SPECTRA MARKETS

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am FX

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A hard hat, claimed by goose barnacles

Current Views

Flat

Phillips vs. “Phillips”

There were audible screams of pain yesterday as the turn in AUD, SPX and everything else caught the market offside. The drop in GBP is also annoying many as this is a move that has been long-awaited but never arriving. Until today. And CAD, a market favorite, has been decimated despite more hawkish noise from The North. I am stopped out of the AUD and will start with a fresh slate next week.

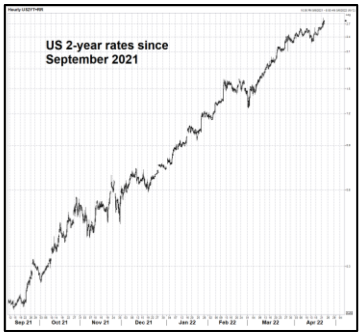
France

The French election is Sunday. Marine Le Pen is trading around 19:1 on Betfair right now, pretty much the longest odds she’s seen throughout the cycle.

			Back all	Lay all		
Emmanuel Macron	1.03 $120942	1.04 $129435	1.05 $50725	1.06 $37650	1.07 $49591	1.08 $39338
Marine Le Pen	17 $538	18 $3897	18.5 $46	19.5 $489	20 $153	27 $344

Therefore, I would think that a Macron victory barely registers in the EURUSD market, especially as the gap after Macron’s Round 1 win got smacked down. If EURUSD opens more than 15 pips higher than today’s close, I will be surprised.

Twos

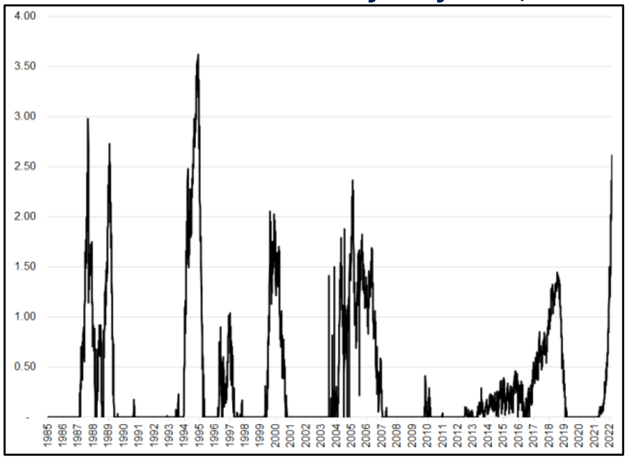


That chart of twos, at right, is one Dennis Gartman would say “goes from lower left to upper right”.

For perspective, the next chart, below, shows the YoY change in US 2-year rates back to 1985. I filtered so it only shows rising rate regimes, just because the chart looks nicer and it’s easier to compare prior tightening cycles.

The most amazing part of this chart is that the huge rip in 2-year yields in 1994 did not lead to a US slowdown or recession. The second amazing thing is that this move in twos is now faster the one in 1999.

Magnitude of YoY rises in US 2-year yields, 1985 to now



In defense of W.A. Phillips

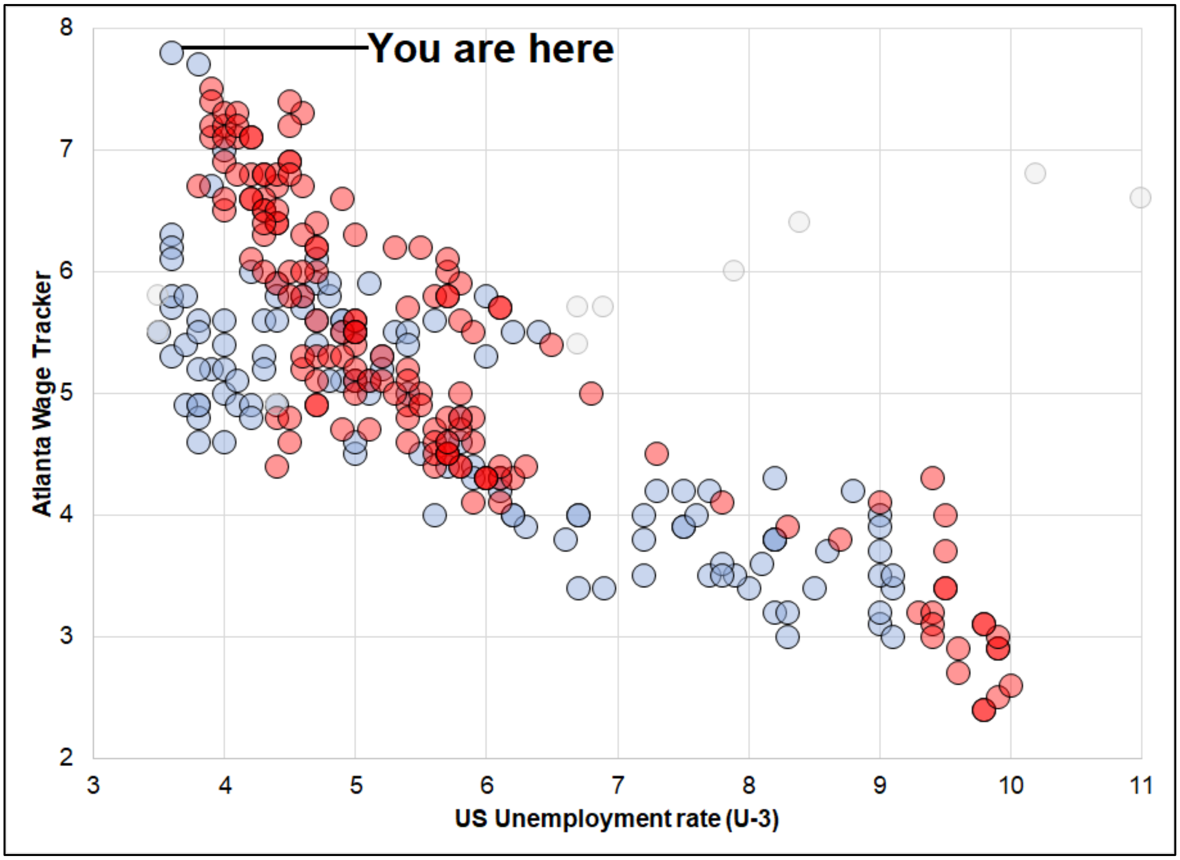
In his classic 1958 paper, William Phillips proposed a "Relation Between Unemployment and the Rate of Change of Money Wage Rates." His hypothesis was:

> When the demand for a commodity or service is high relatively to the supply of it we expect the price to rise, the rate of rise being greater the greater the excess demand. Conversely when the demand is low relatively to the supply we expect the price to fall, the rate of fall being greater the greater the deficiency of demand. It seems plausible that this principle should operate as one of the factors determining the rate of change of money wage rates, which are the price of labour services. When the demand for labour is high and there are very few unemployed we should expect employers to bid wage rates up quite rapidly, each firm and each industry being continually tempted to offer a little above the prevailing rates to attract the most suitable labour from other firms and industries. On the other hand it appears that workers are reluctant to offer their services at less than the prevailing rates when the demand for labour is low and unemployment is high so that wage rates fall only very slowly. The relation between unemployment and the rate of change of wage rates is therefore likely to be highly non-linear.

Phillips argues specifically ***against*** comparing wages to broader inflation in his paper, but for whatever reason, Paul Samuelson and Robert Solow coined the "Phillips Curve" as the plot of price inflation (not wage inflation) vs. unemployment. Since then, the tool has been misidentified and if you see a plot of CPI vs. UR and a headline: "The Phillips Curve is dead!" … You might be convinced! But here's the actual Phillips Curve as posited by William Phillips, not the "Phillips Curve":

Wages vs. unemployment (United States)

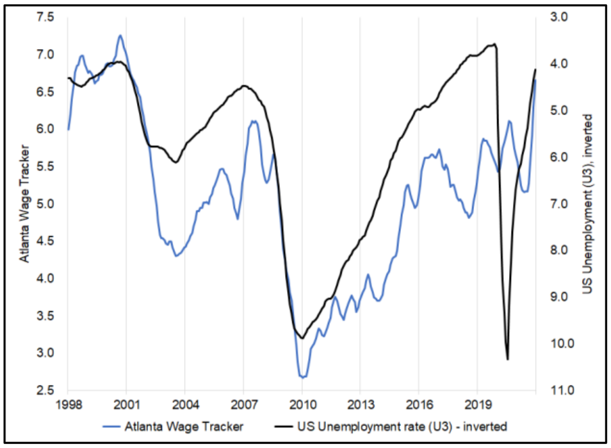
Blue dots are 2010 to now, red dots are 1998 to 2010, gray dots are 2020



It has held up well since 1998, through two completely different monetary policy regimes. The issue is that the transmission from wage growth to CPI is not stable. So, to assume the jump from Original Phillips Curve (wages vs. UR) to Popularly-Known "Phillips Curve" (CPI or PCE vs. UR) is wrong. Sometimes wage growth is correlated to broader inflation, and sometimes it's not.

Same data served another way:

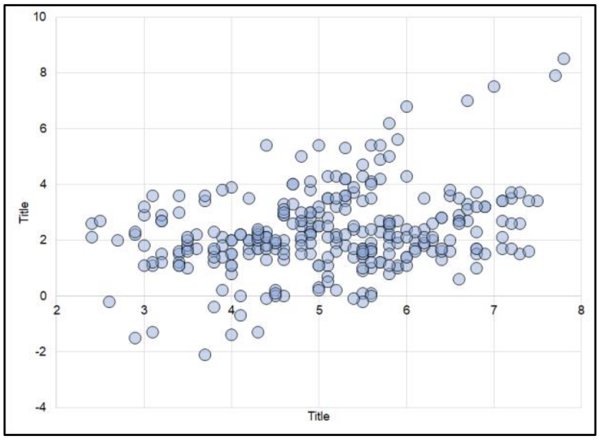
United States: Wages vs. Unemployment (inverted)



Methodology note: The relationship between wages and unemployment is thought to operate with a lag. Phillips used a 7-month lag in his paper. I tried various lags and they don't really change the overall look or slope of the chart, so for simplicity's sake, I used no lags.

So long story short is: The Phillips Curve is alive and well in the United States. What is not clear is the relationship between wage growth and broad inflation. That lack of correlation is visible here:

There has not been a reliable relationship between wages and inflation since 1998



You can color the dots by regime like I did on page 1, and it doesn't change the noisy conclusion

While there are other factors beyond labor market slack that impact the level and direction of wages, the strong relationship posited by Phillips in 1958 remains a pretty good lens through which to look at the US labor market. Criticism of the Phillips Curve as a policy tool makes sense if you use "Phillips Curve" as it's used in popular (but altered from original form) discussions. The tradeoff between jobs and broad inflation is not always clear. But tighter labor markets DO lead to higher wages.

That's all Bill Phillips ever said.

Have an arcade-style weekend.

good luck ⇅ be nimble

A Chuck E. Cheese animatronic abandoned in a landfill

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