Yardeni Research

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Morning Briefing

The Roaring 1990s:
Déjà Vu All Over Again?

Check out the accompanying chart collection.

Executive Summary: Many of this decade's economic and financial market trends bear a striking resemblance to those of the 1990s. That was a decade in which a stock market meltup preceded a meltdown (in the early 2000s), so monitoring meltup indicators today is well worthwhile. Now, as then, stock market strength is translating to significant wealth effects that should keep the economy resilient and monetary policy restrictive for longer. Today, we highlight the two periods' similar economic conditions (comparing the trajectories of real GDP growth, productivity growth, inflation, unemployment, and the federal funds rate) and financial market paths (bond yields, the stock market). … Also: Dr. Ed reviews "The Zone of Interest" (+ + +).

Strategy: The Roaring 1990s vs the Roaring 2020s. Since the start of the 2020s, we've been comparing the current decade mostly to the 1920s and the 1970s. However, the S&P 500's 42.3% meltup since October 12, 2022 to a new record high on February 23 has us considering whether another period represents a possible analogous scenario, i.e., the second half of the 1990s. We see parallels between conditions then and now that may suggest what's up ahead for both the stock market and the federal funds rate (FFR).

Leading the S&P 500 higher back then was the Nasdaq 100 (*Fig. 1* and *Fig. 2*). That seems to be happening again since the ratio of the latter to the former bottomed on January 5, 2023 (*Fig. 3*). We are especially intrigued by the similarity between the recent vertical ascent of Nvidia's stock price and that of Cisco's stock price during the late 1990s (*Fig. 4*).

Indeed, Melissa and I are considering the possibility that the second half of the 1990s' script might be the most likely scenario for the FFR over the rest of the current decade. Back then, stock prices soared. The positive wealth effect boosted economic growth. Inflation was subdued by rapid productivity growth, implying that the inflation adjusted FFR was in line with the so-called "neutral" FFR. Consider the following:

(1) *Real GDP.* The 1990s started with a brief and shallow recession (*Fig. 5*). Real GDP growth rebounded quickly from a low of -1.0% y/y during Q1-1991 to its historical average of 3.1%. During the second half of the decade, it fluctuated around 4.0%-5.0%.

The current decade started out with a brief but severe recession because of the pandemic lockdown in early 2020. It was followed by a very strong recovery. By Q4-2023, real GDP was back to the 3.1% historical average growth rate. Debbie and I expect to see real GDP growing at or above this rate through the end of the decade thanks to solid productivity growth.

(2) *Productivity.* The growth rate of nonfarm business productivity was very volatile during the first half of the 1990s (*Fig. 6*). It soared to 5.0% y/y during Q1-1992. Then it plunged to -0.6% during Q4-1993. During the second half of the decade, it was back over its historical average of 2.0%. It peaked at 4.2% by the end of the decade.

During the first half of the current decade, productivity growth has also fluctuated widely, from 6.8% during Q3-2020 to -2.4% during Q2-2022. But it was back above its historical average at 2.7% at the end of last year. In our Roaring 2020s scenario, we are expecting a productivity growth boom during the second half of the current decade much like the one during the second half of the 1990s.

(3) *Inflation.* In addition to boosting the growth rate of real GDP, productivity (along with hourly compensation) determines unit labor costs (ULC)—the y/y percent change of which is the underlying inflation rate. is the underlying inflation rate. Both ULC and CPI inflation rates fell significantly during the first half of the 1990s (*Fig. 7*). The former dropped from 5.1% in Q4-1990 to -0.2% in Q2-1994. Over this same period, the CPI inflation rate declined from 6.3% to 2.3%. Over the remainder of the decade, it fell to a low of 1.4% in March 1998 and ended the decade at 2.7%.

In our Roaring 2020s scenario, CPI inflation continues to moderate along with ULC inflation as productivity growth continues to improve. ULC inflation was down to 2.3% y/y during Q4-2023 from 6.3% during Q1-2022. If productivity growth climbs to 3.5%-4.5% over the rest of this decade, as we expect, that would boost the growth rate of real GDP while keeping a tight lid on inflation.

