Strike Price

- We explore the risk of a further rise in oil prices after the terror attack against Israel
- Strikes have hit their highest level in 20 years in the US. We look at real wages to gauge the risk of an inflationary catch-up in pay. The UAW strike is also illustrative of the challenges of re-industrialising amid an energy transition

The disappointing inflation print for September in the US may not be too alarming. It could be mere mean reversion after a "too good" August print. Yet, we cannot exclude that a line of resistance is emerging, under a "pincer movement" from higher oil prices combined with a still tense labour market generating persistent wage pressure.

The tragedy in Israel has raised the risk that oil prices rise further. The market reaction has been measured so far, as the lack of unity of the Arab world – a difference with the 1970s – limits the ramifications through OPEC. It is a very volatile situation though as the market ponders the effect of the likely ground operation by Israeli forces in Gaza. The capacity of the US to control the escalation is going to be crucial, but that is what Joe Biden is clearly attempting.

When it comes to endogenous inflationary forces in the US, the intensification of strikes calls for attention. A key issue though is to determine whether there is still a significant real wage gap in the US which could unleash a catch-up ahead. Average wages deflated by headline inflation have been marginally exceeding their pre-Covid level since the end of last year. Non-supervisory and production workers have seen more substantial gains, and after three years of gyrations their real wage is today roughly where it should be when prolonging the trend observed between the end of the GFC and Covid. This should bring a measure of reassurance on the capacity to tame inflation.

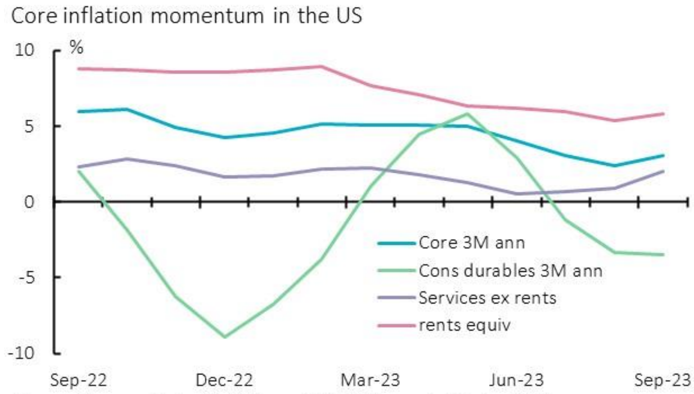
The interest in the strike in the auto sector goes beyond the inflation issue. Indeed, we think it illustrates very well the challenges of reindustrialisation in a context of energy transition. Still, at least the US has stopped the decline in manufacturing jobs – even before IRA. This helps with the social difficulties of sectorial reallocation. People working in manufacturing may not always be able to keep their current job, but they have a higher chance to find a similar job than during the big industrial contraction of the 1990s/2000s.

Setback on US inflation

Last week pressure had abated on the bond market, US 10-year yields moving away from the psychological 5% limit. Last Monday, a speech by Dallas Fed President Lori Logan echoing similar signals sent by Mary Daly and Raphael Bostic made it clear the Federal Reserve (Fed) would take the recent market movements in consideration for calibrating its stance. She explicitly stated that elevated long-term yields could mean the central bank would have to do less on policy rates. Yet, **the nice return to the 4.5% mark – which was in sight by mid-week – was stopped in its track by the US inflation print for September**. Headline consumer prices rose by 3.7%yoy, unchanged from August, against a market expectation of 3.6%. Core inflation duly decelerated, from 4.3%yoy to 4.1% to reach the slowest pace since September 2021, but the details of the release were not completely reassuring.

On a 3-month annualised basis, core re-accelerated, from 2.4% to 3.1% (see Exhibit 1), despite the continuation of a decline in non-energy industrial prices. Rents rebounded marginally, but what the Federal Reserve will not like is that services *excluding* rents also reaccelerated. There was always the risk that while exogenous forces would help bring overall price growth to a less heady pace, a too-resilient economy would create a line of resistance above the Fed's target, and this is what might be materialising in the most recent data. There is no cause for alarm yet: the August print – already in line with the Fed's definition of price stability, well ahead of what the central bank is forecasting - was a bit too good to be sustained and it is perfectly plausible that September saw some innocuous mean-reversion. Taken in isolation the inflation print is not in our view enough to discredit the hypothesis that the monetary tightening has peaked in the United States (US) last July, but another release of that ilk would probably test the patience of the Federal Open Market Committee (FOMC).

