Dear Client:

The labor shortage is going to get worse this year and beyond. A number of industries that were already struggling to fill vacant positions are going to have to look harder and pay more. And even then, many jobs will still go begging.

The economy is nearing “full employment,” when further decreases in the jobless rate would hike wages enough to spur a wave of inflation. But employers all over need more workers. 30% of small firms have had to increase pay recently to find or keep enough staff...an unusually high level. Nearly half of smalls can’t find qualified applicants.

All sorts of workers are in high demand: Not just doctors and high-tech workers but engineers, mechanics, cops, truck drivers, construction workers, cooks, etc. Across the pay scale, the pickings are slim. Areas where the crunch will be worst: Thriving cities in the West, New England and Upper Midwest states.

The building trades are particularly tight. Builders are desperate for carpenters, electricians, plumbers, roofers, painters and other skilled people.

Stricter enforcement of immigration law could also shrink the pool of workers for employers in industries that employ lots of illegal immigrants. Think agriculture, construction, hospitality, manufacturing and food service. A quarter of farmworkers are estimated to be in the country illegally. Ditto for almost 20% of custodial workers.

States where illegal immigrants supply the most labor: Nev., Calif. and Texas. Their patterns of employment vary. In the West, hospitality is the biggest employer of illegal immigrants. In the South, it’s construction. In the Midwest...manufacturing.

Employers will have to get creative to nab the best employees. One strategy that is catching on: Offering more telecommuting, flexible hours or extra time off...options that have particular appeal for younger folks. Emphasizing opportunities for career advancement or continuing education can also help attract applicants. Workers with in-demand skills know they’re needed and expect such enticements.

But there will be no getting around the need to pay more. Nationwide, expect wages to rise by 2.9% this year...faster than 2016’s 2.5%. Some industries are in for bigger increases, even low-wage sectors such as retail and food service.

Rising pay and a lack of applicants will also make automation more attractive for employers who can swap machines for humans. Farmers in particular are looking for mechanical ways to plant or harvest crops. Some in Calif. are replanting orchards and vineyards to make way for more machinery. One tech firm that developed robots to tend lettuce plants without workers is now readying machines to weed cotton fields. Other robot sellers are seeing orders from small firms that never bought them before.
The Federal Reserve appears ready to boost interest rates on March 15... unless a poor jobs report or unexpected inflation data are seen before then. The ability to raise rates reflects a maturing economy and allows room for future cuts if there’s a future downturn. A 0.25% rise would suggest three hikes this year, not two.

Expect the Federal Reserve to wait to trim its balance sheet until late 2018, or perhaps sometime later. The Fed’s assets have risen to $4.5 trillion since 2007... as it bought Treasuries and mortgage-backed securities with newly created dollars in order to drive down long-term interest rates... from just $900 billion a decade ago. But the Fed is in no rush to return to the “normal” level seen before the financial crisis by selling bonds back to investors, which would pull money out of the financial system.

The plan is to go slow to avoid investor panic and surging interest rates. Fed Chair Janet Yellen knows shrinking holdings could spark higher Treasury yields as investors race to react to what they will view as a tightening of monetary policy. Look for the Fed to first lift its short-term interest rate to 2% before gradually starting to pare its balance sheet by not replacing some of the bonds that mature each year.

Don’t count on the Fed’s holdings to sink back to 2007 levels, though. At a minimum, the central bank wants enough assets to match the money supply, which totals $1.4 trillion in circulating currency and will hit $2.5 trillion in a decade.

Midwestern states are poised for brighter growth prospects this year. Look for a modest pickup in regional growth to about 2.3%, up from 1.6% last year. Rising optimism stems from President Trump’s proposals to boost U.S. manufacturing, cut taxes and spend $1 trillion on infrastructure. Expect higher business investment after a flat 2016, though uncertainty about policy, notably trade, is sure to linger.