(4) *Unemployment.* During the 1990s, the unemployment rate rose from 5.4% during January 1990 to a peak of 7.8% in June 1992 (*Fig. 8*). It then trended downward throughout the rest of the decade, finishing the decade at 4.0%.

The jobless rate troughed at 3.5% at the start of the current decade. It spiked to 14.8% during the pandemic lockdown. It was back under 4.0% at the end of 2021 and has remained below this level through January of this year.

So the labor market is already tighter than it was during the late 1990s. We've previously observed that there is an inverse correlation between the unemployment rate and the trend growth rate of productivity (*Fig. 9*). That makes sense: When labor is hard to find, businesses have an incentive to boost the productivity of their employees.

That describes the current situation, in our opinion, which is why we expect that businesses will continue to invest in productivity enhancing technologies. Today's technologies have far more potential to boost both brawn and brain productivity than ever before, and far more businesses than ever before will need that boost given the tight condition of the labor market. And just by happenstance, such brawn and brain technologies are more useful and affordable for almost all sorts of businesses than ever before.

(5) *Federal funds rate*. The federal funds rate fell from about 8.00% at the start of the 1990s to around 3.00% during 1993 (*Fig. 10*). It rose during 1994 and peaked at 6.30% on March 31, 1995. It then ranged mostly between 5.00% and 6.00% for the rest of the 1990s.

Back then, the economy was doing well as productivity growth improved. The unemployment rate was falling. Inflation was subdued. That could very well describe the rest of the current decade. If so, then perhaps the FFR will indeed stay higher (i.e., 5.25%-5.50%) for much longer (i.e., through the end of the decade)!

Yes, but what about the real FFR? Isn't it already too restrictive? If inflation continues to moderate, as we expect, the real FFR will rise and be even more restrictive. To avert a recession from such tightening, won't the Fed have to lower the FFR?

First, for the record, we question the relevance of a real FFR, which adjusts an overnight bank borrowing rate with a y/y inflation rate. The disparate time frames make it a very odd concept, to say the least.

In any event, the FFR is currently 2.24% (*Fig. 11*). The economy had no problems with real

FFRs ranging between 2.00% and 4.00% during the second half of the 1990s. Perhaps, the same is likely to happen over the remainder of this decade. It’s happened before, so it could happen again, especially since the economic environment seems quite similar.

(6) *Bond yields*. While the concept of a real FFR seems odd to us, we have no problem with the real bond yield, i.e., the 10-year US Treasury bond yield less the CPI inflation rate on a y/y basis (*Fig. 12*). It happens to track the 10-year TIPS yield quite well.

During the 1990s, the real bond yield fluctuated in a flat range between a low of 2.0% (December 1990) and a high of 5.3% (November 1994). It is currently 1.0%. If inflation continues to fall to 2.0%, while the nominal bond yield remains around 4.0% (because the Fed keeps the FFR higher for much longer than expected), then the real bond yield would double to 2.0%. That would still be below the real bond yields of the 1990s, when the economy performed perfectly well!

(7) *Stock market.* If this is the 1990s all over again, are we in 1994 or are we closer to 1999? We aren’t sure. However, we are sure that, as occurred during the second half of the 1990s, the stock market is having a significantly positive wealth effect on the economy now that the major stock market indexes are at record highs. That’s another reason to believe that the economy will remain resilient and another reason why the Fed might hesitate to lower the FFR for a while—maybe a long while.

The value of all stocks traded in the US rose fivefold during the 1990s from $4 trillion to $20 trillion (*Fig. 13*). It is currently up fourfold above that level to about $80 trillion.

(8) *Bottom line*. The Roaring 1990s was a decade with lots of similarities to the Roaring 1920s. The 2020s seem to be following a similar script. Both the 1920s and the 1990s ended with stock market meltups that were followed by meltdowns.