Exhibit 1 – Some concerning developments



Source: Bureau of Labor Statistics and AXA IM Research, October 2023

In their influential paper on the roots of the ongoing inflation shock in the US, Ben Bernanke and Olivier Blanchard provided convincing econometric evidence that the "exogenous channel" – energy prices and supply-side disruptions – initially played a bigger role than endogenous excess demand factors – reflected in the tension on the labour market. Yet, in a second phase of the inflation shock, the behaviour of the labour market becomes key. **While we believe a further spike in oil prices is not certain, its probability has risen, heralding the return of exogenous inflationary forces, while labour market tension has not resolved**. A pincer move lifting inflation again – or least producing a line of resistance – thus needs to be explored.

Measured oil market reaction … so far

The oil market reaction to the tragedy in Israel has been limited so far, Brent remaining below its recent peak of USD98/bbl. The main factor behind this is probably the fact that while it is tempting to draw parallels with 1973**, the Arab world is now far less united, which should limit the ramifications at the Organization of the Petroleum Exporting**

Countries (OPEC) level. Hamas probably launched the terror attack to try to scupper a rapprochement between Saudi Arabia and Israel mediated by the US. Frequent noises around a broad pact had emerged in the summer, centred around some concessions to Palestinians in the West Bank, with as an incentive to Riyadh the perspective of a proper security treaty with the US guaranteeing direct support in case of aggression (most probably from Iran). Without elaborating on content, Mohammed Bin Salman said in an interview on 20 September on Fox News that "*everyday we get closer [to a deal with Israel] …and this would be the biggest historical deal since the cold war".* Given the likely reaction of domestic public opinion to Israel's response to the attack, Riyadh will likely put the rapprochement with Israel on pause – this was hinted at by a Saudi official quoted by Agence France Press on Sunday - but such suspension would not necessarily scupper the deal entirely.

It remains a very volatile situation though and the oil market was under some tentative pressure over the weekend, Brent hitting USD90/bbl on Sunday from USD85/bbl on Thursday. At a meeting with his Chinese counterpart, Saudi Foreign Minister stated yesterday that the Kingdom *"condemns all attacks on civilians and opposes Israel's forcible relocation of Gaza residents outside the region*". If Israel's likely ground military intervention in the Gaza strips turns into a protracted operation, we cannot discard the risk public opinion pressure in Saudi Arabia and the United Arab Emirates (UAE) becomes unbearable, forcing some action on oil. Besides, Iran still has the possibility to blockade the Strait of Hormuz, which would then trigger a massive blow to the oil market. Yet, for Iran this would be a self-defeating move, which would strip them of crucial income at a time when their internal political and economic situation is fragile.

So, what to monitor carefully? Probably the US handling of the situation. While Joe Biden has been very clear that he supports an Israeli military reaction, his administration will probably try to make sure a protracted ground operation in the Gaza strip is avoided, and that any retaliations on Iran or against its proxy in Lebanon Hezbollah are also measured. The speech by US Secretary of Defence Lloyd Austin while in Israel last Friday would support this view (e.g., his point on *"this is a time for resolve, not revenge"*). Washington also made it plain on Sunday that they had reached out to Iran by "back channels" to warn the country against escalating the conflict.

As a collateral point, **there is a strong case to speed up financial aid to Egypt**, which is battling a protracted economic and financial crisis, to avoid contagion there and reduce the security pressure on civilians in the Gaza strip by allowing more refugees to cross the border. Releasing the loan disbursements currently held by the International Monetary Fund (IMF) in the latest programme would help, but Washington's capacity to provide unilateral financial support is curtailed. Indeed, this is an area where the US fiscal paralysis triggered by the incapacity of the Republican caucus in the House to unite can be problematic. Last month Joe Biden allowed the full disbursement of military aid to Egypt (USD235mn could have been withheld on the ground of human right violations) but the executive branch has exhausted what had been endorsed by Congress.