Among the states set to gain: Ind.’s auto industry will bolster its economy and get a lift from policies favoring U.S. production. Minn.’s diversified economy of everything from professional services to iron ore will see above-average growth. Even Ill., which faces population declines, will gain momentum on its exports.

Want to profit from the latest innovations coming out of the tech industry? Take a look at these stock picks from *Kiplinger’s Personal Finance* magazine, which aim to give investors exposure to some fast-growing segments within the sector.

To cash in on increasingly high-tech autos, consider Nvidia, a major supplier of the advanced computer chips automakers are using to help cars drive themselves. And Qualcomm, a giant in wireless gear that is boosting sales to carmakers.

When it comes to the internet of things... the low-tech objects and appliances that are getting connected to the web to make them smarter and more productive...

Two names stand out: Broadcom and Splunk. Broadcom is a major supplier of equipment for the data centers needed to process all the new data being generated. Splunk’s software helps businesses turn that incoming data into useful information.

Two robotics companies to consider: Intuitive Surgical, a leading producer of machines that doctors use to perform many minimally invasive surgical procedures. And Cognex, a leader in the machine vision technology that lets robots “see” as they perform increasingly intricate operations, such as assembling computer chips.

Hackers are turning cybersecurity into a big business. Two standout vendors: CyberArk Software, an Israeli company that helps guard vital corporate data. Check Point Software Technologies, also of Israel, sells bundles of software and devices that provide comprehensive protection for large computer networks.

Want to tap the potential of the genomics revolution? Consider Illumina, the top supplier of gene-sequencing machines that help diagnose diseases early, develop personalized treatments and more by cheaply mapping out human genomes.

Also, BioMarin Pharmaceutical, a leader in treating rare genetic diseases.
President Trump’s first proposed budget won’t get very far in Congress. No surprise there. Most presidential budget plans are dead on arrival, in large part because they are purely political documents written in a vacuum, ignoring the fact that lawmakers get to offer their own priorities and programs. Even with Republicans in power, he’ll need to make big compromises to keep some of his campaign promises and appease Republican deficit hawks.

The early fight will be over Trump’s call to increase the military budget by $54 billion, which would require Congress to remove a federal spending cap known as the sequester. The issue isn’t the extra money but where to get it. Some GOPers will balk at slashing foreign aid and domestic programs, as Trump has proposed. They argue that money for the State Dept. and USAID...United States Agency for International Development...is a necessary expense. And a clutch of GOPers will join Democrats to protest deep domestic cuts.

Chances of a government shutdown are slim but can’t be ruled out. There are enough hard-line GOPers to block the budget if Trump doesn’t bend. Bigger fights are coming: Replacing Obamacare. Fixing highways, bridges, rail lines and ports. Cutting tax rates for corporations and individuals.

Trump’s revised travel ban will still face a court test, no matter what it says. On the surface, not applying his order to visa holders should help him to avoid the problems that led to his initial order being blocked in federal court. Presidents do have broad authority to deny entry to certain classes of immigrants in some cases. But a blanket freeze on new visas for immigrants from six nations...Iran, Libya, Somalia, Sudan, Syria and Yemen...would present a major legal test of the Immigration and Nationality Act. Iraq is likely being dropped from the new list.

Any challenge is likely to make note of contradictory intelligence from DHS...Dept. of Homeland Security...that discounted the administration’s view that refugees from the listed countries were security threats. The White House dissed the report.

An end to gerrymandering? It depends on Justice Anthony Kennedy, who often casts the swing vote in a divided Supreme Court. The practice of redrawing election district lines to boost the political fortunes of the party in power is before the Court this year. Kennedy preserved the practice with a narrow opinion in a 2004 Pa. case. But there is much speculation that he will change his mind now.

At the center of the debate: A case involving redrawn election maps in Wis. A district court said redrawing lines to preserve GOP seats was unconstitutional.