So we continue to monitor meltup indicators. That includes analysts’ consensus expectations for S&P 500 long-term earnings growth (LTEG) (*Fig. 14*). It is up sharply from last year’s low of 9.0% during the April 11 week to 14.7% currently. That’s a big jump reflecting upward revisions in the long-term prospects for the growth rate of the MegaCap-8 companies (i.e., Alphabet, Amazon, Apple, Meta, Microsoft, Netflix, Nvidia, and Tesla) following great earnings reports by some of them recently (*Fig. 15*). The LTEG of the MegaCap-8 is up from 13.4% during the January 31, 2023 week to 38.9% during the February 23, 2024 week. Nevertheless, the overall LTEG is still well below previous meltup peaks.

At the same time, we are on alert for a repeat of the 1970s' twin inflation peaks caused by the decade's two energy crises. This concern focuses us on the price of a barrel of Brent crude oil, which remains remarkably subdued in light of the conflicts in the Middle East (*Fig. 16*).

Movie. "The Zone of Interest" (+ + +) (*link*) is a remarkable film about the banality of evil. The film focuses on SS soldier Rudolf Hoss, the commandant of the Auschwitz concentration camp, and his family. They live in a very nice house surrounded by a high wall that doesn't completely hide the adjoining death camp nor the fire and smoke spewed by its chimneys. Beyond the wall, the air is also filled with the sounds of gunshots, barking dogs, and prisoners screaming in terror and pain. Meanwhile, Mrs. Hoss happily tends to her large garden, while the kids enjoy their swimming pool. Mr. Hoss works hard to impress his superiors with the efficiency of his horrible crematory furnaces. Steven Spielberg praised the movie as the best Holocaust movie since his own ("Schindler's List," 1993), highlighting its impact on raising awareness. Unfortunately, raising awareness of this historical horror is needed more than ever today.

Calendars

US: Mon: Dallas Fed Manufacturing Index; New Home Sales 680k; Building Permits 1.47mu; **Tues:** Consumer Confidence 114.0; Richmond Fed Manufacturing Index -4; Durable Goods Orders Total & Nondefense Capital Goods Orders ex Aircraft -4.5%/0.1%; S&P/CS HPI Composite Index 6.0%y/y; Atlanta Fed GDPNow 2.9% (Q1); API Weekly Crude Oil Inventories. (FXStreet estimates)

Global: Mon: UK CBI Distributive Trade Surveys -33; Lagarde; Nagel; Balz; Mauderer; Pill; Breeden; Ramsden. **Tues:** Germany Gfk Consumer Climate -28.5; France Consumer Confidence. (FXStreet estimates)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index hit a new record high for a fifth straight week after trading below its prior (December 27, 2021) record high for 25 months. It rose 1.6% for the week and has posted gains in 15 of the past 17 weeks. The AC World ex-US index rose 1.3% to a 23-month high, but remains in a 10.6%

correction from its June 15, 2021 record high. EMU was the best performer among the regions that we follow with a gain of 2.2%, followed by Europe (1.6%), EM Asia (1.6), and EAFE (1.4). EM Latin America was the worst regional performer last week with a decline of 0.7%, followed by EMEA (0.3) and EM (1.2). Among the major selected country markets that we follow, Spain performed the best last week, with a gain of 3.1%, followed by France (3.0), China (2.7), Sweden (2.6), and Germany (2.2). The worst country performers last week: South Africa (-1.9), Mexico (-1.4), Brazil (-0.2), Australia (0.5), and the United Kingdom (0.7). The 6.5% ytd gain for the MSCI United States remains well ahead of the AC World ex-US index (1.6). EMU's ytd gain of 3.4% puts it ahead of EAFE (2.3), Europe (1.8), and the AC World ex-US. The worst performing regions so far in 2024: EM Latin America (-4.8), EM (0.4), EM Asia (1.0), and EMEA (1.1). Looking at the major selected country markets that we follow, the United States and Japan are the best ytd performers with gains of 6.5%, followed by India (6.1), Taiwan (4.2), France (3.1), and Germany (1.6). The worst performing countries so far in 2024: South Africa (-10.2), Brazil (-5.7), Hong Kong (-4.6), Korea (-3.2), and Mexico (-3.0).