US strikes and wage catch-up

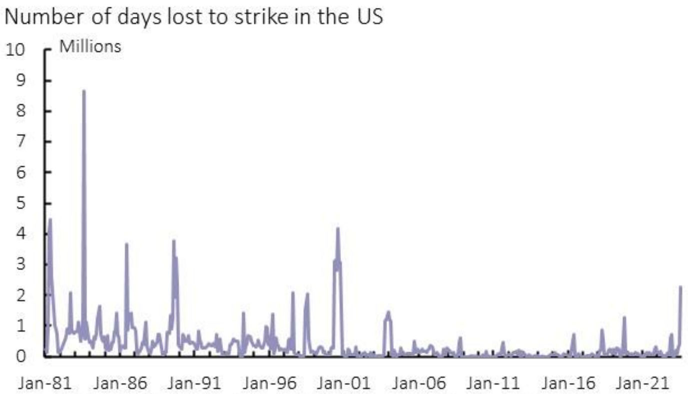
Higher oil prices are thus a heightened risk for inflation landing in the US, but endogenous issues have not disappeared, far from it. Labour market tension is usually monitored in the US with indicators of staff turnover such as the quits rate of the vacancy ratio, but **the number of working days lost to strikes, although at first glance "old fashioned", can also be informative. According to the data from the Bureau of Labor Statistics, it has reached in September its highest level in more than 20 years** (see Exhibit 2). We have alluded several times already in Macrocast to the United Auto Workers action. It is certainly the most spectacular – especially given the involvement of the two likely contenders of the presidential elections next year – but it is not an isolated event, and it goes beyond the usual industrial base of the labour movement. For instance, a large company operating in healthcare – Kaiser Permanente, which employs more than 200K persons in the US – has just found an agreement with the unions on a new contract entailing a pay rise of 21% over 4 years after three days of strike.

True, a high number of strikes does not necessarily conclude in a significant acceleration in wages. Strikes were even more frequent in the early 1980s and that did not stop the historic wave of disinflation at the time. However, cyclical, and structural conditions were different. Mass unemployment was rife in the early 1980s. But precisely, the Fed had to trigger a significant economic slowdown to break the price-wage spiral which contributed, down the line, to the anchoring of wage moderation for the following two decades.

A key feature in Bernanke and Blanchard's approach was to check for "catch-up effects", i.e., whether employees would try to be compensated for their purchasing power loss triggered by the unexpected movements in consumer prices. They found no evidence of such pattern in their wage model estimated over 1990-2019, and the absence of conspicuous residuals when using their model to fit the post-Covid period would suggest that, despite the size of the purchasing power gyrations since the pandemic, no such behaviour has yet emerged. This would be reassuring, but catching up with past inflation is what unions are currently focusing on.

A key source of uncertainty when thinking about "catch-up" is that **there is no obvious way to know what is the "fair" purchasing power level which workers expect**. In Exhibit 3, we first calculated the real wage using the payroll data (average earnings). We have focused here on pay per hour, but we have checked – using weekly pay data – that changes in working time, across the whole period, did not change the picture. The significant rise of first phase of the pandemic is probably largely forgotten now, but Covid initially triggered a bout of deflation (in May 2020 headline consumer prices were 1.7% lower than in December 2019 in seasonally adjusted terms) while wage growth initially maintained its pre-Covid trend at about 3% annualized. Real wages then started falling as inflation was raging as the economy re-opened, before recovering more recently as nominal wage growth accelerated amid declining headline inflation. **Since the end of 2022, real wages have been marginally exceeding their pre-covid level for the "all employees" measure**. Non-supervisory and production workers find themselves in a better position, with gains of c.2% relative to December 2019, as they benefited from faster gains than those towards the upper end of the income ladder, probably because labour shortages have been particularly acute in industries, such as hospitality, where lower-pay workers dominate.

Exhibit 2 – Highest strike activity in the century



Source: Bureau of Labor Statistics and AXA IM Research, October 2023

Exhibit 3 – Is there a need for real wages catch-up?

Source: Bureau of Labor Statistics and AXA IM Research, October 2023

Yet, we cannot discard the possibility that being "made good" on their pre-Covid real wage level would be considered as enough by workers. Indeed, employees may operate under the belief that their real wage should move up on trend rather than merely stagnating. There have been fairly long periods of stagnation, for instance during the Great Financial Crisis (GFC) and its aftermaths (three years between 2009 and 2012) but in general real wages move up, ultimately to catch up with productivity. We have complemented Exhibit 3 by calculating where the real wage should be in September 2023 if it had grown in line with the fairly steady 2012-2019 trend (0.9% per annum). In this case, a significant gap appears for the average earnings of the whole population of employees…but not for non-supervisory and production workers. **In a nutshell, there is no glaring case right now but a steep catch-up in pay in the US, at least**