Wis. is expected to lose the case. But will the ruling apply to other states? That’s where Kennedy comes in. With a vacancy on the Court, Kennedy’s vote on the case is likely to result in a 4-4 tie or a 5-3 ruling to uphold the decision by the district court and toss the gerrymandered map. If the eight justices are split, the lower court’s ruling would stand but would not establish a precedent that applies to other cases. If Kennedy creates a 5-3 majority against the state, though, the ruling would have a broader effect. That could call into question the maps in Fla., Mich., Ohio, Pa., Va...all states where Republicans controlled the process...as well as Mass., Md. and R.I., where Democrats controlled setting the district lines.

A vacant House seat may offer the first clues about legislative races in 2018. The winner of a special election next month will replace former GOP Rep. Tom Price of Ga., who now heads the Dept. of Health and Human Services. The GOP is favored to keep the seat, but Trump carried the suburban Atlanta district by only 1.5 points. Democrats, hoping to rebound, have already put over $1 million into the campaign of Jon Ossoff. Republicans haven’t backed a candidate yet or focused on raising cash.
The future of Medicare is wrapped up in the debate over Obamacare. Substantial changes to the health plan could lead to higher costs... bigger deductibles and higher copays for Part A, which covers inpatient care, and increased premiums for Part B, which covers outpatient medical services.

Also a strong possibility: Less government help for preventive screenings such as colonoscopies and mammograms, flu shots and annual wellness exams.

Prescription drug coverage under Medicare’s Part D would be in play, too, in any tweaking of health care coverage. The so-called doughnut hole in drug coverage is gradually closing under Obamacare. About 25% of the program’s enrollees shelled out enough to reach the coverage gap in 2013, according to one report.

Payment changes in Medicare Advantage would be a mixed bag for beneficiaries. Before Obamacare, payments to the program were 14% higher than the cost of covering similar beneficiaries under traditional Medicare. The law gradually cut the payments so that they are now about 2% higher. Repealing those changes could improve benefits and lower out-of-pocket costs for MA enrollees, since plans have to use any payments above costs to do just that.

On the other hand, bonus incentives to deliver quality care could go away.

Folks with high incomes could get a break in a repeal-and-replace plan. Obamacare subjected a larger share of such beneficiaries to higher Part B premiums over time and added a surcharge to Part D premiums. Also, it included a 0.9% hike in the Medicare Part A payroll tax on the earnings of higher-incomers...

individuals who earn over $200,000 per year and couples making over $250,000.

Free online classes will make it easier to bring robots to more factories, even for first-time users in small- or medium-size firms. Universal Robots, based in Denmark, recently launched an 87-minute online course to train users on the basics of programming its robot arm, which works side by side with workers. The small arm can weld, paint, glue, polish, inspect, screw, package and more.

E-learning will especially help with a new crop of small, collaborative robots, set to drive rising industrial robot sales over the next few years. The online training aims to counter a common complaint: That companies don’t have the skilled workers to add robots that in turn can free up employees to perform more valuable tasks. Besides Universal, makers of “cobots” include Rethink Robotics, Kuka, ABB and Bosch.

Note that smartphones offer many preventive measures against hackers, and the protection that’s built into the mobile devices doesn’t cost you any extra.

Among them: The ability to use a PIN or fingerprint to lock the phone. Two-step authentication for e-mail services, shopping sites, social media apps and more. (The method uses a password plus a one-time code often texted to the user.) And regular updates to mobile operating systems and apps that plug security holes.

Odds favor a green light for retail trading of bitcoins on a major exchange. The Securities and Exchange Comm. appears ready to grant approval to a Winklevoss exchange-traded fund, making it the first to track digital currency. The Winklevoss ETF would trade on the Bats BZX Exchange under the symbol COIN.

Yours very truly

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THE KIPLINGER WASHINGTON EDITORS

P.S. Looking for simple ways to keep more customers? We can help with our webinar on March 14. Go to store.kiplinger.com/cstraining.html to register.