US Stock Indexes (*link*): Thirty-eight of the 48 major US stock indexes that we follow rose last week, up from 29 rising a week earlier. The S&P 400 MidCap Pure Growth index was the best performer with a gain of 2.8%, ahead of S&P 500 Transportation (2.1%), Dow Jones 20 Transports (1.9), S&P 500 LargeCap Growth (1.9), and S&P 100 MegaCap (1.8). The S&P 600 SmallCap Pure Value index was the worst performer with a decline of 1.6%, followed by S&P 600 Value (-1.3), S&P 600 SmallCap Equal Weighted (-1.1), Russell 2000 Value (-1.0), and Russell 2000 (-0.8). Looking at their ytd performances, 38 of the 48 indexes are higher so far. The S&P 400 MidCap Pure Growth index is the best performer so far in 2024 with a gain of 11.8%, follow by S&P 500 LargeCap Growth index (9.9), Russell 1000 Growth (9.1), Russell 3000 Growth (8.8), and S&P 500 LargeCap Pure Growth (8.7). The worst performing major US stock indexes ytd: S&P 600 SmallCap Pure Value (-4.4), S&P 400 MidCap Pure Value (-4.3), S&P 600 SmallCap Value (-4.2), Dow Jones 15 Utilities (-3.7), Russell 2000 Value (-3.0), and S&P 600 SmallCap Equal Weighted (-3.0).

S&P 500 Sectors Performance (*link*): All 11 S&P 500 sectors rose last week, and four outperformed the S&P 500's 1.7% gain. That compares to seven sectors rising a week earlier and eight ahead of the composite index's 0.4% decline. Consumer Staples was the best weekly performer, with a gain of 2.1%, followed by Information Technology (2.0%), Materials (1.9), and Industrials (1.8). Energy was the worst performer, albeit with a gain of 0.4%, followed by Real Estate (0.9) Utilities (1.2), Communication Services (1.5), Health Care (1.5), Consumer Discretionary (1.5), and Financials (1.6). The S&P 500 is up 6.7% ytd with nine of the 11 sectors in positive territory and four ahead of the index. Communication

Services is the best ytd performer with a gain of 11.7%, ahead of Information Technology (9.6), Health Care (8.2), and Financials (6.8). These sectors are lagging the S&P 500 so far in 2024: Real Estate (-3.4), Utilities (-2.6), Materials (1.3), Energy (1.9), Consumer Discretionary (3.0), Consumer Staples (4.0), and Industrials (5.3).

US Economic Indicators

Existing Home Sales (*link*): "While home sales remain sizably lower than a couple of years ago, January's monthly gain is the start of more supply and demand," noted Lawrence Yun, NAR's chief economist. He went on to say, "Listings were modestly higher, and home buyers are taking advantage of lower mortgage rates compared to late last year." *Existing home* sales rose for the third month, by a solid 3.1% in January and 3.9% over the period to 4.00mu (saar), up from its recent low of 3.85mu. Sales fell 1.7% y/y, though declines are on a steep narrowing trend. *Single-family* sales jumped 3.4% to 3.60mu (saar) last month—and was within 1.4% of a year ago—while *multi-family* sales were unchanged at 400,000 units (saar) in January but down 4.8% y/y. *Regionally*, existing home sales in January were a mixed bag, with only the West recording gains on both a monthly and yearly basis: West (4.3% m/m & 2.8% y/y. Sales increased during January in the South and Midwest and were flat in the Northeast—with all three in the red versus a year ago: South (4.0 & -1.6), Midwest (2.2 & -3.1), and Northeast (0.0 & -5.9). Total *housing inventory* at the end of January was 1.01 million units, up 2.0% from December and 3.1% from last January's 980,000 units, with unsold inventory sitting at a 3.0 months' supply at the current sales pace. The *median price* of an existing home for all housing types in January was $379,100, up 5.1% from January 2023—with all four US regions posting price increases.