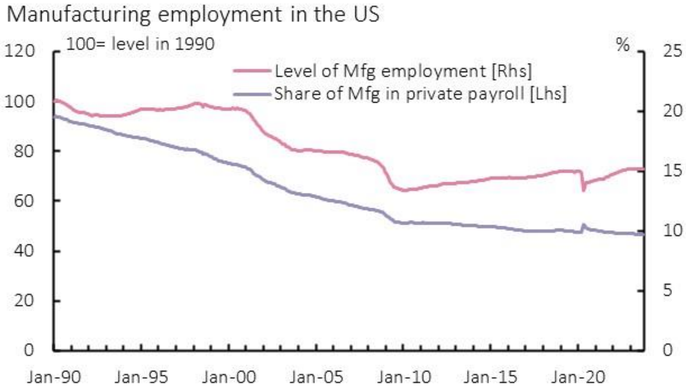
for the blue collars who tend to fill the unions' ranks. This reduces the risk of a major wage drift in the 2024-2025, but of course the accumulation of generous multi-year contracts calls for prudence.

US manufacturing revival

Beyond the inflation issue, the United Auto Workers (UAW) strike deserves a lot of attention since it sheds an interesting light on the main challenges facing manufacturing in the US, as well as some potential internal contradictions in the policies currently in favour in Washington DC.

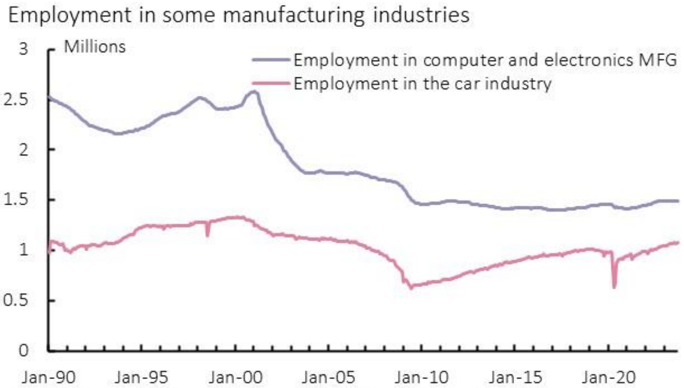
Reports on the "death of manufacturing" abound in the US, but hard statistical facts suggest that **even before the implementation of re-shoring policies under Trump and more decisively Biden, the decline in manufacturing jobs had stopped**. If one excludes the "blip" at the beginning of the pandemic, the trough in manufacturing jobs was hit in early March 2010 at 11.45 million. It stood at just over 13mn in September 2023 (+13.6%). While the commentariat was obsessing on the death of manufacturing, more than one million and a half new jobs were quietly created in this sector. True, as a share of total employees, manufacturing jobs continued to erode somewhat after 2010, but the pace of relative decline was a fraction of what it was during the previous two decades (see Exhibit 4). Such resilience was not the product of a massive migration from "old economy" to "new economy" industrial jobs. Quite the opposite. In Exhibit 5, we looked at the number of employees in the computer (hardware) and electronic components industries: it fell quite steeply roughly at the same time as the "dot com" bubble burst and never recovered. Even if employment in this sector has stabilised over the last 10 years, there is no tangible sign of re-shoring so far. Conversely, **the car industry has been steadily re-creating jobs, and their level in September 2023 was at its highest since 2006.**

Exhibit 4 – Manufacturing jobs decline arrested



Source: Bureau of Labor Statistics and AXA IM Research, October 2023

Exhibit 5 – Employment in the car industry rebounded



Source: Bureau of Labor Statistics and AXA IM Research, October 2023

It's however interesting to look at where these seemingly "old economy" jobs have been created: mostly in Southern states and in California, thanks to the push from overseas carmakers and the emergence of domestic disruptors such as Tesla. Southern states' legislation is less favourable to unions – and Tesla is famously a union-free company. It is in this context that the UAW strike can be better understood. They are seeking a massive pay rise, 36% over 4 years, with a first instalment of 18% – together with a steep reduction in working time (32 hours per week, paid 40), and a restoration of former rights on pension and healthcare employees had to forgo during the last crisis of the car industry. **The UAW strategy is to win an appealing contract from the traditional automakers to incentivise workers in the Southern states and in the disruptors to join the union**, which would have the benefit from their point of view of creating a more level-playing field between the "Detroit three" and their main competitors in the run-up to the conversion to electric cars. Understandably, employers at the "Detroit three" are unconvinced. The rise in their labour costs – which are already higher than in most foreign car makers operating in the US, and at Tesla – would be a certainty if they yield to the UAW demands, while the creation of a "level-playing field" would be only a possibility (Tesla so far has managed to repel three attempts by UAW to unionize its staff).

