A Franklin Templeton Company

AOR Update: Wage Moderation Allows Fed Patience

4 May 2024

Key Takeaways

- Slowing wage growth has helped improve the ClearBridge Recession Risk Dashboard's Wage Growth indicator to yellow and should allay fears of a wage-price spiral that could lead to further monetary tightening.
- The moderation in wage gains has achieved a "Goldilocks" zone supportive of a soft landing, with wages cooling to a level consistent with the Fed's 2% inflation target yet remaining strong enough to support robust consumer spending.
- While the recent uptick in inflation fears may take time to abate, we believe the improved outlook combined with the recent pullback in U.S. equities represents an opportunity for long-term investors.

Wage Growth No Longer Instigating Inflation

Renewed fears of sticky inflation pushed 10-year Treasury yields nearly 50 basis points higher and the S&P 500 Index 4.2% lower in April. However, wage data has continued to moderate in 2024 with average hourly earnings dipping to 3.9% in April, the coolest reading since mid-2021 and down substantially from a peak of 5.9% in early 2022. April's lower reading also brought the three-month annualised rate of change for average hourly earnings to just 2.8%, which suggests wage gains should moderate further in the coming months. With wages slowing to levels consistent with an eventual return to the Fed's 2% inflation target, policymakers do not appear to be in a rush to reverse course and hike interest rates, despite the recent resurgence of inflation fears.

With the pace of wage gains moderating, the Wage Growth indicator in the ClearBridge Recession Risk Dashboard has improved to a cautionary/yellow signal this month, from its previous recessionary/red reading. There are no other changes on the dashboard this month, and the overall signal remains yellow (Exhibit 1).

Historically, once the Wage Growth indicator has turned red once it has stayed through to a recession. However, an array of data suggests the current economic cycle is one of the most unique in modern history. Critically, the moderation in wage gains has reached a more sustainable pace broadly consistent with the Fed's 2% inflation target yet is still strong enough to support robust consumer spending. Wages reaching a "Goldilocks" zone that can support spending (and thus the continued economic expansion) without setting off a wage-price spiral which would spur a return to tighter monetary policy is critical because labour income is the primary source of spending for most Americans.

Exhibit 1: ClearBridge Recession Risk Dashboard

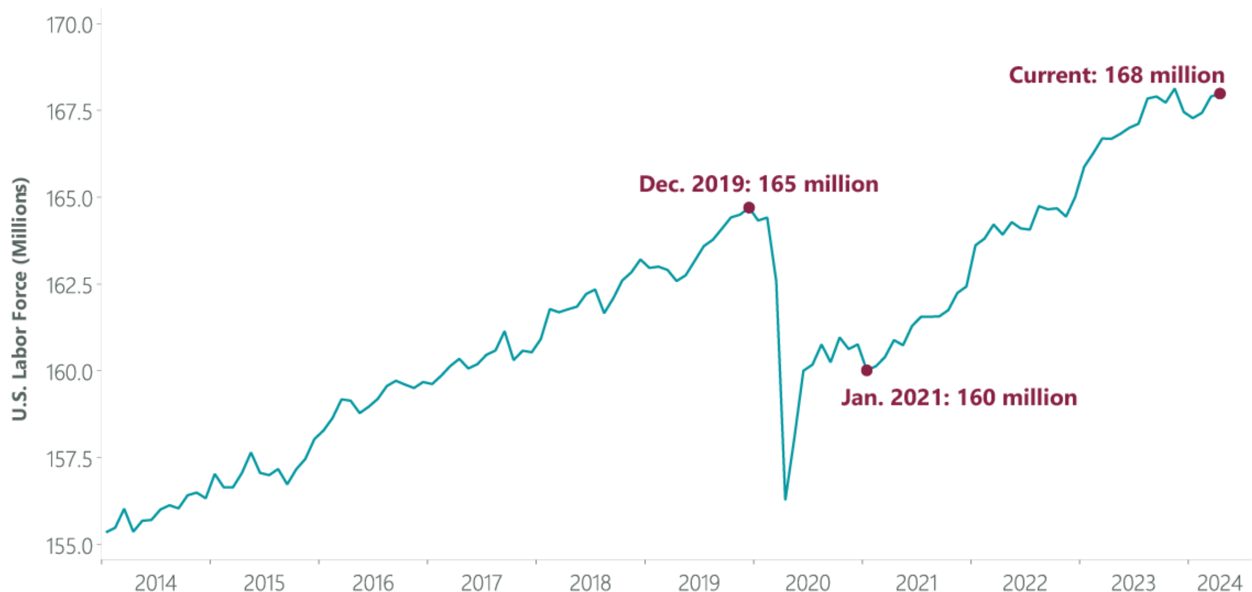
		April 30, 2024	December 31, 2023	September 30, 2023
Consumer	Housing Permits	●	✖	✖
	Job Sentiment	✖	✖	✖
	Jobless Claims	●	●	●
	Retail Sales	●	●	✖
	Wage Growth	●	✖	✖
Business Activity	Commodities	●	●	✖
	ISM New Orders	●	✖	✖
	Profit Margins	✖	✖	✖
	Truck Shipments	●	●	●
Financial	Credit Spreads	●	●	✖
	Money Supply	✖	✖	✖
	Yield Curve	✖	✖	✖
	Overall Signal	●	✖	✖