Global Economic Indicators

US PMI Flash Estimates (*link*): Cost pressures continued to ease, according to February's flash estimate report, while manufacturing activity accelerated and the service sector lost momentum during the month. The *C-PMI* slipped to 51.4 this month from 52.0 in January, though February's rate of expansion was the second fastest since last July. The *M-PMI* (to 51.5 from 50.7) improved to a 17-month high—as *manufacturing output* (52.3 from 49.3) swung from contraction to expansion and production increased on an improvement in supply chains following severe winter weather. Meanwhile, the *NM-PMI* (51.3 from 52.5) sank to a three-month low, though remained above the breakeven point of 50.0 for the 13th successive month. *Turning to pricing*, average prices charged for goods fell from 56.9 in January to 55.0 this month—the lowest level since October 2020—while selling price inflation picked up slightly, though was the second slowest since mid-2020.

Eurozone PMI Flash Estimates (*link*): "Eurozone downturn eases as service sector stabilizes, but price pressures intensify," was the headline of February's flash estimate report. The Eurozone's *C-PMI* edged up from 47.9 in January to an eight-month high of 48.9 in February, with the downturn continuing in the manufacturing sector, while the service sector steadied. The manufacturing sector contracted for the 11th straight month in February, with the rate of decline accelerating again, slipping to a two-month low of 46.1 from January's nine-month high of 46.6 this month. Meanwhile, the NM-PMI climbed to a seven-month high of 50.0 this month, from 48.4 in January. Looking at the two largest Eurozone economies, *Germany's C-PMI* edged down to a four-month low of 46.1 in February from 47.0 in January, with the NM-PMI rising to a two-month high of 48.2 from 47.7 last month, while the M-PMI fell from 45.5 to a four-month low of 42.3, remaining entrenched in negative territory. *France's* economy remained stuck in contractionary territory midway through Q1, though the downturn eased, with its *C-PMI* climbing to a nine-month high of 47.7 this month from 44.6 last month and the output level declining at the slowest pace since May 2023, when the current contraction period began. The *NM-PMI* (to 48.0 from 45.4) rose to an eight-month high, while the *M-PMI* (46.3 from 41.0) reached an 11-month high during the month. In contrast, the *rest of the region* as a whole reported output growth for the second month in February, following declines over the prior five-month period—posting its largest monthly improvement since last May. Faster service growth was accompanied by a near stabilization of manufacturing output.

Japan PMI Flash Estimates (*link*): "Private sector activity stagnates" is the headline of the latest report. The C-PMI output measure climbed from 50.0 in December to a four-month high of 51.5 at the start of this year, though it all but evaporated during February, slipping to 50.3. The M-PMI (to 45.4 from 47.7) output measure shows manufacturing activity fell further into contractionary territory during February, while the NM-PMI (52.5 from 53.1) showed a slowing in service sector growth. The report notes, "One bright spot was the accelerated rise in employment, with the rate of job creation reaching and eight-month high." That said, it was a mixed bag, with nearly all the growth driven by the service sector and manufacturers recording the steepest cuts in workforce numbers in just over three years. *Turning to prices*, price pressures faced by Japan's manufacturers eased during February as the rate of input inflation slowed to a seven-month low, which contributed to the slowest rise in output charges since mid-2021.

Germany Ifo Business Climate Index (*link*): "The German economy is stabilizing at a low level," noted Ifo president Clemens Fuest. The *business climate index* edged up to 85.5 in February from 85.2 in January—which was the lowest level since May 2020. The expectations component (to 84.1 from 83.5) rose this month, while the current situation component was unchanged at 86.9, which was the lowest since July 2020. In *manufacturing*, the business climate index fell this month, as the assessment of the current situation fell to its lowest level since September 2020 and the expectations component remained pessimistic. Meanwhile, the *service sector* saw its business climate improve during the month, led by a more favorable opinion of current business, while expectations were still pessimistic though not as pessimistic as last month. Meanwhile, *trade's* business climate sank further, with companies noticeably less satisfied with their current business situation, though expectations improved slightly. *Construction's* business climate remains at a low level, though did show a slight uptick this month due to a more favorable assessment of the current situation. However, expectations dropped to their lowest level since 1991.

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