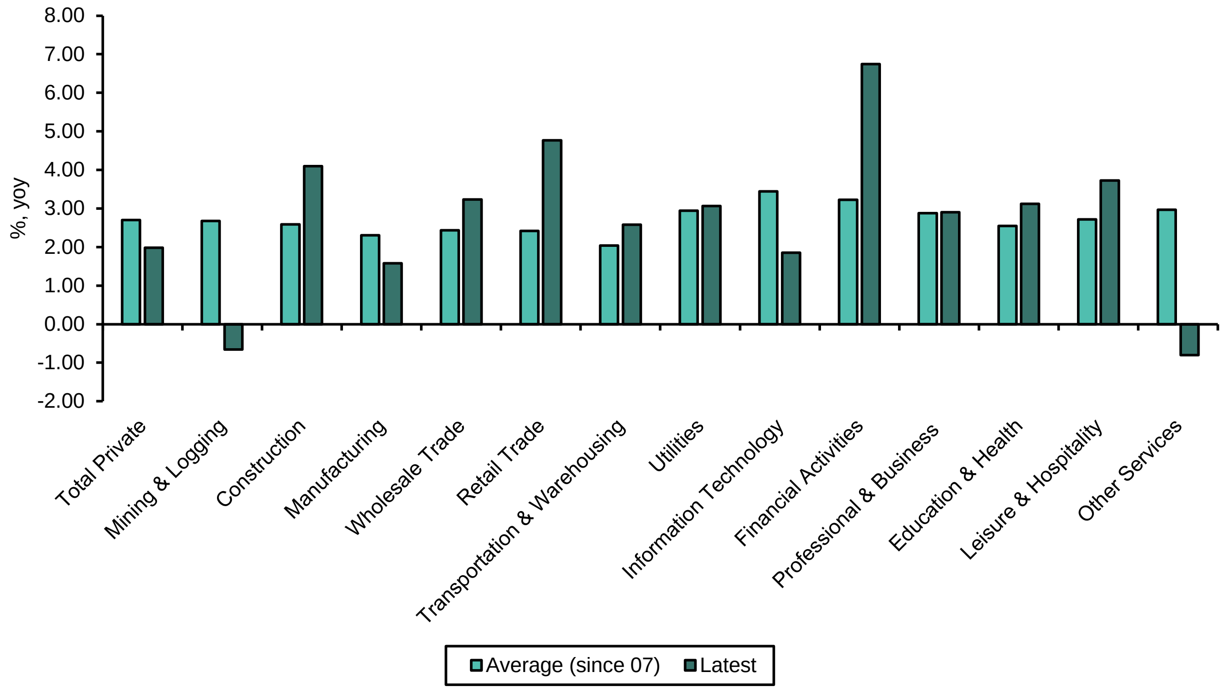
EXHIBIT 2: **US Total private hourly wage growth**



Source: BLS, Bernstein analysis

However, in certain parts of the economy, notably Leisure & Hospitality, Retail, Construction Wholesale Trade and Financial Activities wages are already growing faster than the average over the last 15 years, Exhibit 3.

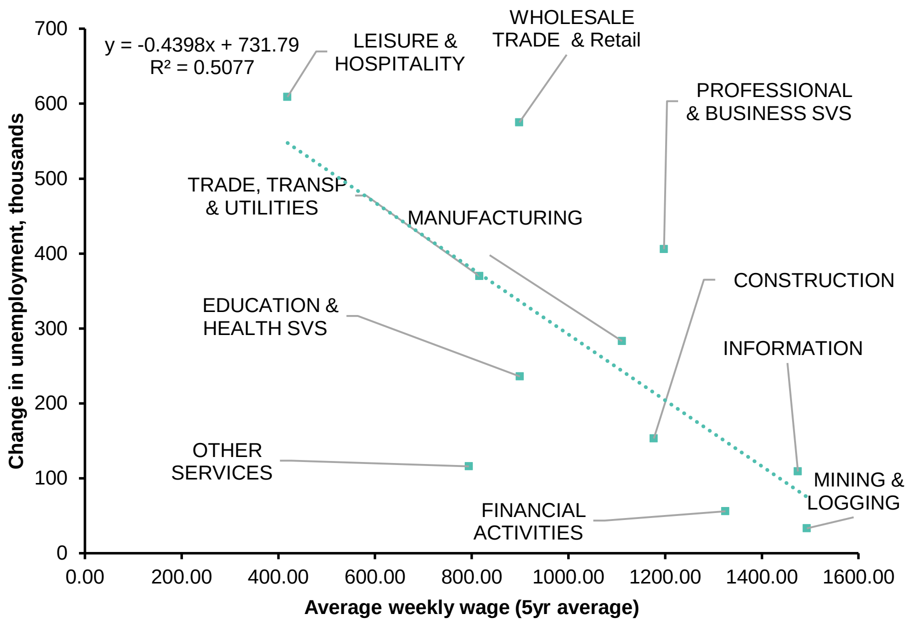
EXHIBIT 3: **US Hourly y-o-y wage growth by industry**