⬆ Expansion ● Caution ✖ Recession

Source: ClearBridge Investments.

The massive wage surge in 2021 was a part of the reason the Fed increased the federal funds rate so aggressively. However, the labour market today bears little resemblance to what was seen at that time. Back then, finding workers was one of the most challenging problems facing employers as the economy exited the pandemic. The labour force — those working or looking for work — in early 2021 was about 4.5 million workers smaller than it was pre-pandemic, even as job openings surged. With labour demand (job openings) exceeding labour supply, wages rose to restore balance. Higher incomes spurred workers to enter the labour force over the next three years, and today the labour force is more than 3 million workers larger than at the end of 2019.

Exhibit 2: Labour Force Has Recovered...And Then Some

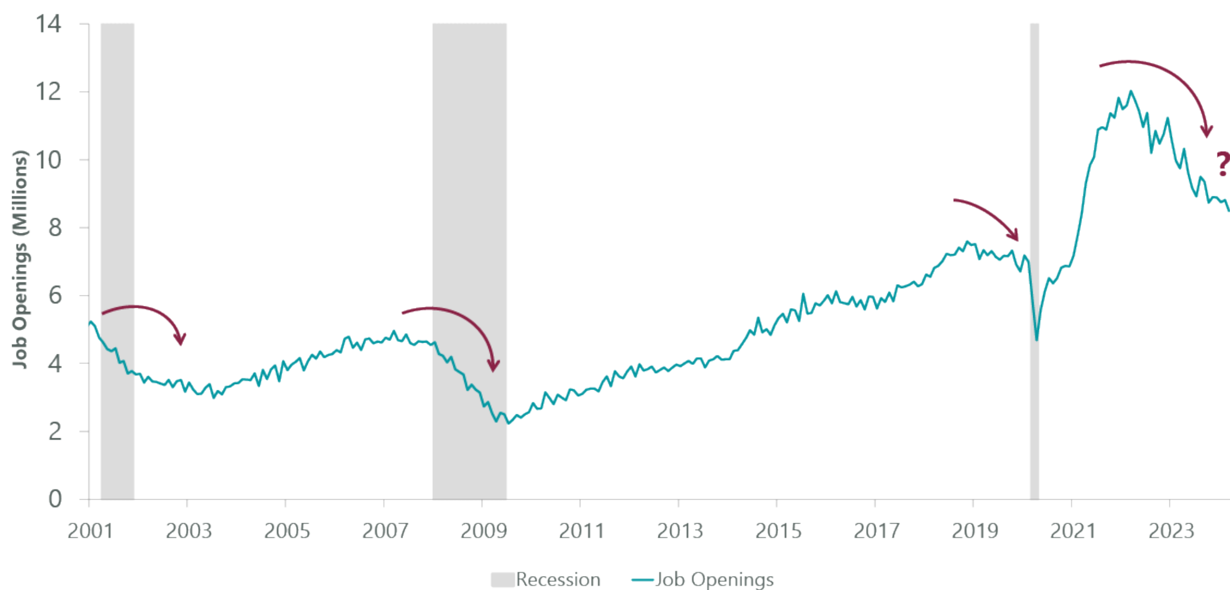


Data as of 3 May 2024. Source: BLS, Macrobond.

Labour supply also benefited in recent years from the pickup in immigration. While this topic can become politically polarising, it has important economic ramifications. The Congressional Budget Office recently revised its estimates of net immigration higher by 3.3 million individuals over the past two years, representing a large pool of additional potential workers. Further, the CBO expects an additional 4.4 million workers to arrive over the next three years relative to prior expectations, which should further add to the pool of potential workers and continue to put downward pressure on wage gains.