Why are we dedicating so many words to an issue which may not necessarily seem crucial to our esteemed readers? Because all this illustrates well some of the challenges of re-industrialisation.

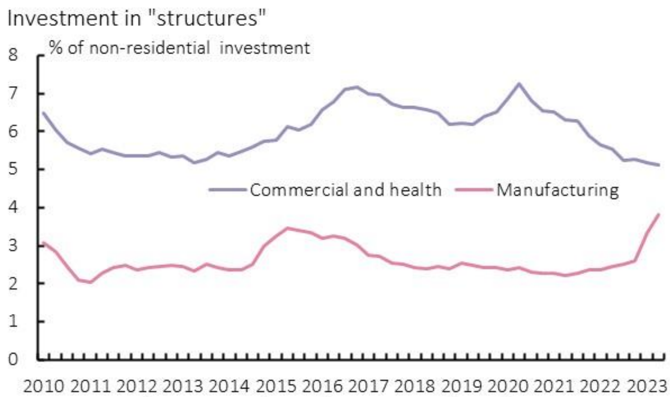
Joe Biden is explicitly siding with UAW, but he failed to pass in the Inflation Reduction Act (IRA) package a piece of legislation which would have made it difficult to non-unionised companies to benefit from all the tax credits available to those embracing the electrification shift (this was opposed by West Virginia Senator Manchin). The positioning of Biden's opponent is not necessarily more comfortable. By expressing his opposition to the shift to electric vehicles, Trump may curry favour with some of the UAW base – which matters to win Michigan next year (he lost there in 2020 after carrying the state in 2016) – but at the same time he can alienate the workers who are already operating in the Electric Vehicles (EV) sector – some of those employed by the "Detroit three".

More fundamentally, what is at stake here is how to pay for the energy transition. Quite understandably, unions are seeking to maximise the benefits for their members – they constantly refer to the bumper profits of the car industry. Meanwhile, consumers' focus is the affordability of the electric cars – which runs counter the unions' interests. The usual way to deal with this conflict is to turn to another stakeholder: the government. Beyond artificially reducing the price of EVs, it could also take charge of the re-training of existing workers hit by the changes – EVs require a much smaller workforce. Yet, as we have been discussing quite often in Macrocast, the financial capacity of the United States' government is currently not necessarily at its peak…

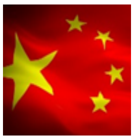
In any case, what is positive is that **the revival of manufacturing in the US makes the social equation less difficult to solve**. Skills are probably more easily transferable from one industrial job to another than from manufacturing to services. Workers currently employed in industry may not have the guarantee their *curren*t job will not be affected, but they now have a more decent chance of finding a *similar* job than in the 1990s.

We made the point that the rebound in manufacturing jobs pre-dates the IRA, but there is now growing evidence that the IRA is magnifying the trend. In Exhibit 6, we looked at investment in "structures" in the US national accounts (in constant dollars). Flows of capex in manufacturing projects – in clear, in plants – have accelerated notably over the last two quarters, closing the gap with commercial and health (in clear, shopping malls and hospitals). While it is an illusion to believe the transition will be a "walk in the park", as the UAW strike suggests, at least the US is giving itself good chances to achieve it.