Source: BLS, Bernstein analysis

Recent trends suggest that there could be a K-shaped recovery in wages where the pandemic entrenches the winners and losers in terms of earning power. In Exhibit 4 we show that the majority of the job losses since the start of the pandemic have been concentrated in industries with earnings at the low range of the spectrum, meanwhile the employment levels in high wage industries are already close to those at the end of 2019. The effect on the overall aggregate wages is uncertain so far but we believe one long-term consequence of this could be that it accelerates a call of Universal Basic Income or similar legislation to support labour.

EXHIBIT 4: **Job losses since end 2019 vs average weekly wages**



Source: BLS, Bernstein analysis

As previously noted, the labour market picture is still distorted by various furlough and government support schemes for workers and businesses globally. As we show in Exhibit 5 the majority of the support measures are expected to be in place at least until September with some extending to the end of the year. Thus, until then it will be very hard to get a clear picture of the true extent of labour shortages and the potential impact on wages.

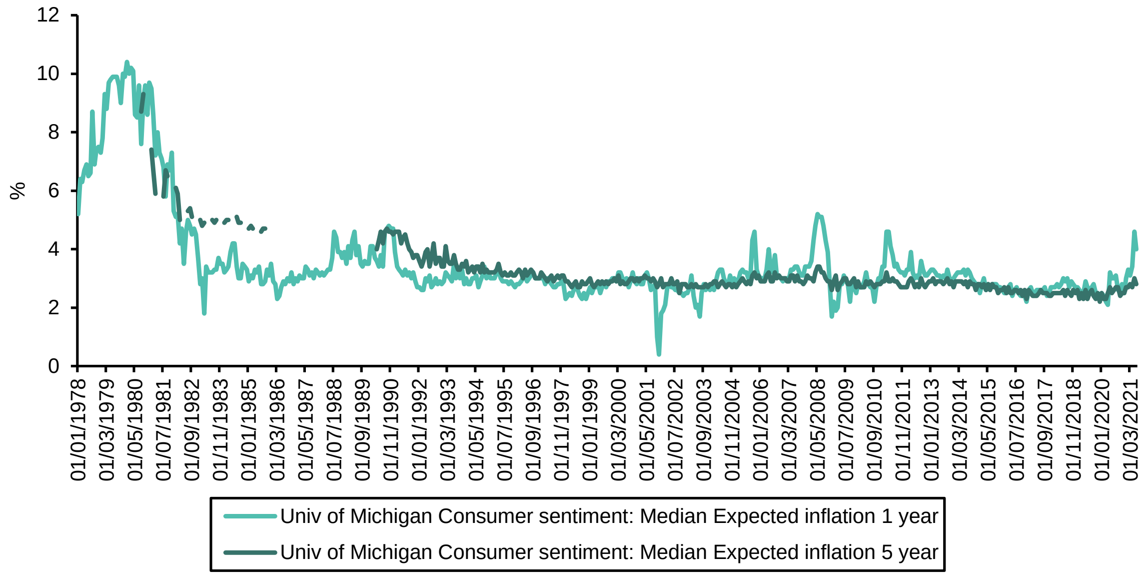
EXHIBIT 5: **Furlough and worker support schemes in the US and Europe**

Region	End date	Details
USA	Start of September 2021	Automatic, additional payments of $300 per week until September 6, 2021 to everyone qualified for unemployment benefits. An extension through September 6, 2021 for people already receiving unemployment benefits. Some states, such as Alaska and Iowa ended their schemes on 12th of June
UK	End of September 2021	
Germany	Up to March 2022	Max duration 2 years from Mar 2020
France	End of 2021	Up to 2 years from Mar 2020
Italy	End of 2021	Special furlough schemes only, ordinary schemes end in June 2021
Spain	End of September	

Source: www.usa.gov, www.bbc.com, www.theguardian.com, Bernstein analysis

For inflation to move from transitory to sticky, one of the key drivers would be if consumer inflation expectations became entrenched and in response workers would demand compensation for that in the form of higher wages via annual cost of living adjustments or wage escalation clauses. As we show in Exhibit 6 short-term consumer inflation expectations have increased materially since the start of the year from 2.5% to 4% currently. Meanwhile the long-term expectations have only risen from 2.2% to 2.8% and are currently below historic average of 3.2%. This supports the view that the most recent spike in prices is viewed as temporary and that so far there are few signs of inflation expectations becoming unanchored.