The labour market also changed on the demand side of the equation, helping bring the market into better balance. Job openings swelled in 2021 when workers were hard to find, rising by nearly 5.5 million from pre-pandemic levels. While some of this increase was likely double postings, it coincided with a period of robust hiring with 7.2 million jobs created in 2021 alone. However, the pace of hiring began to slow in 2022 and job openings began to decline. Although there are still 1.8 million more job openings today compared to the end of 2019, the number of job postings has fallen by 3.7 million from peak, a clear sign labour demand is softening but remains robust.

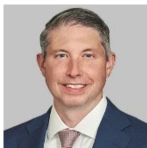
Exhibit 3: Softer Demand, Better Balance



Job openings data as of 31 March 2024. Sources: FactSet, BLS, St. Louis Fed, NBER.

With the labour market coming into better balance and wages falling to a level consistent with the Fed's 2% inflation target, the central bank can afford to remain patient even in the face of a series of unfavourable inflation releases so far in 2024. While historically uncommon outside of a recession, this rebalancing of the labour market is a welcome development that further boosts the already high likelihood of a soft landing. While the recent inflation resurgence may take time to abate — shelter inflation should become more favourable over the summer, for example — the improved outlook combined with the recent pullback in U.S. equities represents an opportunity for long-term investors. Given the S&P 500 has fallen less than 5% from its all-time high, we understand many investors may want to remain patient, waiting for a larger drawdown to materialise. However, positive inflation developments could spark a rally, meaning investors may want to consider using the recent weakness to build starter positions.

About the Authors



Jeffrey Schulze, CFA
Managing Director, Head of Economic and Market Strategy
- 19 years of investment industry experience
- Joined ClearBridge Investments in 2014
- BS in Finance from Rutgers University

Josh Jamner, CFA
Director, Investment Strategy Analyst
- 15 years of investment industry experience
- Joined ClearBridge Investments in 2017
- BA in Government from Colby College

ClearBridge Investments
ClearBridgeInvestments.com.au

Important Information

While the information contained in this document has been prepared with all reasonable care, ClearBridge* accepts no responsibility or liability for any errors, omissions or misstatements however caused. Any views expressed in this material are given as of the date of publication and such views are subject to change at any time. This material has been prepared for wholesale clients only, including investment professionals, qualified investors and investment advisors. This material is not suitable for retail investors and ClearBridge does not authorise the provision of this material to retail investors.

This information is not personal advice. It has been prepared without taking account of individual objectives, financial situations or needs. Where an investment product is mentioned, potential investors should seek independent advice as to the suitability of the product to their investment needs. Reference to shares in a particular company, is not a recommendation to buy, sell or hold that stock. Investors should be aware that past performance is not indicative of future performance.

This information may contain forecasts, including in regard to targets, expected returns, PE ratios and dividend yields. Any such statements are based upon research undertaken by the ClearBridge* investment teams. This research incorporates ClearBridge's reasonable assumptions and beliefs concerning future developments and their potential effect but are subject to risks and uncertainties that may be beyond our control. Returns can be volatile, reflecting rises and falls in the value of underlying investments. Accordingly, ClearBridge does not provide any assurance or guarantee that future developments will be aligned with our expectations, and actual results may differ materially from those expected or anticipated at the time of writing.

The distribution of this document may be restricted in your jurisdiction. This document does not constitute an offer or solicitation in any jurisdiction in which to make such an offer or solicitation would be unlawful. It is your responsibility to ensure that any such product, security, service or investment outlined is available in your jurisdiction.

Issued and approved in Australia by ClearBridge Investments Limited ("CIL"), registered office Level 13, 35 Clarence Street, Sydney, NSW 2000, Australia (ABN 84 119 339 052; AFSL 307727).

Issued and approved in Canada and the United States of America by CIL's subsidiary, ClearBridge Investments (North America) Pty Ltd ("CINA"), registered office Level 13, 35 Clarence Street, Sydney, NSW 2000, Australia (ABN 11 138 069 191).

Neither CIL nor CINA are registered as a broker-dealer. CIL and CINA are neither issuing nor offering the securities of any investment fund in these materials. This material has not been approved or verified by ASIC, the SEC, the OSC or the Autorité des marchés financiers.

ClearBridge is wholly, indirectly owned by Franklin Resources, Inc.

*ClearBridge consists of ClearBridge Investments, LLC. ("CBI") and its affiliated managers whose businesses have been operationally integrated with CBI's, including ClearBridge Investments Limited and its subsidiaries in Australia, and a part of Franklin Templeton Investments Corp. doing business as ClearBridge Investments in Canada.