



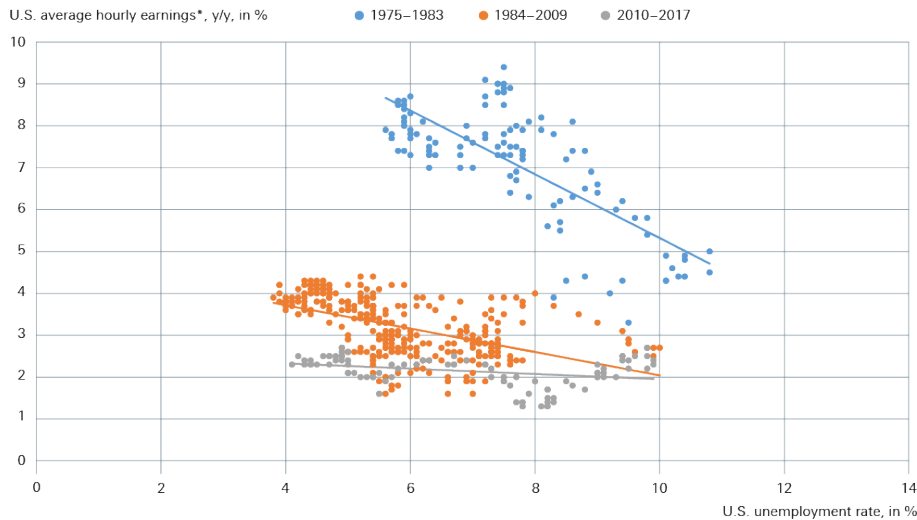
Chart of the week

The real question is no longer whether the Phillips Curve has lately broken down, but why

Among central bankers, market participants and academics, few topics have lately been as heatedly discussed as the Phillips Curve. As you may remember from introductory macro-economics classes, this measures the supposed trade-off between cyclical unemployment and inflation. In the short-run, it is possible to push unemployment below the level consistent with normal labor-market turnover, but only at the cost of permanently higher inflation expectations. That is why generations of central bankers have avidly been watching unemployment rates, so as to intervene before an economy starts to overheat.

In recent decades, however, the relationship between core inflation and cyclical unemployment has gotten flatter and flatter, not just in the U.S. but in many developed economies. The same is true if you simply look at the U.S. unemployment rate and the year-on-year change in average hourly earnings, as our "Chart of the Week" shows. In recent years, there has been barely any relationship at all. That is odd. Of the supposed linkages underlying the Phillips Curve, the most obvious one should be between unemployment and hourly wages. If there are fewer workers available for hire, your chances of finding a better or better paid job should improve. Meanwhile, your boss would have a harder time finding an adequate replacement. All this should lead firms to push up wages. The fact that this is not happening has led some to wonder whether the Phillips Curve is still relevant. We think it is, and not just because elderly central bankers are still paying attention. The real question is no longer whether the Phillips Curve has lately broken down, but why. Frequently stated explanations range from increased foreign competition and declining manufacturing employment, to central banks simply having become more credible in fighting inflation. Few of those, however, come with adequate explanations of what has actually been happening in the labor market since 2010. More research is clearly needed, as they say in the Ivory Tower. And, until we know, it is too early to rule out the Phillips Curve reasserting at some point in the future.

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Sources: Bloomberg Finance L.P., Deutsche Asset Management Investment GmbH, as of 11/9/2017

* Private sector

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