EXHIBIT 6: **Consumer inflation expectations**



Source: Datastream, Bernstein analysis

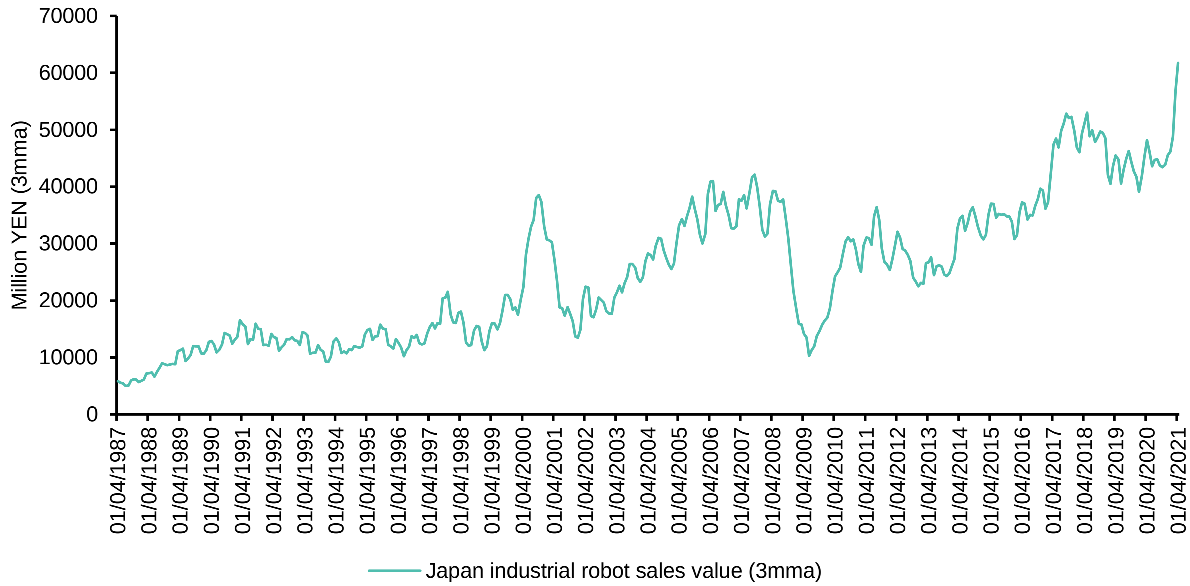
Automation

As the most immediate labour market dislocations abate, in the medium term we think that automation potential will be a crucial consideration in determining how much bargaining power will shift to labour and thus consequently how fast the wages can continue to grow. Recent research from the IMF suggests that past pandemics tended to accelerate automation, particularly when the health impacts were severe.[1] There are preliminary signs that the COVID pandemic is no exception and that it will accelerate the push for automation that was already evident in a number of industries prior to the pandemic.

One clear indication of this is the recent surge in Japanese industrial robot sales. As we show in Exhibit 7 the sales have accelerated sharply since the end of last year and currently are at an all-time high.

