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## Wage/Price Spiral: Then, But Not Now

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In 1980, my employer provided a COLA, a cost of living allowance, in addition to my salary. It was much appreciated, given that at the time I was repaying a floating rate student loan and COLA provided some cash flow to offset the 21½% prime rate of that December. Today, that arrangement seems a bit quaint.

Those were inflationary days and my bit part was to participate in higher compensation as the costs of everything around me also rose. It was my own little wage and price spiral. The larger picture consisted of a series of oil price shocks, a sense of the power of labor (and labor organizations) to make gains for itself, and a muddle of well intended but misguided government policies that enabled this situation to persist.

Fortunately, a few other things were happening that undermined the inflationary forces. First, Paul Volcker had been named Chairman of the Federal Reserve the previous year. My interest rates were high because he and his colleagues were endeavoring to wring out inflation, though at the time I may not have read it that way.

The other thing that happened is that a couple guys down the hall from me got laid off. While the labor market was always viewed as fluid, this was really part of a long-tailed series of events (more than two decades long at this point) that has reduced labor's share of the economic pie. That process continues today, with the rise of global outsourcing and the reduction in the power of labor to influence its own wages.

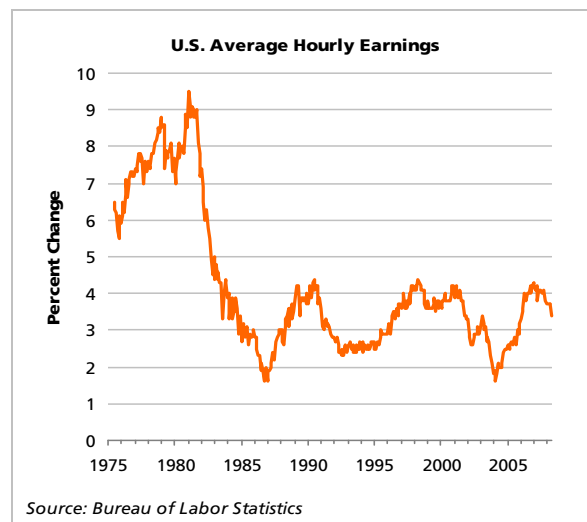
The adjacent chart shows average hourly earnings growth, or the change in the basic hourly rate for major industries as indicated in non-farm payrolls. While there has been some cyclical volatility, we have not seen gains above 5% in nearly three decades.

Today, however, consumers face a higher cost of living due to the headwinds of food and energy prices. What happens to wages? The answer is probably more of the same. Wages won't adjust higher to accommodate increased costs of some components of the shopper's basket. Instead,

consumers will have to cut back on food, or fuel, and/or on some other expenditures. Fringing that dark cloud is the silver lining of lower inflation expectations.

### **It's Been 25 Years Since Earnings Growth Has Exceeded 5%.**

U.S. average hourly earnings (private non-farm payrolls in nominal dollars) year over year, seasonally adjusted.



In the 1970s, an oil shock was transformed into a wage-price spiral largely through inept government actions. Now, however, an inflationary wage-price spiral is not likely, given that labor, which is in global surplus, commands little wage power.

The Fed is vigilant about inflation risk: it is very aware of the need to contain inflationary expectations, as recent hawkish rhetoric indicates. At the same time, reduced pressures on labor costs actually give the Fed a freer hand to accommodate the numerous immediate threats to growth. This suggests that rates can stay lower, and for a longer period of time. ■

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