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Getting Back to Work

Published on: 3 November, 2017 | Author: Investment Team

One of the drivers behind Keyne's monumental "General Theory of Employment. Interest and Money" was his incomprehension at the failure of the economy to provide work for the many idle hands of the time who wanted to find work. There was, after all, no shortage of work to do.

Amongst many other things, the book is an attempt to understand unemployment. There is a whole school built around the "Lump of labour fallacy" but in the end, the economy is no more or no less than the product of the individuals in it.

In the circular flow, your spending is my income. Unemployment is thus doubly wasteful; it deprives the economy of spending and it draws funds from the public purse. The biggest waste of all is the loss of skill, dignity and purpose that comes from well rewarded work.

Interestingly, the employment picture around the developed world is steadily improving. In the UK, the ONS (Office for National Statistics) published figures last week that put UK unemployment at 4.3%, the lowest rate since April 1975.

Economists are busily puzzling their heads over this since the NAIRU (the non-accelerating rate of unemployment) was supposed to be north of 5% but there is no sign of a wage-price spiral that such a low rate of unemployment would have hitherto implied. The NAIRU appears to have shifted down a notch or two.

In the US, the comparable figure is 4.2% and in Germany 3.6%. The aggregate European number is 8.9% pushed up by Greece at 21% and Spain at 16.7% but even these two numbers, though large, are massive improvements on readings taken just after the global crisis.

People are getting back to work.

The missing ingredient, as we have mentioned before, is wage growth. Conventional models would imply upward pressure on wages but, to date, this is largely absent and is almost certainly an under-appreciated factor in recent political unrest from Brexit through Catalonia to Trump.

Nonetheless, the NAIRU is unlikely to be zero and higher employment will eventually raise wages. In a world economy that is still short of demand and which is still prone to goods price deflation, falling unemployment is a welcome sign; potentially raising incomes, aggregate spending and tax revenues.

Those of us brought up in the seventies lived in a world constrained by available supply. We live in a different place today; one where low incomes are supplemented by debt to maintain spending in a world of abundant supply.

The implication of falling unemployment, for investors, is that there are still legs in this recovery.

We would look for a near-term uptick in wages to validate that view.

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