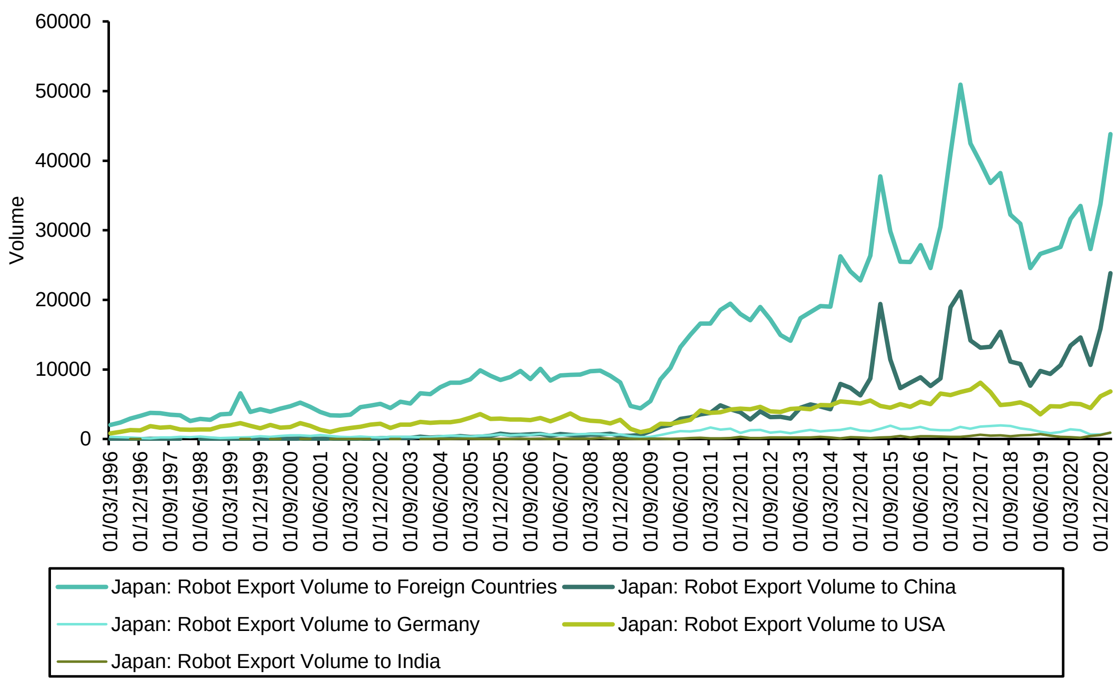
[1] https://www.imf.org/en/Publications/WP/Issues/2021/01/15/Pandemics-and-Automation-Will-the-Lost-Jobs-Come-Back-50000

EXHIBIT 7: **Japan industrial robot sales (3mma)**



Source: Datastream, Bernstein analysis

EXHIBIT 8: **Japan robot export volume**

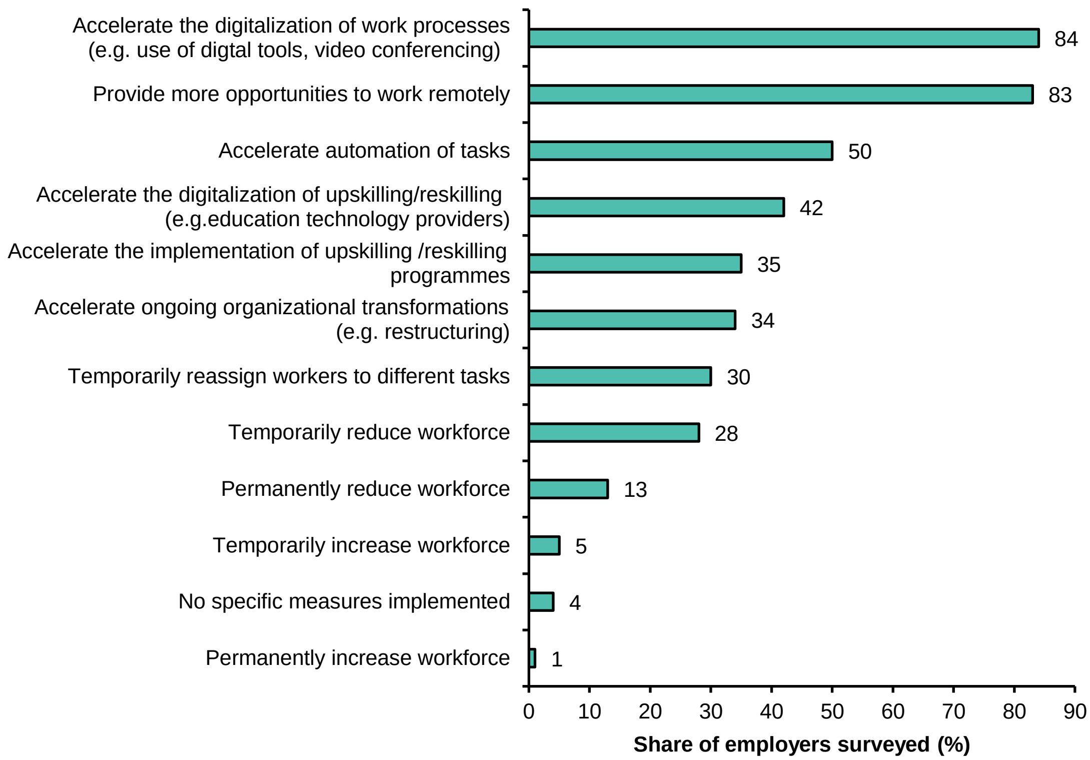


Source: Bloomberg, Japan Ministry of Finance, Bernstein analysis

A similar jump in orders can be seen in the US data. According to the US Association for Advanced Automation in Q1 2021 North American robot orders were up 20% compared with last year – the second-best start to any year on record.[2] Notably, in 2020 robot orders from non-automotive sectors have surpassed automotive robot orders for the first time, suggesting broadening appeal of automation for a range of industries and not simply a further acceleration of automation in industries where it is already high.