Exhibit 6 – Capital coming to the rescue



Source: Bureau of Economic Analysis and AXA IM Research, October 2023

Country/Region	What we focused on last week	What we will focus on in next weeks
	• CPI inflation (Sep) stable at 3.7%, core 4.1% (from 4.3%), core services ex-shelter firmer • FOMC minutes (Sep) majority saw another rise. New Fed speak questioned need amidst higher yields • PPI inflation (Sep) +0.2ppt mom to 2.2% (2.7% core) • Senator Scalise drops out of speaker race with only slim majority win. No clear path from here	• Retail sales (Sep) expected to drop in real terms ex auto & gas. Starting to suggest consumer softening • Empire and Philly Fed surveys (Oct), volatile month to month, both watched for direction in mfg • Fed's Beige Book (Oct) • Existing home sales (Sep) further falls expected • Housing starts (Sep) rebound from 11.3% drop last
	• Euro area industrial production (Aug) came at +0.6%mom, boosted durable good production (+1.2%). Ger data fell again (-0.2%mom after -0.6% in Jul) • Discussion have flourished over balance sheet reduction with debate around remuneration of mandatory reserves and PEPP future. TPI is also coming back on the scene after BTP-Bund spread crossed 200bps	• Final HICPs (Sep) • Business climate in France and ZEW in Germany (Oct)
	• GDP (Aug) rose 0.2%mom in line with expectations supported by unwind in strike impact in services • BRC shop price falls to 6.2% lowest level in one year • RICS survey points to continued housing market strains; rising rents and falling house prices	• CPI inflation (Sep) expected to continue its decline to 6.5% (cons) • Labour market data (Aug/Sep) to be watched closely for signs of wage moderation • Retail sales (Sep) • GfK cons conf (Oct)
	• Current account balance (Aug) surplus triples to ¥2.28 trillion • Economy Watchers Survey (Sep) Current conditions DI came in at 49.9 (down 3.7 m-m) • Core machinery orders (Aug) down 0.5%mom, below expectation	• Trade balance (Sep) deficit expected to continue to narrow • CPI (Sep) expected 2.7%
	• CPI (Sep): 0.0%yoy, 0.2%mom; (Aug: 0.1%yoy, 0.3%mom) • PPI (Sep): -2.5%yoy (Aug: -3.0%) • Exports (Sep): -6.2%yoy (Aug: -8.8%) • Imports (Sep): -6.2%yoy (Aug: -7.3%) • TSF (Sep): 4.12tn RMB (Aug: 3.12tn) • New yuan loans (Sep): 2.31tn RMB (Aug: 1.36tn) • M2 supply (Sep): 10.3%yoy (Aug: 10.6%)	• Wed (18 Oct): GDP (Q3), Fixed asset investment (Sep), Industrial production (Sep), Retail sales (Sep) • Thu (19 Oct): Housing prices (Sep) • Fri (20 Oct): LPR 1Y and 5Y (Oct)
	• Sep inflation (yoy) declined in Czechia (6.9%), Hungary (12.2%), India (5.0%) Mexico (4.5%) & Romania (8.8%). It rose in Brazil (5.2%) & Russia (6.0%) • Q3 GDP accelerated to 0.7%yoy in Singapore • Aug industrial production (yoy) decelerated in Turkey (3.1%) & contracted in Malaysia (-0.3%). It gained steam in India (10.3%)	• CB: Indonesia (5.75%) & Korea (3.5%) to stay on hold • Reaction to elections in Ecuador & Poland (Sunday) • Sep CPI in Malaysia & South Africa • Retail sales (Sep): Brazil, Mexico & Poland • Aug economic activity index: Brazil, Colombia & Peru

Upcoming events	US:	Mon: Empire State Manf survey (Oct); Tue: Retail sales (Sep), Industrial production (Sep), Business inventories (Aug), NAHB housing market index (Oct); Wed: Building permits (Sep), Housing starts (Sep), Long term investment flows (Aug), Federal Reserve issues Beige Book; Thu: Philadelphia Fed index (Oct), Weekly jobless claims (14 Oct), Existing home sales (Sep), Leading index (Sep)
	Euro Area:	Mon: It HICP (Sep); Tue: Ge ZEW Survey current situation and economic expectations (Oct); Wed: EA CPI (Sep); Thu: Fr Insee manf confidence (Oct); Fri: Ge PPI (Sep)
	UK:	Mon: BOE's Chief Economist Huw Pill speaks on UK economic outlook; Tue: Unemp (Aug), Average earnings (Aug); Wed: CPI (Sep), CPIH (Sep), RPI (Sep), PPI input & output (Sep); Thu: By elections in Tamworth and Mid Bedfordshire; Fri: Moody's and S&P review UK's credit rating; Gfk consumer confidence (Oct), PSNB (Sep), Retail sales (Sep)
	Japan:	Mon: Industrial production (Aug) ; Fri: CPI (Sep), Core CPI (Sep)
	China:	Wed: GDP (Q3), Fixed asset investment (Sep), Industrial production (Sep), Retail sales (Sep); Fri: Loan prime rate decision (Oct)

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