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The Morning

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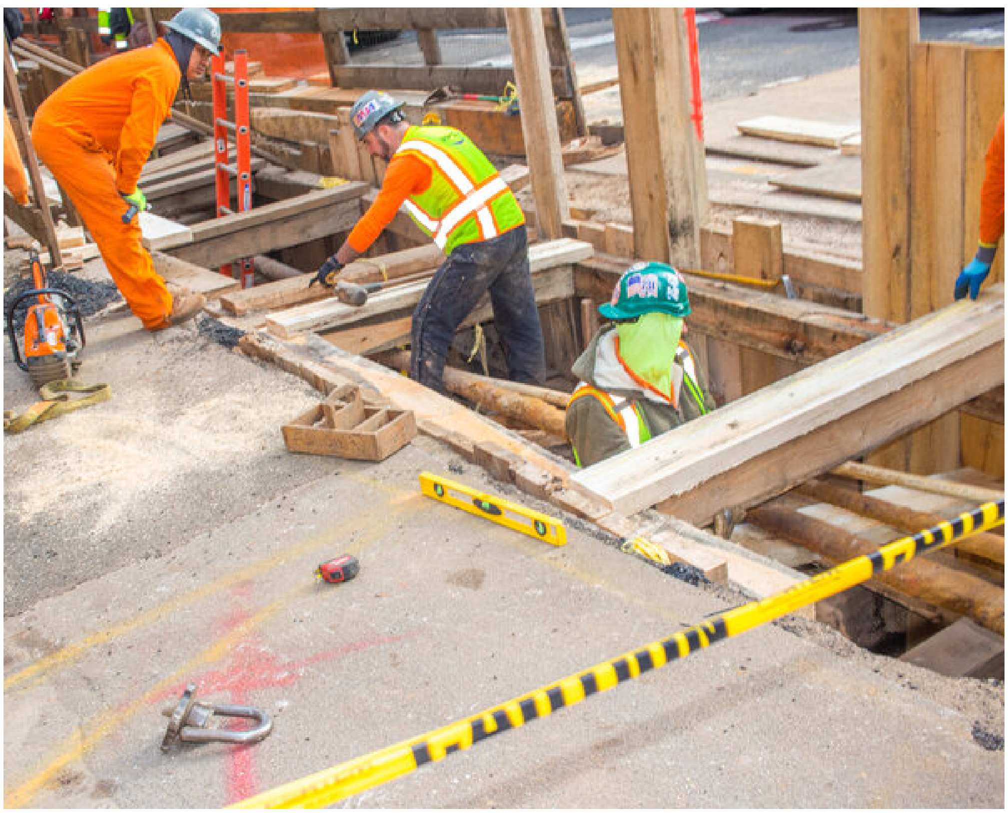
By Ben Casselman
Economics Reporter

Good morning. New data suggests a promising possibility for the economy — that the U.S. avoids big job losses.



Construction workers in New York this week. John Taggart for The New York Times

A constructive step

American workers are getting smaller raises. Counterintuitively, that may be good news for the economy, and for hopes that the United States can avoid a recession.

Regular readers of this newsletter know that the big question facing the economy right now is whether policymakers can bring down inflation without driving up unemployment and putting millions of people out of work.

Some encouraging signs have emerged on that front lately. Inflation has moderated significantly over the past six months, though it remains too high. The job market has proved remarkably resilient: Despite high-profile layoffs in tech and a few other sectors, overall unemployment remains at a half-century low. Data released by the Labor Department yesterday showed only a slight increase in layoffs in December; we'll get fresh data on unemployment tomorrow, when the government releases its monthly jobs report.

But many economists, including policymakers at the Federal Reserve, have viewed those signs of progress warily. That's partly because they've been burned before, initially dismissing high inflation as temporary, only to see it prove more severe and last longer than almost anyone anticipated. But it's also partly because of signs within the economic data that suggest inflation may persist.

Chief among those signs: wages, which have been rising much faster than they were before the pandemic. Fed officials have repeatedly argued that it will be hard for inflation to fall back to their long-term goal of 2 percent as long as wages keep rising at a rate of 5 percent or more a year, as they have been since the middle of 2021.

On Tuesday, however, there was a hopeful sign. Wages in the private sector rose just 1 percent in the final three months of 2022, the equivalent of a 4.2 percent annual growth rate. Jerome Powell, the Fed chair, called the data "constructive" yesterday and applauded the evidence of moderating inflation, even as he warned that both pay and prices were still rising faster than policymakers were comfortable with.

Slower wage growth, slower inflation?

Calling slower wage growth a "hopeful sign" might strike some readers as callous. And ordinarily, faster pay increases are better for both workers and the economy as a whole. Indeed, one of the most persistent problems in the decade before the pandemic was that wages were rising too slowly. When that began to change in 2021, many progressives cheered it as evidence that the balance of economic power was, at least temporarily, shifting back toward workers.

But it’s important to remember that the late-pandemic economy hasn’t been particularly friendly to workers, despite their rapidly rising wages. That’s because prices have been rising even faster. After adjusting for inflation, hourly pay actually fell last year, meaning that workers, on average, saw their standard of living decline. (One notable exception: Pay has increased faster than inflation for many workers in the lowest-paid service industries.)

Ultimately, what matters for workers and their families isn’t wage growth, in isolation. It is wage growth in relation to inflation: An economy with 4 percent wage growth and 2 percent inflation will be better for workers than one with 6 percent wage growth and 8 percent inflation.

Avoiding job losses

To be clear, most economists don’t think that wage growth is the primary reason that inflation has been high recently. And policymakers have said repeatedly that they see no evidence of a dreaded cycle in which pay and prices perpetually push each other higher.

But they also think it will be hard to get inflation fully under control as long as wages keep increasing as fast as they have been. That’s especially true in the service sector, where workers’ compensation accounts for a large share of companies’ costs, and where profit margins are often thin. Hourly pay in restaurants, for example, is up nearly 25 percent over the past two years. Few businesses can sustain that kind of rapid increase in labor costs without also raising prices for customers.

Economists disagree on what it will take for wage growth to slow. One camp, led most prominently by Lawrence Summers, the former Treasury secretary, holds that only a sharp increase in unemployment is likely to cool off salaries and prices of goods and services. That view is based on classic economic models that assume a fairly direct link between the job market and inflation: When unemployment is low, employers compete for workers by raising pay, and then in turn must increase prices to cover their higher costs.

Other economists, however, argue that the world is more complicated. In the period before the pandemic, for example, the job market was strong, but inflation stayed low. In the 1970s, unemployment and inflation were both high. Isn’t it possible that this period, when the economy and job market are adapting after three years of disruption and turmoil, will once again break the rules?

It's too soon to know. But the wage numbers released this week, in conjunction with other recent economic data, hold out the tantalizing possibility that the answer could be yes. If so, that's good news, suggesting that inflation could continue to fall without the wave of job losses that so many forecasters have been predicting, and that Americans have been fearing.

More economic news

- The Fed again raised interest rates, though the quarter-point increase was the smallest in nearly a year.
- Powell said that the Fed was planning "a couple more" increases, and that he expected rates to remain high through 2023.

THE LATEST NEWS

International

- The U.S. will increase its military presence in the Philippines, strengthening the Southeast Asian country's role as a strategic partner in the event of a conflict with China.
- Pro-government media in Hungary have accused the U.S. ambassador there — who is a gay human rights lawyer — of being a menace to the country.

Politics

- "No agreements, no promises," Speaker Kevin McCarthy said after meeting with President Biden about the debt limit.
- Nikki Haley, the Republican former governor of South Carolina, seems close to announcing a 2024 presidential run.