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Your next big raise? Don't hold your breath, some economists say

Paul Davidson July 23, 2017

Still waiting for that big raise? It may be a while.

Many economists are starting to suspect that the forces that once drove both wages and prices higher in a virtuous cycle may no longer apply, or at least could be muted for a prolonged period.

Despite a U.S. economy that largely has healed since the Great Recession, they argue that increasing globalization, the shift by shoppers to cheaper online goods, and puny gains in worker output will continue to constrain wage and price increases.

“I don’t expect to see a breakout in wage growth for at least the next two years,” says **Bernard Baumohl, chief economist of The Economic Outlook Group.**

Other analysts say the factors suppressing pay increases and consumer price inflation are temporary and should fade within months.

The 4.4% unemployment rate means the pool of available workers is relatively small. That should be leading to sharper pay hikes as employers compete to attract and keep employees. In turn, higher salaries typically force companies to raise prices to maintain profits. And higher prices prompt consumers to ask for still-bigger paychecks.

Average earnings rose 2.5% in June from a year earlier. That’s up from the roughly 2% annual pace that prevailed from 2011 to 2014 but below the 3%-plus pre-recession clip in 2007. Of course, salaries in some fields, such as airline pilots and industrial psychologists, rose sharply last year, while pay in others, such as mail carriers and petroleum engineers, declined, according to Moody's Analytics and the Labor Department.

Meanwhile, the measure of annual inflation, or consumer price increases, most closely tracked by the Federal Reserve fell to 1.4% in May after approaching the Fed’s 2% target early this year. It has been stuck below 2% since 2012.

Inflation well above or below the Fed's goal can cause problems for the economy. Sharp price increases can make goods unaffordable for many Americans. And while low inflation sounds like a good thing, it can lead to deflation, or falling prices, that may spur consumers to put off purchases, hampering economic growth.

The Fed is also seeking faster wage and price gains to put more money in workers' pockets and to allow Fed officials to steadily raise interest rates. That would provide them leeway to lower rates if the economy falters.

Last week, Fed Chair Janet Yellen told Congress she still believes inflation has been restrained by temporary factors and will gradually drift up toward the Fed's 2% benchmark. Besides the rollout of unlimited wireless plans, those factors include declines in prices for used cars and clothing.

The Fed is in the middle of an effort to gradually lift its key short-term rate to head off an eventual spike in inflation. But it's expected to hold rates steady at a two-day meeting this week, and Oxford Economics expects inflation to remain low, prompting the Fed to forgo an anticipated third rate hike this year.

"We're watching this very closely and stand ready to adjust our policy" if inflation doesn't pick up, Yellen told Congress.

Here are the longer-term forces crimping wage and price increases:

*** E-commerce**. Low-cost online firms charge lower prices. While consumers have been able to buy online for more than two decades, the shift in purchases from brick-and-mortar stores has accelerated in recent years and many traditional retailers have gone bankrupt or closed outlets. "The competition (online) has become more intense," pushing down prices, **Baumohl** says. Diane Swonk, head of DS Economics, adds the shutdown of traditional retailers spells fewer sales commissions for store clerks, further lowering average prices.

*** Globalization**. The expansion of trade and China's growing role in the global economy have resulted in falling import prices since the late 1990s, says Paul Ashworth, chief U.S. economist of Capital Economics. "Goods prices now tend to be driven by global economic factors as much as domestic U.S. factors," he wrote in a note to clients.

Similarly, lower Chinese wages have led many U.S. manufacturers to curtail pay increases to remain competitive, **Baumohl** says.

*** Inflation expectations**. Surveys and bond prices show that many Americans expect price increases to be modest over the long run, and so they tend not to ask for big raises. "Everybody expects (inflation) to be low," Swonk says. "There's an inertia."

* **Health care prices**. Health care makes up about 20% of the Fed's preferred inflation measure and its annual price increases have fallen to about 1% from about 3% 10 years ago, including the bills paid by insurance plans, Ashworth says. (This doesn't include premiums, which have soared for some Americans). That's largely because the federal government limits the prices charged by doctors and hospitals under Medicare and Medicaid, he says. Uncertainty over the fate of the health care law has intensified the trend, Swonk says, with hospitals reducing hiring. That limits services and price increases.

* **Weak productivity growth**. Productivity, or the average worker's hourly output, has been virtually flat the past year and grown less than 1% annually since 2011. That narrows profit margins for U.S. companies and makes them unwilling to shell out significant wage increases. Economist Jesse Edgerton of JPMorgan Chase partly blames meager business capital spending due to few new labor-saving technologies, and doesn't expect a swift reversal.

Baumohl says businesses are hesitant to invest because of the myriad delays in moving President Trump's proposed cuts in taxes and regulations through Congress.

* **The decline of unions**. Workers' bargaining power has been eroded by waning union membership. About 11% of U.S. workers were union members last year, half the portion in 1983, Labor Department figures show.

Still, some economists believe wage and prices are poised to pick up in coming months. Wholesale prices for goods such as synthetic cloth, sheet-metal and iPhone components increased substantially in the first half of 2017 but there's typically a six-month lag before they affect consumer prices, Goldman Sachs economist Spencer Hill says. He believes they'll push up retail prices by fall.

Meanwhile, the average wages of workers who recently switched jobs already have climbed about 4% a year, and the paychecks of those who stay in jobs tend to follow months later, says economist Tom Porcelli, chief U.S. economist of RBC Capital Markets. "Don't be surprised if wage growth accelerates markedly," he wrote to clients.

And Swonk says workers not counted in the official unemployment rate – such as part-timers who prefer full-time jobs -- are likely still providing employers a surplus labor supply that's tempering pay hikes. As that reserve shrinks to normal levels, raises should pick up, she says.

But Swonk says she's no longer confident that wages and prices will soon ratchet higher. "We're in these unchartered waters," she says. "All of the old rules don't apply."   ###