The Future of Jobs survey conducted by the World Economic Forum also supports the conclusion that the pandemic has accelerated the process of automation and restructuring of the workforce.[3] The survey notes that 50% of surveyed companies are planning to accelerate the automation of tasks and more than 80% are accelerating the digitization of work processes which should also lead to greater efficiency and a lower number of workers performing manual tasks. Moreover, 43% of respondents expect to reduce the current workforce due to technological integration of automation.

EXHIBIT 9: **Planned business adaptation in response to COVID-19**

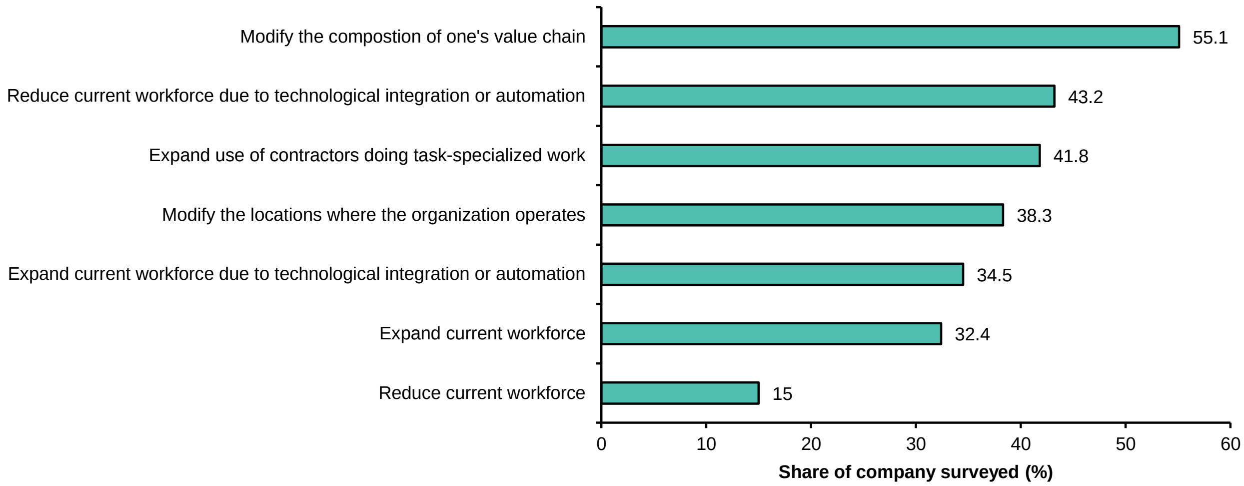


Source: Future of Jobs Survey 2020, *The Future of Jobs Report 2020*, World Economic Forum, October 2020, Bernstein analysis

[2] https://www.businesswire.com/news/home/20210506005239/en/Q1-Robot-Orders-Surge-20-Over-2020

[3] https://www.weforum.org/reports/the-future-of-jobs-report-2020

EXHIBIT 10: **Companies' expected changes to the workforce by 2025 (by share of companies surveyed)**



Source: Future of Jobs Survey 2020, *The Future of Jobs Report 2020*, World Economic Forum, October 2020, Bernstein analysis

Another recent study by Alex W. Chernoff and Casey Warman from the NBER assessed the industries most at risk of automation in response to COVID-19 and future pandemics.[4] They estimate that more than 11.5 million jobs have high viral transmission risk and have high automation potential. According to them the occupations most at risk are – retail sales, administrative roles, cashiers and personal care aides.

Demographics and legislation

We think that in the long run demographic forces will act against the deflationary impact of automation. As we have argued before[5] the favourable demographic tailwinds, such as the entry of China and the former Soviet bloc into the world economy and many women joining the job market, that have massively increased the size of the labour force over the last 40 years are about to go in reverse. Over the coming years, as the world population ages, the size of the labour force will decline. However, this process will be slow moving.

In addition, declining unionisation rates over the same period have also weakened bargaining power of the labour force. We expect this decline to slow or reverse and we also believe that future legislation will be increasingly supportive for workers' rights, such as initiatives to push back against the gig economy that we are seeing already, as well as legislation for higher minimum wage.

[4] Alex W. Chernoff and Casey Warman: COVID-19 and Implications for Automation. Accessible at: https://www.nber.org/system/files/working_papers/w27249/w27249.pdf

[5] Please see the chapter "Inflation, Demographics, Wages and the shape of investment portfolios" in Inflation and the Shape of Portfolios

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